

What the House of Representatives election means for Japanese equities?

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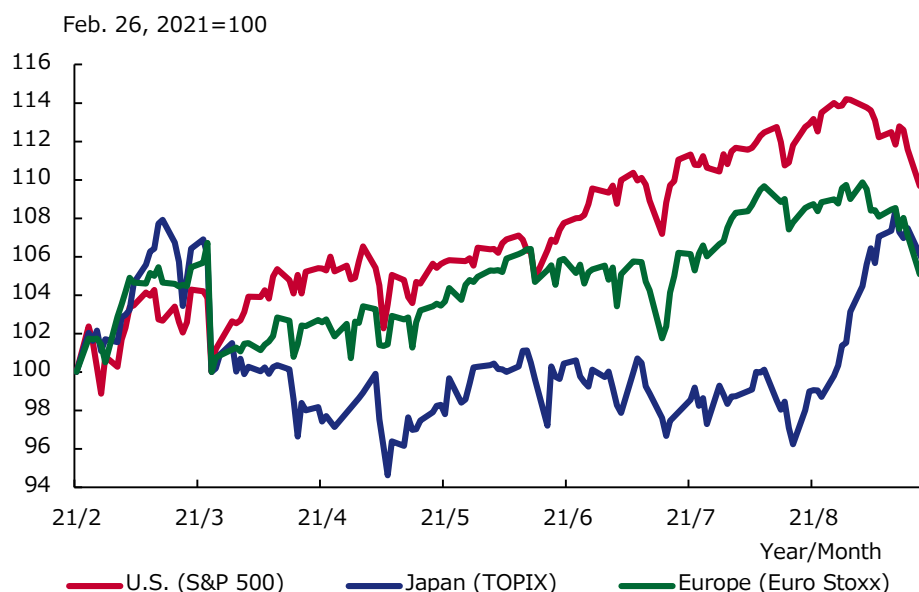
- ▶ Since 3 September, when Prime Minister Suga announced his resignation, Japanese equities have rapidly closed the gap as performance laggards European and US equities. The rise has been comparable to that of European stocks, but not to that of US stocks.
- ▶ This is likely due to progress of vaccination rollout in Japan and a reduction in political uncertainty following Suga's resignation. In the past, we have seen a rise in share prices around polling day in the House of Representatives.
- ▶ In order for Japanese stocks to maintain momentum and further close the gap, we need to see sustained expectations of policies/reforms to further comfort global investors. Therefore, we will keep a close eye on whether the new government's policies and reform agenda will live up to expectations.

Looking at stock prices in Japan, the US and Europe, Japanese stocks have generally lagged since March this year. However, they have bottomed out in the second half of August and risen rapidly since Suga announced his resignation on 3 September. Although not as strong as the US, the rise has been comparable to that of European stocks, indicating that Japanese stocks have made progress in correcting their lagging performance versus global peers. (Figure 1).



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Chief Strategist

Figure 1 : Market Index Performance since March



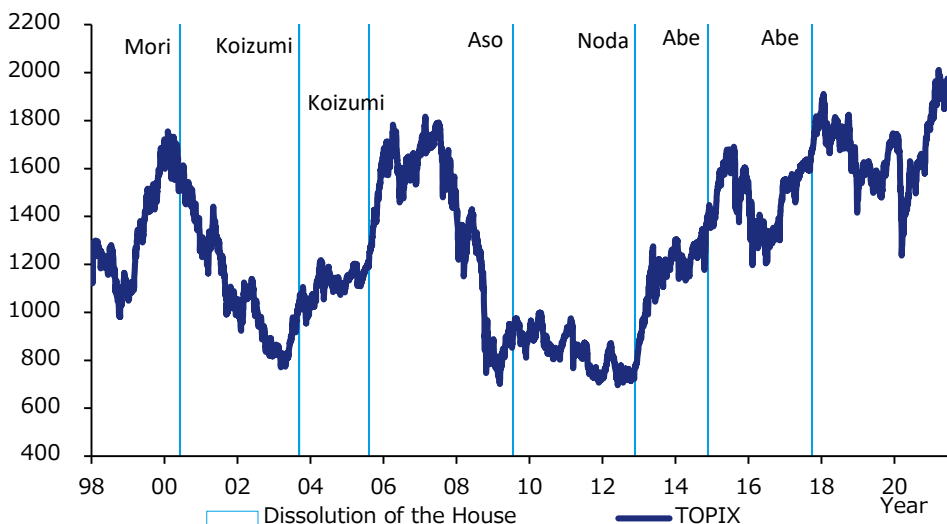
Period : From Feb. 26, 2021 to Sep. 21, 2021 (Daily)
 Source : Bloomberg

“Progress in correcting the lag in Japanese equities”

The direct catalyst for this was Suga's announcement that he was stepping down amid falling approval ratings, which was seen as a boost to the Liberal Democratic Party's (LDP's) approval rating and the hope that a stable government could be formed following the lower house elections. According to an NHK survey, support for the LDP rose from 33.4% in the August survey to 37.6% in the September survey after he announced his resignation.

