Australian Standfirst

Japan's Secular Bull Run:
The Foreseeable End of YCC and NIRP In April

Portfolio Attribution

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Since January 2023, Japan's two preeminent stock indices – the NIKKEI225 and TOPIX – have outperformed the rest of the world, including India's hot SENSEX and even the US's reflationary fueled S&P500 index which today sits at an all-time high.

Cite:- Keeping It Simple: Japan, 25 April 2020

Cite:- Investment Market In Focus: Japan's Bonds, Nikkei225, MOTHERS & Daiwa Non-Financial Indices, 20 January 2021

Cite:- Understanding Reflation & Central Bank Liquidity During A Taper Tantrum: 'Treasury Switches', FIMA Repo Facility & Other Market Microstructural Reforms Are Bullish For Eurozone, Japanese & US Blocs, 14 April 2022

Cite:- Japan Since Abe's Assassination: 2023's Topix Index-Level Appreciation & The Legacy Of Abenomics, 2 December 2022

Of equal quantitative significance was that in February, Japanese stocks reclaimed the historic peak reached over thirty-four years ago as global investors pour money into a country they're anticipating has finally escaped *the lost decade* and persistent deflation, with the Bank of Japan, or BoJ, finally turning the economic supertanker around towards a path of sustainable growth.

It also helped that the *Oracle of Omaha* boosted his holdings in Japan's biggest companies, an endorsement that's further increased the allure of Japanese listed bourses during a period of heightened concerns regarding inverted yield curves and foreign exchange stability following the Greenback's unprecedented run.

One of the key catalysts for the rebound is that signs of inflation — and the country's anticipated exit from negative rates this year — are encouraging companies to put their piles of Yen to work on expanding and improving their business.

Japanese investment exposure had always made sense to the conservative global investor but for the vexing extent to which unconventional monetary policies presented themselves as risky '*known unknowns*', as no major developed economy before it had tried Negative Interest Rate Policies, or NIRP & other equally radical programmes such as those tried by the BoJ since the start of the millennium.

Chiefly among those was Yield Curve Control, or YCC, which to this day remains hotly contested as the most radical and precarious monetary experiment undertaken since the Nixon Shock of 1971.

Cite:- Australian Dollar Impaired By The Greenback: The Threat Of A 'Mnuchin Shock' In April 2020, 4 April 2020

Cite:- Positive Thinkers Stick With Abe, 12 April 2014

The US Federal Reserve's FOMC pondered YCC during the early months of the *Great Corona Crisis, or GCC* but decided against it following lessons learnt post the second world war and **to this authors great frustration**, Australia experimented with YCC in 2020, only to see it implode and send the Australian Dollar and Australian Government Bonds in 2021 into a (much deserved) tailspin. Only Japan has held strong on this radical policy and thus the shift in January's Summary of Opinions, with the addition of the following sentence, *"if...achievement of the target comes in sight, the Bank will likely determine whether to continue with its large-scale monetary easing measures, including the negative interest rate policy"* indicates that a major policy change is approaching regarding NIRP, YCC and how the BoJ manages interest rate expectations.

Cite:- Australia Begins Quantitative Easing, 17 March 2020

Cite:- Australian REPO Operations, March 2020, 22 March 2020

The BoJ's January Summary of Opinions indicating that Japanese monetary policy normalisation is upon us, intervention in the bond market has fallen and ten-year yields remain below the "*soft*" ceiling set by the central bank, paving the way for a formal exit from YCC and negative rates in April this year.

If successfully completed, the BoJ will be the only central bank to have tried and successfully pulled off YCC whilst returning positive momentum to its country's bellwether listed bourses.

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

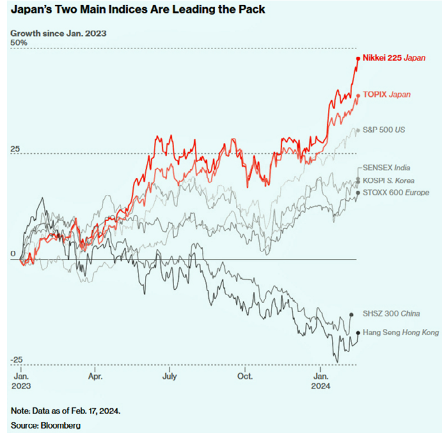
The attraction of Japanese stocks lies partly in the divergent monetary policies across the D10 & China, with the common external shocks of Covid and commodity prices – following the invasion of Ukraine – in the rearview mirror, regional divergence in economic and especially policy outcomes has picked up. Japan has begun to exit from unusually stimulative monetary policy, whilst other central banks have held open the possibility of tightening further, namely the Bank of New Zealand & the Reserve Bank of Australia; at the other extreme, China continues to loosen macro policy, albeit in a piecemeal fashion and most regional central banks are on hold, waiting for further easing in domestic inflation which should normalise in parallel with US interest rate cuts.

Cite:- Japan Hit Hardest In Brexit Shock But Remains An Opportunity, 2 July 2016

But there's more to the Japanese renaissance than simply rates arbitrages and carry trades: foreign investors are the driving force behind the incumbent bull rally, accounting for almost seventy percent of trading in the broader TOPIX Prime Index of stocks, while domestic Japanese buyers are also entering via ETF products.

Cite:- Pokemon Go Places Japan Tech On Investment Map, 30 July 2016

The evidence for this can be found within the TSE's publication of its monthly ETF data for January 2024 purchases by Individual investors, which showed that individual Japanese net bought over US$200 million in ETF units in the month of January alone, almost half of the entire annual net buying seen during calendar year 2023. For foreign investors who have been disappointed by the popularity of the special tax-free NISA accounts – which incentivised NISA-approved Global and US focused mutual funds – these numbers should hopefully ease concerns about Japanese Individual investors not buying their own market. They are buying; however, they appear to be doing so via ETFs rather than mutual funds to do so.



All the while, global buyers have absorbed the selling, with their holdings rising to thirty percent from less than five percent, seen in 1989 when the Japanese market was last on high.

Cite:- Stick with Japan, 7 March 2015

Watch:- Andrew Main & Australian Standfirst Discuss China & Japan in 2015

Even after this year's rally, many Japanese stocks are still at depressed levels, with thirty-seven percent of Nikkei members trading below their book value. In theory, this means investors could make more money by selling off all the company's assets than keeping it as a going concern. This is tantamount to vote of no confidence in management but it also suggests upside potential if the businesses are run well.

For context, only three percent of stocks in the US's S&P500 trade below book value and for the Euro Stoxx600, just one-fifth fall under this category. The low valuations in Japan now are a stark contrast to 1989, when asset prices were at the other extreme: all this means that some fund managers now see the possibility of substantial gains to come for the Nikkei225, TOPIX and MOTHERS sub-indices.

The late Prof. Ezra Vogel's, *Japan as Number One* (1979), sought to predict when Japan would surpass the United States as having the largest economy in the world – this never came to be but now in this new epoch of automation and Artificial Intelligence, Japan presents as an economy that may very likely lead the way and be well-recognised by markets accordingly. ■

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