ATLANTIC
FINANCIAL GROUP

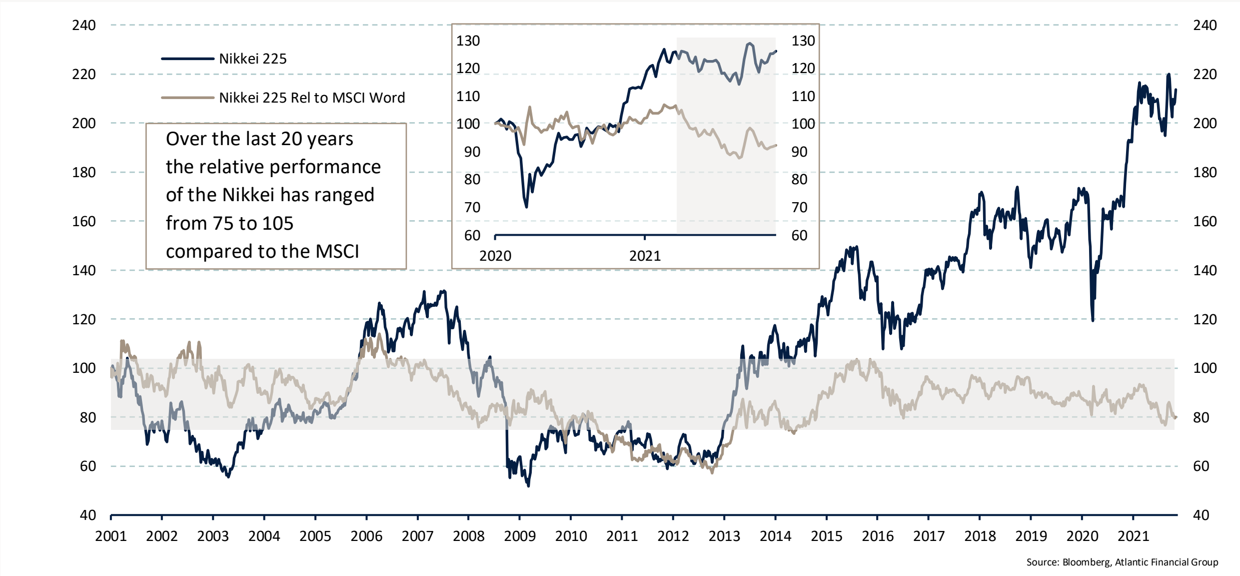
Weekly Investment Focus

22 November, 2021

"JAPAN BOTTOMING OUT"

- Japan struggles to bounce back from the pandemic
- Structural problems, specific to Japan, persist
- Can the new Prime Minister's initiatives boost growth?
- China's regulatory tightening could benefit some Japanese industries

CHART OF THE WEEK: "Prolonged health measures penalize Japan"



FINANCIAL MARKET ANALYSIS

1- Japan struggles to bounce back from the shock

Among the developed countries, Japan has recorded the poorest market performance in Swiss francs. This is reflected in the stagnation of its main indices since the beginning of the year, i.e. +3.1%, while the other markets are showing double-digit growth. The underperformance has been more pronounced since March (see chart of the week). **Two factors partly explain this underperformance: the slow rollout of**

vaccination and the instability of the political situation. However, the situation is changing. In addition, corporate earnings growth is improving, and stocks seem to be fairly valued. **The Japanese market should therefore recover in the fourth quarter thanks to a strong acceleration in growth linked to the reopening of the economy** after the multiple states of emergency that had been put in place in response to the pandemic.

Japan's attractive valuation and the pro-cyclical nature of its economy argue in its favour. Finally, **monetary policy and the likely rise in US interest rates could continue to weaken the yen and thus favour Japanese exporters.** Japan's two main trading partners are China and the United States, which account respectively for 23.8% and 18.6% of its exports (see Fig. 3).

