



# Japanese Stock Market Outlook

---

SMAM monthly comments & views  
- January 2018 -



Sumitomo Mitsui Asset Management

SMAM

---

## Executive summary

---

### ➤ Japanese Economy

Robust exports, especially to Asia & China are driving the Japanese economy, which is underlying the robust business sentiments shown by the latest BOJ TANKAN business survey. The survey also showed that positive business environment is spreading to mid & small companies. The focal points will be if this strong business sentiment could finally ignite substantial wage growth and higher inflation.

- SMAM upgraded GDP growth forecast for FY2017 from 1.5 to 1.8 % on the back of strong Jul-Sep quarter GDP. First forecast for FY2019 was made, which is a little modest at +0.7%. Consumption tax hike scheduled in October 2019 is taken into consideration.
- Supplemental budget for supporting child education is going to be implemented, for which around 2.8 trillion yen is anticipated. Government is also discussing tax incentives for companies which increase wage and capital efficiency.

### ➤ Japanese Stock Markets

After completing the current brief consolidation period, Japanese stock market is expected to move higher above the previous high level in TOPIX recorded in February 2007 driven by robust earnings growth. Expected US tax policy going through congress will be positive for the global stock market. Risk will be heightening of North Korea situation.

- For a longer term, Japanese economy and stock market are expected to gain tailwind from continuing global economic growth. If current robust business sentiment could boost capital expenditure and also wage growth, it could change the Japanese economic environment to more inflationary, which could lead to substantially higher nominal GDP and stock prices.
- Major risks will be such as geopolitical tensions, slowdown of Chinese economy and pre-mature tightening by central banks.

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

---

# Outlook for Japanese Economy

## SMAM economic outlook for FY17-19

- SMAM upgraded GDP growth forecast for FY2017 from 1.5 to 1.8 % on the back of strong Jul-Sep quarter GDP.
- First forecast for FY2019 was made, which is a little modest at +0.7%. Consumption tax hike scheduled in October 2019 is taken into consideration.

(YoY %)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.8%	1.1%	0.7%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	1.2%	0.7%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	1.8%	0.9%	1.0%
Private Capital Investment	3.3%	2.3%	1.2%	3.4%	2.8%	1.8%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.6%	0.7%	0.7%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.6%	-0.7%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.4%	0.2%	0.0%
Exports	8.7%	0.7%	3.4%	5.0%	2.8%	1.7%
Imports	4.3%	0.3%	-1.1%	2.5%	1.5%	1.4%
Nominal GDP	2.2%	3.0%	1.0%	1.9%	1.8%	2.0%
GDP Deflator	2.5%	1.5%	-0.2%	0.1%	0.7%	1.3%
Industrial Production	-0.4%	-1.4%	1.5%	4.5%	3.0%	2.3%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	0.8%	0.8%

Notes: E=SMAM forecasts. SMAM views are as of Dec 19<sup>th</sup>, 2017 and subject to updates thereafter without notice

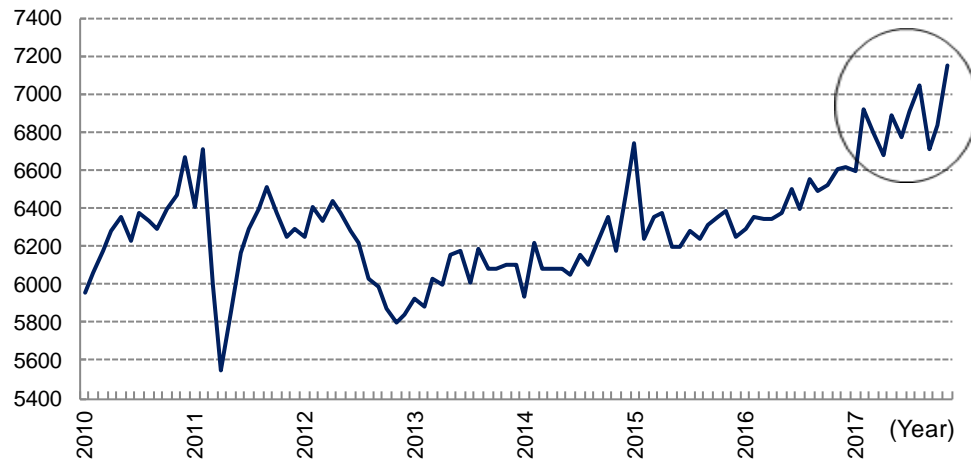
(%, YoY except Net Exports)

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

## Strong export growth continues to drive the Japanese economy

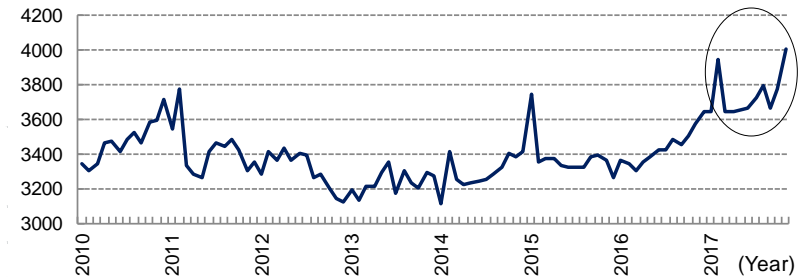
- Robust exports, especially to Asia & China are driving the Japanese economy. Exports to US rebounded in November recovering from damages caused by hurricanes.

