MONTHLY REVIEW – FEBRUARY 2024

OUR PERSPECTIVE

After three decades marked by deflationary woes and a seemingly ever-increasing number of widows, the sun may finally be shining on Japan. Equity markets are making all-time highs for the first time since 1989, amidst talk of an end to deflation and what is generally perceived to be a beneficiary to a stumbling China. Investment conferences are filled with Japanese equity market bulls on what has become a market darling.

So, this month we ask ourselves, has Japan become a consensus trade?

In local currency terms, the TOPIX Index is up 52% in the last two years, whilst the S&P 500 is up mere 22%. Granted, you've given back about 35% in currency terms. However, returns have been robust whilst the currency has reached extreme disparity from fundamentals such as unit-labour cost and purchasing price parity.

One might question, however, whether Japan is really exiting out of their decades of deflation. Whilst strong wage growth suggests otherwise, the reality is inflation in Japan is abating relatively quickly, like other parts of the world. Japanese PPI fell back to a meagre 0.2% in January – down from a 44-year high of 10% in December 2022 – whilst the economy seems to have slipped back into a recession. This will mean the chances of an end to the era of ultra-supportive policy will likely take a little longer than optimists might suggest.

But let's look at the data:

As table 1 shows, since the end of 2012 dividends per share in Japan has grown at an average of 9.9% per annum, whilst dividends in the US have only grown by about 7.5%. Earnings Before Interest and Taxes (EBIT) have grown by almost 8% in Japan, whilst EBIT of the S&P 500 have grown by a mere 5.7%.

The estimated dividend yields on the TOPIX Index is 2.2%, compared to a rather whimpering 1.5% from the S&P. At the same time, we expect dividend growth to remain robust given the strong and generally overcapitalised balance sheets, alongside ongoing governance reform. And the difference is not made up through buybacks, with aggregate buybacks in Japan now equalling the US on a percentage basis.

We also looked into official data on foreign investor flows into Stocks and Equity Funds. Surprisingly, as chart 2 below shows, Japan has actually experienced outflows from foreigners over the last 12 months. This might highlight scepticism…or perhaps proof that Japan is anything but a consensus long!

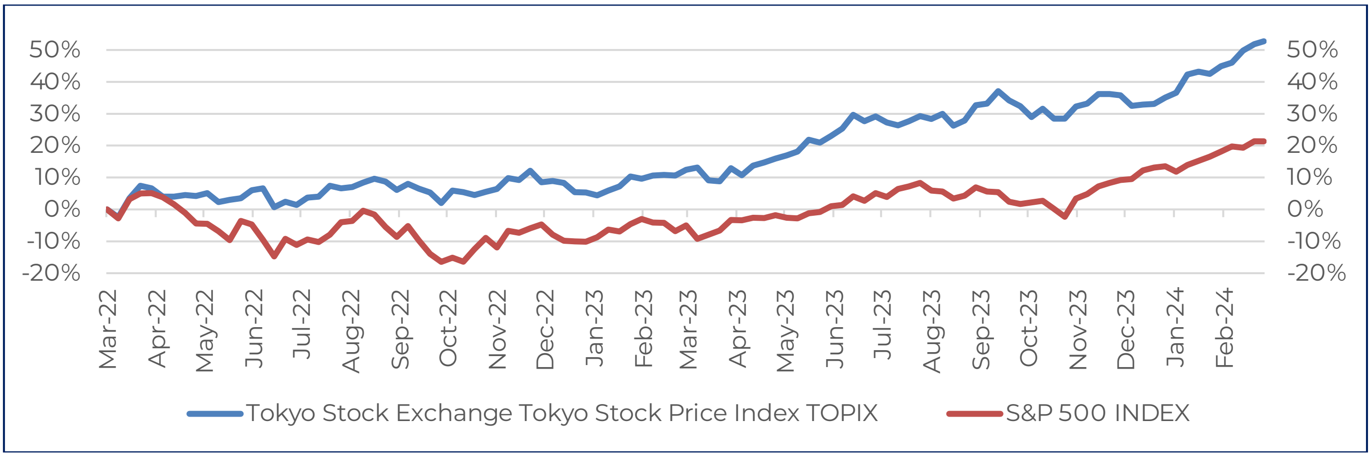
To conclude, investors should look to continue to increase exposure on weakness. Inefficiencies remain rather significant, and we continue to believe investors should embrace active managers that specifically target these. Whilst the TOPIX Index is up 250% since the end of 2012, the reality is that the equity market has not kept up with profit growth and shareholder value creation, driven by these reforms. Indeed, valuations today are more attractive that they were a decade ago when 'Abenomics' was introduced. The late prime minister Abe's 'Third Arrow', which focus on improving governance and increasing shareholder returns, are still in its infancy. Balance sheets remain (too) strong, profitability continues to rise, and a significantly undervalued Yen provides investors with healthy optionality. The sun is only just starting to rise!

Table 1: Dividends and operating profits in Japan have outgrown that of the Unites States since December 2012. This has been driven by changes in corporate governance, rising profitability and increasing shareholders returns.

		TOPIX Index				S&P 500 Index			
		DPS (JPY)	EBIT (JPY)	Div Yield	Est P/E	DPS (USD)	EBIT (USD)	Div Yield	Est P/E
Start Date	31/12/2012	¥18.96	¥88.97	2.23%	17.7x	$ 31.97	$ 137.81	2.25%	14.3x
End Date	20/02/2024	¥54.56	¥210.28	2.24%	15.9x	$ 71.26	$ 257.68	1.47%	21.1x
	CAGR	9.9%	7.9%			7.4%	5.7%		

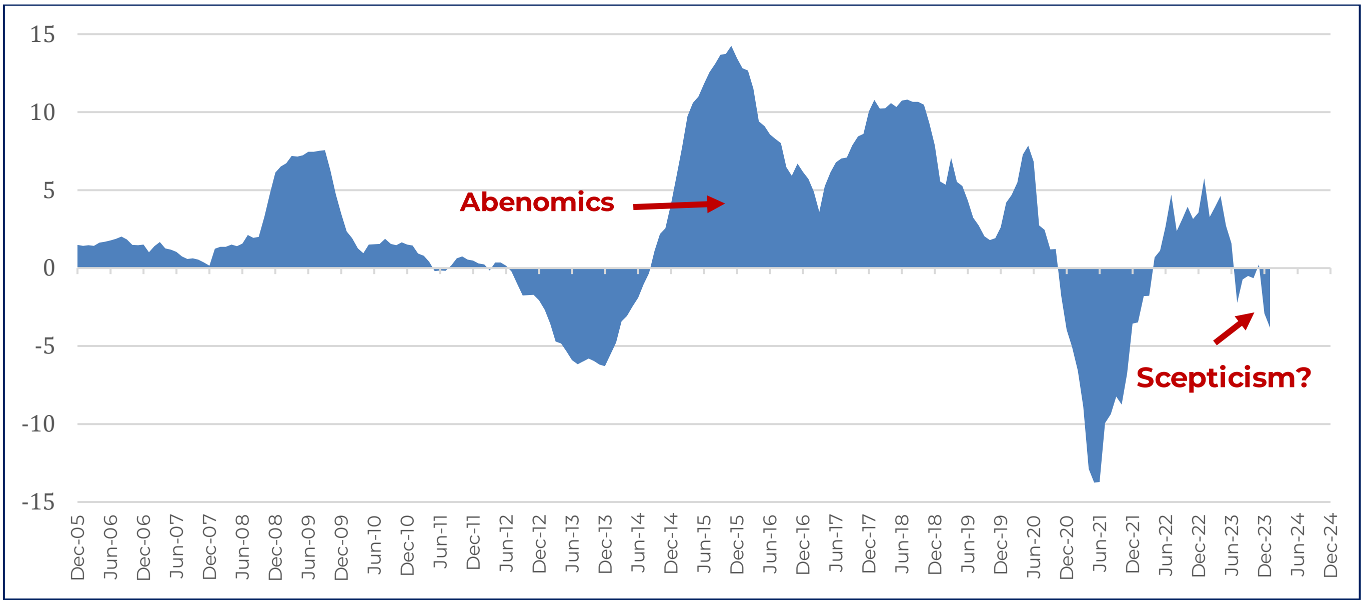
Source: Bloomberg L.P., Shard Capital, 29/02/2024

Chart 1: Local Currency Returns over the last 2 years:



Source: Bloomberg L.P., Shard Capital, 29/02/2024

Chart 2: Net, 12-month cumulative, foreign investor flows into Japanese stocks and equity funds (JPY tr):



