



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-March 2022-



Outlook for Japanese Stock Market

Market Outlook

- We maintain our bullish perspective on the Japanese equity market thanks to encouraging corporate earnings growth and the recovery of the domestic economy.
- Our target of TOPIX is at 2,270 and Nikkei 225 at 32,600 for FY 2022.
- TOPIX EPS could recover by 40+% YOY in the current fiscal year to 134 points, a historical high, and continue its double digit growth to 152 points in the next fiscal year.
- Though concerns over US monetary policy, global inflation and geopolitical risk could keep market volatility high in the near future, the Japanese equity market will resume its bullish trend after digesting various risk scenarios.



TOPIX forecast – expect bullish trend ahead



Note: TOPIX data is from Jan. 1st 2016 to Feb. 18th 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

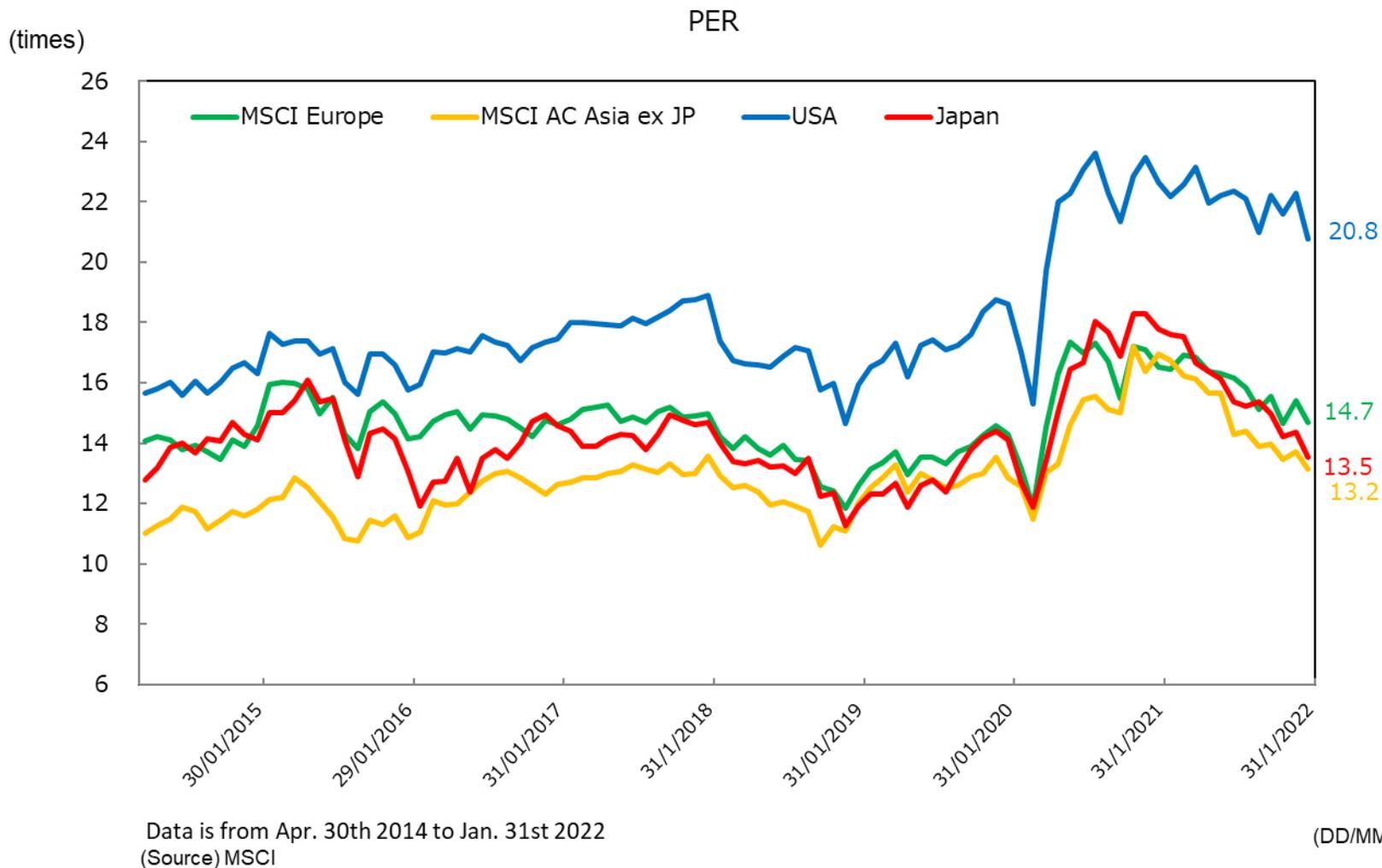
■ Upside Risks

- Rapid normalization of the economy thanks to the establishment of effective new treatments for COVID-19
- Recovery of inbound travel to Japan

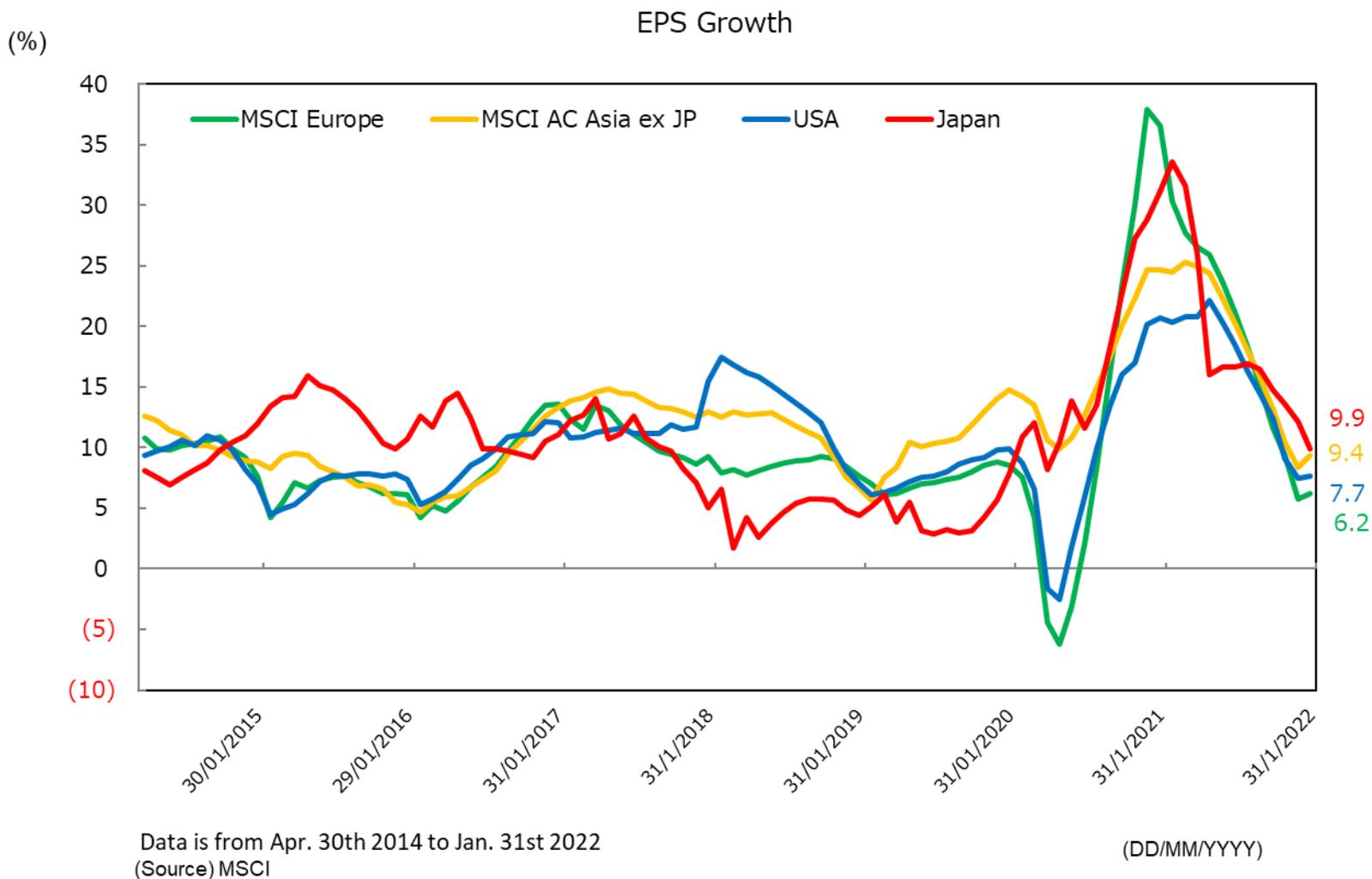
■ Downside Risks

- Delay of the normalization of the economy owing to the spread of the new COVID-19 variant
- Additional inflationary pressure from the bottle neck in the global supply chain
- Concern about stagflation

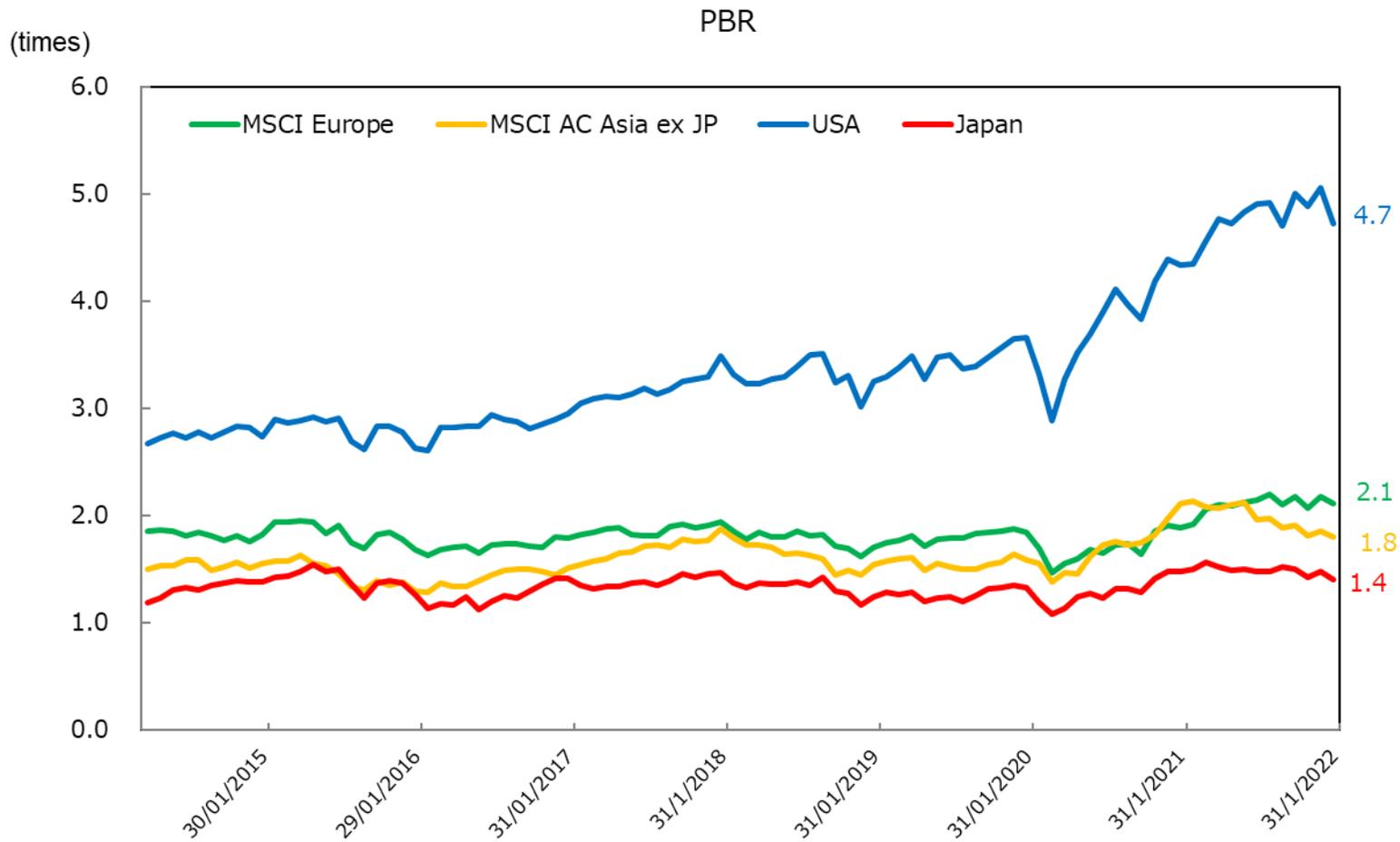
PER back to normal excluding US



Earnings growth slowing to long term average



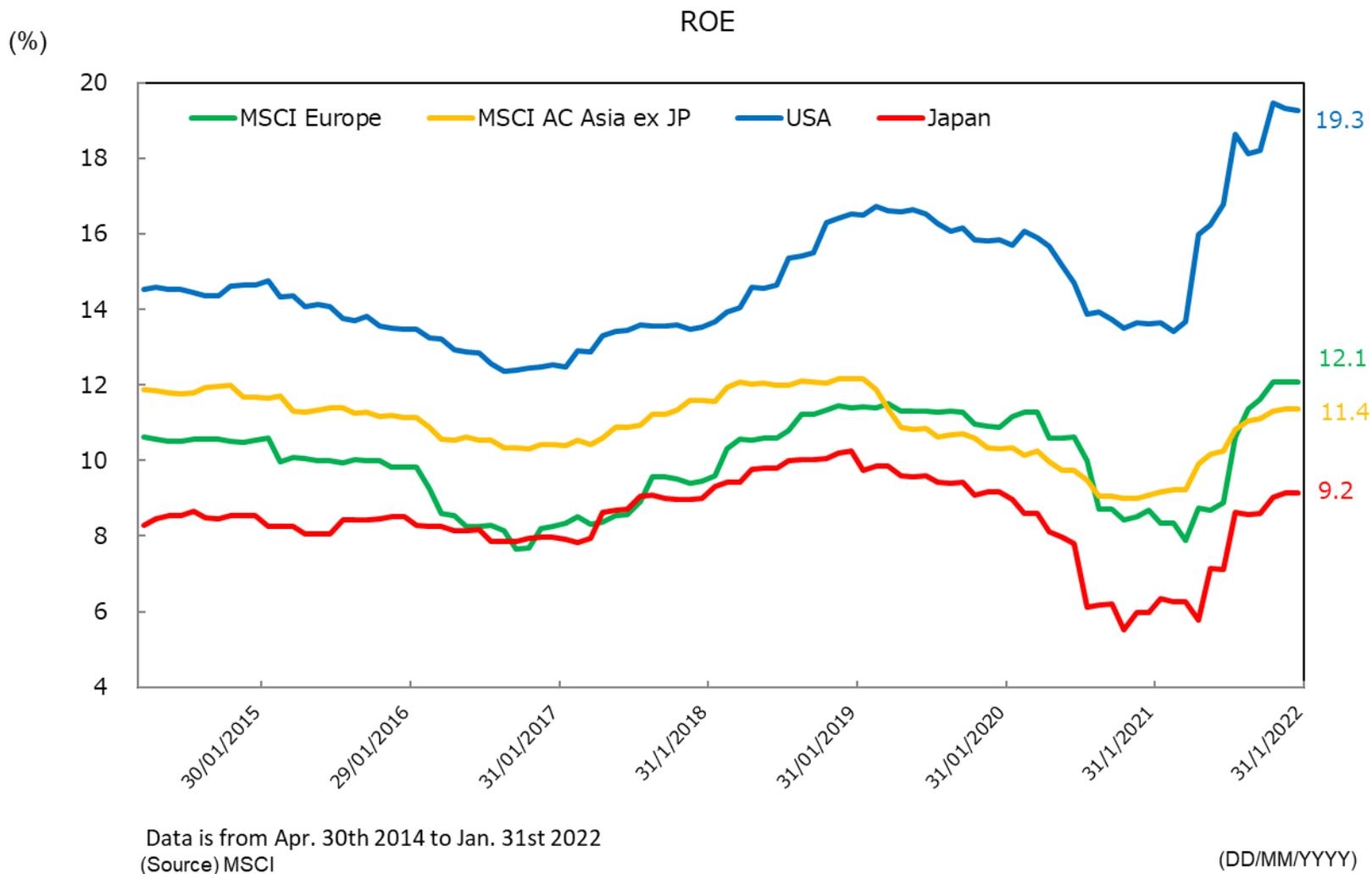
PBR – mind the gap between US and others



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

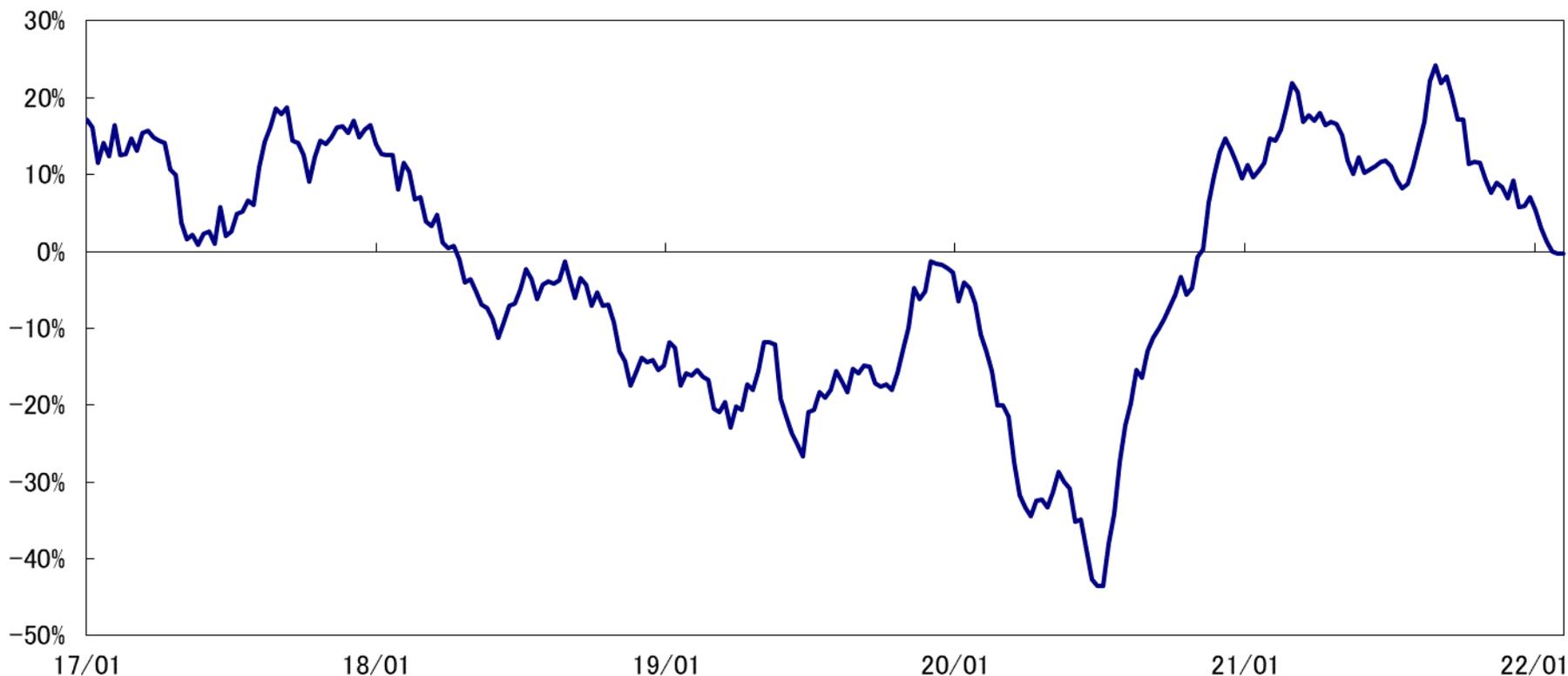
(DD/MM/YYYY)

Japan's ROE recovering but lagging behind peers



Omicron and rising costs weighing on earnings forecasts

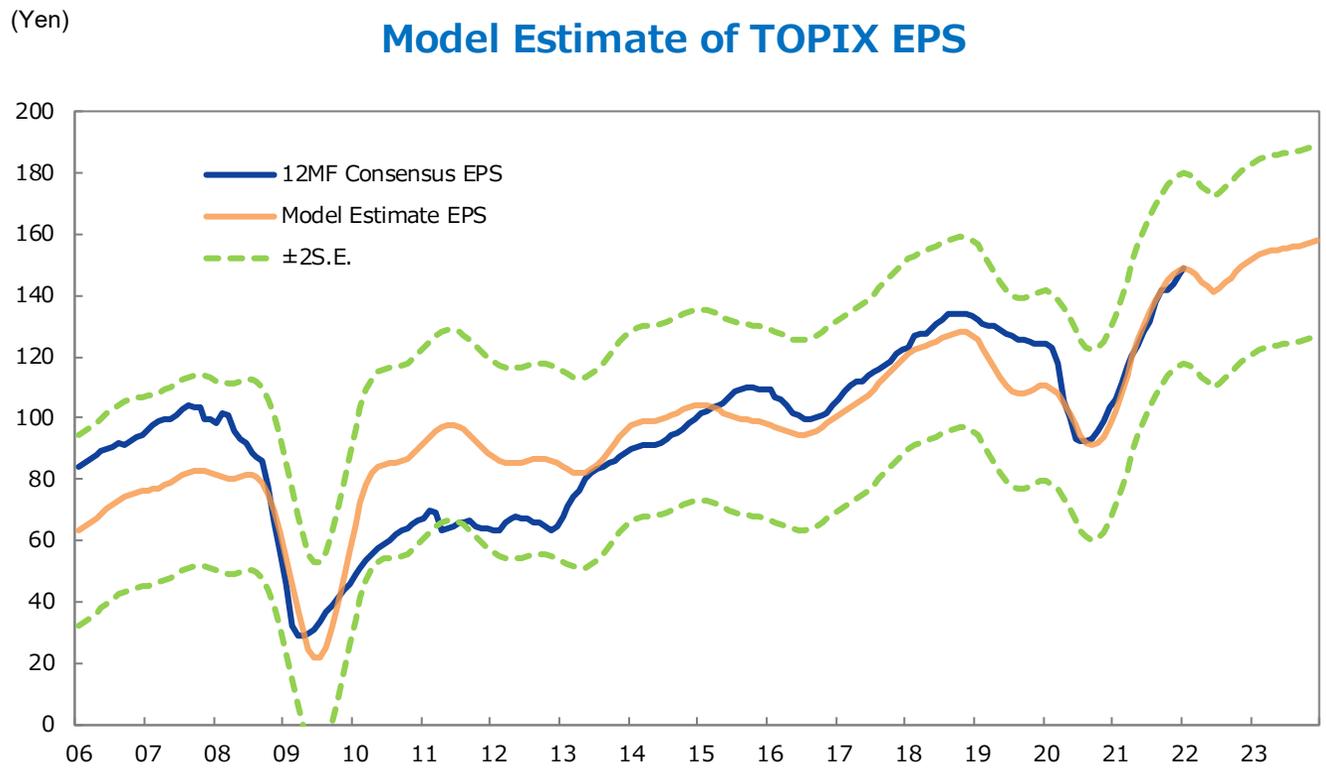
TOPIX Revision Index



Data is from Jan. 3rd 2017 to Feb. 8th 2022
(Source) Datastream, IBES

(YY/MM)

Quants estimate EPS reaccelerates after temporary pause

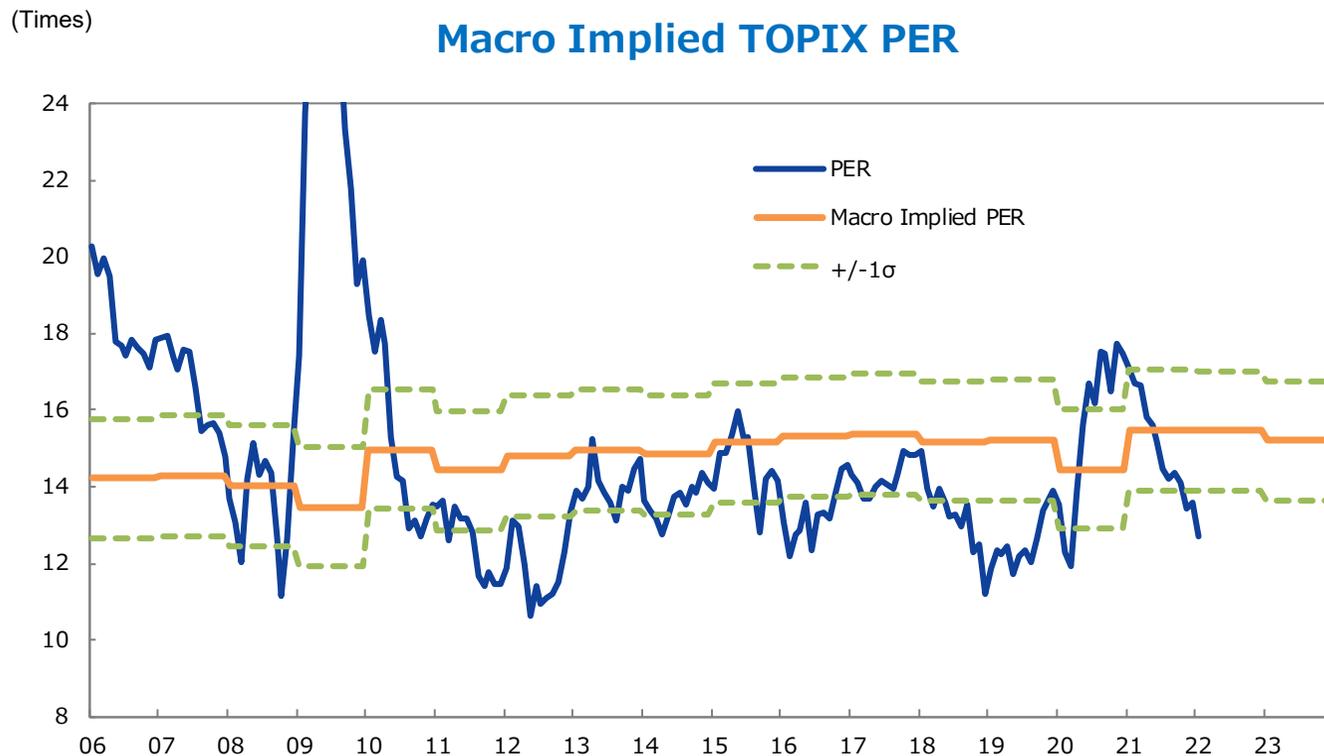


Consensus data is from Jan. 2006 to Jan. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

