

Japanese Stock Market Outlook

SMAM monthly comments & views
- April 2016 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Important political events are scheduled in the first half of this year. A G7 meeting is held in May in Ise-Shima Japan. PM Abe is keen to make it successful running up to an Upper House election in July. Fiscal stimulus is going to be a major issue.

- Core CPI, which excludes fresh food, is forecast to fall into negative numbers in the mid 2016. CPI watched by BOJ, which excludes fresh food & energy, was at 1.1% in January, however, the momentum seems declining, which might push BOJ to make further easing sometime this year.
- GDP forecast was downgraded by 0.1% for both FY2015 and FY2016. Ongoing spring wage negotiation shows lower increase than the previous year, which could be a drag for the private consumption in FY2016. Private capital investment is expected to make a mild contribution to the economic growth going forward.

➤ Japanese Stock Markets

Recently confirmed solidness in the US has slightly eased global risk-off mode, however, uncertainties still linger on. Following the G20 meeting in February, fiscal stimulus measures are eagerly anticipated. 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 12x and 16x except for temporary overshooting. PER has recovered due to some rebounding in stock prices and also downward revision in earnings forecasts. Even considering further down-revision in earnings, current PER doesn't look expensive.
- 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.

Notes: Macro and market views are as of Mar.18th and 23rd 2016 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-17

- GDP forecast was downgraded by 0.1% for both FY2015 and FY2016. Ongoing spring wage negotiation shows lower increase than the previous year, which could be a drag for the private consumption in FY2016.
- Preliminary forecast was set for FY2017 and this weak forecast was due to estimated aftershock of consumption tax hike scheduled in April 2017. The possibility for postponing this tax hike seems to be increasing as famous economists recently invited by the Abe government are suggesting such postponement.

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Real GDP growth	1.0%	2.1%	-0.9%	0.7%	0.8%	-0.2%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.5%	0.8%	-0.7%
Private Housing Investment	5.7%	8.8%	-11.7%	2.1%	2.1%	-3.9%
Private Capital Investment	1.2%	4.0%	0.5%	2.3%	2.7%	-1.3%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.4%	1.0%	0.8%
Public Capital Investment	1.0%	10.3%	-2.6%	-1.8%	-2.9%	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%	2.0%	0.6%	0.9%
GDP Deflator	-0.9%	-0.3%	2.5%	1.3%	-0.2%	1.1%

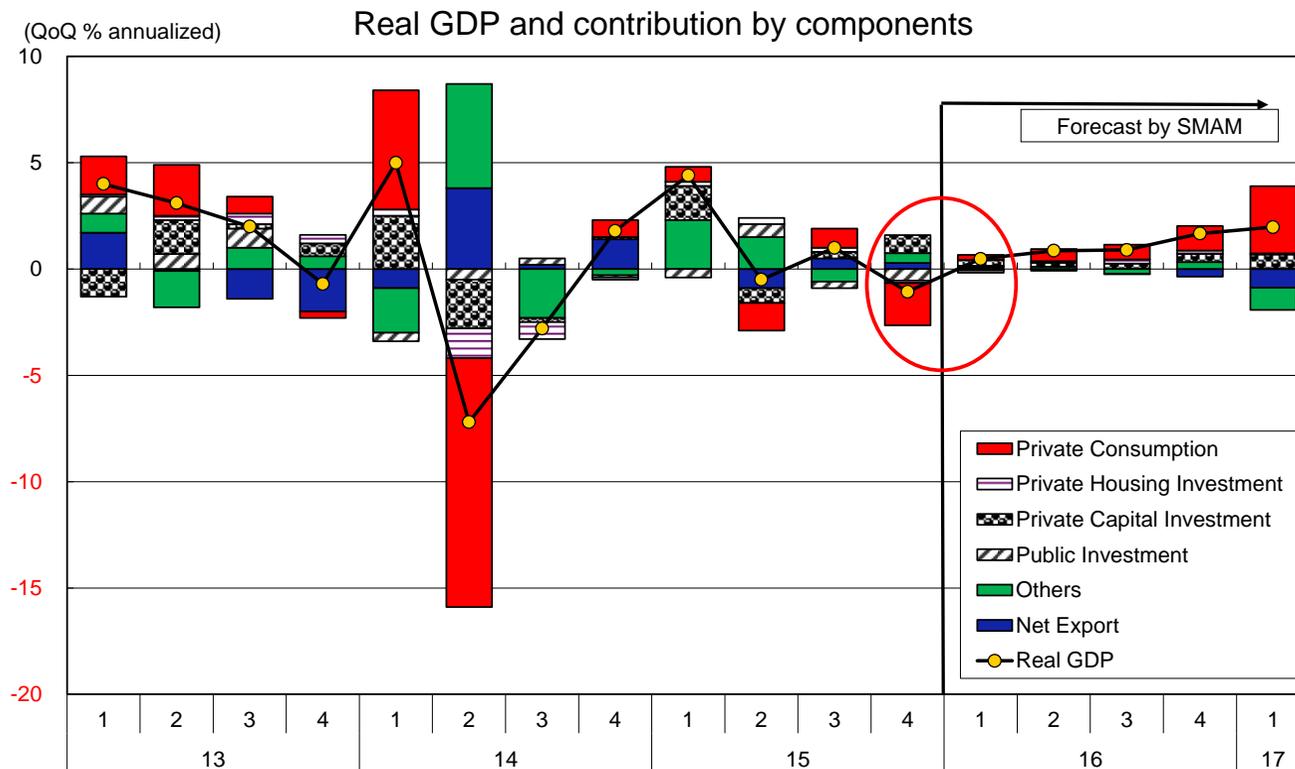
Notes: E=SMAM forecasts. SMAM views are as of Mar. 18th, 2016 and subject to updates thereafter without notice

(%, 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

- Private consumption is forecast to make a mild recovery in Jan-Mar quarter after declining by -0.9% QoQ in the previous quarter. Current forecast assumes some rush demand before the next consumption tax hike scheduled in April 2017.
- Private capital investment is expected to make a mild contribution to the economic growth going forward.

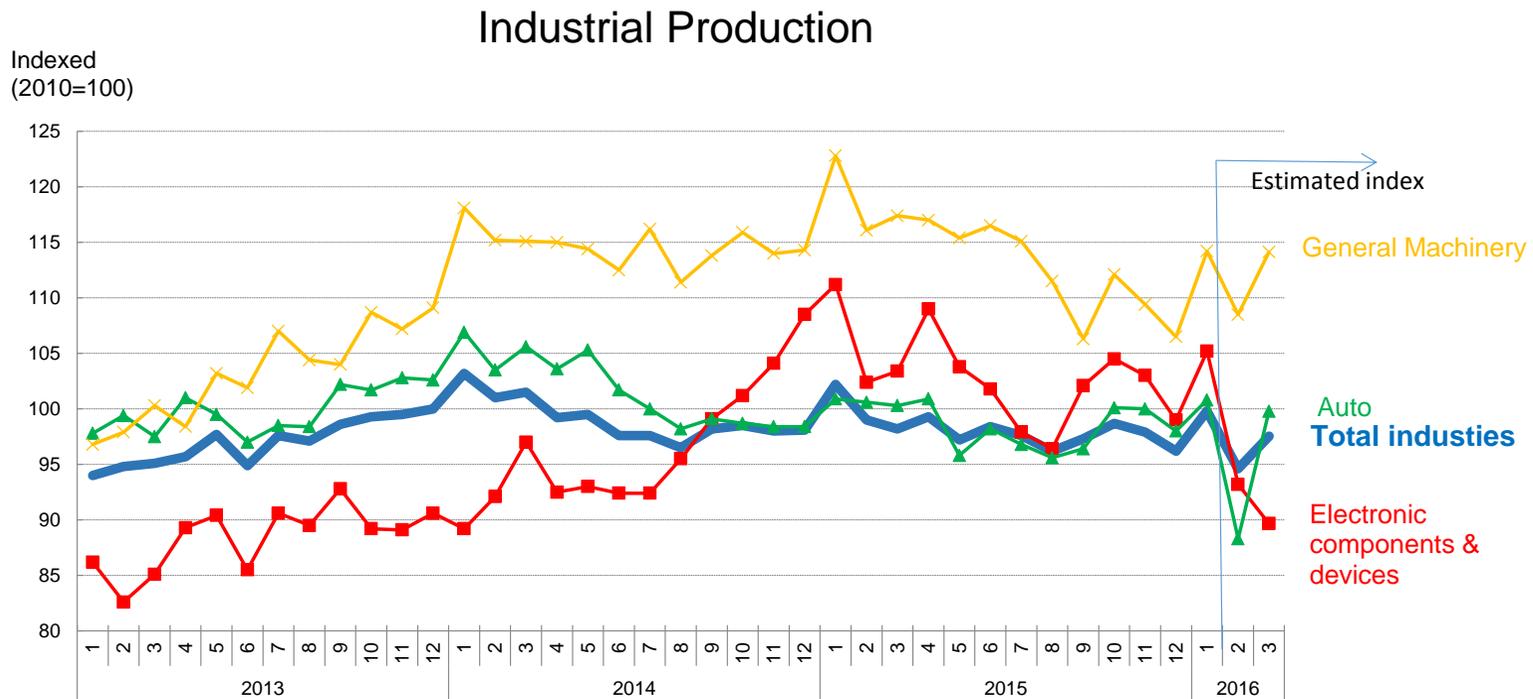


Notes: SMAM views are as of Mar.18th, 2016 and subject to updates thereafter without notice.

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

Industrial production made a recovery in January, but a pull back is estimated

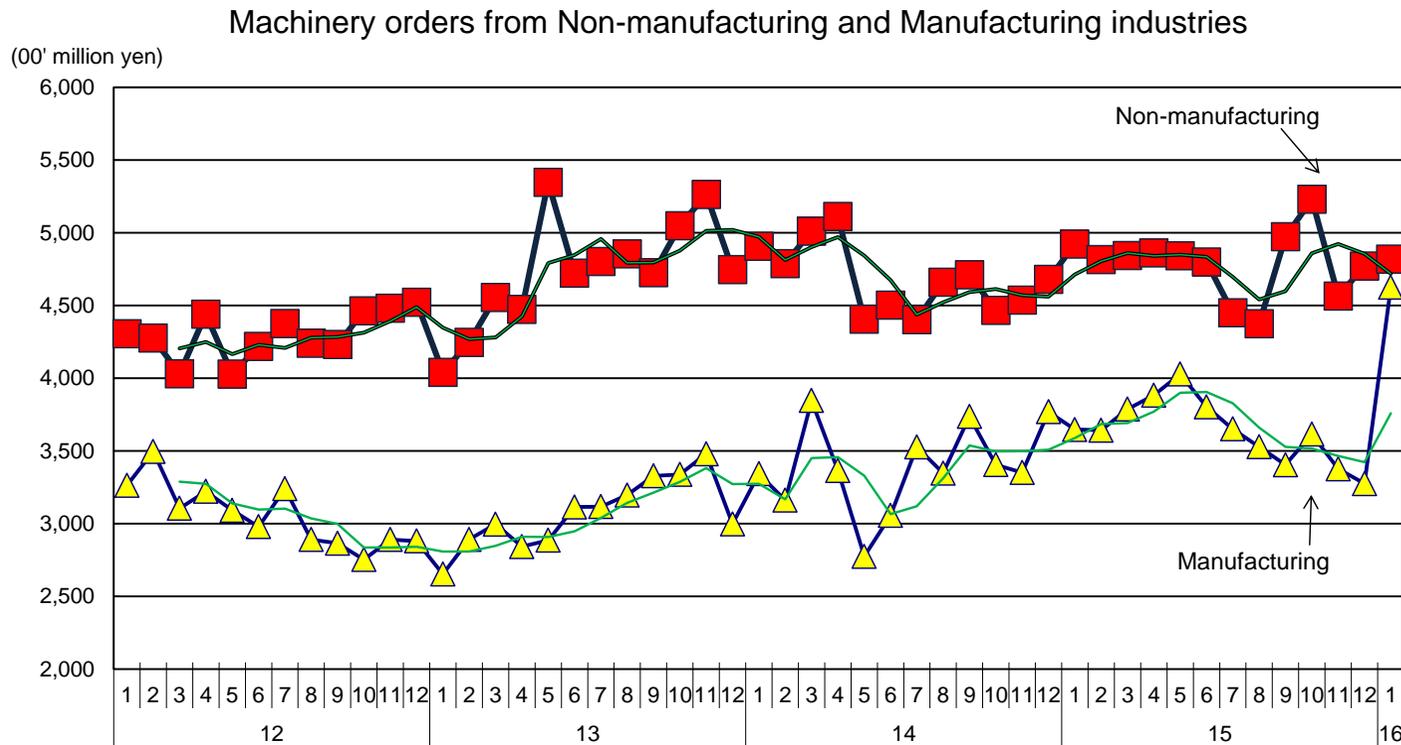
- Industrial production increased by 3.7% MoM in January rebounding from the weakness in the last year end.
- Estimated index for February and March points to a pull back. Electronic components & devices are expected to fall sharply due to such factors as weak sales and production of iPhones and other smart phones. Auto is estimated to have dipped in February due to a temporary stoppage in Toyota's production caused by one of its suppliers.



