



Japanese Stock Market Outlook

SMAM monthly comments & views

- April 2018 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Japanese economy is showing solid growth on the back of robust exports and steadily growing domestic demands. However, uncertainties are likely to remain in global economies as long as controversial US policies such as trade disputes are pursued by the White House and Republicans in order for winning the Mid-term election in November.

- SMAM raised its GDP Forecast for FY2017 slightly due to revised GDP for Oct-Dec quarter. Forecast of solid growth for Japan has been maintained for FY2018 and 2019.
- Pay-scale increase in this spring wage negotiation appears to be about 0.5% and bonus is going to increase by more than 3% YOY. Excluding retiring people, many employees are expected to have 2 to 3% total wage increase when scheduled seniority increase is combined.

➤ Japanese Stock Markets

Volatility will stay in the global stock markets swung by events such as trade negotiations, especially between US and China, and US-North Korea top meeting. Fate of the political power of Abe cabinet is another swing factor for the Japanese stock market. Underlying global economy and corporate earnings are still solid and stock valuation getting more reasonable, which is likely to support the downside of the stock prices.

- Purchasing buy investment trust funds was robust JPY 1,248 billion in February absorbing sales by foreign investors. Increasing presence of individual investors is very positive for the Japanese stock markets in the long-term.
- SMAM's forecast of recurring profits for 224 companies in the research coverage was upgraded from previous 17.1% YOY growth to 20.1% in March. Companies' self-guidance on recurring profits for FY 2017 was up-revised from previous 13.0% to 16.7%, which still has upside room compared to SMAM's forecast...

Notes: Macro and market views are as of Mar 26th 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-19

- GDP Forecast for FY2017 was slightly raised due to revised GDP for Oct-Dec quarter. Forecast of solid growth for Japan has been maintained for FY2018 and 2019.
- Japanese economy is showing solid growth on the back of robust exports and steadily growing domestic demands. However, uncertainties are likely to remain in global economies as long as controversial US policies such as trade disputes are pursued by the White House and Republicans in order for winning the Mid-term election in November.

(YoY %)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.8%	1.4%	0.8%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	1.1%	0.9%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	-0.0%	-1.4%	1.0%
Private Capital Investment	3.3%	2.3%	1.2%	3.5%	2.9%	1.8%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.3%	0.5%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	2.9%	-1.1%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.3%	0.4%	0.1%
Exports	8.7%	0.7%	3.4%	6.9%	4.6%	2.0%
Imports	4.2%	0.3%	-1.0%	4.7%	2.2%	1.4%
Nominal GDP	2.2%	3.0%	1.0%	1.8%	1.8%	1.9%
GDP Deflator	2.5%	1.5%	-0.2%	-0.0%	0.4%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.5%	3.2%	2.0%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	1.0%	0.6%

Notes: E=SMAM forecasts. SMAM views are as of Mar 26th, 2018 and subject to updates thereafter without notice

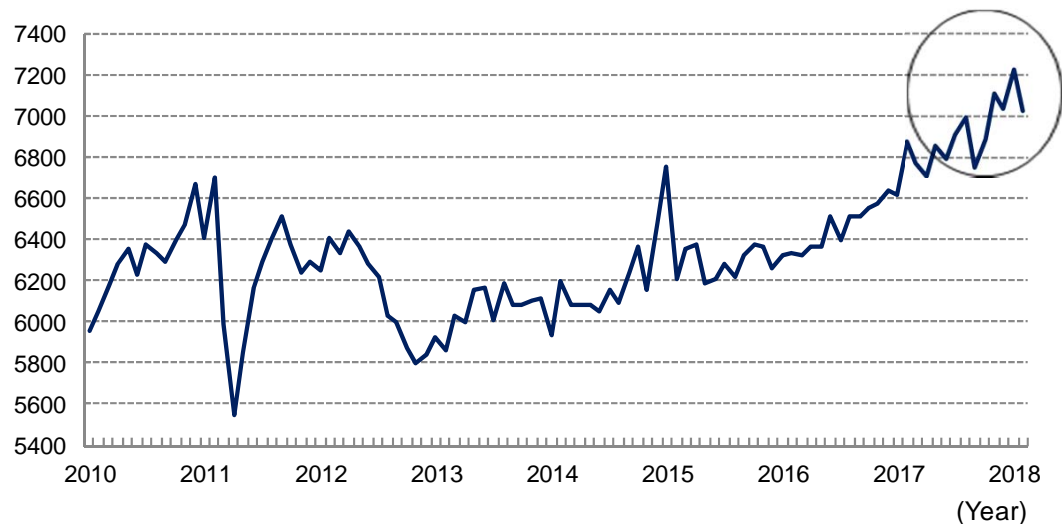
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

(%, YoY except Net Exports)

Export to China and Asia in February is distorted by the timing of Lunar New Year holidays

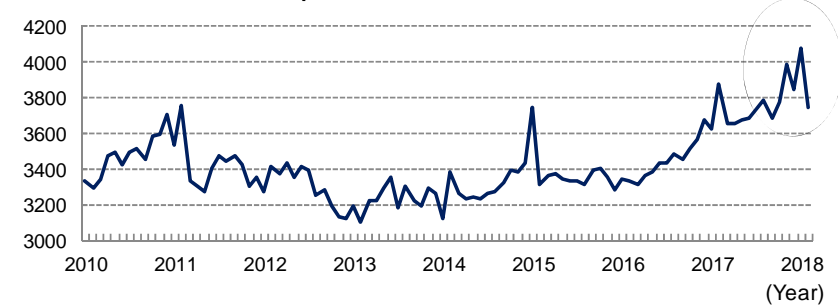
- Exports to Asia and China declined in February due to Lunar New Year holidays falling entirely in February this year. The holidays are based on Lunar Calendar and the timing varies every year between late January and early February.
- Trade conflicts initiated by US is a serious concern.

