MARKET INSIGHTS

INVESTING IN JAPAN: JAPAN FUELS MARKETS WITH QUANTITATIVE EASING

NOVEMBER 2014

The Bank of Japan's (BOJ) recent surprise move to inject more money into the system resonated well with investors. Global markets rallied and Japanese shares in particular rose sharply; the Nikkei index ended October at its highest level since 2007.

The latest easing measures include expanding the monetary base through purchases of Japanese government bonds at an annual pace of 80 trillion yen, up from the earlier target of 60 to 70 trillion yen, and tripling investments in exchange-traded funds and real-estate investment trusts to 3 trillion yen and 90 billion yen respectively.

This is the first policy change since BOJ's Governor, Haruhiko Kuroda, began record asset purchases in April 2013, reasserting his determination to boost inflation towards 2%. Regardless of BOJ achieving its desired outcome, the market-oriented approach to policymaking will likely underpin market sentiment and stock prices in the near term.

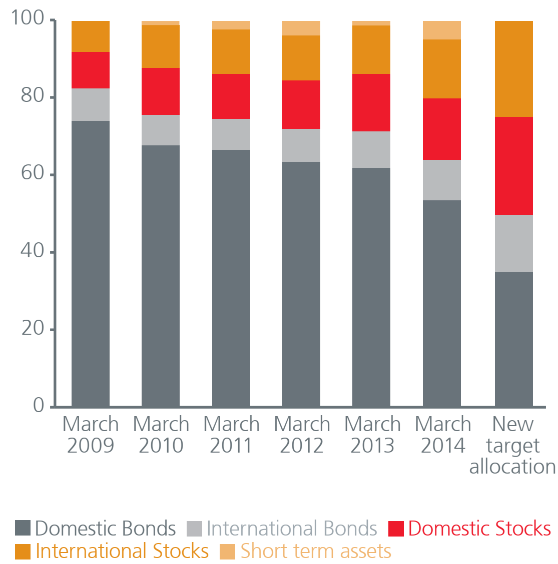
GPIF'S MOVE BODES WELL FOR EQUITIES

Separately, Japan's largest Government Pension Investment Fund ("GPIF") announced plans to double its holding of domestic stocks to 25% of its portfolio. GPIF will also raise the target for overseas stocks from 12% to 25%, investing in both developed and emerging economies for the first time. Given GPIF's USD1.3 trillion asset base[1], it is worth noting that a mere 1% increase in allocation to Japan equities will activate USD13 billion of inflows.

> GPIF's move may be emulated by other pension funds, potentially adding even more liquidity to the equity market.

Individual investors too may be encouraged to invest more of their savings into risk assets. As Japanese households hold 53% of their assets in cash (compared to 15% in the US), a 1% shift from household financial assets into domestic equities over the next five years implies a USD150 billion of new funds into equities[2].

Fig.1. GPIF asset allocation (%)



Source: GPIF, JP Morgan, Eastspring Investments, as at 31 October 2014.

Source: [1]GPIF as at 30 June 2014. [2]Eastspring Investments, BOFA Merrill Lynch Global Research.

EXPLOITING INVESTMENT OPPORTUNITIES – WE LOOK THROUGH MARKET VOLATILITY

Whilst this latest news is supportive for equities, one cannot rule out bouts of market volatility. This year has been a case in point; market performance and volatility has coincided with short term focused participants responding to thematic macroeconomic news flow, irrespective of company fundamentals.

For example, following Japan's consumption tax hike in April, expectations for weaker consumption and economic growth posed a near term headwind for market sentiment. Retail stocks lagged the market and offered value investors like us an ideal opportunity to add to a number of high conviction names whose share prices had been affected by short term sentiment. A point to note is that whilst real gross domestic product shrank immediately after April's sales tax hike, there has since been three months of consecutive growth. Whilst the share price for a number of retail names continue to lag the market in the shorter term, we are willing to be patient and wait to be paid for holding these out of favour names with big valuation upside.

Our investment strategy is thus not based on analysing or extrapolating market themes but conceived on a thorough analysis of long-term company fundamentals.

