

# Japanese equity, an outlook for an overlooked market

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## Key drivers

- Anticipated dollar strength
- Dovish BOJ
- Abenomics paying off
- Better corporate governance
- Focus on ROE
- Higher dividend
- Low price-to-book ratio
- Comparatively low sector valuation

## The USD/YEN and macroeconomics

Numerous investment strategists and funds are highlighting Japanese stocks as a key investment for 2017. Among them is Black Rock which has upgraded their stance from neutral overweight. David Rosenberg chief-economist at Gluskin Sheff + Associates, famous for the newsletter Breakfast with Dave, describes the market as a “big turnaround story”. What makes this market such a high priority for investors and what are the potential risks?

In the beginning of 2016 the broad Japanese index Nikkei 225 fell heavily. However, the index still ended 2016 in the black with an increase of 13.5%. The big move came as a reaction to the election of Donald Trump. A sharp sell-off immediately after the election was followed by a rally and the index regained its previous losses and then some. The main reason for this has been the dollar strength.

The BOJ has been trying to weaken the Yen for several years in an attempt to revive economic growth and get rid of the deflation that has been haunting the economy.

The currency is important because the Japanese economy is heavily reliant on exports to different countries which are negatively impacted by a strong yen. One currency pair is especially important, the USD/JPY. The correlation between the and the Nikkei 225 is almost 66%.

This means an increase in the index can, to a large degree, be explained by a favourable move in the currencies. That was precisely what happened after the US-election when the consensus Trump-trade strengthened the USD considerably.

The importance of exports to the US for the Japanese economy cannot be overstated with an annual trade surplus of 63 billion USD. The prospect of increasing protectionism in the US is therefore an aspect of importance when evaluating investments in Japan. The state visit by Japanese prime minister Shinzo Abe earlier this year has been described as very successful and president Trump stated the importance of the alliance and promised agreements which will be favourable for both parties. What this actually means in is still unclear. For now, this should be a relief for investors.



Nikkei 225 compared to USD/JPY