

Stick with Japan ... it's paying off

- *Stirling Larkin*
- [*The Australian*](#)
- March 07, 2015 12:00AM



Japan's Prime Minister Shinzo Abe, who has overseen successful reform policies. *Source:* AFP

THE truly accomplished global investors succeed because they run the marathon and not the sprint.

Japan's renaissance could only be considered a marathon and best described by the seafaring analogy that a supertanker cannot be turned around on a dime.

The Japanese economy, by any measure, would be considered a supertanker and one that sails the high seas alongside its maritime and economic ally, the US.

Japan still ranks second, after the US, in terms of aggregate wealth per capita and enjoys a greater wealth distribution than any other developed nations reflected in a Gini coefficient (a statistical tool to measure income distribution of a nation's residents) of 63 per cent.

Since writing about Japan and its reform policies stewarded by Japanese Prime Minister Shinzo Abe in this column on April 12 last year ("Positive thinkers stick with Abe"), investments in Japan have been the best performing of all the thematics we have discussed.

With Japanese stocks reaching 7-year highs, coupled with the fact that they have been the best-performing developed market, in US dollar terms, 2015 year-to-date, the question for Australian ultra high net worth (UHNW) investors becomes whether now is the time to exit this race or persevere and seek a "second wind"?

From the perspective of listed companies on Japanese bourses, the fundamentals present a strong argument to remain in the race during 2015.

With reasonable expectations of earnings growth between 12-13 per cent this year, Japan is one of the few markets with positive revisions in earnings-per-share momentum.

Strong earnings growth, an increasing focus on shareholder return, continued monetary policy accommodation and a continued weaker yen, which itself, in turn, supports earnings, all bode well for the global investor seeking portfolio alternatives.

Further to this, an important shift can be witnessed in the graph provided.

So far this year, the MSCI Japan index has risen and this rally occurred despite the yen strengthening against the euro.

This is significant in that it demonstrates a decisive break in the inverse yen-equities correlation, which has broadly applied for more than a decade in the nation of the rising sun.

This shift looks to be partly a function of Japan's rotation from bonds to equities, which was one of the primary goals of the Bank of Japan's bond-buying program, known as "quantitative and qualitative easing" or QQE, which began in April of 2013.

With the open-ended QQE program, BOJ purchases of Japanese government bonds have driven up their prices which, in turn, have compressed these bonds' yield.

With lower yields, asset allocators are prompted to move into riskier assets, thereby driving up the prices of other assets and further compressing yields on private credit.

The wealth effect that this causes, thanks to higher asset prices, then boosts aggregate demand, while the "credit channel effect" — reduced yields in credit markets — lowers financing costs for both companies and households.

This positive scenario supports the reasonable expectation of earnings growth for listed Japanese companies in 2015.

Further still, supported by a competitive yen, the collapse in commodity input costs and a sequential improvement in real wages that feeds into firmer domestic demand was reinforced by the announcement in January that domestic employment had significantly improved, with the job openings-to-applicants ratio reaching its highest levels since 1992.

Improving domestic employment and household wealth in Japan also directly benefits Australia, as we remain one of their key trading partners.

On this, Innes Willox, CEO of Australian Industry Group and Larkin Group Advisory Board member, comments that: "Japan is slowly finding its feet and economically Australia is well placed to develop the relationship for generations to come.

The FTA will provide winners and losers within the Australian economy but overall it gives Australia a chance to build a new economic partnership with one of the region's biggest economies just as it starts to open further to the world."

For Australian businesses and investors alike, one thing is known for certain: that under the fiscal stewardship of Shinzo Abe and the monetary guidance of BOJ chairman Haruhiko Kuroda, Japan will stop at nothing to turn its supertanker away from the path towards continued deflation.

Its unprecedented and unrelenting commitment to “reflation”, through asset purchases and other stimuli can mean only one outcome — yen-denominated asset inflation.

Given the recent decoupling of the yen-equities correlation, the savvy global investor should differentiate between those listed entities whose profit growth and share price gains are mainly attributable to foreign exchange movements and those whose profits are increasingly driven by solid fundamentals and highly competitive business models.

UHNW investors have therefore been advised to own Japanese assets that the Central Bank cannot print, namely, equities.

Alps Electric Co. (6770: JP), Seiko Epson (6724: JP) and Makita Corporation (6586: JP) are all worth keeping an eye on this year, to name but a few

All of these are examples of Japanese companies which have overseas sales of at least 15 per cent, price-earning (P/E) ratios of 20 times or lower and have expectations of operating profit growth at least 15 per cent, excluding the effects of foreign exchange.

The 17th century Japanese poet Matsuo Bash said: “No matter where your interest lies, you will not be able to accomplish anything unless you bring your deepest devotion to it.”

Investing in Japan, without any doubt, requires the deepest of devotion and for those willing to run the course, the greatest of accomplishments may well wait ahead.

*Larkin Group is a Wholesale Wealth Adviser focusing on high yielding global investments
www.larkingroup.com.au*