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Funds Insider

August 2004 Issue 35

No flash in Japan

Legg Mason's Hideo Shiozumi
stays top of the tree

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Deputy Editor

No flash in Japan

Hideo Shiozumi puts the success of his Legg Mason Japan fund down to careful investment for the long term rather than the fast-buck, trading approach adopted by many of his peers. Investors must hope his current optimism is also well founded.

Japanese fund manager Hideo Shiozumi had never heard of the Hungarian-born US financier who contacted him in 1982 with a job offer. Shiozumi was by no means alone, for his new acquaintance was a relative unknown. The same could not be said ten years later. For in 1992 the mystery man led an attack on the pound, which forced John Major's government to free sterling from Europe's exchange rate mechanism (ERM) as the Old Lady's reserves dwindled. The speculator passed into legend as the man who made \$1 billion (£540 million) when he broke the Bank of England. He was none other than George Soros.

Soros had sought out Shiozumi to ask him if he wanted to run a chunk of the Quantum fund, which in a decade's time would fix its crosshairs on sterling. Shiozumi had already established a good record as a fund manager at Robert Fleming, which he reckons led to the call from Soros. 'He might have heard of my name through some investors or institutions in Europe,' Shiozumi recalls. 'I had been running the Fleming Japan fund since 1973 and it was number one in its sector for almost all the years I was managing it. Soros asked me to go over to New York. He wanted me to set up a company to run the Japanese equity portion of Quantum. I think the Japanese part was worth about \$100 million at the time.'

Shiozumi ran money for Soros for a few years but in 1986 he was forced to shut down his fund management firm because of regulatory changes in Japan. The stringent new rules left him unable to secure a fund management license. 'I think one of the requirements was that I had to have more than \$200 million worth of funds under management,' he says. 'I couldn't show that so I had to shut the firm down.' Nevertheless, Shiozumi must surely have learned much

from Soros, even if their association lasted for a short while only? 'Er, no, not really,' Shiozumi replies. 'The Quantum fund was a very highly geared hedge fund. Soros changed his view on the market almost every week. If the market was strong he'd ask me to go fully invested. Then in the following week if the market was weaker he would ask me to raise my cash weighting. For me, it was very difficult to manage money like that.'

The reason why cuts to the heart of Shiozumi's growth-orientated fund management style. He is a long-term investor who likes to undertake fundamental research in a bid to uncover good stocks he can hold for some time. In contrast, Soros required him to adopt a short-term, trading approach to fund management. Indeed, Shiozumi says strict adherence to his preference for long-term investment, together with patience born of experience, is the key reason for his successful career as an investor. He argues it marks him out as different from other Japanese fund managers too.

The latter, he says, trained at stock-churning, commission-hungry brokers during Japan's bubble years of the late 1980s. Their average annual turnover as fund managers is up to 200%, whereas Shiozumi aims for a much lower figure of 30-50%.

Shiozumi says he hit upon the long-term, low turnover technique early on in his career. 'In 1974 I was running the Fleming Japan fund in a trading-oriented way,' he says. 'Then I was asked how the fund would have performed if there had been no portfolio turnover. It turned out it would have done better! Ever since then I've sought to achieve good performance with very low turnover.' It is an approach that has certainly served the £100 million Legg Mason Japan fund well. Shiozumi runs it under contract at his own firm, and it



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'Everything is different to previous recoveries'



SHIOZUMI'S CV

Date of Birth:

23/12/1943.

Education:

Shiozumi graduated in 1967 with a BA in Economics from Guilford College, Greensboro. The latter is in North Carolina in the US.

Career:

Shiozumi joined Robert Fleming in London in 1970, eventually becoming manager of Fleming Japan. In 1982 he joined Jardine Fleming in Tokyo. He then established Shiozumi & Company and Shiozumi America in 1983 to run part of George Soros' Quantum fund. In 1987 he became president of National & Foreign Capital Management. He quit in 1990 to set up Shiozumi Investment, which in 2001 became Shiozumi Asset Management.

Funds:

Shiozumi manages the £100 million Legg Mason Japan fund. He is paid a flat fee rather than a performance fee. The management contract between Legg Mason and Shiozumi's firms stipulates a 12-month notice period. Shiozumi also runs the Bermuda-registered Shiozumi Japan Opportunities portfolio and a US pension fund.

Personal Investments:

Shiozumi has no investments in the Japanese stockmarket. He says regulations do not allow him to invest in the stocks he puts his clients into. Since those are the stocks he likes, he has no money in the Japanese stockmarket.

Hobbies:

He is a very keen tennis fan.

is up 184% since its launch in 1996, compared with an average fall of nearly 4% among funds in the Japan sector and a 23% slide in Japan's Topix index of large-cap Japanese stocks. Shiozumi personally ranks top over every time period from three months to five years in the Japan sector of the Citywire Funds Insider database. He also holds a AAA rating for excellent risk-adjusted performance over the last three years.

