

Letter from SuMi TRUST - The Current Shape of Japan

The New BOJ Governor Nominee: A SuMi TRUST Perspective

By Katsunori Ogawa, Chief Portfolio Manager of the Sakigake High Alpha strategy

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Executive Summary

- The next Bank of Japan Governor (BOJ) has officially been nominated. Kazuo Ueda is an academic and economist who served as a BOJ board member in the 2000s when the central bank introduced its zero-interest-rate policy.
- Based on his past quotes and actions, we do not expect a sudden monetary policy turnaround, and we expect minimal impact on interest rates and the financial market.
- With the BOJ's monetary policy unlikely to change soon, we expect the stock market to focus on corporate fundamentals this year. Sakigake High Alpha (SHA) is a strategy that selects a stock based on its corporate fundamentals, and is off to a good start in 2023, posting a +5.33% return in January. Katsunori is strongly convinced that its performance will continue to recover in 2023 from the dip in early 2022 when the strategy faced challenges due to strong headwinds to the high-growth stocks triggered by the US interest rate hikes.

Kazuo Ueda - a surprise pick to lead the Bank of Japan

The Japanese government has nominated economics professor, Kazuo Ueda, as the next BOJ Governor to succeed the central bank's longest-serving Governor, Haruhiko Kuroda, reports said on February 10th. On February 14th, the government officially submitted its proposal to nominate Ueda as the next Governor. Ryozi Himino, a former Commissioner of the Financial Services Agency with a wealth of experience working for international financial institutions including the Basel Committee on Banking Supervision, and Shinichi Uchida, a career central banker who has worked at the Planning Division of BOJ for many years, were nominated as the two Deputy Governors. The government's nomination requires the approval of both houses of parliament which is expected to take place in March. If approved, Ueda will be the first post-war Governor hailing from academia and the second Governor from the private sector since Makoto Usami, who worked at Mitsubishi Bank and became BOJ Governor in 1964.

Financial markets have been fixated on who the choice would be and until this announcement Masayoshi Amamiya, current Deputy Governor and former Deputy Governor Hiroshi Nakaso, were viewed as the leading candidates, so the choice of Ueda came as quite a surprise. Despite the unexpected selection, the Japanese stock market has remained firm, also reflecting strong U.S. stock performance and the weak yen.

What to expect from the first academic economist BOJ Governor

The markets are closely watching for hints on Ueda's policy stance. To understand his views, we need to look back at his time as a BOJ board member.

Ueda served seven years as a BOJ board member from April 1998 to April 2005. Back then, Japan was facing a banking crisis and debilitating deflation. One of the tools he helped put in place in 1999 to combat deflation was the zero-interest-rate policy, which was unfamiliar to the global financial markets at the time. When the BOJ decided to lift its zero-interest-rate policy in 2000, Ueda voted against the move, stating that 1) The stock market's reaction needs

to be assessed more closely, 2) Suggested interest rates by Taylor's rule had just turned slightly negative or barely positive; we need to wait until rates become more stable and settle in positive territory, and 3) It would not hurt to wait considering the current trend in inflation. As an economist, Ueda gave a clear analysis and stood by his view that Japan was not ready for a rate hike.

Given his past words and actions, we think Ueda's approach is to carefully debate monetary policy based on facts and evidence, and thus would not rush to change monetary policy on becoming BOJ Governor. He will likely be cautious and take time to gauge whether inflation and wages will keep rising. Hence, we are expecting a slow reversal process of the longstanding policies and believe the upside to interest rates is limited at this point. We expect minimum impact on the stock market.

With the academic Ueda as the new Governor, together with his two Deputy Governors, Himino, who has abundant experience in international finance, and Uchida, who has a presence in the BOJ, we believe the new BOJ leadership will be well-balanced.

Sakigake High Alpha: 2022 in Review and Market Outlook for 2023

The SHA portfolio was characterized by a lot more pain than gain in 2022. Globally, central banks raised interest rates for the first time in years to combat surging inflation. The Russian invasion of Ukraine and China's Zero COVID ambitions threw markets into further disarray. The portfolio struggled severely during the correction phase due to its bias towards growth stocks. However, since October when concerns over the Fed's rate hikes began to ease, the portfolio return has bottomed out, and SHA ended 2022 down 8.70%, underperforming TOPIX by 6.25%.

At the beginning of 2023, one of the major risk factors was the monetary policy under the new BOJ Governor. But now we know Governor Ueda is the most likely candidate and he is unlikely to be in a rush to turn monetary policy around, this risk has fallen significantly. Thus, we expect markets to focus on corporate fundamentals this year and it is likely that we will not see the further sell-off of growth stocks that we saw in the first half of last year. We are not only expecting fewer headwinds for the portfolio, but also are optimistic about generating solid portfolio returns as SHA is focused on corporate fundamentals. In fact, we are off to a good start with the portfolio up 5.33%, outperforming TOPIX by 0.90% in January.

As for our investment focus for 2023, we see three key, long-lasting opportunities in the market: 1) Digital Transformation, 2) Green Transformation, and 3) Electric Vehicles. At the sector level, Information Technology and Energy will be the beneficiaries of these three main themes. In addition, we are also optimistic about "Purchasing Power in Emerging Countries" which should benefit from domestic economic resumption as well as the recovery of inbound tourism. In contrast to other major countries that are closely approaching an economic slowdown, Japan's economic activity has just started to pick up, 6-9 months behind other countries. In addition, Japan lifted its border restrictions last October and has begun to re-invite foreign tourists to the country. We are already seeing an increasing number of tourists coming to Japan. Chinese tourists are also expected to return gradually, and this should support domestic consumption.

We continue to be focused on identifying beneficiaries of structural changes and economic dynamics. With our unique investment approach to narrow down the universe based on investment themes, and to select stocks based

on corporate fundamentals, we truly believe our investment approach is effective as the pandemic has accelerated structural changes. With our long-standing experience and multi-thematic approach, we will continue to accumulate portfolio returns by capturing signs of structural change.

About the writer



Katsunori Ogawa, Chief Portfolio Manager of Sakigake HA

Katsunori Ogawa joined the firm in 1994. He was a client relationship manager for public pension funds until 1997. In 2002, Katsunori became the portfolio manager of an active Japanese equity strategy. He applies a thematic/top-down approach in addition to bottom-up stock picking to generate consistent alpha. He is one the first investors to capture Asian (especially Chinese) consumer demand for Japanese consumer durable goods and was an early investor in companies like Unicharm (a paper diaper maker) and Yakult (a lactic fermenting beverage producer).



Katsunori received a BA in economics from Keio University. He is a Certified Member Analyst of the Securities Analysts Association of Japan (CMA) and a Certified International Investment Analyst (CIIA).

He won Japan's Best Equity Manager award by Asia Asset Management in consecutive years from 2020 to 2022, and was recently awarded the same title in 2023.

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