Japan as a Magnificent 7 diversifier

Published 18 December 2024

Aneeka Gupta
Director, Macroeconomic Research, WisdomTree Europe

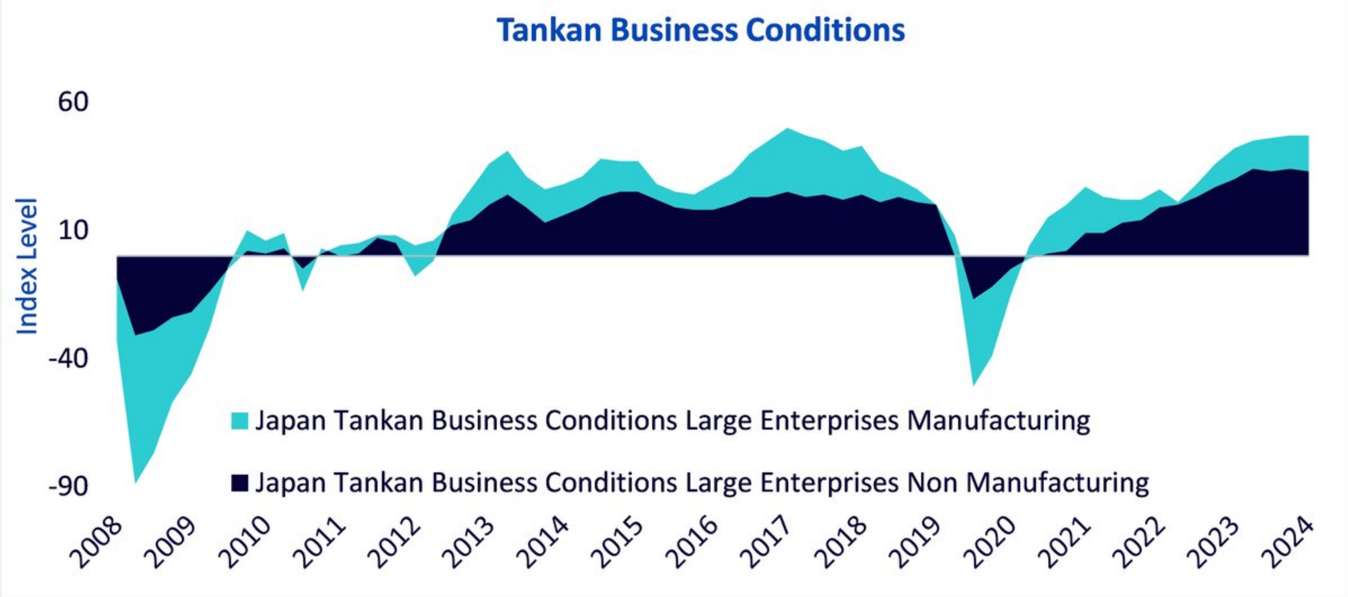
Key Takeaways

- Japan's economy shows signs of stabilisation heading into 2025, with strong Q3 growth driven by services recovery, robust tourism spending, and targeted fiscal stimulus
- The Bank of Japan is unlikely to enter a sustained interest rate hike cycle, as inflation remains moderate and real incomes lag
- A weaker yen and corporate governance reforms have strengthened the case for investing in Japanese exporters

- Related Products WisdomTree Japan Equity UCITS ETF - USD Hedged, WisdomTree Japan Equity UCITS ETF - USD Acc, WisdomTree Japan Equity UCITS ETF - EUR Hedged Acc, WisdomTree Japan Equity UCITS ETF - GBP Hedged, WisdomTree Short JPY Long USD 3x Daily, WisdomTree Short JPY Long EUR 3x Daily Find out more

Japanese growth has been volatile over the past year. While economic output in Q3 grew strongly by 0.3% quarter-on-quarter, two of the last five quarters saw negative growth. A shift away from industrial production towards services appears to be underway. This is evident from the progress witnessed in the auto and tourism sectors. The auto industry is expected to produce 12% fewer vehicles in 2024 than in 20191. In sharp contrast, the tourism industry has seen an average of 3 million foreign visitors a month arrive in Japan, 13% more than in 2019. Foreign tourists are spending more money per trip than then did before the pandemic.

The latest Tankan survey revealed strong business sentiment, particularly in the services sector, and so we expect to see economic stabilisation in Japan next year.



Source: Bank of Japan, Tankan Survey as of 12 December 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Fiscal stimulus to aid Japan's recovery

In response to rising inflation and its impact on households and businesses, the Japanese government has approved a comprehensive economic stimulus package valued at approximately ¥39 trillion (around $250 billion)2. The package is noteworthy as it includes measures proposed by the opposition – the Democratic Party for the People (DPP). One of the DPP's main policy agendas is to lift the ceiling on tax-free income from the current level of ¥1.03mn, thereby stimulating consumption. By lifting the ceiling, the DPP hopes to encourage part-time employees to work longer hours thereby alleviating the shortage in Japan's labour market. Part timers are also less inclined to save, so lifting the ceiling should support higher consumption

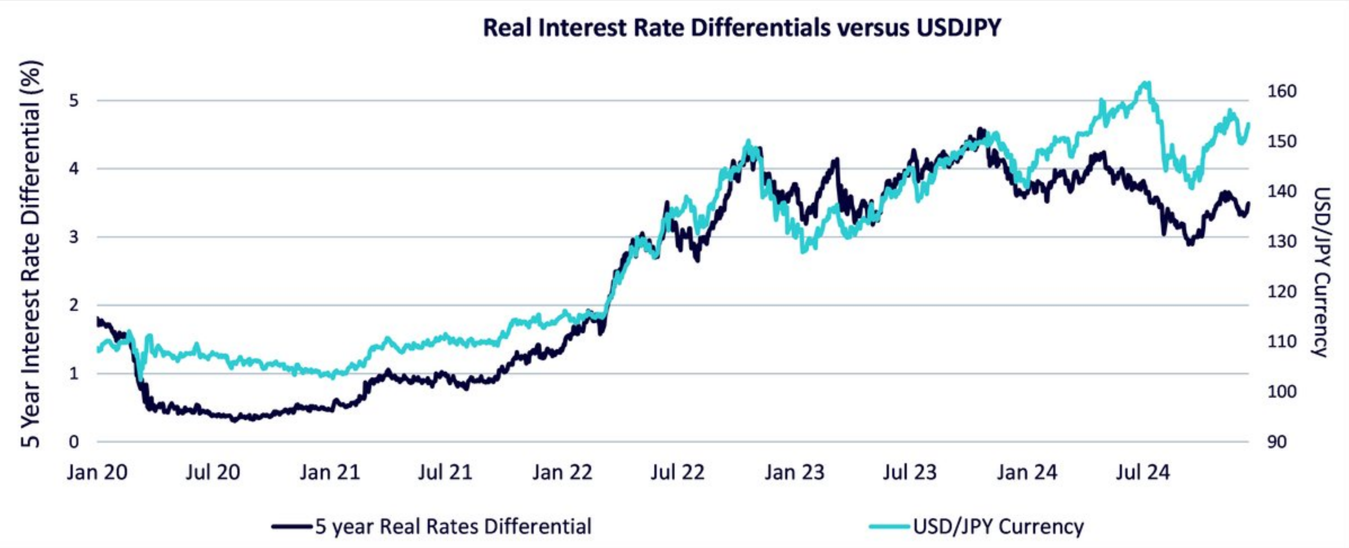
Measures include subsidies to curb rising energy costs and cash handouts to low-income households, as well as an increase in the tax-free salary threshold to boost disposable incomes. In a sign of policy continuity with his predecessor Fumio Kishida, Shigeru Ishiba wants to bring about conditions where wage gains outpace inflation and growth is investment driven.

Inflation not a major threat for the Bank of Japan

Inflation in Japan has recovered from its high of over 4% in 20233 to just over 2% in 2024, primarily due to high goods prices. Services prices have been hovering around the 2% mark this year. Interestingly, tourism has been an important contributor to services inflation. The recreational services subcomponent posted the highest rate of inflation compared to other services over the prior year. If recreational services are excluded from the services sector, it has failed to rise above 2% and is currently only around 1% year-on-year.

