JAPANESE STOCKS ARE RED HOT

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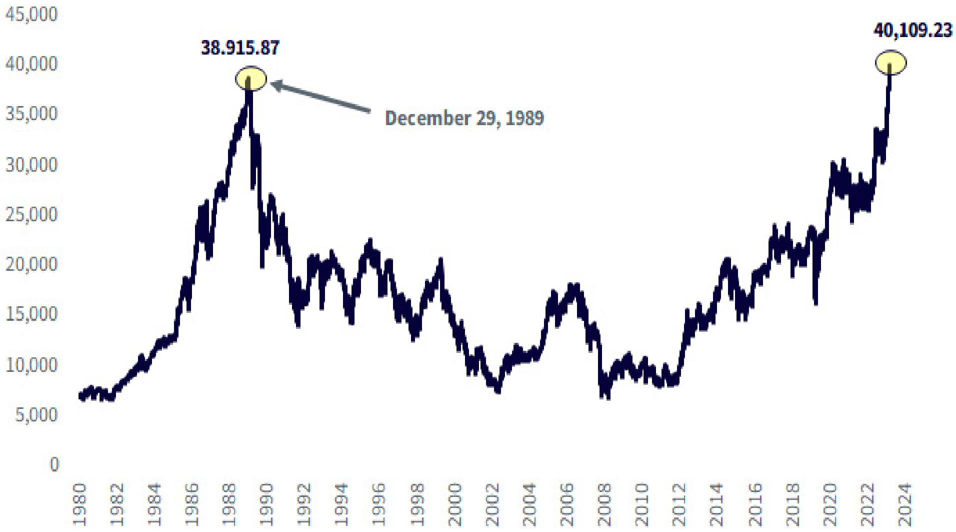
It's a little surreal, having looked at long-term charts of the Japanese stock market for my entire career, but here we are, seeing new all-time highs on the Nikkei 225. The previous record had held since 1989, when many of us mid-career types were children. Granted, the Nikkei is price-weighted like the Dow Industrials, so it's a little blasphemous to cite such a poorly constructed index. Cut us some slack. Everyone is talking about the Nikkei and it is the index they cite on CNBC. It's a big psychological win for Japan's benchmark to surpass 40,000 for the first time.

Figure 1: Nikkei 225



Source: Refinitiv, as of 3/19/24. Past performance is not indicative of future results. You cannot invest directly in an index.

Abenomics, the reform program implemented by former Prime Minister Shinzo Abe, is now over a decade old. The first two planks of Abenomics' "Three Arrows" were monetary easing and fiscal stimulus. Considering the country is barely out of recession right now, it is hard to argue Abenomics spurred some economic miracle.

Then again, even with the Bank of Japan's barely positive policy rate, the attendant collapse in the yen to ¥151 from ¥103 as recently as three years ago could be a set-up for a competitiveness thesis. Still, it is not economic vibrancy that has the market interested in allocating to Japanese stocks.

Abenomics' third arrow, corporate governance reform, is driving sentiment. Progress had been coming in fits and starts. But now Japan has the infamous "Name and Shame" list, which still has the ink drying on it. Named are all the corporations who ignored the Tokyo Stock Exchange's (TSE) demand, namely that listed companies plot out explicit business plans for boosting their profitability and stock prices.

We were pumped about Name and Shame because the TSE has been specifically hammering companies that trade for less than book value, which are the types of stocks that tend to find their way into dividend funds.

We spent all these years trying, sometimes with success, sometimes in futility, to poach business from unhedged Japan ETFs. Fortunately, the MSCI Japan Index has an aggregate price-to-book ratio of 1.55, while the WisdomTree Japan Hedged Equity Fund (DXJ) trades for 1.29 times book.[1] We think we have an alpha generation case because we own more sub-1.0 price-to-book companies.

Last year, we felt like few investors were paying attention to the TSE's obscure memos, which were aggressive in their demands for corporate reform. I would often discuss with our Global CIO, Jeremy Schwartz, why it sometimes seemed like investors were not paying attention to the steady stream of reforms.

But now we have the Nikkei drawing attention to a market that has been ignored by many… with the exception of the M&A crowd (figure 2).

Figure 2: Japan Represents About One-Third of All Asian M&A Activity

Source: Bloomberg, *Dealmaking Booms in Japan as Most of Asia Suffers through Bust*, 2/21/24.

Part of It (But Not All of It) Is "No China, Please"

Make no mistake: last year we saw a ton of ETF creations on DXJ and the WisdomTree India Earnings Fund (EPI) because investors were selling China first and asking questions later.

