



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-June 2022-

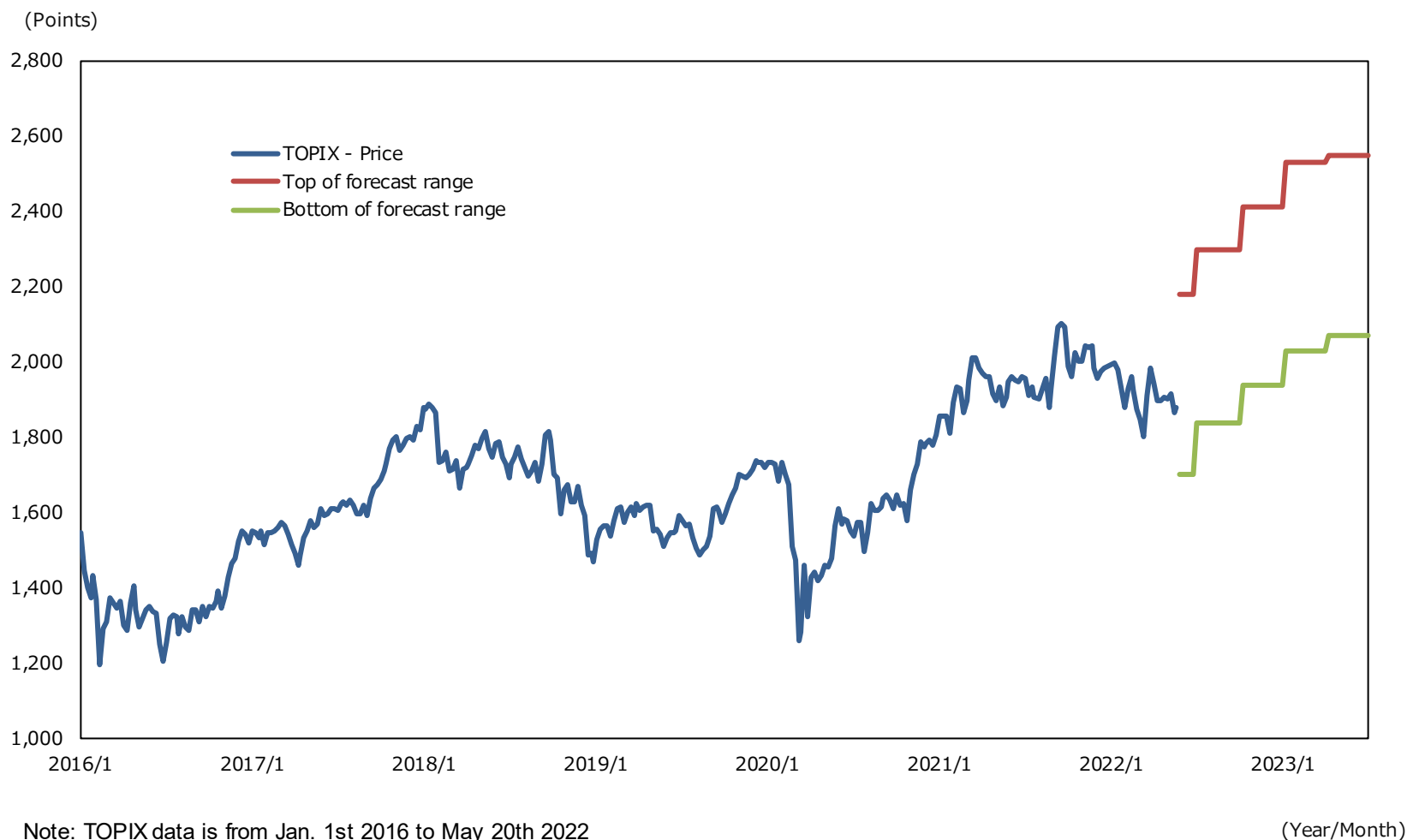


Outlook for Japanese Stock Market

Market Outlook

- We are bullish on the Japanese equity market based on mid-to-long term estimates, including steady outlook of corporate earnings and economic recovery in Japan.
- We maintain our TOPIX target at 2,300 and Nikkei 225 at 32,300 for March 2023.
- The equity market is currently under selling pressure owing to rising material costs, aggressive monetary tightening by the US Federal Reserve, the slowing Chinese economy, and overly conservative earnings guidance offered by companies.
- We expect the market will resume its upward trend after confirming resilient fundamentals and once expectations for fiscal stimulus are met ahead of the upper house election in the summer.

We expect a bullish equity market ahead



Note: TOPIX data is from Jan. 1st 2016 to May 20th 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

Upside / Downside risk scenarios

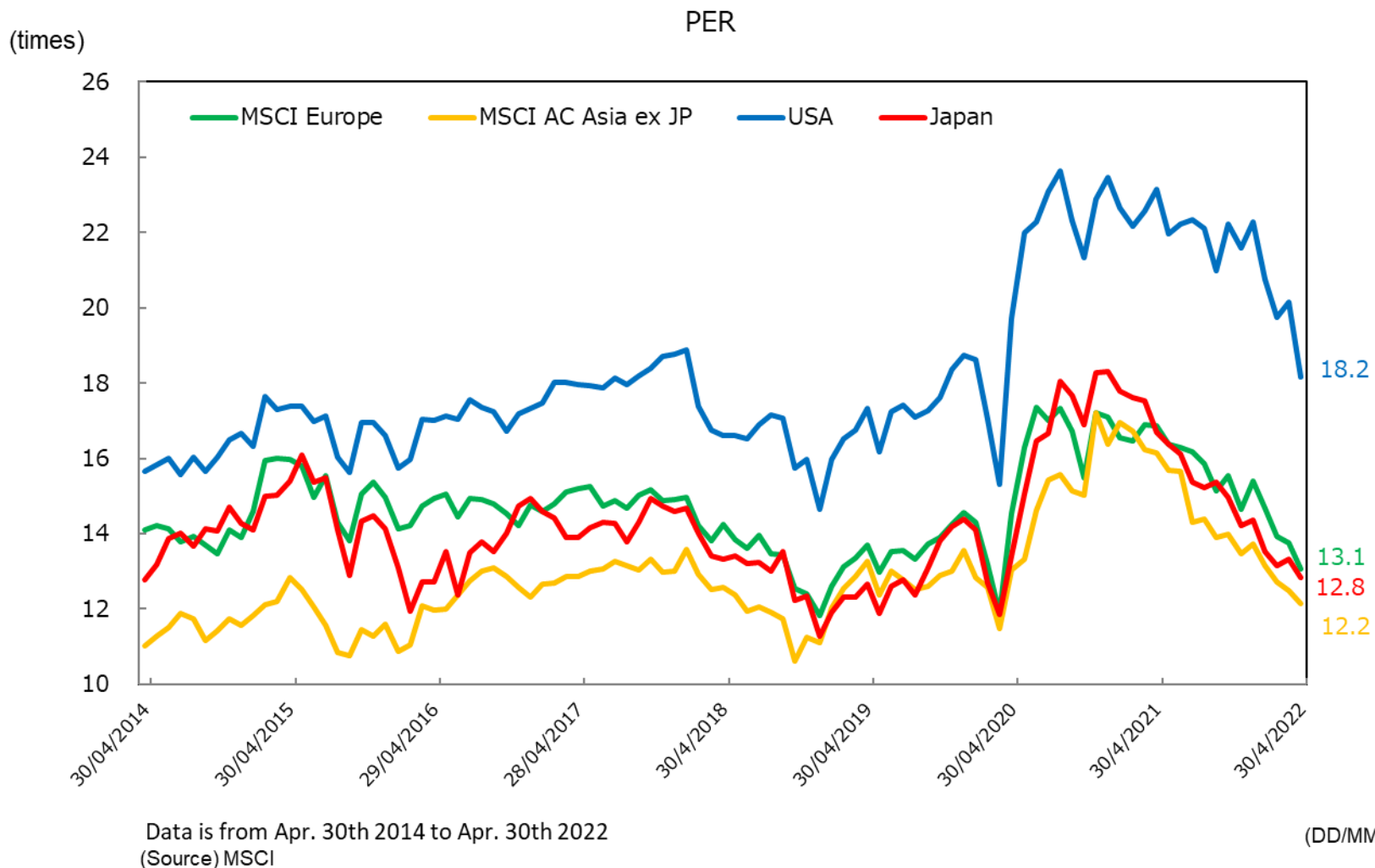
■ Upside Risks

- Acceleration of economic recovery
- Recovery of inbound travel to Japan
- Declining volatility in commodity market

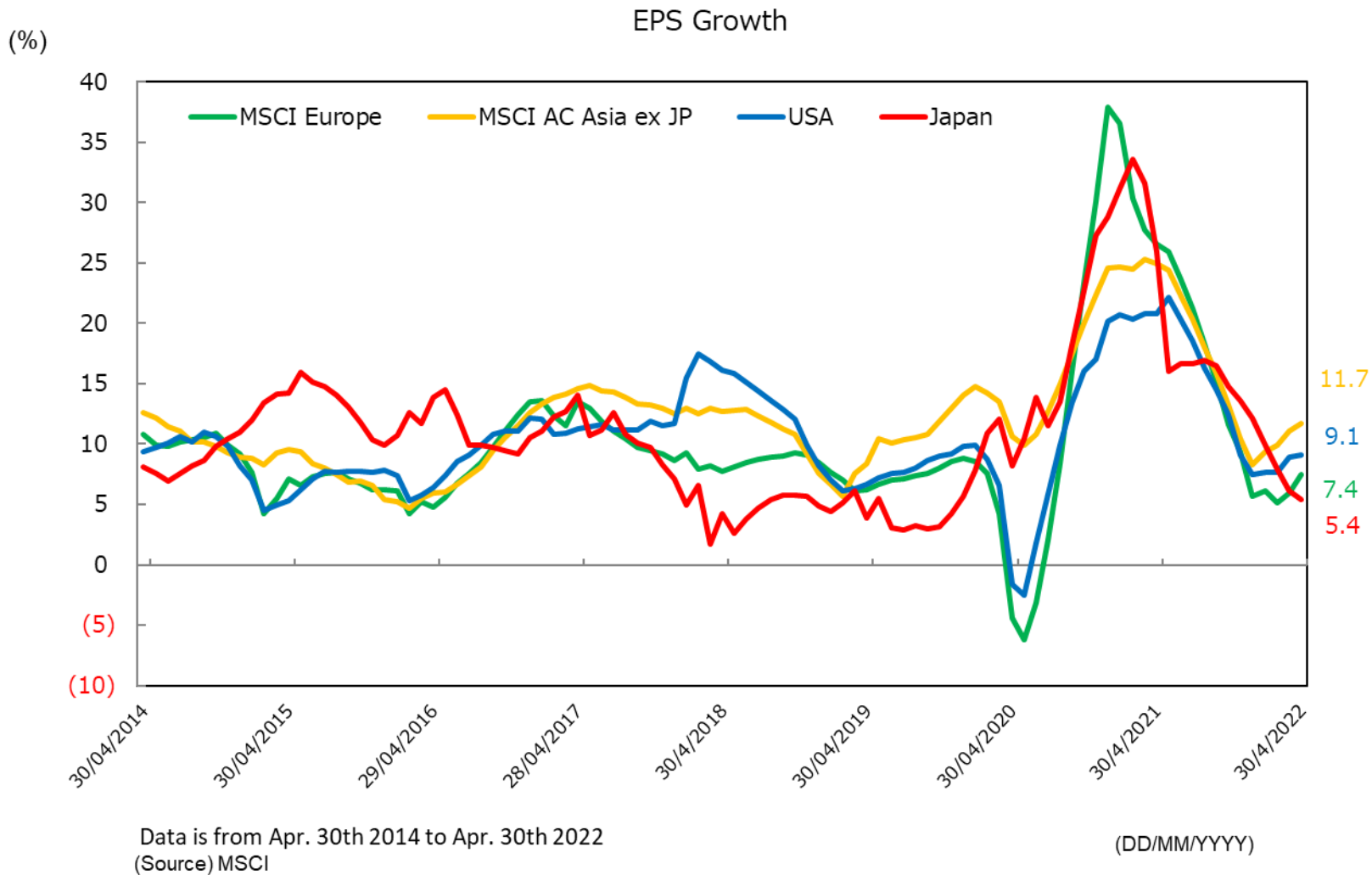
■ Downside Risks

- Escalation of global military conflict
- Growing concern for stagflation

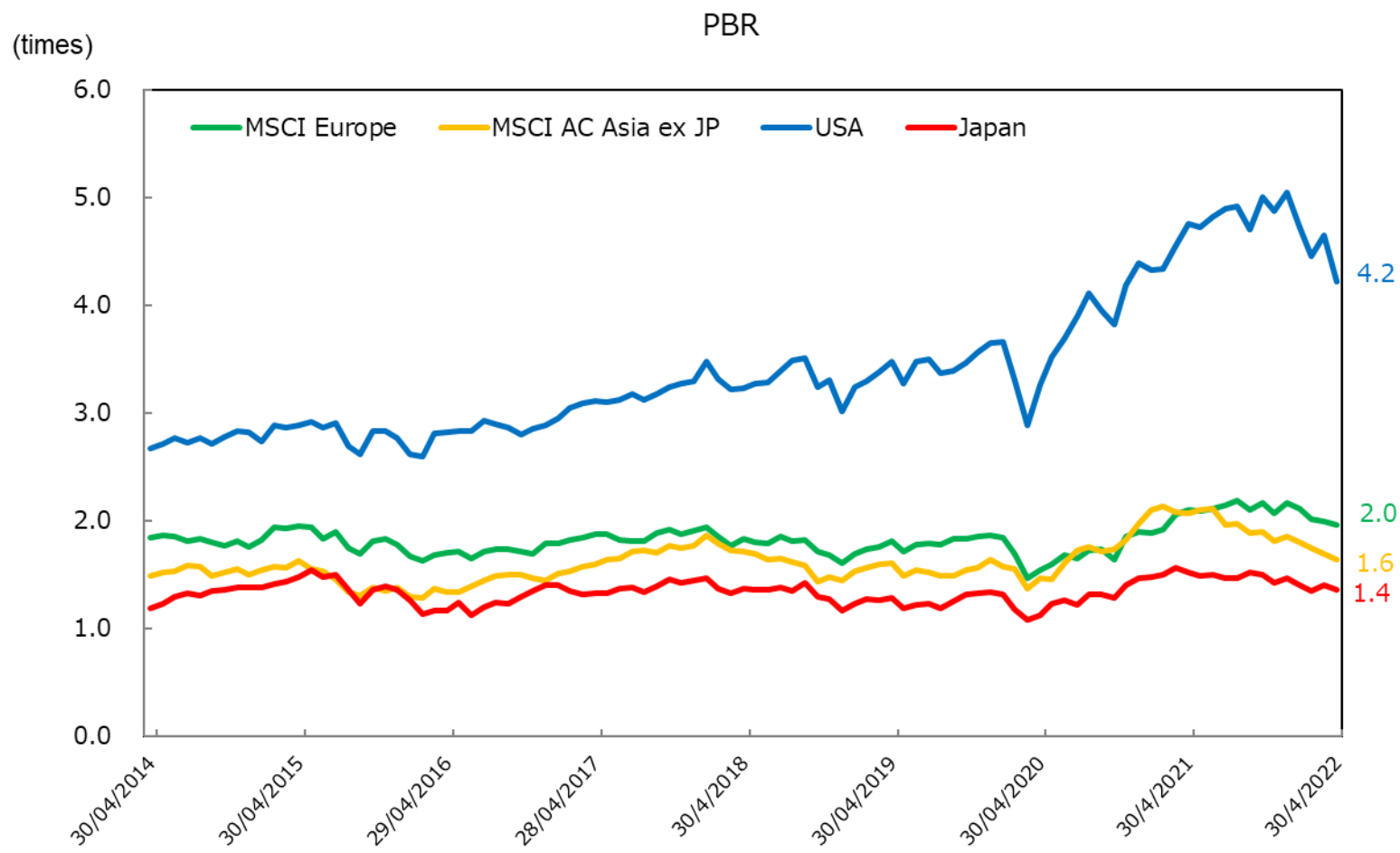
PERs plunge to lowest level after COVID-19 pandemic



