

Equities

7 February 2012 | 28 pages

Japan Equity Strategist

The Big Long: Inside the Rising Sun Machine

■ Equities

- **Three reasons to buy Japanese equities** — First, we think Japan RoE has more room to rise than in other regions. Second, the recovery in Japanese equity prices has lagged the recovery in the fundamentals and they strike us as marked laggards. Third, we expect the economy to pick up steam in 2012 as Japan recovers from the earthquake and we believe yen strength, which has weighed on valuations, is in its final stages. In our view, Japanese equities have more room to rise than those in other regions and we recommend taking a long position.
- **Signs of change in yen strength, which has weighed on valuations** — Since March 2009, the TOPIX-dollar/yen rate multiple has been steady at around 10x. It seems yen strengthening against the dollar as market expectations on US monetary policy were revised heavily in favor of easing translated directly into falls in TOPIX. With the FRB now announcing its policy outlook, we believe the likelihood of major revisions in the market's monetary policy outlook has dropped substantially. Also, Japan's trade deficit is worsening, as there are no prospects in sight for the restart of idled nuclear power plants and companies are expanding overseas production. We think the yen could well be in the final stages of strengthening versus the dollar.
- **Focus on firms with low PBRs and high medium-term EPS growth rates** — As in the March-May 2009 recovery following the post-Lehman low, in the recovery since November 2011 sectors with little PBR deviation from the five year average such as marine transport and securities have delivered impressive performance. We feel these sectors remain very undervalued and expect their outperformance to continue. In 2009 stock selection, medium-term EPS growth rates, together with five-year PBR average deviation, proved to be effective. We believe these two indicators could provide useful perspective as share prices recover moving forward, too.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Contents

Chapter 1: Why Japanese equities now?	3
Reason 1: Japan RoE—more upside than in other regions	3
Reason 2: Share price recovery has lagged fundamentals	4
Reason 3: Only Japan has strong fundamentals; yen strength in its final stages	4
Chapter 2: Signs of changes in yen strength, which has been weighing on valuations	6
Chapter 3: We like companies with low PBRs and high medium-term EPS growth rates	14
What's in store for TOPIX?	14
Sector performance	16
PBRs and medium-term EPS growth rates effective in stock selection in 2009	18
Appendix A-1	24

Chapter 1: Why Japanese equities now?

Our global strategy team is overweight Japan (Figure 1). Broadly speaking, we find three reasons to be overweight Japan now. First, we think Japan RoE has more room to rise than in other regions. Second, the recovery in Japanese equity prices has lagged the recovery in the fundamentals and they strike us as marked laggards. Third, we expect the economy to pick up steam in 2012 as Japan recovers from the earthquake and we believe yen strength, which has weighed on valuations, is in its final stages.

Overweighting Japan

Figure 1. Citi global strategy team: Regional recommendations

Overweight	Neutral	Underweight
Emerging Markets	Australia	US
Asia Pac ex-Japan	Europe ex-UK	
Japan		
UK		

Source: Citi Investment Research and Analysis.

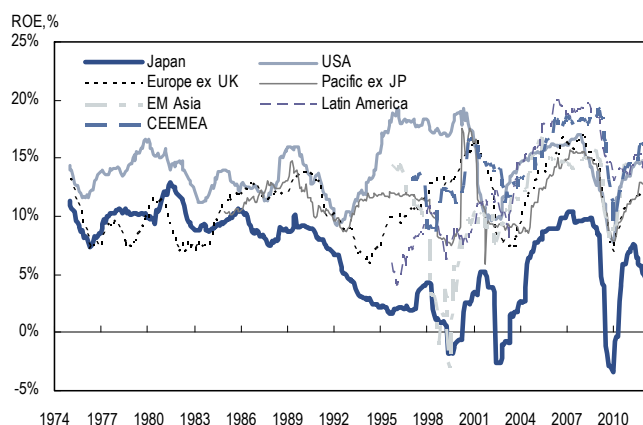
Reason 1: Japan RoE—more upside than in other regions

Figure 2 shows trends in RoE in major regions since 1974. Japan's RoE was just under 10% in the 1980s but after the collapse of the bubble, it fell to below 5% from the 1990s through to the early 2000s. However, it rose above 10% in 2007, as the NPL problem had been resolved and the global economy had been on a long-term recovery.

Only Japan below the historical average

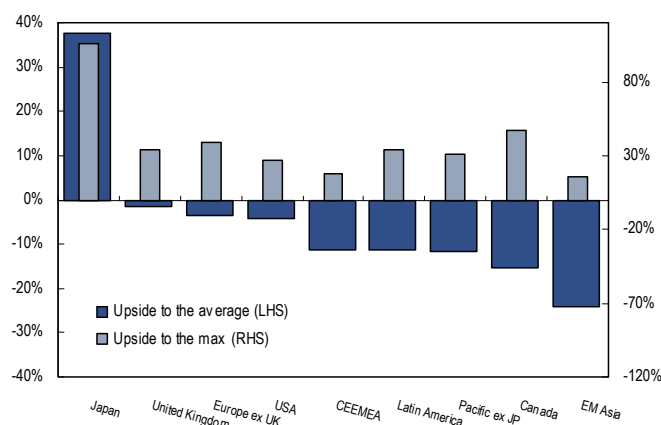
Figure 3 shows the rate of RoE divergence from the current January 2012 RoE and the historical average from 1974-2011. It is only Japan's RoE that is below the historical average and Japan's RoE would rise by more than 30% if it were merely to rise to its historical average. On the other hand, other regions would see all their RoE fall on a return to the historical average.

Figure 2. RoE by region



Source: MSCI, Citi Investment Research and Analysis.

Figure 3. RoE upside potential



Note: Upside calculated using natural log differences.
Source: MSCI, Citi Investment Research and Analysis.

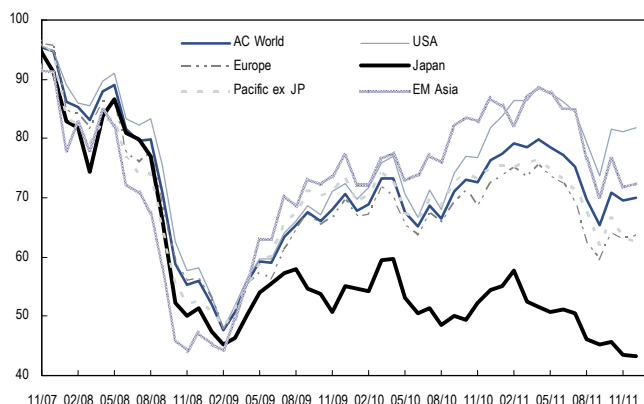
Reason 2: Share price recovery has lagged fundamentals

Only Japan is below its post-Lehman lows

Figure 4 shows MSCI share price indexes by region, with October 2007, when global equity indexes hit their highs, set as 100. Aside from Japan, all other regions have rallied since setting their post-Lehman lows in around March 2009. Only Japan is below its post-Lehman low.

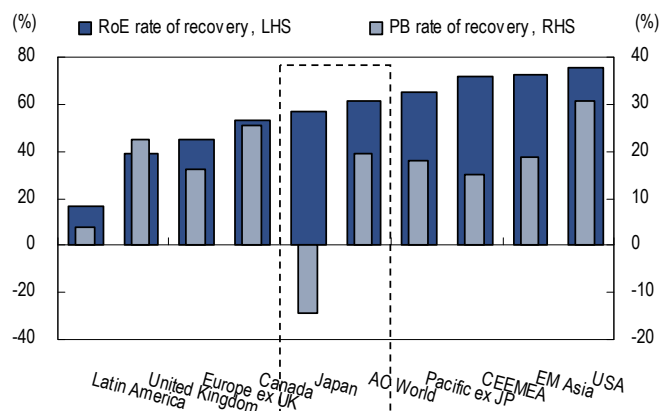
Figure 5 shows how much RoE had recovered versus its decline from the pre-Lehman high to the post-Lehman low (the RoE recovery rate) and how much PBRs had recovered versus their falls from the October 2007 high to the March 2009 low by January 2011 (the PBR recovery rate). Japan's RoE recovery rate was close to 60%, not unimpressive when compared with the global average. Nevertheless, while the global PBR recovery rate is close to 20%, Japan's PBR recovery rate is negative. We think it is fair to say that the recovery in Japanese equities has lagged the recovery in the fundamentals markedly.

Figure 4. Share prices by region



Source: MSCI, Citi Investment Research and Analysis.

Figure 5. Recovery rates for RoE and PBRs compared



Source: MSCI, Citi Investment Research and Analysis.

Reason 3: Only Japan has strong fundamentals; yen strength in its final stages

Only Japan looks set to see substantial acceleration in its real GDP growth rate from 2011 to 2012

Figure 6 shows our real GDP growth rate forecasts by region. For 2012, we are modeling a 2.0ppt rise in Japan's real GDP growth rate, to 1.0% in 2012 from -1.0% in 2011. In contrast, we expect the real GDP growth rate in Europe to deteriorate by 3ppt, to -1.5% in 2012 from +1.5% in 2011, and are likewise forecasting declines in growth rates in many regions in 2012. We think the strength of Japan's relative economic momentum in 2012 will stand out.

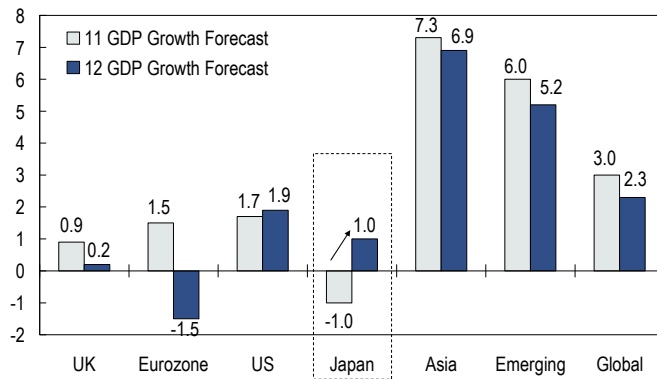
Yen strength in its final stages

And we are also heading toward the final stages of yen strength against the dollar, which as we detail in the next chapter has been weighing down valuations. We would see a weaker yen as a positive for corporate earnings and RoE.