Total export volume  
(seasonally adjusted, yen billion)

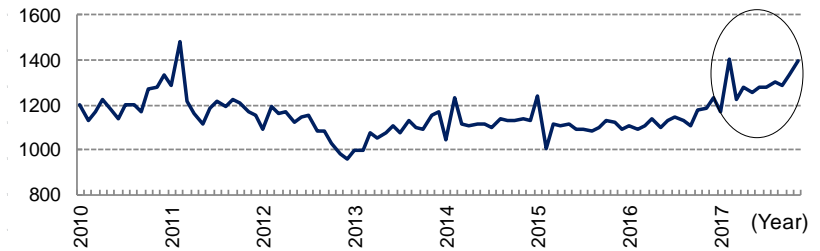


Note: Data is from Jan 2010 to Nov 2017.  
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

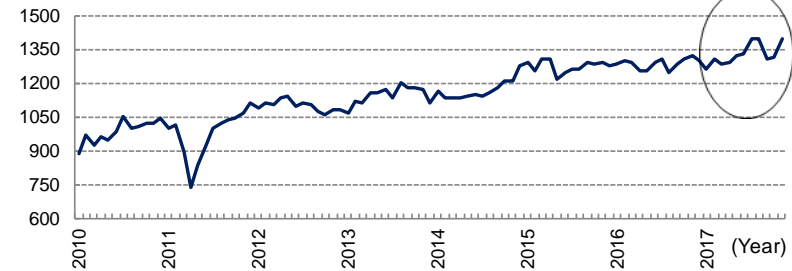
Export volume to Asia



Export volume to China

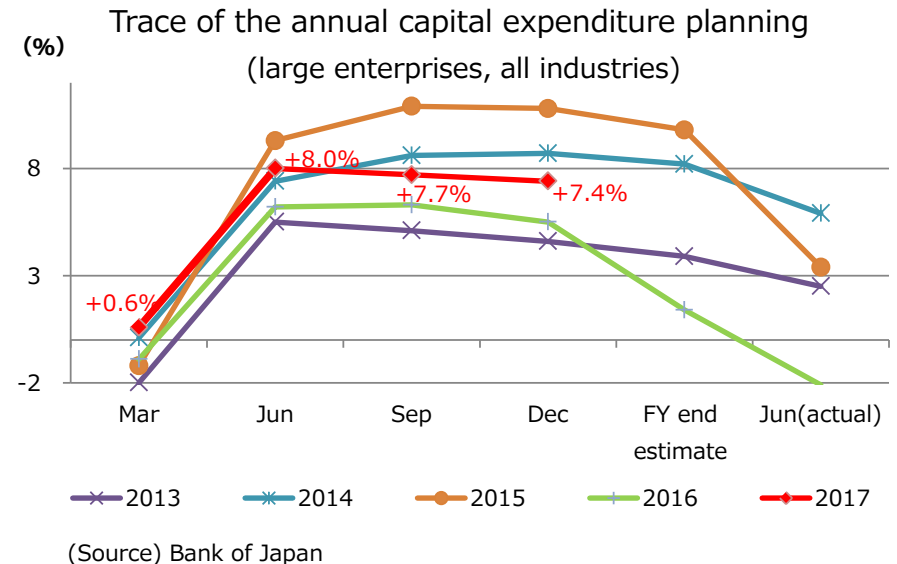
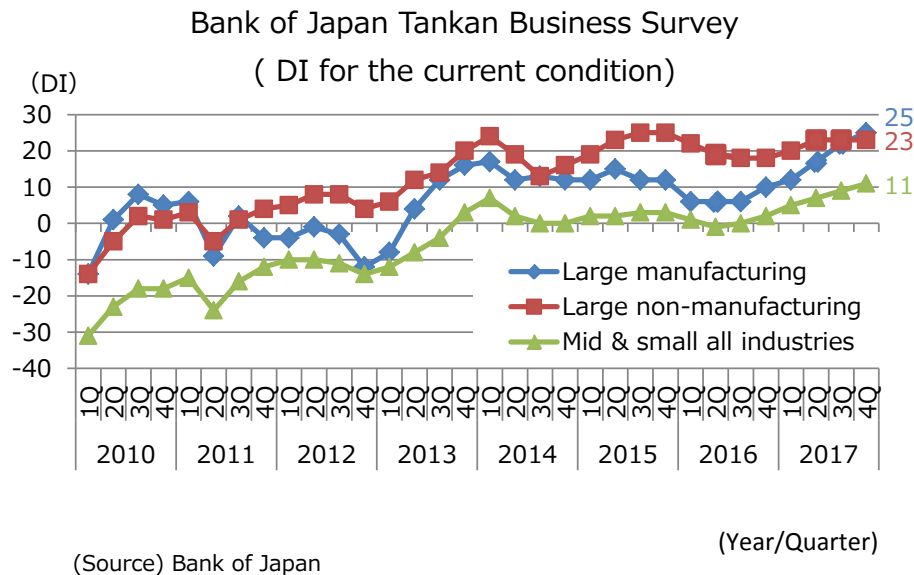


Export volume to US



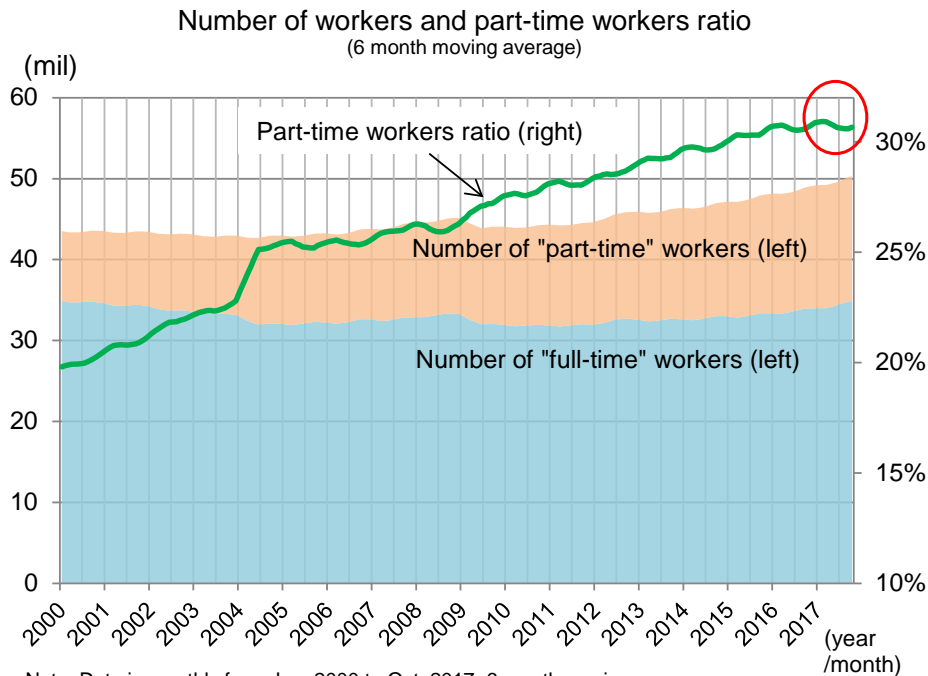
## Business sentiment is at historical high level for Japanese companies

