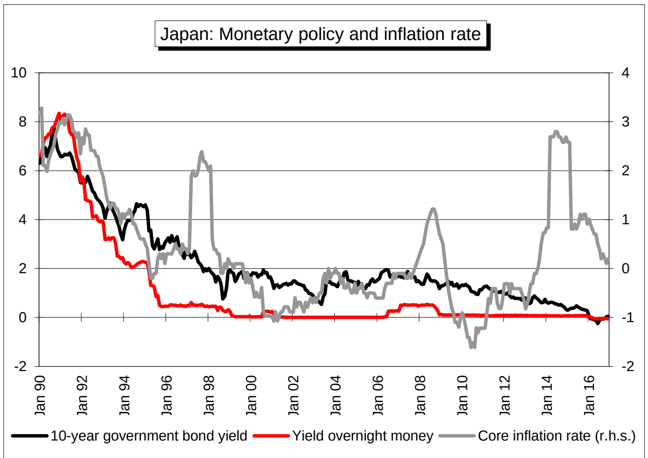
Japan has voted! Banzai or hara-kiri?

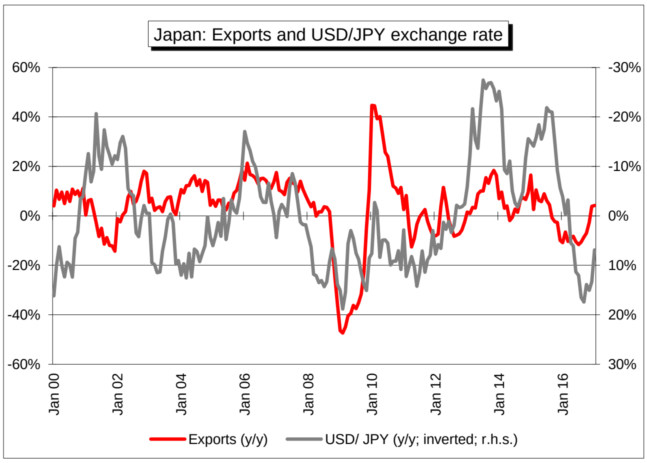
Japanese Prime Minister Shinzo Abe could hardly believe it himself. In last Sunday's snap election, his Liberal Democratic Party (LDP) actually won more than half of the seats in the Japanese parliament. If the existing coalition with the small Shintoist Komeito Party continues, the result will probably suffice for a two-thirds majority, which might make passing announced constitutional changes easy. Once again, the forecasts in advance of the election were completely different. The LDP's reputation was still significantly tarnished in August by charges of nepotism and alleged favors for political friends and supporters. Suddenly, the idea of calling a snap election based on a robust economy in order to secure political power for another four years no longer seemed so smart. New political forces that almost nobody had expected before last summer appeared on the political stage with popular programs and were gratefully able to point to scandals involving government officials. However, the establishment in the governing LDP ruthlessly exploited their disunity and lack of experience and by moving up the date nipped the process of serious challengers forming in the bud. Ultimately, neither the Democratic Party nor the "Party of Hope" founded by Tokyo governor Yuriko Koike could prevent Abe's triumph.



Besides weak opposition and a typhoon that meteorologists compare to hurricane Harvey, which kept many voters at home on election day (voter turnout was at a historic low of just under 50%), North Korean President Kim Jong-Un was probably also partly responsible for the election result. The escalation of threats between Washington and Pyongyang has aroused as much fear in Japan as North Korean missiles falling in the Sea of Japan. Abe took advantage of that and declared a "national crisis" and his exclusive need of a clear mandate to resolve it. The opposition was not in agreement on this issue and could only offer experiments instead of a firm and united strategy. And in crises – not only in Japan – one usually prefers not to switch horses in mid-stream.

