



Japanese Stock Market Outlook

SMAM monthly comments & views
-March 2019-



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

SMAM cut GDP forecast for FY2018 and FY2019 by 0.2% and 0.3% respectively due mainly to weaker global economic growth as a presumption considering recent weak exports, especially to China and Asia. Japanese economy is forecast to keep moderate growth going into FY2020.

- Multiple labor reforming legislations begin in April this year such as stricter overtime ceiling and enabling high skilled professionals to be rewarded on achievements rather than hours worked. Foreign workers acceptance also increases in order for filling labor shortage. Labor reform has a big potential for energizing Japanese economy even with an aging population, since Japan is quite poor in labor productivity in the global league and has a large room for improvement.
- Inflation in CPI is forecast to come down in 2019. Price cut in mobile telecom services scheduled in April has as much as -0.2 % impact. Receding YoY impact of energy price increase also has large effect.

➤ Japanese Stock Markets

Rebound in Japanese stock market has so far lagged US market due to downward revision on corporate earnings, for which China related businesses were hit hard. If businesses in China resume capital investments after the US-China deal, upside for the Japanese stock market could be lifted.

- Earnings announcements for Oct-Dec 2018 quarter are almost complete. Conservative looking self-guidance by companies for FY2018 were revised downward even further, and FY 2018 net profit for TOPIX companies are predicted to fall by around 4% from the preceding fiscal year. Business slowdown in China was unexpectedly severe.
- Foreign investors keep selling Japanese equities, however, the pace of selling seems to be moderating. Japanese companies have been buying back own shares.

Notes: Macro and market views are as of 25th Feb. 2019, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY18-20

- SMAM slightly cut GDP forecast for FY2018 and FY2019 by 0.2% and 0.3% respectively due mainly to weaker global economic growth as a presumption considering recent weak exports, especially to China and Asia.
- Japanese economy is forecast to keep moderate growth going into FY2020.

(YoY %)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Real GDP growth	1.3%	0.9%	1.9%	0.5%	0.5%	0.6%
Private Consumption Expenditure	0.7%	0.0%	1.1%	0.6%	0.5%	0.4%
Private Housing Investment	3.7%	6.3%	-0.7%	-4.6%	0.6%	-3.2%
Private Capital Investment	1.6%	-0.5%	4.6%	3.2%	1.5%	0.5%
Public Consumption Expenditure	1.9%	0.7%	0.4%	1.0%	1.2%	0.8%
Public Capital Investment	-1.6%	0.6%	0.5%	-3.5%	1.0%	0.8%
Net Exports (contrib. to GDP growth)	0.1%	0.8%	0.4%	-0.3%	-0.2%	0.1%
Exports	0.8%	3.6%	6.4%	1.3%	-0.2%	1.6%
Imports	0.4%	-0.9%	4.0%	2.8%	1.0%	0.8%
Nominal GDP	2.8%	0.7%	2.0%	0.4%	1.3%	1.4%
GDP Deflator	1.5%	-0.2%	0.1%	-0.1%	0.8%	0.8%
Industrial Production	-0.6%	0.8%	2.9%	0.6%	1.0%	1.1%
CPI (excl. fresh food)	-0.1%	-0.2%	0.7%	0.8%	0.2%	0.3%

Notes: E=SMAM forecasts. SMAM views are as of 25th Feb. 2019 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

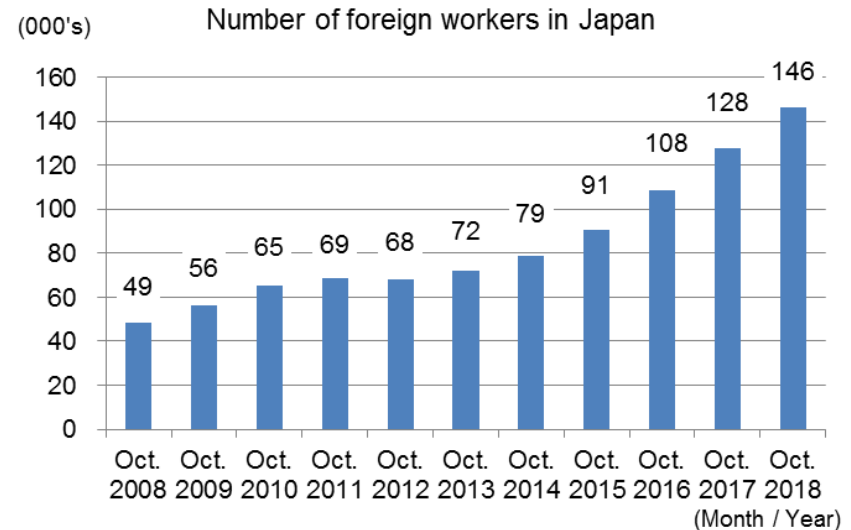
Labor reforming legislations start from April 2019

- Labor reform has a big potential for energizing Japanese economy even with an aging population. According to OECD statistics, Japanese labor productivity in terms of “GDP per hour worked” is very low. Japan is the lowest among G7 countries and its productivity is 65% of the US and 87% of the OECD total. Looking from the other side, Japan has a huge potential if labor efficiency can be improved.
- Multiple labor reforming legislations begin in April this year such as stricter overtime ceiling and enabling high skilled professionals to be rewarded on achievements rather than hours worked. Foreign workers acceptance also increases in order for filling labor shortage.

