C|A

CAMBRIDGE ASSOCIATES LLC

GLOBAL MARKET COMMENTARY

JAPAN: STAY THE COURSE?

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Seth Hurwitz
Kijana Mack

Japan: Stay the Course?

"European investors are extremely negative on Japan. Their opinions are unlikely to change, without massive and unlikely shifts in policy and in corporate behavior.…[V]irtually all European investors agree that Japanese earnings are good, and that valuations are low. However, these arguments are not sufficient to spur buying interest."—Robert Alan Feldman, Morgan Stanley, "Japan Economics: Love's Labor Lost," September 25, 2007.

"Professional investors are selling Japan simply because it hasn't worked. The decision has nothing to do with valuation."—Thomas J. Niedermeyer, Jr., Liberty Square Asset Management, LP, October 1, 2007.

Background

What on earth has happened to Japanese equities? A vast gulf exists between those who have been completely frustrated with Japanese equity performance and prospects and those who find valuations compelling and prospects good. Naysayers have capitulated amid relative underperformance (particularly in euro terms) and the belief that no catalyst for improvement will turn market conditions around any time soon. However, diehard investors are holding on as valuations continue to improve (the result of both selling pressures and relative underperformance) and Japanese economic fundamentals hold up well relative to those of other major developed markets. While we recognize it can take time for value to be realized, we continue to believe that buyers have the better long-term case and that investors should stay the course.

It is useful to review how we arrived at this juncture, particularly since Japanese equities were viewed quite positively in the not-so-distant past. After all, Japan participated fully in the first three years of the global equity boom that began in April 2003, with returns comparable to those of other developed markets (Table A).[1] In 2005, the total return on Japanese equities (about 45% in yen and 26% in U.S. dollar terms) far outdistanced that of all other developed markets.

However, since global markets were roiled in May 2006, Japan has vastly underperformed almost all other markets, both developed and emerging (Table B). Investor sentiment has soured, particularly that of foreign investors, who account for well over 60% of trading volume on the first section of the Tokyo Stock Exchange (TSE). August 2007 saw the biggest sell-off of Japanese equities by foreign investors since October 1987 (Table C).[2] Tellingly, foreign investors have not jumped back into the market in any significant fashion. According to Goldman Sachs, Japanese equities now account for 16% of EAFE[3] fund portfolios, a 5 percentage point underweight compared with the MSCI EAFE Index. Domestic investors,

[1] On the basis of month-end numbers the world market peaked in March 2006 in local currency terms, but peaked a month later in U.S. dollar terms.
[2] In both instances, of course, foreign investors were reacting in large part to turmoil in the U.S. market.
[3] The MSCI EAFE Index is a global developed market index that covers Europe, Australasia, and the Far East, but excludes North America.

meanwhile, have turned up their noses at the market, focusing instead on the carry trade and non-yen-denominated securities.

We have continued to recommend that investors overweight Japanese equities, a theme we began pushing in the first part of 2003. Our rationale has been based on reasonable valuations, a belief in the Japanese economic recovery, and a positive long-term view of Japan. We have tried to avoid being swayed by investor sentiment, recognizing that there are bound to be ups and downs in any market. Still, we must constantly re-evaluate whether the fundamentals have changed and whether Japanese equities are no longer attractive.

A Change in Fundamentals?

Why did the Japanese market not bounce back in the same fashion as other developed markets after the sharp downturns in global equity markets in May 2006, February 2007, and the summer of 2007? After all, those selling frenzies resulted from events that originated outside of Japan and to which Japan appeared to have less direct exposure than many other markets. What uniquely Japanese events have caused investor concern to rise?

The biggest changes in Japan over the last 18 months have been in the political world. The highly popular reformist Prime Minister Junichiro Koizumi resigned in September 2006 and was replaced, first by the inept Shinzo Abe and then, in September 2007, by the still untested Yasuo Fukuda. Meanwhile, the main opposition party resoundingly defeated the ruling coalition in the July 2007 Upper House elections, ushering in an era of divided government, something Japan has rarely experienced. Certainly Koizumi's policies, especially his resolution of the massive nonperforming loan problem that had plagued the major Japanese banks for a decade, inspired investor confidence while the political leadership since his departure has had the opposite effect.[4]

There have also been a not insubstantial number of negatives on the economic and investment fronts. Despite a falling unemployment rate, wage growth has been stagnant (Table D), which helps explain why domestic consumption has been slow to pick up (Table E). Economic growth therefore remains overly dependent upon large firms and exports, making foreign exchange rate risk higher than desirable. Deflationary pressures persist (Table E)—indeed, the Consumer Price Index's rise (on a year-on-year basis) in October was its first in ten months, which has made it difficult for the Bank of Japan to raise policy rates to a level closer to those in other developed markets. Frequent regulatory actions, often perceived as heavy-handed, continue to discourage companies from innovation (e.g., introducing new financial products) and investors from believing that the market functions on the basis of free market principles in the same way as other developed markets. Many Japanese firms have responded to increased shareholder activism by

[4] Just prior to Koizumi's resignation we warned that a failure on the part of the Japanese government to continue reform "would almost certainly lead to a deterioration in the investment climate." Please see our August 2006 Market Commentary *Koizumi Steps Down: The Implications for Investors in the Japanese Market.*

rejecting demands for substantial dividend increases and approving poison pills. And the government's loss of pension records for some 50 million Japanese has hurt confidence in both the government and the system.

Still, the news has by no means been all negative. The economy has grown every month for five years (Table F), making this Japan's longest economic expansion since World War II. Corporate indebtedness is now well below that of U.S. firms while profits have been at record levels for several years. Industrial production is also at record highs. Significantly, growth has been driven by the private sector: the relative size of the government (excluding debt servicing activities) continues to shrink.

In its essentials, the Japan of November 2007 actually looks fairly similar today to the Japan of April 2006. It still boasts a solid infrastructure, leading technology and corporations, the world's second highest level of foreign exchange reserves, and a large trade surplus. At the same time it continues to confront longer-term issues such as an aging—and declining—population, a hollowing out of rural Japan, the largest fiscal deficit among developed markets, and an economy in which major swathes are overly regulated and uncompetitive.

Investors have perhaps been spooked not so much by negative events as by the fact that expected change has not materialized. The biggest manifestations of this have been stagnant domestic consumption, the economy's failure to move decisively out of deflation, the stalling of the reform agenda, and the continued failure of the merger and acquisition (M&A) market to take off. However, while these are all troubling, it is unclear how Japan's investment climate relative to that of other major developed markets can be viewed as worse—or that much worse—today compared with April 2006. Europe's own reform agenda has also lagged and the new leaders of its largest markets are facing their own political challenges. And while Japanese consumption has been in the doldrums it seems clear that America will have to pay the piper at some stage for the massive consumer borrowing that has fueled its growth in recent years. Meanwhile, the crisis in the U.S. subprime market has revealed Europe's substantial exposure to U.S. credit issues. The euro's sharp appreciation also carries risks for the European growth story. Last, but not least, U.S. and European issues have been driven up in part by high expectations for deal flow, but this may prove to be ephemeral given current conditions in the credit markets.

Don't Ignore Valuations

While sellers of Japanese equities appear to have consciously *not* focused on valuations, the slowing—or shutdown—of the reform agenda arguably makes them *more* important. On a historical basis Japanese equity valuations in some respects look better than they have in over 20 years (Table G).[5] Moreover, valuations relative to those of other developed markets look much better than in the past (Table H). For example, Japan's historical return on equity (ROE) is 6.7, far lower than ROEs in other developed markets. A good part of this differential is due to protracted efforts by Japanese firms following the bubble to extract themselves from massive debt burdens. ROEs of about 10 over the last year are the highest they have been

[5] We use valuations for the MSCI Japan Index in this section since this is the benchmark index (either on its own or as part of MSCI's global and international indices) used by most of our clients.

since the mid-1980s. The steady rise over the past five years in foreign ownership of Japanese equities (notwithstanding the recent sell-off) has created pressure for higher returns (Table I).

Based on trailing 12-month reported earnings, the price-earnings ratio (P/E) is at its lowest level since 1983,[6] which perhaps is another example of potential convergence of valuations with other markets. Japanese P/Es have always run much higher than those of other markets, a phenomenon some have attributed to investor recognition of the high capital expenditures that are ostensibly the hallmark of corporate Japan's focus on the long term. While Japanese capital expenditure remains high, the P/E ratio has fallen substantially and looks not too out of line with those of developed markets (Table J)—and increasingly attractive compared to those of other Asian markets, both developed and emerging (Table K).

However, trailing 12-month P/Es were not particularly helpful in understanding Japanese equity valuations throughout most of the 1990s and early in this decade, as the market's aggregate earnings were often tiny or negative, inflating P/Es to astronomical levels. A more telling measure is the normalized P/E adjusted to take into account an assumed convergence of Japanese ROE ratios with those of other markets. On this basis, Japanese equities look downright cheap both from a historical perspective and relative to other major markets (Table L).

Some investors have paid more attention to the price-to-book (P/B) ratio of Japanese equities both because Japanese P/Es have long been such outliers and because the continued strength of Japanese manufacturing perhaps makes this a more useful metric than in the United States. On this basis, Japanese valuations look very attractive (Table M). Whereas Japanese equities historically have had a higher P/B ratio than equities in other developed markets (save the United States), they now trade at a significant discount. A significant percentage of firms have P/B ratios of less than 1.0.[7] Also, many Japanese firms still hold property that they acquired long ago at cost, as well as large amounts of cash.

Dividend yield (DY) ratios present a more mixed but still positive story. At 1.4 they are only slightly higher than their historical average, but well below those of other markets (both developed and emerging). However, the gap has decreased markedly in recent years. DYs have risen over 18% during the current fiscal year, are at their highest level since 1984, and are more than twice what they were at the start of the decade. It is perhaps too optimistic to expect that dividends will soon reach the levels seen in other markets given that many Japanese managers hail from a time when corporations felt a need to have plenty of cash on hand to guard against difficulties in obtaining bank capital. In any event, focusing just on the D/Y ratio obscures the broader reality that, thanks to record corporate profits and share buybacks in Japan, there has been a massive increase in monies returned to shareholders in recent years. Dividend payouts have more than doubled over the past four years. An upsurge in buybacks suggests corporations see their stock as cheap although some have noted that buybacks have been concentrated among a handful of firms.

[6] We exclude P/Es of less than zero during a 12-month and an 11-month period (1999–2000 and 2002–03, respectively) due to the fact that corporate earnings of firms included in the MSCI Japan Index were negative at such times.
[7] While about 10.2% of the 382 firms included in the MSCI Japan Index as of October 31, 2007, had a P/B ratio of less than 1.0, the percentage rises to well over 40% (as of October 1) if the universe is expanded to include all 3,880 companies listed on the first and second sections of the TSE.

Corporations, Corporations, Corporations

The valuations case is bolstered when one analyzes the strength of the Japanese corporate sector. Low wage growth in Japan has impacted domestic consumption negatively, but helped boost corporate profits (Table N). While year-on-year profits fell slightly during the July–September quarter, they remain on track to post a fifth consecutive annual record for fiscal year 2007–08, which ends in March 2008. Cash flow is up, leverage is down, and capital expenditures are expected to grow 11% in fiscal year 2007–08. Corporate productivity has increased faster over the last two years in Japan than in the United States or Europe (Table O). Meanwhile, the level of annual profit growth suggests that Japan is at an earlier stage of the economic cycle than are the United States and Europe. It is also worth keeping in mind that because Japanese profits were depressed for about 15 years after the bubble ended in 1989 they have been expanding from a comparatively low base.

