

## What goes up ...

In September, the Pelargos Japan Reiwa Fund appreciated +3.7% in euro terms, which brings the performance to +10.4% ytd. The Topix rallied +8% in the first two weeks and gave back half of its gains in the second half of the month. On September 3<sup>rd</sup>, Suga-san announced to step down, which ignited a risk-on rally as the odds of a LDP victory in the general election improved significantly. Almost exactly one month later, on October 5<sup>th</sup>, Fumio Kishida was elected as the new LDP-leader and PM. Kishida-san, which is seen as the conservative choice for continuity, replaced 18 of 20 Cabinet members, of which 13 will hold posts for the first time. The old guard, the Triple A faction consisting of Abe, Aso, Amari, is retiring into the back-seats, whilst still in control with most new appointees being their protégées. Kishida-san is the establishment's choice and is on a tight leash. The media picked up on the capital gains and dividend tax increase, however this will not happen as long as the Triple A's are still breathing air. Most importantly, one should not forget that Japanese PMs come with a short expiration date. Kishida-san is the 100<sup>th</sup> PM over a time span of 136 years. Kishida-san will be gone before taxes can be raised. At the end of this month, Japan will hold general elections and before that, investors can only expect good news from the new PM. The fiscal package is ready to go, and Kishida-san's talks about 'redistribution' is one of pushing wages higher, rather than a newly found notion of socialism. Despite extreme labor shortages, repricing of labor has not yet happened. The labor market is too rigid to allow for adjustments downward as well as upward. Abe-san was pushing for higher wages to induce 'good' inflation and this is the line Kishida-san will pursue. This is a good thing as the Japanese service sector has enormous potential for labor productivity improvements. More service output with the same labor input justifies higher wages, which support consumption against demographic headwinds. Enough about politics, at the end it's all about earnings. However, in Japan politics tend to matter more for capital markets than in many other developed economies, because of its centralized decision making with the Ministry of Economy, Trade and Industry (METI) wielding more power over the private sector compared to other developed nations.

This newsletter is normally light on macro comments; however, at occasions it is worth paying attention. Japanese equities are highly sensitive to movements in the US 10yr treasury rate. With the BOJ's yield curve control, the 10yr JGB rate is basically anchored at 0%, which effectively means the yield differential between US 10yr and JGB 10yr is determined by US rates only. The yield differential correlates closely with movements in the USD/JPY cross, thus higher yields in the US means weaker yen, which tends to be a positive for earnings of multinationals such as Toyota, Panasonic etc.. US rates increased substantially in

September and continued so far in October, this favors value over growth, cyclicals over defensives and at the same time large cap over small cap (those tend to be more domestic). The current situation is somewhat unique. The global economy is going through a demand shock sending inflation expectations through the roof, while at the same time growth is throttled down by supply chain bottlenecks and material/energy cost jumps, which is an implied tax on growth. On one hand, the risk to top line shortfalls has increased due to supply constraints and China slowdown and on the other hand margins might be hit as input costs squeeze higher. Very tricky indeed.

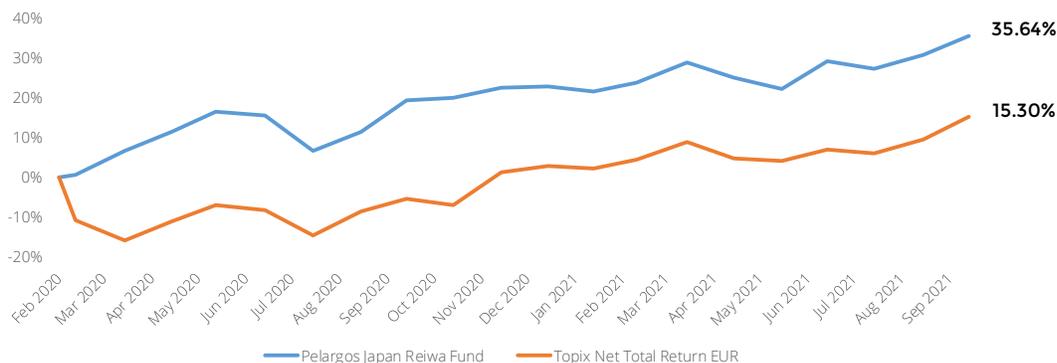
The biggest contributor was Daibiru (ticker 8806), the stock rallied +14% last month, without any material news. This position contributed 0.9%. The other significant contributors were Daiseki Eco Solutions +42% (ticker 1712), Carta Holdings +21% (ticker 3688), Murata +10% (ticker 6981) and Nippo Corp +24% (ticker 1881).

