



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-October 2022-

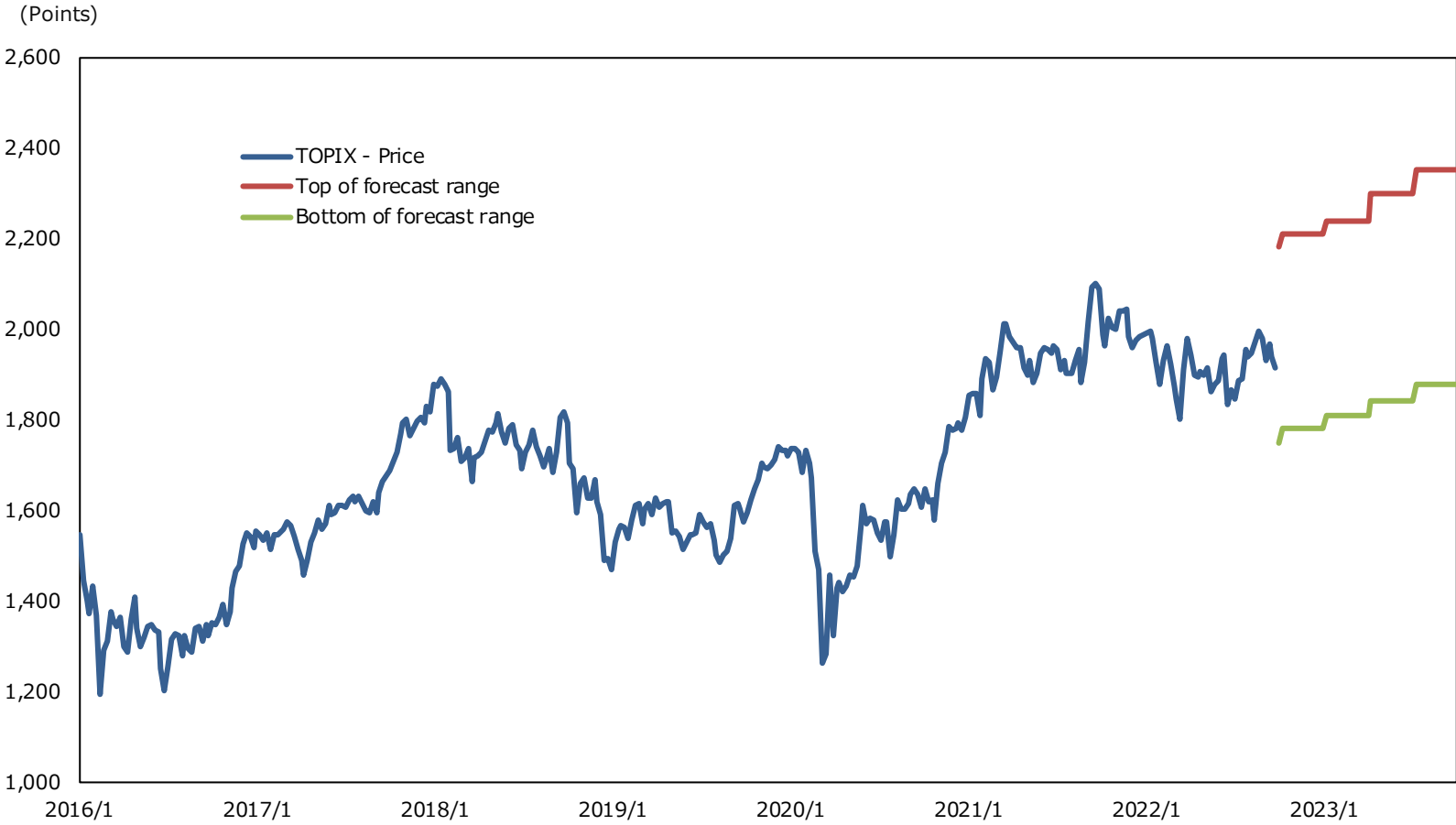


Outlook for Japanese Stock Market

Market Outlook

- We expect range trading in the Japanese stock market in the near future followed by a rally thereafter.
- We believe Japanese stocks will resume their bullish trend after the market confirms the level and timing of the peak of the current monetary tightening in the US and Europe.
- We have revised up our TOPIX target for FY 2022 from 1,960 to 2,040 and that of the Nikkei 225 from 28,400 to 29,200 along with the upward revision of consensus EPS forecast.
- The market downside could be mitigated by the economic recovery in Japan and accommodative monetary policy, whilst the upside will be capped by the prolonged concern about the global economy.

We expect range trading in the near future followed by a rally thereafter



Note: TOPIX data is from Jan. 1st 2016 to Sep. 23rd 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

(Year/Month)

Upside / Downside risk scenarios

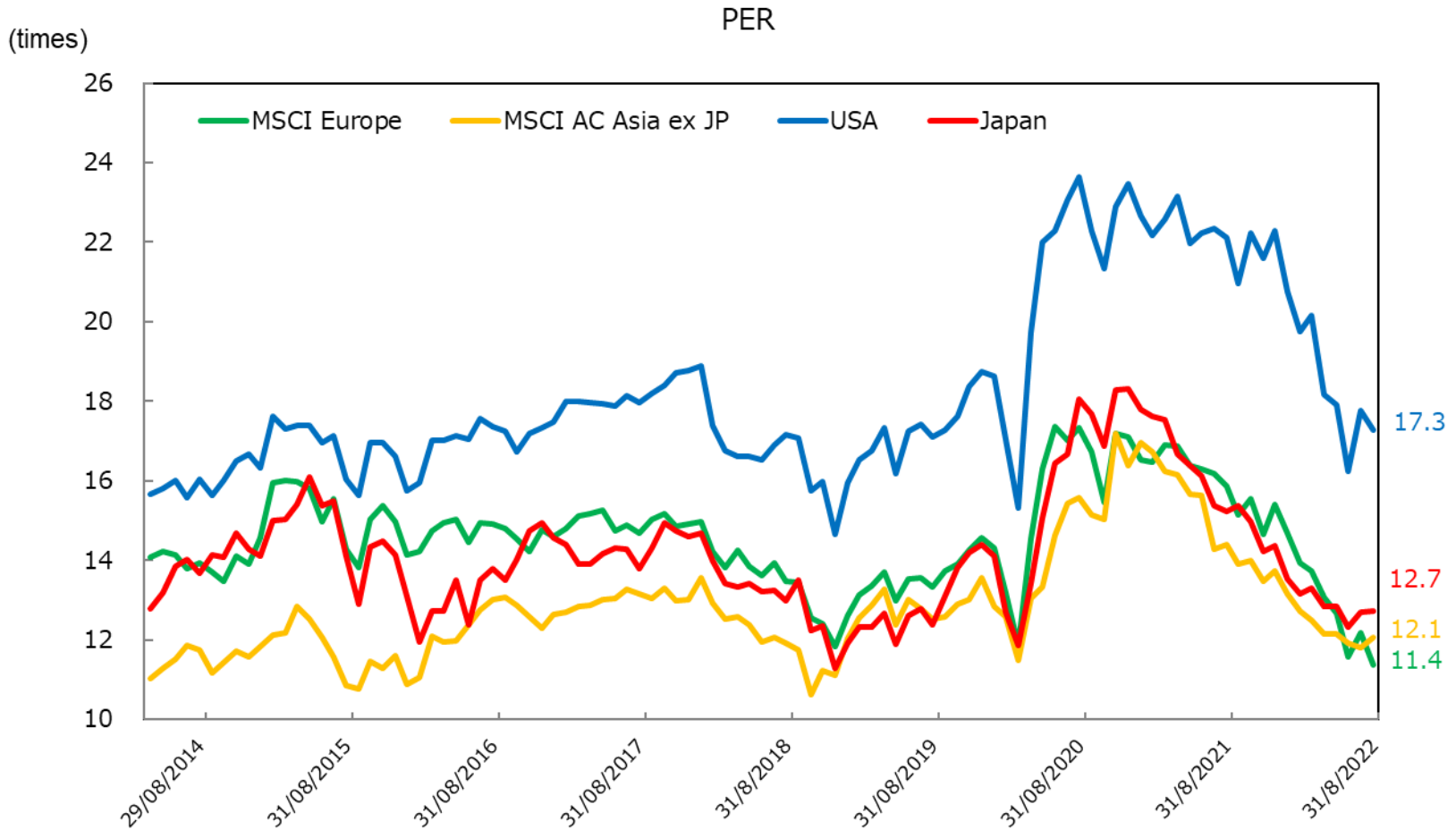
■ Upside Risks

- Recovery of inbound travel from China
- Declining volatility in oil, metals and other commodity markets
- Positive impact from “Doubling Asset-Based Income Plan” by the cabinet

■ Downside Risks

- Concern over fiscal austerity
- Financial crisis in the weak part of the global economy

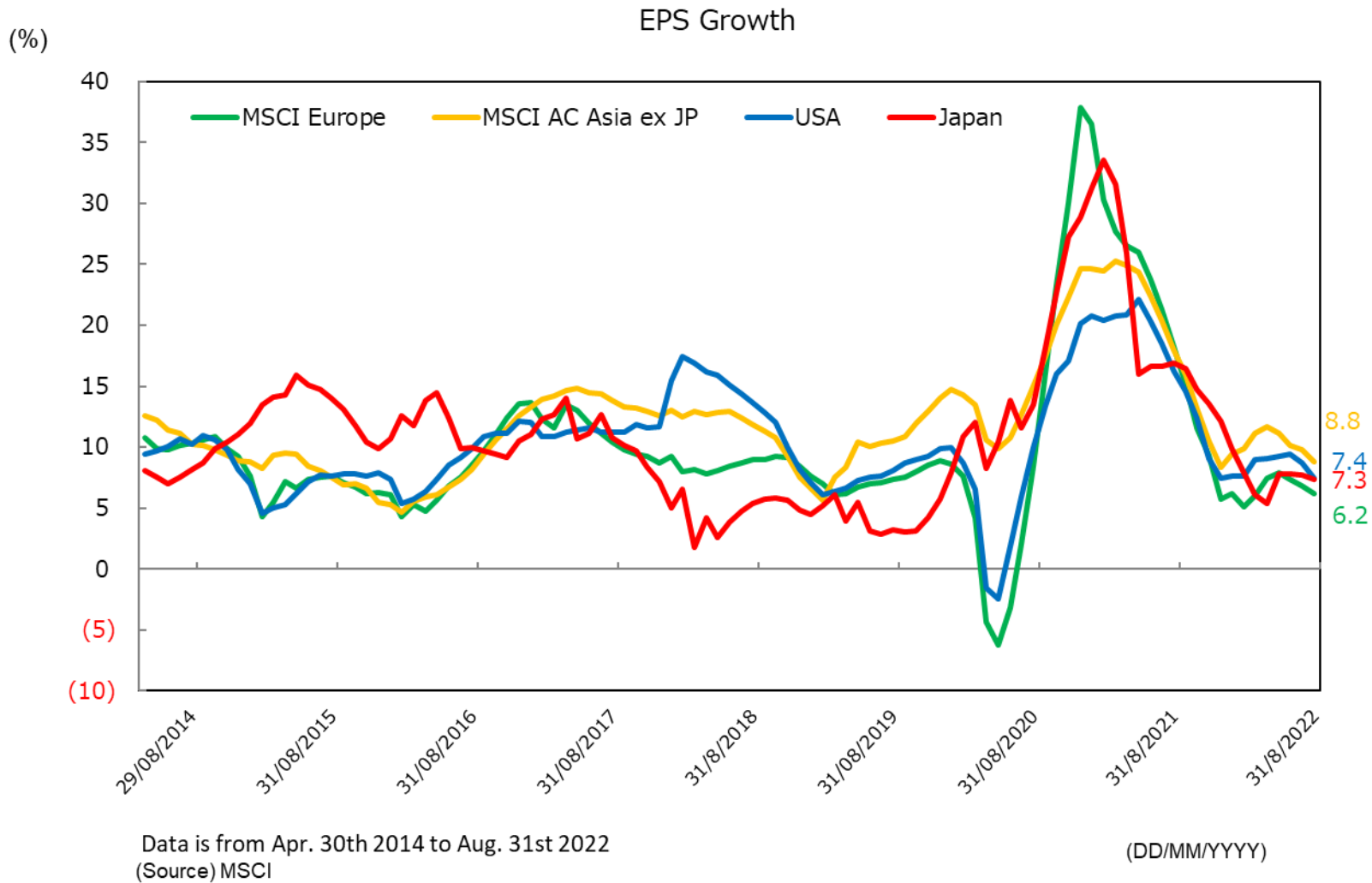
PERs may hit rock bottom except in Europe



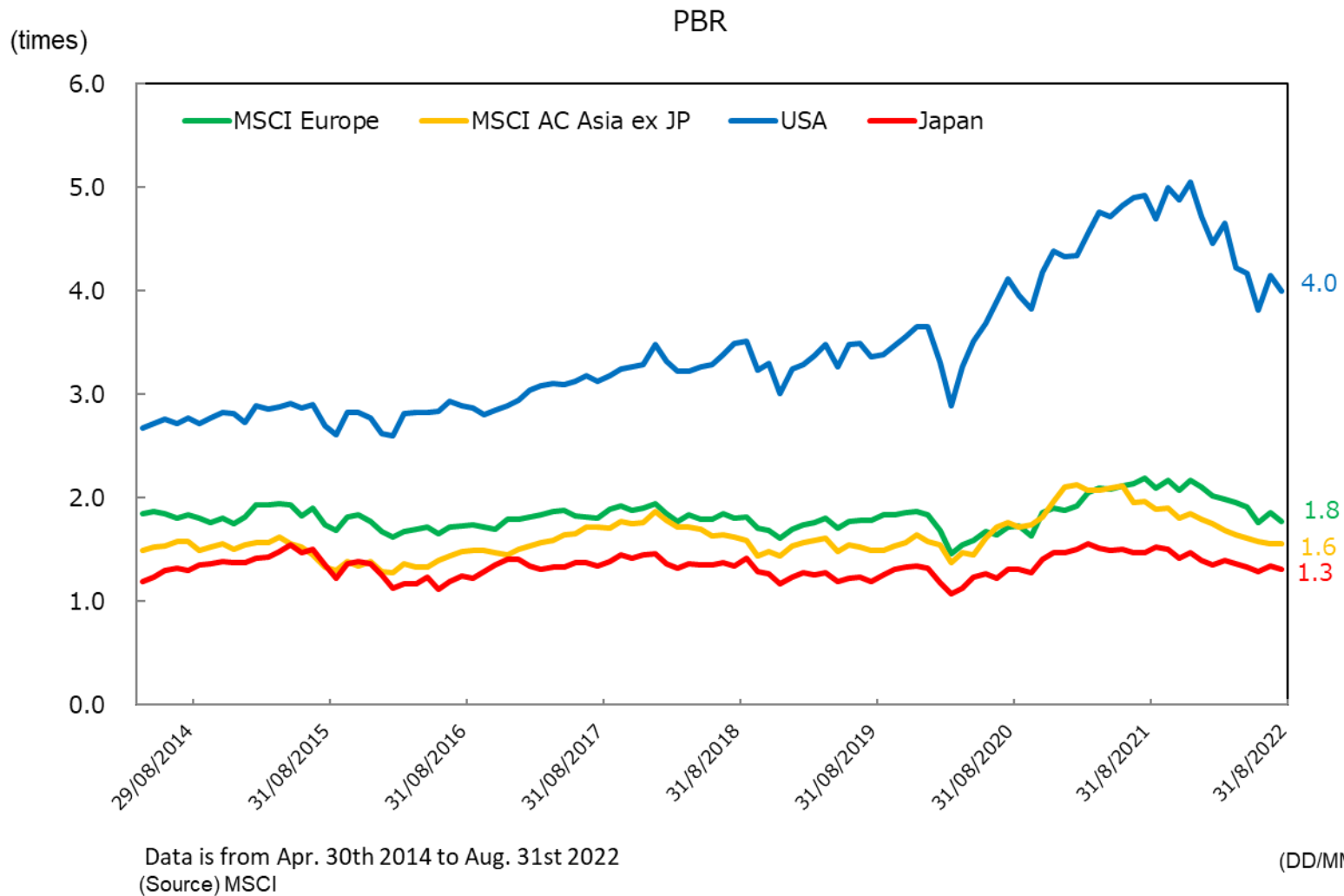
Data is from Apr. 30th 2014 to Aug. 31st 2022
 (Source) MSCI

(DD/MM/YYYY)

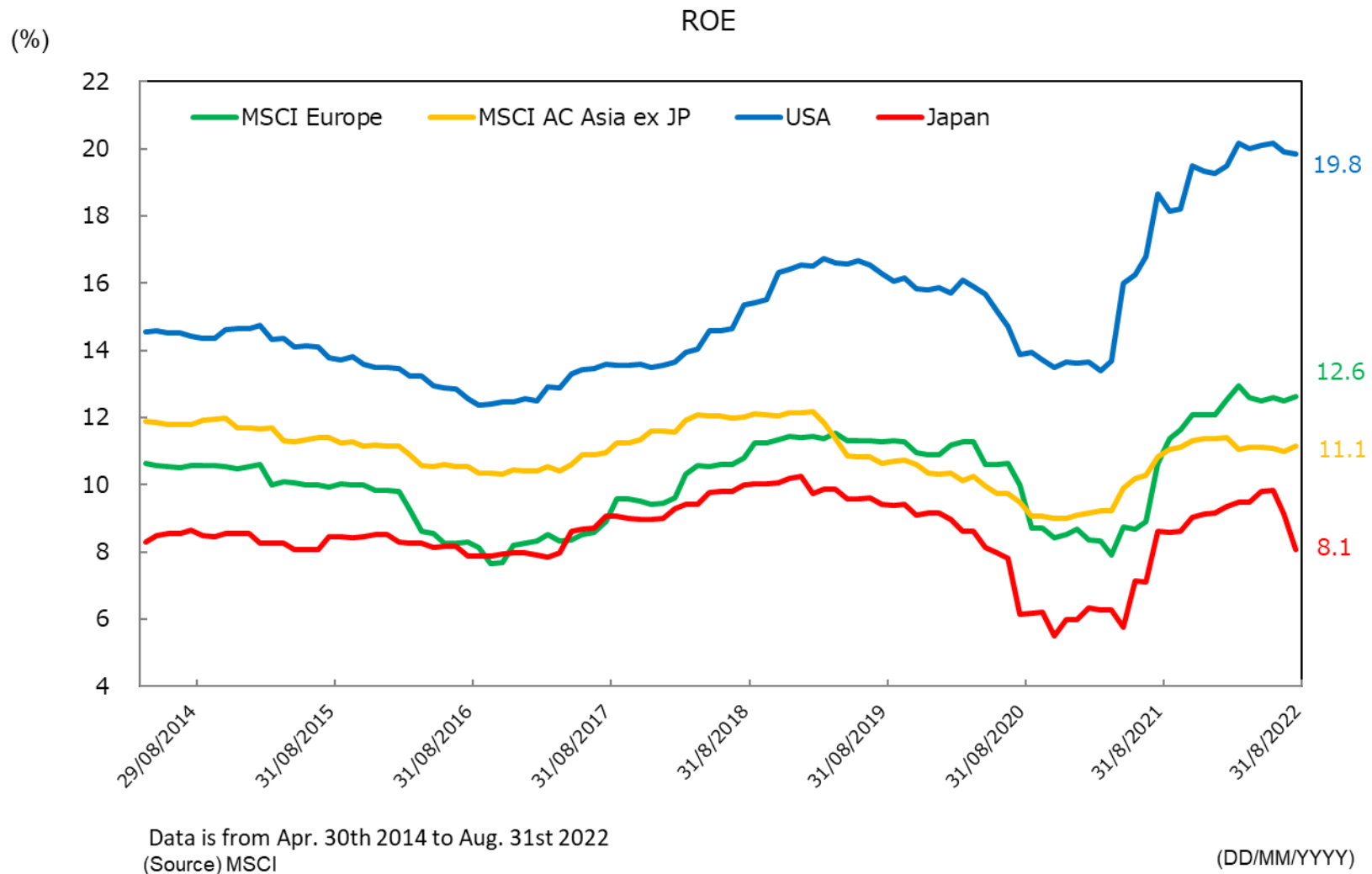
EPS growth stable but gradually slowing



PBRs edged lower due to acceleration of monetary tightening



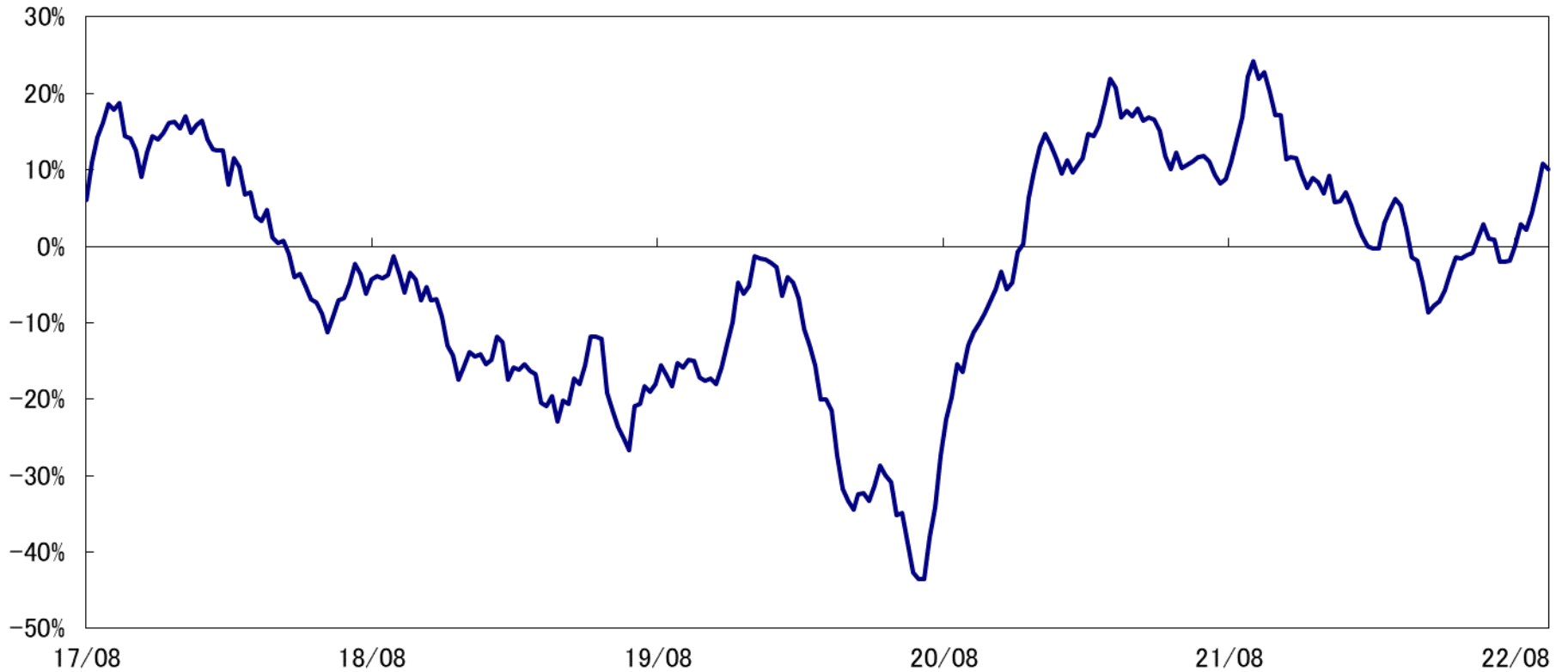
Japan's ROE plunges due to Softbank's significant losses



Note. The above-mentioned company is for illustrative purpose only. We are not advising or recommending to make the long or short positions of the individual stocks.

Re-opening and weak yen boost EPS revision despite global weakness

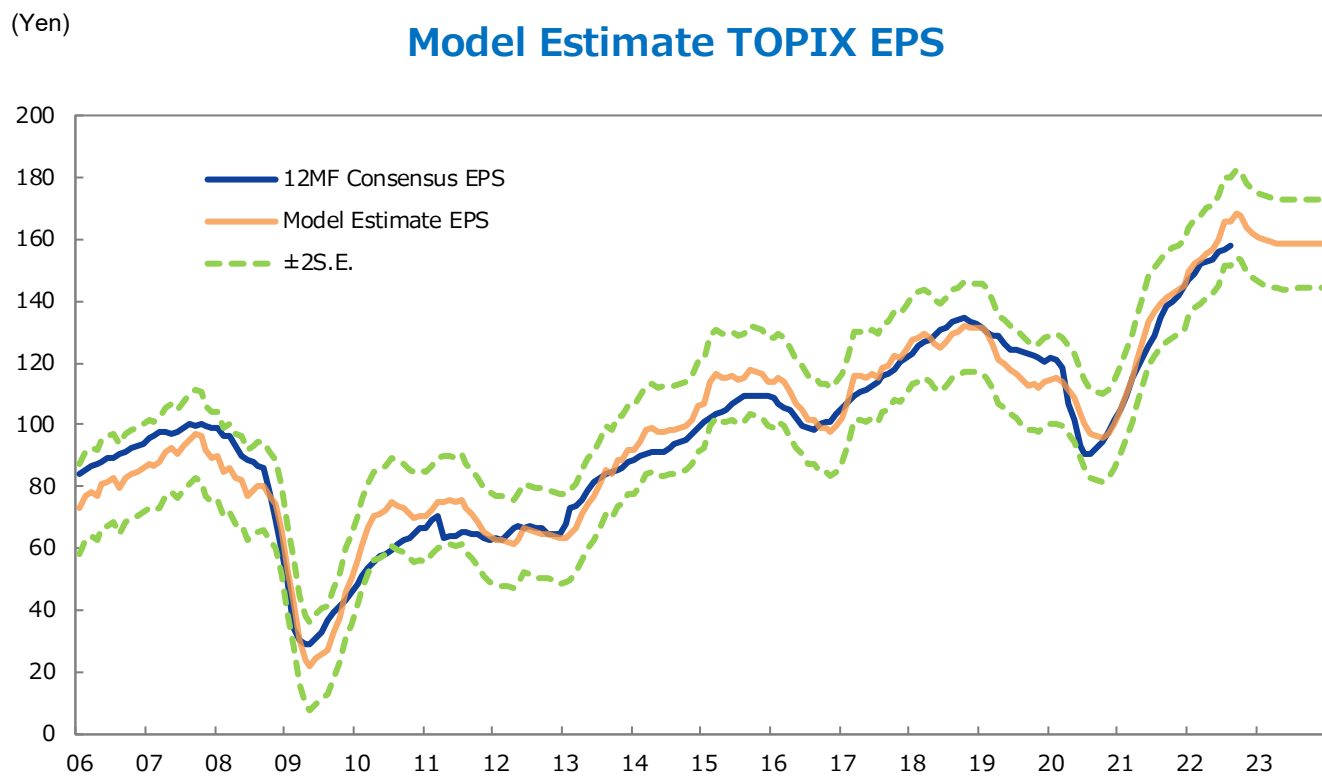
TOPIX Revision Index



Data is from Aug. 1st 2017 to Sep. 13th 2022
(Source) Datastream, IBES

(YY/MM)

