

Japanese Stock Market Outlook

SMAM monthly comments & views

- June 2016 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

Real GDP for Jan-Mar 2016 was +0.4% QoQ, +1.7% when annualized, which was better than forecast. Private consumption was +0.5% QoQ though it was inflated by leap year effects.

- Capital investments, especially from non-manufacturing industries show strength and also manufacturing industries show some resilience when interpreted by recent machinery orders statistics. Government has set nominal GDP target of yen 600 trillion in FY2021. Productivity improvement in the service sector is expected to play a key roll with an ambitious target of 2% per annum improvement.
- Despite recent weakness in consumer spending, fundamentals surrounding households are still solid. Tight labor market should provide job security and aggregated real wage continues to grow where all three factors, nominal wage, number of employees and low inflation contributed in March.

➤ Japanese Stock Markets

Negative news on corporate earnings has been completed. There are many events waiting ahead such as next US interest rate hike, possible monetary & fiscal stimulus in Japan, Upper House election in July. High volatility is expected to stay, however, expectation for further stimulus could lift the stock market for the short term.

- Majority of the Japanese companies set 110 yen/dollar rate for the earnings forecast for FY2016. If yen stabilizes around the current level, further negative currency impact can be avoided, and conservative earnings estimates by companies can be gradually revised upward.
- Sluggish Chinese economy is likely to continue. US economy shows some strength, however, it makes FED rate hike more possible. Overseas economy is going to stay patchy. The key for the Japanese economy and stock market will be what kind and amount of stimulus measures are taken and how effective they turn out.

Notes: Macro and market views are as of May 18th and 20th, 2016 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-17

- SMAM's Real GDP forecast for FY2016 and 2017 are unchanged from the previous month. Recently announced Jan-Mar GDP of annualized 1.7% was better than preceding forecasts even though inflated by leap year effects.
- Current forecast assumes consumption tax to rise from 8% to 10% in April 2017 as scheduled. Odds for postponing this tax hike is rising and if it is postponed GDP forecast will be +0.5% for FY2016 and +0.9% for FY2017.

	FY12	FY13	FY14	FY15	FY16E	FY17E
Real GDP growth	0.9%	2.0%	-0.9%	0.8%	0.8%	0.2%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.3%	0.9%	-0.3%
Private Housing Investment	5.7%	8.8%	-11.7%	2.4%	2.4%	-3.9%
Private Capital Investment	0.9%	3.0%	0.1%	1.6%	1.0%	-1.3%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.6%	1.4%	0.8%
Public Capital Investment	1.0%	10.3%	-2.6%	-2.2%	1.9%	4.0%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	0.0%	0.2%
Exports	-1.4%	4.4%	7.9%	0.4%	2.0%	2.9%
Imports	3.6%	6.8%	3.4%	-0.1%	2.0%	1.8%
Nominal GDP	0.0%	1.7%	1.5%	2.2%	0.3%	1.3%
GDP Deflator	-0.9%	-0.3%	2.4%	1.4%	-0.6%	1.1%

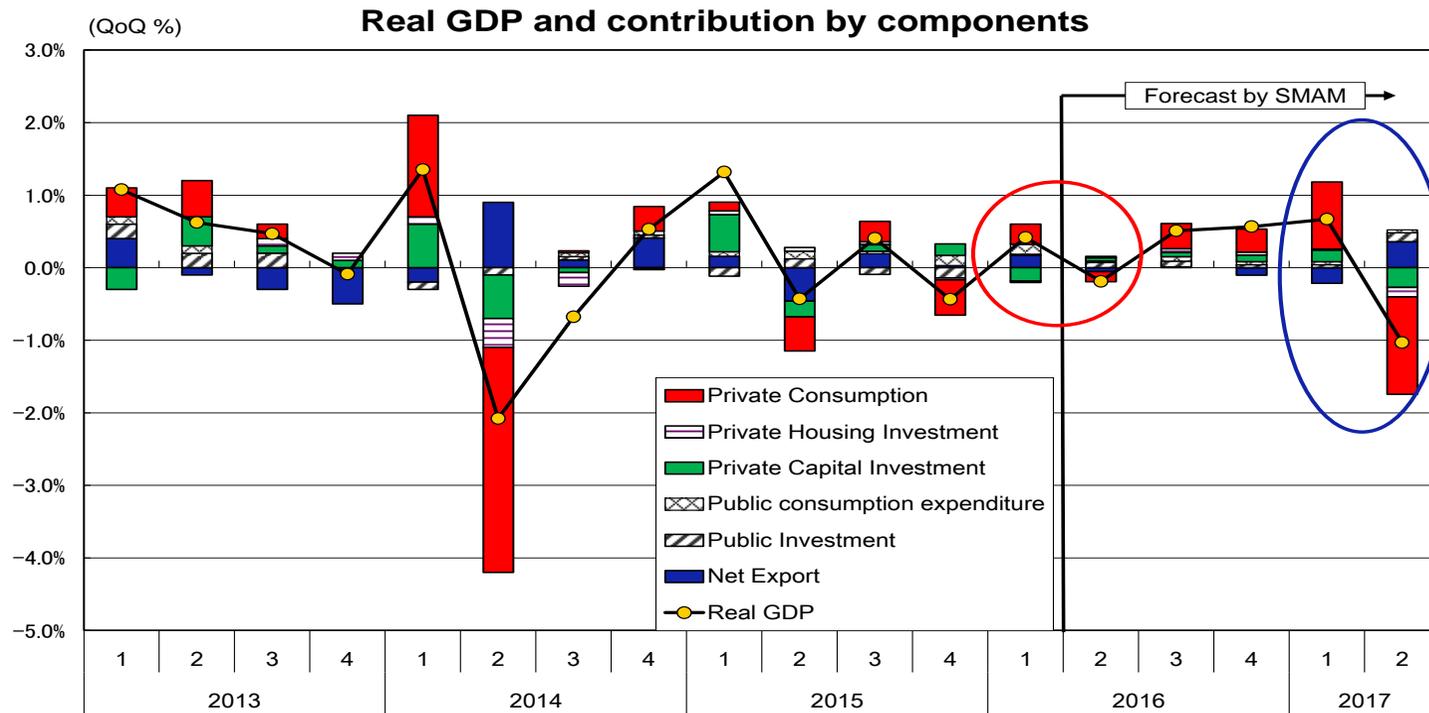
Notes: E=SMAM forecasts. SMAM views are as of May 18th, 2016 and subject to updates thereafter without notice

(%, 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 quarterly economic outlook

- Real GDP for Jan-Mar 2016 was +0.4% QoQ, +1.7% when annualized, which was better than forecast. Private consumption was +0.5% QoQ though it was inflated by leap year effects.
- Private consumption is forecast to decline in Apr-Jun quarter due to the earthquake in Kumamoto and then make recovery from Jul-Sep quarter. A rush demand before consumption tax hike and its reversal contraction are currently included in our forecast for 2017.

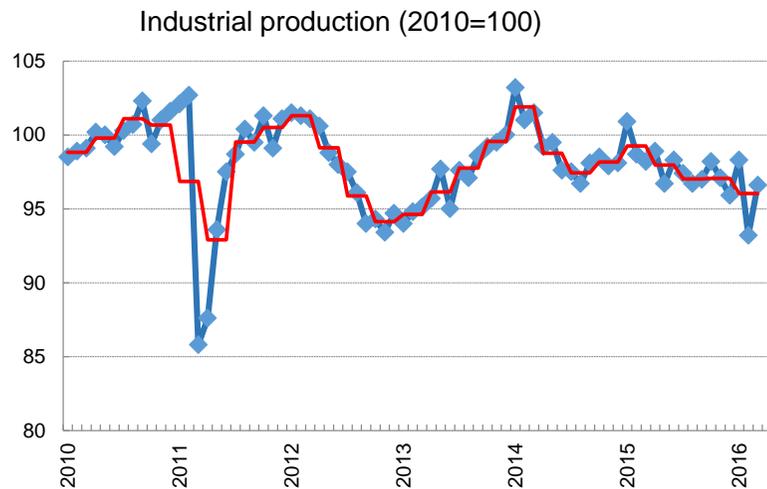


Notes: SMAM views are as of May 18th, 2016 and subject to updates thereafter without notice.

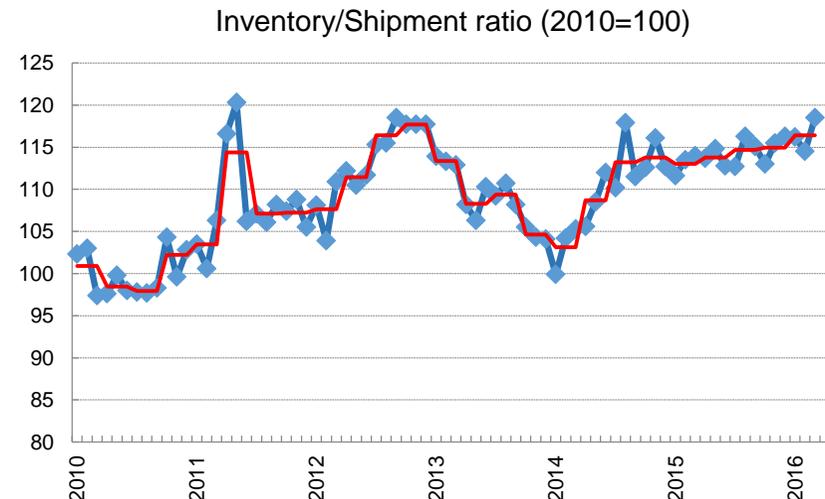
Source: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts.

Manufacturing side of the Japanese economy requires time for recovery

- Industrial production has been declining since 2015, though it made recovery in March from the exceptionally sharp fall in the previous month due to cuts in Toyota's production caused by a trouble in a factory of one of its major suppliers.
- Earthquake in Kumamoto is expected to distort manufacturing indicators for Apr-Jun quarter.
- Inventory stays at high level despite declining production, which is expected to weigh on the recovery of manufacturing side of the economy.



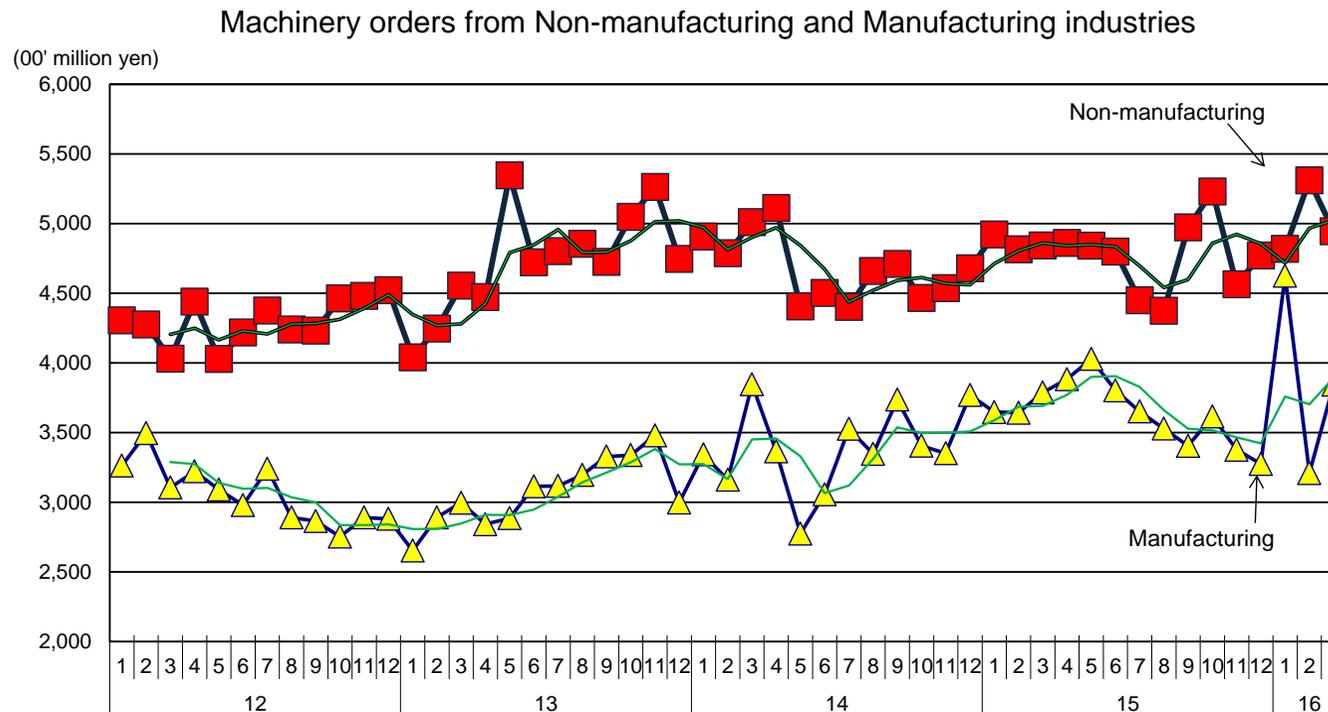
Note: red line is quarterly numbers.
(Source) Ministry of Economy, Trade and Industry



Note: red line is quarterly numbers.
(Source) Ministry of Economy, Trade and Industry

Machinery orders indicate continuing appetite for CAPEX, especially from non-manufacturing side

- Capital investments, especially from non-manufacturing industries show strength and also manufacturing industries show some resilience when interpreted by recent machinery orders statistics.
- Government has set nominal GDP target of yen 600 trillion in FY2021. Productivity improvement in the service sector is expected to play a key roll with an ambitious target of 2% per annum improvement.



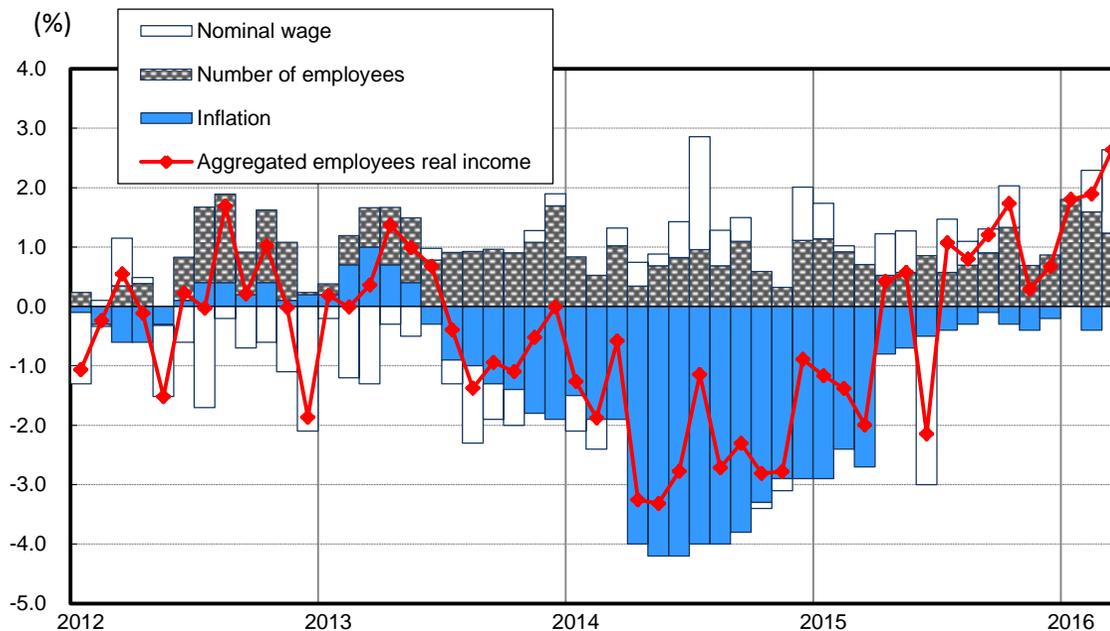
Note: *Green lines are 3 month moving average for each data.
Non-manufacturing excludes orders from shipping & electric power.

(Source) Cabinet Office

Consumers' sentiment should be supported by real income growth and job security

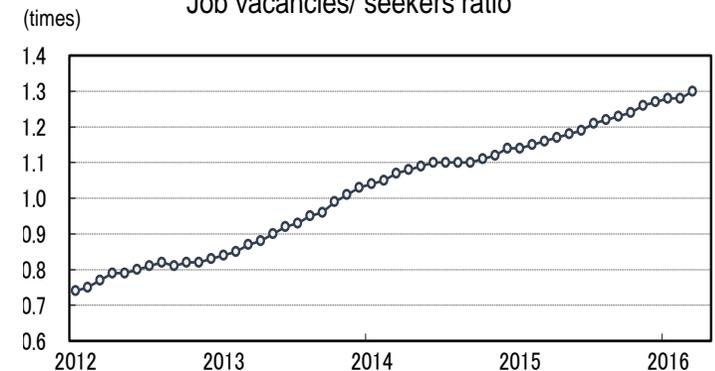
- Despite recent weakness in consumer spending, fundamentals surrounding households are still solid.
- Tight labor market should provide job security and aggregated real wage continues to grow where all three factors, nominal wage, number of employees and low inflation contributed in March.

Aggregated employees' real income and contribution by components (YoY%)



(Source) Ministry of Health, Labor and Welfare

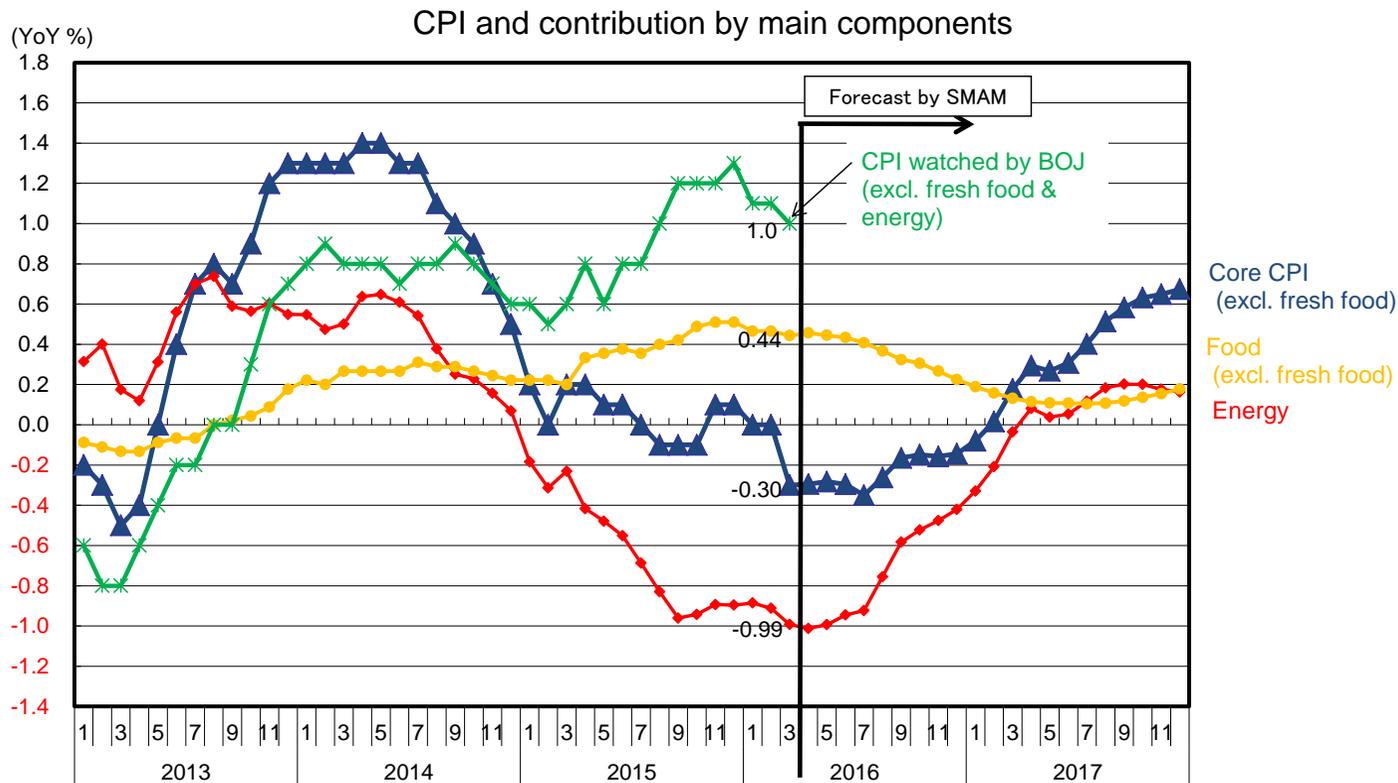
Job vacancies/ seekers ratio



(Source) Ministry of Health, Labor and welfare

Core CPI fell in negative YoY change in March

- Core CPI fell -0.3% YoY in March. It is expected to stay negative for about a year.
- Inflation expectation is falling and CPI watched by BOJ is also declining for the last 3 months. SMAM expect BOJ to make additional easing in June or in July together with the fiscal stimulus measures from the government.



Note: Excluding direct impact from consumption tax hike in April 2014.
 (Source) Ministry of Internal Affairs & Communications, forecast by SMAM.

