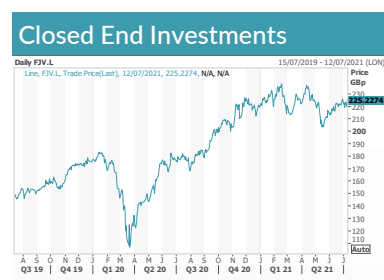


13 July 2021



Source: Refinitiv

Market data

EPIC/TKR	FJV
Price (p)	225
12m high (p)	241
12m low (p)	167
Shares (m)	129.9
Mkt cap (£m)	292
NAV (p, 12 Jul'21)	239.51
Discount to NAV	6%
Country of listing	UK
Market	STMM

Description

Fidelity Japan Trust (FJV) aims to achieve long-term capital growth by investing predominantly in equities and their related securities of Japanese companies.

Company information

Chairman	David Graham
Senior Ind. Dir.	Sarah MacAulay
Chr. Audit Cttee	David Barron
NED	Dominic Ziegler
Portfolio Manager	Nicholas Price (lead) Cenk Simsek (asst.)
Contact	FIL-FidelityInvestmentTrusts@fil.com

investments.trusts.fidelity.co.uk/fidelity-japan-trust

Key shareholders (Feb'21)

Lazard AM	18.6%
Wells Capital Mgt.	11.9%
Fidelity Platform/HL/II	18.9%
City of London IM	7.4%
Wesleyan Assurance	4.1%
Canaccord Genuity WM	3.7%
1607 Capital Ptners.	3.5%

Diary

Mid-Jul	June monthly summary
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Analyst

Mark Thomas	020 3693 7075 mt@hardmanandco.com
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FIDELITY JAPAN TRUST PLC

FJV: fund of the rising returns

Over five years, FJV has outperformed UK markets, UK-listed competition, UK open-ended peers and Japanese benchmarks. The main driver has been FJV's investment process, flexible mandate and active management. FJV gives investors access to Japan's globally competitive companies, structural reforms, improving corporate governance and under-researched mid-/small-caps. These features attracted new investors like Berkshire Hathaway to the country. FJV's main risks are rising inflation (and sentiment to it), a sharp market appetite-style change, and COVID-19. The share price is at a 6% discount to NAV (98% of assets are listed).

- **Other Japanese positives:** Strong 2021 growth in Japan's leading trading partners (US/China) bodes well. Japanese company balance sheets are strong, allowing returns to investors/increased corporate activity. Japan's population is relatively affluent, with plenty of catch-up potential as the economy reopens, and its market valuations are undemanding.
- **Other considerations:** The shares have good liquidity and all of the closed-ended vehicle benefits. FJV has positive ESG credentials. It uses derivative gearing to enhance returns (with higher volatility). FJV's fees have fallen and are in line with peers. Around 40% of portfolio company revenue is global.
- **Valuation:** 98% of investments are valued using quoted prices in active markets. While some may have a degree of illiquidity, the NAV is "real". The discount of 6% is below low-run averages, but it is above that of peers, whom FJV has outperformed. FJV is run for capital growth and pays no dividend.
- **Risks:** FJV has seen periods of short-term underperformance when its investment style is out of favour; typically, when the market undergoes a sharp factor rotation. Usually, recovery has been swift. COVID-19 remains an uncertainty. There are some Japan sentiment issues.
- **Investment summary:** FJV has outperformed its peers, benchmarks and UK indices with a distinctive, active investment approach. Its companies show faster-than-average revenue and EBITDA growth (ca.2x and 3x market, respectively), and have higher ROE and ROIC (around one third above market). It invests for "growth at a reasonable price" (GARP) – so company valuations can be higher. With an active approach, investors are buying FJV's investment process, not its portfolio, on any day. Japan offers tech-enabled growth and structural reforms, and is levered to global trade. FJV's approach can be out of favour but, under the manager's tenure, underperformance periods have been short.

Financial summary and valuation

Year-end Dec (£000)	2017	2018	2019	2020	2021E	2022E
Investment income	44,049	-27,452	52,982	38,535	27,270	30,433
Gains/losses on fin. invst. FV	13,084	-6,873	14,155	22,360	8,680	8,680
Invest management fees	2,568	2,795	2,906	3,287	5,303	6,763
Other expenses	-2,016	-1,843	-1,226	-2,035	-2,121	-2,367
PBT	-461	-555	-600	-605	-542	-542
Investments	221,792	185,987	249,099	303,002	338,149	380,741
Cash	908	0	1,196	4,336	3,370	3,370
NAV	222,527	187,530	252,491	308,806	346,055	388,648
NAV per share (£)	1.64	1.39	1.90	2.37	2.66	2.99
Discount to NAV	-7.7%	-8.5%	-6.6%	-6.8%	-15.6%	-24.8%

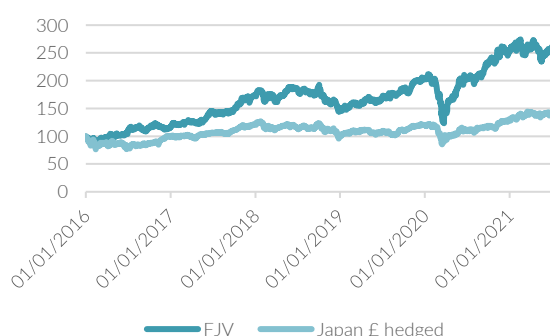
Source: Hardman & Co Research

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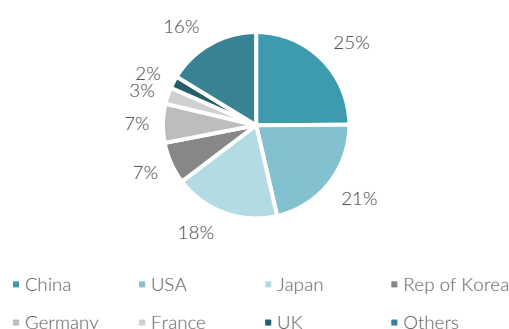
Fidelity Japan Trust plc

FJV outperformed against Japanese whole market, £ hedged (indexed to 100, Jan'16)



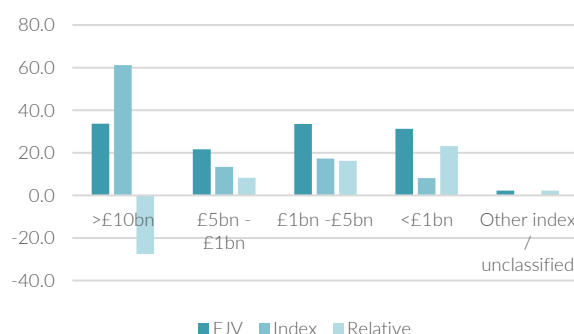
- ▶ Over the medium and long term, FJV has materially outperformed against UK indices.
- ▶ Over the medium and long term, FJV has outperformed UK-listed investment companies in the AIC Japan subsector.
- ▶ Over the medium and long term, FJV has materially outperformed open-ended funds investing in Japan.
- ▶ Over the medium and long term, FJV has materially outperformed against Japanese benchmark indices.

International World Intellectual Property Organisation patent applications by origin in 2020



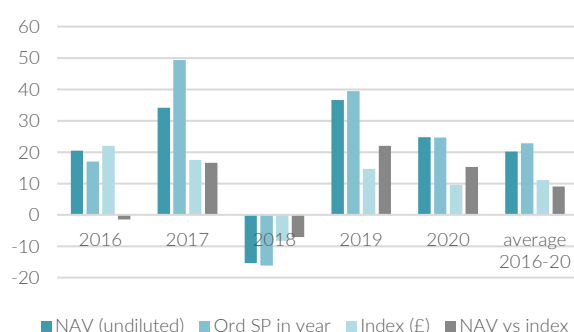
- ▶ Japan's future growth is about tech-enablement – it is second only to the US and China in terms of patents filed.
- ▶ Structural reforms by the government include labour laws, new trade deals and corporate governance. Operating margins are rising, and balance sheets are being restructured.
- ▶ The US and China (ca.40% of Japan's exports) are both likely to show strong growth in 2021. Global trade is important.
- ▶ Actions are being taken to offset the adverse effect of an old and ageing population by developing a digitised, tech-enabled, green economy, creating opportunities for FJV.

FJV portfolio mix by market capitalisation (%) May 2021



- ▶ FJV's team (20, including portfolio managers, analysts and engagement specialists) in Japan identifies mis-priced, under-researched companies. It has a bias to smaller names.
- ▶ Investee companies show faster-than-average revenue and EBITDA growth (ca.2x and 3x market, respectively), and have higher ROE and ROIC (around a third above market).
- ▶ Turnover is relatively high (average 71.5% 2016-20), with a strong sell discipline as investments approach target prices.
- ▶ Net nominal derivatives exposure ranged from -9% to +21% of investment fair value (FV) over 2016-20.

Annual total return for NAV, SP, index and relative to index, 2016-20 (%)



- ▶ Saw an average 20.1% annual total NAV return over 2016-20 (against index 11.1%).
- ▶ Can be volatile – for two years, it was above 30%, and there was one negative year (same for index).
- ▶ FJV is actively managed, and so is more volatile and not statistically correlated to the index.
- ▶ Sharp-style reversals can create near-term headwinds. Normally, FJV's investment approach has overcome them, and underperformance has remained short term.

Source: Company data (team of 20 as at 31 March 2021), Hardman & Co Research

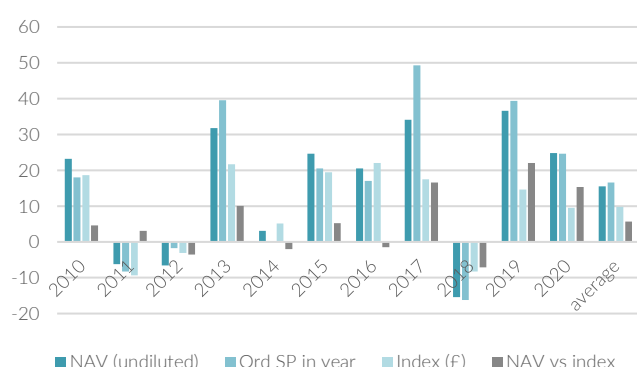
Summary

Investment positives

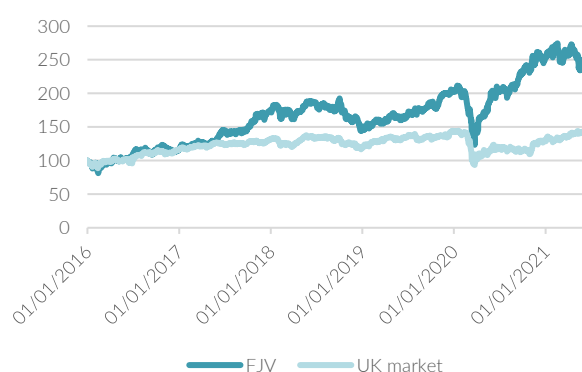
FJV has outperformed UK markets, UK-listed peers, UK open-ended competitors and its Japanese benchmark

For UK investors, FJV has outperformed over the long term against UK indices, listed closed-ended peers and open-ended funds in the same space. This is partially because the Japanese market, over the long term, has outperformed the UK indices, but, much more significantly, because FJV has outperformed the Japanese benchmark indices by an average of 9.1% p.a. over FY'16 to FY'20, including a 15.3% outperformance in FY'20. Stock selection and idiosyncratic alpha mean the fund can perform well across a range of market and economic environments.

Standardised performance total return (%)



FJV, UK market total return, indexed to Jan'16



Source: Refinitiv, Hardman & Co Research

Japan: innovation led long-term growth

In 2020, Japan lodged as many patent applications with the World Intellectual Property Organisation (WIPO) as Germany, France and the UK combined. The government is very active in supporting innovation, including selectively relaxing rules on early-stage businesses, setting up National Strategic Special Zones, special rules to encourage digitisation and a green growth strategy.

Government-led structural reforms to labour markets, products and corporate barriers to entry, and new trade agreements

There have been fundamental reforms introduced in recent years across the labour market, corporate governance and trade. There is strong evidence that they are taking effect (e.g. see an IMF review in 2018).¹ Reforms are intended to increase productivity by providing training and career opportunities across the workforce, as well as increase the labour supply with more female workers, older workers and immigration. There is a natural end to guaranteed lifetime employment, as it is primarily only applicable to older workers approaching retirement. Product and corporate reforms include reducing barriers to entry and major corporate governance changes. New trade agreements with the EU, and in the trans-pacific region, could boost GDP by 3%², while the Regional Comprehensive Economic Partnership (RCEP) potentially reduces costs across Asia by \$90bn³, and Japanese companies could benefit from this.

Improving corporate governance

Some notable changes to corporate governance include the following: i) the Institutional Investors Collective Engagement Forum (IICEF) being established as a lobby group in 2017; ii) the increasing role and numbers of independent directors since rules were introduced in 2015; iii) reducing the number of listed subsidiaries; iv) starting to see a few hostile takeovers and increasing private equity (PE) interest in the Japanese market; v) Keiretsu (business networks often including friendly

¹ IMF November 2018 report: *Macroeconomic Effects of Japan's Demographics: Can Structural Reforms Reverse Them?*

² *Asia Times* and <https://www.econstor.eu/bitstream/10419/202512/1/104346235X.pdf>

³ Source: *Allianz Research*

cross-shareholdings) being under increasing scrutiny; vi) Japanese payouts to investors growing faster than all other regions, except North America, where payouts are up 124%⁴ since 2009 (FJV's investment income has nearly doubled since 2015 and Japanese dividends proved more sustainable in 2020 than the global average – both these factors reflect better governance and the strength of Japanese company balance sheets); and vii) operating returns are on a long-term rising trend, but still have some way to go before they reach international levels. The FSA updated its Stewardship Code in 2020⁵ and Corporate Governance Code⁶ this year, reinforcing the message of regulatory support for better governance and sustainability. Looking forward, further governance reforms are under way, such as the Tokyo Stock Exchange's market structural reform and the revision of the TOPIX index. We expect the environment around Japanese companies to become ever-more supportive of better shareholder relations.

Japan has a positive near-term outlook, benefiting from growth in major trading partners

The US and China are Japan's two biggest trading partners (ca.40% exports), and Japan should benefit from their above-average growth. The Olympics may be a boost, albeit relatively modest. The human impact of COVID-19 has been relatively modest, but it has still seen a 4.7% decline in real GDP in 2020. Material support programmes have been put in place, and growth is expected to resume in 2H'21.

Other Japanese macro factors include strength of Japanese balance sheets, a wealthy population, new investor flows and relatively low P/E

Other Japanese macro factors include i) Japanese companies have above-average cash holdings (if recent trends continue, this will see greater returns to investors, via capital and dividend returns, increased M&A activity, including restructuring listed subsidiaries, and investment in the latest technology, ii) Japan ranks highly for having an affluent population with above-average spending power, iii) new investors (e.g. Berkshire Hathaway) have been investing in Japan, and overseas investors are underweight the asset class, and iv) the Japanese market P/E is ca.75% of the US level, having been above it previously.

FJV can cherry pick from 3,800 potential investments in a market 1.5x the number of under-researched companies as the US. Uses long-established, local-based talent to really understand the market.

Fidelity has seven portfolio managers, 11 analysts and a two-strong sustainable investing team in Japan⁷, and can pick from ca.3,800 potential investments. Specifically, Japan is in the sweet spot of under-researched companies. It has ca.1.5x the number of companies covered by fewer than five analysts as the US.

FJV identifies where the market has mis-judged the growth outlook through detailed, fundamental analysis. Origination of new ideas flows from this analytical model, company meetings, the analyst and fund manager networks, and Fidelity's scale and global research. Compared with local investors, FJV has a competitive advantage in Fidelity's global presence. Compared with international investors, it has been on the ground, with a local team, speaking Japanese for a long time (since 1969). To really understand the businesses, the manager will meet up to 400 companies a year, and the team as a whole will meet more than 3,000 (under current remote working practice).

FJV companies have higher growth and higher margins, and are at higher valuations than market averages

FJV's approach is GARP, favouring energy efficiency, medical technology, Asian consumption and digital transformation. It likes "efficiency enablers", which will benefit from the way people work, shop and play in the post-pandemic world. This does not exclude opportunistically looking at sectors where market sentiment is mispricing growth (for example, in travel and leisure in 2020). FJV companies show faster-than-average revenue and EBITDA growth (ca.2x and 3x market, respectively), higher ROE and ROIC (both around one third above the market), and higher P/E and P/BV ratings. Portfolio risk is then managed through position size and top-level characteristics.

⁴ *Janus Henderson Global Dividend Index*

⁵ <https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/02.pdf>

⁶ <https://www.fsa.go.jp/en/news/2021/20210406.html>

⁷ Source: Fidelity International as at 31 March 2021, including analysts, managers and engagement specialists

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Flexible mandate by market cap, private companies, and derivatives. Portfolio turnover has been ca.70%. Investors are buying into the process, not a specific portfolio, at any given time.

FJV benefits from being closed-ended structure

Japan has mixed ESG credentials, but signs of improvement. FJV companies better than average.

Investment-neutral factors include discount management, gearing, currency exposure, fees, KID disclosure, non-correlation with index, absence of dividend and sensitivity to global, not Japanese, drivers

FJV has a broad mandate with flexibility to take the best opportunities available. A research-driven approach is more likely to find unappreciated growth in medium- and smaller-sized companies than in well-covered large ones, but the manager is market cap-agnostic. Additionally, FJV has modest holdings in unlisted businesses (an area it aims to grow), and we note that 3.6% was added to the NAV when one such investment IPO-ed in March 2021. FJV's flexible mandate means it uses long contracts for difference (simple derivatives) to increase stock-specific exposure in an efficient way. Net derivatives have represented -9% to +21% of the FV of investments (end of FY'16 to FY'20). Average turnover can be relatively high (2016-20 more than 70%), as the manager is "selling what has gone up and recycling into new ideas". This reflects good selling discipline, as investments are trimmed or sold when they approach target prices, and not managed for momentum returns. The top 10 positions average 44% of NAV (generally within a 40%-50% range) and, again, these are actively managed. With such active management, investors are buying FJV's approach, not a specific portfolio, at any given time.

Closed-ended structures can outperform open-ended ones, as they have less cash drag, can invest long term, have a board of directors and allow gearing. We estimate that FJV ranks top compared with all open-ended Japanese funds over five years and has outperformed the average of its closest peers by nearly 3x over this timescale. There is good liquidity in FJV shares, and its register has modest concentration risk.