- The latest BOJ TANKAN survey shows robust business sentiment for Japanese companies.
- Significant upswing continued for large manufacturing companies in 2017. Non-manufacturing companies are sustaining high levels since 2013 when current PM Abe government started.
- Positive business environment is spreading to mid & small companies.
- Companies are planning +7.4% YOY CAPEX increase for FY2017 ( ending in March 2018) at the latest December survey, showing recovery from weakness in 2016.

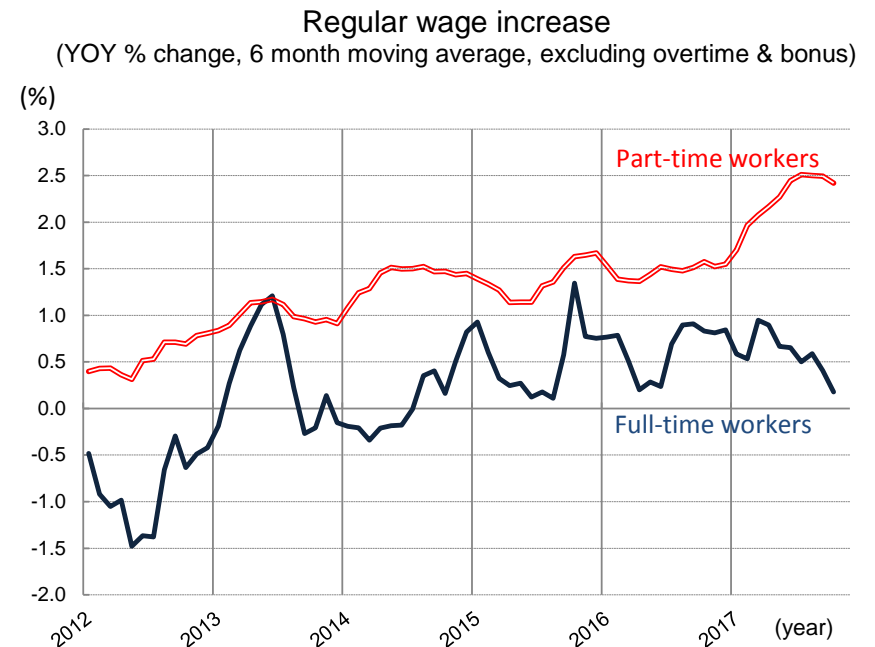


## Extremely tight labor market might ignite faster wage increase

- Number of workers has been mildly increasing despite aging population.
- Ratio of part-time workers, which has been increasing substantially, seems to be plateauing lately due to increasing difficulties to find workers.
- Companies, which are in industries facing severe labor shortage, are offering more full-time jobs to recruit workers.
- Wage increase, which is already prominent for part-time workers, might gradually spread to full-time workers.



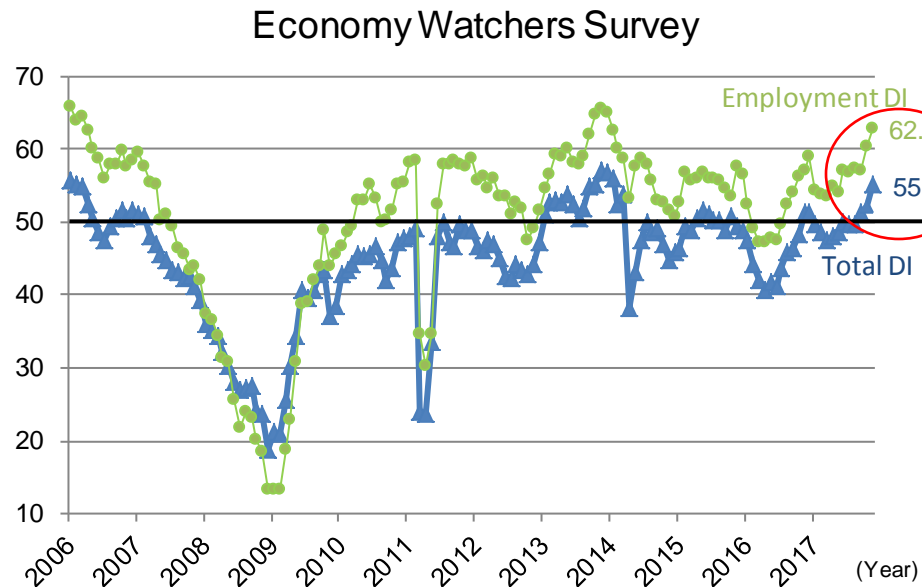
Note: Data is monthly from Jan. 2000 to Oct. 2017. 6 month moving average.  
(Source) Ministry of Health, Labour and Welfare



Note: Data is monthly from Jan. 2012 to Oct. 2017. 6 month moving average.  
(Source) Ministry of Health, Labour and Welfare

## Japanese people are feeling better, for which strong employment is a supporting factor

- Economy Watchers Survey is based on response from people engaged in economic sensitive jobs on the street such as retail shop and taxi drivers.
- Japanese people are feeling better as DI above 50 shows. Favorable job opportunity is one of the supporting factors behind this good sentiment.