Total export volume
(seasonally adjusted, yen billion)

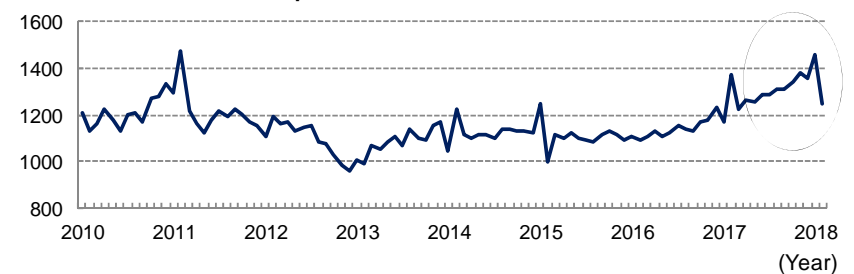


Note: Data is from Jan 2010 to Feb 2018.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

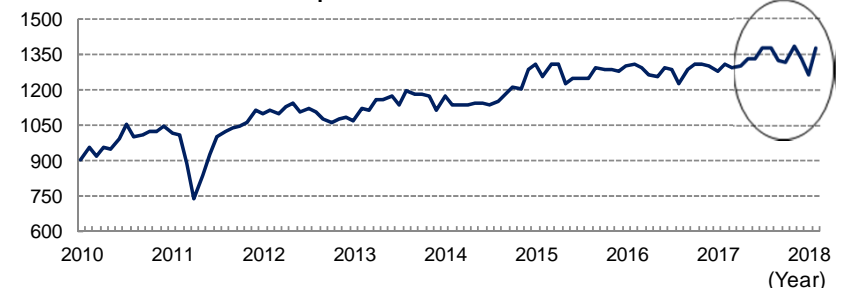
Export volume to Asia



Export volume to China

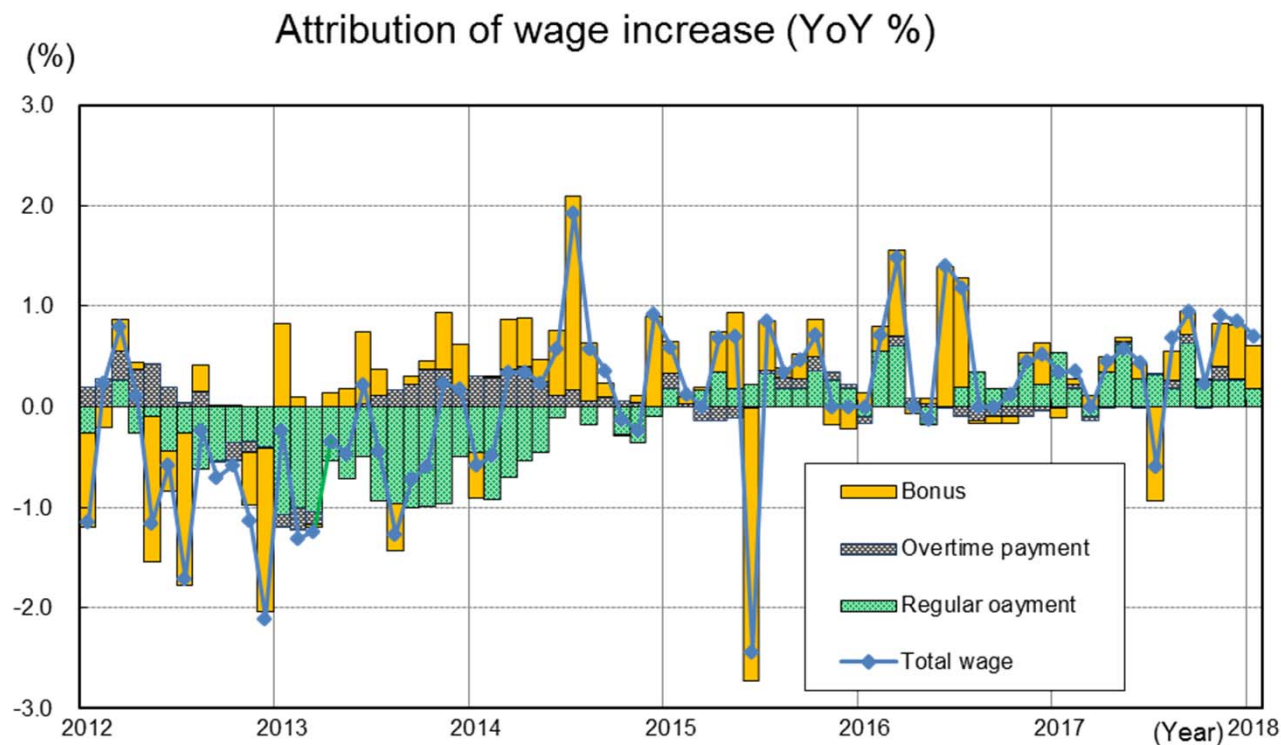


Export volume to US



Wage is rising but the pace is still slow

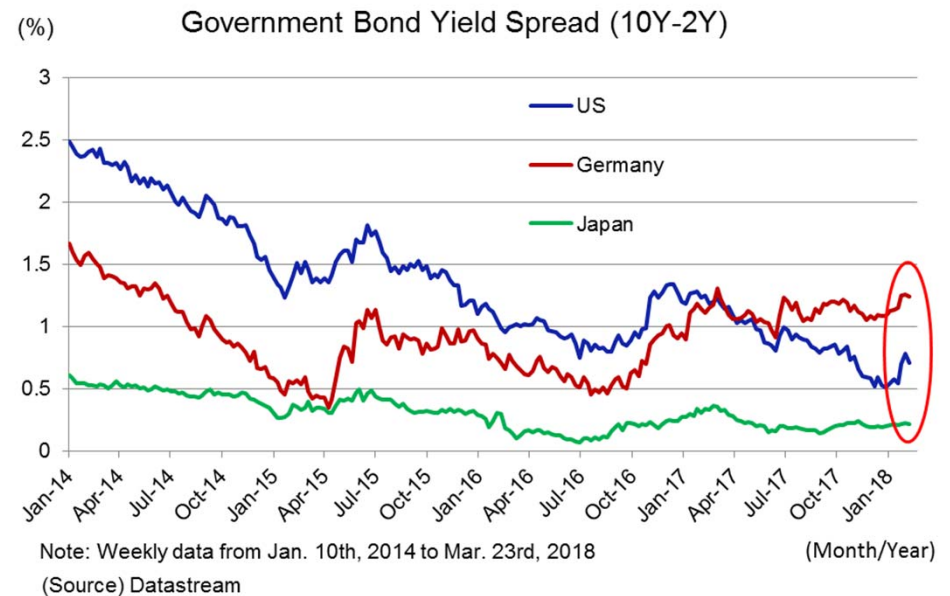
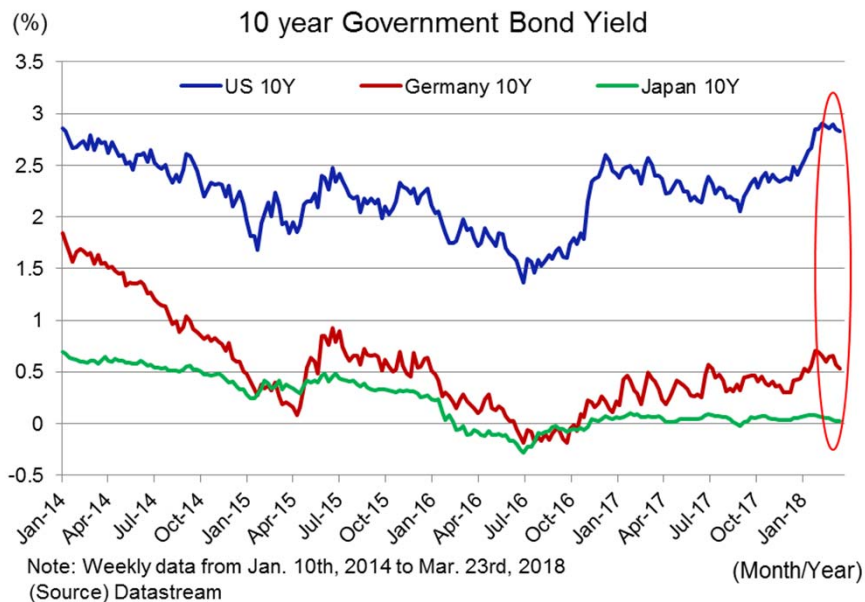
- Wage is rising slowly in Japan despite robust pace of corporate profit increase.
- However, the rising pace is getting a little faster. Pay-scale increase in this spring wage negotiation appears to be about 0.5% and bonus is going to increase by more than 3% YOY. Excluding retiring people, many employees are expected to have 2 to 3% total wage increase when scheduled seniority increase is combined.



Note: Data is from Jan. 2012 to Jan. 2018
(Source) Ministry of Health, Labour and Welfare

