

# Fidelity Japan Trust

Active approach aims to ‘find new winners’

Fidelity Japan Trust (FJV) manager Nicholas Price, in response to the COVID-19-driven global market sell-off, is committed to ‘finding the new winners’. The trust has a significant weighting to technology-enabled sectors, where Japan offers many world-leading companies in areas such as factory automation, precision instruments and semiconductors. However, the manager is also taking another look at oversold services companies and more traditional areas such as retailing and leisure, where extremely depressed valuations may offer a mid- to long-term opportunity.

## FJV is re-establishing its trend of NAV outperformance following the sell-off



Source: Refinitiv, Edison Investment Research. Performance versus TOPIX to 23 April 2020.

## The market opportunity

While the COVID-19 pandemic and the Japanese government’s unprecedented stimulus package in response to it may mean the near-term fiscal and economic picture is worse, Japan is still among the world’s largest stock markets. It is home to many world-leading companies, yet remains very under-owned among UK investors, who may wish to consider allocating to a fund with a focus on finding long-term growth stocks at attractive valuations, backed up by in-depth research.

## Why consider investing in Fidelity Japan Trust?

- Solid long-term performance record in a range of market conditions.
- Long-established, Tokyo-based management team with deep research resources from Fidelity’s on-the-ground team of analysts.
- Multi-cap focus allows manager to search out differentiated ideas.
- New board commitment to target a single-digit discount to NAV could see a re-rating in the shares.

## Discount in long-term range despite market sell-off

At 23 April 2020, FJV’s shares traded at a 9.5% discount to NAV. This is in line with the new target of a maximum single-digit discount in normal market conditions (although given market conditions are far from ‘normal’, it could remain volatile in the near term), and is narrower than the long-term range of averages (from 9.7% over one year to 12.5% over 10 years). The more ambitious discount target, backed up by regular repurchases, could provide support for FJV’s rating.

Investment trusts  
Japanese equities

24 April 2020

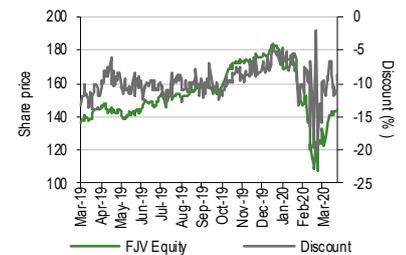
**Price** 144.3p  
**Market cap** £191.0m  
**AUM** £249.1m

NAV\* 159.5p  
Discount to NAV 9.5%

\*Including income. As at 23 April 2020.

Yield 0.0%  
Ordinary shares in issue 132.4m  
Code FJV  
Primary exchange LSE  
AIC sector Japan  
Reference index TOPIX

## Share price/discount performance



## Three-year performance vs index



52-week high/low 183.5p 107.0p  
NAV\* high/low 195.6p 127.8p

\*Including income.

## Gearing

Gross market gearing\* 19.7%  
Net market gearing\* 19.7%

\*As at 31 March 2020.

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**Fidelity Japan Trust is a research client of Edison Investment Research Limited**

## Exhibit 1: Trust at a glance

### Investment objective and fund background

Fidelity Japan Trust (formerly Fidelity Japanese Values) aims to achieve long-term capital growth by investing predominantly in equities and related securities of Japanese companies. Since May 2018 it has used the TOPIX as its reference index, and it is a member of the AIC Japan sector.

### Recent developments

■ 8 April 2020: Results for the year ended 31 December 2019. NAV TR +36.6% versus +14.6% for the TOPIX. Share price TR +39.4%. As part of board succession planning, Sir Laurence Magnus will stand down at the 2020 AGM, with David Graham taking over as chair of the audit committee. Sarah MacAulay has replaced Philip Kay as senior independent director, although he will remain on the board until 2022. Chairman David Robins intends to retire at the 2021 AGM.