PER sank below the bottom of the model estimate range

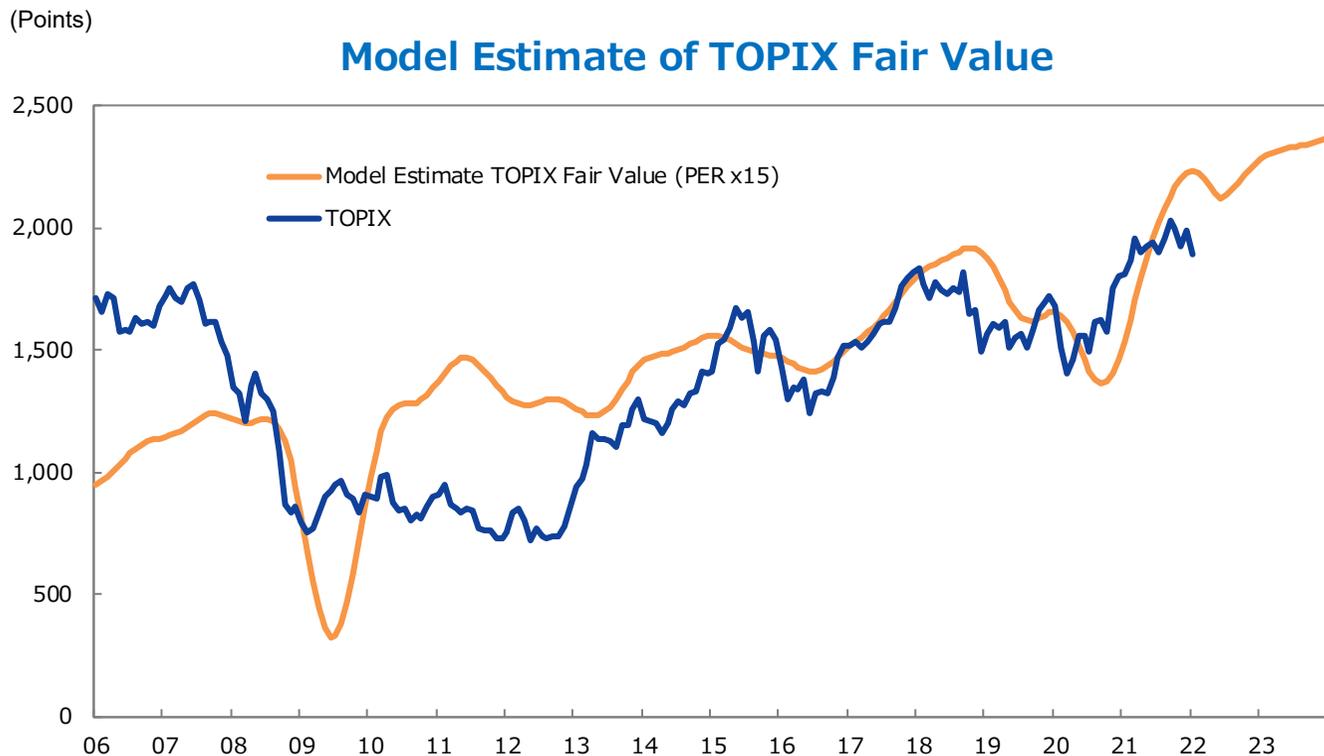


Consensus data is from Jan. 2006 to Jan. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Quants analysis indicates attractive opportunity to accumulate



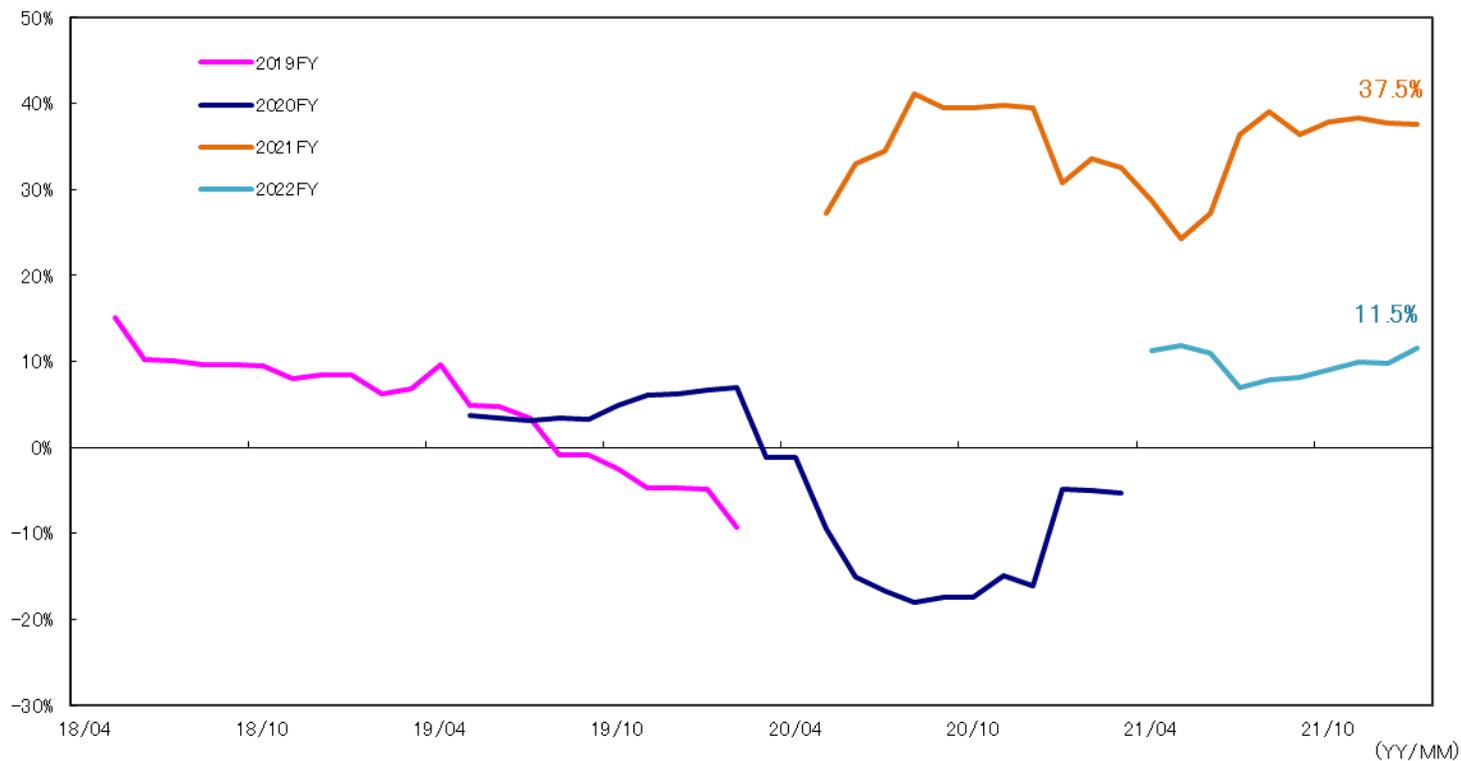
TOPIX data is from Jan. 2006 to Jan. 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Bottom up estimate – steady earnings growth ahead

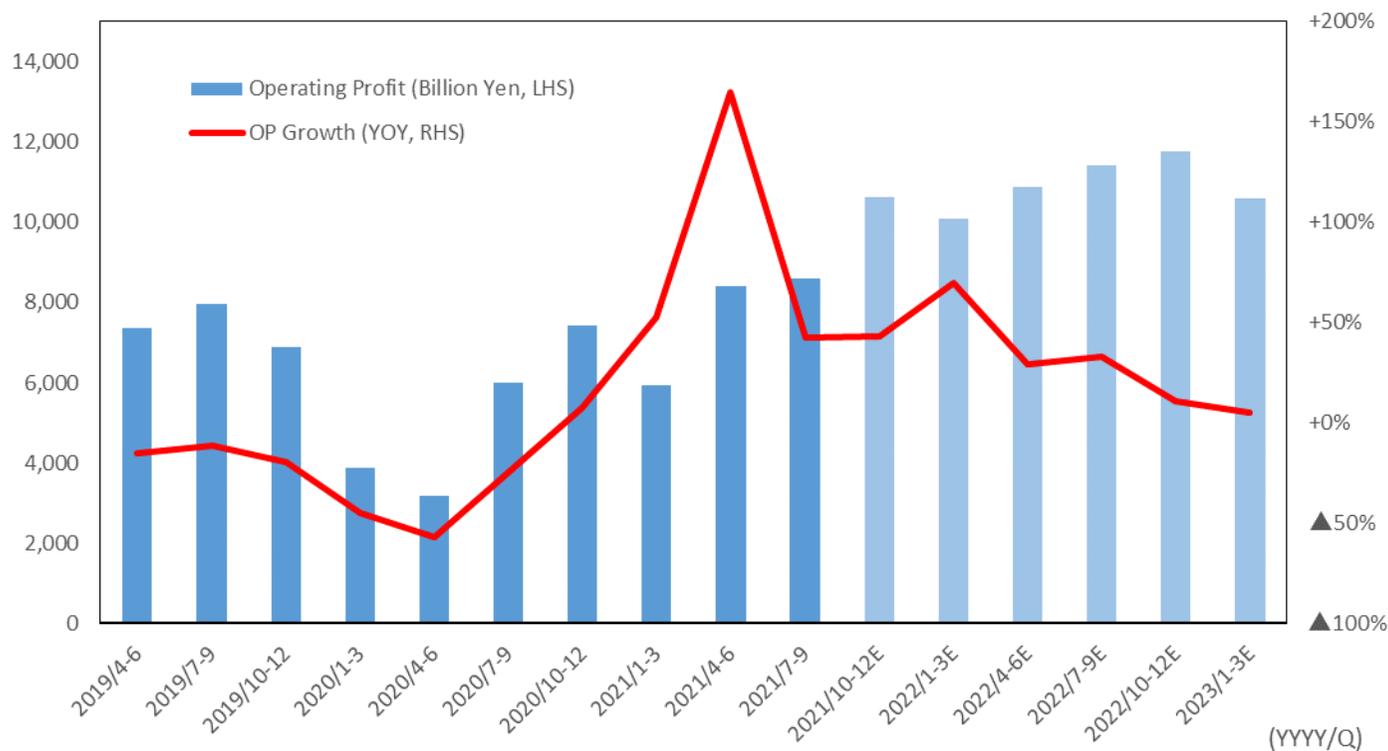
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of Feb. 8th 2022, SMDAM Core Universe (Excl. Financials) consists of 452 major Japanese companies covered by SMDAM in-house analysts.
(Source) SMDAM

Bottom up estimate – steady outlook for operating profit

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



Actual data is from Q2 2019 to Q3 2021, estimate data is from Q4 2021 to Q1 2023
 (Source) SMDAM

Tide of improving corporate governance in Japan

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	205
Insurance companies	24
Pension funds	74
Others	11
Total	320

