



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-July 2024-

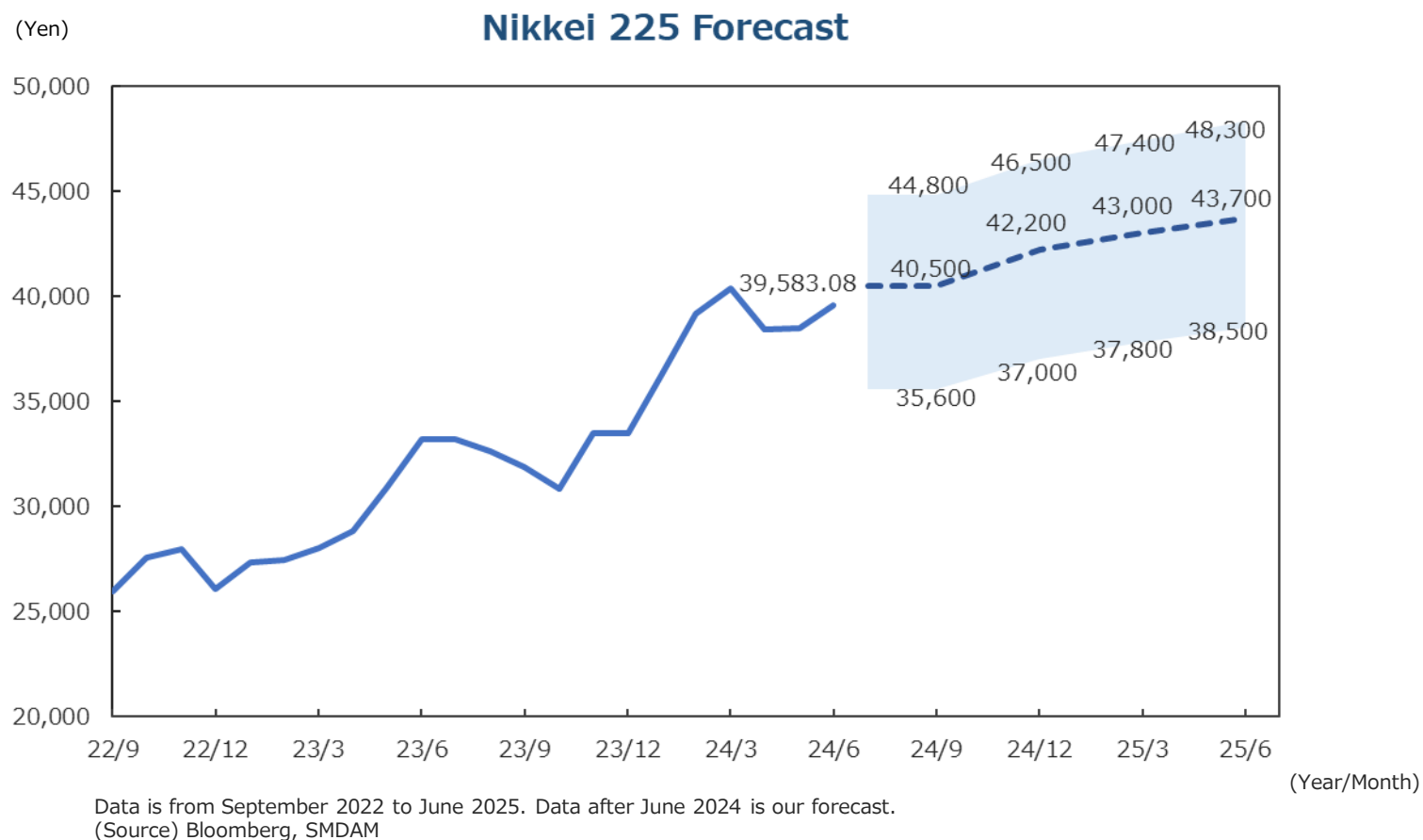


Outlook for Japanese Stock Market

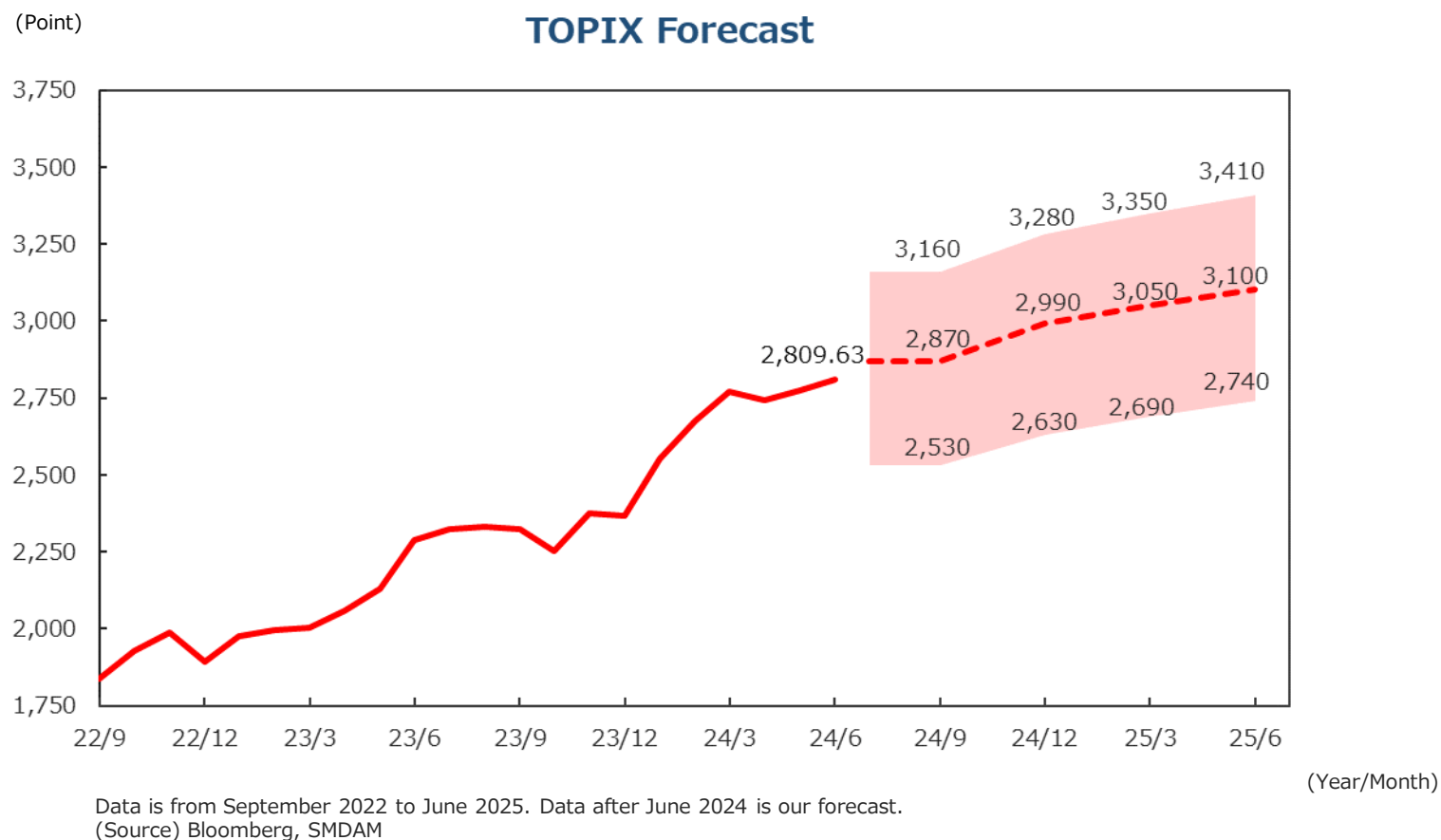
Market Outlook

- We maintain our bullish perspective on the Japanese equity market. We believe steady earnings growth and rebound of consumer spending will lift the equity market in H2 2024 and beyond.
- In the short term, the market could face increasing volatility owing to speculation over monetary policy.
- We have slightly lowered our price target for FY 2024 of the Nikkei 225 to 43,000 and that of TOPIX to 3,050 due to the slowing business cycle of the global economy.
- The strong wage increase negotiated this Spring, which was the highest in 33 years, could boost Japanese consumer spending that makes up more than half of the economy.

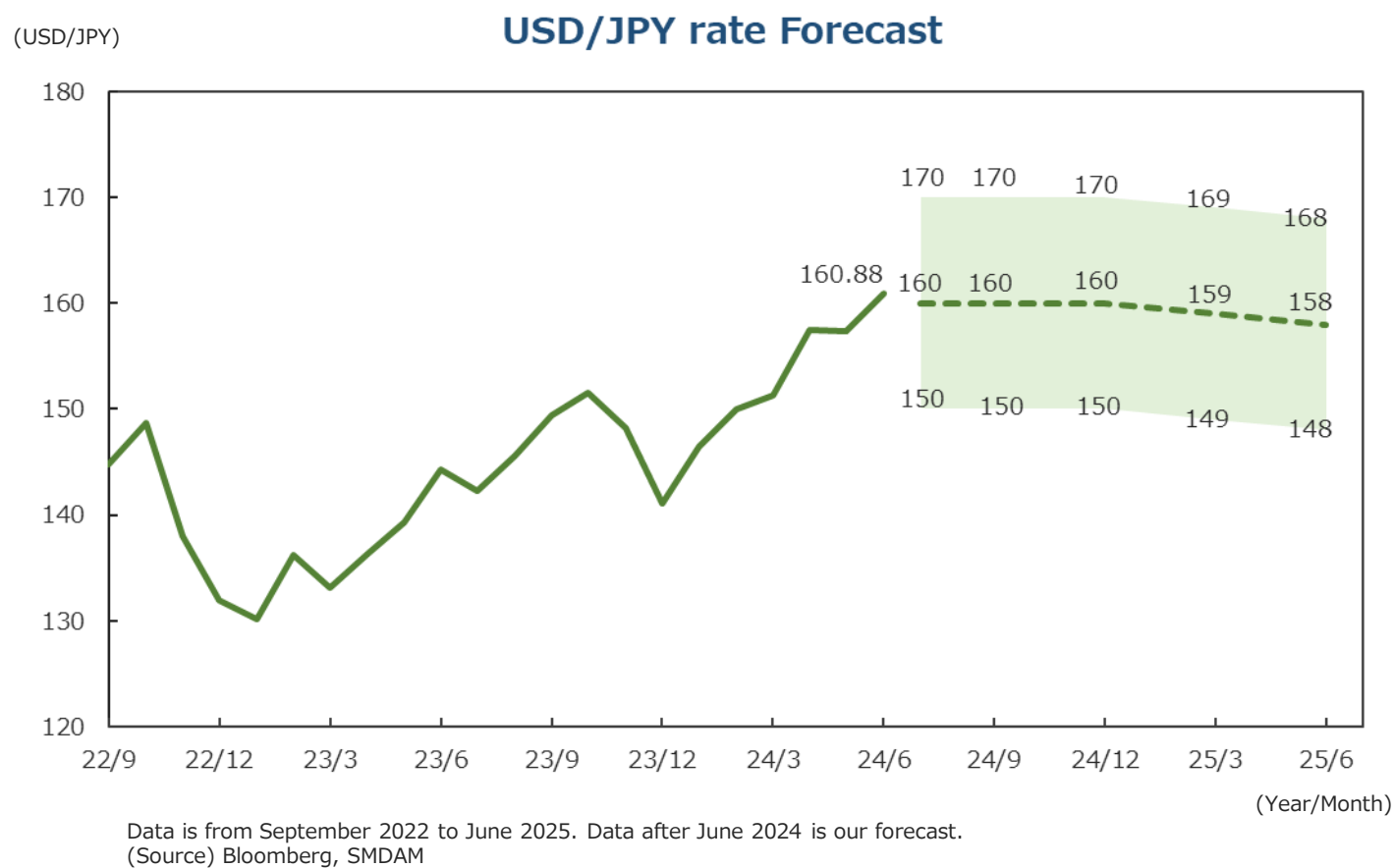
We expect a bullish market to continue going forward



We expect a bullish stock market to continue going forward



JPY faces selling pressure despite BOJ's pivot



Upside / Downside risk scenarios

■ Upside Risks

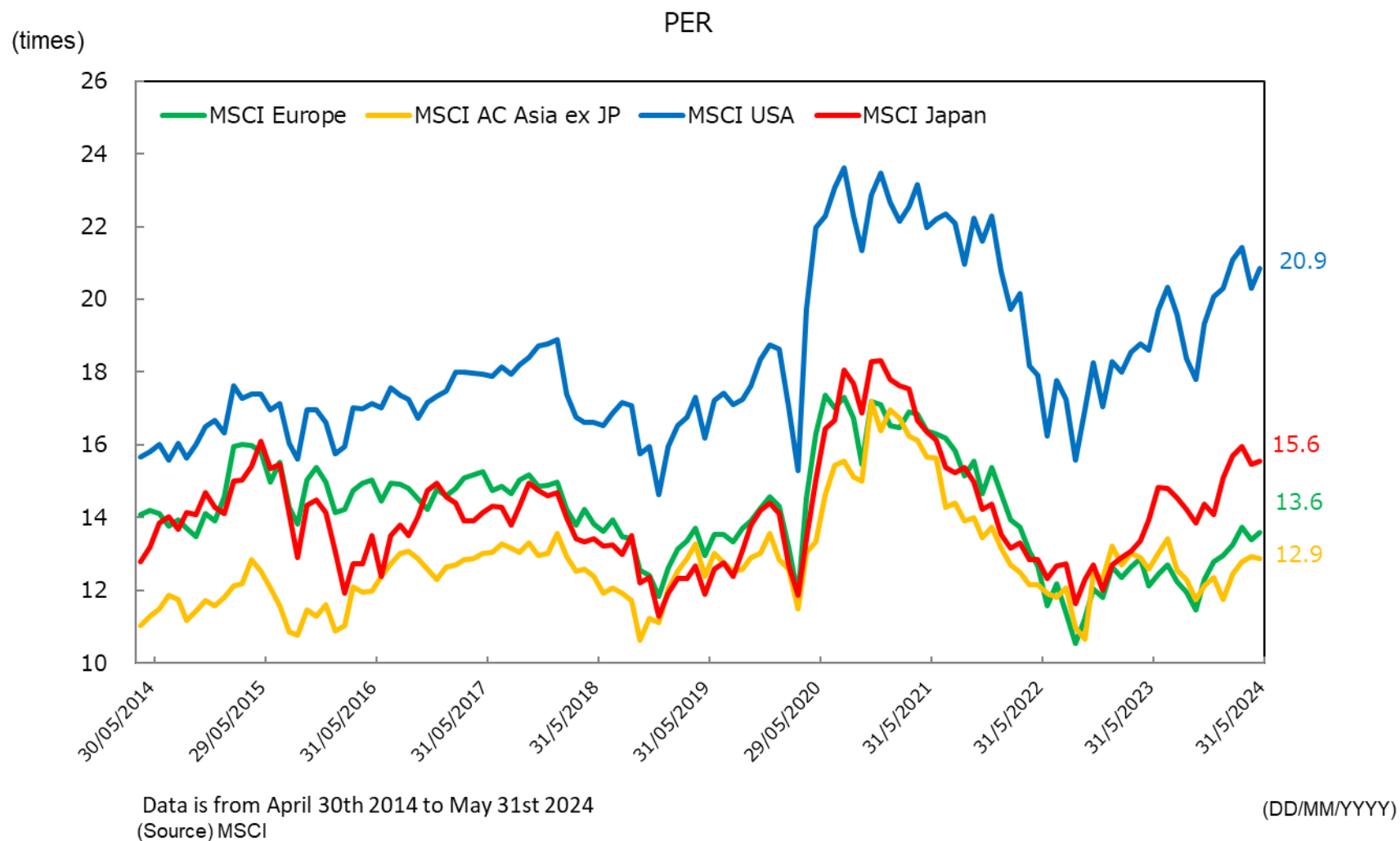
- Growing optimism over virtuous cycle of wage increases and mild inflation
- Prolonged accommodative monetary policy by the Bank of Japan
- Further improvement of corporate governance

