

Source: Square Mile and LSEG Lipper (all rights reserved), Data as at: 31st December 2024.

Overview

This strategy is focused on long-term capital appreciation through an equity portfolio of smaller companies in Japan. Over the long run, we believe this outcome is achievable, but over short-time periods, the strategy is exposed to movements in the stock market and can experience sharp fluctuations in performance, particularly due to its use of gearing (or leverage) which will amplify performance. Typically the share price performance of smaller companies is more racy than larger capitalisation stocks during up markets and more vulnerable to declines during weaker periods. This strategy might be considered by investors with a longer-term investment horizon, who are willing to tolerate the volatility in this area of the market. This Square Mile rating is as at Tuesday 31st October 2023 at 09:00.

Square Mile's Expected Outcome

We believe this trust should be able to outperform the MSCI Japan Small Cap index by 1.5% p.a. over rolling five-year periods.

Square Mile's Opinion

There are thousands of listed smaller companies space in Japan. However, much of the listed universe is under researched, presenting active stock pickers plenty of undiscovered investment opportunities. We believe the manager of this strategy and his colleagues are articulate, highly competent and experienced investors, who are actively supported in their work by the firm. Moreover, the investment process is robust, with all members of the team having a similar long-term investment philosophy and being clearly focused on undertaking detailed stock research. We think they are aptly suited to the task of identifying fast growing businesses which are disrupting traditional business practices, in what is an extensive universe of companies. Given the style of management applied, this strategy can experience highly variable performance relative to the index over the short term, and, in periods when investment styles, such as value, are in favour, it might struggle. It is important to understand that the trust applies gearing, therefore both its absolute and relative returns will be amplified. Moreover, smaller companies tend to be more volatile than their larger peers, which may be accentuated by market moves on both the up and the downside. Overall, we believe this strategy has the ability to deliver outperformance of its benchmark over the longer term, however we acknowledge that it has struggled to meet its performance objective in recent years, therefore investors need to be long-term owners.

Fund Manager's Formal Objective

The trust aims to achieve long-term capital growth principally through investment in small Japanese companies which are believed to have above-average prospects for capital growth.

Outcome: Capital Accumulation	Domicile: UK
Active/Passive: Active	Benchmark: MSCI Japan Small Cap
Asset Class: Equity	IA Sector: Equity Japan Sm&Mid Cap
Yield: 0.71%	Fund size: £318M
Fund Manager: Praveen Kumar	Distribution Pay Date: -
Fund Price: 1.2 Pounds	Dividend Frequency: -
Currency of Share Class: GBP	Share Class Launch Date: 31/07/1985
NAV: 1.4 Pounds	Year end: 31/01/2024
Discount/Premium: -14.26%	Gearing: 11.00%
Permission to distribute from Capital: Yes	Fees charged: Income

Asset Manager Description

Asset Manager Overview

Baillie Gifford is a long established Edinburgh based investment partnership that is well known amongst institutional investors. As a house it is known for its growth investment style, generally lower trading within its portfolios, and focus on long-term investment theses.

Asset Manager ESG Integration

Baillie Gifford became a signatory to the UN Principles for Responsible Investment in 2007, currently having a firm-wide Investment & Stewardship Policy score of 4 out of 5. Baillie Gifford is also a signatory of the UK Stewardship Code and has joined several industry initiatives, including the Net Zero Asset Managers Initiative. At a business level they are committed to double carbon offsetting their own emissions through tree planting. They have also appointed an Environment Officer who is tasked with driving the businesses' own sustainability practices.

Baillie Gifford expect ESG to be of great importance to how they operate in the coming years, however they are not underestimating the increased complexity of the area from both a regulatory, and client preferences, perspective. They therefore look to integrate ESG in a thoughtful way as they believe it deepens company insights and can therefore improve investment returns. They also try to target the most relevant ESG factors at an individual company level.

Over recent years, Baillie Gifford has built a vast team of almost 50 individuals dedicated to ESG and sustainability. Over half of these are ESG Research and Engagement analysts who are embedded into the different investment teams and provide ESG input at a strategy level. The next biggest cohort are the ESG Services team who undertake pre-AGM analysis, execute voting and assist with ESG data. The remainder are split across a climate team who assess the inter-relationships between climate change and businesses, and a small client team. The majority of these recent hires are fairly early in their careers.

Baillie Gifford doesn't provide separated ESG scores for the companies they research, instead the focus is on qualitative in-house ESG research. They will not necessarily look to disinvest from companies in problematic industries, rather they will keep companies on watch and look for improvement over time.

