

# Japanese Stock Market Outlook

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SMAM monthly comments & views

~ December 2014 ~



Sumitomo Mitsui Asset Management

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## Executive summary

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### ➤ Japanese Economy

Jul-Sep GDP came out at surprisingly weak headline number of -1.6% QoQ annualized. This was due to inventory cut back by industries. Private consumption started to show recovery, though still fragile, and delaying the next consumption tax hike for 18 months could stimulate consumer sentiment.

- After the unexpectedly weak Jul-Sep figures, SMAM reduced FY14 GDP growth forecast to -0.5% from previous +0.1%. On the other hand, Forecast for FY15 was raised to 1.4% from previous 1.1% considering simulative effects from postponing next consumption tax hike.
- Exports turned positive in Jul-Sep and it could help Japanese industries as further weakening of yen is expected.

### ➤ Japanese Stock Markets

Surprising move by both BOJ and Abe government inspired a fresh life into the Japanese stock market. Snap election in December will provide Abe led LDP-Komeito coalition with re-strengthened political standings. Size of the supplemental budget spending and wage increase prospect for 2015 spring negotiation round would attract investors' attention for the short term.

- SMAM's forecast range for TOPIX is from 1300 to 1460 until December and from 1260 to 1520 for Jan-Mar 2015. Potential further upward earnings revisions on the back of weaker yen and GPIF's allocation shift to equities will be supportive for the stock market.
- Risks could be such as slowdown in US economy, heightening geopolitical tensions and Abe led coalition to face heavy loss in the election.

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# Outlook for the Japanese Economy

## SMAM economic outlook for FY14-15

- After unexpectedly weak Jul-Sep figures, SMAM reduced FY14 GDP growth forecast to -0.5% from previous +0.1%. On the other hand, Forecast for FY15 was raised to 1.4% from previous 1.1% considering simulative effects from postponing next consumption tax hike.
- Jul-Sep GDP was dragged down by inventory cut back by industries. Private consumption started to show recovery, though still fragile, and delaying the next consumption tax hike for 18 months could stimulate consumer sentiment.
- Exports turned positive in Jul-Sep, which could help Japanese industries as further weakening of yen is expected.

(%YoY except Net Exports)

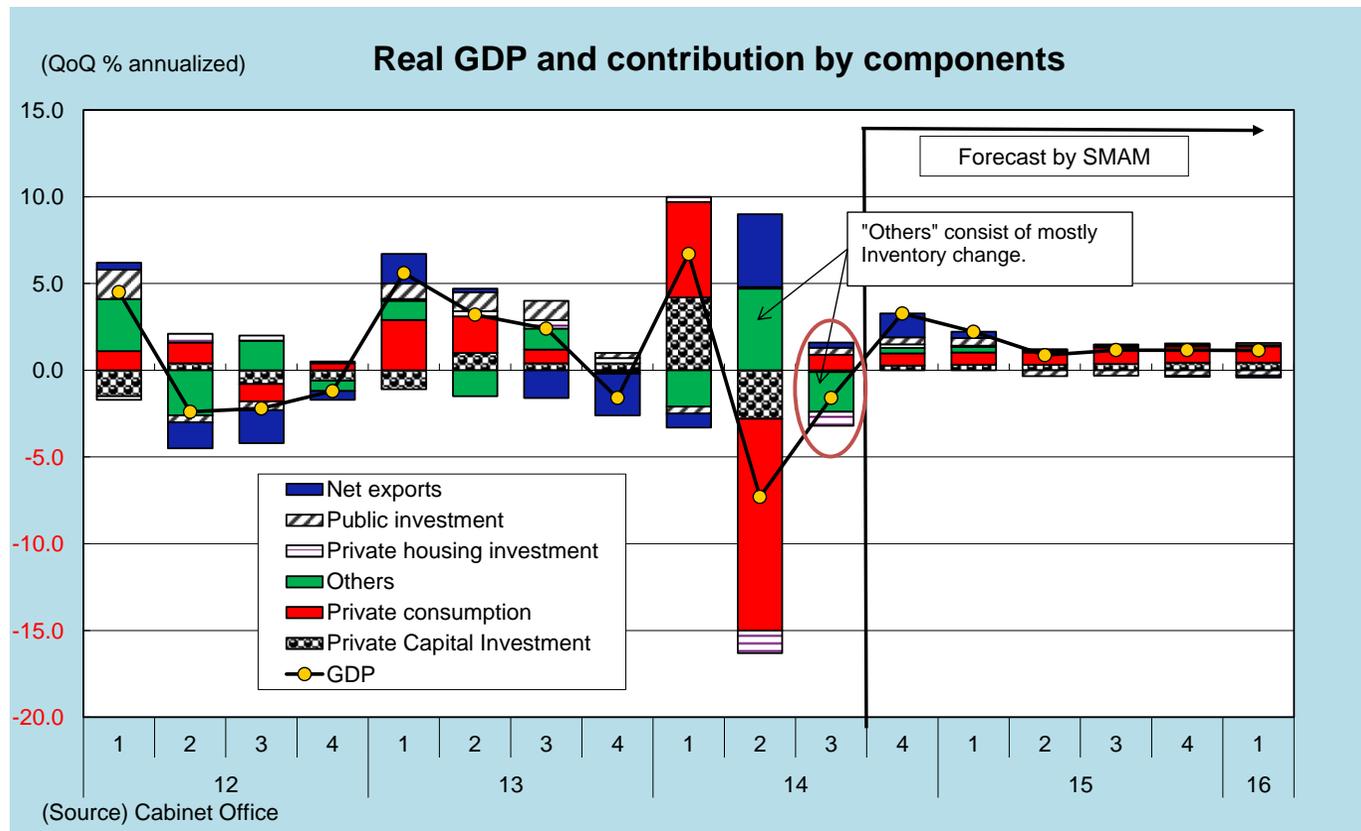
	FY11	FY12	FY13	FY14E	FY15E
Real GDP	0.3%	0.7%	2.2%	-0.5%	1.4%
Private Consumption	1.4%	1.5%	2.5%	-2.9%	1.4%
Housing Construction	3.2%	5.4%	9.5%	-10.1%	1.9%
Private Capital Investment	4.8%	0.7%	2.6%	1.3%	2.4%
Public Consumption	1.2%	1.5%	1.8%	0.5%	0.8%
Public Investment	-3.2%	1.3%	15.0%	4.4%	-1.0%
Net Exports (contrib. to growth)	-1.0%	-0.8%	-0.5%	0.6%	0.1%
Exports	-1.6%	-1.3%	4.8%	6.1%	3.8%
Imports	5.3%	3.6%	7.0%	2.3%	3.6%
Nominal GDP	-1.4%	-0.2%	1.9%	1.3%	2.4%
GDP Deflator	-1.7%	-0.9%	-0.4%	1.8%	1.1%

Notes: P=Official preliminary report, E=SMAM forecasts. SMAM views are as at 17 November 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

