

# The AlphaWeek and Sussex Partners



## Japan Hedge Fund Industry Survey 2021 Edition



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# The AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey

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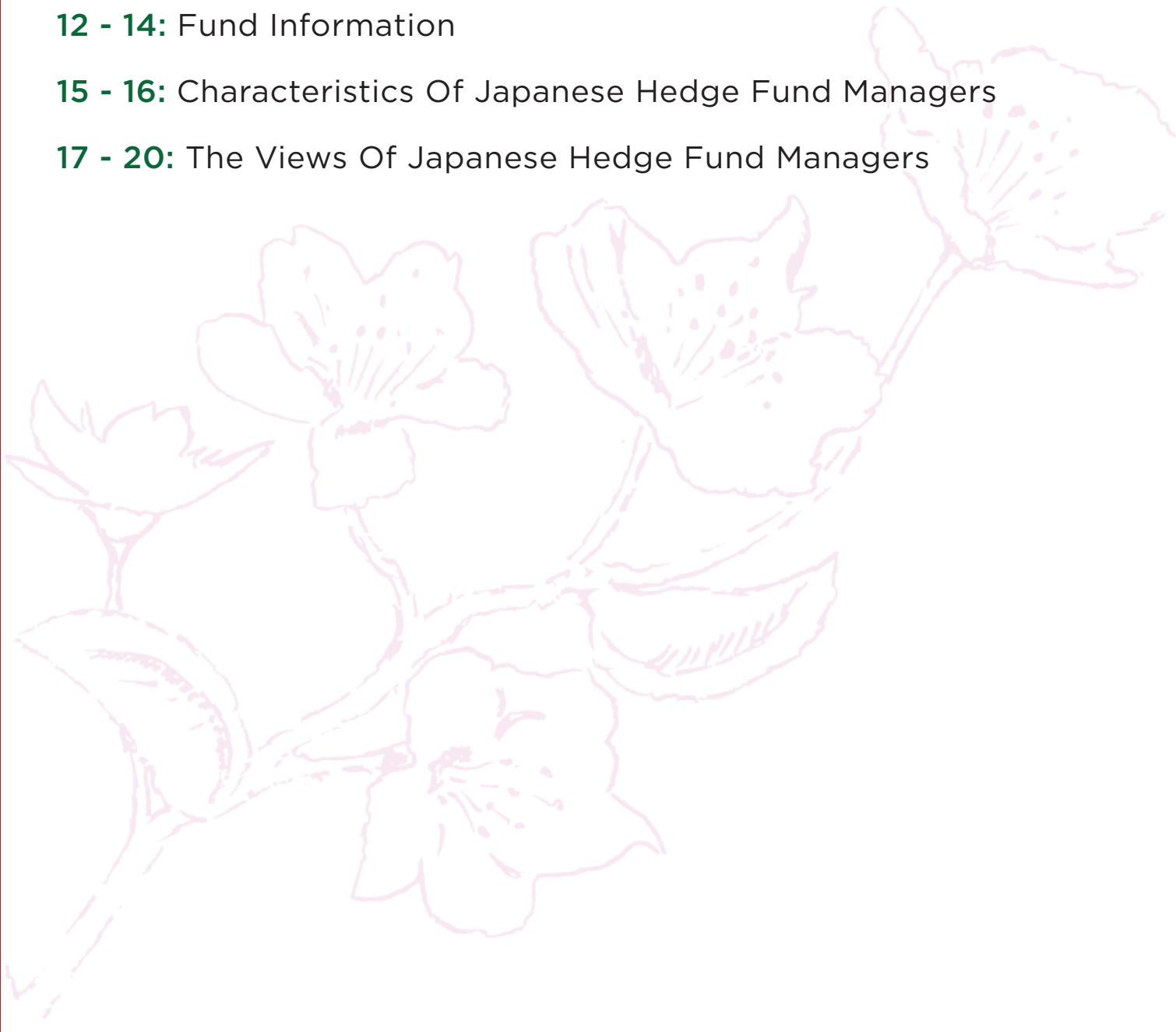
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## Letter From The Editor

Welcome to the 2021 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.

Last year, we set out to learn more about the Japanese hedge fund industry; specifically, how Japanese hedge fund managers feel about investor perceptions of their corner of the hedge fund world.

The genesis of the survey lies in the fascinating idiosyncrasies of the Japanese hedge fund industry when compared to the hedge fund industries of other developed nations. One of these idiosyncrasies is the relatively small number of managers based in Japan when compared to places like the US and the UK, in terms of both absolute numbers of managers and the assets they manage. When factoring in population and GDP, the numbers are starker. Another is that the structure of the Japanese equity market – equity hedge strategies comprise the vast majority of the funds managed by Japanese hedge fund managers – is favourable to fundamental, bottom-up investors due to a lack of coverage of small and mid-cap stocks and a robust framework for shorting. The number of listed companies available to trade dwarfs that of the London Stock Exchange, for example; the Japan exchange group manages five exchanges and contains 3,729 listed companies at the time of going to press.

Last year, we asked Japanese hedge fund managers whether they thought that foreign investors paid enough attention to their funds. A resounding 75% of Japanese hedge fund managers said no, they didn't think that they did. The lack of interest is a surprise. Chief amongst reasons to allocate to hedge funds is to be able to access skill and expertise in order to outperform passive exposure to an asset class. In the U.S. and in Europe, equity hedge funds have not outperformed passive equity exposure since before the GFC, as Patrick Ghali of Sussex Partners explains in his article which begins on page 4. In Japan, however, there is alpha to be found, as Ghali again explains.

We surveyed 22 managers for this year's report. Some answers will surprise, some won't, but what remains the same this year as last year is the uniqueness of the Japan hedge fund industry.

This report could not have been put together without the help of institutional hedge fund investment advisor Sussex Partners and The Consortium for Japan International Asset Management Center Promotion (JIAM), and so, to them, thank you. If you would like more information about next year's survey, or if you have any other questions, please contact me.

We hope you enjoy reading the 2021 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.



Greg Winterton  
Managing Editor, AlphaWeek

November 2020

## Japanese Hedge Funds: Industry Overview, 2020 In Review And Outlook

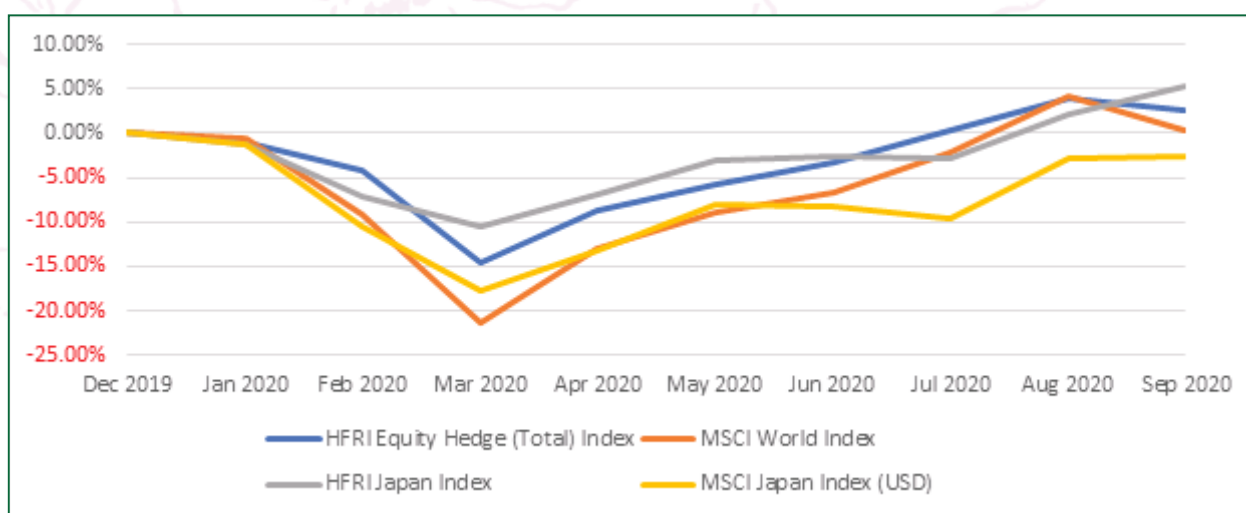
Last year, for the inaugural AlphaWeek and Sussex Partners Japan hedge fund industry survey, we looked at some of the market dynamics which we think make Japan a particularly interesting market from a hedge fund investment perspective. These included, amongst others, a deep, liquid and well-regulated equity market with limited analyst coverage; a large universe of stocks; good availability of shorts; a low percentage of hedge fund assets versus overall market capitalization; and a government-driven reform agenda to ensure better treatment of shareholders. On the flip side, we noted that on top of the cultural differences and language barrier, the industry was limited in size, with many well-known funds closed to new capital. We also noted that the industry was not very transparent; there wasn't any one database that listed all the managers, an accurate industry AUM was hard to come by, and where data on managers was available, it was often inaccurate.

