



April 2010

Japan is Back!

The Japanese market has only started recently to outperform other markets after having underperformed for various years. The Nikkei 225 has now broken above the 11'000 resistance for the first time since March 2008 (see red line in chart below).



We think Japan has a good chance to further outperform global equity markets for the 6 – 9 months coming due to the following fundamental reasons.

Better earning expectations

Japanese corporate earnings for the 1st half of FY 2009/10 were better than expected and the 3Q figures were also above analysts' expectations. EPS estimates of corporates for Q4 FY 2009/10 (Jan–Mar 2010) curiously reflect a 44% QoQ decrease in earnings. In light of economic conditions and exchange rate trends in Jan–Mar 2010 we see a high probability of FY 2009/10 earnings surpassing current estimates substantially. If this turns out to be the case, analysts are likely to raise their existing FY10-11 earnings estimates.

Underinvestment

Japan has been a (justified) underweight country for a few years now. When Prime Minister Koizumi won the snap elections in August 2005, the market rallied by almost 30% in just a few months. On the one side we had a liquidity rally (led by foreigners) and we also had the Yen/\$ rate move from 110 to 120 in the same period. After the 43% rally in 2005, Japan has only disappointed and that is why most foreign investors have reduced their exposure continuously. Since December 2009, when interest in Japan hit a nadir, there has been a dramatic recovery in risk sentiment. Foreign flows into Japan have totalled ¥3.1 trn in the last four months, one of the largest increases in the last 10 years. Accordingly, Japan has outperformed Asia ex-Japan and the world ex-Japan by around 4%.

Asian and Emerging Market Growth

Asian countries are growing quite strongly. GDP growth for 2010 is expected at +8% in India and at +10% in China. Japan will benefit from it, as it is highly exposed to Asian countries. Over 60% of Japanese exports go to Asia. Additionally, GDP will continue to rise at a faster pace in emerging countries compared to developed markets. Emerging countries have ongoing demand for technological development and upgrading. Japan will profit from that as its know-how in technology research & development is still ahead of the rest of the world.



A weaker Yen

The Yen has started to weaken against the US\$ moving from 90 to 94 in March. Over 62% of all Topix members are cyclical stocks, and many are exporters. Most Japanese companies have the Yen/\$ rate between 90 - 92 on their books, so anything above 92 is an additional profit. The Bank of Japan has officially announced that they will continue their quantitative easing, and the new Finance Minister, Mr. Kan (Yes he can!), has officially stated that he would like a weaker Yen to support the economy. Also the Yen might regain the status as the "carry-trade" currency of choice when overseas interest rates (US, Australia) will go up while Yen rates will not move up for a longer period. Furthermore, the Chinese Renminbi is expected to strengthen in the near future and drag along the Korean Won and New Taiwan Dollar. This would further improve Japan's export competitiveness.

Japanese stocks remain highly correlated with the Yen/US\$ rate



We believe that Japan's time has come and that you should allocate some money to the land of the samurais.

Investment Ideas

- The **Cat Nippon Convert (278.352)**, which is a long only convertible bond fund, would be the ideal investment for more conservative portfolio profiles. Convertible bonds generate a higher risk-adjusted return compared to a combination of bonds and equities thanks to their asymmetrical risk/reward profile. 62% of the CB holdings in the fund have a direct export-oriented exposure. The average premium of the fund is 22.2% and the delta stands at 0.42. The annualized volatility of the fund is 5.01 compared to the Topix at 20.94 showing that risk/reward is much better for the CB fund.
- **Catam Japan Advantage (1.088.891)** is a long only equity fund which invests in Japanese large and mid caps.
- The **FIT Galileo Japan (1.005.535)** is a long only equity fund which invests in the Japanese small cap universe. Average price to book of the portfolio's holdings is currently 0.62 x.

For more information about these funds, please do not hesitate to contact us or visit our website www.cat-fund.ch

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