

Fidelity Japan Trust

Unearthing attractively valued growth in Japan

Fidelity Japan Trust (FJV) has recovered well in NAV terms from the global equity sell-off in the last quarter of 2018, which negatively affected its FY18 performance. Manager Nicholas Price says that the sharp de-rating of Japanese equities (which has only partly reversed as share prices have rebounded) means he is able to find many attractive companies trading at unwarranted discounts. The Japanese equity market is extremely under-researched compared with other major developed markets, and the input from Fidelity's large, locally based analyst team, together with Price's own research, makes FJV well-placed to capitalise on investment opportunities that the majority of (particularly overseas) investors may have overlooked. FJV's multi-cap portfolio continues to have a natural bias towards smaller and mid-cap stocks, with Price seeking reasonably priced companies that have high returns on equity and a solid three- to five-year growth outlook.

12 months ending	Share price (%)	NAV (%)	Blended benchmark (%)	TOPIX (%)	R/Nomura Mid & Small Cap Japan (%)	FTSE All-Share (%)
31/03/15	23.0	26.0	28.6	25.9	28.6	6.6
31/03/16	3.6	8.5	2.3	(1.7)	2.3	(3.9)
31/03/17	28.5	20.6	32.5	32.9	32.5	22.0
31/03/18	29.9	32.1	10.3	8.3	10.3	1.2
31/03/19	(4.9)	(6.3)	(1.7)	(1.8)	(3.2)	6.4

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

The market opportunity

Japanese equities are under-owned by overseas investors (c 2% of UK retail AUM, compared with c 7% of global stock market capitalisation), and are also under-researched by sell-side analysts. Forward P/E valuations are low, both in a global context and relative to history, yet corporate earnings growth remains solid year-on-year. Although not immune to a deterioration in global economic conditions, Japan's equity market is more domestically exposed than some others, but also includes many innovative companies with world-leading positions in growing global markets.

Why consider investing in Fidelity Japan Trust?

- Solid medium-term performance record, as well as a strong recovery after underperforming in the Q418 market sell-off.
- Experienced, Japan-resident manager, backed up by large, local analyst team, is able to uncover opportunities that are under-researched by the sell side.
- All-cap approach with natural bias to faster growing small- and mid-cap stocks.
- Flexible, low-cost gearing through contracts for difference (CFDs).
- Japanese equity valuations are low relative to history and to global peers.

Discount near average; benefits from yen strength

FJV's 10.1% discount to cum-income net asset value (as at 18 April 2019) is somewhat below its long-term average level, although it has widened substantially in the past six months. While Japanese equities have suffered from overseas investors' risk aversion, the currency benefits from being seen as a safe haven, so yen strength has boosted returns from FJV's unhedged portfolio for sterling-based investors. The trust invests mainly for capital growth and does not pay a dividend.

Investment trusts
Japanese equities

23 April 2019

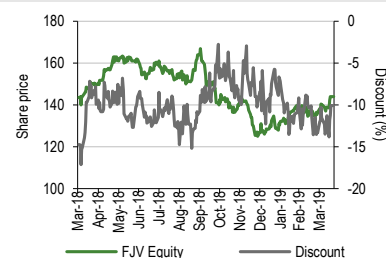
Price 144.0p
Market cap £194.3m
AUM £259.5m

NAV* 160.1p
Discount to NAV 10.1%

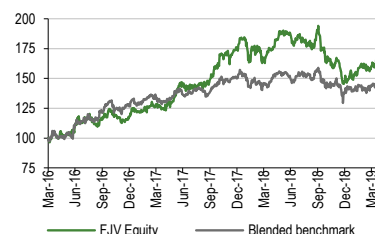
*Including income. As at 18 April 2019.

Yield 0.0%
Ordinary shares in issue 134.9m
Code FJV
Primary exchange LSE
AIC sector Japan
Benchmark TOPIX

Share price/discount performance



Three-year performance vs index



52-week high/low 167.0p 125.0p
NAV** high/low 184.6p 136.0p

**Including income.

Gearing

Gross market gearing* 16.1%
Net market gearing* 16.1%

*As at 28 February 2019.

Analysts

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[Edison profile page](#)

Fidelity Japan Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

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 index as its performance benchmark, and is a member of the AIC Japan sector.

Recent developments

- 29 March 2019: Results for the year ended 31 December 2018: NAV TR -15.4% and share price TR -16.2%, compared with an 8.3% decline in the TOPIX TR index (all in sterling terms). £386k saved as a result of management fee change in H218.
- 31 July 2018: Results for the half-year ended 30 June 2018. NAV TR +8.3% and share price TR +6.8%, compared with +0.5% for the reference index (R/Nomura Mid & Small Cap Japan including dividends until 22 May and TOPIX Total Return thereafter), all in sterling terms.

