

QUARTERLY MANAGER COMMENTARY

Japan Strategy

December 31, 2024

MARKET ENVIRONMENT

Japanese equity markets finished higher during the quarter despite significant volatility. The Bank of Japan (BoJ) held its two-day policy meeting in December and announced it would hold interest rates at 0.25% despite core consumer inflation in Tokyo continuing to accelerate, which contributed to the Yen depreciating to a near 5-month low. This acceleration in inflation combined with a summary of opinions from the BoJ meeting where policymakers expressed confidence in an imminent rate increase is leading analysts to expect an interest rate hike from the BoJ in the near term. Although we are not macro experts, we retain our view that Japan has exited its multi-decade period of deflation and interest rates will normalize over the medium term.

PORTFOLIO PERFORMANCE

The portfolio's return was -7.75% (net) for the reporting period. This compares to the MSCI Japan Index (Net) that returned -3.60% for the same period.

Top contributors:

- Sumitomo Mitsui Financial was a contributor during the quarter. The Japan-headquartered diversified bank's stock price rose after second-quarter results showed a 27% increase in profit year-over-year, largely due to higher interest rates. The company also raised its annual net profit forecast to YEN 1.16 trillion. We continue to believe Sumitomo Mitsui Financial is the best run Japanese megabank with significant leverage to rising rates. The company also maintains a strong balance sheet, which adds to our confidence in this investment.

Performance highlights

Contributors

- Sumitomo Mitsui Financial
- Toyota Motor
- Recruit Holdings

Detractors

- OMRON
- Sugi Holdings
- Olympus

- Toyota Motor was a contributor during the quarter. The Japan-headquartered automobile manufacturer's stock price rose significantly in December after announcing global production was up 6.2% year-over-year and that the return on equity (ROE) target has been nearly doubled for the 2025 fiscal year. We appreciate Toyota's long history of quality and brand equity in the U.S. market and believe the company is one of the best-run auto companies in the world. The company benefits from industry-leading production, supply chain management, and product quality and has steadily taken market share in North America and Europe. We believe Toyota has a long runway for future growth, which can lead to further value realization.
- Recruit Holdings was a contributor during the quarter. The Japan-headquartered human resources and employment services company's stock price rose after posting a strong set of results that led to guidance being increased across all segments. Notably, there was a third straight quarter-over-quarter increase in Indeed

Past performance is no guarantee of future results. The investment return and principal value of this portfolio and any particular holdings may fluctuate. Portfolio holdings are subject to change without notice.

U.S. market revenues despite a still relatively sluggish job market. The company moderately increased its midpoint of consolidated earnings before interest, tax, depreciation, and amortization after raising the low-end of the range significantly. We continue to believe Indeed is the best job site globally and that it has a long runway for growth as it captures an increasing amount of the hiring transaction process.

Top detractors:

- OMRON was a detractor during the quarter. The Japan-headquartered electronic components company's stock price declined after posting second-quarter results where revenue modestly underperformed consensus expectations. Despite these results, the company continues to be a global leader in the automation field, with operations in many countries globally. We appreciate the company's diverse product offerings, as it penetrates several markets with cutting-edge healthcare devices, social systems, and more. In our view, automation continues to grow, and Omron is well positioned to capitalize on this trend.
- Sugi was a detractor during the quarter. The Japan-headquartered drug retail company's stock price declined despite reporting September earnings where total store sales grew 17.2% year-over-year. The pharmacy business was particularly strong, growing 8.9% year-over-year, and the company opened 13 new stores during the period. These positive results accelerated into October and November with over 20% year-over-year increases in same store sales during both periods. Despite temporary share price weakness, we believe Sugi will benefit from the growing role of drugstores in dispensing prescriptions. The company can become a disciplined consolidator in a fragmented industry and is in an excellent position to gain market share. We appreciate the company's capital

allocation strategy and believe the stock offers an attractive upside.

- Olympus was a detractor during the quarter. The Japan-headquartered health care equipment company's stock price declined after posting mixed second-quarter results where revenue targets were slightly missed, but operating profit exceeded consensus expectations. Despite the results, we think Olympus is a great medical business with a management team that has shown strength in selling non-core assets, organizational restructuring, and strengthening the company's balance sheet. We believe that the company's strong positioning in various medical segments offers an attractive long-term upside.

PORTFOLIO POSITIONING

We did not initiate any new positions during the period.

We did not eliminate any positions during the period.

OUTLOOK

As we look forward to 2025, we note that the spread between growth and value remains especially wide relative to history, both in US and international markets. Given this, we believe that it's an unusually attractive time to be a value investor. This growth-led market environment has afforded us an excellent opportunity to build very well-diversified portfolios in companies trading at significantly lower than average valuations across a variety of industries. We remain optimistic about the positioning, strength and depth of opportunity set as we continue to find high-quality businesses trading at bargain prices.

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The MSCI Japan Index (Net) is designed to measure the performance of the Japanese equity market. The index includes large- and mid-cap stocks and covers approximately 85% of the free float-adjusted market capitalization in Japan. This benchmark calculates reinvested dividends net of withholding taxes. This index is unmanaged and investors cannot invest directly in this index.

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