

Japanese Stock Market Outlook

SMAM monthly comments & views

- May 2018 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Global manufacturing activity has slowed down lately probably due to temporary factors such as snapback from demand of reconstruction from hurricane damage in US and pull back from extremely robust semi-conductor demands. Fundamentals of Japanese economy is still solid with tight labor market, rising wage and increasing capital expenditure by companies..

- GDP Forecast for FY2018 was slightly revised from 1.4% to 1.3%. However, the broad picture is unchanged.
- Excluding retiring people, average pay increase achieved in this April's wage negotiation round for FY 2018 was more than 3 % YOY when bonus is included. This was the highest in more than 20 years.

➤ Japanese Stock Markets

Japanese stock market is going to stay volatile since big events such as US-North Korea top meeting and serious trade negotiations between US and its counterparties are scheduled in May and June. Positive results of such events will lift stock prices.

- Current slowdown in global manufacturing activities are expected to turn upwards again probably in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies.
- PER for TOPIX index fell below 14 times, which has been the middle of the range after PM Abe took helm in 2013. It is no longer expensive.

Notes: Macro and market views are as of Apr29th 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-19

- GDP Forecast for FY2018 was slightly revised from 1.4% to 1.3%. However, the broad picture is unchanged.
- Japanese economy is showing solid growth on the back of robust exports and steadily growing domestic demands. However, uncertainties are likely to remain in global economies as long as controversial US policies such as trade disputes are pursued by the White House and Republicans in order for winning the Mid-term election in November.

(YoY %)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.8%	1.3%	0.8%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	1.1%	0.9%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	-0.3%	-2.8%	0.5%
Private Capital Investment	3.3%	2.3%	1.2%	3.5%	3.0%	1.9%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.4%	0.5%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.5%	-1.1%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.3%	0.3%	0.1%
Exports	8.7%	0.7%	3.4%	6.7%	4.8%	2.0%
Imports	4.2%	0.3%	-1.0%	4.6%	2.9%	1.4%
Nominal GDP	2.2%	3.0%	1.0%	1.7%	1.7%	1.9%
GDP Deflator	2.5%	1.5%	-0.2%	-0.0%	0.4%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.3%	3.4%	2.1%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	0.9%	0.6%

Notes: E=SMAM forecasts. SMAM views are as of Apr 29th, 2018 and subject to updates thereafter without notice

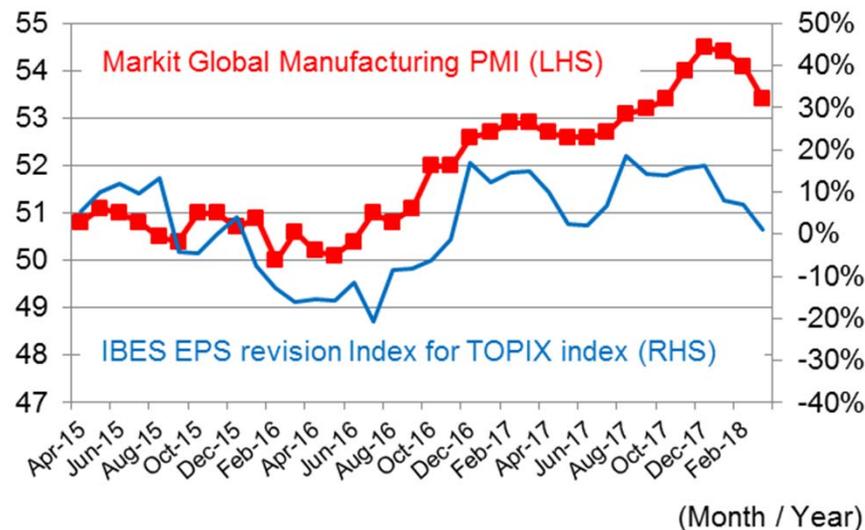
(%, YoY except Net Exports)

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

Global manufacturing activity is in a temporal downturn

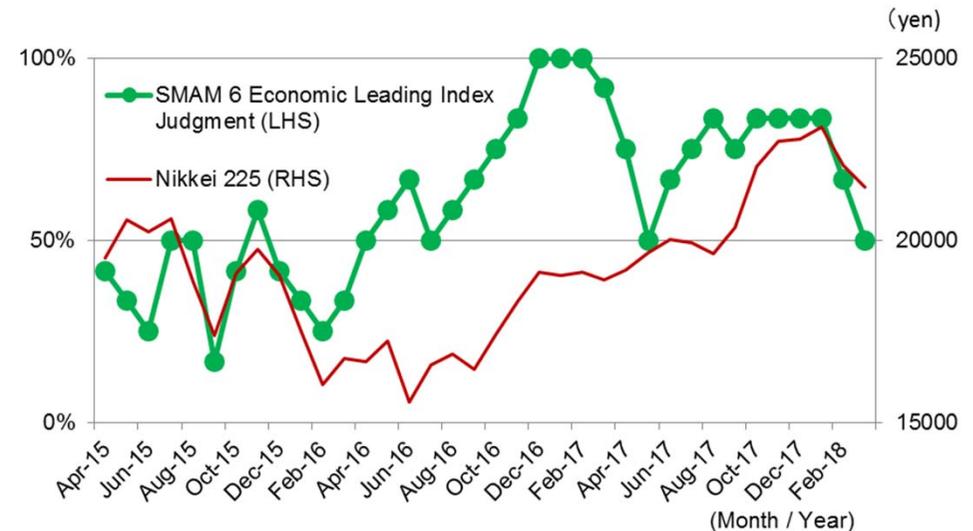
- Momentum is declining for the global manufacturing activities.
- As a main scenario, SMAM expects a) politics in Japan are going to avoid a turmoil, b) trade dispute gradually calms down and c) North Korean crisis is not going to explode.
- If a serious shock coming from such risk events can be avoided, global economy is expected to be back on a recovery trend.