Labor productivity global ranking (GDP per hour worked)

Ranking	Country	2017 (US dollar, 2010 constant prices)
1	Ireland	85.9
2	Norway	80.7
3	Luxembourg	79.5
6	United States	64.1
7	Netherlands	63.0
9	Germany	60.5
10	France	59.8
11	Switzerland	59.2
15	United Kingdom	53.5
16	Australia	52.4
17	Canada	49.8
18	Italy	47.9
19	Spain	47.5
20	Japan	41.9
23	Turkey	38.1
24	New Zealand	37.1
29	Korea	34.3
31	Greece	32.8
36	Mexico	18.8
	G7	56.5
	OECD - Total	48.2

(Source) OECD

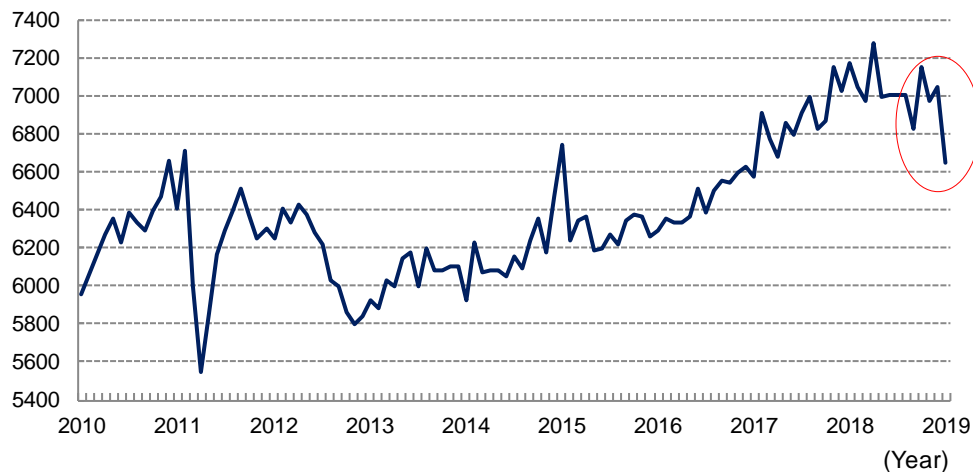


(Source) Ministry of Health, Labour and Welfare

Export to China and Asia fell sharply in January 2019

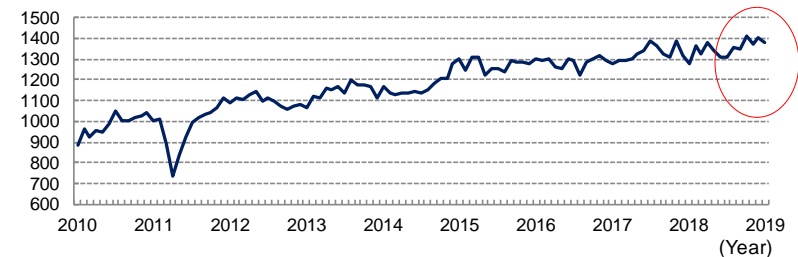
- Growth momentum of Japanese exports has weakened since 2018, for which exports to China and other Asian countries are showing large decline meanwhile exports to US is showing resilience. January number might be distorted just before Chinese lunar new year in early February, however, this weakness causes a concern.

Total export volume
(seasonally adjusted, yen billion)

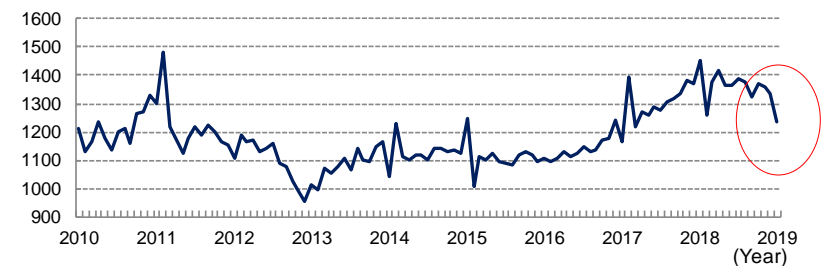


Note: Data is from Jan. 2010 to Jan. 2019.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

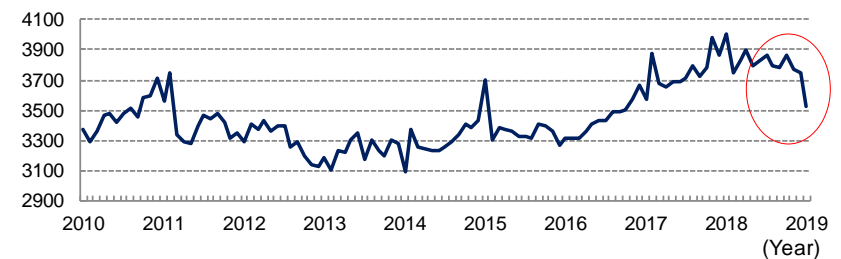
U.S.A.



China



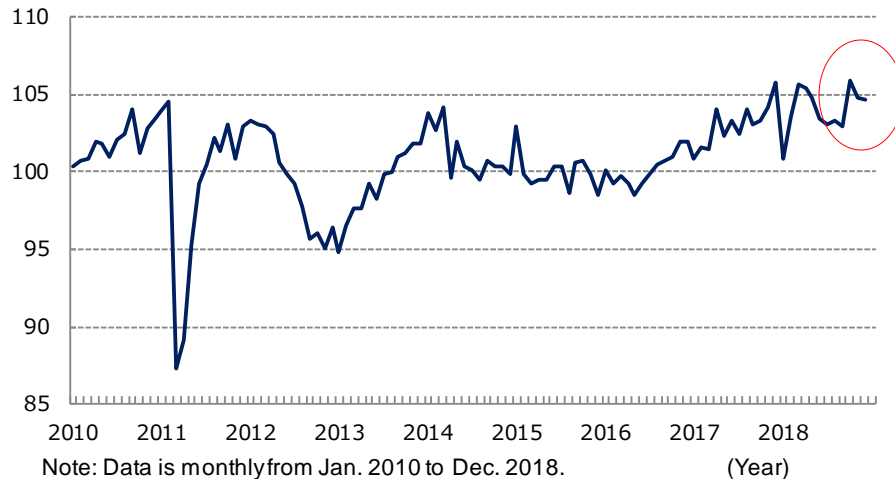
Asia ex. China



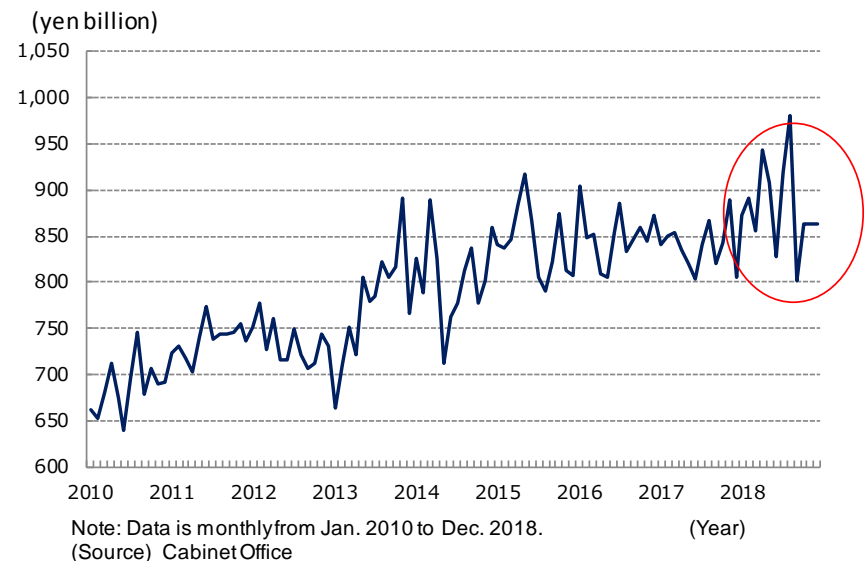
Industrial production stays rather strong, however, decline in machinery orders poses a concern

- Industrial production shows resilience despite weakening exports.
- Recently released machinery orders statistics for December 2018 stayed at low level. Japanese businesses might be getting cautious on capital expenditures.

Industrial production
(Indexed, 2015=100, seasonally adjusted)

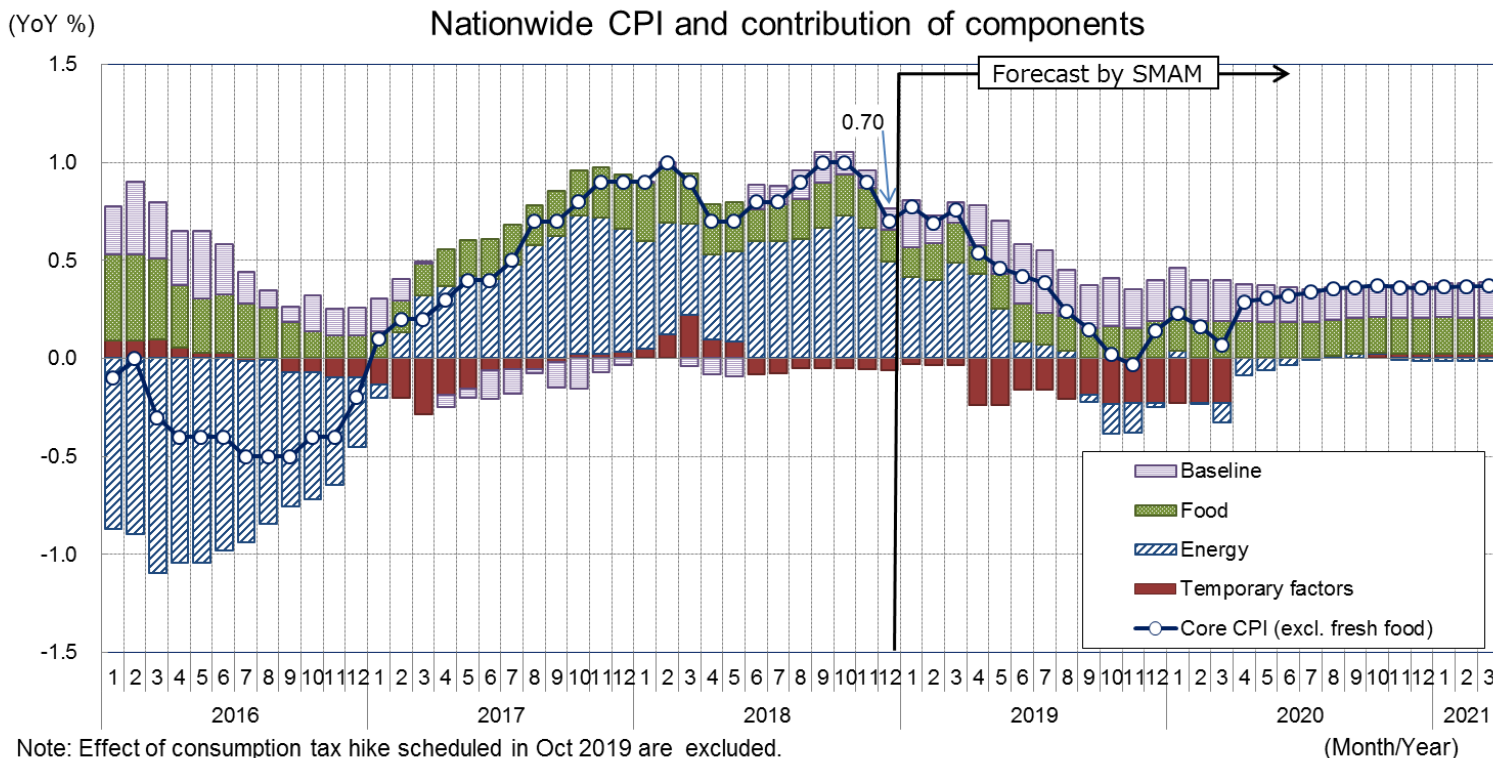


Machinery orders
(excluding orders from Shipping & Electric power industries)



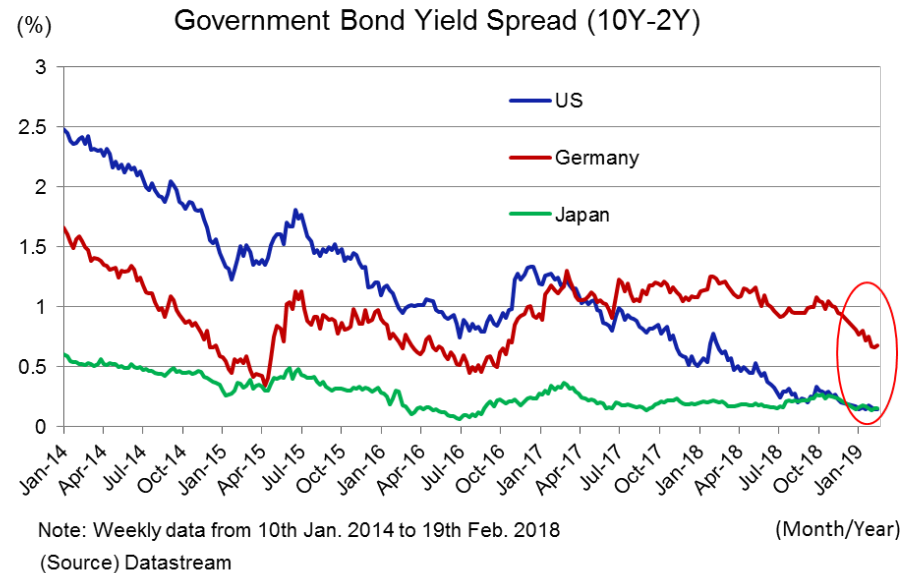
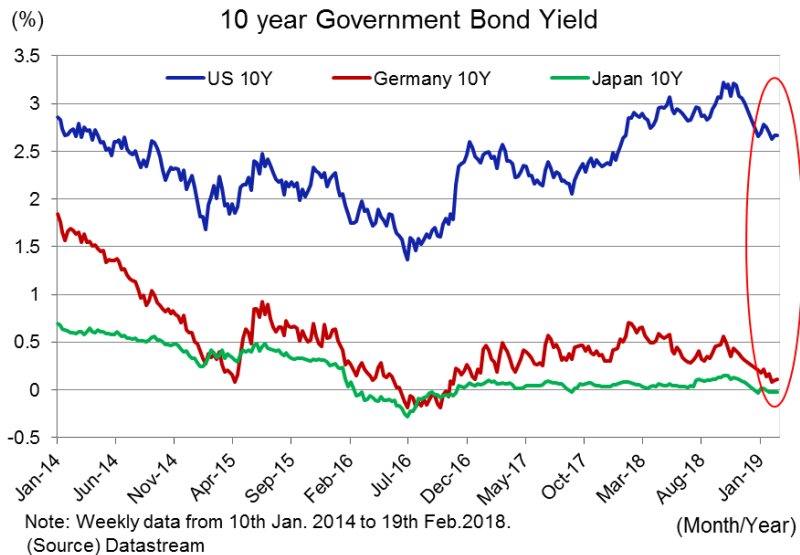
Inflation is forecast to stay very mild

- Inflation in CPI is forecast to come down in 2019. Price cut in mobile telecom services scheduled in April has as much as -0.2 % impact. Receding YoY impact of energy price increase also has large effect. Headline CPI is going to be inflated by consumption tax increase by 2% in October, however, when this tax effect is excluded, CPI is forecast to touch zero % level in late 2019.



Global long term bond yields continued to decline

- FRB in US has dramatically changed its monetary policy stance and stopped tightening.
- Global economy slowed down further bringing interest rates lower. Yield on Japanese 10Y government bond became negative.



US-China negotiation and Brexit seem as influential events

- US-China trade negotiation is progressing. Further tariff increase will be postponed and US president Trump will meet Chinese leader Xi-Jinping.
- Turmoil surrounding Brexit is causing companies to decide streamlining UK operations. Honda announced that it is going to close car manufacturing factory in Swindon.
- In Japan, important elections are scheduled in April and in July. Nation-wide voting for local elections is in April and Upper House Election is held in July. PM Abe's government will take an extra care to keep Japanese economy going in order for avoiding any possible setback in these elections.

Upcoming key events

Month	Region/Country	Events	Notes
2019 March	US-China	1 Deadline for US tariff increase on China=> to be postponed	
		Trump is going to meet Xi-Jinping in late March	
	US	19-20 FOMC meeting	
	China	5 National People's Congress	China sets policies for 2019.
	UK & EU	29 UK is going to exit EU.	
April	Japan	1 New labor legislations begin. Stricter control of overtime working, high skilled professional exemption and widening foreign workers acceptance.	
		7, 21 Nation-wide voting for local elections.	
May	Japan	1 Prince Naruhito becomes the new emperor. Japanese calendar is set for renewal.	Positive economic effect is expected from celebratory atmosphere and calendar renewal.
	US-Japan	26 US president Trump is going to visit Japan to be the first foreign leader to meet the new emperor.	Diplomatic agenda to be discussed.
	US	18 Limit for deciding US action on car tariffs	
June	US	18-19 FOMC meeting	
	Global	28-29 G20 top meeting in Osaka, which PM Abe chairs	
July	Japan	Upper house election	
October	Japan	1 Consumption Tax is scheduled to rise from 8% to 10% Rakuten begins mobile carrier business as the 4th company in Japan	
2020 Jul-Aug	Japan	Tokyo Olympic Games	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

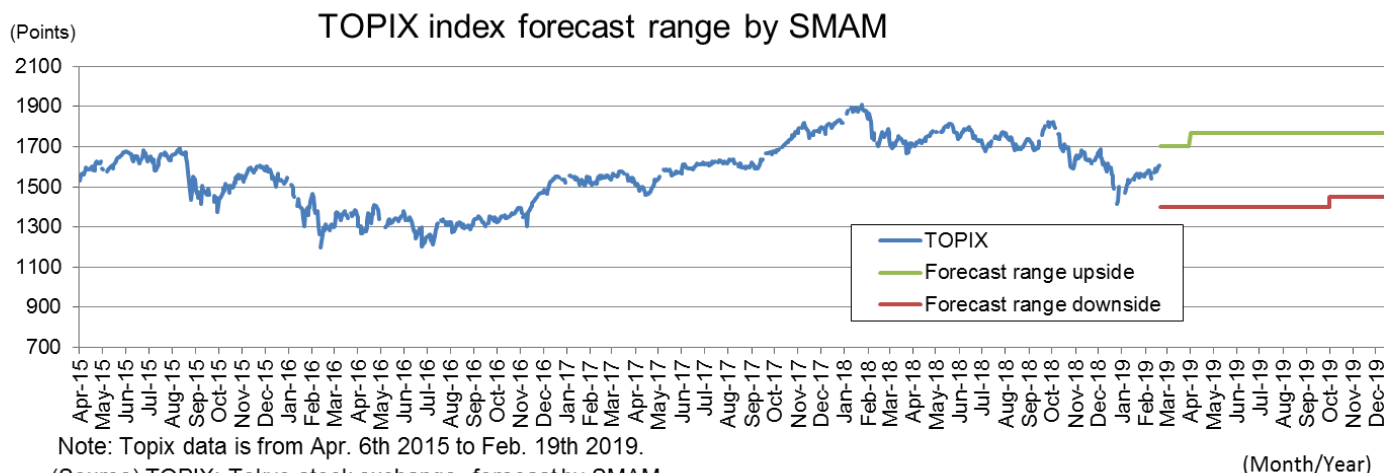
Stock market outlook: Focus is on US-China negotiation and whether it can stop deterioration of economic growth

SMAM short-term view

- Global stock markets has rebounded on a positive expectation of progressing US-China negotiation. Further tariff increase by US on imports from China will be avoided. Focal point will be whether on-going slowdown in global economic growth can be stopped and turned-around. Rebound in Japanese stock market has so far lagged US market due to downward revision on corporate earnings, for which China related businesses were hit hard. If businesses in China resume capital investments after the US-China deal, upside for the Japanese stock market could be lifted.

Longer-term outlook (6-months and beyond)

- SMAM's main scenario for the global economy expects that US economy keeps growing in 2019 despite slight slowdown. Increasing fiscal spending on infrastructure can be expected in China, Japan and US, which could extend the current global economic expansion phase. US-China trade dispute moderates, however, struggles in technology field goes on. Current low stock valuation has room to be adjusted upward if global economic growth gains strength again.



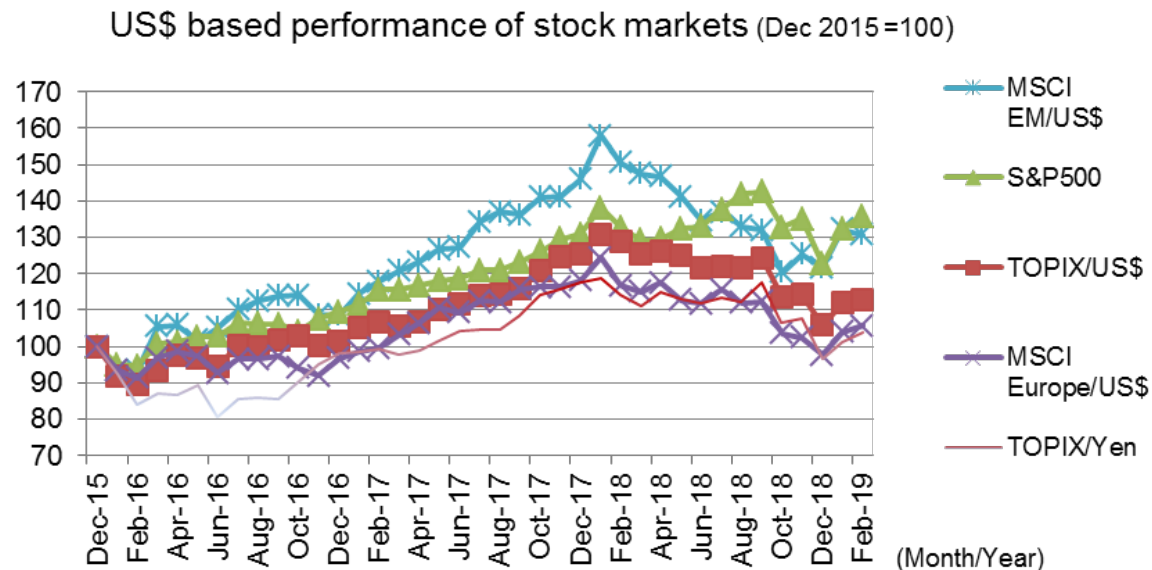
Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Severe tensions between US and China goes on, however, US is going to avoid making a fatal blow for the global economy.
 - US economy keeps growing despite possible mild slowdown. Recession in 2019 is avoided.
 - Japan's private consumption grows mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - Tension in the East Asia or Middle East does not get out of control.
 - Central banks avoid killing economic growth and adjust the pace of monetary normalization.
- **Upside Risks** include:
 - China makes significant concession in the trade negotiation with US.
 - Stronger-than-expected global growth.
 - Denuclearization in Korean peninsula makes a visible progress.
 - Japanese economy gets stronger than expected boosted by large fiscal spending.
- **Downside Risks** include:
 - US economy significantly slows down and puts global economy into a recession.
 - Chinese economy falls into a significant slowdown spreading negative shock globally.
 - Trade negotiation between US and China completely breaks up igniting a decades of power struggle.
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Global monetary tightening intensifies to choke global economy.
 - Political turmoil flares up in US over the impeachment of the President Trump.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of 25th Feb. 2019 and subject to updates without notice.

Recovery in global stock market continues

- US market is leading the recovery of the global stock market.
- FRB's monetary policy change and also increasing hope for the easing of tension between US and China are main supporting factors behind.
- Japanese stock market is lagging in this time's recovery so far. Downward revision on corporate earnings is currently going on, for which slowdown in Chinese economy is making negative impact.

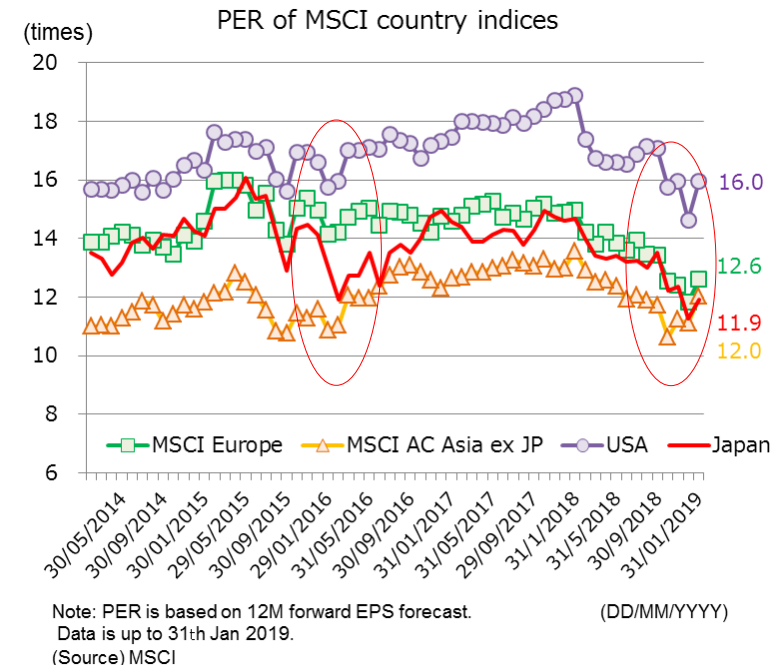
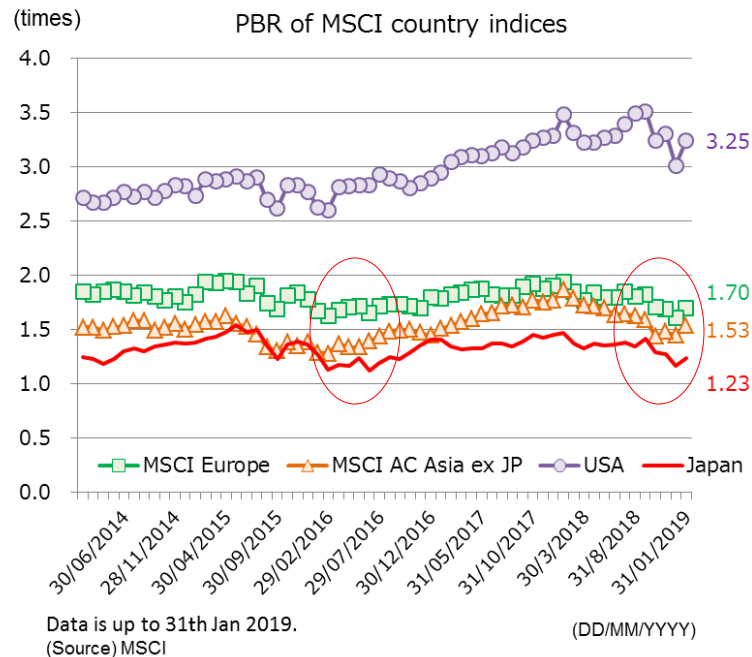


Notes: Data is up to 19th Feb. 2019.

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

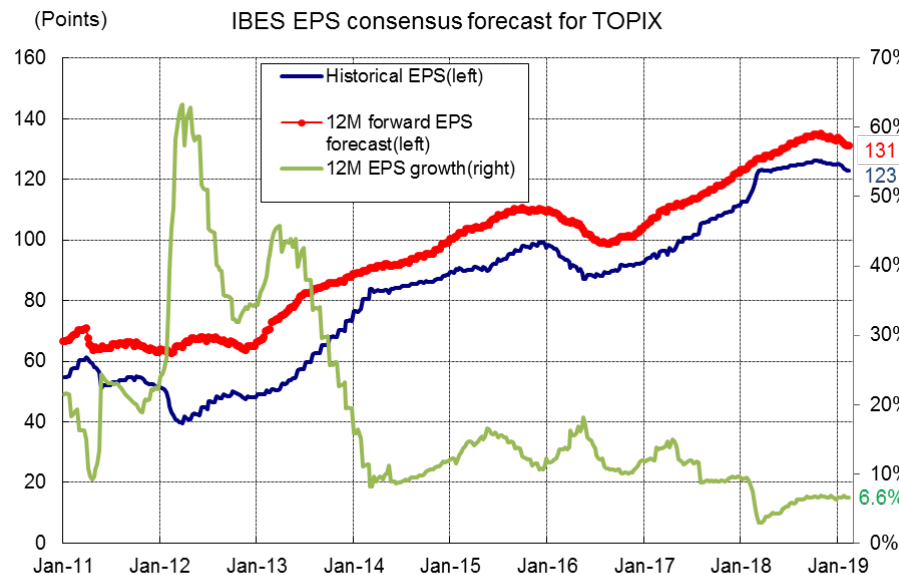
Valuation has come down to similar levels as experienced in the previous downturn in 2016

- Stock valuation has come down to the levels previously experienced in 2016 when slowdown in Chinese economy made negative impact on the global economy.
- Admitting the fact that global economic expansion has got more matured since the last downturn, if Chinese economy can make a positive turnaround this time again, further upside in the stock valuation can be expected.



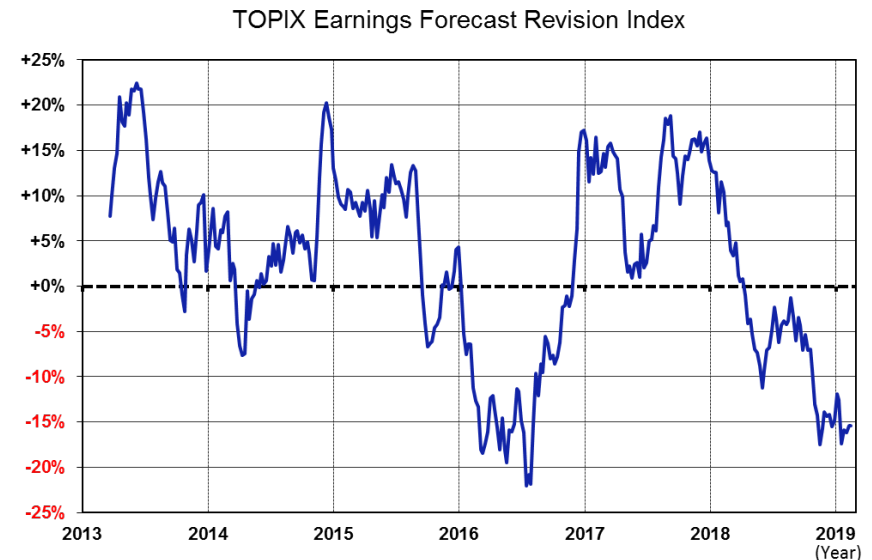
Downward revision continues for Japanese corporate earnings forecast

- Downward earnings forecast revision is continuing for Japanese equity. Similarity can be found between the down-revision in 2016 and the one this time in terms of period and depth. Deteriorating Chinese economy was in the background of the both occasions.
- Earnings announcements for Oct-Dec 2018 quarter are almost complete. Conservative looking self-guidance by companies for FY2018 were revised downward even further, and FY 2018 net profit for TOPIX companies are predicted to fall by around 4% from the preceding fiscal year. Business slowdown in China was unexpectedly severe.



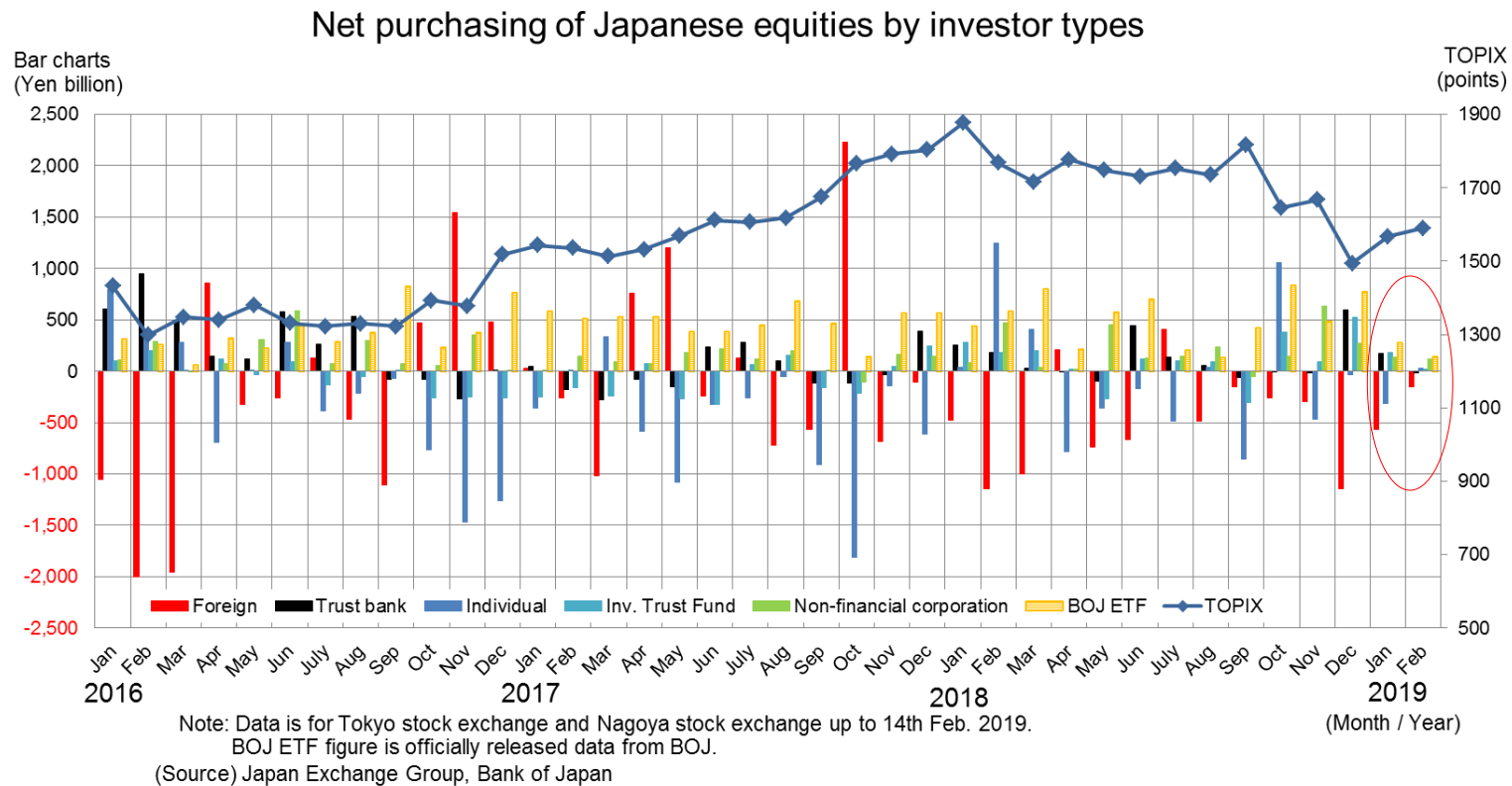
Note: Weekly data from 6th Jan. 2011 to 14th Feb. 2019. (Month/Year)

(Source) Datastream, IBES



Foreign investors' selling seems to be moderating

- Foreign investors keep selling Japanese equities, however, the pace of selling seems to be moderating.
- Japanese companies have been buying back own shares.



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