



Japanese Equities: New Progress in Corporate Governance

27 August 2008

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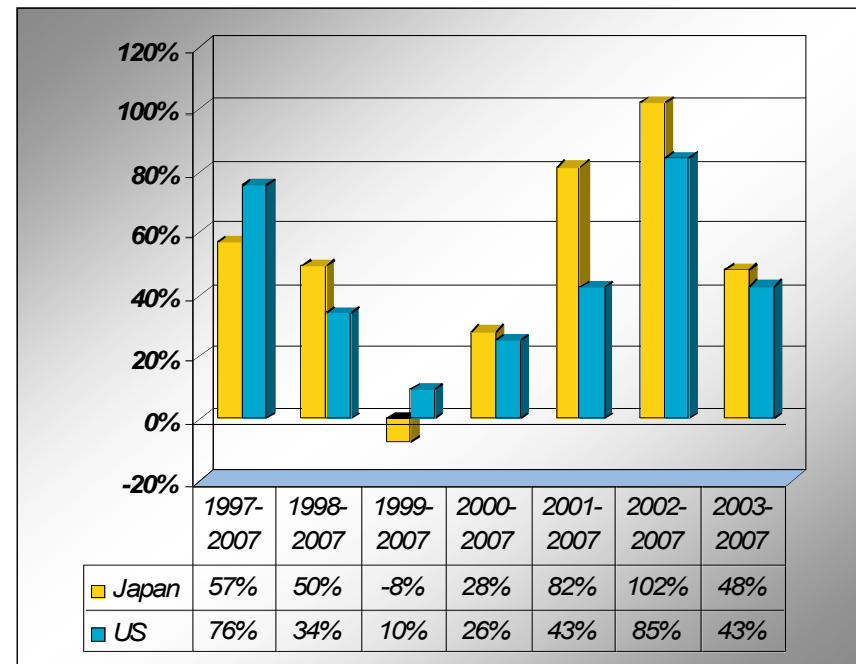
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Why Japan?

- Despite its poor performance in 2007, Japan MSCI in USD terms has nearly equalled or exceeded US MSCI over most long-term timeframes up to 10 years.
- It is also outperforming so far in 2008 – the Japan MSCI has outperformed the MSCI World x-Japan by 5.8% through July.

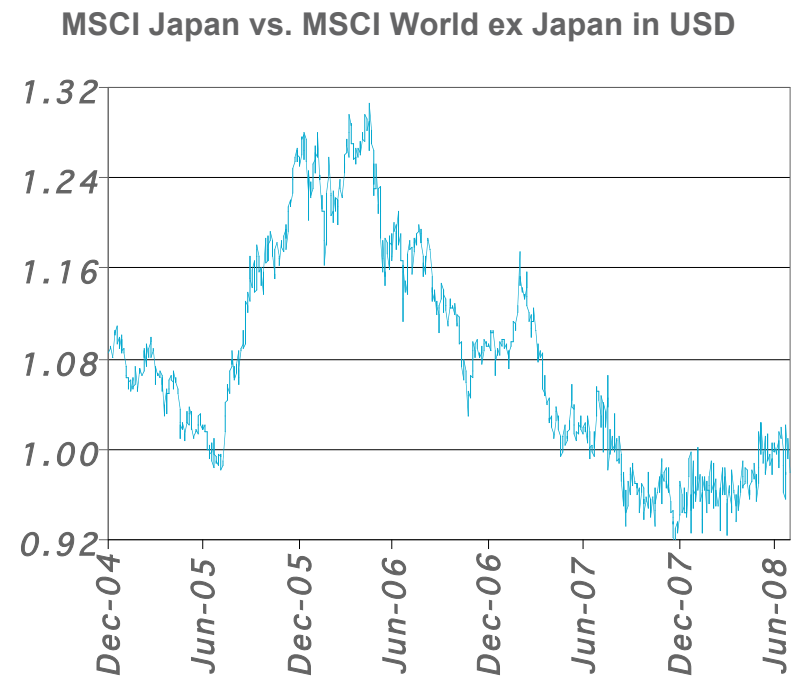
MSCI Japan vs. MSCI US in USD terms
Total Return in % Since Year listed below



Source: Bloomberg, MSCI

2006-2007 Disappointment ~ Return from the Mini-Bubble

- Japan outperformed in 2005 with an extraordinary, bubble-like 43% return. Such a return has only occurred three times in Japan’s post-1960 history and the US has not achieved such since 1964.
- Japan has been giving back its 2005 outperformance ever since, and returning to attractive valuations.
- Since Sep 07, it has outperformed the World ex Japan MSCI, as investors realized that corporate governance was actually improving, despite all the negative headlines about a few “bad eggs,” and that its economic competitiveness remained high.

