



The benefits of Japanese reflation

February 10, 2025

Dear clients, dear partners,

After accounting for 40% of the market capitalization of the MSCI World in the 1980s, the Japanese market now represents just 5.3% - but still 14% for the MSCI World with equal weighting. Best known for its export champions, the Japanese stock market is now benefiting from a domestic reflation that is taking shape, as well as improved treatment of minority shareholders.

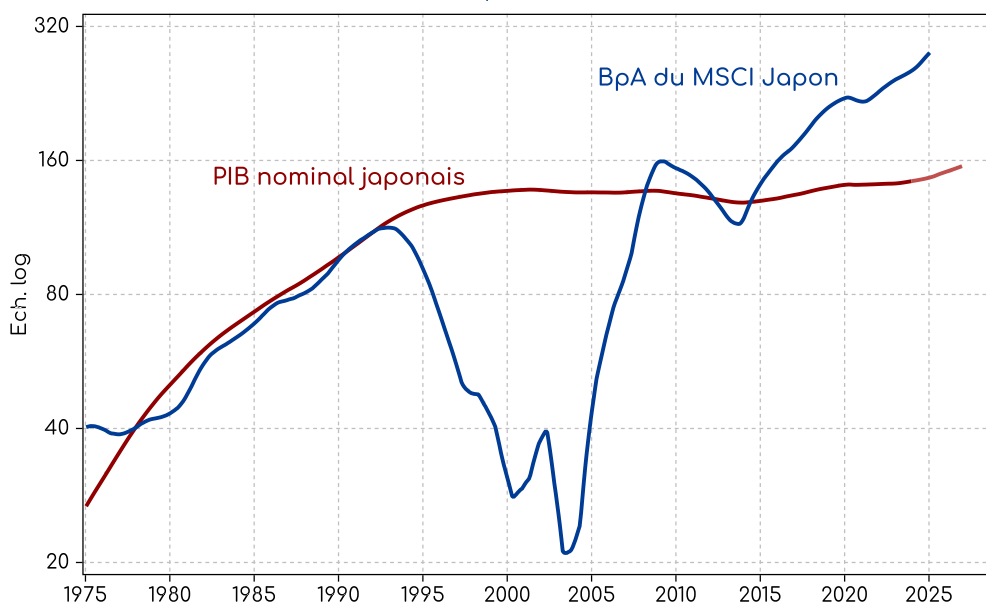
Virtually off the Titans' list - admittedly ultra-dominated by American stocks - the Japanese stock market nevertheless remains very deep, with over 200 companies whose capitalization exceeds 5 billion euros. Long weighed down by the country's very weak growth and domestic deflation, the aggregate profits of listed companies have finally rebounded since the 2000s, thanks to multinationals (Toyota, Sony, Fast Retailing, etc.). Their earnings growth trend is now well ahead of that of the Japanese economy (graph 1).

Thanks to exporters, MSCI Japan profits have clearly outperformed GDP over the past 20 years

Base 100 in 1990 - 10-year moving averages

Grâce aux exportateurs, les profits du MSCI Japon ont nettement surperformé le PIB depuis 20 ans

