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# HOW A WEAKER YEN AFFECTS JAPANESE EXPORTERS

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It is widely known that Japanese equities tend to have an inverse relationship to the performance of the yen. Namely:

- When the yen is appreciating, Japan's stocks face a stiff headwind and tend not to deliver their strongest returns.
- When the yen is depreciating, Japan's stocks tend to find themselves in a much more favorable environment and have delivered much stronger performance.

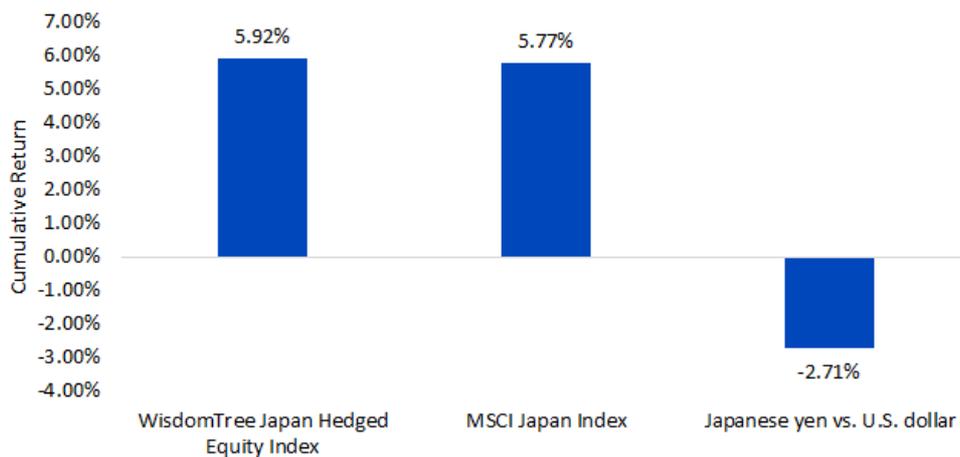
When we look thus far at 2018, data from Japan's Ministry of Finance has indicated that more than \$30 billion has left Japanese equities from foreign investors.<sup>1</sup> Clearly, foreign investors haven't been happy with Japan as an allocation, and a probable factor contributing to this activity is that people have seen the headline number for the Japanese yen/U.S. dollar exchange rate touching below 105—quite a strong level!

## **Warning: Yen Does Not Move in a Single Direction**

While foreign investors would clearly prefer to see the yen/U.S. dollar exchange rate touching levels above 110 and moving toward 120, we caution them not to forget about Japan just because the yen is currently on the stronger end of its trading range. Markets can move quickly, and during bouts of yen weakness, Japanese equities can be interesting tactical trading ideas.

**Example: March 23, 2018, to April 20, 2018, Saw a 2.71% Yen Depreciation—What Did Equities Do?**

**Japan's Equities Reacted Well to Recent Yen Weakness (3/23/18–4/20/18)**

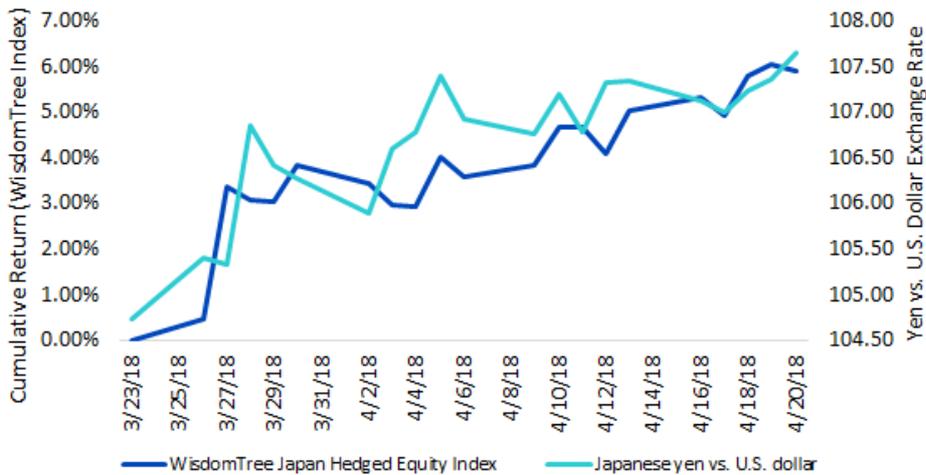


Source: Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index.

