



Japanese Stock Market Outlook

SMAM monthly comments & views

- May 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

SMAM's GDP growth forecast was upgraded by 0.1% both for FY2016 and FY2017 reflecting better than expected Jan-Mar economic readings. Exports from Japan is growing robustly led by such as electronics parts & equipment and general machinery. Industrial production continues to recover led mainly by demand from overseas.

- Order taking of public construction spending has picked up lately, which is forecast to feed through to the actual spending with 2 to 3 months lag.
- The latest "Tankan" business survey released from BOJ in April shows improving business sentiments. DI for manufacturing enterprises rose from 10 to 12 and that for non-manufacturing also improved from 18 to 20. Positive DI means the condition is better than 3 months before.

➤ Japanese Stock Markets

Heightening tension surrounding North Korea weighs on the Japanese stock market for a while and also expected to make Japanese yen volatile. On the other hand, valuation for the Japanese stock market is low and attractive both historically and against peers such as US and Europe, which should limit the downside of the stock prices.

- Companies are going to announce financial results for FY2016 in May and guidance for FY2017 is also made. Initial guidance tends to be conservative and likely to be revised up as FY2017 progresses. Japanese stock market is expected to return to a mild upward trend later in the year on the back of improving fundamentals.

Notes: Macro and market views are as of Apr. 14th and 18th, 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 upgraded by 0.1% both for FY2016 and FY2017 reflecting better than expected Jan-Mar economic readings.
- Trump fiscal policies are expected to be delayed, however, SMAM assumes the policies 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%	1.3%	1.2%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.7%	0.7%	0.6%
Private Housing Investment	8.3%	-9.9%	2.7%	6.1%	0.5%	1.0%
Private Capital Investment	7.0%	2.4%	0.6%	2.5%	2.4%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.8%	1.1%	0.8%
Public Capital Investment	8.6%	-2.1%	-2.0%	-2.6%	3.6%	0.3%
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%	2.7%	3.7%	2.3%
Imports	7.1%	4.2%	-0.2%	-1.0%	1.6%	1.4%
Nominal GDP	2.6%	2.1%	2.8%	1.3%	1.8%	1.6%
GDP Deflator	0.0%	2.5%	1.4%	0.1%	0.6%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.7%	3.8%	2.3%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.7%	0.7%

Notes: E=SMAM forecasts. SMAM views are as of Apr. 14th, 2017 and subject to updates thereafter without notice

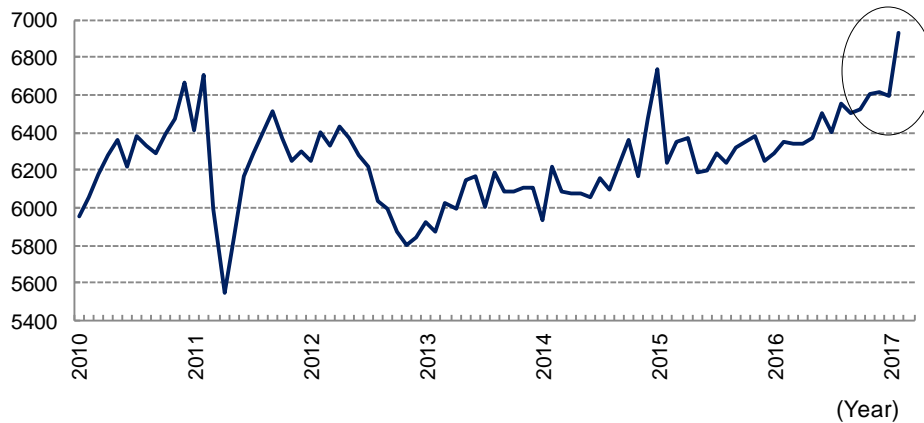
(%, YoY except Net Exports)

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

Strong export growth leads the continuing recovery of the industrial production

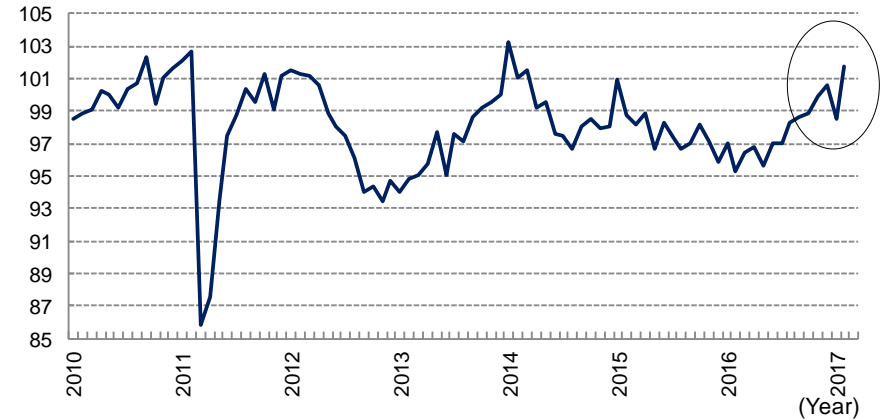
- Exports from Japan is growing robustly led by such as electronics parts & equipment and general machinery.
- Industrial production continues to recover led mainly by demand from overseas.

Export volume
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Feb 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Industrial Production
(2010=100, seasonally adjusted)

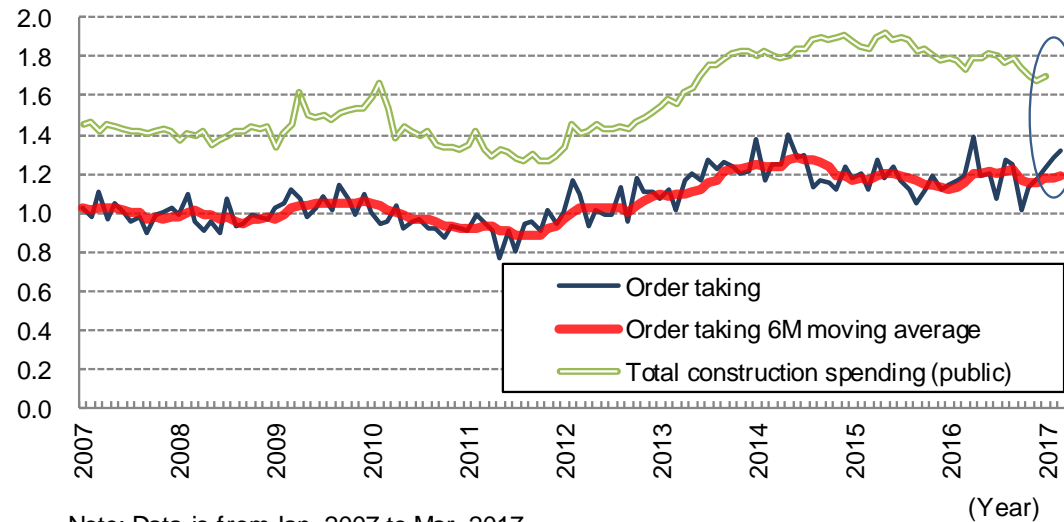


Note: Data is monthly from Jan 2010 to Feb 2017.
(Source) Ministry of Economy, Trade and Industry

Public construction spending is forecast to pick up

- Order taking of public construction spending has picked up lately, which is forecast to feed through to the actual spending with 2 to 3 months lag.

Public construction spending statistics
(Monthly, seasonally adjusted, yen trillion)

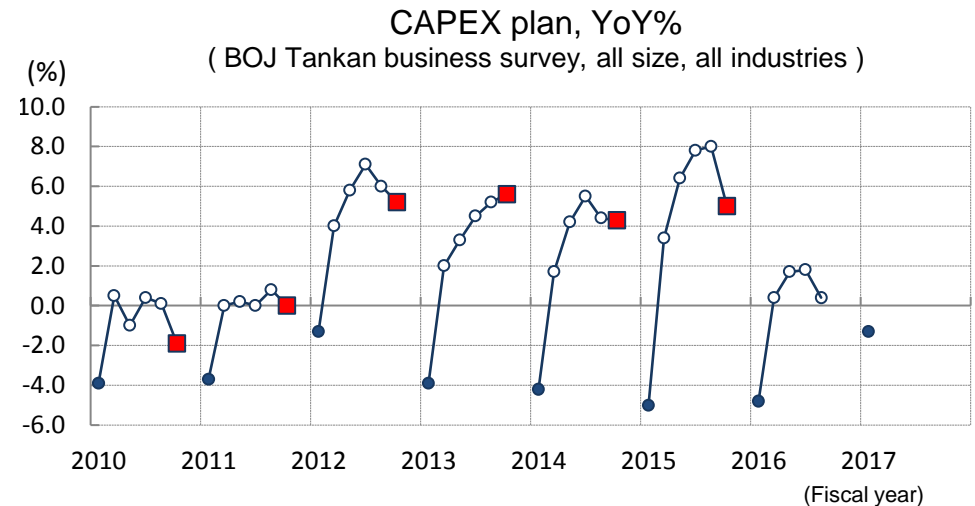
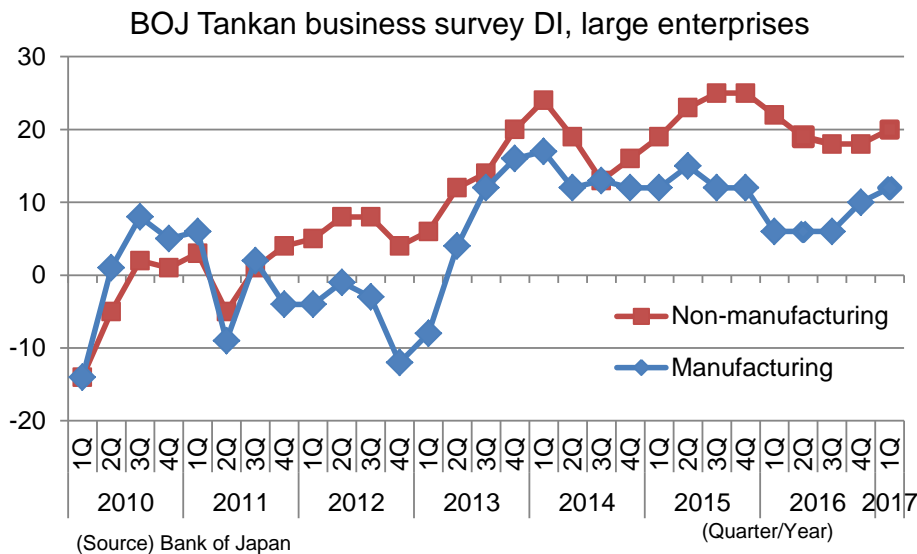


