

A STRONG PM ABE POISED TO DELIVER POSITIVE PRO-GROWTH POLICIES

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On Thursday, Japanese prime minister Shinzo Abe was re-elected as the ruling Liberal Democratic Party (LDP) leader, winning by a very solid 70-30 margin against his one internal competitor. Abe thus has a very strong internal party mandate and will continue to be Japan's prime minister for another three years. This bodes well for Japan's economy in general and Japanese risk assets in particular. From here, two specific forces should combine to allow a [Nikkei](#) rally toward the 30,000 level over the next six months:

1. Pro-growth policy surprises
2. A sharp upturn in the momentum of positive earnings revisions

While the [bull](#) case for Japan equities recently has become more of a consensus view, much of the investment case rests on extremely attractive valuations—[TOPIX price-to-earnings \(P/E\)](#) multiples appear to be back toward the bottom 5% of the range in the past decade. The big worry: Is Japan a "[value](#) trap" with no added "positive surprises" in store to unlock the value? This is where PM Abe's third term plays an important role as a catalyst: against very low expectations that Abe will do anything new or interesting, we expect "Team Abe" to deliver new proactive policy initiatives relatively soon, and with a sense of urgency. Specifically, we look for the following:

1. A new supplementary budget, adding as much as ¥5 trillion (about 0.9% of GDP) to domestic demand

The need for this stems from the various natural disasters that hit Japan over the past six months. About half of the funds should go toward regional reconstruction, but the other half is likely to be earmarked for nationwide disaster prevention measures. There appears to be broad-based consensus for the need of added spending within the ruling coalition, and projects are basically "shovel ready." Expected timeline: mid-October at the latest.

2. A cabinet reshuffle, breakup of government bureaucracies and streamlining of advisory councils

Although most key cabinet positions—ministers of finance, foreign affairs, defense and the chief cabinet spokesman—are unlikely to be changed, key domestic portfolios such as agriculture, labor/welfare, and economic and [fiscal policy](#) are possibly ready for new leadership. A key positive surprise would be the reappointment of Akira Amari. Amari is a trusted Abe inner-circle member who was the key architect of the deregulation and growth strategy in Abe's first [Abenomics](#) cabinet (December 2012 through January 2016). He had to resign over a minor scandal but has been very active on leading LDP and private sector consensus toward the need for greater government efficiency and administrative reform.

Specifically, proposals to break up and streamline the enormous Ministry of Health, Labor, and Welfare are on the agenda, and Amari is a strong advocate for ensuring possible privatization and new private sector investment opportunities as a target for the next round of administrative reforms. A cabinet reshuffle that includes Amari (or one of his protégées) would send a clear signal that the privatization drive is back on the agenda. Timeline: likely with the restart of Parliament by mid-October.

In addition to a cabinet reshuffle and restart of concrete administrative reform agenda, we expect concrete proposals to streamline the multitude of advisory councils that have been set up since Abe assumed power in December 2012. Here, a reshuffle of the private sector participants—basically unchanged in six years—is expected and should be a catalyst for new ideas and a more active policy debate, led by private sector entrepreneurs and leaders.

3. A proactive trade policy with U.S.

The biggest threat to Japan's national prosperity comes from the Trump administration's threat of a 25% tariff on exports of Japanese cars and car parts. This could cut [GDP](#) by as much as half a percent and force TOPIX profit to drop by as much as 15%. Here, Team Abe has been working overtime, and a three-pronged strategy to make President Trump look like a winner appears to be in place: first, raise Japanese imports of agriculture products, soybeans and beef in particular; second, raise Japan's defense spending, hard- and software procurement from U.S. defense makers in particular; and third, a possible "America One Belt, One Road" Japan-funded, U.S.-targeted infrastructure investment fund.

Obviously, the tactical gyrations in trade negotiations are highly unpredictable, but given the highly transactional focus of Trump's deal-making, Team Abe does have a substantial and diversified war chest to deliver something that makes the president look good. In our view, the risks of an actual implementation of the 25% tariffs against Japan is low.

All said, we expect very positive, proactive and pro-growth policy initiatives to become a hallmark for PM Abe's rule over the next six-to-nine months.

And what about earnings? Against current consensus expectations of 5% EPS growth in Fiscal Year 3/19, we maintain our call for 18% growth in earnings per share, primarily driven by top-line sales growth exceeding conservative estimates. The next trigger should come during the next earnings-results season, due to start in the middle or toward the end of October—i.e., right at the same time as Team Abe's new pro-growth and pro-deregulation and privatization agenda becomes clear.

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Bullish : a position that benefits when asset prices rise.

Tokyo Stock Price Index (TOPIX) : A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

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.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

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