Marketing Communication
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Value + Alpha Group

PM's Monthly Perspectives

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The MSCI Japan index advanced due to purchases by non-Japanese investors, the yen's depreciation and the new Nippon Individual Savings Account (NISA). Specifically, the Japanese market was pushed up by non-Japanese investors who bought Japanese stocks on their positive expectations about the Tokyo Stock Exchange's (TSE) call for its member companies to take measures to improve their P/B ratios, about the new NISA small investor tax exemption program, and due to the strong performance of Japanese stocks relative to other global markets in the 2023 calendar year. A weaker yen against the US dollar also contributed to the rise in Japanese equities. As for the new NISA, which was launched in January 2024, the annual investment limits come in two types of investments: "Accumulation Quota" and "Growth Quota." Market participants assumed that individual investors bought Japanese stocks in January using the "Growth Quota" of JPY2.4 million in annual investment limit, as investing using the quota in January is more beneficial for investors than investing in the other months of 2024, and their view that a large portion of the Accumulation Quota of JPY100,000 a month seems to have been used for buying overseas stocks, which would be a factor for sustainable depreciation of the yen. Both of which worked positively for Japanese stocks. And apart from the fundamentals, large-cap stocks, such as the TOPIX Core 30, performed well, driven by purchase orders from overseas investors. Incidentally, immediately after an earthquake hit the Noto Peninsula, the Bank of Japan's (BOJ) termination of its negative interest rate expected by the market was temporarily pushed back, but, toward the end of the month, the expected time of the termination was back to the April-June period, with some people saying that the impact of the earthquake on the Japanese economy would be limited, and the BOJ's view that the likelihood of the realisation of its inflation outlook continued to gradually increase This was presented through its monetary policy meeting (MPM) and the Summary of Opinions expressed at the MPM.

Earnings: October-December earnings season started off with strong results

The earnings announcement season for the September-December quarter got under way. As of 31 January, approximately 31% of major listed companies (excluding financials and listed subsidiaries of a listed company) on the Prime Section of the Tokyo Stock Exchange (TSE) announced their earnings results. According to Daiwa Securities, the aggregate operating income increased +33% year-on-year. Looking at the actual operating income of the TOPIX 500 companies for the quarter of 2023, 45% of them announced higher operating income than analysts' consensus estimates by +10% or more, and 17% announced income falling short of the consensus by -10% or more.

As the fund managers in charge, our focuses for the quarterly earnings reports are on: 1) whether cyclical sectors and industries are showing signs of bottoming out, and; 2) what kind of measures they would announce to improve their price-to-book value (P/B) ratios in response to the TSE's call for P/B improvement. About 1), although some companies in such sectors as electronic components suggested some improvements in business, the number of such companies is still small. Therefore, we cannot conclude that these sectors and industries, as a whole, are bottoming out. Regarding 2), the progress has been mixed. While some companies have been favoured by the market for changing their capital policy, others have not made any new announcements and are sticking to their old medium-term management plan, waiting for their problematic businesses to turn around passively. Below are some examples of positive and negative cases:

Positives

Nomura Holdings: beat analysts' EPS (earnings per share) estimates. In Japan, its performance in primary-market businesses such as initial public offerings and public offerings was strong, and partly driven by increased market anticipation that the US rate-hiking cycle would end, the company's FICC (fixed income, currency, and commodities) businesses, including macro products, credit, securitisation products, and emerging currency transactions, rebounded sharply in the second half of the quarter. Additionally, the company performed very strongly in investment banking, partly due to its role as lead manager on multiple deals. The company also announced plans to repurchase up to 4% of its outstanding shares, and stated that it purchased stocks through the NISA program in January equivalent to one-third of its total purchases through NISA in the entire FY2022, indicating potential for strong future earnings.

Kinden Corp: beat analysts' consensus estimates for sales and operating profits, and its profit ratio for construction contracts improved both at home and abroad. And in response to the TSE's call for P/B improvement, the company released a document demonstrating its efforts to invest for growth and enhance corporate value in their medium-term management plan. The document indicates the company's policy of increasing its total payout ratio from 30% to 50-60%. The company also announced a dividend increase and share buyback plans. Additionally, the company plans to reduce its cross-shareholdings and secure a return on equity (ROE) that exceeds its cost of equity capital.

