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An analysis of the relative performance of Japanese and foreign money management

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Abstract

The increased market share of foreign investment trusts in Japan may be attributed to the fact that Japanese managers have dramatically underperformed benchmarks. Recently, we showed that this underperformance can be attributed to a unique Japanese tax environment. Using data from 1998 though 2001, we find that Japanese and foreign managers are becoming very similar in style and performance. However, Japanese managers suffered in the immediate aftermath of a major April 2000 revision in the tax code. We attribute this result to the huge inflow of new money into this sector and the style shifts necessary to accommodate this flow.

JEL classification: G15; G28
Keywords: Japanese investment trusts; Investment trust taxation; Performance measurement; Investment styles; Foreign competition

1. Introduction

The investment trust business in Japan has grown very substantially over the last few years. Assets of open-type equity funds grew 82% from January 1998 to their maximum value of ¥164 trillion on May 2, 2000, falling to ¥143 trillion by the end of 2001, a net increase of 58% over the entire period. In the period from January 1998 to January 2000 alone, assets of open-type equity funds grew by 61%. As indicated in Fig. 1, a large part

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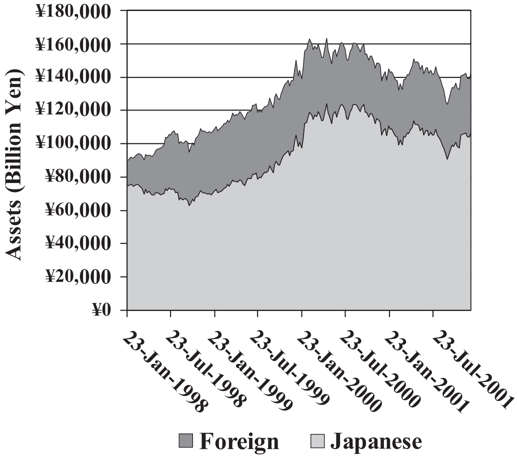

Fig. 1. Assets under management by Japanese- and foreign-owned money management firms, 1998–2001.

of that increase can be attributed to the increase in assets under management by foreign-owned investment trusts. As illustrated in Figs. 2 and 3, foreign investment management firms have recently started to play a major role in the investment trust business in Japan. Over the period from 1998 to 2000, their market share increased substantially,[1] with more than 71% of this growth coming from net inflow of funds, particularly in 1998 (Fig. 4). Most of this increase can no doubt be traced to aggressive marketing by foreign-owned firms. The success of this marketing effort is evident in Figs. 2 and 3, which show the increased market share and how many new foreign firms have entered the market. Fidelity, in particular, has been very successful. This has come at the expense of traditional firms like Nomura and Daiwa. Another reason for the increase in foreign market share is the purchase by foreigners of traditional Japanese asset managers.[2] However, at least part of this increased market share can be attributed to the fact that Japanese investment trusts have underperformed benchmarks in quite a dramatic fashion over the past two decades.[3]

This widely publicized fact has shaken public confidence in the industry, the third largest investment trust business in the world outside of the United States and France. There is a widespread perception that foreign managers are simply more skillful than their

[1] From January 23, 1998 to December 28, 2001, the number of foreign-managed trusts grew from 184 to 490, including 28 funds jointly owned by Japanese and foreign interests. The market share of foreign-managed funds also increased from 16.8% of assets under management in 1998 to 25.7% by the end of 2001.

[2] Merrill's investment trust business grew from ¥1.31 billion to ¥4.40 billion in assets under management from 1998 to 2000 with the acquisition of Yamaichi's franchise. However, their asset management affiliate, Yamaichi Asset Management was purchased by Société Générale and is starting to attain significant market share as SG Yamaichi Asset Management.

[3] This underperformance was documented in Cai et al. (1997). These authors were careful in the way they explained their findings. However, journalists were quick to attribute this poor relative performance to mismanagement by Japanese investment trust managers with articles such as "Japanese investment trusts: Punting in the dark" (*Economist*, January 22, 1994).