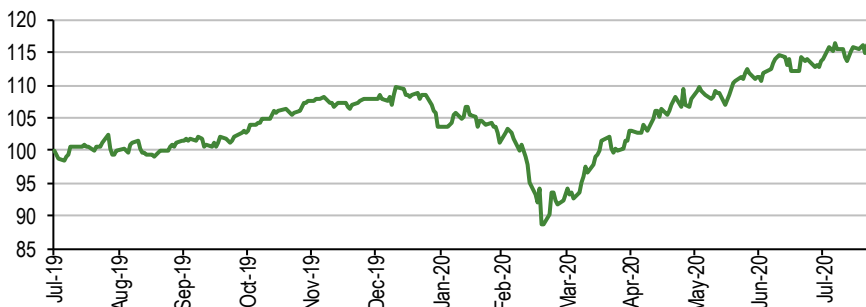


Fidelity Japan Trust

Rewarding investors well in challenging times

Fidelity Japan Trust (FJV) targets long-term capital growth by investing in Japanese companies. Manager Nicholas Price believes the Q120 market sell-off created attractive opportunities to invest in companies that have been overlooked, but which will emerge from the pandemic with greater market share and superior long-term growth prospects. FJV is overweight in technology and IT-related sectors, where the manager expects selected companies will continue to benefit from 5G and coronavirus-driven demand for tech products and related services. The trust has performed strongly in absolute and relative terms in recent months and has outperformed its index, and the UK market, over most periods.

FJV's trend NAV outperformance extends after the sell-off



Source: Refinitiv, Edison Investment Research. Performance vs TOPIX to 24 August 2020.

The market opportunity

Japan has fared relatively well during the coronavirus crisis compared to many other developed countries, and the Japanese government's massive efforts to support the economy should ensure a gradual recovery through H220 and into 2021. The crisis has spurred trends towards digitalisation and remote working, home schooling and entertainment, creating new opportunities for innovative companies and investors seeking long-term growth stocks at attractive valuations.

Why consider investing in Fidelity Japan Trust?

- Significant outperformance of its benchmark over all periods we measure, and an even stronger performance versus the UK market over most periods.
- An experienced Tokyo-based manager with an impressive track record, supported by Fidelity's well-resourced, local team of analysts.
- A new board commitment to target a single-digit discount to NAV.

Discount returns to three-year range after sell-off

The board recently announced a plan to target a single-digit discount in normal market conditions. As at 24 August 2020, FJV's shares traded at a 10.1% discount to NAV. This is slightly wider than the averages of 9.4% and 9.9% over one and three years respectively, but narrower than the longer-term averages of 11.8% over five years and 12.4% over 10 years. The board's new discount target, supported by share purchases where appropriate, has the potential to underpin a re-rating of FJV by investors.

Investment trusts Japanese equities

26 August 2020

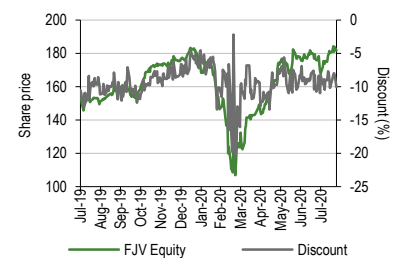
Price 182.0p
Market cap £238.3m
AUM £309.3m

NAV* 202.4p
 Discount to NAV 10.1%

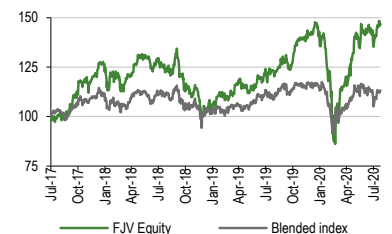
*Including income. As at 24 August 2020.

Yield 0.0%
 Ordinary shares in issue 131.0m
 Code FJV
 Primary exchange LSE
 AIC sector Japan
 Benchmark TOPIX

Share price/discount performance



Three-year performance vs index



52-week high/low 184.3p 107.0p
 NAV* high/low 202.4p 127.8p

*Including income.

Gearing

Gross market gearing* 25.8%
 Net market gearing* 25.8%

*As at 31 July 2020.

