



# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- July 2017 -



Sumitomo Mitsui Asset Management

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## Executive summary

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### ➤ Japanese Economy

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. Increase in Public Capital Investment and Private Capital Investment as well as steady growth of Private Consumption will drive the Japanese economy.

- Private consumption for durable goods seems to be increasing. Renewal demands might be appearing for TV sets, Cars and others purchased on government incentives just after the global financial crisis.
- Approval rating for the Abe cabinet fell from 53% to 48% in June. Disapproval rating jumped from 30% to 36%. Tokyo Metropolitan Assembly election is held on 2nd of July. The party "Tomin 1st", lead by the popular Governor Yuriko Koike, will gain many seats. If Democratic Party of Japan loses too many seats, the trouble for PM Abe could deepen further.

### ➤ Japanese Stock Markets

Japanese stock market might test the upside led by US stock market. Relatively attractive stock valuation compared to US is a positive factor. Possibility of global risk events blowing out has receded at least for now. Continuing expansion of global economy and corporate earnings would support the Japanese stock market in the long term.

- Based on 12M forward EPS of 112, TOPIX PER is calculated at just above 14x. PER for MSCI US index is 18x and for MSCI Europe is 15x, which makes Japanese stock market look attractive in global comparison .
- Major risks are such as historically high stock valuation for US markets, deterioration of PM Abe's political power, geo-political risk in East Asia and confusion in US politics.

Notes: Macro and market views are as of Jun. 16<sup>th</sup> and 20<sup>th</sup>, 2017 respectively, and subject to updates thereafter without notice

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# Outlook for Japanese Economy

## SMAM economic outlook for FY17-18

- GDP for FY2016 was changed from 1.3% to 1.2% due to the Jan-Mar 2017 GDP revised down from first preliminary 1.9% to second-preliminary 1.0%, meanwhile the forecasts for FY2017 and FY2018 were maintained.
- Increase in Public Capital Investment and Private Capital Investment as well as steady growth of Private Consumption will drive the Japanese economy.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.2%	1.2%	1.4%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.6%	0.9%	0.6%
Private Housing Investment	8.3%	-9.9%	2.8%	6.3%	0.5%	0.8%
Private Capital Investment	7.0%	2.4%	0.6%	2.5%	2.7%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.1%	0.4%	0.6%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	4.3%	0.3%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.1%	0.7%	0.4%	0.2%
Exports	4.4%	8.8%	0.7%	3.1%	5.2%	2.3%
Imports	7.1%	4.3%	0.2%	-1.3%	2.9%	1.4%
Nominal GDP	2.6%	2.0%	2.7%	1.0%	1.3%	1.6%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	-0.0%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	3.8%	2.1%
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 Jun. 16<sup>th</sup>, 2017 and subject to updates thereafter without notice

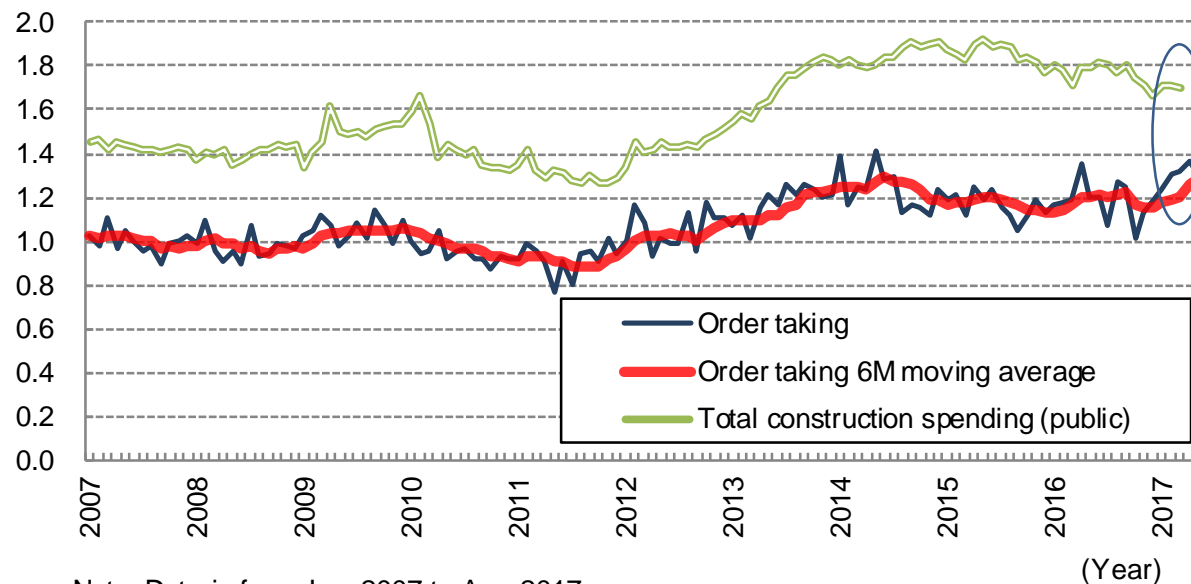
(%, YoY except Net Exports)

