Japan Market Perspectives from Japan Equity Small Cap Absolute Value Fund Manager

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Japanese companies: Take advantage of your “specialty” area and survive the US-China trade wars!

Global stock markets are bracing for uncertainties as tariff wars triggered by US President, Donald Trump, spilled over from the US-China trade frictions to the immigration issue with Mexico. During such times, we should take a step back from the immediate ups and downs and instead focus on the mega-trends impacting certain industries and sectors.

For example, the Japanese electric appliance industry has lost its position as a world leader in the past twenty years. Japanese firms have fallen behind the overseas competition in the fields of consumer electronics (including personal computers and smartphones) as well as their core components, semiconductors. They are no longer the world's top players. But if you look upstream, the landscape is completely different. We can find Japanese companies leading in many fields. Today, I would like to talk about the strengths of Japanese companies in their "specialty" areas.

■Strength in “upstream”

The electronic material industry extends over a number of industries centred on chemicals, but ranging from glass & ceramic products to non-ferrous metals and textiles. Each field is not that large, but if they gain status as the world’s top players in each area, they will be able to achieve double-digit profit margins.

The pace of technological innovation in the upstream market is not as fast as that in downstream products such as semiconductors and end products. However, continuous research and development is required to improve quality and meet customer needs.

If makers go ahead of customer needs, they have to wait until the market catches up with their technologies. In this case, they can demonstrate their strength, “persistence” which has been developed through their rigid employment practices. It may be difficult for you to understand the phrase, “the market catches up with the technology.” The best example of this is the next-generation “5G” mobile phone. As 5G uses high-frequency radio waves, communication device makers can no longer use many of existing materials to avoid the loss of signals.

■Expanding applications of Japanese materials for 5G

While many Japanese electronic materials manufacturers have developed many products for high-frequency waves, those products have been used only for specific areas. But these materials might be available in huge markets such as smartphones in the future.

It will take a long time for the 5G network to spread widely, but mobile device makers should adopt new materials compatible with 5G, at least for flagship models launched in the second half of this year or the next year.

I feel that the number of development projects tailored to specific customers has increased in recent years. As uncompetitive parts and products such as semiconductors and smartphones have been removed from markets, material makers are being forced not only, to improve the general quality of their products but also to develop each product in line with the road map of specific customers to continue to win.

■A new challenge for investors

This trend poses a challenge for investors, because the volume of information disclosed by companies is limited due to non-disclosure agreements between material makers and device makers. Nevertheless, if their materials are adopted as parts of popular items such as iPhone, we can figure this out from the sales figures and the timing of their change. As you know, makers such as Murata, Taiyo Yuden and TDK are considered as "iPhone-related names."

However, if it is about a material for new technologies prior to the launch of product a few years later, all we can do even as professional investors is to imagine for whom or for what the company is going to produce that material.

Another challenge for us is “Huawei.” I mean “materials used for Huawei products.” But we can get only limited information even through direct interviews, with no one being able to make a credible forecast about that company. All I can do now as a fund manager is to pray that Huawei-related names in our portfolio can stave off the ill-effects. Investors may also need to develop a new method for the new era.

Daiwa SB Investments

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Mr Nigauri has 26 years of investment research which dates back to 1991, when he joined Daiwa Institute of Research as a research analyst. Since 1995, Mr Nigauri has focused his research efforts on expanding his expertise in Japanese small-cap equities.

He joined DSBI in October 2002 and is responsible for managing domestic accounts.

He has received prizes from the R&I Fund contest (2012, 2013, 2014 and 2015) as well as from the Lipper Fund Awards Japan (2012 and 2013) and J Money Fund Awards (2016).

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