PBR could rise by close to 20% if Japan's RoE just returned to the historical average

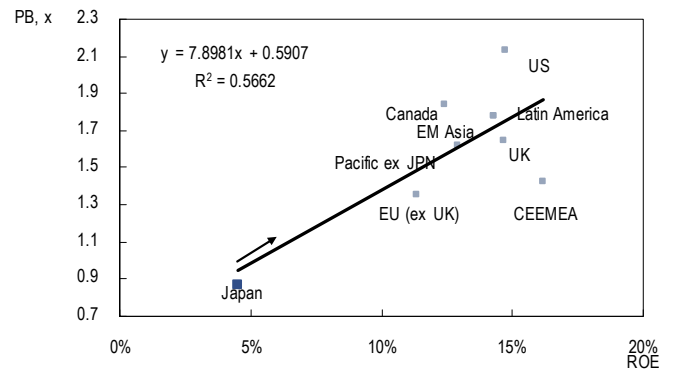
Figure 7 plots RoE and PBR by region. If RoE rises, PBR tends to rise, so we can draw a trend line moving up and to the right to show the relationship. If Japan's RoE were to return to the historical average of 6.5% from the current 4.5% on the recovery in economic momentum and an end to yen strengthening, then we calculate that the PBR could rise 19.6%, to 1.11x from 0.93x.

Figure 6. Forecast real GDP growth rates by region



Source: Citi Investment Research and Analysis.

Figure 7. RoE and PBR



Source: MSCI, Citi Investment Research and Analysis.

Chapter 2: Signs of changes in yen strength, which has been weighing on valuations

Strong yen weighing on valuations

Since FY3/09, the TOPIX-yen/dollar rate multiple has been around 10x

Figure 8 below tracks the TOPIX-yen/dollar rate multiple (TOPIX divided by the yen/dollar rate) over time. We note that this multiple has grown less volatile since the previous decade, and in particular there has been relatively little variation since 2009. The average between 2000 and 2006 was 10.8x with a standard deviation of 2.6, but since FY3/09 the average has been 10.0x with a standard deviation of 0.7. This means that the correlation between the yen/dollar rate and TOPIX has increased. It would appear the TOPIX-yen/dollar rate multiple is 10x +/- 10% (that is, when the yen/dollar rate is ¥76/\$, TOPIX trades at ¥700-¥840 with a mean of around ¥760).

Right now, the 12-month trailing EPS for TOPIX is 37 points, in line with the level seen in May 2004. At that time, TOPIX was 1,124, and currently TOPIX has been trading between 750 and 800, or more than 350 points lower than in May 2004. Indexing the dollar-denominated TOPIX to the May 2004 level of 1,124 would imply a January 2012 value of c1,070. We think that one reason a TOPIX recovery has significantly lagged the recovery in profits is that overseas investors have regarded Japanese equities as overvalued due to the strong yen (Figure 9).

TOPIX would likely rise were the yen/dollar rate to fall

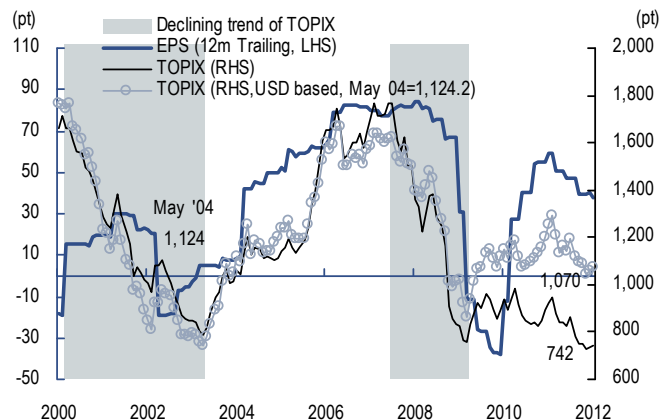
If the yen were to decline against the dollar, we think TOPIX would rise.

Figure 8. TOPIX-yen/\$ rate multiple



Source: Bloomberg, Citi Investment Research and Analysis.

Figure 9. Dollar-denominated TOPIX



Source: Bloomberg, Datastream, Citi Investment Research and Analysis.

Announcement of FOMC member policy rate outlooks likely to reduce change of large revisions to market forecasts

Previously, the market has been too quick to forecast interest rate hikes in the US

In our January 12, 2011 report [Risk to the Japanese equity market on a change in outlook on US monetary policy - Another "QE2 market" possible as outlook shifts to easing](#), we said that the market was anticipating a quick interest rate hike that was not justified by fundamentals like unemployment and inflation. At the time the above report was written, the market was forecasting that an initial interest rate hike would come in March 2012 (Figure 10).

Yen gained ground against dollar as market adjusted its forecast

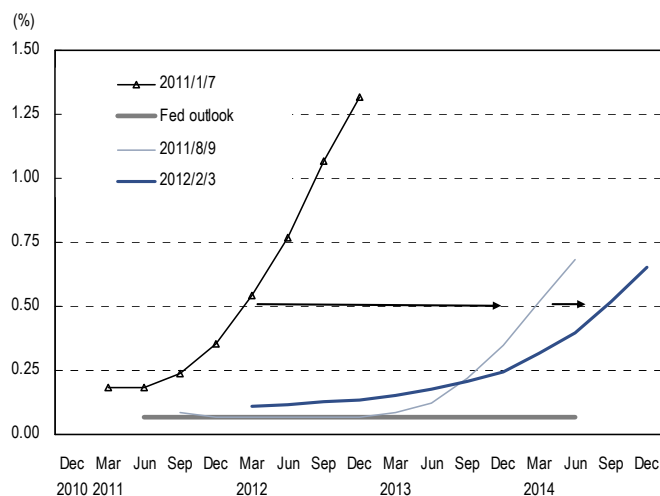
As of February 2012, the market expects the initial rate hike to come in September 2014. That is, in the course of about a year the market has pushed its forecast back by about 2.5 years. Figure 11 tracks the yen-dollar rate and FF futures (the market's monetary policy forecast) since August 2010. One can see that in the process of the market adjusting its US monetary policy forecast significantly toward a more accommodative stance, the yen has appreciated versus the dollar.

Yen has not risen versus the dollar since the FRB announced its policy outlook in August 2011

However, the FRB announced after its August 2011 FOMC meeting that it was likely to keep its ultra-low interest rate policy in place until mid-2013. After that, the market forecast for the rate hike in June 2013 was stable at 25bp or below. With the market's monetary policy forecast more stable, the yen stopped rising against the dollar.

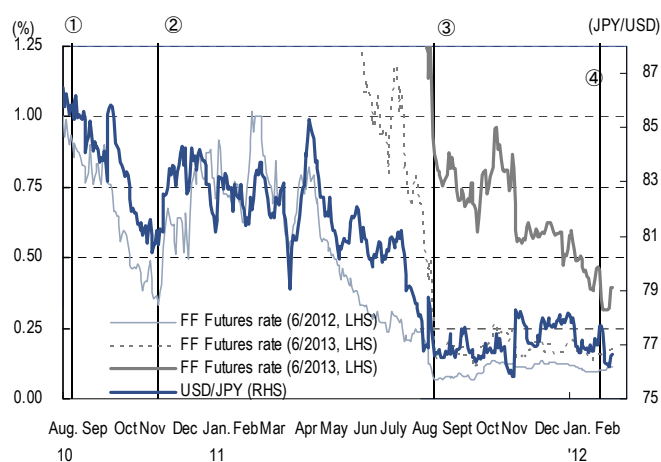
After the FOMC meeting in January 2012, the FRB announced that it would likely keep its ultra-low interest rate policy in place until the end of 2014. In addition, it released the policy rate forecasts of FOMC members for the first time. As we noted in our January 26 report [Japanese Equity Strategist - FRB clarification on the path of the policy rate and the impact on Japanese equities, Part 2](#), the interest rate hike timing suggested by the FOMC policy rate outlooks seems fully consistent with fundamentals like unemployment and inflation. In the future, we do not expect the kind of yen appreciation versus the dollar that tended to occur when the market made major adjustments to its monetary policy outlook, as happened up through August 2011.

Figure 10. Market outlook for monetary policy



Note: Market outlook for monetary policy based on FF rate futures.
Source: Bloomberg, Citi Investment Research and Analysis.

Figure 11. FF futures and yen/dollar rate



Note: ① FOMC, August 2010: Decides to maintain size of its securities holdings, ② FOMC November 2010: QE2, ③ FOMC August 2011: Ultra-low interest rate policy until mid-2013, ④ FOMC January 2012: Ultra-low interest rate policy until late 2014.
Source: Bloomberg, Citi Investment Research and Analysis.

Trade balance deteriorates due to factors like nuclear plant shutdowns

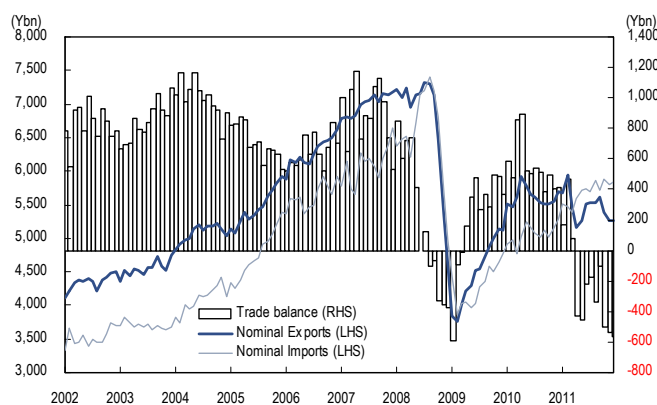
Trade balance also working to stem yen appreciation

We are also seeing changes in the trade balance that could stem yen appreciation. In 2011, the trade balance slipped into the red for the first time in 31 years (Figure 12).

After the March 11 disaster, it became politically difficult to restart nuclear plants that had been shut down due for periodic maintenance. This resulted in an increased dependence on thermal power plants and a rise in imports of LNG (Figure 13). Of the 54 nuclear reactors in Japan, as of February 2012 just three are in operation, and the number is likely to fall to zero in April. It is not clear when nuclear power plants will restart.

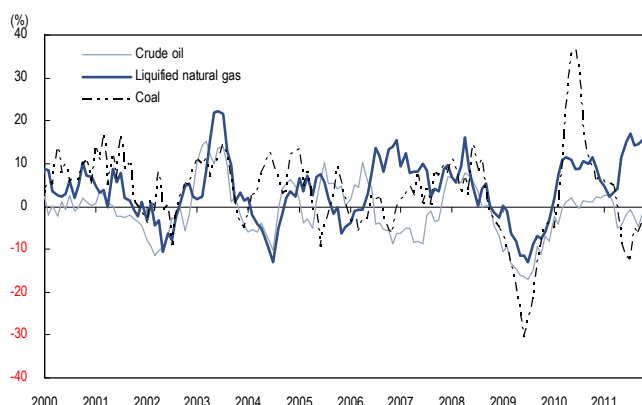
In addition to nuclear plant shutdowns, exports are falling for structural reasons as Japanese firms shift more production overseas (please see our Developed Markets and Economics and Rates team's February 3 report [Japan Weekly - Trade deficits likely will persist well into 2013](#)). All else being equal, a deteriorating trade balance in Japan should mean dollar appreciation versus the yen.

Figure 12. Trade balance



Note: Seasonally adjusted. Monthly data.
Source: MoF, Citi Investment Research and Analysis.

Figure 13. Fuel imports



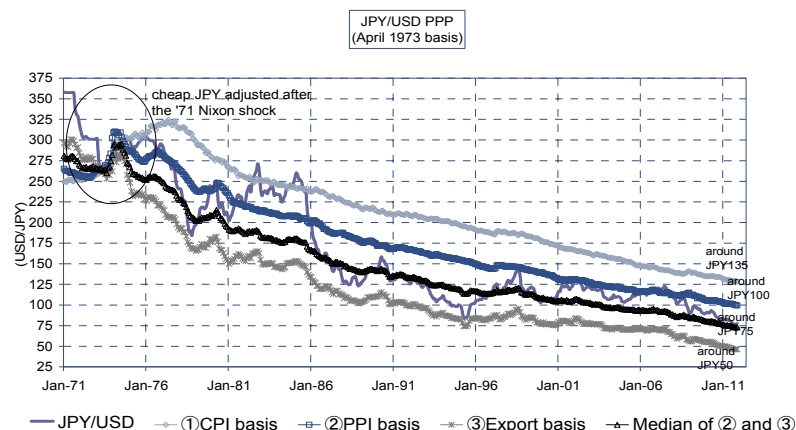
Note: 3MMA.
Source: MoF, Citi Investment Research and Analysis.

PPP suggests limited scope for yen to strengthen further versus the dollar

If the US economy were to strengthen, yen could depreciate, rising above PPP

It would appear the yen/dollar rate is moving more or less in line with the mean of the PPP exchange rate based on producer prices and that based on export prices. Since US economic momentum picked up in the mid-2000s, it has trended well above this mean (Figure 14). Right now the trendline for this mean would suggest about ¥75/\$. If US economic momentum strengthens, the yen could well depreciate and rise further above PPP.

Figure 14. Yen/dollar rate



Source: US Department of Labor, BoJ, IMF, Citi Investment Research and Analysis.

Good news for the US economy

Three pieces of good news for the US economy

Will US economic momentum strengthen, something that would likely push the dollar up versus the yen? We note there have been three pieces of good news recently regarding the US economy. First, there are signs that the housing market has improved. Second, household balance sheet adjustments appear to have ended. Finally, employment improvement appears to have accelerated. We think the yen should weaken against the dollar unless US economic momentum fails to strengthen.

Signs of improvement in the US housing market

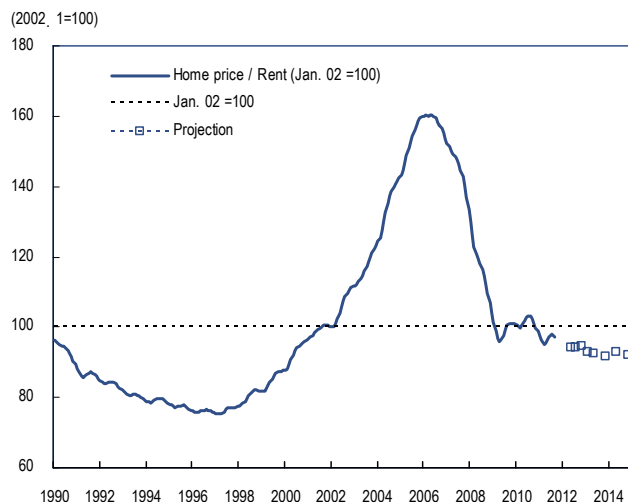
The ratio of housing prices in the US to rents (equivalent to PER for equities) has already fallen below the level seen in 2002, before the housing bubble began, and has begun to stabilize (Figure 15). It would appear that the major decline in prices stemming from the bursting of the housing bubble is over. With rent growth at 2% or more right now, we think housing prices are likely to rise going forward.

Major adjustment to US prices seems to have ended

Leading indicators improving, some government support as well

In addition, the NAHB housing market index (a leading indicator of housing starts) has shown strength (Figure 16). Meanwhile, President Obama has proposed housing market revitalization plans based around support for refinancing home loans at low interest rates. It is also possible that the FRB will restart MBS purchases. If both of these come to fruition, US housing market improvement could accelerate.

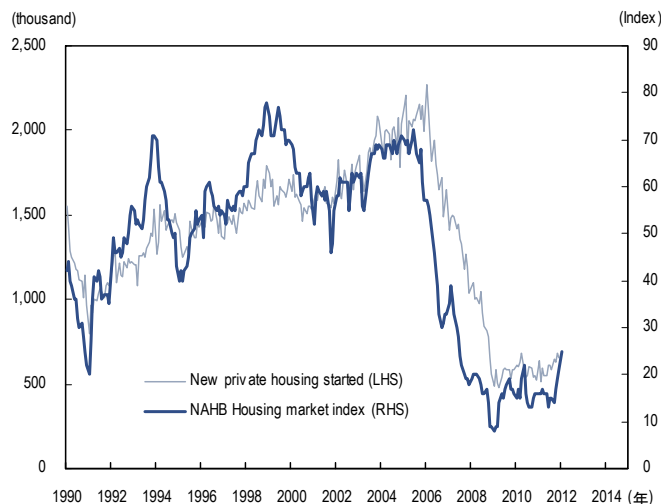
Figure 15. US housing price/rent multiple



Note: Housing prices are from Case-Shiller index, rents are from the CPI's primary residence rental index. Housing price estimates are Case-Shiller index futures for 10 metropolitan areas, while rent estimates assume growth over the last 12 months continues.

Source: Bloomberg, Datastream, Citi Investment Research and Analysis.

Figure 16. NAHB housing market index and new housing starts



Source: Datastream, Citi Investment Research and Analysis.

Ratio of US household debt to disposable income has reverted to the trendline

Household balance sheet adjustments appear to have ended

US household borrowing increased sharply at the same time the housing bubble was forming (Figure 17). However, the ratio of US household debt to disposable income has reverted to the trendline as families have paid down debt. As such, it appears the period of reining in consumption to pay down debt is at an end.

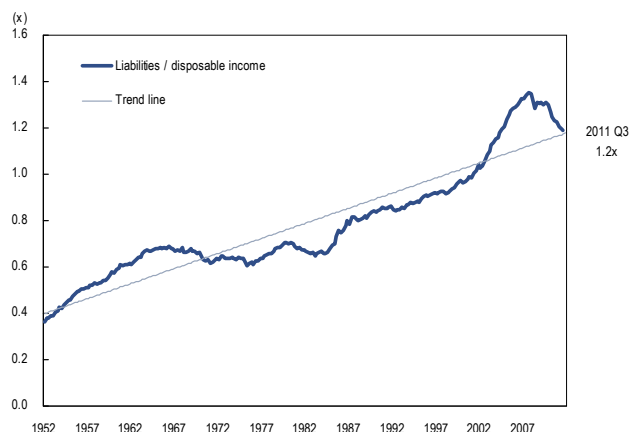
In addition, one way of explaining US consumption behavior is a need to amass “buffer stock”. To prepare for a negative shock to income like unemployment, households target a certain level of assets, and if current assets are below that target they save more, whereas if assets are above that target they spend more.

In Figure 18, we track the ratio of net assets to disposable income and the household savings rate in the US since the 1950s. When the ratio of net assets to disposable income is low (that is, current assets are below target), then the savings rate tends to rise, with the reverse true if the ratio of net assets to disposable income is high (that is, current assets are above target). This is in line with the idea of “buffer stock” as per the above.

We think US households have achieved a net assets-to-disposable income ratio close to their target

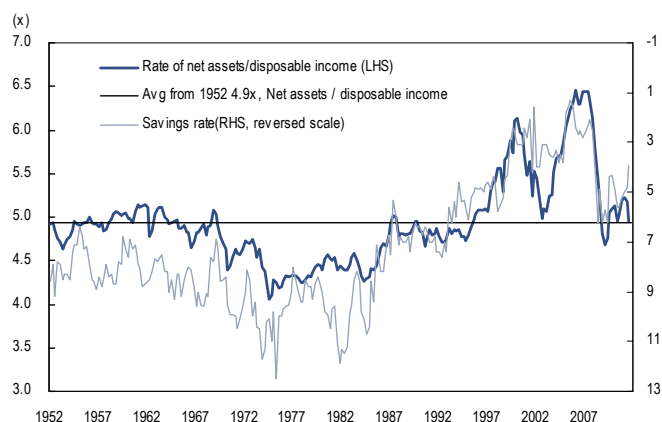
In the third quarter of 2011, the ratio of net assets to disposable income was 5.0x, in line with the average since 1952 of 4.9x. We think US households have amassed asset levels in line with their targets, and we think the savings rate is unlikely to grow sharply from here. We note that US households may think the change of a negative shock to income is currently higher than usual, and as such their target asset level may be higher than it was in the past. Still, we think assets are near target levels.