■ Downside Risks

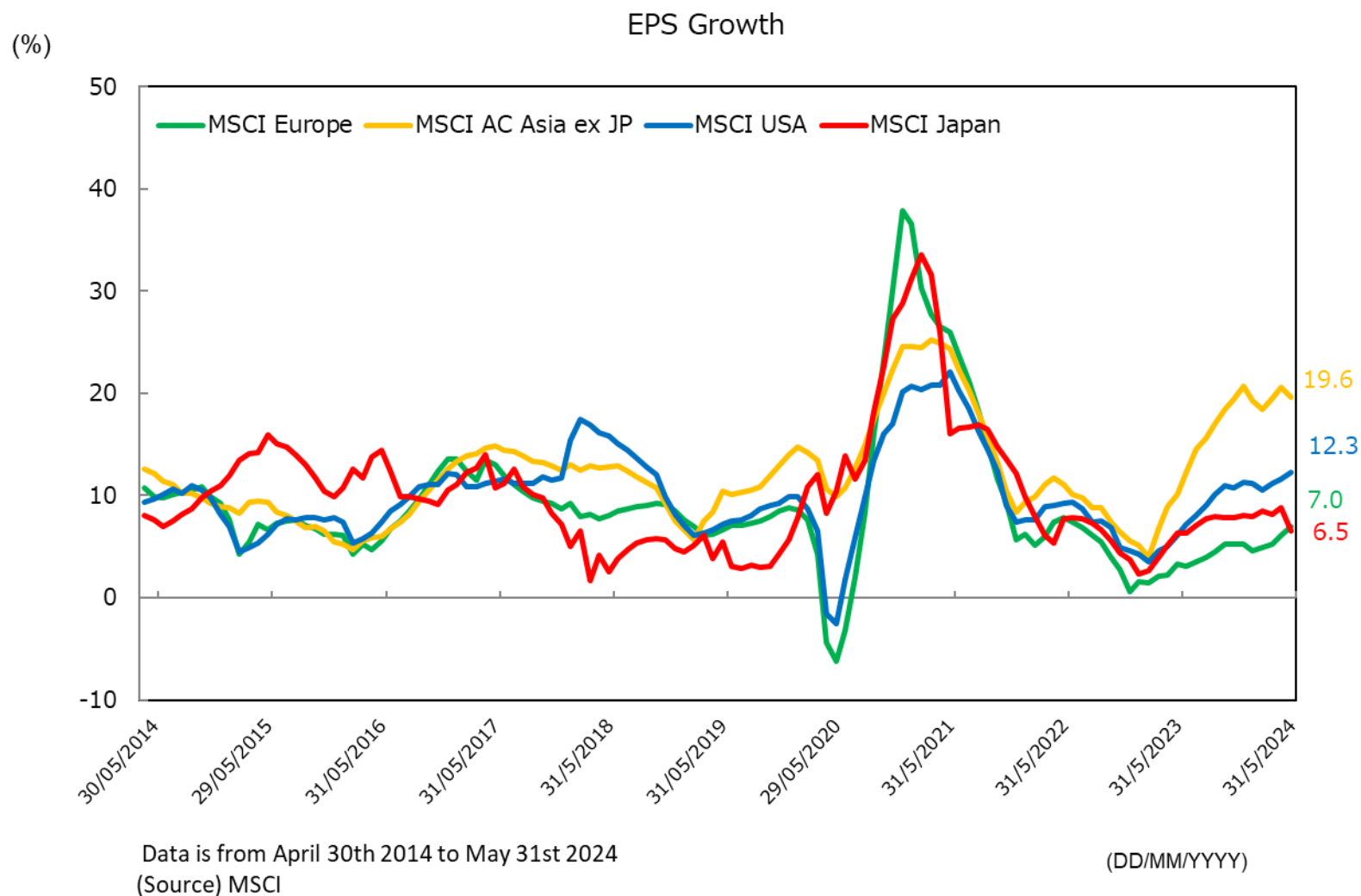
- Tighter fiscal policy to achieve a surplus of primary balance
- Excessive and rapid JPY appreciation
- Hasty monetary tightening by the BOJ
- Political turmoil triggered by the split of the ruling Liberal Democratic Party



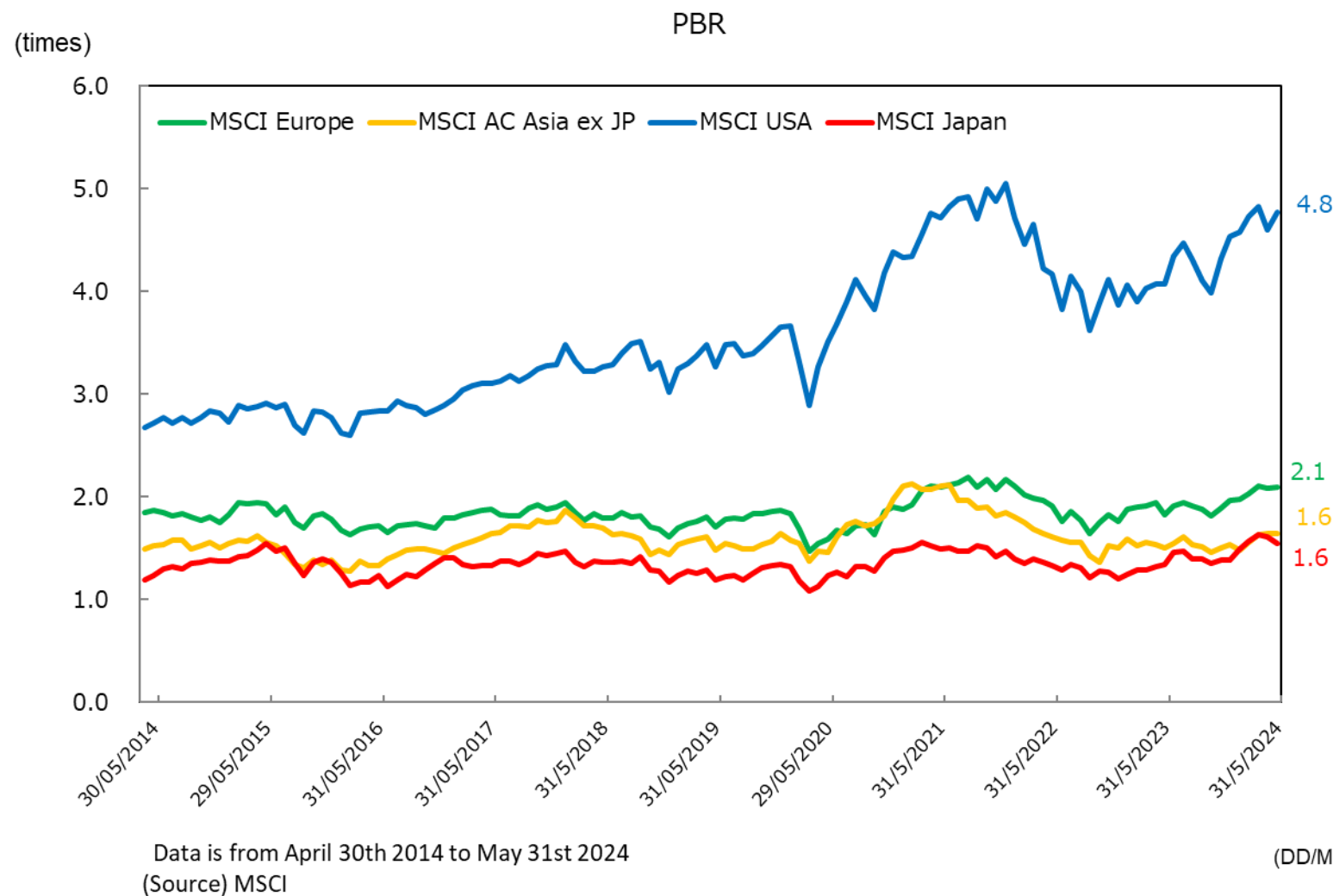
Recent market strength boosts Japan's P/E ratio



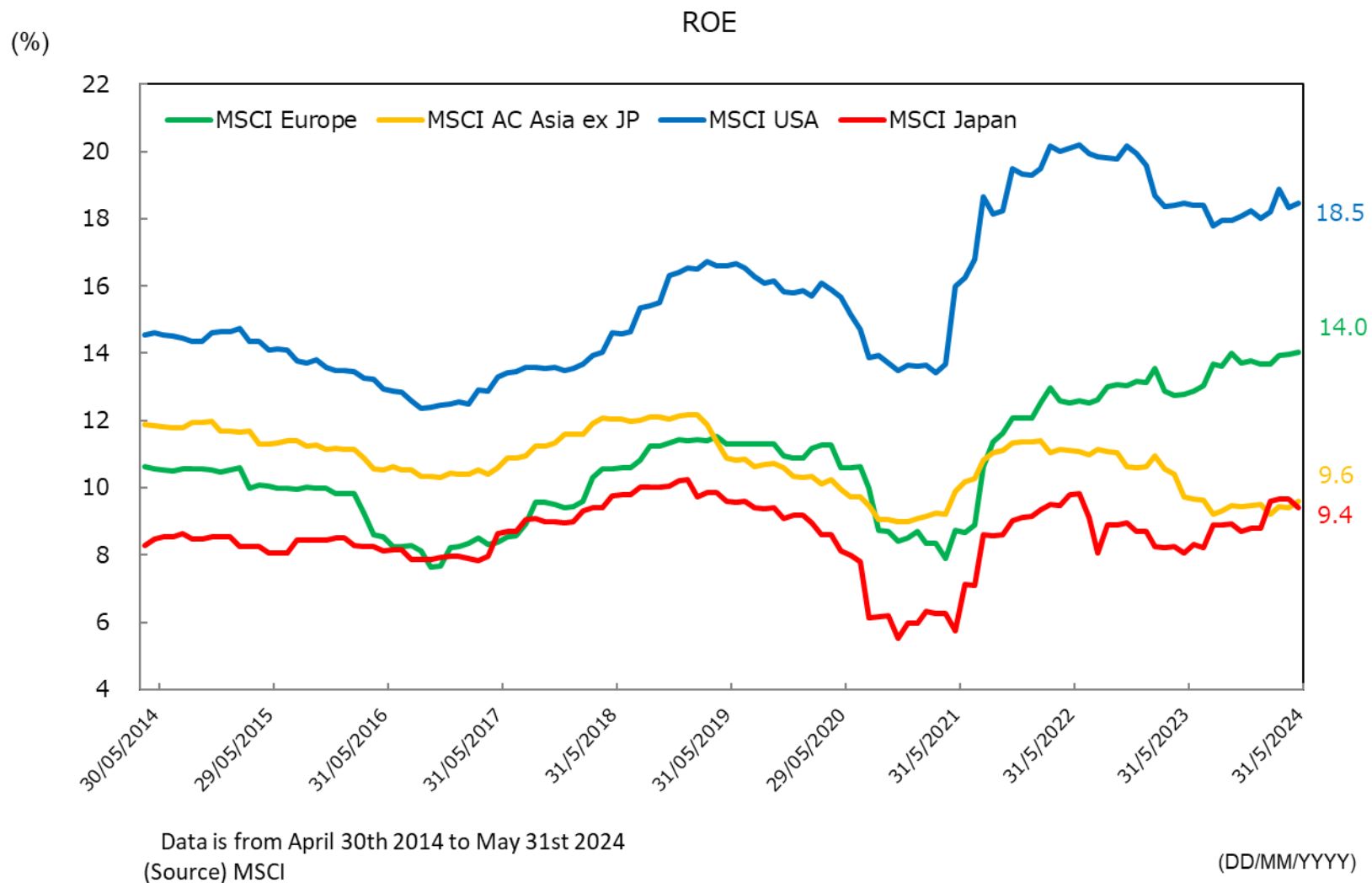
Japan's earnings growth slowing and lagging behind peers



