



# Lazard Insights

Conference Call Series

## Japan

### Is it Really Different This Time?

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## Agenda

- What changes are taking place in Japan?
- Does Japan represent a viable investment opportunity?
- What are the investment opportunities in Japan?

## Will New Government Mean Reform?

- The Democratic Party of Japan (DPJ) is a mix of former socialists and disenfranchised Liberal Democratic Party (LDP) members
- DPJ policy changes that could raise Japan's long-term growth potential include:
  - Encourage families to have more children
  - Regional free trade or European Union-type initiatives
- Broad policy statements from the newly elected Prime Minister have been positive, but:
  - They are long term, structural goals
  - They have been somewhat undermined by comments from other cabinet members

## **In the Near Term, Expect More of the Same**

- It is unlikely that the DPJ will hold together long enough to enact long-term structural changes
- This is the first stage in a multi-year political realignment
- A two-party system dominated by an internationalist party and an isolationist party is the likely outcome

## Secular opportunities

- Japan is at the bottom of its credit cycle with low levels of corporate and individual debt
- Japan is a proxy for growing Asian economies
- Japan has the highest energy efficiency of any developed country
- Japan is at the early stages of political change

## Snapshot of Japan

### **Broad and diversified investment universe**

- Japan is the second-largest market and second-deepest in the world, as indicated by market capitalization and number of stocks\*

### **Less efficient equity market**

- A stable source of alpha for active managers
- Timing entry is a fruitless exercise

### **Differentiated marketplace**

- The country has a low correlation to developed markets

\*As of June 30, 2009  
Source: MSCI, Lazard Asset Management

## Broad and Diversified Investment Universe

As with the U.S. market, the Japanese market is less concentrated towards large-cap names. Concentrating on too few names minimizes full capture of benefits.

- The top 10, 20, 50, and 100 companies in Japan make up a smaller percentage of total market capitalization than any market in the world outside of the United States

	Mkt Cap (USD MM)	# of Stock in MSCI	Top 10(%)	Top 20(%)	Top 50(%)	Top 100(%)
USA	8,584,892	601	19.10	30.96	49.05	63.39
<b>JAPAN</b>	<b>1,995,432</b>	<b>347</b>	<b>21.08</b>	<b>31.75</b>	<b>52.01</b>	<b>70.14</b>
UNITED KINGDOM	1,738,245	105	49.67	70.03	89.25	99.63
FRANCE	857,033	76	53.37	73.38	94.82	100.00
CANADA	830,339	98	42.64	64.26	88.00	100.00
GERMANY	642,787	49	63.89	85.87	100.00	100.00
SWITZERLAND	614,507	36	83.17	93.41	100.00	100.00
AUSTRALIA	610,357	73	57.80	75.51	93.65	100.00
SPAIN	371,683	30	85.98	95.54	100.00	100.00
ITALY	292,444	37	74.77	91.63	100.00	100.00

As of June 30, 2009  
Source: MSCI, Lazard Asset Management

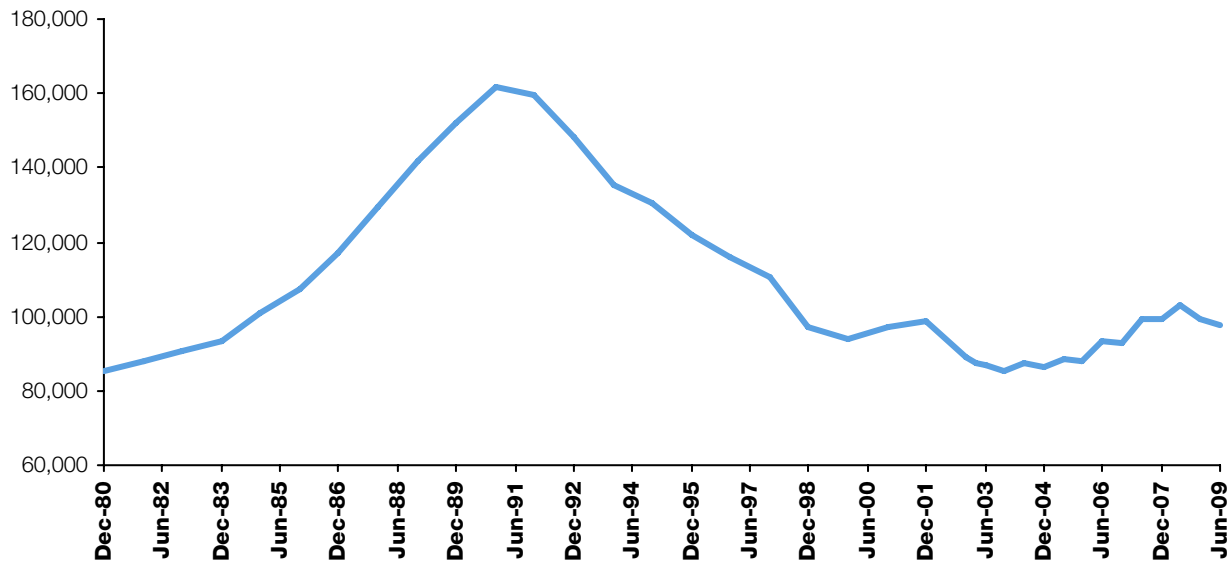
## Is Japan an efficient market?

