

Nikkei 225 : Why at a stalemate for the first time in 31 years and a half

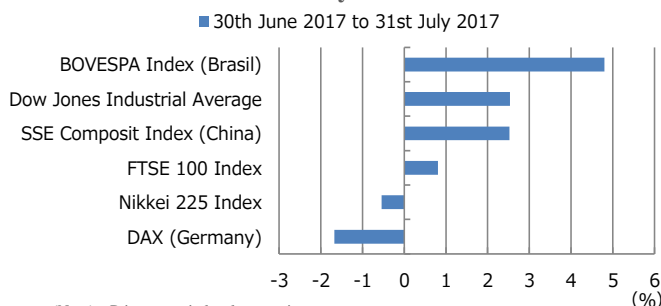
- Price range of Nikkei 225 in July was the narrowest for the first time in 31 years and a half, however, stock prices are not at a stalemate globally.
- Equity market was at a stalemate 31 years and a half ago due to stronger JPY after Plaza agreement (1985) and BOJ’s accommodative monetary policy followed by unprecedented bubble equity market.
- We expect Nikkei 225 to gradually rise, as a stalemate this time is possibly temporal related to announcement of business results.

Price range of Nikkei 225 in July was the narrowest for the first time in 31 years and a half, however, stock prices are not at a stalemate globally

Currently, Nikkei 225 is at a serious stalemate fluctuating around the watershed level of 20,000. In fact, price range (difference of monthly high and low) of July 2017 was only JPY 344.23. Narrower range of JPY 273.65 can only be found back in January 1986. In other words, latest stalemate of Nikkei 225 is for the first time in 31 years and a half.

It seems that the other global equity markets are not following the pattern of Japan as mentioned above. In US, Dow Jones Industrial Average, S&P 500 and NASDAQ Composite Index renewed their record highs on 26th July 2017 en masse. Meanwhile, DAX (German stock index) turned into fall in July after reaching its record high on 19th June. Not only in US and Germany but also in Brazil and China, the direction of their equity markets are clear (Chart 1).

“Chart 1: Percentage change of major stock indices of July 2017”



(Note) Price return in local currencies.
(Source) SMAM, based on Bloomberg L.P. data.

“Table 1 : Percentage change of major stocks constituting Nikkei 225 Index”

Stock Name	% Chg	Data Period
Fast Retailing	-8.2	12 July - 1 August '17
Fanuc Corp.	-2.9	27 July - 1 August '17
Central Japan Railway	3.0	27 July - 1 August '17
Tokyo Electron	-7.8	26 July - 1 August '17
East Japan Railway	0.3	27 July - 1 August '17
Nitto Denko	5.5	28 July - 1 August '17
Shin-Etsu Chemical	-2.1	24 July - 1 August '17

(Note) Major high-priced stocks constituting Nikkei 225 Index. % change is calculated from a day prior to each company’s latest announcement of business results.
(Source) SMAM, based on Bloomberg L.P. data.

Equity market was at a stalemate 31 years and a half ago due to stronger JPY after Plaza agreement (1985) and BOJ's accommodative monetary policy followed by unprecedented bubble equity market

According to observations made before, backdrop of Nikkei 225's stalemate seems to be specific to Japan. For your reference, we would like to examine how Nikkei 225 moved around the month of January 1986 when monthly price range was JPY273.65. G5 countries agreed on depreciating the US dollar on 22nd September 1985 (Plaza agreement). After the agreement, BOJ maintained accommodative monetary policy to avoid recession caused by the stronger yen as sharp “depreciation of USD and appreciation of JPY” progressed.

As a consequence, Japanese financial markets were “flooded with excess liquidity” which eventually begun to pour into Japanese equity market. Stalemate of Nikkei 225 continued till January 1986 as excess liquidity underpinned equity market during the period of progressing yen appreciation. Following February, momentum of bull market strengthened and the unprecedented bubble equity market begun. Nikkei 225 reached the high of 38,957 yen during trading hour of 29th December 1989 and the bubble economy has burst soon after.

We expect Nikkei 225 to gradually rise, as a stalemate this time is possibly temporal related to announcement of business results

We can not simply compare January 1986 to July 2017, as economic conditions and market environment are totally different. However, there are things in common such as currently USD/JPY rate is moving towards “weaker USD / stronger JPY” from the recent peak of 1USD = JPY125.86 (5th June 2015) and Japanese financial markets are “flooded with excess liquidity” due to BOJ's accommodative monetary policy. Even so, we believe that this time it is not the beginning of bubble equity market taking into consideration of reasons mentioned below.

We think main reasons of stalemate of Nikkei 225 are i) support of market by BOJ's ETF purchase, ii) political uncertainty due to falling approval rating of the government, iii) investors stance to wait for a clearer picture of business results and iv) profit taking of high-price stocks after business result announcements (Table 1). For i), purchase of ETF is likely to continue for some times and for ii), focus will be on recovery of approval rating after cabinet reshuffle. Meanwhile, for iii) and iv), they will be discounted by the market as usual as time proceeds and we believe that Nikkei 225 will gradually gain momentum to rise.

*** Please note that this report is a translation of Japanese report written on 2nd August, 2017.**

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter "SMAM"), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- ☐ The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM's judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM's authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited