



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-December 2021-



Outlook for Japanese Stock Market

Market Outlook

- We expect the Japanese equity market to continue on its bullish trend towards FY 2022 thanks to accelerating earnings growth and economic recovery.
- Our price targets for the end of CY 2022 are 2,200 in TOPIX and 31,600 in Nikkei 225.
- TOPIX EPS could rebound by 40+% YOY in FY 2021 to 131 points, a historical high, and to 141 points in FY 2022.
- Though investors are concerned about the bottle neck in the global supply chain and the slowing Chinese economy, caused by excessive real estate investment, non-performing loans and the electricity shortage, in the short term, we expect the market will be back to an upward trend after confirming sound fundamentals of the global economy towards next year.

TOPIX Forecast – steady outlook going forward



Note: TOPIX data is from Jan. 1st 2016 to Nov. 19th 2021
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

(Year/Month)

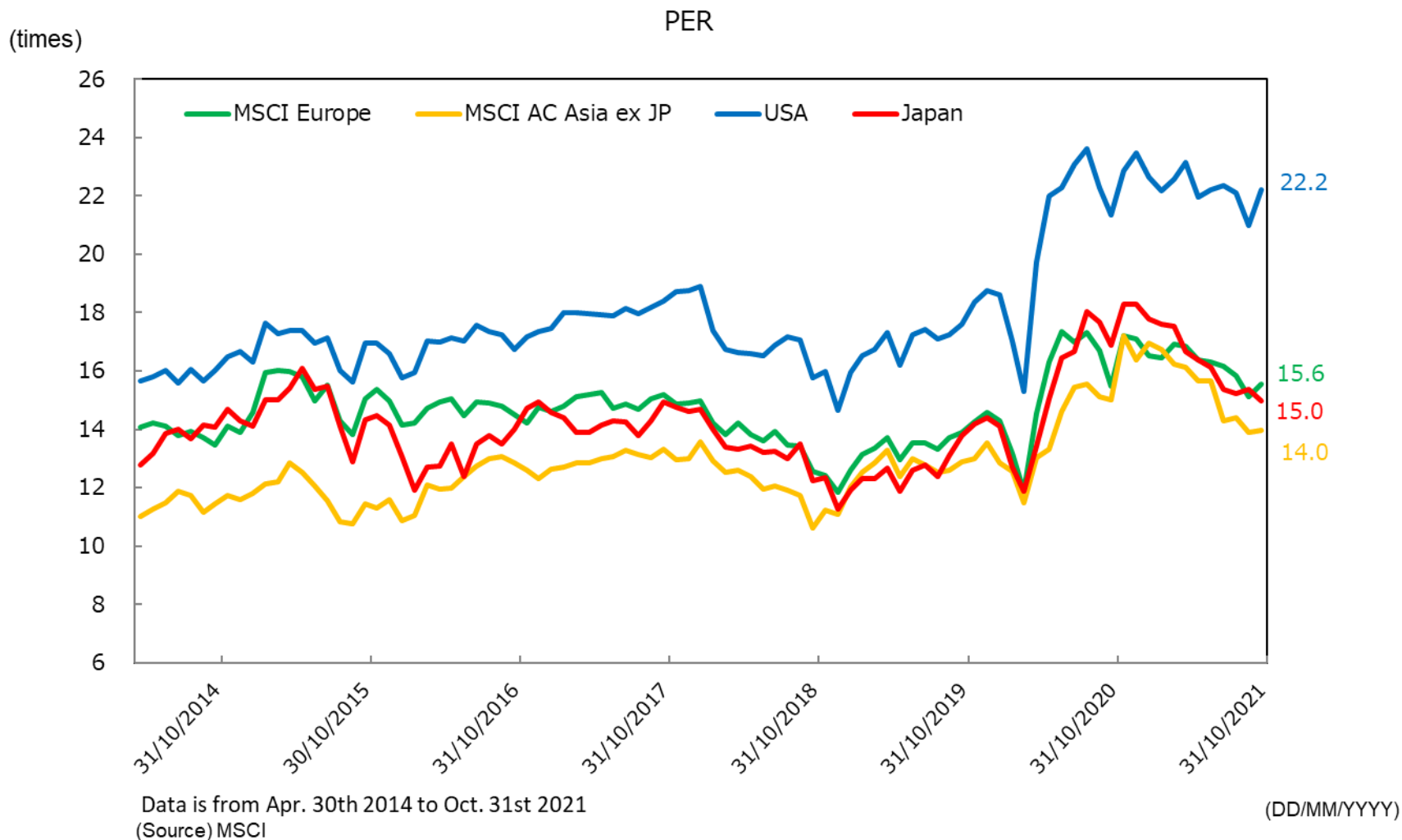
■ Upside Risks

- Rapid normalization of global economy thanks to effective treatment for COVID-19 patients, including COVID-19 pill and antibody cocktail treatment
- Early recovery of in-bound travel activities

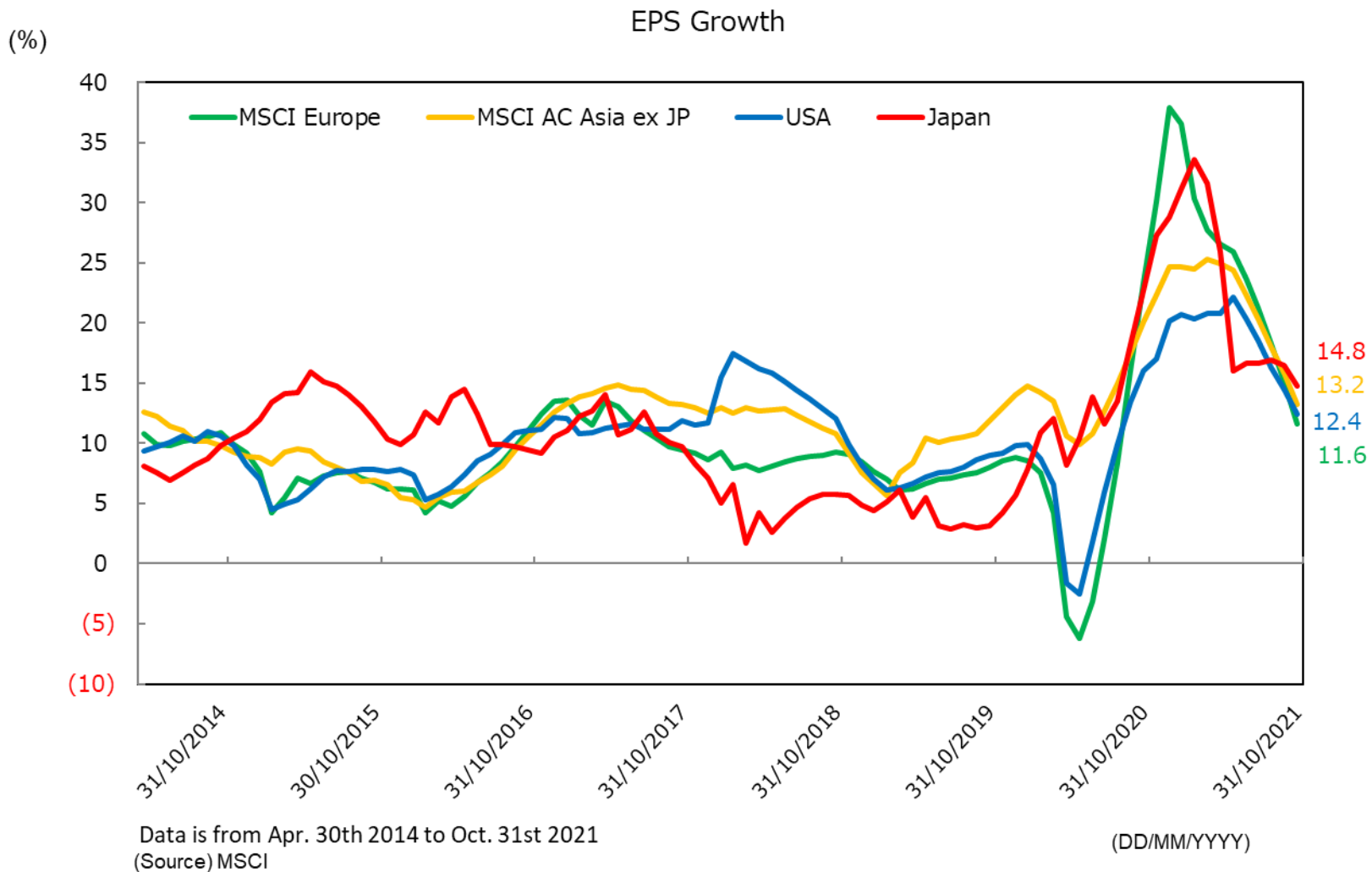
■ Downside Risks

- Delay of normalization of domestic economy due to the spread of COVID-19
- Further deterioration of the bottle neck in the global supply chain
- Concern about stagflation

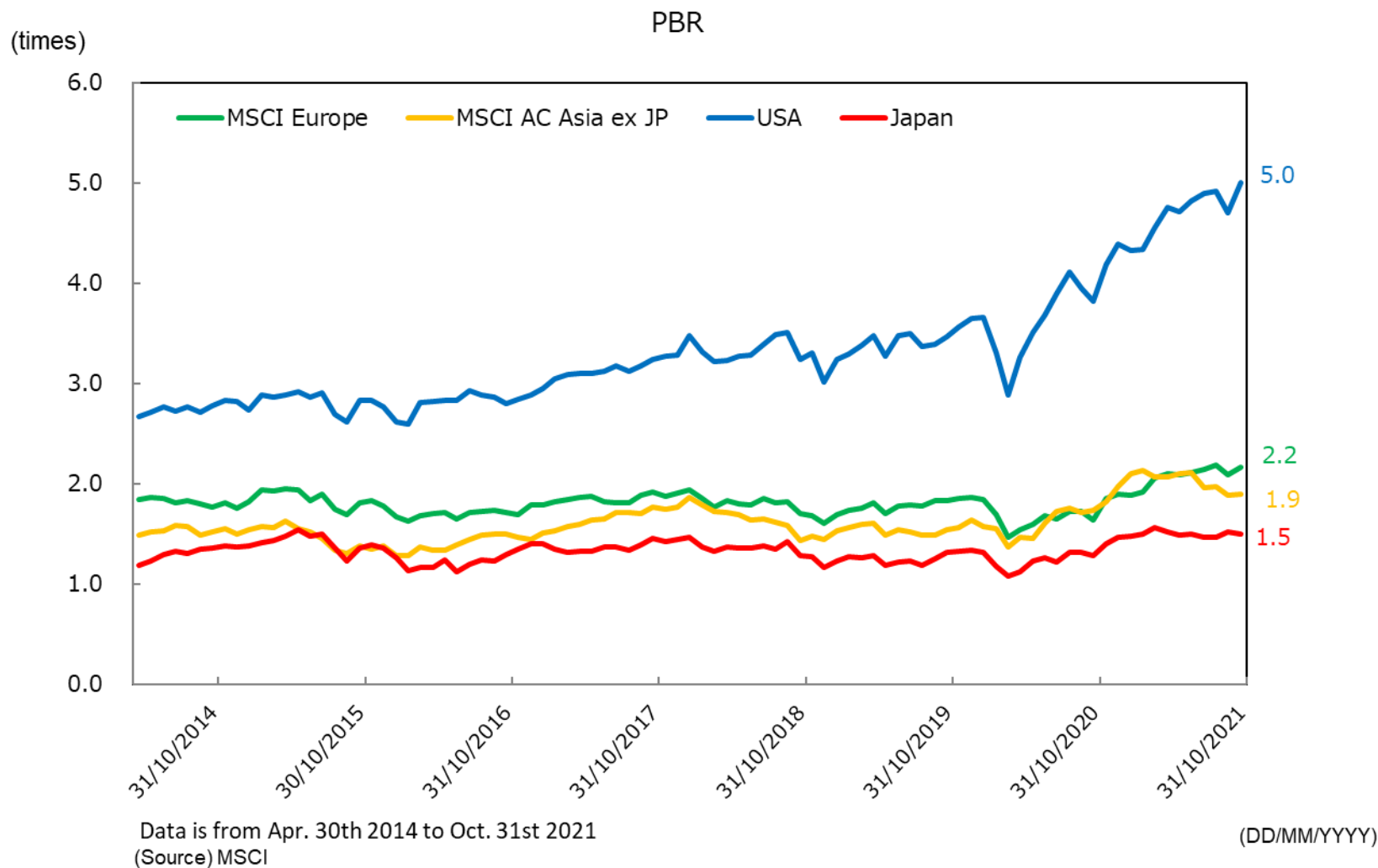
Earnings recovery brings PER back to normal range