(Source) Ministry of Economy, Trade and Industry

Machinery orders from non-manufacturing industries show resilience

- Machinery orders in January was strong at 15% MoM increase lifted by a large order coming from steel industry, which seems a little exceptional.
- Appetite for capital investment in non-manufacturing industries stays high.

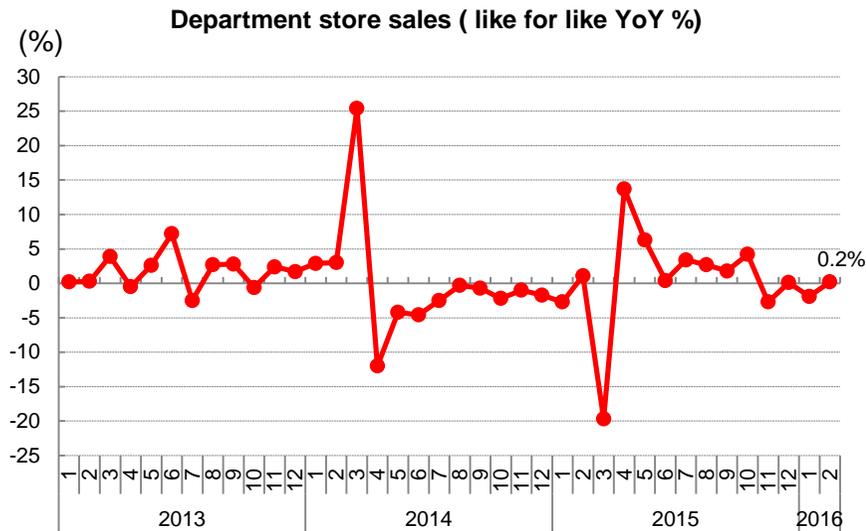


Note: *Green lines are 3 month moving average for each data.
Non-manufacturing excludes ship building & electric power.

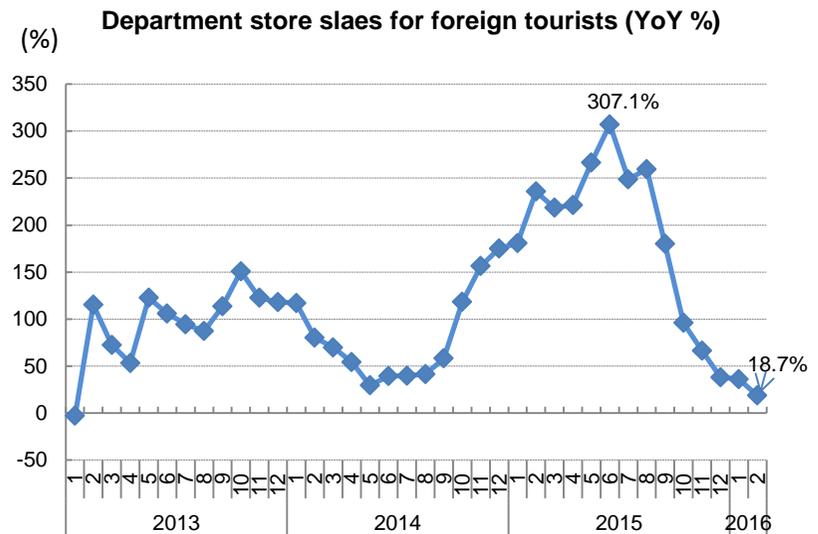
(Source) Cabinet Office

Department store sales is drifting since winter whereas sales for foreign visitors are still rising

- Department store sales fell during the winter partly due to a warm weather, and drifting afterwards.
- After a phenomenal increase once touched 300% YoY in June 2015, sales for foreign tourists recorded still respectable 18.7% increase in February, when many tourists visited Japan during Chinese New Year holidays.



