

Japan Equity

EQUITIES - JAPAN	1 Mth	3 Mth	YTD	12 Mth
MSCI Japan	-10.9	-7.2	-7.2	-10.4
Nikkei 225	-10.1	-8.0	-8.0	-10.6
Topix	-10.5	-6.7	-6.7	-9.7
Jasdaq	-8.6	-5.4	-5.4	-2.0

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

TOPIX fell 8.61% to 869.38 in March. The Japan equity market started the month on a fairly strong note due to expectations of a rebound in the US economy. However, political instability in the Middle East and rising crude oil prices weighed on the market. Stocks plunged sharply after the earthquake struck the north-eastern part of Japan on the 11 March. TOPIX fell to a low of 766.73 on 15 March, but rebounded when the Japan government and the G7 jointly intervened to weaken the Yen. The market stayed broadly flat throughout the latter part of the month due to uncertainties over the outlook of manufacturing activity caused by damage to production facilities, power shortage, and radiation leaks at the Dai-Ichi Nuclear Power Plant in Fukushima.

The five best performing sectors included Mining, Metal Products, Construction, Rubber Products, and Machinery. The worst performers were Electric Power & Gas, Real Estate, Air Transportation, Securities & Commodities Futures, and Other Financing Business.

OUTLOOK AND STRATEGY

	Policy	Change	Comment
Financials	Neutral	↓	Raised weighting banks. Post-earthquake reconstruction could help bring forward loans growth. Office real estate sector outlook is however dampened as the earthquake may delay the recovery in office rentals.
Consumer	Underweight	↓	Raised weighting for consumer staples at the expense of auto and retail. Production disruptions are likely to weigh heavily on auto makers' earnings. Protracted weakness in consumption is also negative for retailers.
Technology	Underweight	↓	Production disruptions are likely to hurt earnings. Prefer tablet PC and smart-phone plays for the medium term.
Energy	Neutral	–	Valuations are undemanding, and prospect of stronger oil price in the near term bodes well for the sector.

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Industrials	Overweight	–	Particularly upbeat on companies which are beneficiaries of re-construction, and higher commodity prices.
Pharmaceuticals	Neutral	–	Like generic companies because of the Japanese government's push for more affordable drugs.
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	–	Unexciting medium-term prospects, and fair valuations. Prefer gas companies to electric power companies.

The devastating earthquake is expected to have negative impact on Japan's economy and corporate earnings in 2011. Consumption, production, and capital expenditure will likely be subject to downward pressure due to large-scale power outages, and supply chain disruptions. An added risk is the knock-on effects from the partial-meltdown at the Dai-Ichi Nuclear Power Plant in Fukushima. Japan may enter a technical recession in 1HFY11. Corporate earnings will be subject to sharp downward revision. However, the economy should steadily recover in 2HFY11 as activity levels normalize, and reconstruction demand kicks in from the third or fourth quarter onwards.

At the current TOPIX level, PBR stands at just 1.0x (over one standard deviation below the historical mean). This suggests that the market has already priced in a significant amount of bad news.

Following the earthquake, we made changes to our Japan model portfolio sector weightings to reflect our more defensive stance. We reduced Consumer Discretionary and Technology to underweight, cut Materials to neutral, and raised Financials and Consumer Staples to neutral and overweight respectively. We have also further increased our overweight in Industrials to reflect our positive view in areas such as construction machinery and commodities trading.

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