From a relatively low base, there have been a number of improvements that are expected to steadily improve Japan's ESG. For Fidelity, ESG is simply good business practice, with both social and financial return benefits. It uses a proprietary model, dedicated teams and third-party data, and has been a signatory to UNPRI since 2012. 80% of FJV's portfolio is invested in companies rated A, B and C (well above the index's 63%), based on Fidelity's own Sustainability Ratings.⁸ FJV's own governance issues, in terms of director longevity, have now been addressed.

Investment-neutral factors

Investment-neutral factors include the following: i) the discount to NAV can be helped by buybacks, but this can create liquidity issues, worsen expense ratios and send mixed messages re growth prospects (FJV does them selectively to keep the discount within single digits, and there is a continuation vote every three years); ii) exposures are geared through derivatives, not debt (gearing is capped at 25% of shareholder funds but can be, and has been, increased with board approval – we believe this increases long-term returns, but introduces greater volatility); iii) currency exposure is complex and can introduce some short-term volatility, but the exposure is not hedged, as, over the long term, the effects are modest and hedging incurs real costs; iv) ongoing charges have fallen sequentially every year since 2012 and are now well below half the level they were 10 years ago (overall, FJV is in line with peers' fees using the AIC basis, while, using KID disclosure, it has the lowest fees across all Japanese investment companies – performance fees can add to costs or reduce them by 20bps, and they are based off a three-year relative record, and so will not move with short-term absolute performance); v) KIDs need to be treated with caution, but, compared with its closest peers, FJV's KID indicates a slightly wider spread of potential performance; vi) given the management approach outlined above, FJV's share price is not closely correlated to indices, and over time, FJV has delivered outperformance; vii) FJV's objective is long-term capital growth – so it does not pay a dividend and viii) Japan, and many of its companies, are more exposed to global trends than domestic ones.

⁸ Source: Fidelity International as of 31 March 2021. The Fidelity Sustainability Ratings were launched in June 2019. As at 31 March 2021, they cover a universe of ca.4,900 issuers in equity and fixed income.

Market appetite for investment style can create headwinds, which FJV's approach has usually overcome

Investment risks/downsides

FJV, on occasion, has seen short-term underperformance when the market has been volatile around inflation worries, dramatically changing from growth- to value-investing, or favoured lower-growth, lower-quality equities. The portfolio is market cap-agnostic, but we believe it is likely to be biased to small-, mid-cap names, which are less well researched. If the market appetite is for large-cap, this again can create a headwind. Usually, recovery has been swift; however, for a period, FJV has faced headwinds, which its stock selection, generally, but not always, has overcome. By way of example, in 2020, FJV's NAV total return fell by 36% between January and March, while the index fell 25%. FJV went on to see a sharper recovery, outperforming over the year.

May see share price volatility

FJV's NAV has shown, and is likely to show, volatility. The NAV average annual return over FY'16-20 (the manager's tenure) was 20.1%, but it ranged from -15% to +37% (and the share price averaged 22.8%, with a range of -16% to +49%). COVID-19 remains an uncertain factor.

Japan has poor GDP record, with impact on sentiment. Looking forward, ageing population is a challenge.

Japan has a poor historical record of GDP growth, and per capita output growth has also lagged other developed markets. Sentiment is likely to be adversely affected by memories of Japan's "lost decade", even though the outlook is very different today. 28% of Japan's population is over 65, compared with the developed world's 19% and a global average of 9%. Consequently, it is likely to see shrinking total and working-age populations, with the multiple adverse economic effects that ensue. The IMF estimates that it could reduce Japan's real GDP by 25% over 40 years (0.55% CAGR). The government policies we identified above are intended to address this problem, and FJV's stock selection, typically, does not give it exposure directly to this risk. Indeed, it sees opportunities in areas that serve the elderly/respond to government actions to address the ageing population (e.g. digitalising the economy, automation).

Japan's government debt could be an issue, as could its slow vaccination rate. Stock markets have recovered strongly, but FJV's stock selection mitigates risk of bubble.

There are some other sentiment issues, which do not affect FJV's portfolio directly but could have an impact on demand for its shares. Pre-pandemic, Japanese central government debt was nearly twice the average of major western developed economies, potentially squeezing out the private sector. Debt levels increased materially with pandemic measures. Japan's slow vaccination rate could see incremental pressures from COVID-19 in the near term. Strong markets may see some concerns about short-term bubbles, but FJV's stock selection gives it a differentiated profile from the market as a whole.

Investors buying into process, not specific portfolio

Portfolio

FJV's portfolio is the result of its bottom-up stock selection, rather than a target. With a relatively high turnover, a result of the manager's strong sell discipline, investors are buying into the process, not the portfolio, at any given time. Note that, at end-May 2021, by sector, FJV was heavily overweight electrical appliances, services and information and communication.

Discount closing would be icing on cake and small part of expected return from compounding capital gains

Valuation

98% of investments are valued using quoted prices in active markets. While some may have a degree of illiquidity, the NAV is "real". The discount to NAV (currently 6.1%) is below the level for most of the manager's tenure (11.2%) and the past three years (8.8%). It is above peer averages (AIC Japan sector 2.8%), but not the highest in the sector. We believe investors should consider investing for the long term, compounding capital gain with any one-off discount reduction as an added bonus, rather than the reason to buy. FJV is run for capital growth and pays no dividend.

Investment attractions

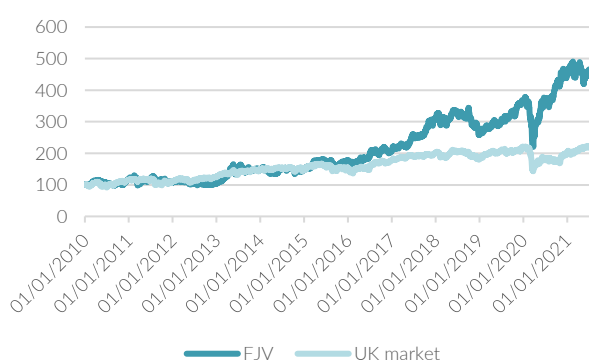
1) FJV: superior investment performance

Performance against UK indices, listed peers and open-ended funds

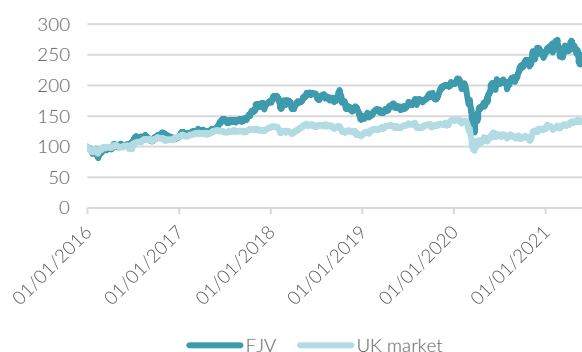
For UK investors, FJV has outperformed over long term against UK indices...

As a UK-listed vehicle, with a high proportion of UK retail shareholders, we believe many investors will look to FJV because they expect superior returns over their UK investments. This expectation has been delivered. As can be seen in the charts below, FJV has materially beaten all these comparators, with its total return being roughly treble the UK indices since 2010 – a performance that has accelerated since the start of 2016 (the current manager's tenure started in September 2015).

FJV, and UK market, total return, indexed to Jan'10



FJV, and UK market, total return, indexed to Jan'16

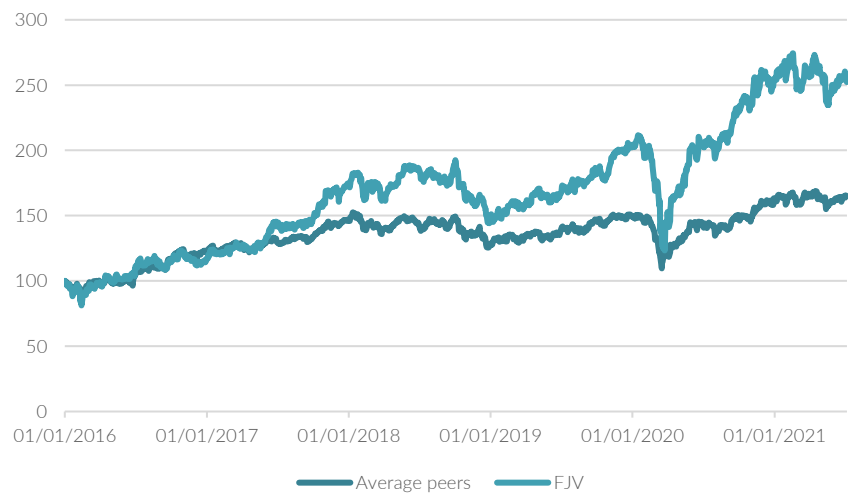


Source: Refinitiv, Hardman & Co Research

...and is well ahead of both listed closed-ended peers and open-ended funds in the same space

Investors wanting to compare FJV with its UK listed peers can see their relative performance updated daily on the [AIC website](#). At the time of this report, FJV is the best-performing "Japan" investment company over five years (broadly speaking, the tenure of the existing manager), and second-best over one year. Looking at open-ended funds, [Fidelity's fund platform](#) lists 69 funds in its Japan and Japan smaller company sectors, of which 59 are actively managed (six in the small companies section). The chart below gives the performance of some of the funds of a similar fund size to FJV. As can be seen, FJV is materially ahead of all these comparable funds, and about three times the average on a five-year view. The best-performing OEIC of a similar size is FSSA Japan Focus B hedged, which, over this period, delivered a total return of 114%, against FJV's 159%. The worst-performing OEIC of a similar size delivered a total return of just 34% over the period. From the broader open-ended Japanese funds of all sizes we have identified, FJV has beaten them all.

Five-year total return of FJV's NAV vs. open-ended peers (%)



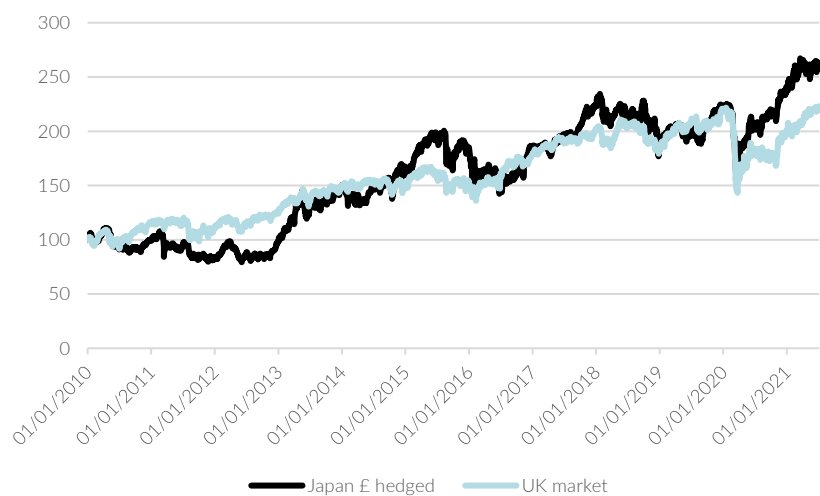
Peers include Jupiter Japan Income, LF Morant Wright Japan B, LF Morant Wright Nippon, Invesco Japan, FSSA Japan Focus hedged, Axa Framlington Japan, Janus Henderson Inst Japan Index Opps. Source: Refinitiv, Hardman & Co Research

This is partially because Japanese market, over long term, has outperformed UK indices...

Long-term outperformance against its benchmark

The chart below shows the sterling-hedged Japanese index total return compared with the UK large-cap and whole market indices. While the start of the decade saw the Japanese market underperform the UK indices, since that date, it has outperformed, leading to an overall outperformance over the period. Since the start of the manager's tenure, the Japanese market (sterling-hedged) has underperformed through to the start of 2020 but is now in line.

Performance total return for Japanese and UK markets, indexed to 100, Jan'10



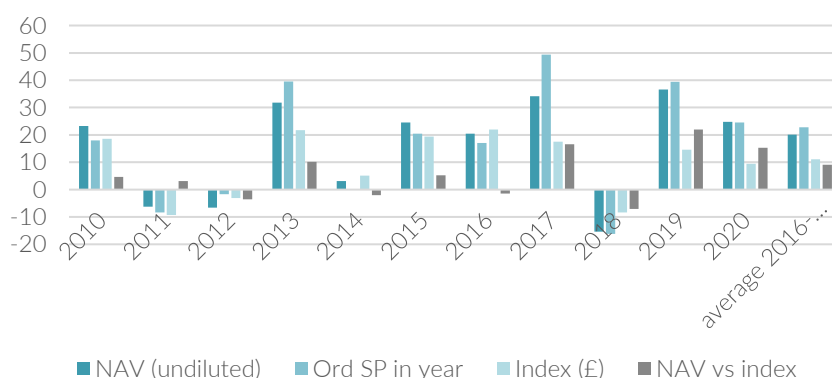
Source: Refinitiv, Hardman & Co Research

Fidelity Japan Trust plc

...but, much more significantly, because FJV has outperformed local benchmark indices by an average of 9.1% p.a. FY'16 to FY'20, including 15.3% outperformance in FY'20

Investors only want not only to be in an attractive market, but also want the best investment in those markets. Again, FJV has delivered on this expectation. As can be seen in the chart below, in three of the five years between 2016 and 2020, FJV outperformed its benchmark. Over that period, the average annual outperformance was 9.1%. We show the chart below to demonstrate not only the outperformance but also the volatility of returns, an issue we address a little later.

Performance total return for FJV's NAV and share price, its sterling index, and comparison of NAV to the index (%)



Source: FJV Report and Accounts, Hardman & Co Research

Stock selection and idiosyncratic alpha mean fund can perform well across different market environments

The following sections explore why Japan is an attractive market, delivering superior returns (and the risks), and how Fidelity has added value. The manager highlights that the focus on individual stock selection, with global brands and industry leaders across the market-cap spectrum, and sources of idiosyncratic alpha mean that the fund can perform well across different market and economic environments, which appears consistent with the performance above (we review 2020 in more detail in the section below).

2) Japan: innovation-led growth potential

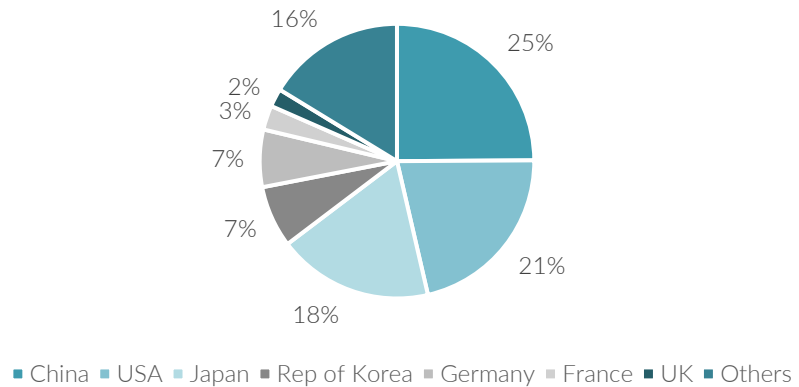
Japan lodged as many patent applications with WIPO in 2020 as Germany, France and UK combined

Japan continues to be a country that innovates, with some headline examples being i) NEC has developed face recognition technology that takes just 0.3 seconds to complete, ii) Panasonic's live translation device,⁹ and iii) driverless vehicles, which the government aims to be in regular public use by 2022.¹⁰ We note that, in March 2021, WIPO reported that, in 2020, there were 276k international patent applications filed via WIPO's Patent Cooperation Treaty, of which Japan accounted for 18%. As the chart below shows, it is only slightly behind China and the US, and ahead of Germany, France and the UK combined. Mitsubishi Electric Corp. was the third-biggest individual filer (2,810).

⁹ <https://phys.org/news/2019-03-japan-eyes-olympics-retake-tech.html>

¹⁰ <https://www.reuters.com/article/us-japan-economy-strategy/japan-looks-to-launch-driverless-car-system-in-tokyo-by-2020-idUSKCN1J00VN>

International patent applications by origin in 2020 (PCT System)



Source: World Intellectual Property Organisation, 2 March 2021, Hardman & Co Research

Government very active in supporting innovation, including selectively relaxing rules on early-stage businesses, setting up National Strategic Special Zones, special rules to encourage digitisation and a green growth strategy

The Japanese government is “committed to being the very first country to prove that it is possible to grow through innovation even when its population declines... all things will be connected through IoT technology and all technologies will be integrated, dramatically improving the quality of life.”¹¹

In practice, what this means is:

- ▶ Japan provides a “sandbox” approach, which allows new ideas to be tested and improved in real-life situations without existing restrictions. Early-stage business models or technologies are proposed to the government and evaluated on their merit. Rules are relaxed to test these innovations within a specified contained sandbox in an approved project. The testing environment allows businesses to conduct pilot projects quickly. If the pilot demonstrations of new technologies/business models work, the government then aims to implement the required regulatory reforms more broadly. A dedicated office for this has been set up to ease the application process.
- ▶ National Strategic Special Zones have been established in 10 areas where advanced structural reform is allowed, in the hope of turning successful test cases into nationwide implementations. As of March 2020, 354 reforms had been put in place since the zones were established in 2013.¹²
- ▶ Special rules are being introduced for the digital market. Given the importance of data handling and security, Japan plans to create a task force to both regulate and stimulate best practices in the digital market arena. It aims to ensure transparency and fairness in transactions between digital platform companies and users through the “Act on Improving Transparency and Fairness of Digital Platforms”, which was enacted in May 2020 and, in May 2021, the parliaments approved the law setting up a digital agency with a staff of 500.
- ▶ Japan presented its new “Green Growth Strategy in line with Carbon Neutrality in 2050” in December 2020, with the aim of having the market-leading position in clean energy. This is partially because it started from a heavy dependence on fossil fuels. In 2019, they accounted for 88% of primary energy supply, the sixth-highest share among the International Energy Agency (IEA) countries.¹³ Not only was this damaging to the environment, but the vast majority of these resources were imported, creating a national security issue. The Green Growth

¹¹ <https://www.japan.go.jp/technology/innovation/>

¹² <https://www.japan.go.jp/abonomics/regulatory/>

¹³ Japan 2021 IEA Energy Policy Review <https://webstore.iea.org/download/direct/4321>

Strategy, in contrast, promotes the creation of a virtuous cycle of economic growth and environmental protection, together with the business community.

3) Japan: government-led structural reforms

A number of fundamental reforms across labour market, corporate governance and trade have been introduced in recent years. Strong evidence that they are taking effect, including independent IMF review in 2018.

