

# The AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey 2023 Edition



SUSSEX PARTNERS

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## Letter From The Editor

Welcome to the 2023 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.

This is the fourth 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.

2022 has seen Western economies begin to raise interest rates to combat the threat of inflation, the first time in decades that a significant upwards resumption in the rate has occurred. Surging prices in everything from energy to food has forced central banks' hands; Japan, however, has remained comparatively insulated, with an inflation rate of 'only' 1.99% allowing the BoJ to keep the Japanese base rate at -0.1% throughout last year.

Equity markets in the country have been moving sideways for most of 2022. The Nikkei 225 was down only -1% last year, and the TOPIX down only -2%, but as Patrick Ghali, Managing Partner of Sussex Partners, co-producer of this survey, discusses in his annual review, Japanese hedge funds have been unable to take advantage of the volatility last year.

What will be interesting in 2023 is how Japan's new Code of Conduct for ESG Evaluation and Data Providers affects Japanese hedge fund managers. The code was finalised on December 15th, 2022, after a three-month consultation period; the document is not a legal requirement, rather a voluntary best practice document, but it will be interesting to see which ESG data providers sign up to it and which don't. There is widespread frustration amongst hedge fund managers generally about what they perceive as conflicting data amongst providers, and the eyes of not only the Japanese hedge fund industry, but regulators around the world, will be watching the effectiveness of this voluntary document in promoting greater transparency and understanding amongst ratings providers.

Last year, 100% of survey respondents were bullish about the opportunities for them to generate alpha in the coming 12 months. This year, that number falls to 82.61%. A sign of the times, perhaps, that doubts are creeping in with regards to the state of the Japanese equity market. What's almost certain, however, is that 100% of survey respondents will be hoping that the 82% are right.

I hope you enjoy reading the 2023 edition of the AlphaWeek and Sussex Partners Japan Hedge Fund Industry Survey.



*Greg Winterton*  
Managing Editor  
AlphaWeek

## Japanese Hedge Funds Review And Outlook 2022/23

Perhaps not entirely surprisingly given the global backdrop, 2022 was yet another challenging year for Japanese hedge funds on an absolute return basis (though not on a relative basis) with the average manager in the HFRI Japan Index returning +0.3% through September of last year. Of course, one could take the view that any positive return last year is a significant achievement, and it certainly shows once again that Japanese hedge funds as a group have been able to weather the storm better than their global peers; through the end of September, the EurekaHedge North America Long Short Equities Hedge Fund Index was down -13.7%.

Significant performance dispersion amongst managers and trading styles, however, has continued. Market neutral managers, and in general strategies for which fundamental analysis plays a key role, especially those focused on longer term investment horizons, continued to struggle to generate meaningful absolute returns last year. Dispersion among these types of managers has been particularly significant, with some managers up over +20% YTD as of September and others nursing losses in the mid-teens for the same time period. Those with a meaningful value tilt seem to have done better, though often on the heels of prior years of significant underperformance when value was very much out of favor due to quantitative easing which pushed up growth names instead.

Once again, this is very much in line with the challenges faced by managers globally in 2022, with the difference to 2021 being that while many equities-focused hedge funds have struggled to generate significant absolute returns, they have generated significant alpha versus their underlying indices. We have also seen some green shoots in terms of fundamentals starting to matter once more to investors. We expect this importance to become even more pronounced as liquidity continues to be drained from markets, interest rates continue to increase, and investors finally realize the importance of company profitability once again. As we have commented on in previous years, those Japanese managers unable/unwilling to adapt to the current environment and who stick to their long-term approaches are amongst those that continue to struggle the most. In the long run they may be vindicated, but we have seen substantial AUM drops for some of those managers in the meantime, and hence sticking to their guns could turn out to be a costly exercise for them both in terms of performance and their overall businesses.

Trading oriented/multi-pm funds have generally done better, with returns in the low single digits to low teens through September of 2022. The issue here though remains the same as before in that there is both a lack of capacity as well as a lack of institutional grade (in a global sense) managers that are available for investment.

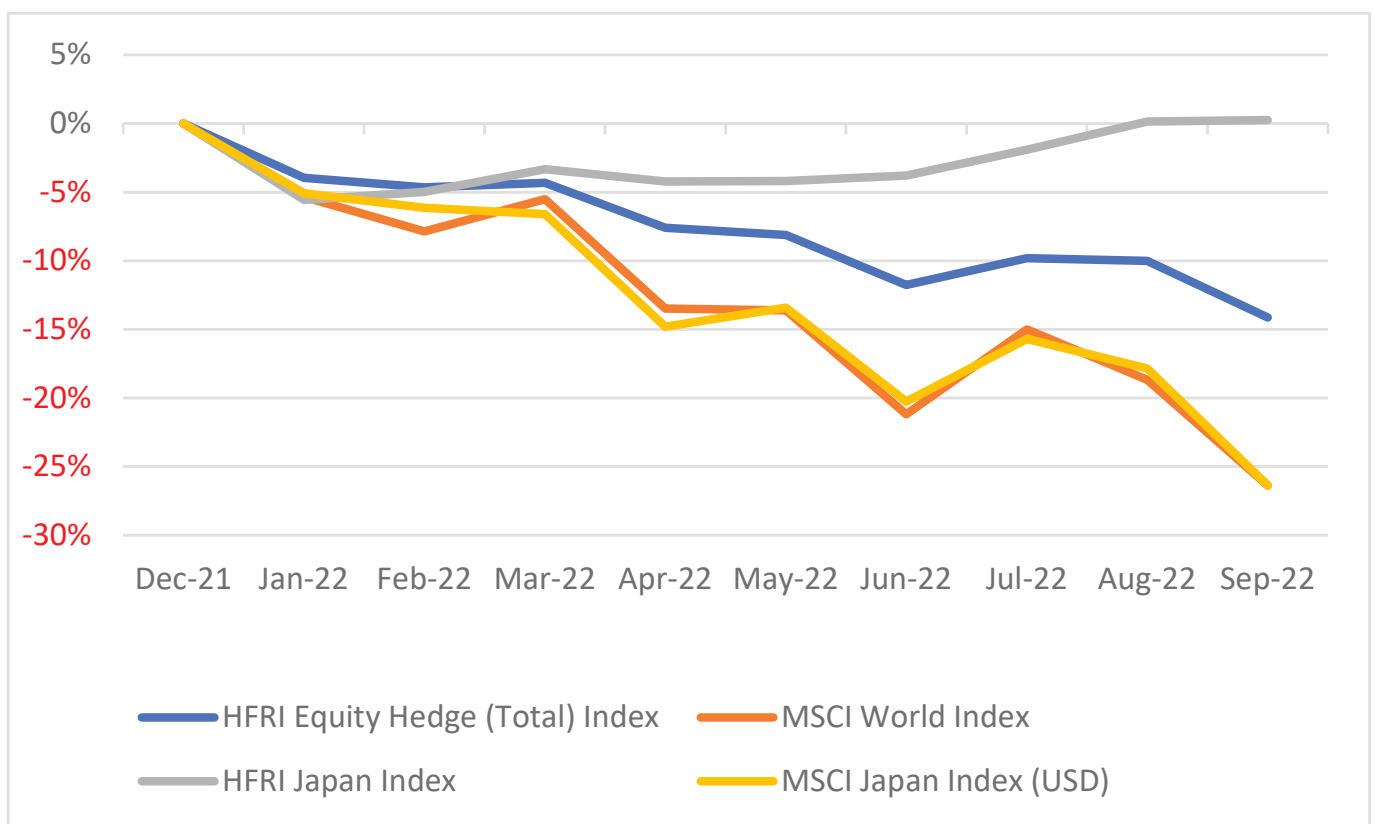
2022 validates our view that holding a diversified portfolio of Japanese managers would have insulated investors to some extent from manager-specific volatility and provided investors with smoother returns, notwithstanding the above-mentioned caveats of capacity and infrastructure which make investing in Japan challenging for all but the most sophisticated allocators with deep knowledge of the Japanese hedge fund industry.

