Market Insight: Japanese Equities

Tokio Marine Asset Management (London) Limited
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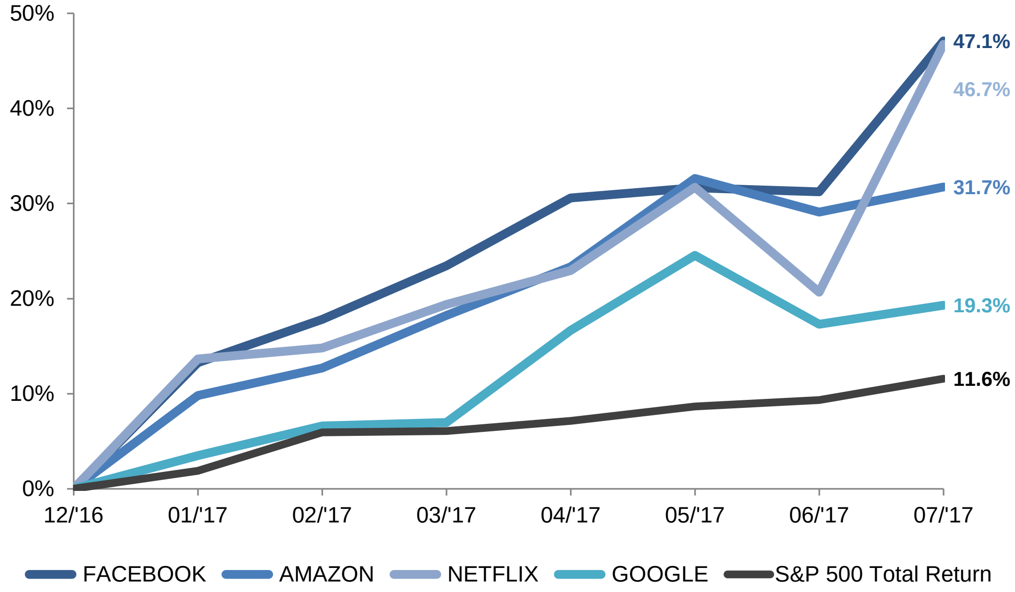
Japan's FANGs: The little known Japanese winners of the IoT revolution

Few individual stocks have generated as much excitement this year as the US FANGs: Facebook, Amazon, Netflix, and Google (now Alphabet). Even though they are well established and known by market participants, the four tech giants have easily outperformed the US equity market as represented by the S&P 500 Total Return Index, presenting an unusual case of high growth given their size and maturity (see chart 1).