Japan's P/B ratio catching up with Asian peers

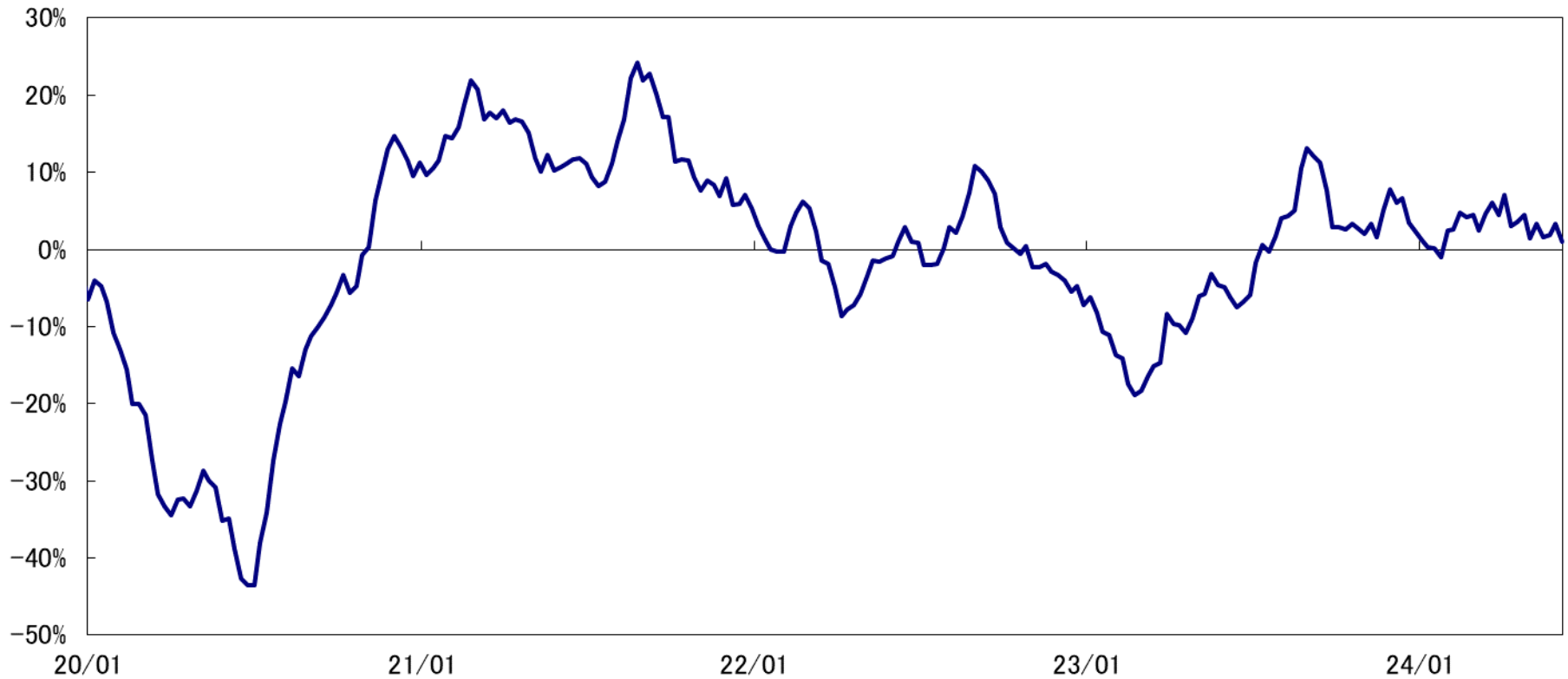


Earnings growth lifts Japan's ROE



EPS revision remains positive despite lackluster economic figures

TOPIX Revision Index

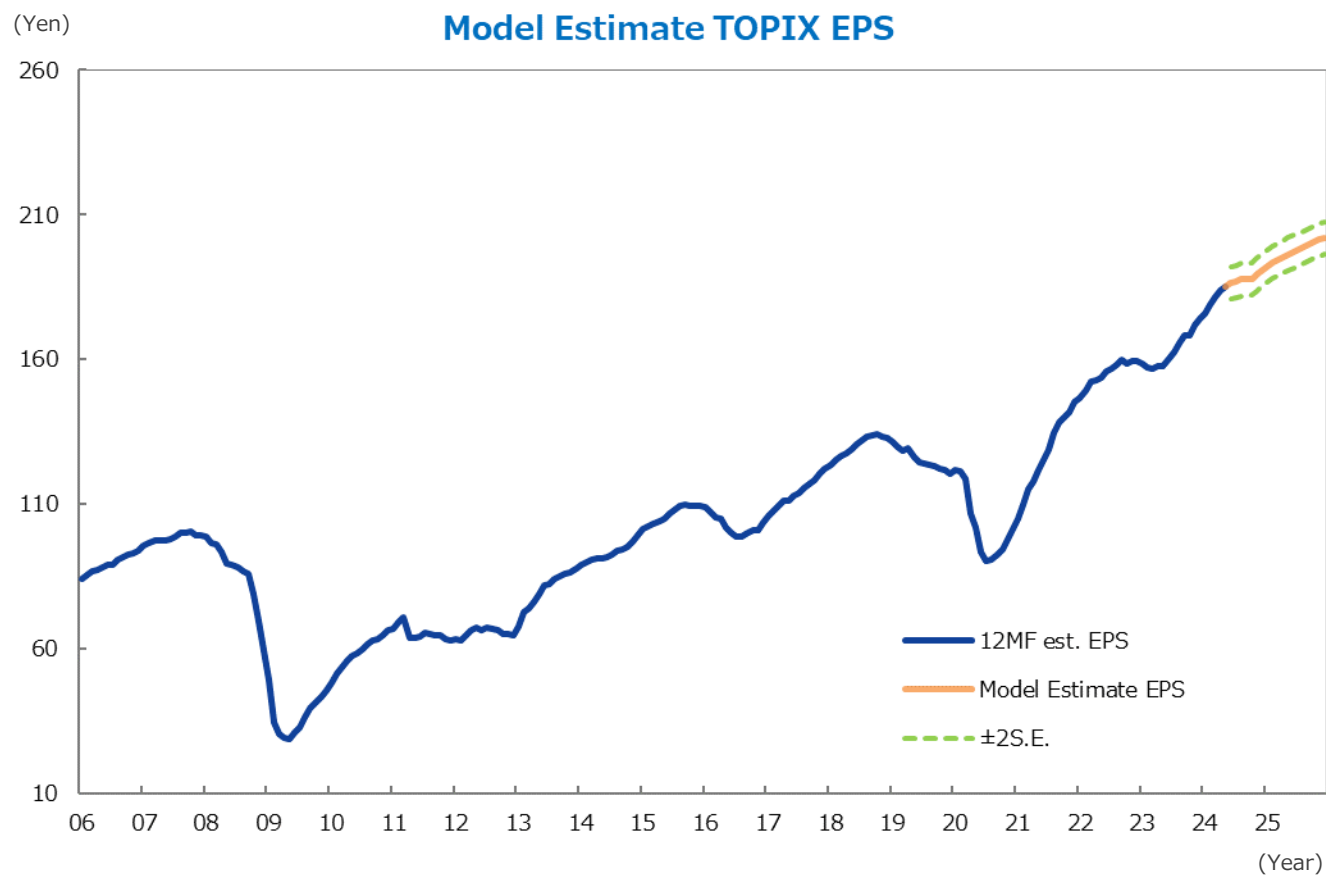


Data is from January 2nd 2020 to June 6th 2024
(Source) Datastream, IBES

(YY/MM)

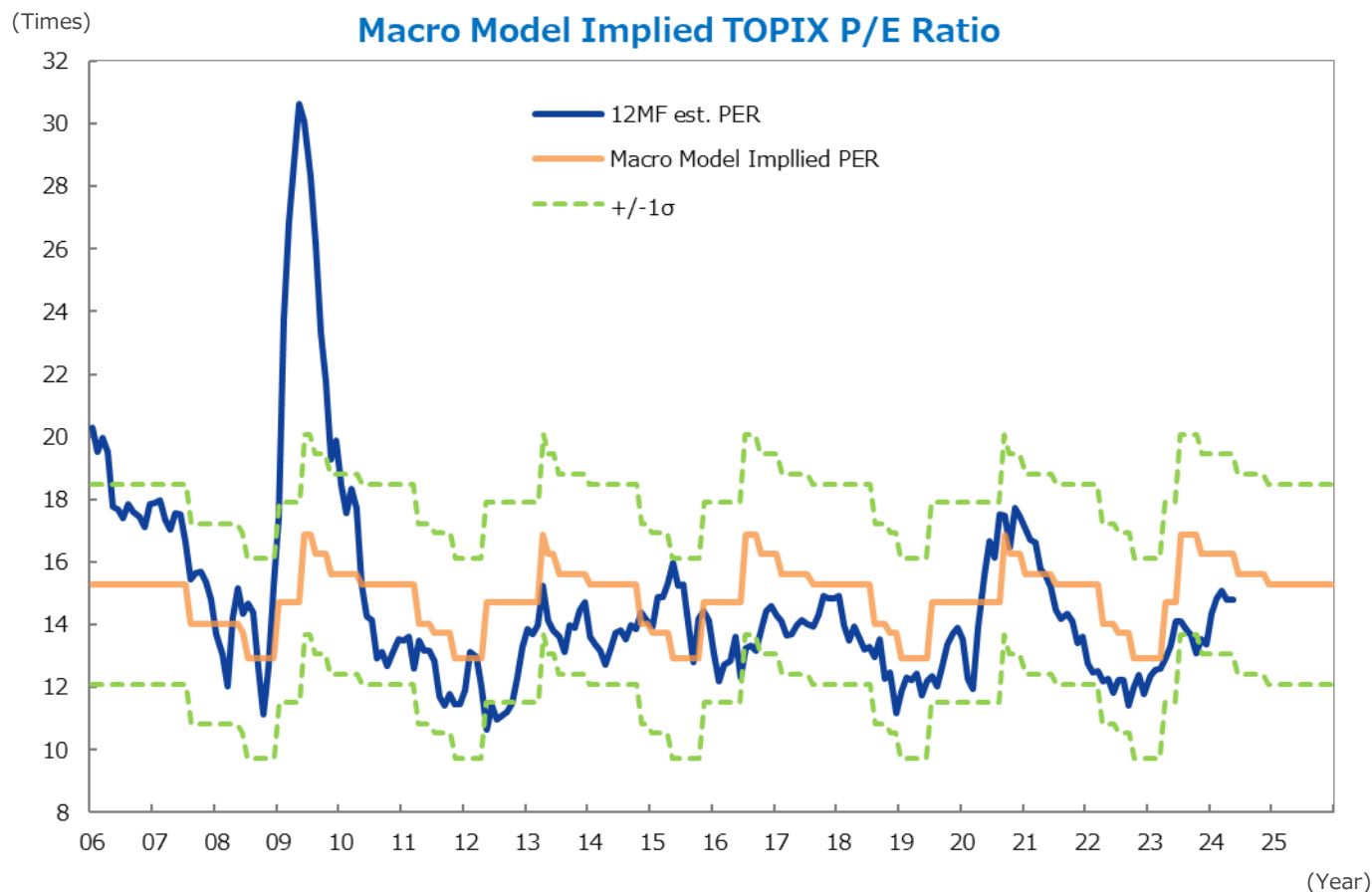


Quant model indicates est. EPS to grow going forward



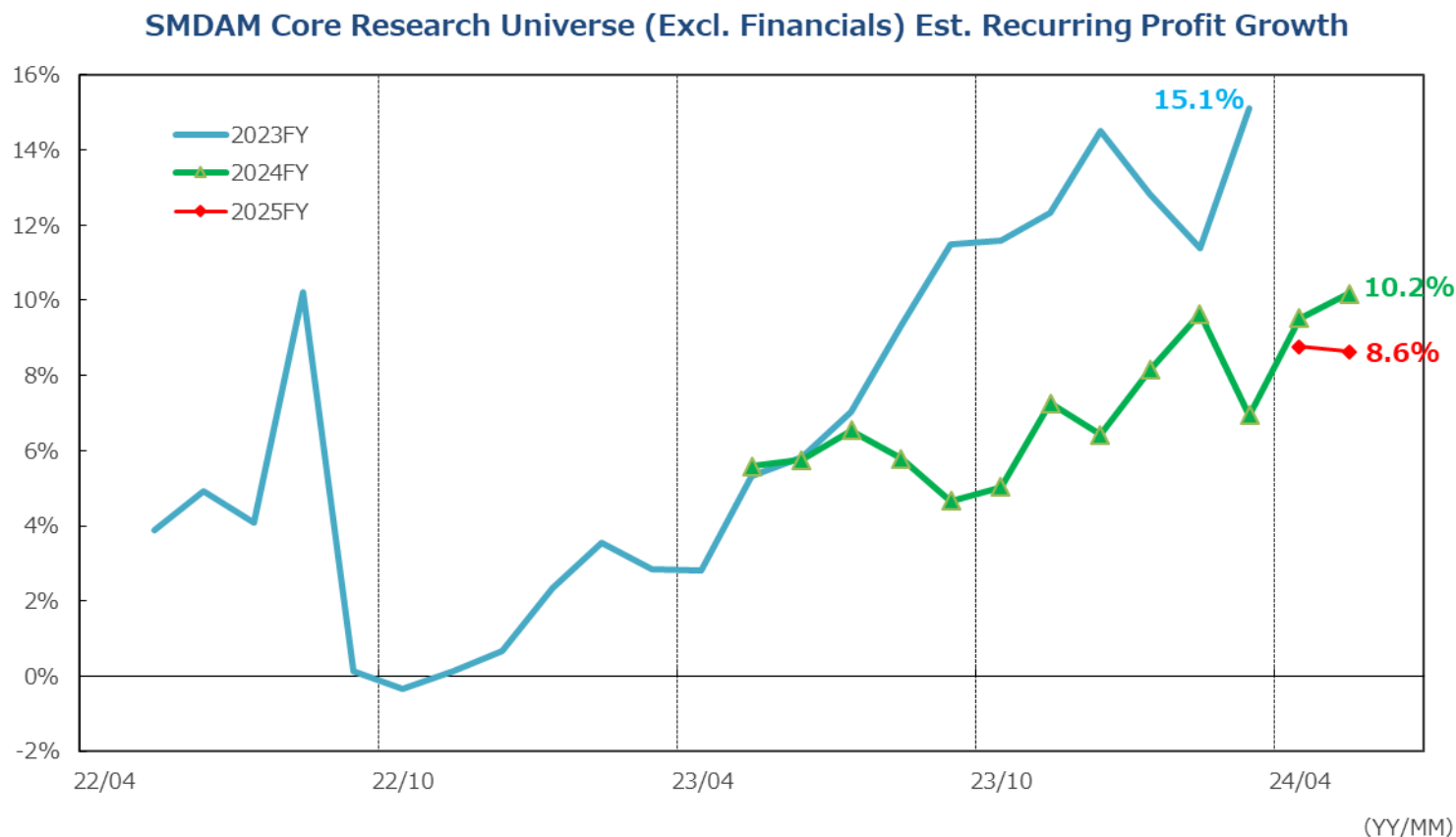
Note: Consensus data is from January 2006 to May 2024. Model estimate Data is from June 2024 to December 2025.
Source: SMDAM

P/E ratio is still below the fair value even after recent rally



Note: Consensus data is from January 2006 to May 2024, Model estimate Data is from February 2006 to December 2025.
Source: SMDAM