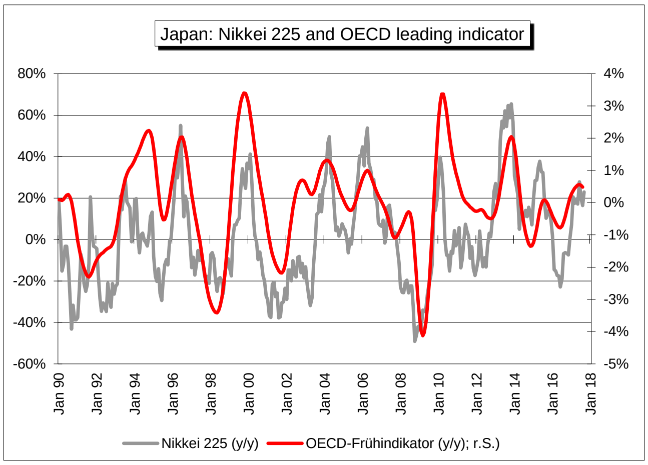
In view of the threats from North Korea, the reelected president's first priority will be to take the tense mood as an opportunity to push through his favorite project, changing the constitution. In force since the end of World War Two, Japan's pacifist constitution, which imposes considerable military restrictions on the country, is to be overturned. That would also strengthen the man-to-man friendship with Donald Trump, who is known to want more such colleagues at the levers of power. The project is controversial among the Japanese people, and more than 50% of them reject a constitutional change on this issue.

Furthermore, in collaboration with the Japanese central bank, the LDP wants to keep economic policy on its current path. After initial frictions, this has been measurable and successful. The Bank of Japan's goal is still to weaken the yen. It intends to import inflation with the help of a weak currency and to optimize the earning power of export industries. Tokyo describes the exchange rate effect, viewed with suspicion in Washington and elsewhere, as collateral damage. The ongoing massive purchases of government bonds and money supply growth are said to serve the purpose of preventing a relapse into deflation. To achieve this goal, monetary policy is being kept extremely loose; EUR 600 billion in government bonds and EUR 45 billion in stock index funds are being purchased this year alone.



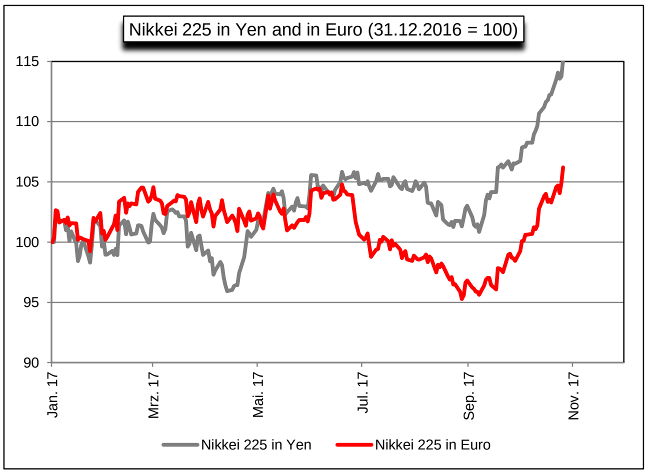
Japan is to continue dealing with already ominous shortages on the labor market (recently 151 job offers found only 100 job seekers) without relying on immigration. Among other things, social benefits are to be increased and channeled (by expanding facilities for child and elderly care) so that more women can be integrated into the labor market. For, this year alone, the share of gainfully employed in the total population has declined by more than 800,000 persons. A new economic stimulus package totaling EUR 15 billion to combat this plight is to be adopted this year. The increasingly tight labor market should lead to somewhat higher wages and salaries in the foreseeable future and hence to higher retail sales and more investments in durable consumer goods.

Besides these macroeconomic and monetary policy factors, we also see positive changes in Japanese corporate governance, which will lead to ever more noticeable effects for investors. The discovery of shareholder value with an investor-friendly dividend policy and more open corporate communication have replaced the conspiratorial public relations work that was usual until a few years ago. On average of the 2,000 stocks in the broad Topix index, dividend yields have increased by almost 60% since 2012. Moreover, greater use is being made of stock buyback programs. Japan's companies have accumulated huge cash reserves in the period following the worldwide financial crisis. The finance ministry in Tokyo calculates these reserves, which are increasingly being used to benefit shareholders, at the record amount of EUR 1.5 trillion. The profitability of Japanese companies has also increased more than proportionately in the past years thanks to numerous rationalization measures. The average equity ratio of Japanese companies has risen significantly to 8.1% now. Despite the rise of the stock markets to a 20-year high, valuation is comparatively moderate with a price-earnings ratio (P/E) of 14.5 and a price-book value ratio (P/BV) of 1.3. Almost 60% of companies are now trading below their intrinsic value. And companies have managed to reduce their debt by half in the last ten years.



