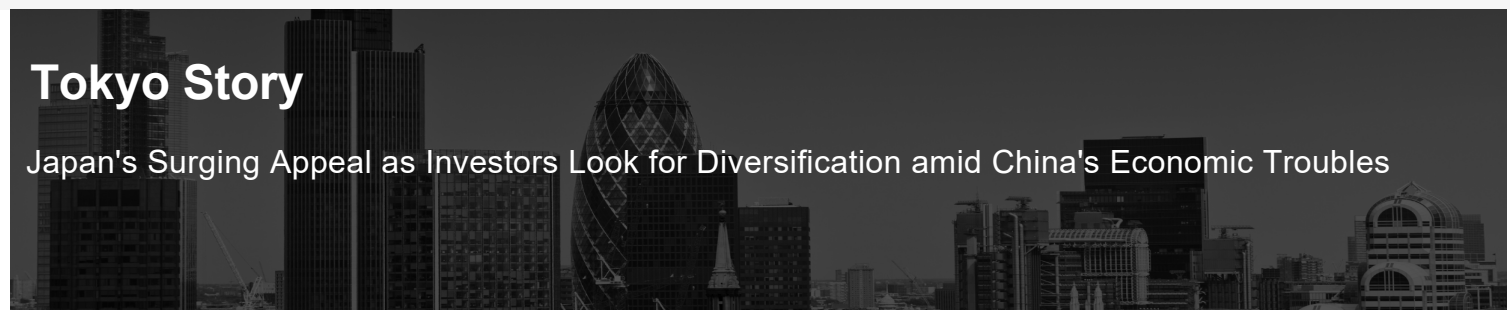




News

Tokyo Story

Japan's Surging Appeal as Investors Look for Diversification amid China's Economic Troubles



05 Dec 2023

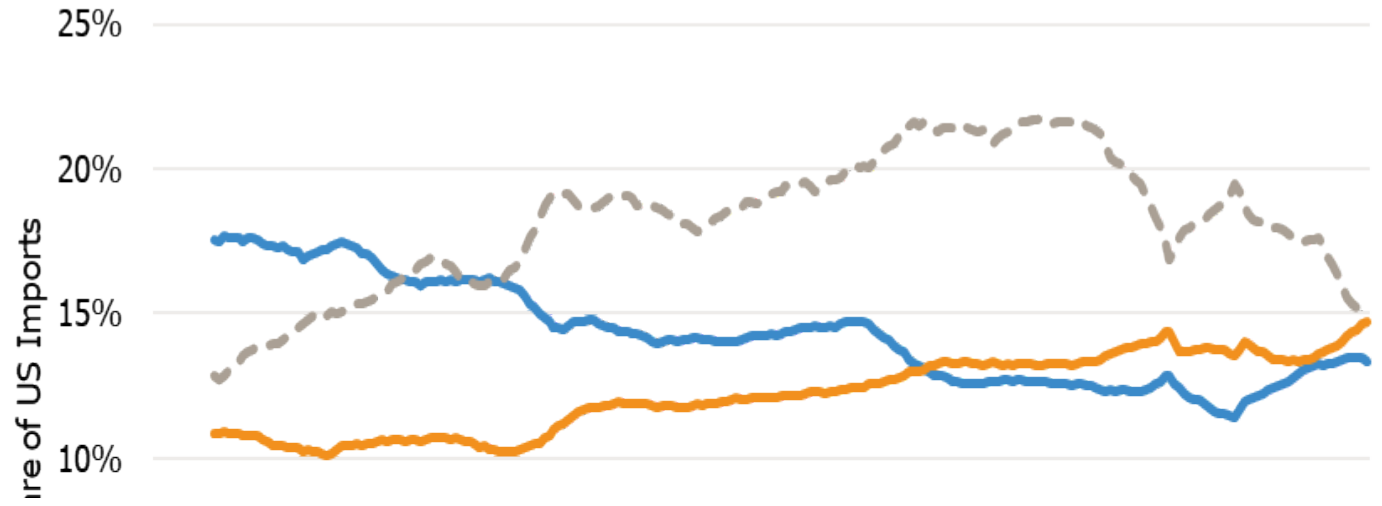
Japan's Surging Appeal as Investors Look for Diversification amid China's Economic Troubles

