

Japanese Stock Market Outlook

SMAM monthly comments & views
- March 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

SMAM's GDP growth forecast was unchanged from the last month. Japanese GDP growth is forecast to be faster than estimated potential growth rate around 0.7%. Despite remaining uncertainties, Trump policies in US are expected to stimulate US economy and spread positive effects to global economies including Japan.

- Japanese exports have been growing rather strongly helped by recovery in China and Asia. Exports to US are moving sideways while exports to EU have been declining.
- Major risk for the Japanese economy will be overseas factors such as a) border tax in US becoming real and b) political turmoil in Europe caused by Brexit negotiation between UK and EU, and many important elections in Europe.

➤ Japanese Stock Markets

Japanese stock market is expected to gradually move up led by strong US stock market. Earnings forecast will continue rising, which should make Japanese stock market valuation more attractive as the time passes. Overseas economies are growing rather strongly, which would support the industrial production in Japan.

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is forecast for FY2017 and upward revision can be expected. BOJ is likely to keep extra-easy monetary policies and further fiscal stimulus can be expected.
- The biggest risk will be how Trump policies could affect the Japanese industries if border tax or other protectionist measures are actually implemented.

Notes: Macro and market views are as of Feb.15th and 17th, 2017 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY16-18

- SMAM's GDP growth forecast was unchanged from the last month.
- Japanese GDP growth is forecast to be faster than estimated potential growth rate around 0.7%.
- Despite remaining uncertainties, Trump policies in US are expected to stimulate US economy and spread positive effects to global economies including Japan.

(YoY %)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Real GDP growth	2.6%	-0.4%	1.3%	1.2%	1.1%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.6%	0.5%	0.6%
Private Housing Investment	8.3%	-9.9%	2.7%	6.1%	0.5%	1.0%
Private Capital Investment	7.0%	2.5%	0.6%	1.7%	1.8%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.8%	1.2%	0.8%
Public Capital Investment	8.6%	-2.1%	-2.0%	-2.0%	4.6%	0.2%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.2%	0.6%	0.3%	0.2%
Exports	4.4%	8.8%	0.8%	2.6%	3.7%	2.4%
Imports	7.1%	4.2%	-0.2%	-1.0%	1.6%	1.4%
Nominal GDP	2.6%	2.1%	2.8%	1.3%	1.7%	1.7%
GDP Deflator	0.0%	2.5%	1.4%	0.0%	0.6%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	3.5%	2.5%
CPI (excl. fresh food)	0.8%	0.9%	-0.0%	-0.3%	0.7%	0.7%

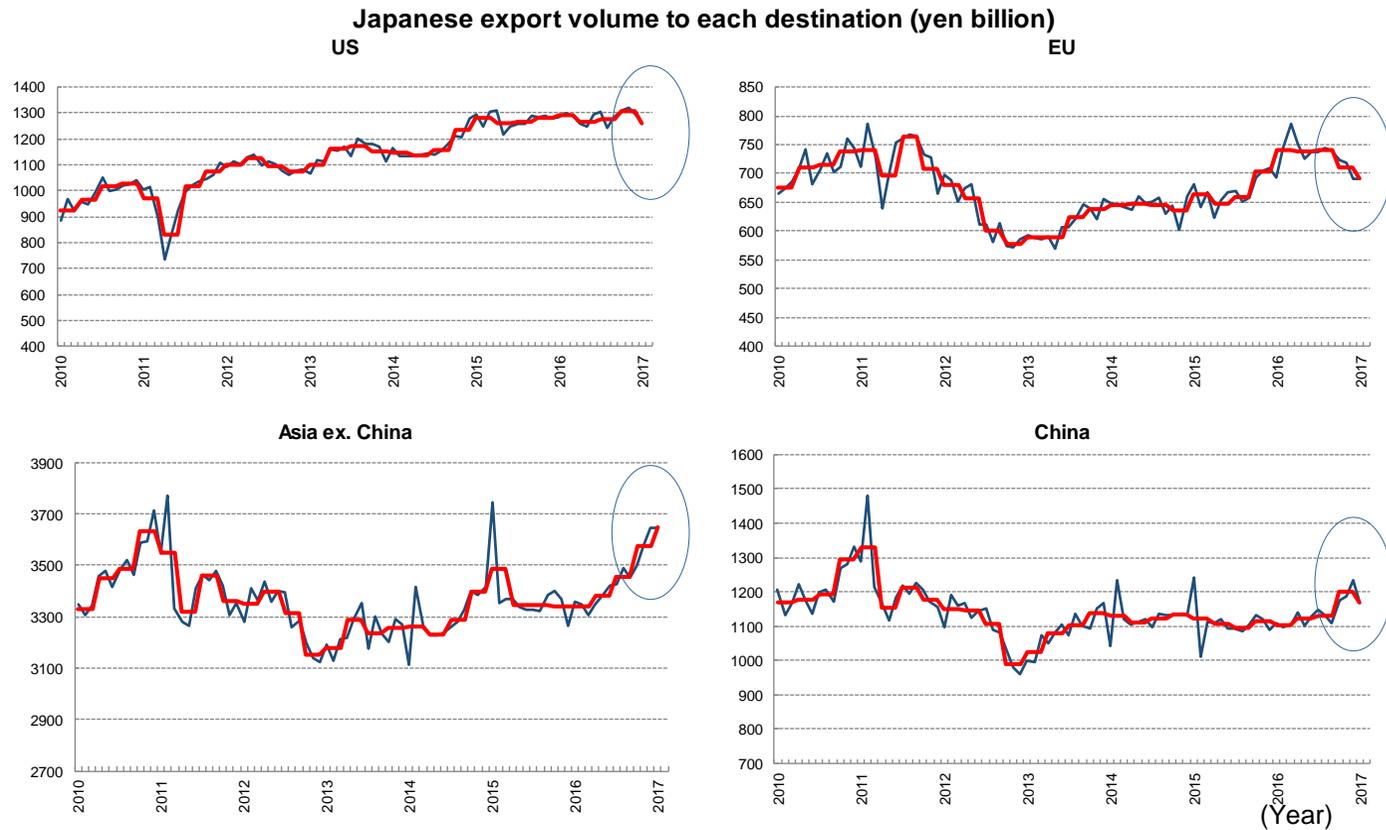
Notes: E=SMAM forecasts. SMAM views are as of Feb. 15th, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

