



Japanese Stock Market Outlook

SMAM monthly comments & views
- January 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

SMAM forecasts the Japanese economy to bottom-out from the 1Q 2015 as private consumption should finally put the last tax hike shock behind. The wage negotiation round starts in the new year and to be finalized by the end of March, which is important for drumming up the consumer sentiment.

- Jul-Sep GDP was revised down from -1.6% to -1.9%. SMAM reduced FY14 GDP growth forecast by 0.1% to -0.6% and also FY15 forecast by 0.1% to +1.3%.
- Export volume is increasing led by IT goods and consumer goods, which provides support to the economy.
- CPI is facing a downward pressure from lower oil prices, which makes BOJ's fight against deflation a tough task.

➤ Japanese Stock Markets

The governing coalition parties won the lower house election in December exceeding even most optimistic predictions. PM Abe successfully increased its political capital, which re-established himself for a long and stable tenure and he will strongly pursue reflationary policies toward the next consumption tax hike now scheduled in April 2017.

- Double digit earnings growth is forecasted for the two consecutive fiscal years, which should provide further upside for the Japanese stock market.
- Risks could be such as slowdown in US and Chinese economies, heightening geopolitical tensions.

Outlook for the Japanese Economy

SMAM economic outlook for FY14-15

- SMAM forecasts the Japanese economy to bottom-out from the 1Q 2015 as private consumption should finally put the last tax hike shock behind. The wage negotiation round starts in the new year and to be finalized by the end of March, which is important for drumming up the sentiment.
- Jul-Sep GDP was revised down from -1.6% to -1.9%. SMAM reduced FY14 GDP growth forecast by 0.1% to -0.6% and also FY15 forecast by 0.1% to +1.3%.
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(%YoY except Net Exports)

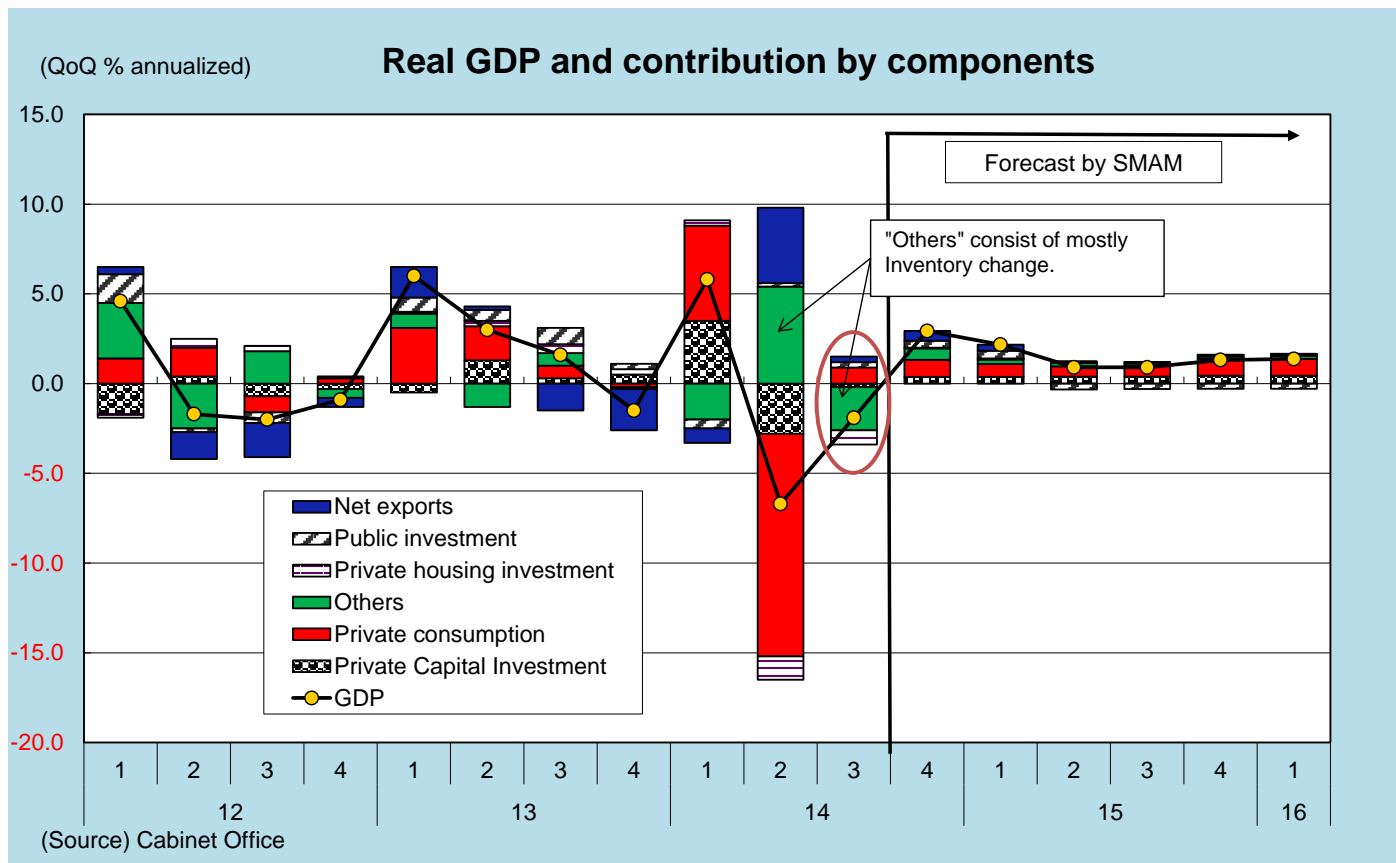
	FY11	FY12	FY13	FY14E	FY15E
Real GDP	0.4%	1.0%	2.1%	-0.6%	1.3%
Private Consumption	1.4%	1.8%	2.5%	-3.0%	1.3%
Housing Construction	3.2%	5.7%	9.3%	-10.9%	1.1%
Private Capital Investment	4.8%	1.2%	4.0%	0.5%	2.6%
Public Consumption	1.2%	1.5%	1.6%	0.5%	0.9%
Public Investment	-3.2%	1.0%	10.3%	3.6%	-1.2%
Net Exports (contrib. to growth)	-1.0%	-0.8%	-0.5%	0.7%	0.2%
Exports	-1.6%	-1.3%	4.7%	6.3%	4.0%
Imports	5.4%	3.6%	6.7%	2.3%	3.5%
Nominal GDP	-1.3%	0.1%	1.8%	1.2%	1.8%
GDP Deflator	-1.7%	-0.9%	-0.3%	1.8%	0.5%

Notes: P=Official preliminary report, E=SMAM forecasts. SMAM views are as at 17 December 2014 and subject to updates thereafter without notice

Source: Cabinet Office: Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

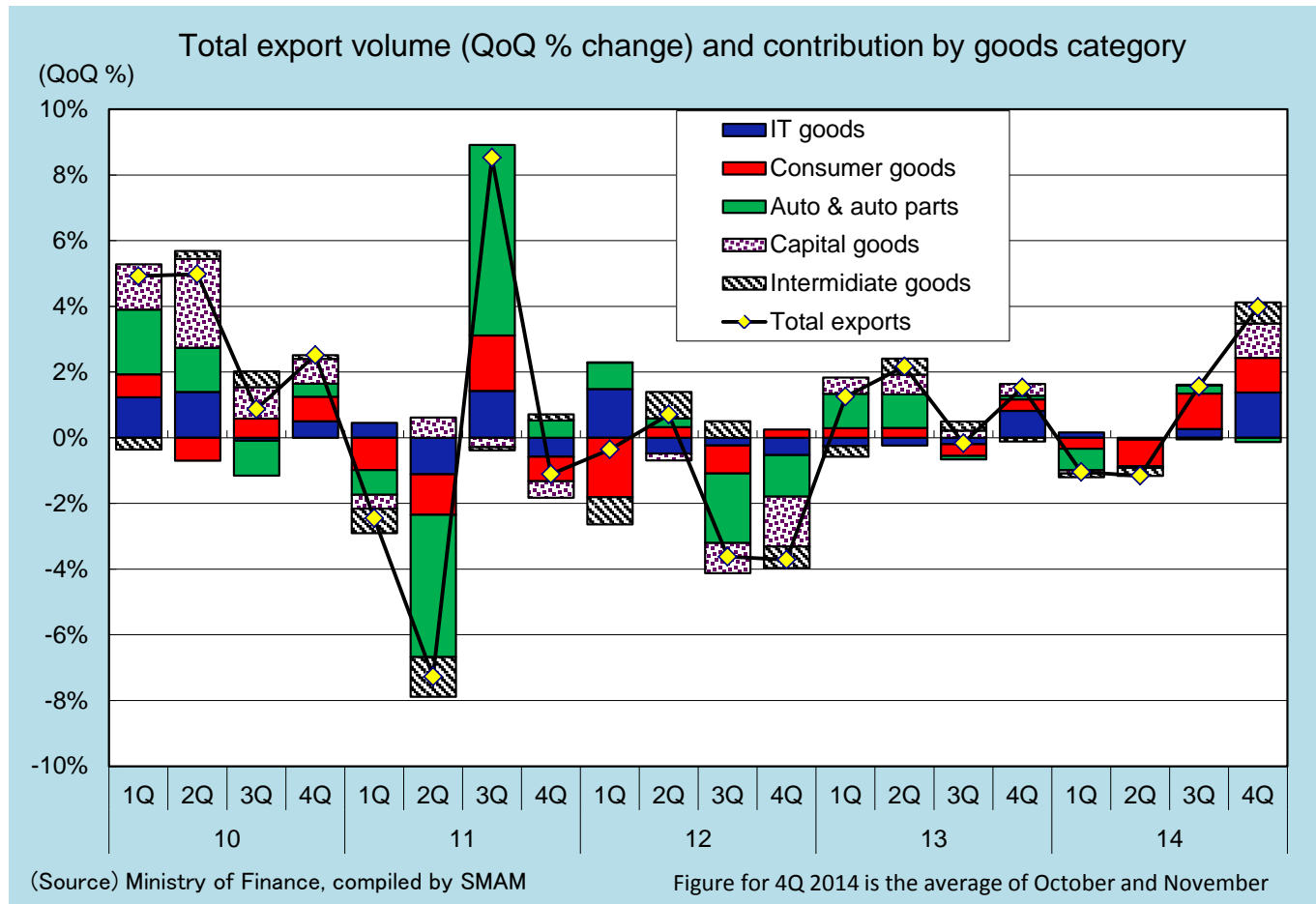
Quarterly GDP : Jul-Sep GDP was further down-revised

- Jul-Sep GDP was revised down from -1.6% to -1.9%.
- Export volume is increasing led by IT goods and consumer goods, which provides support to the economy.



