Kepler | Trust Intelligence

Investing in Japan with investment trusts

Investment trusts can help investors benefit from Japan's corporate governance reforms...

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In the space of around four decades, we've gone from a world where Tokyo's Imperial Palace was worth more than all the real estate in California combined to one where Apple, America's largest company valued at c. $3.6 trillion, is worth almost as much as the 191 companies housed within the MSCI Japan Index combined, which have a total market cap of $3.8 trillion.

Japan's real estate and stock market bubble peaked in late 1989, with land values and share prices falling steeply during the 1990s. The nineties represented a lost decade for Japan, with GDP growing just 1.14% annually – less than a third of the rate it grew by during the eighties.

Today, however, things are looking up. The Nikkei 225, Japan's benchmark stock index, finally eclipsed its 1989 record high in February 2024. That record high was just shy of 39,000 and the market continued to advance, hitting c. 42,000 in July.

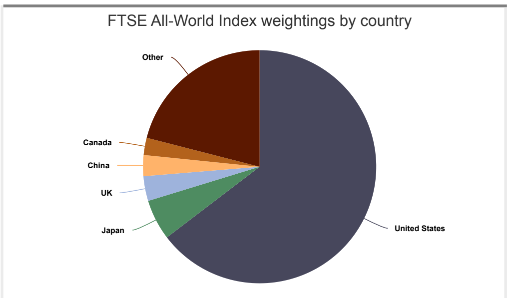
As with many markets, it's traded sideways since then, currently trading at c. 39,500, but there are countless reasons why Japan can continue its ascent in the years ahead.

Why invest in Japan?

Global importance

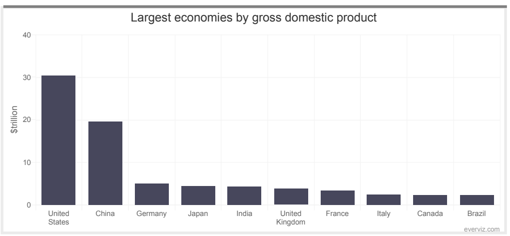
When Japan was really in its heyday more than three decades ago, its weighting within global stock markets peaked at c. 42%. Today, it's a fraction of that, at c. 5.6% but that still makes it one of the key players in the world of investments, as you can see below.

Fig.1: A Key Player In Global Markets



Source: FTSE Russell

Fig.2: An Economic Heavyweight



Source: International Monetary Fund

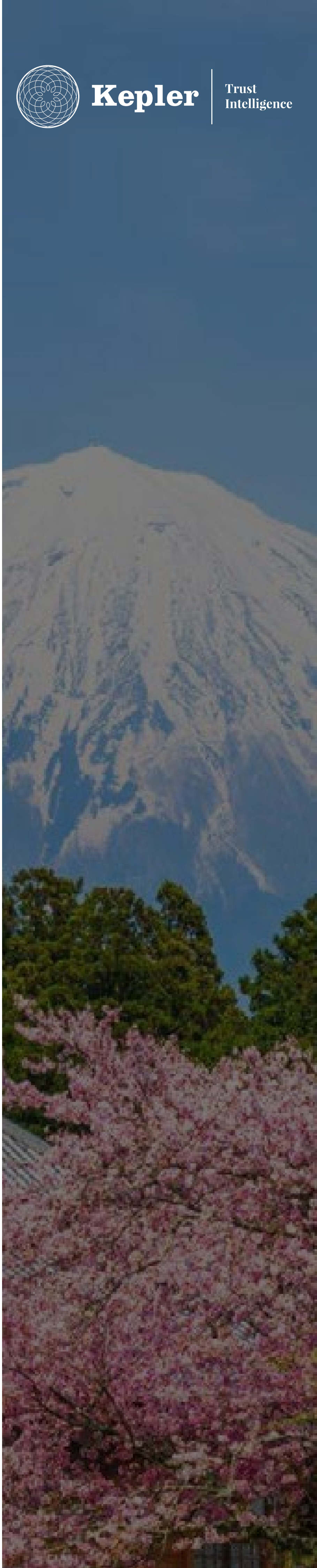
The US continues to take up the bulk of the FTSE All-World Index, but Japan is the second-largest country represented in that index. Indeed, Japan accounts for about one-and-a-half times the size of the UK's weighting.

