

Global Perspective

from the Investment Advisory Group

Japan – The winds of change are a near-term positive for Japanese stocks

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Summary

We view the abrupt resignation of Japanese Prime Minister Yoshihide Suga as a positive near-term catalyst for Japanese equity markets. Investors expect additional fiscal stimulus and renewed political excitement ahead of the general elections in November. While we continue to prefer U.S. equities over international developed markets, we see the opportunity for short-term outperformance by Japanese equities over global peers. However, the window of opportunity may be brief since Japan has had periods of high turnover for Prime Ministers in the past.

What happened

Prime Minister Yoshihide Suga resigned

Due to the unexpected resignation of Prime Minister (PM) Suga, the ruling Liberal Democrat Party (LDP) must choose a new leader by September 29. This will be followed by a general election by November 30. PM Suga hoped to be the continuity leader, following in the footsteps of the previous PM, Shinzo Abe, who was very influential and was Japan's longest continuously-serving PM ever. Unfortunately, Suga's leadership was uninspiring and lasted roughly one year. He was blamed for Japan's bungled COVID-19 response and the lackluster Tokyo Olympics, which were held without spectators and did not deliver the promised economic benefits. More importantly, he lacked a policy agenda of his own and failed to establish a presence in the global foreign policy arena. He also did not speak English, which is viewed as a shortcoming for a PM by Japanese voters. His legacy will be his commitment to make Japan a net-zero carbon emitter by 2050.

Possible replacement candidates

The two leading candidates for prime minister, Taro Kono and Fumio Kishida, were both former foreign ministers, which highlights Suga's foreign policy gap.

A Georgetown University graduate and fluent in English, Taro Kono could bring a fresh face to the LDP and appeal to younger voters. In the past, he was an outspoken critic of the government's closed immigration policies and opposed nuclear power. He believes that Japan needs to bolster its U.S. alliance to counterbalance a rising China and many other countries in the region.

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Fumio Kishida served as both a foreign minister and defense minister. He lost to Suga in the 2020 party leadership race. He closely follows and supports the central bank's 2% inflation goal and expansionary monetary stimulus program. He represents the traditional wing of the LDP and may be viewed as less of a change than Kono.

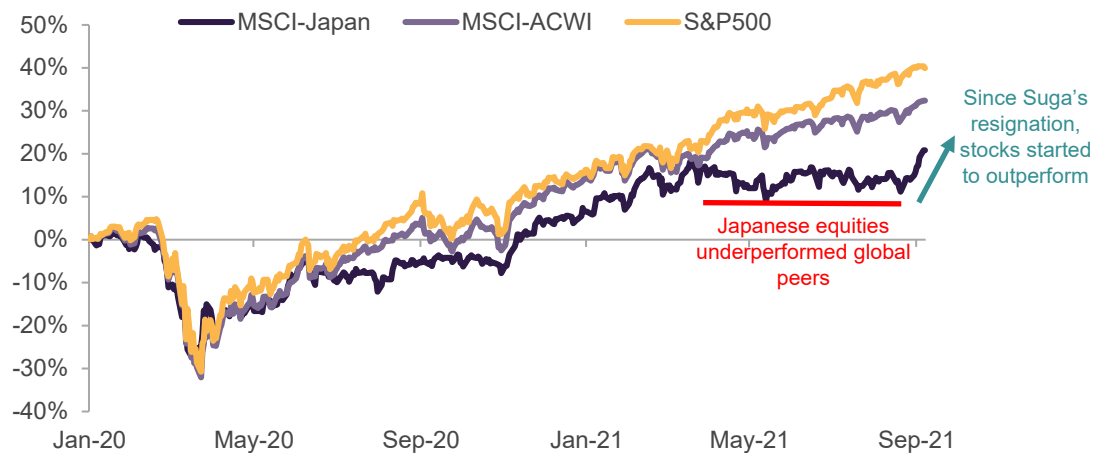
Former PM Shinzo Abe is still the most influential figure within Japanese politics and the LDP. He may steer the party towards another candidate like Sanae Takaichi, who was a former internal affairs minister in his cabinet and would be Japan's first female PM.

Our take

Japan has underperformed global peers, now the tide has turned

Under PM Suga's leadership, Japanese equities significantly underperformed its global peers. Since his resignation, Japanese stocks hit a 30-year high spurred by renewed optimism. Investors sensed the urgency of a new stimulus package before the November election.

Index performance since 2019



Data Source: Truist IAG, Bloomberg

The majority of global investors entered the year with underweight exposure to Japan for many reasons, primarily PM Suga's lack of direction in economic affairs. A new leader, assuming they could be as proactive and bold as Shinzo Abe, could significantly change the country's direction. Every election cycle rekindles that hope, but Japan's typical political leadership lasts only a year, like PM Suga's tenure, and fails to deliver a national leader or a strong lead in foreign policy. This time could be different, and that is what investors are hoping; at least, this seems to be implied based on the price action in Japanese equities since PM Suga's resignation.

The country needs a leader with a vision for Japan, who is able to communicate with foreign leaders (preferably in English), shows the ability to form strong alliances, and more importantly, can revive the aging Japanese economy, which is still the world's third largest. It is not impossible to find a candidate that could do all of this, but we take a doubtful view by looking at the success rate of previous PMs.

Nevertheless, we agree with the excitement in the market that the winds of change in Japan could carry stronger relative performance for Japanese equities in the short term.

Bottom Line

During most of 2021, Japan was a consensus underweight among global investors. Now the tide has turned as the LDP searches for an Abe-style leader.

There is lots of optimism that a new leader could significantly change the country's course, but the actual job is much more complicated than it seems. Since former PM Abe's first departure from the office in 2007, Japan has had five PMs with an average tenure of only a year before Abe's second run. We continue to prefer U.S. equities over international developed markets, but we see an opportunity for short-term outperformance by Japanese equities over global peers.

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