

FUND PROFILE

RSMR

**T. ROWE PRICE
JAPANESE EQUITY FUND**

August 2019



OUR RESEARCH. YOUR SUCCESS

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T. ROWE PRICE JAPANESE EQUITY FUND

OUR FUND PROFILES provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an ‘under the bonnet’ view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk.

The **T. Rowe Price Japanese Equity Fund** has been one of our rated funds since January 2018. It is a multi-cap Japanese equity strategy which launched in April 2006 (SICAV). The investment approach is bottom-up fundamental analysis focusing on high-quality, growth companies that are attractively valued – this includes both transformational secular growth companies which are ‘on the right side of change’ and those companies that are undergoing ‘fundamental improvement’ where growth is mispriced. The fund typically holds between 60 and 100 stocks with a long-term focus resulting in an average holding period of three to five years.

The fund has been managed by Archibald Ciganer since December 2013. He is based in Tokyo and supported by a well-resourced analyst team who benefit from their locally based presence. Since taking over the fund, the manager has generated top decile performance within the sector, with strong stock selection being the key driver to performance.

Overall, we believe that the strength of the locally based research resource at T. Rowe Price, coupled with an experienced fund manager, makes the fund a suitable option for investors seeking exposure to Japanese equity markets.



Patrick Morris, Investment Research Manager, RSMR

Patrick joined RSMR as an Investment Research Manager in 2017. His primary responsibilities include fund manager research and selection across the Investment Association universe and advisory work for intermediary clients. He is a member of the asset allocation and sector review committees at RSMR. Prior to joining RSMR, Patrick worked as an investment manager at BCWM where he managed a portfolio of private and corporate clients advising on pensions, investments and estate planning. Patrick began his career qualifying as a Chartered Accountant (ACA) with Crowe Horwath. He holds a Masters of Finance from Trinity College Dublin and has passed CFA level I.

IA JAPAN SECTOR

The T. Rowe Price Japanese Equities Fund sits in the IA Japan sector. Funds in this sector invest at least 80% of their assets in Japanese equities.

The Japan sector contains over 70 funds available for investors and financial advisers to choose from, covering a large variety of investment strategies and styles, including active, passive and enhanced index funds. A number of funds adopt style or market-cap based strategies including value and growth-biased themes, market-cap focused or multi-cap strategies. Funds that invest in a specialist theme must still meet the required geographic dispersion based on the relevant index.

The variations between the funds makes it difficult for an investor to compare them as different strategies will clearly perform differently depending on market conditions. It is important to recognise this when looking at both absolute and relative performance numbers for funds in the IA Japan sector, and this is particularly relevant for the T. Rowe Price Japanese Equity fund, which has a distinct style of investing.

Since the election of Shinzo Abe as Prime Minister in December 2012, his economic strategy, referred to as Abenomics, has been aimed at escaping deflation through monetary expansion, fiscal stimulus and structural reforms. Whilst Abenomics has been a mixed bag, it has had some successes. The labour market has tightened significantly and there is now some wage growth which, whilst still sluggish, is an improvement on the pre-Abe days. Inflation has yet to hit the Bank of Japan's target of 2%, although deflation has ended for now. Stronger corporate governance in

the form of more independent directors, reductions in cross shareholdings and higher levels of dividends/buybacks is an improving trend while urbanisation rates are also increasing, leading to a rise in middle class income earners. Abe's re-election as leader of the main ruling Liberal Democratic Party in September 2018 puts him on track to continue his reformist agenda.

The Japanese yen has historically been a safe haven currency for investors during times of market uncertainty. This is a function of a net exporting economy with a large current account surplus, resulting in Japan being one of the largest creditor nations in the world. These flows can lead to a higher level of market cyclicality whereby market direction is often inversely correlated to the strength of the yen. Despite this trend however, Japan is home to some of the leading industrial and manufacturing companies in the world which are disrupting traditional business models. This technological innovation, paired with positive structural reforms, means that funds investing in Japan offer strong diversification benefits for investor portfolios.



T. ROWE PRICE

T. Rowe Price Group is an independent, global investment management firm, offering a full range of equity, fixed income, and asset allocation strategies across multiple sectors, styles, and regions. The company, founded in 1937 by Thomas Rowe Price, Jr, is publicly traded and listed on the NASDAQ stock exchange and included in the S&P 500.

Proprietary fundamental research is core to their ability to identify long-term investments. This entails rigorous analysis at the regional, sector, industry, and company level to identify promising investment opportunities—and those to be avoided. The company has built a global investment team of over 500 individuals who work collaboratively to manage client assets.

