

FIVE FITTING SCENARIOS FOR THE YEAR OF THE (FIRE) HORSE

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In the Chinese Zodiac, 2026 is the year of the horse, an animal considered intelligent and responsible, but also somewhat impatient. In Japan, however, this particular iteration of the horse carries a special meaning as it coincides with the element of fire in the zodiac – and thereby hangs a tale.

Several centuries ago, a lovelorn teenager was executed for spreading fires in Edo (today's Tokyo) and the belief grew that women born in the year of the fire horse would drive their husbands to an early grave. Strangely, the unfortunate girl was not actually born in that year but the entertainment industry of the era liked it that way.

The myth was still extant in 1966, the most recent fire horse year, as was shown by the 25% decline in births that year. In today's Japan, believers are likely to be much thinner on the ground but some nervous souls may prefer to be safer than sorry.

Some other superstitions are fading fast too. That soft power is enough to protect Japan's interests; that green power will become a major part of Japan's energy mix; that the United States will always be a reliable ally; and that warfare between advanced countries could never happen.

As usual, last year's scenarios were a mixed bag. The prediction that Sanae Takaichi would take over as Japanese Prime Minister turned out to be correct, likewise the vibe change about nuclear power, which she strongly favours. On the other hand, there were no huge takeovers and the Seven & i deal fell apart without a formal bid being made. Still, US private equity firms have enormous capital to deploy and it would be uncharacteristic if they spurned the opportunity.

Expectations that the Trump administration would want to see the Yen (and the Korean Won) much stronger against the Dollar have also yet to come to pass. America's mercurial President could change his tune any time, especially as the tariff concept seems unpopular with the public – and a more competitive currency would do the job a lot more painlessly. The betting is still that, over time, the Yen will move towards its fundamental value. According to both the International Monetary Fund ("IMF") and the Organisation for Economic Co-operation and Development ("OECD"), the Purchasing Power Parity for Yen/Dollar is in the 90s, a long way from today's market price of USD 1 vs JPY 156¹.

¹ As of 23/12/2025.

SCENARIO ONE – Sanae Takaichi Becomes a Long-Lasting Prime Minister

Over the past 50 years, long-lasting prime ministers in Japan have been thin on the ground. There have been just three of any consequence – Yasuhiro Nakasone², Junichiro Koizumi³, and Shinzo Abe⁴. Each of them had a clear agenda that fitted the times and resonated with the public. Not coincidentally, they presided over bull markets.

Takaichi could be next in the lineage. As of early December, her approval rate in a Nikkei poll was an astonishing 75%, while her party, the previously scandal-hit LDP (Liberal Democratic Party), has ridden on her coattails to a 41% approval. In comparison, the left-leaning Constitutional Democratic Party – the largest opposition party – has a rating of just 6%.

Such favourable polls will not last forever. As the leader of a minority government, it makes sense for her to call a general election sooner rather than later.

Japan is unusual in that younger people tend to be more right-wing than senior citizens, and Takaichi is a poster girl for that tendency when it comes to national security, immigration, and values. But her economics are far from traditional.

Having promised to channel more money into businesses and families, she sent back the budget proposed by the financial bureaucrats, calling it totally inadequate. If “Sanae-nomics” works without increasing inflation, she will be in the Kantei (the Prime Minister’s residence) for a long time to come.

SCENARIO TWO – The Backlash

The late Shinzo Abe was a dyed-in-the-wool conservative but introduced a raft of reforms, several of which opened up new possibilities to foreigners. At the time, Japan seemed paralysed by the so-called “lost decades” and Abe followed the famous dictum of Italian novelist di Lampedusa: “If we want things to stay as they are, everything must change.”

Today, Japan is in a much better place and has the luxury of questioning how much opening is desirable and to whom. Takaichi herself has made some unfavourable remarks about the financialisation of Japanese companies. To add to the concerns, one of Japan’s most admired companies, a manufacturer known for absorbing many other smaller outfits, has been heavily punished for false accounting.