Base 100 en 1990 - Moyennes mobiles sur 10 ans



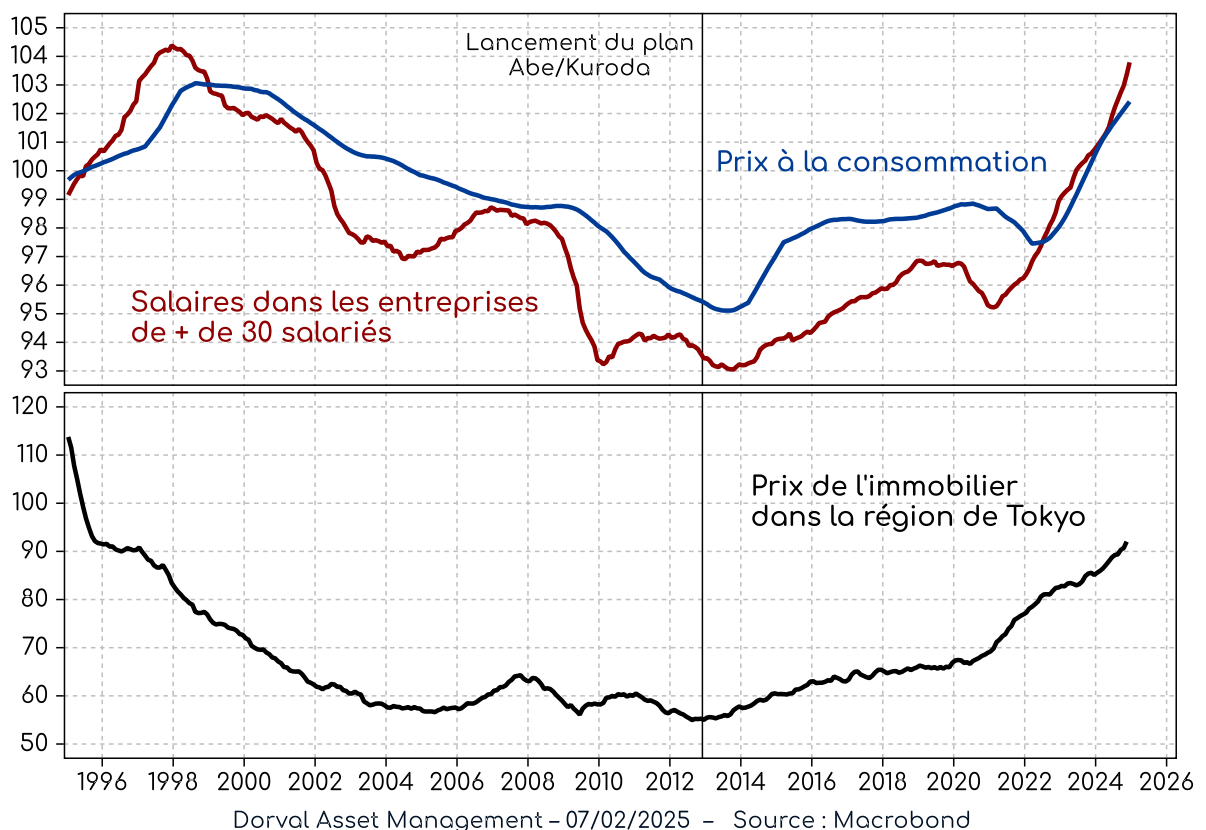
Dorval Asset Management - 07/02/2025 - Source : Macrobond

Japanese nominal GDP / MSCI Japan BpA

Domestic conditions remain important, however, with the Japanese market still accounting for half the sales of MSCI Japan companies. Despite Japanese demographics at half-mast, the reflationary shock decided on at the end of 2012 by Prime Minister Shinzo Abe and Bank of Japan President Haruhiko Kuroda has gradually turned the tide. The explosion of the BoJ's balance sheet, the maintenance of high public deficits and the sharp depreciation of the yen ended up, with the help of post-Covid inflation, producing a bullish momentum on consumer prices, wages and property prices (graph 2). Long a mercantilist, Japan has slowly but clearly changed its economic philosophy. The rise of tourism (especially Chinese tourism) is also contributing to this change in mentality, with tourism revenues reaching half of vehicle export revenues by 2024.

Japanese reflation becomes more convincing

La reflation japonaise se fait plus convaincante



Launch of the Abe/Kuroda plan / Consumer prices / Wages in companies with 30+ employees / Real estate prices in the Tokyo area