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

## 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)

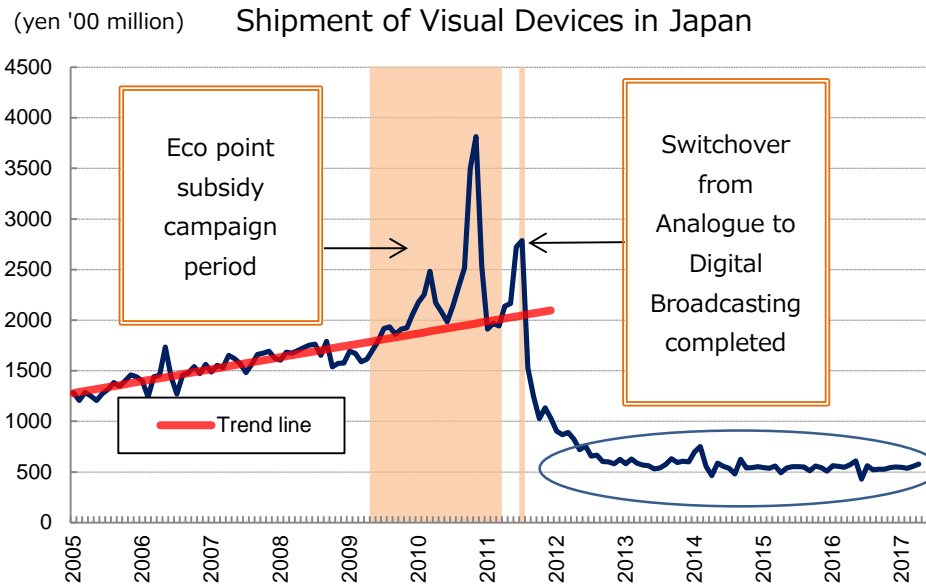


Note: Data is from Jan. 2007 to Apr. 2017

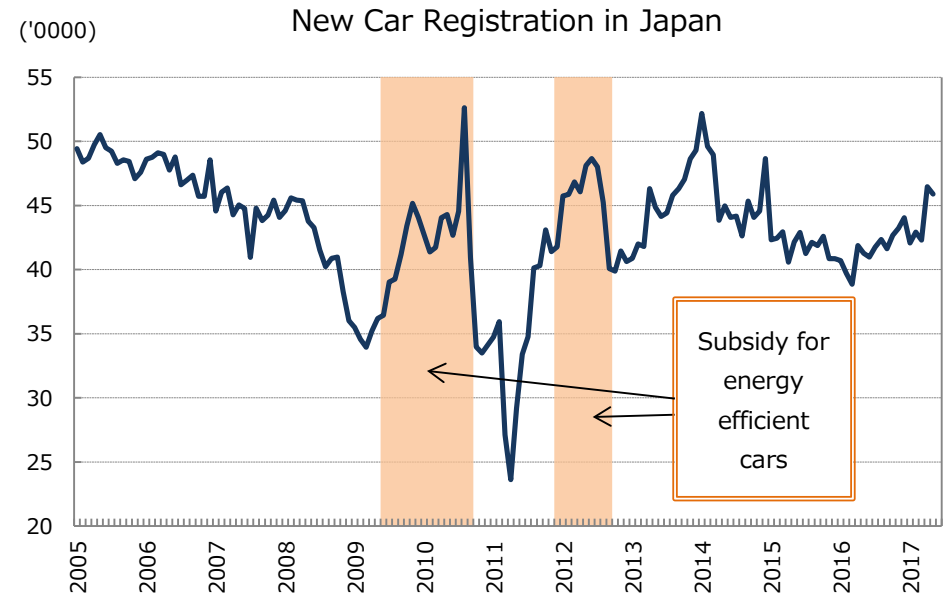
(Source) Cabinet Office, Ministry of Land, Infrastructure, Transport and Tourism, EAST JAPAN CONSTRUCTION SURETY CO., LTD, and compile by SMAM.

## Private consumption for durable goods might be lifted by renewal demands in the near future

- There are early signs that private consumption for durable goods are increasing.
- After the global financial crisis, Japanese government initiated incentives for purchasing such big ticket items as TV sets and new cars as the shaded period in the charts shows. The demand, however, slumped after the end of such incentives as the blue circle in the left chart shows.
- Average lifetime for such durable goods are between 7 and 10 years, and renewal demands might be appearing.



