Japan's value shift

Global equity funds are upping exposure to Japan...

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Warren Buffett's decision to invest heavily in several Japanese companies over the past 12 months has brought up the usual annoying headlines about how great he is, as well as some discussion as to whether stocks listed in the world's third-largest economy are worth reevaluating.

Is that actually happening? A recent analysis by Copley Fund Research provides some answers by looking at the weightings to Japan in a set of Global Equity Funds.

The first thing to note is that the average fund has been underweight to Japan, compared to the MSCI ACWI, for the entirety of the past decade. However, the spread between the average fund weighting and the index weighting has been tightening over the past five years and is now at close to its tightest level since 2014.

Another point that stands out in the report is the proportion of funds that have exposure to Japan. Looking at the past decade again, the proportion of global equity funds investing in Japan hit its lowest level approximately 12 months ago. Since then it has bounced back sharply, from a low of 84.9% to 87.1%.

However, exposure to Japan is markedly different depending on style. Value funds have an average overweight position. In contrast, income funds and growth investors are both underweight on average.

Top down analyses like this can mean you end up capturing data that isn't entirely accurate, mainly because classifying funds can be an exercise in trying to square a circle. For example, the British & American Investment Trust (BAF), as readers can likely infer, invests in US and UK companies and is benchmarked against the FTSE All-Share. However, it is part of the AIC's Global Equity Income Sector.

Nonetheless, Copley's research, which looks at funds globally, does seem to fit broadly with trends we see in the UK's investment trust sector.

For instance, every trust in the AIC's Global Equity Income sector is currently underweight Japan, reflecting the relatively low dividend payouts Japanese companies offer.

In contrast, several trusts in the AIC's Global sector are overweight to Japan. For instance, **Bankers (BNKR)** upped its weighting from 7.4% at the end of October last year, to 13.4% at the end of May. That coincides with a period where the managers have tilted the portfolio more towards value, after a decade-long period focused on growth.

AVI Global (AGT) is probably the most notable trust in the sector when it comes to Japan, with the trust having a 19% weighting to the country. However, the trust managers are Japan specialists and take a differentiated, value-driven approach to markets. For example, a key part of the strategy is to invest in what the managers believe are undervalued investment trusts trading at a discount, and to capture the enhanced returns that a tightening of the discount produces.

In some ways, the tilt towards Japan in value funds also mirrors some of the success we've seen in country specialist trusts. For instance, **AVI Japan Opportunity (AJOT)**, which is managed by the same company as AGT, also takes a value-driven approach to Japanese Smaller Companies and has enjoyed a strong 12 months compared to its benchmark.

Similarly, **CC Japan Income & Growth (CCJI)** has had a very strong 12 months. The trust managers look to invest in companies that can pay increasing, sustainable dividends, and have been able to benefit from some of the corporate reforms we've seen in Japan over the past decade.

For investors considering Japan, CCJI arguably offers a more attractive approach today. As we noted earlier this year, valuations in Japan do look attractive and corporate reforms, as well as modest inflation levels, continue to act as a tailwind for investors. However, stylistic calls remain hard to make and the balance that CCJI offers – valuation-conscious but not pure value plays – may be the better choice to make today.

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