

# QUARTERLY INVESTMENT REVIEW

## Usonian Japan Value Strategy

### Performance returns (JPY)

| ANNUALIZED RETURNS (QUARTER-END)     | Quarter-End | YTD   | 1-Year | 3-Year | 5-Year | 10-Year | Since Inception |
|--------------------------------------|-------------|-------|--------|--------|--------|---------|-----------------|
| Usonian Japan Value Strategy (net)   | 14.39       | 14.39 | 37.30  | 13.75  | 11.70  | 9.81    | 12.04           |
| Usonian Japan Value Strategy (gross) | 14.50       | 14.50 | 38.00  | 14.62  | 12.65  | 10.85   | 13.12           |
| Tokyo Stock Price Index (TR, Local)  | 17.96       | 17.96 | 40.85  | 14.67  | 14.00  | 10.79   | 12.05           |
| Value Add                            | -3.57       | -3.57 | -3.56  | -0.92  | -2.30  | -0.99   | -0.01           |

### Major Performance Drivers

Japanese equities sprang out of the gates in the first quarter. The environment for Japanese equities was supportive as the yen weakened, large companies boosted wages more than expected, and the Bank of Japan (BOJ) showed its confidence in budding inflation by ending the era of ultra-loose monetary policy. On the corporate front, the unwinding of cross-shareholdings picked up steam and regulators are actively discussing further actions to increase transparency and boost the effectiveness of investor engagement. We remain excited about the prospects for Japanese equities given the continuing pressure to reform; improvements in market dynamics resulting from those reforms; and mounting evidence that the Japanese economy is escaping deflation. The gathering momentum for Japanese equities has resulted in a rapid influx of passive capital, awarding strong gains to the largest index constituents. While this has been a relative headwind to our portfolio, which skews small cap, we believe it is a matter of time before investors widen their perspective and capital finds the many attractive smaller companies that have been left behind.

Both macro and corporate factors were at work as Rengo[1] announced the initial tally of wage increases at 5.3%, the yen weakened from 141/USD to 151/USD over the period, and the BOJ tightened monetary policy for the first time since 2007, albeit nominally. On the corporate front, we saw the unwind of strategic shareholdings continue to accelerate, led by Toyota Group and the property and casualty insurers.

While the portfolio delivered strong absolute returns, the environment had a mixed impact on relative returns: Value outperformed the index, however, small caps underperformed the index.[2] Value was bolstered by rising interest rates, in both the U.S. and Japan; expectations of interest rate cuts by the Fed were tempered.[3] Larger stocks have outperformed as investors rushed into large-cap heavy index funds and futures to gain exposure to Japanese equities: net inflows amounted to 6.3 trillion yen in 2023 and 1.2 trillion yen in January alone,[4] half of which was driven by futures buying.[5] Over the past 12 months, value has outperformed the market and small caps have underperformed.

Composite Inception Date: 31-Dec-16

Performance for the year of inception is less than a full calendar year. Returns shown for periods less than one year are not annualized.

**Risks:** Risks associated with investing in the Strategy may include Market Risk - Equities, Management and Operational Risk, Focused Investment Risk, Non-U.S. Investment Risk, and Currency Risk. Returns shown for periods greater than one year are on an annualized basis. To obtain performance information to the most recent month-end, visit [www.gmo.com](http://www.gmo.com).

