Crossbow Partners
Experience & Discipline

20th Goldman Sachs Asia Hedge Fund Symposium in Tokyo

September 25 - 27, 2019

Executive Summary

Largest hedge fund conference in Asia with 500 people registered for the event, including 260 investors who control USD 700 bn of hedge fund assets and 58 managers representing hedge fund assets of over USD 300 bn

20 years ago, Asia hedge fund managers collectively managed USD 10 bn, today Asia HF AuM has grown to approximately USD 330 bn (80% of that growth happened in the last 5 years)

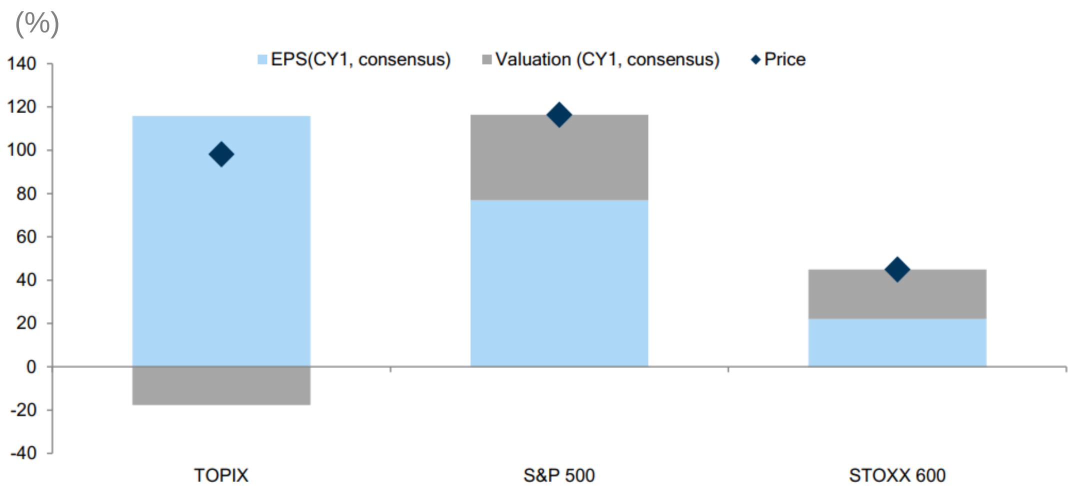
China dedicated strategies are the fastest growing segment and now represent the largest portion of regional AuM of about 20%

The acceleration of opening and reform of China's financial markets, true progress of corporate governance reform in Japan and increasing sophistication of talent and investment tools in the region have attracted HF assets to Asia

Talent sourcing has been become one of the most significant constraints to HF growth in the region

Japan: General Market Observations

Japan remains the only developed market where index gains since 2012 have been solely driven by earnings growth. Despite the strong performance, Japanese equities still trade cheaper than their US and European counterparts on a forward P/E basis. According to Factset, the forward P/E ratio for Japan (Topix) stood at 15x, versus 18x for S&P500 at end of November 2019. When comparing the different drivers of stock returns, one gets very interesting results. As can be seen on the following chart, the entire advance in Japanese stocks can be attributed to earnings growth, while valuations have contracted during the same time period. This is contrary to the US or Europe, where multiple expansion has been a significant driver of stock returns.



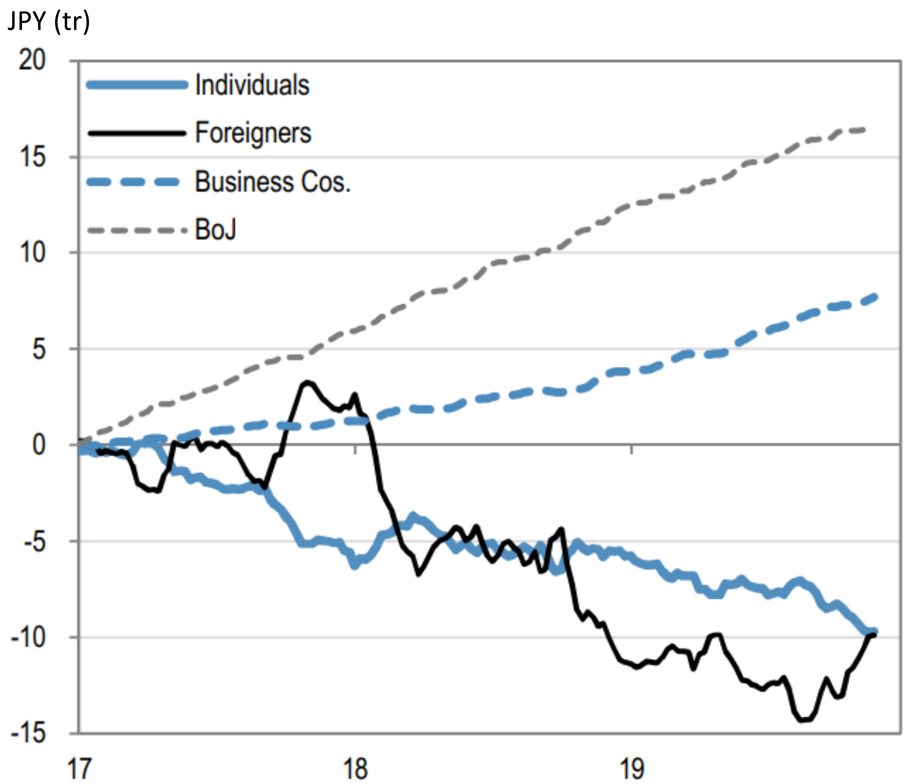
Source: Goldman Sachs

Even on a price-to-book ratio, Japanese stocks appear cheap with 46% of the firms in the Topix Index trading below book value, compared to just 3% and 10% for the US and European markets, respectively. In the first eight months of 2019, Japanese equities have been lagging other developed markets, but at the end of August, Japanese stocks started catching up, rallying almost 20% since then.