This is not to say that there are no problems with Japanese corporations. There are plenty. Many could use capital more effectively and adopt more shareholder-friendly policies. Put more bluntly, many Japanese firms continue to be run by long-time managers who do not consider shareholders *primus inter pares* among stakeholders and feel little need to answer to them, particularly investment funds, which are considered short-term investors (or worse). Japanese managers have given short shrift to the need for corporate rationalization through the sale of non-core assets (including subsidiaries that are separately listed on the TSE) and increased transactional activity, a long-standing area of investor concern. M&A activity, while up by some measures, remains low relative to that experienced in other countries. Moreover, would-be foreign acquirers continue to face a difficult time finding deals in Japan.

Where Are the Japanese Investors?

Backwardness, intransigence, prudence (fill in your preferred term!) on the part of Japanese corporate managers suggest the existence of substantial unlocked value in Japanese equities. It was the expectation that such value would be unlocked sooner rather than later that formed much of the investment thesis of many now-discouraged investors. Other potential drivers of unlocked value such as the privatization of government-owned assets and the re-allocation of the huge amounts of savings held by individual Japanese also are not currently viewed as having materialized to any significant degree.

The last of these points is worth exploring in some detail. Japanese households have for many years held far less of their assets in the equities market than have Americans. Japanese, of course, have had good reason to be skeptical of the local bourse. After all, ¥1 million (slightly under $10,000 in today's dollars) invested in the Topix on January 1, 1990, would have been worth just over ¥660,000 as of October 31, 2007, representing an average annual compound return of -2.3% (-2.8% in real terms).

Nevertheless, individual Japanese (as well as the Japanese government) are well aware that the aging of Japanese society makes it imperative not just to save but to increase their wealth. In fact, households have increased the percentage of their assets held in investments (as opposed to savings) to 20.3% from 14.1%

over the past ten years. Given that Japanese hold some $14 trillion worth of assets, it is clear that a continuation of this trend could provide strong support for equity prices. For example, just 10% of household assets equates to over 32% of the current market capitalization of the TSE First Section.

There is certainly evidence that Japanese investors are prepared to assume risk in search of higher returns. For example, they have plowed $49 billion into the Kokusai Global Sovereign Fund, which is heavily invested in unhedged non-Japanese sovereign bonds. Japanese investors are also avid investors in Chinese and other Asian equities as well as in the risky carry trade. It does not require much imagination to believe that this money will come home when there is high volatility or a steep downturn in foreign markets (although this could of course spell trouble for Japanese equities as well), a sharp move in foreign exchange rates, or a narrowing differential in interest rates.

Should this capital come home, or, more importantly, should Japanese individuals decide to invest a larger portion of their assets within Japan, equities currently represent a very attractive proposition in comparison with bonds. As shown in Table Q, earnings yields on TSE-listed equities are substantially *higher* than the yield on the ten-year Japanese government bond (JGB) while, according to Deutsche Securities, ROE has been at a record positive differential to bond yields.[8] Meanwhile, DYs are within 6 basis points (bps) of ten-year JGB yields (Table P). The DY has exceeded the bond yield three times during the past ten years and equity returns spiked each time.[9] While the spikes lasted only about 10 to 18 months (in yen terms) and JGB yields rose, sometimes sharply, there is reason to believe DYs will remain competitive with bond yields for a longer period this time. In particular, while there is not much room for JGB yields to fall further, there is also little indication that they will rise much even in the medium term given continued deflationary pressures. Meanwhile, DYs are more likely to rise than to fall in light of increasing pressure on Japanese corporations to return money to shareholders.

Conclusion

Japanese economic fundamentals have changed little since the equity rally petered out in early 2006. The failure of domestic consumption to rebound as expected and the concomitant increase in the importance of exports to economic growth mean that Japan is perhaps more susceptible today to a global economic slowdown than it was 20 months ago. Certainly, the reform process has stalled although it bears mention that reform has never moved at the pace outsiders would like. We believe Japanese policymakers recognize that reform is a prerequisite for dealing with long-term structural issues, but also acknowledge that divided government makes it unlikely that much will happen on this front in the short term—although some would argue that a likely delay in the planned consumption tax increase will be a positive side effect of political gridlock. Accordingly, an improvement in investor confidence is most likely to come from a pickup in wages and consumption, the adoption of more shareholder-friendly policies on the part of Japanese corporations

[8] Deutsche Securities data begin in 1985.
[9] The point holds true for the MSCI Japan Index. At 1.4, the DY is less than 3 bps below the yield on the ten-year JGB. The yield gap has been less than 20 bps three times during the last ten years and equity returns over approximately the next 12 months spiked in each case (in both yen and U.S. dollars).

(i.e., *private* sector reform), or a more robust M&A environment that leads to a more efficient corporate sector. Should a recovery take root, there is lots of room for upward momentum, given today's attractive valuations.

Observers should keep an eye on both foreign and domestic investors. Renewed interest on the part of the former is important due to the fact that they account for the lion's share of volume. A more sophisticated approach on the part of activist investors that reflects a greater understanding of the motivation and perceptions of Japanese corporations and the public would also help advance a shareholder-friendly agenda. However, the key to a long and sustained bull market will be a commitment to Japanese equities on the part of domestic investors. It is unclear what will cause this, or when change will occur, but it seems clear that optimism on the part of the Japanese consumer (e.g., from increased wages, or greater faith in the government) and small and medium-sized enterprises, more dividend increases, and greater receptivity to tender offers and shareholder initiatives on the part of Japanese corporations would go a long way.

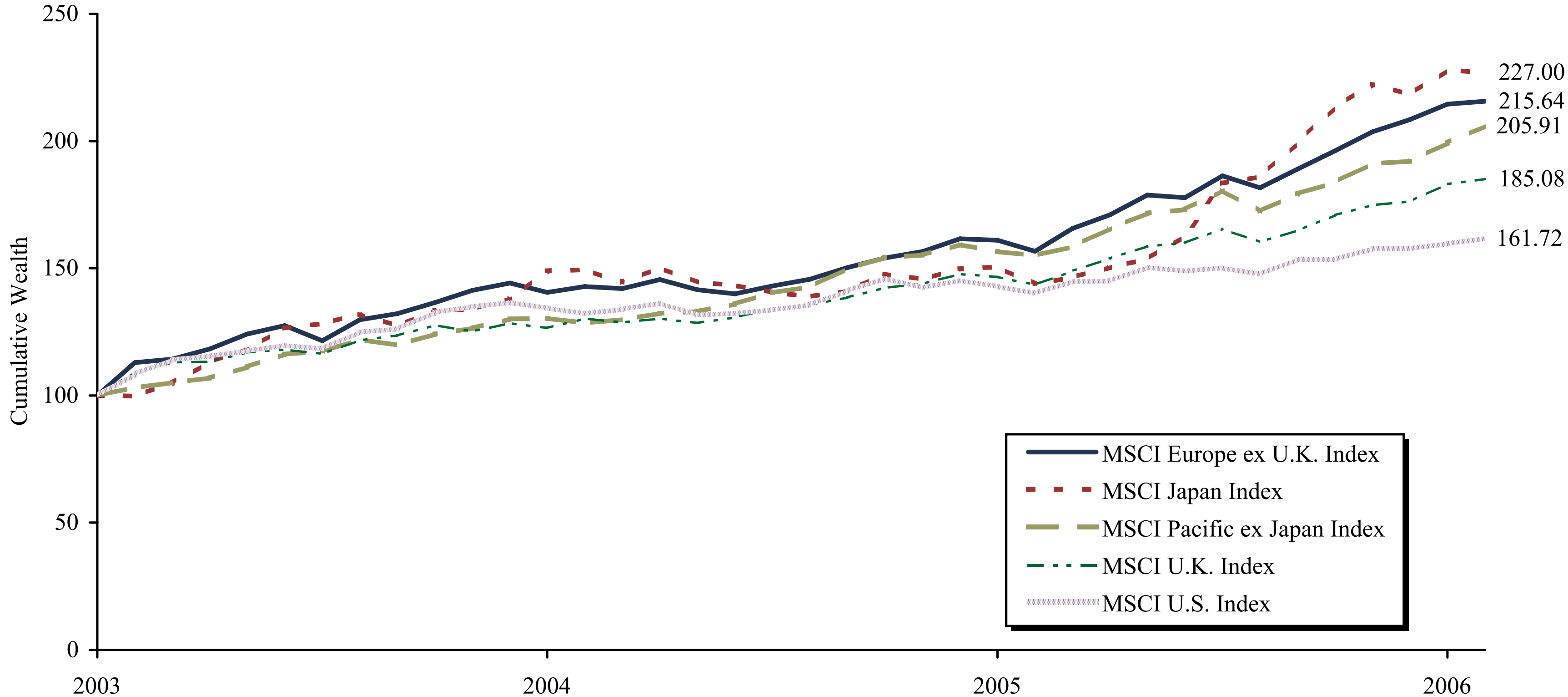
As we have often discussed, Japanese equities provide a significant diversification benefit in a global portfolio. Today's valuations make them a good tactical as well as strategic bet. But it would be wrong to overlook or downplay the pervasiveness of negative sentiment on the part of investors and the effect this is having on the market. Apart from valuations, many managers with whom we have met seem unable to make a very strong case for Japan. Investors therefore need to understand—and be able to tolerate—the risk of a continued period of underperformance by Japanese equities before things get better. Those with a true long-term view and lower sensitivity to the risk of relative underperformance in the short term will want to stay in and perhaps even increase their positions.

Table A-1

CUMULATIVE WEALTH OF DEVELOPED MARKETS INDICES IN LOCAL CURRENCY

April 1, 2003 – April 30, 2006

Cumulative Wealth
(March 31, 2003 = 100)



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

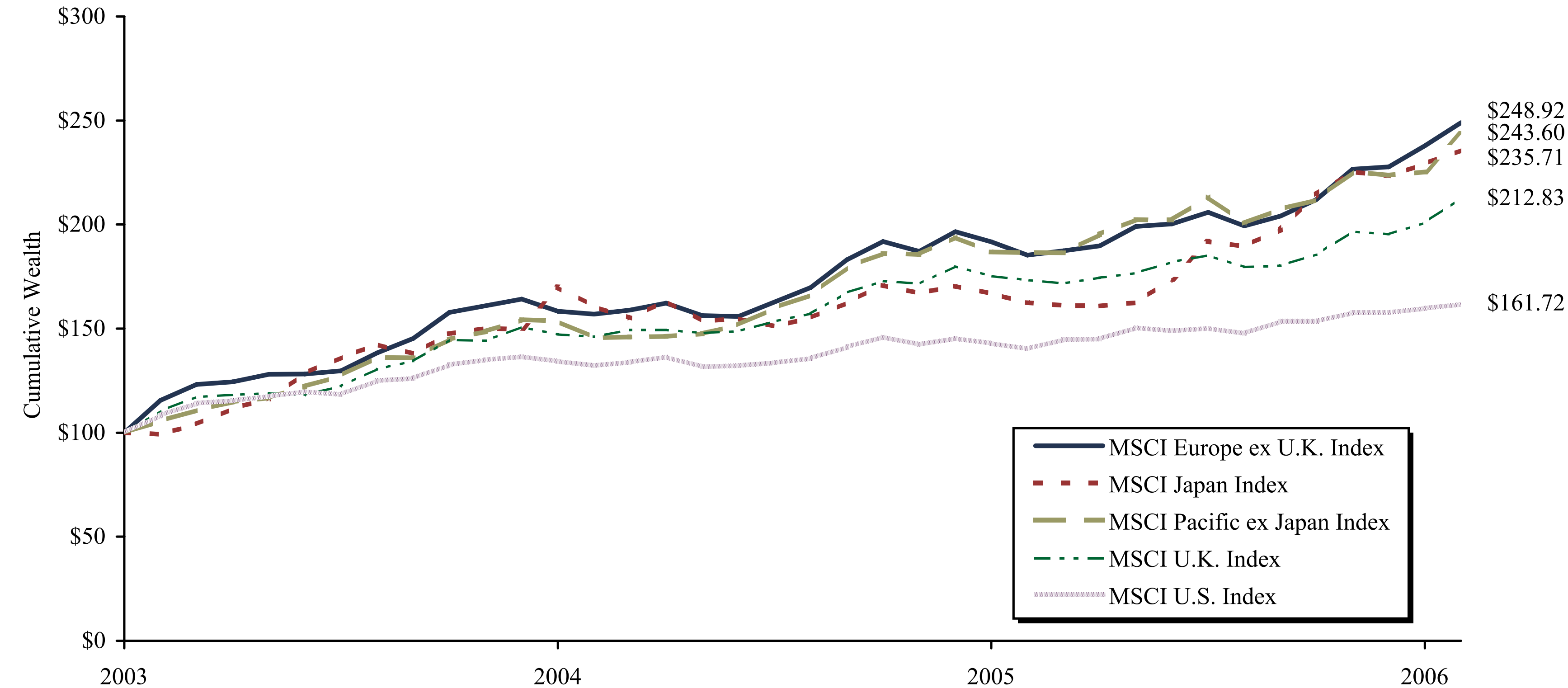
Note: Total returns for MSCI developed markets indices are net of dividend taxes.

