

# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- February 2018 -



Sumitomo Mitsui Asset Management

SMAM

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## Executive summary

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### ➤ Japanese Economy

SMAM upgraded GDP growth forecast for FY2017 from 1.8 % to 2.0% on the back of recent strong economic readings. Forecast for FY2018 and FY2019 was also raised from 1.1% to 1.4% and 0.7% to 0.8% respectively.

- BOJ slightly raised its assessment of inflationary environment and outlook in the latest announcement made after a Monetary Policy Committee Meeting ended on January 23rd. BOJ said, current inflation is “around 1%” rather than “in the latter half between 0 and 1%”. Inflationary expectation is “keeping the same level” rather than “on a little weak tone”.
- Japanese people are feeling better as latest economy watcher survey showed. Favorable job opportunity is one of the supporting factors behind this good sentiment. If significant wage increase is achieved on the back of tight labor market and robust corporate earnings, virtuous cycle with higher inflation could be ignited.

### ➤ Japanese Stock Markets

Japanese stock market is expected to move in an upward trend supported by robust corporate earnings, especially manufacturing companies, and favorable demand & supply condition after TOPIX broke a resistance level around 1800 lasted for 26 years. Major risk factors could be conflicts surrounding North Korea after PyeongChan Winter Olympic Games.

- Net money flow via investment trust funds is worth watching for a long-term effect. Tax exempt accumulation savings scheme for individuals began in January 2018. Individuals are eligible for tax exemption for 20 years on profits earned on accumulating investments via approved investment trust funds up to 400 thousands yen per year.
- Major risks will be such as geo-political risks and unexpectedly hawkish monetary policy by central banks.

Notes: Macro and market views are as of Jan. 19<sup>th</sup> 2018, and subject to updates thereafter without notice.

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# Outlook for Japanese Economy

## SMAM economic outlook for FY17-19

- SMAM upgraded GDP growth forecast for FY2017 from 1.8 % to 2.0% on the back of recent strong economic readings. Forecast for FY2018 and FY2019 was also raised from 1.1% to 1.4% and 0.7% to 0.8% respectively.

(YoY %)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	2.0%	1.4%	0.8%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	1.3%	0.9%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	1.8%	0.9%	1.0%
Private Capital Investment	3.3%	2.3%	1.2%	3.4%	2.8%	1.8%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.6%	0.7%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.6%	-0.7%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.5%	0.4%	0.1%
Exports	8.7%	0.7%	3.4%	6.1%	4.5%	2.0%
Imports	4.3%	0.3%	-1.1%	2.8%	2.0%	1.4%
Nominal GDP	2.2%	3.0%	1.0%	2.1%	1.9%	1.9%
GDP Deflator	2.5%	1.5%	-0.2%	0.1%	0.5%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.8%	2.8%	2.0%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	1.0%	0.6%

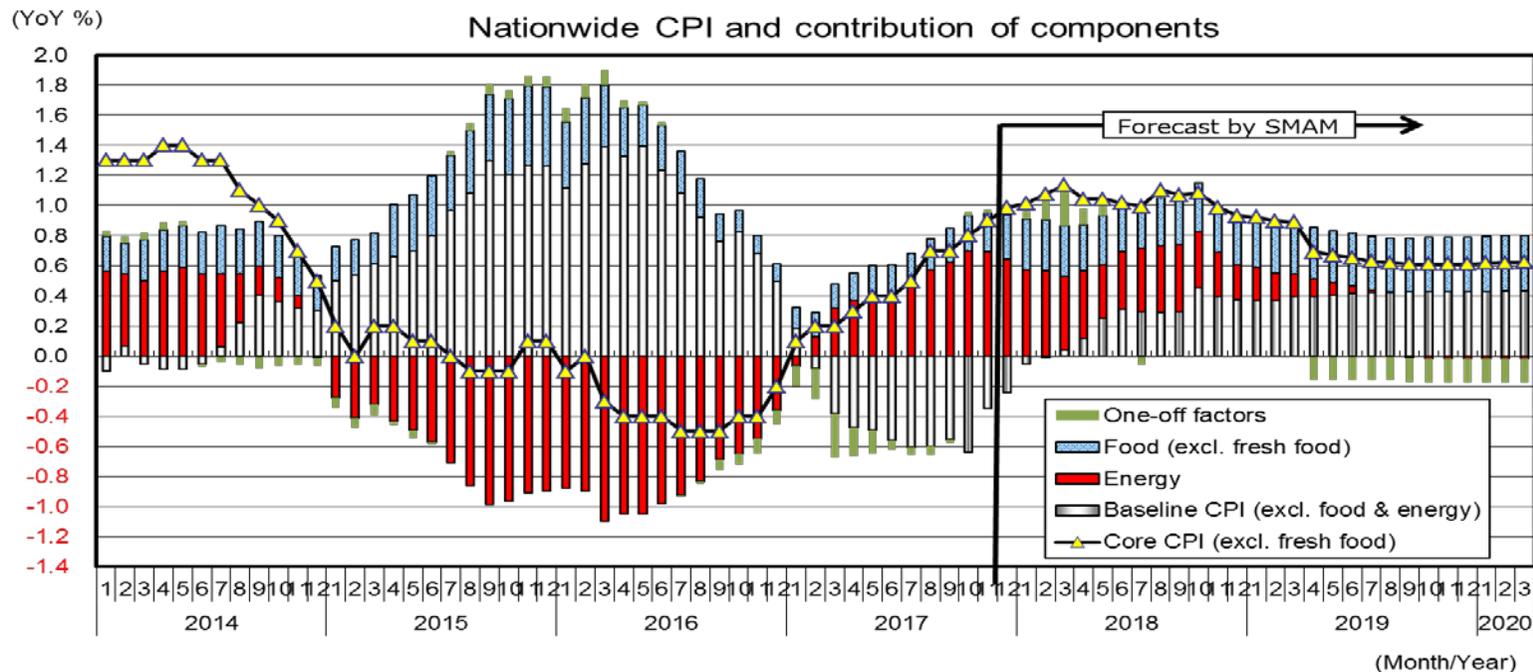
Notes: E=SMAM forecasts. SMAM views are as of Jan 19<sup>th</sup>, 2018 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