Factors that are more structural in nature could also emerge as price drivers for Japanese stocks. Investments by large pension funds and the central bank as well as renewed interest on the part of now underexposed international investors could contribute to a continuing bull market. However, investors are also focusing more attention on Japan due to other factors. Outstanding innovations, like the first hotel run almost entirely by human-like robots in Nagasaki or the high-speed railway capable of covering the 550 kilometers from Tokyo to Osaka in one hour, whose launch will coincide with the Olympic Games in 2020, are evidence of innovativeness that can hardly be found elsewhere. For decades, Japanese investments in research and development have been significantly higher, both absolutely and relatively, than in almost all other industrialized countries. This is likely to be a hugely important factor in a time when growth is increasingly being generated by corrections of misguided past investments.

However, the long-term outlook for the aging Japanese economy remains modest in our opinion despite all these hope-inspiring efforts. At some point, the country's own limited population resources will be exhausted, aging will not stop, and robots do not buy cellphones or automobiles. But from an investor standpoint, Japanese companies have earned more attention, at least with a view to the months ahead, than they were getting some time ago. While interest rates are rising moderately in the United States and the ECB is tapering its bond purchases, there is no talk of that in Japan. The weak yen is likely to stimulate exports further and crank up demand for Japanese stocks in view of the very blatant negative yields of other asset classes. Even though many of the facts described above appear to be priced in already and the stock indexes are near 20-year highs, there is no shortage of interesting stocks in Japan. However, the opposite developments of the yen and the Japanese stock exchange must still be taken into account. This year, the Nikkei 225 has gained about 13% calculated in yen and is thus on a par with the DAX. But calculated in euro, only 4% of that nice result remains. Investing in Japan should therefore always involve a careful analysis of the exchange rate trend. As an old Japanese proverb says: "It is better to think about how not to lose than about how to win."



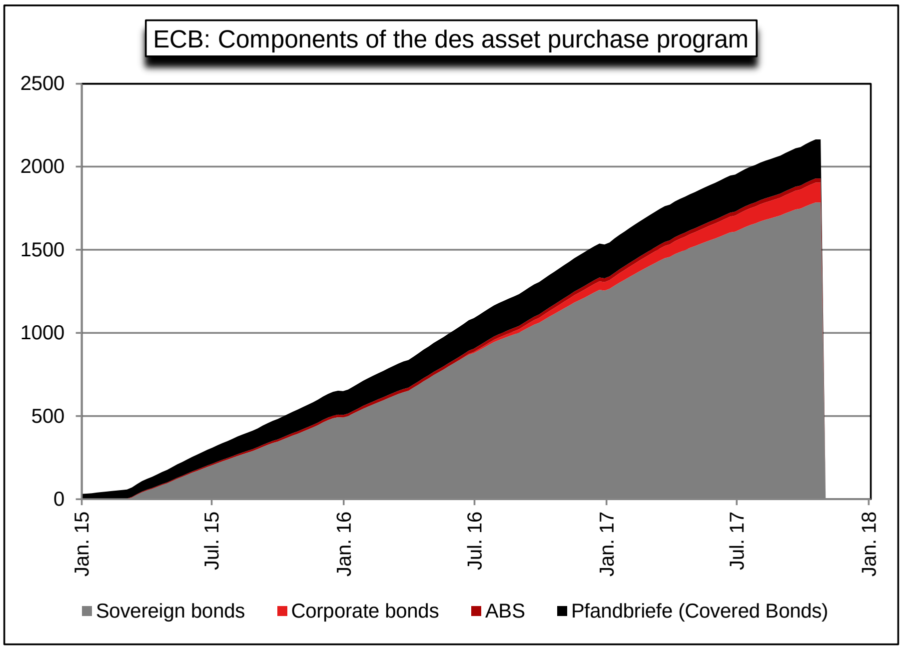
We are grateful for the kind assistance of our Berlin colleague Dr. Frank Geilfuß.