In recent years, Japan has introduced a series of labour market, corporate, product and international trade reforms. We believe these are evolutionary in nature, given Japan's conservative culture, but progress has already started to be made. The new prime minister, Yoshihide Suga, is continuing the reform programme, especially with a greater focus on environmental issues, by recently committing Japan to carbon neutrality by 2050. He is also driving towards digitalising the public sector¹⁴. In 2018, the *IMF reviewed* whether structural reforms could reverse the macroeconomic effects of Japan's ageing population. It concluded "a not-fully-believed path of structural reforms can significantly offset the adverse effect of Japan's demographic headwinds – a declining and ageing population – on real GDP (by ca.15% in the next 40 years), but would not boost inflation". This would reduce the expected GDP decline by nearly two thirds. We note that this does not include the benefits from an acceleration of reforms under the new Prime Minister, nor the innovation policies above.

Labour reforms

Reforms intended to increase productivity by providing training and career opportunities across workforce, as well as increasing labour supply with more female workers, older workers and immigration.

The IMF report also focused on a number of labour reforms.

- ▶ With employment protection for regular workers being relatively high in Japan (see section below), firms have made use of non-regular workers to contain wage costs. However, non-regular workers have lower productivity (less training, combined with less motivation, given limited career prospects). The IMF estimates that a gradual introduction of intermediate contracts (replacing regular and non-regulars over time), whereby intermediates are assumed to be as productive as regular workers, would boost the level of labour productivity (currently growing by ca.1.5% p.a.) by more than 7% in the long run.
- ▶ Raising female labour force participation from 2017 levels (70%) to the average of northern European levels (75%) would increase potential growth by 0.2ppts p.a. Encouraging the female participation rate already increased from 63% in 2010 to 70% in 2017, which gives credibility to this trend.
- ▶ Older workers' participation (those aged 60 and above) is already high in Japan relative to OECD levels, and the IMF assumes that a further 3ppt increase in participation would increase the labour force by around 0.5ppts, with a small impact on potential output growth.
- ▶ Increased migration that lifts the labour force in Japan by 1% would increase potential growth by 0.15ppts p.a. over 10 years. Having long opposed any form of immigration, the government is granting foreign workers short-term visas to help out the tightest sectors, such as healthcare and tourism. Japan's Diet in December 2018 made labour migration possible for two categories of medium-skilled workers in 14 labour-shortage sectors, initially setting a maximum cap of 350,000 migrants over five years. One category is for temporary workers who can remain for a maximum of five years; the second allows unlimited visa renewals and accompaniment by family members, inherently opening a path to permanent settlement. It also introduced less stringent entry requirements, such as not needing to pass a language exam. It is still early days to see what

¹⁴ <https://www.economist.com/asia/2021/01/02/japans-new-prime-minister-drags-government-into-the-digital-era>

effect the reforms will have (see, for example, the Migration Policy Institute's article [Japan's Labor Migration Reforms: Breaking with the Past?](#)), but the direction of travel is positive.

Natural end to guaranteed lifetime employment

More than 25 million workers benefit from guaranteed lifetime employment. Following the 2008 recession, the offer of such terms to new employers reduced sharply (by 2014, just 9% of Japanese companies offered it), meaning that most of the workers with such rights are now aged 45 to 65. As these workers reach retirement, there will be much-improved flexibility in working practice. Given FJV's focus on newer technology and smaller businesses, we would expect a below-average exposure to residual guaranteed lifetime employment businesses.

Product and corporate reforms include reducing barriers to entry and major corporate governance changes

Corporate and product market reforms

The IMF article again highlighted that i) product market reforms, including the easing of barriers to entry in some industries and deregulation of professional services could deliver a 2.4% increase in productivity after five years, ii) restructuring the SME sector could lift the productivity of smaller firms (to 80% of large firms), translating into a 2.5% improvement after 10 years, and iii) corporate governance reform (see section below) could boost the level of investment by 5% over 10 years.

New trade agreements with EU and in trans-pacific region could boost GDP by 3%, while the Regional Comprehensive Economic Partnership (RCEP) potentially reduces costs across Asia by \$90bn

International trade reform

There are several major international trade reforms with an effective reduction of tariffs and non-tariff barriers:

- ▶ The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. It was signed on 8 March 2018 and came into force on 30 December 2018 (Japan was the second-quickest ratifier of the agreement). Additionally, the UK has applied to become part of this agreement, and Colombia, Thailand and the Republic of Korea (ROK) are also considering joining the bloc. *Asia Times* reported an estimated 2% boost to GDP by 2025 because of this deal.¹⁵ There is the added potential that President Biden may be more willing to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, not least as he commented about its predecessor, "TPP wasn't perfect but the idea behind it was a good one".
- ▶ On 15 November 2020, the RCEP, a multi-lateral free trade agreement between China, Japan, South Korea, New Zealand, Australia and the 10 countries in the Association of South-East Asian Nations (ASEAN: Vietnam, Laos, Myanmar, Thailand, Malaysia, Indonesia, Brunei, Cambodia, Singapore, and the Philippines) was signed, and is likely to become effective at end-2021. For most countries, the RCEP consolidates and updates existing arrangements, but it is incrementally beneficial to China, Japan and South Korea. It reduces non-tariff barriers by creating a common rule of origin, easing supply chains and transaction costs. Allianz research puts the reduced costs at \$90bn p.a. (4% on 2019 intra-regional trade and 0.5% on global merchandise trade).¹⁶
- ▶ After negotiations started in 2013, the EU and Japan concluded an [Economic Partnership Agreement](#), which entered into force on 1 February 2019. Some estimates put the benefit to GDP at ca.1%.¹⁷

¹⁵ <https://asiatimes.com/2018/10/cost-benefit-analysis-of-japans-decision-to-join-cptpp/>

¹⁶ Source: [Allianz Research](#)

¹⁷ <https://www.econstor.eu/bitstream/10419/202512/1/104346235X.pdf>

Some modest push-back regulating overseas investment under national security considerations

- ▶ A UK free trade agreement was announced in September 2020. The benefits are likely to be small, and may be seen through the CPTPP, anyway.

The trend is for improving international trade, but Japan has not been immune to the global trend to regulate overseas investment under national security considerations. In August and October 2019, and May 2020, amendments to the Foreign Exchange and Foreign Trade Act of Japan became effective, and could affect sentiment to Japan. The vast majority of foreign investors will get blanket exemptions (and even the limited number of sovereign wealth and pension funds that do not get blanket exemptions can apply on a case-by-case basis), which means that they will actually be marginal beneficiaries. However, poor communication, we believe, means this is not how the change was perceived.

4) Japan: better corporate governance

Japanese culture is conservative, and changes take time, but there have been multiple reforms to corporate governance in Japan, which will shift management and companies' focus more on shareholder returns and less on their historical collegiate approach. The reforms include:

Institutional Investors Collective Engagement Forum (IICEF) lobby group established in 2017

The IICEF was established in October 2017 to help institutional investors "conduct sound and appropriate stewardship activities and to hold constructive dialogues with listed companies in Japan." By way of example of its activities, in 2019, it started a campaign on cross shareholders and parent-subsidary listings. In terms of other shareholder activism, we note a rise in the number of shareholder-initiated proposals (55 in 2020 vs. 23 in 2016). Japanese companies have, perhaps not unsurprisingly, faced a far higher proportion of shareholder proposals to restructure the balance sheet (32% vs. 10% in US). Progress is being made, albeit slowly (80% of board-related shareholder proposals over 2019-21 failed), and is constrained by the relatively low proportion of shares held by institutional investors (27% for TOPIX vs. 61% for the Russell 3000).¹⁸

Increasing role and numbers of independent directors since rules introduced in 2015

The 2014 Reform of the Companies Act introduced a "comply or explain" rule for listed companies regarding the appointment of one "outside director". The 2015 Japanese Corporate Governance Code then introduced a similar rule regarding the appointment of two or more "independent" directors. The ratio of those appointing one or more outside directors jumped from 48.5% in 2010 to 55.4% in 2012, to 74.3% in 2014, and to 98.8% in 2016. However, it is still quite rare for Japanese companies to appoint outside/independent directors to be the majority of their boards and, as in other countries, there have been some concerns about how independent and effective the directors have been. To us, there were two important issues. First, the initiatives were driven by the government looking at how to structurally improve things, and not by a knee-jerk reaction to a specific scandal/short-term problem. Secondly, it is evidence of a directional trend going in the right way and that, over time, there will be great supervision by more independent boards.

Number of listed subsidiaries is reducing

Japan was unusual in that many major corporations were listed at the group level but had listed minority stakes in subsidiaries as well. The governance of such businesses is considered by us to be sub-optimal, as investors in subsidiaries do not have effective control. This has been an issue for many years, but only recently has there been a major change. *The Japan Times* described 2020 as the year "when they really took off". Of note were actions by Nippon Telegraph and Telephone Corporation, Sony (Olympus, which has been a big Fidelity holding), Toshiba (three

¹⁸ <https://transactions.freshfields.com/post/102gin1/shareholder-activism-in-japan-part-2-the-changing-face-of-shareholder-activism>

Starting to see a few hostile takeovers and increasing PE interest in Japanese market

subsidiaries) and Itochu, all of whom fully acquired or divested their previously listed subsidiaries.

In addition to the reduction in listed subsidiaries, we note i) hostile takeovers, while extremely rare, are starting to happen (e.g. ones by Colowide Co and Nitori Holdings), and ii) an increasing presence of PE in raising funds (e.g. Carlyle, in March 2020, raised \$2.3bn for its fourth Japan buyout fund, compared with the \$2.7bn it has invested in the 20 years since first establishing its office in Tokyo) and activity (e.g. Blackstone buying Takeda's over-the-counter business for ¥242bn).

On 24 March 2020, the Japanese Financial Services Agency published its *Principles for Responsible Institutional Investors (Japan's Stewardship Code)* – “to promote sustainable growth of companies through investment and dialogue”. This followed extensive consultations and updated the 2014 initial code (revised in 2017). For those interested in the evolution of the Code, the FSA also provided a track changed option.¹⁹ Additionally, the FSA proposed revisions to the Corporate Governance Code²⁰ this year, reinforcing the message of regulatory support for better governance and sustainability.

Keiretsu (business networks often including friendly cross-shareholdings) under increasing scrutiny

Keiretsu is a vague term but broadly describes the business networks (largely composed of banks, manufacturers, supply chain partners and distributors) that effectively work together for the benefit of the whole group. The practice is long-established, and some of the largest groups include Mitsubishi, Mitsui and Sumitomo. This structure has the benefits of shared information, improving efficiency, lower procurement costs, shared best practices, stability in management and often cross-shareholdings. However, it can also lead to inertia, monopolistic approaches, reduced threat of takeover and, in some cases, excess borrowing. In a 2019 interview, Ken Hokugo, Head of Corporate Governance and the director of Hedge Fund Investments at Japan's Pension Fund Association, noted that around 50% of Japanese companies publicly admitted to having “friendly” shareholders in such a structure. We believe such structures are facing increasing scrutiny and slowly are being dis-entangled.

With further governance reforms under way, such as the Tokyo Stock Exchange's market structure reform and the revision of the TOPIX index, we expect the environment around Japanese companies to become ever-more supportive of better shareholder relations.

5) Japan: balance sheet strength/corporate cash piles/higher dividends

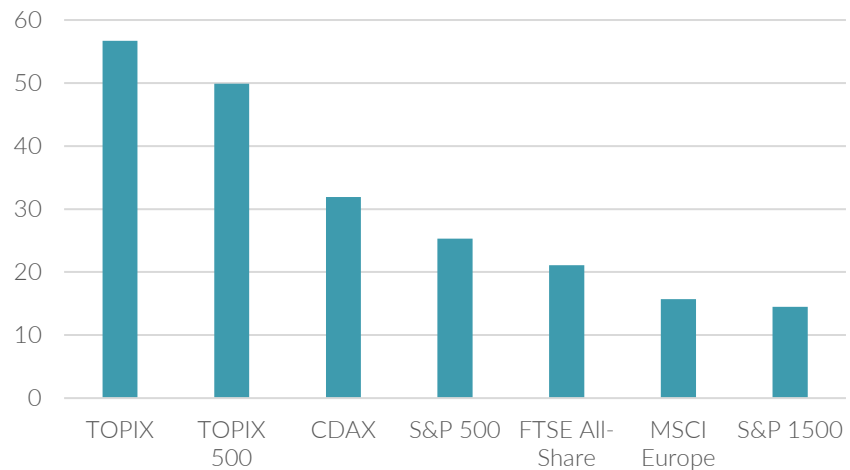
Japanese companies have above-average cash holdings. If recent trends continue, this will see greater returns to investors, increased M&A activity, including restructuring listed subsidiaries, and investment in latest technology.

Japanese companies have been arguably over-cautious in managing their balance sheets, and especially the cash they have retained. The chart below highlights how more than half of Japanese listed entities have net cash, compared with a sixth to a quarter in the US/Europe. This means that they are well positioned to i) give greater-than-average returns to shareholders (see section on dividend payments, noting that the Janus Henderson Global Dividend Index shows that Japanese payouts have grown faster than all other regions except North America since 2009, up 124%), ii) engage in mergers and acquisitions, including restructuring listed subsidiaries, and iii) invest in the latest technology. As noted above, government policy is designed to encourage such activity from a position where, on average, Japanese companies had been under-utilising the latest technology in the past. Over time, we expect a continuation of the recent trends, which have seen all three of the above points being adopted.

¹⁹ <https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/02.pdf>

²⁰ <https://www.fsa.go.jp/en/news/2021/20210406.html>

Percentage of listed companies with net cash by number of companies



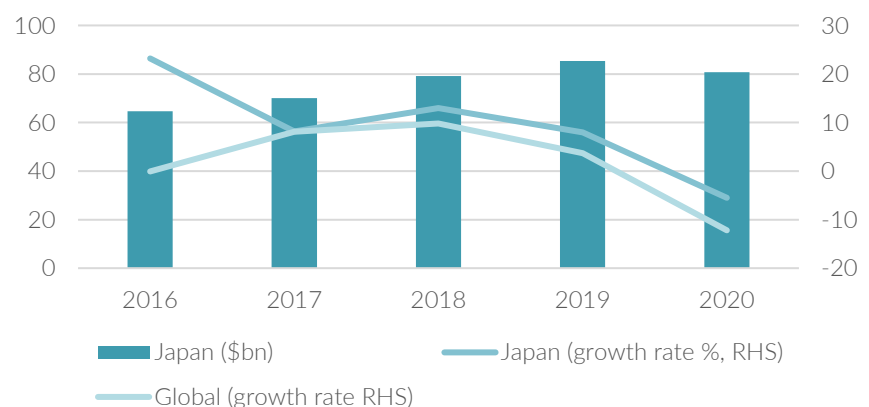
Source: Coupland Cardiff, 25 February 2021 article, Hardman & Co Research

Higher dividends

Japanese payouts have grown faster than all other regions, except North America, up 54% over five years.²¹ FJV's investment income nearly doubled 2015-20.

As the chart below shows, Japanese company dividend growth has exceeded global dividend growth in four of the past five years (from 2016), and matched it in the fifth. Over the period, Japanese dividends have grown 54%, compared with 8% globally (note index below in \$). FJV's investment income has nearly doubled, from £1.7m in 2015 to £3.3m in 2020.

Japan dividend payments (\$bn), growth and global dividend growth (%)



Source: Janus Henderson Global Dividend Index, p23, Hardman & Co Research

Japanese dividends proved more sustainable in 2020

The Janus Henderson Global Dividend Index showed underlying global dividends fell 10.5% (i.e. excluding special dividends and adjusting for currency) in 2020. The UK was one of the worst-hit markets, with an underlying 32.8% fall and a further 9.1% reduction in special dividends. In contrast, Japanese dividends fell just 2.1%, with just one company in 30 cancelling payouts between April and December.

²¹ <https://cdn.janushenderson.com/webdocs/Janus+Henderson+Global+Dividend+Index.pdf>

2020 annual growth rate in dividends (%) – underlying and headline (\$ terms)

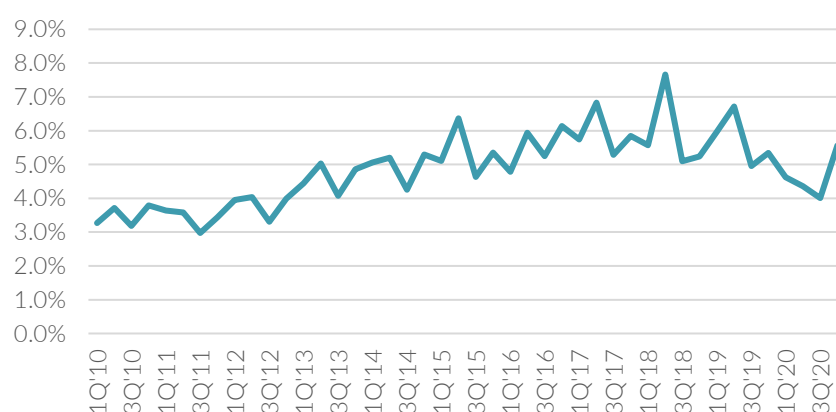
	U/L	Special	Ccy.	Index chg.	Timing	Headline
Japan	-2.1	-0.2	1.8	-5.1	0	-5.6
Europe (ex-UK)	-29.4	-3.1	0.6	-0.7	0	-31.7
N. America	0.1	2.4	-0.1	0.2	0	2.6
Asia Pacific (ex-Japan)	-11.9	-4.8	0.3	-1.9	0	-18.3
UK	-32.8	-9.1	0.3	0.6	0.0	-40.9
Global	-10.5	-1.4	0	-0.3	0	-12.2

Source: Janus Henderson Global Dividend Index, Hardman & Co Research

6) Japan: improving returns

Operating returns are on a long-term rising trend, but still some way to go before they reach international levels

Japan's Ministry of Finance data show that operating profit as a percentage of sales in 2019 was 64% higher than in 2010 and, despite the effects of the pandemic, 2020 was still a third above the level of 10 years before. We also note the Schroders review, which highlighted the number of companies earning sub-5% ROE (ca.650 in 2013 to just over 500 in 2019) and those earning in excess of 15% (ca.180 in 2013 and over 350 in 2019). Directionally, again, this has been a major stride forward. However, we believe Japanese ROEs remain below-average for developed markets, and the reforms above are designed to close this gap.

