Marketing Communication
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Value + Alpha Group

PM's Monthly Perspectives

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MSCI Japan rose due to foreign investors' buying, receding concerns for debt ceiling issues in the U.S., and weaker yen. Brisk buying by foreign investors in April continued in May, a trend driven by Warren Buffett's remarks: "I feel more comfortable with our capital deployed in Japan than in Taiwan," and "they (five Japanese trading houses) were sitting where they were earning 14% on what we were going to pay to buy them… they were going to repurchase shares" and among others. The fact that concerns for debt ceiling issues eased also boosted the stock market. Another factor for the rise in the Japanese stock market is a rise in U.S. interest rates driven by the remark by the Fed Chair, Jerome Powell: "we on the committee have a view that inflation is going to come down not so quickly, it will take some time…in that world, if that forecast is broadly right, it would not be appropriate to cut rates" and the May jobs report, which topped Wall Street estimates, making the Japanese yen weaker against the U.S. dollar. With **NVIDIA's** sales guidance significantly exceeding analysts' consensus estimates, **ChatGPT** and other generative AI and semiconductors became investment themes in the stock market, and semiconductor-related stocks such as **Advantest** soared in Japan.

Supply and Demand: Remarks by Buffett and other key members of Berkshire, which triggered foreign investors' buying of Japanese stocks

From April to May 2023, purchases of Japanese stocks by foreigners have increased. We believe this is due to the TSE's corrective measures for companies with P/B ratios below 1x, the undervalued Japanese stocks, and Warren Buffett's visit to Japan in April 2023, which has increased investors' interest in Japanese stocks. We summarise statements by Buffett and Berkshire related to Japanese equities below.

We are particularly focused on:

(1) Buffett's suggestion of the possibility of investing in Japanese stocks other than the five major trading houses and

(2) Buffett's focus on the difference between the earnings yield (the inverse of P/E ratio) and the cost of financing with yen-denominated bonds, rather than the dividend yield.

Note:
Above names are just for showing examples and SMDAM is not recommending or advising these stocks.

Warren Buffett at Berkshire Hathaway's annual shareholders' meeting (6 May 2023)

- The Japanese thing was simple. I like looking at figures about companies, and here were five very substantial companies, understandable companies, we had done business with maybe all of them in a different ways. If you go some miles from here, our last coal generating plant was built by one of the companies. So they were sitting where they were earning 14% on what we were going to pay to buy them. They were going to repurchase shares. In some cases, they owned a whole bunch of businesses that we could understand as a group, although we didn't mean we had deep understanding on anything. And at the same time, we could take out the currency risk by financing in yen, and that was going to cost us a half of 1%. Well, if you get 14% on one side, a half a percent on the other side, and you've got money that you know forever, and they're doing intelligent things and they're sizable. So we just started buying them. I didn't even probably tell Greg until maybe six months after we'd gotten going, and then when we hit 5% in all of them, we announced on my 90th birthday that we owned over 5%. Recently, we went over for the first time to visit them, and we were more than pleasantly surprised, delighted with what we found there. And now we own 7.4% of them. We won't go over 9.9 without their agreement.
- Berkshire is the largest corporate borrower outside of Japan that exists, and we didn't set out to be that, but it's turned out that way, and we're not done.
- I feel more comfortable with our capital deployed in Japan than in Taiwan.

Greg Abel, vice-chair of Berkshire Hathaway's noninsurance operations, at Berkshire Hathaway's annual shareholders' meeting (6 May 2023).

He came to Japan in April 2023 as a candidate to succeed Buffett.

- Warren went over there to build the trust with these Japanese companies because we do hope there are long-term opportunities, but fundamentally, as Warren highlighted, they're an incredible, they've been a very good investment. I'd also highlight the five meetings we had were really quite remarkable. These companies, the culture, and the history around it, and how proud they are, there are just moments of learning from them. So it was a great experience to spend really two days with the five companies.

Warren Buffett's remarks at the interview in Japan with the Nihon Keizai Shimbun (11 April 2023)

- We own 7.4%, excluding their treasury shares, of each trading house. I first sent a letter to the five companies on 30 August 2020, when our holdings exceeded 5%. It was my birthday and since then we have made several additional investments in them.
- We will not hold more than 9.9% without the consent of their Board of Directors. And we don't think about selling our holdings. [Holding shares in trading houses] is Berkshire's largest position outside the U.S., and we're very happy with that.
- I think these trading houses are very similar to Berkshire. It is expanding not only in Japan but also in the world and has many different businesses. It is not impossible for us to work together in the future.
- The only Japanese stocks we currently hold are trading houses. There are always a few companies in my mind. The key is the price. If the stock price of the trading houses were twice as much as they actually were (when we bought it), we wouldn't have invested in them.
- (In response to the question of what kind of companies he prefers)
  First of all, it is a company that I can understand. I understand business, but I don't know about the current or future competitive environment. I can understand the business of Coca-Cola and American Express. I can also understand the business of the five major trading houses.
- I had the impression that management of the five major trading houses in Japan makes good decisions and never runs out of money. They are doing businesses in Japan and around the world. They have certain check items. We really appreciate the fact that they are generating more money for dividends and share buybacks.

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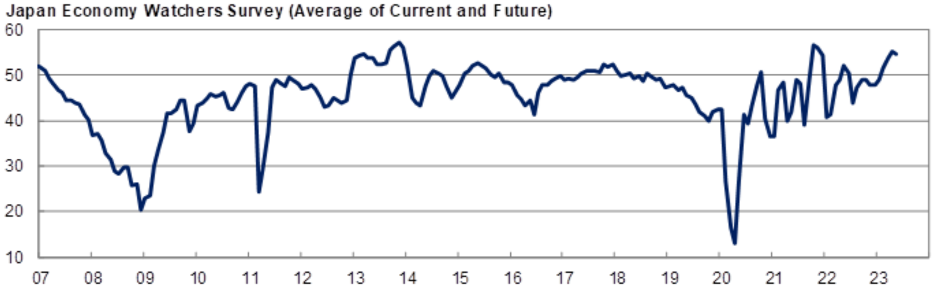
Economy: Japanese Economic Leading Indicators Declined Marginally

The Economy Watchers Survey, which is our most reliable composite leading indicator from the quickness and coverage point of view, showed 54.7 in May, based on the average of current and future, declined by 0.45 from 55.15 in April. Though the level compared with the leading indicators in the US and others is still high, the decline gives us some kind of negative impression because it has been improving in the last 4 months after it hit the bottom in December 2022.

Looking at the survey comments, the following were the reasons of decline: (1) Weak sales of consumer discretionary goods such as home appliances, clothing, and housing due to increase in prices, (2) Some concerns about future consumption such as further price increase of utilities and general products in June and (3) Negative comments from electrical machinery companies such as semiconductors and home appliances.

The survey comments give the impression that re-opening consumption related sector (travel, banquet, event), automobile, system integrator, etc. are relatively solid. We judge this survey shows the implication of bullish outlook on automobile and bearish outlook on electrical machinery such as semiconductor.



Source: Compiled by SMDAM based on Bloomberg data as of 8 June 2023.

Investment Strategy

We expect that the Japanese equity market will go sideways in the short term due to tug-or-war between global economic slowdown and expectations of a change in the management policy of Japanese companies with a P/B ratio below 1x driven by TSE policy. Over the long term, policies that are more open to foreign capital, including 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 crisis and global recession, as major risks, and we believe that the probability of such risk materialising is 50% or higher. Taking these into consideration, we will overweight low-P/B companies with large net-cash positions.

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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.

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Risk warning: On 1 January 2021 the UK left the EU transitional arrangements and no longer benefits from passporting rights into EEA countries.

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