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Letter From Tokyo

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This past week we visited our clients and friends in Japan. The last time we did, three months before Covid, that nation's GDP had ended modestly down 0.2%. During 2020 it plunged 4.3%; about twice as sluggish as the US.

Japan's economy rebounded strongly in 2021 to 2.1% and slowed to 1.1% last year. Projections for this year are settling in around the average growth for the past two years. Analysts say the nation's birth rate – down annually since 2010 – contributes to slower growth.

Japan is struggling with the same issues of all developed economies: supply chain concerns, inflation and commodity prices. Although compared to the US and much of Europe, Japan's consumer price index of 3-4% is not as elevated. That's allowed the BOJ to keep rates at a much lower level, around 0.5%.

The new incoming central bank chief could lead to a more hawkish stance, strengthening the JPY against the dollar and other currencies. This outcome is seen as beneficial to investors' allocation budget to foreign assets in the new fiscal year beginning April.

Meanwhile Japanese institutional investors are wrestling with similar headwinds to those in the US. Prime among these is how to manage volatility in portfolios consisting largely of public strategies that all traded down amid rate and recession concerns last year.

Those investors are looking outward for consistent yield and income solutions. US credit markets, given their relative size, maturity, and diversity, are particularly attractive as sources for investment opportunities. Private credit is also readily understood by managers in Japan, many with banking experience and sophisticated in credit.

Now having experienced the wide price swings of liquid assets of the past three-plus years, these managers have experienced the benefits of private credit and are open to adding to their alternative buckets.

Timing is playing a big role. Those who missed jumping into relationships (or increasing exposure) with top direct lenders since 2019 are regretting it and are planning to do so soon.

Key questions center around the outlook for lending volume, private equity fundraising and investing, and public credit markets. Particularly why issuers, accustomed to BSL access, are now seeking financing in private markets by a considerable margin.

Finally surging currency hedge costs are compelling Japanese clients to seek higher income solutions for foreign assets. High grade taxable fixed income, as an example, can't generate sufficiently positive income gains after those costs. The close to 12% yields of middle market senior loans, however, offer timely and appropriate solutions to that dilemma.