Macro model indicates slowing EPS growth ahead



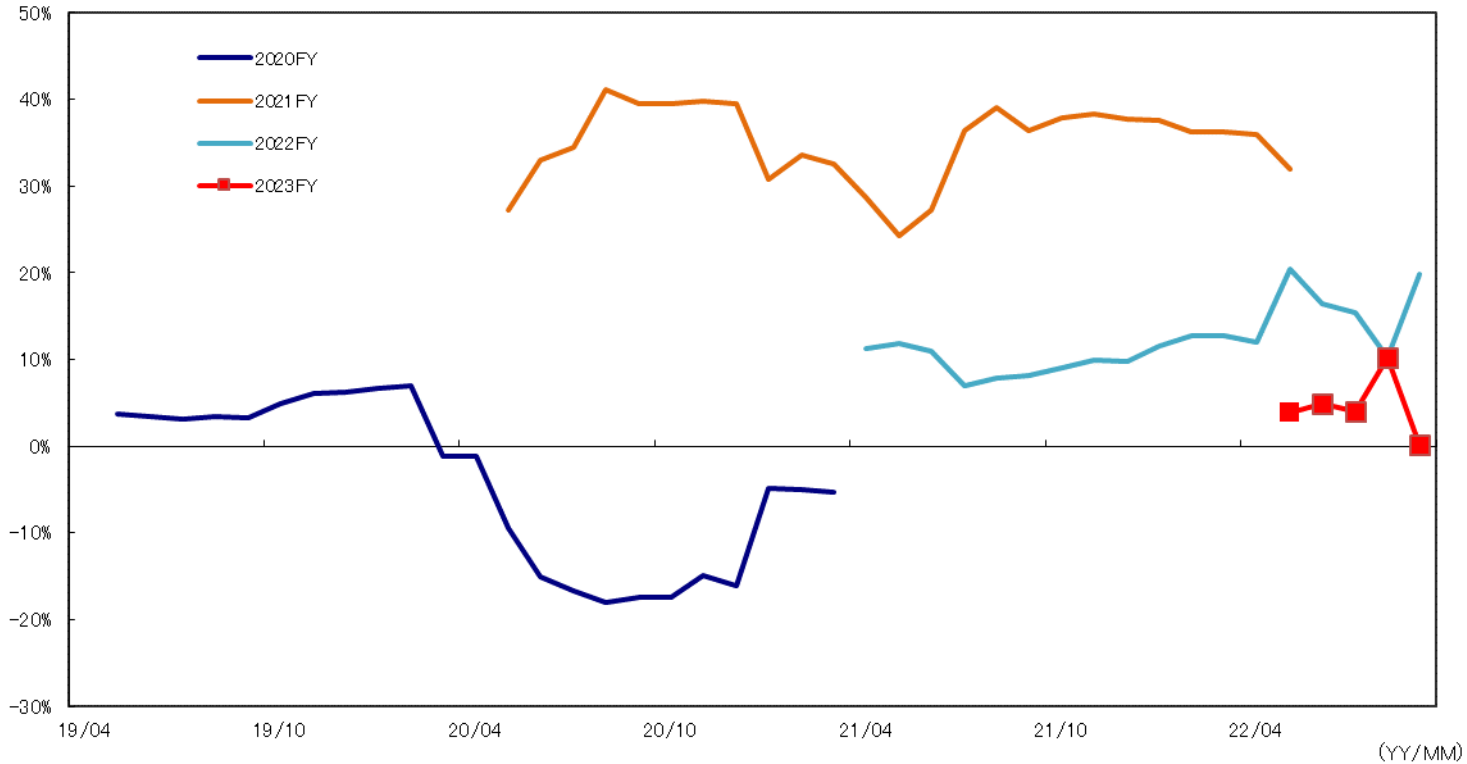
Consensus data is from Jan. 2006 to Aug. 2022, Model data is from Jan. 2006 to Dec. 2023

(Source) SMDAM

(Year)

EPS recovery accelerates followed by a slowdown next year

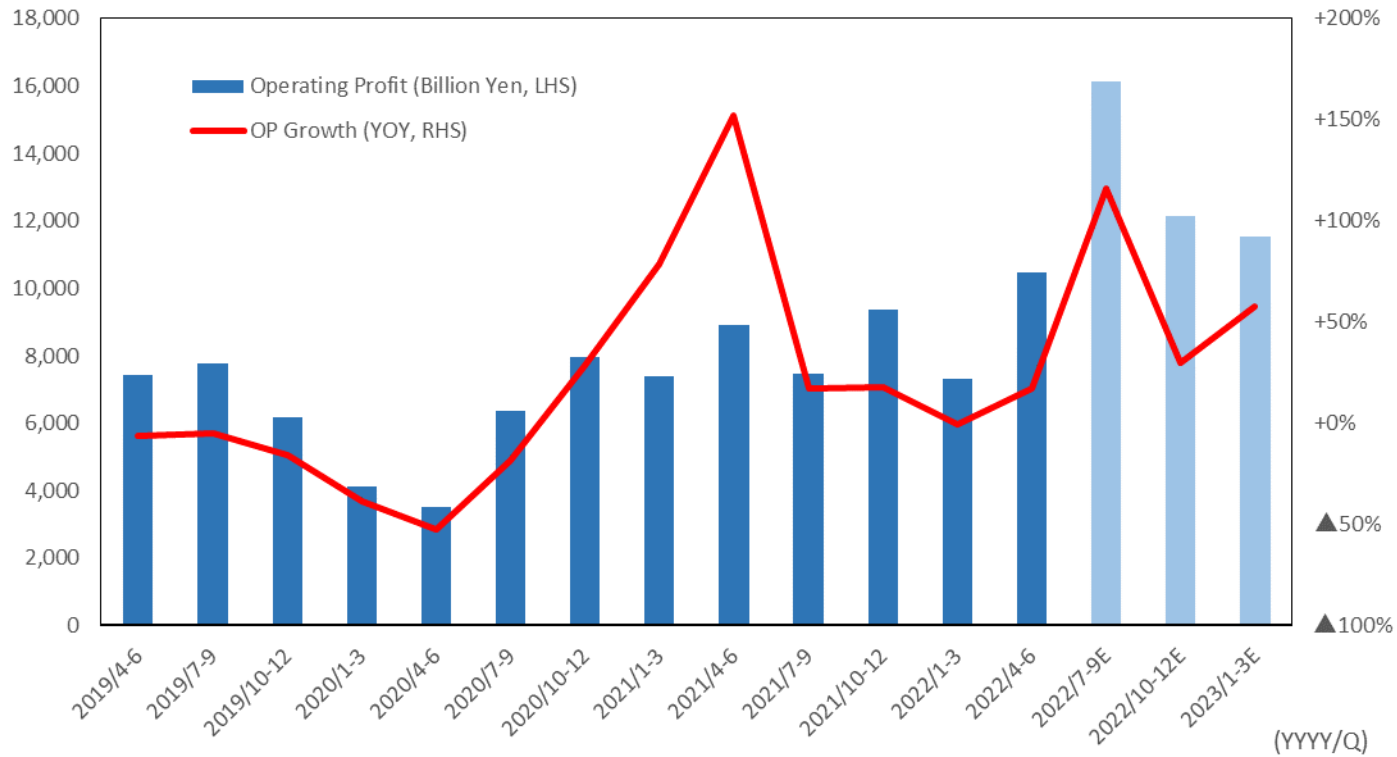
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of Sep. 12th 2022, SMDAM Core Universe (Excl. Financials) consists of 399 Japanese companies covered by SMDAM in-house analysts.
(Source) SMDAM

Operating profit forecast remains strong going forward

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



Actual data is from Q2 2019 to Q2 2022, estimate data is from Q3 2022 to Q1 2023
 (Source) SMDAM

Tide of “Corporate Governance” in Japan

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	202
Insurance companies	24
Pension funds	79
Others	11
Total	322

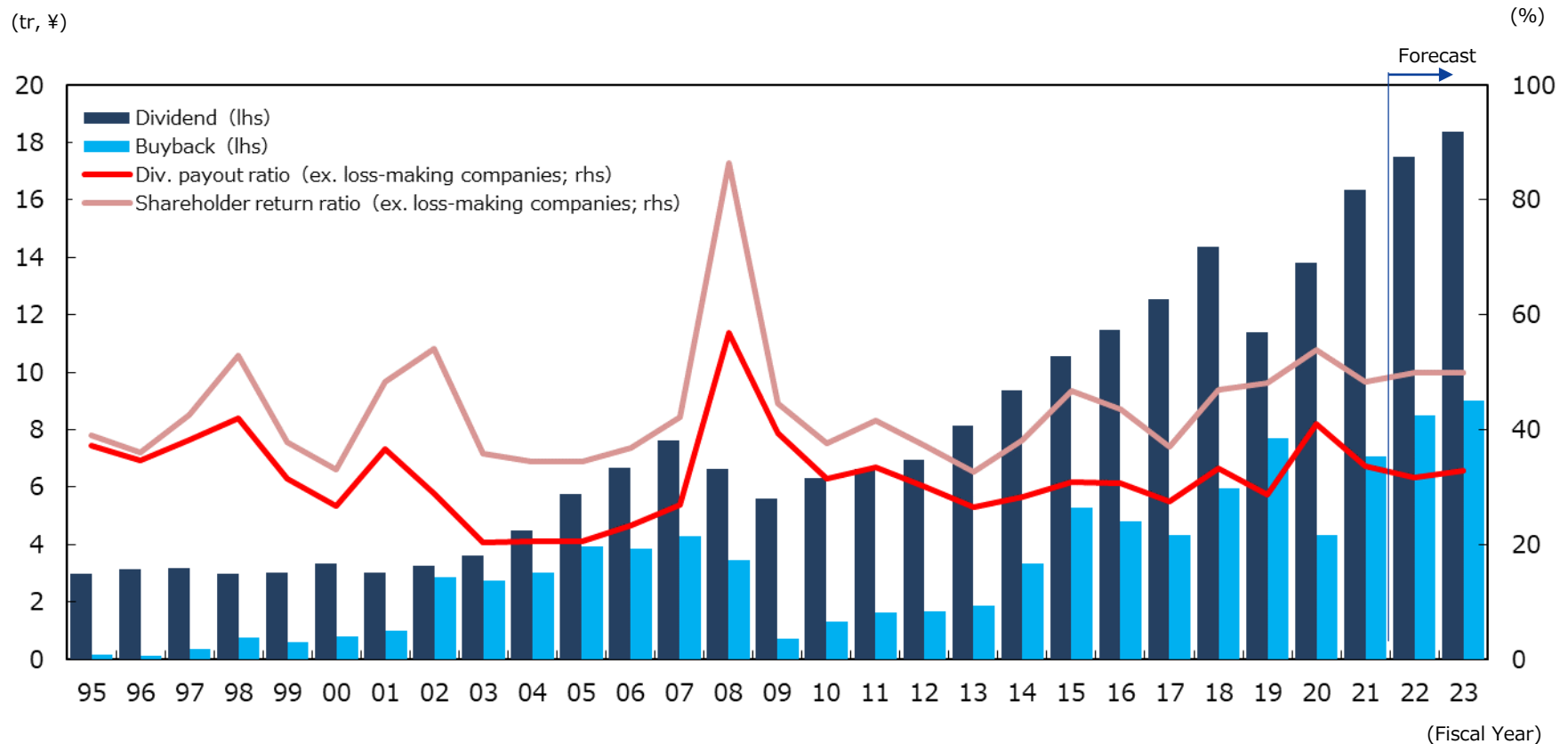
note: As of Aug. 31st 2022

(Source) FSA, SMDAM

- The Stewardship Code (SC) was set in February 2014. Investors are taking a more proactive approach in talking to companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors that 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 breaking historical highs

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



Note: Data is from FY1995 to FY2023, FY2022 and FY2023 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Big return reversal to “small & growth” from “large value”

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	3.46	-0.97	-4.23	-6.53	16.44	19.01	15.91
Total Value	2.47	1.53	6.39	3.76	29.40	18.08	10.34
Top Cap Value	0.98	0.71	6.97	6.30	38.53	26.91	23.06
Large Cap Value	1.74	0.96	7.19	4.95	32.85	19.29	13.40
Mid Cap Value	2.73	1.30	7.47	3.31	25.60	9.11	0.55
Small Cap Value	5.67	4.00	3.23	-1.47	14.90	12.84	-2.68
Micro Cap Value	6.63	3.20	0.14	-1.96	11.57	10.29	-4.60
Total Growth	4.60	-3.65	-13.94	-15.79	4.10	17.93	19.83
Top Cap Growth	2.60	-6.02	-16.33	-15.79	8.11	20.90	23.97
Large Cap Growth	4.06	-4.42	-14.71	-16.02	4.86	19.14	20.97
Mid Cap Growth	6.75	-1.43	-11.68	-16.29	0.00	16.38	16.41
Small Cap Growth	9.27	3.07	-7.12	-14.29	-2.76	7.68	9.36
Micro Cap Growth	9.16	2.99	-10.10	-15.88	-3.92	8.00	10.27
Top Cap Total	1.83	-2.94	-6.67	-6.61	20.85	23.19	22.89
Large Cap Total	2.87	-1.77	-4.88	-6.64	17.70	20.14	18.13
Mid Cap Total	4.49	0.06	-2.05	-6.55	13.37	16.00	11.52
Small Cap Total	6.85	3.68	-0.49	-6.30	8.43	11.77	3.03
Micro Cap Total	7.34	3.14	-2.96	-6.40	6.79	10.67	2.05

Note : As of Sep. 22nd 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** Though the number of COVID-19 infections has been rising sharply, people are becoming accustomed to living with the disease and the economy is recovering due to resilient consumer activities and stable CAPEX levels despite the continued lockdown of large Chinese cities including Shanghai.
- **Inflation is on an upward trend.** While food and energy are major contributors to rising CPI, the positive effect from falling mobile phone charges is also subsiding.