As it relates to the above points, not much has changed over the past 12 months. The opportunity set remains rich, the industry somewhat opaque to outsiders, and the lack of travel options due to COVID-19 has made access even more difficult than in the past.

What has changed, however, is that investors, for the first time in a while, are looking more closely again at Japan as an investment destination. The most high-profile news story in Japan in the past year is, of course, Warren Buffet taking a stake in five Japanese trading houses (to the tune of \$6.5bn), but what's not as high profile is a resurgence in interest in Japanese hedge funds by investors more widely.

The primary reason is that Japanese hedge funds are delivering alpha. The chart below shows a comparison of Japanese and global hedge funds versus their respective MSCI benchmarks on a year-to-date basis. Not only did Japanese hedge funds draw down less in March than their global peers, they are also outperforming them both on an absolute basis - i.e., cumulative return - and a relative basis - i.e., versus their respective benchmark - as of the end of September. While the MSCI Japan index is still in negative territory, Japanese hedge funds have generated an absolute return of over 5% through the end of the third quarter.

**Figure 1: Cumulative Returns, Equity vs Hedge Funds, 2020 Through September**



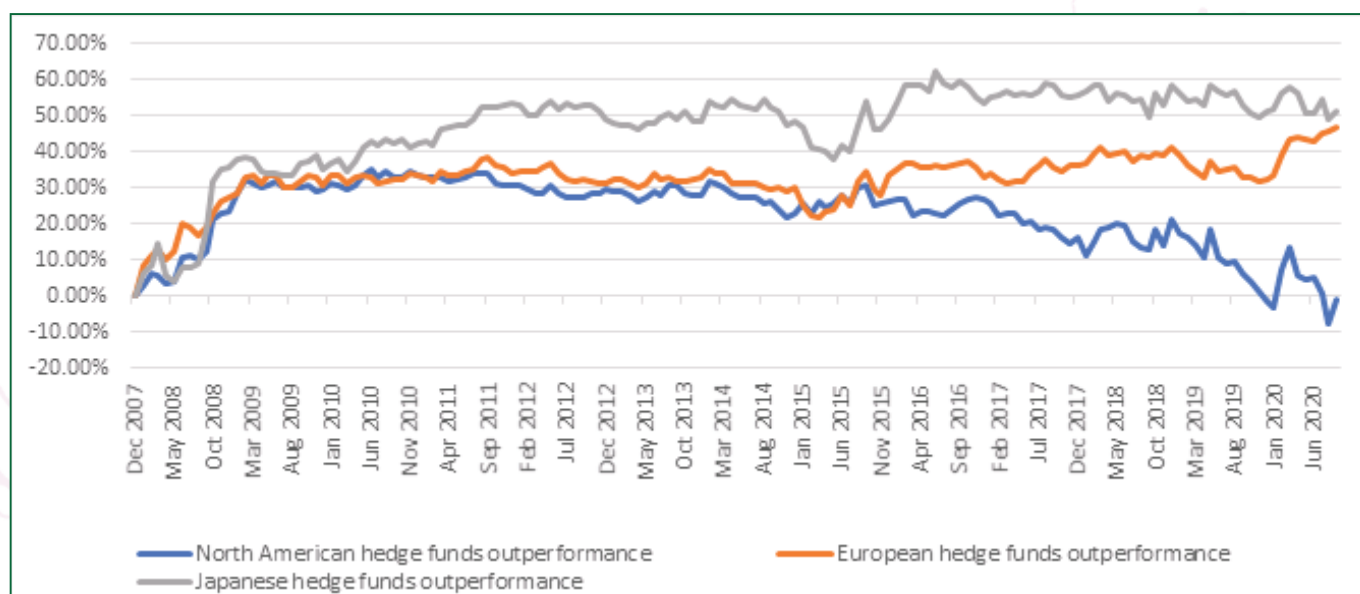
Source: Sussex Partners

Last year, we produced charts showing the longer-term outperformance of hedge funds generally versus equities and we have updated this graph for this year. Since the Japanese hedge fund industry is very heavy on equity strategies, and therefore fits more into the equity exposure segment of an

institutional investor’s portfolio, to produce an apples-to-apples comparison, we’re using the regional EurekaHedge Long/Short equity indexes for benchmarking.

As can be observed, while European hedge funds have closed the gap (to some degree) between themselves and their Japanese hedge fund manager peers since last year’s report, the gap between North American hedge fund performance and that of their Japanese counterparts has widened significantly. It has been our contention for some time that the efficiency, and crowdedness, of North American markets makes it very difficult for active managers to outperform passive investments; the graph below, which shows the cumulative outperformance of hedge funds versus their respective MSCI benchmarks, highlights this. For an investor which allocated to North American hedge funds in 2007, any cumulative outperformance over the past 13 years would have been close to zero. While North American managers, just like their European and Japanese peers, have done well on a relative basis post the GFC, reaching their outperformance peak around June 2010, that relative cumulative outperformance has turned negative during recent years. Put differently, had an investor only started to allocate to North American hedge funds post the June 2010 peak, there would have been a cumulative underperformance.

**Figure 2: Historical Cumulative Outperformance of Equity Hedge Funds vs Equity (December 2007 – September 2020)**



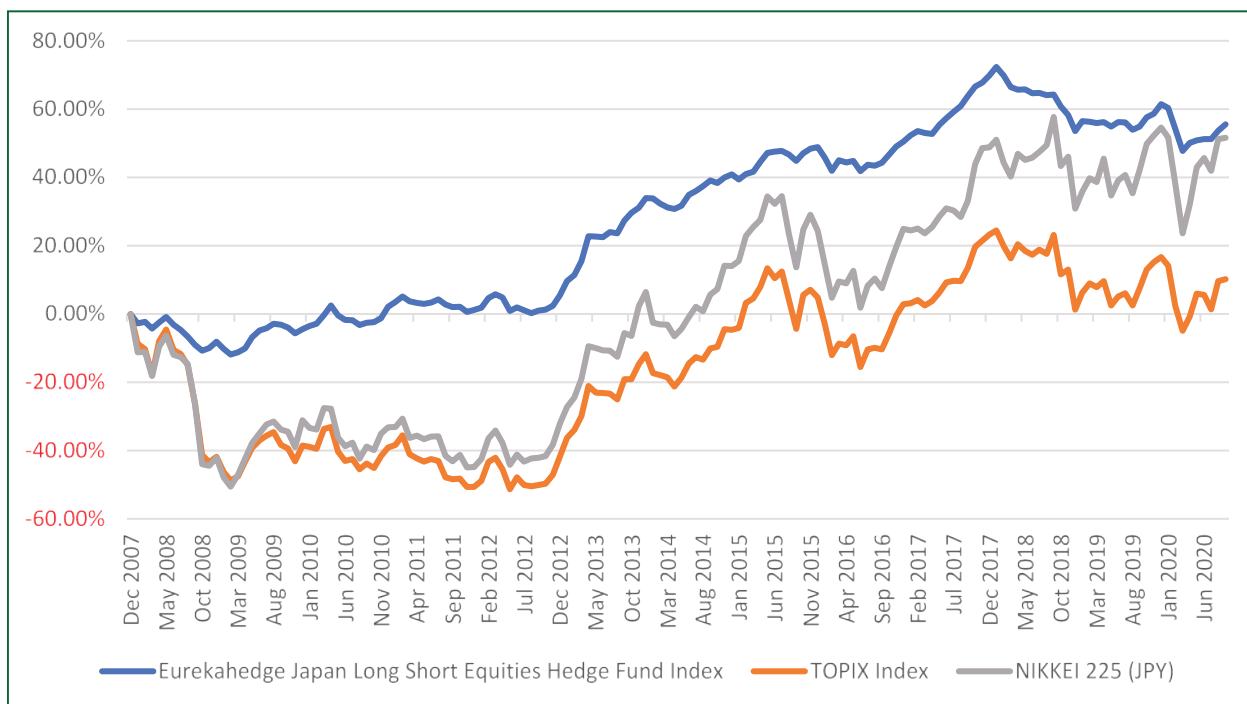
Data: The outperformance of North American hedge funds is calculated as the excess return of the EurekaHedge North America Long Short Equities Hedge Fund Index over the MSCI North America Index (USD). The European hedge funds outperformance is calculated as the excess return of the EurekaHedge Europe Long Short Equities Hedge Fund Index over the MSCI Europe Index (EUR). The Japanese hedge funds outperformance is calculated as the excess return of the EurekaHedge Japan Long Short Equities Hedge Fund Index over the MSCI Japan Index (JPY).