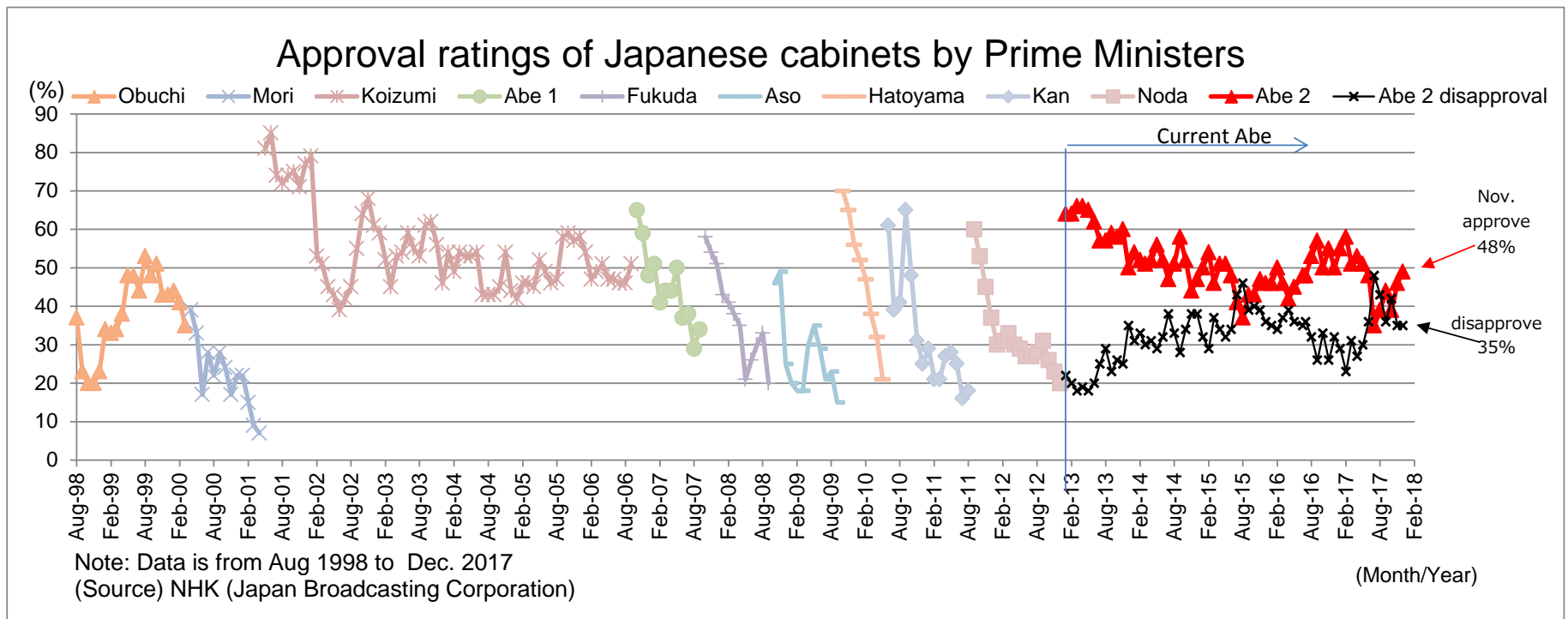


Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is improving. Data period is from Jan. 2006 to Nov 2017.  
(Source) Cabinet Office



## Approval rating for Abe cabinet further improved in December 2017

- Approval rating for Abe cabinet rose to 48% and disapproval rating remained at 35% in December. Stable government is one of the comparative advantage of Japan among the world politics.
- Supplemental budget for supporting child education is going to be implemented, for which around 2.8 trillion yen is anticipated.
- On the other hand, households earning more than 8.5 million annual income is going to face tax increase.
- Government is considering tax incentives for companies which increase wage and capital efficiency.



## Monetary policies, geopolitical tensions and economic policies are going to be main focus

- Unless any unexpected negative impact coming from the events listed below or others, global economy is likely to continue expanding rather strongly.
- Change in monetary policies, especially in US under the new chairman, or geopolitical conflicts are going to be main risk factors.

### Schedule of key events in 1H 2018

Month	Region/Country	Events	Notes
January	Japan	National Diet ordinary session begins	
		22-23 BOJ Monetary Policy Committee Meeting/ Perspective report	
	US	State of Union Address	
		30-31 FOMC	
EU	25 ECB monetary policy meeting		
February	Japan	4Q2017 GDP 1st preliminary estimate	
	US	3 FRB chair Yellen's term ends	
		FRB chairperson's testimony	New chairman Powell's first testimony?
		Budget Message of the President	
	South Korea	9-25 PyeongChang Olympic games are scheduled	Possibility of escalation or soothing of North Korean situation?
North Korea	16 Kim Jong-Il's birthday		
March	Japan	19 Two deputy governors' term ends	
		Spring wage negotiation rounds	Substantial wage hike achievable?
	US	20-21 FOMC	Another rate hike?
	China	China National People's Congress	
April	Japan	8 BOJ governor Kuroda's term ends	Who is next BOJ governor?
		26-27 BOJ Monetary Policy Committee Meeting	
June	Japan	Japanese government releases a) updated growth strategy b) plan of a revolution in human resources development and c) Basic Policies for Economic and Fiscal Management and Structural Reform	