The underperformance of Japanese equities was due in part to the uncertain political situation, but also to the lack of visibility for a reopening of the economy due to delays in vaccination amid the spread of the Delta variant. However, the government announced on 13 September that the number of people who have completed the second round of vaccination has exceeded 50% of the total population. This is almost the same level as in the United States, where the economy is being reopened, and together with the decline in the number of new infections, it is seen as a level that will raise hopes for the reopening of the economy in Japan. According to NHK's count, the number of new infections nationwide has been below 20,000 since 2 September, and fell below 2,000 on 21 September.

Figure 2 : Market Movement throughout Elections



Period : From Jan. 5, 1998 to Sep. 21, 2021 (Daily)

Source : Bloomberg

(Note) Name of Prime Minister who dissolved the house is shown to the left of the day the house was dissolved

While the relationship between the House of Representatives elections and Japanese equities shows that stocks tend to rise during election periods, the extent of the rise depends on the degree of policy expectations. September 2005 (so-called "postal reform election") and December 2012 (inauguration of the second Abe administration), saw sustained upside in Japanese stocks for long periods of time. In contrast, the change of government from the LDP to the Democratic Party of Japan (DPJ) in August 2009 saw an initial rise in share prices during the election period, but this was quickly followed by a slowdown. (Figure 2).

**“Stocks tend to rise around
the House of
Representatives election”**

During the five election periods since 2005 (defined as approximately one month from the day before dissolution to the day before voting), TOPIX has risen in all five cases, with an average return of 6.4%. However, expanding the analysis to a period of about one year following the election, the results have been mixed, and subsequent share price performance has been shown to depend on whether post-election policy expectations, reform expectations, and expectations for a stable government are sustained.

Post-election policy expectations are likely to be a catalyst for foreign investors to invest in Japanese equities, as the December 2012 election, which was the most prolonged of the five elections since 2005, was followed by higher share prices for an extended period of time in the Abenomics market. Foreign investors bought a cumulative ¥21 trillion in cash Japanese equities during the Abenomics market until it peaked in June 2015.

The term of office of the members for the House of Representatives will expire on 21 October. While the date for the election to the House of Representatives has not yet been set, it will be under a new Prime Minister. Recently in the run up to the LDP elections as policy debates have been taking daily among the four candidates campaigning for the LDP presidency, voters' interest seems to be increasing in favour for the LDP in the House of Representatives election.

The four candidates have different beliefs and political positions, and debate in the presidential race has been relatively broad. However, after the election, the most important issues for any candidate are likely to be the compilation of large-scale economic measures and the fight against the Covid-19 pandemic (Figure 3).

“Post-election policy to be defined by economic and Covid-19 measures. Unlikely to be able to demonstrate novel policies and reforms in the near term”

Figure 3 : Comparison of Candidates

Fumio Kishida	Sanae Takaichi
<ul style="list-style-type: none"> ● Maintain proactive fiscal and monetary easing policy, laying out financial commitment in the 10's of trillions of yen ● Establish Reiwa Income Doubling Plan aiming for distributing wealth by expanding the middle tier ● Revise investment income tax 	<ul style="list-style-type: none"> ● Promote the economic resilience plan "Sanaenomics", succeed Abenomics, through ①Large-scale monetary easing; ②Strategic fiscal stimulus and ③Crisis management and growth investments ● Temporary pause the target of primary fiscal balance until 2% inflation ● Consider raising tax on investment income
Taro Kono	Seiko Noda
<ul style="list-style-type: none"> ● Place significant emphasis on security, diplomacy disaster prevention, renewable energy and medical cost reduction, English education and digitization ● Track record on regulatory and administrative reform ● Consider raising tax on investment income 	<ul style="list-style-type: none"> ● Reduce the number of members in the House of Representatives ● Examines the security implications of demographic decline ● Make child care part of the wider growth strategy

Source: Media research

In addition, it goes without saying that it will also be difficult for the new government to achieve stability without first allowing economic activities to resume by tackling new infection rates and hospital capacity issues.

