

# Japanese Stock Market Outlook

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SMAM monthly comments & views

- June 2015 -



Sumitomo Mitsui Asset Management

SMAM

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## Executive summary

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### ➤ Japanese Economy

Japan's economic recovery is under way, as robust Exports and Industrial Production lead the moderate growth. Meantime, faltering Consumption Expenditures are expected to recover due to higher real wages led by nominal wages gain and subdued inflation rate.

- SMAM maintained real GDP forecast at +1.5% in FY2015 and +1.9% in FY2016 respectively.
- Consumption Expenditures are likely to recover from middle of this year on expectations for the increase in nominal wages and wealth effect boosted by higher stock prices.
- Core-CPI is highly likely to stay far below from the inflation forecast by BOJ, but the bank is less likely to move to additional easing.

### ➤ Japanese Stock Markets

Current stocks are fairly valued on upbeat corporate earnings. There would be still some room for upward revision in profit forecast and enhancement in shareholder return by the companies.

- FY2015 corporate profits are expected to be revised upward due to weak JPY and low crude oil price.
- Further improving shareholder return would lift the share prices, while shareholder return remains still low.
- Overseas investors are still increasing net long position in April.
- Downside risk is associated with foreign factors such as geopolitical concerns, unclear monetary policy by Fed and ECB, and possibly negative effects by crude oil price slump.

Notes: Macro and market views are as of May15 and 18, 2015 respectively, and subject to updates thereafter without notice

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# Outlook for Japanese Economy

## SMAM economic outlook for FY15-16

- SMAM maintained real GDP forecast of +1.5% for FY2015 and +1.9% for FY2016.
- Solid economic recovery is on track as Exports and Production are expanding modestly along with US led global growth. Private Consumption is likely to recover from mid 2015 as higher nominal wages and subdued inflation should support the consumer sentiment.

|                                      | FY12  | FY13  | FY14E  | FY15E | FY16E |
|--------------------------------------|-------|-------|--------|-------|-------|
| Real GDP growth                      | 1.0%  | 2.1%  | -1.0%  | 1.5%  | 1.9%  |
| Private Consumption Expenditure      | 1.8%  | 2.5%  | -3.0%  | 1.7%  | 2.0%  |
| Private Housing Investment           | 5.7%  | 9.3%  | -11.8% | 0.2%  | 4.4%  |
| Private Capital Investment           | 1.2%  | 4.0%  | 0.1%   | 2.7%  | 3.2%  |
| Public Consumption Expenditure       | 1.5%  | 1.6%  | 0.5%   | 0.9%  | 0.5%  |
| Public Capital Investment            | 1.0%  | 10.3% | 3.1%   | -1.6% | -1.6% |
| Net Exports (contrib. to GDP growth) | -0.8% | -0.5% | 0.7%   | 0.3%  | 0.1%  |
| Exports                              | -1.3% | 4.7%  | 7.2%   | 5.3%  | 5.0%  |
| Imports                              | 3.6%  | 6.7%  | 3.0%   | 4.0%  | 5.2%  |
| Nominal GDP                          | 0.1%  | 1.8%  | 1.3%   | 2.0%  | 2.4%  |
| GDP Deflator                         | -0.9% | -0.3% | 2.3%   | 0.6%  | 0.5%  |

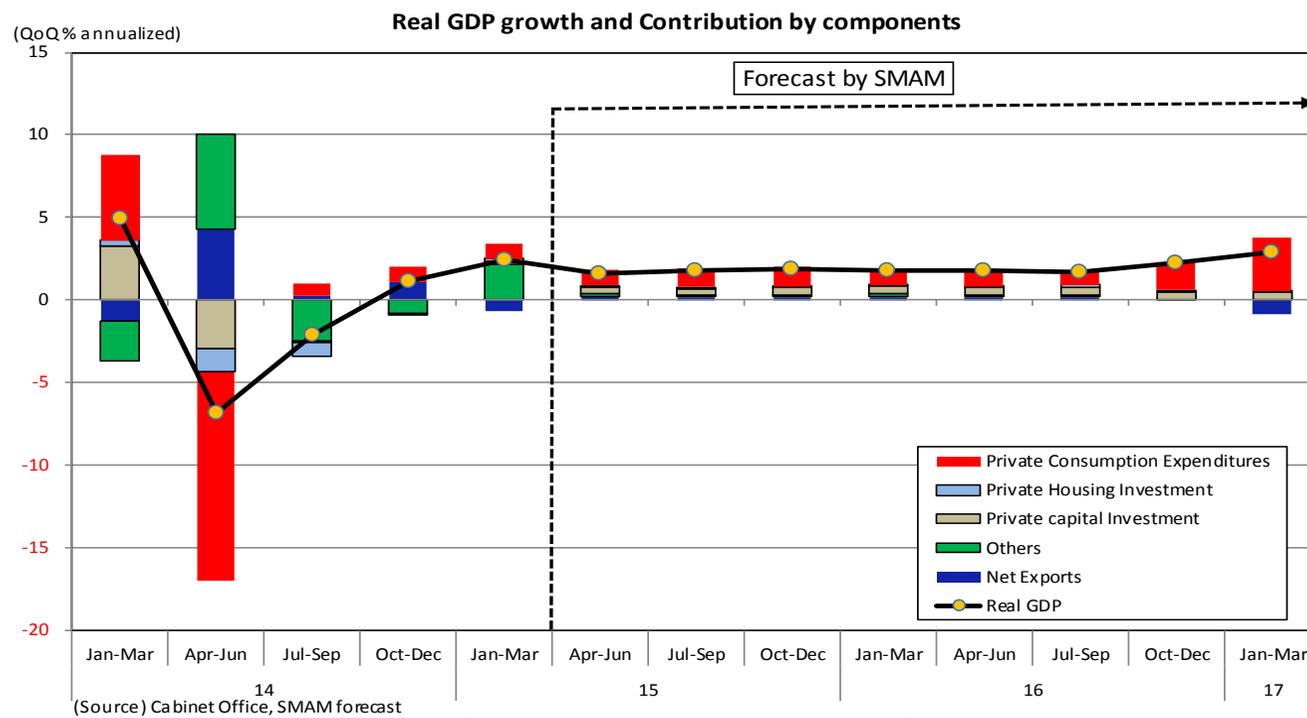
Notes: E=SMAM forecasts. SMAM views are as of May15, 2015 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

## Quarterly GDP: SMAM expects moderate growth

- January-March real GDP released on May 20<sup>th</sup> rising annualized +2.4% QoQ led by the increase in inventory. SMAM maintained quarterly real GDP forecast of +1.6% annualized in April-June, +1.7% in July-September and +1.8% in October-December in FY2015.
- Bank of Japan put off the timing for achieving 2% inflation to “around the first half of FY2016” from “in or around FY2015.” SMAM expects that the bank revises its forecast further downward, however the bank keeps on hold its current monetary policy during this year.



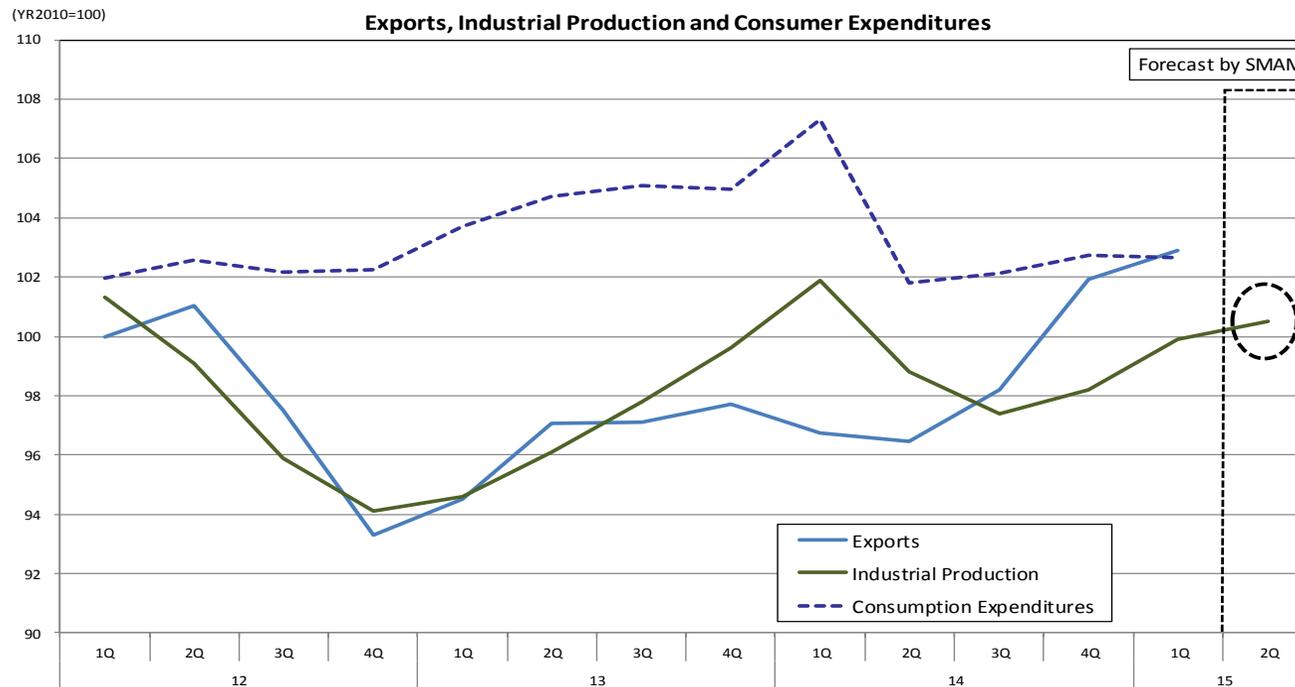
Notes: E=SMAM forecasts. SMAM views are as of May15, 2015 and subject to updates thereafter without notice

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

The above data is as of May 15, 2015.