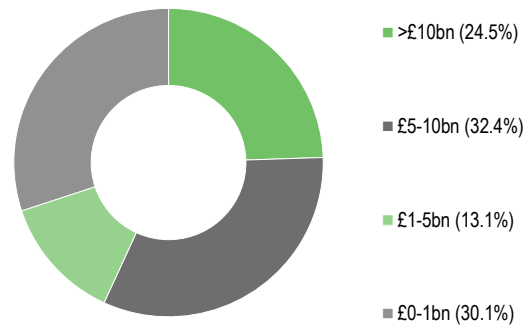
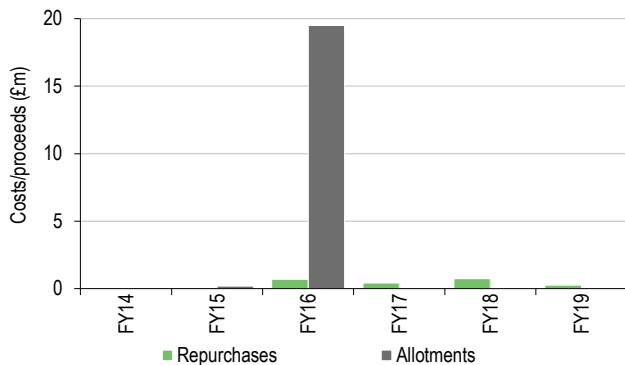
Forthcoming		Capital structure		Fund details	
AGM	21 May 2019	Ongoing charges	1.1%	Group	FIL Investments International
Interim results	July/August 2019	Net gearing	16.1%	Manager	Nicholas Price
Year end	31 December	Annual mgmt fee	Variable (see page 9)	Address	Beech Gate, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RP
Dividend paid	None	Performance fee	None (see page 9)	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 2019	Loan facilities	None (see page 9)		

Share buyback policy and history (financial years)

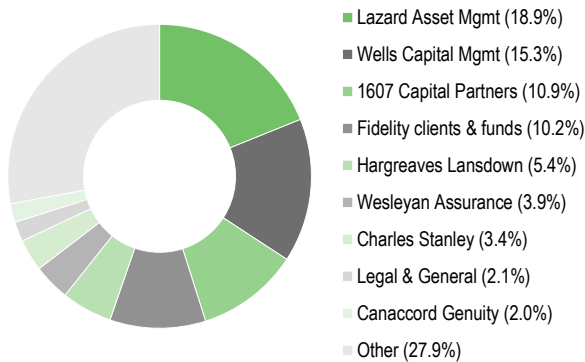
Renewed annually, FJV has the authority to repurchase up to 14.99% of shares and allot shares up to the equivalent of 5% of the issued share capital. Allotments in the chart below include the exercise of subscription shares.

Market capitalisation breakdown (in sterling, as at 28 February 2019)

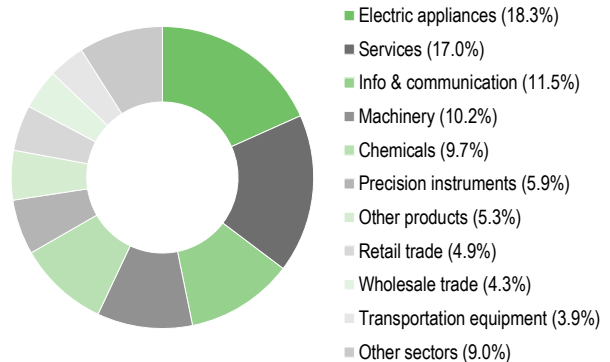
Figures adjusted for gearing. FJV is heavily overweight small and mid-cap growth stocks, has broadly neutral exposure to large-cap growth and small-cap value stocks, and is very underweight large- and mid-cap value stocks.



Shareholder base (as at 8 March 2019)



Portfolio exposure by sector (adjusted for gearing, as at 28 February 2019)



Top 10 holdings by net long position (as at 28 February 2019)

