LOMBARD ODIER
INVESTMENT MANAGERS

PrivilEdge – SMAM Japan Small and Mid Cap (M share class)

Newsletter

High Conviction • Equities **31 March 2022**

For March, the Fund's performance was up 0.74%, underperforming the MSCI Japan Small & Mid Cap Index, which delivered 2.73%.

MONTHLY FUND PERFORMANCE REVIEW

In March, the Fund underperformed its index in an adverse market environment for small caps, while growth and value factors finished at par.

The relative gains were undermined primarily by stock selection, whereas sector allocation was basically positive.

The impact from the difficult stock selection in IT, consumer discretionary and industrials was offset only partly by the positive stock selection in utilities and communication services. The large underweight exposure to consumer staples and the overweight exposure to IT and industrials also helped mitigate the challenging stock choice in sensitive sectors.

The large overweight exposure towards small caps relative to the index (66.2% vs 10.8%) clearly weighed on relative performance.

At the stock level, the best contributor to performance was Creek & River Co. Ltd (1.28% of the portfolio/0.19% positive contribution), which mainly provides staff dispatch services for creative fields, including audio-visuals, game, web and mobile, advertisement and publishing. The company's stock price rose as it announced an upward revision in earnings and dividend of FY 2022 on 25 March. Recurring profit (on a consolidated basis) was revised up by +6.3% to 3.4 billion (bn) Japanese yen (JPY) from JPY 3.2 bn. This further increased profits to record highs for three consecutive fiscal years. Given the strong earnings growth, dividend for FY 2022 was revised up by JPY 2 to JPY 20 (dividend of FY 2021: JPY 16).

The second contributor was a stock initiated in the portfolio in January, Members Co., Ltd (1.5%/0.177%), which mainly provides Internet business support. The company supports the improvement in marketing performance of client companies through the provision of comprehensive web production services. The company's stock price rose, driven by its third-quarter 2022 earnings announcement, which showed a 76% year-on-year increase in operating profit, backed by its strong digital marketing-related sales. The stock price continued to rise on the expectation of a possible upward revision of its FY 2022 guidance.

Finally, the third contributor was the same as in February, West Holdings Corp. (1.45%/0.176%), which engages in solar energy solutions for solar power generation plants, individual customers and corporate, local government and rental management company owners through its subsidiary West Co., Ltd. The company announced a downward revision in H1 recurring profits, due to the loss-making electric power business; however, the market factored in the event, as the company decided to withdraw from this business. Also, the company was bought, as it was considered less affected by the global economic slowdown; moreover, it benefited from soaring crude oil prices.

On the other hand, the largest drag on performance in March was JCU Corp. (1.26%/-0.278%). The group manufactures and sells chemicals, machines and auxiliary equipment for surface treatment. It offers plating technologies (chemicals and equipment) to automobile parts, as well as printed circuit boards used for smartphones, etc. The stock was mainly sold due to 1) shortage of semiconductors, 2) supply-chain disruptions and 3) global economic slowdown caused by Russia's invasion of Ukraine.

The second detractor was Stanley Electric Co. Ltd (1.22%/-0.216%), which manufactures lighting equipment, including head lights, high intensity discharge (HID) assist lamps and rear combination lamps for automobiles. The company also produces liquid crystal display (LCD) and light emitted diode (LED) lamps for communication equipment, office automation equipment and information displays. The ongoing supply-chain disruption, due to the shortage of semiconductors and Russia's invasion of Ukraine, has delayed the recovery in automobile production, affecting the company's top line. In addition, soaring raw material costs have weighed on the company's performance.

Finally, the third detractor was Nifco Inc. (1.21%/-0.21%). The company manufactures synthetic resinous fasteners and plastic components for automobiles and home electronic appliances. It holds the top market share among fastener suppliers for Japanese auto makers. In addition, it focuses on components for advanced driver assistance systems. The ongoing supply-chain disruption, due to the semiconductor shortage and Russia's invasion of Ukraine, has delayed the recovery in automobile production, affecting the company's top line. In addition, rising cost of resin, a raw material for its product, weighed on the company's performance.

FUND POSITIONING

At the end of March, the Fund had 91 holdings, with the initiation of two stocks in the portfolio and the exit of one. The Portfolio Manager initiated a position in Japan Material Co., Ltd (6055 JP Equity; market caps: 1,500 million [mn] US dollars). The company mainly provides specialty gas supply equipment and specialty gas to manufacturing facilities of electronics industries, such as semiconductors. Piping work is going well, due to investments in semiconductor facilities, and gas supply is expected to increase, supported by steady semiconductor production.

The second initiation was Shibaura Electronics Co., Ltd (6957 JP Equity; market caps: USD 382 mn). The company is a major specialised manufacturer of NTC thermistors, which are mainly used for temperature sensors. It has the top share in this field globally. The company's products are used by a wide range of manufacturers of air conditioners, home appliances, office automation equipment and automobiles. Adding to its strong sales for air conditioners, the Portfolio Manager expects growth in demand for eco-friendly cars, such as electric vehicles, going forward

The Portfolio Manager fully exited Sinko Industries Ltd (6458 JP Equity; market caps: USD 340 mn). The company manufactures and distributes industrial air conditioners. It has almost 40% share in central air conditioners. Although its valuation is attractive, the Portfolio Manager has replaced it with other stocks, considering the growth potential of business performance and expected rate of return.

The Fund's top 10 positions accounted for 15.25% of its total assets, with cash accounting for 0.77%.

The portfolio remained largely overweight domestic-demand-oriented service sectors, such as commerce and professional services (strong overweight), consumer services, software services and healthcare services and equipment. In the manufacturing industry, the portfolio was overweight auto components and technology, as well as hardware and equipment, given the expectation of significant growth in the internet-of-things-related businesses.

The Fund continued to hold underweight positions in the materials, real estate, banking (no holdings), capital goods, and food, beverage and tobacco (no holdings) sectors. In these sectors, the portfolio manager believes promising stocks with growth potential are difficult to find in the small- and mid-cap stock segment, given the Fund's enterprise value-focused investment strategies.

By sector, and according to MSCI's classification, this translated into significant overweight positions in IT (+12.4% in relative terms), industrials (+8.7%) and consumer discretionary (+6.1%) and underweight positions in real estate (-7.9%), consumer staples (-5.6%) and financials (-5.5%).

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