## Recovery Process: Exports⇒Production⇒Employment, *Confidence*⇒Consumption

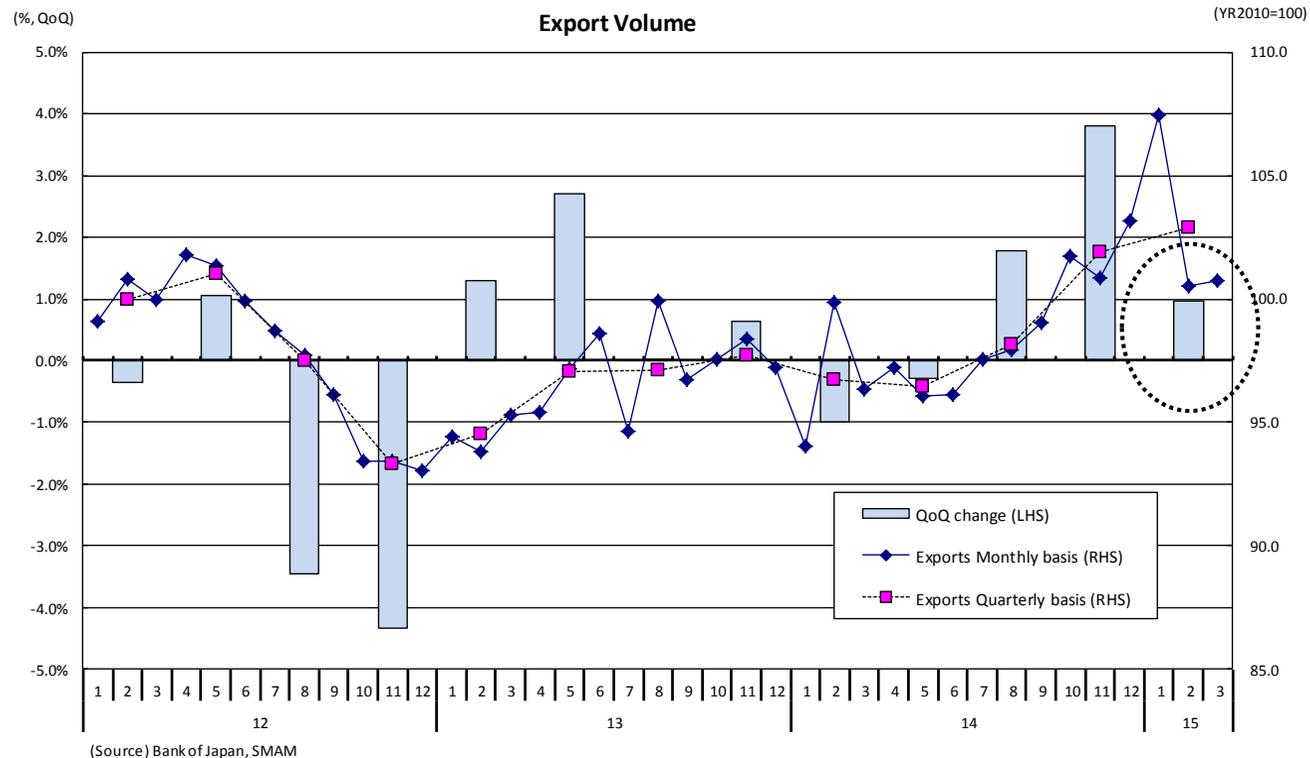
- SMAM forecasts current recovery process in order from Exports to Production and Consumption. The ongoing recovery process is between Confidence and Consumption.
- Stable recovery is highly expected underpinned by robust Exports and Industrial Production, while Consumption is eventually picking up.
- SMAM expect Private Consumption Expenditures to recover from April-June quarter although current consumption data remain weak. Wealth effect by rising stock prices and real wages growth lift up the Consumption.



(Source) Ministry of Economy, Trade and Industry, BOJ, Cabinet Office, SMAM's seasonally adjusted  
 \*1: Industrial Production for 2Q 2015 is estimated based on the data of Industrial Production Forecast Index.

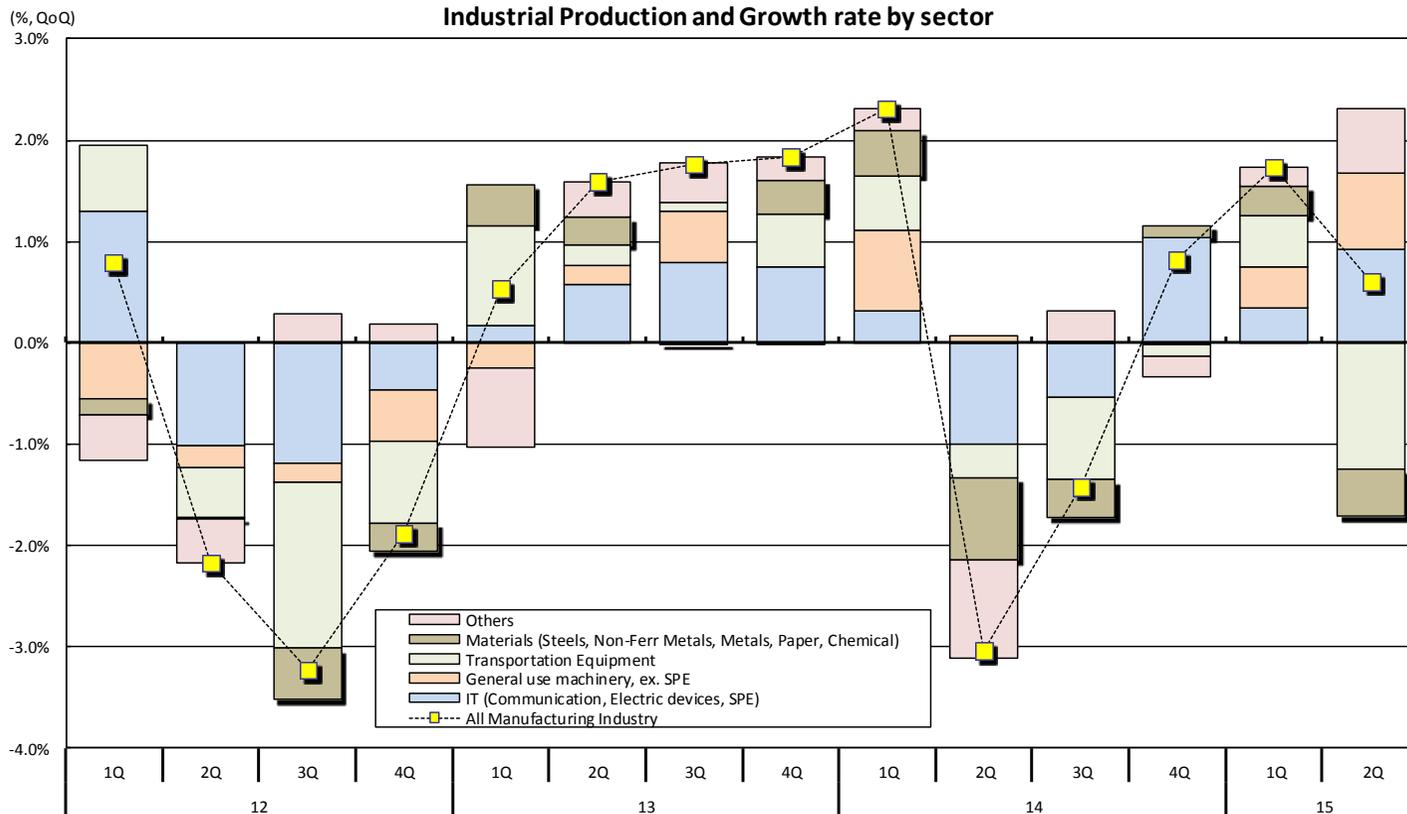
## Exports: Solid growth to Asia, US and EU

- March Export volume slightly gained +0.2% MoM. On 3 month basis, January-March Export volume grew for three consecutive quarters despite at a slower pace of +1.0% QoQ than +3.8% QoQ in October-December 2014.
- Exports are expected to keep moderate growth at 1% from April-June quarter on steady growth to US and EU as well as to upbeat Asian countries (ex. China). Exports to China is likely to grow spurred by China's easing monetary policy going forward.



## Industrial Production: Keeping moderate growth

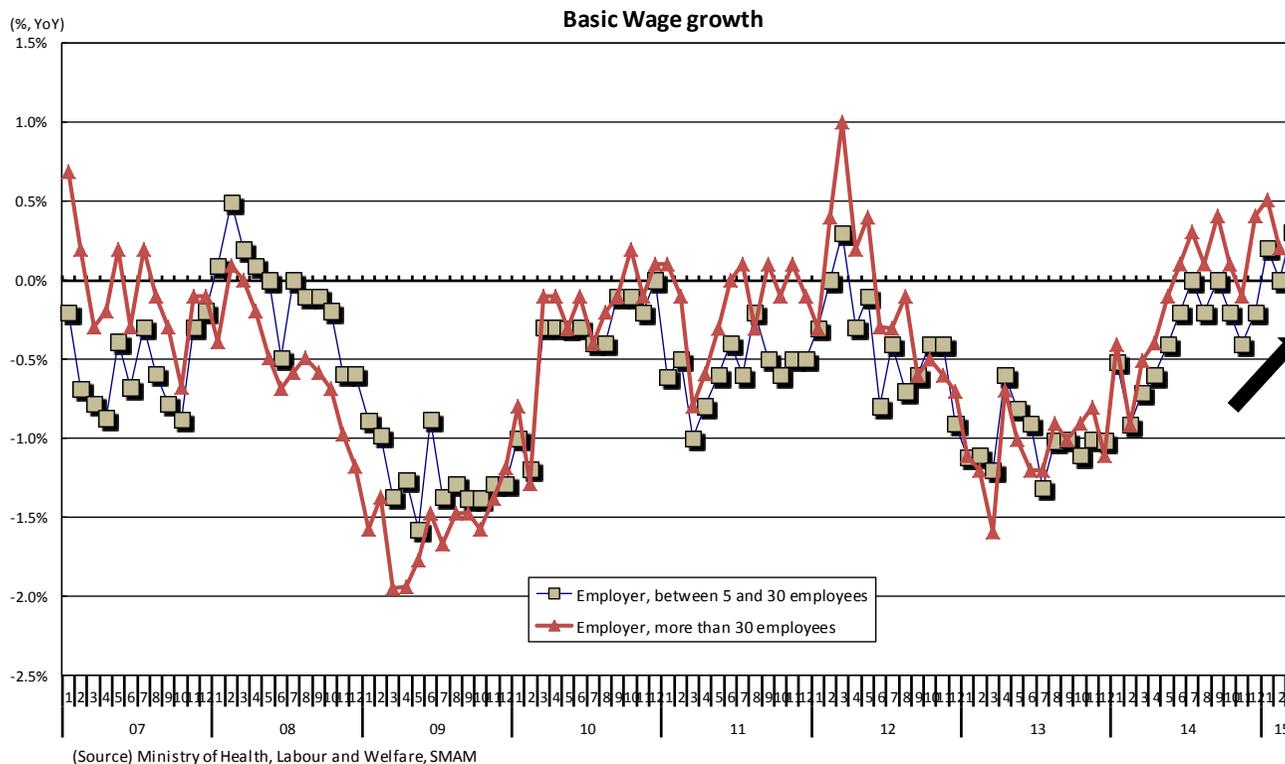
- January-March Industrial Production grew +1.7% QoQ. The IP is likely to keep growing at a moderate speed.
- Production for Materials and IT expanded in April, while that for Transportation Equipment contracted.



(Source) Ministry of Economy, Trade and Industry, SMAM seasonally adjusted  
 \*1: Industrial Production for 2Q 2015 is estimated based on the data of Industrial Production Forecast Index.