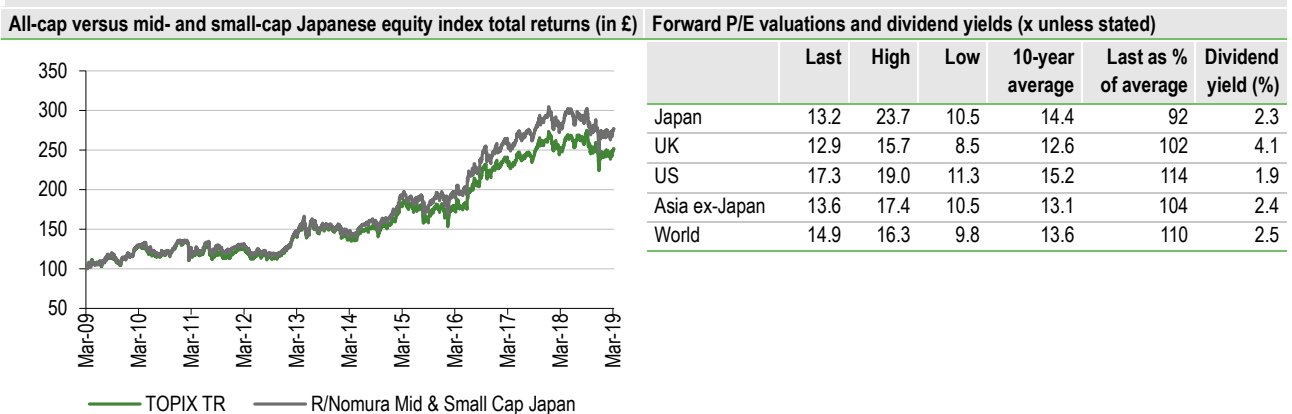
Company	Country	Sector	Portfolio weight %	
			28 February 2019	28 February 2018*
Kosé Corporation	Japan	Chemicals	6.4	N/A
Recruit Holdings	Japan	Services	5.4	N/A
Yamaha Corporation	Japan	Other products	5.1	4.3
Keyence Corporation	Japan	Electric appliances	5.0	3.1
Makita Corporation	Japan	Machinery	4.6	5.6
Sysmex Corporation	Japan	Electric appliances	3.9	3.8
Olympus Corporation	Japan	Precision instruments	3.9	N/A
Misumi Group	Japan	Wholesale trade	3.8	3.2
Daikin Industries	Japan	Machinery	3.4	4.4
M3 Inc	Japan	Services	3.4	6.1
Top 10 (% of portfolio)			44.9	39.8

Source: Fidelity Japan Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-February 2018 top 10.

Market outlook: Favourable balance of risk and reward

After many years of relatively disappointing returns (following the bursting of an asset price bubble in the late 1980s), Japanese equities have provided solid returns for sterling-based investors over the past four to five years (Exhibit 2, left-hand chart). Part of this is due to currency movements, with sterling largely out of favour since the UK's EU referendum in June 2016, and the yen seen as a safe haven in times of global economic uncertainty. However, a quiet revolution in corporate Japan means that company managements are now much more focused on delivering shareholder value, exemplified by the fact that dividend yields (right-hand chart) are now close to the averages for the world and the rest of Asia, and are well above those of the US (all figures using Datastream indices). In terms of equity valuations, Japan is the only market shown below where forward P/E valuations are currently at a discount to their 10-year average, and in absolute terms, only UK stocks (which have been shunned by overseas investors in recent years) are trading at a lower prospective valuation. Risks do remain in the global economic and political outlook, including slowing growth in China (a key export market for Japan, and also a major source of inbound tourism), and the continued lack of resolution to US-driven trade disputes. However, in the absence of a global recession, Japanese corporates should continue to deliver year-on-year earnings growth (Fidelity forecasts this in the mid-to-high single digits), and their current low valuations, coupled with the benefits of corporate reform, mean Japanese equities may look relatively attractive to investors from a risk/reward perspective.

Exhibit 2: Market performance and valuation



Source: Refinitiv, Edison Investment Research. Valuation data as at 11 April 2019, based on Datastream indices.

Fund profile: High conviction all-cap Japan portfolio

Fidelity Japan Trust (FJV), launched in 1994, changed its name from Fidelity Japanese Values in May 2018, as one of a number of measures designed to better reflect its flexible investment approach. At the same time, it also changed its Association of Investment Companies sector from Japan Smaller Companies to Japan, and its benchmark from a mid- and small-cap index to the all-cap TOPIX Total Return index (in sterling), and removed a reference in its investment objective to 'a portfolio... primarily of small and medium-sized Japanese companies'. The trust has been managed since 1 September 2015 by Nicholas Price, who aims to build a portfolio of Japanese companies that offer growth at a reasonable price. His investment approach (see Investment process), which has been consistent throughout his tenure on the trust, naturally leads him towards opportunities in smaller and mid-cap stocks, but he is free to invest across the market capitalisation spectrum (including up to 10% in unquoted companies). Because of this, the board of FJV sees the new sector, benchmark and wording of the objective as providing more accurate signposts for investors who may be comparing Japanese funds. The change of name acknowledges that the trust does not

follow an explicitly 'value' style of investment. Price also manages a number of open-ended funds and segregated mandates using a similar approach, although FJV's closed-ended structure makes it more suited to holding less liquid investments, and also enables the manager to use gearing as a means of running a higher-conviction portfolio, with larger positions in favoured stocks. Rather than using bank borrowing, FJV gears using contracts for difference (CFDs), in a normal working range of up to 25% of net assets (16.1% at end-February 2019).