Fig. 2 - Evolution of the yen year to date

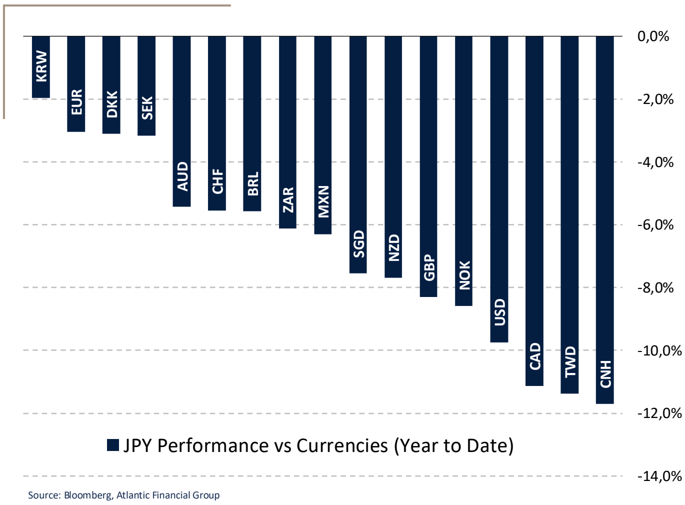
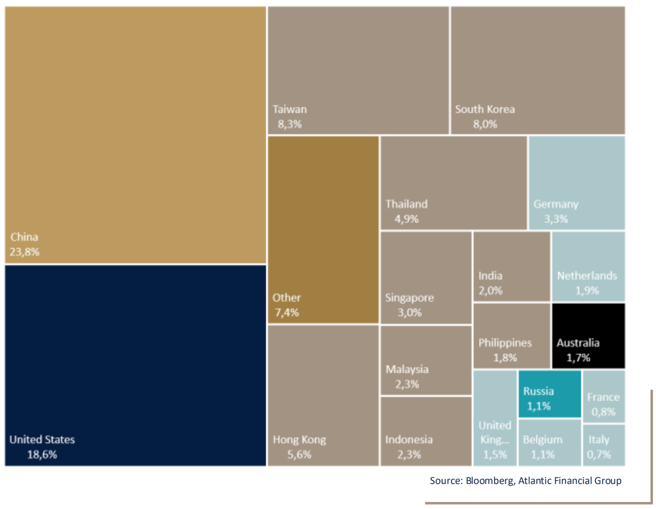


Fig. 3 - Japanese exports by country



Currently, **the Nikkei 225 is trading at 17x and the TOPIX at 14x their 12-month price-to-earnings ratios, a slight discount from their 10-year averages** of 17.7x and 15x respectively. The market rally could be supported by both corporate earnings and rising investor expectations of new government and economic policies.

2- Structural problems, specific to Japan, persist

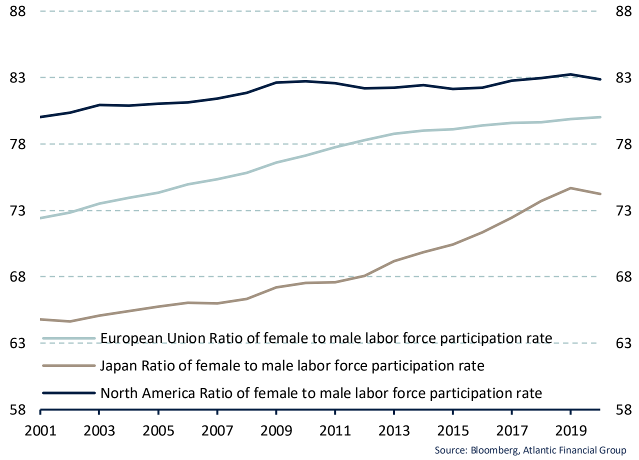
Japan is the third largest economy in the world behind the United States and China. However, it has to cope with **an ageing population, involving rising health and pension costs. It is rapidly losing productivity** (see Fig. 4) and reforms are needed to transform the country, boosting the birth rate while increasing the rate of female labour force participation, which is still far below that of other developed countries (see Fig. 5).

Moreover, **Japan lags behind the rest of the world in digitisation and the use of information and communication technologies. Japan ranks just 27th in the world in digital competitiveness. The** 'home office' was poorly adopted during the pandemic, which further exacerbated the country's economic slowdown and further widened inequalities. **Telework increased sharply for the 20% highest income**

households, from 7% to 31%, while for the 20% lowest income households it increased only from 6% to 8%.