Source: Ministry of Finance, Japan; Shard Capital, 29/02/2024

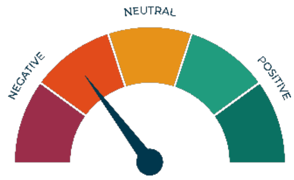
MARKET SNAPSHOT

	Index Series	FX	Last Price		Since: 29/02/2024 MTD	YTD	1 Year TR
EQUITIES	Bloomberg World Equity Index	USD			4.43%	4.92%	23.17%
	Bloomberg World Equity - Growth	USD			5.70%	6.80%	29.97%
	Bloomberg World Equity - Value	USD			1.99%	1.34%	10.69%
	Bloomberg UK Equity Index	USD			-0.21%	-1.67%	4.98%
	Bloomberg US Equity Index	USD			5.40%	6.98%	31.06%
	Bloomberg Europe ex-UK Equity Index	USD			2.17%	2.46%	16.12%
	Bloomberg Japan Equity Index	USD			3.29%	8.26%	27.97%
	Bloomberg Asia ex-Japan Equity Index	USD			5.64%	-0.39%	1.72%
	Bloomberg China Equity Index	USD			8.92%	-1.76%	-18.19%
	Bloomberg Emerging Market Equity Index	USD			4.80%	-0.26%	5.04%
FIXED INCOME	Bloomberg Global Aggregate Index	USD			-1.48%	-2.84%	3.03%
	Bloomberg US Treasury Index	USD			-1.49%	-1.77%	2.63%
	Bloomberg US Corporate Bond Index	USD			-1.61%	-1.78%	6.46%
	Bloomberg UK Gilt Index	GBP			-1.24%	-3.56%	1.20%
	Bloomberg Sterling Corporate Bond Index	GBP			-0.61%	-1.68%	6.59%
	Bloomberg EM Hard Currency Aggregate Index	USD			0.21%	-0.36%	8.12%
	Bloomberg EM Local Currency Govt Index	USD			0.16%	-0.61%	4.95%
CURRENCIES	GBP Trade Weighted Index	GBP	£	74.47	-0.31%	1.11%	4.21%
	USD Trade Weighted Index	USD	$	90.02	1.32%	3.02%	0.57%
	EUR Trade Weighted Index	EUR	€	122.96	0.38%	-0.15%	0.45%
	JPY Trade Weighted Index	JPY	¥	85.61	-1.97%	-4.86%	-9.77%
COMMODITIES	Gold Spot $/Oz	USD	$	2,044.30	0.23%	-0.91%	11.90%
	LME Copper Spot ($)	USD	$	8,354.75	-1.10%	-1.29%	-6.66%
	Oil - Brent ($)	USD	$	83.62	2.34%	8.54%	-0.32%
	Bitcoin ($)	USD	$	61,193.72	42.03%	43.96%	159.75%

Source: Bloomberg L.P. 29/02/2024

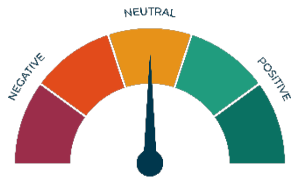
EQUITIES

As earnings season draw to a close, we note that corporate profit growth expectations for 2024 remains weak. The only exception is Japan and the US tech which continues to benefit from AI-driven capex growth. The disinflation narrative has abated, and seemingly equity markets are now driven by Nvidia…and not much else. We remain underweight equity markets due to the unattractive risk-reward outlook, specifically in US equities.



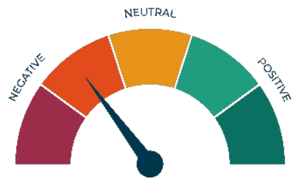
FIXED INCOME

Inflation data was marginally stronger than expected, and as the market pushed out over-optimistic rate hike expectations, the bonds market generally struggled alongside rising yields. Credit spreads were unchanged and remain very tight. Given the significant rise in interest rates and material refinancing risks, credit markets are not being priced accordingly and we remain underweight. We like the absolute yield on offer on shorter-dated government bonds, but also retain a healthy exposure to longer dated Gilts and Inflation linked exposures in the US.



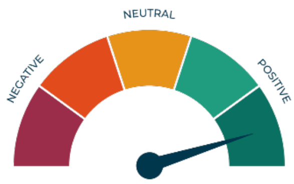
REAL ASSETS

WTI and Brent continues to trade in the 70's to 90's range, a level likely sustainable in the absence of escalations in the middle east or Ukraine. Natural Gas and copper remain weak; we believe an indication of slacking demand. Gold was flat on the month but continues to be the only commodity we are overweight. It remains well above the key $2000 mark and in a strong medium-term upward trend. Given that half the world will vote in national elections this year, we especially like the hedge it provides against monetary devaluation and event risk.



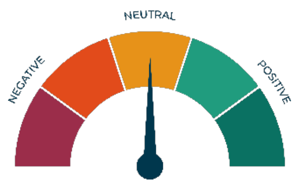
SPECIALIST STRATEGIES

Our specialist strategies continue to play a significant stabilising role within our portfolios. Our managed futures & trend following exposures had a difficult 2023 but a very strong February and we retain significant conviction in their role in our portfolios. As mentioned previously, we specifically retain conviction in the sustainability of the competitive advantage of the strategies we own, and the alignment of interest between the managers, and us and our clients. As for private markets exposure, we retain limited exposure to these, both credit and equity, given our concerns regarding debt and the refinancing cycle.



CURRENCIES

We remain broadly neutral on currencies. On the margin we note that changes in interest rate expectations would likely support a weaker USD. The US Dollar however remains the global reserve currency of choice, and in a severe market dislocation, we expect it to do well. We retain our positive view on the Japanese Yen, which we believe is undervalued with potential catalysts for a revaluation.



CONTACT US

For further information on any of our services, or if you would like to arrange a meeting with an investment manager to see how we can work with you, please get in touch.

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