Quarterly ordinary profits as % sales (all industries except Finance and Insurance)


Source: Ministry of Finance Japan, Hardman & Co Research

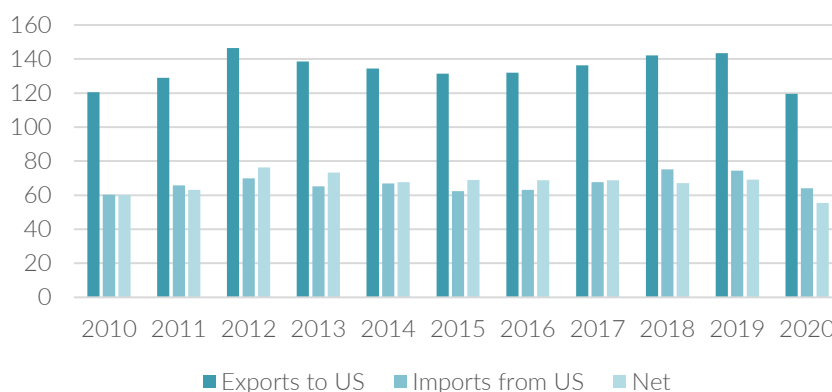
7) Japan: near-term outlook

Benefits from US stimulus-driven growth

As a major trading partner, Japan is likely to benefit from US stimulus-driven growth

The chart below shows the trade in goods between the US and Japan. It is noticeable that exports fell sharply, with slower US growth in 2019 (down \$24bn). Looking forward, as the US economy responds to the latest stimulus package, Japanese exports may be expected to rise to their more recent levels.

Japanese trade with the US (\$bn)



Source: US Census Bureau, Hardman & Co Research

China is biggest trading partner and, again, Japan should benefit from its above-average growth

Operational gearing likely in early stages of a global recovery

Exposure to global trade wars/tension complex, but we believe should not be material issue

Exposure to other global trade

In December 2020, Japan's exports totalled ¥6.71tr, with a positive trade balance of ¥750bn. Of these exports, China accounted for ¥1.6tr and the US ¥1.2tr – in combination, more than 40% of the total.²² The former's GDP is forecast by the IMF to grow by 8.4% in 2021 and the latter by 6.4%.²³ The weight of Japanese exports thus appears to be in above-average growth economies. The trade agreements noted above should help growth in other countries.

The manager highlights that "In the initial stages of a recovery, company managements are reluctant to add cost, which can lead to profit surprises and an earnings-driven market. Additionally, trade tensions have depressed companies' capital expenditure now for over two years and there may be some recovery if they ease."²⁴ We concur with this view.

Japan's exposure to trade wars, between say China and the US, is complex. There are a number of issues, which include i) Japanese multinationals who have manufacturing sites in China that export to the US could be affected, ii) with global supply chains, where any of the links are weakened, this can create pressure through the whole manufacturing chain, iii) importers and exporters unable to source from China/the US may look to Japan, iv) freight rates could fall if there is less global trade, thus reducing costs of exporting to the US, v) Japan's careful and, to date, successful balancing act of being on good terms with both its biggest trading partners could come under pressure, and vi) how trade tensions will evolve under a new US administration is still unclear. On balance, we tend to view a trade war between Japan's two biggest trading partners as being adverse but unlikely to be material on the Japanese market as a whole. We note that some estimates predict that half of Japanese companies will be adversely affected, of which 6% seriously.²⁵ Others, meanwhile, believe that Japanese companies can take advantage of the disruption that a trade war may create.²⁶ Our conclusion is that there are risks, but, overall, this should not be a material issue.

²² <https://oec.world/en/profile/country/jpn>

²³ IMF World Economic Outlook April 2021

²⁴ <https://investment-trusts.fidelity.co.uk/news-and-insights/japan-trust/why-japan-well-placed-perform-global-recovery/>

²⁵ <https://www.reuters.com/article/us-japan-companies-trade-idUSKCN1VX2Y2>

²⁶ <https://www.cnbc.com/2019/08/14/ceo-some-investors-think-japan-can-capitalize-off-us-china-trade-war.html>

Olympics may be boost to growth, but now likely to be relatively modest

Olympics

In theory, the Olympics (23 July to 8 August 2021) may be a positive for Japan's growth, with, *inter alia*, investment in infrastructure, rising tourism/hospitality and a chance to showcase the latest technology. The effects of pandemic-related restrictions, however, are likely to reduce the benefits, especially from tourism and hospitality, and much of the infrastructure has now been built. While a positive, we would not characterise the Olympics as a game-changer in terms of the Japanese market outlook.

Human impact of COVID-19 been relatively modest, but Japan still saw 5% decline in GDP

COVID-19 impact and support packages

In terms of deaths per million of population, Japan (at 119) is the 133rd worst-affected country. By number of total cases per million (6,510), it is ranked 142nd.²⁷ Having an elderly population, these statistics were especially impressive. However, the impact on the economy was greater. The IMF April 2021 *World Economic Outlook* reported a 4.8% GDP decline in 2020, in line with advanced economies overall (Euro Area: 6.6%, advanced Asia: 3.1%, US: 3.5%). Encouragingly, between its October 2020 and April 2021 review, Japan had seen a ca.1% upgrade to forecast 2021 growth. Japan's global trading position meant it also suffered from lower demand elsewhere, especially from the US, where exports in 2020 were down \$24bn on 2019.

Material support programmes put in place

The government has provided significant support (detailed below), third only behind Germany and Italy, and Japan had a much higher proportion of direct, additional spending/foregone revenue, rather than equity, loans and guarantees. These were introduced by a series of measures throughout the COVID-19 pandemic in 2020, including:

- ▶ 13 February: an emergency response package, including loan support for SMEs.
- ▶ 10 March: additional loan company and employment support measures.
- ▶ 7 April: the third emerging economic package to stimulate the economy. The total scale of the package is ¥117tr (\$1.1tr), equivalent to 22% of the country's GDP. About three quarters of the budget was allocated to employment and business support, and the rest was allocated to the healthcare system, consumption promotion campaigns and public investment, etc.
- ▶ 27 May: an additional economic stimulus package worth ¥117tr. Key measures include the establishment of rent-free support benefits for SMEs and providing subordinated loans for large companies, etc.
- ▶ December: a new package worth ¥76tr.

In March 2021, the central bank dropped one policy element, saying that it had removed its ¥6tr annual target of purchasing exchange-traded funds (leaving an overall cap of ¥12tr in place). It had become the largest single shareholder on the Tokyo bourse. It said it would still purchase as necessary, and we note that Japanese markets in mid-May were within 1% of the level before the change in policy was announced. We note that this policy has been in place for several years, and was not pandemic-related.

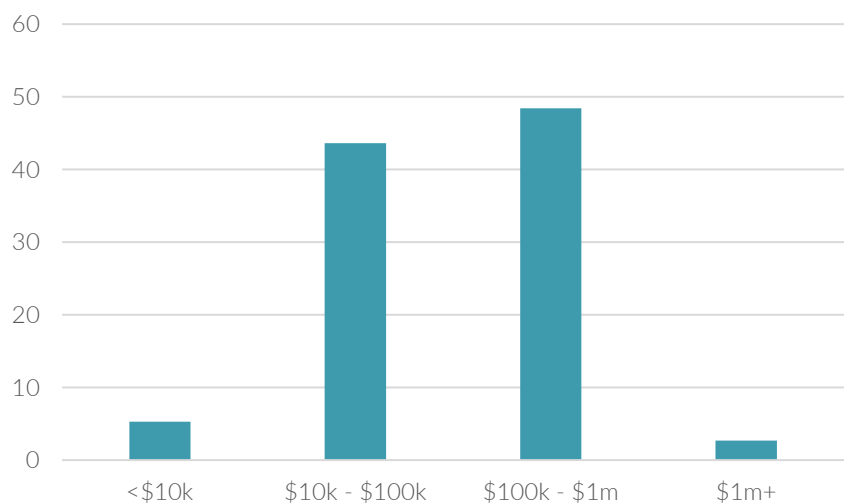
²⁷ <https://www.worldometers.info/coronavirus/>

Japan ranks highly for affluent and wealthy population with high discretionary spending power

8) Japan: affluent population

On OECD statistics, Japan ranks 14th out of 40 countries, with a household-adjusted disposable income of \$29,798, and 12th in terms of net wealth (\$305,878).²⁸ While one risk we explore in detail below is the Japanese ageing population, one positive side effect is that it is a wealthy population with significant discretionary spending power. Relative to some other developed markets, the distribution of wealth is also more even, again seeing proportionately more income in the middle classes.

Population distribution in Japan in 2018 by wealth range (%)



Source: *Statista*, Hardman & Co Research

Also, the household savings ratio has doubled to ca.10% of disposable income, due to depressed consumption and cash payments from the government. Combined with a still tight labour market (the employment rate remains close to the highest level since the 1990s) suggests that there is significant pent-up demand/consumption. Additionally, we believe wealth has an age bias (as in other countries), and so is likely to be more concentrated among the older population, who will be vaccinated first.

9) Japan: attracting new investors like Berkshire Hathaway

Berkshire Hathaway been investing heavily in Japan

The Investment Trust Insider ran an article called *Surprised fund managers welcome Buffett to Japan* on 9 September 2020, highlighting that Berkshire Hathaway had built 5% stakes in Japan's five biggest trading companies (Itochu, Mitsubishi, Mitsui, Sumitomo and Marubeni) over the previous 12 months. At an investment cost of \$1.9bn, Itochu is in the top 10 of Berkshire Hathaway's initial investments still outstanding at end-2020. We note that the overall trend in recent years has been for total foreign ownership to reduce and for international investors to now be underweight Japan.

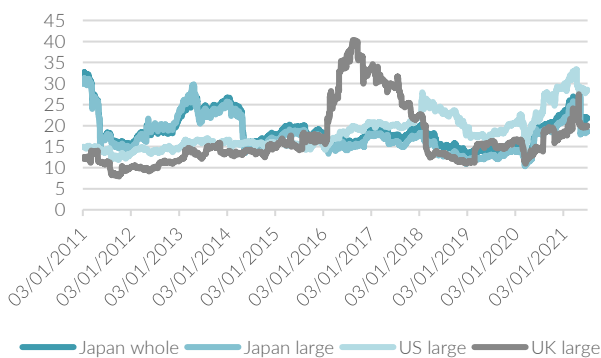
²⁸ <https://www.oecdbetterlifeindex.org/topics/income>

10) Japan: attractive market valuation

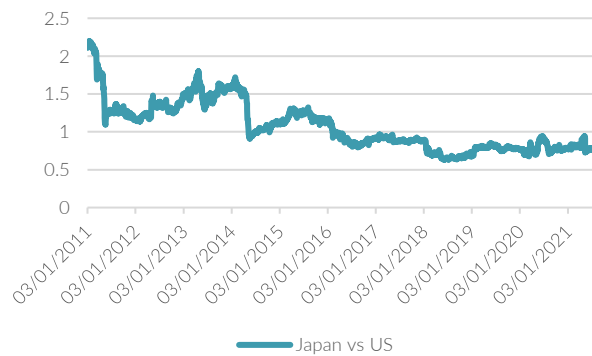
Japanese market P/E ca. three quarters of US/

The charts below illustrate that the Japanese markets traded at a P/E premium to the US/UK for most of the period between 2011 and 2016. Since then, they have traded at a P/E discount (currently ca.21x against the Dow's 28x). The right-hand chart shows that this discount was at its widest in 2018 and has since started to show a slow recovery.

Japanese, US and UK market PE since Jan'11



Japanese P/E as multiple of US P/E since Jan'11



Source: Refinitiv, Hardman & Co Research

11) FJV: investment process

Fidelity has large team of 20 in Japan, and more than 3,800 potential investments.

Japan has ca.1.5x the number of companies covered by fewer than five analysts as the US

In Japan, Fidelity has seven portfolio managers (average industry experience 22 years), 11 research analysts (average industry experience 10 years) and two dedicated sustainable investing members (average industry experience 28 years).²⁹ This team can potentially pick from 3,800 listed companies in Japan, although some do not have sufficient liquidity. Ideas are generated from on-the-ground analyst input, complemented by Fidelity International's global, as well as independent, external research and joining the dots via multiple information sources. Fidelity advises that nearly 2,000 companies on the Japanese market have fewer than five sell-side analysts (by comparison, Europe has ca.1,200, the UK ca.400 and the US 1,400), with an average of just two for small- and mid-cap names. Approximately 1,150 Japanese small- to mid-cap names have no coverage at all. The manager typically conducts ca.350 company meetings each year (rising to more than 400, with pandemic remote-working practices improving efficiency), and the final number of investments is typically between 80 and 100.

FJV's focus is GARP companies, favouring energy efficiency, medical technology, Asian consumption and digital transformation

The manager states that he is "generally looking out over three to five years for companies with a long runway of growth and competitive advantages in a growing addressable market. Key areas which share those characteristics would be energy efficiency solutions, medical technology, Asian consumption and digital transformation providers." Some of the characteristics he is looking for include i) sustainable growth companies that can increase earnings as the global economy stabilises, ii) high-quality services and technology-related companies geared to structural growth trends, such as medtech, automation and 5G, and iii) under-researched companies with new and interesting business models, and unlisted opportunities where Fidelity can make a difference through detailed analysis. The approach looks for quality management teams, above-average earnings growth and ROE (in this market typically 10%+) in order to buy GARP companies, not distressed, cheap companies, or pure growth or momentum plays.

²⁹ Source: Fidelity International as of 31 March 2021

Fidelity Japan Trust plc

FJV companies show faster-than-average revenue and EBITDA growth, higher ROE and ROIC, and higher P/E and P/BV ratings

One consequence of FJV's investment style is that its investee companies show:

- ▶ faster revenue growth (ca.2x Japanese market average in 2021/22 according to Fidelity forecasts, vs. consensus);
- ▶ faster operating profit growth (ca.3x 2021 and 2x in 2022 on the same basis);
- ▶ higher ROE and ROIC (about a third higher in 2021 and 2022); and
- ▶ higher valuations (2022 ca.50% higher underlying P/E and nearly 2x PBV).

Identifies where market mis-judged growth outlook

The bottom-up approach has consistently identified companies where i) the market is mis-pricing future growth, ii) there is a clear disconnect between near-term sentiment and mid- to long-term fundamentals, and iii) where internal change is conducive to a rerating. The focus is on GARP.

Origination of new ideas flows from analytical model and Fidelity's scale

With a relatively high turnover (see below), how new ideas are originated is important. In addition to some overall market filters, the manager generates ideas because of the depth of the research conducted. Each of the 350-400 company meetings p.a., in addition to generating information on that company, can also identify suppliers, customers and competitors that may be of interest. Analysts closely consider the market position of each potential investment, which again generates new ideas. As a large, global investment house, Fidelity is approached by external parties in a way that smaller investors would not be.

Overall portfolio risk then managed through position size

The overall portfolio construction then reflects i) position size, driven by conviction in growth prospects, liquidity, valuations and upside, and ii) stock and portfolio-level risk continually monitored, with all holdings frequently reassessed. As noted above, turnover is relatively high as a result of the manager's sell discipline.

12) FJV: flexible mandate

FJV has broad mandate, with flexibility to take best opportunities available

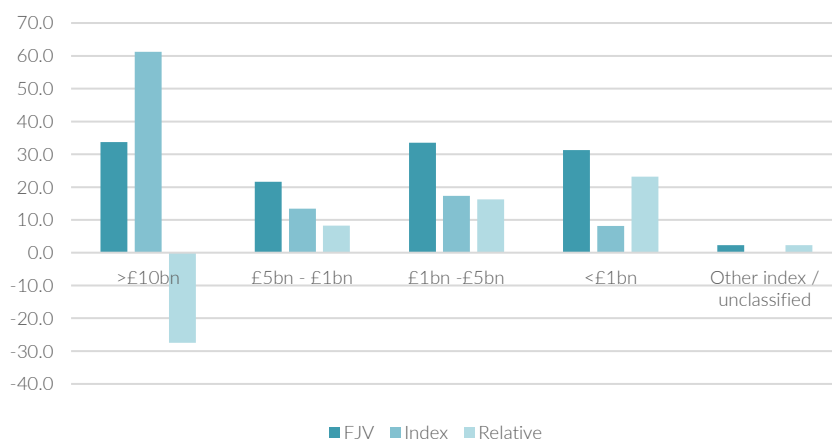
One of the features of FJV is its flexible mandate, which means that it can optimise investments by any measure, including market capitalisation, stock or equity, as well as the stock-picking process identified above.

Invests in all caps but bias is on middle- and smaller-growth companies

Research-driven approach more likely to find unappreciated growth in middle- and smaller-sized companies than well-covered major ones

The chart below highlights how the mandate is used to invest across the market capitalisations spectrum. The chart shows FJV's weighting by market capitalisation. As can be seen, it is significantly underweight large-cap and overweight smaller businesses, especially in the sub-£1bn market capitalisation area, where it is 4x the index weighting. As we detailed above, this is an area where there is less research and where there are more opportunities for price anomalies. In our view, there is also a greater chance of takeover activity, illiquidity discounts and transformational growth, all of which provide potential upside.

Split of FJV's portfolio by market capitalisation (%)



Source: FJV May Factsheet, Hardman & Co Research

Ambition to increase investments in private companies close to IPO

Modest holdings in unlisted business, with intent to grow this area. 3.6% added to NAV when one investment IPO-ed in March 2021.

FJV uses long contracts for difference (non-complex derivatives) to increase stock-specific exposure in efficient way

Market value shown in balance sheet, the "real" exposure in the notes to accounts. Net derivatives represented -9% to +21% of FV of investments FY'16-FY'20.

Invests in unlisted companies

At end-2020, FJV had 1.7% of the portfolio in unlisted investments, and the investment policy allows this to be up to 10%. We understand that the team is actively seeking new opportunities in this arena, noting that the mandate aims for companies that are close to IPO, rather than earlier-stage, unlisted investments. FJV's role with these companies is to be a supportive financial investor; it is not aiming to adopt a more active, PE-style approach.

On 19 March 2021, one holding, the online consumer-to-consumer platform, Coconala, listed on the Tokyo Stock Exchange, and its valuation in the portfolio increased by 351%, from £3m to £14m, increasing the NAV by 3.6%. At the AGM, FJV commented that its success in this area had led to it being approached by more unlisted companies in its target market.

Active user of derivatives

For several years, the derivatives used by FJV have been contracts for difference (the value of which changes with the difference between the current market price and the agreed price in the contract). They are used to increase stock-specific exposure without incurring the cash drag of buying the share themselves. As can be seen in the table on the top five positions three pages below, such contracts are typically used for larger companies where the derivative pricing is more favourable. The exposures created by such derivatives are included at their nominal value and managed in the same way as a share position would be for risk-control purposes. FJV does not have more complex derivatives such as options – so we have no concerns about valuation or the derivative moving in a non-linear fashion with the underlying investment.

