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# The AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey

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2022 Edition



SUSSEX PARTNERS



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## Letter From The Editor

Welcome to the 2022 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.

This is the third iteration of the survey, and we're grateful to the 23 Japanese hedge fund management companies that took the time to complete this year's survey.

It's been an eventful year in Japan. The delayed Olympic and Paralympic games took place in the summer, despite opposition from a vast majority of the population; the country began its roll out of Covid-19 vaccines – albeit at a slower rate than other developed nations - and the country held a General Election in October.

Despite the tumult, the Japanese public equity market has had a solid year, delivering returns of approximately 12% at the time of writing. In September, the TOPIX closed at levels not seen in 30 years, as investors became optimistic that a new administration would better deal with the Covid-19 crisis (many Japanese felt that the vaccine roll-out was too slow).

The vast majority of the Japanese hedge fund industry is comprised of equity hedge fund managers investing in Japanese public equities and thus they will be compared, rightly or wrongly, to the performance of the broader market, and in 2021, they have underperformed when benchmarked against the TOPIX. Japanese hedge fund bulls, however, will point to quantitative easing initiatives and short squeezes playing a part in the advancing valuations of Japanese public equities this year, all short-term factors that institutional end investors with a long-term mindset should consider when they compare Japanese hedge fund managers with passive, long-only exposure to the Japanese market.

Structural tailwinds including the changes forced on Japan Inc. by Japan's Stewardship Code and Corporate Governance Code should continue to provide opportunities for managers able to identify undervalued stocks. The lack of sell-side coverage of the mid- and small-cap space remains, and Japan's equity market provides plenty of liquidity and access to short-selling to generate alpha in all weathers. It perhaps comes as no surprise that every single one of our survey respondents this year is bullish about their opportunity to generate alpha in the coming 12-24 months.

I hope you enjoy reading the 2022 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.



*Greg Winterton*  
Managing Editor  
AlphaWeek  
December 2021

## Japanese Hedge Funds Review And Outlook 2021/22

2021 has been a more challenging year for Japanese hedge funds, with significant performance dispersion amongst managers and trading styles. Market neutral managers, and in general strategies for which fundamental analysis plays a key role, especially those focused on longer term investment horizons, struggled to generate meaningful returns this year. This, by the way, is very much in line with the challenges that these types of managers have been facing globally in 2021, a year in which alpha seems to have been almost non-existent, valuations were, for the most part, meaningless, and earnings hits and misses have not counted for much, but a year in which liquidity reigns supreme.

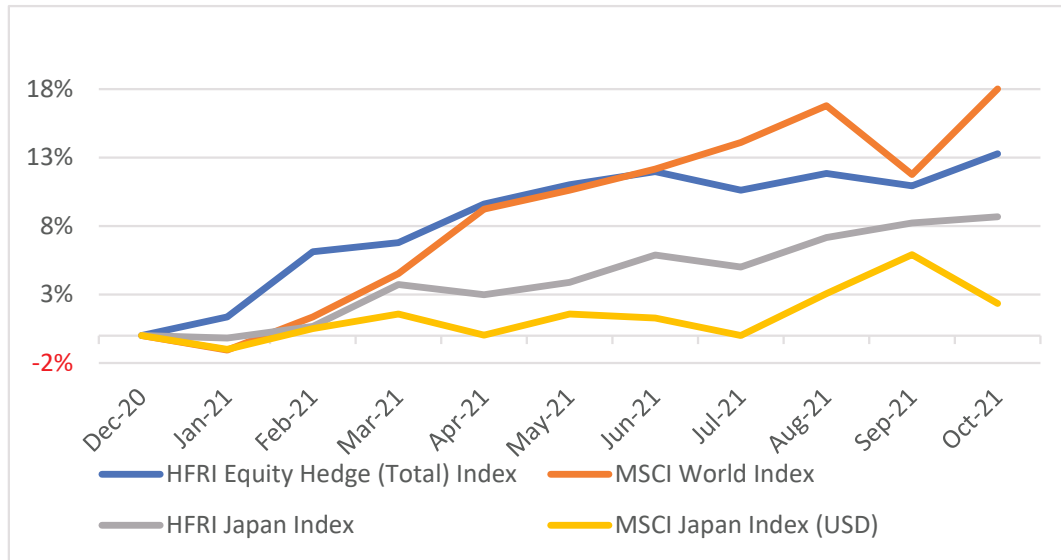
Trading oriented managers, and managers focused on deep value investing, on the other hand have recorded very strong returns this year, albeit in the case of deep value-oriented strategies on the back of sometimes significant losses in prior years. While the liquidity spigot remaining firmly open has helped more nimble managers which were able to take advantage of this, it has continued to create distortions which have posed challenges for those managers firmly focused on fundamentals. Time will tell whether these distortions could perhaps lead to significant profit opportunities down the road for these managers as/when/if fundamentals will become meaningful drivers of price action again, and prices revert to their means. For better or worse, fundamentals-oriented managers don't seem to have veered from their strategy (i.e., no style drift) despite the currently unfriendly environment for this type of investment style.

