



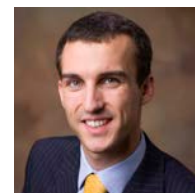
Quarterly Outlook – Japan Equities

NEW ERA BODES WELL FOR JAPANESE COMPANIES

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KEY INSIGHTS

- While the direct impact of Japan's new Reiwa imperial era on markets and the economy should be minimal, the psychological significance is important.
- The structural market reform in Japan in recent years is being reflected in record company profits, higher investor returns, and increasing foreign investment inflows.
- During the second half of 2019, Japanese equities should continue to be supported by robust company fundamentals, a stable economy, and modest global growth.

START OF A NEW ERA

On May 1, 2019, the new Reiwa imperial era commenced in Japan, as emperor Naruhito officially acceded to the throne. While the direct impact of this on the economy, markets, or politics should be minimal, the psychological significance—Reiwa translates to “beautiful harmony”—is important. It represents a symbolic clean slate for Japan, drawing a line under the beleaguered 30-year Heisei era. Given the positive economic and market changes already underway, Japan now has the potential to redefine itself and its role in the world.

Against this backdrop of change, an increasing number of Japanese companies are defying sceptics by transforming business practices and governance standards. We believe this can help corporate profit growth and generate improving shareholder returns. The volume of shareholder buybacks is increasing while merger and acquisition activity also shows promise.

JAPANESE COMPANIES CONVERGING WITH GLOBAL PEERS

From an investment perspective, the equity market is now supported by strong growth in company profits. Indeed, aggregate corporate profits have been exceptional over the past decade, with Japan breaking away from its history of lower returns to converge with the profitability levels of global market peers. The quality of Japanese companies, both in terms of governance standards, and returns for investors, has continued to rapidly improve, closing the gap with Europe and U.S. equity markets.

Over the past five years, for example, the return on equity from Japanese companies has almost doubled. Companies are allocating capital more efficiently, paying higher dividends, and increasing share buybacks, and these improved returns are attracting greater foreign investment.

QUALITY BIAS CAN SHIELD AGAINST TRADE TENSIONS

As well as market-specific drivers, the condition of the global economy remains a key factor supporting the Japanese equity market. An environment of modest global growth should continue to help corporate Japan perform well. We are, however, mindful of the trade-related tensions between the world's two largest trading partners, China and the U.S., and any escalation here is a key risk. While the ideal scenario is that trade war concerns subside and sanctions are lifted, we believe the quality bias within our portfolio holds it in good stead should the trade situation deteriorate.

Risks

The following risks are materially relevant to the portfolio.

Currency risk- Changes in currency exchange rates could reduce investment gains or increase investment losses. **Small and mid-cap risk-** Stocks of small and mid-size companies can be more volatile than stocks of larger companies. **Style risk-** Different investment styles typically go in and out of favour depending on market conditions and investor sentiment.

General Portfolio Risks

Capital risk- The value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

Equity risk- In general, equities involve higher risks than bonds or money market instruments. **Geographic concentration risk-** To the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area. **Hedging risk-** A portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended. **Investment portfolio risk-** Investing in portfolios involves certain risks an investor would not face if investing in markets directly.

Management risk- The investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably). **Operational risk-** Operational failures could lead to disruptions of portfolio operations or financial losses.

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