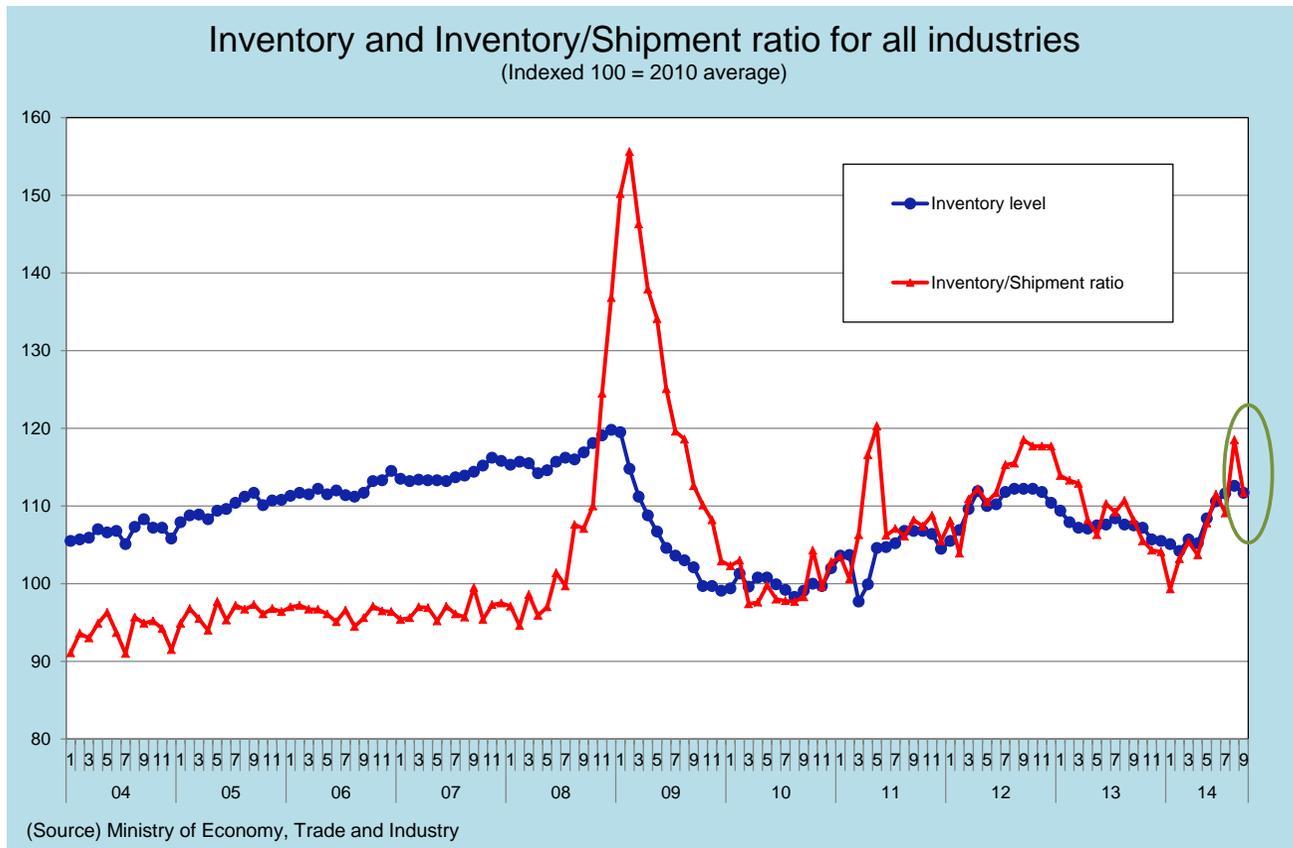
## Quarterly GDP : Inventory cut back by industries dragged Jul-Sep GDP into negative territory

- Jul-Sep GDP came out at surprisingly weak headline number of -1.6% (QoQ annualized and the same applies to the following numbers).
- This was due to inventory cut back by industries, which made contribution of -2.6% .
- Contribution of private consumption was up by 0.9% and expected to continue mild recovery going forward.



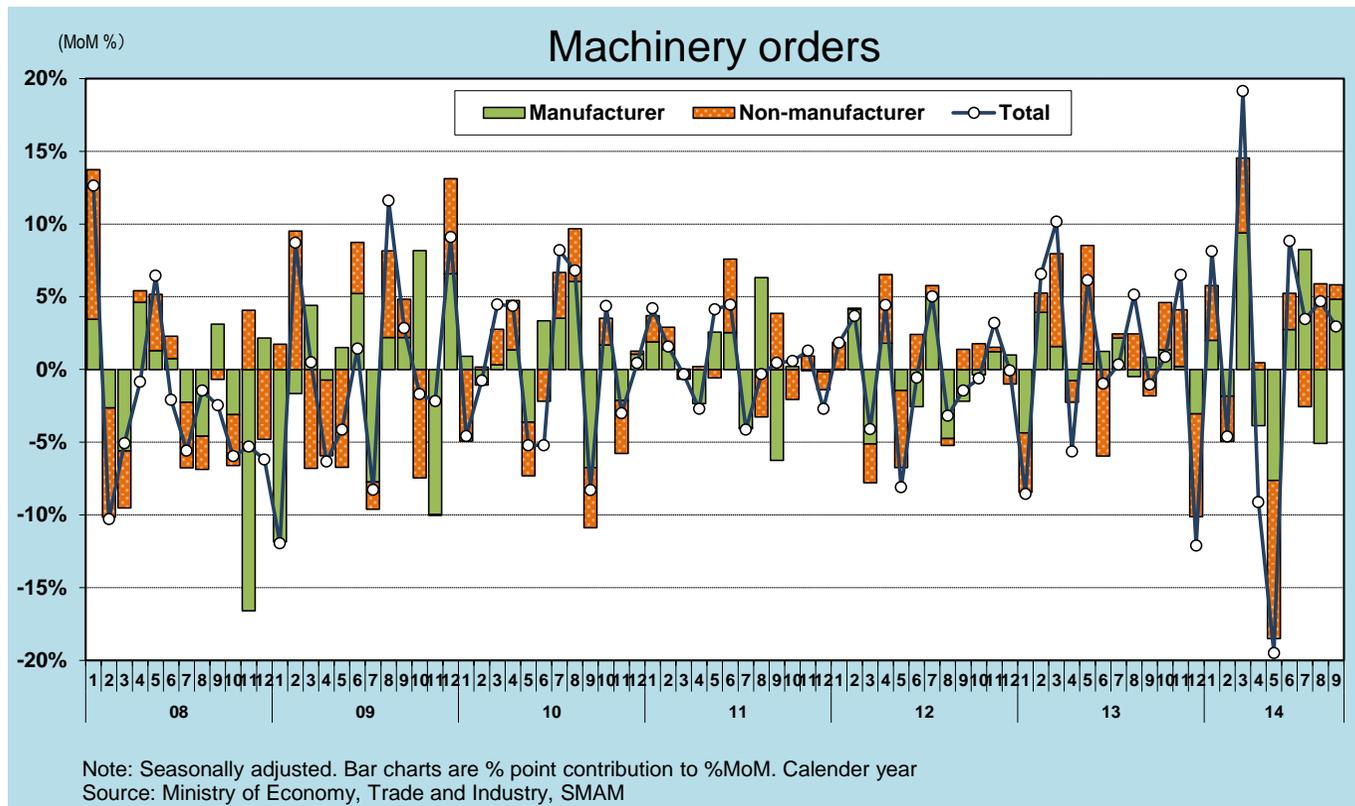
## Inventory rose to a historically high level and had a sharp cut back recently

- Monthly statistics show that inventory reached a historically high level in August, which seems to have triggered a sharp cut back in September.
- The progress in inventory adjustments is favorable for industries as increase in production becomes more likely when recovery in demand takes place.



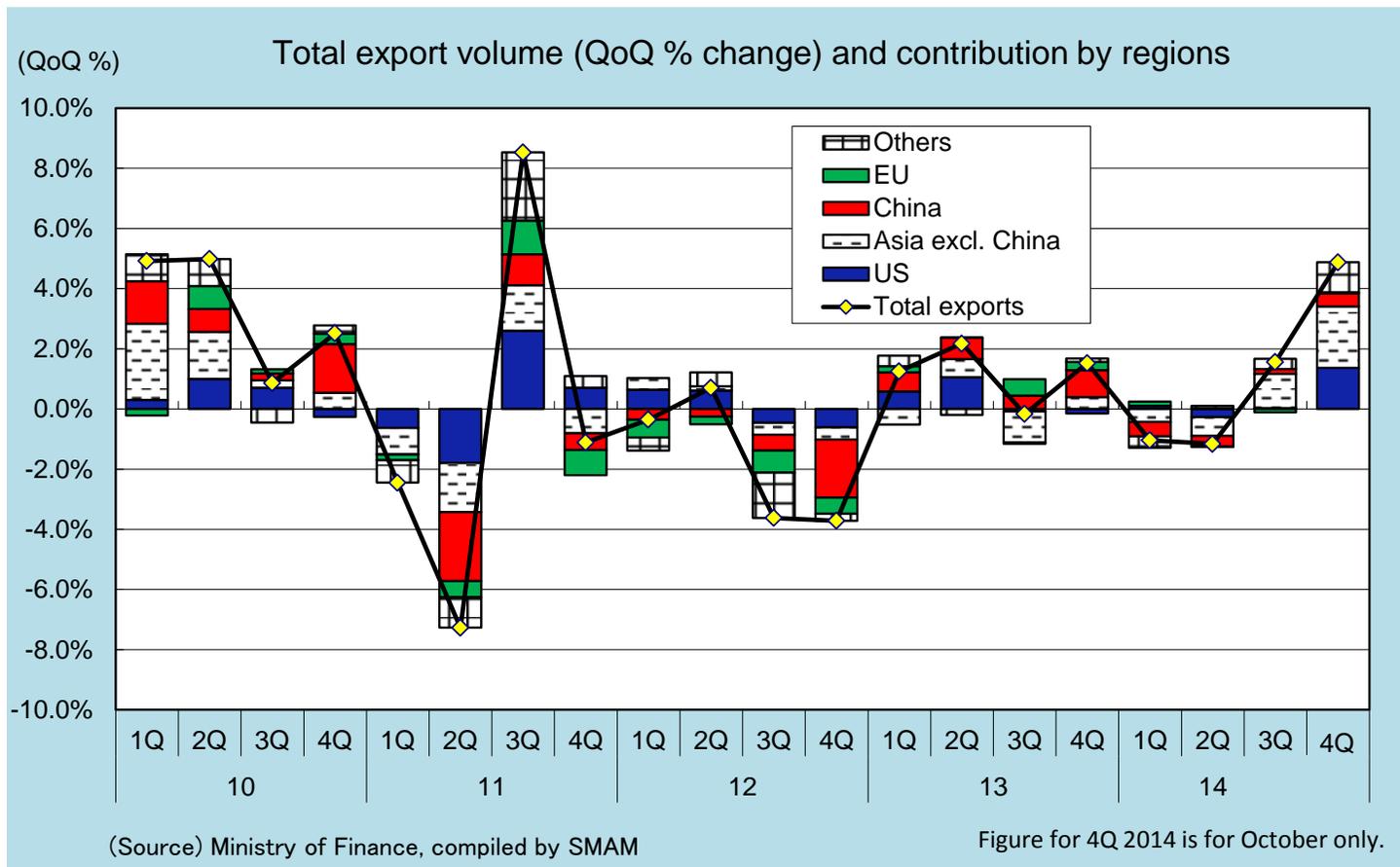
## Machinery orders seem stabilized after volatile 1H

- In the GDP statistics, private capital investment has stalled recording -2.8% and -0.1% for Apr-Jun and Jul-Sep respectively after the sharp increase in Jan-Mar at 4.2 % ( all figures are QoQ annualized contribution).
- However, machinery orders have been showing more stable increase in recent months, which could lead to the recovery in the capital spending in the near future.



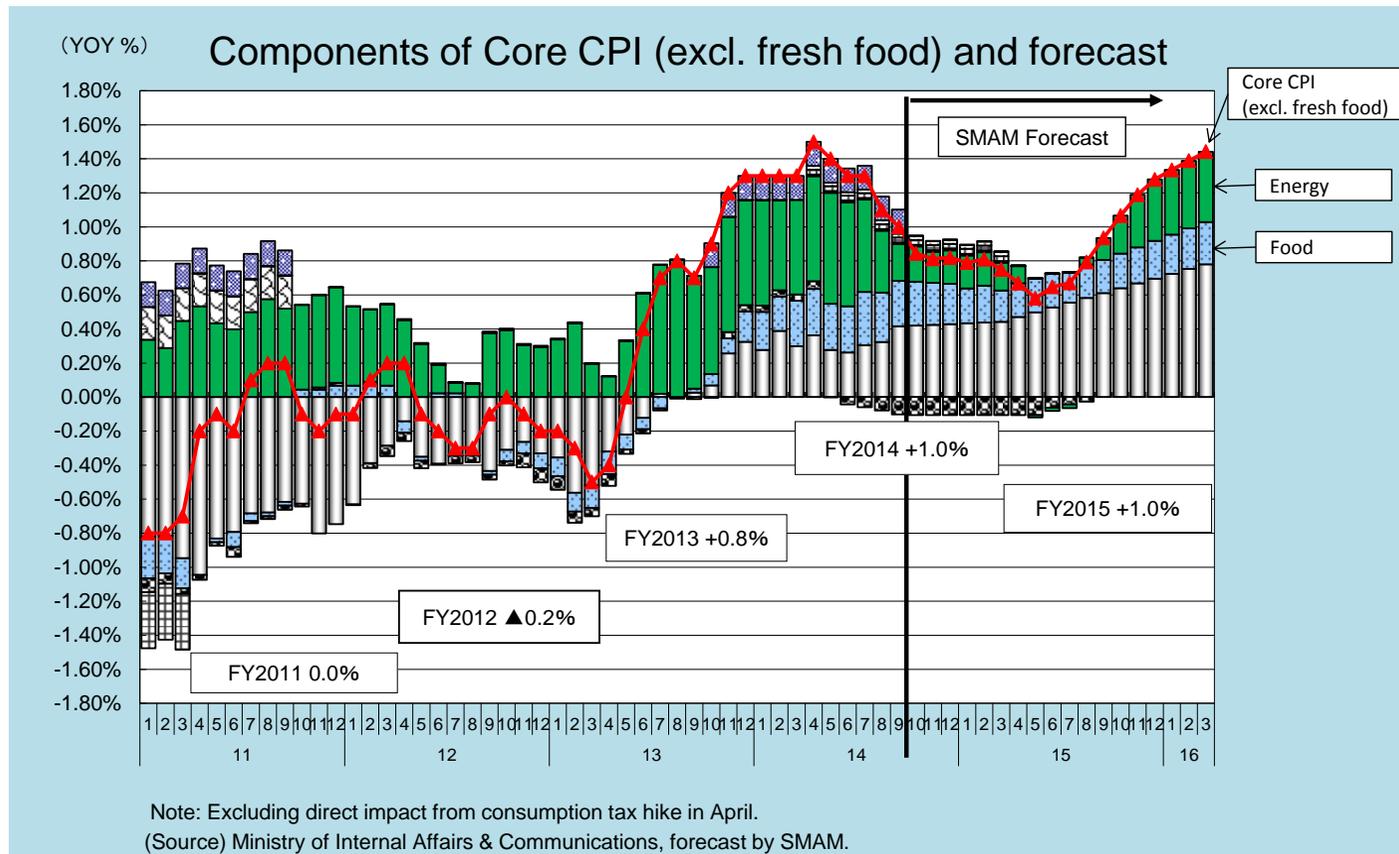
## Increase in exports could offer a helping hand to the Japanese economy

- As a silver lining for the Japanese economy, export volume started to increase in Jul-Sep quarter and accelerated in October helped by US, China and other Asian countries as destinations. Yen is forecast to get even weaker and increase in exports could be a supporting factor for the Japanese economy.



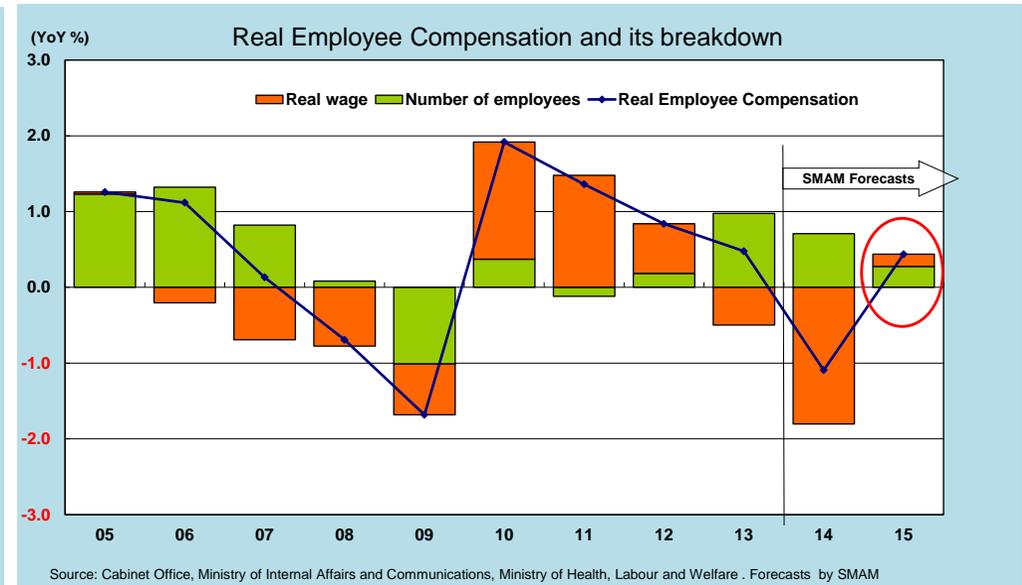
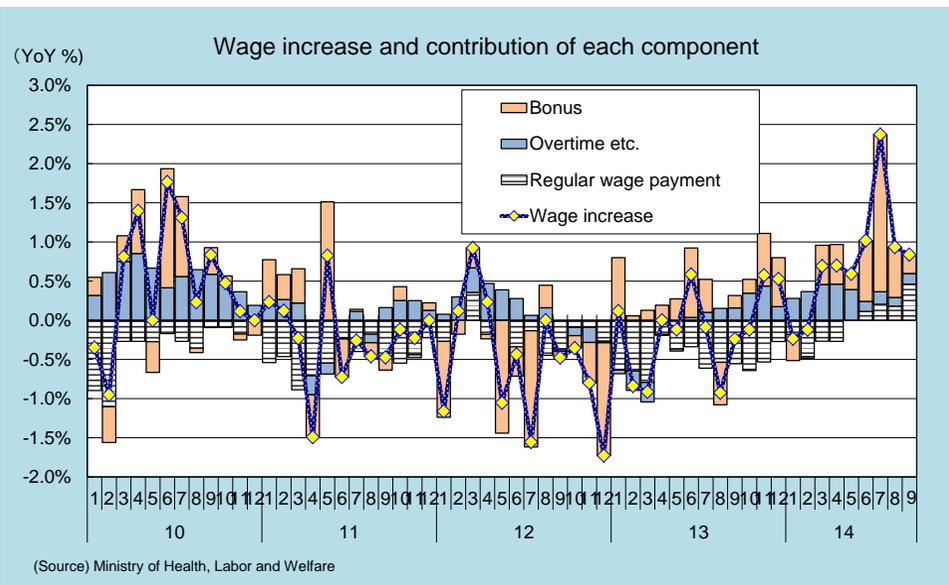
## CPI is expected to slow down on the back of diminishing contribution from energy

- BOJ surprised the global financial markets by announcing another massive monetary easing in October.
- SMAM's current forecast for CPI is still below BOJ's target of 2% and BOJ's nerve might face another test going forward despite the recent additional easing.



## Real wage increase in the next year came into sight after delaying the next tax hike

- Regular wage payment increased by 0.5% in September, for four consecutive months since June.
- Due to higher inflation, contracting real wage has proved too burdensome for the consumers so far.
- Postponing the next round of consumption tax hike paved the way for the increase in real wage in the next year, which is vital for the Japanese economy to decisively escape from the long standing deflation.



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# Outlook for the Japanese Stock Markets

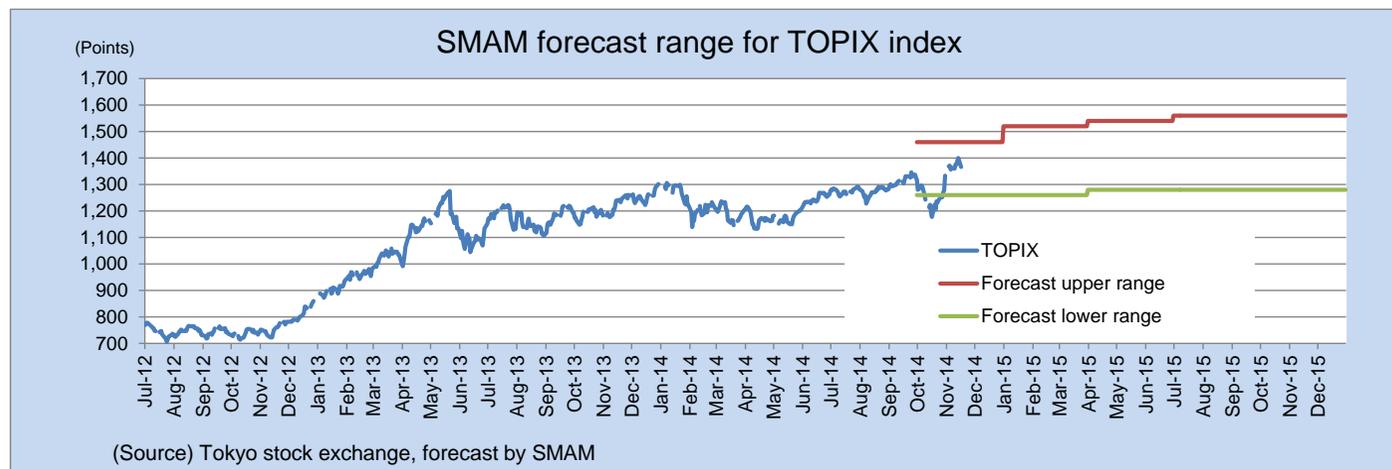
## Stock market outlook: Stimulative policy mix would work positively for the stock market

### SMAM short-term view

- Surprising move by both BOJ and Abe government inspired the fresh life into the Japanese stock market. Snap election in December will provide Abe led LDP-Komeito coalition with re-strengthened political standings. Size of the supplemental budget spending and wage increase prospect for 2015 spring negotiation round would attract investors' attention for the short term.
- SMAM's forecast range for TOPIX is from 1300 to 1460 until December and from 1260 to 1520 for Jan-Mar 2015. Potential further upward earnings revisions on the back of weaker yen and GPIF's allocation shift to equities will be supportive for the stock market.
- Risks could be such as slowdown in US economy, heightening geopolitical tensions and Abe led coalition to face heavy loss in the election.

### 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 Japan's admittedly slow but steady reforms.



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

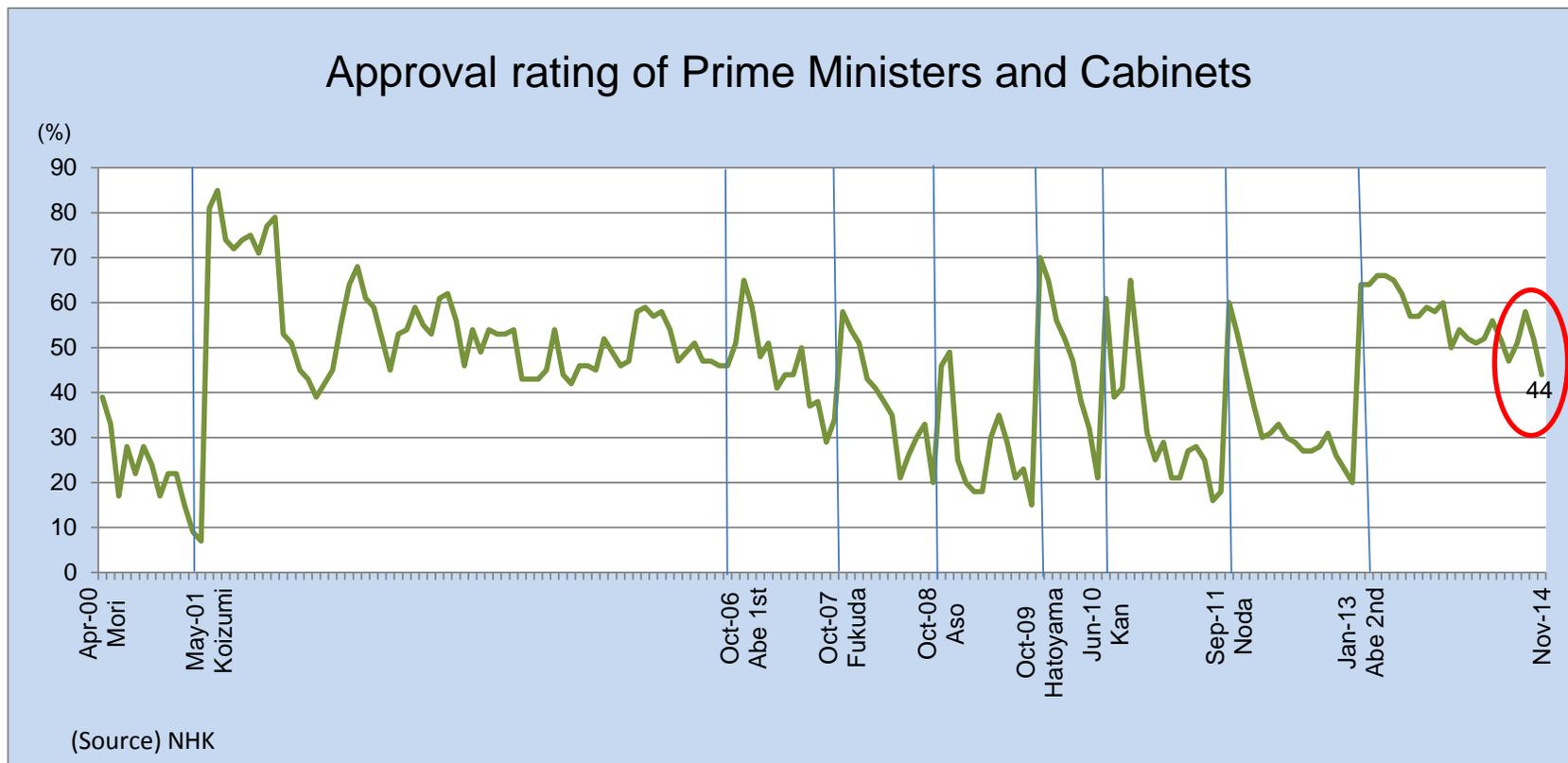
## Base scenario & Upside / Downside risks for our forecasts

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- Our **Base Scenario** is assuming the following views:
  - LDP Komeito coalition parties sustain large majority after the snap election in December
  - 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=JPY118 at CY14 end)
  - 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
  - LDP Komeito coalition parties face heavy loss of lower house seats at the snap election
  - Unsatisfactory earnings revisions by companies

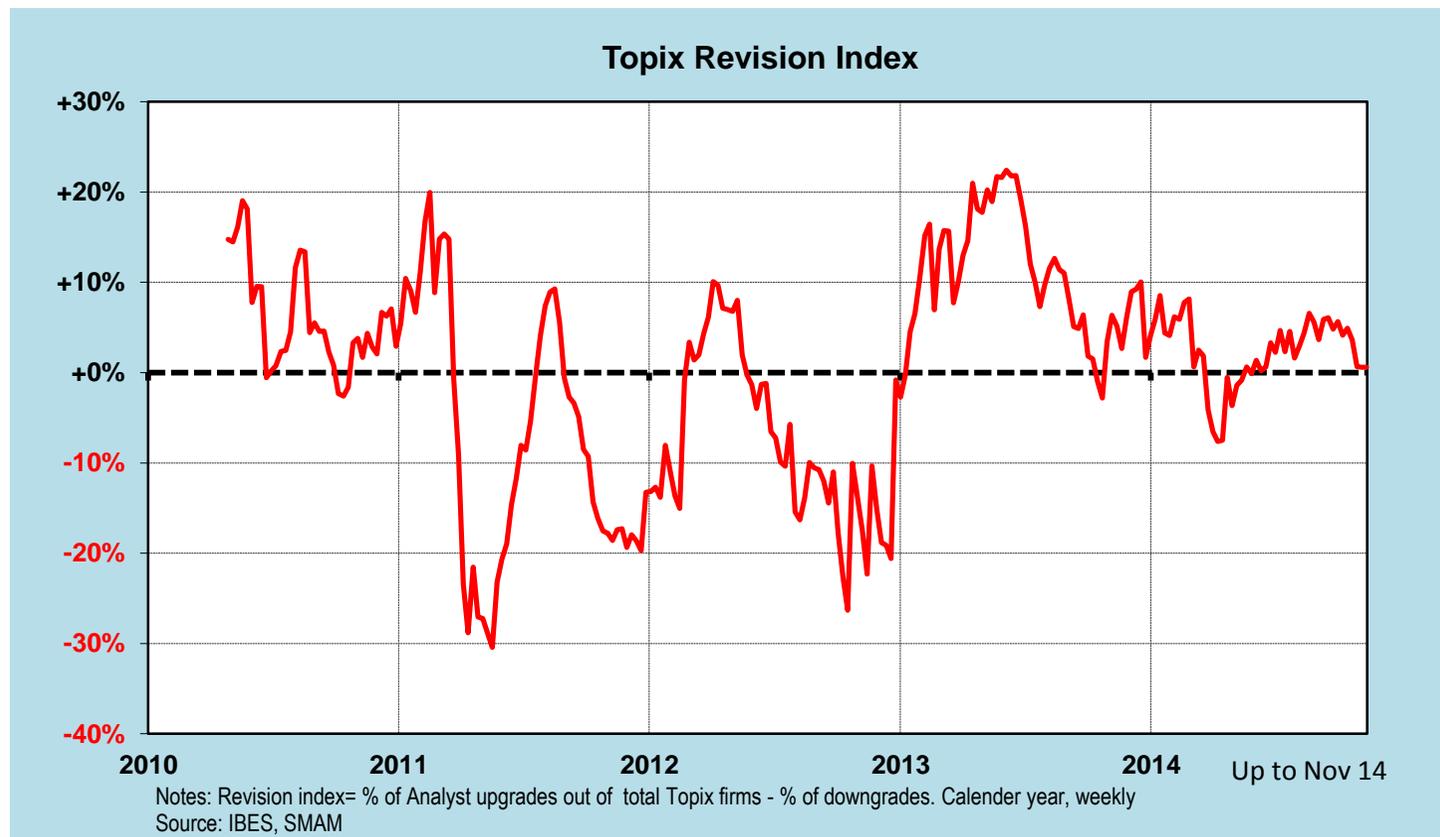
## Snap election is expected to reestablish political standings of PM Abe

- After resignation of two newly appointed cabinet ministers on money scandals, approval rating of PM Abe and his cabinet declined to 44% in November, dangerously close to the historically crucial 40% level.
- LDP has approval ratings of 36.6%, still far ahead of the leading opposition party DPJ at 7.9%, whereas 40% support no party. LDP and Komeito coalition is likely to keep large majority and reestablish its political standings through the snap election even if losing dozens of seats.



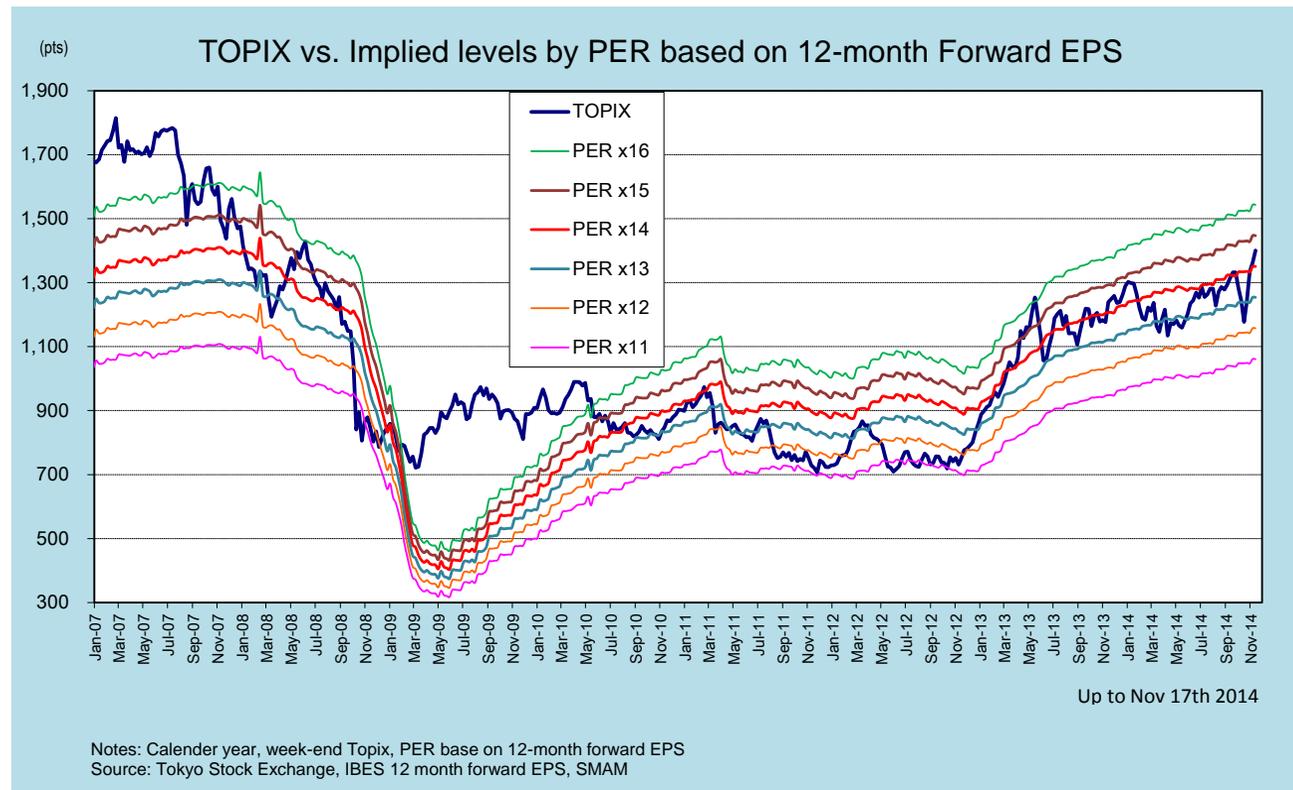
## Earnings forecasts entered a short lull period after the interim announcements