Table A-2

CUMULATIVE WEALTH OF DEVELOPED MARKETS INDICES IN U.S. DOLLARS

April 1, 2003 – April 30, 2006

Cumulative Wealth
(March 31, 2003 = 100)



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

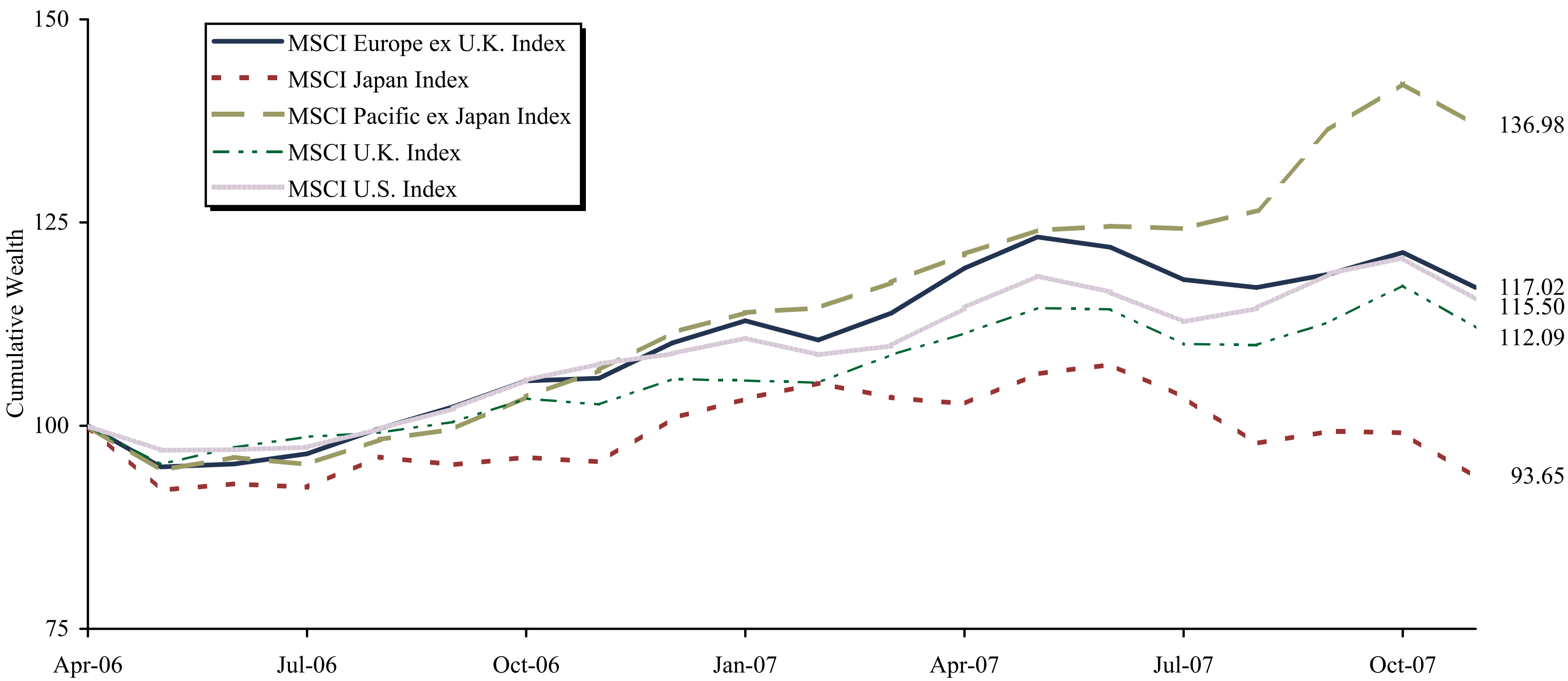
Note: Total returns for MSCI developed markets indices are net of dividend taxes.

Table B-1

CUMULATIVE WEALTH OF DEVELOPED MARKETS INDICES IN LOCAL CURRENCY

May 1, 2006 – November 30, 2007

Cumulative Wealth
(April 30, 2006 = 100)



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

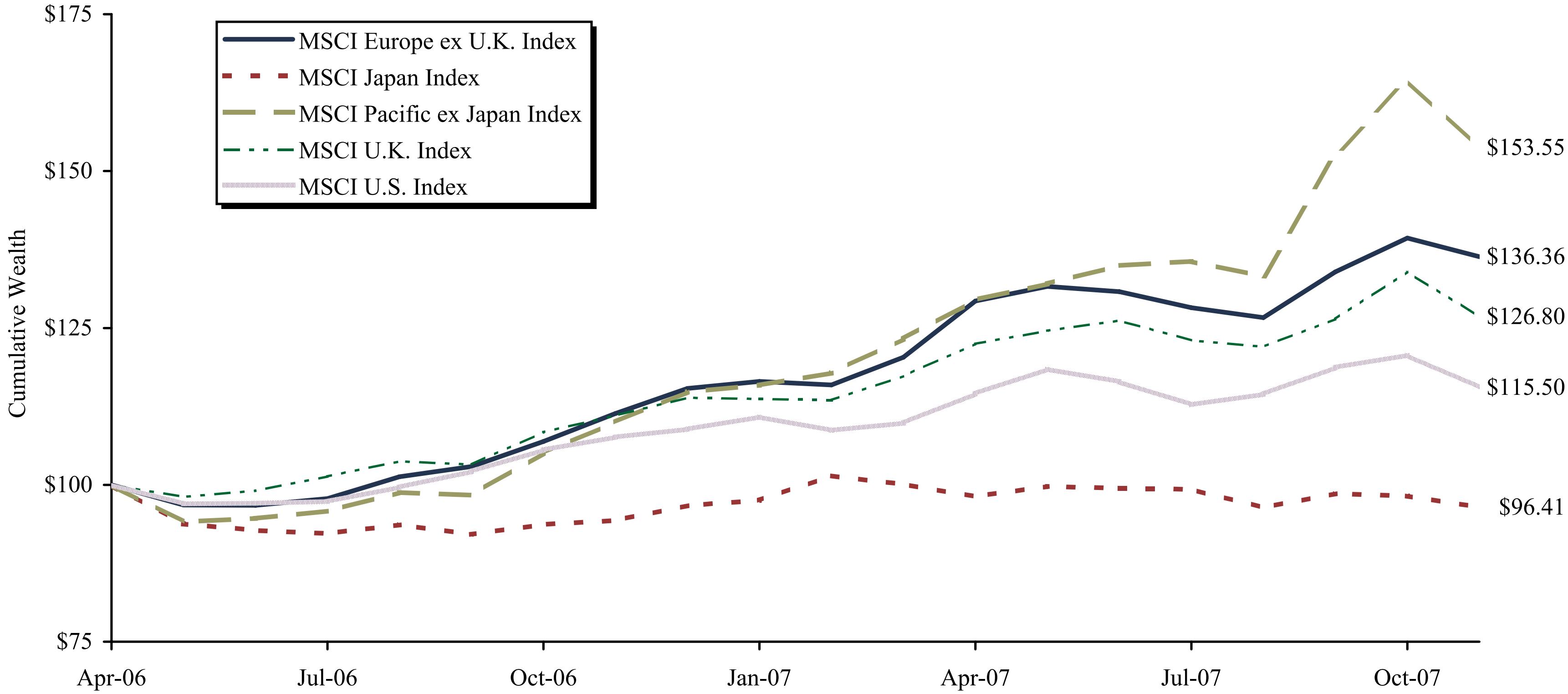
Note: Total returns for MSCI developed markets indices are net of dividend taxes.

Table B-2

CUMULATIVE WEALTH OF DEVELOPED MARKETS INDICES IN U.S. DOLLARS

May 1, 2006 – November 30, 2007

Cumulative Wealth
(April 30, 2006 = 100)



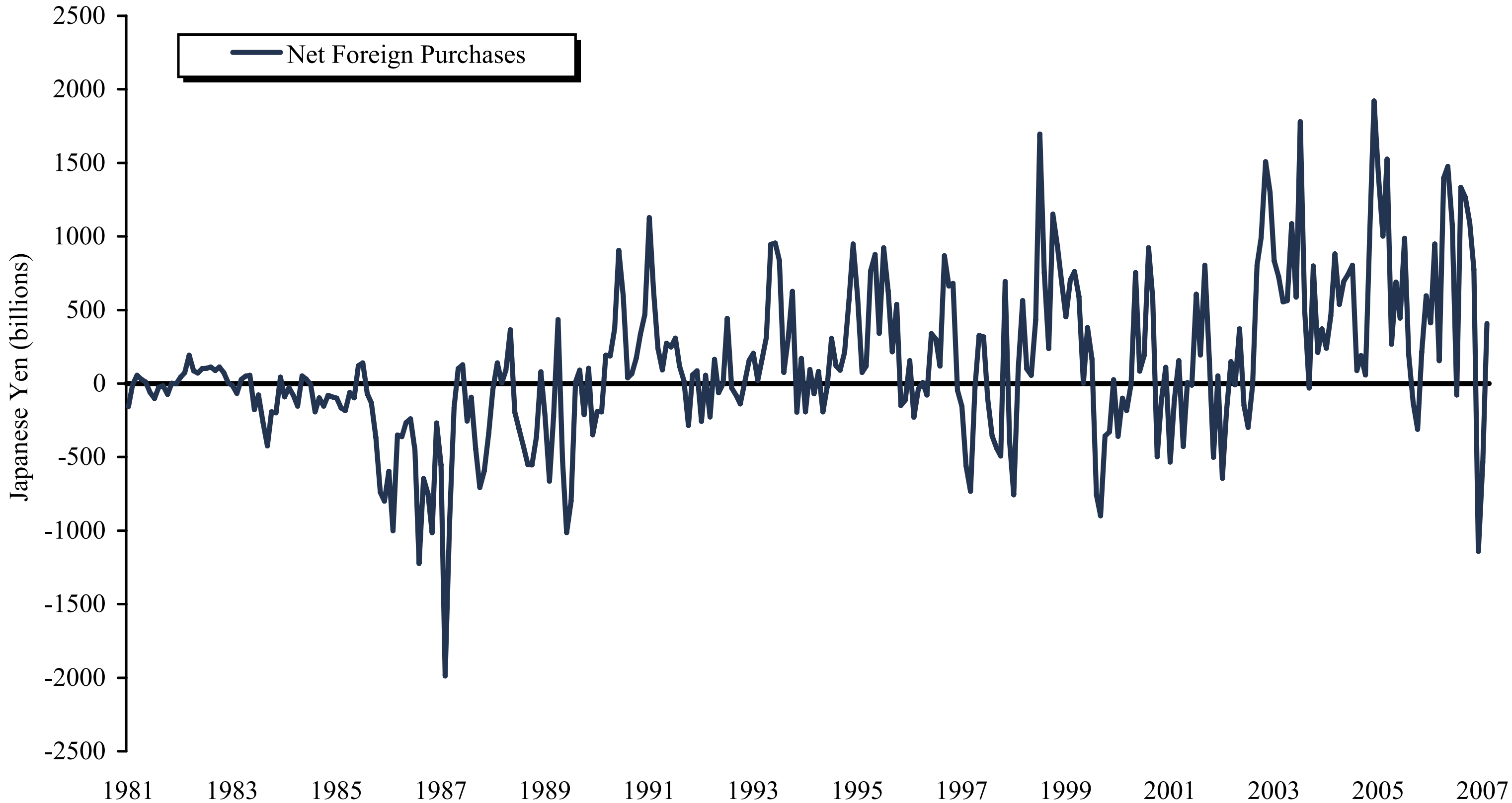
Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Note: Total returns for MSCI developed markets indices are net of dividend taxes.