As we have done in previous years, this year's report updates and compares Japanese

hedge funds as a group with their long only benchmarks as well as with their North American and European peers. This allow investors to judge relative performance and assess whether the added layer of fees and lesser liquidity that invariably come with hedge fund investments are justified.

After underperforming the HFRI Equity Hedge (Total) Index in 2021, the HFRI Japan Index significantly outperformed it last year. The outperformance versus both the MSCI Japan and the MSCI world indices is even more stark, showing that Japanese hedge funds as a group materially protected capital in 2022 versus long only. While Japanese hedge fund as a group were flat (+0.3%), both MSCI indices lost -26.4% during the same period.

Figure 1: Cumulative Returns, Public Equity vs Hedge Funds, 2022 Through September



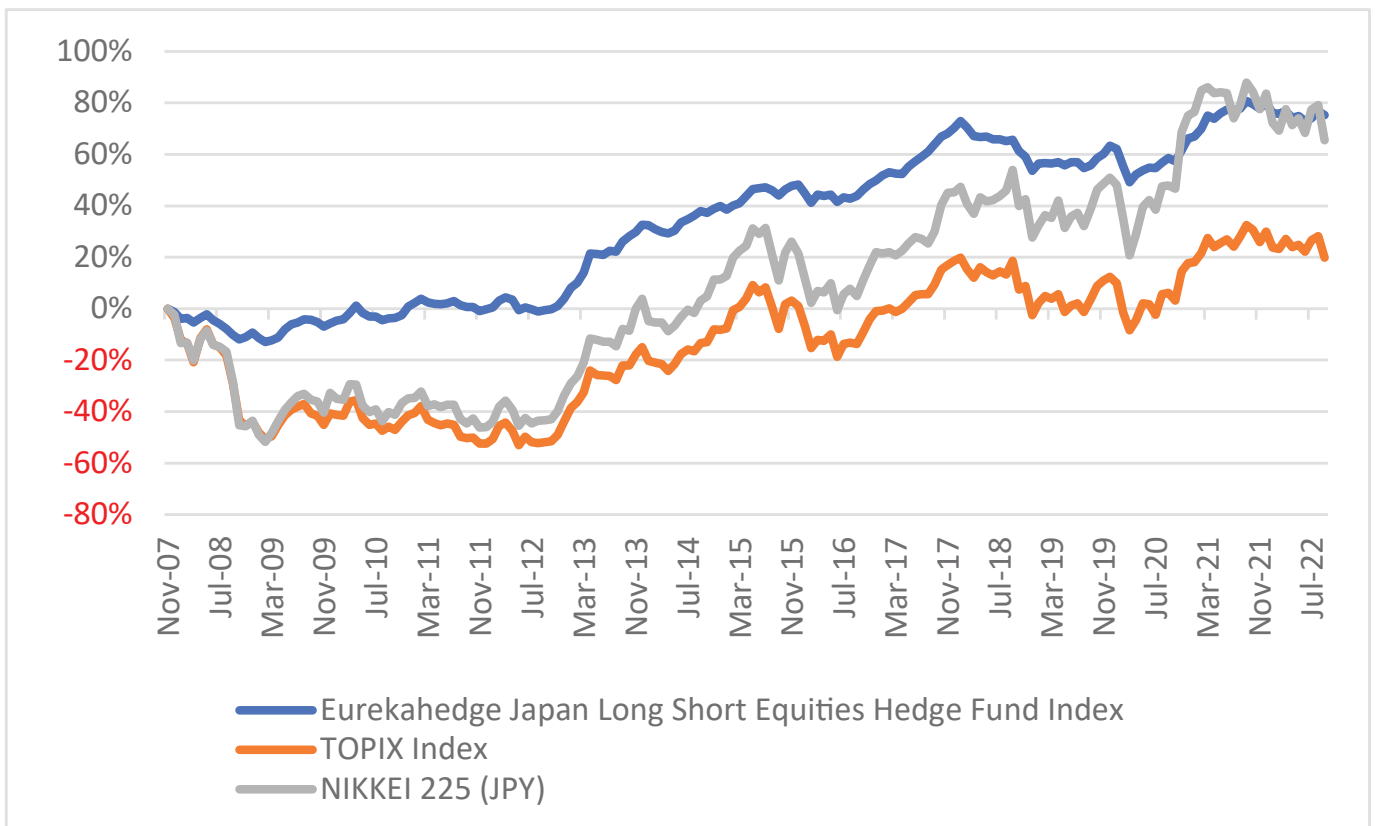
Source: HFR, MSCI

Again, as in previous years, we have also looked at the longer-term comparison of the EurekaHedge Japan long/short hedge fund index versus the TOPIX and the NIKKEI 225 indices (see figure 2).

Since 2007, Japanese hedge funds as a group have marginally outperformed both the TOPIX and the NIKKEI indices on an absolute basis but have significantly outperformed on a risk adjusted basis. While the TOPIX index suffered a maximum drawdown of -53.03% and the NIKKEI 225 index a maximum drawdown of -51.74%, the EurekaHedge Japan index only lost 13.72% over the same period. It is also interesting to observe that these maximum drawdowns occurred during different periods (May 2012 for the TOPIX Index, February 2009 for the NIKKEI 224 Index and March 2020 for the EurekaHedge Japan index). The volatility profile of Japanese hedge funds is also much more benign,

coming in at 5.68% versus 17.93% and 19.48% for the TOPIX and the NIKKEI 225 indices respectively. This shows that Japanese hedge funds continue to be a much better risk adjusted way to invest in Japan than through long only funds, even after taking into account the higher fees and lesser liquidity.