It is not unusual for different strategies to perform differently during different market regimes, and the past few years have certainly been unusual in many ways. Japanese markets historically have been vulnerable to macro flows, as foreign investors have often invested in Japanese markets with a macro rather than a local view. The pandemic has added an additional level of complexity to this and looking at fund performance over the last few years once again shows that holding a diversified portfolio of Japanese managers would have insulated investors somewhat from manager specific volatility and provided them with smoother returns. However, the challenge of finding non fundamental strategies, managers that have an infrastructure and team in place that would be considered "institutional" in a global sense, and that remain open to new investors remains as acute as ever. The inability to travel to Japan has made this even more difficult for foreign allocators, especially those without a local presence, or deep existing networks.

Ultimately, however, for hedge funds to justify their existence, investors want to understand the added value they provide over cheaper and more liquid long-only options. With that in mind, we analyzed the absolute and risk adjusted returns, as well as the cumulative outperformance of Japanese hedge funds for last year's report. We have updated those charts again for this year, including peers in the US and Europe.

While the HFRI Japan Index has underperformed the HFRI Equity Hedge (Total) Index in 2021 (N.B.: it marginally outperformed last year), it did still outperform the MSCI Japan Index (USD).

**Figure 1: Cumulative Returns, Equity vs Hedge Funds, 2021 Through October**

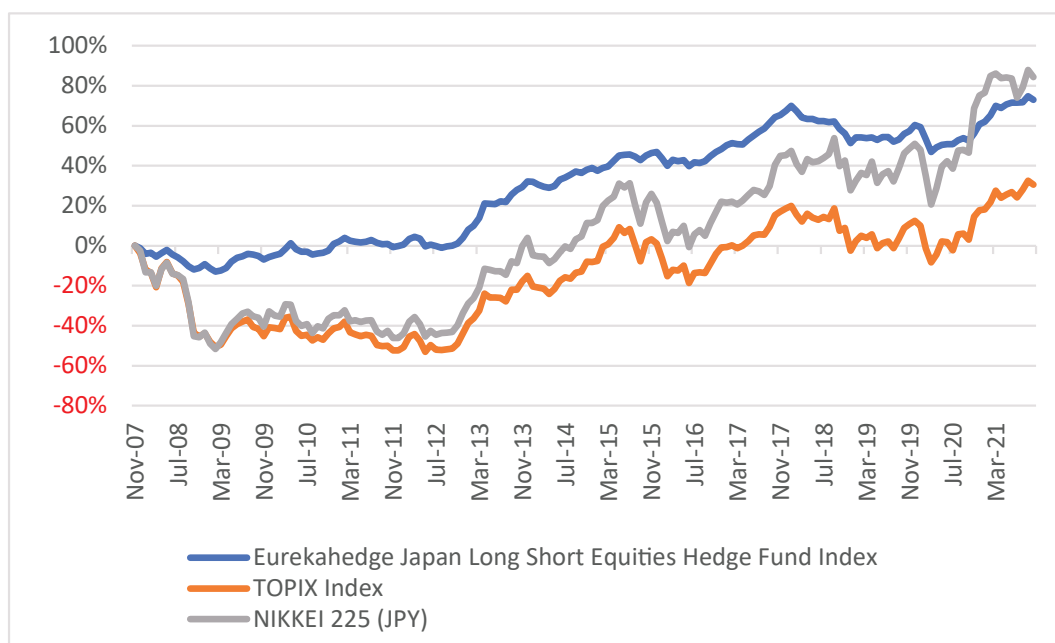


Source: Sussex Partners

It is also instructive to once again look at the longer-term comparison of the Eureka hedge Japan long/short hedge fund index versus the TOPIX and the NIKKEI 225 indices (see figure 2).

Whilst the NIKKEI 225 has now slightly outperformed the Eureka hedge Japan long/short hedge fund index, the TOPIX still has not managed to catch up, and it remains very clear that on a risk adjusted basis Japanese long/short hedge funds have represented a far superior choice than braving the Japanese markets long only. Given the magnitude and speed of the increase of Japanese long only indices in the past year, it is reassuring to see that Japanese long/short managers have not in general been squeezed to such an extent on the short side that this has led to losses. This once again shows that Japanese managers have had efficient risk management in place.

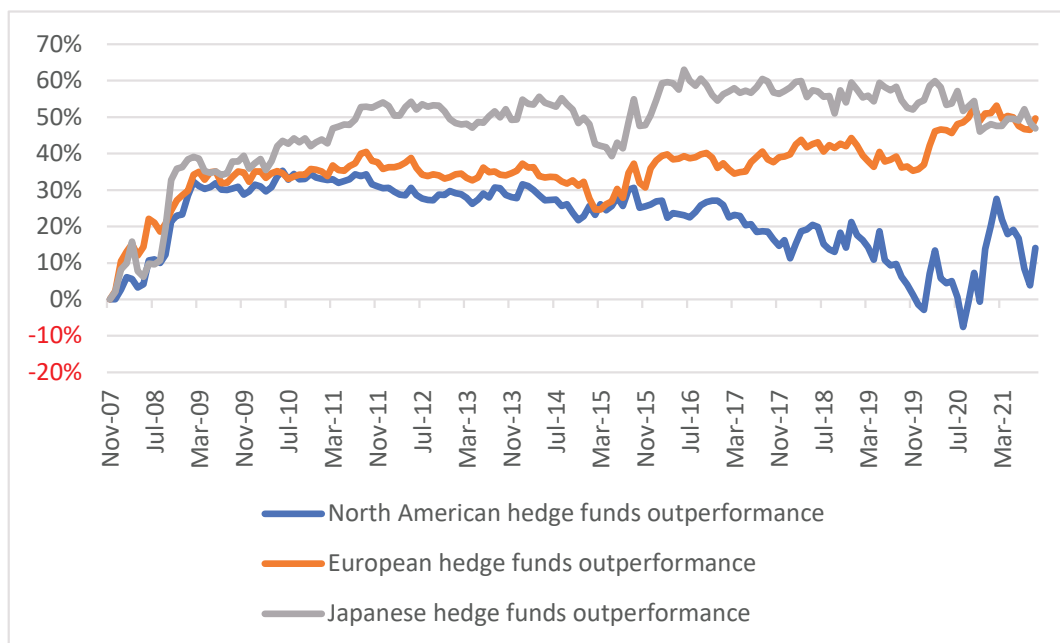
**Figure 2: Historical Cumulative Performance of Equity Hedge Funds Relative to Equity (December 2007 - October 2021)**