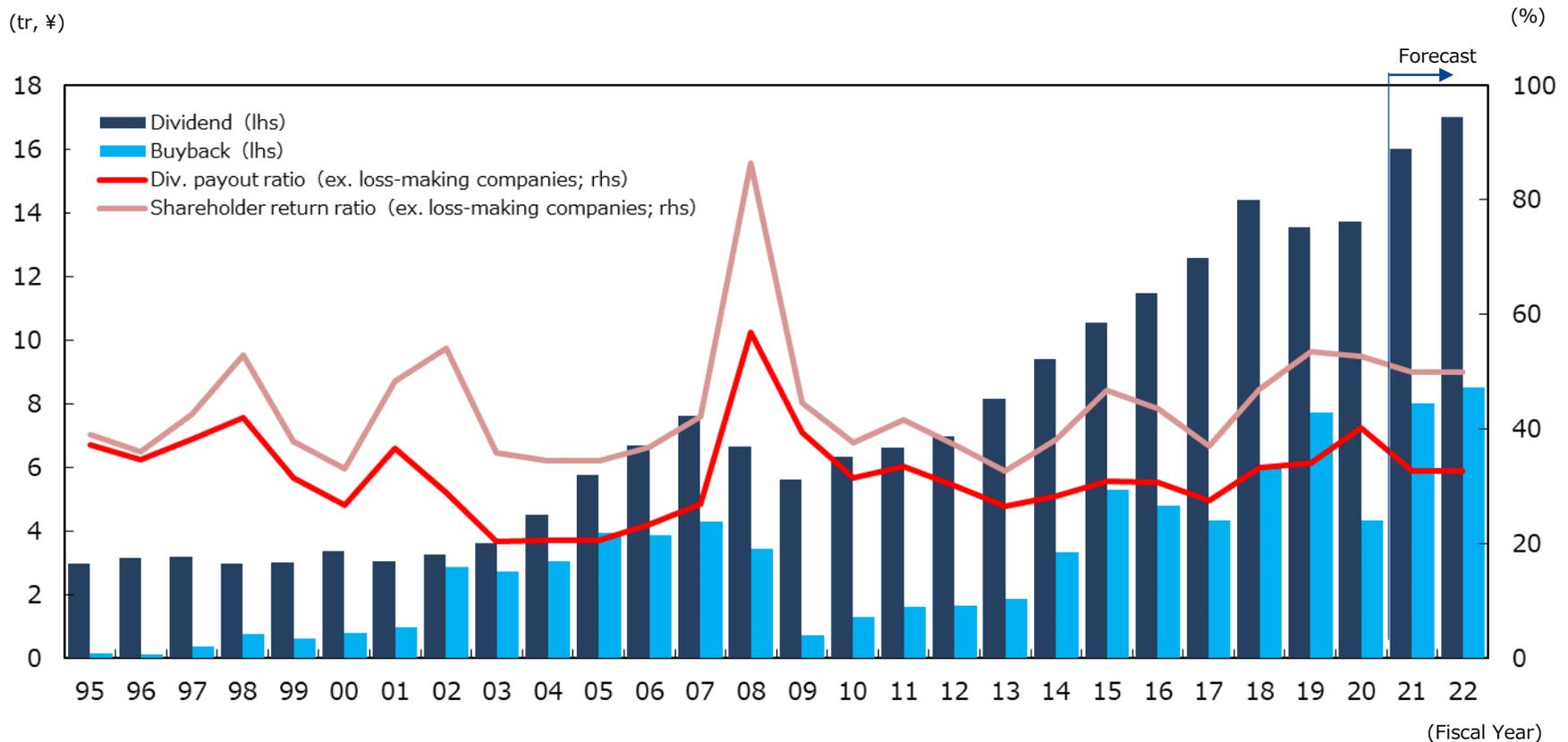
note: As of Jan. 31st 2022

(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.

Encouraging trend of dividends and share buybacks

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 - value stocks dominate recent market

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	-5.59	0.96	-2.74	-1.58	14.51	24.08	26.39
Total Value	2.30	6.40	5.13	8.71	13.33	16.17	12.81
Top Cap Value	2.46	8.73	5.91	12.87	20.53	28.72	22.14
Large Cap Value	2.84	7.53	5.94	10.12	14.78	17.97	14.55
Mid Cap Value	3.33	6.05	5.97	6.82	7.33	3.83	4.18
Small Cap Value	0.09	1.49	1.86	2.50	6.94	8.28	4.64
Micro Cap Value	-0.68	1.58	-0.80	2.44	4.00	9.46	8.04
Total Growth	-12.68	-3.68	-9.93	-10.80	14.12	30.67	40.01
Top Cap Growth	-11.88	-1.62	-10.41	-9.94	17.97	38.83	47.35
Large Cap Growth	-12.31	-3.24	-10.08	-10.72	15.72	33.37	41.89
Mid Cap Growth	-13.09	-5.98	-9.47	-12.07	11.71	24.75	33.26
Small Cap Growth	-15.97	-7.67	-8.62	-11.19	0.83	9.68	23.62
Micro Cap Growth	-20.61	-10.00	-12.31	-15.10	-0.85	9.56	25.40
Top Cap Total	-5.94	2.51	-3.64	-0.51	18.78	33.40	34.13
Large Cap Total	-5.55	1.43	-2.89	-1.42	16.00	26.54	28.75
Mid Cap Total	-4.94	-0.09	-1.70	-2.70	12.28	17.07	21.23
Small Cap Total	-5.90	-2.12	-1.90	-2.64	5.46	9.88	12.71
Micro Cap Total	-7.14	-2.08	-4.28	-3.17	3.52	10.93	15.80

Note : As of Feb. 13th 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- The economy is in a soft patch. The rapid spread of the COVID-19 Omicron variant is hurting consumer sentiment and weighing on the economy as a whole. Though employment and wages are recovering, real income is declining owing to higher inflation. Inflation is slowing thanks to the receding effect of special items, such as travel and hotel fees.

[Outlook]

- ① **We have revised down the real GDP growth forecast for FY 2021 to +2.3% from +2.5% and +2.9% from +3.0% for FY 2022. We have not changed our estimate for FY 2023 at +1.2%.** We have lowered our forecast for FY 2021 and FY 2022 owing to the negative impact of the spread of the Omicron variant, higher inflation and the prolonged issue of the bottle neck in the global supply chain. We have maintained our brighter outlook on FY 2023 and beyond thanks to receding influence of these negative factors and the economic stimulus from the government.
- ② **We have not changed our Core CPI forecast for FY 2021 at +0.1%. We have raised our forecast for FY 2022 to +1.4% from +1.0% and for FY 2023 to +0.9% from +0.8%.** We expect core CPI will approach +2.0% YOY in April 2022 owing to rising energy costs. After that the pace of inflation will decrease with high volatility due to receding influence from energy costs.
- ③ **We expect PM Kishida and his cabinet to maintain the existing policy mix, including fiscal and monetary policy.** If the economy slows further owing to Omicron infections, the government will provide additional fiscal stimulus before the Upper House election in summer 2022.
- ④ **The current accommodative monetary policy of the BOJ will be maintained for the foreseeable future.** However, we should be cautious about the possibility of minor changes in monetary policy because of growing criticism for rising inflation. In addition, since BOJ Governor Kuroda's term will end in April 2023, his resignation could be a turning point for the current accommodative monetary policy.

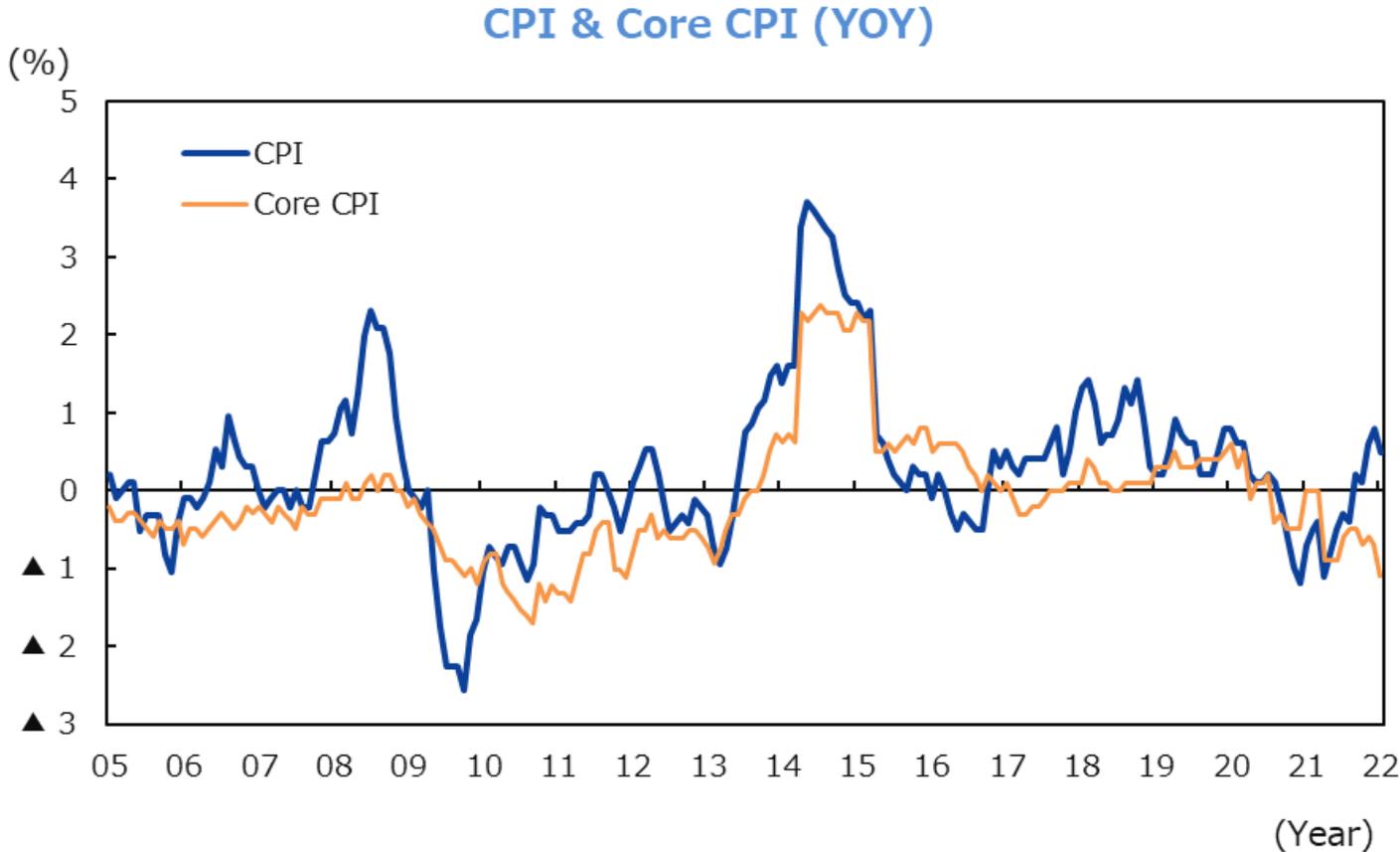
Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY17	FY18	FY19	FY20	FY21 Est	FY22 Est	FY23 Est
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.3%	2.9%	1.2%
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.5%	1.9%	2.9%	1.0%
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-0.9%	-0.2%	0.1%
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	1.2%	3.4%	3.2%
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-5.5%	0.4%	0.2%
Net export contribution	0.4%	-0.2%	-0.4%	-0.7%	1.0%	0.3%	0.1%
Exports of goods and services	6.3%	2.0%	-2.2%	-10.5%	11.9%	4.3%	4.3%
Imports of goods and services	3.8%	3.0%	0.2%	-6.6%	6.0%	2.8%	4.0%
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.3%	3.0%	1.6%
GDP deflator	0.2%	-0.1%	0.8%	0.7%	-0.9%	0.1%	0.4%
Industrial Production Index	2.9%	0.3%	-3.7%	-9.9%	6.2%	4.8%	2.9%
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	1.4%	0.9%
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.4%	7.1%	3.5%	0.2%
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.6%	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