Chart 1 Monthly Cumulative Stock Performance 2017 YTD: FANG* vs SP500 TR

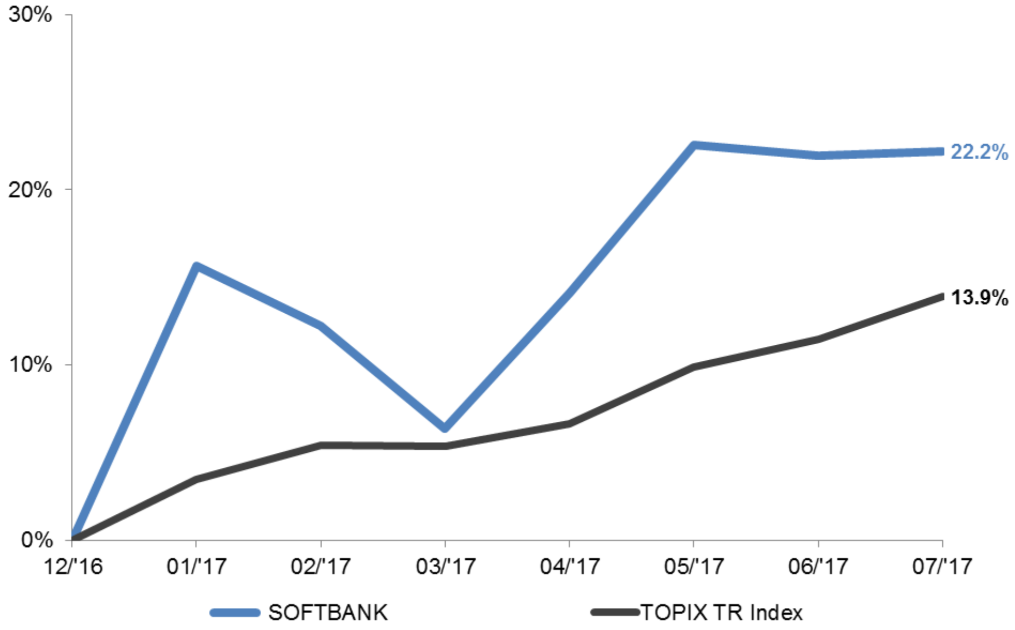


* Total holding period return including dividend

Source: Bloomberg, normalised from end of December 2016

They are a remarkable collection of stocks but the US is not the only region home to such outperformers. If we look at Japan, one name that often comes to mind in this sector is Softbank (9984). With a number of high profile acquisitions and the largest ever venture capital fund on its achievements list, the firm seems to fit the bill. Softbank's stock performance has also been strong – it has outperformed the TOPIX Total Return Index by 8.3% over the first seven months of 2017 on a total return USD basis (see chart 2).

Chart 2 Monthly Cumulative Stock Performance 2017 YTD: Softbank vs TOPIX TR*



* Total holding period return including dividend; USD based performance
Source: Bloomberg, normalised end of December 2016

While we believe there are reasons to be excited about Softbank, these returns are still considerably below the 23.6% outperformance a FANG equal-weighted basket of stocks would have delivered over the S&P500 Total Return Index during the same period.

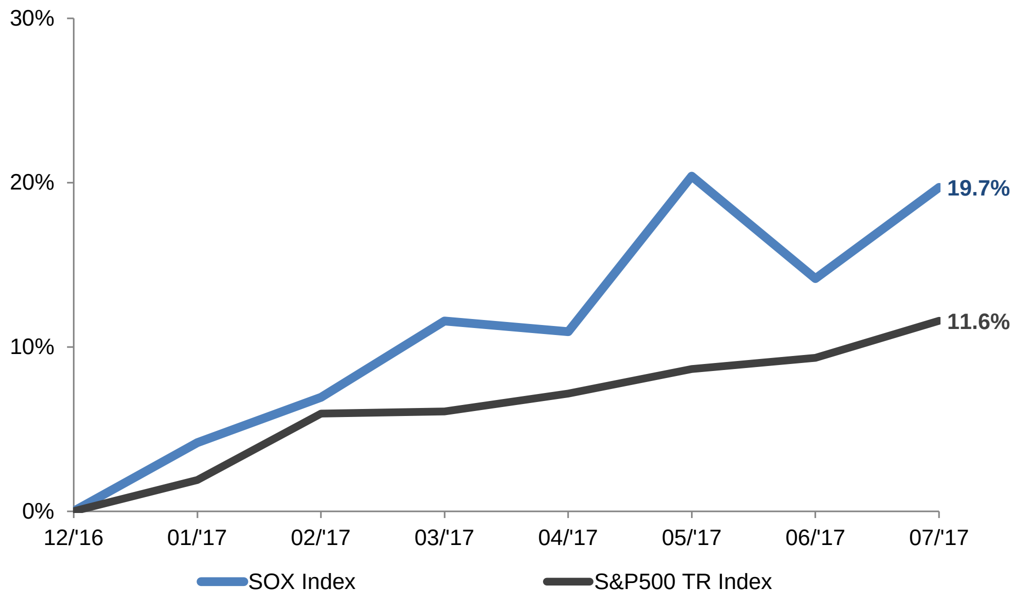
But Softbank is not alone in its future prospects for tech triumph. Rohm (6963) is a semiconductor manufacturer which has outperformed the TOPIX Total Return Index by 21.7%[1] over the same period. Likewise, Disco Corp (6146) is another example. The company is a producer of semiconductor manufacturing devices and has delivered a remarkable 34.6%[1].

Much like the FANGs, there is one thing that unites these individual examples and they have a common underlying theme – the emergence and growth of the Internet of Things (IoT).

While this theme is well covered in the news, it is often consumer technology products such as smartphones that receive the lion's share of attention. However, the far less conspicuous semiconductor industry is benefitting from the IoT trend in a big way. A testament to this is the PHLX Semiconductor Sector Index (aka SOX), which has outperformed the S&P500 by a good margin recently (see chart 3).

