

Japan Equity Strategy

Is this Round Two of Japan's equity rally?

Investment Strategy

Japan equities reignited; déjà vu of Apr-Jun 2023

Reminiscent of the large run-up in stocks that we saw in Apr-Jun 2023, Japan equities reignited after the New Year – we wonder if this is Round Two of Japan's equity rally. We see many similarities too with last year's rally. One factor that sparked last year's rally was the highest *Shunto* wage hike in 30 years. With one large company after another announcing large wage increases over the last few weeks, this year's *Shunto* looks increasingly likely to be even higher. Meanwhile, cost-push inflation has been weakening, and if real wages start rising it will likely have a substantial market impact.

Optimal FX combination providing tailwinds

The Apr-Jun 2023 rally was underpinned by a weakening of the yen in response to the new BoJ Governor Ueda, who took over in April, turning out more dovish than expected. The liquidity supplied to the market following the failure of Silicon Valley Bank in March last year also fueled a weakening of both the yen and the dollar. The simultaneous weakening of the yen and the dollar created an optimal combination for Japan equities, fueling an inflow of overseas investor funds into Japan equities that pushed the market higher, led by blue chips. This time around, the dollar has been weakening in anticipation of Fed rate cuts. Although it has strengthened somewhat recently, the yen has weakened further on the market's view that BoJ's exit from NIRP will be delayed.

Market valuation not yet stretched

However, valuations are not as cheap as they were in Apr-Jun last year. With the median P/E now at 14x and the earnings forecast revision index slightly positive, the stock indices clearly do not have as much upside room as they did last Apr-Jun. A further rise would not be surprising, however, as the P/E multiples are not that expensive. A rise in the median P/E multiple to last year's peak of 14.5x would put TOPIX within reach of 2,550.

Stock selection: Quality cyclical screen

In anticipation of an inflow of funds from overseas investors, Exhibit 4 lists the large-cap quality cyclical names with ROE (FY2) above 8%, financial leverage below 3, beta above 1, and relatively resilient FY2 earnings.

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Investment Strategy
Japan

Masashi Akutsu >>
Strategist
BofAS Japan
+81 3 6225 7754
masashi.akutsu@bofa.com

Tony Lin, CFA >>
Equity Strategist
BofAS Japan
+81 3 6225 8123
tony.y.lin@bofa.com

Tetsuhiro Tokuyama
Strategist
BofAS Japan
+81 3 6225 8499
tetsuhiro.tokuyama@bofa.com

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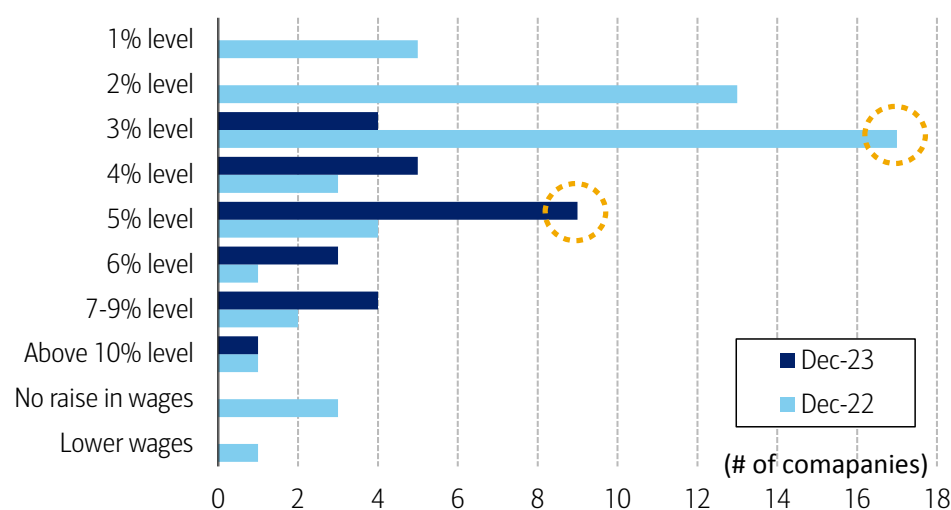
Japan equities reignite rally similar to that of Apr-Jun 2023

Japan stocks reignited in early Jan and posted a 33-year high. This rally is reminiscent of the large run-up in stocks we saw in Apr-Jun 2023. We wonder if this is Round 2 of Japan's equity rally.

