



Japanese Stock Market Outlook

SMAM monthly comments & views
- May 2016 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Large fiscal spending is now expected for FY 2016 and 2017. Forecast for Public Capital Investment was raised from -2.9% to +1.4% for FY 2016 and from +0.3% to +4.0% for FY2017. GDP forecast for FY2017 was lifted from -0.2% to +0.2%.

- Recent earthquake in Kumamoto, Kyushu will pull down private consumption for Apr-Jun to some extent. A series of earthquake has not completely stopped yet and some factories were hit, however, the damage to the Japanese economy is not going to be as large as the case in the past such as Hanshin-awaji in 1995 and East Japan in 2011.
- Important political events are scheduled in the first half of this year. A G7 meeting is held in May in Ise-Shima Japan. PM Abe is keen to make it successful running up to an Upper House election in July. Fiscal stimulus is going to be a major issue.

➤ Japanese Stock Markets

As well as the large fiscal spending now expected, BOJ is likely to make further easing by June in our main scenario. Such stimulus measures are expected to gradually lift Japanese economy and investors sentiments.

- Conservative earnings guidance by Japanese companies are expected for FY2016 when they announce FY2015 results in May, which could cap the upside for the stock market for the short term.
- Chinese economy seems reviving some and US economy seems gathering strength. If this recovering trend continues, hard hit external demand related stocks have a chance for revival, which could lead the Japanese stock market into a upward path again.

Notes: Macro and market views are as of Apr.14th and 18th 2016 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-17

- Large fiscal spending is now expected for FY 2016 and 2017. Forecast for Public Capital Investment was raised from -2.9% to +1.4% for FY 2016 and from +0.3% to +4.0% for FY2017. GDP forecast for FY2017 was lifted from -0.2% to +0.2%.
- Current forecast assumes consumption tax to rise from 8% to 10% in April 2017 as scheduled. Odds for postponing this tax hike is rising and if it is postponed GDP forecast will be +0.6% for FY2016 and +0.8% for FY2017.

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Real GDP growth	0.9%	2.0%	-1.0%	0.7%	0.8%	0.2%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.5%	0.8%	-0.3%
Private Housing Investment	5.7%	8.8%	-11.7%	2.3%	2.7%	-3.9%
Private Capital Investment	0.9%	3.0%	0.1%	2.2%	2.2%	-1.3%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.4%	1.0%	0.8%
Public Capital Investment	1.0%	10.3%	-2.6%	-1.8%	1.4%	4.0%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	0.0%	0.3%
Exports	-1.4%	4.4%	7.8%	0.6%	2.6%	3.0%
Imports	3.6%	6.7%	3.3%	0.1%	3.0%	1.8%
Nominal GDP	0.0%	1.7%	1.5%	2.0%	0.4%	1.4%
GDP Deflator	-0.9%	-0.3%	2.5%	1.3%	-0.4%	1.2%

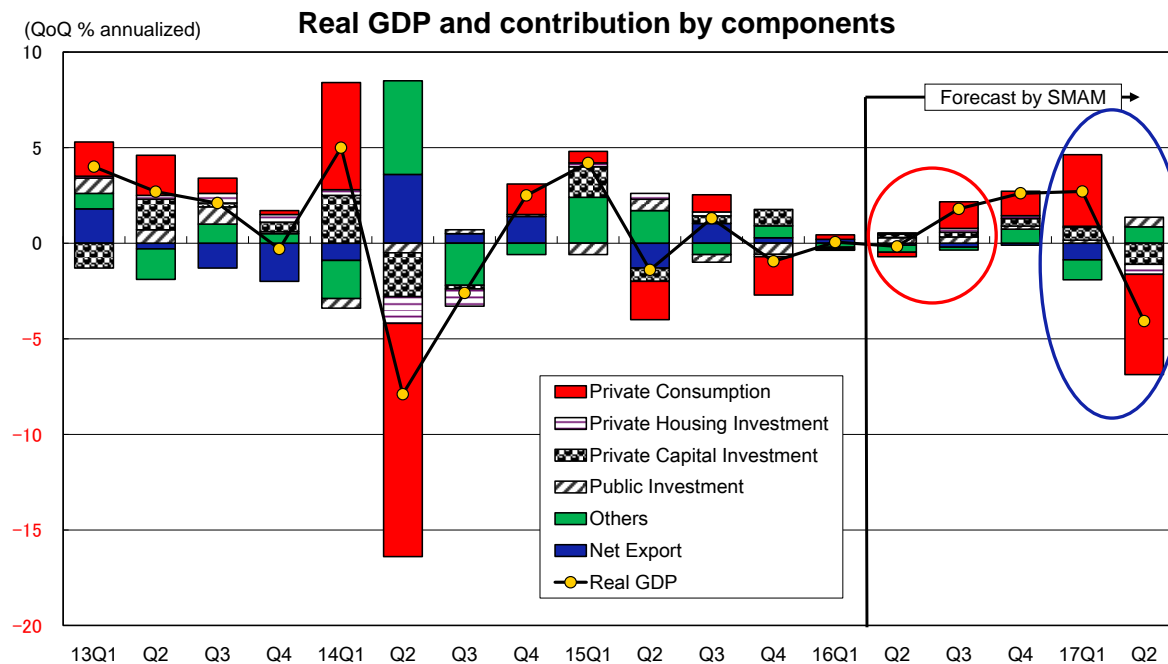
Notes: E=SMAM forecasts. SMAM views are as of Apr. 14th and 18th, 2016 and subject to updates thereafter without notice

(%, 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 quarterly economic outlook

- Recent earthquake in Kumamoto, Kyushu will pull down private consumption for Apr-Jun to some extent. A series of earthquake has not completely stopped yet and some factories were hit, however, the damage to the Japanese economy is not going to be as large as the case in the past such as Hanshin-awaji in 1995 and East Japan in 2011.
- Private consumption is forecast to make recovery from Jul-Sep quarter. A rush demand before consumption tax hike and its reversal contraction are currently included in our forecast for 2017.

