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CIO's View on the Recent Turmoil in the Japanese Equity Market and Announcement of US Reciprocal Tariff by the Trump Administration

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Shintaro Harada, CIO – Active Japanese Equity

The Japanese stock market experienced its second sharp decline this week on April 3rd. The steep market adjustment on March 31st reflects an attempt to price in tariff related concerns ahead of US President Donald Trump's Announcement on April 2nd. However, the reciprocal tariffs were harsher than expected: a 10% levy on virtually all countries, with rates of 34% for China, 20% for the EU, and 24% for Japan, with even higher rates for several other Asian countries.

The announced policy's goal appears to be to increase the purchase of US-made products, reduce the trade deficit, and boost US employment as part of the "Make America Great Again" initiative. However, US automakers General Motors and Ford both fell by 3-4% after the announcement, with sports giant Nike and retail leader Walmart amongst the notable decliners as well. Given that many companies have production lines in Asia and/or Latin America, and have a significant dependence on imported consumer goods, the market has reacted negatively as expected.

The extent to which consumer behavior may be impacted by tariff related price hikes remains to be seen. US consumers are facing additional inflationary pressures, raising concerns about stagflation in the US. Furthermore, if a retaliatory tariff war develops, risks of a bloc economy may come to mind, necessitating consideration of prolonged risks on the global economy.

On the other hand, media reports regarding Elon Musk's resignation from the Department of Government Efficiency and dissent within the Republican Party regarding tariff policies suggest new dynamics at play. It is believed that President Trump will use the imposition of high tariffs as a starting point for negotiations with other countries, but it will be an important issue to watch if and when the current tough stance is eased. While we hope we are at the bottom in terms of pricing in tariff-related news, it is likely that related news flow will continue to be a source of uncertainty in the short term. Additionally, the full year earnings season for the majority of Japanese companies starts later this month, which can always add an element of uncertainty. As a result, the Japanese stock market may become relatively sluggish in the very near term with investors taking a wait and see approach.

Currently, the Japanese market is trading at a PER of approximately 13x and a PBR of 1.2x, placing it well within the undervalued range over the past decade. That said, the impact of the tariffs are yet to be fully reflected into the earnings forecasts which makes it difficult to determine the level of undervaluation. However, we believe the stock prices will reflect these uncertainties towards mid-year when the impacts of tariffs and economic uncertainties subside, and the market will then be shaped by valuations based on corporate business performance. We will continue to aim to seize various investment opportunities amid engaging in solid fundamental analysis and identifying stocks with relatively small tariff impacts, those with high profit certainty in an uncertain economic environment, or those experiencing increased attractiveness due to price declines.

Important Disclosures