

On the ground in Japan

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FOR PROFESSIONAL INVESTORS ONLY

Ruth recently spent a week-long research trip in Japan. She found Tokyo bustling with tourists, company managements in generally buoyant mood, and signs that the Abe government's 'third arrow' is bringing about much-needed change in Japan.

To those of us who have visited Poundland in the UK, a trip to a 100 yen store in Japan is like stepping into another world. We own shares in Seria, which operates 100 yen stores, and I decided to check one out for myself. The store was bright and airy, with wooden floors, beautifully arranged displays and a wide selection of household, stationery and even gardening items. Before I knew it, I had spent ¥2,000 and was contemplating the purchase of a second bag in which to put my selection of Japanese bowls, pens and kitchenware.

Tourists and toilet seats

I was in Japan to spend a couple of days at a conference run by Daiwa Securities, as well as visit some companies in Osaka. Arriving early on Sunday morning, I took advantage of some free time to see what was happening in the shops.

We know that Japan is experiencing a tourist boom, but it is only when you head for Ginza, Tokyo's upmarket shopping area, and see the Chinese tour buses parked one behind the other whilst their occupants move from one luxury boutique to the next carrying more and more bags as they go, that you realise just how big this boom really is. Also on Ginza is the Laox store. Laox was an ailing Japanese consumer electronics retailer, which was bought by a forward-thinking Chinese company in 2011. It is the destination of choice for the Chinese tourists. After buying their high-tech Toto toilet seats (apparently a status symbol back home), they head for the cosmetics floor (all Japanese consumer electronics stores devote at least half of the store to non-electronic items) and buy all manner of Japanese-branded cosmetics.

Later in the week, I surreptitiously followed a Chinese couple around a similar store, this one operated by BIC Camera. I watched as they filled two baskets with assorted cosmetics and over the counter medicines. So lucrative has this trade become that BIC has moved cosmetics, medicines and stationery up from the basement to the third floor and relegated cameras to the basement area.

Doshisha, the wholesaling company we own, told me that their best-selling items this year have been high-end watches. Apparently, these are very popular with Asian tourists and Doshisha has been supplying 2-3 million per month to its customers, with Cartier apparently being the best-selling brand. In October, the government increased the number of goods which can be sold duty-free, and this seems to have provided further fuel to the spending boom. J Front Retailing, which operates Daimaru department stores, said that duty free sales were up 300% in the second half of the year. They are redeveloping their Ginza site and will incorporate a tour bus terminal in the basement of the store.

Full house

Hotel occupancy was at record highs in both Tokyo and Osaka. Tokyo Dome, which operates the hotel next to its baseball arena and amusement park in the centre of Tokyo, told me that occupancy rates were over 90% and average room rates increasing. In the interests of research, I spent an evening checking out their urban onsen (hot spring baths) at the same site. This was a test of both my limited Japanese and my understanding of onsen etiquette - I appeared to be the only foreign visitor - but I can see how this type of attraction could prove very popular with tourists. Kintetsu, an Osaka-based railway company, said that tourists accounted for 48% of the guests at one of their Osaka hotels, compared to 25% in 2012. Osaka is benefiting from the large number of low-cost airlines based at the Kansai International Airport, as well as from the opening of Harry Potter World at Universal Studios Japan.

I had meetings with 27 companies over the course of the week, a mixture of existing holdings and potential investments. Companies were generally feeling upbeat about business prospects. Whilst last year's consumption tax increase had clearly derailed the economic recovery and affected those most exposed to domestic demand, business seemed to be picking up

again. The president of J Front said that high-end spending by wealthy domestic customers had not declined at all, but that it was the volume zone sales which had been hit hardest. He attributed this to the decline in real wages following the consumption tax hike, making the outcome of the current wage negotiations vital.

Booming construction

It was interesting to meet a number of construction-related companies. The market seems to have lost interest in many of these stocks, but for most, business is booming as the reconstruction of Tohoku continues and the Olympic construction gets under way. I met Nishio Rentall, which rents construction equipment to general contractors. The stock has underperformed the market by 18% over the past year and trades on a single-digit p/e multiple. The company's order book is full and management expect the current trend to continue at least until 2018. Inaba Denki Sangyo, which provides electrical equipment to the construction industry, said that their customers were so busy trying to make deadlines that they were not particularly concerned about pricing.

Corporate governance was very much on the minds of all the companies I met, particularly the cash-rich companies with below-average returns on equity. One of them told me that the pressure from shareholders to justify their cash position was “intense”. For many, the requirement to provide a justification of their cross-shareholdings is making them reassess these long-standing positions.

The third arrow: no damp squib

On my last day in Japan, I was invited along to the cabinet office to discuss progress on the Abe government's 'third arrow'. I can't imagine the UK government attempting to communicate directly with foreign fund managers in this way, but given the quality of the press coverage of the revitalisation strategy (to give the 'third arrow' its official name), it makes sense for the Japanese to do so. I understand they had met with a number of other investors and were preparing for an overseas tour to meet more. It was very clear from this meeting that corporate governance is a key part of the strategy. But it was also interesting to hear about the significance of changes being made to the Japanese agricultural system and that the government is already half way to reaching its target of providing an extra 400,000 nursery places. The cabinet office is convinced that this year's wage round will lead to an increase in real wages. Far from being a damp squib, the 'third arrow' is leading to some huge (and long overdue) changes to the Japanese way of life.

Stuck in a traffic jam on our way to the meeting with Tokyo Dome, my companion complained about the amount of traffic in Tokyo and how difficult it is to move across the city by taxi. I thought back to our conversation four years ago, when I clearly recalled him bemoaning the lack of traffic on the streets. Tokyo, he declared, appeared to be dying. The lack of traffic reflected the economic stagnation and the growing irrelevance of his country. As investors, we spend so much time worrying about quarterly earnings numbers and GDP growth that sometimes we are inclined to miss the bigger picture. And the bigger picture is that Japan today is a very different place to Japan four years ago.