Opalesque Roundtable Series '16

JAPAN

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Editor's Note

Despite some global skepticism, Abenomics a success as Japan hedge funds outperform

Abenomics has been on now for three years and the **Nikkei has roughly doubled,** even accounting the 2016 market slump (until mid February 2016.) For the first two years, overseas investors simply didn't believe in Abenomics. And even if now they may still not believe in Abenomics, but it is getting increasingly hard for them to stay out of the market when so many of their global competitors have made money over the past three years. Japan, purely on a relative basis, was not as bad as other markets in terms of volatility, for example, compared to China in 2015. The interest in Japan, whether it's still skeptical or enthusiastic, has grown a lot, and we are seeing this too through an increased footfall of global investors coming to Japan as an investment destination.

So, as a policy response, Abenomics has been a resounding success. **Try to recall post-GFC Japan before Abenomics.** Then, there were real problems with Yen strength, a pro-austerity government and a BOJ that was well behind the curve. Industries were struggling with weak operating environments and faced real liquidity issues after the tsunami. These were acute problems that if not addressed would have resulted in significant negative impacts on the economy.

But the Japanese themselves recognized it was unsustainable and the LDP was voted in a landslide on the Abenomics "three arrows" reflationary platform which addressed these issue simultaneously. The LDP controls both the lower and the upper house, and they have broad approval ratings from the population, specifically because of Abenomics. And, most importantly, everyone is now on the same page, as there is no credible alternative to Abenomics. The regulators are on the same page, the bureaucrats are on the same page, politicians are on the same page, and the voters are on the same page. **There are very few developed countries where such a broad policy mandate exists.** This strength is not widely recognized.

The biggest activist in Japan right now is the government

It's the Japanese government that wants to see corporates now generate higher earnings and all the economic benefits that accrue though higher taxes revenues and wages. The new Corporate Code and Stewardship Code forces management and shareholders talk to each other as to how they can raise returns. Another smart move was the introduction of the JPX 400, an index designed to include only Japan's most profitable, shareholder-friendly companies. Now, rather than just having foreign share holders on the other side of the table berating management for the low returns, the situation is that institutional domestic investors are obliged to actually sit across the table from corporates and engage. **The pressure to reform is coming from all sides,** and this will start to address the major issue that global investors have with Japanese firms: low returns on capital. The gap between the Japanese corporate return on equity versus the rest of the world is already narrowing, and this is clearly a long term opportunity.

It is worth highlighting that **equity investors own a "share" of corporate profitability, not a slice of GDP. Here the news is undeniably positive.** The fact is that not only are corporate profits in Japan at record highs, so too are profit margins. Cash levels at corporates are also record highs, so too are net assets. Growth in earnings is likely to remain solid as corporates focus on core strength and a clear shift away from stakeholder capitalism to shareholder returns.

From Gaijin to local: The transformation of Japanese hedge funds

Japanese hedge funds have undisputedly benefited from Abenomics. But even before Abenomics, since 2008, Japanese hedge fund managers (as measured by the Eurekahedge Index) have been doing well with only one minor down year: **2015: +6.56**; 2014: +5.73; 2013: +27.87; 2012: +5.77, 2011: -1.04; 2010: +8.10; 2009: +6.43.

Over the last ten years, there has been a **fundamental change** in the way Japanese hedge funds are managed. If you go back 10, 12 years ago, most of the large Japan-focused hedge funds were run by foreigners or "gaijin", as foreigners are called here. When Japan went out of favor and pan-Asia (particularly China) became popular, those Japan funds closed down or they may have turned into Asian focused funds. What has happened over the last four or five years is that Japanese managers are now running Japanese hedge funds. And very often, they are poor communicators in English, which creates a bias in Western minds because many people assume that someone can't be very smart if they can't speak English, which is definitely not the case. If, for example, that manager has always worked for pure Japanese institutions, there was never the need to learn English.

The Opalesque 2016 Japan Roundtable was sponsored by Harney Westwood & Riegels and took place end of 2015 in Tokyo with:

1. Kenichi Onuki, General Manager, Products Development Department, Amundi Japan
2. Kenya Yonezawa, CFA, Senior Investment Manager, Sompo Japan Nipponkoa Asset Management
3. Leon Rapp, Portfolio Manager, Rogers Investment Advisors
4. Matthew Roberts, Partner, Harney Westwood & Riegels
5. Rory Kennedy, COO, Rogers Investment Advisors

The group also discussed:

- How to best market a fund in Japan given that it's not a "fly-in, fly-out place" (page 15)
- How do Japanese pension funds and other institutional investors view the opportunities that alternative investments provide? (page 15)
- What is the targeted return of a typical Japanese corporate pension fund? (pages 8, 21)
- Why Japanese hedge funds, even the smaller ones, can offer attractive niche strategies to a global allocator (page 14)
- Why the Japan Post IPO, the largest in the world in 2015, was a game changer in Japan (pages 18-20)
- Which is the fund jurisdiction of choice of Japanese fund managers? (page 16)
- Not much left: A hedge fund manager's take on the "Three Ds": Japan's Debt, Deflation, and Demographics (pages 17, 18)
- What will be the trigger for Japanese retail investors to get out of bank deposits into more investments? (pages 20, 21)
- Discipline & capacity limits: Why most Western institutions will miss the opportunity to invest with Japan hedge funds (page 12)
- How do global investors address the fact that they have under invested in Japan focused talent for almost a decade? (page 10)
- Why Japanese activist managers have been the biggest beneficiary of inflows (pages 13, 20)

Enjoy!

Matthias Knab
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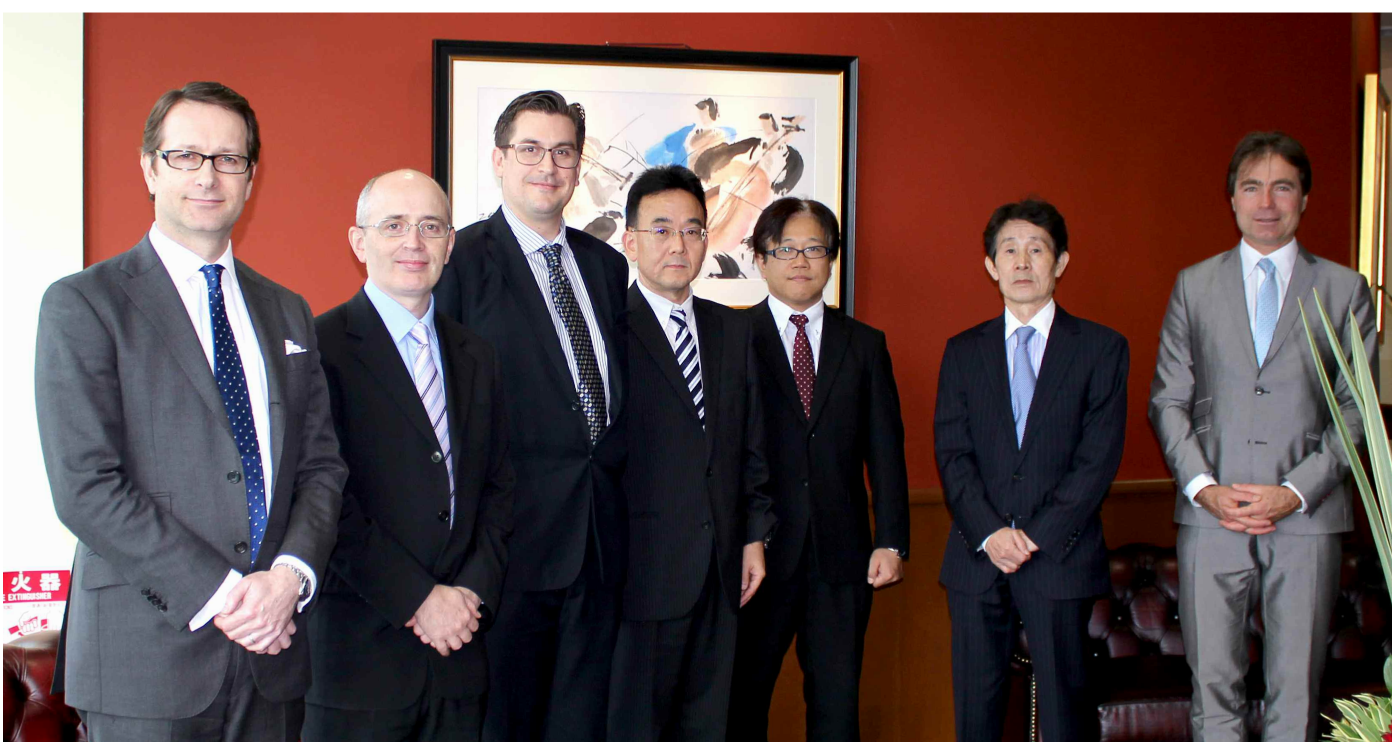
Participant Profiles



(LEFT TO RIGHT)

Leon Rapp, Rory Kennedy, Matt Roberts, Kenichi Onuki, Kenya Yonezawa, Yuji Asano (Harneys), Matthias Knab.