Outlook for Japanese Stock Markets

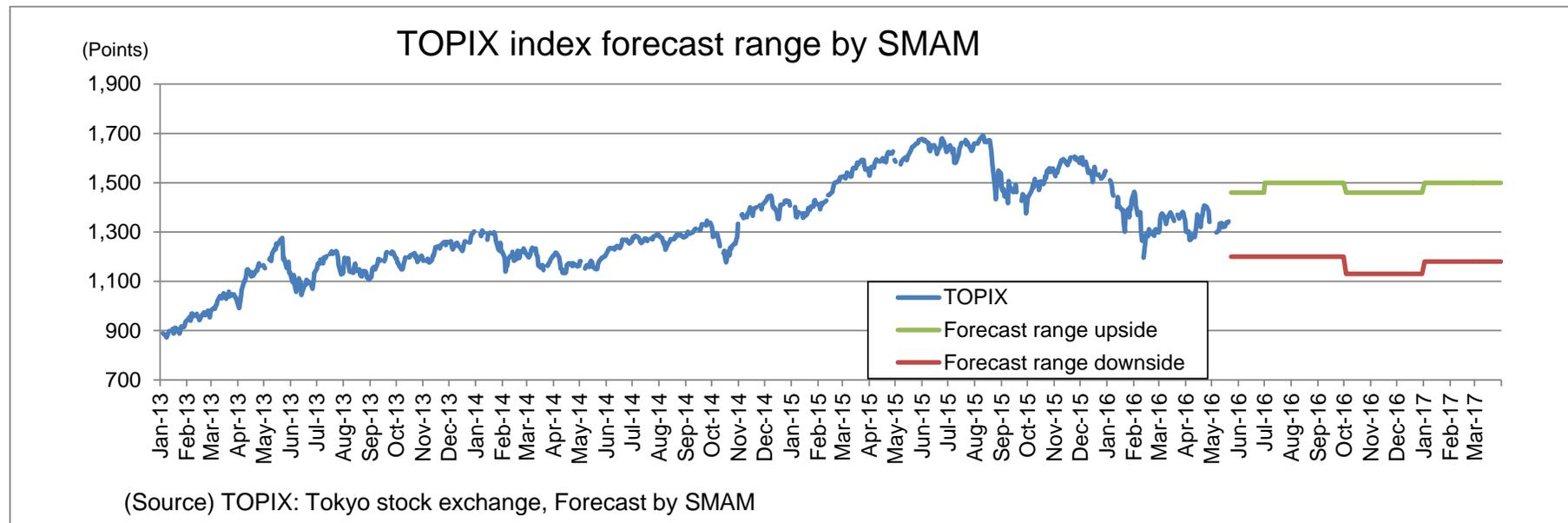
Stock market outlook: waiting for fiscal stimulus measures and global economic recovery

SMAM short-term view

- Negative news on corporate earnings has been completed. There are many events waiting ahead such as next US interest rate hike, possible monetary & fiscal stimulus in Japan, Upper House election in July. High volatility is expected to stay, however, expectation for further stimulus could lift the stock market for the short term.

Longer-term outlook (6-months and beyond)

- Sluggish Chinese economy is likely to continue. US economy shows some strength, however, it makes FED rate hike more possible. Overseas economy is going to stay patchy.
- The key for the Japanese economy and stock market will be a) what kind and amount of stimulus measures are taken and b) how effective they turn out.



Note: SMAM's projection is as of May 20th 2016 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

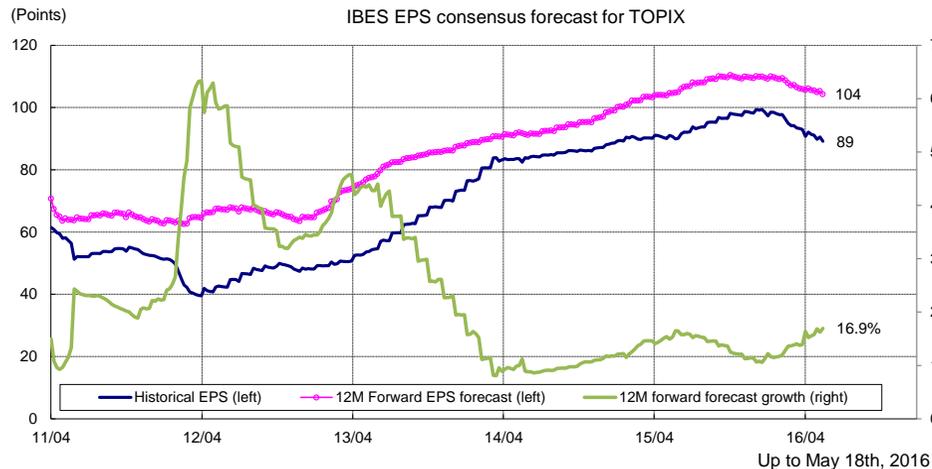
- Our **Base Scenario** is assuming the following views:
 - Global economy does not enter into a recession.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese corporate earnings growth to gradually recover from the negative shock of higher yen.
 - Fiscal stimulus and further monetary easing will be made to sustain economic growth in Japan.

- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by Abe government.

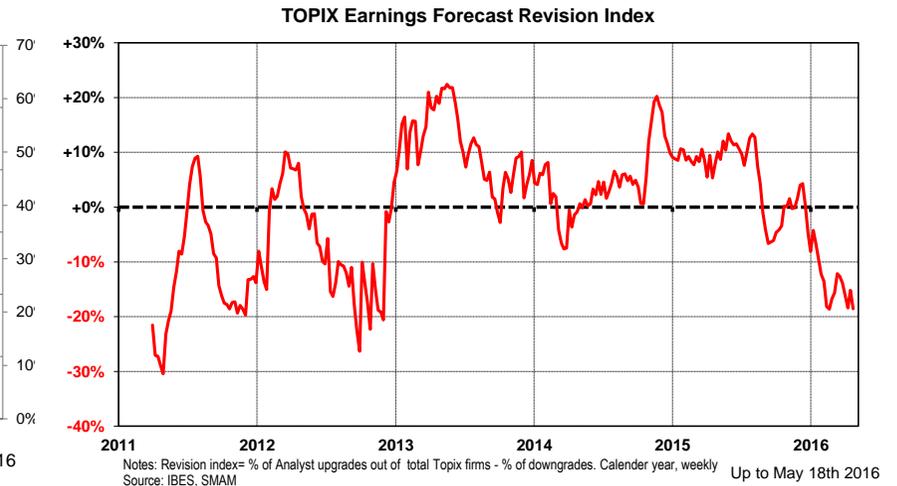
- **Downside Risks** include:
 - Unexpectedly large impact from the process of US monetary policy normalization.
 - Concern over emerging economies including China.
 - Falling oil price causes disastrous problem for oil producing countries.
 - Increasing geopolitical concerns.

