Revisiting Japan as a land of gold

Asset Management One

Is Japan a land of gold as described in the renowned book “The Travels of Marco Polo”? The majority of investors may disagree but I would like to argue that Japan is going through transformations which are often missed even by the smartest investors.

ANCA VASILOV
Head of Equity
Asset Management One International

There are several areas of transformation Japanese companies and the society as a whole are concurrently going through. These are corporate governance, activism, merger and acquisition, disclosure, climate change, and digital transformation.

Notoriously poor corporate governance of Japanese companies is a story of the past. Thanks to the government initiatives to improve corporate management’s mind-sets towards profitability and shareholders, through the introduction and regular revisions of Japan’s corporate governance and stewardship codes, many companies nowadays provide clear strategy and profitability objectives in their guidance, although somewhat conservative. Moreover, they have also conducted record levels of share buy backs over last few years. ROE is expected to bounce back to achieve the 8% target prescribed in the Ito Report published in 2014. Companies are buying back over 4 trillion yen ($40 billion) worth of shares every year and together with dividends, total shareholder return has climbed to above 50% last few years.

We have also seen activism, which the society as a whole had previously been very critical of, gradually taking off in Japan. The recent battle between Sony and Third Point, run by U.S. billionaire Daniel Loeb, is probably the most prominent example. In 2020, twenty-four listed companies received activists’ proposals, a whopping increase from just two companies in 2015, according to IR Japan. Corporate Japan’s move to improve profitability is also evident in the growing number of mergers and acquisitions by Japanese companies. Over 3,500 transactions were completed every year for the last three years.

Disclosure is an area of work in progress. Disclosure in English has been particularly slow with only 30% of listed companies sending out a notice of annual general shareholder meeting in 2020, according to Tokyo Stock Exchange, although the number increased by 7% from a year earlier, with large-cap companies leading the way.

A surprising fact is that Japan tops in terms of the number of TCFD supporters, ranks number two in terms of the numbers of companies taking action on science-based tests and ranks the third in terms of the number of RE100 members. With the revised corporate governance code implemented this year, which encourages companies to provide TCFD or equivalent level of disclosure on climate change actions, and SFDR and Taxonomy coming into effect in Europe, I would expect many Japanese companies are bracing themselves to improve disclosure further in these areas.

In addition, reform of the TOPIX is currently underway, with an aim to enhance attractiveness of the TOPIX index along with reclassification of listing markets. The proposed change is prompting 664 companies, a quarter of its 2,190 constituents, to implement measures to increase free-float market capitalisation in order to remain in the index or to be excluded from the index completely by January 2025.

Digital transformation is another area which has finally taken off in Japan in the wake of the pandemic. With the government finally promoting change and in many respects forcing companies to adopt to a changing reality, digital transformation has accelerated significantly over the last eighteen months. Companies like M3, GMO GlobalSign, and NRI are leading the digital transformation of Japan.

Given the recent tensions between China and the U.S., amplified protectionism around the world, and Beijing’s crackdown on Chinese tech giants, property, education and gaming industries, and growing influence over Hong Kong, is it safe to invest in Chinese stocks? With growing regulatory scrutiny and political risks, the attractiveness of investing directly in Chinese companies is eroding quickly, and no longer compensates for the risks.

My proposition is to play China through Japan. Despite the recent push for “buy made in China” campaign by Beijing, expertise in the production of certain materials, components and machinery relevant for the development of the Chinese manufacturing sector, remains in Japan and offer attractive exposure to growth stories in China.

Japan is a developed market, and, hence, has lower risks compared to emerging markets. It is also a neglected land of gold, where many hidden gems are waiting to be discovered by you.