

INVESTMENT NOTE

06 May 2015

HERMES GLOBAL EQUITIES: FIVE REASONS WHY WE ARE BULLISH ON JAPAN

Geir Lode, Head of Hermes Global Equities, and Lewis Grant, Senior Portfolio Manager, have recently increased their allocation to Japan after becoming more bullish on the country's prospects at the expense of the US.

We were much more positive about the US a year ago, as the market was still enjoying an environment of extremely loose monetary policy. Fast forward to today, we believe the strength of the US dollar and the coming tightening will be significant headwinds for US companies. On the other hand, Japan presents a compelling investment case and we have been increasing our focus on this market based on the following five reasons.

Valuations

The first reason why we like Japan is valuation. The TOPIX is currently trading at about 15.5x forward earnings, while the S&P 500 is more like 17.5x. However, earnings growth expectations in Japan are much higher than the US. We expect 15% earnings growth in Japan over the next year, while we feel it will be high-single digits in the US. We have seen a lot of US-based multinationals tested during the Q1 earnings season.

Sentiment

The signs are positive for Japanese equities right now. Firstly, the Bank of Japan (BOJ) has been aggressive purchasing stock funds in recent months. Secondly, domestic Japanese investors are investing back into the equity market. Finally, we are seeing strong flows internationally.

Currency

There has been a lot of discussion about the impact of Abenomics on the falling yen. It has proved to be an effective policy, but we expect the yen to be much more stable over the next 12 to 18 months. Indeed, the BOJ is now more concerned about the yen becoming too weak. We believe it has reached levels where concerns over the yen are overstated.

Competitiveness

While the Yen was strong from 2008 to 2012 Japanese companies were forced to restructure to stay competitive. Exports have risen moderately and domestic consumption is rising. Compared to three years ago, Japanese stocks now also have the strong tailwinds of the weak currency and lower energy costs. These factors make the investment case for Japanese equities far more compelling. For example, we have a big holding in Toyota, which might be a boring name, but it has an attractive valuation and we feel it will benefit from ongoing restructuring and recovery.

Corporate governance

Japan is finally taking corporate governance seriously. It has introduced stewardship codes and undertaken a lot of work on the governance side, which has historically been a major concern. Japan's stance in this area has led many international investors to believe Japan was not a shareholder-friendly destination. Our process has a real focus on positive corporate governance. We have undertaken research showing companies with poor standards of governance have historically underperformed peers. While Japan still lags Western peers, it is positively changing and we are looking to play this structural change through our portfolio.

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Notes to Editors:

Hermes Investment Management

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Hermes manages assets on behalf of more than 200 clients* across equities, fixed income, alternatives and real estate, with £28.6 billion* assets under management. In Hermes EOS, we have the industry's leading engagement resource, advising on more than £134.0 billion* of assets.

We believe in **Excellence, Responsibility** and **Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure gives clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Equities:** Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan, Greater China
- **Fixed Income:** Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European, UK PRS
- **Alternatives:** Multi Asset, Infrastructure, Private Equity

*Please note the total AuM figure includes £3.7bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 December 2014.