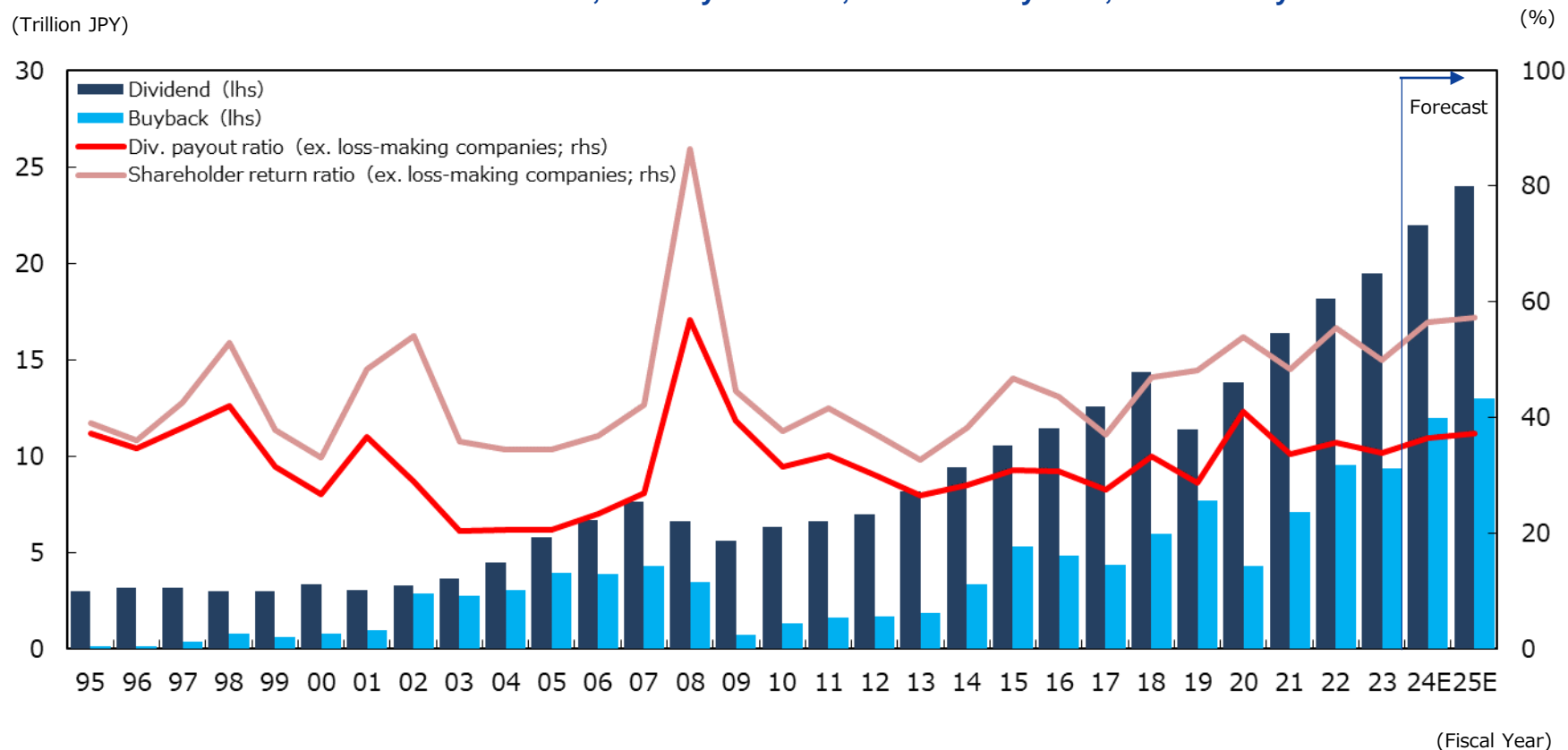
Bottom up research shows earnings growth to continue in 2024



Note: Data is as of 13th June 2024, SMDAM Core Universe (Excl. Financials) consists of 386 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Streak of record-breaking dividends and buybacks

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



Note: Data is from FY1995 to FY2025. FY2024 and FY2025 are forecasts by Daiwa Securities.
Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM



Large cap value continues to dominate 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	-0.55	17.05	15.42	19.11	48.93	40.07	76.69
Total Value	0.70	22.21	20.55	29.13	61.09	66.70	90.78
Top Cap Value	1.21	30.44	28.69	33.44	74.44	85.54	124.48
Large Cap Value	0.60	23.61	22.09	29.92	62.75	71.09	96.30
Mid Cap Value	-0.03	17.30	15.98	26.83	49.98	55.39	64.77
Small Cap Value	1.18	15.93	13.72	25.45	53.38	48.12	67.49
Micro Cap Value	2.71	16.56	13.83	26.59	55.52	49.24	68.14
Total Growth	-1.70	12.58	10.97	10.04	38.69	18.62	61.77
Top Cap Growth	-0.15	17.51	15.69	15.36	45.86	26.73	77.66
Large Cap Growth	-1.41	13.66	12.09	11.17	41.05	20.97	67.44
Mid Cap Growth	-3.90	6.54	5.40	3.51	32.11	10.80	50.12
Small Cap Growth	-4.36	3.30	1.47	0.56	20.25	0.03	20.67
Micro Cap Growth	-5.33	3.62	1.47	0.37	20.11	-2.87	20.83
Top Cap Total	0.38	22.30	20.49	22.90	57.38	49.47	95.91
Large Cap Total	-0.49	18.06	16.51	19.70	50.55	42.16	81.63
Mid Cap Total	-1.75	12.35	11.11	15.47	41.13	32.27	62.82
Small Cap Total	-0.95	10.90	8.84	15.41	39.34	27.49	48.84
Micro Cap Total	-0.03	12.03	9.52	17.47	42.60	30.01	52.19

Note : As of 19th June 2024
(Source) Bloomberg





Outlook for Japanese Economy



Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** In the first quarter of 2024, economic growth turned negative for the first time in 2 quarters due to factors such as a decline in automobile production caused by the certification test corruption scandal, the Noto Peninsula earthquake, and a reactionary decline in royalties and receipts for intellectual property rights. On the other hand, although consumer sentiment, such as "Economy Watchers Survey" and "Consumer Sentiment Index", has been adversely affected by rising inflation, private consumption, CAPEX, and exports have been recovering.
- **Inflation is mixed.** The nationwide core CPI rose +2.2% YOY in April, slowing down from +2.6% a month earlier. Tokyo Metropolitan Area Core CPI in May rose +1.9% YOY, re-accelerate from +1.6% last month. Inflation is accelerating again as electricity prices rise on the back of higher renewable energy levies.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2024 at +0.4% and that for FY 2025 at +0.7%.** The Japanese economy is expected to return to a moderate growth path from Q2 2024. The economy is expected to recover gradually and avoid recession as temporary downward pressure, caused by factors such as a reduction in automobile production, a major earthquake, and a reactionary decline in royalties on intellectual property rights, is expected to ease. In addition, wage increases, fiscal stimulus, such as tax cuts and benefits, and the resilience of overseas economies could lift the economy going forward.
- ② **While we have slightly lowered our core CPI forecast for FY 2024 to +2.5% from +2.6%, we have maintained that for FY 2025 at +2.0%.** The increase in the renewable energy levy and the end of subsidies for electricity and gas are the main factors to lift the nationwide core CPI to the middle of 2% again in the short term. Thereafter, the core CPI is likely to decelerate again due to the waning of cost-push pressures from import prices and the receding energy factor. However, the core CPI is expected to remain stable at around +2% YOY from around H2 of CY 2025, supported by the rise in service prices accompanying wage hikes.
- ③ **We expect the government to continue their accommodative fiscal policy.** In November 2023, Prime Minister Kishida's Cabinet introduced comprehensive economic measures to overcome deflation. The budget, which amounts to 20.9 trillion yen on a national and local spending basis, includes measures to counter high prices, support for growth sectors, and national infrastructure resilience. Flat rate tax cuts are expected to take effect in June 2024. Regarding fiscal policy we are paying close attention to the risk of further expansion to boost the approval rate of the Cabinet and the ruling Liberal Democratic Party, which has declined significantly owing to the slush fund scandal.
- ④ **We maintain our monetary policy forecast. We expect the Bank of Japan to raise its policy rate to 0.25% in October 2024, from current range of 0-0.1%, and then increase to 0.5% in April 2025, and to 0.75% in October 2025.** The Bank of Japan is expected to raise interest rates again in the summer and autumn after confirming the effect of this year's wage increase on inflation. After that, the central bank will raise interest rates once every six months while monitoring the impact of the rate hike on the economy. The risk of a front-loaded rate hike will depend on developments in the foreign exchange market and key inflation figures. We also need to be vigilant about the risk of rising inflation expectation shown in the Bank of Japan's Tankan Survey, Short-Term Economic Survey of Enterprises in Japan, and in the report of corporate prices for the central bank's "Branch Managers' Meeting".

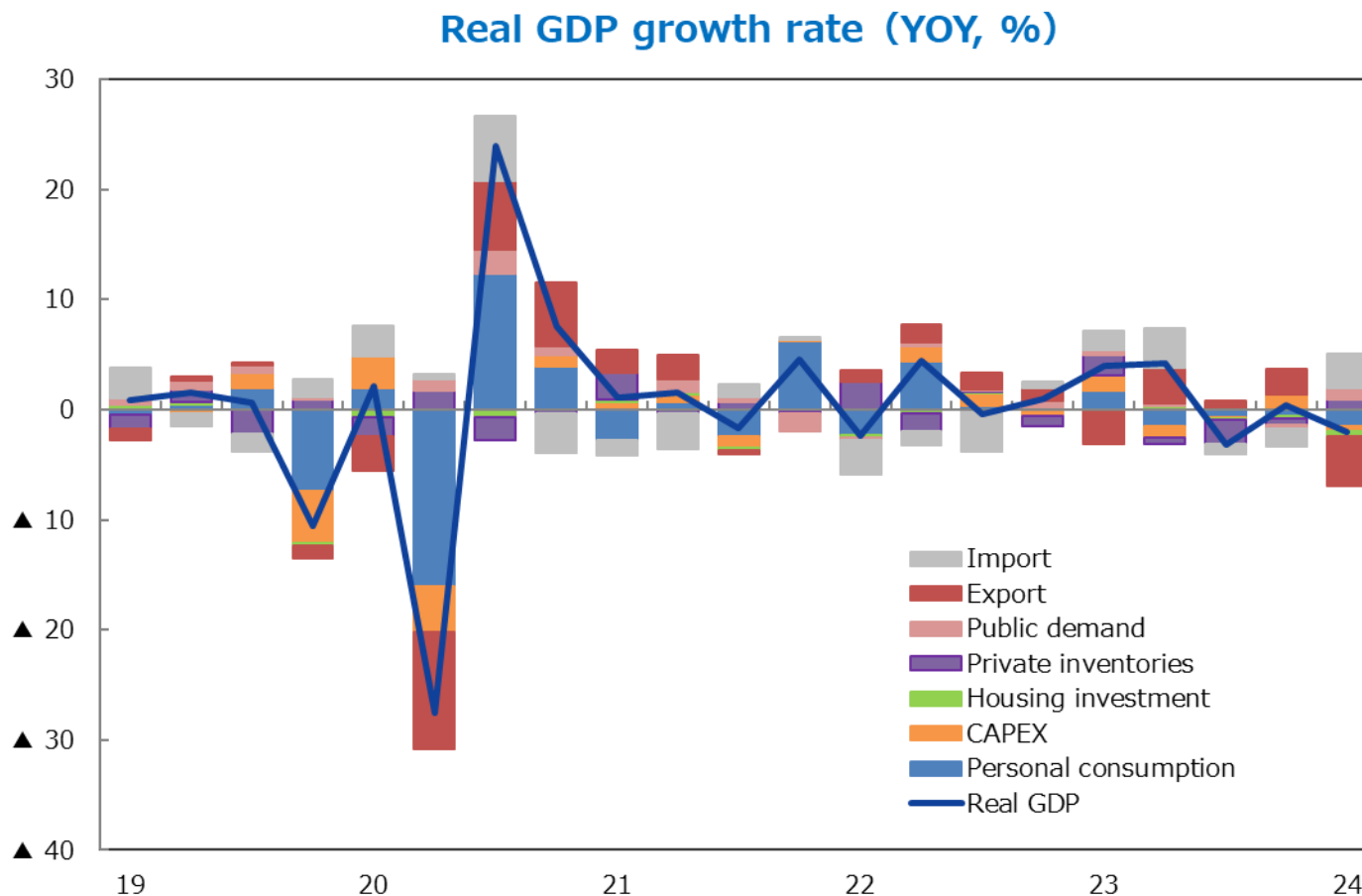


Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY19	FY20	FY21	FY22	FY23	FY24 Est	FY25 Est
Real GDP	-0.8%	-4.1%	2.7%	1.4%	1.2%	0.4%	0.7%
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	-0.6%	-0.1%	1.0%
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	0.6%	-1.8%	-1.0%
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	0.4%	2.3%	0.8%
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.3%	-0.1%	0.0%
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	4.1%	3.0%	0.6%
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.5%	-0.1%	-0.1%
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.0%	2.1%	2.7%
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-3.3%	2.5%	3.1%
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.3%	2.6%	2.3%
GDP deflator	0.8%	0.7%	-0.1%	0.7%	4.1%	2.2%	1.6%
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-1.9%	1.2%	1.8%
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.5%	2.0%
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.3%	1.5%	0.8%
Employee compensation	2.0%	-1.5%	2.1%	2.0%	1.8%	3.5%	3.6%
Unemployment rate	2.4%	2.9%	2.8%	2.6%	2.6%	2.5%	2.3%
Monetary Policy interest rate (Short term)	-0.10%	-0.10%	-0.10%	-0.10%	0-0.10%	0.25%	0.75%

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

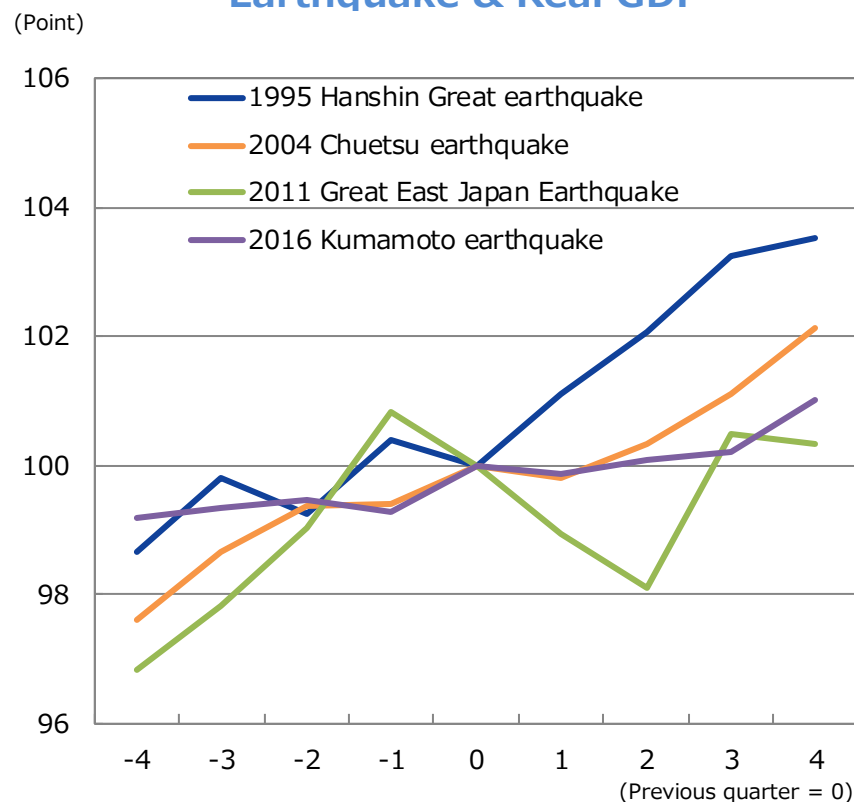
Temporary factors brought Japanese GDP back to negative