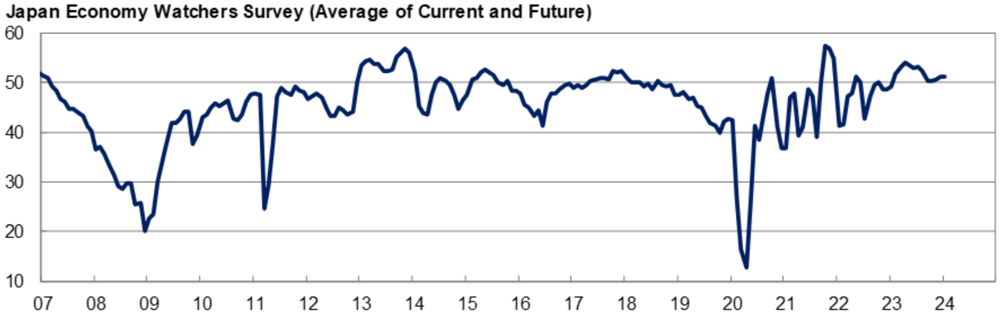
Negatives

Aozora Bank, Ltd: missed analysts' consensus EPS estimates and announced to make significant provisions for loan losses related to office deals in the US, which account for 6.6% of its entire loan book. The bank also indicated that its net income for this fiscal year would be negative and revised its outlook for dividends for the second half of the fiscal year to zero. The US office market is currently experiencing a very severe liquidity shortage due to rising interest rates and the shift towards working-from-home caused by COVID-19. The bank explained that it would review all of its US office deals (47 clients), and recalculate the property values, factoring in the risk of falling property values.

SHIFT Inc: missed analysts' consensus estimates for sales and operating profits. The company has been a growth name, reporting significant increases in sales and profits. The company's operating profit grew by +117% year-on-year in the second quarter before the latest one, and by +104% in the quarter prior to that; however, the growth was +0% for the latest quarter. The company's profit ratio decreased due to several factors: 1) a deterioration in profitability of the business mix due to a rise in the share of the low gross-profit business segments; 2) a fall in testing capacity utilisation rate because of an enlargement in the size of contracted deals; 3) strategic choices made acquiring low-profitability deals, and; 4) pay raises, and among others.

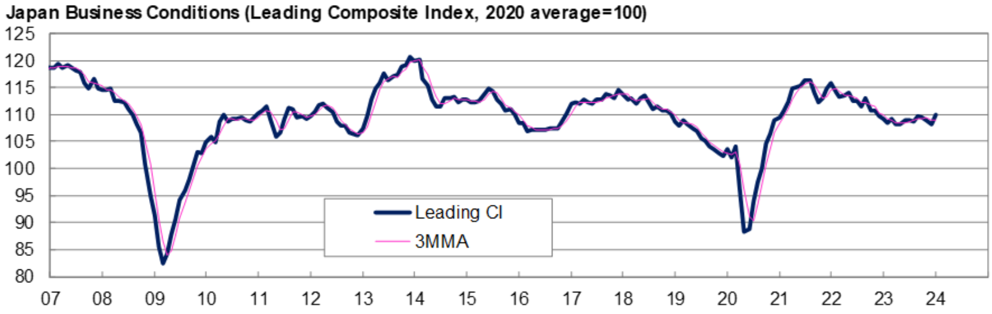
Economy: Japanese leading economic indicators improving, positive for Japanese stocks

Both of Japan's leading indicators that we mainly focus on have improved recently, and the future outlook of Japanese economy seems to be quite favourable. The average value of the current and future Economy Watchers Survey was 51.35 in January, up slightly from 51.10 in December. This suggests the third consecutive month of improvement. There was an earthquake in Noto Peninsula in January. The sentiment for the Hokuriku region has plummeted and travel agencies are downgrading this area due to the trip cancellations. However, with economic indicators improving, we see the situation better than it appears. The comments of those surveyed give us an impression that inbound tourism and automobile production were positive, but the housing-related sector was negative due to the high cost of materials. Also, we have an impression that business conditions differ by income group in general; steady for wealthy people but slightly weak for middle-income and low-income people due to inflation.