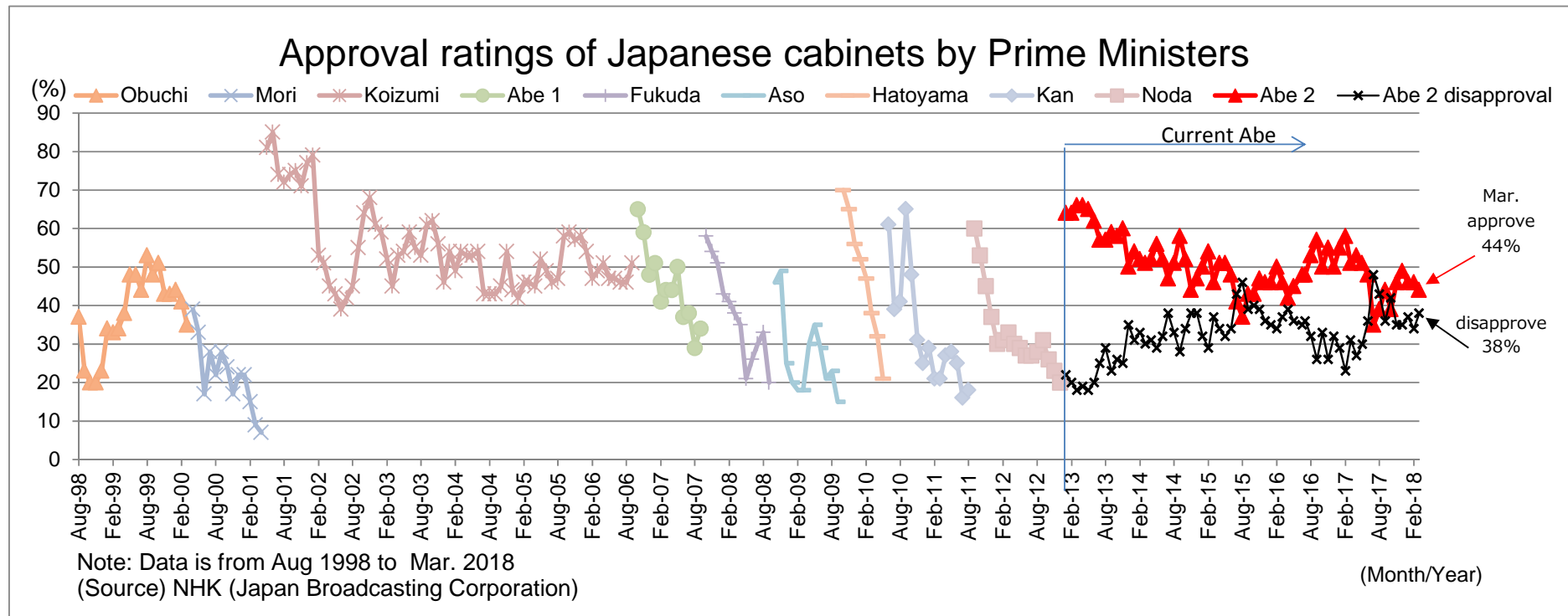
Reappointed BOJ governor Kuroda is going to keep loose monetary policy in Japan

- Mr. Kuroda's reappointment as the BOJ governor was approved by the National Diet in March. Japan is going to keep most loose monetary policy among major global economies.
- Upward pressure for the global interest rate has eased a little after still moderate US wage inflation number and also due to the increasing risk-off mode in the global financial market.



Approval rating for Abe cabinet is on the decline

- According to NHK, Approval rating for Abe cabinet fell by 2% to 44% meanwhile disapproval rating rose by 4% to 38%. The survey was conducted between 9th and 11th of March. More recent survey made by other newspapers show decline in approval rating by more than 10%.
- Confusion is deepening for Moritomo school scandal, in which PM Abe's wife might have been involved in getting favorable land deal for the school from the government. If it forces the departure of some influential ministers of Abe cabinet or PM Abe himself, it could be damaging for the political stability in Japan, though orderly succession is still possible.



It's going to be an eventful months ahead, trade negotiations, US-North Korea top meeting, etc.

- How US and its counterparties can negotiate trade deals and avoid trade war? SMAM expects recent US tariff is a tool for getting a favorable trade deal. Igniting trade war is not beneficial for the US as well as for its counterparties.
- If current serious tension surrounding North Korea can be eased, it's quite positive for Japan.

Upcoming key events

Month	Region/Country	Events	Notes
March	Japan	19 Two deputy governors' term ends	Two deputy governors were approved.
		Spring wage negotiation rounds	Pay rise is going to be faster than last year.
	US	5 DACA expires	
		20-21 FOMC	Another interest rate hike was made.
	EU	8 ECB Monetary Policy Meeting	
	Germany	4 SPD members vote for CDU-SPD alliance	Alliance was achieved.
	Italy	4 General election	Populism has gained grounds.
	South Korea	9-18 PyeongChang Paralympic games	What happens in N Korea after the games?
China	China National People's Congress	Unlimited period of leadership is now in place.	
April	Japan	8 BOJ governor Kuroda's term ends	Kuroda's reappointment was approved in March.
		26-27 BOJ Monetary Policy Committee Meeting & perspective report	
		PM Abe is going to US for a meeting with the President Trump	
EU	27 ECB Monetary Policy Meeting		
May	US	1-2 FOMC	
	North Korea	Meeting is going to be held between US president Trump and North Korea's leader Kim Jong-un by May.	Let's hope that the bomb can be defused.
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	
	US	12-13 FOMC	
	EU	14 ECB Monetary Policy Meeting	
July	Japan	30-31 BOJ Monetary Policy Committee Meeting & perspective report	
	US	31-1 FOMC	
	EU	26 ECB Monetary Policy Meeting	
September	Japan	18-19 BOJ Monetary Policy Committee Meeting	
		PM Abe's leadership of LDP is set for renewal or expiration	LDP leadership election is due
EU	26 ECB Monetary Policy Meeting		
November	US	Mid-term election for US congress	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

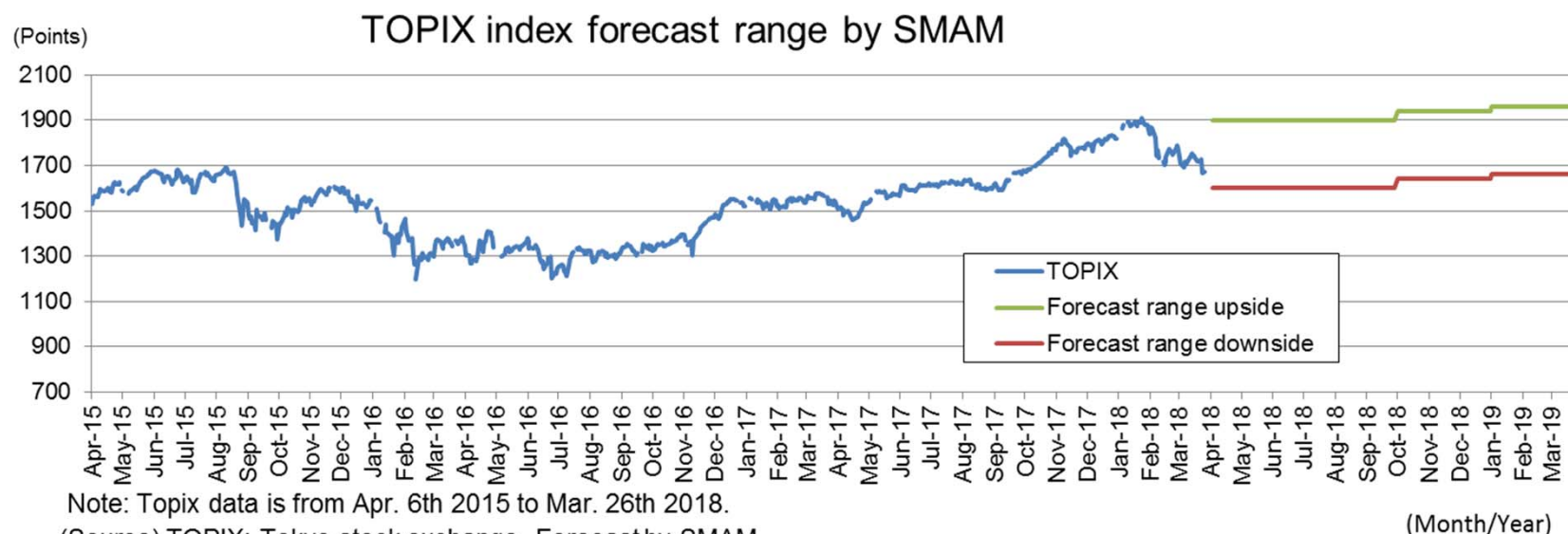
Stock market outlook: An eventful period ahead. Volatility will stay in the stock market.

SMAM short-term view

- Volatility will stay in the global stock markets swung by events such as trade negotiations, especially between US and China, and US-North Korea top meeting. Fate of the political power of Abe cabinet is another swing factor for the Japanese stock market. Underlying global economy and corporate earnings are still solid and stock valuation getting more reasonable, which is likely to support the downside of the stock prices.

Longer-term outlook (6-months and beyond)

- Confrontational trade policy by US is likely to continue until the mid-term election in November, however, president Trump and republicans will not push too far to damage US economy by igniting serious global trade war. Expansionary US budget spending is going to sustain strong US economy, which will sustain moderate and steady growth of economy and corporate earnings in Japan. Unless fatal blow comes from overseas, Japanese stock market is expected to complete the current consolidation phase for the next upward move.



Note: Topix data is from Apr. 6th 2015 to Mar. 26th 2018.

(Source) TOPIX: Tokyo stock exchange, Forecast by SMAM

Note: SMAM's projection is as of Mar 26th 2018 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Despite scare of raising tariff, US is going to make a deal with it's counterparties and trade war 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.
 - Central banks gradually move to normalize monetary policies and avoid killing economic growth.

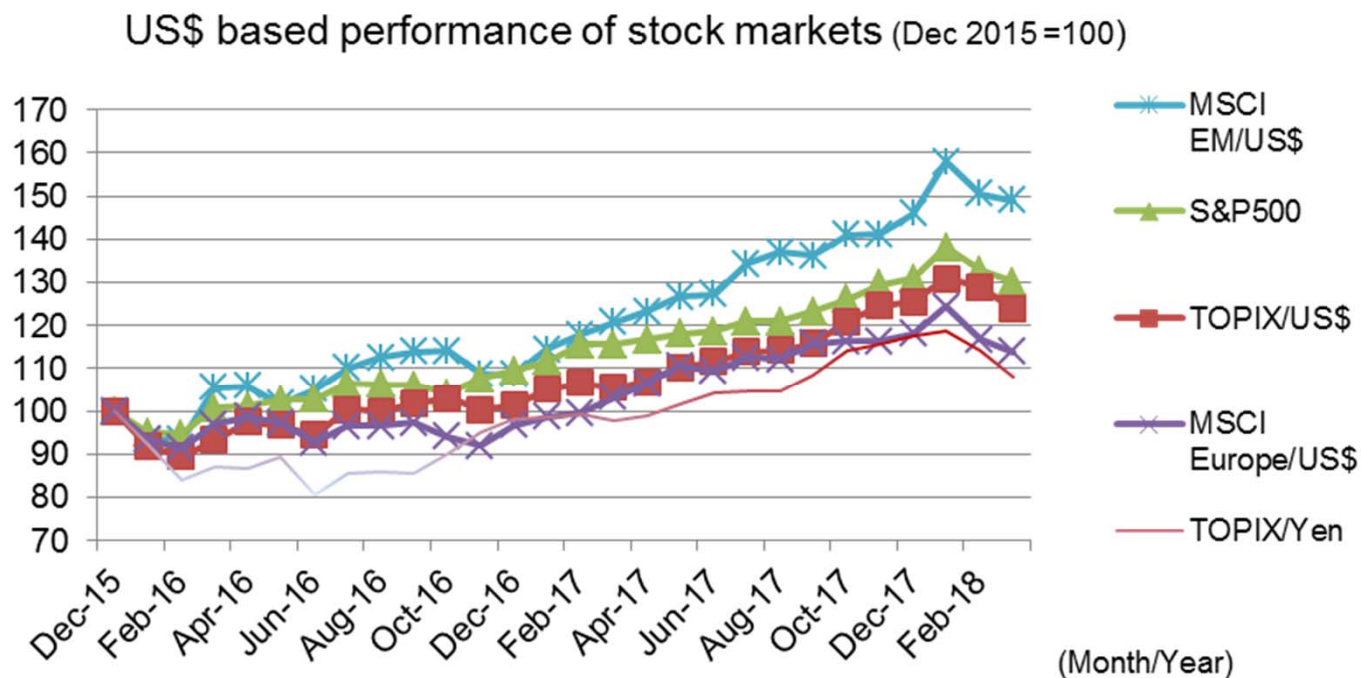
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - North Korea abandons nuclear arms development.
 - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.