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The United States has double the market capitalization of Japan but 10 times the number of employees.

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**Total # of Employees in Japanese Security Firms**

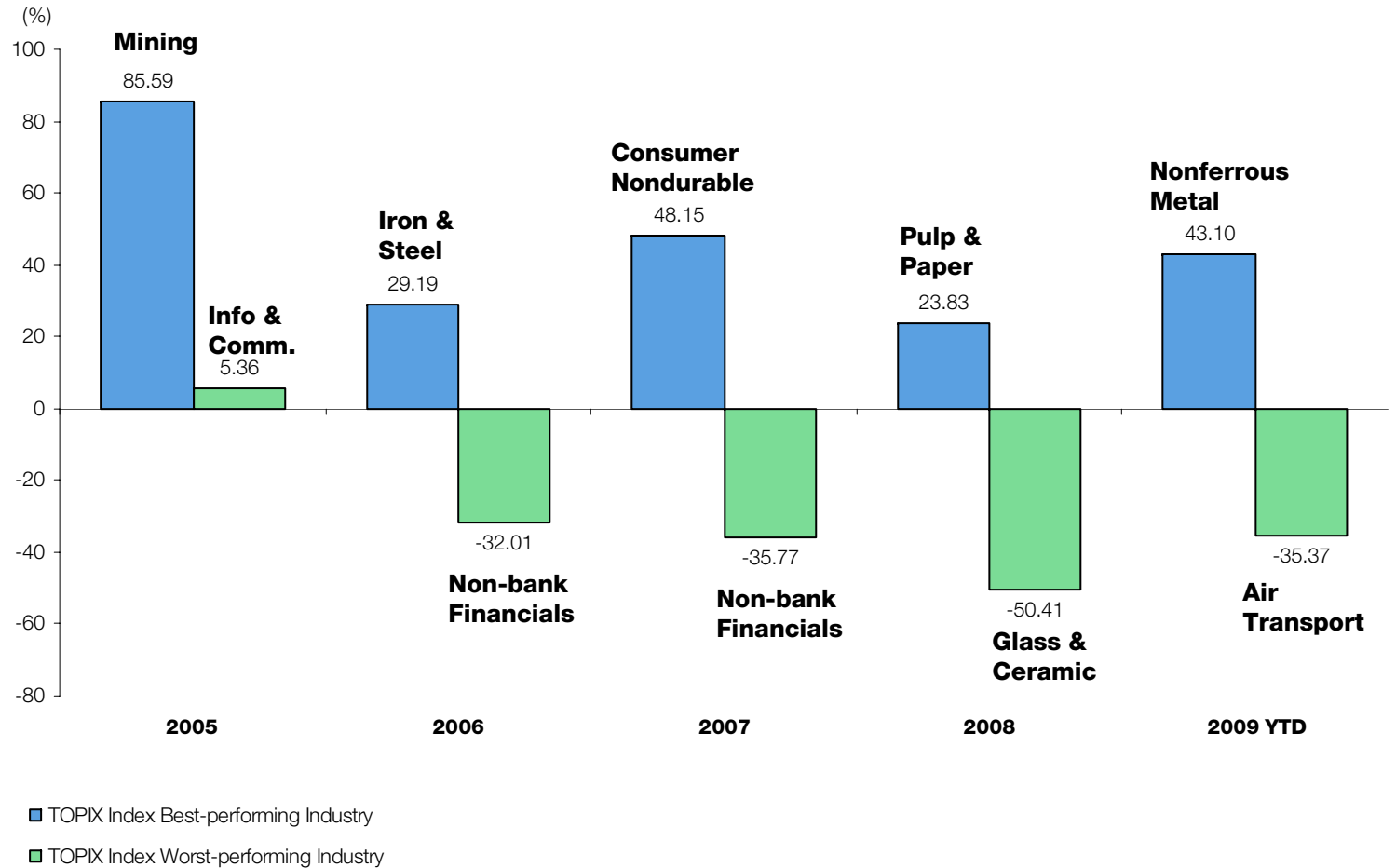


- Employment in the investment industry is down 70% from its peak in 1989
- Nomura, Japan's largest broker, covers 400 out of over 3,000 listed stocks
- 55% of all active managers have outperformed the TOPIX Index in the past decade