Note: Data is monthly from Jan. 2005 to Apr. 2017, seasonally adjusted by SMAM. (Year)  
 (Source) Japan Technologies and Information Technology Industries Association

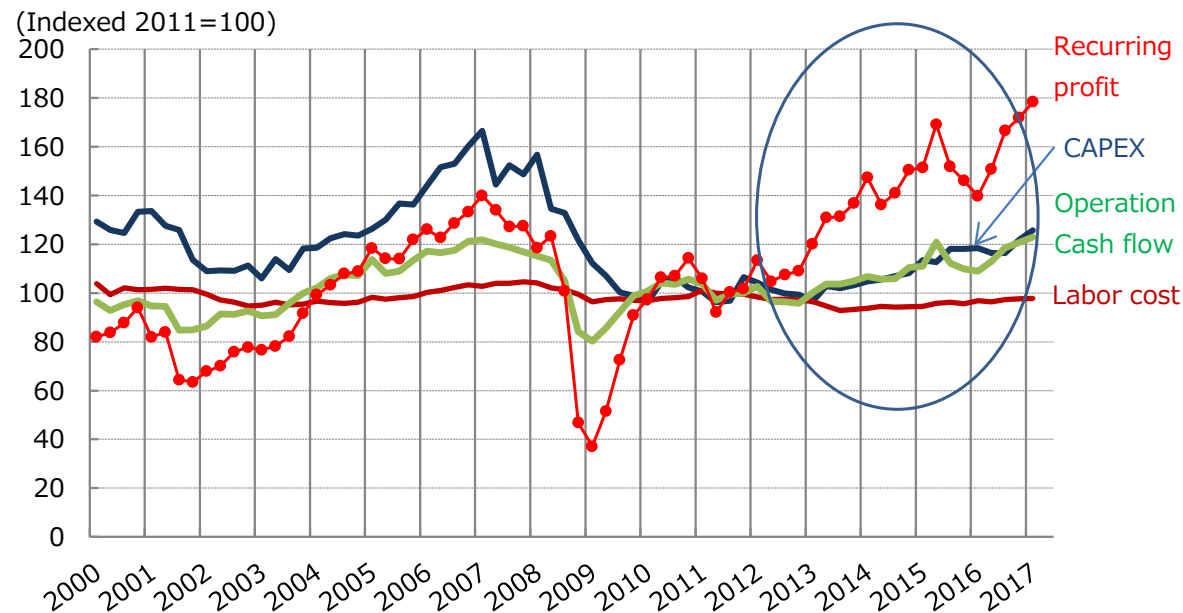


Note: Data is monthly from Jan. 2005 to Apr. 2017, seasonally adjusted by SMAM. (Year)  
 (Source) Japan Automobile Dealers Association, Japan Mini Vehicles Association

## Capital expenditure is on the rise in line with the increasing operating cash flow

- Corporate Financial Statistics released by Ministry of Finance has a broad coverage of businesses including non-listed companies.
- Rising operating cash flow underpins capital expenditure by companies.
- Restrained labor cost might be positive for shareholders in sharply rising profits, however, labor share should be increased in order for lifting private consumption in Japan.

Corporate Financial Statistics (for all industries, all size)