Table C

MONTHLY NET FOREIGN PURCHASES OF JAPANESE EQUITIES

September 1981 – October 2007



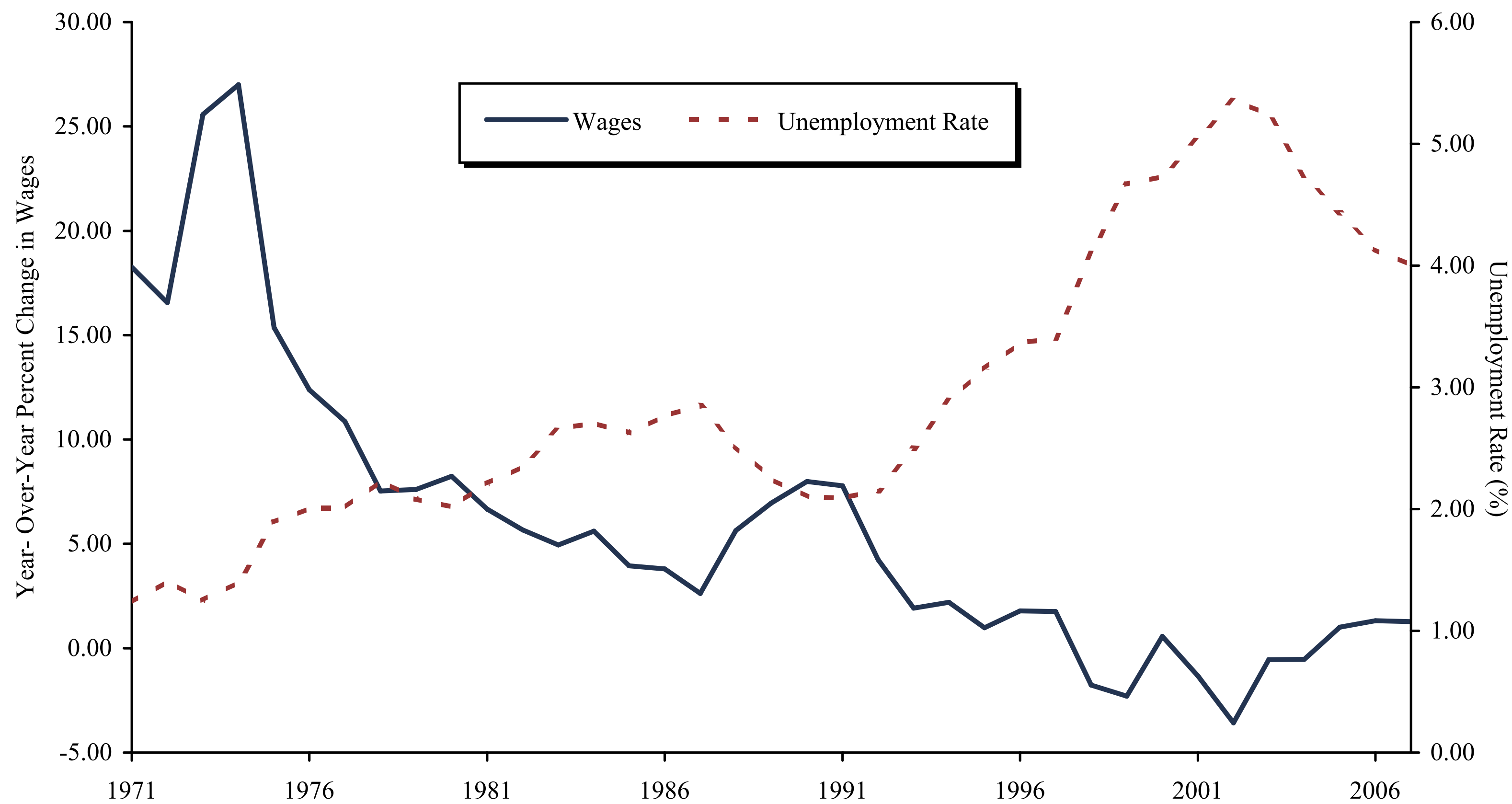
Sources: Thomson Datastream and Tokyo Stock Exchange.

Note: Data based on Tokyo Stock Exchange First Section trading value, excluding proprietary trading.

Table D

JAPANESE WAGE GROWTH AND UNEMPLOYMENT RATES

1971–2007



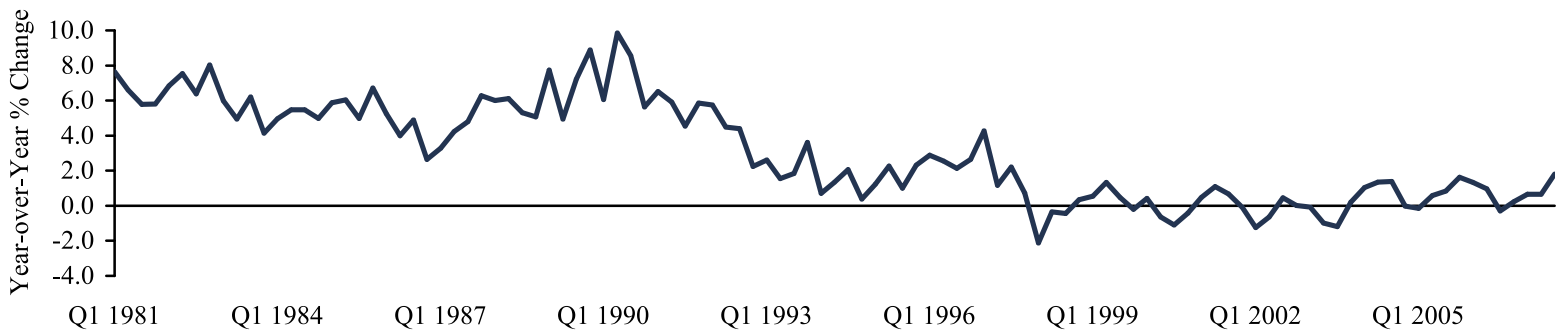
Sources: FactSet Research Systems and Thomson Datastream.

Notes: Graph is based on annual data. Data for unemployment rate are as of September 30, 2007. Data for wages for 2007 are forecasted.

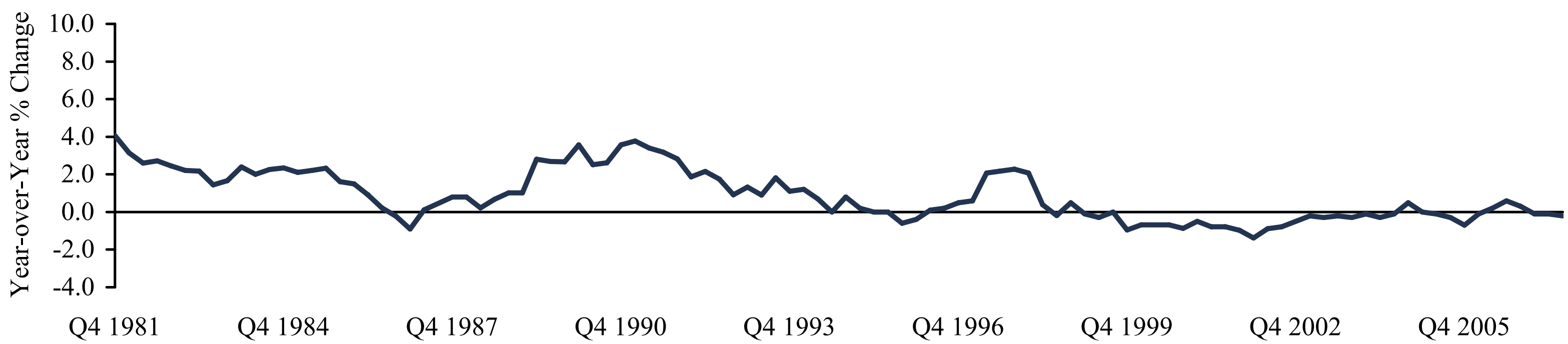
Table E

CONSUMPTION AND PRICES HAVE BEEN SLOW TO RECOVER

Quarterly Changes in Personal Consumption
First Quarter 1981 – Third Quarter 2007



Quarterly Changes in Consumer Price Index
Fourth Quarter 1981 – Third Quarter 2007

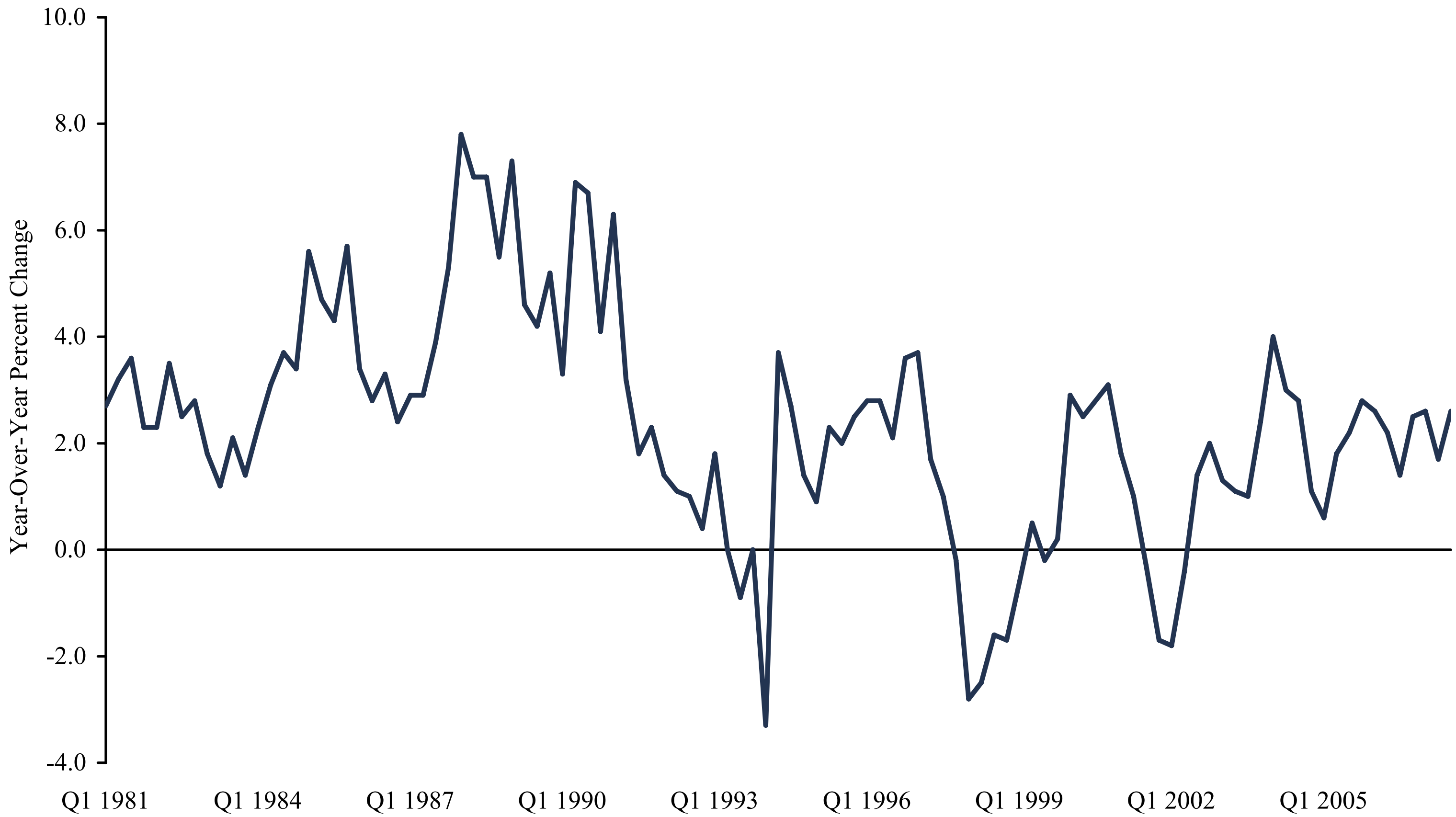


Source: Thomson Datastream.

Table F

QUARTERLY CHANGES IN JAPANESE REAL GROSS DOMESTIC PRODUCT

1981–2007



Sources: Nikkei Net Interactive and Thomson Datastream.

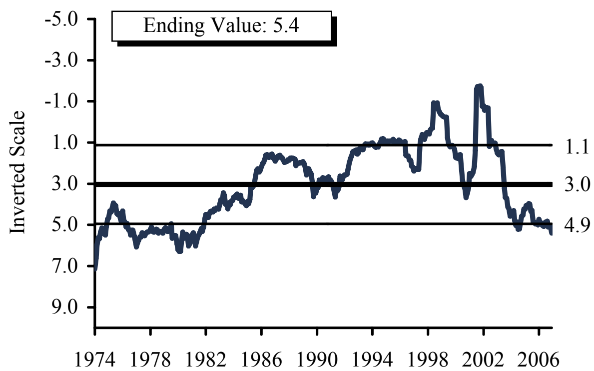
Note: Data for 2007 are as of September 30.

Table G

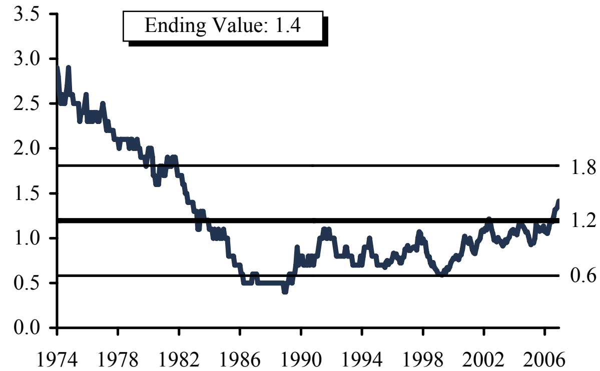
MSCI JAPAN INDEX

December 31, 1974 – November 30, 2007

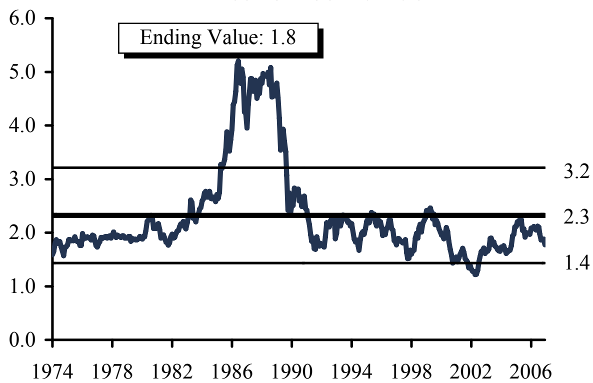
Earnings Yield (%)



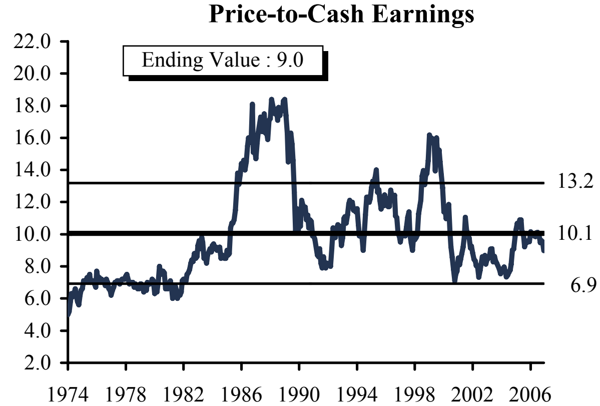
Dividend Yield (%)



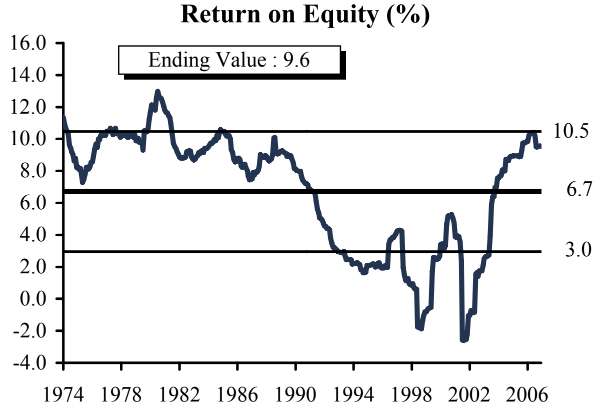
Price-to-Book Value



Price-to-Cash Earnings



Return on Equity (%)



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Note: Return on equity is calculated by dividing the index's price-to-book ratio by its price-earnings ratio.

Table H

HISTORICAL AND CURRENT VALUATIONS OF MSCI DEVELOPED MARKETS INDICES

December 31, 1974 – November 30, 2007

Market	Current	Historical Average	Current	Historical Average	Current	Historical Average	Current	Historical Average	Current	Historical Average
	ROE (%)	ROE (%)	Price-Earnings	Price-Earnings	Price-to-Book	Price-to-Book	Price-to-Cash Earnings	Price-to-Cash Earnings	Dividend Yield (%)	Dividend Yield (%)
MSCI World	16.0	11.9	15.8	18.3	2.5	2.1	10.8	8.7	2.3	3.0
MSCI Japan	9.6	6.7	18.5	46.3	1.8	2.3	9.0	10.1	1.4	1.2
MSCI U.S.	17.0	14.3	16.9	16.8	2.9	2.4	12.0	9.5	1.9	3.2
MSCI Europe ex U.K.	16.5	10.9	14.1	16.5	2.3	1.8	9.5	6.6	2.8	3.5
MSCI U.K.	20.1	14.3	12.5	13.4	2.5	1.9	9.8	8.4	3.3	4.4
MSCI Pacific ex Japan	15.5	11.4	17.8	16.6	2.8	1.9	14.0	11.3	3.1	3.6

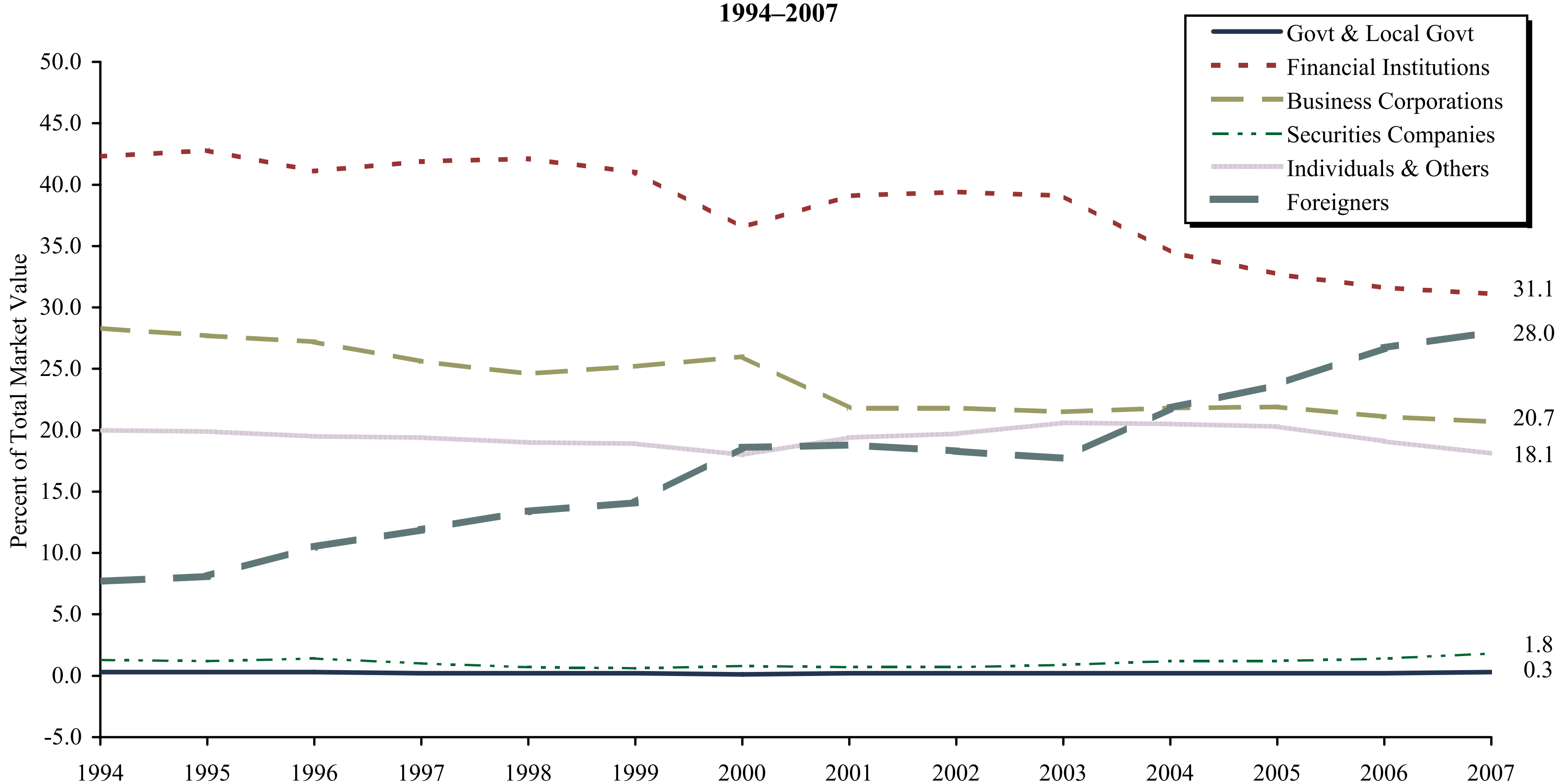
Source: Thomson Datastream.

Notes: Return on equity (ROE) is calculated by dividing the earnings per share by the book value per share. Book value per share is calculated by dividing the index price by its price-to-book (P/B) ratio. Earnings per share is calculated by dividing the price index by its price-earnings (P/E) ratio. P/E, P/B, price-to-cash earnings, and ROE data for the MSCI Pacific ex Japan Index begin on December 31, 1984.

Table I

SHARE OWNERSHIP OF THE TOKYO STOCK EXCHANGE BY MARKET VALUE

1994–2007



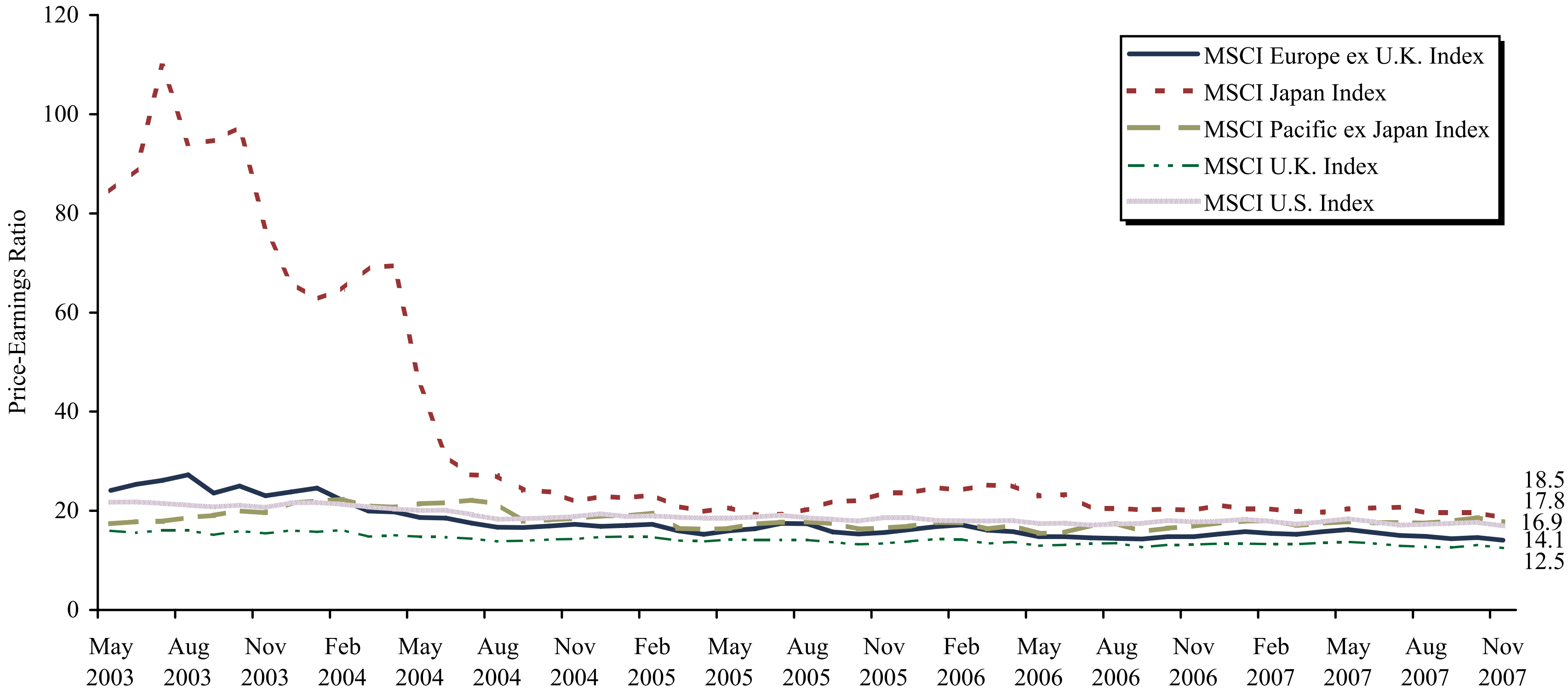
Source: Tokyo Stock Exchange.

Note: The data for each year are as of March 31, the end of the Japanese fiscal year.

Table J

PRICE-EARNINGS RATIOS FOR MSCI DEVELOPED MARKETS INDICES

April 30, 2003 – November 30, 2007



Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

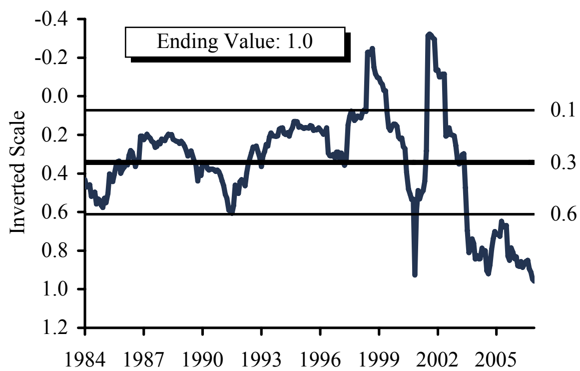
Notes: Price-earnings (P/E) ratios based on trailing 12-month earnings. High Japanese P/Es in 2003–04 reflect the fact that Japanese earnings were very low.

Table K-1

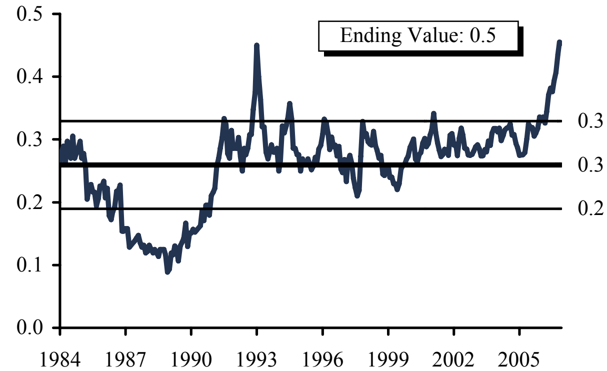
MSCI JAPAN RELATIVE TO MSCI PACIFIC EX JAPAN

December 31, 1984 – November 30, 2007

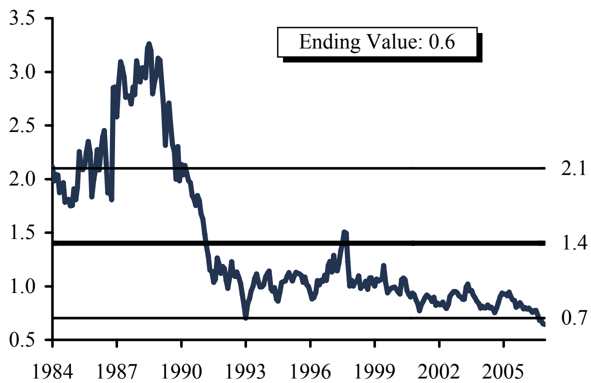
Price-Earnings



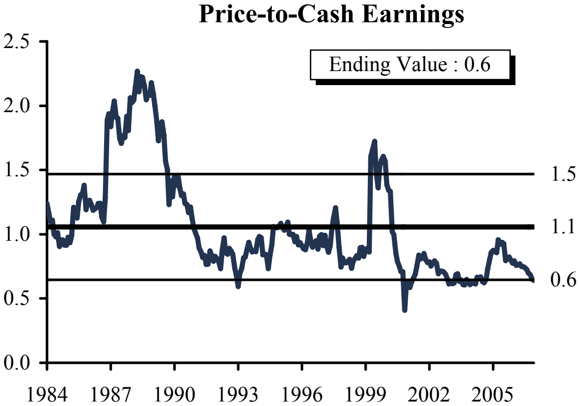
Dividend Yield (%)



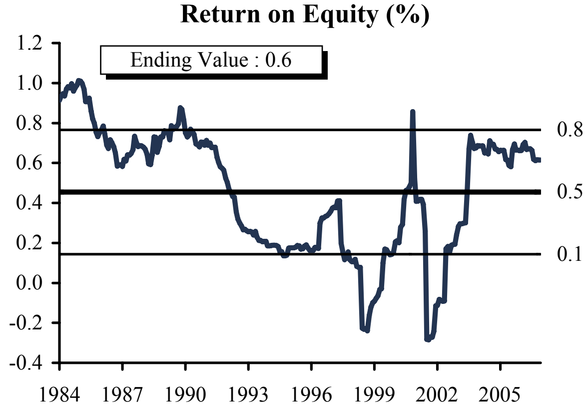
Price-to-Book Value



Price-to-Cash Earnings



Return on Equity (%)

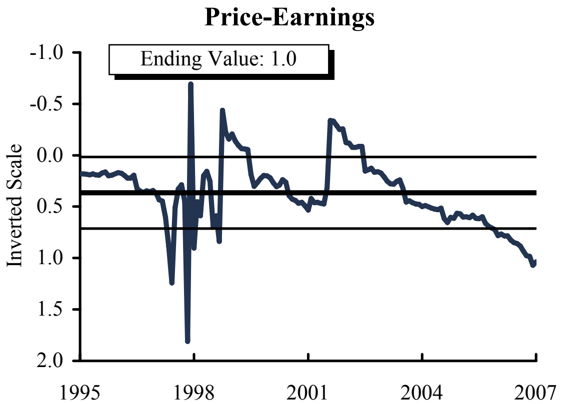


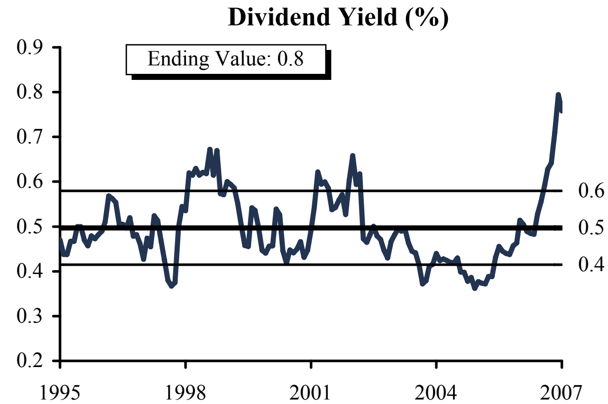
Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