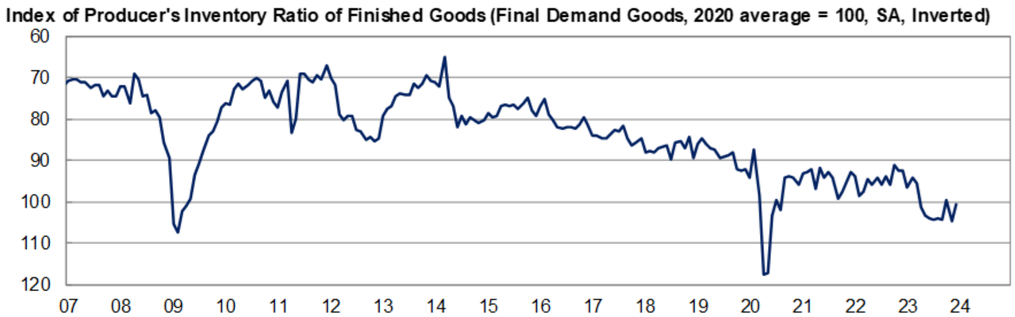
Source: Created by SMDAM (Tokyo) based on Bloomberg, 9 February 2024.

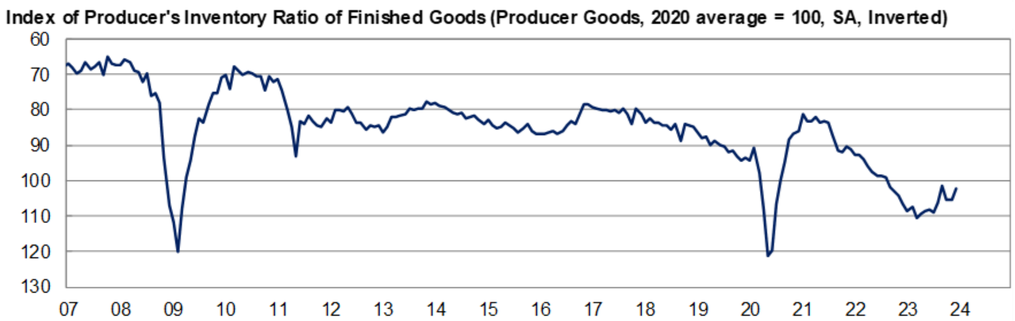
The Japanese composite Leading Indicator, consisting of 11 leading economic indicators, has improved to 110 in January from 108.1 in December. This is a huge improvement and gives us a positive impression.



Source: Created by SMDAM (Tokyo) based on Bloomberg, 9 February 2024.

Looking into details, the improvement in the inventory ratio of final demand goods and intermediate goods is noticeable. This is a leading indicator of industrial production. Consumer sentiment and job openings are also improving. These are leading indicators of consumption and employment.





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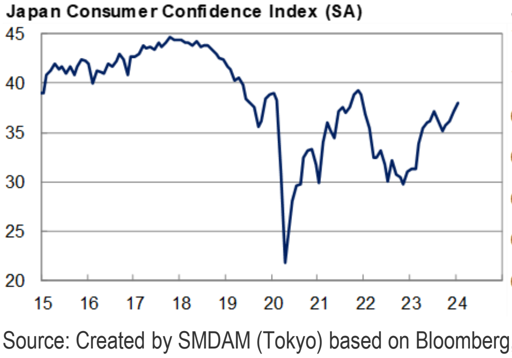

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Investment Strategy

We expect that the Japanese equity market will advance in the short term due to a change in the management policy of Japanese companies with a P/B ratio below 1x driven by TSE policy, earnings growth and an increase in equity purchase amount by individual investors through the new NISA scheme. Over the long term, policies that are more open to foreign capital, including an improvement in corporate governance, as well as policies to boost the immigration intake, are likely to support the market. We identify external factors, such as the outbreak of financial crisis and global recession, as major risks. Taking these into consideration, we will overweight low-P/B companies with large net-cash positions or a lot of unrealised gains on land.

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Mr KAMIISHI joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr KAMIISHI obtained a BA degree in Economics from Keio University (2009) in Japan.

Note:
Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.
CMA: Member of The Securities Analyst Association of Japan.

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