GAM Star Japan Leaders

Marketing material for professional investors / institutional / accredited investors

Market backdrop

In 2024, the TOPIX Total Return Index gained 20.5%, driven by strong foreign investor interest. Key factors included expectations of Japan's exit from deflation and the Bank of Japan's (BoJ) policy shift in March, when it ended negative interest rates and discontinued ETF purchases. The market experienced significant highs in the first quarter, with the Nikkei 225 Index surpassing the 40,000 mark amid a weaker yen and strong buying of large-cap and value stocks.

In July, the yen weakened to over 160 per US dollar, pushing both the Nikkei 225 and the TOPIX to record highs. However, volatility surged in early August as the yen strengthened sharply, contributing to a sharp decline in global equity markets. This was largely due to the BoJ's rate hike to 0.25% at the end of July and its plan to reduce Japanese Government Bonds (JGB) holdings by 8% by the spring of 2026. Weaker US employment data in early August added to recession fears and accelerated the yen's rise, especially as traders unwound yen carry positions. Political developments, including Shigeru Ishiba's victory in the Liberal Democratic Party presidential election, further added to market turbulence.

Despite these challenges, the year ended on a strong note. A weaker yen, a rally in US equities following Donald Trump's victory in the US elections and optimism about a significant business combination in Japan's automotive industry contributed to the TOPIX closing the year with robust gains. The BoJ's monetary tightening contributed to a rise in 10-year JGB yields, climbing from 0.620% at the end of 2023 to 1.090% by the end of 2024, aligning with higher yields on US Treasury notes.

Throughout the year, large-cap stocks and value stocks significantly outperformed across the MSCI style indices, while both small-cap stocks and growth stocks clearly lagged. Momentum effects were particularly pronounced among large-cap stocks, with infrastructure-related sectors and financials staging notable rallies. Sector-wise, financials, energy and industrials performed best, whereas materials, utilities and consumer staples underperformed.

Performance

The fund's reference share class GAM Star Japan Leaders Ordinary JPY Acc increased +5.5% throughout 2024, while its benchmark, the TOPIX Total Return Index, gained +20.5%, resulting in an underperformance of -15.0% (including fees).

The primary source of underperformance for our fund was concentrated in the first and fourth quarters. During this period, a confluence of rising interest rates in both the US and Japan triggered a clear investor preference for value stocks. Notably, large-cap growth stocks, particularly those with high return on equity (ROE), faced formidable challenges and experienced significant underperformance. This clear preference for value stocks placed enormous pressure on our fund's performance. While the relative performance did witness a notable improvement in the second and third quarters, characterised by a halt in the rise of 10-Year US Treasury Yields, it proved insufficient to fully recover the overall result for the year.

Overall, the largest contribution to relative performance in 2024 came from our positioning in IT (+0.63%), utilities (+0.16%) and real estate (+0.10%). At the other end of the attribution table was our allocation towards financials (-3.18%), healthcare (-2.82%) and consumer staples (-2.74%).

Relative performance contributors

Recruit Holdings – HR technology company

The shares contributed +133 basis points (bps) to relative performance. Despite a less dynamic US labour market, the owner of Indeed and a leading HR technology group reported a solid performance which frequently exceeded expectations, prompting a positive revision in its full-year guidance. The market responded favourably to its guidance, which focuses on careful cost control and sales growth. Moreover, Recruit announced plans to reduce its net cash position from JPY 1.1 trillion at the end of March to around JPY 600 billion over the next two years through stable dividends, M&A activities and share buybacks. The position had a weight of 5.6% at the end of the year.

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GAM Investments

Sumitomo Mitsui Trust Holdings – mega trust bank

The shares contributed +65 bps to relative performance. Sumitomo Mitsui Trust Holdings shares benefitted strongly from the rise in 10-year JGB yields and from rising expectations that the BoJ will likely hike its policy rate further in 2025. The position had a weight of 4.4% at year end.

Tokyo Electron – semiconductor production equipment company

The shares contributed +48 bps to relative performance. The company's better-than-expected quarterly results in February and its optimistic outlook propelled relative performance early in the year, especially amid the upswing in the semiconductor industry cycle. Moreover, there are extensive government-backed initiatives underway to construct new fabrications in key regions like the US, Japan and Europe. However, in the second half of the year, the tightening of US trade policy in the IT sector put pressure on the share price. The position had a weight of 3.0% at year end.

