



# Outlook for Japanese Stock Market & Economy

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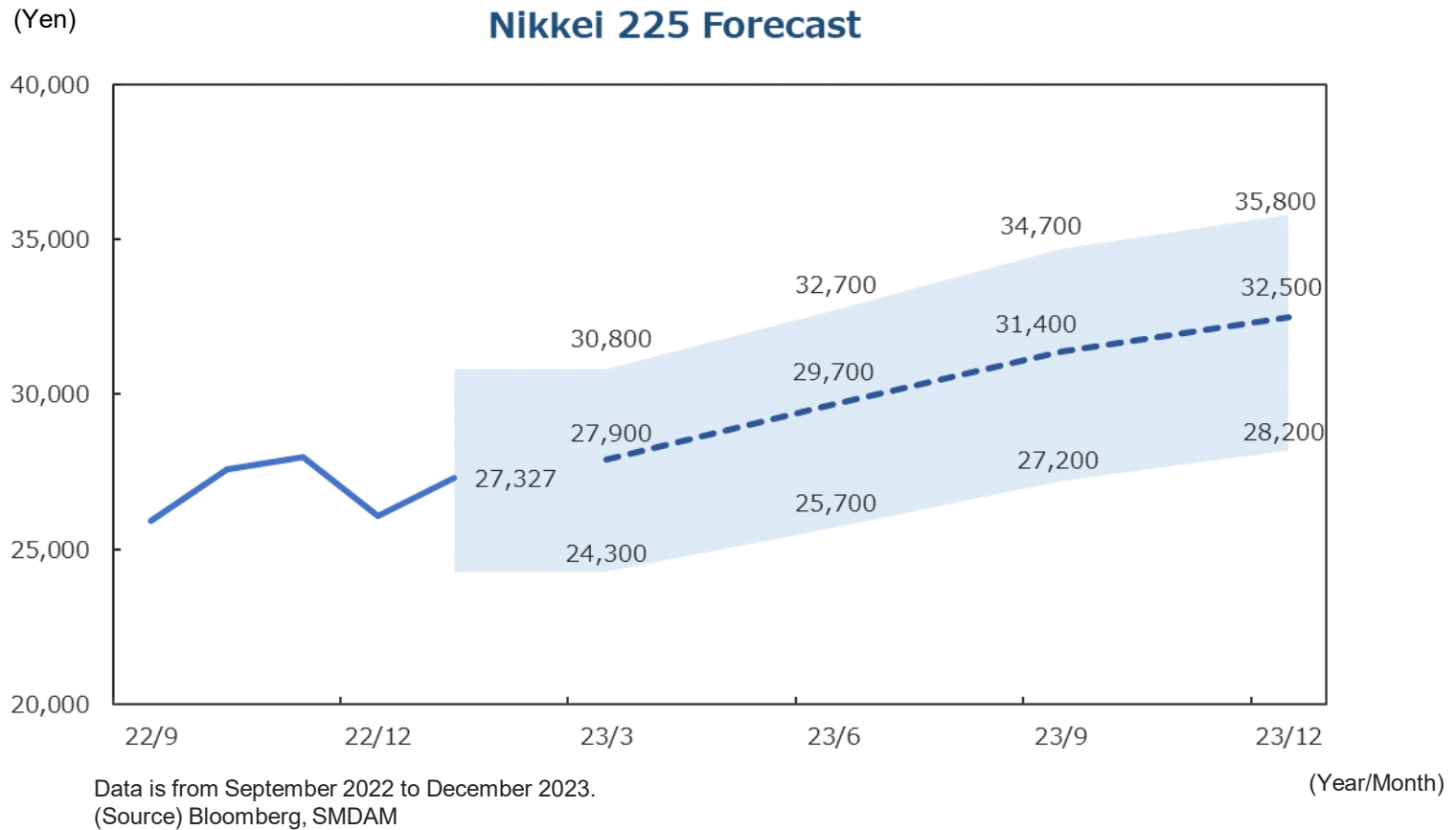
# Outlook for Japanese Stock Market

