



Japanese Stock Market Outlook

SMAM monthly comments & views
- January 2016 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

3Q GDP was revised from -0.8% to +1.0% showing much more solid picture than previously assumed. Export is rebounding from the impact of global slowdown though its sustainability is not yet certain. Fiscal stimulus measure is going to be taken in early 2016, which should be supportive for the Japanese economic recovery whereas substantial expansion of monetary stimulus is not expected in the current condition.

- GDP forecast for FY2015 was upgraded from +0.8% to +1.0% after the significant up-revision of 3Q GDP. Forecast for FY2016 was maintained at +1.0%.
- BOJ added supplemental measures to smoothly operate current pace of monetary expansion in December. The range of average length of maturity for JGB purchased was extended from 7-10 years to 7-12 years. However, JGB annual purchase was held unchanged at 80 trillion yen.

➤ Japanese Stock Markets

One of the uncertainties was cleared as US interest rate was finally hiked, however, global stock markets are yet to find solid footings due to oil prices falling further and unstable emerging economies. Japanese stock market is forecast to be range-bound for a while before gathering enough steam to try upside in 2016.

- The Japanese stock market will get firmer as fiscal measures and further economic policies could lift sentiment of consumers and companies running up to the upper house election expected in July 2016.
- There is a huge potential that shareholder returns from Japanese companies improve to catch up peers in the US and Europe. If such improvements can be achieved, it would make a strong tailwind for Japanese stocks for the long term.

Notes: Macro and market views are as of Dec.17th and 21st 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-16

- GDP forecast for FY2015 was upgraded from +0.8% to +1.0% after the significant up-revision of 3Q GDP. Forecast for FY2016 was maintained at +1.0%.
- For FY2016, private sector is expected to show a reasonable growth, consumption at +1.7%, housing investment at +2.3% and capital investment at +2.1%. Contraction in the public capital investment is the main drag, for which “special spending program of reconstruction from the earthquake and tsunami in 2011” comes to an end.

	FY12	FY13	FY14	FY15E	FY16E
Real GDP growth	0.9%	2.0%	-1.0%	1.0%	1.0%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	0.4%	1.7%
Private Housing Investment	5.7%	8.8%	-11.7%	3.0%	2.3%
Private Capital Investment	0.9%	3.0%	0.1%	1.5%	2.1%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.1%	0.1%
Public Capital Investment	1.0%	10.3%	-2.6%	0.1%	-0.6%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	-0.1%
Exports	-1.4%	4.4%	7.8%	1.5%	3.7%
Imports	3.6%	6.7%	3.3%	1.2%	4.9%
Nominal GDP	0.0%	1.7%	1.5%	2.3%	1.8%
GDP Deflator	-0.9%	-0.3%	2.5%	1.2%	0.8%

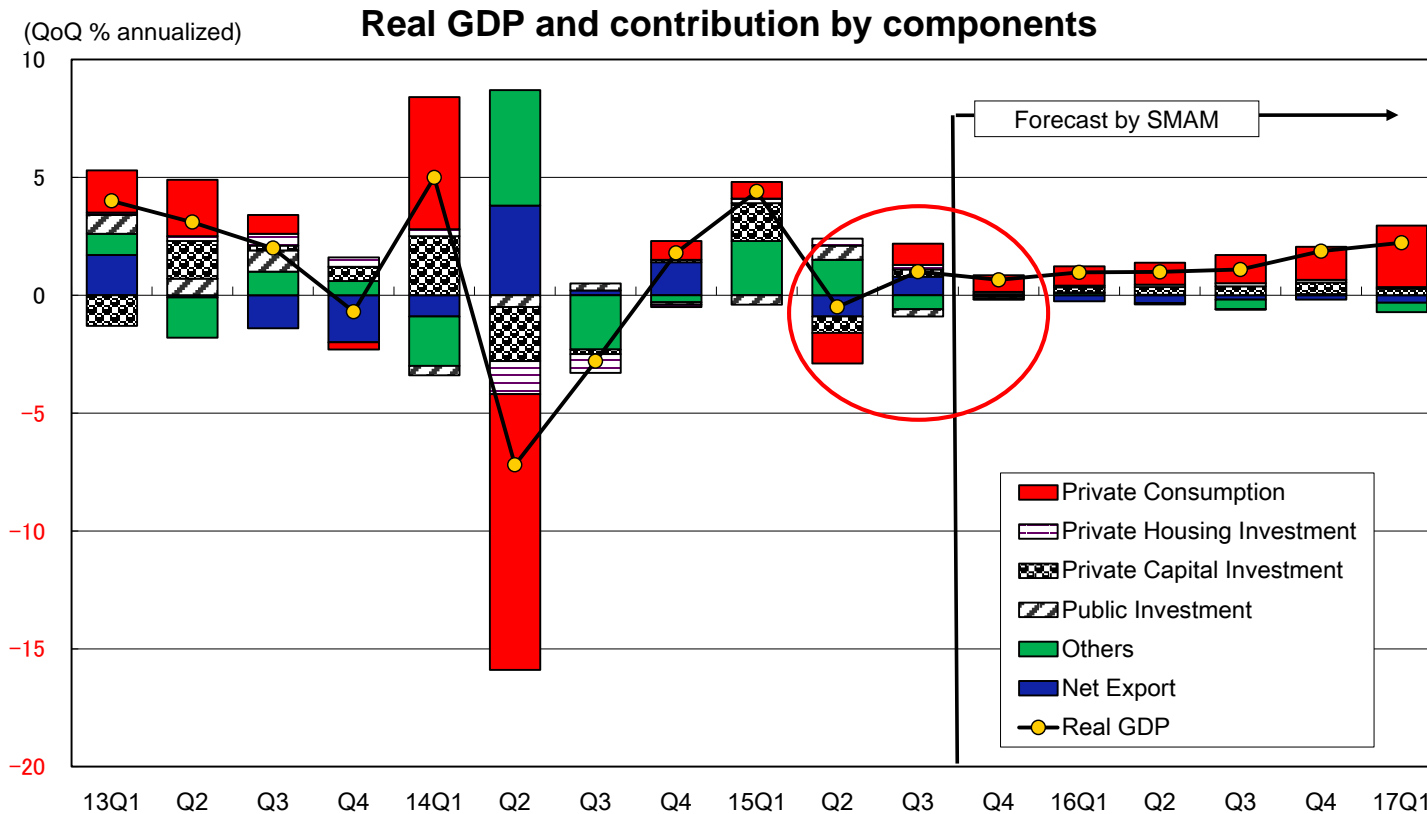
Notes: E=SMAM forecasts. SMAM views are as of Dec. 17th, 2015 and subject to updates thereafter without notice

(%, YoY except Net Exports)

Source: Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

SMAM economic outlook for FY15-16

- 3Q (Jul-Sep) GDP was revised up from previous -0.8% to +1.0 % QoQ annualized due to significant up-revision in Private Capital Expenditure.
- Private consumption has recovered in 3Q and it is expected to lead the GDP growth going forward. GDP is forecast to start growing again from 4Q.

