

Nikko Asset Management Japan Value Fund

Japan

Introduction

(Offshore)

The fund is managed by a highly experienced team. As a value strategy it has a distinctive investment style but applies this pragmatically to try and avoid 'value traps'. The fund is suitable as either a core or satellite holding as long as investors accept the fund's value bias.



[Click here to read the Nikko AM approach to ESG investing.](#)

Why RSMR Rate this Fund

- Well established specialist value team with excellent analytical backup.
- Long term record for strategy.
- The focus on companies providing goods or services needed by society means it avoids businesses in structural decline.
- Pragmatic approach to value allows fund winners to remain in portfolio and grow.
- Nikko AM are major investor in Japanese equities.

Fund Process

The investment philosophy looks to deliver superior performance by making long-term investments in undervalued companies expected to undergo change. The team look to invest when they spot a catalyst for change and the research seeks undervalued companies that offer goods and services that society needs. The approach is contrarian and focuses on undervalued businesses likely to undergo transformation and the team hope to make high returns by owning the stocks through this re-rating. Examples of undervalued companies that are expected to undergo transformation include those in crisis mode where management and employees recognise fundamental changes are needed, companies whose mindset is changing towards enhancing corporate value, and those with unrecognised attractive potential. The fund targets outperformance of 3% p.a. relative to benchmark, is managed with a risk budget to keep it within a 4% tracking error, and is large cap orientated.

When analysing companies, the team look for strong returns from stocks that are underperforming due to structural issues but possess a turnaround catalyst. These are described as Phase 1 stocks where a turnaround will typically last 3-5 years and there is a focus on identifying the catalyst that will ensure this happens. This could be due to a company's own efforts or structural/environmental change in the market. The fund also includes Phase 2 stocks which are underperforming due to cyclical issues. Evaluating these stocks involves an assessment of the type of cycle and position within it and here the team may use the sector specialist team working for Nikko. Cyclical factors depressing a share price could be due to the economic cycle or the product life cycle the company faces. The premise is that in a mature economy most companies will show cyclicalities which gives the opportunity to buy low and sell high. This fund takes a contrarian approach when buying stocks but in order to avoid value traps, if a company does not make any progress in terms of its operations over three years, the position is sold.

The first stage of the investment process uses quantitative valuation screens to highlight cheap stocks and they then conduct detailed qualitative bottom-up fundamental research and analysis. Poor governance stocks are excluded at this stage. This results in a value research universe of 600-700 names.

The value team have their own analysts identifying Phase 1 stocks, and work here looks at business continuity, downside protection and ensures the turnaround catalyst is present. The team look for factors which explain the poor stock performance and there is a focus on out of favour names where there is expected to be positive change. Undervaluation can occur due to excess human resources, too high a level of assets or the market not realising the worth of the business and for stocks trading below book value the team will speak to the management to discuss ways to unlock the value. ESG factors are incorporated into stock selection and whilst Japan historically has been more focused on the E&S factors than governance, the latter is improving with more independent directors on company boards. Nikko AM have made ESG central to the philosophy through the incorporation of Creating Share Value evaluations.

Sales can occur for a number of reasons, varying from stocks where price targets have been achieved, declining confidence in management, or where the investment thesis has not worked out. While the fund is bottom up the portfolio managers do consider macro factors as they believe it would be foolish to ignore big picture issues.

Evaluation

The fund will perform best when value investment styles are in favour which usually coincides with rising expectations for economic growth, and it may struggle when bond yields globally are depressed, and investor focus is on stocks with high earnings visibility.

Application

The strategy's record means the fund can be used as a core holding, although investors need to be aware there is a value bias which means some economic conditions will make delivering outperformance challenging over shorter time periods.

Our Opinion

The fund has established strong performance numbers, which is particularly credible for a value orientated approach. The fund is managed by a dedicated value team, including desk analysts with research augmented by the analyst team at the firm who serve a number of differing strategies. Nikko are a significant investor in the Japanese market. The team use a research-driven approach, which although bottom up focused, is macro aware and returns are highly credible, indicating the fund has avoided value traps.

There are often holdings in the fund which are more typically seen in growth orientated strategies. These stocks would have been bought when they were on depressed valuations, but the team are happy to retain them whilst the re-rating and earnings upgrade story is intact, and the valuation remains modest for the expected future growth. The research process benefits from the dedicated analytical resource, together with Nikko's strong foothold in the market. There are other differentiating features within this value approach – such as its focus on companies which realise that they need to change to survive, and also on businesses whose products are needed by society. This has allowed the team to avoid companies seeing structural or secular declines in the demand. The lead manager for the strategy has been involved in investment markets for over 30 years, so has seen many different cycles.

As a value orientated fund the best periods of relative performance are likely to occur when growth is either strong or rebounding and it can struggle when cheaper stocks are out of favour. The fund managers have proved they do not need a true value market backdrop to deliver outperformance. The strong long term record of the strategy dating back 25 years, the experience of the lead fund manager and the other senior portfolio manager on the team, backed up by a dedicated value orientated research resource, together with the wider research resource of Nikko AM in Japan equities fully justify an RSMR rating for the fund.



Important Notice

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