Analysts

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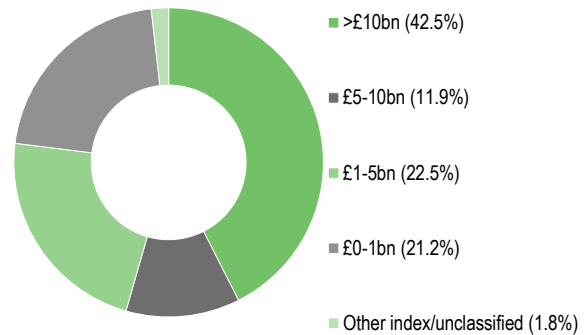
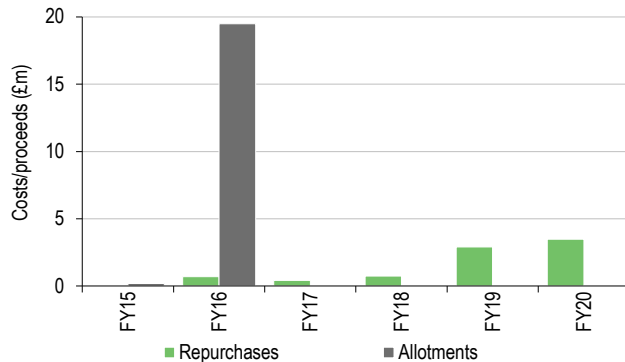
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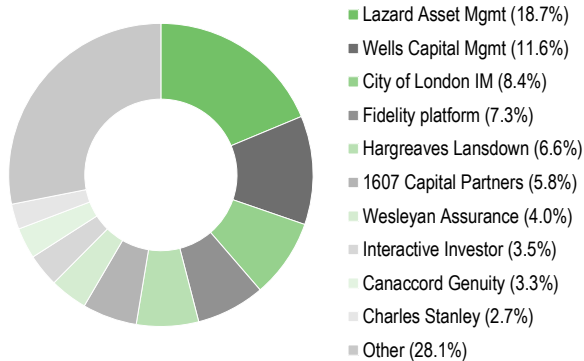
**Fidelity Japan Trust is a research
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Exhibit 1: Trust at a glance

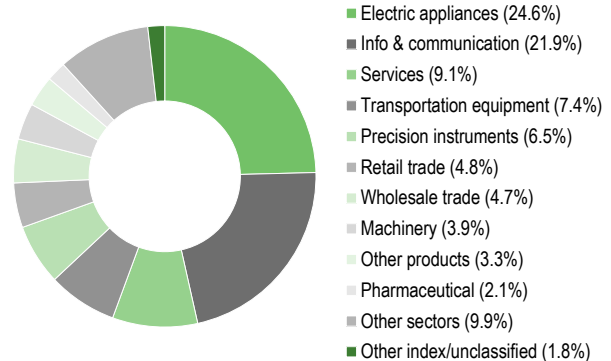
Investment objective and fund background		Recent developments			
Fidelity Japan Trust (formerly Fidelity Japanese Values) aims to achieve long-term capital growth by investing predominantly in equities and related securities of Japanese companies. Since May 2018 it has used the TOPIX as its reference index, and it is a member of the AIC Japan sector.		<ul style="list-style-type: none"> 31 July 2020: HY report for 6 months ended 30 June 2020. NAV TR +2.3% versus -0.8% for the TOPIX. 28 July 2020: David Barron set to join FJV's board from 20 October 2020. He will replace Philip Kay, who steps down on 31 December 2020. 			
Forthcoming		Capital structure		Fund details	
AGM	May 2021	Ongoing charges	1.05%	Group	FIL Investments International
Interim results	August 2021	Net gearing	24.8%	Manager	Nicholas Price
Year end	31 December	Annual mgmt charge (AMC)	0.50–0.90%	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Dividend paid	None	Performance fee	Reflected in AMC	Phone	0800 41 41 10 or 0800 41 41 81 (IFAs)
Launch date	15 March 1994	Trust life	Indefinite, subject to vote	Website	www.fidelityinvestmenttrusts.com
Continuation vote	Three-yearly, next 2022	Loan facilities	None – CFDs used		
Share buyback policy and history (financial years)			Market capitalisation breakdown (in sterling, as at 31 July 2020)		
Renewed annually, FJV has the authority to repurchase up to 14.99% of shares and allot shares up to the equivalent of 5% of the issued share capital. Allotments in the chart below include the exercise of subscription shares.			Figures adjusted for gearing. FJV is typically overweight small- and mid-cap growth stocks, is also overweight in large-cap growth and small-cap value stocks and is very underweight large- and mid-cap value stocks.		



