

March 7, 2014

Dear clients and colleagues,

Here we are at the five-day Daiwa Investment Conference in Tokyo. It is the third consecutive year that we have attended this conference, and we've noticed that the sentiment has certainly changed. In March 2012, there were not many foreign investors and Japanese companies sounded cautious and conservative. One year later, foreign investors showed a lot more interest but the locals were still suspicious about Abenomics (Prime Minister Abe's economic policies). This year, both investors and companies sounded optimistic. Big presentations were full. About 400 companies participated vs. 350 last year, and there were 160 foreign investors vs. 110 last year.

Since the start of Abenomics at the end of 2012, we have seen gradual but clear results. The bold monetary policy has pushed the yen to depreciate by over 20% against the US dollar. Fiscal spending poured on new infrastructure and earthquake rebuild. Structural reforms are being discussed in order to enhance Japan's competitiveness. Above all, for the first time in 20 years Japanese people have begun to feel optimistic about their future.

At the conference, we heard views from different backgrounds. Speakers included strategists, government officials, journalists and management of public companies. What impressed us was their welcome attitude towards structural changes and appreciation of Abe's initiatives. Considering the very conservative nature of Japanese people, that's big. The least enthusiastic comment was "It's better than nothing."

We met with over 20 companies, including two in our portfolio (Lintec and Start Today). Both companies are niche market leaders. Last year they achieved over 35% and 20% profit growth respectively, and we still see steady growth potential. We also found some interesting new names.

In our weekly commentary on Japan last month, we were not sure about the impact of the consumption tax hike from 5% to 8% starting in April. But now several factors have removed that concern: 1) The public is very supportive of the tax hike, because that will lead to much-needed better social welfare; 2) A 5.5 trillion yen stimulus package will be rolled out starting April to offset the GDP slowdown in Q2; and 3) Most companies in the retail industry project a recovery from Q3.

Our optimistic outlook for Japan is confirmed. We believe Japan is on the right track. The GDP slowdown in Q2 should be short-lived and yield long-term positive effects. We expect the yen to depreciate further and the stock market to move higher after the January correction.

Regarding political tensions with China and Korea, Mr. Shigeru Ishiba (Secretary-General of LDP / Former Minister of Defense of Japan) gave a pretty clear message at a Daiwa presentation. Japanese people should remember their history and avoid past mistakes. War is good for no one.

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COMMENTARY_{cont.}



Have a nice weekend.

The Global Alpha team

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