Management Report

Alternative investment fund manager ("the AIFM")	**Nomura Asset Management Co., Ltd.**
Alternative investment fund ("the AIF")	**NEXT FUNDS TOPIX Exchange Traded Fund**
Reporting period ("the year")	**23rd Reporting Period (July 11, 2023 - July 10, 2024)**

26TH SEPTEMBER 2024

STRICTLY PRIVATE AND CONFIDENTIAL

This document sets out the disclosures required under point (c) of Article 22(2) of the “DIRECTIVE 2011/61/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010” (hereinafter, “AIFMD”) as well as Article 105 of the “COMMISSION DELEGATED REGULATION (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision” (hereinafter “Level II Regs”).

The information required by AIFMD and Level II Regs is included in the Explanatory Booklet on the Investment Trust (hereinafter, “the Prospectus”) of the AIF and this Management Report supplements it by providing additional information which is not included in the Prospectus.

The AIF Prospectus is also available on the AIFM website.

https://global.nomura-am.co.jp/nextfunds/products/1306_Pros.pdf

1. Market Review

1.1 July-September 2023

Japanese equities narrowly extended their winning streak for a ninth consecutive month, adding 2.45% for the third quarter of 2023. Nevertheless, the positive momentum began to wane as investor anxiety grew over a potential shift from the “goldilocks” scenario towards higher for longer period of tight monetary policy. In July, the market greeted the European Central Bank (ECB) and the Federal Reserve (Fed) calmly when they delivered their expected 25bps rate hikes, but uncertainty over the future policy direction kept the positive mood short lived. In line with expectations, the Fed decided to keep the policy interest rate unchanged at the September monetary policy meeting, but failed to sooth investor nerves. The FRB expressed doubts over the chances of an interest rate cut in the coming year, fuelling expectations that the monetary regime of higher for longer policy rates would continue. The yield on US 10-year treasury bonds climbed steadily to 4.6% and beyond with little resistance, reaching levels not seen in more than 15 years.

Similarly, investor focus shifted to Bank of Japan (BOJ) policy actions. In July, the BOJ decided to fine-tune its yield curve controls (YCC) by effectively raising the cap on its 10-year bond yield trading range to 1% while keeping the previous cap of 0.5% as a reference figure rather than as a firm limit. The move followed intense speculation over the possibility of further BOJ policy changes.

A subtle change in BOJ Governor Ueda's comments at a press interview in September caught the attention of investors, hinting at a possible end to negative interest rates by the year end, even before the results of next year's annual wage negotiations are available in March to April. This statement led to a rapid shift in market expectations, with the timing of a policy rate hike by the BOJ being brought forward from the middle of next year to the first quarter. Although Governor Ueda later clarified his comments by suggesting a premature policy change could pose risks to the economy, market expectations remained difficult to quell.

Despite the lack of changes to either the BOJ monetary policy framework or forward guidance in its latest meeting, the market continued to test the central bank’s resolve. The 10-year JGB yield climbed higher and surpassed the psychological threshold of 0.75%.

Interestingly, the currency market did not align neatly with the views of the equity and fixed income markets. The yen recovered briefly following the YCC adjustment and Governor Ueda's interview in September, but quickly resumed a downward path against the US dollar as expectations of the widening interest rate gap between Japan and the US took precedence.

In response to the upward movement of long-term interest rates in Japan and the US, investors shifted away from growth stocks and sought refuge in value stocks. This led to significant differences in the performance of value and growth indices, with the Russell/Nomura Value index rising by over 8% and the Growth index falling by more than 4% during the quarter. Financials emerged as the primary beneficiary of this market trend, followed by the Automobiles sector. Many companies in these sectors are trading at single-digit price-to-earnings ratios or well below their book values. Conversely, the Capital Goods, Electronics, and Medical sectors ended the quarter lower.

1.2 October-December 2023

Japan’s market rally began to lose some momentum but still managed to register a positive return, rising by 2.04% for the fourth quarter of 2023. While the market experienced corrections in October and December, it finished the year on a positive note, breaking out of a historical range that has constrained it for more than 30 years. Market performance during this quarter was largely dictated by changing monetary policy expectations and fluctuations in the USD/JPY exchange rate. Initially, investors were forced to reassess the overall investment environment amid the risk of a “higher for longer” monetary policy regime, as the 10-year US Treasury yield climbed rapidly and briefly touched the 5% level in October. Equity prices inevitably corrected as investors struggled to determine where the benchmark risk-free rate would eventually settle. Shortly afterwards, investor sentiment swung decisively from the acceptance of the “higher for longer” interest rate environment to a sense that the first interest rate cut might come rather earlier than expected. Signs of receding inflationary pressure and some cooling of economic activity raised hopes of an end to the tightening cycle and even a pivot to loosening. The 10-year US Treasury yield experienced a remarkable U-turn and dropped sharply to 3.8%, lower than where it stood at the beginning of the quarter. This helped to infuse some fresh optimism into the equity markets. In response, the yen finally stemmed its decline against the US dollar and Euro, and began to appreciate toward the end of the year. This strengthening yen weighed on export-oriented sectors of the stock market, capping the upside of the overall market.