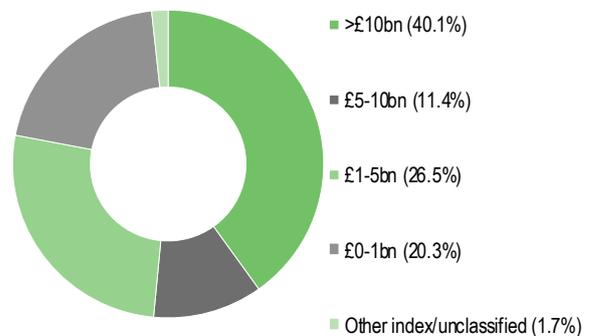
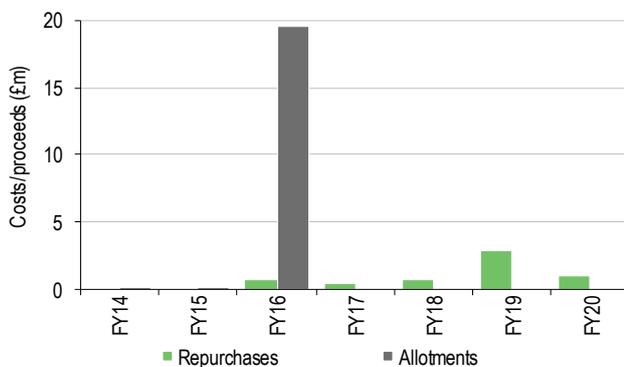
Forthcoming		Capital structure		Fund details	
AGM	May 2020	Ongoing charges	1.1%	Group	FIL Investments International
Interim results	August 2020	Net market gearing	19.7%	Manager	Nicholas Price
Year end	31 December	Annual mgmt charge (AMC)	0.50-0.90%	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Dividend paid	None	Performance fee	Reflected in AMC	Phone	0800 41 41 10 or 0800 41 41 81 (IFAs)
Launch date	15 March 1994	Trust life	Indefinite, subject to vote	Website	<a href="http://www.fidelityinvestmenttrusts.com">www.fidelityinvestmenttrusts.com</a>
Continuation vote	Three-yearly, next 2022	Loan facilities	None – CFDs used		

### Share buyback policy and history (financial years)

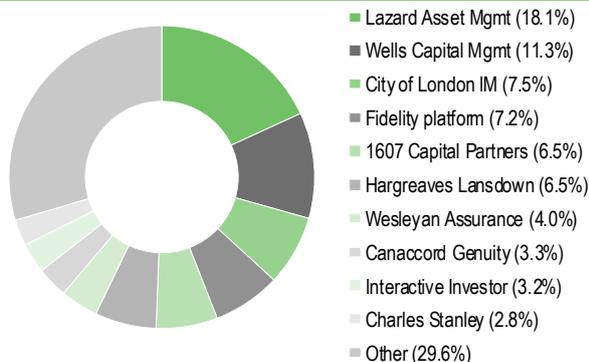
Renewed annually, FJV has the authority to repurchase up to 14.99% of shares and allot shares up to the equivalent of 5% of the issued share capital. Allotments in the chart below include the exercise of subscription shares.

### Market capitalisation breakdown (in sterling, as at 31 March 2020)

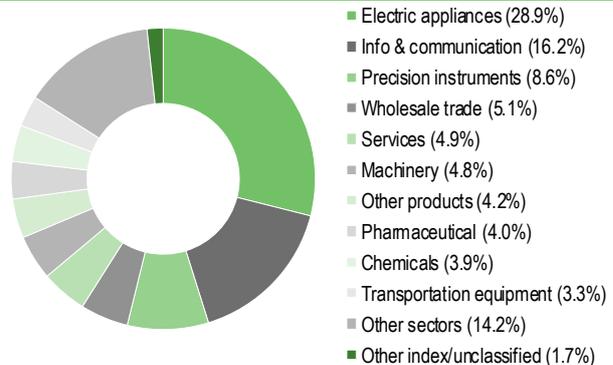
Figures adjusted for gearing. FJV is typically overweight small- and mid-cap growth stocks, is also overweight in large-cap growth and small-cap value stocks, and is very underweight large- and mid-cap value stocks.



### Shareholder base (as at 31 March 2020)



### Portfolio exposure by sector (adjusted for gearing, as at 31 March 2020)



### Top 10 holdings by net long position (as at 31 March 2020)

Company	Country	Sector	% of net assets	
			31 March 2020	31 March 2019*
Olympus Corporation	Japan	Precision instruments	7.4	4.0
Murata Manufacturing	Japan	Electric appliances	7.2	1.1
JustSystems	Japan	Info & communication	5.7	2.9
Keyence Corporation	Japan	Electric appliances	5.2	5.1
Misumi Group	Japan	Wholesale trade	5.1	3.9
Eisai	Japan	Pharmaceuticals	4.4	N/A
Shimano	Japan	Transportation equipment	3.7	3.8
Yamaha Corporation	Japan	Other products	3.6	5.1
TDK Corp	Japan	Electric appliances	3.5	1.4
Tokyo Electron	Japan	Electric appliances	3.3	N/A
<b>Top 10 (% of net assets)</b>			<b>49.1</b>	<b>44.5</b>

Source: Fidelity Japan Trust, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-March 2019 portfolio.

## The fund manager: Nicholas Price

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### The manager's view: Seeking new winners amid the turmoil

While Japan initially seemed to have avoided being significantly affected by the COVID-19 pandemic, in recent weeks the situation has worsened, and the whole country is now under a state of emergency in order to alleviate pressure on its healthcare system. Schools have been closed since late February 2020, and many large-scale events have been cancelled or postponed, including the Tokyo Olympics, which is now expected to take place in 2021.

In order to alleviate tight funding conditions and to stabilise markets, Price says that by March the Bank of Japan had already doubled the upper bounds of its annual asset purchase targets to ¥12tn for exchange-traded funds and introduced new funding operations to provide loans. At the end of the month, Prime Minister Shinzo Abe announced that the government would compile Japan's 'boldest ever' package of economic measures to address the impact of COVID-19, with the stimulus reaching c ¥117tn as of 20 April, following the announcement of direct payments of ¥100,000 to every citizen. Combined with ¥26tn (4.7% of 2019 GDP) in the previous stimulus package formulated at the end of 2019, the government will likely announce a total headline figure exceeding 25% of 2019 GDP, well above the scale of stimulus measures during the global financial crisis of 2008/09.

Even before the coronavirus outbreak, the Japanese economy was looking somewhat fragile. Price notes that real GDP contracted by an annualised 7.1% in the fourth quarter of 2019, with corporate capex, consumer spending and residential investment all showing sharp declines, driven by the impact of a sales tax hike and severe typhoons that occurred at the same time. 'Now we are looking towards at least three straight quarters of negative growth,' he says.

One of the most immediate effects of the COVID-19 pandemic has been a sharp fall in tourist arrivals, particularly from China, where the outbreak originated. The number of inbound visitors dropped almost 60% year-on-year in February (the largest decline since the month following the 2011 earthquake), with those from China down by a huge 88%. Similarly, inbound tourists from South Korea, Taiwan and Hong Kong fell sharply. However, while tourism receipts as a percentage of GDP have increased significantly since Tokyo was selected for the 2020 Olympic Games, they still account for less than 1% of nominal GDP.

In terms of FJV's response to the crisis, Price says he has incorporated the study of liquidity stress for some of the more highly geared companies facing significant revenue declines. 'We are also looking for long-term survivors within value chains,' he says, with analysts focusing particularly on identifying competitive companies that are trading at historical trough valuations, mostly on a price/book basis.

In the trust's recent annual report for the year ended 31 December 2019, Price commented that 'it is our job to get active and find the new winners when others are standing shell shocked'. In practice, he says, this means going out and visiting or calling a lot of companies, and casting the net more widely in order to find stocks with attractive long-term fundamentals that are trading at reasonable valuations, as well as identifying the winning stocks of the future across various sectors, such as domestic names and those with exposure to production in China.

### The portfolio

At 31 March 2020, the top 50 holdings in FJV's portfolio accounted for 108% of net assets (out of a total of 119.7% including gearing), while the top 10 made up 49.1%, an increase in concentration from 44.5% a year earlier. Stocks are selected on a bottom-up basis, with ideas coming both from the manager himself and from Fidelity's Tokyo-based research team, who monitor a universe of

c 1,000 investable stocks, looking broadly for companies with a three- to five-year runway of growth, 10%+ return on equity, strong competitive position and quality management team.

As shown in Exhibit 2, the largest sector exposure is to electric appliances, which is also the largest increase over 12 months and the biggest overweight versus the TOPIX. Electric appliances is a diverse group that includes many technology stocks, such as those related to semiconductors. Four of FJV's top 10 holdings at 31 March (semiconductor stocks Murata Manufacturing and Tokyo Electron and electronic components maker TDK Corp, as well as factory automation specialist Keyence Corporation) are in the electric appliances sector, and together make up 19.2pp of the 34.6% exposure. FJV's top 10 sector weightings make up 84.1% of the total portfolio (adjusted for gearing), compared with 65.3% of the index. Almost two-thirds (64.3%) of FJV's net long positions (53.8% adjusted for gearing) are in the three technology-related sectors of electric appliances, information and communications, and precision instruments, compared with 26.5% of the index.

**Exhibit 2: Portfolio sector exposure vs reference index (% unless stated)**

	Portfolio end- March 2020	Portfolio end- March 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Electric appliances	34.6	21.6	13.0	14.2	20.4	2.4
Info & communication	19.4	13.3	6.1	9.7	9.7	2.0
Precision instruments	10.3	6.7	3.6	2.6	7.7	4.0
Wholesale trade	6.1	5.3	0.8	5.0	1.1	1.2
Services	5.9	18.9	(13.0)	4.9	1.0	1.2
Machinery	5.8	11.7	(5.9)	4.9	0.9	1.2
Other products	5.0	6.2	(1.2)	2.5	2.5	2.0
Pharmaceutical	4.8	N/S	N/A	6.6	(1.8)	0.7
Chemicals	4.7	11.5	(6.8)	7.6	(2.9)	0.6
Transportation equipment	4.0	4.8	(0.8)	7.3	(3.3)	0.5
Other sectors	17.0	15.5	1.5	34.7	(17.7)	0.5
Other index/unclassified	2.0	0.0	2.0	0.0	2.0	N/A
	<b>119.7</b>	<b>115.5</b>		<b>100.0</b>		

Source: Fidelity Japan Trust, Edison Investment Research

Price says that while he is not making significant changes to the underlying positioning of the trust, indiscriminate selling as a result of the COVID-19 pandemic has created opportunities to buy good companies at more attractive prices. In the current environment this includes stable growth stocks in areas such as pharmaceuticals and IT/online services that can continue to increase earnings in an adverse macroeconomic environment. However, he adds that there is greater risk in trying to time the market than in maintaining existing positions in whose medium-term growth prospects he has strong conviction.

While the sell-off has affected segments such as technology, the manager believes that there will be a good upcycle ahead for these companies after a short-term delay, which should be beneficial for the portfolio. The impact from any decline in domestic consumption as a result of social distancing measures is likely to be limited, as the portfolio has a relatively low weighting in this area. Over the longer term, Price says there will be more automation demand in China for Japanese companies such as Keyence, as the pandemic has brought companies to realise that labour can be a weak link in the supply chain. 'A large fiscal expansion in China would also create opportunities in areas such as technology, autos and consumer goods', he adds.

As well as focusing on short-term share price weakness in quality companies, Price has also been exploring opportunities that are trading at extremely oversold levels, in some cases below their price/book valuations during the global financial crisis of 2008/09. Examples here include individual names in areas such as real estate and construction, which currently account for only a small proportion of the FJV portfolio (0.1% and 0.8% respectively at end-FY19, rising to 2.0% and 1.7% at 31 March 2020), as well as services.

The trust retains a larger weighting in mid-sized and smaller companies than the index (57.3% in sub-£10bn companies at 29 February 2020, adjusted for gearing, compared with 41.8% of the TOPIX). However, the proportion in the largest companies has increased markedly over the past 12

months due to the increased technology exposure in the portfolio, with 48.0% on a net long basis (40.1% after adjusting for gearing) invested in the £10bn+ segment at end-March 2020, compared with 27.6% (23.9% adjusted for gearing) a year earlier. The increase has mainly been at the expense of those in the £5–10bn market cap range.

## Performance: Short-term pain but long-term gain

**Exhibit 3: Five-year discrete performance data**

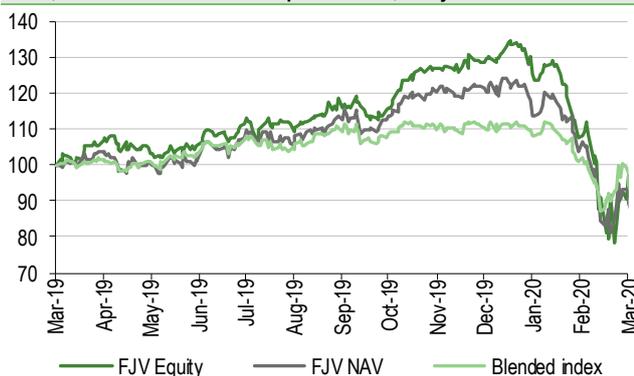
12 months ending	Share price (%)	NAV (%)	Blended index* (%)	TOPIX TR (%)	R/Nomura Mid & Small Cap Japan (%)	CBOE UK All Companies (%)
31/03/16	3.6	8.5	2.3	(1.7)	2.3	(4.1)
31/03/17	28.5	20.6	32.5	32.9	32.5	22.6
31/03/18	29.9	32.1	10.3	8.3	10.3	1.2
31/03/19	(4.9)	(6.3)	(1.7)	(1.8)	(3.2)	6.2
31/03/20	(2.9)	(6.8)	(2.5)	(2.5)	(6.7)	(19.1)

Source: Refinitiv. Note: All % on a total return basis in pounds sterling. \*Blended index is a mid- and small-cap Japan index until 22 May 2018 and TOPIX thereafter.

