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Japan hit hardest in Brexit shock, but remains an opportunity

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It is difficult to remain sanguine after the unprecedented events of the past week.

However, well prepared global investors, who knew that volatility, uncertainty and market movements were expected around the months of June or July, have kept their poise and even found unique and timely opportunities to recalibrate portfolios.

In fact those investors have doubled down on tactical investment opportunities and reaffirmed where they believe markets and the real economies that bedrock them will be heading nearing 2017.

One such conviction opportunity remains Japan, represented by the Nikkei 225 large-cap bourse and related indices.

Of all of the significantly capitalised developed market bourses, Japan suffered the largest hit when the shock of Brexit came to bear and these bourses constituted a large chunk of the $US2.08 trillion wiped off markets globally following the surprise vote.

The Nikkei tumbled 1286 points (7.9 per cent) on Friday, June 24, the day the referendum result was announced and the TOPIX fell 94.2 points (7.3 per cent). On Monday, however, the Nikkei finished up 2.4 per cent and the TOPIX gained 1.8 per cent. Buying focused on domestic demand/defensive sectors and their constituent stocks, where recent performance has been strong, while selling from domestic trust banks (pensions), focused on external demand and financials sectors, which have performed poorly to date.

The rational among us acknowledging the following factors have been crucial for Japan:

• G4 currencies in order of weakness following the Brexit shock are unsurprisingly the British pound, euro, US dollar and the yen. Bullish sentiment on the yen as a safe currency has intensified.

• The USD/JPY is on the verge of the ¥100 threshold as reverberations from the Brexit vote look to linger for now.

• The Japanese government should seek US understanding for a forex intervention, pointing out that Brexit-related yen appreciation could worsen global risk-off sentiment.

• Japanese Prime Minister Shinzo Abe pledged to use all the forces at his command to address global risk as chairman of the recent G7 summit.

He said at an emergency meeting of the government and BoJ this week that G7 nations should come together to "nip any risks in the bud". The BoJ has been in contact with other central banks to ensure the co-ordinated supply of ample liquidity.

• Japanese bourses were the largest markets open during the Brexit shock and thus unfairly copped the brunt of it.

What has also been forgotten during the tumult of these post-Brexit trading windows has been that Brexit was as much a no-confidence vote in the European experiment as it was a conviction for the British to seek self-rule and in these respects, global investors have been concurring, demonstrated by their selling of "EMEA" — Europe, Middle East and Africa — multi-asset positions.

With record volumes seen in Japanese bourse recalibrations this week, savvy global investors have taken another look at access channels such as the Japanese TSE Mothers Core ETF (1563: JP). But most important of all, the question remains how far will Japan retrace and does the timing align with the portfolio expectations of Australian global investors?

To best understand this, it is important to accept that the BoJ's ineffective monetary policy is its own doing — its inconsistency, poor communications, and of course, negative interest rate policy, have disenfranchised global institutional market supporters.

So it became important that last week, Takako Masai has been chosen to replace BoJ policy board member Koji Ishida, who reaches the end of his term on June 29.

Ishida hailed from one of the megabands and was strongly opposed to the negative interest rate policy, but Masai appears to be rather more tolerant. If BoJ governor Kuroda should propose another round of easing, he can almost certainly count on support from deputy governors Kikuo Iwata and Hiroshi Nakaso versus dissenting votes by Takahide Kiuchi and Takehiro Sato.

As has been continually discussed within this column since November, it was clearly foreseeable that mid-2016 was set to become a turbulent, volatile and unsettling geopolitical and economic window. But it therefore becomes especially imperative that Australian global investors stick to their portfolio plans, patient and rational. All else is commotion.

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