



# Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

-April 2022-



# Outlook for Japanese Stock Market

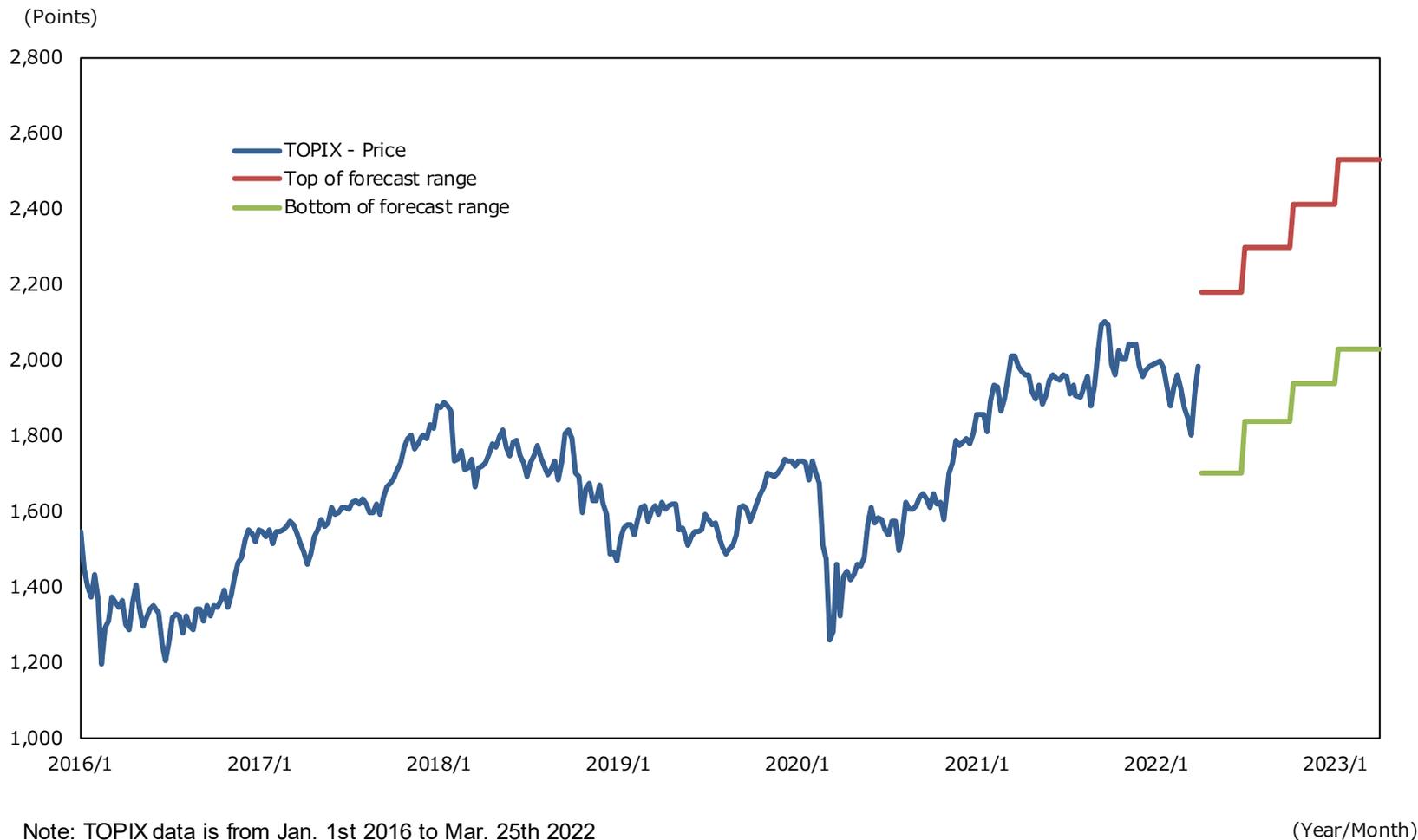
## Market Outlook

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- We believe the Japanese equity market will resume its bullish trend once the volatile market environment, caused by uncertainty over geopolitical risk in Europe and concern about cost-push inflation in the near future, has settled.
- We expect the market will be supported by improving economic fundamentals, such as recovery of nominal GDP growth and surging corporate earnings, for the mid-to-long term.
- Our TOPIX target is at 2,300 and Nikkei 225 at 32,300 for March 2023.
- TOPIX EPS could rebound by 43% YOY to 134 points in the current fiscal year, a historical high, and continue its double digit growth to 155 points in the next fiscal year.



# Equity market expected to resume bullish trend ahead



Note: TOPIX data is from Jan. 1st 2016 to Mar. 25th 2022  
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

# Upside / Downside risk scenarios

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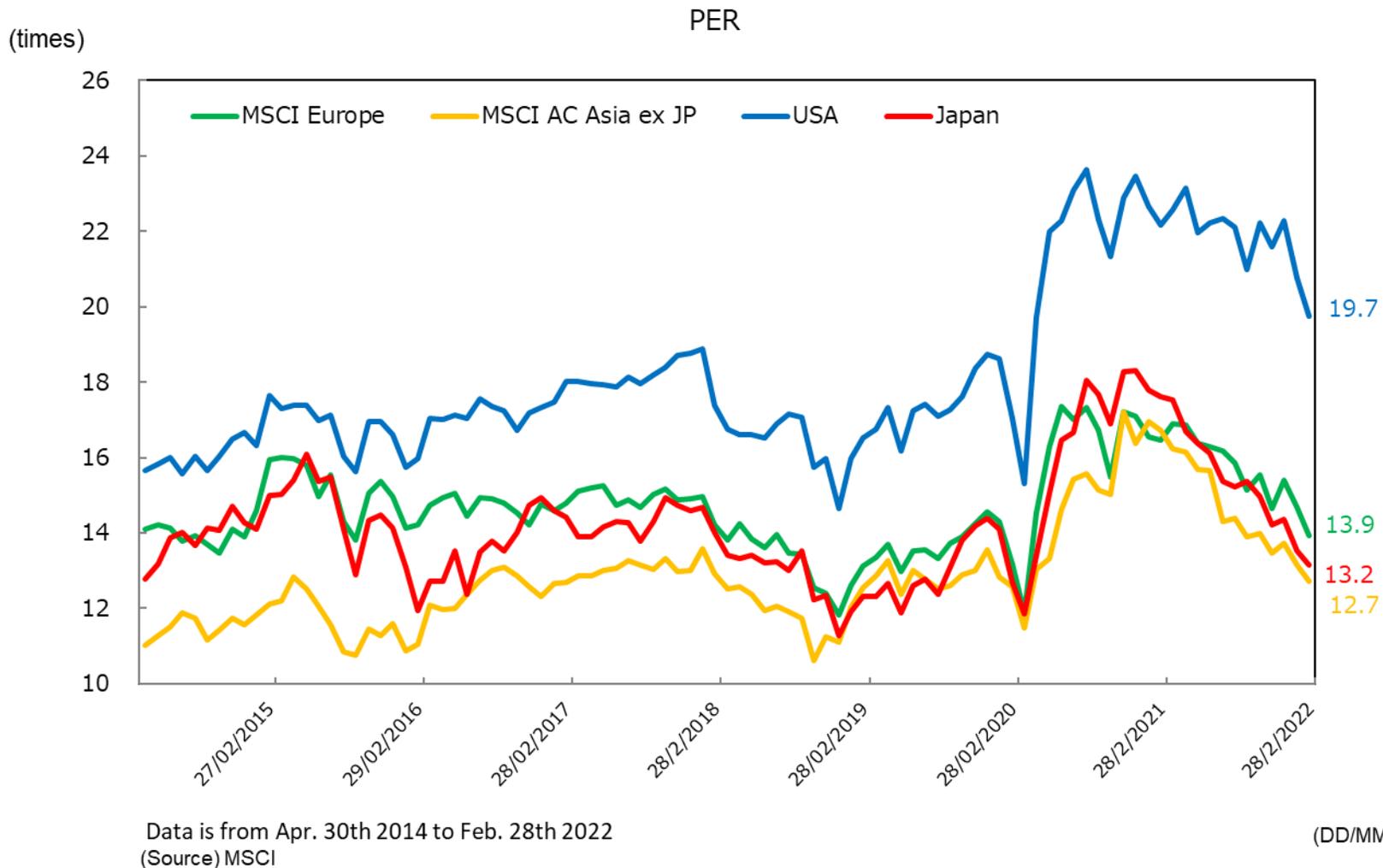
## ■ Upside Risks

- Acceleration of economic recovery
- Recovery of inbound travel to Japan
- Past peak of commodity market rally
- Economic stimulus by the government before upper house election

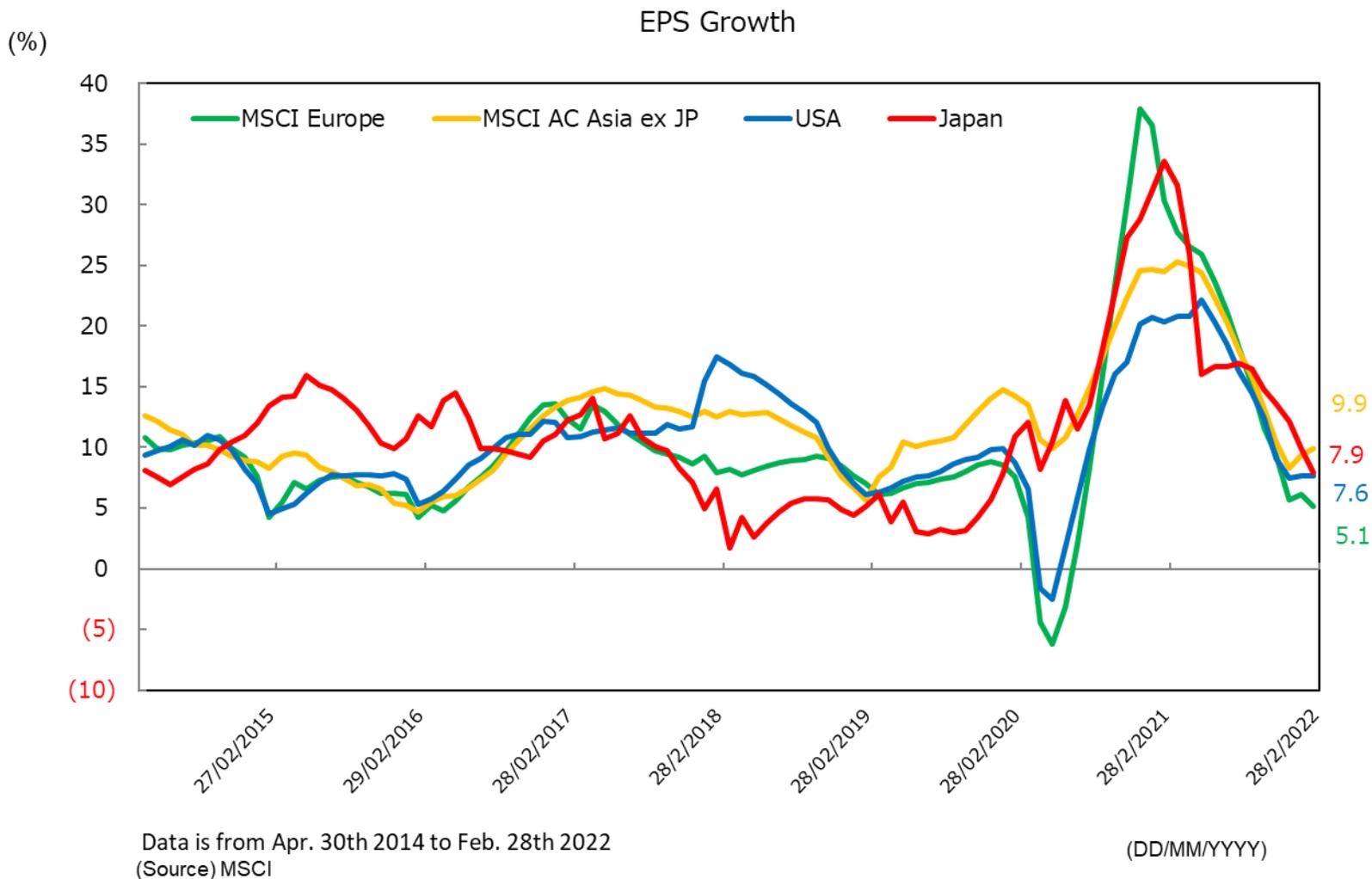
## ■ Downside Risks

- Further deterioration in the bottle neck of the global supply chain
- Rise of infections of COVID-19 new variant
- Escalation of global military conflict
- Stagflation