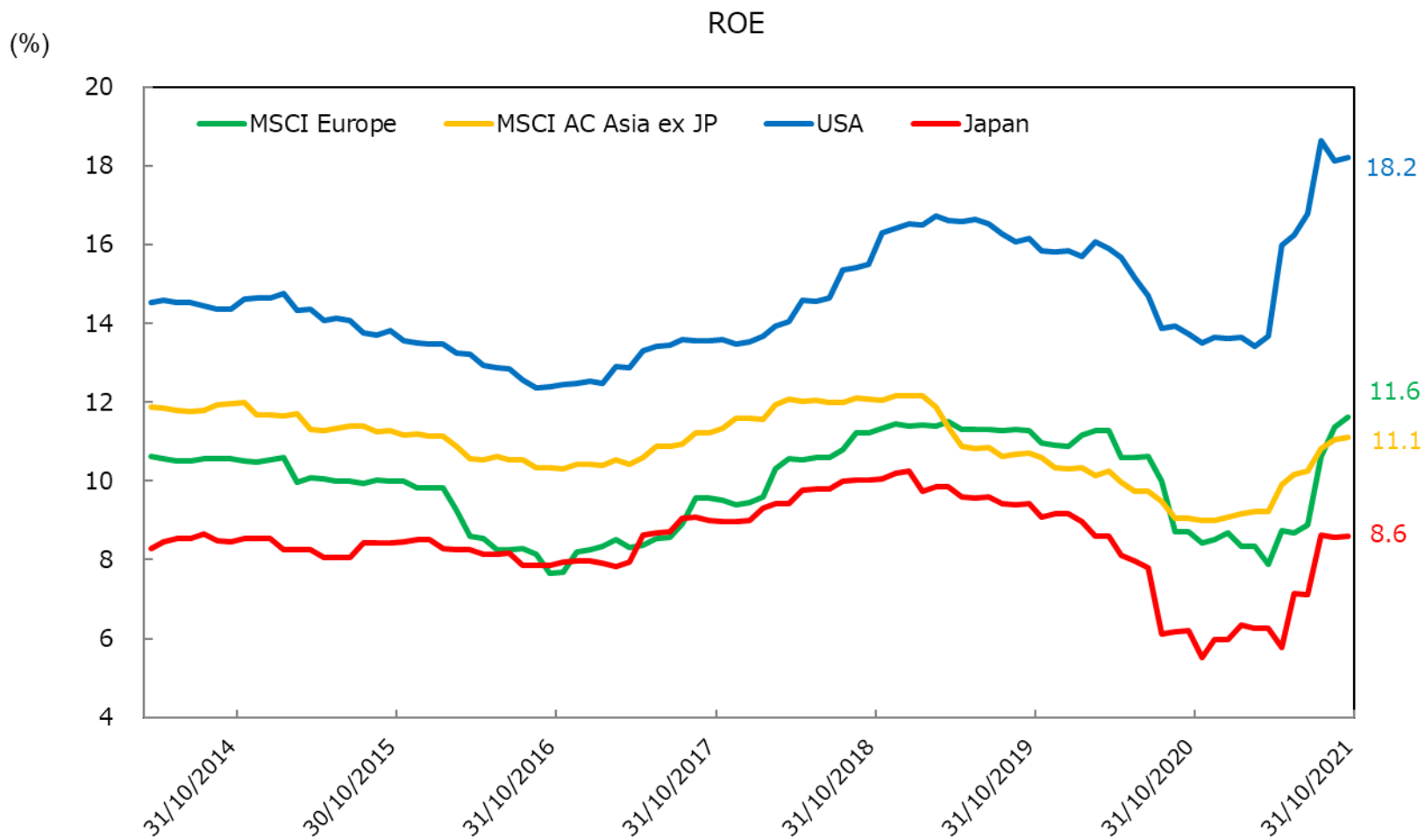
EPS growth rate back to normal after big swing



PBR – mind the gap between US and others



Japan's ROE – recovered but still lagging behind peers



Data is from Apr. 30th 2014 to Oct. 31st 2021
 (Source) MSCI

(DD/MM/YYYY)

Earnings results continue to beat street consensus

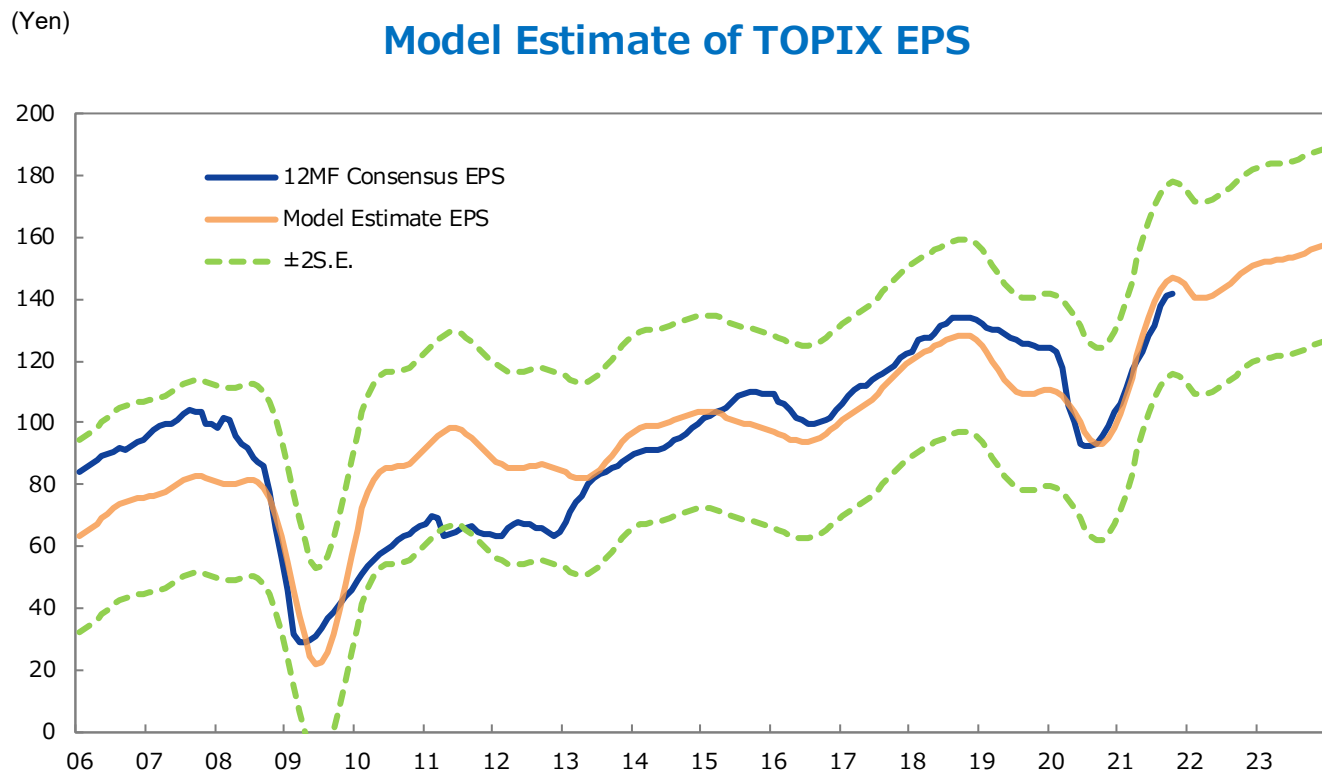
TOPIX Revision Index



Data is from Jan. 1st 2016 to Nov. 8th 2021
(Source) Datastream, IBES

(YY/MM)

Quants model suggests brighter outlook of EPS

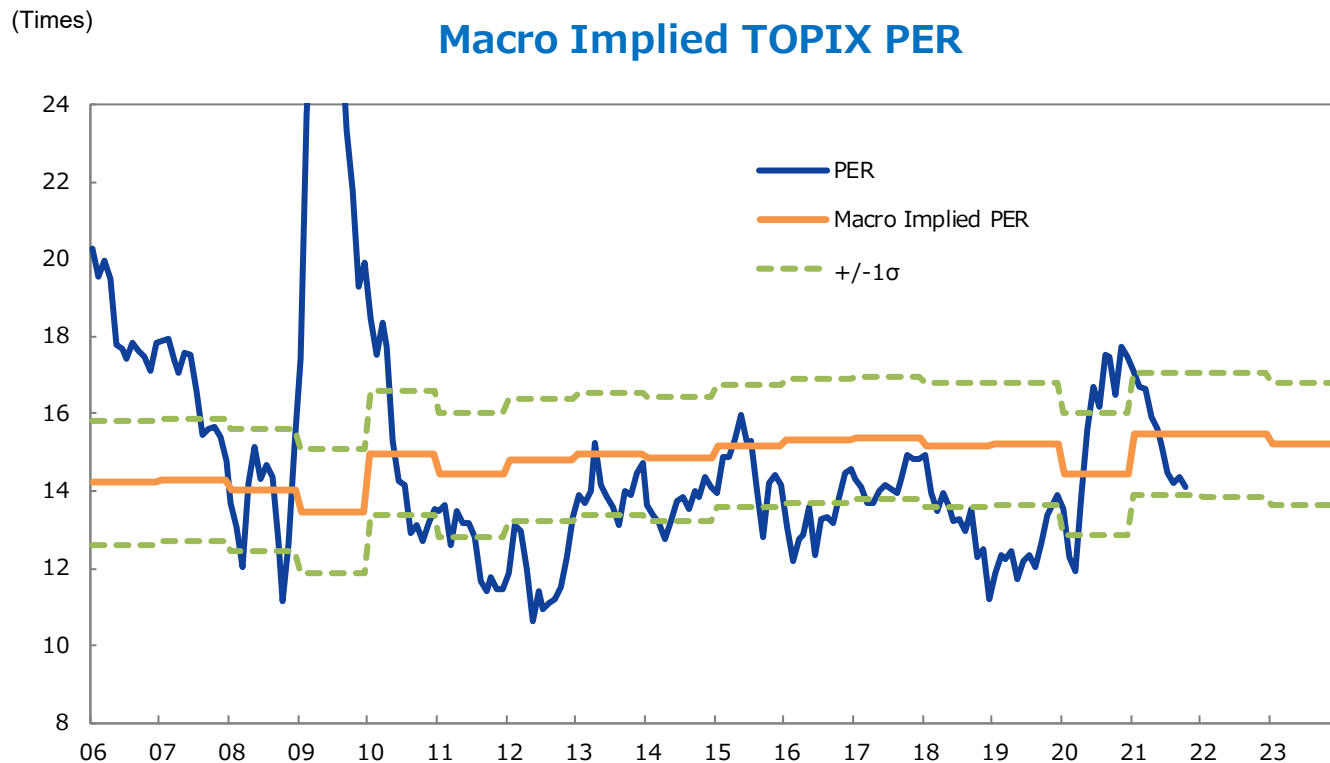


Consensus data is from Jan. 2006 to Oct. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Quants model indicates attractive valuation

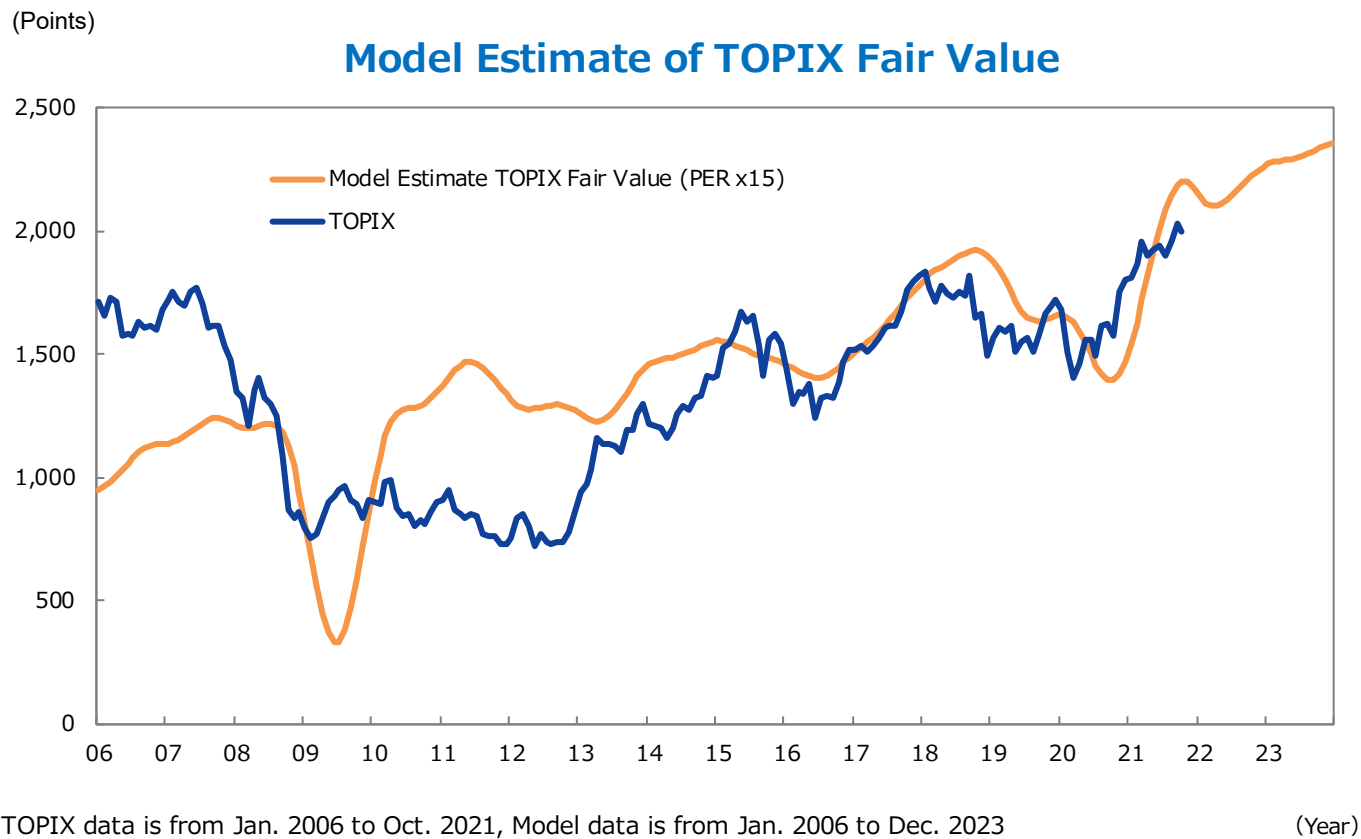


Consensus data is from Jan. 2006 to Oct. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Quants model illustrates bullish outlook for Tokyo stocks