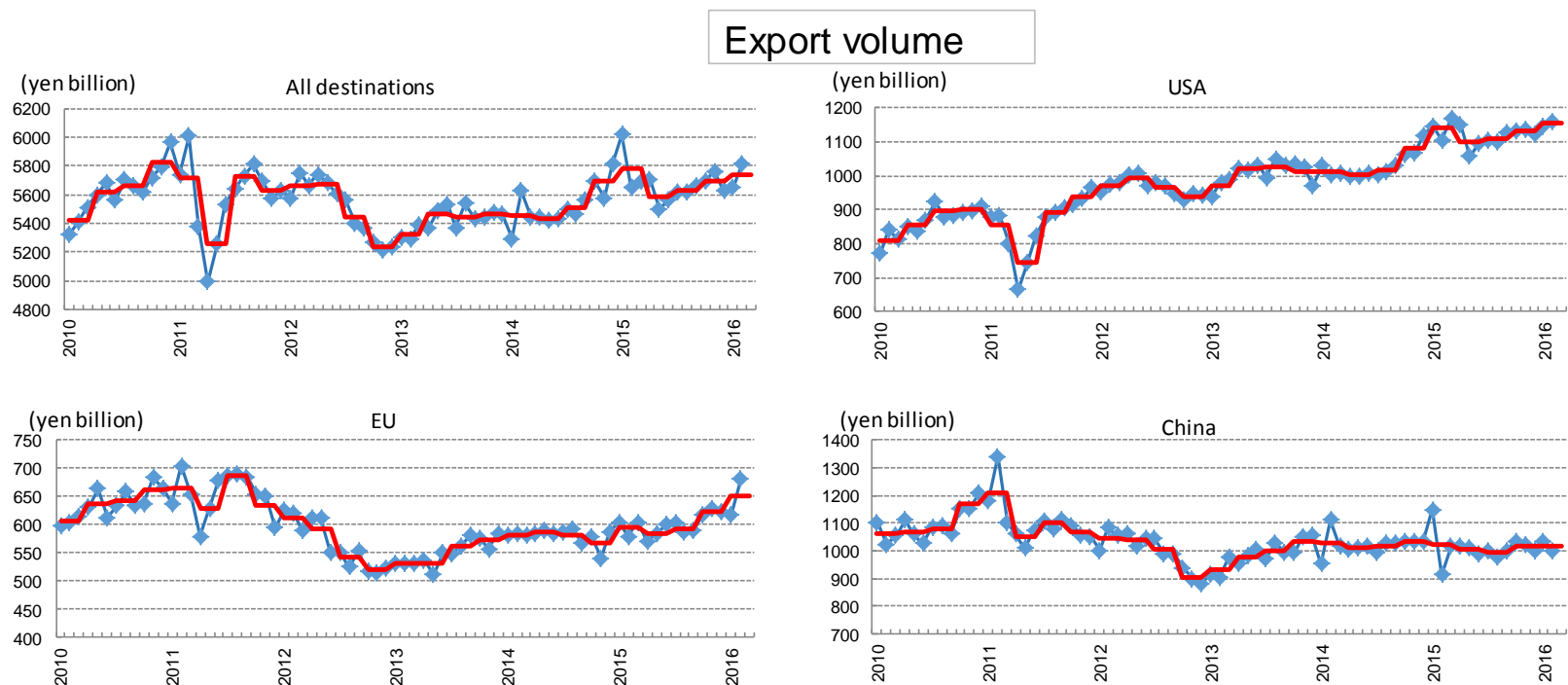


Notes: SMAM views are as of Apr.14th, and 18th, 2016 and subject to updates thereafter without notice.

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

Total export volume is not deteriorating despite sluggishness to China and Asia

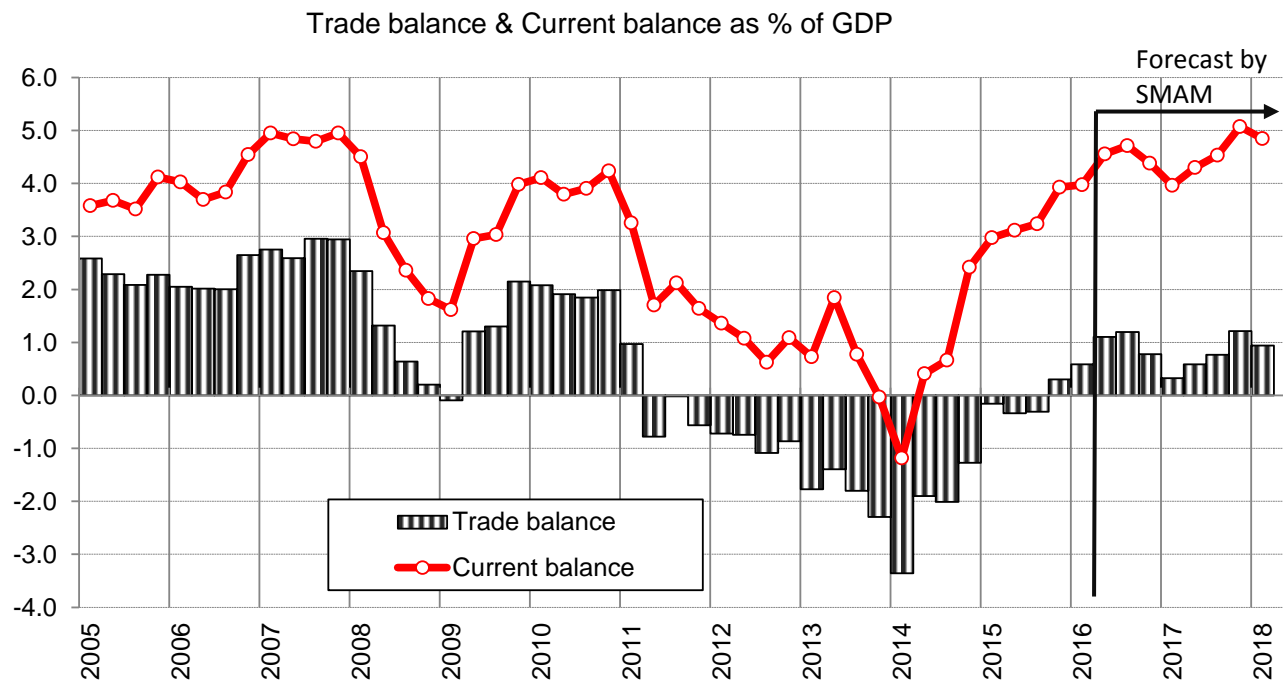
- Export volume from Japan is not deteriorating despite weakness to China and Asia.
- Latest strength in export to EU might be exceptional, however, exports to EU and USA has been rather solid so far.



