

Introducing Our Japan Strategist Roundtable Discussion

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WisdomTree has compiled a Japan Strategist roundtable—a compilation of views from three top Japan investment strategists. In separate one-on-one interviews, we asked these strategists to share their views on Japan's equity markets, the economy, government initiatives and the currency, and published our full discussion [here](#). The strategists for our Roundtable included: 1) Naoki Kamiyama – Head of Japan Equity Strategy at Bank of America Merrill Lynch 2) Masatoshi Kikuchi – Pan Asia Chief Equity Strategist at Mizuho Securities Equity Research 3) Jesper Koll – Director of Japan Equity Research at J.P. Morgan Japan In this introductory blog, we highlight some of the bottom line takeaways and encourage you to read more to get the detailed takes. WisdomTree notes that forecasts and estimates have certain inherent limitations and may not actually come to pass. We'll continue with this blog series to highlight major topics of discussion. ***Let's start with the strategists' ultimate bottom lines—the shorter-term outlook for the markets. The most optimistic of the three strategists was Jesper Koll. Jesper believes we are in a structural bull market for risk assets, with a target for the TOPIX of 1,600 in the next 12 to 15 months (current levels are below 1,200). One of his main reasons: He is above consensus on his earnings outlook. Why? Jesper Koll:*** Margins are currently 4.1%. Over the last decade, the high has been 5.1%, and I think that it's very likely that margins will go back up to at least 5.1%. You are in a sweet spot with a benefit of higher productivity and cyclical pickup in output. Secondly, note that the capital stock for the listed companies has actually fallen by about 7% over the last three years. So, fixed cost gearing has improved tremendously. ***You think that consensus earnings catch up with your view and that's a driver for 2014 markets? Jesper Koll:*** Yes, this time last year, Japan was still undiscovered. People were still looking in the rearview mirror and saying, "Oh, well. It's just a one-day wonder." By now, every manager has been to Japan, has visited companies, and I think that certainly the global investment community now basically is afraid of being short Japan. While investment is rising, it's still underinvested. The naysayers say, on a risk-adjusted basis, the cost of engaging in Japan is just very high. Look at it in U.S. dollar terms. The Nikkei was up about 25% last year, with a volatility of just slightly above 20%, while the [S&P](#) was up just shy of 30% with a volatility of about half of what Japan delivered. The reason for the volatility is the fact that you've got no engagement from the domestic institutional investor. Japan is like an emerging market in the sense that you've got global speculators playing against local retail investors while the domestic institutional investors basically are sitting back. ***Masatoshi Kikuchi was more conservative in his outlook based on the strong past gains of 2013. Masatoshi Kikuchi:*** Last year, the Nikkei 225 went up more than 50%. After a sharp rally, my research shows the following years tend be more modest. Therefore, I expect more modest returns this year. There were two exceptions when the stock market

was strong in two or three consecutive years. First in 1951, an exceptional year because there was a Korean War and special demand for the Korean War. The second exception was 1958 to 1960. At that time, it was a great economic expansion era to our 1964 Tokyo Olympics, where the stock market rallied for three consecutive years. This second exception period—1958–1960—has been compared by some to the current period. We have the 2020 Tokyo Olympics, therefore we have big spending or capital expenditures for six years before the Olympics takes place in 2020. Some of the bullish people say the same thing could happen now. But I think economic conditions are still quite different from the 1960s. Japanese economic growth rates were over 10%, but now it's just 1% or 2%. Therefore, my conclusion is that this year stock market returns will be more modest after very strong performance last year. **And from Naoki Kamiyama on his outlook for the market: Naoki Kamiyama:** My year-end target for the TOPIX is 1,420, so I think there is about a 19% upside potential from levels on February 4, 2014. Earnings (EPS) growth is expected to be a little less than 10%—because of a consumption tax hike [from 5% to 8%] in April, I am conservative on EPS. I think we get some [P/E](#) expansion, mostly from global expectations of a recovery—not only from Abenomics, but a global economic recovery. Japan is outperforming other markets because its rate of change in EPS is higher than other markets and it has a higher sensitivity to the global economic recovery. *WisdomTree notes that forecasts and estimates have certain inherent limitations and may not actually come to pass.* **How does the yen factor into your estimates? Naoki Kamiyama:** Our year-end forecast for the yen/dollar exchange rate is 108. I used a conservative forecast in coming up with EPS—I used 105 yen/dollar as average of the year. In my main scenario for the markets, I expect market confidence in the global recovery; especially the U.S. will improve. The last U.S. employment report was not great, but I have stronger confidence in the U.S. recovery. I think the yen will be weaker in the first half, and the market will be led by exporters. I have a bear scenario, where the yen trades down to 95, and that would be a scenario if the U.S. recovery was weaker than expected and market participants were less confident in a global recovery—and things would go back to the original position before Abenomics started around 95 yen/dollar. **We will continue to highlight sections of the Japan Strategist roundtable in a series of blog posts, but to see our full strategist roundtable, please click [here](#).**

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