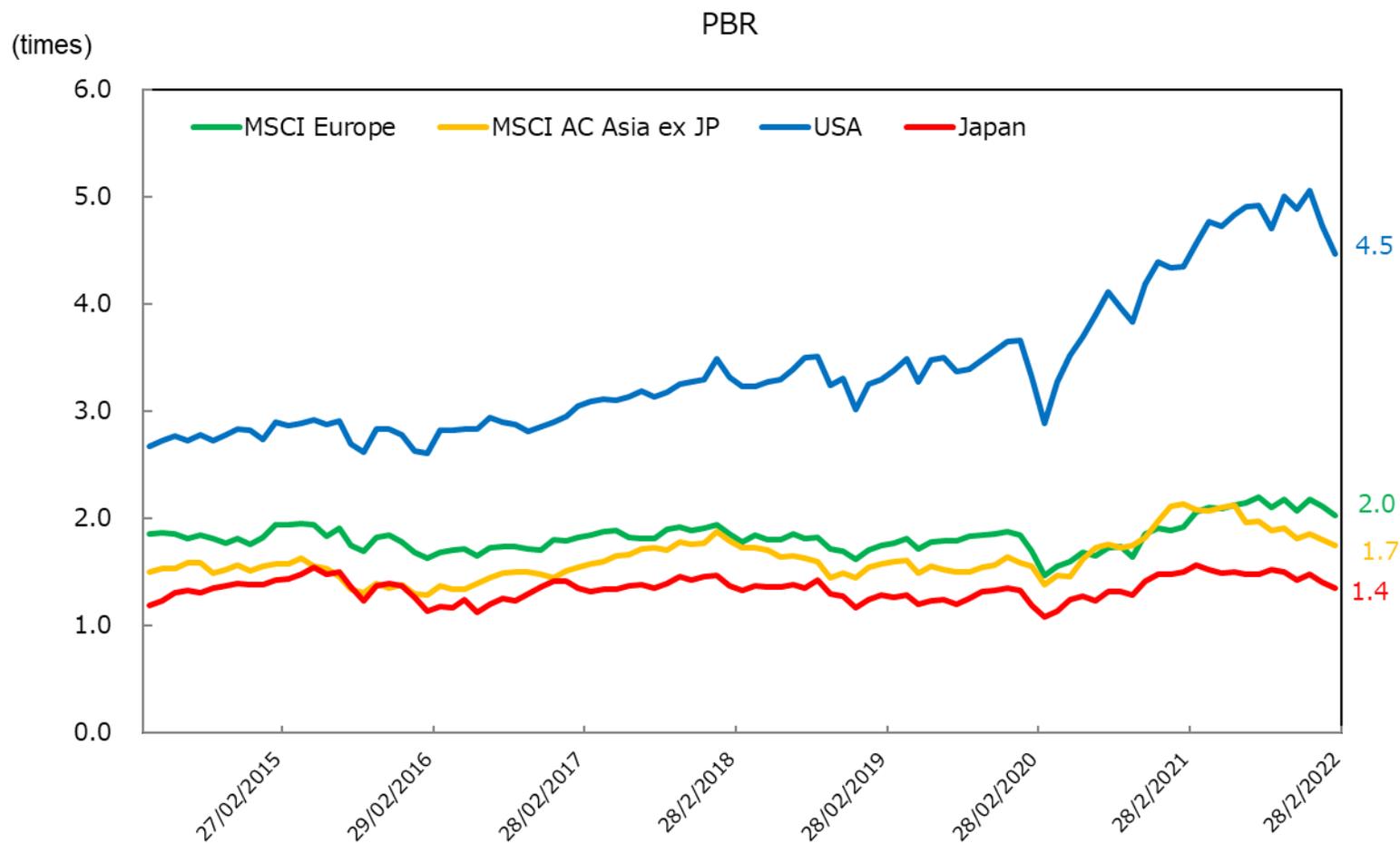
# Falling PERs indicate rising risk premium for equities



# Earnings growth back to normal



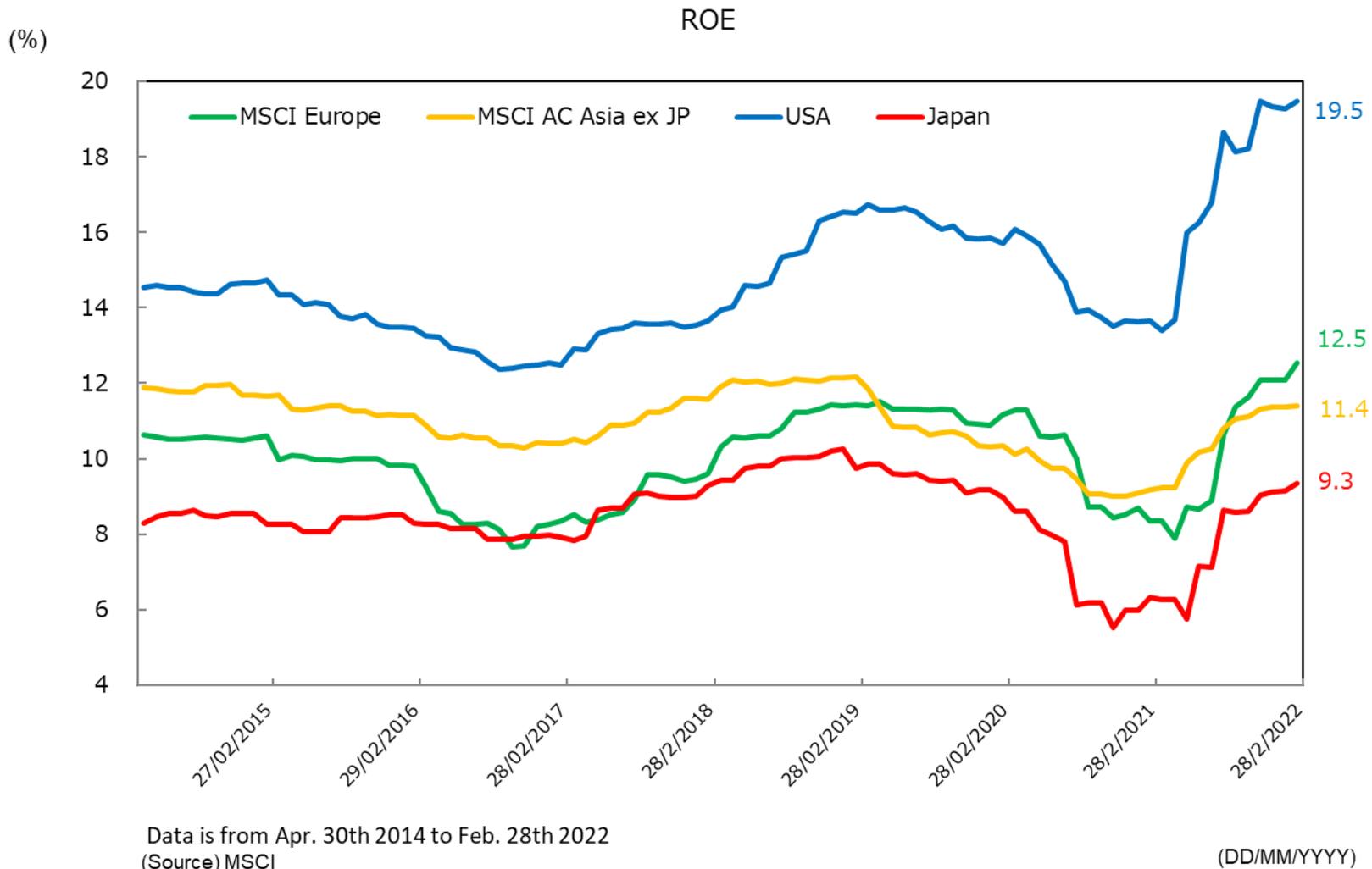
# PBR – mind the gap between US and others



Data is from Apr. 30th 2014 to Feb. 28th 2022  
(Source) MSCI

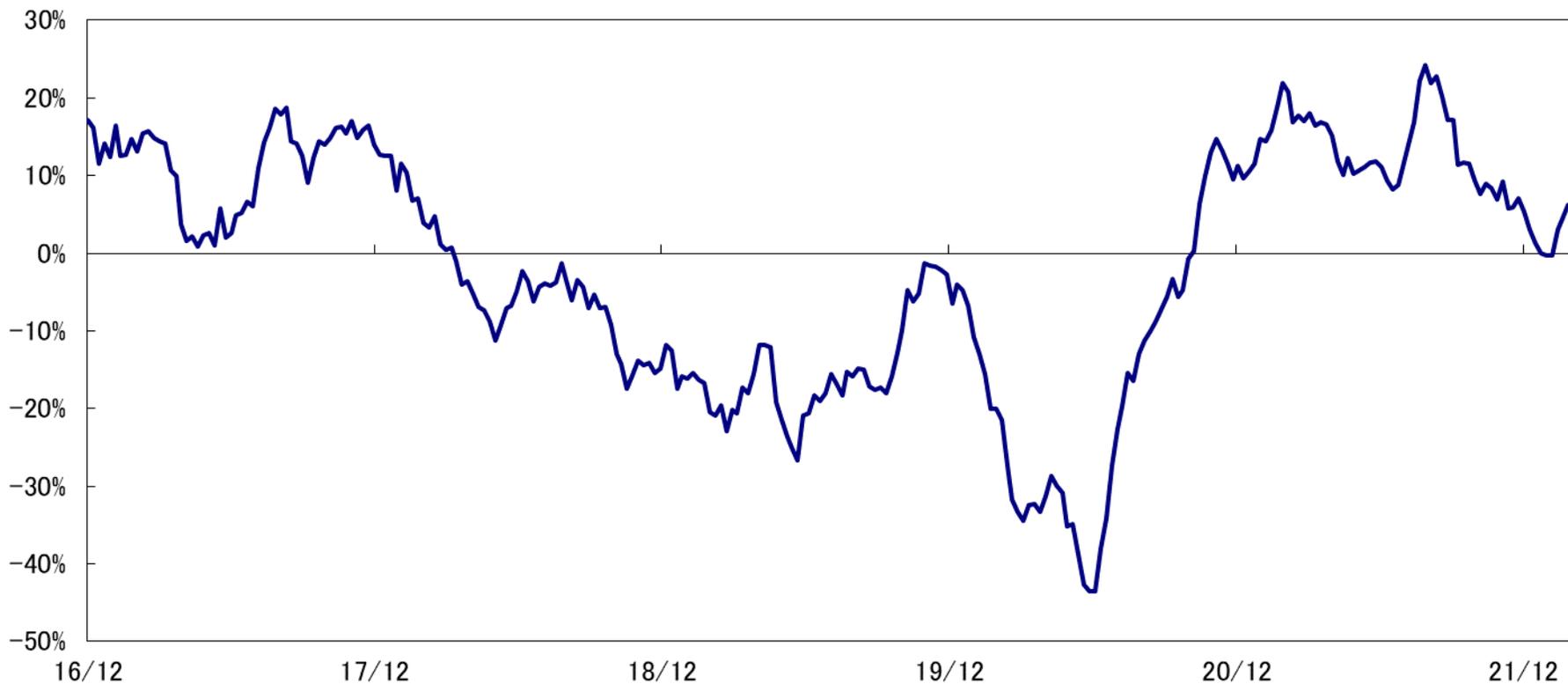
(DD/MM/YYYY)

# Japan's ROE recovering but still lagging behind peers



# Geopolitical risk and inflation weighing on corporate earnings

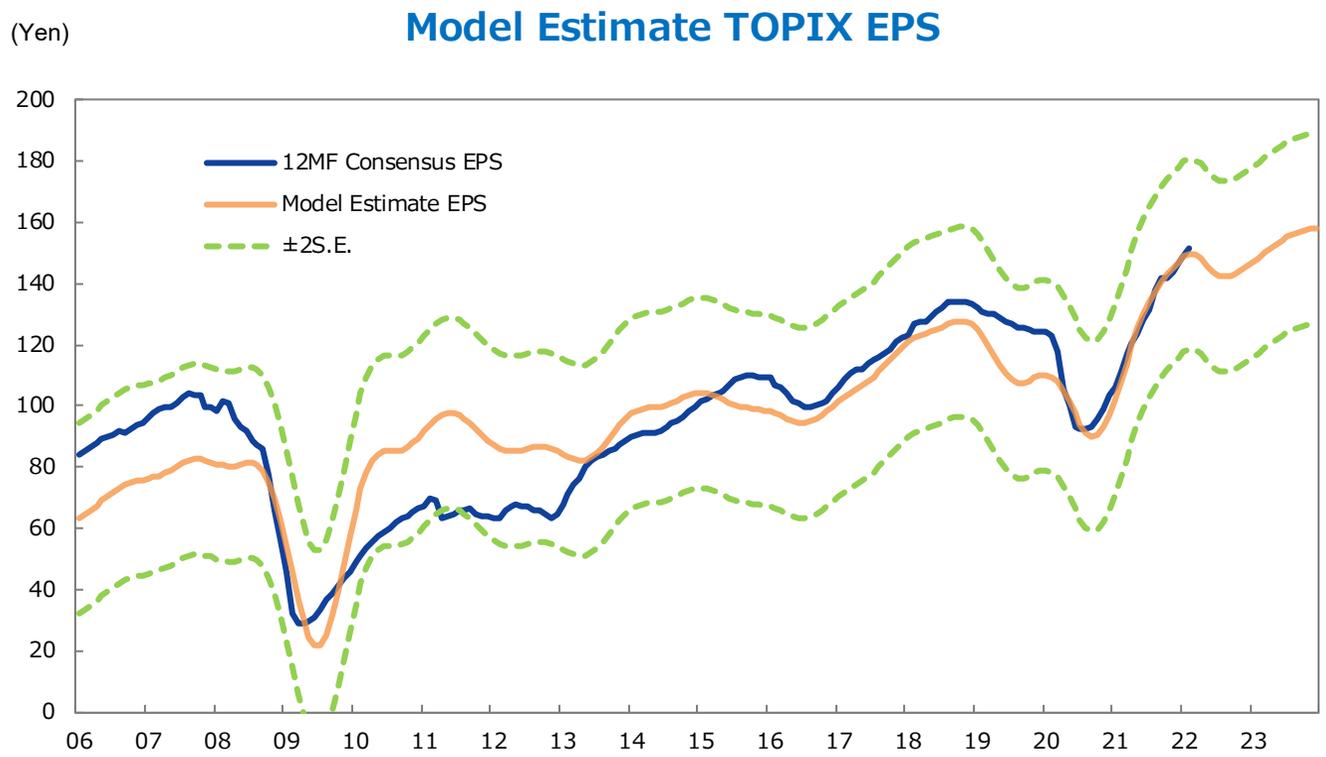
TOPIX Revision Index



Data is from Dec. 31st 2016 to Mar. 11th 2022  
(Source) Datastream, IBES

(YY/MM)

