

# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- March 2016 -



Sumitomo Mitsui Asset Management

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## Executive summary

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### ➤ Japanese Economy

The global negative head wind continues and Japanese economy is starting to show some fragilities notably in manufacturing sectors. Private consumption was weak in 4Q 2015 partly affected by a warm winter. On the other hand, private capital investment shows resilience especially in non-manufacturing sectors.

- Japanese financial systems are trying to adjust to the new regime of negative interest rate. It requires some time for judging if this new easing policy could actually stimulate the economy as BOJ intends or confuses financial systems and economy. Interest rate for individuals would not become negative yet due to the guidance by the government to financial institutions.
- Strong employment is supportive for the consumers, however, wage increase has not been large enough to stimulate private consumption. Spring wage negotiation round is currently going on, which could be rather disappointing as global economic slowdown makes companies more conservative.

### ➤ Japanese Stock Markets

Lots of variables remain for a considerable time such as US interest rate policy, unfolding effects of negative interest rates in Japan and further monetary & fiscal policies possibly taken by global authorities. Japanese stock market is expected to move within a wide box range with high volatility for the short term.

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 12.5x and 16x. The recent low of 1196.28 in TOPIX reached on 12th February seems at oversold level. At 1180 in TOPIX, PBR is 1.0 times and some downside protection could start to work under this level.
- Due to accumulating cash and low share prices, large share buybacks have been announced by companies, which is surely positive for the stock market in the long run. Negative interest rate should make it even harder for companies to justify huge amount of idling cash.

Notes: Macro and market views are as of Feb.15th and 17th 2016 respectively, and subject to updates thereafter without notice

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# Outlook for Japanese Economy

## SMAM economic outlook for FY15-17

- GDP forecast was downgraded for FY2015 and FY2016 both from +1.0%. Private consumption has been weaker than previously forecast whereas private capital investment was revised upward due to recent solidness.
- Preliminary forecast was set for FY2017 and this weak forecast was due to estimated aftershock of consumption tax hike scheduled in April 2017. There is a possibility for postponing this tax hike again if sluggishness continues for Japanese and global economies.

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Real GDP growth	0.9%	2.0%	-1.0%	0.8%	0.9%	-0.2%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.3%	1.2%	-0.7%
Private Housing Investment	5.7%	8.8%	-11.7%	2.1%	2.1%	-3.9%
Private Capital Investment	0.9%	3.0%	0.1%	2.2%	2.6%	-1.3%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.3%	1.0%	0.8%
Public Capital Investment	1.0%	10.3%	-2.6%	-1.3%	-1.6%	0.3%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	0.0%	0.2%
Exports	-1.4%	4.4%	7.8%	0.6%	2.7%	2.9%
Imports	3.6%	6.7%	3.3%	0.1%	3.1%	1.7%
Nominal GDP	0.0%	1.7%	1.5%	1.9%	0.9%	0.9%
GDP Deflator	-0.9%	-0.3%	2.5%	1.1%	-0.1%	1.2%

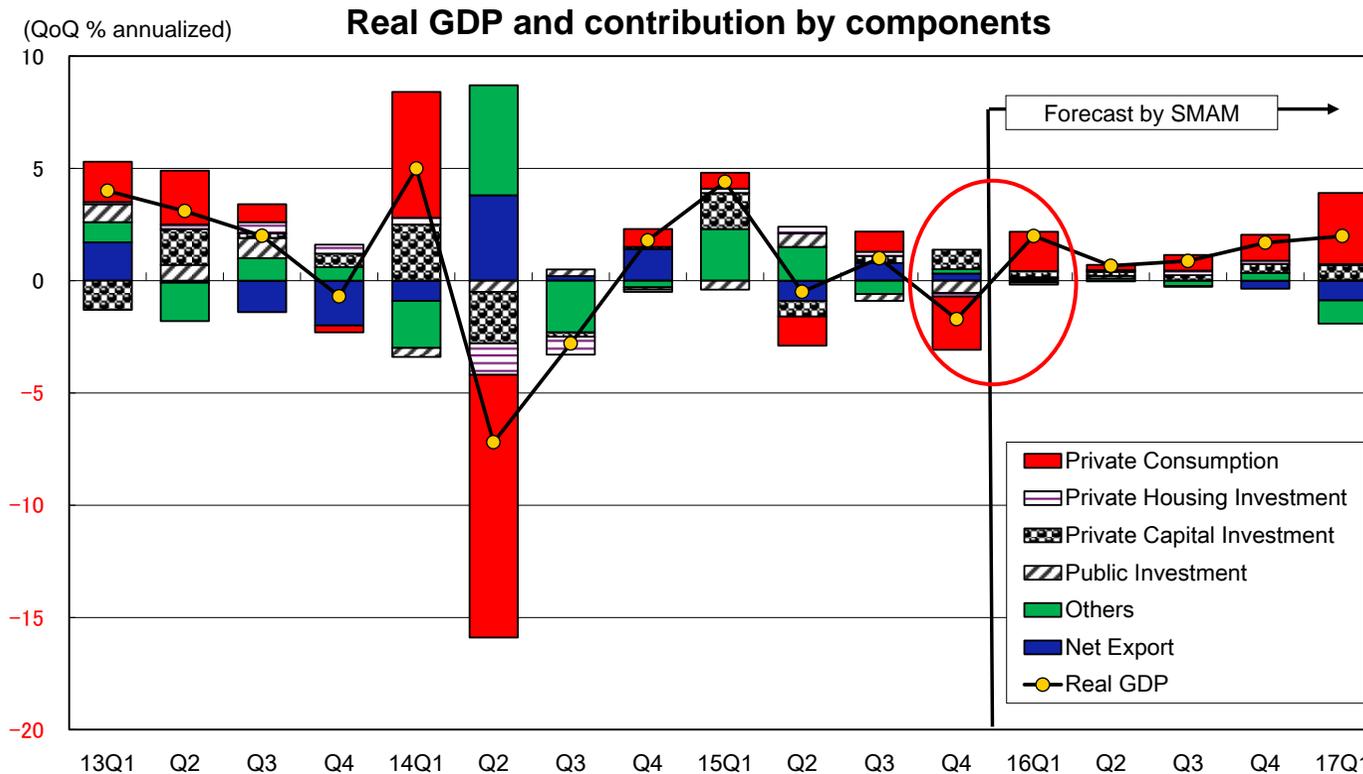
Notes: E=SMAM forecasts. SMAM views are as of Feb. 15<sup>th</sup>, 2016 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

## SMAM economic outlook for FY15-16

- GDP in 4Q 2015 was -0.4% QoQ, which was -1.4% annualized. Private consumption detracted by -0.8% QoQ, for which warm weather was partly blamed for weak consumption on winter clothes and other seasonal items.
- Private capital investment is a bright spot with QoQ growth of +1.4%. in 4Q.