In the coming years, the business is hoping to enhance their client reporting around ESG and sustainability, as well as increase the number of explicitly 'sustainable' funds within their product offering.

Board Overview

The board has five members, with an average tenure of just over three years. There is a broad range of skills and experience across the board including accountancy, robotics engineering, investment management services and asset management. All of the board are independent which we feel is a crucial element and a key advantage of the investment trust structure. Of its board members, four are owners of the trust which gives us encouragement that the board is aligned with minority shareholders.

Fund Description

Fund Manager/Team Overview

This trust is managed by Praveen Kumar, however he is supported by the Edinburgh based Japanese team, which is made up of around 10 members, a number which is considered large enough to deal with the workload but small enough to ensure that decisions can be swiftly made. Alongside the core team there are also two additional researchers based in Tokyo and a dedicated ESG analyst. Portfolios run within the Japanese franchise follow a team based approach and all members share the same growth investment philosophy and process of identifying attractively priced Japanese securities.

Investment Philosophy & Process

Baillie Gifford believes that share prices follow earnings and that attractive opportunities can therefore be found in companies that offer above average sustainable growth in earnings and cash flows. The philosophy and process are very much focused on company research and identifying as yet undiscovered and small companies, with high growth rates and business models which could disrupt large industries and their stalwarts by using proprietary tech or internet-focused business models. That being said, the team seeks a number of key features when considering potential investment ideas, including a positive industry background, a durable competitive edge, strong financial characteristics and management team interests that are aligned with shareholders.

The manager defines small cap stocks as firms with market capitalisations of less than 150 billion yen at the time of purchase, and the final portfolio will be constructed on the merits of individual companies and will comprise of between 40 and 80 holdings. The mandate permits the manager with freedom to invest where he sees fit, but there are some risk guidelines in place, mainly at a stock level. For example, the maximum single stock position is 10% of the portfolio, a 5% holding size will trigger a review and the maximum stock position at the time of initial purchase is 3%. This strategy also has the ability to invest in up to 10%, at the point of purchase, in unlisted companies.

Fund ESG Integration

ESG is integrated into this strategy's investment process, and accounts for one of the four-factor investment framework. Within this, respective analysts will assess the ESG credentials of individual stocks prior to investment. Alongside this, the Japanese investment team has an integrated governance and sustainability analyst, Cian Whelan, who helps provide input and challenge to the team at the stock level. Furthermore, the team will, and do, vote against management if actions are deemed not in the interests of shareholders. The team will also engage with their holdings over the course of investment in order to unlock their potential value with respect to ESG capabilities.

Ultimately, whilst ESG factors are embedded within the thought process of the Japanese team, it does not drive their final investment decision, but instead is a lens through which they view the potential risks and opportunities within any investment case.

Discount/Premium Policy

The board does not operate a formal discount control mechanism, but do commit, under normal market conditions, to minimise the discount to the prevailing net asset value. Over the last financial year to 31st January 2023, the trust bought back 100,000 shares, at a cost of £154,000. The trust, however, remains at a discount, trading at an average c.10% discount over the last year, which is slightly wider than its closed ended peers.

Debt Structure & Gearing Policy

The board recognises the long-term advantages of gearing; therefore, it is structural. Gearing levels are discussed by the board and managers at every board meeting, with a maximum of 30% gearing allowed. The five-year average gearing is 11%, with it ranging between 5 to 18% over the last three years. Borrowing facilities are made through a combination of revolving credit and fixed rate loans, with some borrowings made in yen to limit the exchange rate exposure.

Dividend Cover & Reserves

The trust's policy is to pursue long-term capital growth, with no specific dividend policy. The trust has not paid a dividend for many years, with the last one being paid in 1988.

Risk Summary

This trust is invested in Japanese equities and is exposed to the yen, both of which are generally quite volatile as the Japanese market and currency can, at times, be driven by factors utterly unrelated to company fundamentals. The manager of this trust has a long-term investment horizon and focuses on investing in growing companies at the lower end of the market capitalisation spectrum which are typically more volatile than their larger peers. Moreover, the final portfolio is constructed in a conviction manner, without reference to its benchmark index, and can include up to 10% exposure, at the point of purchase, in unlisted companies. This results in a strategy that can, and will, look and act very differently to the index, especially over shorter timeframes. In addition, its return profile can also be amplified by its application of gearing. Therefore, this strategy may be more suitable for investors with a longer time horizon, who are not seeking index like returns, and are willing to accept a greater level of variability around said index.