# Quants model indicates EPS reaccelerates after temporary pause

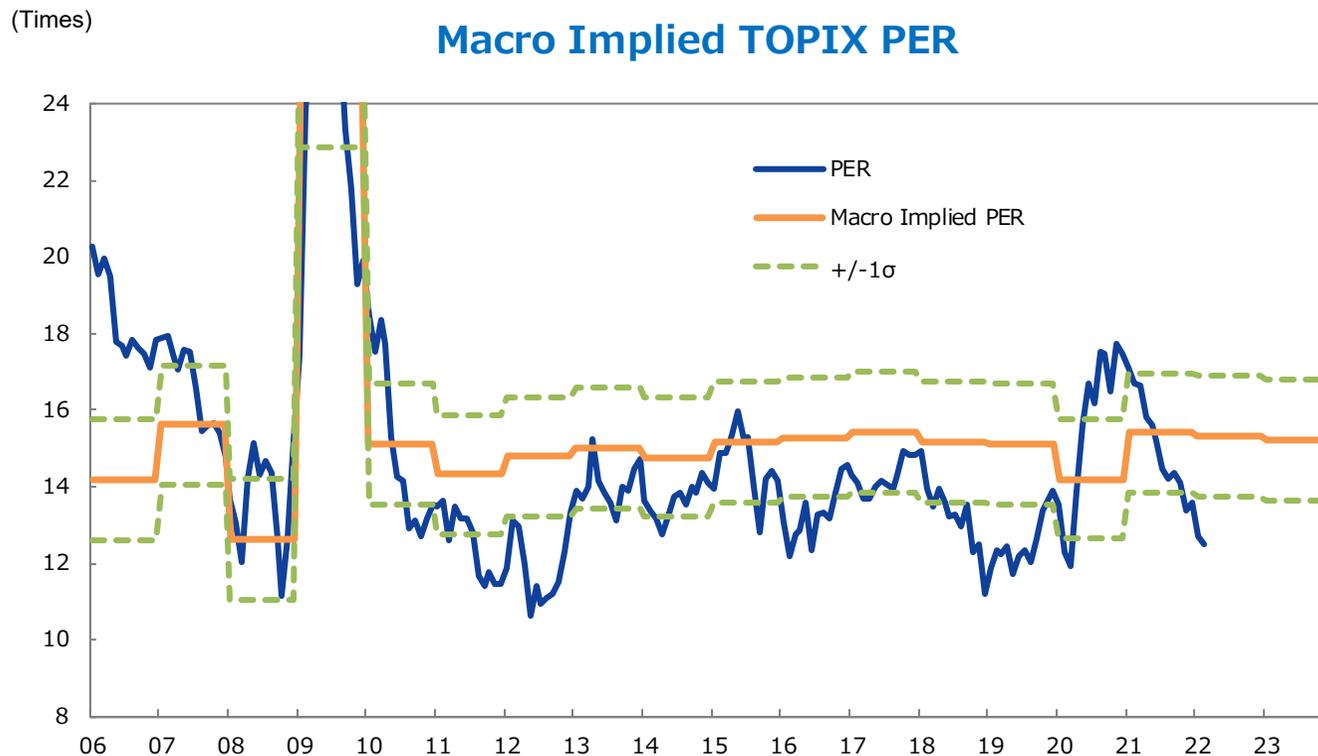


Consensus data is from Jan. 2006 to Feb. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# PER sank far below the bottom of the normal range

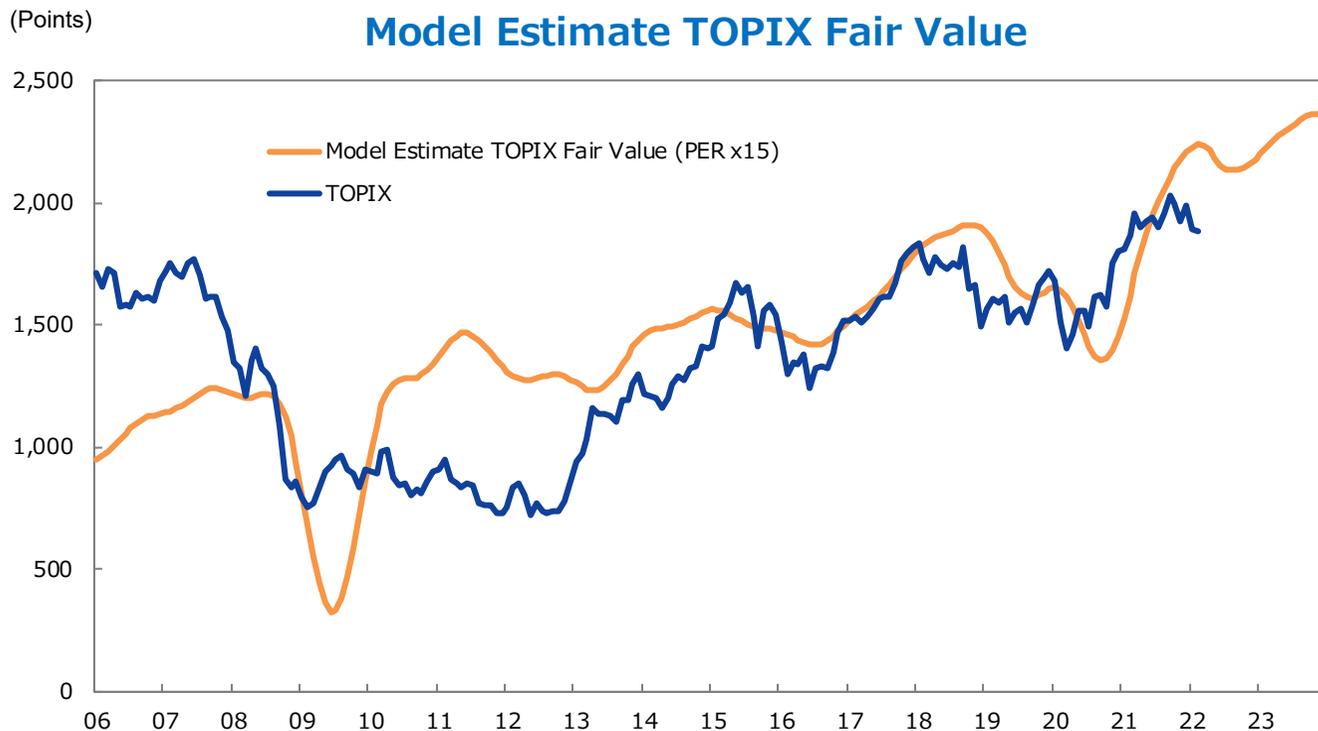


Consensus data is from Jan. 2006 to Feb. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Quants model suggests attractive opportunity to accumulate



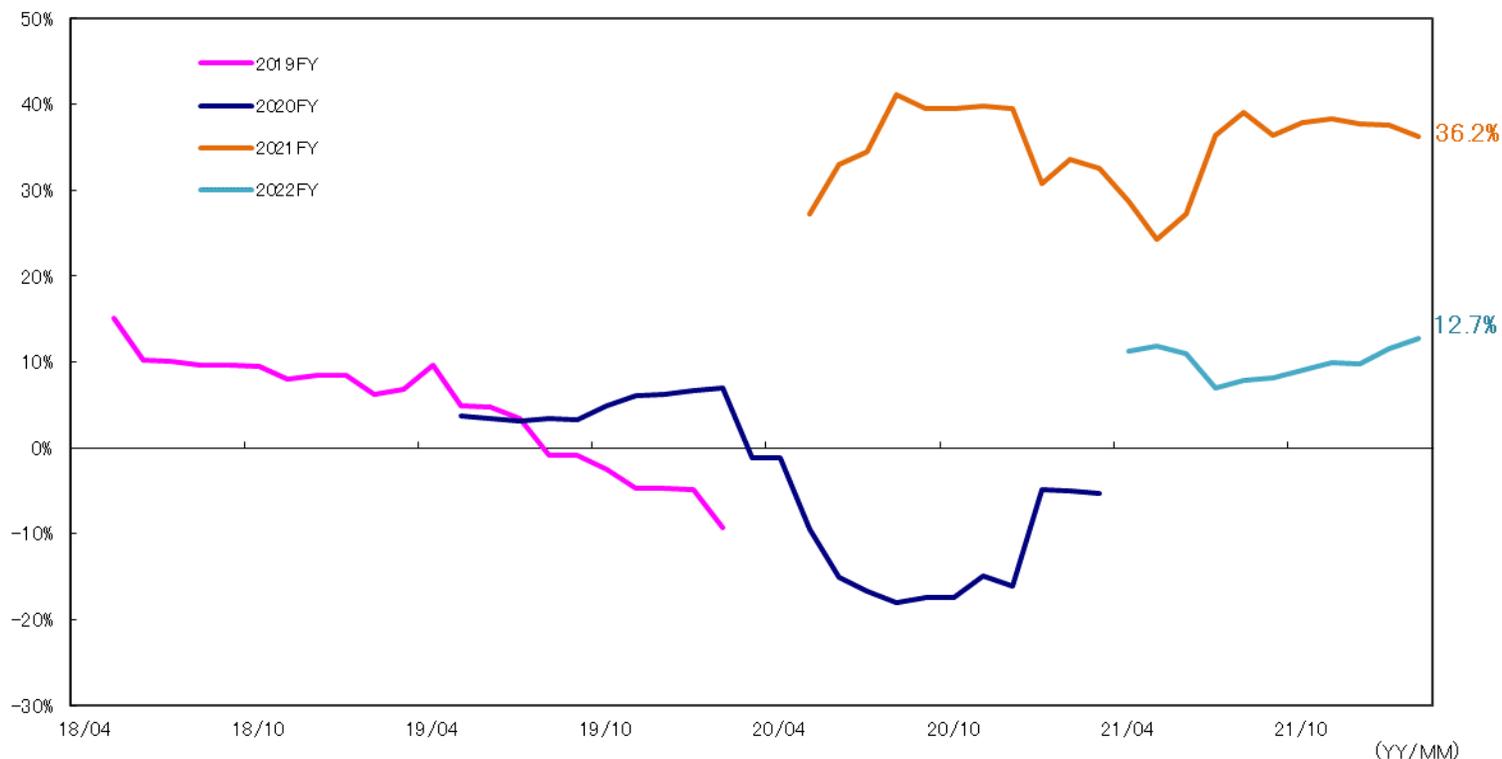
TOPIX data is from Jan. 2006 to Feb. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Bottom up estimate – steady earnings outlook

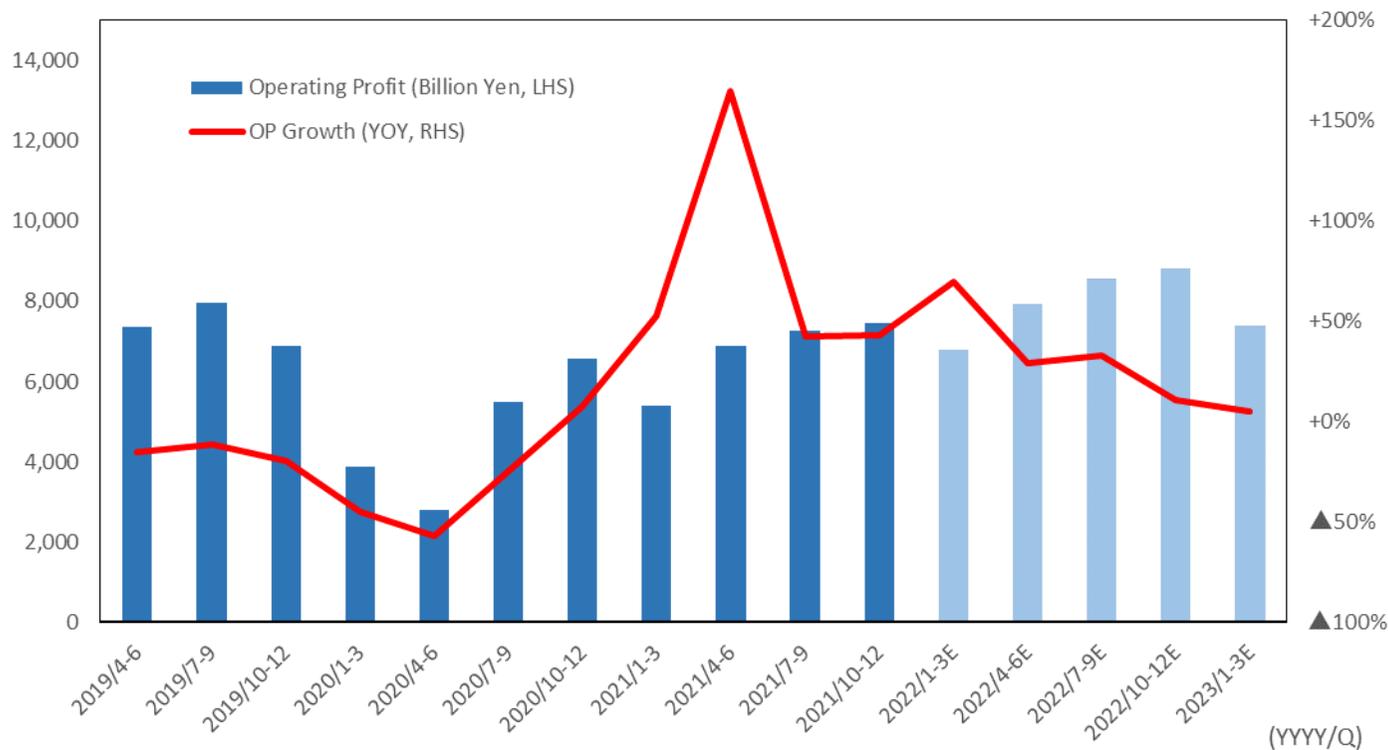
## SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of Mar. 14<sup>h</sup> 2022, SMDAM Core Universe (Excl. Financials) consists of 431 major Japanese companies covered by SMDAM in-house analysts.  
(Source) SMDAM

# Bottom up estimate – steady outlook for operating profit

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 improving 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	74
Others	11
<b>Total</b>	<b>321</b>

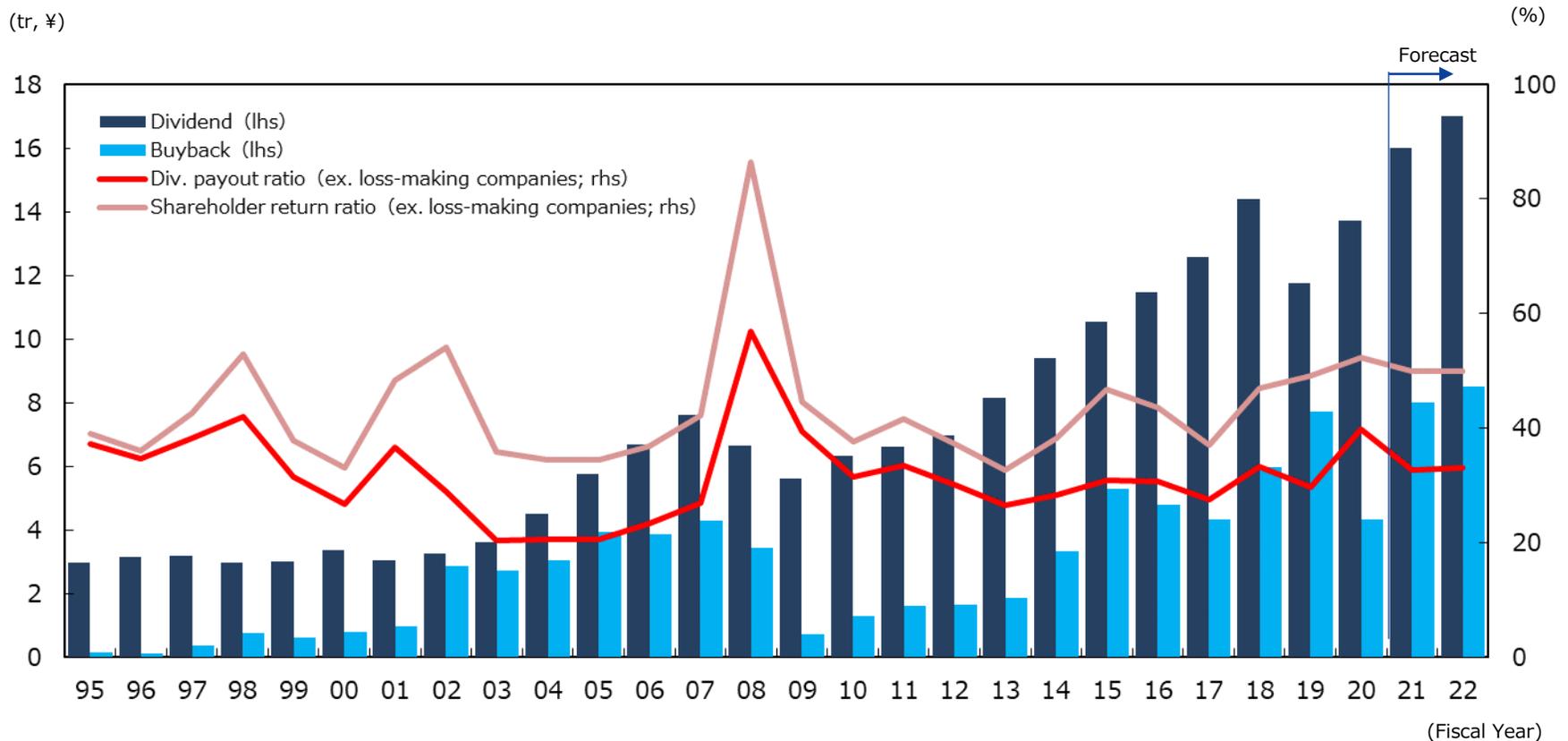
note: As of Feb. 28th 2022

(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 shareholders' return

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



Note: Data is from FY1995 to FY2022, FY2021 and FY2022 are forecasts from Toyo-Keizai for dividends and from Daiwa Securities for share buybacks.

