

# Japanese Stock Market Outlook

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SMAM monthly comments & views

- June 2017 -



Sumitomo Mitsui Asset Management

SMAM

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## Executive summary

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### ➤ Japanese Economy

Jan-Mar 2017 Japanese GDP came out at rather strong 2.2% annualized growth, which recorded 5 consecutive quarters of positive growth. Exports are forecast to grow by robust 5% and public capital investment by 4.4% and private capital investment by 2.8% in FY2017, which will lead the Japanese economy.

- Upswing in the global economic growth is expected to continue despite possible short-term slowdown in developed countries. Import volume by emerging countries has been sharply rising, which would underpin the global economy. Global liquidity is still accommodative and there seems to be no immediate threat for the financing by emerging countries.
- Foreign tourists are visiting Japan in increasing numbers. No sign of negative impact from geo-political tension in the East Asia surrounding North Korea so far.

### ➤ Japanese Stock Markets

Expectation for Trump policies is receding due to a gridlock in US congress and possible "Russia-gate" scandal. However, global economy is on a self sustainable growth path, which is positive for the Japanese stock market. Low & attractive valuation for the Japanese stocks compared to other markets should be supportive in the long run.

- Corporate earnings guidance for FY2017 from Japanese companies was conservative, which forecast about 5% YOY growth though upward revision is likely to be made around autumn. Risk of North Korea lingers and without a domestic event to boost the stock prices in the immediate future, Japanese stock market would need to establish a ground for a while preparing for the next upward move.
- Approval rating for the current Abe cabinet was comfortably high at 51% in May, for which tensions with North Korea probably was one of the supporting factors helping his image as a strong leader.

Notes: Macro and market views are as of May. 17<sup>th</sup> and 19<sup>th</sup>, 2017 respectively, and subject to updates thereafter without notice

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# Outlook for Japanese Economy

## SMAM economic outlook for FY17-18

- Jan-Mar 2017 Japanese GDP came out at rather strong 2.2% annualized growth, which recorded 5 consecutive quarters of positive growth.
- Exports are forecast to grow by robust 5% and public capital investment by 4.4% and private capital investment by 2.8% in FY2017, which will lead the Japanese economy.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.2%	1.3%	1.4%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.6%	0.7%	0.6%
Private Housing Investment	8.3%	-9.9%	2.8%	6.5%	0.9%	0.8%
Private Capital Investment	7.0%	2.4%	0.6%	2.3%	2.8%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.1%	0.6%	0.7%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.1%	4.4%	0.3%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.1%	0.7%	0.4%	0.2%
Exports	4.4%	8.8%	0.7%	3.1%	5.0%	2.3%
Imports	7.1%	4.3%	0.2%	-1.4%	2.3%	1.4%
Nominal GDP	2.6%	2.0%	2.7%	1.1%	1.4%	1.6%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	-0.0%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	4.1%	2.2%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.7%	0.7%

Notes: E=SMAM forecasts. SMAM views are as of May. 17<sup>th</sup>, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

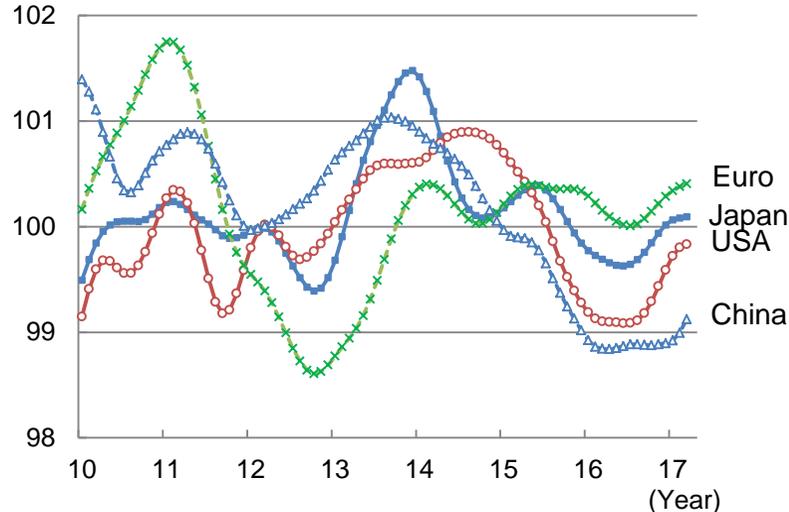
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

## Continuing expansion of the global economy should underpin robust export from Japan

- Upswing in the global economic growth is expected to continue despite possible short-term slowdown in developed countries.
- Import volume by emerging countries has been sharply rising, which would underpin the global economy.

