
JAPAN STRATEGIST ROUNDTABLE: NICHOLAS SMITH ON TAX POLICIES, ABE'S POPULARITY AND THE OVERALL MARKET ENVIRONMENT

Jeremy Schwartz – Global Chief Investment Officer
10/09/2014

On a trip to Japan in early September, I had the pleasure of having breakfast with Nicholas Smith, the Japan equity strategist for Credit Lyonnais Securities Asia (CLSA). We discussed Japan's tax policies, Prime Minister Abe's popularity and the overall market environment. Here are the highlights of our conversation. *Question: One of the policy changes investors would like to see is the cut in the corporate tax rate. Please talk about the tax environment that has led to this change in policy.* Smith: Japan has one of the highest corporate tax rates in the world, second only to the United States. But one problem is that an ever increasing number of companies don't pay any tax. Back in the early 1950s, only 16% of companies did not pay corporate taxes, but today it is 70% of companies—dominated by smaller companies. Generally speaking, corporate profits have increased over 60% cumulatively over the last 50 years, while corporate tax receipts are down 50% cumulatively over the same period. When I look at that, I have asked people at the Ministry of Finance: How did you mess this up so badly? The desire to lower rates and broaden the base of tax collected upon is much needed. *Question: What is the impact of reducing the tax rate?* Smith: I have calculated that if Japan reduces the corporate tax rate from the 39.3% [effective tax rate](#) currently to be in line with the effective tax rate in the United States of 27%, this would lead to a 20% increase in the earnings for the [TOPIX 500 Index](#) (after tax earnings). *Question: One part of the [third-arrow](#) growth strategies was reforming some of the public pension funds like the [Government Pension Investment Fund \(GPIF\)](#) to modernize asset allocations away from the low-yielding [Japanese government bonds \(JGBs\)](#). When do you expect this to take place?* Smith: There is a big question whether some of the flows to trust banks this year were caused by the GPIF purchases. I have looked at it, and we have talked to asset managers. My sense is the GPIF has not started increasing allocations to equities yet, but it will very soon. We could expect to see the purchases in September and October, if not already. The GPIF may very well be considering making purchases before fully announcing its new policy, as investors will try to buy ahead of the GPIF if they were fully clear on their intentions. *Question: There is some media focus on the declining support for Abe prior to his Cabinet reshuffle. What's your take on how Abe is doing?* Smith: I believe Abe really has unprecedented support. Former Prime Minister Koizumi (some might call him "Elvis" for his popularity) was less popular than Abe at this stage of his run as prime minister. Usually there is an initial surge of popularity in the first few months in office, and then it trends downward. The historical average of popularity of Cabinet support ratios I have found as approximately one-third. I see Abe's support over 50% at this stage. Thus far, he's the most popular prime minister in three decades. This also shows in the execution of the bills that were passed that he submitted to parliament: 97.5% of the bills he has submitted were executed, a percentage only matched by Koizumi in 2003. *Question: One of the priorities of the Abe*

government is to increase women in the workforce due to the shrinking labor supply. What do you think needs to be done here? Smith: The lack of women in the workforce is not because companies are unwilling to hire. It's largely a problem of retention due to a lack in performance-based pay. Women need to be rewarded for working efficiently so they can leave early. Women don't quit because households or childcare needs compel them to; they quit mostly because the employment system rewards hours worked, not performance. You are currently incentivized to work longer but not to work smarter. That is clearly visible in the [labor productivity](#) numbers. Japanese [per capita gross domestic product \(GDP\)](#) used to be substantially higher than the USA, but in 2012, per capita GDP in both Japan and France was broadly 30% below the USA. Lower French per capita GDP was largely explained by their working 24% fewer hours. But the Japanese reported working 9% more hours. The French were economically less rich because they chose to spend more time with their families; the Japanese were less rich despite spending little time with their families. *Question: What are some of the investment themes relating to Abe's strategy to get more women into the workforce?* Smith: The number of women returning to the workforce is likely to remain high for the next several years. While these women are paid substantially less than regular employee men, their income is an incremental positive to household income. Women returning to work will make it look as though wages are falling, whereas what is really happening is a change in the mix. On a like-for-like basis, pay is going up for both regular and non-regular employees, at both big and small companies. That looks like good news for consumption generally. We want to thank Nicholas Smith for spending time with us and for his insights. For more insights from Mr. Smith and some of the other strategists and economists we spoke with in Japan, please see our full roundtable [here](#).

Important Risks Related to this Article

Information provided herein should not be considered tax advice. Investors seeking tax advice should consult an independent tax advisor. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Investments focused in Japan are increasing the impact of events and developments associated with the region, which can adversely affect performance.

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.

DEFINITIONS

Effective tax rate: The average tax rate at which a corporation's pre-tax profits are taxed, taking into account all forms of taxation paid by the company.

TOPIX 500 Index: A capitalization-weighted index designed to measure the performance of the 500 most liquid stocks with the largest market capitalization that are members of the TOPIX.

Third arrow policies: The part of Japan's Abenomics process of reform that is focused on structural changes intended to promote economic growth.

Government Pension Investment Fund (GPIF): Japan's largest public pension fund.

Labor productivity: Measure of how much labor is able to accomplish, given the use of a set amount of resources, most often the number of hours worked.

Per capita gross domestic product (GDP): Gross domestic product of an economy divided by the number of people within that economy. Higher numbers indicate a higher standard of living for that economy.