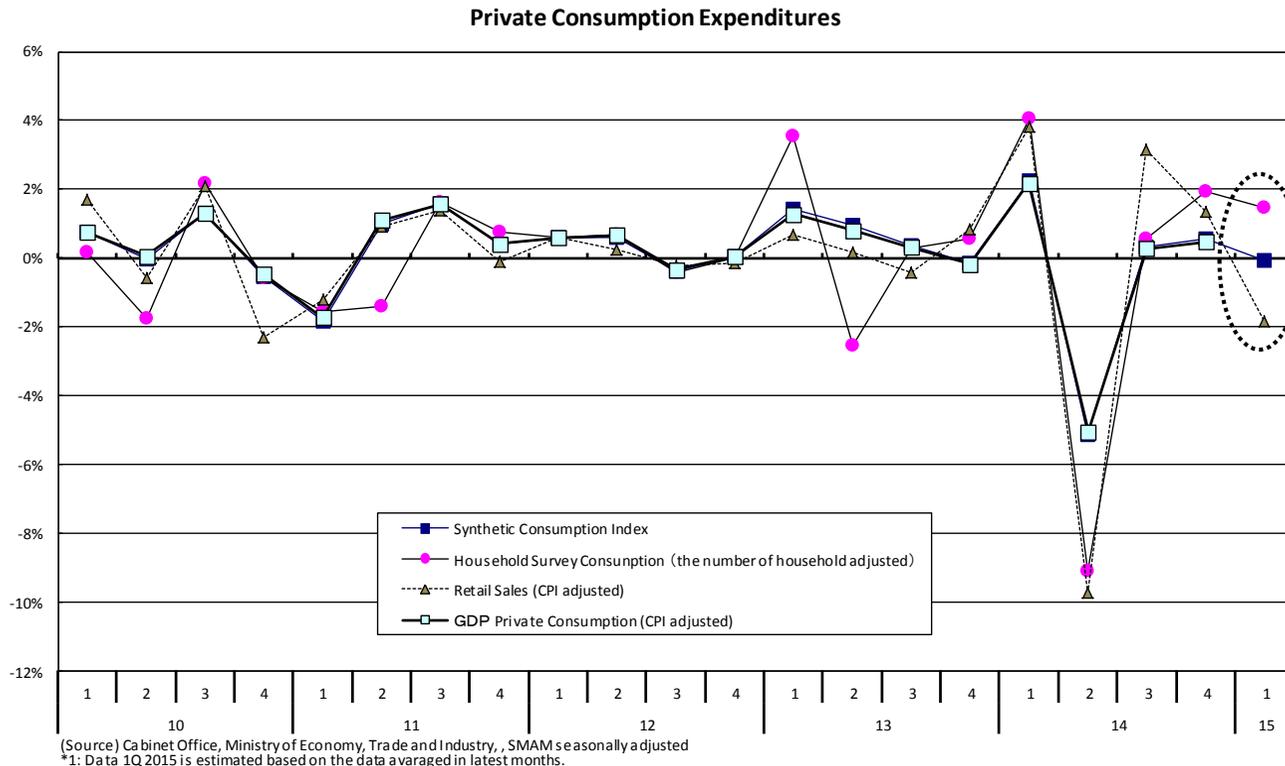
## Wages: Rising nominal wages

- March Unemployment rate declined to 3.4%, reaching a nearly full employment. A tight job market will help nominal wages to rise.
- Nominal wages are expected to accelerate to +1.2% YoY in FY2015 and +1.3% in FY2016 from +0.5% in FY2014 as nominal wages such as pay scale, bonus and other unscheduled wages are rising. The pay scale accelerated to +0.75% in FY2015 from +0.52% in FY2014. Scheduled wage (Basic wage) is expected to grow steadily to +0.7% in FY2015 and +0.8% in FY2016.



## Private Consumption: Likely to recover in April-June

- January-March consumption data remain still subdued, whereas SMAM expects the recovery starts from April-June quarter. On a monthly basis, latest data show some improving signs. In addition, upbeat nominal wages and wealth effect on higher stock prices should support the consumption.



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# Outlook for Japanese Stock Markets

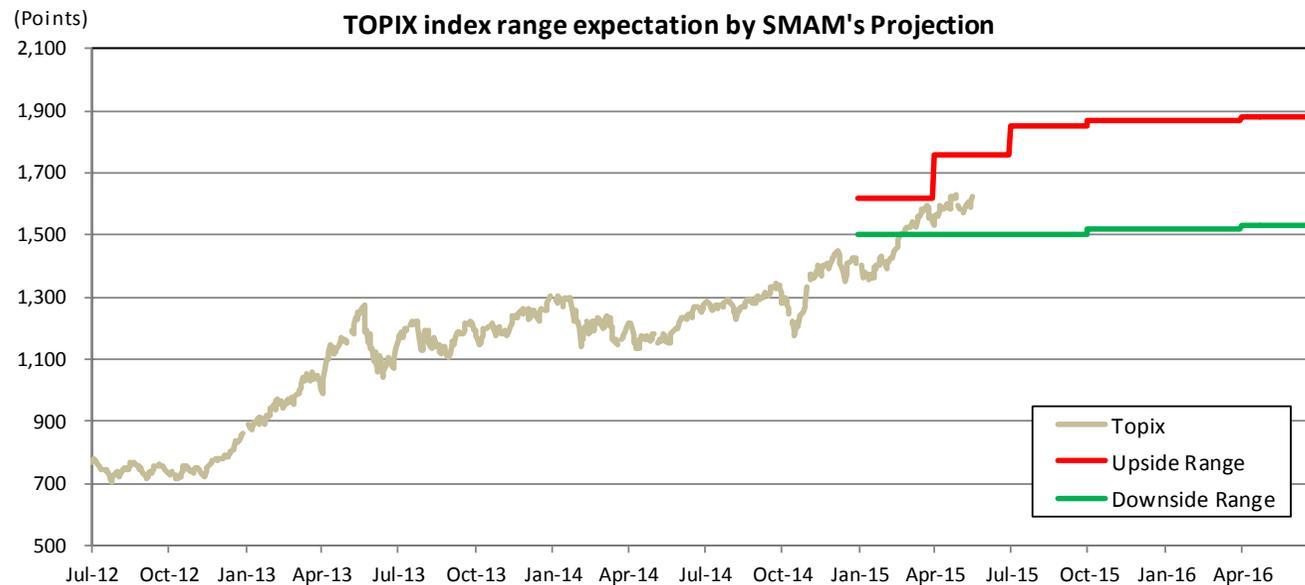
## Stock market outlook: Earnings growth prospects should help the stock market

### SMAM short-term view

- In addition to moderate growth in Production and Exports, Consumption recovery would lift the macro economy. Corporate earnings are expected to continue growing in FY2015.
- The stock market is expected to keep advancing as Japan's reflation policy is very likely to continue until next consumption tax hike in 2017. Increasing expectation for dovish US rate hike should also support the market.

### Longer-term outlook (6-month and beyond)

- For longer-term, we continue to expect the market to track on a modest uptrend, underpinned by US-led global growth, solid corporate earnings and strengthened reflationary policies in Japan. More focusing on shareholder return such as dividend increase and share buyback are another positive aspect.