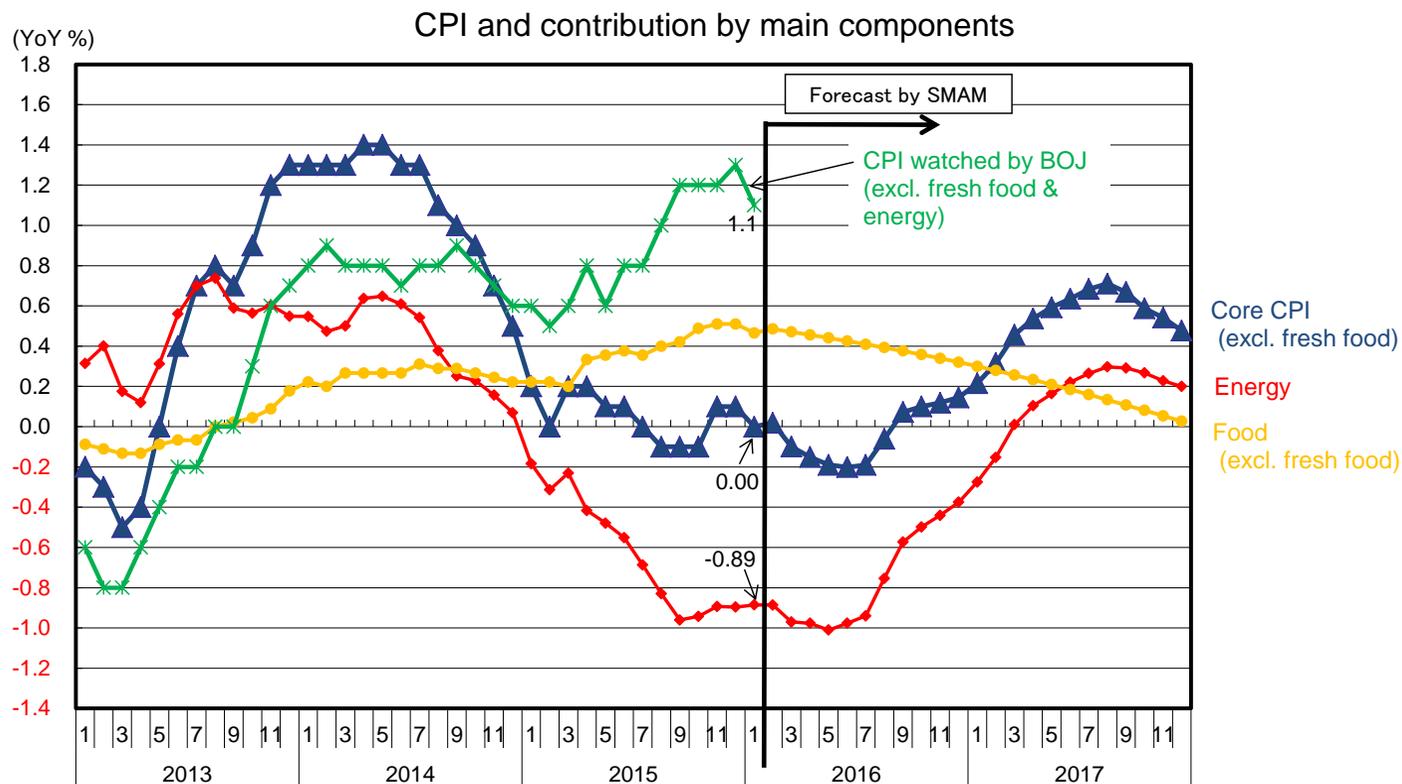
(Source) Japan Department Store Association



(Source) Japan Department Store Association

Core CPI is forecast to dip into negative territory in mid 2016

- Core CPI, which excludes fresh food, is forecast to fall into negative numbers in the mid 2016.
- CPI watched by BOJ, which excludes fresh food & energy, was at 1.1% in January, however, the momentum seems declining, which might push BOJ to make further easing sometime this year.

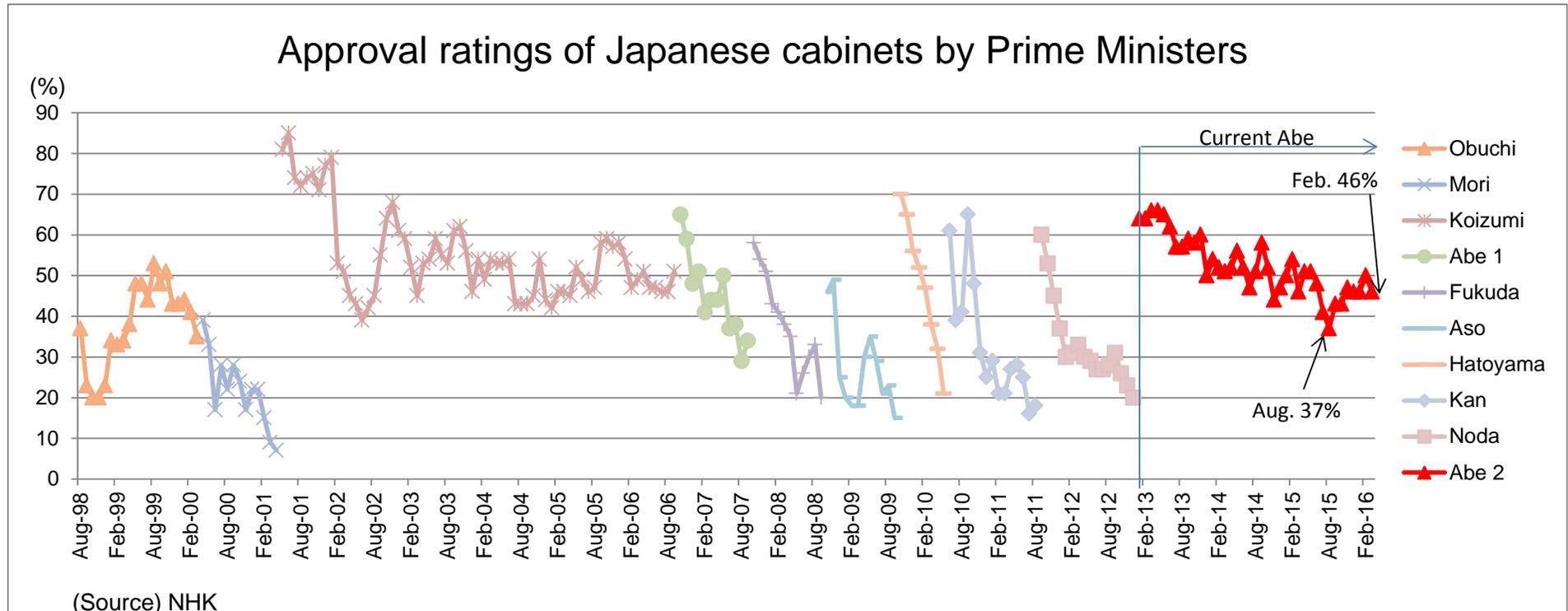


Note: Excluding direct impact from consumption tax hike in April 2014.