There are a couple of things worth highlighting about these performance figures. First, Legg Mason Japan is very volatile. So far it has delivered the extra return required to justify its riskier character. Shiozumi explains he aims to maximize performance in good stockmarket periods and then minimize losses in bear phases. 'I don't think my style is risky providing clients are prepared to hold on the for the long term,' he says. 'But if they try and trade the fund's units over the short term, then yes that could be very risky. The fund cannot keep going up at a high rate forever. But what I think is important is the fund's performance over long periods, like three, five or seven years.'

The second point to note is the fund's volatility stems partly from the fact its portfolio is made up of smaller company stocks, 80% of which are longer-term, strategic holdings. This raises the question as to why Legg Mason Japan is classified in the mainstream Japan rather than Japanese Smaller Companies sector. Similarly, it is fair to ask why the fund is benchmarked against Topix, the index of large-caps, rather than the TSE Second Section index of smaller company stocks. The answer is the fund's mandate allows Shiozumi to invest in large company stocks should he so desire.

So why doesn't he? Put simply, because he looks for companies growing profits at over 20% per year. More precisely, he searches for growth at a reasonable price (Garp),

which means he selects stocks with price/earnings to growth ratios below one, where a peg ratio divides a stock's P/E by its annual percentage earnings growth figure. Once the Japanese economy slid into deflation and recession in the early 1990s, only small-cap stocks could meet Shiozumi's criteria. Interestingly, this approach also took him to companies focused on Japanese consumers. This is surprising since, in aggregate, Japanese consumers were reluctant to spend during Japan's 'lost decade' of poor economic performance.

'I've targeted small-cap stocks ever since the Japanese economy collapsed,' Shiozumi explains. 'I figured that was the best way to gain exposure to new, fitter companies best able to deal with the more difficult economic environment. As for the Japanese consumer sector, yes, it has been depressed for more than ten years. But certain types of companies, mainly discount retailers, have been able to do well. Such companies just did not exist before 1990. In fact, over 80% of the holdings in the Legg Mason fund were established in the last two or three years. They have been growing fast because they are tuned into changes in people's lifestyle and spending habits.'

Shiozumi is optimistic about Japan's current economic and stockmarket recovery. He sides with those who feel the recovery is structural and sustainable rather than doubters who argue it is cyclical and fragile. There is certainly a raft of encouraging economic figures to please optimists. Real gross domestic product growth was 2.5% in 2003, according to official statistics. The annual rate of growth in the first quarter of 2004 was a healthy 5.6%. These figures account for deflation, still a problem in Japan but one which appears to be waning. Some analysts think it is hard to account for

Holding	%
Gulliver International	6.90%
Quin Land	4.85%
Apple International	3.99%
Arbeit-Times	3.88%
Don Quijote	3.70%
Take and Give Needs	3.69%
Aark Corporation	3.50%
Karula	3.72%
Phoenix	3.39%
For-side.Com	3.35%

Source: Legg Mason

deflation accurately and prefer to look at nominal figures. They are reasonably encouraging too. Nominal GDP growth was minus 0.1% in 2003 and 3% at an annual rate in the first quarter of this year.

Notably, the current export-led recovery appears to have injected some life into private demand, which has raised hopes the economic revival could be self-sustaining. Real private demand rose 3% in 2003 and at an annual rate of 7% in the first quarter of

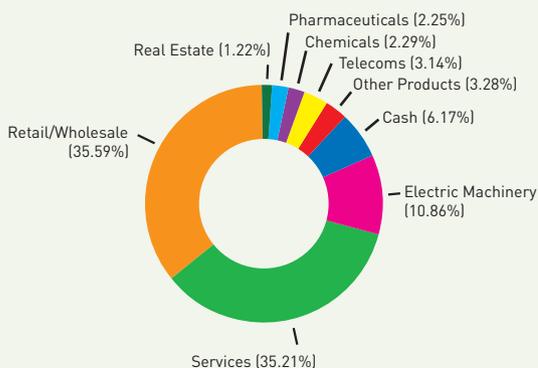
2004. The equivalent nominal figures are 0.6% and 4.2% respectively. In contrast, public demand is falling in nominal and real terms, whereas in the past government expenditure triggered brief revivals that eventually petered out.

'Everything is different to previous recoveries,' Shiozumi says. 'Banks are in better financial shape, real GDP growth has been positive for some time and consumer confidence is up. Strong exports are part of the reason for the recovery, but the more important reason is that Japan is very near to completion of its financial restructuring. I think Japan might beat deflation next year. People are worrying about interest rates rising in the US, but in Japan we need higher rates, because higher rates would show Japan's economy has produced inflation and is definitely recovering. The authorities won't raise rates until they are sure of the recovery.'

Hopefully, Shiozumi is right to side with the optimists. However, many analysts still fret the current Japanese recovery will prove to be another false dawn. The worry is Legg Mason Japan's upward trajectory since the stockmarket turned in April last year looks dizzyingly steep. If the optimists are wrong and the stockmarket retrenches, investors must hope the fund does not tumble too far down the other side of the slope. ★

Shiozumi has a strong small-cap bias

Legg Mason Japan: sector breakdown (%) at May 2004



Source: Legg Mason

Shiozumi has turned £1000 into £1629 against £881 from his average peer

Total return - five years to 30 June 04

Source: Citywire