Note: Data is from Jan. 2007 to Mar. 2017

(Source) Cabinet Office, Ministry of Land, Infrastructure, Transport and Tourism, EAST JAPAN CONSTRUCTION SURETY CO., LTD, and compile by SMAM.

Japanese companies are cautiously optimistic

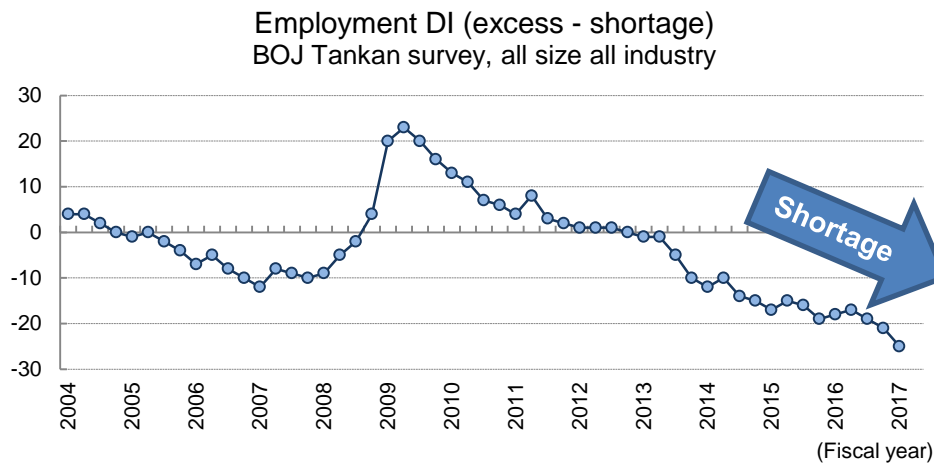
- The latest “Tankan” business survey released from BOJ in April shows improving business sentiments. DI for manufacturing enterprises rose from 10 to 12 and that for non-manufacturing also improved from 18 to 20. Positive DI means the condition is better than 3 months before.
- Plan for capital expenditure tends to make a cautious reading at the beginning and then revised-up later. March 2017 survey shows that companies are planning -1.3% YoY change. This is actually higher than the beginnings of fiscal years in the past.



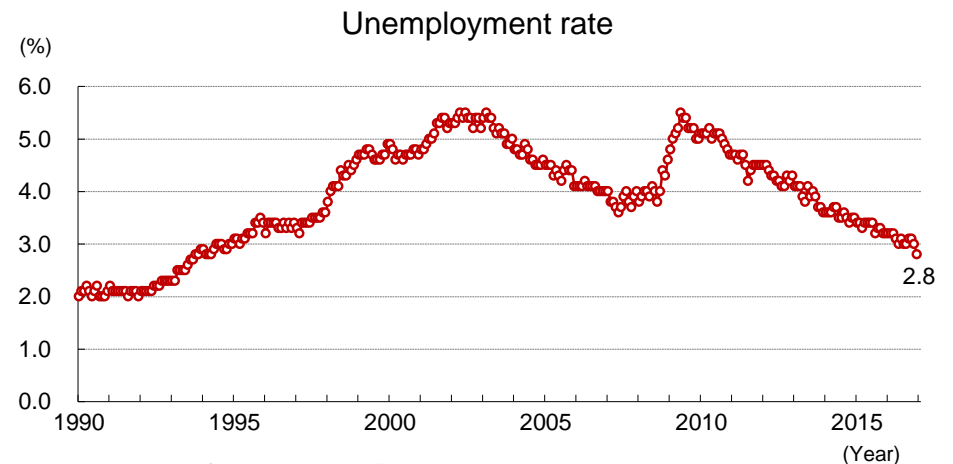
Note: Plotted are plan at Mar. Jun. Sep. Dec., Mar estimate , and final result.
(Source) Bank of Japan

Labor shortage is getting serious

- The latest BOJ Tankan survey also shows that companies are feeling it more difficult to find workers.
- Unemployment rate fell to 2.8% in February 2017, which was the lowest in almost 24 years.



