

Japan equity monthly

October 2020

10 November 2020

We discuss the reasons behind the Japanese equity market's recent outperformance and the factors likely required for the gains to be sustainable in the longer term. We also assess the recent surge by the Mothers Index and key points to watch going forward.

By Naoki Kamiyama, Chief Strategist

Why Japanese equities are outperforming their developed market peers

The Japanese equity market has held up relatively well over the past several months during the global market turmoil, with the Nikkei Stock Average outperforming its developed market peers. It would be tempting to conclude that factors specific to Japan, notably the country's relatively low number of COVID-19 infections and deaths, give its market an edge. Such an argument, however, becomes less convincing when considering that savings prompted by precaution are increasing and consumption remains subdued, even though Japan has not experienced a second COVID-19 wave such as that currently afflicting the US and Europe.

Rather, we believe that Japanese equities are supported by the fact that manufacturers form a significant component of the market. As such, the recent recovery by Japanese exports on the back of strong external demand—Chinese manufacturing, for example, has rebounded quickly—is more of a supportive factor for Japanese equities, in our view.

The outperformance by Japanese equities therefore may not be based on particularly solid foundations as the market owes much of its gains to demand generated outside the country. A recovery by domestic demand in such areas as services and transport will be crucial for the equity market to keep its momentum going in the longer run. We are seeing nascent signs of a recovery in domestic demand, spurred in part by the government's "Go To Travel" subsidy campaign. Such a recovery would likely enhance the allure of Japanese equities. And the delayed summer Olympic Games, if held as planned in Tokyo next year, may provide a further boost for domestic demand.

Analysing the recent surge by the Mothers Index

The Tokyo Stock Exchange's (TSE) Mothers Index for Japanese start-ups has been on a roll this year. Boosted by strong demand for companies that are expected to perform well in the wake of the pandemic, such as biopharmaceuticals and technology start-ups, the Mothers rallied to a 14-year high in October, prompting a number of observers to point out that it is outperforming better-known indexes such as the NASDAQ.

The surge by the index is fuelled by companies that are generating actual profits on one hand, and those rising on mere expectations of future profits on the other. Profit-generating companies on the Mothers are not unlike the GAFA stocks: they have a relatively clear growth path ahead. Companies rising on expectations of future profit alone, however, risk a quick reversal in fortunes if themes currently working in their favour, notably Prime Minister Yoshihide Suga's digitization initiative, lose their appeal.

Would-be investors also have to remember that most companies leave the Mothers and re-list on the TSE's first and second sections once they become profitable entities. This is why an apple-to-apple comparison cannot be made between the Mothers and the NASDAQ. In the case of the Mothers, it is critical to carefully assess each company rather than draw conclusions based on the strength of the whole index.

Market: Japan equities slip in October on COVID-19 concerns and rising yen

The Japanese equity market fell in October, with the TOPIX (w/dividends) declining 2.84% on-month and the Nikkei 225 (w/dividends) falling 0.88%. From the beginning of the month, stocks rose on expectations for progress toward the passing of an additional stimulus package in the US to support the coronavirus-hit economy. However, concerns emerged from mid-month over the potential economic impact of stricter measures in Europe to combat a second surge of COVID-19 cases, while stimulus talks between the ruling and opposition parties in the US faced a stalemate, which led to greater uncertainty over the economic outlook. In addition, Japanese exporters faced worries that the rising yen against the US dollar would have a negative earnings impact. As a result, stocks finished the month lower. Of the 33 Tokyo Stock Exchange sectors, six sectors rose, with Marine Transportation, Insurance, and Metal Products posting the strongest gains. In contrast, 27 sectors declined, including Pharmaceuticals, Mining, and Land Transportation.

Exhibit 1: Major indices

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	0.2%	4.0%	22.6%	6.6%	21%
JGB Yield (%pt)	-0.04	-0.01	-0.01	+0.02	-0.29
JPY/USD	-0.2%	-1.9%	-2.7%	-2.1%	-12%
JPY/EUR	-2.0%	2.5%	4.1%	5.0%	-7%
MSCI World	-3.6%	7.5%	27.8%	8.6%	39%
TOPIX	0.5%	4.3%	15.9%	2.4%	4%
TPX-100 (Large)	-1.1%	3.1%	13.3%	0.8%	2%
TPX-400 (Mid)	2.0%	5.5%	19.5%	4.4%	5%
TPX-Small	4.9%	7.5%	20.6%	5.4%	17%

Source: Bloomberg, as of 30 September 2020

Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.3%	2.4%	2.8%	2.4%	1.9%
Price/Earn (e)	21.2	18.0	12.9	13.7	14.9
Price/Book	1.1	1.1	1.0	1.2	1.3
Daily Turnover	45	44	46	47	48
Market Cap.	621	570	559	634	569
MSCI World					
Div. Yield (e)	2.1%	2.2%	2.9%	2.5%	2.5%
Price/Earn (e)	24.0	23.0	15.9	17.1	17.0
Price/Book	2.5	2.4	1.9	2.3	2.1

(e) stands for consensus estimates by Bloomberg.

Turnover and market cap in JPY trillion.

Source: Bloomberg, as of 30 September 2020

Exhibit 3: Major market indices

TOPIX



USD/JPY



Source: Bloomberg, as of 30 September 2020

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment. This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

Australia: This document is issued in Australia by Nikko AM Limited (ABN 99 003 376 252, AFSL 237563). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article

139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.