Japanese exports continue to grow and Asia and China are the main growing destinations

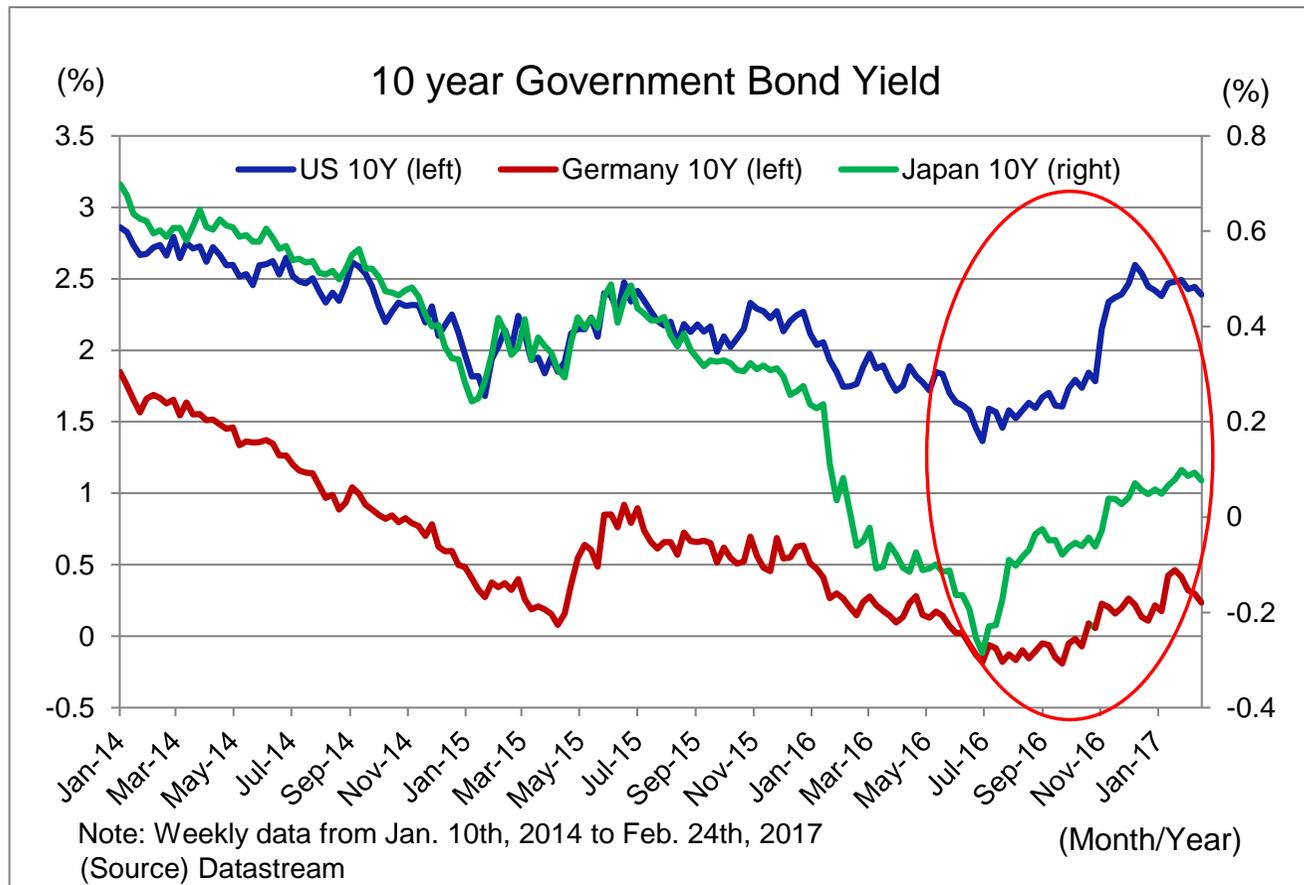
- Japanese exports have been recovering rather strongly helped by recovery in China and Asia.
- Exports to US are moving sideways while exports to EU have been declining.