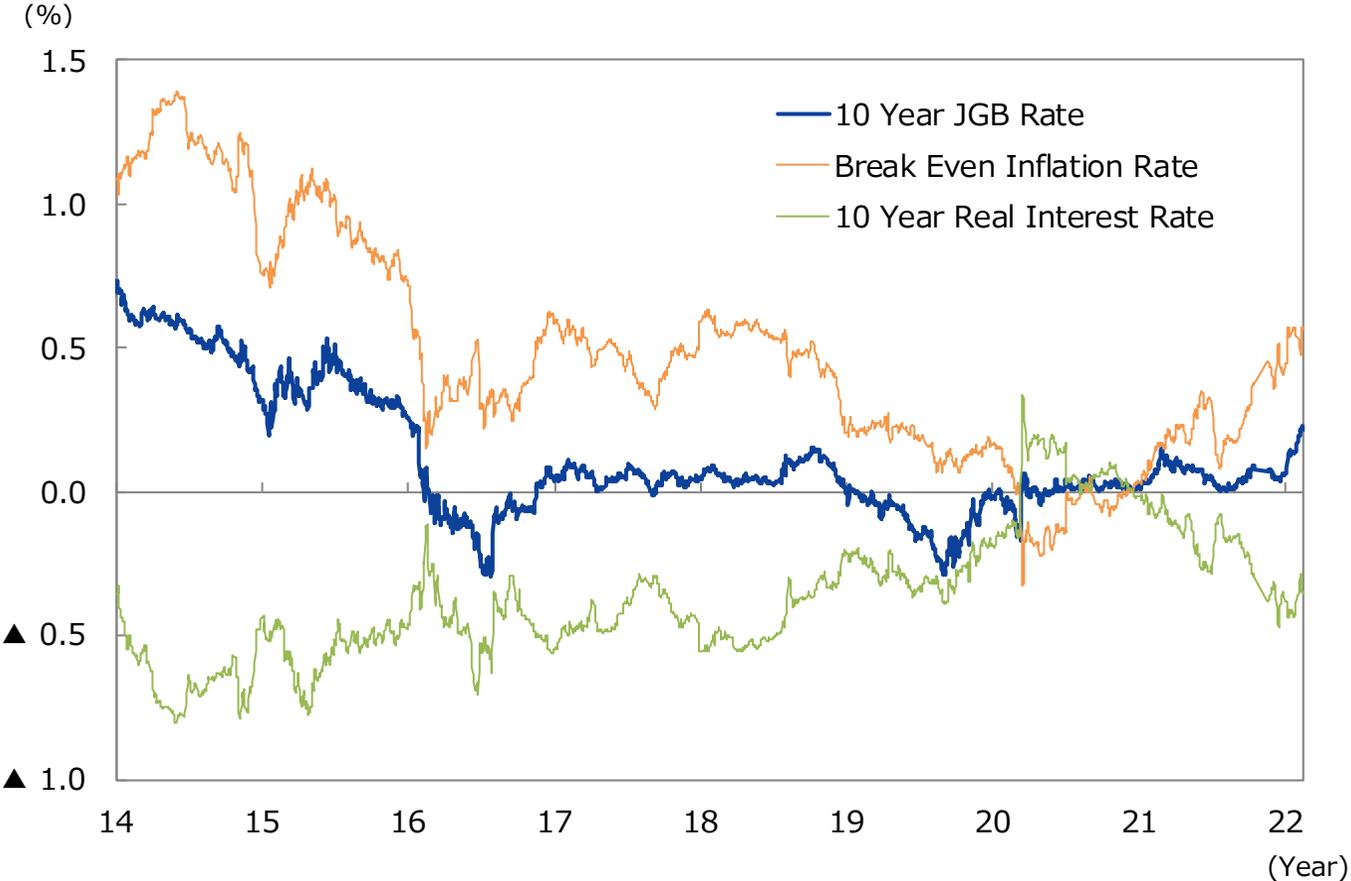
CPI declines despite higher energy costs



(Data) Jan. 2005 to Jan. 2022
(Source) MIAC, Bloomberg, SMDAM

Inflation expectation pushes JGB 10 years yield to six-year high

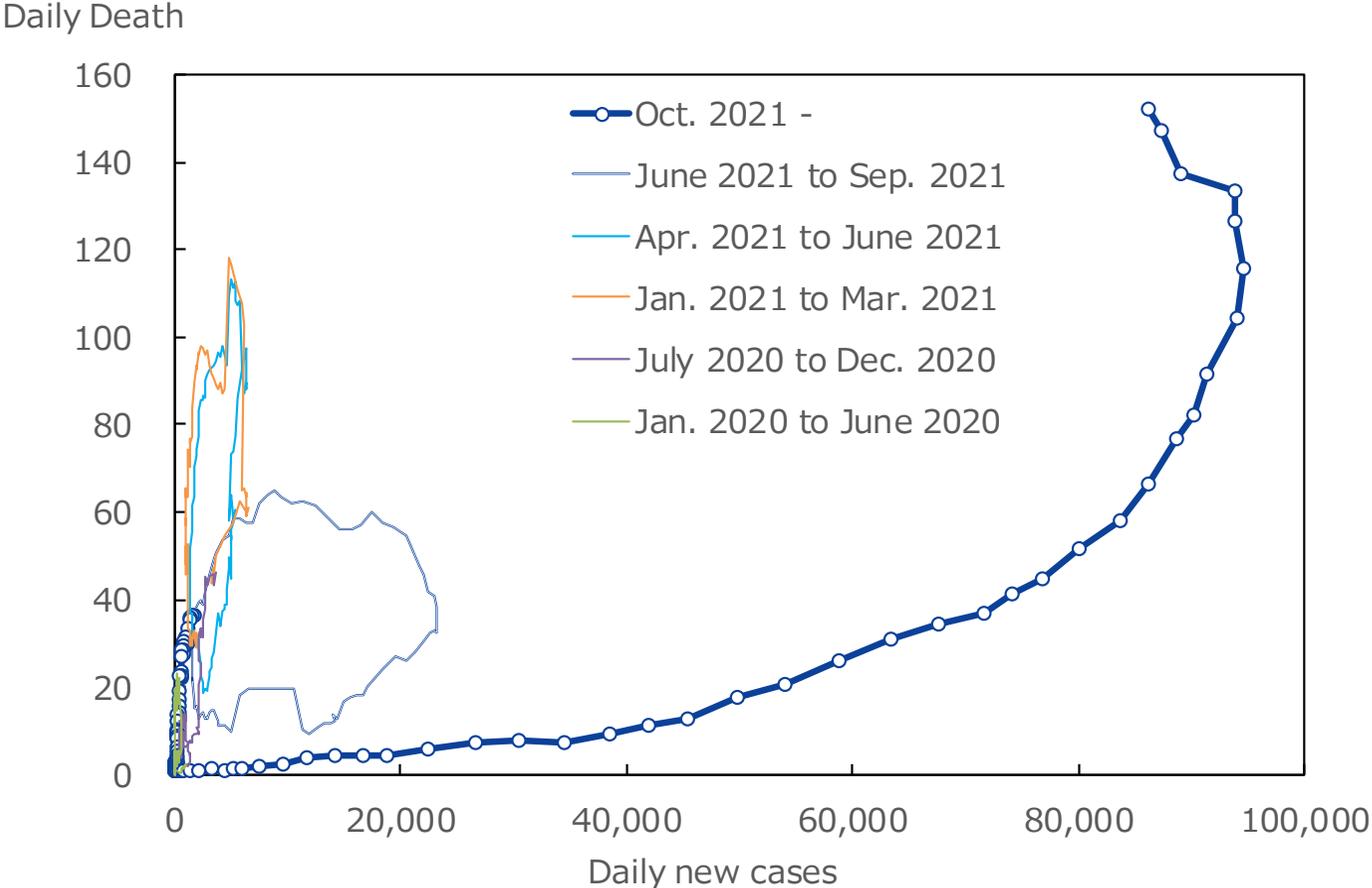
JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to Feb. 15th 2022
(Source) Bloomberg, SMDAM

Omicron fueled the hardest ever COVID-19 surge in Japan

COVID-19 New patients and confirmed deaths in Japan

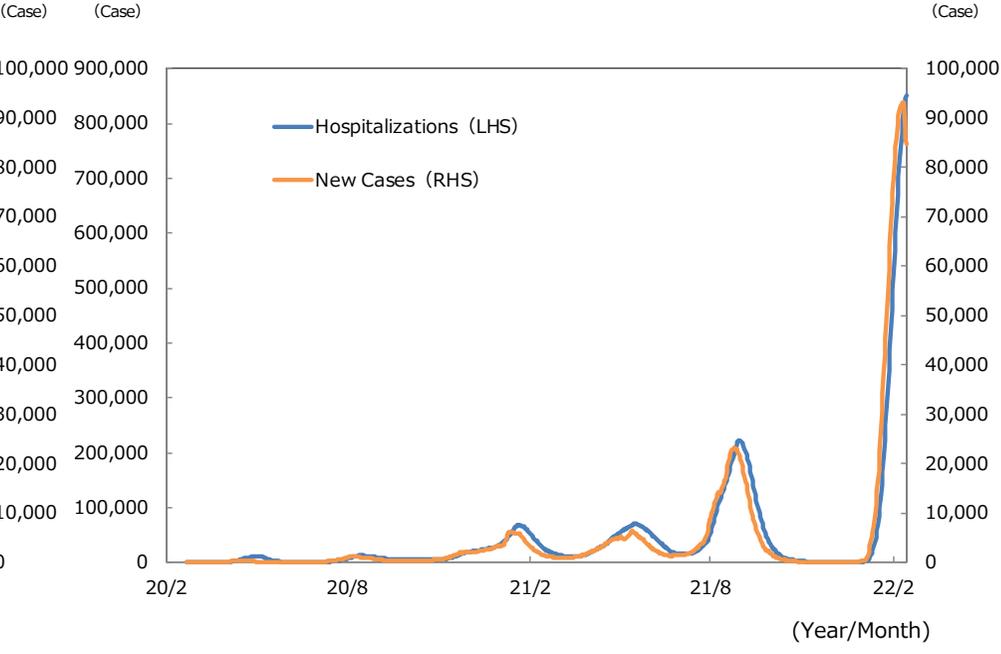
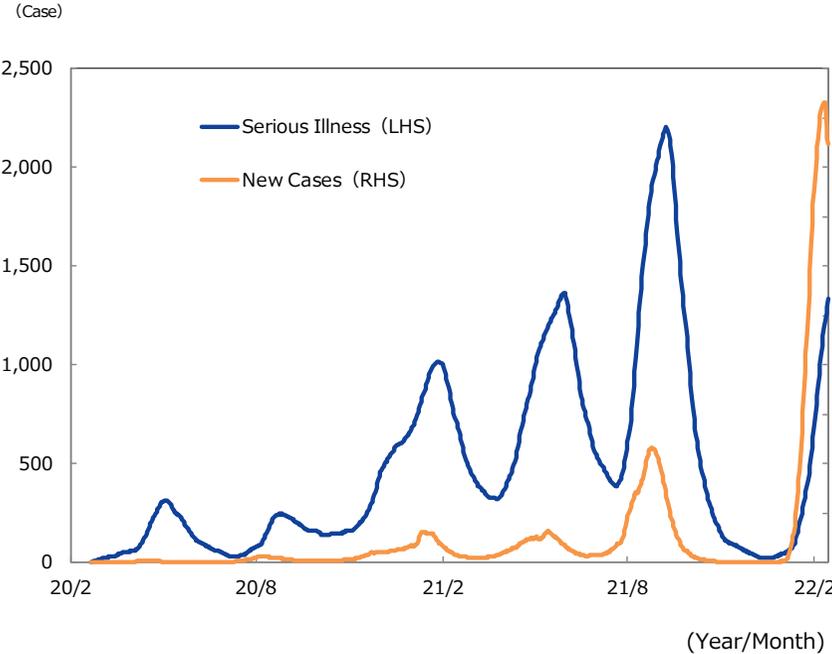


(Data) 7 days moving average, From Jan. 1st 2020 to Feb. 14th 2022
(Source) Bloomberg, SMDAM

