Baillie Gifford™

Japan Trust: manager insights

December 2023

Investment manager Matthew Brett discusses performance and why developments such as rising entrepreneurialism and progress in AI make for compelling growth opportunities in Japan.

Your capital is at risk. Past performance is not a guide to future returns.

Hello, and welcome to this annual update of the Baillie Gifford Japan Trust. My name is Matthew Brett, and I am the Trust's manager.

As a reminder, the Japan Trust aims to deliver long-term capital growth through investment in companies which we believe have above-average prospects for growth, and mainly focuses on those of medium to small size.

In this short update, I will talk about performance, portfolio changes and the reasons we are excited about the future.

Performance

Recent performance has been disappointing. Over the year to 31 August 2023, the Baillie Gifford Japan Trust PLC's net asset value total return per share was -5.4 per cent compared to the +6.7 per cent total return of the TOPIX Index, in sterling terms.

The sectors that are driving the growth in the market are traditional value sectors like cars, mega-banks and some industrial companies. These are areas where we have little exposure, as we believe these types of companies offer little fundamental opportunity for growth investors.

The market backdrop has been unhelpful for the types of growth companies that we invest in. It is always difficult for us to assess when businesses will become better appreciated, which is why we try to focus more on the underlying progress of sales and profits in the expectation that, over the long term, these will be reflected in share prices. Like you, we would have preferred to see significantly better share price results over the past couple of years but, in general, we see solid ongoing progress at individual businesses and take significant comfort from that.

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Reflecting this operational progress, the Board has decided to propose a final dividend of 10p per ordinary share. This represents an 11 per cent increase on the 9p paid last year.

Portfolio update

Our focus has been on continuing to try and improve the portfolio. During the past year we have bought nine new holdings and sold seven.

We have been able to take advantage of the high levels of pain being felt in smaller growth companies' share prices to initiate holdings in companies such as Vector, the public relations agency, SWCC Showa, which makes high-voltage cables, Nihon M&A, which does mergers and acquisitions in Japan, and Lifenet, the online life insurer. The very large share price moves have exceeded the changes in company fundamentals, which we believe presents opportunities for long-term investors.

The sales that we made spanned a variety of reasons, from considering the shares to be fully valued due to cyclical increase in resource prices, such was the case for Inpex and Toyota Tsusho, or becoming doubtful on the long-term prospects, which was the case for Shimano and Makita.

Overall, the turnover remained low at around 9 per cent, meaning that more than 90 per cent of the portfolio was unchanged when compared to the previous year. Net gearing decreased to 17 per cent, reflecting our belief in the significant opportunities available.

Investment landscape

The most significant development of the year from an investment perspective has been the leap forward in artificial intelligence large language models, such as ChatGPT. AI can be thought of as comprising multiple layers: chips, datacentres, models, and applications, for example. Currently much excitement has been about the opportunity in the first layer, chips, but as time progresses, we expect a broader view to be taken about where the opportunities are.

The investment landscape remains complex and at times contradictory, but technological progress and the investment opportunities that flow from it remain a constant. We expect this technology shift to provide opportunities for many of the companies within the portfolio including, but not limited to, Softbank, Rakuten, CyberAgent and GMO Internet.

We're seeing more entrepreneurial, founder-led businesses in Japan than ever before, and around 30 per cent of the portfolio has a founder-owner, which is more than three times that of the market. Over the long run, we think these businesses are more likely to act entrepreneurially in seizing new opportunities than a business run by 'salarymen' being pushed along by short-term pressure from shareholders.

Looking forward

We recognise that the past two years have been difficult for shareholders of the Japan Trust and we hugely appreciate your support.

We are sticking to an approach that has been effective over the decades of trying to buy businesses with attractive long-term growth prospects, not fiddling with the portfolio, and letting those businesses generate the returns over time. This approach has never worked every year, and the past two years have been a particularly challenging time.

However, we believe that the opportunities for growth investing in Japan are the greatest since the Global Financial Crisis and ask for shareholders' continued support.

Annual past performance of The Baillie Gifford Japan Trust PLC to 30 September each year (net %)

	2019	2020	2021	2022	2023
Share price	-3.3	6.6	16.3	-29.0	-2.5
Net Asset Value	0.6	9.3	14.3	-25.2	0.5
TOPIX Index	-0.3	2.4	15.6	-13.5	15.1

Source: Morningstar and TOPIX. Total return, sterling.

Past performance is not a guide to future returns.

Important information and risk factors

This film was produced and approved in December 2023 and has not been updated subsequently. It represents views held at the time and may not reflect current thinking.

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The specific risks associated with the **Japan Trust** include:

- The Trust invests in overseas securities. Changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.

- The Trust can borrow money to make further investments (sometimes known as "gearing" or "leverage"). The risk is that when this money is repaid by the Trust, the value of the investments may not be enough to cover the borrowing and interest costs, and the Trust will make a loss. If the Trust's investments fall in value, any invested borrowings will increase the amount of this loss.

- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.

- The Trust can make use of derivatives which may impact on its performance.

- Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.

- The Trust's exposure to a single market and currency may increase risk.

- Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.

- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.

- The aim of the Trust is to achieve capital growth. You should not expect a significant, or steady, annual income from the Trust.

Further details of the risks associated with investing in the Trust, including a Key Information Document and how charges are applied, can be found in the Trust specific pages at www.bailliegifford.com, or by calling Baillie Gifford on **0800 917 2112**.