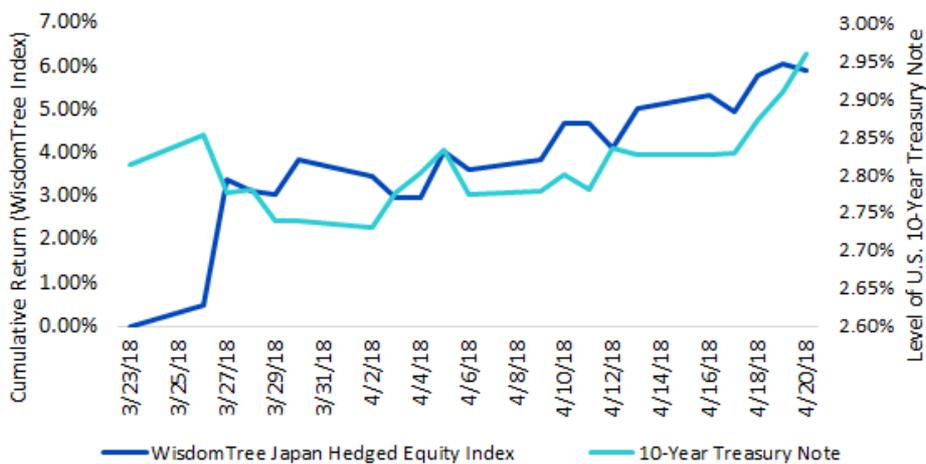
- Clearly, Japan’s equities reacted well to the downward movement in the yen.
- The [WisdomTree Japan Hedged Equity Index](#) focuses its approach on exporters—this would lead us to expect that it should respond more strongly to the yen’s moves. We see here—admittedly over a short period—that this was the case compared to the broader [MSCI Japan Index](#).

**Key Relationships: The Yen and [U.S. 10-Year Treasury Note](#) Interest Rates**

WisdomTree Japan Hedged Equity Index Has Responded to Recent Weakening Yen (3/23/18–4/20/18)



WisdomTree Japan Hedged Equity Has Also Shown a Short-Term Positive Relationship to U.S. 10-Year (3/23/18–4/20/18)



Source: Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index.

- On the left side, we can see the clear relationship between a weakening yen against the U.S. dollar and the performance of the wisdomTree Japan Hedged Equity Index. This is highly related to our first chart—it just shows a way to look at the relationship from a more “across time” or “[correlation](#)” perspective.
- On the right side, we can see that there is also a relationship between the WisdomTree Japan Hedged Equity Index and the level of the U.S. 10-Year Treasury note. Historically, we’ve seen a positive correlation between a rising U.S. 10-Year note and the performance of the wisdomTree Index shown here—and with the 10-Year getting very close to 3%, it is important to bring this relationship back to the forefront.

In 2018, the yen had been one of the strongest-performing currencies, despite the rise in the 10-Year. In late April, the yen started coming under more pressure that coincides with the rise in U.S. versus Japanese yield differentials.

We'd point out that from a pure equity valuation perspective, we find Japan to be one of the more attractive markets globally. This starts with the compensation an investor takes to own equities over safer assets like bonds. The earnings yield risk premium over Japanese bond yields is among the highest globally—given a 10-year Japanese government bond yield that is anchored near zero and an earnings yield on WisdomTree's Index that is almost 7.8%. The comparable ratio for the [S&P 500 Index](#) is below 2% given a trailing 12-month [price-to-earnings \(P/E\) ratio](#) that is more than 20x and a 10-year bond yield that is approaching 3%.

### Japan's Equities Look Extremely Attractive Compared to Government Bonds

Index	Trailing 12-Month Earnings Yield	10-Year Government Bond Yield	Spread (Earnings Yield/ Bond Yield)
WisdomTree Japan Hedged Equity Index	7.85%	0.06%	7.79%
MSCI Japan Index	7.36%	0.06%	7.30%
S&P 500 Index	4.69%	2.96%	1.73%

Source: Bloomberg. Data is as of 4/20/18. Past performance is not indicative of future results. You cannot invest directly in an index. 10-Year government bond yield for the Japan-focused equity Indexes is the 10-Year Japanese government bond. For the S&P 500 Index, this refers to the 10-Year U.S. Treasury note.

In our view, if tensions over global trade recede and North Korea risk also seems to fade, Japanese equities seem poised for recovery.

<sup>1</sup>Sources: Bloomberg, Japan Ministry of Finance, based on data with one-week lag in reporting, current as of 4/13/18.

#### Important Risks Related to this Article

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## DEFINITIONS

**MSCI Japan Index**: A market cap-weighted subset of the MSCI EAFE Index that measures the performance of the Japanese equity market.

**U.S. 10 Year Treasury Note**: A debt obligation issued by the United States government that matures in 10 years.

**Correlation**: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

**S&P 500 Index**: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

**Price-to-earnings (P/E) ratio**: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.