² Yasuhiro Nakasone (27 May 1918 – 29 November 2019) was a Japanese politician who served as Prime Minister of Japan from 1982 to 1987. His political term was best known for pushing through the privatization of state-owned companies and pursuing a hawkish and pro-United States foreign policy. Data source: https://en.wikipedia.org/wiki/Yasuhiro_Nakasone

³ Junichiro Koizumi (born 8 January 1942) is a Japanese retired politician who served as Prime Minister of Japan and president of the Liberal Democratic Party (LDP) from 2001 to 2006. He retired from politics in 2009. He is the sixth-longest serving Prime Minister in Japanese history. Data source: https://en.wikipedia.org/wiki/Junichiro_Koizumi

⁴ Shinzo Abe (21 September 1954 – 8 July 2022) was a Japanese statesman who served as Prime Minister of Japan and President of the Liberal Democratic Party (LDP) from 2006 to 2007 and again from 2012 to 2020. He was the longest-serving prime minister in Japanese history, serving for nearly nine years. Data source: https://en.wikipedia.org/wiki/Shinzo_Abe

Meanwhile, a weak Yen has brought millions of tourists to Japan and priced out foreign travel for ordinary Japanese citizens, the best domestic hotels having lifted their charges to international levels.

A common and annoying experience is to see squads of middle-aged foreign tourists zooming around Shibuya and other major intersections in noisy “Mario-style” go-karts. It’s hard to believe, for example, that the French would tolerate such nonsense.

More serious and long-lasting are the issues of guest workers and immigration. Given its demographics, Japan needs more workers from overseas. Indeed, these days, the construction and convenience store sectors would barely function without them. Handled as badly as in Europe, the outcomes could be a disaster but, fortunately, Japan has time to learn from the mistakes of others and ensure that new workers contribute to the country’s well-being.

Expect a tougher immigration regime, with citizenship harder to attain and a speedy removal of troublemakers.

SCENARIO THREE – The Return of Interest Rates Signifies Normality

It has been decades since Japanese interest rates were worth looking at, but recently Japan’s long-term bonds have been attracting attention and even some concern. The 30-year bond offers a yield of about 3.4%. That is a far cry from the 0.6% of five years ago and is labelled a record-breaking level by excitable journalists. The reality is that it started life in the midst of the country’s deflationary era so it is no surprise that yields were so low for so long.

Compared to the yield on the UK’s equivalent bond (5.2%), it is no big deal. The UK needs to have high-yielding bonds because it has much higher expected inflation and relies on “the kindness of strangers”, having run a current-account deficit every year since 1986. In contrast, expected inflation for Japan is low and the country is self-financing, running a current-account surplus equivalent to 4.8% of Gross Domestic Product (“GDP”).

Japan’s 30-year bond now delivers a real yield, meaning one that is higher than expected inflation. At about 1.4%, it is hardly a shocker. Rather, just another piece of evidence showing that Japan is normalising. Yes, investors who bought the bond early in the decade will have miserable returns but they should have braced themselves for that already.

Could yields go higher? Possibly, but a steeper yield curve (a representation of bonds with different maturities) is by no means always bad news, at least not for investors in equities.

Especially with regard to bonds, some people seem to enjoy apocalyptic narratives about Japanese finance. We have heard many times that Japan is the most indebted country in the world (in reality, it is the world’s second largest creditor nation) and that collapse is around the corner whereas, in fact, it has already experienced one of the greatest financial collapses of modern times during which asset prices cratered and banks were insolvent.

Today's Japan is finally shaking off the trauma. The stock market will not rise every year but the trajectory is definitely upwards. As for government bonds, they will settle and revert to being boring, which should be the case.

SCENARIO FOUR – Learning to Live with Chinese Espionage and Propaganda

In the late 1930s and early 1940s, Mao Zedong⁵ believed that Taiwan should become an independent country. That made sense, since the island had never been considered part of China. It was only after the Chinese Civil War was over, and Chiang Kai-shek's⁶ troops had fled to what was then called Formosa, that Mao decided unification was a good idea.

Even then, he was in no hurry, telling Henry Kissinger⁷ in 1972 that China could wait another 100 years. It is only in more recent times that China's approach has become increasingly threatening.

