

Market Insight: Japanese Equities

Tokio Marine Asset Management (London) Limited
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Japan – turning lemons into lemonade



Japan – more than just averages

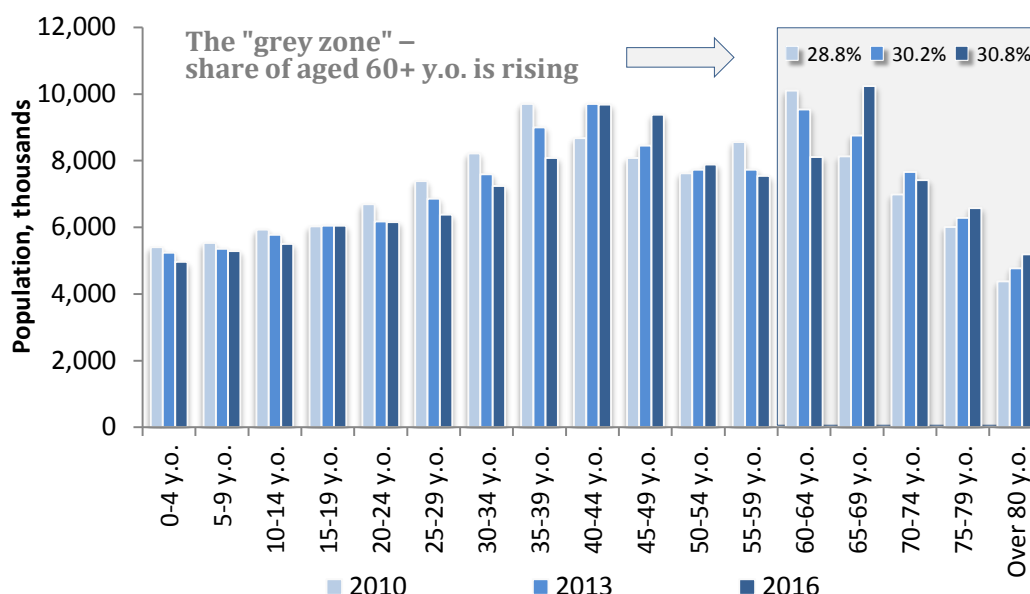
There is a range of opinions about where Japan's financial market is headed. Some investors speak of a doomsday scenario, as expanding government debt drags Japan into the abyss. Others point to the improving macro indicators and predict strong recovery on the back of Abenomics.

While we are generally optimistic, we nevertheless think it would be imprudent to ignore the considerable dispersion between individual stocks' performance. This dispersion is often hard to spot behind the headline

average numbers reported in the news. In this article we attempt to shed some light on two specific areas: (1) Japan's ageing population; and (2) Asia ex-Japan economies outpacing Japan. While at the first look they might remind one of lemons by leaving a sour aftertaste, they can still be excellent ingredients to make lemonade- at least as far as investment ideas go.

Japan's shrinking population

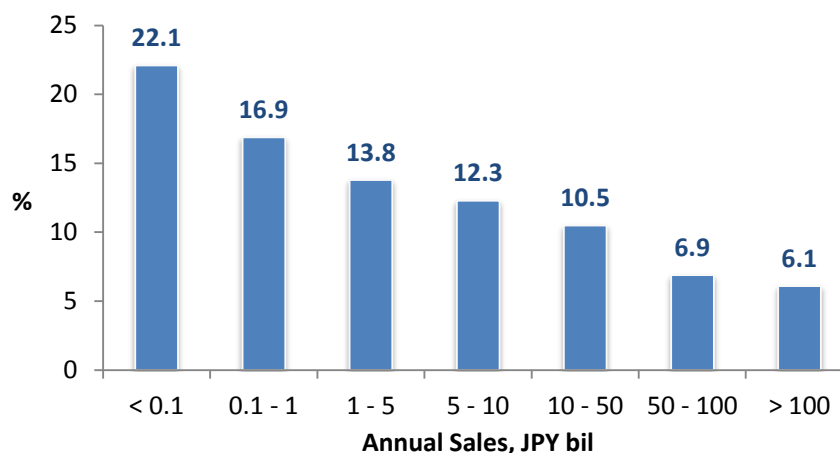
Chart 1 Japan's Population by Age Group, 2010-2016



Source: Ministry of Internal Affairs and Communications (Japan)

Japan’s population has been ageing for a long time now, leaving the country battling for sustainability of its pension system, and companies finding it increasingly difficult to find and retain employees. Small and medium enterprises in particular, most of which are family-owned, increasingly faced the successorship problem.

