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Markets Business

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Buy, sell or hold: today's best share tips

How Japan could unlock real value

NIPPON ACTIVE VALUE FUND

Market cap	Net asset value
£444m	236p

Why would any sane investor sink money into Japanese small and medium-sized companies? They don't exactly scream transparency, and many of their executives are still ambivalent about foreigners nosing around their businesses.

But in 2014 the then-prime minister, Shinzo Abe, opened things up. He launched a corporate governance reform programme to improve stock performance, not least because the government collectively owned up to 30 per cent of the shares on the Tokyo stock market. He insisted on investing institutions actively engaging with companies, and established clear guidelines for board transparency and accounting practices.

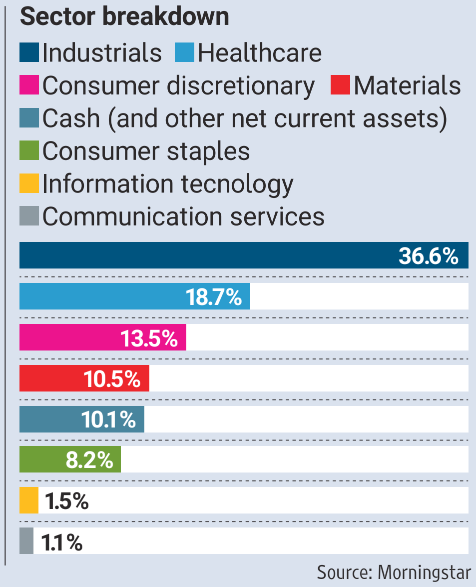
The opportunity for investors was clear, and seven years ago the long-time Japan-watcher Jamie Rosenwald switched Nippon Active Value Fund (NAVF) to a dedicated activist strategy to take advantage of the government's policy.

In 2023 his hand was strengthened when the government programme insisted that firms trading below book value or returning under 8 per cent on equity must announce improvement plans. Nearly half of Japanese quoted companies still trade below book value. Because the working-age population is declining, smaller companies often have limited human resources and difficulties establishing management succession.

Opportunity knocks

Nippon Active Value

Sector breakdown



ADVICE Buy
WHY Not without risk, but on balance an attractive proposition

The fund targets the 85 per cent of Japanese companies run by salarymen, the local term for risk-averse managers who sit on cash reserves, own no equity, hoard cash, are protected by huge cross-shareholdings, and use company money to buy property or art that often accounts for more than half their asset value. So there's plenty of scope for share prices to rise as that wealth is unlocked.

Paul ffolkes Davis, co-founder of NAVF and chairman of its investment adviser, Rising Sun Management, estimates it will take several years to iron out the anomalies. And the Japanese stock market is on average cheaper than Korea, Vietnam, Thailand and India. So this is more than just a one-off and there is plenty of scope for profit.

"From a cultural point of view," ffolkes Davis says, "a lot of managers are really quite happy with their companies' low valuations. What we're trying to do is disturb the sleeping patterns of, in our view, badly run, but quite good firms."

NAVF has only 27 holdings, worth about £450 million in total. That compares with a total £103 million value in 2020. One of the biggest investments, Eiken Chemical, specialises in genetic testing and colorectal cancer screening, activities that should prosper amid Japan's ageing population. Its overcapitalised and cash-laden balance sheet makes it a target for activist investors, and NAVF holds almost 10 per cent.

The fund has an undrawn £70 million borrowing facility with Northern Trust, and is sitting on £10 million of cash. It does not hedge its foreign exchange exposure. According to its official hedging policy, while the board has the discretion to use derivatives such as futures or forward contracts to limit volatility, they choose to leave the portfolio entirely exposed to movements in the yen and sterling exchange rate.

If the yen falls against the pound, NAVF's UK investors suffer as income and other returns yield fewer pounds. From inception to mid-2025, NAVF's underlying portfolio grew by 231 per cent in yen terms. But, because the yen depreciated sharply in that period, the return in sterling terms was only 141 per cent.

Conversely, when the yen rises against the pound, it confers an immediate boost. This is, in effect, an additional element in the portfolio. If, as NAVF expects, the Bank of Japan gradually raises interest rates, the yen should recover, to UK shareholders' benefit. Many Japanese companies will gain, too, as a stronger yen will cut import costs.

This is not an investment for the cautious. Nevertheless, last year it paid a 5.52p dividend, 70 per cent higher than the year before, to produce a 2.5 per cent yield. The increase reflects the fund's success in squeezing cash from its portfolio. And the share price is within striking distance of the 233p net asset value after a 17.4 per cent return on capital in 2025.