In addition, with nominal GDP for 2025 of c. $4.4 trillion, according to the International Monetary Fund, Japan is the fourth largest economy in the world, narrowly behind Germany.

With all of this in mind, it makes sense that investors should consider investing in Japan and that the country should form a key part of their portfolio, particularly if you consider that an all-equity index investor has just over 5% of their cash invested there.

Corporate governance reforms

A key structural driver of Japanese equity markets looking forward are meaningful changes to corporate governance standards, which were instigated by the former prime minister Shinzo Abe shortly after he was elected in 2012, forming part of his economic policies known as Abenomics. While this has been an ongoing push over the past decade, meaningful progress has been made in recent years.



Historically, Japanese corporate governance standards meant that many firms would retain earnings but not reinvest or pay dividends. They also had cross holdings designed to prevent corporate takeovers and reduce the influence of 'outsider' shareholders.

Ultimately, these old-guard mindsets needed to change, prompting the introduction of reforms aimed at enhancing the governance standards of listed Japanese companies. These rules emphasised improvements in corporate value, growth prospects and capital efficiency.

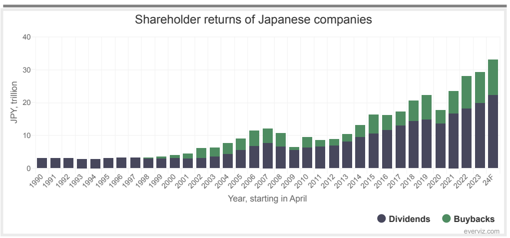
The reforms have been enforced indirectly through stock market listing rules, meaning that a company wanting to achieve a top-tier 'Prime' listing on the Tokyo Stock Exchange must adhere to new rules.

For example, companies must have independent board directors if they want Prime status. The result has been that 95% of companies listed on the Prime Market now appoint one-third or more independent directors, up from only 6.4% when reforms were introduced in 2014.

Similarly, companies must now declare cross-shareholdings and annually assess whether they are appropriate. Another significant rule change requires firms trading below book value to make reforms that will increase that amount and disclose what those are publicly. Failure to do so means losing a Prime rating or even delisting.

The goal here is to encourage firms that often sit on large cash piles to either reinvest that money or return it to shareholders via dividends and/or share buybacks.

Fig.2: Improving Corporate Governance



Source: Toyo Keizai

A real step change in shareholder returns has been observed in Japan, with the combined amount of dividends and share buybacks made by Japanese companies almost trebling from c. 10.5 trillion yen (£54.9 billion) in 2013 to c. 33 trillion yen in 2024.

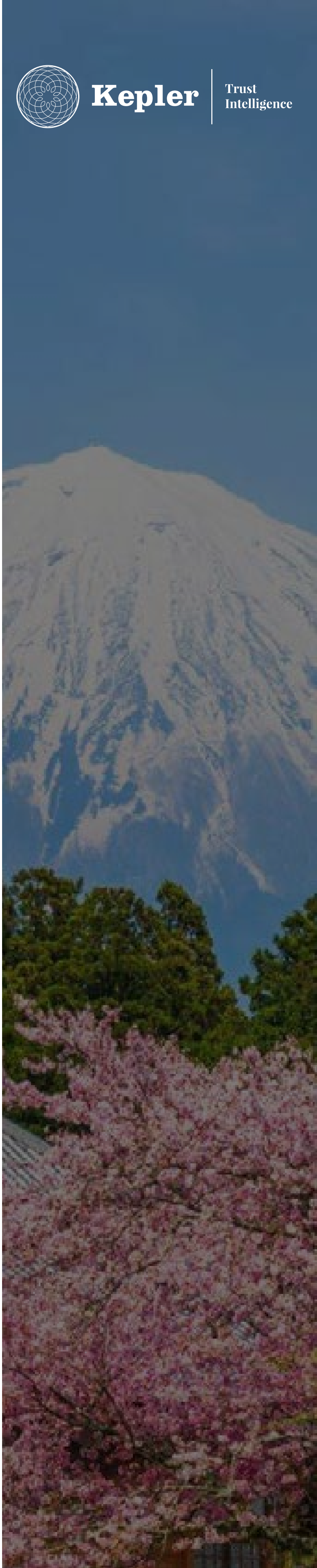
Technological innovation

Japan is a world leader in many industries and even if its domestic economy has problems, that doesn't mean publicly traded companies can't deliver growth globally. For example, about half of the world's industrial robots are produced in the country. As you might expect given that stat, the country is a global leader in robotics and automation systems.

