

Thinking International: What's Driving Japanese Equity Performance?

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This blog post is the third installment of a four-part series that examines the tactical and strategic case for investing internationally despite a multi-year period of U.S. equity outperformance.

Since the previous peak in Japanese markets, investors have long hoped for a so-called “virtuous cycle” to finally take root in Japan. Despite some of the most accommodative central bank policies in the world, Japan has experienced doggedly low levels of inflation and even disinflation. With prices forecast to be lower in the future, consumers are incentivized to forego consumption and increase their savings rate. For Japanese companies, this results in anemic sales growth and a headwind for earnings. This cycle may be ending now.

Like most other countries in the developed world, Japan has seen the lingering impacts of supply chain disruptions result in stubbornly persistent inflation. However, this has also had the effect of incentivizing consumption today rather than in the future. As economic activity increases, wages are also starting to rise. This combination of rising wages and consumption creates a positive feedback loop resulting in a virtuous cycle of investment, labor productivity growth and potentially higher multiples for Japanese stocks.

Big Catalyst: TSE Reform

For all of the reasons highlighted earlier, the same investment cycle also applies to companies. One of big thorns in the side of global asset allocators was that Japanese markets perpetually appeared cheap based on common value metrics such as price-to-book value. With future profits potentially crimped by low growth, many companies hoarded cash as opposed to reinvesting in their businesses. This resulted in a high percentage of companies trading at significant discounts to their book value. In response, the Tokyo Stock Exchange (TSE) sent a public letter at the end of January 2023 to listed companies imploring them to take steps to increase their book value per share through share buybacks, dividend increases and capex investment.

The TSE published a report titled, “Action on Cost of Capital-Conscious Management and Other Requests” at the end of March 2023. This required companies to (a) increase actions that are conscious of returns

on equity (ROE) and cost of capital, (b) seek improvements in ROE through investment in human capital, capex and business line restructuring, (c) repurchase shares and hike dividends on a continual basis promoting long-term growth and (d) increase dialogue with investors about corporate targets and strategies for enhancing returns.

According to JPMorgan, at the time of the announcement in January, there were 922 companies trading below book value. Since then, 308 of these companies have announced share buybacks or dividend increases. It is also forecasted that many other companies such as banks may be poised to do more on this front once the turbulence from the U.S. regional banking crisis moves further out of memory. While many investors may fear that they have in effect “missed the trade,” we believe this may be the start of a multi-year process that starts to see fundamental changes to Japanese company fundamentals and multiples.

Looking under the Hood

As we show in the table below, one of the single biggest drivers of returns over the last year has been this focus on shareholder yield: increasing dividends and share buybacks.

1-Year Attribution: WisdomTree Japan Hedged Equity Index vs. MSCI Japan Local Index

WTUSMF - WisdomTree U.S. Multifactor Index
 WTEPS - WisdomTree U.S. LargeCap Index
 WTDGI - WisdomTree U.S. Quality Dividend Growth Index
 WTQGRW - WisdomTree U.S. Quality Growth Index
 WTLDI - WisdomTree U.S. LargeCap Dividend Index
 WTDI - WisdomTree U.S. Dividend Index
 WTHYE - WisdomTree U.S. High Dividend Index
 WTSDG - WisdomTree U.S. SmallCap Quality Dividend Growth Index
 WTMEI - WisdomTree U.S. MidCap Index
 WTSEI - WisdomTree U.S. SmallCap Index
 WTSDI - WisdomTree U.S. SmallCap Dividend Index
 WTMDI - WisdomTree U.S. MidCap Dividend Index
 WTEMSC - WisdomTree Emerging Markets SmallCap Dividend Index
 WTEMHY - WisdomTree Emerging Markets High Dividend Index
 EMXSOE - WisdomTree Emerging Markets ex-State-Owned Enterprises Index
 INXSOE - WisdomTree India ex-State-Owned Enterprises Index
 CHXSOE - WisdomTree China ex-State-Owned Enterprises Index
 WTIND - WisdomTree India Earnings Index
 WTEHIT - WisdomTree Europe Hedged Equity Index (TR)
 WTIDJTRH - WisdomTree Japan Hedged Equity Index (TR)
 EMCLOUD - BVP NASDAQ Emerging Cloud Index
 WTCDDG - WisdomTree Canada Quality Dividend Growth Index
 WTMDIC - WisdomTree U.S. MidCap Dividend Index
 CADWTMDIHC - WisdomTree U.S. MidCap Dividend Index CAD-Hedged
 WTGDHY - WisdomTree Global High Dividend Index
 WTGDGXG - WisdomTree Global ex-U.S. Quality Dividend Growth Index
 WTIDGH - WisdomTree International Hedged Quality Dividend Growth Index
 WTDFA - WisdomTree International Equity Index
 WTDFAHD - WisdomTree Dynamic Currency Hedged International Equity Index
 WTDHYE - WisdomTree International High Dividend Index
 WTILDI - WisdomTree International LargeCap Dividend Index
 WTIDG - WisdomTree International Quality Dividend Growth Index
 WTIMDI - WisdomTree International MidCap Dividend Index
 WTISDI - WisdomTree International SmallCap Dividend Index
 WTISDIHD - WisdomTree Dynamic Currency Hedged International SmallCap Equity Index
 WTIDJH - WisdomTree Japan Hedged Equity Index
 WTEDG - WisdomTree Europe Quality Dividend Growth Index
 WTEHIP - WisdomTree Europe Hedged Equity Index
 WTGEH - WisdomTree Germany Hedged Equity Index
 WTESC - WisdomTree Europe SmallCap