## Inflation is firming up in Japan

- BOJ slightly raised its assessment of inflationary environment and outlook in the latest announcement made after a Monetary Policy Committee Meeting ended on January 23<sup>rd</sup>. BOJ said, current inflation is “around 1%” rather than “in the latter half between 0 and 1%”. Inflationary expectation is “keeping the same level” rather than “on a little weak tone”.
- Abrupt policy change is not likely, however, investors are paying increasing attention to unexpected policy change by central banks.



Note: Effect of consumption tax hike in April 2014 and scheduled in Oct 2019 are excluded.

(Source) Ministry of Internal Affairs & Communications

## Strong export growth continues to drive the Japanese economy

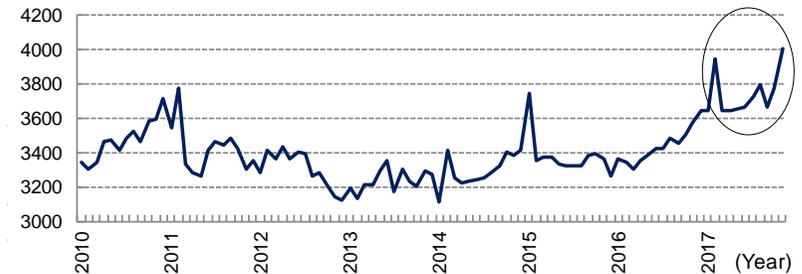
- Robust exports, especially to Asia & China are driving the Japanese economy. Exports to US rebounded in November recovering from damages caused by hurricanes.

Total export volume  
(seasonally adjusted, yen billion)



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

Export volume to Asia



Export volume to China

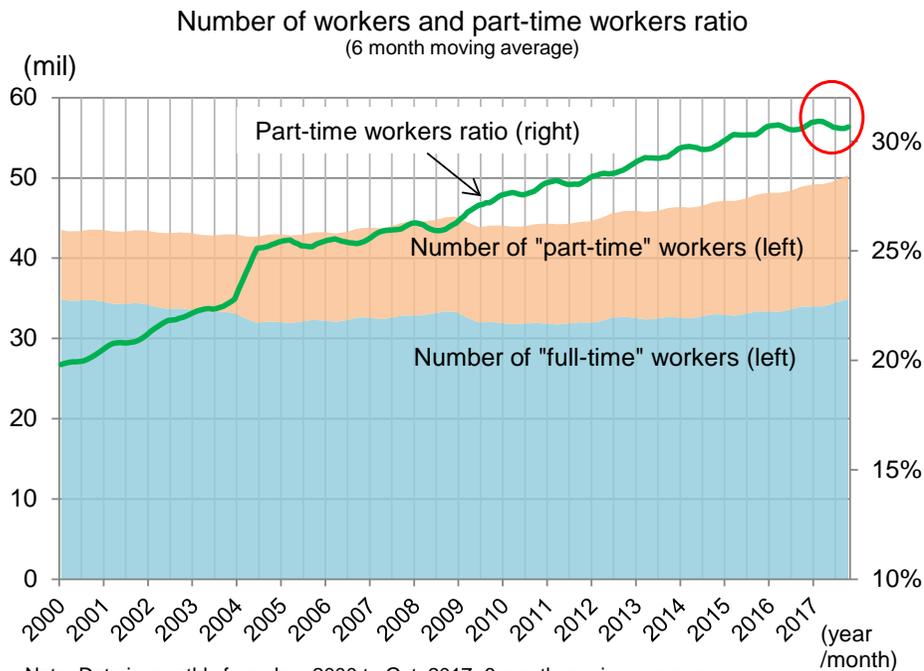


Export volume to US

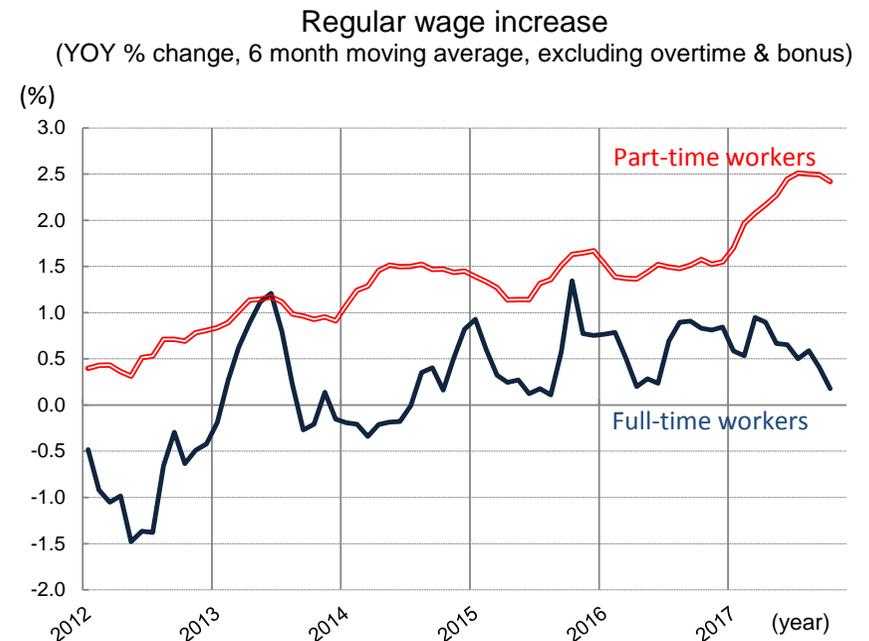


## Extremely tight labor market might ignite faster wage increase

- Number of workers has been mildly increasing despite aging population.
- Ratio of part-time workers, which has been increasing substantially, seems to be plateauing lately due to increasing difficulties to find workers.
- Companies, which are in industries facing severe labor shortage, are offering more full-time jobs to recruit workers.
- Wage increase, which is already prominent for part-time workers, might gradually spread to full-time workers.



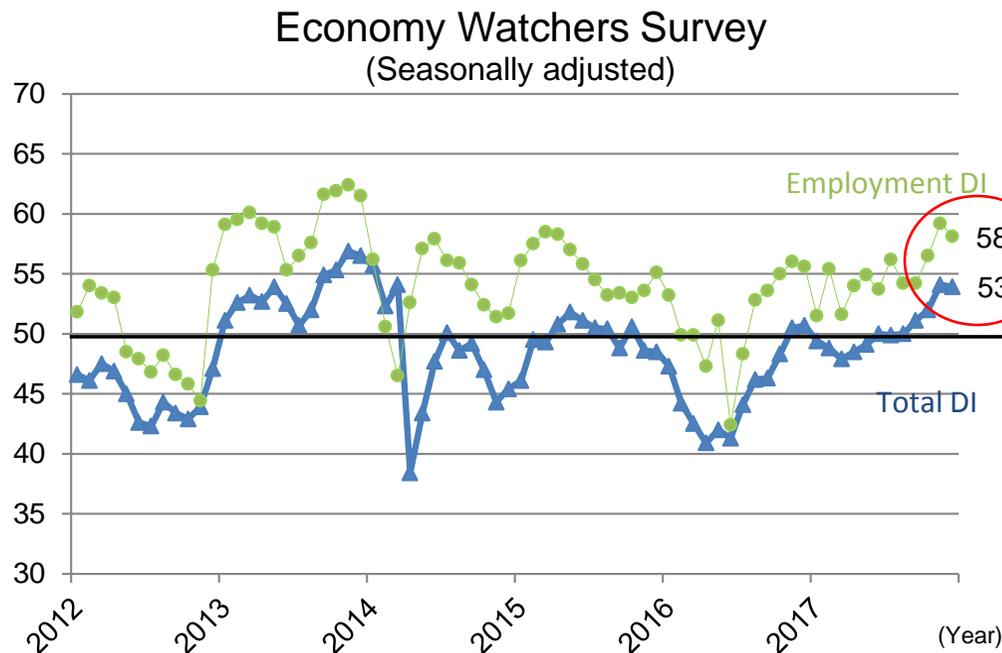
Note: Data is monthly from Jan. 2000 to Oct. 2017. 6 month moving average.  
(Source) Ministry of Health, Labour and Welfare



Note: Data is monthly from Jan. 2012 to Oct. 2017. 6 month moving average.  
(Source) Ministry of Health, Labour and Welfare

## Japanese people are feeling better, for which strong employment is a supporting factor

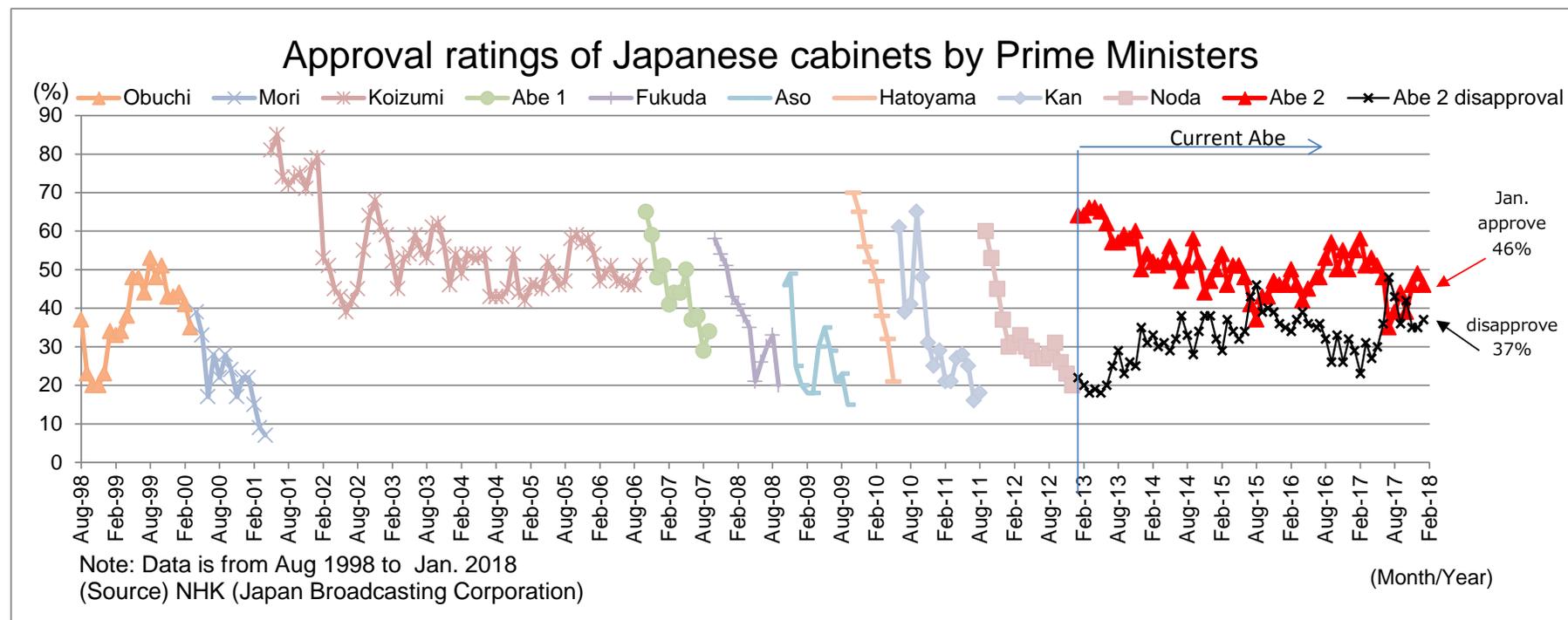
- Economy Watchers Survey is based on response from people engaged in economic sensitive jobs on the street such as retail shop and taxi drivers. DI for the current condition in December 2017 was 53.9 showing that people were feeling better.
- Japanese people are feeling better as DI above 50 shows. Favorable job opportunity is one of the supporting factors behind this good sentiment.



Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is improving. Data period is from Jan. 2012 to Dec. 2017.  
(Source) Cabinet Office

## Approval rating for Abe cabinet hovers at comfortable level

- Approval rating for Abe cabinet edged down by 2% to 46% in January, which is comfortably higher than a critical 40% level breached in the middle of 2017.
- Supplemental budget for supporting child education is going to be implemented, for which around 2.8 trillion yen is anticipated.
- On the other hand, households earning more than 8.5 million annual income is going to face tax increase.
- Government is considering tax incentives for companies which increase wage and capital efficiency.



## Monetary policies, geopolitical tensions and economic policies are going to be main focus

- Unless any unexpected negative impact coming from the events listed below or others, global economy is likely to continue expanding rather strongly.
- Change in monetary policies, especially in US under the new chairman, or geopolitical conflicts are going to be main risk factors.

### Schedule of key events in 1H 2018

Month	Region/Country	Events	Notes
January	Japan	National Diet ordinary session begins	
		22-23 BOJ Monetary Policy Committee Meeting/ Perspective report	
	US	State of Union Address	
		30-31 FOMC	
EU	25 ECB monetary policy meeting		
February	Japan	4Q2017 GDP 1st preliminary estimate	
	US	3 FRB chair Yellen's term ends	
		FRB chairperson's testimony	New chairman Powell's first testimony?
		Budget Message of the President	
	South Korea	9-25 PyeongChang Olympic games are scheduled	Possibility of escalation or soothing of North Korean situation?
North Korea	16 Kim Jong-Il's birthday		
March	Japan	19 Two deputy governors' term ends	
		Spring wage negotiation rounds	Substantial wage hike achievable?
	US	20-21 FOMC	Another rate hike?
	China	China National People's Congress	
April	Japan	8 BOJ governor Kuroda's term ends	Who is next BOJ governor?
		26-27 BOJ Monetary Policy Committee Meeting	
June	Japan	Japanese government releases a) updated growth strategy b) plan of a revolution in human resources development and c) Basic Policies for Economic and Fiscal Management and Structural Reform	

(Source) Various publications, assembled by SMAM

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# Outlook for Japanese Stock Markets

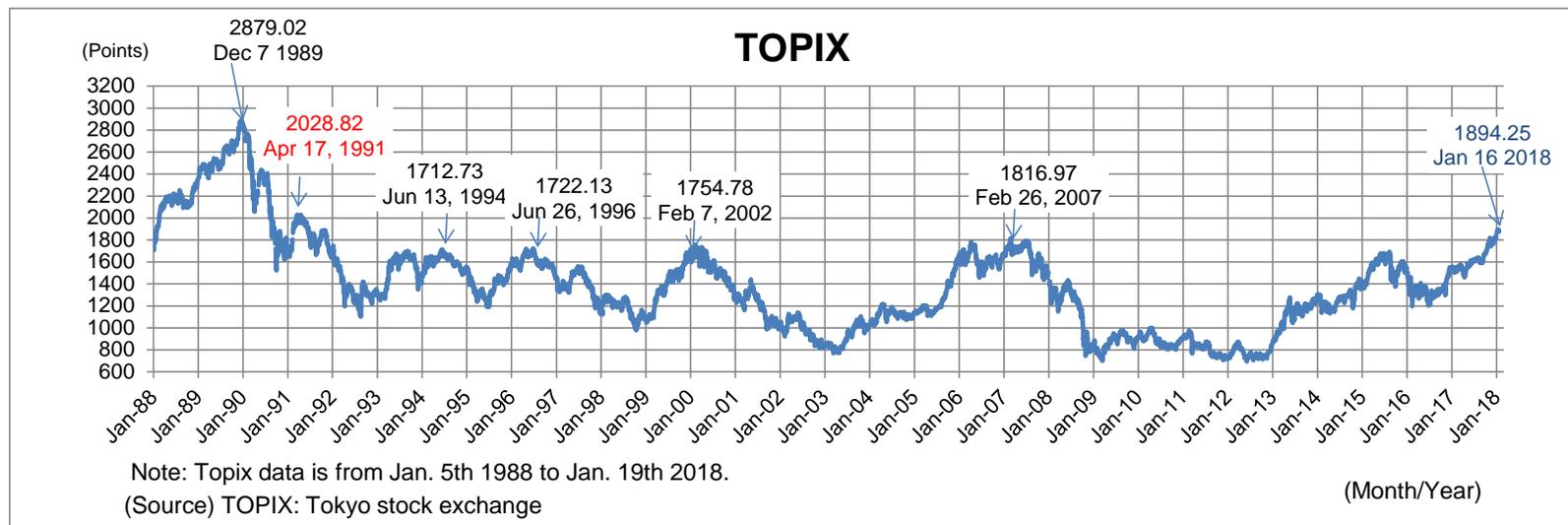
## Stock market outlook: Expected to be buoyed by strong earnings growth