Global manufacturing PMI & EPS revision index for TOPIX



Note: Data is monthly from Apr 2015 to Feb 2018
(Source) Markit Economics, IBES

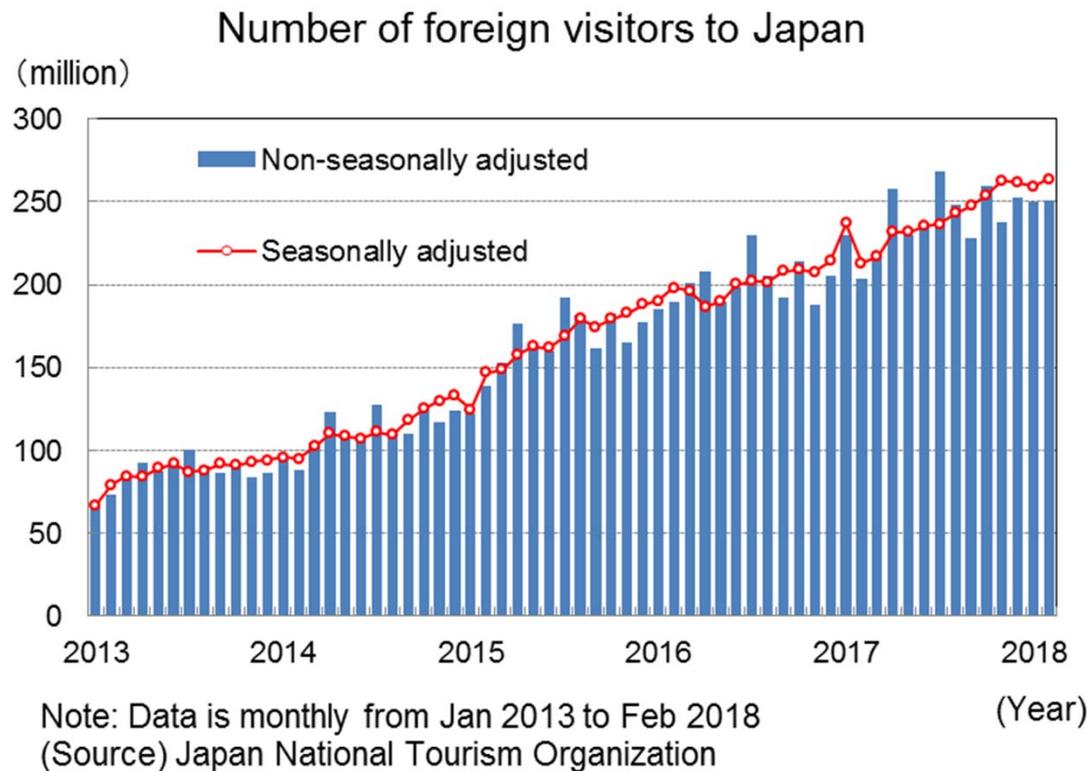
SMAM 6 Economic Leading Index Judgment and Nikkei 225



Note: SMAM 6 Economic Leading Index is a DI calculated from selected 6 economic indicators, one of which is SMAM original survey on semi-conductor manufacturers. Data is monthly from Apr. 2015 to Mar. 2018.
(Source) SMAM