(Source) Various publications, assembled by SMAM

---

# Outlook for Japanese Stock Markets

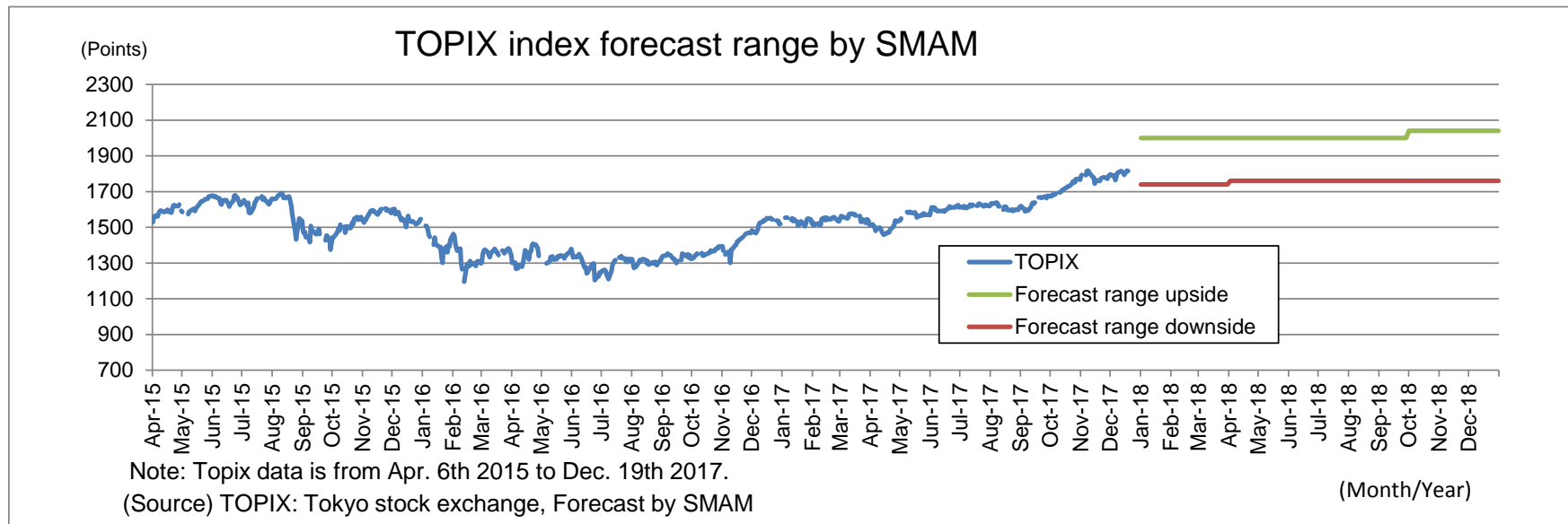
## Stock market outlook: Expected to be buoyed by strong earnings growth

### SMAM short-term view

- After completing the current brief consolidation period, Japanese stock market is expected to move higher above the previous high level in TOPIX recorded in February 2007 driven by robust earnings growth. Expected US tax policy going through congress will be positive for the global stock market. Possible risk will be heightening of North Korea situation.

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

- Japanese economy and stock market are expected to gain tailwind from continuing global economic growth. If current robust business sentiment could boost capital expenditure and also wage growth, it could change the Japanese economic environment to more inflationary, which could lead to substantially higher nominal GDP and stock prices. Major risks will be such as geopolitical tensions, slowdown of Chinese economy and premature tightening by central banks.



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

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

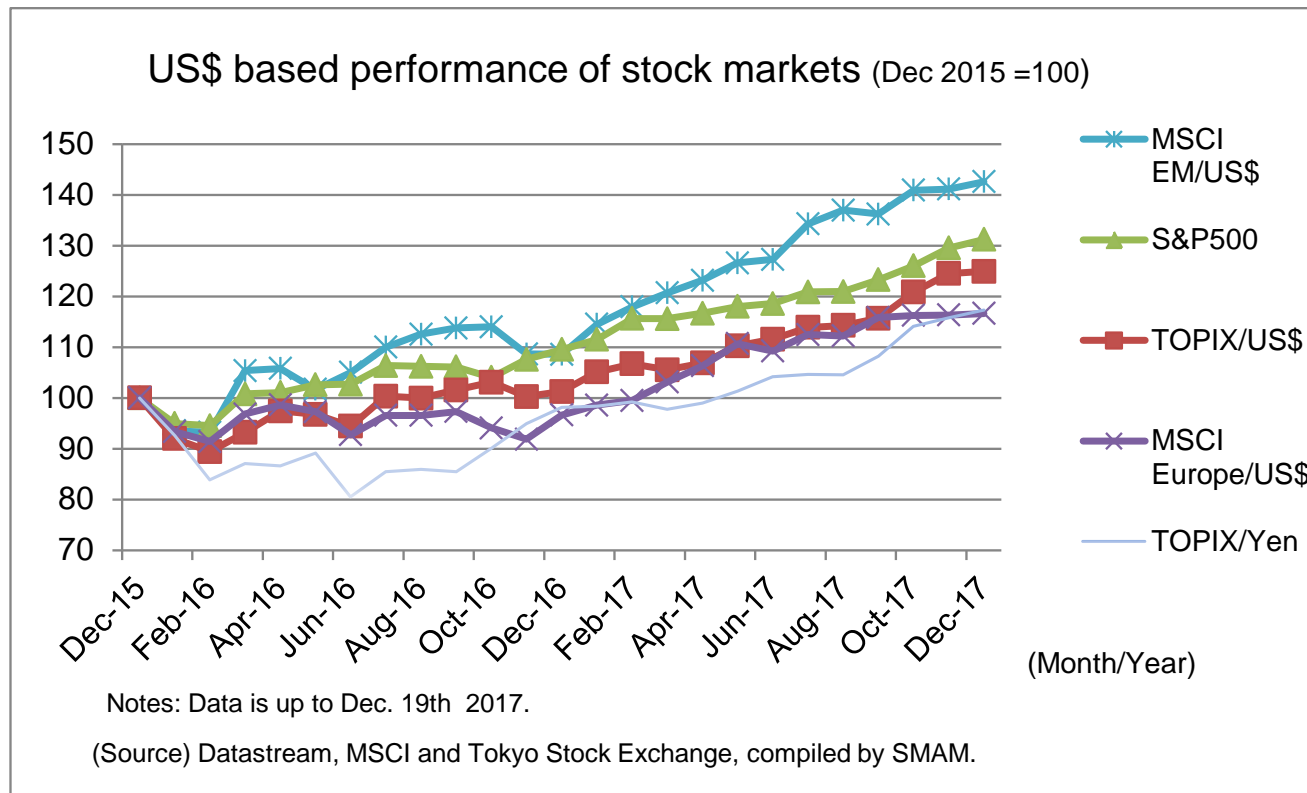
---

- Our **Base Scenario** is assuming the following views:
  - Practical Trump trade policies are made and serious trade disputes can be avoided.
  - US economy keeps growing.
  - 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.
  - North Korea abandons nuclear arms development.
  - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.
  
