



MARKET INSIGHTS

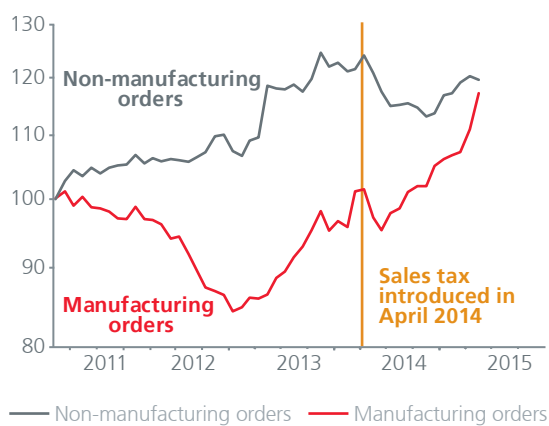
HIDING IN PLAIN SIGHT! JAPAN'S ORDERS SURGE – INVESTORS ARE FOCUSED ELSEWHERE

AUGUST 2015

Japan's manufacturing new orders surge!

They have risen over 25% since June 2014. The rise since this January has been almost vertical. So how is it that investors are seemingly overlooking this huge increase? With current developments in China and US, investor attention may simply have been diverted. Fig.1. below provides another possible, more intriguing, reason, which, if correct, suggests some strong sales and profit figures in the not too distant future.

Fig.1. Surging manufacturing orders¹ disguised by lower rises elsewhere



Source: Cabinet Office, Japan from Datastream as at 4 August, 2015.

STRONG ORDER REBOUND DISGUISED

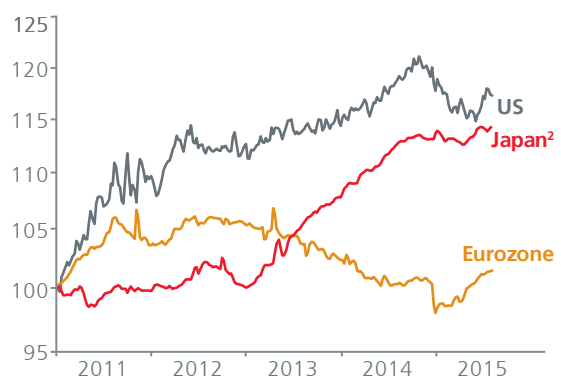
Non-manufacturing new orders, until recently, were falling; these had surged in 2013 in anticipation of the new sales tax in April 2014. Not unexpectedly, they declined after the introduction of the tax. But their fall

dampened total headline figures and so disguised the strong rebound in manufacturing orders. (These too had been impacted by the arrival of the sales tax, but to a much lesser extent). With non-manufacturing orders again rising, total headline new orders could be strong in the coming months.

STRONG ORDERS = STRONG SALES

Corporate sales forecasts in Japan have been relatively strong compared with other major markets (see Fig.2). But sales growth forecasts stalled in 2014 presumably reflecting the post sales tax pause in actual sales. The overall impression one gets is that the underlying surge in manufacturing orders has escaped the notice of many analysts. The recent uptick in forecasts suggests that some analysts are beginning to see the bigger picture.

Fig.2. Company sales forecasts in Japan are strong



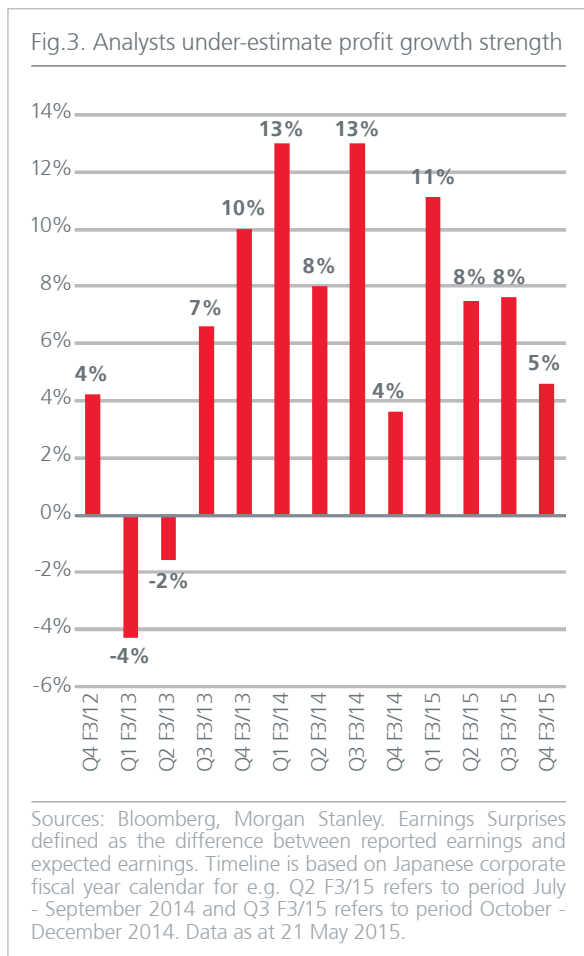
Source: IBES consensus 12-month forward forecasts from Datastream as at 4 August, 2015. All series are index to 100 as at 1 January, 2011 and are in local currencies.

