

Intro to Stock Investment in Japan

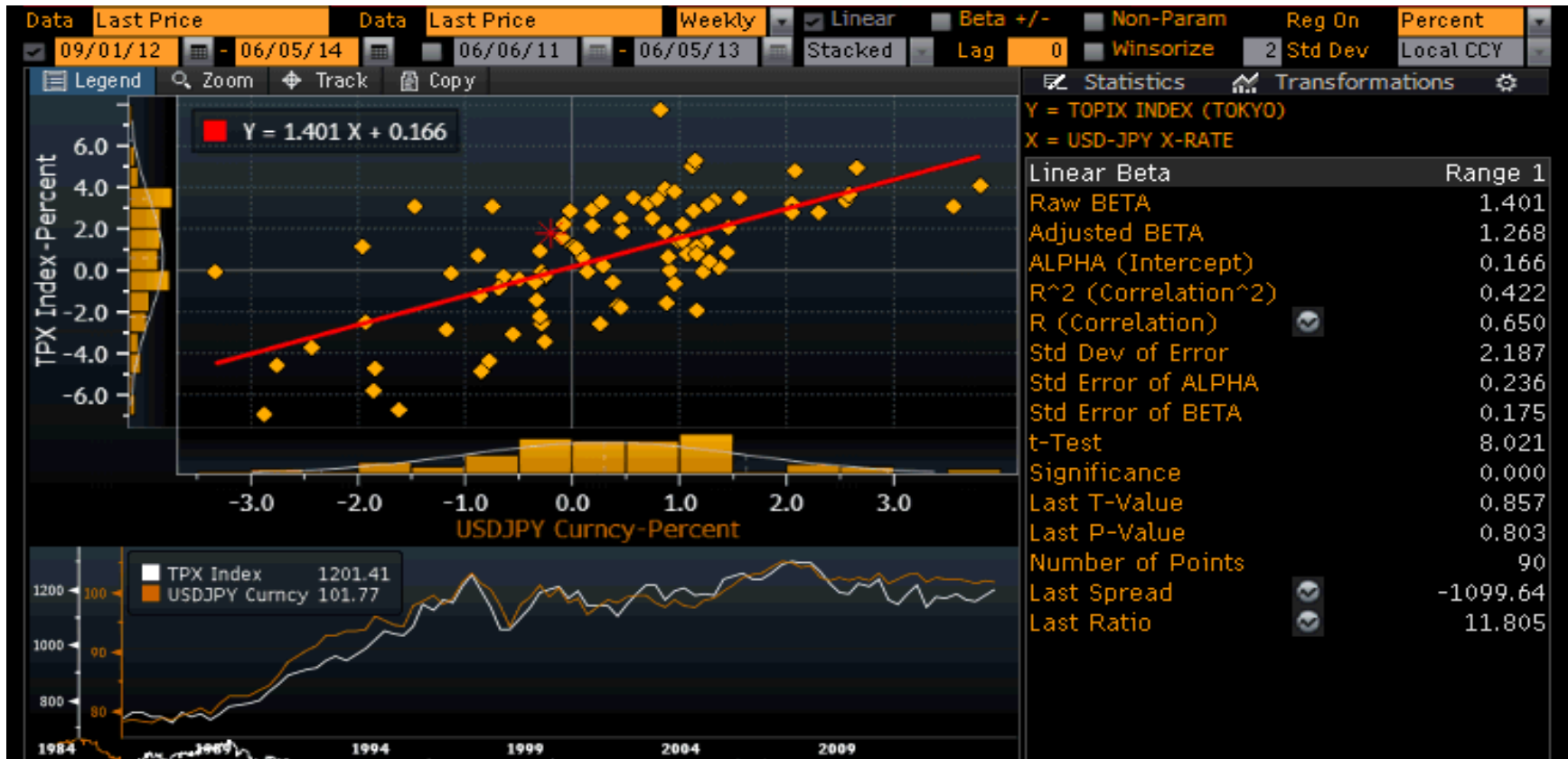
Yoshiki Nakayama

KONJA Corporate Research

Basic Info about Stocks in Japan

- “Kabu” = stock
- Forth largest exchange in the world based on the trade volume
- Japanese stock market consists (TSE) of 1) First Section (more blue chips), 2) Second section (less blue chips), 3) Mothers (high-growth companies)
- Almost 3000 companies are listed
- Its stock market price is called “TOPIX”
- Nikkei 225 is also used as a stock market price, which is consisted of the selected companies from TOPIX First Section