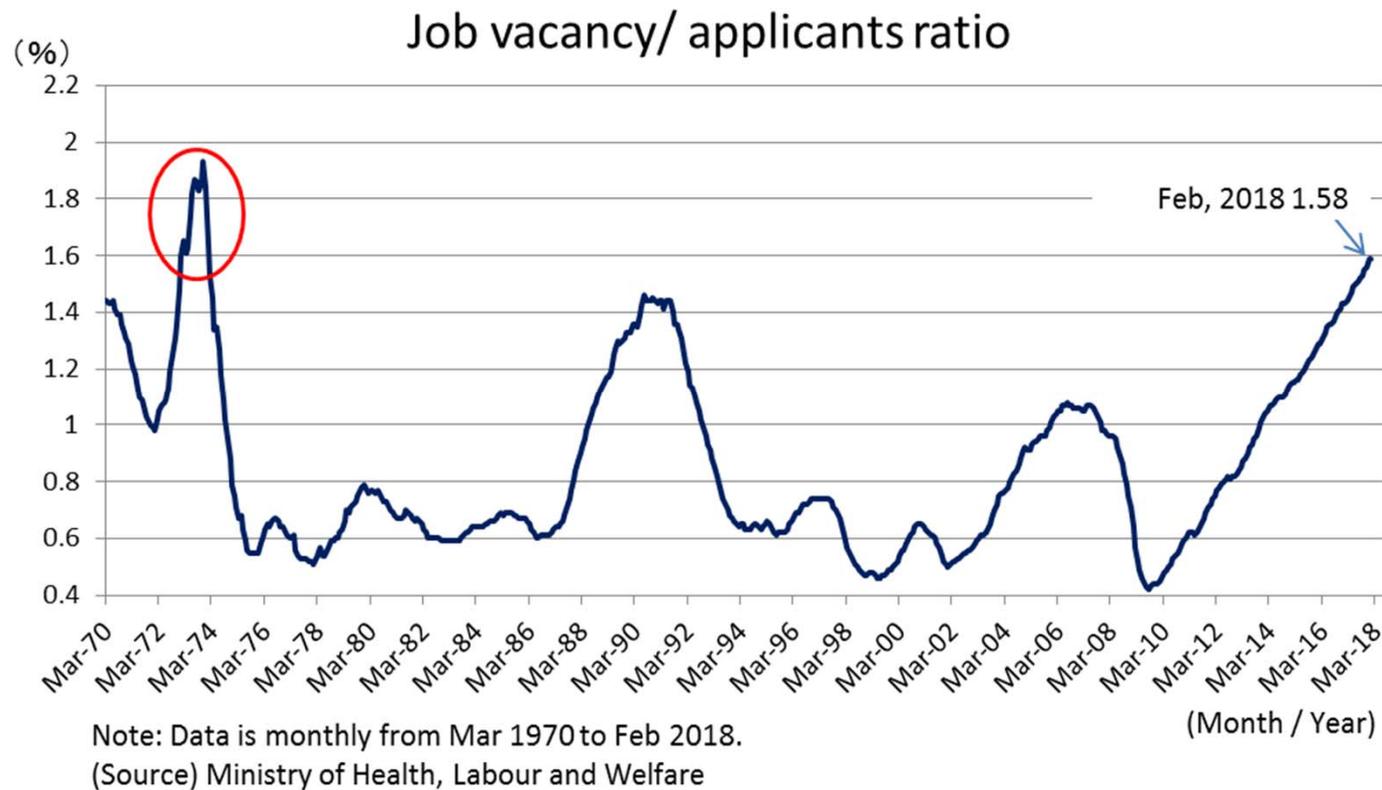
Number of foreign visitors to Japan continues to expand

- Number of foreign visitors nearly quadrupled since the beginning of 2013.
- Tourists' favorite destination is expanding to local areas, which ignited activities of expansion or renewal of local facilities such as hotels and shops helping local economies.



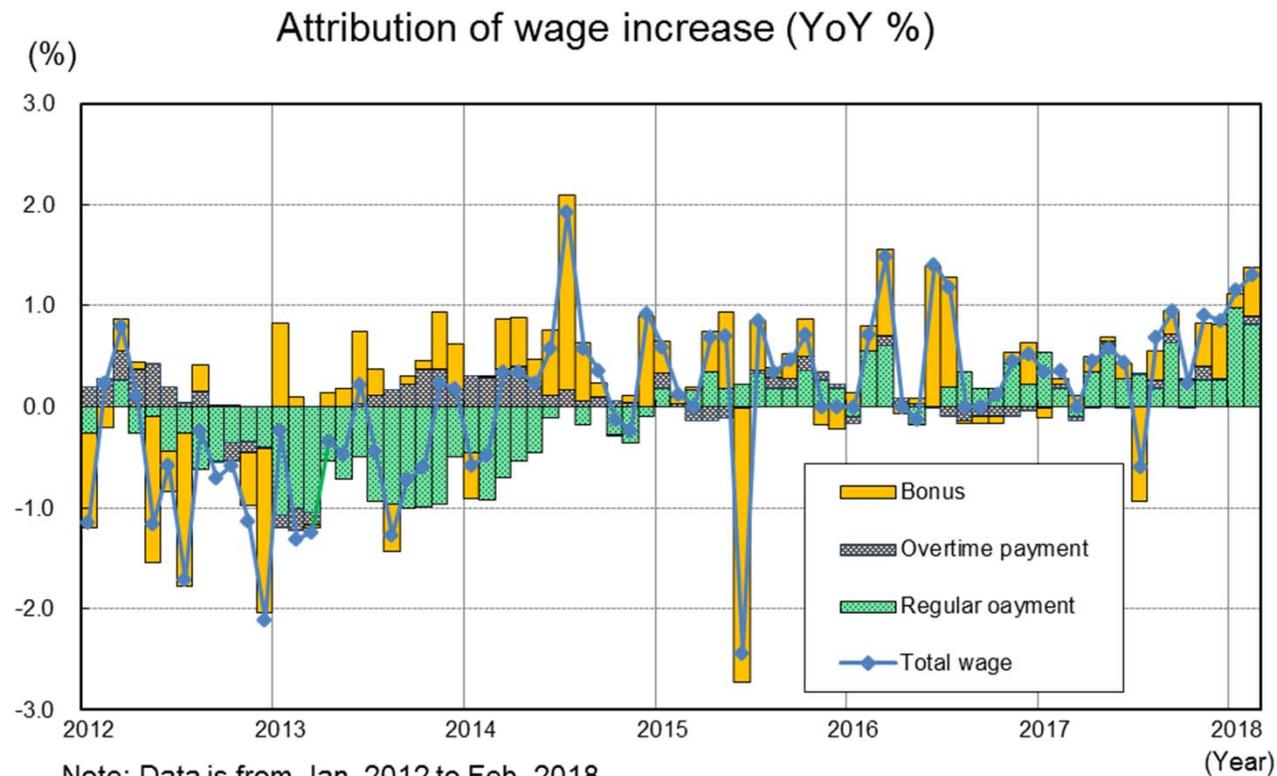
Labor market is getting extremely tight

- Tightness of the labor market in Japan is only comparable to the high economic growth era in 1970's.
- Medium-to-small enterprises are feeling severer difficulties in finding workers.
- Capital spending on improving labor efficiency and productivity is going to keep strong.