Omicron brings the worst ever infection rate in Japan

COVID-19 New Cases and Serious Illness

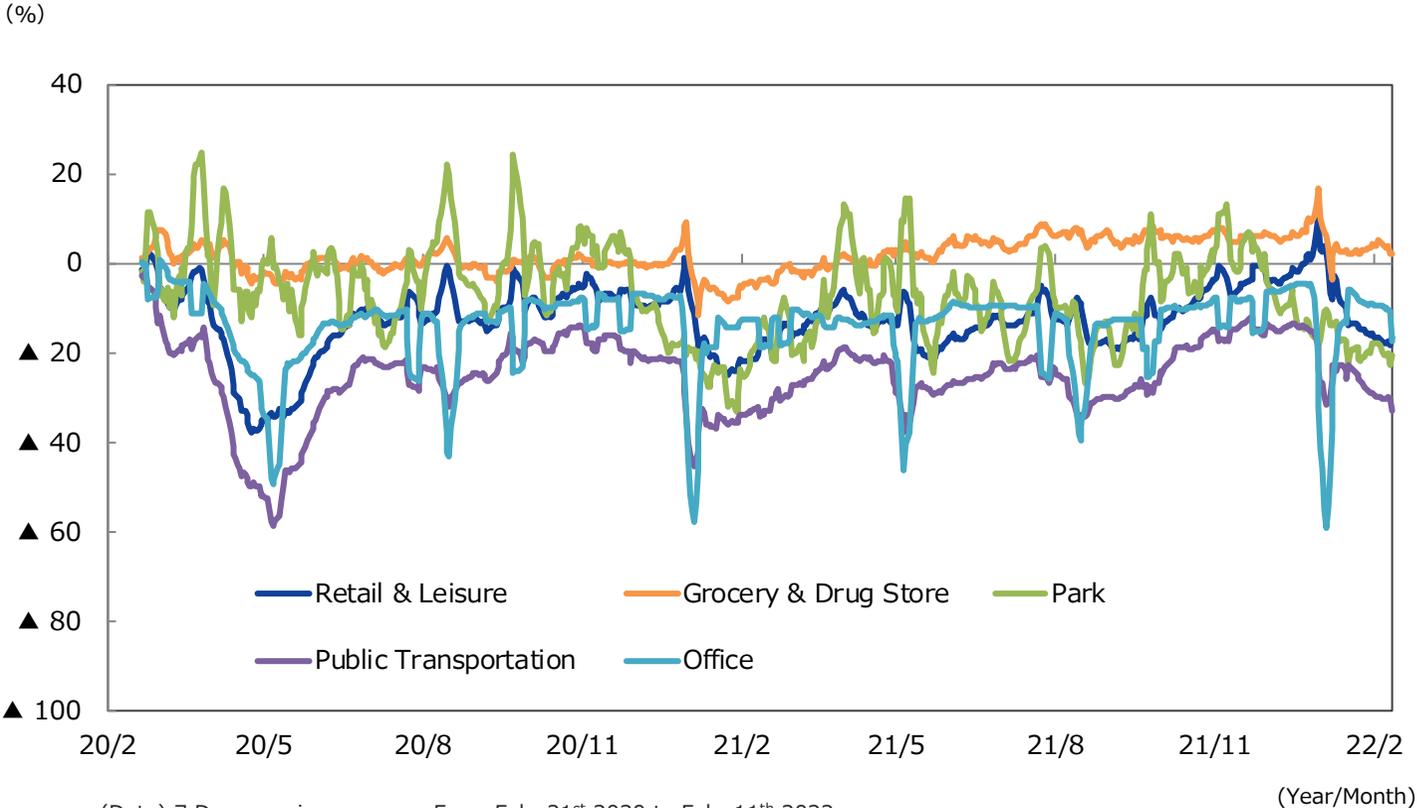
COVID-19 New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 21st 2020 to Feb. 14th 2022
 (Source) MHLW, NHK, SMDAM

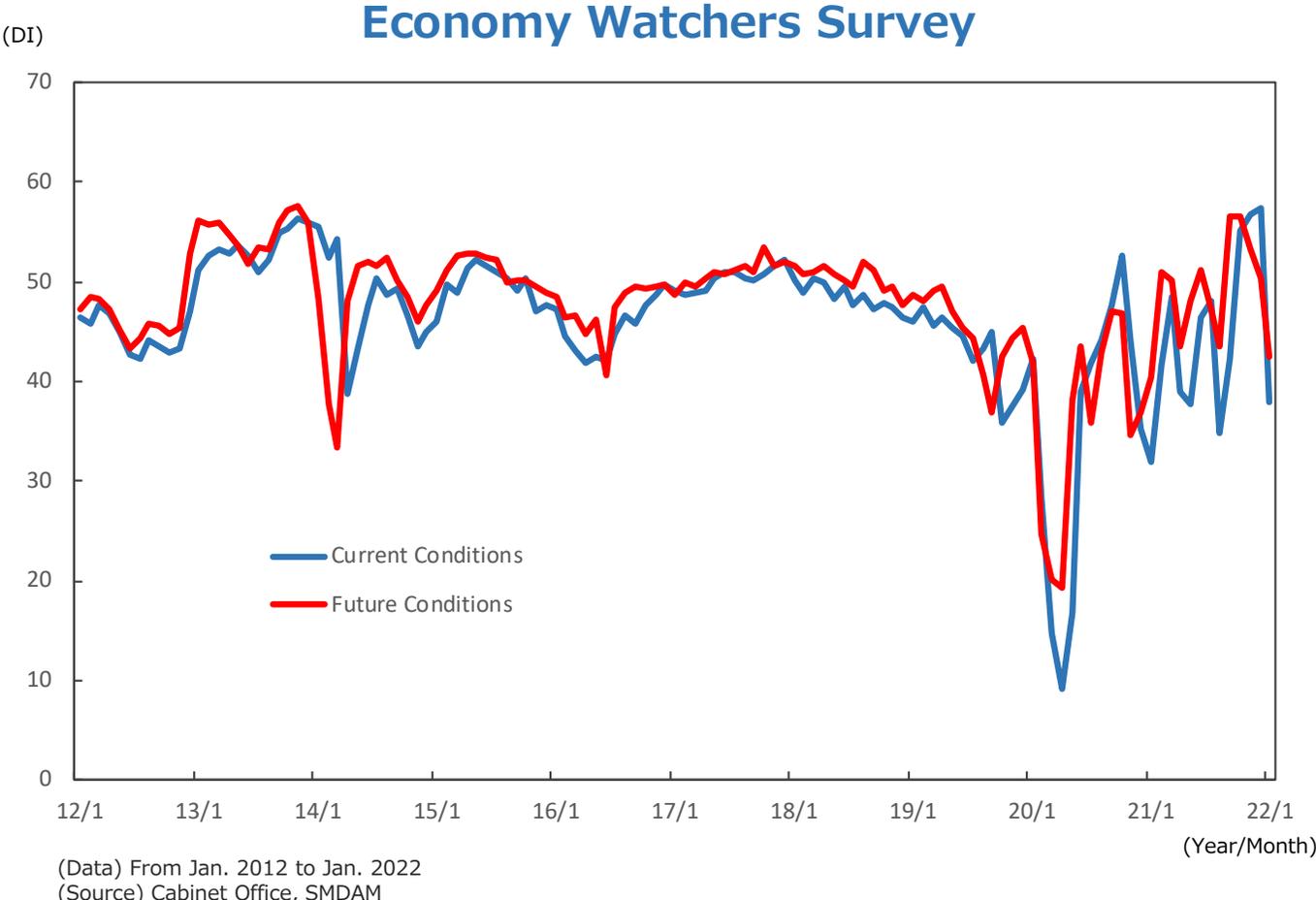
Omicron weighs on people's mobility

Google Community Mobility Report, Japan



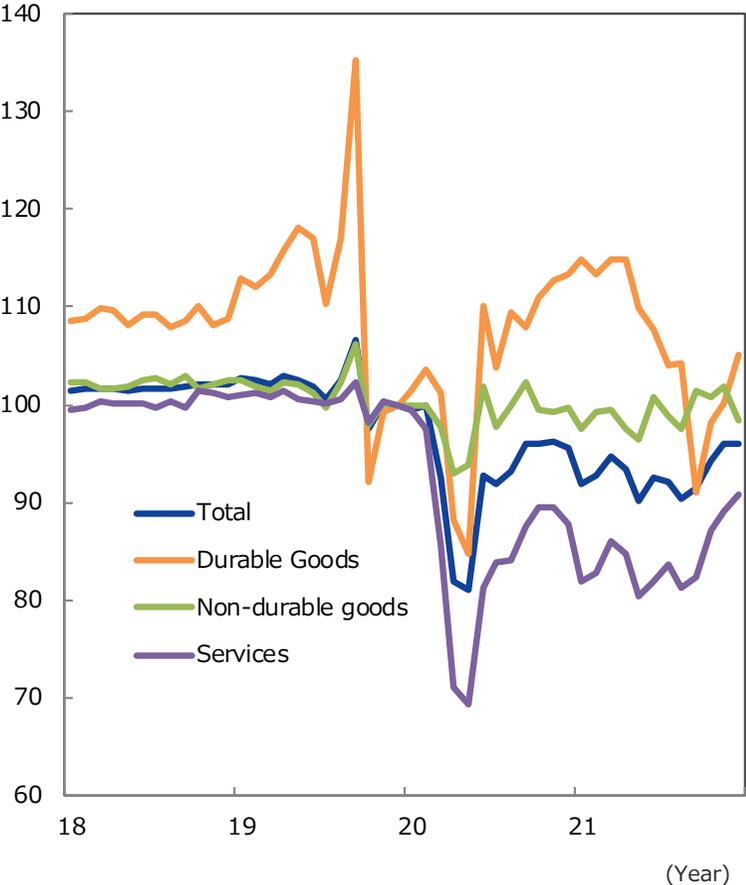
(Data) 7 Days moving average, From Feb. 21st 2020 to Feb. 11th 2022
(Source) Google, SMDAM

Steep decline of consumer activities owing to Omicron infections

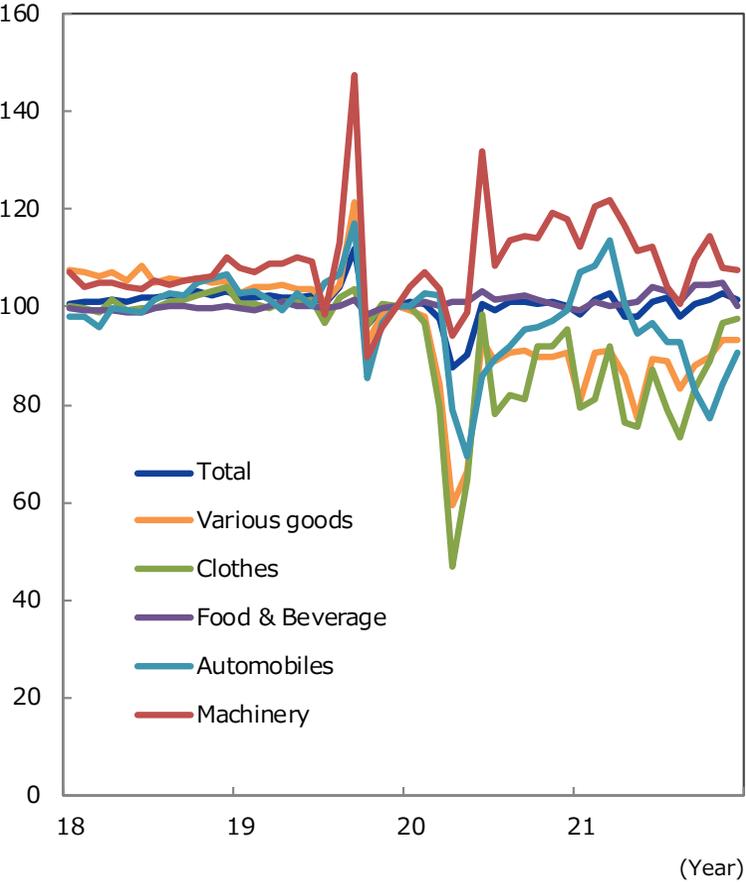


Sales of autos and consumer durables come back

Consumer Activity Index (Dec. 2019 = 100)



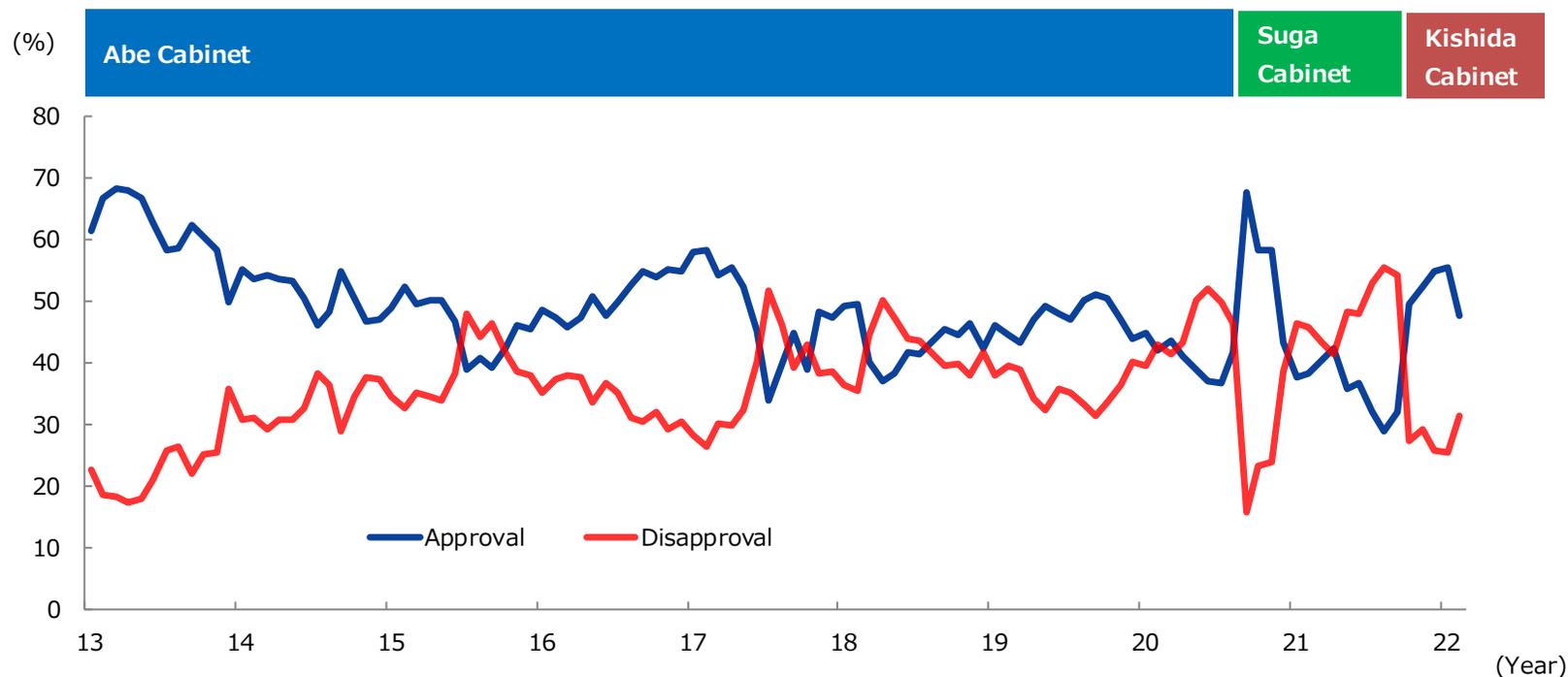
Retail Sales (Dec. 2019 = 100)