T. Rowe Price serves clients in over 40 countries from 16 offices around the globe and is one of the largest active fund managers in the world.



JAPANESE EQUITY FUND

Manager	Archibald Ciganer
Structure	OEIC and SICAV
IA Sector	IA Japan
Launched	Japanese Equity Fund OEIC – 13th March 2017 Japanese Equity Fund SICAV – 11th April 2006
Fund Size	£161.1m as at 30.8.19

Fund Management Team

The fund is managed by Tokyo-based manager Archibald Ciganer, who has ultimate responsibility for the construction of the portfolio. He is supported by eight dedicated Japan analysts, who are predominantly split by sector with small-cap responsibilities also allocated among team members.

The manager can also leverage the global research platform at T. Rowe Price, comprising approximately 165 equity research analysts and over 60 senior equity investment managers based in various locations including Baltimore, London, Tokyo, Hong Kong, Singapore, Sydney and Zurich.

Archibald Ciganer, Fund Manager (Since December 2013)

Archibald Ciganer is a vice president of the T. Rowe Price Group, Inc and T. Rowe Price International Ltd. Since December 2013, he has been the portfolio manager for the Japan Equity Strategy, having previously covered the telecom, transportation, utility, media and consumer sectors as a research analyst. He joined T. Rowe Price in 2007 having begun his career as a credit analyst with BNP Paribas in Japan. He also worked in the firm's Investment Banking Department and more recently as a vice president in Mergers and Acquisitions. He graduated from the Paris Institute of Political Studies with a degree in finance and accounting, and has also earned the Chartered Financial Analyst designation. He is fluent in Japanese, English and French.

Fund Objectives & Targets

The objective of the fund is to identify high quality companies to hold for the long term in order to benefit from the compounding effect. The fund targets a return of 3% or greater (gross of fees) in excess of the

benchmark (TOPIX Index) over a full market cycle (three to five years). The manager aims to construct a portfolio of between 60 to 100 stocks to achieve this outperformance with turnover expected to be within the 25% – 75% range depending on market conditions.

Portfolio weightings are a residual of the stock selection process but sector allocations are expected to be within +/- 10% of the benchmark while position sizes are limited to +/- 4% with a minimum position of 0.4% in absolute terms. The tracking error in the fund is expected to be 3% to 6% per annum. The active share in the fund is generally above 80%.

Investment Philosophy

The investment philosophy is driven by the belief that long-term growth in earnings and cash flow creates shareholder value in the Japanese market. The team believe they can add significant value to investors over time by investing in companies that exhibit sustainable growth across the market-capitalisation spectrum. This can include both transformational secular growth companies which are 'on the right side of change' and those companies that are undergoing 'fundamental improvement' where growth is mispriced. Bottom-up fundamental research is critical in the stock selection process and they believe that patience is also a source of excess returns.

Investment Process

The investment process begins by filtering down the investment universe which comprises approximately 1,200 companies, across the full capitalisation range above US\$300 million. The manager uses a multifactor proprietary screening process as an initial screening tool narrowing the opportunity set to around 450 companies. All industries are considered within this process. The dedicated analyst team then conduct fundamental research and analysis on the opportunity set to confirm growth prospects and assess valuations. This in-house research is the most important source for value added.

The analyst team is both multicultural and multilingual and based predominantly in Tokyo although team members also sit in Singapore,

Hong Kong and London. They are organised across designated sectors with some small-cap responsibilities also allocated among team members. The analysts seek to identify companies that can consistently deliver top and bottom-line growth over the economic cycle while generating healthy cash flows. They typically focus on four main areas in their initial assessment of a company – industry characteristics, the business model, the management team and the stock price valuation. When analysing the industry characteristics, the analyst identifies whether the industry has high barriers to entry, they review the main players in the market and select companies which have the ability to gain market share conducive with sustainable growth. Quality and franchise value are also important characteristics. The business model assessment compares sustainable debt-to-equity ratios and the potential for shareholder value creation. Some companies may have reversed a trend where there is a noticeable improvement in fundamentals. Valuation analysis is conducted to confirm the attractiveness of an investment based on free cash flow yield and prospective free cash flow growth.

Company site visits and face-to-face meetings are a core component of the research process, given the local presence of the team. These meetings are used to gain a first-hand insight into how the company operates and to scrutinise the management's strategic vision. The team will often discuss a company management's ability to execute their plan and the resources needed for them to achieve their objectives. The capital allocation record of the management team is important and whether they own stock or have incentives tied to shareholder returns. The analysts may also meet with competitors, customers and suppliers, as well as other industry experts. The investment process is predominantly bottom-up, although there is a top-down element whereby the team can leverage the expertise of other specialists at T. Rowe Price for macroeconomic analysis. A high level of communication across the team promotes an understanding of risk factors with macro and political assumptions incorporated into the analysis of each investment opportunity.