Note: Data is from Q1 2019 to Q1 2024.
Source: Cabinet office, SMDAM

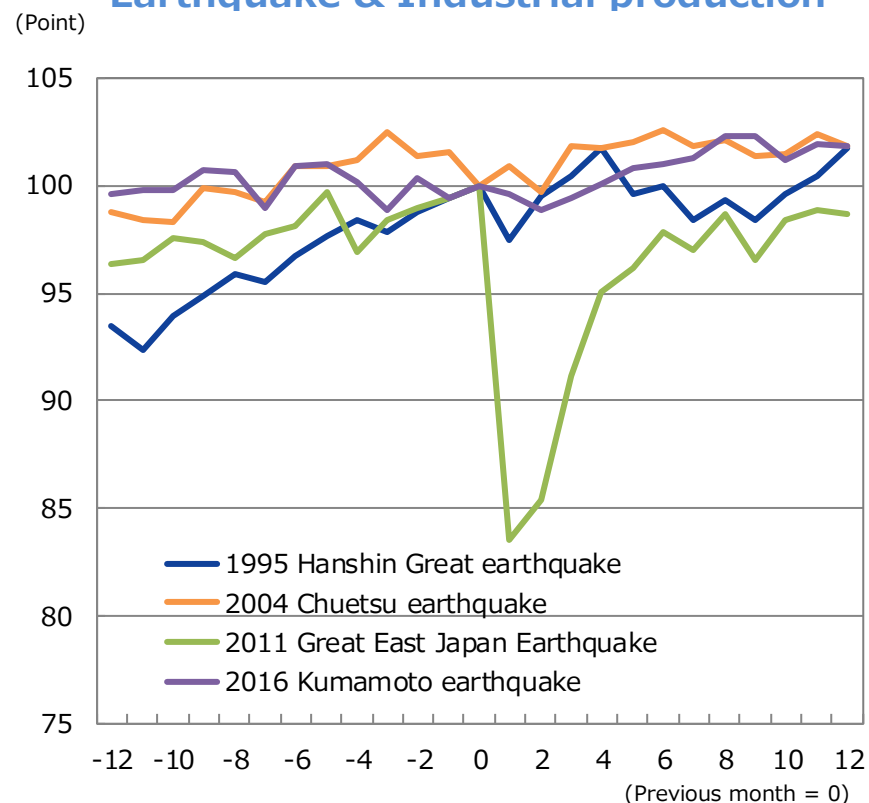
Earthquakes have had short lived impact on the economy

Earthquake & Real GDP



Note: Data of the previous quarter of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

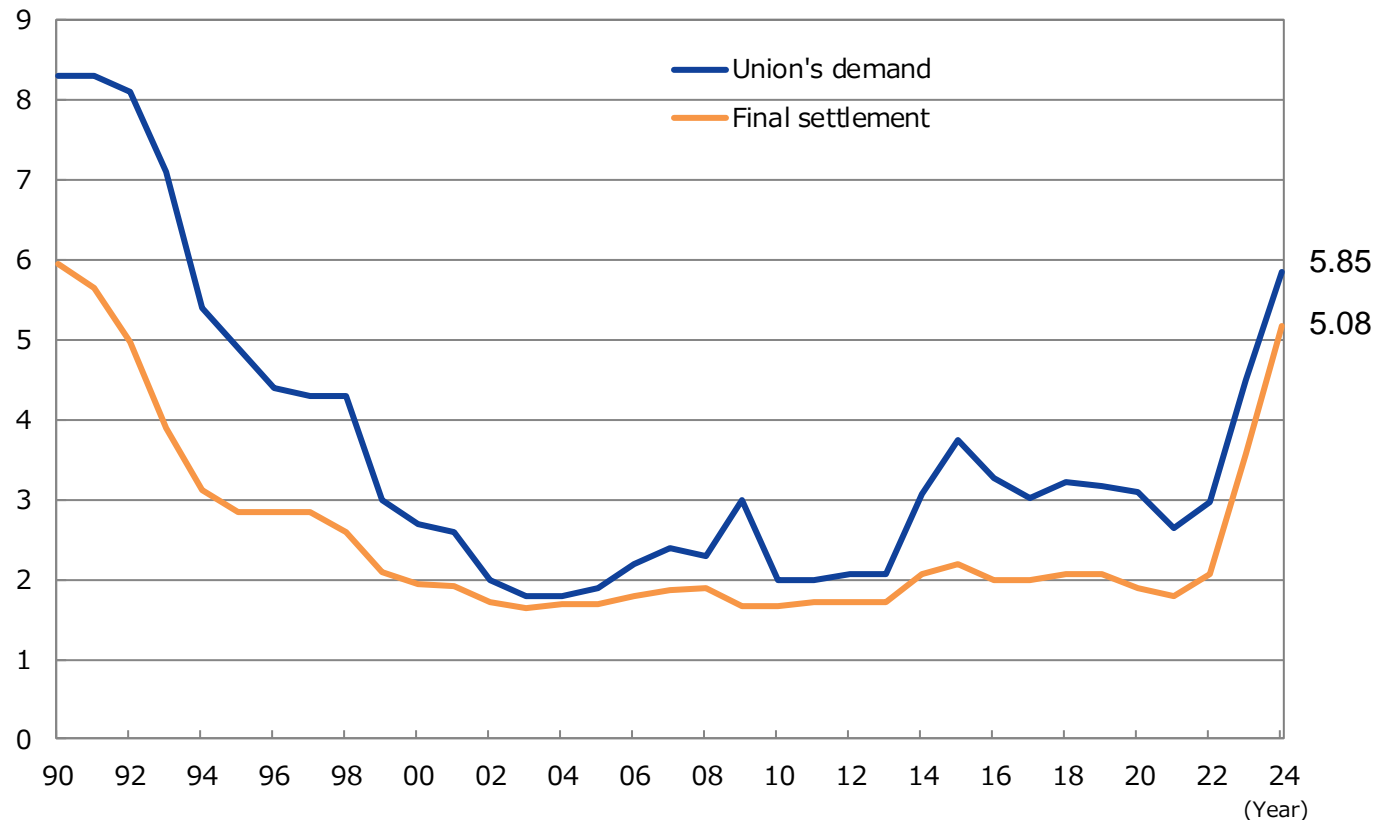
Earthquake & Industrial production



Note: Data of the previous month of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

Highest wage increase in 33 years

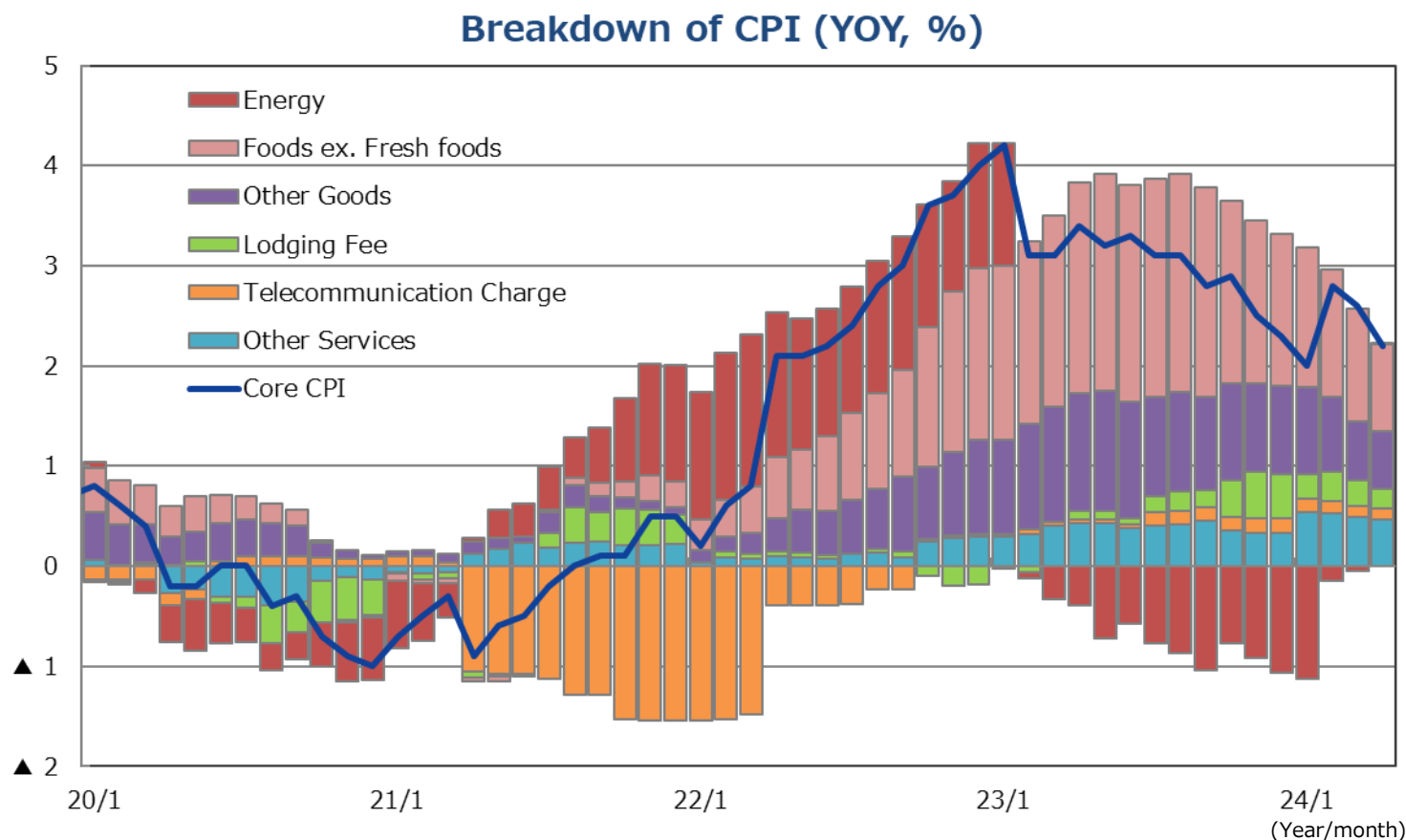
Wage increase (YOY, %)



Note: Data is from FY 1990 to FY 2024.
Source: Japanese Trade Union Confederation, SMDAM

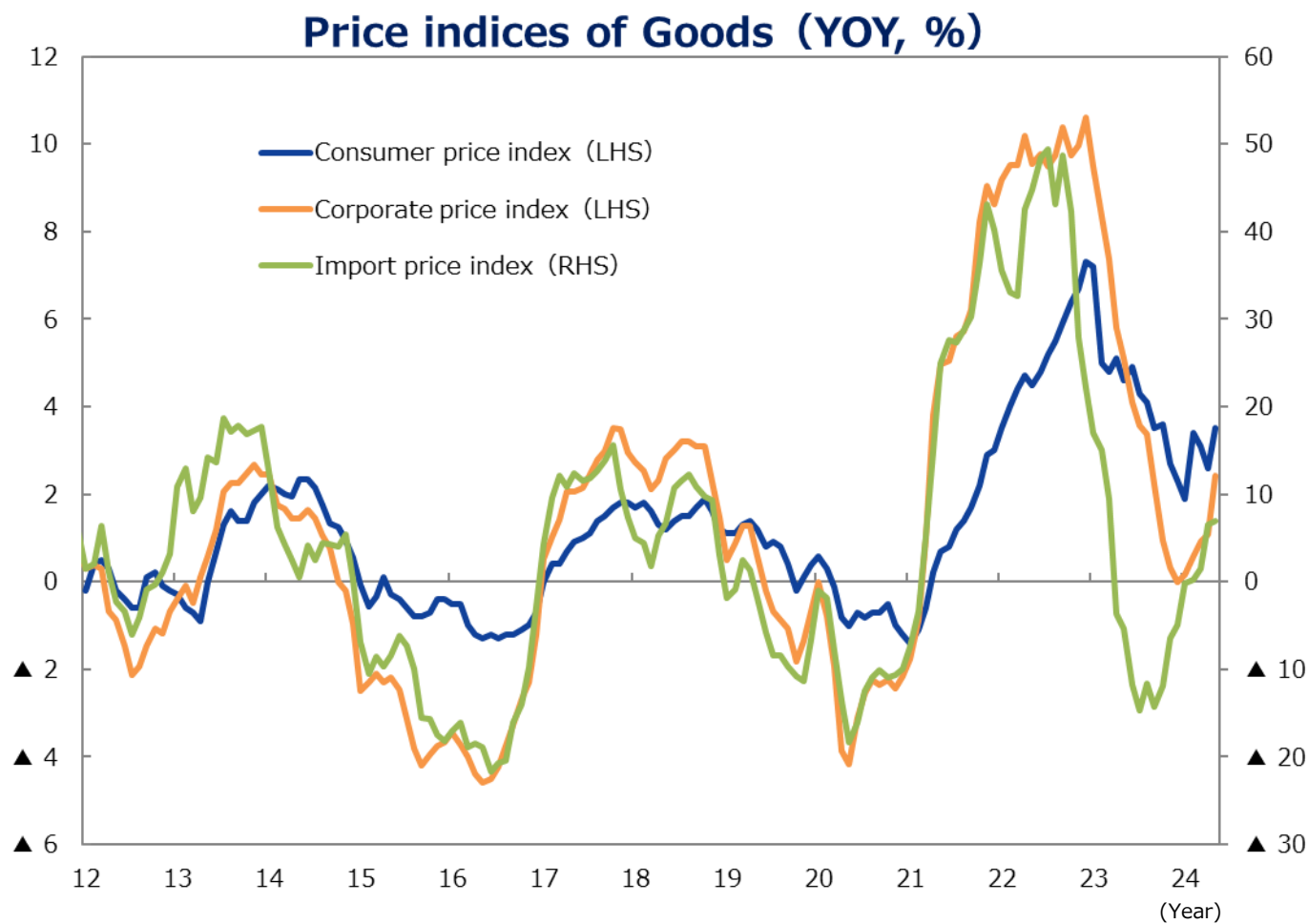


End of utility bill subsidies lift CPI temporarily



Note: Data is from January 2020 to April 2024.
Source: MIAC, SMDAM

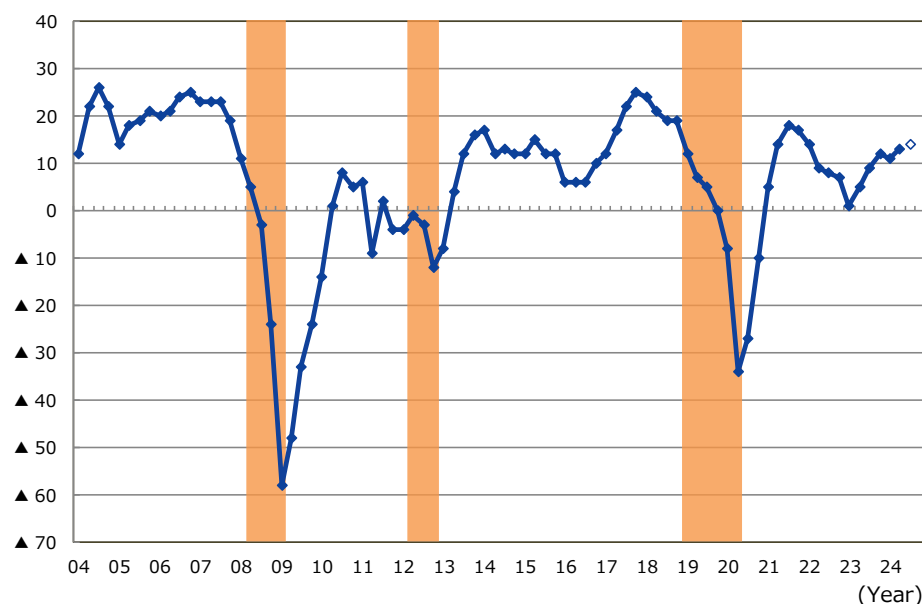
Cost push inflation again?



