FUND COMMENTARY SICAV

EASTSPRING INVESTMENTS – JAPAN DYNAMIC FUND

A member of Prudential plc (UK)

October 2015

INVESTMENT OBJECTIVE

This Sub-Fund aims to generate long-term capital growth through a concentrated portfolio of equities, equity-related securities, bonds, and currencies. The Sub-Fund will invest primarily in securities of companies, which are incorporated, listed in or have their area of primary activity in Japan. The Sub-Fund may also invest in depository receipts including ADRs and GDRs, convertible bonds, preference shares, warrants and fixed income securities issued by Japan entities.

FUND DETAILS

Benchmark
MSCI Japan Index (Net) – used for reference purposes only

Portfolio Manager
Dean Cashman

FUM
USD 1,733m

Share class	Inception date	Currency
A	7-Feb-11	USD
A(hedged)	9-Sept-13	USD
A_s	20-Jan-14	SGD
A_s(hedged)	9-Sept-13	SGD
B	14-Dec-12	USD
C	9-Jul-12	USD
D	5-Jul-06	USD
R (hedged)	19-Dec-14	USD
R_g (hedged)	19-Dec-14	GBP

MARKET REVIEW

- In recent months, global equity market volatility has remained high, and Japan was not immune to swings in market sentiment. After falling over 15% since its August 2015 highs, Japan equities rebounded in October.

- Swings in global equity market sentiment have coincided with shorter term news flow linked to the "comforts" and "concerns" for the global cycle. Negative sentiment has often lead to the market's narrowing focus on companies with shorter term earnings visibility, which appear to be more defensive in nature. We observe the market is often overpaying for "comfort" in such companies. We avoid following the thematic preferences of the market. Instead, our approach is to let the significant share price anomalies lead us to the best potential opportunities based on valuation.

- Importantly, we continue to observe encouraging trend fundamentals at a company level, and this is a significant driving factor in the longer term re-rating for Japan. Whilst headline growth and macroeconomic indicators are drawing a mixed picture, trend earnings in Japan continue to surprise on the upside. Additionally, the labor market continued to tighten, with the jobs-to applicants' ratio advancing to 1.23 in August, the highest since January 1992. The unemployment rate is at an 18-year low of 3.4%, continuing to support the outlook for a wage-growth cycle ahead.

- Whilst earnings improvement has already been discounted in the price of some stocks, valuation dispersion remains wide in Japan. This is supportive for our approach which aims to identify and exploit extremes of valuation in the market. Additionally, there is now a strong economic imperative for companies to improve capital efficiency encouraging shareholder oriented behaviour and positive use of cash. Increased ownership of equities has sparked a rising focus on governance from domestic investors in order to "unlock value". Investor engagement with companies is beginning to focus on improving capital efficiency, increasing dividends as well share buybacks to improve total returns.

FUND PERFORMANCE

- The Fund returned 10.1% on a bid-to-bid basis (Class A) in October, in line with its reference benchmark.

- **In 2015**, the Fund returned 14.8% (Class A) compared with a gain of 10.3% for the reference benchmark.

- The Fund is a concentrated portfolio of our highest conviction investment ideas and is managed without regard to the reference benchmark. Wide deviations in performance from the market may be expected in the shorter term.

All data as of 31 October 2015 unless otherwise stated.
Not all share classes listed may be offered in your jurisdiction. Please check with your distributors on the availability.
Source: Eastspring Investments, JP Morgan Equity Research, Jefferies Global Equity Strategy.

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KEY CONTRIBUTORS

Honda Motor Co Ltd, Kaneka Corp, and Mitsubishi UFJ Financial Group (MUFG) were key contributors to the Fund performance in October.

- The market had been focused on issues relating to the cost of Honda's capacity expansion; some underperforming models; and airbag related recalls. The market has been extrapolating these risks and after an extensive due diligence using very conservative assumptions, the portfolio manager believes the Fund is being compensated for risks associated with valuation for Honda Motor Co Ltd. More recently, share price rose from low levels as the market may have begun to recognize the valuation gap.

- Kaneka Corp, a specialist chemical manufacturer, has a global leading position in products including functional plastics and specialty fibres. The market had been extrapolating cyclical pressure on earnings and poor profitability of Kaneka's thin film solar cell business and the cost of restructuring this business which, given the strong core business, provided us a valuation opportunity. Improving price performance suggests the market is beginning to recognise the longer-term sustainable earnings and the position has been used as a funding source for other attractively valued opportunities.