1 Total USD return

Chart 3 Cumulative Performance: SOX Index vs S&P500 TR Index

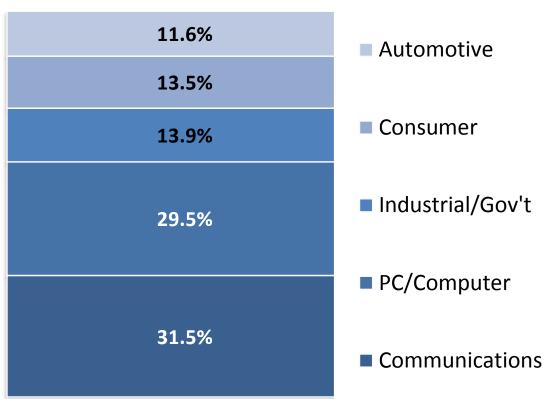


Source: Bloomberg, normalised at end of December 2016

Meanwhile, we are also seeing opportunities in industrial electronics and IT services sectors as well. What the success of these sectors show us is that one important, distinctive feature of IoT is diversity. In the case of semiconductors, demand has long been largely dominated by computers, and more recently by communications, particularly smartphones, which combined accounted for 61% of the global semiconductor market in 2016.

This has provided an advantage to lower cost, larger manufacturers who can benefit from economies of scale by concentrating on comparatively uniform mainstream demand; the race was on for smaller and faster chips (see chart 4).

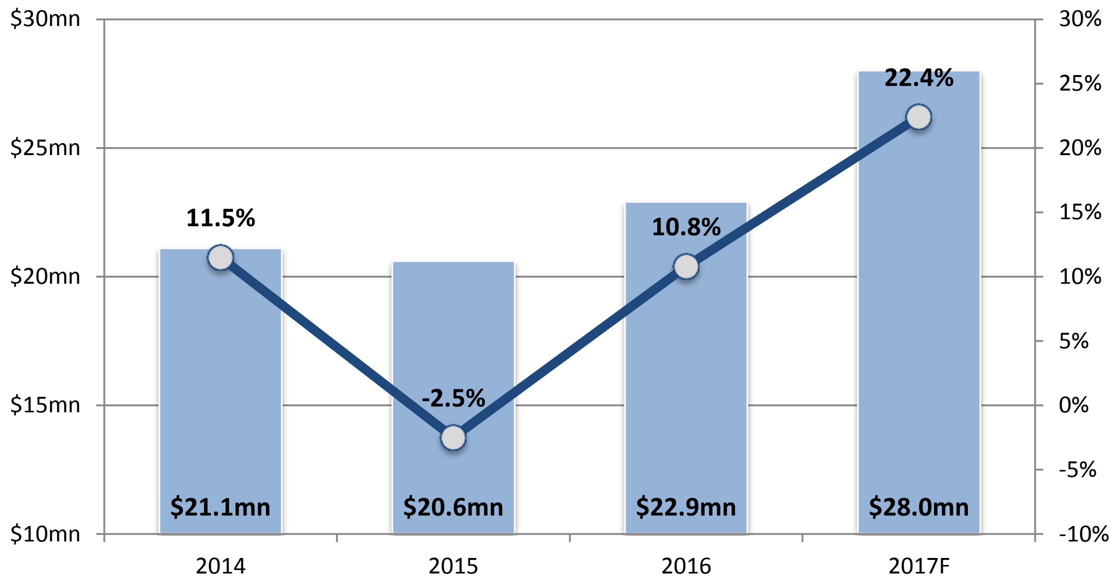
Chart 4 2016 Total Global Semiconductor Market, by End Use



Source: World Semiconductor Trade Statistics

Unlike computers, the processing power requirements for IoT connected devices are actually comparatively low. On the other hand, the chips for such devices require much more heterogeneity in design and integration into individual devices, including the software that runs them. This has shifted focus from production efficiency to technological know-how, which is exactly where Japanese firms have maintained an edge in our view.

Chart 5 2014-2017F Automotive IC Market



Source: IC Insights

The performance of semiconductor companies overall has been far from uniform. Among the 31 stocks in the Semiconductors & Semiconductor Equipment segment of the TOPIX Index, many performed poorly, with three actually delivering double-digit negative returns. Valuations can also be quite high, with a quarter of the 31 stocks listed having a P/E ratio in excess of 30 times. Therefore, we feel picking the right names is as important as ever.

Our approach to selecting stocks both in the semiconductor industry as well as others has consistently been to select growth names, while also paying sufficient attention to valuations (Growth at Reasonable Price or 'GARP'). This philosophy has paid off over the two decades we have managed the GARP investment strategy, and with plenty of opportunities like those mentioned above, we feel confident about continuing to select the most interesting ideas for our clients.

Tokio Marine Asset Management is a Japan/Asia equity specialist with over 30 years' market experience and approx. $56.2 bn AUM (as of June-end 2017).

GARP Product info

Our flagship Japanese Equity GARP strategy is a diversified portfolio of growth stocks with a two-decade-long track record.

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