Fig. 4 - Labour productivity

Fig. 5 - Female participation rate

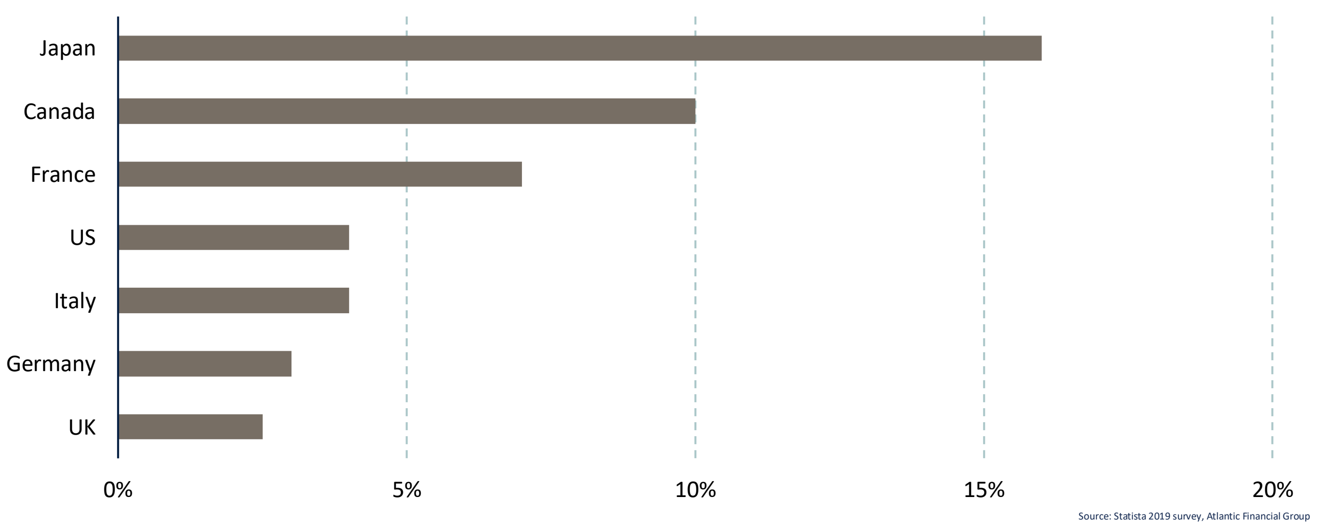


3- Can the new Prime Minister's initiatives boost growth?

Fumio Kishida, **the new prime minister, has promised stimulus packages** in the wake of the COVID-19 pandemic but must at the same time ensure that public finances are in order, with Japan's debt peaking at 256% of the country's GDP in 2020 according to the International Monetary Fund. **A supplementary budget of about 2% of GDP could still be approved by the end of the year.**

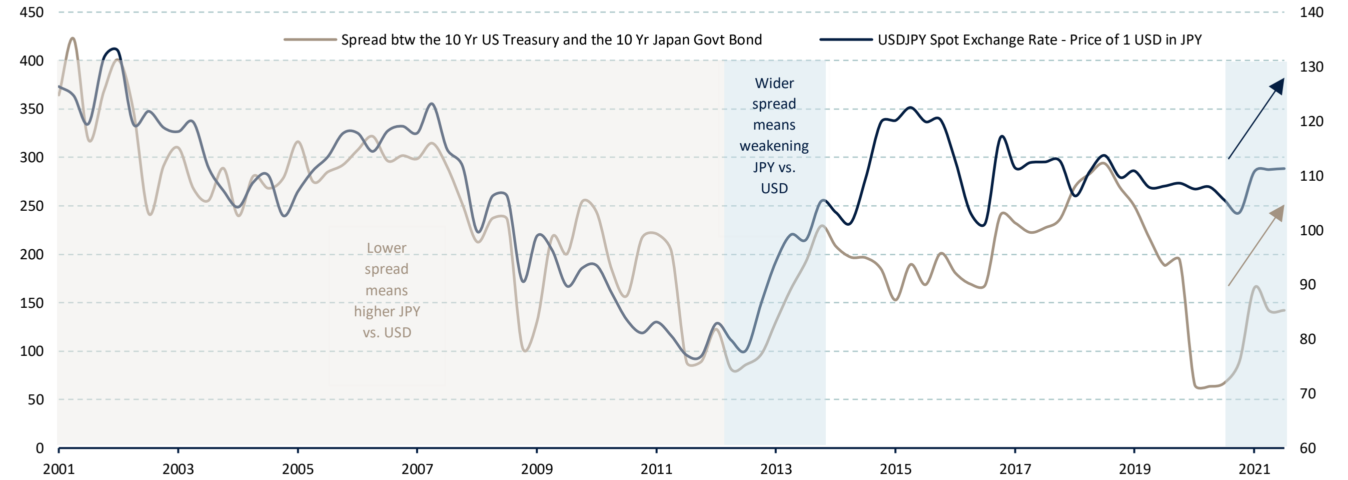
Among the initiatives envisaged, **household consumption assistance and "Go To Travel" subsidies are expected to support the consumer and leisure sectors.** Cash benefits are planned to encourage people to claim ID, social security, and tax cards that are critical to the government's digitization efforts. The Japanese have shown less enthusiasm than others to shift their spending online during the pandemic (see Fig. 6). For its economy to experience a V-shaped recovery, the government and businesses must make greater use of digital transformation technologies, i.e. encourage digital payments, to stimulate household consumption.