### OECD Composite Leading Indicators

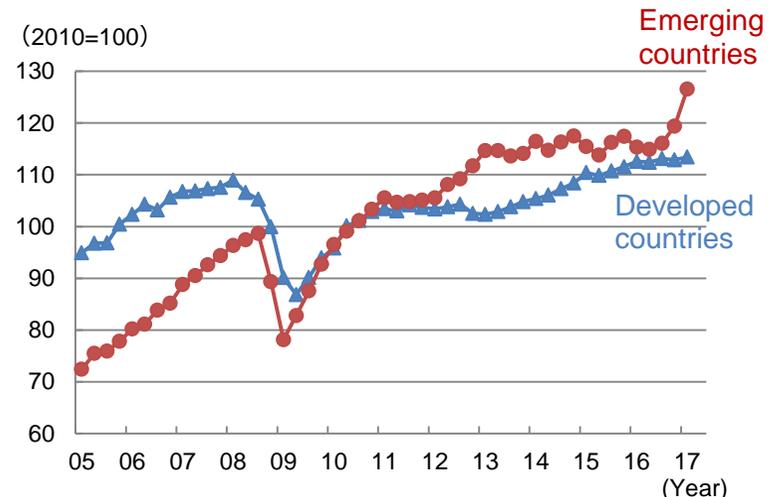
(Long-term trend = 100)



Note: Data is from Jan. 2010 to Mar. 2017.

(Source) OECD, compiled by SMAM

### Import volume



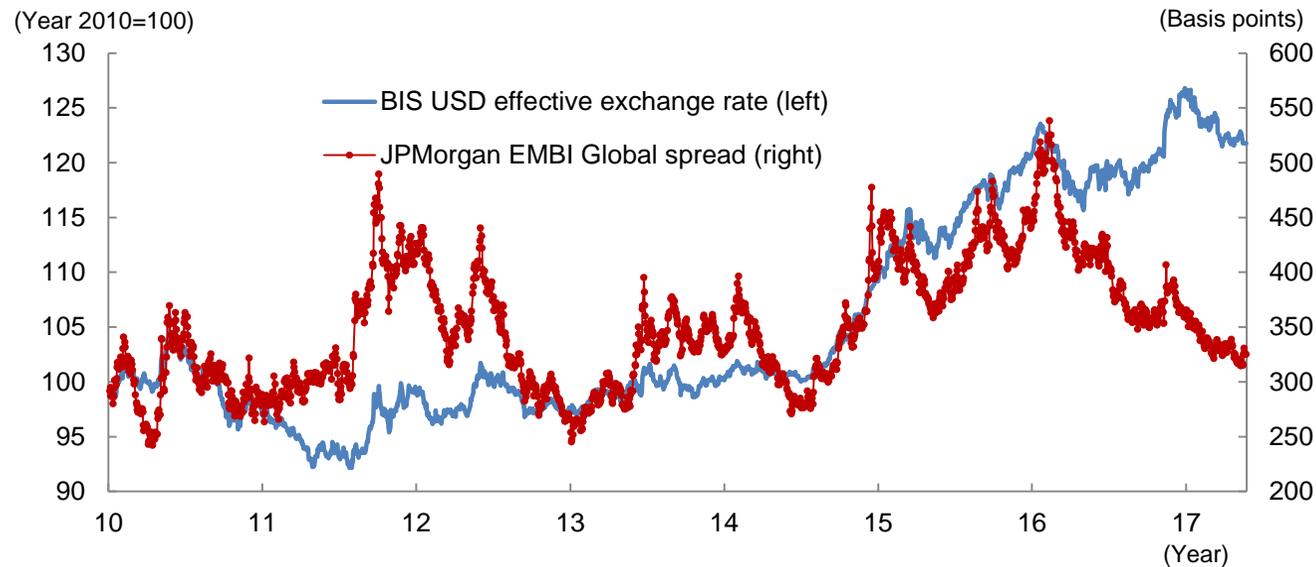
Note: Data is from 1Q 2005 to 1Q 2017 where the last data is the average of Jan & Feb 2017 data.

(Source) Netherlands Bureau for Economic Policy Analysis (CPB), compiled by SMAM

## Interest rate rise in the US has not hit financing capabilities of emerging countries yet

- Despite prospect for higher interest rate in the US, yield spread of emerging countries' bonds stays very calm.
- Global liquidity is still accommodative and there seems to be no immediate threat for the financing by emerging countries.