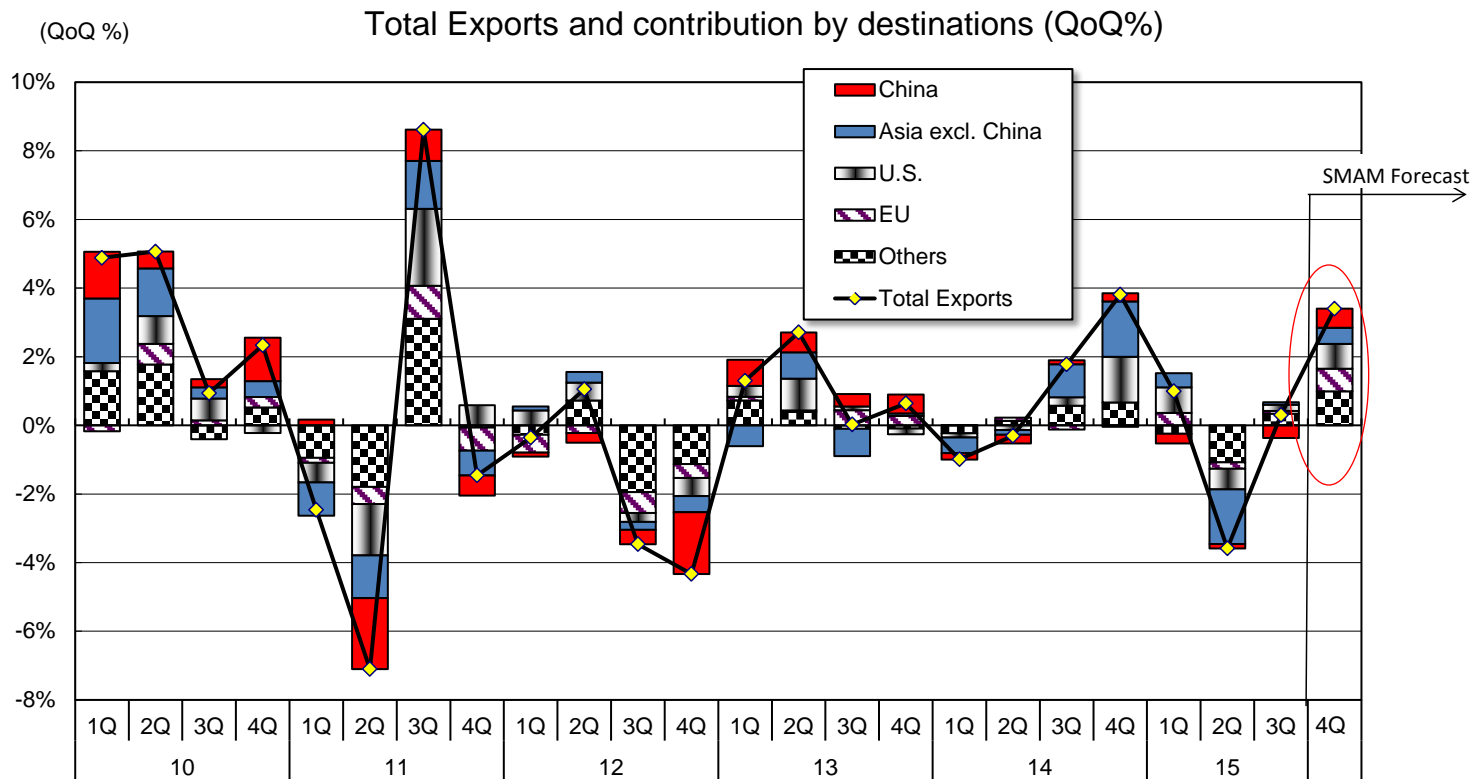


Notes: SMAM views are as of Dec.17th, 2015 and subject to updates thereafter without notice.

Source: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts .

Negative effects from global economic deceleration on Japanese exports are easing

- After a sharp fall in exports in 2Q, total exports from Japan recovered to positive territory in 3Q and expected to show solid recovery in 4Q examining monthly data released so far.

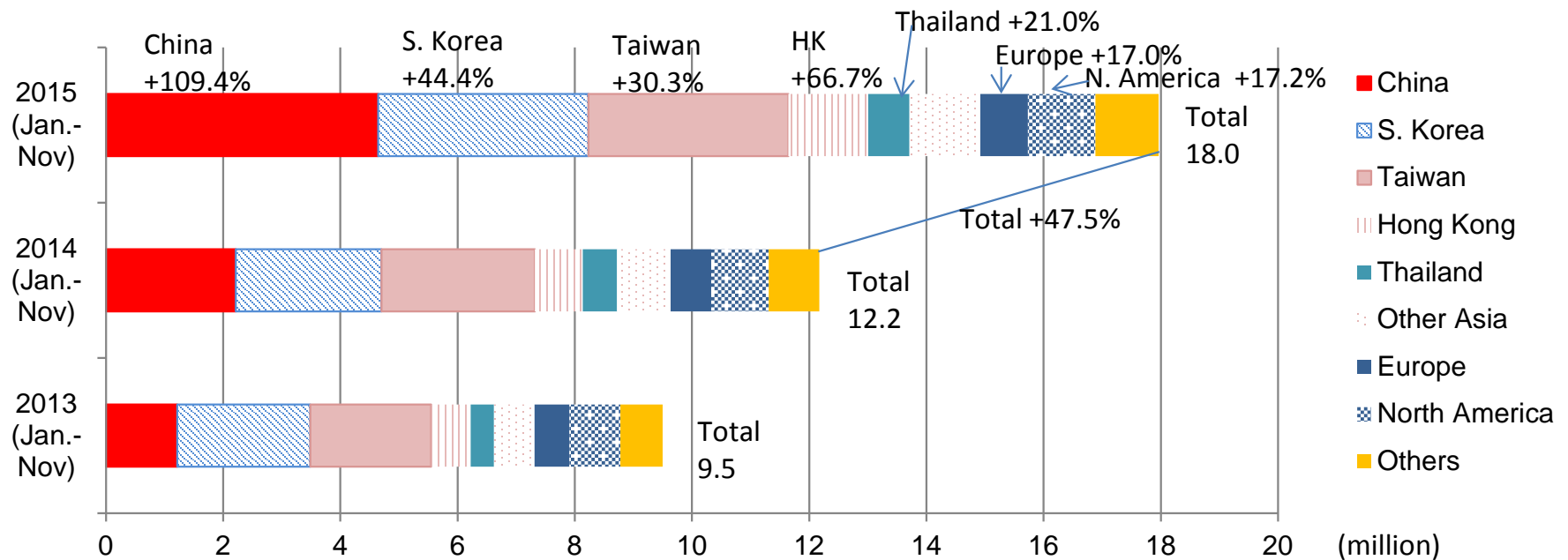


(Source) Ministry of Finance and Bank of Japan, compiled by SMAM

Tourism to Japan keeps booming

- Growth in number of visitors to Japan shows no sign of impact from global economic slowdown.
- In Jul-Sep, spending by tourists contributed Japanese GDP by approx. 0.1% annualized and further ripple effects on related industries can be expected.

Robust inbound tourism to Japan (Jan.-Nov.)

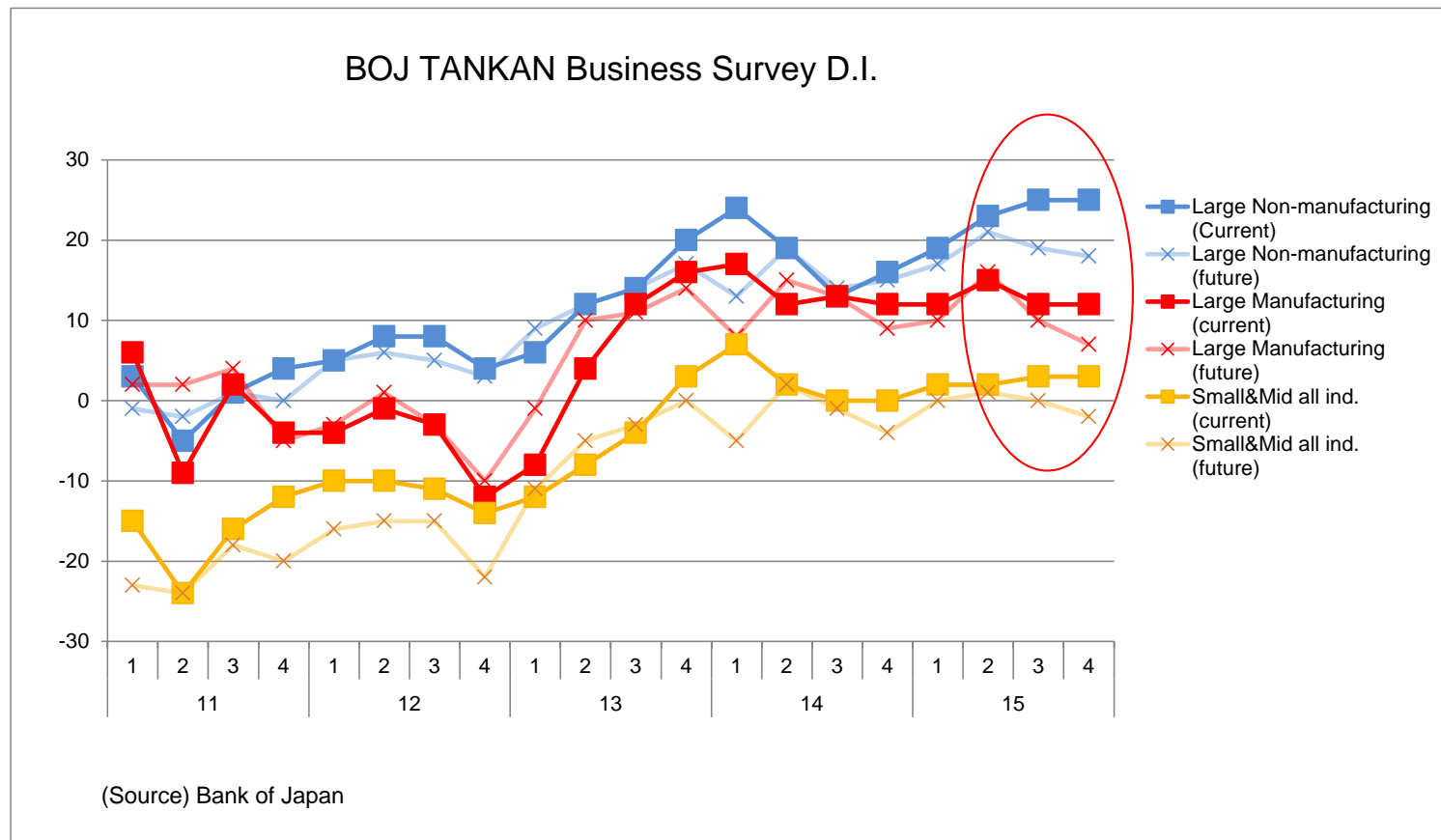


Note: Percentage shows increase of 2015/2014

(Source) Japan National Tourism Organization

Business sentiment shows resilience with some caution for the future

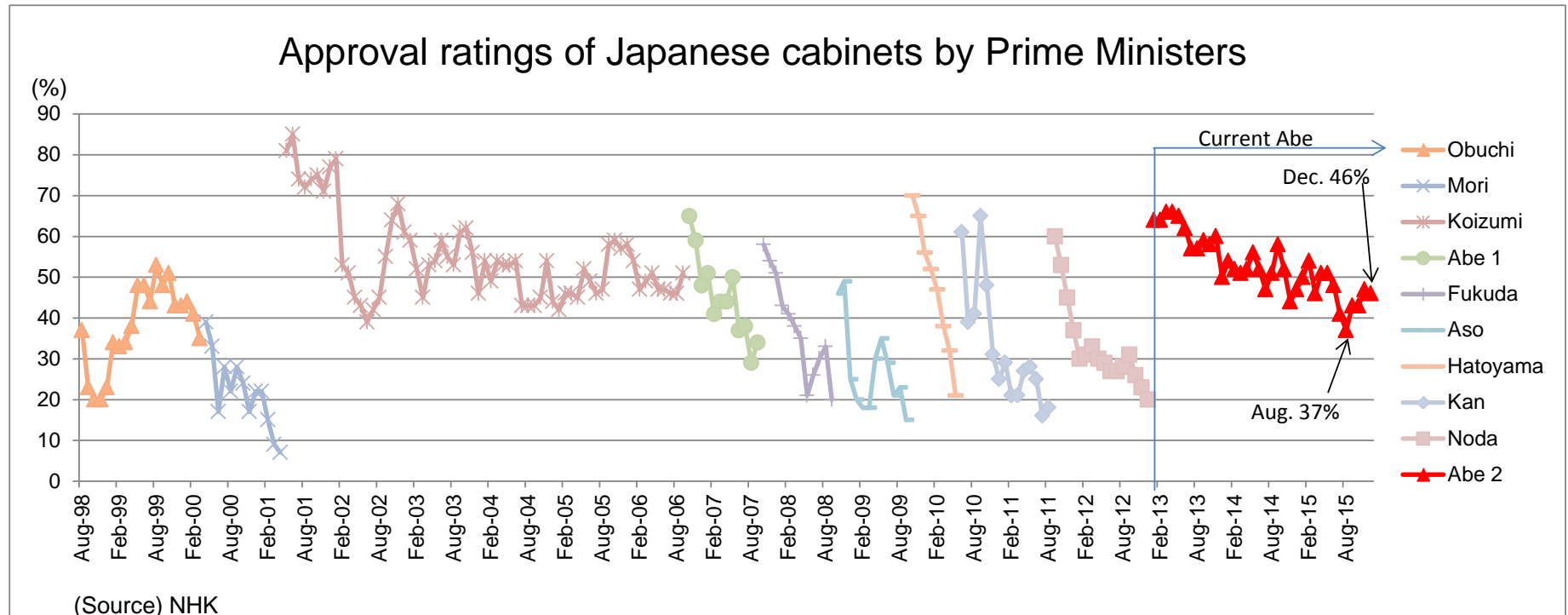
- TANKAN business survey by BOJ shows business sentiment is holding despite recent slowdown in Japanese economy.
- DI for non-manufacturing large enterprises is at historically high level whereas that for manufacturing is holding OK though caution for the future rose.



Stimulus measures are expected in early next year

- Upper house election is scheduled in July 2016.
- Stimulus measures on the fiscal side were approved by the Cabinet.

Corporate tax cut to 29.97 %, strategic spending preparing for TPP, supporting elderly care, child bearing ,etc.