Source: Sussex Partners

Looking at the cumulative outperformance of equity hedge funds versus their respective equity benchmarks, we see a slight deterioration of the outperformance of Japanese hedge funds since last year. The most significant changes since last year are that European hedge funds for the first time have overtaken Japanese hedge funds in terms of outperformance versus their own benchmark, and that North American hedge funds have managed to move off the 0% line, albeit in a very choppy and perhaps not sustainable manner. Despite this deterioration in cumulative outperformance by Japanese managers, the outperformance achieved remains very attractive, and especially so over the long term, and particularly as measured against North America which still attracts the lion share of investments into hedge fund.

**Figure 3: Historical Cumulative Outperformance of Equity Hedge Funds vs Equity (December 2007 - September 2021)**



Source: Sussex Partners

As the world weans itself off central bank liquidity, and as fundamentals once again come to the fore, it will be very interesting to see what opportunities this may augur for Japanese managers. A more fundamentals driven market, the resurgence of the value factor, together with further improvements in corporate governance are additional elements which could portend strong returns going forward for Japanese hedge funds. Japan, as an exceptional alpha market for hedge funds, should persist for the time being, while limited capacity with the best managers, and a limited amount of funds from which to choose remain headwinds both for the Japanese hedge fund industry and for allocators looking to build a diversified portfolio of managers.

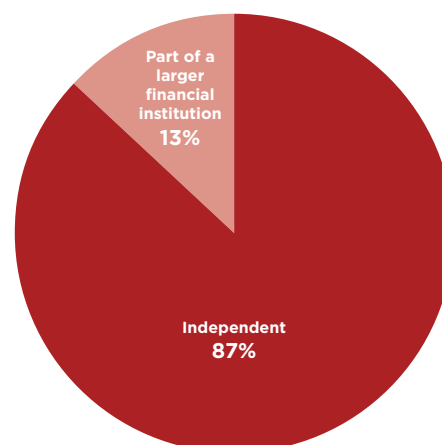
*P. Ghali*

Patrick Ghali  
 Managing Partner  
 Sussex Partners  
 December 2021

## Section 1 : Firm Information

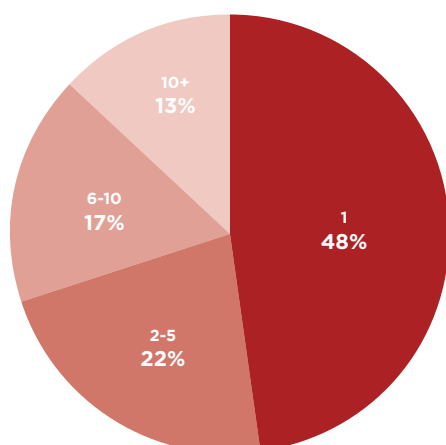
### Q1: Is your firm part of a larger financial institution or is it independent?

Last year, 82% of the survey respondents were independent firms, and this year that rose to 87%. The consistency in the data reinforces the fact that the Japanese hedge fund industry is heavily populated with boutique firms.



Source: AlphaWeek & Sussex Partners

### Q2: How many funds or products does your firm offer?

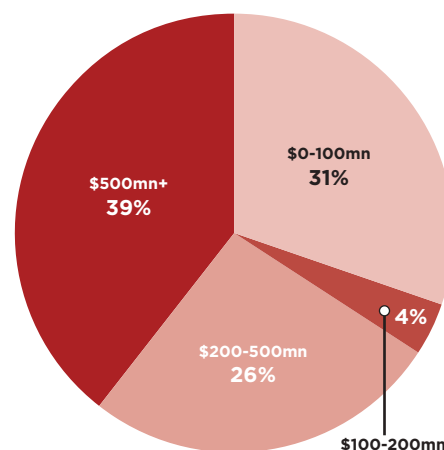


Source: AlphaWeek & Sussex Partners

Nearly half (48%) of this year's survey respondents manage the one fund/product; again, this is to be expected in an industry where most of the constituents are boutiques. Just over a fifth (22%) manage between two and five funds/products, and only three manage more than ten.

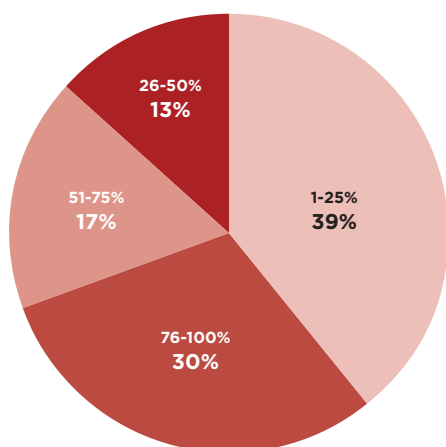
### Q3: What is the total AUM managed by your firm in USD?