A stable administration is required in order for the Prime Minister to implement his/her own policies and reforms. It is highly likely that there will be questions on the timing and feasibility of policies amid the ongoing fallout of the Covid-19 pandemic. We will need to monitor the situation to see whether the new administration will successfully achieve the level of internal stability to be able to execute its policies and reforms.

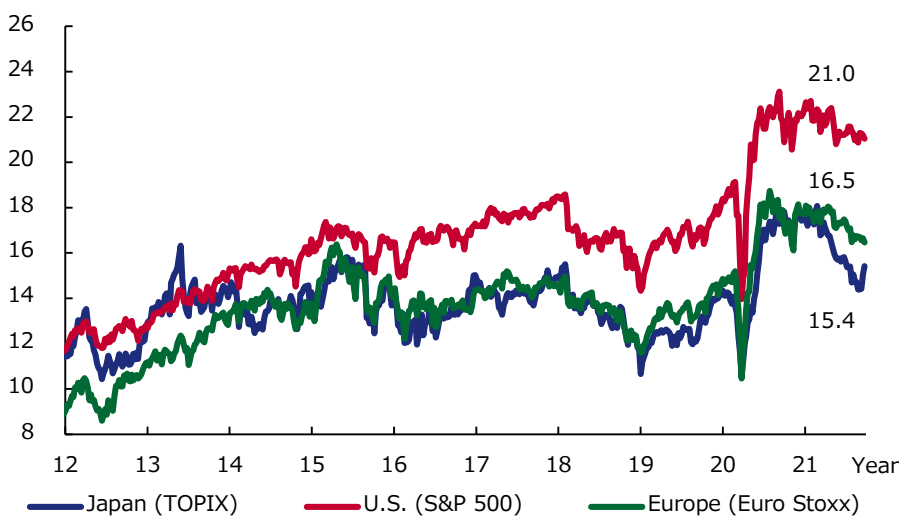
During the Abenomics market characterized by the three arrows of (i) aggressive monetary policy, (ii) fiscal stimulus, and (iii) growth strategy, foreign investors bought a cumulative total of around ¥21 trillion in physical Japanese equities, but they have significantly reduced their positions since the peak in June 2015. They sold around ¥9.3 trillion between June 2015 and September 2016, and around ¥10 trillion between November 2017 and August 2021.

However, from the fourth week of August 2021 to the second week of September 2021, when Japanese stocks rose rapidly, foreign investors bought a relatively large amount of Japanese shares in the form of both cash and futures contracts, totaling about ¥2.1 trillion (cash: about 0.7 trillion yen). This suggests that foreign investors, who have been reducing their positions, have started to buy back Japanese stocks in the run-up to the House of Representatives election.

“Further upside in Japanese equities contingent on sustained expectations under a stable government”

If we compare the price/earnings ratios (P/E) of Japanese, US and European stocks in the long term, we see that the 12-months forward P/E of Japanese stocks (TOPIX) and European stocks (Euro STOXX) have been trading at roughly the same level, and at 17% lower than US stocks (SP500). Given the recent rally, Japanese equities have recovered to the same level as European equities in terms of performance since the end of February, but traded at some 7% lower than that of Europe and some 27% lower than that of the US in P/E terms (Figure 4).

Figure 4 : Comparison of market PER in US, Europe and Japan



Period : From Jan. 3, 2012 to Sep. 21, 2021 (Weekly)

Source : Refinitiv

(Note) Forward 12-month basis; Label of data for Sep. 21, 2021

The rise in Japanese equities since the latter half of August has been triggered by progress in the vaccination rollout, a fall in the number of new case, and receding uncertainty surrounding the political situation following Suga's announcement that he would be stepping down. This has been accompanied by an uptick in purchases of Japanese equities by overseas investors. As expectations for the post-election period rise, based on the aforementioned P/E gap between European equities, we think there is ample room for upside in Japanese equities.

If policy and reform expectations are sustained once the new government takes office, this could trigger foreign investors to raise their weightings in Japanese equities. If the recovery in Japan's corporate earnings is on a par with that in Europe and the US, we envisage a sustainable upward movement, accompanied by buying from overseas investors.

However, the new government will first need to maintain control of the pandemic, restart the economy, and implement policies and reforms within the new challenge of a post-Covid 19 environment, which will be a difficult task. We need to keep a close eye on whether the new government will remain stable and whether foreign investors will continue to buy into Japanese equities.

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