
THERE IS GOLD IN THE TOKYO STOCK EXCHANGE'S OBSCURE MEMOS

Jeff Weniger – Head of Equity Strategy
10/03/2023

“With this year as the first year of my ‘asset income doubling plan,’ we will promote, boldly and fundamentally, the shift from savings to investments.”

– Japanese Prime Minister Fumio Kishida, February 2023

Nothing will put you into a deep nap quite like a PowerPoint deck entitled, “Summary of Discussion on Measures to Improve the Effectiveness of the Market Restructuring.”

It’s dry and boring, but there is some gold inside the 12-pager that can be tackled over a cup of coffee. In my view, what is inside it and other similar Tokyo Stock Exchange (TSE) memos is the primary bull case for Japanese equities.

Firstly, the TSE reminds us that the government is expanding the Nippon Individual Savings Account (NISA) program.

Individuals who participate are exempt from a 20% tax on capital gains and dividends. Starting in 2024, the maximum contribution will be tripled from ¥400,000 to ¥1,200,000. To put that in “IRA terms,” it would be like if we had a program in the U.S. that had a set-aside maxed out at \$2,739 and then they expanded the maximum contribution to \$8,219. This may be one of the initiatives Kishida had in mind when speaking of a “bold” promotion of the investing society.

We get more meat and potatoes later in the memo in the part that addresses the [*price-to-book thing*](#). The TSE explains:

Considering that the purpose of this market restructuring is to contribute to the improvement of corporate value of listed companies, it will be meaningless unless we address the fact that about half of all listed companies have a price-to-book ratio below 1. Whether or not we can take any steps forward to improve financial indicators such as PBR is a point of discussion at the council.

There is one way we can interpret the TSE’s dislike of sub-1 price-to-books. It would be very easy to host a ton of symposiums, invite bigwigs, talk about it over dinner and then watch as the status quo persists. That is a possibility to be appreciated.

However, consult the TSE’s March memo, entitled “Action to Implement Management that Is Conscious of Cost of Capital and Stock Price.” It followed up:

While share buybacks and dividend increases are considered effective means of improving profitability, if shown as such by the company’s analysis of whether the balance sheet effectively contributes to value creation, TSE is not necessarily expecting companies to use only these or solve issues with a one-off response. Efforts are expected on a fundamental level to attain profitability in excess of cost of capital on a sustained basis and achieve sustainable growth.

In order to fall within the TSE’s guidelines, companies need to put together an “Analysis of Current Situation,” whereby management has to analyze the company’s cost of capital and profitability at board meetings. They are then tasked with developing “policies, targets, planning periods and specific initiatives for improvement.” Finally, the price-to-book thing is expanded out to include other metrics. In this document that the companies are mandated to compile, they need to explicitly discuss either the stock

price, the market cap, or price-to-book and price-earnings ratios. Also, they need to put all of that in specific context. One or more of these four measures must be addressed:

- [Weighted average cost of capital \(WACC\)](#)
- [Cost of equity](#)
- [Return on invested capital \(ROIC\)](#)
- [Return on equity \(ROE\)](#)

Then, the TSE “expects companies (to)...engage in dialogue with investors including overseas investors based on this disclosure.”

To give an idea on where the country stands on some of the above metrics, the [MSCI Japan Index](#) trades for 15 times forward earnings, while the [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#) is priced at a 12.1 times [forward multiple](#). Broad Japan exposures only rarely trade at a premium to the U.S., and that is the case now; the S&P 500’s [forward P/E](#) is 20.6.

Time will tell if the TSE’s push will be taken to heart, but there is plenty of upside if Corporate Japan can get its act together. Currently, MSCI Japan’s ROE is only 8.7%, while [DXJ's](#) 11.3% is better but well below the 17.8% being posted by the [S&P 500](#). A closing of the profitability gap is necessary if the TSE’s push can be measured a success.

All fundamental metrics as of 8/31/23.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in Japan, thereby increasing the impact of events and developments in Japan that can adversely affect performance. Investments in currency involve additional special risks, such as credit risk, interest rate fluctuations and derivative investments, which can be volatile and may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund’s prospectus for specific details regarding the Fund’s risk profile.

For the top 10 holdings of DXJ please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/dxj>

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.

Related Blogs

+ [Blending Strategies for Japan Positioning](#)

Related Funds

+ [WisdomTree Japan Hedged Equity Fund](#)

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.

DEFINITIONS

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.

Weighted average cost of capital (WACC): The average rate that a business pays to finance its assets. It is calculated by averaging the rate of all of the company's sources of capital (both debt and equity), weighted by the proportion of each component.

Cost of Equity: Represents the amount of compensation investors demand to invest in the future profits of company.

Return on Invested Capital (ROIC): Measures the efficiency of invested capital and how it relates to generated returns.

Return on Equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

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

Forward multiple: A valuation ratio that reflects a company's value on the basis of an estimated financial metric, i.e. forecasted earnings performance.

Forward P/E ratio: Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

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.