The similarities with the Apr-Jun 2023 rally are numerous. One factor that sparked the rally was the highest Shunto wage hike in 30 years. This time around, one large company after another has announced large wage increases over the past few weeks. For example, in the Nikkei Shimbun's survey of 100 corporate presidents, the Shunto wage increase forecast chosen by the highest number of respondents was 5%, well above the last year's 3% forecast (Exhibit 1). The Shunto wage increase wound up at 3.6% in 2023 and is likely to surpass that this year (our economist forecasts a base salary increase of 2.5-3.0%; see our 10 Jan [Japan Watch](#)). Meanwhile, cost-push inflation has been weakening. A rise in real wages would probably have a significant market impact.

Exhibit 1: "Survey of 100 corporate presidents": expectations of Spring wage negotiation rate

"5%" answers most concentrated in Dec-23, surpassing "3%" in Dec-22



Source: BofA Global Research, Nikkeishimbun

Note: Survey period from Dec 7- 21, 2023.

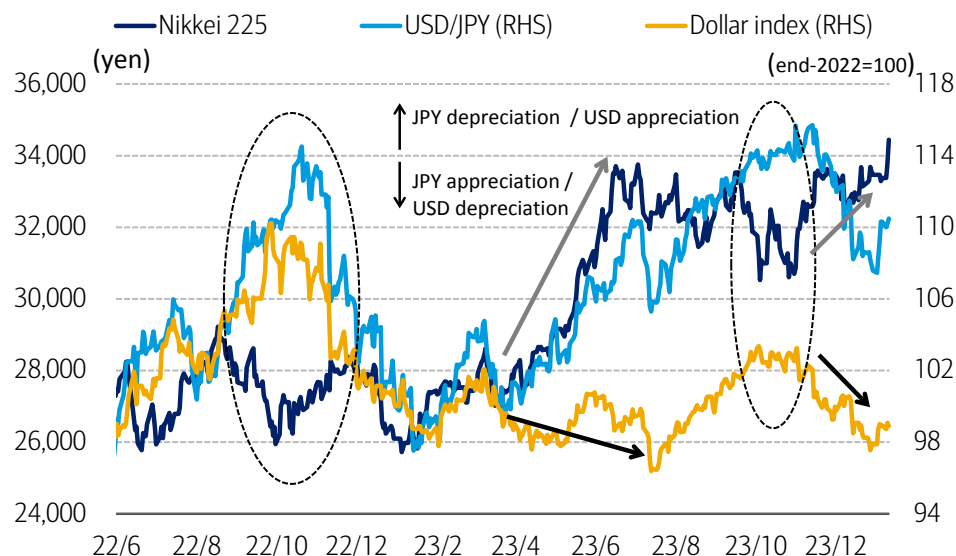
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The Apr-Jun 2023 rally was underpinned by a weakening of the yen in response to the new BoJ Governor Ueda, who took over in April, turning out more dovish than expected. The liquidity supplied to the market following the failure of Silicon Valley Bank in March last year also fueled a weakening of both the yen and the dollar. The simultaneous weakening of the yen and the dollar is an optimal combination for Japan equities (a weaker dollar has a stimulating impact on the global economy), and the inflow of overseas investor funds into Japan's stock market pushed share prices higher, led by the blue chips.

This time, as well, the dollar has weakened significantly in anticipation of Fed rate cuts. Although it has strengthened somewhat recently, the yen has weakened further on the market's view that BoJ's exit from NIRP will be pushed back (Exhibit 2). As we have highlighted, a FX combination of a weaker dollar and a mildly stronger yen would not be necessarily negative to Japan equities (see our 15 Dec [Japan Equity Strategy](#) note). Conversely, in recent years, Japan stocks have tended not to rise when the yen is weakening against cross-currencies, but the dollar is strong against the other currencies. As of the writing of this report, the US CPI scheduled for release on 11 Jan was not yet out. Be aware that the scenario could change depending on the CPI data.