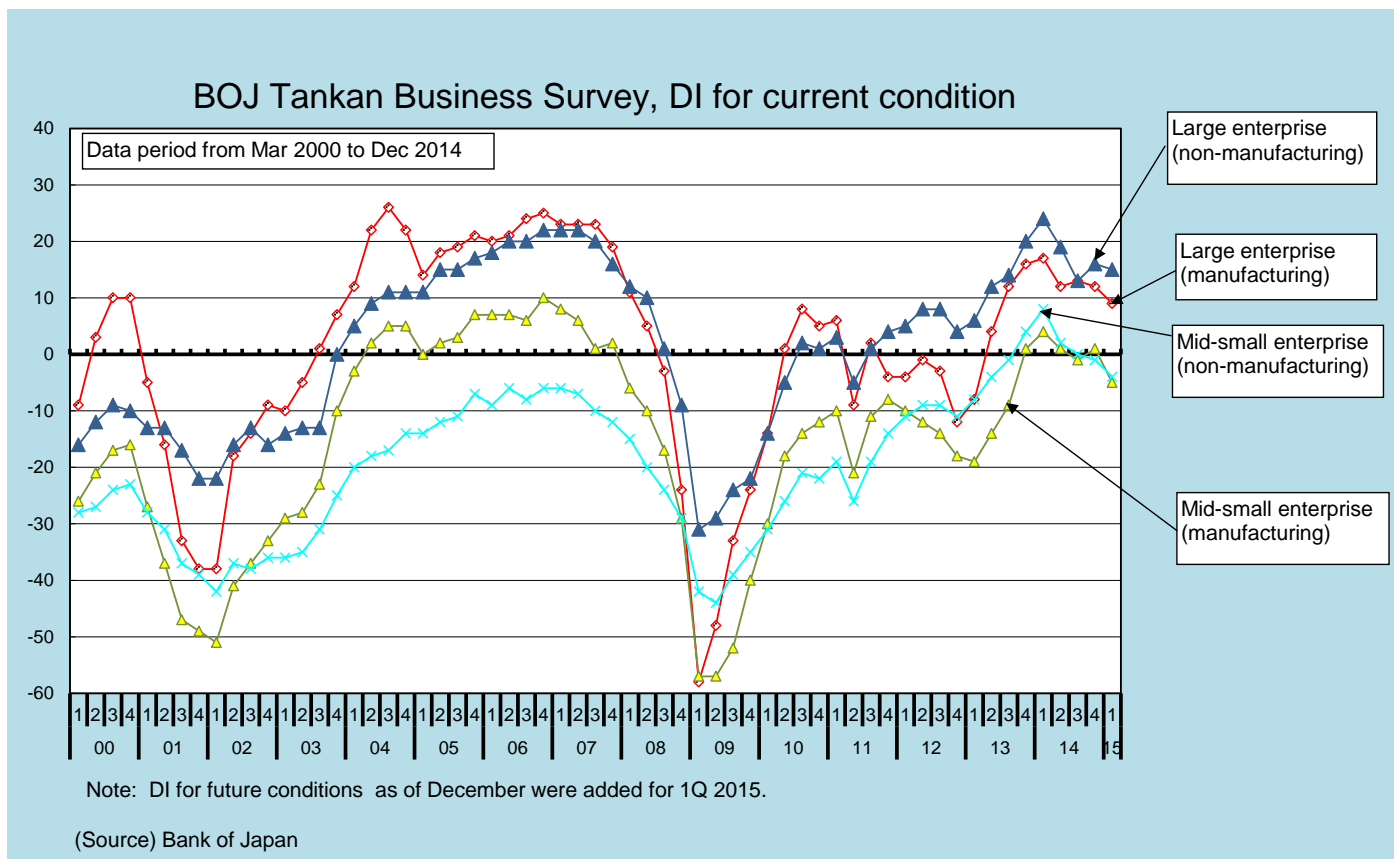
Export is expanding led by IT and consumer goods

- Export of electronics parts is growing as well as consumer goods, meanwhile growth of Auto related goods is stagnant, which probably resulting from progressed production shift to overseas.



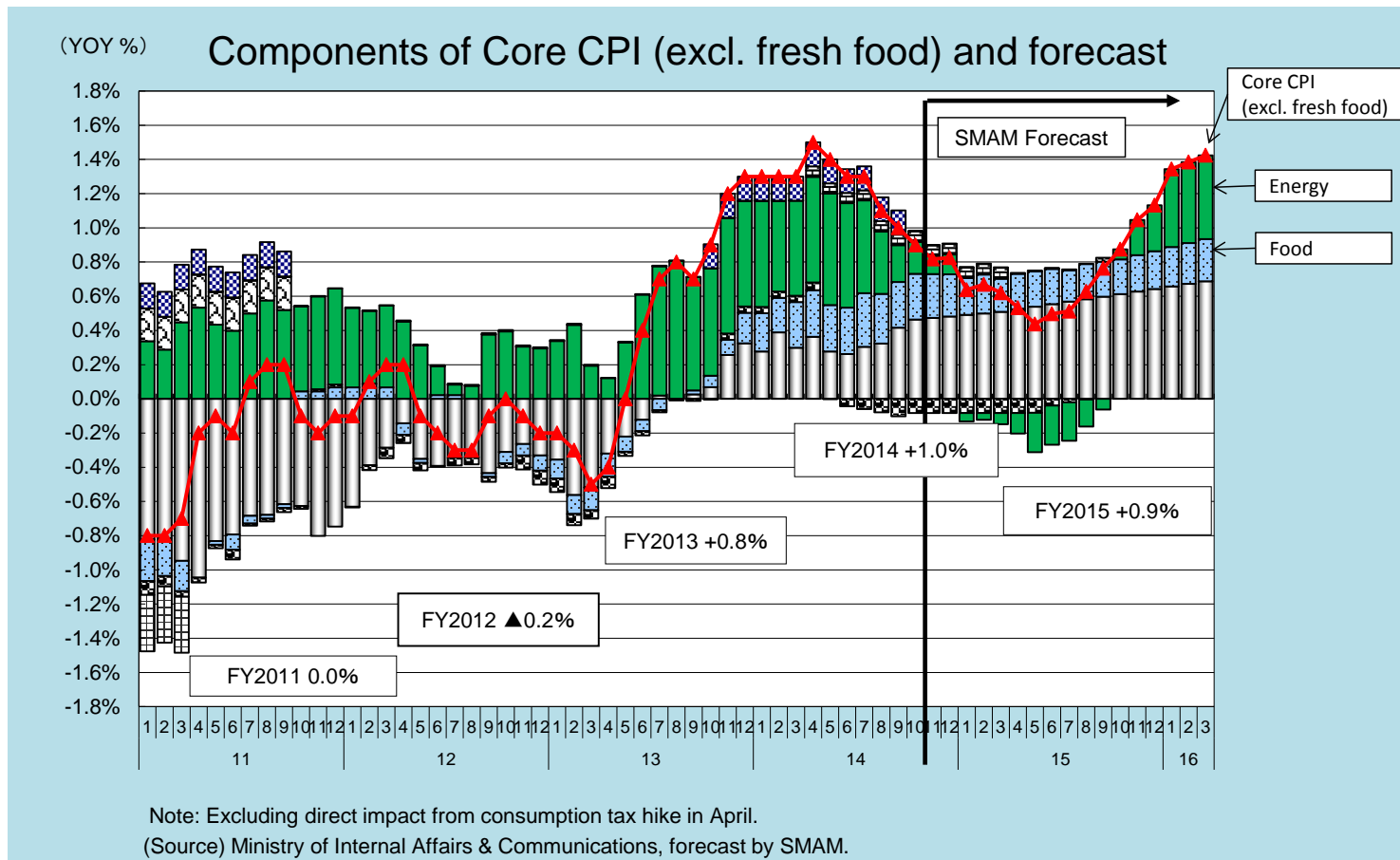
Stagnant domestic economy affects sentiment of small –mid enterprises while large ones sustain

- Stagnant economy in Japan is affecting small-mid companies while large companies are holding relatively positive business sentiments, which is in line with the strong corporate earnings growth.
- Domestic economy is bottoming out and positive growth is expected for 2015 and beyond, which will lift the sentiment in the next year.



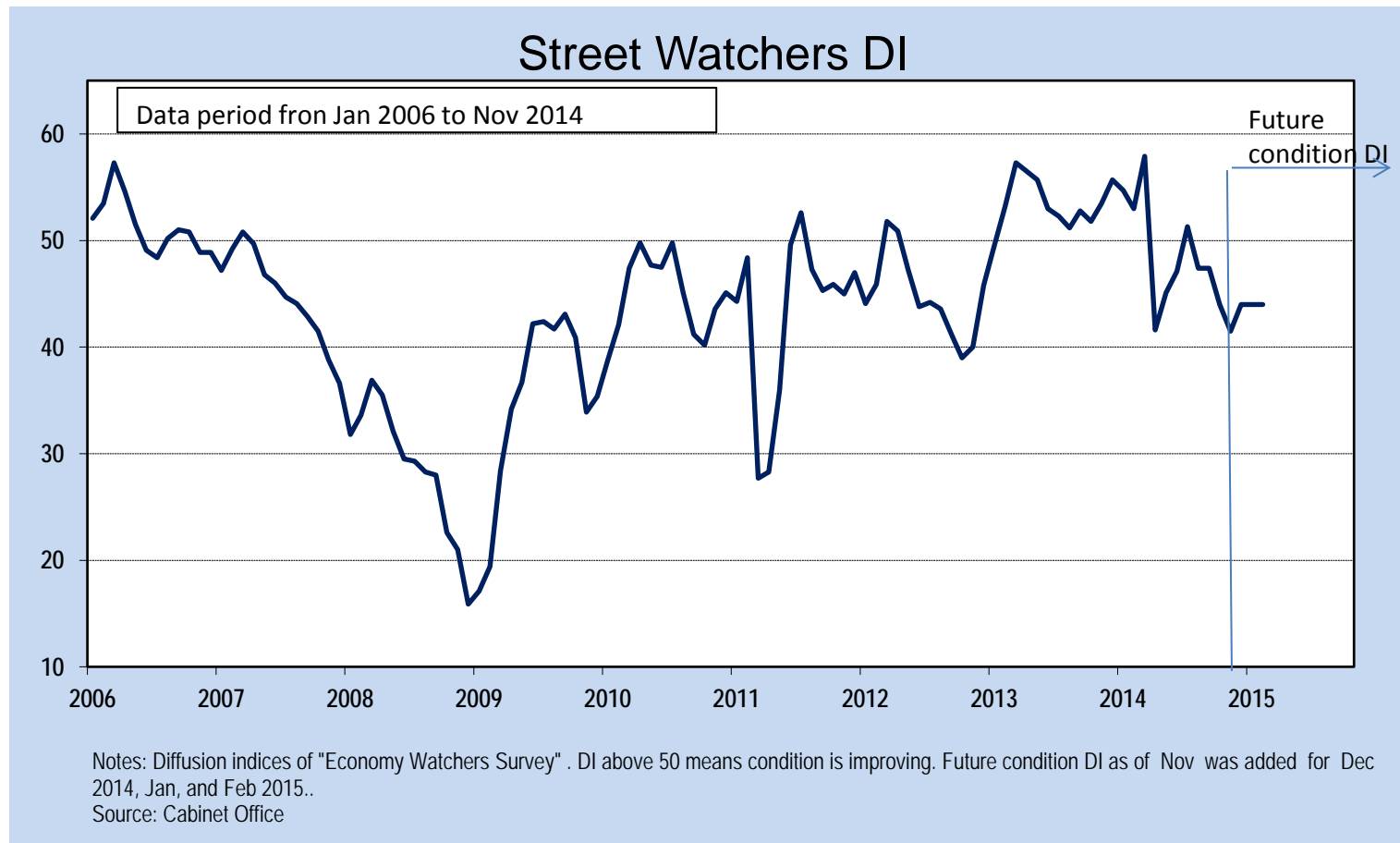
Falling oil price is pulling down CPI

- Falling oil price is putting downward pressure on CPI, for which SMAM expect to fall below 0.5% in the middle of 2015. BOJ will have uphill task to achieve its current CPI forecast of 1.7% for FY2015.



Consumer sentiment has been deteriorating, which is expected to rebound next year

- Consumer sentiment has been declining after the consumption tax hike in April.
- Wage negotiation round starts early next year and to be finalized by March. Whether robust corporate earnings should feed to sizable wage increase is important for the Japanese economy.



Outlook for the Japanese Stock Markets

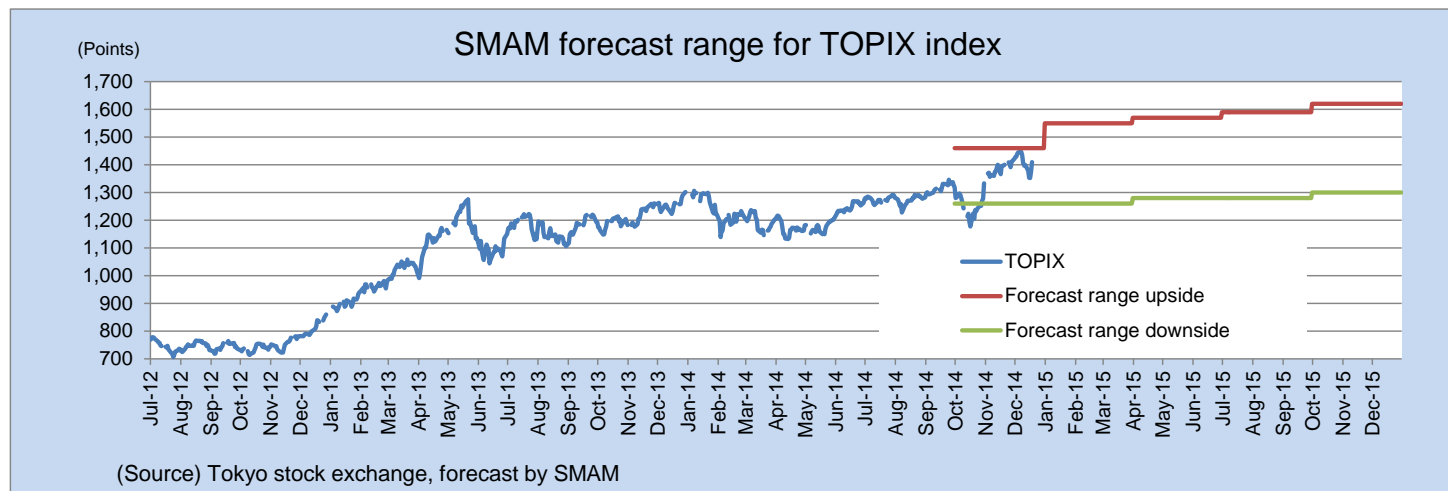
Stock market outlook: Strengthened reflationary policy should support the stock market

SMAM short-term view

- The governing coalition parties won the lower house election in December exceeding even most optimistic predictions. PM Abe successfully increased its political capital, which re-established himself for a long and stable tenure and he will strongly pursue reflationary policies toward the next consumption tax hike now scheduled in April 2017.
- Double digit earnings growth is forecasted for the two consecutive fiscal years, which should provide further upside for the Japanese stock market.
- Risks could be such as slowdown in US and Chinese economies, heightening geopolitical tensions.

Longer-term outlook (6-month and beyond)

- For longer-term, we continue to expect the market to track on a modest uptrend, supported by US-led moderate global growth, solid corporate earnings growth and strengthened reflationary policies in Japan.



(Source) Tokyo stock exchange, forecast by SMAM

Note: SMAM forecasts are as at 19 December 2014 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - PM Abe continues long and stable government
 - Global economic growth is going to be sustained led by strong US economy
 - Japan's recovery from tax-hit weak demand
 - Political supports including reasonably effective growth strategies
 - Growing expectations for positive earnings revisions by corporates

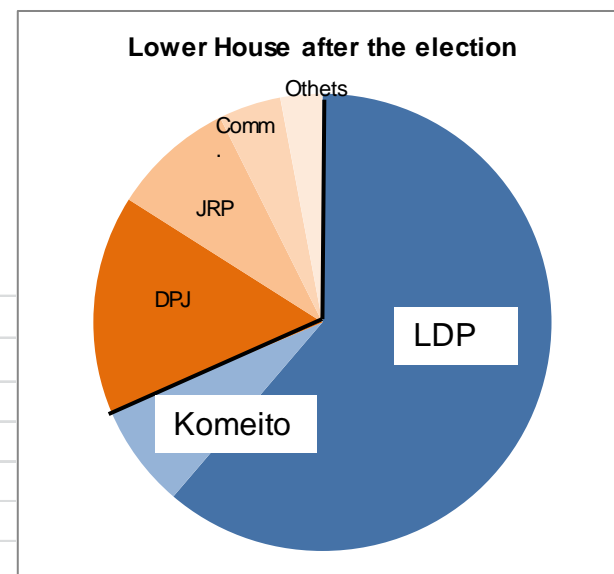
- **Upside Risks** include:
 - Weaker JPY than a base assumption (USD=JPY120 at March 2015)
 - Stronger global growth
 - More powerful measures by Japanese authorities

- **Downside Risks** include:
 - Markets to turn around to deeper risk-off mode, should geopolitical tensions grow
 - US economy to slowdown
 - Unsatisfactory earnings revisions by companies

PM Abe successfully increased its political capital by the snap election

- The governing coalition parties together increased the seats to 326, which was beyond the most optimistic predictions, well exceeding 317 seats required for passing laws even after rejected by the Upper House.
- PM Abe successfully increased its political capital, which re-established himself for a long and stable tenure.
- Abe administration will strongly pursue reflationary policies toward the next consumption tax hike now scheduled in April 2017.

	After the election on 14th Dec.	% of total seats	Before the election	% of total seats
Total seats	475	100%	480	100%
Two thirds of the total	317	67%	320	67%
Governing Coalition	326	69%	324	68%
Liberal Demcratic Party	291	61%	293	61%
Komeito	35	7%	31	6%
Deemocratic Party of Japan	73	15%	62	13%
Japan Restration Party	41	9%	42	9%
Communist Party	21	4%	8	2%
Others including 1vacancy	14	3%	44	9%
Opposition Parties	149	31%	156	33%



(Source) Yomiuri news paper

Further weakening of Yen is helping corporate earnings growth

- SMAM upgraded recurring profit growth forecasts both for FY2014 and FY 2015 mainly due to the assumption change in Yen/US\$ rate from 100 to 115. Two consecutive fiscal years of double digit earnings growth is forecasted.
- Sectors leading earnings growth are Auto, Consumer electric appliances and Electric power & Gas.

Earnings Tabulations (SMAM Core Research Universe excl. financials)

(% change)	FY 2012 (Actual)	FY 2013 (Actual)	Forecasts for FY 2014		Forecasts for FY 2015	
			as of Sep 2014	as of 10th Dec 2014	as of Sep 2014	as of 10th Dec 2014
Timing of the forecasts made	-	-				
Revenue	3.5%	13.5%	3.2%	3.7%	3.3%	3.5%
Operating Profits	6.8%	35.1%	7.0%	8.1%	11.9%	16.4%
Recurring Profits	9.9%	39.3%	7.1%	11.2%	12.6%	13.5%
Net Earnings	28.0%	85.4%	7.5%	12.0%	14.7%	15.4%

*Figures show bottom-up yoy annual growth forecasts by SMAM equity analysts.