This year the Shunto wage negotiations reached 5.1%, its highest level since 1991 according to Japan's largest umbrella group for labour unions4. This increases the likelihood of nominal wages rising over the next year. Yet, as real incomes remain below pre-pandemic levels, the Bank of Japan (BOJ) wants to see wages rise in tandem with inflation. Prices in the services sector have risen no faster for labour intensive services than for services with a low wage cost component so Japan is unlikely to experience a wage price spiral.

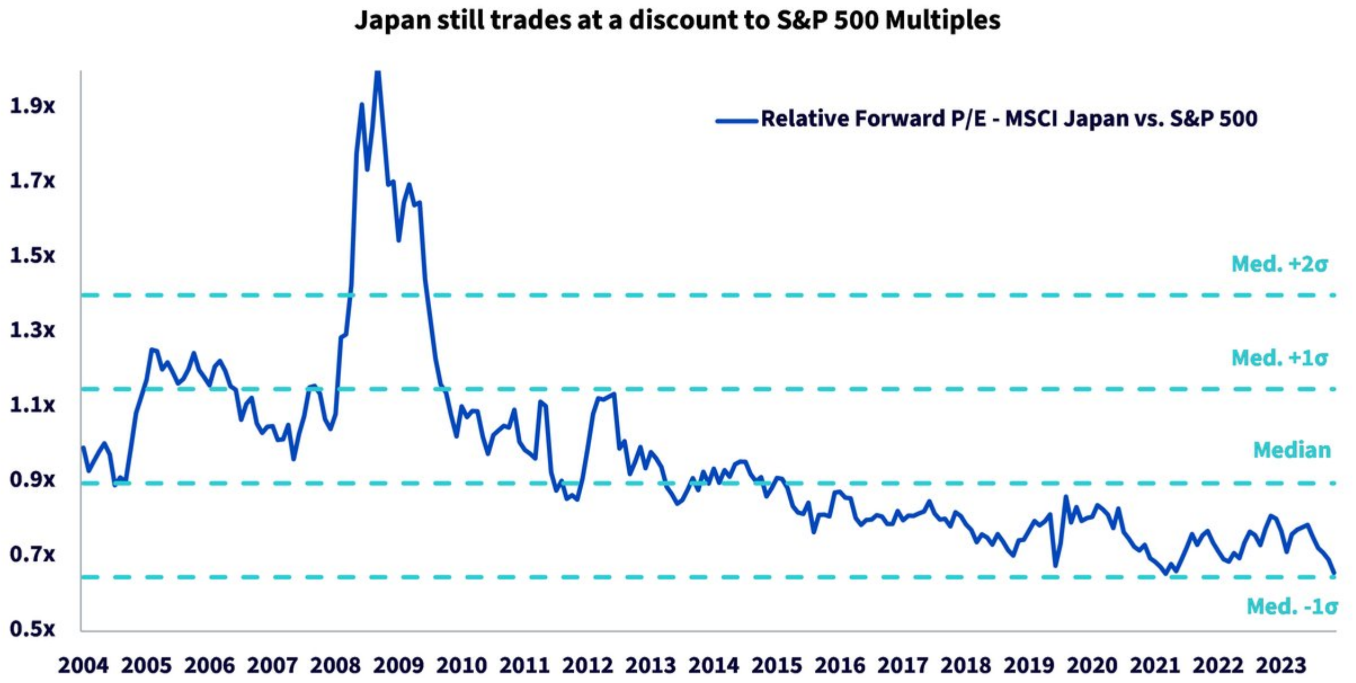
While inflation in Japan is unlikely to return to zero, it won't justify a sustained cycle of interest rate hikes by the BOJ. The global environment following the US presidential election supports this view as the market has dialled down on expectations of further interest rate cuts in the US. Thus, a further interest rate hike by the BOJ is less likely to result in strong market reaction as witnessed in August 2024.



