



RBC BlueBay  
Asset Management



# Asian takeaways

## Kobe Beef Chronicles

For Professional Investors Only | Marketing Communication



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**“The last few months have also seen an intriguing political and market backdrop.”**

Having recently returned to Japan for another research trip, we were struck, as always, by innovation taking place across Japanese companies. From sports shoes to theme parks to nuclear fusion technology, we provide several case studies that demonstrate that the country is looking to the future and provides attractive opportunities for stock picking.

The last few months have seen an intriguing political and market backdrop. When the Nikkei fell over 20% during three days in August, the media implied the end of the Japanese equity rally, calling the 5th August ‘Black Monday’. We attributed this drop to Bank of Japan (BoJ) Governor Kazuo Ueda’s more-hawkish-than-expected comments post-rate hike, excessive concern regarding the U.S.’s hard landing scenario, and accumulated carry trade positioning. However, as all three concerns unwound, the Nikkei finished the month slightly positive and has continued to rise, albeit with continued volatility.

### Recent events in Japan draw interest

As we touched down in Tokyo, we commented on how this historic recovery created a great opportunity for foreign investors to buy Japanese companies and noted how it did not scare off new Nippon Japan Individual Savings Account (NISA) participants. Revamped at the beginning of the year, Japan’s NISA tax-exemption offers a system for small scale investment and has been encouraging more retail investors to consider the country’s equity market.

During a meeting with Japan Exchange Group’s (JPX) chief representative, Isamu Matsumoto, he pointed out that while the Japanese equity market had seen net foreign asset flows of JPY3.1 trillion in 2023, inflows through August 2024 totaled JPY3.3 trillion, exceeding all of 2023’s annual net flows. As for NISA, from January to June 2024, JPY7.9 trillion was invested in “growth” and JPY2.2 trillion in the alternative “tsumitate” accounts, offering balanced long-term diversified investment. This makes the total JPY10.1 trillion across the two types. Of this, 41% was allocated to domestic stocks, which exceeded market expectations<sup>1</sup>.

<sup>1</sup> Tokyo Stock Exchange

Another notable news item was the regime change from Japanese Prime Minister Fumio Kishida to Shigeru Ishiba on 27 September. Sanae Takaichi, an Abenomics disciple, was seen as the most likely candidate for Prime Minister, but the surprise pick of a monetary hawk triggered “Ishiba shock,” with the Nikkei falling 4.8%<sup>2</sup> in just one day. Just like Ueda’s hawkish comments within the BoJ were modified by his deputy governor Uchida, Ishiba took a U-turn on his stance on rate hikes. Since Ishiba did not win by a significant margin, he needs to solidify his base within the Liberal Democratic Party (LDP), which makes it hard for him to deviate from his predecessor’s policies. In fact, Ishiba has indicated that he will continue the Kishida administration’s economic policies, which pushed the Nikkei back to 40,000. This may be seen as proof that investors believe the Kishida administration had achieved a virtuous cycle of wage growth, modest inflation, and consumption recovery, so continuation of these policies would be positive, in our view.

**“Just like Ueda’s hawkish comments within the BoJ were modified by his deputy governor Uchida, Ishiba took a U-turn on his stance on rate hikes.”**

Following the October election results, a change in the LDP leader seems quite likely early next year ahead of Upper House elections in the summer. However, these political developments should not matter too much to the Japanese economy nor the BoJ in our opinion. Wage growth remains upbeat and is structurally underpinned by a labour shortage.

### **“Imagineering”: combining creativity with technology**

#### **ASICS – technological strength and design innovation**

On a sunny day after a typhoon in September, we explored the ASICS Research & Development centre in Kobe. We discovered that the company’s approach is focused on biomechanics: the science of how the body’s parts work together to move. ASICS’ researchers study biomechanics for athletes, analysing data obtained from sensors installed on their bodies and the court or running track. They can even create different shoes based on a runner’s strengths, such as stride length.

While ASICS shoes have been known to be high performing, comfortable and durable, historically they have not been considered fashion forward. Today however, scientists and designers work together to optimise both performance and design, drawing inspiration from nature and attracting many influencers. One of their more recent releases, the ACTIBREEZE 3D Sandal, is 3D printed which allows for customised and personalised shoes. We believe this will be the next trend in footwear.



Browsing an impressive array of footwear options at an ASICS store.



Fantasy Springs – an amusement park for Disney fans of all ages.

#### **Fantasy Springs – a dreamland for kids and adults alike**

Another example of technology blending with creativity that we experienced during our trip was Fantasy Springs, the newest expansion to the Tokyo DisneySea resort featuring Frozen, Peter Pan and Tangled. The operator, Oriental Land (OLC), spent USD2 billion<sup>3</sup> building Fantasy Springs, the most costly expansion in Disney history. Fantasy Springs is a dreamland for children who love Disney princesses, but also for adults who appreciate European elegance, thanks to its subtle but sophisticated rockwork – Mount Rushmore meets Snow White and Beauty and the Beast.