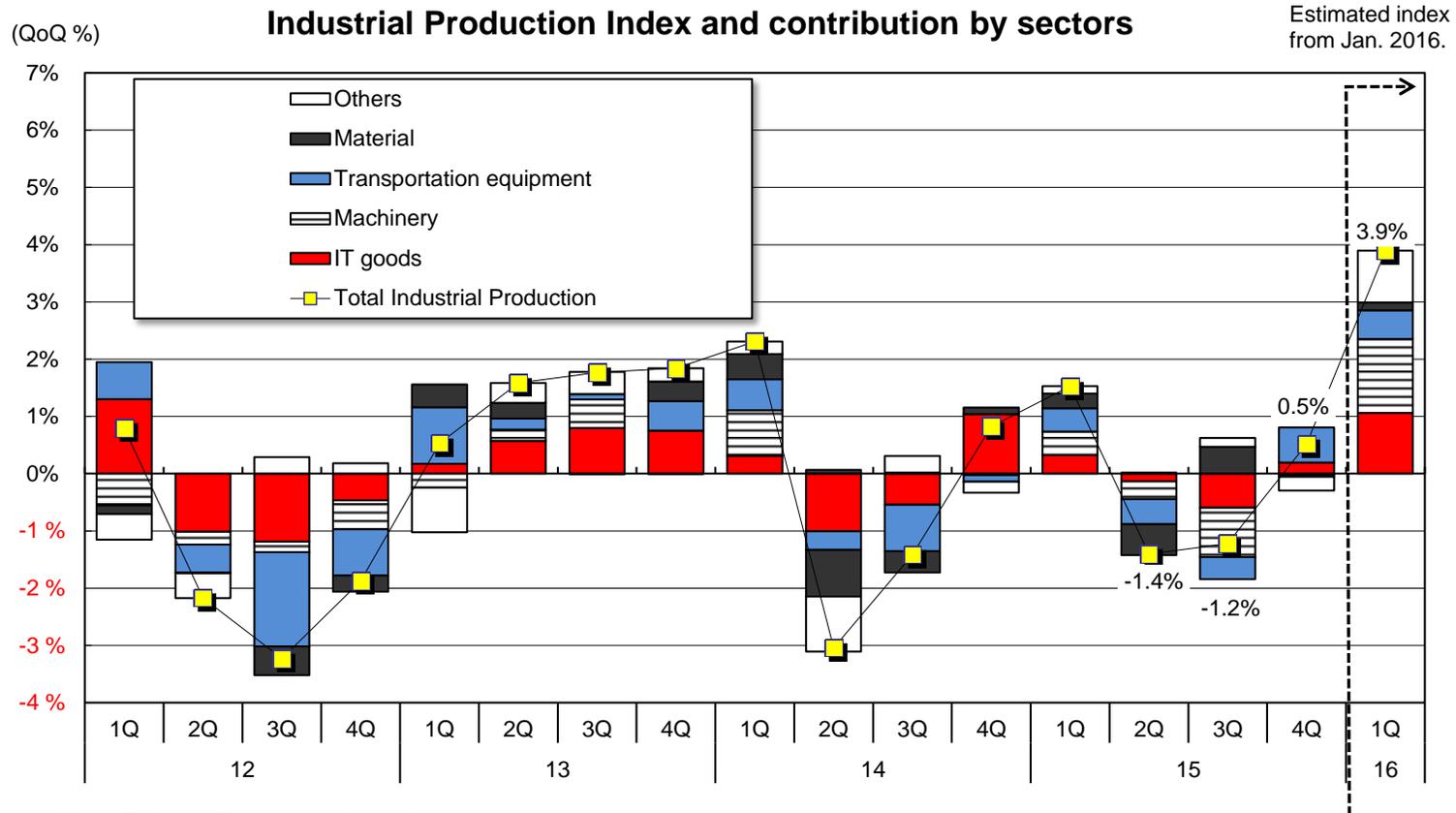


Notes: SMAM views are as of Feb.15<sup>th</sup>, 2016 and subject to updates thereafter without notice.

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

## Industrial production is recovering though estimate for 1Q 2016 might be optimistic

- Industrial production has been rather resilient considering slowing-down global economies.
- Estimated index tends to be optimistic from the recent experience and 1Q 2016 could be revised downward.