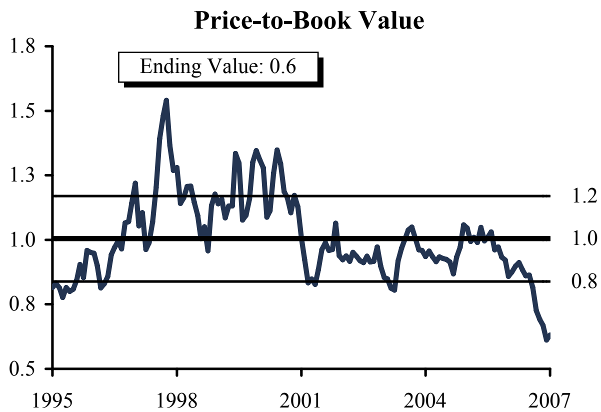
Table K-2

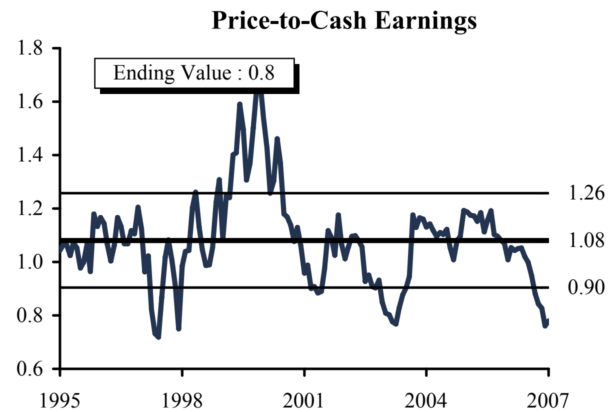
MSCI JAPAN RELATIVE TO MSCI EMERGING MARKETS ASIA

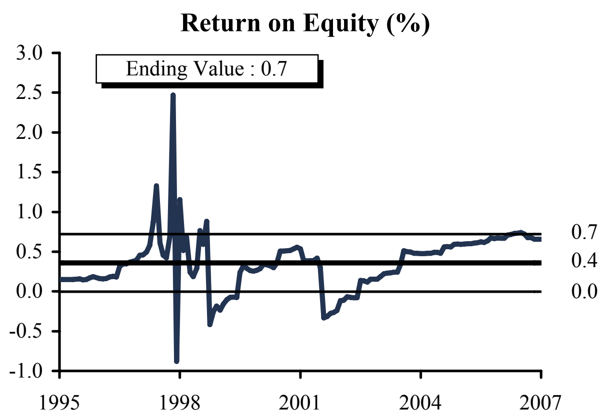
November 30, 1995 – November 30, 2007











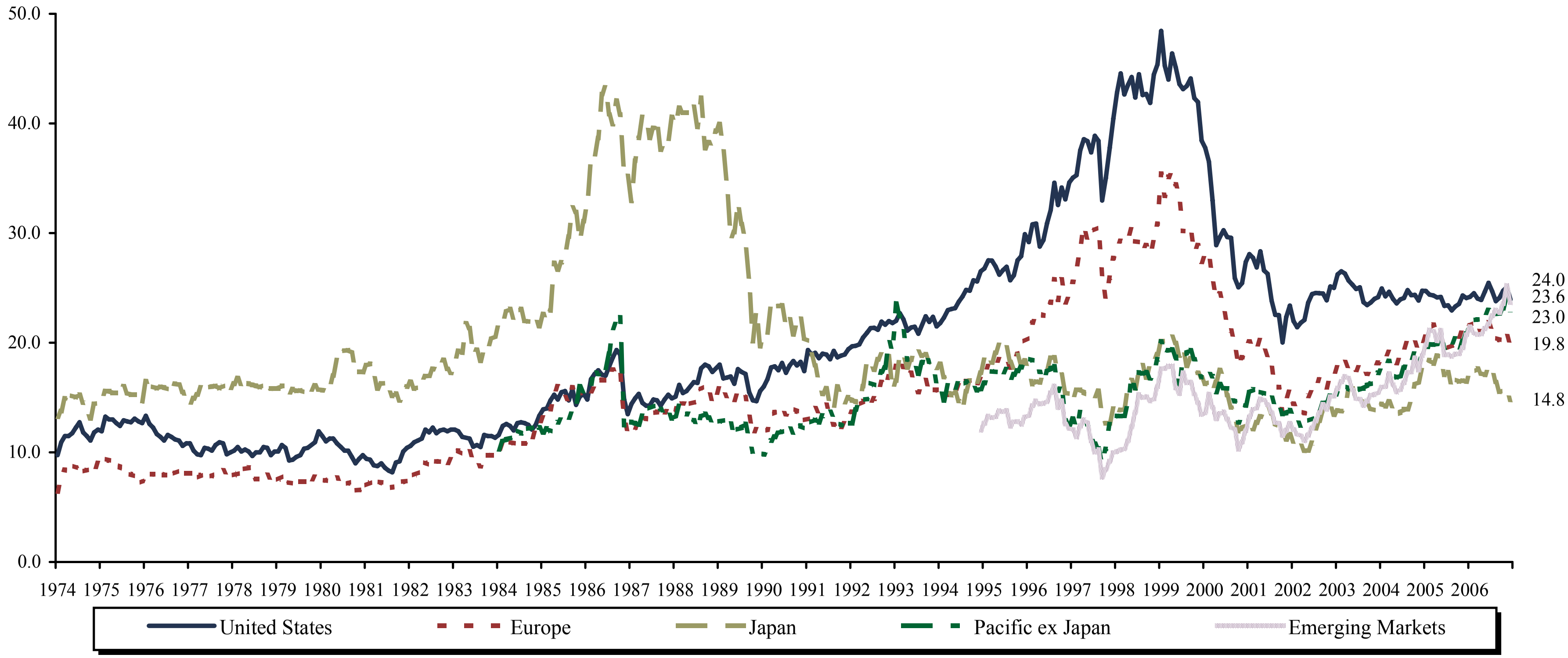
Mean
One Standard Deviation

Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Table L

NORMALIZED ROE-ADJUSTED P/E RATIOS

MSCI Developed and Emerging Markets
December 31, 1974 – November 30, 2007



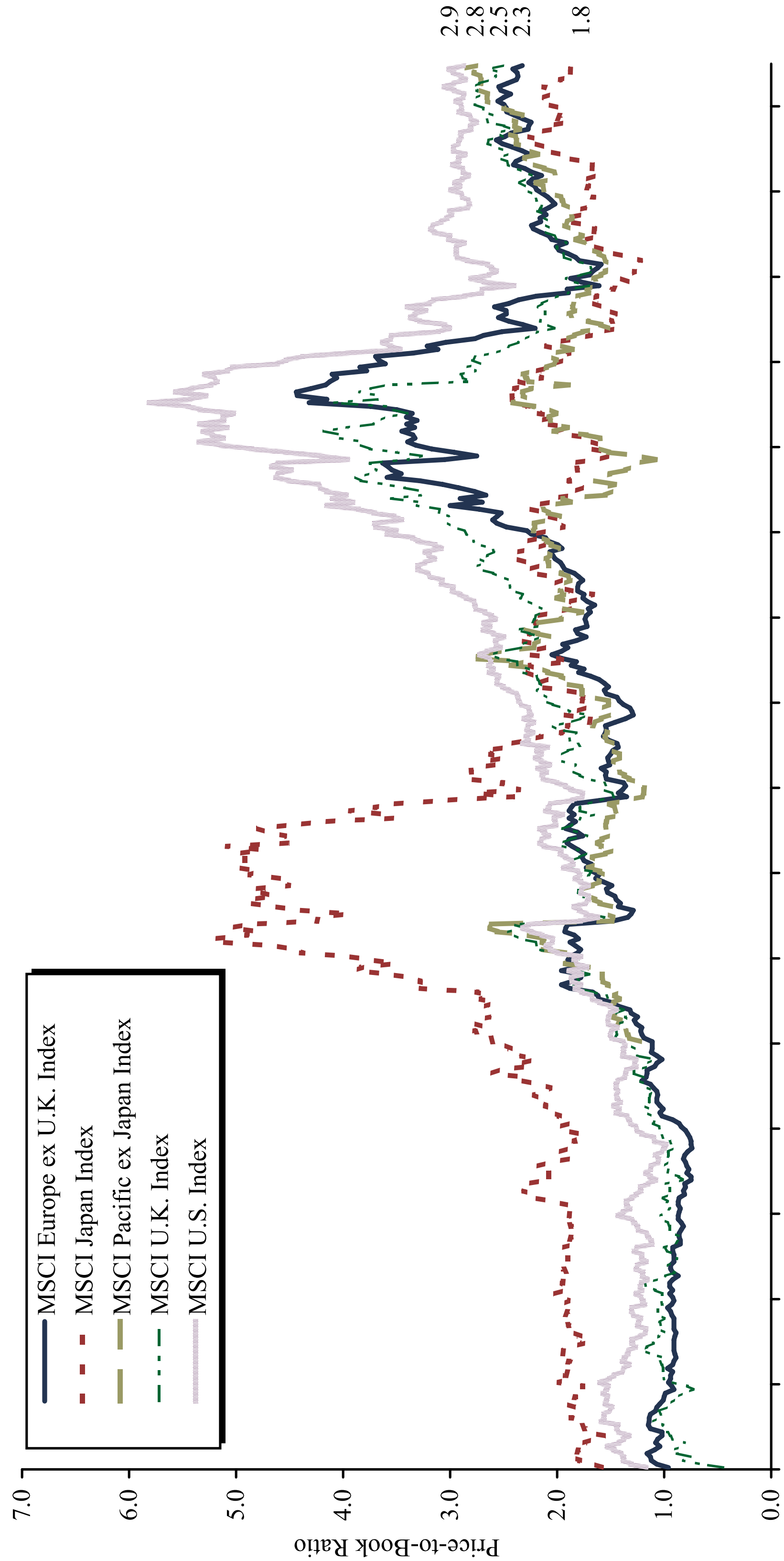
Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Return on equity (ROE) is calculated by dividing the index's price-to-book ratio by its price-earnings (P/E) ratio. The ROE-adjusted P/E ratio is the current P/E based on trailing 12-month earnings multiplied by the ratio of the current ROE to an assumed long-term historical average ROE of 12 for equity markets. Data for MSCI Pacific ex Japan Index and MSCI Emerging Markets Index begin in December 1984 and November 1995, respectively.

Table M

PRICE-TO-BOOK RATIOS FOR MSCI DEVELOPED MARKETS INDICES

December 31, 1974 – November 30, 2007



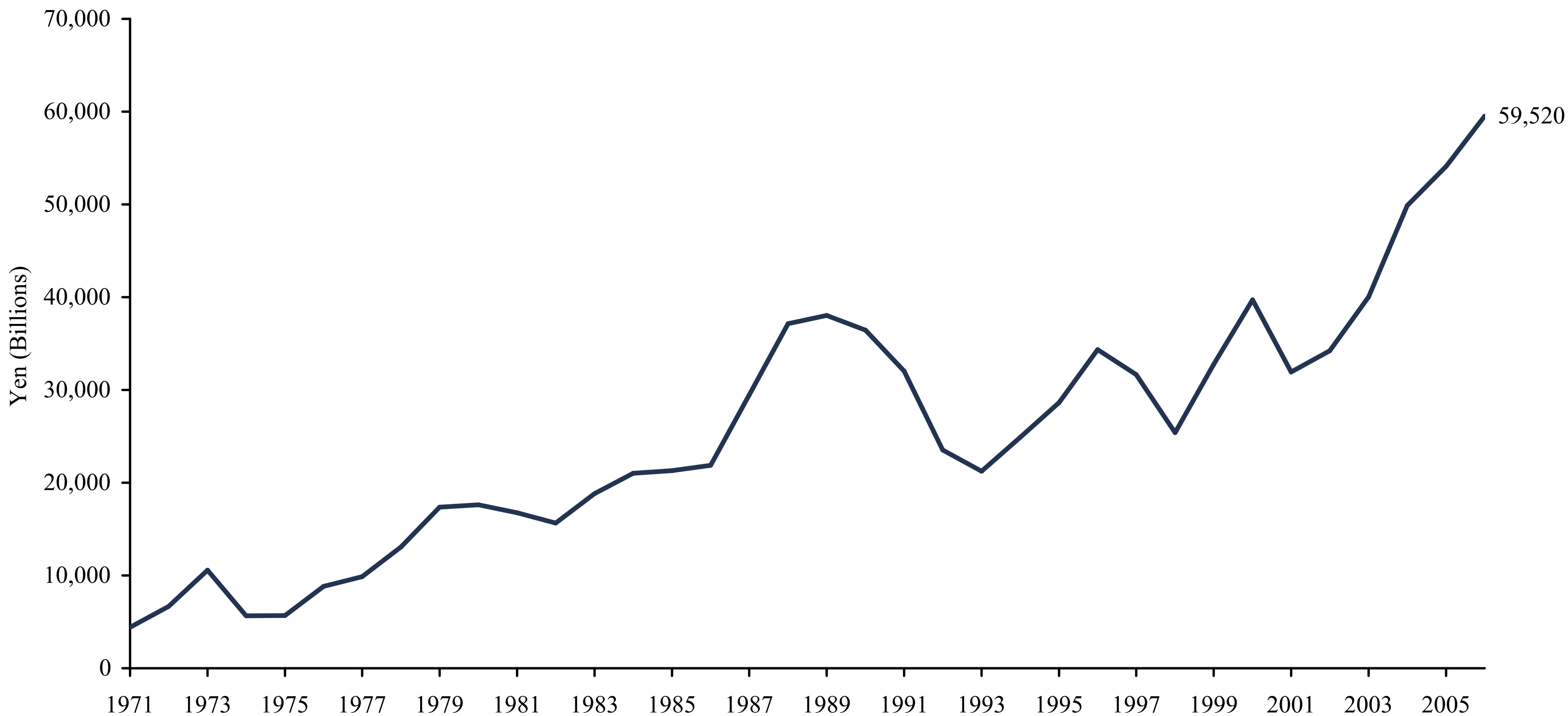
Sources: MSCI Inc. and Thomson Datastream. MSCI data provided "as is" without any express or implied warranties.

Note: Data for MSCI Pacific ex Japan Index begin December 31, 1984.

