



Japanese Stock Market Outlook

SMAM monthly comments & views
- November 2015 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

Japanese economy is likely to stay under pressure from sluggish external demand for a while. Policy measures taken in China and their effectiveness hold a key. Fiscal and monetary measures can be expected in Japan early next year, which should lift Japanese economy to be back on a recovery path again.

- GDP forecast for FY2015 was downgraded from +0.7% to +0.6% due mainly to weaker exports and private capital investment. Forecast for FY2016 was also downgraded from +1.1% to +0.9%.
- For FY2016, private sector is expected to show a reasonable growth, consumption at +1.8%, housing investment at +4.3% and capital investment at +2.1%. Contraction in the public capital investment is the main drag, for which “special spending program of reconstruction from the earthquake and tsunami in 2011” comes to an end.

➤ Japanese Stock Markets

Risk-off mode has moderated somehow, which made global markets to rebound lately. The Japanese stock market will be in a range bound move for the short term until expected fiscal and monetary measures are brought in early next year though downside risk seems limited with low valuation for the stock market.

- Corporate earnings are expected to keep growing despite increasing pressure on top-line sales. Lower costs such as energy and materials have been supportive so far. Some caution is required as analysts are revising earnings forecasts more often downward than upward recently.
- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 13x and 16x. Current PER below 14x is in a lower side of this range and downside for the stock market seems limited.

Notes: Macro and market views are as of October 16th and 21st 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-16

- GDP forecast for FY2015 was downgraded from +0.7% to +0.6% due mainly to weaker exports and private capital investment. Forecast for FY2016 was also downgraded from +1.1% to +0.9%.
- For FY2016, private sector is expected to show a reasonable growth, consumption at +1.8%, housing investment at +4.3% and capital investment at +2.1%. Contraction in the public capital investment is the main drag, for which “special spending program of reconstruction from the earthquake and tsunami in 2011” comes to an end.

	FY12	FY13	FY14	FY15E	FY16E
Real GDP growth	1.0%	2.1%	-0.9%	0.6%	0.9%
Private Consumption Expenditure	1.8%	2.5%	-3.1%	0.2%	1.8%
Private Housing Investment	5.7%	9.3%	-11.7%	2.9%	4.3%
Private Capital Investment	1.2%	4.0%	0.5%	1.1%	2.1%
Public Consumption Expenditure	1.5%	1.6%	0.4%	1.1%	0.2%
Public Capital Investment	1.0%	10.3%	2.0%	1.0%	-0.1%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	-0.4%	-0.4%
Exports	-1.4%	4.4%	7.9%	-1.7%	1.7%
Imports	3.6%	6.7%	3.6%	0.5%	4.4%
Nominal GDP	0.1%	1.8%	1.6%	1.3%	1.7%
GDP Deflator	-0.9%	-0.3%	2.5%	0.7%	0.7%

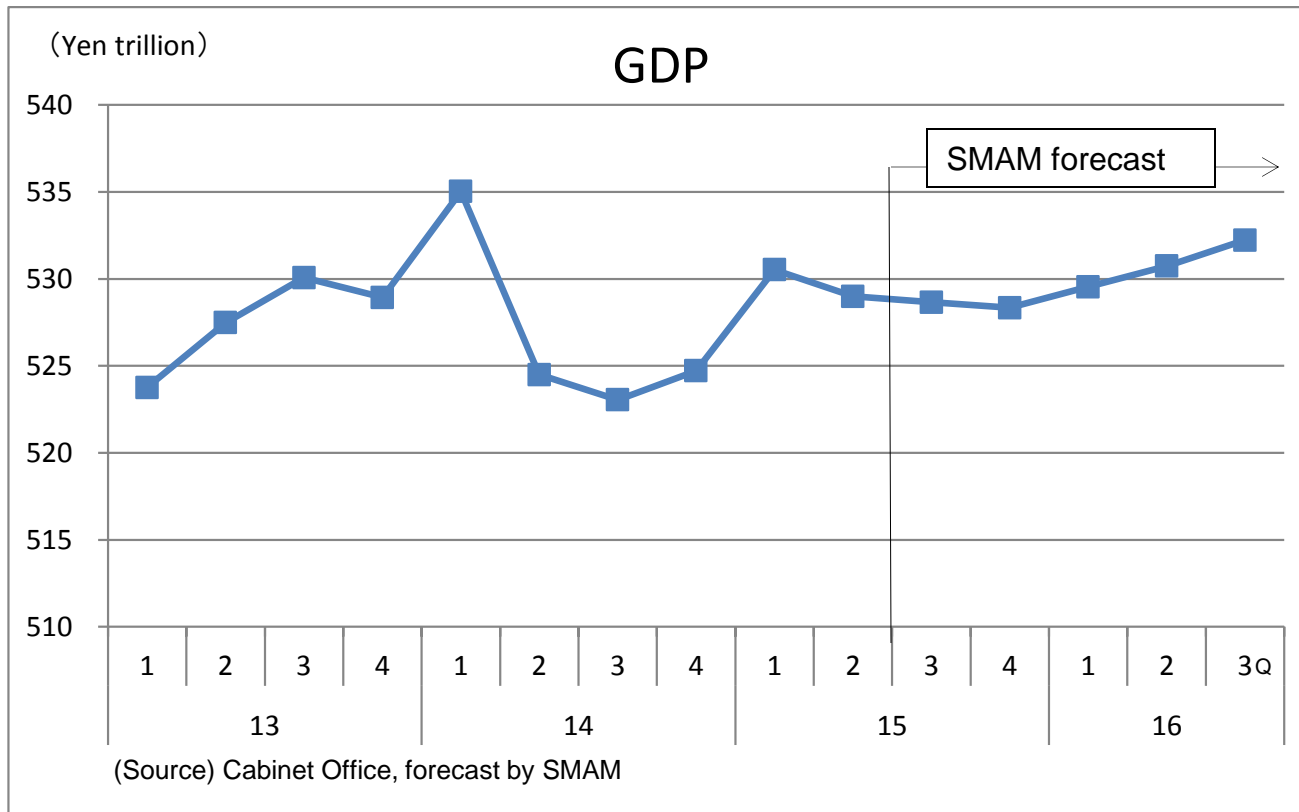
(%, YoY except Net Exports)

