



Inside Japan: Reasons for Optimism

See Japan in New Light

Japanese equities have scaled impressive heights in recent times, with the TOPIX and Nikkei 225 reaching their highest levels since the 1990s. Japan is on an upward trajectory that could sustain for the rest of the decade and beyond. We see reasons for confidence in Japan's reflationary outlook, the factors are driving growth and why it is different this time.



A Future-Proofed Economy

Demographic-driven innovations

An ageing population and low birth rates have spurred innovations in industries such as factory automation, robotics, and healthcare utilising Big Data, Internet of Things and Artificial Intelligence. With corporate profits continuing their strong upward trend, Japan is poised to be the guiding light as other developed economies confront similar demographic concerns in the near future.

Vital conduit to Asia's growth

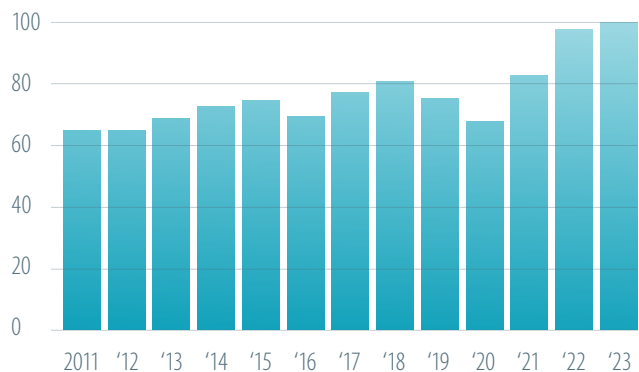
Japan is the world's 4th largest exporter. It occupies a unique place globally, serving as a bridge between east and west, and between developing and emerging markets. Japan's exports hit a record high in 2023 and increased for the third year straight since 2020 due to strong automobile shipments and the effects of the weak yen¹.

Tourism continues to drive economic growth

The weak yen is boosting tourism in Japan and **the country has attracted over 25 million tourists in 2023. There is still room for growth as tourism levels have yet to reach its peak.** Tourism also accounts for almost 1% of Japan's GDP and tourism spending has surpassed pre-pandemic levels and reached a record high in 2023 with an amount to 5.31 trillion Japanese yen.

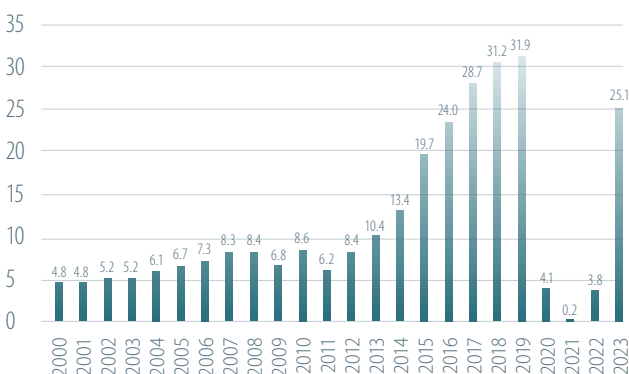
Japan's exports

(in trillions of yen)



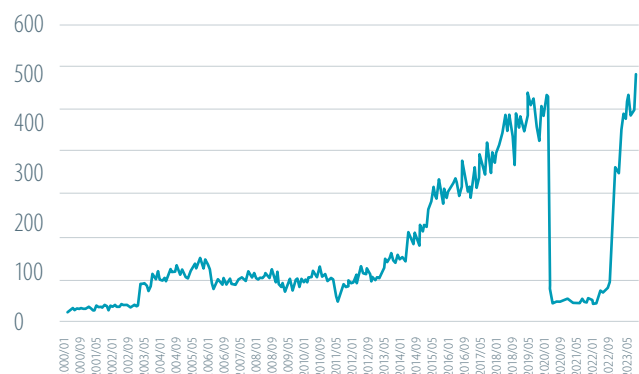
¹Source: Japan's Ministry of Finance, 24 January 2024

Number of Inbound Tourists (mn)



Source: Japan National Tourism Organisation (JNTO) as of end-December 2023

Monthly Inbound Tourism Spending (JPYbn)



Source: Bank of Japan as of end-December 2023

Key Investment Drivers

Improved corporate governance

The Tokyo Stock Exchange (TSE) has initiated a series of initiatives aimed at fostering transparency, accountability and shareholder value. The most significant of these was its **2023 Guidance aimed at driving companies to adopt improved corporate governance practices**. The goal is to ensure Japanese companies listed on the prime stock markets comply with a governance framework that promotes sustainable growth and protects investor interests.