Source: Toyo Keizai, Quick, and INDB compiled by Daiwa Securities

# Winners and losers - value dominates recent equity market

## Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
<b>RN Japan Equity</b>	<b>-2.16</b>	<b>-6.55</b>	<b>-3.29</b>	<b>-4.08</b>	<b>51.97</b>	<b>20.63</b>	<b>24.66</b>
Total Value	5.99	2.19	4.79	1.72	57.44	13.46	15.70
Top Cap Value	7.37	5.55	6.21	7.68	68.22	26.24	27.30
Large Cap Value	7.19	3.95	6.16	3.92	61.59	15.72	18.51
Mid Cap Value	6.97	1.99	6.10	-0.52	53.34	1.89	6.63
Small Cap Value	1.08	-5.26	-0.74	-7.57	40.07	3.89	3.43
Micro Cap Value	-0.28	-5.00	-2.96	-6.13	36.98	4.87	5.52
Total Growth	-9.84	-12.60	-10.67	-6.87	45.13	26.03	38.41
Top Cap Growth	-9.84	-10.40	-10.96	-3.98	49.40	34.73	46.49
Large Cap Growth	-9.89	-12.13	-10.76	-6.20	45.98	28.81	40.58
Mid Cap Growth	-9.97	-15.07	-10.40	-9.93	40.06	19.51	31.22
Small Cap Growth	-9.46	-16.84	-9.88	-12.95	37.11	4.65	20.01
Micro Cap Growth	-11.49	-18.32	-12.71	-16.48	41.95	4.75	21.21
Top Cap Total	-2.70	-3.78	-3.84	0.74	57.40	30.10	36.42
Large Cap Total	-2.22	-4.96	-3.17	-1.86	53.94	23.15	30.30
Mid Cap Total	-1.46	-6.61	-2.10	-5.42	49.38	13.56	21.79
Small Cap Total	-2.49	-10.76	-4.02	-10.24	40.06	5.37	8.51
Micro Cap Total	-3.71	-9.24	-5.91	-9.43	40.18	6.02	12.65

Note : As of Mar. 21st 2022  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- The economy is stagnant. While COVID-19 infections have peaked and people are returning to normal activity, the level of consumer activities is still low and sluggish. In addition, a sharp rise in energy costs, caused by the Russian invasion of Ukraine, put downward pressure on the economy. The employment situation is improving with rising real income. Inflation is accelerating owing to surging energy, food, and accommodation costs.

## [Outlook]

- ① **We have revised down the real GDP growth forecast to +2.3% from +2.4% for FY 2021, +2.4% from +2.8% for FY 2022, and +1.1% from +1.2% for FY 2023.** We revised down our growth forecast for FY 2022 due to rising commodity prices and deteriorating overseas economies. We expect negative growth in the first quarter of 2022 owing to rising infections of the COVID-19 omicron variant. Meanwhile, the economy is expected to return to positive growth from the second quarter of 2022 on the back of declining COVID-19 infections and fiscal stimulus before the election of the upper house. However, given the downward pressure on the economy caused by conflict in Ukraine, we are more cautious than before about the momentum of the economy.
- ② **We have not changed our Core CPI forecast for FY 2021 at +0.1%. We have raised our forecast for FY 2022 to +1.7% from +1.4% and for FY 2023 to +1.0% from +0.9%.** We expect core CPI will reach +2.0% in April 2022 owing to rising energy costs and the pace of inflation will be hovering just below 2%.
- ③ **We expect PM Kishida's cabinet to maintain the existing economic policy mix.** If the economy slows further owing to conflict in Ukraine, the government could provide additional fiscal stimulus as much as 10 trillion yen.
- ④ **Despite rising inflation, the current accommodative monetary policy will be maintained by the BOJ in the near future. Recent changes to the members of the BOJ policy committee suggests PM Kishida's intension to keep distance from the existing reflationary monetary policy. We see the growing likelihood of the policy change in "Yield Curve Control" after the end of BOJ Governor Kuroda's term in April 2023. His resignation could be a turning point for the current accommodative monetary policy.**

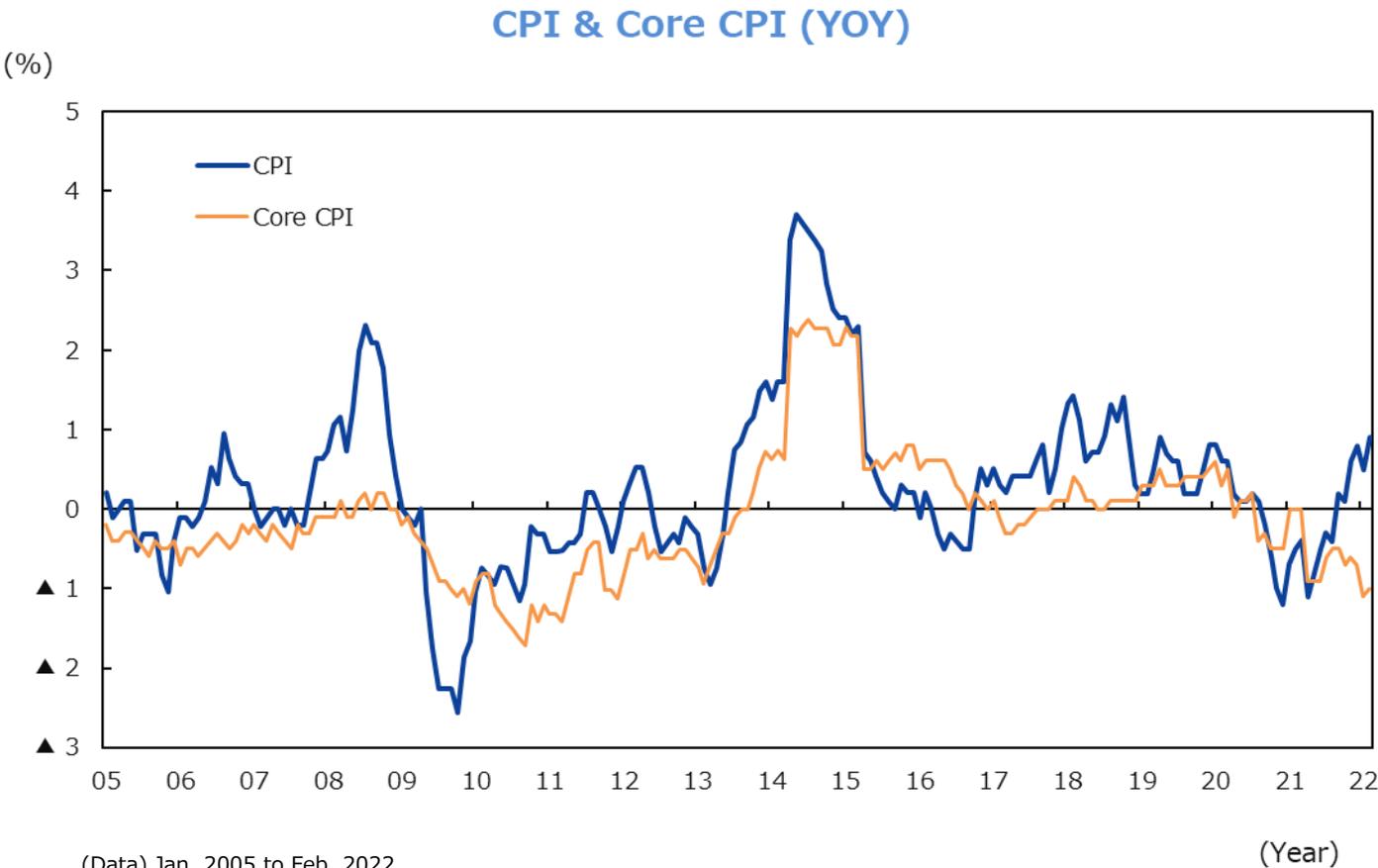
# Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY17	FY18	FY19	FY20	FY21 Est	FY22 Est	FY23 Est
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.3%	2.4%	1.1%
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.3%	2.7%	1.0%
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.3%	-0.8%	0.0%
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	1.2%	2.5%	3.1%
Public fixed capital formation	0.6%	0.9%	1.6%	5.2%	-7.2%	-0.6%	0.4%
Net export contribution	0.4%	-0.2%	-0.4%	-0.6%	1.1%	0.0%	0.0%
Exports of goods and services	6.3%	2.0%	-2.2%	-10.5%	12.8%	2.2%	3.3%
Imports of goods and services	3.8%	3.0%	0.2%	-6.7%	6.4%	2.0%	3.5%
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.2%	2.3%	1.5%
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.1%	0.0%	0.4%
Industrial Production Index	2.9%	0.3%	-3.7%	-9.9%	6.1%	3.3%	2.8%
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	1.7%	1.0%
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.4%	7.4%	5.5%	0.4%
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.6%	1.5%	1.1%
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.8%	2.6%
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%

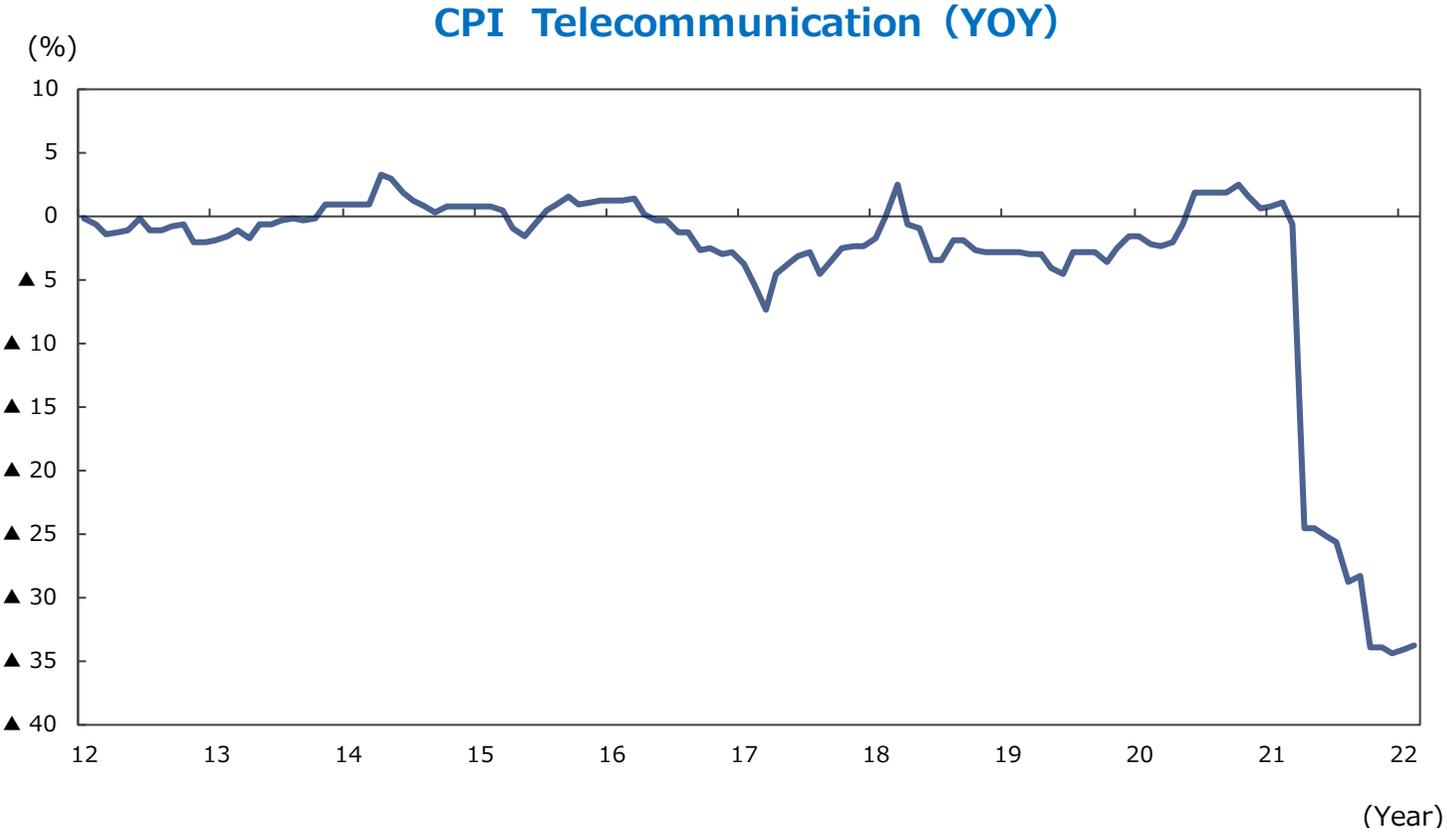
(Note) Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

