

WHY THE TIMING LOOKS RIGHT FOR JAPAN

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On last week's Behind the Markets podcast, we had the pleasure of speaking to Jesper Koll, Senior Advisor to WisdomTree, about the current state of Japanese markets and politics. Japan has a new prime minister, and a noted [value](#) investor Warren Buffett just made a \$6 billion investment in five Japanese stocks, highlighting some opportunities.

Japan's PM Steps Down

While Prime Minister Abe resigned due to health reasons, there is consistency and stability in Japanese politics given that the new prime minister, Yoshihide Suga, was a leader in Abe's administration and orchestrated many of his policies. [Fiscal](#) and [monetary](#) stimuli look firmly in place, with the head of the Bank of Japan (Governor Kuroda) remaining in his job until 2023, and the head of the finance ministry remaining the same as under Abe.

Japan pushed the envelope for fiscal expansion supported by central bank easing, but raising the consumption tax created challenges. Suga made it clear that the consumption tax will not increase for the next 10 years. There also has to be a general election by late 2021, so keeping fiscal spigots open will be part of the strategy to rally support.

Warren Buffett Invests in Japanese Companies

We spoke to Koll about why Buffett bought positions in five Japanese trading companies. We've recently covered this topic in some detail, outlining the other [reasons beyond cheap valuations](#).

No Yen Exposure: An underappreciated point is that Buffett made these Japan investments while also neutralizing his yen exchange rate risk. Most investors leave currency [unhedged](#), and I think Buffett shows that focusing on buying inexpensive overseas assets—focusing solely on the equity opportunity while taking currency exposure off the table—is the most sensible way to allocate over the long run.

Japan for Global Cyclical Trade: Some investors are positioning for a market rotation from defensive sectors and technology outperforming to more cyclical ones leading the charge over the near term. Japan is one of the most cyclical growth stories around the world, as 60% of listed company profits comes from overseas. A decade ago, America was 50% of Japanese corporate profits, but now it is down to less than one-quarter. China is up from 8% to more than 20% of profits and is experiencing a V-shaped economic recovery after the initial rout caused by the pandemic. Koll expects earnings surprises from the growth in China. He also anticipates that Japan will benefit from rising U.S. tensions with China as companies need to find new places to do business.

Japan's [Small Caps](#) as Strategic Allocation for Next 3–5 years: Koll sees a [merger and acquisition](#) boom on the horizon with [mid-size](#) companies consolidating. This should be very good news for small-cap companies as a structural play for Japanese markets.

Tesla Killer? Japan is known for its car companies, and Koll sees developments at Toyota (through sheer volume of production) and Nissan innovating in the electric vehicle space as a "Tesla killer." That will be interesting to watch, given the importance of car companies to [large-cap](#) Japan.

You can listen to the full conversation with Jesper Koll below.

Behind the Markets on Wharton Business Radio · Behind The Markets Podcast: Jesper Koll

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DEFINITIONS

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.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Unhedged : Strategy that includes the performance of both the underlying asset as well as the currency in which it is denominated. The performance of the currency can either help or hurt the total return experienced.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Mid-Cap : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.