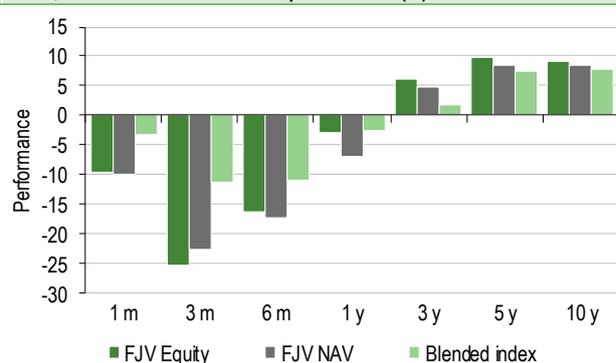
FJV has a good longer-term total return performance record, beating the blended index in both share price and NAV terms on an annualised basis over three, five and 10 years to 31 March 2020 (Exhibit 4, right-hand chart). For its most recent financial year (ended 31 December 2019), it substantially outperformed the TOPIX total return of +14.4%, with NAV and share price total returns of +36.6% and +39.4% respectively, boosted by holdings such as Murata Manufacturing, Olympus and Sysmex. However, having performed particularly strongly in Q419 (Exhibit 4, left-hand chart), it has fallen more steeply than the TOPIX in 2020 to date, and has underperformed the index in the last two discrete years to 31 March (Exhibit 3). It is interesting to note that, in contrast to many global stock markets, the weakness in Japan began at the very beginning of the year, as it became clear that the increase in sales tax was having a larger-than-anticipated impact on economic activity. Thus the global sell-off in March – rather than representing a sharp reversal from historic highs, as in many markets – merely accelerated the existing trend, and the bounce towards the end of the month pared back the loss on the TOPIX to 3.3% in sterling terms, compared with a decline of 15.2% for the CBOE UK All Companies Index.

**Exhibit 4: Investment trust performance to 31 March 2020**

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised. \*Blended index is a mid- and small-cap Japan index until 22 May 2018 and TOPIX thereafter.

In terms of recent performance attribution for FJV, Price says that while defensive stocks, as well as selected stable growth names, have done relatively well, cyclical and manufacturing names (to which the portfolio has a greater degree of exposure) retreated significantly amid concerns over global growth. 'Some stocks that had done well previously have sold off very quickly, and that has hurt performance in the near term,' he adds. Conversely, the lack of exposure to financials

(especially banks, where FJV currently has no holdings) has helped in relative terms as markets sold off and interest rates fell from already rock-bottom levels.

**Exhibit 5: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to TOPIX TR	(6.5)	(15.7)	(5.9)	(0.4)	15.7	17.8	28.7
NAV relative to TOPIX TR	(6.9)	(12.7)	(7.2)	(4.3)	11.4	11.6	19.0
Price rel to R/Nomura Mid & Small Cap Japan	(7.4)	(13.6)	(3.9)	4.1	20.4	18.3	22.5
NAV rel to R/Nomura Mid & Small Cap Japan	(7.8)	(10.6)	(5.1)	(0.0)	15.9	12.0	13.3
Price relative to CBOE UK All Companies	6.6	0.7	8.5	20.0	37.8	56.2	58.2
NAV relative to CBOE UK All Companies	6.1	4.2	7.1	15.2	32.7	47.9	46.3

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2020. Geometric calculation.

## Valuation: No material change in rating after sell-off

At 23 April 2020, FJV's shares traded at a 9.5% discount to cum-income NAV. In spite of some volatility during March (the discount reached a 10-year low of 2.2% and a three-year high of 22.1% in the space of three days), this is not materially different from longer-term ranges (average discounts of 9.7%, 10.3%, 11.9% and 12.5% over one, three, five and 10 years respectively). The board regularly buys back shares (subject to an annual limit of 14.99% of shares in issue) to manage FJV's discount to NAV; in the past 12 months, 2.5m shares (1.9% of the share base) have been bought back, at a cost of £3.7m. In the recent annual report for FY19 it announced a change in its discount control policy, to target a single-digit discount to NAV in normal market conditions.