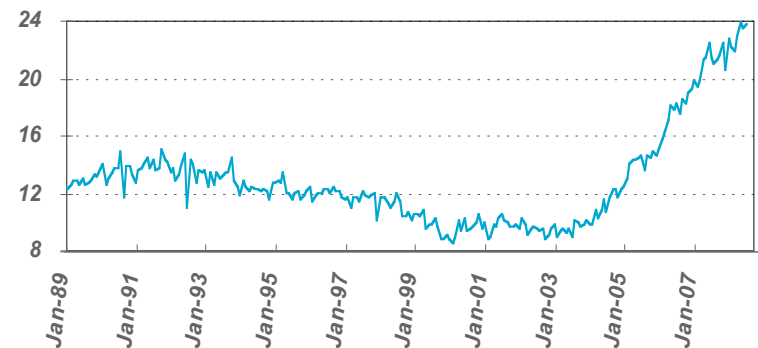


Source: Bloomberg, MSCI

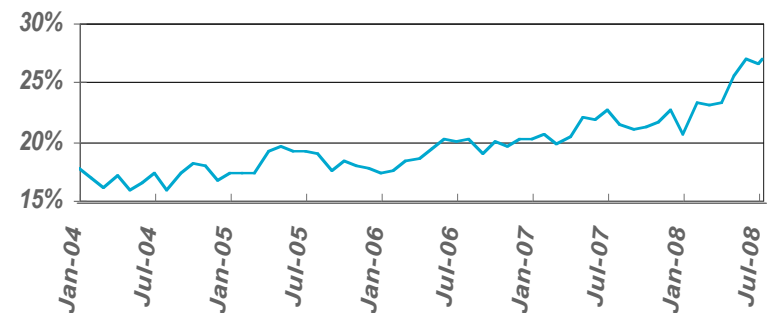
“Real Money” ~ “Corporate Governance in Japan”

- Cash dividends surged by 21% p.a. since 2003 as management dividend policy changed 180 degrees. 2007 growth ran at 18% YoY compared to 10% in the US and 9% in Europe.
- Equity-income type investing is a powerful theme to attract Japanese individual investors, which also helps prevent hostile takeover attempts.
- At 27%, TOPIX’s dividend payout ratio is rising sharply and while below European levels, is near the present US level of 30%.
- We target a 30% payout ratio in 2009 and 40% in 2012.
- The 1.82% current dividend yield is the highest since the mid-1980s. The prospective dividend yield is even higher.

Dividend paid by TOPIX in Yen



TOPIX Dividend Payout Ratio

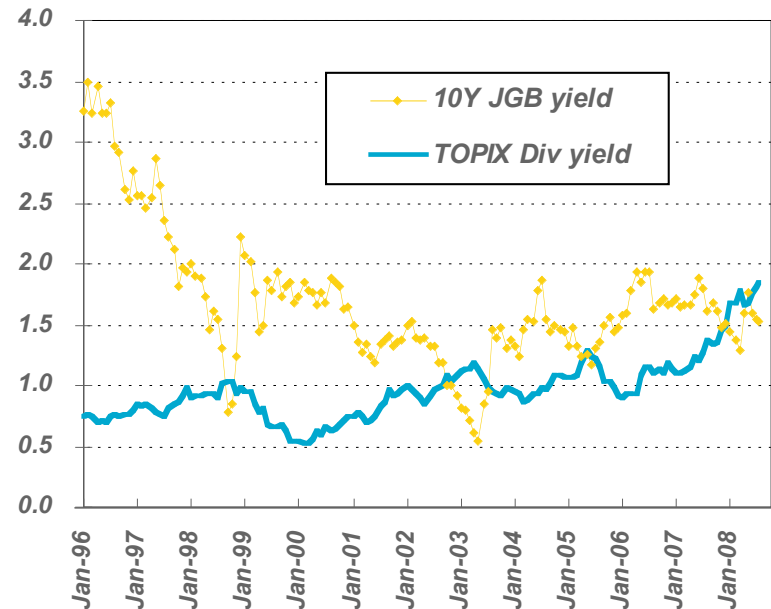


Source: Datastream

Dividend Yield Helps Support Equities

- TOPIX dividend yield now exceeds the 10Y JGB yield by 20%.
- Such has only occurred three times in the past.
- Every time this has occurred, it has been a good buying opportunity for stocks.
- MSCI US dividend yield is 56% of 10Y Treasuries and while MSCI Europe is 97% of the 10Y Bund.
- Also, TOPIX's dividend yield is triple the yield of shorter term interest rates.

Dividend Yield of TOPIX vs. 10Y JGB



Source: Datastream

The Shift to Dividends

- In FY07, 41 companies among the TOPIX 100 had negative earnings growth, but only 3 cut their dividends.
- 70 companies increased their dividends, with 23 of them doing so despite negative earnings growth.

FY07

		Earnings Growth		Total
		+	-	
Dividend	Increase	47	23	70
	No Change	11	15	26
	Cut	1	3	3
Total		58	41	99

Source: Nikko AM

The Shift to Dividends

- Despite the fact that 35 companies among TOPIX 100 forecast negative earnings growth in FY08, only 2 announced to cut their dividends (with one due to disappearance of a special “anniversary” dividend).
- 37 companies have forecast an increase their dividends, with 12 of them doing so despite negative earnings growth.

