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LION GLOBAL INVESTORS

THE LONGER VIEW ON JAPAN'S GROWTH STORY

Corporate Japan is expanding abroad and using its pricing power at home

Wee Ban Yew
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LionGlobal Japan Growth Fund

Abenomics has had an instant effect on corporate Japan and the stock market. More good news will follow, creating investment opportunities in exporters and domestically-focused stocks across the capitalisation scale. The earliest effect was to push down the yen, with obvious benefits for exporters.

'The first arrow of Abenomics, bond monetary policy, was the key driver for the weaker yen, which in turn boosted corporate profits and the stock market as well. While the Bank of Japan has kept up its asset purchase program into 2014, it has not expanded the programme so far. The weakening yen trend has tapered off temporarily,' says Wee Ban Yew, head of Japan Equities and lead manager of the LionGlobal Japan Growth Fund.

He expects further measures as the Bank of Japan's (BoJ) initial asset purchase programme runs only to the end of 2014. Corporate Japan is already reaping the benefits of a weaker currency. Competitiveness has risen, as have margins. Profits generated overseas also look larger when converted back to yen. Yet currency can be fickle, hence a widespread push by large and small caps to shift production closer to Japan's biggest markets across the world. Those firms that generate big profits in emerging markets are already finding it tougher as local currencies depreciated in 2013.

Exporters can expect a boost when other measures come into force. Japan is currently negotiating with a host of nations and regions to lower barriers to trade. European Union talks will be important, but Japan's entry into the Trans-Pacific Partnership that includes the USA could be more important. Other reforms will be more local in nature.

'From an equity investor point of view, the most exciting reform will be whether corporate taxes are cut from the current 35.6% - by how much and when. But Japan would have to put in place other measures to make it attractive as a country of investment, for example, the availability of both local and overseas human resources,' says Wee.

New strategic economic zones, tourism and casinos and the 2020 Olympics should boost many sectors, even if some effects will only be short-term.

> 'The Japanese economy will regain its vibrancy'

'We anticipate the Japanese economy will regain its vibrancy in the coming years and for Japanese corporates to strengthen their profits further. We see attractive opportunities in both globally competitive companies and domestic-oriented companies,' says Wee.

Globally competitive companies are shifting strategies from defending profitability from the strong yen through cost reductions. They are now on the offensive to gain share in existing markets or to expand into new markets. Wee says consumer products companies like Pigeon, Unicharm, Kao and Omron (home-use healthcare devices) are aggressively raising production and sales in emerging markets. Others, such as Daikin Industries, have taken to acquisitions to penetrate new markets.

'We like companies that can compete and grow in the global market. We particularly like companies that can establish themselves in emerging markets where there is secular demand growth. We can find many such companies in the auto and machinery sectors, and also in global consumer brand companies,' he says.

The shift from a deflationary to an inflationary mindset is affecting domestic firms too. They now have opportunities for greater pricing power. Real estate is a clear beneficiary of a stronger economy and asset inflation. Elsewhere, domestic services and leisure-related companies like Oriental Land - the Disneyland Tokyo - operator clearly benefit from stronger consumer sentiment as well as greater tourist numbers.

The longer-term picture is optimistic, although short-term factors continue to play on investors' minds. April's tax hike may temporarily weaken domestic consumption. The yen's fall has halted for the time being. Even so, the global recovery is already compensating.

