



Japanese Stocks Are Soaring – Want In?

Description

There have been few worse jobs in the investment industry over the past 20 years or so than being the manager of a Japanese mutual fund. Since 1990, the Nikkei 225 has declined by more than 70% as the country's once dominate economy has crumbled. However, over the last three months, Japanese stocks have been all the rage, putting in a return in excess of 30% and handily beating the Canadian and American markets and their single digit returns during this period. Is it finally time to consider a position in Japan for your investment account?

One of the things that is attractive about the Japanese market is that it's cheap. The Nikkei 225 trades at a price/book multiple of 1.1 which compares favourably to the S&P/TSX Composite multiple of 1.9 and the S&P 500 multiple of 2.3. 70% of all Japanese stocks trade below book value compared to 12% on the S&P/TSX Composite. Very cheap!

In addition, some of the industry's heavy hitters are indicating an interest in Japan. In his most recent quarterly, Jeremy Grantham, the "G" in big time institutional money management firm GMO and somebody that is more often right than wrong, indicated that in a world where almost all global assets are once again becoming expensive courtesy of U.S. Fed policy, Japan is a market that is only moderately overpriced.

The spark

Japanese stocks began to run when the Liberal Democratic Party (LDP) won the December election. Since, the value of the Yen has declined significantly on expectations of continued monetary easing measures from the Bank of Japan. A move endorsed by the LDP, which is bent on improving the country's economy (and equity market) through monetary measures.

Felix Zulauf, a Swiss based hedge fund manager and member of the Barron's Roundtable, suggests that further monetary easing could continue to push the Yen lower and drive Japan's inflation rate from below 0% to the 2% level. Stocks in general like inflation and export driven corporations (cars, electronics) like a weak Yen.

Short term monetary moves aside, Japan remains a fiscal disaster. John Mauldin, an

economist/strategist/all around interesting guy, has for many years described the Japanese economy as “a bug in search of a windshield”. The country carries a debt to GDP ratio of 230% (U.S. slightly more than 100%) and a budget deficit that is 8% of GDP (U.S. 6.7%). Plus, Japan has one of the worst demographic profiles in the world, a dynamic that will make reducing this massive debt almost impossible. As indicated however, underneath these bigger picture issues is a very cheap stock market and a government motivated to drive it higher.

What's a Canadian to do?

If these characteristics are of interest, one way for us Canadians to play is through the Canadian \$ hedged **iShares Japan Fundamental Index Fund (TSX:CJP)**. The currency hedge is important as part of the Japanese government's game is knocking down the value of the Yen. Without the hedge, this currency devaluation would have a negative impact on your total return.

This is a similar suggestion to the one that Zulauf recently made to the Barron's Roundtable. One of his picks for U.S. investors was the **Wisdom Tree Japan Hedged Equity Fund (NYSEMKT:DXJ)**. Incidentally, the Wisdom Tree Japanese ETF is #2 YTD for its inflows of \$2.1 billion....that's for a \$3.5 billion fund. Huge!

The Foolish Bottom Line

In our long-term focused work, occasionally, a shorter-term opportunity will develop that offers a reasonable risk/return relationship. This situation potentially exists with the Japanese market. If the Yen continues to fall relative to other global currencies, given its valuation, the Japanese stock market is likely to continue its rally. Governments can have an amazing influence over stock prices in the short-term (look at the U.S.) and it is far better to get in when their tricks are just beginning. Proceed with caution, but in my opinion, there is still room for the Japanese market to run.

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Fool contributor Iain Butler owns shares in the iShares Japan Fundamental Index Fund. The Motley Fool has no positions in the stocks mentioned above.

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