**Performance Returns:** Performance data quoted represents past performance and is not predictive of future performance. Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. Data presented prior to August 1, 2017, was generated by the Japan Value Strategy manager, Drew Edwards, and his team while employed at Advisory Research, Inc. In August 2017, Usonian Investments LLC began operations, and Mr. Edwards continued his management of the Strategy with Usonian. On August 7, 2020, Usonian Investments LLC was acquired by GMO and GMO became the investment adviser to the Japan Value Strategy. Following the acquisition, Mr. Edwards continues to manage the Strategy as an employee of GMO using the same investment process. Performance shown here reflects the performance of other investment firms unaffiliated with GMO at which the accounts were managed. Performance results from prior firms have been linked to the results achieved at GMO beginning on August 7, 2020. GMO did not calculate the performance data prior to the acquisition but believes such data to be accurate. GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on [GMO.com](http://GMO.com) by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only. The local market in which some accounts in the composite are priced was closed for Good Friday on March 29, 2024. Therefore, the performance for the strategy and corresponding benchmark will utilize March 28 for purposes of the ending valuation for the March return and the starting valuation for the April return. Gross returns are presented gross of management fees and any incentive fees if applicable. These returns include transaction costs, commissions, withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. If management and incentive fees were deducted performance would be lower. For example, if, before fees, the strategy were to achieve a 10% annual rate of return above its hurdle rate each year for ten years, and an annual advisory fee of 1% and incentive fee of 20% of net returns above the hurdle rate were charged during that period, the resulting average annual net return (after the deduction of management and incentive fees) would be approximately 7.20%. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only. Data presented prior to August 1, 2017, was generated by the Japan Value Strategy manager, Drew Edwards, and his team while employed at Advisory Research, Inc. In August 2017, Usonian Investments LLC began operations, and Mr. Edwards continued his management of the Strategy with Usonian. On August 7, 2020, Usonian Investments LLC was acquired by GMO and GMO became the investment adviser to the Japan Value Strategy. Following the acquisition, Mr. Edwards continues to manage the Strategy as an employee of GMO using the same investment process. Performance shown here reflects the performance of other investment firms unaffiliated with GMO at which the accounts were managed. Performance results from prior firms have been linked to the results achieved at GMO beginning on August 7, 2020. GMO did not calculate the performance data prior to the acquisition but believes such data to be accurate.

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## **Major Performance Drivers Cont.**

Against this backdrop, the portfolio trailed the TOPIX index in local terms. Stock selection in Industrials contributed to relative performance for the quarter, while selection in Information Technology and Materials detracted compared to the TOPIX.

We are typically satisfied if we can keep up with the index when it rallies more than 20% for various reasons, including that our portfolio is conservatively capitalized (meaning its equity returns benefit less from financial leverage in a strong market). The current environment of 40%+ annual gains in the TOPIX (and 46.7% for the Nikkei 225) is undoubtedly a headwind for our relative performance. Based upon our experience, the market will adjust as fundamental investors sell some large cap names that were indiscriminately bought during acute capital inflows, and overlooked smaller cap names are bought.

For a more detailed discussion on these topics, please see our complete Quarterly Letter, available from your GMO relationship manager.

[1] Rengo is the Japanese Trade Union Federation, which represents workers at many of Japan's large companies.

[2] Performance of the market, value, and small caps is defined as the total returns of MSCI Japan, MSCI Japan Value, and MSCI Japan Small Cap indices, respectively, in yen terms.

[3] 10-year JGB yields increased from 0.61% on December 31 to 0.71% on March 28, and U.S. 10-year Treasury yields increased from 3.9% to 4.2% over the same period.

[4] Reuters, "At last, FOMO puts Japan's stocks back on global wish list," Asahi Shimbun, February 22, 2024.

[5] Reuters, "Foreign flows into Japan stocks topped 6 trillion yen in 2023," January 11, 2024.

## PRODUCT OVERVIEW

The Strategy seeks long term capital appreciation over a full market cycle and measures its performance against the TOPIX Total Return Index (the "Index") for performance comparison purposes. The Strategy employs a fundamental, value-oriented approach to invest in Japanese equities. Additionally, the Strategy focuses on protecting capital in down markets and strives to have lower total volatility compared to the Index.

In managing the Strategy, GMO's Usonian Japan Equity team follows a disciplined, bottom-up approach using fundamental research to identify Japanese equities that we believe are undervalued and profitable with high quality balance sheets. The team spends considerable time developing a high level of knowledge about our companies and focusing on downside risk. Additionally, as long-term investors, we engage collaboratively with corporate management to unlock shareholder value.

## IMPORTANT INFORMATION

**Comparator Index(es):** TOPIX (Net of dividend withholding tax) is a free-float adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the TSE First Section.

The above information is based on a representative account in the Strategy selected because it has the fewest restrictions and best represents the implementation of the Strategy.

## ABOUT GMO

Founded in 1977, GMO is a global asset manager committed to delivering superior performance and advice to our clients. We are privately owned, which allows us to singularly focus on our sole business – achieving outstanding long-term client investment outcomes. Offering multi-asset, equity, fixed income, and alternative strategies, we invest with a long-term, valuation-based philosophical approach.

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\*GMO's West Coast Hub is comprised of members of Investment, Global Client Relations, and other teams located in and around the Greater San Francisco area

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