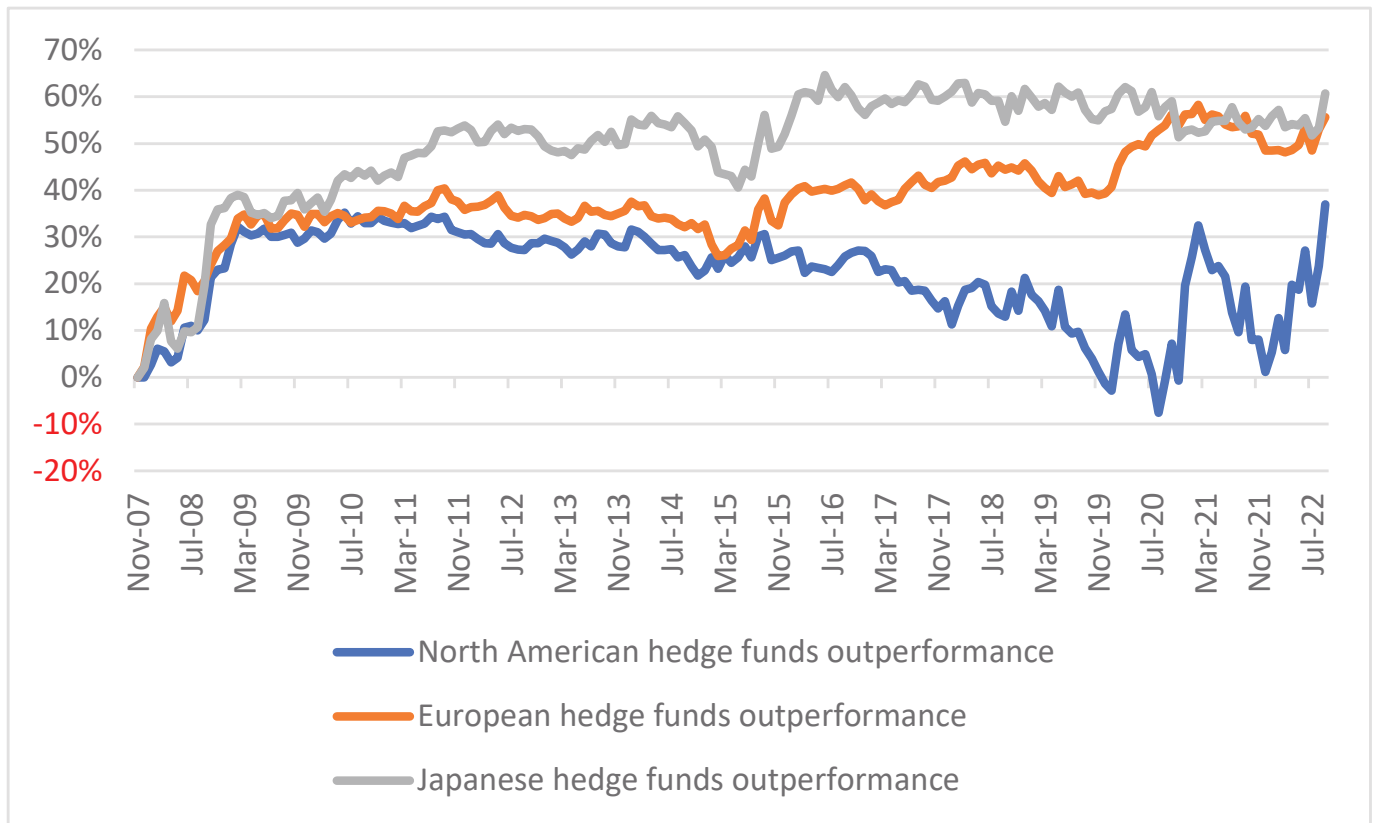
Figure 2: Historical Cumulative Performance of Equity Hedge Funds Relative to Public Equity (December 2007 - September 2022).



Source: Eurekahedge, Bloomberg

Japanese hedge funds as a group continue to show the largest outperformance over time versus their equity benchmarks and their North American and European peers and this cumulative outperformance has further improved last year (see figure 3). However, North American hedge funds have narrowed the gap somewhat, owing to the big losses in North American equity indices this year (the MSCI North America index is down -25.5% YTD) versus the more muted losses among North American hedge funds (the Eurekahedge North America Long Short Equities Hedge Fund Index is down -13.7% during the same period). The big difference, of course, being the fact that Japanese hedge funds have made a return this year, albeit small, whereas North American hedge funds have lost money in 2022 so far. It is still striking to see how consistent the long-term gap remains between Japanese hedge funds and their North American peers. While North American equity-oriented hedge funds continue to represent the single largest part of the hedge fund industry, Japanese hedge funds continue to be but a small sliver of the overall industry AUM. Given their consistent alpha generation it would perhaps make sense for investors to consider allocating more to Japanese and less to North American equity hedge funds.

Figure 3: Historical Cumulative Outperformance of Equity Hedge Funds vs Equity (December 2007 - September 2022)



Data: North American equities = Eureka hedge North American Hedge Fund Index vs. MSCI North America Index (USD), European equities = Eureka hedge European Hedge Fund Index vs. MSCI Europe Index (EUR), Japanese equities = Eureka hedge Japan Hedge Fund Index vs. MSCI Japan Index (JPY).  
 Source: Eureka hedge, MSCI

The alpha opportunity for Japanese hedge funds seems to have continued uninterrupted, though the headwinds the industry faces (limited capacity, limited number of funds, language and cultural barriers and less institutional grade firms) haven't changed in recent years. Perhaps a resurgence in travel to Japan and continued strong performance will help to ease these bottlenecks over time.

*P. Ghali*

Patrick Ghali  
 Managing Partner  
 Sussex Partners  
 December 2022

## Questions and Answers

### AlphaWeek Hedge Funds Q&A: Yasuko Hirabayashi, Nomura

The Japanese hedge fund industry has endured a difficult 2022, but then, so has the rest of the hedge fund world, particularly those trading public equities. AlphaWeek's Greg Winterton spoke to Yasuko Hirabayashi in Nomura's Prime Brokerage Division in Tokyo to learn more about what Nomura thinks about the current state of the Japanese hedge fund industry.

**GW:** Yasuko, it's been a tough year for the hedge fund industry, both in terms of performance and assets being pulled out of the space by allocators. Are you seeing allocators pulling money from hedge funds in Japan as well, and are they delaying making new allocations?