Fig. 6 - Shares of people who did not shop online in the past year (%)



The yen's weakness should drive growth resumption and make exporting companies more competitive. In recent months, the divergent policies of the FED and BoJ have contributed to the depreciation of the yen against the dollar. The yen remains sensitive to interest rate differentials (see Fig. 7).

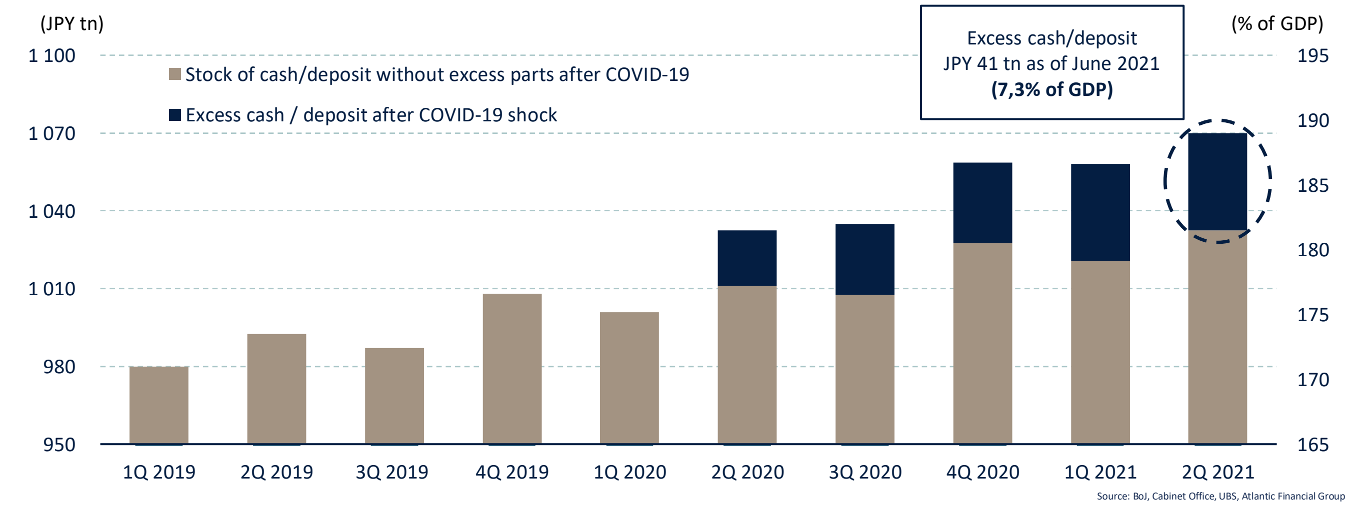
Fig. 7 - Interest rate differentials and changes in the USD/JPY exchange rate



Source: Bloomberg, Atlantic Financial Group

In the short and medium term, when the yen depreciates, exporting companies increase their profits by raising yen prices or reducing foreign currency prices and increasing export volumes. **Companies that invest abroad see the yen value of their overseas profits increase.** The service sectors benefit from the increase in foreign tourists and service exports. Finally, households may face a decline in purchasing power, but many Japanese companies prefer to reduce their margins rather than impose price increases on Japanese consumers. Moreover, at the end of the second quarter of 2021, **Japanese households still had excess savings of** 41 trillion yen or 7.3% of BIP. These reserves are expected to be quickly converted into consumer goods in the 4th quarter of this year. (see Fig. 8). **All these changes will have positive effects on the whole economy.**

Fig. 8 - Excess savings in households



Source: BoJ, Cabinet Office, UBS, Atlantic Financial Group

4- China's regulatory tightening could benefit some Japanese industries

Chinese regulatory measures announced in recent months have weighed on Chinese growth and exports. For example, China's desire to reduce its iron ore consumption could benefit Japanese steel exporters like Nippon Steel Corporation. **Japan is indeed the second largest exporter of steel after China.**

Moreover, **the US withdrawal from free trade agreements in Asia under President Donald Trump has left Japan in the driver's seat.** The latter currently holds the chairmanship of the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), an 11-nation trade bloc that is home to 500 million consumers and which China and Taiwan have recently applied to join.