Fantasy Springs is an excellent example of creative imagination combined with technical know-how. Peter Pan’s Neverland Adventure, Anna and Elsa’s Frozen Journey, and Rapunzel’s Lantern Festival all skillfully apply audio-animatronics, a form of robotics animation created by Walt Disney. Advanced technology bridges the gap between old and new, reality and fantasy, and dynamic and tranquil.

<sup>2</sup> The Japan Times, Tokyo stocks fall 4.8% in first day of trading after Ishiba’s victory (japantimes.co.jp).

<sup>3</sup> Forbes, Look Inside Tokyo Disney’s \$2.1 Billion Expansion, Fantasy Springs, 24.05.2024 (Forbes.com).



There is, however, room for improvement, particularly around the simplification of systems and with provision of an entertaining atmosphere. Currently, to get into Fantasy Springs requires a pass, which OLC intends to eliminate soon. The company has also been emphasising crowd control since the pandemic, which might have been the reason for the larger spaces between rides. However, a few musical performers and small retail shops would add an intimate and lively feeling to Fantasy Springs, which we believe would be beneficial. Having only opened in May, we hope to see attention from Oriental Land on customer experience moving forward - a historical strength of theirs.

### Digitalisation: government focus on information technology

As part of governmental reform for growth, METI (Ministry of Economy, Trade and Industry) is promoting investment in the information technology sector in Japan to offset a labour shortage. To do this, Japan needs to improve productivity by 7% or increase the number of foreign workers from the current level of 2 million to 6 million. In the past the nation has not been known as open to immigration, but today Japan is actively seeking to attract more foreign investment and labour.

We visited SAKURA Internet, which was certified as a “cloud program” vendor by METI under the Economic Security Promotion Act and will invest JPY13 billion<sup>4</sup> (50% government subsidised) in a new GPU data center/cloud services. Being the sole domestic data centre operator, SAKURA Internet is benefiting from strong demand from regional governments, who would rather not give Japanese national data to foreign companies.

We also visited Fujikura and DISCO, both of which have a competitive advantage in a strong *monozukuri* (manufacturing) culture. Fujikura has a 30-40%<sup>5</sup> global market share in optical wiring components and is experiencing strong demand for its products as data centre operators compete to build AI servers. Its strength lies in its connecting (*tsunagu*) technology. Fujikura also has 60-70%<sup>6</sup> share of the global market for MT ferrules, an important advanced optical connector component. Fujikura’s signature product is called the ‘spider web’. To create it, they combine 12 fibres into one web ribbon of 200 microns in diameter. The combined fibre is thinner than hair – so fine that it is difficult to connect one cable to another. Since cable can only be delivered in a certain length, it needs to be connected on site by human hands. Fujikura also has the global number one market position in this connecting device, and the company is striving to make this process more efficient.



Taking a closer look at Fujikura’s Spider Web Ribbon technology.

As Fujikura plans to create value via *tsunagu* technology, DISCO’s *kiru* (cutting), *kezuru* (grinding), and *migaku* (polishing) technology is another master-craft technology in semiconductor equipment. Disco has an 80%<sup>7</sup> share of the market for dicers and grinders for back-end processes. Typical examples are dicers that cut wafers, grinders, and polishers. Each of these types of equipment uses consumables. Demand for DISCO’s high bandwidth memory is expected to remain strong over the medium term and demand for advanced packages, including CoWoS (chip on wafer on substrate), has increased. DISCO has a wide range of applications, from advanced semiconductors to mature generation semiconductors, power semiconductors, automotive, image sensors, and electronic components. The ratio of consumables is also high, and stable business performance is expected among semiconductor production equipment peers (SPEs).

### Nuclear fusion technology: Japan’s future power policy

In 2011, Japan’s Fukushima nuclear power reactor, which once generated 30% of the country’s electricity, was halted following damage from an earthquake and the subsequent tsunami waves caused. Yet, a 2023 poll conducted by the Japanese newspaper Asahi Shimbun revealed that while 42% of respondents oppose resuming plant operations, 51% of respondents are in favour of it<sup>8</sup>.

One of the main reasons for this shift in sentiment is the steep hike in global energy prices caused by the Russia-Ukraine war. Within Japan, yen depreciation has led to higher costs for domestic power consumption and electricity costs have skyrocketed. Also, with the target of reaching net-zero emissions by 2050, the government has no option but to restart nuclear power plants to provide additional power supply. Currently, out of the 54 nuclear reactors in Japan, only 33 are operable, and only 13 are operational.