(Source) Ministry of Internal Affairs & Communications, forecast by SMAM.

Political events hold the key for the outlook of Japanese economy and stock markets

- Important political events are scheduled in the first half of this year.
- A G7 meeting is held in May in Ise-Shima Japan. PM Abe is keen to make it successful running up to an Upper House election in July.
- Fiscal stimulus is going to be a major issue.



Outlook for Japanese Stock Markets

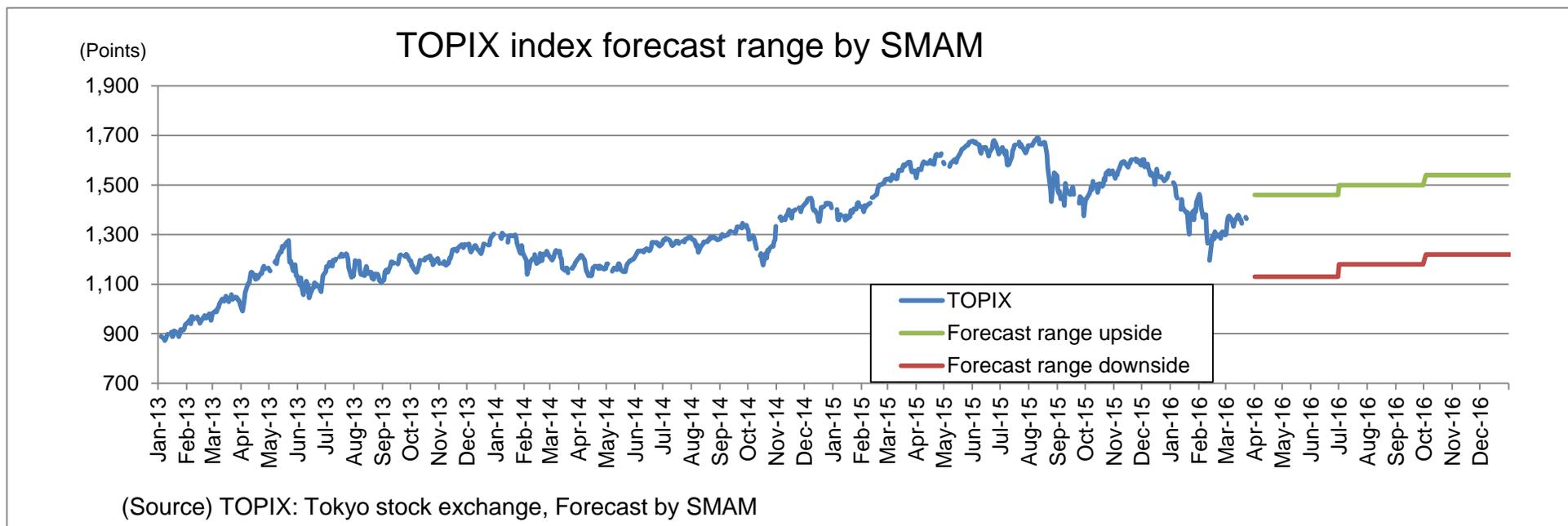
Stock market outlook: waiting for fiscal stimulus measures and global economic recovery

SMAM short-term view

- Recently confirmed solidness in the US has slightly eased global risk-off mode, however, uncertainties still linger on. Following the G20 meeting in February, fiscal stimulus measures are eagerly anticipated. 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 some 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 Mar. 23rd 2016 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

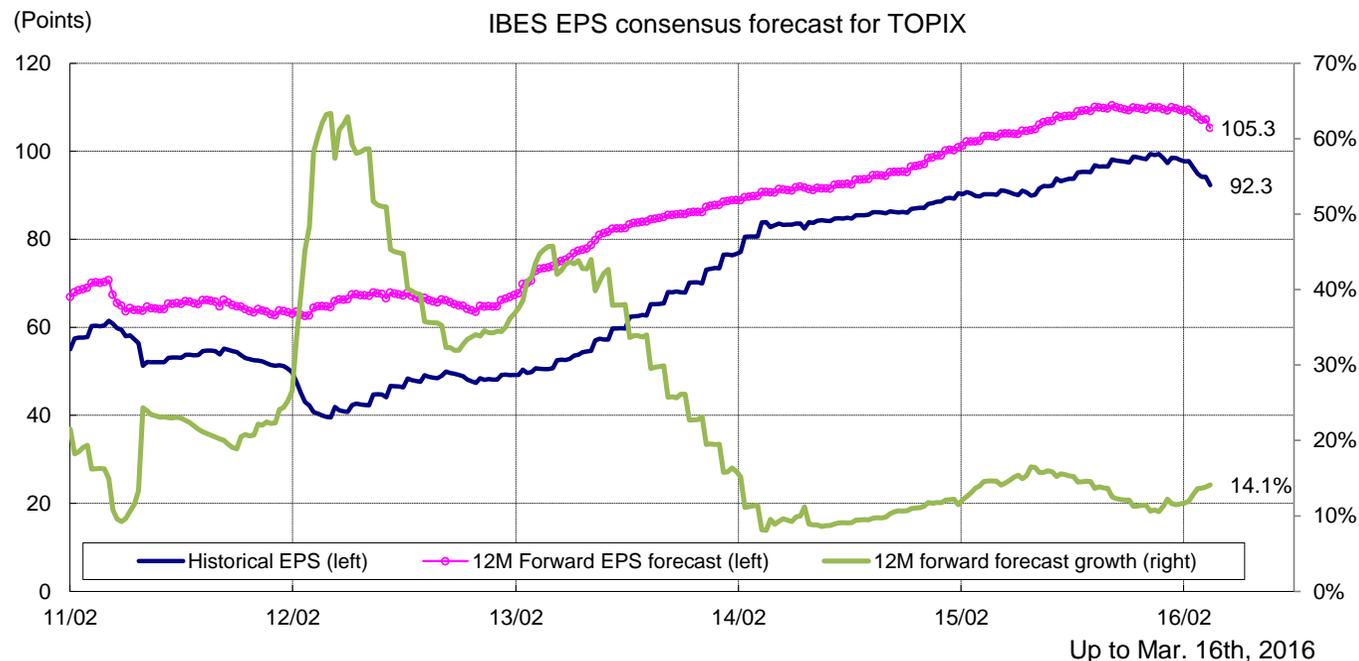
- Our **Base Scenario** is assuming the following views:
 - Global economy does not enter into a recession.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese corporate earnings keep growing at higher pace than in peer countries.
 - Reflationary policy to be continued 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 are currently revised downward