Note: Blue lines are for monthly and red lines are for quarterly data.
(Source) Ministry of Finance, Bank of Japan

Trade balance is recovering as Japanese economy feels full benefit from low energy cost

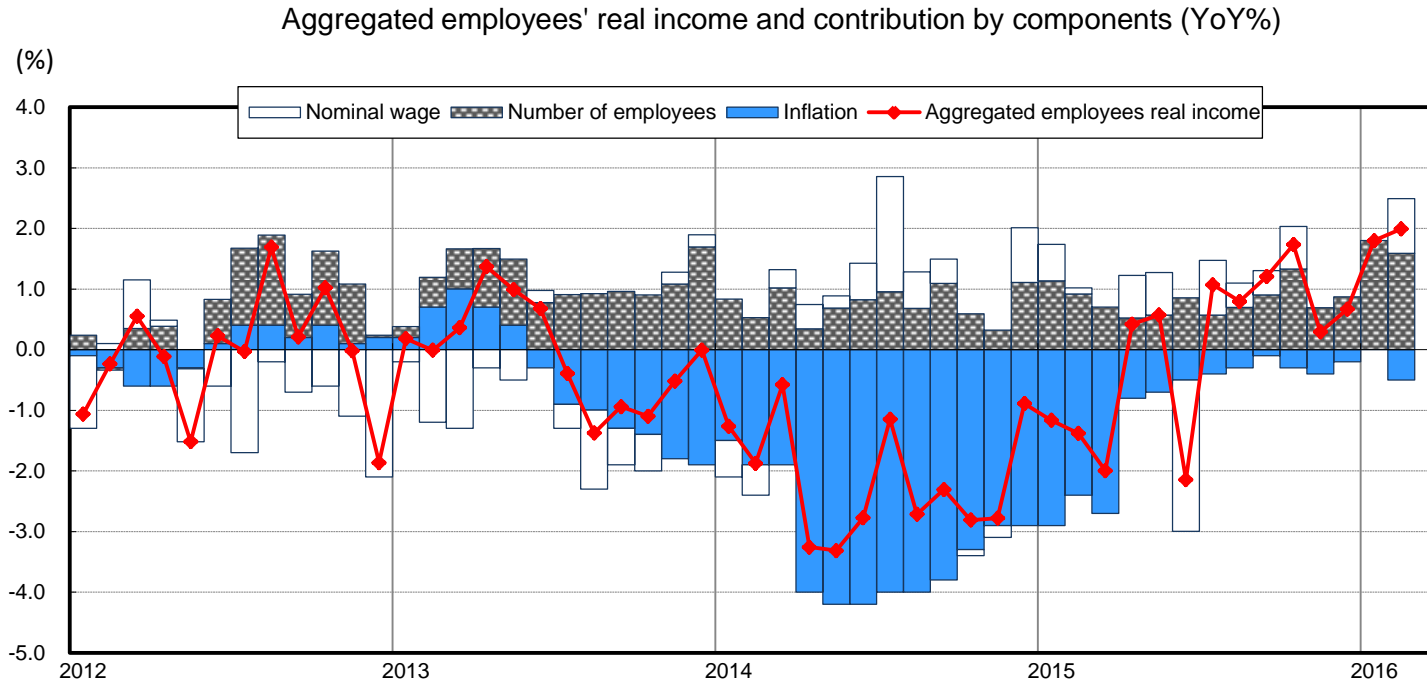
- Trade balance is recovering and expected to stay in positive territory. Current balance is also recovering to the historically high level.
- This is a double edged sword for the economy and stock market. This positive balance shows relative strength of the Japanese industries and national finance ,however, it could also mean the fundamental economic force for weaker yen is receding, though flow of capital is also important for the direction of currencies.



(Source) Ministry of Finance, Bank of Japan

Increase in number of employees is driving the growth in aggregated real income

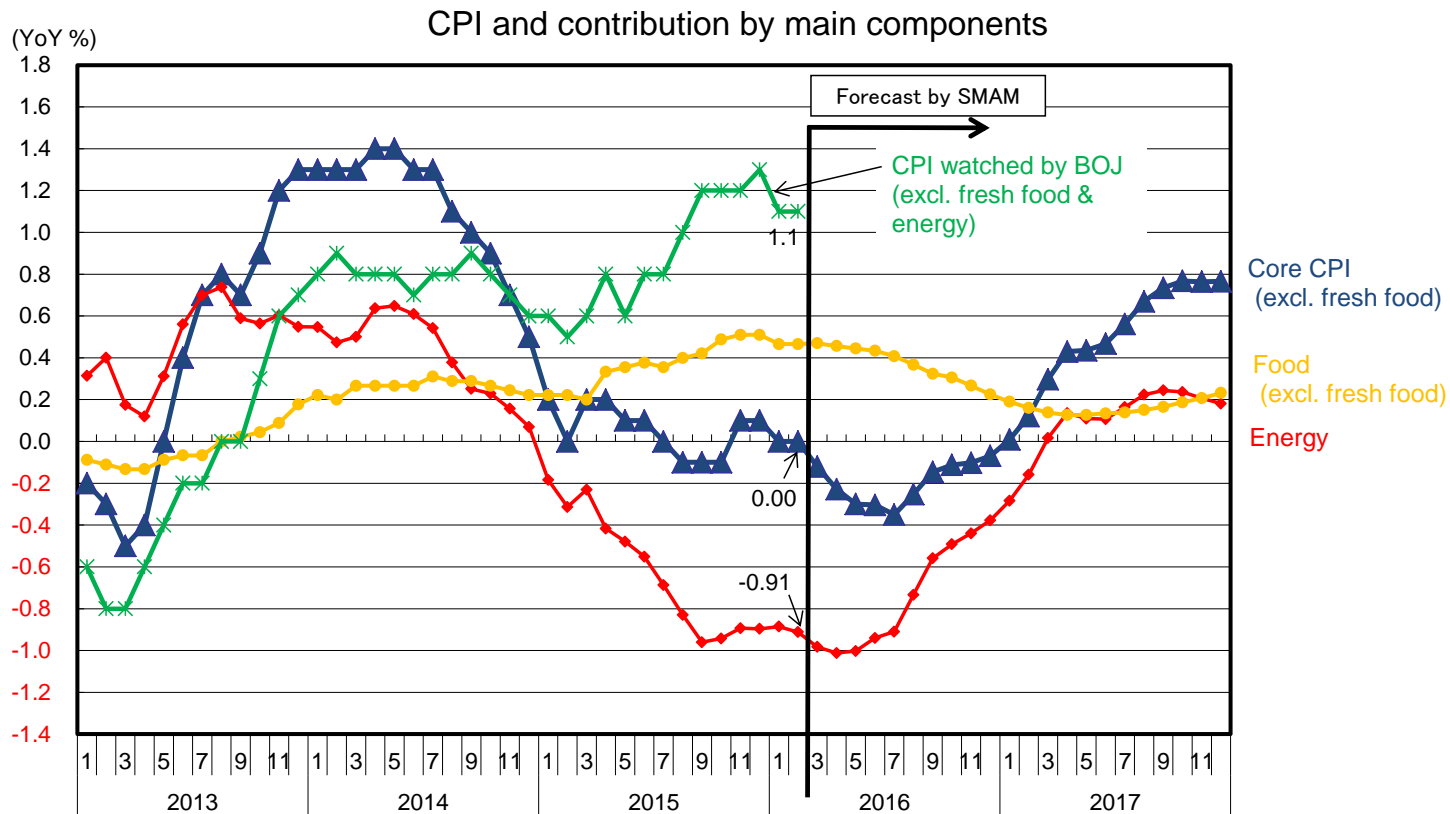
- The spring wage negotiation “Shunto” this year was a little disappointing due to a growing cautiousness on corporate profits, which could weigh on the private consumption.
- If you look at it from a different angle, however, aggregated real income has been increasing rather solidly driven by increase in number of employees.



(Source) Ministry of Health, Labor and Welfare

Core CPI is forecast to dip into negative territory in mid 2016

- Core CPI, which excludes fresh food, is forecast to fall into negative numbers in the mid 2016.
- CPI watched by BOJ, which excludes fresh food & energy, was unchanged at 1.1% in February, however, the momentum seems declining and further easing from BOJ is expected this year.



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

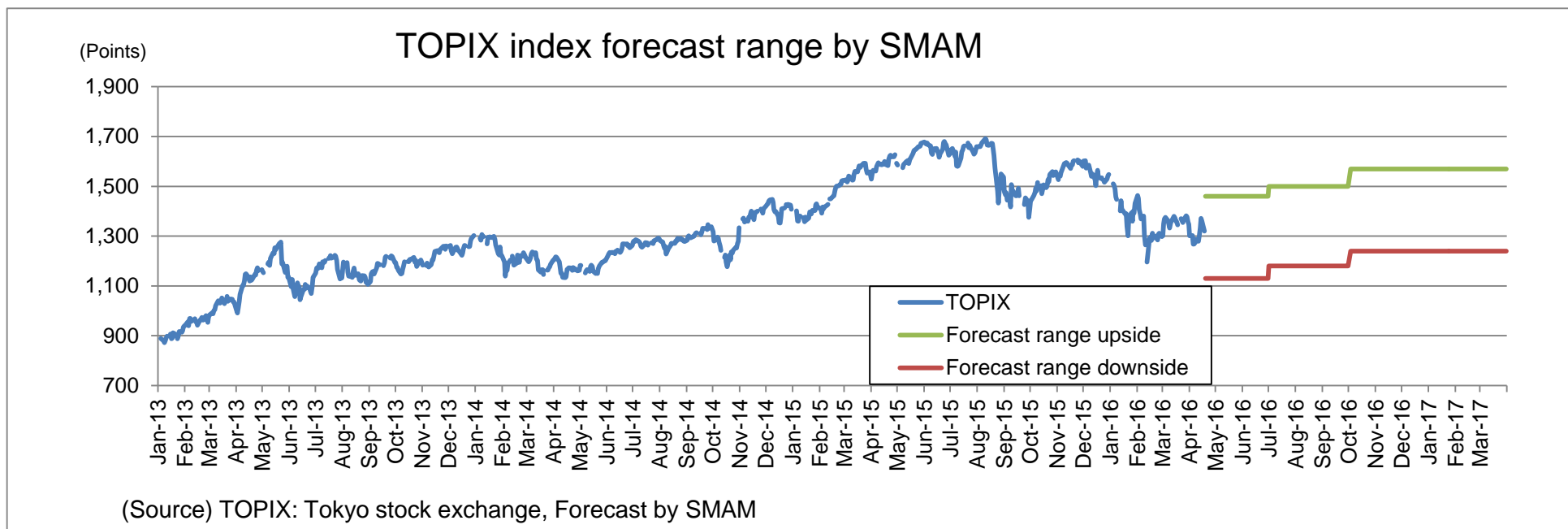
Stock market outlook: waiting for fiscal stimulus measures and global economic recovery

SMAM short-term view

- Conservative earnings guidance by Japanese companies are expected for FY2016 when they announce FY2015 results in May, which could cap the upside for the stock market for the short term.