US dollars & yield spread of emerging bonds



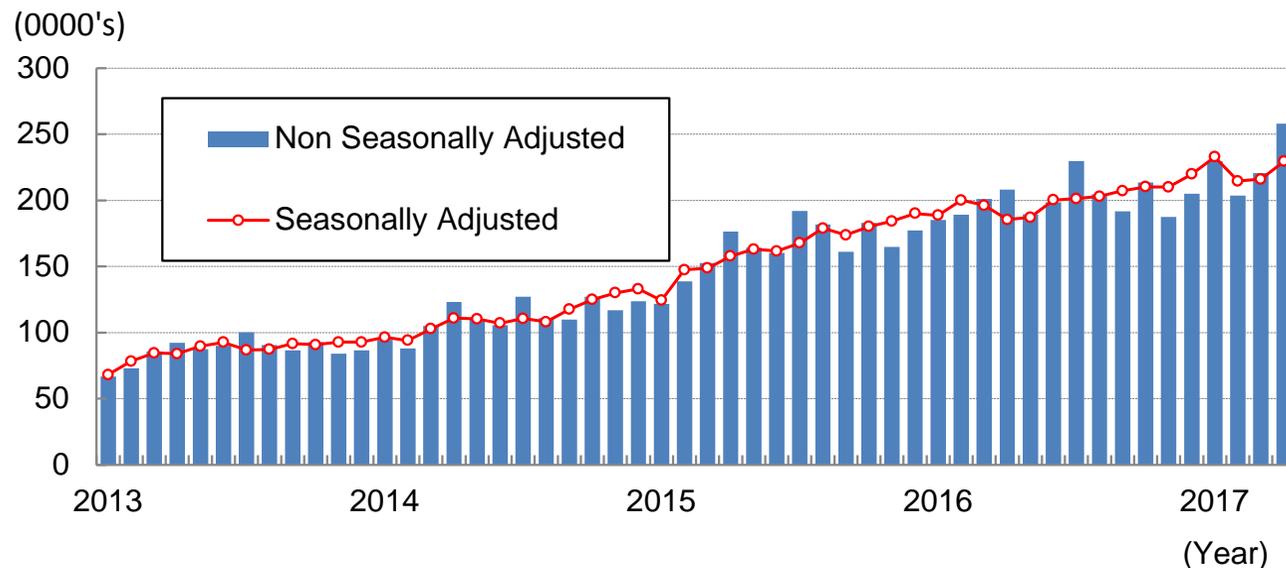
Note: Data is from Jan 4th 2010 to May 16th 2017 for the yield spread and to May 9th for the US\$.

(Source) Bloomberg

## Number of tourists to Japan keeps rising

- Foreign tourists are visiting Japan in increasing numbers. No sign of negative impact from geo-political tension in the East Asia surrounding North Korea so far.
- After explosive rise in number of tourists coming for shopping in the early stage, more visitors are coming to Japan for experiencing Japanese life and culture these days, which is good for sustainable tourism boom to Japan.

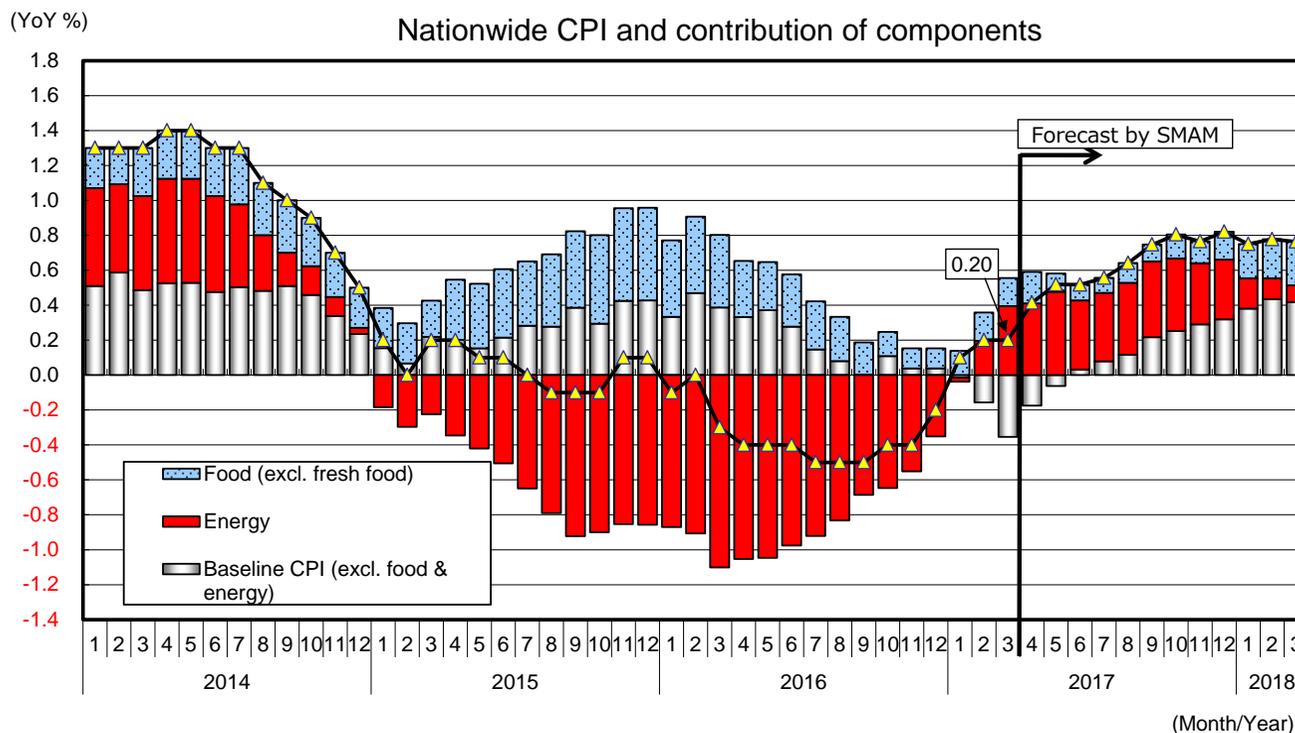
### Number of Foreign Visitors to Japan



Note: Data is from Jan 2013 to Apr 2017.  
(Source) Japan National Tourism Organization

## CPI is creeping up, but not strong enough for BOJ to feel confidence

- CPI is slowly rising led by positive change in energy prices. Baseline CPI was still negative in March, which is expected to become positive around Summer this year.
- In recent statistics, prices for communications such as cost for mobile network services and smartphones are declining, which is providing downward pressure on CPI.



