AJBell Investcentre

Fundamentals with Russ Mould

September 2017

Welcome to the latest edition of Fundamentals. This time around I'm going to look at a so-called passive fund, namely **Vanguard FTSE Japan ETF.**

[CAPTION - Vanguard FTSE Japan UCITS ETF (GBP)
EPIC code – VJPN
SEDOL – B9L8M65
ISIN – IE00B95PGT31]

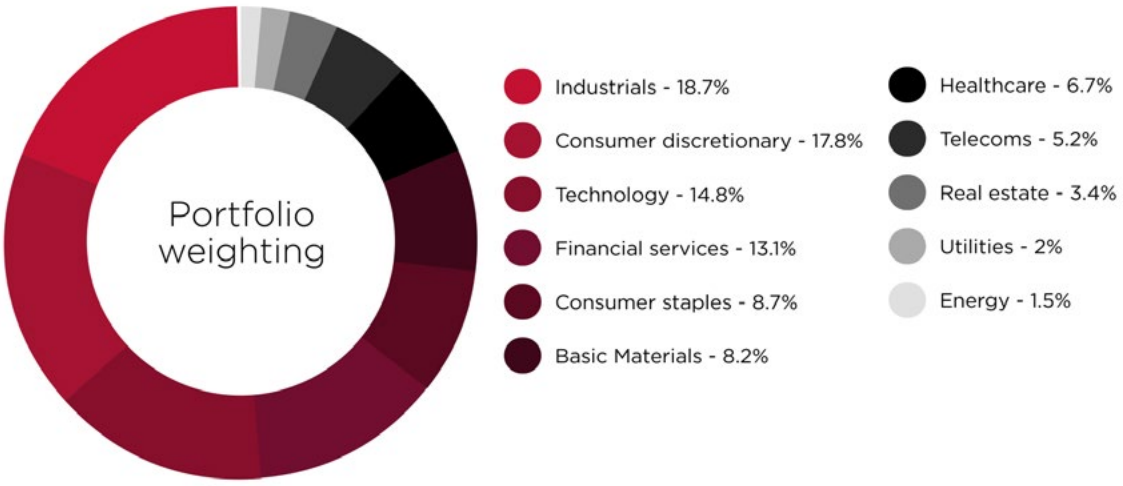
This is an Exchange-Traded Fund or ETF. It is designed to track the performance of the underlying assets and deliver that performance, minus its running costs.

In this case the ETF is tracking the FTSE Japan index, which covers large and mid-cap Japanese stocks that are themselves members of the FTSE All-World index.

The ETF uses physical replication to provide performance, which means it owns the actual underlying stocks. As I sit here there are 493 companies in the portfolio and the top 10 holdings represent just under 18% of the assets under management, so any investor buying this will get diversified exposure to the Japanese stock market.

The largest individual stock positions are car maker Toyota, Mitsubishi UFJ Financial, technology-to-telecoms group Softbank, Sony and Sumitomo Mitsui Financial.

This first chart shows the £850 million portfolio's weightings by sector. Industrials, consumer discretionary and tech are the three biggest exposures, at 19, 18 and 14% of the total assets respectively. By contrast, energy, utilities and real estate have a combined presence of only 7%:



Source: iShares factsheet, Morningstar

Dividends are paid quarterly and the historic yield is around 1.6% based on the 36 pence of dividends paid out over the past 12 months and a price for the ETF just north of £22.