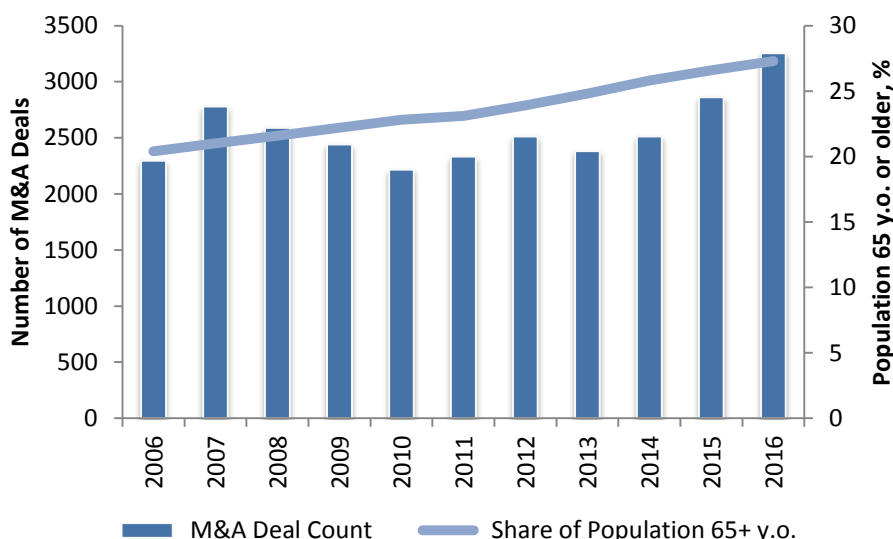
Chart 2 Share of CEOs aged 70 or over by Firm Annual Sales



Source: Teikoku Databank, Ltd, 2017

When unable to find a successor, business owners often choose to sell it, and this has contributed to the increase in M&A deal count over the recent years.

Chart 3 Share of Population 65+ y.o. and M&A Deal Count in Japan

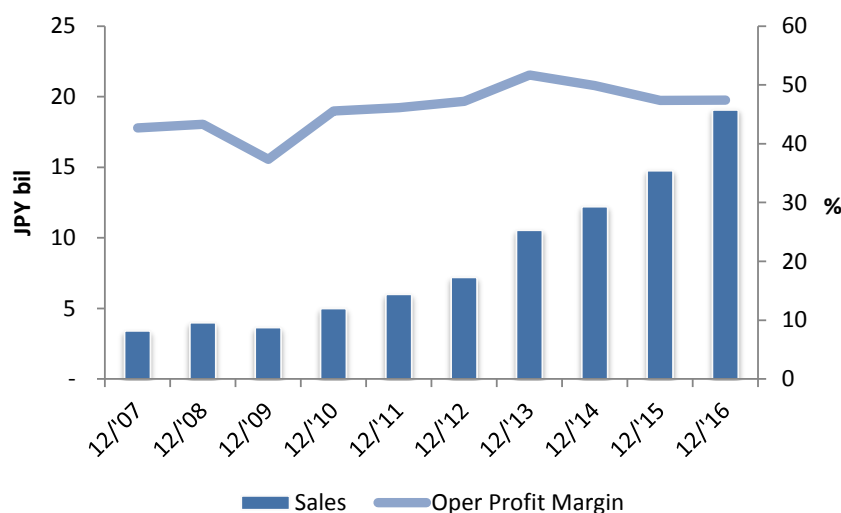


Source: Bloomberg Intelligence

One example of a company benefiting from this trend is Nihon M&A Center (2127) – an advisory firm providing services mostly to small and medium enterprises. They recognised the extent of the successorship problems early on, and built relationships with 301 regional banks and credit unions which lend money to SMEs. The synergy was straightforward, and Nihon M&A Center’s sales have

grown significantly on the back of it.

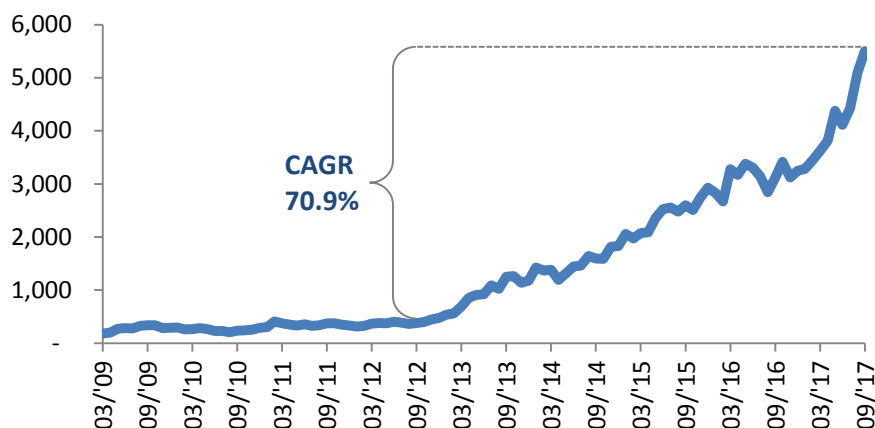
Chart 4 Nihon M&A Center’s Sales and Profit Margin



Source: Bloomberg

Investors took notice, and the stock has risen at a CAGR of 70.9% over the past five years. This is just one example of how companies in Japan can grow despite the apparent weakness of the macroeconomic fundamentals.