**YH:** I believe a large number of global allocators moved away from Japan exposure, or if they continue to hold Japan, they at least slimmed their Japan holdings during the last few years. Despite the volatility we've seen in global markets, we think the trend was reversed in 2022 and more allocators are revisiting Japan managers on the back of outperformance when compared to Global or Asia equity long short strategies. As far as I have seen, investors' focus has been on low vol, low net oriented strategies. That being said, the universe of available managers is not large, thus eventually leading to capacity constraints in my view.

**GW:** The Japanese hedge fund industry is dominated by equity-based strategies, but other strategies like managed futures have done well this year. Why do you think there aren't more macro and managed futures-type products available to investors from Japanese managers?

**YH:** The Japanese equity market is a deep enough market and inefficiency is also there, which provides a number of opportunities to generate alpha. Language and cultural barriers are another aspect that Japanese corporates have which are country-specific in nature compared to other global markets, thus a fundamental stock picking approach can create opportunity for managers in Japan. Additionally, single country equity long short strategies are relatively simple and have only light initial instalment requirements, compared to data driven systematic strategies, which would require a relatively larger cost in terms of capital and manpower.

**GW:** One of the main selling points for the existence of actively managed equity strategies in Japan is the relative lack of sell-side coverage of medium- and small-cap stocks. Does this still represent an opportunity for Japanese hedge fund managers?

**YH:** I believe so. The small to mid-cap space should offer more opportunity – it has lots of hidden gems. But diminishing sell side research coverage relative to regional markets in Asia is a trend that we're observing across the market. Deep fundamental analysis and rigorous risk management capability bodes well even for larger cap focused active managers.

**GW:** What are Japanese hedge fund managers telling you about the Japanese



Stewardship Code, the Corporate Governance Code and the new ESG Code? Do you think these codes also benefit hedge fund strategies over long-only strategies, and why?

**YH:** The Stewardship Code and the Corporate Governance Code increase corporate activities with regards to shareholder rights and valuation enhancement, which bodes well for the long term, but also managers are finding opportunities arising from both the long and short perspective. The ESG Code implementation is a growing concept, for sure, however, I believe ESG initiatives are taken by larger organizations more proactively while boutique managers are lagging – this might be the case for other regions too. We find high expectations remain from Japanese hedge funds on Japanese corporate governance reform in general.

**GW:** Lastly, Yasuko, the TOPIX index has weathered the storm much better than the S&P 500 index, or the FTSE 250. What's the bull case for exposure to Japanese equity hedge strategies in the medium term?

**YH:** As mentioned, the Japan market is a deep enough market and offers multiple ways to generate alpha. The accumulation of managers' stock picking knowhow and deep fundamental analysis have proven their capability; in particular, market neutral/low net strategies have done particularly well YTD. Lately, we find a number of managers implementing sub-sector or customized baskets approach as hedging tools which also minimize the impact from the herding effect on crowded positioning.

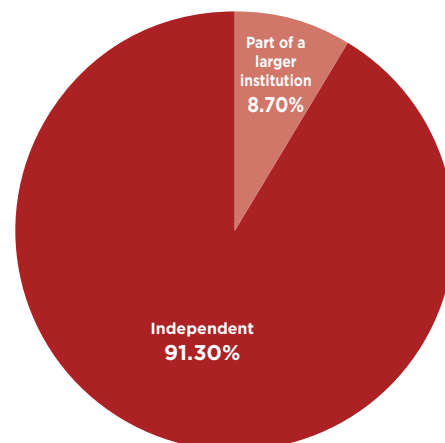
Thematic trades, such as reopening/inbound and potential FX intervention by the Bank of Japan, along with ongoing governance improvement, provide mid-term support for further revaluation of the Japanese equity market.

*Yasuko Hirabayashi works in Capital Introduction at Nomura*

## Section 1 : Firm Information

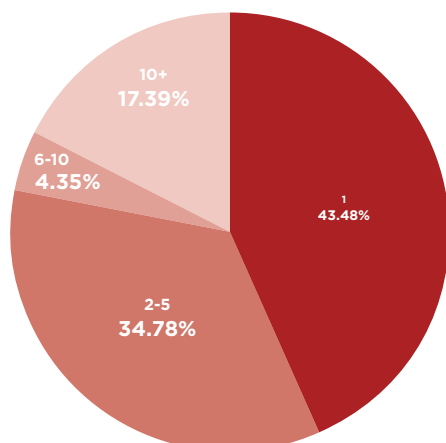
### S1Q1: Is your firm part of a larger financial institution or is it independent?

The % of survey respondents this year which are independent shops rose slightly to 91.3% from last year's 87%, but the data reflects the nature of the hedge fund industry in that the vast majority of firms are smaller, owner-led companies.



Source: AlphaWeek & Sussex Partners

### S2Q2: How many funds or products does your firm offer?

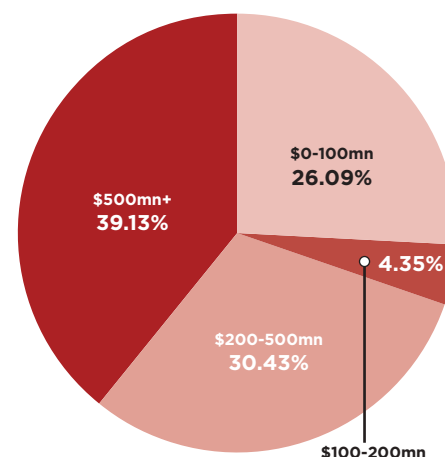


Source: AlphaWeek & Sussex Partners

Little change from 2022 as the vast majority of Japanese hedge fund firms manage five or less funds / products.

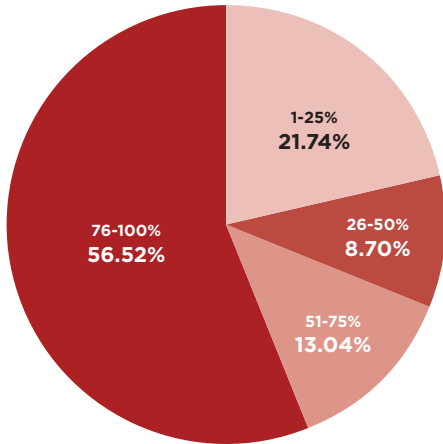
### S1Q3: What is the total AUM managed by your firm in USD?

Similar to last year, the distribution of AUM amongst Japanese hedge funds is fairly even, with the exception of the \$100-200m bracket. Notably, just shy of 40% of survey respondents manage more than \$500mn.



