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ASK TYLER

By some measures, “Abenomics” has failed. The public debt burden has risen to about 230% of GDP — 15 percent above its 2012 level. Deflation has also still been an issue with the core measure of inflation is back down at its 2013 level.

Clearly, Japan is at a crossroads. With Abe’s reinforced mandate and post-election pledge to push forward with his economic reform program, could the Japanese equity market experience another leg upward? We think so.

To be sure, Japan faces some serious structural headwinds. But everyone and their brother-in-law knows that (high debt levels, aging demographics, etc.). Few understand the micro story. Over the last decade, Japanese companies faced the twin burdens of chronic deflation and an overvalued currency.

What has been the result? First, corporate Japan is now extremely lean and efficient. Aggregate Japanese return on equity has been trending upwards as companies have focused on improving corporate governance and benefitted from a weak yen. Japan is also a veritable hotbed of companies at the forefront of several technologies reshaping the global economy — including robotics, electric cars and alternative energy (in the words of one analyst, “they make cool stuff”).

Second, Japanese small caps are priced at the frontier of value, if not over the edge – deep into bargain territory. Thirdly, lower oil prices are indisputably positive for Japan, which imports most of its energy needs. Fourthly, Japan is likely transforming itself from a nation of savers to a nation of investors. Contrary to popular belief, Japanese savers have never been wealthier, with a net worth that is double what it was at the peak of the 1980s bubble.

Finally, and perhaps most importantly, Japan continues to lead the world in unconventional monetary policy. The IMF estimates that the Bank of Japan will run out of government bonds to buy next year or in 2018 when its ownership will reach JPY400trn (the bank also owns 47% of domestic ETFs). Expect further forays into the realm of unorthodox policy. Notably, “helicopter money” — a true money-financed fiscal stimulus — will likely surface in Japan first. Investors may balk at the efficacy of these policies, but they should also understand that they are immensely helpful in raising asset prices.

INVESTMENT IMPLICATIONS

Abe’s true master plan is to stoke a stock market rally and Japanese “animal spirits”, which in turn should lead to wage increases, capital investment and ultimately, an increase in the return on invested capital. That’s the theory, anyway. But don’t bet on it. However, do believe that Abe and the Bank of Japan will continue to aggressively underwrite a rising stock market (and depreciating currency). Couple that familiar macro story with strong micro underpinnings and Japan’s equity market looks set to prosper.

WITH JAPANESE
PRIME MINISTER
ABE DECLARING
VICTORY IN THE
RECENT ELECTION,
WHAT IS YOUR
VIEW ON JAPAN?

Abenomics Still In Play.

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