Quantitative and Qualitative Monetary Easing (QQE) by BOJ

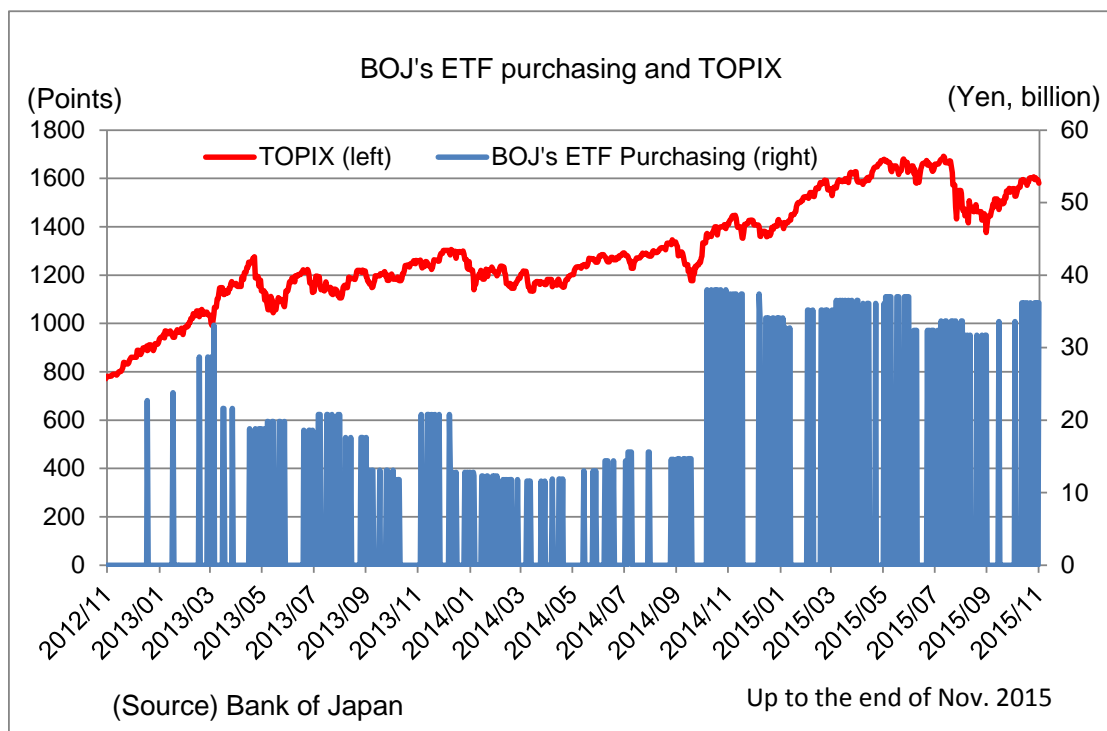
- BOJ is operating QQE2, an up-scaled easing from October 2014.
- At the Monetary policy committee meeting On Dec. 18th 2015, BOJ added supplemental measures for smooth easing operations, which BOJ governor Kuroda denied as expansion of the easing.
- Among the measures, the range of average length of maturity for JGB purchased was extended from 7-10 years to 7-12 years. However, JGB annual purchase was held unchanged at 80 trillion yen.

BOJ's Balance Sheet

(Yen trillion)

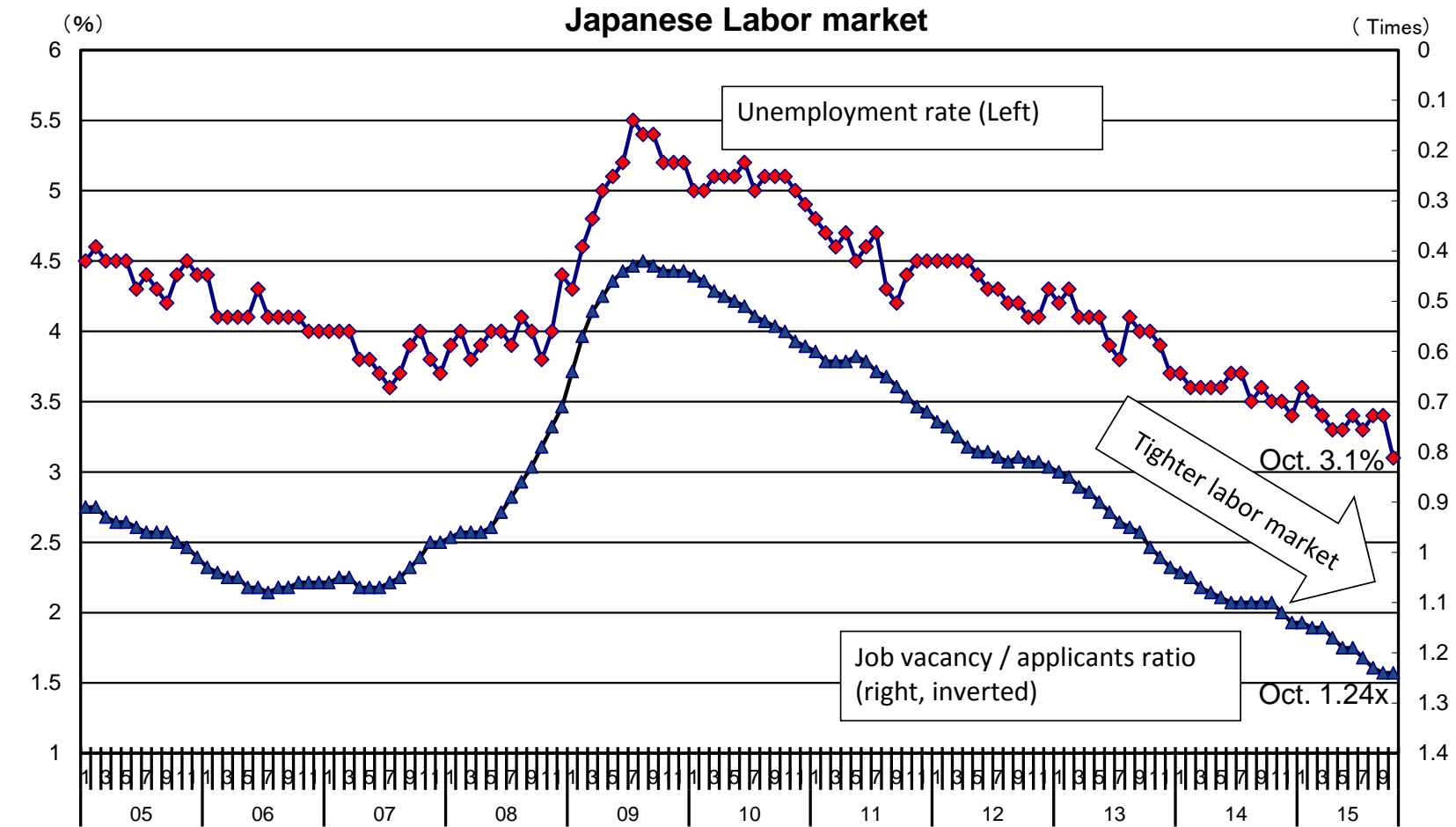
	Dec-14	Oct-15	Increase	Annual target
JGB	201.8	271.0	69.2	80.0
CP	2.2	2.2	0.0	0.0
Corporate Bonds	3.2	3.2	0.0	0.0
ETFs	3.8	6.4	2.6	3.0
J-REIT	0.2	0.3	0.1	0.1

