

# Views from the Japan Equities Small Cap Desk

## Author



**Tatsuro NIGURI, CMA**  
Senior Portfolio Manager

*“An incentive to increase dividends is rising...”*

*“Low shareholder returns at the moment suggests a big room for dividend increases...”*

## Go for small, cheap and “stingy” stocks

As I pointed out in the previous column the bullish trend for small and cheap stocks is reaching the final stage - their advances actually abated to a certain extent during the new year period. While the so-called growth stocks keep an upward trend albeit with wild fluctuations. Given the tendency that price movements of cheap stocks lag behind those of the overall market, cheap stocks could turn up again at any time.

### ▪ Expectations for dividend increase in cheap stocks

We can also expect dividend increases as the fiscal year-end for most Japanese companies is coming closer. Benefits from dividend increase in cheap stocks are considered to be bigger than those in growth stocks. Corporate performances are not that strong in general but better than the pessimistic scenario developed last year amid the escalation of US-China trade disputes. The chance to increase dividends has finally come for companies that had ‘kept dividends on hold’ to brace for emergencies despite the willingness to do so.

An incentive to increase dividends is rising not only among large companies but also among midsize companies, though midsize companies fall one step behind large companies. We saw a substantial number of companies announce dividend increases for the current fiscal year at the beginning of the fiscal year despite weak estimates on earnings. I believe many other companies also accept ‘the idea to increase dividends amid earnings declines’.

### ▪ The pay-out ratio of 30% is too low

Japanese companies used to “set a target pay-out ratio at 30%” but now they feel that “30% is too low.”

I myself think the pay-out ratio of 30% is an appropriate level for companies where the amount of money invested exceeds depreciation charges for long-term earnings growth, but too low for most of the domestic companies with sufficient cash reserves. They should apply all the profits to dividends in my opinion.

Low shareholder returns at the moment suggests big room for dividend increases. While it might be difficult for securities companies which enhanced shareholder returns ahead of other industries to increase dividends further without earnings growth, companies who have enjoyed high profits with low pay-out ratios might well be able to increase dividends on a sustainable basis once they take the helm toward that direction.

- **How to find companies with potentials to increase dividends**

Then how can we find companies with potentials to increase dividends. Unfortunately, I don't have an answer for it. All I am implementing as a portfolio manager is to select cheap stocks in terms of profits, invest in a wide range of sectors and wait until they turn up.

Companies that are seen to be 'mean' (stingy) among investors can give a bigger surprise to the market than those that are expected to increase dividends in investors' eyes when they announce dividend increases. So, I think my strategy that doesn't guess their true thought on that purpose is not that bad.

**Source: Based on article by Tatsuro NIGAURI, featured in The Nikkei Online Edition on 21 January 2020**

## Tatsuro NIGAURI, CMA Senior Portfolio Manager, Value + Alpha Group

Mr Nigauri has 26 years of investment research which dates back to 1991, when he joined Daiwa Institute of Research as a research analyst. Since 1995, Mr Nigauri has focused his research efforts on expanding his expertise in Japanese small-cap equities. He joined DSBI in October 2002 and is responsible for the Small Cap Absolute Value strategy as the lead portfolio manager. He is an award-winning manager and has received many accolades including the Lipper Fund Awards Japan (2012, 2013 and 2016), the R&I (Rating and Investment Information Inc.) Fund Awards (consecutive years from 2012-2019) as well as the J Money Fund Awards (2016 & 2017).

Mr Nigauri obtained a BA degree in Economics (1991), from the University of Tokyo in Japan. He is a Certified Member Analyst of the Security Analysts Association of Japan.

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### Contact Details

Business Development and Client Relations

Phone: +44 (0) 20 7507 6400

Email: [smdukmarketing@smd-am.co.jp](mailto:smdukmarketing@smd-am.co.jp)

Sumitomo Mitsui DS Asset Management (UK) Limited  
5 King William Street, London, EC4N 7DA  
United Kingdom  
[www.smd-am.co.uk](http://www.smd-am.co.uk)