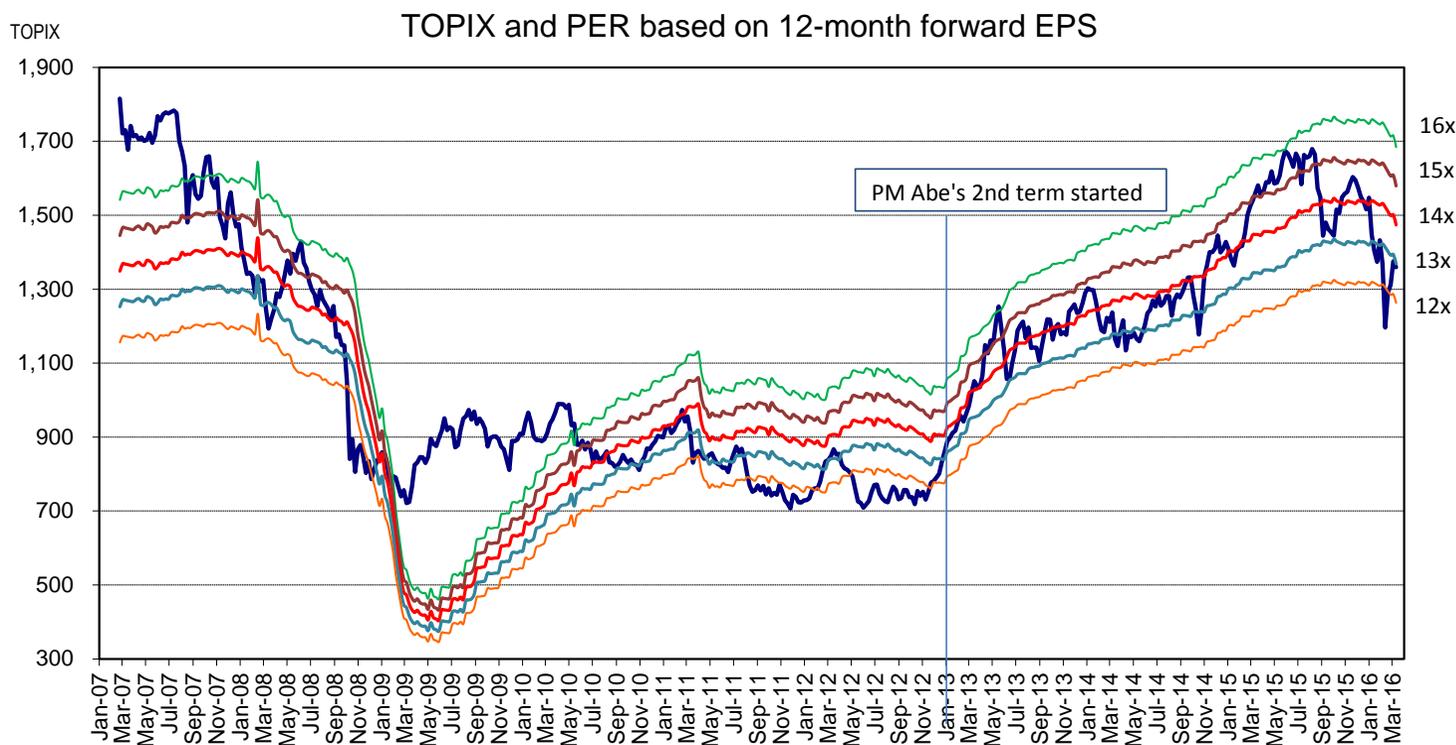
- After rather disappointing earnings results for Oct-Dec 2015, both historical and 12m forecast earnings have been revised downward according to IBES.
- SMAM covers 216 companies excluding financials for regular researches and forecasts recurring profits to grow 7.6% for FY 2015 ending in March and 5.6% for FY 2016 assuming 115 yen/\$ rate.
- Companies will announce own forecasts for FY 2016 around in May. If yen/\$ stays around current 110-112 level, companies' earnings guidance for FY 2016 could be more conservative.



