



Source(s): Japancrush.com

## Japan

*This Time For The Money*

Grant's Interest Rate Observer 2013 Spring Conference

# 2013 is a Tokowaka Year in Japan, Time For Real Change

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*“Tokowaka” – continual renewal*



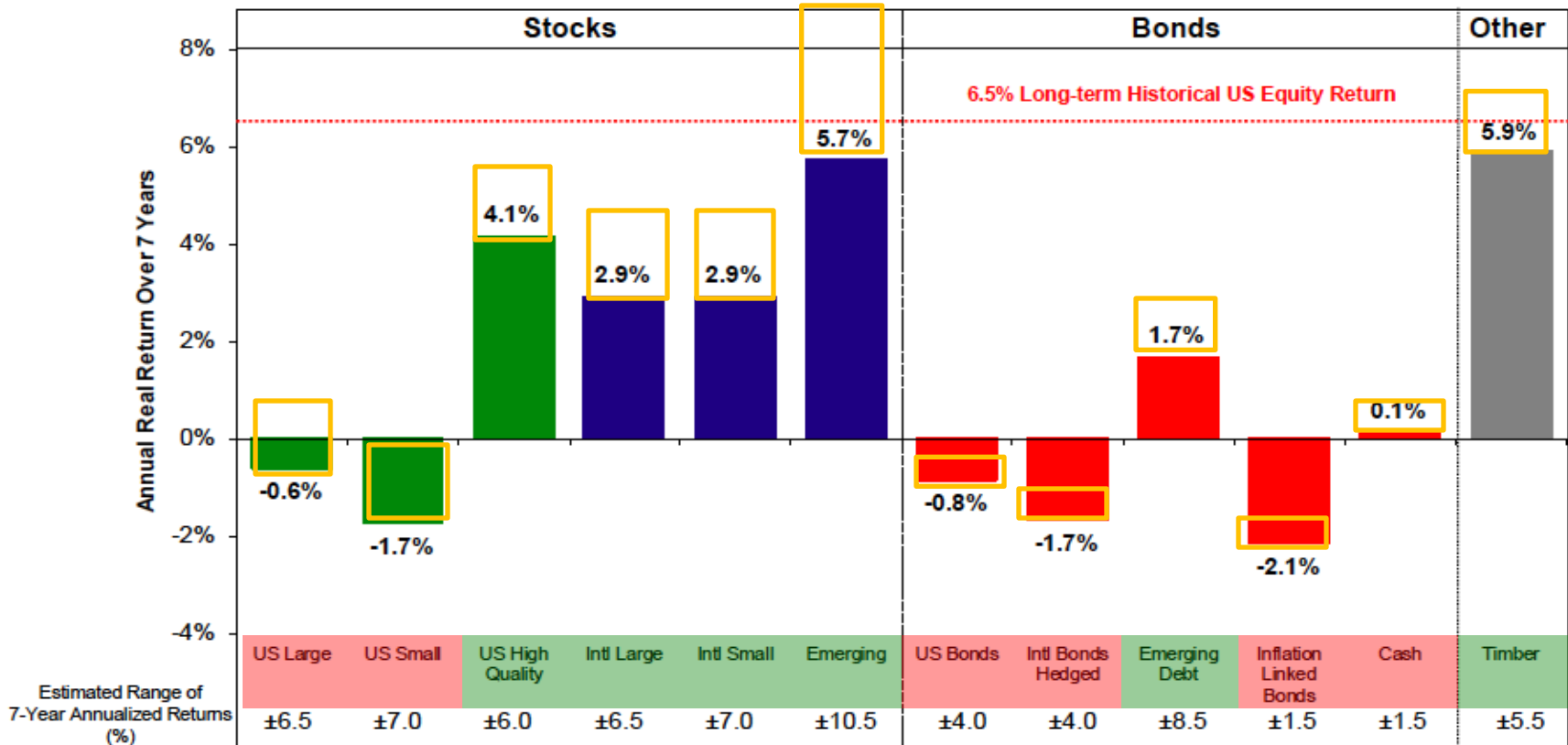
The Ise Grand Shrine

Source(s): Taiyo Pacific Partners, Tokowaka – Continuous Renewal – Shrine being torn down and reconstructed for 61st time since 678.

# JG: Negative Real Returns in Traditional Assets Till 2020

## GMO 7-Year Asset Class Return Forecasts\* Alpha

As of February 28, 2013



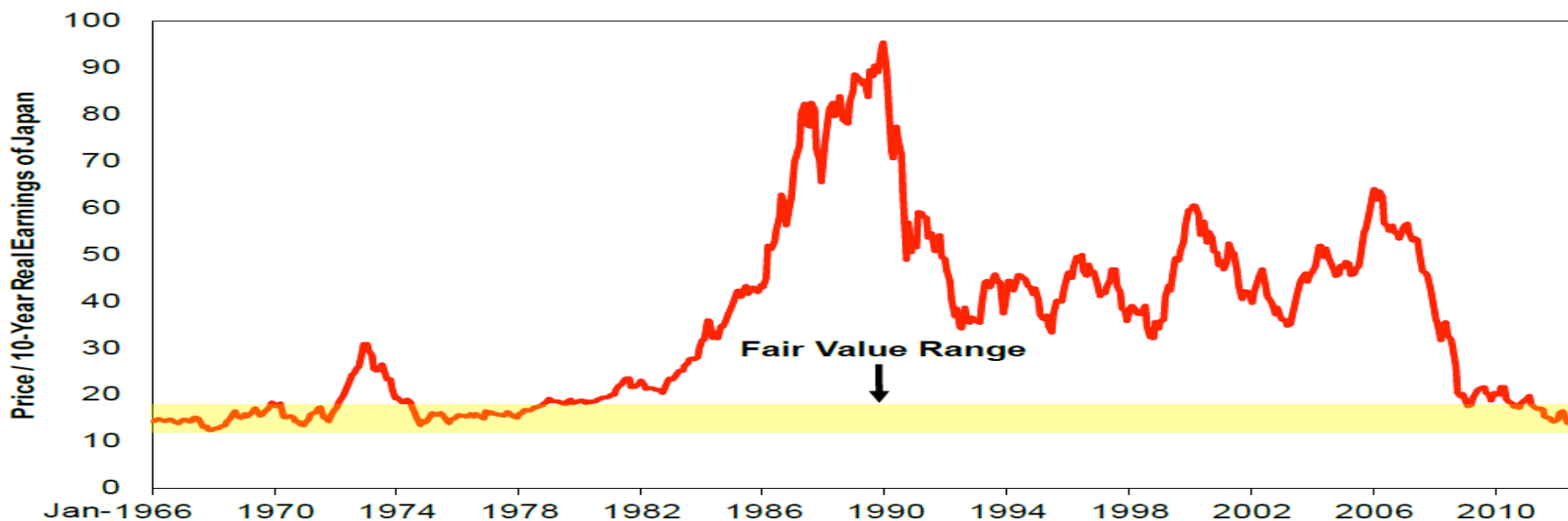
\*The chart represents real return forecasts for several asset classes and not for any GMO fund or strategy. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Forward-looking statements speak only as of the date they are made, and GMO assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results may differ materially from those anticipated in forward-looking statements. US inflation is assumed to mean revert to long-term inflation of 2.2% over 15 years.

GMO

Source(s): Grantham, Mayo, Otterloo ("GMO").

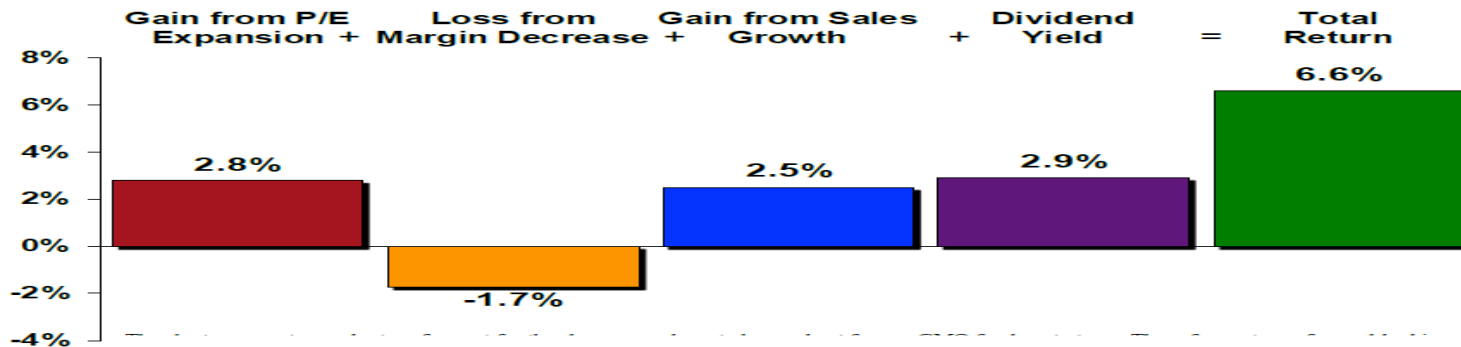
Source: GMO

# Japan: A Developed Market With Solid Forecast Returns



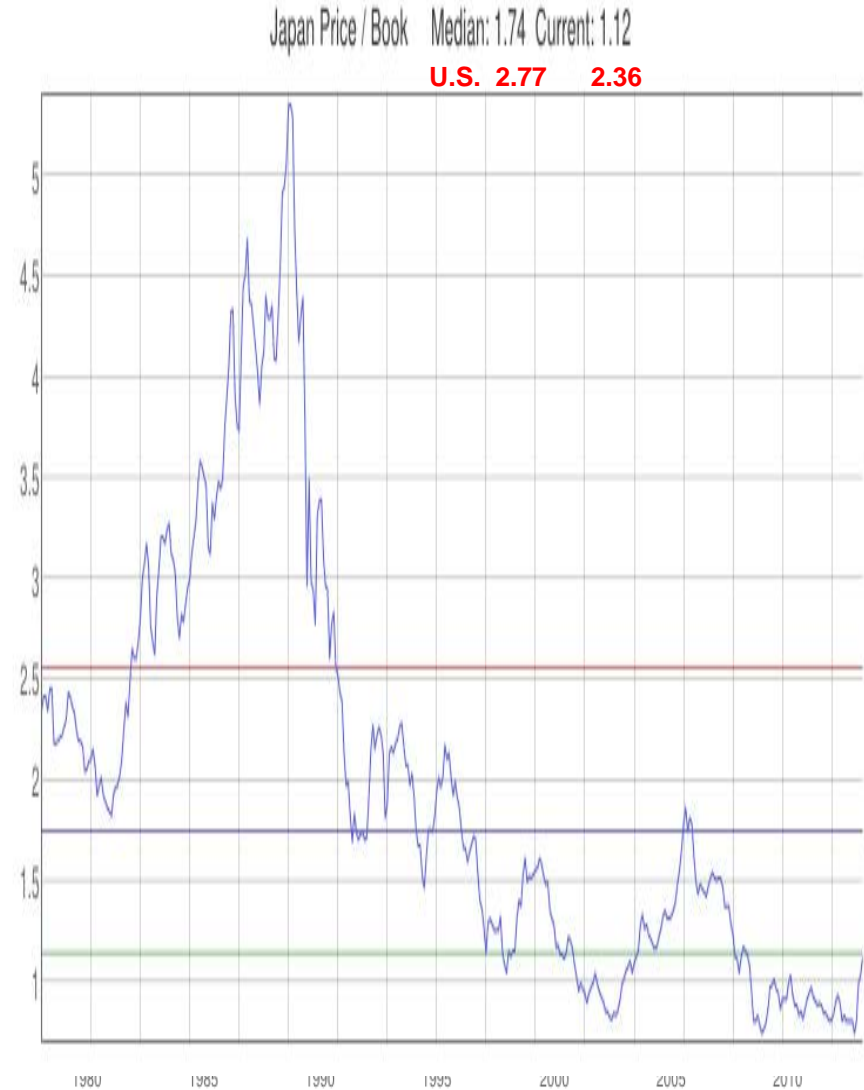
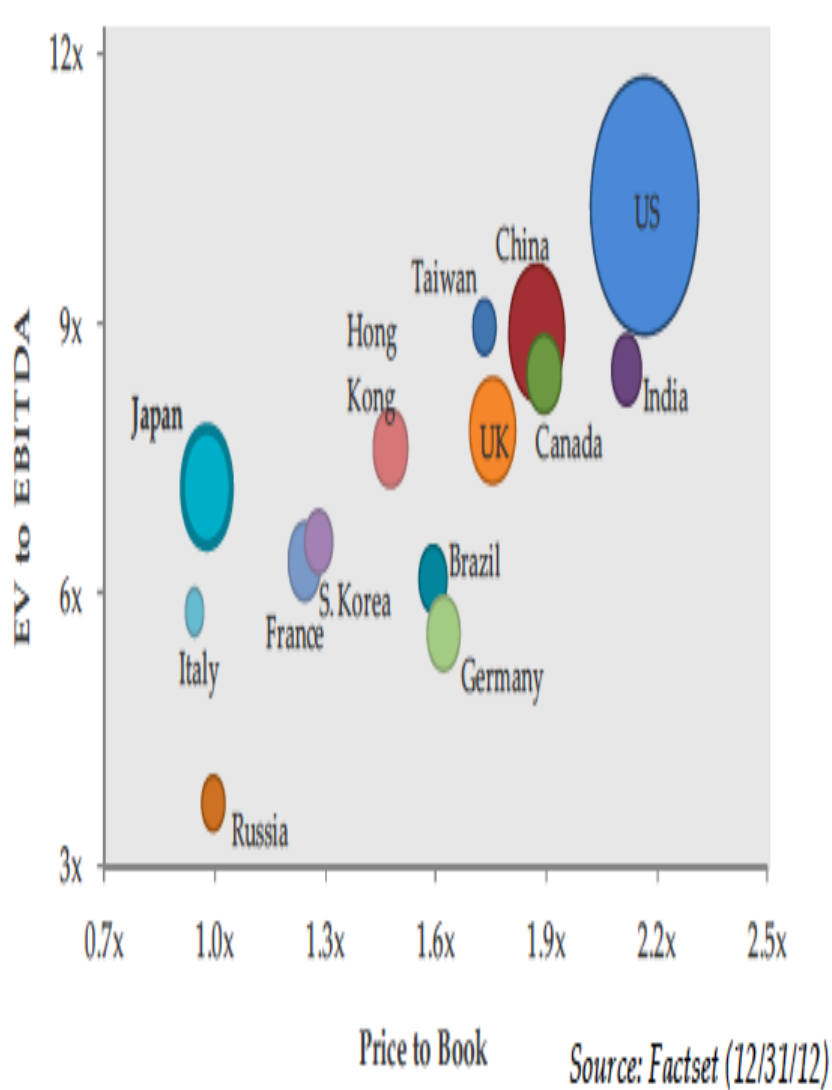
Components of annual return of Japan stocks, with regression over 7 years