(Source) Bank of Japan



Tight labor market continues to push wage higher for the long term

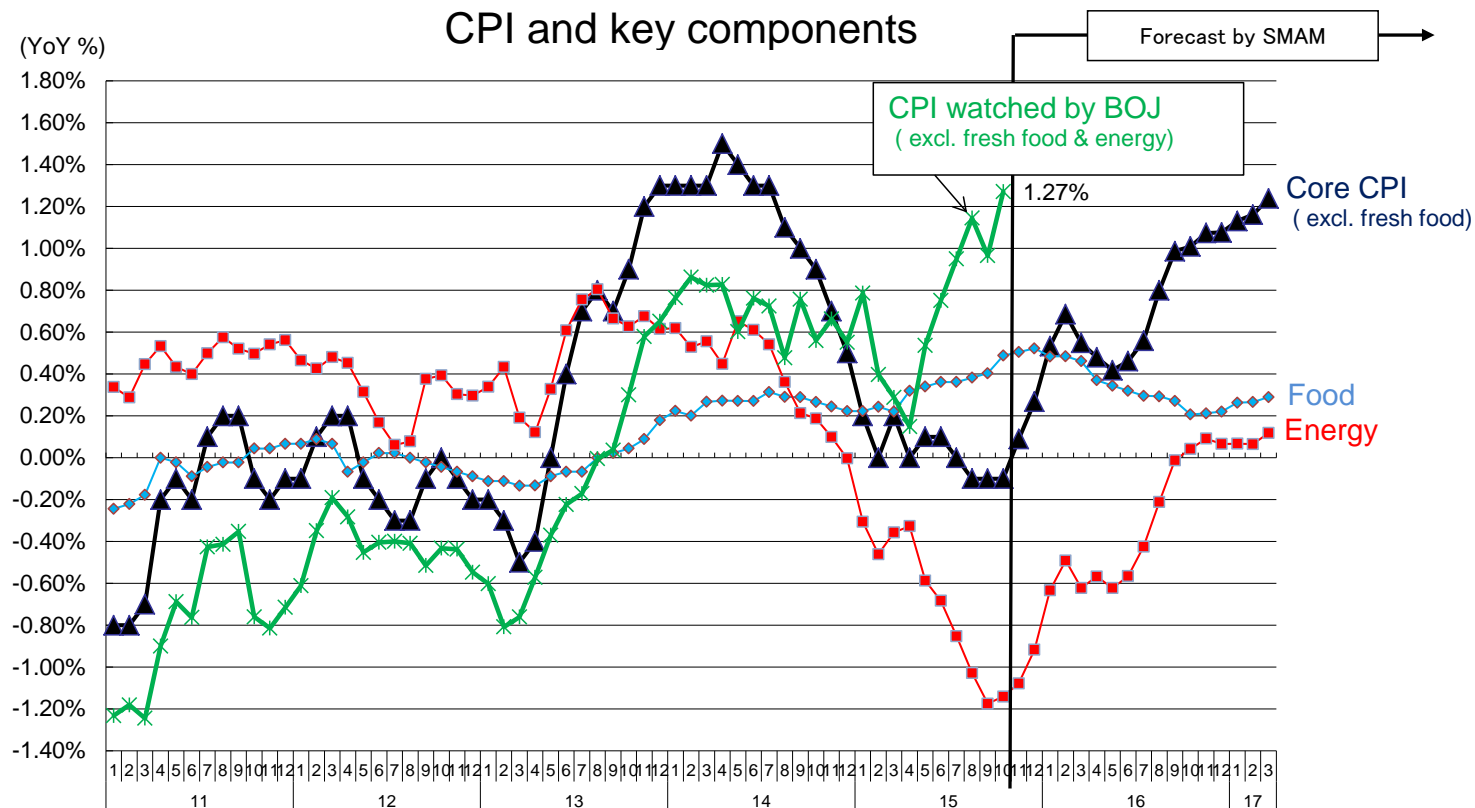
- Tight labor market continues, which should structurally cause upward pressure for wages.



(Source) Ministry of Internal Affairs & Communications, Ministry of Health, Labor & Welfare

BOJ says underlying inflationary trend is alright---

- Underlying CPI trend is solidly rising when fresh food and energy were excluded, which is watched by BOJ.
- However, BOJ lowered its forecast for Core CPI, official inflation target, in October. Forecast for FY 2015 was cut from 0.7% to 0.1% and FY 2016 from 1.9% to 1.4% as the median forecast by committee members.



Note: Excluding direct impact from consumption tax hike in April 2014.

(Source) Ministry of Internal Affairs & Communications, forecast by SMAM.

Outlook for Japanese Stock Markets

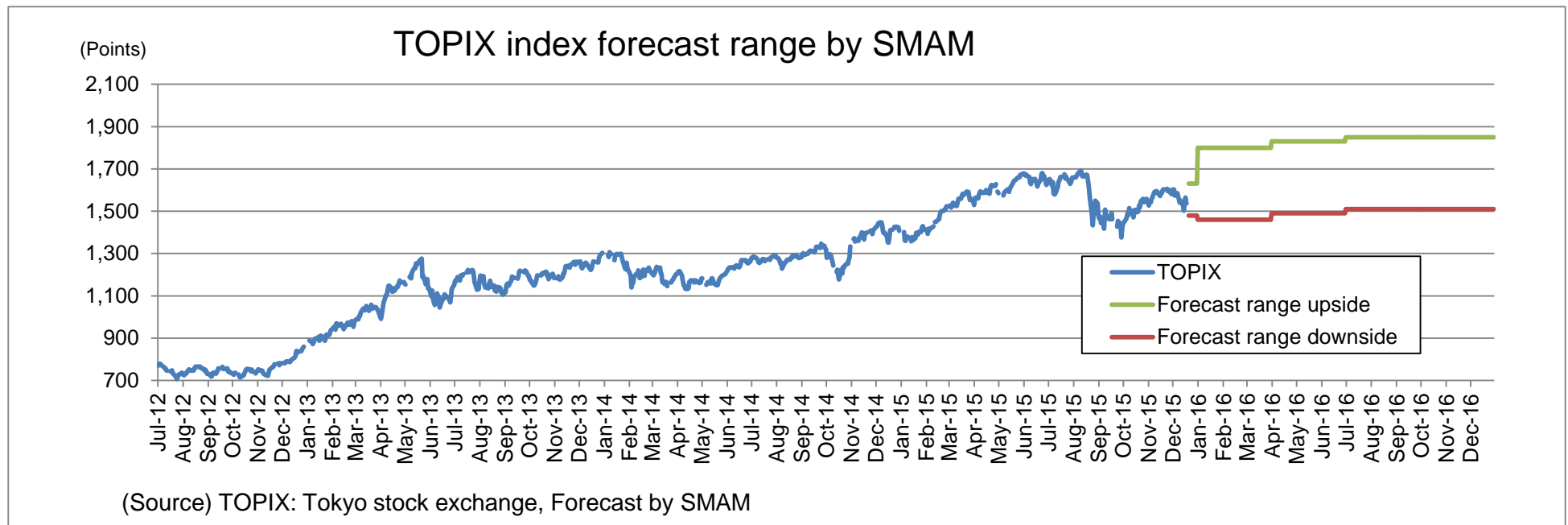
Stock market outlook: The stock market is waiting for further stimulus measures

SMAM short-term view

- One of the uncertainties was cleared as US interest rate was finally hiked, however, global stock markets are yet to find solid footings due to oil prices falling further and unstable emerging economies. Japanese stock market is forecast to be range-bound for a while before gathering enough steam to try upside in the next year.

Longer-term outlook (6-months and beyond)

- FRB's tightening pace will be moderate enough not to choke US economy and probably global economy.
- The Japanese stock market will get firmer as fiscal measures and further economic policies could lift sentiment of consumers and companies running up to the upper house election expected in July 2016.



