

Value + Alpha Group

PM's Monthly Perspectives

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In October, the MSCI Japan index decreased in reaction to excessive expectations for the lower house election despite some positive factors. Japanese equities gained ground in September on unreasonable hopes for the Liberal Democratic Party (LDP) leadership contest and the lower house election but fell back and offset earlier rises in the first half of October when Kishida won the leadership battle at the end of September, as investors acknowledged that there should be no big change in policies. Positive factors such as the JPY depreciation against the USD and a decrease in US initial claims boosted domestic stocks later in the month but the rebound was slower than that of US stocks because Japan was expecting the lower house election on 31 October and earnings results of domestic companies had been mixed.

Policy: Business-friendly policies should continue given the LDP secured a majority in the lower house election

Japan's ruling LDP won 261 seats in the lower house election on 31 October. The party secured not only a sole majority but also an absolute stable majority that enables it to manage the parliament smoothly. Whether it can secure a sole majority or not had been a focal issue, but it lost only 15 seats from those it held before the dissolution of the house. The party was forced to have a bitter fight in many constituencies due to the unified opposition, but the electoral cooperation among opposition parties failed to bear fruit as it turned out. Prime Minister Kishida could ride out the general election in peace though it was held immediately after he took office.

The number of seats held by each party before and after the lower house election:

	Liberal Democratic Party	Komeito	Constitutional Democratic Party	Japanese Communist Party	Nippon Ishin (Japan Innovation Party)	Democratic Party For the People	Independent/ Others
Pre-election	276	29	109	12	11	8	15
Post-election	261	32	96	10	41	11	14

Created by SMDAM based on NHK data, correct as at 9 November 2021.

The ruling LDP emphasises economic growth while the Constitutional Democratic Party, the other major political party in Japan, places emphasis on social welfare. The LDP has controlled the government with its coalition partner Komeito up until the election and no significant change in the number of seats won by these parties should indicate that voters support the current ruling coalition government. What drew our attention was a sharp increase in the number of seats won by Nippon Ishin. The party whose spirits are more business-friendly than those of the LDP upholds economic policies such as tax breaks and regulatory reforms. An increase in its seats suggests that people are now demanding more business-friendly policies.

The second Kishida cabinet will be set up after he calls a special parliamentary session to re-elect himself as PM. He is likely to keep most of the members of his cabinet while LDP secretary general Amari expressed his intent to step down after he lost his seat in the single-seat constituency though he stayed in parliament via the proportional representation vote. Kishida is likely to decide whether to accept his offer or not based on the latest election results and situations within the party.

At any rate, a decline of Amari's influence in domestic politics is inevitable, raising concerns over a momentum in economic security and energy policies (such as reopening of nuclear power plants and construction of compact nuclear reactors), given Amari has played a central role in these areas. Meanwhile, the appointment of Amari as secretary general weighed down the government approval rating soon after Kishida's inauguration because Amari is suspected of money-related scandal. As a result, Amari's resignation may boost the approval rating for the Kishida administration.

We now pay attention to economic packages and a meeting for the realisation of a new form of capitalism as macroeconomic policies by the new administration. Given repeated pledges by Kishida that he would adopt economic packages "worth several tens of trillions of JPY," he is expected to unveil positive fiscal policies while bearing a medium to long-term fiscal reconstruction in mind. The packages are likely to include not only assistance grants for households, especially for those in need and those for businesses such as sustainability benefits and rent subsidies to help those severely affected by the pandemic but also subsidies for investments in science and innovation, climate change initiatives, measures to build national resilience against disasters and the reopening of "GO TO" travel campaigns (a policy in which the government subsidises travel expenses). A supplementary budget for the FY2021, a source for these economic packages, shall be formulated within this year. While Komeito, the LDP's coalition partner, vowed to introduce a support benefit package worth across-the-board JPY100,000 per child up to high school age as well as new MyNaPoints worth across-the-board JPY30,000, the party may have difficulty implementing given the LDP secured a single-party controlling majority.

A council for the realisation of a new form of capitalism was launched to create a virtuous cycle of growth and distribution of wealth. Kishida emphasised a need to strengthen the economic growth by promoting the digital transformation etc. as the first step of distribution and issued an instruction to submit an urgent proposal by the middle of November. While the proposal is unlikely to go into depth given a limited time frame, the Kishida administration is expected to continue discussing core policies toward next summer when the upper house election is held.

Earnings: Mixed earnings results for the July-September quarter/ Slightly cautious stance on the course of the Chinese economy

The earnings announcement season for the July-September quarter got under way. As of 5 November, approximately 57% of major listed companies (excluding financials) on the first section of the Tokyo Stock Exchange (TSE) announced their earnings results. According to Daiwa Securities, the ratios of those whose operating income topped/ fell below the market consensus by 10% or more were 36% and 27% respectively. These results were mostly in line with our expectation while we found sceptical comments on the course of the Chinese economy from electronic parts/ machinery makers and retailers.

Positives

Sony Group: The electronics device maker that also provides contents beat the consensus estimates of sales and EPS. It benefited from a stay-at-home policy not only by avoiding a decline in demand for its TV sets and digital cameras but also through strong sales of add-on contents such as streaming music and games. Its image sensor unit earned solid earnings thanks to hot sales of products for industrial machines despite growing concerns over the slowdown in the Chinese smartphone market. The group rode on the strength of these factors and upgraded its earnings forecast for the FY2021.

Marubeni: The general trading company not only beat the consensus estimate of EPS but also upgraded an EPS forecast for the FY2021. Its energy & metals group benefited from rising iron ore/ crude oil prices while other groups including meat packers posted favourable earnings with strong sales of fertilisers in the US. Now that it is likely to achieve the target net debt/equity ratio given recent strong earnings, it said share buyback programs, for which the company had no plan before, came into its sight.

Negatives

Murata Manufacturing: The electronic parts maker beat the consensus estimates of sales and EPS, but it indicated that its order intake decreased in September and October and its clients are involuntarily accumulating inventories in recent months. The company usually unveils sales/ production forecasts for the next quarter but didn't do so this time, this was not appreciated by investors.

Ryohin Keikaku: The retailer couldn't beat the consensus estimates of either sales or operating income. In addition, its sales forecast and operating income forecast for the FY2022 fell below the consensus estimates. Hopes for the economic growth in East Asia, particularly China, faded given its assumption that existing store sales and operating income there for the FY2022 will not change and grow by +0.1% respectively, though the region has drawn a great deal of interest.

Investment Strategy

We expect that the Japanese equity market will advance in the short term on the back of the economic recovery and 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 likely to support the market. We identify external factors, such as the outbreak of financial crises and another global recession, as major risks because they might bring about the sharp JPY appreciation. Taking these into consideration, we will overweight the consumer discretionary sector and stocks with low price/book (P/B) ratios.

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Note:

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