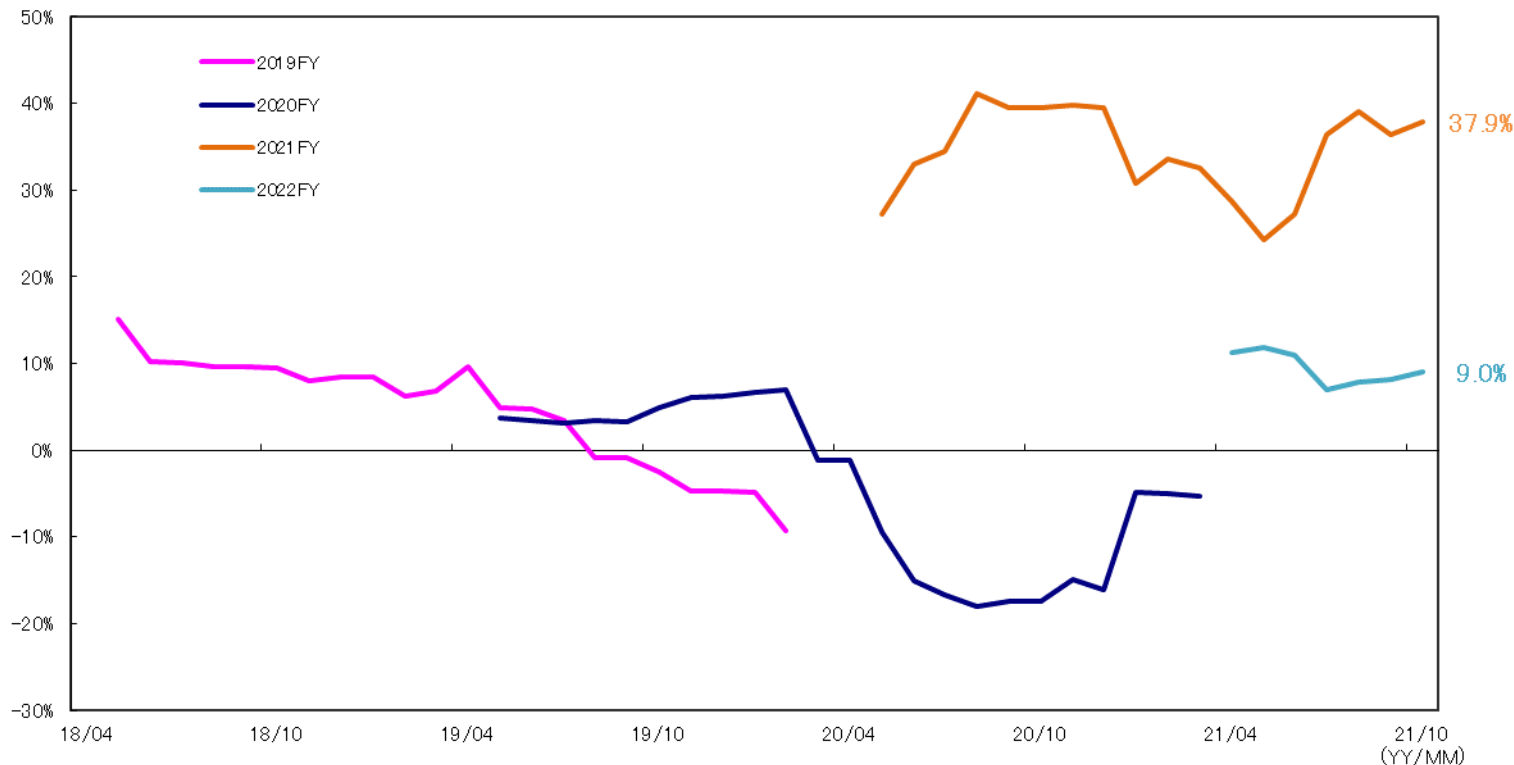
TOPIX data is from Jan. 2006 to Oct. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Bottom up estimate – profit growth back to normal next year

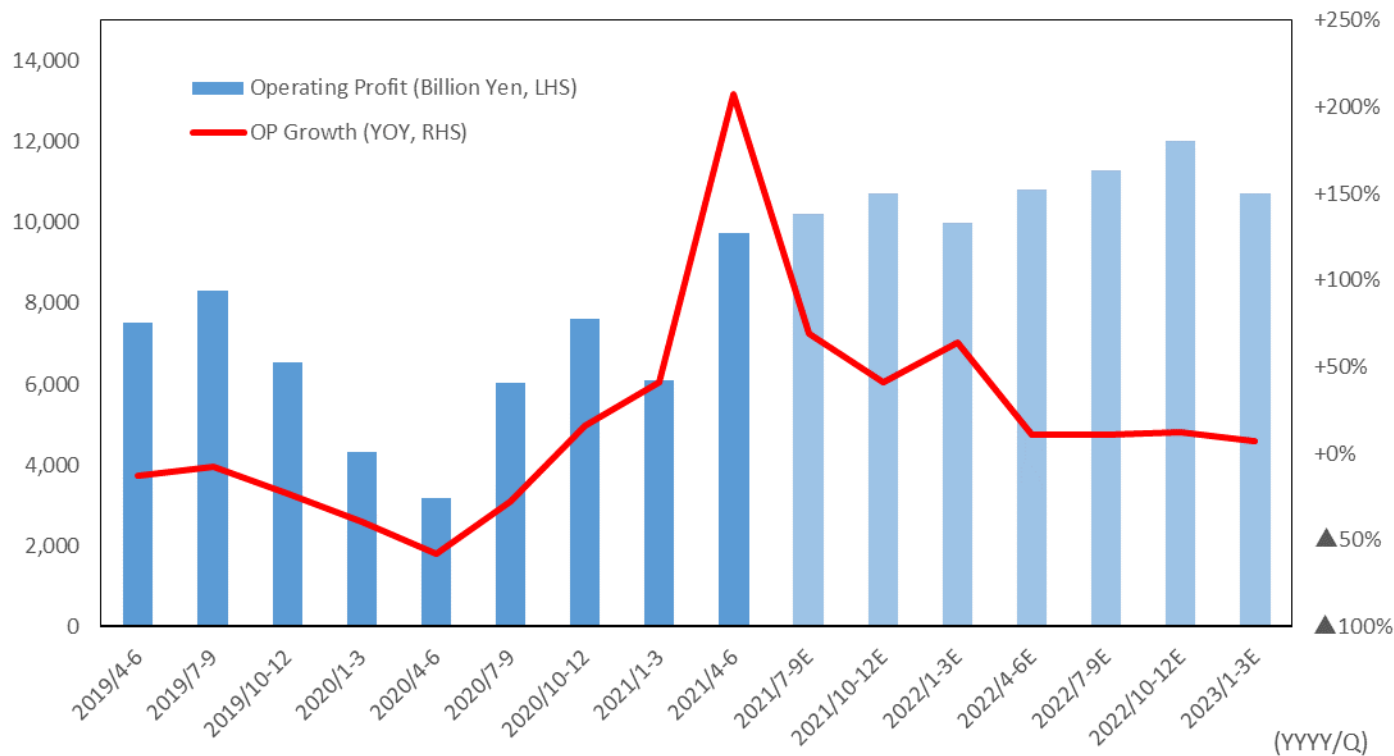
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of Nov. 11th 2021, SMDAM Core Universe (Excl. Financials) consists of 450 major Japanese companies covered by SMDAM in-house analysts.
 (Source) SMDAM

Bottom up estimate – steady outlook of operating profit

Operating Profit (All Industries Excl. Financials and Softbank Group)



(Source) SMDAM

Corporate culture – favorable changes for shareholders

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	204
Insurance companies	24
Pension funds	74
Others	12
Total	320

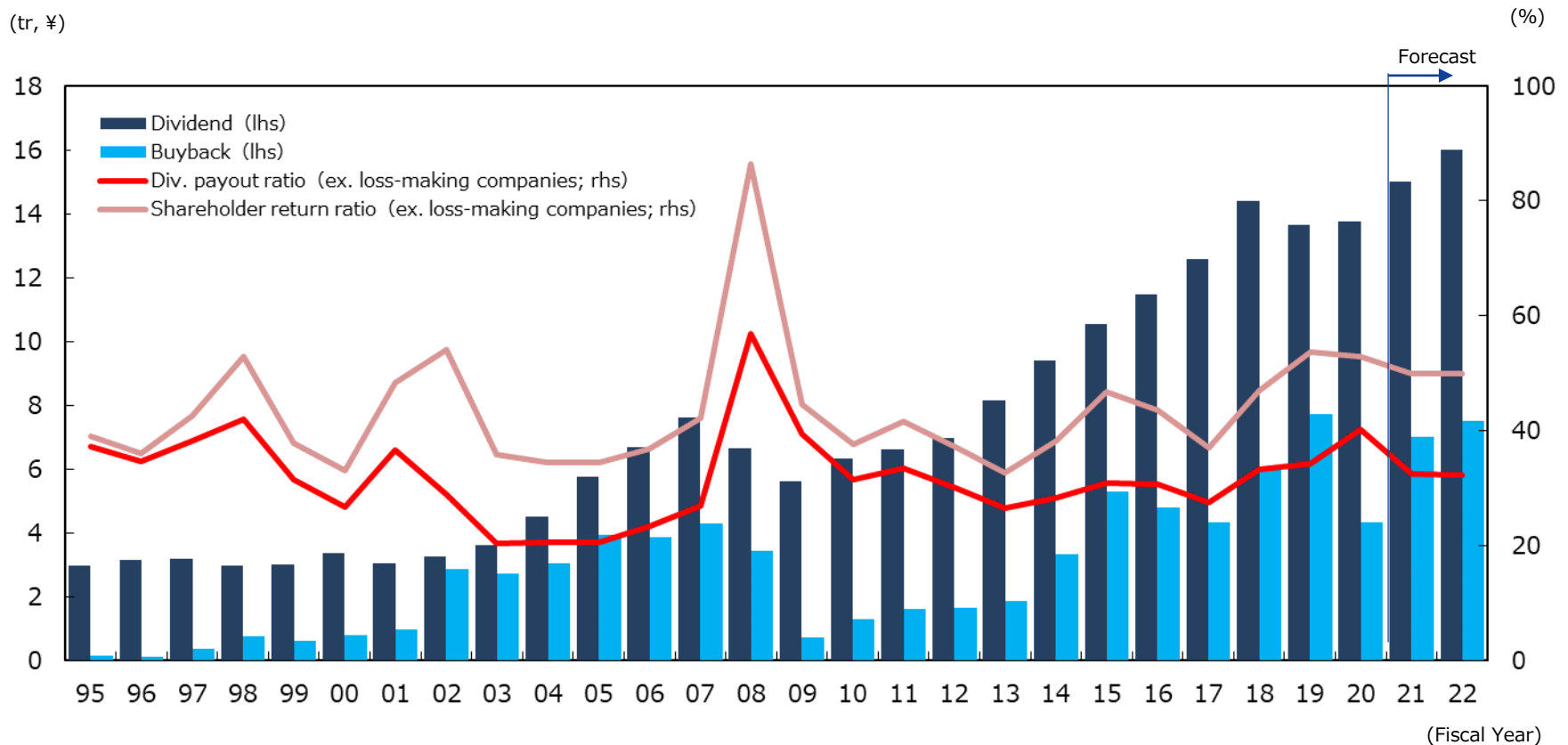
note: As of Oct. 31st 2021

(Source) FSA, SMDAM

- The Stewardship Code (SC) was set in February 2014. Investors are taking a more pro-active approach in talking to the companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors which have publicly accepted the SC.
- After the inception of the Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve their governance, efficiency and shareholder returns.
- These two codes have been progressively reviewed and enhanced, and are making visible impact on corporate behavior and investors' attitudes as shareholders.
- In a recent amendment of the CGC, companies are required to explain the rationale of "cross holdings" or "strategic holdings" of other companies' shares, which implicitly provide protection against takeovers and hostile shareholder actions, and is often negative for achieving shareholder value.
- The SC was reinforced in March 2020 to require investors to evaluate ESG factors.

Dividends and buybacks – increasing shareholders’ returns

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2022, FY2021 and FY2022 are forecasts from Toyo-Keizai for dividends and from Daiwa Securities for share buybacks.

Source: Toyo Keizai, Quick, and INDB compiled by Daiwa Securities

Winners and losers

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	6.21	7.05	13.09	18.82	20.84	26.41	44.38
Total Value	2.92	2.45	17.06	20.41	8.10	7.06	20.70
Top Cap Value	4.90	5.29	22.60	26.80	17.42	18.90	29.23
Large Cap Value	3.50	3.01	18.82	22.20	9.43	8.47	21.67
Mid Cap Value	1.76	0.21	14.29	16.73	-1.11	-5.14	11.34
Small Cap Value	0.14	-0.23	9.13	12.36	1.98	0.64	15.47
Micro Cap Value	1.38	2.06	8.34	11.68	0.84	2.02	19.89
Total Growth	10.00	12.49	9.12	17.06	32.97	46.94	70.21
Top Cap Growth	11.59	14.19	11.06	20.97	38.81	56.37	78.83
Large Cap Growth	10.13	12.66	9.11	17.54	35.02	49.91	71.89
Mid Cap Growth	7.69	10.09	5.88	11.98	28.87	39.93	61.13
Small Cap Growth	8.70	10.82	9.21	12.43	16.52	24.45	55.06
Micro Cap Growth	13.10	13.43	13.37	17.97	23.95	30.81	70.64
Top Cap Total	8.37	9.87	16.14	23.61	28.58	37.60	53.57
Large Cap Total	6.75	7.66	13.71	19.84	23.11	29.39	46.80
Mid Cap Total	4.41	4.53	10.26	14.66	15.52	18.10	37.33
Small Cap Total	2.78	3.12	9.17	12.45	7.70	9.74	30.18
Micro Cap Total	4.73	5.32	9.84	13.61	8.49	11.57	36.56

Note : As of Nov. 17th 2021
(Source) Bloomberg



Outlook for Japanese Economy

Summary of Japanese economic outlook

Current Status and Outlook of the Japanese Economy

[Current Status]

- The economy is coming back to the recovery trend. Despite negative factors such as the price hike of raw materials and the bottle neck in the global supply-chain, the economy has been lifted by consumer spending thanks to the progress of vaccinations and the lifting of coronavirus restrictions.

[Outlook]

- ① **We have revised down our real GDP growth forecast to +2.7% from +3.3% for FY 2021 and +2.6% from +2.9% for FY2022. We expect the economy will grow by 1.3% in FY 2023 in real terms.** Major reasons for the downward revision for FY 2021 and FY 2022 are negative growth in the second quarter affected by the COVID-19 delta variant and the bottle neck in the global supply-chain. We expect the economy will re-accelerate in the second half of FY 2021 thanks to easing restrictions on people's activities, progress in vaccinations, resolving the global supply-chain issues and the supplementary budget. From FY 2022, economic growth will slow down as the positive effects from these factors are expected to fade.
- ② **We have lowered our core CPI forecast to 0.0% from +0.1% for FY 2021, and +0.9% from +1.1% for FY 2022. We expect core CPI will be +1.3% in FY 2023.** The major reasons for the revision is a sharp decline in mobile phone charges. We expect the soaring cost of raw materials to fuel inflation in FY 2022.
- ③ **The current accommodative monetary policy of the BOJ will be maintained for the foreseeable future.**
- ④ **We expect new PM Kishida and his cabinet to maintain the existing policy mix, accommodative fiscal and monetary policy. A supplementary budget for FY 2021, of as much as 78.9 trillion yen, could boost the domestic economy in the near future.**

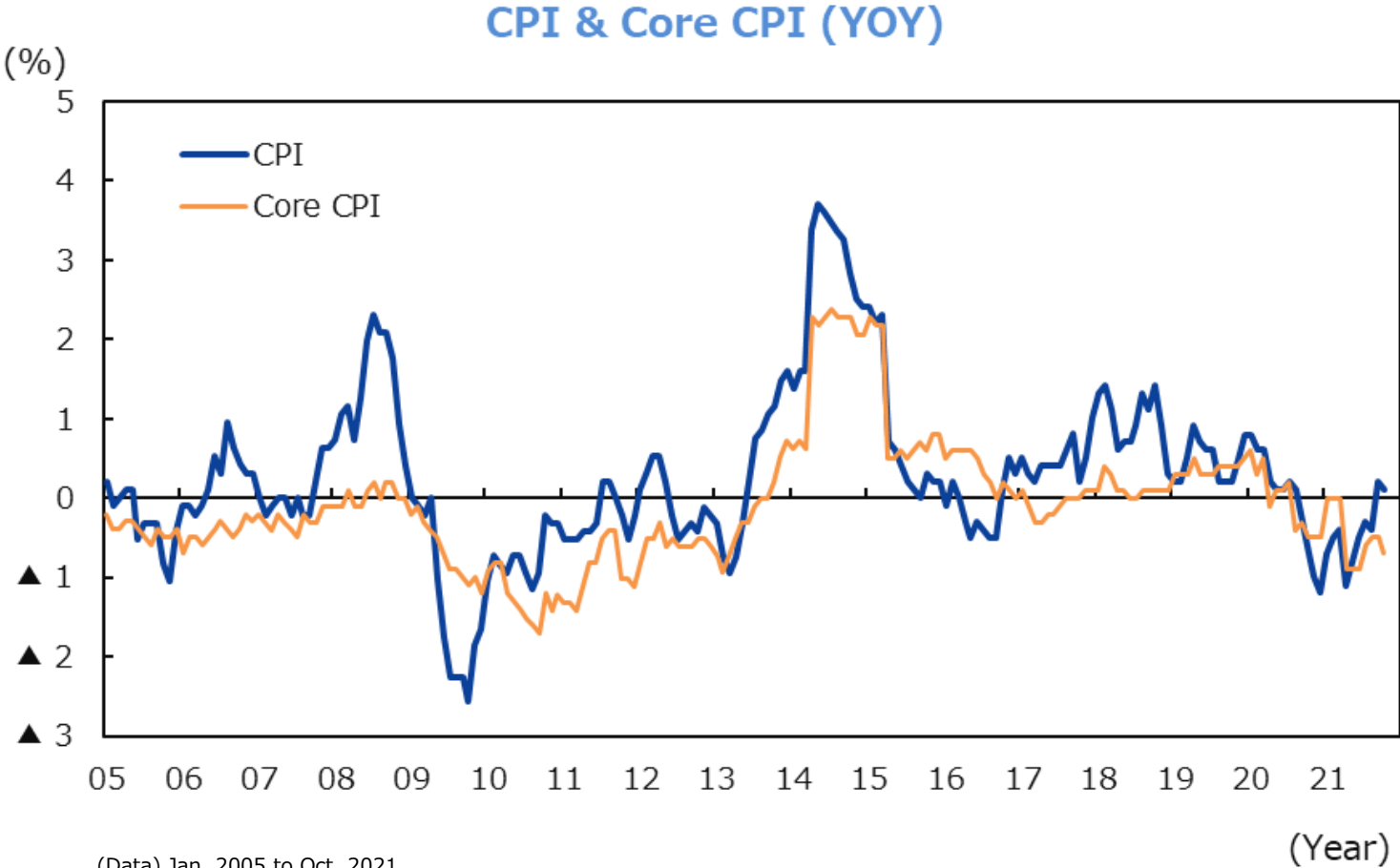
Forecast of Japanese economy

Forecast of Annual Real GDP Growth								
Fiscal Year	FY17	FY18	FY19	FY20	FY21 Est	FY22 Est	FY23 Est	
Real GDP	1.8%	0.2%	-0.5%	-4.4%	2.7%	2.6%	1.3%	
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.8%	2.5%	2.4%	1.0%	
Private housing investment	-1.8%	-4.9%	2.5%	-7.2%	-0.6%	0.1%	0.2%	
Private-sector capital investment	2.8%	1.0%	-0.6%	-6.9%	1.2%	3.8%	3.2%	
Public fixed capital formation	0.6%	0.8%	1.5%	4.2%	-3.3%	0.9%	0.2%	
Net export contribution	0.4%	-0.2%	-0.4%	-0.6%	0.8%	0.3%	0.0%	
Exports of goods and services	6.3%	2.0%	-2.2%	-10.4%	12.2%	4.8%	4.0%	
Imports of goods and services	3.8%	3.0%	0.2%	-6.8%	7.1%	3.4%	3.8%	
Nominal GDP	2.0%	0.1%	0.3%	-3.9%	1.8%	2.9%	1.8%	
GDP deflator	0.2%	-0.1%	0.9%	0.6%	-0.9%	0.2%	0.5%	
Industrial Production Index	2.9%	0.3%	-3.7%	-9.9%	6.8%	5.2%	2.8%	
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.0%	0.9%	0.6%	
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.4%	6.0%	1.2%	0.2%	
Employee compensation	2.0%	3.2%	2.0%	-2.0%	1.4%	1.7%	1.2%	
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.7%	2.6%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

(Note) Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

(Source) Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

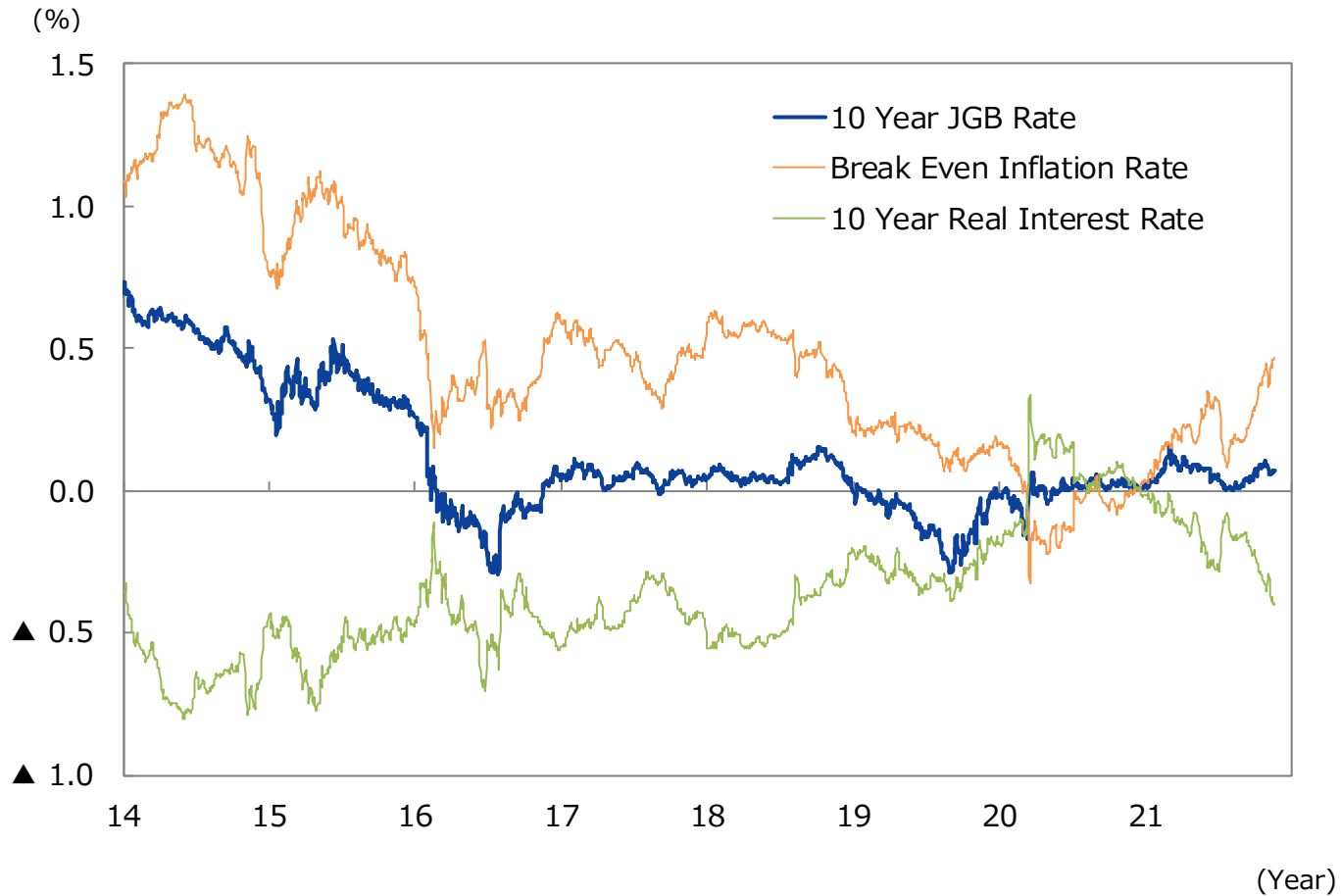
Deflation is still alive in Japan



(Data) Jan. 2005 to Oct. 2021
(Source) MIAC, Bloomberg, SMDAM

Inflation expectations take off?