Notes: E=SMAM forecasts. SMAM views are as of Oct16th, 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

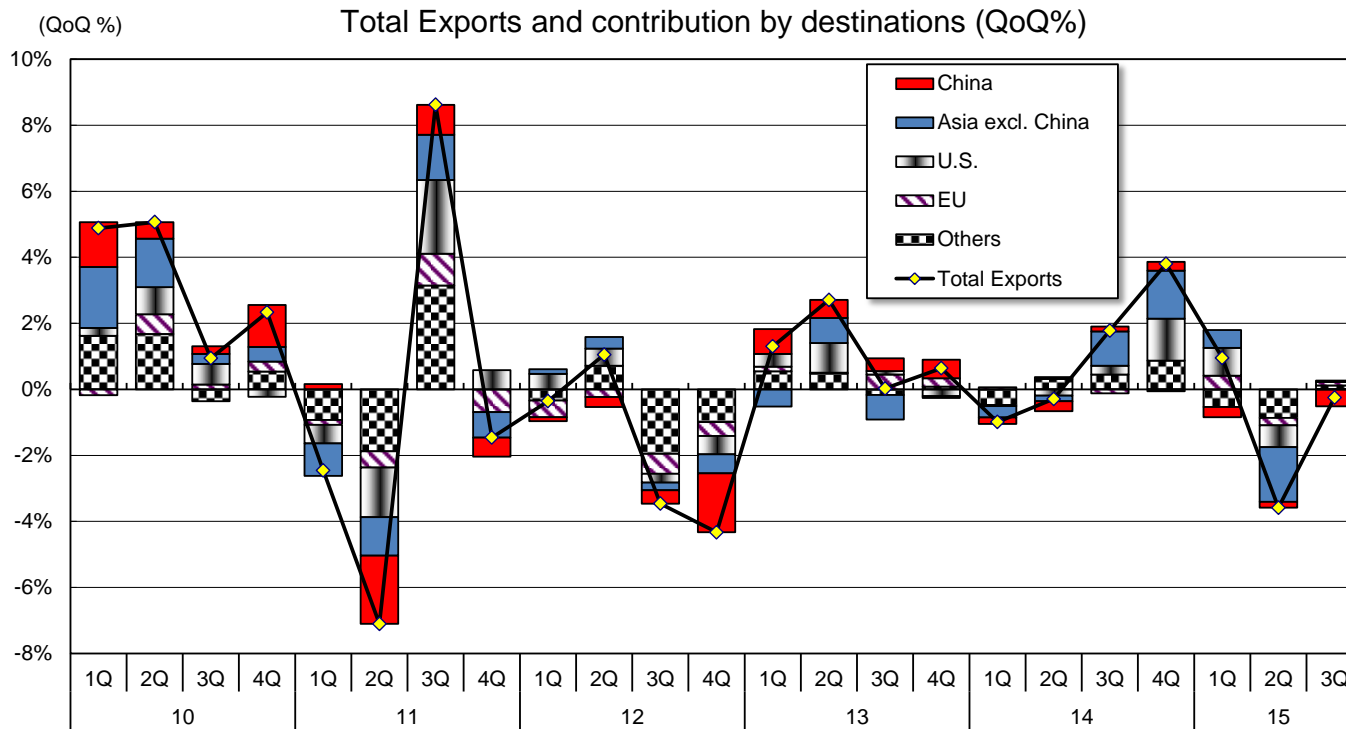
SMAM quarterly GDP forecast for FY15-16

- GDP is likely to stay under pressure from sluggish external demand for a while. Policy measures taken in China and their effectiveness hold a key.
- Fiscal and monetary measures can be expected in Japan early next year, which should lift Japanese economy to be back on a recovery path again.



Deteriorating exports to China and other Asian countries are causing negative effects

- Continuing slowdown in Chinese economy is spilling over to other Asian countries, which is causing negative growth in exports from Japan. Declining exports lead to lower industrial production and causes a concern for the private capital investment.

