

## TRANSCRIPT: EPISODE 401

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## [INTRODUCTION]

**Staci West (SW):** Welcome back to the Investing on the go podcast brought to you by FundCalibre. This week we're discussing shifting domestic sentiment in Japan and why growth is reasserting itself in Japanese equities with technology and robotics as a central theme.

**James Yardley (JY):** I'm James Yardley, and today I'm joined by Richard Kaye, the fund manager for the Comgest Growth Japan Fund. Richard, hello.

**Richard Kaye (RK):** Hi, James. Great to be here.

## [INTERVIEW]

**JY:** Thanks very much. And I believe you're coming to us live from Japan today, so it is great to get your insights on the ground. So, I mean, Japan has often been seen as quite a difficult market for international investors to understand. So can you give us a picture of how things are on the ground at the moment? I mean, I think obviously we've got a new prime minister come in at the start of this year, haven't we? Which was quite well received by the markets Sanae Takaichi, if I'm pronouncing that correctly. And obviously we've also then had the Iran situation, and I think Japan is obviously as a net importer of energy quite affected by that. And all the other kinds of macro factors and inflation, which we're going on about. So, yeah, can, can you give us that overall picture of where we are?

**RK:** Yeah, sure. And thank you very much James, and thank you again for the opportunity. Thank you for that question. Being in Japan is extremely important to answer that question, that set of questions, because right now there's quite an important sentiment change going on in this country. I feel it very much just talking to regular people, like taxi drivers or restaurant owners. We see it very much in the stock market's performance. You've gotta remember this is a country that's been through 30 years of stock market decline. Everyone told them their past it, they're ex-growth, all that kind of stuff. The last year or so of stock market

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performance has challenged that perception. And there's a sentiment change as people are starting to believe in themselves. I'm not saying the stock market defines everything, but it's an important indicator of sentiment.

And when you watch the news at seven o'clock, nine o'clock, the Japanese PVC, NHK, they'll always talk about the stock market. They'll always have folks in the street that they're asking, you know, for their reaction. As the Nikkei goes to yet new highs, there's a sentiment change on the ground. And I feel it, and I see it. You referred to the new Prime Minister, of course, she's the first lady Prime minister of Japan, got a lot of press for that. But she's a very interesting person in addition to her gender. She's come from a difficult background. She's been able to engage young people in politics for the first time, I'd say, in a generation. And she's secured an extraordinary majority. She's retained an extraordinary personal popularity rating even months into her premiership.

All of these things, again, I say, represent a sentiment change. And one feels it. We speak almost every day to companies that we hold shares in or we're thinking about buying. And one feels that the consumer is back, infrastructure spending is back, capital spending by companies in Japan is back and it's all great. Of course the Houthi crisis has been big for Japan. Japan since it's been a modern economy has had to import all of its resources. I think it's the biggest economy with no resources out there on the planet. But Japan dealt with it.

Remember, Japan's had an energy crisis before. Japan's got a vast solar and hydroelectric power base. Japan's been switching on its nuclear power stations for a number of years now, overcoming the fears and the risks that were highlighted during the Fukushima crisis. And Japan has built a natural gas relationship and LNG relationship with Australia which means that Australia is 40% of its natural gas supply now. And in fact, oil is the smallest energy source for Japan. Of course, you need oil to run cars. You can't, you know, they haven't switched to hydrogen yet, or electric vehicles that much. But other than that, their use of different energy sources has been very impressive. And they have not really been crippled by the Houthi crisis in ways that other Asian economies have been.

So yes, as a sentiment change, Houthis were a source of thought for them. They've dealt with it. They've actually been increasing US oil procurements. And of course, if the Houthi crisis is moving towards resolution that'll be unequivocally good for them, as for other nations in the region.