- After the consecutive upward revisions, it entered a lull hovering around the neutral level after most companies announced interim results.
- Japanese yen is getting weaker than the presumption rates on which analysts base their earnings forecasts and further upward revision can be expected going forward.



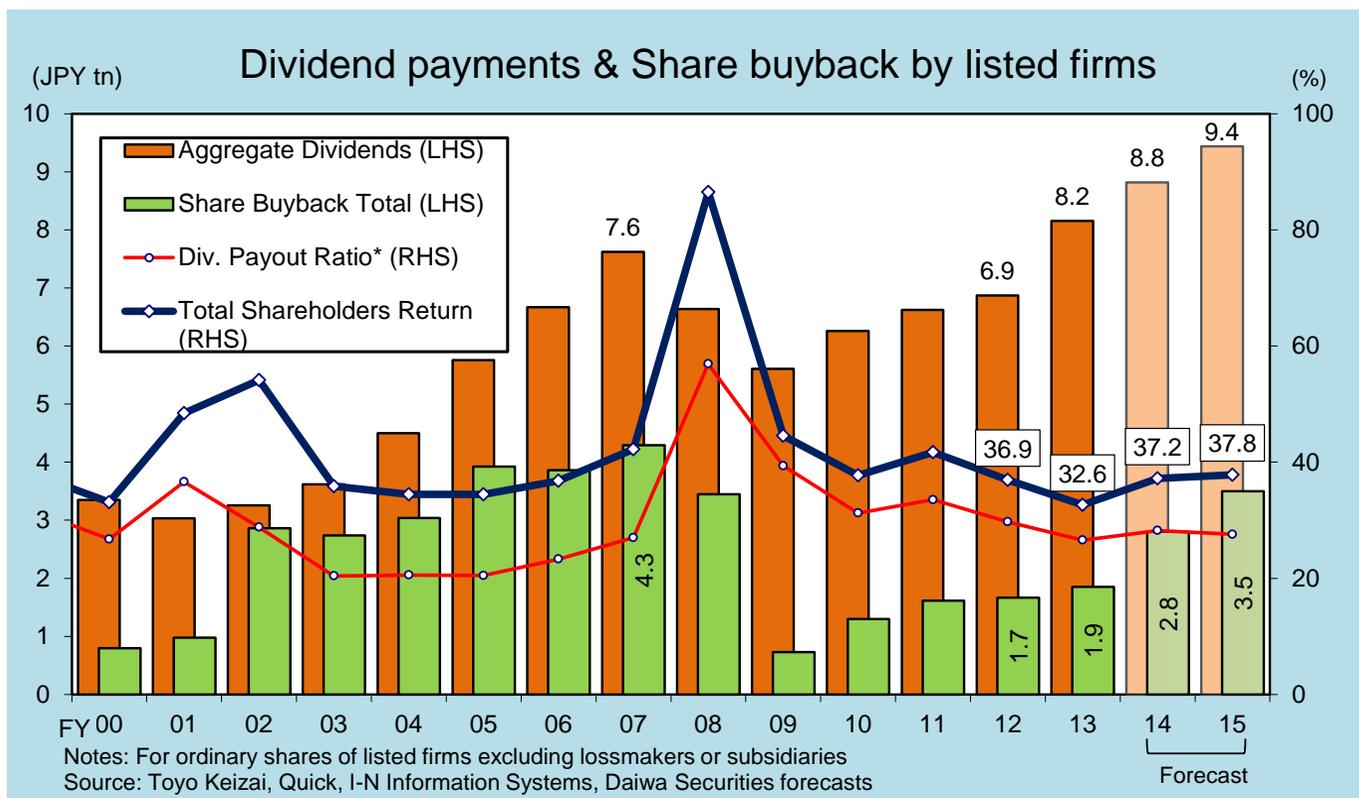
## Japanese stock market looks fairly valued

- As of Nov 17 2014, IBES 12 month forward EPS forecast for TOPIX was 96.45. PER range after Abenomics has been mostly between 13x to 15x, which equals to 1253 and 1446 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 1520, which assumes 5% upward EPS revision to 101.27 and 15x PER.