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

Worst ever COVID-19 infection rate hits approval rate of PM Kishida

Cabinet approval rate



(Data) From Jan. 2013 to Feb. 2022

(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and 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	49.7
FILP	12.5	39.3	7.7	6.0

(Source) SMDAM

PM Kishida’s economic policy – “growth and distribution”

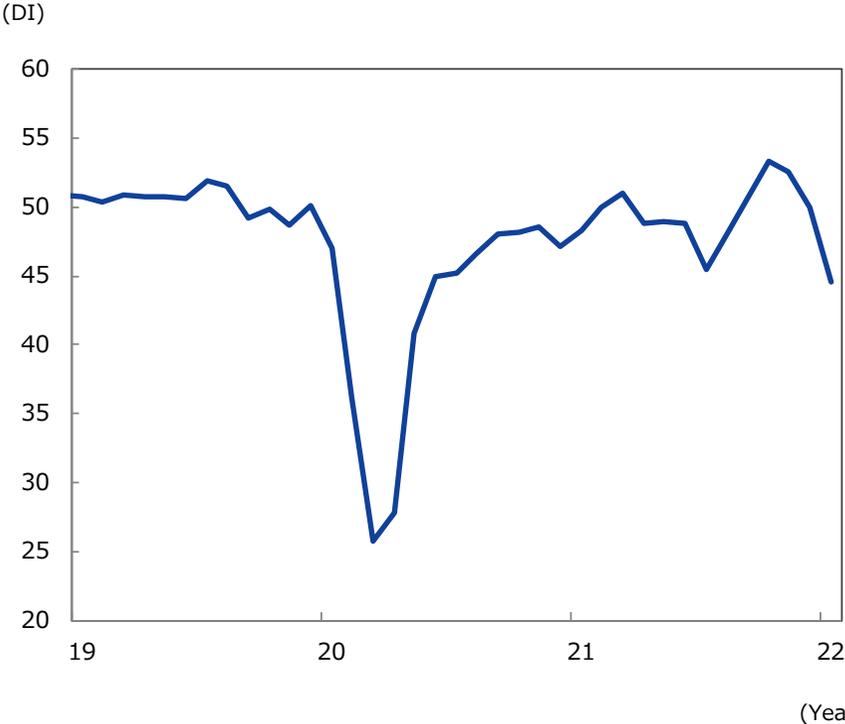
Leader of Ruling LDP and His Economic Policy

Name	Fumio Kishida
Political Career	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
Policy overview	<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 (10 trillion yen university endowment fund) ▪ Economical National Security (promote free and reliable data flow) ▪ Digital Rural City-State Vision (early rollout of 5G) ▪ Support for Aging Society (universal social insurance) ■ Income Doubling & Distribution-Oriented Policy

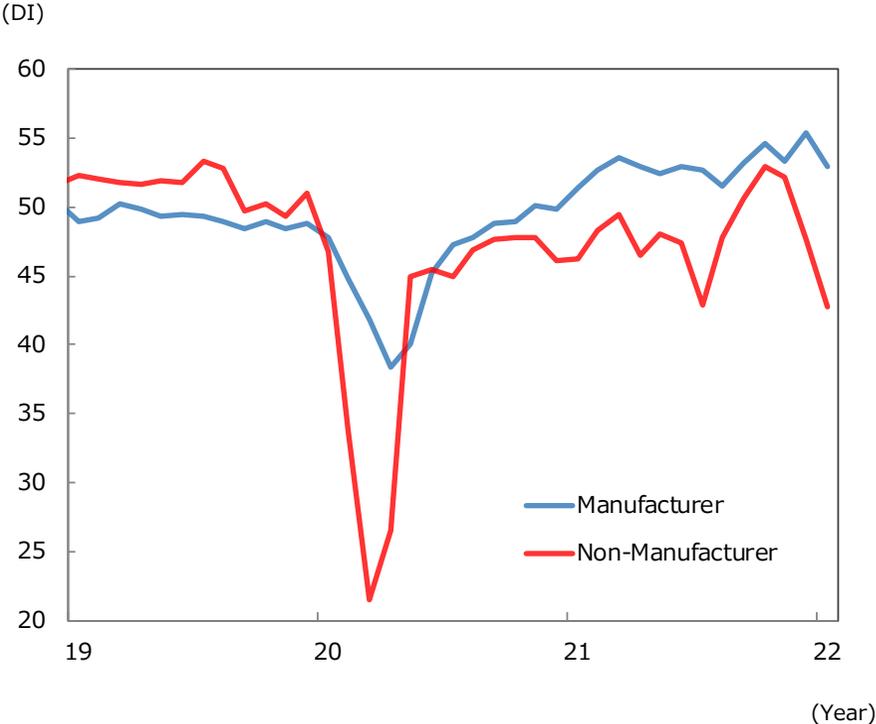
(Source) SMDAM

Omicron drags down non-manufacturers' sentiment sharply

Composite PMI



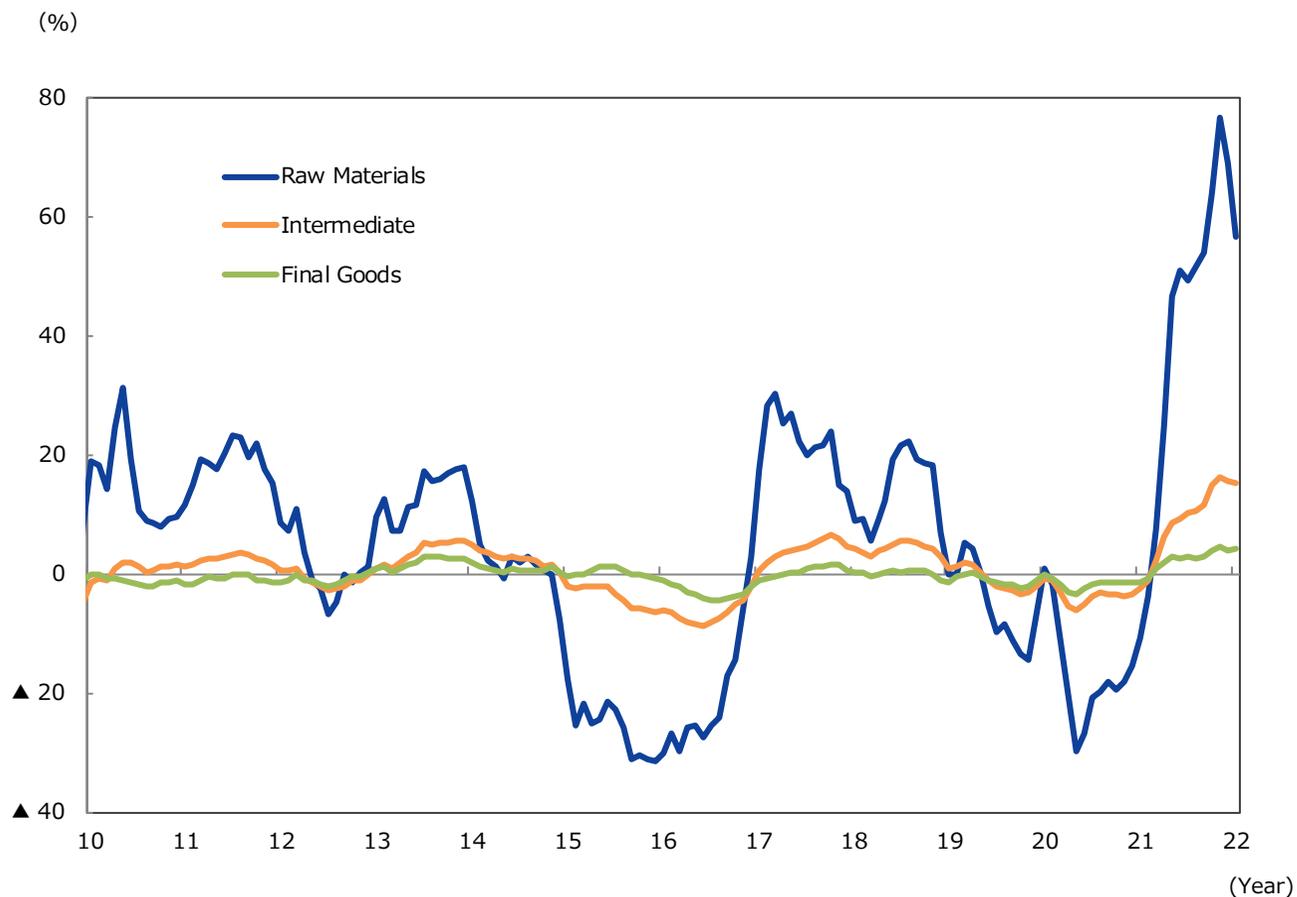
PMI, Manufacturer & Non-Manufacturer



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

Japanese companies facing margin squeeze

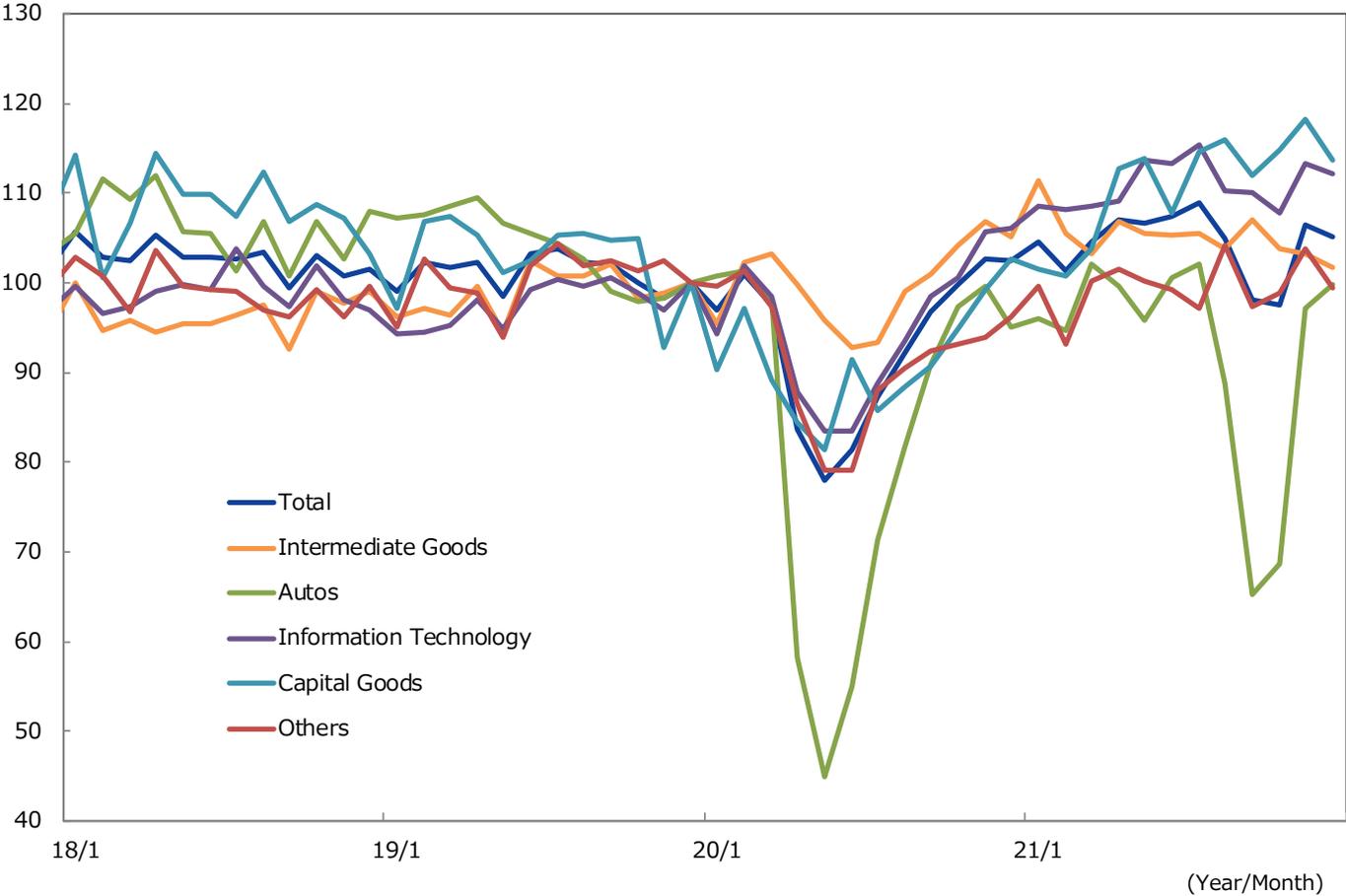
Corporate Price Index (YOY)