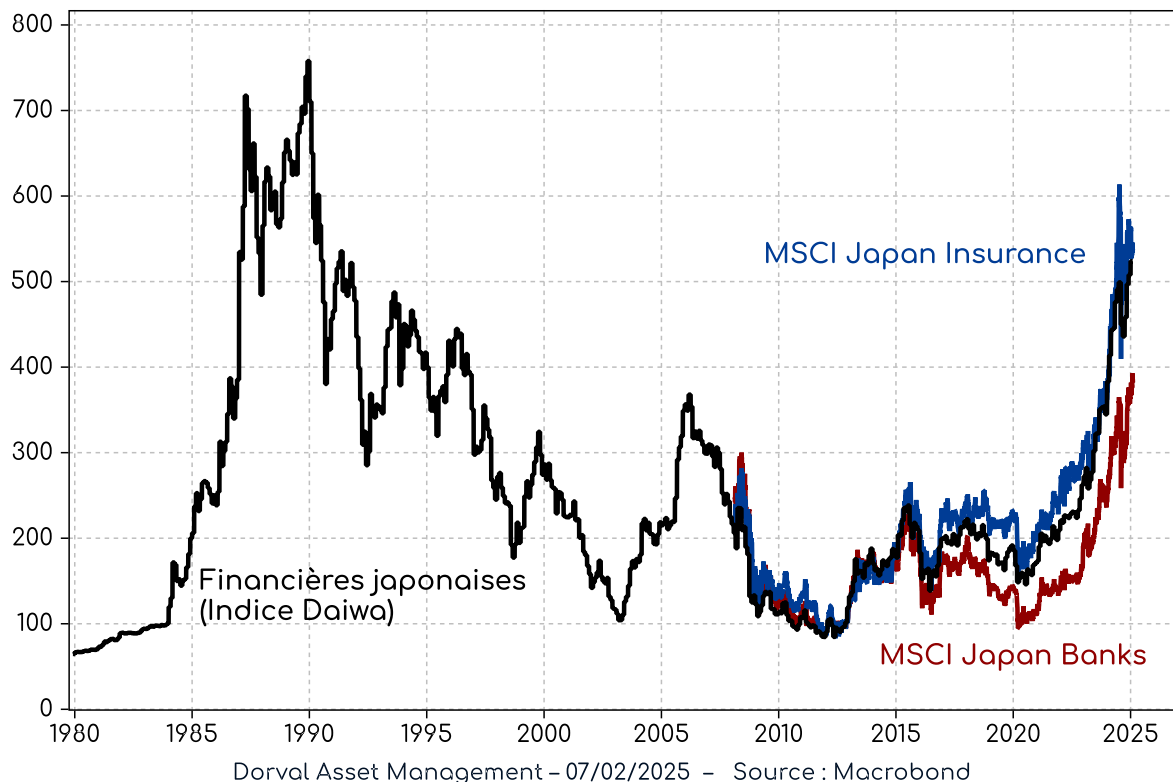
Since the beginning of last year, Japan has entered a crucial new phase, that of a cautious readjustment of its monetary policy, with a rise in short rates - from -0.1% to +0.5% - and stabilization of the BoJ's balance sheet at 125% of GDP. The consensus is for further rate hikes in the coming months, but rates will remain negative in real terms, with inflation hovering around 2%. Among the domestic stocks benefiting most from these developments, Japanese financials are leading the way (graph 3). They are benefiting from an improving economy, rising property prices and higher nominal interest rates. For this sector, the change is radical compared to the context of 1990-2012. Financials account for just over 15% of the MSCI Japan's capitalization.

Japanese financials, a new phoenix

Price excluding dividend - Base 100 in 2012

Financières japonaises, un nouveau phénix

Cours hors dividendes - Base 100 en 2012



Japanese financials

For investors, the benefits of Japanese reflation are becoming increasingly visible thanks to advances in corporate governance. Long criticized for ignoring the interests of minority shareholders, Japanese listed companies have slowly but clearly evolved since the first major governance laws of the late 2000s, and even more so since 2015. Many constraints remain, but the practice of cross-shareholdings, for example, has declined significantly, and the appointment of independent members to management committees has become more widespread. The legislative process has been further strengthened in 2021, bringing Corporate Japan closer to current practice in Europe and the United States. For shareholders, these developments have resulted in higher dividend payouts and more frequent share buybacks. Once again, the financials stand out, with very strong dividend growth (graph 4), and a dynamic share buyback policy. Japan's MSCI "Buyback yield" index, which overweights companies that buy back their shares, includes 32% financials, versus 15% for the classic index.