Chart 5 Nihon M&A Center’s Historical Stock Price Performance

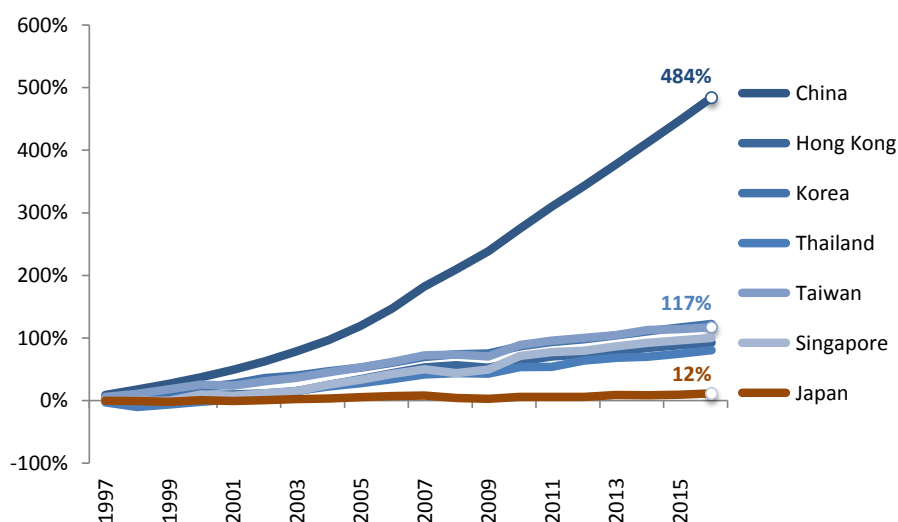


Source: Bloomberg, as of end of September 2017

Rest of Asia catching up with Japan

After the burst of Japan’s bubble in the late 1980s, other Asian countries took the spot in the limelight. The Asian tigers (Hong Kong, Singapore, South Korea and Taiwan), soon followed by China and others exhibited significant growth, and Japan was left behind.

Chart 6 Cumulative Real GDP Growth: Japan vs Selected Asian Countries



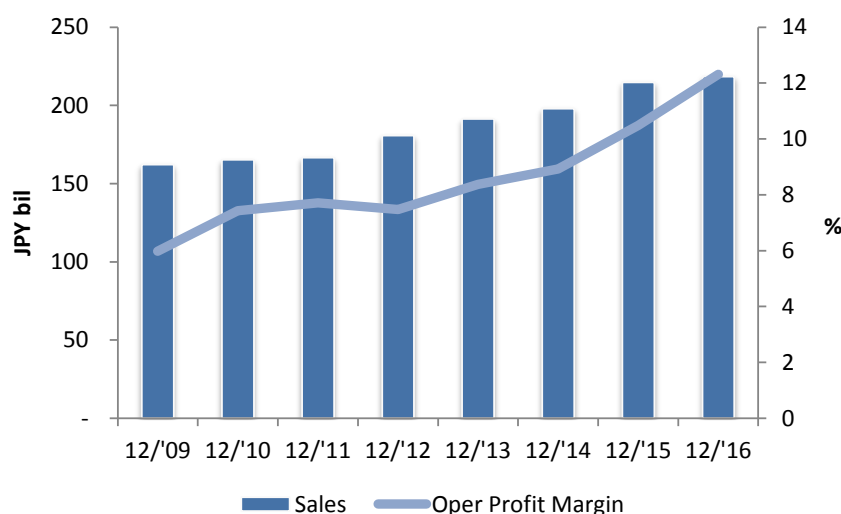
Source: Bloomberg

Again, on the surface this is a negative development for Japanese companies as strong competition emerged in Asian countries. However, as Asian economies developed, their citizens became wealthier and Japanese merchandise, long known for its high quality, increased in demand.

One company that took advantage of this trend is Pola Orbis (4927). This multi-brand cosmetics manufacturer has been successful in capturing the demand for high quality and the shift to ‘soft’ products. While the domestic market is showing little to zero growth, the firm’s leading and most highly priced beauty care line product line Pola has been gaining traction with Asian clients.

Pola Orbis is now in an enviable position where its highest margin product is also the fastest growing one. As a result, the sales have been increasing, but more importantly, the profit margin has been expanding at the same time.

Chart 7 Pola Orbis’ Sales and Profit Margin



Source: Bloomberg

This is another example of how Japanese companies have successfully turned ‘lemons’ into ‘lemonade’, and continue to do so today.

Our investment approach on the Japanese Equity GARP strategy – focusing on Growth at Reasonable Price or ‘GARP’ – has consistently been effective in identifying such growth names, while also paying attention to valuations. This philosophy has paid off over the past two decades that we have managed the strategy, and with plenty of opportunities like those mentioned above, we feel confident about continuing to select interesting ideas for our clients.

Tokio Marine Asset Management (TMAM)

TMAM is a Japan/Asia equity specialist with over 30 years’ market experience and approx. \$57.2 bn AUM (as of September-end 2017).

Product info

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

For more information about the issues raised in this article, please contact Business Development at Tokio Marine Asset Management (London) Ltd.

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