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

Exports losing momentum except for autos

Real Export (Dec. 2019=100)

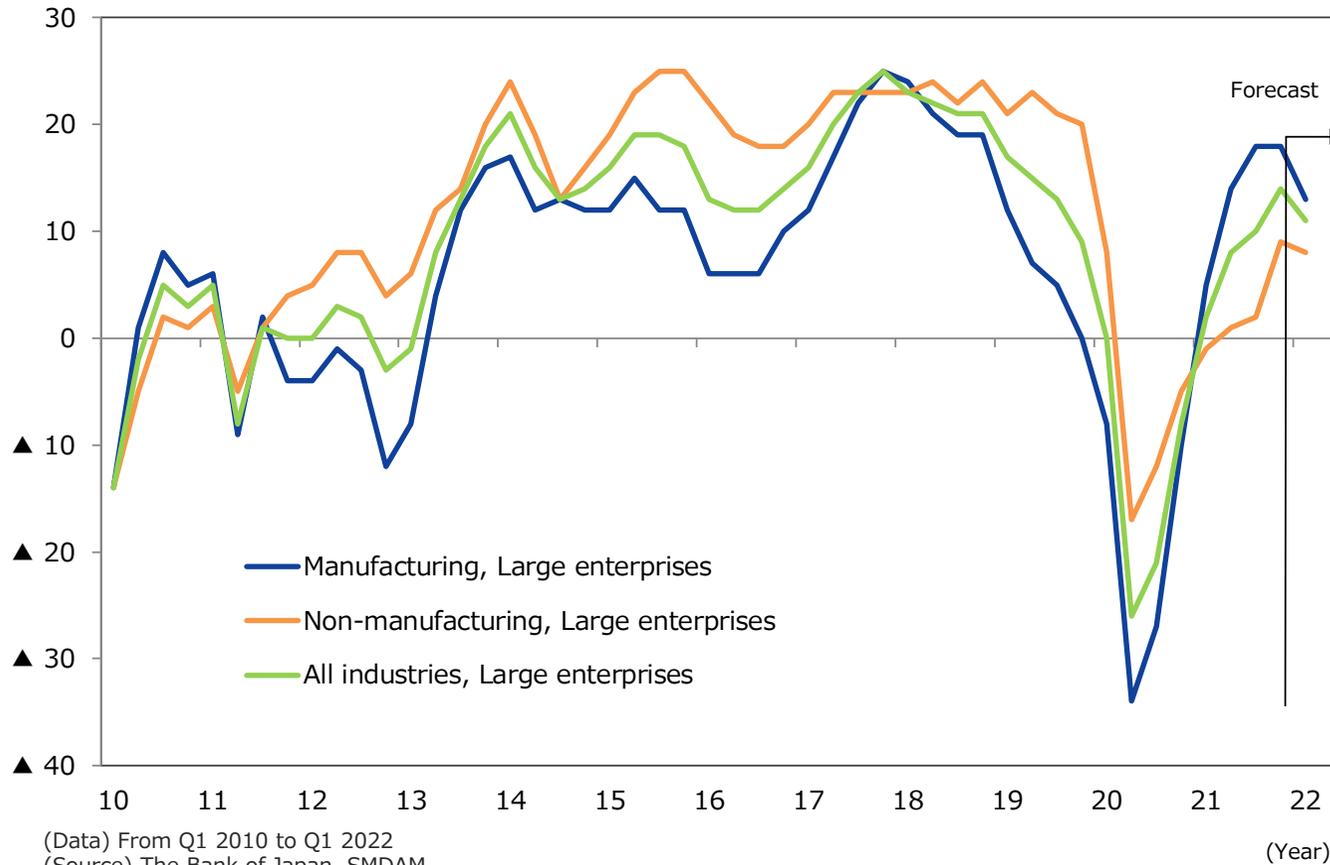


(Data) From Jan. 2018 to Dec. 2021
(Source) Bank of Japan, SMDAM

Japanese companies see bumpy outlook ahead

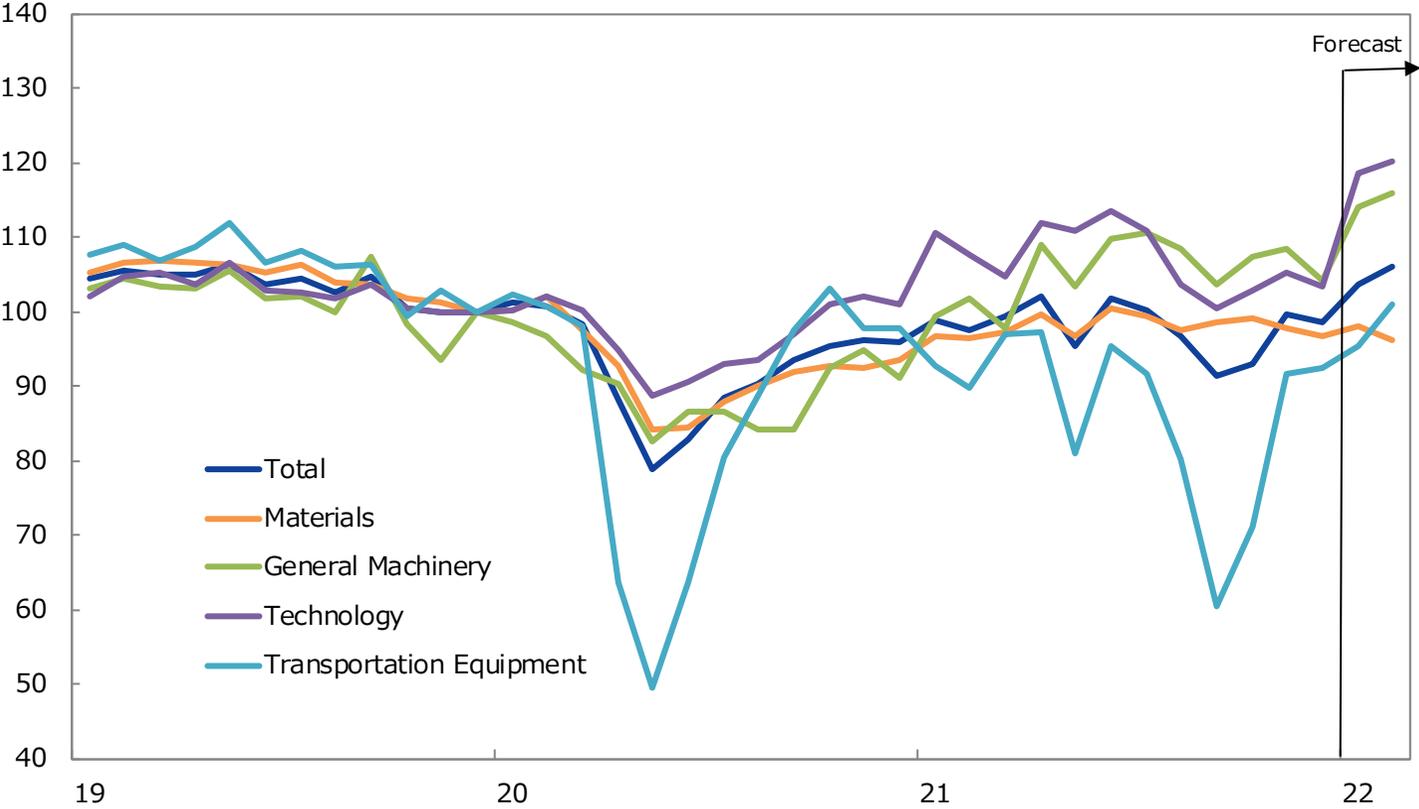
Bank of Japan "Tankan" Economic Survey (Large Enterprises)

(DI, "Good"-"Bad")



Industrial production to re-accelerate in the near future

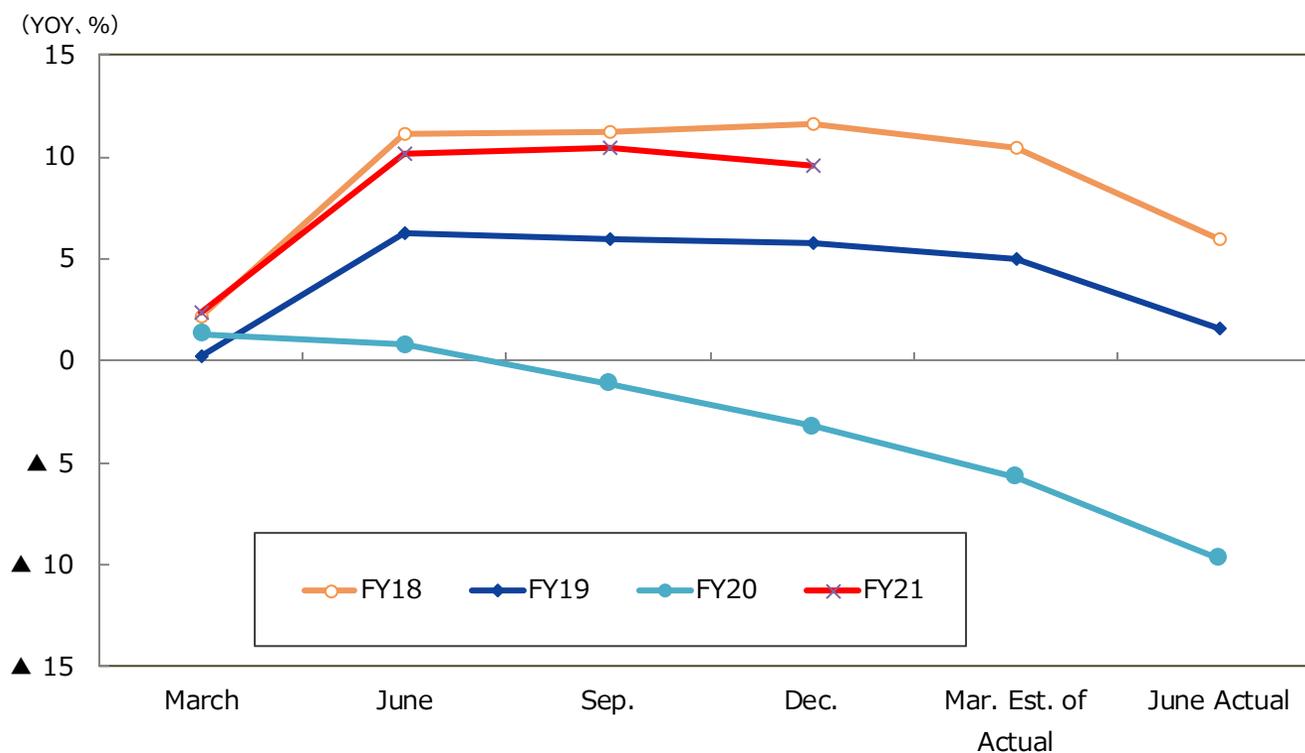
Industrial Production (Dec. 2019=100)



(Data) From Jan. 2019 to Feb. 2022
(Source) METI, SMDAM

Japanese companies cutting size of CAPEX slightly

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



(Source) The Bank of Japan, SMDAM

Schedule of major events

Schedule of Major Domestic Events			
2022	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	mid	Release of CY 2022 Q1 GDP
	Summer		Release of Execution Plans and Schedules of "New Capitalism Realization Conference"
	June	8 15 16-17	Revision of CY 2022 Q1 GDP End of Ordinary Diet Session Monetary Policy Meeting Cabinet Decision on Bold Economic Policy and Growth Strategy G7 Summit in Germany
	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	mid	Release of CY 2022 Q2 GDP
	September	early 21-22	Revision of CY 2022 Q2 GDP Monetary Policy Meeting Change of Top Party Officials of LDP
	October	27-28 30	Monetary Policy Meeting G20 Summit in Indonesia
	November	mid	Release of CY 2022 Q3 GDP
	December	early 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

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

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