(Source) TOPIX: Tokyo stock exchange, Upside and Downside range: forecasted by SMAM

Note: SMAM's Projection is as of May 18, 2015 and subject to updates without notice

Upto June 2016

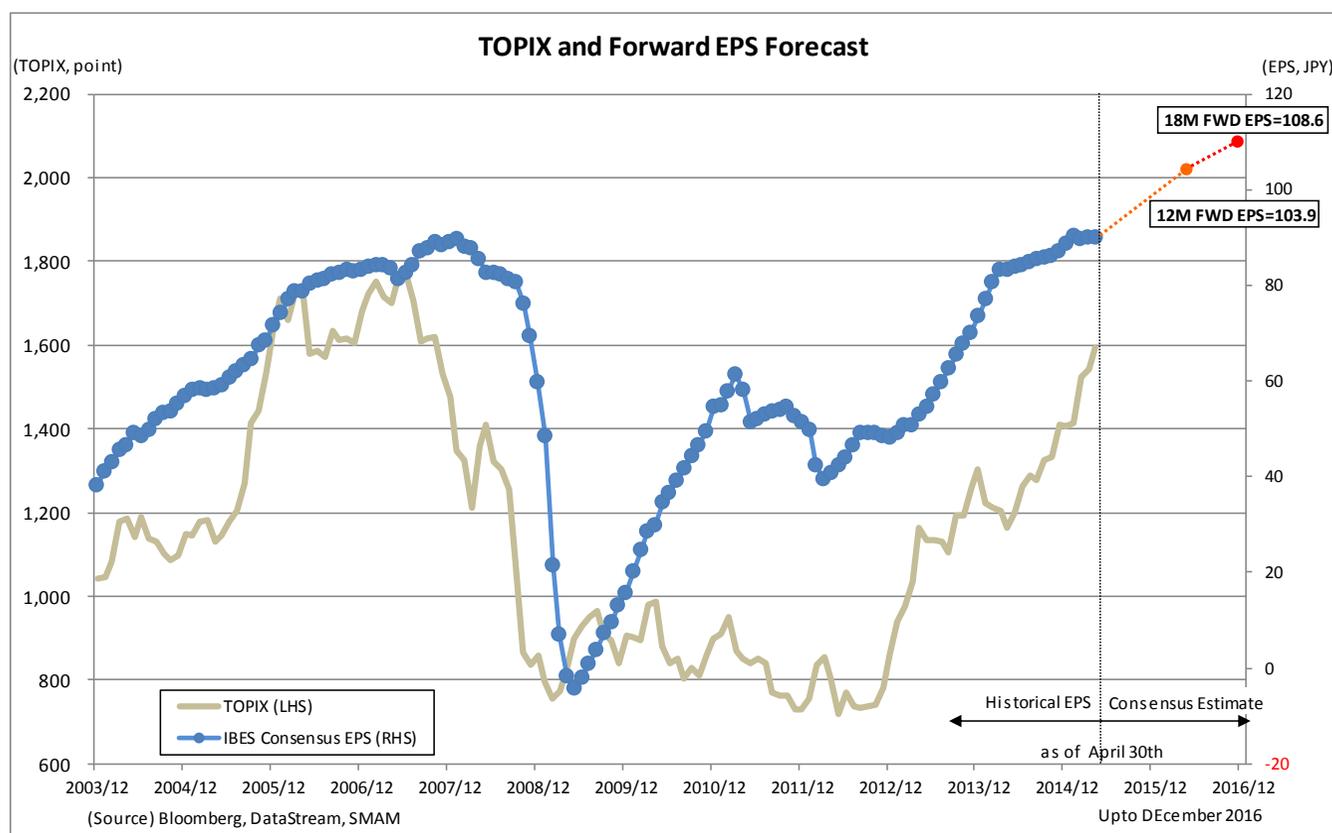
## Base scenario & Upside / Downside risks for our forecasts

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- Our **Base Scenario** is assuming the following views:
  - Global economic recovery to be sustained led by strong US economy
  - Japan's mild recovery from tax-hit weak demand buoyed by reschedule of next tax hike until 2017
  - Growing expectation for positive corporate earnings revisions due to weaker JPY
  - Reflationary policy to be continued toward the next consumption tax hike
  
- **Upside Risks** include:
  - Stronger-than-expected global growth
  - Stronger-than-expected measures by Abe government
  
- **Downside Risks** include:
  - Slowdown in global economy
  - Concern over global deflation
  - Increasing geopolitical concerns