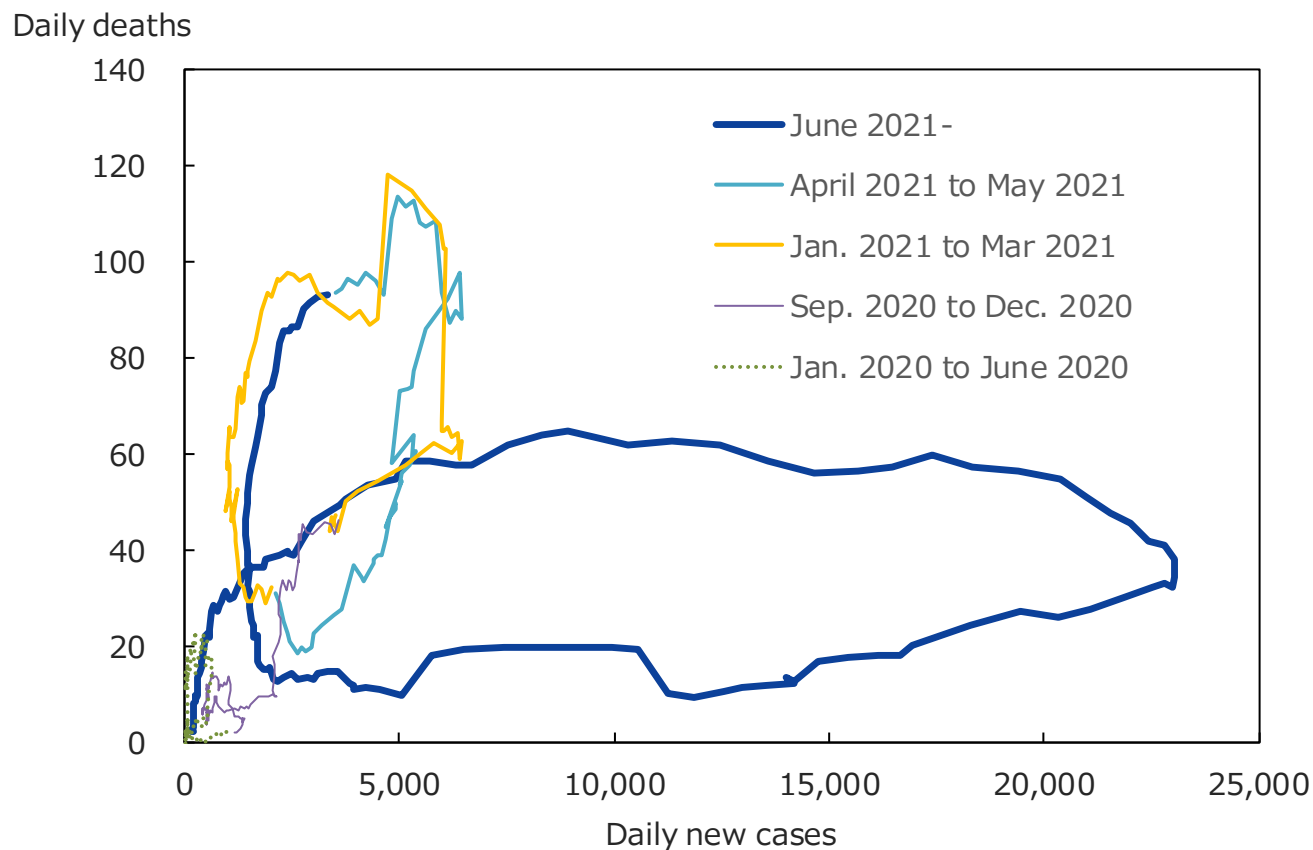
JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to Nov. 17th 2021
(Source) Bloomberg, SMDAM

Surprising decline of COVID-19 infections

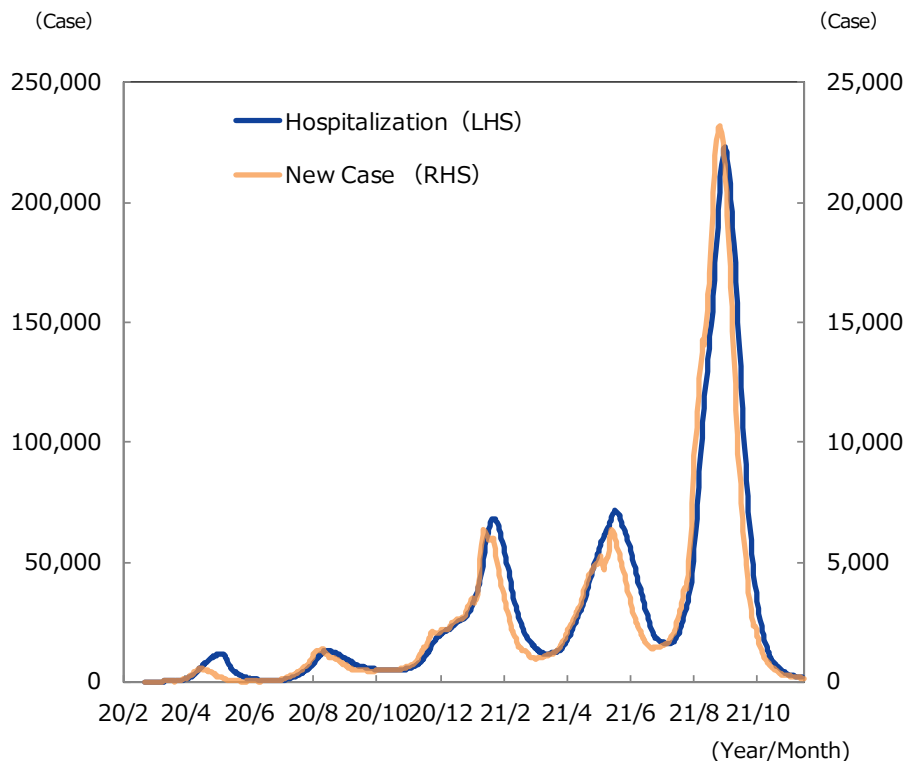
COVID-19 New patients and confirmed deaths



(Data) 7 days moving average, From Jan. 1st 2020 to Nov. 14th 2021
(Source) Bloomberg, SMDAM

Surprising decline of COVID-19 infections

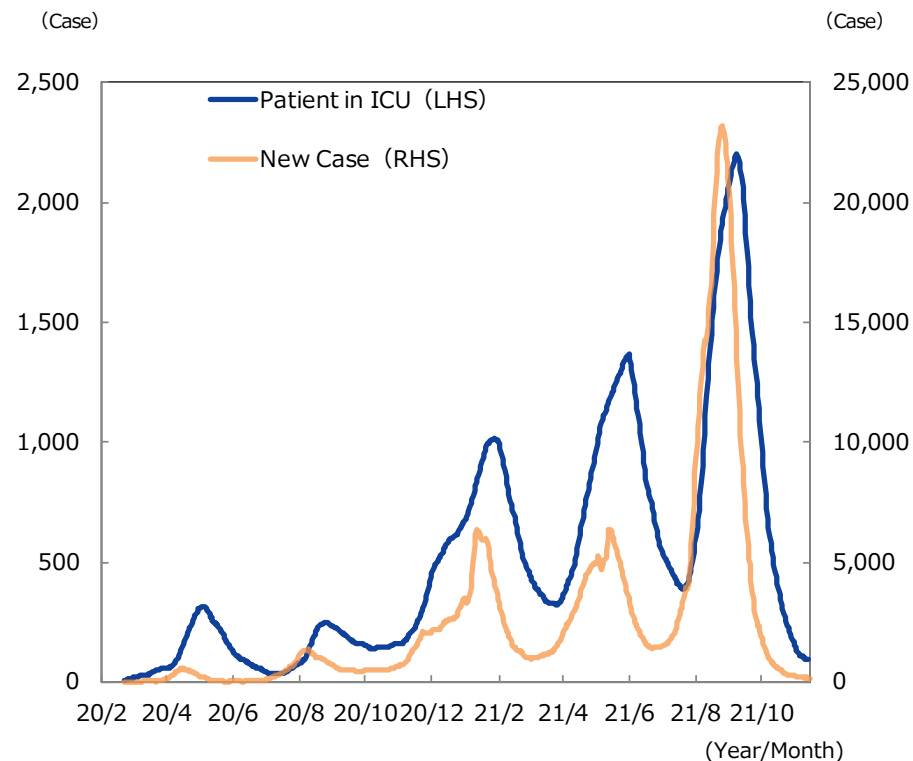
New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 1st 2020 to Nov. 14th 2021.