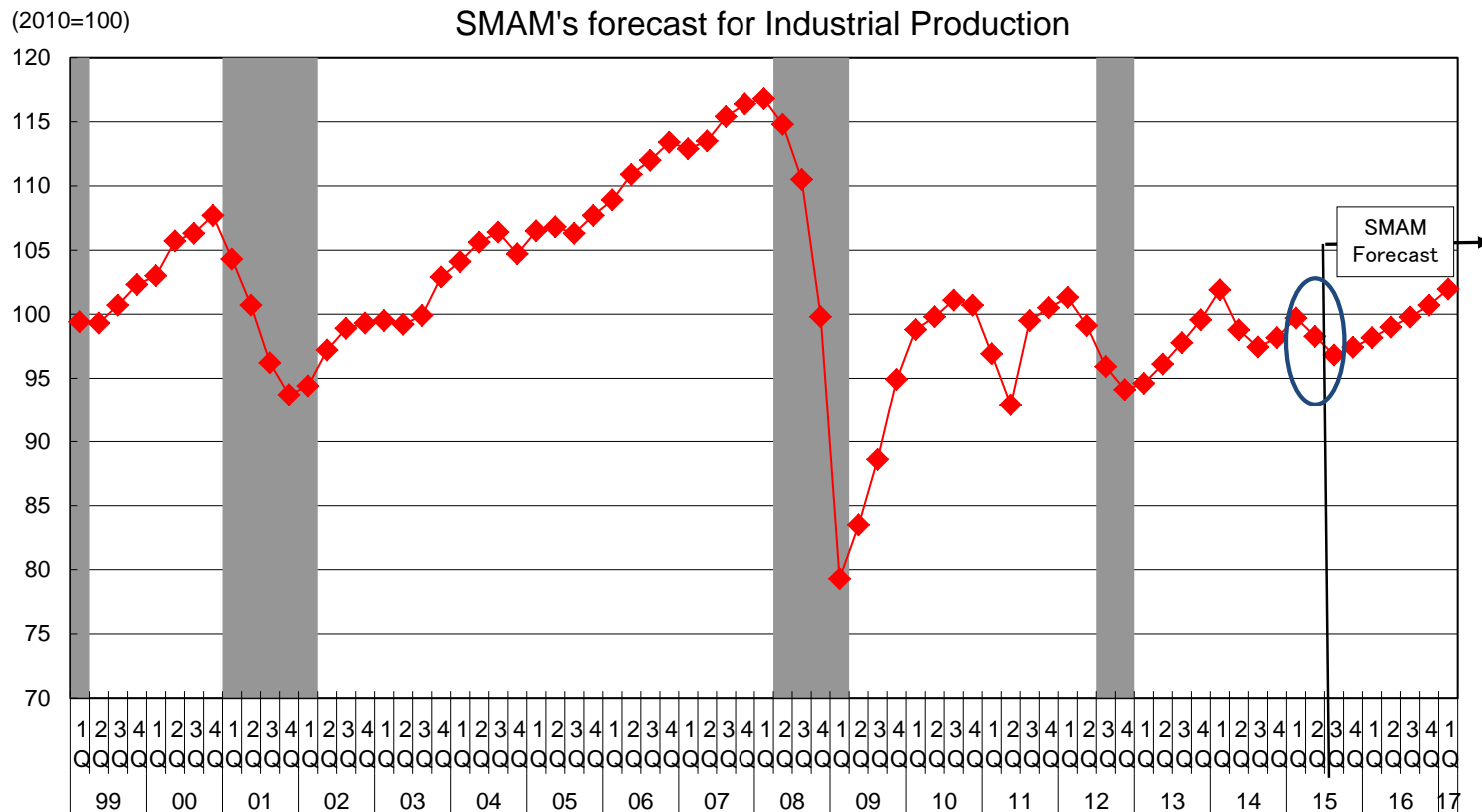


Note: Data for 3Q2015 is the average of monthly data already announced.

(Source) Ministry of Finance and Bank of Japan, compiled by SMAM

Negative impact of China's slowdown on Industrial Production has been larger than expected

- Recently released Industrial Production (IP) data were worse than previously forecast. SMAM revised forecast for 3Q2015 from previous -0.3% to -1.5% (QoQ % change).
- Due to continuing slowdown in China, recovery in IP from 4Q2015 is currently estimated as moderate.