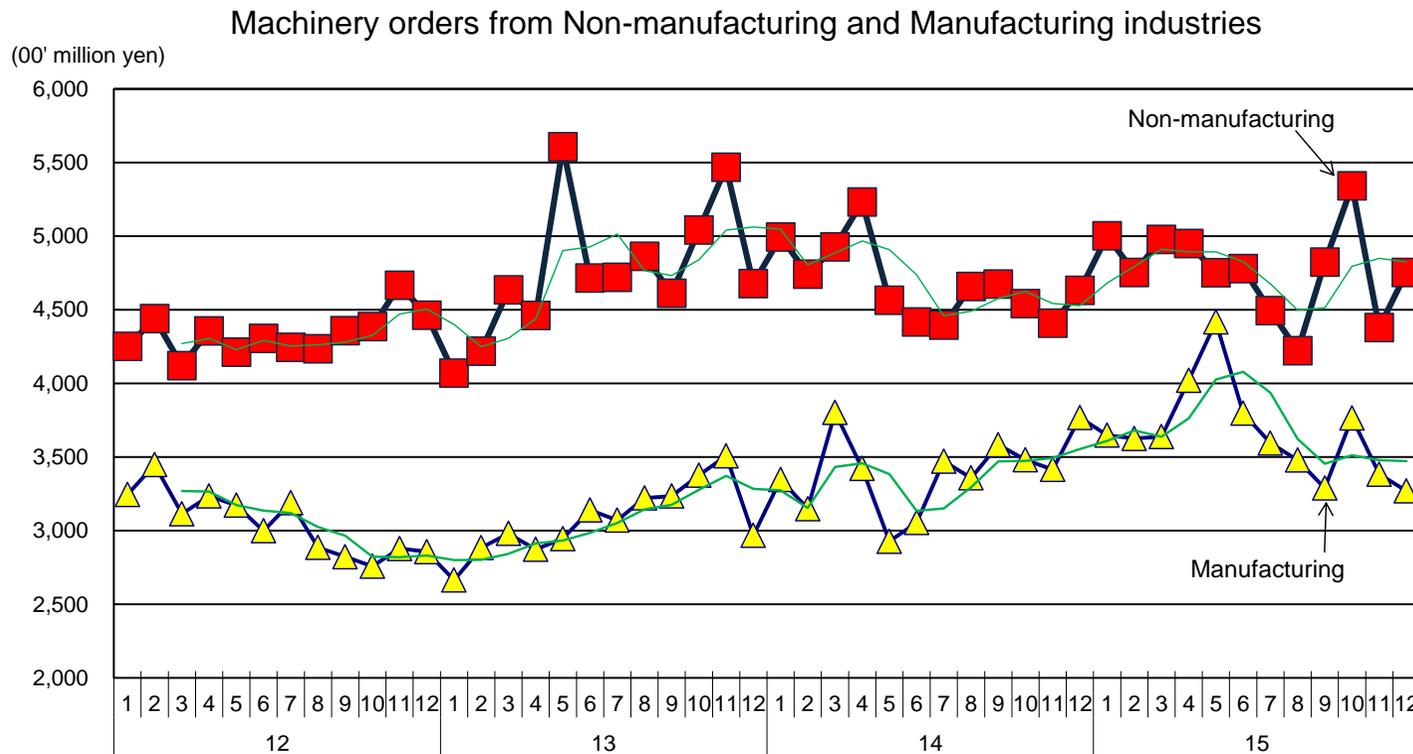


Note: Estimated Index from Jan. 2016 are used.

(Source) Ministry of Economy, Trade and Industry

## Machinery orders from non-manufacturing industries show resilience

- Manufacturing industries are negatively affected by global economic slowdown.
- Appetite for capital investment in non-manufacturing industries stays high, which is also witnessed in this statistics. Transportation sector is making the largest contribution for the recent machinery orders.



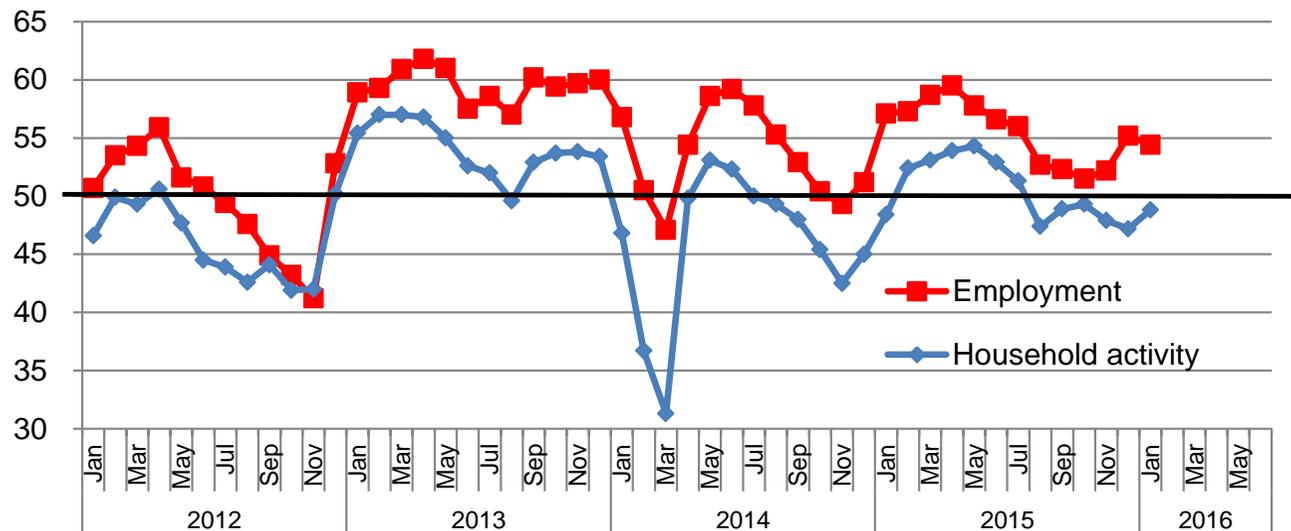
Note: \*Green lines are 3 month moving average for each data.  
Non-manufacturing excludes ship building & electric power.

(Source) Cabinet Office

## Consumers sentiment has been rather weak since last summer despite strong employment

- Consumer sentiment declined last summer due to such negative factors as rising prices and rainy weather, and then global economic slowdown and falling stock prices.
- Strong employment is supportive for the consumers, however, wage increase has not been large enough to stimulate private consumption. Spring wage negotiation round is currently going on, which could be rather disappointing as global economic slowdown makes companies more conservative.

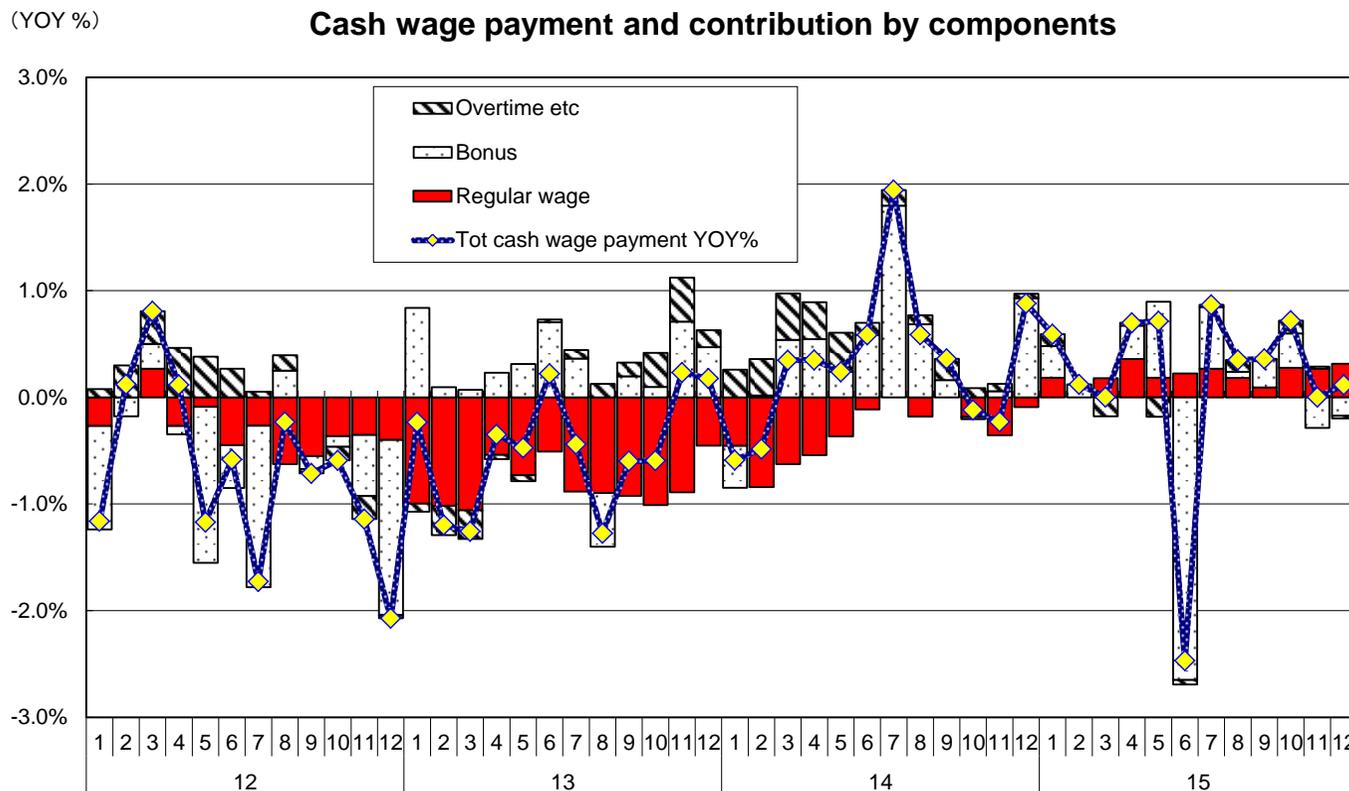
Economy Watchers DI (for future conditions)



Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is expected to improve.  
Source: Cabinet Office

## Regular wage increase is a supportive but not fast enough to offset inflation

- Regular wage has been increasing since the beginning of 2015, which is encouraging.
- When inflation was adjusted, real wage for 2015 slightly declined though it could have been distorted by large decline of bonuses in June 2015, for which statistical error caused by changing sample families was a possibility.



(Source) Ministry of Health, Labor and Welfare

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# Outlook for Japanese Stock Markets

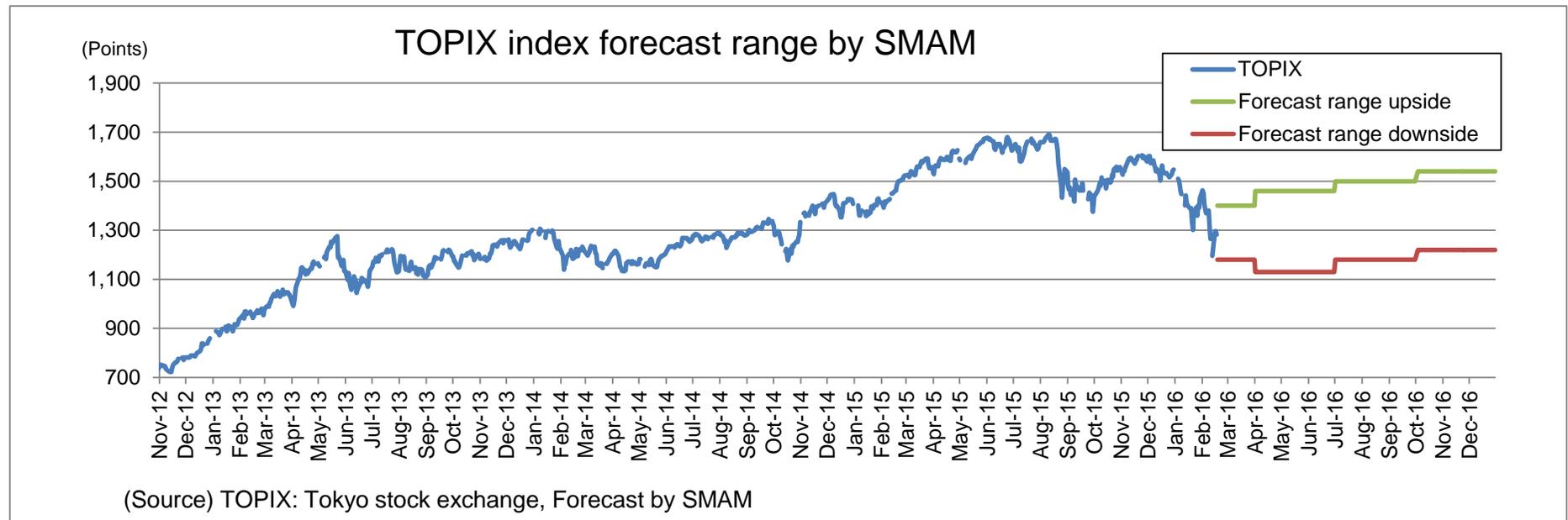
## Stock market outlook: waiting for a confirmation of global economic recovery

### SMAM short-term view

- Uncertainties surrounding the stock market will linger for some time, Chinese economy, Oil price, US slowdown, strong yen, possible earnings setback and so on. Japanese stock market is expected to move within a wide box range with high volatility for the short term.

