

# Q&A



HENNESSY JAPAN FUND  
(HJPNX/HJPIX)  
HENNESSY JAPAN SMALL CAP FUND  
(HJPSX/HJSIX)

## [ Comments and Opinions ]

### PORTFOLIO MANAGEMENT



- » Lead Portfolio Manager of the Hennessy Japan Fund
- » Analyst and Portfolio Manager with SPARX since 1999

**Masakazu Takeda, CFA, CMA\***



- » Lead Portfolio Manager of the Hennessy Japan Small Cap Fund
- » Analyst and Portfolio Manager with SPARX since 1999

**Tadahiro Fujimura, CFA, CMA\***

\*Chartered Member of the Security Analysts Association of Japan

### ABOUT THE FUNDS' SUB-ADVISOR

Tokyo-based SPARX Asset Management Co., Ltd. is the sub-advisor to the Hennessy Japan Funds. Since its founding in 1989, SPARX has grown to be one of the largest and most experienced Asia-based asset management specialists.

### FOR MORE INFORMATION

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*In the following commentary, Portfolio Managers Masakazu Takeda and Tadahiro Fujimura discuss Japan's economy, current stock valuations, the impact of the recent election in Japan and geopolitical events, and make the case for investing in Japan.*

#### **1. In the third quarter of 2017, Japan's economy grew for the tenth straight quarter, the longest stretch of growth since 2007. What has been fueling this growth?**

Gross domestic product (GDP) growth in Japan is being driven by three main factors:

1. Growth in consumption
2. Increasing capital investment
3. Higher net exports

The labor market in Japan is very tight – the unemployment rate is just 2.8% - and so wages have been rising and consumer confidence has been moving steadily higher, all of which is encouraging Japanese consumers to spend more. Companies, meanwhile, have been investing more to automate their factories, reduce costs and stay competitive. Investment has also been increasing in response to the reduction in corporate tax rates which Prime Minister Abe's administration implemented from 2012 to 2016. And lastly, a weaker yen and solid economic growth in the countries that buy Japanese products, including the U.S., have benefited Japan's exporters.

#### **2. The Japanese market has been rising – is the market looking expensive now? What do you think of Japanese stock valuations?**

Japanese stocks are trading at about 15x 2017 earnings. This makes the Japanese market one of the cheapest major equity markets in the world today. The S&P 500, for example, is trading at about 21x 2017 earnings. So relative to international equities, Japanese stocks do not appear expensive at all. In fact, they might even be viewed as undervalued.

Relative to historical Japanese valuations, we believe the market today also offers good value. Over the past five years, corporate earnings per share and the TOPIX have both risen by about 120%. In other words, even though the Japanese market has risen, it has not seen any multiple expansion over this time period and is no more expensive today relative to earnings than it was five years ago. Japanese small- and large-cap companies are currently trading at approximately the same price-to-earnings, however, small-cap companies are growing faster at a rate of 12% versus 8% for large-caps.

And, if the government continues to focus on corporate governance reforms, we believe returns on capital will improve in Japan, encouraging investors to place higher valuations on Japanese equities than they do today. So, we believe there is opportunity for multiple expansion in the Japanese market over the long term.

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### JAPAN FUND FACTS

Symbol	
Investor	HJPNX
Institutional	HJPIX
CUSIP	
Investor	425894102
Institutional	425894201
Inception Date	10/31/03

### JAPAN SMALL CAP FUND FACTS

Symbol	
Investor	HJPSX
Institutional	HJSIX
CUSIP	
Investor	425894300
Institutional	42588P767
Inception Date	8/31/07

### 3. Prime Minister Abe and the LDP won the election in Japan in October. Could you tell us what that means for the political situation in Japan going forward?

The landslide victory in the Lower House for the incumbent LDP has given Prime Minister Abe an even stronger mandate to continue with his economic policies and structural reforms. The victory means that it is likely Abe will win the LDP leadership vote next year, preserving policy continuity in Japan probably until the end of the decade. It also means that the current governor of the Bank of Japan will be reappointed next year, adding another welcome layer of stability for the economy and for the markets. We believe the election victory means that Japan can continue to move in the right direction with a pro-growth central bank and a reform-minded government.

### 4. How are political events in North Korea affecting Asian markets?

While heightened tensions with North Korea have been widely discussed in the U.S. and Japan, they have not negatively impacted the Japanese economy nor the stock market. In fact, consumer sentiment in Japan from July through September has improved.

While the country's proximity to North Korea may be concerning, South Korea's economy appears stable, and its market performance over 2017 has been stronger than other Asian markets.

### 5. Can you summarize the case for investing in Japan?

The bull case for Japan rests on three major factors. First, earnings are growing for Japanese companies. Over the last three years, earnings for both large- and small-cap companies in Japan have been growing at 10% annually. Growth is being powered by innovation, cost-cutting and growth in export sales. Second, Japanese stocks are selling at very reasonable valuations and with increasing returns on capital and a new focus on returning excess cash to shareholders, we believe valuations could move higher over time. Third, the political situation in Japan is stable and the recent election makes it very likely that the current, pro-growth policies will remain in place. We believe these factors will continue to drive Japanese equity prices higher over the next few years.

*Investors should consider the investment objectives, risks, charges and expenses carefully before investing. This and other important information can be found in the Fund's summary and statutory prospectuses, which can be obtained by calling 800-890-7118 or visiting [hennessyfund.com](http://hennessyfund.com). Please read the prospectus carefully before investing.*

**Mutual fund investing involves risk. Principal loss is possible. The Funds may invest in small and medium capitalized companies, which may have more limited liquidity and greater price volatility than large capitalization companies. The Funds invest in the stocks of companies operating in Japan; single-country funds may be subject to a higher degree of risk. The Funds may experience higher fees due to investments in pooled investment vehicles (including ETFs).**

The Tokyo Stock Price Index (TOPIX) is a market capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. One cannot invest directly in an index. Return on capital is a ratio which is estimated by dividing the after-tax operating income by the book value of invested capital. Earnings per share is a company's profit divided by its number of common outstanding shares. Price-to-earnings ratio is the market price per share divided by earnings per share. **Earnings growth is not representative of the Fund's future performance.**

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