

## Recent Points of Interest in US and Japanese Equities

2 November 2023

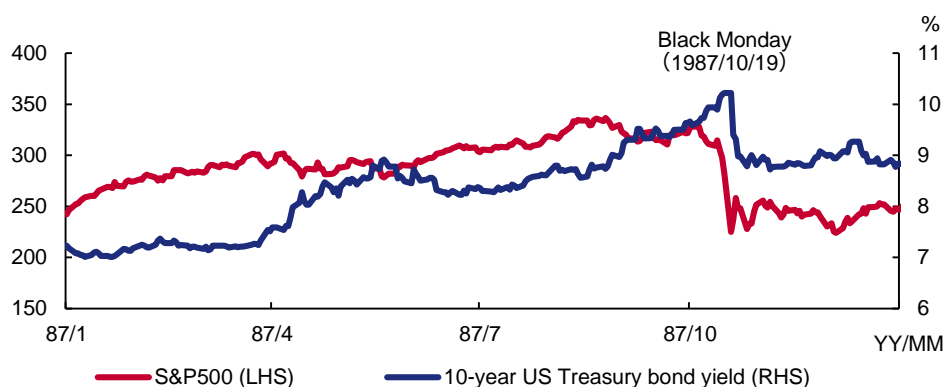
- ▶ US equities: Although the upside looks heavy due to the rise in long-term interest rates, a major adjustment has not yet occurred. While there is caution regarding the reduction in liquidity, it is believed that a significant correction can be avoided if the rise in long-term interest rates stays at the current level and the view of the economy not entering a recession is maintained.
- ▶ Japanese equities: The buying momentum from foreign investors has subsided. However, there is a possibility that the disclosure of specific initiatives by companies in response to the Tokyo Stock Exchange's request will progress, which could once again strengthen preference for Japanese equities.

US equities have experienced a slight slowdown and adjustment since August. This can be attributed to a significant increase in long-term US interest rates impacting valuations. In this context, there are concerns about the similarity between these movements and the events preceding the 1987 Black Monday, when US equities remained resilient amidst a sharp rise in long-term interest rates. Some are suggesting that caution should be exercised in light of this (Figure 1).



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**Figure 1: US Equities and Long-Term Interest Rates in 1987**



Source: Refinitiv

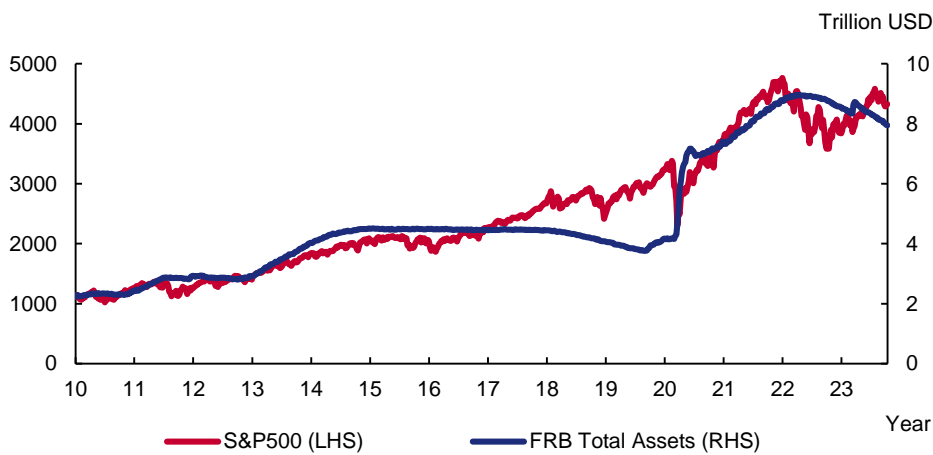
Note: Daily data from 1 January 1987 to 31 December 1987

**“US Equities and Rising Long-Term Interest Rates”**

Another factor influencing stock prices is the shrinking liquidity associated with the Federal Reserve’s balance sheet contraction (Figure 2). Some believe this could result in an adjustment in stock prices. However, it is believed that for an actual adjustment in stock prices to occur, the possibility of a significant economic recession in addition to shrinking liquidity is required.