Note: Blue lines are for monthly and red lines are for quarterly data.
 Data is monthly from Jan 2010 to Jan 2017.
 (Source) Ministry of Finance, Bank of Japan

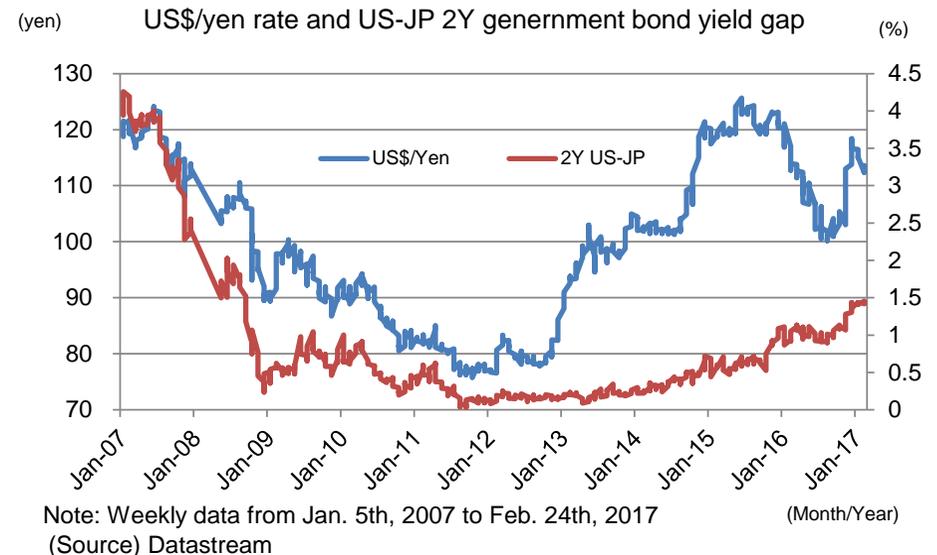
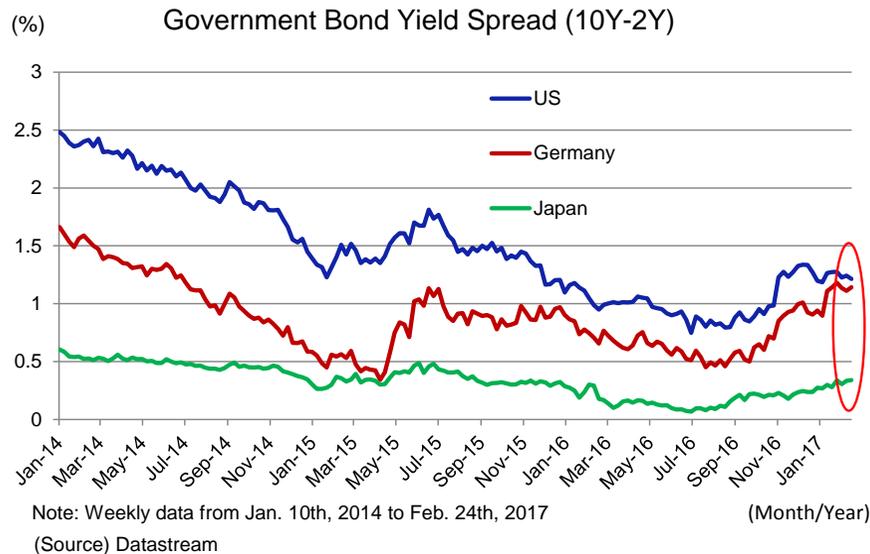
Is it really possible for BOJ to control long-term yield at extremely low level?