Note: Effect of consumption tax hike in April 2014 is excluded.

(Source) Ministry of Internal Affairs & Communications

## Relief for the Europe. Risks are possible “Russia-gate” scandal and conflicts in East Asia.

- Risk on global politics receded in Europe.
- Major risks are possible “Russia-gate” scandal and unexpected blowout of conflicts involving North Korea, which cannot be put in the following schedule.

### Schedule of key events in 2017

Month	Region/Country	Events	Notes
Apr & May	France	Presidential election	Resulted in a great relief for EU supporters.
June	Japan	Updated "growth strategy" is announced	"Work style reform" and "reducing cost for education" are likely be mentioned.
		BOJ Monetary Policy Committee Meeting	
	US	FOMC	Another rate hike is anticipated.
	France	Lower house election	
July	Japan	(2nd) Election for the Tokyo Metropolitan Assembly	Crack may grow between governing coalition parties, LPD and Komeito.
		BOJ Monetary Policy Committee Meeting	BOJ's quarterly perspective report for Japanese economy & prices
	Global	G20 meeting	
August	Germany	General election	
September	France	Upper house election	
	Spain	Referendum in Catalonia for independence	

(Source) Various publications, assembled by SMAM

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# Outlook for Japanese Stock Markets

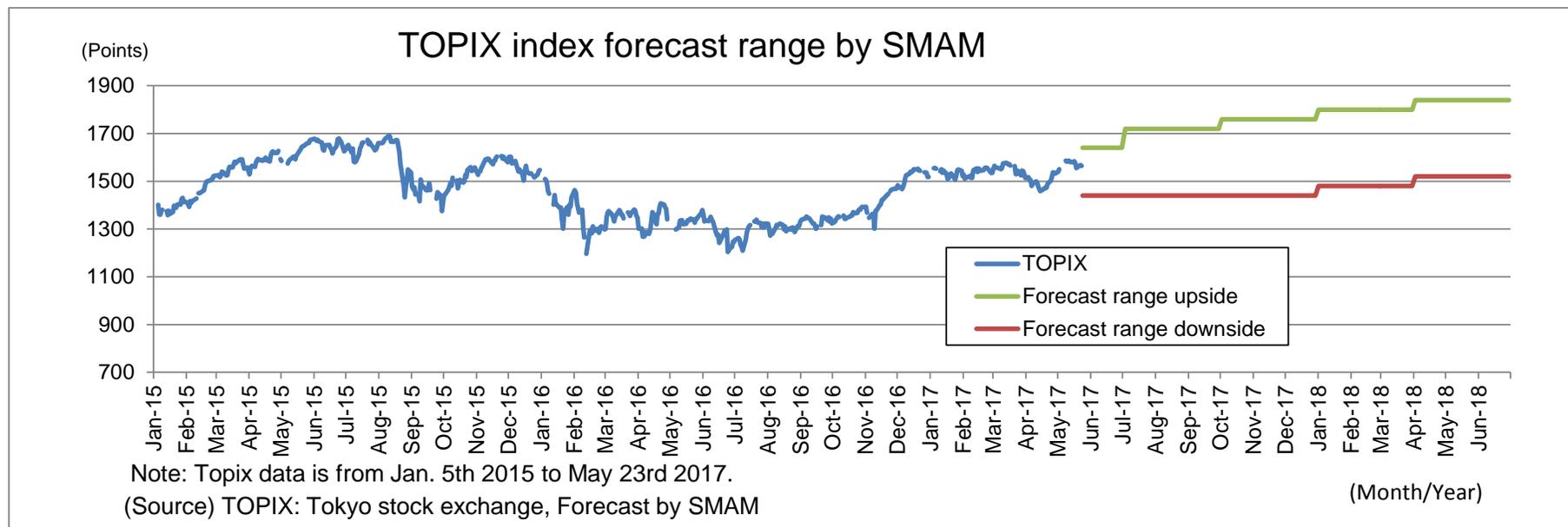
## Stock market outlook: a series of risk events still linger on the stock markets

### SMAM short-term view

- Corporate earnings guidance for FY2017 from Japanese companies was conservative, which forecast about 5% YOY growth though upward revision is likely to be made around autumn. Risk of North Korea lingers and without a domestic event to boost the stock prices in the immediate future, Japanese stock market would need to establish a ground for a while preparing for the next upward move.

### Longer-term outlook (6-months and beyond)

- Expectation for Trump policies is receding due to a gridlock in US congress and possible "Russia-gate" scandal. However, global economy is on a self sustainable growth path, which is positive for the Japanese stock market. Low & attractive valuation for the Japanese stocks compared to other markets should be supportive in the long run.