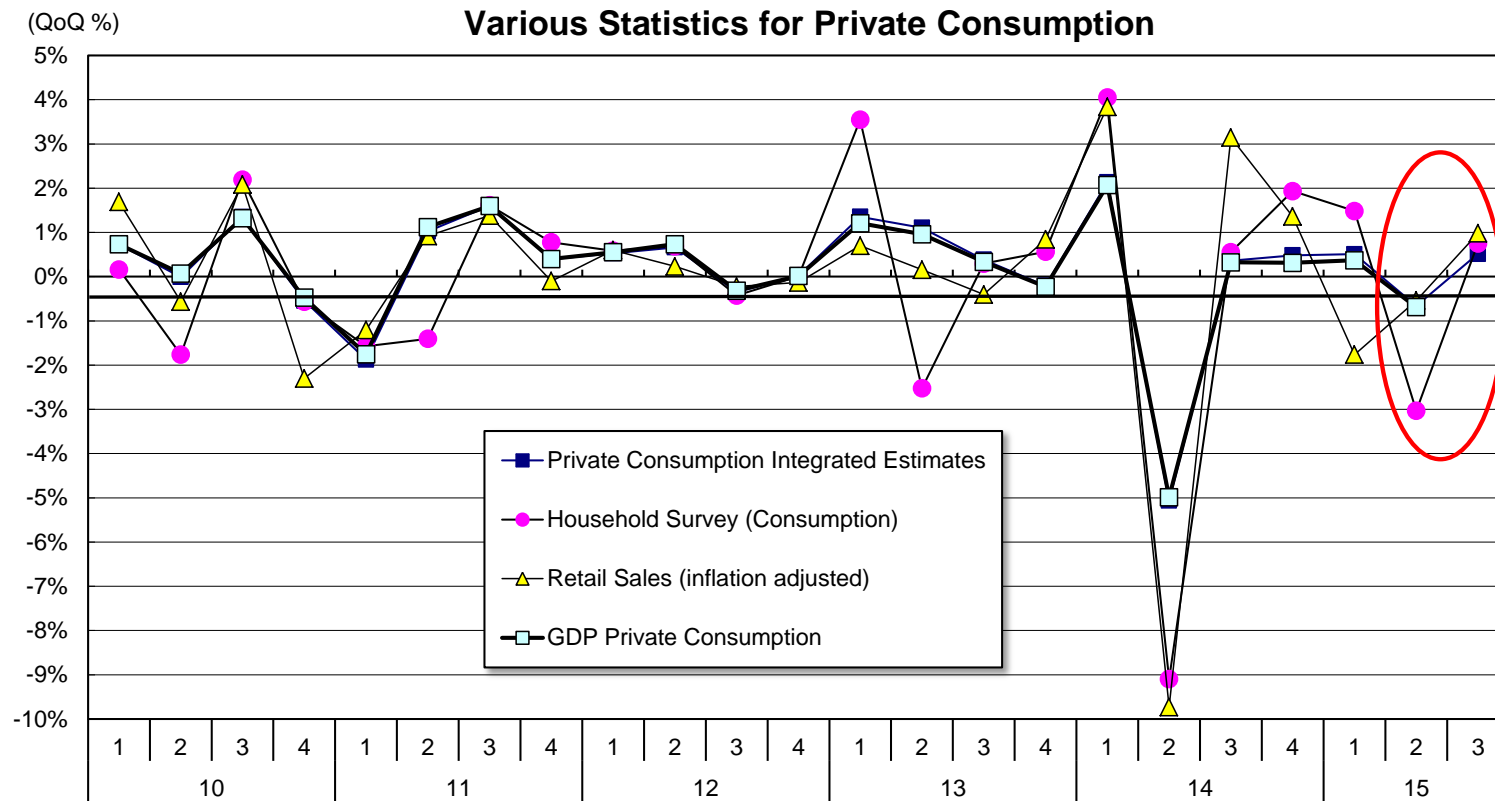


Note: Shaded period means recession.

(Source) Ministry of Economy, Trade and Industry, Forecast by SMAM

Private Consumption is recovering from a temporal dip in Apr-Jun quarter

- Private Consumption is recovering in July-Sep quarter from the dip in the quarter before, for which miserable weather and rising prices for essential items were partly blamed.