Source: Bloomberg, WisdomTree as of 13 December 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

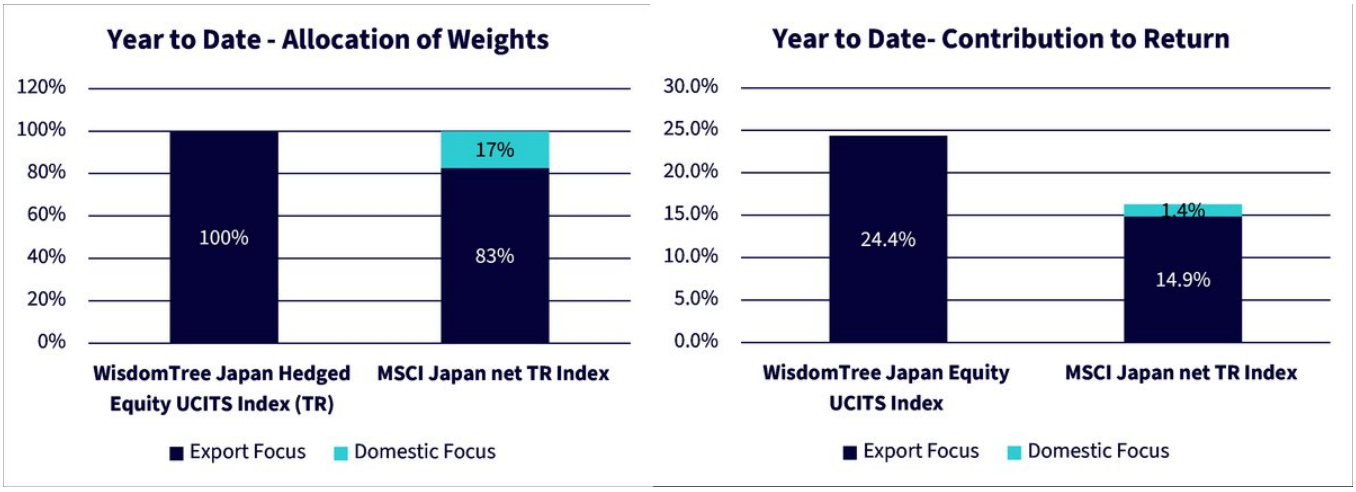
Favouring Japanese exporters: weaker yen and global resilience

As a result, the likelihood of the yen remaining weak against the US dollar for the rest of the year remains high. The yen continues to play a major role in corporate fundamentals. Initiatives aimed at deepening corporate governance reforms have encouraged cash rich companies to put their capital to productive use. Japanese exporters continue to benefit from a weaker yen and resilient global macro backdrop. In 2024, the WisdomTree Japan Hedged Equity UCITS Index rose 28.8% whilst the Nikkei Index rose 19.1%5. Despite the strong performance in 2024, Japan still trades at a significant discount to the S&P 500 Index with the relative forward Price to Earnings (P/E) multiple approaching 1-standard deviation below the median, providing an attractive route to diversify concentrated portfolios.