Note: SMAM's projection is as of May 19<sup>th</sup>, 2017 and subject to updates without notice.

## Base scenario & Upside / Downside risks for our forecasts

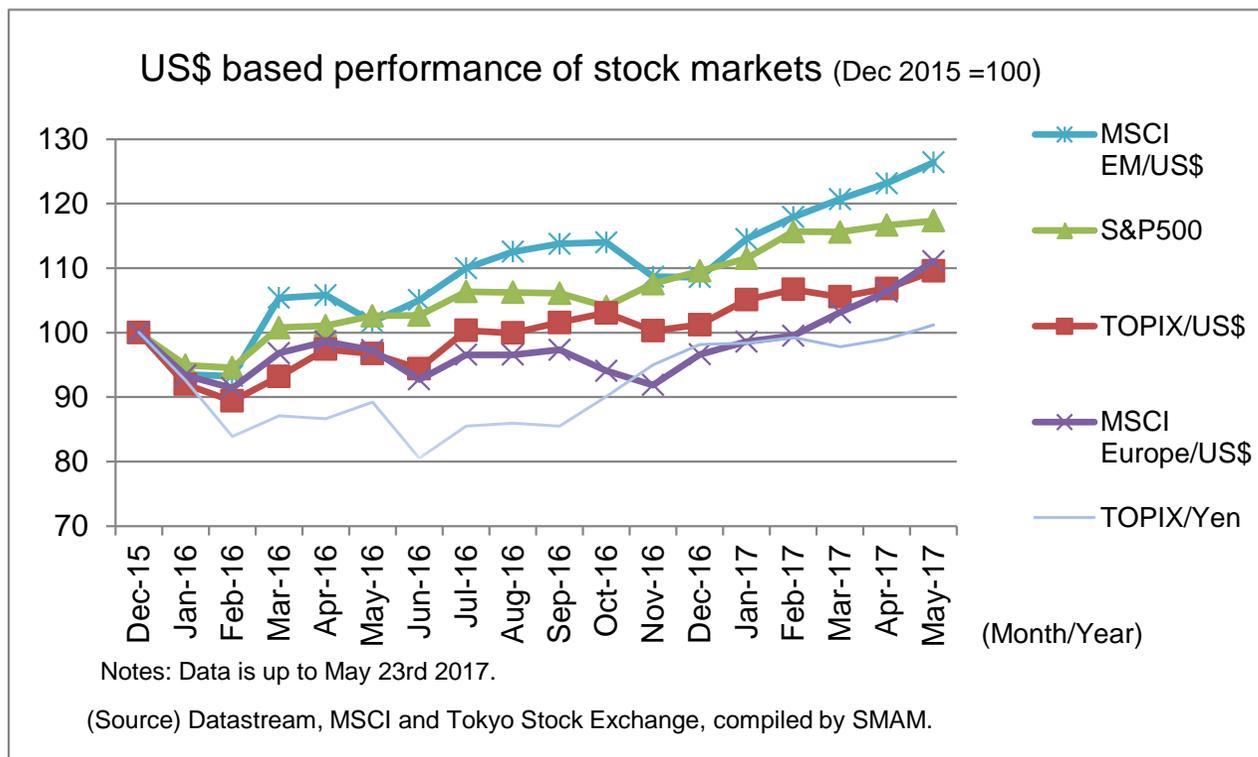
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- Our **Base Scenario** is assuming the following views:
  - Practical Trump trade policies are made and serious trade disputes can be avoided.
  - Expansionary policies in US keep global economies on a growth path.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
  - Further fiscal stimulus will be made and extra easy monetary policy should sustain economic growth in Japan.
  - Tension in the East Asia does not ignite a war.
  
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - Stronger-than-expected measures by the Abe government.
  
- **Downside Risks** include:
  - Confrontational foreign policies taken by Trump presidency shake global trades.
  - Trump policies for stimulating US economy fail to pass US congress.
  - "Russia-gate" scandal flares up.
  - Populism gains in Europe further destabilizing EU.
  - Heightening geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - "Moritomo" and "Kake" scandals make a fatal blow to PM Abe.

Note: SMAM's projection is as of May, 19<sup>th</sup>, 2017 and subject to updates without notice.