The size of assets managed by Japanese hedge fund managers is evenly spread. Almost a third (31%) of survey respondents manage less than \$100mn in assets, up slightly from 27% last year; 30% manage between \$100 - \$500mn and 39% of respondents manage \$500mn or more.



Source: AlphaWeek & Sussex Partners

**Q4: What percentage of your total AUM comes from investors based outside Japan?**



Source: AlphaWeek & Sussex Partners

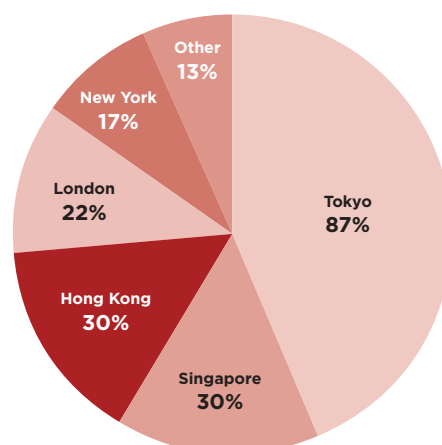
Last year, 50% of survey respondents said that more than 75% of their AUM comes from outside Japan; that's fallen sharply to 30% this year. 39% of survey respondents now say that less than a quarter of the assets they manage comes from abroad.

*\*The percentages do not add up to 100 due to rounding*

**Q5: Which of the following locations do you have offices in?**

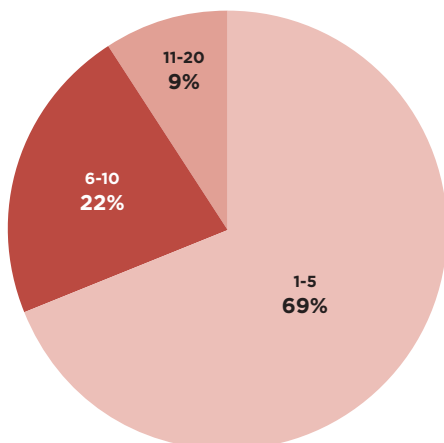
The spread of offices is similar this year to last, perhaps unsurprisingly. In addition to Tokyo, Singapore, thanks to its proximity and its lower tax regime, and Hong Kong, remain the second and third most popular locations for an office, whether that be the HQ or a satellite.

*\*The percentages do not add up to 100 due to this being a multiple selection question*



Source: AlphaWeek & Sussex Partners

**Q6: How many investment professionals do you employ which are solely focused on your hedge funds?**



Source: AlphaWeek & Sussex Partners

Similar to last year, the majority of firms – 70% this year – have between 1 and 5 investment professionals, something that again should be unsurprising for an industry heavily populated with smaller firms.

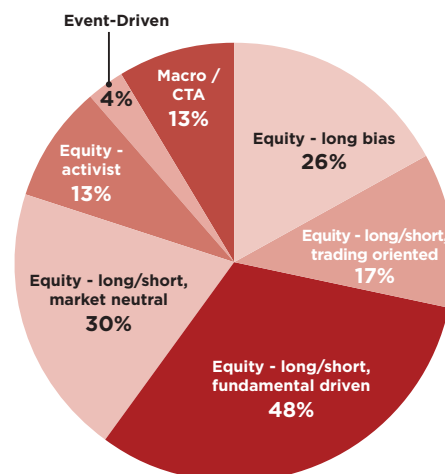


## Section 2: Fund Information

### Q7: Which strategies do you run?

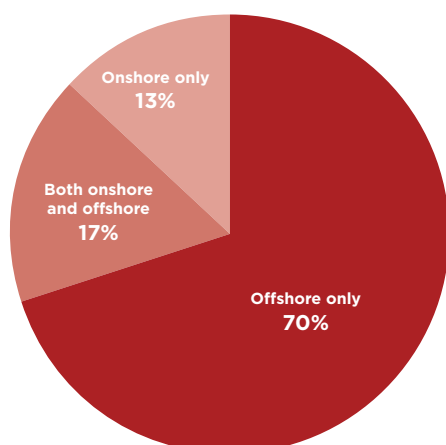
We tweaked the answers to this question this year to try and get a more granular look at the approaches and strategies employed by Japanese hedge fund managers. Equity long/short was the primary category, with 96% of firms reporting using this strategy. Within that, half take a more fundamental/discretionary approach. Only 13% of firms describe themselves as being Activists.

*\*The percentages do not add up to 100 due to this being a multiple selection question*



Source: AlphaWeek & Sussex Partners

### Q8: Do you offer only onshore funds, only offshore funds, or both?

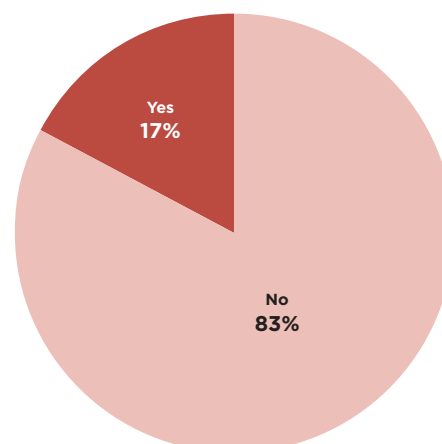


Source: AlphaWeek & Sussex Partners

Offshore dominates here again, with 70% of respondents offering this to investors, with only 13% offering an onshore-only product for domestic investors.