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Introduction

Leon Rapp
Rogers Investment Advisors.

My name is Leon Rapp, I am a portfolio manager at Rogers Investment Advisors. We are in the process of launching a Japan focused long short equity strategy, the Erasmus Japan Fund. I've been involved with Japan for some 30 years now and Japanese stock market since 1992.

Rory Kennedy
Rogers Investment Advisors.

My name is Rory Kennedy, I am COO at Rogers Investment Advisors. I've been living in Japan for more than 15 years. Rogers Investment Advisors is part of the Wolver Hill Group focused on alternatives investing in Asia and headquartered here in Tokyo. I have been working in the hedge fund space in Asia, both on the fund manager side and on the investor side, for the last 10 years or so.

Kenichi Onuki
Amundi Japan

My name is Kenichi Onuki. I'm working for a company called Amundi Japan, a French asset management group. Amundi was formed as a subsidiary of Credit Agricole and Societe Generale and is publicly listed on the Euronext Paris market. I mostly cover retail public funds and retail & wholesale private investment trusts.

Kenya Yonezawa
Sompo Japan Nipponkoa Asset Management

My name is Kenya Yonezawa from Sompo Japan Nipponkoa Asset Management, a Japanese asset management company. We are engaged both in the discretionary asset management for institutional investors and in the mutual fund industry for retail investors. I have been working in the alternative investment space for over 15 years here in Tokyo. I have been in charge of fund of hedge funds over the time, in particular Japan focused funds of hedge funds And also we are conducting hedge fund investment management for pension funds, which offers global single hedge fund investment opportunities for those investors.

Matt Roberts
Harney Westwood & Riegels

My name is Matt Roberts. I'm a partner at Harney Westwood & Riegels. We are an offshore law firm practicing BVI, Cayman Islands, Bermuda, Cyprus and Anguilla Law. I have been working in private practice now for over 15 years and as an offshore lawyer for over seven years. I've been involved in many fund launches of Japanese retail and institutional funds for a range of major institutions as well as small managers.

Matthias Knab Please give us an update on the recent developments and investment opportunities in Japan.

Rory Kennedy: Japan, just to start off, is always considered to be a difficult market for investors, whether you're investing directly in the markets or you're investing in hedge funds as we do, and 2015 has been no different.

Japan has very often been not the tail that wags the dog, but the recipient of much of the turmoil in the world. So for example, whatever is happening in America, whatever is happening in China, usually affects Japan often to an even greater extent.

2015 has been a difficult year for Japan and despite all of the positive fiscal and governmental changes that have happened, Japan hasn't outperformed the rest of the world.

For Japanese hedge fund managers, 2015 has been a very difficult year just like it was for many other countries. The range of performance by Japanese hedge managers can been wide, with some outliers being up +20% or down -5% for the year. However, I think the **typical Japanese hedge fund manager is probably up between 5% and 10% for the year and so have outperformed many of their global peers.**

Leon will probably talk a lot more about the market itself, but what I'd like to point out is that **interest in Japan has probably never been higher.** We are now in year three of Abenomics at this point. I think for the first two years, overseas people simply didn't believe in it. And even if now they may still not believe in Abenomics, but it is getting increasingly hard for them to stay out of the market when so many of their global competitors have made money over the past three years. Japan, purely on a relative basis, was not as bad as other markets in terms of volatility, for example, compared to China in 2015.

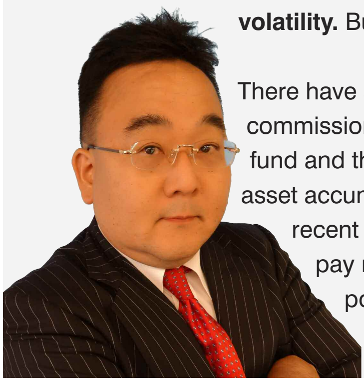
So the interest in Japan, whether it's still skeptical or enthusiastic, has grown a lot, and we are seeing this too through an increased footfall of global investors coming to Japan as an investment destination. Just as a personal observation, **I have never seen so many tourists visit Japan.** Historically, going back decades, Japan and Tokyo in particular was always seen as an incredibly expensive place. Now, helped by the decline in the Yen, which is of course a deliberate policy by the government here, people coming to Japan are often surprised how cheap things can be. With the exception of income taxes, we find that almost everything else is cheaper here compared to Hong Kong, Singapore or any of the major European and American cities.

When Tokyo was awarded the 2020 Summer Olympic Games in 2013, Prime Minister Abe announced a target of 20 million visitors annually to Japan. The Olympics is still some years away, but Japan is already on target to reach 20 million visitors potentially in 2016, so they are far ahead of schedule already. And contrary to the media view which often emphasizes difficulties between China and Japan, the number one group of visitors to Japan are the mainland Chinese, who come over and are very often pleasantly surprised to discover that's not the terrible place they've been taught about in school and on mainland TV, but instead find a fascinating, clean, safe and welcoming country!

So I'm very encouraged not only from the investment story but by the real signs on the ground here as well, even if that doesn't particularly fit the outside perception of Japan being in terminal decline at the moment.

Kenichi Onuki: I mostly deal with Japanese individual investors. Most of them still hesitate to take risks, not because of risks in the market but maybe because that's the nature of the Japanese people. As it is well known, most of the Japanese retail financial assets are held by the elder people, so people well over 50 or 60 years old. What we and other asset managers are trying to do is to reallocate some of that money from zero or little yielding deposits to more risky assets like investment trusts or hedge funds.

In fact, **the risk profile that Japanese investors so much love is actually not so far from those of traditional hedge funds, so a low to medium return – 5% to 10% annually, just like Rory said – at controlled risk and low volatility.** But when we tell someone this is a hedge fund, then people drastically change their mind.



There have actually been some changes on the distribution side of funds in Japan. It used to be a commission based model where the distributor would try to sell most of a fund's assets at the launch of the fund and then just leave it after the inception. This model is now changing to one that is more based on an asset accumulation. There have also been some changes in the inflows and outflows of mutual funds in the recent several years. One of the most popular products in Japan are distribution funds, so funds that pay monthly dividends. Of course, the higher the dividend, the better. So actually, many of the popular funds currently offer more than 20% annual distribution.

Matthias Knab Where is the return coming from?

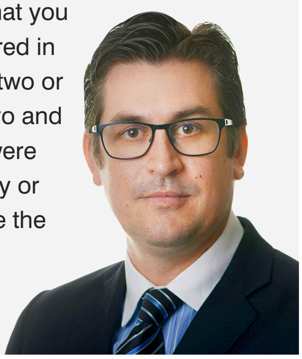
Kenichi Onuki Sometimes, not all of the 20% is coming from the return of the product, some of that 20% is coming from just a capital payback.

Rory Kennedy So they are cannibalizing their own money in a pretty big way.

Kenichi Onuki Yes, you are right. And indeed, it is said that some investors misunderstand that distribution as an actual return of the fund, and therefore we need to continue to educate investors more about what is the real return and what is just a capital payback. Also the regulators are aware of that issue, so it's an ongoing issue for us.