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

- Lots of variables remain for a considerable time such as US interest rate policy, unfolding effects of negative interest rates in Japan and further monetary & fiscal policies possibly taken by global authorities.
- When global uncertainties are gradually cleared, especially the Chinese economy, the Japanese stock market will make recovery and start to build grounds for the upside trial.



Note: SMAM's Projection is as of Feb. 17th 2016 and subject to updates without notice

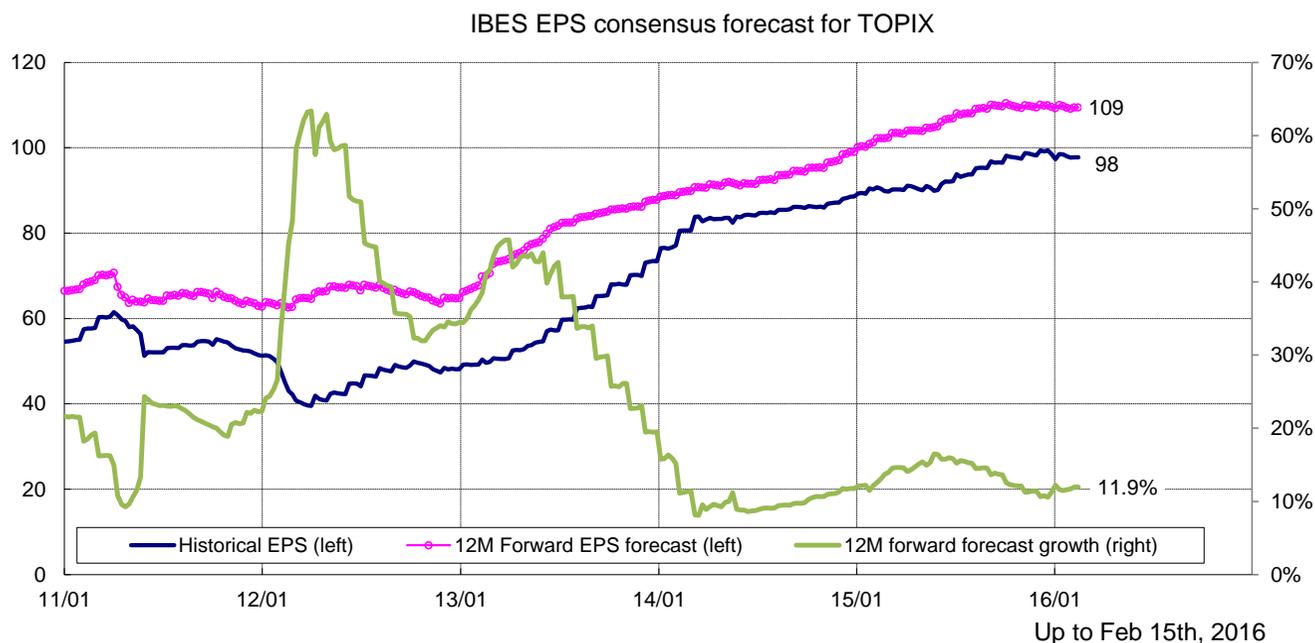
## Base scenario & Upside / Downside risks for our forecasts

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- Our **Base Scenario** is assuming the following views:
  - Global economy does not enter into a recession.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese corporate earnings keep growing at higher pace than in peer countries.
  - 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.
  - Falling oil price causes disastrous problem for oil producing countries.
  - Increasing geopolitical concerns.

## Earnings growth is expected to continue for Japan

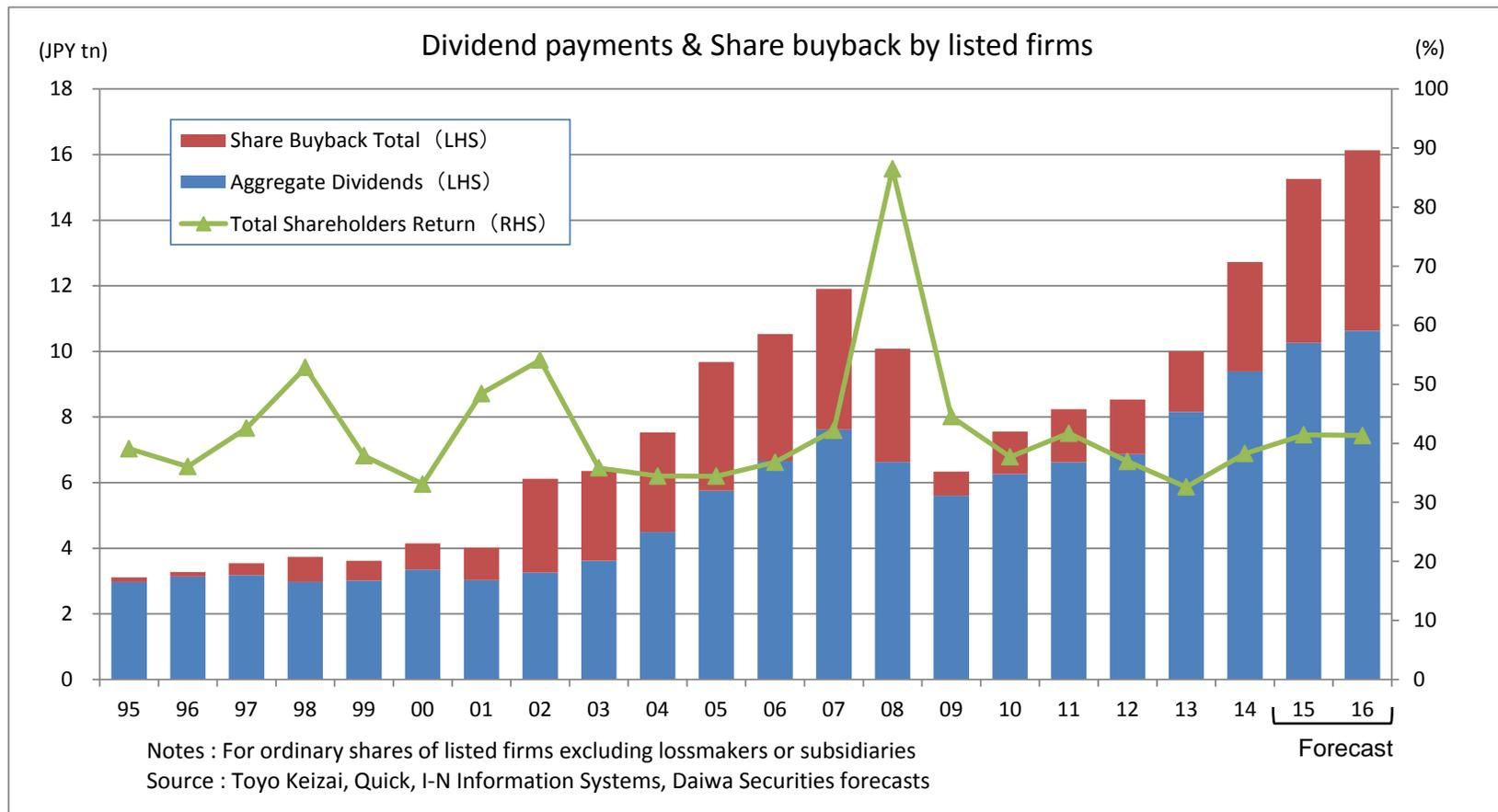
- According to IBES, analysts are forecasting EPS to grow by 11.9% in the 12 months forward, however, downward revision will be made.
- Global economic slowdown and strong yen are weighing on companies. According to Nikkei newspaper, Apr-Dec 2015 recurring profit grew +5.9% YOY. Profit forecast by companies for entire FY2015 was to grow by +2.3% for all listed companies having fiscal year end in March excl. financials.
- Profit forecast by companies could be a little conservative, however, uncertainty for the corporate earnings could undermine the reliability of stock valuations.