[Outlook]

- ① **We have revised up our real GDP growth forecast for FY 2022 from +1.5% to +1.9% but remain unchanged at +0.7% for FY 2023.** We raised our estimate for the current fiscal year due to the upward revision of Q2 GDP. Regarding H2 of the economy, we foresee a stable outlook due to rising CAPEX and easing supply side constraints. On the other hand, we expect a slowing economic recovery owing to the deterioration of foreign economies.
- ② **We have raised Core CPI forecast for FY 2022 from +2.3% to +2.4% and also revised up our FY 2023 forecast from +1.0% to +1.2%.** Inflation forecasts have been raised due to a change in the assumption of the USD/JPY foreign exchange rate from 135 to 140 yen. While core CPI could accelerate to around 3% YOY in 2022, it could slow down on/after 2023 thanks to easing pressure from cost-push inflation and a slowing economy.
- ③ **We expect PM Kishida to maintain his accommodative economic policy.** PM Kishida will be expected to draw up a comprehensive fiscal stimulus in October. An extraordinary session of the Diet is likely to be convened in the fall to establish a supplementary budget of up to 15 trillion yen. However, following the recent sharp decline in his cabinet's approval rating, political pressure from the ruling LDP for additional economic measures may intensify. On the other hand, PM Kishida and his administration may shift their priority from the economy to fiscal consolidation in the long run.
- ④ **We expect the Bank of Japan to maintain its accommodative monetary policy, even after the end of Governor Kuroda's term in April 2023, as they seem to believe that wage increases and continued monetary easing are the key to consistently achieving their price target.** Though PM Kishida's administration is expected to appoint new BOJ board members with flexibility to review current monetary policy, it is unlikely to change monetary policy through 2023 due to weakness in wage increases and a slowdown of overseas economies.

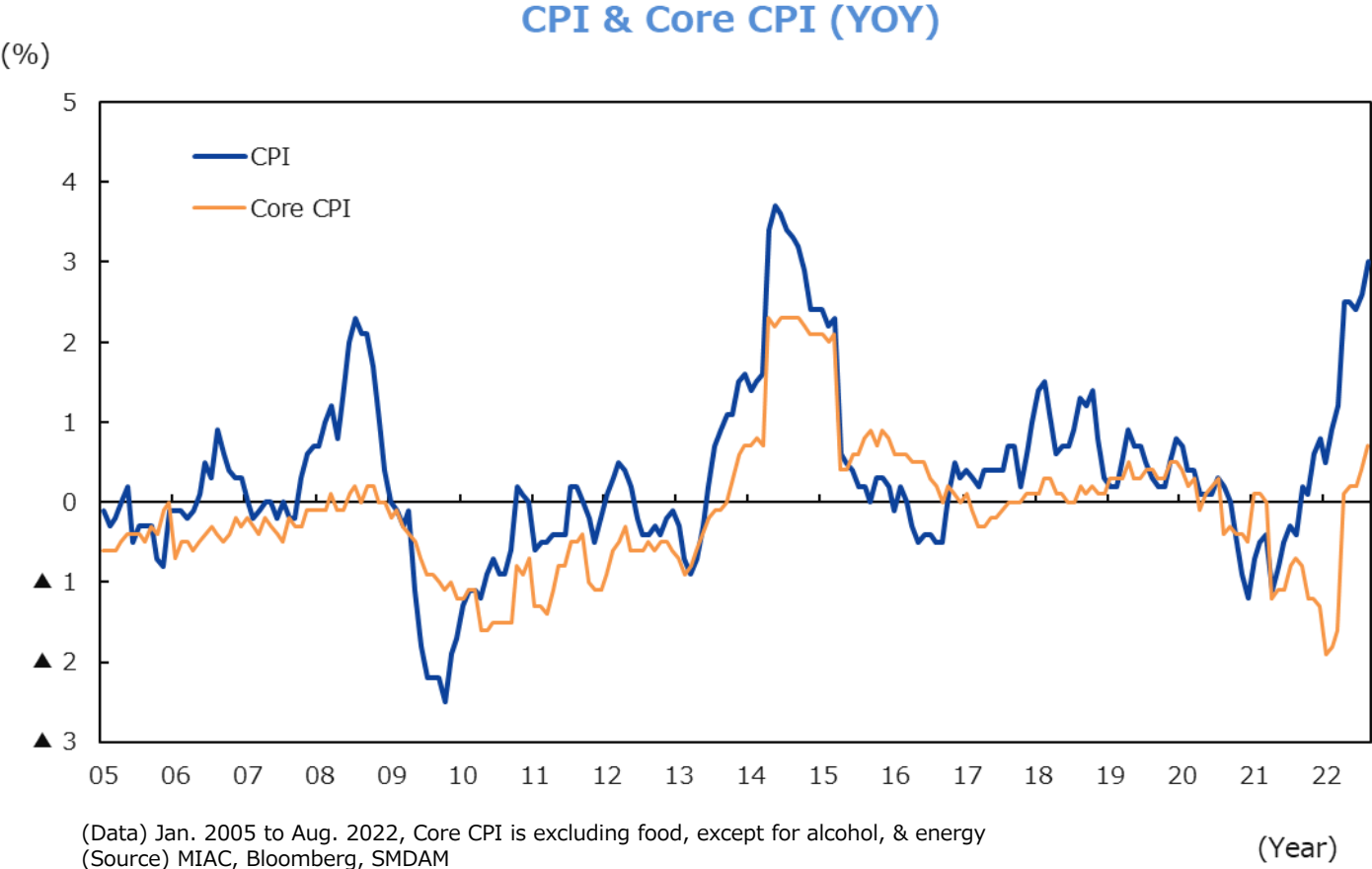
Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY17	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.2%	1.9%	0.7%	
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.6%	2.5%	0.8%	
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.6%	-4.8%	-0.9%	
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	0.8%	3.5%	1.0%	
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-9.4%	-3.3%	0.5%	
Net export contribution	0.4%	-0.2%	-0.5%	-0.6%	0.8%	-0.2%	-0.1%	
Exports of goods and services	6.3%	2.0%	-2.3%	-10.2%	12.5%	2.0%	-0.4%	
Imports of goods and services	3.8%	3.0%	0.2%	-6.5%	7.2%	3.3%	0.1%	
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.2%	2.0%	1.5%	
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.0%	0.1%	0.8%	
Industrial Production Index	2.9%	0.3%	-3.7%	-10.0%	5.9%	0.6%	1.0%	
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	2.4%	1.2%	
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.5%	7.0%	7.3%	0.6%	
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	2.0%	1.2%	
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

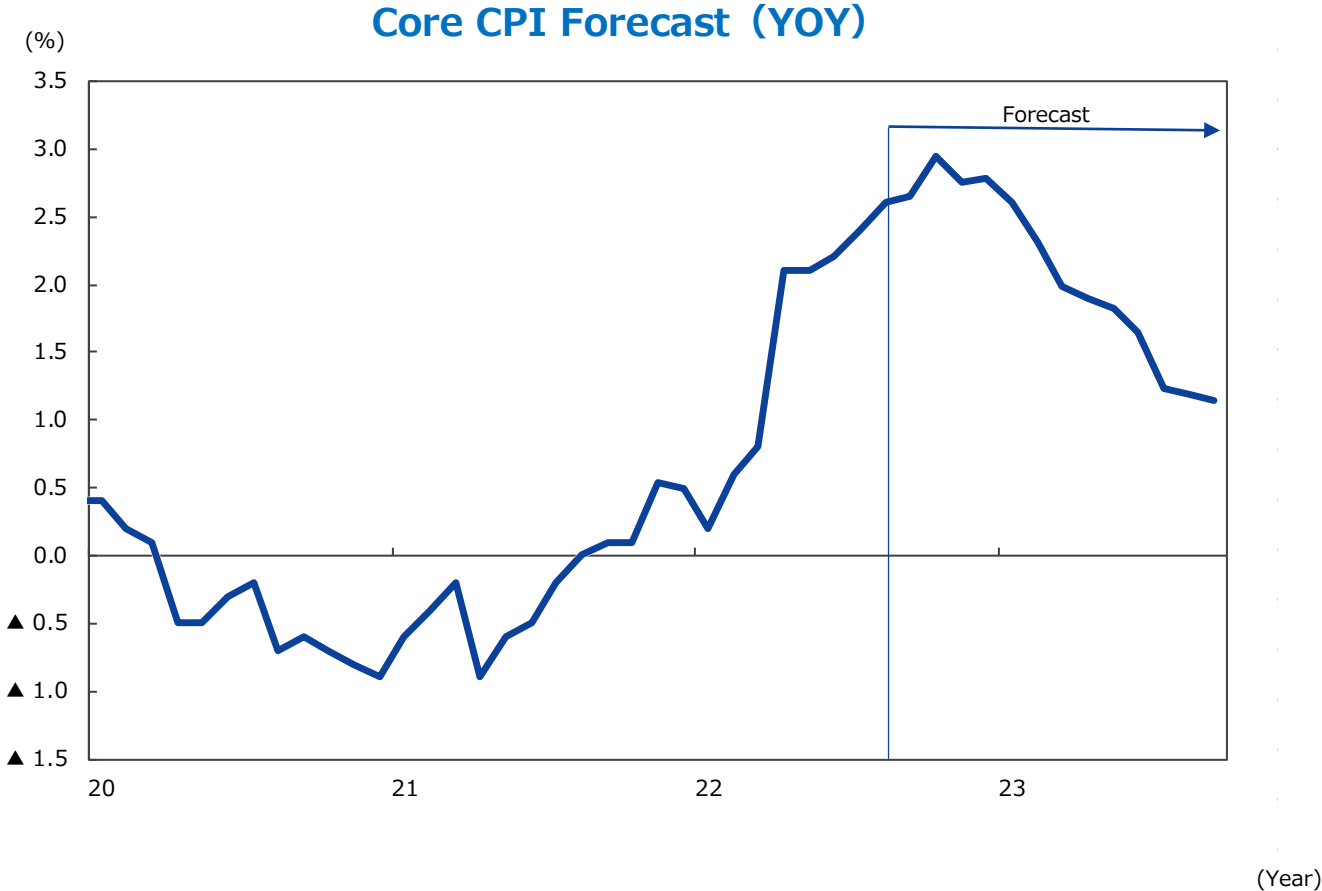
(Note) Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

(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

Finally inflation has come back to Japan



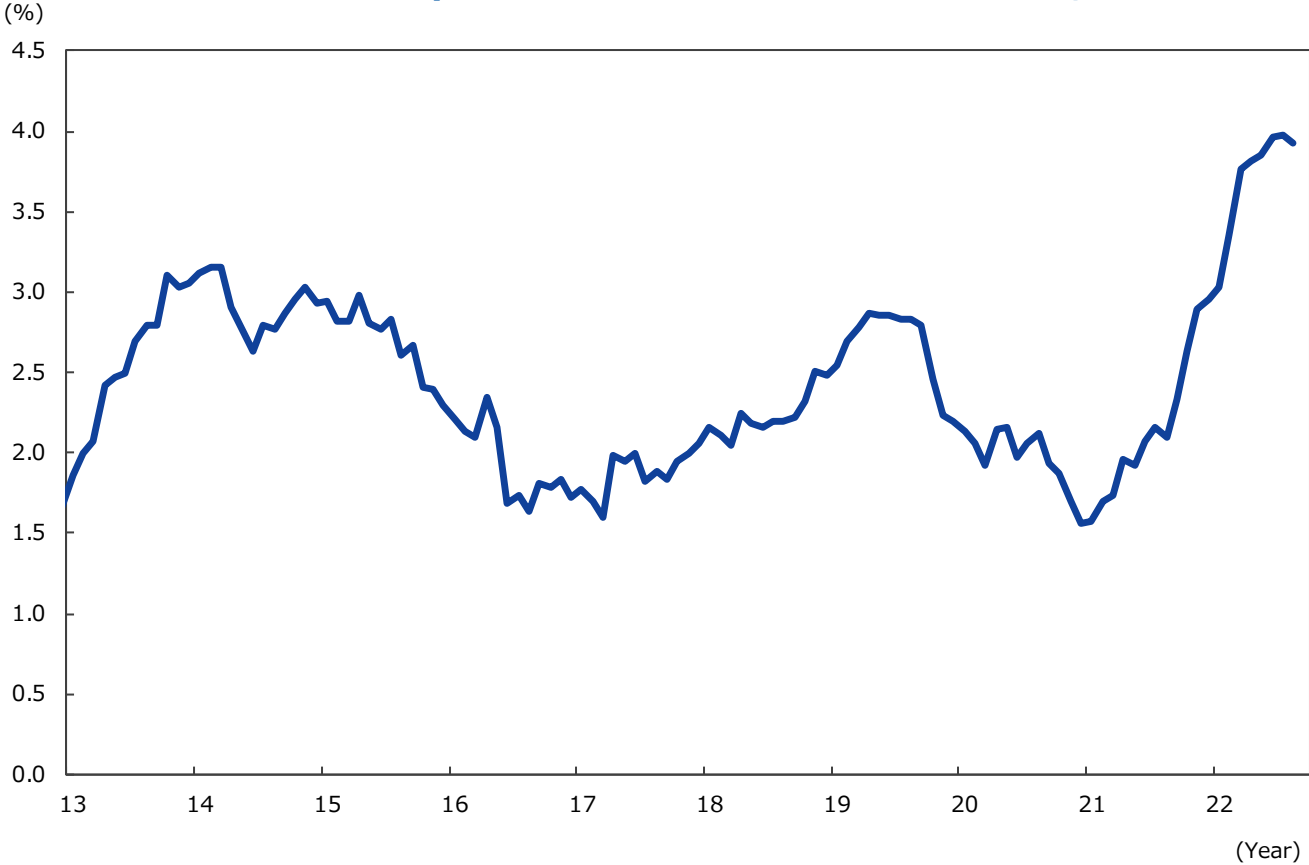
Core CPI may hit in autumn then decelerate afterwards



(Data) Data is from Jan. 2020 to Sep. 2023. Data after Aug. 2022 are forecast Forecast is based on the assumption of foreign exchange rate at 1 USD = 140 JPY and crude oil price at 95 USD per barrel.
(Source) Cabinet Office, SMDAM