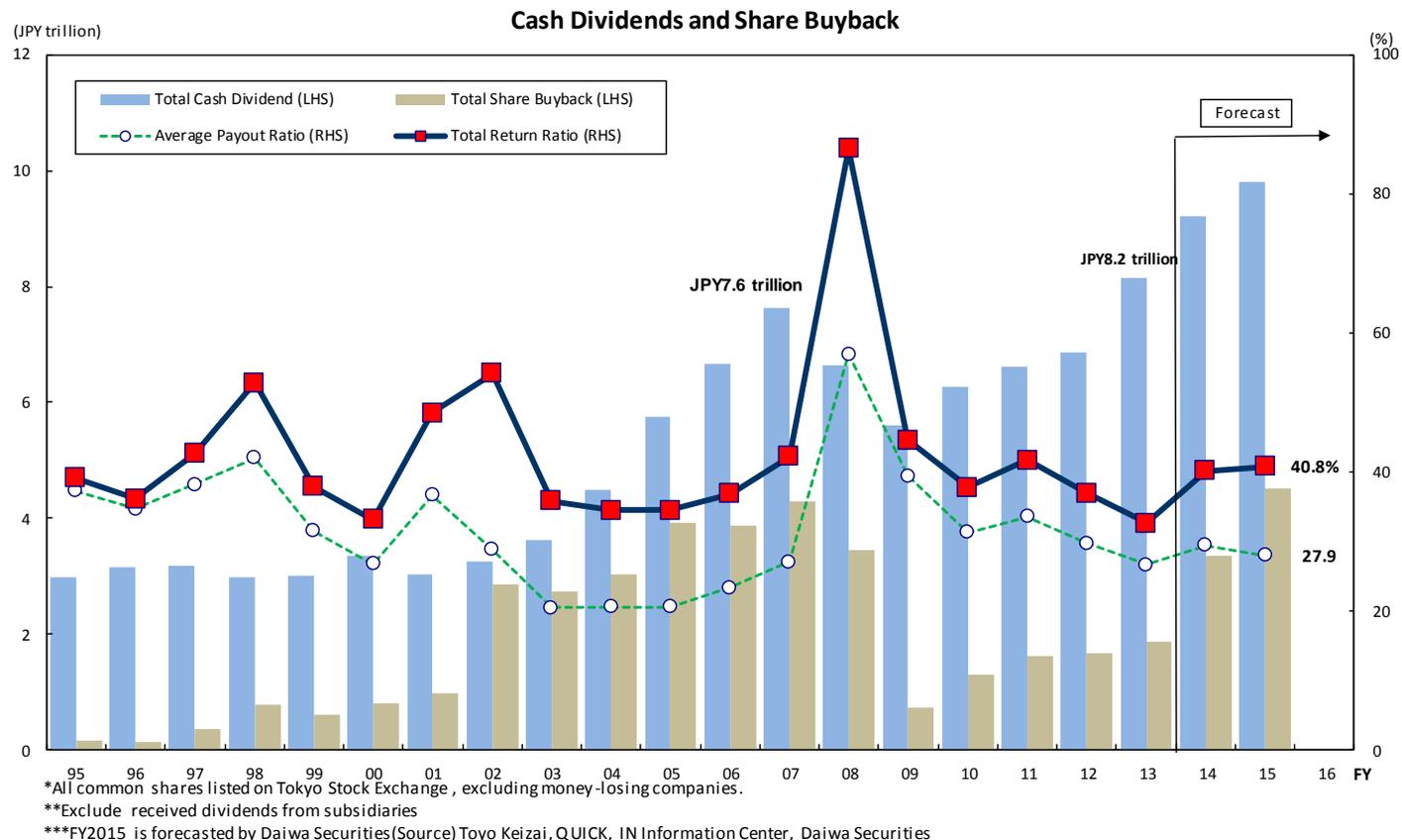
## TOPIX / EPS forecast: fairly valued on upbeat forward EPS

- IBES consensus EPS continues rising supported by solid growth prospects. IBES 12 month and 18 month forward EPS are 103.9 and 108.6 respectively, while TOPIX EPS is currently 90.00 as of May 15<sup>th</sup>.
- TOPIX of 1,607.11 as of May 15<sup>th</sup> seems fairly valued as the current P/E's are 14.8x and 15.5x based on the IBES 18 month and 12 month forward EPS forecasts.



## Shareholder return: Still room to enhance payout and buyback

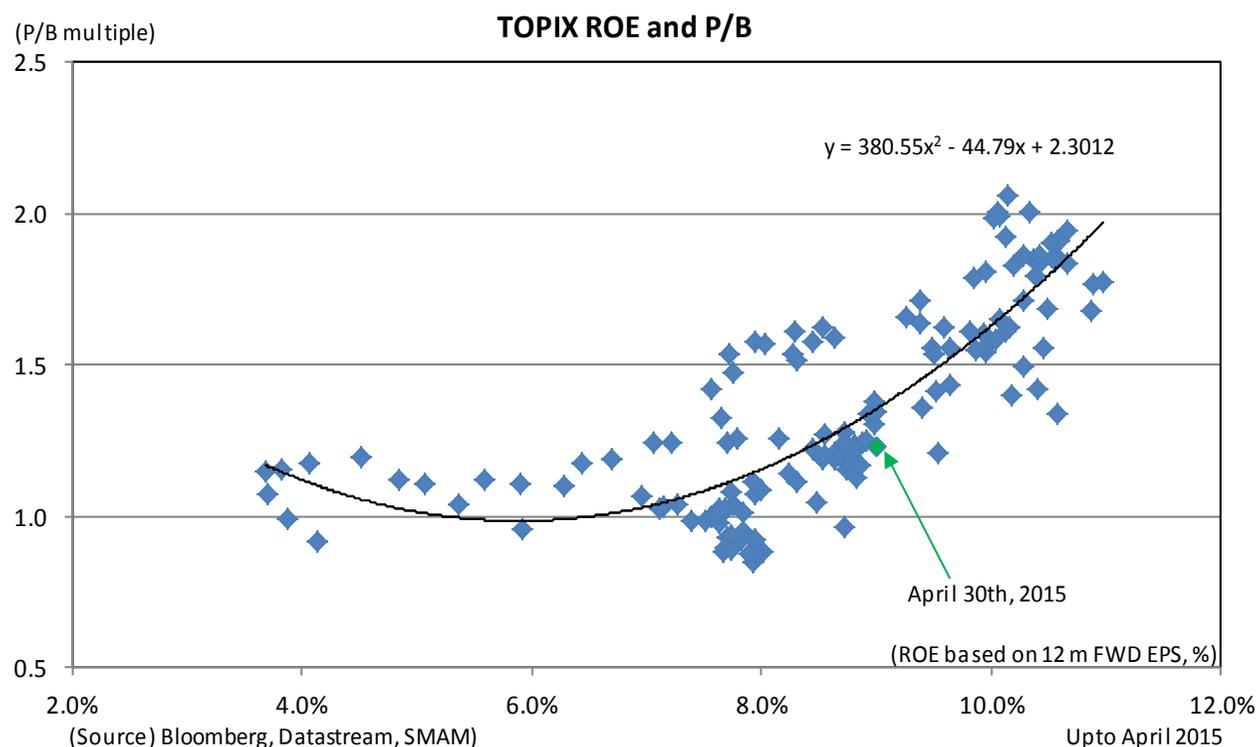
- Total cash dividends are expected to continue expanding led by upbeat earnings, whereas dividend payout is growing at slower pace, remaining low dividend payout ratio at about 30%. Total shareholder return (share repurchase + cash dividends) should be raised from current 40% as many companies have set a ROE target as one of management goal. Further enhancement in shareholder return should lift the stock prices.



