

COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

---

---

Public Investment Memorandum

ECM Feeder Fund 2 LP  
(Effissimo Capital Management, Pte. Ltd.)  
Global Public Equity

---

---

Raymond J. Schleinkofer, CFA  
Senior Portfolio Manager, Traditional Investment Strategies

Jeffrey R. Burton, CFA, PRM  
Senior Portfolio Manager, Non-US Public Equity

May 4, 2018



### **Recommendation:**

Staff, together with Aksia, LLC, recommends that PSERS invest up to \$200 million in ECM Feeder Fund 2, LP and/or related investment vehicles (severally and collectively "Fund"). This recommendation is based on our assessment of the investment strategy, the manager's demonstrated track record and the strategic fit within the overall global equity program.

### **Firm And Vehicle Overview:**

Effissimo Capital Management, Pte. Ltd (Effissimo or the Firm) was founded in 2006 by Yoichiro Imai, Takashi Kousaka and Hisaaki Sato. Effissimo is a bottom up fundamental value investor that invests in the securities issued by Japanese corporations that trade at substantial discounts to intrinsic value. The firm manages \$6.8B in total AUM including \$6.5B in the flagship master feeder fund and a co-investment vehicle for special situations. The capital invested by the principals, related parties and affiliates represents approximately 10% of AUM and is the Firm's second largest investor. Effissimo employs twenty-two individuals including a ten-person investment team based in Singapore. The Fund's investment advisor is registered with the Monetary Authority of Singapore and is an exempt reporting advisor with the U.S. SEC. The firm is wholly owned by the directors and employees, and there are no outside equity owners.

The Fund is structured with US Onshore and Cayman Feeders investing into the ECM Master Fund, which operates as a Cayman Unit Trust. While various share classes and fee arrangements exist, all investors have the same liquidity rights. Effissimo offers both U.S. Dollar and Japanese Yen share classes (we have elected the U.S. Dollar share class).

### **Market Opportunity:**

Japan is the second largest equity market in the world with \$6.3T in market capitalization and over 3,600 companies listed.<sup>1</sup> Japanese companies represent a full 17% of the MSCI World Ex US Index. Its highly liquid capital markets are grounded in a transparent, democratic, legal system that is respectful of private property rights. Japan is the third largest economy in the world with GDP per capita of \$38,400.<sup>2</sup> Efficient infrastructure, low crime and world-class companies like Softbank, Toyota and Sony make Japan a critical component of a global equity portfolio.

Nevertheless, corporate Japan trades at a PE ratio of 13.2x vs. 21x for the US, 16x for developed international markets generally (MSCI EAFE) and 15x for Emerging Markets. Driving the pessimistic attitude has been a 30 year struggle with deflation, debt, aging demographics, rapid political turnover and a corporate culture that often subjugated shareholder rights to other management priorities. The TOPIX still trades 11% below the peak levels achieved in 1989.

Although Japanese valuations remain below those of other developed nations, this corporate and economic backdrop is changing. Prime Minister Shinzo Abe, now in his 6th year, has served longer than the previous five leaders combined and has brought policy continuity and reform. The corporate tax rate has fallen from 41% to 31% on his watch and a recently announced credit could reduce rates to the mid-twenties for companies expanding through capital expenditures and increasing employee wages. Bank of Japan president Haruhiko Kuroda has engaged in an unparalleled quantitative easing program that has nearly quadrupled the central bank's balance sheet to 95% of GDP.<sup>3</sup> Unemployment remains at an enviable 2.7% and the number of foreign workers in Japan has grown nearly 60% since Abe came into office.<sup>4</sup> Moreover, Japan has become a prime tourist destination as emerging Asia spends its growing

---

<sup>1</sup> Source: Bloomberg and MSCI. Note: Japan falls to third if all of the China A shares currently excluded from standard indexes are incorporated.

<sup>2</sup> International Monetary Fund

<sup>3</sup> Source: Bloomberg

<sup>4</sup> Japan Ministry of health, labor and welfare



wealth. In 2017 foreign visitors rose 19% to 29M.<sup>5</sup> Perhaps most importantly, corporate Japan has seen a growing focus on shareholder value. The FSA Council of Experts has published a Stewardship Code, which aims to improve corporate governance by improving proxy voting participation and investor accountability. The code offers recommendations effectively requiring independent directors on corporate boards, enhancing transparency of management compensation and requesting companies to commit to a minimum 8% return on equity in principle.<sup>6</sup>

### **Investment Strategy:**

While Effissimo will likely benefit from the auspicious backdrop for Japanese equities, such an environment is not central to the manager's strategy. Indeed much of the manager's impressive track record was delivered in years when the outlook for Japan was far less sanguine. Notwithstanding the improving environment, corporate Japan frequently suffers from inefficiencies that can be eliminated through the cooperation of active shareholders and properly aligned management teams. Effissimo seeks to invest in securities which trade at a substantial discount to the combined business and asset values. (i.e. "intrinsic value."). The manager then looks to profit by: (a) realizing capital gains as security prices revert to fundamental value over the long term and (b) receiving dividend, interest, and other distribution payments if and when declared and paid by each portfolio company.