Weekly outlook for October 30-November 3, 2017

	May	June	July	Aug.	Sept.	Oct.	Release
DE: Import prices, m/m	-1.0%	-1.1%	-0.4%	0.0%	0.3%		Oct. 27
DE: Import prices, y/y	4.1%	2.5%	1.9%	2.1%	2.4%		Oct. 27
DE: Retail sales, m/m	0.2%	1.3%	-1.2%	0.5%	0.6%		Oct. 30
DE: Inflation rate, flash, y/y	1.5%	1.6%	1.7%	1.8%	1.8%	1.7%	Oct. 31
DE: Core inflation rate, flash, y/y	1.3%	1.6%	1.7%	1.6%	1.5%	1.5%	Oct. 31
DE: Unemployed, change in k	-8	5	-10	-6	-22	-14	Nov. 2
DE: Unemployment rate	5.7%	5.7%	5.7%	5.7%	5.6%	5.5%	Nov. 2
DE: Markit PMI, manufacturing	59.5	59.6	58.3	59.4	60.6	61.0	Nov. 2
EUR19: Business climate	0.9	1.15	1.04	1.08	1.34	1.30	Oct. 30
EUR19: Economic confidence	109.3	111.1	111.3	111.9	113	113.2	Oct. 30
EUR19: Consumer confidence, final	-3.3	-1.3	-1.7	-1.5	-1.2	-1.0	Oct. 30
EUR19: Industrial confidence	2.8	4.5	4.5	5	6.6	7.4	Oct. 30
EUR19: Inflation rate, flash, y/y	1.4%	1.3%	1.3%	1.5%	1.5%	1.5%	Oct. 31
EUR19: Core inflation rate, flash, y/y	0.9%	1.1%	1.2%	1.2%	1.1%	1.2%	Oct. 31
EUR19: Markit PMI, manufacturing	57.0	57.4	56.8	57.4	58.1	58.7	Nov. 2

MMWB estimates in red

Chart of the Week: A cautious step by the ECB towards normalizing monetary policy



The European Central Bank (ECB) will start tapering its bond purchases in January 2018. It has been buying securities at an average monthly total of EUR 60 billion since April 2017 (before that EUR 80 billion). From January 2018 to at least September 2018, the amount will decrease to EUR 30 billion. Altogether, the ECB now has bonds totaling EUR 2.1 trillion on its balance sheet, of which government bonds account for almost EUR 1.8 trillion, covered bonds for EUR 230 billion, and corporate bonds for EUR 120 billion, and asset-backed securities for EUR 25 billion. The exact details concerning the future arrangement are still lacking, but it may be assumed that government bonds will account for most of the volume reduction. About EUR 5-6 billion per month are likely to be invested in corporate bonds in the period to September 2018 (so far about EUR 7 billion), and the rest in government bonds. Moreover, the ECB will reinvest all redemptions and interest payments, thus additionally increasing the monthly purchase total. Overall, this can only be described as a very cautious first step towards normalizing monetary policy, since the ECB balance sheet will continue to grow, albeit at a somewhat slower pace than before. Monetary policy in the euro zone will thus remain very expansionary, and we do not expect appreciable effects on the general level of interests, especially since bond purchases will not be abruptly discontinued even after September 2018. Further adjustments of monetary policy in the form of interest rate increases are not to be expected until long after the end of the purchase program and thus not before 2019. If the economic outlook or financing terms in the euro zone should worsen, the ECB might even decide to expand the volume of purchases again. Investors hoping for higher interest rates will therefore have to remain patient.