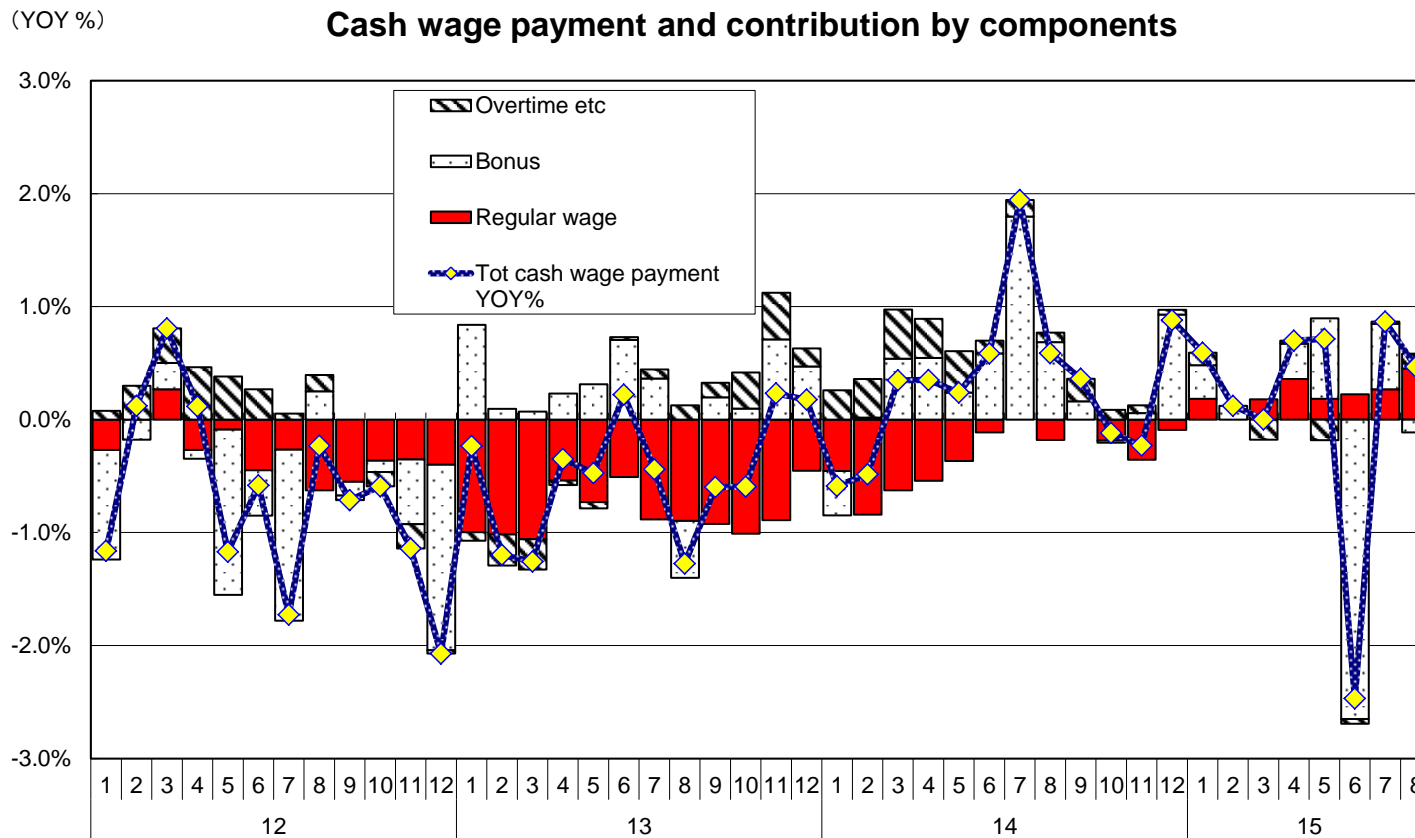


Note: Data for 3Q2015 is the average of monthly data already announced.

(Source) Cabinet Office, Ministry of Economy, Trade and Industry

Increase in regular wage has been positive for consumers

- Regular wage payment has been increasing YOY since January 2015, which has been positive for consumers.
- Whether this increasing trend in wage can be sustained in and after FY2016 is quite important for the Japanese economy, and underlying strength in corporate earnings requires close attention.



(Source) Ministry of Health, Labor and Welfare

Outlook for Japanese Stock Markets

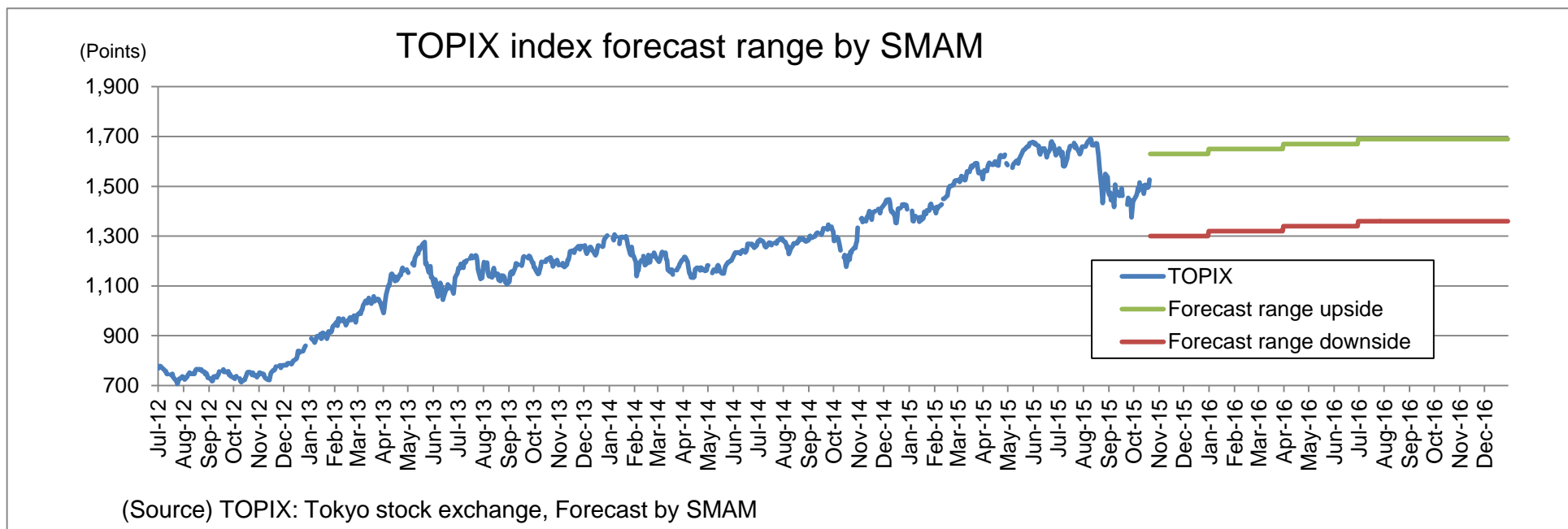
Stock market outlook: The stock market is waiting for further stimulus measures

SMAM short-term view

- Risk-off mode has moderated somehow, which made global markets to rebound lately. The Japanese stock market will be in a range bound move for the short term until expected fiscal and monetary measures are brought in early next year though downside risk seems limited with low valuation for the stock market.

Longer-term outlook (6-months and beyond)

- Chinese economy is expected to gradually stabilize as policy measures buildup further and start to take effect.
- Atmosphere around the stock market would get brighter as fiscal measures and additional monetary stimulus are expected in early next year and further economic policies and initiatives can be announced running up to the upper house election expected in July 2016.