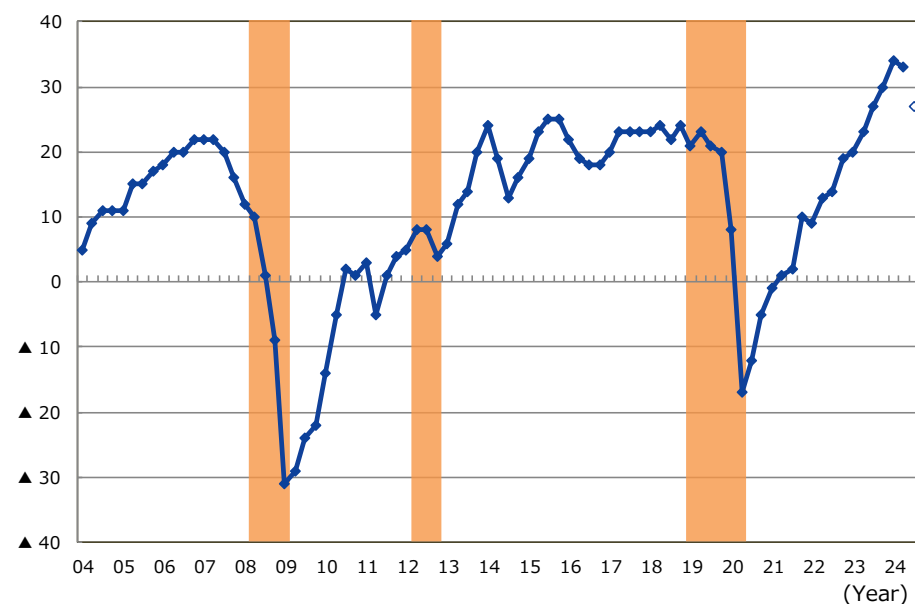
Note: Data is from January 2012 to May 2024.
Source: MIAC, Bloomberg, SMDAM

Non-manufacturers sentiment fell for the first time in 4 years

BOJ business condition DI Large manufacturers (%)



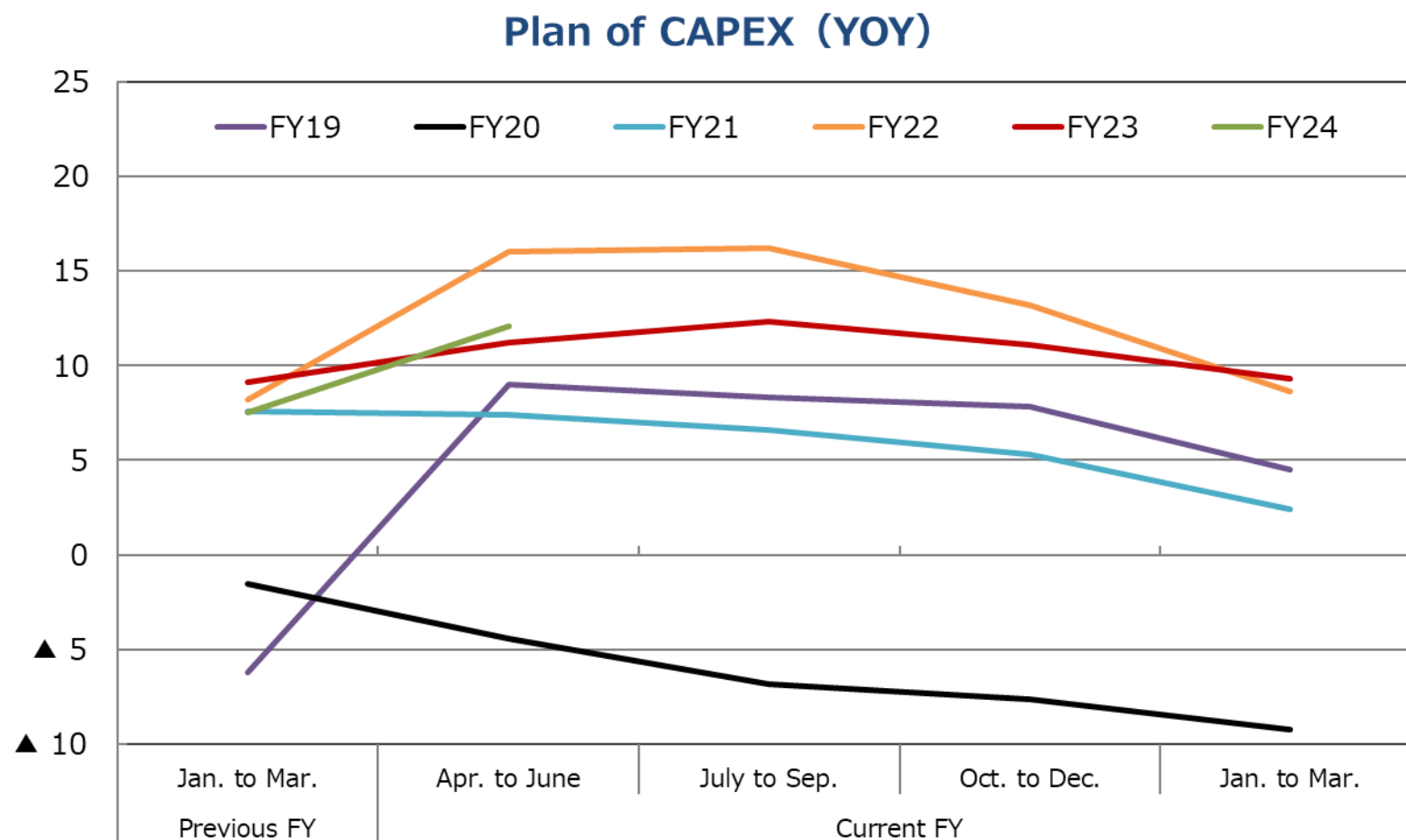
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q2 2024. The orange shadow are periods of economic recession.

Source: The Bank of Japan, SMDAM

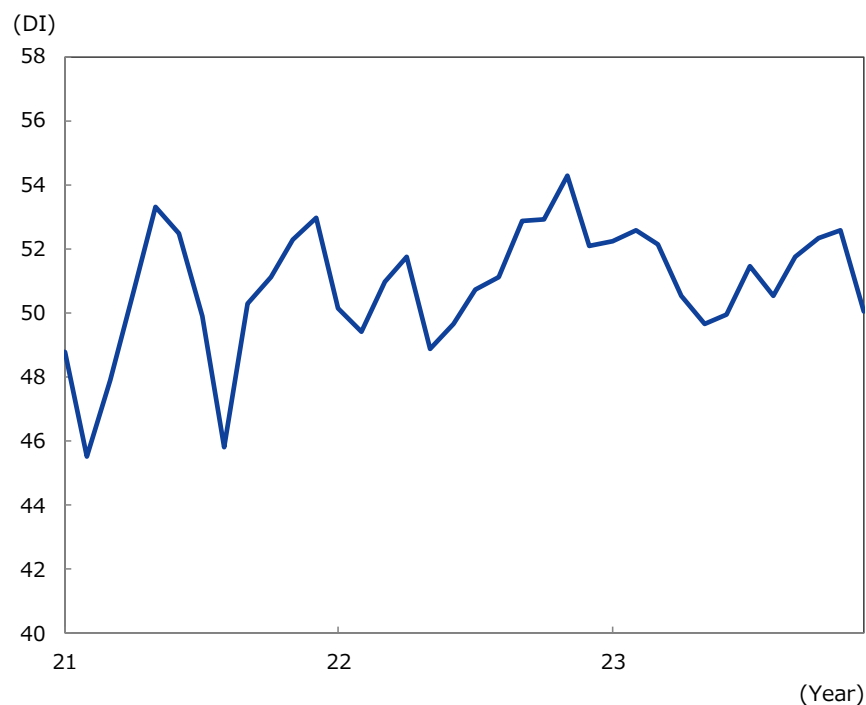
CAPEX maintains a brighter outlook in 2024



Note: Data is from Q1 FY2018 to Q3 FY2024. All industries, all sizes, including software, excluding land and R&D
Source: Cabinet Office, SMDAM

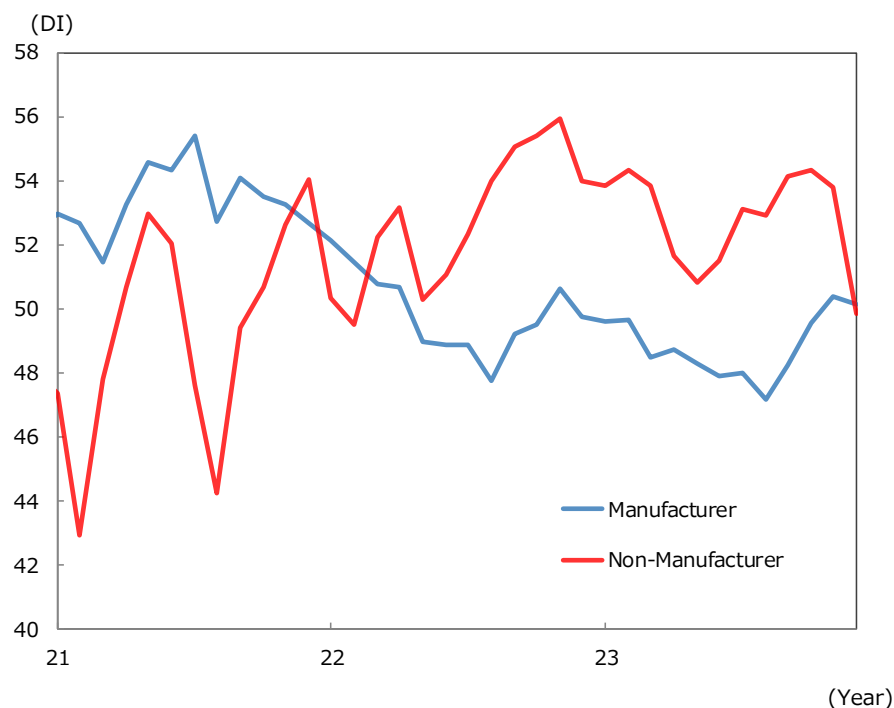
Service PMI plunges sharply due to sluggish outlook ahead

Composite PMI



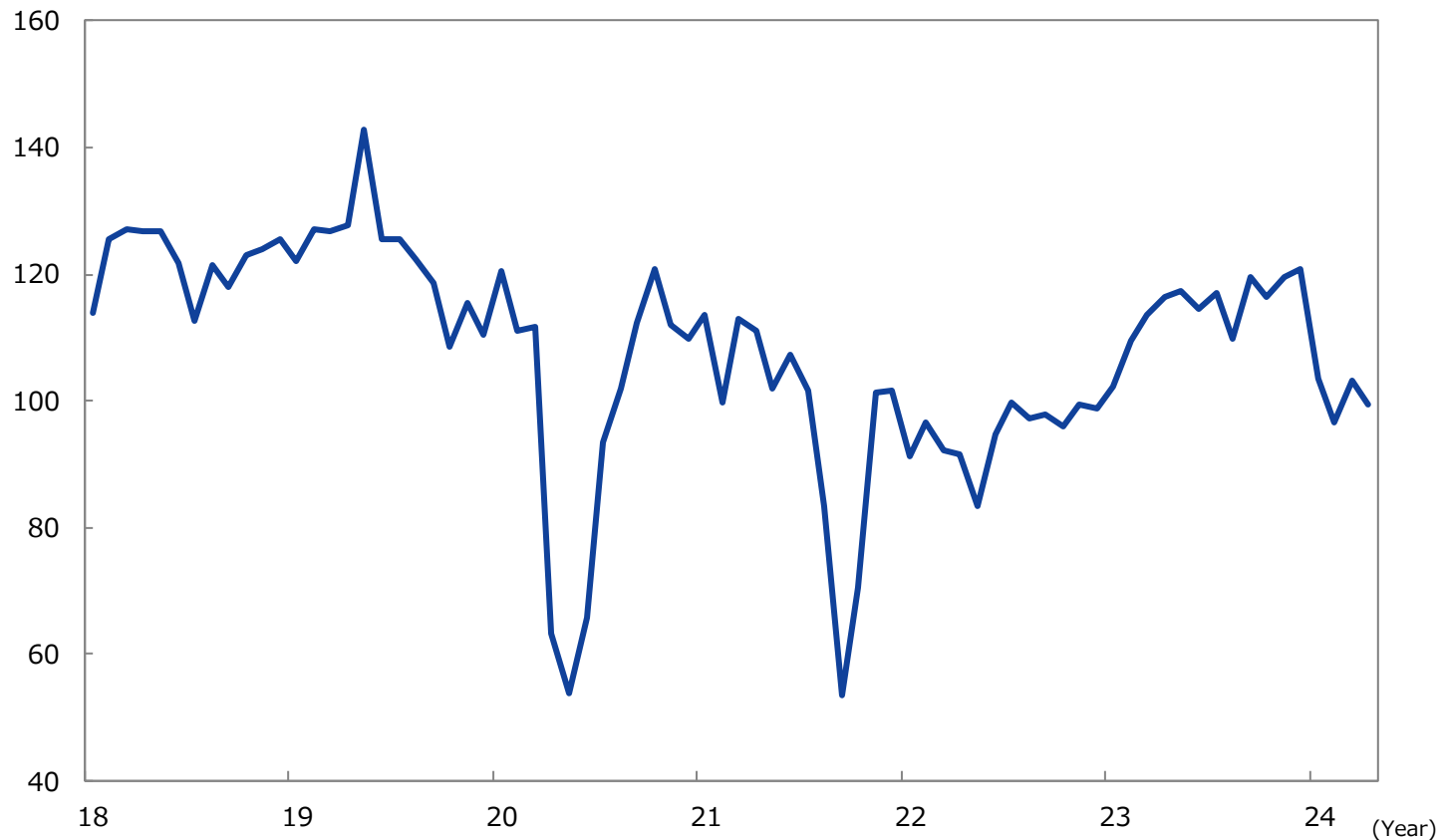
Note: Data is from July 2021 to June 2024.
Source: Bloomberg, SMDAM

PMI, Manufacturer & Non-Manufacturer



Auto production plunges owing to product certification scandal

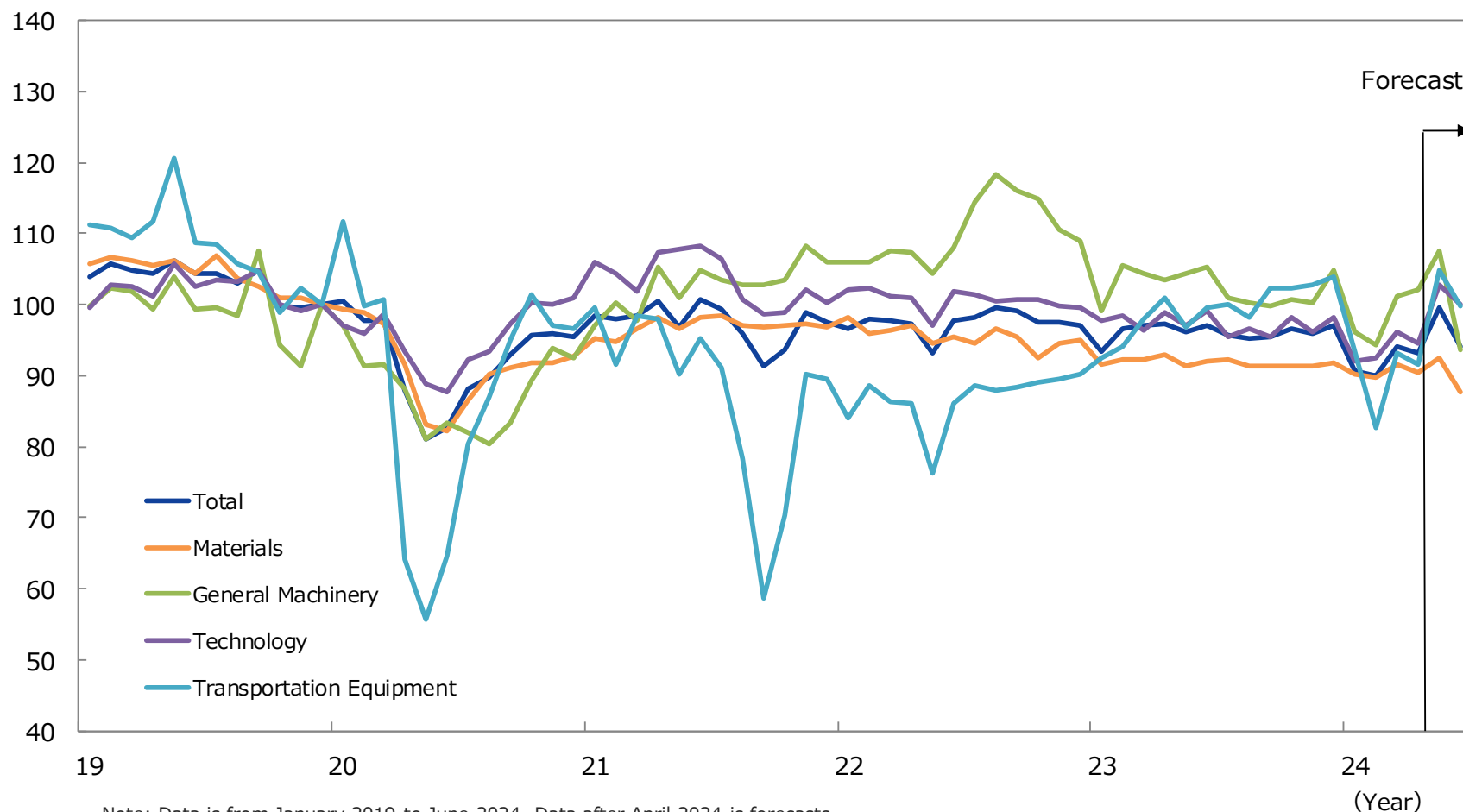
Automobile production (2020=100)



Note: Data is from January 2018 to April 2024.
Source: METI, SMDAM

Industrial production to decline due to falling auto production ahead

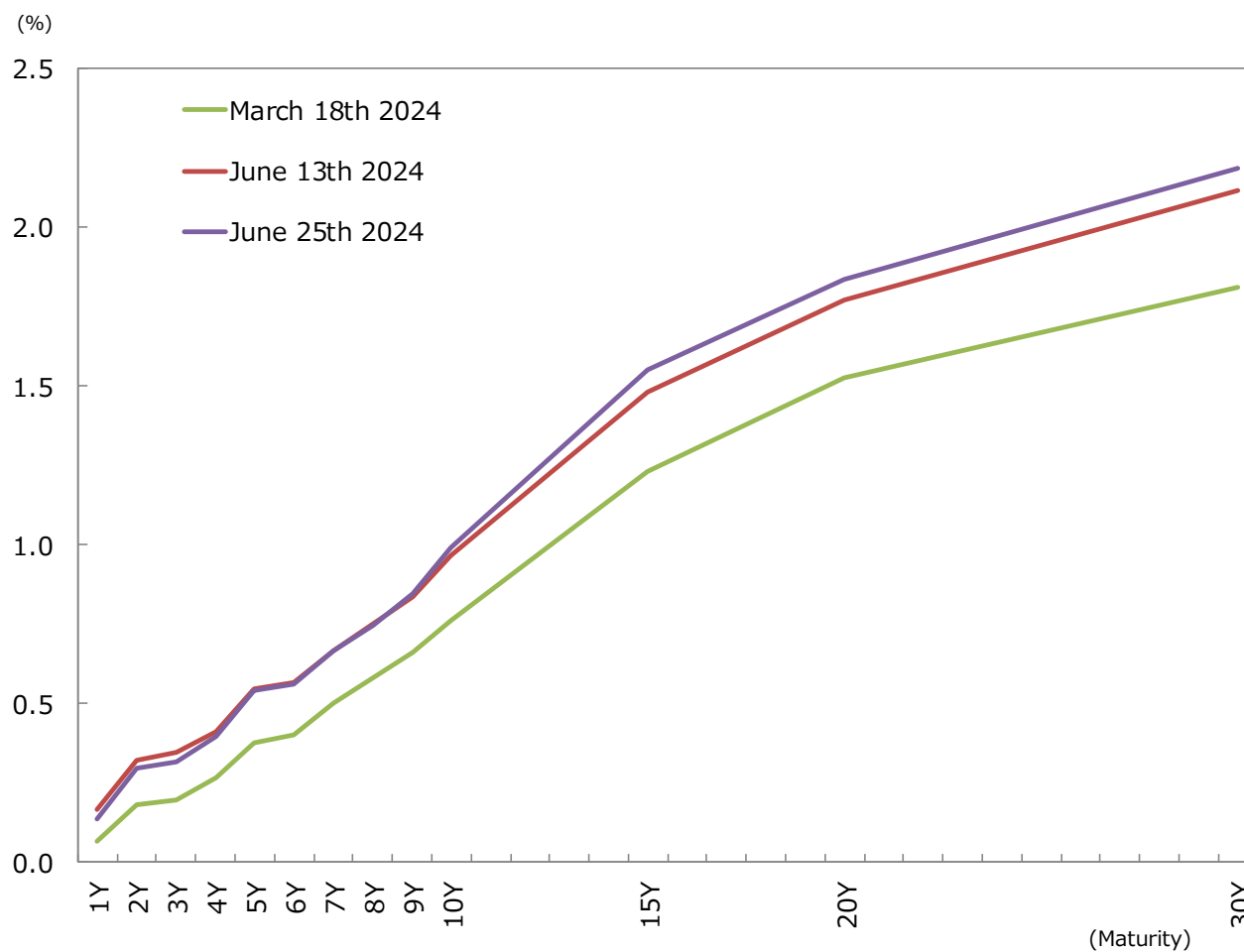
Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to June 2024. Data after April 2024 is forecasts.
Source: METI, SMDAM

JGB yield curve pricing QT & further rate hike

Yield Curve of Japanese Sovereign

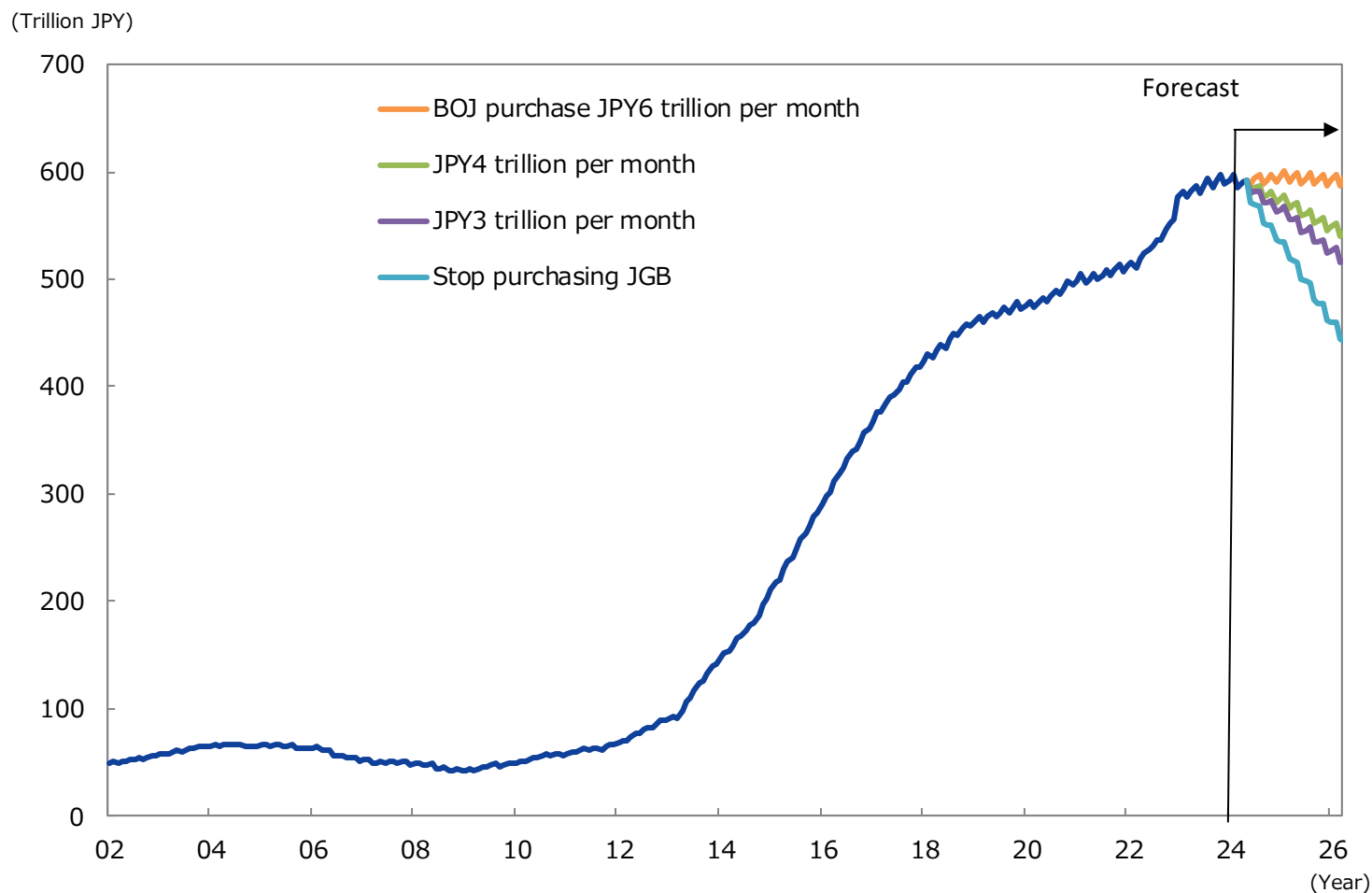


Source: Bloomberg, SMDAM



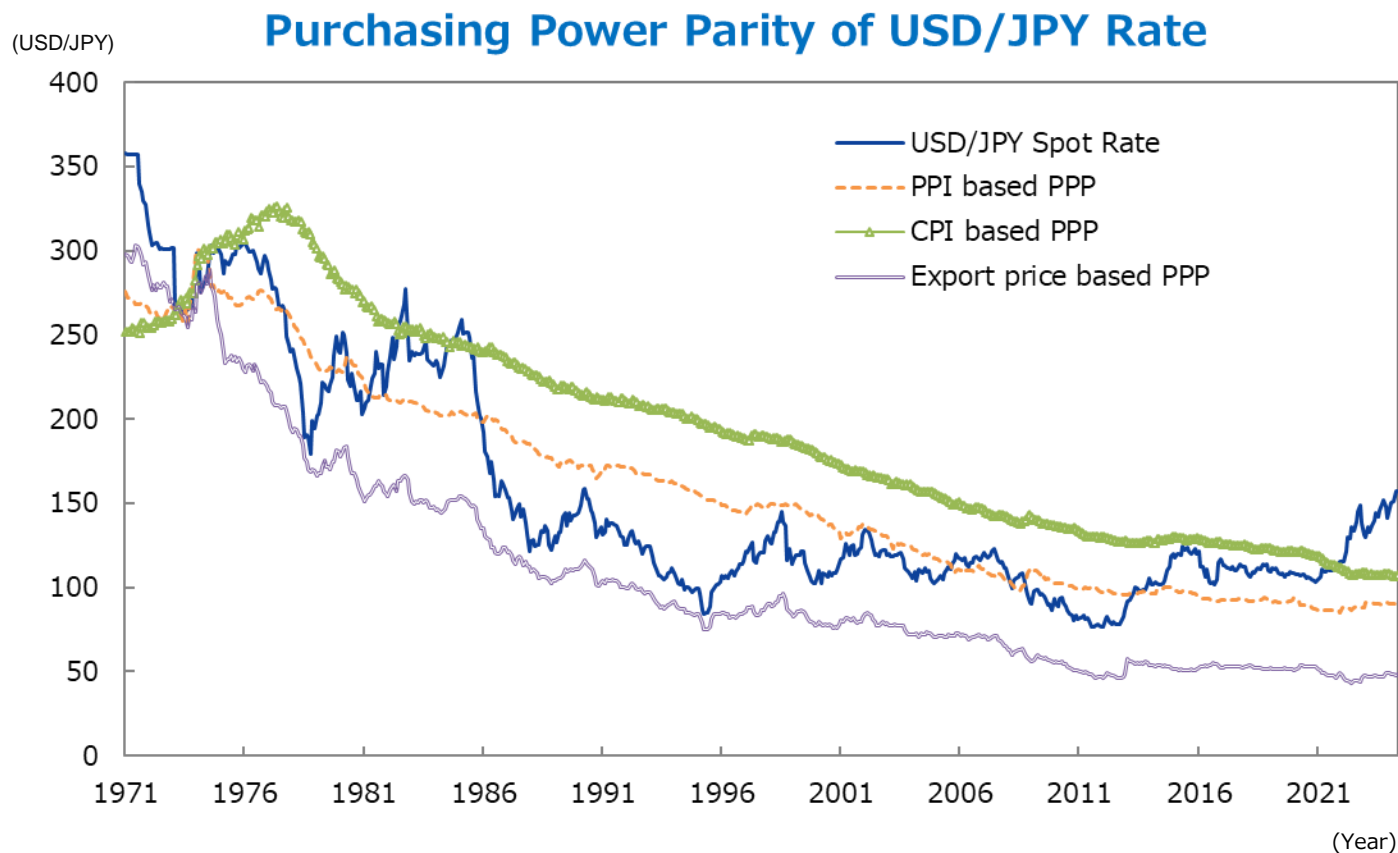
The BOJ to start quantitative tightening soon

BOJ's holding of long term JGB



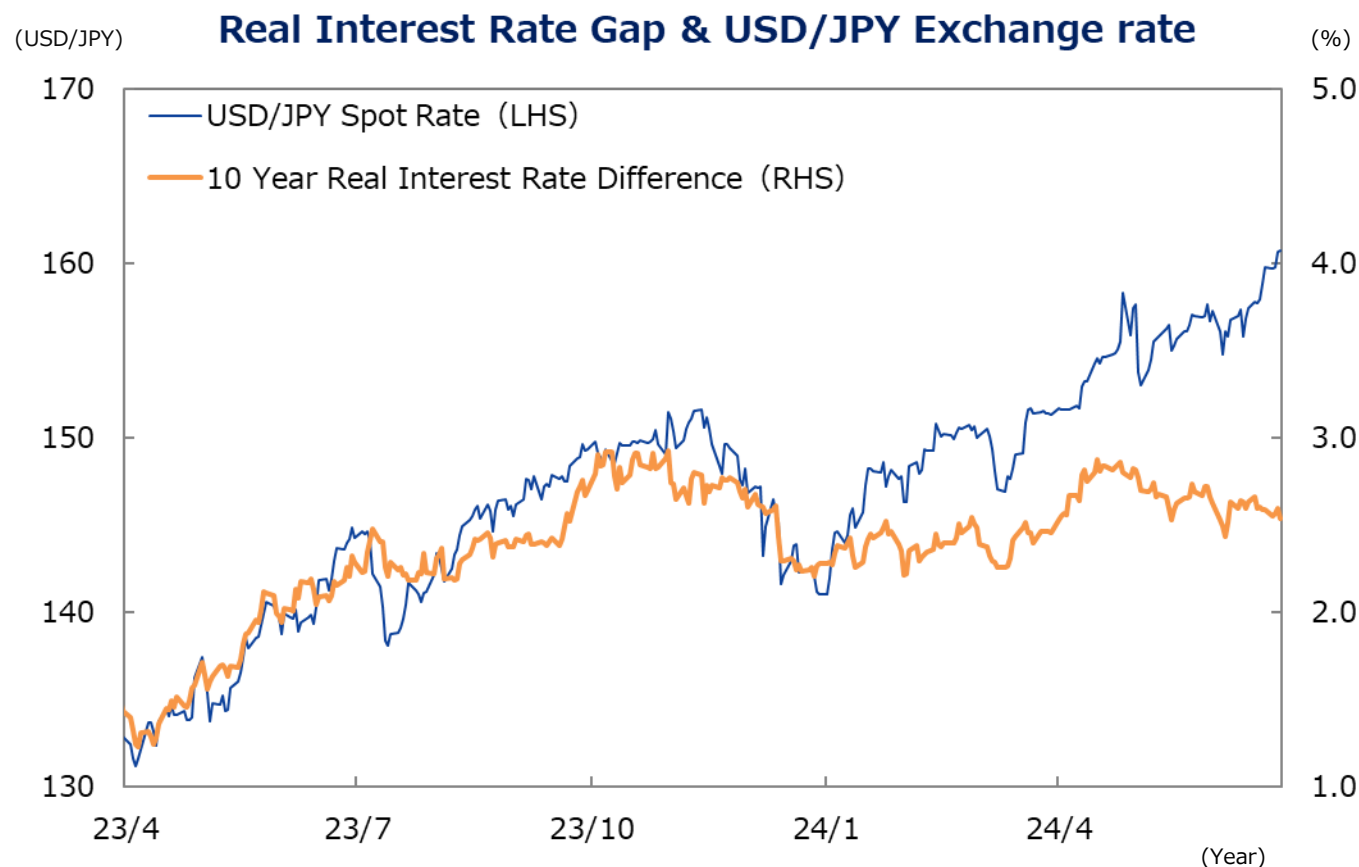
Note: Data is from January 2002 to March 2026. Data after May 2024 is forecasts.
Source: METI, SMDAM

Weakening JPY diverges from purchasing power parity



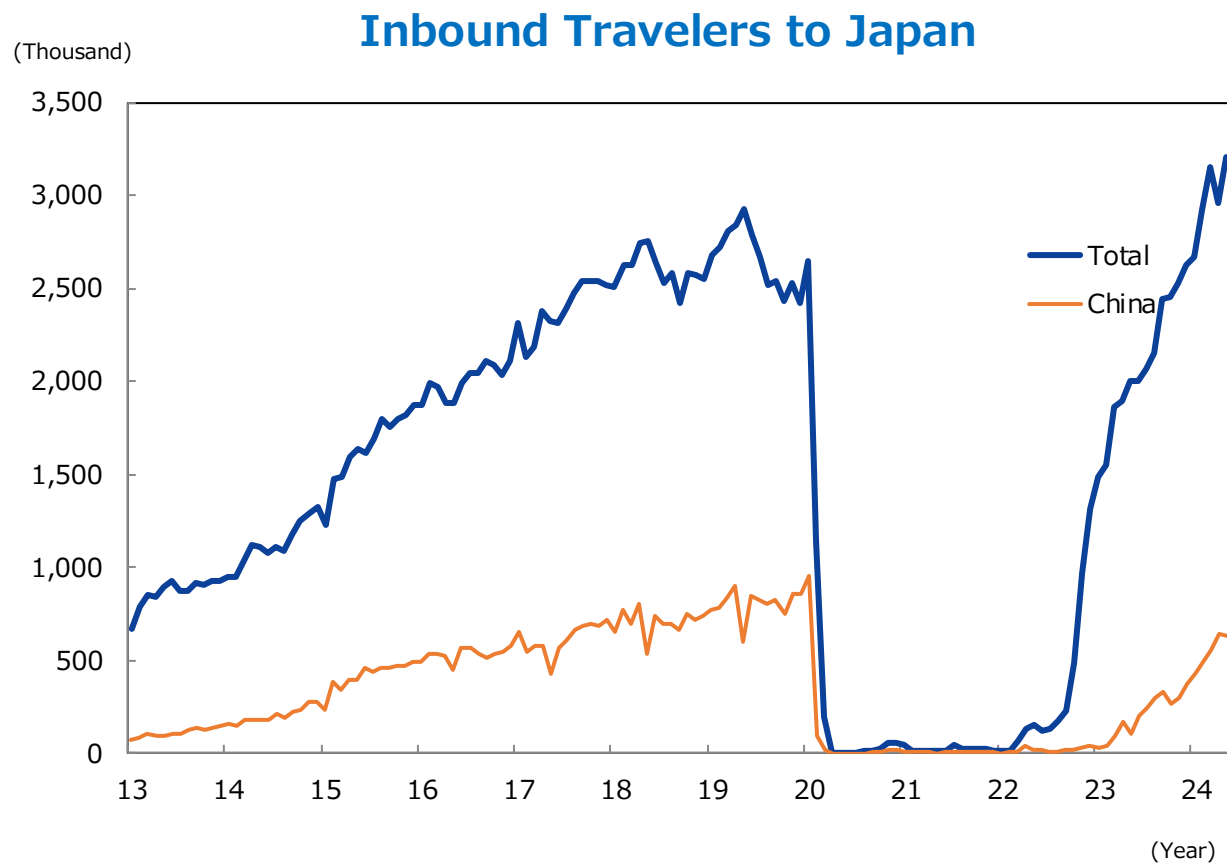
Note: Data is from January 1971 to May 2024.
Source: DOL, Bank of Japan, SMDAM

Real interest rate gap starts losing correlation with USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2023 to 27th June 2024.
Source: Bloomberg, SMDAM

Weakening JPY boosts inbound travel

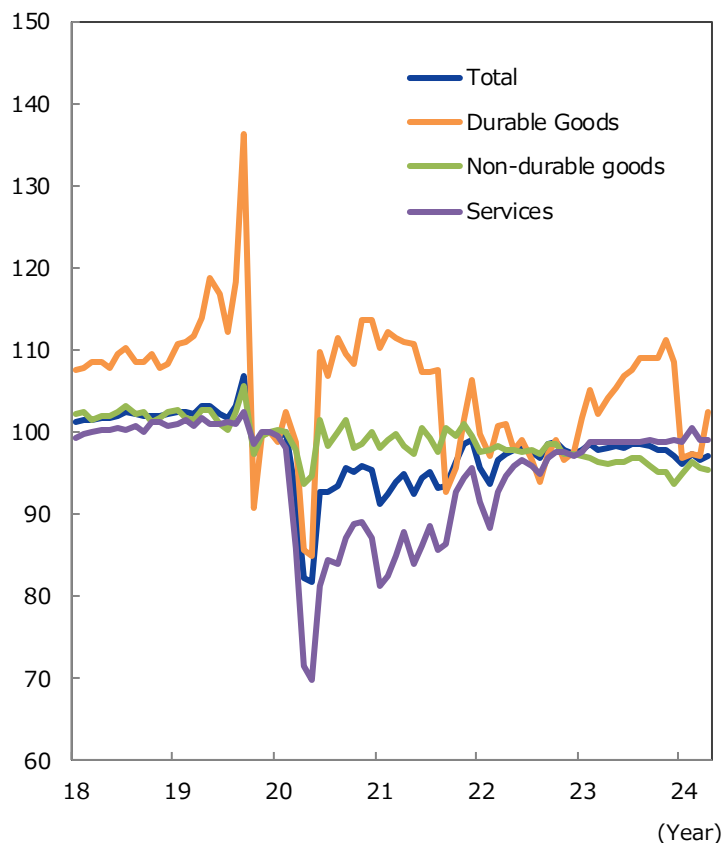


Note: Data is from January 2013 to May 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

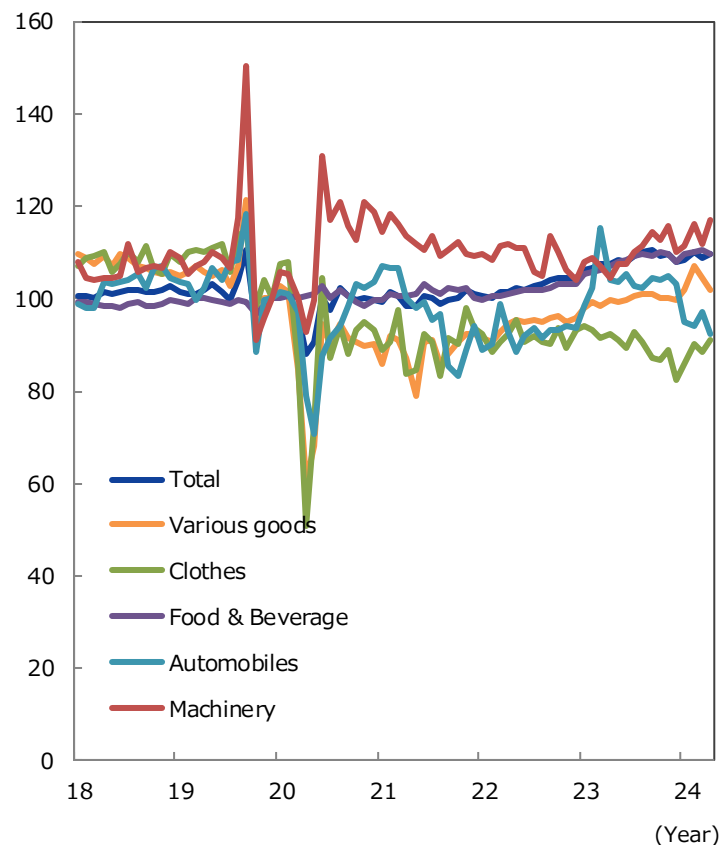


Retail sales is mixed due to sluggish real income growth

Consumer Activity Index (Dec. 2019 = 100)



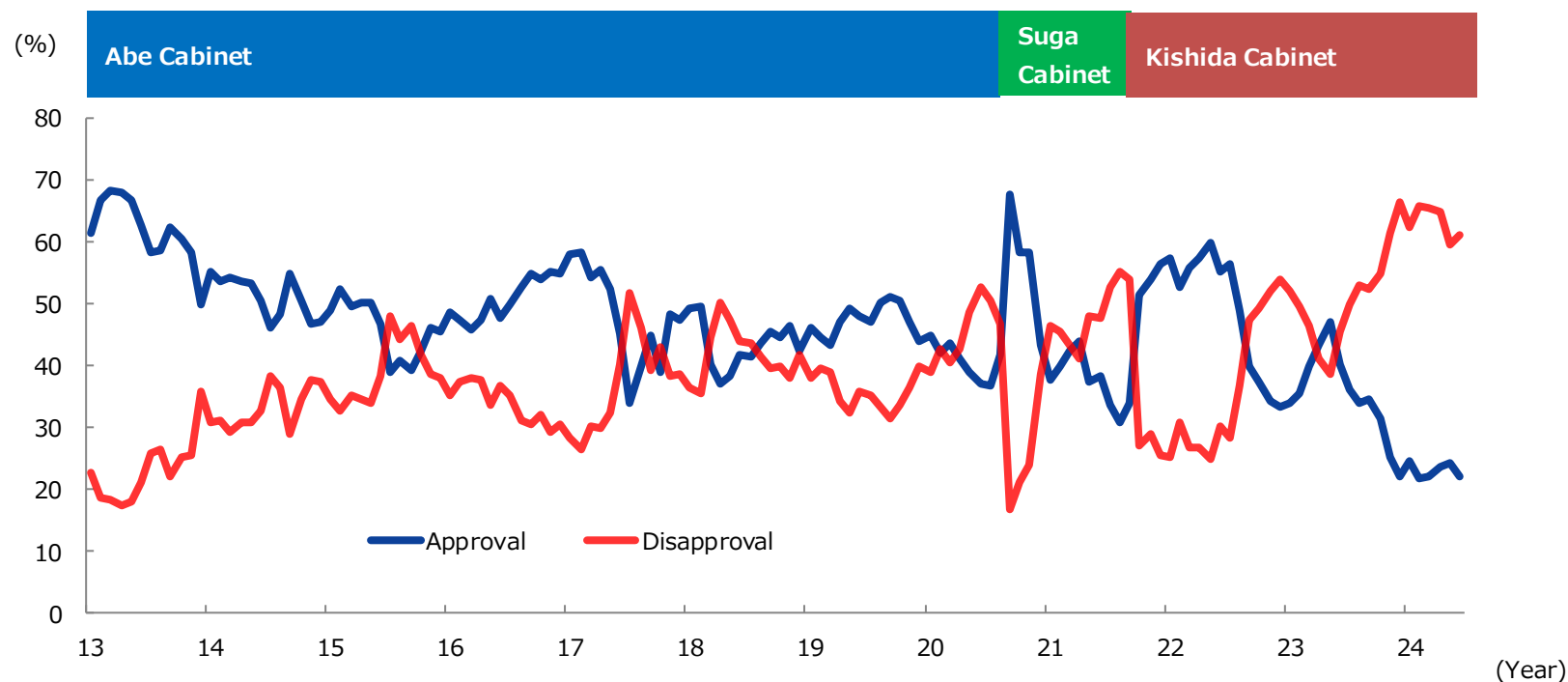
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to April 2024.
Source; Bank of Japan, METI, and SMDAM

PM Kishida losing cohesive power within the ruling LDP

Cabinet approval rate



Note: Data is from January 2013 to June 2024.

Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2024	July	30-31	Monetary Policy Meeting Summation of annual spring wage negotiations (final session)
	August	15	Release of Q2 GDP
	September	9 19-20 30	Revision of Q2 GDP Monetary Policy Meeting Termination of the presidency of the LDP
	October	30-31	Monetary Policy Meeting
	November	15	Release of Q3 GDP
	December	9 18-19	Revision of Q3 GDP 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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