Source: Bloomberg

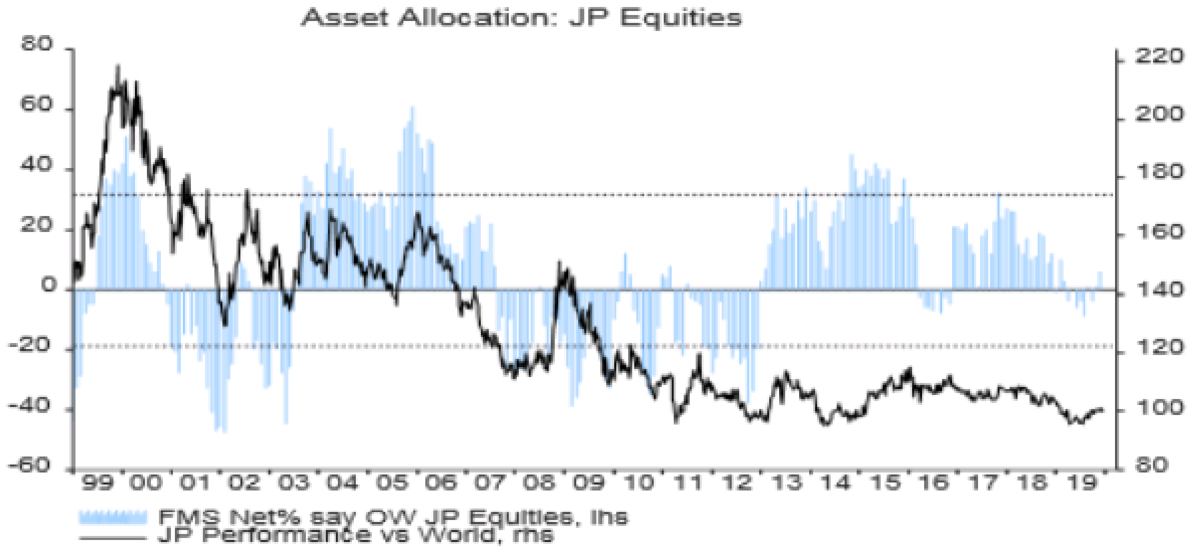
The underperformance in 2019 was mainly driven by headwinds including the intensifying trade war between the USA and China, weaker global growth, JPY appreciation, earnings disappointments, and VAT hike concerns. However, looking ahead to 2020, most of these factors are likely to reverse, as easy monetary conditions are likely to remain throughout 2020 and the peak of the US-China trade war is behind us. Weak global growth hit Japanese exports in 2019, but capex and consumption have been resilient, and domestic demand will likely remain as the key growth driver. About 2/3 of Japanese GDP is driven by private domestic demand (i.e. consumption and capex) vs. just 16% by exports. Additional easing from the BoJ is unlikely at this moment, but the government approved a fiscal package in the equivalent of USD 120 bn to mainly finance the repair of damage caused by typhoon Hagibis, which was the worst storm to hit the country in decades.

In 2019, the main sellers of Japanese equities have been foreigners and individuals/investment trusts, amounting to a total of JPY 4.2 tr (=USD 39 bn). As a hedge fund pointed out during a meeting, foreigners have sold everything what they had accumulated since the start of Abenomics and the potential downside due to more foreigners selling is very limited. On the other side, the BoJ and corporates have been steady buyers of Japanese equities. Corporates announced record amounts of buyback programs in 2019. Corporates together with the BoJ will likely continue to be the largest source of equity demand. The following chart shows the accumulated net purchases by different investor groups since the start of 2017.



Source: JP Morgan

Given higher conviction about global growth, a weaker JPY and hopes of a US-China trade deal, foreigners have aggressively started buying Japanese equities in the 4th quarter. BofA's Global Fund Managers Survey draws a similar picture. After two years of steady reductions to Japanese equities, global fund managers have finally started increasing their allocations to Japanese equities in the last couple of months. Still, only 6% of fund managers from the latest BofA Global Fund Manager Survey are currently overweight Japanese equities.



Source: Bank of America

Clearly, a lot of the good news have already been discounted by the market. If the economic recovery runs into trouble and the market senses that corporate earnings are unlikely to improve as implied by the consensus estimates, share prices could be negatively affected. Other key downside risks for the market include a re-escalation of trade friction (US-China and/or US-Japan), weaker than expected global growth, a sharp JPY appreciation and an adverse US election outcome. In 2020, Japan will be hosting the Summer Olympics and Paralympics. It will be interesting to see how Japan's growth will be impacted after the Olympics, since history shows that other countries have seen slowdowns in growth rates after hosting the Olympic Games.