Source: Sussex Partners

The performance of Japanese hedge funds so far in 2020 once again supports the less correlated nature of Japanese hedge fund returns (as discussed in last year’s report) to the MSCI Japan Index, as well as the ability of Japanese hedge fund managers to better manage risk and protect capital in periods of severe stress such as the GFC and the COVID-19 pandemic. It is also encouraging to see a continuation of the long term trend of hedge fund outperformance in Japan (incidentally, a similar outperformance can be seen from specialist long-only managers in Japan where these have also significantly, positively, outperformed long-only indices this year and over long periods of time).

In effect, what this means is that Japan is one of the few countries where active management seems to clearly outperform passive investing. Looking at data going back to 2007, and comparing the TOPIX index, the NIKKEI index, and the EurekaHedge Japan Long Short Hedge Fund index we can see that this has consistently been the case for the past 13 years. Had we looked at the EurekaHedge Japan Hedge Fund index instead, which includes Japanese hedge funds more broadly, most of which are equity focused, the outperformance would be even more pronounced.

**Figure 3: Historical Cumulative Performance of Equity Hedge Funds Relative To Equity (December 2007 - September 2020)**



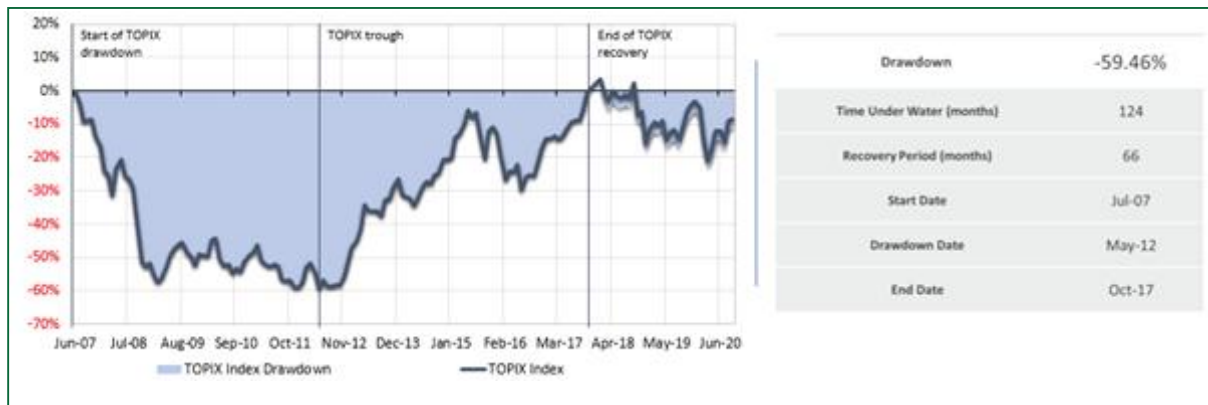
Source: Sussex Partners

This makes intuitive sense, of course, considering the anatomy of the Japanese market (as described in last year’s report) as well as in light of Japanese listed company valuations. It also shows that Japanese hedge funds have consistently been able to generate alpha not just from their longs but also from their shorts. In many ways, Japan can therefore be seen as the “last fundamental story” amongst developed markets.

Looking at more recent performance, there is no shortage of Japanese hedge funds which are up over 10% this year, with some even having generated returns net of fees of more than 20%. Whereas the past two years have been challenging for fundamental long/short managers in Japan (in particular those with small and mid-cap biases), and especially versus those which are more trading oriented, 2020 has so far been a very good environment for them. While fundamental oriented strategies can, and will, go through periods where they aren’t being rewarded by markets, the expectation eventually should be that markets will normalise (though timing is never certain), and this can be seen in the performance of these funds this year with many amongst this year’s top performers overall. Japanese stocks, and consequently Japanese hedge funds, may further benefit should one of the worst periods of underperformance on record for value-oriented stocks come to an end. Such a rotation would certainly be extremely profitable for some of the local managers. Market neutral managers are also doing well this year, once again showing not only very strong consistency of returns but also higher absolute returns this year than in prior years. Overall, 2020 so far has been a very strong year for Japanese hedge funds both in terms of absolute and relative returns.

This is particularly encouraging since it has historically been very challenging to generate any returns at all in Japan. At the time of last year’s report, the TOPIX index was still -41.1% below its 1989 peak. Since then it has lost further ground and is now -43.65% below that peak. The recovery from its most recent drawdown, which started in July 2007 and ended in October 2017, was also short lived.

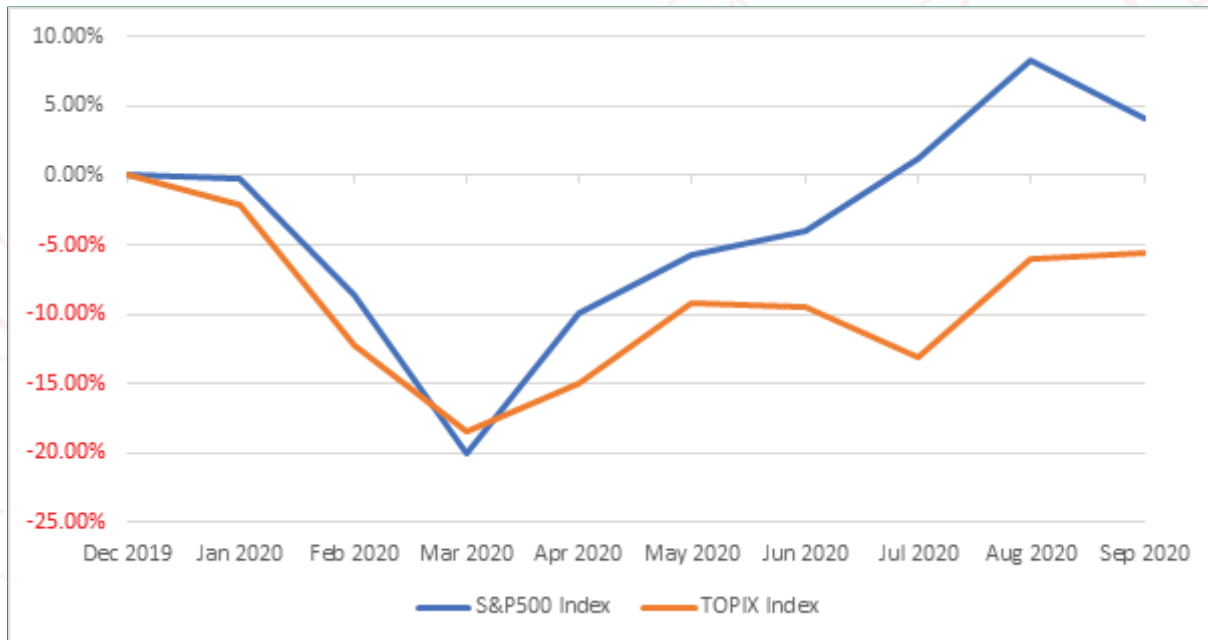
**Figure 4: Historical Cumulative Returns (June 2007 - September 2020)**



Source: Sussex Partners

This, of course, continues to be in stark contrast to markets like the US, where despite this year’s crisis, the S&P 500 is making new highs but hedge funds are not providing the same outperformance (See figures 1 & 2 above). This starkly illustrates the real value provided by hedge funds in Japan, not only on a relative basis, but more importantly on a consistent, absolute return basis.