Uncertainty over global economy weighs on Japan's EPS growth



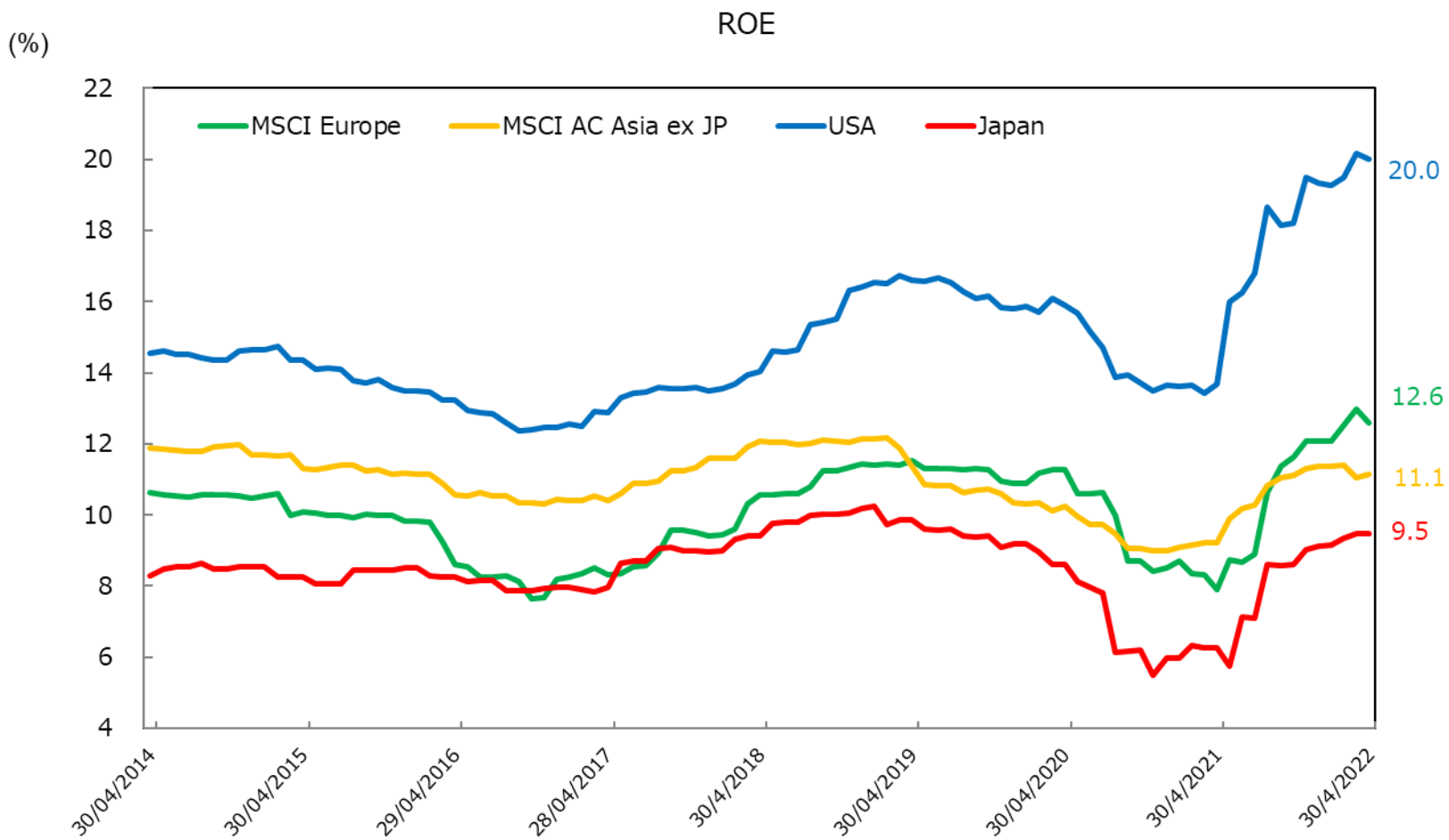
Correction of GAFAM leads to sharp drop in US PBR



Data is from Apr. 30th 2014 to Apr. 30th 2022
(Source) MSCI

(DD/MM/YYYY)

Japan's ROE continues its steady recovery

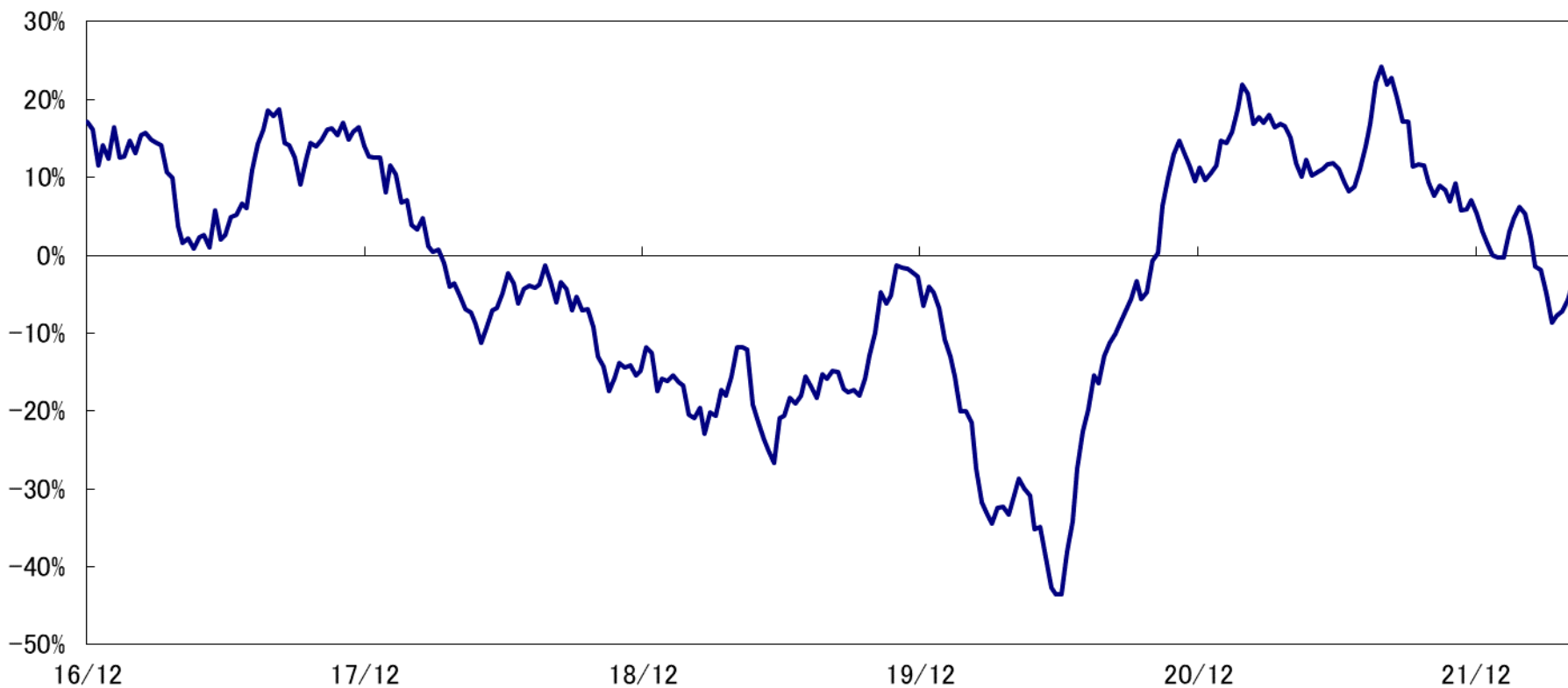


Data is from Apr. 30th 2014 to Apr. 30th 2022
 (Source) MSCI

(DD/MM/YYYY)

Earnings revision hits bottom after digesting Ukraine War

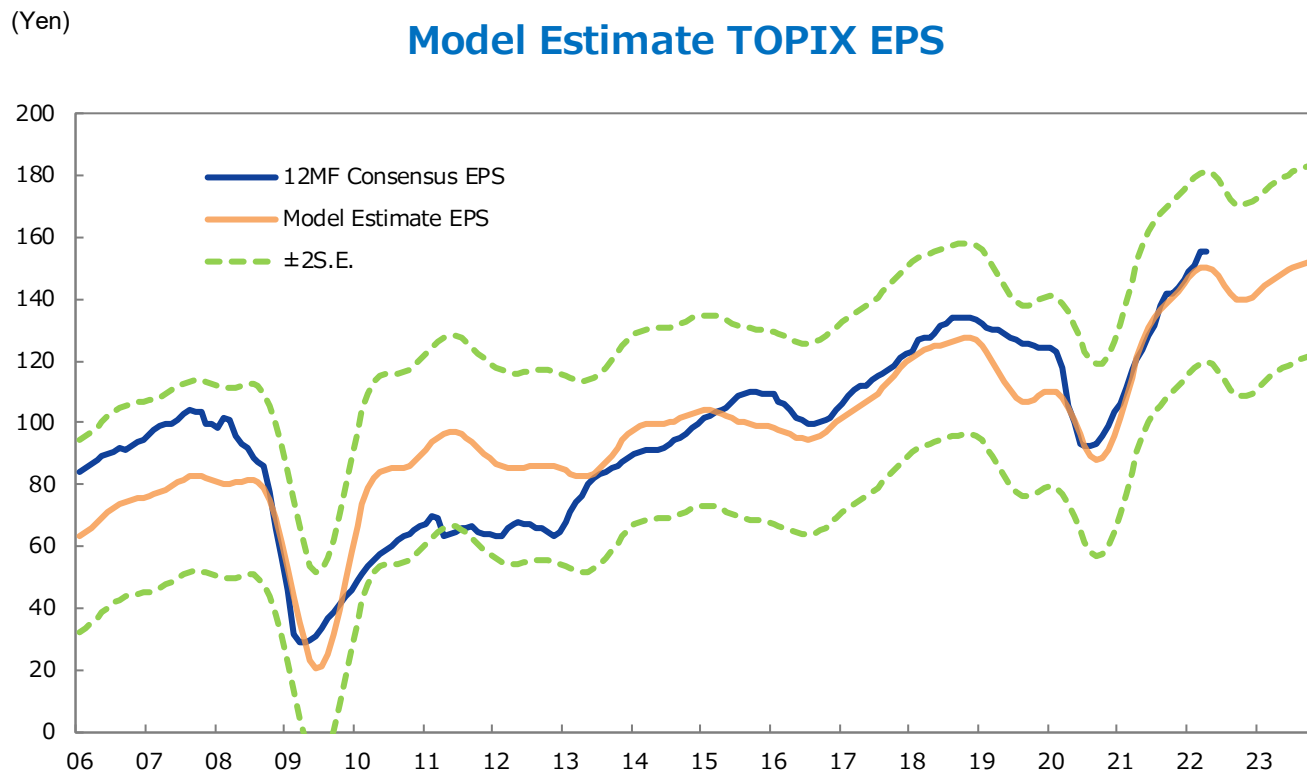
TOPIX Revision Index



Data is from Dec. 31st 2016 to May. 13th 2022
(Source) Datastream, IBES

(YY/MM)

Quants model indicates temporary pause of EPS growth ahead

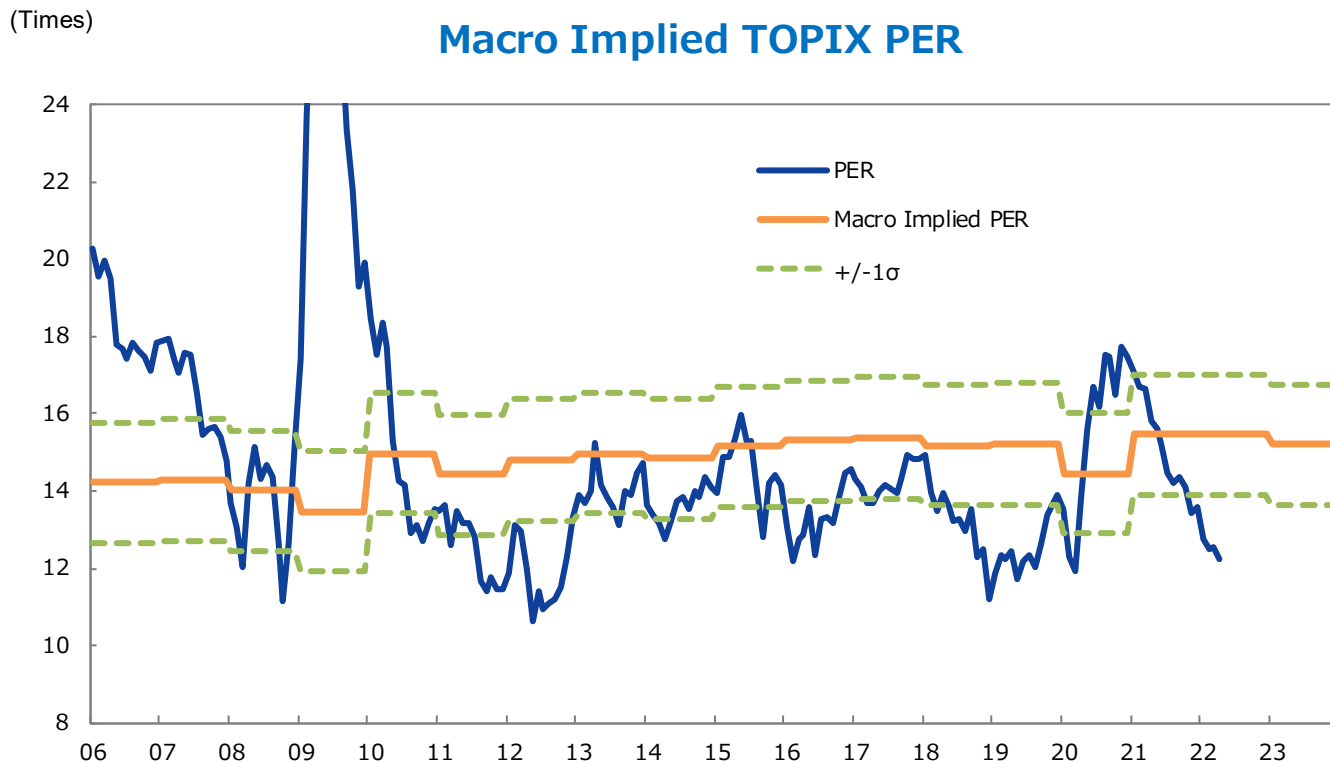


Consensus data is from Jan. 2006 to Apr. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

PER sinks far below the bottom of the normal range

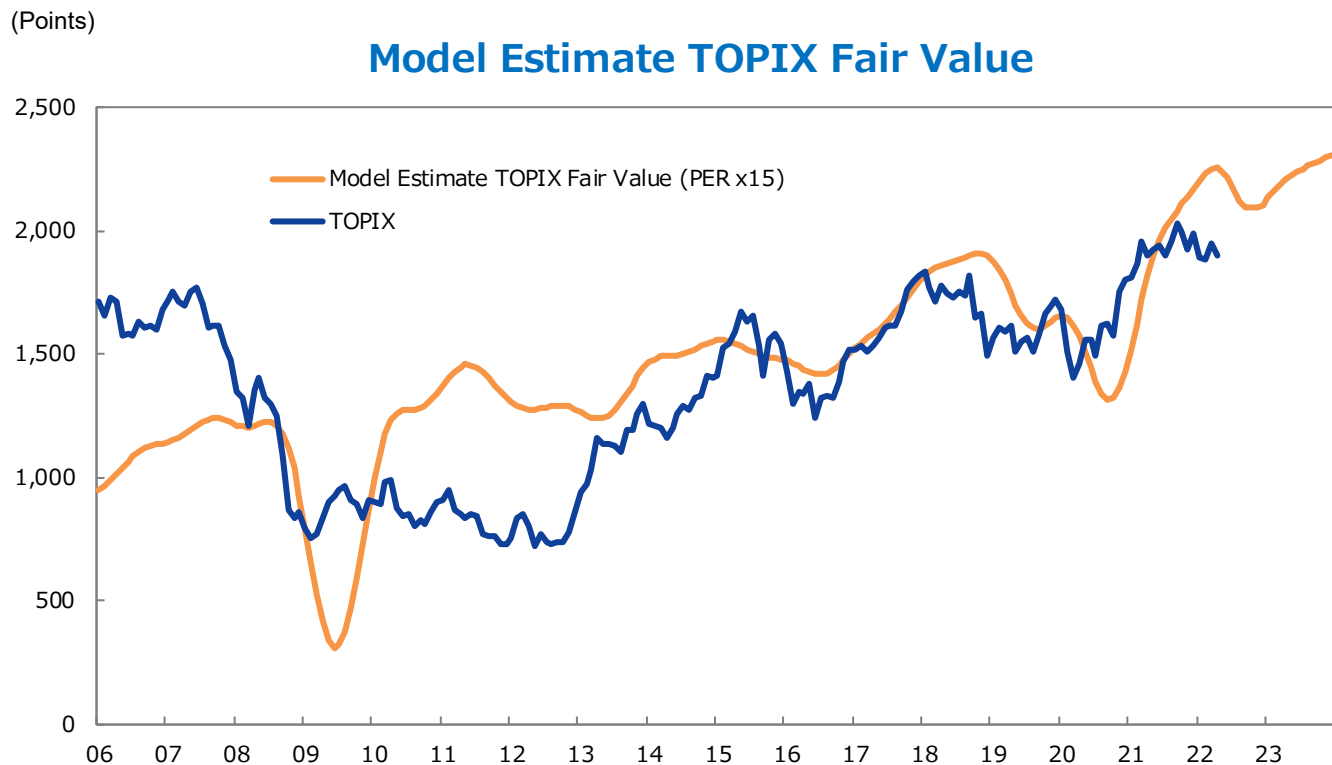


Consensus data is from Jan. 2006 to Apr. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Quants model suggests opportunity to accumulate



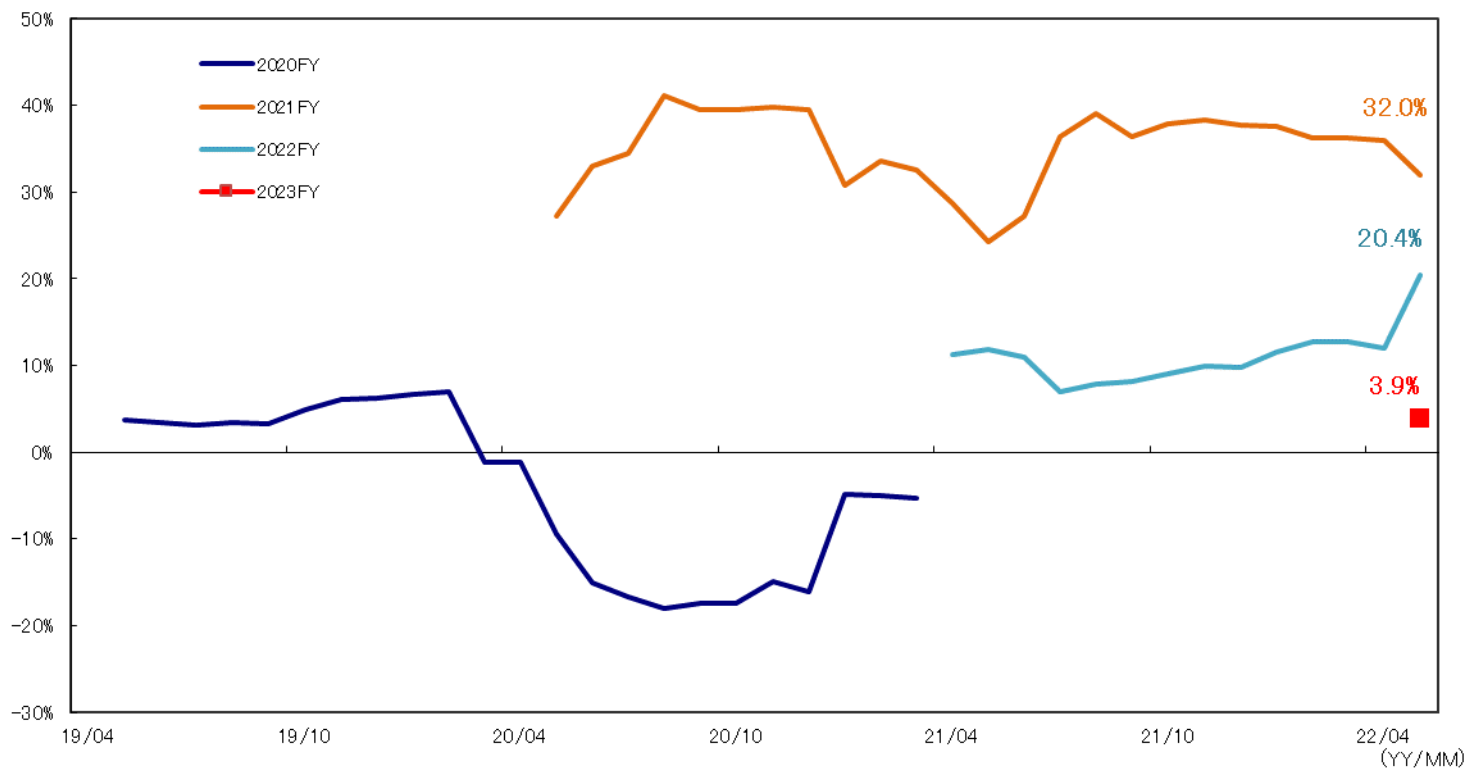
TOPIX data is from Jan. 2006 to Apr. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Bottom up forecast raised despite gloomy environment

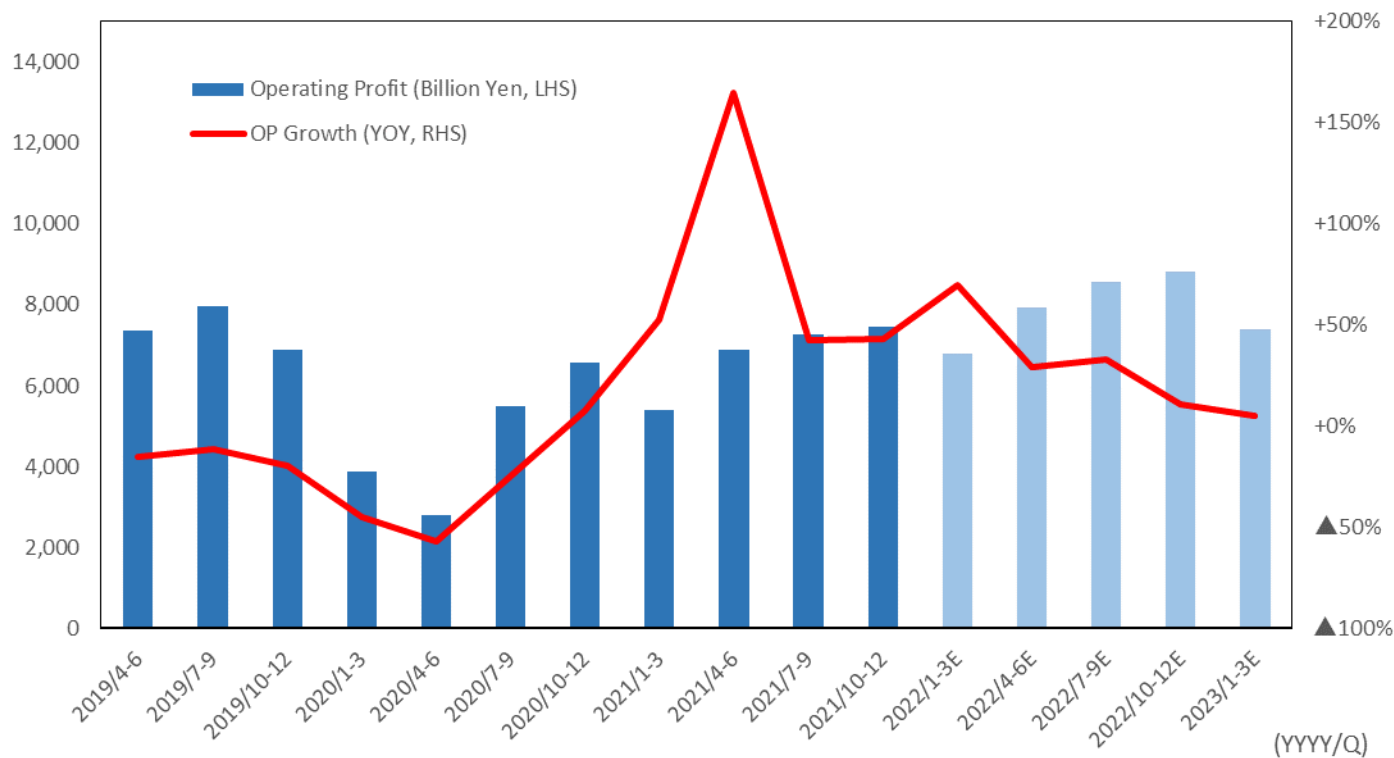
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of May 17th 2022, SMDAM Core Universe (Excl. Financials) consists of 431 major Japanese companies covered by SMDAM in-house analysts.
 (Source) SMDAM

Bottom up earnings estimate remains positive

Operating Profit (All Industries Excl. Financials and Softbank Group)



Actual data is from Q2 2019 to Q4 2021, estimate data is from Q1 2022 to Q1 2023
 (Source) SMDAM

Tide of “corporate governance” in Japan

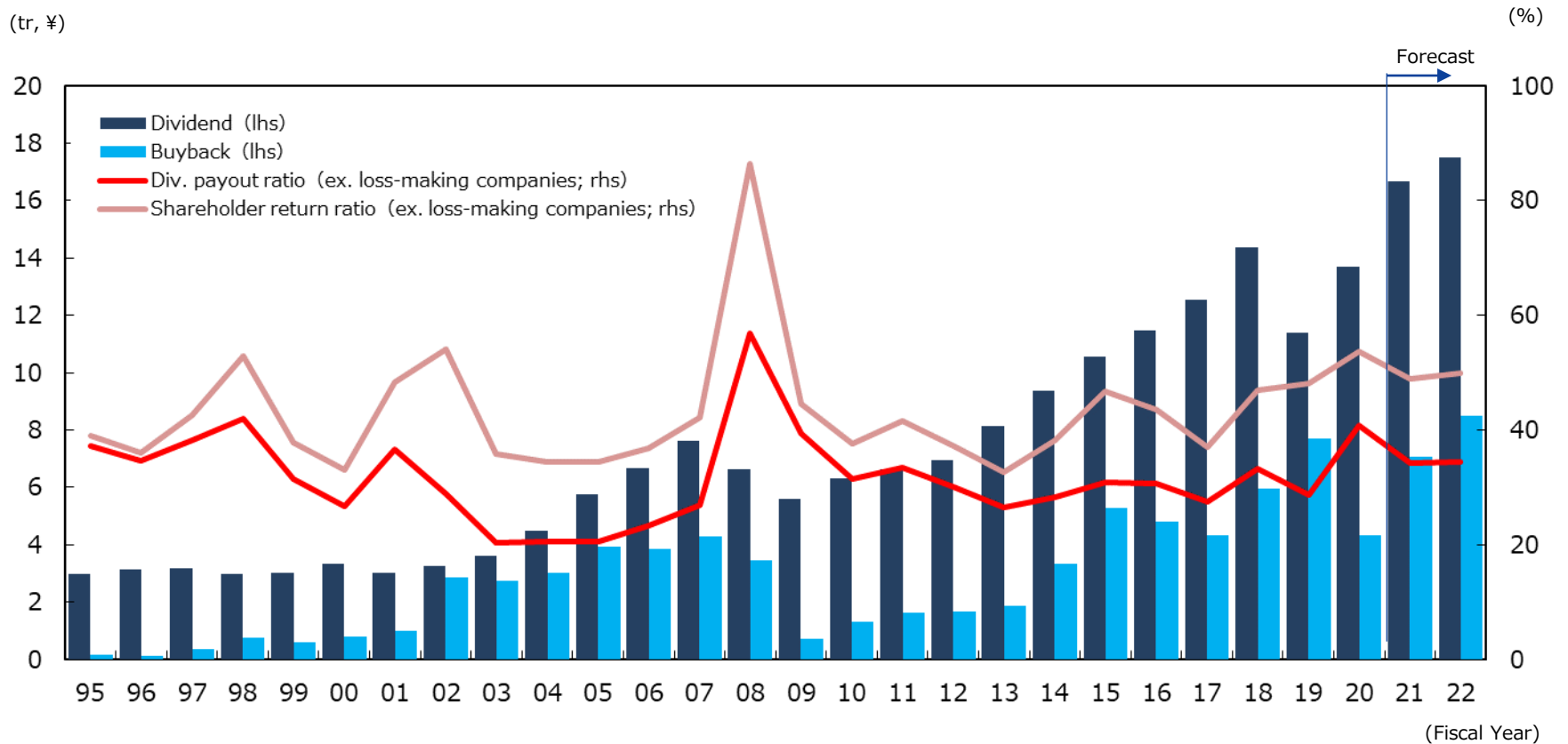
Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	206
Insurance companies	24
Pension funds	77
Others	11
Total	324

note: As of Apr. 30th 2022
(Source) FSA, SMDAM

- The Stewardship Code (SC) was set in February 2014. Investors are taking a more proactive approach in talking to companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors that have publicly accepted the SC.
- After the inception of the Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve their governance, efficiency and shareholder returns.
- These two codes have been progressively reviewed and enhanced, and are making visible impact on corporate behavior and investors' attitudes as shareholders.
- In a recent amendment of the CGC, companies are required to explain the rationale of “cross holdings” or “strategic holdings” of other companies' shares, which implicitly provide protection against takeovers and hostile shareholder actions, and is often negative for achieving shareholder value.
- The SC was reinforced in March 2020 to require investors to evaluate ESG factors.

Upward trend of dividends and buybacks

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2022, FY2021 and FY2022 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Winners and losers – large cap value dominates market

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	1.42	-7.25	-5.93	-1.85	27.47	22.75	20.26
Total Value	2.35	1.62	2.95	4.01	38.05	19.75	13.35
Top Cap Value	4.03	3.23	5.19	8.59	49.85	31.91	27.05
Large Cap Value	3.30	2.92	4.60	6.04	42.71	22.38	16.87
Mid Cap Value	2.35	2.51	3.83	2.91	33.73	9.88	3.42
Small Cap Value	-1.65	-3.73	-3.69	-4.50	18.99	8.72	-1.45
Micro Cap Value	-2.59	-4.93	-6.49	-3.52	15.02	8.37	-1.25
Total Growth	0.42	-15.32	-14.05	-6.85	16.91	23.91	25.77
Top Cap Growth	1.06	-14.34	-14.19	-4.46	23.93	31.22	34.07
Large Cap Growth	0.30	-15.21	-14.32	-6.50	18.30	26.33	27.57
Mid Cap Growth	-1.09	-16.79	-14.59	-9.98	9.39	18.32	17.37
Small Cap Growth	1.47	-16.32	-11.57	-10.21	5.19	5.14	10.38
Micro Cap Growth	2.93	-20.79	-15.01	-13.77	4.04	4.65	12.29
Top Cap Total	2.42	-6.98	-6.15	0.82	34.86	31.02	30.05
Large Cap Total	1.78	-7.04	-5.83	-1.03	29.74	25.30	23.12
Mid Cap Total	0.78	-7.15	-5.32	-3.66	22.63	17.38	13.54
Small Cap Total	-0.61	-8.40	-6.52	-6.90	14.16	8.12	4.17
Micro Cap Total	-1.09	-10.03	-9.07	-6.79	12.03	8.04	5.03

Note : As of May 24th 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- The economy is recovering. Although the prolonged concern for higher inflation, the slowing global economy, and the bottle neck in the global supply chain weigh on consumers and business sentiment, the economy continues its recovery thanks to improving domestic demand. While the employment situation is getting better, real income is declining owing to higher inflation. Inflation is accelerating due to rising food costs and the receding effect of falling mobile phone charges.

[Outlook]

- ① **We have not changed our real GDP growth forecast for FY 2022 at +2.1% and for FY 2023 at 1.3%.** We estimate the economy will come back to a steady growth trend in Q2 after a temporary pause in Q1 caused by COVID-19 infections and restrictions on peoples' activities. The re-opening of the economy and fiscal stimulus could be major drivers of domestic economy despite higher inflation and the bottle neck in the global supply chain.
- ② **We have revised up our Core CPI forecast for FY 2022 to +1.8% from +1.6% and for FY 2023 to +1.1% from +1.0%.** We have raised our forecast for FY 2022 due to the change in our estimate of foreign exchange rate. We expect core CPI will accelerate to +2.0% in April 2022 and continue to stay at around a similar level through the year due to rising food prices and other core CPI items.
- ③ **We expect PM Kishida's cabinet to maintain its economic policy to boost the economy.** Currently the government is executing economic measures to ease negative impact from rising energy costs, and additional fiscal stimulus of as much as 10 trillion yen will follow in the near future to support the economy.
- ④ **Despite rising inflation, the current accommodative monetary policy will be maintained by the BOJ in the near future as the BOJ regards it difficult to control cost-push inflation through monetary tightening. Recent changes to the members of the BOJ policy committee suggest PM Kishida's intention to distance himself from the existing reflationary monetary policy. We see a growing likelihood of change to monetary policy by relaxing the yield curve control after the end of current BOJ Governor Kuroda's term in April 2023. We expect his resignation to be a turning point for the current accommodative monetary policy.**

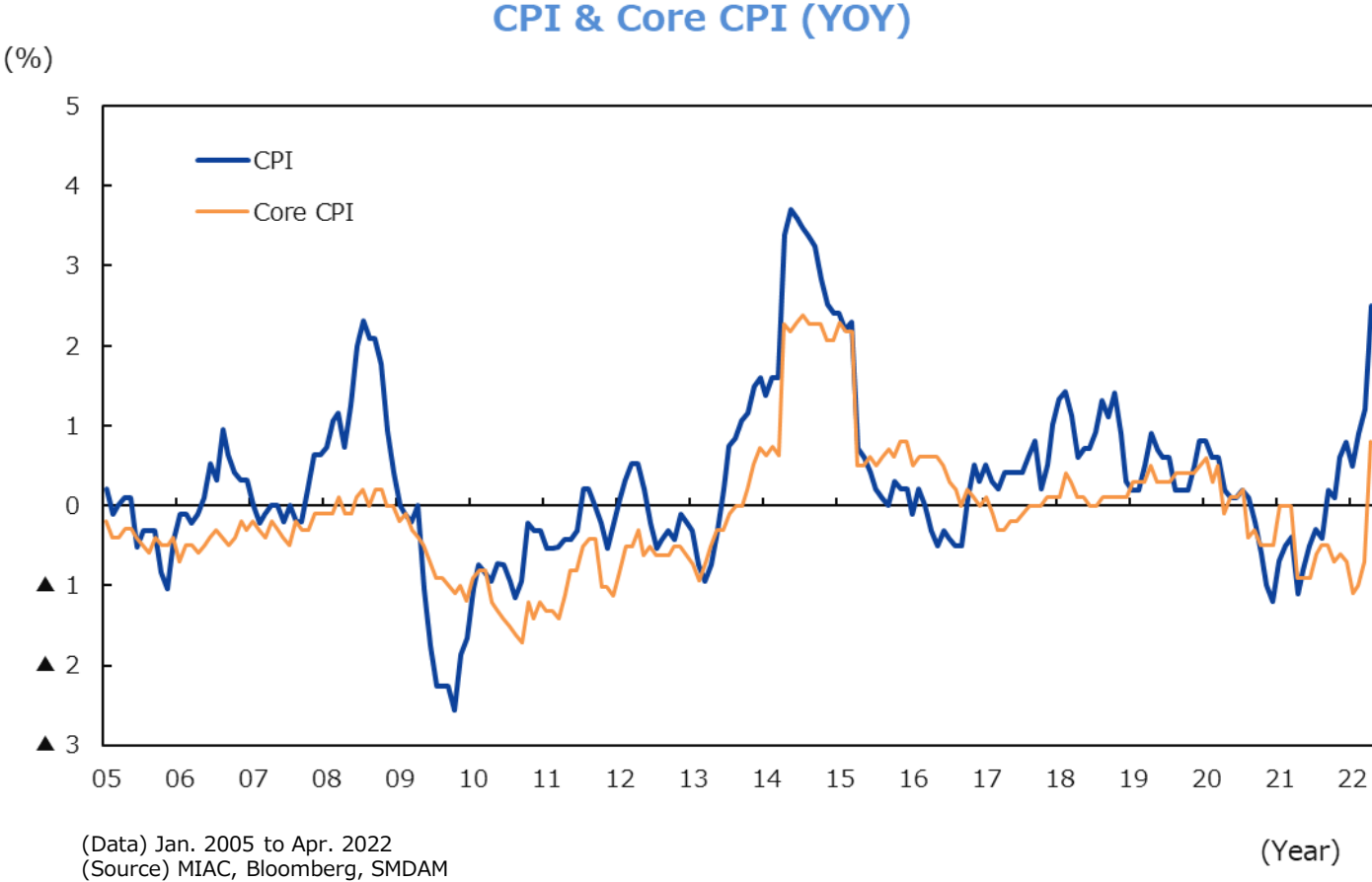
Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY17	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.1%	2.1%	1.3%	
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.6%	2.3%	1.1%	
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.6%	-1.2%	0.1%	
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	1.3%	2.8%	3.2%	
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-9.3%	-3.2%	0.6%	
Net export contribution	0.4%	-0.2%	-0.5%	-0.6%	0.8%	-0.1%	0.1%	
Exports of goods and services	6.3%	2.0%	-2.3%	-10.2%	12.5%	1.8%	3.6%	
Imports of goods and services	3.8%	3.0%	0.2%	-6.5%	7.2%	2.3%	3.3%	
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.1%	2.3%	1.9%	
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.0%	0.3%	0.6%	
Industrial Production Index	2.9%	0.3%	-3.7%	-10.0%	5.9%	3.0%	3.4%	
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	1.8%	1.1%	
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.4%	7.3%	6.0%	0.4%	
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	1.5%	1.3%	
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.6%	2.4%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

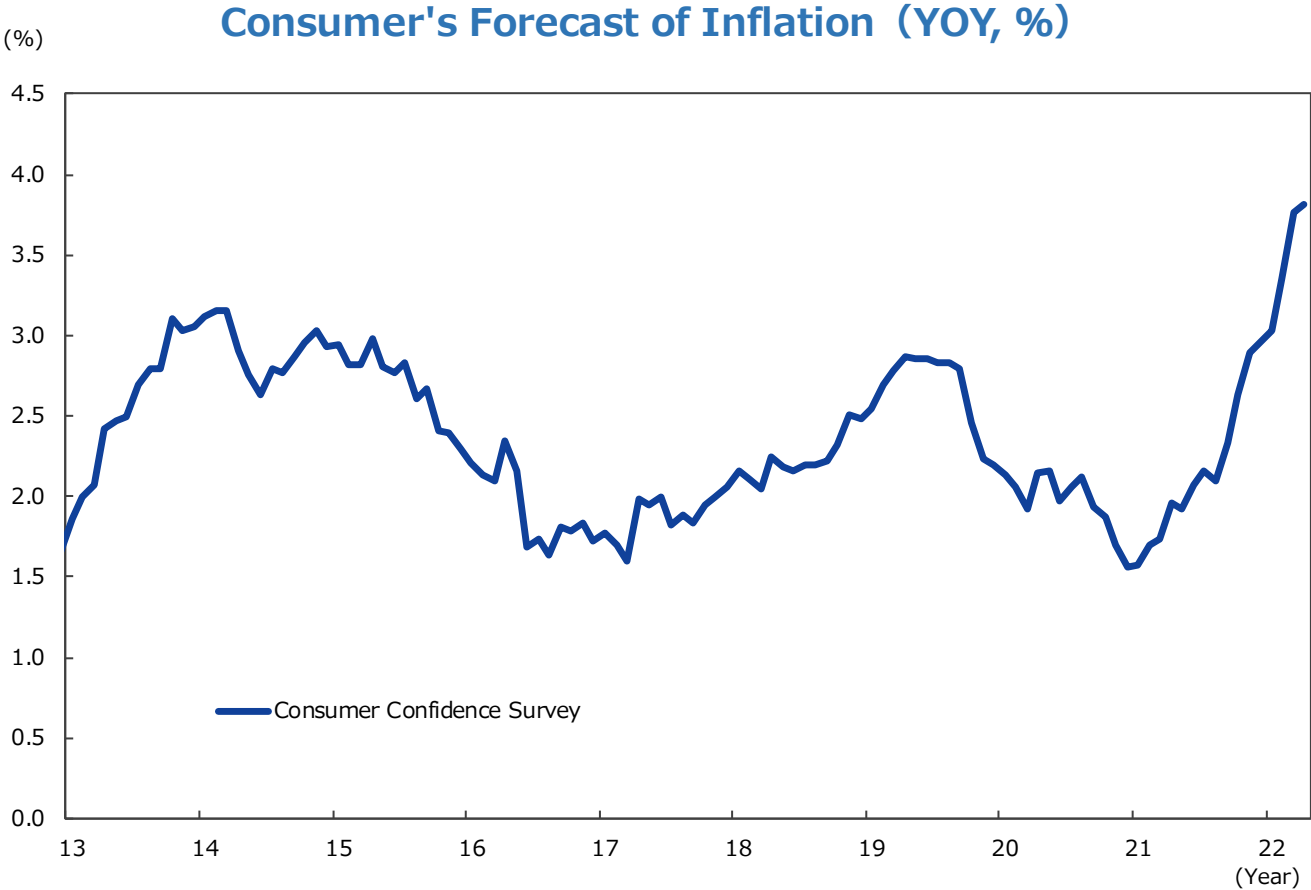
(Note) Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

(Source) Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Inflation finally returns to Japan



Consumers' inflation expectations growing



(Data) Weighted average of inflation forecast of "Consumer Confidence Survey".
Data is from Jan. 2013 to Apr. 2022.
(Source) Cabinet Office, SMDAM

Yield curve control by BOJ pushes real interest sharply lower

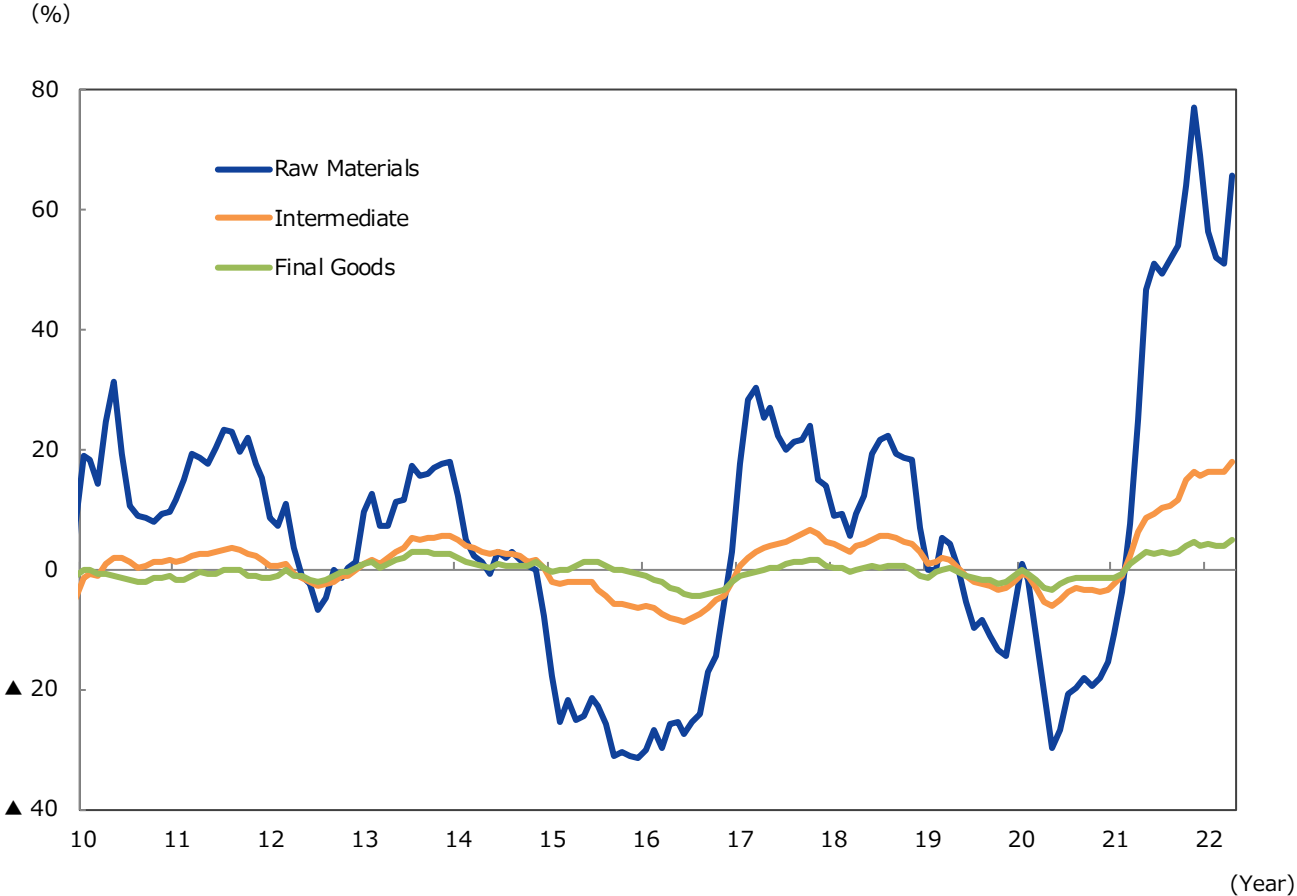
JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to May 18th 2022
(Source) Bloomberg, SMDAM

Companies struggling to pass through rising input costs

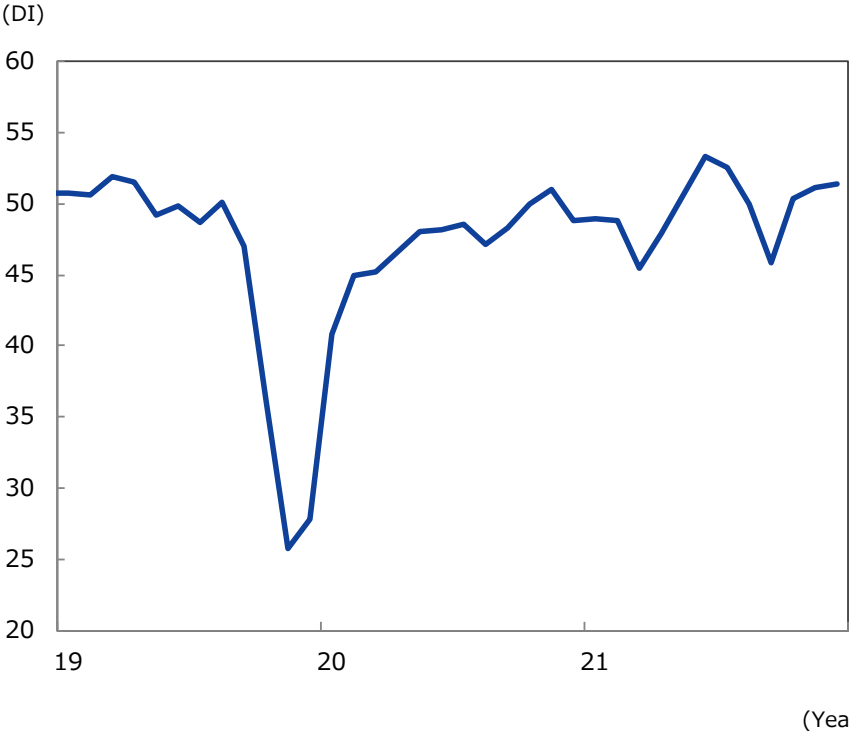
Corporate Price Index (YOY)



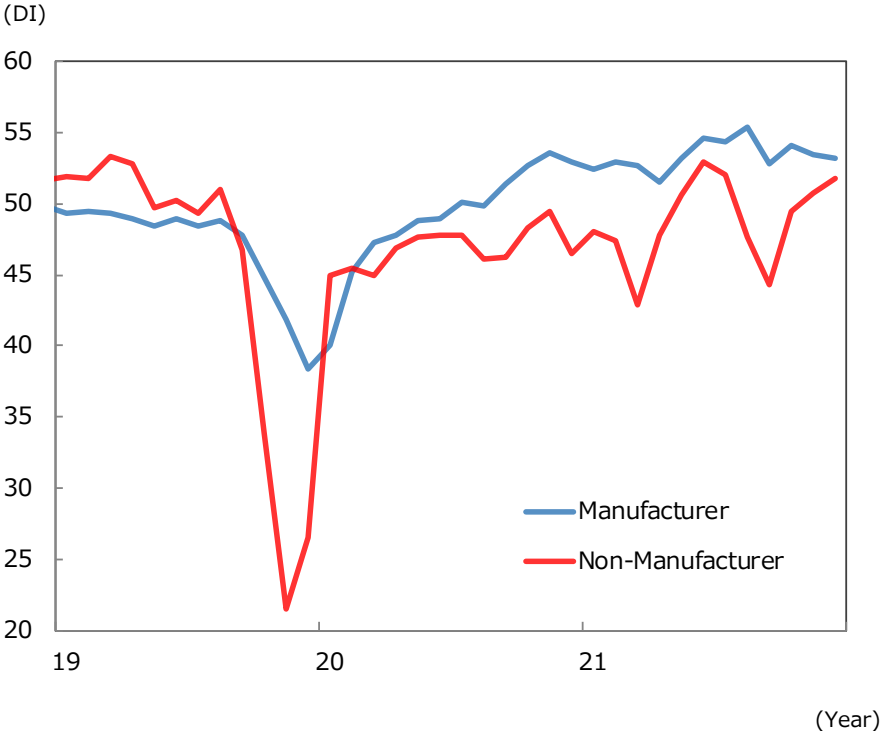
(Data) From Jan. 2010 to Apr. 2022
(Source) Bank of Japan, SMDAM

Re-opening of economy pushes service PMI higher

Composite PMI



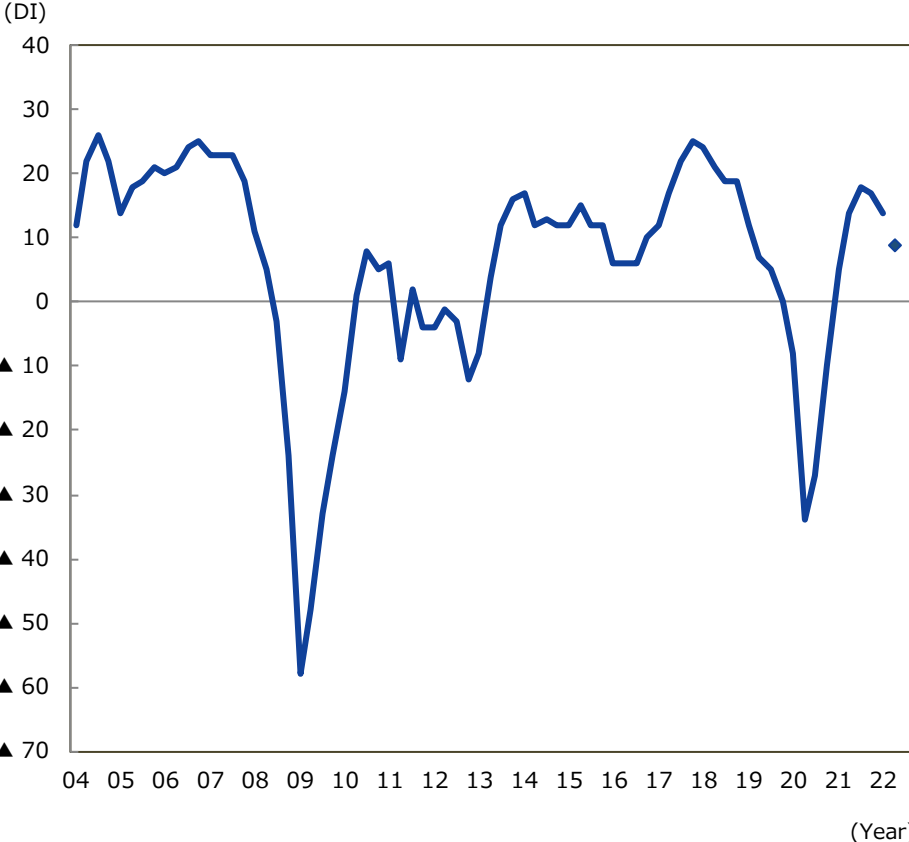
PMI, Manufacturer & Non-Manufacturer



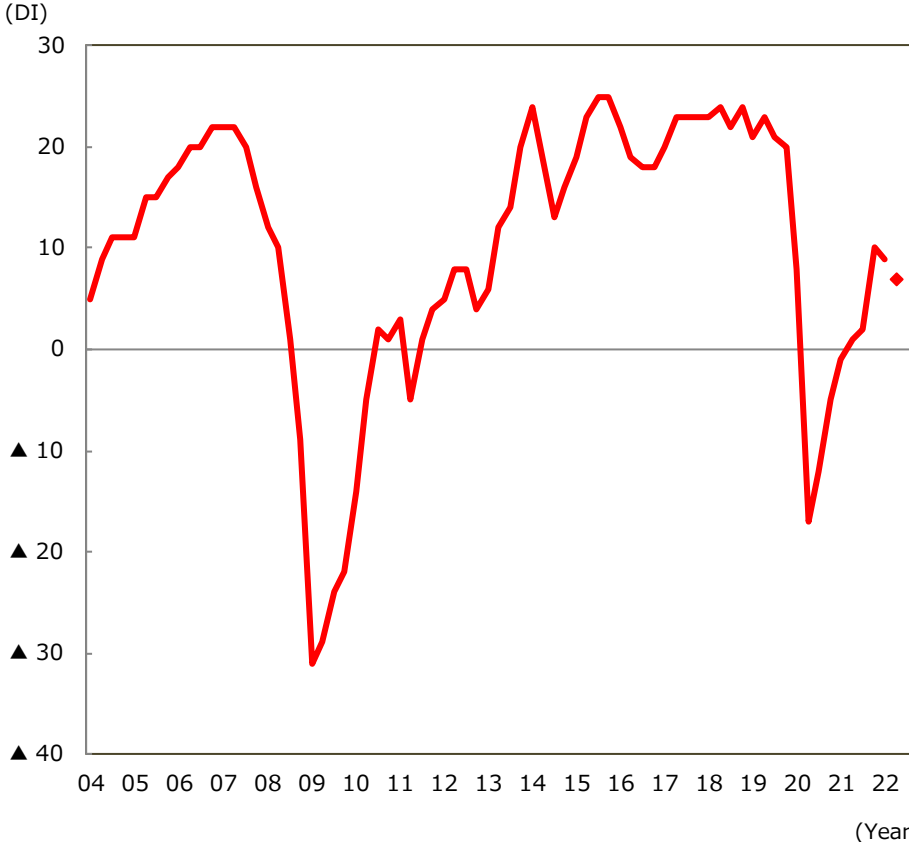
(Data) From June 2019 to May 2022
(Source) Bloomberg, SMDAM

Uncertainty weighs on business sentiment for the near future

BOJ Tankan DI (Large Manufacturer)



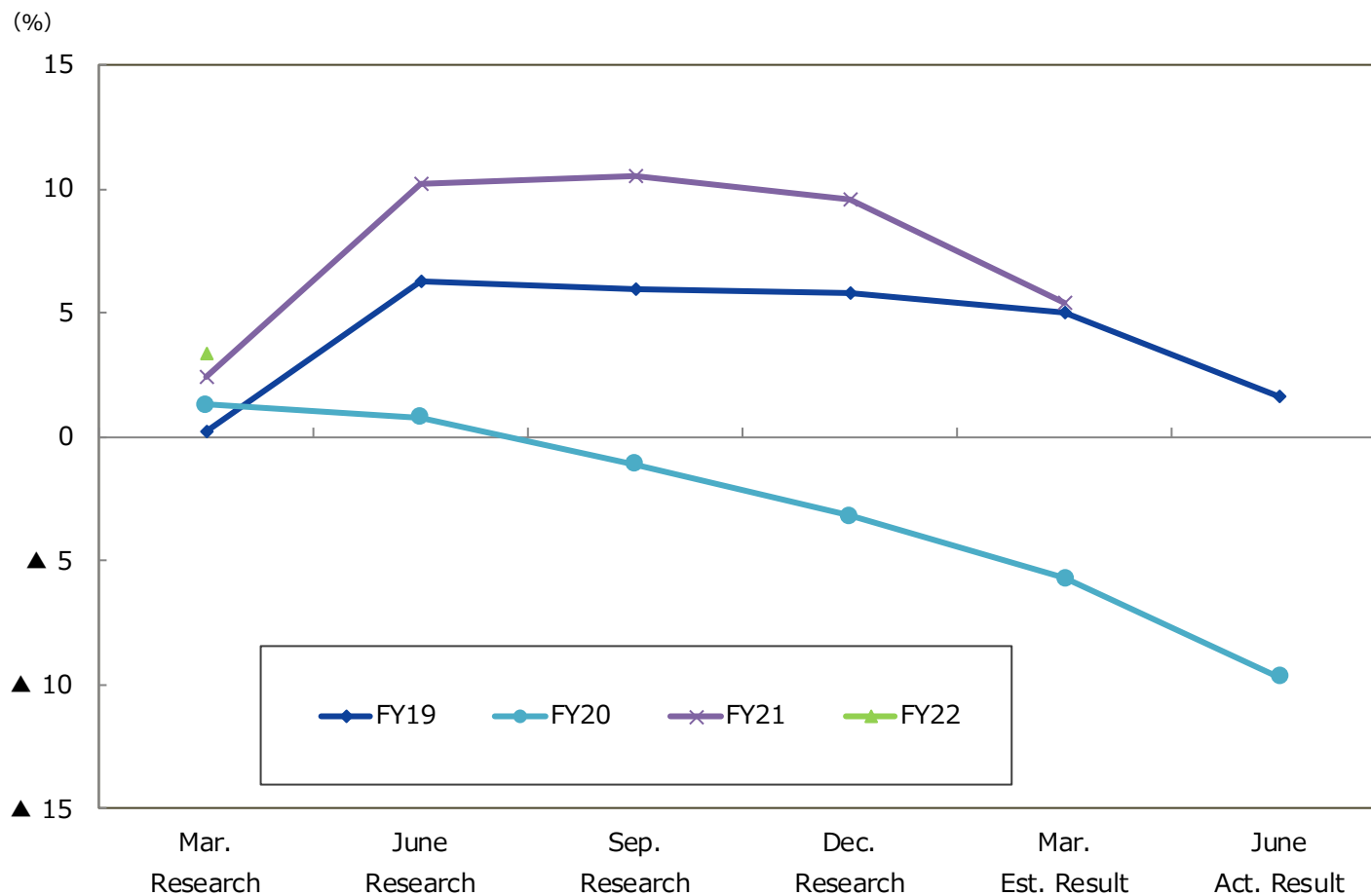
BOJ Tankan DI (Large Non-Manufacturer)



(Data) "Tankan DI, diffusion Index" is business sentiment calculated by the number of "Yes" minus "No". Data is from Q1 2004 to Q2 2022, data for Q2 2022 is forecast figure.
 (Source) Bank of Japan, SMDAM

CAPEX of FY 2022 starts slowly as usual

Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)

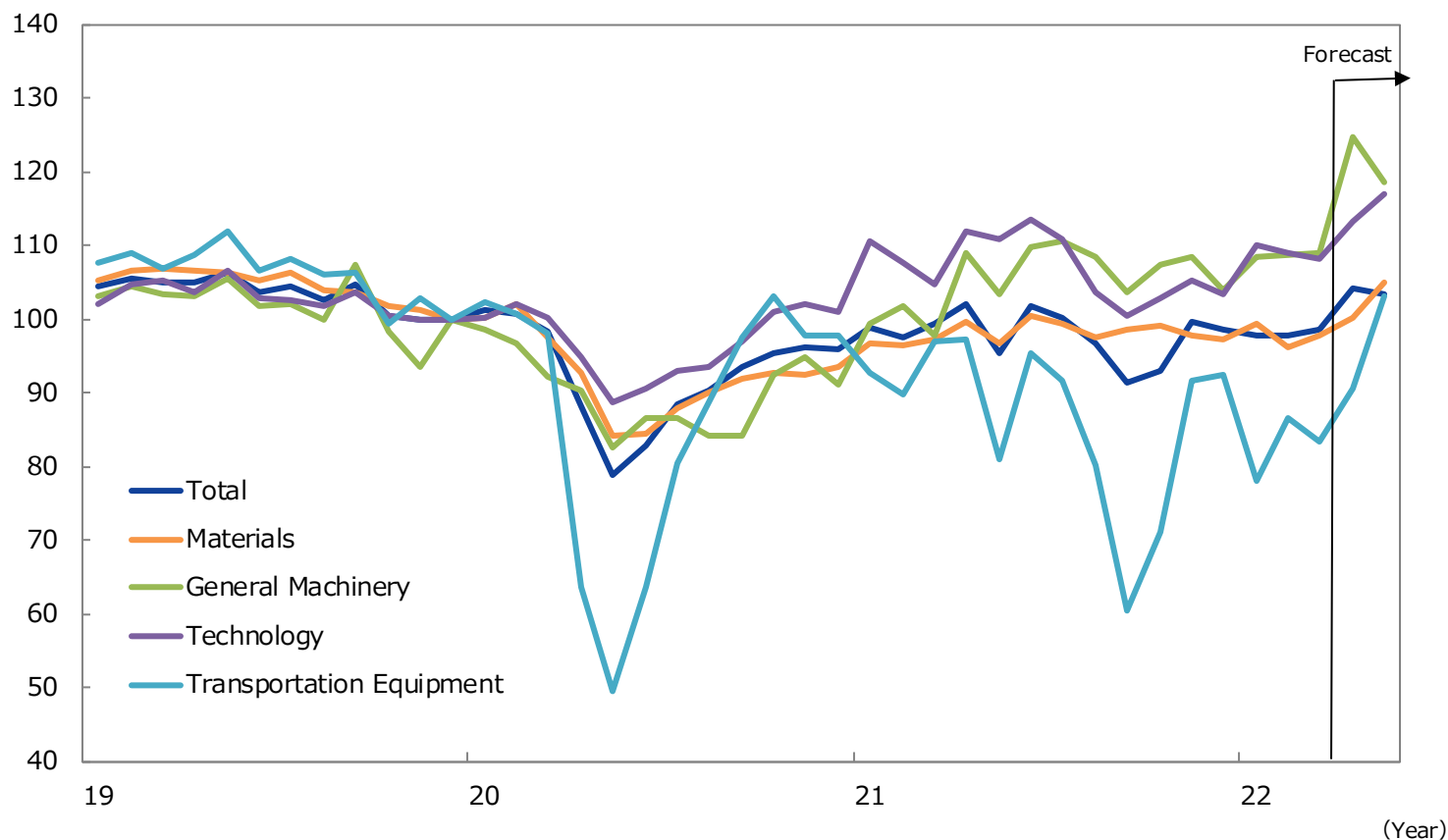


(Data) Data is from Q1 FY 2019 to Q1 FY 2022
(Source) The Bank of Japan, SMDAM

(Quarter)

Auto production may rebound soon

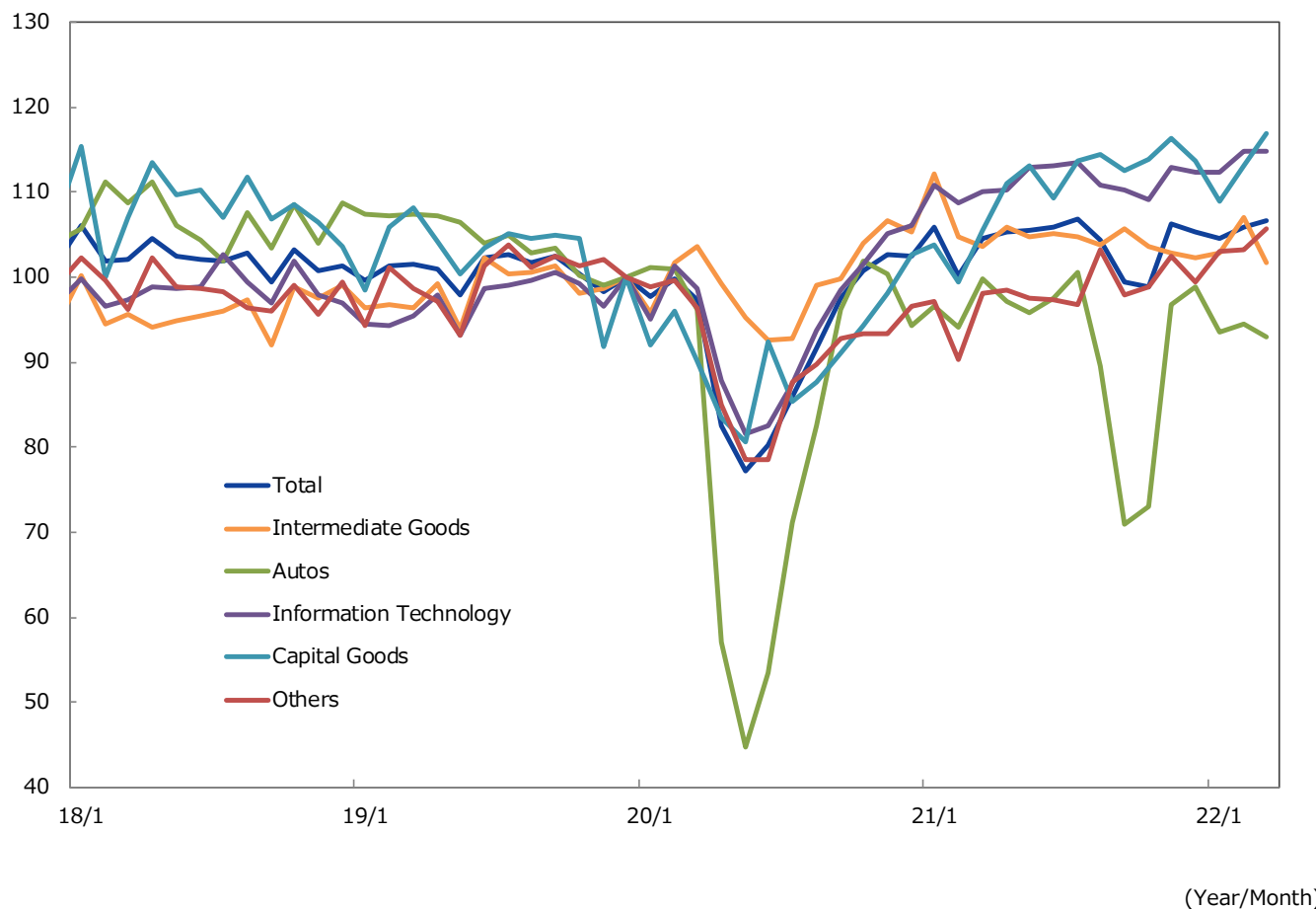
Industrial Production (Dec. 2019=100)



(Data) From Jan. 2019 to May 2022.
(Source) METI, SMDAM

Yen's weakness has not yet accelerated exports

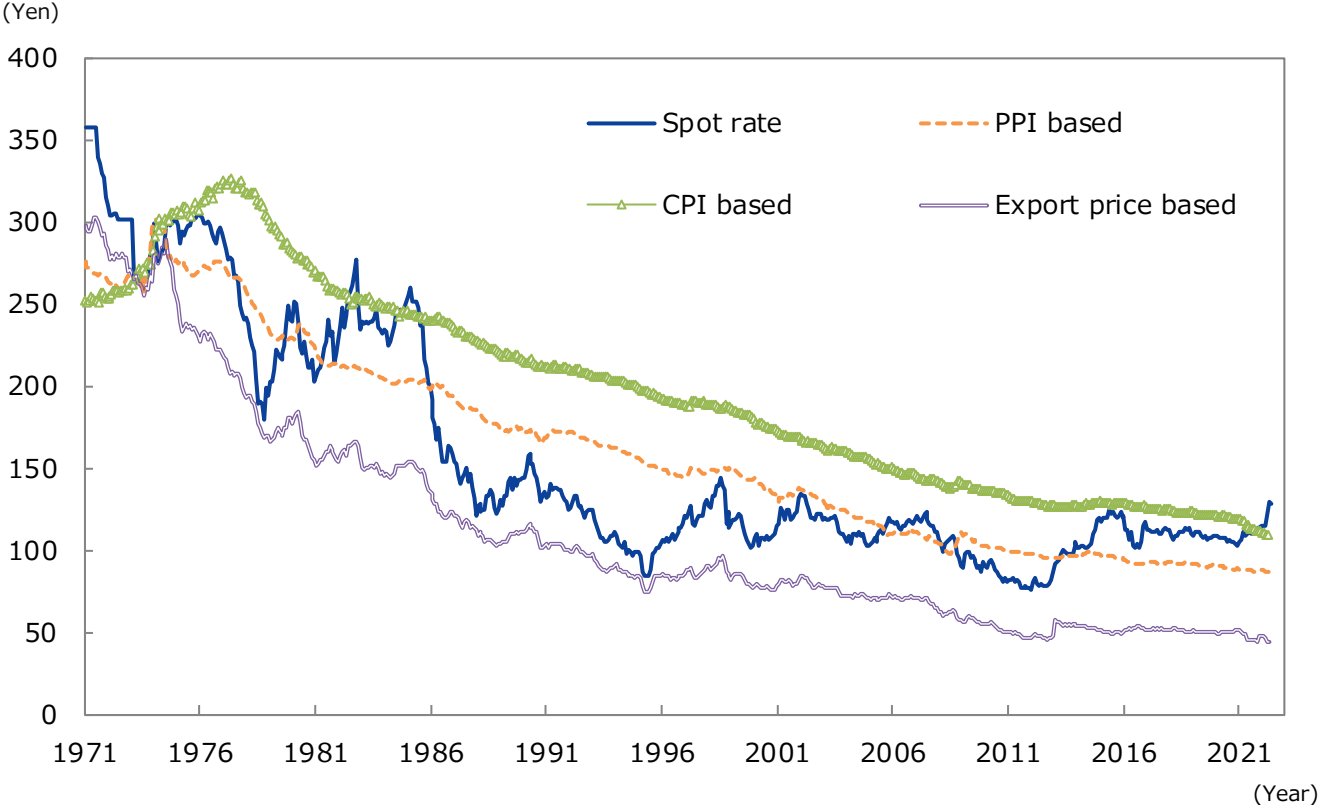
Real Export (Dec. 2019=100)



(Data) From Jan. 2018 to Mar. 2022
(Source) Bank of Japan, SMDAM

USD/JPY rate breaks 30+ years resistance

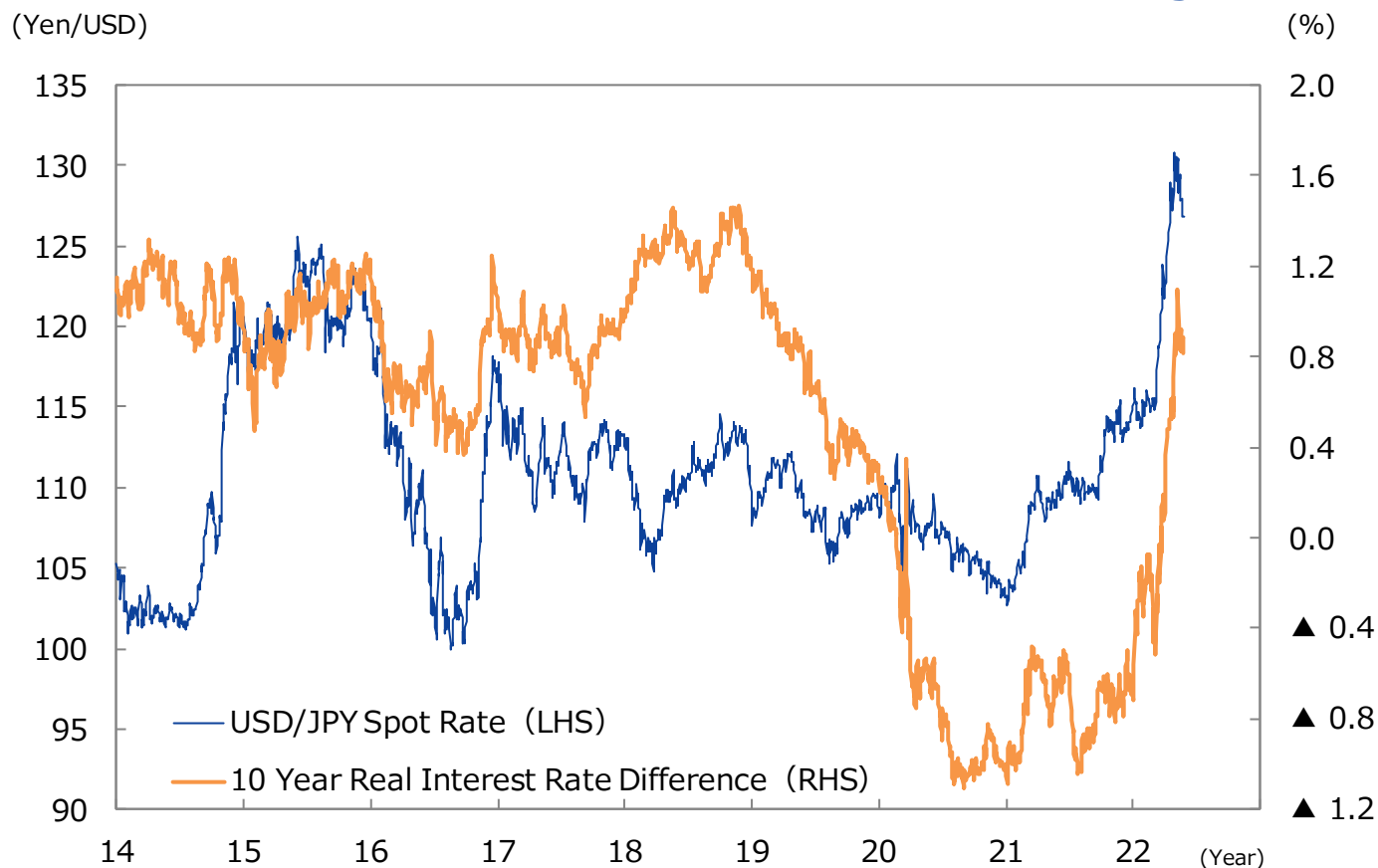
Purchasing Power Parity of USD/JPY Rate



(Data) Spot Rate is from Jan. 1971 to May 2022, PPP is from Jan. 1971 to Mar. 2022.
(Source) DOL, Bank of Japan, SMDAM

Widening gap of real interest rate drives recent JPY weakness

Real Interest Rate Difference & USD/JPY Exchange rate

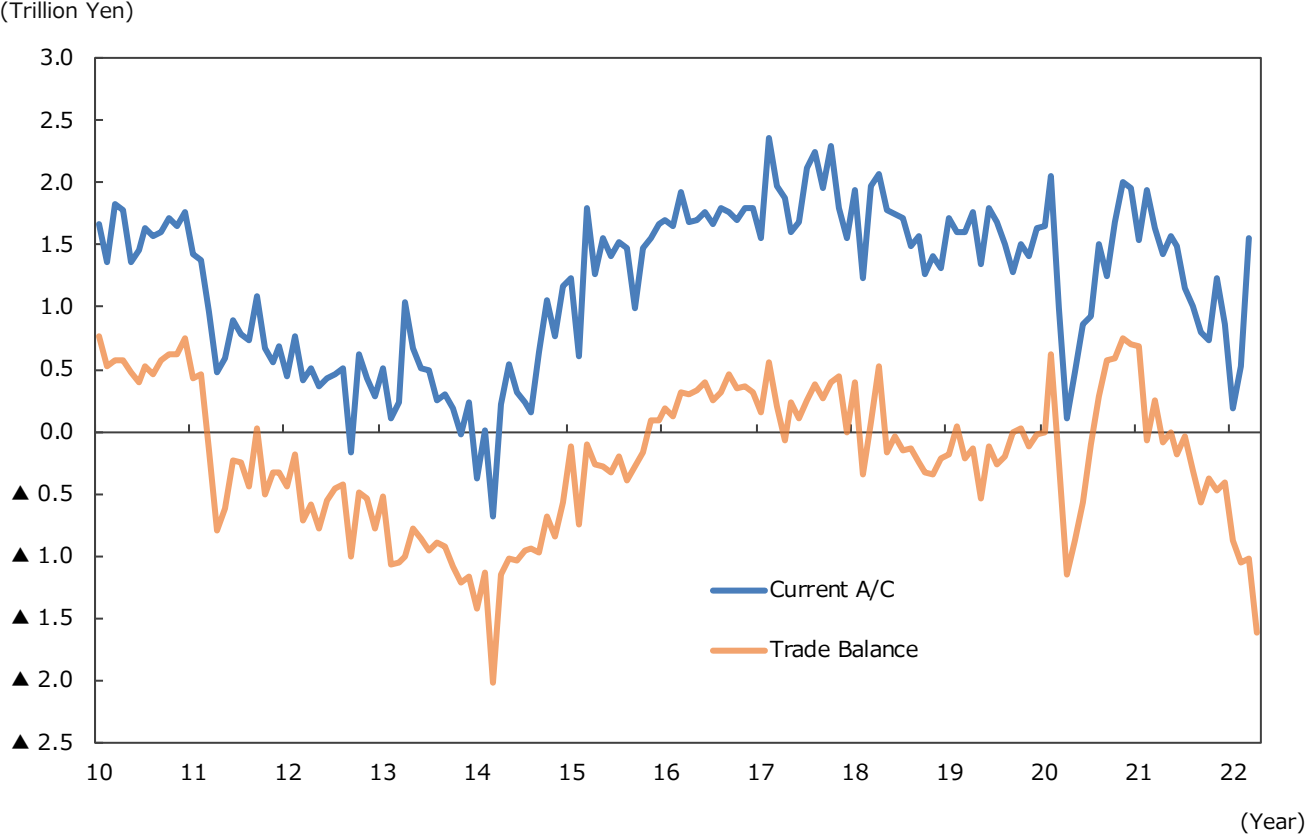


(Data) From Jan. 1st 2014 to May 24th 2022.

(Source) Bloomberg, SMDAM

Rising material/energy costs weigh on trade balance

Current Account & Trade Balance



(Data) Seasonally adjusted. Current account is from Jan. 2010 to Mar. 2022.
Trade balance is from Jan. 2010 to Apr. 2022.
(Source) MOF, SMDAM

Japan's marginal exposure to Russian business

Trade Exposure to Russia (%)

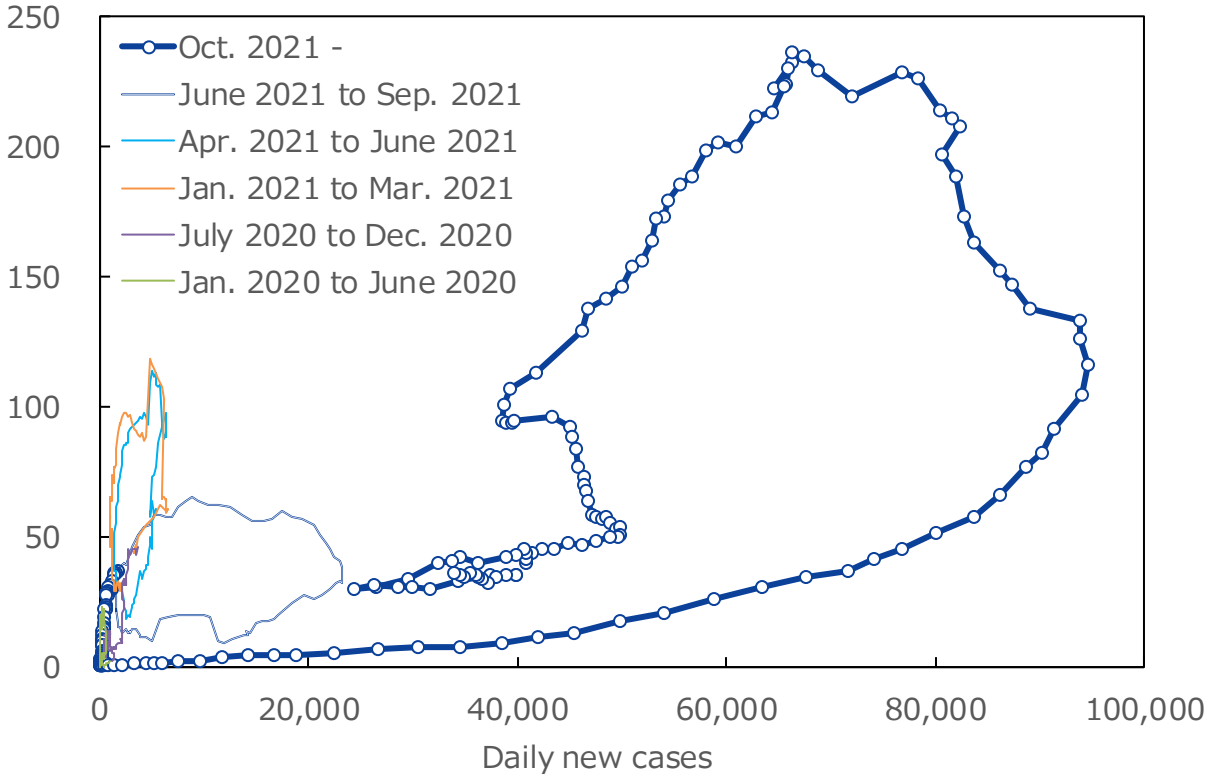
	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Export	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01	0.00
Electronics	0.07	0.01	0.00	0.00
Transportation Equipment	0.56	0.09	0.00	0.00
Others	0.07	0.01	0.00	0.00

(Data) As of year 2021.
 (Source) MOF, SMDAM

COVID-19 infections peaked and daily deaths declined sharply

COVID-19 New patients and confirmed deaths in Japan

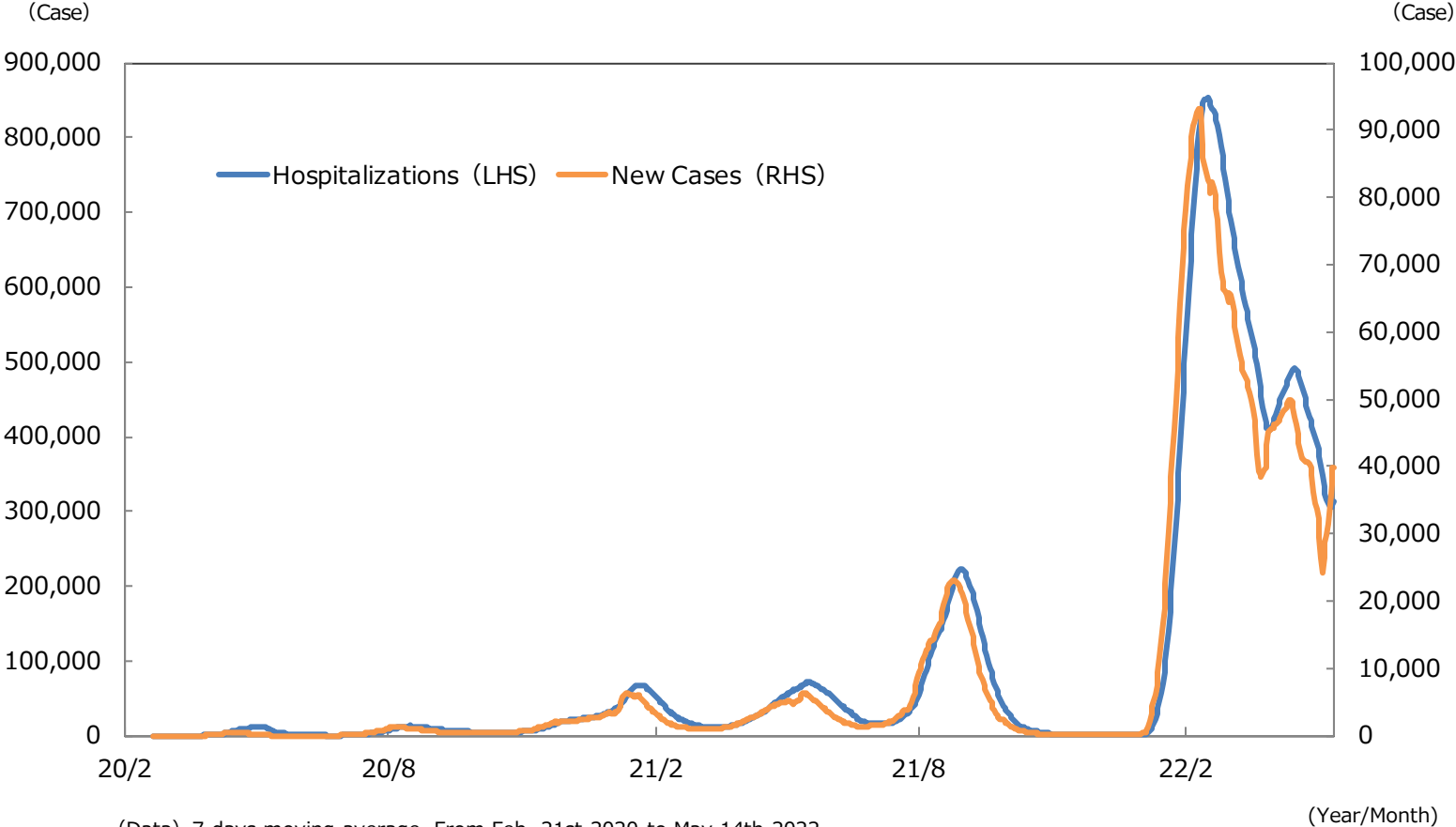
Daily Death



(Data) 7 days moving average, From Jan. 1st 2020 to May 24th 2022
(Source) Bloomberg, SMDAM

COVID-19 infections peaked but still hovering at high level

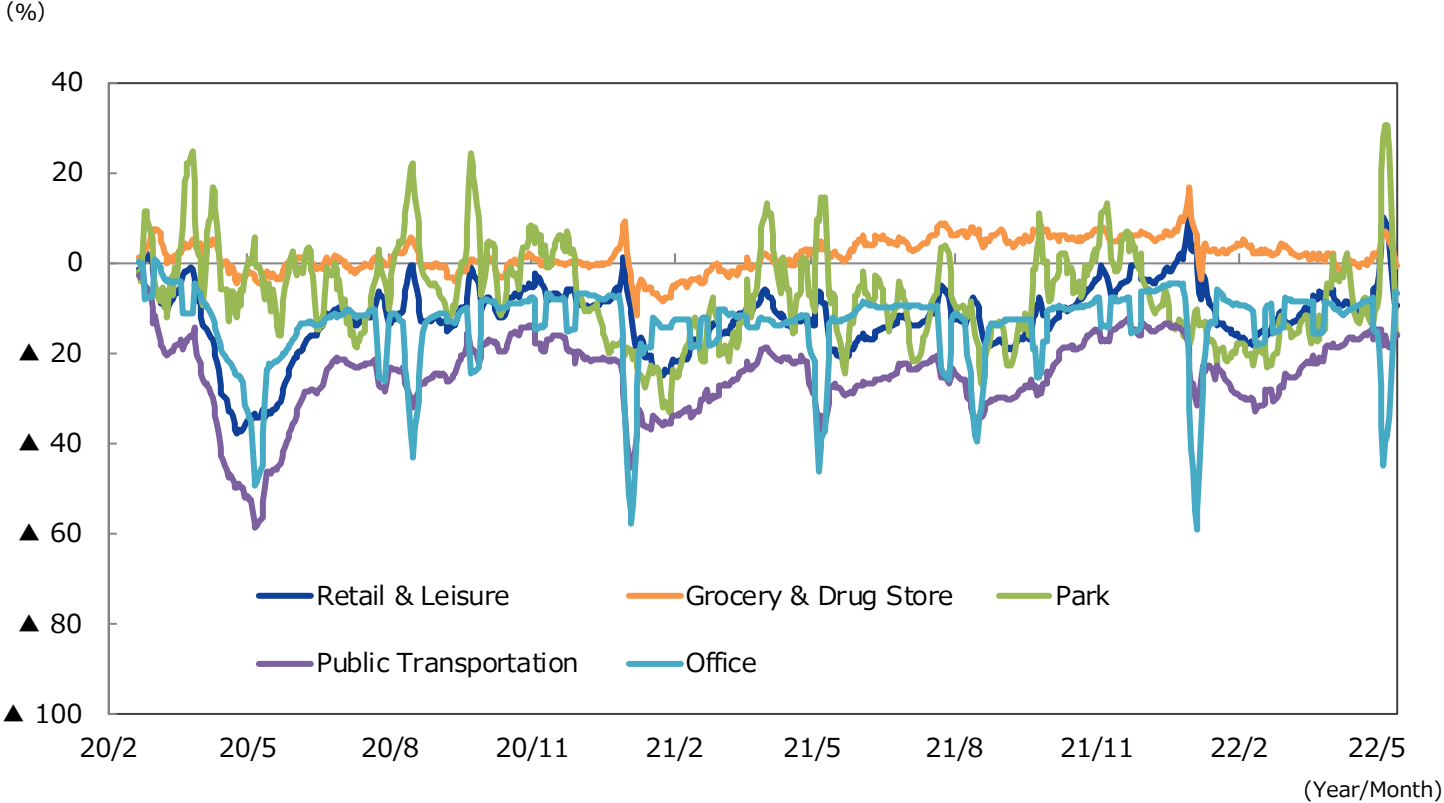
COVID-19 New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 21st 2020 to May 14th 2022.
(Source) MHLW, NHK, SMDAM

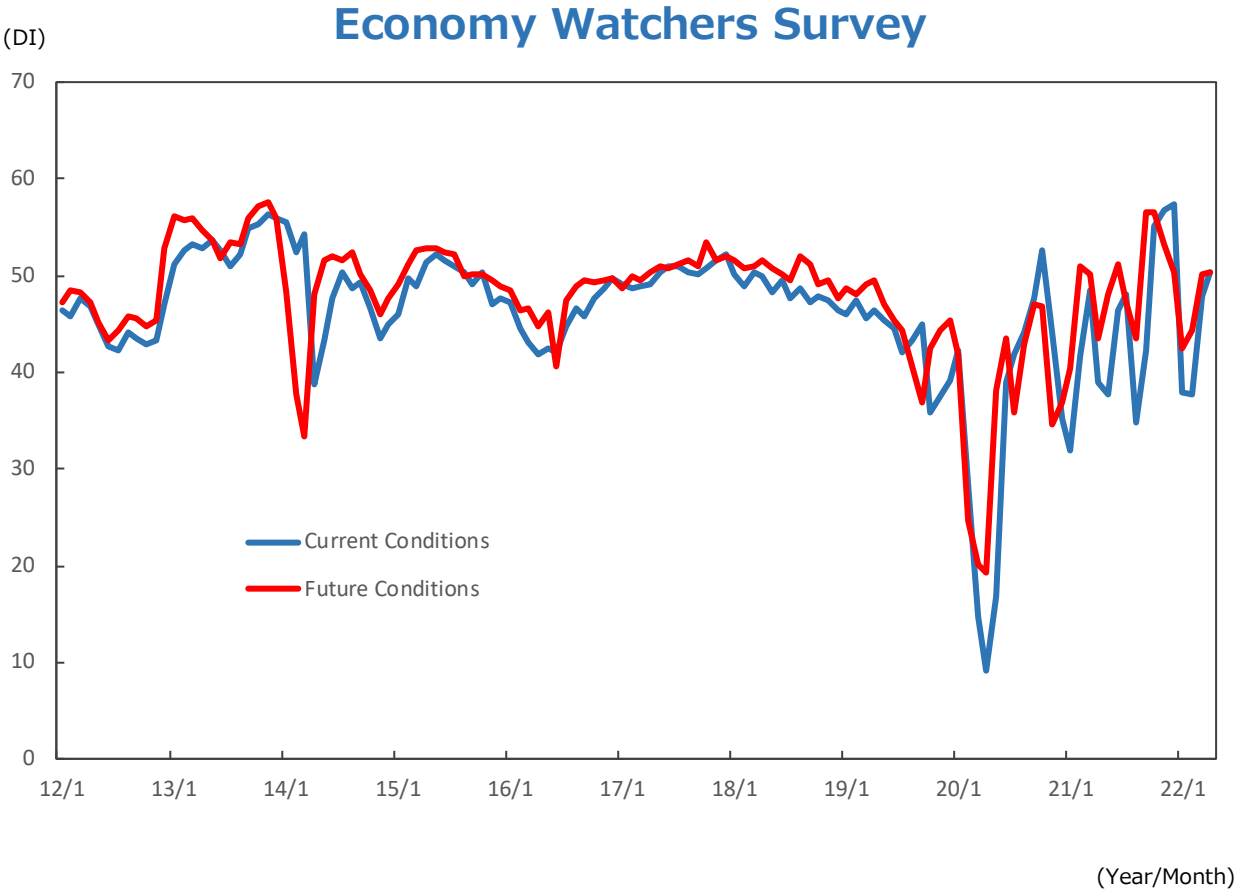
Long holiday in May causes big swing in mobility data

Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21st 2020 to May 14th 2022
(Source) Google, SMDAM

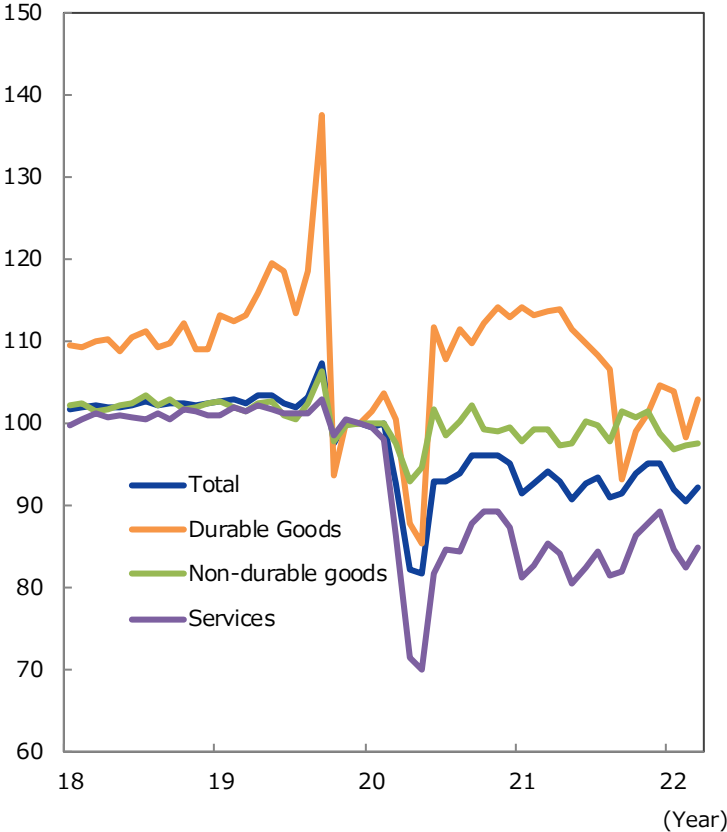
Consumers come back thanks to re-opening of economy



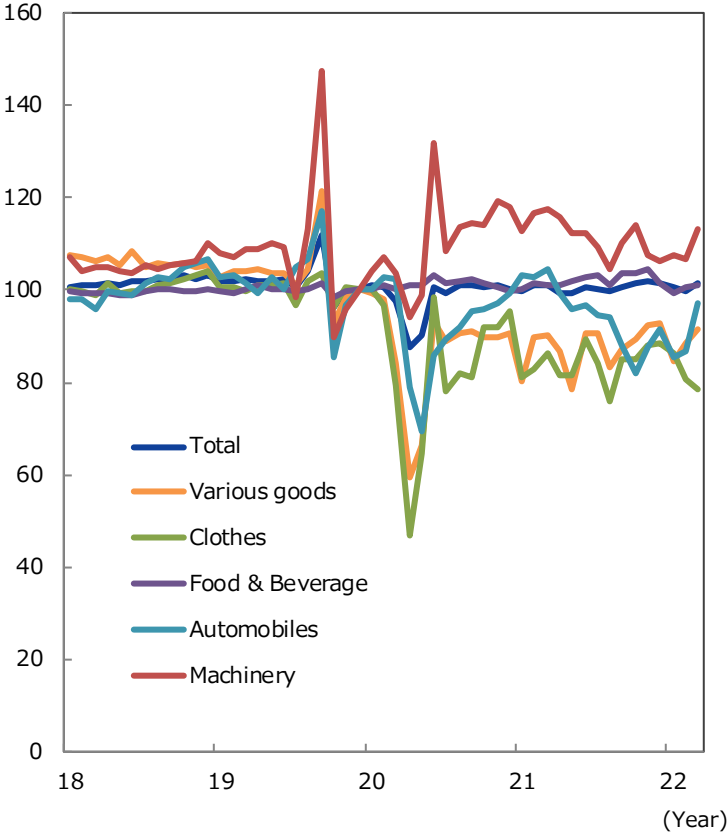
(Data) From Jan. 2012 to Apr. 2022
(Source) Cabinet Office, SMDAM

Retail sales come back slowly excluding clothes

Consumer Activity Index (Dec. 2019 = 100)



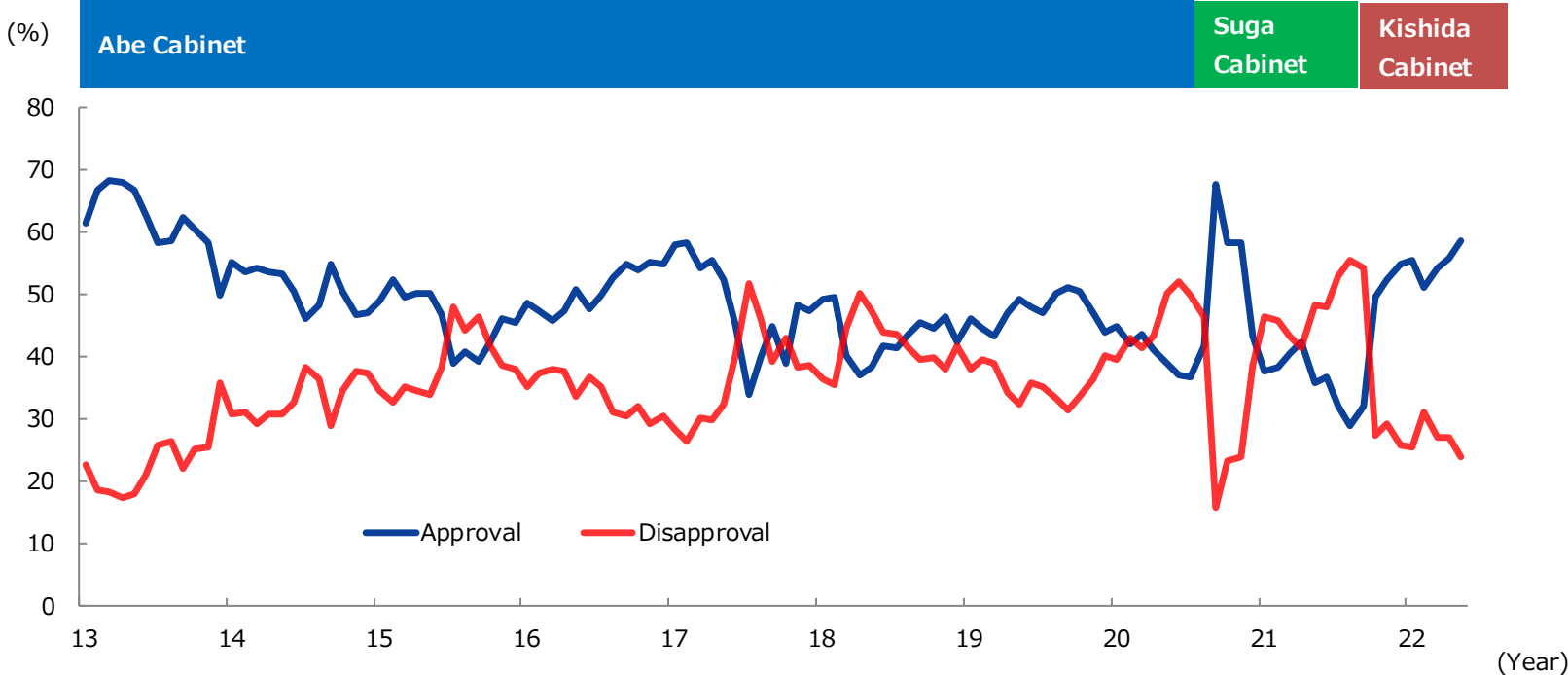
Retail Sales (Dec. 2019 = 100)



(Data) From Jan. 2018 to Mar. 2022.
 (Source) Bank of Japan, METI, and SMDAM

PM Kishida maintains high approval rate

Cabinet approval rate



(Data) From Jan. 2013 to May 2022
(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Six trillion yen economic package

Emergency Economic Measures (Trillion Yen)

	National Expense			Size of Measures
		Reserve Fund	Supplementary budget	
Counter measures against rising crude oil	1.5	0.3	1.2	1.5
Stabilize supply of raw materials and foods	0.5	0.1	-	2.4
Support for SMEs affected by high raw material prices	1.3	0.1	-	6.5
Support for people in need	1.3	1.0	-	1.3
Securing reserve funds	1.5	-	1.5	1.5
Total	6.2	1.5	2.7	13.2

(Source) SMDAM

Schedule of major events

Schedule of Major Domestic Events			
2022	June	8	Revision of CY 2022 Q1 GDP
		15	End of Ordinary Diet Session
		16-17	Monetary Policy Meeting
		26	G7 Summit in Germany Release of Execution Plans and Schedules of "New Capitalism Realization Conference"
	July	20-21	Monetary Policy Meeting
		23	End of the Term of two members of the BOJ Monetary Policy Committee
		25	End of the Term of House of Councilors
August	15	Release of CY 2022 Q2 GDP	
September	8	Revision of CY 2022 Q2 GDP	
	21-22	Monetary Policy Meeting Change of Top Party Officials of LDP	
October	27-28	Monetary Policy Meeting	
	30	G20 Summit in Indonesia	
November	15	Release of CY 2022 Q3 GDP	
December	8	Revision of CY 2022 Q3 GDP	
	19-20	Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023	

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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