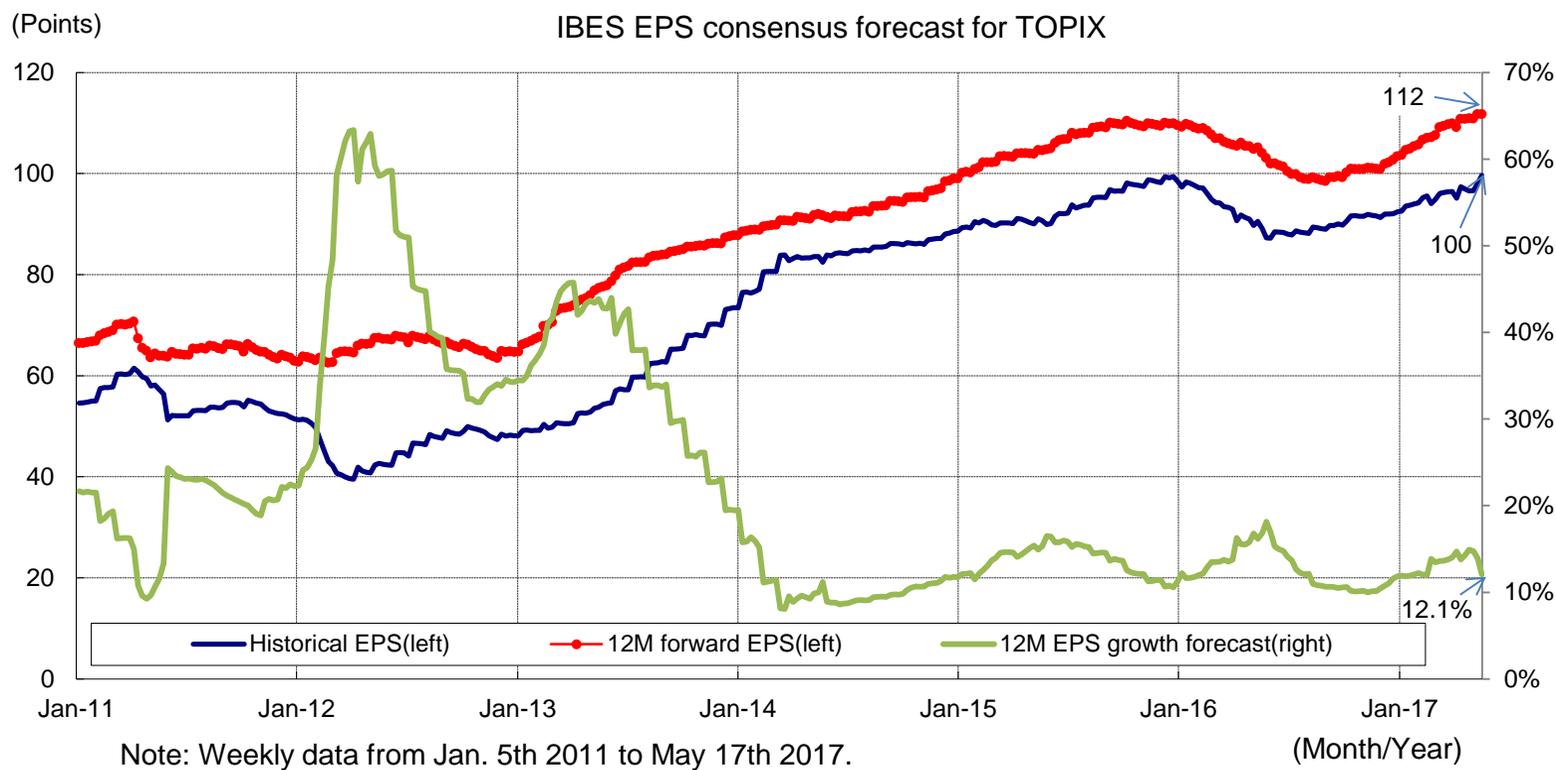
## Europe is in a strong recovery in both currency and stock prices

- Strong rally continued for Europe reignited by reassuring win by Macron at the French presidential election.
- Emerging markets has also continued strong rally.



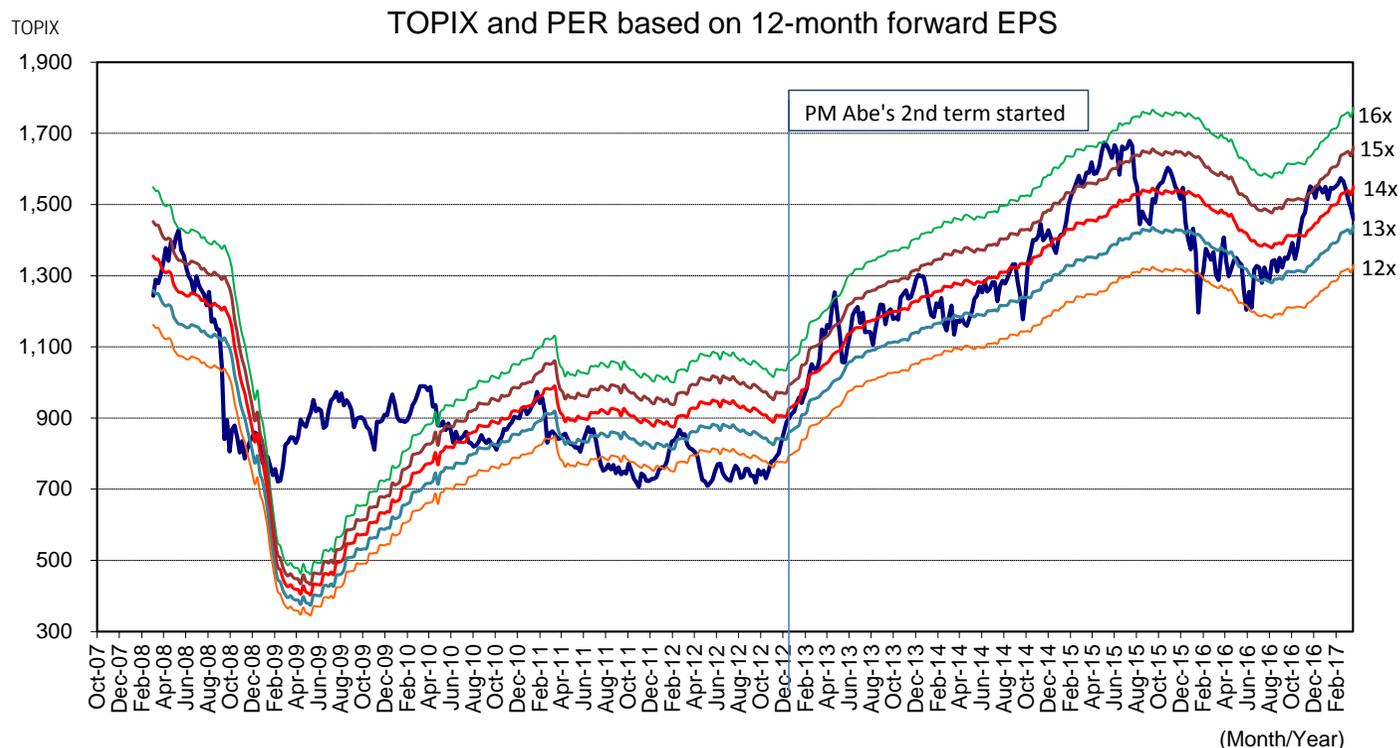
## EPS forecasts by analysts continue to expand

