

# We don't just analyse performance. We actively encourage it.

## JAPAN SPECIAL SITUATIONS\*

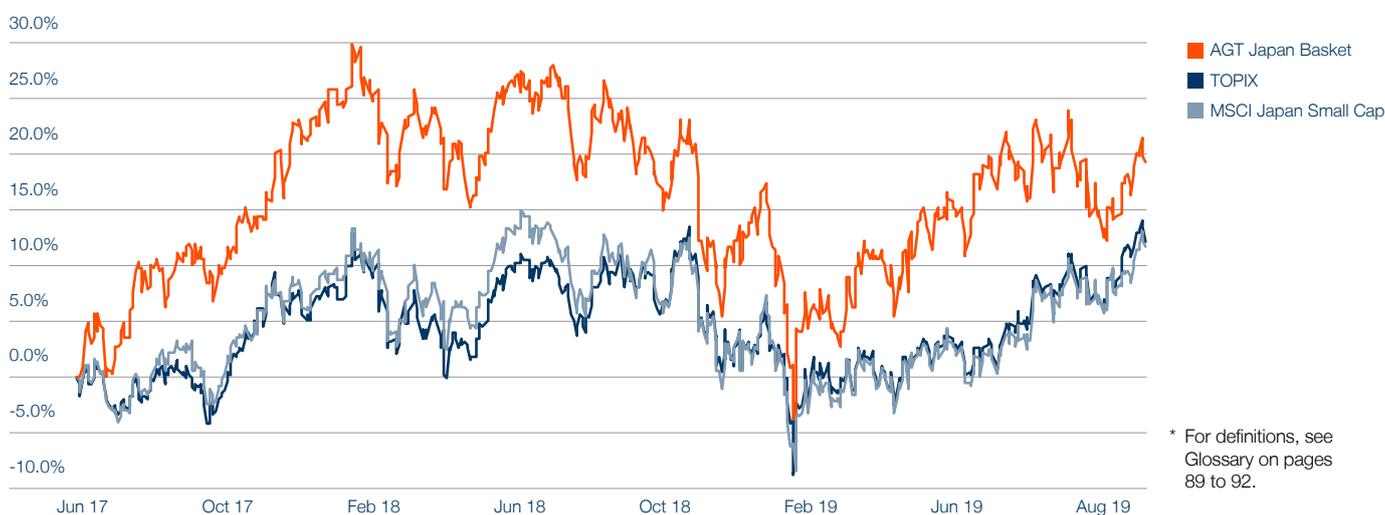
The Japan Special Situations basket is a portfolio of 18 cash- and securities-rich Japanese operating companies. Driven by the Abe administration, pressure is mounting on Japanese companies to change their corporate governance practices and capital allocation policies. We believe that it is increasingly probable that these companies will begin to return excess capital to shareholders or put it to more productive use, with highly attractive risk-adjusted returns for shareholders.

It has been over two years since we launched the Japan Special Situations basket. This basket was created to exploit a niche opportunity that we saw in undervalued, overcapitalised, small-cap Japanese companies. These companies have generated an enormous amount of cash which they have not been able to invest fast enough, leading to a large accumulation of cash on the balance sheet. With the introduction of the Corporate Governance Code in 2015, companies have been returning this to shareholders, through increased payout ratios and record-high buybacks.

Despite the positive actions of many companies, Japanese stocks have lagged over the past year. The MSCI Japan Small Cap has fallen -1% against the S&P 500, which rose +10%, and the MSCI Europe, which gained +5% (in GBP).