As of June 30, 2009

Source: Japan Securities Dealers Association, Lazard Asset Management

# Opportunities Offered By Dispersion

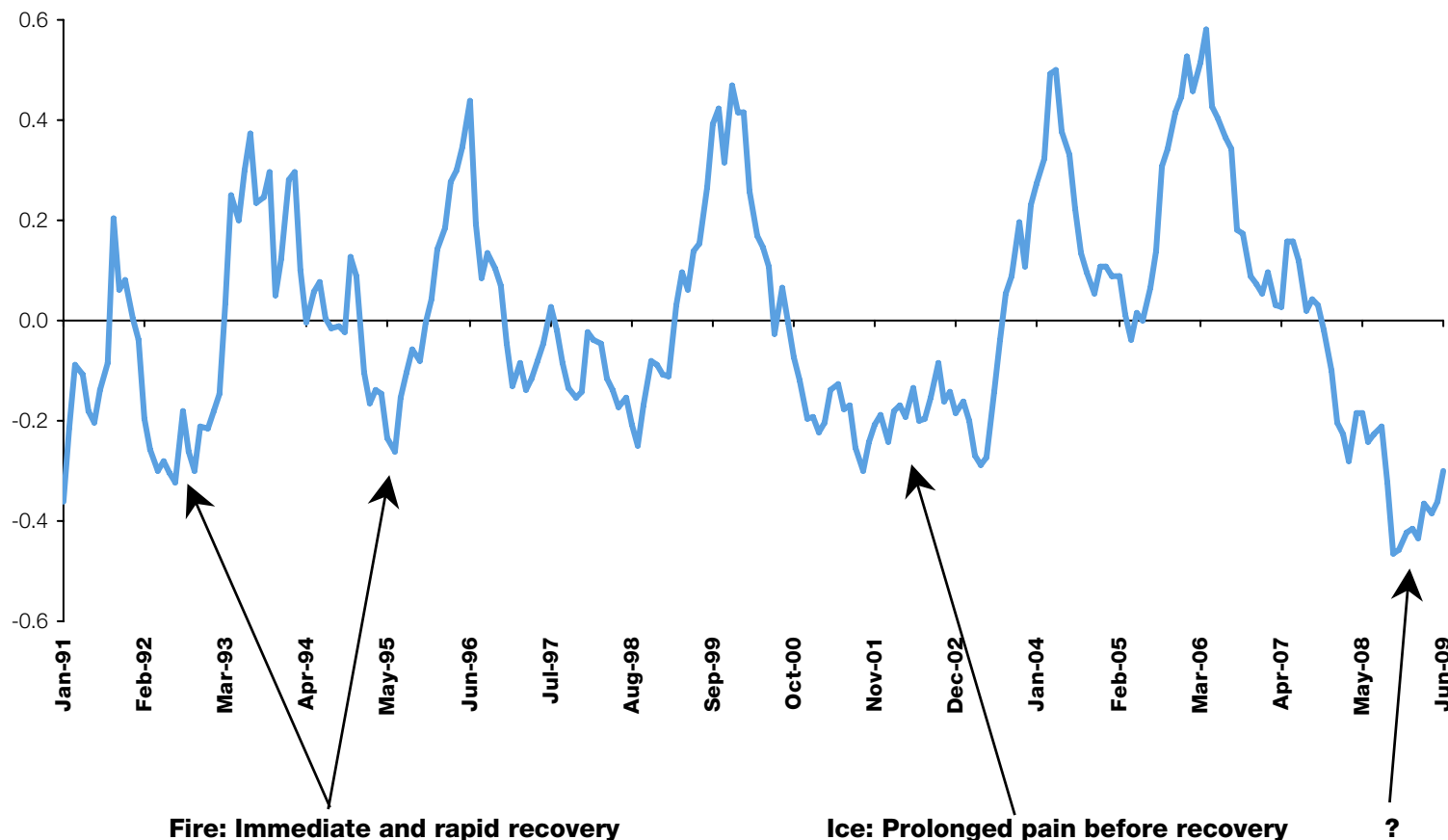


As of October 19, 2009  
Source: Bloomberg

## The Trouble with Timing Japan

Unlike most other markets, when Japanese shares move from bottom to top, they do so more quickly than when they fall from top to bottom. Timing an entry can be a fruitless exercise.

**MSCI Japan Index Rolling 12 month price returns (in JPY)**



As of June 30, 2009  
Source: MSCI, Bloomberg, Lazard Asset Management

## Low Correlation to Developed Markets

Japan remains one of the largest economies globally. However, correlation analysis reveals true diversification benefits for international investors.

	THE WORLD INDEX	WORLD ex-USA	WORLD ex-Japan	EAFE	EAFE ex-Japan	U.S.	JAPAN	U.K.	FRANCE	CANADA	GERMANY	SWITZERLAND	AUSTRALIA	ITALY	SPAIN
THE WORLD INDEX	1.000														
WORLD ex-U.S.	0.956	1.000													
WORLD ex-Japan	0.958	0.862	1.000												
EAFE	0.951	0.999	0.852	1.000											
EAFE ex-Japan	0.921	0.915	0.939	0.911	1.000										
U.S.	0.890	0.723	0.952	0.711	0.791	1.000									
JAPAN	0.711	0.812	0.507	0.819	0.537	0.421	1.000								
U.K.	0.849	0.841	0.859	0.837	0.909	0.729	0.512	1.000							
FRANCE	0.836	0.833	0.855	0.831	0.920	0.718	0.469	0.777	1.000						
CANADA	0.781	0.728	0.807	0.698	0.742	0.755	0.463	0.658	0.651	1.000					
GERMANY	0.800	0.781	0.840	0.778	0.900	0.706	0.388	0.726	0.864	0.623	1.000				
SWITZERLAND	0.754	0.763	0.746	0.766	0.804	0.630	0.497	0.722	0.723	0.519	0.682	1.000			
AUSTRALIA	0.732	0.727	0.733	0.715	0.748	0.634	0.494	0.674	0.616	0.722	0.608	0.532	1.000		