Note: SMAM's Projection is as of Dec. 21st 2015 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

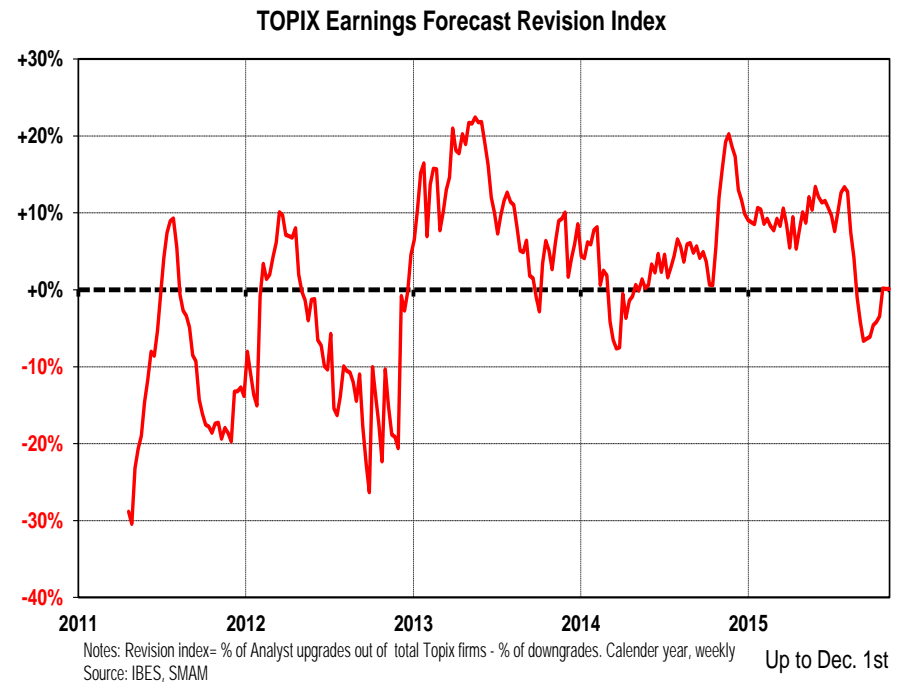
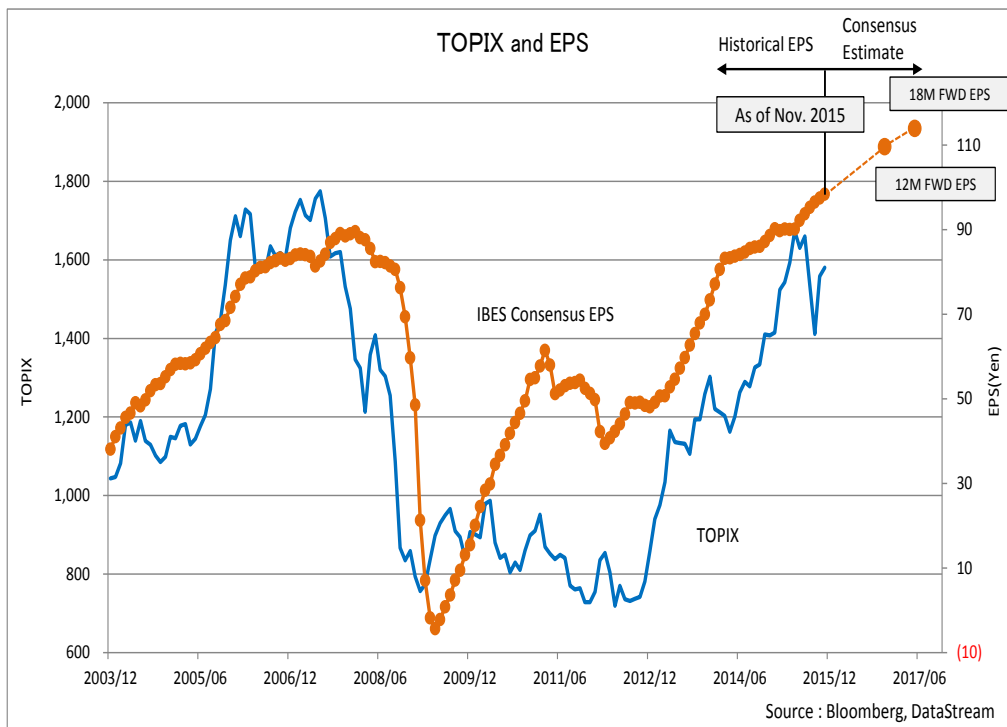
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's private consumption to grow mildly supported by higher real wages growth
 - Growing expectation for positive corporate earnings revisions due to weaker JPY
 - Reflationary policy to be continued toward the next consumption tax hike

- **Upside Risks** include:
 - Stronger-than-expected global growth
 - Stronger-than-expected measures by Abe government

- **Downside Risks** include:
 - Unexpectedly large impact from the process of US monetary policy normalization
 - Concern over emerging economies including China
 - Increasing geopolitical concerns

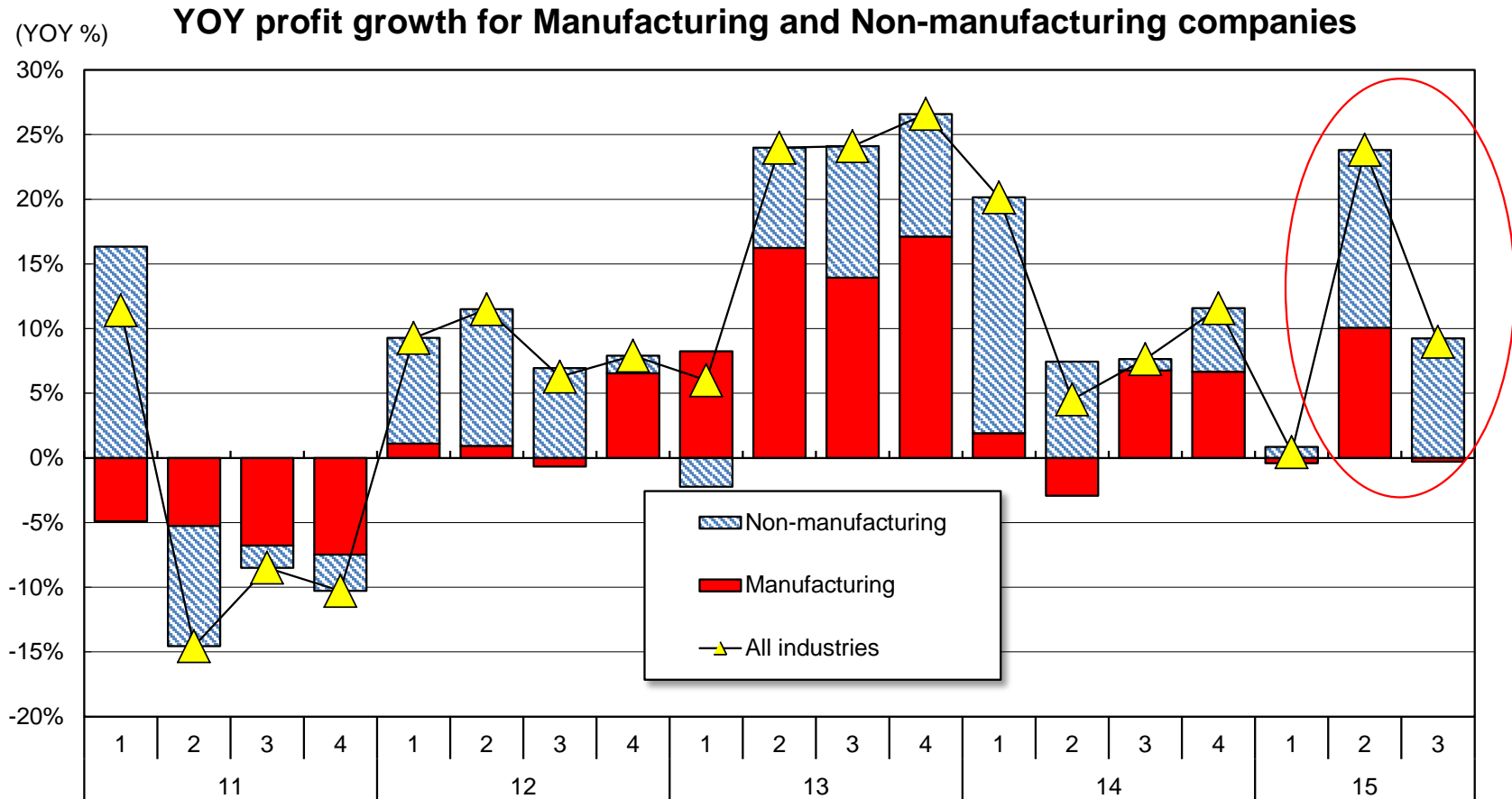
Earnings growth is expected to continue for Japan