The Prime Minister is also aware of the importance of ensuring greater independence of the archipelago with regard to strategic goods such as electronic components and rare earths, especially since the manufacturing sector still represents a significant share of GDP, i.e. about 26.5%. The sector has a well-deserved reputation for high quality, durability and sophistication. There are leaders in sectors such as automotive (Toyota), agricultural machinery (Kubota), and manufacturing equipment (Fanuc) and advanced equipment (Keyence). The gaming industry includes two world-renowned companies, Sony & Nintendo.

To remain competitive, Japan relies on innovative product design, high quality standards and skilled manufacturing rather than low-cost manufacturing as in China.

Conclusion:

Japan suffers from an aging population and a decline in competitiveness, partly offset by the automation and robotization of its factories. The pandemic has accentuated certain weaknesses, but the country could see a strong acceleration in growth in the coming months thanks to the reopening of the economy and the government subsidies promised by the new Prime Minister. Finally, the temporary weakness of the yen could boost this recovery through increased exports of high value-added manufactured goods. In the longer term, Japanese society needs to reform to return to sustainable growth.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2021 Year-to-Date (%)	2020 (%)	2019 (%)
Equities							
World (MSCI)	754.9	60.69	-0.2%	2.3%	18.8%	16.9%	27.3%
USA (S&P 500)	4 698	67.02	0.4%	4.1%	26.7%	18.4%	31.5%
USA (Dow Jones)	35 602	46.29	-1.3%	0.6%	18.2%	9.7%	25.3%
USA (Nasdaq)	16 057	69.13	1.3%	6.2%	25.3%	45.1%	36.7%
Euro Area (DJ EuroStoxx)	483.5	62.95	-0.2%	4.1%	24.5%	0.8%	27.3%
UK (FTSE 100)	7 224	45.96	-1.6%	0.3%	15.6%	-11.4%	17.2%
Switzerland (SMI)	12 545	70.70	0.2%	5.0%	20.6%	4.3%	30.2%
Japan (Nikkei)	29 774	57.52	0.5%	1.8%	10.0%	18.3%	20.7%
Emerging (MSCI)	1 269	45.14	-1.3%	-1.9%	0.3%	18.8%	18.8%
Brasil (IBOVESPA)	103 035	38.01	-3.1%	-6.9%	-13.4%	2.9%	31.6%
Russia (MOEX)	4 003	34.37	-2.6%	-6.1%	28.0%	14.8%	38.4%
India (SENSEX)	58 593	44.69	-0.5%	-3.3%	26.1%	17.2%	15.7%
China (CSI)	4 912	51.20	0.0%	-0.6%	-4.5%	29.9%	39.2%
Communication Serv. (MSCI Worl	114.56	48.47	-1.0%	-0.8%	15.0%	24.2%	25.1%
Consumer Discret. (MSCI World)	433.5	69.33	1.7%	6.1%	15.2%	37.0%	28.2%
Consumer Staples (MSCI World)	280.4	51.01	-0.9%	2.4%	7.0%	8.8%	22.4%
Energy (MSCI World)	186.4	32.30	-3.9%	-7.3%	34.9%	-27.7%	13.9%
Financials (MSCI World)	151.0	37.61	-2.4%	-1.8%	25.3%	-3.1%	24.1%
Health Care (MSCI World)	357.4	49.60	-0.6%	2.2%	14.0%	15.4%	23.3%
Industrials (MSCI World)	332.6	54.78	-0.9%	1.7%	16.6%	11.8%	27.2%
Info. Tech. (MSCI World)	573.7	72.89	1.9%	6.6%	27.3%	46.2%	47.5%