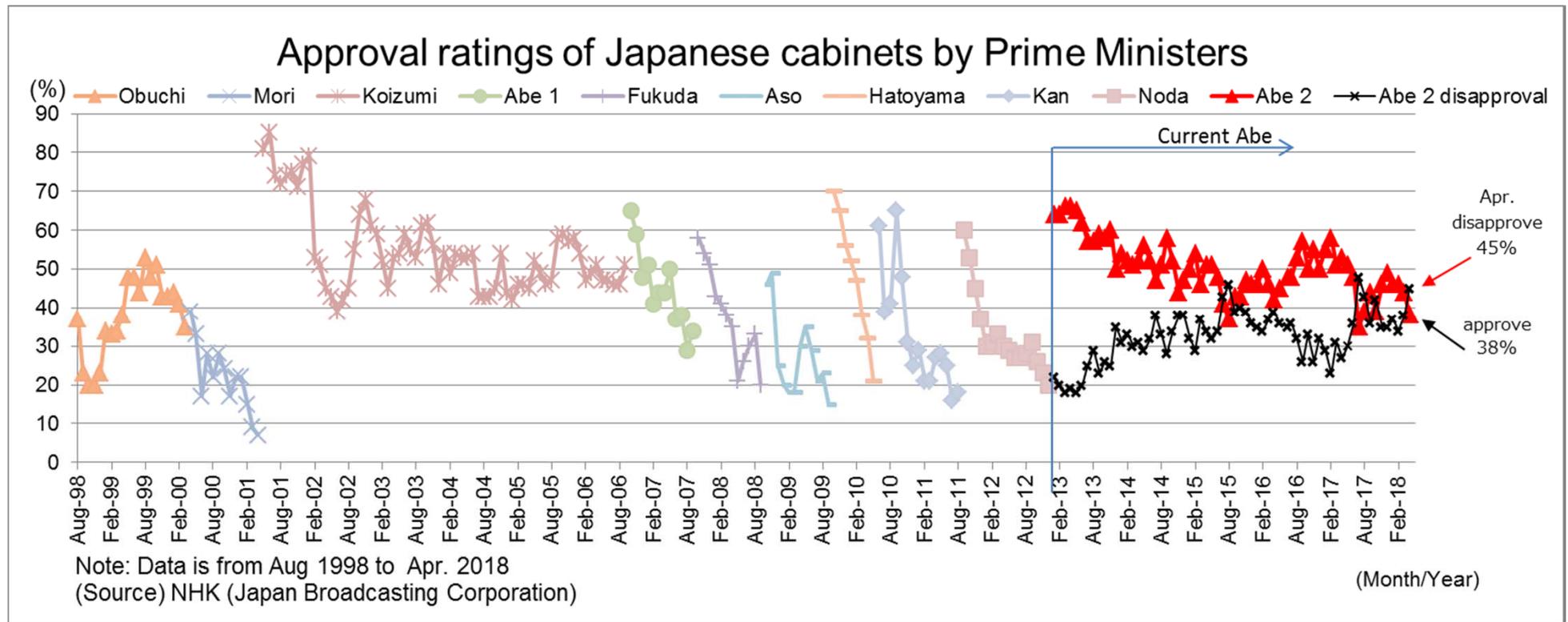
Wage increase is gradually gathering pace

- Excluding retiring people, average pay increase achieved in this April's wage negotiation round for FY 2018 was more than 3 % YOY when bonus is included. This was the highest in more than 20 years.



Approval rating for Abe cabinet is on the decline

- According to NHK, Approval rating for Abe cabinet fell by 6% to 38% meanwhile disapproval rating rose by 7% to 45%. Yet the approval rating for the governing party LDP is holding well due to weak opposition parties.
- Confusion is deepening for Moritomo school scandal, in which PM Abe's wife might have been involved in getting favorable land deal for the school from the government, and Kake school scandal, in which PM Abe might have influenced the government approval giving a license to his friend to open a new veterinary school.
- If it forces the departure of some influential ministers of Abe cabinet or PM Abe himself, it could be damaging for the political stability in Japan, though orderly succession is still possible.



Potential candidates to succeed PM Abe

- Mr. Kishida, currently the Chairman of Policy Research Council of Liberal Democratic Party, and former Foreign Minister. His political stance is similar to PM Abe except Mr. Kishida is a little fiscal conservative.
- Mr. Ishiba, former defense minister, stood against PM Abe at the previous LDP leadership election. His political stance is not clear.

Two candidates for the next Prime Minister

	Policy stance		
	Fiscal	Monetary	Other (remarks)
Fumio Kishida	Less aggressive (compared with Abe)	Less aggressive (compared with Abe)	<ul style="list-style-type: none"> • Improve company productivity • Increase wage • Increase consumption tax rate
Shigeru Ishiba	Clear stance hasn't been shown yet	Less aggressive (compared with Abe)	<ul style="list-style-type: none"> • Reduce income tax rate • Increase consumption tax rate • Increase corporate tax rate

(Source) SMAM

BOJ is going to keep extra easy monetary policy

- The BOJ's new governing members are dominated by doves.
- Current dovish members are going to stay if they complete the current term. The earliest term ends in 2020.

