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Arcus

The New Whale in Town: Japan's University Endowment Fund Makes a Splash

Summary

- Market sources suggest that Japan's new University Endowment Fund has started to invest
- Investment into domestic equities could reach Yen 3 trillion
- The need for income could make high dividend yield stocks attractive
- A bold government initiative, it could bolster confidence in equities and set a precedent

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Japan's newly created University Endowment Fund may be dwarfed by the Moby Dick of the Tokyo market, the Government Pension Invest and Investment Fund ("GPIF"), with its Yen 200 trillion of assets under management ("AuM"), but it is still a sizeable entity. It is starting with Yen 5 trillion of AuM, with a near-term target of Yen 10 trillion. That would make it larger than the Harvard and Yale endowments combined.

Details of asset allocation are not disclosed, but the reference portfolio has 65% in equities and 35% in bonds. If it were to follow the GPIF model, that would suggest a holding of Yen 2-3 trillion in domestic equities.

The fund operates under the aegis of the Science and Technology Agency, and the money is being sourced from the Government's Fiscal Loan and Investment Programme, sometimes known as Japan's "shadow budget". The idea is to provide capital for designated research institutions and scholars, thus upping Japan's game in key technologies.

To that end, the target return has been set at 4.38%, which is calculated as a real return of 3% plus long-term inflation of 1.3%. Japan's financial press speculates that high dividend stocks could be in favour, as the income target could then be met without recourse to taking capital gains.

The director of investment and effective boss is Masakazu Kida, formerly head of alternative investments at Norinchukin Bank, a cooperative financial institution with a huge investment portfolio. The investment teams are made up of recruits and secondments from other financial companies, as well as some promising newcomers to the industry. It looks like in-house investment management will play a much larger part than it does in the outsourcing model used by GPIF.

This new whale is not large enough to impact the market as a whole, but it marks another important stage in the evolution of Japan's investment culture. True believers in the free market might not approve, but by stepping up its exposure to equities, the Japanese government is sending a signal of confidence to other investors. Whether it knows it or not, it is also making a statement about its own future direction. A return to deflation and hard money-obsessed central banking – indeed anything that might cause a structural bear market – must be avoided at all costs as the victims would include some important government institutions.

On the other hand, if all goes well, institutions of many kinds might decide to follow suit.