Materials (MSCI World)	357.3	49.38	-1.8%	-0.6%	12.6%	21.6%	20.8%
Real Estate (MSCI World)	226.6	52.65	-0.3%	1.2%	18.7%	-5.7%	24.0%
Utilities (MSCI World)	154.1	48.64	0.1%	0.9%	4.7%	4.8%	22.3%
Bonds (FTSE)							
USA (7-10 Yr)	1.56%	53.90	0.2%	1.2%	-2.5%	9.3%	7.4%
Euro Area (7-10 Yr)	0.00%	62.05	0.7%	1.5%	-1.3%	4.5%	6.7%
Germany (7-10 Yr)	-0.32%	68.50	0.6%	2.2%	-1.1%	3.0%	3.0%
UK (7-10 Yr)	0.88%	58.54	0.3%	2.2%	-4.1%	5.4%	4.8%
Switzerland (7-10 Yr)	-0.20%	56.81	0.4%	0.9%	-1.9%	0.4%	2.0%
Japan (5-10 Yr)	0.08%	50.99	0.0%	0.2%	0.0%	-0.1%	0.0%
Emerging (5-10 Yr)	4.69%	45.11	-0.1%	0.3%	-2.4%	5.2%	13.3%
USA (IG Corp.)	2.28%	49.71	0.5%	0.7%	-1.2%	9.9%	14.5%
Euro Area (IG Corp.)	0.38%	54.81	0.2%	0.7%	-0.3%	2.8%	6.2%
Emerging (IG Corp.)	5.06%	51.18	0.1%	0.2%	-2.2%	8.1%	13.1%
USA (HY Corp.)	4.41%	42.48	-0.2%	0.1%	4.3%	7.1%	14.3%
Euro Area (HY Corp.)	3.29%	56.29	0.0%	0.5%	3.5%	2.3%	11.3%
Emerging (HY Corp.)	7.35%	37.88	-0.5%	-0.2%	-2.4%	4.3%	11.5%
World (Convertibles)	453.7	44.83	-1.3%	-0.2%	6.0%	38.8%	17.3%
USA (Convertibles)	618.1	43.57	-1.8%	-0.6%	7.4%	54.5%	22.8%
Euro Area (Convertibles)	4 187	65.91	0.6%	1.5%	1.7%	6.1%	7.6%
Switzerland (Convertibles)	186.4	56.62	0.2%	0.3%	-0.2%	0.5%	2.4%
Japan (Convertibles)	201.7	55.76	0.1%	0.2%	3.7%	2.8%	2.6%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	719.9	78.89	n.a.	1.3%	8.6%	2.5%	9.3%
Distressed	956.7	77.47	n.a.	1.1%	12.6%	1.5%	1.4%
Event Driven	811.6	80.24	n.a.	1.7%	14.7%	3.1%	8.2%
Fixed Income	391.5	72.34	n.a.	-0.3%	4.3%	2.2%	6.1%
Global Macro	1 197.3	73.01	n.a.	0.4%	9.3%	2.0%	10.4%
Long/Short	908.3	71.37	n.a.	0.6%	8.4%	3.6%	12.2%
CTA's	341.7	73.16	n.a.	3.9%	12.4%	-3.2%	9.0%
Market Neutral	284.6	64.90	n.a.	0.5%	4.7%	-0.1%	1.6%
Multi-Strategy	689.7	76.31	n.a.	0.4%	6.2%	1.4%	7.3%
Volatility							
VIX	17.91	53.88	9.9%	14.1%	-21.3%	65.1%	-45.8%
VSTOXX	19.12	57.66	18.4%	17.4%	-18.2%	67.5%	-41.5%
Commodities							
Commodities (CRB)	569.1	n.a.	-0.3%	0.2%	28.2%	10.5%	-1.9%
Gold (Troy Ounce)	1 845	58.36	-1.0%	2.9%	-2.8%	24.9%	18.3%
Oil (WTI, Barrel)	76.10	36.74	-5.9%	-8.3%	56.8%	-20.5%	34.5%
Oil (Brent, Barrel)	78.50	37.42	-4.0%	-6.3%	54.9%	-23.0%	24.9%
Currencies (vs USD)							
USD (Dollar Index)	96.199	70.33	0.8%	2.7%	7.0%	-6.7%	0.2%
EUR	1.1272	28.00	-0.8%	-3.2%	-7.7%	9.7%	-2.2%
JPY	114.23	42.94	-0.1%	-0.6%	-9.6%	5.3%	0.9%
GBP	1.3445	40.15	0.2%	-2.3%	-1.6%	2.8%	3.9%
AUD	0.7252	36.95	-1.3%	-2.9%	-5.7%	9.5%	-0.4%
CAD	1.2638	35.06	-1.0%	-2.2%	0.7%	1.8%	5.0%
CHF	0.9300	38.55	-0.5%	-1.5%	-4.8%	9.8%	1.4%
CNY	6.3808	59.98	0.0%	0.1%	2.3%	6.7%	-1.2%
MXN	20.843	38.87	-1.0%	-3.2%	-4.5%	-4.9%	3.8%
EM (Emerging Index)	1 730.3	46.98	-0.2%	-0.1%	0.6%	3.3%	3.1%

Source: Bloomberg, Atlantic Financial Group — Total Return by asset class (Negative \ Positive Performance)

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