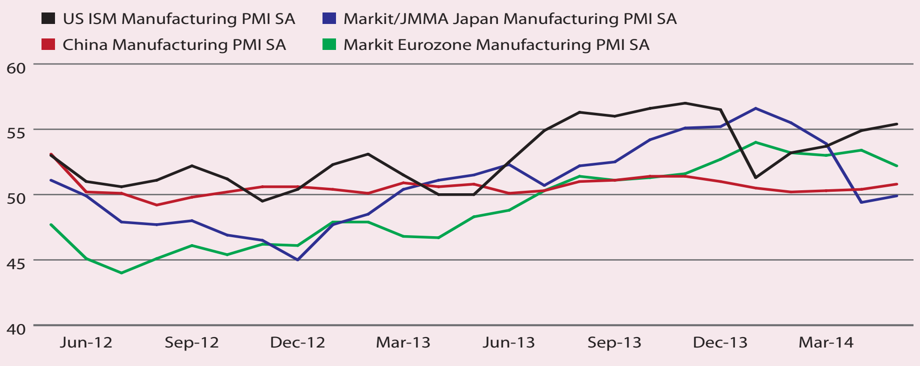
'With the global economy growing steadily, led by the US, prospects are good for continued profit growth. Dividends in Japan have been raised in financial year 2013 across the market in general as profits recovered. Share buybacks have also increased. Based on the strong cash flows and balance sheets of many Japanese companies, we believe there is room for improvement in dividend payouts or share buybacks,' says Wee.

That optimism has encouraged global investors to review their thinking on Japan. Local retail investors have too, egged on by the return of inflation.

> 'There is room for improvement in dividend payouts'

BUSINESS CONFIDENCE IS ALREADY IMPROVING

SOURCE: BLOOMBERG, AS AT 31 MAY 2014



'Investors have been disappointed so far in 2014 by the lack of further expansion of quantitative easing by the BoJ. Uncertainty about the economy and corporate profits caused by the consumption tax hike has also weighed on sentiment. This has led to some profit-taking in the market,' says Wee.

'While it is still too early to assess the impact of the consumption tax hike on the economy and companies, conditions in April and May do not appear to be very negative across most industries. This has provided some support for market sentiment. Further confirmation is probably needed in the coming months to see if companies can overcome the consumption tax setback and post stronger profits this year,' he adds.

We also thinks investors should look past the one-time effects.

'If the post-tax hike conditions improve from now, we are likely to see upwards revisions of profit forecasts. This will reverse the downwards revisions we saw at the start of the year as the tax hike approached. This will be positive for the market. Positive surprises may come from further growth measures by the government. But we caution that there can be equal disappointment if any measures announced lack details,' says Wee.

LionGlobal Japan Growth Fund remains well placed to take advantage of the longer-term positive trends. It is focused on growth, often found at its strongest among mid- and smaller-companies. Wee and his team actively seek out undervalued companies displaying such strong growth characteristics. Understanding their long-term earnings drivers is key to delivering alpha as the firms benefit from Japan's cyclical recovery.

'Although our strategy focuses on stock picks and not sectors, the portfolio has a bias towards the industrial and information technology sectors where there are many globally competitive companies in growth industries. These include factory automation companies like Mitsubishi Electric, Omron, Keyence and SMC. We expect structural growth in this area as wage inflation in emerging countries and the need for efficiency improvements across industries propels the shift towards greater automation,' says Wee.

The LionGlobal Japan Growth team also has a preference for medical equipment and consumer brand companies. They are already experiencing structural growth from increasing wealth levels in emerging markets. Rising wealth has created greater demand for better health monitoring and a shift towards high-value consumer goods like baby diapers. Companies involved in these industries include Asahi Intecc, Sysmex, Omron, Pigeon and Unicharm. More globally, he sees the shift towards greater electrification and safety systems in automobiles driving growth of auto parts-related companies such as NSK, Nidec and Denso.

LIONGLOBAL JAPAN GROWTH

- LionGlobal Japan Growth Fund recently won Lipper Fund Awards 2014 for best equity Japan fund over 10 years in Singapore and Taiwan
- The Fund is 4 star rated by Morningstar as of 31 May 2014
- It has won over 25 industry and peer-review awards since its inception on 3 December 1999 as a testament to its consistent performance
- The Fund returned -2.0% against -4.6% for the TOPIX Total Return Index since its inception. In the 12-months ending May 2014, the Fund returned 5.7% against 5.0% for the TOPIX Total Return Index*.

* Source: Morningstar, as at 31 May 2014. Returns are in SGD terms on bid-to-bid basis with dividends reinvested. Past performance is not indicative of future performance.