**JY:** And I mean, we've seen a significant style rotation in Japan over the past few years. So obviously value stocks have done extremely well, which has hurt funds like yours. But is that now starting to change a bit because obviously over the last year your fund has had very strong performance after a difficult few years, but has been very strong last year. So are we sort of returning to more of a normal kind of stock picking environment where perhaps the macro factors dominate a bit less or just where that kind of quality growth style can perform well again, versus the perhaps value stocks which have just kind of surged on this sentiment change?

**RK:** Yes. I think the simple answer, James, is yes. I think there has been a style change back to what I think is the Japan market's natural mindset, which is growth investing. Japan is a nation of innovators. It's a nation of survivors. It's a nation of people who, like we discussed earlier, don't have an awful lot of resources at all, but they become the second or the third biggest economy in the world. They have extraordinary companies that supply the semiconductor global supply chain. They supply contents, manga clothing, which has become globally successful. It's basically a growth economy. And the companies that the market ultimately honors over time have been growth. We had three years of, as you described James, value markets, and a lot of people, as is natural, I think. So we had all three awful years of value. Therefore, the future is gonna be the

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same way. You know, we just extrapolate from the last three years. I, of course, being a growth investor, extremely prejudiced, think that that interpretation is wrong, and that in fact, growth is the natural character of the Japanese market. And I think we're going back to that natural character.

Like you say, our fund's performance actually for two years now against the index has been slightly ahead. 21 to 23 was an awful period for us. I think a lot of the trends that dominated that 21 to 23 period have started to abate. And frankly speaking, in one simple sentence, the rapid depreciation of the yen, Japanese yen, was a major factor which correlated to the so-called value behavior in Japan. And all of that started to abate, and yes, we're getting a return to great growth companies across the universe of Japanese investing, but especially in technology supply chain opportunities.

**JY:** Yes, I mean, and looking at your portfolio, I think you've got a clear overweight to technology, so you've got about roughly 31% versus 16% for the index in technology and an underweight in the more value kind of industrials and financials, I guess. So I mean, how connected is Japan to the big AI trade, which has been happening globally? Are you benefiting from that? And why do you like these technology businesses so much, and what is your sort of outlook for them?

**RK:** Thank you. On the first comment you made, you are exactly right. Our tech technology weighting in the fund is about one third. We have two other major themes, which are: the growth of Asia and Japan's work in that, and also change Japan or the social changes of the country itself in which you can invest. But technology is about a third. And on your second question, how linked are we in Japan in our portfolio to the global AI trade? We are quite linked. The people who build data centers in America or China buy stuff from us. They buy equipment, materials, software from Japanese companies, and a lot of those Japanese companies are in the Comgest Japan fund. We have no shame at all in saying that.

A lot of the Japanese companies are also indispensable and unique providers of that particular deposition tool, lithography tool, material. All of the world's semiconductors that are used in data centers, for inference, the so-called GPUs graphic processor units of Nvidia or Intel or AMD, are packaged. They have thermal resistant packages, made by two Japanese companies and basically nobody else. And I could give other examples. All of that story is very important for the Japanese technology universe and our fund has benefited from it. But again, I want to say that that's not the only theme we have in the fund. The change in Japan theme and growth of Asia themes are also quite important long-term drivers for the growth thesis in our view.

**JY:** Do you want to expand on those other themes a little bit more then?

**RK:** Thank you James. Yes, I will. First of all, regarding the change-in-Japan theme, we touched on it in the first question, but the fact that Japan has chosen a female leader is an extraordinary event, given that most developed countries have not ever made that choice. The fact that Japan has been issuing 1,300 work visas to foreigners, mostly Chinese Vietnamese but anybody can come, for a number of years now and therefore addressing its birth rate problem, addressing its labor shortage problem with very innovative policies is also fascinating. And we can invest in those themes. We invest, for example, in a company which is involved with the labor placement of women in franchising, women in the workforce. That company also works with Asian labor agencies to bring people into Japan. A lot of it is blue collar, but not only. And these changes in the way that Japan manages itself, the way Japan is trying to optimize its workflow.