The dedicated analyst team rate investment candidates within their coverage from 1 (highest) to 5 (lowest). The remaining stocks are

monitored closely and may also have models built for them if they attract attention. The analyst team are also encouraged to generate their own stock ideas while a paper portfolio (The Japan Research Strategy) is also run where analysts assign relative weights to every stock under their coverage within the TOPIX Japan Index to express their individual conviction. In the second half of 2018, the company also rolled out a new proprietary 'Responsible Investment' rating system which is now fully integrated into the overall research process. This system is also used to rank companies according to their Environmental, Social and Governance ('ESG') considerations and strengths. In-house specialists work with the analysts and portfolio managers to identify ESG risks and to highlight factors which may have a material impact on investment performance. The analyst rankings, along with the RI ratings, are documented in a proprietary database, known as the Research Management System (RMS), along with a detailed description that includes the analyst's rationale for the stock rating and the relevant analysis of the company, which incorporates financial metrics, valuation, ESG as well as other relevant factors. This is distributed daily to update any rating changes and company visits for example.

In terms of portfolio construction, the manager has sole decision-making responsibility. Position sizes are determined by the level of conviction the manager has in a company (within the risk parameters of the mandate). He is actively involved with the analyst team during the idea-generation and refinement process and will cross-reference analyst output with his own analysis when seeking investible companies. He may also test the assumptions within their models to ensure that the risk/reward ratio for each security remains attractive. Stocks are added to or trimmed as they become oversold or overbought respectively – this rebalancing process is a key driver of the sell discipline. A material change in the initial investment thesis, for example where earnings forecasts have changed based on a revision of company fundamentals or where growth areas of a business have not evolved as anticipated, may also trigger the sell discipline.

Risk management is of fundamental importance and runs through the investment process. Portfolio managers, as the risk owners, are



supported by the Enterprise Risk Group (ERG), with oversight by the Risk Management Oversight Committee and the International Equity Steering Committee. The head of equity risk meets with the manager on a quarterly basis to discuss key outputs and trends. The manager also has access to daily reporting on portfolio positioning and risk exposures including tilts in market-cap, sectors, regions and a range of other risk metrics. The manager and traders are partners throughout the life of each trade as the traders contribute market perspective and company specific details. The trading team actively monitor liquidity in prospective and existing investments and the investment risk team distribute bi-weekly, monthly and quarterly reports to the manager. Currency exposure is assessed at an individual security level rather than a fund level.

PAST & CURRENT POSITIONING/STRATEGY

A key differentiating feature of this strategy is a higher weighting towards mid and small cap names relative to the benchmark. The investment-weighted median market capitalisation in the fund averages approximately \$8.5bn compared to the TOPIX Japan Index of over \$16bn. At the end of Q1 2019, the fund held 43% in large caps (54% index weighting), 28% in mid-caps (31% index weighting) and 29% in small caps (16% index weighting). The fund profile results in a higher number of holdings relative to other funds in the sector as maximum position sizes vary with market cap and liquidity. The manager does however take conviction in his approach with the top ten names typically accounting for 30% of the overall portfolio.

The fund is generally split between secular transformational growth companies (75% – 80%) and fundamental improvement companies (20% – 25%). This style bias typically leads to the fund being structurally overweight sectors such as machinery, IT and services and generally underweight in lower quality areas including banks, metals and construction. In the machinery sector, there are a number of holdings which are market leaders in their industries including Miura, Daikin and Hoshizaki. Miura is Japan's top boiler manufacturer, Daikin, the world's leading air conditioning manufacturer and Hoshizaki is an established manufacturer of commercial kitchen and food service equipment. In the service sector, the manager believes that a tight labour market is positive for staffing agencies and has exposure to this theme through Solasto and Recruit Holdings. Electrical appliances and precision instruments is another area where the manager has found attractive growth stories with FANUC, a world leader in the production of industrial robots, being a notable holding. The fund has historically been underweight banks as they tend to underperform in an ultra-low interest rate environment while competition in the sector is very high, leading to an almost unlimited supply of loans at very low rates. Two notable exclusions which are large constituents in the index include Mitsubishi UFJ Financial and Sumitomo Mitsui Financial.