Relative performance detractors

M3 – digital healthcare platform

The shares detracted -226 bps from relative performance. M3's share price continued to decline especially during the second quarter following a disappointing earnings release in late April. The decline was primarily due to the decrease in Covid-related businesses and an impairment in the company's overseas operations. Excluding Covid-related factors, underlying performance still fell short of our expectations, with earnings growth not yet accelerating. This underperformance is mainly attributed to constraints on marketing budgets at large pharmaceutical companies, which are M3's clients. The position had a weight of 3.8% at year end.

GMO Payment Gateway – digital payment company

The shares detracted -157 bps from relative performance. Although operating profits grew at a solid pace of 24% year-over-year, the shares underperformed the market due to a decline in the valuation multiple. Additionally, some investors were disappointed when the company announced the departure of one of its larger clients, who opted to move their digital payment infrastructure in-house. This development is expected to dampen profit growth in the next fiscal year. However, the trend towards digital payments in Japan remains steady, and the company is well-managed, suggesting a likely return to operating profit growth near 25% in the following year. The position had a weight of 3.8% at year-end.

Unicharm – personal care company

The stock detracted -146 bps from relative performance. The year started with subdued guidance following underperformance in China and Thailand in late 2023. Price increases and favourable currency movements boosted first quarter results, particularly in Japan, although competition and inventory issues persisted in Southeast Asia and China. However, India and premium feminine care held up well. Unicharm shares fell sharply in the fourth quarter as quarterly results were impacted by higher promotional, advertising and logistics costs. In addition, there was a notable slump in demand for baby care products in Southeast Asia. The position ended the year with a weighting of 3.2%.

Positioning

At the close of 2024, our fund strategically maintained a portfolio of 24 stock positions, each broadly equally weighted. The annual rebalancing, conducted in June 2024, ensured that the portfolio retained its equilibrium over a 12-month period. In terms of sector allocation, industrials held the largest absolute weight (28.7% with seven holdings). Following closely were IT (16.8% with four holdings) and consumer discretionary (16.4% with four holdings). Notably, we deliberately avoid exposure to specific sectors such as energy, telecommunications carriers and utilities.

GAM Investments

Throughout the reporting period, we made one transaction in the portfolio. In September, we initiated a position in Disco Corporation, a leading Japanese semiconductor equipment manufacturer with a 70% to 80% global market share in wafer grinding, polishing and cutting processes. The company is well-positioned to benefit from increased investments in High Bandwidth Memory (HBM) for AI data centres, as well as growth in chiplets, wafer bonding applications and Silicon carbide (SiC) technologies. We expect the structural expansion of semiconductor investments and rising demand for advanced packaging solutions to drive Disco's growth. Notably, this addition contributed +45 bps positively to our relative performance for the year.

Our investment philosophy continues to revolve around a disciplined stock selection approach anchored in fundamental research, primarily targeting leading businesses. Our targeted stocks exhibit superior long-term growth potential, high ROE, low leverage and a substantial discount to calculated fair value at the time of purchase. The portfolio will continue to maintain its concentrated nature, typically housing 20 to 30 positions, all with an equal weighting structure. We reaffirm our commitment to annual rebalancing, ensuring that our investments align with our strategic objectives each June.

Outlook

In our view, Japan is at a critical inflection point, presenting long-term investors with compelling opportunities. After decades of deflation, the country is transitioning into a reflationary environment. Corporate reforms that prioritise improved governance, higher ROE, enhanced P/B ratios, and increased shareholder returns will remain key drivers in the years to come. Ten-year inflation expectations have been rising steadily over the last three years and appear to be increasingly anchored in the Japanese consumer mindset. Therefore, in 2025, the BoJ is expected to continue its rate hike cycle with the aim of stabilising inflation to the BoJ's target level. Meanwhile, labour unions are targeting record-high wage growth of approximately 6% in 2025, which is expected to drive real wage growth and bolster real consumption activity, further supporting economic recovery.

The Japanese market is attractively valued at a 15.6x P/E multiple, slightly below its 10-year average, and looks particularly inexpensive compared to the increasingly concentrated MSCI World Index. Over the next three fiscal years, the TOPIX index is projected to achieve 7.4% per annum earnings growth based on consensus analyst estimates, while companies in our Leaders portfolio are expected to deliver robust 15.1% growth, according to those same estimates.[1] Therefore, we believe there is potential for them to outpace the benchmark. Importantly, our portfolio trades at a substantial discount to TOPIX when adjusted for expected earnings growth. With its combination of structural tailwinds, attractive valuations and strong growth prospects, we believe our strategy offers a highly compelling investment opportunity.

1 Source: Bloomberg.

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