- MUFG has a strong balance sheet and diversified earnings stream. Specifically, offshore loans now represent approximately 40% of total loans, compared with 20% in 2005. Foreign loans may re-price as the US rate cycle normalizes, which could be supportive for net interest margins. MUFG's cost structure is stable and likely to be contained. The bank has surplus capital which meets Basel III requirements and has ample scope to pay dividends or share buybacks.

Kaneka Corp, Sony Corp, and Mitsubishi UFJ Financial Group (MUFG) were key contributors to the Fund performance in the year to date.

- **In the year to date**, The Fund benefited from stock selection in some Technology and Global Basics names, including Sony Corp, Kaneka Corp Teijin Ltd, as well as in Financials such as MUFG.

- In the context of rising market expectations and share price performance, the Fund has been gradually taking profit on Sony and fully exited the position in September. More recently, Sony Corp has taken additional steps to restructure its mobile phone business. It has also closed the PC business, which is another example of Sony's commitment to ongoing restructure. Sony stands to benefit as restructuring leads to a reduction in costs and a focus on higher value products in an asset-light, software-centric business model.

KEY DETRACTORS

- All stocks in the Fund performed positively in October. As a result, there were no detractors from absolute performance during the month.

Advantest Corp, Toshiba Corp, and Mitsui OSK Lines were key detractors from the Fund performance in the year to date.

- **In the year to date,** Advantest Corp, Toshiba Corp, and Mitsui OSK Lines detracted the most from Fund absolute performance. Amid rising risk perceptions and global growth concerns, the market continues to favour defensive stocks over those perceived to be more exposed to the global cycle. This presents opportunities for our long term relative valuation approach to exploit.

- Advantest Corp is a manufacturer of semiconductor testing equipment. Whilst market sentiment has become increasingly negative, the Fund Manager has gained a high conviction around Advantest's longer term trend fundamentals. In particular, consideration has been given to Advantest's market position and revenue growth in its core business of semi conductor testers, growth in other businesses, its ongoing R&D spending, and how it continues to address costs. It also offers exposure to an increasingly neglected segment of the market.

- We continuously monitor price and trend fundamentals for all holdings. Ongoing negative market sentiment has impacted the share price for Toshiba and the accounting issues have created a significant price episode. The opportunity is underpinned by a significant valuation upside that more than compensates the Fund for the associated risks. Our detailed due diligence applies conservative assumptions to build our understanding of the likely level of sustainable returns for Toshiba. Our team analysis and debate has considered, amongst others, issues relating to cash flows; contingencies for impact of improper accounting on past results; nuclear power projects overruns; and dilution risk. In understanding their effect on the likely level of longer term sustainable earnings, the team has also considered the potential for meaningful write downs and whether they are likely to be ongoing or a one off matter. We will continue to respond to changes in price and trend fundamentals.

- A position in Mitsui OSK Lines (MOL) was built when the shipping industry had entered a weak global cyclical environment with a significant over supply in the shipping fleet. Shipping rates and profitability were falling sharply. Our analysis suggested MOL was trading at a significant discount to the replacement value of its entire fleet. Positive signs are emerging that overcapacity in the shipping industry is beginning to be addressed.

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FUNDCOMMENTARY SICAV

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FUND ACTIVITY

Profits were taken in outperforming stocks and cash has been redeployed to high conviction names.

- During the month, the Portfolio Manager sold shares in outperforming companies, where valuations look relatively less compelling compared to other high conviction positions. This included selling shares in companies such as Ricoh Co Ltd, East Japan Railway Co, and Sumitomo Forestry. The Fund also sold out the remaining position in Mitsui Chemicals.

- The Portfolio Manager took advantage of relative share price weakness to add to Toshiba Corp, JSR Corp, Daiichi Sankyo, Nomura Real Estate Holdings, Sumitomo Corp, and Rohm Co Ltd.

STRATEGY AND OUTLOOK

The Fund will continue to focus on the numerous valuation outliers with significant sustainable earnings potential.

- The market's shorter term focus on thematic macroeconomic news flow can drive significant share price anomalies for the Fund to exploit. The approach is to look through, and exploit, shorter term market volatility by applying a disciplined long term valuation approach.

- Importantly for our investment approach, relative valuation dispersion in the market remains wide with the number of out-of-favour, relative valuation outliers increasing. This market dynamic presents opportunities for our valuation discipline to exploit.

- We note that there are many companies in strong financial health. Corporate improvement was driven by meaningful restructuring at the company level. The strength of earnings improvement remains underappreciated by the broader market.

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Eastspring Investments (Singapore) Limited (UEN. 199407631H)
10 Marina Boulevard
#32-01 Marina Bay Financial Centre Tower 2
Singapore 018983
Tel: 6349 9711 | Fax: 6509 5382

eastspring.com.sg