While Japan's economy displays some resilience, it still seems to lack vigour. Industrial production declined by 0.9% (mom) in November, following two consecutive months of positive gains. Lower output of motor vehicles, certain electronics equipment, and general-purpose machinery was responsible for the monthly fall. Core CPI, which excludes fresh foods and energy, slowed to 3.8% (yoy) in November from 4.0% in October and 4.2% in September.

At the end of October, the Bank of Japan (BOJ) adjusted its Yield Curve Control (YCC) measures, while keeping the overall policy framework unchanged. Instead of imposing a fixed upper bound of 1.0% on the 10-year Japanese government bond (JGB) yield, the BOJ will set this level as a reference rate and allow the 10-year JGB yield to rise above it while remaining prepared to counter any speculative movements. This fuelled speculation that the BOJ might soon scrap its negative interest rate policy, yet the BOJ made no further policy changes and Governor Ueda reiterated his view that an increase in confidence would be needed in the prospect of a virtuous cycle of wage growth and inflation.

There was some notable dispersion of returns by sector and style during the quarter. The Automobiles sector bore the brunt of the negative impact of the strengthening yen, declining by nearly 6%. Many Commodity sub-sectors declined; maritime shipping being the main exception due to expectations of tighter supply-demand conditions as shipping is re-routed from the busy Suez Canal route to around the Cape of Good Hope. The lack of a decisive monetary policy change prompted a sell-off in the Financials sector. On the other hand, the Electronics and the Information/System sectors advanced, led by rallies in semiconductor stocks, and media and internet-related stocks respectively. Growth stocks outperformed their value peers.

1.3 January-March 2024

The Japanese equity market continued its upward trajectory in the first quarter of 2024, gaining a further 18.14%, including dividends. The Nikkei 225, a Japanese price-weighted index equivalent to the Dow Jones Industrial Average, and a more frequently cited market gauge in the general media, reached a new record high for the first time in over 34 years. It last traded near this level back in December 1989 around the apex of Japan's economic bubble. Although the recording of a new high for one particular index is largely symbolic, it also signalled increased investor interest in Japanese equities and elevated expectations that the economy might be escaping from thirty years of stagnation. Positive momentum in Tokyo was also supported by rallies across the global equity markets, positioning Japan alongside other record-breaking equity indices worldwide. A rise in long-term US Treasury yields due to persistent US inflation triggered a minor and temporarily sell-off, dampening some of the enthusiasm for aggressive rate cuts in the future. Despite these challenges, global equity markets remained resilient, and the Japanese market quickly recovered, defying any profit-taking pressure.

The Bank of Japan (BOJ) announced some significant policy changes following the monetary Policy Meeting on 18-19 March by ending negative interest rates and by scrapping the Yield Curve Control policy measure. The decision was driven by stronger than expected outcomes from annual wage negotiations, signalling a new era for the Japanese economy. Coupled with ongoing corporate governance reforms, this provided more reasons for optimism in Japanese equities. The currency market reacted calmly to the decision, with the yen weakening to a 34-year low against the US dollar despite verbal interventions from the Vice Finance Minister for International Affairs, Masato Kanda, and other officials.

Despite the welcome news that annual labour-management negotiations had resulted in higher than expected wage settlements, the Japanese economy still faces challenges. With the fourth quarter 2023 GDP revised upward, the economy narrowly avoided a technical recession. However, weak personal consumption continues to exert a significant drag on economic growth. Inflation continues to outpace broad wage growth and has eroded consumer purchasing power. One silver lining is that the first round of this year's wage negotiations has resulted in pay increases of more than 5% for unionised employees, the highest increase in more than thirty years and meaningfully higher than the current inflation rate of around 2.5% to 3%. On the other hand, industrial production declined by 0.1% (mom) in February, following a steep 6.7% fall in January. A fall in automobile output had a negative impact on overall production data, as a Toyota Motor affiliate had to halt production due to the suspension of product safety approvals and labour accidents. The outlook is positive but still requires some caution.

