Navigating Japan Equities: Monthly Insights From Tokyo (May 2024)

Capex and wages to impact inflationary mindset; looking for growth narratives amid adjustment in Japan stocks

This month we analyse why the influence of capex and wages on spending behaviour are key to gauging whether an inflationary mindset is taking hold among households; amid an adjustment by Japanese stocks from record highs, we also look for growth narratives to sustain a long term uptrend.

By Naoki Kamiyama, Chief Strategist
10 May 2024

Capex, wages key to inflationary mindset taking hold among households

In yet another indication that inflation is gaining a firm foothold in Japan, the core consumer price index (CPI) excluding fresh food items rose 2.6% year-on-year in March. This keeps it above the Bank of Japan (BOJ)'s 2% target for the second consecutive year. However, to gauge whether an inflationary mindset is becoming entrenched among households, the influence of capital expenditure (capex) and wages on spending behaviour may provide a more accurate insight.

Following the annual "shunto" wage negotiations between employers and Japan's biggest labour union, Rengo, the average base salary is projected to rise by 3.57% this year. This marks the highest increase in over three decades. The rise is significant in two ways. Firstly, the substantial wage hikes to be granted by companies are backed by increasing sales and profits. When the deflationary mindset was still prevalent, companies tended to limit capex, set a cap on wages due to an excess of labour and reduce production. However, companies are now taking a more aggressive approach. They are finding it more beneficial to invest in capex and increase production, and amid the current labour shortage, to increase wages to retain and attract talent.

One reason why the CPI may not reliably indicate the establishment of an inflationary mindset among households is its exclusion of wage data. If wage growth cannot keep up with inflation, households may find it difficult to shake off a deflationary mentality. However, the significant rise in base salaries following the shunto negotiations suggests that growth in wages could eventually surpass inflation. This condition—a real rise in wages—will allow an inflationary mindset to take hold as it will enable income to keep up with expenditure.

Depreciation in the yen, which recently fell to a 34-year low versus the dollar, could undermine the transition to an inflationary mindset even if wages rise in real terms. This is because a weak currency, which inflates import costs, tends to impact the more visual aspects of consumption, such as spending on energy and food. There are encouraging signs, however, as energy costs have been declining while the rise in food prices appears to be decelerating.

Despite recent adjustments, Japan stocks seen maintaining their uptrend

The surge in Japanese stocks that took the Nikkei Stock Average to a record high above 40,000 has slowed, and the index has been hovering near 38,000 for the past month. Despite this slowdown, the stock market, in our view, is still in the midst of a long-term uptrend, and our forecast for the Nikkei to reach 45,000 at the end of the current fiscal year in March 2025 remains unchanged.

We maintain our forecast for two reasons. Firstly, the Middle East tensions that emerged in April, causing a decline in Japanese stocks, may not be having such a detrimental impact on oil prices as initially feared. Oil prices have in fact declined since tensions between Israel and Iran escalated in April. While developments between the two countries continue to be watched closely, the market has had an opportunity to observe that actual oil-producing nations were relatively unaffected by this recent surge in geopolitical tensions.

Secondly, the market was ready to take a breather after the sharp rally in March, and adjustments were necessary. The Nikkei's pullback from record highs was closely correlated with a drop in the Philadelphia Semiconductor Index, or SOX, during the same period. Semiconductor-related companies were instrumental in the Nikkei's record-breaking rally. Although their recently released results were generally positive, even a slight expression of concern about future earnings from some companies seemed to momentarily dampen sentiment towards the sector. Expectations for semiconductors appeared to have outpaced reality. Adjustments were due, though the sector is seen continuing to benefit from AI-driven demand in the long term.

Looking ahead, Japanese stocks could benefit from the market's focus shifting away from the weak yen's advantages and growing interest in sectors beyond semiconductors. The weak yen's impact on the gains seen in Japanese stocks is indisputable, with exporters being the primary beneficiaries. However, other sectors with growth potential, such as travel and hospitality, banking, retail sales and real estate, could benefit from actual economic expansion. These sectors still have room for more growth as Japan continues to transition into an inflationary economy. Moreover, these sectors will be relatively immune to the yen's fluctuations at a time when the BOJ's monetary policy could trigger currency volatility. Even if the yen appreciates over time, Japan still possesses numerous potential growth narratives supported by fundamentals.

Japan equities slip in April as geopolitical tensions cast shadow over the market

The Japanese equity market ended April lower with the TOPIX (w/dividends) down 0.91% on-month and the Nikkei 225 (w/dividends) falling 4.86%. The BOJ left its monetary policy unchanged at its April Monetary Policy Meeting, supporting Japanese equities, but the market was negatively impacted by investors' growing risk-off sentiment amid escalating tensions in the Middle East as well as the decline in the US equities market as the outlook faded for the Fed to cut rates at an early stage, given the announcement of strong economic indicators in the US. Semiconductor-related stocks also weighed down the Japanese market after a major Taiwanese contract semiconductor manufacturer scaled back its outlook for chip market growth. Another negative factor was disappointing earnings results released by certain major firms both in Japan and abroad.

Of the 33 Tokyo Stock Exchange sectors, 13 sectors rose, with Marine Transportation, Nonferrous Metals, and Wholesale Trade posting the strongest gains. In contrast, 20 sectors declined, including Pulp & Paper, Retail Trade and Air Transportation.

Exhibit 1: Major indices

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	38,405.66	-4.9%	5.8%	24.5%
JGB Yield	0.879	+0.152	+0.147	-0.068
USD/JPY	156.92	3.7%	6.1%	4.1%
EUR/JPY	168.25	3.0%	5.1%	4.7%
MSCI World	3,305.30	-3.9%	3.1%	19.4%
Valuation	Mth-end	1-mth	3-mth	6-mth
TOPIX	2,743.17	-0.9%	7.5%	21.7%
Div. Yield (e)	2.3%	2.2%	2.5%	2.5%
Price/Earn (e)	16.0	15.8	14.2	14.1
Price/Book	1.4	1.4	1.2	1.2

Source: Bloomberg, 30 April 2024

Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.3%	2.2%	2.5%	2.5%	2.7%
Price/Earn (e)	16.0	15.8	14.2	14.1	13.4
Price/Book	1.4	1.4	1.2	1.2	1.1
Daily Turnover	95	99	90	83	59
Market Cap.	973	960	856	769	578
MSCI World					
Div. Yield (e)	2.0%	2.0%	2.2%	2.2%	2.7%
Price/Earn (e)	18.6	18.8	16.5	16.7	15.5
Price/Book	3.0	3.1	2.7	2.7	2.2

Source: Bloomberg, 30 April 2024

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: 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.

Luxembourg and Germany: This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secateur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

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.

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 nether 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 Decree80/98, 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.