The TSE has also adopted a strategy of publicly disclosing lists of companies that are either in compliance with or in defiance of these governance initiatives since January 2024. Those failing to comply are left off the compliance list, creating a direct incentive for companies to elevate their governance practices or face reputational risks.

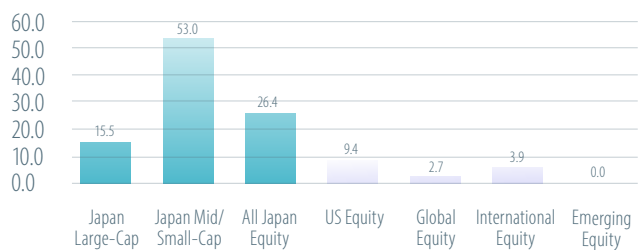
Such reforms are geared to make **Japanese equities more competitive globally and result in higher Return on Equity (ROE)²**.

Significant value remains to be unlocked

47%³ of the holdings in the TOPIX Index are not covered by researchers from research houses. This offers potential to uncover opportunities that may be overlooked. We see a trend of Japanese active funds outperforming funds that invests into other regions in the long term. This is highly visible for Japan's mid and small cap funds which invests into small and medium-sized companies in Japan.

³Source: Bloomberg as of end-December 2023

% Japanese Funds Outperforming Their Benchmarks (10yr)



Source: Nikko AM based on S&P Dow Jones Indices SPIVA® Japan Scorecard Mid-Year 2023

Higher domestic spending to be unleashed

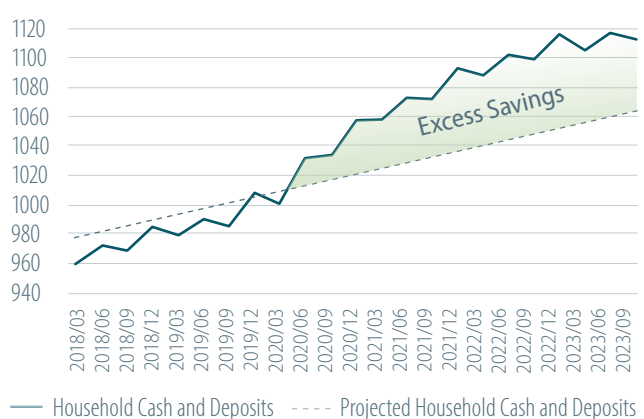
The combination of extended pent-up demand and the highest wage hikes in decades, **following the 2023 "Shunto" spring wage negotiations, is likely to lead to higher consumer spending in Japan in 2024 and beyond**.

The 2023 Shunto negotiations between labour unions and employers resulted in the highest wage increases in decades, and returned confidence in the Japanese economy. Not only a response to the rising cost of living, this was also as a strategic measure to boost economic growth through enhanced consumer spending.

The "forced savings"⁴ of Japanese consumers, estimated at JPY 50 trillion, could serve as a catalyst for sustained economic growth as these savings are deployed across a number of different sectors. Japan has never looked so exciting for cash-rich domestic consumers.

Reforms in the Nippon Individual Savings Account (NISA)⁵ - a new type of tax exemption programme for small investments, is expected to be an effective instrument for individuals' mid-to-long term asset accumulation as well as a functional conduit of funds to promising businesses.

Household Cash and Deposit (JPY trillion)



Source: Bank of Japan as of end-September 2023

²Return on Equity is the measure of a company's net income divided by its shareholders' equity. It is used to measure how efficient a company is at generating income and growth.

⁴Forced savings refers to income that households could not spend because of restrictions on activities and movements imposed after the novel coronavirus pandemic hit in early 2020.

⁵NISA is a tax-exempt savings account scheme that was created in 2014 to encourage residents in Japan to save and invest.

Time to Invest in Japan?

Macro-level changes as well as significant policy and structural reform initiatives are shaping future economic growth of Japan. Combined with attractive valuations and their strength as a vital conduit to Asia, Japanese corporations may be one of the best long-term plays to unlock hidden opportunities.

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- Market and credit risks
- Liquidity risks
- Product-specific risks

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