Longer-term outlook (6-months and beyond)

- Large fiscal spending is now forecast in Japan. BOJ is expected to make further easing by June in our main scenario. Such stimulus measures are expected to gradually lift Japanese economy and investors sentiments.
- Chinese economy seems reviving some and US economy seems gathering strength. If this recovering trend continues, hardly hit external demand related stocks have a chance for revival, which could lead the Japanese stock market into a upward path again.



Note: SMAM's Projection is as of Apr. 18th 2016 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Global economy does not enter into a recession.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese corporate earnings keep growing at higher pace than in peer countries.
 - Reflationary policy to be continued toward the next consumption tax hike.

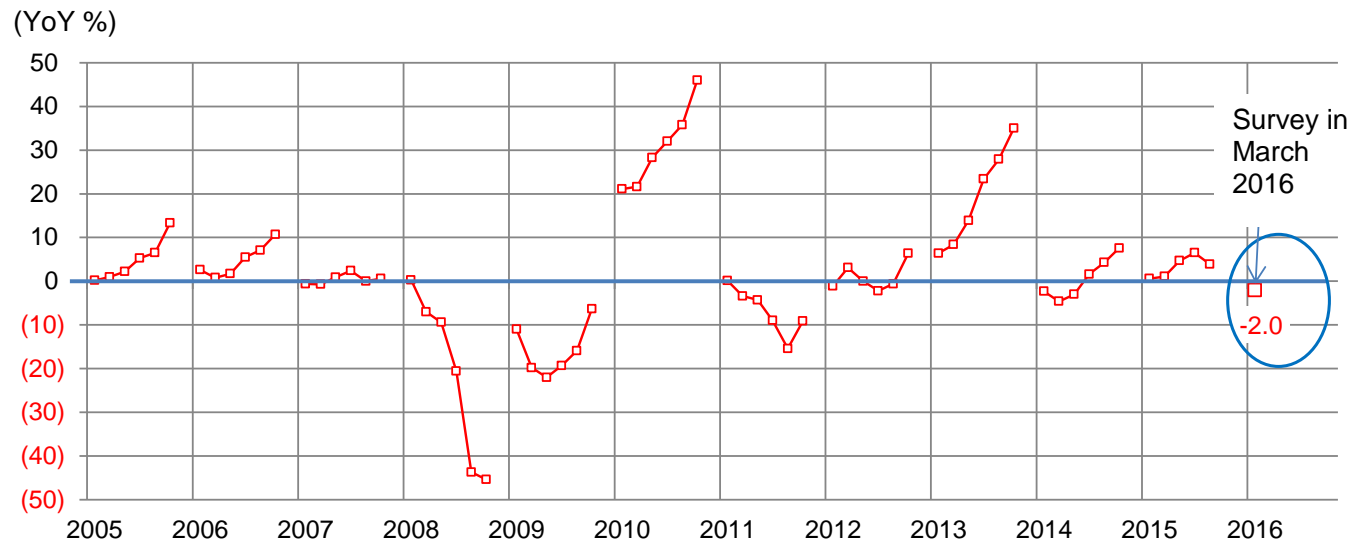
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by Abe government.

- **Downside Risks** include:
 - Unexpectedly large impact from the process of US monetary policy normalization.
 - Concern over emerging economies including China.
 - Falling oil price causes disastrous problem for oil producing countries.
 - Increasing geopolitical concerns.

Earnings planning for the fiscal year 2016 started conservatively just as a usual practice

- The chart below tracks the earnings planning by large enterprises released in BOJ Tankan quarterly business survey. YoY negative growth of -2.0% was planned for FY2016 in March survey.
- As a usual practice, Japanese companies started planning conservatively and revised it upward except in FY2008 and 2009 affected by financial crisis and FY 2011 hit by East Japan Earthquake and Tsunami.

Change in earnings forecasts by companies for each fiscal year,
BOJ TANKAN Business survey , large enterprises