- The latest 12M forward EPS forecast for TOPIX was 112, which was higher than the previous historical record of 110 in October 2015.
- 12.1% EPS growth is forecast in the coming 12 months.



## PER (Price Earnings Ratio) at 14x looks cheap compared to other markets

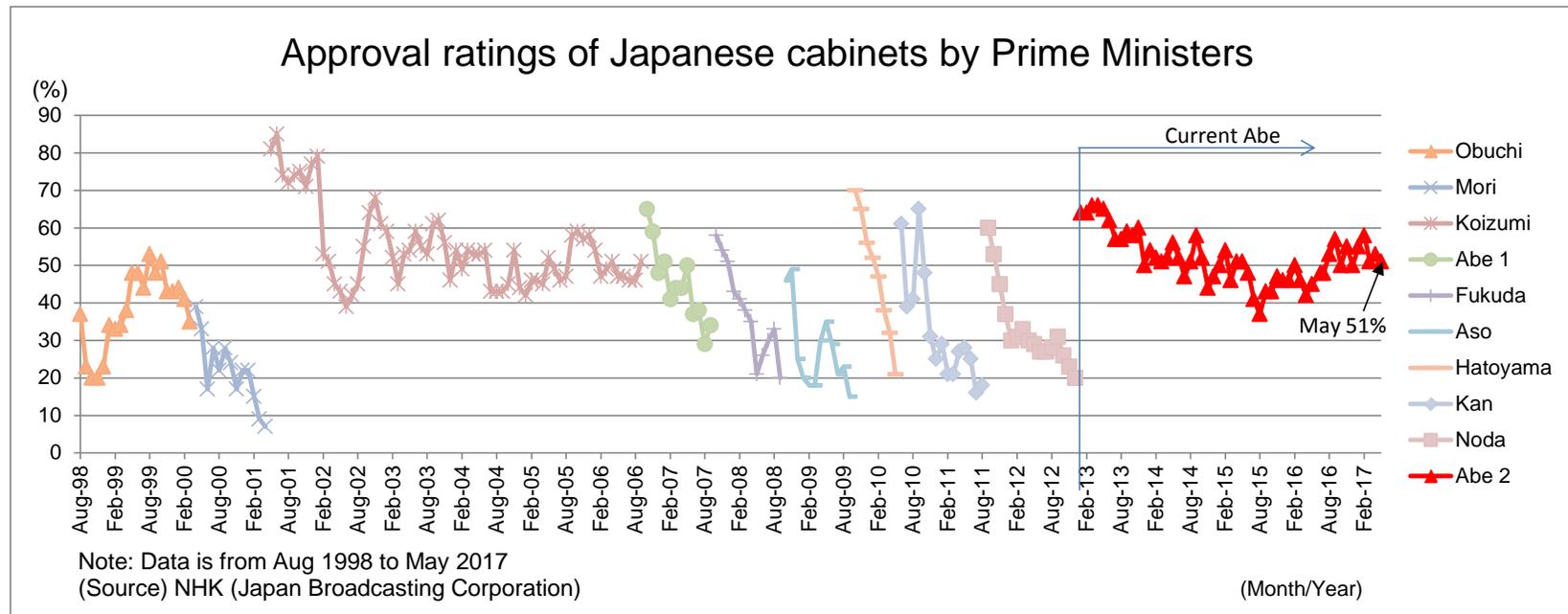
- Japanese stock market valuation in TOPIX about the middle of the range between 12x and 16x after PM Abe's second term began.
- Based on 12M forward EPS of 112, TOPIX PER is calculated at just below 14x.
- PER for MSCI US index is 18x and for MSCI Europe is 15x, which makes Japanese stock market look attractive in global comparison .