Shareholder base (as at 31 July 2020)



Portfolio exposure by sector (adjusted for gearing, as at 31 July 2020)



Top 10 holdings (as at 31 July 2020)

Company	Country	Sector	Portfolio weight %	
			31 July 2020	31 July 2019*
Shimano	Japan	Transportation equipment	6.9	4.1
JustSystems	Japan	Information & communication	6.3	4.0
Olympus Corporation	Japan	Precision instruments	6.1	5.2
Z Holdings	Japan	Information & communication	6.0	N/A
Murata Manufacturing	Japan	Electric appliances	5.1	N/A
Misumi Group	Japan	Wholesale trade	4.8	3.8
Keyence Corporation	Japan	Electric appliances	3.8	5.0
TDK Corp	Japan	Electric appliances	3.4	N/A
Recruit Holdings	Japan	Services	3.3	3.7
Softbank Group	Japan	Information & communication	3.1	N/A
Top 10 (% of portfolio)			48.8	43.9

Source: Fidelity Japan Trust, Edison Investment Research, Bloomberg, Morningstar, Refinitiv. Note: *N/A where not in end-July 2019 top 10, although Murata Manufacturing, TDK Corp and Softbank were held in the portfolio at that time. Their holdings represented 2.2%, 1.5% and 1.2% of the portfolio respectively.

The fund manager: Nicholas Price

The manager's view: Crisis-driven changes create opportunities

FJV's manager, Nicholas Price argues that Japan has fared relatively well during the coronavirus crisis, compared to many other developed countries. Although infections are on the rise again, especially in Tokyo, severe cases and deaths remain low. However, the economy was fragile even before the onset of the pandemic. GDP contracted at an annualised 7.0% in Q419, due to the adverse impact of a consumption tax hike and severe typhoons and has been further damaged by the effects of the lockdown. The economy slipped into recession in Q120 (-2.5% on an annualised basis), and Q2 bore the brunt of the lockdown, with growth contracting at an annualised rate of 27.8%. Consumption and exports declined sharply and service industries, including tourism, have been hit especially hard. Inbound foreign tourism has now all but ceased and the postponement of the Tokyo Olympics from July 2020 until next year removed one potential source of near-term stimulus.

However, Price notes that the Japanese government's response to the crisis has been the most aggressive among the G20 so far. Combined headline fiscal stimulus now totals 40% of GDP and the government will maintain an expansionary fiscal stance into 2021. Employment adjustment subsidies have softened the impact of job losses, and cash payments of ¥100,000 (c £750) to each citizen may well be followed by further subsidies later in the year. Initiatives also include a government programme to encourage domestic tourism, and follow-up programmes to bolster eating out and event attendance are mooted. Furthermore, the Bank of Japan has expanded its quantitative easing efforts, including measures to assist the corporate sector. Given all this support, the manager believes that the worst is now over for the Japanese economy and that Japan is likely to experience a gradual recovery from H220. A tailwind from China will help Japanese manufacturing industries, as will a pick-up in global demand for autos.

Meanwhile, Price says that the Q120 equity market sell-off has created investment opportunities. 'Globally, bear markets often create turning points and changes in market leadership' he says. 'I am therefore looking at some discarded stocks that are likely to emerge stronger from this unprecedented situation. Significant fiscal stimulus and government subsidies could throw up new leadership and new winners from discarded losers', Price adds.