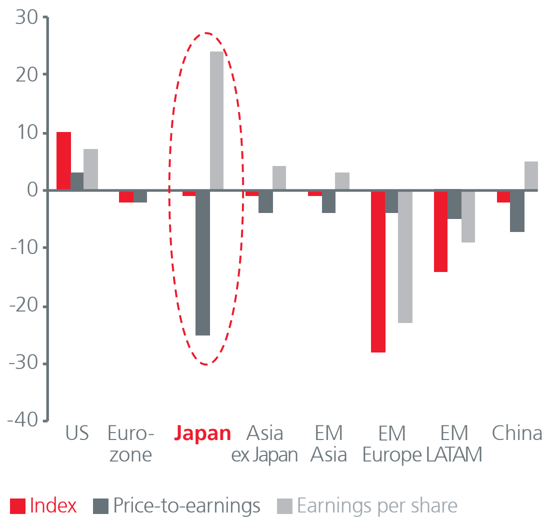
> Big price dislocations are opportunities for us to buy shares in cheap companies we deeply understand from a fundamental perspective. We exploit extremes of market pricings.

WHY INVEST IN JAPAN TODAY?

We believe the investment case for Japan equities is based on an ability to identify attractively valued companies with sound fundamentals that have yet to be recognised by the market.

Japanese equities look undervalued relative to other developed markets and their own history. Moreover,

Fig.2. Decomposition of market performance (%)



Source: Eastspring Investments. Chart shows change in the relevant market MSCI Index and how much of that change was due to (a) a change in the historical price earnings multiple and (b) the declared earnings per share (as measured by IBES). Data between 29 October 2013 and 29 October 2014. All data in USD except China (in CNY). This chart is for guidance only.

over the past year, Japan delivered strong earnings growth which has not been reflected in share prices (refer to Fig.2). This provides an opportunity for investors like us to build meaningful positions in attractively valued companies with strong franchises. We find many companies in strong financial health. We observe that companies' restructuring efforts are continuing and in some cases have accelerated. The strength of earnings improvement remains under appreciated by the broader market. The signs have been encouraging thus far. To date, reported second quarter earnings have broadly exceeded expectations.

Abenomics has succeeded in bringing Japan's undervalued equity market into focus. The policy package has changed inflation expectations and served as a catalyst for global investors to reconsider their entrenched negative views about Japan. The recent moves will continue to fuel interest in Japan's equity market, we think. Ultimately, we believe real sustainable change in Japan will be delivered by further improvements in corporate efficiency and performance.

Disclaimer

This document is produced by Eastspring Investments (Singapore) Limited and issued in:

Singapore and Australia (for wholesale clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore, is exempt from the requirement to hold an Australian financial services licence and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Australian laws.

Hong Kong by Eastspring Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong.

United Arab Emirates by Eastspring Investments Limited which has its office at Precinct Building 5, Level 6, Unit 5, Dubai International Financial Center, Dubai, United Arab Emirates. Eastspring Investments Limited is duly licensed and regulated by the Dubai Financial Services Authority (DFSA). This information is directed at Professional Clients as defined by the Conduct of Business rulebook of the DFSA and no other person should act on it.

United States of America (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is registered with the U.S Securities and Exchange Commission as a registered investment adviser.

Luxembourg (for institutional and professional investors only) by Eastspring Investments (Luxembourg) S.A., Grand-Duchy of Luxembourg.

United Kingdom (for institutional and professional investors only) by Eastspring Investments (Luxembourg) S.A. – UK Branch, 125 Old Broad Street, London EC2N 1AR.

Chile (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN:199407631H), which is incorporated in Singapore and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Chilean laws.

The afore-mentioned entities are hereinafter collectively referred to as **Eastspring Investments**.

This document is solely for information purposes and does not have any regard to the specific investment objective, financial situation and/or particular needs of any specific persons who may receive this document. This document is not intended as an offer, a solicitation of offer or a recommendation, to deal in shares of securities or any financial instruments. It may not be published, circulated, reproduced or distributed without the prior written consent of Eastspring Investments.

Past performance and the predictions, projections, or forecasts on the economy, securities markets or the economic trends of the markets are not necessarily indicative of the future or likely performance of Eastspring Investments or any of the funds managed by Eastspring Investments.

Information herein is believed to be reliable at time of publication but Eastspring Investments does not warrant its completeness or accuracy and is not responsible for error of facts or opinion nor shall be liable for damages arising out of any person's reliance upon this information. Any opinion or estimate contained in this document may subject to change without notice.

Eastspring Investments (excluding JV companies) companies are ultimately wholly-owned / indirect subsidiaries / associate of Prudential plc of the United Kingdom. Eastspring Investments companies (including JV's) and Prudential plc are not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America.

For more information contact content@eastspring.com | Tel: (65) 6349 9100