Because such high yielding funds are so popular currently and very well sold, both distributors and clients are asking for those kinds of funds and unfortunately tend to ignore the other good funds that may have a lower return but also lower risk. But given the current demand dynamics, Amundi is now creating products to attract those clients, using multi asset strategy and wrap them up as a very attractive product.

Matt Roberts: One of the things that always strikes me about the Japanese market is the innovation that you can see with certain financial products that have been offered to retail investors which may not be offered in other jurisdictions throughout the world. For example, whilst they are not very popular at the moment, two or three years ago we saw the "double-decker" or "triple-decker" fund structures being used here in Tokyo and in offshore funds being offered to Japanese investors, where effectively the investment products that were developed with a certain investment strategy, whether it was something like a long-short equity strategy or another investment strategy, also added currency hedging and derivatives trading strategies to provide the prospect of additional returns to investors.



Contrast this to the types of offshore investment products that we commonly see managers offer in say Hong Kong or China – those investment strategies are relatively basic, with currency hedging and derivatives trading strategies not being implemented to the level that we saw here in Tokyo. So it was quite an interesting time to work in the Japanese funds space, but these structures sort of fell out of favor with the Japanese regulators, largely because the industry didn't do a particularly good job of explaining to retail investors how these products really worked and what risks were involved. But certainly we haven't seen comparable retail products offered in any other jurisdiction, except perhaps the US of course.

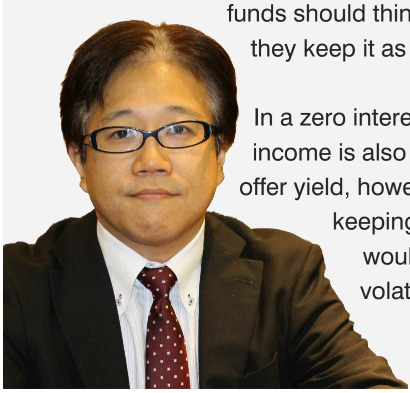
Generally I tend to think that the **Japanese investor appears to be a bit more sophisticated than the average investor in other markets,** because the culture of investing is something that's quite strong here. But of course I agree that some work still needs to be done to educate investors, particularly retail investors, about the features of certain products, particularly these high yield products which are effectively cannibalizing themselves to generate returns for investors.

Also from our perspective, we see a lot of potential for the Japanese fund sector, and this is the reason why we decided to invest in opening a Tokyo office earlier this year, being only the second offshore firm to do so. In particular, we have observed that there is a lot of interest in Japanese equities market and Japanese products, not only from within Japan, but there's great interest also from outside of Japan, particularly from other Asian markets such as China. This is because the ongoing volatility in the Chinese market has led a number of investors there to look at Japan with fresh eyes. There's an appreciation that some of the products offered in Japan seem to be more attractive and that it is a safe jurisdiction as well. Certainly Japan is perceived to be safer than China where the scale of issues like accounting irregularities and fraud has made investing in Japanese assets a much more attractive proposition from a risk management perspective.

The other aspect is that managers located outside of Japan also have an enormous interest in adding Japan to their investment strategy, if they haven't already done so. As others have observed, Japan exposure has been excluded or has been underweight in investment managers' selection of prospective assets and we see that this trend is changing because of some of the robust fundamentals in the Japanese economy.

Kenya Yonezawa: I agree with Kenichi, generally. Japanese investors, including pension funds, are relatively sensitive to risks. Recently a typical Japanese corporate pension fund may target an annual return of around 3%, those stances are reflected to their asset allocation.

Actually, Japanese equity market movement is characterized by many foreign investors' actions. A recent development was that the GPIF (the large Japanese Government Pension Fund) decided to invest more in Japanese equities, and also many other participants got involved in Japanese equity investments. However, after the deflationary decades, when the Nikkei now touched 20,000 on the backdrop of Abenomics, this may be a motivation to reduce Japanese equities for some corporate pensions. That is because when you look into their funding status, many pensions seem to have a surplus, or at least have recovered their funding status, thanks to market rally we were having, at least until the end of 2015. Many pension funds should think about how they manage the surplus under their low expected return. For example, should they keep it as deposits for future liabilities, or as a risk buffer?



In a zero interest rate environment, cash may be an option, however that is not for the long-run. Fixed income is also an option to allocate. But you can easily understand the situation is not easy. Bonds can offer yield, however, it is so low and unfortunately it comes with potential downside risks. On the other hand, keeping a high allocation to equity is also difficult under the limited risk budget. So at this stage, I would be thinking that hedge funds with good risk-return profile are good options to control the volatility and get a stable return.

Matthias Knab So what in general can you say is the use or the perception of alternatives like long-short strategies by the Japanese pensions in general? What is the current allocation, and where are they taking that allocation ratio?

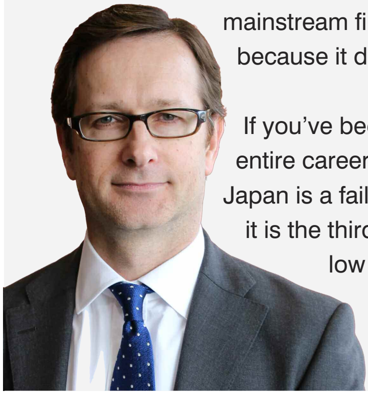
Kenya Yonezawa: I think that going forward, **Japanese pensions will allocate more to alternative investments,** and not only to Japanese equity long-short, but also global equity long-short strategies. So our firm is offering equity long-short related products with a global and or a Japan focus. Investing into mid risk with mid return products is reasonable. So after reducing their equities exposure, even reducing bond allocation, we will see that pension funds' allocation to alternative assets will continue to rise.

Leon Rapp: In my opinion there tends to be too much skepticism towards Japan, particularly among global investors. **As a policy response, Abenomics has been a resounding success.** Try to recall post-GFC Japan before Abenomics. Then, there were real problems with Yen strength, a pro-austerity government and a BOJ that was well behind the curve. Industries were struggling with weak operating environments and faced real liquidity issues after the tsunami. These were acute problems that if not addressed would have resulted in significant negative impacts on the economy.

But the Japanese themselves recognized it was unsustainable and the LDP was voted in a landslide on the Abenomics “three arrows” reflationary platform which addressed these issue simultaneously. Yet, three years later perception overseas continues to be, *“Abenomics is not working, it’s not successful, what’s going on in Japan?”*

It is worth highlighting that **equity investors own a “share” of corporate profitability, not a slice of GDP.** Here the news is undeniably positive. The fact is that not only are corporate profits in Japan at record highs, so too are profit margins. Cash levels at corporates are also record highs, so too are net assets. Growth in earnings is likely to remain solid as corporates focus on core strength and a clear shift away from stakeholder capitalism to shareholder returns. The corporate sector in Japan is in rude health. That demonstrates very clearly the resounding success of Abenomics.

People can get sidetracked by what goes on politically with some of the diplomatic issues that are happening. Abe's cabinet approval rating dipped whilst his focus shifted to constitutional amendments away from economic priorities. But all through this period the opposition parties were unable to capitalize, with approval ratings in the single digits. The LDP controls both the lower and the upper house, and they have broad approval ratings from the population, specifically because of Abenomics. And, most importantly, everyone is now on the same page, as there is no credible alternative to Abenomics. **The regulators are on the same page, the bureaucrats are on the same page, politicians are on the same page, and the voters are on the same page.** There are very few developed countries where a broad policy mandate exists. This strength is not widely recognized.



The issue is that I think a lot of people who look at Japan, particularly from abroad, are influenced by how the mainstream financial media reports on Japan, which exhibits a consistent negative bias. That is problematic because it detracts from the truth of what’s actually going on, but it also provides an opportunity.

If you’ve been a global portfolio manager for the last 15-20 years, if you only make one decision for your entire career to have a zero weighting in Japan, you would have done quite well. The risk of those avoiding Japan is a failure to recognize a turning point. Of Abenomics’ three arrows – monetary, fiscal and regulatory – it is the third that actually addresses the underlying structural problems for the equity market. Chronically low returns for capital for Japanese corporates, a general aversion to shareholder returns, and passive domestic institutional engagement, have been clear reasons not to invest in Japan despite cheap valuations.