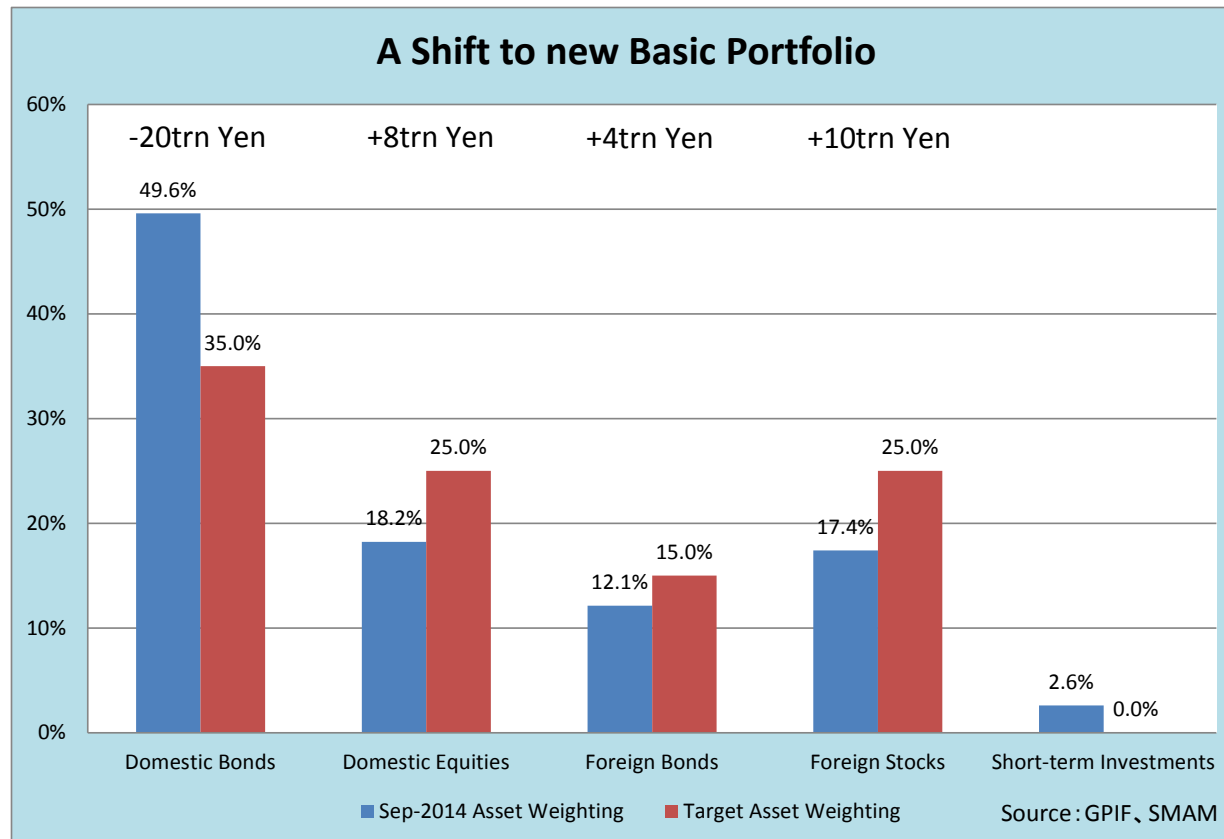
*A Japanese Fiscal Year is from April to March the following year.

*Assumptions for forecasts:

	As of Sep 2014	As of Dec 2014
FX rate (Yen/US\$)	100	115
FX rate (Yen/€)	140	140
Crude Oil CIF (Japan)	\$105/barrel	\$80/barrel

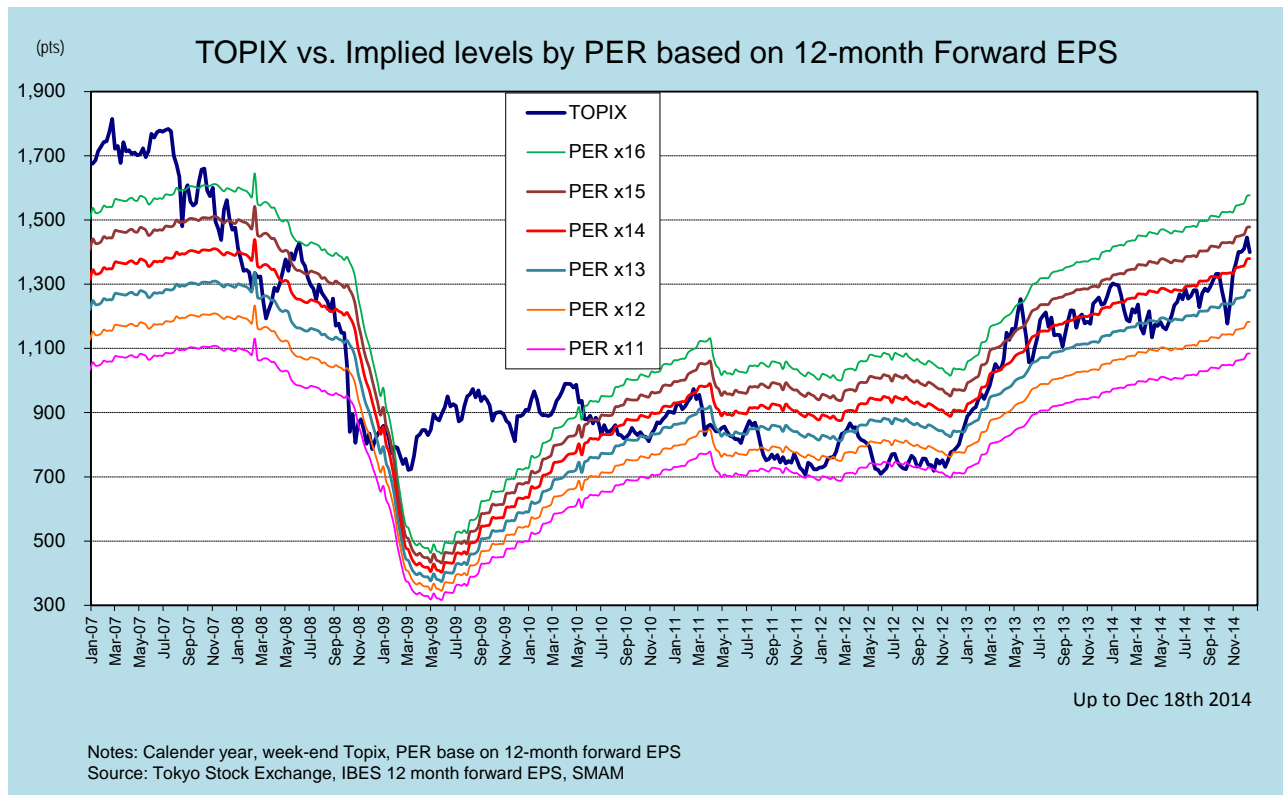
Allocation change in public pension funds

- Asset allocation change for GPIF (Government Pension Investment Fund) was officially announced on 31st Oct the same day as surprise easing by BOJ.
- GPIF is on the process of making this allocation shift, which transfer 20 trillion yen from domestic bonds to Japanese equity and foreign assets.
- The shift could be completed as early as in 2015.



