Scott McGlashan: 2010 could mark a new beginning for Japan

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JO Hambro Capital Management's Scott McGlashan is confident the Japanese economic and stockmarket recovery will continue in 2010 as western economies remain hamstrung by a lack of capacity.

McGlashan, who once famously warned investors to avoid Japanese equities when he was at Invesco Perpetual in the early 1990s, said the combination of an easing in Japanese monetary policy and the culmination of quantitative easing elsewhere could be a new beginning for the country, benefitting investors in his JOHCM Japan fund.

He said: 'Last year was a year of quantitative easing for central banks around the world, except Japan which only increased its balance sheet by 6% whereas the Fed and Bank of England doubled theirs. Japan did not join the party last year. No monetary stimulus artificially pushed up share prices.'

'At a time when the Fed, ECB and Bank of England are looking for exit strategies, the Bank of Japan has huge capacity to ease. Over the next year or two the actions of central banks threaten to undermine the rally in security prices see in developed world over the past year, with the exception of Japan where central bank activity could help push prices higher.'

McGlashan also points out that on most metrics Japanese equities are near historically cheap levels and strong research and development bodes well for Japanese trade and innovation over the long term.

He says green technology is one area which is looking particularly attractive. 'Japan devotes a considerably higher proportion of GDP to research and development than any other industrialised nation,' he explains.

'Assuming we really are seeing long-term climate change, Japanese companies are likely to be leaders in this field. Japan accounts for nearly half of the inventions in the area of climate-related technologies (and three times as many as the United States). If you believe the future is green, you should invest in Japan.'

McGlashan says his fund is well positioned for the recovery in Japan: 'The collapse in growth and profits was unprecedented in the post-war period. Corporate Japan is now recovering rapidly. Profits began to rebound in the summer of 2009 and will accelerate in the current year. As a result, the valuation of Japanese shares should fall to near 50-year lows on most metrics.'

'Corporate Japan has already de-leveraged, and the level of corporate gearing has fallen back to the levels prevailing in the 1960s. At a time when the ability of companies in the United States and Europe to expand is inhibited by their need to de-leverage, Japanese companies are exceptionally well placed to take advantage of the potential growth that emerging markets or new technologies may provide.'

In the three years to the end of February McGlashan has returned 0.7% on his JOHCM Japan fund in sterling terms compared to -10.25% decline in the Topix Index. His maximum drawdown over this period was -24.3%.