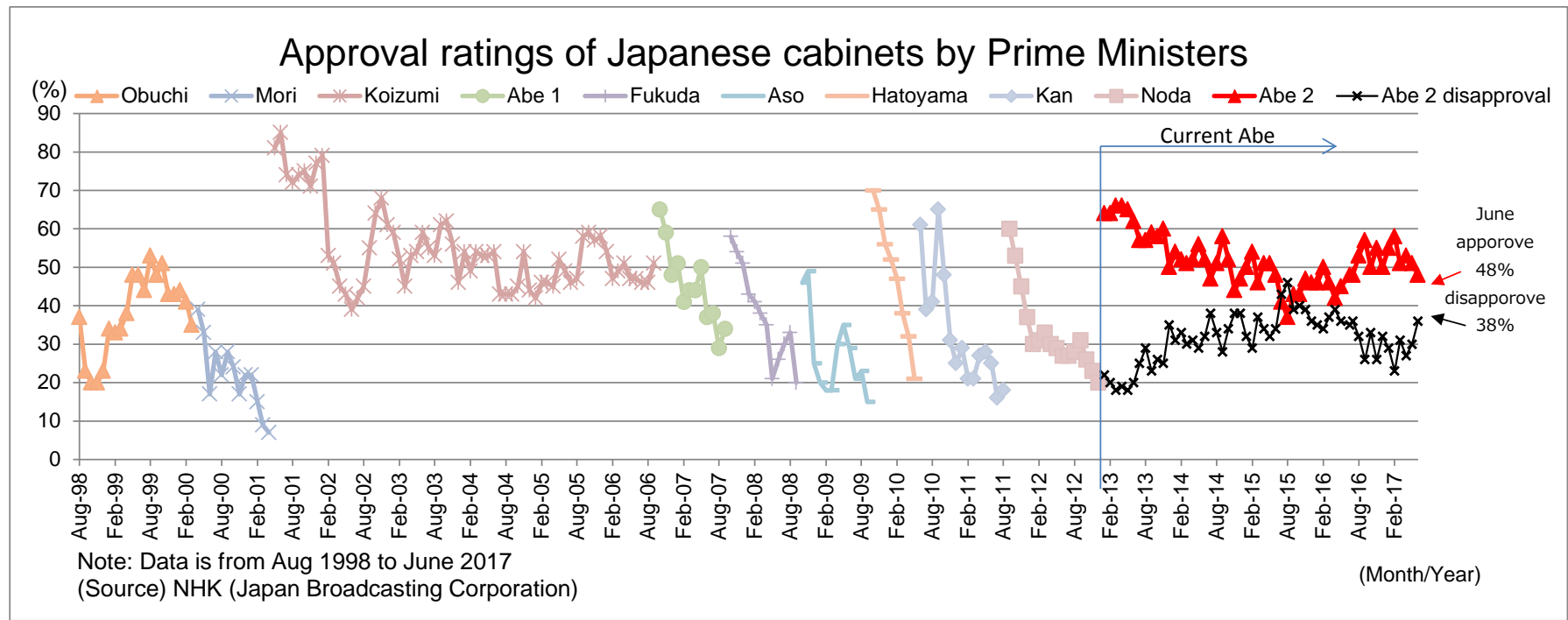


Note: Data is quarterly from 1Q 2000 to 1Q 2017.

(Source) Ministry of Finance

## Approval rating for Abe cabinet is deteriorating

- Approval rating for the Abe cabinet fell from 53% to 48% in June. Disapproval rating jumped from 30% to 36%.
- “Kake-school scandal” is causing a damage to PM Abe’s reputation. He is suspected to have benefitted one of his closest friends in gaining approval of opening a school for a feline practitioner. Arrogantly looking passage of some national security related bills were also negative.
- Tokyo Metropolitan Assembly election is held on 2nd of July. The party “Tomin 1st”, lead by the popular Governor Yuriko Koike, will gain many seats. If Democratic Party of Japan loses too many seats, the trouble for PM Abe could deepen further.





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# Outlook for Japanese Stock Markets

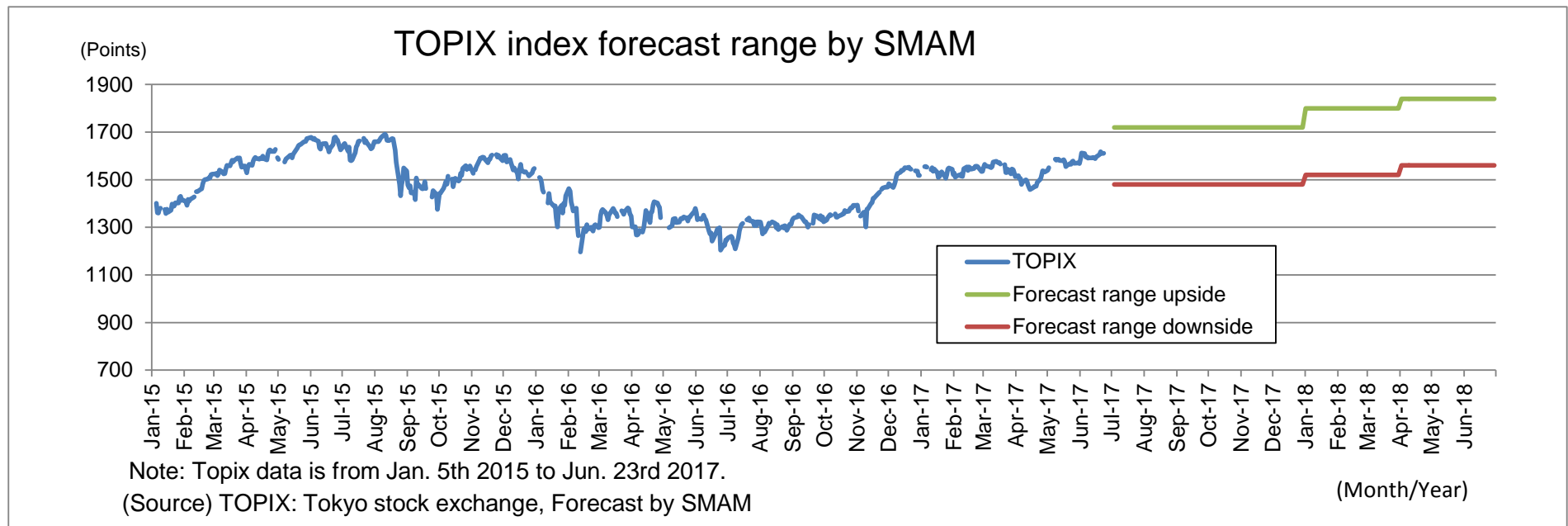
## Stock market outlook: Japanese stock market might follow the lead of the US market

### SMAM short-term view

- Japanese stock market might test the upside led by US stock market. Relatively attractive stock valuation compared to US is a positive factor. Possibility of global risk events blowing out has receded at least for now.

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

- Continuing expansion of global economy and corporate earnings would support the Japanese stock market in the long term. Major risks are such as historically high stock valuation for US markets, deterioration of PM Abe's political power, geo-political risk in East Asia and US politics.



Note: SMAM's projection is as of Jun. 20 th, 2017 and subject to updates without notice.

