JAPAN'S RETIREMENT CONTRIBUTION OVERHAUL IS FUELING ITS BULL MARKET

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Though the MSCI Japan Index has returned "only" 17.0% over the last year, trailing the 22.9% run for the S&P 500, the performance disparity is obscured by the yen's sharp losses. Over that same timeframe, our yen-hedged DXJ (the WisdomTree Japan Hedged Equity Fund) has posted a 51.5% return, while the MSCI Japan US Dollar Hedged Index was up 40.6%.[1]

Why the strong run for Japanese equities?

A key theme has been the view that everyday people who have been living in a cash-hoarding society can be encouraged to buy stocks.

It has been over 20 years since Richard Thaler and Cass Sunstein coined the term "libertarian paternalism," which asserts that institutions can prompt, or nudge, people into making choices that the system desires.

In the money management industry, perhaps the best example of a libertarian paternalistic nudge is 401(k) automatic enrollment. Without it, many newly hired workers may contribute zero to their employer's retirement plan. But when auto-enrolled, many join the 401(k) solely because it is the default option.

What Japan is going through right now is not an auto-enrollment overhaul but a contribution max-out changeup. More than a nudge, this is a shove.

Japan's NISA (Nippon Individual Savings Account) program is like a traditional IRA. As I get into Japan's annual contribution overhaul, context is critical. In the U.S., the 2024 traditional IRA maximum contribution is $7,000 per person, with an extra $1,000 catch-up contribution for those over age 50. The amount doesn't rise much either; the maximum is only a couple thousand dollars more than the $5,000 cap in 2008. Keep these quantities in mind as we come to Japan's contribution max-out overhaul.

Japan figures the way to nudge the public into the stock market is to simply let the tax shelters do the work.

Before this year, the country had three NISAs, just as the U.S. has a few different kinds of IRAs (Roth, Traditional, SEP and so on).

One retirement account type is the Tsumitate NISA. It is for people who aren't immersed in the ins and outs of investing, so the money is put into preselected mutual funds. The other is the General NISA, in which account owners can buy individual stocks and self-direct the assets. The third is the Junior NISA for minors. That one just got scrapped, leaving the other two.

Before, Japanese investors had to pick one NISA for their contributions. If they chose to max out the General NISA, they were capped at ¥1.2 million ($7,947) per year. For the Tsumitate, the cap was ¥400,000 ($2,649).

For 2024, the maximum contribution for the General NISA has doubled; the Tsumitate tripled. Critically, investors can now make the maximum contribution to *both* (Figure 1).

Figure 1: NISA Maximum Contributions, Last Year vs. This Year

Account Type	General NISA	Tsumitate NISA	
	Investors Can Pick **ONE**		
Max Contribution (2023)	¥1,200,000	¥400,000	
USD Equiv.	$7,947	$2,649	
	Investors Can Max Out **BOTH**		**Total (Max Out Both)**
Max Contribution (2024)	¥2,400,000	¥1,200,000	**¥3,600,000**
USD Equiv.	$15,894	$7,947	**$23,841**

Source: Japan Securities Dealers Association.

The ability to max out retirement plans is made easier when wages are growing. Every spring, Japan's biggest corporations engage in the *shunto* labor negotiations. The result of those negotiations sets the stage for pay across the country. This year's 5.28% pay boost marked the sharpest wage inflation in 33 years, well ahead of core and headline CPI, which are both up 2.8% year over year.

Some big players are warm on Japanese equities. On February 28, J.P. Morgan published "Japan: Is this time different?" According to the firm's strategists, "The strong rally has investors asking whether the market has run too far. We think no, and there is still a strong case for an overweight towards Japanese equities."

