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The facts: Investors' focus in April remained on the conflict in the Middle-East, as traffic in the Strait of Hormuz remained suspended. Macroeconomic indicators and first quarter earnings were not impacted so far, but confidence started to deteriorate in Japan.

The geopolitical situation remained hung to discussions between Tehran and Washington. After threatening to take out Iran in one night, Donald Trump agreed on a ceasefire. This truce turned out to be fragile though. After US forces seized an Iranian ship, Tehran said they would not let traffic through the Strait of Hormuz, which prompted the USA to impose a naval blockade on all Iranian ports and shipping. Negotiations however seemed to continue, with the main disagreement lying on a moratorium on Iran's uranium enrichment, but the US President promised the war was "very close to over". At the end of the month, though, traffic through the Strait remained very limited with no sign of improvement, thus blocking nearly one fifth of the world's oil supply. The barrel closed above \$110, near its four-year high, and to make things worse, the United Arab Emirates announced it would leave the OPEC.

In this context, **Japan's Prime Minister kept saying that she would neither impose fuel-saving measures nor compile a supplementary budget**, but sought alternative oil supplies. Takaichi-san confirmed the release of an extra 20-day worth of oil reserves from early May. **Her strong popularity, though, started to show the first signs of weakening in several polls.**

For now, official economic data remained relatively unaffected. Some of it was still dating back to February (like the stable capacity utilization and the strong monthly machinery orders). As for indicators relating to March, the jobless rate remained tight at 2.7%, industrial production

was just down 0.5% MoM, while both exports and imports were up more than 10% YoY. However, several surveys pointed to a loosening confidence. The quarterly Tankan survey, whose data had been collected throughout the month of March, remained benign. It actually showed the best current conditions since 1991. The outlook component however deteriorated particularly among industries directly affected by higher oil prices, and large companies of all industries forecast an average net profit decline of 2.5% for FY2026. The Economy Watchers outlook survey, whose polling had been carried out later (from March 25 to the end of the month) and covers people engaged in economically-sensitive jobs, showed a sharper decline in sentiment. It was back to a level not seen since the Covid period. Additionally, the Cabinet Office's **consumer confidence index fell 7.8 points between February and April, to its lowest reading in twelve months.** This likely reflected growing concerns about energy-related inflation, even as government gasoline subsidies mitigated the direct effect on households.

Consumer prices remained contained for now with all March inflation metrics (national, ex-fresh food and ex food & energy) remaining below the Bank of Japan's 2% target. Yet producer prices accelerated to 2.6% YoY, reflecting a rise in prices for petroleum-related and chemical inputs. Import prices also jumped 7.9% in the same period. **This prompted the BoJ to adjust its inflation forecasts at its policy meeting, raising them from 1.9 to 2.8% for FY26 and from 2.0 to 2.3% for FY27.** The central bank however did



not change its monetary policy and kept its short-term rates at 0.75%, although three of the Policy Board's nine members voted in favor of a hike. The US Federal Reserve remained on hold as well, which kept the dollar/yen rate relatively stable at about 160. This lasted until the last day of the month, during which it the yen rebounded 2.4% after reports suggested that the government had intervened.

The last few sessions of the month also saw one third of the Topix members release their earnings, but many of them did

so after the last close, without any impact on the month's performance. **The first innings pointed to a strong season with respectively 61 and 56% exceeding sales and EPS estimates, according to LSEG data.** However, the lack of visibility and the cautious statements regarding the war continued to prevail in companies' comments.

The effects: The conflict has not been resolved, yet investors appreciated the de-escalation. The Topix index gained 6.6% in April, led by AI-related growth categories. Despite its Value style bias, our selection outperformed by about 36bps.

As Iran and the USA reached a ceasefire and kept negotiating, the index climbed and its month-to-date return was as high as 9% in the first half of April, only 3% below the all-time high reached in February. The second part of the month saw some profit-taking amid the lack of progress in the geopolitical situation, but solid earnings and the bright outlook for AI-related companies, which confirmed the acceleration of demand, softened the effects. **The Nikkei 225 index, which is much more exposed to the AI theme than the broader Topix, continued to climb, and closed 16.1% higher, breaking the 60,000 level for the first time ever.** The Softbank conglomerate, together with semiconductor equipment manufacturers Advantest & Tokyo Electron, make up about 25% of the index, and explain its different behavior. For the same reason, the Topix Growth index rose nearly twice as much as its Value peer.

Sector returns were particularly diverse. At one end, **AI-related categories posted double-digit rises, and banks followed with high-single-digit gains amid higher rates. At the other end, oil-related categories were significantly lower on hopes of a geopolitical solution, while defensive and consumer-related categories were marginally down.**

Among the best TSE sectors, Non-Ferrous Metals gained nearly 32% because of their exposure to optical fiber, which is benefiting from a strong demand for AI datacenters. Electric Appliances, which accounts for nearly 20% of the Topix index, went up more than 20% as factory automation players released strong earnings. Yaskawa, for example, reported particularly robust orders from the semiconductor industry and US data centers. Memory supplier Kioxia, whose share price nearly tripled since the start of the year amid NAND shortage, surged another 97% in April as the Nikkei newspaper said the company was considering to pay a dividend. Intel's strong results, indicating the accelerating use of CPUs to power AI agents, also supported semiconductor and electrical component manufacturers. Softbank Group, which owns Intel's competitor Arm Holdings, went up 47%, causing most of the 10% gain delivered by the Information & Communication sector in April.