Figure 17. Ratio of US household debt to disposable income



Source: Bloomberg, Datastream, FRB, Citi Investment Research and Analysis.

Figure 18. Ratio of US household net assets to disposable income and household savings rates

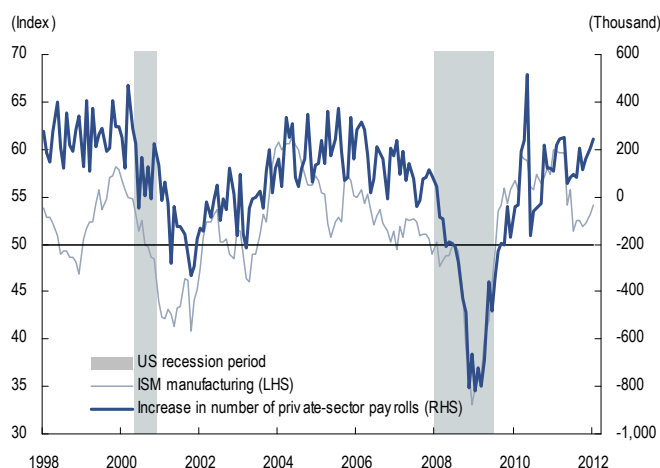


Source: Bloomberg, Datastream, FRB, Citi Investment Research and Analysis.

Strong recovery for employment as well

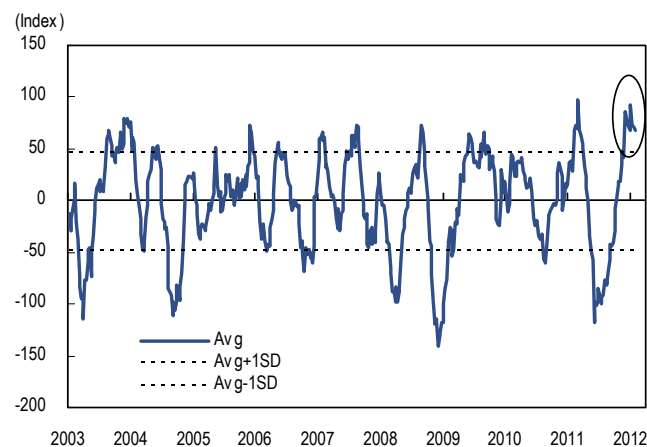
With the US economy improving, an employment recovery is gathering momentum as well. Non-farm payrolls were up by 243,000 in January, well above expectations. If this pace of job growth were to continue, employment would be in line with previous periods of recovery (Figure 19). We also note that the US economic surprise index is more than one standard deviation above its average (Figure 20).

Figure 19. Job numbers and the ISM manufacturing index



Source: Datastream, Citi Investment Research and Analysis.

Figure 20. US economic surprise index



Source: Bloomberg, Citi Investment Research and Analysis.

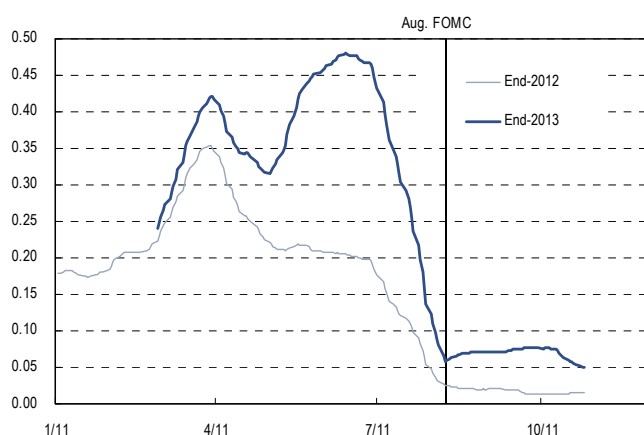
Size of stock market response to US economic surprises growing

After the August 2011 FOMC meeting, the FRB said that it intended to keep its ultra-low interest rate policy in place until at least mid-2013, and since then the degree of variation in the market's outlook for US monetary policy has shrunk (Figure 21). This

means that even if there is a positive economic surprise in the US, it is less likely that the market will decide that US monetary policy will tighten. As a result, although the response of forex and interest rates to a positive economic surprise in the US appears to have moderated, the size of response by equities (both in the US and Japan) appears to have grown (Figure 22). For more on this, please see our January 24 memo [Japan Equity Strategist - FRB clarification on the path of the policy rate and the impact on Japanese equities](#).

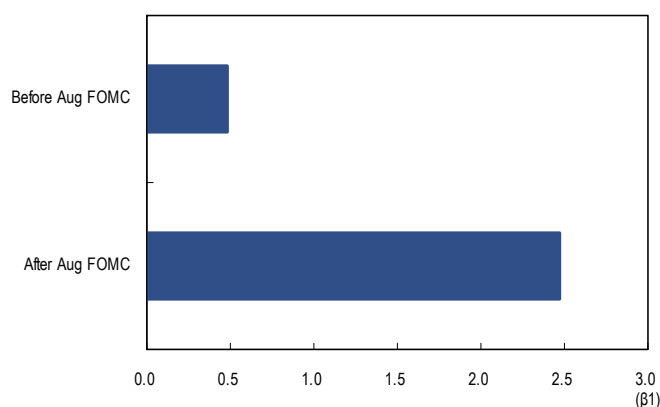
As noted above, in January 2012 non-farm payrolls rose by 243,000 MoM, above the forecast of 140,000. As a result, the S&P 500 rose 1.5% on the day while TOPIX rose 1.2%.

Figure 21. Variation in market's monetary policy outlook



Note: Variation in the market's monetary policy outlook is measured by the standard deviation for FF rate futures three months hence.
Source: Bloomberg, Citi Investment Research and Analysis.

Figure 22. TOPIX response to US employment surprises



Note: Rate of TOPIX change (%) from a 100,000-job surprise in US non-farm payrolls.
Source: Citi Investment Research and Analysis.

Foreign investment in Japanese equities rising as US economy recovers

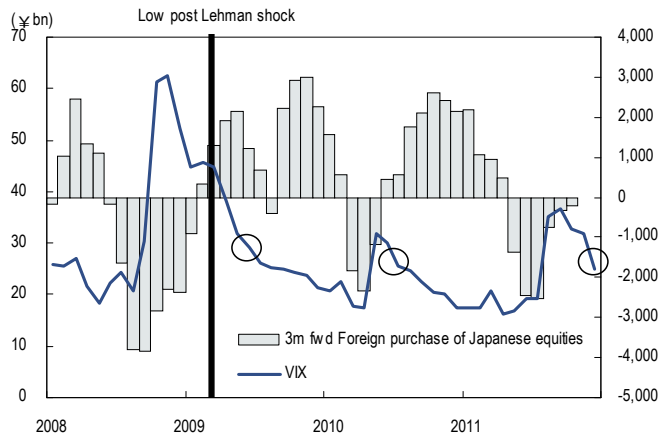
We look for increased buying of Japanese equities by foreign investors

In our view, a recovery in the US economy will be positive for Japanese equities via routes other than forex rates. Unless the risk appetite of foreign investors fails to increase despite a US economic recovery, we think buying of Japanese equities by foreign investors will pick up.

Figure 23 tracks the VIX index and net buying of Japanese equities three months later. In the past, when purchasing by foreign investors has fallen to a level in line with what is seen now after the VIX index rose (meaning investor concern grows), foreign investors often then turn net buyers three months after this increase. In January 2012, foreign investors were net buyers of Japanese equities for the first time in three months, and we think this will continue to be the case going forward.

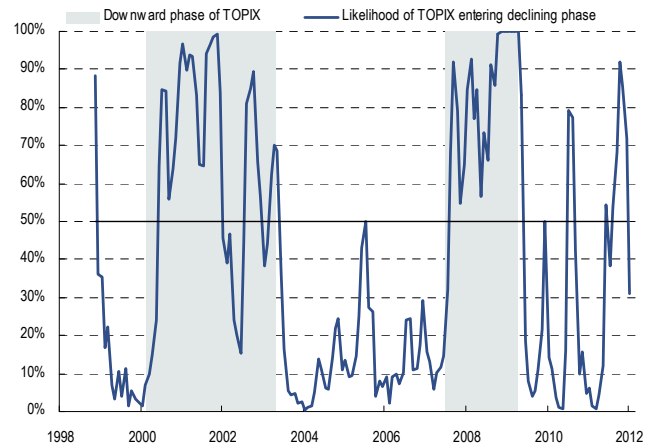
The likelihood that TOPIX is in a downward phase has fallen below 50% based on the amount of Japanese equity purchasing by foreign investors, the TOPIX advance/decline ratio over the past three months, the US ISM manufacturing index, and the principal components of other economic indicators (Shoko Chukin's economic sentiment index, five-year JGB yields, the US S&P 500, five-year Treasury yields, and the price of nickel all of which are closely correlated with TOPIX). See Figure 24 below.

Figure 23. VIX index and foreign investment in Japanese equities



Source: Bloomberg, Citi Investment Research and Analysis.

Figure 24. Estimates likelihood TOPIX is in a declining phase



Source: Bloomberg, Datastream, Citi Investment Research and Analysis.