The market enjoyed a broad based rally while wide return dispersion by size, sector, and style was evident. Large cap stocks that can act as a proxy for the broad Japanese equity market, which include Tokyo Electron, Mitsubishi, Toyota Motor, and Softbank Group, led the 1Q2024 market rally on the back of steady inflows from international investors. Large cap stocks therefore outperformed relative to their mid and small cap peers. In sector terms, Automobiles stood out as a major beneficiary of the weak yen. The Financial sector as a whole rallied, with investment banks/brokers and insurance sub-sectors leading the way. Real estate stocks within the Infrastructure sector enjoyed the strongest outperformance, as the BOJ's monetary policy outlook provided some relief against fears of hasty monetary tightening. Heavy machinery stocks within the Capital Goods sector also performed strongly on expectations that Japan's increased defence spending would benefit defence contractors in addition to expectations of a recovery in the machinery cycle. In terms of style, value continued to outperform growth stocks in Japan.

1.4 April-June 2024

The Japanese equity market was relatively directionless during the second quarter, but managed to close 1.69% (TOPIX Total Return Index) higher. A last-minute rally toward the end of June helped the Japanese equity index to extend its positive returns for seven consecutive quarters. In the absence of fresh catalysts to generate some immediate upside in the market, investor enthusiasm seems to have softened. International investor fund flows, where large inflows had been a major force behind the spectacular rally in the first quarter, turned into a net outflow for five consecutive weeks up to the third week in June. Management guidance for the current fiscal year to March 2025 expects a mid-single-digit rate of decline in corporate earnings, which dampened the sentiment of some investors who counted on continuing positive momentum.

What caught investor attention more than the equity market, which lacked a decisive trend, was the distinct weakness of the Japanese yen despite the narrowing interest rate gap between the US and Japan. The US 10-year Treasury yield declined from its recent peak of 4.70% in April to fall as low as 4.22% at one point this month. The 10-year Japanese government bond (JGB) yield hovered above 1.0%, up from 0.6% at the beginning of the year. Officials from the Ministry of Finance continue to warn of possible market intervention to deal with excessive currency movement. Yet, the foreign exchange market defied and ignored these market and non-market signals, sending the yen plunging to a thirty-eight-year low against the US dollar and an all-time low against the Euro since its creation in 1999. Various explanations are offered by market observers, such as increasing capital outflows due to international diversification by domestic retail investors and structural changes in components of the current account surplus, which would not necessarily entail the repatriation of corporate earnings from overseas. However, they do not yet seem to provide a convincing explanation for the accelerating drop in the yen's value. The erosion of total returns from investing in Japanese stocks from the viewpoint of international investors due to currency depreciation, despite local share price appreciation, could have also induced some fund outflows.

Japan's economic performance remained mixed. Industrial production growth, which fell by 0.9% (mom) and disappointed in April, recovered somewhat sharply in May, increasing by 2.8% (mom), compared to the expected 2.0%. The rebound was broad-based with thirteen out of fifteen industries surveyed recording positive gains. Automobile production led the way, gaining 18.1% (mom). The forecast index, however, predicts a volatile production trend over the coming months, and future visibility remains unclear.

While the overall market remained largely flat, there was some noticeable sector performance divergence. The Financial sector was the strongest performer, led by property and casualty insurance stocks. They announced medium-term plans to accelerate the unwinding of cross-shareholdings and to increase the scale of buyback programs. Banks also performed well on expectations that higher interest rates will boost net interest margins and earnings. While value stocks continued to outperform growth stocks, the performance gap has narrowed. This helped the growth-oriented Information/System sector to rebound and recoup some of its earlier underperformance. On the other hand, the Automobiles sector declined and underperformed, failing to respond positively to the depreciation of the yen, even though it is the most currency-sensitive sector. The Infrastructure and real estate sectors proved especially vulnerable to rising interest rates and therefore underperformed.

2. Management Activities during the year

The AIF aims at investment performance linked to the TOPIX ("the benchmark"). For cash equities, the AIFM traded individual stocks to keep their investment ratios nearly equivalent to those of the benchmark.

Furthermore, the AIFM utilized futures as usual for effective cash equitization.

3. Performance of the AIF compared to the benchmark

For the year, the AIF outperformed the benchmark as below.

	Benchmark Performance	Net asset value of the AIF [1]	Difference

[1] *The distribution of the AIF is assumed to be reinvested.*

Percent change for the year	**+29.7%**	**+32.5%**	**+2.9%**

The difference in performance is mainly attributable to:

- Dividends from stocks held by the AIF
- Income from stock lending
- Costs incurred by the AIF due to management, listing, and index license fees

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<Important Information>

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