As stipulated in Effissimo's proxy voting guidelines, the Fund shall exercise the proxies of each investment security such that it results in long term capital gains. In circumstances, where there is concrete evidence that the management of the portfolio company poses a threat to the value of the portfolio company, or where Effissimo's proposals or recommendations may boost the value of the portfolio company, Effissimo may make proposals or recommendations to such portfolio company. If the portfolio companies are unwilling to accept the Fund's proposals or recommendations and whereby such stalemate is deemed likely to have a negative impact on the portfolio company's value, the Fund may exercise a variety of shareholder rights in order to increase future and preserve current value.

While Japanese management teams have often ignored shareholder rights, the legal system offers a broad array of shareholder protections for investors willing to enforce their rights. For example, by owning just 1% the total voting rights of a company consecutively for six months or more, a shareholder can propose resolutions at the annual general meeting of shareholders. At 3% a shareholder can request to inspect the accounting books and records or call an extraordinary shareholders meeting. Finally with 33.4% of the voting rights (for six consecutive months) the shareholder can take "negative control" of the company (i.e., they can veto major management actions). Effissimo prefers situations where these actions are taken with minimal active involvement. The manager's location in Singapore provides the legal protections and operational flexibility of an international shareholder while still offering full regular access to Japan.

### **Portfolio Construction:**

Effissimo's portfolio construction philosophy ensures that returns reflect the outcome of the manager's stock selection and active involvement rather than market beta. Core elements of this philosophy are:

- **Concentration**
- **Sector Agnostic**
- **All Capitalization Portfolio**
- **Japan Only**
- **Fully Invested Equity Exposure**

---

<sup>5</sup> Wikipedia Tourism in Japan

<sup>6</sup> Note ISS recommends voting against the appointment of executives failing to achieve an average 5% ROE over the trailing five year period.



### **Investment Instruments:**

The vast majority of Effissimo's positions are expressed through publicly traded equities; however, the manager has opportunistically taken positions in corporate debt when it has identified opportunities that offer a risk/return profile similar to that of its public equity positions. Listed options are occasionally utilized to hedge the portfolio or refine exposure to a specific equity situation.

### **Investment Team:**

Misters Imai and Kousaka manage the portfolio jointly and are responsible for all investment ideas and the assignment of analytical tasks. The portfolio managers drive all interaction with corporate management teams. They are supported in this effort by a team of eight investment professionals. Founding partner Hisaaki Sato acts as the Firm's chief financial officer and head of compliance and is supported by an 8-person (full time) operational and administrative staff. Key individuals and their backgrounds are listed in Appendix A.

### **Investment Highlights:**

<b>Uniquely Skilled Manager With A Broad Opportunity Set</b>
Over the past decade, Effissimo has demonstrated an ability to extract value from the highly inefficient Japanese equity market. Since inception in 2006 Effissimo has delivered net annualized returns of 12.9% vs. 2.0% for the MSCI Japan Index with equivalent volatility. Effissimo has outperformed the benchmark index in 81% of historical rolling one-year periods and in every rolling three-year period since inception.
<b>Repeatable Process</b>
While corporate governance in Japan has often been indifferent to the interests of public shareholders, the Japanese legal system offers substantial protections for investors. Effissimo's straightforward strategy of defending these rights when necessary, in a firm but discreet manner has proven successful.
<b>Favorable Economic and Political Backdrop</b>
While Effissimo's strategy is not dependent on Japanese equity beta, the economic reforms of Prime Minister Shinzo Abe and the monetary policies of Bank of Japan governor Haruhiko Kuroda provide a positive tailwind for Japanese equities. Additionally, a series of corporate reforms adopted by the Japanese FSA serve as a catalyst to advance shareholder rights and return on equity for Japanese shareholders.
<b>Serves Our Long Run Portfolio Construction Goals</b>
The manager's deep fundamental work on core positions serves to inform our internal management efforts helping to improve the equity portfolio overall. It also offers a more nimble vehicle for applying its private equity-like strategy should the market experience a severe correction. Over time we anticipate co-investment opportunities will offer another avenue to reduce the cost of equity alpha.
<b>Enhances Overall Portfolio Efficiency</b>
Effissimo's highly concentrated portfolio construction approach is designed to ensure that security selection and active involvement drive returns. This is evident in the low correlations with broad equity indexes. Importantly, this strategy contrasts with our existing large capitalization managers (Marathon, Baillie Gifford and TCI) providing diversification benefits as evidenced by the historical excess return correlations of 0.44, -0.04, 0.26, respectively.