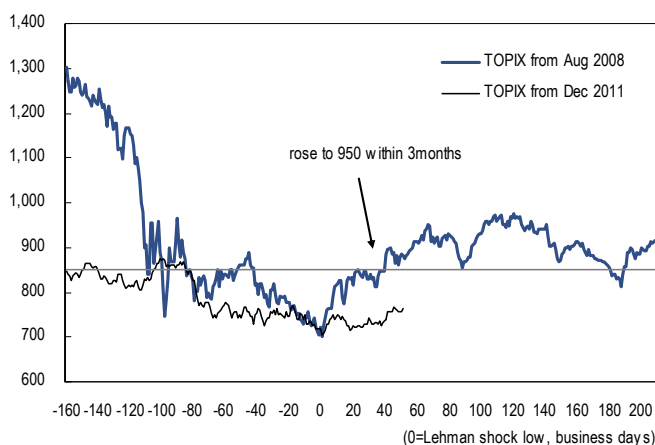
Chapter 3: We like companies with low PBRs and high medium-term EPS growth rates

What's in store for TOPIX?

After hitting its post-Lehman low, TOPIX climbed to 950 in three months

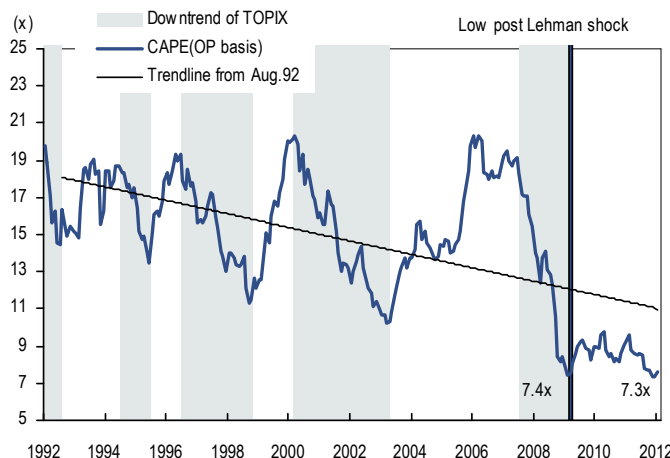
TOPIX fell to 706.48 on November 24, 2011. It hit a post-Lehman low of 700.93 on March 12, 2009 (Figure 25). Valuations have also fallen to close to the post-Lehman lows. The cyclically adjusted PER (CAPE) stood at 7.3x at end-November 2011, versus 7.4x at end-February 2009 (Figure 26). After hitting its post-Lehman low, however, TOPIX rallied sharply reaching 885.43 on May 12, two months after the low, and 950.54 on June 12, three months after the low.

Figure 25. TOPIX at the post-Lehman low and recently



Source: Datastream, Citi Investment Research and Analysis.

Figure 26. The TOPIX CAPE



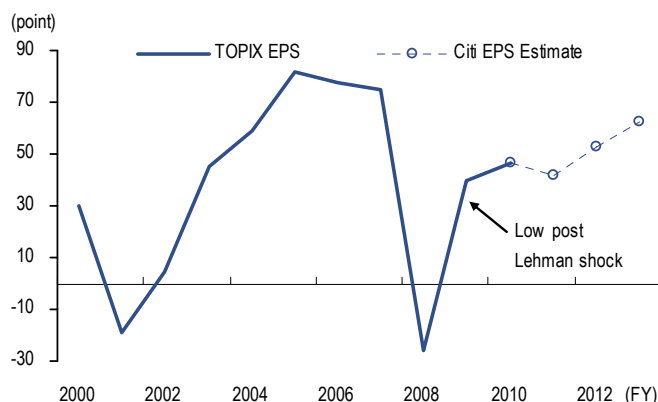
Source: Astra Manager, Citi Investment Research and Analysis.

Expecting FY3/14 TOPIX EPS to be some 50% above the FY3/10 level

We see the global economy as continuing to recover, driven by the US and China, even if the European economy enters a recession. Using a top-down approach based on our economy outlook assumptions, we put FY3/14 TOPIX EPS at 63, over 50% ahead of FY3/10A TOPIX EPS of 40 (Figure 27).

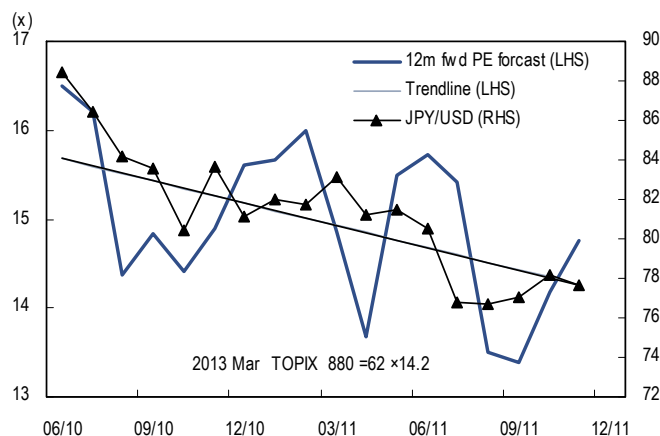
We argued in our December 15, 2011 report, [Japan Equity Strategist - 2012 Outlook: Chance of Japanese share rebound, likely timing](#), that Japanese equities were likely to rally given the rapid recovery in TOPIX following the post-Lehman low, valuations, and corporate earnings. Using a 12-month forward forecast earnings PER of 14.2, we set our March 2013 TOPIX target at 880 (Figure 28).

Figure 27. TOPIX EPS estimates



Source: Astra Manager, Citi Investment Research and Analysis.

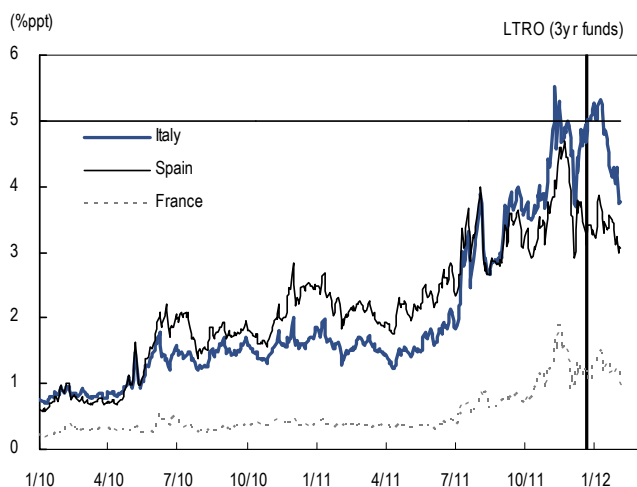
Figure 28. 12-month forward forecast earnings PER



Source: Bloomberg, Citi Investment Research and Analysis.

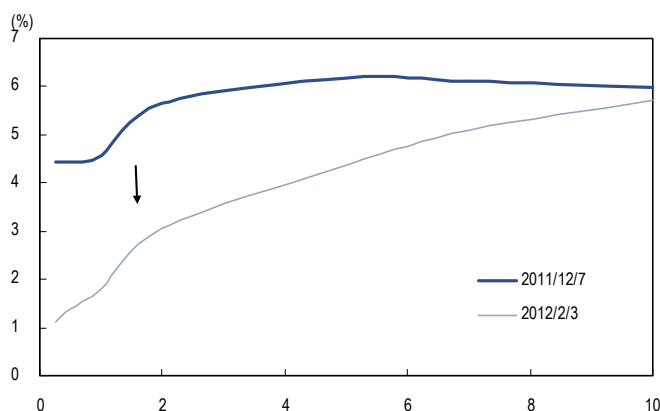
In our January 4 report, [Japan Equity Strategist Flash - Impact of US and European monetary policy developments on Japanese stocks](#), we noted that if the sovereign debt markets for major European countries such as Italy recovered their composure on the expansion of the long-term refinancing operations by the ECB, it would likely be a positive for Japanese equities. After the November 3, 2011 liquidity injection, the Italian yield spread over Germany shrank and the Italian yield curve has shifted, as shown below (Figures 29 and 30). The ECB is slated to supply a second round of three-year funds at the end of February. We see a growing likelihood that stocks will rally globally, without going through declines, which would put pressure on the authority to take proper policy actions.

Figure 29. Italian, Spanish, and French long-term sovereign yields: Spreads over Germany



Source: Bloomberg, Citi Investment Research and Analysis.

Figure 30. Italy: Yield curve



Source: Bloomberg, Citi Investment Research and Analysis.

In the rally following the post-Lehman low, low PBR sectors outperformed

Sector performance

Between March and May 2009, after the post-Lehman lows, sectors that looked undervalued in terms of degree of divergence from their five-year PBR average tended to turn in impressive share price advances (Figure 32). Based on this, in our aforementioned December 15, 2011 report ([Japan Equity Strategist - 2012 Outlook: Chance of Japanese share rebound, likely timing](#)), we said that we expected outperformance by marine transporters, securities, steel, real estate, mining, and non-ferrous metals in the next rally phase.

Looking at sector performance between November 24, 2011, and February 3, 2012, we note that marine transporters, securities, steel, mining, and non-ferrous metal have outperformed. Outperformance has been particularly marked in marine transporters and securities (Figure 33).

