

## What's revealed after Nikkei Average Recovered to JPY23,000

- Japanese stock was bought as US-China agreement on putting trade sanction on hold was deemed lowering risk of trade war.
- Expectation on upward revision of corporate earnings on back of weaker JPY against USD due to rising US interest rate drove stock price high.
- Generally, upside potential of stock price driven by market expectation is limited. Stock market supported by earnings growth expectation can be seen a little later.

### Japanese stock was bought as US-China agreement on putting trade sanction on hold was deemed lowering risk of trade war

Nikkei 225 Index closed recovering JPY23,000 level on May 21 due to 1) shrinking concerns over US-China trade friction and 2) progress of weaker JPY against USD. As to (1), US and China held a trade talk on the 17th and 18th, and released a joint statement on the 19th. The joint statement includes effective measures to reduce US trade deficit against China and China agreeing on dramatically increasing imports from US (diagram 1).

Furthermore, as a result of US-China trade talks, they have agreed to put trade sanction on hold during the talks. They are expected to negotiate over specific items and amounts going forward. By this agreement, the Japanese stock was bought as market deemed risk of US-China trade frictions escalating to "Trade War" has receded.

“Diagram 1: Key points of joint statement on US-China trade talks”

- Implement effective measures to reduce US trade deficit against China.
- China to dramatically increase import of goods and services from US.
- US to increase export of agricultural goods and energy.
- Obey protection of intellectual property and strengthen cooperation.
- Promote bilateral investments.
- Continue negotiation of senior officials.

(Source) SMAM, based on The White House data.

“Diagram 2 : EPS & PER of Nikkei 225 Index”

	EPS (JPY)	×	PER (x)	=	Stock Price (JPY)
As of April 10	1,700.02	×	12.82	=	21,794
	↓		↓		↓
	decrease		increase		increase
As of May 18	1,642.58	×	13.96	=	22,930

(Note) Estimate EPS and PER based on Nikkei 225 index.  
 (Source) SMAM, based on The Nikkei data.



## **Expectation on upward revision of corporate earnings on back of weaker JPY against USD due to rising US interest rate drove stock price high**

Regarding (2), USD strengthened to JPY111 level on May 18 due to recent hike in US long-term interest rate. In January to early February 2018, US long-term interest rate hike prompted major countries' stock price to decline and JPY to be bought on risk aversion. However, we think this is not the case this time, as market was relieved by announcement of FRB, led by new chairman Jerome Powell, in March that they would continue to raise US interest rates moderately.

According to news reports, major companies' assumption for foreign exchange rate will be about JPY106.70 against USD on average. Therefore, if actual USD rate moves stronger against JPY than the assumed rate, export companies will have a room to revise their earnings upward. In this case, stock price tend to rise on expectations of companies' earnings upward revision. It seems that this is one of the major factors for the recovery of Nikkei 225 Index to the current JPY23,000 level.

## **Generally, upside potential of stock price driven by market expectation is limited. Stock market supported by earnings growth expectation can be seen a little later**

Now, we would like to evaluate price level of Nikkei 225 Index using EPS (Earnings Per Share) and PER both based on earnings forecast, respectively. As of April 10 (before the peak of financial result announcements), EPS and PER of Nikkei 225 Index were at about JPY1,700 and 12.82 times respectively (diagram 2). Later, on May 18 (after most financial result announcements are finished), EPS declined to about JPY1,643 while PER increased to 13.96 times, indicating that Nikkei 225 Index was pushed up by expectations.

Although Nikkei 225 Index recovered to JPY23,000 level, upside for the stock price is limited without support of profit increase (EPS rise). In some cases, stock price could still keep rising supported by expectations (PER rise), however, it should be noted that risk of consolidation increases in tandem with rising over-valued sentiment of investors. In order for EPS to rise, companies have to revise up their earnings estimation at their fiscal end (quarterly and semi-annually) based on their business progress. Thus, stock price is expected to rise from late July to early August (Apr-Jun quarterly results season) or late October to early November (interim results to come) backed by strong earnings estimation .



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