

Baillie Gifford Japan Trust: Manager Insights

December 2024

Investment manager Matthew Brett explores the trust's performance, strategic shifts towards sustainable growth, and the exciting potential of Japanese technological advancements and AI.

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

Matthew Brett: 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.

In the 12 months to the end of August [2024], the trust's net asset value (NAV) rose 10 per cent. A good outcome in absolute terms, but unfortunately this number lagged the 14.7 per cent return delivered by the market and a widening discount resulted in a less impressive 4.4 per cent share price total return during the period.

Although disappointing, these numbers hint at an inflection point in Japanese equity market returns - which is a good sign for the trust's prospects.

Since Covid, Japan's market has enjoyed a significant cyclical upswing. Growth has been in abundance. Volumes were turbo-charged on the resurgence of global economic trade and prices for Japanese products were effectively hiked thanks to a complementary fall in the currency.

Roll forward a few years, to 2024, and these stimulatory cyclical factors are now starting to subside. This change threatens Japan's export orientated market and the sustainability of profit margins for some of its biggest auto and industrial constituents, which we don't own. In contrast, our portfolio has leant away from cyclical companies, towards companies exposed to more sustainable secular sources of growth.

Portfolio update

The market's preference for cyclical stocks opened-up attractive entry opportunities in several structural growth themes, resulting in 6 new purchases during the year.

Two of these are within healthcare, including Eisai (which has pioneered the world's first approved drug that addresses one of the root causes of Alzheimer's) and Nakanishi (a manufacturer of ultra-high speed & ultra-precision spindles with rising dental and surgical application).

We also added to several stalwart growth companies: with the purchase of Nippon Paint and Kansai Paint, which have leading share in China and India, respectively, two of world's fastest growing markets for paint; we also added to our skincare exposure with the purchase of Kosé, known for its prestige brands like Albion, Decorté and its "clean beauty" brand Tarte, which place the company in prime position for rising consumer spend within the region.

The final purchase was Daikin, a market leader in air conditioning technology. Daikin is catering to rising worldwide demand for energy-efficient air conditioning units, which by some counts, are projected to increase from a 2 billion base to over 5.6 billion units by 2050, equivalent to 10 new air conditioning units being bought every second until 2050.

These structurally supported growth opportunities were funded from the sale of 5 positions: Outsourcing, which was the subject of a management buyout; and also MS&AD Insurance, Denso, Iida and ITOCHU, where the forward-looking growth prospects have diminished.

Prospects

Looking forward, in the absence of abundant growth and stripped of cyclical support, the margins of some of Japan's largest companies could become strained.

In contrast, those that are addressing secular trends (like Daikin or Eisai) will be far more capable of delivering sustainable earnings growth.

Strong operational improvements from several of our most significant overweights, like SoftBank, CyberAgent and Rakuten, already support this thesis. And their success is only just beginning to be rewarded by the market.

After such an unfavourable period, the tide is beginning to turn in our favour. An improving market backdrop, with the acceleration and confluence of several technological advancements, especially within the AI field, make it a particularly exciting juncture for growth investing.

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

	2020	2021	2022	2023	2024
Share price	6.6	16.3	-29.0	-2.5	8.4
Net Asset Value	9.3	14.3	-25.2	0.5	10.9
TOPIX Index	2.4	15.6	-13.5	15.1	10.7

Source: Morningstar, Tokyo Stock Exchange, total return in sterling.

Past performance is not a guide to future returns.

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- 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**.