- **Downside Risks** include:
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - Global monetary tightening intensifies to choke global economy.
 - Confrontational foreign policies taken by Trump presidency igniting a trade war.
 - "Russia-gate" scandal flares up.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Mar. 26th 2018 and subject to updates without notice.

Global market made a synchronized decline in March

- Global stock markets fell in tandem driven by negative developments such as US escalating trade sanctions.
- In US\$ terms, strong yen has softened the stock price decline of Japanese stocks.



Notes: Data is up to Mar. 26th 2018.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.

Profit forecasts were upgraded in March

- SMAM's forecast of recurring profits for 224 companies in the research coverage was upgraded from previous 17.1% YOY growth to 20.1% in March.
- Companies' self-guidance on recurring profits for FY 2017 was up-revised from previous 13.0% to 16.7%, which still has upside room compared to SMAM's forecast.
- Strong growth of sales volume is forecast to continue to provide solid profit growth running into FY 2018.
- Assumed foreign exchange rate for FY 2018 is 110 yen/ US\$. If actual rate significantly deviate from this assumption, it could have a material impact on profits.

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 Mar 2018 (as of 5th Dec 2017)	as of 5th Mar 2018 (as of 5th Dec 2017)
Sales (YoY %)	0.7%	-3.4%	8.1% (7.2%)	3.1% (2.5%)
Operating Profits (YoY %)	11.8%	-1.3%	19.1% (17.0%)	8.2% (8.9%)
Recurring Profits (YoY %)	2.9%	3.7%	20.1% (17.1%)	8.8% (9.5%)
Net Profits (YoY %)	-0.6%	18.3%	23.7% (12.2%)	2.2% (9.3%)
Recurring profits (YoY %)				
Manufacturing 134 companies	1.5%	-1.6%	24.2% (20.3%)	8.5% (9.8%)
Non-manufacturing 90 companies	5.2%	12.4%	14.2% (12.5%)	9.2% (8.9%)
Self guidance by 224 companies			16.7% (13.0%)	

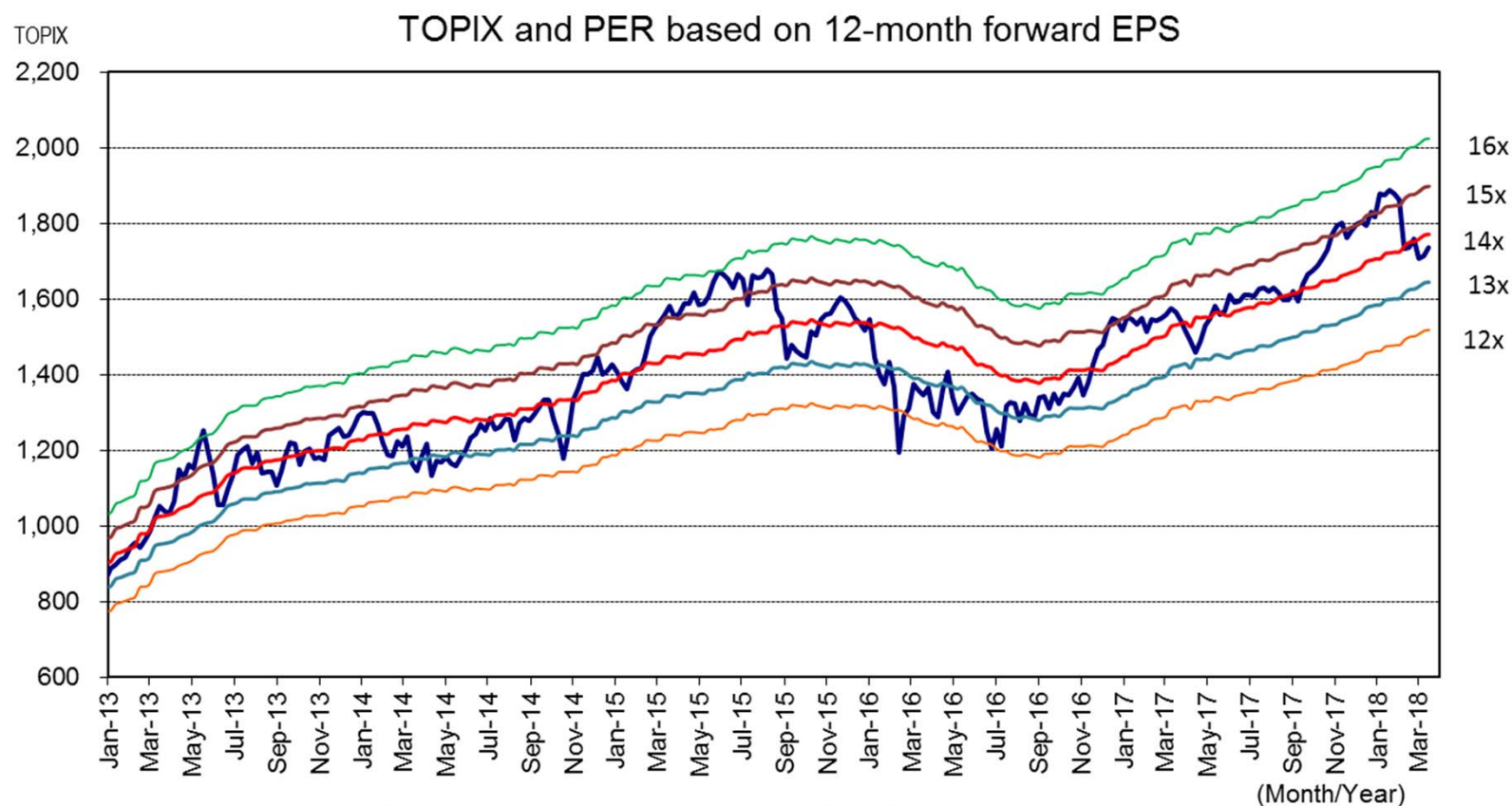
Note: Key assumptions for the Mar. forecasts for FY 2017 are Yen/US\$ 111 and Yen/EUR 130.9.