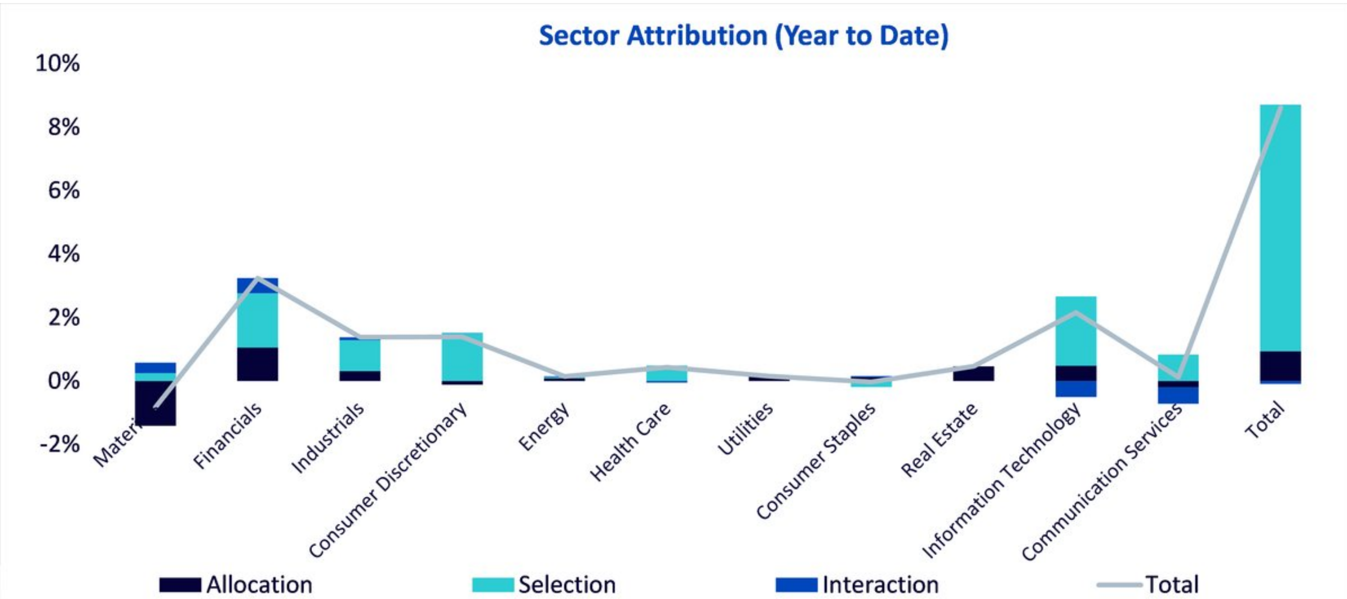
Source: Bloomberg, WisdomTree as of 30 November 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Taking a hedged exposure, amidst the weaker yen versus the US dollar with the WisdomTree Japan Equity UCITS ETF - USD Hedged (Ticker: DXJ) provided a higher return of 25.9% year-to-date in 20246. Dollar-based investors get a free carry trade sweetener for tapping into Japanese equities. Investors can earn a 4.7% return from swapping their in-demand dollar for yen, near the highest level since 2000. The outperformance of the WisdomTree Japan Hedged Equity UCITS Index versus the MSCI Japan net Total Return Index is closely tied to its higher tilt towards dividend paying Japanese exporters as highlighted below.



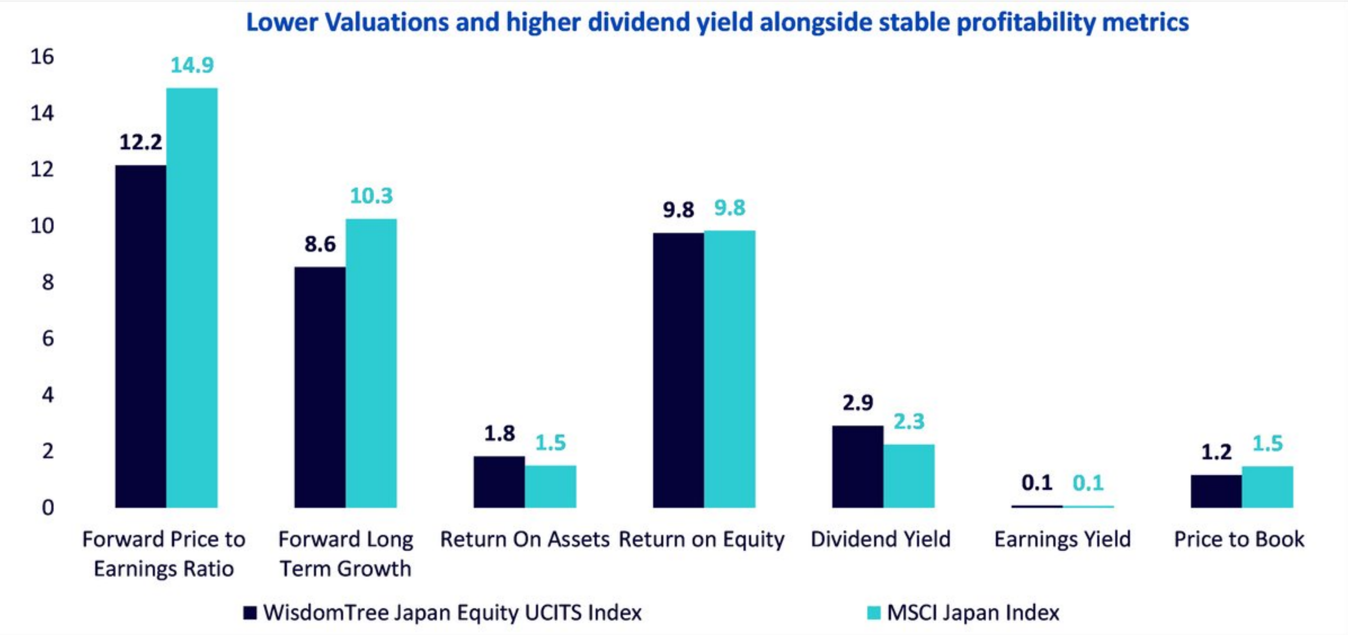
Source: FactSet, WisdomTree from 29 December 2023 to 29 November 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

