

## Market commentary

# How to view the Japanese equities market at present

Nathan Gibbs

---

*We remain positive on the outlook for Japan's economy and stock market as we believe the changes in policy by both the Bank of Japan and the government are not yet fully reflected in stock prices. Although corporate earnings were strong for the fiscal year ended in March 2014, forecasts for this fiscal year are still conservative and we therefore expect a cycle of positive upwards revisions to profits as we go through 2014.*

*"Although inflation numbers might show some temporary weakness in coming months, the Bank of Japan does seem to have successfully raised inflation expectations and has laid the groundwork for a sustained exit from previous period of deflation. As the economy normalizes and consumer confidence improves as a result, we find many attractive opportunities for investment.*

*"Schroders' investment process is driven by detailed research on individual companies, rather than sectors or themes. However, we are currently generating ideas particularly strong ideas among companies which are primarily exposed to the domestic market as this is where we feel many of the positive revisions will be focused this year. So, the changes in the domestic economy currently look more important to us than short-term fluctuations in the exchange rate which have been the primary focus for many investors in late 2013 and early 2014. Although it is very early days, we have been encouraged by the fact that the upward move in the market in May and June has occurred without any additional weakening of the currency.*

*"Within the domestic economy, we find undervalued opportunities particularly in sectors such as retail and transportation. At this stage of the cycle, construction stocks should also see strong orders, especially with the added impetus from the Olympic Games in 2020. However, most of the general construction stocks already appear overvalued to us, particularly in light of the sharp increase in wages being seen as the market for construction workers is tightening rapidly. We currently prefer instead to focus on condominium builders and some housing stocks.*

*"Indeed, the issue of wage inflation is a particular focus for us. For the Japanese economy as a whole, a return to wage growth after years of deflation is undoubtedly a positive change but, of course, it is not necessarily positive for individual companies faced with higher labour costs. In addition to construction companies we should therefore be wary of sectors such as trucking and parcel delivery where volume growth and the number of drivers required are inextricably linked.*

*"One other positive development is the ongoing pick up in capital expenditure in Japan. This is generating strong order growth for companies who produce machinery, factory automation and robotics and all of these areas are well represented within our clients' portfolios."*