Position	Name	Term of office	Policy stance
Governor	Kuroda	April 8, 2023	Dovish
Deputy Governor	Amamiya	March 19, 2023	Dovish
Deputy Governor	Wakatabe	March 19, 2023	Dovish
Policy committee member	Harada	March 25, 2020	Dovish
Policy committee member	Funo	June 30, 2020	Dovish
Policy committee member	Sakurai	March 31, 2021	Dovish
Policy committee member	Masai	June 29, 2021	Dovish
Policy committee member	Suzuki	July 23, 2022	Neutral
Policy committee member	Kataoka	July 23, 2022	Dovish

(Source) Various publications

It's going to be an eventful months ahead, trade negotiations, US-North Korea top meeting, etc.

- Trade negotiation is going into more serious stage from may. Time limits are set by US in May and June.
- If North Korean situation makes meaningful progress, it will be a strong positive for the Japanese economy and also for the Japanese stock market.

Upcoming key events

Month	Region/Country	Events	Notes
May	US	1-2 FOMC 15 USTR public hearing on raising tariff 21 US Department of the Treasury proposes on investment by China Time limit for lifting economic sanction on Iran	
	North Korea	Meeting is going to be held between US president Trump and North Korea's leader Kim Jong-un by May.	Let's hope that the bomb can be defused.
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	
	US	12-13 FOMC Time limit for trade negotiation on tariff	
	EU	14 ECB Monetary Policy Meeting	
July	Japan	30-31 BOJ Monetary Policy Committee Meeting & perspective report	
	US	31-1 FOMC	
	EU	26 ECB Monetary Policy Meeting	
September	Japan	18-19 BOJ Monetary Policy Committee Meeting PM Abe's leadership of LDP is set for renewal or expiration	LDP leadership election is due
	EU	26 ECB Monetary Policy Meeting	
November	US	Mid-term election for US congress	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

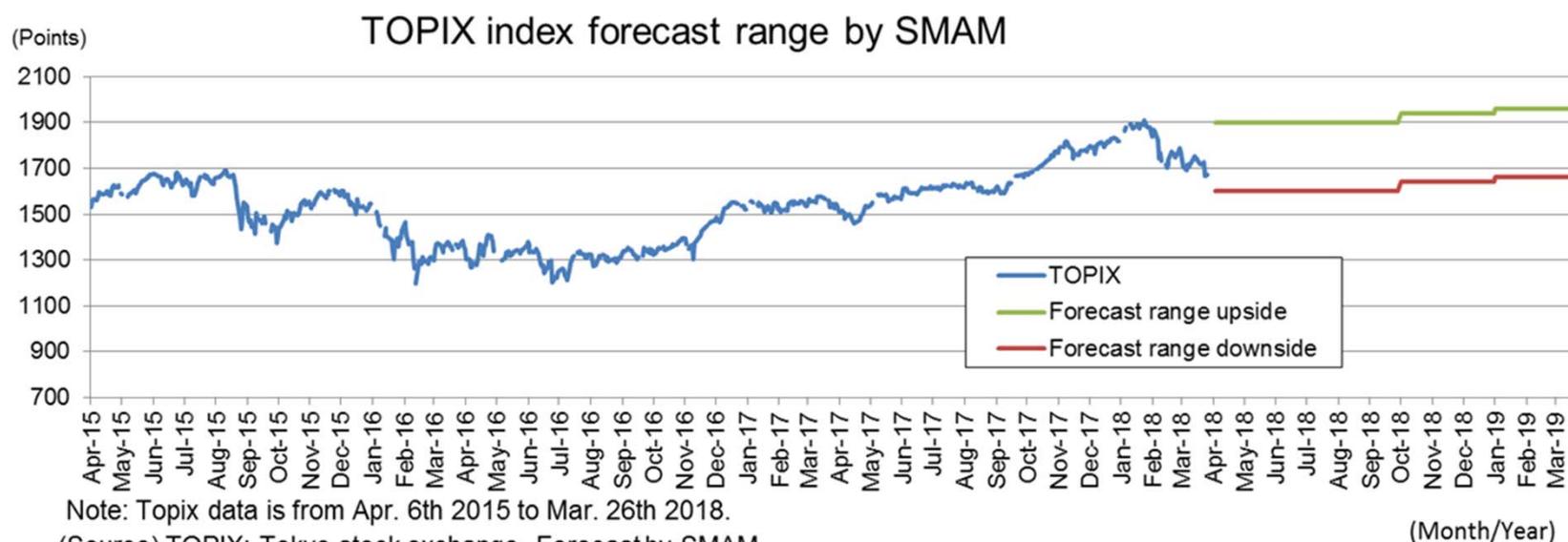
Stock market outlook: An eventful period ahead. Volatility will stay in the stock market.

SMAM short-term view

- Japanese stock market is going to stay volatile since big events such as US-North Korea top meeting and serious trade negotiations between US and its counterparties are scheduled in May and June. Positive results of such events will lift stock prices. Earnings results for FY 2017 is coming out in May, however, companies are likely to be conservative on future guidance.

Longer-term outlook (6-months and beyond)

- Current slowdown in global manufacturing activities is expected to turn upwards again probably in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies.



Note: SMAM's projection is as of Apr 29th 2018 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Despite scare of raising tariff, US is going to make a deal with it's counterparties and trade war 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\$.
 - PM Abe's survival is in a little doubt, however, current policies continues even by the successor.
 - Tension in the East Asia does not ignite a war.
 - Central banks gradually move to normalize monetary policies and avoid killing economic growth.

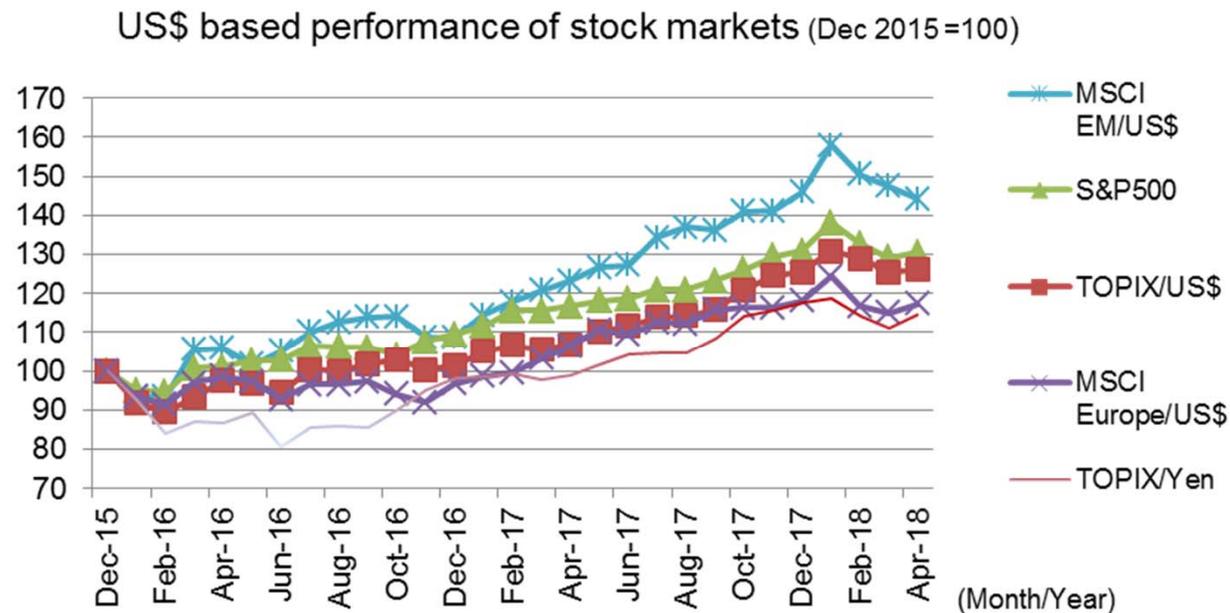
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - North Korea abandons nuclear arms development.
 - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.

- **Downside Risks** include:
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - Global monetary tightening intensifies to choke global economy.
 - Confrontational foreign policies taken by Trump presidency igniting a trade war.
 - "Russia-gate" scandal flares up.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Apr. 29th 2018 and subject to updates without notice.

Global markets are drifting sideways

- Global stock markets in general drifted sideways so far in April. Investors are waiting to get more clear sight of events such as trade negotiation, North Korea and corporate earnings results.
- Emerging market underperformed so far in April.

