

Japan Equity Monthly

October 2021

9 November 2021

We explain how the recent lower house election win gives Japan's new prime minister a free hand to pursue policies aimed to help the economy recover from COVID-19. We also analyse why a weaker yen no longer provides as much of a boost to equities.

By Naoki Kamiyama, Chief Strategist

Election win gives new PM a free hand to pursue post-COVID-19 economic recovery

Japan's ruling Liberal Democratic Party (LDP) and its coalition partner Komeito comfortably won the lower house election on 31 October, taking 293 of the 465 seats in contention and gaining an "absolute stable majority". It was a major victory for Prime Minister Fumio Kishida, who had just taken office at the beginning of October and needed a convincing win to solidify his political foothold. As the coalition had been expected to struggle at the polls, the win was greeted with relief by the market, helping ease concerns foreign investors may have held towards Japanese equities prior to the election. An absolute lower house stable majority gives the coalition control of the 17 standing committees and grants it the committee chairperson posts, permitting it to move legislation through committees in case of a tie vote. This means Kishida can pursue his policies with minimum interruption; in addition, many aspects of Abenomics will likely be left intact.

Of immediate interest to the market is how Kishida can shore up Japan's medical capabilities, an area where the previous administration under Prime Minister Suga fell short. The medical system was nearly overwhelmed at the height of the pandemic even though Japan's coronavirus cases in proportion to the population were low compared with those of other developed economies. Enhancing PCR testing, in addition to establishing field hospitals and mobilising medical personnel during emergencies are some of the measures Kishida is expected to pursue. Such measures are seen as crucial towards further re-opening the economy, allowing the country to better handle future coronavirus waves.

Another area of interest is the supplementary budget Kishida aims to compile. The supplementary budget is expected to fund measures such as cash handouts for people hit by the pandemic. Household spending stemming from such handouts is unlikely to boost GDP, but it could nudge the economy towards recovery as it did in the US. Not all of Kishida's agenda will be market friendly. He did water down his proposal to raise the capital gains tax rate, but he appears to be sticking to his pledge to relax rules that currently require companies to disclose earnings reports every quarter, which, if realised, could potentially mean less information for investors as some companies may opt out of quarterly reporting. That said, the European Union ended obligatory quarterly financial reporting but many companies continue to release earnings reports every quarter, and this could provide potential hints towards how the issue could be handled in Japan.

Why is a weaker yen no longer as supportive for Japan equities?

Recent market movements suggest that a weaker yen is no longer as supportive for Japanese equities as it once was. The Japanese currency has weakened steadily this year against the dollar amid expectations that US and Japanese monetary policies will diverge; in October, it fell to a four-year low, nearly touching 115 yen to the dollar. However, the yen's decline has had a limited impact on equities, with the Nikkei Stock Average moving sideways or even falling during bouts of yen weakness. Before we explore why the weak yen is no longer as supportive for

equities, we need to go back to the early years of Abenomics. The Nikkei was at around 9,000 when the Abe administration's economic policies started late in 2012. The index's rise towards 20,000 three years later can be attributed almost entirely to a weaker yen, which sank on the Bank of Japan's aggressive monetary easing. At the time, Japanese companies did not have to do much to improve earnings; exporters' earnings were automatically boosted by the weak yen and the broader equity market rose in turn. A weak yen came to be strongly associated with rising equities.

What escapes many, however, is that currency levels had less of a fundamental impact during the next market phase, which saw the Nikkei reach 24,000 in 2018. By this time Japanese exports had increased significantly. It was no longer the price effect of a weaker yen that was helping exporters, but they were instead benefitting from the sheer increase in export quantities. Currently, fiscal stimulus measures in countries re-opening from the pandemic like the US and the resulting surge in demand for Japanese goods is more important for exporters' bottom line than foreign exchange rates.

When the yen weakens significantly, the negative effects of the phenomenon, such as the higher cost of importing goods like crude oil, are often highlighted. The logic behind such views is that higher prices of imports will negatively affect the economy recovering from the pandemic. However, we need to remember that Japan exports more than it imports. This means that a weak yen will only become a serious issue if demand for Japanese goods drops so much that the country ceases to be a net exporter but still needs to continue importing some basic goods.

Market: Japanese stocks decline in October

Japanese equities ended October lower with the TOPIX (w/dividends) down 1.42% on-month and the Nikkei 225 (w/dividends) down 1.89%. The market was initially weighed down by US debt ceiling concerns as well as worries about a slowdown in the Chinese economy. Mid to late month, share prices were negatively affected by inflation concerns. The market trimmed some losses on continually declining COVID-19 cases and a weakening yen, although these factors were unable to prevent the market from declining overall in October. Of the 33 Tokyo Stock Exchange sectors, 10 gained, with Mining, Nonferrous Metals, and Glass & Ceramics Products posting the strongest gains. In contrast, 23 sectors declined, including Air Transportation, Electric Power & Gas, and Land Transportation.

Exhibit 1: Major indices

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	4.9%	2.3%	0.9%	27.0%	69%
JGB Yield (%pt)	+0.05	+0.01	-0.02	+0.07	+0.12
JPY/USD	1.9%	1.4%	1.2%	6.0%	7%
JPY/EUR	-0.3%	-1.3%	-0.2%	4.7%	13%
MSCI World	-4.3%	-0.4%	6.9%	27.0%	78%
TOPIX	3.5%	4.5%	3.9%	24.9%	46%
TPX-100 (Large)	4.0%	4.9%	5.2%	28.9%	50%
TPX-400 (Mid)	2.7%	3.2%	0.8%	19.6%	39%
TPX-Small	3.1%	5.7%	5.2%	17.2%	42%

Source: Bloomberg, as at 29 October 2021

Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.1%	2.1%	1.9%	2.3%	2.1%
Price/Earn (e)	14.9	15.5	21.0	21.0	14.5
Price/Book	1.3	1.3	1.4	1.2	1.2
Daily Turnover	68	54	53	53	49
Market Cap.	752	706	709	602	525
MSCI World					
Div. Yield (e)	1.9%	1.8%	1.9%	2.2%	2.6%
Price/Earn (e)	19.4	20.6	21.2	22.5	17.2
Price/Book	3.0	3.0	2.9	2.4	2.0

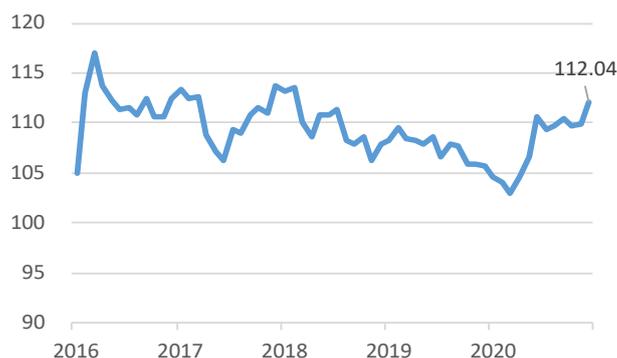
(e) stands for consensus estimates by Bloomberg. Turnover and market cap in JPY trillion. Source: Bloomberg, as at 29 October 2021

Exhibit 3: Major market indices

TOPIX



USD/JPY



Source: Bloomberg, as at 29 October 2021

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment. This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to

Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.