(Source) Datastream, IBES

PER is in the lower half of the range for the current PM Abe's tenure

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 12x and 16x except for temporary overshooting.
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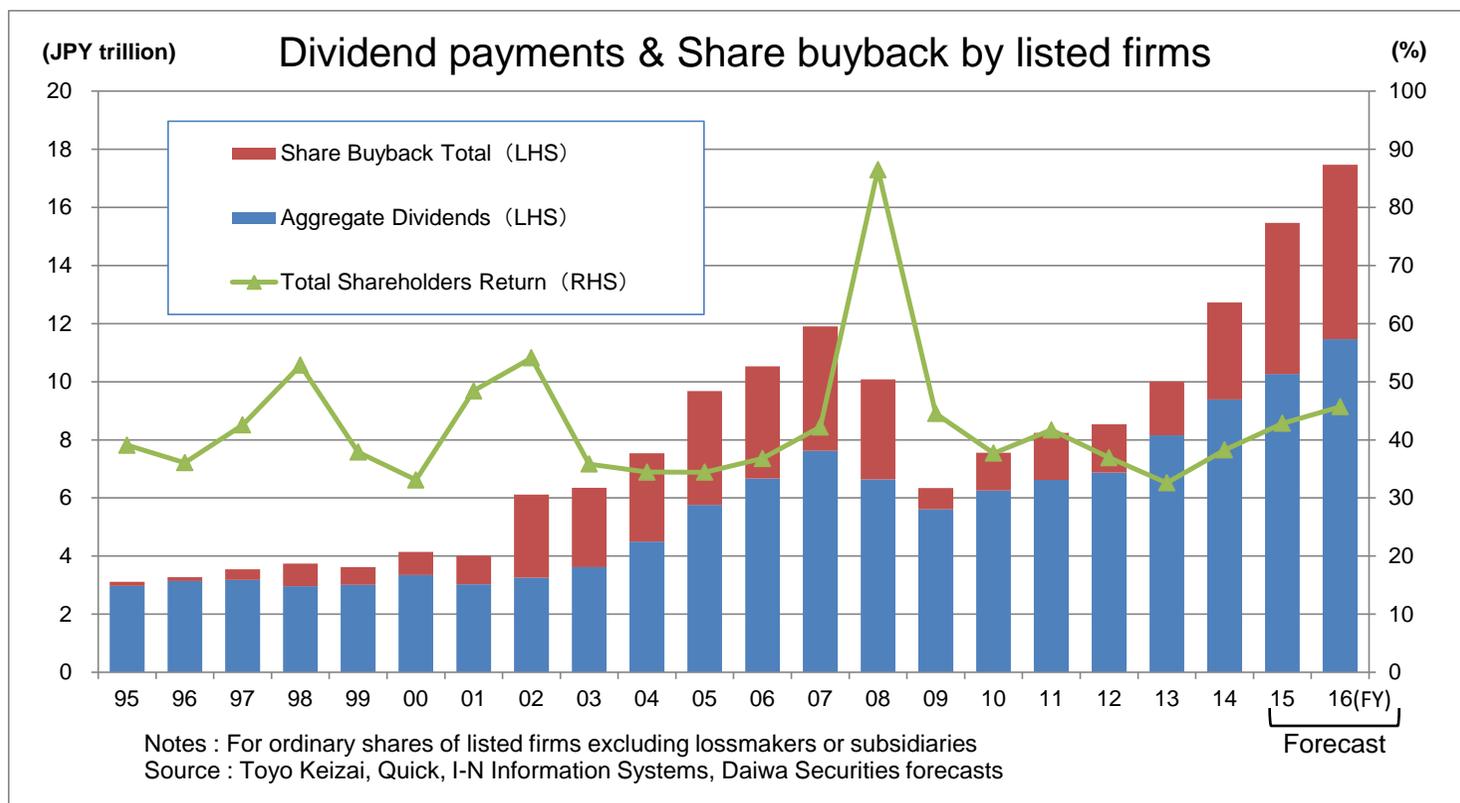


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
 Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Mar. 11th 2016 when TOPIX was 1359.32

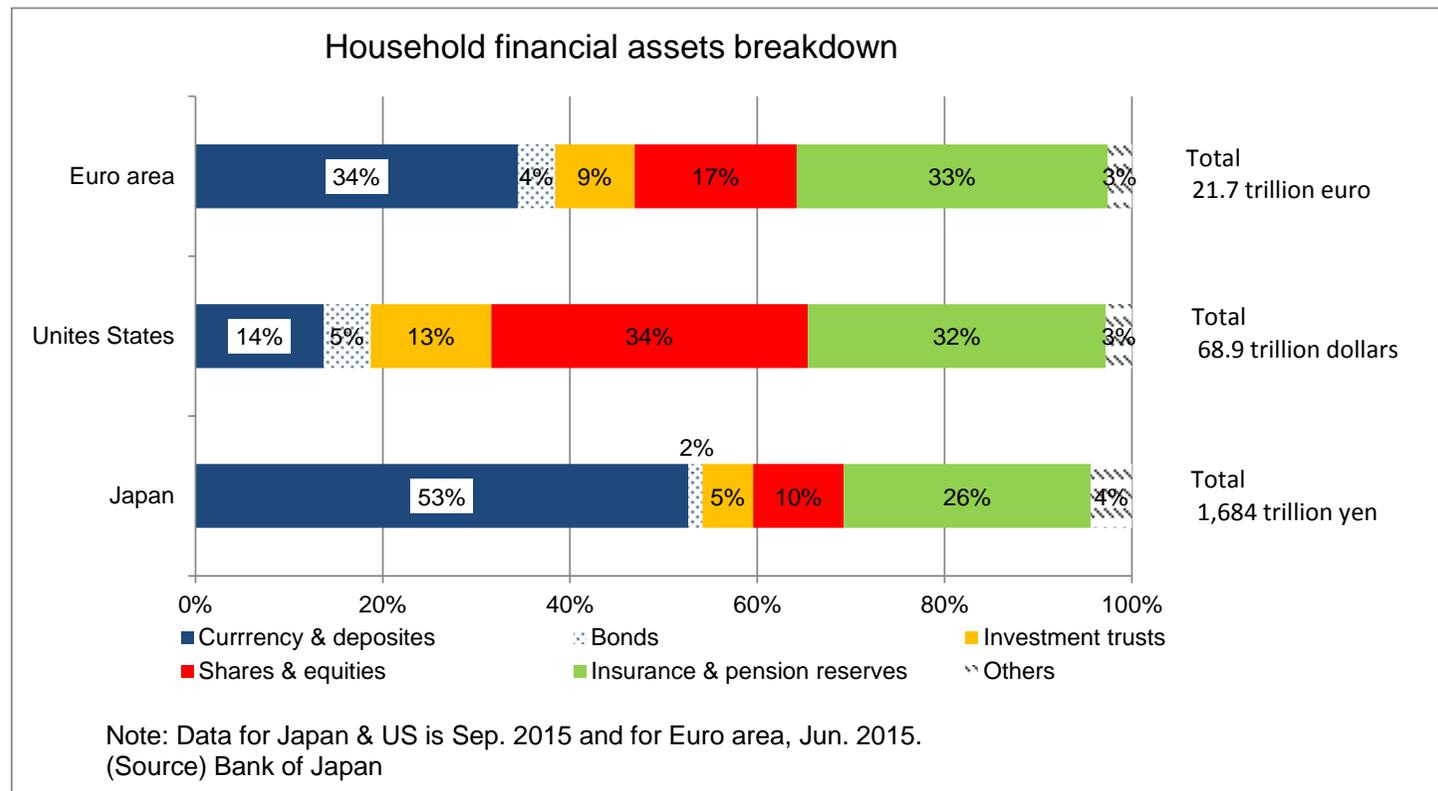
Total shareholders return is forecast to increase in FY 2015 and 2016