Note: Data is weekly from Oct. 26th 2007 to Apr. 12th 2017. TOPIX was 1459.07 at the end of the period.  
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

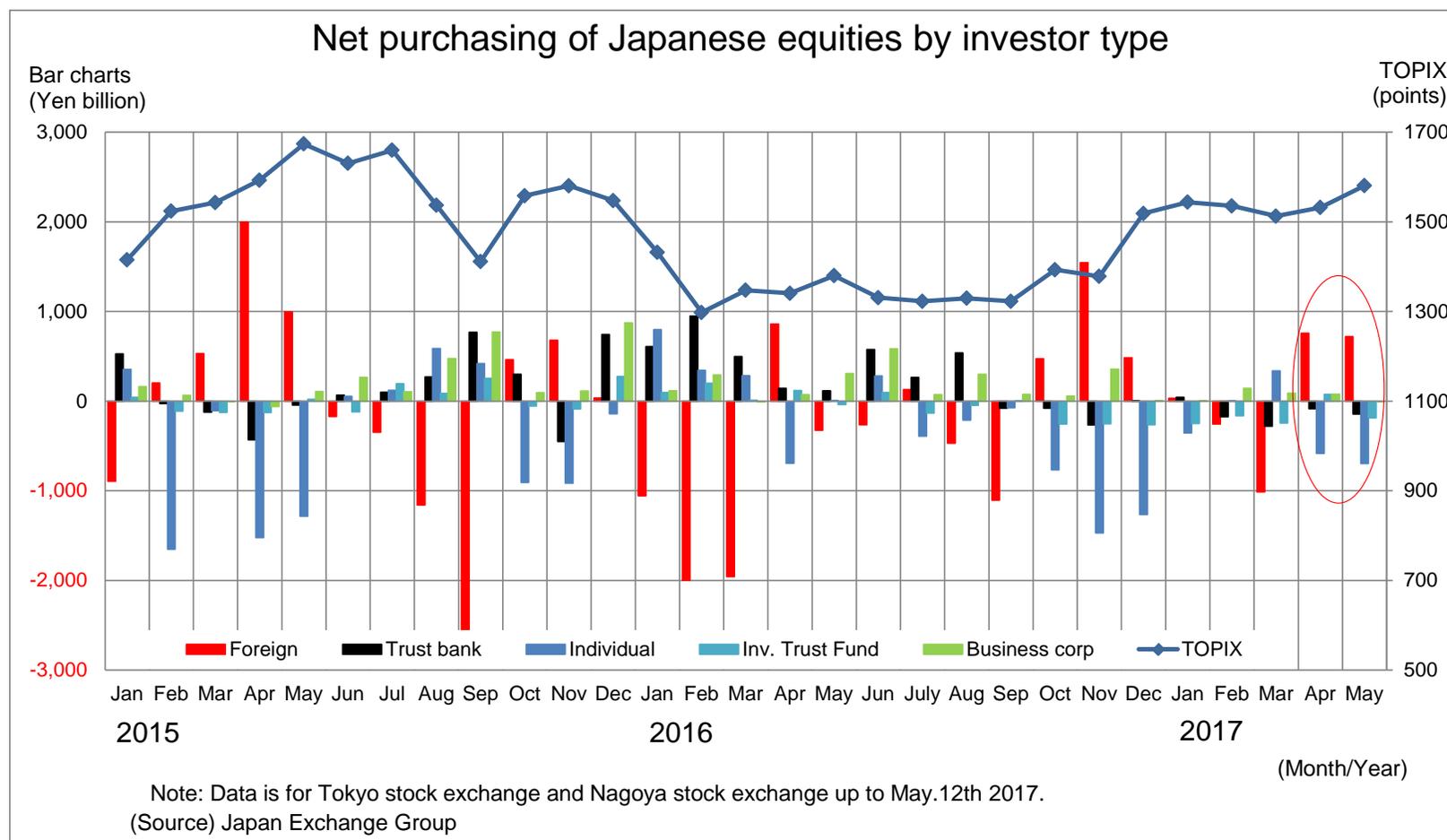
## Approval rating for Abe cabinet is holding at comfortably high level

- Approval rating for the current Abe cabinet was comfortably high at 51% in May, for which tensions with North Korea probably was one of the supporting factors helping his image as a strong leader.
- There are signs of complacency among the Abe cabinet and governing Liberal Democratic Party such as “Kake school” scandal, another scandal said to be involving PM Abe himself, and dreadful comments and following resignation by a cabinet minister.
- PM Abe said in May that he intended to push for the reform of the Japanese Constitution by 2020, which might tone down his priority of “growth strategy” and “balancing the primary balance of the national budget” .



## Foreign investors bought back Japanese equities in April and May

- Individual investors sold Japanese equities in April and May amidst the heightening tensions with North Korea.
- Foreign investors were buying back on the contrary.



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