Source: AlphaWeek & Sussex Partners

**S1Q4: What % of your total AUM - for all of your funds/programs combined - comes from investors based outside of Japan?**

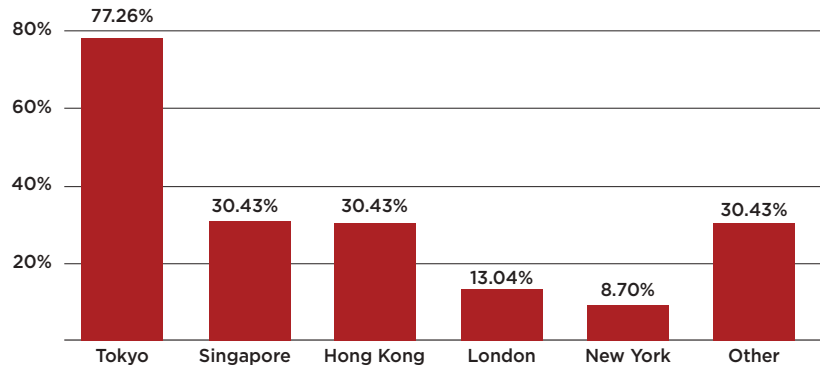


Source: AlphaWeek & Sussex Partners

A fairly significant change this year as more than half of survey respondents say that more than 75% of their total AUM comes from investors outside Japan.

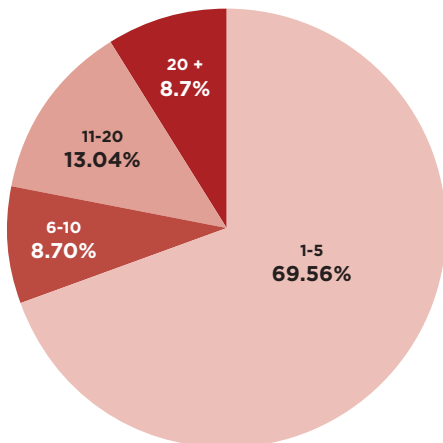
**S1Q5: Which of the following locations do you have offices in?**

Tokyo is of course the most popular location for offices, whether that be the main office, a research office, or both. Singapore and Hong Kong unsurprisingly make up the top three.



Source: AlphaWeek & Sussex Partners

**S1Q6: How many investment professionals do you employ which are solely focused on your hedge funds?**



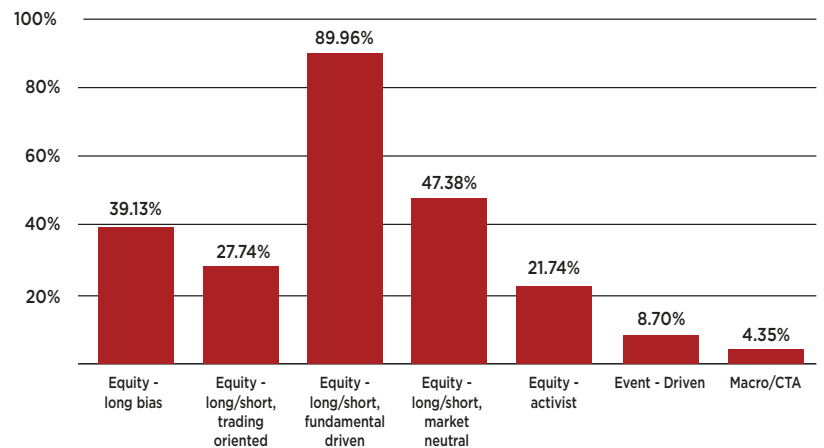
Source: AlphaWeek & Sussex Partners

In keeping with the nature of the Japanese hedge fund industry - i.e., it consists of smaller, independent firms - the vast majority of survey respondents have five people or less focused only on their hedge fund strategies.

## Section 2: Fund / Program Information

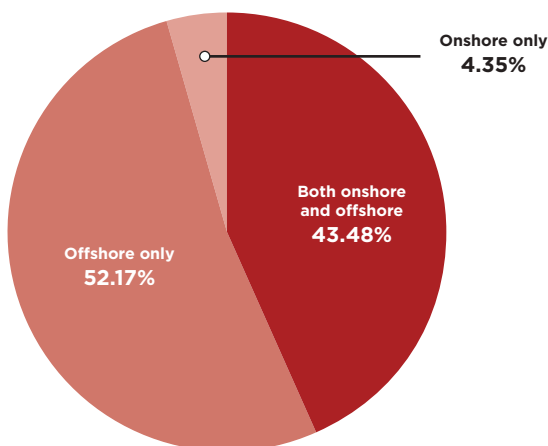
### S2Q1: Which strategies do you run?

In keeping with the specificity we began in 2022, we let survey respondents pick as many of these as they liked. Still intriguing is the lack of event-driven and macro/managed futures hedge fund strategies in Japan.



Source: AlphaWeek & Sussex Partners

### S2Q2: Do you offer only onshore funds, only offshore funds, or both?

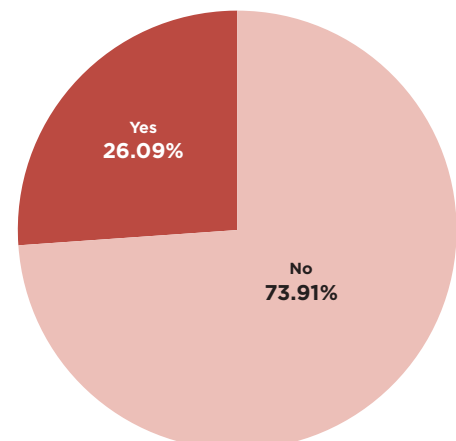


Source: AlphaWeek & Sussex Partners

Offshore still dominates in Japan but the mix has closed this year, with 43.48% of survey respondents saying that they offer both on- and off- shore products, up from only 17% in 2022.

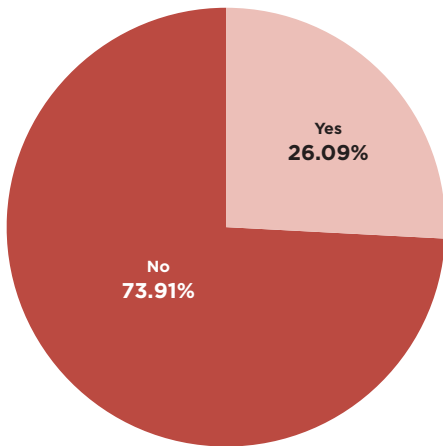
### S2Q3: Do you offer any UCITS-compliant funds?

Slightly more survey respondents offer UCITS compliant funds than last year, but as a general trend, the wrapper is still not particularly popular amongst Japanese hedge fund managers.



