
TACTICAL IDEA: DURING YEN WEAKNESS DON'T FORGET ABOUT JAPANESE EXPORTERS

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02 May 2018

It is widely known that Japanese equities have an inverse relationship to the performance of the Yen. Namely:

- When the Yen is appreciating, Japan's stocks face a stiff headwind and tend not to deliver their strongest returns
- When the Yen is depreciating, Japan's stocks tend to find themselves in a much more favourable environment and have delivered much stronger performance

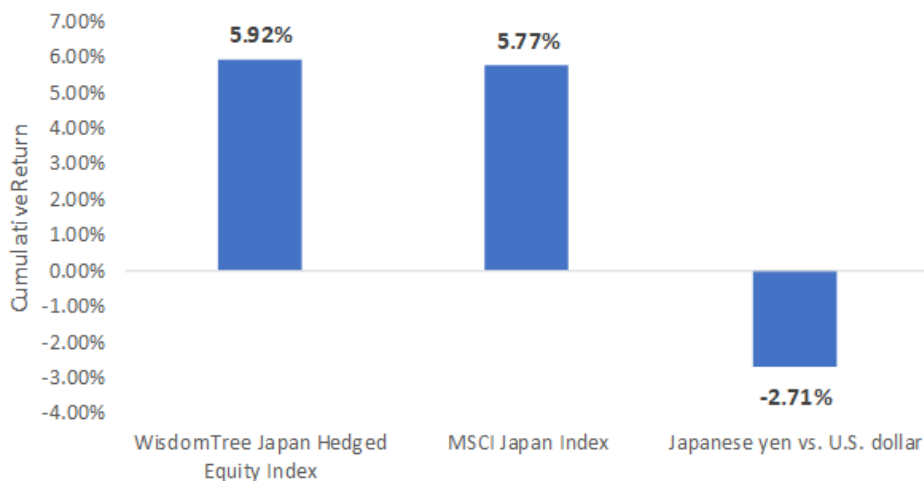
When we look thus far at 2018, data from Japan's Ministry of Finance has indicated that more than \$30 billion dollars has left Japanese equities from foreign investors¹. Clearly, foreign investors haven't been happy with Japan as an allocation, and a probable factor in contributing to this activity is that people have seen the headline number for the Japanese Yen/US Dollar exchange rate touching below 105—quite a strong level!

Warning: Yen does not move in a single direction

While foreign investors would clearly prefer to see the Yen/US Dollar exchange rate touching levels above 110 and moving towards 120, we caution them to not forget about Japan just because the yen is on the stronger end of its trading range. Markets can move quickly, and during bouts of yen weakness, Japanese equities can be interesting tactical trading ideas.

Example: 23 March 2018 to 20 April 2018 saw a 2.71% Yen depreciation—what did the equities do?

Japan's Equities Reacted well to Recent Yen weakness (23 March 2018 to 20 April 2018)

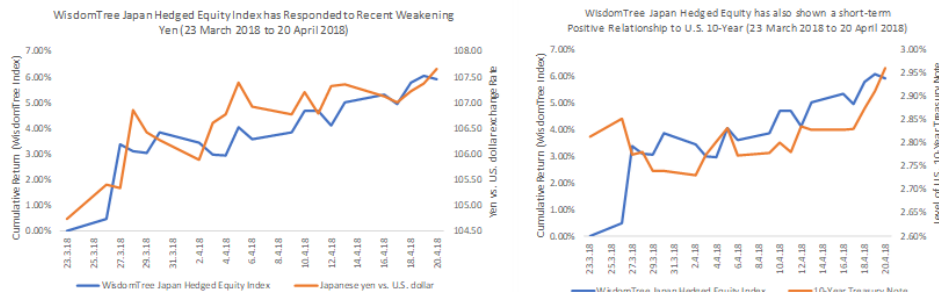


Source: Bloomberg.

Past performance is not indicative of future results. You cannot invest directly in an Index.

- Clearly, Japan’s equities reacted well to the downward movement in the yen.
- The WisdomTree Japan Hedged Equity Index focuses its approach on exporters—this would lead us to expect that it should respond more strongly to the Yen’s moves. We see here—admittedly over a short-term period—that this was the case relative to the broader MSCI Japan Index.

Key Relationships: The Yen & the US 10-year treasury note interest rates



Source: Bloomberg.

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- On the left side, we can see the clear relationship between a weakening Yen against the US Dollar and the performance of the wisdomTree Japan Hedged Equity Index. This is highly related to our first chart—it just shows a way to look at the relationship from a more “across time” or “correlation” perspective
- On the right side, we can see that there is also a relationship between the WisdomTree Japan Hedged Equity Index and the level of the US 10-year treasury note. Historically, we’ve seen a positive correlation between a rising US 10-year and the performance of the wisdomTree Index shown here—and with the 10-year getting very close to 3%, it is important to bring this relationship back out to the forefront.

In 2018, the Yen had been one of the strongest performing currencies, despite the rise

in the 10-year. In late April, the yen started coming under more pressure that coincides more in sync with the rise in US vs Japan yield differentials.

We'd point out that from a pure equity valuation perspective, we find Japan one of more attractive markets globally. This starts with the compensation one takes to own equities over safer assets like bonds. The earnings yield 'risk premium' over Japanese bond yields is among the highest globally—given a 10-year Japanese government bond yield that is anchored near zero and an earnings yield, on WisdomTree's index that is almost 7.8%. The comparable ratio for the S&P 500 Index is below 2% given a trailing 12-month PE ratio that is over 20x and a 10-year bond yield that is approaching 3%.

Japan's equities look extremely attractive relative to government bonds

Index	Trailing 12-Month Earnings Yield	10-Year Government Bond Yield	Spread (Earnings Yield - Bond Yield)
WisdomTree Japan Hedged Equity Index	7.85%	0.06%	7.79%
MSCI Japan Index	7.36%	0.06%	7.30%
S&P 500 Index	4.69%	2.96%	1.73%

Source: Bloomberg. Data is as of 20 Apr. 2018. 10-Year Government bond yield for the Japan-focused equity Indexes is the 10-Year Japanese Government Bond. For the S&P 500 Index, this refers to the 10-Year U.S. Treasury Note.

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If tensions over global trade recede, North Korea risk also seems to fade, Japanese equities seemed poised for recovery.

¹ Sources: Bloomberg, Japan Ministry of Finance, based on data with 1 week lag in reporting, current as of 13 April 2018.

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