JAPANESE DIVIDENDS SET NEW HIGHS

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Japan became an investors' darling in 2013 on the heels of Shinzo Abe being elected in December 2012 and enacting a platform of economic change and reform known as Abenomics, which comprised Abe's "three arrows." The yen weakened considerably, and Japanese stocks were the best performers in the developed markets in 2013. The first arrow of Abenomics was achieved through aggressive monetary expansion, as the Bank of Japan (BOJ) initiated a bold monetary stimulus package—anchored by an all-in, "do whatever it takes" mindset to achieve a 2% inflation goal on a sustained basis. In 2014, the market appears frustrated that the BOJ has not enacted more monetary easing measures, but why should it? At present rates, the BOJ is already expanding its balance sheet by more than any other central bank in the world—doubling the purchases of the U.S. Federal Reserve, with an economy just one-third the size[1]. Japan's inflation readings have been heading higher, and all signs are that the BOJ's policies are generally moving Japan in the right direction. I believe Japan offers some of the best return prospects in the developed world over the next three to five years. And this is not reliant on more central bank actions. The case for Japan today is as a traditional value play. Japan's earnings are increasing more than stock prices—and I expect to see an increasing amount of capital returned to shareholders in the form of higher dividends and buybacks. As will be discussed below, Japan's dividends reached a new peak, and I expect this trend to continue. WisdomTree conducts an annual rebalance of its dividend-weighted Indexes once a year. The developed world Indexes screen for data as of May 31 each year, and this process provides a treasure trove of dividend data across time. As we review the results and implications of this year's dividend changes, we start a blog series by discussing the overall trends in Japanese dividends and what sectors drove the major changes.

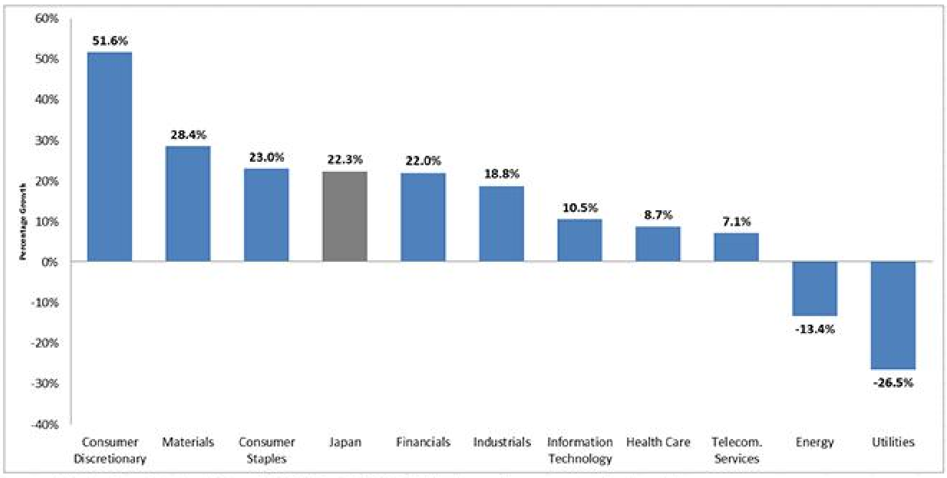
Figure 1: Japan *Dividend Stream* Growth

		2008	2009	2010	2011	2012	2013	2014
USD	*Dividend Stream*	$65.0	$56.8	$51.2	$70.1	$73.9	$64.0	$77.2
	Percent Growth		-12.6%	-9.9%	37.0%	5.4%	-13.5%	20.7%
Yen	Dividend Stream	¥6,861	¥5,418	¥4,671	¥5,717	¥5,789	¥6,426	¥7,859
	Percent Growth		-21.0%	-13.8%	22.4%	1.3%	11.0%	22.3%

Sources: WisdomTree, Standard & Poor's, 5/31/14. *Dividend Stream* is in billions. Dividends are not guaranteed and a company's future abilities to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.

- **Japan *Dividend Stream* Reaches New High** – The *Dividend Stream* has reached a new high of ¥7.86 trillion, an increase of 14.6% from the 2008 high. In dollar terms, the Dividend Stream also reached a new high of $77.2 billion, an increase of 4.5% from the 2012 high. The most recent annual dividend growth was led by larger companies such as Toyota that are typically more export focused and benefited from a weaker yen.[2] Even though the total dollar value of dividend growth was up significantly more than the median or typical stock's dividend growth, growth was still broad based, with increases across eight out of 10 sectors.

Figure 2: Sector *Dividend Stream* Growth



Sources: WisdomTree, Standard & Poor's, 5/31/13–5/31/14. Dividend growth percentage displayed in yen.

• **Consumer Discretionary-Led Sectors** – The sector displayed the highest percentage increase and became the largest cash dividend-paying sector at more than ¥1.8 trillion, representing approximately 23% of the total *Dividend Stream*. The growth was led by large cash increases among exporters such as Toyota Motor Corp., Panasonic and Bridgestone. Toyota and Bridgestone also had significantly higher percentage growth than the Consumer Discretionary sector, while Panasonic recently reinstated its dividend after canceling it in 2012. • **Utilities and Energy Lagged** – Although both sectors saw double-digit declines in percentage growth, neither was significant in terms of the total stream because they represent the two lowest-paying sectors, each less than ¥100 billion. **Conclusion** Since Shinzo Abe was elected, Japan has been the best-performing regional market. But I take comfort in the fact that the overall valuations of Japanese stocks, even after impressive price gains, have actually become cheaper on a price-to-earnings basis because earnings increased even more; note that this stands in stark contrast to the situation of European or United States indexes, where smaller gains were all driven by market price-to-earnings ratios rising. Two key initiatives from Abenomics' third-arrow reforms revolve around corporate governance and investor stewardship. Both reform initiatives are designed to encourage companies to become better allocators of capital and encourage them to use their stockpiles of cash, leading to more distributions to shareholders. We see this trend of higher dividend payouts as sustainable for some time, especially as profits continue to increase. To read the full research on our Japan Index rebalance, click here. [1]Source:WisdomTree, Bloomberg, as of 05/31/14. [2]Toyota was a 0.98% weight in the WisdomTree DEFA Index as of 6/24/14

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DEFINITIONS

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

Monetary Expansion : Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Inflation : Characterized by rising price levels.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

Qualified dividends : Dividend paid by corporations meeting certain criteria defined by the Internal Revenue Service and therefore eligible in certain instances to be taxed at rates below a tax filer's tax bracket on ordinary income.

Stock buybacks : When a company uses cash to purchase shares of its own stock within the market, which is thought to be supportive for the share price.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.