**Figure 5: Year to Date Cumulative Returns, 2020 Through September**



Source: Sussex Partners

On the political front, we believe that the election of Yoshihide Suga will bring a continuation of Shinzo Abe’s policies and therefore should not fundamentally change the investing environment in Japan. We expect the opportunity set to remain rich for now, and though Japan is enjoying renewed investor interest, it would take a considerable amount of capital inflows to erode the structural inefficiencies of this market and for its alpha potential to be curtailed in a significant way.

The Japanese hedge fund market remains small, and though there have been a number of high profile/high quality launches in the past couple of years, overall capacity hasn't significantly increased; several funds have either shut down or stopped taking new investor capital in the past year. The outperformance this year versus long-only as well as global peers should, however, further increase interest by international allocators in what persists as one of the most interesting alpha opportunities in the hedge fund industry.





## Section 1 : Firm Information

### Q1: Is Your Firm Part Of A Larger Financial Institution Or Is It Independent?

Less than a fifth of survey respondents come from a hedge fund division that is part of a larger parent.

The vast majority - 82% - are independent.

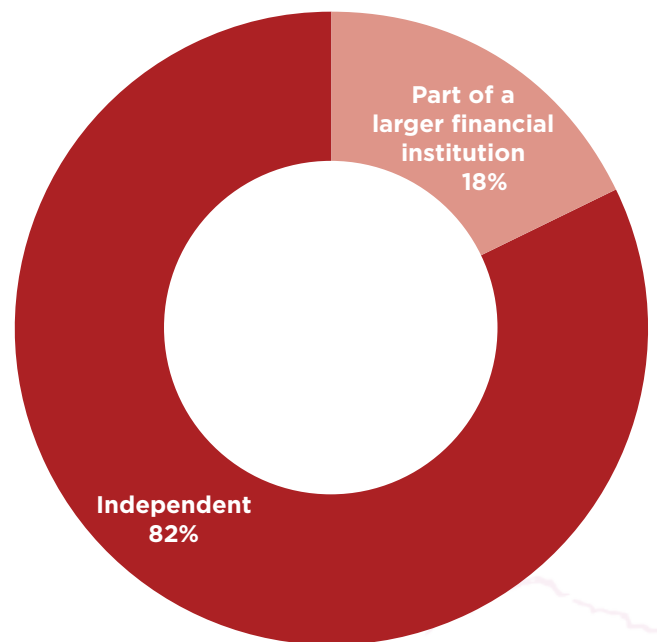
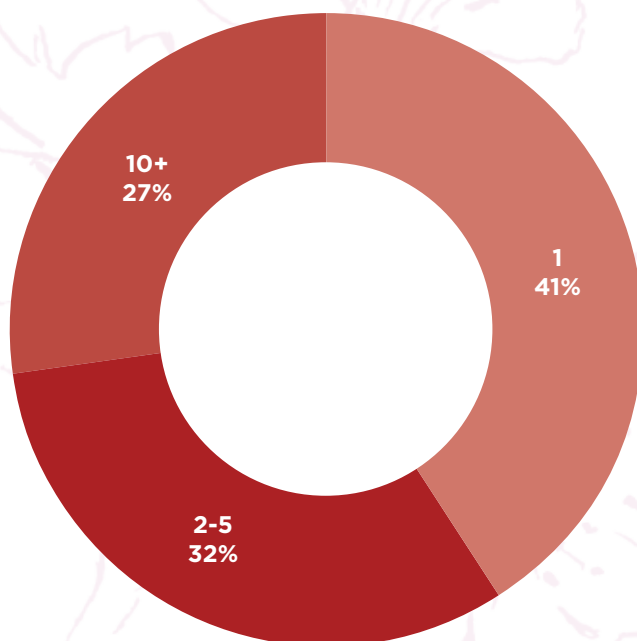


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q2: How Many Funds / Products Does Your Firm Offer?



Slightly more than two-fifths of survey respondents manage one fund or product, at 41%. Nearly a third - 32% - manage between two and five products, and just over a quarter manage more than ten. None of the survey respondents said that they manage between six and ten products.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q3: What Is The Total AUM Managed By Your Firm In USD?

A little more than a quarter - 27% - of survey respondents manage less than \$100mn in total assets. 14% managed between \$100-200mn and \$200-500mn and almost half - 45% - managed more than \$500mn in total assets across all products.

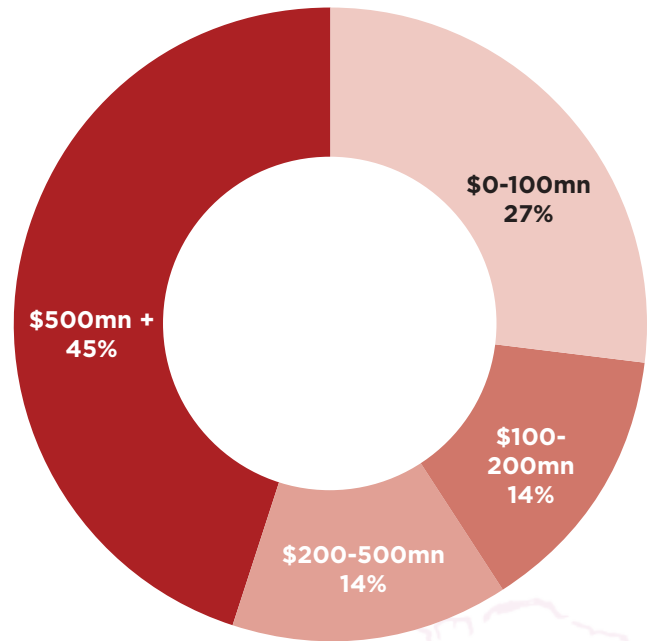
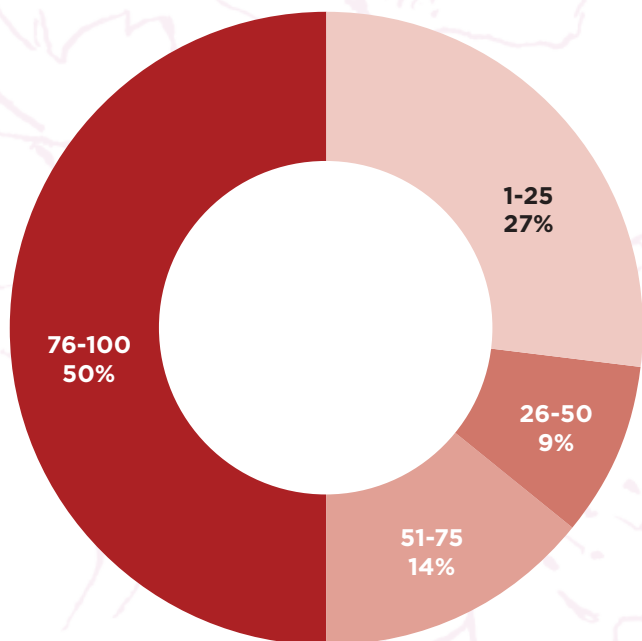


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q4: What % Of Your Total AUM Comes From Investors Based Outside Japan?



Half of all survey respondents said that more than 75% of their AUM comes from investors based outside Japan. A little more than a quarter - 27% - said that less than a quarter of their AUM comes from abroad.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q5: Which Of The Following Locations Do You Have Offices In?**

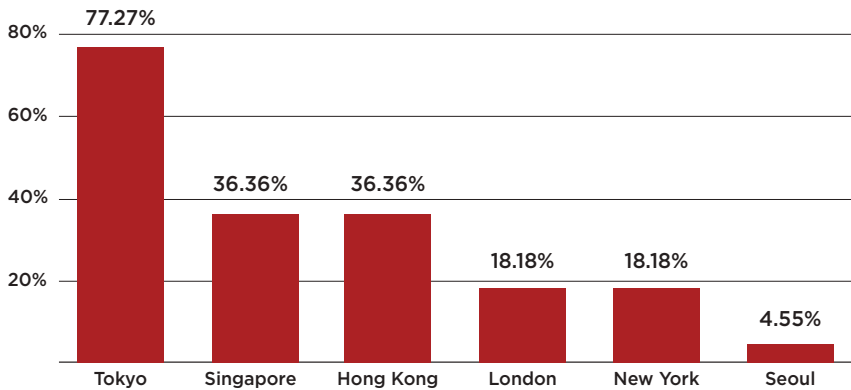


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

Tokyo naturally dominates this list: more than three quarters of survey respondents have a presence in Japan’s capital. Not all of these offices are headquarters, however. Sometimes, these will be smaller, research offices to help the ‘boots on the ground’ effort. Singapore and Hong Kong are the second most popular locations.

