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Feature Articles

This month's focus: **"Strategy for Financial Institutions under Ultra-low Interest Rate Environment"**

This paper studies the impact of NIRP on bank profitability in Japan. The study gives a detailed analysis of the differences between a) the estimated impact that was published (by YOSHIZAWA) in February 2016 right after the announcement of NIRP by BOJ and b) the actual impact in the first half of FY16 (ended September 2016) by scrutinizing financial results released by banks. The paper also covers the challenges facing Japanese banks under NIRP taking into account the macroeconomy and environment surrounding the banking industry in Japan, as well as looks at the similarities and differences in Eurozone countries which introduced NIRP prior to Japan.

In the recent near-zero interest rate environment, investment in securities by Japanese financial institutions is facing a turning point. While bank savings are increasing, demand for loans is still only moderate, and thus intensifying investment in securities is becoming essential. This paper identifies challenges and opportunities of such investment for financial institutions in this near-zero interest rate environment in a risk appetite framework. How to expand the investment universe, how to plan investment in a forward looking way, and how to recognize/react to early warning signals of financial market turbulence are discussed.

In September 2016, the Bank of Japan (BOJ) conducted "a comprehensive assessment of the developments in economic activity and prices as well as policy effects since the introduction of quantitative and qualitative monetary easing (QQE)", as a result of which it concluded that price expectations in Japan are formed more adaptively than in other countries. With both the potential growth rate and natural rate of interest stagnating and expectations being formed adaptively, market interest rates will remain low under additional downward pressure from yield curve control. Institutional investors, if they are to earn return, will be required to expand value-adding capacity through investment activity as financial intermediation by further enhancing a wide range of information production.

Inflation and interest rates in the US and Japan have seen one large economic cycle over the past 60 years. This paper attempts to estimate time-varying ex-ante risk premium and duration of equities derived from ex-post excess returns over this period by treating equities as quasi-perpetual bonds. Our analysis revealed how they behaved during stock market bubbles and panics, how expected real return of equity varied over time, and optimal asset allocation under different economic cycles.

Prospects

Series of Purposeful Dialogs between Securities Analysts and Companies [6]

Point of View

Article

This paper investigates the profitability of a strategy that selects stocks based on their historical same-calendar-day returns. We document return seasonality in the Japanese stock market. Independent from the various definitions of return seasonality, we find that forming a calendar time portfolio based on seasonality generates alpha of 9% per year after controlling for size and book-to-market ratio.

Assuming a pension fund whose return objective is linked to an inflation or wage rate, we examine asset allocation minimizing lower partial moment (LPM) from the target rate of return. When we minimize the second order lower partial moment, taking into account serial correlations and non-normality of return series, domestic bonds account for the bulk of asset allocation. As an investment horizon becomes longer and/or we minimize first- or zero-order LPM, allocation to riskier asset classes replaces domestic bonds. Only in portfolios minimizing zero-order lower partial moment do stocks account for a majority portion of a portfolio.