- Corporate earnings are expected to keep growing despite continuing pressure on top-line sales. Lower costs such as energy and materials have been supportive so far.
- SMAM forecasts recurring profit growth for 215 non-financial companies covered by its own equity analysts, +14% in FY2015 and +7.3% on FY2016.



Manufacturing is feeling pain of global weakness, Non-manufacturing stays strong

- Slowdown in global economy has directly affected profits of manufacturing companies.
- Non-manufacturing companies show resilience.



Note: Data is recurring profit.

(Source) Ministry of Finance, Corporate statistics

Huge potential for improving total shareholder returns

- There is a huge potential that shareholder returns from Japanese companies improve to catch up peers in the US and Europe.
- If such improvements can be achieved, it would make a strong tailwind for Japanese stocks for the long term.

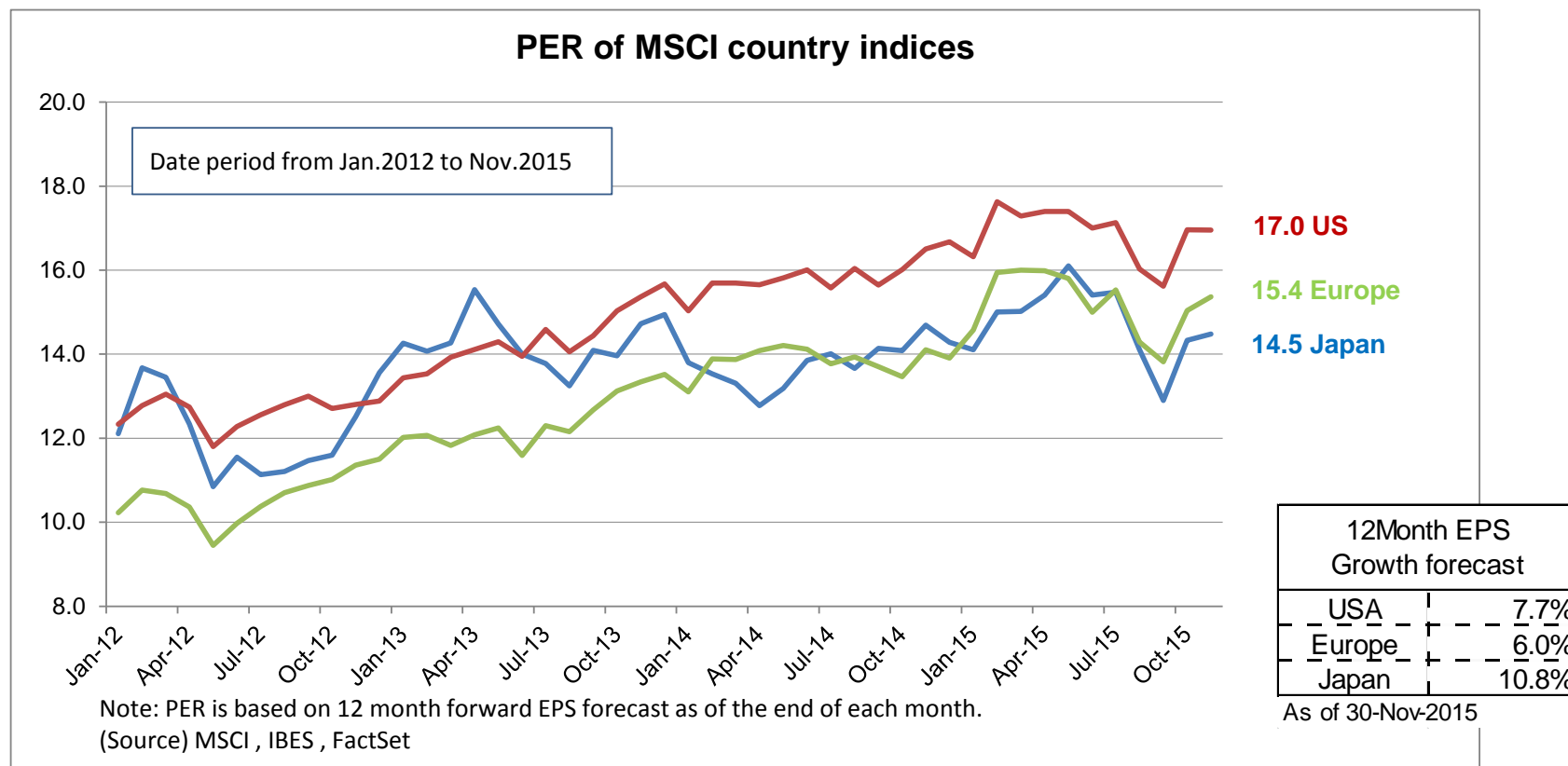
Comparison of shareholder returns among major stock markets

	Total shareholder return ratio a) + b)	Dividend payout ratio a)	Share buyback/ Shareholder earnings b)
Japan	41.9%	30.9%	11.0%
USA	94.2%	37.3%	56.9%
Europe	81.5%	52.7%	12.0%

Notes: Data is for 2014. All listed companies for Japan, S&P500 for USA and Bloomberg 500 for Europe.
(Source) Nomura Securities.