The manager is also seeking companies likely to benefit from the coronavirus-induced surge in demand for tech products and services to assist remote working and home schooling. In his view, Japanese companies have lagged their foreign counterparts in adopting digitalisation and home working due to an entrenched, paper-driven business culture and long-standing underinvestment in IT infrastructure. However, he believes that the health and economic crisis has highlighted the need for companies to enhance their digital capabilities. These efforts are being encouraged by the government, which has set firms a target to implement remote working for 70% of their employees, as well as introduce staggered commutes and other social distancing measures. The trend towards online working is not confined to business; the government is also encouraging the use of remote services in education and healthcare and stepping up digitalisation across the public sector. Price is particularly interested in companies providing internet services, e-commerce and educational software – including those at pre-IPO stage – that can benefit from changes to the way consumers work, shop and entertain themselves.

In summary, the manager says that although volatility may continue in the short term, perhaps in response to the ongoing spread of the virus in the US and developing countries such as India, he believes that 'volatility creates opportunities'. In his view, Japan continues to offer an attractive combination of cash-rich companies, with low relative valuations, set to benefit from secular growth trends. He stresses that Fidelity's team of analysts on the ground in Japan puts the trust in a strong

position to continue to identify mispriced winners and reward investors, even in the current challenging environment.

The portfolio

FJV has a mid- and small-cap growth focus and the manager adopts a bottom-up investment approach, driven by long-term fundamentals, not short-term momentum. He is supported by Fidelity's Tokyo-based research team, which monitors an investable universe of around 1,000 stocks. The manager seeks companies in strong competitive positions, with quality management teams, growth potential over three to five years and projected return on equity of 10% or more. He argues that many such businesses, especially small-cap companies, are overlooked by most investors and thus undervalued. FJV's portfolio typically comprises 80–110 holdings.

The manager stresses that there have not been any significant changes to the overall composition of the trust's holdings and sectoral weightings in recent months. Shifts in sectoral allocations have been driven mainly by performance (see Exhibit 2). He has maintained the overweight exposure to technology stocks, with a focus on companies that will benefit from the shift to 5G and the rising trend towards digitalisation, including home working and learning. These are included in the electric appliances, information & communication and wholesale trade sectors. Key tech-related holdings include electronic component makers Murata Manufacturing and TDK, factory automation (FA) machinery specialist Misumi Group, educational software company JustSystems and Z Holdings, which the manager believes has a good chance of being re-rated as a 'super app' company, with long-term growth potential. All these companies are among the trust's top 10 holdings (see Exhibit 1). Many of the portfolio's holdings are market share gainers that are well positioned to come out of the current downturn stronger than their competitors – among them, FA specialist Keyence, also in the top 10. Exposure to transportation equipment has been boosted by an increase in position size and the strong performance of Shimano – now FJV's largest holding – a bicycle parts company that has benefited from increased global demand as commuters avoid public transport.

At end-July 2020, FJV's top 10 holdings made up 48.8% of the portfolio, an increase in concentration from 43.9% at end-July 2019, despite recent profit-taking prompted by the strong performance of some holdings. Recent additions to the portfolio include software-as-a-service (SaaS) companies in the mid- and small-cap space that were sold down to attractive levels. Individual names include Shift, a software testing company, and Sansan, a B2B and B2C contract management services business. The manager believes all these stocks are under-covered by the market. Price has scope to invest up to 10% of the portfolio in unlisted stocks. Raksul, an internet-based printing and transport company, was an example of such a holding prior to its listing in May 2018. FJV currently holds three unlisted companies and the team is actively seeking new opportunities in this arena.

Exhibit 2: Portfolio sector exposure vs reference index (% unless stated)

	Portfolio end- July 2020	Portfolio end- July 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Electric appliances	24.6	24.7	(0.0)	15.8	8.8	1.6
Info & communication	21.9	11.5	10.4	10.8	11.1	2.0
Services	9.1	15.3	(6.2)	5.3	3.8	1.7
Transportation equipment	7.4	4.2	N/A	7.0	0.4	1.1
Precision instruments	6.5	6.4	0.1	2.6	3.9	2.5
Retail trade	4.8	2.4	2.3	5.1	(0.3)	0.9
Wholesale trade	4.7	4.8	(0.1)	4.5	0.2	1.0
Machinery	3.9	7.4	(3.5)	5.4	(1.5)	0.7
Other products	3.3	5.4	(2.2)	2.5	0.8	1.3
Pharmaceutical	2.1	N/S	N/A	6.8	(4.7)	N/A
Other sectors	9.9	16.7	(6.8)	34.2	(24.3)	0.3
Other index/unclassified	1.8	1.1	0.7	0.0	1.8	N/A
	100.0	100.0		100.0		