- 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.



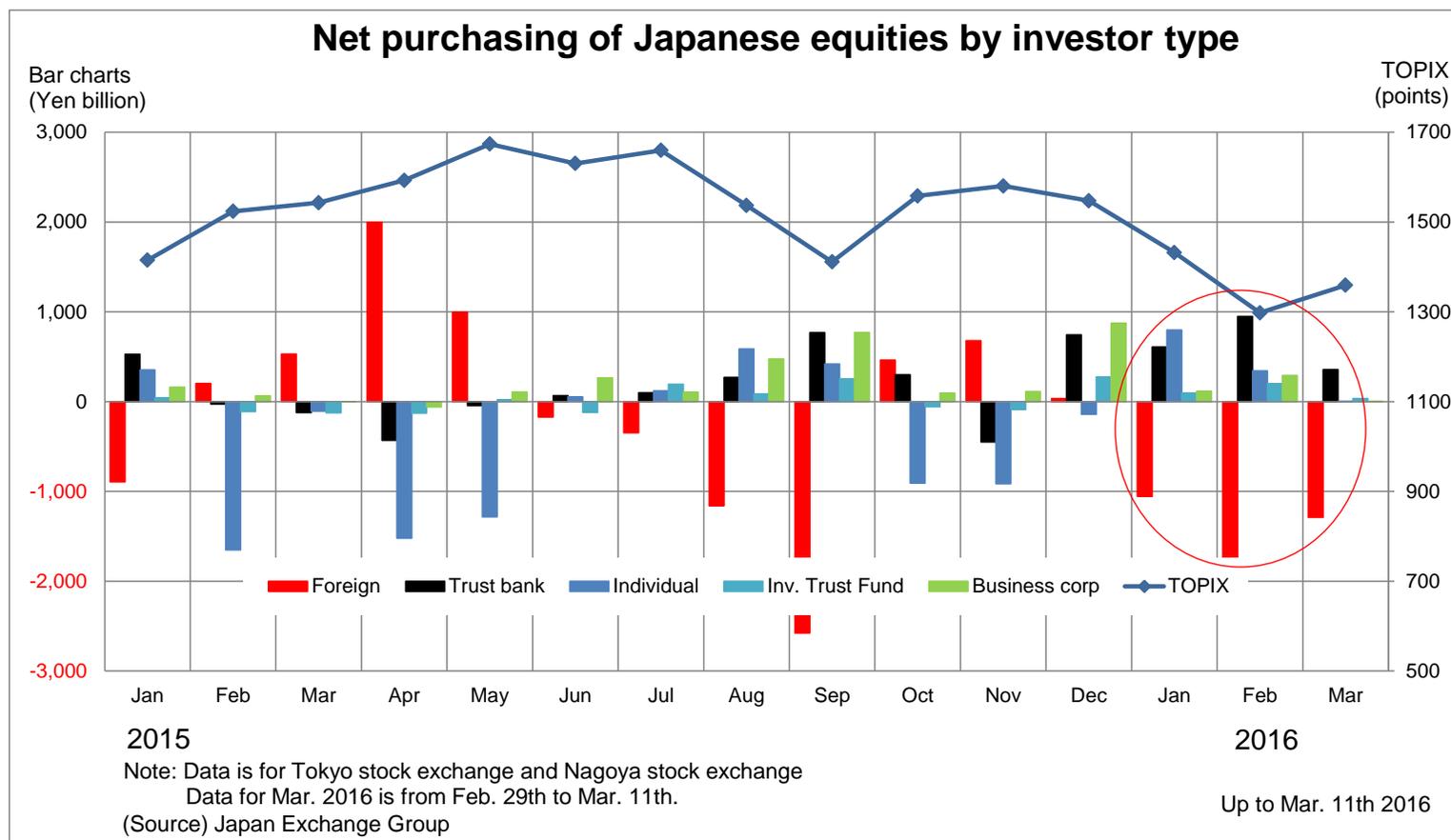
Could negative interest rate cause shift in huge household assets in Japan?

- 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.



Foreign investors are selling and pension funds are buying

- Foreign investors continue to sell Japanese equities whereas trust banks, mostly representing pension funds, are the largest purchaser.
- In the exchange traded futures, foreign investors sold 1.2 trillion yen in January then bought back 0.77 trillion yen in February. They started selling futures again in the 2nd week of March.



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