Borsen-Zeitung

Interview with Peter Tasker, Arcus Investment

"Japan's equities will adjust to a stronger yen"

The benchmark indices Nikkei 225 and Topix soared in January because many investors expect monetary policy to be tightened if wages continue to rise. However, Peter Tasker from the British Japan specialist Arcus Investment warns against expecting too much. Nevertheless, share prices could still rise further.

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Peter Tasker has been working as an analyst and strategist in Japan since the 1980s.
Source Arcus Investment

BZ: Mr Tasker, has foreign interest in Japanese equities increased?

The Japanese market has indeed performed well for ten years, but for most of that time it has paled in comparison to the exceptionally strong US stock market. When Warren Buffett came to Japan last spring to look after his investments in five trading companies, he reminded investors not to put all their eggs in one basket and that Japan was an obvious market. After all, Japan has overtaken China to become the second largest stock market in the world. I think it could go much higher if American investors start to get excited about Japan.

BZ: At the moment, all investors are waiting for wages to rise enough for the Bank of Japan to give up the negative interest rate and yield curve control. What is your opinion?

I have been sceptical about this for some time. If wages rise, the Bank of Japan could move to raise interest rates, possibly as early as spring. However, we have been waiting for signs of higher wages since spring 2023, as 70% of Japanese employees work in smaller companies that only raise their wages slightly.

BZ: So no change in monetary policy in April, as predicted by the majority of analysts?

Inflation is falling and the labour market is not strong enough to support a large increase in wages. But we could see the first overlap of rising wages and falling inflation. On the other hand, the Bank of Japan has made some mistakes in this century and it wants to be sure that deflation is really over for good. It is therefore not impossible that it will not raise interest rates at all this year.

BZ: What will the Bank of Japan do if inflation falls below its 2% target?

It would be ironic if Japan were to fundamentally miss its 2% target after all the global inflation. In this case, the Bank of Japan could say that it will review the target. But in doing so, it would be admitting that the 2% can never be achieved sustainably. Which would mean that it could never raise interest rates in the coming decades. So maybe it could just say 1% instead of 2% as a target, for example.

BZ: How necessary is higher inflation to support the stock market?

Low inflation is not necessarily a bad thing. Stocks have risen since 2012 when inflation was below 1%. So I think the market can live with low inflation, but not with deflation.

BZ: And if the Bank of Japan abolishes the negative interest rate and yield curve control, how far will the key interest rate rise?

The Japanese economy is fundamentally weak due to the ageing labour force. Under the current circumstances, the key interest rate will remain very low, but the yield on 10-year government bonds could rise to over 1%.

BZ: Investors love a good story. The current story in Japan is that corporate governance is becoming more and more shareholder-centred. Do you share this view?

This reform is real. In the 1980s, most companies didn't talk to investors at all. If you asked them for a meeting, they would say
'No' and that they were speculators. At that time, the board members from Insiders together, the companies had networks of cross-shareholdings and ordinary investors had no say. There was no incentive to increase dividends and share buybacks were not even allowed. All this changed with the bursting of the bubble during the 1990s, when CEOs could no longer go to the banks if their company was in trouble. The banks were too weak.
That's why Nissan sold itself to Renault. The system collapsed.

BZ: What changes did former Prime Minister Shinzo Abe bring?

He considered himself a failure if the stock market did not rise. So he made some significant changes to the Government Pension Investment Fund (GPIF), which until then had no investment concept at all. He turned it into a professional fund. There were also some fundamental governance reforms, with more outsiders as directors. The government created a code for hostile takeovers, making the defending company liable and requiring a bid at a premium.

BZ: What is the main reason for this development?

I think Japan has thrown itself into the arms of the United States for the rest of this century after recognising the rise of a confident and hegemonic China. A key moment was the dispute over the Senkaku Islands in the East China Sea and the anti-Japanese riots in China in 2012. Before that, Japan had maintained friendly relations with China since the 1980s, when the neighbouring country was still very poor.

BZ: What has changed since then?

In the face of unrest and the fact that China's GDP had overtaken Japan's, Japan's elite realised that this friendship was no longer sustainable. To show the Americans that they were now fully on their side, the Japanese had to become more culturally aligned with America. Abe opened Japan to foreign tourists, foreign capital and foreign labour, and stock market rules had to become more American, for example by allowing hostile takeovers. Perhaps the only thing missing is the recognition of same-sex marriage.

BZ: How important is the cheap yen for attracting foreign investors?

Japan's currency should not be so cheap. In terms of purchasing power, the yen should be at 100 yen per dollar, not 150, but currencies can stay at a false parity for a long time. A cheap yen is also a competitive advantage for Japan, it is one reason why TSMC is building two chip factories in Japan.

BZ: But can the stock market adjust to a stronger yen?

It is hard to believe that the yen can get any weaker. It is much more likely that it will strengthen. This would reduce the profitability of some large exporters. However, the market will adjust. Many domestic companies in Japan could benefit from cheaper imports from abroad. And Japan's share prices also rose in the years when the exchange rate was110 to 120 yen per dollar. A return to these levels would only disrupt the market temporarily.

BZ: How does the Arcus Japan Fund take these trends into account?

We pursue a value approach. We look at companies that are cheap, identify the reasons for this and see how they can develop positively. So we invest in companies that are seen as problematic, rather than the big companies that everyone loves. The three largest positions are Mitsubishi Estate (property), Japan Post Holdings and IHI Corp (industrial conglomerate). Of course, as with any approach, this doesn't always work. But we are sticking with it, even if everyone else is focussing on growth.

About the person

Peter Tasker is co-founder and strategist of Arcus Investment (https://professional.arcusinvest.com) in London with USD 2 billion in assets under management. Tasker was previously a senior market strategist at Dresdner Kleinwort Benson. The Oxford University graduate is also a commentator for print media and television on Japanese financial issues, author of several books on Japan and lives two-thirds of the year in Tokyo and one-third in rural southern France.