The fund manager: Nicholas Price

The manager's view: Plenty of good-value opportunities

Price points out that in spite of steady earnings growth being delivered by Japanese companies in aggregate, the sell-off in equity markets during 2018 means Japanese equities are now trading at low P/E valuations relative to history. As a result, investors have the opportunity to capitalise on the disparity between the encouraging growth prospects for corporate Japan, and what the manager sees as excessively negative investor sentiment. While the average forward P/E multiple for the stocks that make up the TOPIX index has risen somewhat since the turn of the year, from 10.7x at end-December to 12.6x at end-March, this still represents a discount to global equity markets, and a substantial discount to the dominant US equity market. Although analyst expectations for future corporate earnings growth globally have been revised downwards in recent months, Price says that the flexibility shown by the US Federal Reserve in the face of changing macro expectations, as well as Chinese government efforts to support the slowing economy there, should translate into an improved cycle of earnings revisions by the second half of 2019. This would be further boosted by any easing in trade frictions between the US and the rest of the world (particularly China).

The manager aims to generate outperformance by spotting signs of positive change that will benefit companies over the medium to long term. With this in mind, he says he sees attractive investment opportunities in three principal areas: stable growth companies with high-quality franchises, that can continue to increase earnings even as the global economy shifts from acceleration to stabilisation; businesses that are exposed to structural growth trends in Japan and across Asia (such as factory automation, staffing and recruitment, and medical technology); and innovative but under-researched companies, which Fidelity's large analyst team is often able to identify before their potential is recognised by the wider market.

From a macro perspective, Price says that despite the worsening in external trade demand over the past year, Japanese companies and the economy are relatively well placed to grow, as they are more geared to domestic demand: c 60–65% of TOPIX companies' revenues (and c 70% for the FJV portfolio) are domestically derived, which is in sharp contrast to the UK FTSE 100, where c 70% of company earnings come from overseas. With labour market conditions in Japan remaining extremely tight, there is scope for further wage growth, which should boost demand for consumer goods and services. He notes that a planned VAT increase from 8% to 10% in October may reduce demand towards the end of this year, although it is likely to have a positive effect in Q319 as people bring forward purchases ahead of the tax hike. The last increase (from 5% to 8% in 2014) did provoke a relatively severe downturn in consumption, but the manager points out that the forthcoming increase is smaller, and also that there are several important exemptions and reliefs, such as for food, newspapers, autos and home purchases/renovations. The tax increase is designed to be a permanent source of funding for free preschool education and day care, so the impact on the pockets of working parents of young children should be limited, and it may encourage a further rise in women's participation in the labour force, which in turn would benefit the economy.

Asset allocation

Investment process: Seeking growth at a reasonable price

FJV's manager, Nicholas Price, is a member of Fidelity's well-resourced, Tokyo-based Japanese equities team, which includes 13 analysts (part of a c 140-strong global equity research network). Before becoming a portfolio manager in 2000, Price was a member of the analyst team for six years; he continues to conduct his own research on companies (c 30% of FJV's holdings are stocks the manager has identified as promising candidates for investment), as well as drawing on the analysts' ideas.

Portfolio construction is bottom-up and largely unconstrained, subject to certain limits and guidelines set out in the investment policy. Single positions are typically no more than 6pp over or under their benchmark weighting, and a maximum 12% of the portfolio (including CFD exposure) may be held in a single company or group of connected companies at the time of investment. FJV may not hold more than 7.5% of the shares of a single company, or 10% for a group of companies. Sector weightings are an output of stock selection, but will typically be no more than 10pp over or under the benchmark weighting. However, this limit is largely academic, as only one of the 33 TOPIX sectors – electric appliances – makes up more than 10% of the total.

The manager seeks stocks that offer growth at a reasonable price, building a high-conviction, multi-cap portfolio (with a mid- and small-cap bias) of c 80–110 holdings, with the aim of achieving capital growth in higher than the TOPIX Total Return index (in sterling terms). Price's investment universe comprises more than 2,000 stocks listed in Tokyo or on Japanese regional exchanges, as well as unlisted companies, which may make up a maximum of 10% of the portfolio. The Japanese equity market is less well researched by the sell side (investment banks and brokers) than any other major developed market, and mid- and small-cap stocks are particularly under-researched, with 90% of listed Japanese companies covered by fewer than five sell-side analysts, and more than half the universe having no analyst coverage at all. Fidelity's large analyst team (which has c 400–500 stocks under coverage) thus has the ability to uncover attractive investment opportunities that other investors may overlook. The analysts provide ongoing coverage of stocks, assigning all the companies they cover a rating between 1 (a strong buy) and 5 (a strong sell), and producing a fundamental research report on each one at least every 120 days.

Exhibit 3: Portfolio market cap exposure versus TOPIX index (% unless stated)

	Portfolio end-February 2019	Portfolio end-February 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
>£10bn	24.5	23.5	1.0	55.6	(31.1)	0.4
£5–10bn	32.4	27.7	4.7	15.2	17.2	2.1
£1–5bn	13.1	18.8	(5.7)	20.2	(7.1)	0.6
£0–1bn	30.1	29.7	0.4	9.0	21.1	3.3
Other index/unclassified	0.0	0.3	(0.3)	0.0	0.0	N/A
	100.0	100.0		100.0		

Source: Fidelity Japan Trust, Edison Investment Research. Note: Adjusted for gearing.

Price typically conducts c 400 company meetings each year, with both listed and unlisted companies from across the size spectrum. He assesses businesses' sustainability and barriers to entry, valuations, liquidity, and upside and downside potential. Candidates for inclusion in the portfolio should offer a three- to five-year runway of growth, with returns on equity (ROE) above 20% a year, reasonable valuations (assessed versus the medium-term earnings outlook as well as relative to history and industry peers, both in Japan and globally) and shareholder-friendly management. This naturally leads the manager to favour faster-growing small- and mid-cap companies. Price prefers businesses with strong domestic brands and competitive positions, which have scope for international expansion. The majority of the FJV portfolio is made up of companies that are growing their sales and profits above the average for their industry, supported by secular growth trends.

However, a smaller proportion is in turnaround situations that have suffered a temporary setback and are trading at historically low valuations.

A key focus in portfolio construction is identifying signs of change, including in fundamentals (such as a company moving into a new market or product segment), sentiment, the industry environment (from both a competitive and a regulatory perspective), or valuation methodology. Spotting signs of positive change early can give the manager the opportunity to buy into companies before a re-rating occurs, while a negative change in sentiment – all else being equal – may offer the chance to buy into an otherwise strong company while its share price is depressed.

Price takes a disciplined approach to portfolio construction, with position sizes based on conviction, liquidity and potential upside. All holdings are assigned a target price, and the manager will trim positions to lock in gains as they approach the target, recycling the proceeds into better-value opportunities. Long CFDs are used to add gearing on a stock-by-stock basis. As well as exiting positions when stocks reach their target price, the manager may sell a holding if a change in the outlook means it has begun to look overvalued at its current price. The dynamic approach to portfolio management leads to a relatively high turnover of c 75–100% a year (FY18: 75.1%).

Current portfolio positioning

At 28 February 2019, FJV had 92 holdings (including seven CFDs), towards the middle of the indicative 80–110 stock range. The top 10 positions made up 44.9% of the total, an increase in concentration from 39.8% a year earlier (see Exhibit 1). Seven holdings were common to the top 10 in both periods.

In terms of sectors (Exhibit 4), there have been some notable changes to weightings over the past 12 months. One such change was a 4.1pp increase in the electric appliances exposure to 18.3%, which is also one of the largest overweights versus the benchmark. Price says that during the Q418 sell-off, semiconductor and components stocks were among the worst performers, underperforming the TOPIX by c 30–50% and seeing their forward P/E ratios fall from c 30x to single figures. The manager took new positions in stocks including Renesas Electronics, SCREEN Holdings and ROHM Semiconductors (all semiconductor stocks), as well as the large-cap Murata Manufacturing, which makes ceramic capacitors. Price says he believes the correction in the semiconductor sector is nearly complete, and the Fidelity analyst team expects stabilisation in the short term, and then a reacceleration in the second half of the year. The largest change in sector weighting was a 5.6pp increase in information and communications, where the manager added a position in word processing software specialist JustSystems. Price says the company is enjoying favourable earnings growth, and in the medium term is expected to expand its sales growth in online supplementary educational services for children. The strong performance of online printing firm Raksul since its IPO in May 2018 has also boosted the information and communications weighting.

Exhibit 4: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-February 2019	Portfolio end-February 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
Electric appliances	18.3	14.1	4.1	12.9	5.4	1.4
Services	17.0	13.7	3.3	4.9	12.1	3.5
Info & communication	11.5	5.9	5.6	8.4	3.1	1.4
Machinery	10.2	14.9	(4.8)	4.8	5.4	2.1
Chemicals	9.7	4.8	5.0	7.3	2.4	1.3
Precision instruments	5.9	N/S	N/A	2.0	3.9	2.9
Other products	5.3	7.3	(2.0)	2.0	3.3	2.7
Retail trade	4.9	7.9	(3.0)	4.9	0.0	1.0
Wholesale trade	4.3	4.1	0.2	5.0	(0.7)	0.9
Transportation equipment	3.9	4.3	(0.4)	8.1	(4.2)	0.5
Real estate	N/S	4.3	N/A	N/A	N/A	N/A
Other sectors	9.0	18.8	(9.7)	39.9	(30.9)	0.2
	100.0	100.0		100.0		

Source: Fidelity Japan Trust, Edison Investment Research. Note: Adjusted for gearing. N/S = not separately stated; may be included in 'other sectors'.

The chemicals weighting has more than doubled over the past year, largely reflecting a significantly increased holding in cosmetics firm Kosé Corporation, which is now FJV's largest position. Kosé makes high-prestige branded cosmetics, and is seeing very strong sales growth across Asia, particularly in China and South Korea. Its brands include Sekkisei and Decorté, and it also acquired the US-focused makeup brand Tarte in 2014. Kosé had experienced some negative sentiment on fears of a slowdown in demand from China, but has benefited from a recent rebound in tourism to Japan (Price says tourist arrivals were a record 33.3 million in January 2019), which boosted department store cosmetics sales by c 20–40% year-on-year.

The biggest reduction in sector exposure over 12 months to 28 February 2019 was in machinery, where heavy equipment maker Komatsu was sold, and the positions in Daikin (air conditioning units) and Makita (tools for the trade and DIY markets) were trimmed. Services is the largest sector overweight (12.1pp above the TOPIX weighting), and its weighting increased over the 12-month period, although Price says exposure has fallen versus six months ago, as he has taken some profits in stocks that have done well, such as online healthcare portal M3, jobs website operator Recruit Holdings, and business services provider Nihon M&A Center. Price says FJV continues to have limited exposure to low-growth defensive sectors and interest rate-sensitive financial stocks.

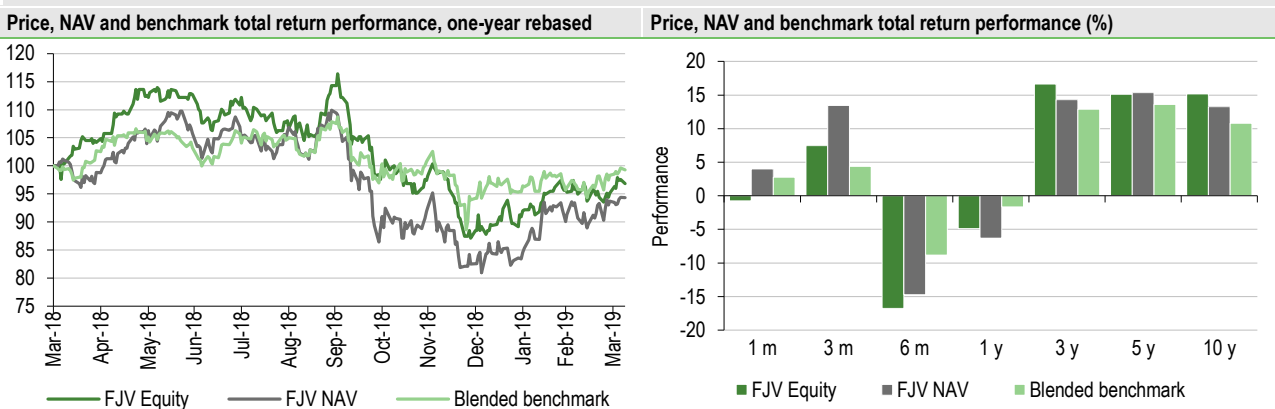
The most significant recent purchase has been Olympus Corporation, now the seventh-largest position in the portfolio. While UK-based investors may associate the firm mainly with cameras, it has a broad portfolio built on optical and digital precision technology, and is the world's leading manufacturer of medical endoscopes, with c 70% global market share. Although historically it has been less profitable than peers, Olympus has recently initiated a transformation plan that has enhanced Fidelity's view of its growth prospects and future profitability. The company has already seen an improvement in balance sheet management, increasing its free cash flow to make more strategic M&A deals and improve shareholder returns, yet it still trades at a discount to its peers.

Among the biggest sales in recent months was Japan Tobacco (previously a top 10 holding), which Price had tactically added to the portfolio as a defensive position, in anticipation of a 'risk-off' period. The manager also reduced FJV's former top 10 position in Suzuki Motor Corporation after a period of strong share price performance.

Gearing has risen over the past few months, from a low point of 12.7% at the end of September 2018 to 16.1% (around the long-term average) at the end of February 2019. Price capitalised on the market weakness at the end of 2018 to add to favoured holdings using CFDs.

Performance: Re-establishing trend of outperformance

Exhibit 5: Investment trust performance to 31 March 2019



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised. Blended benchmark is the R/Nomura Mid & Small Cap Japan index (£) until 22 May 2018 and the TOPIX index (£) thereafter.

FY18 was very much a year of two halves for FJV, with the trust posting negative returns on both an absolute and a relative basis for the full year (to 31 December), after outperforming in the first half. However, as shown in Exhibit 5, the long-term trend of NAV outperformance has been re-established since the turn of the year, with total returns of 13.5% for the first three months of 2019 (share price TR of 7.5%), compared with 4.4% for the TOPIX index. Q418 saw the steepest decline in Japanese equities since the global financial crisis, with mid- and small-cap growth stocks, which account for the majority of FJV's portfolio, falling by more than defensive large-caps such as utility companies. Over 12 months to 28 February 2019, FJV's overweight positions in machinery and retailers detracted from performance, while positive contributions came from areas such as information and communication, services, and precision instruments. Price comments that the machinery sector was hit particularly hard in the Q418 sell-off, as it is highly geared to industrial automation in China, and one of the principal causes of the negative market sentiment globally was fear over a slowdown in the Chinese economy, as well as the impact of US trade tariffs on China's export-orientated manufacturing sector.

At a stock level, among the largest negative contributors over 12 months to 28 February were tool maker Makita and niche small-cap machinery stock Nissei ASB Machine, which makes plastic moulding machines. There were also secondary effects on stocks such as staffing company UT Group, which supplies temporary workers for the manufacturing sector and sold off on concerns over labour demand. Ryohin Keikaku, which operates the Muji store chain, was another detractor, although as a longstanding holding it has made a positive contribution in aggregate. This stock has since been sold, as the manager felt supply chain issues and rising costs limited further upside. However, gains from the top positive contributors outweighed losses from the biggest detractors over the year to end-February 2019, and the portfolio's bias to growth over value stocks has once again been beneficial as the market rebounded following the Q418 sell-off. Notable performers over the 12 months included Vistaprint-style online printing company Raksul (held since before its IPO in May 2018), global job search portal Recruit Holdings, precision medical instrument maker Asahi Intecc, and Yamaha Corporation, whose principal business is musical instruments.

Exhibit 6: 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	(3.4)	2.9	(8.7)	(3.2)	12.3	15.5	65.1
NAV relative to TOPIX TR	1.2	8.7	(6.5)	(4.6)	5.7	16.7	39.8
Price rel to R/Nomura Mid & Small Cap Japan	(3.5)	3.4	(8.9)	(1.8)	12.1	8.6	49.6
NAV rel to R/Nomura Mid & Small Cap Japan	1.1	9.2	(6.6)	(3.2)	5.5	9.7	26.7
Price relative to FTSE All-Share	(3.3)	(1.8)	(15.2)	(10.6)	20.9	50.4	43.1
NAV relative to FTSE All-Share	1.3	3.7	(13.2)	(11.9)	13.7	51.9	21.2

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2019. Geometric calculation.

Exhibit 7: NAV total return performance relative to blended benchmark over five years



Source: Refinitiv, Edison Investment Research

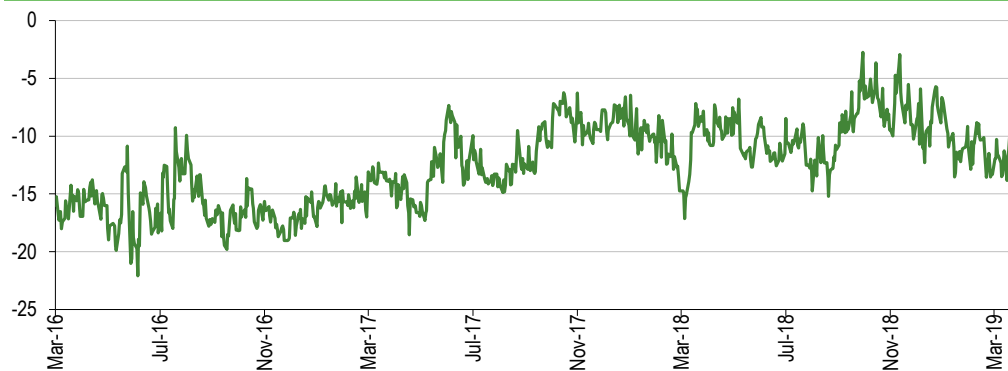
As shown in Exhibit 6, although FJV underperformed both its old small-cap benchmark and the TOPIX index over six and 12 months to 31 March 2019, it has strongly outperformed on both a NAV and a share price total return basis over most other periods. Exhibit 7 shows FJV's performance

versus the blended benchmark over five years. Manager Nicholas Price has run the portfolio since 1 September 2015, and has outperformed in aggregate over his tenure, even accounting for the relatively severe underperformance versus the TOPIX index in Q418.

Discount: Close to long-term averages

At 18 April 2019, FJV's shares traded at a 10.1% discount to cum-income net asset value. This is somewhat narrower than the medium- to long-term averages (12.4% over both three and five years, and 13.1% over 10 years), but a little wider than the one-year average of 9.9%. It is also substantially wider than the 10-year low of 2.7%, seen amid the market volatility in late October 2018, when the NAV fell by more than the share price. The discount has widened since the market lows at the end of December, as the increase in NAV has outstripped the rise in the share price. There is thus potential for it to narrow again if investors begin to look more favourably on Japanese equities. The fact that the discount remains close to the long-term average only a month before the three-yearly continuation vote suggests a reasonable degree of confidence in the market that shareholders will vote in favour of continuation, as the trust's board recommends.

Exhibit 8: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

A conventional investment trust with one class of share, FJV had 134.9m ordinary shares in issue at 18 April 2019. The board may buy back up to 14.99% of shares outstanding, or allot shares up to 5% of the issued share capital, in order to manage a discount or premium. In the 12 months to 18 April 2019, 661,000 shares (c 0.7% of the share base) were bought back at a cost of c £981,000.

FJV is permitted to use gearing up to 40% of net assets, with prior board approval required if the manager wishes to gear by more than 25%. Rather than having a borrowing facility, FJV gears using long contracts for difference (CFDs), which allow the manager to increase exposure to individual stocks at a fraction of the cost of buying them outright. Using CFDs has the same effect on portfolio returns as gearing using borrowed money, increasing gains on stocks that go up in value, while magnifying losses on those whose share prices fall. FJV's gross market exposure was 116.1% at 28 February 2019, equivalent to net gearing of 16.1%.

Fidelity receives a base annual management fee of 0.70% of net assets, reduced from 0.85% of gross assets with effect from the start of H218. A variable element was introduced at the same time, under which the fee may rise to a maximum of 0.90% if FJV outperforms the TOPIX index, or fall to a minimum of 0.50% if it underperforms. FY18 was a transitional period, with the fee calculated on the old basis for the first half of the year and the new basis for the second half. Nevertheless, FJV

reported a saving of £386,000 versus FY17 as a result of the new structure. Ongoing charges for the year were 1.1%, compared with 1.3% in FY17.

Dividend policy and record

FJV invests for long-term capital growth rather than income, and has not paid a dividend for more than 20 years. Although corporate governance reforms have encouraged companies to pay higher dividends, the small- and mid-cap growth companies in which FJV invests are still not particularly high-yielding, and the small amount of portfolio income the trust receives (c £2.8m in FY18, or c 2p a share) tends to be largely offset by management fees charged to the revenue account (c £1.9m in FY18, or c 1.4p per share).

Peer group comparison

Below in Exhibit 9 we show the members of the Association of Investment Companies' two Japan-focused sectors – Japan and Japan Smaller Companies. FJV is now a member of the Japan peer group, having moved from the smaller companies sector in May 2018 (to more accurately reflect its all-cap approach, rather than as a result of any change in its investment process).

Following the sharp sell-off in the last quarter of 2018, most of the funds in both sectors have posted flat to negative NAV total returns over 12 months to 16 April 2019, with FJV ranking third of the six trusts in the AIC Japan sector. FJV has outperformed the Japan sector average over one, three and five years, and ranks second over three, five and 10 years, although its 10-year performance is below the average as a result of the particularly strong performance of Baillie Gifford Japan. Average returns from the small-cap sector have been higher over all periods shown. FJV's ongoing charges are above the average for the Japan peer group but in line with the Japan Smaller Companies sector average. While none of the funds in either sector charges a performance fee, there is a performance-related element to FJV's new variable management fee structure (see page 9). FJV currently trades at the third-widest discount in the AIC Japan sector, and its discount is also wider than the average for Japan Smaller Companies. In common with most of its former peers in the smaller companies sector, FJV does not pay a dividend. (The JPMorgan Japan Smaller Companies trust has recently adopted a high distribution policy; however, this is largely paid out of capital and revenue reserves.)

Exhibit 9: AIC Japan and Japanese Smaller Companies sectors as at 17 April 2019*

% 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	194.3	(0.7)	49.9	116.9	250.6	1.1	No	(11.2)	116	0.0
Aberdeen Japan	77.1	(7.5)	19.5	77.1	231.8	1.2	No	(13.5)	111	1.0
Baillie Gifford Japan	722.2	(0.5)	59.4	137.5	411.7	0.7	No	3.2	111	0.1
CC Japan Income & Growth	198.7	(1.5)	44.1			1.1	No	3.7	116	2.5
JPMorgan Japanese	659.5	1.2	37.8	115.3	233.2	0.7	No	(11.7)	110	1.2
Schroder Japan Growth	232.2	(3.8)	33.7	81.1	199.5	1.0	No	(10.3)	112	2.2
Sector average (6 funds)	377.9	(2.4)	38.9	102.7	269.0	0.9		(5.7)	112	1.4
FJV rank in sector	5	3	2	2	2	2		4	1	6
AIC Japan Smaller Companies										
Atlantis Japan Growth	95.5	0.7	56.9	105.8	292.5	1.6	No	(10.2)	101	0.0
Baillie Gifford Shin Nippon	496.8	2.5	68.5	216.1	751.4	0.8	No	3.5	109	0.0
JPMorgan Japan Smaller Cos	208.8	(2.9)	39.7	124.6	248.2	1.1	No	(13.0)	108	4.7
Sector average	267.0	0.1	55.0	148.8	430.7	1.1		(6.6)	106	1.6

Source: Morningstar, Edison Investment Research. Note: *Performance to 16 April 2019 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

FJV has six directors, all non-executive and independent of the manager. David Robins was appointed to the board in 2011 and became chairman in 2012. Philip Kay joined the board in 2004 and has been the senior independent director since 2016. Sir Laurence Magnus, appointed in 2010, has served as chairman of the audit committee since 2011. Dominic Ziegler became a director in 2014, and two new directors – Sarah MacAulay and David Graham – were appointed in 2018. The directors have diverse professional backgrounds, spanning investment management, banking, corporate finance, economics, journalism and accountancy. The whole board undertakes a due diligence visit to Japan every year or two.

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