

Abe Wins Election During My Trip to Japan

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I boarded my flight from Newark Liberty Airport to Narita, Tokyo, just as early results of the recent election were rolling in. The first headline I read said it all: “Abe’s Bloc Wins Big in Japan’s Upper House Vote.” As I left Tokyo on Friday to return home, the headlines were dominated by that morning’s inflation reading, which turned positive at +0.4%, slightly higher than expectations and an indication that Abe’s policies are having an impact in the battle against deflation and falling prices¹. My trip to Japan—to discuss with institutional investors six WisdomTree exchange-traded funds (ETFs) that have filed notifications with the Financial Services Agency of Japan (FSA)—was packed with meetings and shared insights. Many investors discussed their views on Abe’s policies. The early economic indicators look quite positive. At 4.1%, Japan’s first-quarter gross domestic product (GDP) growth came in better than expected². Earnings expectations are rising. And there was this latest positive inflation news. With the Liberal Democratic Party’s latest election victory in the Upper House, Abe does not have to worry about another election for three years. This type of political stability in Japan is in stark contrast to the revolving door of prime ministers that characterized the political scene over recent years. Abe has gone “all-in” with his economics strategy and wants to waste no time in getting his three-arrow growth strategies in place. Investors should take Abe seriously—he and his partners at the Bank of Japan (BOJ)—will continue to do whatever it takes to end deflation and stimulate real growth in the Japanese economy. **A Policy Brief from the BOJ** One of the highlights of our trip was a meeting with BOJ representatives to hear about its monetary policies in person. These representatives used very comforting words: The BOJ would continue to do “whatever it takes” to achieve its goal of stimulating 2% inflation. Like Abe, the BOJ is fully committed to its policies—double the monetary base, buy risky assets, including exchange-traded funds and real estate investment trusts (REITs)—and it has no plans to back down. A stated goal of these BOJ policies is to change investor behavior, stimulate asset prices and thereby improve consumer sentiment. The BOJ cannot say they are targeting a weaker yen exchange rate against the U.S. dollar, but of course the yen is a critical variable to this overall picture. The BOJ representatives reinforced to us that higher asset prices stimulate consumer sentiment. Bears on Japan equities should also take note: The BOJ has put its cards on the table—and I believe its plans are clear: It will do whatever it takes to keep consumer sentiment improving, including further measures to stimulate asset prices, if necessary. **Potential Risk: Will Abe Get Distracted?** A number of observers worry that there are two sides to Abe, a fact that risks getting him distracted. There is the three-arrow, economics oriented Abe. But there is also a nationalistic Abe, who has caused rumblings with China over disputed island territories and a plan to revise Japan’s pacifist constitution. Critically, in order for Abe to revise the constitution, he needs a two-thirds majority in the Diet. A Japan Times article³ stated that Abe could get the required votes for amending the constitution, yet it also noted that Abe appeared realistic that more debate was needed on this topic. Many believe Abe is now quite practical. He

himself has said that he failed to properly prioritize his agenda in his last bid as prime minister and that he would not make that mistake this time around. He has travelled the country and found that people's top concern was the resurrection of the economy. Thus it has become his primary mission. The practically minded Abe should see that creating a rift with China is counterproductive. China accounts for 20% of Japanese exports and has become Japan's largest trading partner⁴, and I believe this practical Abe will end up winning the day and will not cross the line with China. **Is This Time Really Different?** Japanese investors—both institutional and retail—are supportive of Abe yet largely remain skeptical of Abenomics. Can you blame them? They have been plagued by a 23-year bear market, where the Nikkei 225 Index declined from about 39,000 to its current levels of around 15,000, and 15 years of deflationary forces⁵. The Japanese have taken to heart that it is quite dangerous to say, "This time is different." Yet things do appear different in Japan this time. Nowhere in the world are the government and the central bank as coordinated in their attempts to lift the economy and financial markets as they are in Japan. Both the BOJ and the government believe that equity markets are key drivers of consumer sentiment, and they are thus both explicitly targeting higher asset prices through their policies. I believe it takes a brave soul to fight this path and that local Japanese investors will eventually come around to this view, providing further demand for Japanese equities. **Looking Forward to Returning** I left Japan tired yet invigorated—there were a lot of meetings and much sushi and sake consumed. Sushi in New York, with all due respect, is just not the same. I also left Tokyo knowing that I would have to return to Japan soon (if not for more sushi). Interest in WisdomTree's Japan ETFs, given our recent notification filing with the FSA, is growing. In my next blog I will explore in more detail why this is the case. ¹Ben McLannahan, "Japan Posts Highest Inflation Rate since 2008," FT.com, July 26, 2013. ²Ben McLannahan, "Japan Posts Highest Inflation Rate since 2008," FT.com, July 26, 2013. ³"Upper House Election 2013/Challenges Await Abe at Home, Abroad," The Japan News, July 29, 2013. ⁴Takashi Nakamichi, "Japan Trade Suffers amid China Dispute," The Wall Street Journal, October 22, 2012. ⁵Source: Bloomberg.

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