



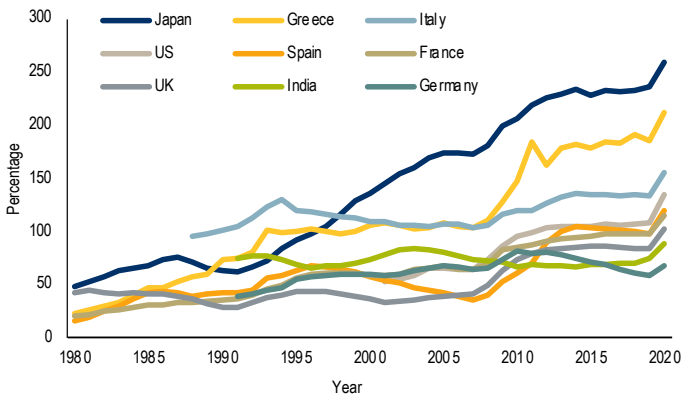
August 2023

Why Japan now

Over the past few decades, Japan's backdrop has made the economy less appealing to investors than its developed market counterparts. The Japan economy has experienced decades of challenges including unfavorable demographics, a heavily indebted economy, the real estate bubble of the late 1980s, and other issues including the keiretsu system (a network of interlocking businesses that has contributed to dominant Japanese companies taking on bad debt). Whilst the equity market has moved somewhat autonomously against these challenges, we feel the asset class has been overlooked as a result of these headwinds.

However, as the macro environment for the country improves, we are seeing a renewed interest in Japanese equities, and potential strong tailwinds for investors in the asset class:

Exhibit 1: Japan public debt as % of GDP vs other DM

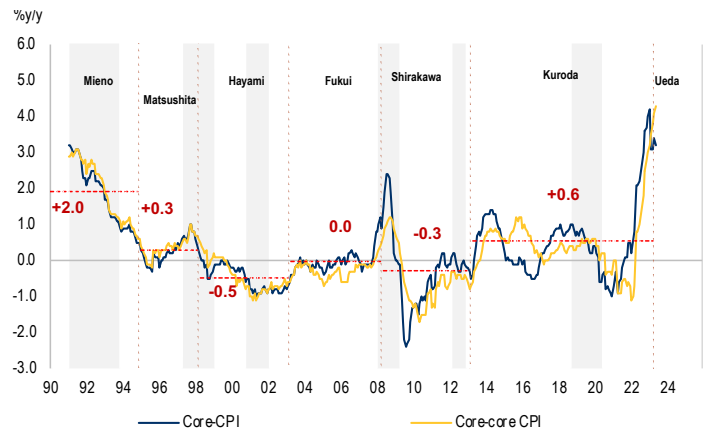


Source: MUMSS Research, IMF World Economic Outlook. Data as of January 2023.

Inflation

Rising global inflation and associated rate hikes have created an exogenous shock for Japan, entering uncharted territories in terms of its consumer price index (CPI) and the Japanese yen. While inflation is currently above target, the rise in Japan's CPI has been treated positively as the country has faced a relatively constant state of deflation since the 1990s.

Exhibit 2: Average core CPI inflation during each Bank of Japan governor's term

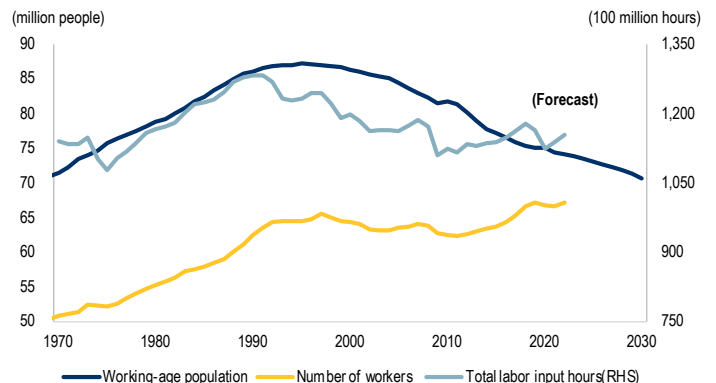


Source: UBS Research, MIC (Ministry of Internal Affairs and Communications). Note: VAT hike impact in 1997 and 2014 are excluded. Shaded area shows recession; red figures show average core CPI inflation during each governor's term. Data as of April 2023.