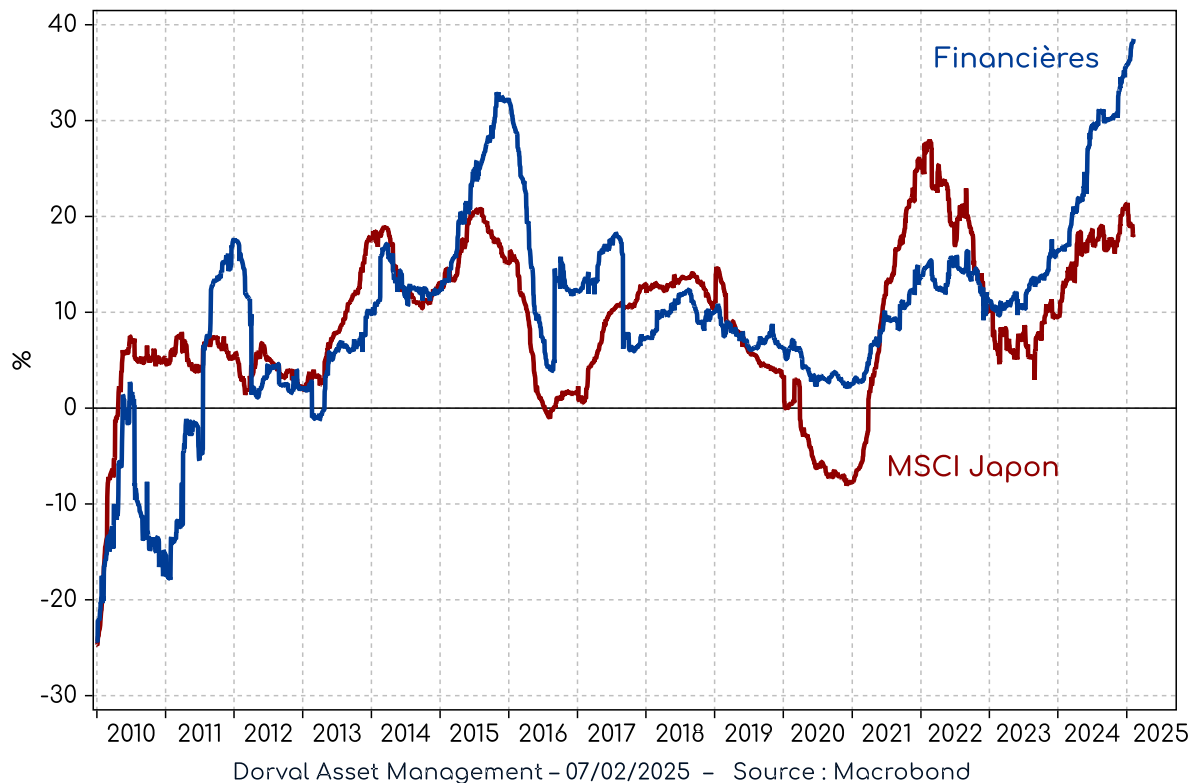


Better treatment for minority shareholders

Annual dividend growth (Bloomberg estimations)

Les actionnaires minoritaires mieux traités

Croissance annuelle des dividendes (estimations Bloomberg)



Financial / MSCI Japan

In our global portfolios, Japan features prominently, with 16% of the equity portfolio. In particular, Japanese financials account for a quarter of our financials theme basket. On the risk side, we are keeping an eye on the consistency of the interest-rate recalibration policy, which should remain gradual to minimize the risks of destabilization, whether on the currency market or for the economy.

Our exposure rates are as follows:

- Dorval Convictions: 65% net exposure to equities, including 60% Euro Stoxx 50 SRI core basket, 6.5% financials basket, 4% small-cap basket. Euro Stoxx 50 futures and options hedging.



Dorval Asset Management

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Paris Trade and Companies Register No. B 391392768 - APE 6630 Z - AMF
accreditation no. GP 93-08

111, boulevard Pereire, 75017 Paris – Tel.: +33 1 44 69 90 44 – F: +33 1 42 94 18 37

www.dorval-am.com

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