	P/E	Profit Margin	Real Sales per Share Growth	Dividend Yield
Starting Levels	12.3	3.4%	0.0%	2.6%
Assumption for Next 7 Years	15.0 (Terminal Value)	3.1% (Terminal Value)	2.5%	2.9%



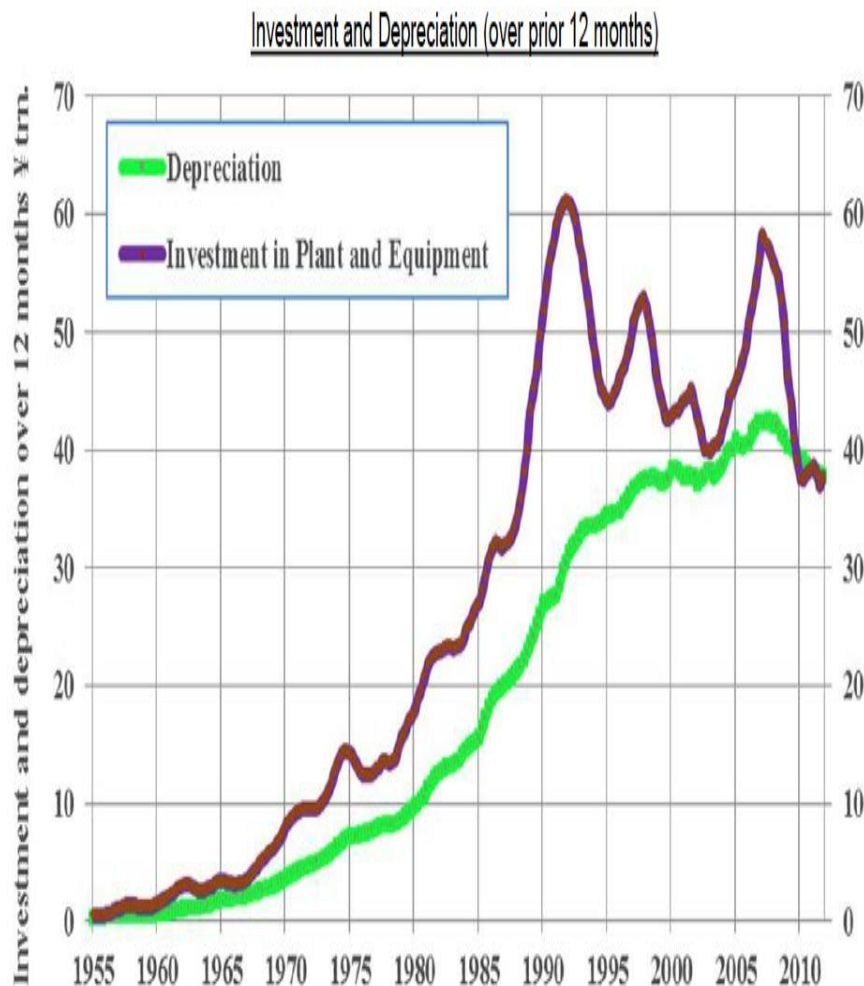
Source(s): GMO.

# Japanese Equities are Cheap vs. ROW and to Own History



Source(s): Taiyo Pacific Partners, Tradingeconomics.com.

# Bonus: Depreciation Overstated, Book Value Understated



Source: Smithers & Co. As at March 2012

Source(s): Sloane Robinson.

	EPS Growth		P/E			P/B	EV/	ROE		10-yr
	(X, %)	2013	2014	2013	2014	2013	2008	EBITDA	Div.yld	bond yld
						trough	2013	2013	2013	(Current)
Japan	25%	13%	13.7	12.2	1.05	0.86	6.3	8.2%	2.3%	0.8%
<b>Accounting Differences Result in Significantly More Free Cash Flow in Japanese Corporations</b>										
US	7%	6%	13.7	12.9	2.29	1.52	7.5	17.3%	2.3%	1.9%
Europe	9%	12%	12.2	10.9	1.68	1.01	6.9	14.6%	3.8%	1.9%
Asia (ex. Japan)	13%	14%	12.2	11.1	1.58	1.23	6.6	13.3%	3.1%	--

Source: Goldman Sachs. As at January 2013

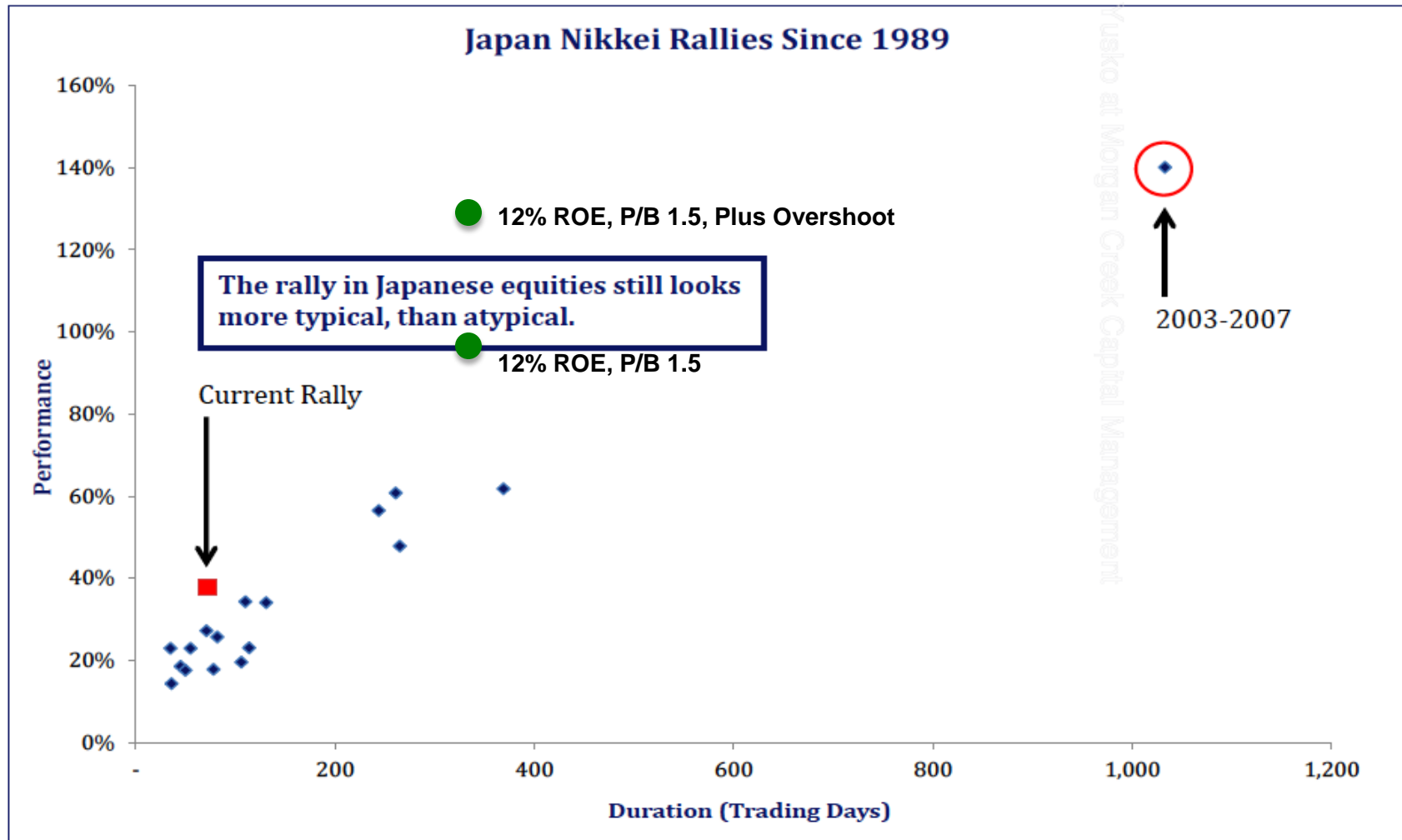
# Buffet's Favorite Valuation Indicator Not Stretched Here



Source(s) Tradingeconomics.com.