Dividend IndexWTESEH - WisdomTree Europe Hedged SmallCap Equity IndexWTJSC - WisdomTree Japan SmallCap Dividend IndexWTJSEH - WisdomTree Japan Hedged SmallCap Equity IndexWTMDPL - WisdomTree Growth Leaders IndexWTDFAH - WisdomTree International Hedged Equity IndexWTDGICT - WisdomTree U.S. Quality Dividend Growth Index CAD (NTR)WTDGIDCT - WisdomTree U.S. Quality Dividend Growth Index Variably CAD-Hedged (NTR)WTDGIHCT - WisdomTree U.S. Quality Dividend Growth Index CAD-Hedged (NTR)WTDXF - WisdomTree U.S. Dividend ex-Financials IndexWTEHITC - WisdomTree Europe CAD-Hedged Equity Index (NTR)WTEMI - WisdomTree Emerging Markets Dividend IndexWTEMXC - WisdomTree Emerging Markets Ex-China IndexWTGRE - WisdomTree Global ex-US Real Estate IndexWTIDGCT - WisdomTree International Quality Dividend Growth Index CAD (NTR)WTIDGD - WisdomTree Dynamic Currency Hedged International Quality Dividend Growth IndexWTIDGDCT - WisdomTree International Quality Dividend Growth Index Variably CAD-Hedged (NTR)WTHYECT - WisdomTree U.S. High Dividend Index CAD (NTR)WTHYEHCT - WisdomTree U.S. High Dividend Index CAD-Hedged (NTR)WTIDGHCT - WisdomTree International Quality Dividend Growth Index CAD-Hedged (NTR)WTIDXF - WisdomTree International Dividend ex-Financials IndexWTISDIH - WisdomTree International Hedged SmallCap Dividend IndexVS.MXJP - MSCI Japan Local Currency As of:12/30/201112/31/201212/31/201312/31/201412/31/201512/30/20166/30/20177/31/20178/31/20179/29/201710/3

Attribution Component

Average Category Weight

Category Performance

Category

Allocation

Stock

Selection

Interaction

Total

Attribution

Index

Weight

Benchmark

Weight

+/- Wgt

WT Index

Return

Benchmark

Return

Source: WisdomTree, as of 7/31/23. Past performance is not indicative of future results. You cannot invest directly in an index.

Over this period, companies ranking in the top quintile based on shareholder yield have outperformed companies in the bottom quintile by nearly 40%! Additionally, WisdomTree's approach, which focuses on exporters and dividend payers, showed even more value versus a market cap-weighted approach.

While Japan has experienced periods of false dawns in the past, we believe that we are still in the early innings of a meaningful shift in Japanese corporate behavior that focuses on shareholder returns. After being challenged publicly by TSE officials, many companies have already responded. As profits continue to increase as part of a virtuous cycle of growth in Japan, we believe an even more meaningful shift may soon occur. For investors seeking targeted exposure, we believe the [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#) may be poised to benefit from these trends.

For access to the complete developed international market insight, click [here](#).

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in Japan, thereby increasing the impact of events and developments in Japan that can adversely affect performance. Investments in currency involve additional special risks, such as credit risk, interest rate fluctuations and derivative investments, which can be volatile and may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.