

## Deteriorating investor sentiment sees poor start for equity markets in 2008

*By Michael Wood-Martin, Fund Manager, Japanese Equities*

Equity markets have had a poor start to 2008 as investor sentiment has deteriorated in the face of worsening economic news as a result of the fall out in the now well publicised global credit crunch. Japanese equities have suffered alongside developed markets although not as badly as other markets in the Asian region. Nevertheless Japan has failed to live up to its potential after what had promised to be a lucrative period for equity investors. The stockmarket peaked in early 2007 and has declined since. Is it time to double up or cut and run?

To put the current level of the market in perspective, equities have retreated by a quarter over the past several months. This is a severe fall and one which anticipates significant economic weakness in the year ahead. Although the economy remains dependent on overseas demand to propel growth, the export base is now well diversified and much less reliant on the US market than in the past.

To date the export sector has been resilient despite the downturn in the US while benefiting from expansion in economies elsewhere. The domestic economy remains lacklustre but there are few of the excesses within Japan that have come to haunt economies elsewhere. If anything there have been a number of policy misdemeanours which have served to hold the economy back, such as the housing sector, the effects of which should gradually unwind as the year progresses thus having a potentially beneficial impact on activity, possibly consumption. The corporate sector has improved its standing through an increase in profitability and a rise in dividends. M&A has yet to flourish as it has in more developed markets although one might interpret this as an opportunity yet to materialise.

The immediate concern for the Japanese market is that, as will probably be the case elsewhere, the multi year profit expansion is coming to an end. The rise in the yen can only hasten such an event as a higher currency crimps exporters' profitability. Uncertainty surrounding the outlook for global growth and the possibility of a further rise in the yen were the credit crunch to extenuate, may keep the influential foreign investor away from the market. Domestic investors have shown little appetite for equity investment. However it is dangerous to get too negative as Japanese equities have the habit of catching investors unaware when spirits are low. Share prices can advance rapidly once sentiment takes a turn for the better, perhaps triggered by an event such as better than expected news within the economy. With a growing clamour of dire economic predictions, aggressive easing by the US Fed and stocks at a very low ebb, perhaps such a turning point for Japanese equities is not too far away.

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