# Market Outlook

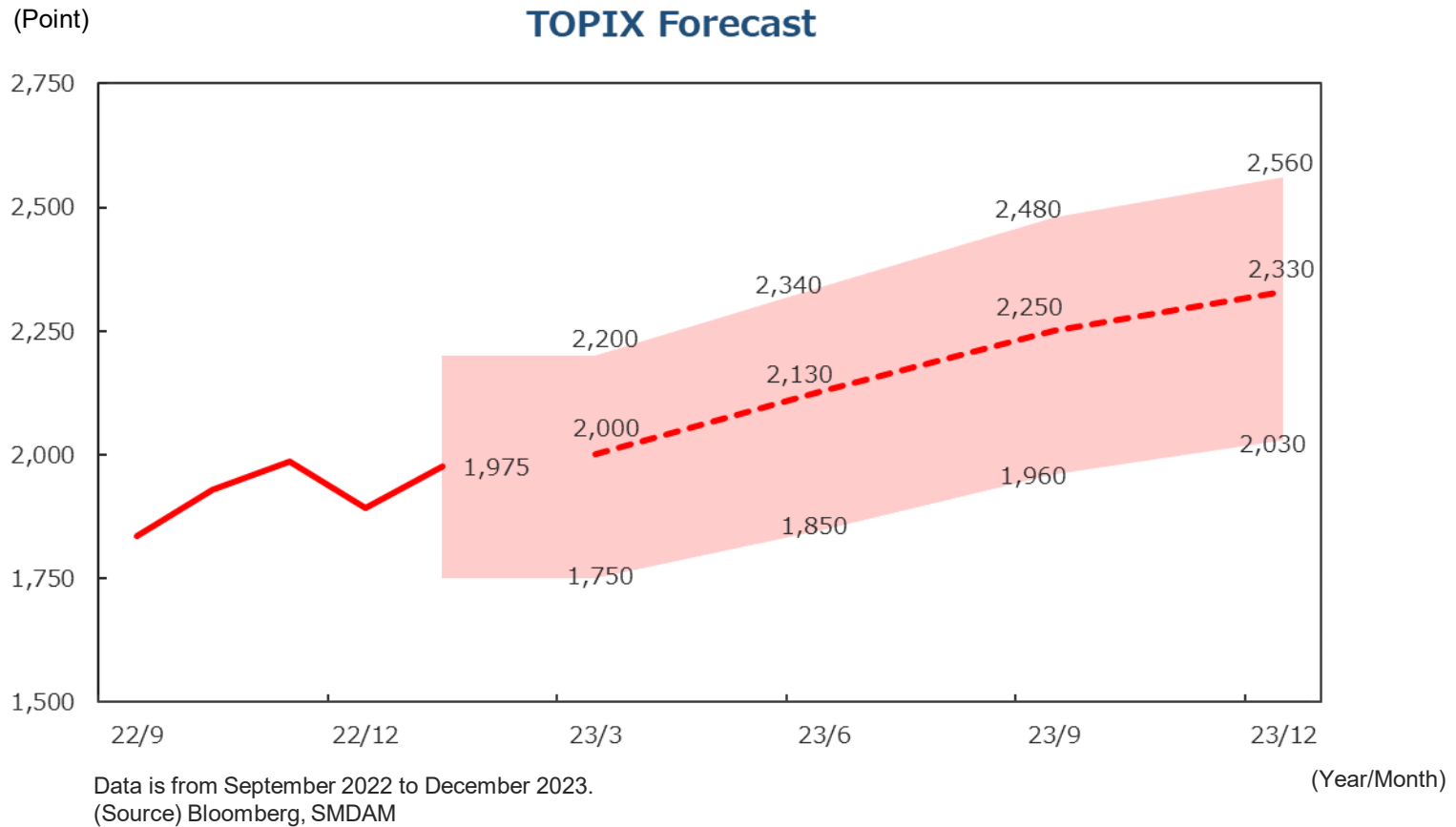
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- We expect the market will resume its bullish trend after confirming the peak of FED tightening and the trough of the global economic cycle.
- We foresee the market will be in a trading range in the near future. While stable domestic demand and economic recovery in China could support the market, the sluggishness of the global economy could weigh on market sentiment for some time.
- We have maintained our TOPIX target at 2,330 and that of the Nikkei 225 at 32,500 as of the end of 2023.
- We expect a strong tailwind to the domestic consumer sector if Chinese travelers come back to Japan after relaxing the “Zero COVID-19 policy”.