- **Downside Risks** include:
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - Pre-mature tightening of monetary policies chocks global economy.
  - 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.

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

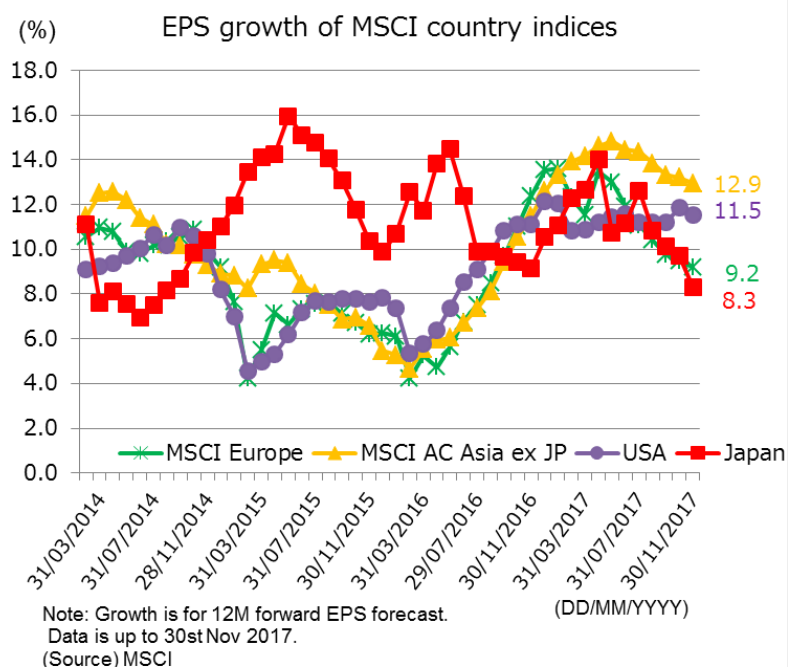
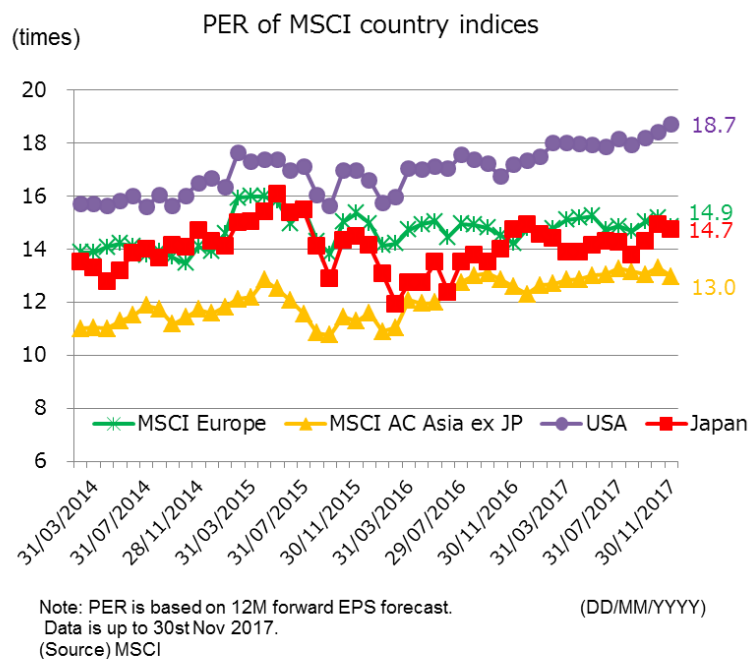
## US market and emerging markets continue to lead the global stock market

- US market is leading the strong global stock markets. Emerging markets are moving even higher.
- Japanese and European stock markets took a breather.



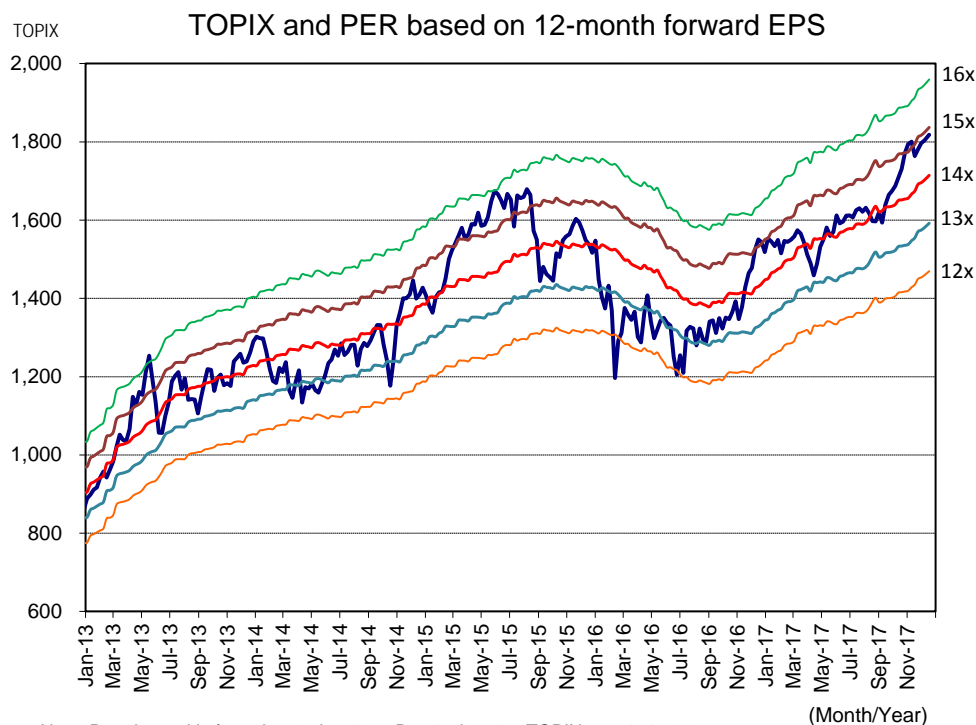
## High PER for US is probably discounting positive effects from tax reform

- PER of US stocks rose even higher, which is probably discounting positive effects from corporate tax cuts and repatriation of overseas held cash to be poured in share-buybacks.
- Comparing US, Europe and Japan, market with higher EPS growth forecast is given higher PER.
- If positive earnings surprise continues for Japanese companies to lift EPS growth forecasts, Japanese stocks could become attractive at current valuation level.