In terms of disclosure, on day one, assuming no price movement, the contract for difference has no accounting value no matter how large an exposure has been created. As the price moves, and so the market value of the derivative evolves, this change is reflected as either an asset or liability on the balance sheet, with the corresponding gain/loss shown in the income statement. The real portfolio exposure through derivatives is given in note 10 to the accounts. As can be seen, on the asset side, this has ranged from 4% of investments to 24% and, on the liability side, from 2% to 12%, even though the balance sheet exposure has remained small. The net derivative portfolio exposure, as a percentage of the FV of investments has ranged from -9% to +21%.

Derivative assets and liabilities, and total investments in balance sheet, end-December 2016-20 (£000)

	2016	2017	2018	2019	2020
Derivative assets	4,619	1,123	269	3,048	1,932
Portfolio asset exposure via derivatives	37,358	31,628	6,789	39,975	71,273
Derivative asset exposure as % investments	23%	14%	4%	16%	24%
Derivative liabilities	-424	-456	-6,529	-1,075	-91
Portfolio liability exposure via derivatives	7,765	10,697	23,226	6,286	7,013
Derivative liability exposure as % investments	5%	5%	12%	3%	2%
Net derivative exposure as % investments	18%	9%	-9%	14%	21%

Source: FJV Report and Accounts, Hardman & Co Research

Other factors to consider are:

Only modest impact on liquidity risk

- ▶ With contracts for differences, there may be margin calls, which vary with the value of the derivative. Such calls have the potential to be a material drag on liquidity if there are large, adverse market movements. In FJV's case, over the past six years, the cash at settlement houses and brokers has been material at one year-end only once, and then it represented only 4.1% of investments.

Can create credit risk, but FJV deals only with best-quality counterparties

- ▶ Contracts for difference are bilateral ones negotiated with large investment banks, rather than exchange-traded futures. We highlight this issue as, in theory, it introduces a credit risk should those investment banks not be able to fulfil the contracts, but FJV deals only with global investment banks.

Primarily, level 2 accounted (i.e. valued by reference to observable inputs not quoted prices) as largely bi-lateral agreements with global investment banks

- ▶ All of FJV's derivatives are level 2 fair-value-hierarchy accounted. This is quite a technical issue, but it means that they are valued by reference to observable inputs, rather than quoted prices (which would be level 1-accounted or level 3-accounted, and these are valued by using inputs that are not based on observable market data). This is the usual treatment for such instruments.

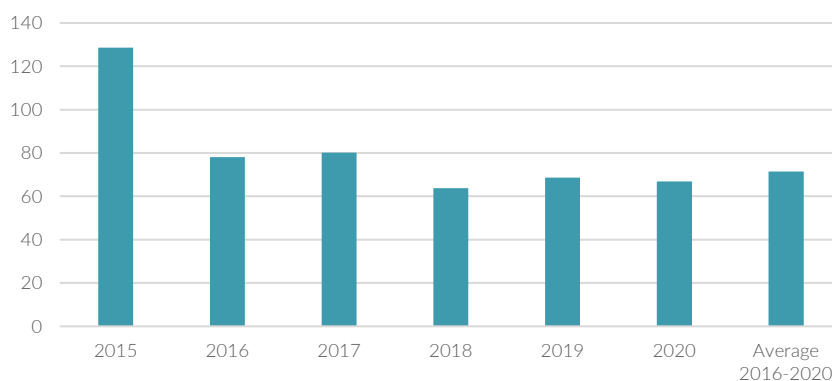
13) FJV: active manager

Turnover of portfolio

Average turnover very high (2016-20 over 70%), as manager "selling what has gone up and recycling into new ideas". Strict discipline to sell when investments reach target prices, rather than running them for momentum.

The table below shows how quickly positions can change, depending on the stage of the cycle and the availability of investment ideas, with, for example, electrical appliances doubling as a proportion of the portfolio in 2019, services halving and machinery and chemicals being reduced by two thirds. The chart below shows turnover calculated by taking the average of the total amount of securities purchased and the total amount of the securities sold in the reporting year divided by the average fair value of the investment portfolio of the company. For the period 2016-20 (the manager took over in September 2015, and so a greater churn may be expected that year), the average turnover was 71.5%, with the manager "selling what has gone up and recycling into new ideas." The manager emphasises that the turnover reflects a strict selling discipline, so that, when investments approach their target price, they are trimmed or sold, rather than running such positions for their momentum. In a rising market, more companies are likely to reach their target price more quickly, which is another factor in the turnover seen in recent years.

Turnover of portfolio, 2015-20 (%)



Source: FJV Report and Accounts, Hardman & Co Research

Active portfolio management means
investors should not buy FJV for its sector
positioning at any given time

Sector trends, 2015-20

The table below shows how the portfolio has evolved by sector. The manager's bottom-up stock selection leads to sector exposures that are very different from the index. At the end of 2020, the most notable were 16% overweight in electrical appliances, 15% in information and communication, 8% in services, and a zero weight in banks and insurance (6% index). The weightings below include FJV gearing effects – so its total sector weight is 123.5% at the end of 2020.

Portfolio summary (as at end-December)

Sector (%)	2015 FJV	2016 FJV	2017 FJV	2018 FJV	2019 FJV	2020 FJV	2020 Bnchmk.
Electric Appliances	12.6	15.2	13.0	16.2	35.2	33.1	17.3
Information & Communication	4.5	7.0	10.9	10.7	12.5	24.6	9.2
Services	15.9	10.5	15.6	19.6	9.5	13.3	5.8
Retail Trade	8.6	9.3	9.1	9.3	6.3	6.7	4.8
Wholesale Trade	1.9	1.4	7.7	4.9	5.5	6.7	4.6
Machinery	17.5	11.9	13.4	13.9	5.1	5.0	5.8
Precision Instruments	1.2	0.6	3.8	3.4	10.3	4.9	2.8
Other Financing Business	10.3	2.6	4.2	2.2	2.1	4.3	1.1
Chemicals	10.3	6.8	4.1	11.9	3.4	4.2	7.6
Other Products	5.1	10.4	8.6	6.7	6.6	3.9	2.8
Transportation Equipment	4.2	12.6	0.0	6.1	7.5	3.8	7.4
Real Estate	3.5	3.9	3.8	1.6	0.1	2.5	1.9
Foods	1.1	3.4	2.6	1.8	2.7	2.0	3.5
Unlisted	0.0	0.0	0.0	0.0	1.5	1.8	0.0
Construction	0.3	0.3	0.4	0.6	0.8	1.8	2.3
Metal Products	3.5	4.7	2.3	0.6	0.4	1.5	0.6
Land Transportation	0.0	0.0	0.5	0.1	0.0	0.9	3.5
Pharmaceuticals	10.1	9.2	6.6	2.2	2.8	0.2	5.9
Rubber Products	3.6	4.1	4.2	2.7	1.7	0.4	0.5
Banks	0.0	5.3	0.8	0.0	0.0	0.0	4.4
Insurance	0.0	1.1	3.1	0.0	0.0	0.0	1.9
Iron & Steel	0.0	0.1	0.0	0.0	1.5	0.0	0.6
Others	2.4	3.9	4.0	0.7	1.5	1.9	5.7
Total	116.6	124.3	118.7	115.2	117.0	123.5	100

Source: FJV Report and Accounts, Hardman & Co Research

FJV incurred just £52k of purchase costs on £134m of purchases, so investors not incurring churn costs

Largest holdings a mix of long-held positions and more actively traded positions

Through the judicious use of low-cost derivatives, the cost of this turnover is modest. In 2019, for purchases of £134m, FJV incurred transaction costs of £52k.

Changes in top five positions

The table below shows the evolution of the top five holdings in each year 2016-20. Changes can be dramatic, with, for example, the top two holdings in 2019 being new that year, and three of the top five holdings changing by more than 3% of NAV in just one year. Four of the top five holdings in 2017 were down to zero by end-2019.

History of top five holdings over past five years (as % NAV)					
December	2016	2017	2018	2019	2020
MISUMI Group	0.0	3.3	3.7	4.1	5.5
Murata Manufacturing*	0.0	1.5	0.1	8.1	5.3
Koito Manufacturing*	0.0	0.0	0.7	0.0	5.2
Z Holdings	0.0	0.0	0.0	1.6	4.9
Recruits Holdings*	0.0	1.5	5.8	0.2	3.8
Olympus*	0.0	0.0	0.0	7.1	2.9
JustSystems	0.0	1.4	2.5	5.5	3.8
Keyence*	2.1	3.1	4.7	4.7	3.6
Yamaha	1.7	4.3	5.7	4.5	2.9
Kose	0.0	0.0	6.8	0.0	0.0
Makita	2.0	4.8	5.5	0.0	0.2
M3*	3.3	6.0	3.1	0.0	0.0
Daikin	2.3	4.9	3.8	3.6	1.8
Sysmex Corporation	2.2	4.8	3.4	0.0	0.0
Yamaha Motor*	6.8	2.2	0.0	0.0	0.3
Nippon Shinyaku*	5.4	3.0	0.0	0.0	0.2
Mitsubishi UFJ Financial*	5.3	0.8	0.0	0.0	0.0
Nissan Chemical Industries	5.1	0.0	0.0	0.0	0.0
SoftBank*	4.7	1.7	0.7	0.0	0.0

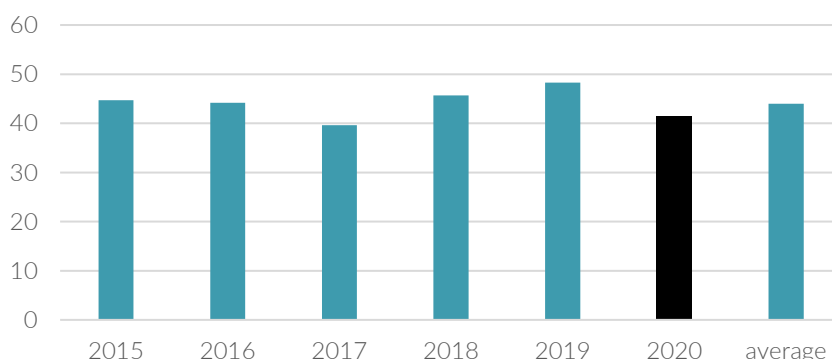
*includes CFDs, as well as shares. Source: FJV Report and Accounts, Hardman & Co Research

The top five holdings at end-May 2021 were NOF (chemicals 7.5%, index 0.1%), Keyence (electrical appliances 6.6%, index 2.0%), MISUMI Group (wholesale trade 5.9%, index 0.2%), Recruit Holdings (services 5.0%, index 1.4%) and Ryohin Keikaku (retail 3.4%, index 0.1%).

Portfolio concentration in top 10 holdings

The chart below shows the top 10 positions as a percentage of the NAV at the year-ends from 2015 to 2020. On average, this has been 44%, although, in recent years, it has been above this level. The manager is running a portfolio with a relatively high concentration in the top holdings, where, as noted in the section above, the major holdings are refreshed regularly.

Top 10 average 44% of NAV (generally in 40%-50% range)

Top 10 positions, 2015-20 (% of NAV)


Source: FJV Report and Accounts, Hardman & Co Research

Closed-ended structures outperform open-ended, as they have less cash drag, can invest long term, offer more favourable trading options, have a board of directors to supervise, and allow gearing

14) FJV: closed-ended structure

There are many open-ended investment vehicles available to those wanting to invest in Japan/Japanese smaller companies. However, we see structural advantages in FJV's closed-ended vehicle structure, including:

- ▶ Greater ability to exploit illiquidity premium in investments. We note that FJV has two unlisted investments (ca.2% of portfolio but limit is 10%) and a further 31% in companies with a market capitalisation of under £1bn.³⁰
- ▶ The manager can make longer-term decisions, without having to worry about needing to sell assets to meet investor redemptions.
- ▶ The shares are listed on a stock exchange – this offers investors the ability to buy and sell shares at any time in normal trading hours, as well as the comfort from the governance associated with a listing.
- ▶ Less cash drag, as there is no need to hold liquidity against potential redemptions.
- ▶ Boards of directors – the independent directors provide an additional layer of oversight, protecting investors' interests with due diligence trips to Japan, typically every 12-18 months.
- ▶ Gearing – the ability of investment companies to borrow money to invest means that they may perform better over the long term (see section below); at end-2020, the gearing level was 23% (cap 25%).

We estimate top-quartile vs. open-ended funds over five years

The AIC has indicated that, across all closed-ended vehicles, it believes the incremental return is over 1% p.a. Looking at FJV over the past five years, we estimate that it is one of the top of the actively managed Japan/Japan small company funds available to retail investors on [Fidelity's fund platform](#).

³⁰ March 2021 Factsheet

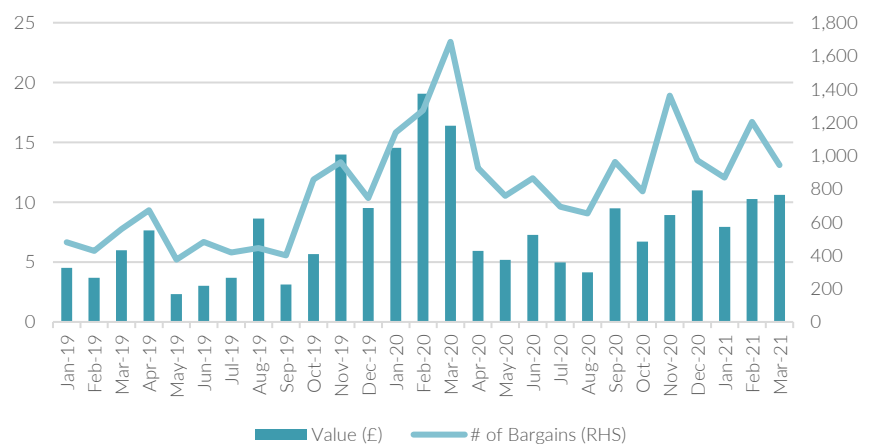
Five-year total return of FJV's NAV vs. open-ended peers (%)


Peers include Jupiter Japan Income, LF Morant Wright Japan B, LF Morant Wright Nippon, Invesco Japan, FSSA Japan Focus hedged, Axa Framlington Japan, Janus Henderson Inst Japan Index Opps. Source: Refinitiv, Hardman & Co Research

15) FJV: good liquidity in shares

Good liquidity in FJV shares, and register has little concentration

FJV's share trading has been very liquid, even in challenging market conditions. The chart below shows the number of trades and the average monthly trading volume through both 2019 and 2020, and indicates that liquidity was strong through the early stages of the pandemic. In 2019, the value traded was £72m (rising to £113m in the more active 2020) – a quarter of the current market capitalisation of £292m.

Monthly trading by number of shares and average value (RHS £000)


Source: LSE, Hardman & Co Research

Large shareholder mix of long-term holders and new ones. Two large holders sold out since 2016, during which time discount more than halved.

The table below shows the disclosed major shareholders. As can be seen, there is a mix of stable, long-term holders and some who have traded in and out. From 2016 to 2020, the discount reduced from 17% to 7%, and fully absorbed the reduction seen by, say, Wells Capital and 1607 Capital, with new shareholders like City of London Investment Management coming on board.

History of major shareholders, 2016-20 (%)

December	2016	2017	2018	2019	2020
Lazard Asset Management	19.1	23.0	20.0	17.9	18.6
Wells Capital Management	22.7	18.2	15.5	11.6	11.9
City of London Investment Management	n/d	n/d	n/d	6.1	7.7
Hargreaves Lansdown	n/d	n/d	5.3	6.5	7.3
Fidelity Platform Investors	7.6	7.8	7.8	7.1	7.3
Wesleyan Assurance	4.1	3.9	4.0	3.9	4.0
Interactive Investor	n/d	n/d	n/d	3.0	4.0
1607 Capital Partners	n/d	12.8	10.8	9.4	3.6
Canaccord Genuity Wealth Management	n/d	n/d	n/d	2.9	3.5
Charles Stanley	n/d	0	3.5	3.4	2.9

Note: n/d = not disclosed. Source: FJV Report and Accounts, Hardman & Co Research

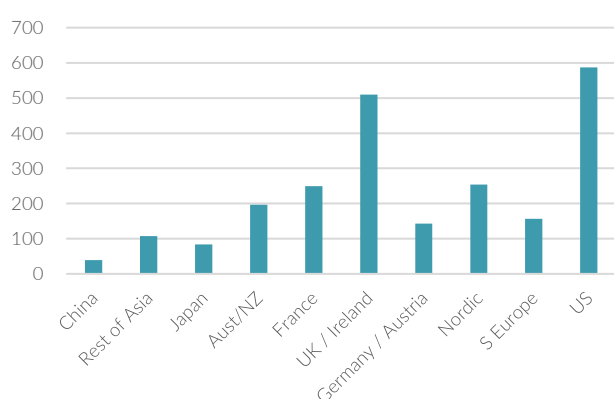
16) FJV: positive (relative) ESG credentials

Japanese market as a whole

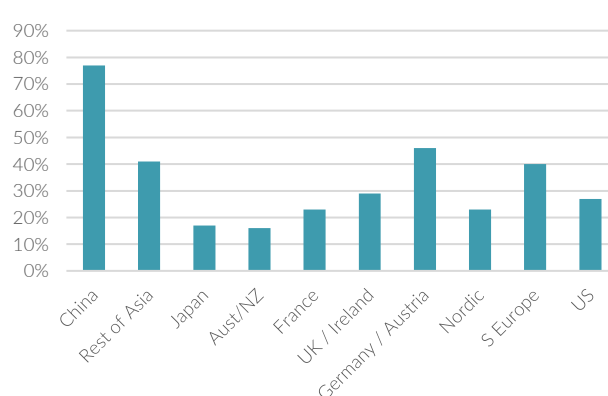
Japan has mixed ESG credentials. From relatively low base, been a number of improvements, and expected to progress steadily.

To measure how Japan adheres to ESG principles, we note the UN reports signatories to its *Principles for Responsible Investment (PRI) by region*. As can be seen in the tables below, there were less than 100 net new signatories in Japan in FY'19-FY'20. This is around a fifth of the level of the UK/Ireland or a sixth of the US's increase. The rate of growth, from the low base, is one of the lowest in the world. From this challenging start, we highlight above a number of corporate governance improvements currently under way in Japan. Fidelity also notes that Japan now has the largest number of TCFD (Task Force on Climate-related Financial Disclosures) supporters and CDP (Carbon Disclosure Project) A-rated companies in the world. Given the other business changes, such as digitalisation, that we discussed earlier, it may be expected that, as Japanese companies use technology, they will be better positioned to adapt to climate change.

Net new signatories to UNPRI, 2019/20



Growth rate in net new signatories (%)



Source: UN, Hardman & Co Research

Fidelity analysis indicates that market-wide Japan appears weak because of disclosure practice (and language), rather than actual performance

On 26 April 2021, the Fidelity International team posted an insight piece, called *The arbitrage opportunity in Japanese sustainability ratings*. Its conclusion was: "From our analysis and engagement with companies, we believe this is not due to any fundamental differences in strategy, but more to do with cultural reasons around disclosure practices and language. As Japanese companies improve disclosure, ESG ratings should catch up and the market should adjust valuations accordingly. For investors, this creates an opportunity to benefit from the correction."

For Fidelity, ESG is simply good business practice

Uses proprietary model, dedicated teams and external consultants, and has been signatory to UNPRI since 2012

81% of portfolio invested in companies rated A, B and C (well above index's 66%)

Own governance issues now addressed

Fidelity-wide approach to ESG

FJV dedicates four pages of its 2020 Report and Accounts to ESG in the Investment Process. Fidelity has been a signatory to the United Nations Principles for Responsible Investment (UNPRI) since 2012, and submits an annual report detailing how it incorporates ESG into its investment analysis. In practice, we understand that Fidelity:

- ▶ Employs a proprietary sustainability rating process (established in 2019), leveraging its internal research and interactions with corporates. Analysts assign an overall A to E rating (C being understood as the sector average) for each rated name on a sector-relative basis.
- ▶ Has a dedicated sustainable investing team.
- ▶ Subscribes to an external ESG research provider and rating agency to supplement its organic analysis. Fidelity receives reports that include company-specific and industry-specific research, as well as *ad hoc* thematic research looking at particular topics.
- ▶ Fidelity International receives external research from specialists in this area. In addition, external parties provide "controversy alerts" on companies within its coverage. This brings to Fidelity International's attention events and news flow that may have an impact on the investment company's business/reputation.

FJV-specific ESG

Based on Fidelity's own ESG proprietary ratings, FJV has 81% of the portfolio invested in companies rated A, B and C (well above the index's 66%). The majority of the remainder are not yet rated, but we understand that this unrated portion has fallen consistently, as Fidelity continues to expand the depth of its ESG research coverage. New names added to the portfolio may take a little time to go through the formal internal rating process, but their ESG credentials form an integral part of the investment thesis. Working closely with the team of research analysts and the dedicated sustainable investing team on the ground in Japan, the manager's approach is about engagement to improve, and it sees this as a valuation re-rating opportunity, as well as a social responsibility. On page 7 of the 2020 Report and Accounts, the manager gave a case study where it had encouraged both increased disclosure/shareholder engagement, but also the release of a detailed ESG data book, which it believes now constitutes best practice. FJV's 9 June 2021 review, [*Brighter outlook for Japanese stocks?*](#) also highlighted opportunities in ESG.

FJV's portfolio distribution by Fidelity ratings (%)			
	FJV	Index	Relative
A	14	16	-2
B	43	35	+8
C	24	15	+9
D	5	6	-1
Not rated	15	30	-16

Source: FJV 2020 Report and Accounts (some rounding differences), Hardman & Co Research. The Fidelity Sustainability Ratings were launched in June 2019. As at 31 March 2021, they covered a universe of ca.4,900 issuers in equity and fixed income.

We note that, historically, the board of FJV was very long-standing (at end-2019, three of the five had been on the board for more than nine years). This has now been addressed, with the stepping down of Sir Laurence Magnus (May 2020), Philip Kay (end-2020) and David Robins (the Chair, May 2021). A continuation vote takes place every three years, with the next one due at the 2022 AGM.

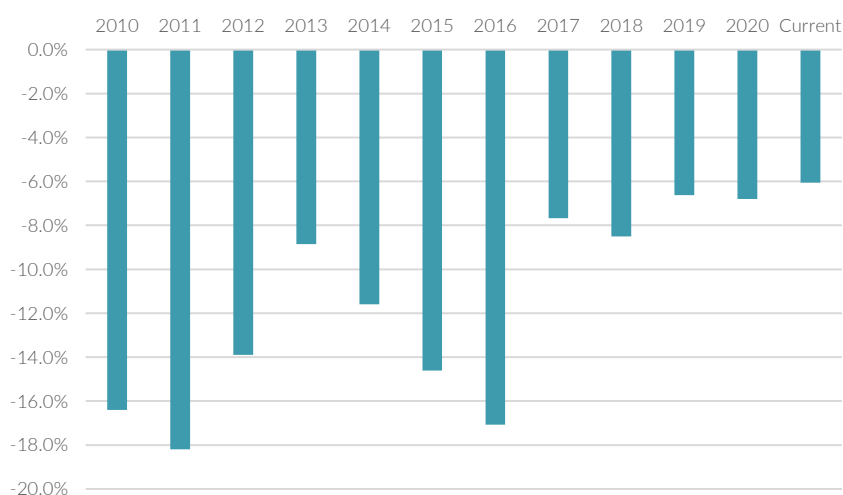
Investment-neutral issues

1) FJV: discount-control mechanisms

Discount can be helped by buybacks, but this can create liquidity issues, worsen expense ratios and send mixed messages re growth prospects. FJV acts selectively to keep discount within single digits.

The board's formal discount-control policy is that it will seek to maintain the discount in single digits in normal market conditions and, under certain circumstances, will repurchase shares. This was done most actively when the discount was at its widest, in 2020 (£4.4m bought back) and in 2019 (£2.9m), but there were also purchases in 2018 (£714k) and 2017 (£412k). In May 2021, 60k shares were bought back; in June 2021, 375k shares were bought back.

Year-end share price discount to NAV (%)



Source: FJV Report and Accounts, Priced 12 July 2021, Hardman & Co Research

Continuation vote every three years

As noted, a continuation vote takes place every three years, with the next one due at the AGM in 2022. Given the market-beating performance and the fact that, at the last vote, on 21 May 2019, 99.88% of shareholders voted in favour of continuation, we would expect it to pass again. We believe there is an element of virtuous circle with this vote. If there is a material discount, which could encourage some shareholders to press for termination, this is likely to see incremental buyers and a natural pull to par, which then reduces the incentive to vote against termination.

2) FJV: gearing

Exposures geared through use of derivatives, not debt

Other than a modest £1.7m in 2018, FJV has not used balance sheet debt to gear its balance sheet but, as noted above, it does increase exposure, and so gears the portfolio through the use of long contracts for difference (CFDs). The chart below shows the history of gearing since 2010. There was a low point of 15% at end-2018, rising to highs of nearly 25%. Under the current manager, it has averaged 20%. The market correction in the first quarter created opportunities to add or increase positions in attractive growth stocks in the communications, technology and healthcare sectors.

Gearing as a percentage of shareholder funds since 2010



Source: FJV Report and Accounts, Hardman & Co Research

Gearing capped at 25% of shareholders but can be, and has been, increased with board approval

The Portfolio Manager has the discretion to be up to 25% geared. However, with the board's approval, gearing at one point in FY'20 was increased to 27.5% in order to take advantage of the attractive opportunities available in the market at that time, before dropping back to 23.5%, within the standard policy.

By introducing gearing, FJV:

Increases returns but also volatility. Over long term, should help enhance returns.

- Increases the long-term return. FJV, historically, gave an attribution analysis and, from 2010 to 2017, on average, gearing added 2.5% p.a. to the NAV. The average gearing level over this period was 20%, the same as under the current manager.
- Introduces further volatility in investments and markets, which are already volatile (see section below). Over 2010-17, the impact of gearing on the annual NAV ranged from -1.9% to +9.6%. The high end of that range was also when the market delivered its strongest growth – so gearing increased the volatility.
- Does not create liquidity issues, given the limited amount and structural use of derivatives.

3) FJV: currency exposure

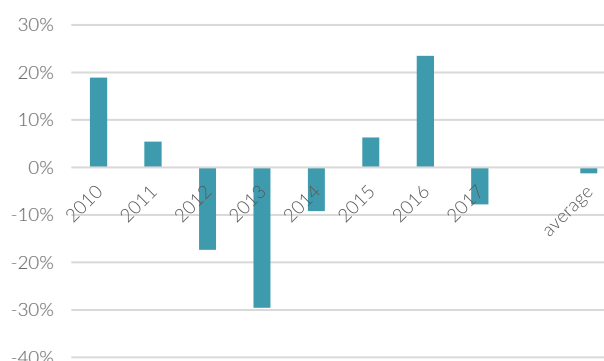
Currency exposure is complex. Can introduce some short-term volatility, but exposure not hedged. Over long term, effects modest, and hedging incurs real costs.

The left-hand chart below shows the yen/sterling exchange rate, which was quite volatile between 2010 and 2016, but has been more stable since. FJV's currency exposure is complex, with its investee companies having a range of currency revenue streams but reporting in yen, combined with FJV being a sterling-listed and sterling-reporting business. Looking at the profit and loss account, the impact of forex has been small, but this rather misses the point, as most of the effect is taken in the valuation of the assets, and not in this line. Until 2017, in its accounts, FJV gave an attribution analysis for the progression of the NAV, which is shown in the right-hand chart below. As can be seen, it has introduced some volatility over periods. For example, in 2016, post Brexit, the NAV total return was 20.5%, but there was an exchange rate gain of 23.5%. What the chart also shows is that, over time, the effect is relatively modest, and we believe investors know they are buying a yen asset. Accordingly, FJV does not hedge this risk, as there is a real cost in hedging.

Sterling to yen exchange rate



Forex impact on NAV progression in year (%)



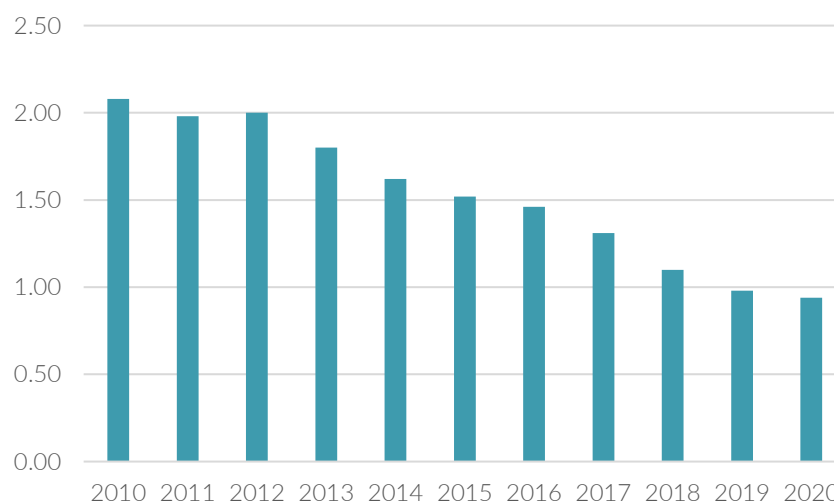
Source: Refinitiv, FJV Report and Accounts (attribution disclosure ceased in 2017), Hardman & Co Research

Ongoing charges fallen sequentially every year since 2012, and now well below half level 10 years ago

4) FJV: fees falling, but in line with peers

The overall trend in ongoing charges is shown below, falling sequentially every year since 2012, and now well below half the level 10 years ago. The largest element is the investment management fee, the base element of which is set at an annual rate of 0.70% of net assets (this was reduced from 0.85% in July 2018).

FJV ongoing charges (%)



Source: FJV Report and Accounts, Hardman & Co Research

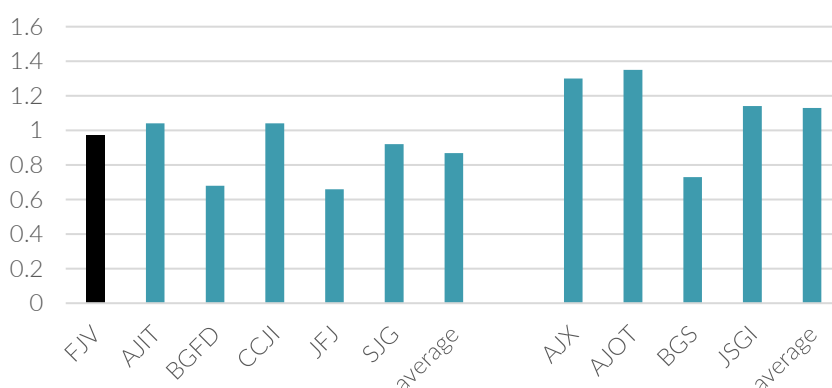
Performance fee based off three-year daily relative performance. Can +/- 20bps and, as three-year record, will not move with short-term absolute performance in any year.

Additionally, there is a +/- up to 0.20% variation fee based on performance relative to the reference index. The variable management fee is accrued daily and paid monthly, with the calculation based off three-year relative returns. The variable fee thus will not reflect performance in any single year, but it does better reflect the time horizon on which investors in the fund focus. In 2020, despite the strong outperformance, this added just 10bps to charges, while, in 2019, there was a credit of 15bps. Investors should not be surprised to see performance fees in years of absolute falls, and vice versa.

FJV in line with peers on AIC basis

Relative to other companies in the AIC subsector, FJV's ongoing charges are slightly above-average for investment companies investing in the whole Japanese market, and below-average for those looking at smaller companies, which, given its business mix, suggests it is very much in line with its peers.

AIC ongoing charges (%) for Japanese funds

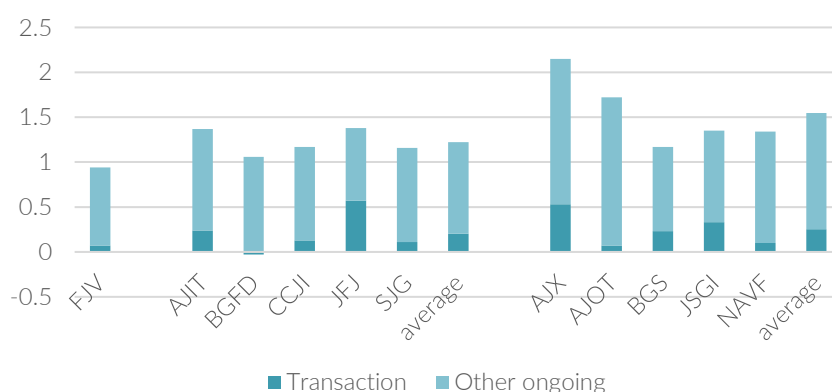


Source: Company websites (no disclosure by the new Nippon Active Value), Hardman & Co Research

Using KID disclosure, FJV has lowest fees across all Japanese investment companies

The disclosure using the KID measure is more favourable for FJV, where it is the lowest-cost investment company among peers. It is around three quarters of the immediate peers and just 60% of the smaller company comparisons. The incremental saving is ca.60bps p.a. compared with the smaller companies, and 26bps against the more general Japanese peers.

KID charges (%) for Japanese investment companies



Source: Companies' KIDs, Hardman & Co Research

KIDs need to be treated with caution, but, against closest peers, FJV's KID appears to indicate slightly wider spread of potential performance

We, like many others, have concerns about some of the methodologies in calculating KID information (for example, likely performance under different scenarios is based off share price performance, which makes it very sensitive to the date of the KID). With that large caveat, our May 2019 report, [Understanding the deepest discounts](#), did find correlations between extreme discounts and the KID stress scenarios. Against its closest peers, FJV has a slightly higher downside stress loss, but a higher positive return in the moderate and favourable scenarios. Against the wider peer group, FJV again has a slightly higher stress scenario and in-line returns in the other

scenarios. Given the vagaries within the calculation, again, we characterise FJV's KID disclosure as indicative of a slightly broader spread than that of its peers.

KID disclosure by FJV and peers					
	Risk factor	1 year stress	Moderate	Favourable	Date of KID
FJV	5	-83.5%	10.8%	43.6%	Oct'20
AJIT	4	-66.0%	10.9%	+34.9%	Mar'21
BGFD	5	-84.9%	14.3%	49.9%	Dec'20
CCJI	5	-86.4%	1.7%	37.4%	Oct'20
JFJ	4	-71.4%	18.1%	49.6%	Apr'21
SJG	5	-54.3%	4.5%	36.6%	Mar'21
Average		-72.60%	9.90%	41.68%	
AJX	5	-72.4%	12.9%	49.3%	Jan'21
AJOT	5	-77.8%	3.6%	36.3%	Dec'20
BGS	5	-87.6%	21.9%	69.1%	Oct'20
JSGI	5	-81.8%	14.3%	50.1%	Mar'21
NAVF	3	-53.9%	-3.6%	15.5%	Aug'20
Average		-74.7%	9.8%	44.1%	

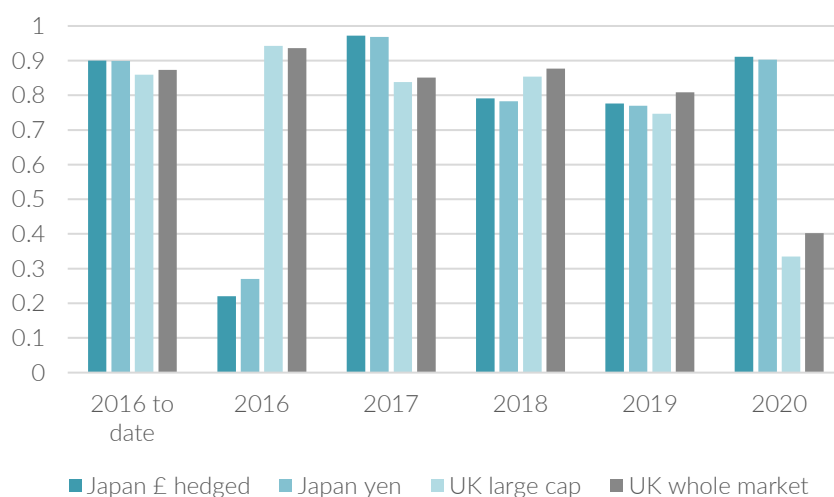
Source: Companies' KIDs, Hardman & Co Research

6) FJV: variable correlation with indices

Given management approach outlined above, not surprising that FJV's share price has variable correlation to indices. Over time, FJV has delivered outperformance.

The chart below shows the correlation between FJV's share price (in sterling) against i) the Japanese market (sterling-hedged), ii) the Japanese market (in yen), and iii) the UK large-cap and UK whole market. The chart shows that, while, generally, there is a correlation, this does vary, especially in periods of instability.