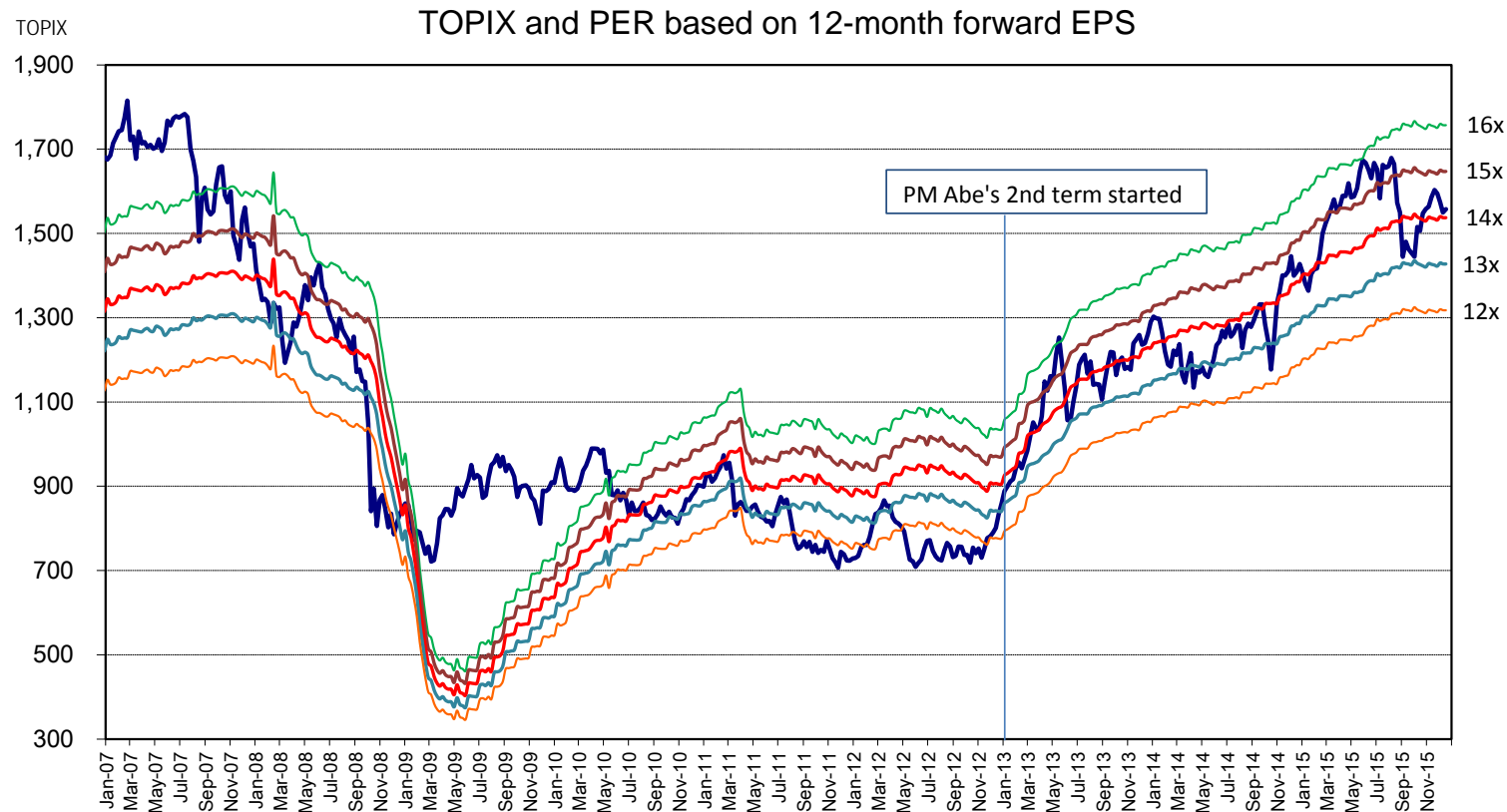
PER has fallen globally and relative attractiveness for Japan still holds

- Markets rebounded from the trough on additional policy measures and confirmation of continuing economic growth in the US. PER for Japan stays low and attractive compared to US and Europe.
- Better fundamentals in Japan, such as faster earnings growth and improving corporate governance should be favorable for Japanese equities.



PER for Japanese stock market seems attractive in historical comparison

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 13x and 16x.
- Current PER around 14x is in a lower side of this range and seems attractive.



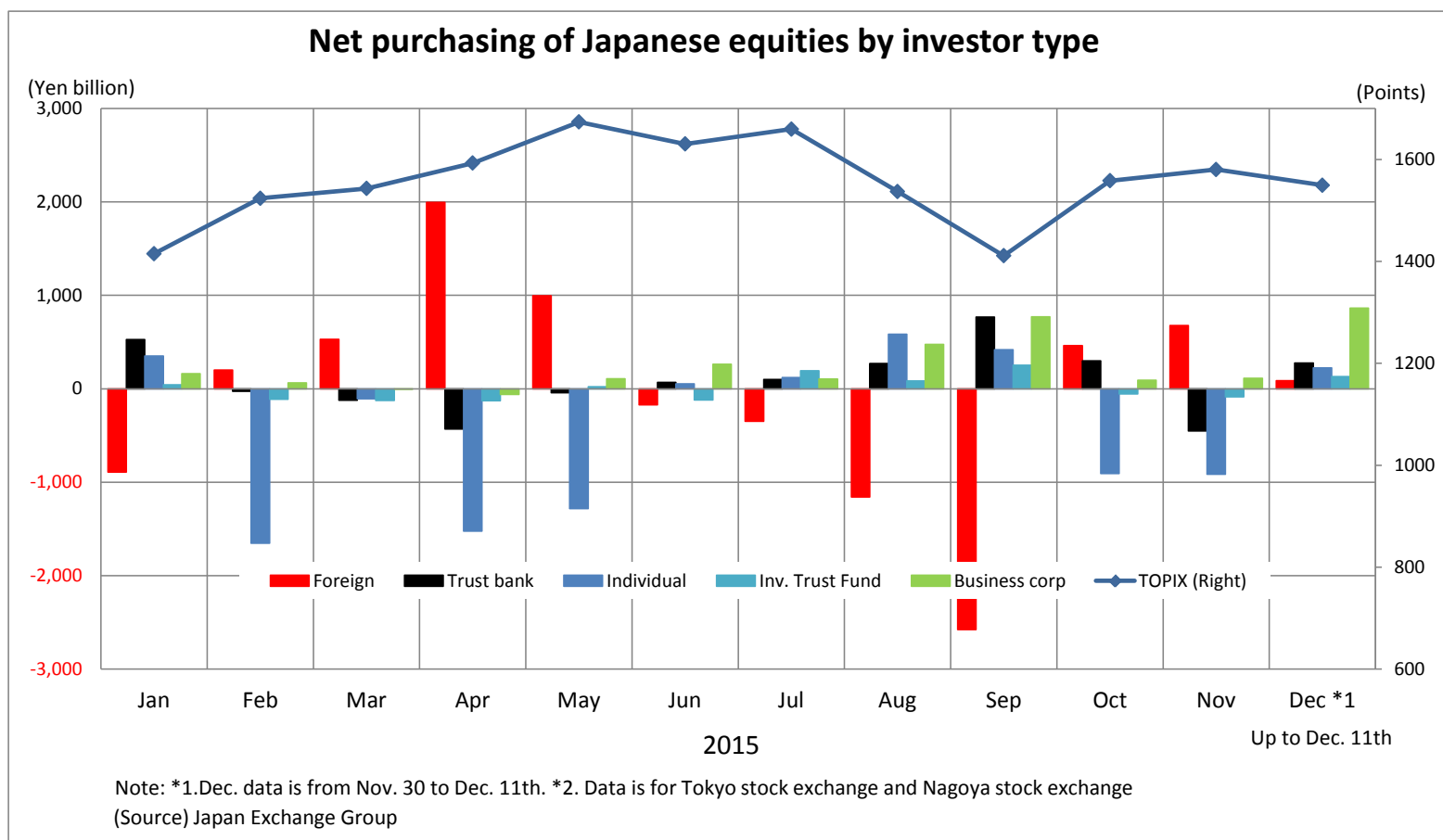
Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES

Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to December 17th 2015

Supply-Demand balance: Foreign investors purchasing moderated in December

- In the first 2 weeks in December, foreign investors' purchasing moderated whereas share buyback by business corporations was very active.
- During the same period, however, foreign investors sold derivative futures by approximate 1.4 trillion yen, which pulled down the stock market.



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