Some of the larger index constituents held in the fund include Softbank Group, Keyence, Nippon Telegraph and Telephone ('NTT') and Takeda

Pharmaceuticals. Softbank Group, a holding company mainly engaged in communication and internet related businesses gives the fund exposure to a range of fast-growing technology names including Alibaba, Uber and Nvidia. The manager covered this company as an analyst and believes that owner-manager Masayoshi Son has demonstrated excellent allocation of capital in the past. Keyence, a company which produces vision and laser sensors used in factory automation, is viewed as a high returns business in an industry that is secularly growing. NTT is one of the largest telecommunications companies in the world. The holding company operates through a number of segments including regional, international, mobile and data communication businesses while NTT DOCOMO, a separately listed subsidiary of NTT, is also held as the predominant mobile phone operator in Japan. The team are also positive on Takeda Pharmaceuticals, which was recently granted approval to manufacture and market an arthritis drug in Japan. Toyota, Sony and Honda are large index constituents which have not been held in the fund for some time.

Given the preference to identify companies further down the market-cap spectrum, the fund often invests in companies that are not listed on the benchmark, which can account for 10% to 15% of the fund on average. Some notable holdings include Miura and Solasto, which are both referenced above, while Daio Paper is also a large weighting in the fund. Daio Paper is primarily engaged in the manufacture and sale of paper products. Some other companies which are held on the index, and are large overweights in the fund, include GMO Payment Gateway, the largest payment processor in Japan, SMS, which is focused towards creating an information infrastructure for an aging society and Chughai Pharmaceutical. More recently, the manager has sold Japan Tobacco, due to increasing concerns about the threat of heat-not-burn products to their market share while a new position was initiated in Hamamatsu Photonics, a global leader in products that work with emitting or detecting particles of light. The team also participated in the IPO of Softbank Corporation, one of Japan's largest wireless carriers, in Q4 2018.

The manager does not want the performance of the fund to be driven by macro factors – for example, holding domestic orientated companies

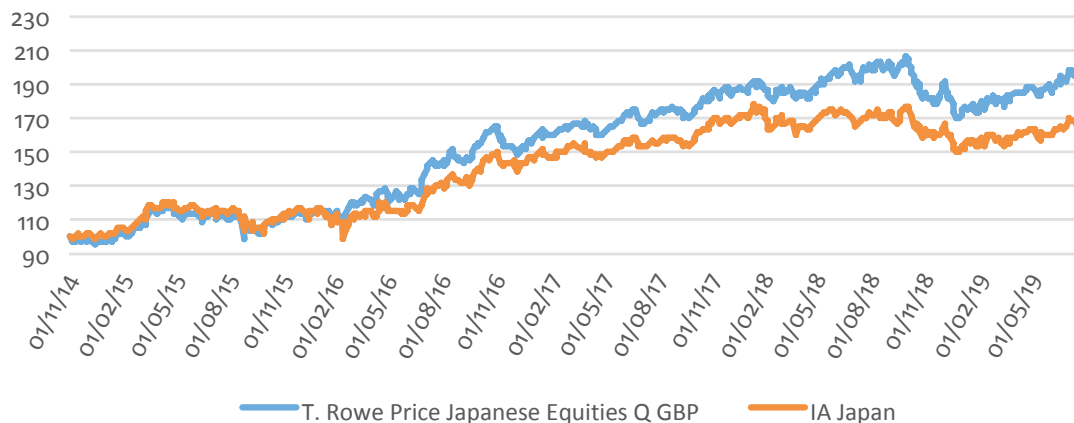
which tend to perform well when the yen is strong, and export orientated names which tend to perform well when the yen is weak. For this reason, he closely monitors the balance of domestic and overseas earners in the fund. As banks fit into the category of being domestic cyclicals, the manager takes compensating exposure in both domestic and cyclical names. The manager remains positive on the backdrop for Japanese equities going forward believing that corporate earnings growth is likely to exceed global peers. He is confident that the quality bias, paired with the neutral currency positioning, can offset the risks of investing in smaller companies during periods of market downturns.

PERFORMANCE

Performance History

1st November 2014 – 31st July 2019

Rebased to 100



Source: T. Rowe Price

**The UK OEIC product of the strategy launched in March 2017. Due to the short performance history, we have illustrated the strategy performance using the Luxembourg based SICAV product which has a longer performance history. The underlying securities held in both products are the same, however they may have different weighting in the portfolios at certain times due to trading and settlement times varying.*

Archibald Ciganer took over the management of the Luxembourg-based SICAV strategy on 27th December 2013. Since that date to 31st July 2019, the fund has generated top decile returns of 102%, outperforming the sector average returns of 71.9%. The fund has exhibited strong alpha generation in upward trending markets with stock selection in the small cap area contributing significantly to returns. It can however exhibit higher levels of annualised volatility than the sector average given its underlying profile.

The fund posted negative returns of -3.27% in 2014 lagging the sector average which ended marginally positive at 0.62%, as stock selection within IT and services was the main detractor to performance. These sectors however, were the main source of alpha generation over the following three years, with the team identifying strong growth companies further down the market cap spectrum. Examples of such names include Miura, GMO Payment Gateway and SMS Co Ltd. Two stocks in the retail trade sector, Start Today and Seria, have also contributed strongly. The former, an e-commerce retailer and business developer, continued to benefit from the long-term shift taking place toward online retail purchases. Seria, which is not in the benchmark, operates discount stores where all items are priced at JPY ¥100, an attractive pricing model in an environment where wages have been stagnant. Automobile company Suzuki was another notable performer as it has capitalised on the fast-growing Indian vehicle market thanks to its Indian business, Maruti Suzuki

India. In terms of calendar year performance, the fund generated returns of 21.07% (2015), 32.7% (2016), and 20.3% (2017) ranking top quartile within the sector in 2015 and 2016 and second quartile in 2017.

In 2018, the fund lost -7.8% relative the sector average losses of -11.4%. The first quarter of the year was flat due to growing concerns about a global slowdown and a possible trade war. During the summer months however, the fund performed strongly and posted returns of 10.7% (sector average 3.5%) for the first nine months of the year. Stock selection in the service sector was strong during this period with companies such as SMS, Benefit One and Solasto contributing to performance. In Q4, Japanese equities fell sharply amid a widespread sell-off in global equity markets. The main underperformers during the quarter included those sectors that would be most at risk from trade conflict, a stronger yen, or a slowing economy, including areas such as machinery, electric appliances and precision instruments. Following a period of sector leadership, IT stocks also sold off sharply, alongside their global counterparts. The overweight towards these areas resulted in the fund falling -16.8%, further than the sector average losses of -14.6%. At the company level, the largest detractors over the quarter were Hoshizaki Corporation, Miura and Softbank Group.

In the first seven months of 2019, the fund has returned 16.3% relative to the sector average returns of 13.7%. Despite the mixed economic data in Q1, the IT and service sectors rebounded strongly from Q4 with GMP Payment Gateway, Softbank and Benefit One contributing to returns. A notable overweight in pharmaceutical companies Chugai and Takeda also benefitted as both were granted approvals for different drugs. The market was more subdued in Q2 as uncertainty about demand had an outsized impact on the direction of the market. The lack of exposure to banks, electric power and the gas sector has also contributed to relative returns through 2019.

SUMMARY & EVALUATION

This is a multi-cap growth-orientated portfolio typically holding between 60 and 100 companies. The investment philosophy is bottom-up fundamental analysis seeking durable companies on the right side of change. The fund is generally split between secular transformational growth companies (75% – 80%) and fundamental improvement companies (20% – 25%). This style bias typically leads to the fund being structurally overweight in sectors such as machinery, IT and services and generally underweight in lower quality areas including banks, metals and construction. There is a long-term focus resulting in an average holding period of three to five years. The team also seek compelling opportunities outside the benchmark which can often represent between 10% – 15% of the overall fund. This leads to a high active share typically in excess of 80%.

T. Rowe Price are well known for the strength of their in-house analytical resource. They have built a strong Japanese equity analyst team, with six team members, including the fund manager based in Tokyo. This local presence enables on-the-ground research with a high emphasis on meeting with company managers. This is particularly relevant in the Japanese market where an understanding of cultural nuances can create deeper insights into company objectives and performance. It also enables the team to keep close contact with companies further down the market cap spectrum – a key differentiator for this fund within the sector. This is combined with input from the global research platform on secular growth trends.

The fund has been managed by Archibald Ciganer since December 2013. Archibald, a fluent Japanese speaker, worked in Japan for a number of years prior to joining T. Rowe Price in 2007. Since taking over the management of the fund, he has generated top decile performance within the sector. The main driver of this outperformance has been

strong stock selection, particularly in the small cap area of the market, highlighting the strength of the analytical team working under the manager. An environment of strong earnings growth momentum is a tailwind for this type of fund. The fund may underperform during periods where there is a deep value rally led by low quality speculative companies. Additionally, given the multi-cap composition of the fund, it can lag the market when large-caps outperform in more defensive markets. Given the nature of the fund, the annualised volatility can be higher than the sector average.

Overall, we believe that the strength of the locally based research resource at T. Rowe Price, coupled with an experienced fund manager, makes the fund a suitable option for investors seeking exposure to Japanese equity markets.

ABOUT US

RSMR

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality and without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.



Ratings

Our innovative range of ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

Our research. Your success.

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