Yet the introduction of the Corporate Governance and Stewardship Code combining with public funds that invest according to smart beta mandates should be augmenting existing pressure from increasingly prominent foreign shareholders who now control over a third of listed Japan equities.

This will start to address the major issue that global investors have with Japanese firms: low returns on capital. Yet, the gap between the Japanese corporate return on equity versus the rest of the world is already disappearing. I expect this trend to continue. So, when Japanese corporates not only are cheap but offer the same return as their global peer, that same global portfolio manager who has not needed to look at Japan in the past now needs to know what's going on.

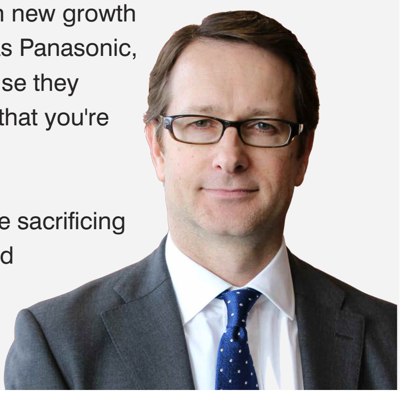
The problem is that the global investors have under invested in Japan focused talent. They haven't had dedicated Japanese teams for years, they find themselves scrambling or just investing in the same reliable names, not daring to venture beyond a Toyota or a Keyence. They don't have the ability or confidence to study broader opportunities. What holds them back is their unease that Japan will disappoint. And therefore, the initial default reaction is, *"Well, I don't really believe that Abenomics will address Japan's problems."* If they had people actually here that were demonstrating to them what was going on, my view is that they would be far more constructive and willing to treat Japan equities as long term core investment position, not merely a trading opportunity to be cut at the first sign of weak economic data point.

As mentioned, the introduction of the Corporate Governance Code and the Stewardship Code has already had large impact on the mindset of managements. The JPX 400, despite being invested in bond-like equities, has been a positive on market sentiment. Combining these policy levers prods Japanese corporates to become better stewards of capital. Those positive changes will further unfold over the coming years, I believe. Some corporates will be proactive with change while others will drag their feet. This is why stockpicking in Japan will be more important going forward.

Through such policy actions and other levers such as tax efficient NISA accounts the government is determined to change investor views of the Japanese stock market. Equities that generate a higher shareholder returns in the form of dividends or buybacks – both are at record highs and growing – should change the perception of Japan as a trading market. So, fundamentals become the real driver of equity valuations. That's essentially what is beginning to take place in Japan now. But again, with like so many of these things, the recognition of these developments lags what was actually taking place.

Matthias Knab Leon, I understand you are in the process of launching a fund, can you tell us more about your strategy and how in detail you aim to capitalize on the positive developments you have described in Japan?

Leon Rapp: The Erasmus Fund aims to capitalize on the fundamental changes taking place in Japan, with a particular focus on large and mega caps. It will have a long bias, in recognition that the changes taking place are broadly positive. The strategy seeks to identify those Japanese companies which now recognize that they need to raise returns above the cost of capital. It also looks to capture growth by investing in corporates that are able to capitalize on new growth opportunities. Corporates that can shink into areas of core competitiveness and grow, such as Panasonic, are significant opportunities. A number of large companies remain reluctant to do that, because they remain focused on growing sales. And when growing sales, you often move into businesses that you're not competitive in and your core competency basically becomes diluted.



So by actually cutting areas you are not competent in and generating low margins, you will be sacrificing some of your sales, but your profitability improves. Your returns on capital improve as well and obviously, shareholders value that quite highly. And yet, there's been a lot of resistance to that going forward.

Matthias Knab From where?

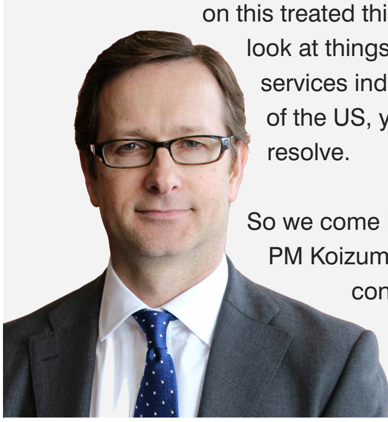
Leon Rapp: From the corporates themselves. The larger corporates are often still in an empire building mode which essentially is grow sales and market share as much as you can, and hoping that profits will come back at some later point. They mistake size for strength and efficiency. Large corporates here in the industrial space operate seven to eight different divisions, and within them, hundreds of different products. They may boast very large market shares here in Japan, but they are globally irrelevant. The rolling stock industry here is a great example. There are six large companies that make rolling stock in Japan, but they only have a combined share equivalent to Siemens, the #3 maker globally after Bombardier and Alstom.

The point is that being number one in Japan means nothing globally. If you're running a global company, you have to be aware that your competitors are no longer here in Japan. The rest of the world has grown into much larger scale and generates higher returns which can be ploughed back into R&D or further M&A. The rational response would be for the Japanese to consolidate, yet this often occurs only after all other avenues are exhausted.

These changes are now slowly beginning to take place and I expect they will accelerate going forward. What I expect will happen is that industries will deconstruct themselves and then reconstruct according to their chosen competencies. This change will probably take place over the next five to ten years, and I think this is a significant opportunity because you'll see structurally rising returns on capital. And again, from the global investor perspective, if a Japanese company is offering the same returns on capital as a German or an American company, then it should also move to the same valuation levels.

What about top line earnings growth, particularly domestically? Here too the picture is upbeat. Japan remains very dynamic in terms of its technology and R&D spending. A declining base of workers in Japan means that labor saving investments will be needed. That is not just spending on tangibles such as discrete and process automation, but also intangible investments in IT and software, an area that Japan has historically lagged. Both should contribute to improve the productivity of labor.

Abe recently talked about a lofty 600 trillion Yen target for Japan GDP, which is currently around 500 trillion. Most commentary on this treated this with a great deal of skepticism, particularly since there was no timeframe. But actually, if you look at things very closely, GDP could be significantly boosted by raising productivity in the domestic services industry, where levels are nearly half that of the US. If you were to raise productivity levels to that of the US, you can get to 600 trillion. So it's achievable, but it's obviously going to require a lot of political resolve.



So we come back full circle. Abe is a very successful prime minister, with approval ratings on par with ex-PM Koizumi. On current pace, he looks set to become one of the longest serving PMs. He effectively controls both houses of parliament, including a supermajority in the more powerful lower house. The opposition essentially is nonexistent, so the combination of all these factors reinforces the government's commitment to pro-growth economic policies.

Rory Kennedy: I just want to emphasize what Leon is saying about Abe and his government. **Japan is not unique in having deep structural problems.** I think people would say that obviously about Europe as well, about China, and America. All of these developed countries – or in China's case, developing country – have massive social and economic problems. But nowhere else in the world is there a large country with a democratically elected government that has complete control over both sets of parliaments, that has broad approval ratings and a mandate for structural change and has also effective control of the Central Bank and its civil service.

So when people talk about how can we see change in Japan or how Japan could change, the question I put forth is that *where else in the world right now can you actually see the changes that you are hoping for, but in Japan?*

I mean America has such a partisan system at the moment, who knows if they can implement the changes they need? Europe has numerous problems and it's not getting any easier there because of the immigration crisis. So I would say, in comparison to the rest of the world, while Japan has huge structural problems; maybe uniquely, it may actually have the ability to solve those problems. And that in itself should influence how investors place money purely on a macro basis.

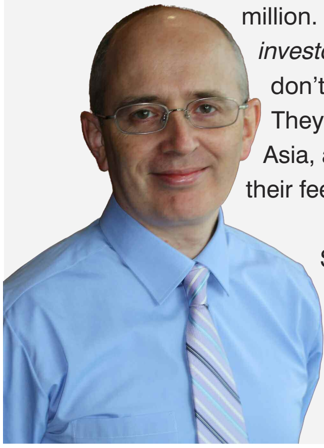
Matthias Knab Let's take a deeper look at Japanese hedge funds and alternative strategies. What has happened when it comes to new launches and new strategies, and how has investor demand developed for those products?