# Current Rally is Just Getting Started, Lots of Headroom

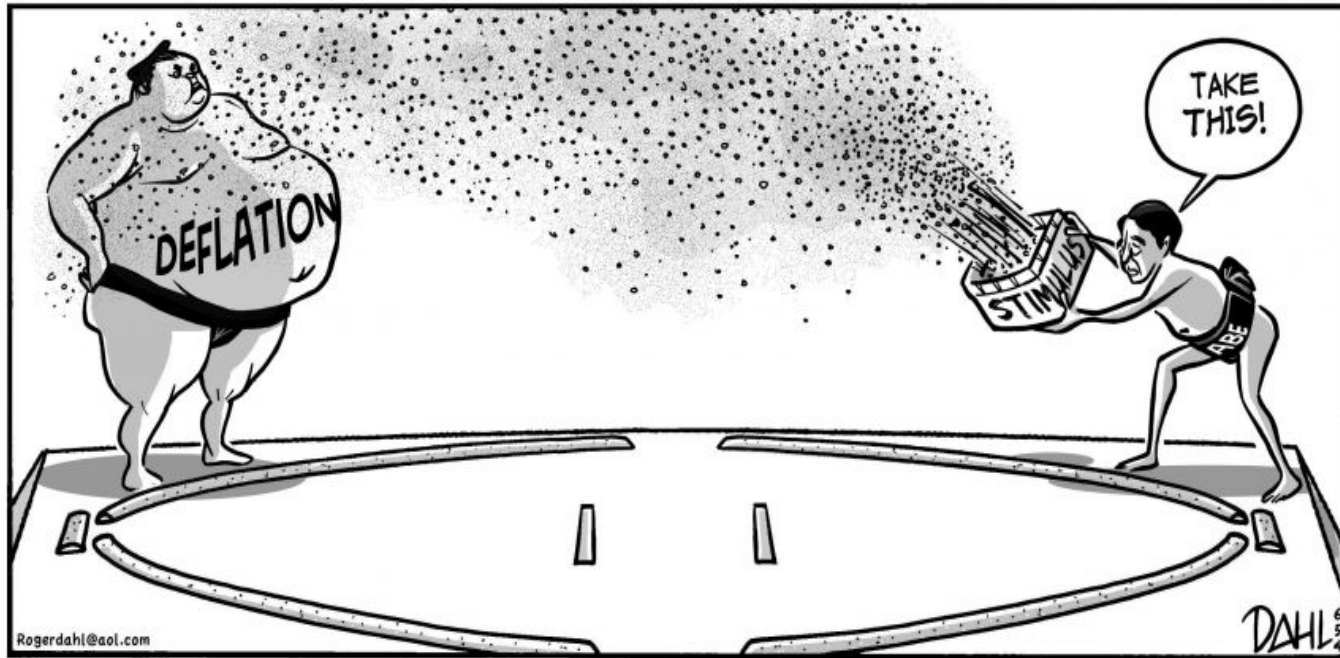
## THE JAPANESE EQUITY RALLY IN CONTEXT



Source(s) Strategas Research Partners, Sloane Robinson estimates.



# “Abenomics” is the Plan to Create the Tokowaka Renewal



Abe government's **"Print & Spend"** economic policy framework is the most aggressive attempt by a Japanese government in recent history to tackle the country's two-decade long deflation once and for all

- Aggressive monetary easing to overturn the Yen's appreciation
- Flexible fiscal expansion to support domestic demand
- Long term strategy to revive domestic investment

# Japanese Corporations Fighting Yen for Past Twenty Years

## Nikkei—23-Year Downtrend Is Broken



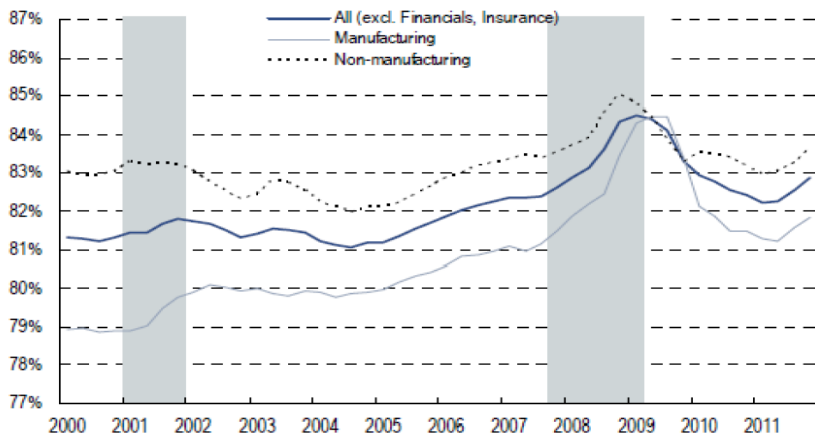
## USDJPY: Price of 1 USD in JPY



Source(s): Strategas Research Partners.

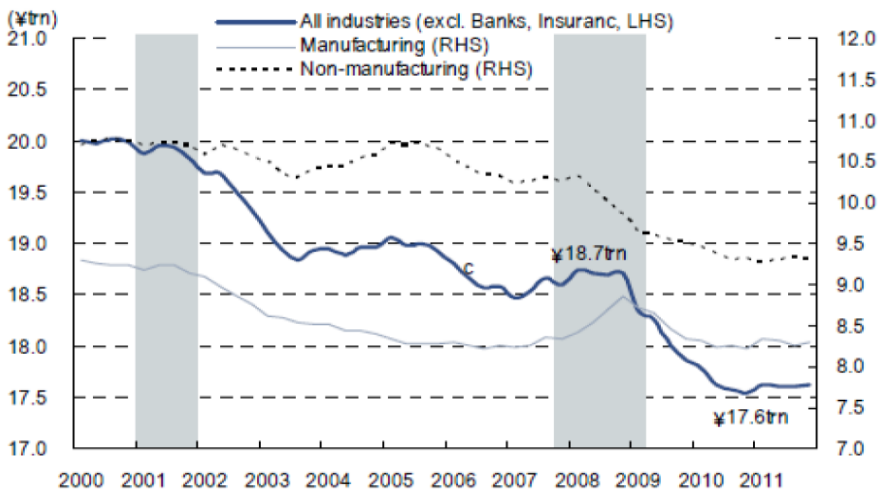
# By Relentlessly Slashing Costs, Maintained Profit Margins

Ratio of Variable Costs to Sales - (4-period moving average)



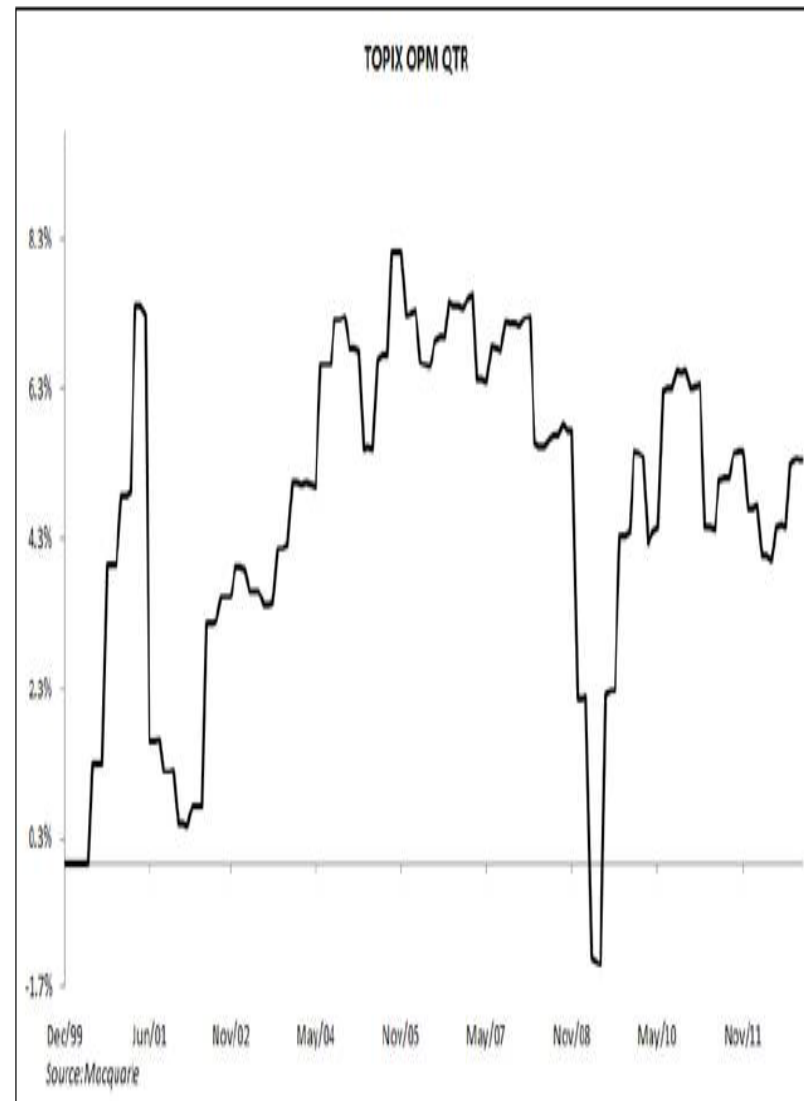
Source: Citibank. As at April 2012

Fixed Costs (4-period moving average)



Source: Citibank. As at April 2012

Source(s): Sloane Robinson, Nezu Asia.