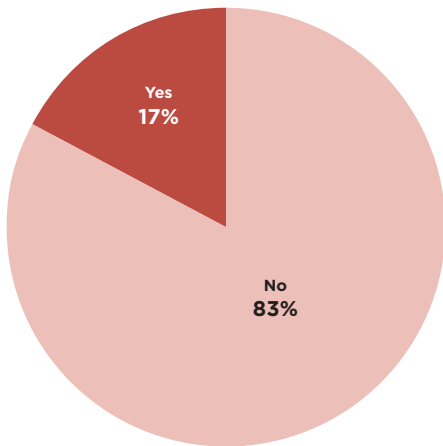
### Q9: Do you offer any UCITS-compliant funds / products?

83% of firms don't offer a UCITS-compliant version of their funds/products. That's up from 68% last year.



Source: AlphaWeek & Sussex Partners

**Q10: Are you planning on launching any UCITS-compliant funds / products?**

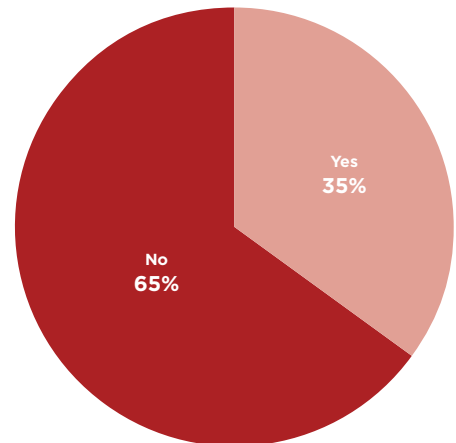


Source: AlphaWeek & Sussex Partners

Again, despite the doors that a UCITS-compliant products opens in Europe in particular, Japanese managers have little interest in launching a UCITS variant in the future.

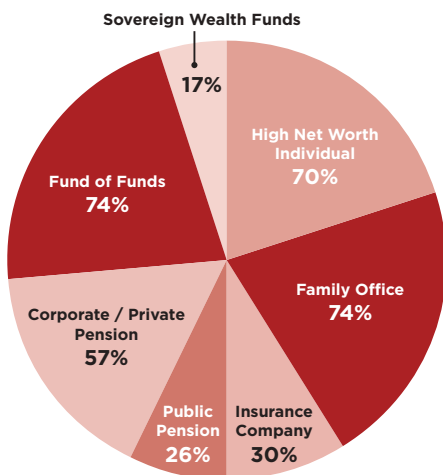
**Q11: Have you launched any new funds in the past year?**

35% of survey respondents have launched a new fund in the past 12 months, suggesting that, despite the challenges brought on by the pandemic in terms of the difficulties in holding face to face meetings, there are managers able to raise fresh capital for new opportunities.



Source: AlphaWeek & Sussex Partners

**Q12: Which investor types do you currently receive allocations from?**



Source: AlphaWeek & Sussex Partners

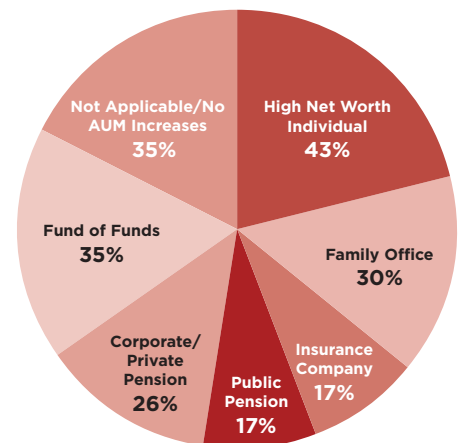
High net worth individuals, family offices and fund of funds comprise much of the investor base in Japan, with around three quarters of survey respondents reporting these client types. Public pensions are again the least common investor type, the same as last year.

*\*The percentages do not add up to 100 due to this being a multiple selection question*

**Q13: Which investor types have accounted for any AUM increases in the past year?**

Given the make-up of the investor base in the previous question, it's unsurprising that HNWI's, family offices and fund of funds have accounted for most of the inflows in the past 12 months. 35% of managers haven't seen any inflows, and none have reported allocations from sovereign wealth funds in the past year.

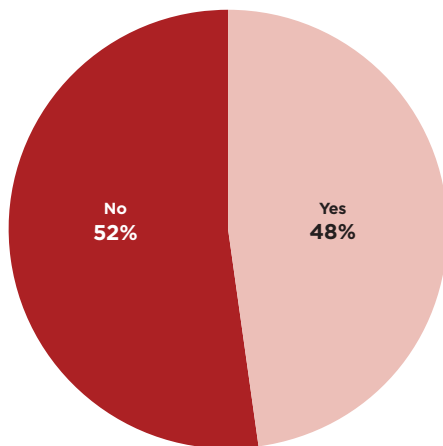
*\*The percentages do not add up to 100 due to this being a multiple selection question*