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

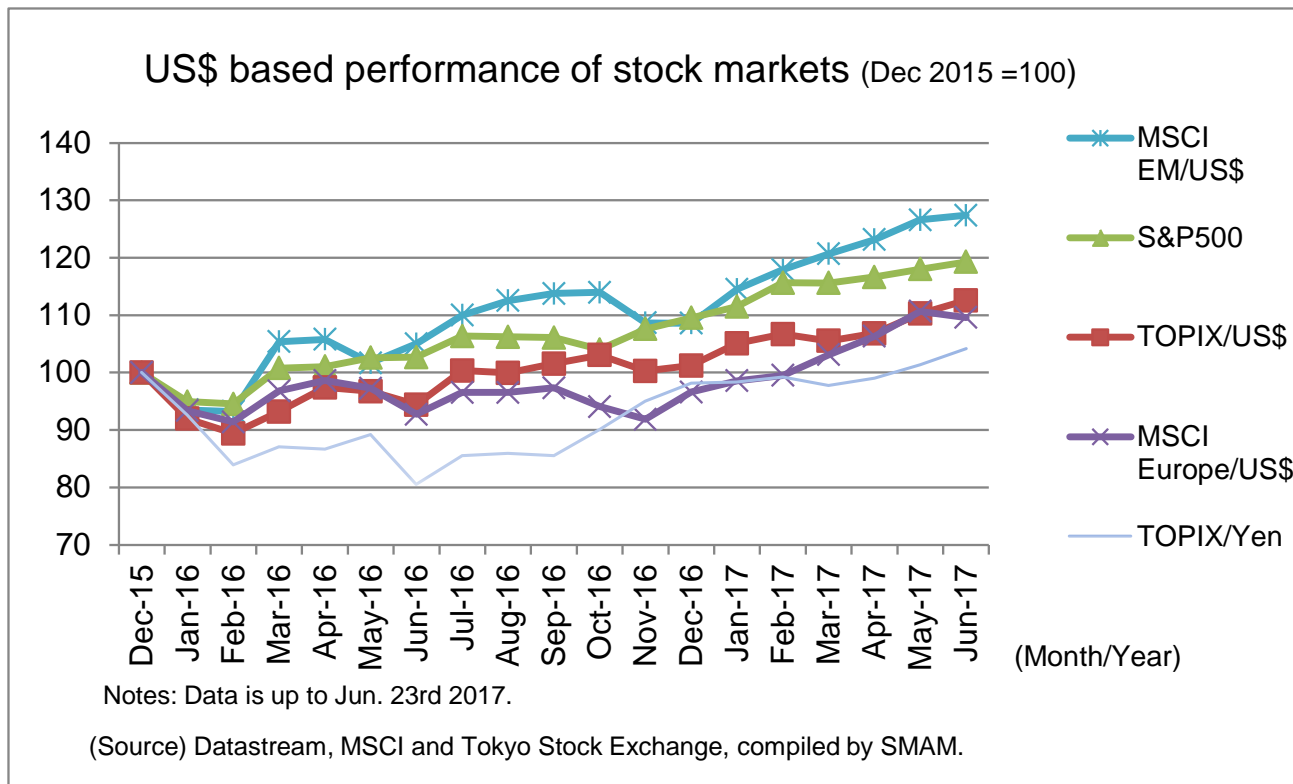
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- Our **Base Scenario** is assuming the following views:
  - Practical Trump trade policies are made and serious trade disputes can be avoided.
  - Expansionary policies in US keep global economies on a growth path.
  - Japan's private consumption 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.
  - "Russia-gate" scandal flares up.
  - Populism gains in Europe further destabilizing EU.
  - Heightening geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - "Moritomo" and "Kake" scandals make a fatal blow to PM Abe.

Note: SMAM's projection is as of June 20<sup>th</sup>, 2017 and subject to updates without notice.

