

JAPANESE EQUITIES: Q&A WITH JOËL LE SAUX



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Joël Le Saux, Portfolio Manager of Oyster Japan Opportunities recently sat down with Juliana Auger, Investment Specialist, to discuss some concerns that investors have raised on the current state of affairs and how it affects the Japanese market.

JA: *The US-China trade wars and China growth slowdown have been in the headlines for months. What knock-on effect does this have on Japan?*

JLS: On aggregate Japanese companies have little exposure to China. Indeed, the most popular smartphone brands are Chinese and the most popular foreign cars are German. Even though China is the largest global car market, less than one out of ten Toyota cars are sold there. Having said that, the Chinese economic slowdown is weighing on some cyclical sectors that are more difficult to substitute like robotics, factory automation and commodities such as steel. In our portfolio, we only hold three companies, including Toyota, that belong to the fifty Japanese constituents of the Nikkei China Related Index; our exposure to China is low.

JA: *That is reassuring. However in 2018 a record amount of foreign money left the Japanese equity market. What explanation could you suggest for this?*

JLS: The market is often viewed as peripheral for westerners, it has far less weight than the US or Europe in global indices. It is a victim of behavioral finance which suggest that investors have a home market bias...and Japan is 10,000 kilometers away. Investors typically have more appetite for high beta emerging markets and China in particular. Yet, Japanese equity as an asset class is lowly correlated to other equity markets like the US and Europe. And as contradictory as it may sound, emerging markets are actually quite correlated to European markets. Additionally, the currency component offers significant de-correlation for European investors. The yen really has its place in a global asset allocation thanks to its risk-off optionality. Therefore, investors would be wise to add Japan to diversify their European and US allocations.

JA: *Okay so it's better to include Japan than to exclude it. For those investors who left recently, would now be a good time to re-enter the market?*

JLS: Japanese equities are currently inexpensive and valuations already integrate a slowdown in global economic growth and downward revisions to consensus earnings estimates. The Price to Book multiple in particular is at 6-year lows,

at around 1.1x down by about 15% since last summer. At such low P/B, the Japanese market is quite attractive as investors could expect annual gains in line with the over 8% Return on Equity. Separately, the market dividend yield is about 2.5%, to which we can add another 1% in share buybacks for a total return to shareholders above 3.5%. During this current earnings season, many companies announced significant and unexpected buyback programmes like Softbank and Sony. Viewed globally, the Kabuto-cho represents an attractive source of diversification to confront potential risks in Europe such as Brexit and Italian/French political instability. And contrary to the Federal Reserve or the ECB, we have a very good visibility on the future actions of the Bank of Japan which is "stand still". In 2019, the advantage compared to other major equity markets will be Japan's stability.

JA: *That would certainly be welcomed by investors. Going one level deeper then, where do you see particularly good investment opportunities within the Japanese equity market?*

JLS: Given the ongoing global economic slowdown, I prefer domestic companies and multinationals exposed to the US market. Public works/infrastructure related companies offer attractive valuations and good visibility without being exposed to the global cycle. While for financial stocks, which are trading at record-low valuations, their share prices are embedding a free call option on a steepening of the yield curve.