Note: SMAM's Projection is as of October 21st 2015 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

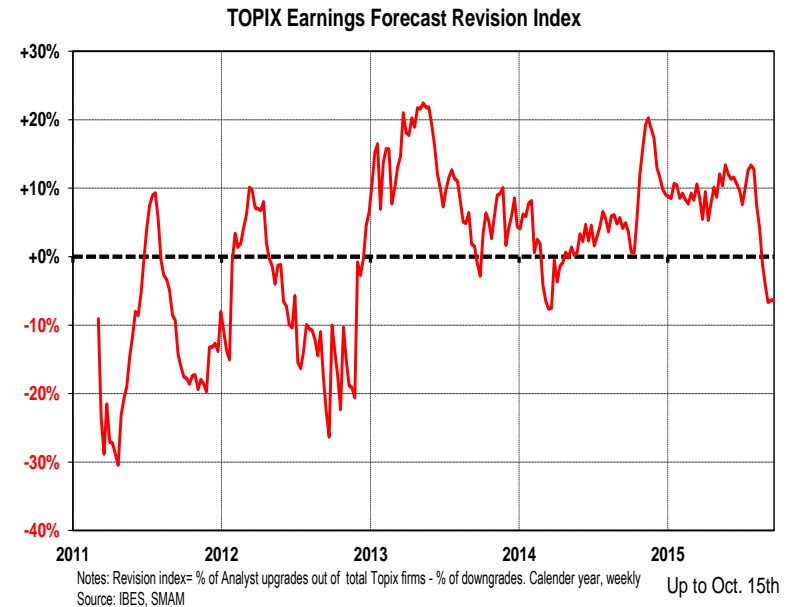
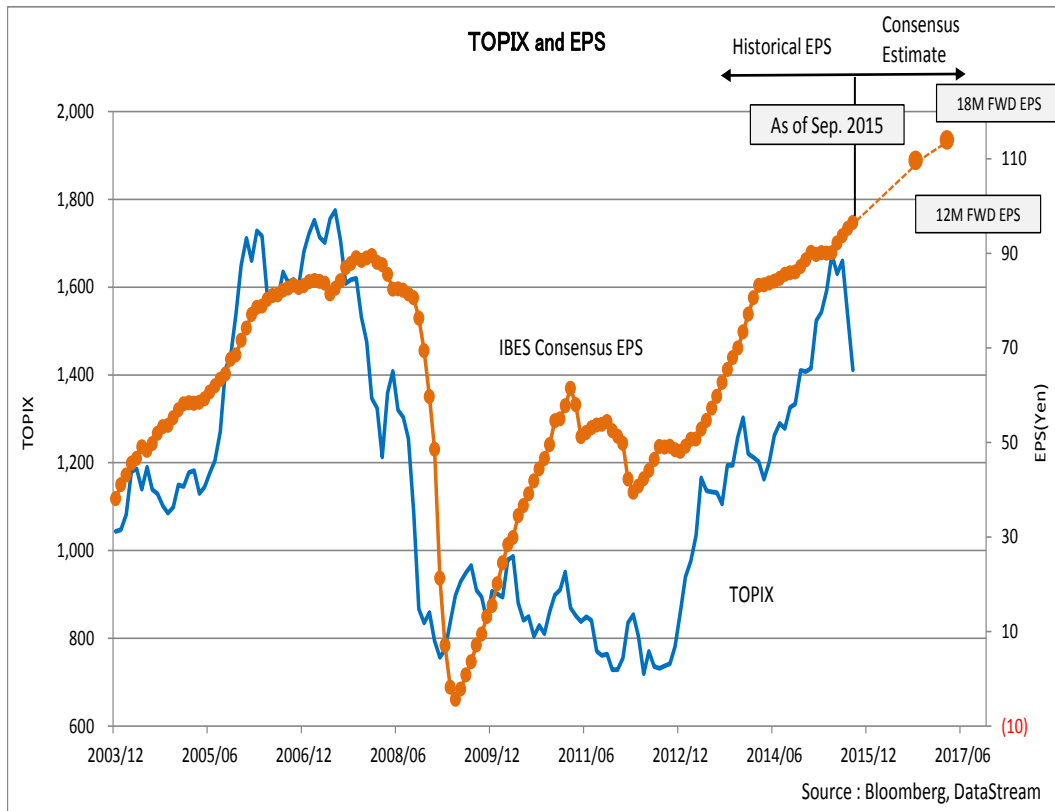
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's private consumption to grow though mildly supported by higher real wages growth
 - Growing expectation for positive corporate earnings revisions due to weaker JPY
 - 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:
 - Unexpectedly large impact from the process of US monetary policy normalization
 - Concern over emerging economies including China
 - Increasing geopolitical concerns