Forecasts for FY 2018 are Yen/US\$ 110 and Yen/EUR 135.

(Source) SMAM Corporate Research Group, Toyo Keizai

PER for TOPIX index fell to the mid level since PM Abe took helm in 2013

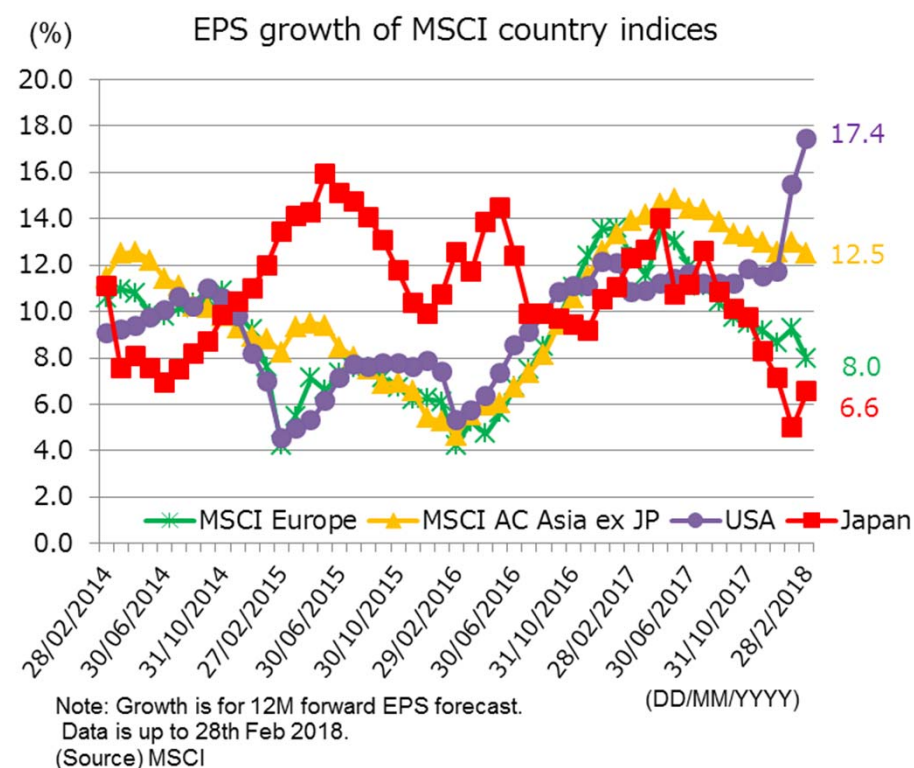
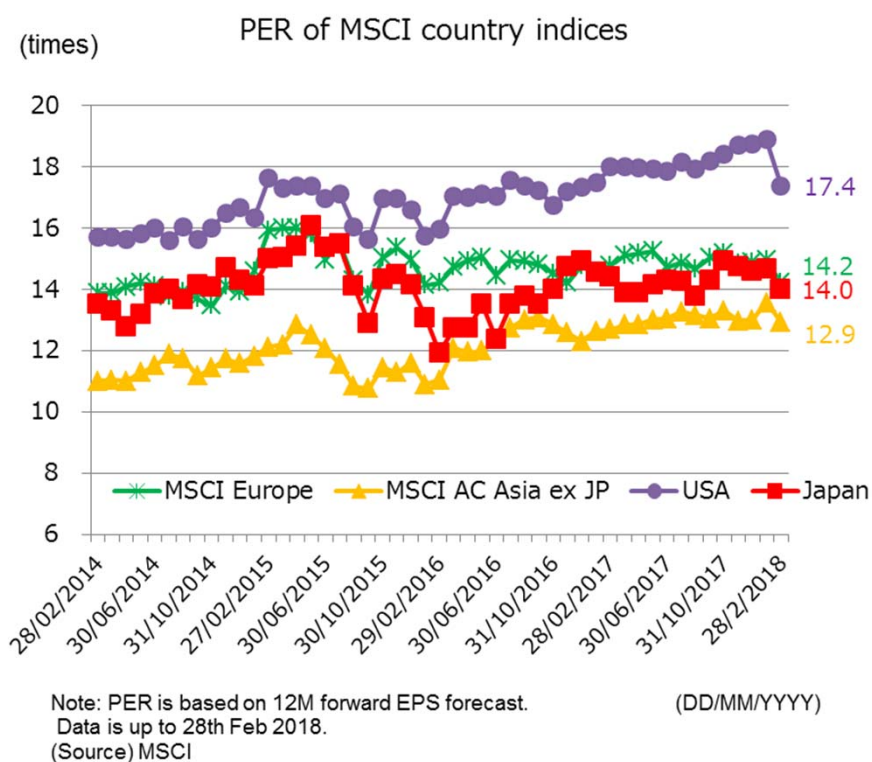
- PER for TOPIX index fell below 14 times, which has been the middle of the range after PM Abe took helm in 2013.
- As long as global economy stays strong, Japanese economy and corporate profits are going to have tailwinds. Current valuation level seems reasonably attractive.