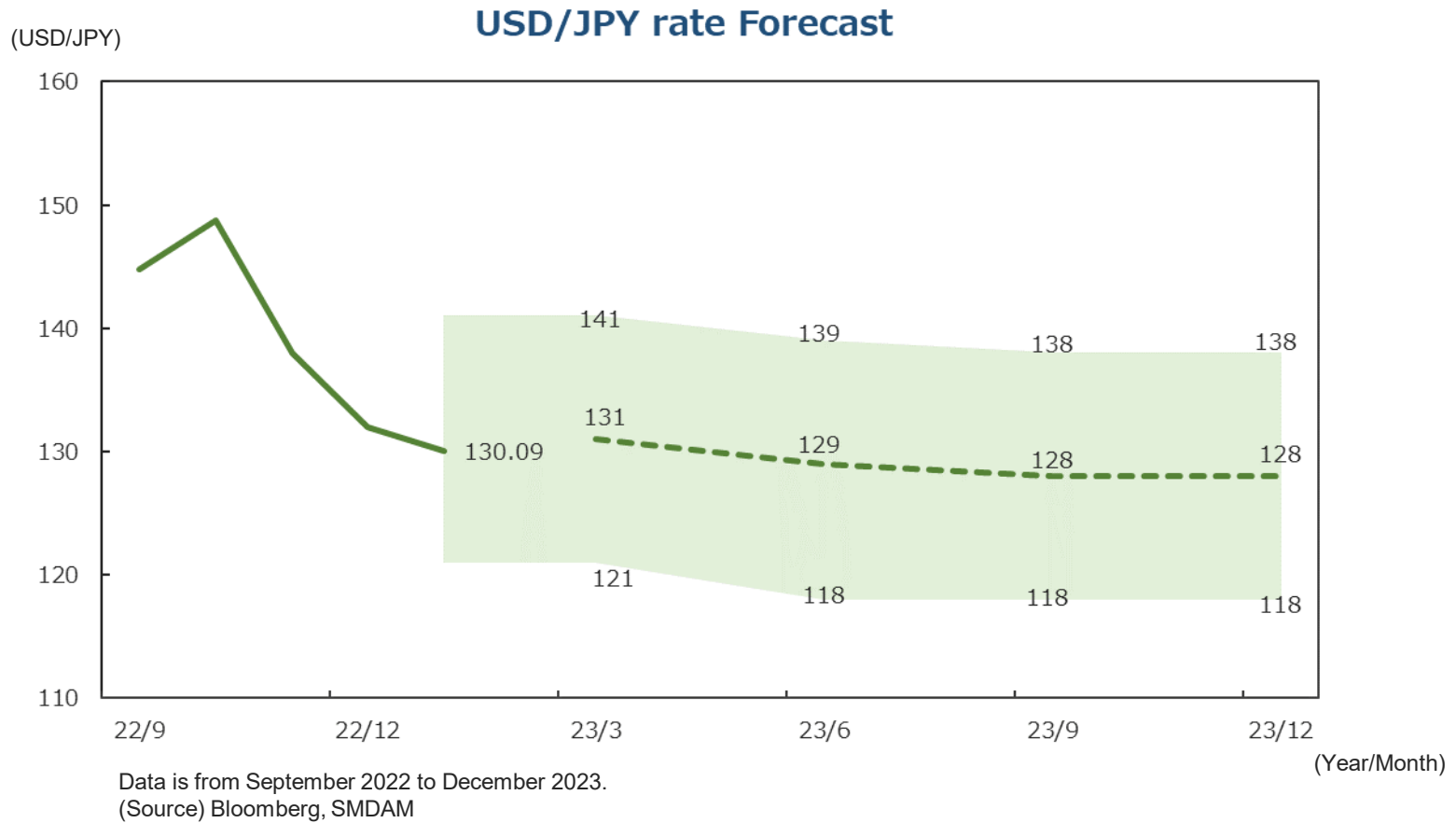
# Equities to resume bullish trend after range trading