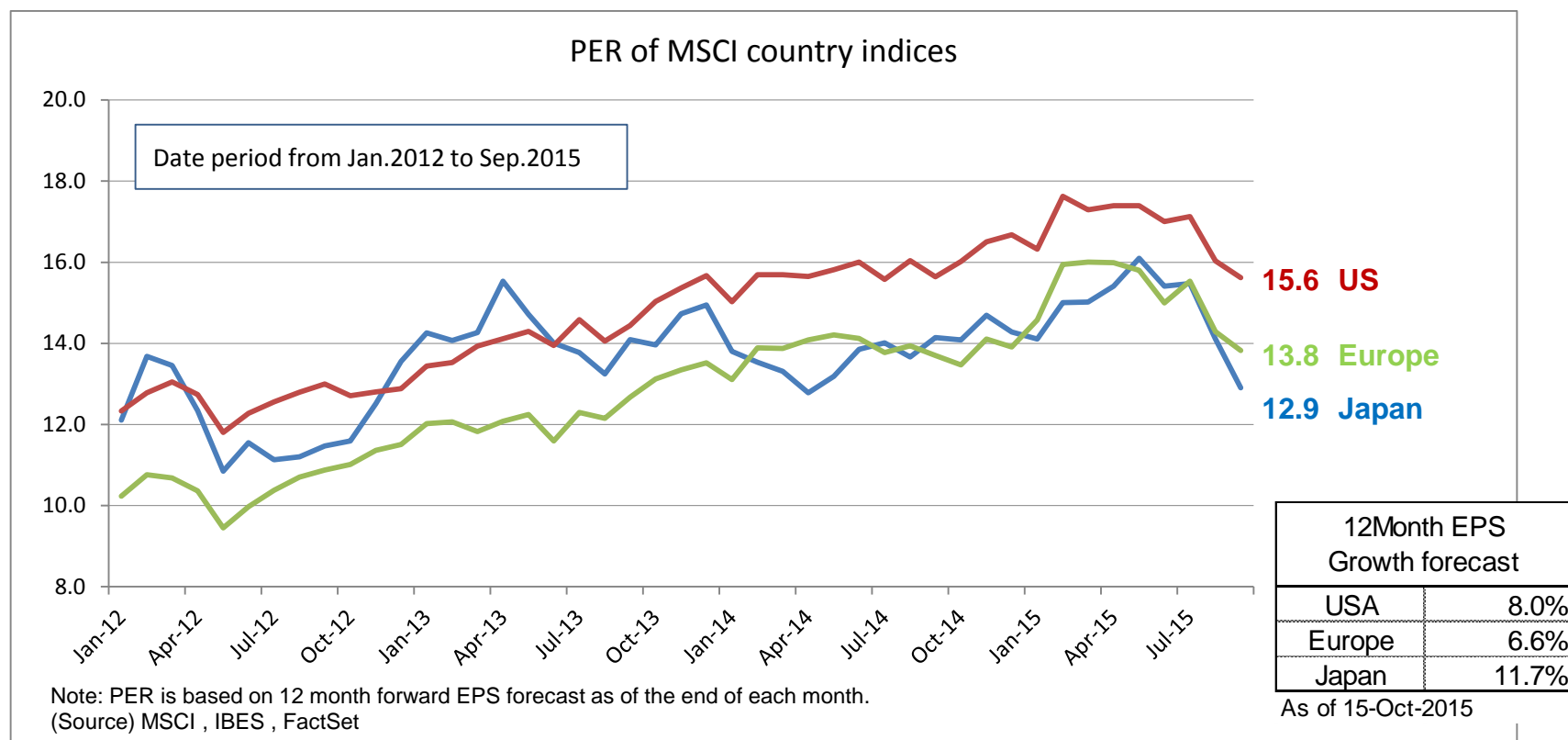
Earnings growth is expected to continue for Japan with a caution for down-revisions

- Corporate earnings are expected to keep growing despite increasing pressure on top-line sales. Lower costs such as energy and materials have been supportive so far.
- Some caution is required as analysts are revising earnings forecasts more often downward than upward recently.



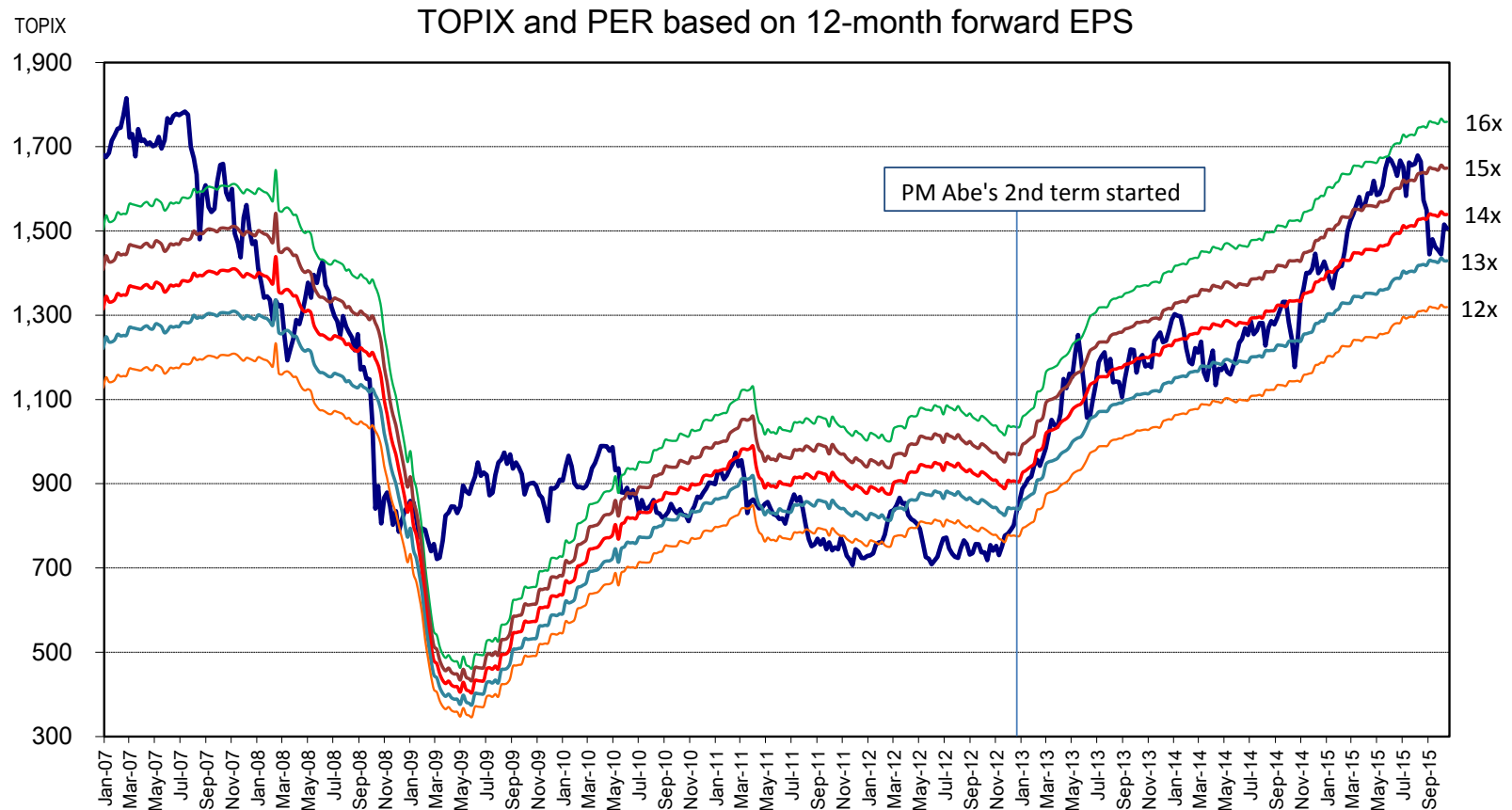
PER has fallen globally and relative attractiveness for Japan still holds