That was great news for our Japan and India strategies, but the risk was that the bull run in those countries was based on portfolio clean-outs, not because our investor base was truly enamored with them.

That brings me to figure 3, which is heartening because China rallied hard in recent weeks. By the logic of "they're selling China and switching to Japan and India," we should have seen material weakness, maybe losses in DXJ and EPI. That has not been the case. Maybe we overestimated how much of it was "no China, please."

Figure 3: Performance since 1/31/24

Source: WisdomTree PATH, as of 3/18/24. CXSE: WisdomTree China ex-State-Owned Enterprises Fund, EPI: WisdomTree India Earnings Fund, DXJ: WisdomTree Japan Hedged Equity Fund, MXJP: MSCI Japan Index, 500: S&P 500 Index

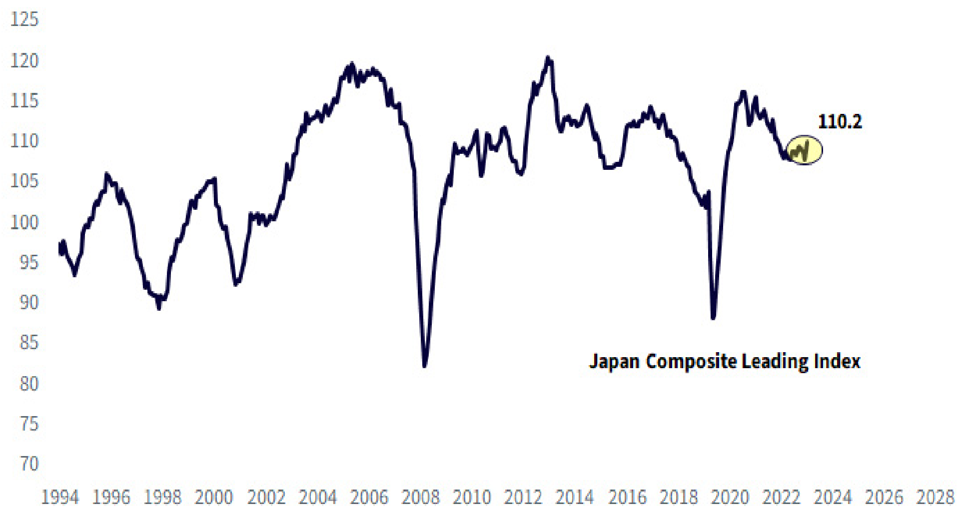
Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.

For the most recent month-end and standardized performances and to download the Fund prospectus, please click the respective ticker: CXSE, EPI, DXJ.

The Nikkei's move to new all-time highs comes at an unusual time; Japan just released a GDP report that skirted recession. It's a bizarre situation in the country too, because exports were up 7.8% in the year to February, while imports were largely flat, rising just 0.5%. That comes back to the ¥151 exchange rate, which has helped DXJ because of its cheap yen-reliant exporter screen.

Promisingly, Japan's recession-mired economy may also have green shoots, if leading indicators are to be believed. The Composite Leading Index is trying to get some footing (figure 4).

Figure 4: Composite Leading Indicators Are Trying to Head Higher



Sources: Refinitiv, Japan Cabinet Office, Japan Statistics Bureau, Ministry of Internal Affairs and Communication, as of January 2024.

We have three Japan-oriented strategies:

- **DXJ: WisdomTree Japan Hedged Equity Fund**
- **DXJS: WisdomTree Japan Hedged SmallCap Equity Fund**
- **DFJ: WisdomTree Japan SmallCap Dividend Fund**, which does not have the currency hedge

I didn't get into it here, but Japan is also reforming retirement savings accounts. I think this is an underappreciated bull catalyst. I'm working on a blog post for that specific subject. Stay tuned.

[1] Price-to-book ratios are as of January 2024.

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DEFINITIONS

Japan’s Nikkei : Short for Japan’s Nikkei 225 Stock Average, the leading and most-respected index of Japanese stocks. It is a price-weighted index comprised of Japan’s top 225 blue-chip companies on the Tokyo Stock Exchange. The Nikkei is equivalent to the Dow Jones Industrial Average Index in the U.S.

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.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

MSCI Japan Index : A market cap-weighted subset of the MSCI EAFE Index that measures the performance of the Japanese equity market.

Price-to-book ratio : Share price divided by book value per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Composite Index of Leading Indicators : The Composite Index of Leading Indicators, otherwise known as the Leading Economic Index (LEI), is an index published monthly by The Conference Board. It is used to predict the direction of global economic movements in future months.