Source: AlphaWeek & Sussex Partners

**S2Q4: Are you planning on launching any UCITS-compliant funds?**

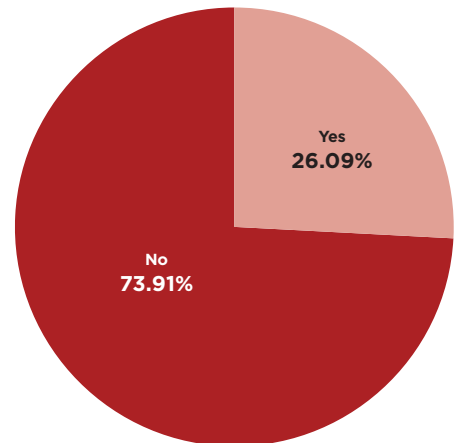


Source: AlphaWeek & Sussex Partners

The results here are both surprising and unsurprising, depending on your perspective; the former because UCITS opens doors in Europe, the latter because the results here haven't changed much over the past few years.

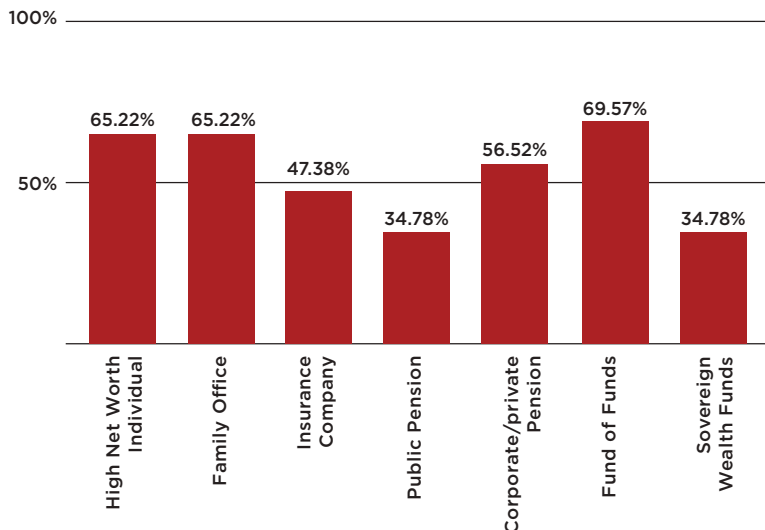
**S2Q5: Have you launched any new funds in the past 12 months?**

A quarter of survey respondents have launched a new fund in 2022, which, whilst lower than last year's 35%, is still encouraging given everything that's happened in global markets this year.



Source: AlphaWeek & Sussex Partners

**S2Q6: Which investor type(s) do you currently receive allocations from?**

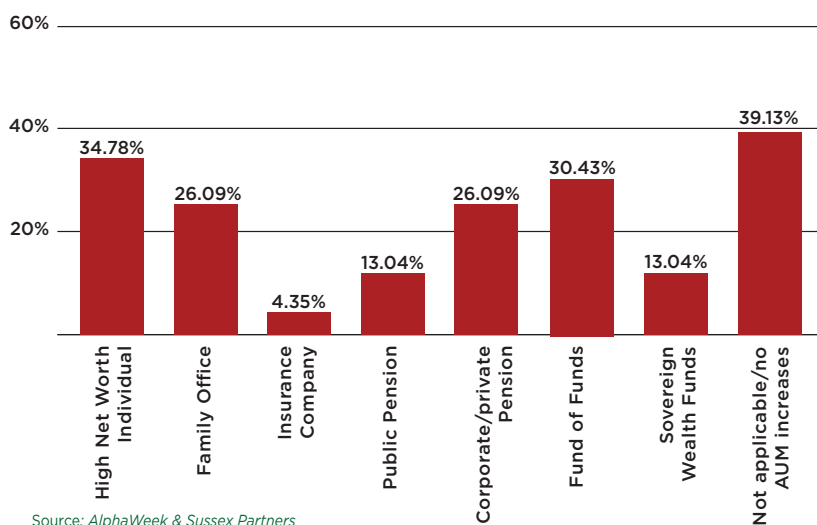


Source: AlphaWeek & Sussex Partners

A more even distribution of results here than in last year's survey, but fund of funds, family offices and high net worth individuals still occupy the top three spots in terms of the investor type that puts money into Japanese hedge funds.

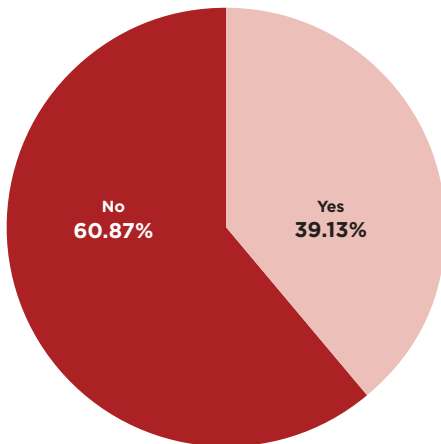
### S2Q7: Which investor type(s) have accounted for any AUM increases in the past year?

In keeping with the prevailing investor base in the Japanese hedge fund industry, fund of funds, family offices and HNWI's have accounted for most of the allocations this year, with corporate/private pensions maintaining their interest.



## Section 3: Characteristics Of Japanese Hedge Fund Managers

### S3Q1: Do you engage in activism or company management engagement?

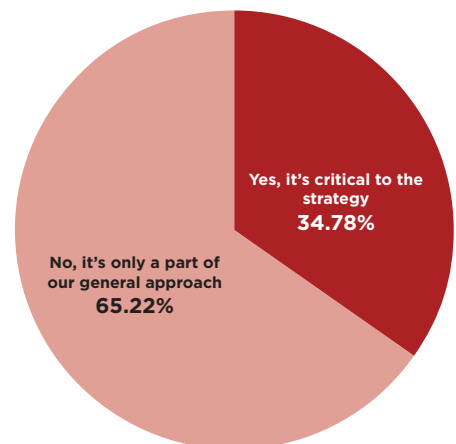


Source: AlphaWeek & Sussex Partners

The balance of responses has changed since last year, more in favour of those who don't use activism-type efforts as part of their approach.

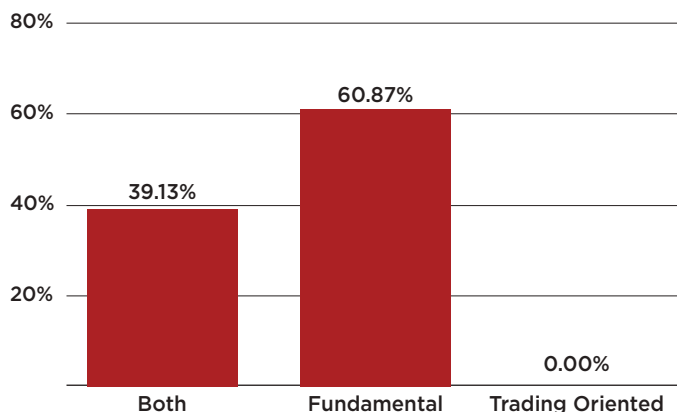
### S3Q2: If you do you engage in activism or company management engagement, do you consider it critical to your strategy or not?