- PER has fallen globally on decelerating economic growth and concern for further deterioration.
- If these concerns can be lightened by policy measures by governments and some evidence of stabilizing economies, PER could be lifted again.
- Better fundamentals in Japan, such as faster earnings growth and improving corporate governance should be favorable for Japanese equities.



PER for Japanese stock market seems attractive in historical comparison

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 13x and 16x.
- Current PER below 14x is in a lower side of this range and downside for the stock market seems limited.

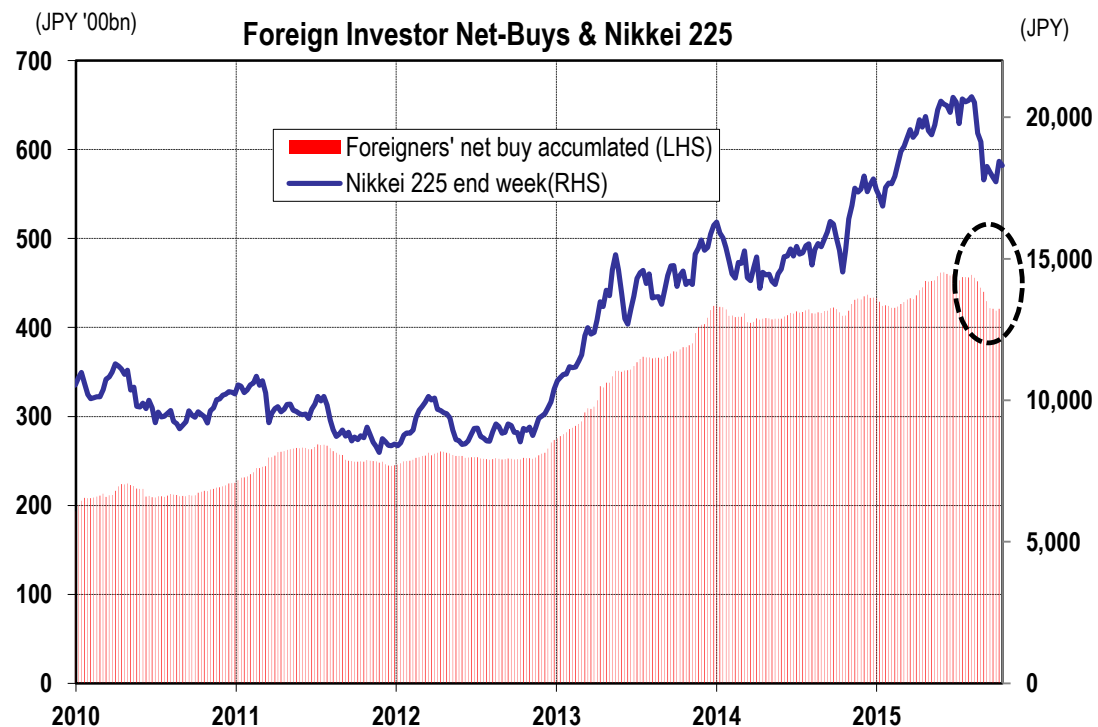


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
 Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to October 15th 2015

Supply-Demand balance: Foreign investors' risk-off seems receding

- Between August 10th and October 2nd, foreign investors sold as much as 7 trillion yens in Japanese stock markets when trades of individual stock and futures are combined. For the week between October 5th and 9th they bought back some and selling pressure has receded.
- Japan Post is going to be listed on the stock exchange on November 4th, for which good appetite from individual investors is expected on high dividend yield and low PBR.



Notes: Calendar year, weekly. Foreign investors' net purchase of TSE listed stocks
Source: Tokyo Stock Exchange, SMAM

Up to Oct 16th

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