Rising import prices push inflation expectations higher

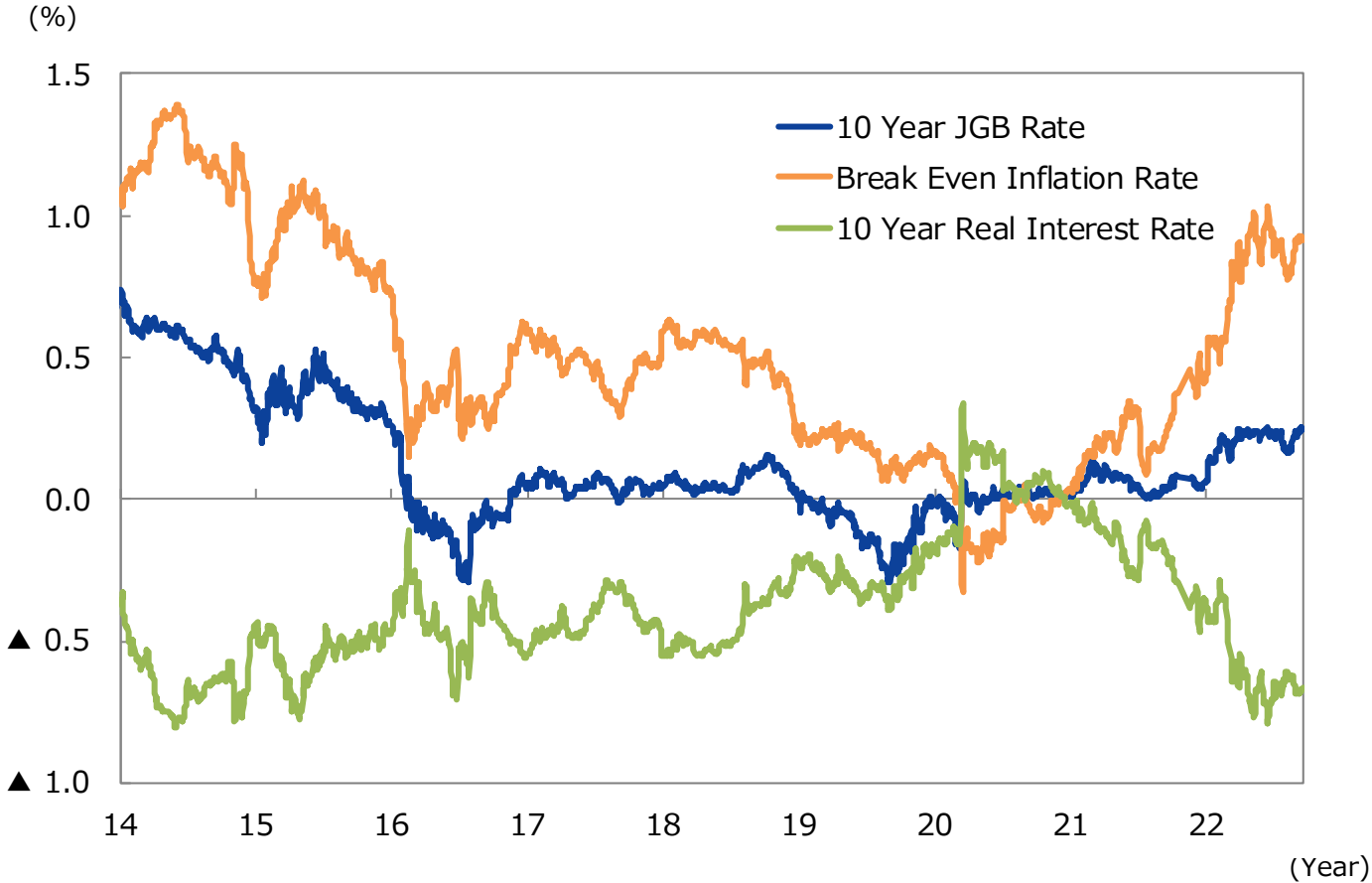
Consumers' Expectation of Inflation Rate (YOY, %)



(Data) Weighted average of inflation forecast of "Consumer Confidence Survey".
Data is from Jan. 2013 to Aug. 2022.
(Source) Cabinet Office, SMDAM

BOJ's yield curve control push real interest rate lower

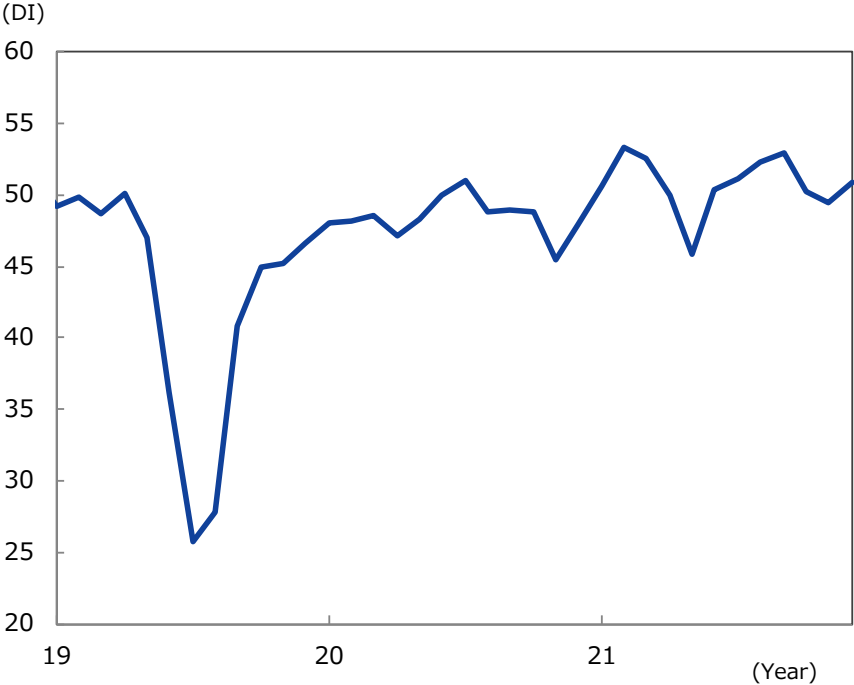
JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to Sep. 19th 2022
(Source) Bloomberg, SMDAM

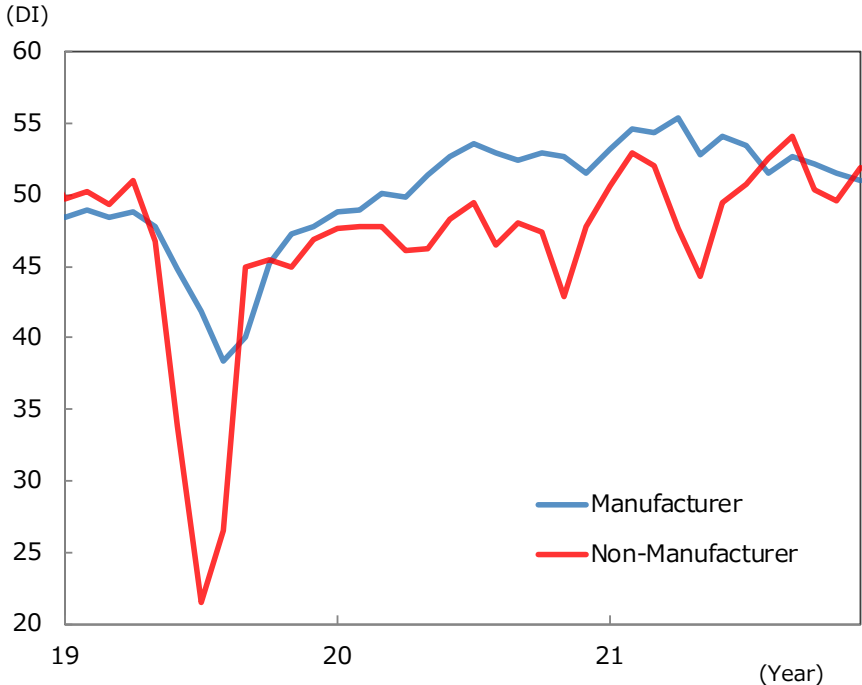
Concern for global economy weighs on manufacturers' sentiment

Composite PMI



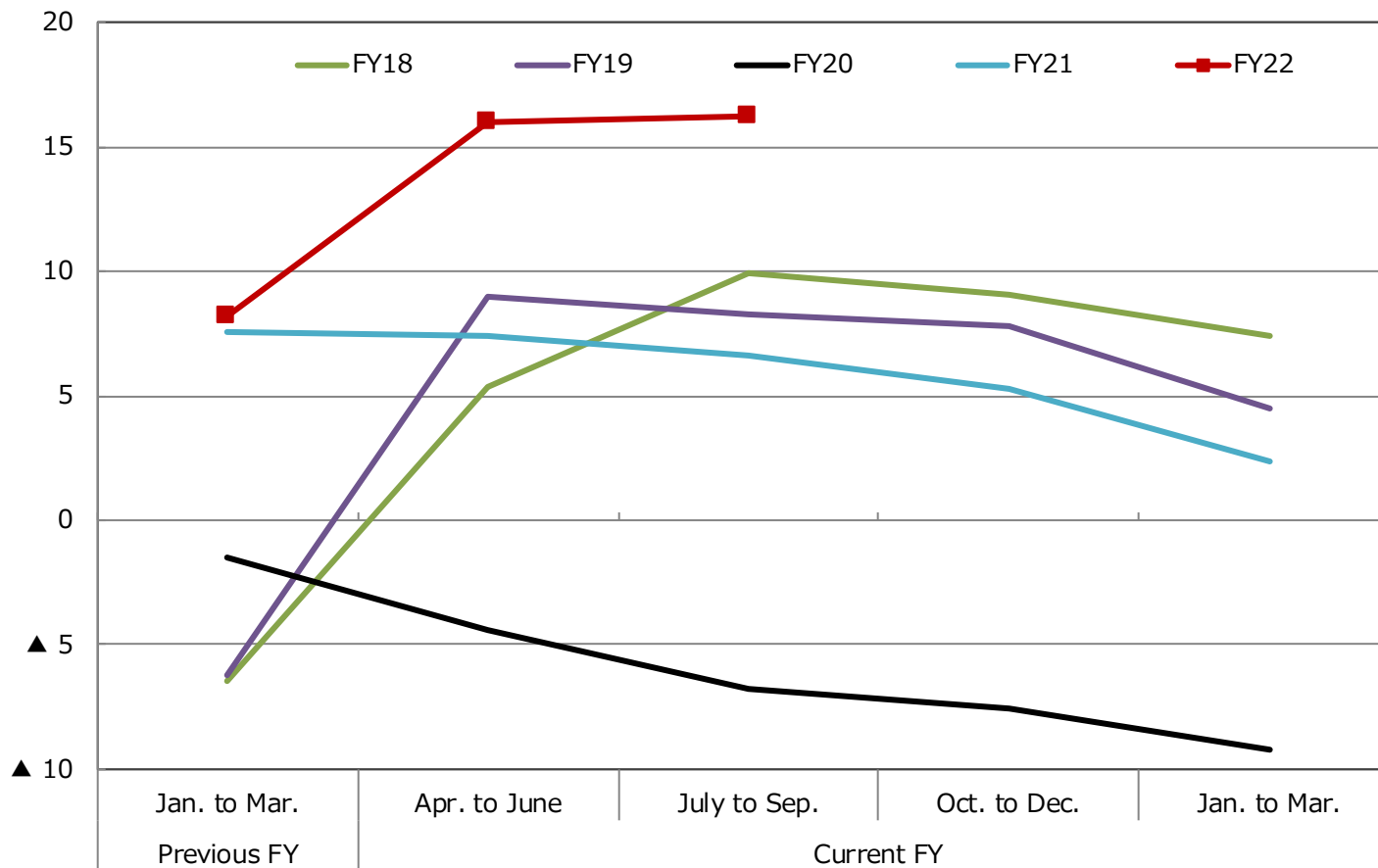
(Data) From Oct. 2019 to Sep. 2022
(Source) Bloomberg, SMDAM

PMI, Manufacturer & Non-Manufacturer



Re-opening lifts CAPEX growth to five-year high

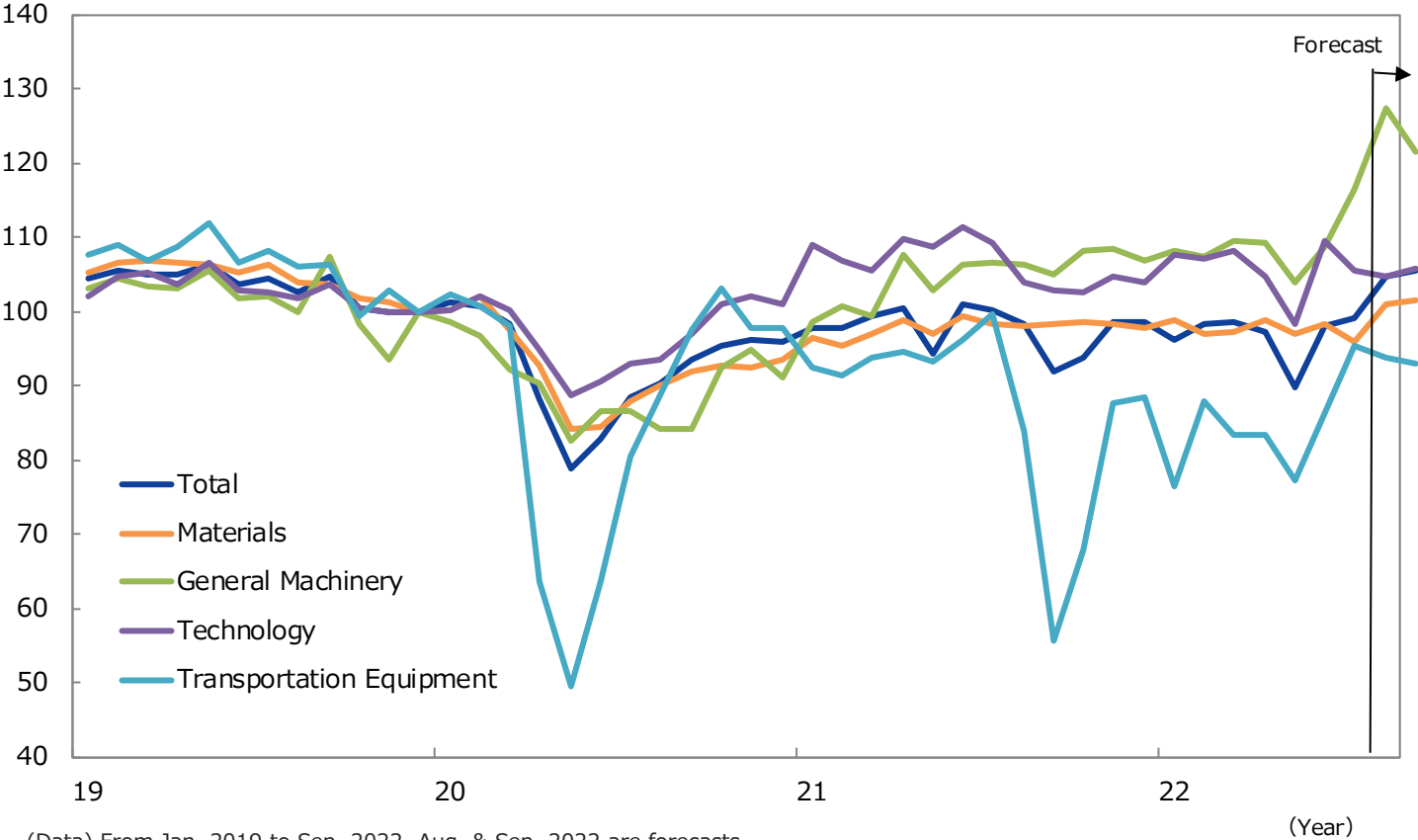
Plan of CAPEX (YOY)



(Data) All industries, all sizes, including software, excluding land and R&D, from Q1 2018 to Q3 2022
 (Source) Cabinet Office, SMDAM

Recovery of industrials to slow ahead due to global economy

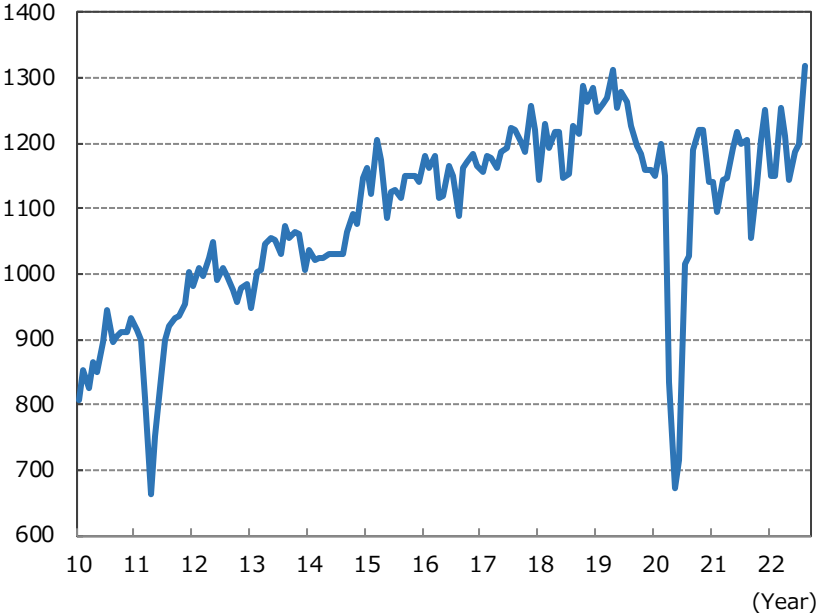
Industrial Production (Dec. 2019=100)



(Data) From Jan. 2019 to Sep. 2022. Aug. & Sep. 2022 are forecasts.
(Source) METI, SMDAM

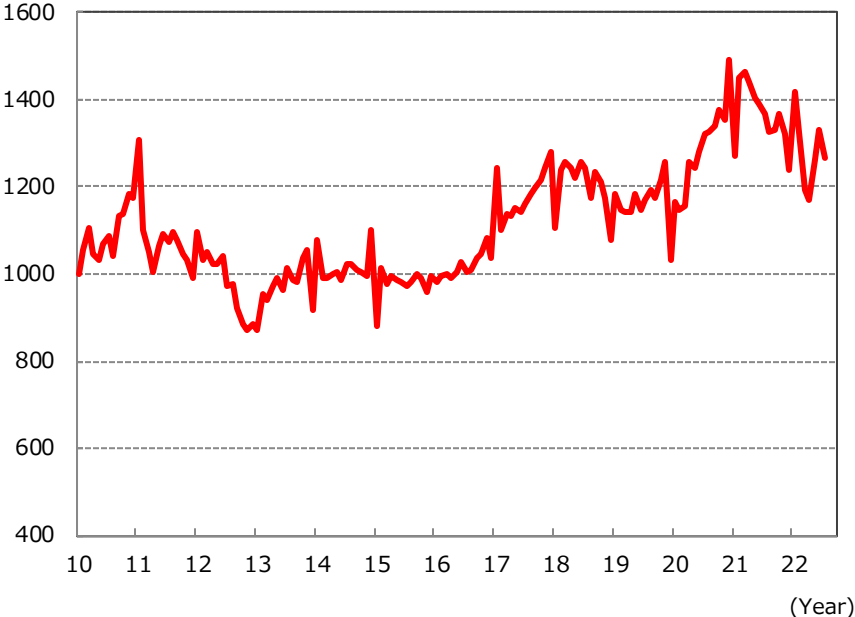
Exports to China losing steam owing to slowing growth

Real Export to US (SA, Billion Yen)



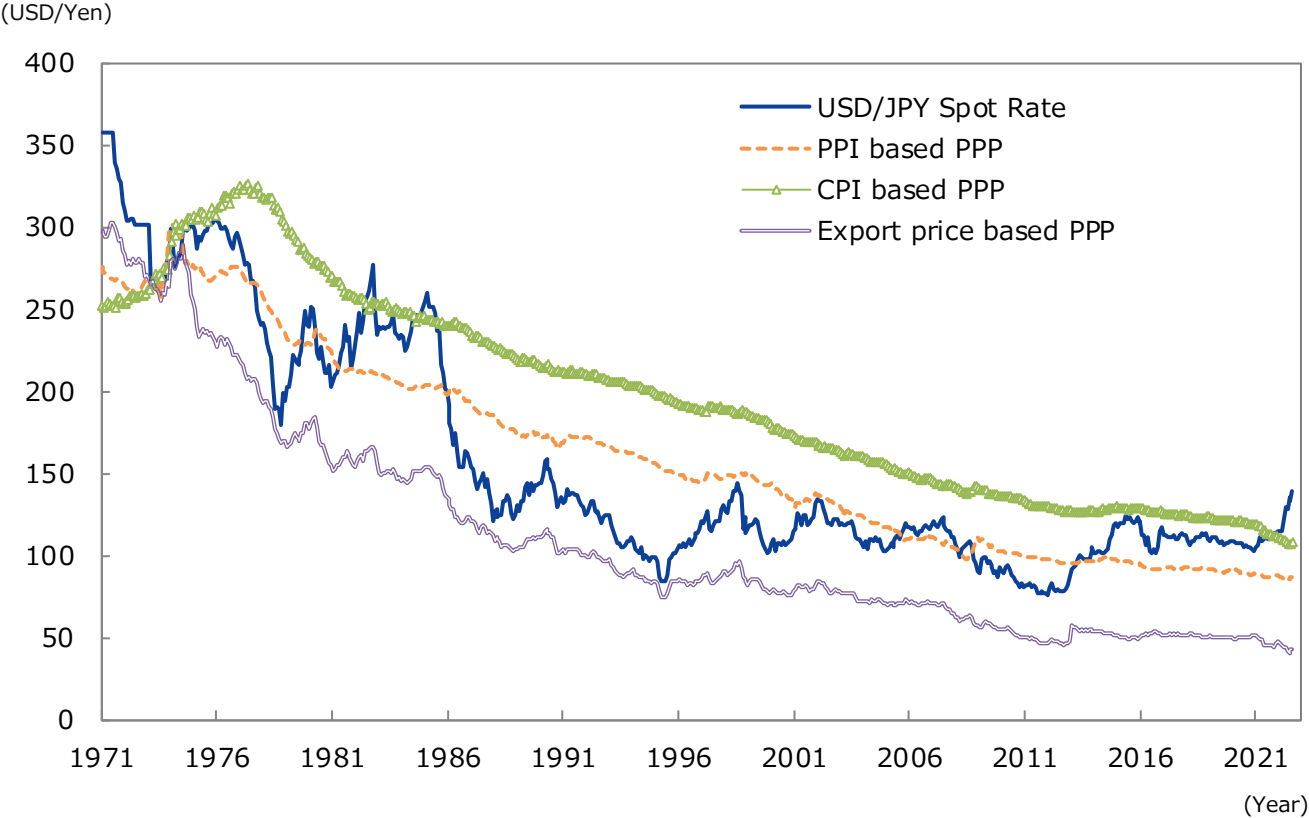
(Data) From Jan. 2010 to Aug. 2022.
(Source) MOF, Bank of Japan, SMDAM

Real Export to China (SA, Billion Yen)



USD/JPY exchange rate breaks 30+ years' PPP resistance

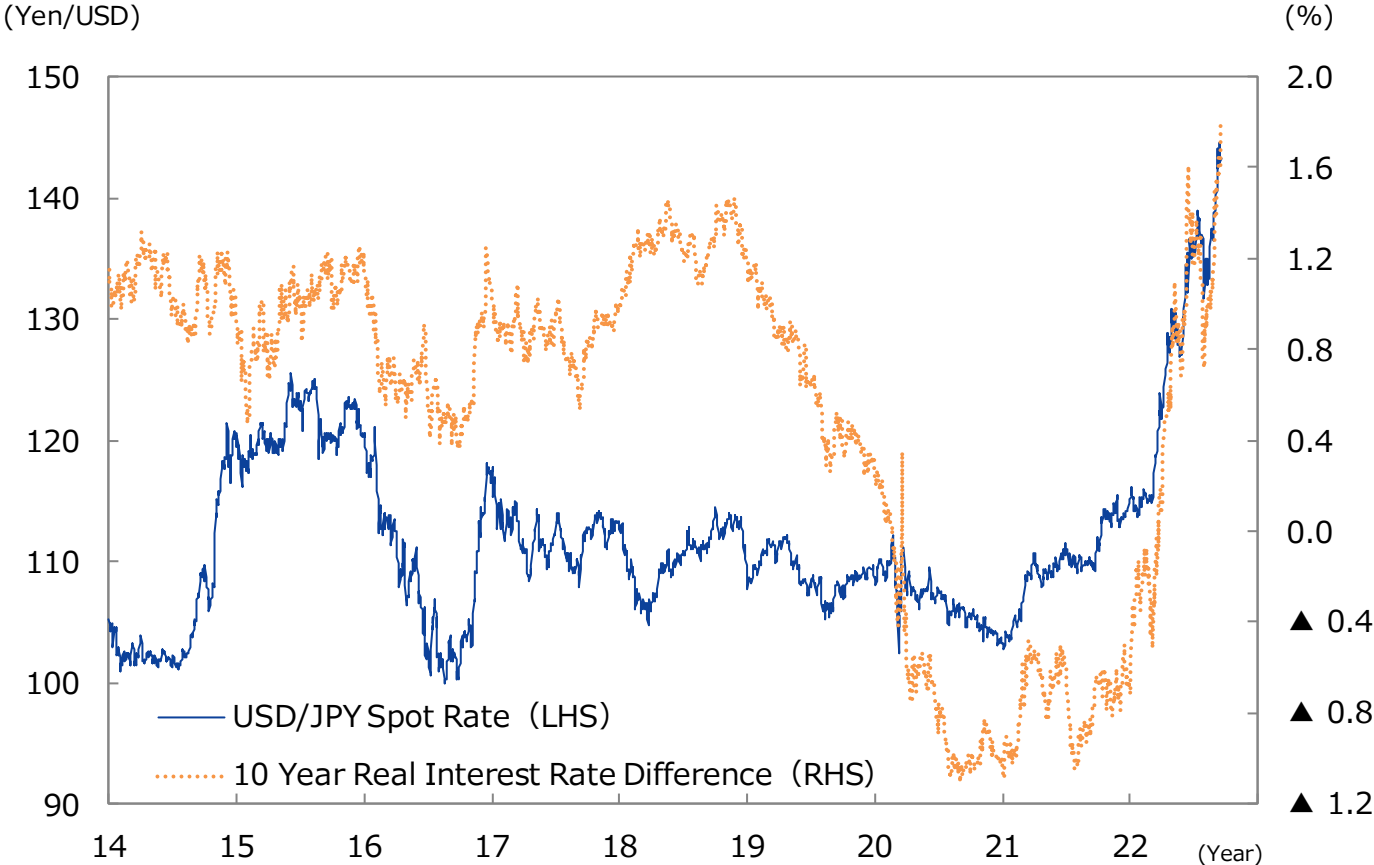
Purchasing Power Parity of USD/JPY Rate



(Data) Data is from Jan. 1971 to Aug. 2022.
(Source) DOL, Bank of Japan, SMDAM

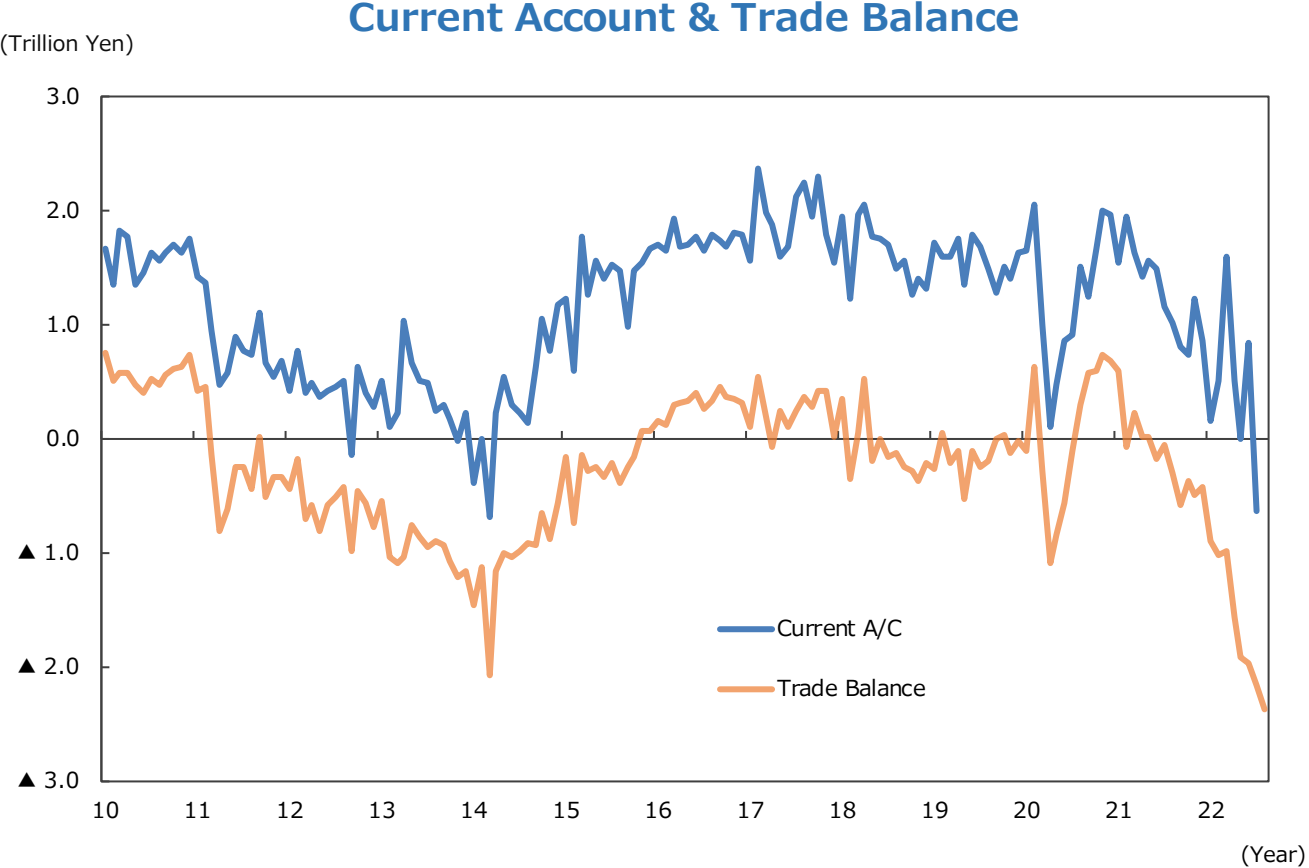
Real interest rate gap lifts dollar yen rate higher again

Real Interest Rate Gap & USD/JPY Exchange rate



(Data) From Jan. 1st 2014 to Sep. 19th 2022.
(Source) Bloomberg, SMDAM

Rising food & energy costs cause huge trade deficit



(Data) Seasonally adjusted. Current account is from Jan. 2010 to July 2022.
Trade balance is from Jan. 2010 to Aug. 2022.
(Source) MOF, SMDAM

Japan's marginal exposure to Russian business

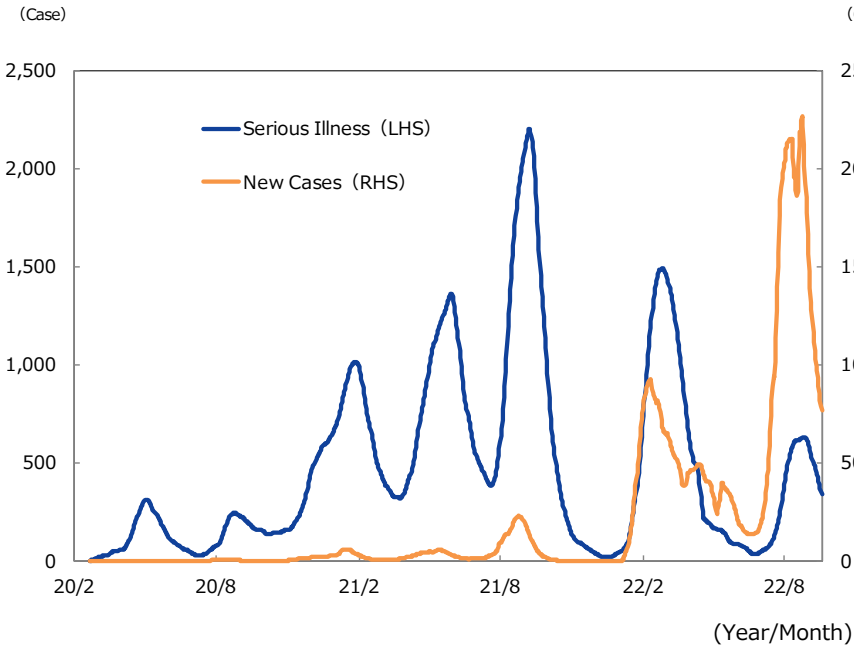
Trade Exposure to Russia (%)

	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Export	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01	0.00
Electronics	0.07	0.01	0.00	0.00
Transportation Equipment	0.56	0.09	0.00	0.00
Others	0.07	0.01	0.00	0.00

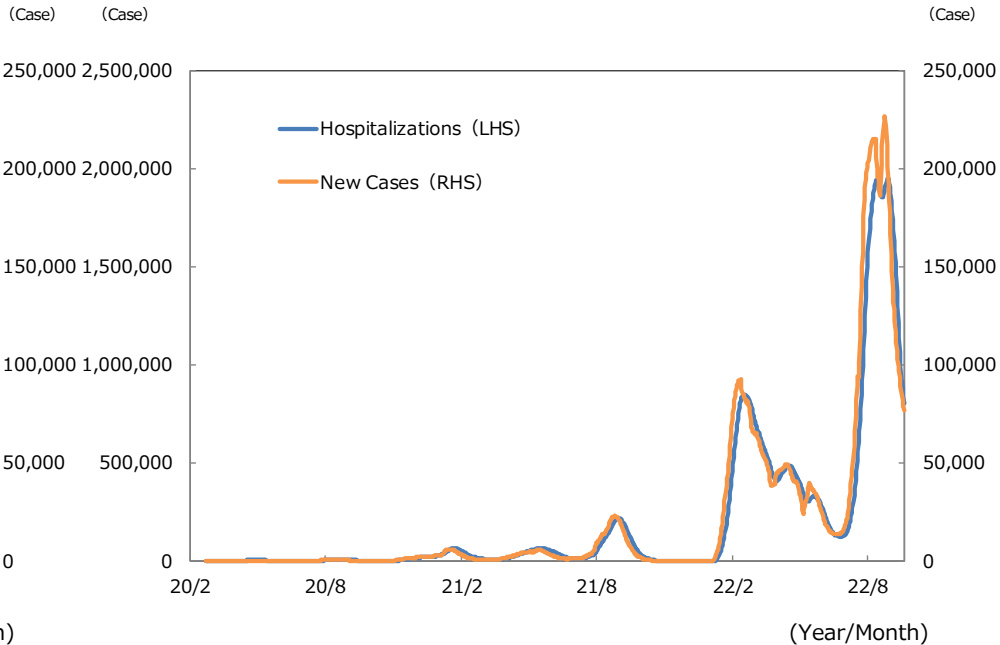
(Data) As of year 2021.
 (Source) MOF, SMDAM

COVID-19 infections plunge sharply after reaching global peak

COVID-19 New Cases and Serious Illness



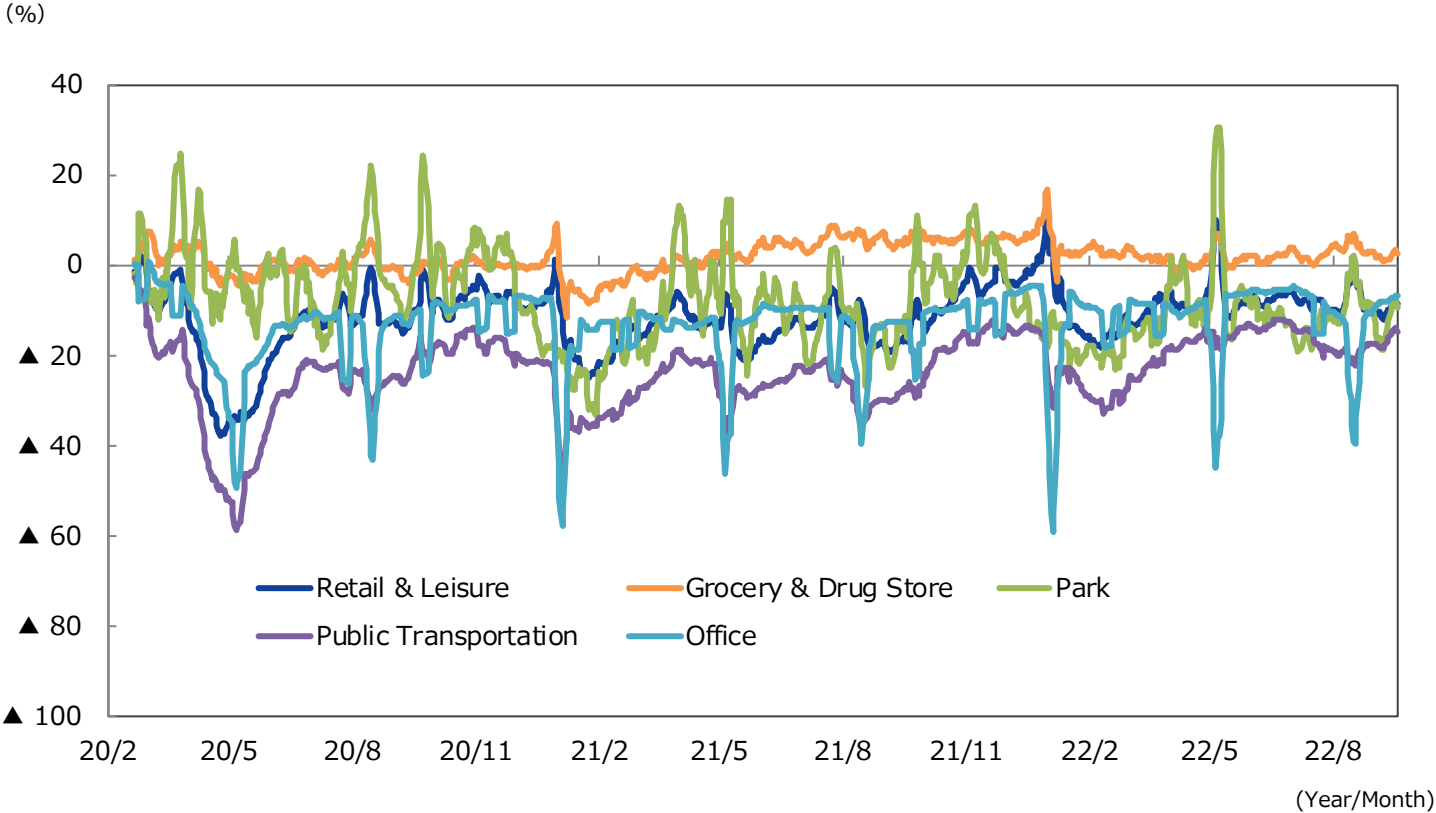
COVID-19 New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 21st 2020 to Sep. 18th 2022.
 (Source) MHLW, NHK, SMDAM

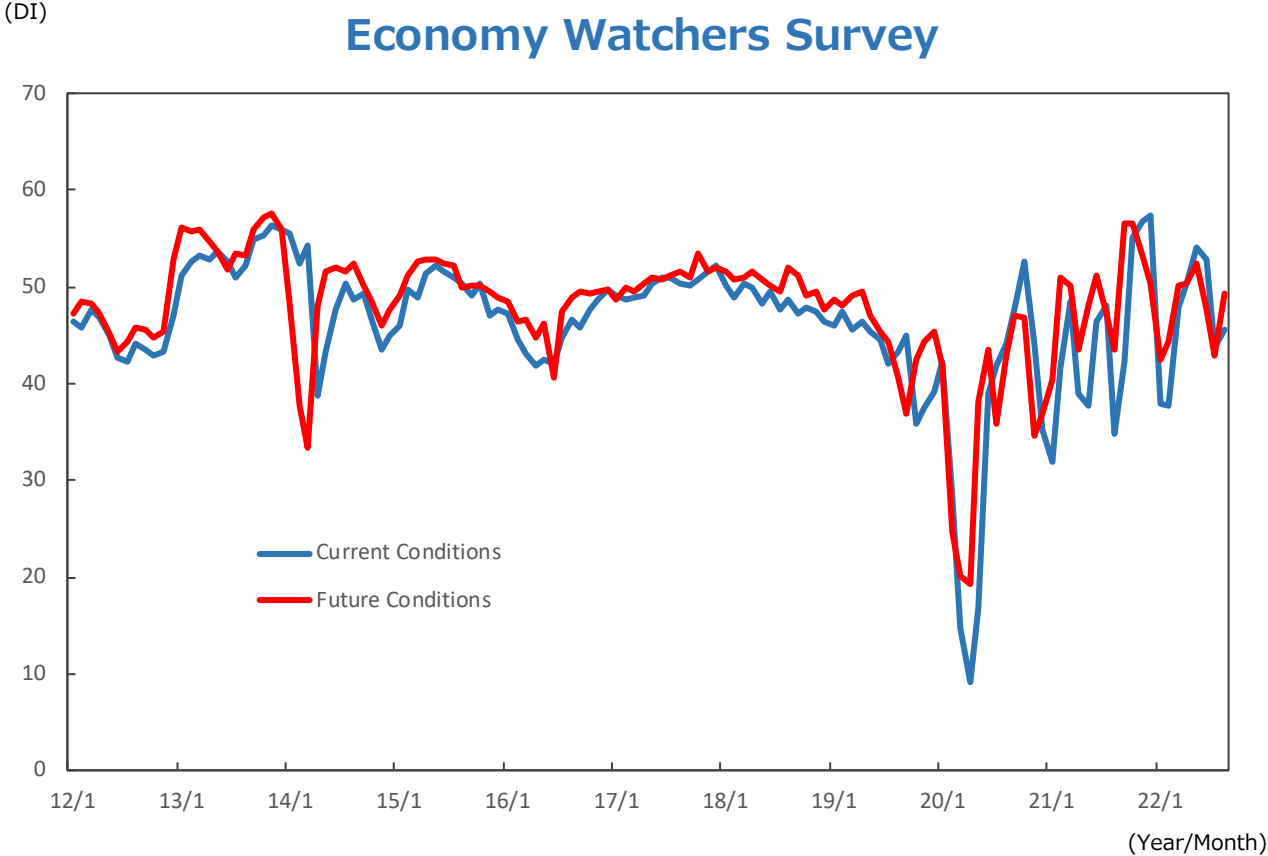
Mobility data endorses trend of normalization of Japanese economy

Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21st 2020 to Sep. 18th 2022
(Source) Google, SMDAM

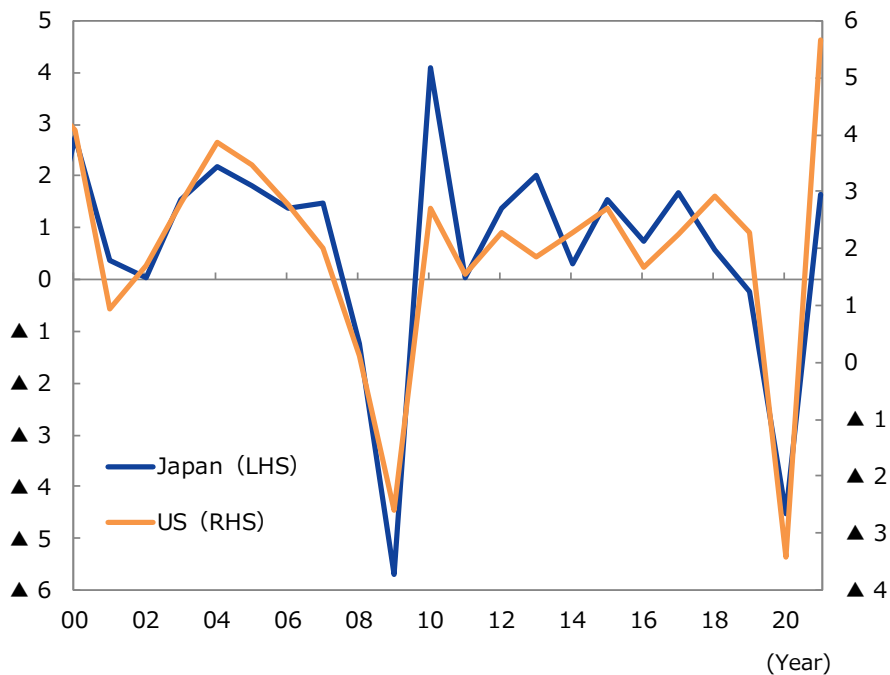
Re-opening of the economy may lift consumer activities ahead



(Data) From Jan. 2012 to Aug. 2022
(Source) Cabinet Office, SMDAM

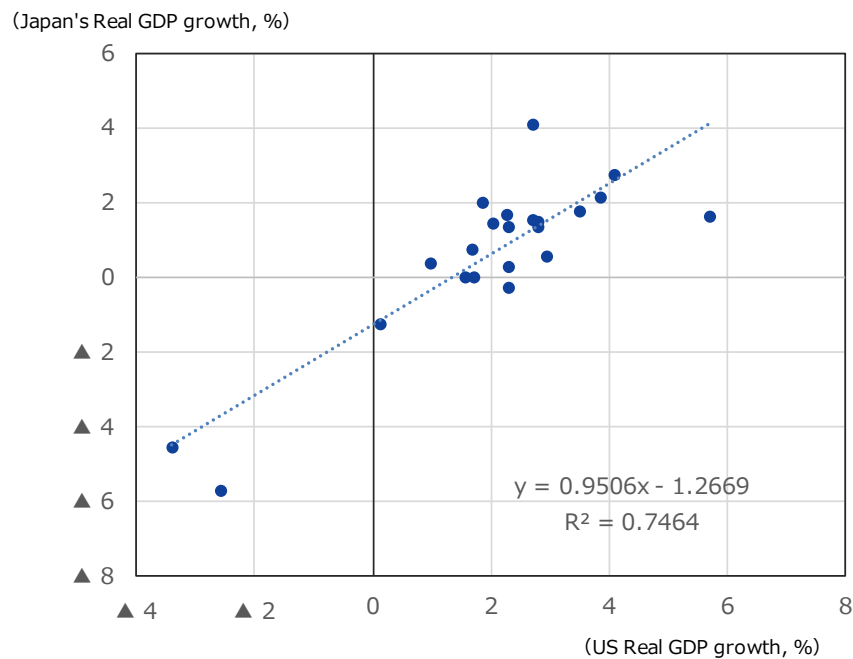
Strong GDP growth correlation between US and Japan

Real GDP Growth (YOY, %)



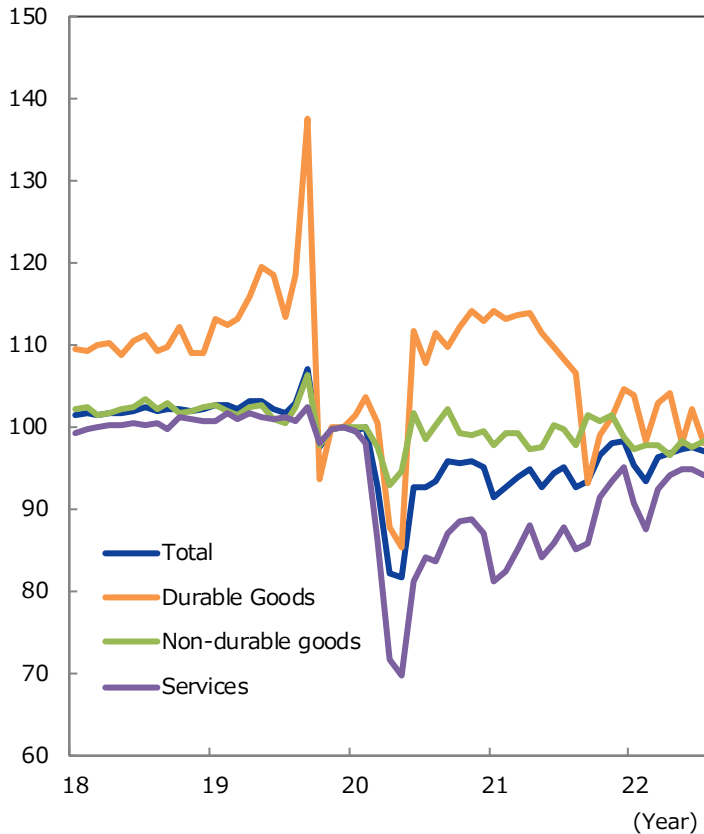
(Data) From 2000 to 2021
(Source) IMF, SMDAM

Correlation of Real GDP Growth



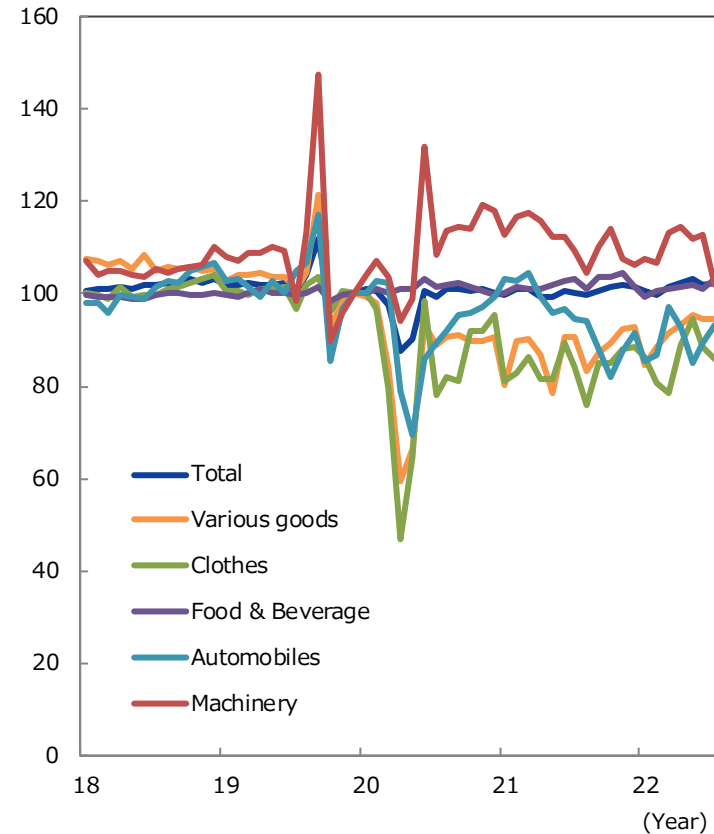
Tailwind for durables weakens due to normalization of the economy

Consumer Activity Index (Dec. 2019 = 100)



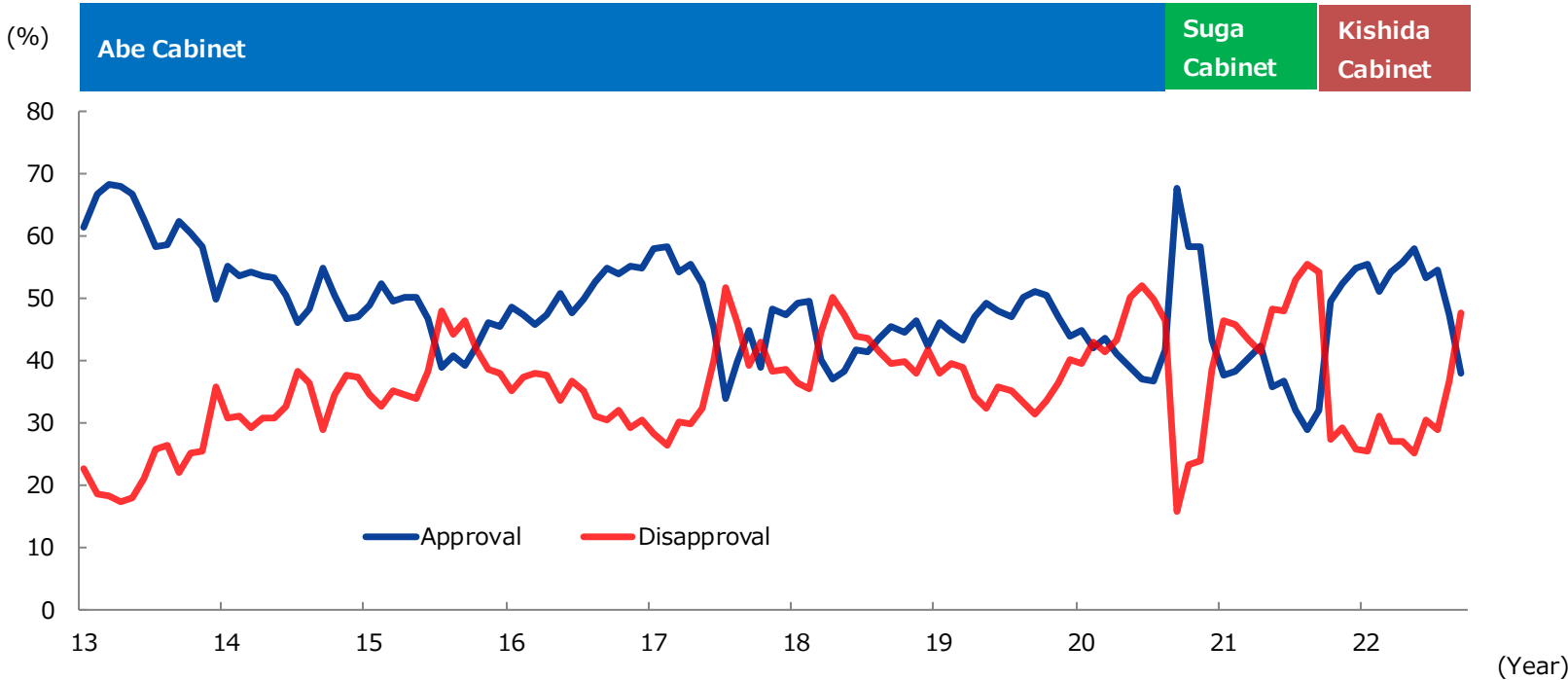
(Data) From Jan. 2018 to July 2022.
(Source) Bank of Japan, METI, and SMDAM

Retail Sales (Dec. 2019 = 100)



“Unification Church” scandal seriously hits PM Kishida’s approval rating

Cabinet approval rate



(Data) From Jan. 2013 to Sep. 2022
(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Schedule of Major Domestic Events			
2022	October	27-28	Monetary Policy Meeting Formulation of comprehensive economic measures
	November	15 15-16	Release of CY 2022 Q3 GDP G20 Summit in Indonesia
	December	8 19-20	Revision of CY 2022 Q3 GDP Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023
2023	January	17-18	Monetary Policy Meeting Convocation of the ordinary diet
	February	14	Release of CY 2022 Q4 GDP
	March	9 9-10 19	Revision of CY 2022 Q4 GDP Monetary Policy Meeting Term expiration of the BOJ vice governor Amemiya and Wakatabe Enactment of the budget and tax reform bill of FY 2023
	April	8 27-28	Term expiration of the BOJ governor Kuroda Monetary Policy Meeting Nationwide local elections
	May	19-21	G7 Summit in Japan
	June	15-16	Monetary Policy Meeting Big-boned policy decisions End of the ordinary Diet session

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

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