Stock marktes	As of 27.10.2017 13:56	Change versus -1 week	-1 month	-3 months	YTD
Dow Jones	23401	1,0%	5,0%	8,3%	18,4%
S&P 500	2560	-0,1%	2,6%	3,4%	14,4%
Nasdaq	6564	-0,6%	3,0%	2,4%	21,9%
DAX	13224	1,8%	5,0%	7,8%	15,2%
MDAX	26721	2,7%	4,2%	8,5%	20,4%
TecDAX	2522	1,1%	4,6%	11,6%	39,2%
EuroStoxx 50	3656	1,5%	3,3%	5,3%	11,1%
Stoxx 50	3203	0,5%	2,1%	2,5%	6,4%
SMI (Swiss Market Index)	9200	-0,4%	0,7%	2,9%	11,9%
Nikkei 225	22008	2,6%	7,9%	10,3%	15,1%
Brasilien BOVESPA	75896	-0,5%	2,0%	15,6%	26,0%
Russland RTS	1109	-2,6%	-1,9%	9,7%	-3,8%
Indien BSE 30	33157	1,8%	4,8%	2,9%	24,5%
China Shanghai Composite	3416	1,4%	2,2%	5,3%	10,1%
MSCI Welt (in €)	2026	1,6%	4,1%	4,1%	5,1%
MSCI Emerging Markets (in €)	1108	1,2%	4,1%	5,2%	16,7%
Bond markets					
Bund-Future	163,14	86	121	154	-101
Bobl-Future	131,60	4	18	-25	-203
Schatz-Future	112,26	3	8	25	-4
3 Monats Euribor	-0,33	0	0	0	-1
3M Euribor Future, Dec 2017	-0,33	0	-1	-2	0
3 Monats $ Libor	1,37	1	4	6	38
Fed Funds Future, Dec 2017	1,28	1	4	4	0
10 year US Treasuries	2,46	13	23	13	1
10 year Bunds	0,42	2	1	-8	21
10 year JGB	0,07	0	5	0	2
10 year Swiss Government	-0,05	3	2	-8	16
US Treas 10Y Performance	577,95	-1,0%	-1,7%	-0,2%	1,5%
Bund 10Y Performance	606,59	-0,8%	-0,7%	0,9%	-0,5%
REX Performance Index	483,60	0,0%	0,1%	0,5%	-0,4%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,75	6	2	-8	8
IBOXX BBB, €	1,26	5	-1	-11	-24
ML US High Yield	5,95	-1	-4	0	-51
JPM EMBI+, Index	835	-0,8%	-0,5%	1,7%	8,2%
Convertible Bonds, Exane 25	7343	0,5%	1,4%	2,2%	6,2%
Commodities					
CRB Spot Index	429,95	0,3%	0,2%	-2,5%	1,6%
MG Base Metal Index	348,33	0,8%	4,7%	12,4%	24,5%
Crude oil Brent	59,11	2,6%	1,0%	18,1%	4,2%
Gold	1266,47	-1,7%	-3,0%	1,3%	9,4%
Silver	16,92	-1,8%	-0,6%	2,7%	5,4%
Aluminium	2172,75	1,3%	2,3%	13,8%	27,5%
Copper	6983,75	0,7%	9,0%	12,7%	26,4%
Iron ore	59,15	-2,1%	-16,1%	-9,8%	-25,8%
Freight rates Baltic Dry Index	1555	-1,7%	3,5%	58,7%	61,8%
Currencies					
EUR/ USD	1,1605	-1,9%	-2,2%	-0,8%	10,1%
EUR/ GBP	0,8865	-1,3%	0,7%	-0,8%	3,9%
EUR/ JPY	132,47	-0,5%	-0,5%	1,7%	7,4%
EUR/ CHF	1,1632	0,8%	0,6%	5,1%	8,3%
USD/ CNY	6,6510	0,5%	0,4%	-1,5%	-4,3%
USD/ JPY	113,75	1,1%	1,8%	1,7%	-2,7%
USD/ GBP	0,76	0,9%	3,0%	-0,3%	-5,6%

Carsten Klude +49 40 3282-2572 cklude@mmwarburg.com
Dr. Christian Jasperneite +49 40 3282-2439 cjasperneite@mmwarburg.com
Dr. Jörg Rahn +49 40 3282-2419 jrahn@mmwarburg.com
Julius Böttger +49 40 3282-2229 jboettger@mmwarburg.com
Martin Hasse +49 40 3282-2411 mhasse@mmwarburg.com
Dr. Rebekka Haller +49 40 3282-2452 rhaller@mmwarburg.com
Bente Lorenzen +49 40 3282-2409 blorenzen@mmwarburg.com