Additional Information

Annualised Return: -19.99%
Annualised Volatility: 19.31%
Max Drawdown: -50.78%
Max Gain: 13.67%
Max Loss: -23.52%
Sharpe Ratio: -
Sortino Ratio: -0.99

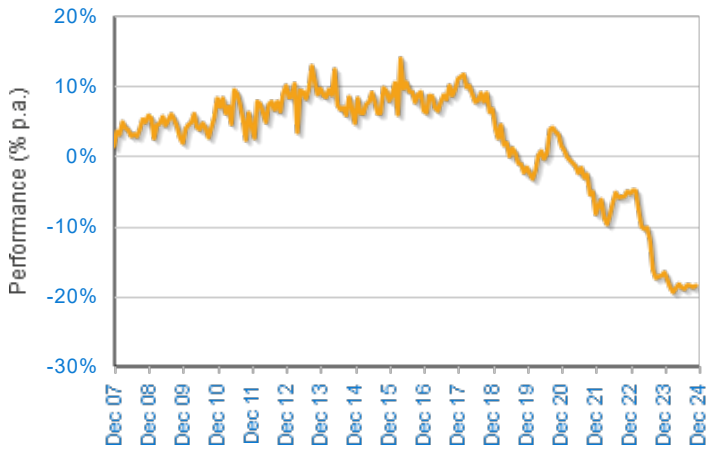
(3 years data to last month end unless otherwise stated)

Qualitative Risk Assessment

	Significant	Potentially Significant	Not Significant
Equity Risk			
Interest Rate Risk			
Credit Risk			
Exchange Rate Risk			
Liquidity Risk			
Emerging Markets Risk			
Derivative Risk			
Manager Risk			
Gearing Risk			
Discount/Premium Risk			

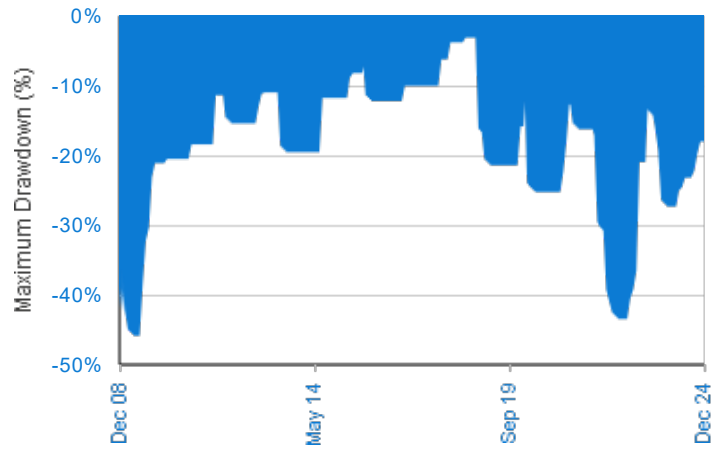
For the full summary of the risks, [click here](#)

3 Year Rolling Sector Outperformance



Source: Square Mile and LSEG Lipper (all rights reserved), Data as at: 21st January 2025. Share price total return.

Maximum Drawdown (Rolling 12 Months)



Source: Square Mile and LSEG Lipper (all rights reserved), Data as at: 20th January 2025

Calendar Year Performance To Quarter End

Period	Fund (%)	Sector (%)
2024	-14.8	1.8
2023	-14.1	2.7
2022	-30.5	-11.2
2021	-17.2	-2.5
2020	48.5	14.2

Source: Square Mile and LSEG Lipper (all rights reserved), Data as at: 30th January 2025

Value for Money

The annual management fee is 0.75% on the first £50 million, 0.65% on the next £200 million and 0.55% on the remaining net assets, calculated and payable quarterly. We believe the use of tiered fees is a positive for investors as it passes on economies of scale as the trust gets bigger. The ongoing charge, as at 31st January 2023, was 0.74%, which was the cheapest versus its peer group. When also considering that its trading cost (TC), which was marginally above its peer group average, the total cost of investment (TCI) offers good value, in our opinion, with it being below the peer group average.

OCF v Peer Group



0.72%

Transaction Costs v Peer Group



-

TCI v Peer Group



0.72%

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Square Mile Analysts

Ajay Vaid - Investment Research Analyst

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Rating Changes

The Square Mile ratings are reviewed every 6 months. For full details on the methodologies, [click here](#).

There have been no ratings changes over the last 12 months.

All Rated Investment Trusts

For a full list of all Square Mile rated funds, [click here](#).

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