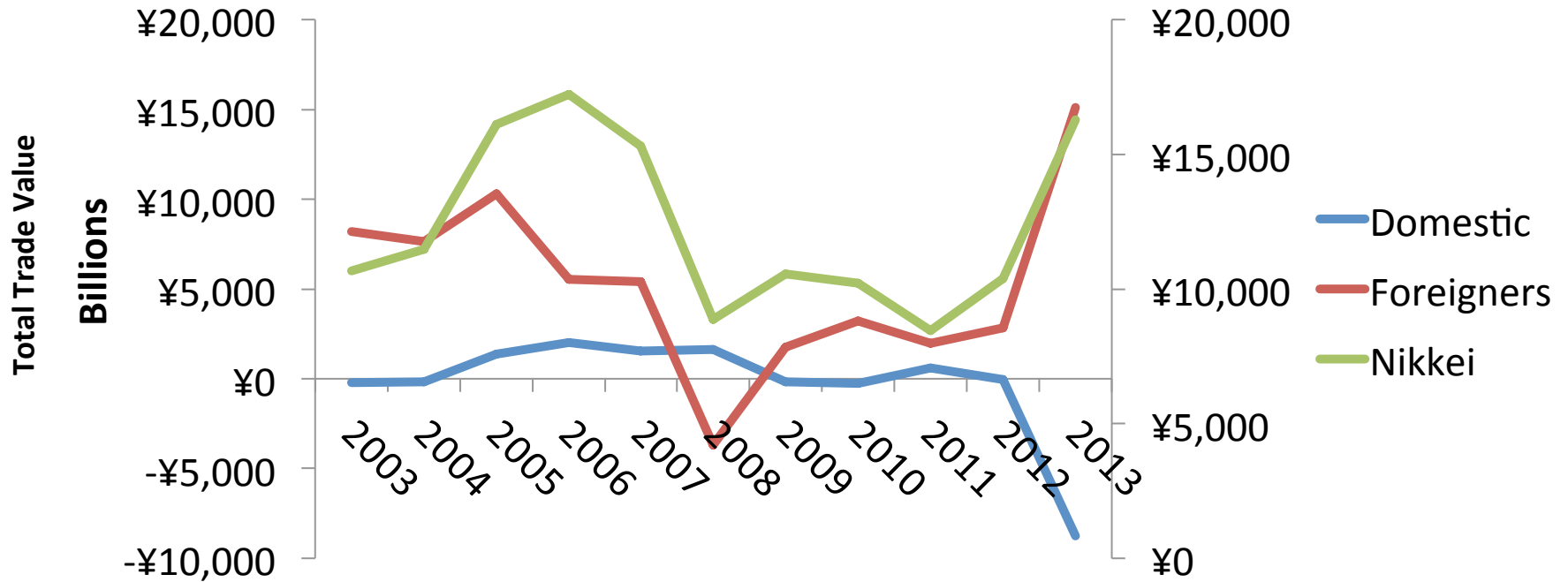
Weak Yen = Higher Stock Price



Recently, there is a high correlation between JPYUSD and the stock price. Weaker yen translates into more competitive advantage and increases the profit by the foreign-currency adjustment account for exporting companies such as SONY, TOYOTA and other big manufacturing companies

Foreign Investors

Nikkei and Trade Decomposition



The correlation between the foreigners trade and the Nikkei Index is 0.69, which indicates the high correlation. This is because 50~70% of the Japanese equity trade at Tokyo Stock Exchange is done by the foreign investors. Therefore, the trade by foreigners at TSE is a good indicator for the stock movement. The info is found at <http://www.tse.or.jp/english/market/data/sector/index.html>

What do Foreign Investors want?