(Source) Datastream, IBES

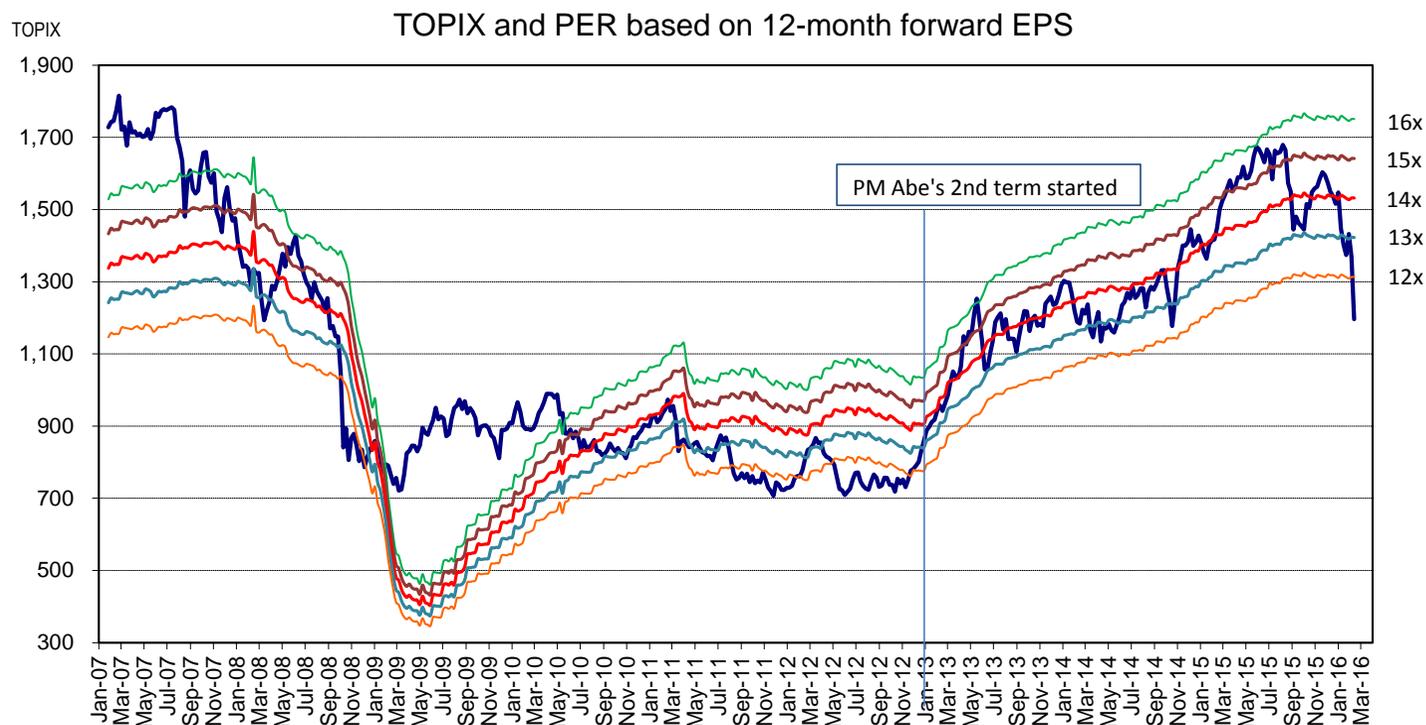
## Increasing share buybacks should be supportive for the share prices in the long term

- Due to accumulating cash and low share prices, large share buybacks have been announced by companies, which are surely positive for the stock market in the long run.
- Negative interest rate should make it even harder for companies to justify huge amount of idling cash.



## Current PER indicates the stock prices have already discounted lots of pessimism

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 12.5x and 16x. The recent low of 1196.28 in TOPIX seems at oversold level.
- At 1180 in TOPIX, PBR is 1.0 times and some downside protection could start to work under this level.