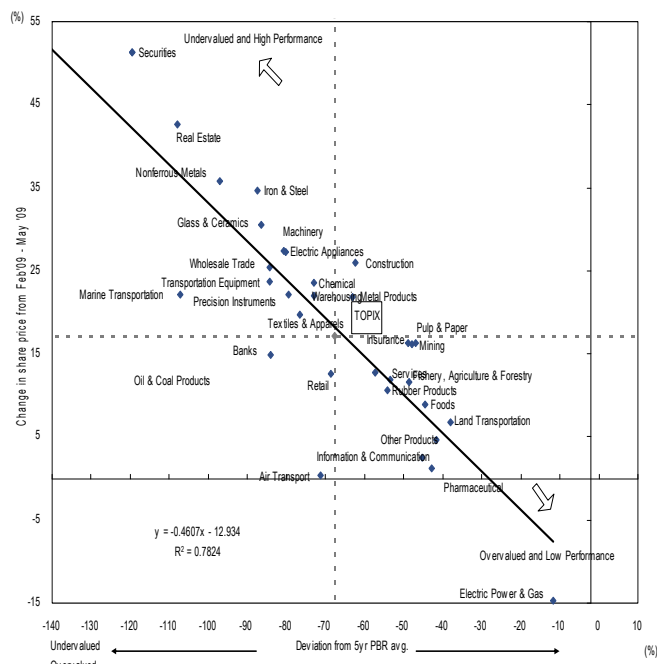
We think marine transport, securities, and banks are still in attractive positions in terms of value (degree of deviation from the five-year PBR average) and momentum (historical three-month share price performance; Figure 34). In momentum terms, we think transportation equipment and wholesalers are attractively positioned, as they benefit from a recovery in the US economy and monetary easing. We think defensive sectors tend to underperform when the broader market is in a rally phase and reflect this in our sector opinions, which are shown in Figure 31.

Figure 31. Sector opinions

Overweight	Neutral	Underweight
Consumer staples	Material	Consumer staples
Financials	Telecommunications	Health Care
	Industrials	IT
	Utilities	
	Material	

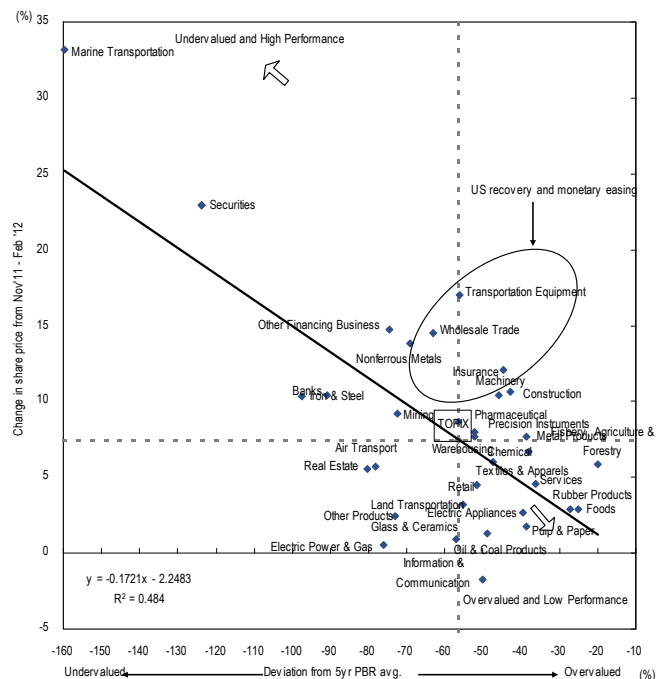
Source: Citi Investment Research and Analysis.

Figure 32. Sector performance in the recovery from end-February 2009



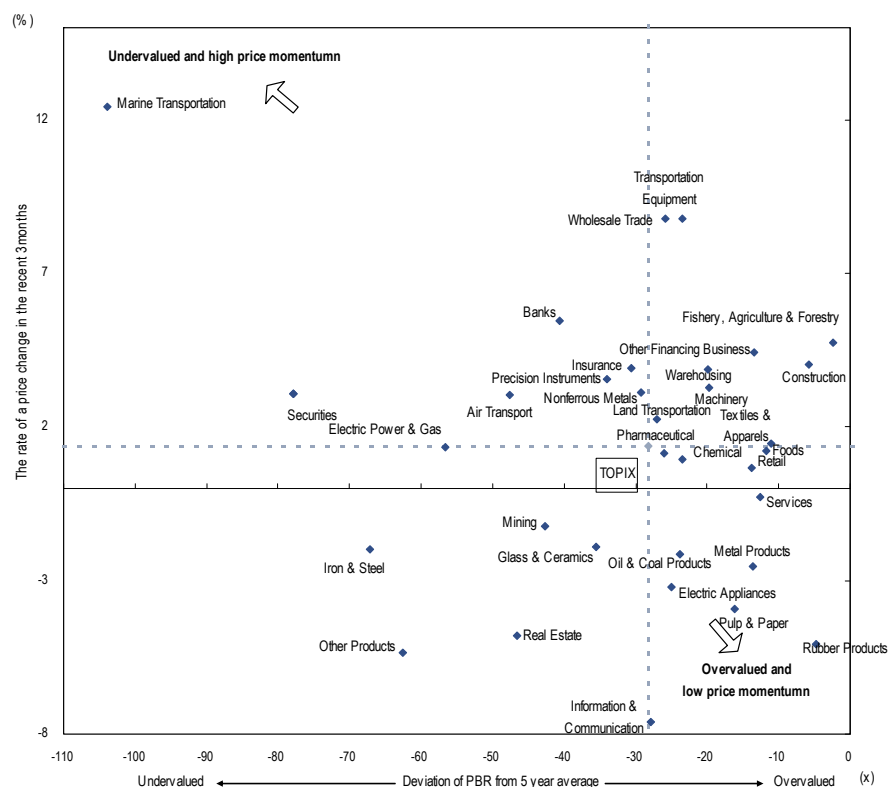
Note: Share price rates of change are from end-February 2009 to end-May 2009.
Source: Astra Manager, Citi Investment Research and Analysis.

Figure 33. Sector performance in the recovery from end-November 2011



Note: Share price rates of change are from November 24, 2011, to February 3, 2012.
Source: Astra Manager, Citi Investment Research and Analysis.

Figure 34. Sector opinions based on valuation and momentum



Source: Astra Manager, Citi Investment Research and Analysis.

PBRs and medium-term EPS growth rates effective in stock selection in 2009

In 2009, stock selection using deviation from the five-year PBR average was effective. Figure 35 shows deviation from the five-year PBR average from the TOPIX 500 at end-2008 and the rate of share price rise/decline in 2009 on the vertical axis. The more undervalued the company looked in terms of deviation from the five-year PBR average, the higher its share price gain tended to be.

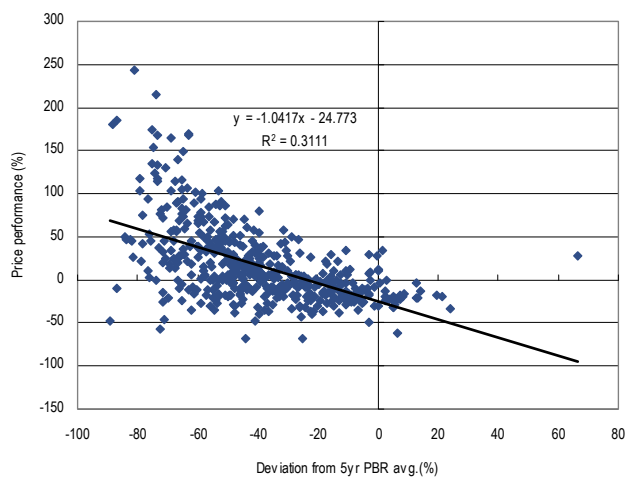
On looking for another effective stock selection tool, we discovered that the five-year EPS growth rate was useful. The numbers in parentheses below are t-values. The universe is the TOPIX 500.

Rate of 2009 share price gain = - 26.3 – 1.04PBR + 0.32 EPS 5-year growth

(7.8) (14.0) (4.4)

Figure 37 shows companies with high estimated rates of gain calculated from deviation from the five-year average PBR and the five-year EPS growth rate using the above formula by 10 major sectors. Figures 38 and 39 show companies with high estimate growth rates according to investment themes that are in the spotlight.

Figure 35. Rates of deviation from the five year PBR and share price performance in 2009



Note: All Topix 500 names.

Source: Astra Manager, Citi Investment Research and Analysis.

Figure 36. Leading stocks based on undervaluation and medium-term growth rates in 2009

	Code	Company	Sector	Deviation from 5yr PBR avg.	EPS5y growth	Projection	09 price performance
1	3116	TOYOTA BOSHOKU	Trans.Equip.	-86.9	39.7	76.3	185.3
2	5481	SANYO SPECIAL STEEL	Iron & Steel	-67.2	99.9	74.9	55.8
3	6113	AMADA	Machinery	-53.0	140.8	73.0	35.1
4	6103	OKUMA	Machinery	-75.8	61.8	71.7	45.6
5	7731	NIKON	Prec. Inst.	-64.7	96.1	71.1	72.8
6	5727	TOHO TITANIUM	Nonfer.Mtls	-81.8	32.5	68.7	44.3
7	6141	MORI SEIKI	Machinery	-63.3	87.1	66.7	21.0
8	8591	ORIX	Oth.Fin.Bus.	-81.4	23.6	65.5	25.7
9	7988	NIFCO	Chemicals	-63.3	81.2	64.9	105.7
10	6506	YASKAWA ELECTRIC	Elec. App.	-79.4	26.9	64.5	116.9

Source: Astra Manager, Citi Investment Research and Analysis.