We invest in a software company that does accounting software for small companies, for example, or works in cashless transaction infrastructure, for example. All of those changes as the society adapts to the new

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circumstances it faces of aging, but also having to bring in people from elsewhere to help them and think of new ways of doing things. And we invest with our fund and we believe in the constant adaptability of the Japanese since they've been the modern economy. And we invest in companies that represent that.

The other theme I mentioned real quick is the growth of Asia. Asia's obviously the biggest and most rapidly growing portion of the entire world. A lot of Asia's future is supplied by Japan. I talk about brands, I talk about contents, I talk about the tools, which Japan supplies for the industrialization of China, greater China, Southeast Asia whether it's numerical controller tools or sensors or robots themselves. Japanese companies dominate a huge amount of the industrialization story in Asia. And those companies, again, are well represented in our fund. It's companies like Fanuc and Yaskawa and Keyence and so on. And the growth of Asia is a very important dynamic to support those companies. And again, represents a very important growth theme for the Japanese market in our view.

**JY:** Yes, I mean, robotics is a very exciting area for the future potentially. And Japan, of course, has always been the world leader in robotics in my view. But can they maintain that lead? Is that a strong growth area going forward? I mean, obviously the competition is likely to become a lot fiercer, I guess, from the likes of Tesla, from China, et cetera, in terms of humanoid robots and whatever else may be coming down in the next five to 10 years. But can you get exposure to that as well in Japan and can they maintain that leadership?

**RK:** Yeah, thank you very much. I think that there are areas of robotics that the Japanese will dominate for decades. And in particular, I refer to what they call numerical controllers or basically machine tool interfaces. The things that make robots do stuff or the things that make lathes on a production line do stuff, or drills. All of those programming softwares for such tools are basically coming from Japan right now. Why can't the Chinese make them? Well, they can. Or Koreans, or Americans. It's just that Japan has decades of installed base advantage. Millions in fact, tens of millions I understand, of frequently asked questions relating to their operating software, which has made their operating software, the defaults for the control of machine tools and robots pretty much throughout the world. The robots themselves, yes, other people can make them but the control of the robots and everything that goes along with that, devices like servo motors, multi access movement, and so on have tended to be dominated by the Japanese because they control the software because of their multi-decade advantage in that area.

**JY:** Great. And just finally, I mean, what would you say to an investor who would say "Oh, I just buy the S&P" or "I just buy a global tracker" or whatever. I mean, why should they care about Japan in their portfolio?

**RK:** There are two major reasons. One is that the S&P has actually lagged the Japanese market for at least two years now. Everyone still assumes that the American market is the greatest place to invest. Well, actually, it has not been, and even when it was you could buy seven stocks. I exaggerate somewhat. But the market was vastly concentrated around the MAG7. The Nikkei or other Japanese indices have surpassed the S&P for a number of years now. And within the Nikkei again, a fund that chooses carefully the leaders of Japan, tomorrow's Japan will, we believe, continue to deliver better performance than the S&P index or the Japanese index.

A second major factor James, just to round up real quick, people don't realize that Japan, because its market went down for 30 years, stopped believing in itself. Japanese investors stopped holding Japanese equities. Japanese institutional investors still have a very small home country bias. That's changing. And the local institutional investors of Japan are some of the biggest in the world. Japan Post Bank, Nippon Life, these vast Japanese banks and trust banks, as they return to their market and invest in great companies for long duration investments to match pension liabilities. They represent a natural force which is supporting the kind

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of investment that we make in great companies that will support Japan's tomorrow. That's why we have to invest in Japan, and of course, in the style that we believe in our view.

**JY:** That's fantastic, Richard. We can really feel your, you know, your energy and passion for Japan. Thank you very much for joining us today. That's been great.

**RK:** It's been a pleasure. Thank you very much.

**SW:** Comgest Growth Japan is a concentrated portfolio of only 30-40 high-quality long-term growth companies that are either head-quartered, or carrying out their predominant activities, in Japan. To learn more about the Comgest Growth Japan fund please visit [fundcalibre.com](http://fundcalibre.com) and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.