FY08

		Earnings Growth				Total
		+	No Change	-	No Estimate	
Dividend	Increase	25	0	12	0	37
	No Change	24	2	16	1	43
	Cut	0	0	2	0	2
	No Estimate	5	1	5	6	17
Total		54	3	35	7	99

Source: Nikko AM

Mergers Occurred at Record Levels in 2007

- One only hears of the failures and poison pills, but a record amount of mergers occurred in 2007, including over 300 listed firms.
- The mergers were virtually all domestic mergers, but such entail significant rationalization and industry consolidation.
- Industries with the most mergers include some of the most resistant to such in the past decade: the food, department store and electronics sectors.
- Hostile hedge fund takeovers are unwelcome in Japan, but are occurring by several methods.
- A large acquisition by foreign multinational would greatly help market sentiment.

*Notable 2007 Merger Announcements**

- Sharp-Pioneer
- JVC-Kenwood
- Clarion-Hitachi
- Pentax-Hoya
- Daimaru-Matsuzakaya
- Isetan-Mitsukoshi
- Calpis-Ajinomoto
- Nichiro-Maruha
- Myojo-Nissin Foods
- Fujiya-Yamazaki Baking
- Mercian-Kirin
- Q'sai-NIF SMBC Ventures
- Kagome-Asahi Beer
- Sumisho Lease-Sumitomo Corp
- JSAT-Skyperfect

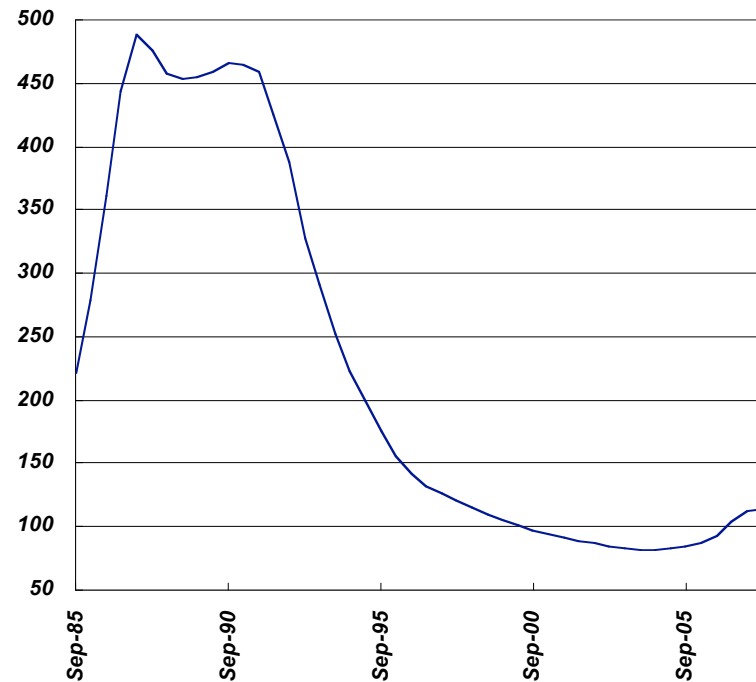
Source: Bloomberg

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Japan in Completely Different Asset Cycle ~ *Deflation Ends*

- Land prices have recovered, and will likely slightly decline in 2008, but are not severely overextended.
- Japan's banking system is starting to experience some write-downs, but its underlying foundation is very strong.

Tokyo Commercial Land Price



Source: Japan Real Estate Institute

G-3 Valuations Comparison

- Based upon current IBES data, Japan is now only slightly more expensive on a 2008 PER basis than the US. A higher multiple is justified in our view by lower long-term interest rates and better cyclical conditions (not late in the asset price cycle).
- Japan's 2008 IBES EPS growth estimate remains positive, but market is already discounting approximately 8% decline in such, in our view.
- The high growth of dividends and the higher dividend yield vs. local interest rates is extremely important to local investors.

	07 PER (IBES)	08 PER (IBES)	09 PER (IBES)	07 EPS growth	08 EPS growth	09 EPS growth	P/B	Div Yield (trailing)
Europe MSCI	10.7	10.6	9.3	10%	1%	14%	1.8	4.2%
US MSCI	15.4	14.4	12.0	-2%	7%	21%	2.4	2.2%
Japan MSCI	15.3	15.2	13.3	9%	1%	14%	1.6	1.8%

Source: MSCI/IBES as of July 30, 2008

Summary

- While Japan will not be immune to global forces, its economy is on firm foundations and important progress in corporate governance is occurring.
- Valuations are now quite low.
- The country hosts some of the world's best companies, especially in the automobiles, electronics and materials sectors, with a specialization on energy conservation and pollution control.
- Its asset and credit markets, particularly regarding real estate, are not rolling over from over-extended levels, but rather recovering after a decade long restructuring.
- One only hears of the failures and poison pills, but Japan is alive and well and worthy of investor consideration.
- The Japanese equity market is under-appreciated as solid long-term global performer with solid currency fundamentals.



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