Figure 37. Stocks screened on PBRs and five-year EPS growth rates by industry

	Company	Sector	MCAP (¥bn)	Share price (¥)	3m price change (%)	Deviation from 5 yr PBR avg. (%)	Div Yld (%)	FY12 RP change (%)	EPS 5yr growth rate (%)	Estimated share price change (%)
Utility	9107 KAWASAKI KISEN	Marine Trans	119	155	3.3	-67.0	0.0	-9.3	-14.3	41.1
	9104 MITSUI O.S.K. LINES	Marine Trans	388	322	16.2	-62.0	0.8	-25.9	-13.6	37.8
	9101 NIPPON YUSEN	Marine Trans	362	213	12.1	-57.3	0.9	-35.5	-2.7	36.5
Electric/Precision Equipment	7974 NINTENDO	Other Prod.	1,471	10,380	-12.4	-68.8	1.0	-89.5	-14.9	40.7
	4062 IBIDEN	Elec. App.	254	1,686	-4.6	-54.0	1.8	195.5	-16.0	29.0
	6752 PANASONIC	Elec. App.	1,563	637	-13.1	-50.9	1.6	-134.9	-18.5	22.6
	4902 KONICA MINOLTA HD	Elec. App.	313	588	-0.7	-47.5	2.6	8.6	-18.6	20.3
	7752 RICOH	Elec. App.	443	595	-10.4	-54.8	4.2	-251.5	-29.3	17.8
Financials	8308 RESONA HOLDINGS	Banks	967	349	-1.1	-178.8	3.4	-8.2	-73.3	129.3
	8604 NOMURA HOLDINGS	Sec.&Com.Fut	1,174	307	5.9	-62.0	2.6	100.0	-38.8	29.5
	8795 T&D HOLDINGS	Insurance	557	817	7.1	-56.1	2.8	20.0	-14.9	29.4
	8473 SBI HOLDINGS	Sec.&Com.Fut	139	6,210	-2.1	-61.0	0.3	100.0	-43.3	26.8
	8309 SUMITOMO MITSUI TRUST	Banks	1,078	253	-1.6	-47.7	3.2	-17.0	-25.4	19.1
Construction/Real Estate	1808 HASEKO	Construction	89	56	12.0	-129.3	0.0	2.8	-27.6	97.1
	8933 NTT URBAN DEVELOPMENT	Real Estate	194	59,000	9.5	-53.5	2.0	4.3	-6.5	30.2
	8830 SUMITOMO REALTY & DEVELOPMENT	Real Estate	718	1,508	-7.2	-39.1	1.3	6.4	0.3	17.3
Iron & Steel/Machinery	5411 JFE HOLDINGS	Iron & Steel	839	1,366	-5.1	-66.0	1.5	100.0	-26.4	34.1
	5631 JAPAN STEEL WORKS	Machinery	228	613	17.9	-57.0	1.6	13.3	5.7	34.0
	5401 NIPPON STEEL	Iron & Steel	1,300	191	-2.6	-56.4	0.8	83.3	-22.9	26.7
	5541 PACIFIC METALS	Iron & Steel	86	437	0.5	-55.0	0.0	109.3	-15.5	26.2
	5406 KOBE STEEL	Iron & Steel	380	122	-5.4	-48.9	1.6	47.4	-13.0	19.5
Auto	7211 MITSUBISHI MOTORS	Trans.Equip.	532	96	-5.0	-71.7	0.0	27.3	12.1	52.9
	7003 MITSUI ENG. & SHIPBUILD	Trans.Equip.	119	143	20.2	-52.0	2.8	-3.6	-7.0	28.1
	3116 TOYOTA BOSHOKU	Trans.Equip.	159	849	-9.0	-53.3	1.9	18.8	-17.4	25.6
	7282 TOYODA GOSEI	Trans.Equip.	173	1,333	-2.3	-44.4	2.7	95.2	1.3	25.0
	6995 TOKAI RIKI	Trans.Equip.	129	1,364	7.0	-29.0	2.2	76.5	-21.7	1.8
Materials	4043 TOKUYAMA	Chemicals	93	267	-0.4	-63.6	2.2	8.3	-16.0	35.4
	5214 NIPPON ELECTRIC GLASS	Gl.&Cer.Prod	329	661	-6.6	-56.5	2.1	-2.7	1.7	32.7
	5333 NGK INSULATORS	Gl.&Cer.Prod	341	1,009	8.3	-46.4	2.0	23.1	-3.0	22.8
	4901 FUJIFILM HOLDINGS	Chemicals	934	1,815	0.7	-40.9	1.9	41.0	14.2	20.6
	5801 FURUKAWA ELECTRIC	Nonfer.Mtls	145	205	-5.5	-46.2	1.2	69.0	-16.3	17.3
Consumption	9744 MEITEC	Services	54	1,539	2.0	-45.4	3.8	16.7	68.5	43.0
	2768 SOJITZ	Wholesale Trade	171	137	2.2	-64.0	2.2	6.4	-31.3	31.5
	2685 POINT	Retail Trade	75	3,065	-7.4	-49.9	3.9	13.2	5.2	26.6
	9831 YAMADA DENKI	Retail Trade	479	4,955	-14.6	-45.0	1.5	4.3	10.4	24.8
	2730 EDION	Retail Trade	64	601	-3.2	-34.0	3.3	3.7	17.7	16.7
Information Communication	4689 YAHOO JAPAN	Inf.&Com.	1,423	24,450	-1.7	-48.3	1.4	3.6	10.6	29.6
	9984 SOFTBANK	Inf.&Com.	2,378	2,147	-16.8	-29.1	0.5	15.0	45.0	18.4
	4716 ORACLE JAPAN	Inf.&Com.	341	2,682	-2.3	-35.8	2.7	3.9	-0.1	11.4
Pharmaceuticals/Foods	2501 SAPPORO HOLDINGS	Foods	115	293	1.4	-46.6	2.4	14.8	14.3	26.8
	4507 SHIONOGI	Pharm.	349	995	-2.3	-42.8	4.0	27.3	1.8	17.8
	4519 CHUGAI PHARMACEUTICAL	Pharm.	688	1,229	4.6	-32.0	3.3	2.9	0.8	8.8
	2593 ITO EN	Foods	162	1,291	-3.2	-36.2	2.9	5.9	-15.5	7.1

Note: As of February 6, 2012. Our universe is the TOPIX 500. Toyo Keizai forecasts. Utilities comprises electric power, land transport, marine transport, air transport, and warehousing and freight-related firms. Electronics/precision comprises electronic equipment, precision equipment, and other products. Financials comprise banks, brokers/commodities, insurers, and other financials. Construction and real estate comprises construction and real estate. Steel and machinery comprises steel, metal products, and machinery. Autos comprises transportation equipment and rubber products. Materials comprises mining, textile products, paper, chemicals, oil and coal, glass and ceramics, and non-ferrous metals. Consumer comprises wholesale, retail, and services. IT comprises information and telecom equipment. Medical/food comprises agriculture, fisheries, and forestry, food and beverages, and pharmaceuticals.

Source: Astra Manager, Toyo Keizai, Citi Investment Research and Analysis.

Figure 38. Stocks screened on PBRs and five-year EPS growth rates by investment theme (1/2)

	Company	Sector	MCAP (¥bn)	Share price (¥)	3m price change (%)	Deviation from 5 yr PBR avg. (%)	Div Yld (%)	FY12 RP change (%)	EPS 5yr growth rate (%)	Estimated share price change (%)
US economic recovery	6472 NTN	Machinery	177	332	-2.1	-34.4	3.0	119.4	-14.2	8.2
	6995 TOKAI RIKI	Trans.Equip.	129	1,364	7.0	-29.0	2.2	76.5	-21.7	1.8
	7762 CITIZEN HOLDINGS	Prec. Inst.	160	457	11.5	-28.3	1.8	17.2	-3.9	0.7
	6971 KYOCERA	Elec. App.	1,274	6,660	-2.2	-23.0	1.8	21.2	3.3	0.2
	7230 NISSIN KOGYO	Trans.Equip.	83	1,262	17.9	-23.0	1.9	60.5	-11.7	-0.1
US monetary easing	2768 SOJITZ	Whsle Trade	171	137	2.2	-64.0	2.2	6.4	-31.3	31.5
	8933 NTT URBAN DEVELOPMENT	Real Estate	194	59,000	9.5	-53.5	2.0	4.3	-6.5	30.2
	5801 FURUKAWA ELECTRIC	Nonfer.Mtls	145	205	-5.5	-46.2	1.2	69.0	-16.3	17.3
	8830 SUMITOMO REALTY & DEVELOPMENT	Real Estate	718	1,508	-7.2	-39.1	1.3	6.4	0.3	17.3
	5803 FUJIKURA	Nonfer.Mtls	87	241	2.6	-44.4	1.0	257.1	-14.6	16.5
Aging society	9022 CENTRAL JAPAN RAILWAY	Land Trans.	1,387	645,000	-2.4	-34.4	1.4	12.9	-0.4	7.7
	9202 ALL NIPPON AIRWAYS	Air Trans.	616	244	4.3	-29.6	0.8	25.0	-11.1	7.7
	4502 TAKEDA PHARMACEUTICAL	Pharm.	2,618	3,315	-5.4	-31.7	5.4	-25.9	-4.0	5.5
	4543 TERUMO	Prec. Inst.	682	3,590	-6.9	-29.9	0.9	16.8	-1.6	2.8
	9021 WEST JAPAN RAILWAY	Land Trans.	641	3,205	-2.4	-23.0	2.8	1.9	-8.7	-6.0
Rush demand prior to tax hike	8830 SUMITOMO REALTY & DEVELOPMENT	Real Estate	718	1,508	-7.2	-39.1	1.3	6.4	0.3	17.3
	8802 MITSUBISHI ESTATE	Real Estate	1,742	1,253	-8.7	-39.9	1.0	3.5	-8.2	14.6
	8801 MITSUI FUDOSAN	Real Estate	1,125	1,276	-3.0	-35.0	1.7	6.0	-7.9	8.9
	9613 NTT DATA	Inf.&Com.	719	256,400	-1.0	-31.7	2.3	4.6	-5.9	7.3
	7203 TOYOTA MOTOR	Trans.Equip.	10,296	2,986	17.0	-27.2	1.7	411.8	-24.0	-0.6
Emerging markets	7211 MITSUBISHI MOTORS	Trans.Equip.	532	96	-5.0	-71.7	0.0	27.3	12.1	52.9
	3116 TOYOTA BOSHOKU	Trans.Equip.	159	849	-9.0	-53.3	1.9	18.8	-17.4	25.6
	4901 FUJIFILM HOLDINGS	Chemicals	934	1,815	0.7	-40.9	1.9	41.0	14.2	20.6
	5201 ASAHI GLASS	Gl.&Cer.Prod	742	625	-5.7	-37.6	4.2	-15.2	12.2	16.7
	7951 YAMAHA	Other Prod.	132	670	-11.7	-47.3	1.5	11.4	-28.1	12.2

Note: As of February 6, 2012. Our universe is the TOPIX 500. Toyo Keizai forecasts. In the Figure above, we select names in each investment theme likely to see high share price growth based on PBR and five-year EPS growth. Companies in the US economic recovery theme are those where US sales accounted for 15% or more of total sales in FY10. Companies in the US monetary easing theme are taken from retail, non-ferrous, wholesale, mining, and petrochemical firms. Companies in the aging society theme are those that could benefit from an aging society as per Figure 35 in our October 26 report "Japan Equity Strategist Japan market's lost two decades: Past mistakes a lesson for the future" as well as pet-related names. Companies in the rush demand prior to a consumption tax hike theme are taken from those mentioned in our November 9 report "Japan Equity Strategist Hike in consumption tax: Sense of relief amid pain". We select companies in the emerging markets-related theme from among TOPIX 500 companies where 15% or more of sales come from emerging markets.