<sup>4</sup> Sakura Internet Inc., Macquarie Equity Research, 08.08.2023.

<sup>5</sup> Fujikura, Nomura Global Markets Research, 09.09.2024.

<sup>6</sup> Wire & cable: Corning’s results, Nomura Global Markets Research, 30.10.2024

<sup>7</sup> Disco, Macquarie Equity Research, 18.10.2024.

<sup>8</sup> World Nuclear News, Poll finds record support for Japanese reactor restarts, 21.02.2023 (worldnuclearnews.org).

Around the same time that the Academy Award-winning film *Oppenheimer* opened in Japan, the largest and most advanced nuclear fusion reactor, JT-60SA, commenced its official operations in Japan's Ibaraki Prefecture. This technological innovation represents a collaborative initiative between the European Union and Japan to establish nuclear fusion as a future sustainable and clean energy source, and our team member Selina Lu had a chance to pay a visit.

*"We have been trying to create a sun on Earth,"* said Hidenobu Takenaga, director of the Naka Fusion Institute of the National Institutes for Quantum Science and Technology (QST). Existing nuclear reactors work using fission, the nuclear reaction where atoms are split apart, while JT-60SA works by power of fusion, where two atoms slam together. A fusion reactor would mimic the same process that powers the sun and could theoretically produce virtually unlimited clean, renewable energy. Fusion also doesn't produce the same radioactive byproducts that fission does, making it safer overall.

### **Nuclear power attracts more interest**

We find it interesting that just as a group of Japanese atomic bomb survivors is awarded the 2024 Nobel Peace Prize, nuclear power is starting to be seen as a practical method of power generation that contributes to decarbonization. Google CEO Sundar Pichai is also considering the use of nuclear power plant electricity and small modular reactors (SMR) for their data centers. Microsoft has announced plans to purchase electricity from Three Mile Island in the U.S., and Amazon has announced plans to develop SMR facilities. The International Atomic Energy Agency has revised upwards its annual projections for the expansion of nuclear power.

We discussed this shift in future power policy for Japan during our meeting with Keigo Akimoto, a Professor at the Tokyo Institute of Technology. Mr. Akimoto emphasised the importance of restarting nuclear power plants and explained that current energy generation cannot meet the demand for electricity. This will increase given strong demand for power in the IT sector coming from data centres, digitalisation, and electrification of various industries. However, Japan is likely to delay its carbon neutrality target since it requires further CapEx. The hurdle for increasing renewable energy installation is high, as grid integration and power transmission both need to be upgraded, while Japan lacks the required land for solar and wind capacity installation. The cost of other options such as hydrogen and biomass sources is also high.



JT-60SA – the world's largest and most advanced Tokamak-type fusion reactor.

To reach Japan's energy transition goal, nuclear power will be a necessary option. It's also critical for Japan to secure long-term liquefied natural gas (LNG) contracts for energy use. Japan has a well-developed supply chain and is one of the leading countries for developing nuclear fusion energy technology. At the first meeting of a government panel on Japan's nuclear fusion strategy, held in September 2023, members from both academia and industry said that fusion research has entered a critical stage where international cooperation is giving way to competition. Nuclear fusion technology will likely be commercialised by 2050.

There is a real risk across both tech and energy if Japan falls behind that trade deficits could worsen substantially. Having already reached a JPY8 trillion trade deficit for crude oil in 2021<sup>9</sup>, the deficit in the computer services segment could reach the same by 2030 from its current JPY1.4 trillion level without government intervention, on the back of US big tech dominance and artificial intelligence trends<sup>10</sup>.

### **Conclusion**

While politicians are too busy fighting for seats, the energy deficiency clock is ticking. The BoJ can be *"behind the curve"* as Japanese consumers' inflation expectations are low, but as for technological advancement, competition, and power generation, we really don't have time for this. What is clear is that it feels as though change is underway and that wider Japan is looking to the future. As bottom-up stock pickers, we feel as though the country has much to offer, and we expect investor interest in the country to grow, as companies continue to innovate.

<sup>9</sup> METI, "Strategy for Semiconductors and the Digital Industry" Compiled, 04.06.2021 (meti.go.jp).

<sup>10</sup> Ibid.

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### Selina Lu

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Selina is a portfolio manager on the RBC Asian Equity team at RBC GAM. She is the team's commodities, utilities, and consumer specialist. Selina joined the organisation in 2018 as a part of a graduate program that allowed her to work in a variety of roles in Toronto and Hong Kong across North American equities and Asian equities. Prior to this, she had worked at a major Canadian financial institution, gaining experience in corporate banking, credit risk, and finance. Selina began her career in the investment industry in 2010.

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