Why so? Chiang, the Chinese Communist Party's bête noire, is long gone, as is his son and heir. Taiwan has a population of just 23 million against China's 1.5 billion. A vibrant democracy, it was the first Asian country to legalise gay marriage and has a higher GDP per head than Japan. It is not going to hurt anyone – and that, of course, is the problem. Taiwan's existence is a living rebuke to the history of the Chinese Communist Party ("CCP").

Geopolitics is important too. If China successfully absorbed Taiwan, it would have clear blue water from which to launch its battleships and carriers. The likely outcome would be that other Asian countries would accept that the US was no longer top dog and a de facto Sinosphere would come into being.

So Takaichi was correct to state that a Taiwan emergency would be existential for Japan. The subsequent brouhaha was highly revealing. In particular, the Global Times⁸, which is a mouthpiece for the CCP, cast doubt on Japan's sovereignty over Okinawa. Perhaps they would like to stir up trouble there; perhaps they are already doing so.

In several countries, Chinese researchers, businessmen and students have been identified as spies. Some are in deep cover, having naturalised as citizens of the host country, and doing important political work. Japan will not be an exception. It will need to strengthen its laws and recruit many more spy-catchers.

⁵ Mao Zedong (26 December 1893 – 9 September 1976) was a Chinese politician, revolutionary, and political theorist who founded the People's Republic of China (PRC) in 1949 and led the country from its establishment until his death in 1976. Mao served as Chairman of the Chinese Communist Party (CCP) from 1943 until his death, and as the party's de facto leader from 1935. His theories, which he advocated as a Chinese adaptation of Marxism-Leninism, are known as Maoism. Data source: https://en.wikipedia.org/wiki/Mao_Zedong

⁶ Chiang Kai-shek (31 October 1887 – 5 April 1975) was a Chinese politician, revolutionary, and military commander who led the Republic of China (ROC) from 1928 until his death in 1975. His government was based in mainland China until it was defeated in the Chinese Civil War by Mao Zedong's Chinese Communist Party (CCP) in 1949, after which he continued to lead the ROC government on the island of Taiwan. Chiang served as leader of the Nationalist Kuomintang (KMT) party and the commander-in-chief of the National Revolutionary Army (NRA), which was reorganized into the Republic of China Armed Forces in 1947, from 1926 until his death. Data source: https://en.wikipedia.org/wiki/Chiang_Kai-shek

⁷ Henry Alfred Kissinger (May 27, 1923 – November 29, 2023) was an American diplomat and political scientist who served as the 56th United States secretary of state from 1973 to 1977 and the 7th national security advisor from 1969 to 1975, serving under presidents Richard Nixon and Gerald Ford. Data source: https://en.wikipedia.org/wiki/Henry_Kissinger

⁸ The Global Times is a daily Chinese tabloid under the auspices of the Chinese Communist Party's flagship newspaper, the People's Daily, commenting on international issues from a Chinese nationalistic perspective. Established as a publication in 1993, its English version was launched in 2009. Data source: https://en.wikipedia.org/wiki/Global_Times

SCENARIO FIVE – Japan Reaches the Quarter-Finals of the World Cup

Japan is remarkable for the number of sports in which it competes at a world-class standard. The exploits of Shohei Ohtani, a Japanese baseball player in the American major leagues, are known to all fans of the game, and it was not that long ago that the Japanese rugby team knocked the fearsome South African Springboks out of the World Cup.

In 2026, the United States, Canada, and Mexico will jointly host the biggest tournament of them all, the football (soccer) World Cup. Interestingly, there are no standout teams this time. Spain is the favourite but Brazil, Germany and France are not as strong as usual. All-time great Lionel Messi will be there. However, at the age of 38, he will not be able to take an average Argentine team all the way as was the case four years ago.

In the last World Cup, Japan achieved the giant-killing feat of beating both Spain and Germany. This time, it should progress further as there are now five Japanese players in the English Premier League – the most competitive league in the world – including the highly experienced Wataru Endo, the captain, and the super-skilled Kaoru Mitoma. That gives the squad a sporting chance of making it to the last eight.