

Navigating Japan Equities

Monthly Insights from Tokyo (June 2022)

Assessing why losses by Japan equities have been limited in 2022 and the return of inbound tourism

8 June 2022

This month we explain why losses by Japanese equities so far in 2022 have been limited relative to their peers; we also assess the positive impact a return of inbound tourism could have on Japan's economy and markets.

By Naoki Kamiyama, Chief Strategist

Why losses by Japanese equities have been relatively limited in 2022

Global equities have been on the back foot so far in 2022, weighed down by factors including inflation concerns, the threat of higher interest rates and geopolitical risks. Japanese equities have also suffered in 2022, although their decline has been limited compared to global peers. As of this writing, the Nikkei Stock Average had fallen 2.9% since the end of 2021 while the S&P 500 had shed 13.5% and the MSCI World Index 13.8%. One reason losses by Japanese equities have been limited is because Japan has been less affected so far from the negative effects of global inflation and the geopolitical risks emanating from the Russia-Ukraine conflict.

We believe that another reason behind the relatively good performance by Japanese equities is due to how industries are set up in Japan compared to other developed market economies. With coronavirus restrictions being lifted across the developed world, consumption patterns—particularly in the US—have clearly shifted from those centred on stay-at-home demand to out-of-home activity, such as shopping, dining and traveling. This shift has resulted in lower growth expectations for stay-at-home stocks, in turn also denting growth prospects for giant tech companies. All in all, this development has negatively affected stock market valuations. Japan, in contrast, does not have any notable stay-at-home stocks nor big tech names to speak of. Export growth supported the country during the pandemic; Japan's industrial structure is centred on export goods, while entertainment services (such as subscription streaming providers) play a limited role. As such, any decreases in stay-at-home demand does not have much of an impact on Japanese stock indices. Furthermore, Japanese exporters have been boosted by the steadily declining yen.

This industrial structure, which has helped limit losses in Japanese equities due to a shift in consumer demand patterns, may suit foreign investors seeking to make defensive asset allocations. Japanese equities may therefore provide a sound choice for those looking to allocate their assets at the country level.

The return of inbound tourism and impact on the Japanese economy and markets

After closing its doors to foreign tourists following the COVID-19 outbreak two years ago, Japan is poised to relax its entry restrictions in a bid to lure back travelers from abroad. Starting later in June, tourists from 98 countries and territories will be allowed into Japan, although visitors will initially be limited to those taking part in guided package tours. The government, which plans to eventually allow the number of tourists to recover to pre-pandemic levels, appears to have been nudged into action after being criticised as the only G-7 nation maintaining stringent border controls. However, the government may not want to take too much risk before the upper house elections in July. Once the elections are safely out of the way with the outcome in its favour, the government may be emboldened to further relax its stance on inbound tourism, and a variety of domestic sectors geared towards foreign visitors could benefit as early as the summer.

As the number of foreign tourists to Japan had practically dropped to zero during the pandemic, even a modest recovery will look impressive. Though likely to be at a very gradual pace, return of inbound tourism will give

businesses who had prepared for the 2020 summer Olympics in Tokyo the chance to make up for opportunities lost when the games were closed to foreign visitors because of the pandemic. Following the upper house elections, the government could also take steps to encourage domestic tourism through various subsidy and discount schemes, providing the economy with an additional lift.

The weaker yen, which fell to a fresh two-decade low versus the dollar early in June, is likely to significantly boost inbound tourism. The yen was seen to have enhanced the allure of Japan as a holiday destination back in 2015 when the currency edged above 120 to the dollar. It is currently above 130 to the dollar, which could serve as a powerful incentive for second and third-time visitors. The return of foreign tourists in significant numbers could have a visible market impact as the companies likely to benefit, such as airlines, railway operators and hotel operators, tend to be large-cap stocks.

Market: Japan stocks rise in May on China easing, hopes for economic activity normalising

The Japanese equity market rose in May, with the TOPIX (w/dividends) up 0.78% on-month and the Nikkei 225 (w/dividends) rising 1.61%. Earlier in the month equities were weighed down by factors such as the US Federal Reserve's big interest rate hike and its decision to reduce its balance sheet. However, from mid-month onward the market rallied as China's central bank moved toward monetary easing, including cutting mortgage interest rates. Japanese stocks were further boosted by expectations for a return to normal economic activity levels in Japan as the country announced the easing of entry restrictions for overseas tourists which have been in place throughout the pandemic. Of the 33 Tokyo Stock Exchange sectors, 18 sectors rose with Marine Transportation, Mining, and Oil & Coal Products among the most significant gainers. In contrast, 15 sectors declined, including Pulp & Paper; Fishery, Agriculture & Forestry; and Services.

Exhibit 1: Major indices

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	1.6%	2.8%	-1.9%	-5.5%	36%
JGB Yield (%pt)	+0.01	+0.05	+0.19	+0.16	+0.16
JPY/USD	-1.3%	10.7%	13.4%	16.7%	14%
JPY/EUR	0.0%	5.5%	6.8%	2.4%	7%
MSCI World	-0.2%	-6.3%	-10.0%	-6.2%	46%
TOPIX	0.7%	1.4%	-0.8%	-0.5%	19%
TPX-100 (Large)	0.7%	2.4%	-0.2%	1.5%	25%
TPX-400 (Mid)	0.8%	-0.1%	-1.7%	-4.5%	10%
TPX-Small	0.4%	-1.5%	-2.4%	-1.8%	7%

Source: Bloomberg, as at 31 May 2022

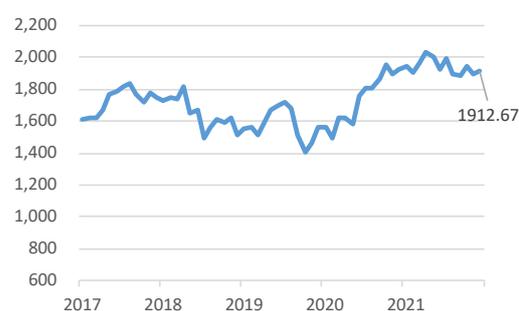
Exhibit 2: Valuation and indicators

Valuation /indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.5%	2.4%	2.2%	2.1%	2.1%
Price/Earn (e)	12.4	13.4	14.2	15.5	14.4
Price/Book	1.2	1.2	1.3	1.3	1.3
Daily Turnover	62	62	59	58	51
Market Cap.	700	715	735	722	604
MSCI World					
Div. Yield (e)	2.1%	2.0%	1.8%	1.8%	2.5%
Price/Earn (e)	16.3	17.7	19.5	20.6	17.3
Price/Book	2.7	2.8	3.1	3.1	2.2

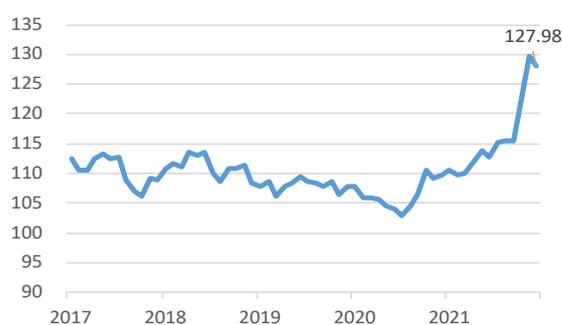
(e) stands for consensus estimates by Bloomberg. Turnover and market cap in JPY trillion. Source: Bloomberg, as at 31 May 2022

Exhibit 3: Major market indices

TOPIX



USD/JPY



Source: Bloomberg, as at 31 May 2022

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.

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.