

## MUTUAL FUNDS

# Top-Performing Mutual Fund Finds Hidden Gems In Japanese Small Caps

**BY LAWRENCE CARREL**  
INVESTOR'S BUSINESS DAILY

Hennessy Japan Small Cap Fund (HJPSX) takes the IBD Best Mutual Funds Award as the top-performing mutual fund in the international stock category because of what fund managers Tadahiro Fujimura and Tetsuya Hirano do every single day: dig deeper than anyone else to find hidden stock gems.

Over the past 10 years the fund has posted an average annual return of 12.01%, which towered over the 1.94% of the broad international stock benchmark, the MSCI EAFE index. The fund beat that benchmark last year with a gain of 49.58% vs. EAFE's 25.03%. Hennessy Japan Small Cap turned in average annual gains of 21.9% and 21.27% for the past three and five years vs. EAFE's 7.8% and 7.9%.

In an interview with Investor's Business Daily, Fujimura talked about the fund managers' investment process, what gives them an edge in the small-cap space and the outlook for Japanese small caps amid concerns over a looming trade war sparked by recent moves by President Trump. Fujimura is the chief investment officer of SPARX Asset Management, the \$223.6 million Hennessy Japan Small Cap Fund's subadvisor in Japan.

The fund holds about 60 stocks, with the top 10 holdings accounting for about 19% of assets. Hennessy Japan Small Cap at year-end had about 37% of its assets in industrial companies, including its top three holdings: Hito-Communications, Shibuya and Okamura. It had 23% in tech stocks, including electron microscope maker Jeol. The next largest weighting was 20% in consumer cyclicals such as Bic Camera.

**IBD:** What are you doing that other Japanese small-cap funds don't? What's your strategy?

**Tadahiro Fujimura:** The fund is all Japanese companies. Our investment philosophy is bottom-up stock picking. We don't depend on outside research-

ers or analysts. We visit companies and do our own analysis. SPARX started as small-cap specialists in 1989. We have a 27-year history researching small-capitalization stocks. I joined SPARX in 1999. It's an almost 20-year career researching small-caps.

There are 3,600 listed companies in Japan. Depending on your definition, there are many small-cap companies. If you define large-caps as the top 70% of the total market capitalization of the Japanese stock market, then large-caps are only about 200 companies. We define the bottom 15% of the market as small caps and the 15% in between as mid-caps. Altogether, this 30% is about 3,400 stocks. And it's not very well covered in Japan because all the major brokerage firms don't cover these companies. Since 1989 SPARX has focused on covering these uncovered names.

**IBD:** In the small-cap fund can you buy small-cap and midcap stocks?

**Fujimura:** No. We just focus on the bottom 15% because it's a small-cap fund. Most small-cap managers have given up covering this huge universe. But SPARX has already researched 3,000 companies at least once. Personally, during the time I've been covering small caps, I have researched 2,000 companies by myself. So, one of the strong points of our investment process is to uncover a broader universe of smaller, attractive small caps that other fund managers don't cover.

**IBD:** What's the average market cap of a company in the fund?

**Fujimura:** We define small-caps as anything less than \$2 billion in market capitalization. The average market cap for a company in our fund is \$1 billion.

**IBD:** Why do you think the fund is doing so well?

**Fujimura:** Because I'm working very hard. (laughter) We've been researching on a daily basis for 20 years. I don't change anything about our research activities. Sometimes that works well, sometimes not, but we believe that

we're not influenced by the outside environment. Just researching by ourselves and looking for attractive companies. Last year was a good year because we invested very well and that contributed to the performance.

**IBD:** How long do you hold on to stocks?

**Fujimura:** The average turnover of the fund is 30%. Our average time horizon is three years or longer. I believe compared with other managers our investment horizon is longer because we're more focused on long-term fundamentals rather than market trends.

**IBD:** You say you're not affected by outside things; do you think the fund is likely to be hurt or benefit from a trade war?

**Fujimura:** Fortunately in my universe there are few steel, aluminum or raw material-related companies. These types of companies are included in the large-cap companies. Generally speaking, small-caps are more domestic companies.