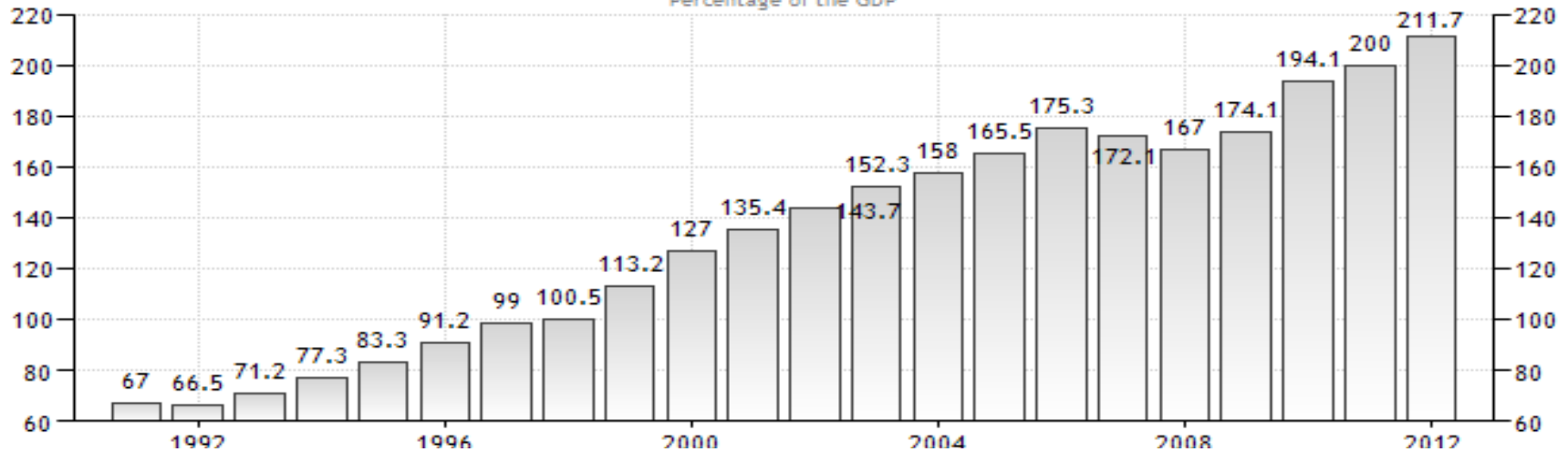


Source: Macquarie

# Difficult Growth Environment, GDP Nearly Flat Since '96

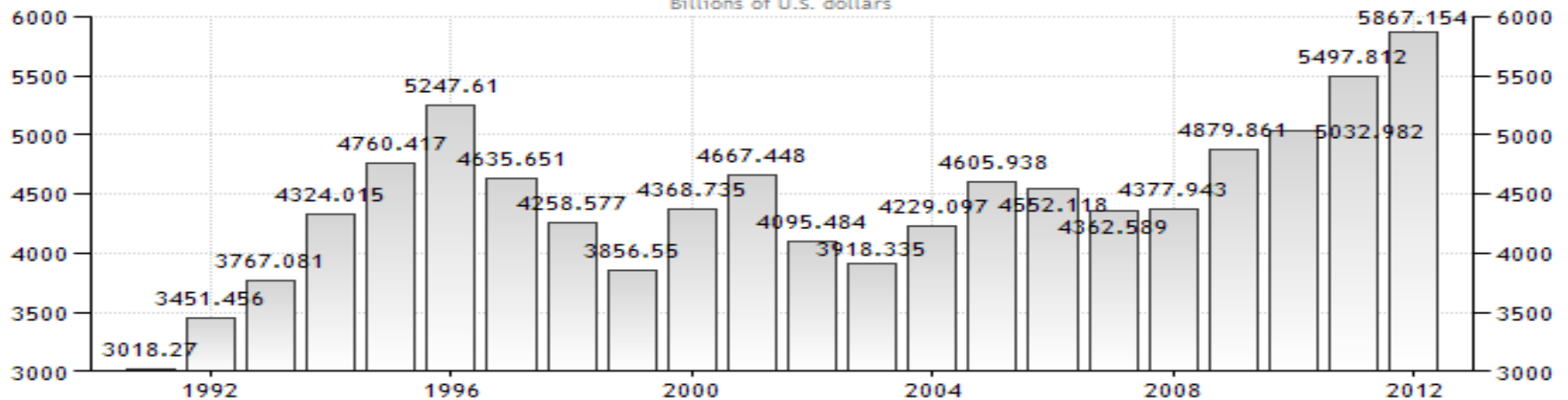
**JAPAN GOVERNMENT DEBT TO GDP**

Percentage of the GDP



**JAPAN GDP**

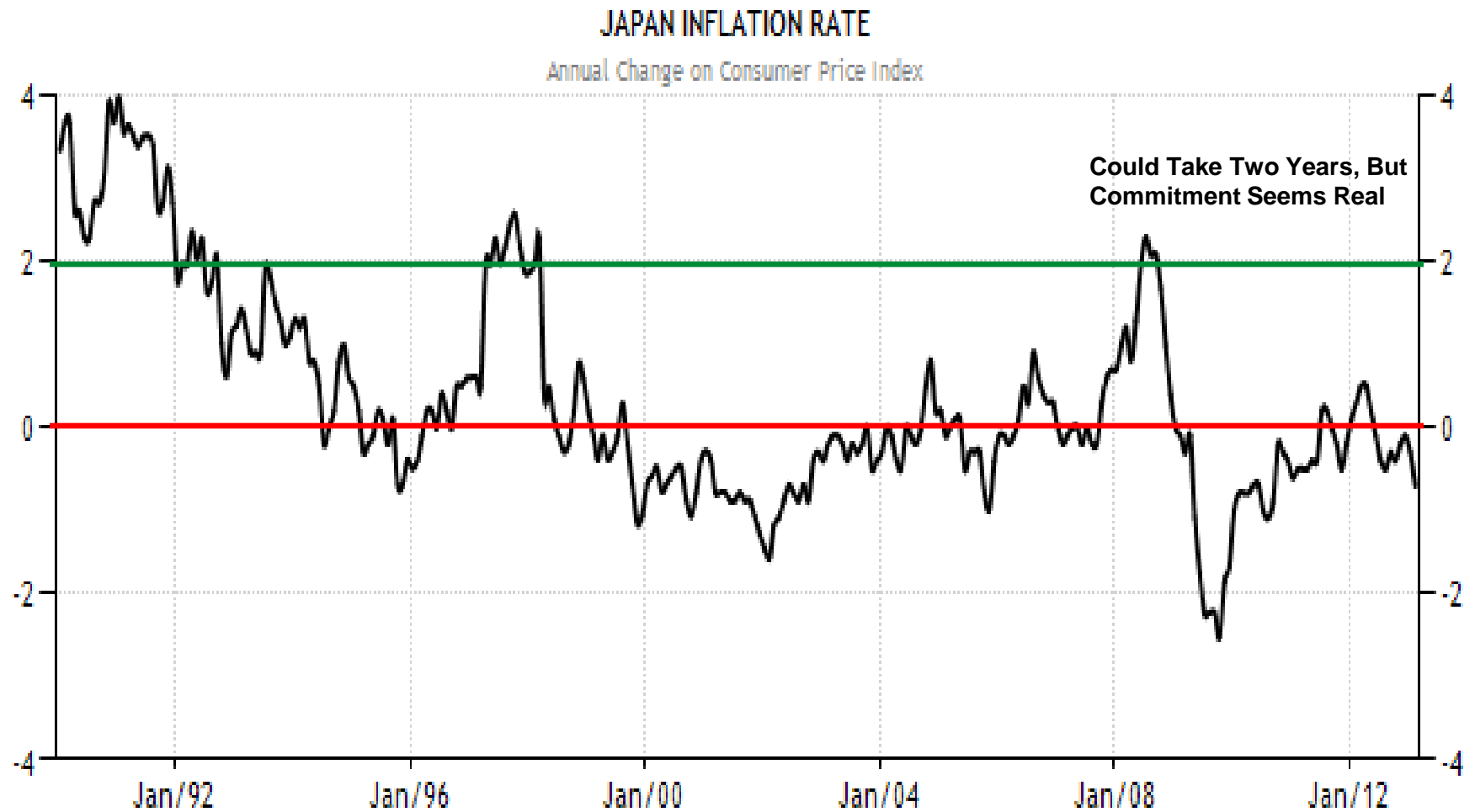
Billions of U.S. dollars



SOURCE: WWW.TRADINGECONOMICS.COM | THE WORLD BANK GROUP

Source(s): Tradingeconomics.com.

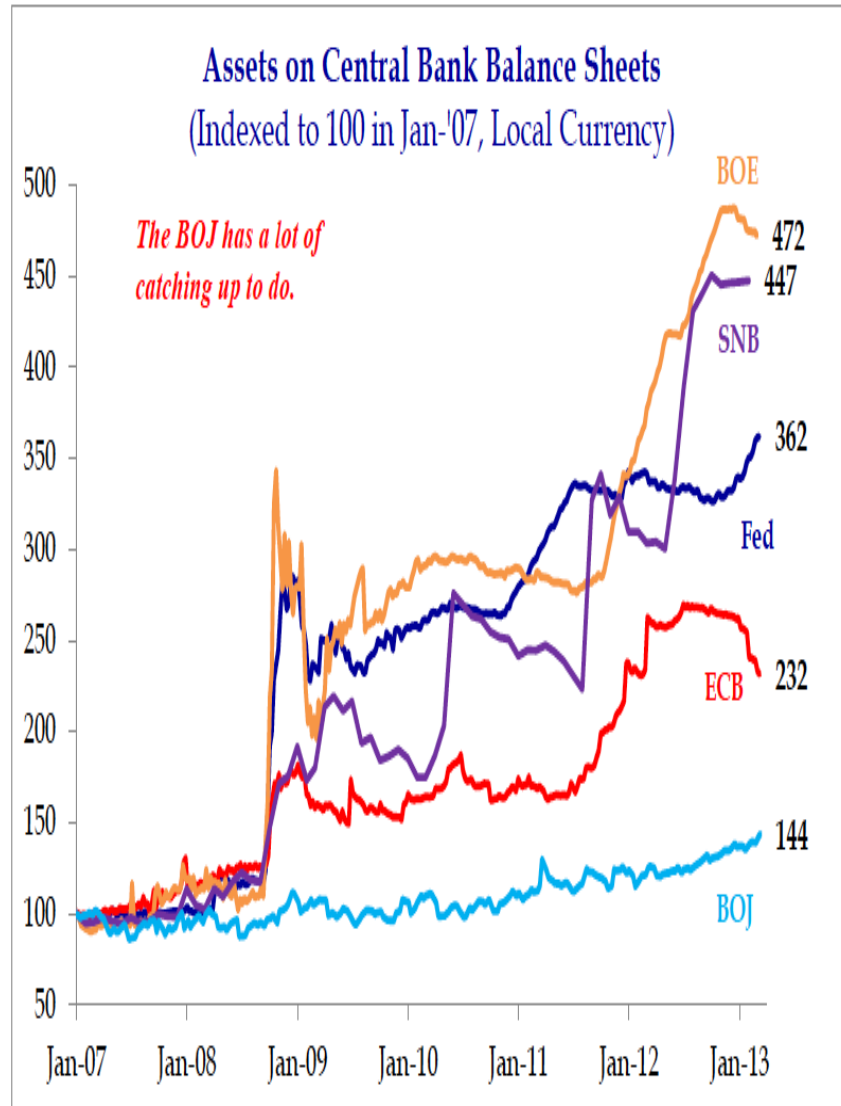
# Japan Mired in “Noflation” for 20 Years, New BOJ Target 2%



SOURCE: WWW.TRADINGECONOMICS.COM | MINISTRY OF INTERNAL AFFAIRS & COMMUNICATIONS

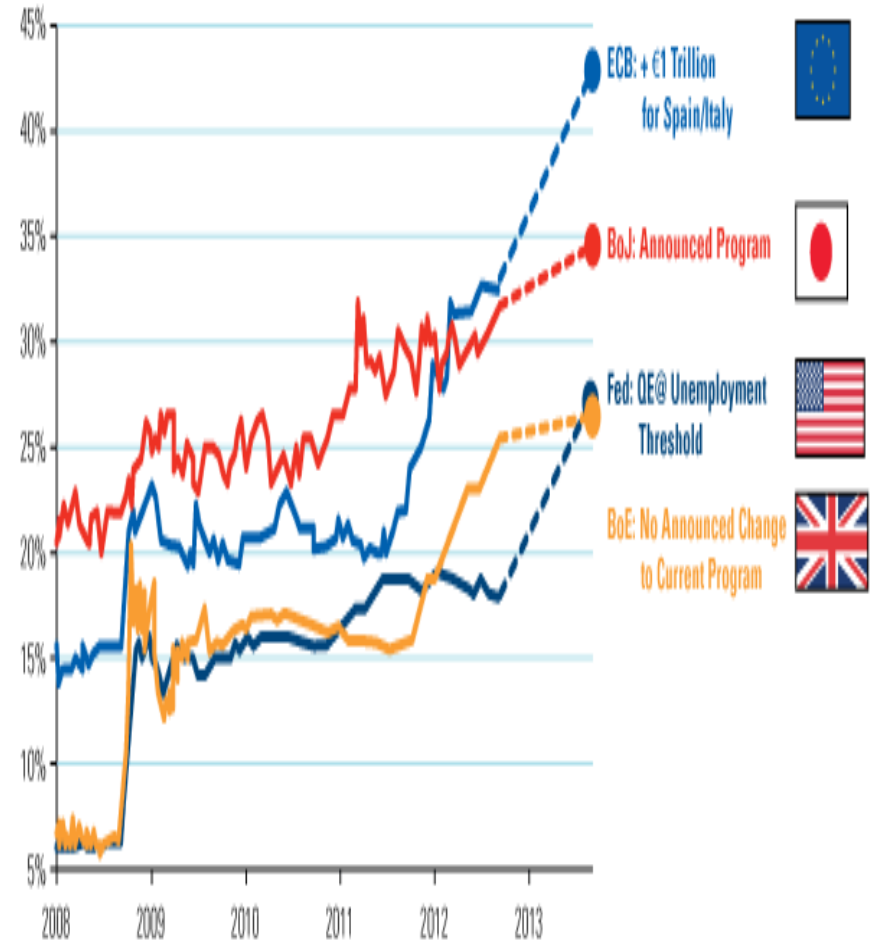
Source(s): Tradingeconomics.com.

