Investment considerations for investing in Japan

Global investors’ sentiment towards Japan continues to be very bearish. Given the improved domestic economic environment and the rich list of high quality companies trading at historically low valuation levels ASPOMA thinks this is not justified.

In this edition we share with you some of our latest observations about the Japanese economy, Japanese companies, share price developments and latest research.

1) Japan’s appealing macro and earnings outlook

Japan’s annualized first quarter GDP growth was recorded at 4.7% and the domestic news flow out of Japan continues to improve. While ignored by most investors amidst the continuing focus on the Eurozone and China, the interesting point is that data out of Japan has continued to surprise positively with consumption being the main driver of economic growth over the past four quarters.

Figure 1

Japan no longer has the lowest 10-year bond yield in the global investment universe. That distinction now belongs to Switzerland with a 10-year bond yield of 0.52%
Japan’s retail sales growth has accelerated for the last six months

The improving data from Japan have come before the post-quake reconstruction spending has really kicked in. 40% of the ¥15tn reconstruction budget for Tohoku was left unspent at the end of last fiscal year leaving ¥4.8tn to be carried over for extra spending in the current fiscal year.

Japan also stands out on earnings: This is reflected in the EPS YoY growth forecast (consensus) for this earnings season. The consensus is looking for 60% EPS growth against 10% in the US. While Japan’s EPS growth estimates might also be exposed to downward revisions, a high growth is well supported by the very depressed EPS comparison base as a result of last year’s disasters in Japan (earthquake, tsunami and nuclear accident).

Consensus YoY EPS growth forecasts for Japan are much higher than for Germany, US and UK.
We also get positive signals from the index-linked bond market which is pricing in positive inflation expectations and therefore an end to the deflationary environment in which lower and lower prices created a downward spiral of lower demand and production affecting negatively corporate profits and wages.

Figure 4
The index-linked bond market continues (for more than five month) to show positive inflation expectations

2) Investment Approach for Japan

In the context of our ASPOMA Japan Opportunities Fund launched in Q1 2012 we recently updated some research on the Japanese stock market which we would like to share with you:

Japan as the third largest world economy and the second largest stock market (TOPIX index comprising 1672 companies) provides a very rich and diverse investment universe. Japan is the home of many excellent world-class companies. These companies are spread over many sectors. Many Japanese companies with global leadership positions can be found in the capital goods sector (machinery, factory automation, semi production equipment, pneumatics, CNC, bearings, machine tools, construction machinery and engines) and the semiconductor materials sector (front- and back-end-process semiconductor materials, lithium-ion-batteries and LCD materials). The transportation equipment sector (eg automobiles and components) is another area where we believe many Japanese companies have global competitive advantages.
While the overall Japanese stock market has delivered disappointing returns over the past 20 years we have identified a reasonably large group of highly efficient and successful international companies which as a group were able to deliver outstanding operational results and share price performance during that time.

Figure 5
Internationally oriented Japanese companies have delivered strong absolute (+140% vs. TOPIX Index -40%) and relative share price performance during the past 16 years

Main characteristics of these internationally oriented companies are:

a) Superior sales and earnings per share growth (Figure 6);

b) Permanently higher return on equity and margins than the overall Japanese universe (Figure 6);

c) Outperformance of TOPIX Index in 14 of the past 16 calendar years (Figure 7);

d) Attractive absolute share price performance of +140% since 1996, surpassing American, European and German stock market returns.

Source: ASPOMA, Bloomberg
Internationally oriented Japanese companies deliver systematically higher margins and growth rates over many years resulted in higher share price performance.

Figure 6

Relative performance of internationally oriented universe vs. TOPIX Index by calendar years

Source: ASPOMA, Citigroup, Bloomberg

ASPOMA has launched a Japanese equity fund focusing on this universe of stocks. Using a disciplined stock selection process the fund invests in the 50 most attractive stocks from the Japanese investment universe.
The combination of an extreme low valuation level of the overall Japanese equity market (0.85x price to book ratio, a 40 years low) and an improving domestic economy provides an attractive investment environment for international investors. With our recently launched Japanese equity fund ASPOMA provides an interesting investment vehicle to take advantage of this environment.

To address different investor’s requirements currency hedged (against CHF and EUR) and non-hedged fund share classes are available.

For more information on the ASPOMA Japan Opportunities Fund (ASPJAPS LE) please contact ASPOMA Asset Management AG.

3) Research findings about Japan’s export success story

In this context we would also like to highlight a recent IMF Working paper which looked into the question if Japan’s export successes have been the result of “divine wind” (surge of exogenous external demand to China/ASEAN driven) or of productivity gains of Japanese firms now materializing after long fought restructuring efforts. The study supports our view that the quality of the products in combination with a substantial improvement in productivity and international competitiveness were the main factors behind Japan’s successes in export oriented industries.

The full research document can be downloaded at: