CAN BOJ POLICY STIMULATE JAPAN'S EQUITY MARKET?

Jesper Koll — Senior Advisor
03/18/2020

This week's Bank of Japan (BOJ) actions lay a strong foundation for a successful counter to the rising COVID-19 depression risks. To become credible and successful, its focus now shifts to three major areas: two at home and one abroad.

- First of all, we need to see Japanese fiscal policy quickly be coordinated and compound the new monetary steps. Here, we expect a special package to be compiled before month-end, worth as much as 1.5%–2% of gross domestic product (GDP), primarily focused on added zero-rate loan facilities and wage-bill support. This will add concrete transmission channels to the new credit facility announced by the BOJ this week.

- Second, we'll need to see domestic institutional investors follow the BOJ's lead and raise their allocation to yen equities. As of March 16, the BOJ is set to buy approximately 4.1% of the market. However, if the BOJ (and corporate buybacks) remains the only source of net equity buying power—and private domestic savers continue to sell—Japan's monetary policy will become nothing but the biggest experiment in financial socialism ever seen in a free-market economy.

  In my view, corporate leaders will do their share to attract domestic savers by not cutting dividends and *not* significantly reducing their share buyback plans. The record cash balances of listed companies—almost 130% of GDP—certainly allow for this, despite the coming cash flow squeeze. Japan's new and improved capital stewardship and corporate governance priorities have raised hopes that corporate leaders will now have enough capitalists' focus to pass this simple test in coming months.

  Clearly speaking, if, as I suspect, dividends are maintained, domestic investors now have no excuse to not follow the BOJ and raise domestic equity portfolio allocations. With the new fiscal year starting April 1, chances are good that we'll start seeing more positive private investor flow activity before long.

- Finally, we'll need to see energized resolve for international policy coordination in general, and well-coordinated currency policy in particular. Governor Kuroda made it very clear that a currency war and devaluation temptations must be avoided at all costs. A sustained surge in the yen toward, say, ¥95/$ would almost certainly overpower the positive counteroffensive in the fight against a COVID-19 depression launched this week by the BOJ.

What Did the BOJ Resolve?

Specifically, the BOJ decided to:

1. Raise the upper limit of annual ETF buying from ¥6 trillion to ¥12 trillion. This brings total BOJ buying power to approximately 4.1% of the Japanese market (at current TOPIX market cap of ¥286 trillion).

   Importantly, Governor Kuroda went out of his way in the press conference to clarify that, yes, the ETF buying program will indeed be doubled, thereby explicitly dispelling market concerns that the annual purchase guideline may still be unchanged at ¥6 trillion, despite the new ¥12 trillion budget. (This misconstrued interpretation of this week's policy decision may have contributed to the market sell-off following the BOJ announcement, which was during the trading day, while the governor's press conference was after the close.)

   All said, the governor's credibility is on the line, and we must see a credible path toward the doubling of daily BOJ ETF buying in coming days. If, as we suspect, concrete actions do follow this week's words, investor confidence in the BOJ support for the domestic equity market should grow.

   Indeed, the flow-of-fund story for Japanese equities is starting to look quite compelling: The BOJ is set to buy 4%

of the market, share buybacks are set to run about 2% of market cap and there's a dividend yield of around 3%. Meanwhile, the risks of an accelerating exit by global investors would appear to be low, given they already cut positions to record low levels by the end of December, at approximately 7%–8% below global benchmarks.

2. Pledged to just about double its purchasing plan (to ¥180bn for REITS, ¥4.2trn for corporate bonds and ¥3.2trn for commercial paper) for REITS, corporate bonds and commercial paper.

3. Create a new special funds supply operation to support COVID-19-affected corporate liquidity, which will provide companies with zero-interest loans with a maturity of up to one year.

4. Provide U.S. dollar liquidity by cutting USD swap loan rates and offering USD weekly with 84-day maturity, in addition to the one-week maturity previously offered. This new JPY/USD swap agreement is coordinated with the Federal Reserve (Fed), European Central Bank (ECB), Bank of Canada (BOC), Bank of England (BOE) and Swiss National Bank.

5. *Not* change interest rate policy. This is a very positive development, in our view. Adding further negativity to bank profit margins, which is what negative rates would do, would not only be counterproductive to the ETF-buying impact on stocks (by fueling further earnings revisions down from the banks), but it would also raise the possibility of potential systemic risks creeping into the banking system, with regional lenders and credit unions in focus.

All said and done, at this week's emergency BOJ policy meeting, the central bank added significant firepower to its war chest of potential asset purchases and liquidity provision. If, as we suspect, the coming days do confirm a de facto doubling of BOJ ETF buying, and Prime Minister Abe follows up with a quickly compiled emergency fiscal package in a week or so, the path toward recovery in Japanese markets should become clearer and more credible. A new Japan bull market would start if we get evidence that private domestic investors are indeed following the BOJ lead and raising their domestic equity portfolio allocations.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Dividend : A portion of corporate profits paid out to shareholders.

Cash flows : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

TOPIX 500 Index : A capitalization-weighted index designed to measure the performance of the 500 most liquid stocks with the largest market capitalization that are members of the TOPIX.

Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Swap : A swap is an agreement between two parties to exchange payments based on a reference asset, which may be a currency or interest rate but also may be a single asset, a pool of assets or an index of assets.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Bullish : a position that benefits when asset prices rise.