# BOJ Been on Sidelines Since Crisis, Let The War Begin...



### Central Bank Balance Sheets

Percent of GDP



Source: FRB, BEA, ECB, Eurostat, BoE, UK office for National Statistics, BoJ, Japan Cabinet office, JP Morgan

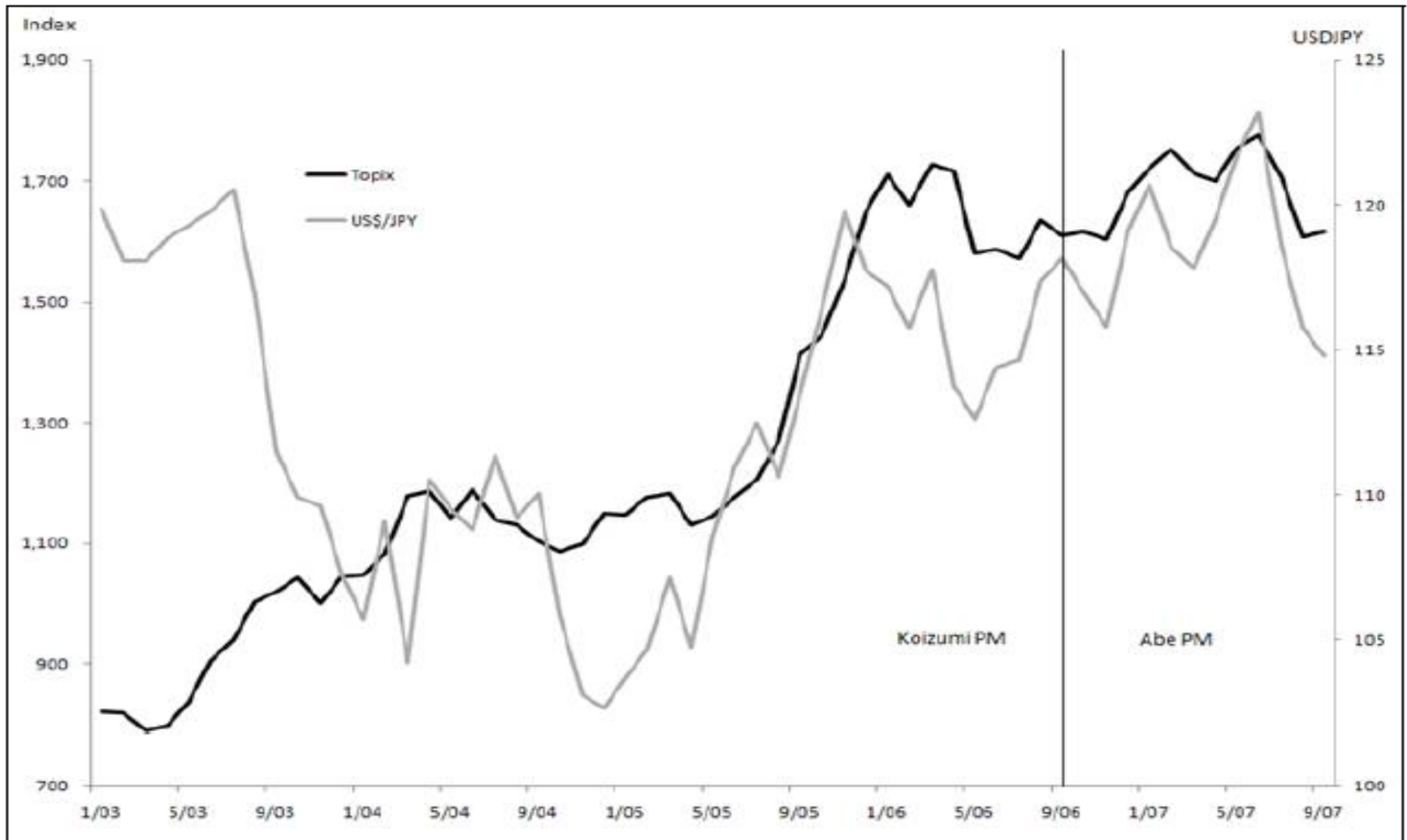
Source(s): Strategas Research Partners, JP Morgan.

# We Have Seen This Movie Before...



Source(s): Japantimes.co.jp.

# Abe I Challenged Hawkishness of Koizumi, Topix Doubled



Source(s): Nezu Asia.



# Within Broad Bull Market, Some Really Huge Winners

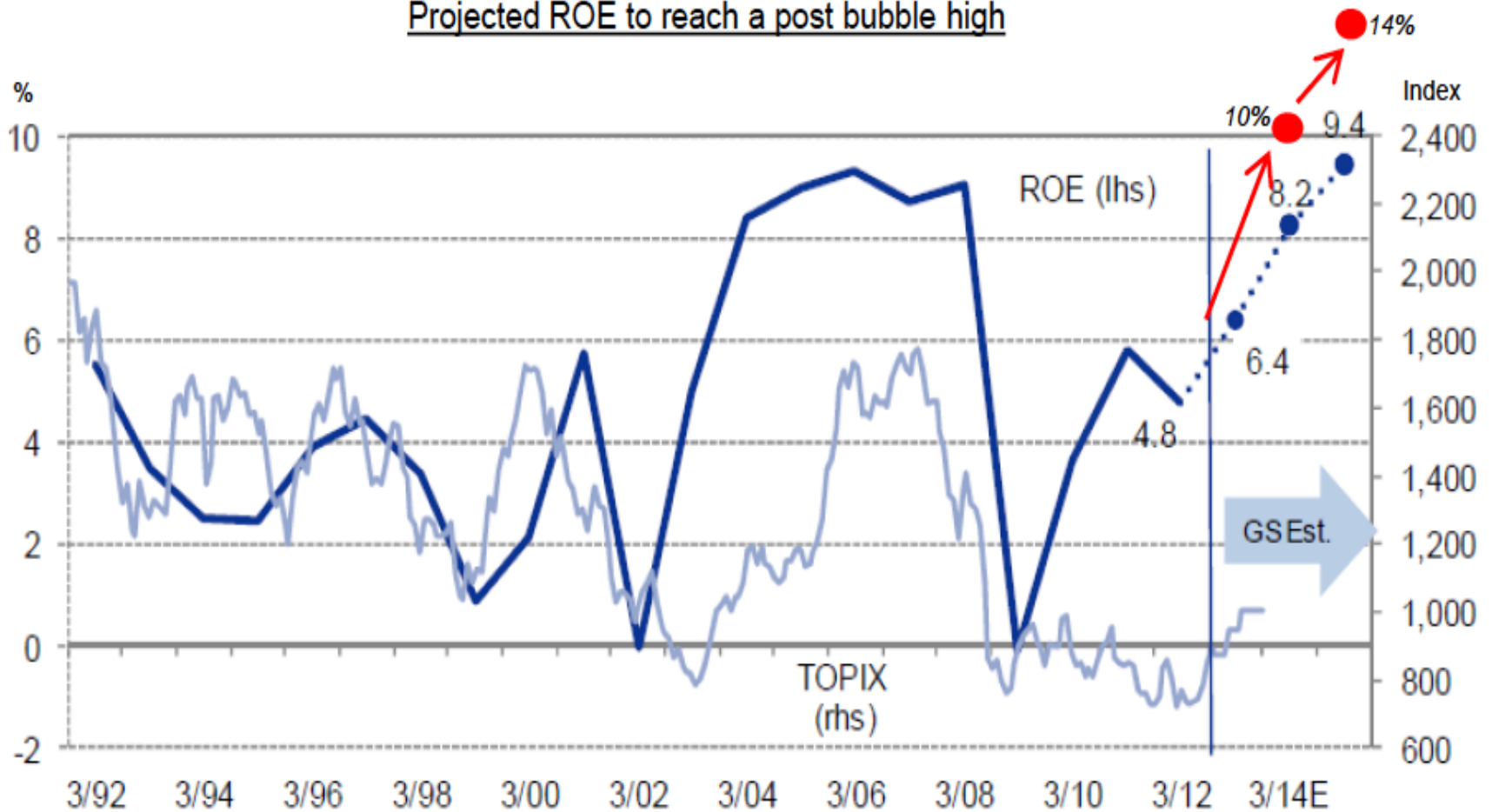
Top 10 sectors in 2005		CY2005 performance
1	MINING	104.9%
2	REAL ESTATE	100.6%
3	NONFER METAL	86.6%
4	IRON & STEEL	84.1%
5	WHOLESALE TRD IND	82.3%
6	TXTL & APPRL	74.7%
7	MACHINERY	70.2%
8	WARE&HARB TRNS	68.1%
9	RETAIL TRADE	61.1%
10	SEC&CMDTY FUTR	59.9%
Worst 10 sectors in 2005		CY2005 performance
1	PULP & PAPER	17.5%
2	INFO & COMM	17.5%
3	PHARMACEUTICAL INI	20.9%
4	ELEC POWR & GAS	21.0%
5	AIR TRANSPORT	22.1%
6	FOODS	24.3%
7	OTHER PRODUCTS	26.2%
8	METAL PRODUCTS	26.7%
9	ELECTRIC APPL	27.9%
10	RUBBER PRODUCTS	31.9%

Top 10 sectors 2003-2005		03-05 performance
1	IRON & STEEL	295.5%
2	REAL ESTATE	258.2%
3	WHOLESALE TRD IND	226.3%
4	NONFER METAL	211.7%
5	MARITIME TRAN	210.7%
6	BANKS	197.2%
7	OTHER FINC BUS	176.0%
8	TXTL & APPRL	175.7%
9	MINING	174.0%
10	GLSS & CRMC PRD	166.4%
Worst 10 sectors 2003-2005		03-05 performance
1	PULP & PAPER	25.2%
2	INFO & COMM	32.1%
3	ELEC POWR & GAS	37.5%
4	PHARMACEUTICAL IND	43.4%
5	LAND TRANSPRT	47.9%
6	OTHER PRODUCTS	56.3%
7	ELECTRIC APPL	58.3%
8	AIR TRANSPORT	62.9%
9	SERVICES	63.7%
10	FOODS	66.1%

Source(s): Nezu Asia.

# Abe II Stimulus Will Sharply Increase Corporate ROE

Projected ROE to reach a post bubble high



Note: Based on TSE1-listed firms with consolidated data available from 2006. GS Global ECS Research estimates for FY3/13, FY3/14 and FY3.15.

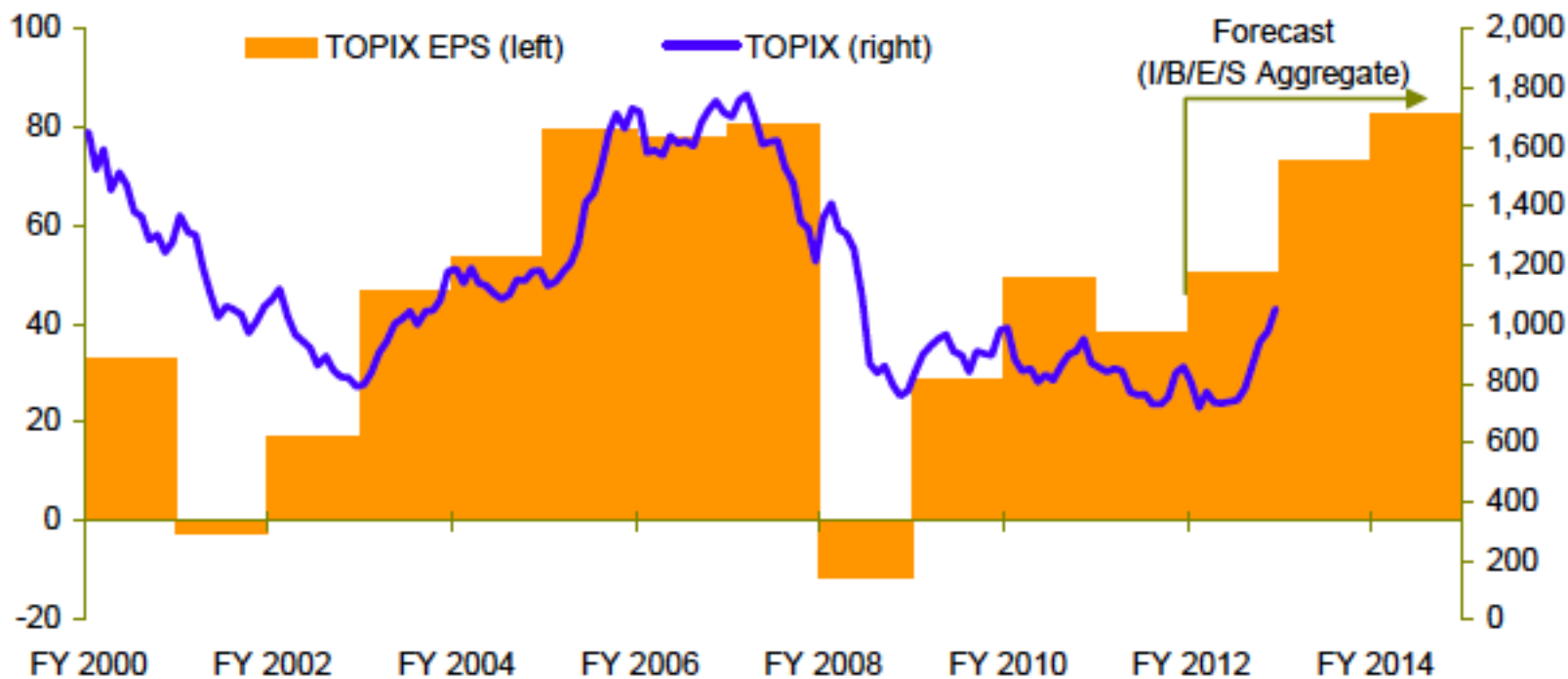
Source: Goldman Sachs. As at January 2013 ● Sloane Robinson LLP estimate.