Rory Kennedy: The number of new Japanese hedge fund launches is very low at the moment. I guess since 2007, every year the number of dedicated Japan strategies has been going down a bit. But while there are still a good number of them, they tend not to be in public view and operate often at a smaller size. From global investors who come to Japan or attend conferences in the region, I hear it all the time; they say there's not enough quality in Japanese managers. But it depends on what you mean by quality. If you mean a quality manager who comes with a long personal track record, whose fund is $500 million+ in size and he's brand new, yes you're going to have a problem to find such funds in Japan. But if you're prepared to invest into smaller and newer managers or if you have built long-term relationships on the ground in the region, then you will have access to both closed managers and newer talent.

So the real issue is that quality managers are here, but it is not as simple as in the rest of the world to find them. If you're on the ground here, you will find quality managers that you can get in early and build a relationship with.

I think there's been a real change in the way money is managed in Japan over the last 10 years. If you go back 10, 12 years ago, most of the large Japan-focused hedge funds were run by foreigners or "gaijin", as foreigners are called here. When Japan went out of favor and pan-Asia (particularly China) became popular, those Japan funds closed down or they may have turned into Asian focused funds. What has happened over the last four or five years is that Japanese managers are now running Japanese hedge funds. And very often, they are poor communicators in English, which creates a bias in Western minds because many people assume that someone can't be very smart if they can't speak English, which is definitely not the case. If, for example, that manager has always worked for pure Japanese institutions, there was never the need to learn English.

Another thing that many of these managers have learned from looking other track records of other managers is not to be asset gatherers. So the general tendency for Japanese hedge funds is to close when they get to $300, $400, $500 million. And, of course, *it's ironic that at the exact moment when they are the most attractive for Western investors, when they have a track record and they have the AUM, it's too late for those investors.* They don't want your managed account for $100 million that you're going to squeeze them for half fees. They're already full and they have a waiting list of people who have been invested at them for years in Asia, and who will happily pay full fees for alpha. In fact, we have even seen such managers putting up their fees above the "2 & 20".

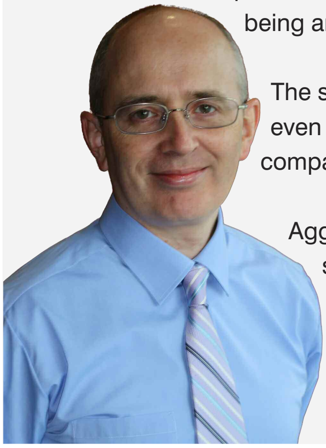


So I guess the point I'm trying to get across is that you have to be on the ground. If you complain that you can't find Japanese managers, then obviously, you're not taking enough risk yourself as institution to support those managers, either through managed accounts or by day one investing, for which there's a huge opportunity, or you have been not looking at Japan long enough to build up relationships.

Matthias Knab Can you give me just some examples of strategies that you have seen launching over the past years?

Rory Kennedy: I would say that Japanese activist managers have been the biggest beneficiary of inflows (outside of long-only and the ETFs) since the start of Abenomics. Activist managers, both new and existing, have been raising billions of dollars. And of course, activism is one of those strategies where the more you raise, your returns don't necessarily degrade because it allows you to go after bigger companies with your strategy, but that will mostly not apply for most long-short and for other strategies.

Matthias Knab There are different forms of activism. If you look at the US, some funds are having a hard time now regarding their actions, there is a lot of press about certain funds and campaigns. Is there a Japanese way of activism or do you also have a widespread array of approaches when it comes to activism towards Japanese corporates?

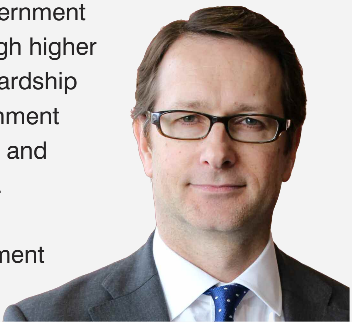


Rory Kennedy: What Onuki-san was mentioning before, when the Japanese people think of hedge funds as a dirty word, that is actually because of aggressive Western style activism, which has been shown, generally speaking, not be effective in Japan. Here, there's no quicker way to get the public, the government and the press against you than by being an aggressive activist.

The successful activists in Japan have all been what they call "friendly activists", or maybe they don't even use the word "activism" at all, but they take the same approach. They go in and they work with a company and give the management constructive feedback rather than making pure demands.

Aggressive activism works well in Western countries when you have a supportive media and a shareholder based culture that's predisposed to saying, "Yeah, this company needs to change." But when your style of investing in Japan presents itself as confrontational and antagonistic, it creates a cultural barrier and automatic resistance even from your natural allies among the media and other investors.

Leon Rapp: Japan does not have a lot of equity linked compensation. What that means is that there is very little incentive for senior management to have a high stock price, because they don't participate in the upside. So that force is not as strong as it is for example in the US or Europe or elsewhere.



But, talking about activists, **the biggest activist in Japan right now is the government.** The government wants to see corporates generate higher earnings and all the economic benefits that accrue though higher taxes revenues and wages. They do this by bringing the Corporate Code, by bringing in the Stewardship Code to actually get both sides talking to each other as to how they can raise returns. The Government Pension Investment Fund (GPIF) adopting the newly created JPX400 index, with its focus on ROE and corporate governance, further encourages a shift away from passive capitalization benchmarking.

Now rather than just having foreign share holders on the other side of the table berating management for the low returns, the situation now is that institutional domestic investors are obliged now to actually sit across the table from corporates and engage. So the pressure to reform is coming from all sides now.

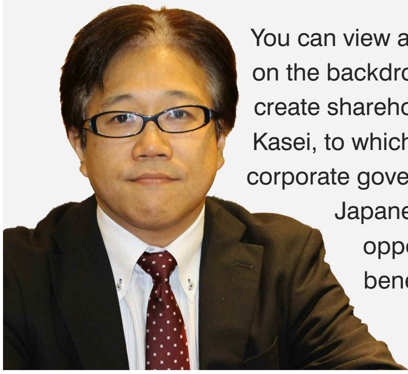
Rory Kennedy

So from one perspective, you could even argue that in Japan it's now the government that has effectively taken on the role of the aggressive activist. Some people might say, "Well that's half of your work done.", and maybe it is, but I think you still can't come in with an antagonistic approach here. In one sense, taking an aggressively antagonistic approach may actually be counter-productive because the target company can avoid taking responsibility and making the changes it needs by presenting the activist as the "bad guy" who needs to defended against at all costs.

Kenya Yonezawa: I would like to point out some other aspects regarding the Japanese equity long-short and Japanese equity investments. Most launches are still following the equity long-short type of strategy. Some may have certain variations such as long biased, others may emphasize their trading as a key component. As Rory already mentioned, the number of launches or how much money they raise, those aspects are not comparable to the global average. Also the average AUM of the Japanese equity long-short is small if compared to current global equity long-short strategies. When you look at global hedge funds, there are quite a few multi billion firms, the AUM of Japan funds, is much smaller, like $300 million or even below $100 million. But even if they are smaller, I can say those can be attractive niche strategies from global allocators' perspective. Japanese equity long-short is a very good investment option and alpha source for adding diversification benefits.

If we look back to late 1990s, we experienced the technology bubble, where internet related or electric exporter names had a huge valuation. On the other hand, value names or old-economy type stocks did not perform so well at that time. But after year end of 1999, when the bubble started to collapse, Japanese equity long/short managers performed extremely well, because they were long very cheap smaller cap and short the ones with a higher valuation, typically large stocks, at that time.

I cannot say history is repeatable, but it is said it rhymes or can echo in a different form. So if we see the current situation, Abenomics has been on now for three years and Nikkei has roughly doubled. When you look at individual stocks, typically the larger names, higher ROE or low beta stocks performed very well, which may be linked to the context of governance issue or other catchy measured under Abenomics. But, even though the general market performed well, such a dynamic is not always having positive effects on Japanese equity long/short managers, and some times the impact can also be negative. Managers can experience many distortions in the market, sectors and relative values. At some point in the future, we may face a collapse similar to the technology bubble. Of course, I can't say anything reasonably about possible crashes, but possibly the closing or conversion of such valuation gaps will then bring significant profitable opportunities to Japanese equity long/short strategies.