**“The Impact of Shrinking Liquidity on Stock Prices”**

**Figure 2: US Equities and Total Assets of FRB**



Source: Refinitiv  
Note: Weekly data from 1 January 2010 to 13 October 2023

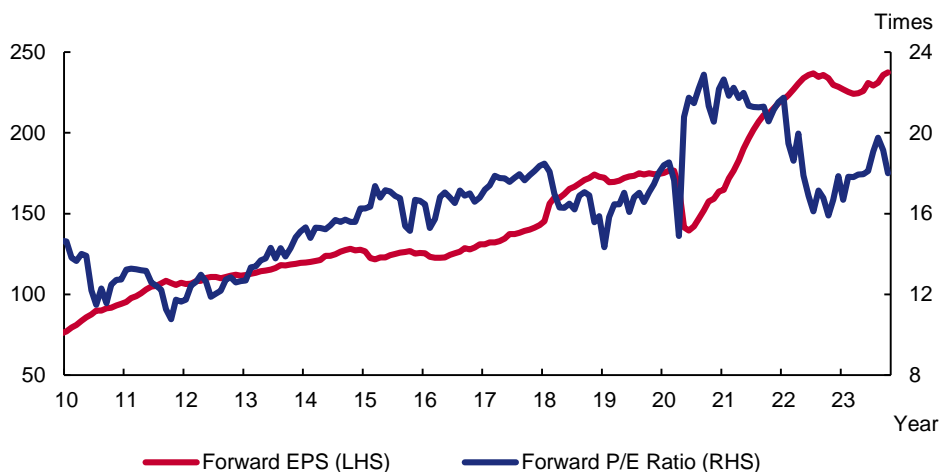
When examining the recent liquidity contraction, the pace of this contraction has been gradual and has not rapidly returned to pre-pandemic levels. It is important to note that this gradual liquidity contraction has been primarily driven by the unwinding of emergency pandemic measures, rather than a sharp reversal in overheated macro demand. Therefore, it is believed that the likelihood of a severe economic recession is low.

The stock market crash of 1987 is believed to have been caused by a combination of factors that increased concerns about rising interest rates. In particular, there were concerns about the potential uncontrollable rise in long-term interest rates in the US due to the expansion of the "twin deficits" (budget deficit and current account deficit). While there are lingering concerns about the supply and demand situation for US Treasuries at present, it is not as severe as it was then.

Looking at the recent forecasted earnings per share (EPS) of US equities for the next 12 months, there was a downward trend earlier this year, but it has since turned upward due to expectations of a soft landing for the US economy (Figure 3). Unless the current rise in long-term interest rates in the US leads to the belief that a recession will occur, it is predicted that the improved profit outlook will provide support and prevent a significant adjustment in US equities. Additionally, Federal Reserve officials, including Chairman Jerome Powell, are closely monitoring the recent rise in long-term interest rates, which is not expected to lead to an uncontrollable increase.

**“Stock Price Adjustment  
Unlikely to Occur Unless  
Recessionary Fears Emerge”**

**Figure 3: US Equities Forward P/E Ratio and Forward EPS**



Source: Refinitiv  
Note: Monthly data from January 2010 to October 2023

This indicates a low likelihood of a severe economic recession and supports the notion that a stock price adjustment is unlikely unless recessionary fears emerge.

After reaching a post-bubble high in mid-September this year, TOPIX has experienced a slightly subdued trend. However, the year-to-date rate of return has remained above 20% and there has not been a significant adjustment.

At the end of March, the Tokyo Stock Exchange (TSE) requested listed companies to implement management practices that are conscious of capital costs and stock prices. There is an expectation that companies, especially those with low price-to-book (P/B) ratios, will actively respond to this request. Subsequently, the P/B ratio of TOPIX has significantly increased, temporarily reaching a level that is one standard deviation ( $\sigma$ ) above the average of the past 10 years (Figure 4). It is worth noting that while the "average  $+1\sigma$ " is considered to be the historical upper limit, there have been instances where TOPIX exceeded the "average  $+2\sigma$ ". Nonetheless, the current movement can be considered to remain within the range of conventional fluctuations.