Source: Fidelity Japan Trust, Edison Investment Research

The trust retains an overweight exposure to mid-sized and smaller companies compared to the TOPIX. At end-July 2020, 42.5% of the portfolio was invested in large-cap stocks (>£10bn), about 14pp underweight compared to the index (adjusted for gearing). It held significant overweights to mid-cap (£5–10bn) and small-cap (£1–5bn) stocks and a lesser overweight to micro-cap companies. The level of gearing increased to 25.8% at end-July 2020, up from 14.4% at the same time last year, as the manager sought to take advantage of the opportunities created by the Q120 market correction to add or increase positions.

Performance: Outstripping the index and UK market

Exhibit 3: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	Blended index* (%)	TOPIX TR (%)	R/Nomura Mid & Small Cap Japan (%)	CBOE UK All Companies (%)
31/07/16	15.9	22.4	19.8	15.7	19.8	4.1
31/07/17	26.1	14.3	17.6	16.8	17.6	15.0
31/07/18	29.6	27.5	10.8	9.7	9.8	9.1
31/07/19	(5.0)	(2.8)	1.0	1.0	(1.9)	1.1
31/07/20	9.8	7.1	(6.0)	(6.0)	(7.4)	(18.5)

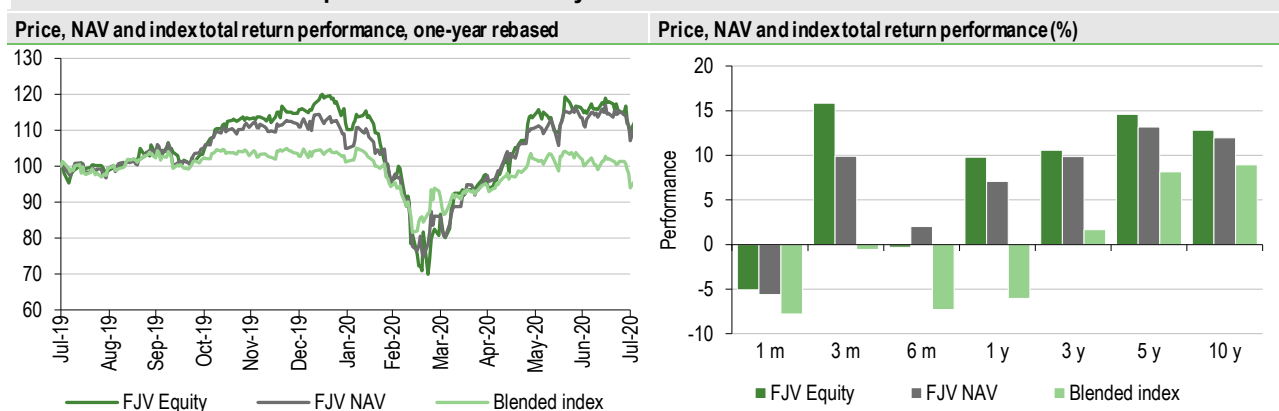
Source: Refinitiv. Note: All % on a total return basis in pounds sterling. *Blended index is a mid- and small-cap Japan index until 22 May 2018 and TOPIX thereafter.

FJV's performance in recent months has recovered sharply after negative returns in Q120. Over the three months to end-July 2020, FJV returned 15.9% on a price basis and 9.9% on an NAV basis, comprehensively outpacing the index, which returned -0.5%. It has also made solid absolute returns and outperformed the index significantly in price and NAV terms over one, three, five and 10 years (Exhibit 5). The trust has also outperformed Japanese mid- and small cap companies over all these periods on both a share price and NAV basis. Of particular relevance for UK investors, FJV has outperformed the broad UK market even more significantly over one, three, five and 10 years – a reminder of the benefits of diversification away from the UK market.

