

Value + Alpha Group

## PM's Monthly Perspectives

## Author



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## MARKET DEVELOPMENTS

The MSCI Japan index declined due to the stronger yen, concerns about a US economic slowdown at the beginning of the month, and the unwinding of momentum trades, despite a rise in global stock markets due to heightened expectations of a US rate cut. In depth, the cause of the decline in the Japanese stock index is three-fold: 1) The yen became stronger after Kazuo Ueda, governor of the Bank of Japan (BOJ), said that "real interest rates are at a very low level at present" and the interest rate gap between Japan and the US narrowed; 2) Concerns about a US economic slowdown grew in response to weaker-than-expected US Institute of Supply Management (ISM) Manufacturing Purchasing Managers' Index (PMI), the US unemployment rate that triggered the Sahm recession rule, and the first US rate cut since 2020 in sight, and; 3) Momentum trades (short yen bonds, short yen, long Japanese equity futures by commodity trading advisors (CTAs), and momentum buying of cash equities), by which positions were built up because the market had been moving in one direction, were unwound. After the plunge of Japanese stocks in early August, however, the market rebounded in response to positive ISM Services PMI and jobless claims, a dovish comment from the BOJ vice president Shinichi Uchida, as well as solid corporate earnings, etc. Incidentally, the fall in the stock market came amid a fall in several asset classes since 17 July, and on 5 August, the circuit breaker was triggered not only in the cash equity and futures markets, but also in the bond markets. The high volatility in August could also have been caused by several other factors, such as: 1) the presence of systematic trend-following funds had increased; 2) the implementation of the circuit breaker prevented investors from placing "buy" orders for equity futures as they could not arbitrage between cash equities and futures; and; 3) the demand for selling futures by bearish leveraged ETFs and investment trusts increased.

**Market: Buy Japanese stocks when P/B is 1.45x or below, 12-month forward P/E is 16.1x or below, or corporate earnings fall sharply**

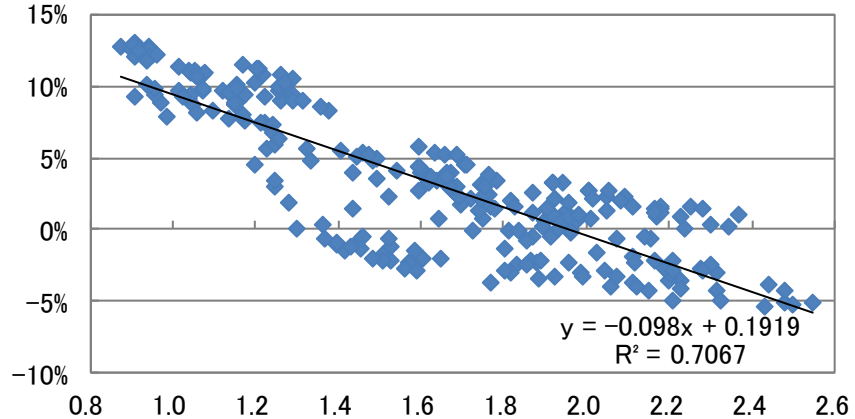
Returns on equity investments are higher if you invest when valuations are cheaper. This may seem obvious, but it is surprisingly difficult to invest according to this principle. This is because there is some kind of decline in stock prices before valuations become attractive, and the fear of this could prevent you from acting. However, when considering when to invest in stocks, we believe that you should start from this obvious fact.

If you plot TOPIX valuations such as P/B or P/E on the horizontal axis and TOPIX total returns (annualised) over the past 10 years on the vertical axis, there is an inverse correlation. In other words, the cheaper the valuations, the higher the returns over the following decade.

The 10-year annualised return of the TOPIX was 5% or more when (1) the P/B ratio was 1.45x or less, (2) the P/E ratio was 16.1x or less, or (3) the P/E ratio appeared high due to a sharp decline in earnings due to a financial crisis, etc. At the end of August 2024, the P/B ratio of the TOPIX was 1.37x and the 12-month forward P/E ratio was 14.5x, and, thus, from the valuation point of view, we believe now is a good time to buy Japanese stocks. Japanese stocks fell sharply in early August, but the earnings of Japanese companies remained solid and, in line with the fundamentals, Japanese stocks recovered from the low of 5 August.