For those that do engage more heavily with company management, it's become less important to them, with two third of survey respondents saying that it's only a part of their overall approach.



Source: AlphaWeek & Sussex Partners

### S3Q3: What type of manager do you consider yourself to be?

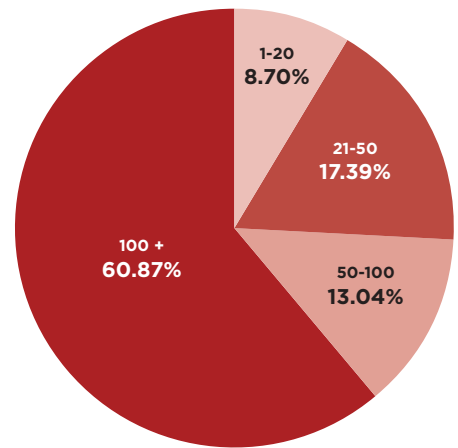


Source: AlphaWeek & Sussex Partners

None of our survey respondents this year consider themselves to be 'trading oriented' (it was only 4% last year). An overwhelming majority of Japanese hedge fund managers say that take a fundamental approach to managing their strategy.

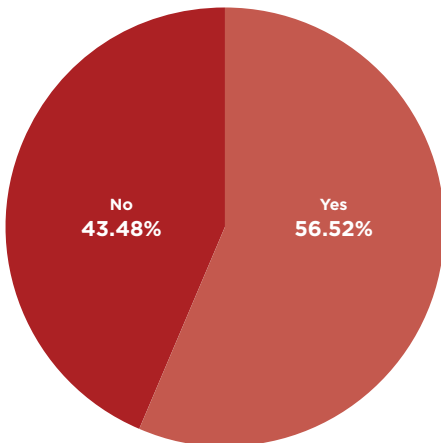
**S3Q4: How many positions do you hold at any one time?**

It's a well known idiosyncrasy amongst Japanese managers that they tend to have a larger number of positions in their portfolios than their Western peers. That's certainly true of this year's survey respondents.



Source: AlphaWeek & Sussex Partners

**S3Q5: Do you deliberately consider ESG issues when taking a position?**

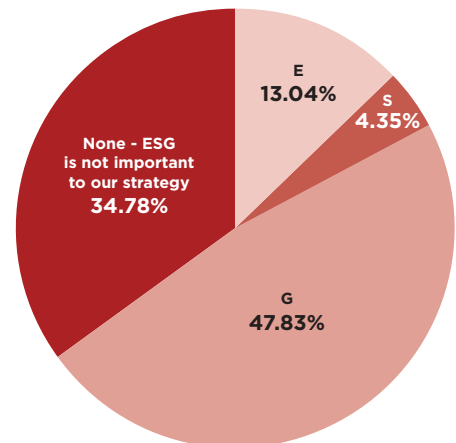


Source: AlphaWeek & Sussex Partners

Interestingly, this year, the balance has swung in favour of the ESG set. More than half say they consider ESG issues when taking a position, up from last year's 39%.

**S3Q6: If you do consider ESG issues when taking a position, which of the ESG pillars – Environment, Social, Governance – is most important to your strategy?**

ESG in Japan, however, is all about Governance. It's by far the biggest consideration for those that do look at their portfolios through an ESG lens.



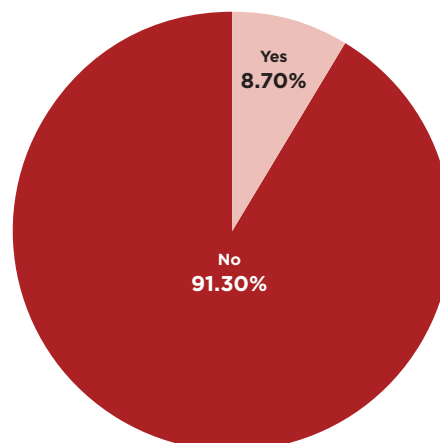
Source: AlphaWeek & Sussex Partners



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

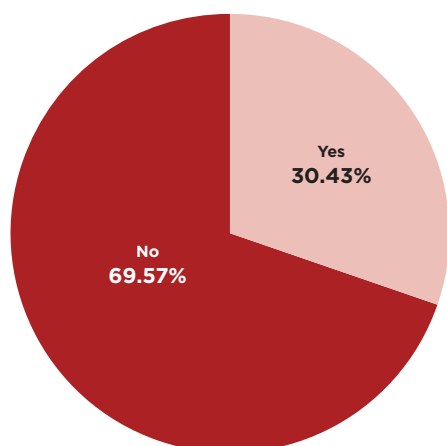
### S4Q1: Do you think foreign investors pay enough attention to domestic Japanese hedge fund managers?

The most popular answer to this question is unlikely to ever be 'yes' but even so, less than 10% of survey respondents think foreign investors pay enough attention to Japanese hedge fund managers, down from 26% last year.



Source: AlphaWeek & Sussex Partners

### S4Q2: Do you think domestic investors pay enough attention to domestic Japanese hedge fund managers?

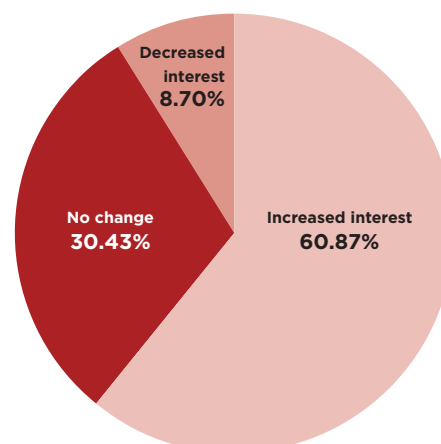


Source: AlphaWeek & Sussex Partners

In keeping with the question above, the % of Japanese hedge fund managers that think domestic Japanese investors pay enough attention to their industry has fallen in 2022.

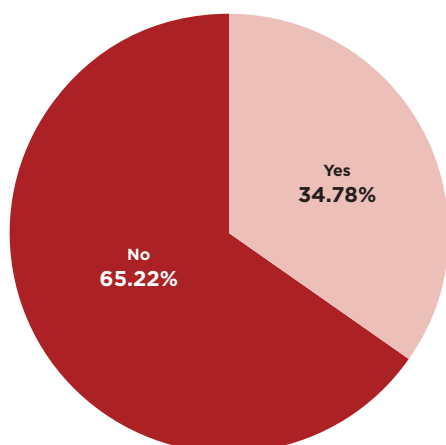
### S4Q3: Have you seen increased or decreased interest in your fund(s) in the past 12 months?

