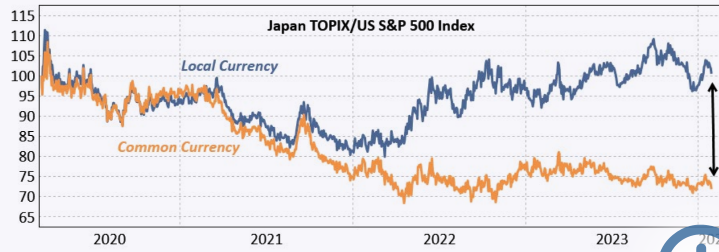
HOT TOPIX

When asked what the hottest major global stock market has been in recent years, most investors would unflinchingly respond the United States. This makes sense. US mega-cap growth stocks have been at the epicenter of a speculative boom in artificial intelligence-adjacent companies. It may come as a surprise then, that since the lows of the COVID market crash in March 2020, Japanese stocks have outpaced their American peers in local currency terms, with the TOPIX climbing 119%.

Of course, "local currency" is the catch. Per the chart below, the plummeting Japanese yen has created a cavernous gap between local currency and common currency returns when compared against the US S&P 500. The depressed yen also creates a conundrum for prospective investors. At current levels, the export-oriented composition of Japanese equity indices receives a competitive boost. But should the yen recover, the historically inverse relationship between stocks and the yen could work against further share price appreciation. We think that given how extreme the yen undervaluation has become, the currency and the stock market could rally simultaneously for a period of time, or at minimum, not move in opposite directions.

In recent years, the primary driver of the yen's weakness versus most major currencies worldwide has been interest rate differentials. The Bank of Japan (BoJ) is still running extremely accommodative monetary policy, despite a sharp interest rate hiking cycle virtually everywhere else. This is set to reverse. Despite a glacial approach to tightening, the BoJ has taken steps to diminish the impact of its yield curve control policy. Moving interest rates out of negative territory is likely forthcoming. But even if the BoJ sits on its hands, other influential central banks are now contemplating rate cuts. The path of least resistance for the yen should be up.



Rebased to 100 at March 16, 2020
Sources: Macrobond, S&P Dow Jones, Tokyo Stock Exchange, Forstrong Global Asset Management

One facet of the Japanese equity story that has spurred investor interest is reform potential (a ringing endorsement last year from Warren Buffett didn't hurt either!). Corporate Japan is notorious for hoarding cash and widespread cross-ownership. Japanese stocks look attractive on a valuation basis, particularly when it comes to price-to-book value. But this has been the case for years, as the low (relative to international peers) return on equity generated by these conservative behaviours has discouraged investors from affixing any meaningful premium on Japanese businesses. Changing these deeply entrenched tendencies could unlock significant value, but previous efforts at governance reform over the past decade have failed to move the needle. However, new market restructuring rules introduced last year by the Tokyo Exchange Group include more forceful measures to improve capital efficiency. While a wholesale change is admittedly a long shot, an improving shareholder environment, even if marginally so, should be viewed constructively.

Longer-term, significant challenges remain. Aging demographics are a phenomenon in most developed economies worldwide, but the issue is particularly acute in Japan, where the annual population growth rate has been negative since 2008. The country's aversion to immigration means that labour shortages could increasingly become a bottleneck. Additionally, the neighbouring Chinese economy continues to move up the value chain, directly competing with Japan in a growing number of export categories.

At its simplest, the industrial orientation of Japanese stocks means they can be viewed as a pro-cyclical asset class that thrives in an expansionary global growth environment. With a resilient US economy and Europe and China showing signs of turning the corner, the macro backdrop for Japanese stocks looks favourable. Our view is that Japan is attractive from a cyclical perspective, and we have increased exposure this quarter.

GLOBAL STRATEGY OVERVIEW

CASH

Most major central banks are likely at or very near peak interest rates. Historically, long-term returns for stocks and bonds are strongly positive in the years following terminal rate hikes. We remain near fully invested with cash at neutral levels in client portfolios.

BONDS

A sharp sell-off in developed market bonds last quarter briefly pushed yields up to a level where extending duration began to look attractive. Unfortunately, as the US 10 year treasury bond yield breached the 5% level, a reversal ensued almost immediately, pushing the yield back down to near 4%. With this recent re-inversion of yield curves, we find no convincing argument to extend duration this quarter.

EQUITIES

A resilient US economy and green shoots of recovery emerging in China should bode well for global growth in 2024. Despite a handful of pockets of overvaluation, most equity markets remain reasonably priced despite this constructive economic backdrop. We remain overweight equity exposure in client portfolios.

OPPORTUNITIES

Gold prices have surged anew recently as expectations of peak interest rates (nominal and real) and a falling US dollar have added to an investment case supported by a wave of central bank buying and geopolitical flare-ups. However, gold mining equities have struggled to keep pace as rising labour, material and transportation costs have eaten into profit margins and financing conditions have tightened materially. We have initiated a position in gold mining equities in growth-oriented strategies this quarter.

FORSTRONG
GLOBAL ASSET MANAGEMENT INC.

STRATEGY DASHBOARD: Q1 - FEBRUARY 2024

FORSTRONG STRATEGIES	INCEPTION DATE	1 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEARS	SINCE INCEPTION
BALANCED								
Global Income	30/06/08	-0.14%	-0.14%	3.44%	1.49%	3.27%	5.46%	6.96%
Global Balanced	30/06/03	-0.85%	-0.85%	1.94%	1.88%	5.13%	6.60%	6.72%
Global Growth	30/06/03	-1.01%	-1.01%	2.48%	3.60%	6.86%	7.99%	7.85%
Core Income	30/06/08	-0.46%	-0.46%	2.99%	1.81%	3.57%	4.74%	5.94%
Core Balanced	30/06/03	-1.12%	-1.12%	1.49%	3.02%	5.56%	6.13%	6.80%
Core Growth	30/06/03	-1.28%	-1.28%	0.88%	4.56%	6.88%	7.13%	7.69%
GLOBAL EQUITY								
Emerging Markets Equity Focus	31/01/19	-3.84%	-3.84%	-8.14%	-3.66%	0.91%	-	0.91%
Global Ex-North America Equity Focus	31/12/19	-1.92%	-1.92%	0.49%	1.08%	-	-	3.30%
ALTERNATIVE INCOME								
High Income Opportunities	30/06/22	-1.73%	-1.73%	1.80%	-	-	-	10.98%

* Performance as of January 31st, 2024

Performance statistics for ETF Managed Portfolios are calculated from documented actual investment strategies as set by Forstrong's Investment Committee and applied to its portfolios mandates, and are intended to provide an approximation of composite results for separately managed accounts. Actual performance of individual separate accounts may vary with average gross "composite" performance statistics presented here due to client-specific portfolio differences with respect to size, inflow/outflow history, and inception dates, as well as intra-day market volatilities versus daily closing prices. Performance numbers are net of total ETF expense ratios and custody fees, but before withholding taxes, transaction costs and other investment management and advisor fees. Past investment results provide no indication of future performance. Future returns are dependent on the general investment environment, the nature of the investment mandate and specific portfolio risks. A rate of return for one year or less is not annualized.