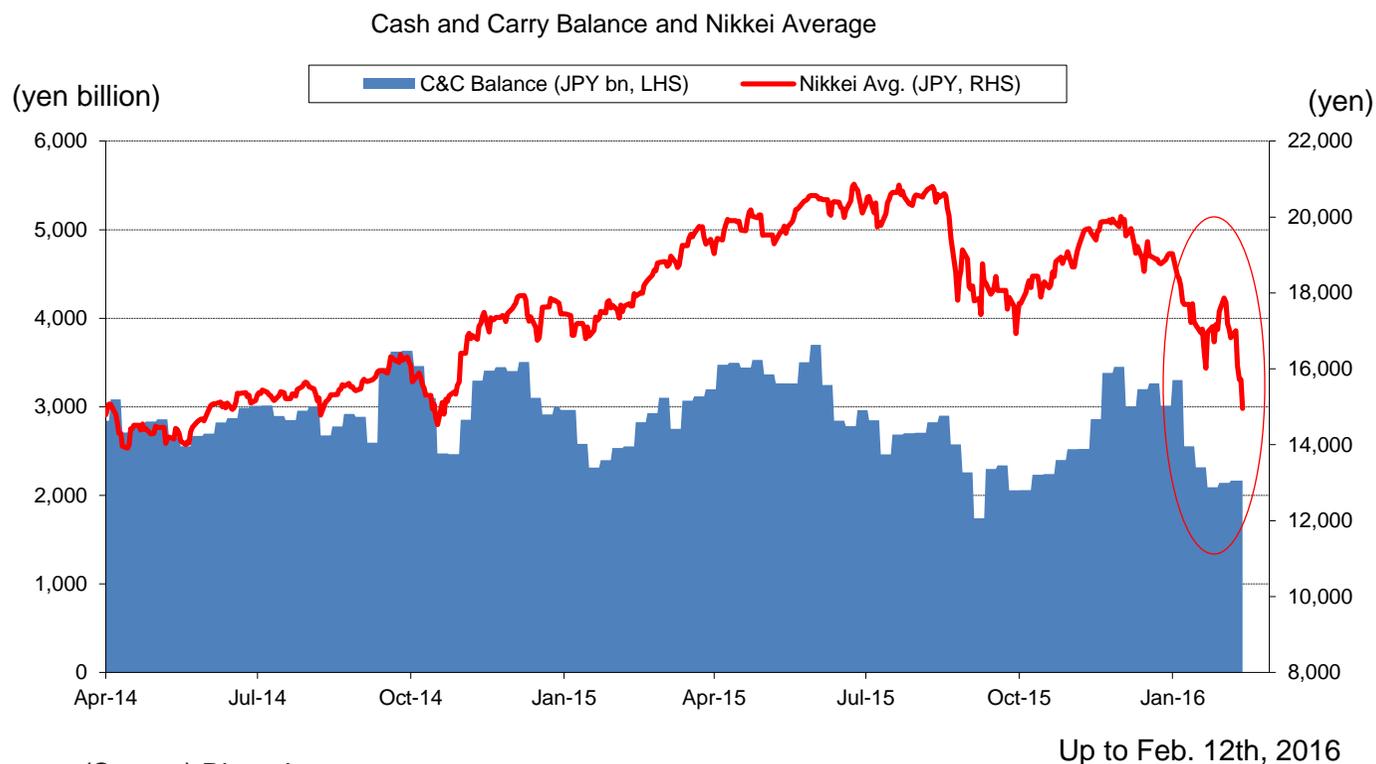


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES  
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Feb. 12th 2016 when TOPIX was 1196.28.

## Short term investors such as hedge funds seem to be taking a heavy short positions

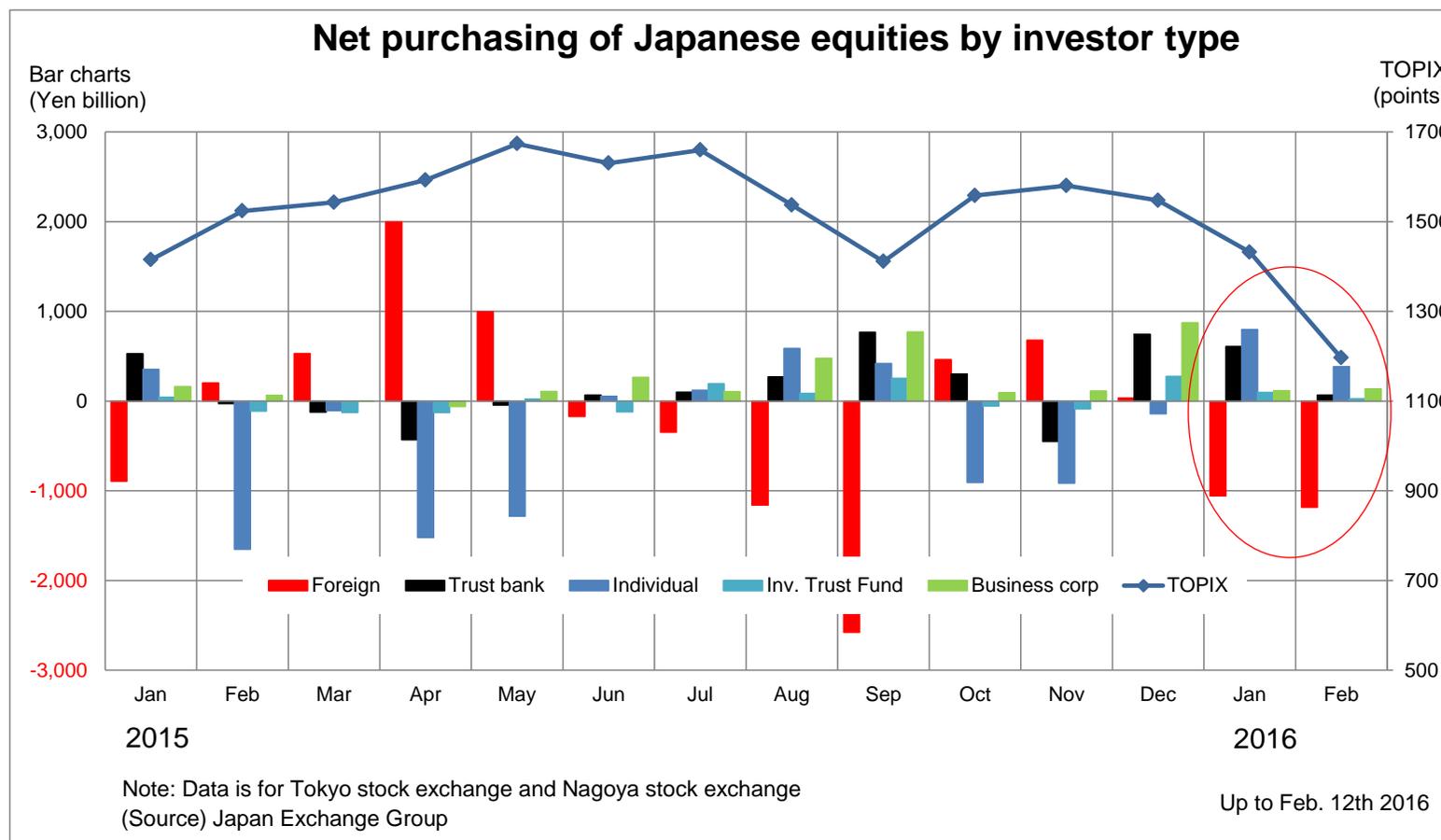
- Cash & carry arbitrage position is the amount of cash shares bought as a paring with short positions in derivatives. It is regarded as an indicator for activities of short term investors such as hedge funds.
- After the turn of the year, this arbitrage position has declined sharply, which indicates short term investors are heavily selling Japanese equities using derivatives.