Exhibit 2: Nikkei 225, USD/JPY and Dollar index

"JPY depreciation and USD depreciation" is the best FX combination for Japan equities, similar to Apr-Jun 2023



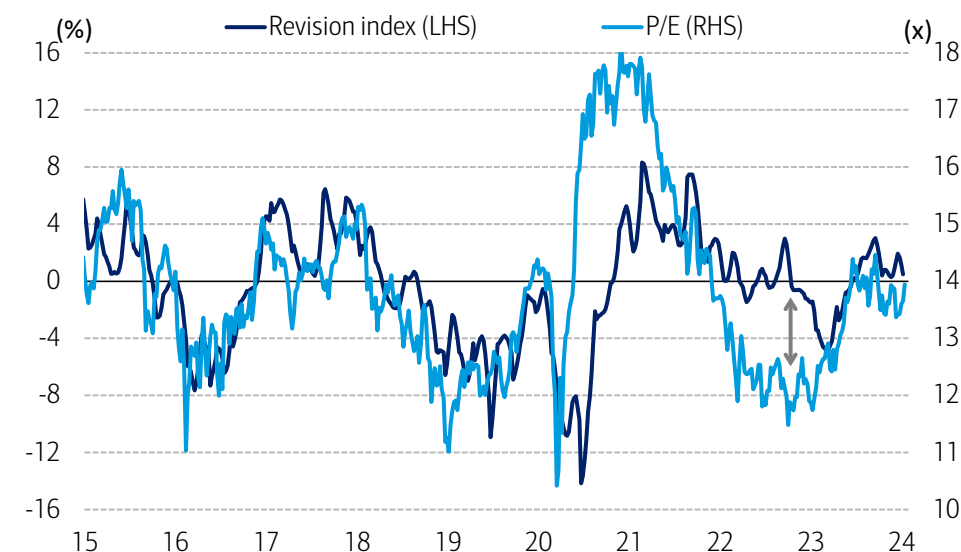
Source: BofA Global Research, Bloomberg, BoJ

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However, valuations are not as cheap as they were in Apr-Jun last year. When P/E multiples dropped to 12x, the bottom of their range, early in 2023, the revision index improved dramatically, leaving room for a substantial increase in the indices (Exhibit 3). With the median P/E currently at 14x and the earnings forecast revision index slightly positive, the stock indices clearly do not have as much upside as they did last Apr-Jun. A further rise would not be surprising, however, given the P/E multiples are not that expensive. If the median P/E multiple were to rise to last year's peak of 14.5x, it would put TOPIX within reach of 2,550 (using a N/T ratio of 14.2x would mean a Nikkei 225 of 36,000).

Exhibit 3: TOPIX revision index and 12-month forward P/E

Current market P/E trades around median range (14x)



Source: BofA Global Research, Refinitiv

Note: Based on I/B/E/S 12-month forward EPS estimate, 4 week MA for revision index.

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Furthermore, the global economy is more likely to recover in FY24, when the effects from central bank rate cuts start to materialize. The 12-month forward EPS, a blend of FY23 and FY24 forecasts, is therefore likely to rise as end-2024 draws near. Provided that the macro scenario for FY24 does not change, we expect the market's upside to increase between now and end-2024.

Additionally, (1) an inflow of individual investor funds sparked by the new NISA limits; and (2) the TSE's publishing on 15 Jan of its list of companies complying with its disclosure request (and monthly updates of the list after that) should also be positive catalysts for Japan equities.

In preparation for an inflow of funds from overseas investors, Exhibit 4 lists the quality large caps with ROE (FY2) above 8%, financial leverage below 3, beta above 1, and relatively resilient FY2 earnings. Meanwhile, with the Fed not having yet decided when it will start cutting rates, the style rotation between value and growth is unlikely to be stable. We believe it makes sense to hold those value stocks that are positioned to reform their business portfolios and shareholder payouts and/or offer high dividend yields (see our 10 Jan [2024 market trajectory and Jan-Mar stock selection](#) report for a list of stocks with high dividend yields).

Exhibit 4: Quality cyclical names in Japan

Large caps with ROE (FY2) above 8%, financial leverage below 3, beta above 1, and relatively resilient FY2 earnings