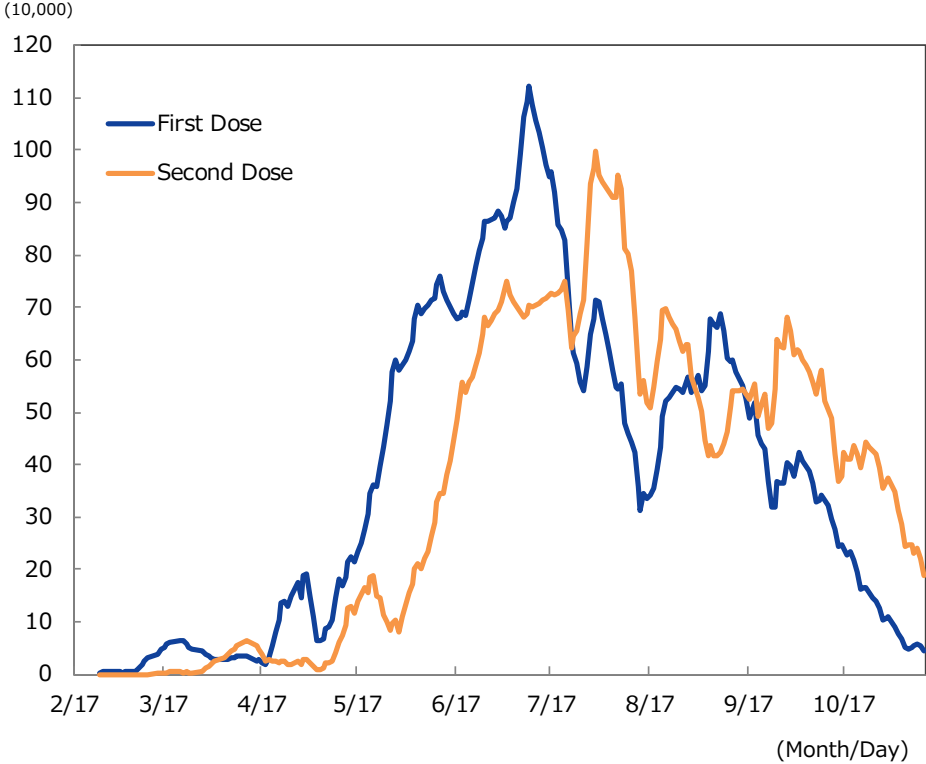
(Source) MHLW, NHK, SMDAM

New Cases and Patients in ICU

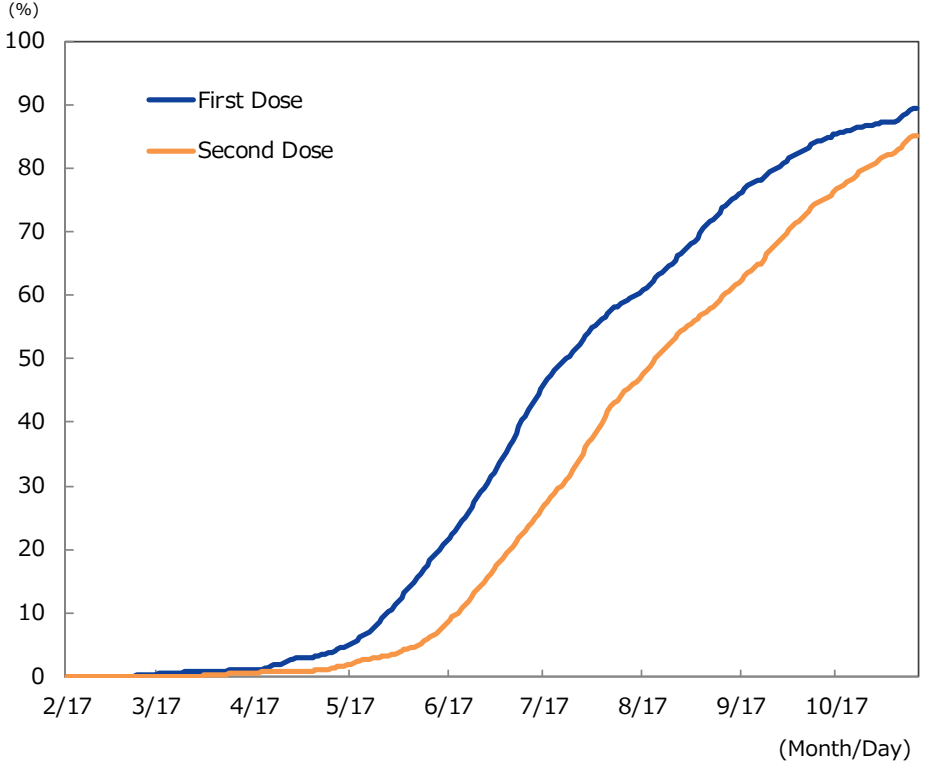


Rapid progress of COVID-19 vaccinations

Daily number of vaccinations



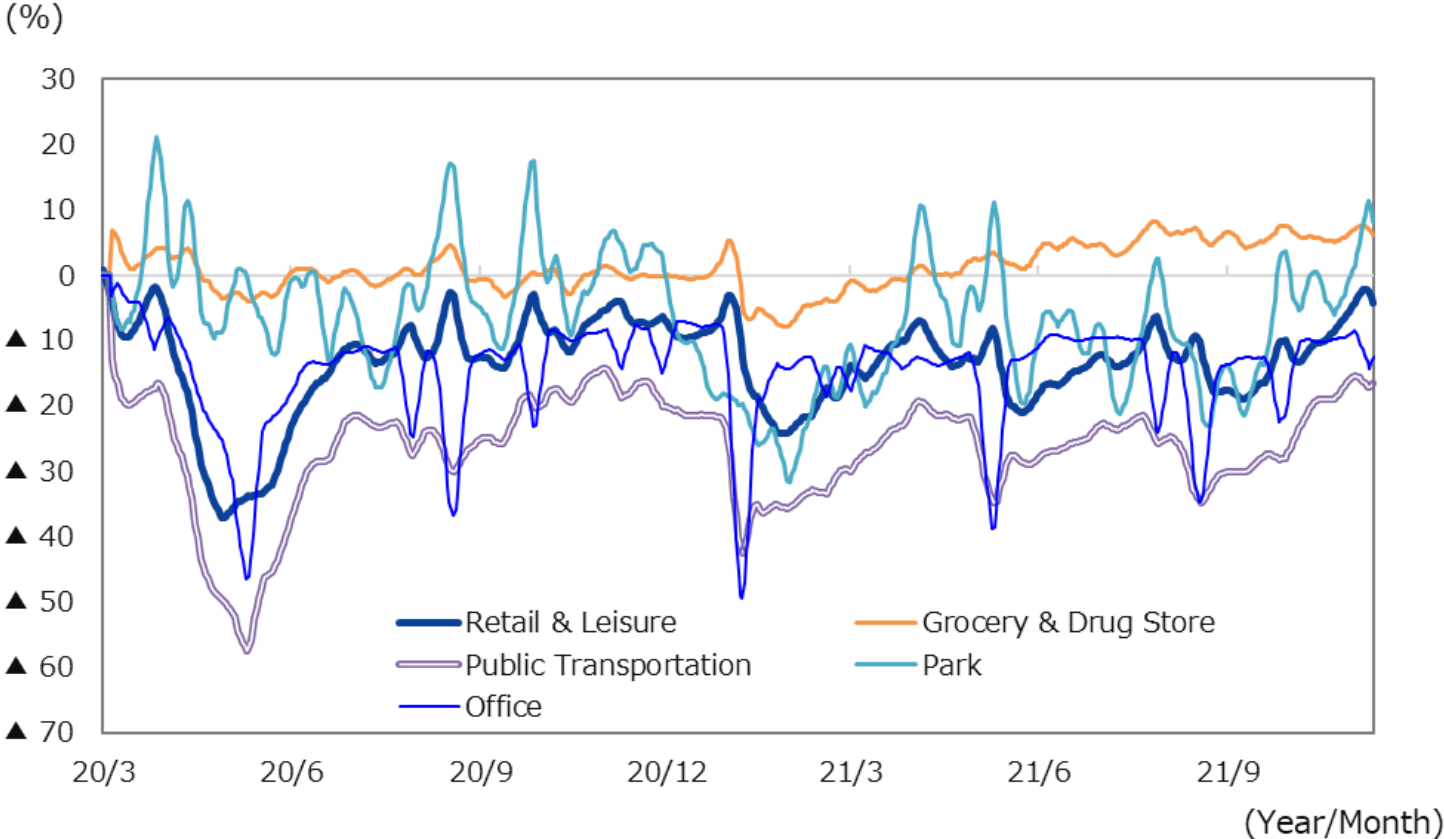
Total vaccination/ population ratio



(Data) From Feb. 17th 2021 to Nov. 11th 2021
(Source) MHLW, SMDAM

Mobility levels return except for public transport

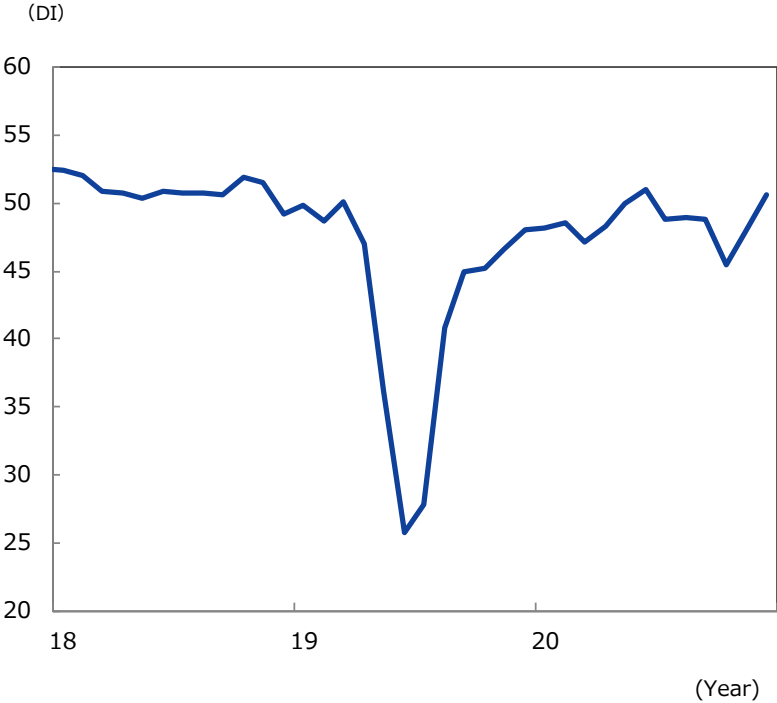
Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Mar. 1st 2020 to Nov. 11th 2021
(Source) Google, SMDAM

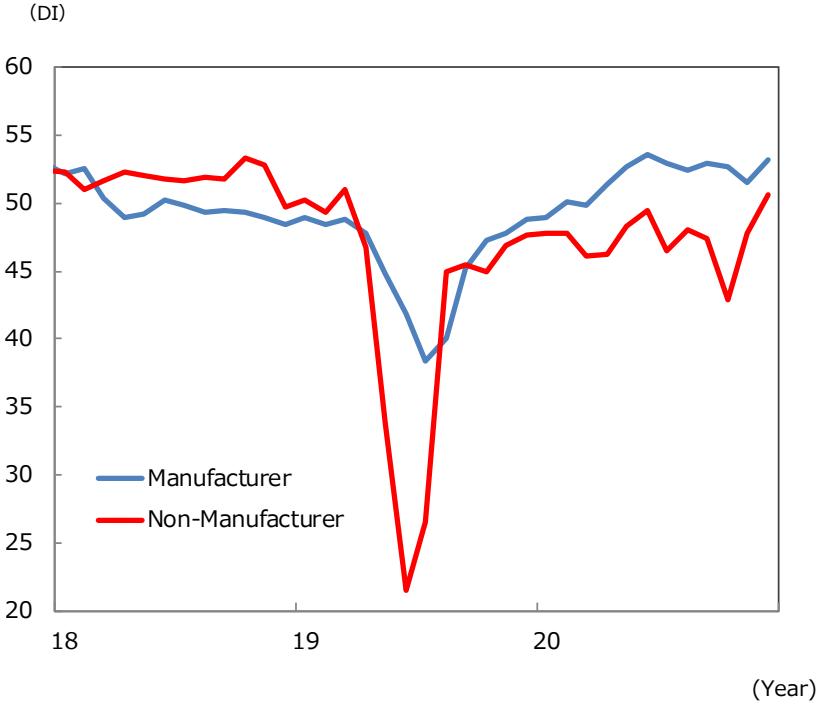
Purchasing manager index – manufacturers lead recovery

Composite PMI



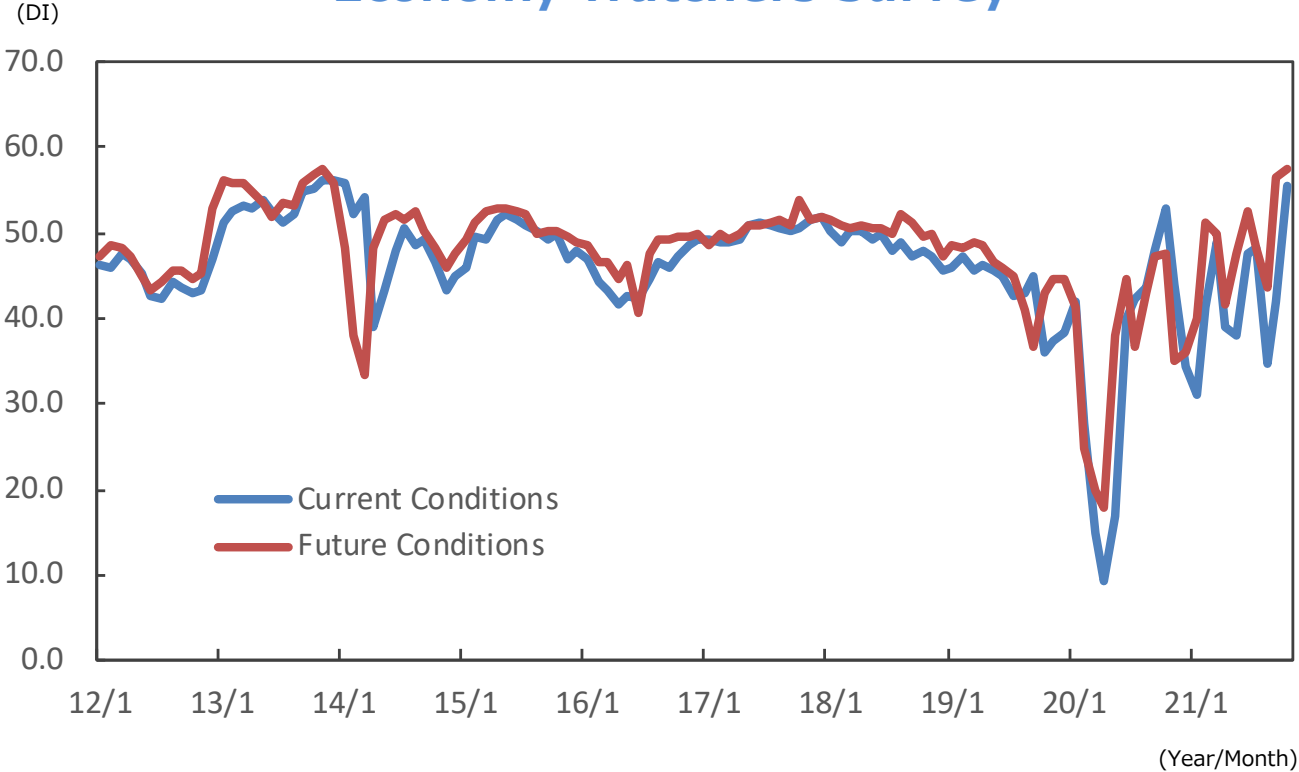
(Data) From Nov. 2018 to Oct. 2021
(Source) Bloomberg, SMDAM