Source(s): Sloane Robinson.

# Corporate Japan Could Experience Explosive EPS Growth

The result of this potent mix of Japanese renewal and political will is an MSCI consensus estimate calling for 25% EPS growth in 2013 and 24% in 2014 for Japanese equities... more than double any other MSCI region<sup>1</sup>.

## TOPIX EPS

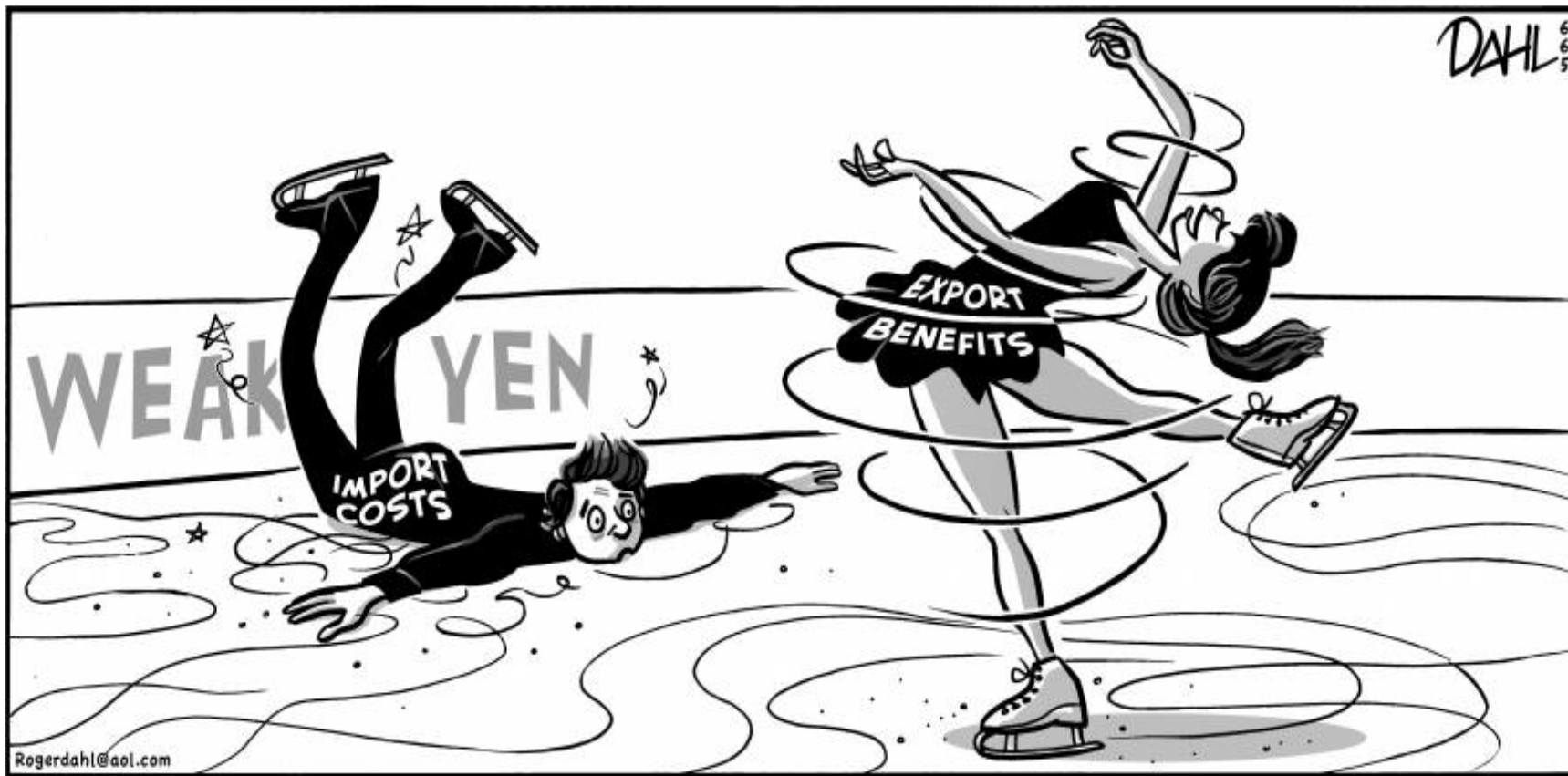


FY 2000 ~ FY 2014 (TOPIX:Mar 2013)

\*FY yyyy : from Apr yyyy to Mar yyyy+1

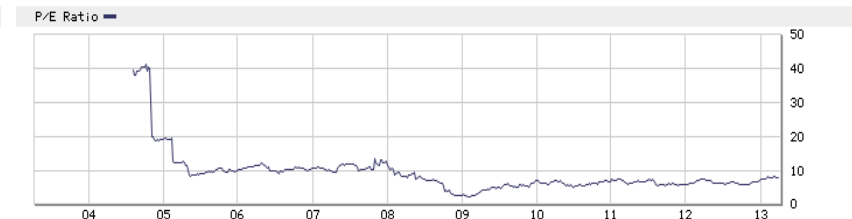
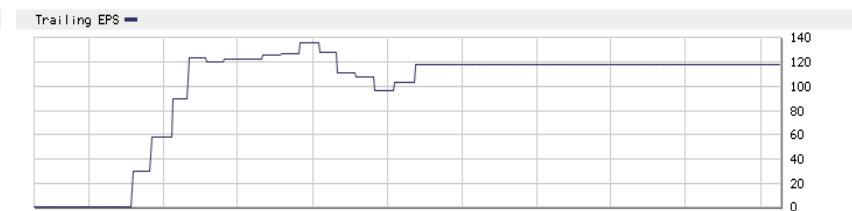
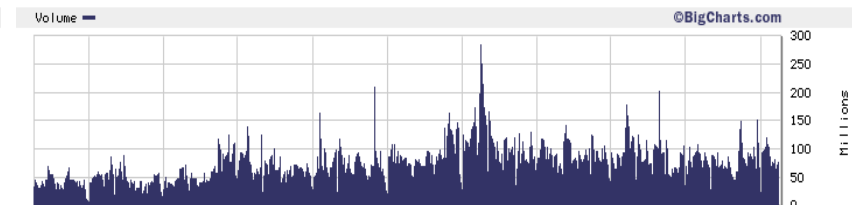
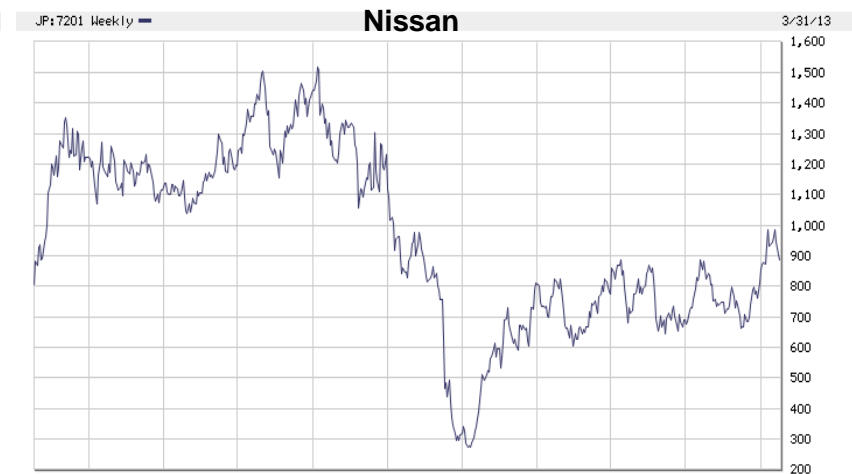
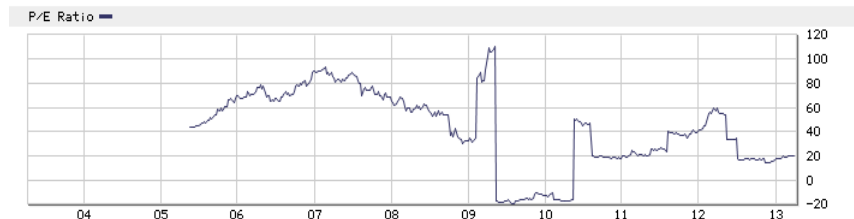
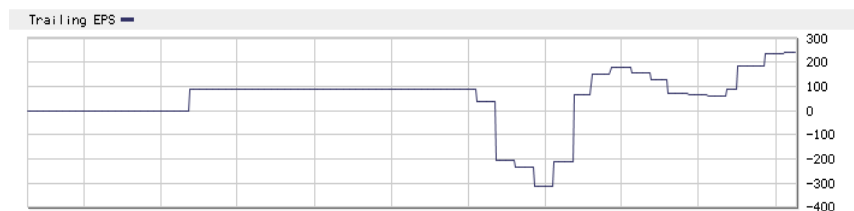
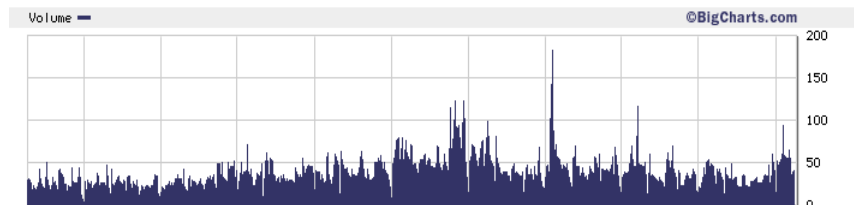
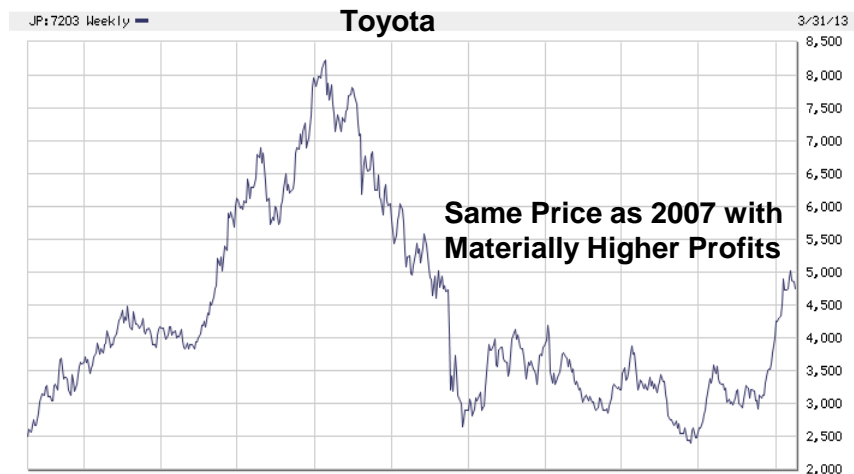
Source: Thomson Reuters/DATASTREAM

