



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-August 2022-

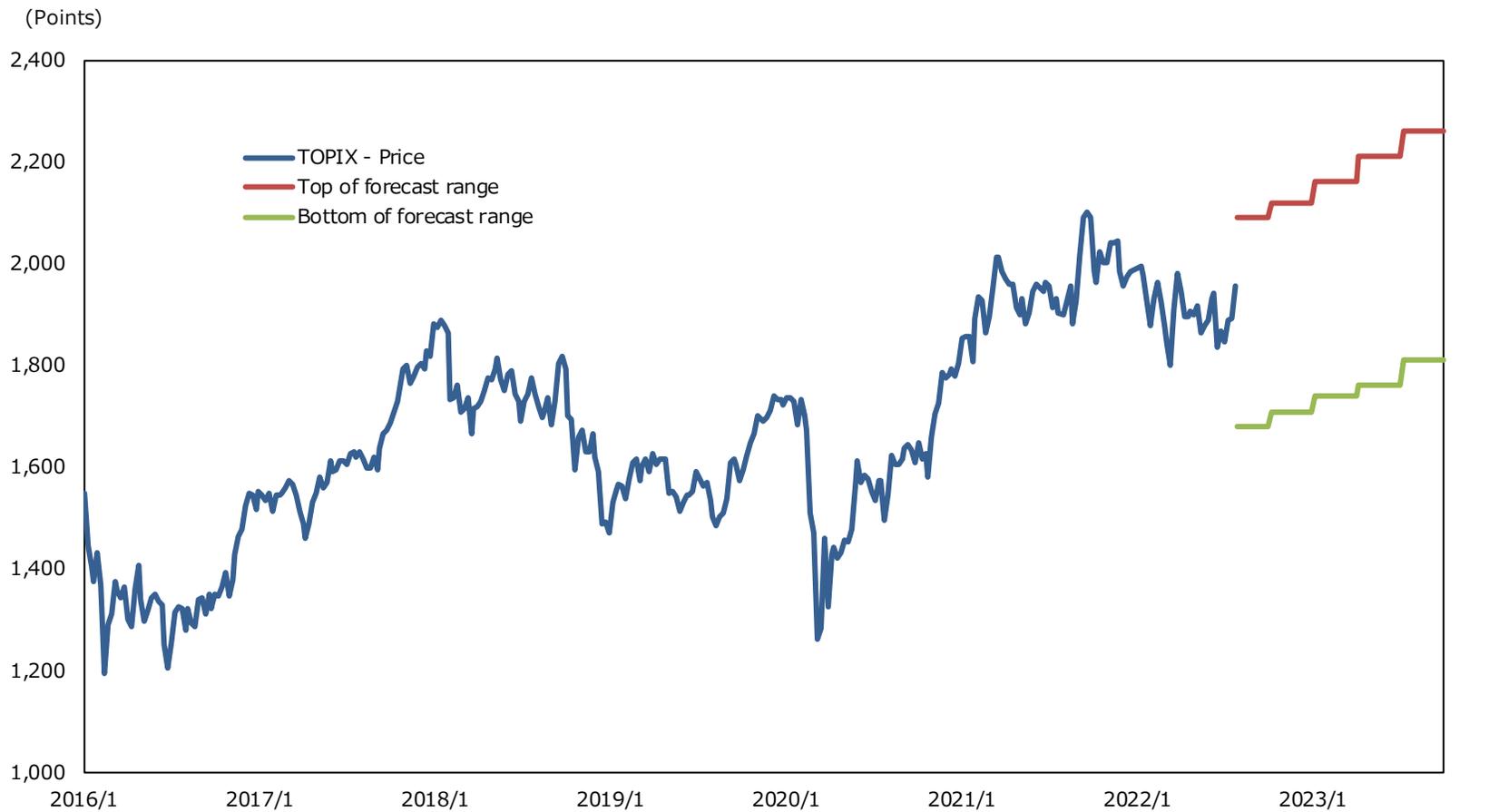


Outlook for Japanese Stock Market

Market Outlook

- We have lowered our TOPIX target to 1,960 from 2,230 and Nikkei 225 to 27,800 from 31,600 for March 2023 due to revision of the EPS estimate.
- We have revised down our EPS forecast of TOPIX owing to sluggishness of the global economy despite a stable domestic economy and continuing accommodative monetary policy by the BOJ.
- We expect range trading in the Japanese stock market to continue in the near future. While the economic recovery and monetary policy will support the market, uncertainty over the global economy could put downward pressure on the market.
- We believe Japanese stocks will resume their bullish trend after the market confirms the peak of the cycle of global monetary tightening.

We revised down our equity market forecast



Note: TOPIX data is from Jan. 1st 2016 to July 22nd 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

Upside / Downside risk scenarios

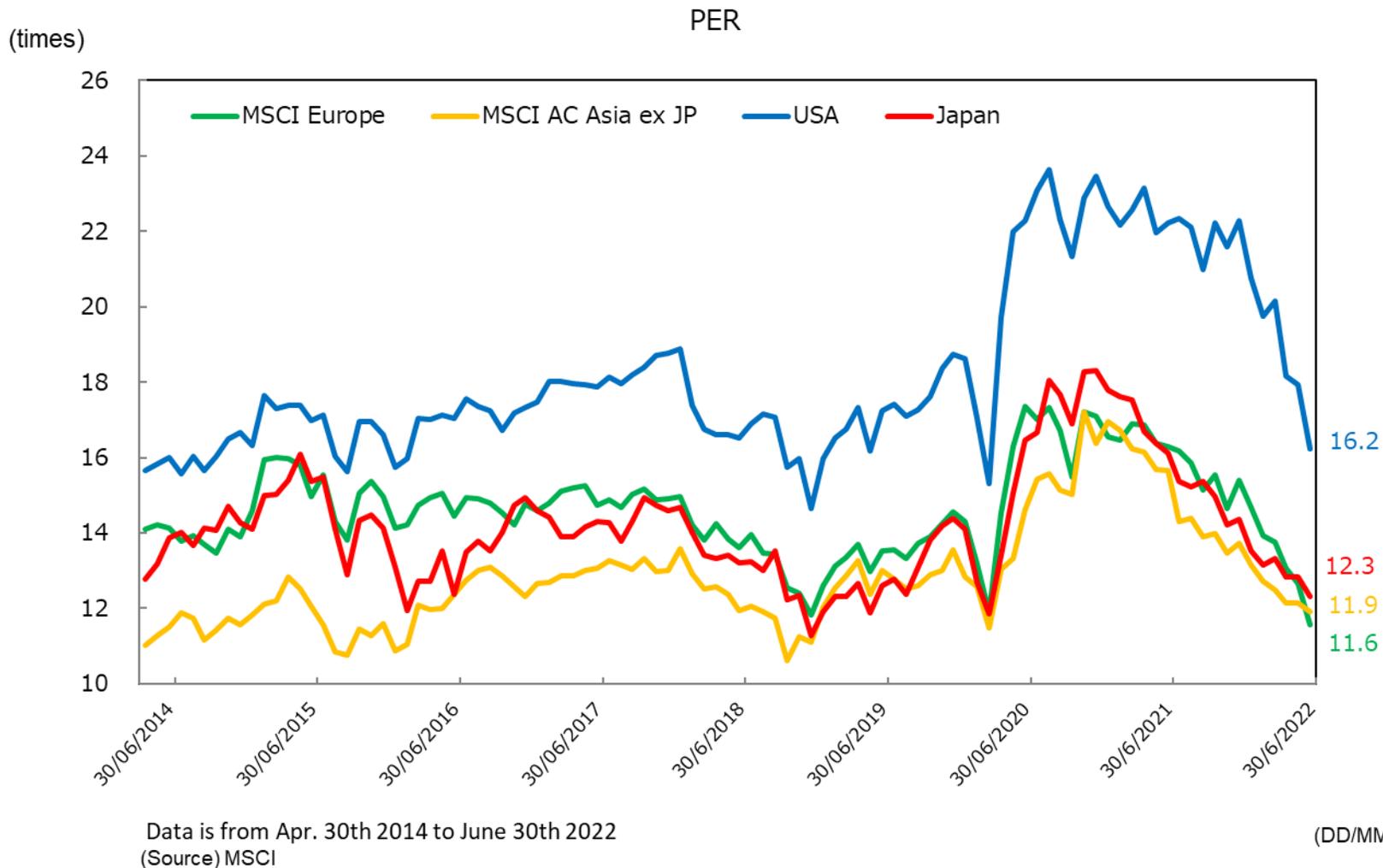
■ Upside Risks

- Recovery of inbound travel from China
- Declining volatility in oil, metal and other commodity markets
- Positive impact from “Doubling Asset-Based Income Plan” by the cabinet