PMI, Manufacturer and Non-Manufacturer



Brighter outlook on consumer activities

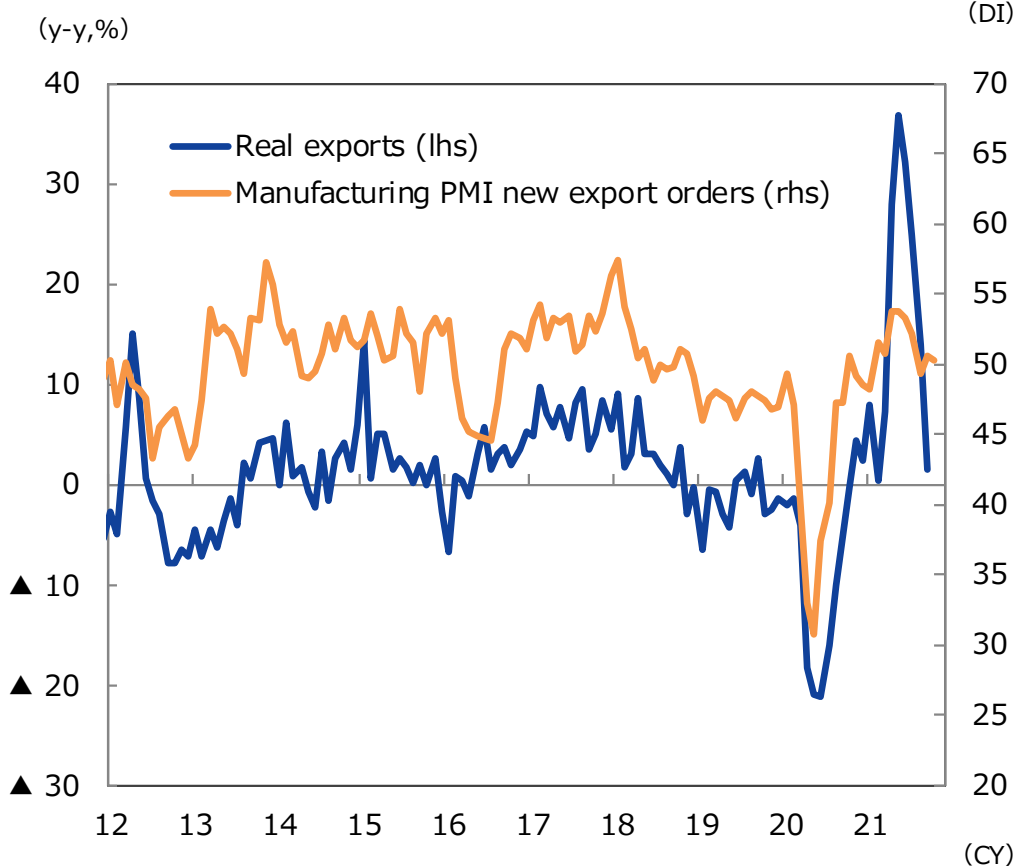
Economy Watchers Survey



(Data) From Jan. 2012 to Oct. 2021
(Source) Cabinet Office, SMDAM

Exports decline sharply despite steady orders

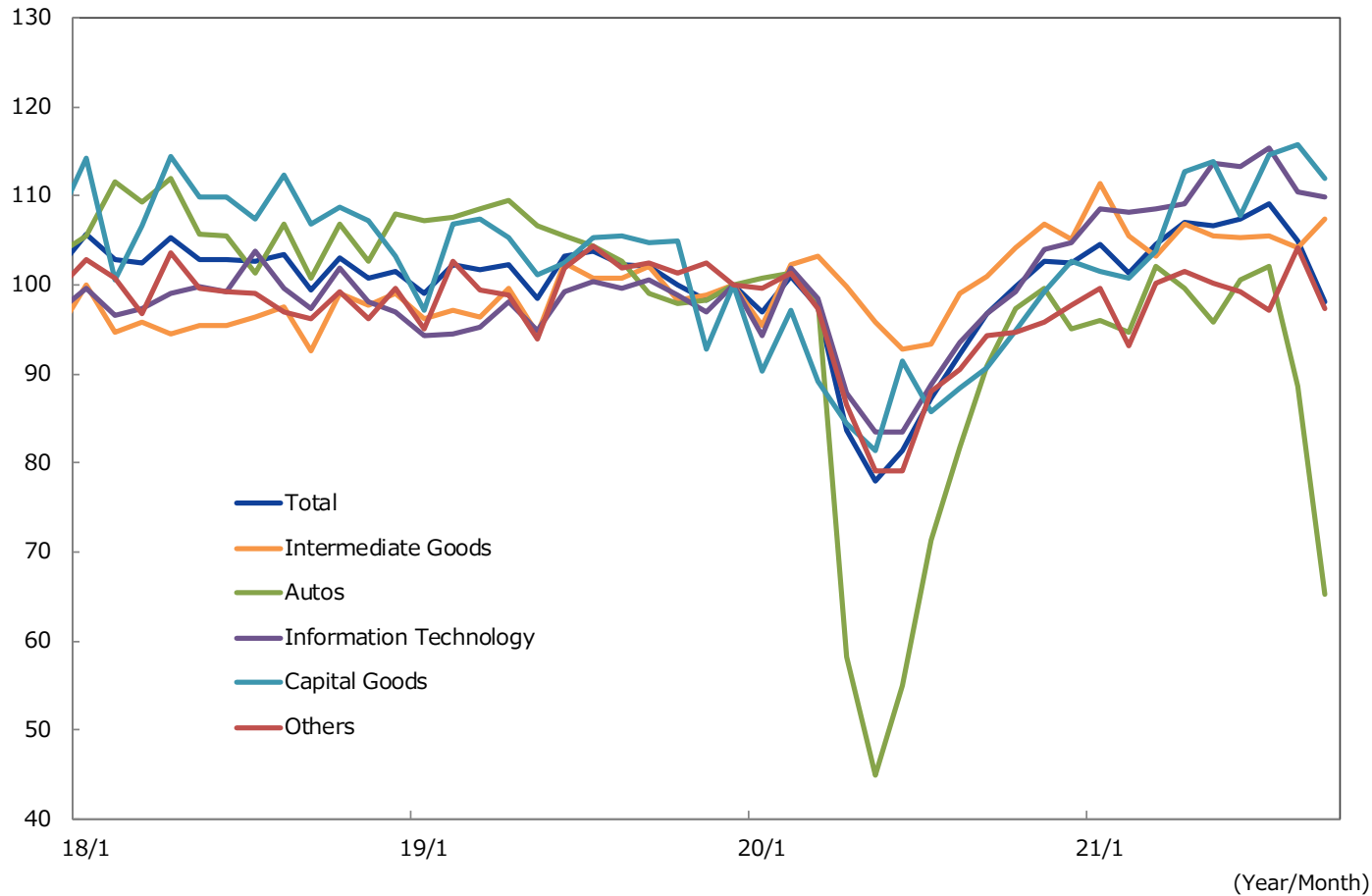
Real exports and manufacturing PMI new export orders



(Data) Real export is from Dec. 2011 to Sep. 2021, MFG PMI new export is from Dec. 2011 to Oct. 2021
(Source) BOJ, Cabinet Office, Markit and SMDAM

Shortage of semiconductors and parts hits autos

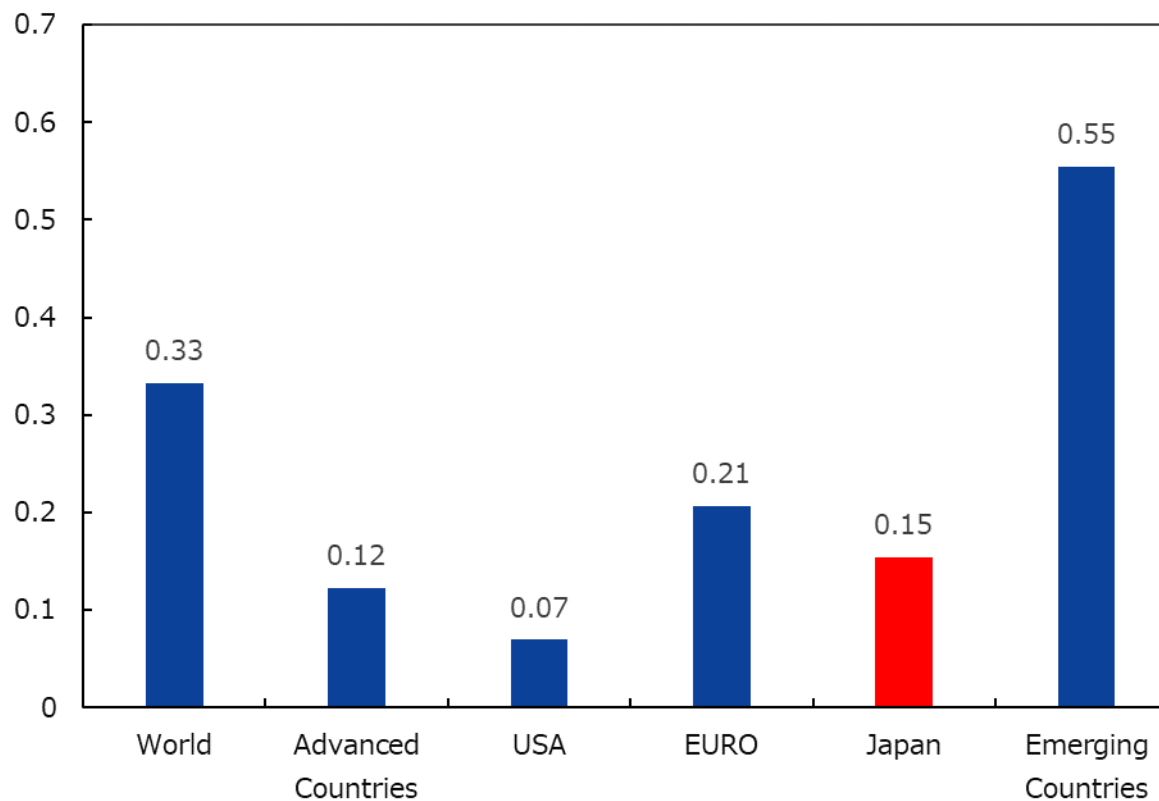
Real Export (Dec. 2019=100)



(Data) From Jan. 2018 to Oct. 2021
(Source) Bank of Japan, SMDAM

Slowing Chinese economy has limited impact on Japan

Elasticity Coefficient to Chinese Industrial Production



(Data) Estimate period is from Jan. 2015 to July 2021
(Source) Centraal Bureau voor de Statistiek, SMDAM

Economic stimulus – larger than anticipated

Size of Economic Stimulus (Trillion Yen)

	Emergency Economic Measures for COVID-19 Infections	Second Supplementary Budget for FY 2020	Comprehensive Economic Measures for People's Lives and Livelihoods	New Economic Measures of PM Kishida Cabinet
Date of Decision	20/04/2020	27/05/2020	08/12/2020	19/11/2021
Size of Stimulus	117.1	117.1	73.6	78.9
Fiscal Spending	48.4	72.7	40.0	55.7
Expenditure of Government	35.8	33.2	32.3	43.7
FILP	12.5	39.3	7.7	5.0

(Source) SMDAM

New PM's economic policy – growth and “distribution”

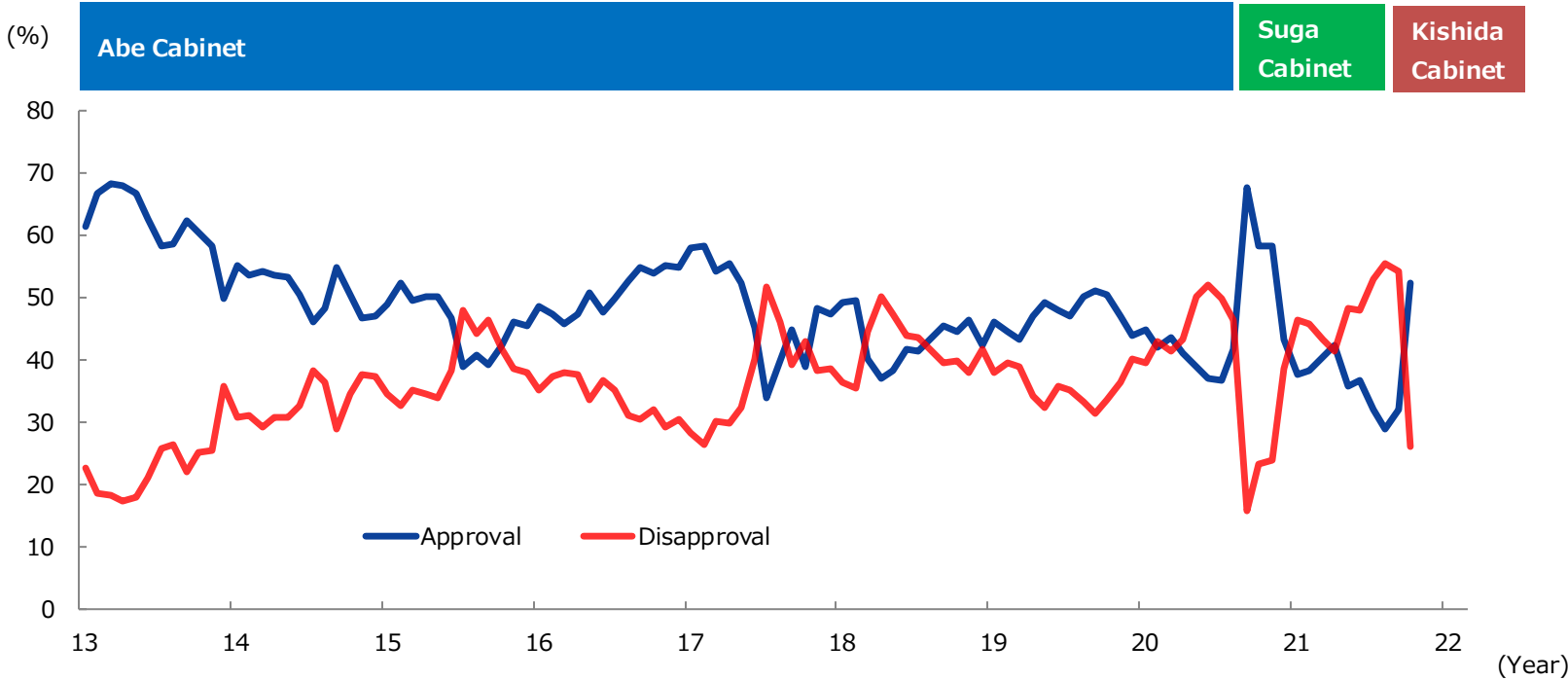
New Leader of Ruling LDP Party and his Economic Policy

Name	Fumio Kishida
Key Biographies	Former Political Chairman of LDP Former Chairman of the Diet Affairs Committee of LDP Former Minister of Defense Former Minister for Foreign Affairs
Faction	Kishida
Slogan	<ul style="list-style-type: none"> ■ New Japanese-style capitalism based on the virtuous cycle of growth and distribution ■ Transformation from Neoliberalism
Orientation of Economic Policy	<ul style="list-style-type: none"> ■ Rectifying Economic Disparities
Economic Policy	<ul style="list-style-type: none"> ■ "Growth Strategy with Four Tactics" <ul style="list-style-type: none"> ▪ Science & Technology Nation ▪ Economical National Security ▪ Digital Rural City-State Vision ▪ Support for Aging Society ■ Income Doubling & Distribution-Oriented Policy

(Source) SMDAM

Cabinet approval rate jumped but relatively low after new PM

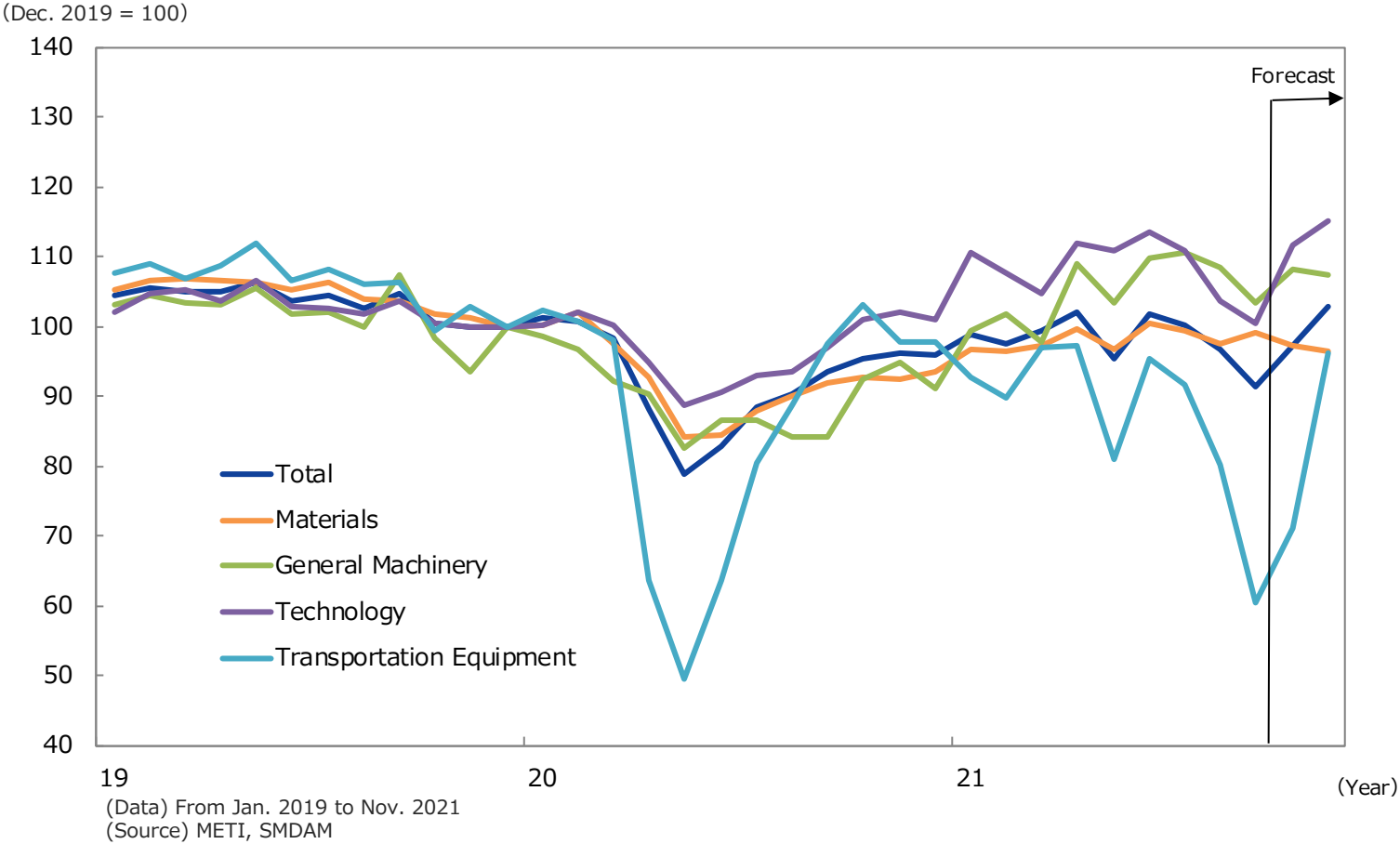
Cabinet approval rate



(Data) From Jan. 2013 to Oct. 2021
(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

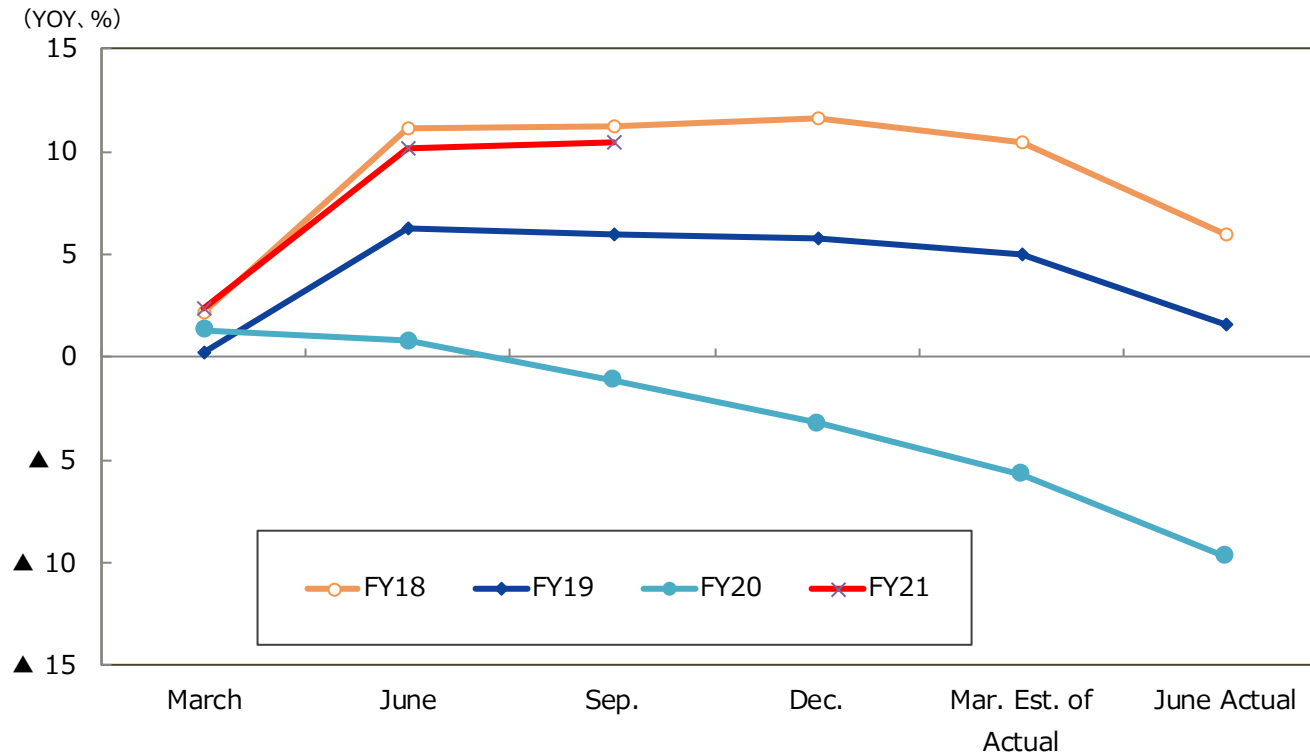
Industrial production – autos catching up in the near future

Industrial Production (Monthly)



Steady outlook of CAPEX

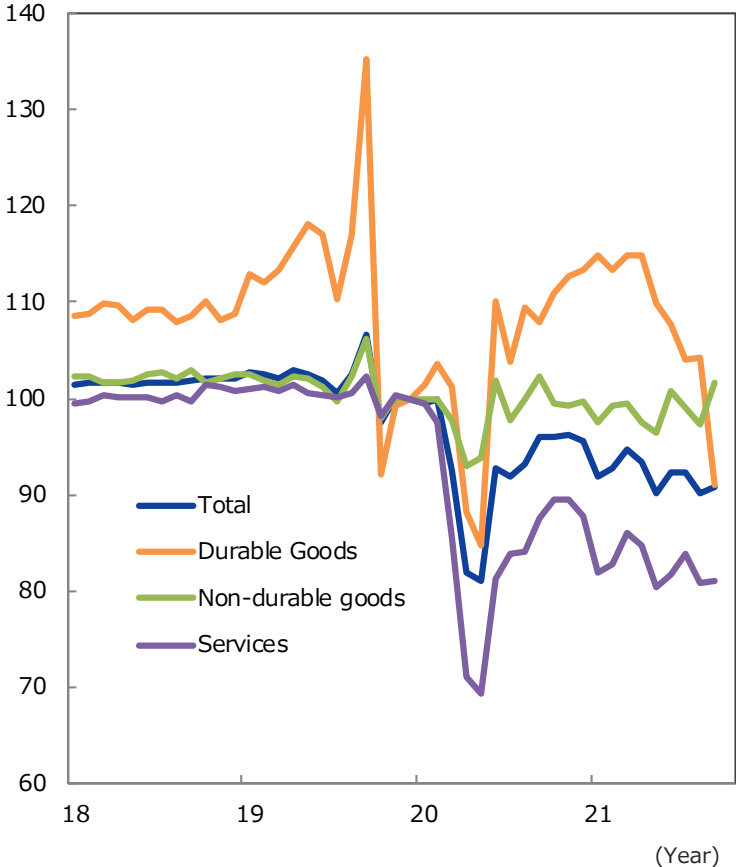
Plan of CAPEX, Inc. Software, Ex. Land and R&D



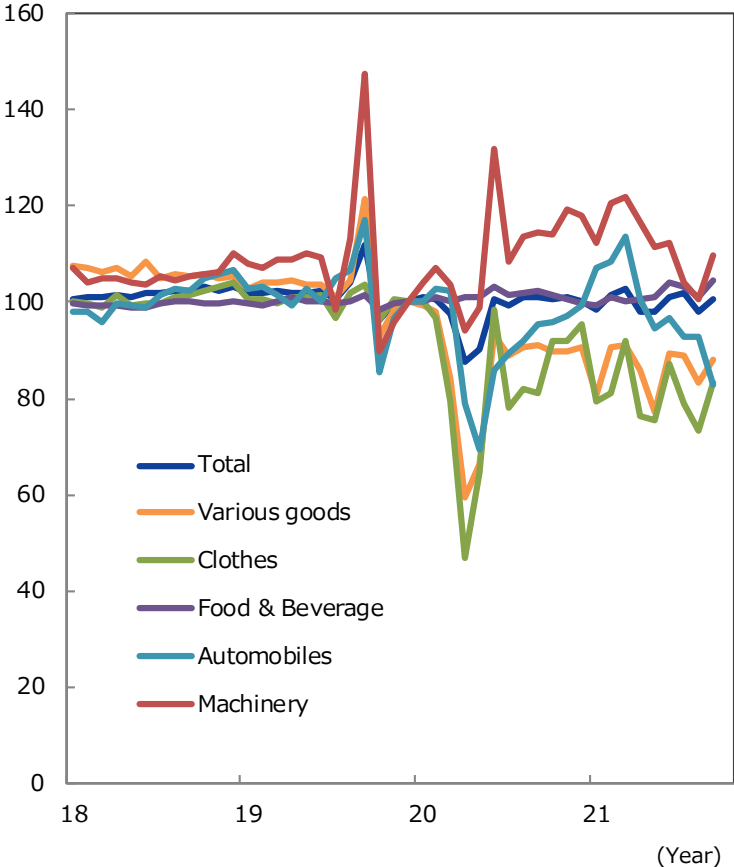
(Source) The Bank of Japan, SMDAM

Shortage of inventory hits auto sales

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



(Data) From Jan. 2018 to Sep. 2021
 (Source) BOJ, METI, and SMDAM

Schedule of major events

Schedule of Major Domestic Events			
2021	December	6 8 16-17	Start of Extraordinary Diet session Revision of CY 2021 Q3 GDP Monetary Policy Meeting Establish Supplementary Budget of FY 2021 Outline of Tax Reform of FY 2022 Cabinet Decision on the Budget of FY 2022
2022	January	17-18	Monetary Policy Meeting Start of Ordinary Diet Session
	February	15	Release of CY 2021 Q4 GDP
	March	9 17-18	Revision of CY 2021 Q4 GDP Monetary Policy Meeting Establish Initial Budget of FY 2022
	Spring		Release of Grand Design of "New Capitalism Realization Conference"
	April	27-28	Monetary Policy Meeting
	May		
	June	16-17	Monetary Policy Meeting End of Ordinary Diet Session Cabinet Decision on Bold Economic Policy and Growth Strategy G7 Summit
	July	20-21 23 25	Monetary Policy Meeting End of the Term of two members of the BOJ Monetary Policy Committee End of the Term of House of Councilors
	August		
	September	21-22	Monetary Policy Meeting Change of Top Party Officials of LDP
	October	27-28	Monetary Policy Meeting
	November		
	December	19-20	Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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