# A stock exchange policy update opens a compelling case for Japan

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It's an exciting time for Japanese equities. Warren Buffett is turning his attention back to Japan. He raised his stake in each of the five major Japanese trading houses to 7.4% last week, from the original 5% he acquired in August 20201. Japan's trading houses ("sogo shosha") have deep roots in the country's economy, dating back hundreds of years and providing everything from energy to food. Given Buffett's penchant for value stocks, his investment strategy is reminiscent of companies trading at a steep discount, high dividend yields with lower risk. At present, Japanese equities are trading their deepest 29% discount to their long-term average, globally2. It seems logical that Buffett's interest could pique further well priced investment opportunities in Japanese equities.

*Source: Bloomberg, WisdomTree as of 20 April 2023. Please note: P/E refers to the Price to Earnings ratio defined as ratio for valuing a company that measures its current share price relative to its per share earnings.*

**Historical performance is not an indication of future performance and any investments may go down in value.**

**Economic re-opening effect more evident in consumption**

In addition to Buffett's vote of confidence in Japanese equities, there are a number of other factors supporting the view that Japan could have an edge versus global equities. Unlike Western economies, Japan has only just begun reaping the full benefits of the re-opening of its economy following the COVID-19 lockdowns.

According to immigration statistics announced on 14 April, a total of 1.88mn foreign visitors entered Japan in March, up 23% from 1.53mn in February, reaching 70% of its pre-pandemic 2019 average3. The steady pick up in travel will help the economy normalise in the wake of the pandemic. Consumption is likely to benefit from the economic re-opening.

Spring in Japan is the season for Shunto, the annual wage negotiations between company management and unions. The strong wage growth delivered by the financial year 2023 should boost real household incomes and positively impact consumer sentiment. According to the March consumer confidence survey, the headline consumer confidence index rebounded to its highest level since April 20204. The increase in wage hikes could also support a sustained recovery in consumption.

**Implications of Tokyo Stock Exchange's (TSE) change in policy**

Change is rarely fast in Japan. Almost a year has passed since the Japan Exchange Group doubled down on corporate governance enhancements.

The reforms were billed as the TSE's biggest overhaul in 60 years and a clear attempt to reinvigorate enthusiasm for Japanese equities.5

These initiatives included the restructuring of TSE's cash equity markets into three new segments: Prime Market, Standard Market and Growth Market—each segment having its own set of eligibility criteria. The ultimate impact of the reshuffle was muted. After three years of deliberation, the eventual requirements for the Prime Market were substantially weakened.

Nonetheless, the reforms represented a step forward for Japanese corporate governance. The TSE announced about half of its listed companies had a price-to-book ratio below 1x. According to the TSE, these companies are to disclose their policies and specific initiatives for improvement.

According to the TSE, all Japanese exchange-listed companies are required to meet the inclusion requirements of the market segments for which they are listed by 2025 or risk being labelled as securities under supervision or even delisting.

This means many historically cash-heavy Japanese companies face increasing pressure to improve their numbers, possibly by funnelling historically high excess cash reserves into increased buybacks or dividends.

**Higher pay-out ratios by Japanese equities reflect the impact of TSE's policy change**

It seems investors should dispel the myth that Japanese companies do not reward shareholders. Evident from the chart below, total pay-out ratios by Japanese companies have been steadily increasing since last year.

*Source: Factset, WisdomTree as of 31 March 2023.*

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1 Bloomberg as of 11 April 2023.

2 Bloomberg, WisdomTree as of 20 April 2023.

3 Immigration Services Agency of Japan, 14 April 2023.

4 Source: Bloomberg as of 31 March 2023.

5 Eri Sugiura and Leo Lewis, "Overhauled Tokyo Stock Exchange Makes Debut," The Financial Times, 4/4/22.

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