Source: AlphaWeek & Sussex Partners

## Section 3: Characteristics Of Japanese Hedge Fund Managers

### Q14: Do you engage in activism or company management engagement?

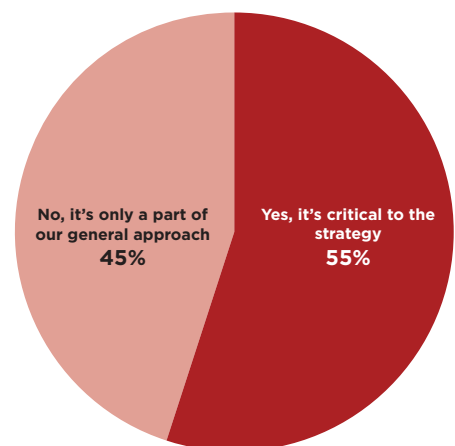


Source: AlphaWeek & Sussex Partners

Last year, only a third (36%) of respondents said that they engage in activism or company management engagement. This year, that's up to 48%, suggesting that Japanese hedge fund managers are increasingly taking a 'hands-on' approach to managing their portfolio.

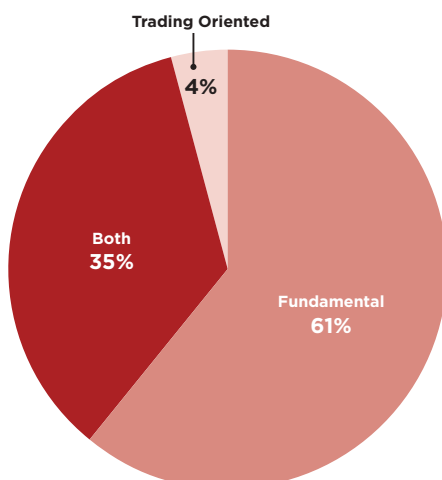
### Q15: If you do engage in activism or company management engagement, is it critical to your strategy?

New for this year, we wanted to understand the extent to which, for those that do take an activist approach, activism is embedded in a manager's strategy. It's roughly 50/50.



Source: AlphaWeek & Sussex Partners

### Q16: What type of manager do you consider yourself to be?

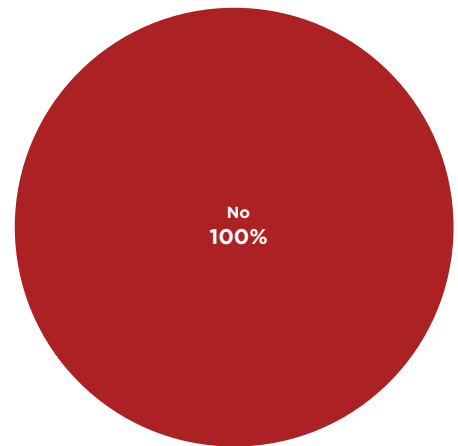


Source: AlphaWeek & Sussex Partners

61% of survey respondents say that they consider themselves to take a fundamental/discretionary approach to managing their funds/products, similar to last year's 68%. Again, the consistency in the data reflects the well-understood nuances of the space.

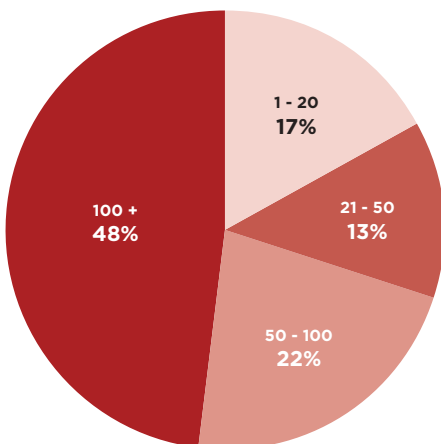
**Q17: Have you changed your investment style – for example, switched from long-biased to long/short – in the past twelve months?**

There's no style drift in the Japanese hedge fund industry. None of the survey respondents have changed their investment style, reflecting their conviction that they can generate alpha using their existing approach.



Source: AlphaWeek & Sussex Partners

**Q18: How many positions do you hold at any one time?**

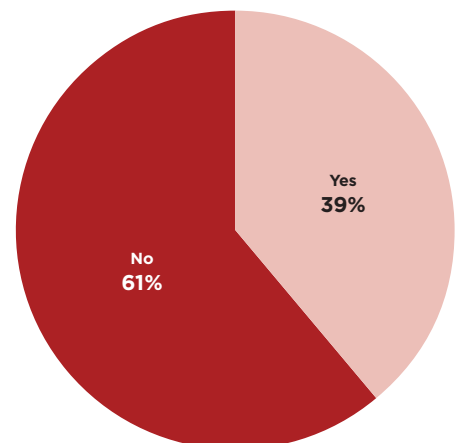


Source: AlphaWeek & Sussex Partners

Almost half of Japanese hedge fund managers maintain more than 100 positions at any one time, a huge amount when compared to their Western peers. Only 17% hold less than 20 positions simultaneously; clearly, spreading risk is key in Japan.

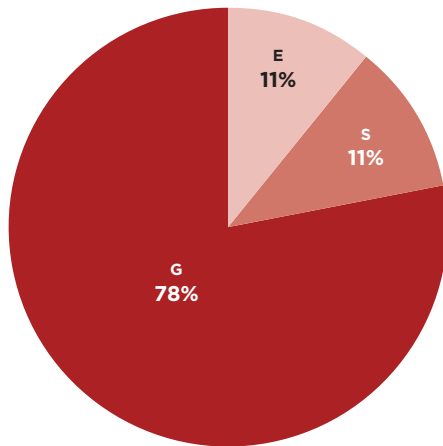
**Q19: Do you deliberately consider ESG issues when taking a position?**

Only 39% of Japanese hedge fund managers consider ESG issues when taking a position. This is consistent with much of the coverage of the intersection of hedge funds and ESG and the challenges reported by hedge fund managers globally with regards to implementing ESG into their investment process.