Despite the perceived lack of attention paid to their industry by investors both foreign and domestic, almost two-thirds of Japanese hedge fund managers say that they have enjoyed increased interest in their products this year.



Source: AlphaWeek & Sussex Partners

### S4Q4: Do you feel that Japanese hedge funds are under fee pressure from their investors?

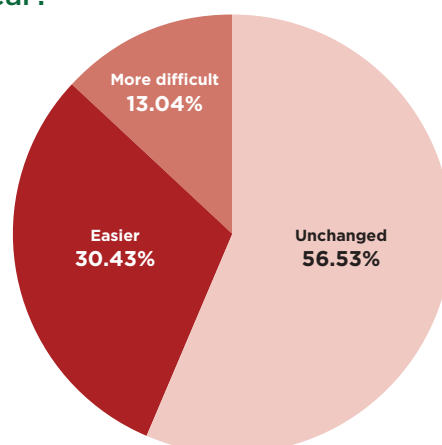


Source: AlphaWeek & Sussex Partners

Japanese hedge fund managers don't seem to think that they are under fee pressure, but there has been an increase on last year from those who think there is. Perhaps a trend to watch, here.

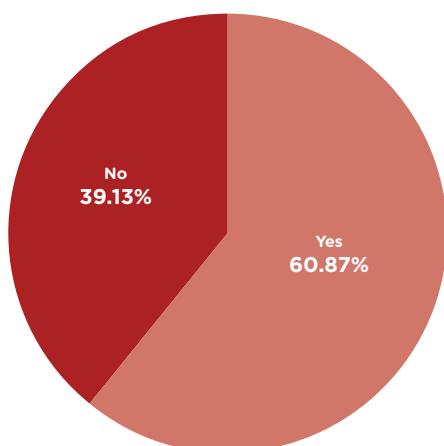
### S4Q5: Do you think it's getting easier or more difficult for new hedge funds to become registered in Japan? Or is it unchanged from last year?

Another potential trend to watch here. Almost a third of survey respondents think it's getting easier for new hedge funds to become registered in Japan, up from only 17% last year.



Source: AlphaWeek & Sussex Partners

### S4Q6: Has the Japanese Stewardship Code been a benefit so far?

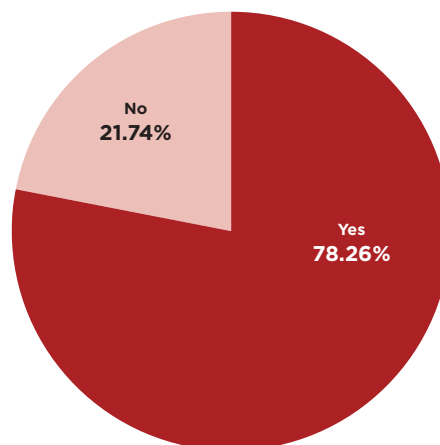


Source: AlphaWeek & Sussex Partners

Japanese hedge fund managers continue to believe that the Japanese Stewardship Code has been a benefit to their strategies since it was introduced in 2014.

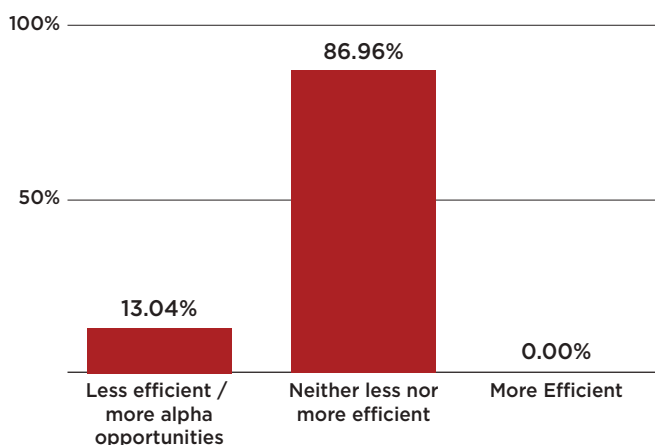
### S4Q7: Has the Japan Corporate Governance code been a benefit so far?

New for this year, a vast majority think the Japan Corporate Governance Code, most recently revised in 2021, has been a benefit to their strategies.



Source: AlphaWeek & Sussex Partners

### S4Q8: Do you feel that the Japanese capital markets have become more or less efficient over the past 12 months?

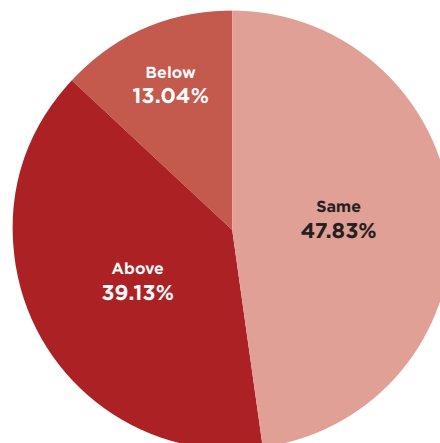


Source: AlphaWeek & Sussex Partners

The overwhelming majority of respondents think that conditions have remained unchanged in the past twelve months, with none saying that Japanese capital markets have become more efficient in the past year, down from 4%. Perhaps surprisingly, only 13.04% think that the market has become less efficient in the past year.

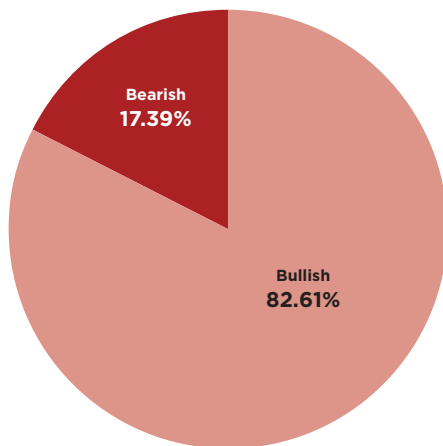
### S4Q9: Do you view the opportunity set as above, below, or the same as the average of the last five years?

Significant changes from last year, when 70% thought the opportunity set was above the 5 year average. This year, only 39.13% think that's the case, with almost half thinking that it's unchanged.



Source: AlphaWeek & Sussex Partners

**S4Q10: Are you bullish or bearish about the opportunities for alpha generation over the next 12-24 months?**



Source: AlphaWeek & Sussex Partners

The final question in our survey is always the bottom line: are you bullish or bearish? Last year, 100% of our survey respondents were bullish. What a difference a year makes – almost a fifth are now bearish. One to watch.



SUSSEX PARTNERS

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