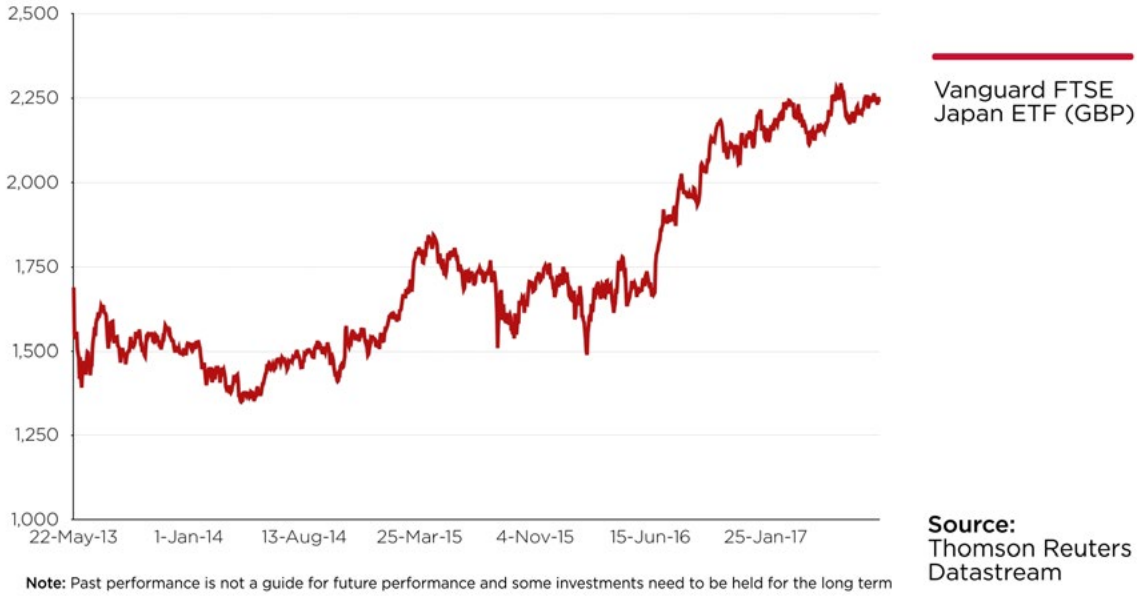
The ongoing charge figure for the ETF is just 0.19%, a figure beaten by just two of 37 rival products, so Vanguard FTSE Japan ETF looks pretty cost competitive.

The ETF is just over four years old and it comes with a four-star ranking from Morningstar, for those who put value in such things. As a final point, the ETF comes with both sterling and dollar-priced versions – we are talking about the one that is denominated in pounds on this occasion.

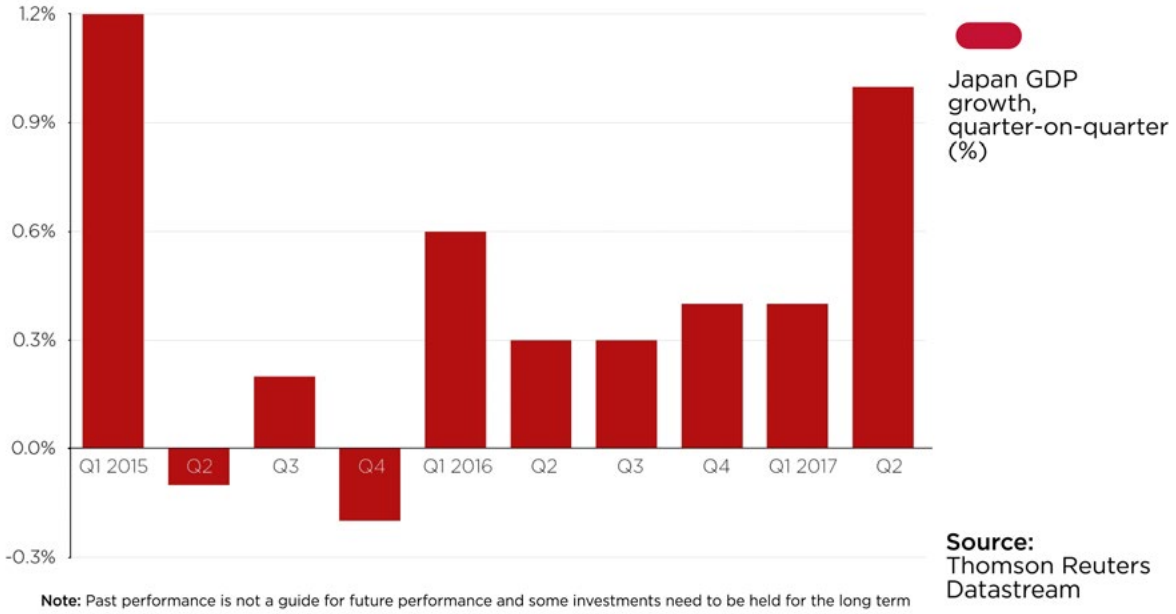
Those are the mechanics so the next question is why an investor would consider this ETF for their portfolio today? I think there are three factors to consider:

- The first is that Japanese stocks are doing pretty well. The Nikkei 225 index is back flirting with the 20,000 mark it last reached in summer 2015 while the broader Topix benchmark is trading near 1,600, again pretty much a two-year high, as we can see here:

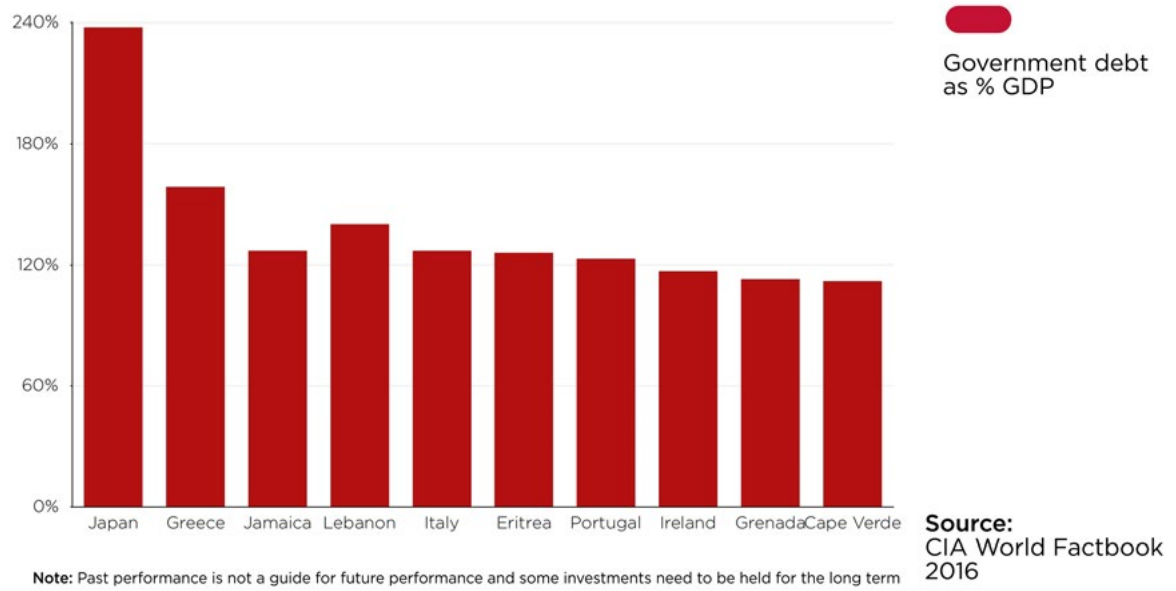
Those figures mean that the Vanguard FTSE Japan ETF has done well since inception too, as we can see here:



- The second is that Japan has just recorded its sixth straight quarter of GDP growth, its best run in a decade. This suggests that Prime Minister Shinzo Abe's programme of economic, political and social reforms – known as 'Abenomics' – is working, ironically at a time when Mr Abe's popularity with the voters is sagging to the lowest levels seen since he took power in late 2012:



- The third is that Japanese companies, encouraged by Abenomics, are becoming more shareholder aware, increasing dividends, launching share buybacks and focusing on bolstering profits and return on equity.
- With 493 holdings and a low ongoing charge figure, Vanguard FTSE Japan ETF provides cost-effective and nicely diversified exposure to these three themes. But this is not to say the product is suitable for everyone because there are three risks and possible downsides that must be taken into account.
- First, that 1.6% yield may not be enough for income seekers.
- Second, the Bank of Japan is running a huge Quantitative Easing programme, running at ¥80 trillion a year, or around £560 billion – remember the UK's total QE scheme has come to just £445 billion. And the Bank of Japan is not just buying bonds either – it is buying ETFs like this one, so sceptics will want to know why you should buy a market where the central bank was the single largest buyer of stocks in 2016 and where the central bank owns three-quarters of the total assets in Japanese ETFs, according to research from Societe Generale. What happens when the Bank of Japan stops QE and stops buying? Or tries to unwind it and starts selling?
- Third, in terms of economics, Japan is where no-one wants to go. It has run QE and low or zero-interest policies (to match those of the US, UK and Europe) on and off for the last 20 years, as it battles deflation, weak demographics and Government debts that come to around 240% of GDP – the highest figure in the world, as we can see here. Bears of Japan will therefore argue the country remains a debt-riddled basket case destined to suffer poor growth unless the social reforms go even further and the taboo subject of immigration is tackled to help compensate for the low birth rate:



There is also the additional complication of the regional tensions stoked by North Korea's sixth nuclear test and its test flight of a missile over Japanese territory.

When you do your research it is therefore important to make sure that Vanguard FTSE Japan ETF fits your own personal overall investment strategy, target returns, time horizon and appetite for risk.

Thank you for watching and I look forward to seeing you next time.

AJBIC/RM/T/20170912