**“Japanese Equities and Response to TSE Requests”**

Figure 4: The P/B Ratio of TOPIX



Source: Bloomberg

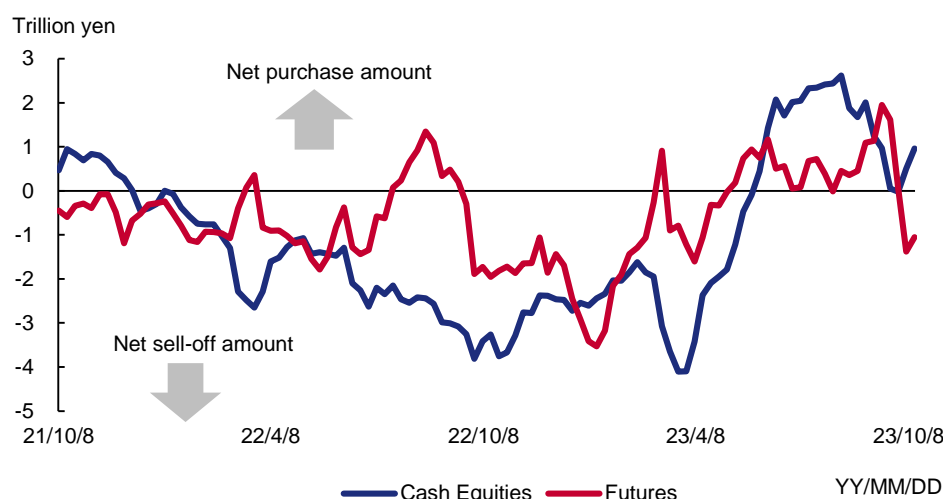
Note: 1. Daily data from 4 January 2013 to 19 October 2023

2. Trailing PB as compiled by Bloomberg

3. The average and standard deviation ( $\sigma$ ) are for the above period

During the April-June quarter of this year, foreign investors displayed strong buying momentum in Japanese stocks. Looking at the trading activity of foreign investors (both cash equities and futures) in Japanese equities since the formation of the Kishida Administration in October 2021 (Figure 5), it can be observed that cash buying momentum has particularly increased since April. However, selling pressure has emerged since August, resulting in an overall neutral position as of early October under the Kishida Administration.

**Figure 5: The Trading Activity of Foreign Investors in Japanese equities (since the formation of the Kishida Administration)**



Source: Bloomberg

Note: 1. Weekly data from the week of 4-8 October 2021 to the week of 10- 13 October 2023  
 2. The cumulative net purchase amount of Japanese equities, total of two markets

At the end of August, the TSE disclosed the aggregated results of its survey on the response status to the request for companies listed on the TOPIX Prime market with a fiscal year ending in March. Looking at the disclosure ratio of the implementation status (Figure 6), it can be observed that 45% of companies with a large market capitalization and a P/B ratio below 1x have made some form of disclosure. However, the disclosure ratio for companies with P/B ratios above 1x or with relatively smaller market capitalizations is relatively low.

**“TSE also Requests Response from Companies with P/B Ratios of 1x or Above”**

**Figure 6: The Disclosure Ratio of the Implementation Status (Prime Market)**

	<b>PBR Less than 1x</b>	<b>PBR 1x or more</b>
<b>Market Cap.</b>	<b>45% disclosed</b> (Disclosed initiatives: 31% Disclosure status as “under consideration”: 14%)	<b>26%</b> (Disclosed initiatives: 21% Disclosure status as “under consideration”: 5%)
<b>JPY 100 billion or more</b>	<b>39%</b> (Disclosed initiatives: 22% Disclosure status as “under consideration”: 17%)	<b>15%</b> (Disclosed initiatives: 9% Disclosure status as “under consideration”: 6%)
<b>JPY 25 billion – 100 billion</b>	<b>25%</b> (Disclosed initiatives: 12.5% Disclosure status as “under consideration”: 12.5%)	<b>15%</b> (Disclosed initiatives: 8% Disclosure status as “under consideration”: 7%)
<b>Less than JPY 25 billion</b>		

Source: TSE. “Action to Implement Management that is Conscious of Cost of Capital and Stock Price” 29 August 2023

Note: 1. As of 14 July 2023

2. The companies disclosing “under consideration” are the ones that disclosed they are “considering taking action” in corporate governance reports and other corporate announcements

The TSE points out that there seems to be a misconception that companies with P/B ratios already exceeding 1x do not need to take any action. It also acknowledges the possibility that some companies may lack the resources to formulate a response, while others question the significance of addressing the request.

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In October, the TSE announced its intention to strengthen efforts to encourage further disclosure. Specifically, it plans to start publishing a list of companies that have disclosed their initiatives based from the beginning of next year, with monthly updates. The TSE also mentioned that it will disclose cases that have received strong support from investors and other stakeholders.

As a result, it is expected that there will be increased disclosure from companies in the future. This increased disclosure, coupled with growing expectations for the Japanese economy to overcome deflation, could potentially lead to a resurgence in foreign investor-driven buying of Japanese stocks.

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**“A List of Companies that  
Have Disclosed their  
Response will be Published  
from the Beginning of Next  
Year”**

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