ITALY	0.659	0.681	0.646	0.678	0.712	0.522	0.410	0.551	0.676	0.541	0.666	0.509	0.474	1.000	
SPAIN	0.788	0.793	0.775	0.794	0.831	0.651	0.500	0.707	0.784	0.576	0.743	0.652	0.607	0.680	1.000

- The Japanese banking system is among the healthiest in the world and is in an expansionary phase of its credit cycle
- Japanese banks are well capitalized and investing in Western financial institutions
- 79% of Japanese stocks are trading below book value, and the TOPIX is at lows not seen since the 1980s

From January 1990 to June 2009  
Source: MSCI, Lazard Asset Management

## Identifying Future Winners and Losers

### Potential Winners

- Green technology – The lowest per capita energy consumption of any developed country
- Game software – A counter cyclical industry
- Netbooks – Diffusion of PCs in the developing world
- Telecoms – The worlds largest FTTH network
- Health care – Spending increase for an aging society

### Potential Losers

- Durable goods - Mass assembly of goods, particularly autos
- Basic industries – Lack of scale and high cost base
- Diversified conglomerates – Lack of focus on core competencies
- Traditional retail platforms – New formats and distribution channels undermine profits

## Conclusions

- Economic and political transition in Japan
- Inefficient market, which offers a great opportunity to exploit mispricing
- Sharp contrast between winners and losers
- Secular change in Japan's role from exporter to America to an integral part of Asia, which is not currently reflected in valuations
- Negative demographics, which offer both challenges and opportunities

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