Strong yen and sluggish overseas demand has been negative for the corporate earnings in FY2015

- Earnings announcement for FY 2015 has almost finished. According to Mitsubishi UFJ Morgan Stanley Securities, YoY recurring profits growth was +2.1% and shareholder earnings growth was -2.2% for all companies listed on Tokyo Stock Exchange 1st section and ending fiscal year in March. For FY2016, companies forecast +0.3% recurring profit growth and +10.6% shareholder earnings growth.
- Majority of the Japanese companies set 110 yen/dollar rate as a proposition for the earnings forecast for FY2016, which is about the middle of SMAM's current forecast range for yen/dollar, between 102 and 115 for FY2016.
- If yen stabilizes around the current level, further negative currency impact can be avoided, and conservative earnings estimates by companies can be gradually revised upward.

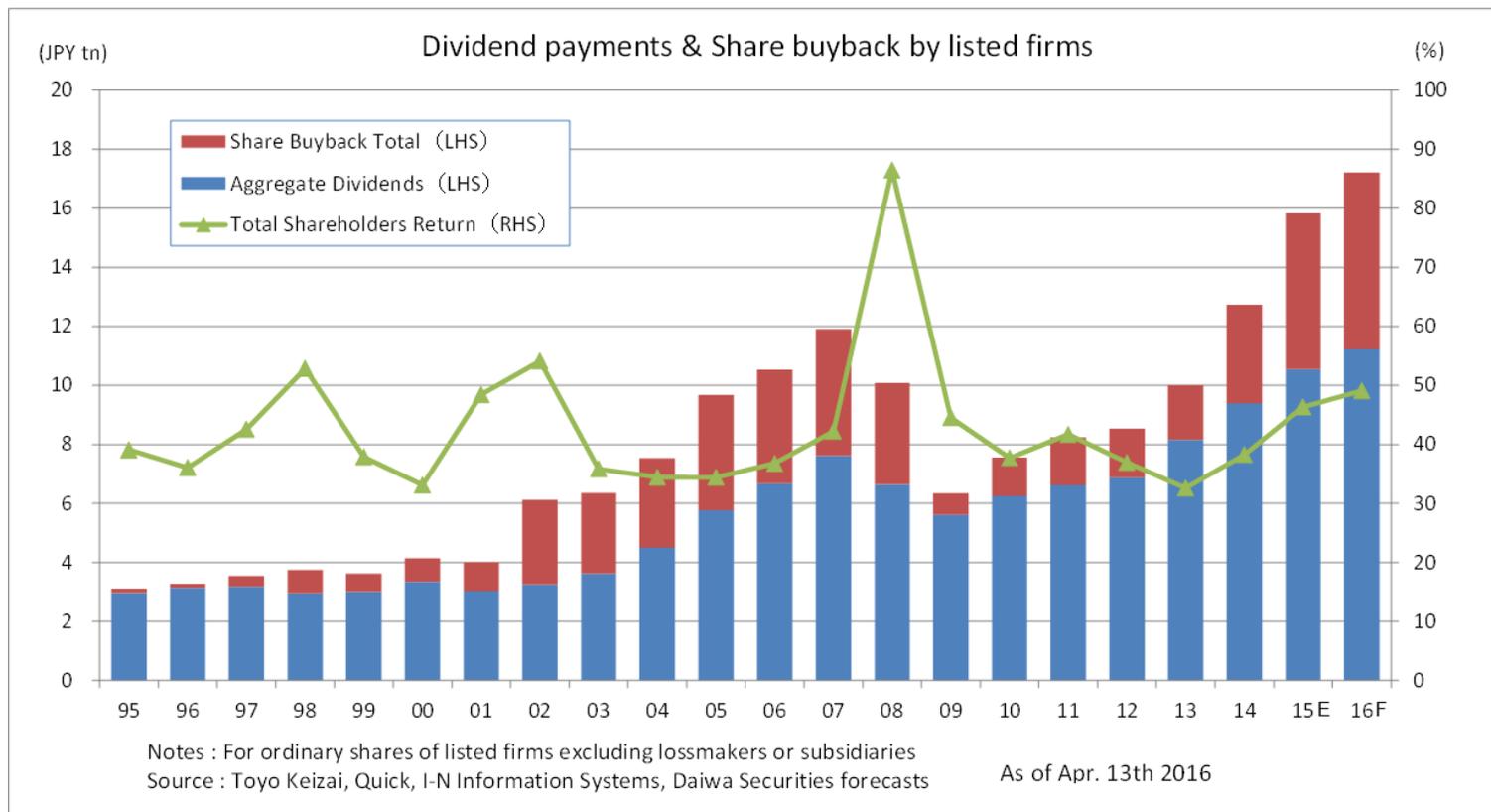


(Source) Datastream, IBES



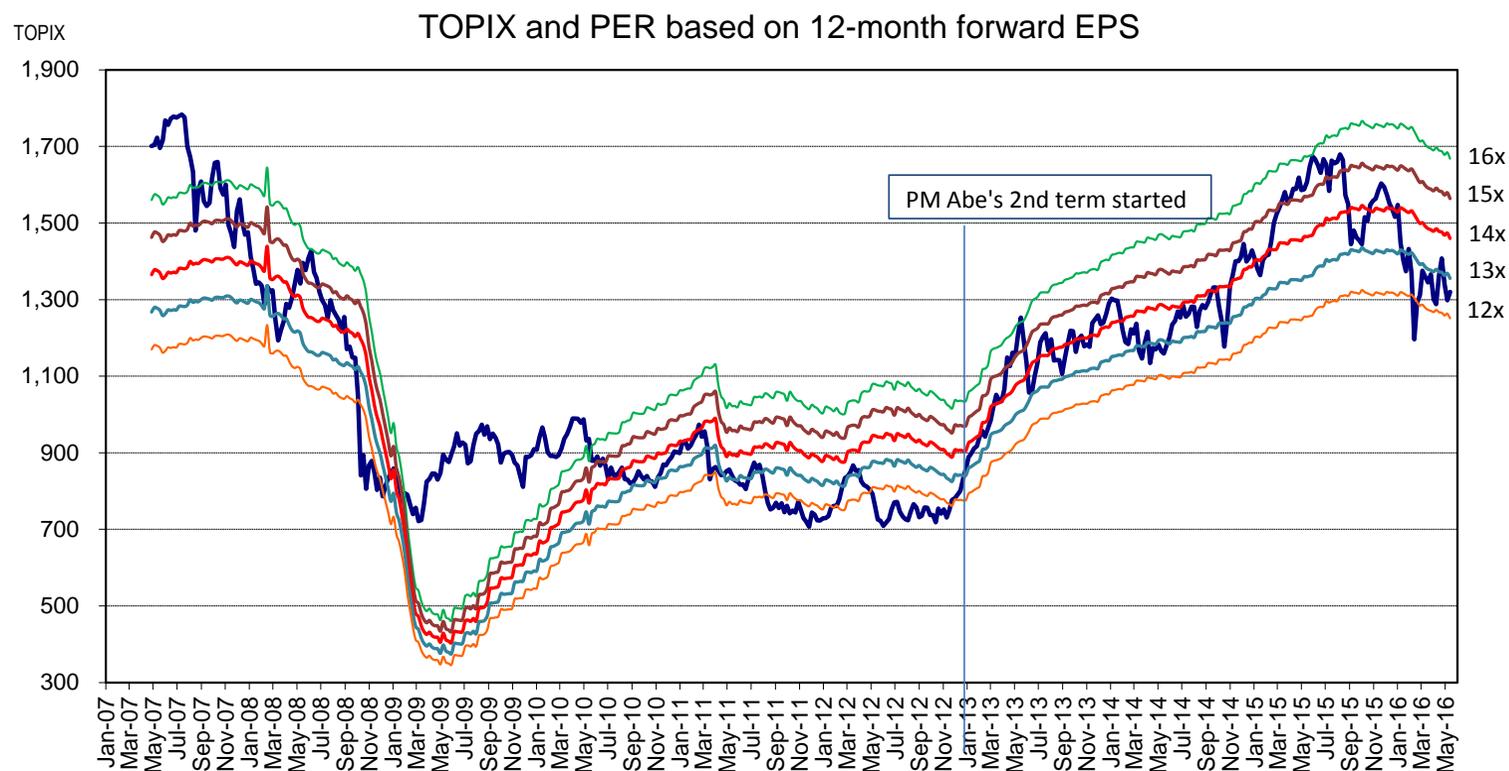
Japanese companies continue large share buy-back programs

- Despite declining earnings growth for FY2015, many companies have announced large share buy-back programs for FY2016, which is an encouraging sign that they keep positive attitude for enhancing shareholder returns.
- Total shareholder return ratio is expected to rise to 46.4% in FY2015 and forecast to rise further to 49.1% in FY2016 in just 4 years from the latest trough of 32.6% recorded in FY2013.



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.
- Even considering further down-revision in earnings, current TOPIX level doesn't look expensive.