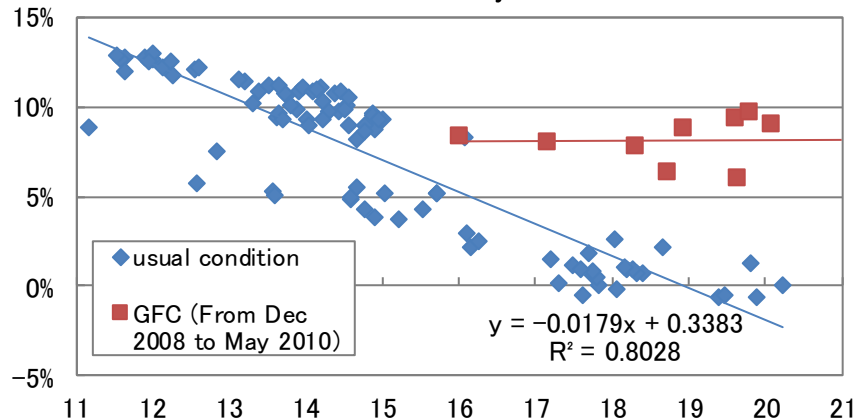
Just like a cold wave hitting your town, there are times when markets plunge, but when they do, please remember the opening words. It may help you decide when to buy Japanese stocks.

**TOPIX Actual PBR vs 10 year annualized returns**



Source: Bloomberg, TOPIX PBR since October 1993, SMDAM as at 30 August 2024

**TOPIX Forward 12 month PER vs 10 year annualized returns**



Source: Bloomberg, TOPIX PER since June 2005, SMDAM as at 30 August 2024  
GFC: Global Financial Crisis

**Policy: Major candidates for LDP's presidential election on 27 September and their policies**

The Liberal Democratic Party (LDP) has decided to hold a presidential election to choose a successor to President Fumio Kishida, with the official announcement on 12 September and voting on 27 September. The LDP is fundamentally a pro-business party, and no matter who wins, pro-business policies are expected to continue in principle. And it is also likely that a snap election for the House of Representatives will be called after a new president is elected, and even then, the pro-business policies are expected to continue, as the LDP's current approval rating is significantly higher than that of other parties, and the ruling coalition, including the LDP, is expected to win a majority in the election. In addition, there is an anomaly in Japan that stock prices tend to rise before a general election of the House of Representatives.

Among the candidates, 43-year-old Shinjiro Koizumi will become Japan's youngest prime minister if he wins, and the stock market is expected to respond favourably to his structural reform agenda, such as easing regulations on layoffs and fully deregulating the conditionally approved ride-hailing services. Sanae Takaichi's policy ideas are quite similar to those of former Prime Minister Shinzo Abe, and she is an expansionary fiscal and dovish monetary policy proponent. If she wins, she will also become Japan's first female prime minister, which is also likely to be positive for the stock market. While Taro Kono advocates structural reform, he is somewhat hawkish on monetary policy and a proponent of fiscal reconstruction, and, thus, his impact on the stock market is likely to be neutral. Lastly, Shigeru Ishiba places an importance on the regional economy and is in favor of raising taxes on financial income, so he is likely to have a negative impact on the stock market.

The policy stances of major candidates are as follows:

**Policy stances of major LDP presidential election (○: positive for the stock market, △: neutral, and ×: negative)**

	Koizumi	Ishiba	Takaichi	Kono
Economic growth or social security	○ Economic growth	× Social security	○ Economic growth	○ Economic growth
Fiscal policy	△ N/A	× Advocates fiscal reconstruction	○ Advocates expansionary policy	× Advocates fiscal reconstruction
Monetary policy	△ N/A	× Hawkish	○ Dovish	× Hawkish
Raising taxes on financial income	○ Against	× For	△ N/A	○ Against
Reviewing layoff regulations	○ For	△ N/A	△ N/A	○ For
Policy focus	Fully approve ride-hailing services Abolish the annual-income threshold for tax deduction	Invigorate the regional economy Proliferate nuclear shelters	Reinforce national defence capabilities Promote technological advancements on robots, semiconductors, and materials	Reform labour market Require every citizen to file a tax return

Source: SMDAM as at 6 September 2024.

### Investment Strategy

We expect that the Japanese equity market to advance due to a change in the management policy by Japanese companies, driven by the Tokyo Stock Exchange's call for enhancements in the P/B ratio. Over the long term, policies that are more open to foreign capital, including an 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. We feel that the risk of a US recession has increased. Taking these into consideration, we will overweight low-P/B companies with large net-cash positions or a lot of unrealised gains on land.

**Risk Warning: Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.**

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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.

CMA: Member of The Securities Analyst Association of Japan.

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