Correlation co-efficient between FJV share price and prices of indices



Source: Refinitiv, Hardman & Co Research

FJV's objective is long-term capital growth, so does not pay dividend

7) FJV: dividend policy

Among the immediate peers in the AIC Japan sector, three pay dividends with a yield in excess of 2%, two pay modest ones (yields sub-1%), and FJV pays no dividend at all. The five listed in the AIC Japanese smaller companies sector have a similar spread, with one also not paying a dividend. We believe investors are buying FJV for its capital growth and that, for a stock such as this, the absence of a dividend is not an issue.

8) Japan: global businesses

Through much of this report, we have highlighted specific conditions, opportunities and risks in the Japanese market. It is important to caveat these comments. First, GDP growth and markets are not always correlated, even over the medium term. Secondly, many Japanese companies are global businesses or have the product set/technology to become global businesses in the future. This is one theme within FJV's investment approach. Global trade is an important driver to many companies that happen to be domiciled in Japan. Within FJV's portfolio companies, we understand that international revenue is approximately 40%-50% of the total.

Investment risks

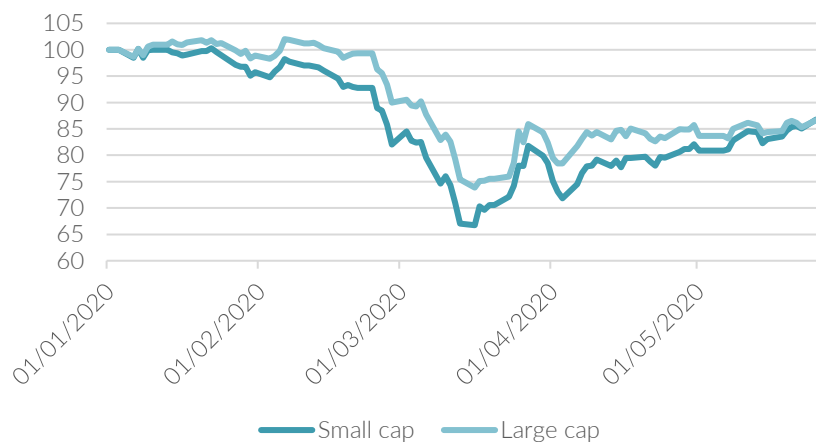
1) FJV: market appetite for investment style

FJV's investment style, at times, has seen short periods of relative underperformance, which have been blips in the long-term record of outperformance. We highlight some of the factors below. Investors trying to time such events in the future may miss out on the rapid recoveries that have been a feature of the past and, as the saying goes, it is the time in the market, not timing the market, that delivers returns.

FJV market cap-agnostic, but likely bias towards small-/mid-cap. Headwind when market buying large-cap.

As noted, FJV is exploiting anomalies in companies where the market is mis-pricing future growth and that are under-researched. Structurally, we are of the view that this will lead to a bias in small-/mid-cap names. The manager is agnostic to market cap, and does invest in large-cap names, but, in our view, there is a greater probability that they will be smaller ones. When the market appetite is for large-cap, not small-cap, names, this may create a headwind. As can be seen in the chart below, through 1Q'20, Japanese small-caps underperformed large-caps by nearly 10%.

Japanese large- vs. small-cap indices, indexed to Jan'20



Source: Refinitiv, Hardman & Co Research

GARP approaches face headwind if market buying value over growth – may be fuelled by rising rates

FJV is very stock-specific in its investments, but the best description for its approach is GARP. While not a “growth at any price investor”, it is likely to be more sensitive to the market appetite for growth overall. When there is a sharp reversal from overall market appetite for growth and into value, this is likely to create a headwind. One factor driving this trend can be inflationary expectations. As we have seen across the world, rising inflationary expectations can see rising long-term interest rates. In turn, these reduce the present value of the future earnings from growth companies to a much greater extent than is the case for value ones. Consequently, growth stocks can underperform against value ones.

If market buying lower-quality names, there will also be a headwind

One further example of this is that, as we noted above, FJV's companies have faster revenue and EBITDA growth, and higher returns than average. When the market appetite is highly risk-on and there is appetite for lower-quality businesses, again there can be a headwind. Such times are most common at early stages of market rallies and commonly seen with a sharp reversal from growth into value opportunities.

Gearing will exacerbate falling markets

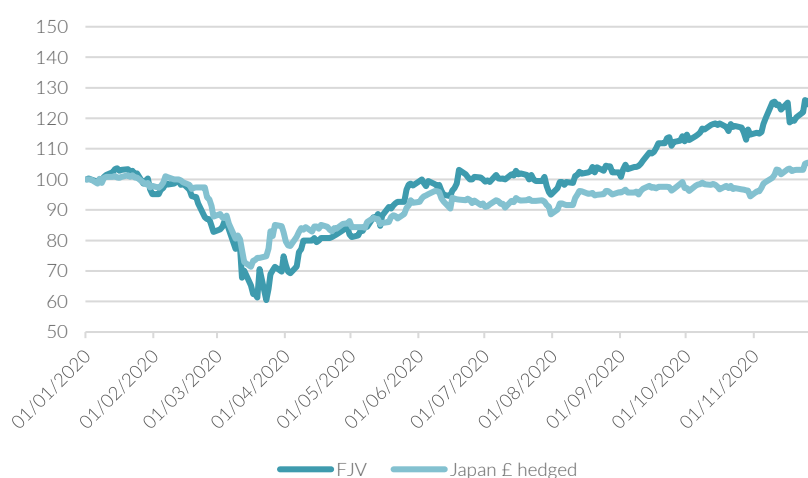
Underperformance in 1Q'20 on style rotation was reversed to a 15% outperformance over whole year

As noted above, FJV uses gearing to enhance long-term returns. When markets are falling, this gearing is likely to create headwinds to performance.

Full-year 2020 as a case study

The performance of the trust through 2020 is an example of what investors may reasonably expect. As the pandemic emerged, markets fell (adverse gearing impact) and, as noted above, small-cap underperformed against large-cap. FJV underperformed the Japanese market materially. The underperformance was short-lived; so, within a couple of months, it was back in line, and progressively outperformed through the year.

FJV and Japanese market (£ hedged), indexed to 1 Jan'20



Source: Refinitiv, Hardman & Co Research

2018 saw underperformance as markets fell, driven partially by rising interest rates. FY underperformance against index's 7% was recouped threefold in following year.

October 2018 as a case study

In October 2018, the trust's NAV fell 17.2%, against the benchmark fall of 7%. The market fall was driven partially by rising long-term interest rates in the US, and was exacerbated by US-China trade tensions and mounting concerns over a slowdown in China and the impact on corporate earnings in Japan. Overseas investors turned into net sellers of Japanese stocks as the month progressed, although predominantly in futures, rather than cash equities. Value stocks outperformed, whereas growth and momentum stocks, and stocks with high foreign ownership, saw the steepest declines. Again, there was the gearing effect compounding market falls. The sharp fall near the year-end saw an underperformance in the year of 7%, but, in 2019, FJV outperformed by 22%, before a further 15% outperformance in 2020.

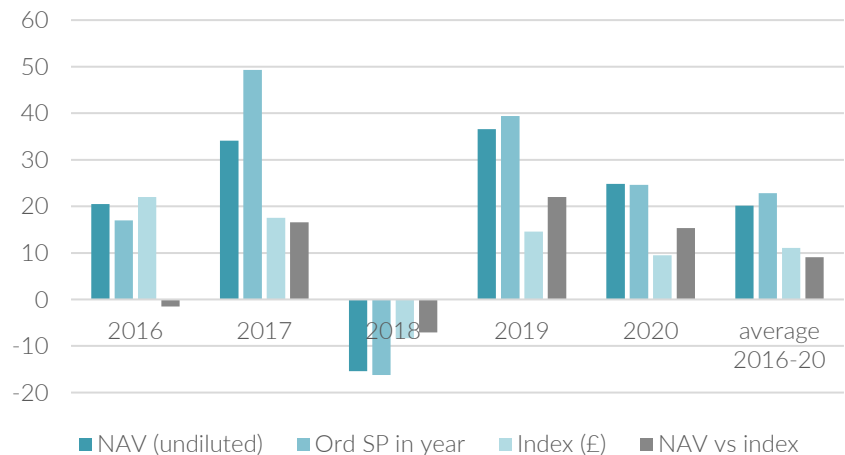
2) FJV: volatility of returns

FY'16-FY'20 NAV average annual return was 20%, but ranged from -15% to +37% (and share price averaged 23%, with a range of -16% to +49%)

FJV's investment style is likely to generate incremental volatility to markets that are already volatile. FJV has achieved long-term outperformance, but it is operating in markets that are volatile. Additionally, its investment approach – leading to divergence from the index – is likely to generate further swings in performance. The chart below shows the volatility of returns in the NAV, share price and index for FY'16-FY'20 (Nicholas Price, the manager, was appointed on 1 September 2015). While, over this period, the NAV average annual return was 20%, it ranged from -15% to +37% (and the share price averaged 23%, with a range of -16% to +49%). 2016 included a 23.5% uplift from forex effects (the year's performance was -3.0%, otherwise), which had an impact on the average, but not the spread or performance

against the benchmark. In four of the past five years (and nine of the past 11 years), it has shown more volatility than the benchmark index.

Annual total returns since manager's appointment



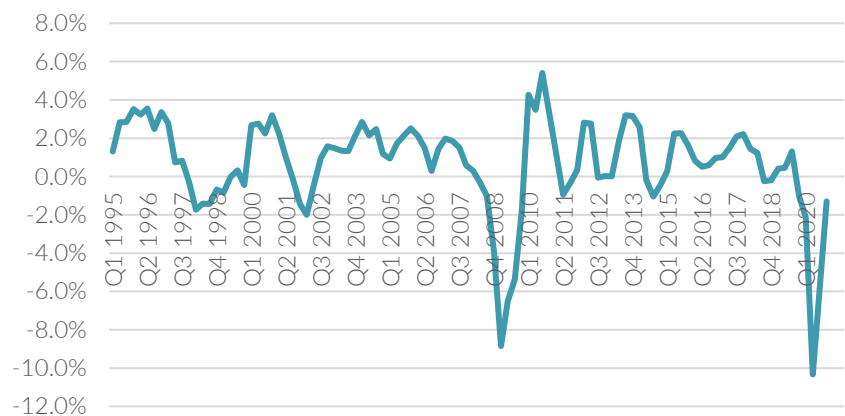
Source: FJV Report and Accounts, Hardman & Co Research

3) Japan: sentiment to historical GDP growth and productivity

Poor historical record of GDP growth

We have outlined above how and why Japan is expected to stimulate technology-driven GDP growth going forward. Historically, though, its record has been weak, with just 0.7% average annual growth since 2010 (the 10-year record up to 2019 was 0.6%). Such a weak GDP record creates headwinds for markets for domestic earnings. Markets do not, of course, always reflect domestic GDP, especially when many companies have international, if not global, earnings, but it can affect sentiment to the shares.

Japan's annual GDP growth



Source: Refinitiv, Hardman & Co Research

Per capita output growth lagged world and developed markets, but global companies capture the growth outside Japan

Per capita real GDP in Japan grew at a slower rate than the world average in every year since 2013, and more slowly than the US in all but one year. On average, 2013-22 projected, it was/will be 0.8% slower than the world and 0.3% slower than the US.

Sentiment is likely to be adversely affected by memories of Japan's "lost decade", even though outlook very different now

Sentiment to the lost decade for stock market

Commentators often refer to the lost decade that Japan faced after the stock market crashed in the 1990s. From a market perspective, it was more like two lost decades, as it has only really been since 2012 that the headline index has seen steady appreciation. For some investors, we believe that this extended period of underperformance may taint their view of the outlook, but we highlight that all the issues we identified above in the investment-attractions sections make the market fundamentally different from this perception. As we noted, the Japanese market has outperformed the UK market (and, for that matter, the European and Shanghai markets). Japan is undergoing a steady margin and cashflow expansion, with profits bottoming out near 2000 levels, and then beginning a very long-term uptrend.

Level of Japanese market from 1985 to date



Source: Refinitiv, Hardman & Co Research

4) Japan: sentiment to ageing population, a drag on future growth

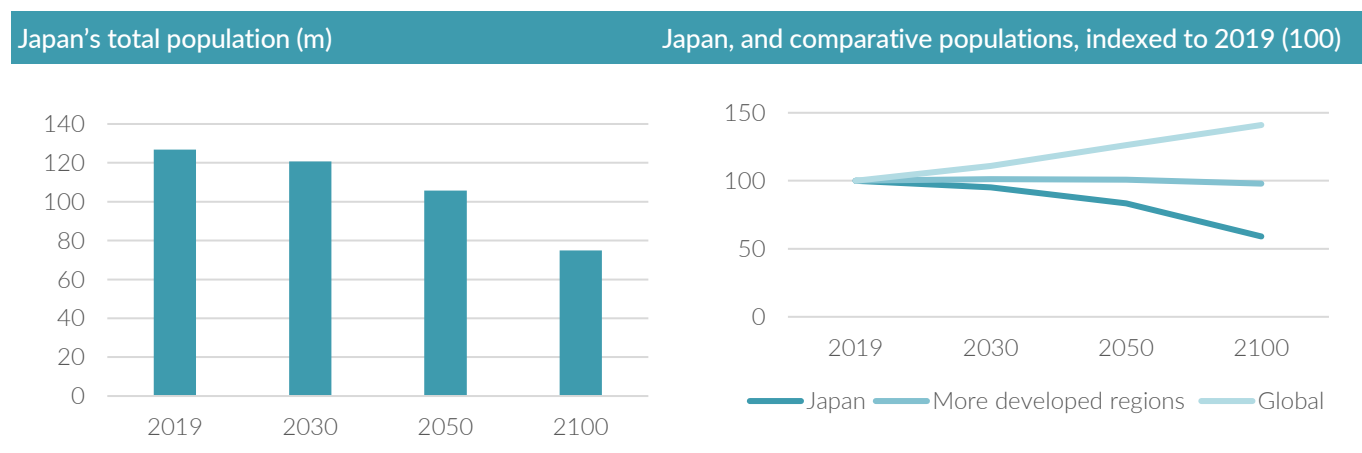
28% of Japan's population is over 65, against the developed world's 19% and a global average of 9%. Likely to see shrinking total and working-age populations with multiple adverse effects. IMF estimates it would reduce Japan's real GDP by 25% over 40 years (0.55% CAGR).

We believe one of the biggest potential drags on the sentiment to Japanese companies is the impact of the ageing population on its GDP growth prospects, and so on domestic earnings (noting our point above about global exposures). 28% of Japan's population is over 65, against the developed world's 19% and a global average of 9%. This is due partially to long life expectancy (84 years compared with the developed world average of 79 and the global average of 72) and, after Hong Kong, Japan has the second-highest life expectancy in the world. Combined with low fertility rates and very modest migration (72k annual average), this is likely to lead to a shrinking population.³¹

The effects are multiple, including i) a declining population and so lower domestic demand, ii) increased social security, health and care costs, iii) reducing the active tax-paying work force, iv) falling savings rates, as people move to spend their resources, rather than save for the future, and v) increasing inefficiency, as businesses reduce investment to match their falling demand outlook. If no mitigating

³¹ UN World Population Prospects 2019

action were taken, the IMF estimates that this would reduce Japan's real GDP by 25% over 40 years (0.55% CAGR).³²



Source: *UN World Population Prospects 2019*, Hardman & Co Research

Government policies we identified above intended to address this problem

We do not believe the Japanese government is ignoring these risks. The actions that we outlined above to drive innovation, to reform the business and labour environment, and to enter new trade agreements have been put in place to mitigate the effects of this demographic trend.

Sentiment issue for FJV, as it can invest in opportunities created by ageing population

FJV, as we have noted above, is an active manager driven by stock-specific investments. It does not need to be invested in companies that are exposed to the adverse effects of an ageing population and, indeed, it makes the point that this demographic trend creates opportunities to service the elderly, and that opportunities also arise from the actions the government is taking to address it (e.g. digitalisation of the economy). It is also worth noting that 40%-50% of portfolio company revenues come from outside Japan. We do not underestimate, though, how sentiment to FJV shares can be affected by adverse commentary about Japanese macro issues.

5) Japan: sentiment to recent market performance

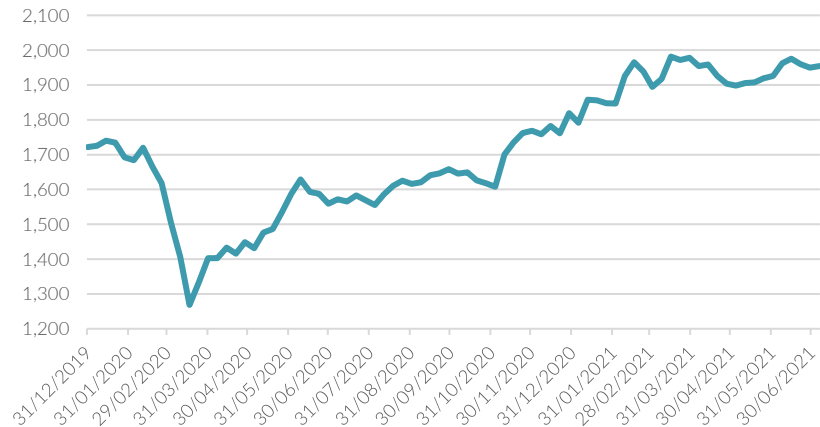
Strong stock markets may see some concerns about short-term bubble, but FJV's stock selection gives it very different profile

Since before the pandemic, the Japanese stock exchange has risen by nearly a fifth to its highest level since 1990. Investors should note that, going into 2020, technology names accounted for 46% of the index³³, while financials were just 2% (these apply to the overall index, not FJV's portfolio or its benchmark). By contrast, the FSTE 100 had just 1% in IT and 20% in Financials at that time, while the Dow Jones was somewhere between the two. This sector mix means that rises in the index should not be viewed as a concern. From an FJV-specific perspective, given the active management we have described above, the index and its composition are of little relevance.