Note: data is from 1Q FY2004 to 1Q FY2017.
(Source) Bank of Japan



Note: data is from Jan. 1990 to Feb 2017.
(Source) Ministry of Internal Affairs and Communications

Crunch time continues for Europe and the world

- A crunch time continues in France experiencing a tight race for the presidency. Europe is going to face other important political events such as election in Germany and other countries.
- Heightening tension surrounding North Korea is an unpredictable risk event not only for Japanese but global economy.

Schedule of key events in 2017

Month	Region/Country	Events	Notes
March	US	The Budget Message of The President	Only the outline was released. Obama care reform was withdrawn.
	Japan	Convention of the Liberal Democratic Party	Maximum consecutive party leadership was extended to 3 terms.
		Spring wage negotiations	Base pay rise is going to be lower than in 2016.
		Budget for FY2017 to be approved	
		Action plan for changing working practice	Limit the monthly overtime. Encourage people to leave office early and spend.
	Netherlands	General election	Feared surge of right wing was avoided.
UK	Notification of exiting EU	What kind of a deal UK can extract from EU?	
April	Japan	BOJ Tankan business report	
		BOJ perspective report	
	US	(28th) Temporary budget for 2017 needs renewal	Can President Trump & US congress work together?
Apr & May	France	Presidential election	
June	Japan	Election for the Tokyo Metropolitan Assembly	Crack may grow between governing coalition parties, LPD and Komeito.
	UK	General election	
	France	Lower house election	
July	Global	G20 meeting	
August	Germany	General election	
September	France	Upper house election	
	Spain	Referendum in Catalonia for independence	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

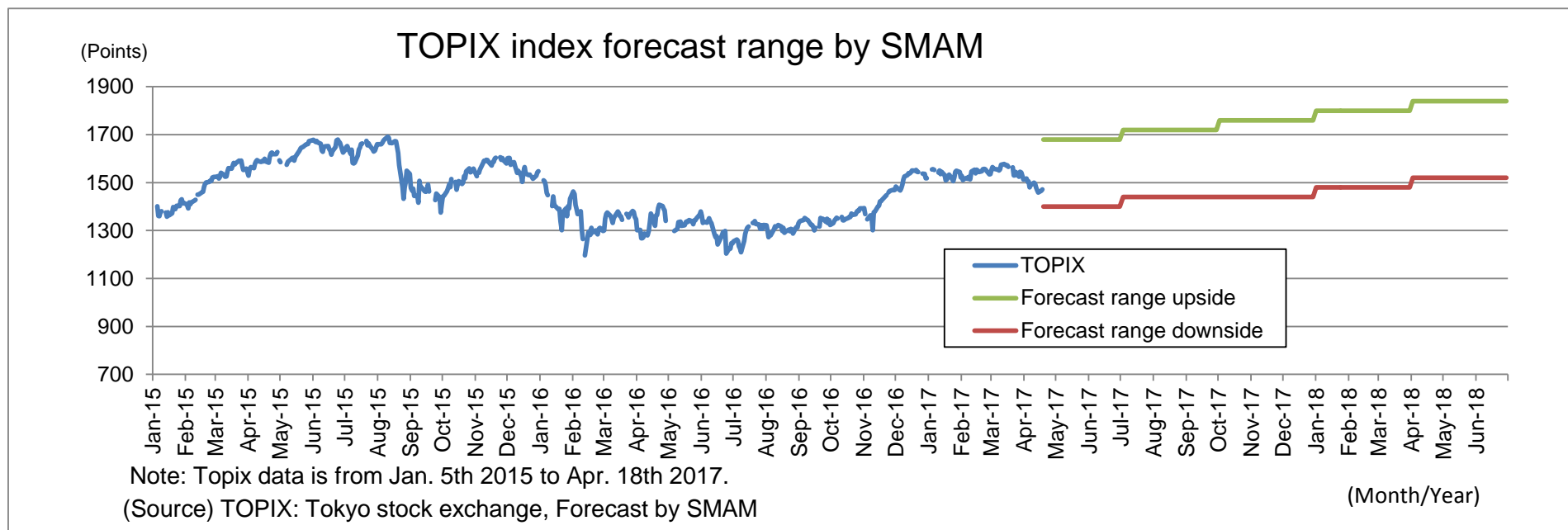
Stock market outlook: a series of risk events will weigh on the stock market for a while

SMAM short-term view

- Heightening tension surrounding North Korea weighs on the Japanese stock market for a while and also expected to make Japanese yen volatile. On the other hand, valuation for the Japanese stock market is low and attractive both historically and against peers such as US and Europe, which should limit the downside.