Source: Astra Manager, Toyo Keizai, Citi Investment Research and Analysis.

Figure 39. Stocks screened on PBRs and five-year EPS growth rates by investment theme (2/2)

	Company	Sector	MCAP (¥bn)	Share price (¥)	3m price change (%)	Deviation from 5 yr PBR avg. (%)	Div Yld (%)	FY12 RP change (%)	EPS 5yr growth rate (%)	Estimated share price change (%)
High dividend yield	9744 MEITEC	Services	54	1,539	2.0	-45.4	3.8	16.7	68.5	43.0
	2685 POINT	Retail Trade	75	3,065	-7.4	-49.9	3.9	13.2	5.2	26.6
	9503 KANSAI ELECTRIC POWER	Elec.Pwr & Gas	1,126	1,199	2.9	-47.4	5.0	13.6	-2.9	20.5
	9508 KYUSHU ELECTRIC POWER	Elec.Pwr & Gas	506	1,067	2.4	-49.8	4.7	37.5	-15.3	19.6
	4507 SHIONOGI	Pharm.	349	995	-2.3	-42.8	4.0	27.3	1.8	17.8
Recovery demand	5406 KOBE STEEL	Iron & Steel	380	122	-5.4	-48.9	1.6	47.4	-13.0	19.5
	6305 HITACHI CONST. MACHINERY	Machinery	331	1,539	0.1	-34.9	1.9	7.1	-22.5	3.9
	4042 TOSOH	Chemicals	140	233	-4.9	-27.1	1.3	60.0	-18.9	2.5
	9735 SECOM	Services	839	3,595	-1.0	-23.4	2.5	3.8	1.5	-0.5
	1928 SEKISUI HOUSE	Construction	479	708	3.7	-26.2	2.8	9.5	-12.8	-3.7
Non-nuclear power	4043 TOKUYAMA	Chemicals	93	267	-0.4	-63.6	2.2	8.3	-16.0	35.4
	5631 JAPAN STEEL WORKS	Machinery	228	613	17.9	-57.0	1.6	13.3	5.7	34.0
	7003 MITSUI ENG. & SHIPBUILD	Trans. Equip.	119	143	20.2	-52.0	2.8	-3.6	-7.0	28.1
	5333 NGK INSULATORS	Gl.&Cer.Prod	341	1,009	8.3	-46.4	2.0	23.1	-3.0	22.8
	6752 PANASONIC	Elec. App.	1,563	637	-13.1	-50.9	1.6	-134.9	-18.5	22.6
High growth & cost control	5631 JAPAN STEEL WORKS	Machinery	228	613	17.9	-57.0	1.6	13.3	5.7	34.0
	9984 SOFTBANK	Inf.&Com.	2,378	2,147	-16.8	-29.1	0.5	15.0	45.0	18.4
	8830 SUMITOMO REALTY & DEVELOPMENT	Real Estate	718	1,508	-7.2	-39.1	1.3	6.4	0.3	17.3
	6988 NITTO DENKO	Chemicals	498	2,867	-9.0	-30.1	3.5	22.0	6.3	11.2
	4519 CHUGAI PHARMACEUTICAL	Pharm.	688	1,229	4.6	-32.0	3.3	2.9	0.8	8.8
High global shares	5401 NIPPON STEEL	Iron & Steel	1,300	191	-2.6	-56.4	0.8	83.3	-22.9	26.7
	6752 PANASONIC	Elec. App.	1,563	637	-13.1	-50.9	1.6	-134.9	-18.5	22.6
	6472 NTN	Machinery	177	332	-2.1	-34.4	3.0	119.4	-14.2	8.2
	7741 HOYA	Prec. Inst.	732	1,682	1.9	-32.0	3.9	22.4	-6.5	7.7
	4543 TERUMO	Prec. Inst.	682	3,590	-6.9	-29.9	0.9	16.8	-1.6	2.8

Note: As of February 6, 2012. Our universe is the TOPIX 500. Toyo Keizai forecasts. In the Figure above, we select names in each investment theme likely to see high share price growth based on PBR and five-year EPS growth. Companies in the high dividend yield theme come from the top 50 in terms of dividend yield in the TOPIX 500. Companies in the recovery demand theme are taken from those mentioned in our August 3 report "Japan Equity Strategist Politics could delay a supplementary budget". Companies in the non-nuclear power theme are taken from companies we think are likely to benefit from increased demand for power generated using non-nuclear methods. For the high growth & cost control category, we select from companies with high rates of sales growth from FY3/01 to FY3/11 and with high recurring margins in FY3/11 (from companies ranked within the top 100 in both categories in the TOPIX 500). For the high global shares category, we select from among the companies featuring in our October 26 report, Japan Equity Strategist Japan market's lost two decades: Past mistakes a lesson for the future.

Source: Astra Manager, Toyo Keizai, Citi Investment Research and Analysis.

Figure 40. Model portfolio (as of February 6)

Code	Company	Market weight Share prices (¥)	Citi weight	Rating	RP YoY (%)		PER (x)		ROE (%)	MCAP (¥bn)	Pct to chg vs. TOPIX (%)	
					FY11E	FY12E	FY11E	FY12E			FY11E	3m
Consumer staples		Underweight	6.6%	4%								
2875	Toyo Suisan	1,913	4%	1	-4.4	16.2	12.9	10.7	9.0%	195	-1.9	2.4
Materials		Neutral	8.0%	8%								
5233	Taiheiyō Cement	165	4%	1H	140.1	82.6	12.7	11.3	7.7%	203	7.4	6.4
6988	Nitto Denko	2,867	4%	1	-31.6	22.0	15.2	10.4	7.3%	472	-9.4	-0.4
Health Care		Underweight	6.0%	3%								
4503	Astellas Pharma	3,210		1	25.2	5.5	16.6	14.7	8.6%	1,483	6.3	1.7
Industrials		Neutral	22.0%	22%								
6301	Komatsu	2,205	5%	2	17.6	12.6	12.2	10.8	17.6%	2,065	11.4	18.4
6273	SMC	13,900	4%	1	1.1	12.7	17.4	16.0	9.8%	953	11.3	11.2
6326	Kubota	703	4%	2	8.8	12.9	14.4	12.8	9.4%	883	7.3	9.0
6954	Fanuc	13,030	5%	1	16.2	3.2	18.0	17.2	15.6%	2,550	0.7	8.8
9020	East Japan Railway	4,875	4%	1	-7.8	19.7	16.5	11.7	6.3%	1,928	3.0	-0.8
IT		Underweight	12.0%	8%								
7741	Hoya	1,682	3%	1	24.9	13.9	10.3	9.5	18.0%	726	1.4	0.5
7751	Canon	3,400	5%	1	-3.3	35.5	16.4	12.0	9.5%	4,085	-2.9	-1.0
Consumer Discretionary		Overweight	19.4%	23%								
2685	Point	3,065	3%	1	-5.3	15.7	9.5	8.0	19.7%	73	-7.8	-3.4
4324	Dentsu	2,519	4%	1	6.3	23.1	22.2	16.2	5.6%	628	7.7	6.6
7201	Nissan Motor	755	5%	1	0.2	32.4	9.7	7.4	10.5%	3,158	2.3	9.5
6902	Denso	2,417	4%	1	-22.3	77.0	19.1	10.6	5.2%	1,948	-0.1	12.1
7269	Suzuki Motor	1,805	4%	1	10.2	13.3	16.2	13.4	7.0%	1,013	10.0	11.7
7453	Ryohin Keikaku	3,830	3%	1	18.0	14.4	10.2	8.8	12.5%	103	7.2	3.3
Financials		Overweight	18.1%	22%								
8306	Mitsubishi UFJ Financial Group	375	5%	1	9.5	2.0	6.0	8.2	5.9%	5,304	10.1	10.4
8591	ORIX	7,360	4%	1	62.7	-2.3	9.9	9.5	6.5%	791	7.0	12.2
8604	Nomura Holdings	307	4%	1	-8.4	71.5	28.5	11.7	1.9%	1,124	5.4	22.8
8830	Sumitomo Realty & Development	1,508	5%	1	-5.4	8.1	15.5	14.2	9.6%	715	-7.6	9.7
8960	United Urban Investment	85,500	4%	1	5.3	5.4	1.8	1.7	4.6%	180	-4.3	-2.3
Telecommunication Services		Neutral	3.3%	4%								
9433	KDDI	479,500	4%	1	0.4	9.3	7.8	6.8	12.2%	1,833	-19.9	-5.3
Utilities		Neutral	2.9%	4%								
9531	Tokyo Gas	354	4%	1	-48.2	87.3	27.0	12.9	4.0%	915	12.2	-0.9
Energy		Neutral	1.5%	2%								
1605	Inpex	511,000	2%	1	49.8	-13.9	8.1	11.2	10.9%	1,866	-3.7	2.2

Note: Index weightings based on sector weightings in the S&P Japan Equity Index.
Source: S&P Global Equity Indices, Citi Investment Research and Analysis.

Appendix A-1

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