Source: AlphaWeek & Sussex Partners

**Q20: If you do consider ESG issues when taking a position, which of the ESG pillars - E, S or G - is most important to your strategy?**



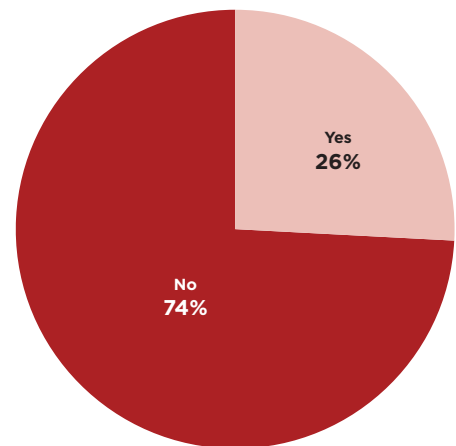
Source: AlphaWeek & Sussex Partners

Governance dominates the ESG conversation in Japan, with 78% of those who do say that ESG is a consideration when taking a position identifying Governance as the most important of the three ESG pillars.

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

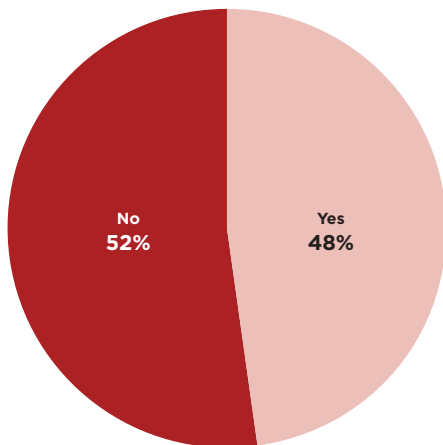
**Q21: Do you think that foreign investors pay enough attention to domestic Japanese hedge funds?**

Only 26% of Japanese hedge fund managers say that they think foreign investors pay enough attention to Japanese hedge funds. That's low, but it is up from 18% last year, which should offer encouragement to the industry.



Source: AlphaWeek & Sussex Partners

**Q22: Do you think domestic investors pay enough attention to domestic Japanese hedge fund managers?**

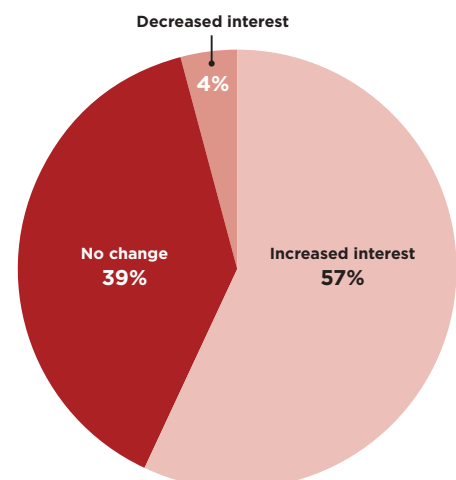


Source: AlphaWeek & Sussex Partners

Last year, 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. This year, however, that number has fallen sharply to 52%, something that should offer strong encouragement to the Japanese hedge fund industry.

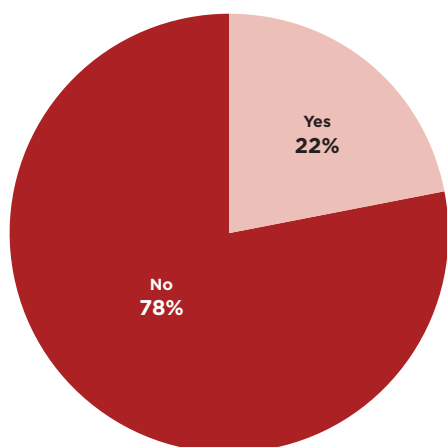
**Q23: Have you seen increased or decreased interest in your fund in the past 12 months?**

57% of Japanese hedge fund managers saw increased interest in their funds/products in the past twelve months, up from 50% last year.



Source: AlphaWeek & Sussex Partners

**Q24: Do you feel that Japanese hedge funds are under fee pressure from their investors?**

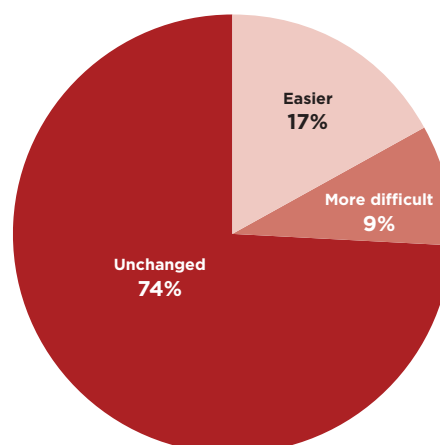


Source: AlphaWeek & Sussex Partners

Hedge fund fee pressure has been a feature of the hedge fund industry in the west for years, but last year, almost two-thirds of respondents said that they feel that they don't get this pressure. This year, it's a similar story, with 78% saying this isn't an issue in their industry.

