Expectations for Japanese Equity Market

1st June 2009, Mr. Yoshihisa Nakagawa, chief portfolio manager of GARP (Growth At Reasonable Price) strategy at Tokio Marine Asset Management Co., Ltd, ("TMA") reveals his positive outlook on the Japanese equity market.

Short-term outlook

We have been bullish on the Nikkei index for some time and the index rose to the levels we expected. We see more room for higher prices and we believe the Nikkei will rise to somewhere between 11,000 and 12,000 yen.

- Due to the easing of deflationary concerns in Japan and the implementation of structural changes in 2005, some foreign investors accumulated net buying positions as a result of over expectation. Individual investors seeking yield also became net buyers for the first time in 20 years. The balance of supply to demand has changed to reflect quite a strong positive trend in this regard.

- The unprecedented number of government-led financial packages to tackle the credit crisis has led to the possibility of the world economy recovering faster than anticipated. In Asia, Japan is well positioned to capture any uptick in the continent's prospects as a result of the number of industries it has sensitive to regional developments, and the nation's large and long-standing footprint in the region.

- Despite weak expectations, production levels in Japanese companies may recover sooner than the market expects partly as a result of their swift action to reduce inventories.

- The Japanese credit market, which does not suffer from the same issues as those in the West, stands to recover on the back of an upturn in the equity market. The Japanese issues are market-related rather than systemic in nature and reflect the strong Yen and weak equity market, not the high leverage levels in companies as is the case in Western markets. Japan has the lowest price to book ratio among all developed markets. Considering that credit risk in Japan is lower than in the US or Europe, pricing in Japan appears to be at "worst case" levels.

Medium-term view

In the medium term, the case for investment in Japan also looks compelling particularly for investors taking a longer term view.

- The Japanese credit cycle, which synchronises with the construction cycle, is currently positive. In the past, it has been the norm that the bottom of the cycle has occurred in the "even" decades (1960s, 1980s and 2000s), and the peak in the "odd" decades (1970s and 1990s). Consequently, the cycle should be turning positive toward early 2010s.

- As global reserves of fossil fuels dwindle and energy shortages become more of an issue, Japan's growth should not suffer significant impairment due to its access to advanced technologies and alternative energy sources. The country is already very advanced in its use of hybrid cars, nuclear energy and fuel-efficient mass transit systems. It is these sorts of technologies that should ensure support the further growth and development of Japan and the Asian region as a whole.

- In Japan, it is common for a gap of about five years to occur between key occurrences and improvements to materialise. Having rejected its first hostile acquisitions proposed by foreign funds in 2006, Japanese companies should experience an increase in M&A and hostile takeover activity in 2010, which should improve their capital return. Another occurrence that supports this includes the reaction to the first ever restructuring in Japan in 1993 by Pioneer, a consumer electronics firm. This corporate action led to a boycott of their
- products at the time; 5 years later, restructuring practices has become common practice in Japan.

Longer-term view: Era of inflation could bring benefits to Japan

- We think market pricing is at a level that you would expect at the start of an inflationary period. Due to the nation's efficient economy and a strong position as a net lender, we believe Japan should be able to obtain the maximum benefit in this sort of environment.

Active management could help investors reap benefits of upturn in Japan

- Despite widespread views to the contrary, successful stock selection and the use of a proven active manager who is experienced in the Japanese market may well be the best way to outperform the market and produce greater than benchmark performance.

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