April 2021

Market Commentary

Japanese equities continued to rise in March, as approval of the US fiscal stimulus package and progress of Covid-19 vaccinations induced investor optimism about economic recovery.

The Japanese yen weakened against the US dollar following a rise in interest rate differential between the two currencies.

With the lifting of the state of emergency in Tokyo and its surrounding prefectures, the domestic economy's outlook is improving.

This was reflected in Japan's business survey index, with large companies' businesses conditions for the April-June quarter in the positive territory at plus 2.5. There are, however, resurgences in infections, leading to a stop-start progress in the full resumption of economic activity across the country. The government lifted the state of emergency in Tokyo and its surrounding prefectures on 21 March amidst reduced hospital occupancy for Covid-19 patients, after it was earlier lifted in seven other prefectures in February. It now plans to begin vaccinations for the elderly citizens from mid-April in certain municipalities, after a delay due to domestic clinical trials and a cautious approval process.

The Bank of Japan introduced slightly more flexibility to its policy to allow for sustainability of its asset purchase programme.

Long-term interest rates are now allowed to move in a range of +/- 0.25% as opposed to 0.2%. The central bank also announced abolishing its 6 trillion yen annual target for purchasing exchange-traded funds, and its intention to purchase TOPIX-linked ETFs only going forward. The latter announcement was followed by a weakness in the Nikkei 225 index, but it is worth noting that Bank of Japan's purchase of Nikkei-linked ETFs had already been relatively small.

The reversal of winners and losers from the pandemic continued in the month of March, but to a lesser extent compared to the previous two months.

The recent beneficiaries of rising inflationary expectations, amid a broader resumption of economic activity, continued to outperform. But companies that have seen a pullback in valuations have also continued to post favorable earnings and newsflow. These include a machinery components provider , which upgraded its full-year forecasts on the back of revenue growth in China and efficiency gains from IT, automation and selective investments.

In healthcare, one company started clinical trials for its newly-developed Covid-19 vaccine, the first messenger RNA vaccine developed by a Japanese company. It was also encouraging to see our holdings continuing to make investments for the future, such as a surgical equipment maker , which consolidated a company that develops low-cost surgery support robots.

The Japan FSA's draft version of revisions to the Corporate Governance Code was a disappointment; investors however are pushing back against weak governance.

The proposed revisions to Japan's Corporate Governance Code, released during the month, suggested that independent directors make up a third of a corporate's board of directors – and that this would apply only for the so-called blue chips of the Japanese market. This was a poor outcome: we recognize that majority independent boards are not foolproof against egregious corporate behavior, but Japan is a market with a still-sizeable amount of cross shareholdings. In addition, a notable number of corporate subsidiaries are listed on the market, for which transactions have oftentimes gone against minority shareholders. Japan is not alone in having cases of weak governance, but shareholders' actions to hold corporates accountable have been lacking. To mitigate such governance risks, we have always advocated for active ownership, proxy voting and firm engagement with corporates, alongside investing in well-run companies with good governance.

Governance aside, our discussions with corporates often address broader risks and are consultative in approach, with encouragement to embrace best practice.

Examples during the month include the continuation of a dialogue with a baby products company to improve disclosure, including its initiatives and targets in carbon emissions and sustainable sourcing, where the company has made good progress but has yet to be widely recognized by the public owing to sparse disclosure. We are also working with a hair products manufacturer to disclose its stringent processes for selection of raw material, which we believe can be an excellent selling point for its products. The proposed revisions to Japan's Corporate Governance Code suggest that companies will be encouraged to disclose business risk related to future climate change.

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For information on Japanese equities:
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