Longer-term outlook (6-months and beyond)

- Japanese economy is solidly recovering supported by strong global economies. Public spending is forecast to increase too. Companies are going to announce financial results for FY2016 in May and guidance for FY2017 is also made. Initial guidance tends to be conservative and likely to be revised up as FY2017 progresses. Japanese stock market is expected to return to a mild upward trend later in the year.



Note: SMAM's projection is as of Apr. 18th, 2017 and subject to updates without notice.

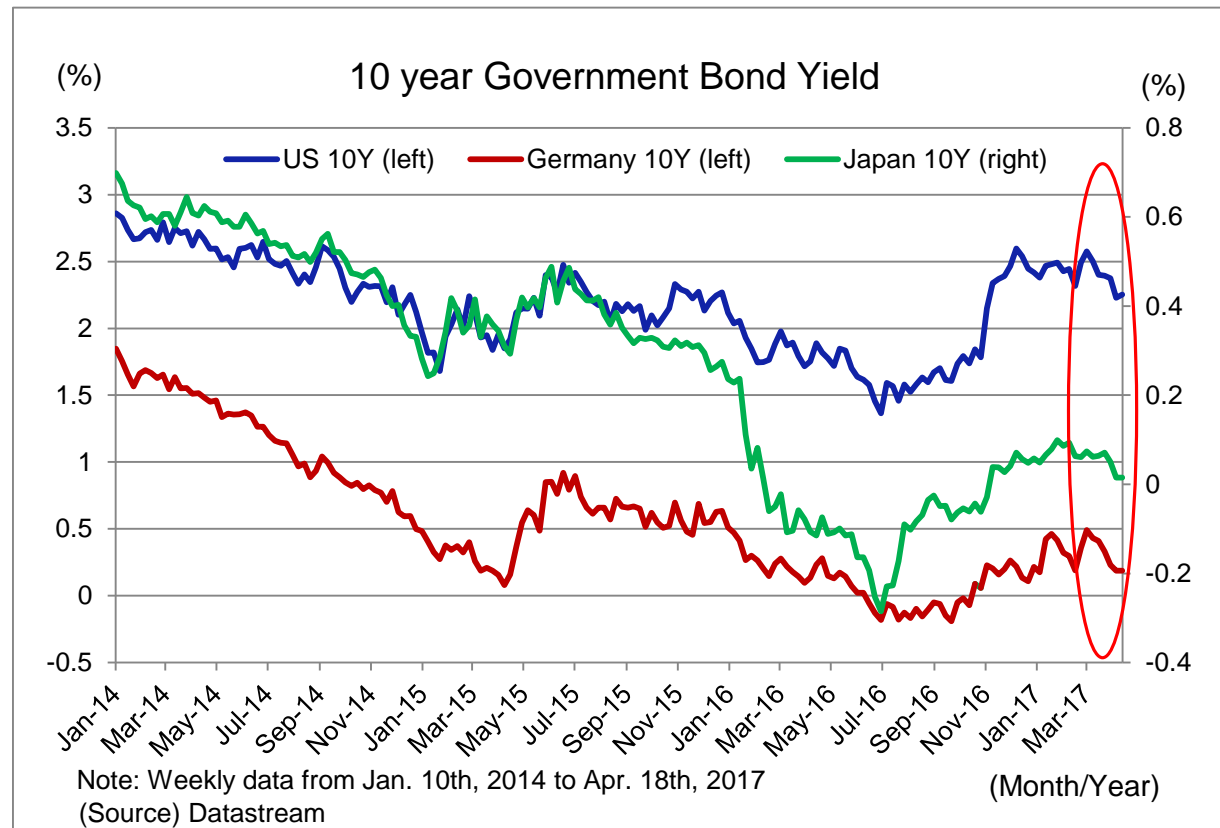
Base scenario & Upside / Downside risks for our forecasts

- 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.
 - Tension in the East Asia does not ignite a war.
- **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.
 - Trump policies for stimulating US economy fail to pass US congress.
 - Populism gains in Europe further destabilizing EU.
 - Heightening geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - "Moritomo scandal" makes a fatal blow to PM Abe.