The Right Target for the Third Arrow

Corporate Managerial Efficiency in Japan
Compared with the United States


By Niall Ferguson, Lawrence Lindsey,
and Daniel Loeb

June 2013



AMERICAN ENTERPRISE INSTITUTE

According to Daniel Loeb, the hedge fund manager of Third Point in the U.S. who owns 1.6% of Sony shares as the 5th largest shareholders of Sony as of September 2013

1. Do not count on the fiscal stimulus and monetary easing too much to revive the Japanese economy
2. Structural reforms to focus on economic restructuring in the private sector is needed the most
3. Reforms include TPP, deregulation, abolishing the vested interest, more shareholders-based corporate governance reform and corporate tax cuts
4. The gross assets held by the Japanese companies are 1848 trillion yen, with the total net profit of 32 trillion yen (1.7% return). Whereas American companies have \$35.9 trillion with \$1.379 trillion (3.8% return).  Inefficient Management by Japanese companies

ROE comparison

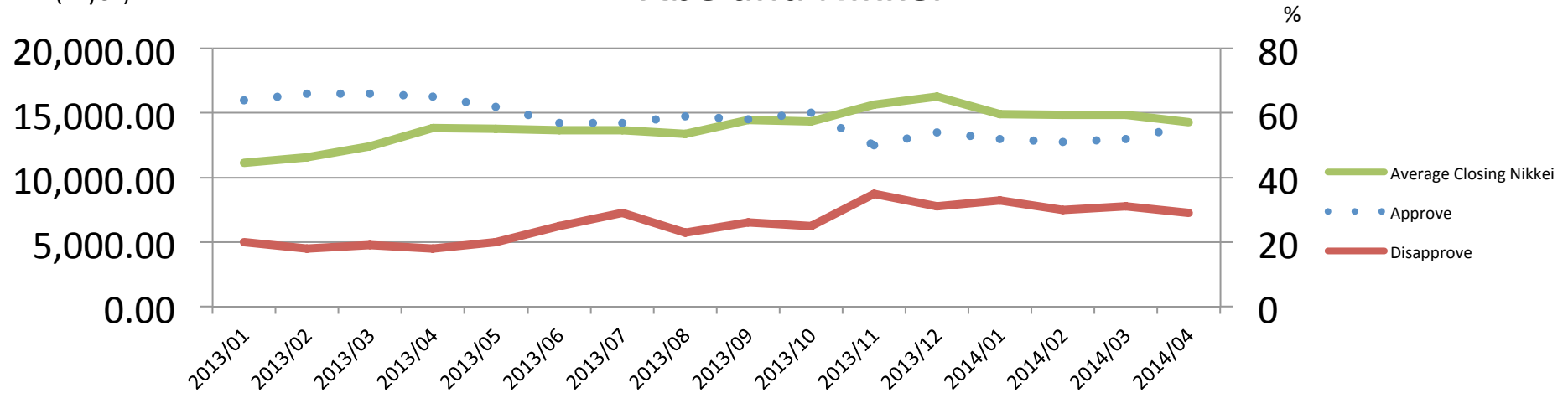


Japanese ROE has been underperforming other stock exchanges (S&P as an example above) By Dupont analysis, ROE is lower because of the profit margin is significantly lower

Stock and Abe

Abe and Nikkei

Average Nikkei Closing Price
(in yen)



Abe Disapproval Rate could be a Good Stock Price Indicator

Disapproval rate of PM Abe Sinzo correlates well with the Nikkei price movement lagging one month. As the chief economist at Mizuho, Mr Ueno, his popularity is based on the stock market movement. One possible explanation for this correlation is that whenever his disapproval rate goes up, Mr Abe implements or announces favorable for the stock market, so the following month, the disapproval rate goes down, and the stock also goes down because he does not have to make any stock market favorable actions/comments.

(Method) Approval and disapproval rate is used from NHK (National TV Broadcaster) one month lagging since the data is collected in the first or second week of the month, and the average Nikkei closing price is calculated at the end of the previous month to be consistent. <http://www.nhk.or.jp/bunken/yoron/political/>

Price Keeping Operation

- Price Keeping Operation: the stock market favorable actions or comments made by the government
- 1. GPIF: Japanese public pension plan holds \$1.2 trillion assets, and PM Abe plans to come up with a plan to invest the portion of the assets in the Japanese stocks in June 2014. The total Japanese stock market size is \$4.3 trillion, and the current bet is that GPIF would invest in JPX Nikkei Index 400.
- 2. NISA : Capital gain and dividend tax deduction for the small individual investors. The government plans to attract \$0.25 trillion capital into the stock market
- 3. Portfolio Rebalancing: Japanese banks, and insurance companies (Institutional investors) are known for its risk-averse attitude, and invest in the Japanese bonds not stocks. BOJ bought a huge amount of the Japanese bonds out of its market from the institute investors to direct the institutional investors to the equity market. According to Daiwa, from March 2013 to February 2014, the Japanese banks decreased its equity holding by 0.2%.
- 4. BOJ has \$18 billion worth Nikkei ETFs and REITs, and might purchase more
- 5. Reforms: see previous slides