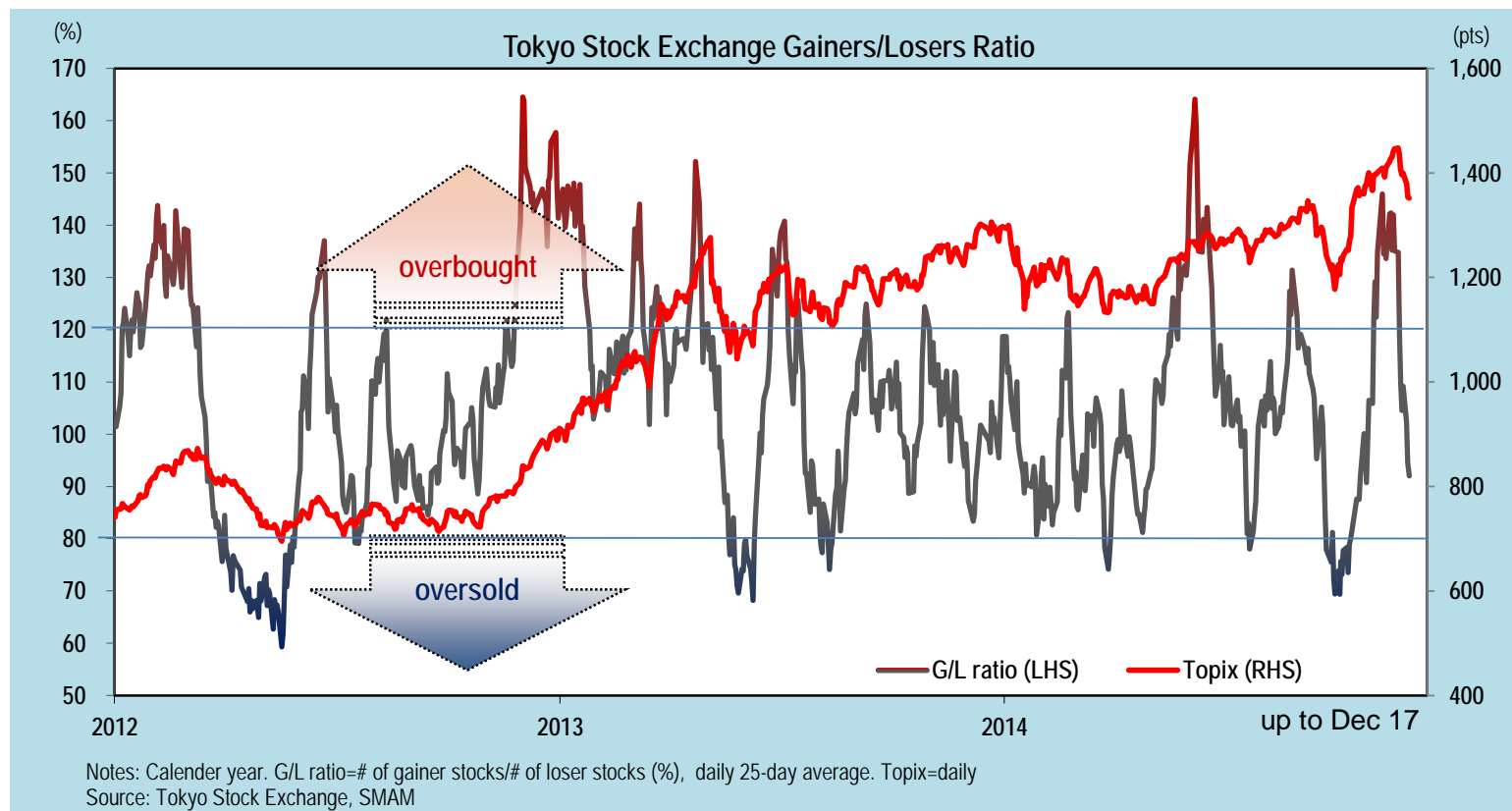
Japanese stock market looks fairly valued

- As of Dec 18 2014, IBES 12 month forward EPS forecast for TOPIX was 98.55. PER range after Abenomics has been mostly between 13x to 15x, which equals to 1281 and 1478 points for TOPIX index respectively based on this EPS.
- Current Japanese yen level is much weaker than the presumption rate for analysts forecasts and further upward revision can be expected. SMAM's current upside of the forecast range for TOPIX until March 2015 is 1550, which assumes 5% upward EPS revision to 103.48 and 15x PER.



Japanese market went through a short term retreat from overheating

- The ratio of number of stocks rose vs. fell is commonly used for monitoring heat in the stock market. The ratio over 120% is regarded as overheated.
- The ratio was extremely high at the beginning of December, and then retreated toward the Lower House election on 14th Dec. After further consolidation in the following week, the market made a rebound and could be ready for the next rally.



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