### SMAM short-term view

- Japanese economy is expected to show strength supported by robust exports, growing capital expenditure and solid private consumption. Japanese stock market is expected to move in an upward trend supported by robust corporate earnings, especially manufacturing companies, and favorable demand & supply condition after TOPIX broke a resistance level around 1800 lasted for 26 years. Major risk factors could be conflicts surrounding North Korea after PyeongChan Winter Olympic Games.

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

- As a baseline scenario, robust global economic growth is expected to continue, which should provide strong corporate earnings growth to Japanese companies blowing tailwinds to the Japanese stock market. If sizable wage increase can be achieved on the back of record high corporate earnings, increasing business confidence as well as ever tighter labor market, virtuous economic cycle with higher inflation might be kicked in. Major risks will be such as geo-political risks and unexpectedly hawkish monetary policy by central banks.



Note: SMAM's projection is as of Jan 19<sup>th</sup> 2018 and subject to updates without notice.

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

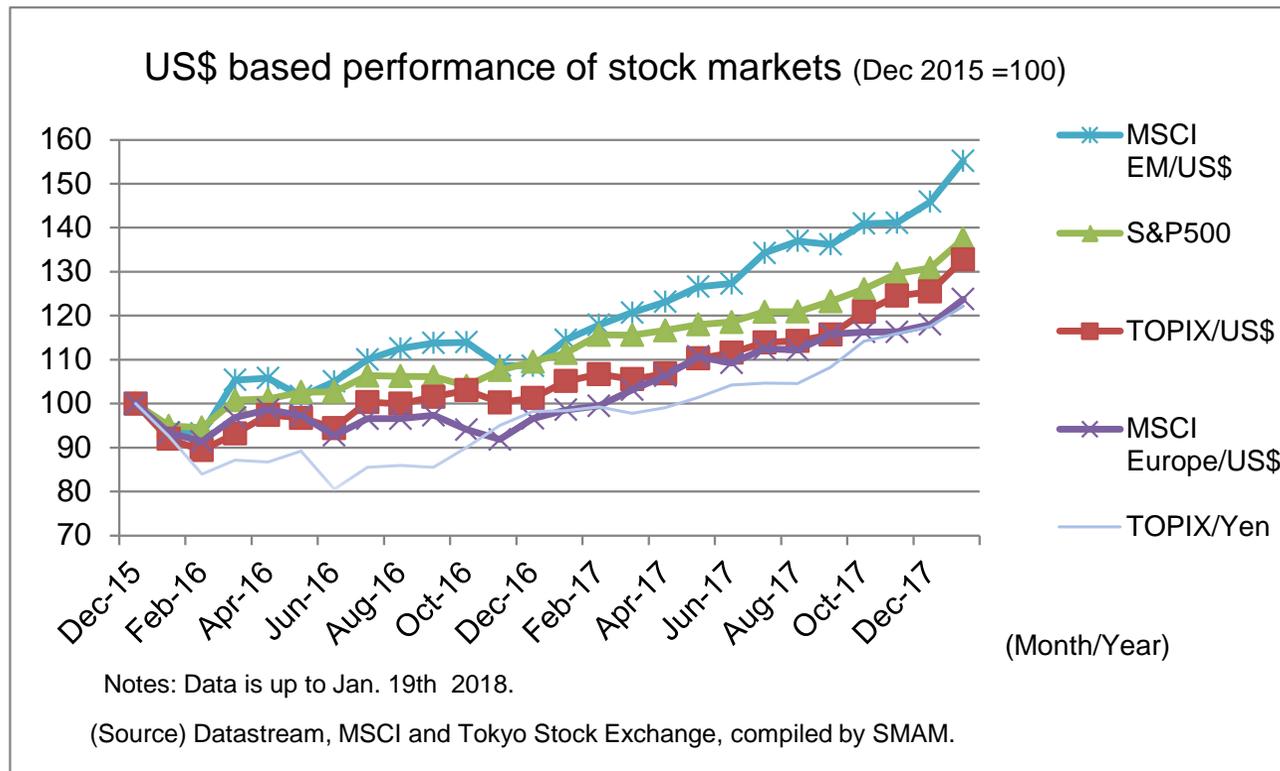
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- Our **Base Scenario** is assuming the following views:
  - Practical Trump trade policies are made and serious trade disputes can be avoided.
  - US economy keeps growing.
  - Japan's private consumption to grow mildly supported by wage growth.
  - 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.
  - North Korea abandons nuclear arms development.
  - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.
  