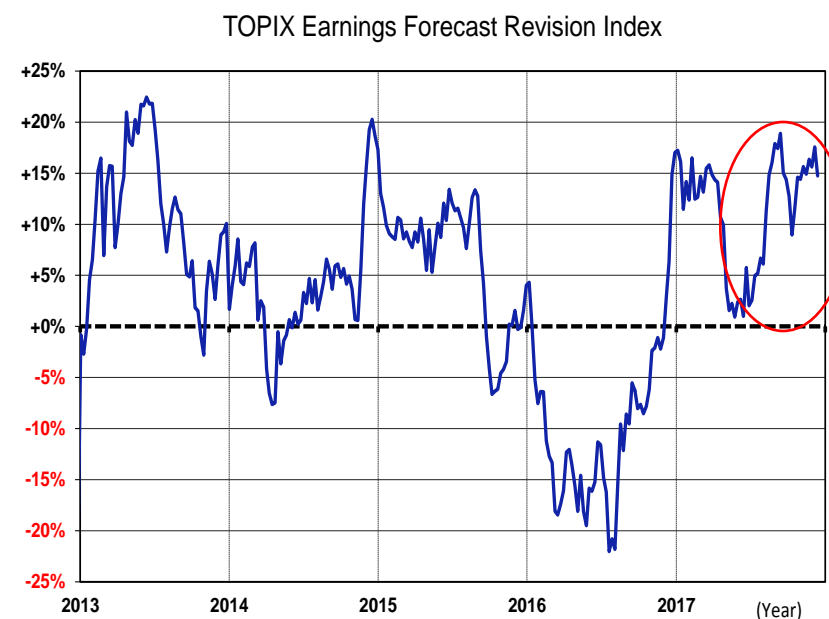


# Upward revisions of EPS forecasts are currently going on for Japanese companies

- Upward revision of EPS forecasts by analysts continues.
- PER for TOPIX index is just under 15 times, which may not look cheap. However, high valuation can be sustained if currently forecast rapid earnings expansion continues, which allows share price to rise in line with the EPS growth .



Note: Data is weekly from Jan.2nd 2013 to Dec.18th 2017. TOPIX was 1817.90 at the end of the period.  
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM



Notes: Revision index= % of Analyst upgrades out of total Topix firms - % of downgrades.  
 Data is weekly from Jan. 7th 2013 to Dec. 13th 2017.  
 (Source): IBES, SMAM



## SMAM revised profit forecast for FY 2017 by 2% to 17.1%

- Jul-Sep quarterly earnings were surprisingly strong. SMAM profit growth forecasts were revised upward for both FY 2017 and 2018. Self-guidance for FY2017 made by companies also rose by 5.6% to 13%, which still provide room for upward revisions going forward.
- Sales forecast for FY2017 was raised to robust 7.2% . Both sales volume and sales price are increasing, which underpins sustainable earnings growth.

SMAM Corporate Earnings forecasts (224 Companies research coverage excl. financials)

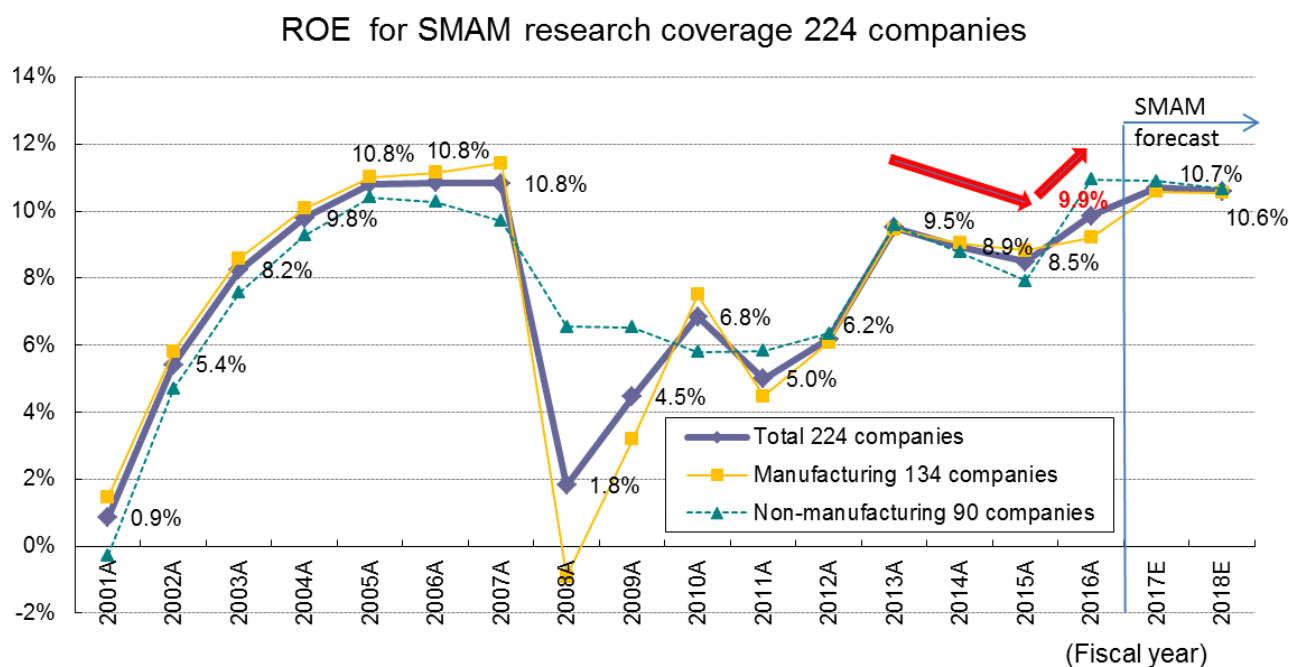
Fiscal year	FY 2015	FY 2016	FY 2017E	FY 2018E
Date of forecast	Actual	Actual	as of 5th Dec 2017 (as of 5th Sep 2017)	as of 5th Dec 2017 (as of 5th Sep 2017)
Sales (YoY %)	0.7%	-3.4%	7.2% (6.4%)	2.5% (2.1%)
Operating Profits (YoY %)	11.8%	-1.3%	17.0% (14.3%)	8.9% (8.2%)
<b>Recurring Profits (YoY %)</b>	<b>4.5%</b>	<b>2.1%</b>	<b>17.1%</b> (15.1%)	<b>9.5%</b> (8.3%)
Net Profits (YoY %)	-0.6%	18.3%	12.2% (10.1%)	9.3% (7.9%)
Recurring profits (YoY %)				
Manufacturing 134 companies	3.5%	-3.5%	20.3% (16.9%)	9.8% (9.4%)
Non-manufacturing 90 companies	6.2%	11.4%	12.5% (12.5%)	8.9% (6.5%)
Self guidance by 224 companies			13.0% (7.4%)	