On the contrary, sectors that had gained the most in March ended up among the worst this month, as if investors had considered the conflict was over. Mining and Oil & Coal Products, which respectively include oil explorers and refiners in the Japanese classification, lost 11.3 and 7.9%. All sectors linked to transportation also went down, and announcing price hikes, as Japan Airlines, ANA Holdings or



East Japan Railway did, made little difference. Marine Transportation, which investors initially expected to benefit from increased freight rates and longer routes, ended down 6%. Defensive sectors were also neglected. Electric Power & Gas and Pharmaceuticals were down about the same magnitude, while food stocks barely rose. Consumer-related sectors such as Retail Trade and Transportation Equipment were also down slightly, as inflation threatened demand. Toyota reportedly plans to cut overseas production by about 38,000 units until November, due to the worsening situation in the Middle East.

Once again, activists from different nationalities got involved in several Japanese companies, whose stock price was boosted by the news. To name a few, America's Elliott Investment took a stake in Japanese air-conditioner manufacturer Daikin, saying it was "materially undervalued". London-based activist Palliser Capital made a "significant investment" in factory automation firm SMC, and pushed a large share buy-back program, while Dalton Investment requested two seats on Yakult Honsha's board.

Our selection delivered a decent performance, especially considering its structural value bias. We managed to

Our decisions: Amid a continuing lack of visibility, and as the earnings season was just starting at month-end, we did not change anything in our moderately defensive portfolio.

April did not bring any clarity about the conflict in the Middle East, and its consequences on global growth and companies' earnings. Our quantitative screening did not trigger any Sell signal, other than one on trading company Itochu, which was caused by a one-off situation skewing indicator calculations and limiting the model's relevance on that specific stock. We thus opted to keep Itochu, which is less exposed to the current surge in resources prices than most others, but whose balanced business portfolio helps weather all kinds of economic environments. Its diversified

outperform the Topix index by 36 bps. Not only did we have more outperforming than underperforming stocks, but the former beat the latter by a greater magnitude than average. Most of that came from our technology overweight exposure which, for a value strategy, might sound unusual. Our top three stocks, namely Murata Manufacturing, Renesas Electronics and Advantest, gained 39% or more in April. All of them are benefiting from greater AI infrastructure demand, whether it is for passive components, semiconductors, or testing equipment. Sensor leader Keyence also gained 30% after announcing its strongest sales growth in thirteen quarters and considering to submit a plan to cancel treasury shares at the next AGM. Kakaku.com, which offers online services ranging from job search to restaurant and hotel booking, continued to do extremely well, as a Swedish firm was said to be considering a takeover. At the other end, our more defensive positions, including telecom companies and pharmaceuticals as well as oil-related firms, were unsurprisingly down the most in April.

trading activities around the world are also better suited for risks related to procurement and supply chain risks.

As a result, the characteristics of our selection did not move much. **Our portfolio keeps a two-point valuation advantage against our benchmark's P/E, for about the same expected long term growth, which makes it an attractive option** (especially given that the Japanese market's multiple has stretched to 16x forward earnings).



The outlook: We see deeper implications from the conflict in the Middle-East than what the market wants to believe for Japan's energy-dependent economy. As always, this crisis may however have advantages, if it forces the government and companies to accelerate steps to increase their resilience.

We believe that the situation between Iran and the USA has not improved. **No one knows when the Strait of Hormuz will fully reopen. In any case, even when it does, things will take some time to return to normal.** This month, Dow Chemical's CEO said that just clearing the Strait's logjam would take almost a year. Countries have started to deplete their energy reserves at a time when they usually start restoring them for the next winter. Moreover, the symbolic break of the UAE from OPEC highlights a growing division among major oil producers, which will weaken the group's ability to manage global supply after the end of the war in Iran. The Japanese government is convinced that it can source oil from elsewhere. Yet it takes more time and more money to do so. Japan proudly announced the arrival of its first tanker from the USA. Its content however corresponded to only one day of the national consumption. Moreover, switching entirely to US crude is not a realistic option. In fact, most Japanese refineries are configured to process Middle-Eastern crude, which is much heavier. Durably relying on US crude would require making changes to refining processes and adjusting the equipment.

In the meantime, analysts' earnings forecasts have barely moved. The lack of supply could however weigh on the manufacturing activity (even if demand remains buoyant like in AI). Cost increases may not be fully passed on to prices and demand is more or less elastic to price hikes. In the latest Tankan survey, companies expected their net profit to decline by 2% in the next fiscal year. This does not seem that conservative compared to a similar assumption taken at the same time last year before the Liberation day tariffs hit. Moreover, analysts' consensus still sees earnings growing 13.2%, according to Graphene Investments' calculations using LSEG/IBES data. Admittedly, companies assumed that the yen would strengthen to 148 for one dollar, and forecasts differ from one industry to another.

The upcoming bulk of the earnings season will give more clarity about where we actually stand, ... if company managers actually can assess it.

The market recouped half of its March losses, and the Topix index is just about 5% below its all-time high, but **the current 16x forward PE may actually be underestimated if earnings estimates are unrealistic. Even if we adjust figures for this reason, Japanese equities probably remain cheaper than other markets such as Wall Street, but Japan is also more vulnerable.** The new Prime Minister faces the big challenge of reducing the country's dependence on imported fuels and focusing on alternative energies, including renewable and nuclear, while Japanese companies review their own dependence, cut costs and adjust their procurement strategy. At least, on that matter, Japanese firms have faced energy shortage situations before, like with the Fukushima disaster. **Quick adaptability and execution will make the difference in this environment, which we see as a stock picking market.**

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