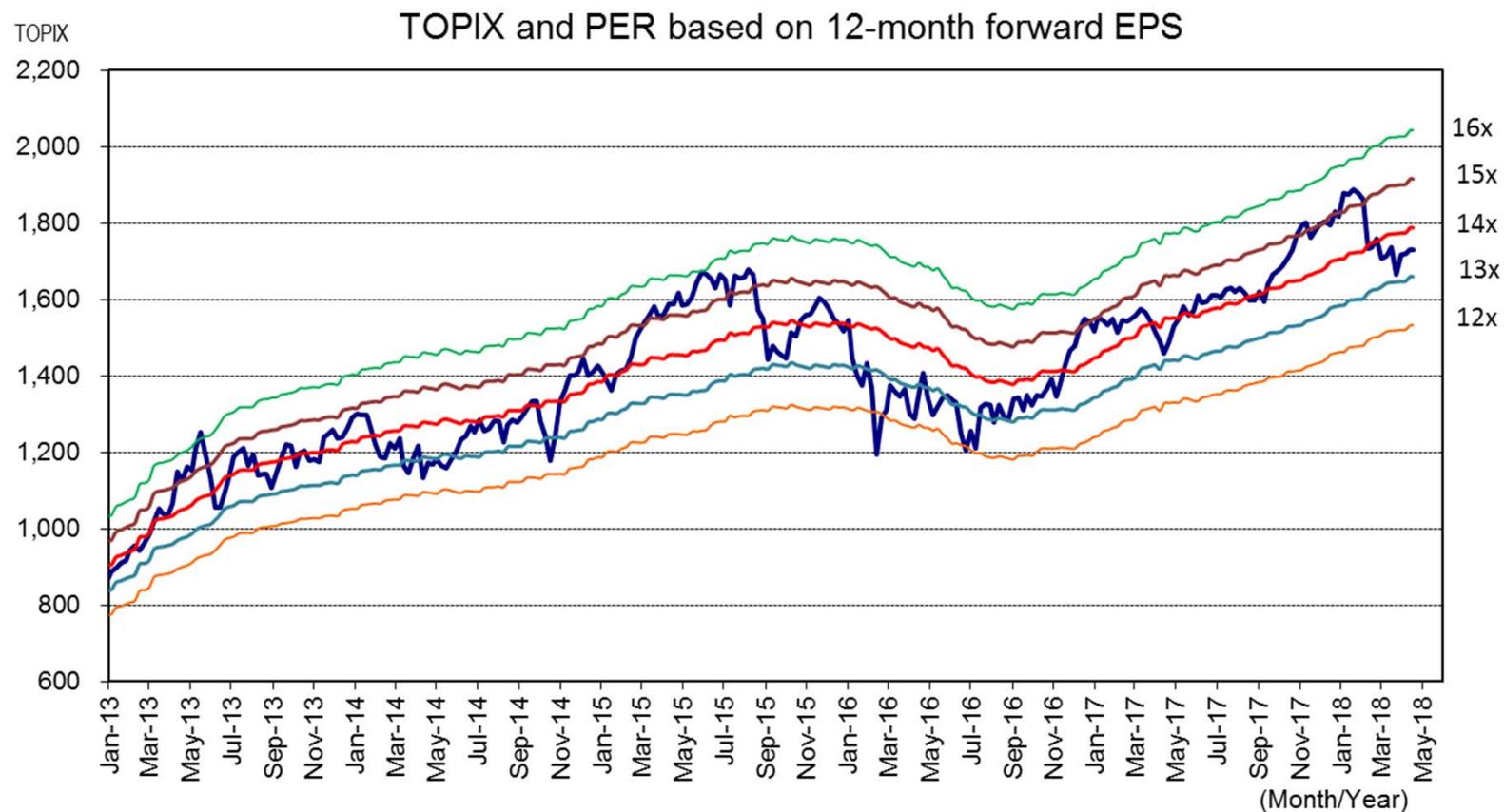


Notes: Data is up to Apr. 26th 2018.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.

PER for TOPIX index fell to the mid level since PM Abe took helm in 2013

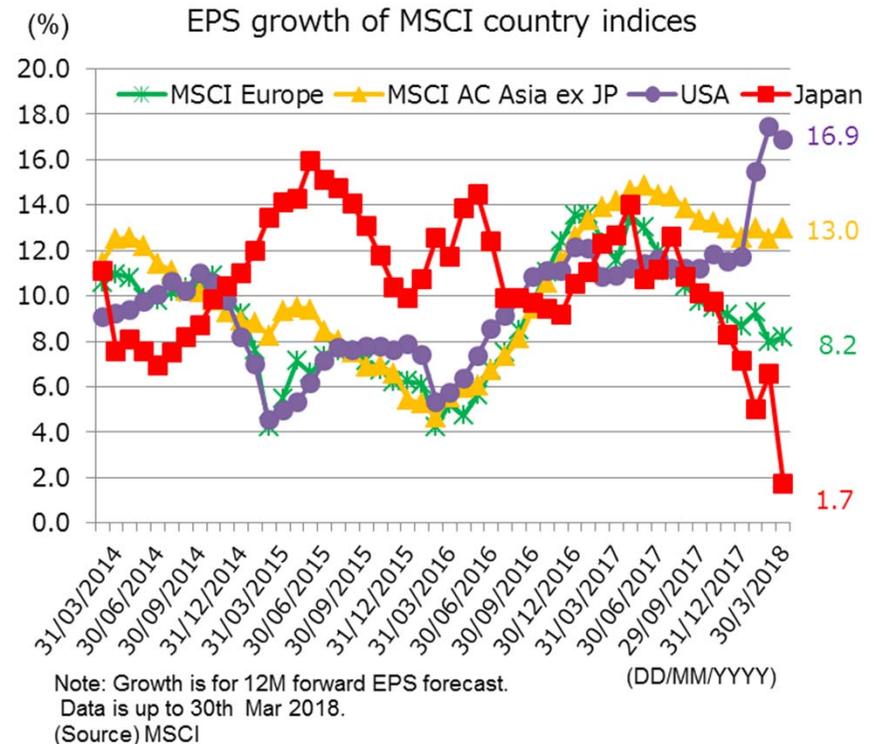
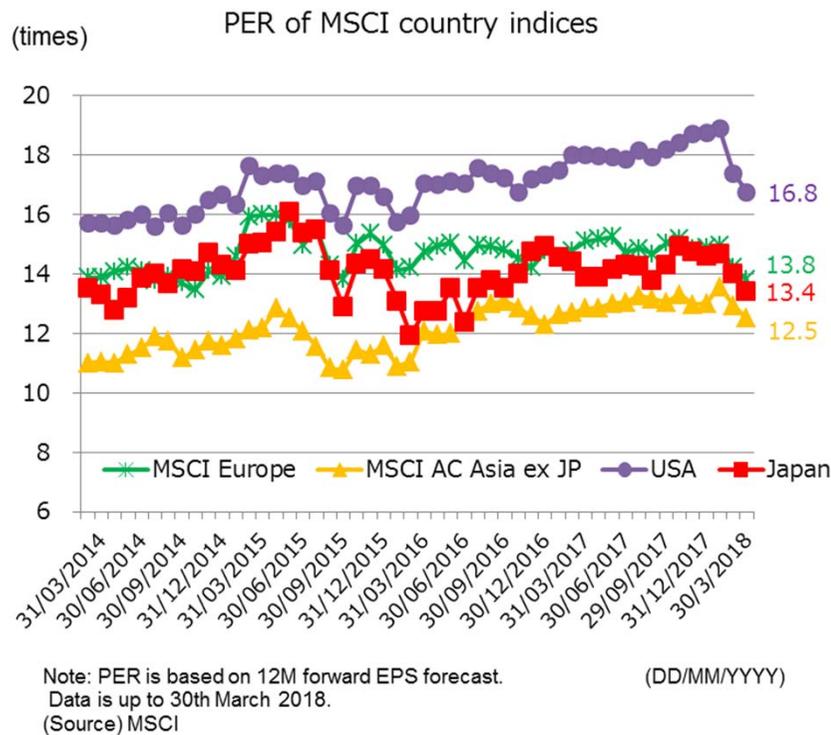
- PER for TOPIX index fell below 14 times, which has been the middle of the range after PM Abe took helm in 2013. It is no longer expensive.
- Currently slowing momentum of earnings growth is a little worrying, however, if concern on global trade and economy gradually recedes, recovering earnings forecast could make the current valuation level attractive to investors.



Note: Data is weekly from Jan.4th 2013 to Apr.17th 2018. TOPIX was 1729.98 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

PE ratio declined to more reasonable level

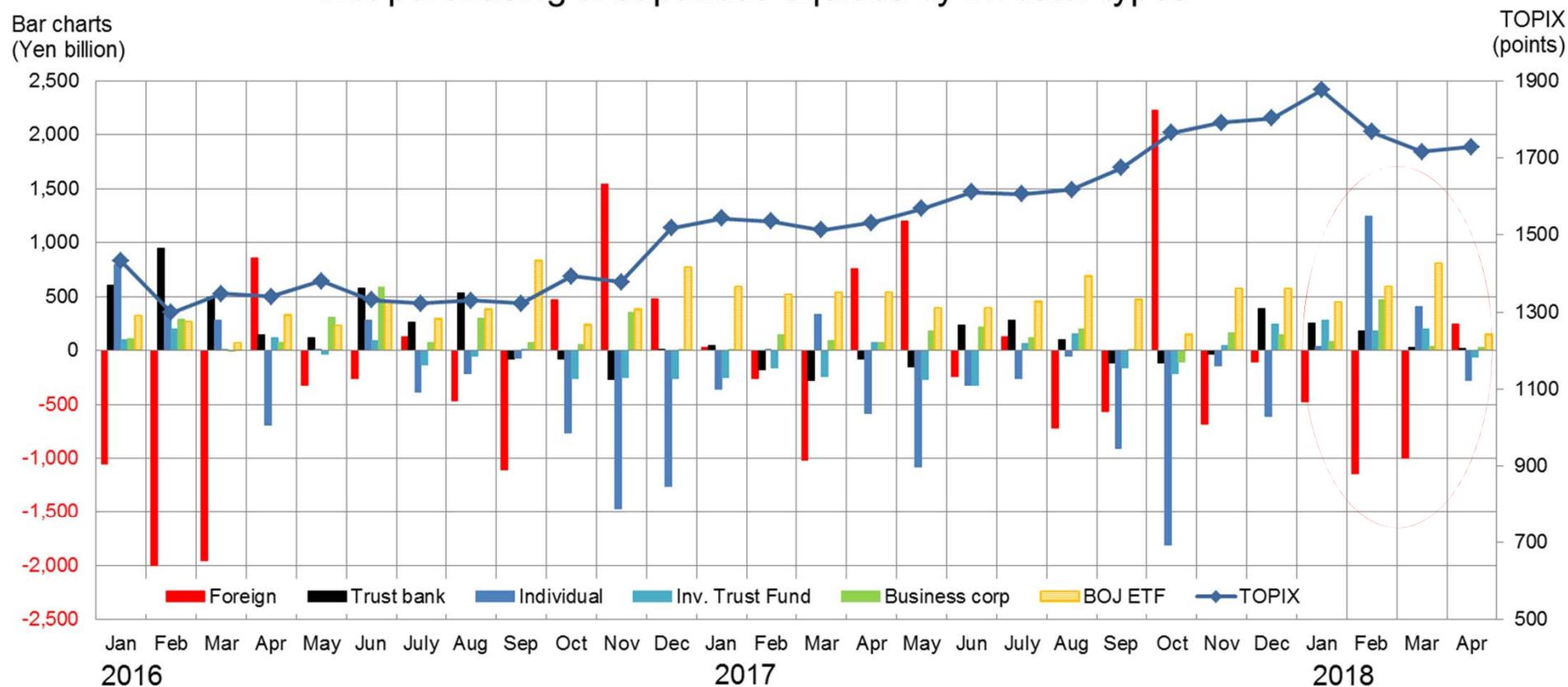
- PE ratio declined to more normal level in March.
- After rapid earnings growth for FY2017 was all reflected in the EPS, 12M forward EPS forecast for Japan declined in March.
- Another round of EPS upward revision is required for lifting the 12M forward EPS, however, companies are expected to make conservative earnings guidance for FY2018 when announcing financial results for FY2017 in May.



Selling from foreign investors stopped in April so far

- Foreign investors mildly bought back Japanese equities so far in April.
- After a significant fall in share price since February, investors are searching for a clue for which way to go next.

Net purchasing of Japanese equities by investor types



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to Apr.13th 2018.

BOJ ETF figure is officially released data from BOJ.

(Source) Japan Exchange Group, Bank of Japan

(Month/Year)

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