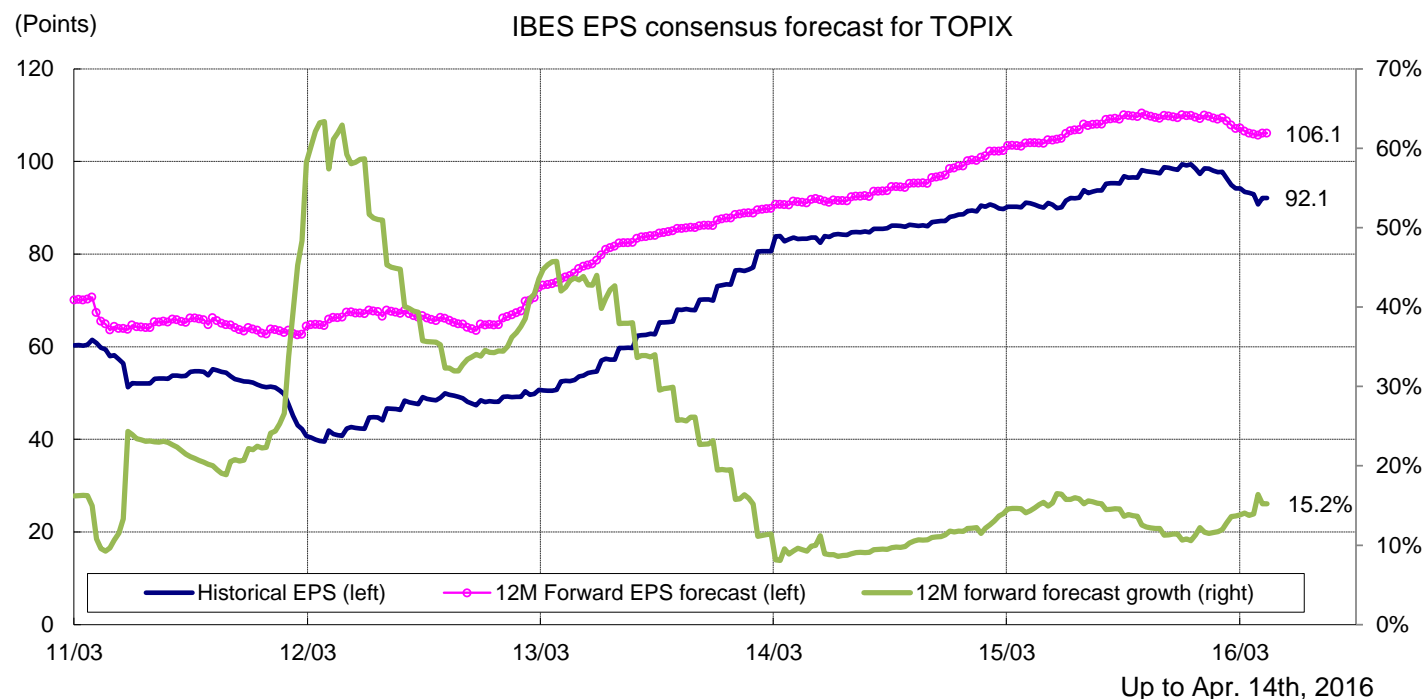


Note: For each year, data is survey in March, June, September, December followed by the last estimate and actual result.

(Source) Bank of Japan

Historical earnings are revised downward and forward earnings forecast to follow

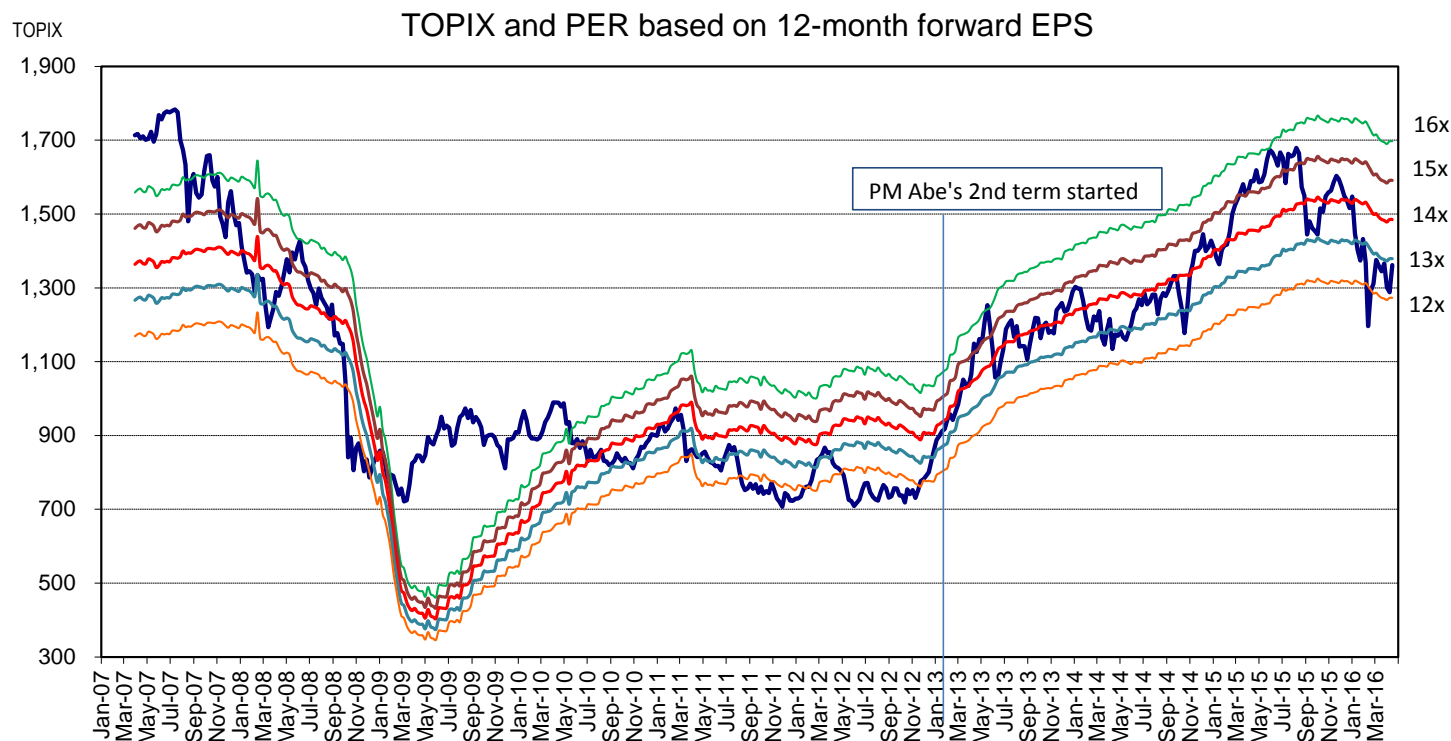
- According to IBES consensus estimate, historical earnings have been revised downward recently and 1Y forward earnings forecast by analysts is likely to follow downward for a while.
- SMAM covers 216 companies excluding financials for regular researches and forecasts recurring profits to grow 7.6% for FY 2015 ending in March and 5.6% for FY 2016 assuming 115 yen/\$ rate.
- Companies will announce own forecasts for FY 2016 around in May. If yen/\$ stays around current level below 110, companies' earnings guidance for FY 2016 could be conservative.



(Source) Datastream, IBES

PER is in the lower half of the range for the current PM Abe's tenure

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 12x and 16x except for temporary overshooting.
- Even considering further down-revision in earnings, current PER doesn't look expensive.