- **Downside Risks** include:
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - Pre-mature tightening of monetary policies chocks global economy.
  - Confrontational foreign policies taken by Trump presidency shake global trades.
  - "Russia-gate" scandal flares up.
  - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Jan. 19<sup>th</sup> 2018 and subject to updates without notice.

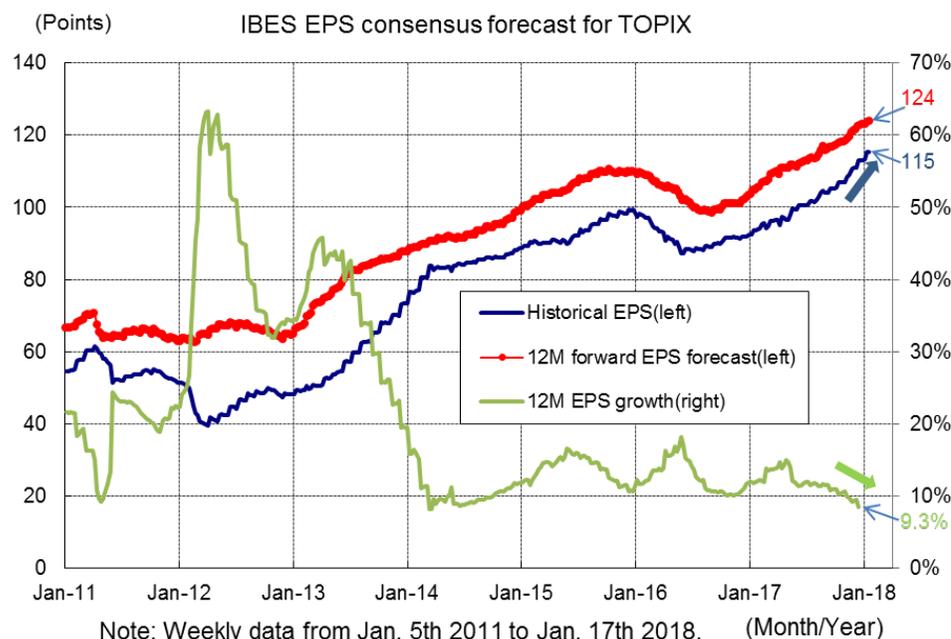
## Japanese stock market in US\$ terms is performing strongly compared to peers

- Strong performance continues for emerging markets.
- US stock market leads the global stock markets by renewing new highs.
- Japanese stock market shows resilience to strong yen and its performance is actually better than US in US\$ terms so far in January 2018 as of Friday 19<sup>th</sup>.

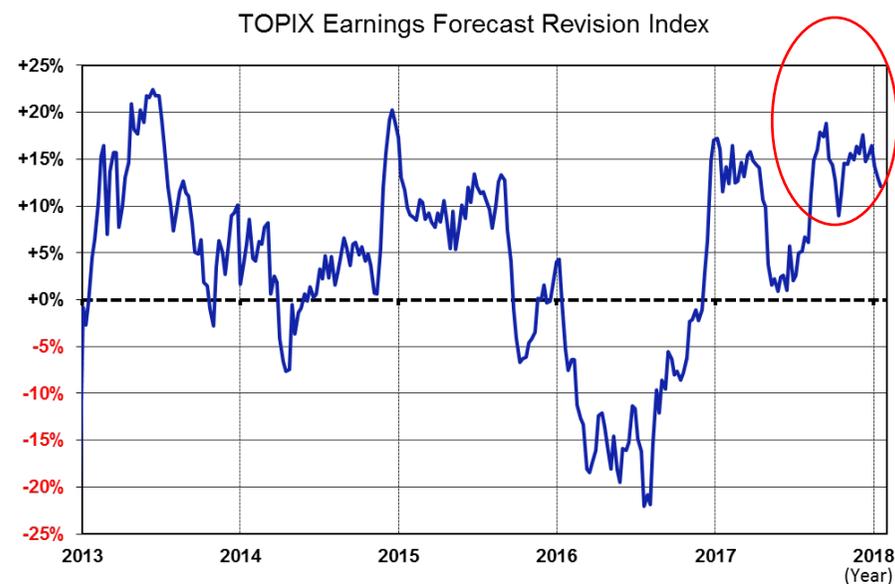


## EPS upward revision is continuing, which provides upside room for the stock prices

- Analysts are revising EPS forecasts for Japanese companies upwards.
- On the surface, 12M forward EPS growth rate is declining. However, this is due to the very rapid growth of historical EPS outpacing upward revisions made by analysts.

