

A Japan Strategist Roundtable: What's Next for Japan?

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The start of 2014 was a challenging time for the Japanese equity markets. Growth expectations for the U.S. were revised down, causing U.S. interest rates to fall and the Japanese yen to rally.¹ Japanese equity markets were one of the worst performers globally for much of the first four months of the year.² This can be partly attributed to the strengthening yen and the persistence of negative correlation between equities and the yen. But recently things started to perk up. The yen weakened from 102 to above 109.³ Japanese equities have clawed back their earlier losses in 2014, with the TOPIX actually breaking through its December 31, 2013, highs. With all this change, what should we expect from the Japanese markets going forward? I recently spent time in Tokyo and want to share my observations from the trip. I attended two Japanese investment conferences, the Mizuho Japan Investment Forum and the Bank of America Merrill Lynch Japan Conference. I also met with a representative from the Bank of Japan's market intelligence group and heard the head of its statistics department present at the Mizuho conference. I met with some of Japan's top investment strategists: Jesper Koll of J.P. Morgan, Masatoshi Kikuchi from Mizuho and Nicholas Smith of Credit Lyonnais Securities Asia (CLSA). I have shared insights from those conversations to help frame the opportunity represented by Japan. Some bottom-line takeaways from these conversations, fleshed out in much more detail in our [full report](#):

- 1) Consumption Tax Hike Impact:** Economically, everyone is focused on the 5% to 8% rise in the consumption tax that occurred this year, and the raging debate surrounds the issue of whether Japanese prime minister Shinzo Abe and his government will raise it from 8% to 10% as planned later this year. It is a close call, but I expect the hike will go through, and the conversations we profiled in the piece shed some light on this thinking.
- 2) More Bank of Japan (BOJ) Action:** One of the disappointing factors for the equity markets earlier this year was that the BOJ was sanguine about the economy and did not undertake additional monetary policy accommodation. Many believed the BOJ would take further action to support the economy given that it had just instituted the first consumption tax hike. Despite this inaction, I believe there is scope for the BOJ to expand its purchases of exchange-traded funds (ETFs) meaningfully. However, it may not expand the purchases of Japanese government bonds (JGB) significantly. This is because the JGB yields have compressed even more than I think the BOJ believes is warranted.
- 3) Improving Corporate Fundamentals and Valuations:** As we have discussed in numerous research pieces, Japan's profits have been increasing steadily and valuations are getting less expensive. Abe's policies, commonly referred to as Abenomics, are focused on increasing corporate profitability, and a number of forces even outside of government initiatives are accelerating these trends. I see Japan as having some of the best prospects for equity markets over the next five to six years heading into the Tokyo Olympics in 2020.
- 4) Abenomics and the Growth Strategy Is a Marathon—Not**

a Sprint: Abe's policies are on track with meaningful reform that ought to support the economy and asset markets. We want to thank the participants in our roundtable for the great discussion with them and hope you enjoy the conversations as much as we did. To read our full Japan Strategist Roundtable, please [click here](#). 1Source: Bloomberg, 12/31/13 to 8/31/14. U.S. interest rates refer to the 10-Year U.S. Treasury note. 2Source: Bloomberg, 12/31/13 to 4/30/14. Refers to TOPIX. 3Source: Bloomberg, 8/8/14 to 9/19/14. The levels refer to the spot exchange rate between the yen and the U.S. dollar.

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