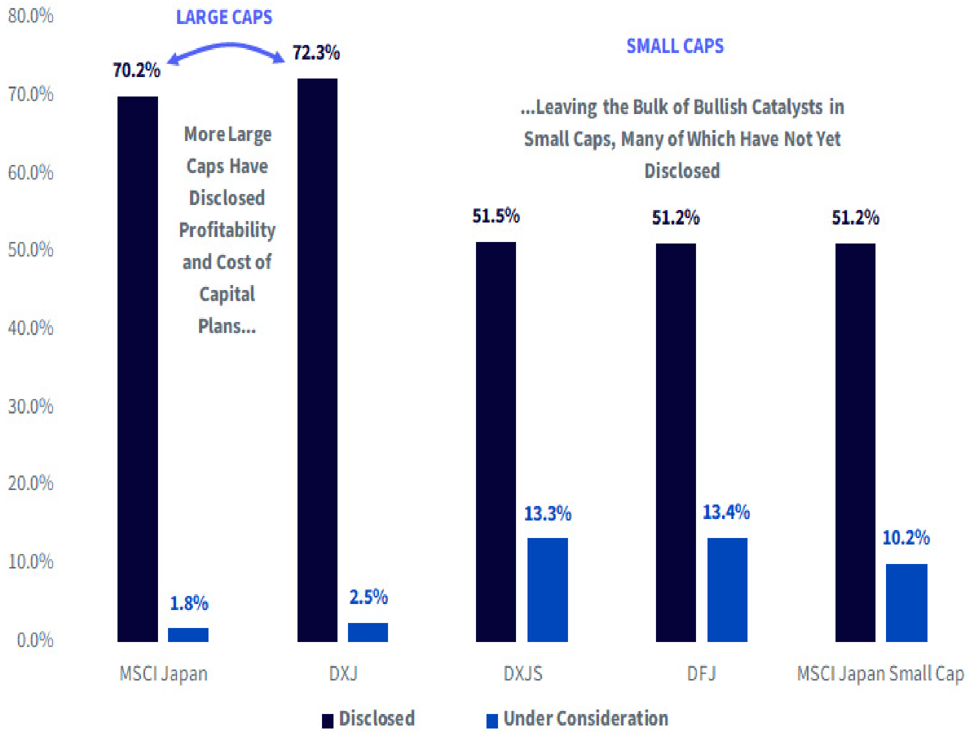
Morgan Stanley's Asia team put out a mega report on April 2: "Alpha, Beta, Thematic Biweekly—NISA Surge into Japan's Secular Bull Market and Asian Equity Supply/Demand." According to its strategists, "Inflows from tax-free Japan NISA accounts to Japan equities are running 4x our bull-case estimates." Japan and India are Morgan Stanley's top DM and EM picks, respectively.

Japan also has a fighting chance of witnessing double-digit broad-market earnings-per-share growth in both 2024 and 2025. The initiative that could catalyze this growth is continued progress in the country's corporate governance reform initiative.

On that front, the Tokyo Stock Exchange has started publishing the "Name and Shame" List, which explicitly notes which publicly traded companies have disclosed their plans for improving their profitability metrics, as demanded by the exchange.

Using the WisdomTree Japan Hedged Equity Fund (DXJ) as a proxy for Japan as a whole, stocks representing 72% of the country's market capitalization have made such disclosures. Another 3% have put the TSE's disclosure requirement "under consideration," which means they are getting around to doing it but have thus far dropped the ball.

Figure 2: Japan's "Name & Shame" List: More Large Caps Have Disclosed Game Plans



Sources: MSCI, WisdomTree, as of 4/3/24. Disclosures from Tokyo Stock Exchange, as of 2/29/24.

Whether investors err on the side of something large cap like DXJ or small cap like DFJ or DXJS, the diligence homework assignment for the reader this year is to keep an eye on NISA flows. Indicators suggest that the bull market needs Japanese people to put their 2024 NISA contributions into Japanese equities. If they're using the money to buy Amazon and Meta – or plowing into bonds – then we believe the thesis will need to be reassessed.

[1] **Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.**

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S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor’s Index Committee designed to represent the performance of the leading industries in the United States economy.

MSCI Japan US Dollar Hedged Index : The index is designed to provide exposure to Japanese equity markets, while at the same time mitigating exposure to fluctuations between the value of the U.S. dollar and Japanese yen.

Shunto : the Japanese word for the annual spring round of wage negotiations conducted between big business and trade unions within Japan.