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Quarterly Outlook – Japan Equity

EXPECTATIONS OF POLICY CONTINUITY SUPPORT JAPANESE EQUITIES

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KEY INSIGHTS

- Prime Minister Shinzo Abe's resignation was initially taken negatively on concerns his reform and dovish agenda would be canceled.
- However, we have been encouraged by his replacement, Yoshihide Suga, and the early signs are reassuring; he seems even more focused than his predecessor on the economic reforms that we believe Japan requires.
- We also believe the expected global economic recovery next year will provide a cyclical tailwind for Japan.

Global equities were supported in the third quarter by improving macroeconomic data, dovish central banks, a better-than-expected second-quarter earnings season, and a decline in coronavirus cases in Europe and the U.S. Sentiment was boosted by expectations that the global economy is recovering and will continue to improve over the next 18 months.

Japanese equities generated a positive return but lagged developed markets slightly. Japanese growth stocks outperformed their value peers, although this abated toward the end of the quarter. This was supportive of the portfolio as we had repositioned for a reversal here in the short term as the global economy recovers from the pandemic. On a sector basis, IT and services and electric appliances and precision instruments outperformed, while electric power and gas and energy resources declined over the quarter.

THE END OF "ABENOMICS"?

Prime Minister Shinzo Abe resigned in August due to ill health, bringing to an end an eight-year term during which he established political stability, enhanced Japan's international presence, and introduced "Abenomics," a new brand of constructive economic and social reform.

Abe's resignation was initially taken negatively on concerns his reform and dovish agenda would be canceled. However, we have been encouraged by his replacement, Yoshihide Suga, and the early signs are reassuring. He has already introduced a Digital Reform Agency and seems even more focused than his predecessor on the economic reforms that we believe Japan requires.

“Japanese equities generated a positive return but lagged developed markets slightly.”

GLOBAL ECONOMIC RECOVERY TO PROVIDE A CYCLICAL TAILWIND

With Japanese companies in net cash and corporate governance standards continuing to improve—even as profits have come under pressure—the asset class is an attractive investment proposition, in our view, and trading at a discount to regional peers. As we enter the next stage of the equity cycle and the evolution of domestic and international political governance, we continue to believe that Japan is a compelling active management case given the market is under-owned and that it displays positive change dynamics. We also believe the expected global economic recovery next year will provide a cyclical tailwind for Japan.

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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