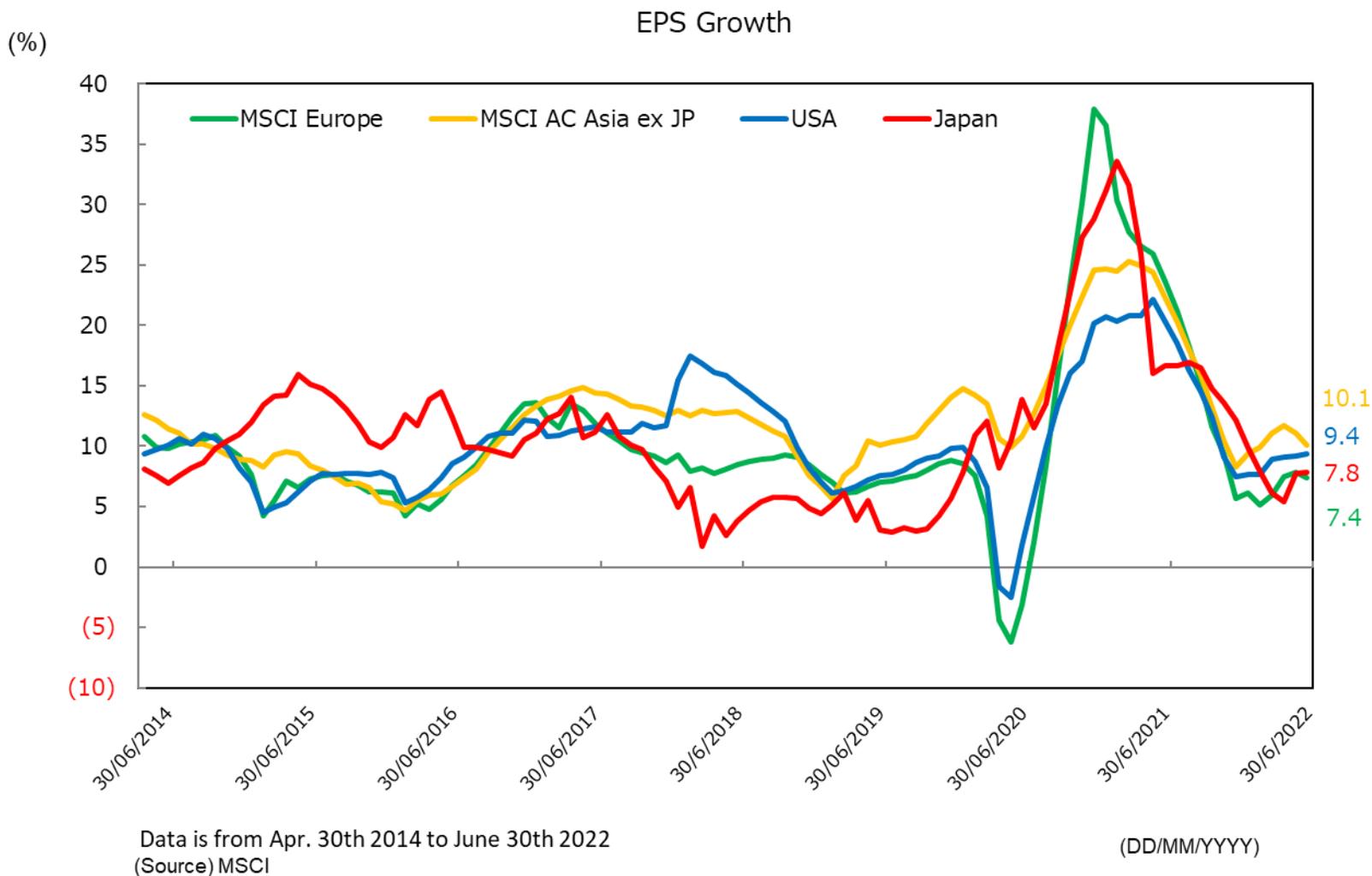
■ Downside Risks

- Concern over fiscal austerity
- Concern over stagflation

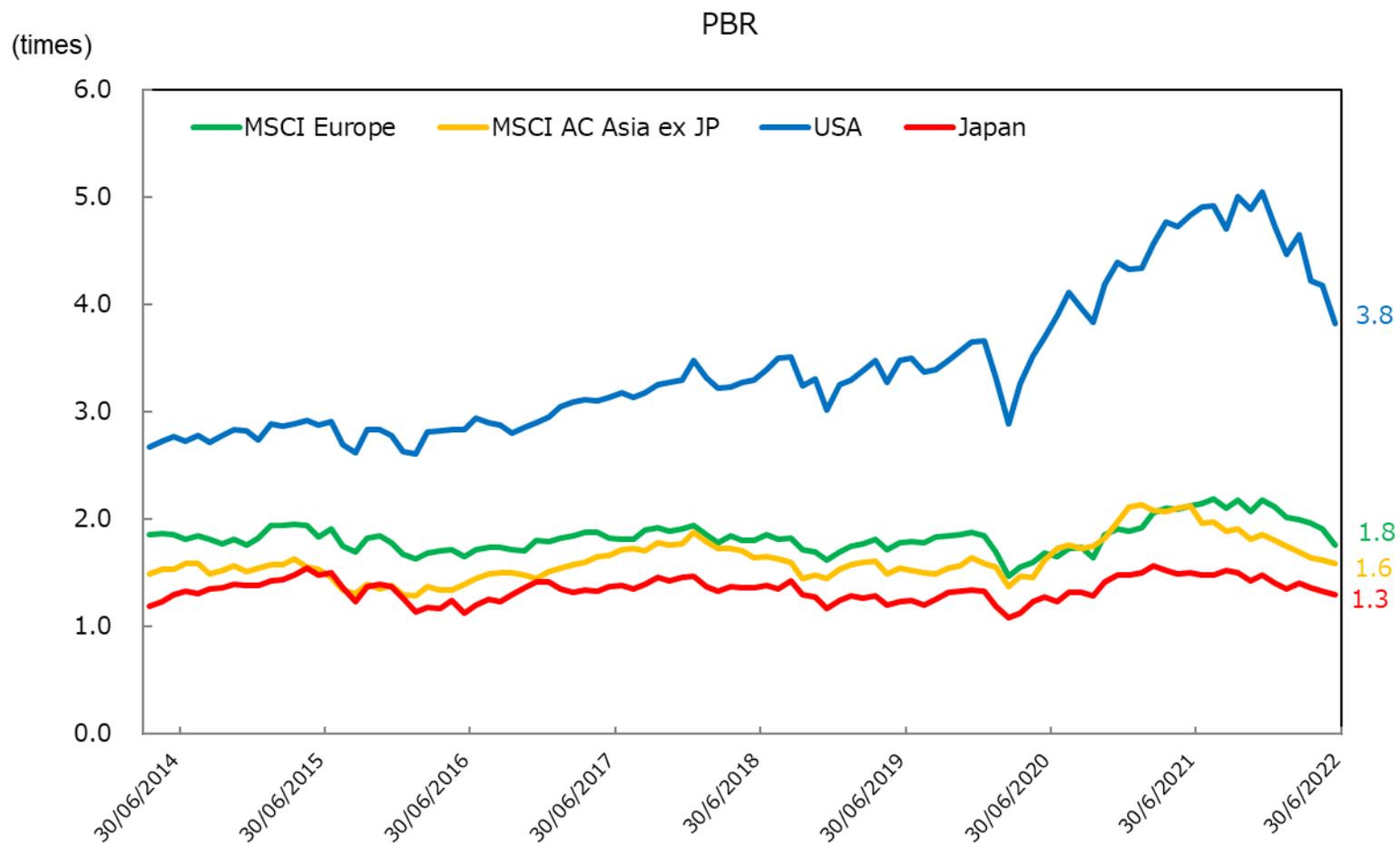
Concern for global economy pushes PERs sharply lower



Earnings outlook remains stable despite concern over the economy



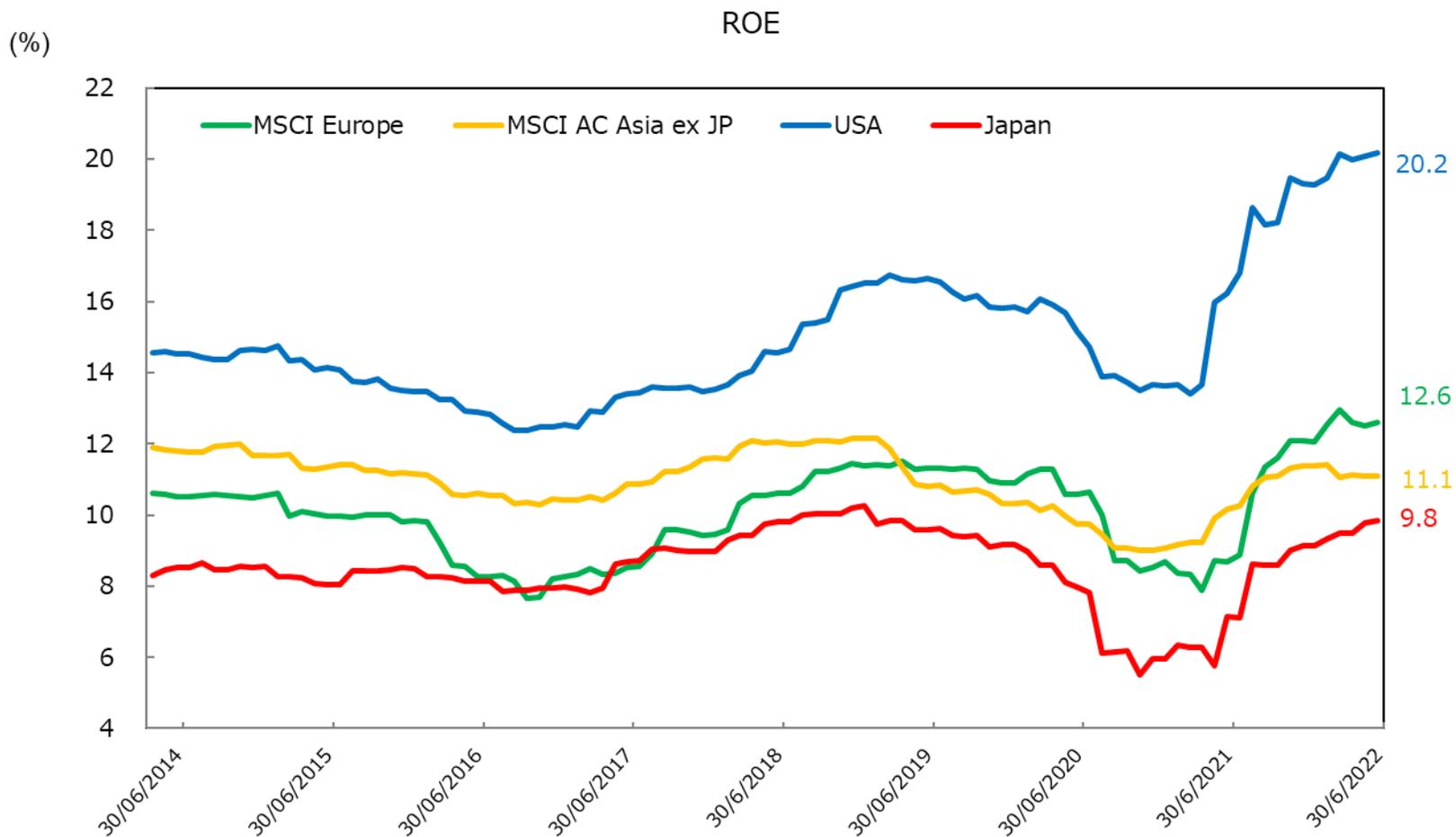
Consolidating PBR gaps between US and global peers



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

(DD/MM/YYYY)

Japan's ROE approaching double digits

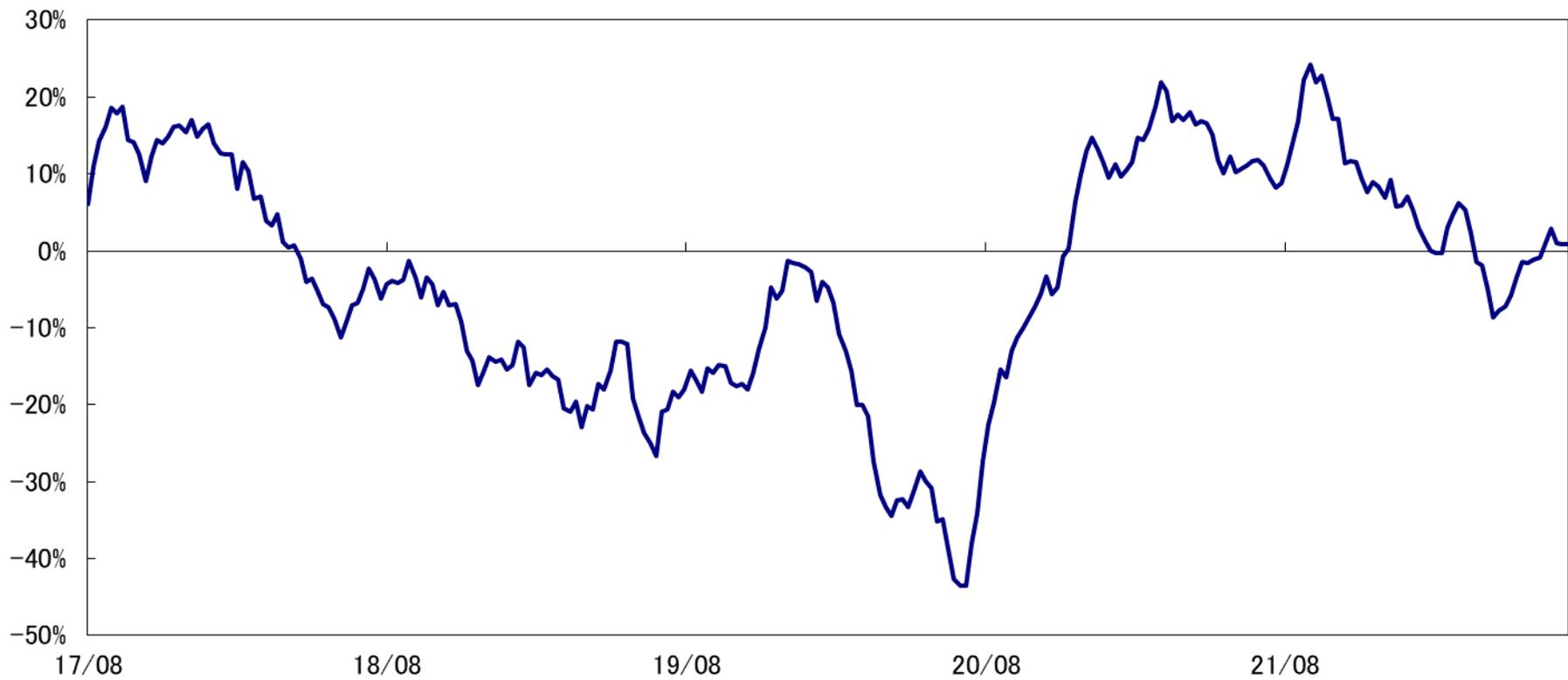


Data is from Apr. 30th 2014 to June 30th 2022
 (Source) MSCI

(DD/MM/YYYY)

Earnings revision remains positive in difficult environment

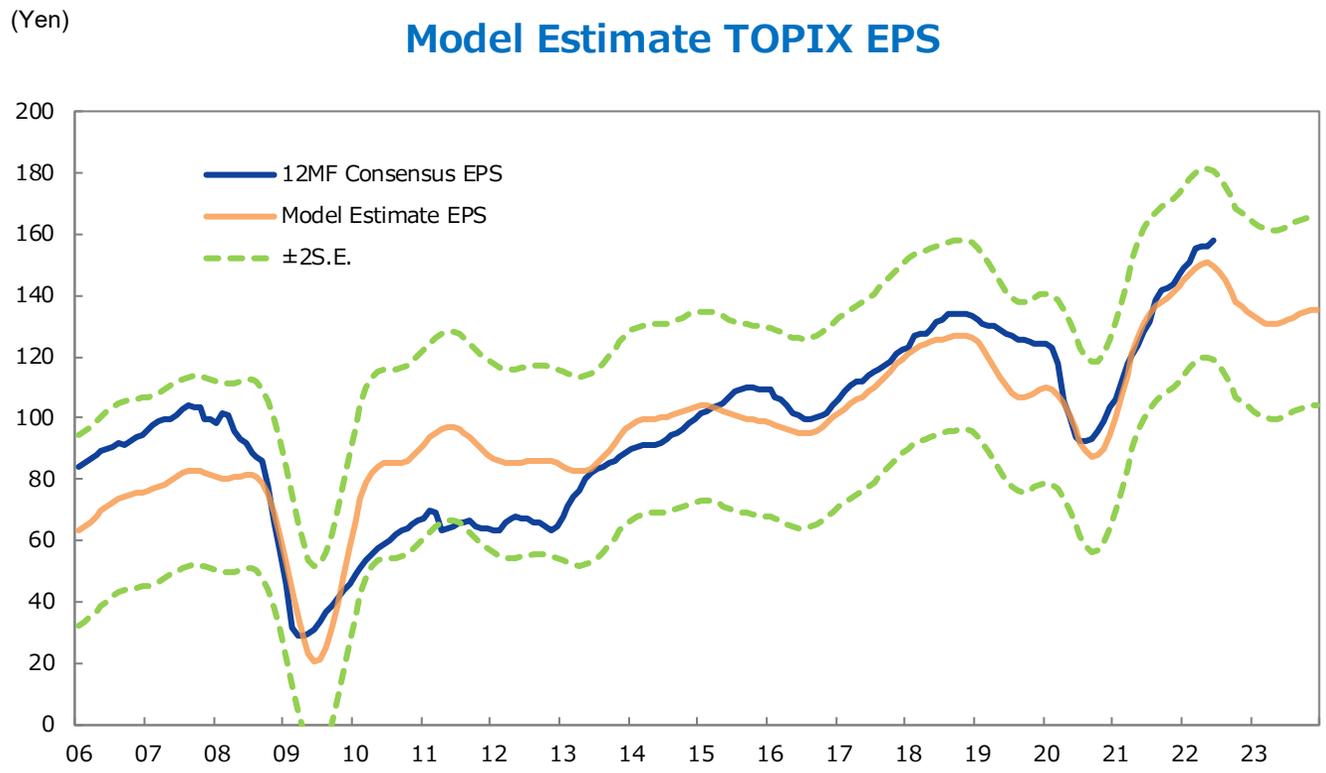
TOPIX Revision Index



Data is from Aug. 1st 2017 to July 12th 2022
(Source) Datastream, IBES

(YY/MM)

