

Progress on Abe's Third Arrow Policies: From Savings to Investment

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In my last few [Japan-centric research notes](#), I have been discussing takeaways from my recent trip to Japan. Part of this trip involved meetings with various securities brokerage firms, many of which are working directly with Japanese retail clients. One question I had for four of the five largest brokerage firms I met with regarded the progress they are seeing from the new initiative to change Japan's investment culture, a critical component of Abe's "third arrow" policies. One bullish case for Japanese equities shows a pie chart of the approximate \$15 trillion in Japanese household assets, over 50% of which is sitting in the bank, or under the proverbial mattress.¹ For every \$10,000, these bank assets earn a measly \$1 of interest income, given today's interest rates.² Abe is trying to change the mentality; his slogan "From Savings to Investment" summarizes an initiative referred to in Japan as "NISA," or Nippon Individual Savings Account. The NISA accounts offer Japanese citizens the opportunity to invest up to ¥1 million per year tax free for a period of five years. The expected increase in flow for these assets out of the bank and into equities can be a potential driver for the equity market going forward, so I wanted to get a gauge of the progress these new accounts are making now that they have been open for two months. Some of the comments we received from brokerage firms regarding NISA: **1) NISA accounts are thus far opened largely by existing clients:** One of the goals of the NISA accounts is to spur investment from new investors who keep most of their assets in the bank. What the brokerage firms have found thus far is that as much as 90% or more of new NISA accounts are from existing clients, many of whom already have brokerage accounts and may be using the opportunity to shelter some of their taxable gains. This may be as expected, as the program is still only two months old and it takes time to change behavior. The government is pulling out all the stops to encourage this change, including having famous Japanese actresses participate in commercials for the new NISA program. **2) NISA investors have a preference for individual high-dividend stocks:** Japanese investors tend to have NISA accounts primarily focused on local Japanese stocks or investment strategies focused on Japanese stocks with high dividend yields. We are seeing a higher demand and better performance for Japan's dividend-paying stocks this year.³ **3) NISA, in its current form, needs restructuring: a. Rebalancing needed:** One of the features of the NISA account is that it does not allow for portfolio rebalancing. In other words, once an investor sells an investment inside the account, he or she loses the tax-preferential treatment going forward. As part of a regular and ongoing dialogue, the brokers we spoke with are providing the Japan Financial Services Agency with feedback on the program, which they hope can be amended in the future.⁴ **b. NISA needs extension in period:** The comments we heard universally agree that NISA accounts should be extended indefinitely. The five-year window of tax preference is something the brokers think has the potential to be extended as a first step, before it's

ultimately extended indefinitely. **Increasing Real Estate Wealth Is Another Key Driver** While the equity markets are an important indicator for both the government and the Bank of Japan (BOJ) to judge the success of Abenomics, the chief executive of Monex Securities, Oki Matsumoto, made an excellent point: On March 19, the results of an annual land appraisal will be released. Matsumoto believes this year's land prices are set to show the first year-over-year increase in prices in a long time, which would indicate to the Japanese people that the era of deflation may be coming to an end. Putting the importance of this in context, Japan's equity markets are worth \$4–\$5 trillion, and retail investors own approximately one-quarter of those assets, or roughly \$1 trillion.⁵ The gains from the “wealth effect” last year of stock prices going up, fueling consumption, were definitely evident. But the real estate market in Japan is worth over \$25 trillion⁶, or more than five times the equity market—and many more citizens participate in that asset class. An increase in real estate values has the potential to change both consumption and investment behavior, as households feel their wealth increase. We will be watching that March 19 indicator very closely to see how a more positive wealth effect from real estate gains fuels the markets and the economy—but chances are, it will show a positive impact. As we know, the BOJ activities have a component geared to buying real estate investment trusts (REITs), and their performance has been quite strong, bringing more positive sentiment to that sector. A house is a big-ticket item—Matsumoto believes that more money will flow into the equity markets as a result of the gains in real estate. **Conclusion on Investment Progress** In summary, while progress is just mixed so far on the current NISA account structure, the brokerage firms believe NISA is quite important to their future business, and they are doing all they can to attract new clients and investors. NISA may be restructured in coming years, and I believe the wealth effect from an improvement in real estate prices will help the progress along Abe's mantra: from savings to investment.

1Source: Bank of Japan, WisdomTree on Household Asset Allocation Data. 2Source: Nicholas Smith, CLSA. 3Source: WisdomTree Japan Dividend Index. 4Comments made at the CLSA Japan Forum 2014. 5Source: Bloomberg, as of 1/31/2014, for the market capitalization of the TOPIX. 6Source: Monex, as of 12/31/2013.

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