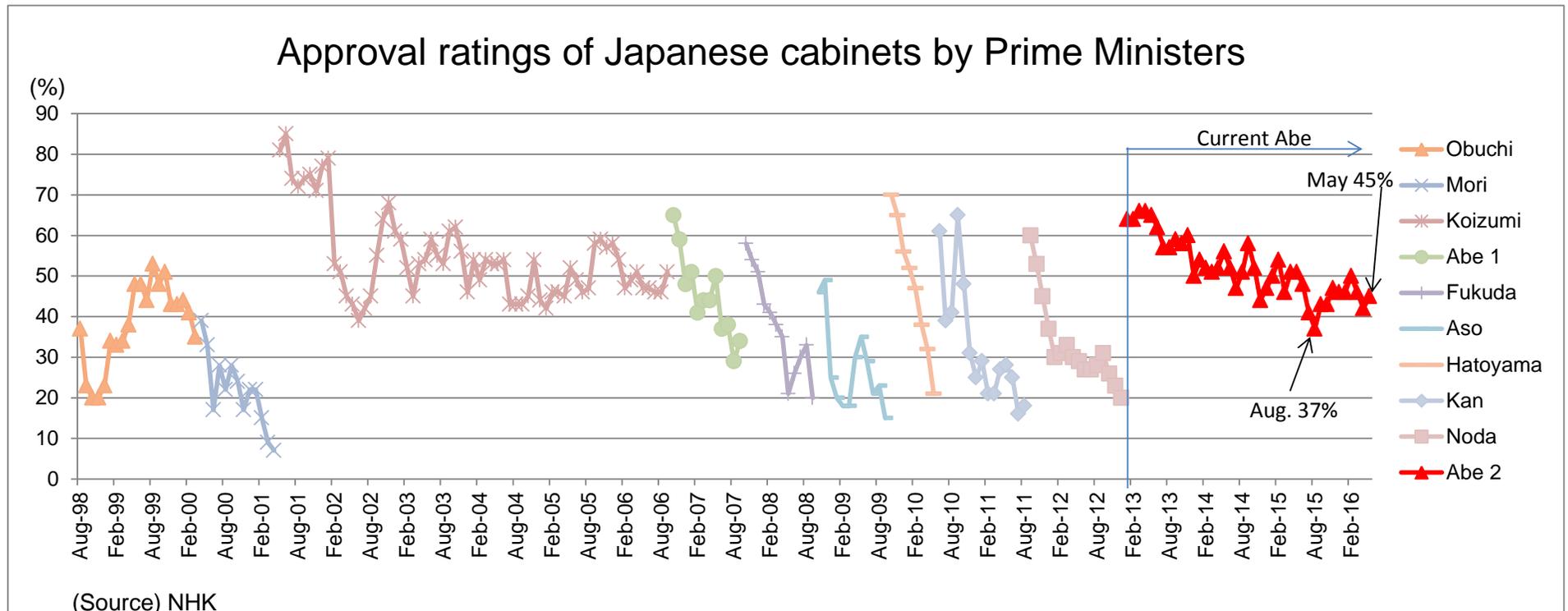


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to May 13th 2016 when TOPIX was 1320.19

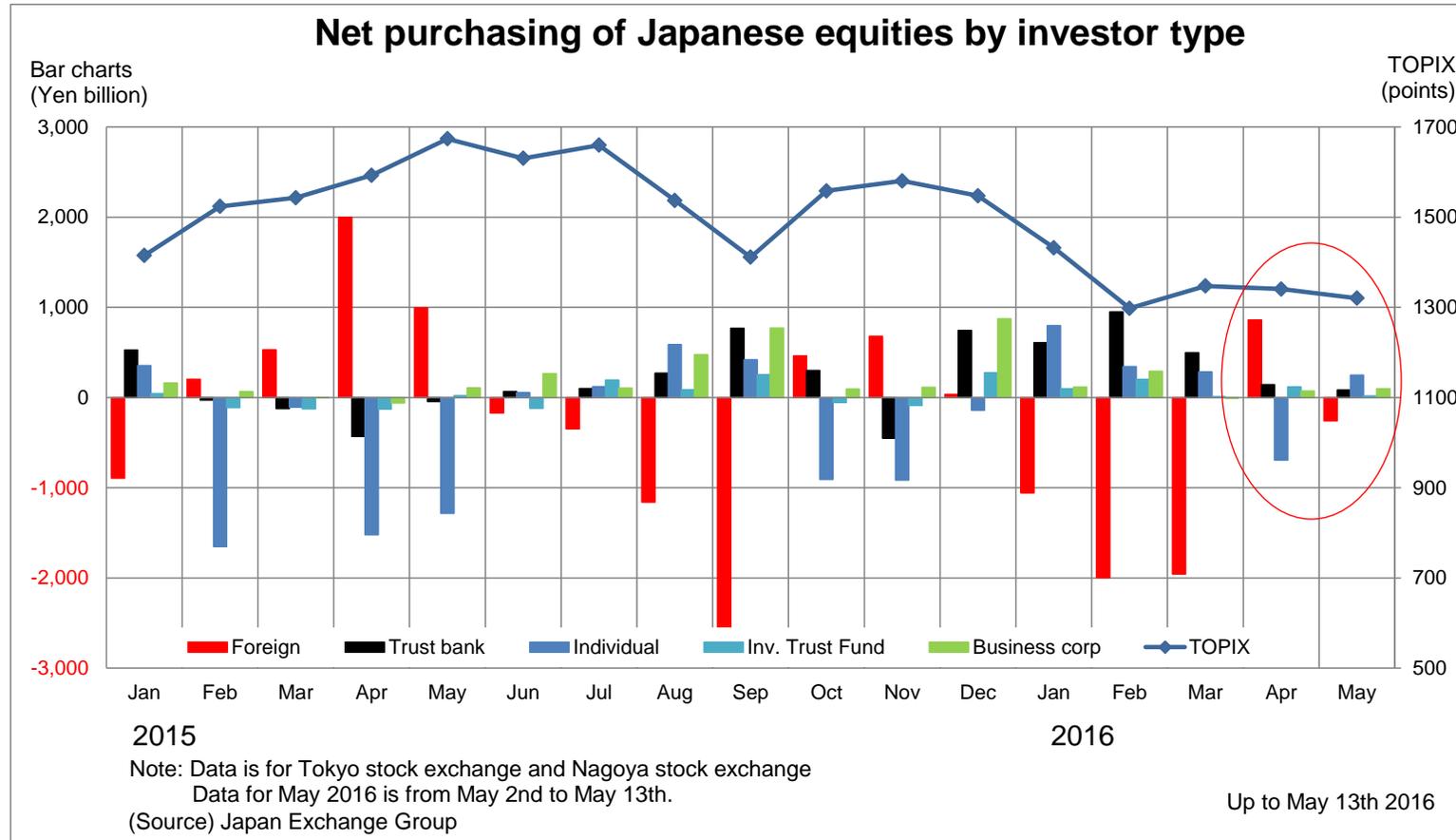
Abe cabinet has so far survived challenging issues such as earthquake and foreign affairs

- Approval rating of Abe cabinet improved to 45% in May surviving challenging issues such as management of Kumamoto earthquake disaster and various diplomatic issues, which are US president Obama's planned visit to Hiroshima and other top level negotiations preparing for the G7 meeting in Japan.
- Declaring coordinated fiscal stimulus at G7, which PM Abe has been targeting, is not likely to be made, however, large fiscal spending plan can be expected from Japanese government.



Selling pressure from overseas subsided

- Selling by foreign investors peaked out in March.
- Business corporations are expected to be a constant buyer going forward due to a record making share buy-back programs announced by companies.



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