

# Japan Equity Monthly

## July 2021

10 August 2021

We talk about the importance of staying focused on the broader implications of Japan's corporate governance reforms when misconduct at major companies make the headlines; we also discuss the prospects for real estate and whether the market presents a bargain.

By Naoki Kamiyama, Chief Strategist

### Staying focused on corporate governance reforms amid news of corporate misconduct

Some well-known Japanese companies have recently received a significant amount of media attention, with Toshiba accused of colluding with a government ministry to thwart foreign investor interests while Mitsubishi Electric was revealed to have falsified key data for three decades. These companies made headlines at a time when Japan is trying to reform its corporate governance framework, prompting some to question the effectiveness of the reforms. However, we believe that investors should stay focused on the bigger picture. These recent examples should be seen as internal control issues; on the other hand, the ongoing corporate governance reforms are broader in scope and intended to alter and raise Japan's stock market to standards that are acceptable to global investors.

One case in point, the Tokyo Stock Exchange (TSE) is scheduled to reorganise its current five market sections into three in April 2022. The TSE's reorganisation bid is part of a plan to boost the exchange's global competitiveness by ensuring that listed firms continue improving their corporate governance and thereby remain profitable. For example, the TSE's current top tier segment, the First Section, will be reorganized into the "Prime" section, which will impose tougher listing requirements on companies. Market expectations are that companies, with the aim of listing or remaining listed on Prime, will maintain high corporate governance standards.

There are two notable listing criteria for Prime. First is the requirement for companies to fill at least one third of their boards with external directors. This will be a major change for Japan's boardrooms as there will be almost an instant need for a large number of external directors (potentially thousands). Second is the requirement for Prime-listed companies to have a free float of at least 35%. Raising the free float requirement will not only shift investor focus away from overall market capitalisation but will also further encourage the liquidation of cross-shareholdings—a type of shareholding long frowned upon by investors. The changes being undertaken by the TSE will provide an opportunity to re-evaluate the Japanese market and are expected to attract global investors by enhancing corporate governance and improving boardroom transparency.

### Japan's real estate market shows recovery signs, but performance could be uneven

Japan's real estate market appears to be showing signs of a recovery from the pandemic-induced slump. For example, new condominium sales in the Tokyo area reportedly surged in the first half of 2021. The real estate market initially slumped earlier in the pandemic partially due to restrictions placed by the government on the service sector. These led to a slowdown in business operations for restaurants and other similar establishments, particularly in urban centres. However, after an initial delay, the rollout of COVID-19 vaccines in Japan is finally beginning to pick up pace, and prospects have marginally improved for the service sector. Moreover, a shift to work from home early

in the pandemic did not result in demand for offices declining as much as some had feared. A significant portion of workers are expected to return to their offices once the economy begins normalising, which should be a supporting factor for office-related REITs. The pandemic also saw the emergence of so-called satellite offices that have popped up halfway between suburbs and the central areas of major cities such as Tokyo, enabling workers to access the conveniences of an office without exposing themselves to a full commute. As such, active investment opportunities in the office space could increase.

As with Japanese stocks, which have already recovered their pre-pandemic levels, the real estate market could also make a similar comeback once the country's economic recovery gathers momentum. The point is the real estate market has not fully priced in such a recovery, thus presenting a potential bargain which foreign investors appear to have been the first to discover. A market recovery, however, will not favour all real estate sectors, in our view. Prime office spaces in large cities stand to benefit while demand for second-tier property in smaller cities could decline as some workers will continue working from home.

### Market: Stocks fall in July amid concerns of slowing global economic recovery

The Japanese equity market fell in July, with the TOPIX (w/dividends) declining 2.18% on-month and the Nikkei 225 (w/dividends) falling 5.23%. Although Japanese equities briefly followed US equities higher on positive US corporate earnings expectations, the market was ultimately weighed down by concerns over a slowing global economic recovery as the US ISM Non-Manufacturing PMI came in weaker than expected. In addition, the Japanese government announced its fourth state of emergency for the Tokyo area, spurring worries that a domestic recovery would be delayed. Following this, investors took an increasingly risk-off approach. Coupled with growing concerns over the continued increase in COVID-19 infections in Japan, this resulted in the market's decline. Of the 33 Tokyo Stock Exchange sectors, 11 sectors rose, with Marine Transportation, Insurance, and Fishery, Agriculture & Forestry posting the strongest gains. In contrast, 22 sectors declined, including Other Products, Pharmaceuticals, and Mining.

#### Exhibit 1: Major indices

| Index           | 1-mth | 3-mth | 6-mth | 1-yr  | 5-yr  |
|-----------------|-------|-------|-------|-------|-------|
| Nikkei 225      | -5.2% | -5.3% | -1.4% | 25.7% | 62%   |
| JGB Yield (%pt) | -0.04 | -0.08 | -0.03 | +0.02 | +0.09 |
| JPY/USD         | -0.7% | 0.4%  | 4.8%  | 3.7%  | 6%    |
| JPY/EUR         | -0.9% | -0.9% | 2.4%  | 4.4%  | 13%   |
| MSCI World      | 1.7%  | 4.4%  | 15.3% | 33.2% | 78%   |
| TOPIX           | -2.2% | 0.1%  | 5.1%  | 27.1% | 43%   |
| TPX-100 (Large) | -2.2% | 1.0%  | 6.0%  | 28.4% | 44%   |
| TPX-400 (Mid)   | -2.7% | -2.2% | 2.5%  | 25.0% | 39%   |
| TPX-Small       | -0.4% | 2.3%  | 7.6%  | 24.7% | 48%   |

Source: Bloomberg, as at 30 July 2021

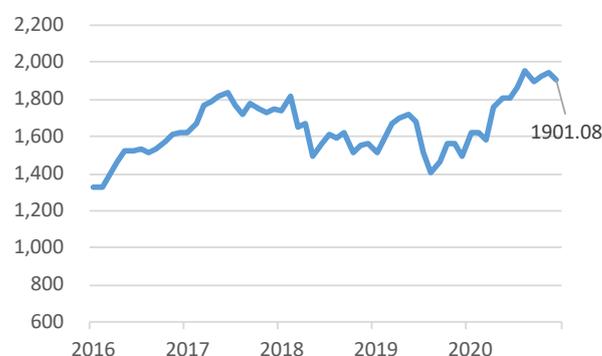
#### Exhibit 2: Valuation and indicators

| Valuation /indicator | Mth-end | 3-mth | 6-mth | 1-yr | 5-yr |
|----------------------|---------|-------|-------|------|------|
| <b>TOPIX</b>         |         |       |       |      |      |
| Div. Yield (e)       | 2.1%    | 2.1%  | 2.0%  | 2.2% | 2.2% |
| Price/Earn (e)       | 14.9    | 16.1  | 22.1  | 20.7 | 13.8 |
| Price/Book           | 1.3     | 1.3   | 1.3   | 1.2  | 1.1  |
| Daily Turnover       | 45      | 50    | 53    | 50   | 49   |
| Market Cap.          | 706     | 714   | 697   | 615  | 501  |
| <b>MSCI World</b>    |         |       |       |      |      |
| Div. Yield (e)       | 1.8%    | 1.9%  | 2.0%  | 2.0% | 2.6% |
| Price/Earn (e)       | 20.2    | 20.7  | 20.7  | 24.8 | 17.5 |
| Price/Book           | 3.1     | 2.9   | 2.7   | 2.6  | 2.1  |

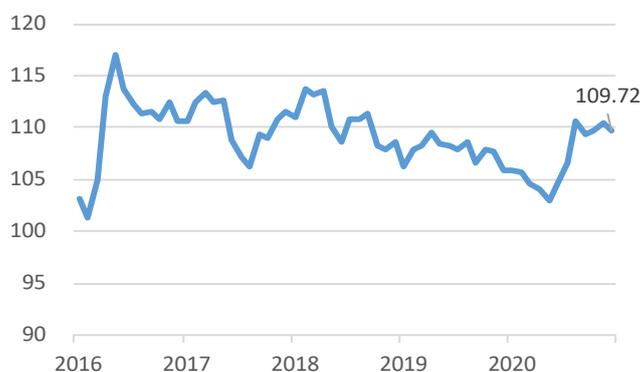
(e) stands for consensus estimates by Bloomberg. Turnover and market cap in JPY trillion. Source: Bloomberg, as at 30 July 2021

#### Exhibit 3: Major market indices

##### TOPIX



##### USD/JPY



Source: Bloomberg, as at 30 July 2021

**Important information:** This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment. This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

**Japan:** The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

**United Kingdom and rest of Europe:** This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

**United States:** This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

**Singapore:** This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

**Hong Kong:** This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

**New Zealand:** This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

**Kingdom of Bahrain:** The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

**Kuwait:** This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

**Kingdom of Saudi Arabia:** This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to

Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

**Oman:** The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

**Qatar (excluding QFC):** The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

**United Arab Emirates (excluding DIFC):** This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

**Republic of Korea:** This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.