

Strategy Bulletin Vol.190

Japan's return from wonderland – 2018 (Summary)

In October 2017, the Nikkei Average rose for 16 straight days, which is widely regarded as the longest-ever consecutive stock market upturn. Moreover, this index has returned to the halfway point of the drop following the bursting of Japan's asset bubble in the early 1990s. Technical indicators show that Japan's stock market has probably advanced to a new dimension. But do the fundamentals justify this view?

Musha Research believes that this stock market rally signifies that Japan's return from "wonderland" has started. For more than 10 years, money in Japan has been flowing from downstream to upstream. But even as money continued to flow uphill, everyone regarded this as a normal situation. Japan was truly a wonderland. As a result, what should have been a fertile and well irrigated region instead became a desolate wasteland. At the same time, this reverse flow produced an increasing volume of unused water behind the upstream dam. People downstream have grown weary of living in a land that produces no crops. They have become convinced that their homeland is a barren place with no hope for a brighter future. These people have 70% of their financial assets sleeping in deposits that produce no interest income. Moreover, people have been taking their money out of stocks year after year even though stock dividend yields were 2% and earning yields were 7%.

But now the return from this financial wonderland is finally starting. The emerging benefits of Abenomics have created a crack in the dam that is allowing the massive volume of stored water to rush downstream. This flow is at last beginning to return Japan to financial normalcy with ample downstream capital. These events will probably trigger an enormous shift of capital that brings Japan back to a normal distribution of savings similar to the U.S.: 70% in stocks and mutual funds and 20% in bank deposits. A shift of this magnitude is likely to dramatically alter supply-demand dynamics for stocks.

Everything is in place to justify this return to normalcy. Earnings at Japanese companies have never been stronger. Companies have established business models that are completely in step with the new global business climate (in terms of geopolitical events, new technologies and the new industrial revolution, and globalization). Furthermore, economies are healthy worldwide and global stock prices, already at record highs, are gaining momentum because of China's high-tech investment boom. As Asia's middle class grows, increasing numbers of these consumers are going to Japan to buy high-quality Japanese products. Also, as Japan's population ages and the number of children declines, indications of a severe labor shortage are beginning to appear. Constant deflation and pervasive, deep-rooted pessimism that characterized Japan's wonderland are both coming to an end. At this point, there is virtually no doubt that the Nikkei Average is poised to climb to an all-time high just as has already happened in many other countries. Japan is on the verge of a momentous change of direction in 2018 that has the potential of propelling the Nikkei Average to around ¥30,000, the lower end of its fair value range of ¥30,000 to ¥40,000.

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