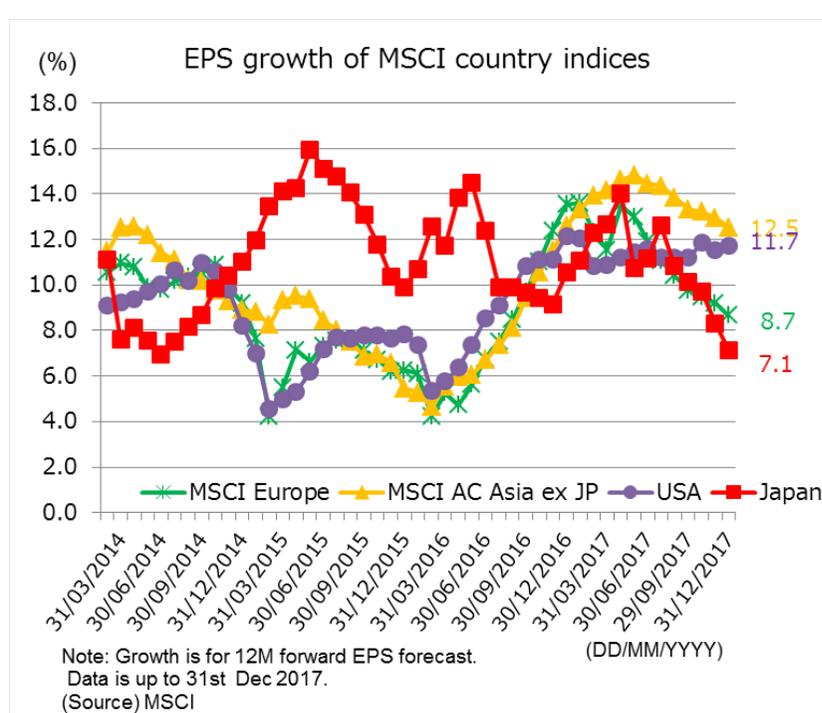
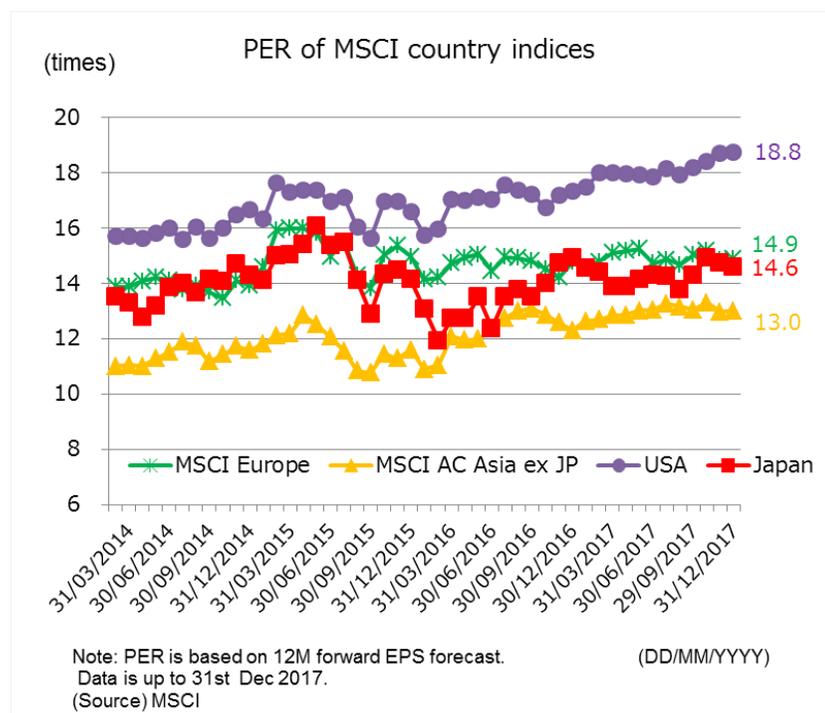


(Source) Datastream, IBES



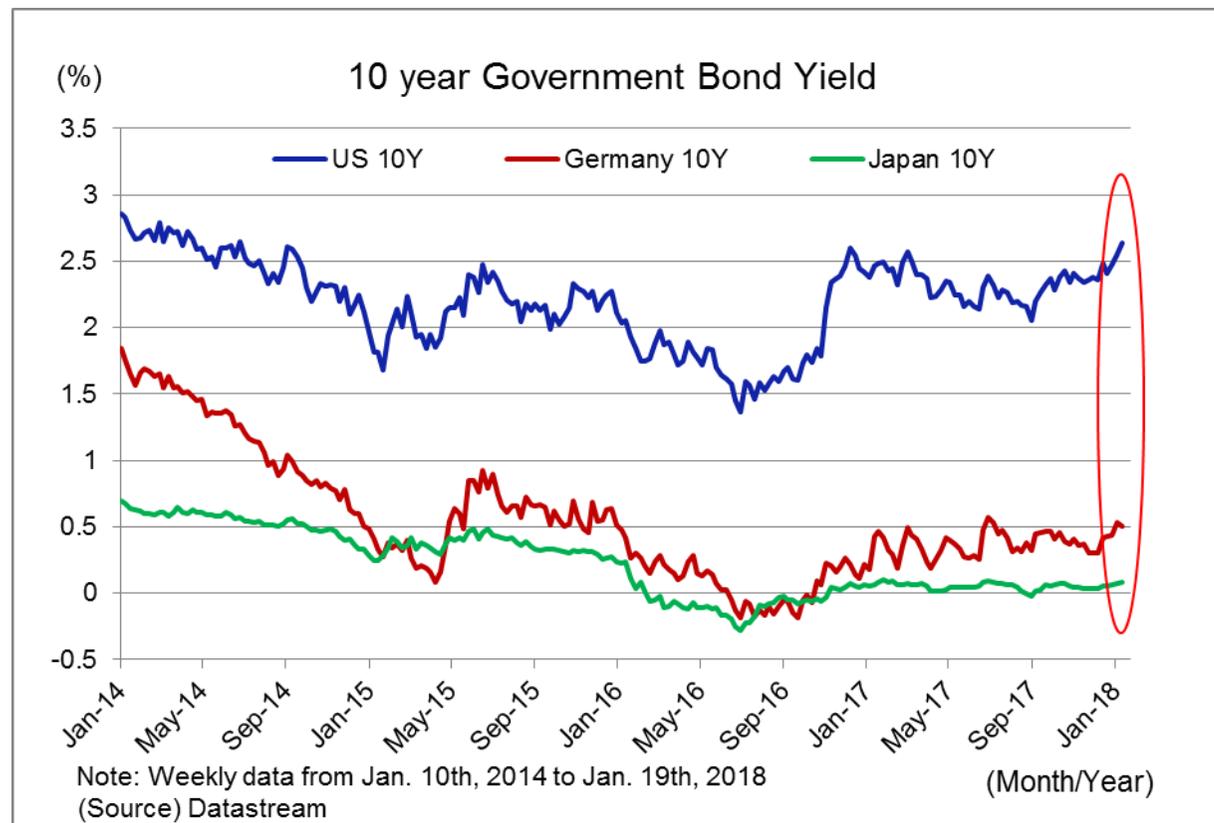
## High PER for US is probably discounting positive effects from tax reform

