

Japan still an attractive investment

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Comment from Peter Brooke, boutique head, Macro Strategy Investments

Summary: The recent massive earthquake and tsunami in Japan, while horrific in terms of human tragedy, have in fact enhanced the tactical attractiveness of the Japanese equity market by further driving down prices there. Given the broad diversification of our funds, no one holding (like the exposure to the Japanese equity market fall) can meaningfully impair their performance. Importantly, their potential for outperformance remains a key reason to maintain our overweight position.

Our fund exposure to Japan: It is important to remember that Macro Strategy Investments (MSI) constructs very well-diversified funds across a multiplicity of geographies and asset classes, aiming to provide the very best performance for a given amount of risk. As a result, the exposure of our funds to Japanese equities is very small as a proportion of each fund, and is able to influence their performance only at the margins. Each fund's current indicative exposure to Japan is shown below:

- Old Mutual Flexible Fund 3.6% of assets
- Old Mutual Balanced Fund 3.0% of assets
- Old Mutual Stable Growth Fund 2.3% of assets
- Old Mutual Real Income Fund – no international exposure (except BAT)

Why are we investing in Japan? We have believed since the latter part of 2010 that Japan offers a contrarian short-term trading opportunity for reasons of both price and theme. Price-wise, the Japanese equity market has experienced massive underperformance for years, and at the beginning of 2011 was trading at the same levels in real terms seen 30 years ago. Its shares are un-loved and under-owned (shown by the market's price:sales ratio of 0.6 times and its price:book ratio of a very low 1.2 times).

Also, the yen's exchange rate had appreciated strongly in 2010 and had a good probability of moving weaker in 2011, possibly through government intervention. These factors, combined with the theme of the improving global growth environment, gave us a strong conviction that it was a good time to buy Japanese equities.

Has anything changed? The Japanese equity market has now plunged by some 20% or so (from start of March to time of writing), making it even cheaper than before. When we invest in a company's stock, we are buying its earnings for the long term, so a temporary disruption in this earnings stream (such as that caused by the earthquake) is not meaningful.

Turning to theme, obviously for Japan right now the short-term outlook is not great. However, we believe the earthquake represents only a short-term disruption to the economy and company earnings growth, and therefore the underlying reasons for investing remain in place.

Investment implication: We will hold and consider increasing our Japanese equity exposure given the current cheap valuations on offer, as appropriate to each of our funds.