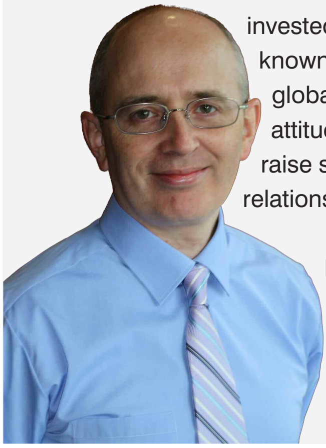


You can view activism as a kind of deep value investment which will probably continue performing so well on the backdrop of governmental and shareholder pressure that the corporations take more effort to create shareholder value. At the same time, there are compliance issues aware off, like Toshiba and Asahi Kasei, to which we also have to pay attention. Remember, 2015 is thought to be the first year of the corporate governance in Japan. There are many problems to solve, but by clearing such hurdles, the Japanese economy and market should be getting better. Those processes will give us opportunities. Although the Japanese equity long/short may be under headwind, they will benefit from changing process going forward.

Matthias Knab Can you tell us more now Japanese pension funds and other institutional investors view the opportunities that alternative investments provide? You already said that the allocation will increase, but what's the dynamic? Do they still need more education? Do they still need more convincing, or is there anything that's holding them back, or are they just ready to take on more exposure?

Kenya Yonezawa: Some pension funds have experienced much hedge fund investments yet, however, some are about to liquidate, mainly Employees' pension funds, typically sector-based commingled ones, due to regulatory changes after "AIJ problems" in Japan. The remaining funds, the corporate pension funds, tend to be much more educated. They also get advice from pension fund consultants. I think that in order to get their 3% target, some may require more not only typical hedge fund exposure, but also more multi-asset strategies, where they mix bond and some specific risk assets with more discretionary overall management for the portfolio. We prepared and offered a new line-up of merger arbitrage funds, for example. We expect this may be suitable to middle risk, middle return mandates, for which, I believe, corporate pensions can easily allocate more.

Rory Kennedy: From what I am seeing as well, **Japanese pension funds and Japanese institutions have a clear bias towards larger managers and towards global strategies.** This is of course true for the rest of the world, but particularly so in Japan, So they are not necessarily interested in an US-focused hedge fund or an Europe-focused hedge fund, let alone an Asia focused hedge fund. They are looking for global managers, typically with at least 5 billion dollars in AUM or more.



And there's a huge amount of money here in Japan, there are trillions and trillions of dollars which need to be invested in alternatives. But where the money will go is a bit of a "chicken and egg" situation. It's well-known that it's difficult and expensive to set up and get licensed to distribute here in Japan, so most global managers struggle with that. **Japan is not a fly-in, fly-out place.** You can't just fly in with the attitude, "Here's my wonderful track record and pedigree, and now give me your money...." Rather, to raise significant AUM, you have to have either representatives based here or you have to have close relationships here, and preferably be able to do client service in Japanese.

My firm have been helping some global managers exactly with this issue, those who don't want to get fully licensed here in Japan, but want help accessing local domestic investors. But as mentioned, there is a clear bias towards the billion dollar AUM global-focused manager. So if you are that kind of a manager, I think there's a lot of money up for grabs in Japan right now.

Matthias Knab Matt, what do you see when it comes to new launches and to the general evolution of the Japanese investment manager?

Matt Roberts: Over the past years big Japanese institutions, some of the mega-banks, were rolling out new fund products, sometimes as often as three or four a month, which was at that time a combination of Japanese domestic funds products and also some offshore foreign funds products aimed at Japanese investors. Some offshore funds were structured as parallel funds replicating the investment strategies of existing domestic funds or were structured together with domestic funds as master-feeder vehicles where appropriate.

And so there was this huge spate of new fund launches which led to a boom in Japanese fund formation work, and those who were working in that space did quite well, and just to pick up on Onuki-san's earlier point, a lot of that was driven by a desire of the investment managers to earn their commissions from such fund launches, and so they get the big subscriptions upfront, earned the nice commissions, and then effectively launched a fund with a similar investment strategy two weeks later. We saw that quite a bit.

That really dropped off when the Japanese regulators become more sensitive to this practice and started to take steps to discourage it, and because the returns that were being generated for investors and the ongoing oversight by the investment managers of these funds by the major institutions was perhaps not at the level that the authorities were hoping. With the difficulties in the resources economies we have naturally witnessed a decline in the commodities markets which has also negatively influenced the launch of some of some funds focused on emerging markets, whereas three or four years ago we saw a lot of those. So the number of fund and product launches has decreased since that time, but is still quite healthy and there is still a continued interest of course in the Japanese domestic equities markets and Japanese domestic funds for the reasons that Leon and Rory have mentioned. But there is also real interest in certain overseas markets as well. A lot of investors of course have been watching a number of other overseas markets and emerging economies and looking to deploy capital in Asia-focused strategies or global strategies that take advantage of the developments in those markets.

In the offshore funds sector, we see the Cayman Islands continuing to be used as the domicile of choice by Japanese investment managers as a result of the many advantages that Cayman funds offer and investor familiarity. In particular, we expect that the use of the Cayman Islands exempted unit trust structure (which is the preferred investment vehicle for Japanese offshore hedge funds as a result of Japanese investor familiarity, tax and regulatory reasons) will continue and should be quite healthy. We are very bullish about Cayman and its importance to the Japanese economy.

We also see that there is a lot of interest by Japanese institutions in the potential of China, and particularly investing into Chinese equities products that they consider are properly regulated products. The Shanghai or Shenzhen QDLP products or the RQFII products also regulated Chinese products, and at the moment only Chinese managers that are licensed by the Chinese government to offer those products. But what we are seeing is a number of Japanese institutions looking to either partner with, or enter into joint ventures with, those institutions, to participate as investors in those products, and then potentially to be able to offer those products to Japanese investors by way of a feeder fund structure as well. So there is strong appetite for Chinese investment products and we see there's appetite for the better regulated sort of products in some of the equities markets in China. There is a lot of interest in Japan as of course there is in the rest of the world in how the Chinese authorities are going to regulate the investment funds space which has lagged behind other areas to date.

There's of course also demand for other markets or products from other investment funds markets like Hong Kong and Singapore. Leaving aside the Asian regulated funds products, also twe also see enormous interest in UCITS and Luxembourg SICAVs and managers who are offering those sorts of products as well, on the basis that they are considered to be very well-regulated products, and who may be focused on some asset classes which are not apparent in the Japanese market necessarily. Whilst many Asian investors may consider Europe to be an unattractive investment destination due to its ongoing weakness in certain key countries, they are interested in certain asset classes where they see long term value. Those investment managers who manage to properly tap into investor sentiment regarding those assets classes of interest can also do well.

Switching focus to the Japanese pension funds, where there is an enormous pool of investor capital that can be deployed quickly, a couple of years ago there was a bit of a sea change when GPIF, the Japanese Government Pension Investment Fund, decided to make an adjustment to the way it was allocating to the domestic market here in Japan because the returns from domestic investment in Japanese bonds were not sufficient.

GPIF also decided to redeploy some of that enormous multi-billion dollar capital it has overseas to also invest in overseas private equity type products. So they made an initial investment with the OMERS platform, which is the Ontario Municipal Employees Retirement Scheme. This was quite an important development when Japan's leading pension fund, a government pension fund actually, makes an investment into a private equity platform and is an example of how a Japanese institution can pave the way for other institutions to follow. So we see investment managers may be looking to structure their funds in a manner that will attract pension fund money and potentially offering hybrid hedge fund structures might help them with that process.