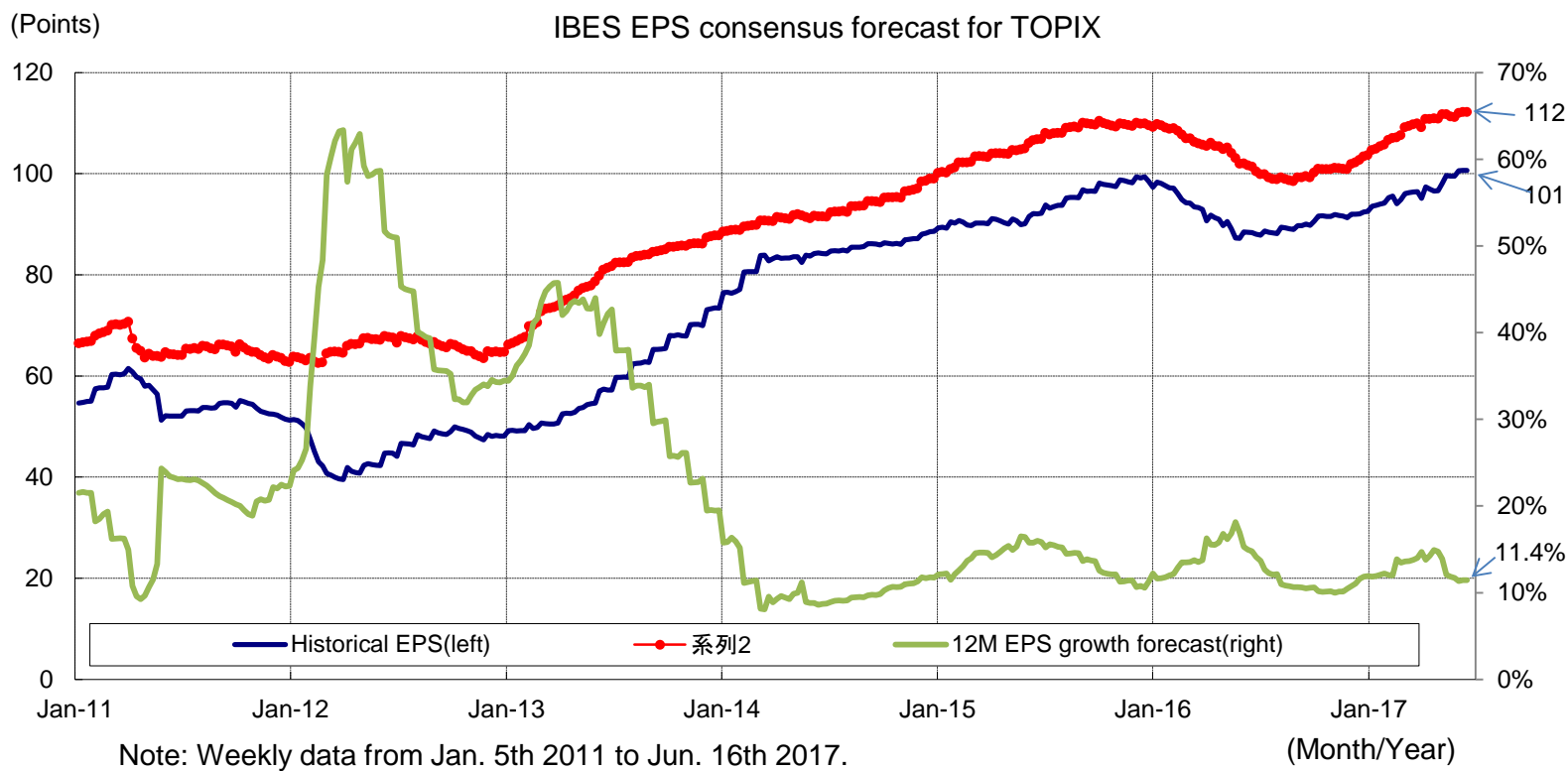
## Japanese stock market caught up with other markets in June

- Europe took a breather in June. Rally continues for Emerging markets and US stocks.
- Japanese stock markets made a catch-up move in June after lagging other markets.



## EPS forecasts by analysts continue to expand

- The latest 12M forward EPS forecast for TOPIX advanced steadily to 112. Historical EPS also advanced.
- 11.4% EPS growth is forecast in the coming 12 months.



(Source) Datastream, IBES

## ROE recovery has been achieved by improving profit margin so far

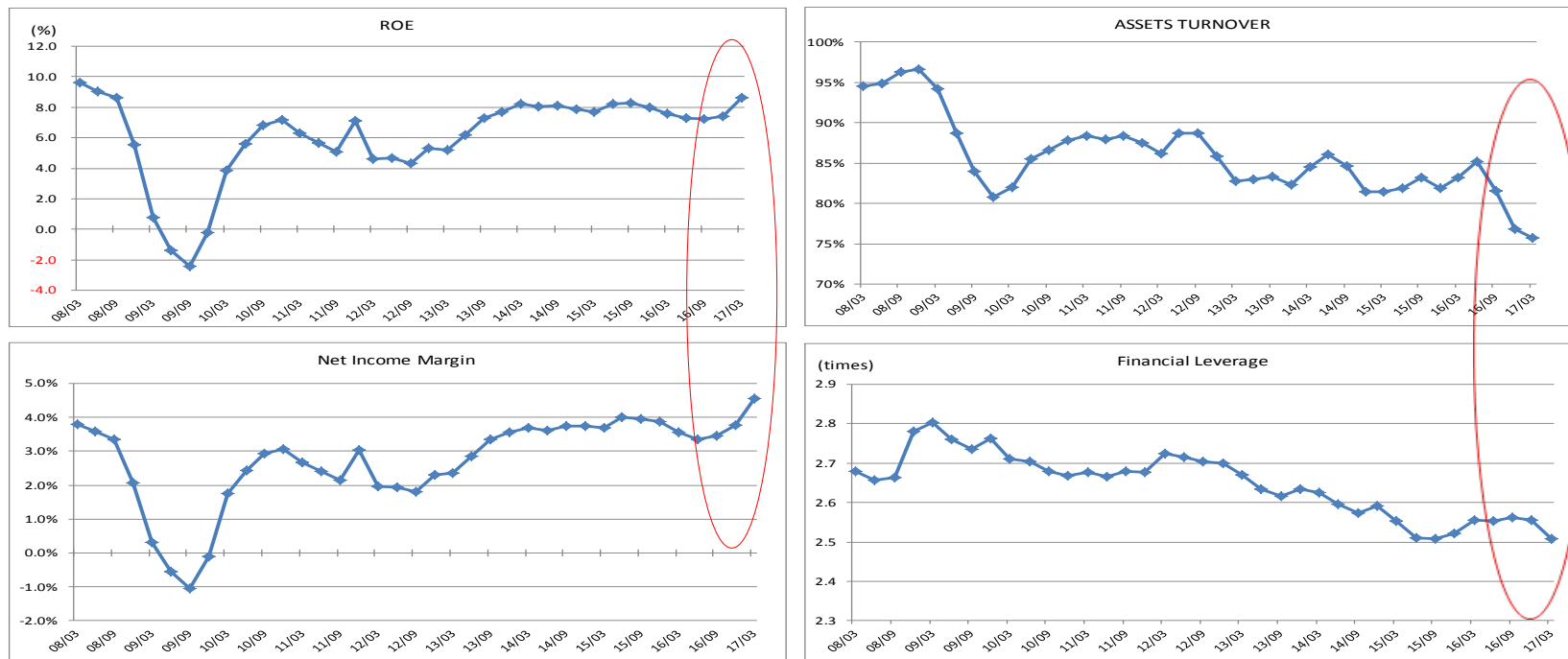
- ROE (Return on Equity) can be decomposed into the following.

$$\text{ROE} = \text{Financial Leverage} \times \text{Asset Turnover} \times \text{Net Income Margin}$$

$$(\text{Total assets} / \text{Shareholder equity}) \times (\text{Sales} / \text{Total assets}) \times (\text{Net income} / \text{Sales})$$

- Substantial improvement of Net Income Margin is very positive development, since this has been the biggest factor why ROE of the Japanese companies are inferior to US companies.
- As a whole, asset/ capital efficiency still need to improve despite positive efforts found in individual companies.

Decomposition of ROE for TOPIX

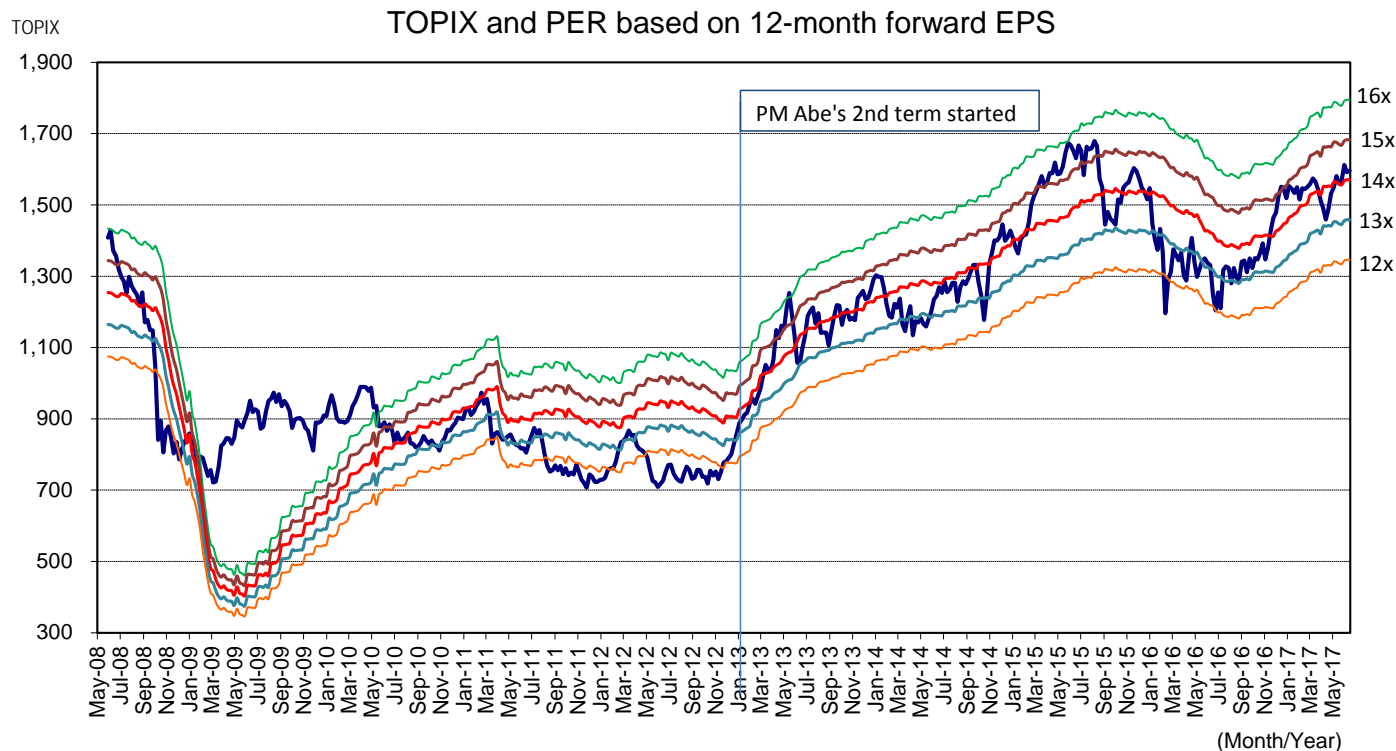


Note: Data is quarterly from 1Q 2008 to 1Q 2017.

(Source) FactSet and compile by SMAM

## PER (Price Earnings Ratio) at 14x looks cheap compared to other markets

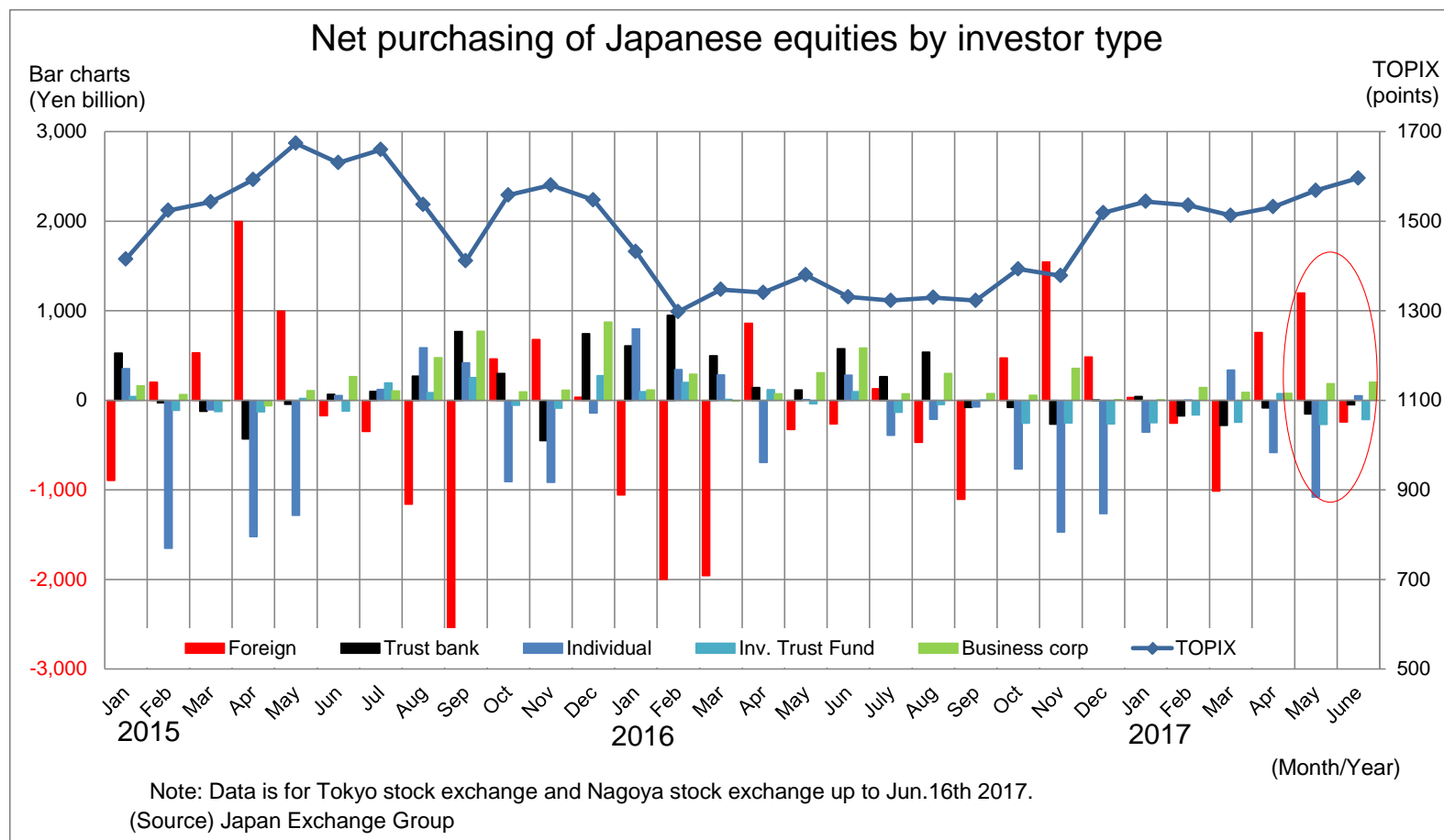
- Japanese stock market valuation in TOPIX about the middle of the range between 12x and 16x after PM Abe's second term began.
- Based on 12M forward EPS of 112, TOPIX PER is calculated at just above 14x.
- PER for MSCI US index is 18x and for MSCI Europe is 15x, which makes Japanese stock market look attractive in global comparison .



Note: Data is weekly from May 30th 2008 to Jun. 16th 2017. TOPIX was 1596.04 at the end of the period.  
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

## Foreign investors bought Japanese equities in May

- Foreign investors were buying Japanese equities in May and turned to sell slightly in June.
- Investors activities slowed in the first half of June.





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