(Source) Bloomberg

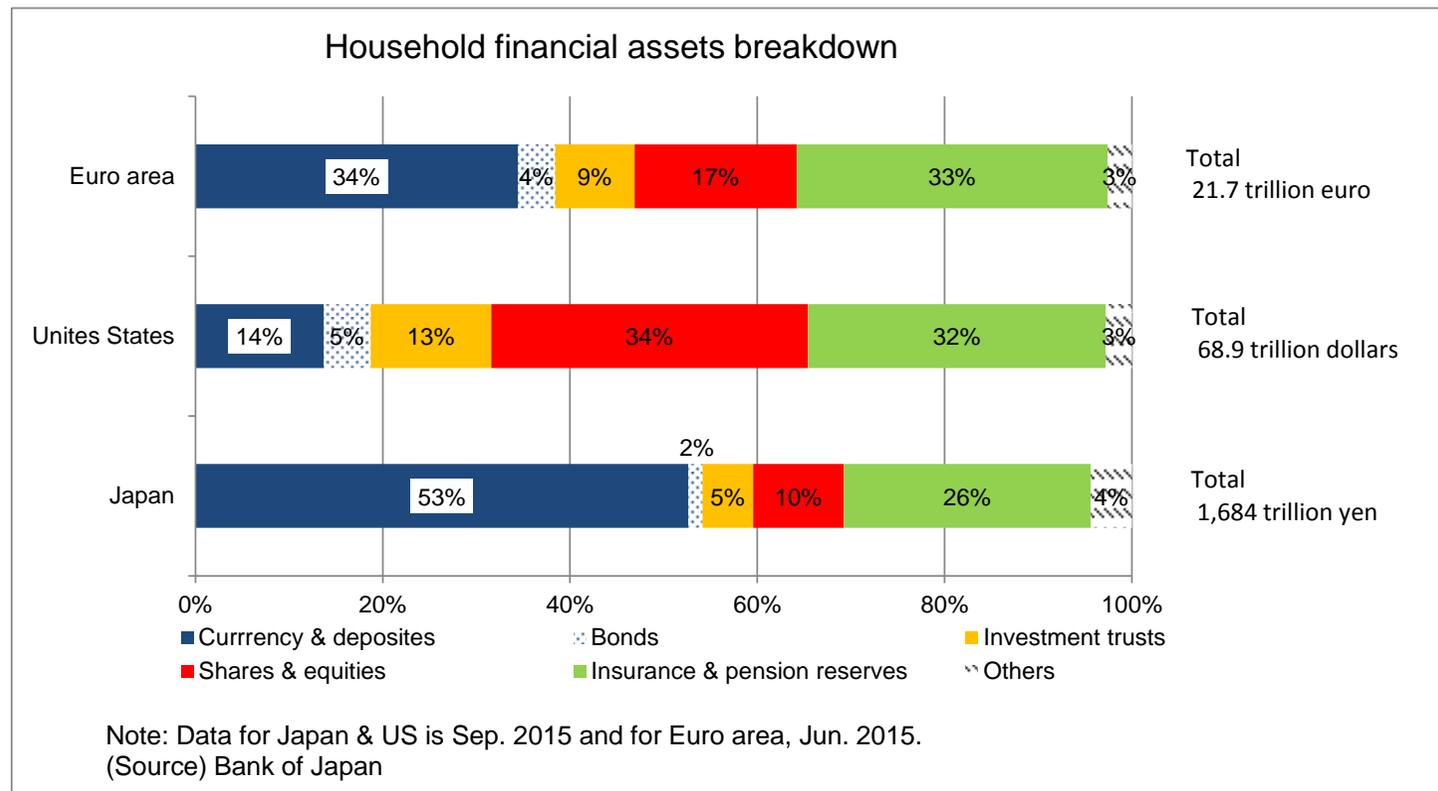
## Supply-Demand balance: Foreign investors selling is pulling the stock prices down

- Foreign investors have sold 2.2 trillion yen of Japanese listed shares this year out-powering domestic investors' purchasing.
- In the exchange traded futures, foreign investors sold 1.2 trillion yen in January, however, bought approx. 1 trillion yen in February up to 12th.



## Could negative interest rate cause shift in huge household assets in Japan?

- In Japan, as much as 53% of huge household assets are held in cash and deposits with minimal yields.
- Interest rate for individuals would not become negative yet due to the guidance by the government to financial institutions, however, individuals might start looking for more yield for their assets.
- On the other hand, if negative interest rate confuses financial systems and uncertainty deepens, individuals could be discouraged to take risks for their savings.



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