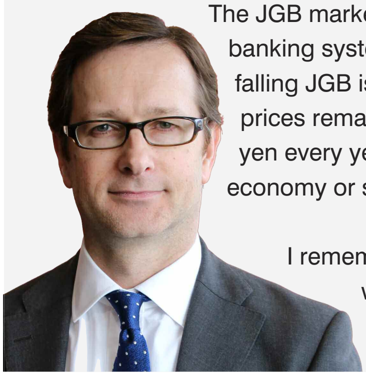
In the quest for generating value for an aging population, we see the pension funds looking into overseas markets, looking at P/E style investments or looking at equities strategies that they think are going to generate a high return for their investors. And certainly, there are the other real opportunities in the Japanese domestic market to improve returns for investors by generating shareholder value as a result of Abenomics and the many reasons that Leon just mentioned.

But surely, some of those changes will be more of a long-term process. While the government is very keen to get these changes implemented quickly, we think *culturally* it will not be that easy to change the power structures of a possibly entrenched management and board culture that exists in Japan. For example, the sort of hierarchical way in which management is promoted throughout the organization and how the boards are run here is quite different to Western boards in the sense that potentially decisions may be made in a way that's not necessarily in the best interest of the company in generating shareholder value, as we might see it happen in other economies where you have more independent boards. So we expect those kind of processes will be taking some time to change. The adoption of the Japan Stewardship Code and Corporate Governance Code are important steps to expediting this process.

Rory Kennedy I actually have a question for Leon. One group of issues that I hear time and time again from overseas people when they talk about Japan or when they read anything about Japan are the three Ds; the Debt, Deflation, and Demographics. These are always the standard reasons why people don't want to invest in Japan or think they shouldn't invest in Japan. I was wondering Leon, what's your take on the three Ds?

Leon Rapp: These are well-rehearsed sound bites, particularly from foreign pundits, about why you want to avoid investing in Japan. Many of the bombastic statements of Japan's economic demise have been proven to be wide of the mark. Yet these myths continue to be believed by otherwise sophisticated investors. Obviously gross government debt is high in Japan relative to GDP, but financing or servicing the debt does not present an issue.

Deficit financing was prominent while you had an economy that was weak, as it should be, but the elasticity of tax revenues has proven be stronger than expected. When you strengthen the economy, you get rising tax revenues and deficit financing can drop quite considerably. Unsurprisingly, this is exactly what we are seeing right now. So actually JGB issuance is falling, but the demand is still there, both from the BOJ and a rising deposit base.



The JGB market is essentially one that's driven by supply and demand. There are excess deposits in Japan's banking system. That gets channeled through via banks into the purchase of JGBs. And when you have falling JGB issuance, which is what you seen now, you still have a very tight supply and demand, so JGB prices remain very high. Add into the mix a central bank that is expanding its monetary base by 80 trillion yen every year. So essentially, the JGB market is no longer a reliable indicator of price trends in the economy or sovereign risk premium.

I remember very vividly just a few years ago the concerns that the JGB market was in a bubble and would become the next Greece, which itself has defaulted five times since 1800s. This was clearly an invalid argument.

Japan has defaulted only once in 1942 during WW2 under very different circumstances. Even Germany has defaulted eight times modern history. Japan also owns its debt and controls its monetary policy. I don't expect the JGB market itself will collapse anytime soon due to sovereign concerns.

One further point, the sovereign gross government debt figures are generally quoted on a misleading gross rather than net basis and exclude unfunded public pension and benefit liabilities. Include those in the discussion, and Japan is no longer a debt outlier globally. For an equity market investor, Japanese debt should be a non-issue.

When it comes to demographics, yes Japan is aging, just like everybody else, but Japan is actually ahead of the curve here. **The working population has been dropping steadily since about 2000, but gross national income has continued to grow.** For Japan, there is no definitive correlation between declining workforce and the overall level of the economic activity. If anything, a smaller labor pool should be a tailwind for wage levels.

The other one was deflation. Japan price levels have fallen by 20% over the past 15~20 years. No wonder Japanese have had very low margins and returns on capital, because it has been very difficult when you invest to put out a new product only to find yourself in competition with somebody else who is running their facilities at full capacity to try and basically push out as much products as they can. Effectively it is a race to the bottom.

But what's actually happening right now is that the best indicator of prices in the broad economy – the GDP deflator – has been in positive territory for the past two years, and growing strongly at +1.8% currently. Deflation has been quashed. I find it best to ignore CPI given its narrow focus and weighting of energy.

If you look at Japan closely, there is a far more latent economic potential from rising productivity which more than offsets angst from debt levels, demographics or deflation. It really should not be a matter of concern to any equity investor.

Rory Kennedy: There have been enormous amounts of changes in Japan over the past few years that I don't think have been acknowledged overseas. For example, we had the Japan Post IPO which was the largest IPO in the world in 2015. It was massively oversubscribed by Japanese retail investors, and clearly this is also an attempt by the government to bring retail back into the market again, where they are highly underrepresented compared to the rest of the world.

As for Japan Post itself, it's one of the largest financial institutions in world but barely known outside of Japan. Prior to Abe, the last significant prime minister in Japan was Koizumi who was PM a few years ago. At that time, one of his big projects was to privatize the Japan Post, but there was enormous resistance from vested interests against this, and it never happened.

And yet flash forward to the current Abe government, and the Japan Post IPO went without a hitch - something that was inconceivable six, seven years ago and created a massive political battle at that time. But the current government has effectively no opposition and so can make major changes across the economy.

Another area people have long tried to bring change is agriculture. Also there, the battle is against vested interests and the prevailing wisdom was that you can't go against the farmers. That has now been done as well, Japan has signed up for TPP against the farmers' own interests in theory. Even though the farmers are one of the biggest traditional supporters of the ruling party, the LDP, they have been sacrificed to the greater goal of structural reform. So again and again we are seeing massive changes in Japan, which the Japanese government (in my opinion at least) are very poor about advertising to the world.

Japan is seen as a nation of small farmers, which indeed it is. Another example of fascinating change is that the price of Japanese rice (the Japonica brand or strain of rice the domestic famers produce) is now at the current exchange rate competitive with the giant rice producers in California.

So here we find that even the small farmers can be competitive against gigantic farming groups in the Western world.

And this is even before this current generation of farmers that are starting to die off and their land will be bought up by agriculture companies here as well.

I think that these two stories, the Japan Post privatization and agricultural reform, were areas that were always held as key example of Japan's inability to change and yet they have.

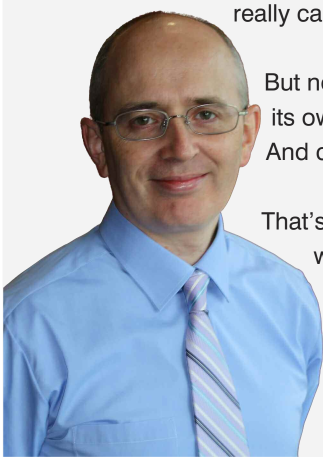
Another one would be that probably most people outside of Japan may still think that there are mainly jobs-for-life in Japan as part of their seniority system. But no, that is not the case any more. Something like 30-40% of Japanese corporations use temporary labor, so it is as easy for those companies to get rid of those workers as it is in America, for example. That is another gigantic change and another reason why corporates are able to be more nimble nowadays, because they don't have the burden of labor requirements that you have in many European countries, for example. It was always seen as a competitive advantage that America didn't have those labor and support requirements, but now, they don't have them in Japan anymore either. Labor is now a flexible rather than fixed cost for most companies.

Despite all of this, I still get from overseas investors: "Yes, ***but***, yes ***but***.." I sometimes wonder how many more factors we have to talk about before people are willing to acknowledge that structural change is taking place in Japan?

Well, speaking for us and what we have done, we have made very good money for our clients over the last few years, because we have been invested in these changes. As Leon touched upon, while maybe ten years and even up to three or four years ago, from global investment management perspective, there was career risk if you invested in Japan. But what we are currently more and more seeing is that there is significant opportunity cost to not be invested in Japan.

Matthias Knab You mentioned your funds and that you have made money for your clients, and we also discussed that there's increased risk appetite now also for Japan. Can you tell me more details about your investor base and their specific goals and preferences?