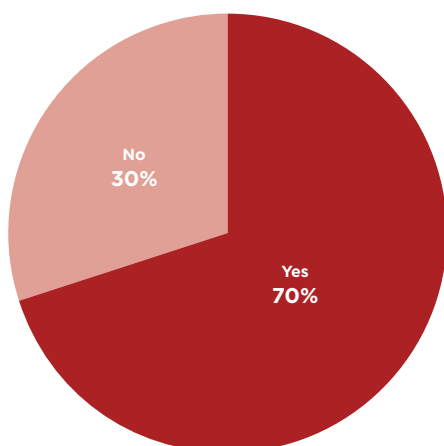
**Q25: Do you think that it's getting easier for new hedge funds to become registered in Japan?**

Despite efforts by the Tokyo government to make it easier for new hedge funds to get registered, only 17% think that this is the case. 83% say that it's actually more difficult or that it's stayed the same when compared to last year.



Source: AlphaWeek & Sussex Partners

**Q26: Has the Japanese Stewardship Code been a benefit so far?**



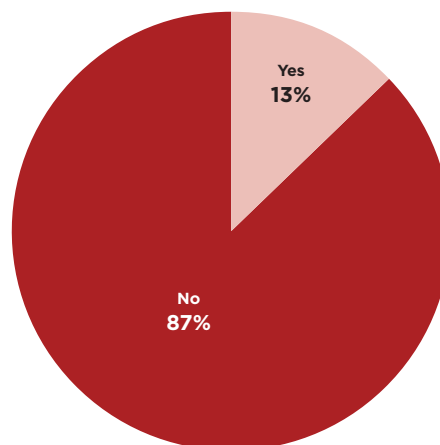
Source: AlphaWeek & Sussex Partners

The Japanese stewardship code remains a boon to the Japanese hedge fund industry. Originally introduced in 2014 and revised most recently in March 2020, it has provided something of a tailwind, particularly for managers with an activist bent.



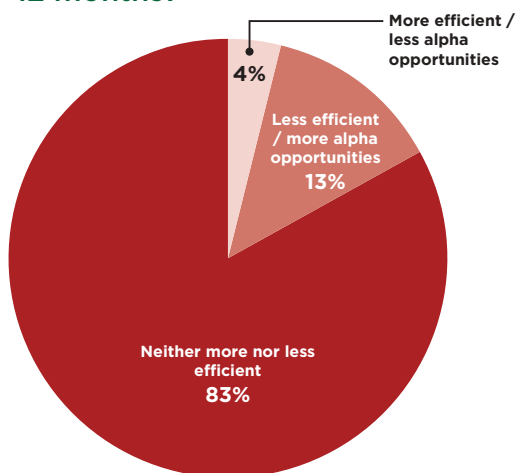
**Q27: Do you think the regulatory environment in Japan hinders hedge funds' ability to generate alpha?**

Last year, more than three-quarters of Japanese hedge fund managers said that there's nothing hindering their alpha-seeking efforts from a regulatory standpoint. That's up to 87% this year, suggesting that the regulatory environment isn't punitive.



Source: AlphaWeek & Sussex Partners

**Q28: Do you feel that the Japanese market has become more or less efficient over the past 12 months?**

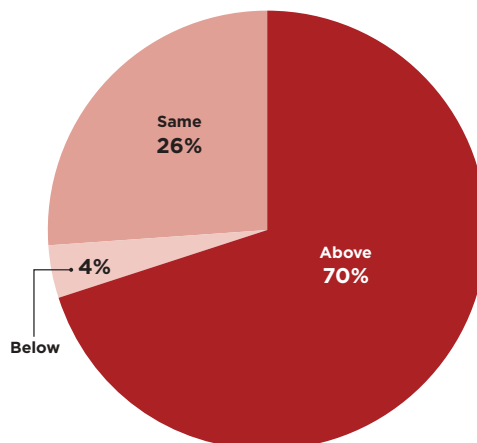


Only 13% of Japanese hedge fund managers think that the Japanese market is becoming less efficient, but only 4% say that it's more efficient, leaving the vast majority - 83% - saying that it's unchanged.

Source: AlphaWeek & Sussex Partners

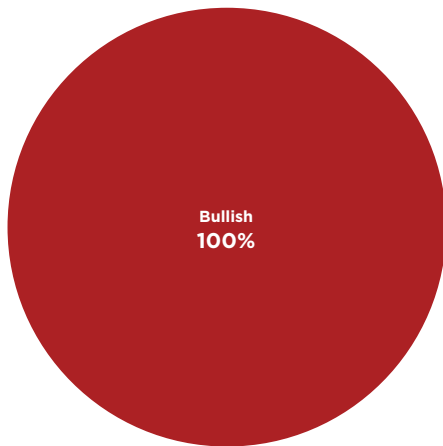
**Q29: Do you view the opportunity set as above, below, or the same as the average of the last five years?**

96% of Japanese hedge fund managers say that they think the opportunity set is above (70%) or the same (26%) as last year, with only 4% saying that it's below the average of the last five years.



Source: AlphaWeek & Sussex Partners

**Q30: Are you bullish or bearish about the opportunities for alpha generation in the next 12-24 months?**



Source: AlphaWeek & Sussex Partners

Finally, following on from the previous question, confidence clearly isn't an issue in the Japanese hedge fund industry – 100% of respondents are bullish about the outlook for alpha generation in the coming 12-24 months.



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