# Like Abe I, There Will Be Winners and Losers This Time



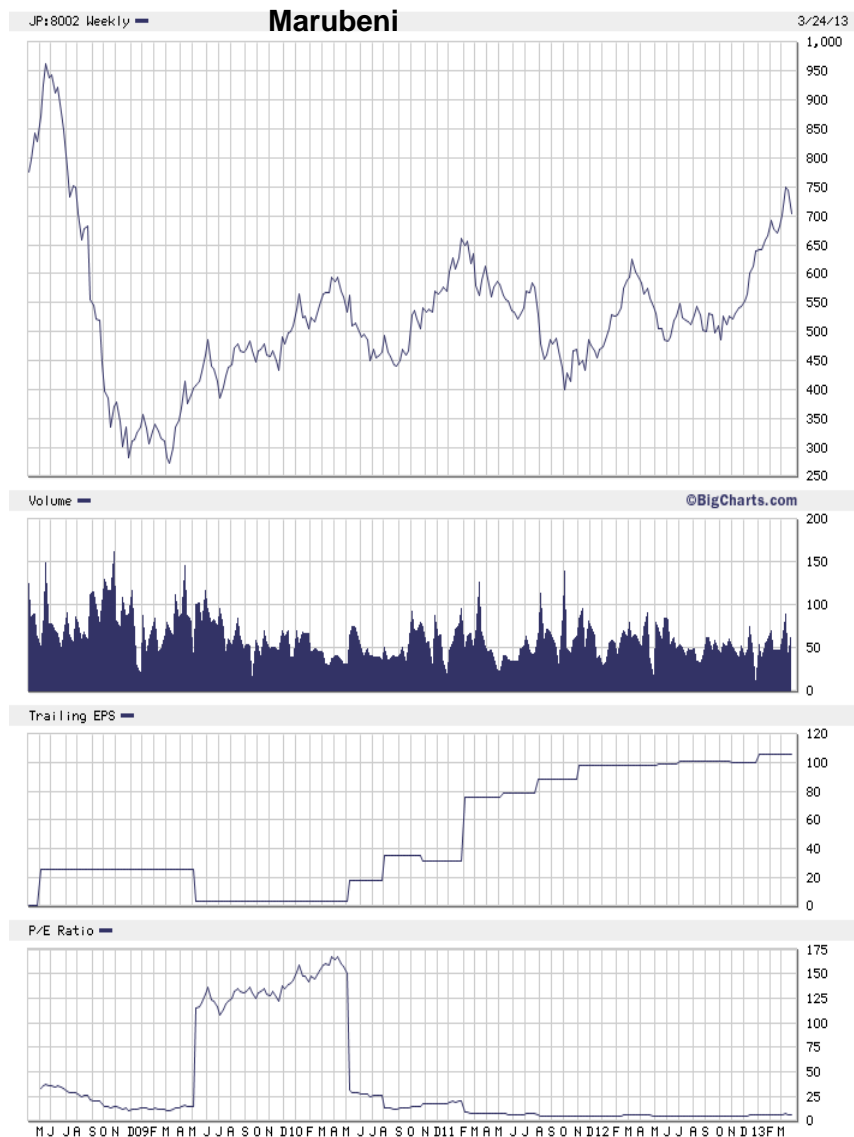
Source(s): Japantimes.co.jp.

# With Yen at 2007 Level of 110, Toyota's Profits Rise 70%



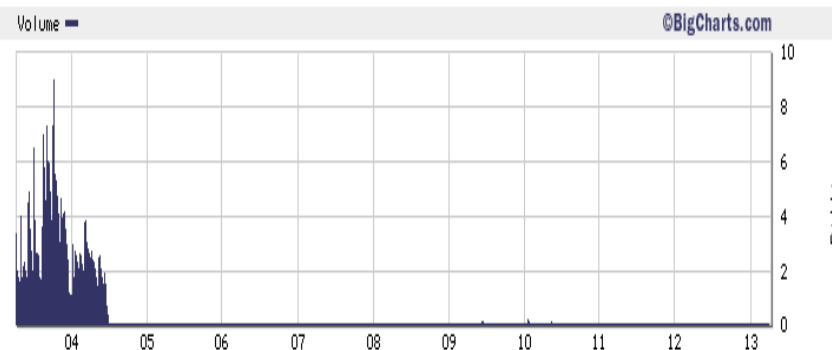
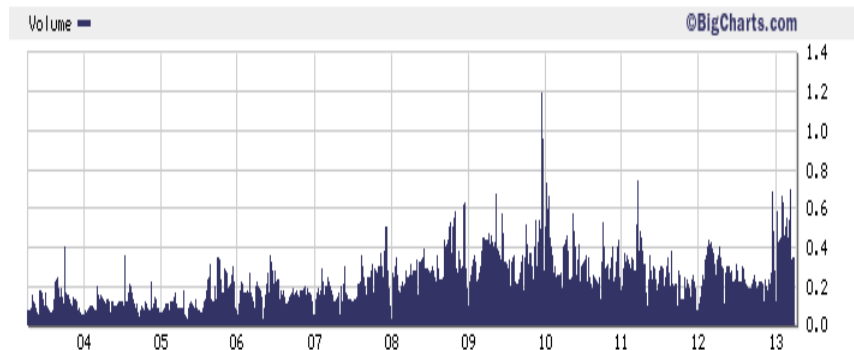
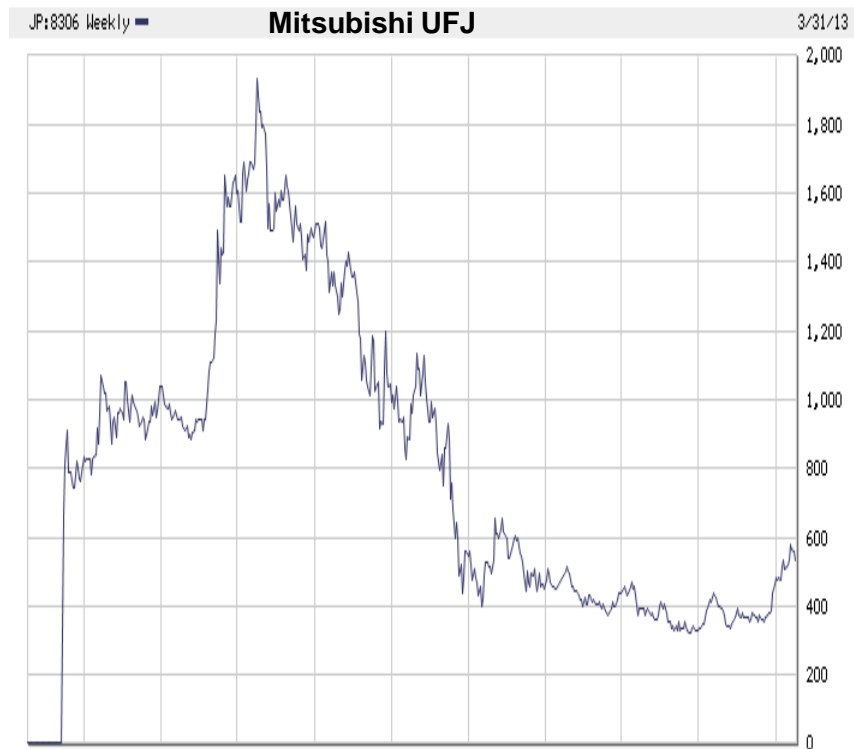
Source(s): Bigcharts.com.

# Trading Companies Have Gotten Religion on ROE, Profits



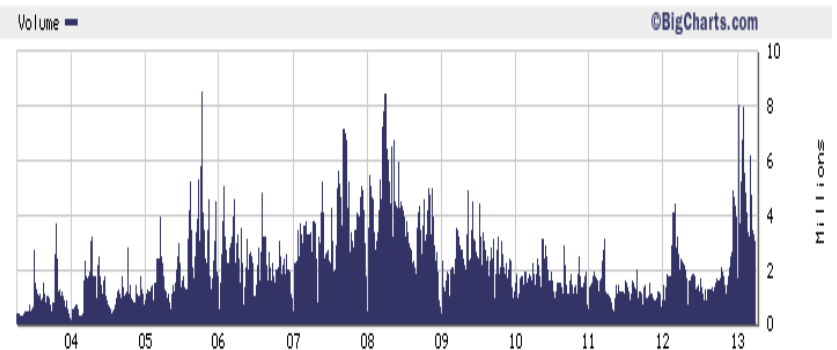
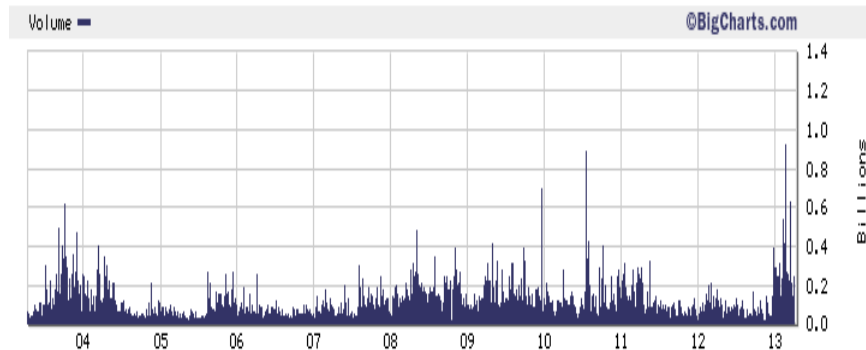
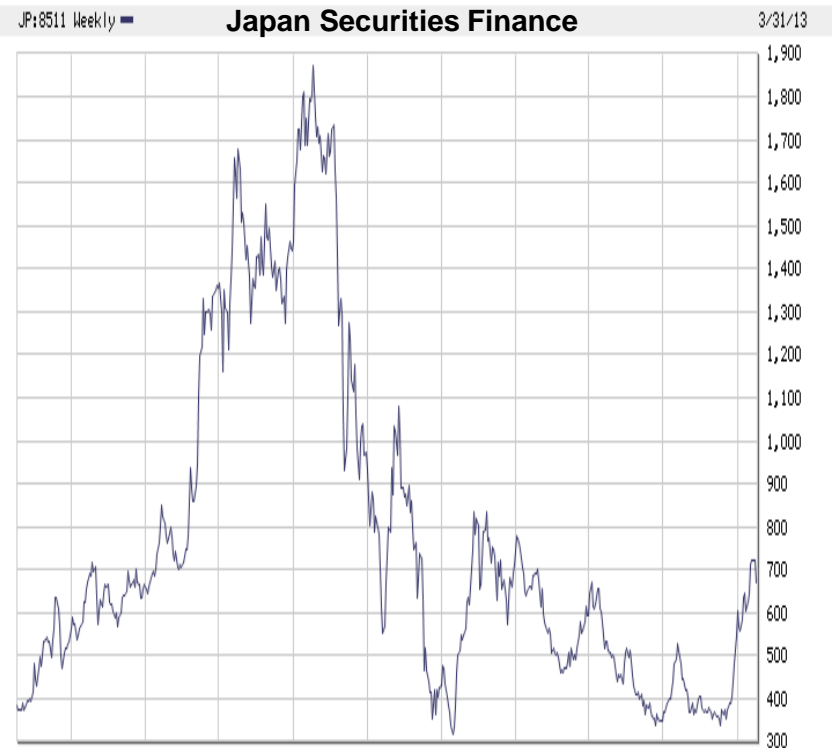
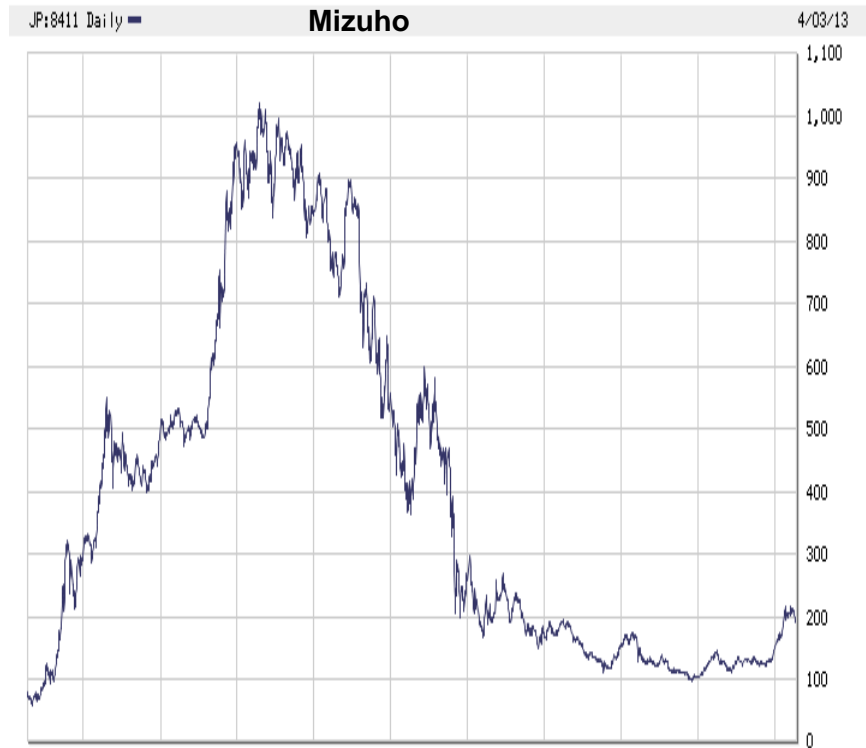
Source(s): Bigcharts.com.