### **Investment / Risk Considerations:**

<b>Headline Risk</b>
Effissimo has adroitly avoided the publicly waged campaigns that have impeded the effectiveness of similar strategies in Japan. Nevertheless, Effissimo is routinely the leading shareholder in core positions, requiring public filings that can attract press attention no matter how reticent the manager may be.



<b>Keyman Dependence</b>
The strategy is highly dependent upon Misters Imai, Kousaka and Sato and returns would likely suffer in their absence. We take comfort from the fact that the portfolio managers have the vast majority of their net worth invested in the fund. They, their affiliates, related parties and the Firm's employees represent 10% of total assets. It is also reassuring that the three have worked together for the majority of their professional careers.
<b>Tracking Error</b>
Effissimo's strategy is driven by stock selection without regard for benchmark composition. Historical tracking error has been 11% per annum. Short term periods of underperformance are almost assured. Historically such periods have been followed by sharp rebounds on both an absolute and relative basis. We would look to utilize these opportunities to build our position.
<b>Concentration</b>
Effissimo's portfolio is highly concentrated meaning that individual positions will have a meaningful impact on the overall portfolio. This concentration can boost volatility and the downside risk in scenarios where the manager's thesis proves incorrect. Offsetting this risk is the fact that most holdings are trading at deep discounts and reflect very little optimism from the market.
<b>Liquidity</b>
The success of Effissimo's strategy is highly dependent upon patient capital. In many instances the manager will own over 10% of a portfolio company and in some cases this can grow to substantially greater figures. Effissimo's investor liquidity terms reflect these requirements. Hard lock ups, substantial redemption notice, gates and side pocketing combine to assure that manager will not be forced to exit positions prematurely.
<b>Asset Growth</b>
Effissimo has grown to \$6.8B in AUM through performance and subscriptions. While this reduces the potential impact of small capitalization companies, economies of scale are present in active situations, allowing Effissimo to amass greater representation in mid and large cap companies.

**Finance Committee Disclosure:**

Relationship with Aksia:	None Disclosed
Introduction Source:	Investment Office Staff
Placement Agent:	None Used
PA Political Contributions:	None Disclosed
Potential Conflicts:	We are not aware of Effissimo having any material investment conflicts.
PSERS History with the Investment Manager:	This investment will be PSERS' first investment with the manager.
PSERS Allocation Implementation Committee Approval:	May 4, 2018

**Oversight Responsibility:**

Investment Office:	Tom Bauer Raymond J. Schleinkofer Jeffrey R. Burton	Deputy CIO, Traditional Investments Senior Portfolio Manager Senior Portfolio Manager
External Consultant:	Aksia LLC	



## Appendix A: Manager Biographies (age attained in CY2018)<sup>7</sup>

### **Mr. Yoichiro Imai (40), Director of the General Partner and the Management Company**

Prior to founding the Management Company, Mr. Imai served as a Portfolio Manager for MAC Asset Management, Inc., and MAC Asset Management Pte. Ltd. Previously from 2003 through 2004, Mr. Imai served as a Fund Manager at Nikko Asset Management, Inc., Prior to being promoted to Fund Manager, Mr. Imai held a variety of positions in the Value and Active Quantitative Strategies Group at Nikko Asset Management. Mr. Imai holds a Bachelor of Economics from Yokohama National University.

### **Mr. Takashi Kousaka (40), Director of the General Partner and the Management Company**

Prior to founding the Management Company, Mr. Kousaka served as a Portfolio Manager for MAC Asset Management, Inc. and MAC Asset Management Pte. Ltd. Previously, from 2002 through 2004 Mr. Kousaka was Venture Partner at Stockton Funds LLC, an investment fund specialising in special situations, venture capital and structured finance investments. During his tenure at Stockton Funds Mr. Kousaka also served as Chief Financial Officer of Mediacode LLC, a media application venture sold to Yahoo!. Prior to his tenure at Stockton Funds LLC, Mr. Kousaka was Founder, Director and President of Kick, Inc., which was sold to Sony Corporation of America. Mr. Kousaka started his career as a Senior Engineer at MyPoints, Inc., which was subsequently sold to United Airlines. Mr. Kousaka holds a Bachelor of Science from the University of California at Berkeley and an MBA from the University of Pennsylvania.

### **Mr. Hisaaki Sato (45), Director of the General Partner and the Management Company**

Prior to being nominated as Director of the General Partner and the Management Company, Mr. Sato served as the Chief Financial Officer for MAC Asset Management Pte. Ltd and held a variety of roles in the Corporate Planning and Finance Department at M&A Consulting, Inc., including the support of founding Dot Commodity, an online commodities trading venture. Previously, from 2002 to 2004, Mr. Sato was employed at PricewaterhouseCoopers in their Valuation and Strategic Consulting Division. Mr. Sato started his career in the Risk Management and Control Division of the Metal Sector at Mitsui & Co. Mr. Sato holds a Bachelor of Economics from the University of Tokyo.

---

<sup>7</sup> Source: Effissimo Capital Management

Manager Recommendation Memo

May 3, 2018

Board of Trustees  
 Pennsylvania Public School Employees' Retirement System  
 5 North Fifth Street  
 Harrisburg, PA 17101

Re: ECM Feeder Fund 2 LP

Dear Trustees:

Aksia LLC, having been duly authorized by the Board of PSERS, has evaluated and hereby recommends a direct allocation to ECM Feeder Fund 2 LP ("ECM") in line with PSERS Investment Policy Statement, Objectives, and Guidelines. It is further recommended that PSERS invest up to \$200 million in ECM.

Effissimo Capital Management Pte Ltd ("Effissimo") was founded in June 2006 by Yoichiro Imai (PM) and Takashi Kousaka (PM), both of whom were employed at MAC Asset Management ("MAC"), which managed \$3.8bn at its peak in March 2006. Prior to MAC, Imai served as a fund manager at Nikko Asset Management from 2003 to 2004 and Kousaka was a venture partner at Stockton Funds LLC from 2002 to 2004. The two left MAC in June 2006 to launch Effissimo, which was seeded by a US-based university which remains one of the firm's top 5 investors today.

The fund pursues a Japan-focused deep value and event driven strategy with an overlay of activism intended to create value proactively over a 2 to 5-year time frame, or longer. The manager is seen as a "hard" activist, meaning that the manager is willing to confront boards and/or management teams publicly through proxy contests or legal action if shareholder friendly actions are not taken. In Japan, especially in the small and mid-cap space, many believe corporate governance and capital allocation decision making to be less rigorous than in the US or Europe, and given recent policy/regulatory changes, this could create an accommodative environment for an activist approach. Aksia has a favorable view on the manager's research skills and ability to extract value. The manager also takes advantage of their reputation to elicit company management's awareness to take actions by themselves (e.g. initiate share buy-backs). This is one of the core strengths of Effissimo, as without much action from the manager's side, company management may react to shareholders' benefit. Since inception, the fund's core focus has shifted from small-to-mid cap (\$500 to \$5bn) to mid-to-large cap (\$5bn to >\$20bn) stocks relative to AUM growth. By sector, there tends to be a bias to Financials, Consumer Discretionary, Industrials and IT. The manager appears to have a disciplined business philosophy and has been managing one strategy with the same investment philosophy since inception.

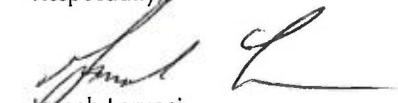
Aksia's recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines:

- Due diligence of the investment process, including a review of their investment strategy, investment team personnel and structure, and risk management;
  - Most recent investment due diligence visit conducted February 2, 2018
- Due diligence of ECM Feeder Fund 1's operations, including an operations and infrastructure review, regulatory and compliance review, PPM review, Form ADV review, and Financial Statement Review;
  - On-site operational due diligence visit conducted May 17, 2017 for the 2017 review. The most recent on-site visit for the 2018 review of Fund 1 & Fund 2 (in progress) was conducted March 16, 2018.
- Evaluation of the ECM strategy within the context of the current investment environment; and
- Appropriateness of ECM as a component of the PSERS' portfolio.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in ECM, since their needs, objectives, and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of ECM. Aksia manager recommendation memos should be reviewed with other Aksia due diligence materials, including the due diligence reports. In addition, please consult your tax, legal and/or regulatory advisors before allocating to any private investment fund.

Please feel free to contact us should you have any questions about this recommendation.

Respectfully,



Joseph Larucci  
 Partner, Head of Equity Strategies



Simon Fludgate  
 Partner, Head of Operational Due Diligence