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## **The Baillie Gifford Japan Trust - Update**

Duration: 0:06:30

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### **Presenters**

- Perry Gourley
- Sarah Whitley

**Perry Gourley:** Hello I'm Perry Gourley I'm here today with Sarah Whitley manager of the Baillie Gifford Japan Trust, Hello Sarah.

**Sarah Whitley:** Hello Perry.

**Perry Gourley:** Sarah, how would you describe the current state of the Japanese economy?

**Sarah Whitley:** Like all the other major economies in the world the Japanese economy is in quite a weak state at the moment because of its high dependency on manufacturing. It's been hit quite hard since the Lehman shock of September and, at the moment; industrial production is falling quite sharply and consumers are quite risk averse despite the fact that they haven't got over geared balance sheets, and sentiment is quite weak.

**Perry Gourley:** And against that backdrop are there any grounds for optimism?

**Sarah Whitley:** Well, one reason is that Japanese manufacturers have cut back their production so sharply that it looks like production will bottom in the current quarter or in the next couple of months, and begin to increase sometime between April and May. So it looks like we may have seen the worst in terms of momentum for manufacturing in Japan. I suppose the other reason for optimism is that there has been quite a lot of government action around the world including in Japan's major export markets, the US and China. And we're beginning to see in China some figures beginning to improve as the government's stimulus package begins to take effect.

**Perry Gourley:** And how would you describe current valuations for Japanese small-, mid- and large-cap companies?

**Sarah Whitley:** There's not much difference between the large companies and the smaller companies in terms of valuations at the moment, but it does look as if valuations are quite cheap. Japanese stocks are yielding more than double the Japanese JGB (Japanese Government Bonds) bonds at the moment, probably their highest level of yield ever. Short term P/Es (price earnings ratios) are relatively expensive, but I don't think that is particularly helpful given the sharp downturn in earnings that we're facing, and stocks again as cheap as they ever have been on price to book valuations.

**Perry Gourley:** And how do those valuations compare against global counterparts?

**Sarah Whitley:** Japanese stocks are much cheaper on price to book. They're probably still more expensive on P/E ratios but Japanese accounting remains conservative in many ways in that losses on shares are written down through the P&L (profit and loss) account. Japanese companies amortise the goodwill if they make any takeovers and these have quite a significant effect on the overall reported earnings. So I think if you strip them out they're probably

much of a muchness with comparative companies elsewhere. Although optically the P/Es are more expensive, but I'm not sure again that if P/Es are a good way of valuing stocks in the middle of a very deep recession.

**Perry Gourley:** And do you expect Japanese companies to cut their dividends?

**Sarah Whitley:** In the first half of the year dividends rose 12% in Japan, it may be that dividends are cut a bit, but more for reasons to do with the social contract between workers and companies in Japan. I think if companies are going to make a lot of staff redundant they feel they cannot continue to pay high dividends, so it may be that in the year that they make people redundant they will cut back on the dividends, but overall we expect to see dividends continuing to rise maybe apart from the current year to March 2009 and the year to March 2010.

**Perry Gourley:** And what do you feel is behind the increased focus on shareholder returns in Japan?

**Sarah Whitley:** I think it's the need of the shareholders for returns. Traditionally Japanese companies were owned a lot by what we call relationship shareholders who weren't particularly interested in financial returns, they wanted returns through business relationships or through the relationship they had with the company. I think holders now, whether they are domestic or international, all would like to see some kind of financial return and increasingly they would like to see a good dividend yield or continued share buy-backs, both of which have increased significantly in the last five years in Japan.

**Perry Gourley:** Are Japanese companies becoming more involved in M&A (mergers and acquisitions) activity at home, and abroad?

**Sarah Whitley:** Yes, there was a huge spurt of M&A activity from Japanese companies overseas in 2008. I think since the huge turmoil in markets since October that (M&A activity) has tailed off a bit. I think that it is rather a pause than a stop and we would expect them to continue to try and develop their business by picking up cheap assets overseas. Japanese companies have strengthened their balance sheets significantly since the beginning of the decade and, I think, are looking for opportunities as over-gearred companies overseas become more distressed. Also domestically I think it is quite clear that we'll see significantly more domestic consolidation. We have already seen it in some domestic industries, for example, the petroleum refining industry is going to consolidate and I think we will see it in several more of the perhaps less efficient domestic industries.

**Perry Gourley:** Has the focus of your portfolio altered over the past six to twelve months?

**Sarah Whitley:** Yes, we've reduced our levels of gearing in terms of the portfolio, both in terms of the overall borrowings that we've got and invested in the market, and also in terms of selling some of the more financially geared companies because we think that financial gearing isn't a positive at the moment. We haven't made big switches between those whose business is domestic and those whose business is more global, because I think that most of the businesses we invest in that have business overseas are still very competitive.

**Perry Gourley:** Is it more domestic or export orientated?

**Sarah Whitley:** It's a balance, we're trying really to find competitive companies and we don't really take a strong view between global and domestic companies. It's really more between good companies and bad companies.

**Perry Gourley:** And Sarah could you talk us through how you've managed the gearing of the trust recently.

**Sarah Whitley:** Throughout 2008 we had quite significant levels of gearing in the market. This we cut back at the beginning of this year and the markets again have been quite weak so we're just beginning to put some of it back in the market.

**Perry Gourley:** And finally Sarah, in general terms what attributes do you feel companies need to survive the current economic conditions?

**Sarah Whitley:** They need a clear competitive advantage, strong financials, and access to funding and able management.

**Perry Gourley:** Sarah that's been most interesting, thank you for your time today.

**Sarah Whitley:** Thank you Perry.

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