

Rediscovering Japan with Nomura Asset Management

Historically, Japan has been a difficult market for many overseas investors to fully comprehend, with several misconceptions about the Japanese corporate sector likely weighing on decisions to initiate or increase allocations. “Why should I invest in a market with little to no economic growth?” is still one of the most frequently asked questions about Japan, even though the Japanese equity market has become a healthy one driven by corporate fundamentals and earnings since valuations normalized post Global Financial Crisis (Chart 1), and a sizable gap between corporate and economic performance has grown over the last 30 years. In fact, recurring profits have nearly tripled since the 1990’s, while Japan’s nominal and real GDPs have essentially been flat (Chart 2).

Chart 1: Historical TOPIX Performance vs EPS

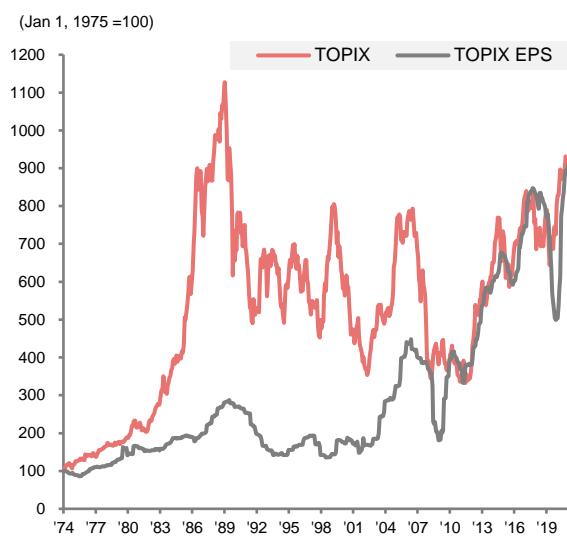
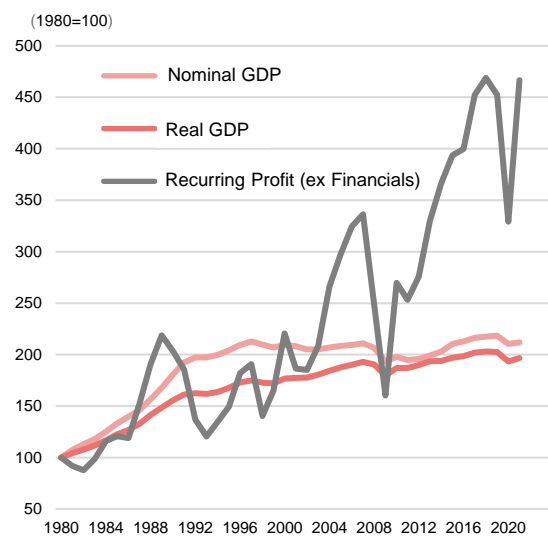


Chart 2: Japan’s GDP vs Corporate Earnings



Source: Chart 1: Bloomberg. Chart 2: Datastream as of March 31, 2022.

A low Return on Equity for the market overall has been another common reason given by investors for not being able to fully buy into Japan. While it is true that a large percentage of the Japanese companies listed on the TOPIX index have low ROEs, that doesn’t mean there isn’t an abundance of investment opportunities in the Japanese equity market. Only 21% of TOPIX constituents have an ROE above 15% compared to 58% of stocks listed on the S&P 500, but because the TOPIX is a much broader index, there are actually 378 companies with an ROE above 15% listed on the TOPIX compared to 275 issues for the S&P 500 (Chart 3). Additionally, the companies with high ROEs in Japan are trading at much more attractive valuations than those in the US (Chart 4), providing investors with a sizable universe of cheap quality stocks.

Chart 3: Stocks with ROE of 15% or higher

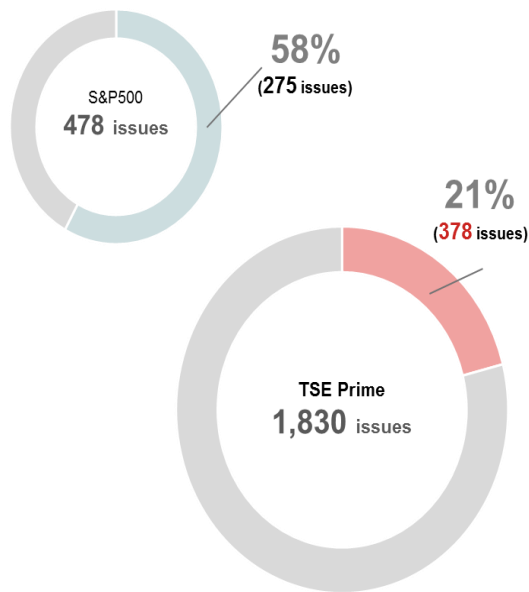
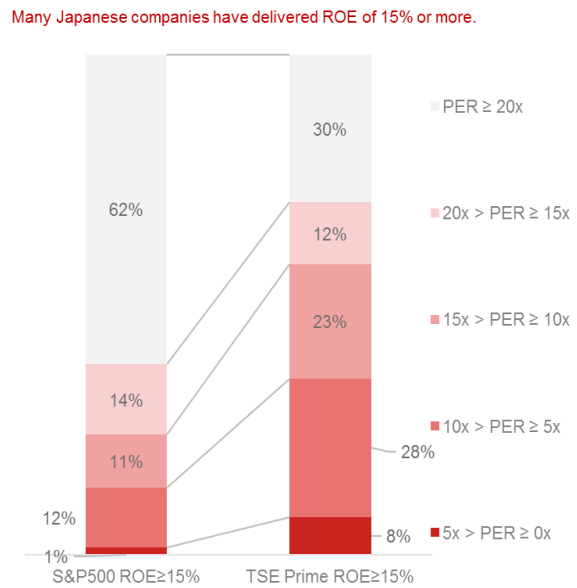


Chart 4: Valuations of stocks with ROE of >15%



Source: Chart 3 and 4: Nomura Asset Management based on FactSet Data as of March 31, 2022.

More importantly, perhaps, Japan's capital markets are modernizing, and even companies with lower ROEs may present attractive investment opportunities as corporate governance reforms and increased engagement activity continue to facilitate positive changes in corporate attitudes and improved capital efficiencies. Shareholder returns, which we believe is a key indicator of this change, have already doubled from 10 trillion JPY to over 20 trillion JPY since 2013, but there is still plenty of room for further growth.

In addition to the above, there are many shorter term reasons to take a closer look at Japanese equities now. The Japanese market is trading at its most attractive valuations relative to global equities in 50 years, and the real effective exchange rate shows the Japanese yen is even cheaper than in 1985 before the Plaza Accord. Inflation in Japan is also still in the manageable 2% range, putting the BOJ in a unique position amongst central banks of developed markets where monetary policy will likely remain accommodative until at least next spring. A potential global economic slowdown will obviously impact Japanese equities, but the expected recovery in domestic consumption and the full fledged re-opening of Japan are expected to help offset any expected downturns in the global macro environment. In the end, we believe there are many Japanese companies that are underappreciated global market leaders in key industries of the future. It is our hope that Nomura Asset Management will be able to aid investors rediscover Japan and take advantage of the compelling opportunities being provided by the market.

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