- PER of US stocks rose even higher, which is probably discounting positive effects from corporate tax cuts and repatriation of overseas held cash to be poured in share-buybacks.
- Comparing US, Europe and Japan, market with higher EPS growth forecast is given higher PER.
- If positive earnings surprise continues for Japanese companies to lift EPS growth forecasts, Japanese stocks could become attractive at current valuation level.



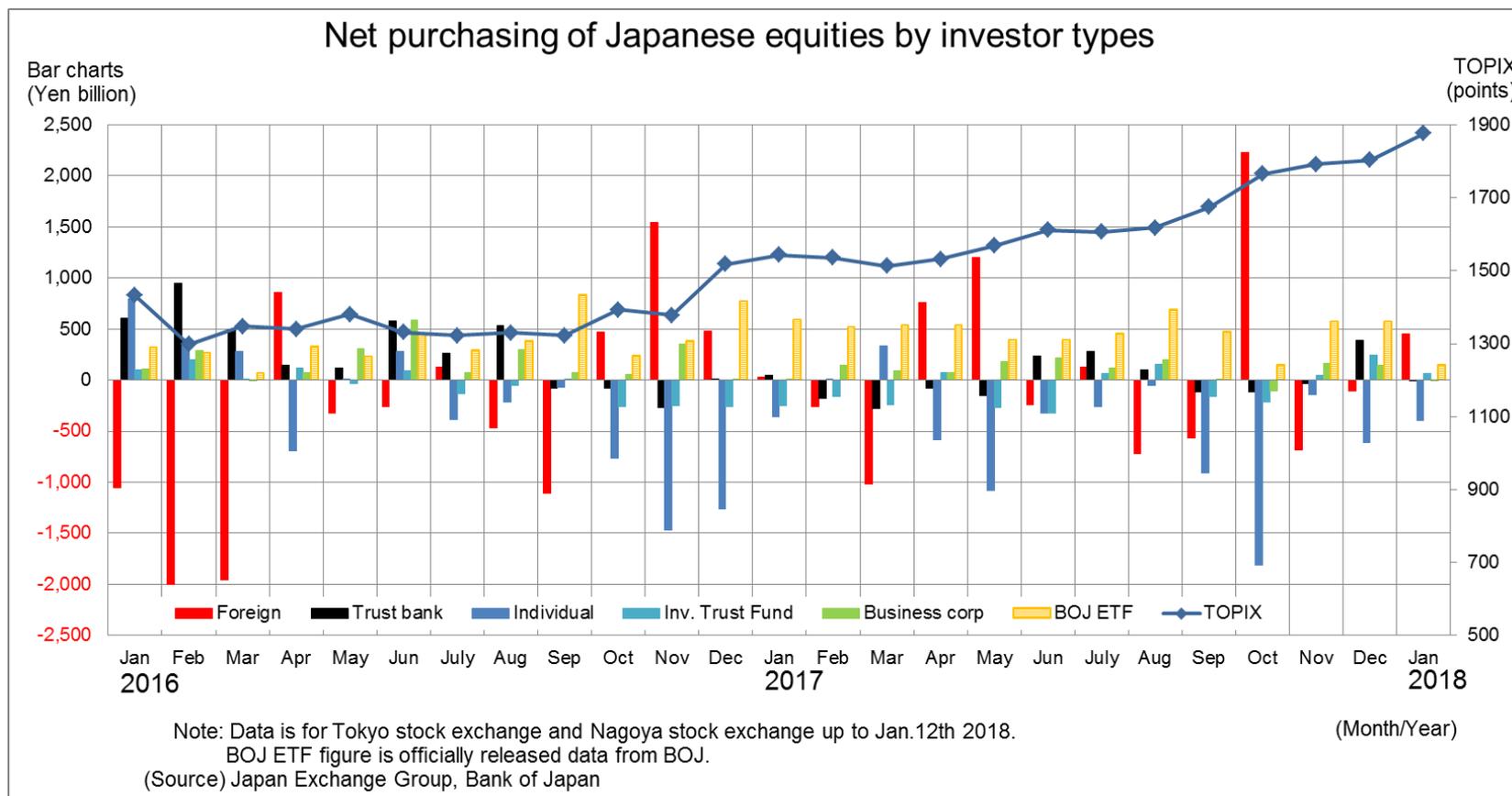
## Some caution is required for rising interest rates

- It is not an immediate threat to the stock markets, however, interest rates started to rise and seem to be heading further upwards.
- In theory, higher interest rates are a limiting factor for stock valuation.



## Net purchasing of Japanese investors might be on the rise

- Activity of foreign investors was mild in Dec.
- Net money flow via investment trust funds is worth watching for a long-term effect. Tax exempt accumulation savings scheme began in January 2018. Individuals are eligible for tax exemption for 20 years on profits earned on accumulating investments via approved investment trust funds up to 400 thousands yen per year.



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