Note: Key assumptions for the Dec. forecasts for FY 2017, Yen/US\$ 111.1, Yen/EUR 129.6

(Source) SMAM Corporate Research Group, Toyo Keizai

## ROE is expected to rise to 10.7% in FY2017

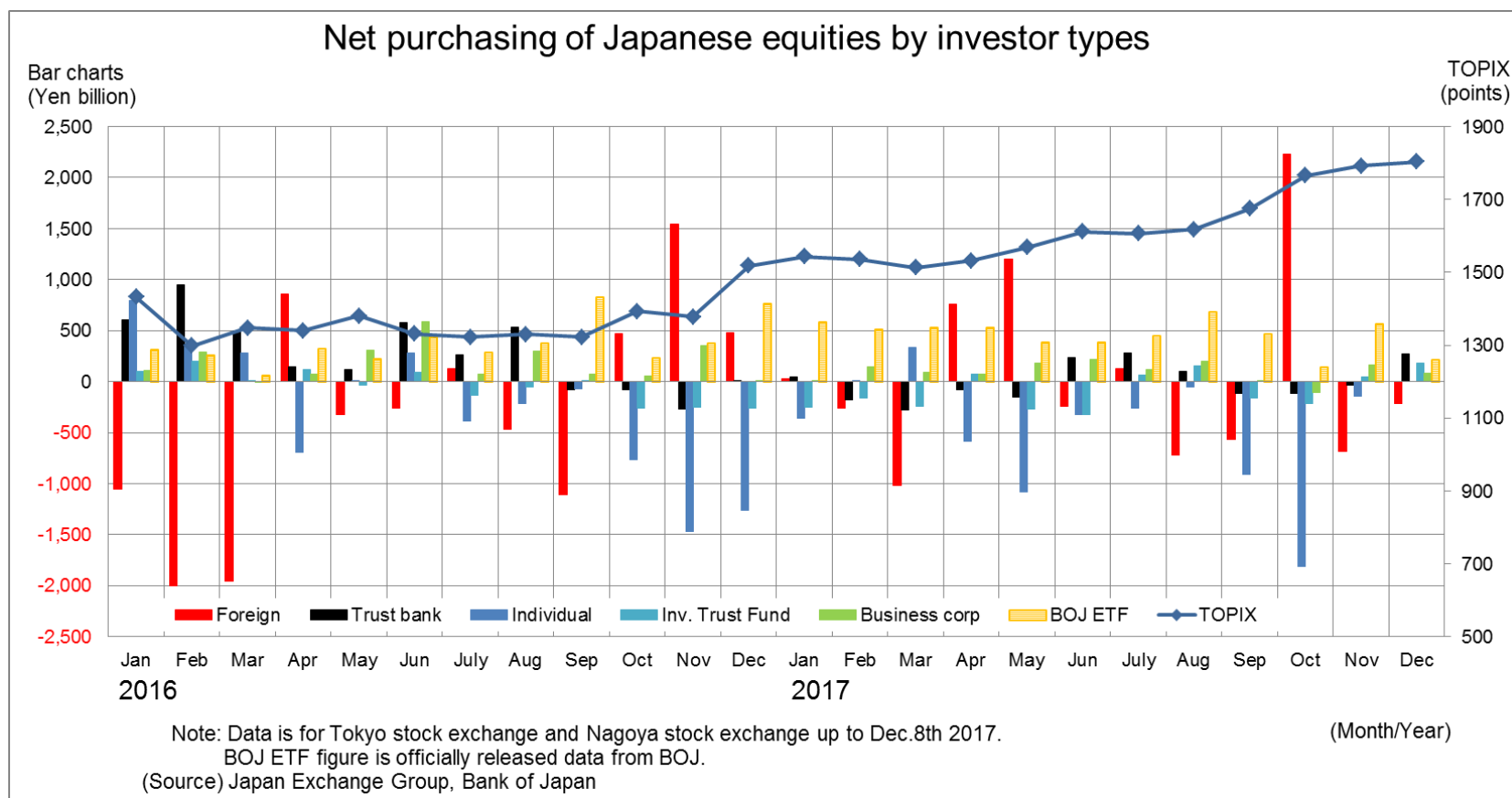
- ROE forecast for FY 2017 was slightly revised upward by 0.2% to 10.7% due to higher earnings now forecasted.
- Current ROE forecast for FY2018 is just about the same level at 10.6%. The pace of rapidly accumulating capital increase is expected to be slightly faster than EPS growth.



Note: Forecast is as of 5th Dec 2017. Displayed numbers are for total companies.  
 (Source) SMAM Corporate Research Group

## BOJ was absorbing sales by foreign investors since November

- BOJ resumed purchasing in November as the stock market retreated from the preceding rally.
- Foreign investors turned to mildly selling Japanese stocks since November.
- Individual investors attitude might be turning to more positive.



# Disclaimer

---

**Please read this disclaimer carefully.**

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter “SMAM”), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM's judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM's authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited