



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-November 2023-

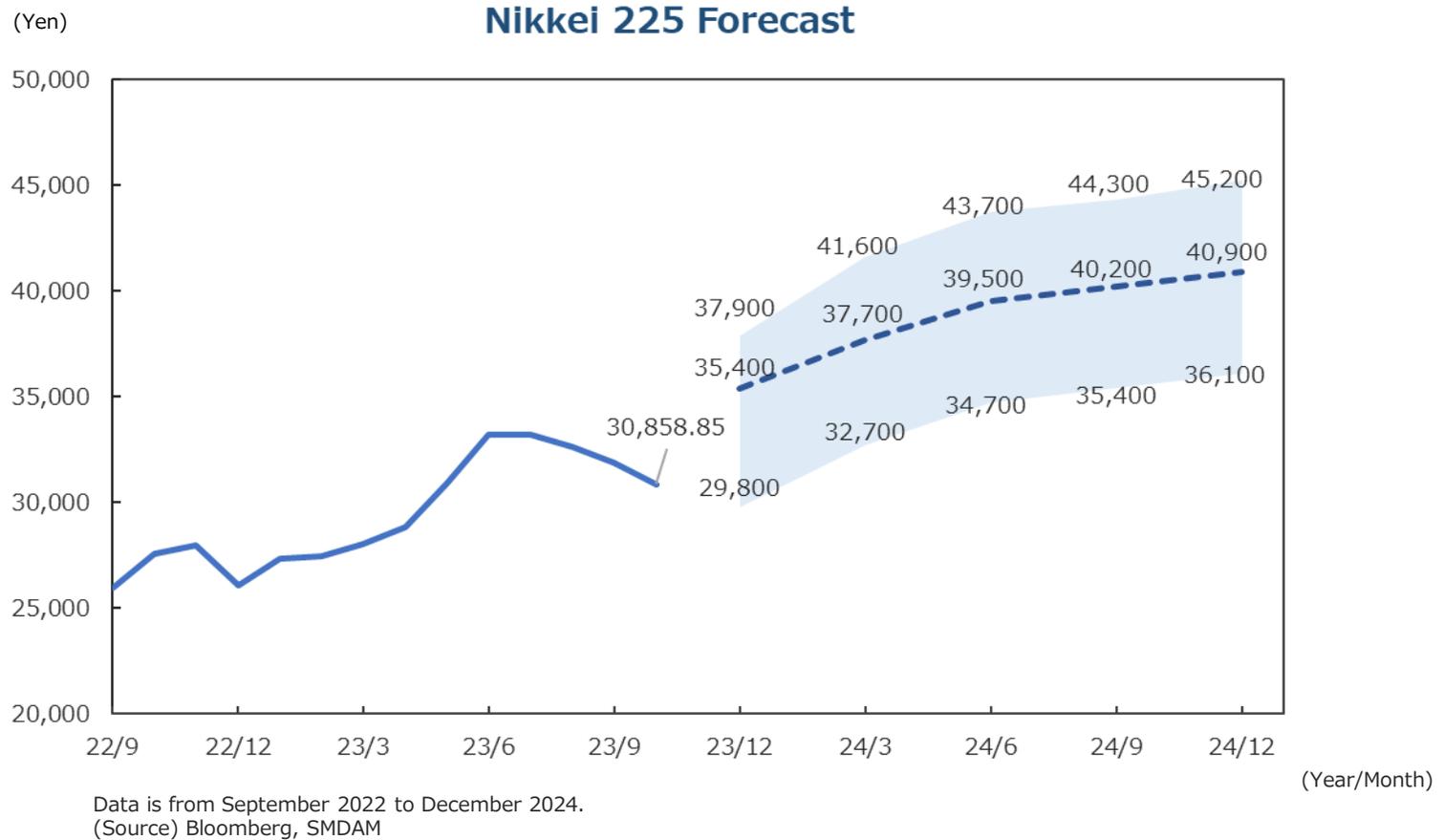


Outlook for Japanese Stock Market

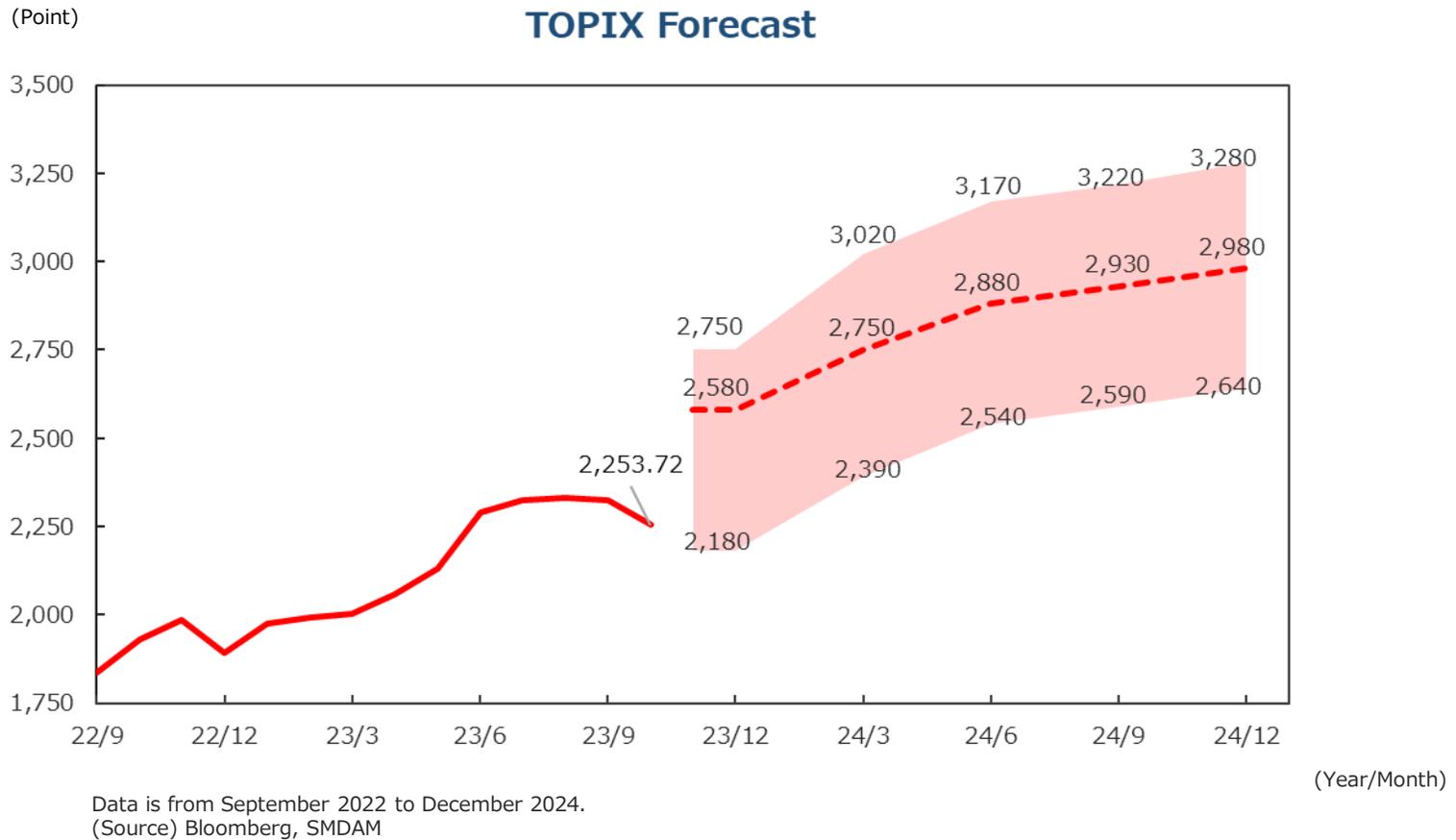
Market Outlook

- We are bullish on the Japanese equity market due to strong corporate earnings, encouraging nominal GDP growth, and the bottoming out of the business cycle in the manufacturing sector.
- Growing confidence over the virtuous cycle of mild inflation and wage increases could provide a boost to the Japanese stock market going forward. Politically motivated fiscal stimulus could also fuel bullish market sentiment further.
- The market focus has moved to the possibility of monetary tightening rather than the state of the economy.
- We foresee the TOPIX index reaching 2,980 and Nikkei 225 reaching 40,900 by the end of next year.

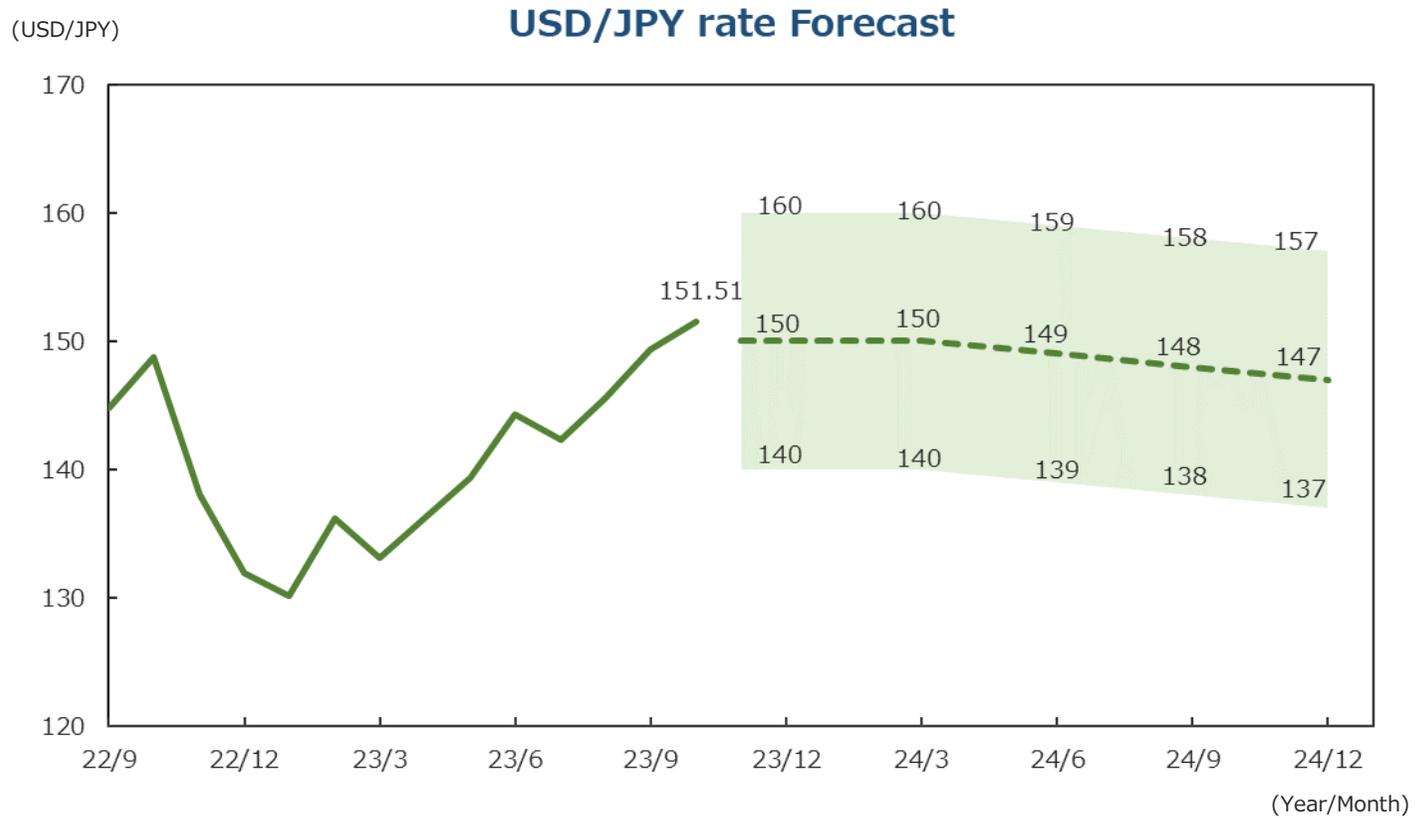
We see bullish market outlook ahead



We see bullish market outlook ahead



Modest JPY appreciation ahead due to FED & BOJ pivot



Data is from September 2022 to December 2024.
(Source) Bloomberg, SMDAM

Upside / Downside risk scenarios

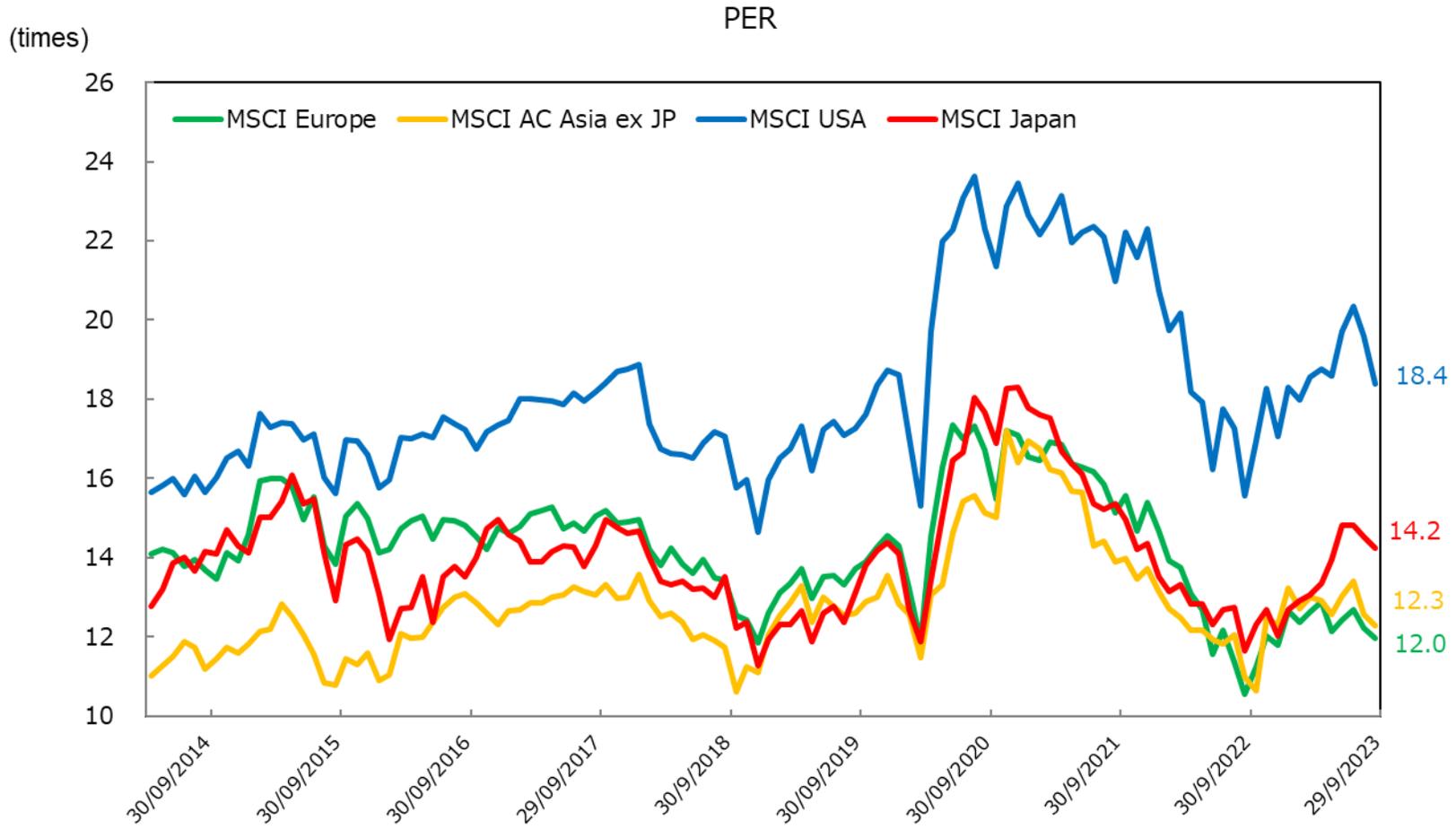
■ Upside Risks

- Growing optimism over mild inflation and wage increases
- Postponement of the Bank of Japan's lifting of large-scale monetary easing

■ Downside Risks

- Excessive JPY appreciation and its negative impact on corporate earnings
- Renewed concern over systemic risk of global financial system
- Geopolitical risk and its negative influence on the global economy

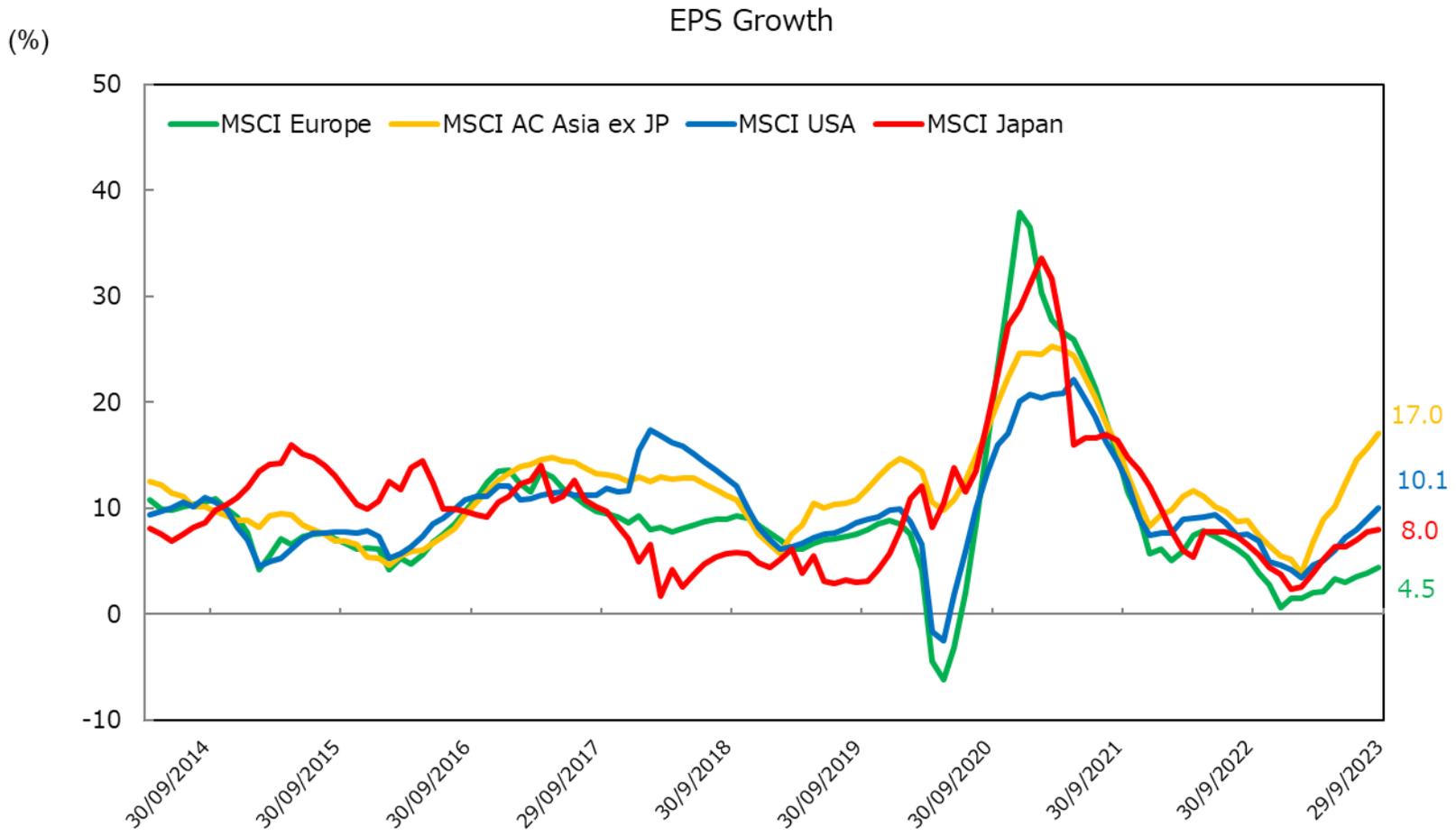
Bond yields impact P/E ratio globally



Data is from April 30th 2014 to September 30th 2023
 (Source) MSCI

(DD/MM/YYYY)

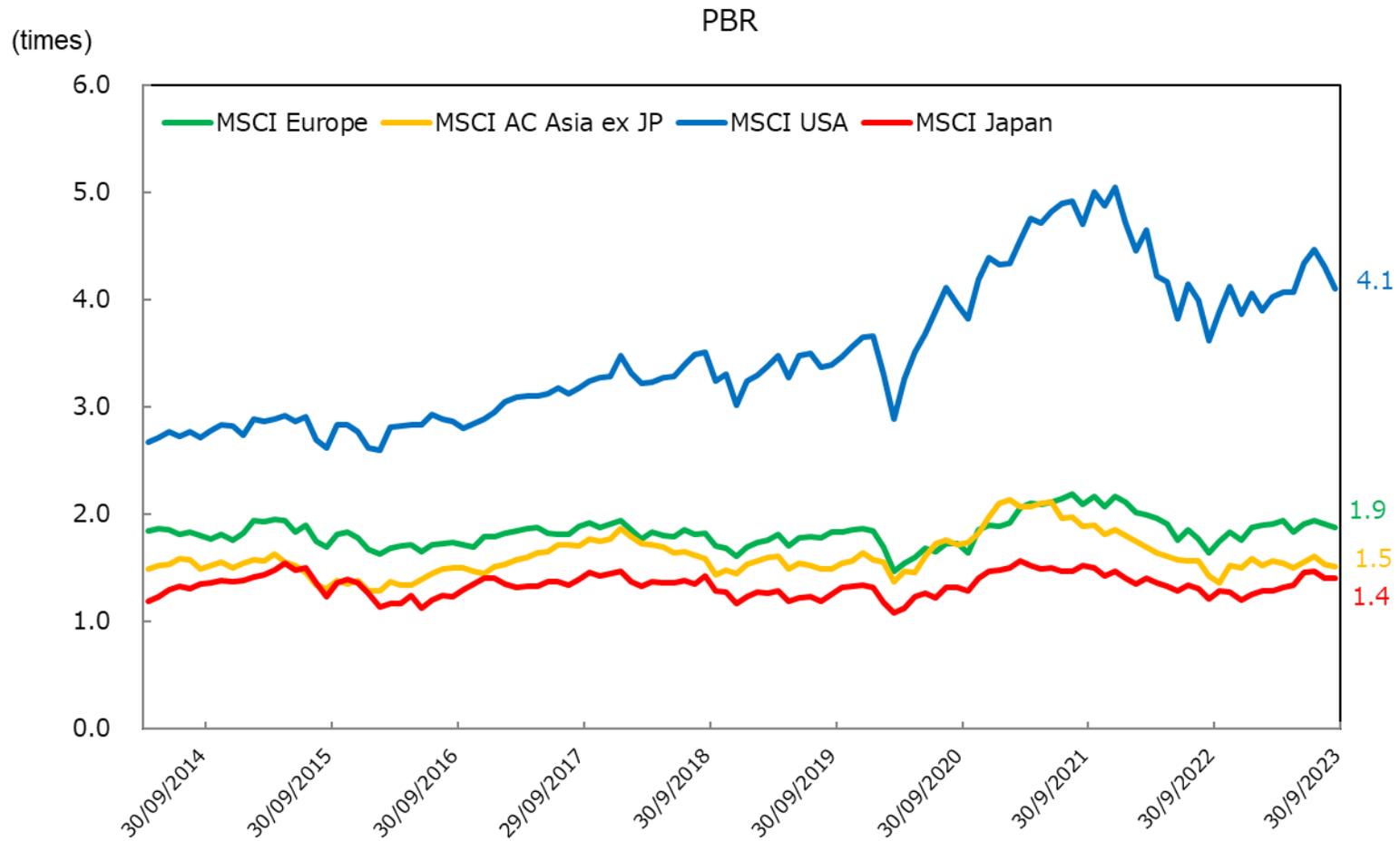
Corporate earnings outlook increasingly optimistic



Data is from April 30th 2014 to September 30th 2023
 (Source) MSCI

(DD/MM/YYYY)

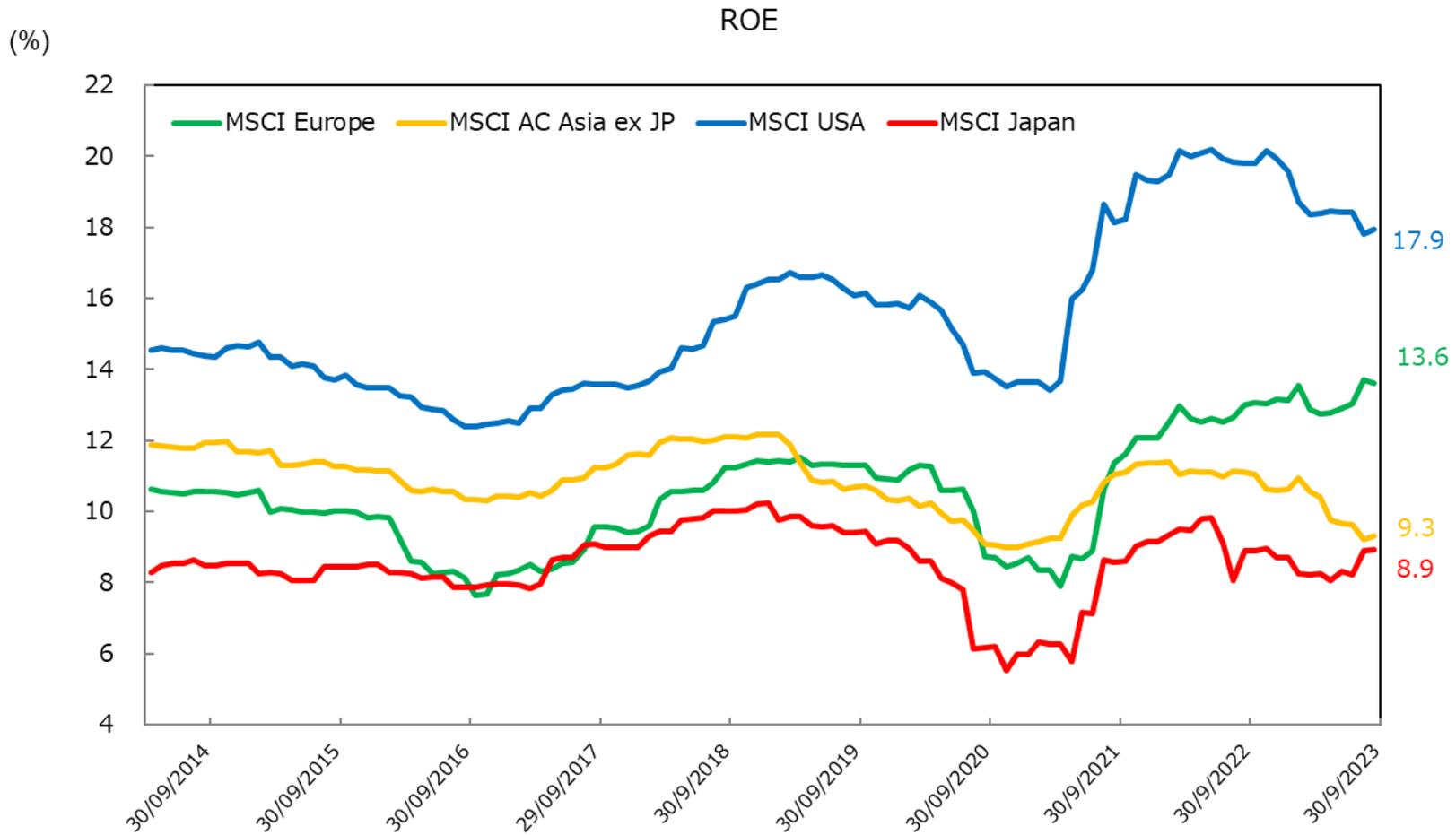
Japan's P/B ratio hit bottom but still lower than peers



Data is from April 30th 2014 to September 30th 2023
(Source) MSCI

(DD/MM/YYYY)

Japanese ROE rising with solid earnings growth

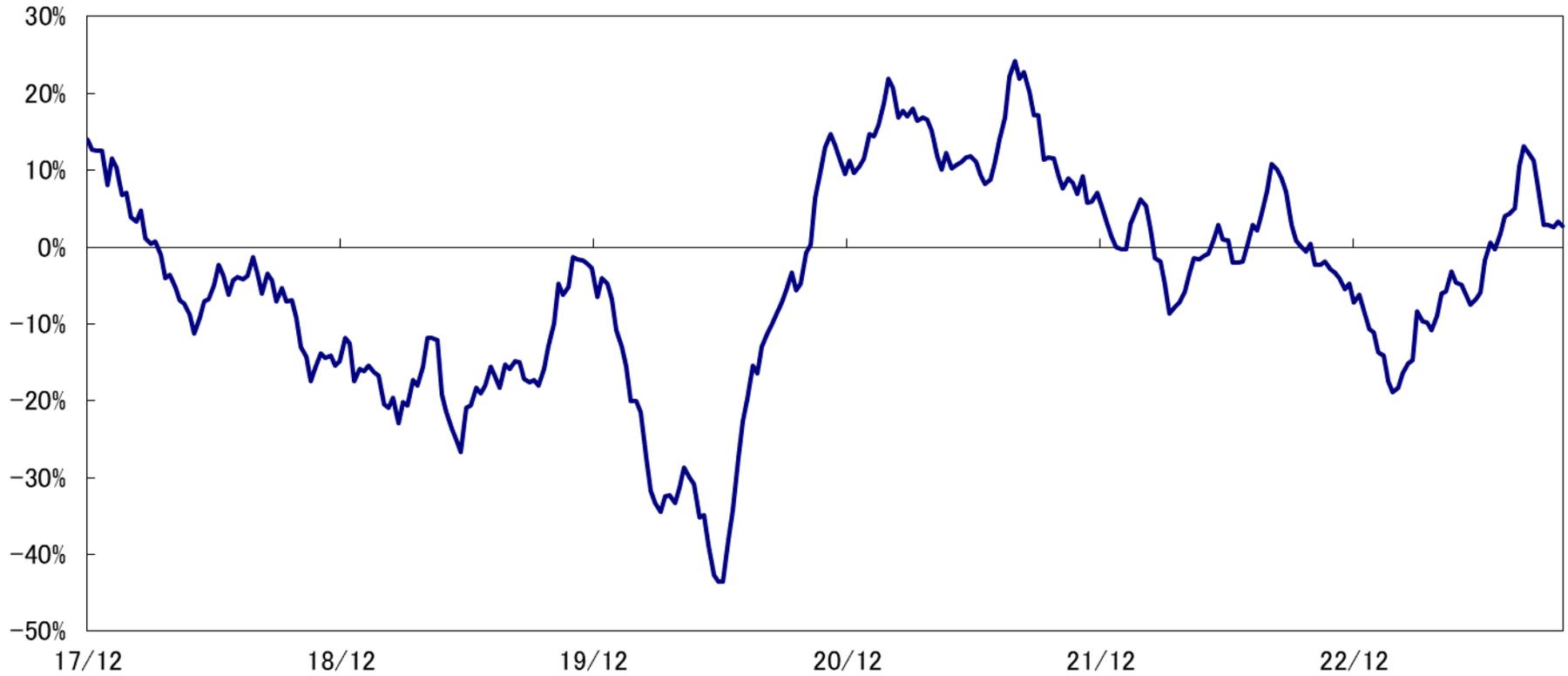


Data is from April 30th 2014 to September 30th 2023
 (Source) MSCI

(DD/MM/YYYY)

EPS revision maintains its positive trend

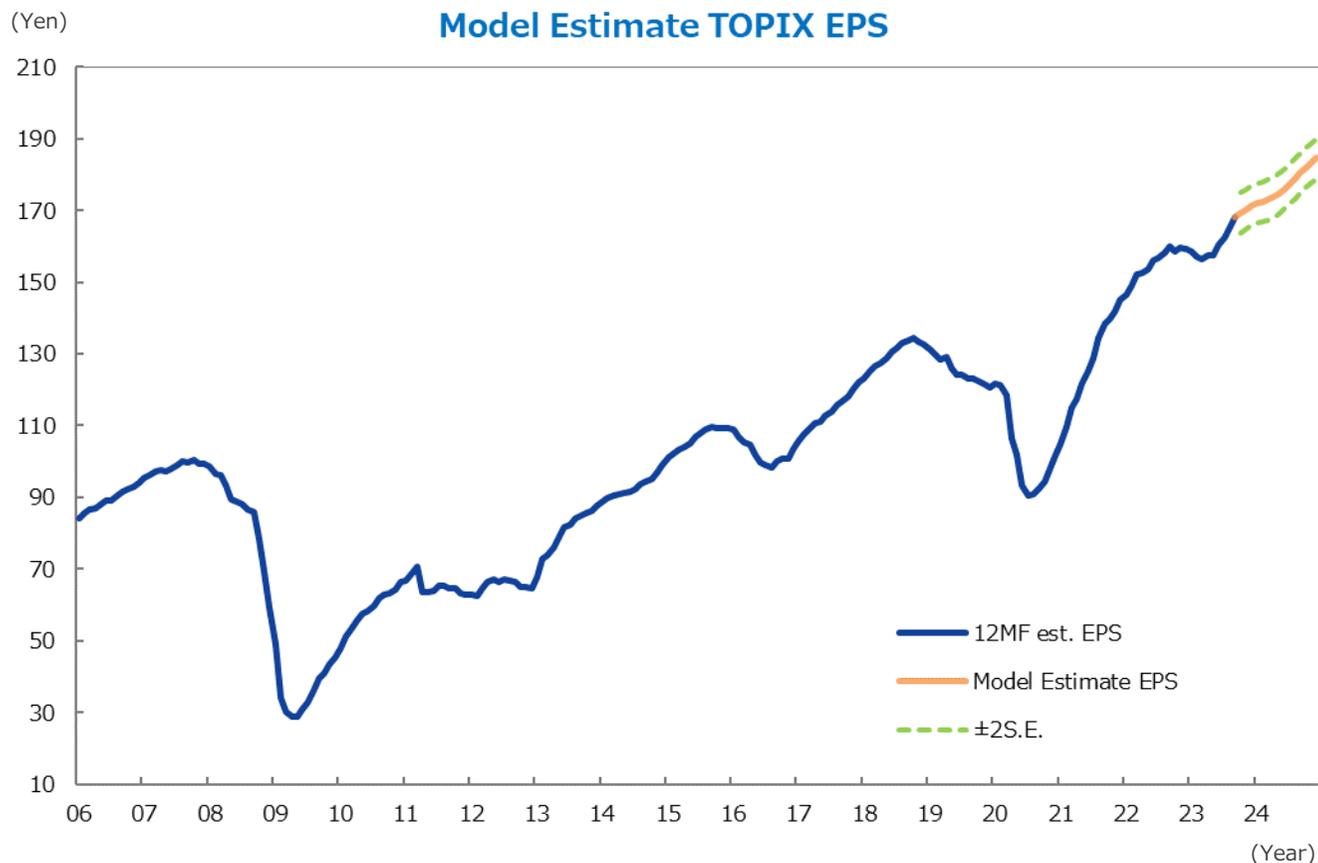
TOPIX Revision Index



Data is from December 28th 2017 to October 26th 2023
(Source) Datastream, IBES

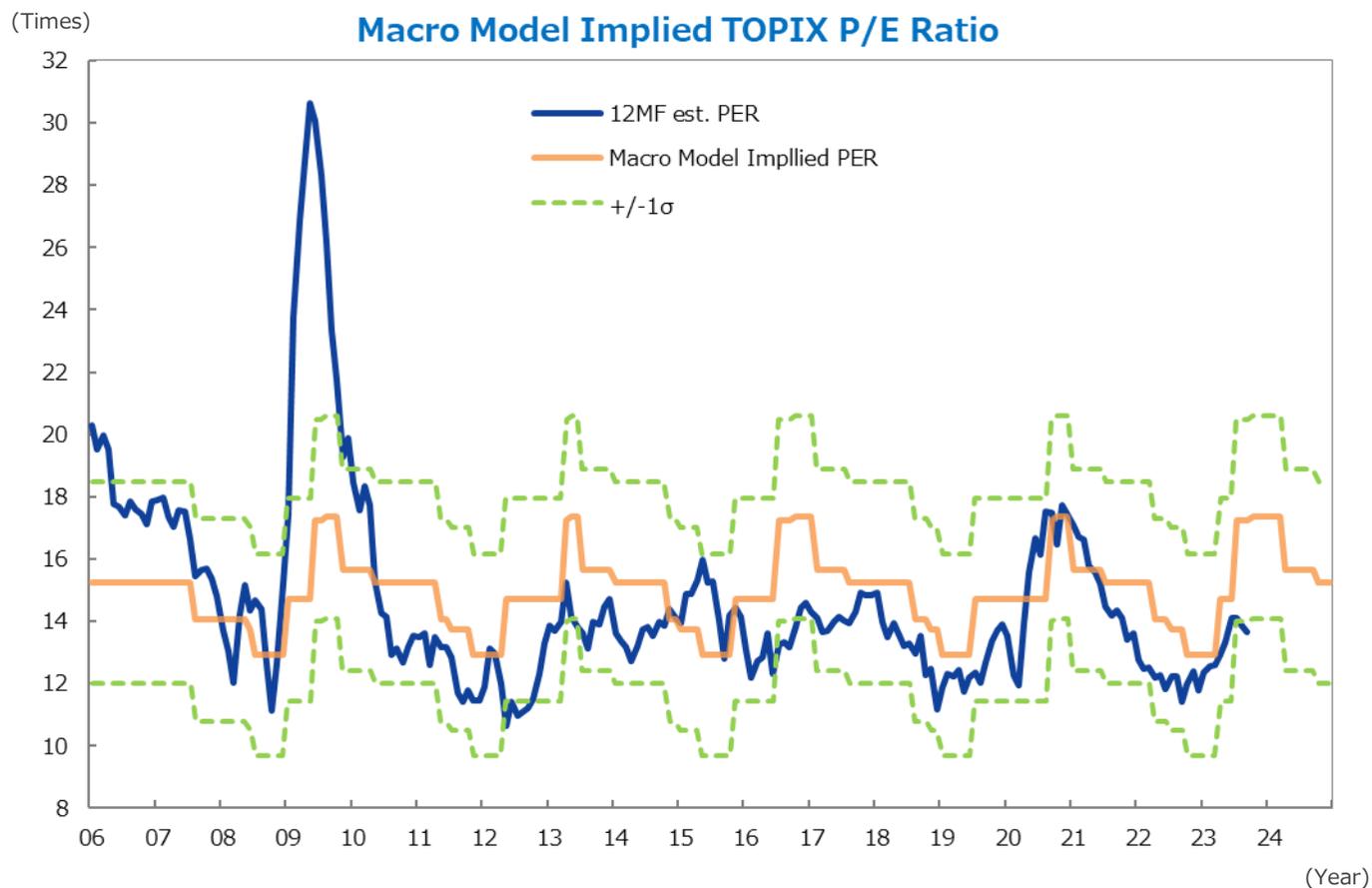
(YY/MM)

Quant model suggests encouraging earnings outlook



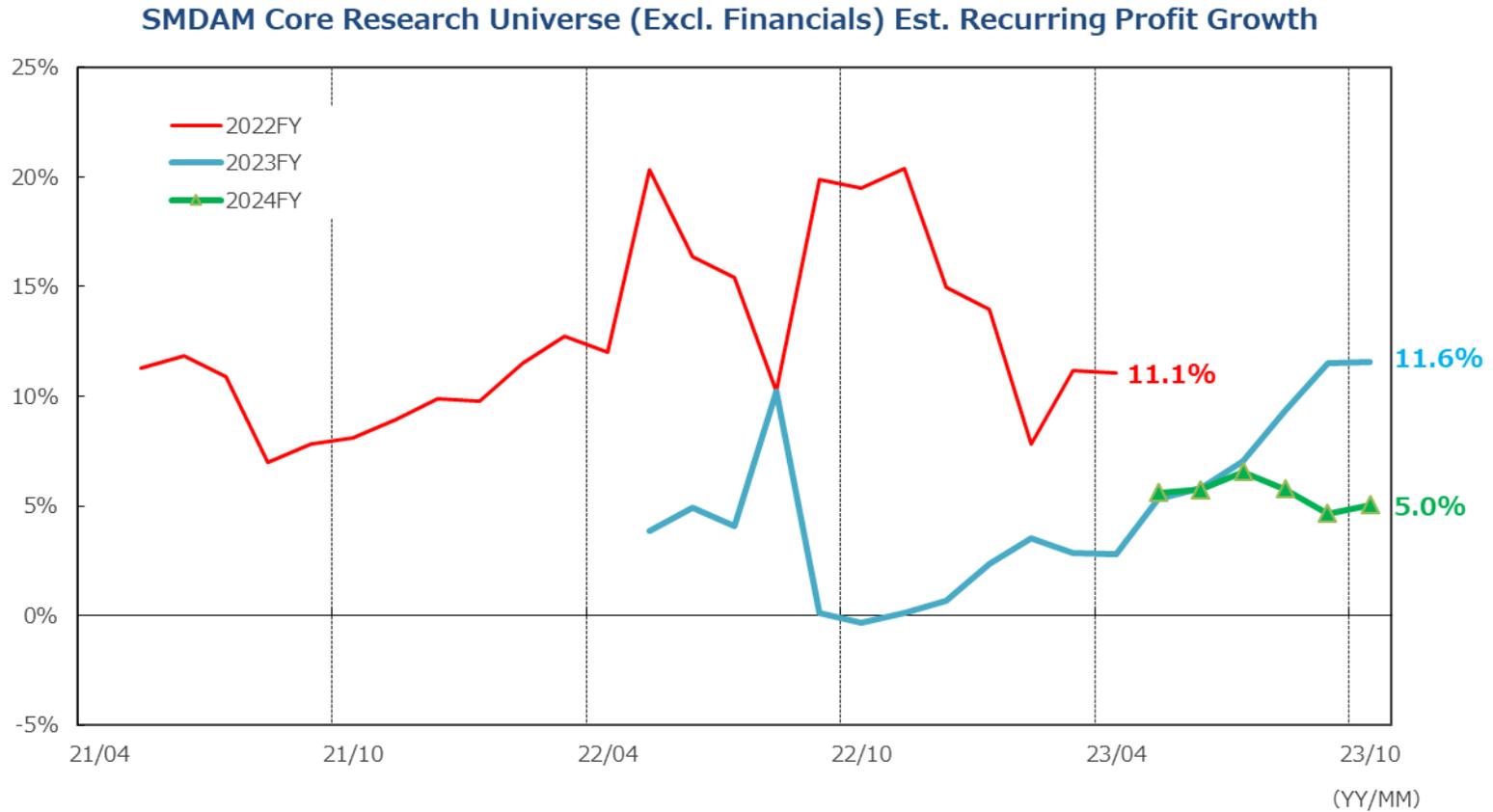
Note: Consensus data is from January 2006 to September 2023. Model estimate Data is from October 2023 to December 2024.
Source: SMDAM

Model indicates further upside of P/E ratio



Note: Consensus data is from January 2006 to September 2023, Model estimate Data is from January 2006 to December 2024.
Source: SMDAM

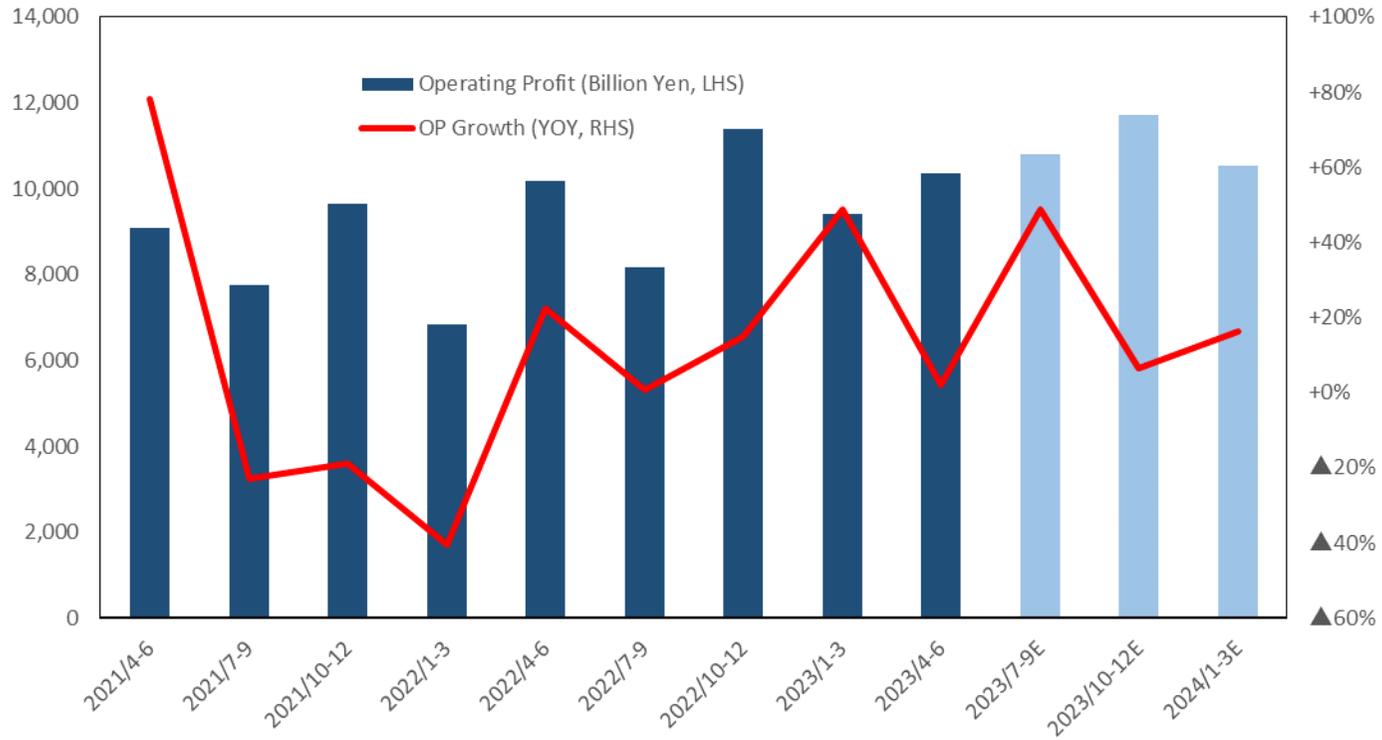
Strong earnings growth followed by modest increase next year



Note: Data is as of 11th October 2023, SMDAM Core Universe (Excl. Financials) consists of 397 Japanese companies covered by SMDAM in-house analysts.
 Source: SMDAM

Stable operating profit outlook going forward

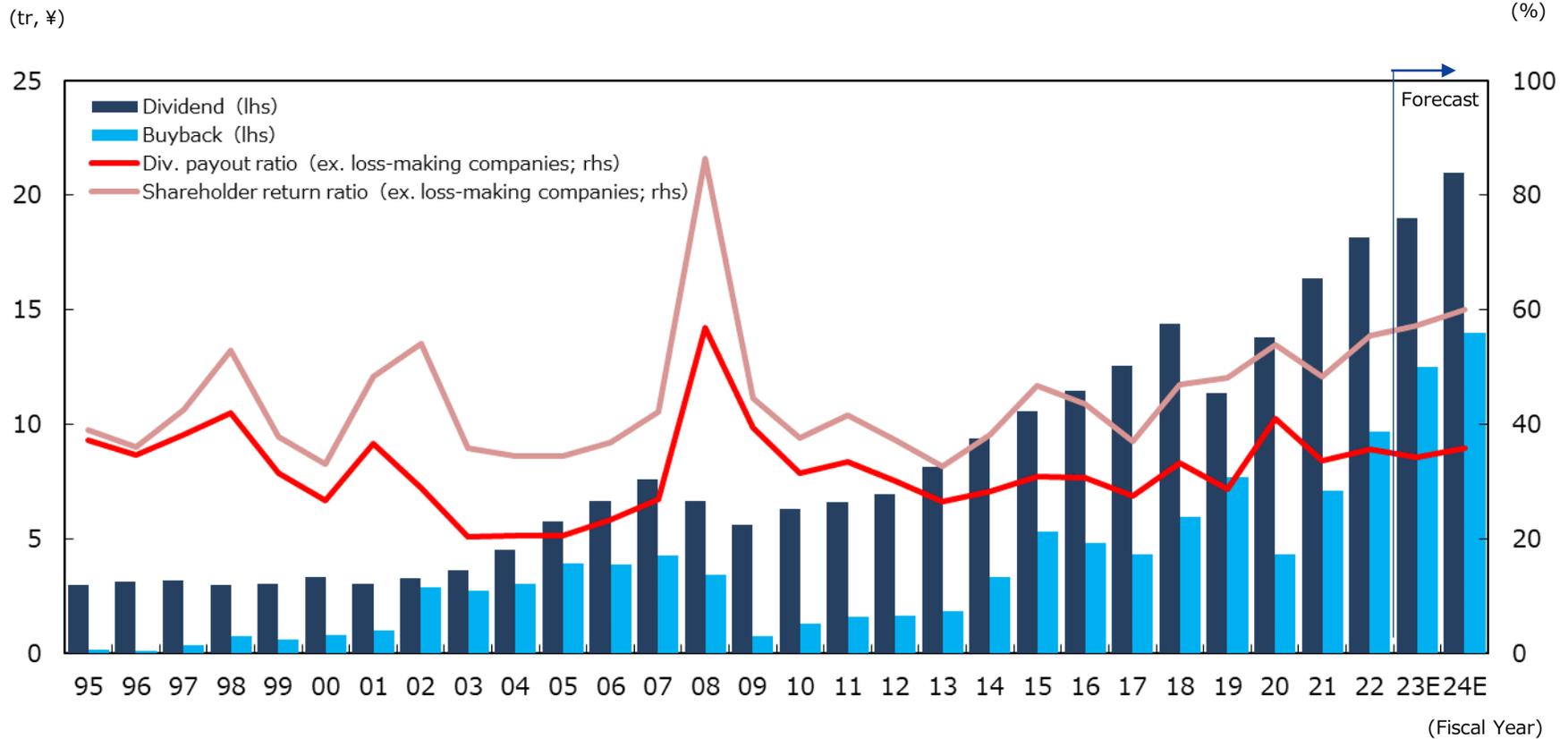
Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q1 2021 to Q2 2023. Estimate data is from Q3 2023 to Q1 2024.
Source: SMDAM

Dividends and buybacks continuing to beat historical highs

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



Note: Data is from FY1995 to FY2024. FY2023 and FY2024 are forecasts by Daiwa Securities.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Large cap value dominates Japanese 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	-1.03	10.81	19.59	18.76	11.30	38.07	34.50
Total Value	4.17	19.39	27.98	29.48	31.91	68.83	38.86
Top Cap Value	3.65	23.23	31.84	35.25	40.53	87.59	60.71
Large Cap Value	4.22	20.54	29.24	31.10	34.46	74.88	42.99
Mid Cap Value	5.02	16.98	25.77	25.71	26.83	59.67	20.96
Small Cap Value	3.92	14.32	22.42	22.49	21.03	43.98	21.49
Micro Cap Value	3.30	12.30	20.18	21.25	20.05	38.62	20.34
Total Growth	-6.21	2.64	11.51	9.02	-5.79	12.75	28.39
Top Cap Growth	-6.30	3.21	13.45	10.93	-4.76	19.25	35.54
Large Cap Growth	-6.12	3.24	12.95	10.35	-4.81	14.96	32.04
Mid Cap Growth	-5.81	3.30	12.06	9.35	-4.80	8.59	26.71
Small Cap Growth	-6.92	-2.10	0.77	-1.14	-13.76	-4.39	2.00
Micro Cap Growth	-7.06	-3.16	-1.30	-2.17	-16.99	-7.00	0.19
Top Cap Total	-1.78	11.92	21.57	21.26	13.18	46.11	45.47
Large Cap Total	-1.17	11.31	20.63	19.82	12.05	40.53	38.06
Mid Cap Total	-0.19	10.34	19.15	17.62	10.44	32.75	27.80
Small Cap Total	-0.19	7.92	13.78	12.83	6.54	23.60	14.72
Micro Cap Total	-0.01	7.21	12.87	13.07	6.84	21.96	14.79

Note : As of 19th October 2023
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** The Bank of Japan's "Tankan" business survey shows strong business sentiment thanks to improving profit margin and resumption of economic activities. CAPEX also looks favorable, with pent-up demand, manpower shortages, and de-carbonization and digitalization as supporting factors. Despite the headwinds of higher prices, consumer spending remains stubborn. Exports are solid as overseas economies, led by the United States, avoid a slowdown.
- **Inflation is slowing down.** While the nationwide core CPI rose by 3.1% in August YOY, unchanged from the previous month, the Tokyo metropolitan area core CPI rose by 2.5% in September YOY, down sharply from 2.8% the previous month. Goods inflation has been slowing, such as energy, food and daily necessities, and the pressure on import prices and other costs has eased.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2023 at +1.9% and we have raised that for FY 2024 from +1.0% to +1.2%.** While the review of GDP forecast for Q3 2023 and the forecast for change in monetary policy next spring undermine the outlook for the economy, changes in the scale of the government's fiscal stimulus, foreign exchange assumptions and the outlook for salary increases in 2024 boost the projection for the economy. We expect economic recovery to continue with the steady recovery of private consumption and CAPEX. Regarding consumer activities, high prices are a headwind, but higher wages are likely to mitigate the negative effects. With regard to CAPEX, labor shortages, de-carbonization, and digitalization are major drivers for demand. A supplementary budget is expected to be enacted within FY 2023, and economic measures are expected to come into effect. On the other hand, exports, which are currently strong, are likely to slow growth moderately as the US economy slows down going forward.
- ② **We have raised our core CPI forecast for FY 2023 from +2.7% to +2.8% and that for FY 2024 from +1.8% to +2.0%.** The upward revision was primarily due to a change in currency assumptions and an increase in FY 2024 wage increase forecast. Looking ahead, it is highly likely that the core CPI will follow a deceleration trend due to the reduction in cost push pressure from import prices, but the pace of deceleration will be moderate owing to the weak yen. Core CPI is likely to fall below 2% in the second half of FY 2024, but we have raised our forecast from the lower 1% range to the upper 1% range.
- ③ **PM Kishida and his cabinet will continue its accommodative economic policy.** PM Kishida has said he will compile an economic package in the coming days, which is expected to cost about 15 trillion yen. The scale of economic measures is expected to be smaller than in recent years, taking into account the easing of COVID-19 restrictions and a positive shift in the GDP gap. However, it is possible that Prime Minister Kishida will expand the scale of his economic measures in order to improve his sluggish approval rating.
- ④ **Regarding monetary policy, we expect a pivot in April 2024, specifically the elimination of the YCC (Yield Curve Control) and an increase in short-term policy rate.** Main reasons for the policy change are an increase in the outlook for wage hike in FY 2024, a slower pace of inflation decrease due to changes in exchange rate assumptions, and hawkish comments from participants of the BOJ Monetary Policy Meeting. The reason for assuming a policy change will occur in April 2024 is that the BOJ will confirm the results of the spring wage negotiations in mid-March 2024 and is likely to announce in April 2024 through its "Outlook Report" that the probability of achieving the price stability target has increased.

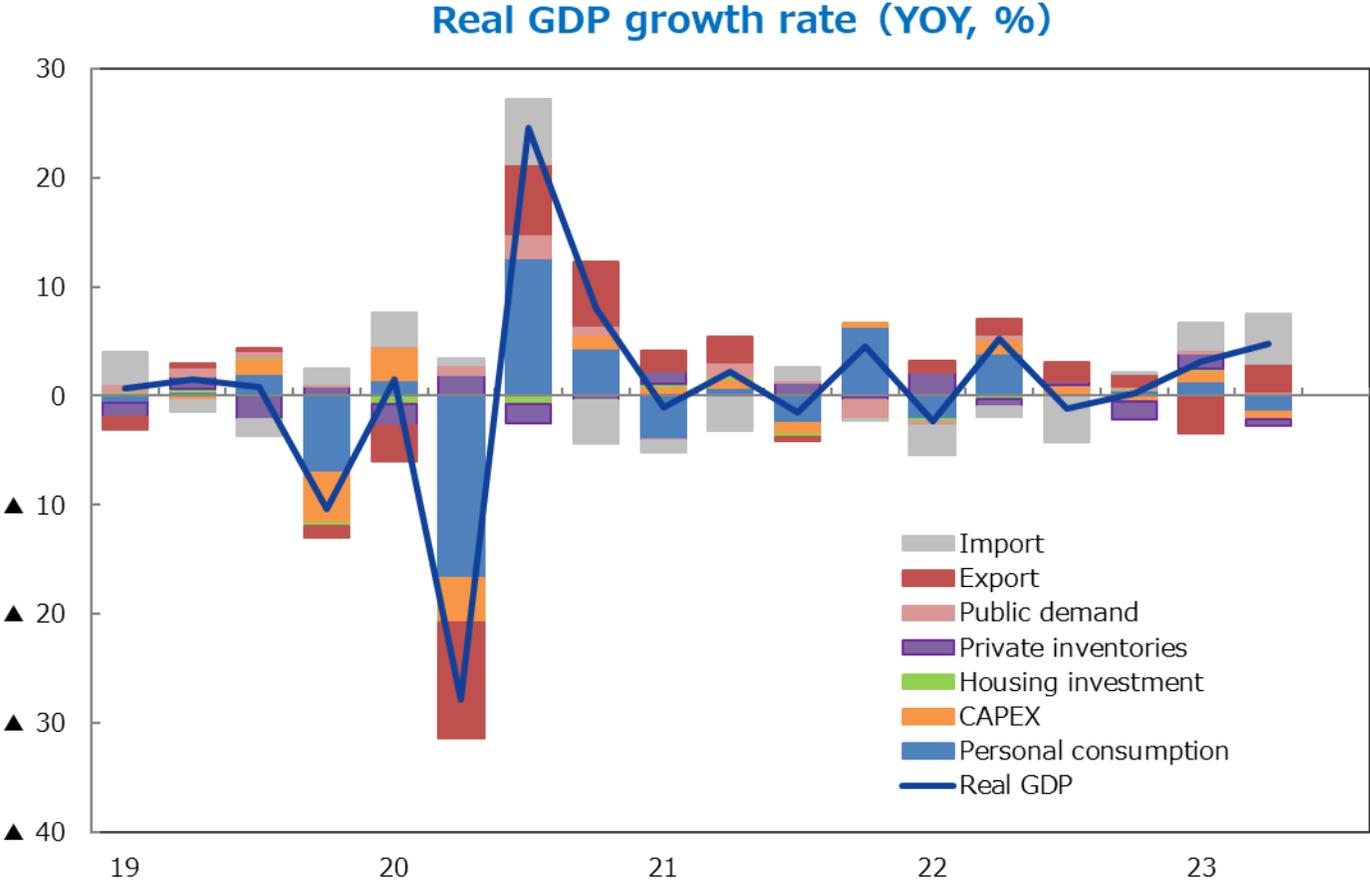


Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY18	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est
Real GDP	0.2%	-0.8%	-4.1%	2.7%	1.4%	1.9%	1.2%
Private final consumption expenditure	0.1%	-0.9%	-5.1%	1.5%	2.5%	0.1%	1.0%
Private housing investment	-4.8%	2.5%	-7.2%	-0.6%	-3.0%	2.2%	-0.5%
Private-sector capital investment	1.6%	-1.2%	-5.4%	2.3%	3.1%	0.7%	2.0%
Private inventory investment	0.1%	-0.2%	-0.3%	0.4%	0.2%	-0.1%	0.0%
Public fixed capital formation	0.9%	1.6%	4.9%	-6.5%	-3.1%	1.8%	0.2%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	1.2%	0.0%
Exports of goods and services	2.0%	-2.3%	-9.9%	12.4%	4.5%	2.7%	3.4%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.2%	-3.5%	3.3%
Nominal GDP	0.2%	0.0%	-3.4%	2.5%	2.0%	5.2%	2.6%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.7%	3.3%	1.4%
Industrial Production Index	-0.1%	-3.6%	-9.7%	5.7%	-0.3%	0.2%	1.9%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.8%	2.0%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	2.2%	0.9%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	2.8%	2.7%
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.6%	2.6%	2.4%
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	0.0%

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.
Source: 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

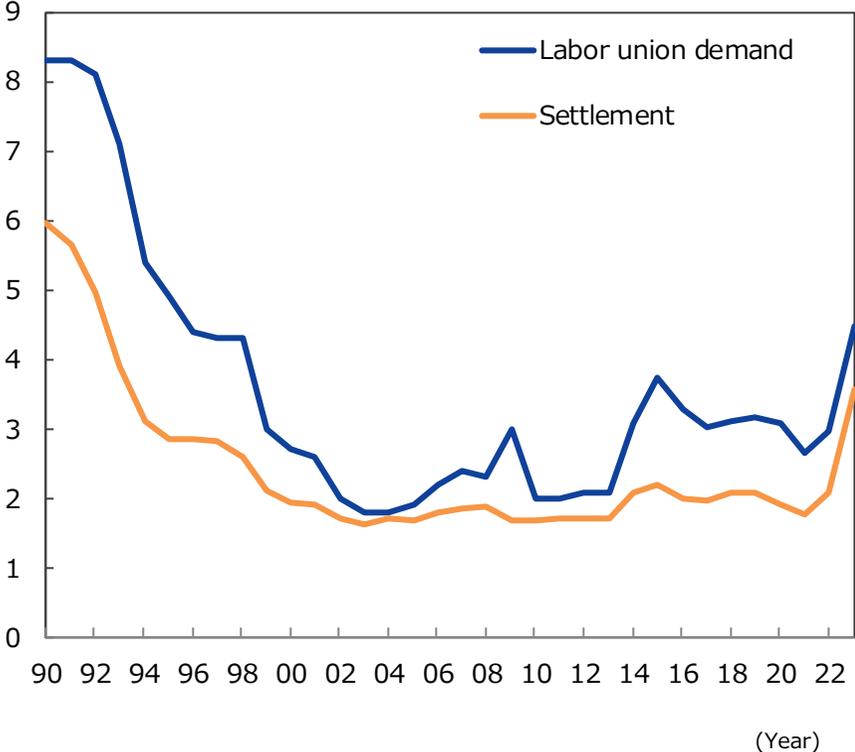
Net export boosts Japan's GDP despite slowing consumption



Note: Data is from Q1 2019 to Q2 2023.
 Source: Cabinet office, SMDAM

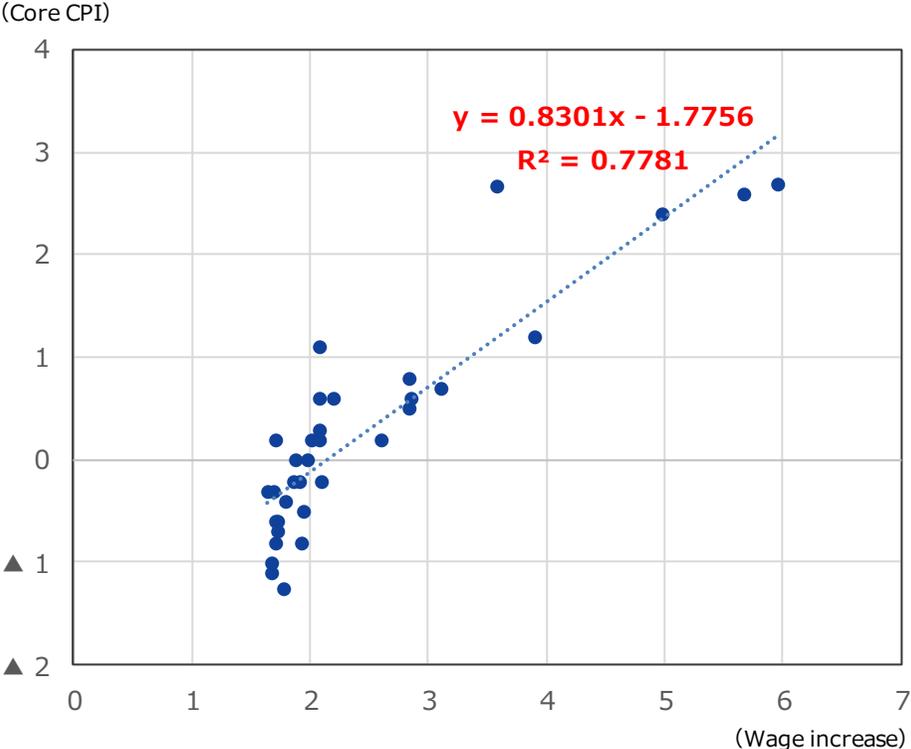
Start of a virtuous cycle to overcome deflation

Wage increase demand & settlement (YOY, %)



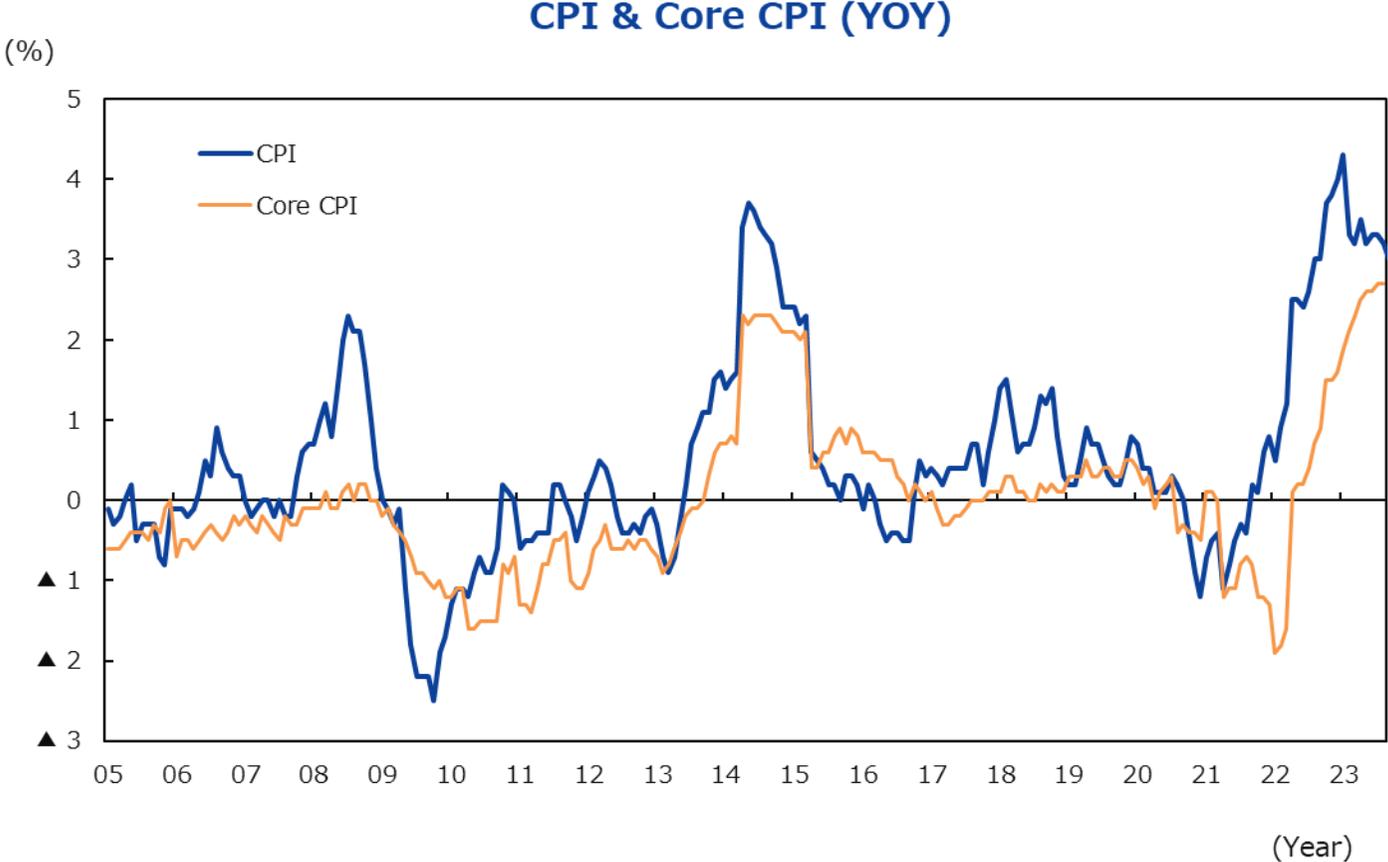
Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

Wage increase & Core CPI (YOY, %)



Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

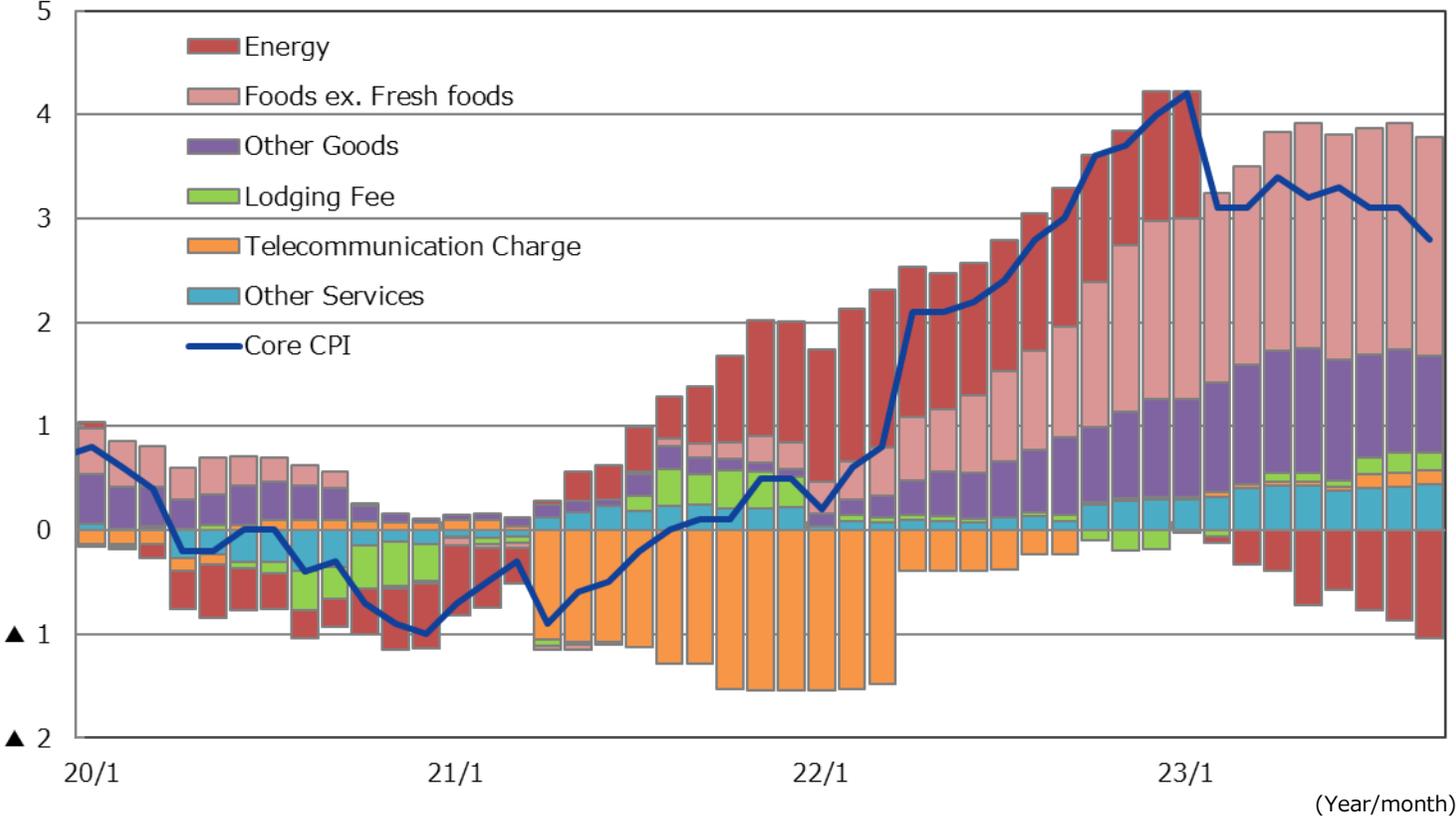
Sticky core inflation despite falling energy prices



Note: Data is from January 2005 to September 2023, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

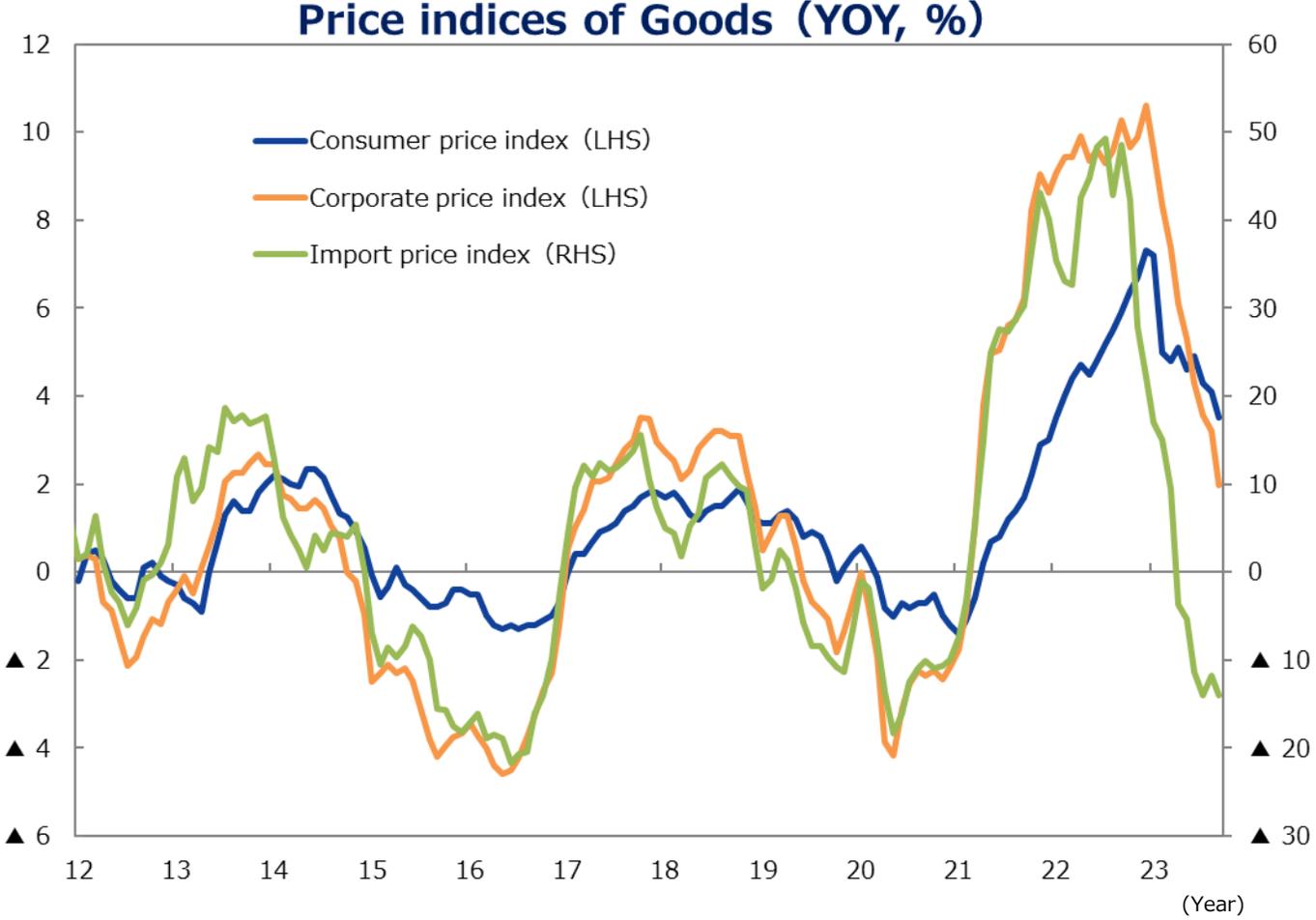
Foods and goods keep Japan's inflation high

Breakdown of CPI (YOY, %)



Note: Data is from January 2020 to September 2023,.
Source: MIAC, SMDAM

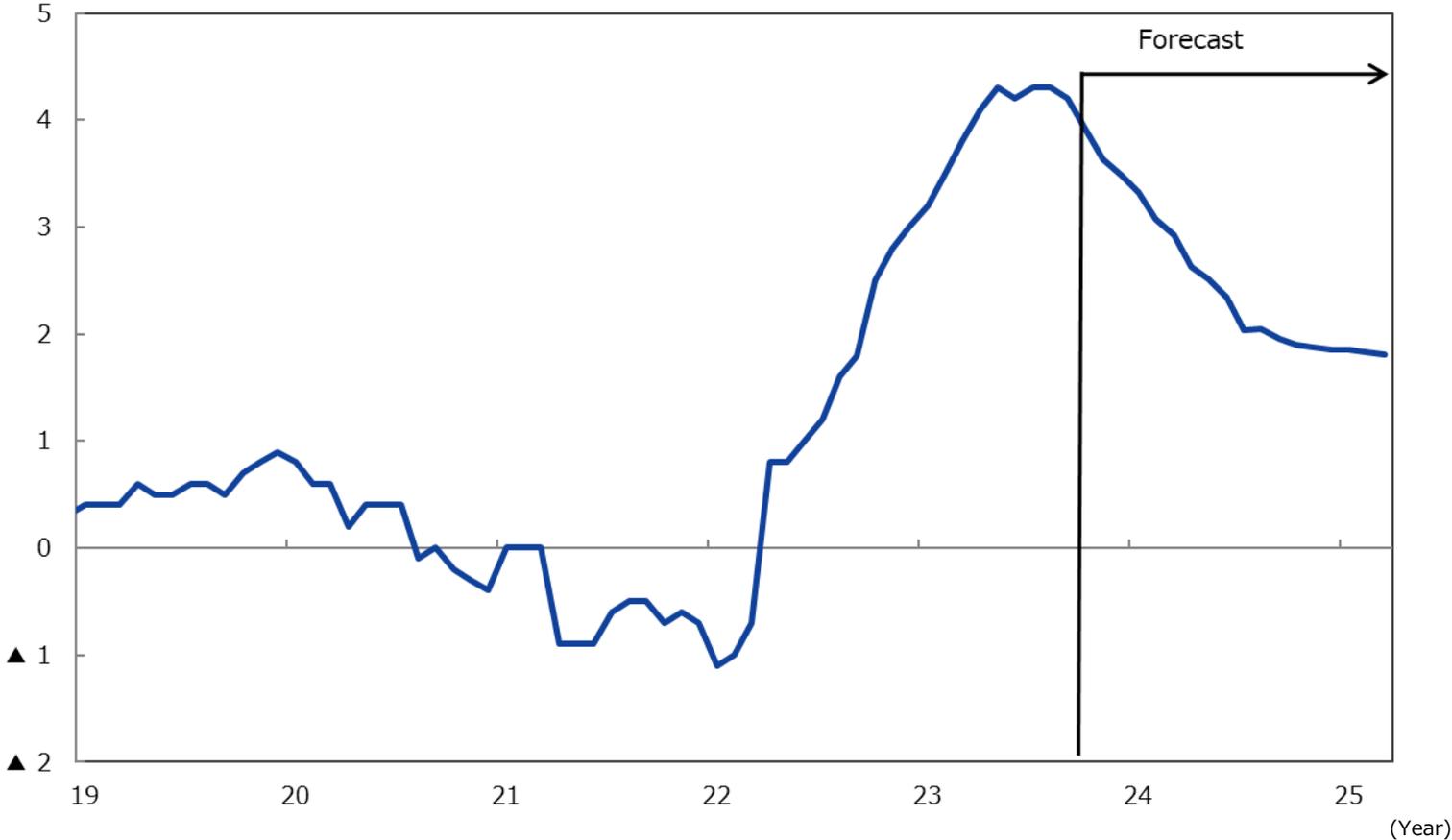
Profit margin improving thanks to falling input prices



Note: Data is from January 2012 to September 2023.
Source: MIAC, Bloomberg, SMDAM

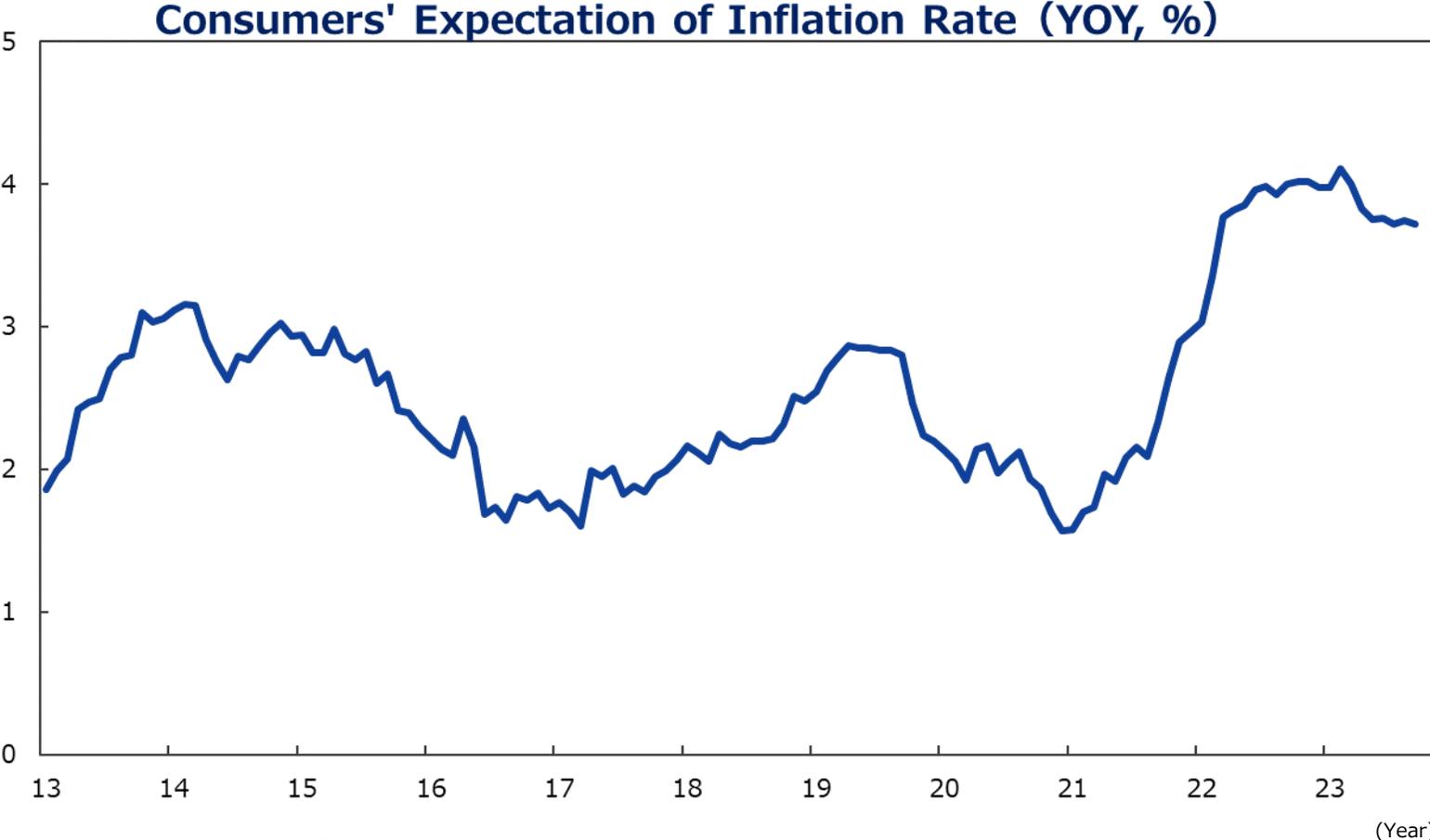
BOJ repeated upward revision of inflation forecast

BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's Core CPI is excluding fresh foods & energy. Data from October 2023 are forecasts.
Source: The Bank of Japan, SMDAM

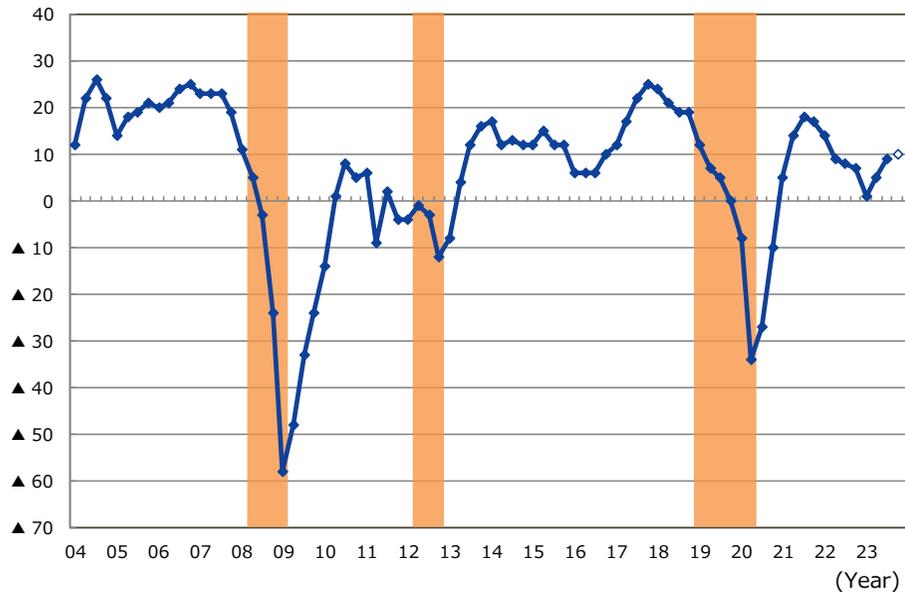
People expect high & sticky inflation going forward



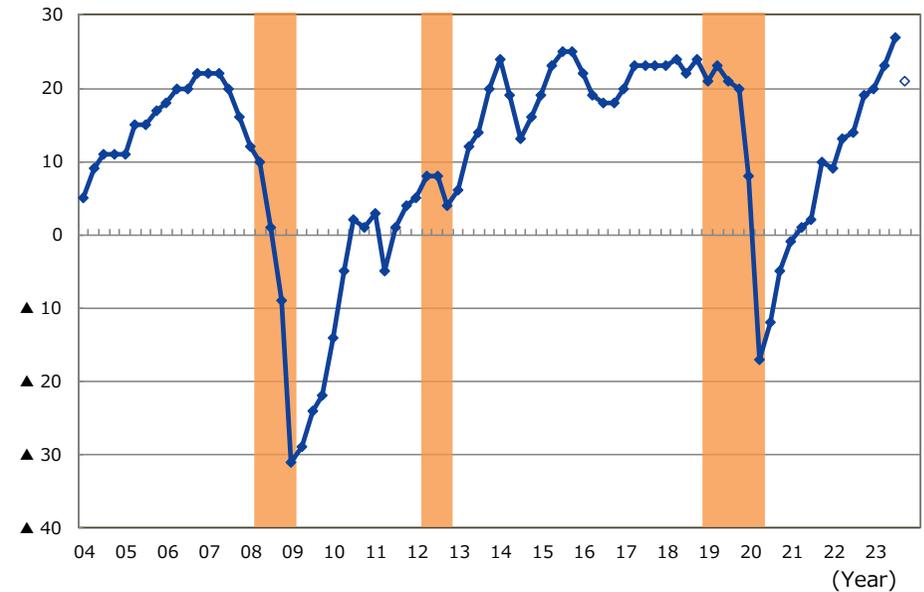
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to September 2023.
Source: Cabinet Office, SMDAM

Services continue rally & manufacturers start recovering

BOJ business condition DI Large manufacturers (%)



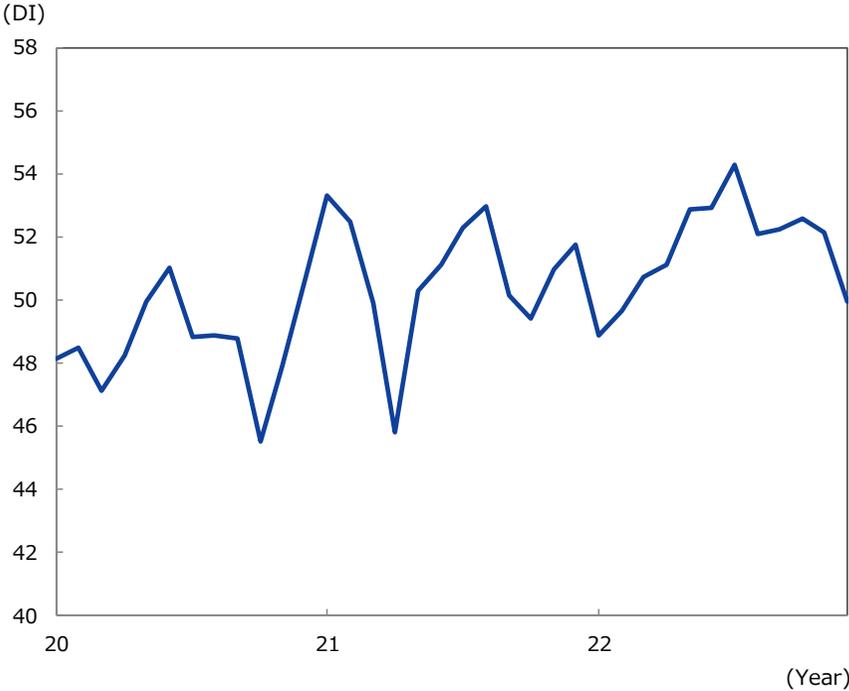
BOJ business condition DI Large non-manufacturers (%)



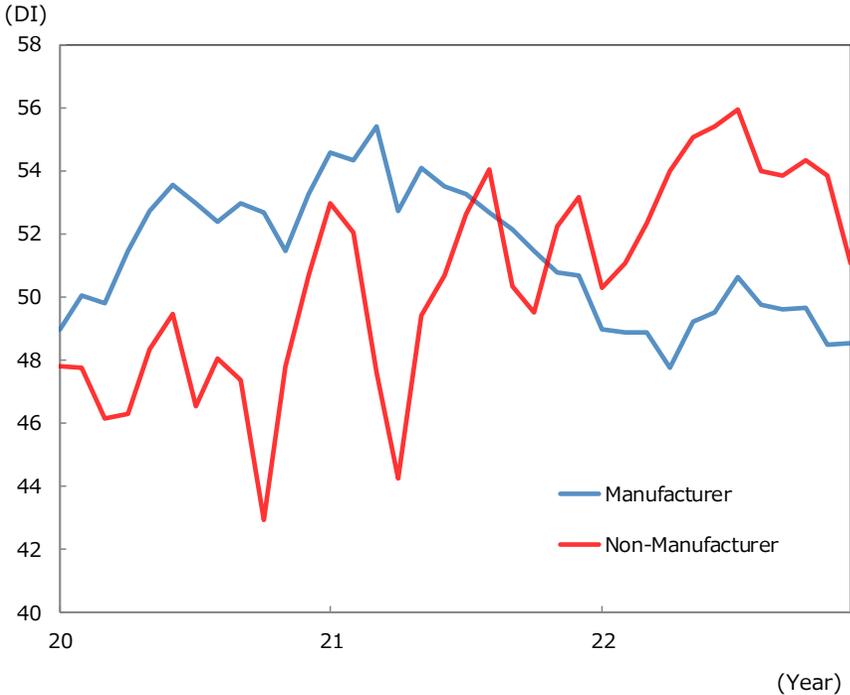
Note: Data is from Q1 2004 to Q3 2023. The orange shadow are periods of economic recession.
Source: The Bank of Japan, SMDAM

Soft data shows sign of slowing business activities of services

Composite PMI



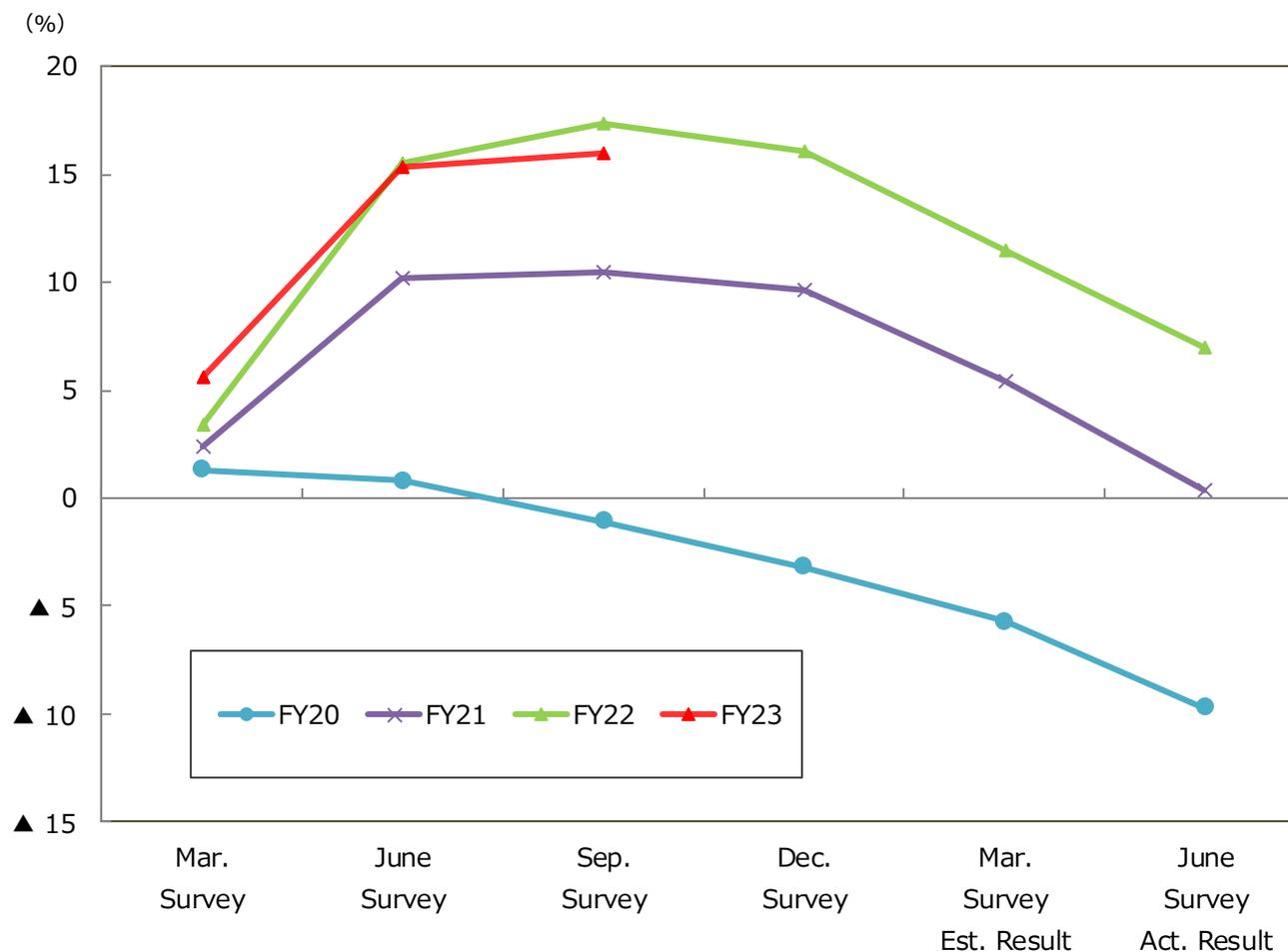
PMI, Manufacturer & Non-Manufacturer



Note: Data is from November 2020 to October 2023.
Source: Bloomberg, SMDAM

Weakening Yen and de-risking lift CAPEX in Japan

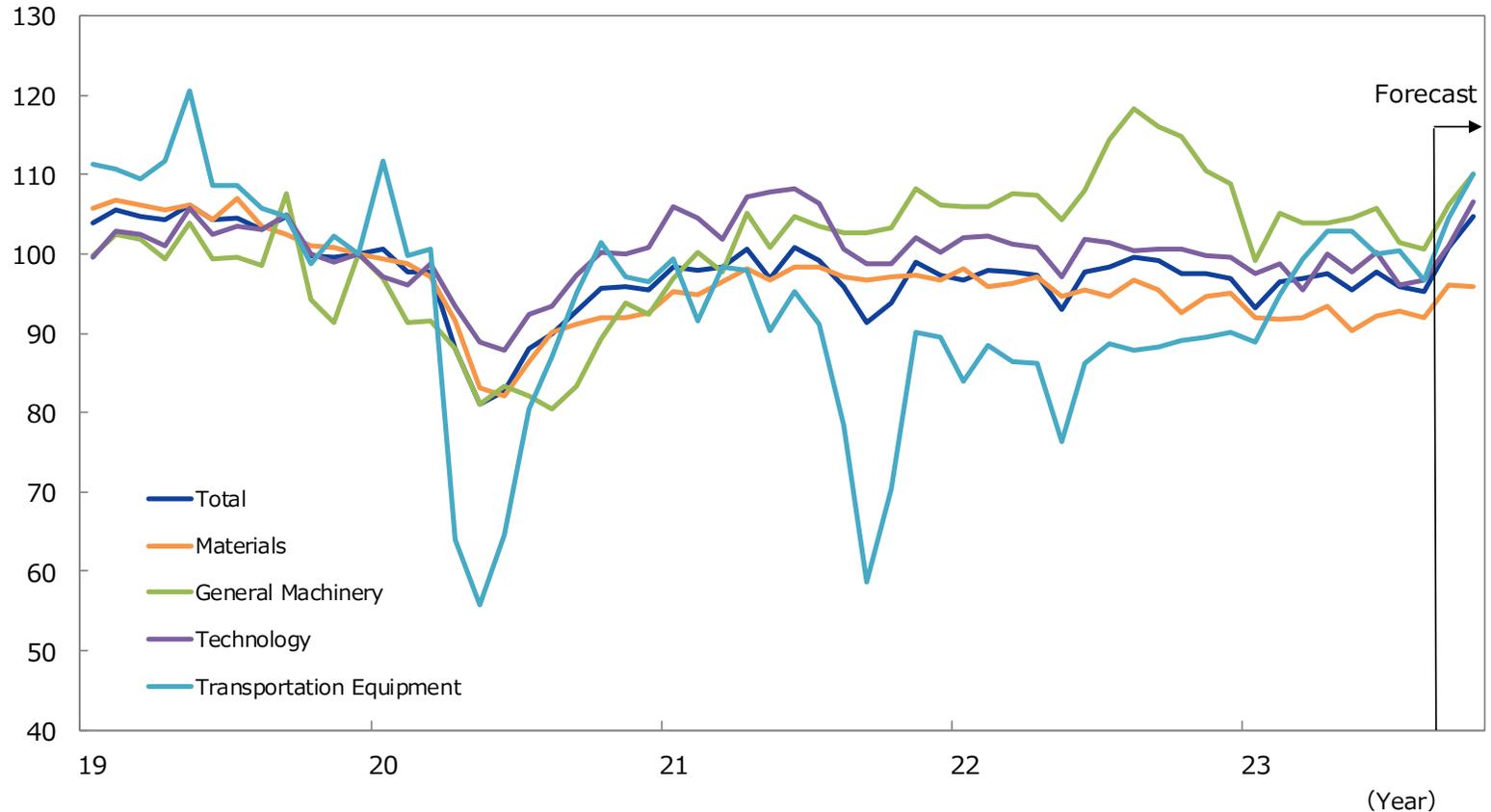
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



Note: Data is from Q1 FY2020 to Q3 FY2023.
Source: The Bank of Japan, SMDAM

Auto production and CAPEX boost industrial production ahead

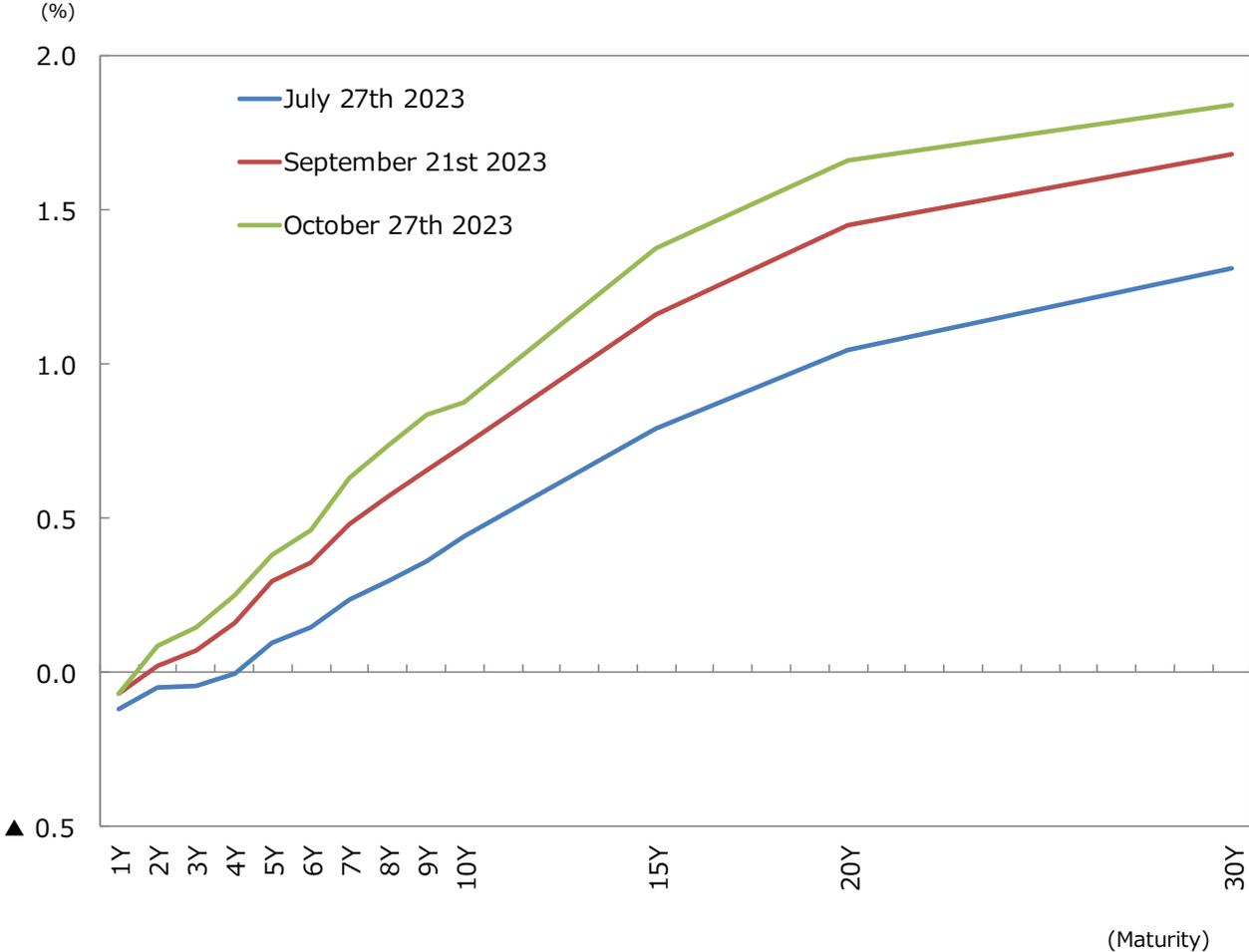
Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to September 2023. Data after September 2023 are forecasts.
Source: METI, SMDAM

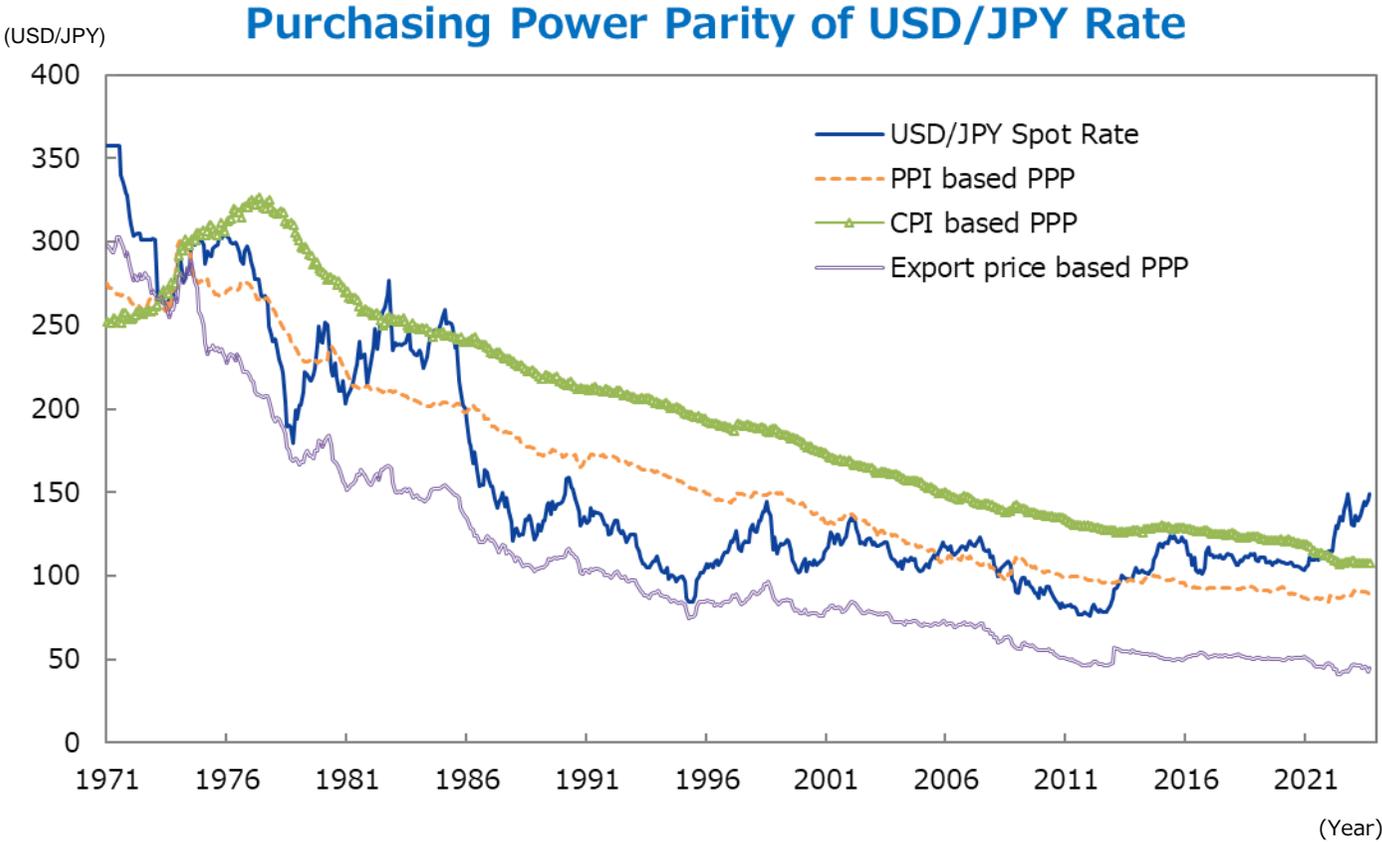
Curves “bear steepening” owing to changes in monetary policy