³² IMF Working Paper, Macroeconomic *Effects of Japan's Demographics: Can Structural Reforms Reverse Them?*

³³ https://indexes.nikkei.co.jp/nkave/archives/file/nikkei_stock_average_factsheet_en.pdf

Level of Japanese whole market, indexed to End 2019



Source: Refinitiv, Hardman & Co Research

FJV shown strong selling discipline, and not carried away by momentum

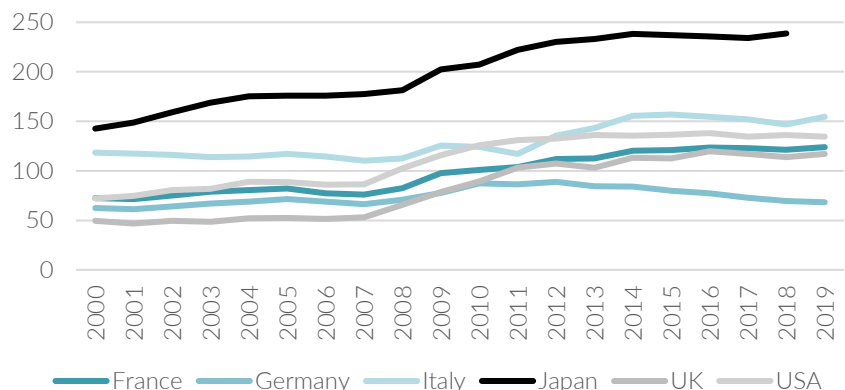
Again, we characterise this risk as sentiment. For FJV specifically, we note that the manager comments that the historically high turnover reflects a tight selling discipline. This should mitigate some of the concerns about recent market rises, and FJV is not carried away with momentum in its own portfolio.

Pre-pandemic, Japanese central government debt was nearly twice average of major western developed economies, potentially squeezing out private sector. Increased materially with pandemic measures.

6) Japan: sentiment to government debt

Abenomics is the nickname for the three-pronged approach that prime minister Shinzo Abe adopted on coming to power for the second time in 2012. The three legs were enacting structural reforms (detailed above), combined with expansionary fiscal and monetary policies, all of which are expected to continue under his replacement, Yoshihide Suga. Economists will argue over the success or failures of the policies (without doubt, they stimulated demand), but one result has been the continued expansion of government debt ahead of international peers. The chart below highlights how, before the pandemic, Japanese central government debt was nearly twice the average of major western developed economies. Given the pandemic deficits, it is probable that Japan's central government debt will increase sharply. Some economists argue that one reason for Japan's slow growth has been the fact that the public deficits squeezed out private-sector borrowing, and thus reduced investment.

Central government debt to GDP (%)



Source: OECD, Hardman & Co Research

Japan's slow vaccination could see
incremental pressures from COVID-19

7) Japan: slow vaccination rate

At the time of writing, Japan has vaccinated ca.30% of its total population, well behind most of the EU (54%), let alone the US (55%) or the UK (68%)³⁴. Given the age of the population, and age-related risks from COVID-19, there is a risk that Japan could face further and extended negative impacts. While FJV is positioned for global leaders and structural growth, further lockdown-type restrictions could have an adverse effect on some of its investments, and sentiment to them.

³⁴ <https://ourworldindata.org/covid-vaccinations?country=GBR>

Portfolio

Comparisons with peers

The table below shows FJV's portfolio compared with that of its listed peers, based off latest information at the date of publication – updates can be found on the companies' websites. It should be remembered that FJV works with bottom-up selection, with risk parameters then applied to the portfolio; so the concentration is mainly on the result of the investment decision, and not the aspiration of/driver to it. In terms of business message:

- ▶ FJV is heavily overweight Electric Appliances (more so than its listed peers), Information & Communications (broadly in line with its listed peers), Services (broadly in line with listed peers) and Retail (more than its listed peers);
- ▶ a key underweight appears to be financials; and
- ▶ FJV employs more gearing than its peers (see section above).

Portfolio summary of FJV and immediate peers (taken from latest factsheet disclosure)

	FJV (May'21)	AJIT (May'21)	BGFD (May'21)	CCJI (May'21)	JFJ (May'21)	SJG (May'21)	FJV Index
Sector (%)							
Electric Appliances	24.5		14.3	9.0	16.9	10.5	17.8
Services	18.2		20.2	9.7	18.8		5.6
Information & Communications	18.0	12.3	16.6	14.2	20.1	13.1	9.0
Chemicals	10.3		7.7	15.2	4.4	7.7	7.4
Retail	8.4		2.5		9.9	4.4	4.5
Wholesale Trade	7.4			8.1		7.9	4.7
Machinery	5.1		18.2		7.8	11.0	5.6
Other Products	4.2			6.4	5.5		2.6
Food	3.5						3.4
Precision Instruments	3.2				7.9		2.7
Real Estate	n/d	4.3	3.5	13.1	2.0	3.6	n/d
Banks/Financial	n/d	9.5	9.0	22.9	1.6	8.2	n/d
Industrials	n/d	23.4					n/d
Other	14.0			5.3	4.8	33.6	36.7
Total gross asset exposure	116.8	99.6	95.0	97.3	99.7	100	100.0
Cash		0.4	5.0		0.3		0
Other/unclassified	5.5						0
Total incl. derivatives	122.3	100.0	100.0		100.0	100	100.0

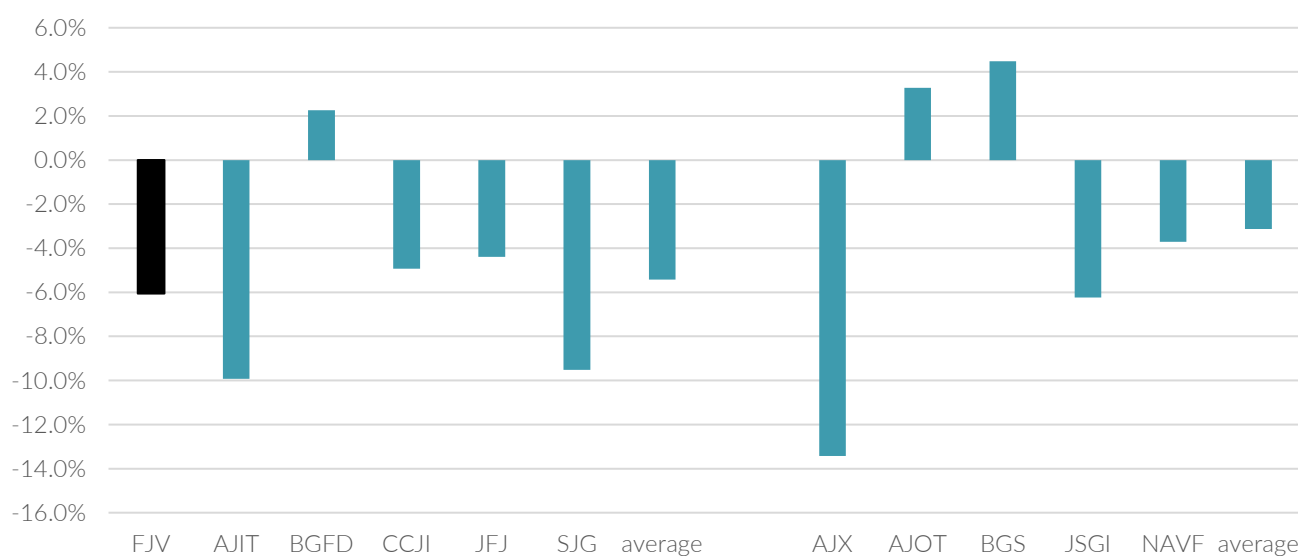
AJIT disclosure and benchmark different basis (has 26.1% in consumer discretionary and 5.0% in consumer staples)

Source: Factsheets and websites, Hardman & Co Research

Valuation

As can be seen in the chart below, FJV's discount is broadly in line with that of its peers in the AIC Japan subsector and slightly higher than the average for Japanese smaller companies.

Other Japan/Japanese smaller company discounts/premiums to NAV (%)

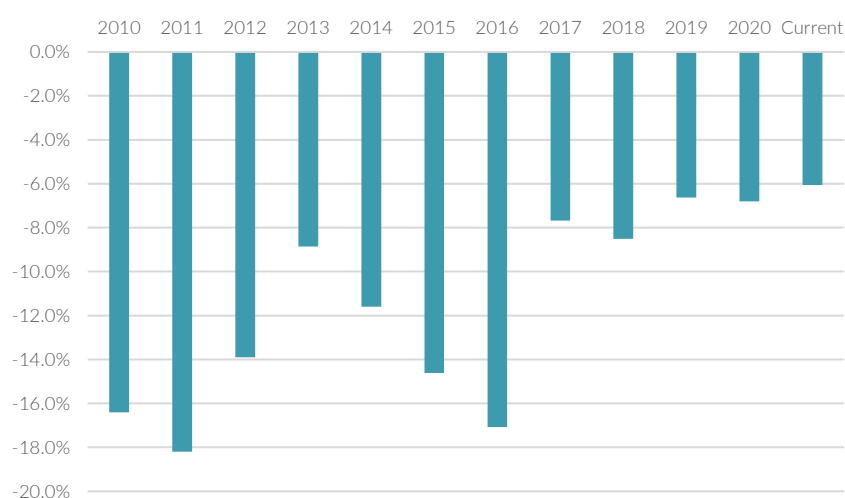


Source: LSE, priced on 12 July 2021, Hardman & Co Research

Current discount slightly below recent past

As can be seen, since the end of 2017, FJV has generally traded at a mid- to high-single-digit discount to NAV.

FJV's historical discount to NAV (end-December) and latest



Source: FJV Report and Accounts, NAV announcement, dated 12 July 2021, LSE, Hardman & Co Research

Financials

Income statement (£000)

Year-end Dec	Revenue	2020 Capital	Total	Revenue	2021E Capital	Total	Revenue	2022E Capital	Total
Gains/losses on derivatives		38,535	38,535		27,270	27,270		30,433	30,433
Gains/losses on fin. invst. FV		22,360	22,360		8,680	8,680		8,680	8,680
Income	3,287		3,287	5,303		5,303	6,763		6,763
Investment management fees	-358	-1,677	-2,035	-373	-1,748	-2,121	-417	-1,950	-2,367
Other expenses	-597	-8	-605		-542	-542		-542	-542
Foreign exchange gains/losses		-475	-475		0	0		0	0
Profit/(loss) bef. finance costs & taxation	2,332	58,735	61,067	4,929	33,661	38,590	6,346	36,621	42,968
Finance costs	-26	-104	-130	-100		-100	-100		-100
Profit/(loss) before taxation	2,306	58,631	60,937	4,829	33,661	38,490	6,246	36,621	42,868
Taxation	-252		-252	-275		-275	-275		-275
Profit/(loss) after taxation for the year	2,054	58,631	60,685	4,554	33,661	38,215	5,971	36,621	42,593
Earnings/(loss) per ordinary share (p)	1.56	44.53	46.09	3.50	25.89	29.40	4.59	28.17	32.76

Source: FJV Report and Accounts, Hardman & Co Research

Balance sheet (£000)

@ 31 Dec	2015	2016	2017	2018	2019	2020	2021E	2022E
Investments	115,532	161,777	221,792	185,987	249,099	303,002	338,149	380,741
Current assets								
Derivative instruments	1,056	4,619	1,123	269	3,048	1,932	5,000	5,000
Other receivables	1,063	534	652	3,263	899	668	668	668
Amounts held at futures clearing houses and brokers	0	0	0	7,611	0	21	21	21
Cash and cash equivalents	220	620	908	0	1,196	4,336	3,370	3,370
Total current assets	2,339	5,773	2,683	11,143	5,143	6,957	9,059	9,060
Total assets	117,871	167,550	224,475	197,130	254,242	309,959	347,208	389,801
Current liabilities								
Derivative instruments	-1,117	-424	-456	-6,529	-1,075	-91	-91	-91
Bank loans		0	0	-1,718	0	0	0	0
Other payables	-754	-721	-1,492	-1,353	-676	-1,062	-1,062	-1,062
Total current liabilities	-1,871	-1,145	-1,948	-9,600	-1,751	-1,153	-1,153	-1,153
Net current assets	116,000	166,405	222,527	187,530	252,491	308,806	346,055	388,648
Net assets	116,000	166,405	222,527	187,530	252,491	308,806	346,055	388,648
NAV per share (£)	1.02	1.22	1.64	1.39	1.90	2.37	2.66	2.99

Source: FJV Report and Accounts, Hardman & Co Research

Appendix 1: company matters

Registered in England and Wales, with registration number 2885584. Registered office: FIL Investments International, Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP.

Investment objective

The company aims to achieve long-term capital growth by investing predominantly in equities and their related securities of Japanese companies.

The Investment Manager is not restricted in terms of size or industry of the underlying entities in which it invests. The company may also hold cash or invest in cash equivalents, including money-market instruments, and is able to use derivatives for efficient portfolio management, gearing and investment purposes. The company has adopted a variable management fee, which is calculated by referencing performance relative to the TOPIX index (Tokyo Stock Exchange TOPIX Total Return Index).

Board of Directors

All the Directors are non-executive directors, and all are independent.

David Graham – Chairman

David Graham is a Chartered Accountant by training (PwC). His career has been in investment management, firstly as a Japanese and Asian fund manager with Lazards in London, Hong Kong and Tokyo, and then building businesses, establishing offices and managing client relationships across Japan, Asia Pacific, UK, Europe, Middle East and Africa for BlackRock. He is currently a non-executive Director of both Templeton Emerging Markets Investment Trust plc and JPMorgan Chinese Investment Trust plc, and he also serves on the boards of DSP India Investment Fund and DSP India Fund, both umbrella fund structures providing access to Indian equity and fixed-income markets.

He was appointed on 22 May 2018, and appointed as Chairman of the Audit Committee on 19 May 2020.

Sarah MacAulay – Senior Independent Director

Sarah MacAulay has 20 years of Asian investment experience in London and Hong Kong, managing and marketing portfolios across numerous jurisdictions. She is a non-executive Director of Schroder Asian Total Return Investment Company plc and Aberdeen New Thai Investment Trust plc. She is also a non-executive Director of JPMorgan Multi-Asset Trust plc, of which Sir Laurie Magnus is also a non-executive Director.

She was appointed on 22 May 2018, and appointed as Senior Independent Director on 10 October 2019.

Dominic Ziegler – non-executive Director

Dominic Ziegler currently holds the post of Asia Columnist and Senior Asia Writer at *The Economist* in Hong Kong. He has more than 25 years' experience in top-flight journalism and commentary, with a special expertise in East Asian affairs – particularly Japan – having previously served as The Economist's Tokyo Bureau Chief.

He was appointed on 17 November 2014.

David Barron – Chair of Audit Committee

David Barron has spent 25 years working in the investment management sector and, until November 2019, was Chief Executive Officer of Miton Group plc, following six years with the firm. Prior to this, he was Head of Investment Trusts at JP Morgan Asset Management for more than 10 years, having joined Robert Fleming in 1995. He is currently Chairman of Dunedin Income Growth Investment Trust plc and a non-executive Director of Premier Miton Group plc. He is also a lay-member of the Council of Lancaster University. He is a Member of the Institute of Chartered Accountants of Scotland, having qualified with Thomson McLintock (now KPMG).

He was appointed on 20 October 2020.

Portfolio Managers

Nicholas Price – Lead Portfolio Manager

Nicholas Price brings over 20 years' investment experience in the Japanese equity market, having joined Fidelity's Tokyo office in 1993 as a research analyst, before becoming a portfolio manager in 1999. Nicholas's investment approach is focused on GARP, utilising Fidelity's extensive research capability.

He was appointed on 1 September 2015.

Cenk Simsek – Assistant Portfolio Manager

Cenk Simsek joined Fidelity as an analyst in 2016, covering the technology and FA machinery sectors, having previously worked at CLSA Securities in Tokyo for eight years. Since July 2019, he has been the Lead Portfolio Manager for the FIJ Select Technology Fund. Cenk graduated from Istanbul Technical University (Turkey) and gained an M.B.A. from Koc University (Turkey).

At the 2021 AGM, the relative roles of the managers were explored. It was emphasised that Nicholas is the lead manager, who has the ultimate say on any investment. However, he works closely with Cenk, whose main responsibility is as a tech analyst; he has detailed knowledge in this key area.

Shareholder breakdown

The chart below shows the trend of shareholders over the past five years.

Mix of FJV's shareholders at year-end (% total)					
	2016	2017	2018	2019	2020
Advisor-based	2	3	4	4	5
Institutional	75	68	58	54	50
Platforms	13	15	18	20	22
Wealth management	10	14	20	22	23

Source: FJV Report and Accounts, Hardman & Co Research

Investment restrictions

In order to diversify the company's portfolio, the board has set the following investment guidelines for the Portfolio Manager. These guidelines and their impact are monitored on a daily basis, and reported regularly to the board:

- ▶ A maximum of 7.5% in the aggregate of all securities of any one company or other investment entity (10% for any group of companies) at the time of purchase, which is further limited to 12% of the company's equity portfolio, based on the latest market value.

- ▶ A maximum of 10% of its assets (at the time of acquisition) in securities that are not listed on any stock exchange or traded on the JASDAQ market. The company would not normally make any such investment, except where the Portfolio Manager expected that the securities would shortly become registered for trading on the OTC market, or become listed on a Japanese stock market.
- ▶ A maximum of 30% of its assets (at the time of acquisition) in equity-related and debt instruments. The company may also invest in derivatives for efficient portfolio management to protect the portfolio against market risk. Any such investment would normally be at a low level, as the company invests primarily in shares.
- ▶ A maximum of 15% of the company's total assets may be invested in the securities of other investment trust companies.
- ▶ The maximum that the company can hold in cash, or invest in cash equivalents, including money-market instruments, is limited to 25% of the total value of the company's gross assets. This limit will not include any amounts required as collateral to cover unrealised losses on derivatives. In practice, the cash position will normally be much lower.

Appendix 2: Tokyo Stock Exchange

Sections of the Tokyo stock exchange (TSE)

The First and Second Sections represent the main boards of the TSE, where leading large and second-tier Japanese and foreign companies are listed. The First Section, in particular, is viewed as one of the top-ranking markets in terms of size and liquidity, as foreign investors account for a large portion of equity trading. The First and Second Sections are referred to collectively as the "Main Markets."

"Mothers" offers a trading market for companies with growth potential, which aim to be reassigned to the First Section in the near future.

JASDAQ is a market characterised by the three concepts of i) reliability, ii) innovativeness, and iii) region and internationalisation. JASDAQ is split into the "Standard" market for growth companies with a certain size and business performance and the "Growth" market for companies with stronger future growth potential and unique technologies or business models.

In the TOKYO PRO Market, exchange-approved J-Advisers conduct listing examinations of prospective companies and offer post-listing support in place of the exchange.

Despite its name, trading for the 477 companies listed on the Osaka Stock Exchange takes place in Tokyo.

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(Disclaimer Version 8 – Effective from August 2018)

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The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>

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