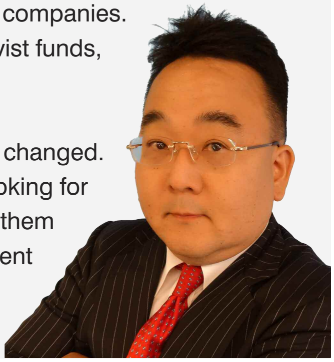
Rory Kennedy: We work with a variety of investors. For professional hedge fund and fund of funds investors, Japan used to be a strategic play, because if you look at Asia ten years ago, Japan was the only significant developed market while the rest of Asia were more emerging markets and often too small, and so not many institutional or professional investors really cared.



But now with the rise of China to become a gigantic economy and an important investment destination in its own right, things have changed. In think Japan has become a tactical play rather than a strategic play. And certainly, at the moment Japan is in play.

That's not to say investors know exactly where to put their money or how to invest in Japan, but certainly we see a considerable interest, and many people call us and ask what they should do. Maybe that could be a real estate play, for example. It doesn't necessarily have to be hedge funds. Or it could be venture capital. But there is an enormous amount of interest in Japan, but the real challenge is always how to do it, and that's simply because if you haven't looked at Japan for ten years, it's not surprising that you don't know how to access the markets or opportunities in Japan properly.

Kenichi Onuki: Just a few more thoughts about what Rory said about how Japan is changing. Ten years ago, you couldn't call your fund activist when you wanted to launch a Japanese or even foreign equity funds. But after the government and now also more of the larger investors focus on corporate governance and the ROEs, people are changing. Now, we may be able to at least say that we will discuss, consult or negotiate how to maximize shareholders' return with the companies. That leads me to believe that probably ten years from now there could be much more room for activist funds, M&A funds or private equities to be more successful in the Japanese market.



And also, compared to the few years ago, retail investors' attitude towards Japanese equity is quite changed. Like the successful IPO of Japan Post Bank (Yu-Cho), people now want something, and they are looking for some catalyst to put their money into the Japanese equity. If there is a good or persuasive story for them to invest in a specific stock or specific sectors or themes, they are now willing to pay. This is the recent change I feel, especially over the last years. It's a drastic change thanks to Abenomics.

Kenya Yonezawa

What do you think is considered a good return now in Japan? And is there a difference in the expected return for a retail, conventional mutual fund return versus for institutional investors?

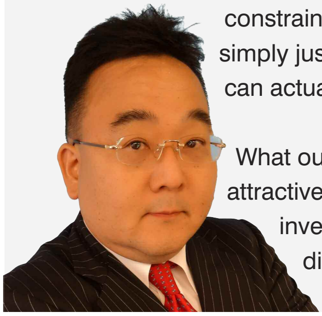
Kenichi Onuki

I would say it really depends on the client segment. For some very conservative investors like bank depositors, maybe 2% would be enough, but the product must have very very low risk profile.

Matthias Knab

With liquidity, right?

Kenichi Onuki: That is an interesting aspect. While retail public funds usually have daily liquidity, the actual liquidity constraints of retail investors, especially bank depositors, are not necessarily so strict. They are used to simply just put their money into bank deposit for many years, so they have no need to use it right now and can actually put their money into the low risk, low return type product for many years.



What our firm and probably other asset managers are trying to do now is to offer those bank depositors an attractive alternative with low risk, low return products. For those, a 2-4% return would be fine for them. Other investors like brokers' clients that are often higher risk takers would perhaps look at more than double digit annually.

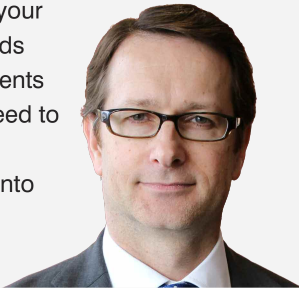
Yuji Asano (Harneys)

This is interesting. If you consider how major central banks buy government bonds and keep interest rates globally at their historical lows, I just cannot believe my eyes that deposits yield 0.5% or less, even in such countries with a higher inflation like the UK. I am not sure about how much longer those people will like to keep their money in such deposits.

When 15 or 20 years ago UK rates were at 15%, you did not have to invest into any fund, you just kept your money in a deposit. In Japan, the reason why I am asking this question is that people are very much likely to keep their money in deposits and few tend to change their mind to diversify that money in the investment fund.

At the moment, interest rates are so low, there is no incentive to keep your money in a deposit. However, so much money is tucked in there, even at such a low rates. I really wonder what could be the trigger to change the mind of the masses of Japanese retail investors towards more investments?

Leon Rapp: That's inflation. I think inflation is the answer. In a deflationary environment you can keep your money in the deposit and it will generate real value. When you start to see a shift out of deflation towards inflation, then you actually have a real active encouragement to move away from deposits into investments that actually make you a higher return. When you keep getting negative returns in your deposit, you need to actually look at funds or other asset investments that are out there. That's generally the mechanism by which I think the BOJ essentially wants to get the excess deposits from the banking system for Japan into higher returning investment opportunities.



Kenichi Onuki

Another reality of the Japanese retail market is that the bank depositors tend not to buy products from brokers, but they stick to their own banks. So if a bank can offer attractive low risk, low return type product and educate and show them what is the effect of the inflation to the real purchasing power of their money, drastic money flows can happen in the near future.

Matthias Knab

Is this happening? Do banks offer a broad range of investment options for their retail clients?

Kenichi Onuki

Mega-banks yes, but for the smaller banks, those other options are not so well-established. A lot of retail assets are in the deposit of regional banks. I would think that it is also important to offer alternative investments to bank deposits to clients of those type of financial institutions.

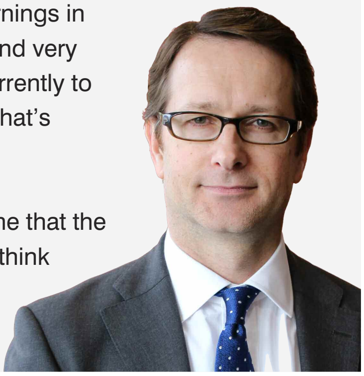
Kenya Yonezawa: We talked a lot about Japan, but I was wondering what your views are about the global investment outlook as we enter 2016? What's your view on GDP or earnings growth, for example?

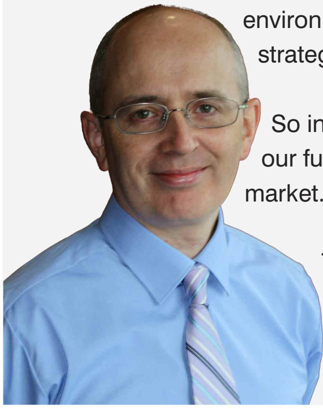
We interact daily with many managers and get a lot of reports from hedge fund managers, but my impression is that most of them don't have a specific big idea, at least in the macro strategy. There seems to be a lot of wait and see on the global landscape, while my expectation is as well that the Japanese economy is actually getting better, slowly but steadily.

I don't know if and how much the Nikkei might go up, but just on the strategy basis, long-term strategies are a very good engine for creating good outcomes for institutional investors targeting maybe not so much the higher single digits, but around the mid or three to five percent target returns.

Leon Rapp: I think being constructive is the default position when it comes to the outlook for earnings in particular. Let's not forget that the corporate tax rate is going to be cut here. Abe has come out and very resolutely said he wants to continue to cut the corporate tax rate from the mid 30% where it is currently to below 30%. If pretax earnings were flat, that alone would give you earnings growth in Japan, so that's another positive thing for Abenomics.

Also, the continued focus on cost cuts as well and on returns on capital will demonstrate over time that the average Japanese corporate is a much higher returning entity than it has been in the past, and I think that will eventually feed through to stronger equity market prices.





Rory Kennedy: For us, it is not of such a fundamental importance whether the market goes up or goes down, because ultimately we manage and invest in hedge funds, and we expect our managers to make money in both environments. Also, the more difficult, the more choppy the environment, then you'll see quality hedge fund strategies will work.

So in some ways, a choppy market is even better, because it allows people, for example in our case, in our fund of funds, to show we are producing alpha and it's just not beta earned simply through a rising market.

This is not how we see it – Japan should not simply be a destination for investment, but rather an access channel to find good corporate earnings or good alternative investment opportunities that happen to be in Japan.