For years we have been investing in the listed pavement companies, expecting an industry consolidation. The companies we have selected were Maeda Road, Nippo Corp and Nippon Road. Maeda Road shareholders received a juicy offer for the majority stake in March last year and the company was merged with two other Maeda family members to form the new merged entity with the uninspiring name Infroneer Holding (ticker 5076). Nippo Corp received a take-over bid by its parent company (Eneos) on September 7<sup>th</sup>. The bid price is outrageously low and utterly unfair to minority holders. Since the announcement 24 million shares have traded hands, whilst there are 119 million shares outstanding and 51 million free float. Thus 50% of the free float has been traded and several vocal shareholders have stepped forward to complain about Eneos' Board of Directors (BoD) stealing Nippo Corp. from its minority shareholders. The shares have been trading above the bid price since, and unsurprisingly Eneos has refused to increase its bid. However, the pressure on Eneos' BoD is increasing with regulators having a closer look at the deal structure and validity of the process.

## OUTLOOK

Japan was somewhat late with regards to vaccinating its population, but caught up very quickly with almost 70% of its population fully vaccinated. The country currently is in full re-opening mode with office workers returning to the corporate offices. As we enter the 4<sup>th</sup> quarter of 2021, earnings season will start soon and surprises will be plentiful. The global economy turned up-side-down last year and the path back to 'normal' will certainly lead to a different 'equilibrium'. Our top 10 positions are tilted towards corporate engagement and parent-subsidiary unwind. More than ever, we pay attention to business models that have pricing power and/or able to pass through cost increases.

## STRATEGY CHARTS AND FACTS



### TOP 10 POSITIONS

DAIBIRU	7.4%
SONY GROUP	7.1%
INFO SERVICES INTL DENTSU	5.5%
HEIWA REAL ESTATE	4.4%
IDEMITSU KOSAN	4.4%
FUJITEC	4.2%
MURATA	3.8%
SG HOLDINGS	3.6%
ADVANTEST	3.6%
JTOWER	3.6%

### TOP 5 MOVERS

DAIBIRU	0.90%
DAISEKI ECO. SOLUTION	0.63%
CARTA HOLDINGS	0.57%
MURATA	0.34%
NIPPO	0.32%

### FUND PERFORMANCE\*

	PJRF	TOPIX
Month to date performance	3.74%	5.09%
Year to date performance	10.43%	11.99%
Inception to date performance	35.64%	15.30%

\*inception date 17 February 2020, Total Net Return TOPIX Index in euro performance

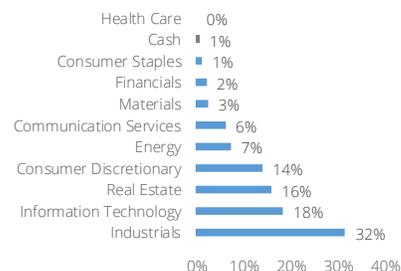
### FUND FACTS\*

Fund size in mln EUR	34.72
Fund size in mln USD	40.21
Firm size in mln EUR	170.27
Firm size in mln USD	197.19

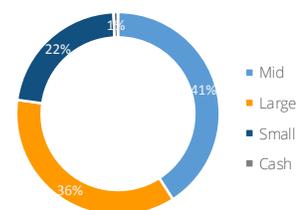
### TOP 5 SHAKERS

HEIWA REAL ESTATE	-0.38%
DAIFUKU	-0.22%
JTOWER	-0.17%
ADVANTEST	-0.11%
SG HOLDINGS	-0.11%

### SECTOR EXPOSURE



### MARKET CAP EXPOSURE



## STRATEGY PERFORMANCE

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	ITD
2021	-0.81%	1.60%	4.09%	-2.87%	-2.29%	5.72%	-1.33%	2.51%	3.74%				10.43%	35.64%
2020		0.74%	5.93%	4.50%	4.60%	-0.81%	-7.66%	4.43%	7.08%	0.54%	1.97%	0.28%	22.83%	22.83%



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