

## First a green jacket, now a green light for Japan?

by Michael Clough

Two weekends ago Hideki Matsuyama became Japan's first male winner of one of golf's four major championships by claiming the Masters at the prestigious Augusta National Golf Club. Only three of the world's top 100 ranked male golfers are from Japan. The country is underrepresented in the upper echelons of the golfing world and it is often underrepresented in investors' portfolios too.

Today, Japan accounts for 7.5% of the developed world global equity market, much smaller than the 44% it once accounted for in the late 1980s<sup>1</sup>. Indeed, the equity market is still 24% lower than the peak reached over 30 years ago. Back then the four largest companies in the world were Japanese (all banks). Now you're looking around the 50th largest before you find a Japanese name (Toyota) and past the 150 mark to find the first Japanese bank (MUFG Bank). The 'Lost Decades' is a phrase that refers to the period of low economic growth and low inflation (otherwise known as stagnation) that has crippled Japan's economy ever since that equity market bubble of the late 80s burst. Combine the scars from these events with a notoriously ageing society and less favourable corporate governance than many developed market peers and it is perhaps unsurprising that Japan hasn't been number one on investors' lists of late. But there are reasons to be more optimistic going forwards.

Former Prime Minister Shinzo Abe introduced his three arrows approach, which became known as 'Abenomics', in 2012 to help drive the economy out of its sluggish state, identifying loose monetary policy, expansive fiscal policy and structural reform as prerequisites. Whilst these were never going to be quick fixes, Japan's current Prime Minister Yoshihide Suga has made clear his intentions to ensure the policies of his predecessor endure. His pro-deregulation stance should also be supportive.

Monetary policy in Japan has been ultra-loose for years, involving negative interest rates, massive bond purchases, yield curve control and equity purchases. Whilst the central bank recently amended its approach towards equity ETF purchases to only intervene during market falls rather than steadily increasing its holdings, they still committed up to ¥12trn (\$110bn) of equity investments each year<sup>2</sup>.

Whilst these approaches have failed to ignite inflation to date, they remain hugely accommodative.

The impact of fiscal policy has been mixed over the years and a rise in consumption tax in 2014 and 2019 did little to spur on growth and inflation but government intervention through the coronavirus pandemic has been massive. Across three different stimulus packages throughout 2020 the government injected the equivalent of almost \$3 trillion into the economy, accounting for over 50% of GDP, the highest of any G20 country (the US is at 26% of a \$20trn economy).

On structural reform, one key component has been improving corporate governance, something that has long been criticised in Japan. Hefty cash piles may be indicative of a misallocation of capital, one facet of corporate governance that policy is designed to address. There is greater focus now on shareholder returns through higher dividend distributions and share buybacks. Historically the dividend yield of Japanese equities has lagged that of the global equity market. Now it offers a small yield premium, despite a lower payout ratio compared to peers, suggesting there is room for this premium to grow.

The Japanese equity market is also well placed to benefit as economies reopen from pandemic related restrictions. Whilst energy exposure is very limited, the index has significant allocations to other cyclical sectors including industrials, automotives and financials which should do well as economic recovery takes hold. Current valuations at the index level might not get the deepest value investors too enthusiastic but a forward price earnings ratio of 17x is cheaper than both Europe and the US.

Risks do remain of course. Whilst Japan has kept coronavirus fatalities well below that of other developed economies, there has been a surge in cases in recent weeks and the country's vaccination rate is one of the lowest globally. The issues around ageing demographics must also still be addressed. However, there are certainly reasons to be cheerful. Hideki Matsuyama took home the green jacket at Augusta National. Perhaps now is the time for investors to give Japan the green light.

<sup>1</sup> [www.investmentoffice.com/Asset\\_Management/Observations/Indices/Japanese\\_Stock\\_Market\\_Bubble\\_in\\_the\\_late\\_1980s.html](https://www.investmentoffice.com/Asset_Management/Observations/Indices/Japanese_Stock_Market_Bubble_in_the_late_1980s.html)  
<sup>2</sup> [www.boj.or.jp/en/announcements/release\\_2021/k210319a.pdf](https://www.boj.or.jp/en/announcements/release_2021/k210319a.pdf)



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