Yield Curve of Japanese Sovereign



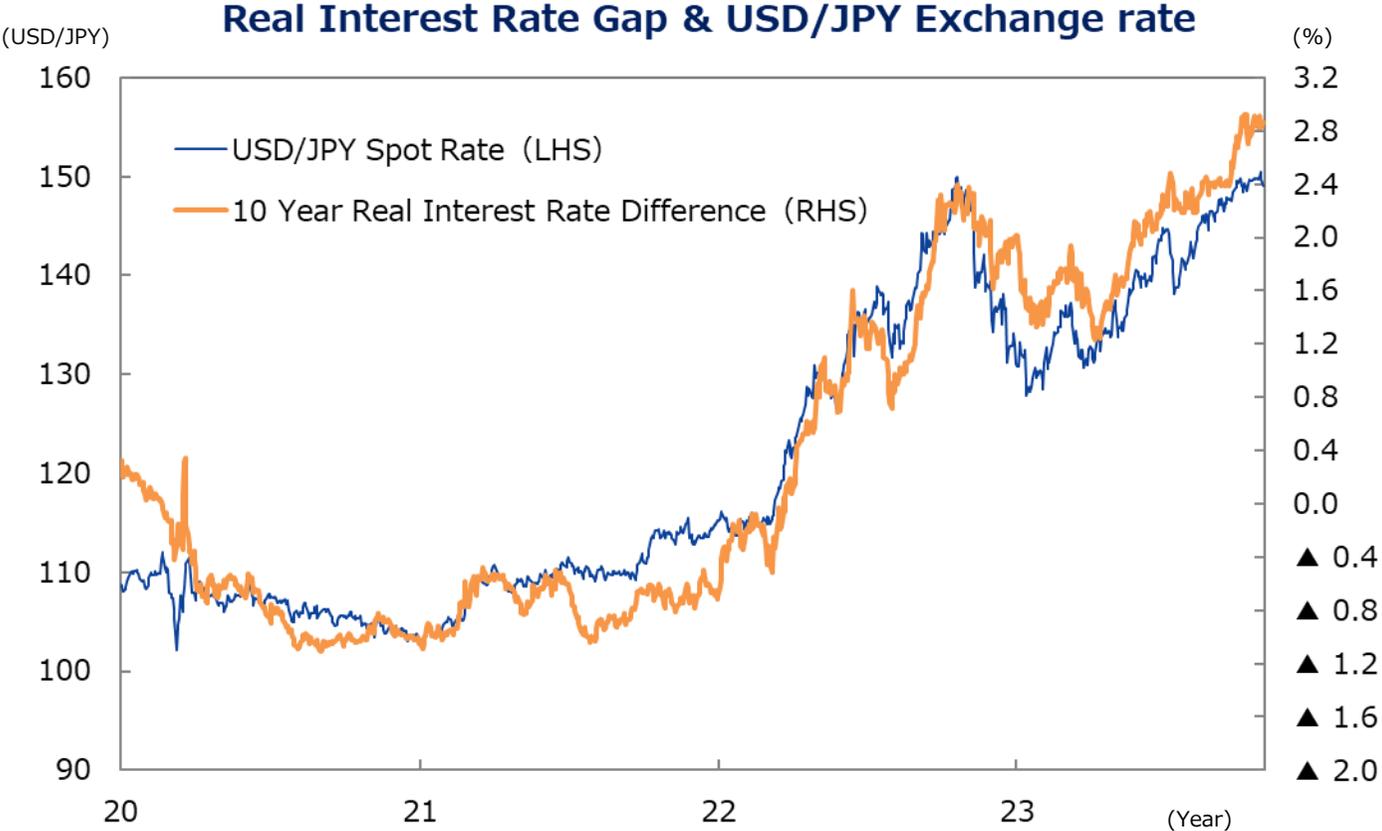
Source: Bloomberg, SMDAM

USD/JPY diverges from range of purchasing power parity



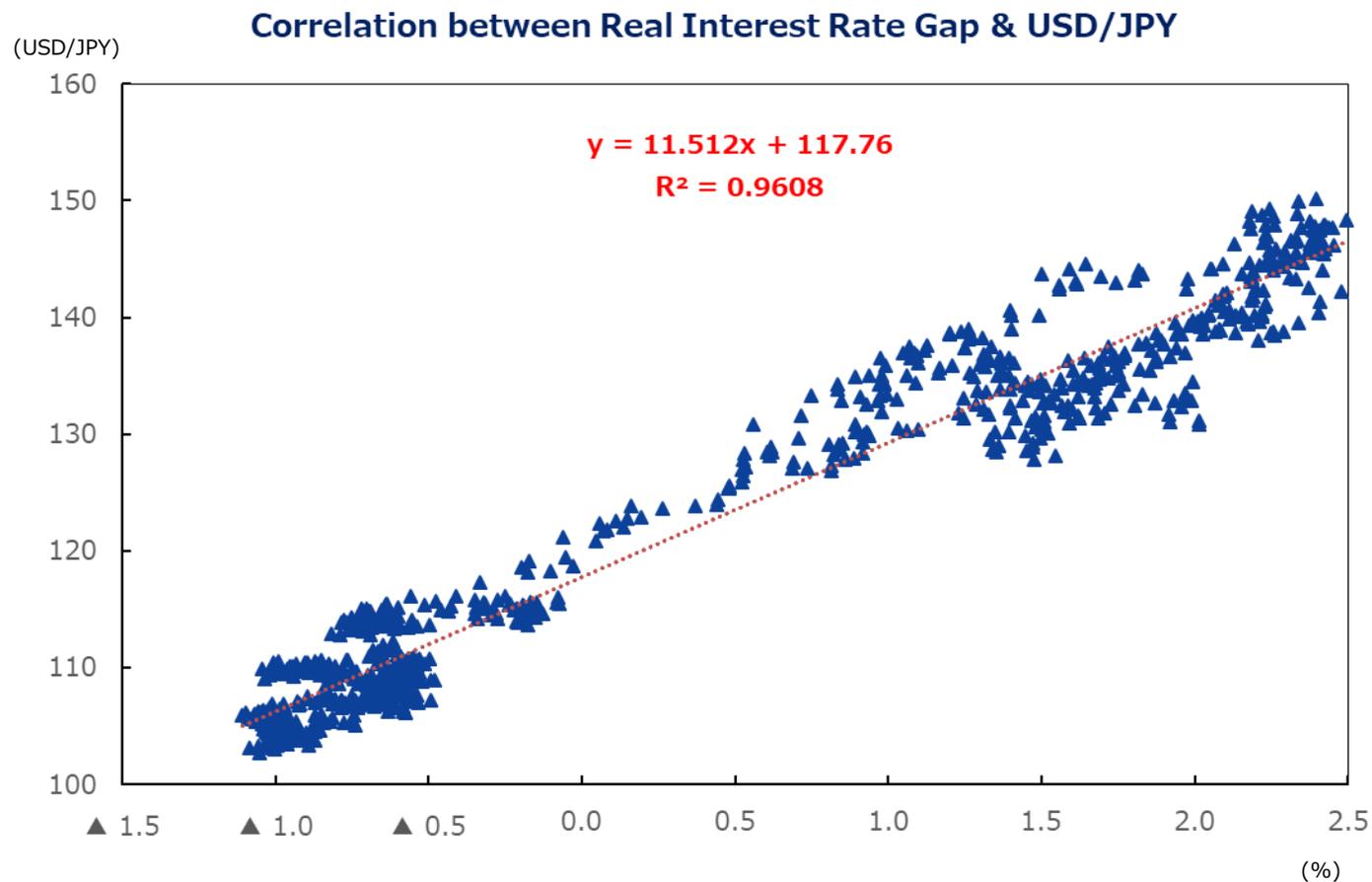
Note: Data is from January 1971 to September 2023.
Source: DOL, Bank of Japan, SMDAM

USD/JPY rate fluctuates with real yield gap



Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 30th October 2023.
Source: Bloomberg, SMDAM

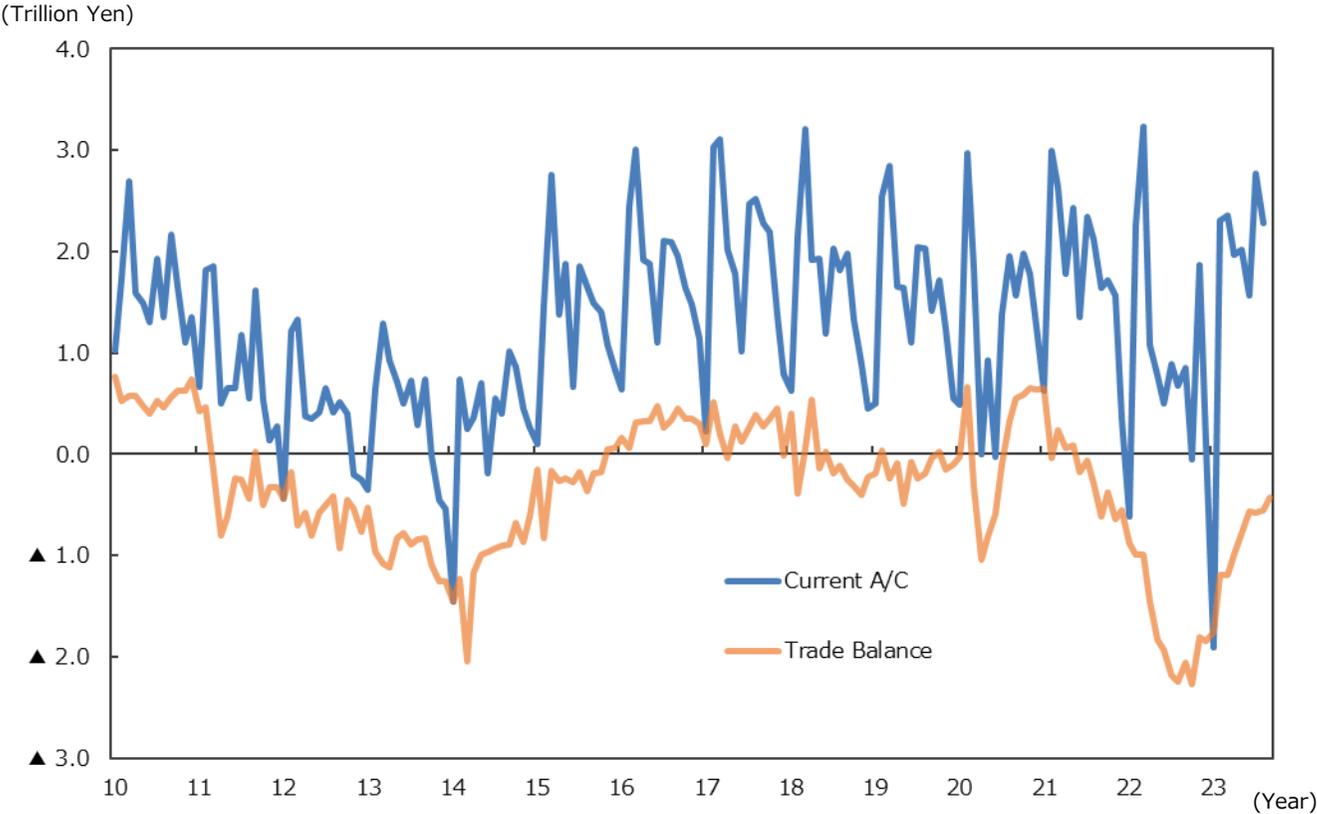
Real yield gap dominating USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 30th October 2023.
Source: Bloomberg, SMDAM

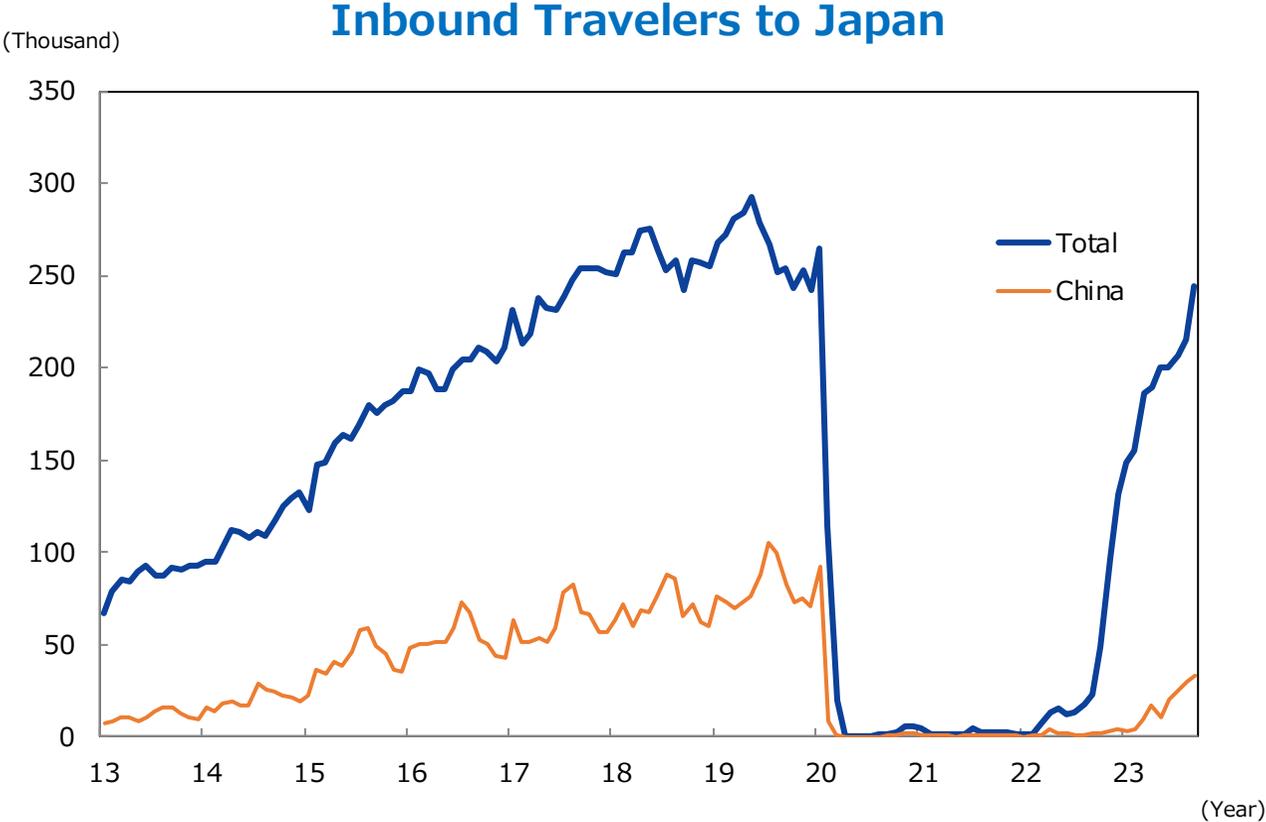
Trade deficits shrank due to falling energy prices

Current Account & Trade Balance



Note: Data is Seasonally adjusted. Current account is from January 2010 to August 2023. Trade balance is from January 2010 to September 2023. Source: MOF, SMDAM

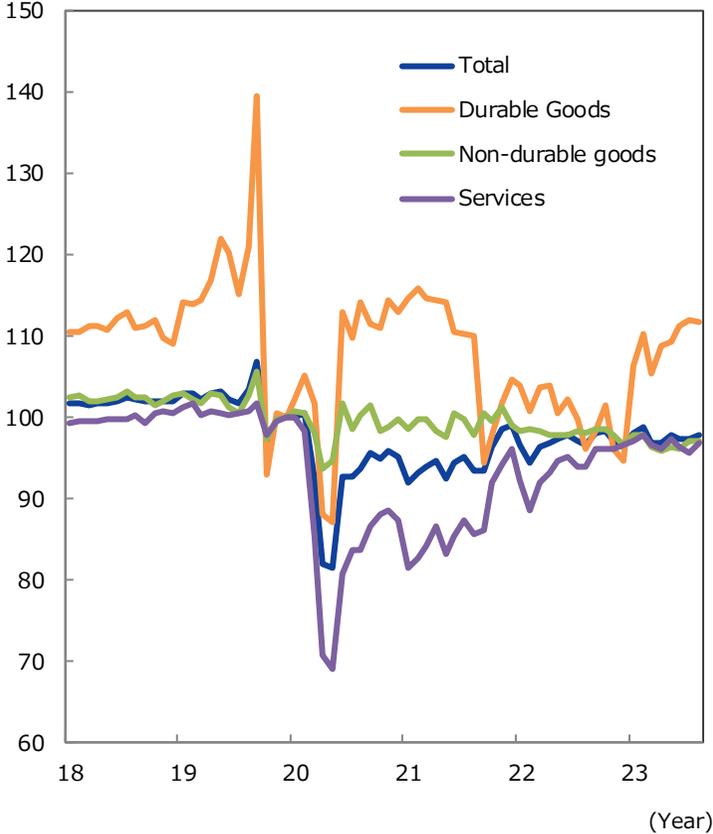
Inbound travel surging without major recovery from China



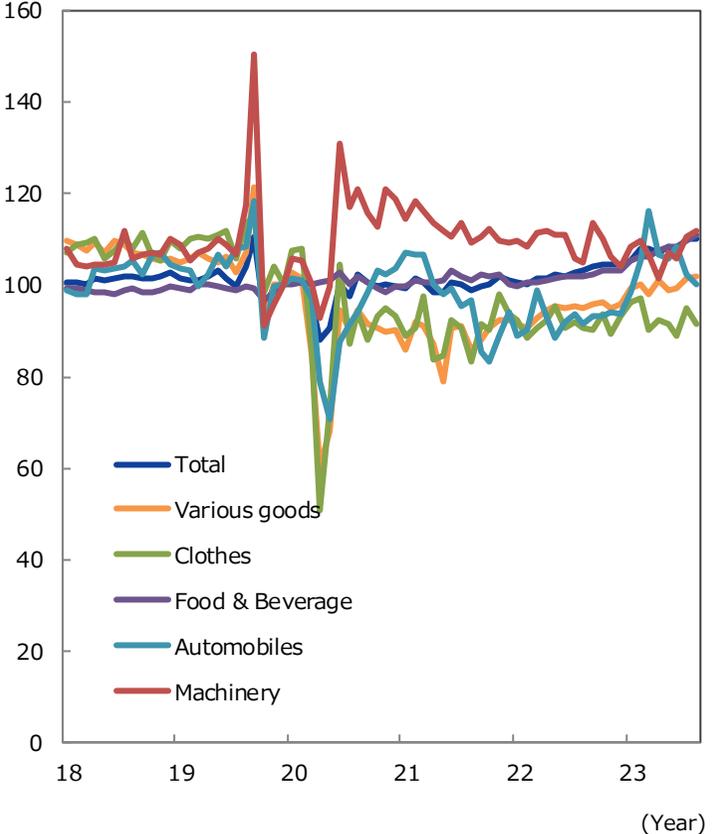
Note: Data is from January 2013 to September 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Normalization of auto production lifts durable goods sales

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to August 2023.
 Source; Bank of Japan, METI, and SMDAM

PM's approval rate continues to fall due to confusion around tax policies

Cabinet approval rate



Note: Data is from January 2013 to October 2023.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2023	November	15	Release of CY 2023 Q3 GDP
	December	8 18-19	Revision of CY 2023 Q3 GDP Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline
2024	January	1 22-23	Start of new NISA (Nippon Individual Savings Account) Monetary Policy Meeting Convening of the ordinary Diet session
	February	15	Release of CY 2023 Q4 GDP
	March	11 18-19	Revision of CY 2023 Q3 GDP Monetary Policy Meeting Enactment of FY 2024 budget and tax reform bills
	April	25-26	Monetary Policy Meeting Release of BOJ view report
	May		Multi-faceted review \$ Second workshop
	June	13-14	Monetary Policy Meeting Cabinet decision on the broad policy End of the ordinary Diet session
	July	30-31	Monetary Policy Meeting
	September	19-20 30	Monetary Policy Meeting Termination of the presidency of ruling LDP
	October	30-31	Monetary Policy Meeting
	December	18-19	Monetary Policy Meeting Cabinet approval of the initial budget for FY 2025 and the outline for tax reform

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

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