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Value + Alpha Group

PM's Monthly Perspectives

Author

Takuya KAMIISHI, CMA
Portfolio Manager

In February, the MSCI Japan dropped due to concerns over the new strain of coronavirus. The stock market advanced early in the month on the back of the announcement on economic stimulus measures by China, the better-than-expected US ISM Manufacturing PMI and the JPY depreciation against the USD, but the market then fell back in the middle of the month when Japan saw its first coronavirus death and **Apple** downgraded its earnings forecast while the JPY depreciation propped up stock prices. The market sharply declined late in the month as investors reinforced risk averse attitudes following the global epidemic of the coronavirus. The JPY appreciation against the USD also weighed down the stock prices.

Economy: We believe in an economic recovery in light of past data despite worsening economic indicators for February following the spread of the coronavirus.

While the number of new coronavirus cases in China is declining steeply, new cases in the rest of the world including South Korea, Iran, Italy and Japan is on an exponential upward trajectory. Given this widespread infection, the risk of the virus is no longer centered on China but on worldwide economic downturns.

As at 22.00 on 9 March, 507 people have tested positive for the coronavirus in Japan, excluding those infected on chartered flights and cruise ships. The number is smaller than in South Korea or Italy, but we are still in critical conditions.

Under these circumstances, on 26 February, Japan's Prime Minister Abe asked event organisers to cancel, postpone or scale back nationwide sporting/cultural events for the next two weeks. Additionally, he called on all the elementary, middle and high schools to close temporarily from 2 March to early April. Economic activities are already slowing down following these requests. Various events including Tokyo Marathon 2020 and music concerts have been cancelled and major companies have started to switch over to telecommuting amid an increase of infected persons.

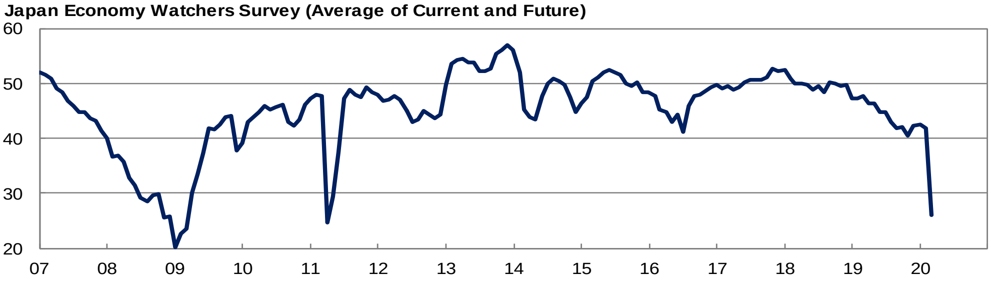
While these countermeasures against the virus bring benefits in reducing disease transmission, they damage the economy by pushing down the consumer spending. That said, their impact is mixed. When we look at the same-store sales in February, department stores had a hard time (**Takashimaya** -12%, **Matsuya** -32% year-on-year) while drug stores performed well with the heavy buying of masks, tissue papers, pot noodles, disposable diapers and sanitary items by consumers. (**Tsuruha Holdings** +7%, **Kusuri No Aoki** +12% year-on-year).

The Economy Watchers Survey (average of current and future/one of the most important leading indicators in Japan) for February dropped by 15.9 from 41.9 to 26.0 month-on-month following the spread of the coronavirus. This was the second biggest range of decline since records began after 23.2 in March 2011 when the Great East Japan Earthquake hit Japan. According to its comments, we can list a few features of the latest slump:

1) While the 2011 earthquake hit mainly manufacturers, slumps in consumption-related non-manufacturers such as the food service industry, retailers and travel agencies stand out this time.

2) Almost all the companies expressed concerns about the virus, while many of them are feeling uneasy for no specific reasons with no impact on their revenues or earnings at the moment.

Despite the sharp drop to 24.6 in March 2011, the indicator turned up in April and continued to advance for the next few months (29.3 in April, 37.6 in May and 47.4 in June). Therefore, we expect domestic economic indicators to turn up again unless any further negative factors break out.



Source: Bloomberg, as at 9 March 2020.

Monetary Policy: The BoJ's policy was welcomed by investors. Additional measures should be introduced when the JPY hit 95-100 level against the USD.

Central banks around the world have announced new policies following the outbreak of the coronavirus. The Federal Reserve's 50-basis point rate cut as an emergency measure undermined investor confidence, an emergency statement on 2 March by the Bank of Japan (BOJ) Governor Haruhiko Kuroda has been welcomed by investors. We can say that the BOJ has dealt effectively with post-coronavirus markets so far. Furthermore, the view that the BOJ is likely to introduce additional policies such as an expansion of its ETF purchase programs if the JPY gains to 95-100 against the USD should boost stock prices. We will show you a brief summary of BOJ's statement on 2 March below.

- Statement summary by the Governor: Global financial and capital markets have been unstable recently with growing uncertainties about the outlook for economic activity due to the spread of the coronavirus. The BoJ will closely monitor future developments and will strive to provide ample liquidity and ensure stability in financial markets through appropriate market operations and asset purchases.
- JPY500 billion in short-term liquidity to banks: The BoJ conducted government-bond buying operation on 2 and 3 March in the Gensaki market (the system where financial institutions offer target interest rates and those with higher rates can win loans under repurchase or resell agreements). The bank implemented it for the first time in four years and it was the first time in nine years since March 2011 for the bank to implement it for two straight days. The BoJ signalled that it would respond aggressively to any economic weakness amid worldwide market turbulence on the back of the spread of the coronavirus. However, the BoJ received bids totalling only JPY150 billion, well short of its target of JPY500 billion. This tells us that capital needs are not growing just yet.
- ETF purchases worth more than JPY100 billion: The BoJ has stepped in with record-breaking JPY101.4 billion purchases of ETFs. We were surprised at the bank's operation as it bought ETFs in the bullish market this time, while it usually buys them in afternoon sessions after confirming the stock price decline in morning sessions. The bank didn't buy J-REITs this time.

Investment Strategy

We expect that the Japanese equity market will advance with the economic recovery and ongoing accommodative monetary policies. Over the long term, more open policies to overseas funds including the improvement in corporate governance as well as policies to boost the immigration intake are also likely to support the market. We identify external factors, such as the escalation of trade frictions and worldwide recessions, as major risks because they might bring about a sharp yen appreciation. Taking these into consideration, we will overweight the cyclical sectors, such as industrials and financials.

Takuya KAMIISHI, CMA
Portfolio Manager, Value + Alpha Group

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.

Disclosures

Contact Details

Business Development and Client Relations

Phone: +44 (0) 20 7507 6400

Email: 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