## ROE and TOPIX : TOPIX will be priced higher as ROE rises from current 9%

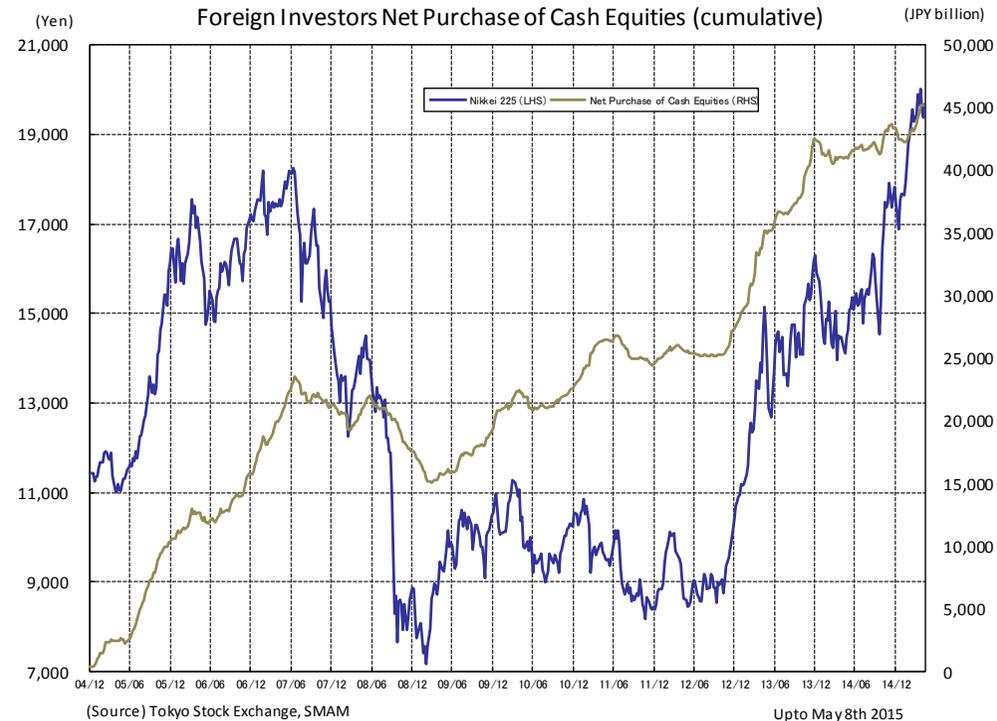
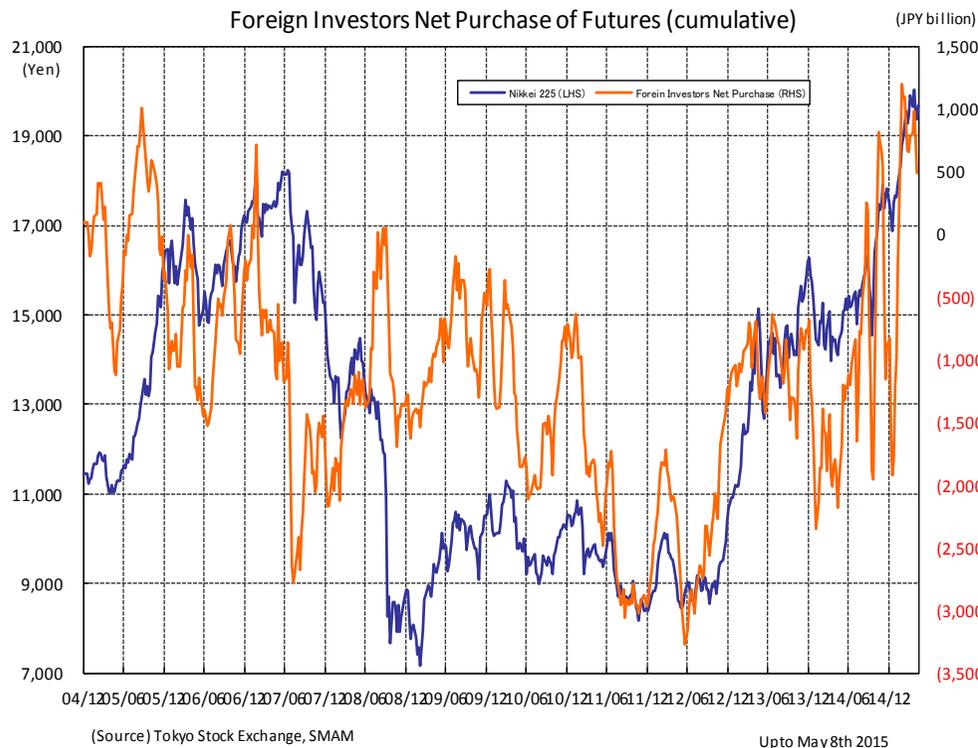
- The following chart shows the relationship between Return on Equity (ROE) and Price to Book (P/B) for TOPIX. ROE and P/B of TOPIX as of April 30<sup>th</sup> were 8.99% and 1.38x.
- On this regression analysis, TOPIX would rise to 1,880 based on TOPIX's Book Value of 1,155.27 as of April 30<sup>th</sup> if ROE were raised to 10%.

$$*PBR = 380.55 \times 10\%^2 - 44.79 \times 10\% + 2.3012 = 1.63, \text{ TOPIX} = 1.63 \times 1,155.27$$



## Supply-Demand balance: Continuing net-long by overseas investors

- Overseas investors maintain net long position. On a futures transaction, the investors turned to be a net long position of JPY99 billion in April from a net short of JPY520 billion in March. On a cash equities transaction, they also increased net long position to JPY1,995 billion in April from JPY530 billion in March.



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