

What Investment

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How to deal with

RISK

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Buying back shares in Japan

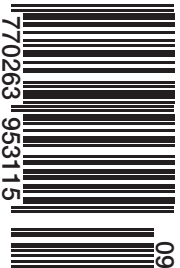
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Driven by corporate governance requirements, Japanese corporations have embarked on a wave of share buybacks creating a golden opportunity for investors

Japanese companies have been buying back their shares at unprecedented rates in recent years as part of efforts to improve their corporate governance. Last year, share buybacks in the country hit a record JPY7.5trn (\$68bn).

The trend towards improving shareholder returns has already provided plenty of new investment opportunities for investors, like ourselves, who specifically target those companies seeking to reward shareholders through a combination of rising dividends and share buybacks. But with large swathes of corporate Japan still sitting on large stockpiles of cash as attitudes towards investors continue to evolve, we think buybacks could still have further to go.

Why would a firm buy back its shares?

From an investor's perspective, a share buyback has the potential to increase the value of their holdings. By decreasing the total number of shares in issue, each remaining share will be worth a greater percentage of the total.

Buybacks also mean that investors are likely to see an increase in their earnings per share and dividend yield, provided the firm does not reduce the total amount of money it intends to pay back to its shareholders. Often the higher capital efficiency of the company is recognised through a higher p/e ratio, creating further value for the shareholder.

Japan's emerging buyback culture

After decades of chronic absence, share buybacks have increased dramatically in Japan since the global financial crisis. Alongside a rapid rise in dividend payments, the amount of cash being returned to investors through buybacks has risen from JYP0.5trn (\$4.7bn) in 2010 to JPY7.5trn (\$70.5bn) in 2017.

This move towards returning excess cash flow to investors has at least partly been spurred



Share buybacks: A golden opportunity in Japan's new era of corporate governance

Japanese corporations have dramatically increased share buybacks in recent years. **Richard Aston** examines the reasons for this trend and highlights the opportunities for investors it creates

by Prime Minister Shinzo Abe. His drive to improve Japan's corporate governance throughout his tenure as leader has been backed by both the Bank of Japan and the Japan Pension Association. In 2014, Japan even introduced a stewardship code seeking to create better dialogue between institutional investors

and company management aimed at making firms more profitable.

Indeed, since we launched the CC Japan Income & Growth Trust Plc in 2015, a number of our holdings have undertaken share buybacks.

For example, in the last fiscal year Nippon Telegraph &



Telephone announced a buyback programme for the eighth consecutive year and Sumitomo Mitsui Financial Group its first for six years. Both companies continue to stress the importance of maintaining stable and growing dividends accompanied by a flexible approach to managing their capital through equity buybacks.

Where does the future lie?

Although the treatment of Japan's shareholders has been improving, it is still very much at an emerging stage; there are

many companies who have yet to fully appreciate the importance of capital efficiency and consistent shareholder returns. As a result, there is still a sizeable amount of cash left on Japan's corporate balance sheets.

Indeed, around half of listed non-financial companies in Japan have net cash on their books. In March last year, these firms collectively held a record-high JPY189trn (approximately \$1.7trn) in cash and cash equivalents. Not only does this level of cash suggest that these firms are financially secure but it also means there is plenty more

cash to be returned to investors if improving attitudes continue.

With Abe being re-elected last October and Japan's next election slated for 2021, there is a good chance of this happening.

Sticking to your word

We believe we are at the start of an exciting trajectory in Japan. If buybacks and standards of governance continue to rise, then both valuations and returns to shareholders are likely to improve.

It would be relatively easy to just put together a portfolio of Japan's highest-yielding stocks however not all companies in Japan have a bright future.

We believe it is far more important to ensure this income is sustainable by identifying companies that can continue to grow but can complement this growth with an appropriate consideration to returning excess cashflow to shareholders through sustainable dividends and share buybacks.

Richard Aston is Portfolio Manager of CC Japan Income & Growth Trust.

What Investment's view

The CC Japan Income & Growth Trust was launched back in December 2015 and is the only investment trust run by the Coupland Cardiff Asset Management which is a London-based boutique fund manager with a superb reputation in Asian and Japanese equities.

This trust has outperformed Japan's Topix index significantly in the two-and a half years. According to Trustnet its shares have returned 71.14% to 20th July this year, and although the yield is currently only 2.2% against the initial yield of 3-3.25%. Trustnet analysts point out the underlying portfolio is showing evidence of underlying growth.

For investors with little or no exposure to Japanese equities through an investment trust, this fund is well worth a look and taps into one of the best fund managers in the sector, supported by a group of highly experienced investors in the Coupland Cardiff group.