Consensus EPS forecast stronger than macro model estimate

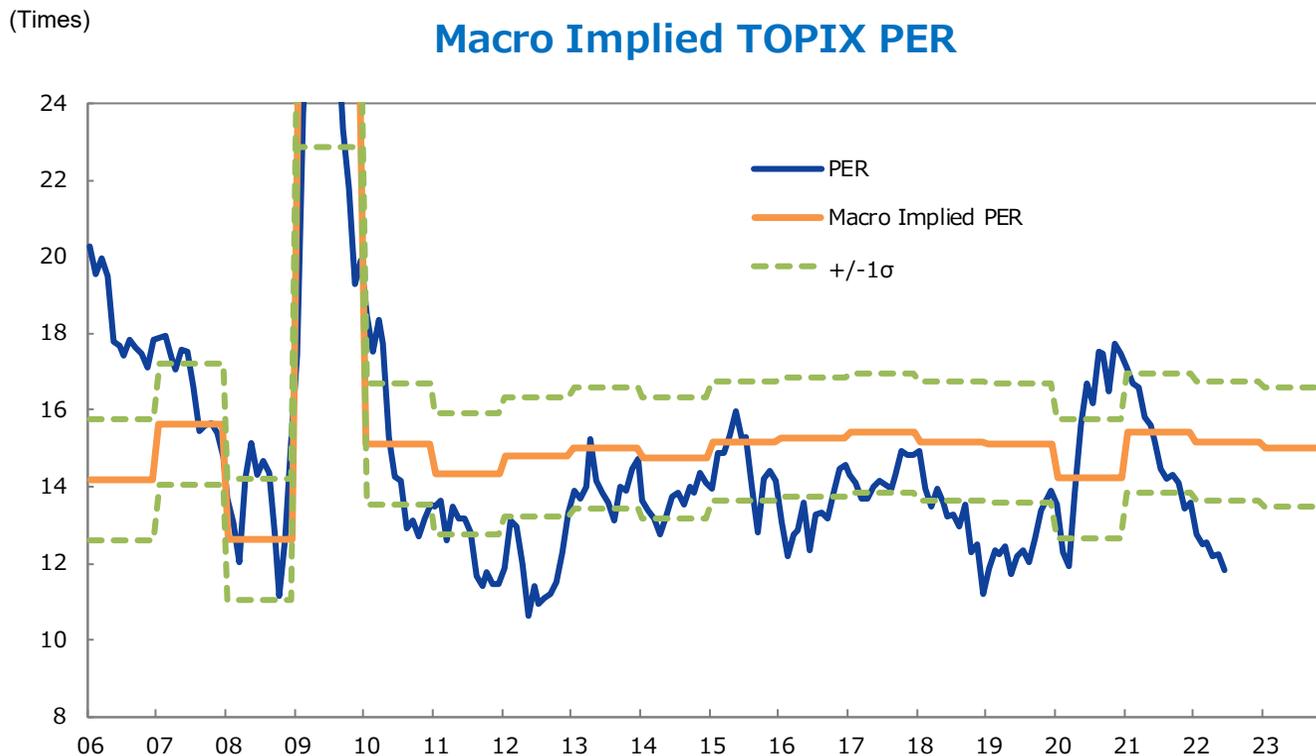


Consensus data is from Jan. 2006 to June 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

PER sank far below the bottom of the normal range

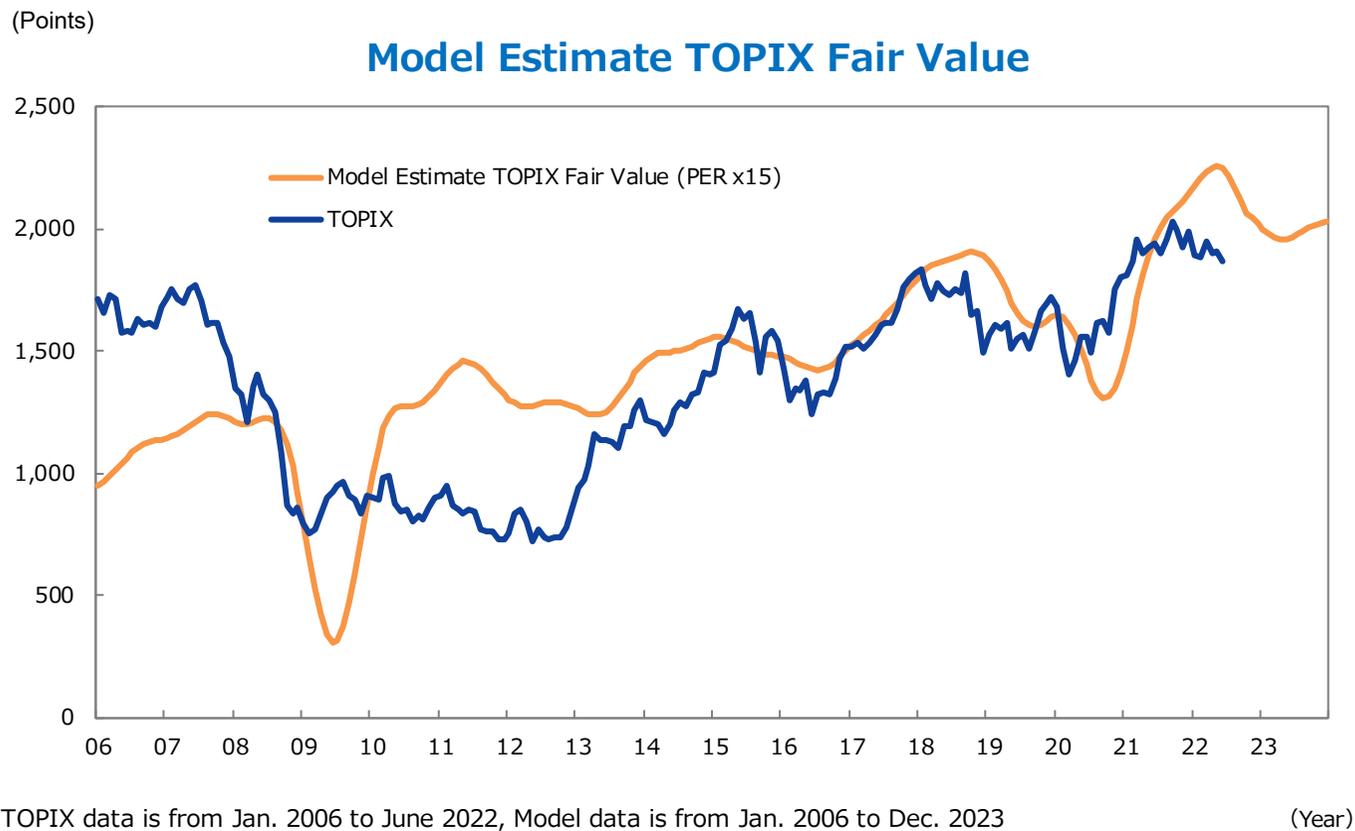


Consensus data is from Jan. 2006 to June 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

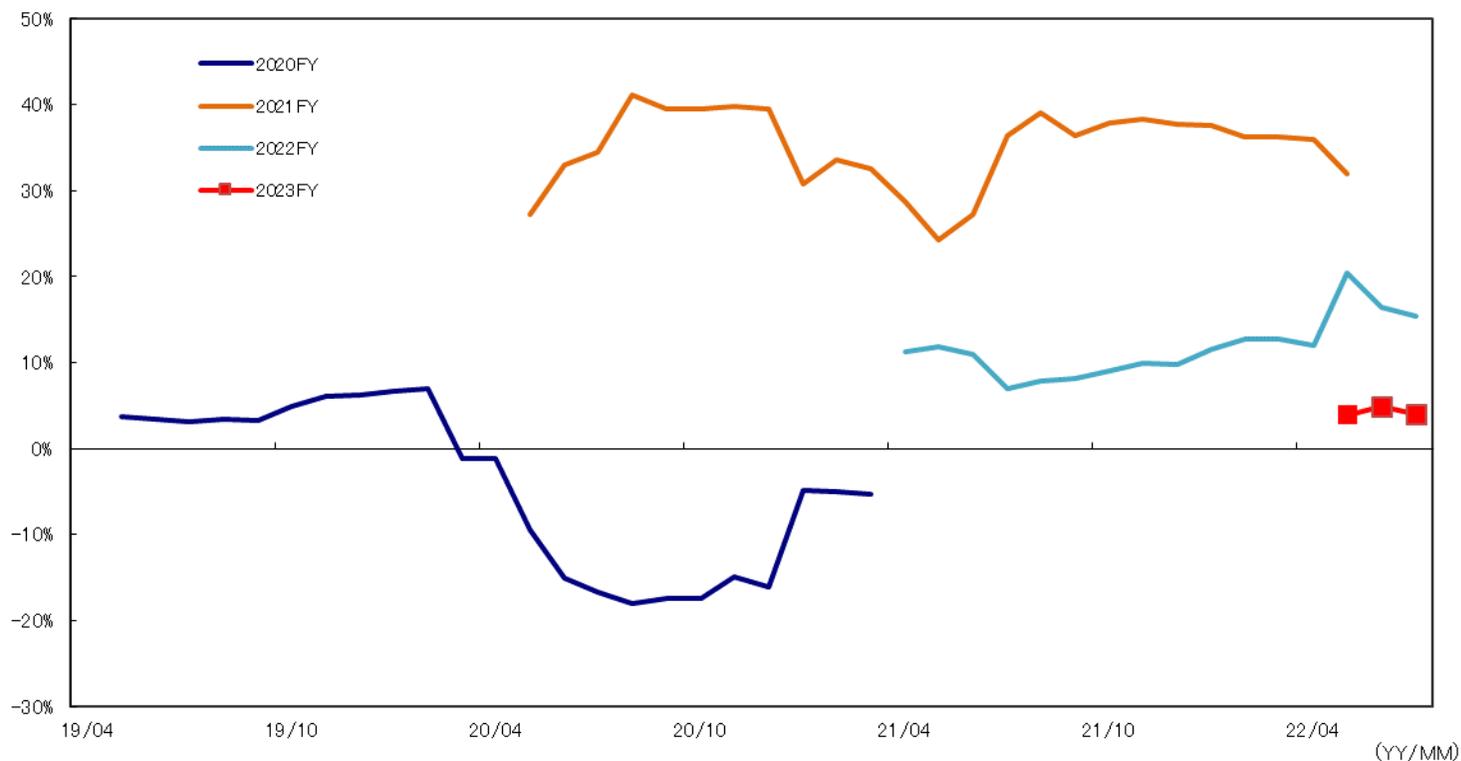
(Source) SMDAM

Market slides ahead of fair value peak



Earnings growth slowing due to gloomy business environment

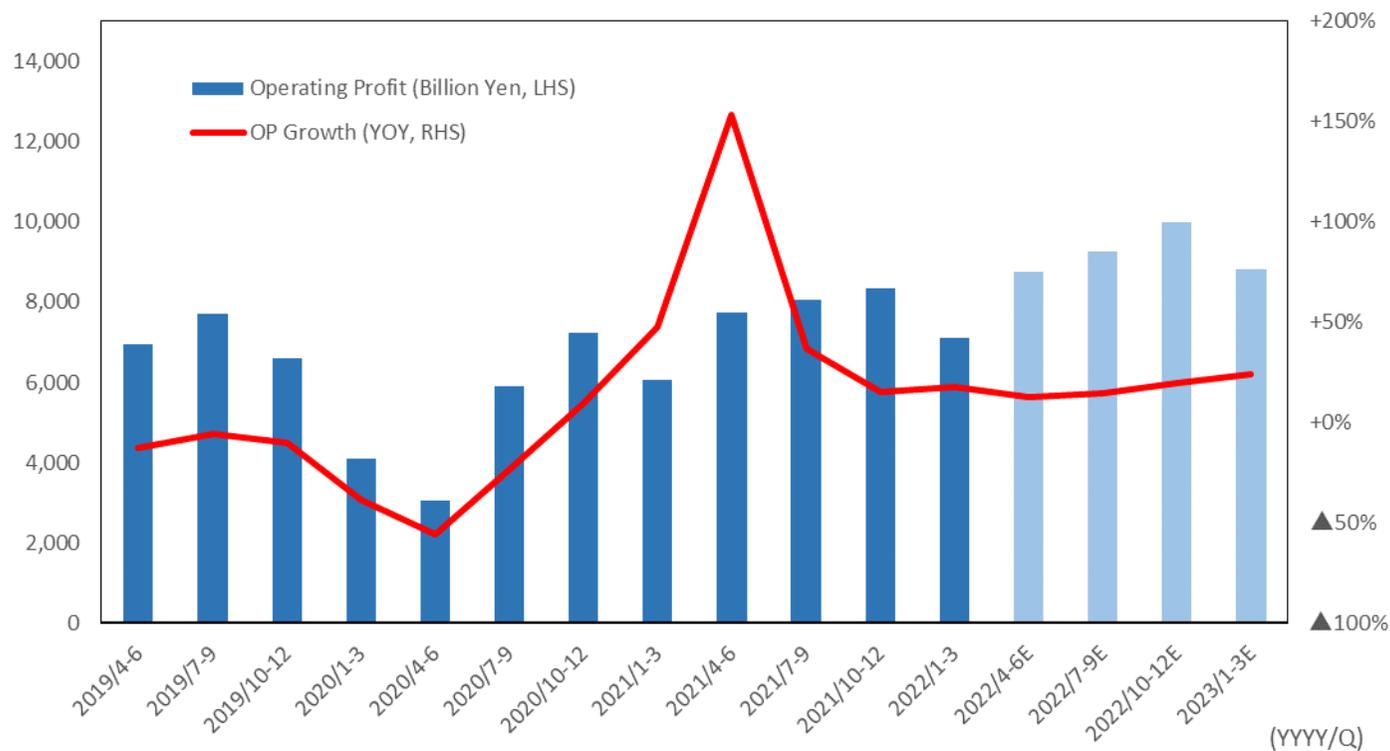
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of July 13th 2022, SMDAM Core Universe (Excl. Financials) consists of 407 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 Q1 2022, estimate data is from Q2 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	205
Insurance companies	24
Pension funds	77
Others	11
Total	323

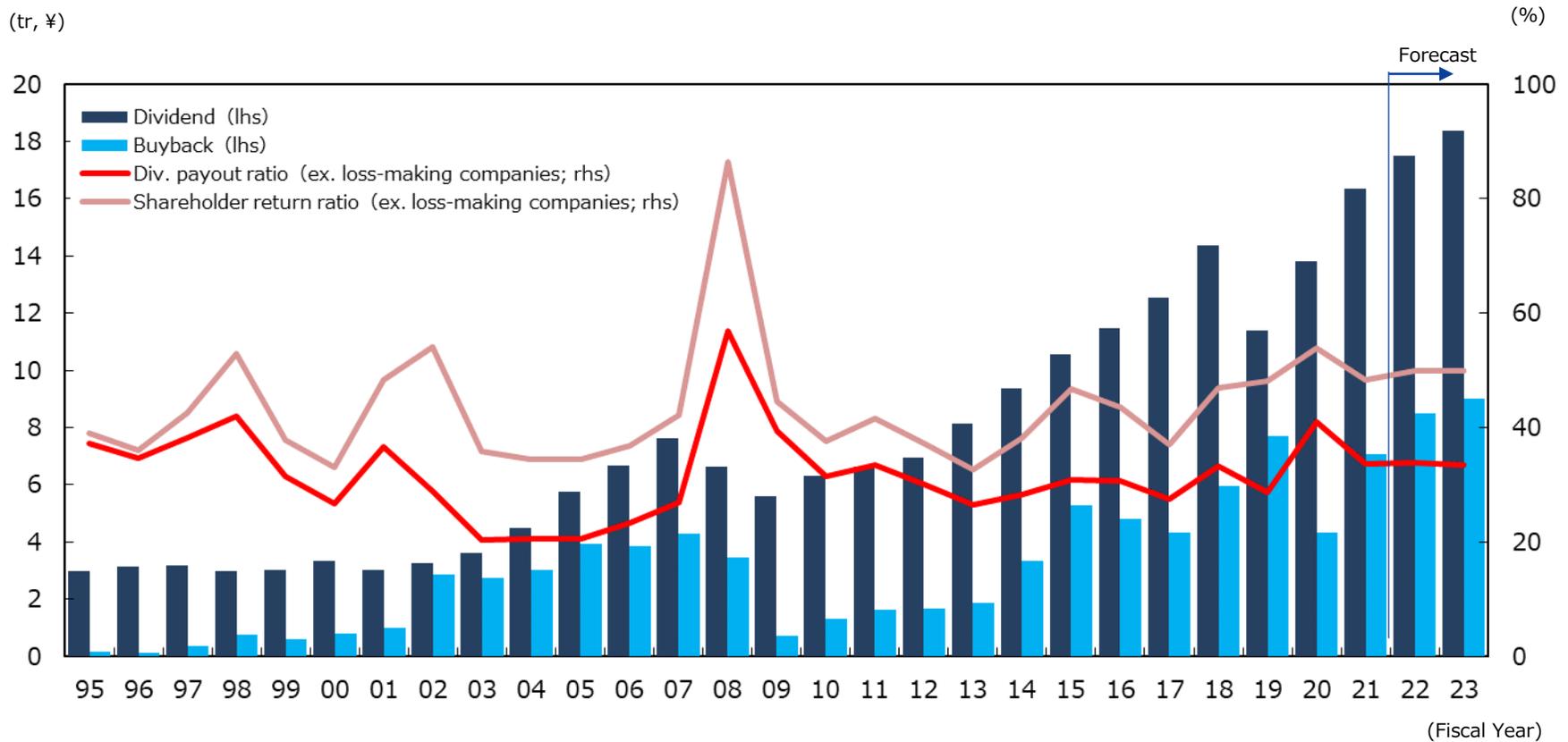
note: As of June 30th 2022

(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.

Dividends and buybacks increasing beyond historical highs

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



Note: Data is from FY1995 to FY2023, FY2022 and FY2023 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Mid-small cap starts outperforming large cap

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	1.13	1.13	-2.52	2.18	22.85	25.22	20.42
Total Value	1.41	4.31	6.25	9.21	34.42	21.28	12.98
Top Cap Value	-0.30	3.84	7.61	12.14	42.72	31.19	27.14
Large Cap Value	0.55	4.22	7.18	10.66	37.52	22.89	16.12
Mid Cap Value	1.70	4.74	6.63	8.80	31.40	12.00	1.74
Small Cap Value	5.23	4.68	2.50	2.96	21.22	14.30	-0.36
Micro Cap Value	4.30	3.27	-0.78	2.11	16.23	12.48	-0.72
Total Growth	0.83	-2.10	-10.54	-4.00	11.86	27.37	26.56
Top Cap Growth	-0.26	-3.76	-11.76	-1.94	15.27	32.31	33.54
Large Cap Growth	0.71	-2.51	-10.87	-3.52	12.66	29.70	28.47
Mid Cap Growth	2.53	-0.16	-9.20	-6.11	8.37	25.40	20.68
Small Cap Growth	1.74	1.55	-7.66	-8.68	4.49	9.01	10.25
Micro Cap Growth	2.31	1.42	-10.46	-11.45	3.87	8.73	10.94
Top Cap Total	-0.28	-0.38	-3.73	3.80	26.74	31.24	29.81
Large Cap Total	0.63	0.71	-2.76	2.73	24.06	27.26	23.17
Mid Cap Total	2.08	2.44	-1.24	1.27	20.51	21.82	14.01
Small Cap Total	4.03	3.61	-1.15	-1.48	15.26	13.18	4.91
Micro Cap Total	3.73	2.74	-3.71	-2.21	12.78	12.26	5.03

Note : As of July 21st 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- The economy is recovering thanks to the “re-opening” of the domestic economy from the COVID-19 pandemic despite the negative impact from lock-down in Shanghai and higher inflation. We have confirmed improving business sentiment, high consumer confidence levels and stable CAPEX.
- Inflation is on an upward trend. Although Japan’s core CPI in May was stable YOY, Tokyo’s core CPI in June accelerated from May owing to cost-push inflation that buoyed the prices of foods and consumer durables.

[Outlook]

- ① **We have lowered our real GDP growth forecast for FY 2022 to +1.5% from +2.0% and for FY 2023 to +0.7% from +1.5%.** The main reason for the changes is the downward revision of the US economy. In addition, lockdown in Shanghai also contributed negatively to our economy forecast. We expect the economy in H2 of FY 2022 to be supported by the receding impact of lock-down in China and recovery in CAPEX, while economic growth will slow in FY 2023 owing to sluggishness of the US economy.
- ② **We have lowered our Core CPI forecast for FY 2022 to +2.2% from +2.3% and for FY 2023 to +1.0% from +1.2%.** The main factor for these revisions is the change in our crude oil price estimate. We expect that core CPI will accelerate to the mid-2% range in FY 2022 due to cost-push inflation, whilst inflation could moderate in FY 2023 thanks to a slowdown in economic growth and receding pressure from energy and material costs.
- ③ **We expect PM Kishida to maintain his economic policy to boost the economy.** While the cabinet will prepare for an additional fiscal stimulus, including measures against inflation, in the near future, we should pay attention to the possibility of a policy shift towards mid to long term fiscal consolidation after the ruling LDP’s landslide victory in the upper house election.
- ④ **We expect the Bank of Japan to maintain its accommodative monetary policy, even after the end of Governor Kuroda’s term in April 2023. The BOJ regards salary increases as key to the stability and sustainability of healthy/mild inflation and it’s reasonable to continue easy monetary policy to protect the economy from a possible slowdown of the US economy going forward.**

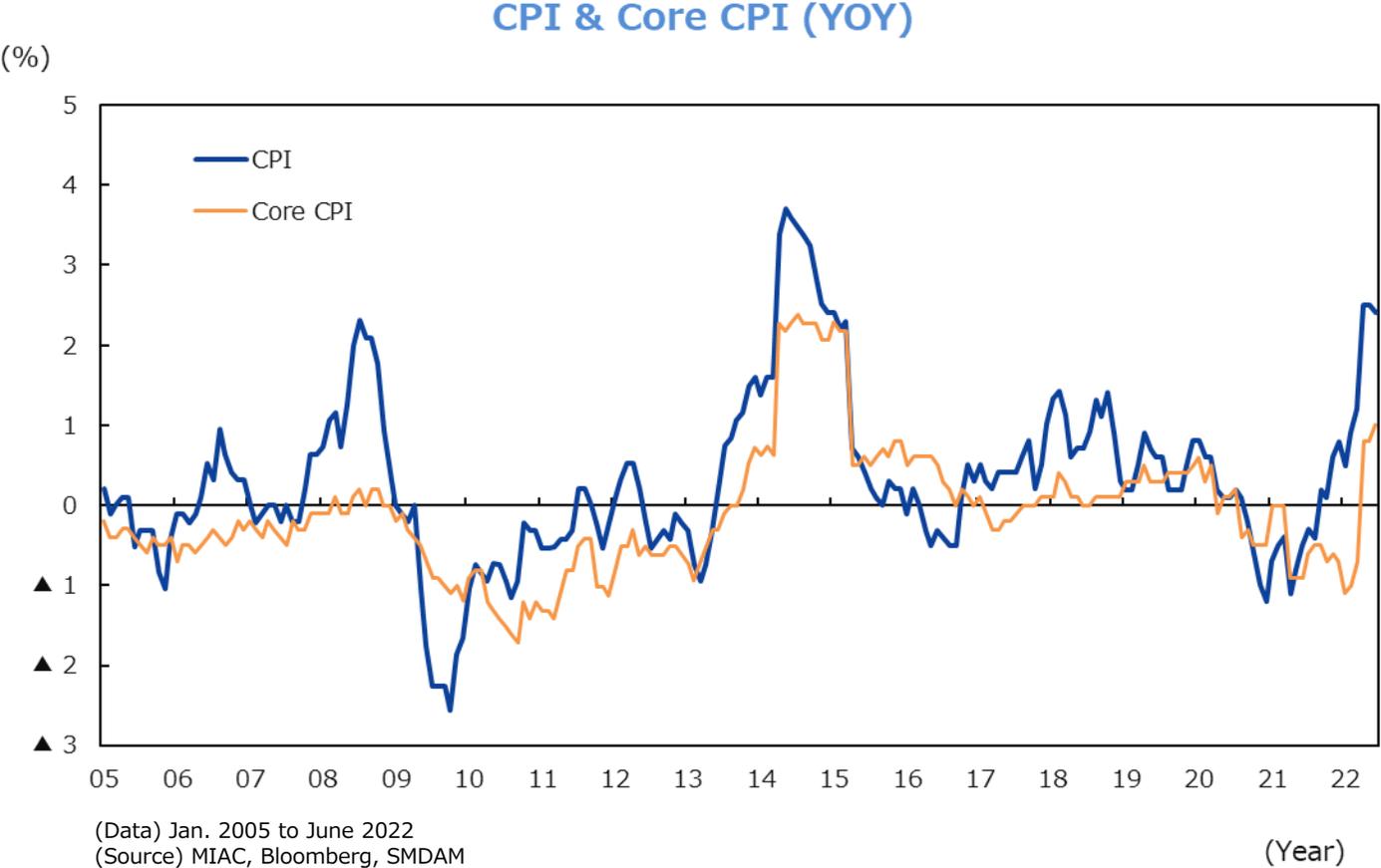
Forecast table for the Japanese economy

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%	2.2%	1.5%	0.7%
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.6%	2.4%	0.9%
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.6%	-2.1%	-0.6%
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	0.8%	1.6%	1.1%
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-9.4%	-3.2%	0.5%
Net export contribution	0.4%	-0.2%	-0.5%	-0.6%	0.8%	-0.5%	-0.1%
Exports of goods and services	6.3%	2.0%	-2.3%	-10.2%	12.5%	-0.4%	-0.4%
Imports of goods and services	3.8%	3.0%	0.2%	-6.5%	7.2%	2.0%	0.3%
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.2%	1.7%	1.2%
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.0%	0.2%	0.5%
Industrial Production Index	2.9%	0.3%	-3.7%	-10.0%	5.9%	-1.3%	1.0%
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	2.2%	1.0%
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.5%	7.0%	6.7%	0.4%
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	2.1%	1.2%
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%
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.

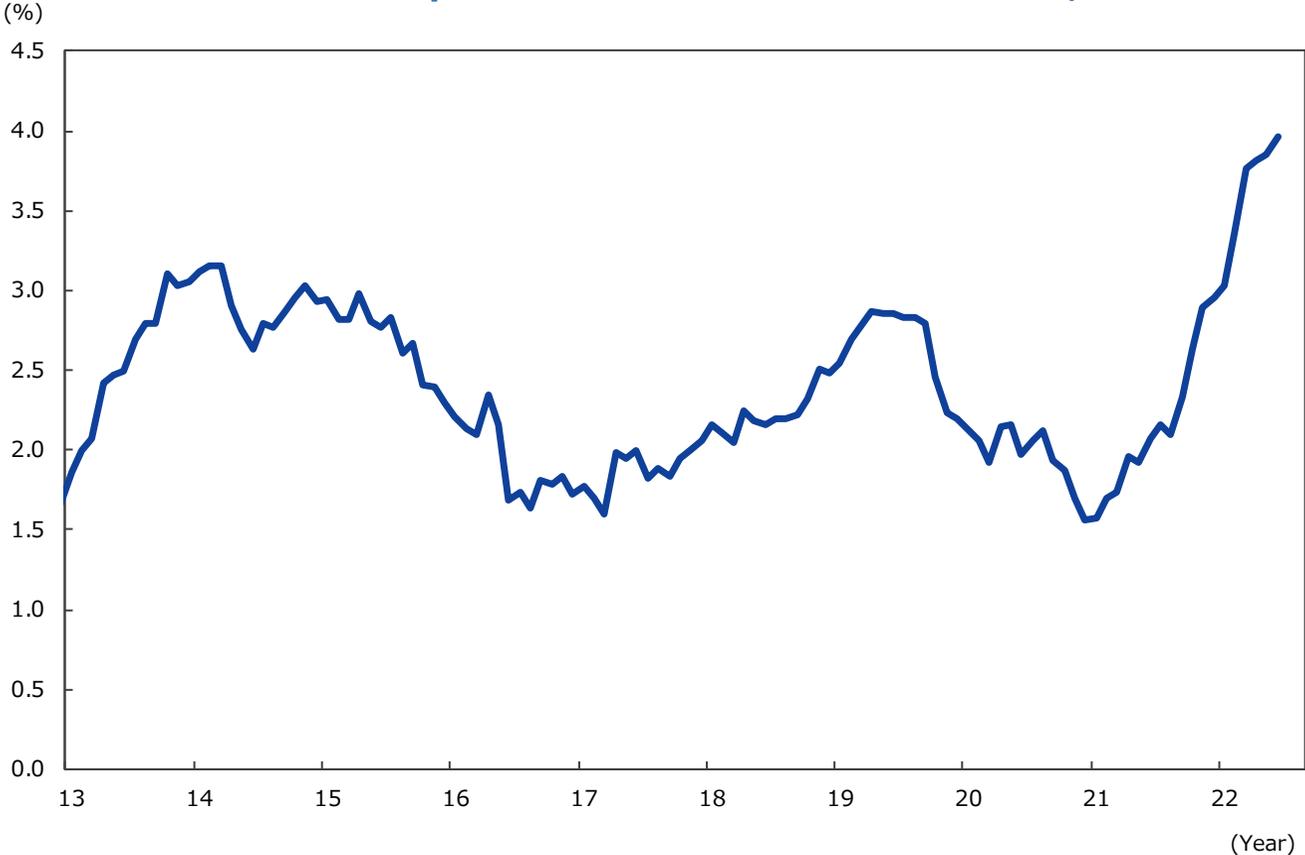
(Source) Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Inflation has finally come back to Japan



Consumers expect acceleration of inflation ahead

Consumers' Expectation of Inflation Rate (YOY, %)



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

BOJ's yield curve control brings real interest rate lower

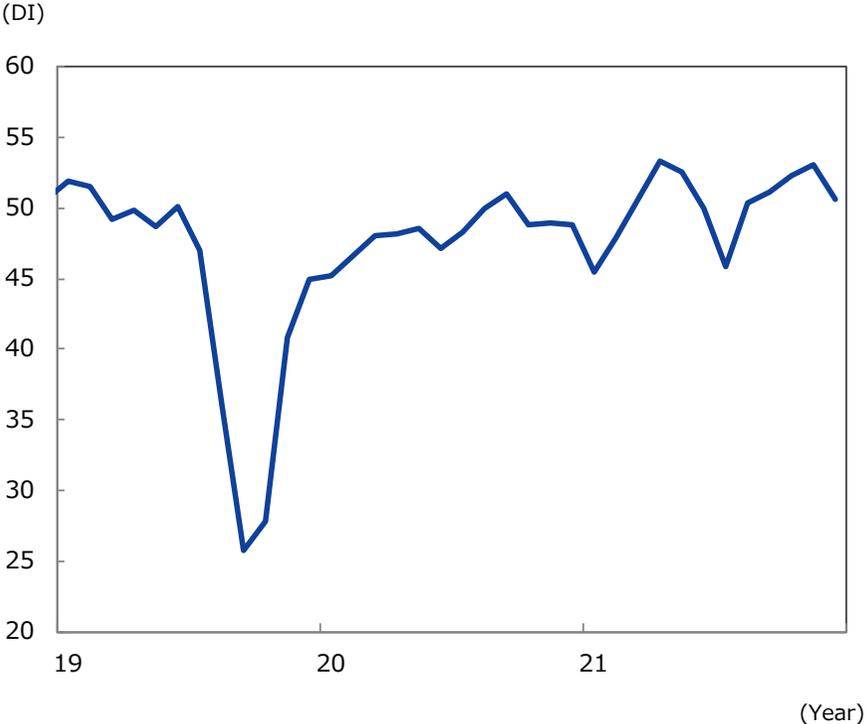
JGB, BEI, and Real Interest rate



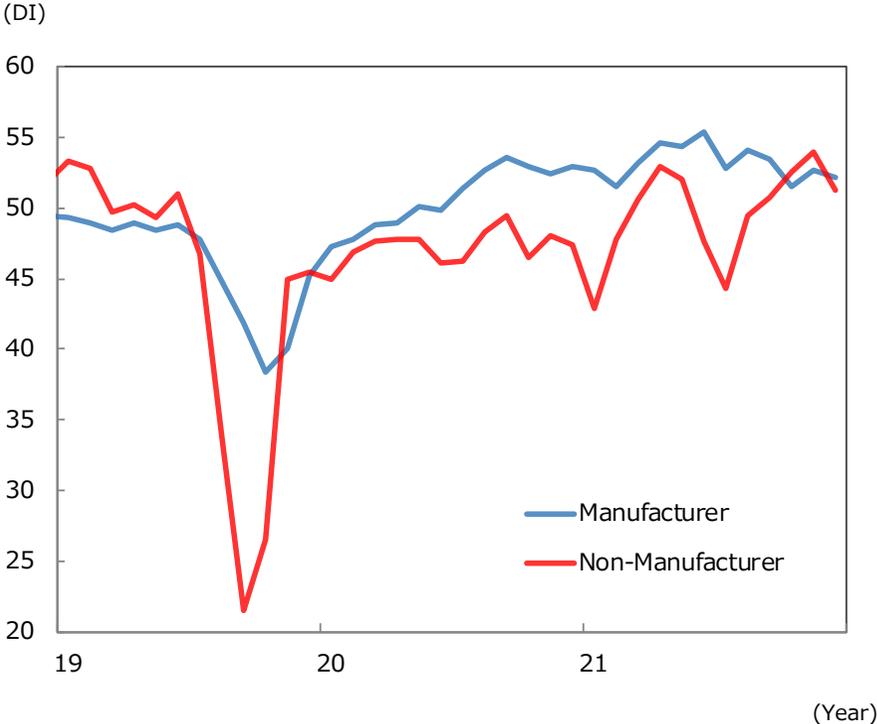
(Data) From Jan. 1st 2014 to July 19th 2022
(Source) Bloomberg, SMDAM

Concern for inflation and recession weigh on business sentiment

Composite PMI



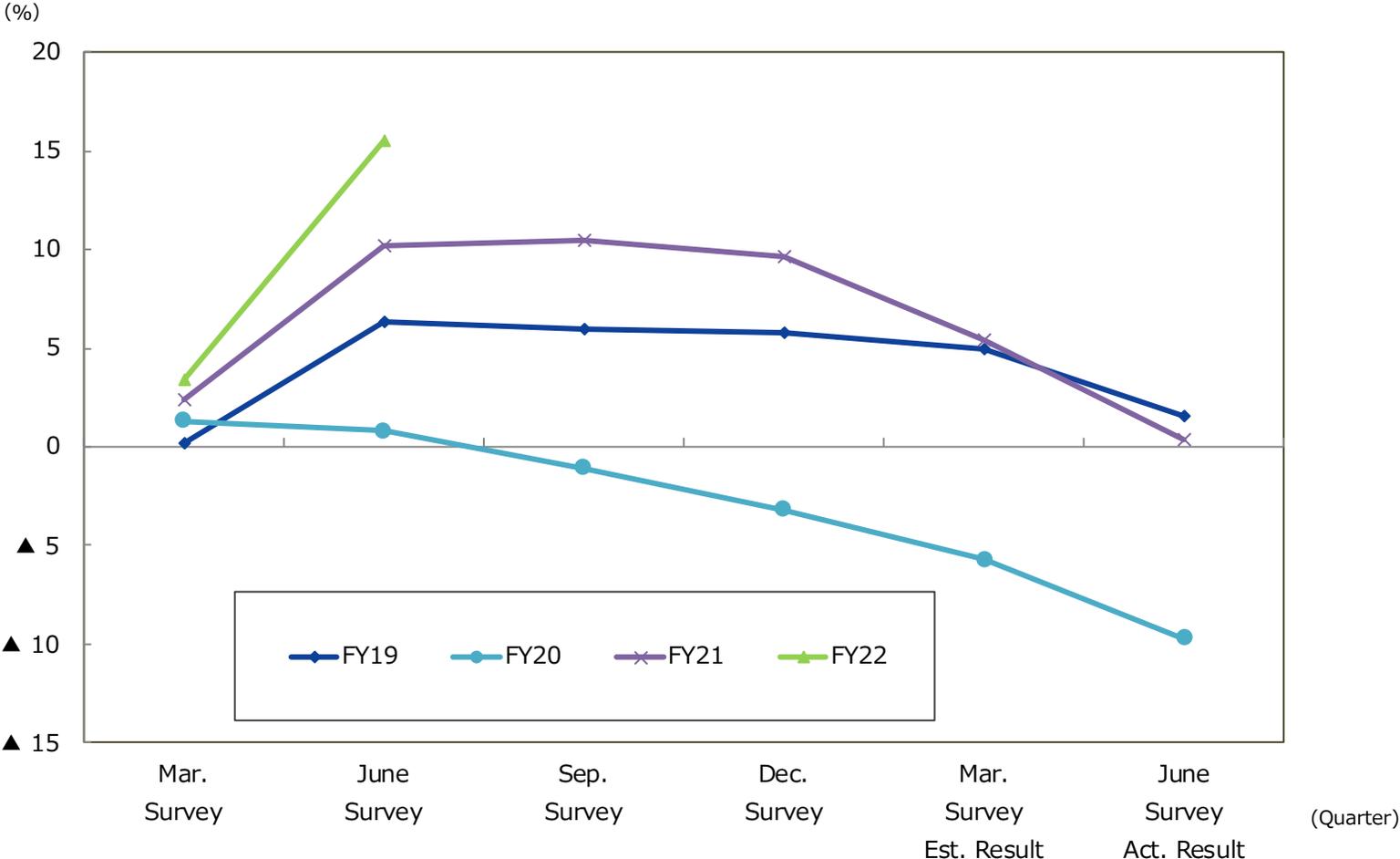
PMI, Manufacturer & Non-Manufacturer



(Data) From Aug. 2019 to July 2022
 (Source) Bloomberg, SMDAM

Re-opening of the economy boosts CAPEX plan

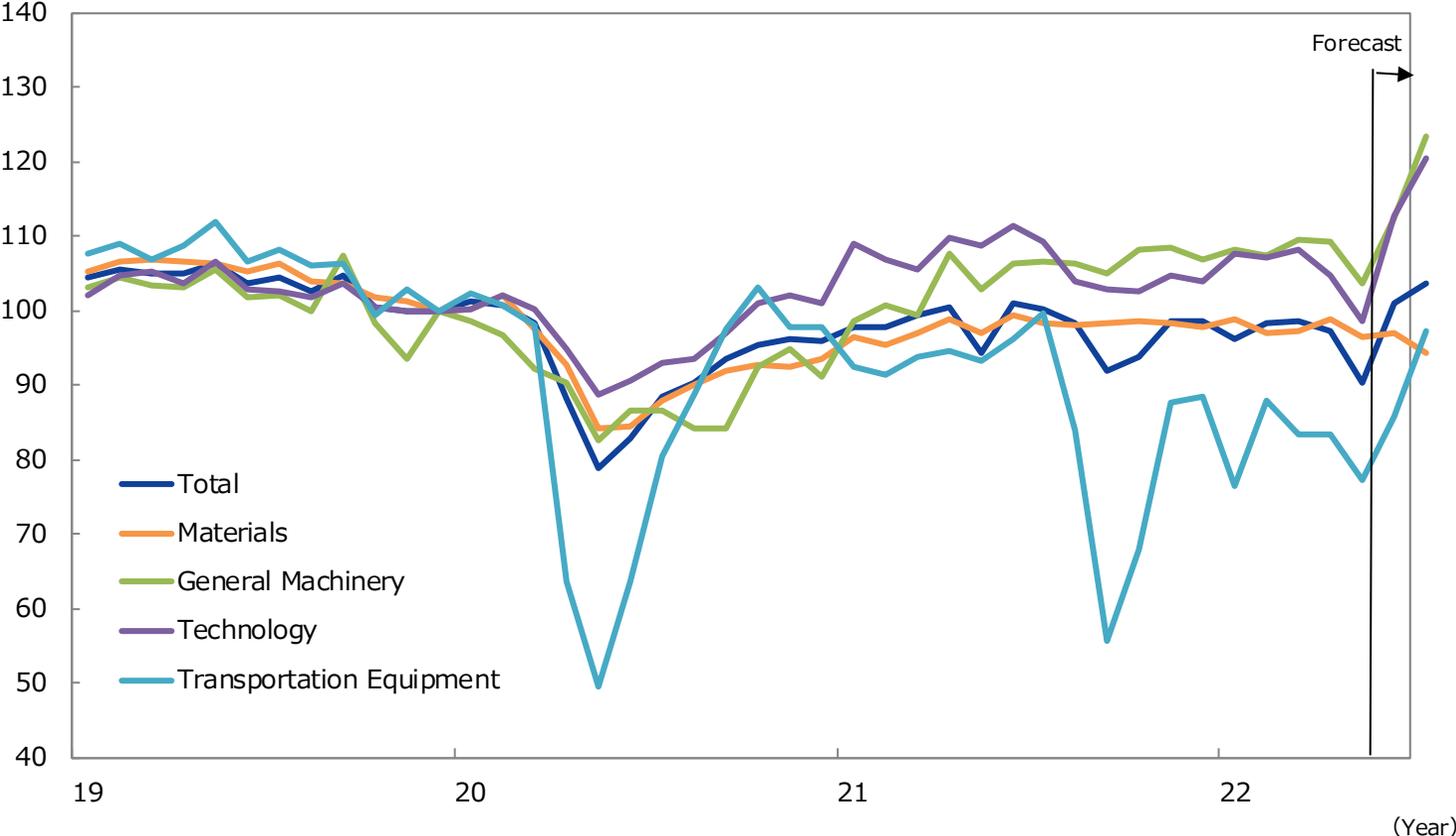
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



(Data) Data is from Q1 FY 2019 to Q2 FY 2022
 (Source) The Bank of Japan, SMDAM

Re-opening of the economy boosts industrial production ahead

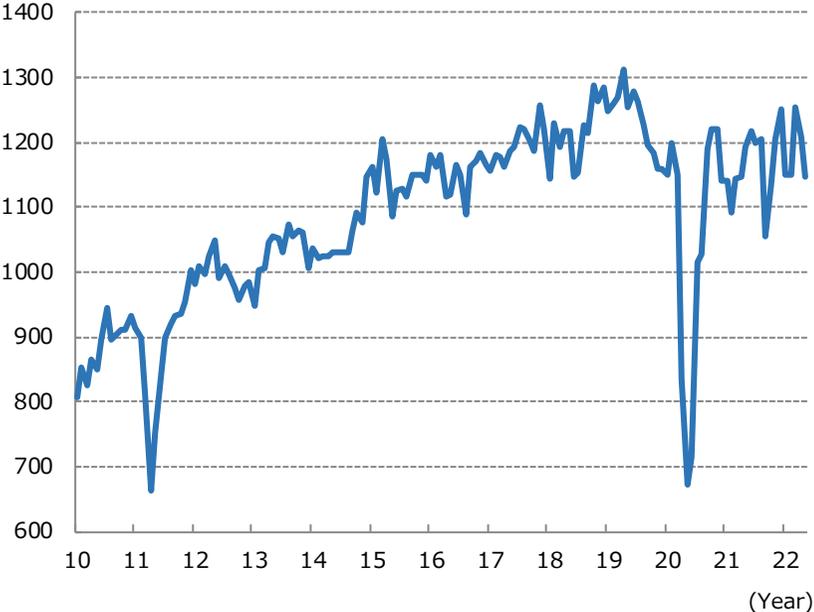
Industrial Production (Dec. 2019=100)



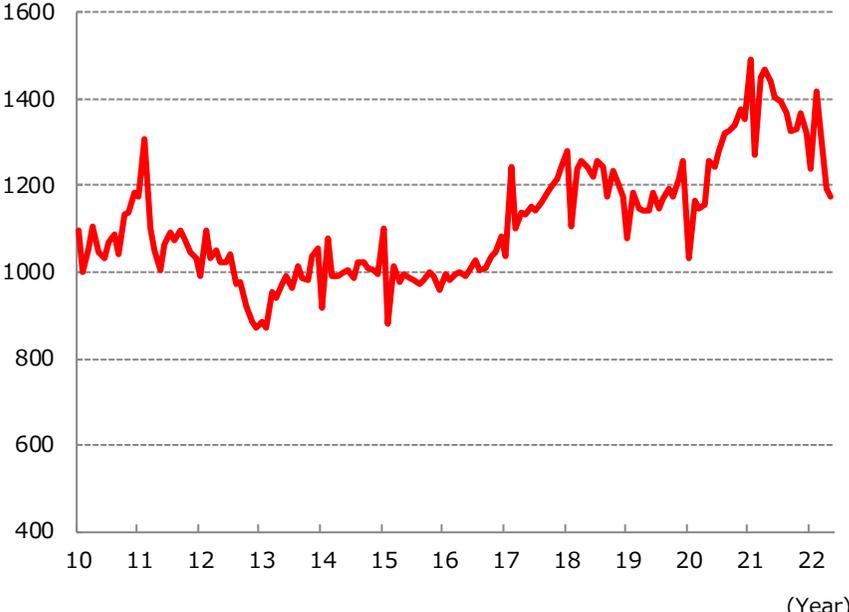
(Data) From Jan. 2019 to July 2022.
(Source) METI, SMDAM

Lockdown in Shanghai drags down Japan's exports to China

Real Export to US (SA, Billion Yen)



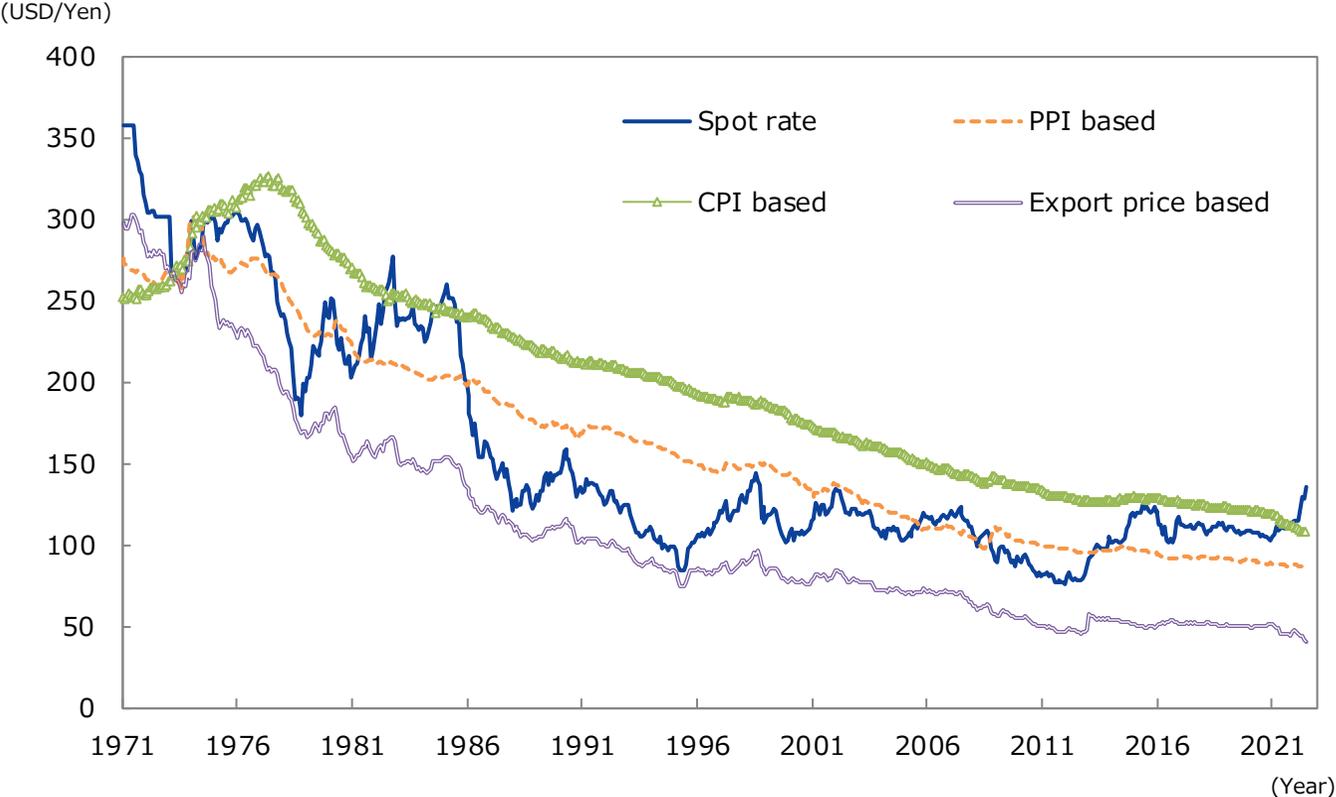
Real Export to China (SA, Billion Yen)



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

USD/JPY exchange rate breaks 30+ years' resistance

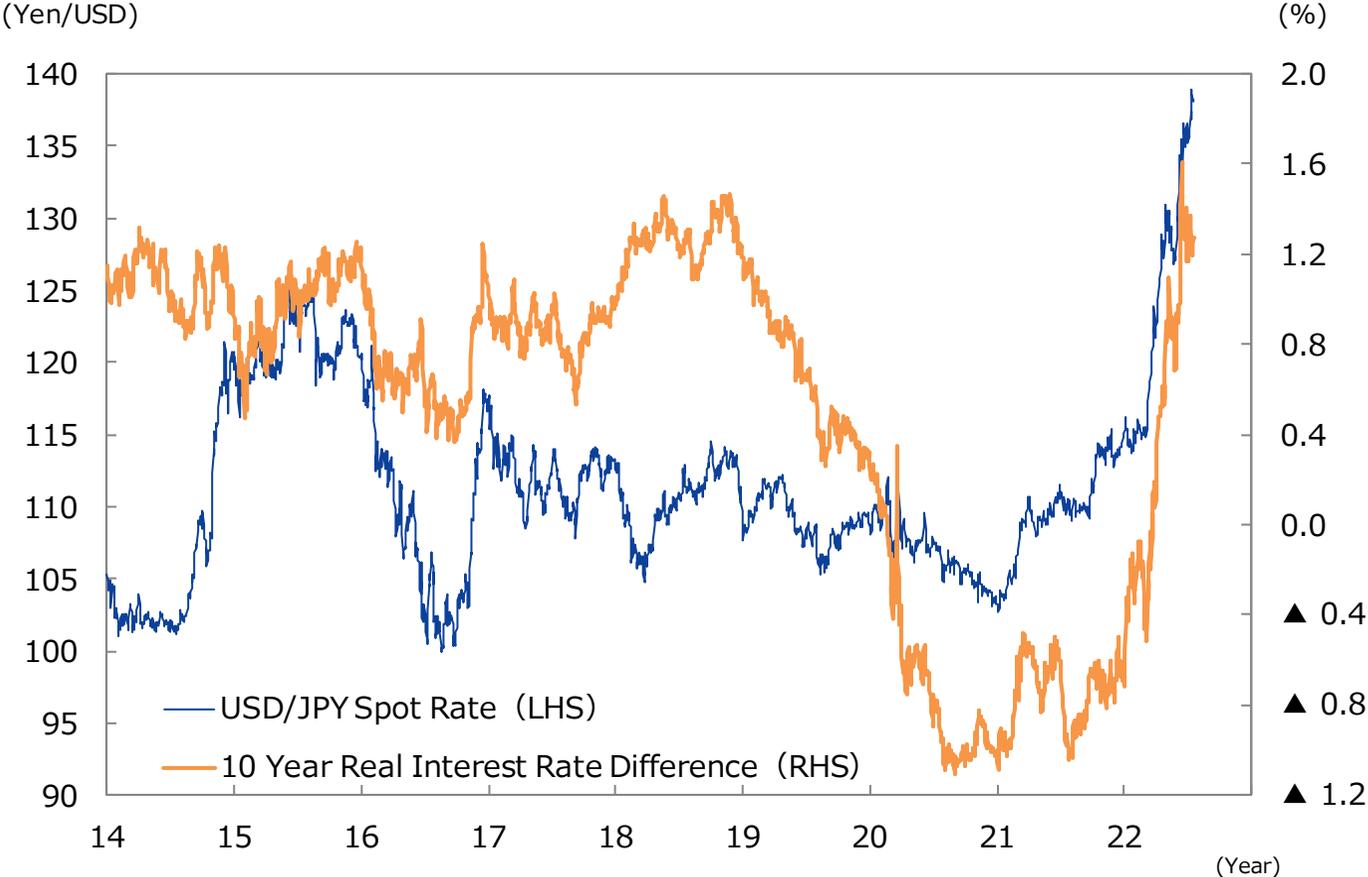
Purchasing Power Parity of USD/JPY Rate



(Data) Data is from Jan. 1971 to June 2022.
(Source) DOL, Bank of Japan, SMDAM

USD/JPY rate continues its rally despite shrinking interest rate gap

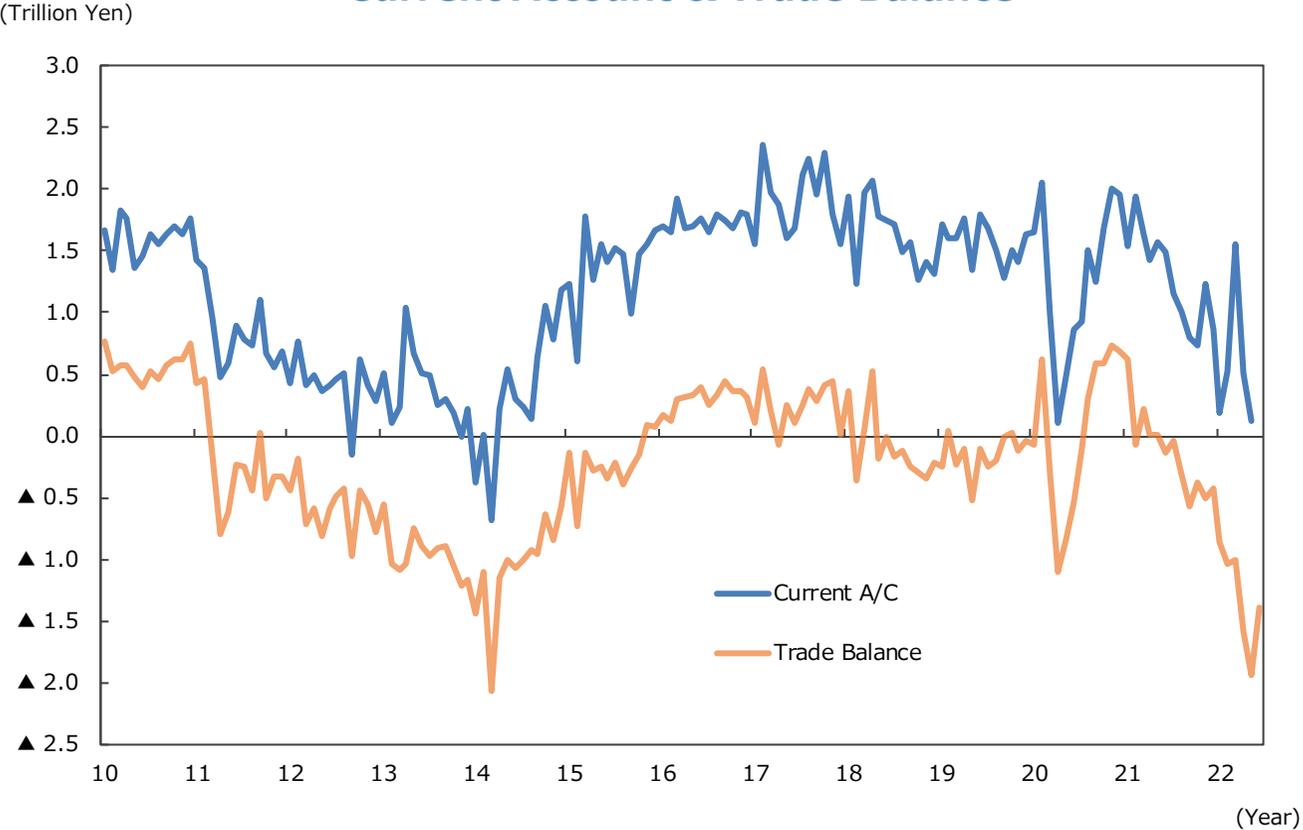
Real Interest Rate Gap & USD/JPY Exchange rate



(Data) From Jan. 1st 2014 to July 19th 2022.
(Source) Bloomberg, SMDAM

Rising energy brought huge trade deficit

Current Account & Trade Balance



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

Japan's marginal exposure to Russian-business

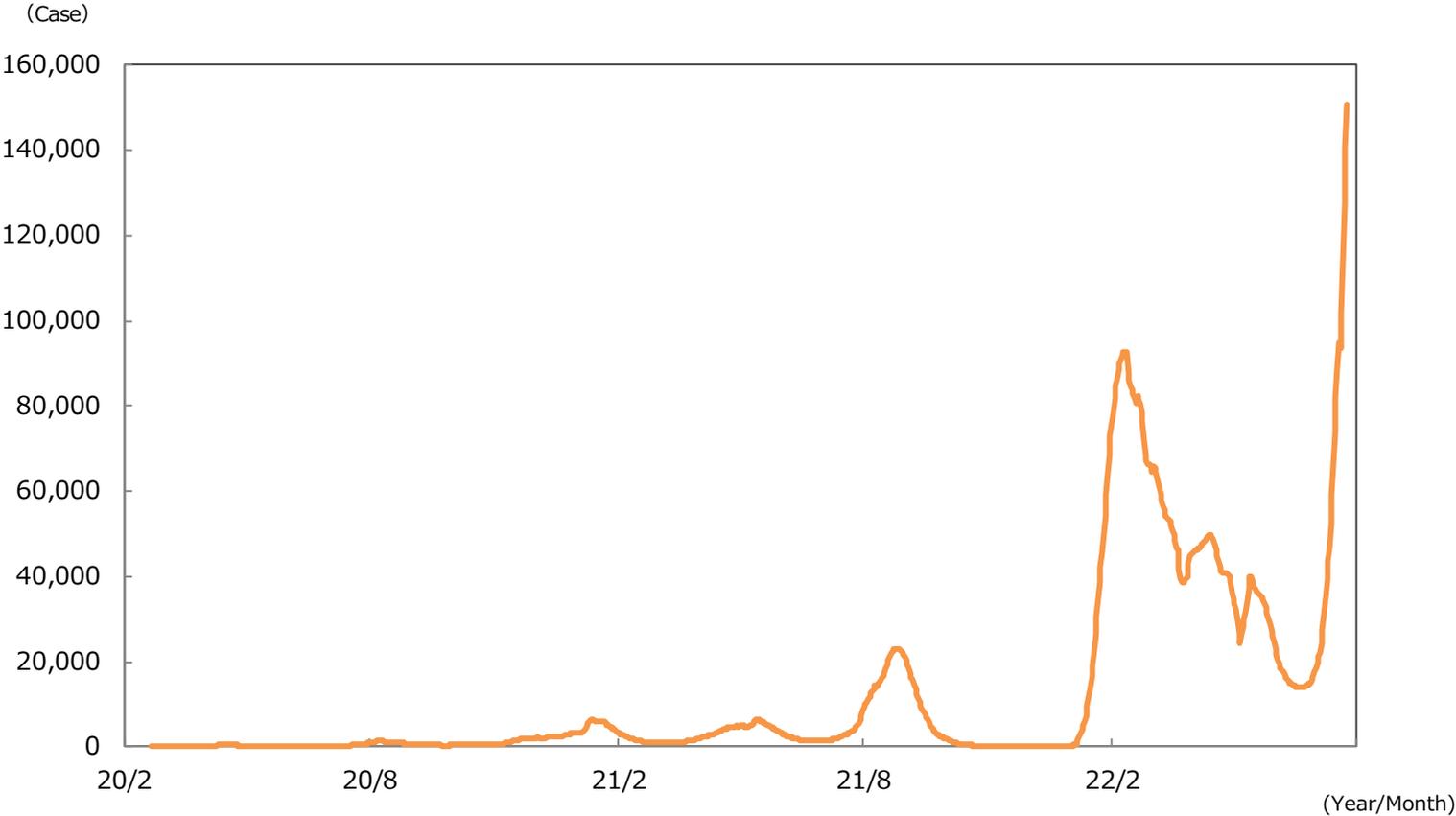
Trade Exposure to Russia (%)

	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

BA.5 variant brings “Seventh Wave” of COVID-19 infections

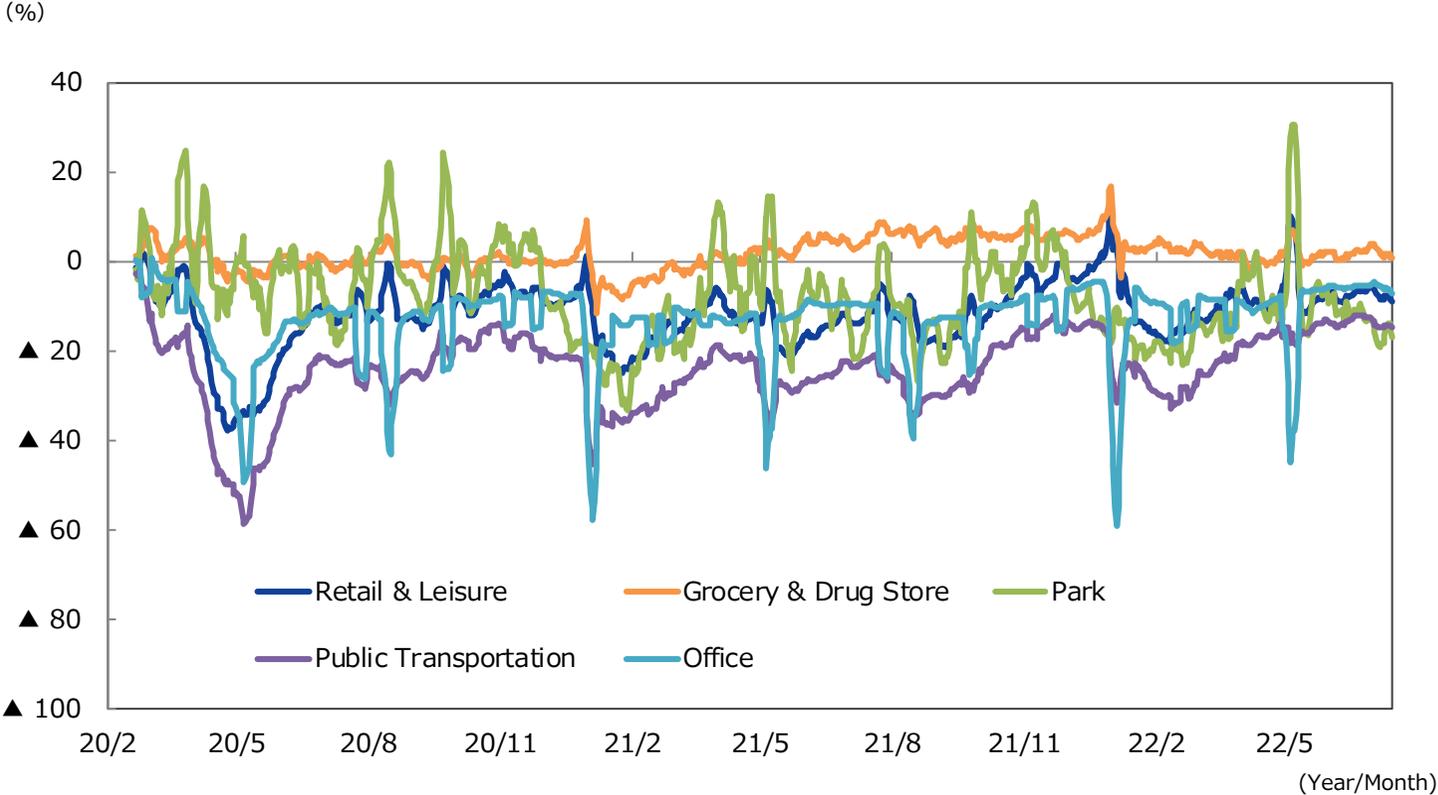
COVID-19 New Cases



(Data) 7 days moving average. From Feb. 21st 2020 to July 24th 2022.
(Source) MHLW, NHK, SMDAM

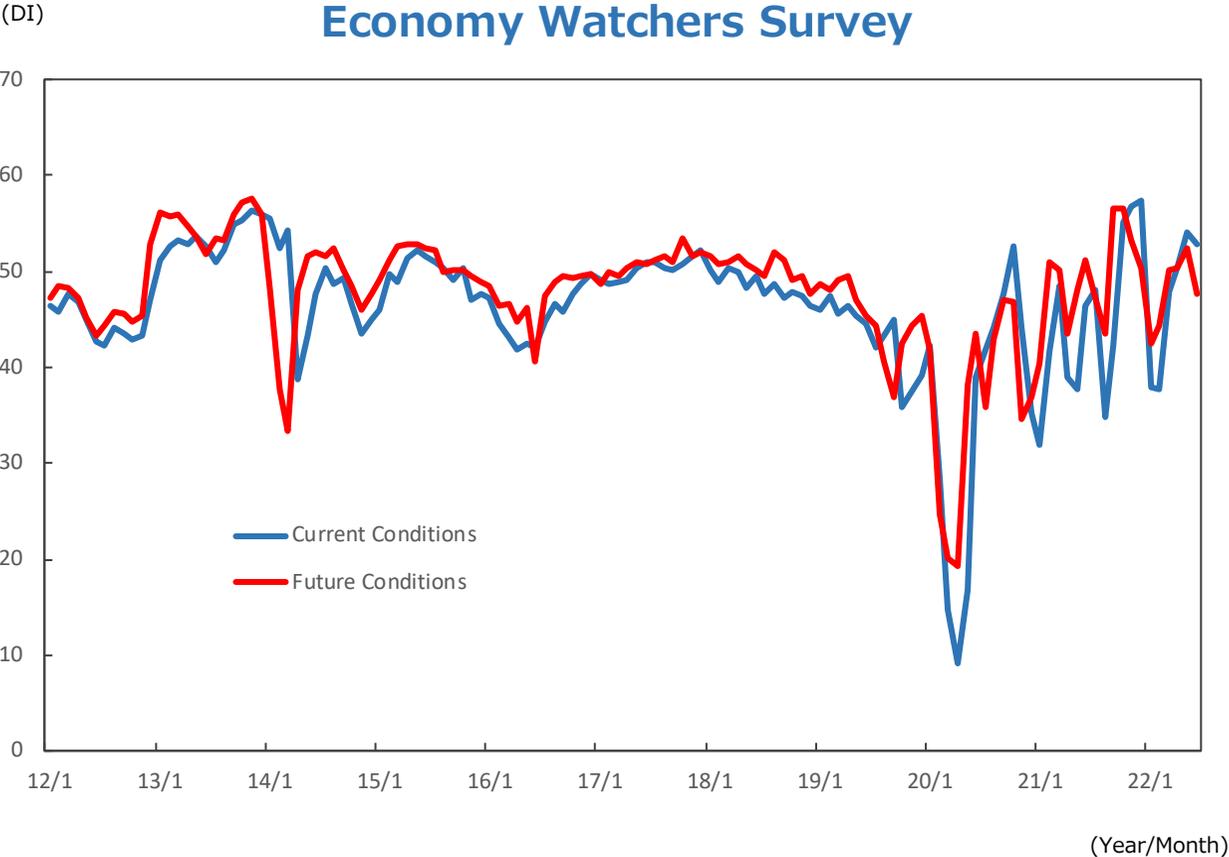
Mobility starts declining owing to surging BA.5 infections

Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21st 2020 to July 15th 2022
(Source) Google, SMDAM

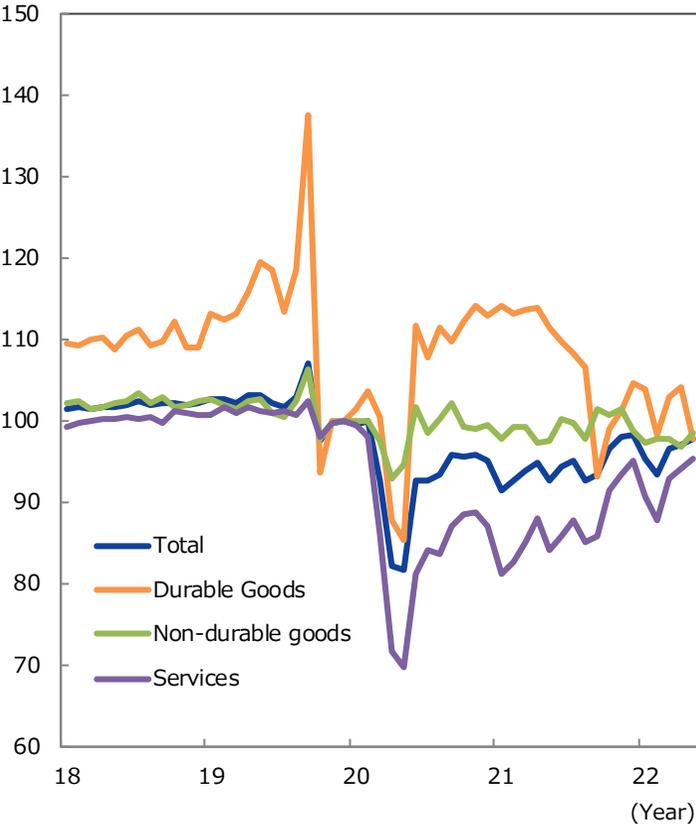
Inflation and COVID-19 weigh on consumer business ahead



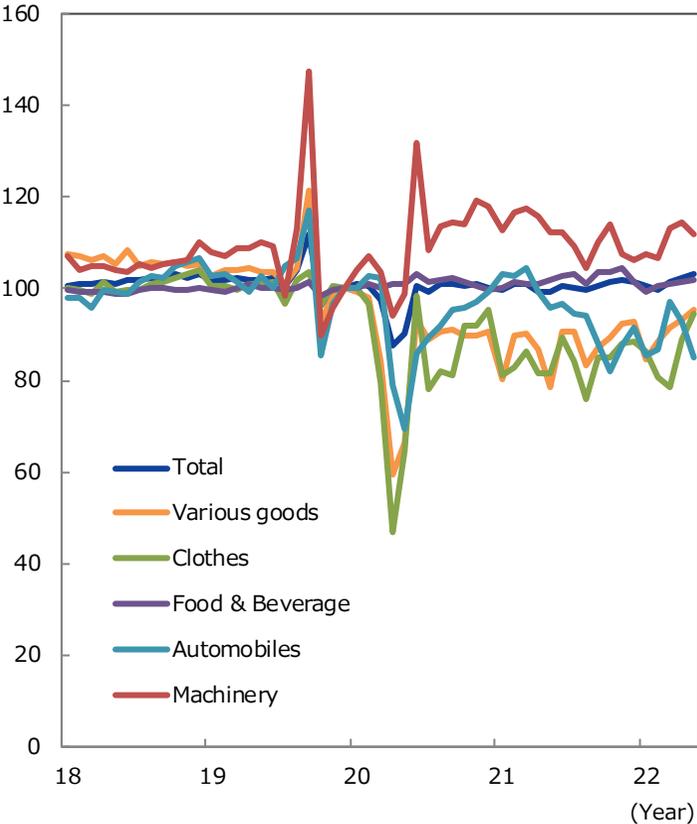
(Data) From Jan. 2012 to June 2022
(Source) Cabinet Office, SMDAM

Service spending recovering, while autos and durables slowing

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



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

Ruling LDP wins big after assassination of former PM Abe

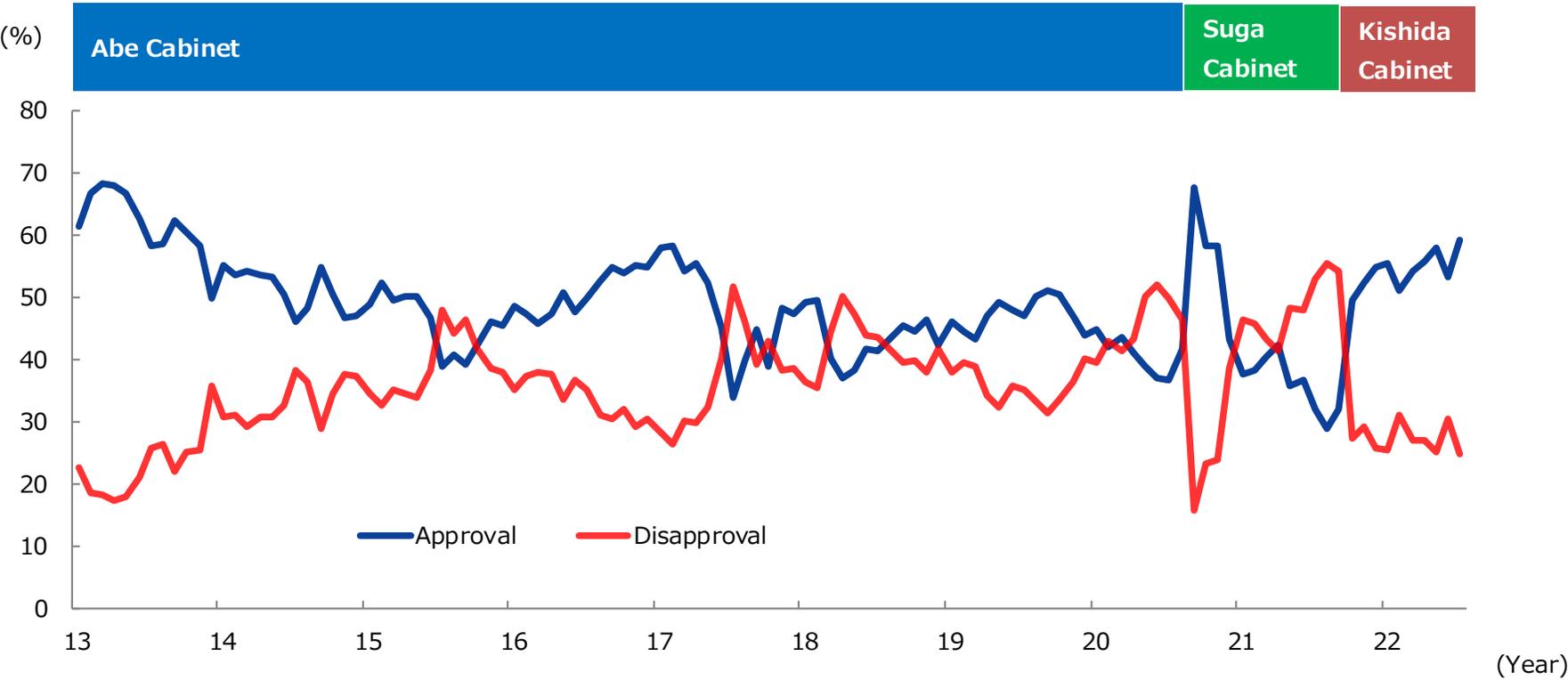
Results of the Upper House election on July 10th

	Reelection		Non-reelection	Total	
	After election	Before election		After election	Before election
LDP	63	55	56	119	111
Komeito	13	14	14	27	28
Restoration Party	12	6	9	21	15
National Democratic Party	5	7	5	10	12
Constitutional Democratic Party	17	23	22	39	45
Communist Party	4	6	7	11	13
Reiwa Shinsengumi	3	0	2	5	2
Social Democratic Party	1	1	0	1	1
NHK Party	1	0	1	2	1
Others	6	8	7	13	15
Ruling Party	76	69	70	146	139
Constitutional amendment	93	82	84	177	166
Total	125		123	248	

(Source) NHK, SMDAM

So far so good: PM Kishida retains high approval rating

Cabinet approval rate



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

Schedule of major events

Schedule of Major Domestic Events			
2022	August	15	Release of CY 2022 Q2 GDP
	September	8 21-22	Revision of CY 2022 Q2 GDP Monetary Policy Meeting Change of Top Party Officials of LDP
	October	27-28 30	Monetary Policy Meeting G20 Summit in Indonesia
	November	15	Release of CY 2022 Q3 GDP
	December	8 19-20	Revision of CY 2022 Q3 GDP Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023
2023	January		Convocation of the ordinary diet
	February	14	Release of CY 2022 Q4 GDP
	March	9 19	Revision of CY 2022 Q4 GDP Term expiration of the BOJ vice governor Amemiya and Wakatabe Enactment of the budget and tax reform bill of FY 2023
	April	8	Term expiration of the BOJ governor Kuroda Nationwide local elections
	May	19-21	G7 Summit in Japan
	June		End of the ordinary Diet session

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

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