Australian Standfirst

Keeping It Simple – Japan

Portfolio Attribution

25 April 2020

Stirling Larkin, CIO

Investors have long understood that paying a relatively low price for an asset tends to be a good starting point for generating outperformance in the future.

Purchasing any asset to realise its future performance in practical terms involves patience, a keen eye and some degree of acumen in knowing when to exit, or sell these assets before rotating into the next '*investment*' or opportunity set.

However, inherent in this, belies the assumption that patiently holding these valuable assets until consummation involves weathering market vicissitudes and structuring risk mitigation contingencies in advance, not knowing what or when the next crisis will be.

When crises do strike, executing against these contingency plans, almost always, involves redeeming invested capital or deploying risk managed tools, such as capital-protection derivatives, to fight rear guard actions against the menace at play.

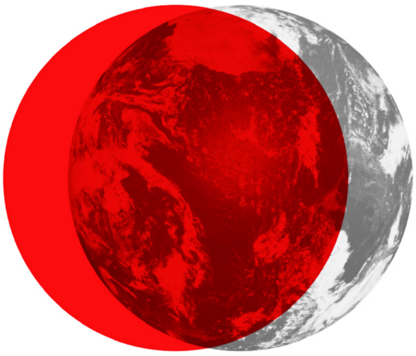
During these times, there is no succedaneum for quality; quality assets, quality risk management apparatus and quality marketplaces that respect the rule of law, integrity and the aegis of bears and bulls past.

In pursuit of quality, primary due diligence almost always seems to lead us to Japan and Japanese markets, where the abundance of opportunity sets are only matched by this markets' reputation for redeeming investors capital during tumults, which in Ultra High Net Worth (UHNW) and Family Office wealth management, remains the perennial and paramount objective.

For many, there is no education in the second kick of a mule – Japan scorched umpteen during their lost two decades and bond investors have never forgotten that in the past century, Japan has had its hand in all three of the most injurious banking crises, namely, (i.) the massive failures that accompanied the US depression of the 1930's, (ii.) the collapse of Japan's banking system itself, after its epic 1980's bubble, and (iii.) the ongoing crisis of eurozone banks, which has yet to see its cessation.

Notwithstanding, even in spite of two lost decades, the size of Japan remains impressive and their reputation for honouring transnational market rules remains above reproach.

Cite:- **Stick With Japan**, 7 March 2015



For an economy with only the tenth-largest population in the world, it continues to support the second largest equity and bond markets globally whilst also remaining an economic powerhouse in technology, automobiles, electronics, machinery and, of increasing importance, robotics.

Furthermore, Japan homes a sophisticated and usable derivatives agora, with established regulatory and prudential oversight enforcement powers.

Cite:- **Nikkei225 Exodus**, 12 September 2018

But what has really animated the revived opportunity set in Japan since 2015 has been ***Abenomics***, the nomenclature namesake of Prime Minister, Shinzō Abe, who has followed the blueprint left by the Depression-Era Japanese Finance Minister, Mr Korekiyo Takahashi.

Japan's involvement in the failures that accompanied the US depression of the 1930's, was led by Takahashi, whom courageously, first abandoned the gold standard in December 1931, thereby devaluing the Yen overnight.

This sparked the first of the modern era currency wars.

Once this was accomplished, the Japanese government then ran large fiscal deficits.

The combination of these two factors successfully restarted their industrial output and assisted Japan in becoming the **world's best equity market performer between 1931 to 1939**.

For fear of oversimplifying history or economics, Abenomics has attempted to achieve the exact same reflationary result but has sizeable advantages over the euro bloc, for unintended reasons.

Since 1995, Japan's non-financials sector has roughly doubled while Japanese bank quoted market valuations have fallen eighty percent.

As a result, non-financial firms have learnt to operate without banks, by moving to positive cash flows and building up more than US$5 trillion of cash, almost equivalent to the market value of the Tōkyō Stock Exchange's first section.

That means they have been well positioned to weather market vicissitudes, such as the 2011 Fukushima Daiichi nuclear disaster and today's ***Great Corona Crisis***, or GCC.

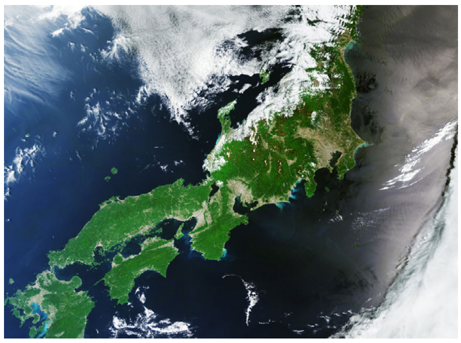
Cite:- Ignore Japan At Your Peril If You're An Investor, 4 October 2017

The Bank of Japan's *faux pas* was to let the yen double in value on a trade-weighted basis between 1985 to 1995 as this herculean move first fuelled the bubble and then drove the following deflationary depression.

This was corrected after Japan's currency collapsed between 2010 and 2012 and as Japan's structural depression ended in 2015 and since then shares of non-financials have more than doubled and the yen has been left substantially undervalued.

Given that the second cardinal rule of UHNW wealth management is to ensure valuable assets are not sold too soon, given that, that could prove to be just as costly as selling too late, the obvious question remains why shouldn't Japanese listed and quoted opportunity sets remain at the front of the conviction list?

For Australian investors, Japan continues to be critically important to us.



Australia's economic fabric, terms of trade and investment markets remain deeply engaged with those of Japans.

In particular, the stability of the Australian Dollar, often considered a ***hot currency***, relies on the relative stability of the Yen both as a transactional and reserve currency and if we think foreign exchange is volatile today, contemplate a world without the Yen.

Cite:- Japan hit hardest in Brexit shock but remains an opportunity, 2 July 2016

Keep it simple – when pursuing quality during challenging times, look towards Japan.