Table N

CORPORATE PROFITS FOR JAPANESE COMPANIES

April 1, 1971 – March 31, 2007



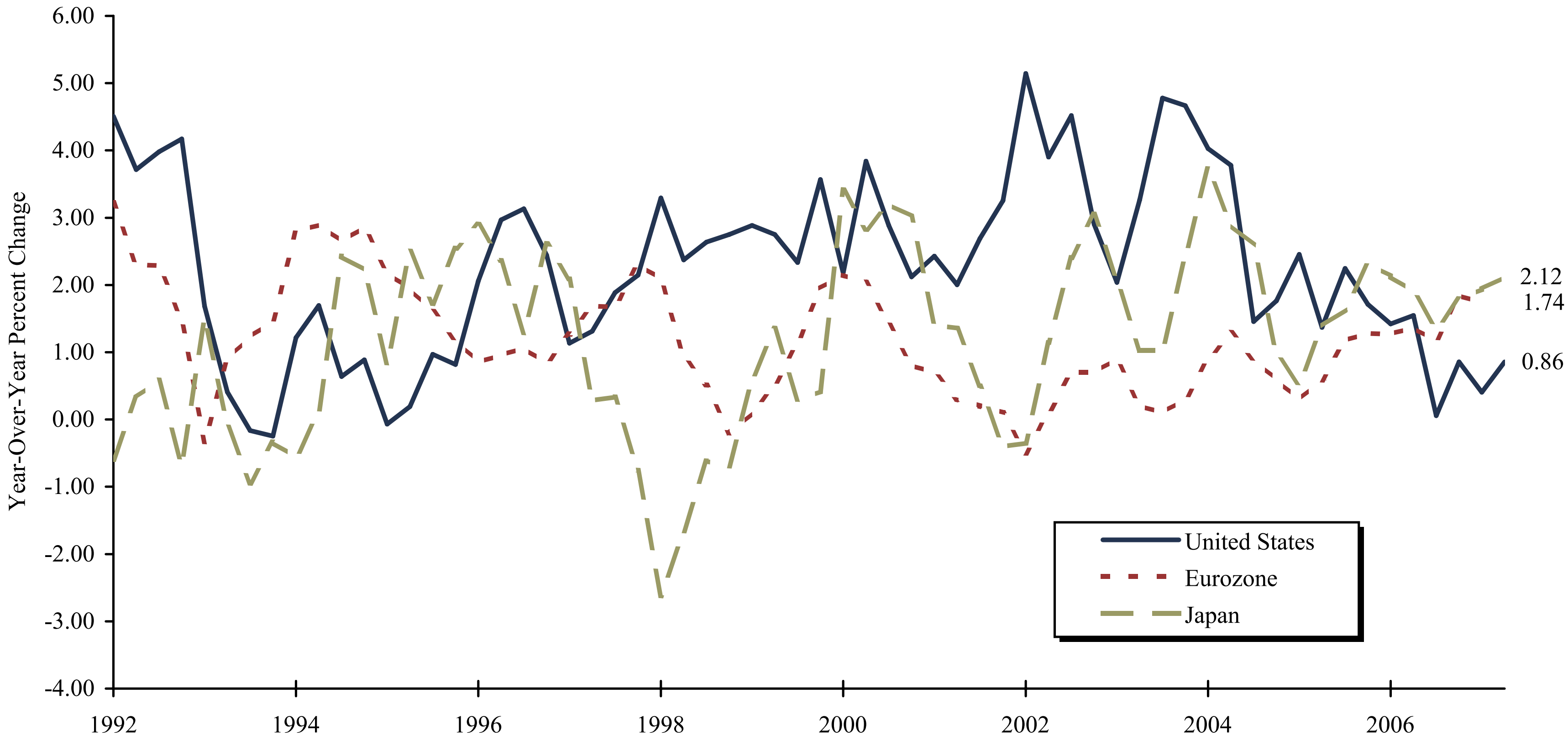
Source: Thomson Datastream.

Note: The data for each year are as of March 31, the end of the Japanese fiscal year.

Table O

COMPARATIVE LABOR PRODUCTIVITY

January 1, 1992 – June 30, 2007



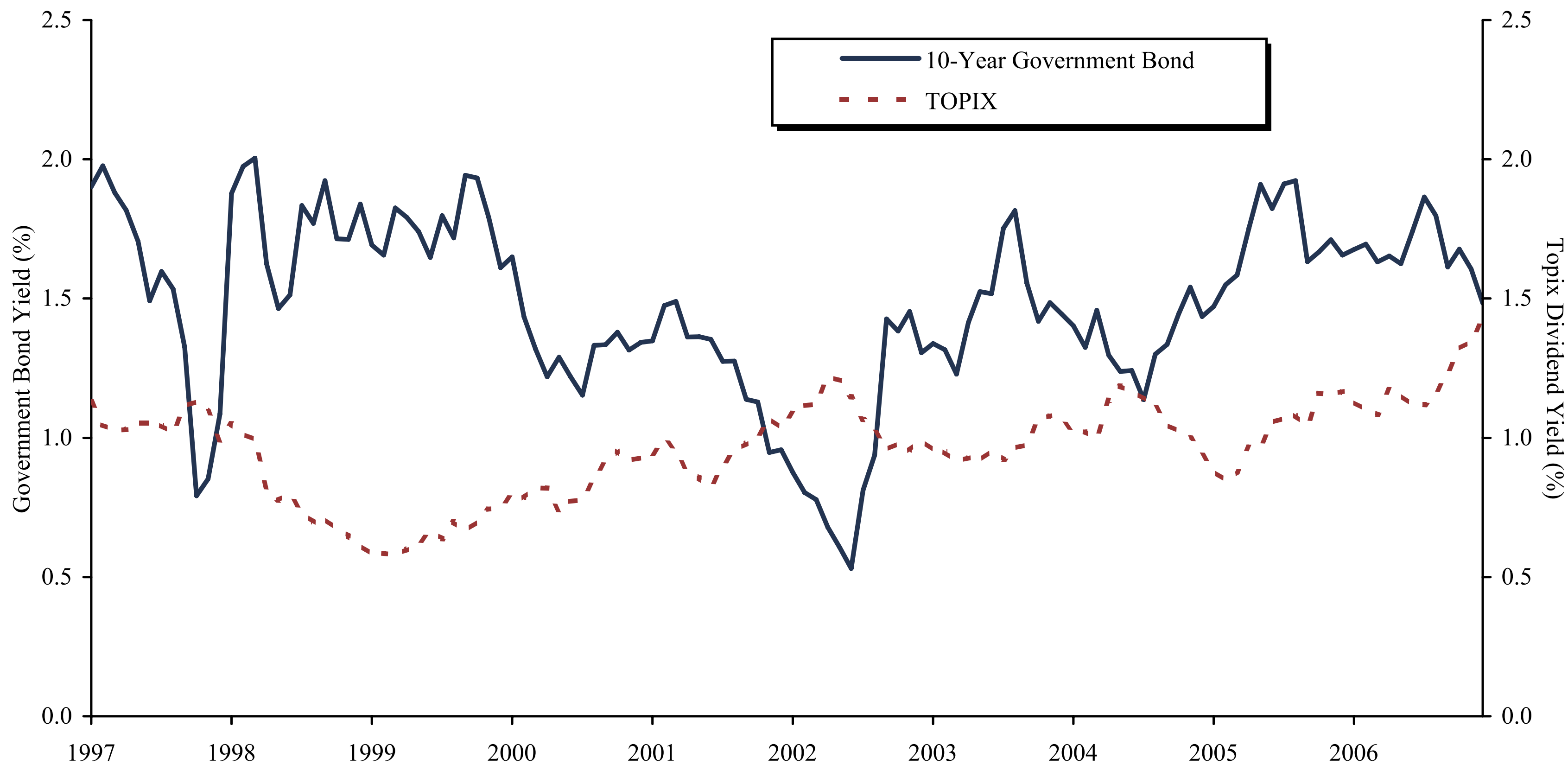
Source: International Monetary Fund.

Note: Eurozone data are as of March 31, 2007.

Table P

TOPIX DIVIDEND YIELD VERSUS 10-YEAR JAPANESE GOVERNMENT BOND YIELD

December 31, 1997 – November 30, 2007

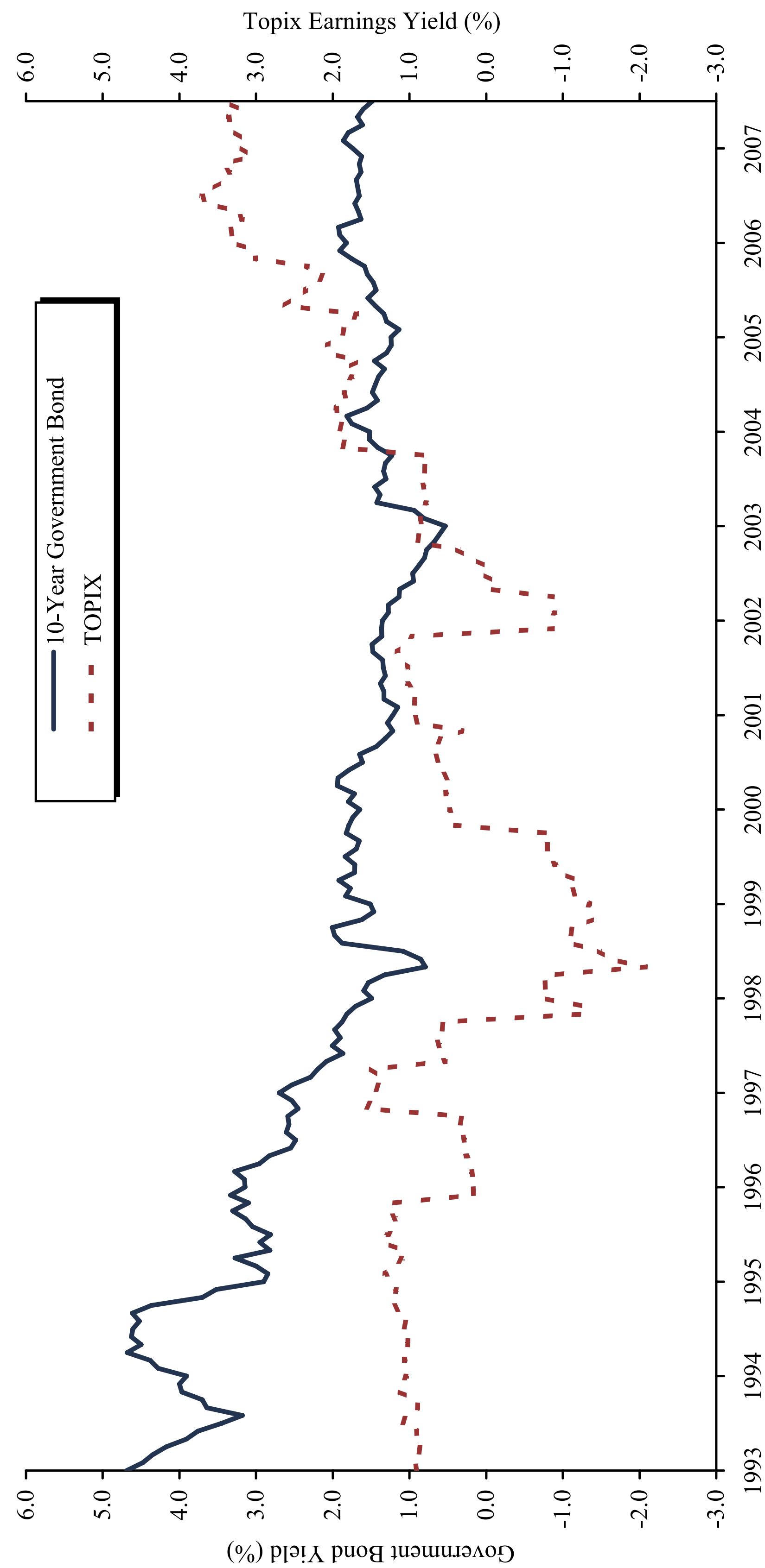


Sources: Bloomberg L.P. and Thomson Datastream.

Table Q

TOPIX EARNINGS YIELD VERSUS 10-YEAR JAPANESE GOVERNMENT BOND YIELD

May 31, 1993 – November 30, 2007



Sources: Bloomberg L.P. and Thomson Datastream.