Japanese Equity Report

Tokio Marine Asset Management (London) Ltd

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Market update and outlook following recent volatility in China

The Japanese market, which had plunged due to the Greek debt crisis and a sharp decline in the Chinese stock market in early July, recovered strongly in early August when TOPIX surged above 1700 points, the highest point this year on 11 August on the back of good April-June corporate earnings results together with continuous support for Greece and price stabilising measures introduced by the Chinese government.

After the recovery however, the market began to decline once again as the People's Bank of China set in motion a Yuan devaluation which began on 11th and 12th August. The bank announced that the measure was just a one-off and the market stabilised for the time being after the announcement.

On 18th August, the market was disappointed as the Chinese government seemed to have less room to launch another round of measures to support the equity market. In addition to this, the Purchasing Managers' Index (PMI) in China fell well below the previous month’s value to 47.1 in August, which amplified the concerns of investors.

Concern over the Chinese economy decelerating has created a sluggish commodity market and put downward pressure on equity markets across the globe. Also, it is alleged that the US is going to raise interest rates in September and investors are becoming cautious about the global financial markets.

Current outlook and investment strategy

One of the differences between the current weak state of markets and the markets in July is that this time we see investors changing their behaviour to become more risk-averse, while the weakness in July was just a correction from an overheated market.

In Japan, real GDP growth for the April to June quarter became negative and confidence in sustainable economic growth seems to be fading. CPI, which is the main inflation target for the Bank of Japan is still slow and another round of monetary easing and fiscal expansion is expected.

On the other hand, if we extrapolate the pace of earnings growth of the April to June quarter to estimate the full year earnings results, it would be likely that there might be an upward revision. Due to the currently weak equity market, the PER taking the fiscal year estimate is now below 15 times and we think the level of valuations for Japanese equity have come down to a normal level.

We think the Japanese market will be unstable in the short term due to concerns over the external environment.

In order to stabilise the global capital market, we think there should be some conditions met, such as more clarity on US monetary policy which might tame volatile emerging countries' currencies and equity markets, and a proactive commitment to fiscal expansion by the Prime Minister of Japan.

Under such circumstances, the market price could deviate from the intrinsic value of companies. We would like to take this opportunity to invest in companies which have high potential to create better returns through thorough fundamental analysis.

All information presented in this report is provided by Tokio Marine Asset Management Co., Ltd. unless otherwise mentioned.

Contact us

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