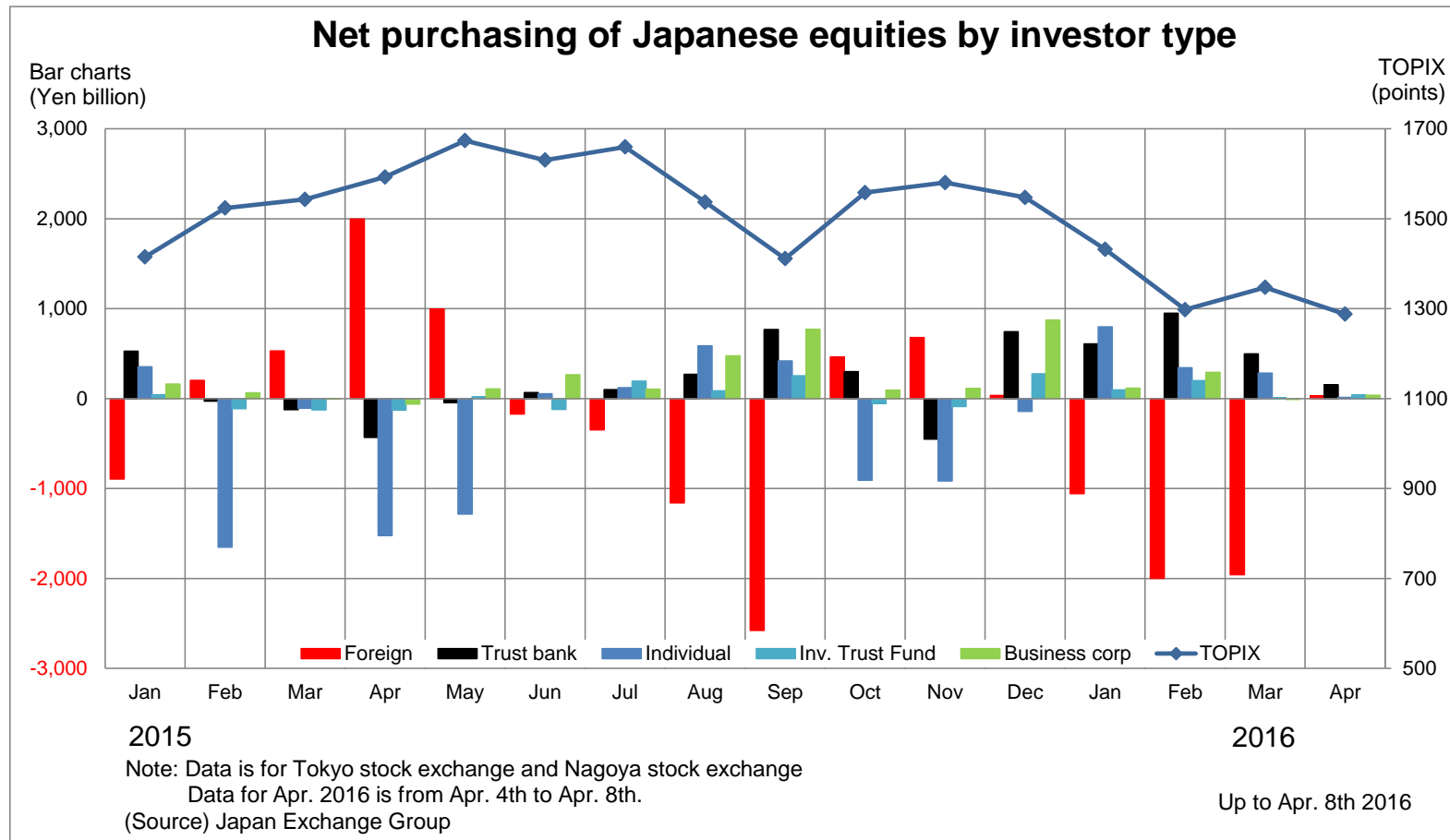


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Apr.15th 2016 when TOPIX was 1361.40

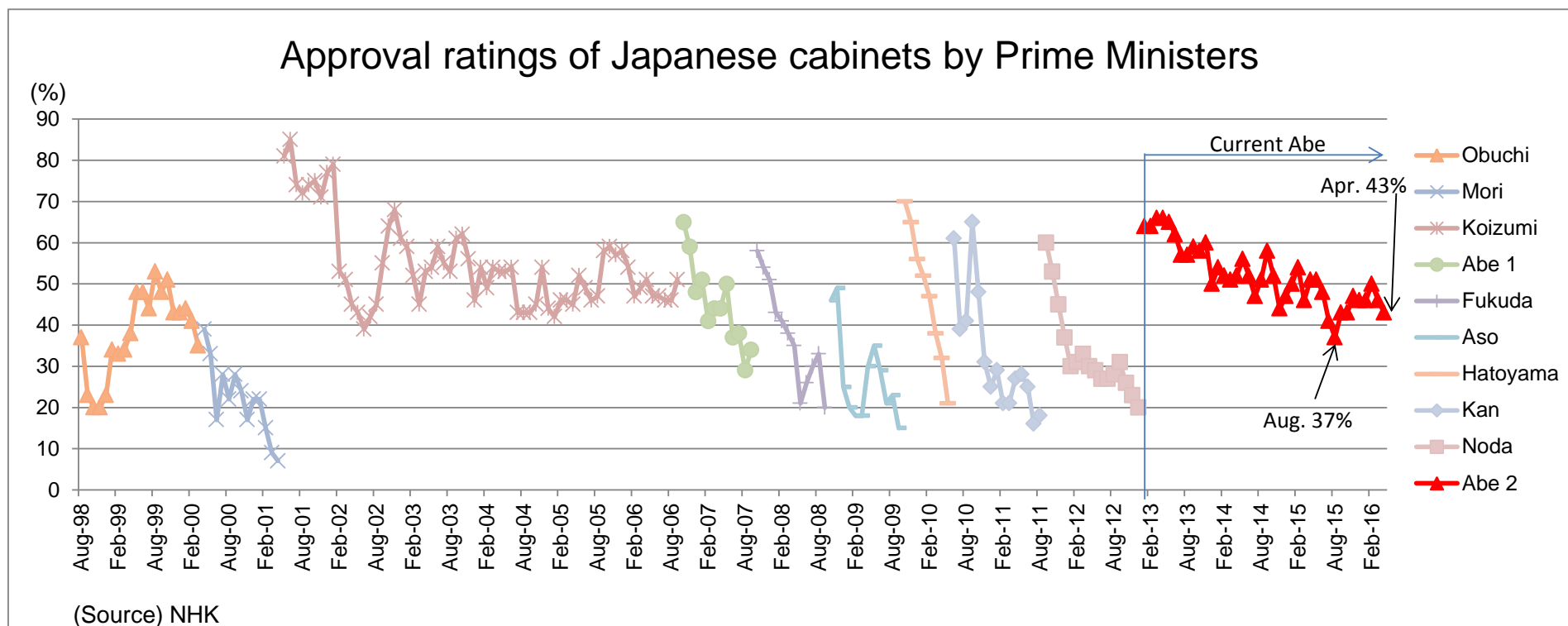
Foreign investors are selling and pension funds are buying