TSE	Name	Sector	MKT CAP (tn JPY)	RP growth (FY2, %)	RP revision (FY2, vs. 3 months prior, %)	ROE (FY2, %)	Beta (6m)	Financial leverage (x)	P/E (FY2, x)	Relative return since 2023 (% vs TOPIX)
7203	TOYOTA MOTOR CORP	Transportation Equipment	44.0	0.2	15.6	12.8	1.5	2.6	10.4	25.7
8035	TOKYO ELECTRON LTD	Electric Appliances	11.7	26.7	-0.3	22.8	1.4	1.5	29.2	69.5
4063	SHIN-ETSU CHEMICAL CO LTD	Chemicals	11.2	9.5	1.2	14.5	1.0	1.2	18.0	41.0
8001	ITOCHU CORP	Wholesale Trade	9.7	2.8	0.0	15.1	1.4	2.7	11.4	22.8
6501	HITACHI LTD	Electric Appliances	9.3	9.0	6.0	11.4	1.2	2.5	15.3	33.8
4519	CHUGAI PHARMACEUTICAL CO LTD	Pharmaceutical	9.0	5.0	3.5	19.4	1.0	1.3	26.6	42.1
7267	PANONDA MOTOR CO LTD	Transportation Equipment	8.3	4.7	1.5	8.9	1.5	2.2	7.8	24.3
6902	DENSO CORP	Transportation Equipment	6.7	11.6	3.2	11.2	1.5	1.7	12.3	9.7
6981	MURATA MANUFACTURING CO LTD	Electric Appliances	5.9	18.4	2.1	10.3	1.2	1.2	22.6	4.1
6273	SMC CORP	Machinery	5.1	11.0	-2.9	10.9	1.3	1.1	25.5	16.2
6503	MITSUBISHI ELECTRIC CORP	Electric Appliances	4.3	9.5	0.5	8.3	1.2	1.7	15.2	30.5
8002	MARUBENI CORP	Wholesale Trade	3.9	0.7	1.4	13.7	1.5	2.8	8.4	27.8
4543	TERUMO CORP	Precision Instruments	3.5	15.0	2.3	10.2	1.1	1.4	29.0	2.5
4901	FUJIFILM HOLDINGS CORP	Chemicals	3.5	9.6	0.1	8.4	1.0	1.5	14.1	3.8
6752	PANASONIC HOLDINGS CORP	Electric Appliances	3.5	13.2	0.7	9.4	1.2	2.2	8.9	1.1
6594	NIDEC CORP	Electric Appliances	3.3	7.3	-0.1	11.9	1.1	2.1	17.2	-45.9
5401	NIPPON STEEL CORP	Iron & Steel	3.2	9.6	3.1	9.8	1.1	2.3	6.7	16.3
7269	SUZUKI MOTOR CORP	Transportation Equipment	3.0	10.0	10.5	13.1	1.1	2.2	10.1	17.6
2802	AJINOMOTO CO INC	Foods	2.9	11.3	-2.3	13.7	1.1	2.0	25.5	13.3
6762	TDK CORP	Electric Appliances	2.6	27.9	3.6	9.8	1.4	2.2	17.2	27.5
4307	NOMURA RESEARCH INSTITUTE LT	Information & Communication	2.4	10.7	-0.1	21.0	1.1	2.1	26.5	10.2
6701	NEC CORP	Electric Appliances	2.3	17.5	0.8	8.3	1.2	2.5	16.1	56.9
7270	SUBARU CORP	Transportation Equipment	1.8	1.9	23.6	13.8	1.5	1.9	5.4	11.6
7832	BANDAI NAMCO HOLDINGS INC	Other Products	1.8	7.0	-0.0	14.9	1.0	1.4	17.2	-23.2
4091	NIPPON SANSO HOLDINGS CORP	Chemicals	1.6	1.2	6.6	11.6	1.2	3.0	16.6	72.9
2413	M3 INC	Services	1.6	14.4	-0.6	16.8	1.2	1.3	26.6	-64.2
7202	ISUZU MOTORS LTD	Transportation Equipment	1.5	5.4	0.5	12.9	1.3	2.3	8.1	-4.5
7259	AISIN CORP	Transportation Equipment	1.4	10.8	6.5	8.9	1.4	2.4	8.7	20.8
6988	NITTO DENKO CORP	Chemicals	1.4	10.0	-1.0	11.3	1.1	1.3	12.7	14.2
5411	JFE HOLDINGS INC	Iron & Steel	1.3	7.2	-1.3	8.8	1.2	2.6	6.3	19.7
9697	CAPCOM CO LTD	Information & Communication	1.2	11.6	-2.4	23.1	1.1	1.3	25.8	-4.7
1812	KAJIMA CORP	Construction	1.2	8.7	-0.0	11.1	1.1	2.6	10.1	32.9