# LDP Wants Financials Market Cap to Double, Big Tailwind



Source(s): Bigcharts.com.

# LDP Wants Financials Market Cap to Double, Big Tailwind



Source(s): Bigcharts.com.



# New Zombies: The Recent Short Squeeze Might Be Over



Source(s): Bigcharts.com.

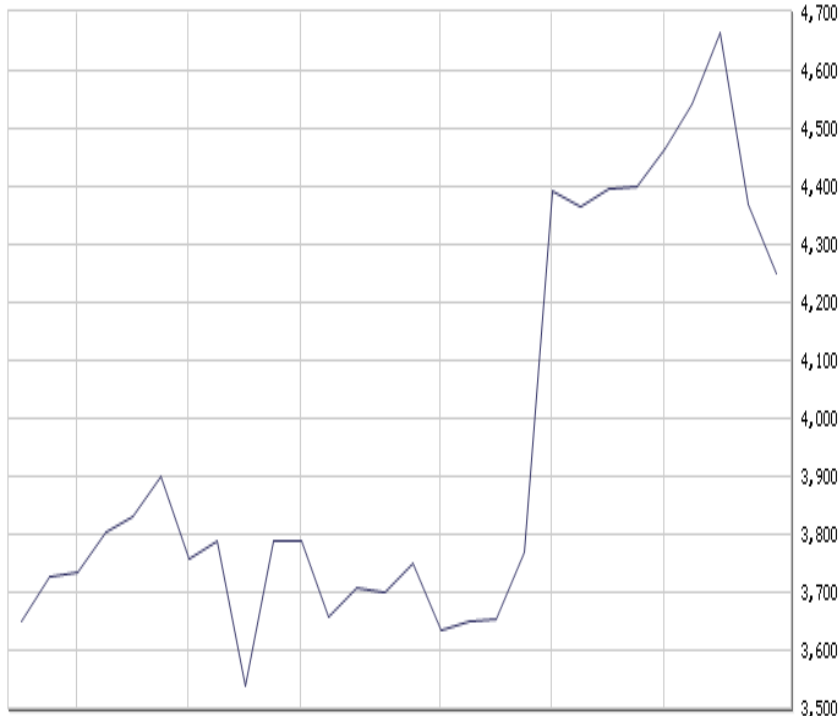
# New Zombies: Signs of Life or Dead Cat Bounce? UHDTV



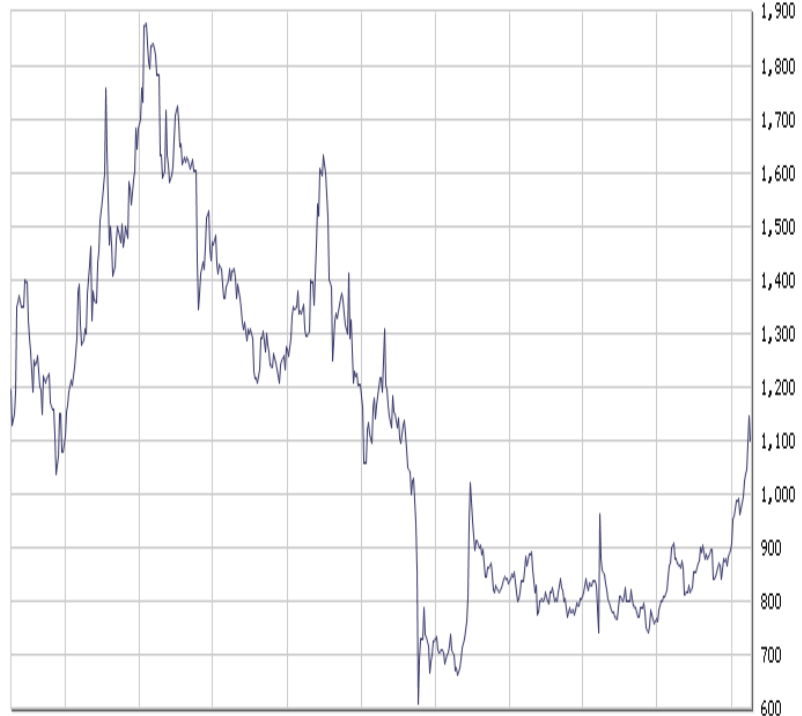
Source(s): Bigcharts.com

# Airlines & Foods Struggled Last Reflation, TPP Change?

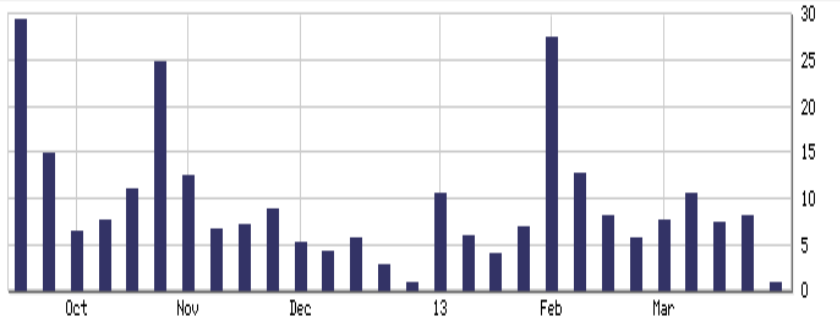
JP:9201 Weekly **JAL** 3/31/13



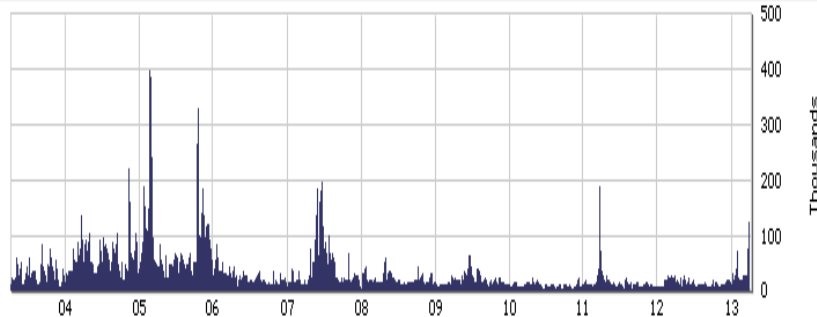
JP:2599 Weekly **Japan Foods** 3/31/13



Volume **JAL** ©BigCharts.com



Volume **Japan Foods** ©BigCharts.com



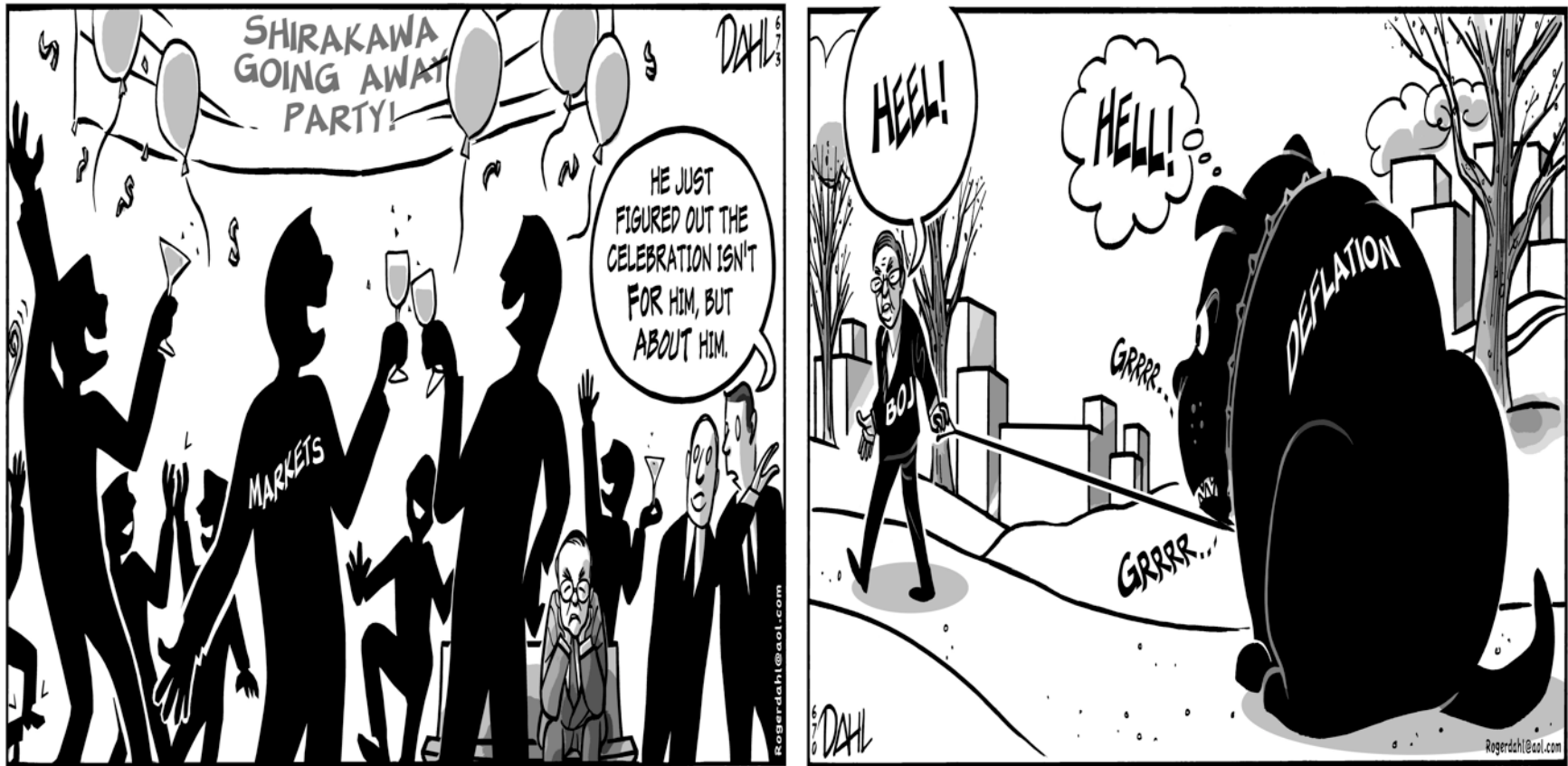
Source(s): Bigcharts.com.

# Diapers & Gen Y Clothes are En Fuego, Input Costs Rise?



Source(s): Bigcharts.com.

# Be Careful What You Ask For, You Just Might Get It...



*Sayonara, Shirakawa-san, Konnichiwa, Kuroda-san, Ganbaru!*

# Important Disclosures

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# Important Disclosures

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**S&P 500 Index** -- this is an index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The index is a market-value weighted index – each stock's weight in the index is proportionate to its market value. Definition is from Standard and Poor's.

**MSCI EAFE Index** -- this is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. Morgan Stanley Capital International definition is from Morgan Stanley.

**MSCI World Index** -- this is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance. Morgan Stanley Capital International definition is from Morgan Stanley.

**Nikkei-225 Index** -- This is an index consisting of the price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange. The Nikkei Stock Average was first published on May 16, 1949, where the average price was Yen176.21 with a divisor of 225.

**Japan Topix** - Also known as the Tokyo Stock Price Index, is a capitalization weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. The index is supplemented by the sub-indices of the 33 industry sectors. The index calculation excludes temporary issues and preferred stocks, and has a base value of 100 as of January 4, 1968.

**Citi JGB Index** – this index is intended to measure the performance of a long position in 10-year JGB (Japanese Government Bonds) Futures. The underlying assets of 10-year JGB Futures are Japan-government issued debt securities (JGBs) with a remaining term to maturity of not less than 7 years and not more than 11 years as of their issue date and the futures contract delivery date.

**MSCI Japan Index** -- this is a free-float adjusted market capitalization weighted index that is designed to track the equity market performance of Japanese securities listed on Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. The index has a base date of December 31, 1987. Definition is from MSCI.

**JGB** – refers to Japanese Government Bonds.

**BOJ**– refers to Bank of Japan.

# Contact Information

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