**Q6: How Many Investment Professionals Do You Employ Who Are Solely Focused On Your Hedge Funds?**

Almost two-thirds of survey respondents – 64% - have between one and five people focused exclusively on their hedge fund products. Slightly less than a quarter – 23% - employ between six and ten people who work only on hedge fund products, 9% have between 11 - 20 and 4% have 21 or more.

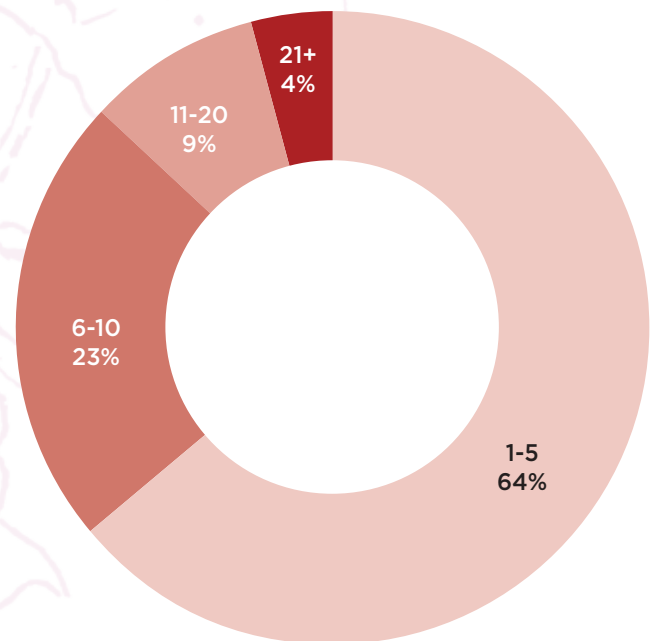


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

## Section 2 : Fund Information

### Q7: Which Strategies Do You Run?

Equity strategies dominate the Japanese hedge fund industry. Nearly 80% of survey respondents say that they run equity long/short strategies and more than a third manage equity long bias products.

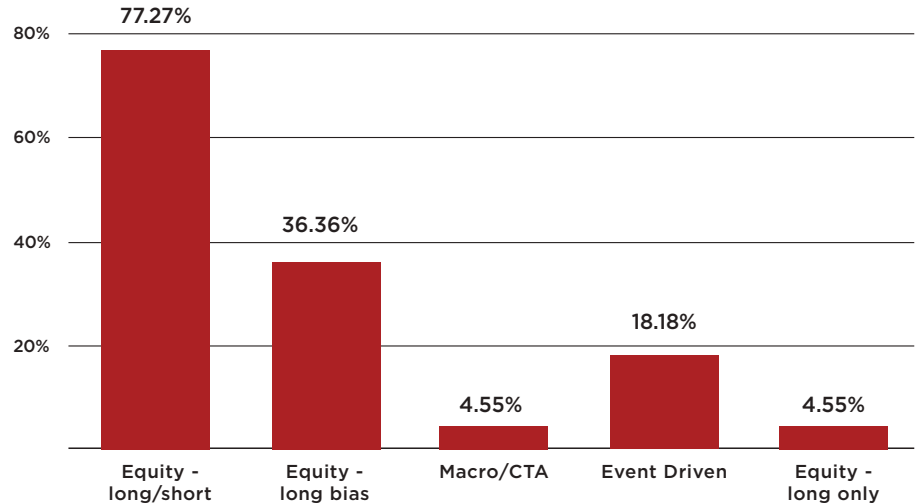
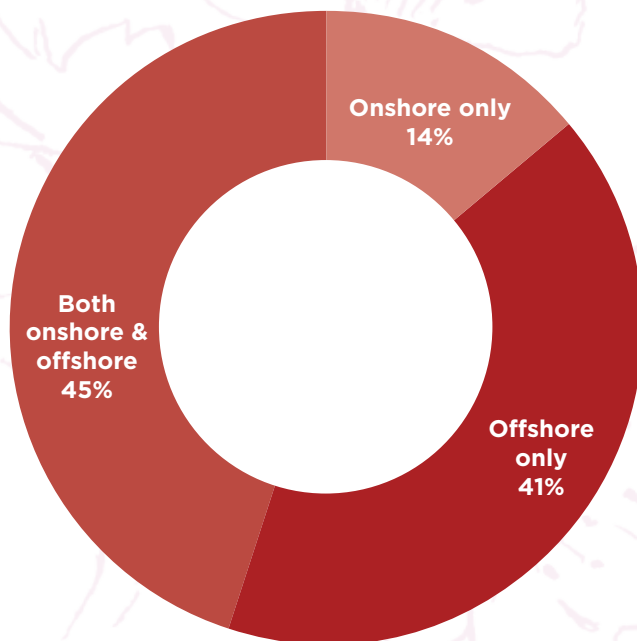


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q8: Do You Offer Only Onshore Funds, Only Offshore Funds, Or Both?



Only 14% of survey respondents offer onshore funds. Nearly half - 41% - offer offshore funds exclusively and 45% offer both fund types to their investors.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q9: Do You Offer Any UCITS-Compliant Funds?

Despite the increasing global popularity of the UCITS wrapper, two-thirds of our survey respondents don't offer UCITS-compliant funds.

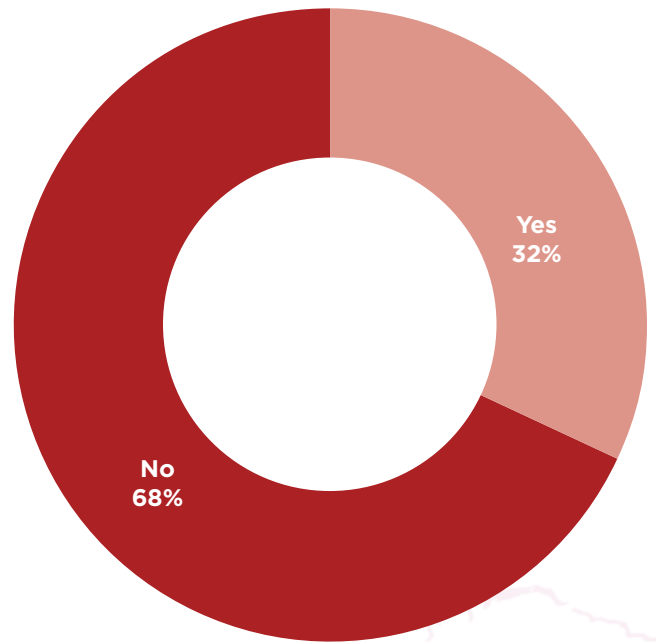
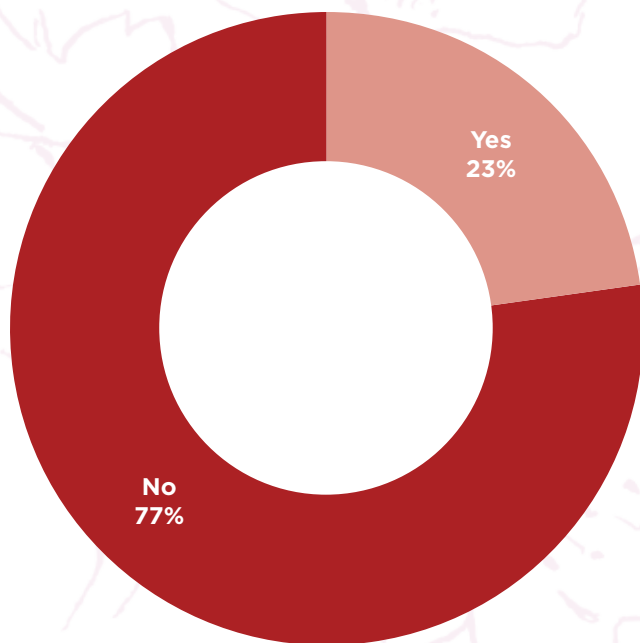


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

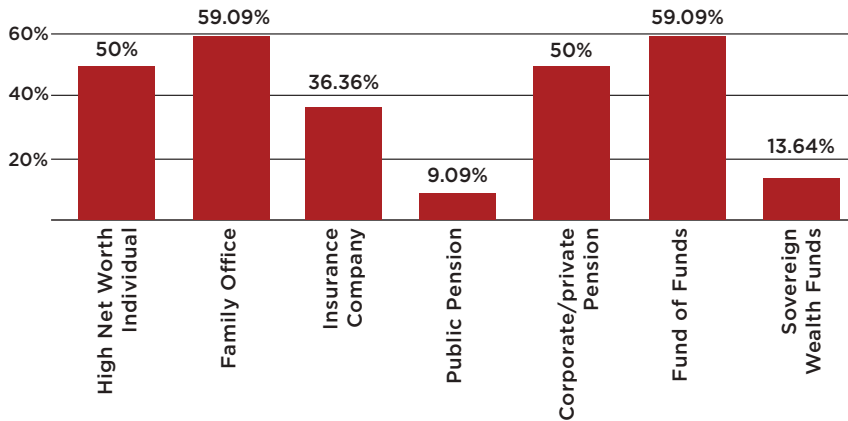
### Q10: Are You Planning On Launching Any UCITS-Compliant Funds?



There is even less interest in changing the status quo. Slightly more than three-quarters of survey respondents say that they are not planning on launching any UCITS-compliant funds.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q11: Which Investor Types Do You Currently Receive Allocations From?**



Public pension plans and sovereign wealth funds aside, the distribution of investor types in Japanese hedge funds is fairly even.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q12: Which Investor Types Have Accounted For Any AUM Increases In The Past Year?**

The investor types accounting for inflows in the past year have been fairly evenly split; public pensions and sovereign wealth funds accounted for much smaller percentages of the total, however.

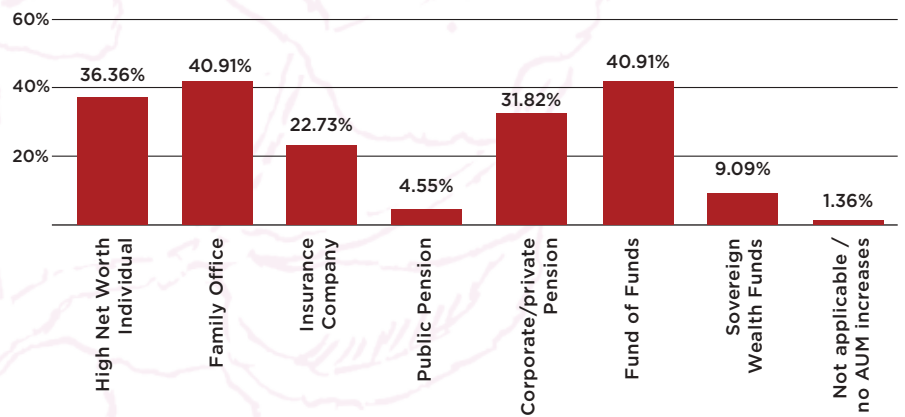


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

## Section 3: Characteristics Of Japanese Hedge Fund Managers

### Q13: Do You Engage In Activism Or Company Management Engagement?

Nearly two thirds of survey respondents say that they don't consider themselves to be activist investors.

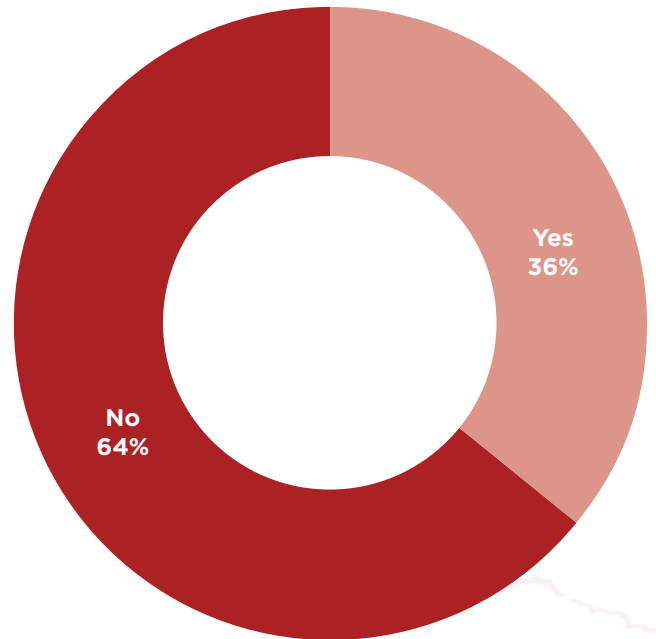
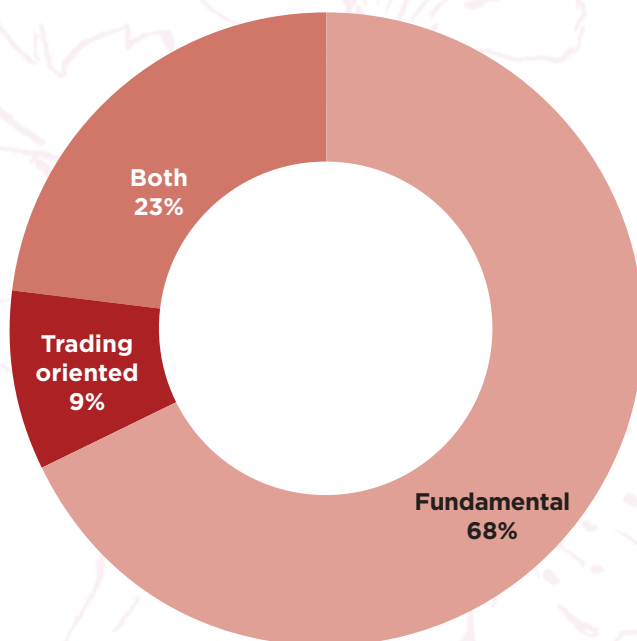


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

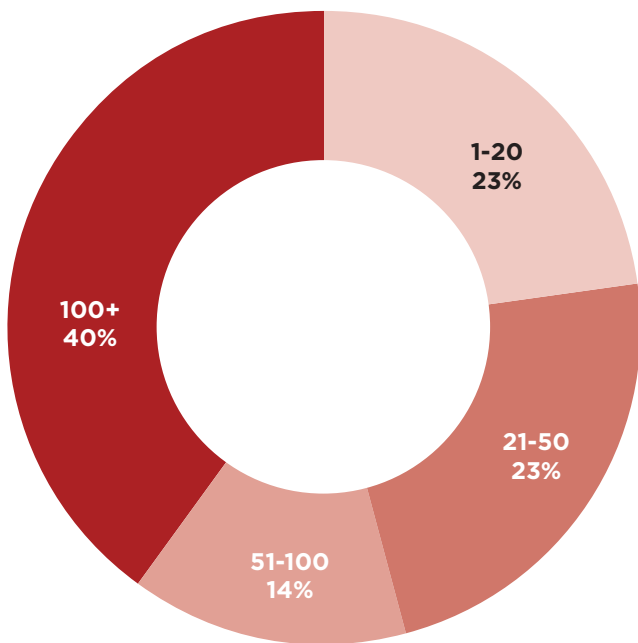
### Q14: What Type Of Manager Do You Consider Yourself To Be?



More than two thirds of survey respondents say that they consider themselves as having a fundamental approach, with only 9% being trading-oriented. Nearly a quarter - 23% - say they are both.

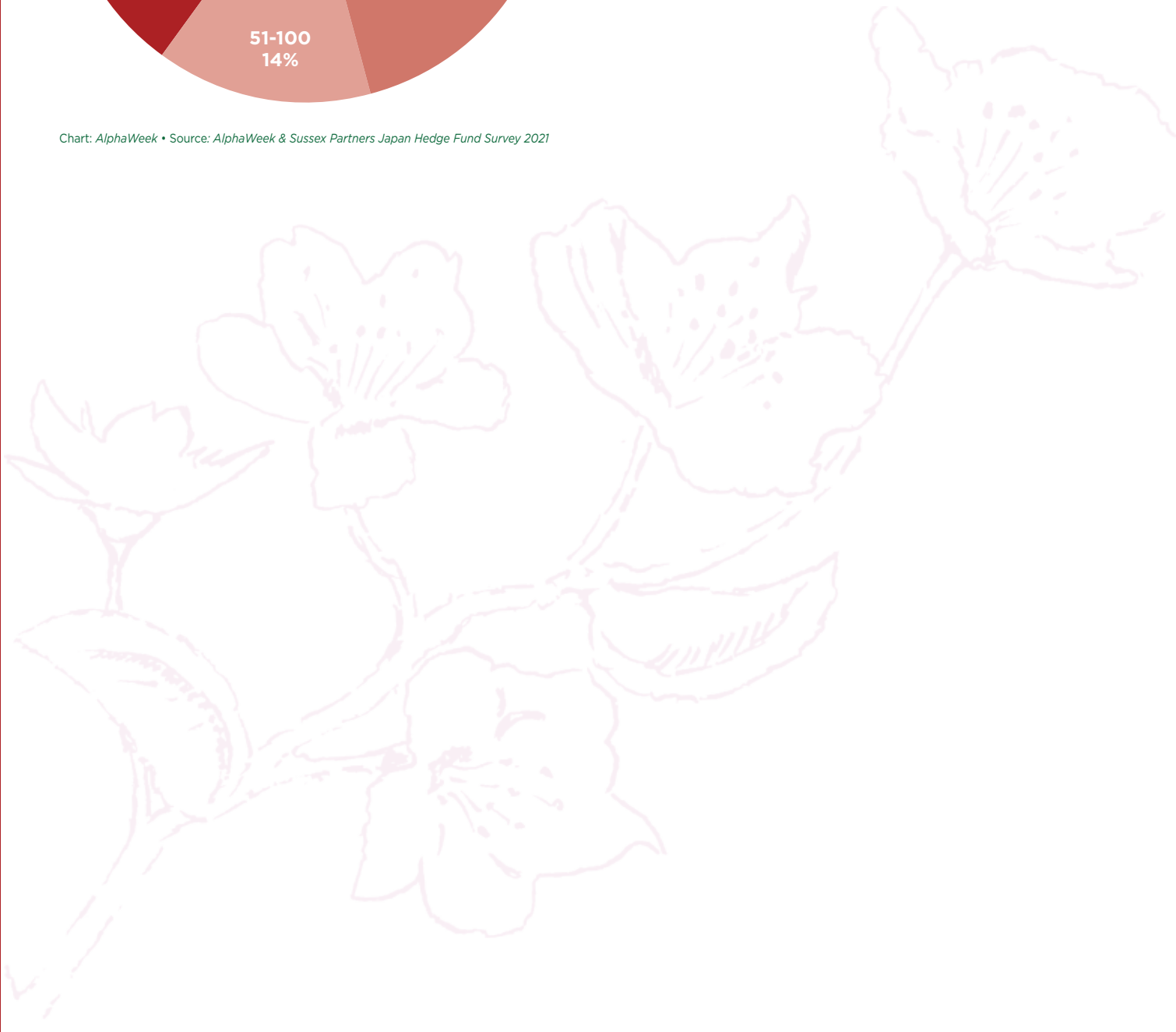
Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q15: How Many Positions Do You Hold At Any One Time?**



Japanese hedge fund managers are known for maintaining many positions in their funds, much more than is standard in the west. This is borne out in the survey results: 40% of managers say they maintain more than 100 positions at any one time and less than a quarter manage twenty or less positions simultaneously.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021





## Section 4: The Views Of Japanese Hedge Fund Managers

### Q16: Do You Think That Foreign Investors Pay Enough Attention To Domestic Japanese Hedge Funds?

82% of survey respondents said that they don't think that foreign investors pay enough attention to domestic Japanese hedge fund managers. That's up from 75% last year.

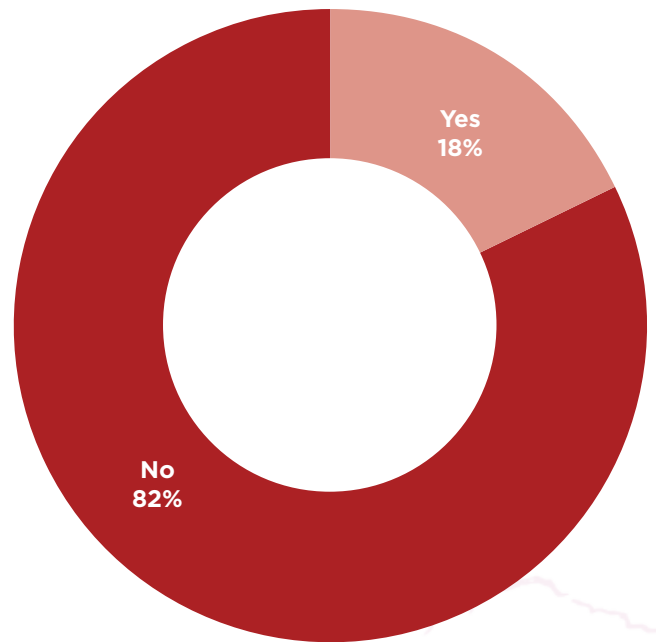
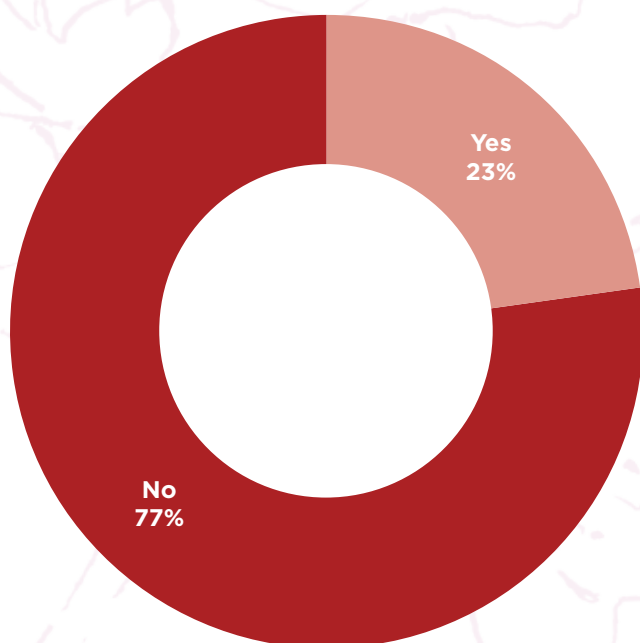


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

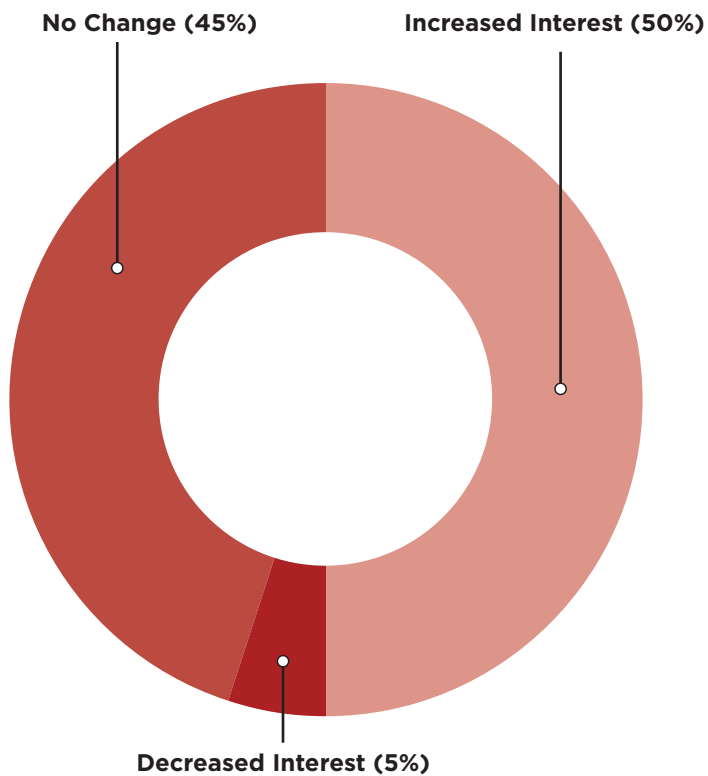
### Q17: Do You Think Domestic Investors Pay Enough Attention To Domestic Japanese Hedge Fund Managers?