Note: Data is weekly from Jan.4th 2013 to Mar.16th 2018. TOPIX was 1736.63 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

US corporate tax cuts lifted EPS growth forecast for Japan as well as US

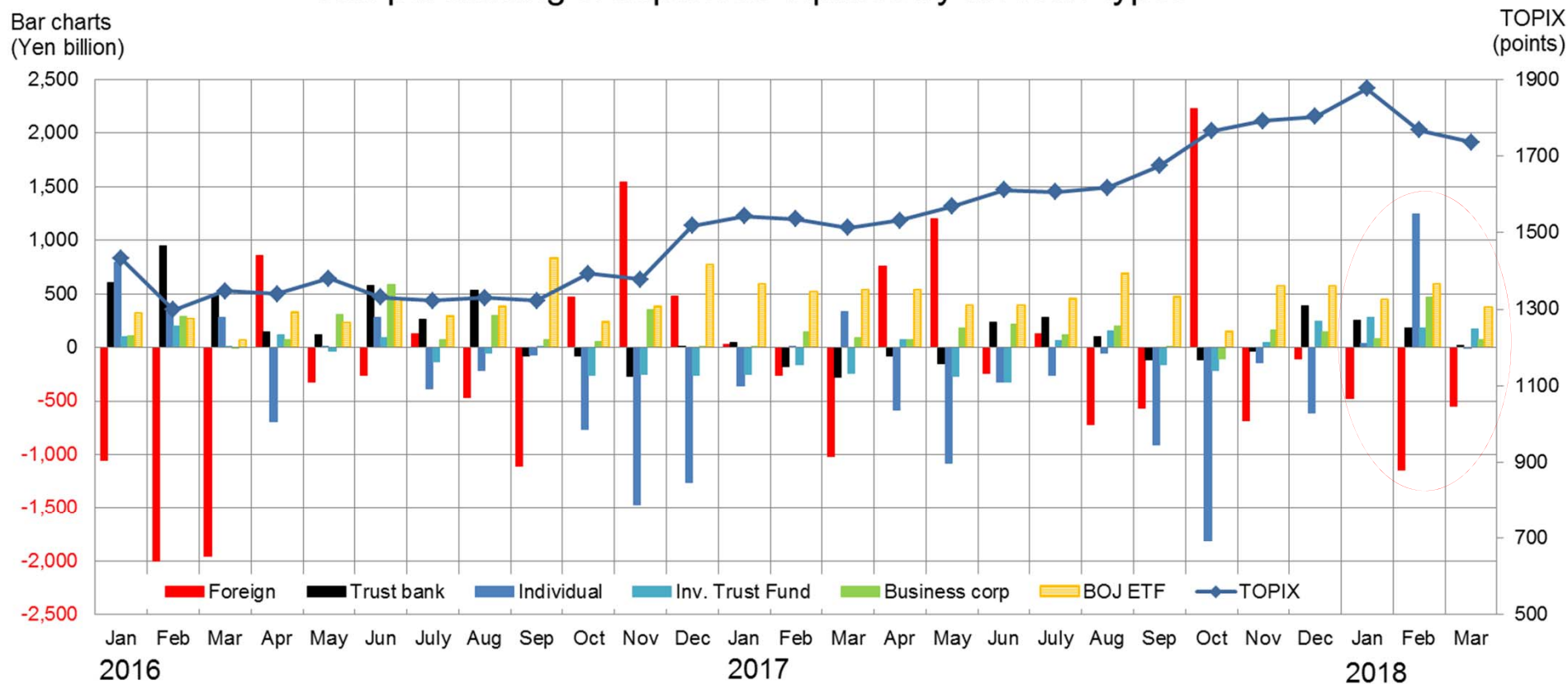
- 12M EPS growth forecast for Japan rose in February mainly due to tax cuts effects on companies having large business operation in US. The forecast for US rose further.
- However, the EPS forecast of 6.6% for Japan is not appealing enough unless it is further up-revised.
- PER has fallen to a historical average for Japan, which looks reasonably attractive in global comparison, lower than US and Europe.



Domestic investors kept purchasing so far this year

- Purchasing buy investment trust funds was robust JPY 1,248 billion in February absorbing sales by foreign investors. Increasing presence of individual investors is very positive for the Japanese stock markets in the long-term.

Net purchasing of Japanese equities by investor types



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to Mar.16th 2018.
BOJ ETF figure is officially released data from BOJ.
(Source) Japan Exchange Group, Bank of Japan

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