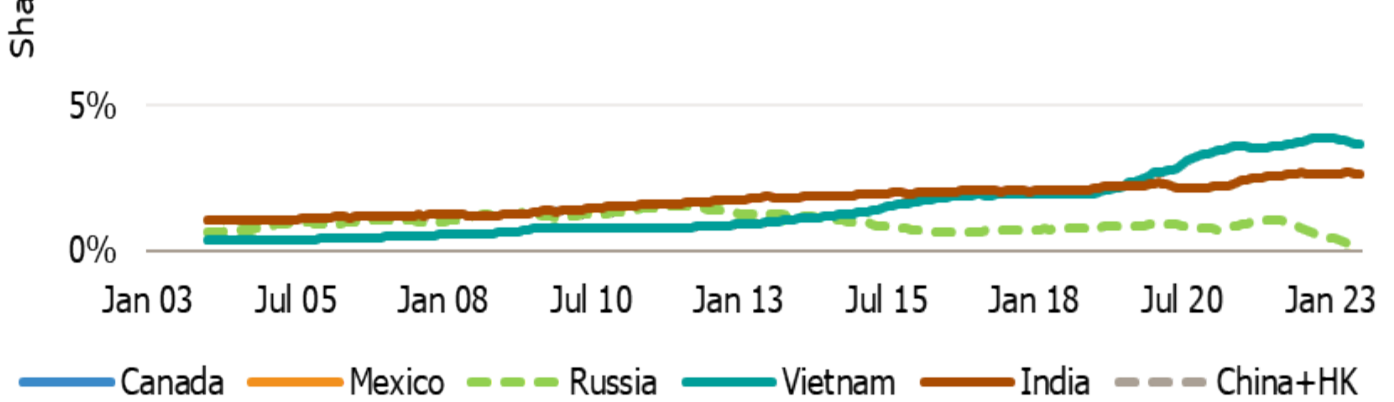
The following blog is taken from a conversation with James Syme and Nudge Richyal on Price Discovery webinar, Out of China... into Where? first broadcast live on 27 October 2023 (<https://www.brighttalk.com/webcast/14281/595124>).

China's growth over the past generation lifted its share of US imports from almost nothing in the 1980s to 22% by 2018. Since then it has faced numerous challenges, including weakened domestic demand, a rising public debt levels, an ageing population and the fall-out of global decoupling. The result has been a fall in China's share of US imports to 15% in 2023¹, taking it back to where it was 10 years ago.

Decoupling in Action

Trump administration imposes first tariffs on China in January 2018





Source: US Census Bureau as at 27 September 2023.

Make no mistake, China still has compelling opportunities (see *Rising Chinese Stars*), but in terms of policy, China's recovery efforts, such as its limited use of quantitative easing (QE), have proven ineffective. A crucial hurdle, rooted in its Marxist-Leninist principles, is the government's reluctance to allocate resources directly to households within the centrally planned economy.

As China is displaced as the supplier-of-choice of global, and particularly US, demand, who are the beneficiaries? Mexico and Canada are strategically positioned to attract US imports through integrated supply chains, geographical proximity and political sympathy, benefiting from the move to 'nearshoring' or 'friendshoring'. Further away, but still politically sympathetic, Vietnam and India are drawing increasing interest. (See *The Dragon's Slumber*).

In the pursuit of diversification away from China, Japan has emerged as a compelling and unexpected alternative, a close neighbour of China and an even closer ally of the West. Japan's economic landscape, like China's, bears the weight of significant government debt (Japan's public debt is currently a staggering 263% of GDP²).

Japan presents an attractive option for investors wary of China, but there's an inherent challenge in navigating Japan's stock market, with its nearly 4,000 listed companies. But that, too, is changing. Earlier this year, the Tokyo Stock Exchange threatened to delist companies that failed to implement strategies to enhance profitability and long-term returns to lift valuations. Around 39% of TOPIX-listed firms trade beneath their book value, starkly contrasting to the mere 5% of companies in the S&P 500 Index. The exchange's strategy involves 'naming and shaming' underperforming firms, pressuring them to enhance shareholder relations, improve their balance sheets and provide a return on equity to investors.

Japan's submerged valuations are challenging the cultural barriers that have made private equity buyouts very rare. A changing mindset among a new generation of management is transforming the landscape, with increasing activity and a heightened focus on shareholder value.

Like nature, investors abhor a vacuum. As China's place in the global economy changes, others are ready to fill out the space.

Source:

¹US Census Bureau. As at 27 September 2023

²<https://tradingeconomics.com/japan/government-debt-to-gdp#:~:text=Japan%20recorded%20a%20Government%20Debt,percent%20of%20GDP%20in%201980>

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