Stock selection in technology, medtech and internet-related sectors made a material contribution to performance over recent months. JustSystems, a top three holding, was a key contributor. This company provides tablet-based educational software for children and continues to gain market share. Increased demand for tablets owing to a surge in home schooling provided a further recent tailwind for its share price. FJV's holding in Olympus, a global leader in endoscopes, has been a standout contributor to recent returns. The share price hit new highs on the announcement of plans to sell its loss-making camera business. The manager believes its strategy, a new product cycle in 2020, combined with management's strong commitment to improve profitability will ensure the company's discount to global peers continues to shrink. As mentioned above, bicycle parts maker Shimano has added to returns due to an increased holding and outperformance on expectations that global demand for its products will increase as people avoid congested public transport. Companies such as Keyence and Misumi, which are involved in factory automation, contributed to outperformance against the index due to a rise in demand for semiconductor and 5G applications.

The positive performance impact of these holdings was only partially offset by negative contributions from Raksul and confectionery company Kotobuki Spirits, which was hurt by travel restrictions reducing demand for souvenir sweets. However, the manager expects Kotobuki Spirits' strong balance sheet to allow it to take market share from weaker rivals on the rebound, and benefit from government incentives to encourage domestic travel. Some semiconductor-related companies, including Screen Holdings and Renesas Electronics, also detracted from performance, but orders, earnings and margins are expected to improve significantly next year.

At a sector level, overweights in the three tech-related sectors – electric appliances, information & communication and precision instruments – produced the strongest performance, led by medtech, internet subscription and some semiconductor-related companies. The portfolio's significant underweight position in banks also assisted performance in a declining interest rate environment. Conversely, the underweight stance in pharmaceuticals was the biggest detractor, while overweights in other finance, services and other products also hurt. In terms of style, mid- to large-cap growth companies generated the strongest returns, significantly outperforming value stocks. Sterling-based returns also received some support from yen strength since the beginning of the year.

Exhibit 4: Investment trust performance to 31 July 2020


Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised. *Blended index is a mid-and small-cap Japan index until 22 May 2018 and TOPIX thereafter.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to TOPIX TR	2.9	16.5	7.5	16.8	29.9	40.5	55.9
NAV relative to TOPIX TR	2.4	10.5	10.0	13.9	27.4	32.0	44.5
Price relative to R/Nomura Mid & Small Cap Japan	3.6	15.9	7.7	18.6	35.7	40.8	49.8
NAV relative to R/Nomura Mid & Small Cap Japan	3.0	9.9	10.2	15.7	33.1	32.3	38.8
Price relative to CBOE UK All Companies	(1.4)	14.6	21.9	34.7	50.2	83.5	93.2
NAV relative to CBOE UK All Companies	(2.0)	8.7	24.7	31.3	47.4	72.3	79.0

Source: Refinitiv, Edison Investment Research. Note: Data to end-July 2020. Geometric calculation.

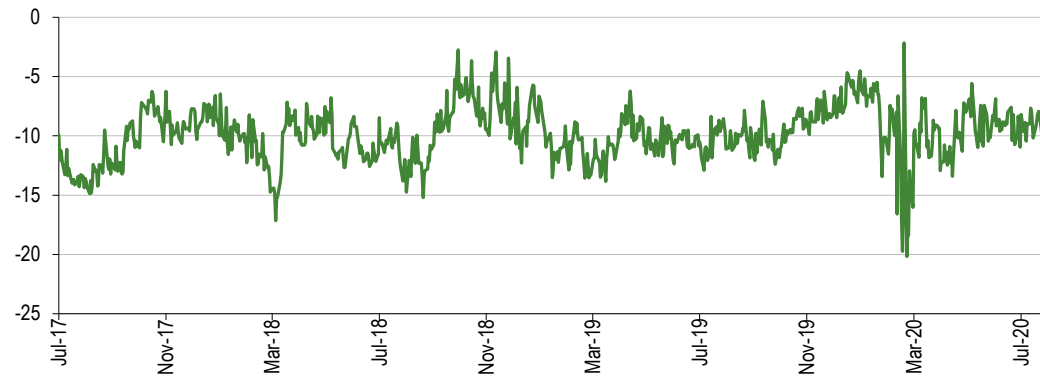
Valuation: Relative stability resumes after brief sell-off

March was a particularly volatile time for FJV's share price as its discount to NAV reached a 10-year low of 2.2%, then almost immediately hit a three-year high of 22.1% the same month. However, at 24 August 2020, the shares traded at a 10.1% discount to NAV, compared to average discounts of 9.4%, 9.9%, 11.8% and 12.4% over one-, three, five- and 10-year periods respectively.