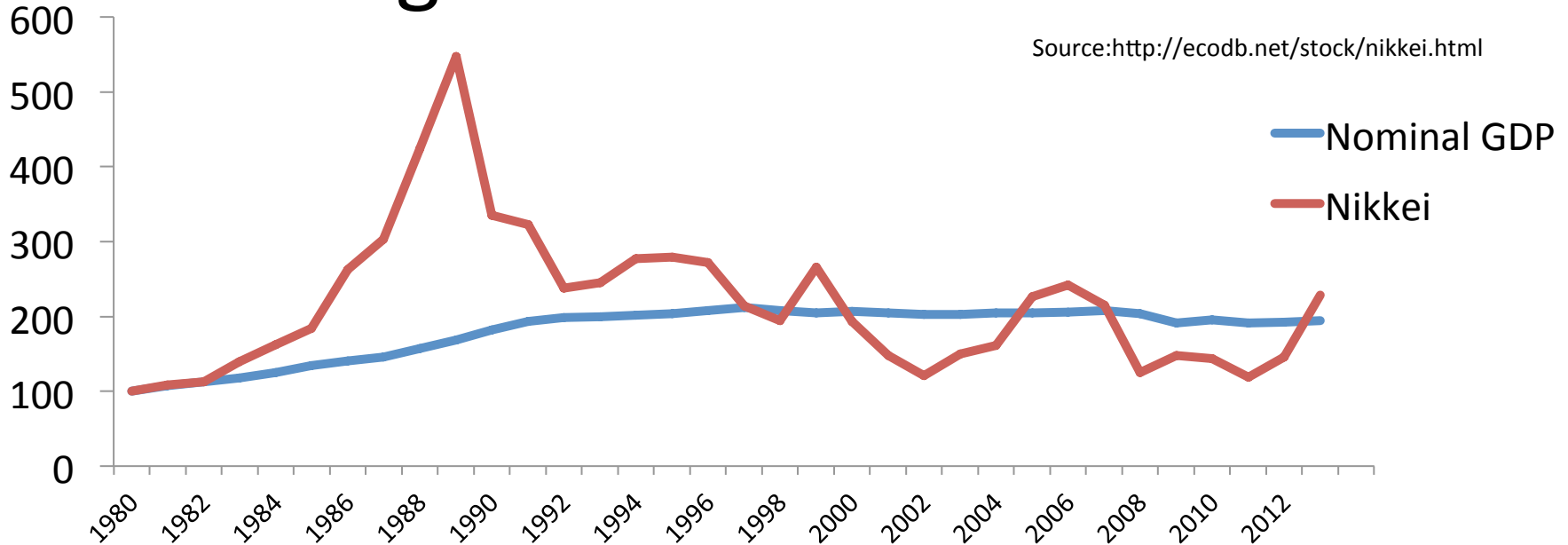
Undervalued



$P/B < 1 \Rightarrow$ better to liquidate the company, and, for a long time, Japanese P/B has been less than 1 or slightly above 1 and still underperforms Americans (S/P). According to Nikkei, almost 50% of companies on TOPIX is less than 1 P/B. In Japan, all the listed companies have \$0.7 trillion cash assets, and not being able to use them effectively. Other indicators, such as trailing P/E, confirm Japanese stocks are undervalued.

According to Bloomberg, P/E is 14.35 (June 10th, 2014), and S&P P/E is 17.94, so Japanese P/E is below the US's.

Regression to the Mean



Taking the year 1980's value for both Nominal GDP and Nikkei Average as 100 and plotting the growth on the chart, it is easy to notice that Nikkei grew faster than the nominal GDP, but once it hits its peak like 1989 in the form of the stock bubble, it grows negatively and converges to the nominal GDP growth rate. In the economics, the nominal GDP growth rate correlates with the stock market growth rate very well since both growth rates are somewhat based on the growth rate of the profits produced by the companies in the country or the stock market. Japanese stock price might grow in the short term, but in the long term, it would be determined by the nominal GDP growth rate, and the nominal GDP growth rate in Japan is low. Japanese stock may not be a good long term investment, unless its nominal GDP grows substantially.