¹Private sector machinery orders excluding volatile orders. ²Note that in November 2014, there was a break in this series as forecasts for heavily weighted Mitsubishi Corp moved from a GAAP to IFRS basis. Eastspring Investments has adjusted for this one-off decline.



PROFIT GROWTH UNDER-ESTIMATED

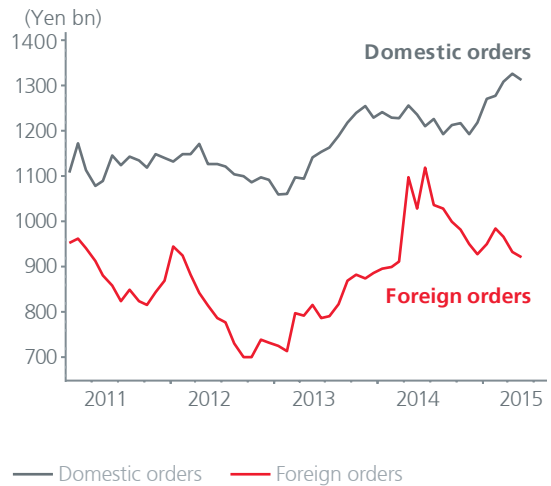
If we are correct in our reasoning, we have a very good explanation as to why the actual profits announcements have exceeded the consensus profit forecasts for the past ten straight quarters – analysts have missed the upswing in manufacturing orders and so are low-balling their profit forecasts! With the reporting season underway, we would be surprised if we did not see further profit outperformance.



DOMESTIC ORDERS ARE IN THE DRIVER'S SEAT

The encouraging news is that rising domestic demand seems to be driving the surge in new orders. As domestic activity accounts for around 88% of Japan's economy, the bounce back in domestic orders should be a harbinger of good news – especially as export growth resulting from the weak yen has still to cut in. Refer to Fig.4. ▶

Fig.4. Foreign orders have yet to respond to the "ferociously" competitive yen



Source: Cabinet Office, Japan from Datastream as at 4 August 2015. Each series is exponentially smoothed with a weighting factor of 0.3. The series are in yen terms.

THE "FEROCIOUSLY" COMPETITIVE YEN

With the yen already at a 40 year low³, it is just a matter of time before exports begin to respond.

Fig.5. The highly competitive yen is boosting margins. Foreign orders have yet to respond.



Source: JP Morgan real effective exchange rate from Datastream as at 4 August 2015.

It also seems that the Bank of Japan does not want to see the yen weaken much further on a trade weighted basis according to Governor Kuroda⁴. Fears of further currency losses seem less likely to be realised.

³On a real effective exchange rate basis as measured by JP Morgan from Datastream as at 4 August 4 2015. ⁴As reported by Bloomberg on 10 June 2015.

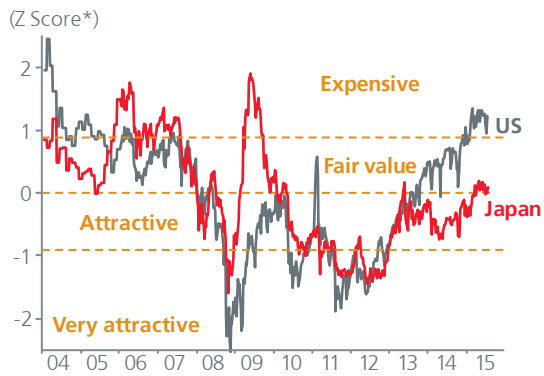


THE JAPAN STORY IS HEATING UP

All in all, Japan's underlying corporate growth looks stronger than given credit. More significantly, growth is forecast where it will benefit investors i.e. in rising corporate sales (and ultimately profits). Better still, this bullish outlook has only been partially discounted as Fig.6. below illustrates.

The contrast with the US is stark. Japan looks poised to have a good second half.

Fig.6. Japan has only partially discounted this strong order outlook



Source: Eastspring Investments, MSCI and IBES from Datastream, as at 4 August 2015. *The "Z" valuation is a composite measure giving equal weighting to the variation of the historical price to book ratio from its long-term trend and the variation of the prospective price earnings multiple from its long-term trend. The two outer dotted lines represent the limits within which around 70% of all values lie.



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