More than three quarters - 77% - of survey respondents said that they don't think that domestic Japanese investors pay enough attention to domestic Japanese hedge funds. That's a significant increase from 45% last year.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q18: Have You Seen Increased Or Decreased Interest In Your Fund In The Past 12 Months?**



Half of our survey respondents said that they had seen increased interest in the past 12 months and 45% said there had been no change. Only 5% said that interest had fallen.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

**Q19: Do You Feel That Japanese Hedge Funds Are Under Fee Pressure From Their Investors?**

Fee pressure is a feature of the hedge fund industry in the West, but, apparently, less so in Japan. Almost two-thirds of respondents said that they feel that Japanese hedge funds are not under fee pressure from investors.

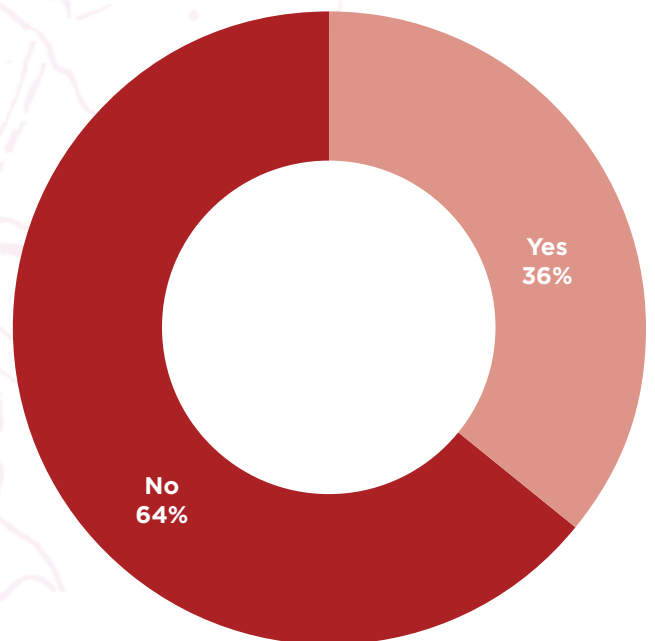


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q20: Do You Think That It's Getting Easier For New Hedge Funds To Become Registered In Japan?

Almost two-thirds of our survey respondents say that it is not getting easier for new hedge funds to become registered in Japan.

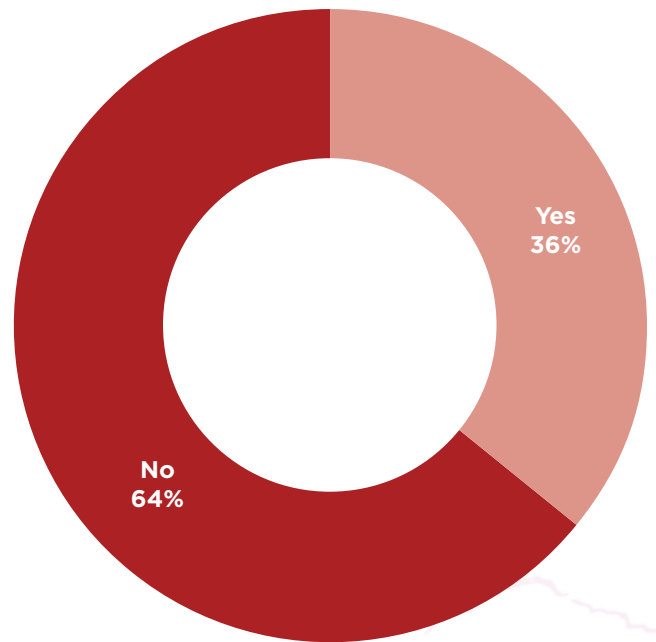
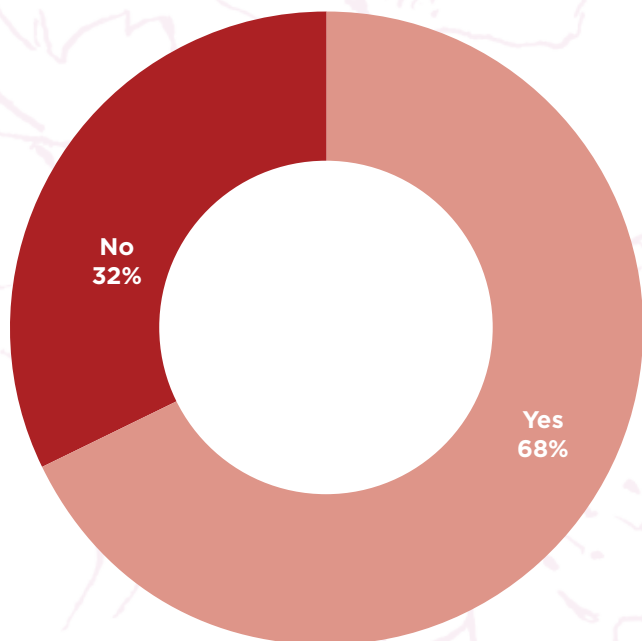


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q21: Has The Japanese Stewardship Code Been A Benefit So Far?



The Japanese stewardship code, originally introduced in 2014 and revised most recently in March 2020, has been a benefit to the Japanese hedge fund industry, according to slightly more than two-thirds of our survey respondents.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q22: Do You Think The Regulatory Environment In Japan Hinders Hedge Funds' Ability To Generate Alpha?

There's no problem with the regulatory environment in Japan, according to the survey respondents. More than three-quarters say that it's not a hindrance to alpha generation opportunities.

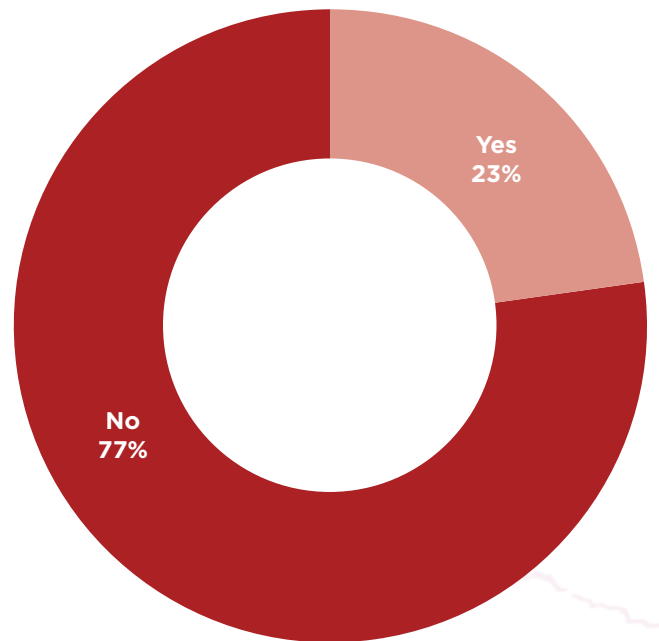
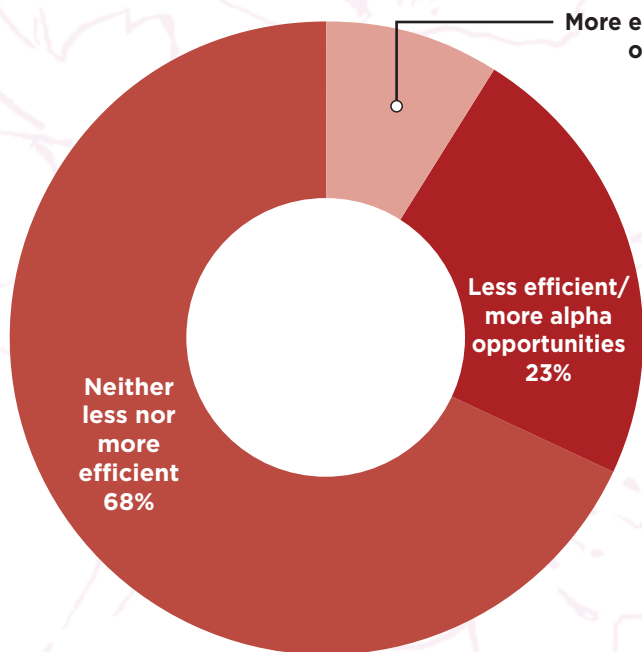


Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021

### Q23: Do You Feel That The Japanese Market Has Become More Or Less Efficient Over The Past 12 Months?



Slightly more than two-thirds of survey respondents say that the efficiency of the Japanese market is unchanged from a year ago. Almost a quarter say that it's less efficient, which should, in theory, lead to increased opportunities for alpha generation for hedge fund managers.

Chart: AlphaWeek • Source: AlphaWeek & Sussex Partners Japan Hedge Fund Survey 2021



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