Labor market

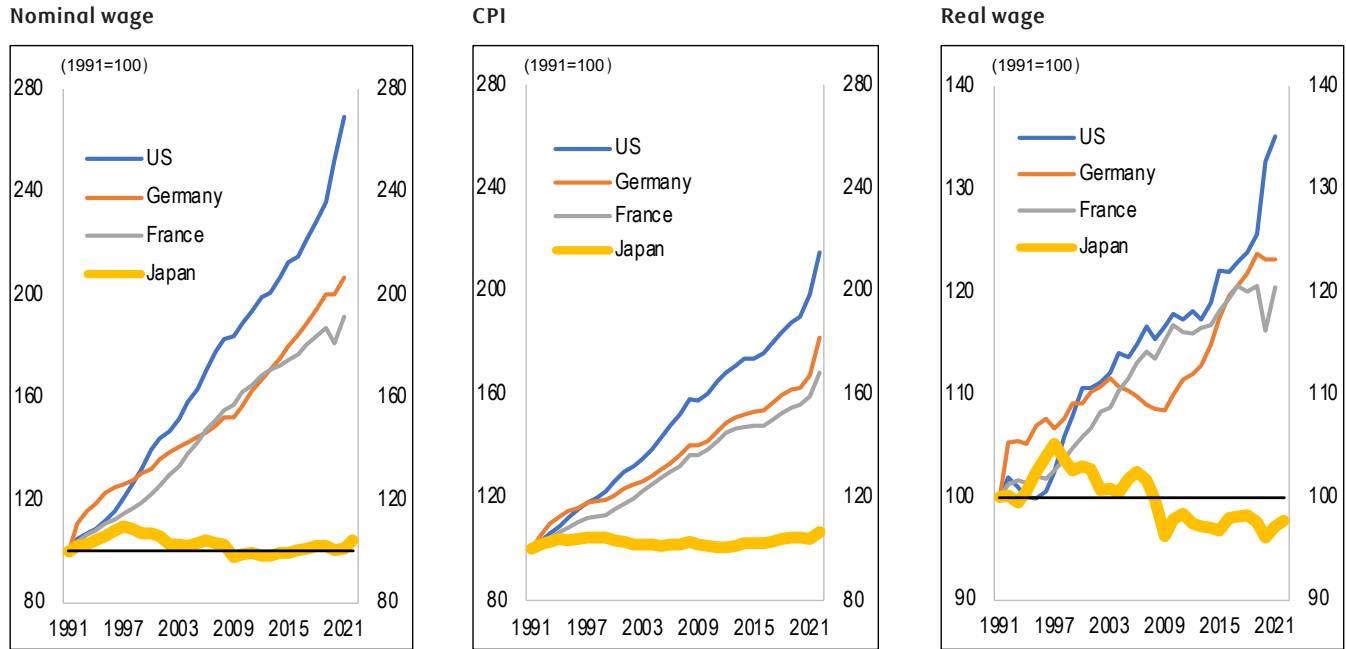
Despite demographic challenges and a declining younger population, Japan has historically resisted increasing its foreign labor force. While that may continue to be the case, the domestic labor shortage is making wage hikes and labor market structure changes seem inevitable, and we are seeing evidence of companies placing stronger emphasis on employees and corporate governance reform.

Exhibit 3: Labor demographics



Source: Mizuho Securities Equity Research, based on MHLW. Data as of December 2022.

Exhibit 4: Wage inflation



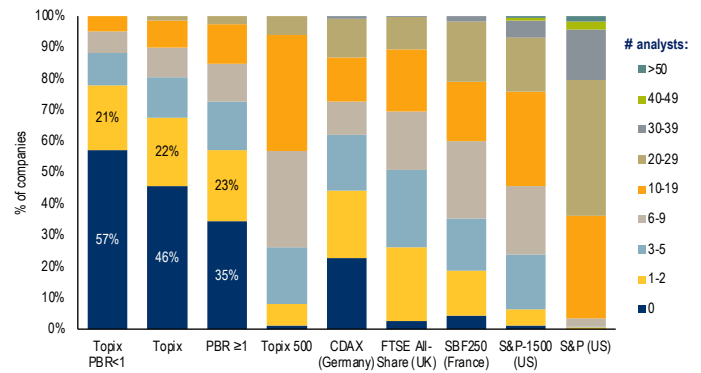
Source: OECD, IMF, MIC, Goldman Sachs Global Investment Research. As of December 2022.

Wage hikes are particularly important to a country like Japan in which real wages have been in decline since the 1990s. This weak wage growth explains a significant portion of Japan’s CPI trends versus other developed markets. Whilst recent spring annual wage hikes (Shunto) have been led by large corporations, if these trends spill over into SMEs, long-held inflation expectations can materially shift into positive territories.

Why active

Japanese equities today provide an attractive opportunity for active investors. The asset class is under-researched compared to other developed markets, providing ample opportunities for active investors in stock picking and idiosyncratic alpha. Additionally, active managers are uniquely positioned to capture opportunities arising from disruption, as well as those associated with ESG, elements that are not captured by backward-looking passive strategies.

Exhibit 5: Sell-side coverage

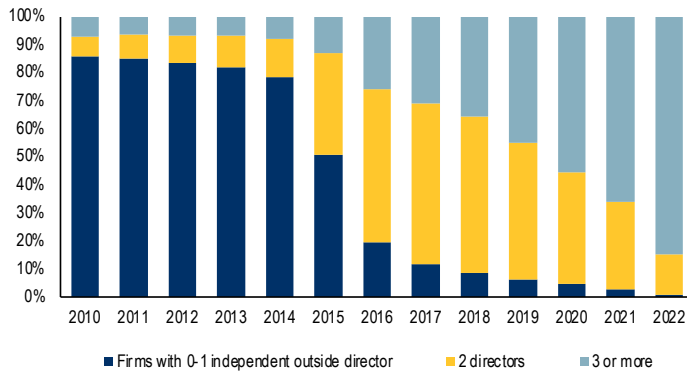


Source: CLSA Research. Data as of June 2023.

Unlike passive strategies, active investors are also able to provide selective exposure to the asset class in structurally winning industries and companies. Through fundamental, in-depth research, active investors are able to identify unique opportunities in companies with high quality management and strong corporate governance.

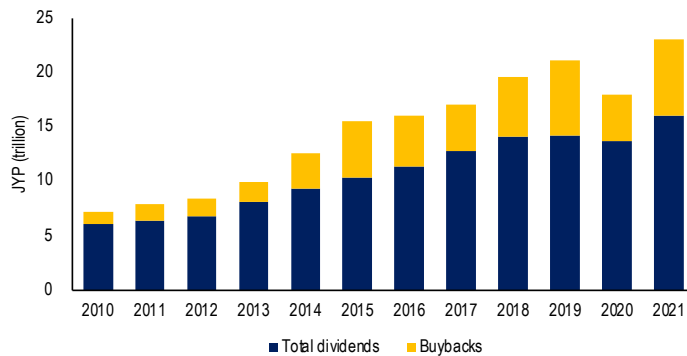
As previously mentioned, we have seen progress when it comes to corporate governance and best practice in Japan, including improvements in board structure and reporting, increasing the opportunity set for stock pickers and leading to growth in total shareholder returns.

Exhibit 6: More independent outside directors



Source: TSE, Corporate Governance Report. Data as of December 2022.

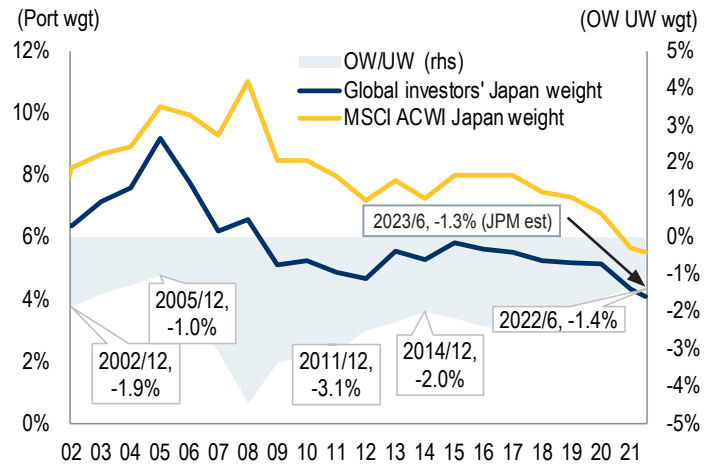
Exhibit 7: Growth in total shareholder returns



Source: TSE, Corporate Governance Report. Data as of December 2022.

Finally, despite Japan being the 3rd largest economy globally, the market is under-owned by global allocators. Given relatively muted performance, in particular versus U.S. equities, in the last decade, allocators have underweighted Japan significantly in recent years. This presents another compelling argument for active investors, as both corporate fundamentals and fund flows could provide strong tailwinds to the market.

Exhibit 8: Global investors' Japan weighting and Japan's weighting in the MSCI ACWI Index



Source: IMF, MSCI, Bloomberg Finance L.P., J.P. Morgan. Note: Date for 2022 as of end June; OW (overweight and UW (underweight) relative to MSCI ACWI Index. Data as at May 2023. Note: IMF publishes data every six months. June 2022 is the latest published data as of June 2023.

Why RBC Japan Equity

The RBC Asian Equity Team is long-term and risk aware in its approach, with a near-10 year track record of investing in the region. The RBC Japan Equity Strategy employs an all-cap core exposure to Japanese Equities, driven by regional perspectives and industry specialists. The Team's bottom-up approach allows it to focus on companies with strong balance sheets, consistent cash flow generations, and high and/or improving return on capital. The team takes a disciplined yet unconstrained view of the benchmark to build differentiated excess returns over time through a high conviction portfolio. Combining the team's industry expertise alongside the growing tailwinds in the market, RBC Japan Equity may provide differentiated exposure and performance to an otherwise underweighted portfolio to the Japanese market.

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