- Foreign investors continue to sell Japanese equities whereas trust banks, mostly representing pension funds, are the largest purchaser.
- Foreign investors' selling eased in April, however, they sold 176 billion yen of exchange traded futures in the week between April 4th and 8th.



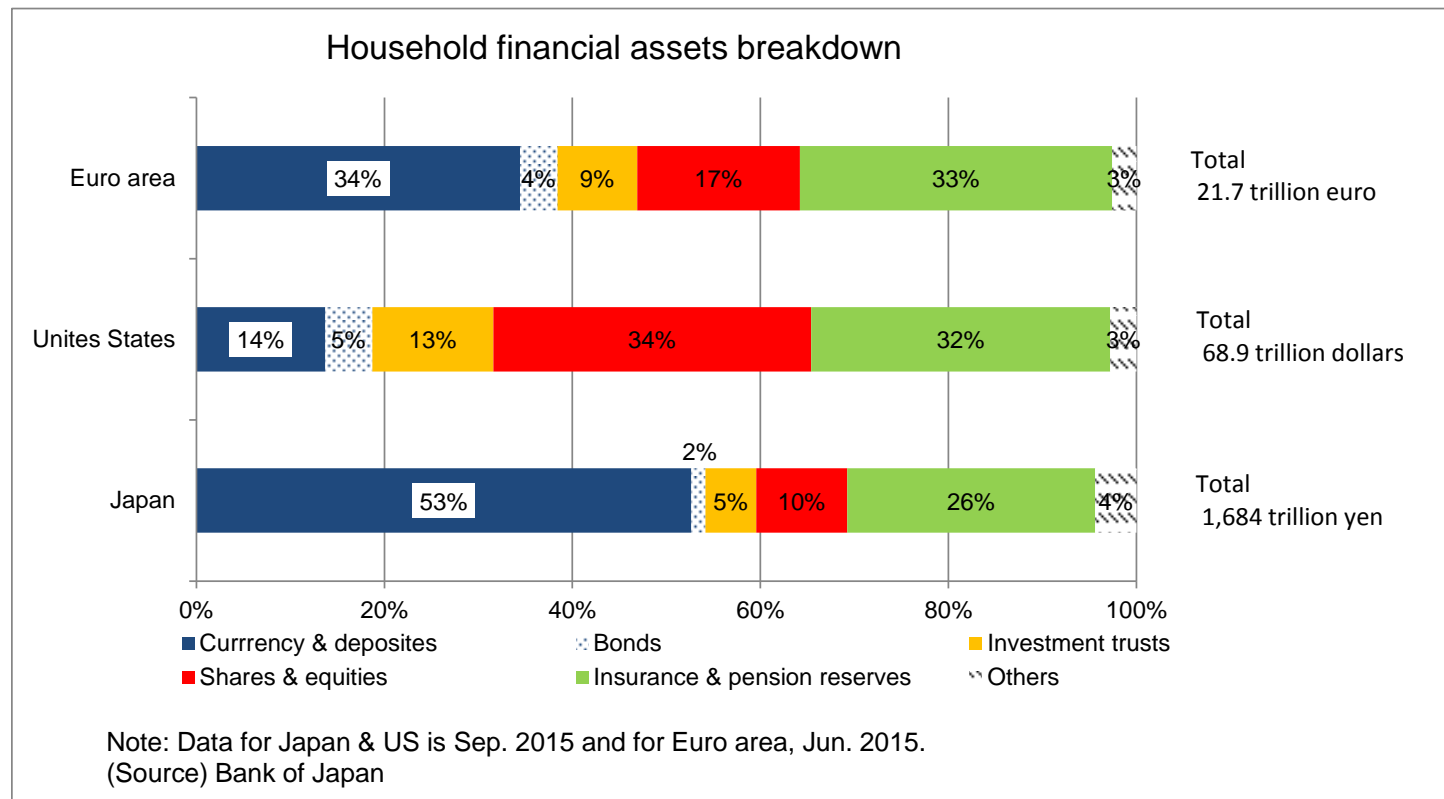
Political events hold the key for the outlook of Japanese economy and stock markets

- Important political events are scheduled in the first half of this year.
- A G7 meeting is held in May in Ise-Shima Japan. PM Abe is keen to make it successful running up to an Upper House election in July.
- Fiscal stimulus is going to be a major issue.



Could negative interest rate cause shift in huge household assets in Japan?

- In Japan, as much as 53% of huge household assets are held in cash and deposits with minimal yields.
- Interest rate for individuals would not become negative yet due to the guidance by the government to financial institutions, however, individuals might start looking for more yield for their assets.
- On the other hand, if negative interest rate confuses financial systems and uncertainty deepens, individuals could be discouraged to take risks for their savings.



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