WisdomTree classifies export-oriented companies as those companies that derive at least 20% of their revenue from countries outside Japan. The higher stock selection in sectors such as financials, information technology, consumer discretionary and industrials played an important role in the 8.6% outperformance of the WisdomTree Japan Hedged Equity UCITS Index versus the MSCI Japan net Total Return Index Year to Date.



Source: FactSet, WisdomTree from 29 December 2023 to 29 November 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

On comparing key fundamental metrics of the WisdomTree Japan Hedged Equity UCITS Index versus the MSCI Japan Dividend net Total Return Index we find the WisdomTree Japan Hedged Equity UCITS Index offers attractive value-based fundamentals via lower valuations alongside a higher dividend yield without compensating for quality metrics.



Source: FactSet, WisdomTree from 29 December 2023 to 29 November 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

1 Bloomberg as of 31 August 2024.
2 Japan Ministry of Finance.
3 Bloomberg as of 31 January 2023.
4 Yomiuri November 2024.
5 Bloomberg from 29 December 2023 to 12 December 2024.
6 FactSet, WisdomTree from 29 December 2023 to 31 October 2024.

Important Risks Related to this Article

IMPORTANT INFORMATION

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland. **Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority. WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request. This marketing communication has been prepared for professional investors, but the WisdomTree products set out in this document may be available in some jurisdictions to any investors, subject to applicable laws and regulations. As the product may not be authorised or its oering may be restricted in your jurisdiction, it is the responsibility of every person or entity to satisfy themselves as to the full observance of the laws and regulations of the relevant jurisdiction. Prior to any application investors are advised to take all necessary legal, regulatory, tax and investment advice on the suitability and consequences of an investment in the products. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be aected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an oer for sale nor a solicitation of an oer to buy any product or make any investment. An investment in exchange-traded products (“ETPs”) is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks. The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes. This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents. This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could dier materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements. WisdomTree Issuer ICAV wording

The products discussed in this document are issued by WisdomTree Issuer ICAV (“WT Issuer”). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland (“CBI”). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities (“UCITS”) under the laws of Ireland and shall issue a separate class of shares ("Shares”) representing each fund.

The Fund is described in a Key Information Document (KID) or Key Investor Information Document (KIID) for UK investors, and the prospectus of WT Issuer (“WT Prospectus”). A copy of the WT Prospectus and the KID / KIID is available, for EEA/UK only, in English at www.wisdomtree.eu. Where required under national rules, the KID will also be available in the local language of the relevant EEA Member State. Investors should read the WT Prospectus before investing and should refer to the section of the WT Prospectus entitled »Risk Factors¼ for further details of risks associated with an investment in the Shares.

The summary of investor rights associated with an investment in the fund is available in English on WisdomTree Europe¼s website. WisdomTree Management Limited may decide to terminate the arrangements made for the marketing of its collective investment undertakings. In such circumstances, shareholders in the aected EEA Member State will be notified of this decision and will be provided with the opportunity to redeem their shareholding in the fund free of any charges or deductions for at least 30 working days from the date of such notification. Notice to Investors in Switzerland – Qualified Investors

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree¼s website: **https:** //www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports

Some of the sub-funds referred to in this document may not have been registered with the Swiss Financial Market Supervisory Authority (“FINMA”). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich

Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent. For Investors in France:

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the oering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

For Investors in Malta: This document does not constitute or form part of any oer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

For Investors in Monaco: This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.