- 10Y Japanese Government Bond yield (JGB) is kept at still very low level by BOJ at less than 0.1% as BOJ's controlling target is "around 0%".
- When the scale is magnified for JGB and compared to US and German bond yields, it becomes apparent that upward pressure is simultaneously acting on these yields.



Expected stimulative Trump policies in US should make US\$ fundamentally strong

- US interest rates eased a little recently, which stopped the strengthening of US\$ for a while.
- US government may not be in favor of strong US\$, however, expected stimulative policies would make US\$ strong in the long run.



Trump policy: Is the border tax in US going to be real?

- In Japan, the probability of the border tax in US becoming real is not highly rated. This is one of the biggest risk for Japanese economy and corporate earnings.
- Auto is by far the largest source of trade deficit with Japan and deficit on Electrical goods & parts comes second. Deficits on the latter will be actually larger if electric parts used in goods made in China and exported to US are added.

Trade deficits of US
from Jan. to Dec. 2016

vs. China			USD bil	vs. Japan			USD bil
STIC code	Category	Trade balance		STIC code	Category	Trade balance	
1	76 Telecommunications equipment	-79.7		1	78 Auto	-47.6	
2	75 Office machines	-62.7		2	77 Electrical goods & parts	-8.0	
3	89 Other manufacturing	-49.8		3	74 General machinery	-7.0	
4	77 Electrical goods & parts	-34.2		4	71 Power-generating machinery	-6.3	
5	84 apparel	-31.5		5	72 Specialized machinery	-6.3	
6	82 Furniture	-21.8		6	75 Office machines	-2.8	
7	69 Other metal goods	-18.2		7	73 Metalworking machinery	-2.4	
8	74 General machinery	-15.9		8	88 Photographic apparatus	-2.0	
9	85 Footwear	-14.7		9	62 Rubber products	-1.8	
10	65 Textile	-10.5		10	67 Iron & steel	-1.6	
	Top 10 total	-339.0			Top 10 total	-85.8	
	Total trade balance	-347.0			Total trade balance	-68.9	

(Source) US Census and compiled by SMAM

Political events should gather attention in 2017

- Real economic policies in US will take some time to be decided after debates in congress after the statements made by President Trump in February and March.
- Europe is going to face important events such as notification of Brexit, elections in France, Germany and other countries.

Schedule of key events in 2017

Month	Region/Country	Events	Notes
February	Japan	First estimate of 4Q 2016 GDP	
	US	(28th) State of the Union Address	Trump policy becomes clearer.
March	US	The Budget Message of The President	Fiscal plan of the Trump White House is going to be revealed.
	Japan	Convention of the Liberal Democratic Party	Extend maximum party leadership from 2 terms running?
		Spring wage negotiations	
		Budget for FY2017 to be approved	
		Action plan for changing working practice	"Premium Friday" started in 24th Feb. and many workers left office early.
	Netherlands	General election	
UK	Notification of exiting EU?		
April	Japan	BOJ Tankan business report	
		BOJ perspective report	
Apr or May	France	Presidential election	
June	Japan	Ordinary Session of National Diet ends	
	Japan	Election for the Tokyo Metropolitan Assembly	
	France	Lower house election	
July	Global	G20 meeting	
August	Germany	General election	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

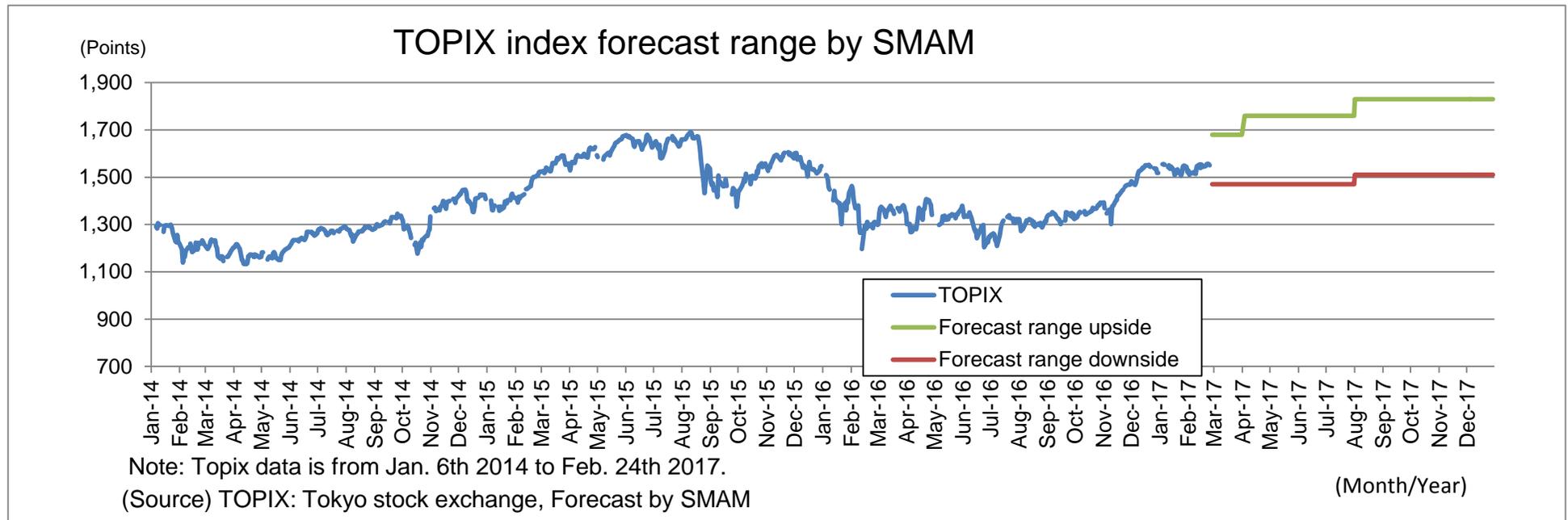
Stock market outlook: Waiting for the real Trump policies to take shape

SMAM short-term view

- Japanese stock market is expected to gradually move up led by strong US stock market. Earnings forecast will continue rising, which should make Japanese stock market valuation more attractive as the time passes. Overseas economies are growing rather strongly, which would support the industrial production in Japan.

Longer-term outlook (6-months and beyond)

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is forecast for FY2017 and upward revision can be expected. BOJ is likely to keep extra-easy monetary policies and further fiscal stimulus can be expected. Risks are how Trump policies could affect the Japanese industries if border tax or other protectionist measures are actually implemented.



Note: SMAM's projection is as of Feb. 17th, 2017 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Practical Trump trade policies are made and serious trade disputes can be avoided.
 - Expansionary policies in US keep global economies on a growth path.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - Further fiscal stimulus will be made and extra easy monetary policy should sustain economic growth in Japan.

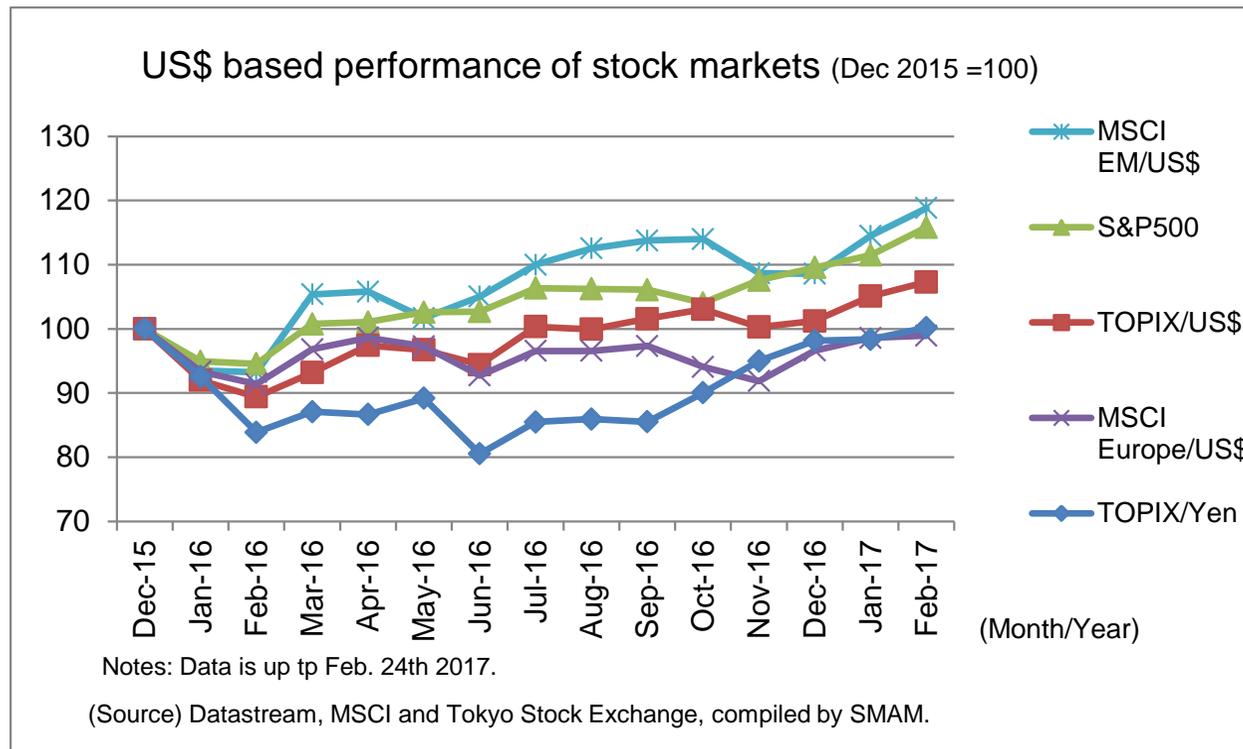
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

- **Downside Risks** include:
 - Confrontational foreign policies taken by Trump presidency shake global trades and deepen geo-political tensions.
 - Populism gains in Europe further destabilizing EU.
 - Unexpectedly large impact from the process of US monetary policy normalization.
 - Rekindled concern over emerging economies including China.

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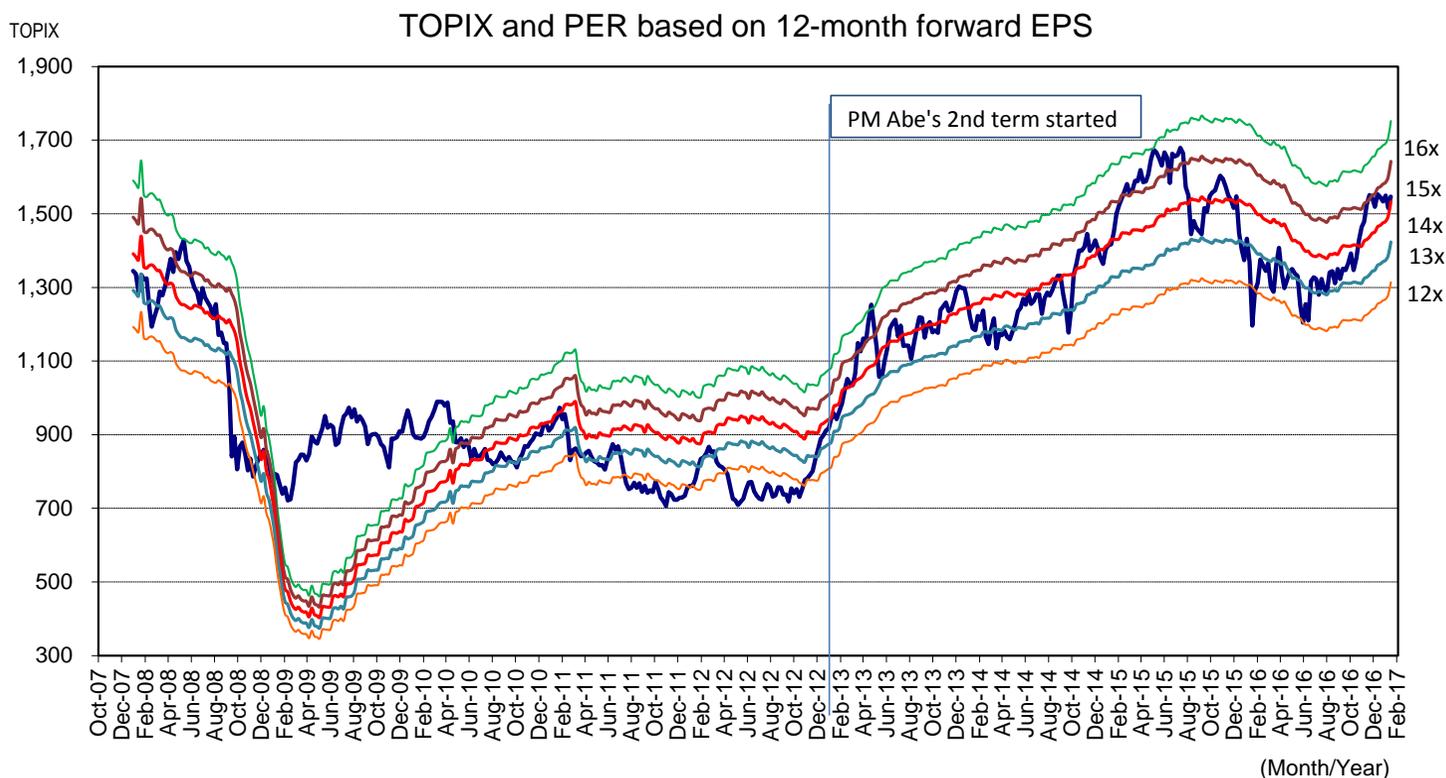
Global stock market rally has continued in 2017 so far

- Globally, major stock market indices continued to rise in US\$ terms.
- Emerging market showed a sharp recovery meanwhile European market is lagging. Probably, political uncertainties are casting shadow over the investors' sentiment.



PER (Price Earnings Ratio) came down to 14x due to higher EPS forecast

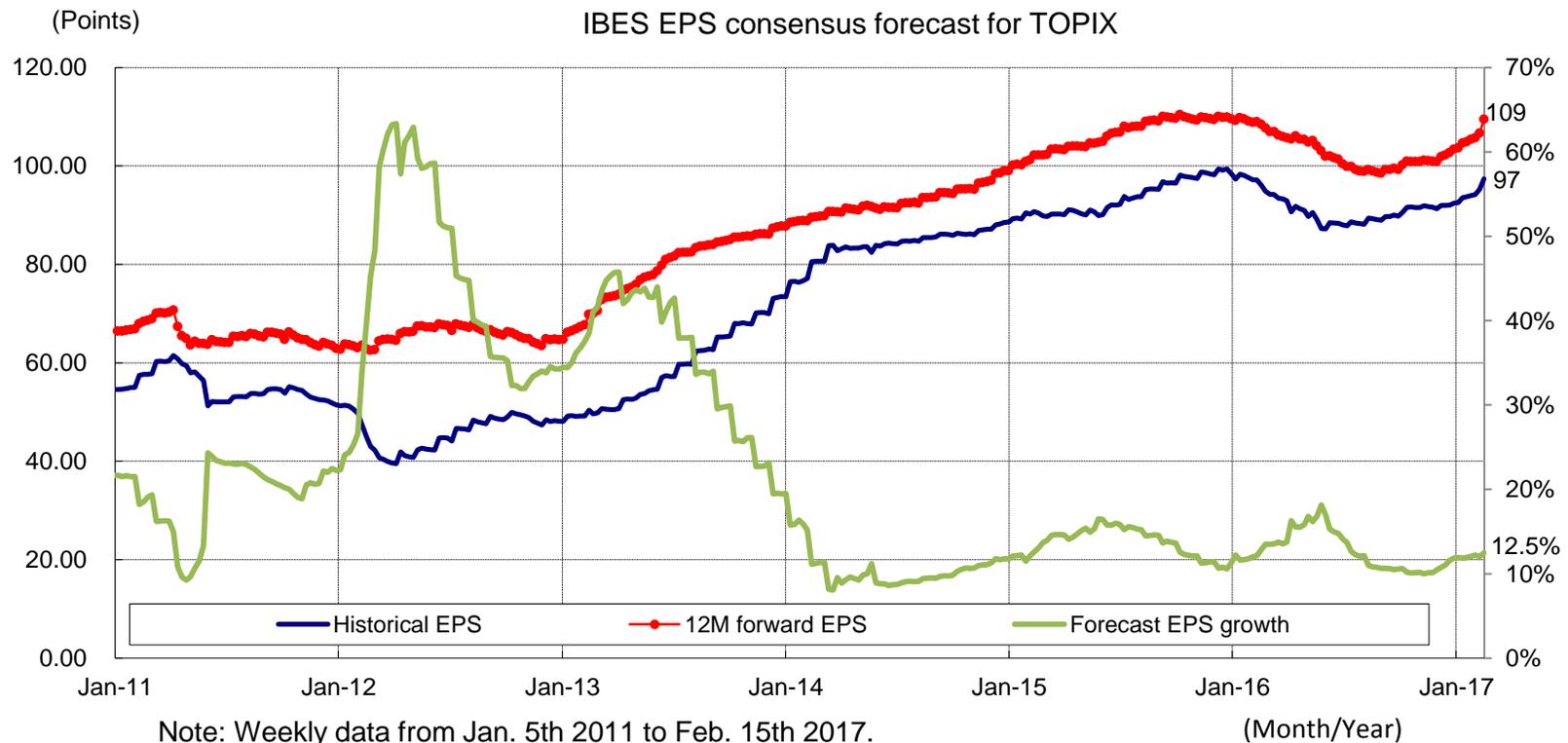
- From 30th Dec 2016 to February 10th 2017, PER came down from 14.69x to 14.12x, whereas TOPIX rose from 1518.61 to 1546.56. Japanese stock market valuation in TOPIX is at the middle of the range between 12x and 16x after PM Abe's second term began.



Note: Data is weekly from Oct. 26th 2007 to Feb. 10th 2017. TOPIX was 1546.56 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

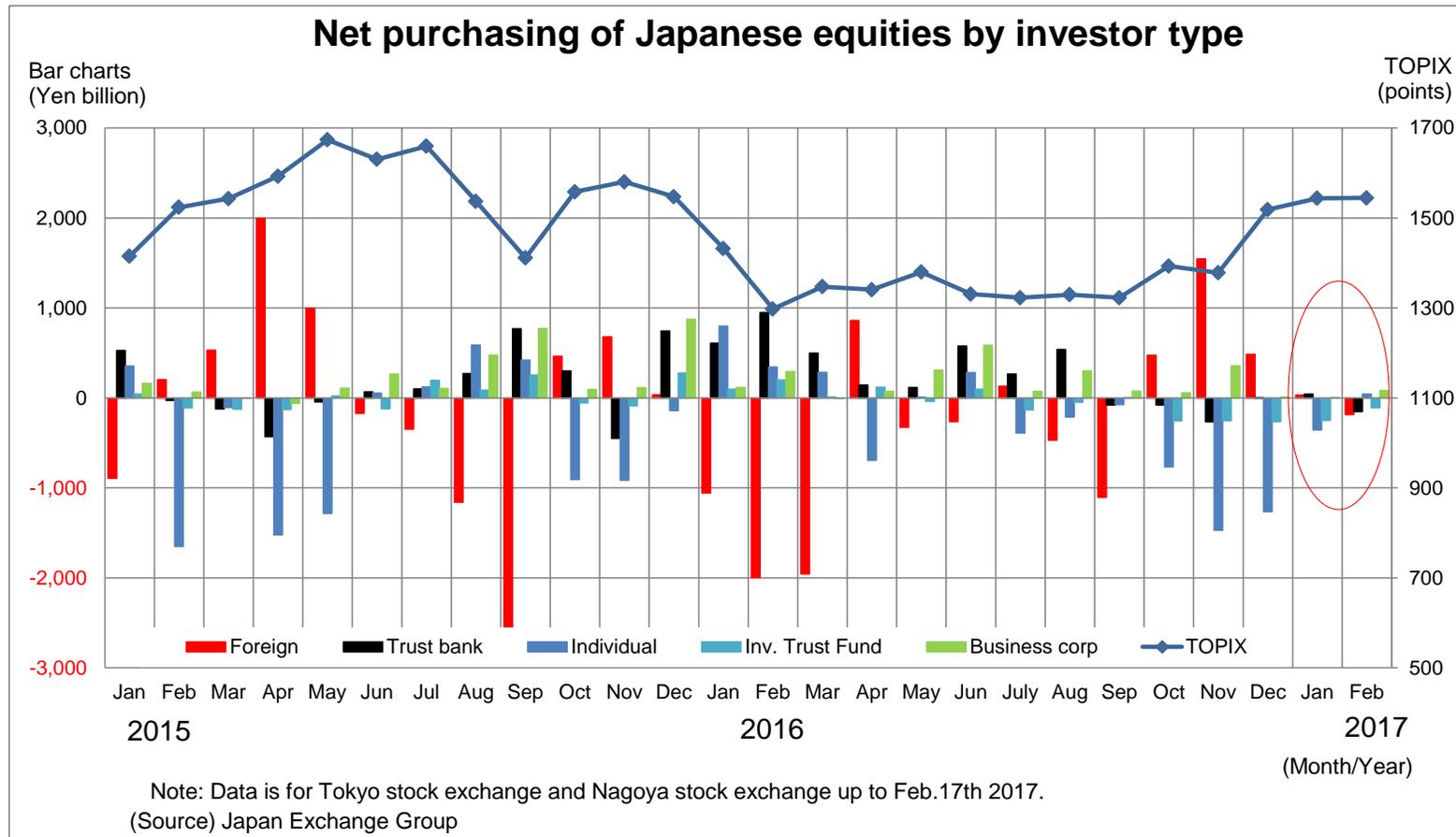
EPS forecasts by analysts continue to expand

- Latest 12M forward EPS forecast moved up over 109, and it is less than 1 point from the highest level reached in December 2015.
- 12.5% EPS growth is forecast in the coming 12 months.



Investors activities slowed so far this year

- After the Trump rally, investors are waiting for the real Trump policies.



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