

Market Update Note – Japanese Equities Team

Japanese Equities



We have seen considerable nervousness return to global markets in early 2008.

In this Market Update, we present the views of the Japanese equities team, explaining the current market background and their outlook.

Due to the recent market volatility, the Japanese equity market fell by approximately 9% over Monday 21 and Tuesday 22 January 2008. From the beginning of 2008, Japanese equity markets have declined largely due to the worldwide subprime loan problem. However, despite this recent instability equity markets, we continue to believe Japanese equities will rise in May or June after companies announce their corporate results for 2007 (year-ending March 2008) and their forecasts for 2008. Until then, we anticipate this period of market volatility to continue.

Our Strategy

We are tracking the business momentum of companies on a monthly base. In 2006, small caps declined largely because of the expanding gap between initial forecasts made by companies and their earning results. However in the full year for 2007, we expect companies, including small caps, to be able to keep profit growth at the same level as their initial earnings forecast. We are also vigilantly analyzing companies' earnings trends to see how they might be affected by a slowdown in the global economy and the possible impact of a market fall.

How are the structural factors for Japanese equities?

Global investors are currently taking a pessimistic view on Japanese corporate governance after the Bull-Dog Sauce's takeover defence issue in June 2007 (the use of a poison pill defence). We think that this issue effected Japanese equity markets, with stocks on low price-earnings ratio, especially small caps, declining largely after this issue.

We think that corporate governance is improving but very slowly and we have yet to see a good trigger with regards to positive news. Finally, we feel that valuations (PER 15, price-to-book of 1.5) are now attractive and believe that value investors in particular will soon focus on Japanese equities.

Overview

- Despite recent market volatility, expect the Japanese market to rise mid-year.
- Corporate governance is improving.
- Valuations on Japanese equities are now attractive.

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