



Japanese Stock Market Outlook

SMAM monthly comments & views
- February 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Moderate economic recovery is ongoing, supported by Exports, while slow recovery is expected for Consumption as wage increase is vital to improve consumer's confidence and ongoing wage negotiation round hold the key.

- SMAM maintains full year forecast unchanged, although October-December GDP was revised up to +3.2% from +2.9%.
- Moderate economic recovery in 2015 is supported by favorable Exports, while Capex and Consumption are slow to recover.
- Core-CPI is expected to fall far from BOJ's target rate due to lower oil prices. Additional monetary easing might be required to accomplish its inflation target.

➤ Japanese Stock Markets

The market would advance discounting the increase in expectation of earnings up-revision at October-December quarter announcement, as SMAM EPS forecast and IBES consensus are going up.

- Corporate earnings are expected to be revised upward at October-December quarter and full year end, due to depreciation of JPY.
- After the global market correction in January, the overheat of Japanese market in December has faded away.
- Downside risk includes negative impact to real economy and capital market turmoil led by oil price plunge.

Outlook for the Japanese Economy

SMAM economic outlook for FY14-15

- SMAM maintains full year forecast for FY2014 and FY2015, while core-CPI forecast was revised down to +0.6% from 0.9% in FY2015 due to lower oil price.
- Moderate recovery is expected in FY2015 due to improvement in Exports and Production, while Consumption is expected slow to recover.
- SMAM forecasts current account surplus exceeding JPY15 trillion in FY2015 due to lower crude oil price. Trade deficit is anticipated to drop to JPY0.7 trillion in FY2015 from JPY10.7 trillion and JPY6.3 trillion in FY2013 and FY2014. *forecast is based on crude oil price of USD45 per barrel until YR2015/6 and USD60 thereafter
- Core-CPI is anticipated to fall into nearly “zero” as early as in April due to lower oil price. The expectation for additional monetary easing is increasing.

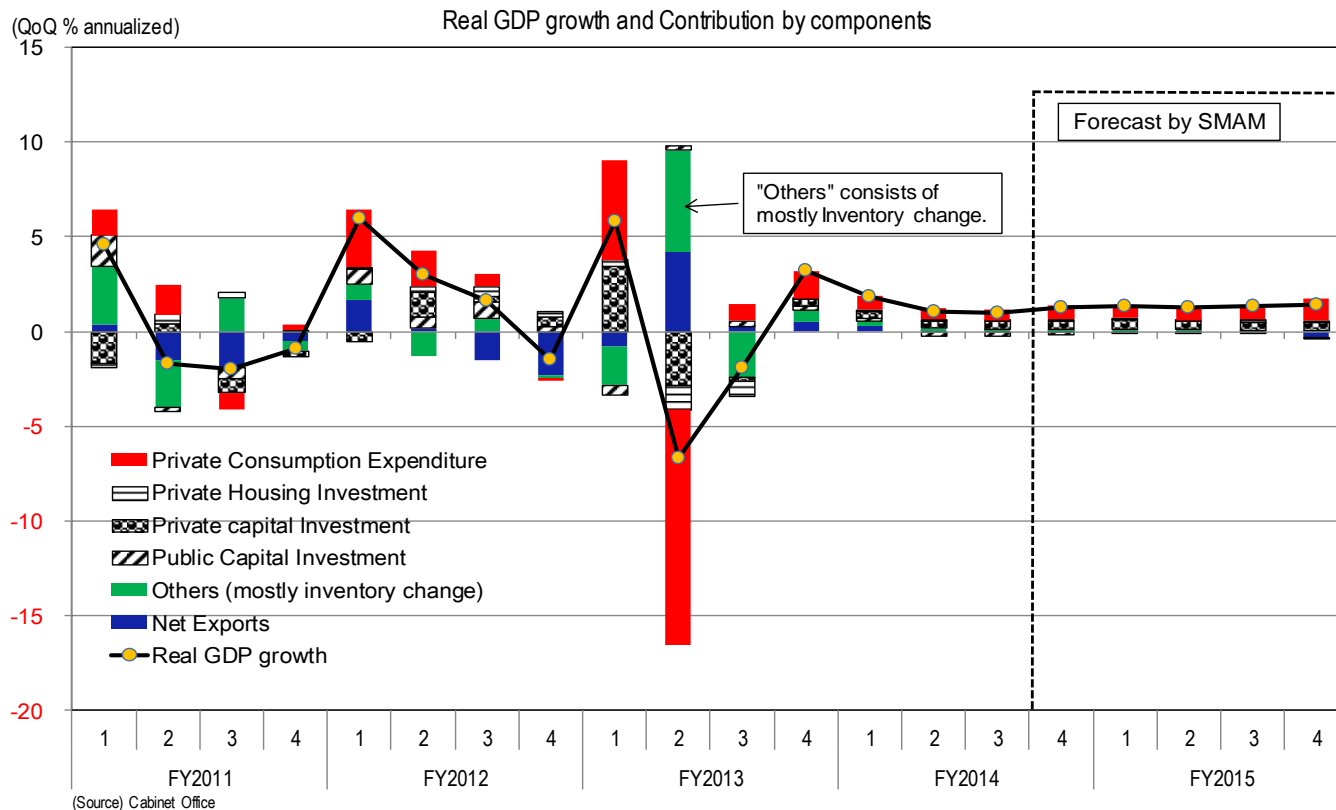
	FY11	FY12	FY13	FY14E	FY15E
Real GDP growth	0.4%	1.0%	2.1%	-0.6%	1.3%
Private Consumption Expenditure	1.4%	1.8%	2.5%	-2.9%	1.3%
Private Housing Investment	3.2%	5.7%	9.3%	-10.9%	1.1%
Private Capital Investment	4.8%	1.2%	4.0%	0.5%	2.6%
Public Consumption Expenditure	1.2%	1.5%	1.6%	0.5%	0.9%
Public Capital Investment	-3.2%	1.0%	10.3%	2.6%	-1.2%
Net Exports (contrib. to GDP 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%	1.1%	1.6%
GDP Deflator	-1.7%	-0.9%	-0.3%	1.7%	0.2%

(%, YoY except Net Exports)

Notes: P=Official preliminary report, E=SMAM forecasts. SMAM views are as at 16 January 2015 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

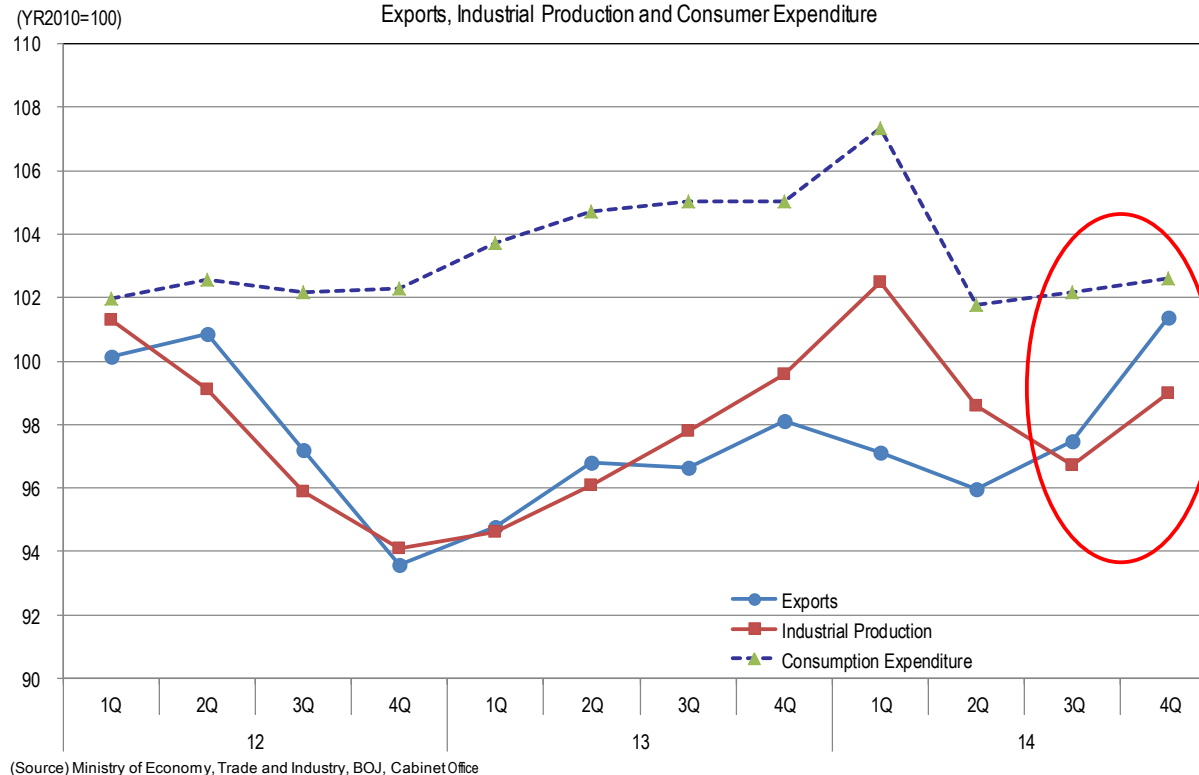
Quarterly GDP: Recovery from slowdown in Apr-June and July-Sept quarters

- October-December GDP forecast was revised up to +3.2% from +2.9%, and the economy is likely to bottom out in October-December from 2 consecutive quarter slowdown.
- Export volume is expected to expand to +4.3% QoQ ann. in October-December from +1.6% in July-September.



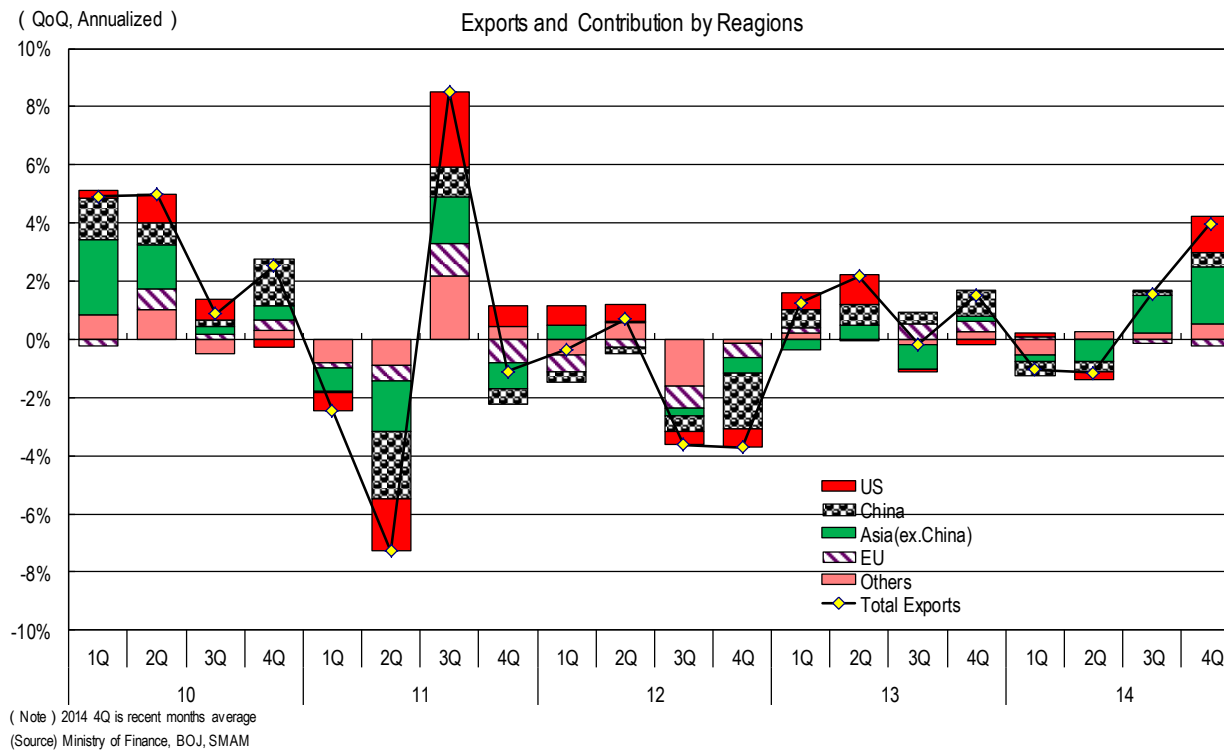
Recovery Process: Exports ⇒ Production ⇒ (Employment, Confidence) ⇒ Consumption

- SMAM forecasts this recovery process in order from Exports, Production and Consumption.
- Growing Exports are picking up Production from October-December quarter, while Consumption is lagging behind the others.
- Consumption is likely to recover eventually as wage is expected to increase through “Wage Negotiation Round” and successful wage increase could lift Consumer Confidence.



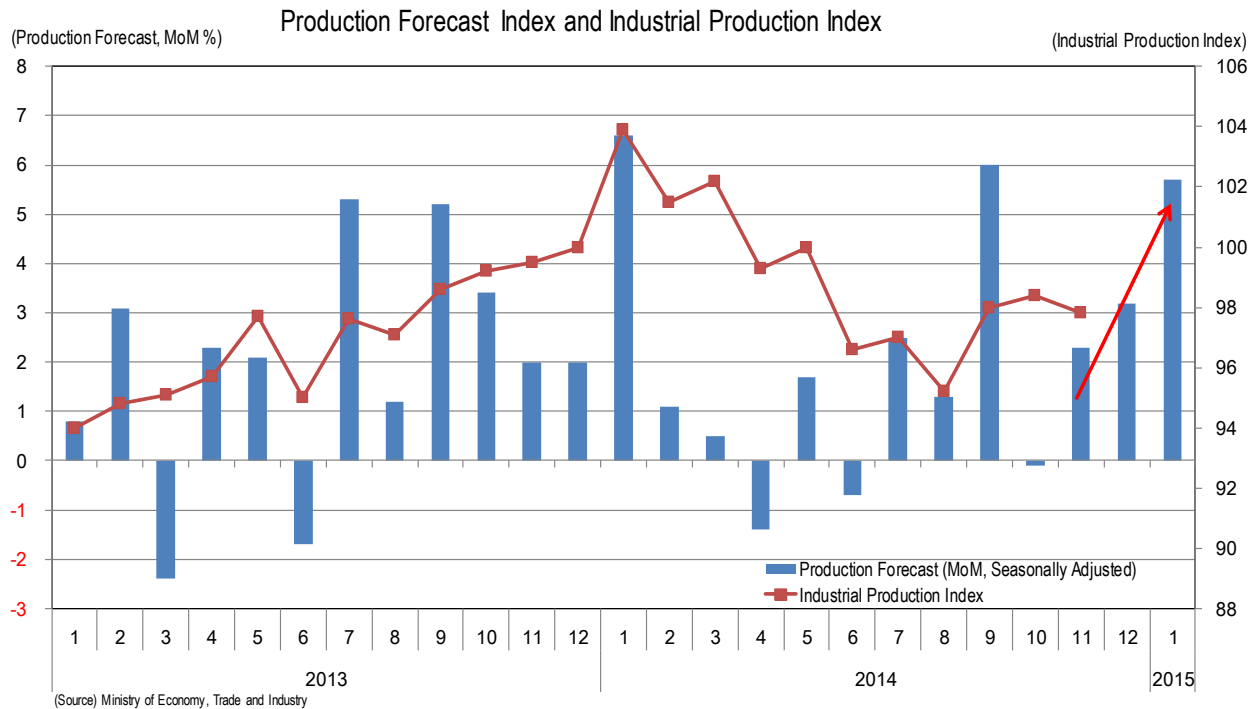
Exports: Accelerating Exports to U.S. & Asia and for IT-related goods

- Export volume is expected to grow to +4.3% QoQ ann. in Oct-Dec from +1.6% in July-September. Customs clearance based exports jumped +13.4 YoY in 1H of December.
- Exports to US and Asia as well as those for IT goods are favorably growing.



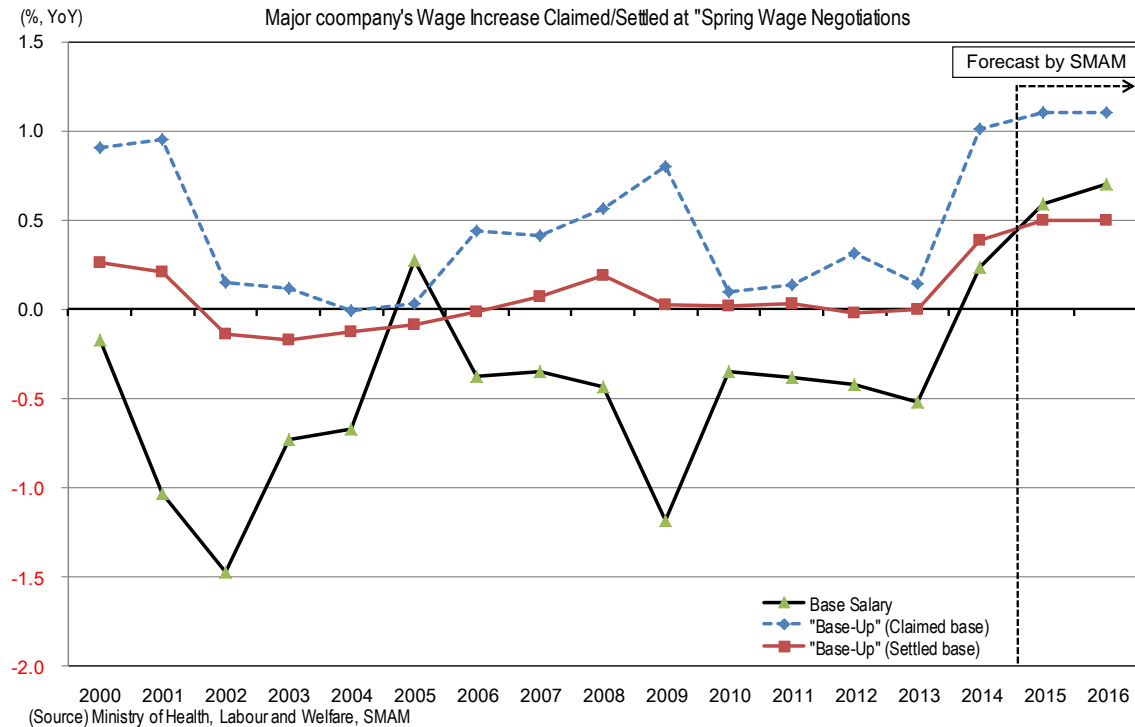
Production: Likely a temporary dip in November IP

- Industrial Production sank by -0.6% MoM in November, contrary to market consensus of +0.8%.
- In contrast, Production Forecast Index shows solid recovery of +3.2% MoM in December and +5.7% MoM in January, mainly led by IT related goods.



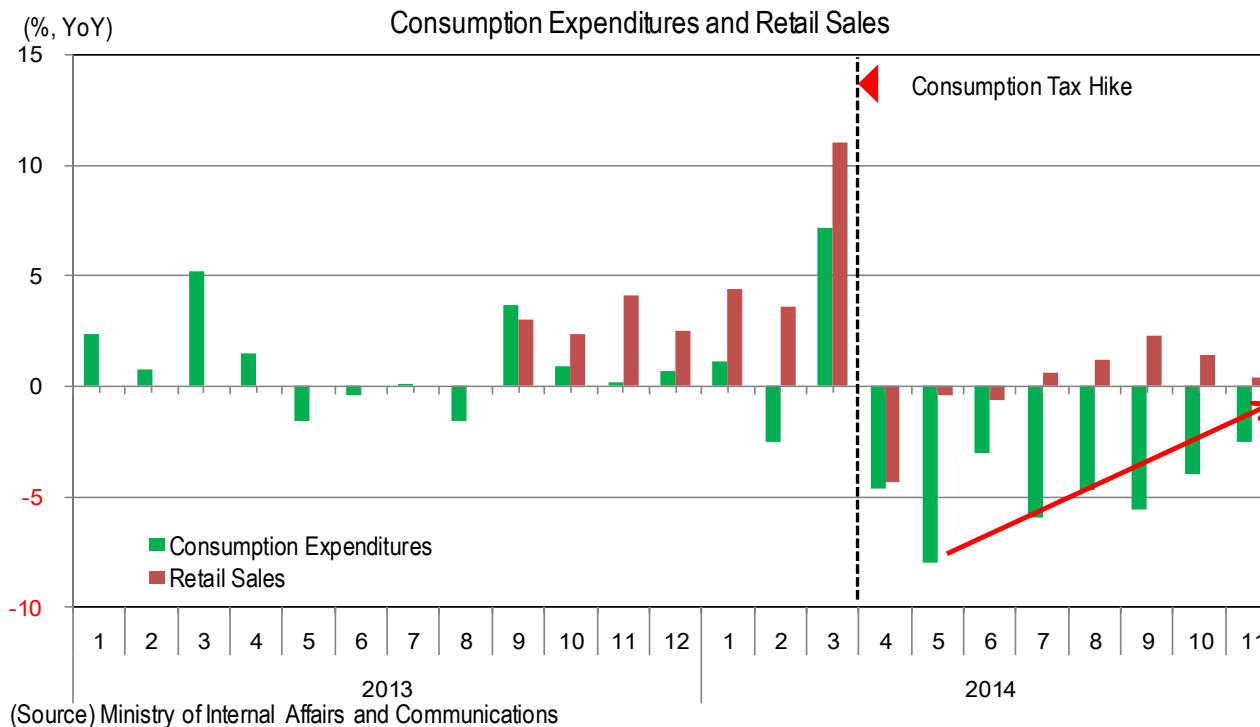
Employment & Confidence: +0.6% Wage increase to be expected

- Due to favorable corporate earnings, base salary is expected to grow to +0.6% YoY for FY2015 from +0.2% YoY in FY2014 through “Wage Negotiation Round” scheduled by the end of March.
- Pay scale increase, called “Base-Up” is also expected to grow to +0.5% YoY in FY2015 from +0.4% in FY2014.
- Real wage is also likely to increase by +0.3% YoY amid putting off the next consumption hike until 2017.



Consumption: Still slow but improving month by month

- Consumer expenditures were down by 2.5% YoY in November for 8 consecutive months since consumption tax hike in April.
- However, the negative gap has been decreasing. Negative impact of the tax hike would be finally going behind.
- November Retail Sales slightly gained by +0.4% YoY.
- SMAM expects Consumption expands by +1.3% YoY in FY2015 due to wage increase as well as wealth effect led by increasing stock market, although less than +1.0% base salary increase might be a limited impact to boost consumer confidence.



Outlook for the Japanese Stock Markets

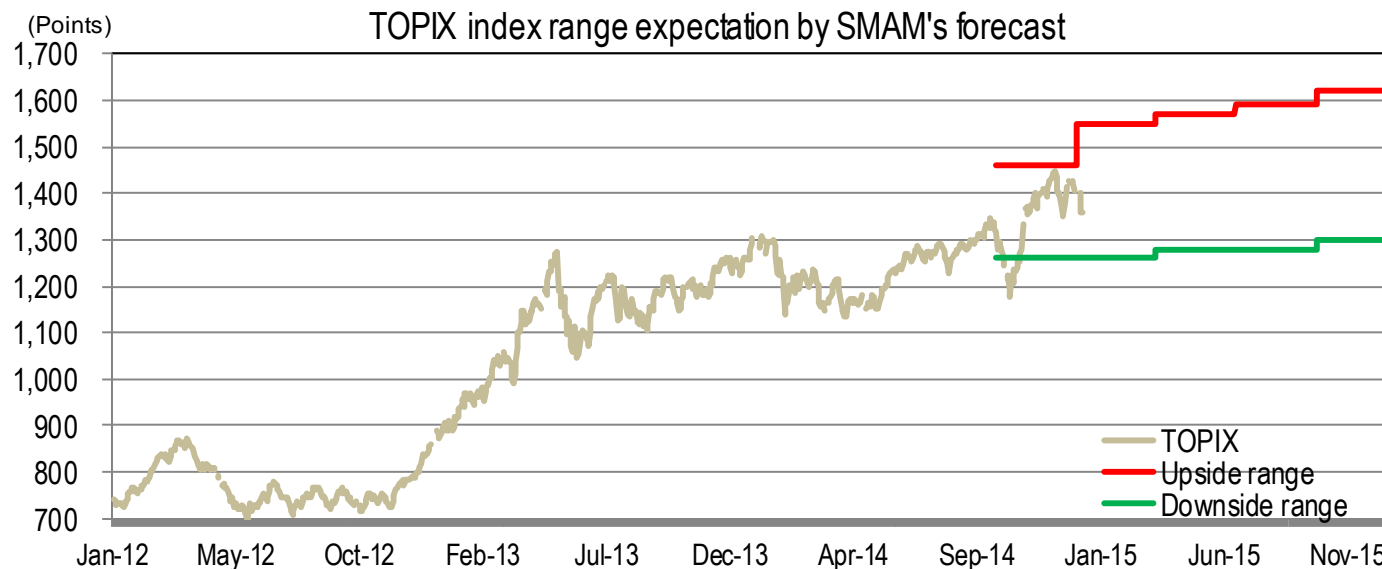
Stock market outlook: Strengthened reflationary policy should support the stock market

SMAM short-term view

- SMAM forecasts double digit earnings growth for 2 consecutive fiscal years. Expectation for corporate earnings up-revision is increasing prior to October-December quarter earnings release, due to depreciation of JPY.
- Downside risk includes negative impact to global economy and capital market turmoil triggered by oil price plunge and uncertain monetary policy in U.S. and Europe.

Longer-term outlook (6-month and beyond)

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



(Source) TOPIX: Tokyo stock exchange, Upside and Downside range: forecasted by SMAM
Note: SMAM's forecasts are as at 21 January 2015 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Reflationary policy to be continued by Abe government
 - Global economic recovery to be sustained led by strong US economy
 - Japan's recovery from tax-hit weak demand buoyed by rescheduled next tax hike until 2017
 - Growing expectations for positive corporate earnings revisions due to weaker JPY

- **Upside Risks** include:
 - Stronger global growth than expectation
 - Stronger measures than expectation by Abe administration

- **Downside Risks** include:
 - US and China's economy to slowdown
 - Concern about global deflation
 - Global capital market turmoil to be continued led by crude oil price plunge

Economic Stimulus Package: +0.3% to raise GDP

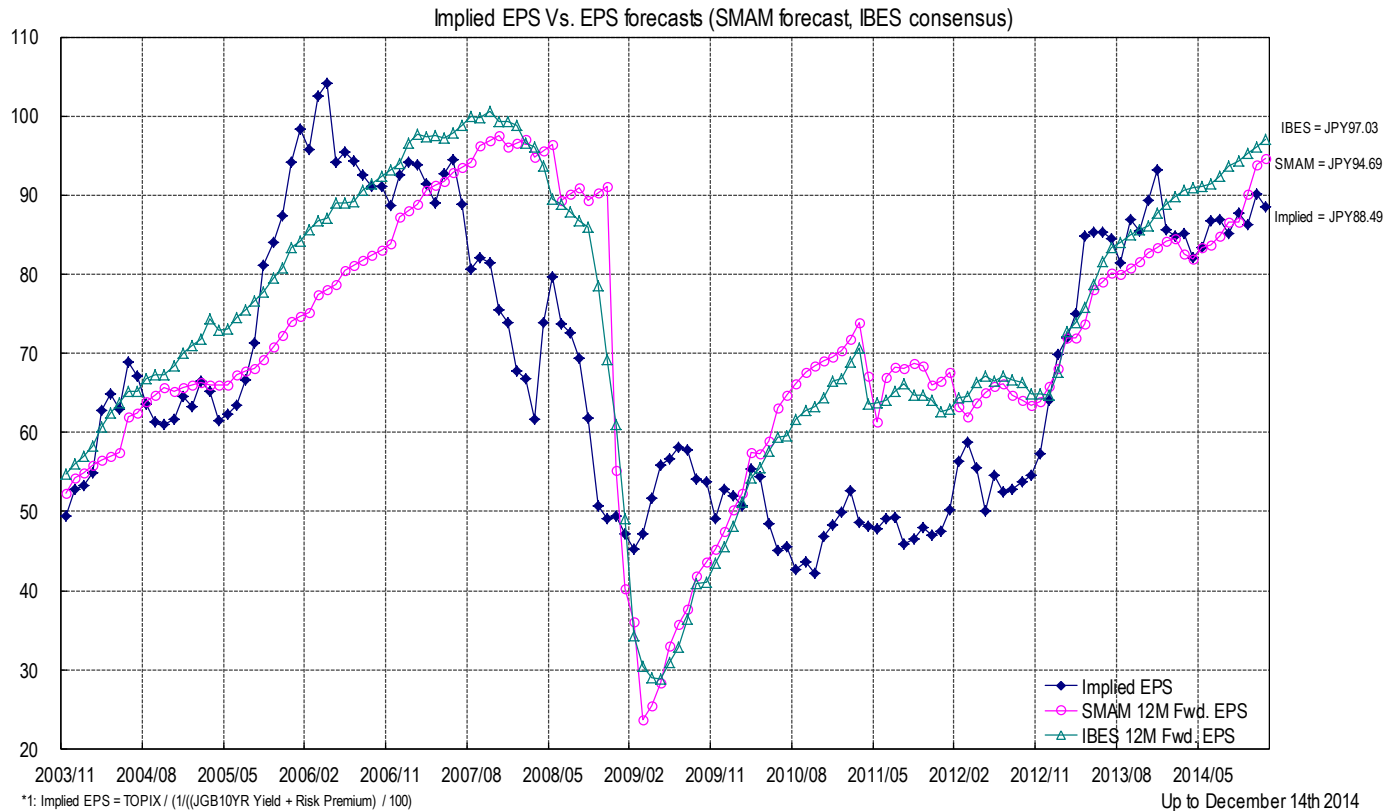
- Abe government released economic stimulus package on 11th January as “Emergency Economic Stimulus Package” for FY2014.
- SMAM expects the totaling JPY3.5 trillion supplemental budget to boost economy at most +0.3%.

Financial Size of Emergency Economic Stimulus Package and Its Impact to Economy			
Measures	Financial Size of Supplementary Budget (JPY trillion)	Budget/GDP (%)	Expected Impact to Economy (%)
Supporting mid-small businesses and human capital	1.2	0.24	0.05
Revitalizing the regional economy	0.6	0.12	0.02
Acceleration of the efforts for reconstruction of the areas damaged by the Great East Japan Earthquake	1.7	0.34	0.27
Total	3.5	0.70	0.34

(Source) Cabinet Office, SMAM

Implied EPS Vs. EPS forecasts: Upbeat EPS forecast

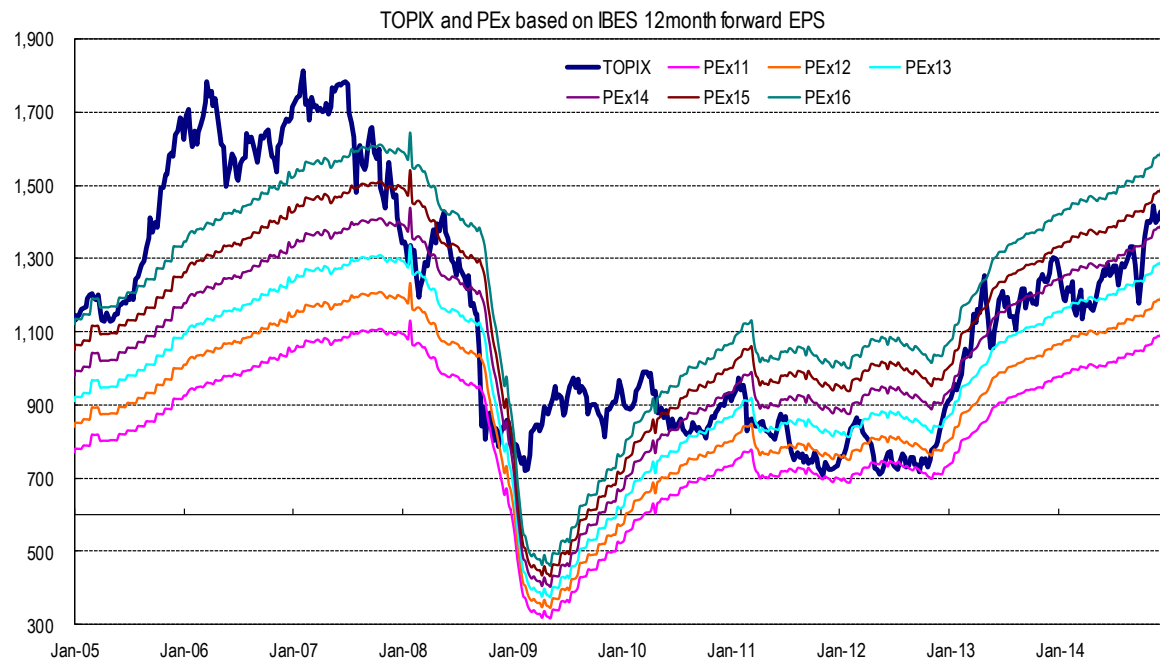
- EPS forecasts are rising led by increasing expectation of up-revision of corporate earnings. The both EPS forecasts of IBES consensus and SMAM forecast are currently JPY97.03 and JPY94.69 higher than JPY88.49 of Implied EPS.
- Japanese equity market is likely to discount upbeat earnings momentum.



*1: Implied EPS = TOPIX / (1/(JGB10YR Yield + Risk Premium) / 100)
 *2: SMAM forecast is expected based on earnings projection of ERG core univ. (exc. Financials)
 *3: IBES consensus is TOPIX based EPS
 *4: Risk Premium is 2 YR average
 (Source) IBES 12month forward EPS, SMAM

TOPIX range forecast: Fairly valued but further upside potential

- IBES 12 month forward EPS forecast for TOPIX was JPY100.27 as of January 16 2015. PE multiple has ranged between 13x and 15x since Abe government started. Based on these values, TOPIX is evaluated between 1,304 and 1,504, which shows current Japanese stocks and TOPIX 1,363 as of January 16 are fairly valued within this range.
- Assuming weaker JPY and lower oil prices such as USD/JPY=120 and WTI=USD50/barrel, corporate earnings would be revised up by +5%. The +5% increase in EPS forecast raises TOPIX range to between 1,368 (13x) and 1,579 (15x).

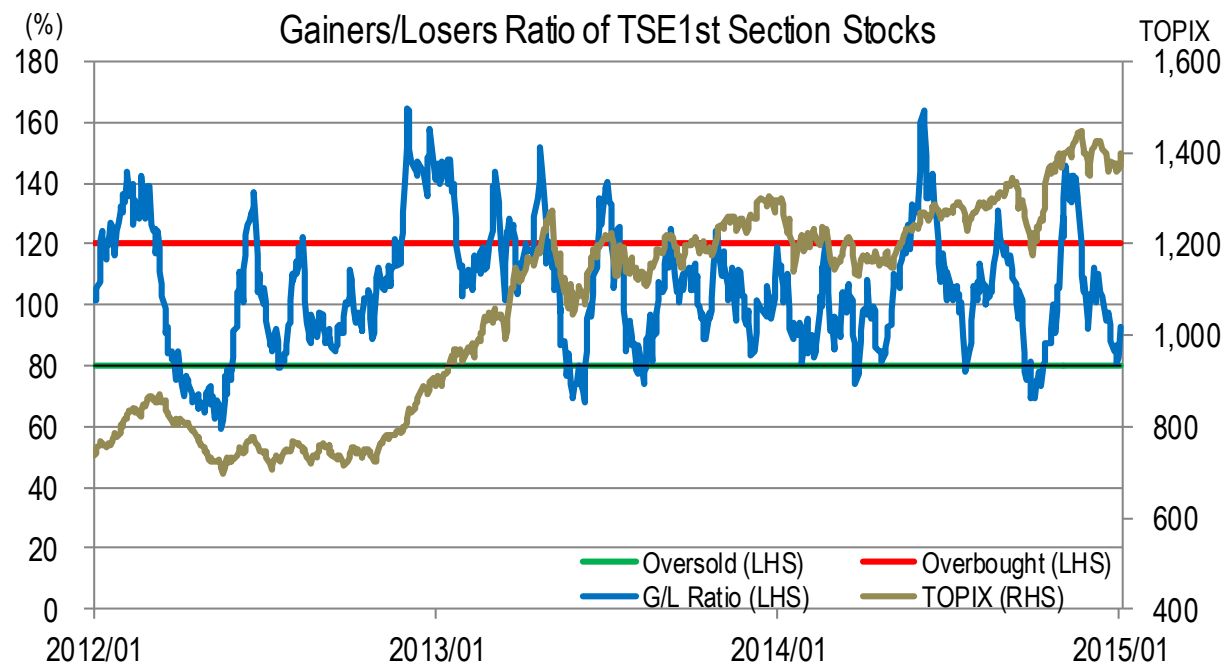


*1: Calendar year, week-end Topix, PEx based on IBES 12month forward EPS
 *2: SMAM forecast is expected based on earnings projection of ERG core univ. (exc. Financials)
 (Source) Tokyo Stock Exchange, IBES 12month forward EPS, SMAM

Up to January 16th 2015

Technical analysis: Overheating has retreated

- The ratio of number of stocks rose vs. fell is commonly used for monitoring heat in the stock market. The current ratio of 90% indicates slightly lower than neutral.
- The market has retreated from overbought in December and return to neutral range through global equity market correction in 1H of January triggered by crude oil price plunge. Japanese market could be ready for the next rally buoyed by strong October-December quarter corporate earnings released from the end of January.



1*: Calendar year, G/L Ratio=# of gainers stocks/# of Losers stocks (%), daily 25 day average

Up to January 21th 2015

2*: Topix-daily

(Source) Tokyo Stock Exchange. SMAM

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