

JAPAN LOOKS CHEAP AND “YEN HEADWIND” MAY RECEDE ON ELECTION PROSPECTS

Jeremy Schwartz – Global Chief Investment Officer
12/03/2012

Japan is an equity market that intrigues me and a handful of notable value investors such as David Herro, Morningstar’s International Stock Fund Manager of the Decade, and James Hunt of Tocqueville Asset Management.¹ Earlier this year, I published a [research piece](#) based on historical dividend yield analysis that described what I saw as bullish prospects for Japan’s equity markets based on its relatively low prices. Japan has been plagued by a perpetual bear market for much of the last 25 years. The last five years have been especially difficult—from the global recession and financial crisis to the earthquake and tsunami of 2011—and were compounded by an ever-rising yen that made Japanese exports less competitive in the global marketplace. In a research piece entitled “The Sun Also Rises?” Hunt spoke of a “quadruple whammy” of negative factors plaguing Japan, including: • A slowdown in Japan’s [GDP](#) • A slowdown in China’s GDP (one of Japan’s largest export markets) • A territorial dispute between China and Japan • An ever-rising yen This fourth whammy—the rising yen—is the one I want to focus on in this post. Hunt writes of the yen: *The Yen has defied economics for some time, in part because Japanese investors’ reflexive response in the face of risk is to bring money home and invest it in Yen-denominated assets, and because with domestic deflation, real interest rates in Japan are actually higher than their U.S. counterparts, which are being suppressed by government policy. It has been a fool’s game to guess when the Yen would finally weaken, but economic healing in the west and eventually inflation and rising interest rates here could certainly be a catalyst, as could money printing in Japan. Meanwhile, the strong Yen has forced exporters to become more cost efficient in Japan and to move production to lower cost sites in Asia, which will enhance their profitability in the long run.*² I agree that it has been especially difficult to predict the yen’s performance, to put it mildly. But I believe that the yen is currently the single most important factor driving Japan’s relative performance. As one piece of highly anecdotal evidence, just look at the first quarter of 2012—when the yen weakened 7% and Japan was the best-performing country in the developed world markets.³ On this front, we have recently seen very positive developments and a shift in sentiment. The change in tone is coming from an election set to take place on December 16, which Shinzo Abe, leader of the Liberal Democratic Party, is projected to win. Abe, a former prime minister, has vowed to weaken the nation’s currency and boost government spending to stimulate the economy. The specific rhetoric getting the most attention has been Abe’s call for “unlimited easing from the central bank to weaken the yen.” Many of the nation’s exporters have started to see their stocks react very positively on speculation that the yen’s very outsized strength over the past five years may be set to reverse course with an Abe victory in the December 16 election.⁴ Given this potential shift the yen may have started, it is all the more interesting that on November 30, 2012, WisdomTree implemented a special, one-time rebalance of the Japan Hedged Equity Index to focus more weight on Japan’s global multinational exporters. I believe the currency-hedged nature of this Index calls for a tilt to companies that would benefit from a

weaker yen; we thus added a new filter to the Index to remove from inclusion companies that were primarily operating locally in Japan. This filter specifically focuses on companies that derive more than 80% of their revenue from Japan. To see a more detailed analysis of the shift that occurred as a result of this Index enhancement, please see this [research piece](#). In closing, I believe Japan's stocks are attractively priced, but we need to see the yen continue to move downward to keep the momentum going for Japan's stocks. The election on December 16 could be a very helpful catalyst. **Time to invest in Japan? [\(Video\)](#)** ¹Source: Roben Farzad, "Japanese Stocks? Yes, They Really Think So," Bloomberg Businessweek, Nov. 23, 2012. ²Source: James Hunt, "The Sun Also Rises? A Contrarian Take on Japanese Equities." Tocqueville, Nov. 14, 2012. ³Based on MSCI country index data and countries in the MSCI EAFE Index. Also see our research note. ⁴Source: Anna Mukai, "Japan Automakers Jump on Bets Abe Will Weaken Yen: Cars," Bloomberg, Nov. 27, 2012.

Important Risks Related to this Article

Investments in a single country may be subject to greater market volatility.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.