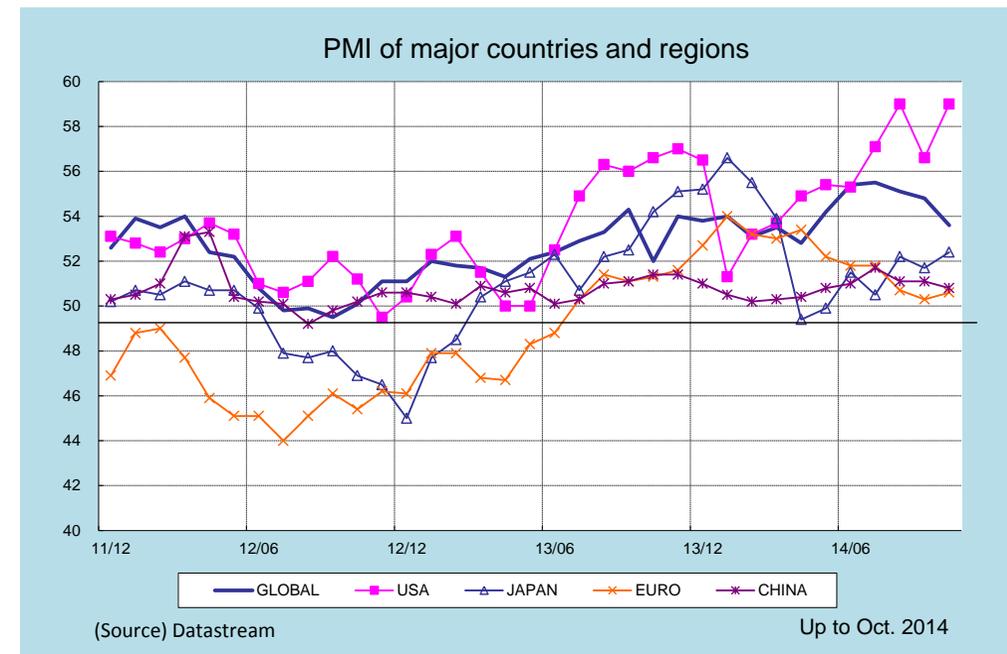
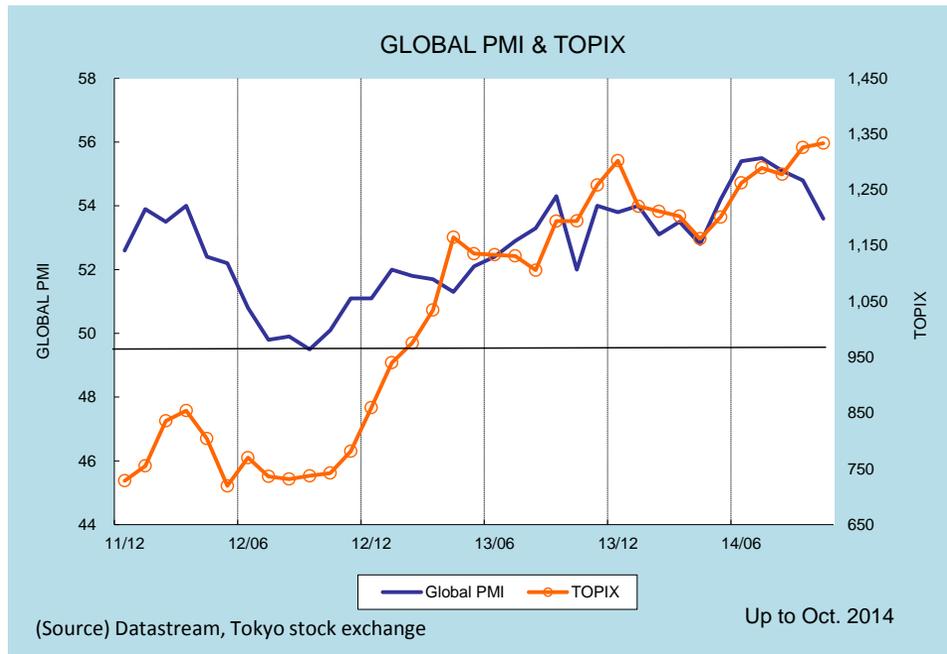
## Forecasts for shareholder returns are revised further upward

- SMAM monitors forecasts for shareholder returns every month, which has been showing upward revisions. Dividends for FY2014 and 2015 were revised upward by 0.2 and 0.3 trillion yen respectively in November from the previous month.
- Social environments are rapidly changing and companies are under pressure for making better management from shareholder views, which will improve the efficiency of the companies and should be beneficial for corporate value in the long term. Increasing number of companies are setting ROE targets these days.



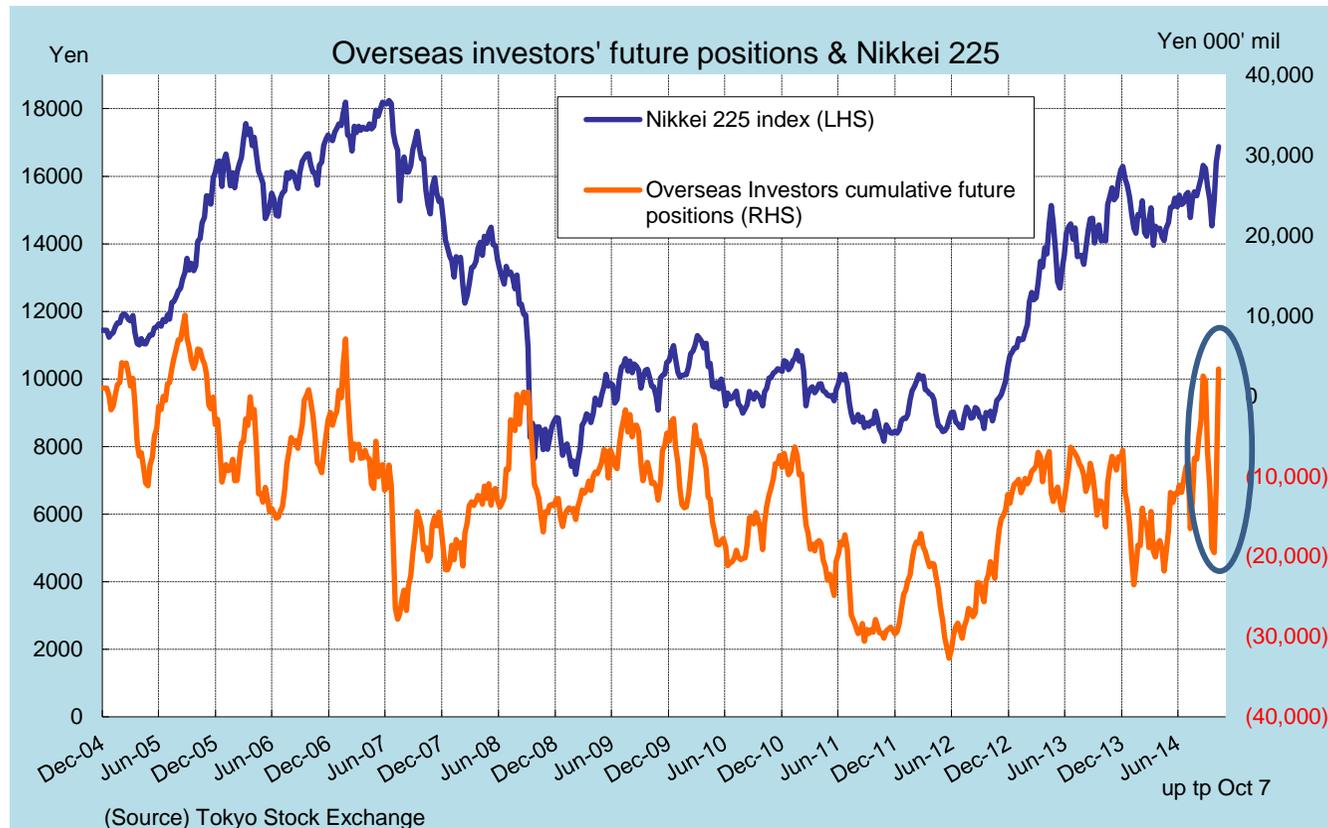
## Any material slowdown in global economy could be a risk for the stock market

- Observing the monthly movements in the charts below, Japanese stock market might be extended a little compared to the declining global PMI, which is sustained solely by US.
- US PMI has stayed at high level and could be due for a cyclical slowdown in the short term. Pick up in other countries and regions are much awaited.



## Future selling by overseas investors was swiftly rewound to open a new rally

- Future selling by overseas investors, which we pointed as a factor behind the correction in the stock market last month, was swiftly rewound to ignite recent rally in the Japanese stock market.



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