Hence, unlike the UK, where technology stocks account for just 1.9% of the market, Japan has a thriving tech sector. Information technology accounts for 14% of the MSCI Japan Index; while that's less than half its weighting in the MSCI USA Index, it's pretty high.

Japan's tech sector is also benefitting from the rising demand for semiconductors and growing enthusiasm around artificial intelligence. The country is home to a host of companies that are well-positioned in these areas and can take a hand in satisfying that growing appetite.

Moreover, manufacturers are seeking to diversify production away from the likes of China and Taiwan due to geopolitical tensions. This is creating new opportunities for Japan to strengthen its presence in the semiconductor space.



Other publicly traded companies share that role in their respective fields and have continued to deliver impressive growth over the last two decades.

Sony and Nintendo, for example, are both among the 10 largest video game companies in the world by revenues. Similarly, Uniqlo's parent company Fast Retailing has delivered share price returns over the last five years that would not look out of place among the US tech giants.

Why it's hard to invest directly in Japanese stocks

When it comes to putting all of this into action and investing in Japanese companies, one might find it difficult. That's because accessing Japanese stocks is much more difficult than some other foreign markets such as Europe or the US.

A basic problem is many investment platforms simply don't offer access to Japanese equities. Those that do often have large minimum order sizes and hefty dealing fees, as well as limiting their offering to large caps. With AJ Bell, for instance, you need to deal over the phone with a minimum purchase order size of £10,000.

Aside from these hurdles, individual investors must also contend with some of the idiosyncrasies of Japanese corporate life.

About half of small- and mid-cap Japanese stocks have one or no analyst covering them. Compounding this is the fact that many of these companies don't release financial reports or trading updates in English, although this is changing.

Along with a dearth of third-party English-language information, this makes it difficult to evaluate prospective investments. Active investors are thus left with something of an uphill battle if they want to invest in Japanese stocks directly.

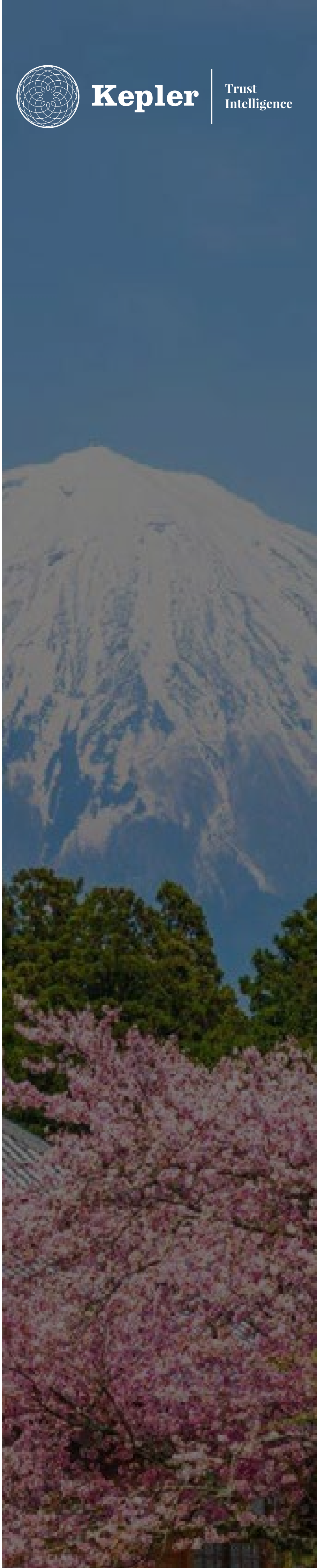
Why invest in Japan with investment trusts

Japan-focused investment trusts provide a solution to these problems. As London-listed funds, they're easily accessible to individual investors but still provide exposure to Japanese shares, without any outsized dealing fees or high minimum order sizes.

They are also actively managed, with a portfolio manager, perhaps backed by a team of equity analysts, with strong expert knowledge. This arguably means they're better able to capture the nuances of the local market and identify promising investment opportunities than an individual struggling to run a company's results through Google Translate.

In addition, investment trusts can be selective, which is important in a country like Japan, where the corporate governance improvements are constantly throwing up under-the-radar investment opportunities.

Finally, investment trusts' closed-ended nature, along with that local expertise, means they can move down the market-cap scale to get exposure to companies that large funds may be unable to touch.



Case Study

CC Japan Income & Growth (CCJI)

Company: Chikara Investments LLP

Launched: December 2015

Manager: Richard Aston

Ongoing charges: 1.03%

Investment policy: The investment trust aims to provide investors with dividend income and capital growth via investment in Japanese equities.

Comparative Index: TOPIX

Investors looking for exposure to Japanese equities may consider CC Japan Income & Growth (CCJI). Launched in 2015 by Chikara Investments, a specialist asset manager focused on India and Japan, the investment trust aims to deliver income and capital growth to shareholders by investing in Japanese equities.

CCJI tends to invest in three different sets of companies. There are those that look capable of paying a growing dividend, others that can pay a consistent dividend above the market average and, lastly, companies that look like they're undergoing a turnaround in attitude towards shareholders.

The investment trust uses structural gearing to enhance returns. This is achieved by using contracts for difference (CFDs), given their low cost and flexibility, along with access to an overdraft facility.

CCJI has managed to outperform its benchmark since launch. Despite this, the investment trust has often traded at a discount to its net asset value.

1) What is the investment trust's goal?

CCJI aims to deliver a total return to shareholders by investing in Japanese equities. The investment trust places a strong emphasis on generating income as well as providing capital growth.

2) What kind of stocks do the managers like?

CCJI's investment process is driven more by the income and growth opportunities a company provides, as opposed to a particular macroeconomic theme or belief in a certain sector. The investment trust is diversified across a range of industries as a result, with no one sector holding sway over the portfolio. This investment trust is prohibited from having one stock make up more than 10% of its holdings.

The bulk of the portfolio is made up of companies that have demonstrated consistent growth in their dividend payment over time. The remainder of the portfolio is allocated to stocks paying a stable yield above the market average and to companies undergoing some form of turnaround – acting as a catalyst for a change in dividend policy.

3) Are investment decisions driven by a particular investment style?

CCJI is managed for total return and can be described as a 'core' strategy, offering investors an attractive income profile without compromising in the quality or growth potential of its underlying holdings. As a result, portfolio manager Richard Aston tends to sift through thousands of companies in order to find those that can provide some assurance of paying income to shareholders but which still offer growth potential to investors. The need to balance these factors means there is typically only a small set of companies that the investment trust managers are happy to invest in.

4) How many stocks does this investment trust typically hold?

CCJI usually holds a relatively small number of stocks compared to other trusts. As at 31/12/2024, the trust held 39 stocks. This number is not fixed and can change over time but it is typically between 30 and 40 stocks.

5) What is this investment trust's dividend policy?

Although the investment trust is focused on providing income to shareholders, it does not have a specific yield target. However, at the time of writing, CCJI has a fully covered dividend yield of 2.9% and has managed to increase dividend payments to shareholders every year since inception. This is not a guarantee of future returns.

6) What are the ongoing charges?

The investment trust's ongoing charges are 1.03%.

7) Does this investment trust have performance fees?

CCJI does not have performance fees.

8) How much attention do the managers pay to the index, and to what extent are absolute returns important?

The investment trust is not restrained in any way by the index and does not make investment decisions based on it.

9) How much does the portfolio deviate from the index?

The managers tend to deviate strongly from the index, as they look for opportunities outside of the larger stocks found within it. As at 31/12/2024 the active share of its portfolio was 80.8%. This approach has paid off, as CCJI has historically outperformed the index.

10) Does this investment trust use gearing and if so, is it structural or opportunity led?

CCJI uses structural gearing to enhance growth and income opportunities in the portfolio. Gearing is undertaken through long only contracts for difference (CFDs) and equity swaps.

View the latest research note here

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