(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

# Rising energy makes divergence between headline and core inflation



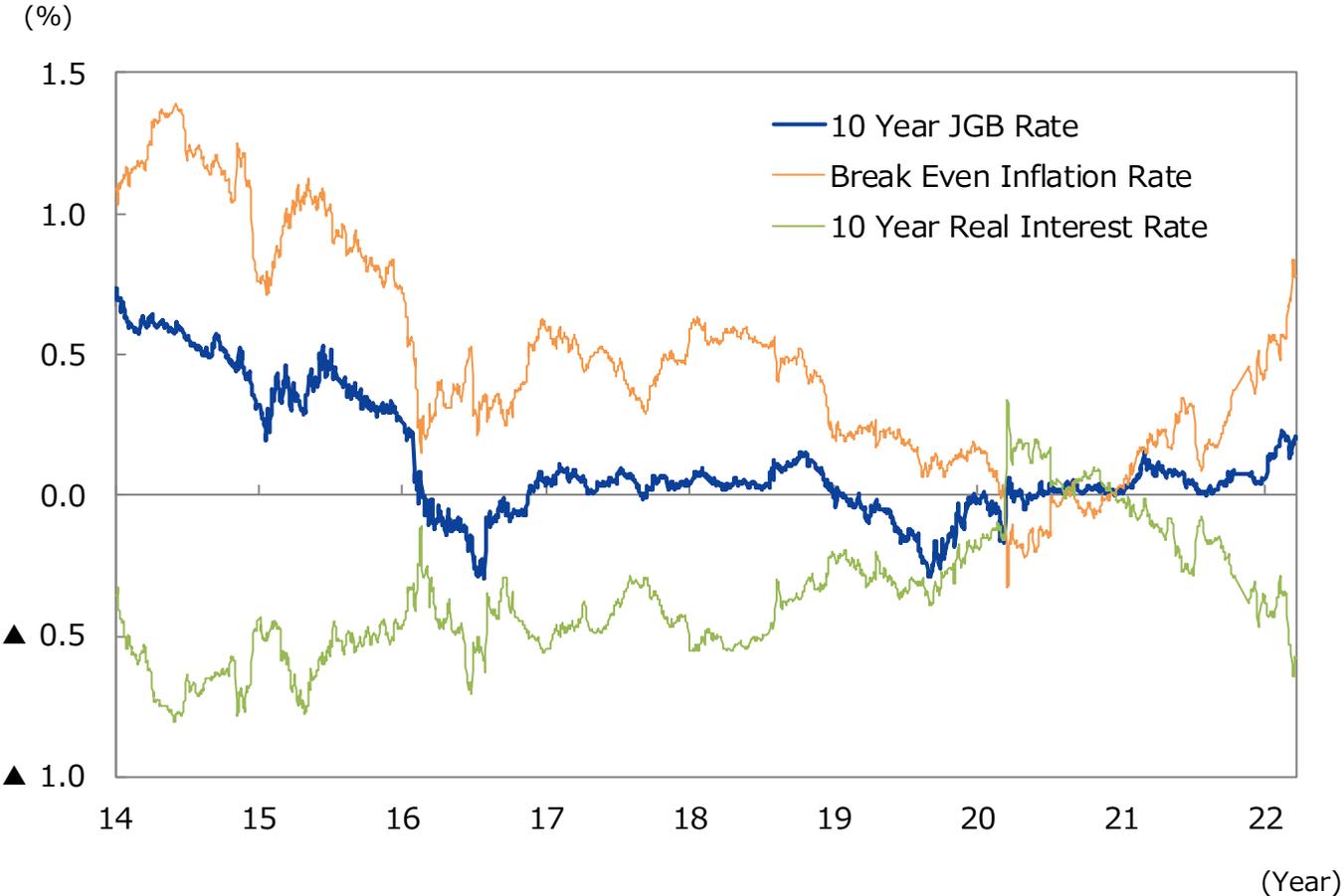
# Mobile phone charges pushing inflation lower



(Data) Jan. 2012 to Feb. 2022  
(Source) MIAC, Bloomberg, SMDAM

# Rising BEI & yield curve control of BOJ push real interest rate lower

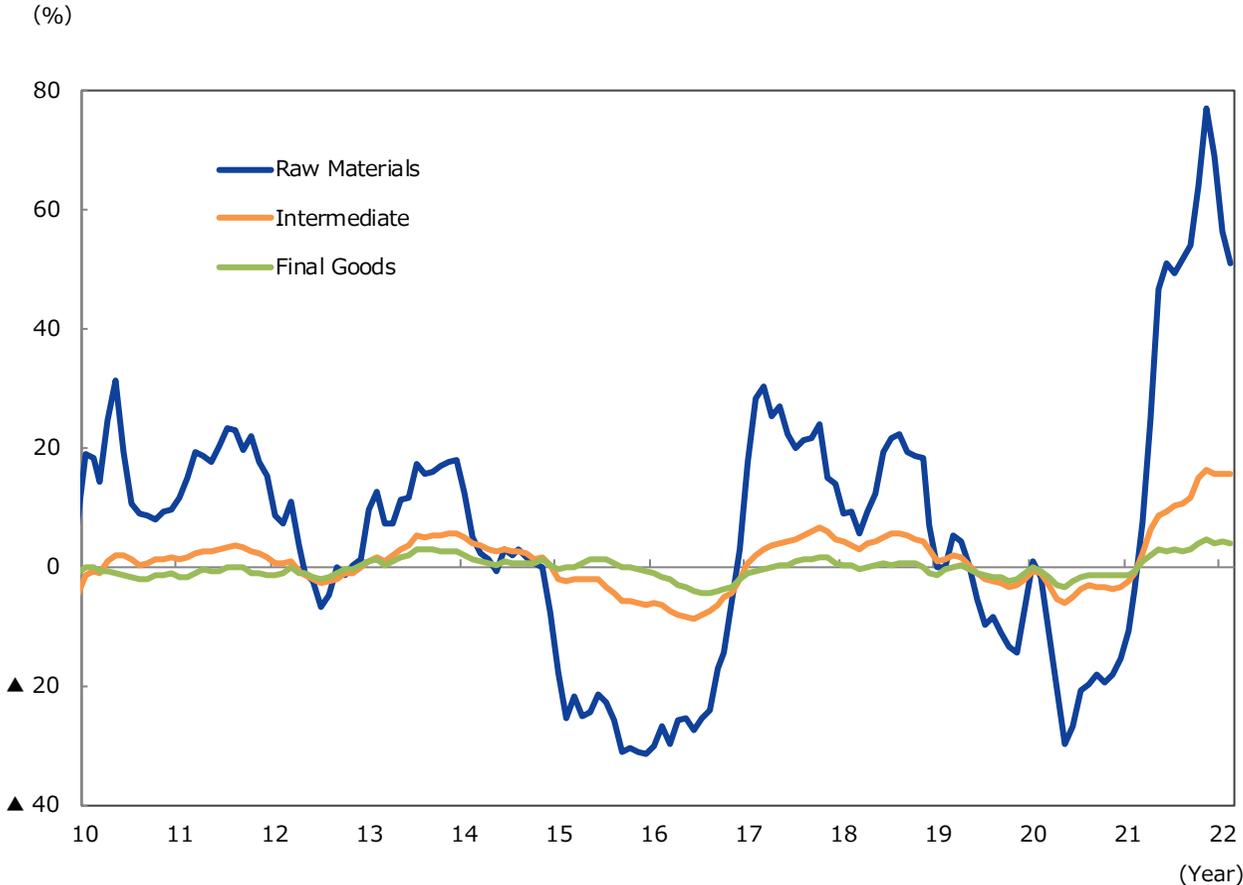
## JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to Mar. 21st 2022  
(Source) Bloomberg, SMDAM

# Companies struggling to pass through rising input costs

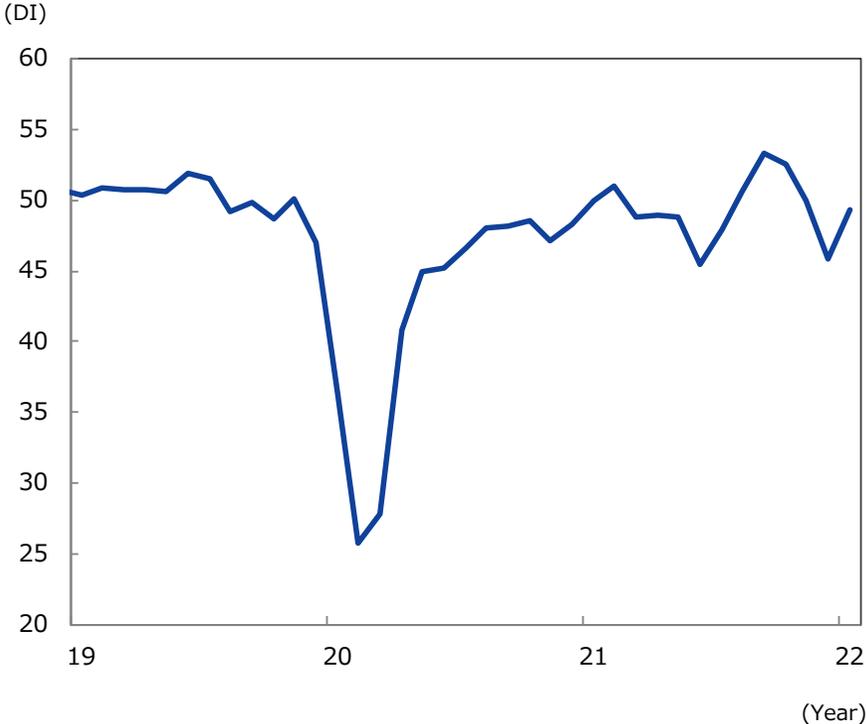
## Corporate Price Index (YOY)



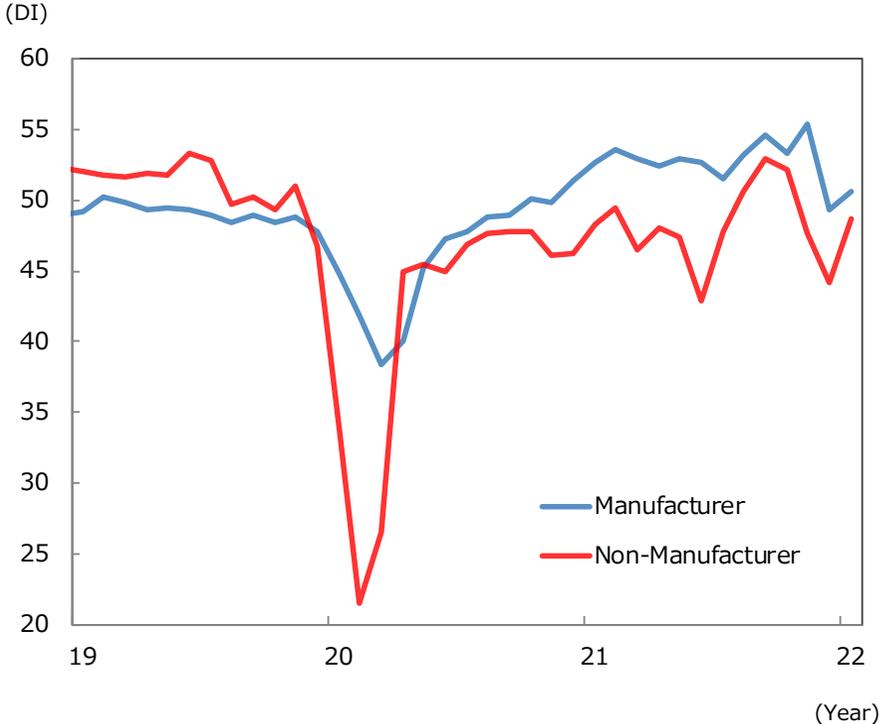
(Data) From Jan. 2010 to Feb. 2022  
(Source) The Bank of Japan, SMDAM

# PMI slightly higher past peak of Omicron infections

### Composite PMI

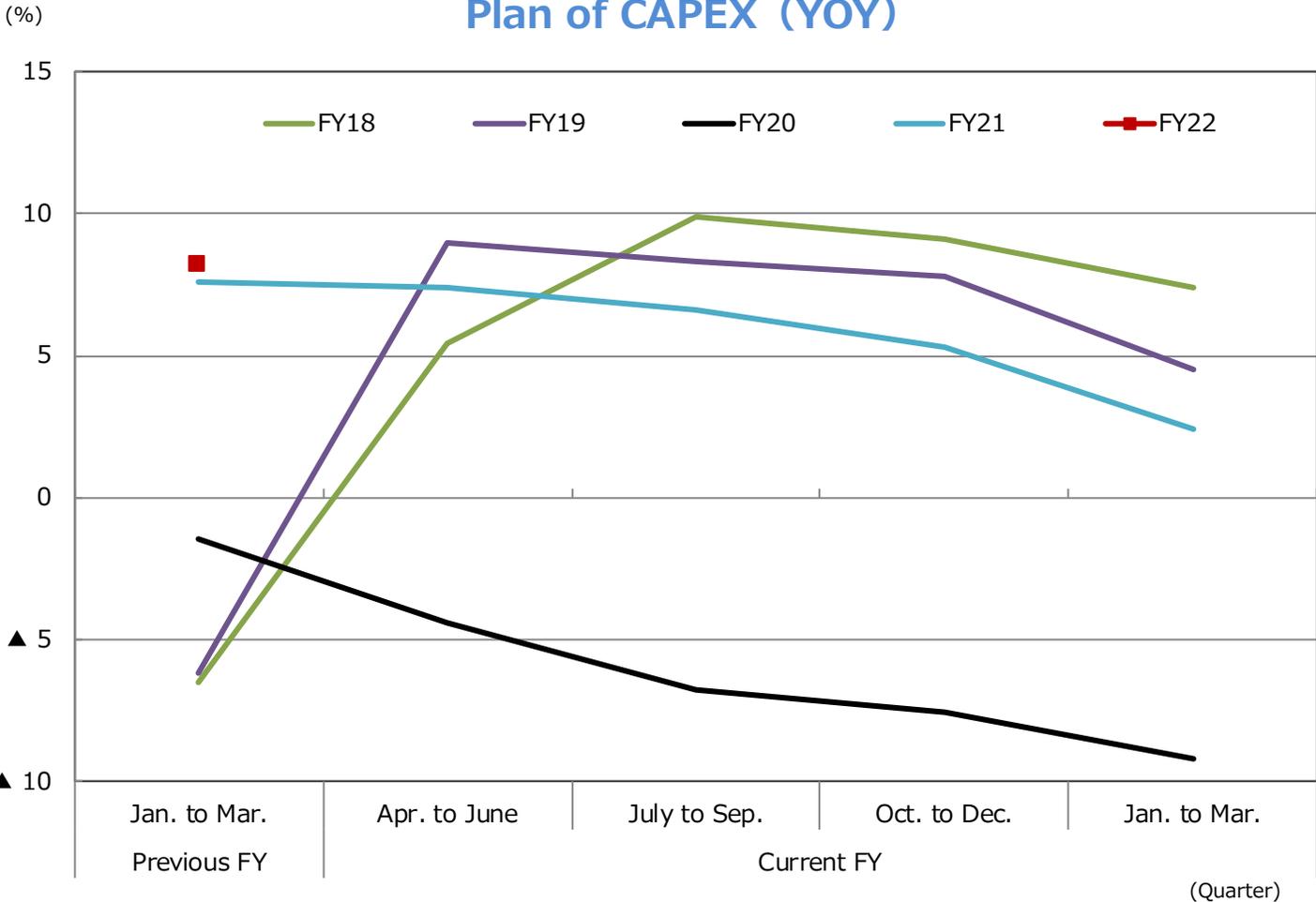


### PMI, Manufacturer & Non-Manufacturer



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

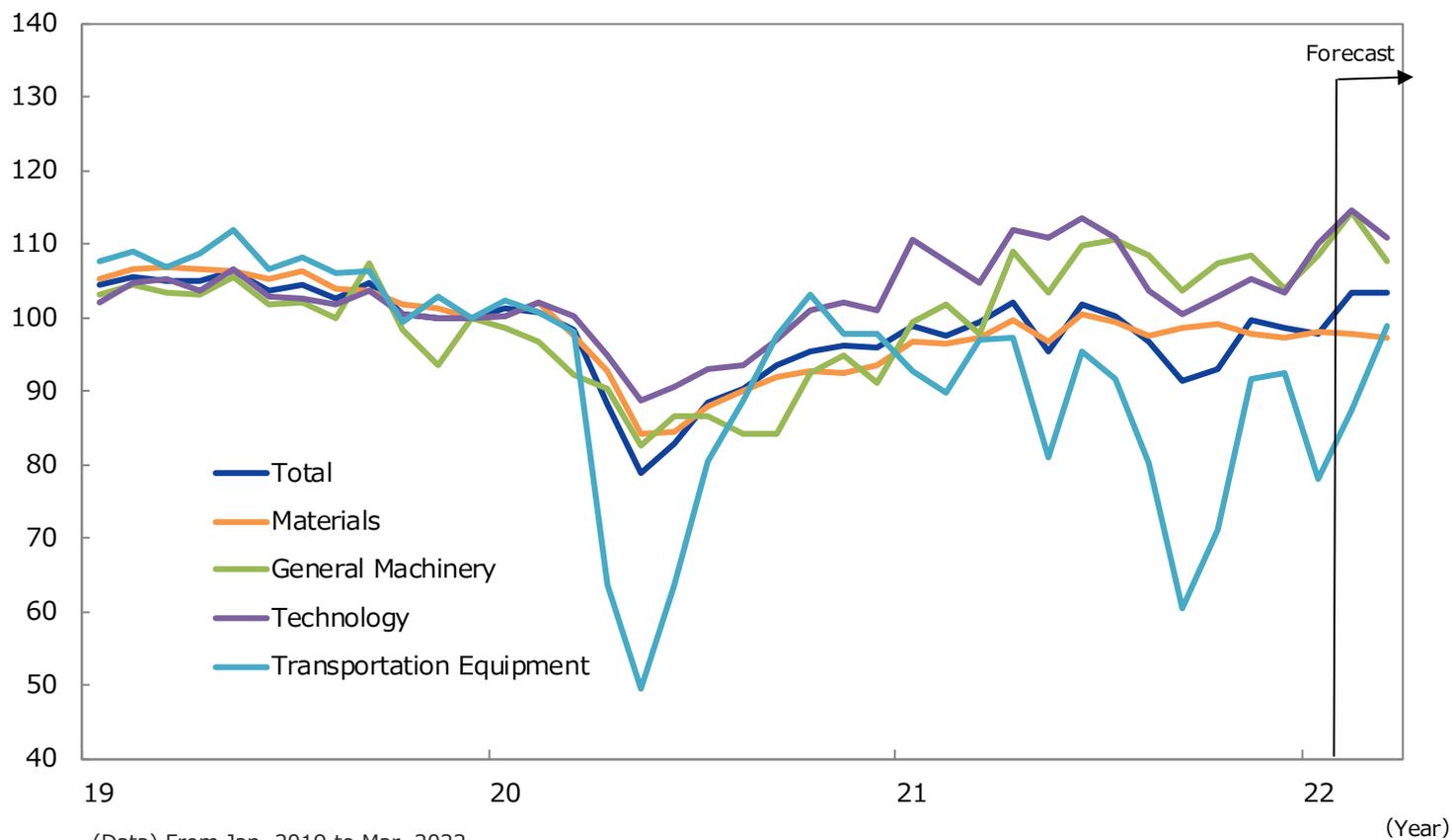
# Plan of CAPEX still stable despite severe environment



(Data) All industries, all sizes, including software, excluding land and R&D, from Q1 2018 to Q1 2022  
 (Source) Cabinet Office, SMDAM

# Auto production coming back to normal soon

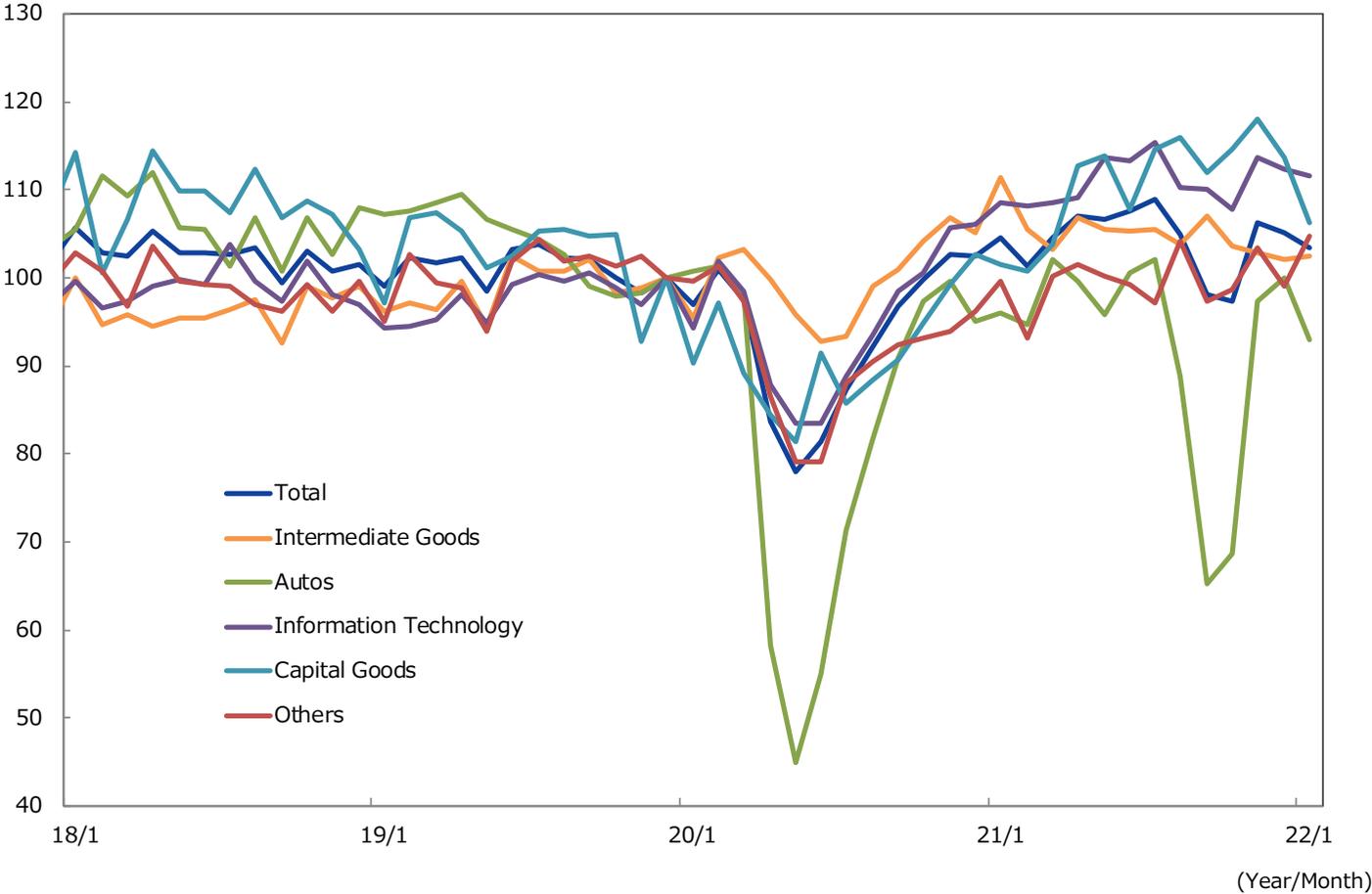
## Industrial Production (Dec. 2019=100)



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

# Exports losing momentum despite yen's weakness

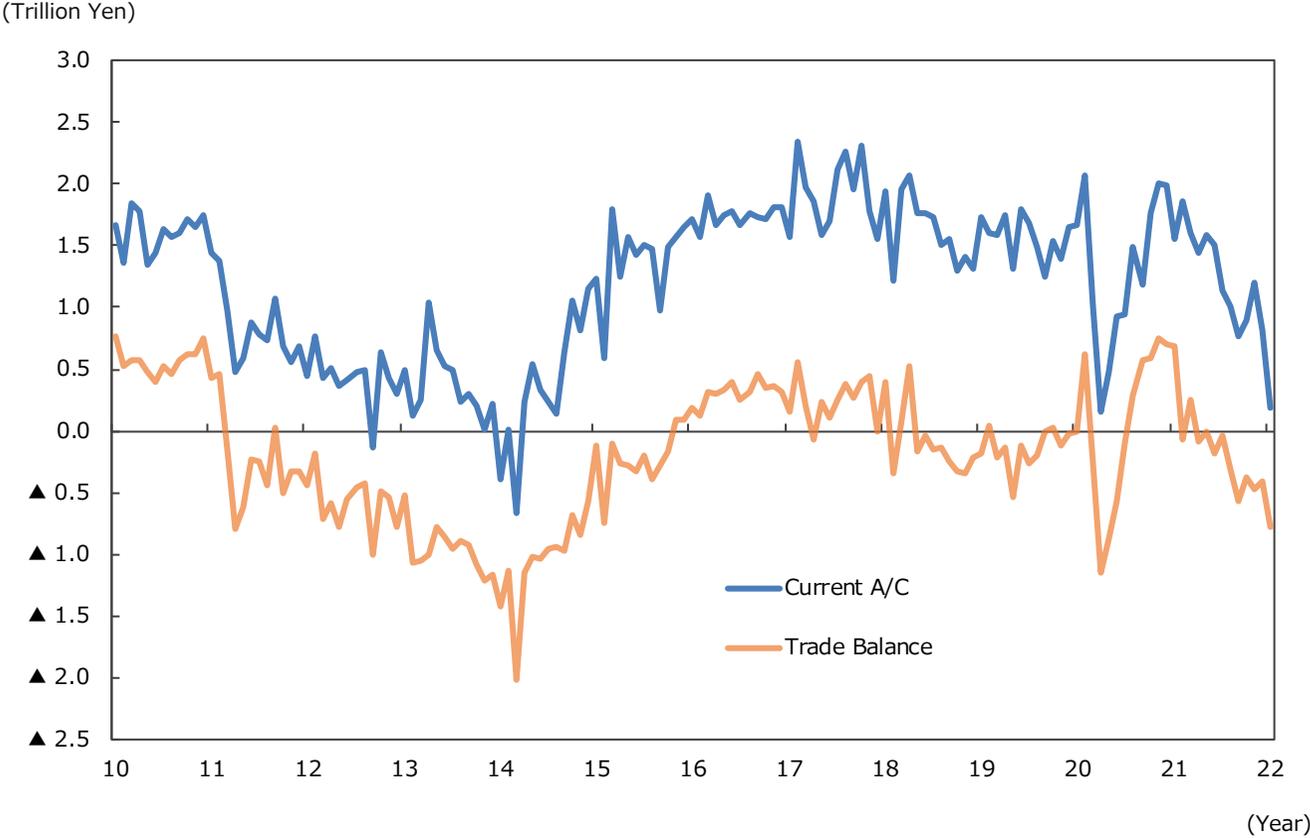
## Real Export (Dec. 2019=100)



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

# Rising material/energy costs hit trade balance

## Current Account & Trade Balance



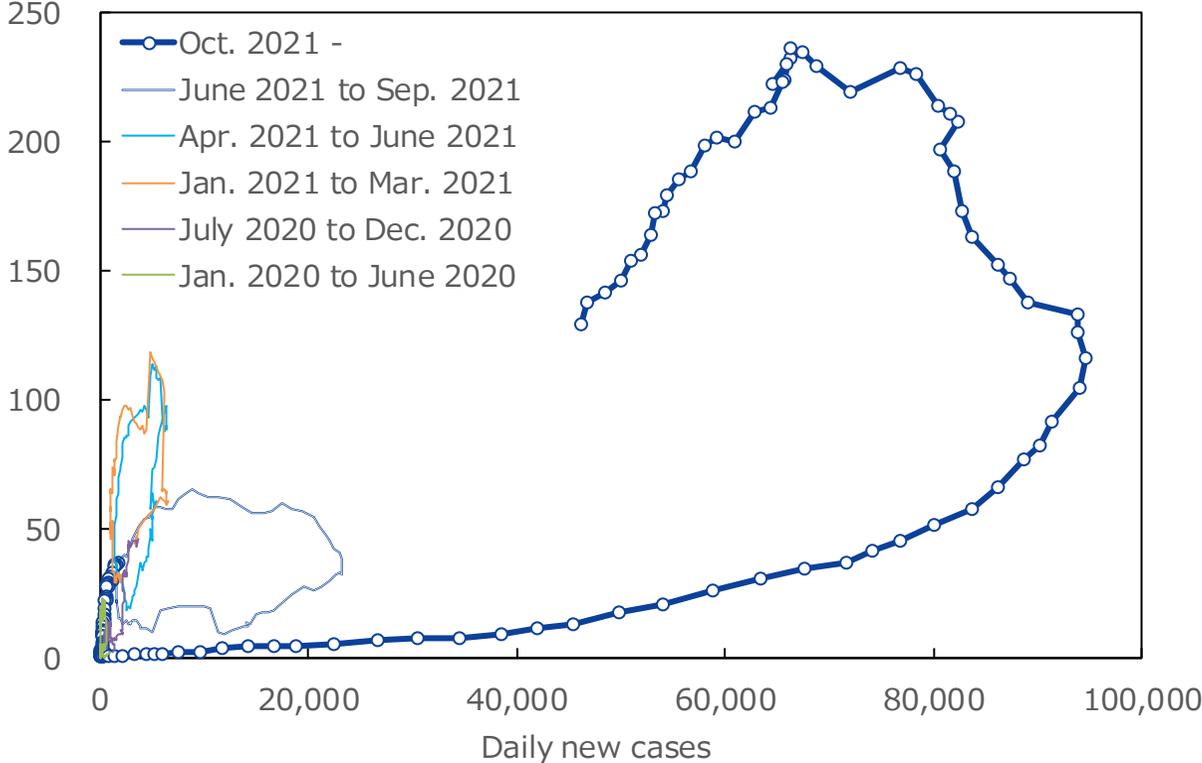
(Data) Seasonally adjusted, Current account balance is from Jan. 2010 to Jan. 2022,  
Trade balance is from Jan. 2010 to Feb. 2022.

(Source) MOF, SMDAM

# COVID-19 infections settle down slowly & steadily

## COVID-19 New patients and confirmed deaths in Japan

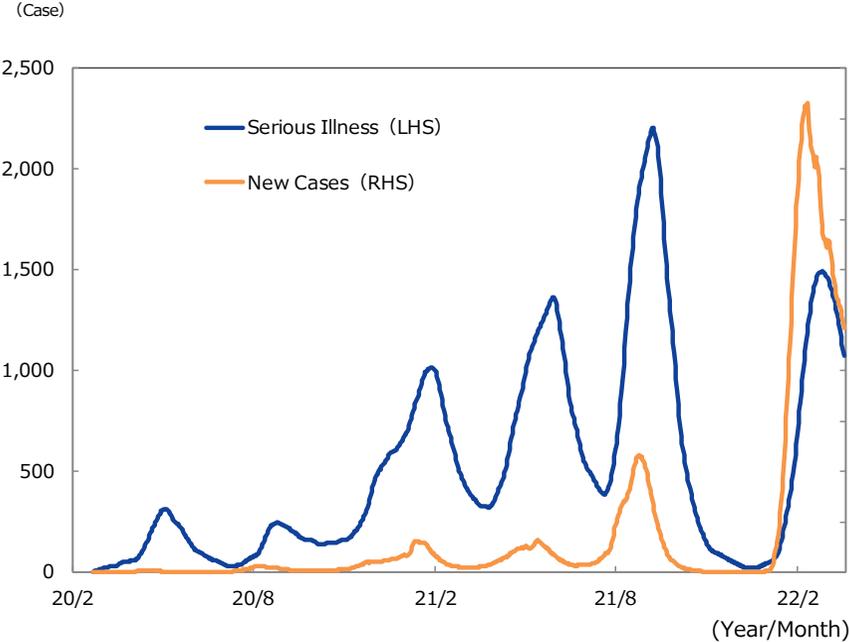
Daily Death



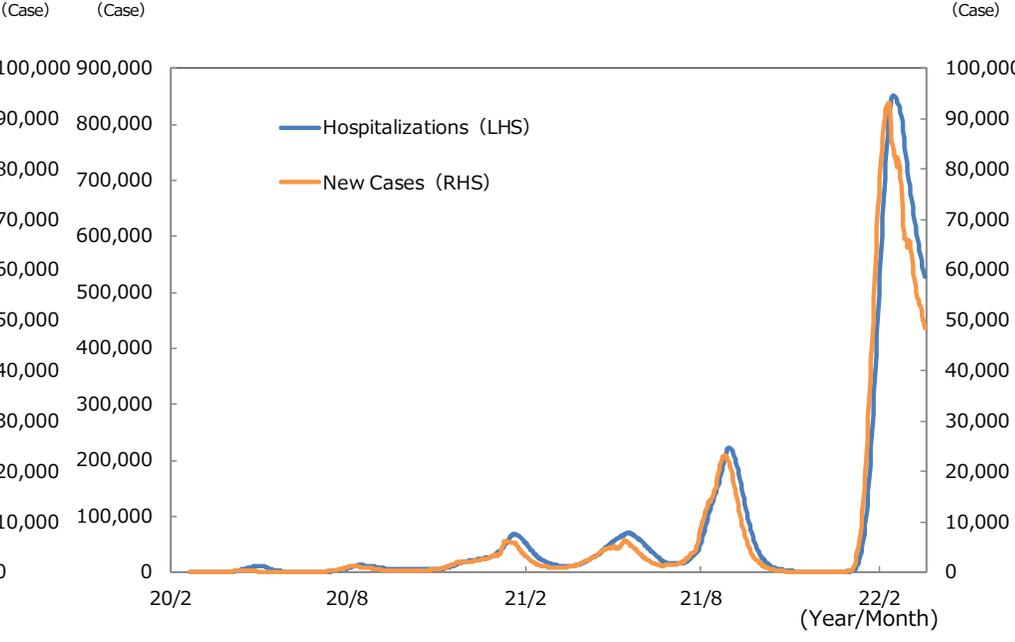
(Data) 7 days moving average, From Jan. 1st 2020 to Mar. 21st 2022  
(Source) Bloomberg, SMDAM

# Omicron infections peak

COVID-19 New Cases and Serious Illness



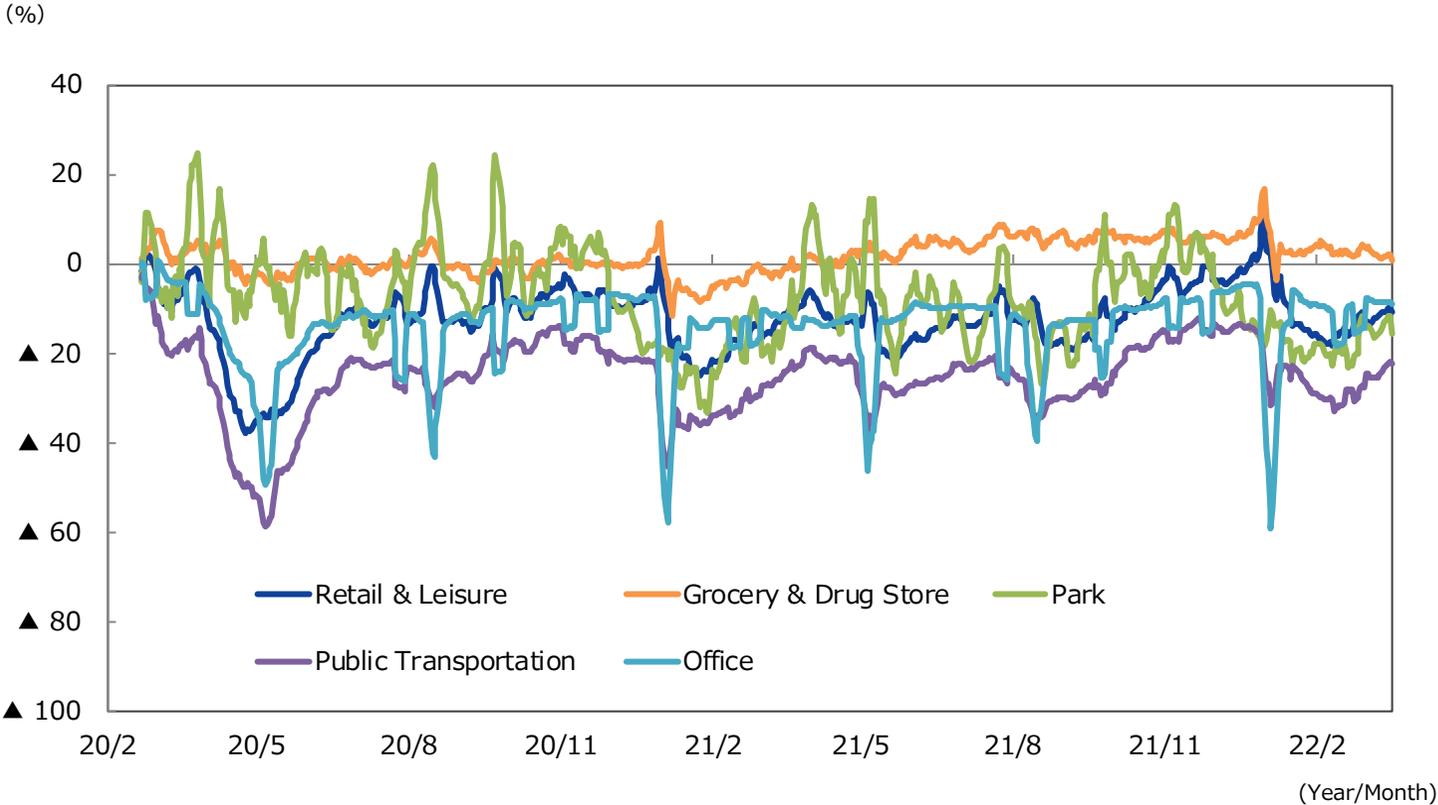
COVID-19 New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 21st 2020 to Mar. 19th 2022  
 (Source) MHLW, NHK, SMDAM

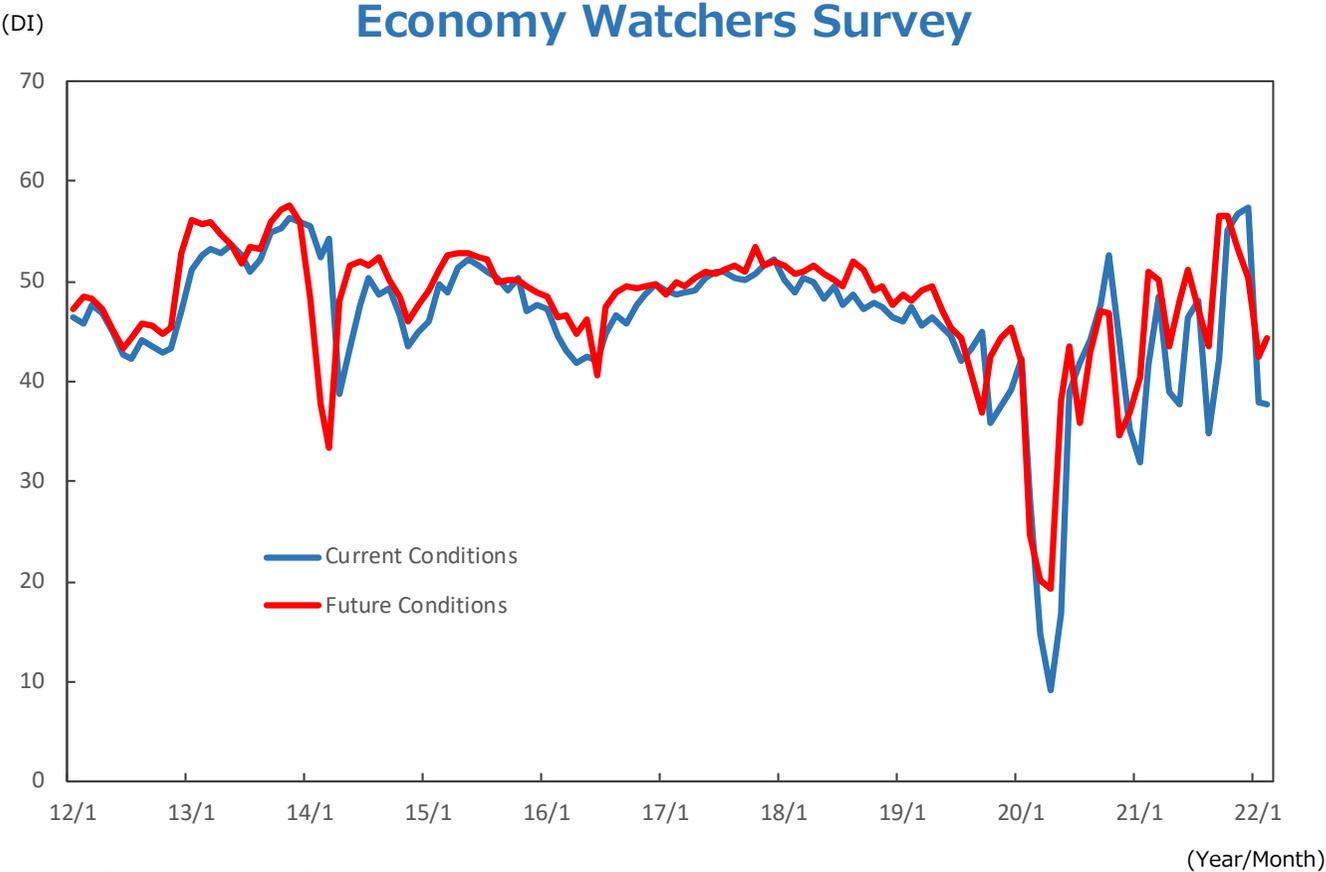
# Mobility coming back slowly despite peak in infections

## Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21<sup>st</sup> 2020 to Mar. 18<sup>th</sup> 2022  
(Source) Google, SMDAM

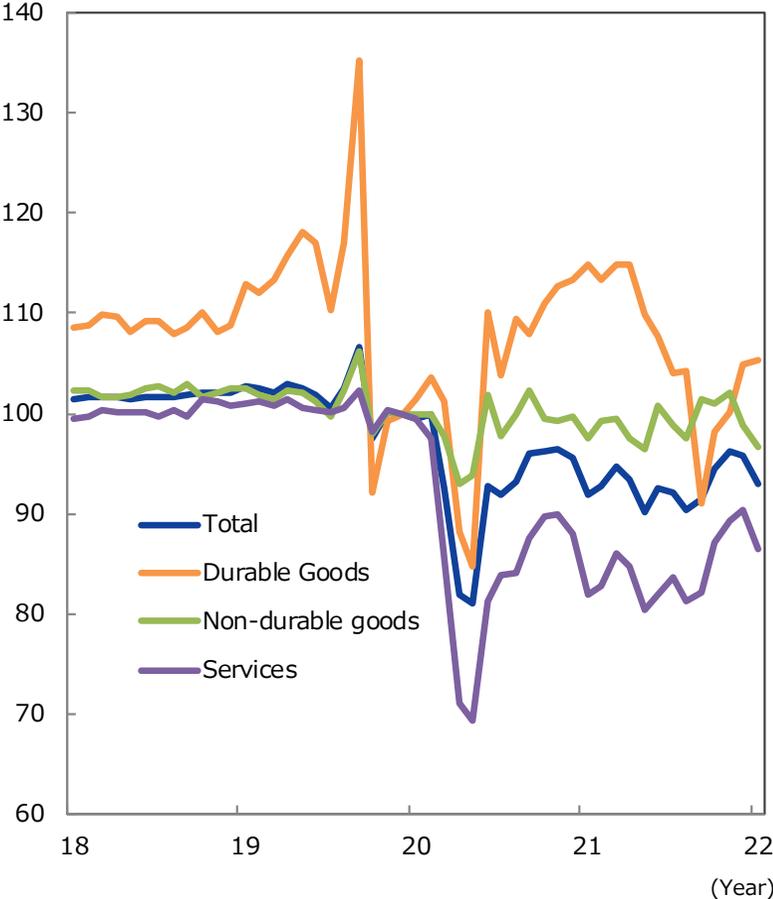
# COVID-19 and inflation weighing on consumers



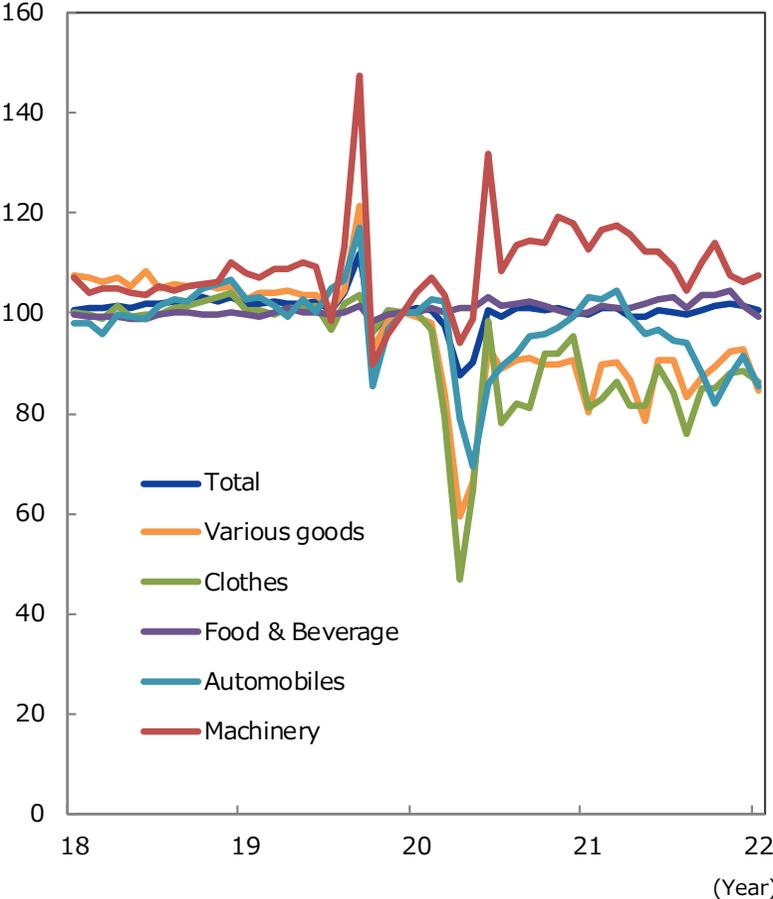
(Data) From Jan. 2012 to Feb. 2022  
(Source) Cabinet Office, SMDAM

# Consumer activities slowing excluding durables

Consumer Activity Index (Dec. 2019 = 100)

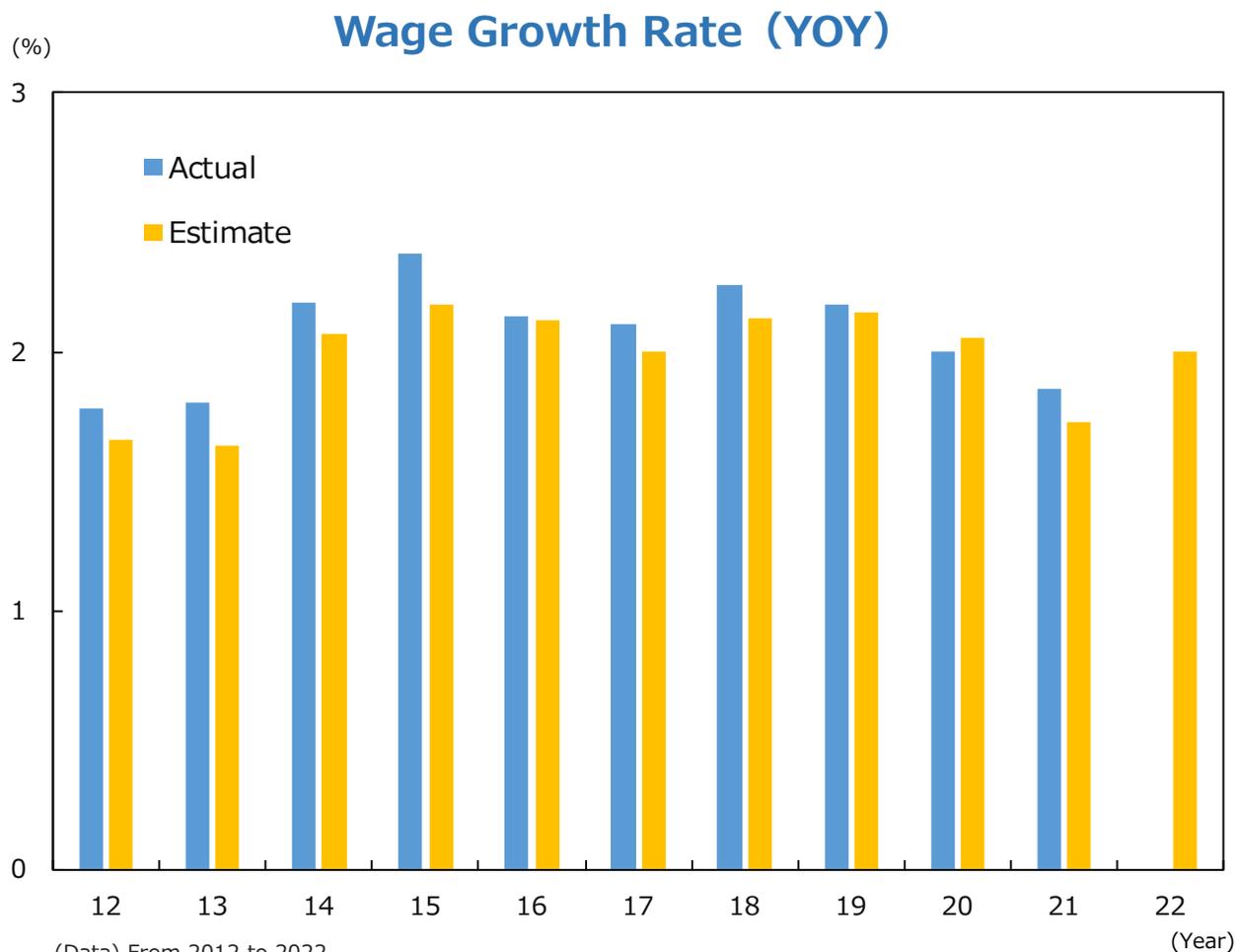


Retail Sales (Dec. 2019 = 100)



(Data) From Jan. 2018 to Jan. 2022  
 (Source) BOJ, METI, and SMDAM

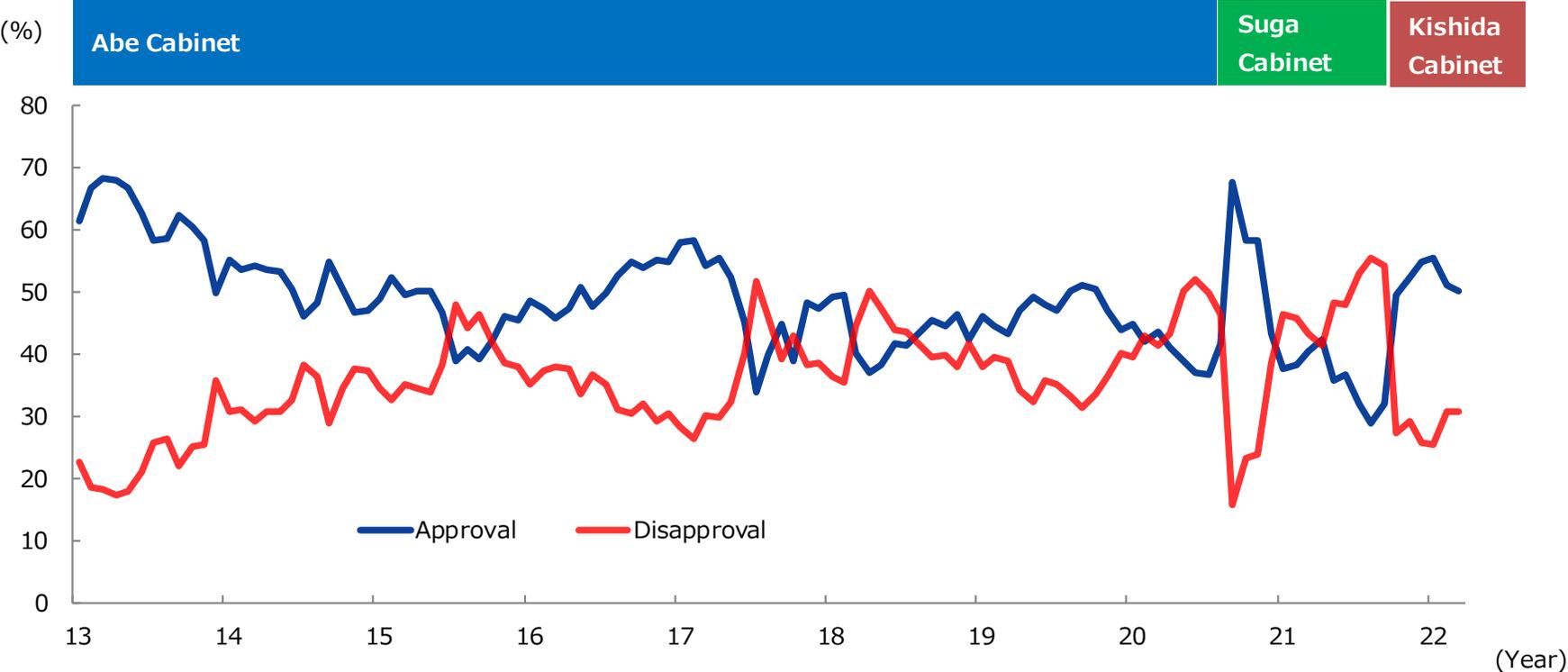
# Wages expected to increase slightly higher than last year



(Data) From 2012 to 2022  
(Source) MHLW, The Institute of Labor Administration, SMDAM

# PM Kishida keeps stable approval rate

## Cabinet approval rate



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

# Economic stimulus larger than anticipated

Size of Economic Stimulus (Trillion Yen)

	Emergency Economic Measures for COVID-19 Infections	Second Supplementary Budget for FY 2020	Comprehensive Economic Measures for People's Lives and Livelihoods	New Economic Measures of PM Kishida Cabinet
<b>Date of Decision</b>	4/20/2020	5/27/2020	12/8/2020	<b>11/19/2021</b>
<b>Size of Stimulus</b>	117.1	117.1	73.6	<b>78.9</b>
<b>Fiscal Spending</b>	48.4	72.7	40.0	<b>55.7</b>
<b>Expenditure of Government</b>	35.8	33.2	32.3	<b>49.7</b>
<b>FILP</b>	12.5	39.3	7.7	<b>6.0</b>

(Source) SMDAM

# PM Kishida’s economic policy – “growth and distribution”

## Leader of Ruling LDP and His Economic Policy

<b>Name</b>	<b>Fumio Kishida</b>
<b>Political Career</b>	Former Political Chairman of LDP Former Chairman of the Diet Affairs Committee of LDP Former Minister of Defense Former Minister for Foreign Affairs
<b>Faction</b>	Kishida
<b>Policy overview</b>	<ul style="list-style-type: none"> <li>■ New Japanese-style capitalism based on the virtuous cycle of growth and distribution</li> <li>■ Transformation from Neoliberalism</li> </ul>
<b>Orientation of Economic Policy</b>	<ul style="list-style-type: none"> <li>■ Rectifying Economic Disparities</li> </ul>
<b>Economic Policy</b>	<ul style="list-style-type: none"> <li>■ "Growth Strategy with Four Tactics"             <ul style="list-style-type: none"> <li>▪ Science &amp; Technology Nation (10 trillion yen university endowment fund)</li> <li>▪ Economical National Security (promote free and reliable data flow)</li> <li>▪ Digital Rural City-State Vision (early rollout of 5G)</li> <li>▪ Support for Aging Society (universal social insurance)</li> </ul> </li> <li>■ Income Doubling &amp; Distribution-Oriented Policy</li> </ul>

(Source) SMDAM

# Schedule of major events

Schedule of Major Domestic Events		
2022	Spring	Release of Grand Design of "New Capitalism Realization Conference"
	April	27-28 Monetary Policy Meeting
	May	18 Release of CY 2022 Q1 GDP
	Summer	Release of Execution Plans and Schedules of "New Capitalism Realization Conference"
	June	8 15 16-17 Revision of CY 2022 Q1 GDP End of Ordinary Diet Session Monetary Policy Meeting Cabinet Decision on Bold Economic Policy and Growth Strategy G7 Summit in Germany
	July	20-21 23 25 Monetary Policy Meeting End of the Term of two members of the BOJ Monetary Policy Committee End of the Term of House of Councilors
	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

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

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- Past performance is not necessarily indicative of future results.
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