

Japan Equity

EQUITIES - JAPAN	1 Mth	3 Mth	YTD	12 Mth
MSCI Japan	1.7	-4.5	-15.3	-15.3
Nikkei 225	2.1	-3.1	-11.8	-11.8
Topix	1.9	-4.5	-13.5	-13.5
Jasdaq	5.1	-1.4	-1.8	-1.8

Returns in Singapore dollars. Source: Bloomberg, 31 December 2011

In December, TOPIX ended flat at 728.61 versus a month ago. US economic indicators showed some positive signs but risk aversion remained elevated due to intensification of the Euro zone debt crisis. In Japan, the Diet approved the third supplementary budget, and the DPJ is now enacting a fourth supplementary budget. The latest development, while positive, was widely expected, and hence did not lift the market.

The five best performing sectors included Maritime Transport, Pharmaceutical, Warehouse & Harbour Transport, Land Transport, and Fishery, Agriculture & Forestry. The worst performers were Air Transport, Real Estate, and Insurance.

Outlook and Strategy

	Policy	Change	Comment
Financials	Neutral	-	Post-earthquake re-construction could help bring forward loans growth. Office real estate sector outlook is dampened as the earthquake may delay the recovery in office rentals, although negatives are largely discounted.
Consumer	Neutral	-	Overweight consumer staples at the expense of consumer discretionary. Like selective opportunities within the retail space, e.g. niche players with room to gain share within the domestic market, and those with growing overseas exposure.
Technology	Neutral	-	Excess inventory overbuild is weighing on demand. Like tablet PC, ultra-book and smart-phone plays for the medium term.

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Energy	Neutral	–	Geopolitical risks in the Middle East could result in higher prices in the near term.
Industrials	Neutral	–	Selective exposure to companies which are beneficiaries of re-construction, and the trend towards automation.
Pharmaceuticals	Underweight	–	Like generic companies because of the Japanese government's push for more affordable drugs. Pipeline risks and upcoming NHI price revisions in 2012 make the sector unattractive as a whole.
Materials	Neutral	–	Electric arc furnace companies could benefit from post-earthquake re-construction. Also like selected specialty chemicals and electronic materials stocks.
Info Communications	Neutral	–	Anaemic top-line growth makes the sector relatively unattractive, but valuations and dividends provide downside support.
Utilities	Underweight	–	Regulatory risks in the new term post-nuclear crisis. Unexciting medium-term prospects; and fair valuations. Prefer gas companies to electric power companies.

While the Japan market appears undervalued, the risk of further global financial instability has not subsided. We continue believe any sustained rebound would require a bottoming out of both economic and earnings indicators, as well as credible measures to address the Euro zone debt crisis, and further monetary loosening policies in China and the rest of Asia.

In view of the highly uncertain macro outlook, we would maintain our defensive stance for now. We would adopt a bottom-up stock-picking approach, favouring quality companies with structural drivers, and high dividend yield stocks. We are overweight Consumer Staples, neutral Industrials, Materials, Technology, Financials, Energy, and underweight Utilities, Pharmaceuticals, and Consumer Discretionary.

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