7735	SCREEN HOLDINGS CO LTD	Electric Appliances	1.2	2.8	9.0	17.7	1.2	1.9	18.6	152.9
9766	KONAMI GROUP CORP	Information & Communication	1.1	7.2	-0.1	13.3	1.2	1.5	18.3	8.0
7261	MAZDA MOTOR CORP	Transportation Equipment	1.0	2.6	24.2	12.4	1.6	2.3	4.7	40.8
6504	FUJI ELECTRIC CO LTD	Electric Appliances	0.9	9.0	1.5	12.3	1.4	2.3	12.1	-6.9
4183	MITSUI CHEMICALS INC	Chemicals	0.9	35.0	-0.8	11.1	1.1	2.6	9.2	17.6
7936	ASICS CORP	Other Products	0.8	16.4	5.8	19.5	1.5	2.5	22.1	19.1
1911	SUMITOMO FORESTRY CO LTD	Construction	0.8	9.7	1.7	13.3	1.1	2.5	7.9	56.0
6361	EBARA CORP	Machinery	0.8	7.9	3.3	13.7	1.3	2.3	13.2	54.5
5334	NITERRA CO LTD	Glass & Ceramics Products	0.7	0.8	6.1	13.4	1.0	1.6	9.0	20.2
6532	BAYCURRENT CONSULTING INC	Services	0.7	27.4	-0.6	38.4	1.3	1.3	21.6	-16.6
4527	ROHTO PHARMACEUTICAL CO LTD	Pharmaceutical	0.7	11.8	2.2	14.4	1.2	1.5	19.4	3.1
6845	AZBIL CORP	Electric Appliances	0.7	0.7	1.8	11.9	1.1	1.5	25.3	20.1
5101	YOKOHAMA RUBBER CO LTD	Rubber Products	0.5	13.0	5.2	10.2	1.2	1.9	7.5	35.5
2181	PERSOL HOLDINGS CO LTD	Services	0.5	17.9	0.4	20.6	1.0	2.4	13.7	-44.6
6113	AMADA CO LTD	Machinery	0.5	1.9	6.9	8.1	1.3	1.3	12.9	21.1
8111	GOLDWIN INC	Textiles & Apparel	0.5	8.7	2.8	24.3	1.1	1.5	20.6	-24.3
5929	SANWA HOLDINGS CORP	Metal Products	0.5	0.1	8.5	14.8	1.1	1.8	12.3	51.5
3116	TOYOTA BOSHOKU CORP	Transportation Equipment	0.4	5.3	6.0	13.3	1.4	2.5	7.0	7.0
4202	DAICEL CORP	Chemicals	0.4	4.5	3.8	15.0	1.2	2.6	7.8	23.4
5105	TOYO TIRE CORP	Rubber Products	0.4	1.8	12.1	14.1	1.1	1.9	7.0	33.2
7729	TOKYO SEIMITSU CO LTD	Precision Instruments	0.4	20.0	0.5	14.0	1.2	1.4	17.0	78.9
6028	TECHNOPRO HOLDINGS INC	Services	0.4	14.6	1.2	23.0	1.0	1.9	18.7	-28.0
7988	NIFCO INC	Chemicals	0.3	1.0	0.8	12.1	1.4	1.6	11.7	-4.8
5344	MARUWA CO LTD	Glass & Ceramics Products	0.3	14.3	3.5	15.5	1.1	1.1	19.5	53.0
7282	TOYODA GOSEI CO LTD	Transportation Equipment	0.3	9.0	5.8	9.2	1.5	1.9	7.7	6.5
5233	TAIHEIYO CEMENT CORP	Glass & Ceramics Products	0.3	22.2	9.2	1.0	2.6	6.5	6.5	13.8
6951	JEOL LTD	Electric Appliances	0.3	10.4	17.2	1.3	2.0	14.9	14.9	41.4

Source: BofA Global Research, QUICK

Note: Universe consists of TOPIX stocks with mkt cap above 300 bn JPY, screened based on the following conditions: ROE (FY2) above 8%, financial leverage below 3, beta above 1 and relatively resilient FY2 earnings above 0, RP revision above -3 over the last 3 months; listed in descending order of mkt cap. This is a screen and not a recommended list either individually or as a group of stocks and options. Investors should consider the fundamentals of the companies and their own individual circumstances / objectives before making any investment decisions.

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