Given its focus on long-term capital growth and the low level of dividends historically on offer from Japanese companies (particularly in the small- and mid-cap space) compared with some other markets, FJV has not paid a dividend for more than 20 years. In FY19 the trust received portfolio income of £2.91m or c 2.2p per share, which was largely offset by fees and costs, which amounted to £2.16m or c 1.6p per share. With effect from 1 January 2020, FJV has moved from charging 100% of these costs to the revenue account, and now splits the cost 80:20 between capital and revenue, reflecting the trust's focus on capital growth to generate returns. However, while this will gradually reduce the deficit on the revenue reserve, FJV's board has guided that the future payment of dividends was not a major consideration in making the change.

**Exhibit 6: Share price discount to NAV (including income) over three years (%)**



Source: Refinitiv, Edison Investment Research

## Peer group comparison

FJV is a member of the Association of Investment Companies' Japan peer group, having moved from the Japanese Smaller Companies sector in May 2018. However, as it retains a bias towards mid-sized and smaller growth companies, we show both groups in Exhibit 7 to aid comparison.

In performance terms, FJV's NAV total return is ahead of the Japan peer group over one, three and five and 10 years to 20 April 2020, ranking third, second, first and third respectively. It has also outperformed the Japanese Smaller Companies sector average over one year, although it trails this group over three, five and 10 years. However, it is worth noting that the five- and 10-year averages are somewhat skewed by the outsize returns from the growth-focused Baillie Gifford Shin Nippon fund, which has declined by 7.7% over one year compared with FJV's -0.4% NAV total return.

Ongoing charges are above the Japan average but in line with the average for the Japanese Smaller Companies funds. None of the funds charges a performance fee, although there is a performance element in FJV's variable management fee, with a base fee of 0.7% within a range of 0.5% to 0.9%. While all the funds have some level of gearing, FJV's net market gearing of 18% at end-March is above the average for both groups. The trust is the only member of the Japan sector not to pay a dividend (although some of the peers may pay partly out of capital); two of the Japanese Smaller Companies funds also have zero yields.

**Exhibit 7: AIC Japan and Japanese Smaller Companies sectors as at 21 April 2020\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield
<b>AIC Japan</b>										
<b>Fidelity Japan Trust</b>	<b>189.4</b>	<b>(0.4)</b>	<b>31.5</b>	<b>69.6</b>	<b>159.5</b>	<b>1.1</b>	<b>No</b>	<b>(10.6)</b>	<b>118</b>	<b>0.0</b>
Aberdeen Japan	77.2	7.8	12.5	24.6	125.7	1.1	No	(12.9)	112	2.7
Baillie Gifford Japan	597.1	(7.6)	20.3	53.5	230.6	0.7	No	(4.6)	108	0.5
CC Japan Income & Growth	158.3	(11.2)	9.7			1.1	No	(3.9)	121	3.8
JPMorgan Japanese	701.4	9.0	35.8	64.5	175.9	0.7	No	(12.8)	115	1.1
Schroder Japan Growth	197.5	(8.6)	(2.3)	16.4	99.0	1.0	No	(13.3)	112	3.0
<b>Sector average (6 funds)</b>	<b>346.3</b>	<b>(2.1)</b>	<b>15.2</b>	<b>39.8</b>	<b>157.8</b>	<b>0.9</b>		<b>(9.5)</b>	<b>114</b>	<b>2.2</b>
<b>FJV rank in sector</b>	<b>4</b>	<b>3</b>	<b>2</b>	<b>1</b>	<b>3</b>	<b>1</b>		<b>3</b>	<b>2</b>	<b>6</b>
<b>AIC Japanese Smaller Companies</b>										
Atlantis Japan Growth	77.9	(1.6)	36.6	53.3	181.0	1.6	No	(18.3)	106	1.3
AVI Japan Opportunity	108.0	(10.4)				1.0	No	2.8	112	0.0
Baillie Gifford Shin Nippon	420.5	(7.7)	35.1	106.5	401.7	0.7	No	(5.2)	105	0.0
JPMorgan Japan Smaller Cos	204.4	7.2	29.4	70.4	160.6	1.1	No	(14.3)	106	4.7
<b>Sector average</b>	<b>202.7</b>	<b>(3.1)</b>	<b>33.7</b>	<b>76.7</b>	<b>247.8</b>	<b>1.1</b>		<b>(8.7)</b>	<b>107</b>	<b>1.5</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 20 April 2020 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

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