

Japan holds value for flexible player

Japan exports 57% of its goods to Asia Pacific countries and, as intraregional trade grows and the region prospers, Japan's stockmarket offers value and flexibility to the Pan-Asian investor.



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The 'Asian century' is well underway. With China's emergence as an economic titan, global power is shifting from West to East. But for most fund managers, 'Asia' is less than the sum of its parts. Why? Because most Asian strategies are missing one of the biggest pieces of the puzzle: Japan.

It's a curious anomaly – like investing

But just as striking as the differences are the similarities. The drivers of Japan's post-war growth, China's 'economic miracle' and the rise of the 'Asian Tigers' are very similar. China, Japan, Korea, Hong Kong, Taiwan and Singapore: all six share a high regard for education (and hence a highly skilled workforce) and a commendable work ethic rooted in a common aspect of their culture – Confucianism. And today, companies across East Asia are competing directly with one another. So the ability to pick stocks from across the region's sectors is increasingly important.

"Other Pacific economies have been drawn into China's orbit"

And while Japan lines up with its East Asian neighbours in many respects, it is also akin to further-flung Pacific countries: Japan and Australia, for example, share China as their biggest export market. China's

in Europe but excluding Germany, or running a Latin American mandate without Brazil. After all, Japan is still Asia's biggest economy by nominal GDP. And the Japanese stockmarket is the largest in Asia – and the second-largest in the world. But for most professional investors, the ex-Japan index is part of the furniture.

Today, however, there is a compelling case for a genuine pan-Asia-Pacific strategy. This case rests on the region's growing integration, its huge diversity, and on the flexibility that the pan-Asian approach affords.

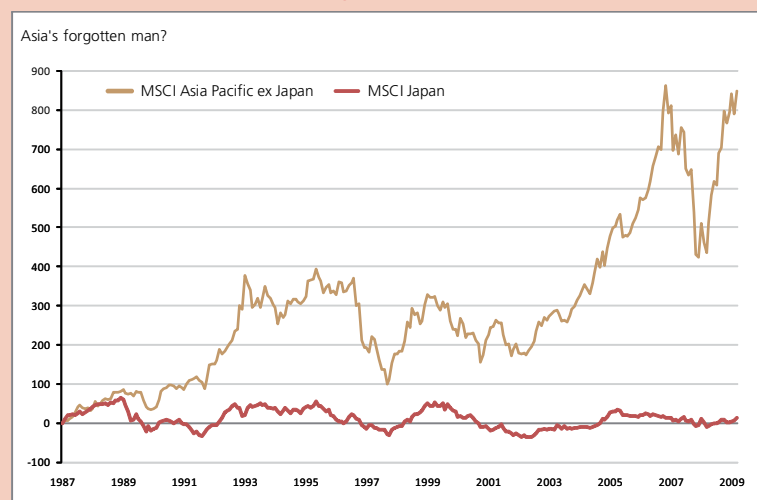
At one time, of course, Japan looked and behaved very differently from the rest of Asia. While its neighbours mired in political upheaval or post-colonial trauma, Japan boasted a highly developed and technologically advanced economy. But things have changed. With Japan saddled with deflation and the demographic nightmare of an ageing population, the contrast now is between a stagnant Japanese economy and the extraordinary growth produced by China and the four 'Asian Tigers'.

'economic miracle' has made it not just the 'workshop of the world' but a vast market for raw commodities and consumer goods. As the populations of Chinese cities swell, the emerging middle class is increasingly aspiring to the lifestyles of the developed world. And to fuel its expanding cities, the country has developed a vast appetite for iron ore, oil, copper and coal.

By catering to these needs, other Pacific economies have been drawn into China's orbit. In 1970, only 35% of Japan's exports went to its Pacific neighbours in Asia and Oceania. Today, that figure stands at 57%. Meanwhile, Australia's mines provide much of the raw materials that China devours. In return, China has been providing cheap

labour for Japanese, Taiwanese and Korean manufacturers. As China climbs the value chain, however, the provision of low-cost labour is shifting elsewhere, with Vietnam now providing an even cheaper workforce for Asian firms. And all the while, shippers and logistics firms across the region are facilitating – and benefiting from – these closer relationships.

PERFORMANCE OF JAPANESE EQUITIES



Source: Lipper Hindsight

But even as Pacific economies become increasingly interconnected, so they – and their stockmarkets – remain highly distinctive. Pan-Asian investors face a hugely diverse set of opportunities: from Chinese property developers to the household names in Japanese electronics; from Indian consumer stocks to Australian mining giants.

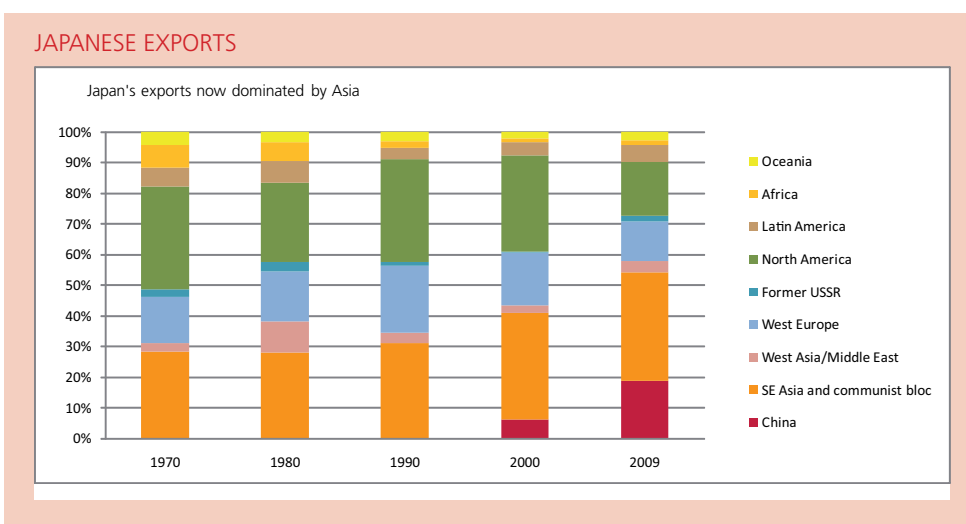
As Japanese companies' traditional areas of dominance are challenged by rivals elsewhere in the region, a pan-Asian manager can exploit the shifting dynamics. Holding Samsung while not holding Sony would be one example – playing the new order against the old.

Finally, a pan-Asian approach provides an enviable degree of flexibility. The region's mix of 'developed' and 'emerging' markets are highly complementary. While stocks listed in 'emerging' Asian markets are still seen as 'risk assets', Japan and Australia are regarded differently. Japan offers the truly global brands that other Asian markets lack, while the Australian stockmarket's correlation to Asia is relatively low. This allows a fund manager to play the economic

cycle by owning Australian commodity suppliers, Indian consumer-goods manufacturers or Japanese car-makers as the climate demands. In the long term, this is the best way to profit from Asia's extraordinary growth.

The pan-Asian approach provides short-term flexibility too. In the aftermath of the global financial crisis, for example, Japanese industrials offered the reassurance of significantly stronger balance sheets than their regional peers. Today, their cost-cutting has significantly enhanced their gearing to the recovery.

So, at a time when stocks in most Asian markets look expensive against their long-term historical averages, Japan's stockmarket looks cheap – and the encouraging noises made by Mr Kan since his recent elevation to prime minister add a potential catalyst. After the Japanese market's comparatively lacklustre performance last year, there are compelling reasons for increasing weightings to Japan. Happily, the pan-Asian investor can act accordingly.



Source: Meti