**IBD:** What's going on in Japan's stock market right now?

**Fujimura:** I think one reason for our good performance is the better performance of small caps compared with large caps. The Japanese stock market did very well last year for several reasons. The Japanese economy is getting better, and generally speaking, in the early stage of the economy's growth, large-caps perform well. But this improvement is spreading into other areas, and small caps started getting the benefit of economic growth. That's one reason.

Another reason is valuation. Small caps were deeply undervalued compared with large caps. Finally, the valuations are reaching the same level as large caps. So, valuation improvement and earnings growth, combined with economic growth, both contributed to the better performance of the small caps compared to the large caps.

Another thing, large-cap Japanese companies are in trouble. The auto companies, like Nissan Motor and Subaru recently had scandals. Kobe Steel

and Toshiba, too. This was only in the large-cap area, not the small-cap area.

Larger companies generally are facing how to deal with old, legacy assets and adapting to the new environment. But new, smaller companies have the advantage to deal with new technology. I think last year was a typical year for larger companies facing troubles and scandal. But, the smaller companies didn't have so many troubles.

**IBD:** How is the Japanese economy looking in general?

**Fujimura:** One point I'm focusing on is deflation. The Bank of Japan has been targeting 2% inflation, but it hasn't

achieved that yet. In the Japanese economy, on the retail side, many consumers believe that deflation remains and keep waiting for prices to decline. So, that's why the domestic economy is still sluggish and waiting to improve. I believe one of the big problems in a deflationary environment is that profit margins are always under pressure. If deflation ends, most domestic-based companies will have room to improve their profit margins.

**IBD:** What do you see as the risks for the market and small caps in particular?

**Fujimura:** Consumer sentiment. Small caps have more consumer-

related names in their universe. I believe Japanese consumer sentiment is coming forward because wages are increasing and the employment rate is increasing. But if consumer sentiment is damaged, then small caps are at risk. But I don't think the environment will worsen. The Japanese yen is getting stronger. However, that may be a risk for export-driven companies.

**IBD:** Any other risks?

**Fujimura:** Energy price increases. The Japanese economy depends on oil imports. If oil goes up that will have a big effect. We need energy efficient infrastructure.

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*Investors should consider the investment objectives, risks, charges and expenses carefully before investing. This and other important information can be found in the Fund's statutory and summary prospectuses. To obtain a free prospectus, please call 800.966.4354 or visit [hennessyfund.com](#). Please read the prospectus carefully before investing.*

Top ten holdings for the Hennessy Japan Small Cap Fund can be found [here](#). Fund holdings and sector allocations are subject to change at any time and should not be considered a recommendation to buy or sell any security.

**Mutual fund investing involves risk; Principal loss is possible. The Fund invests in small and medium capitalized companies, which may have more limited liquidity and greater price volatility than large capitalization companies. The Fund invests in the stock of companies operating in Japan; single country funds may be subject to a higher degree of risk. The Fund may experience higher fees due to investments in pooled investment vehicles (including ETFs).**

Inception date for the Hennessy Japan Small Cap Fund is 6/15/2015. The MSCI EAFE Index (Morgan Stanley Capital International, Europe, Australasia, Far East) is an index created by Morgan Stanley Capital International (MSCI) that serves as a benchmark of the performance in major international equity markets as represented by 21 major MSCI indexes from Europe, Australia and Southeast Asia. One cannot invest directly in an index.

**Diversification does not assure a profit nor protect against loss in a declining market.**

IBD's Best Mutual Funds 2018 Awards criteria: Stock mutual funds qualify for this exclusive recognition only if they have beaten the broad market over all four of the following time periods: past one, three, five and 10 years. Awards were earned in 12 mutual fund categories. The top five ranked by 10-year performance are highlighted as the best of the best. The winning international stock mutual funds were compared to the MSCI EAFE Index in each of the four periods through December 31, 2017.

Portfolio turnover is a measure of how frequently assets within a fund are bought and sold by the managers. **Earnings Growth is not a measure of the Fund's future performance.**

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