FJV's board has an active policy of share buybacks (up to a limit of 14.99% of shares in issue) to manage the discount. In the annual report, released in early April 2020, the board announced a change in its discount control policy and is now targeting a single-digit discount to NAV, under normal market conditions. To this end, in the six months to 30 June 2020, the trust repurchased 1.7m ordinary shares into treasury. Between the end of the reporting period and 24 August 2020, the board bought another 538,500 shares, leaving the number of shares at 131.0m.

FJV has not paid a dividend for more than 20 years. This is a result of its focus on long-term capital growth and the low level of dividends historically on offer from Japanese companies, compared to other markets. The board has indicated that it is unlikely to pay a dividend in the foreseeable future.

Exhibit 6: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research.

Peer group comparison

FJV has been a member of the Association of Investment Companies' Japan peer group since May 2018. Before this date, it was a member of the Japanese Smaller Companies sector. As the trust retains a bias towards mid-sized and smaller growth companies, Exhibit 7 provides a comparison of performance against both these sectors. FJV's performance ranks second among its current five peers over one, three and five years and third over 10 years. It has also outperformed the average of the AIC Japanese Smaller Companies sector over one and three years, while lagging slightly over five years and more significantly over 10 years. FJV's ongoing charge is slightly above the average of its current peers, but in line with the average of the smaller companies funds. None of the funds charges a performance fee, although there is a performance component to FJV's variable management fee, which comprises a base fee of 0.70%, within a 0.50–0.90% range. Its current discount of 10.1% is narrower than the average of its Japan peers. All the funds use gearing, but FJV's net market gearing of c 26% is higher than that of all its current and former peers. It is the only trust in its sector not to pay a dividend, but two funds in the Japanese Smaller Companies sector also have zero yields.

Exhibit 7: AIC Japan and Japanese Smaller Companies sectors as at 21 August 2020*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge (%)	Perf fee	Discount (ex par)	Net gearing	Dividend yield
AIC Japan										
Fidelity Japan Trust	240.9	15.4	37.1	105.1	248.7	1.1	No	(10.1)	126	0.0
Aberdeen Japan	81.9	11.7	16.9	43.9	158.4	1.0	No	(17.7)	112	1.8
Baillie Gifford Japan	749.6	6.3	24.0	90.4	347.0	0.7	No	(3.5)	108	0.4
CC Japan Income & Growth	157.3	(10.4)	4.6			1.1	No	(12.8)	121	3.9
JPMorgan Japanese	878.8	21.9	46.7	105.2	273.5	0.7	No	(10.5)	115	0.9
Schroder Japan Growth	210.2	(3.3)	(3.7)	33.3	142.8	1.0	No	(15.9)	112	2.8
Sector average (6 funds)	415.5	5.2	17.7	68.2	230.4	0.9		(12.1)	114	2.0
FJV rank in sector	3	2	2	2	3	1		2	1	6
AIC Japanese Smaller Companies										
Atlantis Japan Growth	90.3	9.1	29.9	85.0	272.6	1.6	No	(19.3)	106	1.3
AVI Japan Opportunity	116.3	0.7				1.0	No	(3.6)	112	0.0
Baillie Gifford Shin Nippon	547.4	10.3	40.1	152.8	568.6	0.7	No	(3.5)	105	0.0
JPMorgan Japan Smaller Cos	237.1	17.6	35.3	107.0	267.3	1.1	No	(18.2)	106	4.2
Sector average	247.8	9.4	35.1	114.9	369.5	1.1		(11.2)	107	1.4

Source: Morningstar, Edison Investment Research. Note: *Performance to 20 August 2020 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

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