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

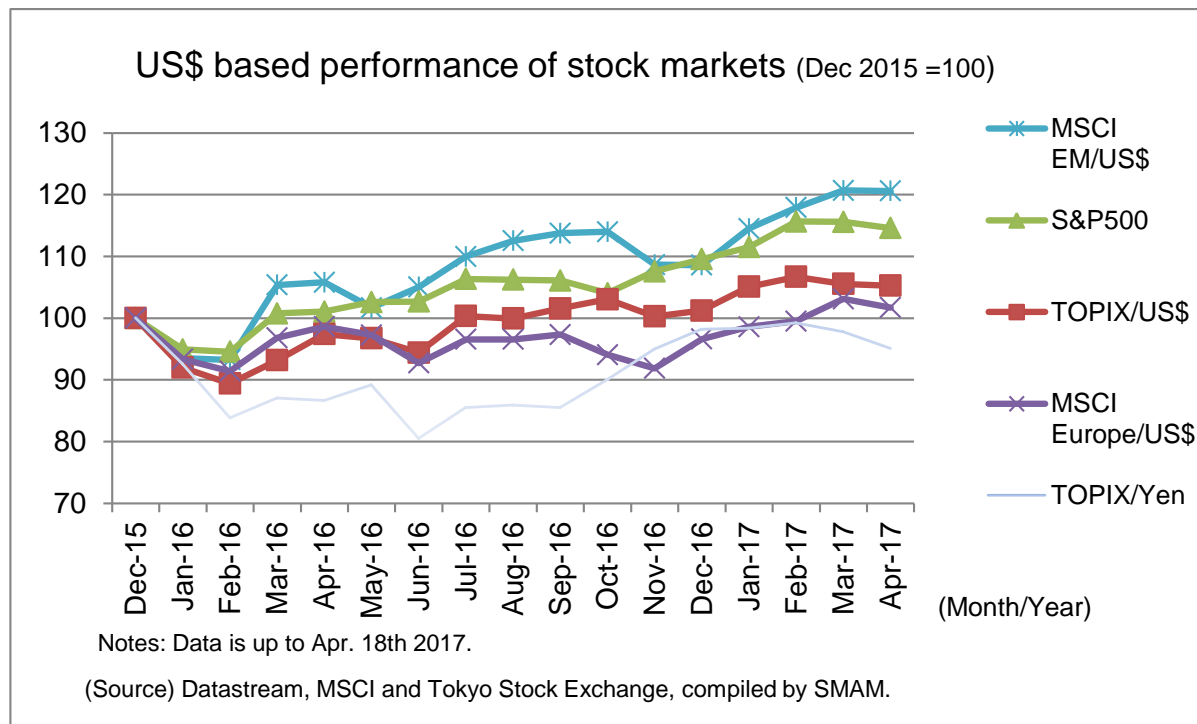
Optimism for the global economy faded a little

- Investors are putting money back to bonds recently, which brought government bond yields to come down.
- In the backgrounds are fading optimism for US Trump policies and also heightening geopolitical tensions surrounding North Korea and Syria.



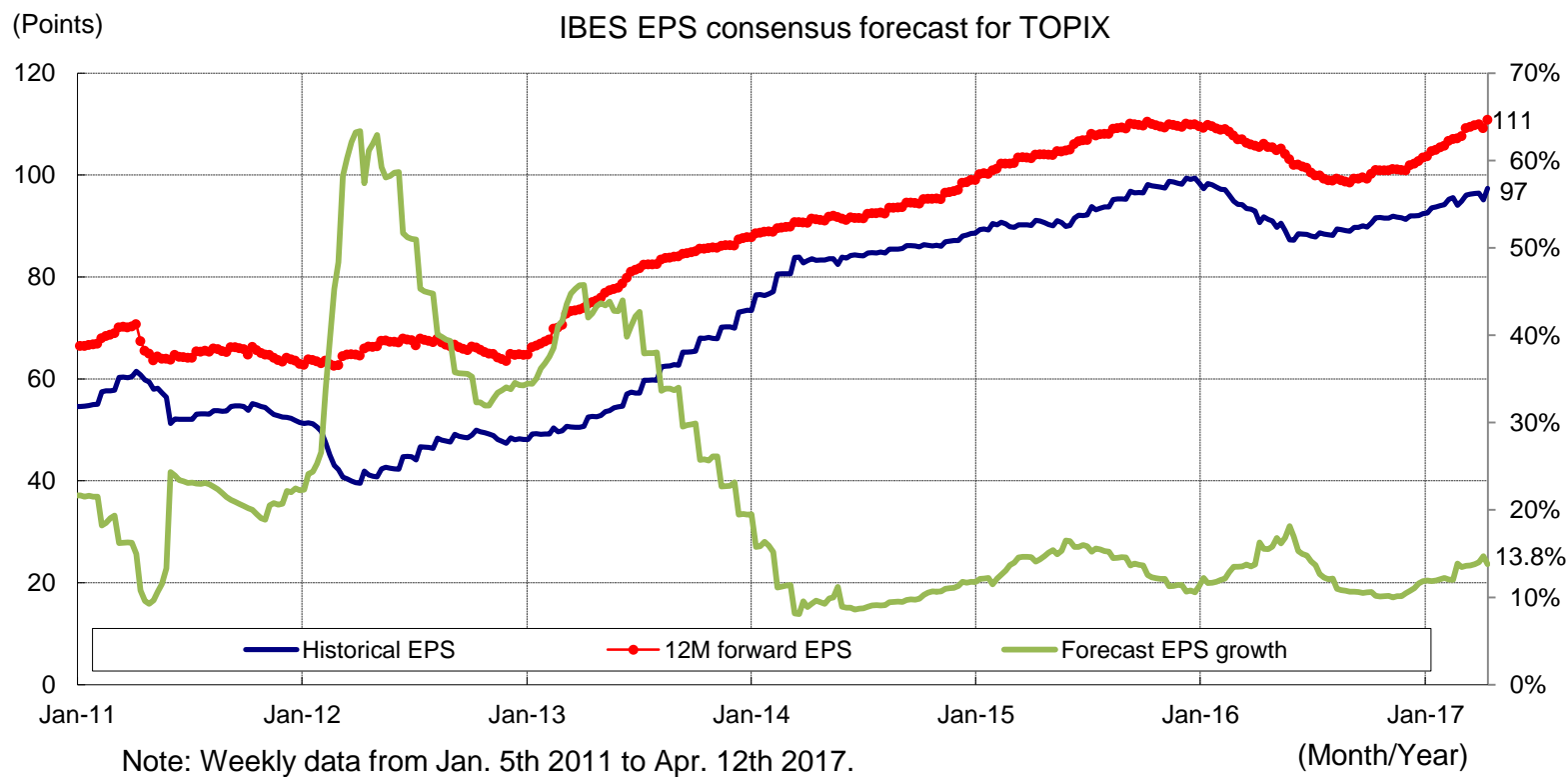
Stock markets in developed countries retreated in April

- Stock markets in developed countries fell with heightening geopolitical tensions and receding expectation for the Trump policies in stimulating global economy.
- Emerging markets showed resilience so far.



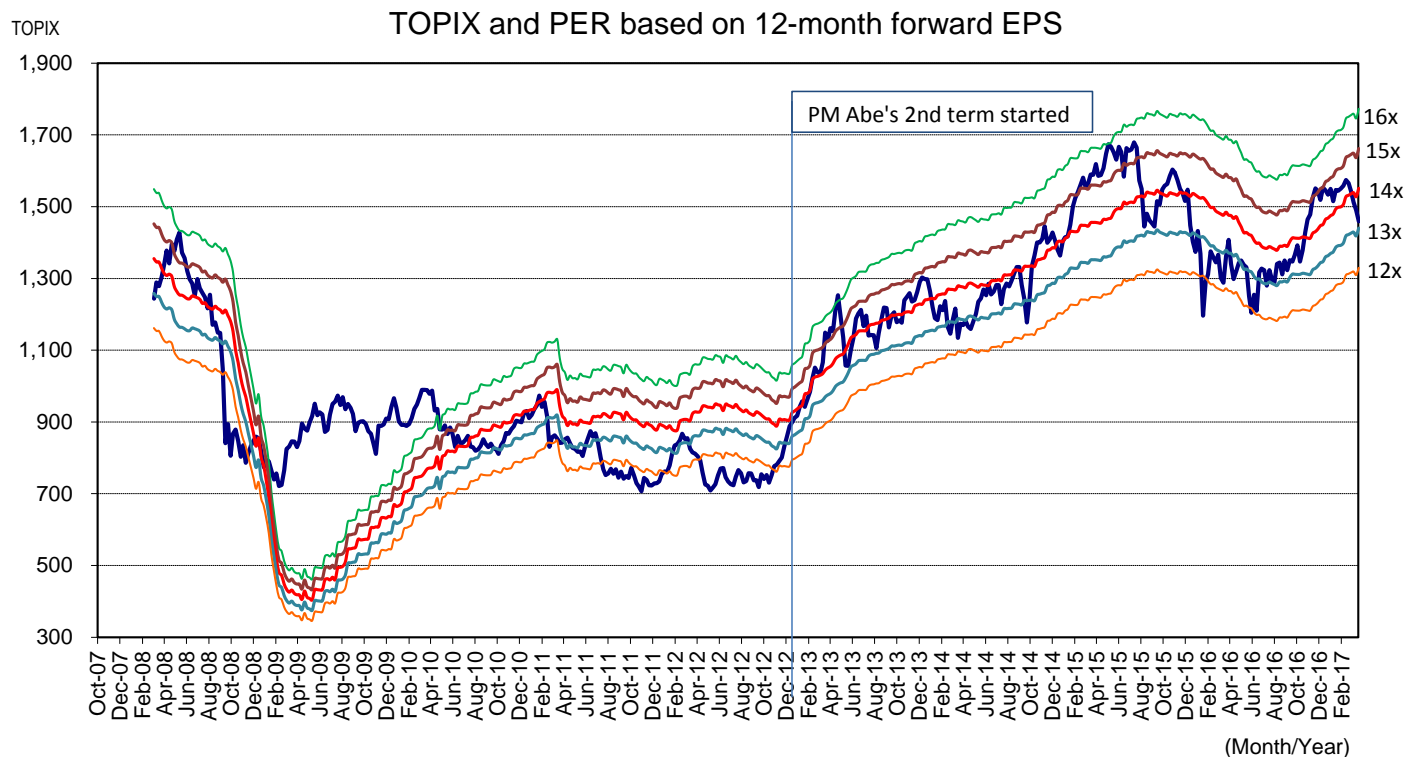
EPS forecasts by analysts continue to expand

- The latest 12M forward EPS forecast was 111, which beat previous historical record of 110 in October 2015.
- 13.8% EPS growth is forecast in the coming 12 months.



PER (Price Earnings Ratio) at 13x looks cheap

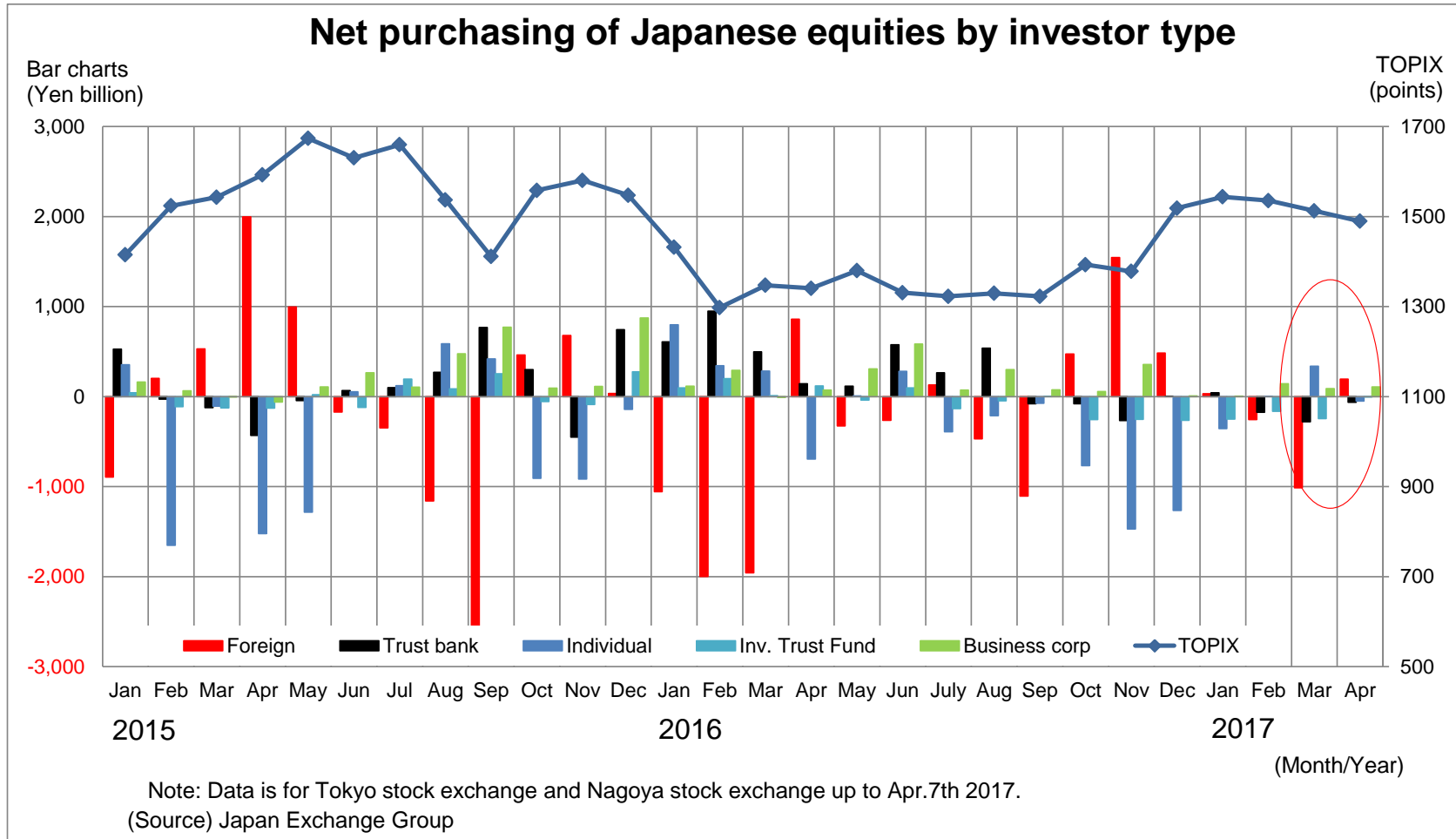
- Japanese stock market valuation in TOPIX is in the lower side of the range between 12x and 16x after PM Abe's second term began.
- Based on 12M forward EPS of 111, TOPIX PER is calculated at just above 13x.
- PER for MSCI US index is 18x and for MSCI Europe is 15x, which makes Japanese stock market look attractive in global comparison .



Note: Data is weekly from Oct. 26th 2007 to Apr. 12th 2017. TOPIX was 1459.07 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

Foreign investors sold Japanese equities in March

- Investors are sitting on the wall watching developments in East Asia and Trump policies in US.



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