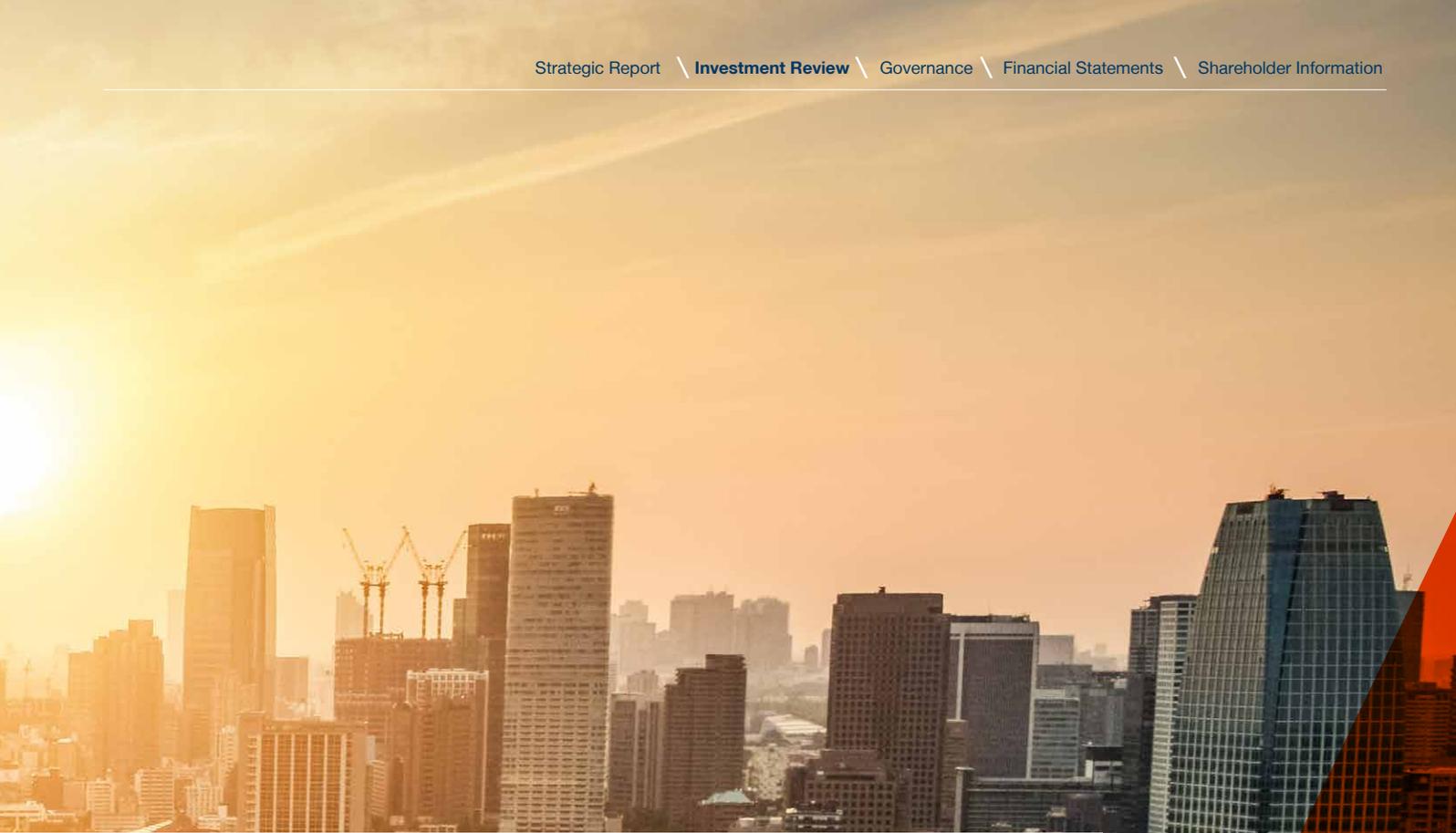
The fractious US-China trade war and the view from foreign investors that Japan is a never-changing, expensive proxy for global growth, has continued to take its toll. The mismatch to how we see fundamentals and how foreigners view the market creates exciting opportunities for us.

### PERFORMANCE OF JAPAN SPECIAL SITUATIONS BASKET SINCE LAUNCH



Source / AVI, FactSet. All data total return GBP.

\* For definitions, see Glossary on pages 89 to 92.



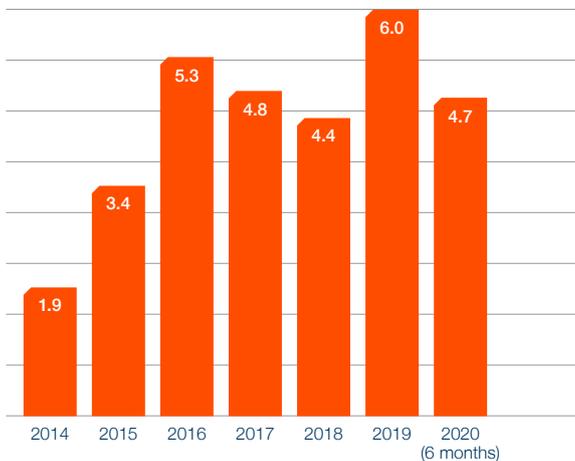
📍 Tokyo Tower, Japan

Despite this, the basket is still ahead of the MSCI Japan Small Cap Index, returning +18% since inception versus the index's +11%, and, most importantly, valuations have become cheaper. The EV/EBIT of the basket has fallen from 3.7 at the start of the financial year to 3.1 at the end, and, similarly, the percentage of the market cap that the basket has covered by net cash and investment securities has increased from 75% to 91%. Lower valuations give greater upside to our fair values. Coupled with the progress we are seeing on the corporate governance front, we are excited about the prospects of this basket, which is why it remains our largest portfolio weight.

**91%**

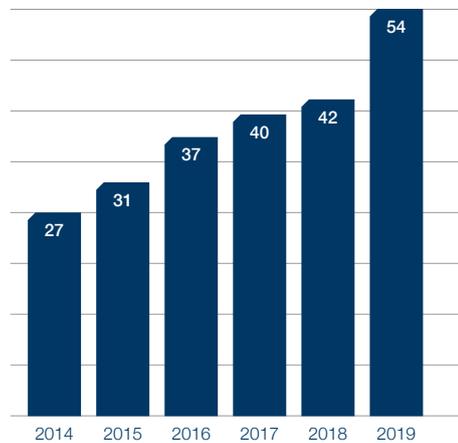
On average, net cash and investment securities account for 91% of the market capitalisation of the stocks in the basket\*.

**JAPANESE LISTED COMPANIES COMPLETED BUYBACKS (JPY TRILLION)**



Source / Nomura

**NUMBER OF SHAREHOLDER PROPOSALS IN JAPAN IS RISING SLOWLY BUT STEADILY**



Source / CLSA

\* For definitions, see Glossary on pages 89 to 92.