# Equities to resume bullish trend after range trading



# Speculation upon “pivot” of FED and BOJ drives USD/JPY ahead



# Upside / Downside risk scenarios

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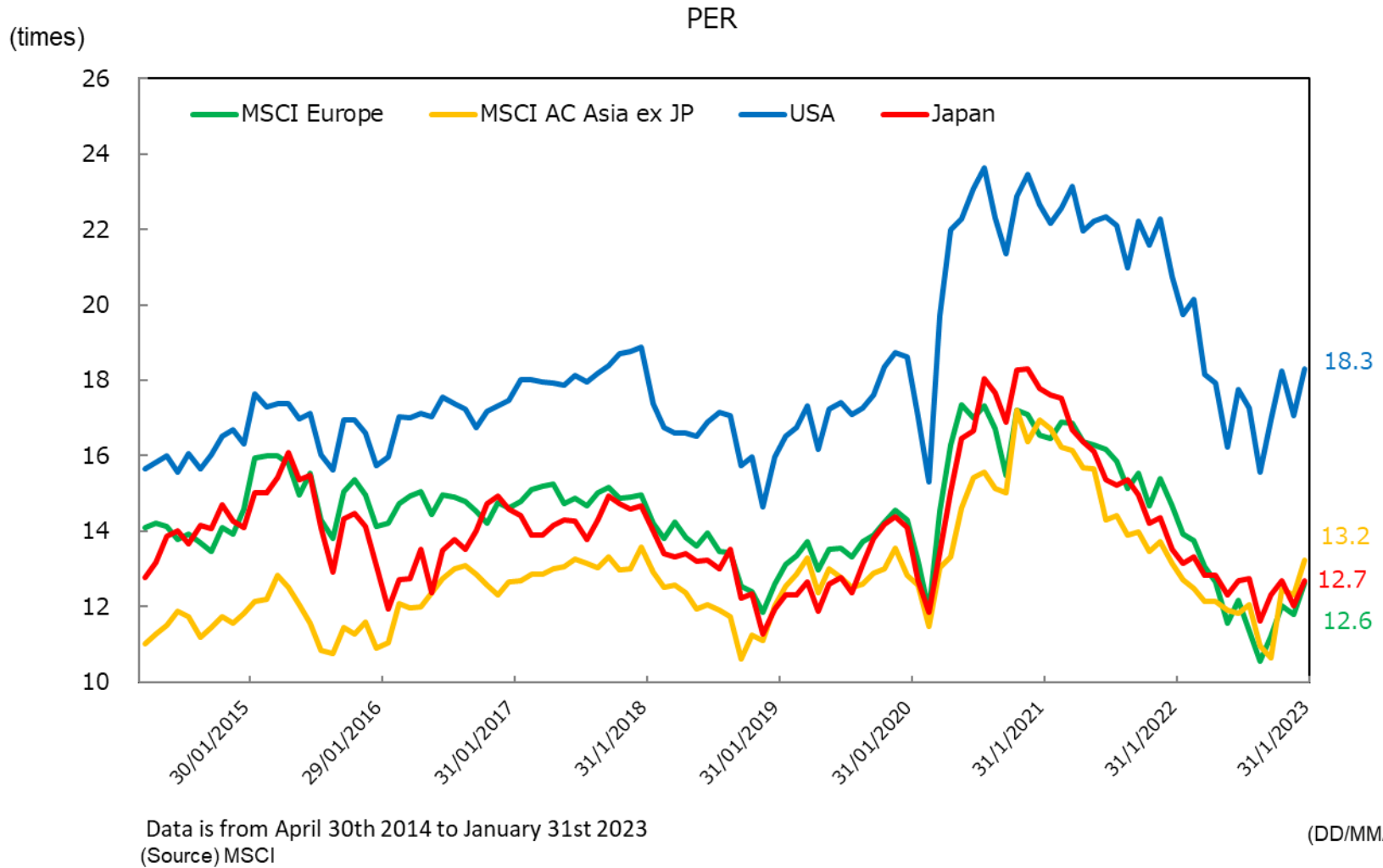
## ■ Upside Risks

- FED pivot and monetary easing
- Growing expectation for mild inflation in Japan

## ■ Downside Risks

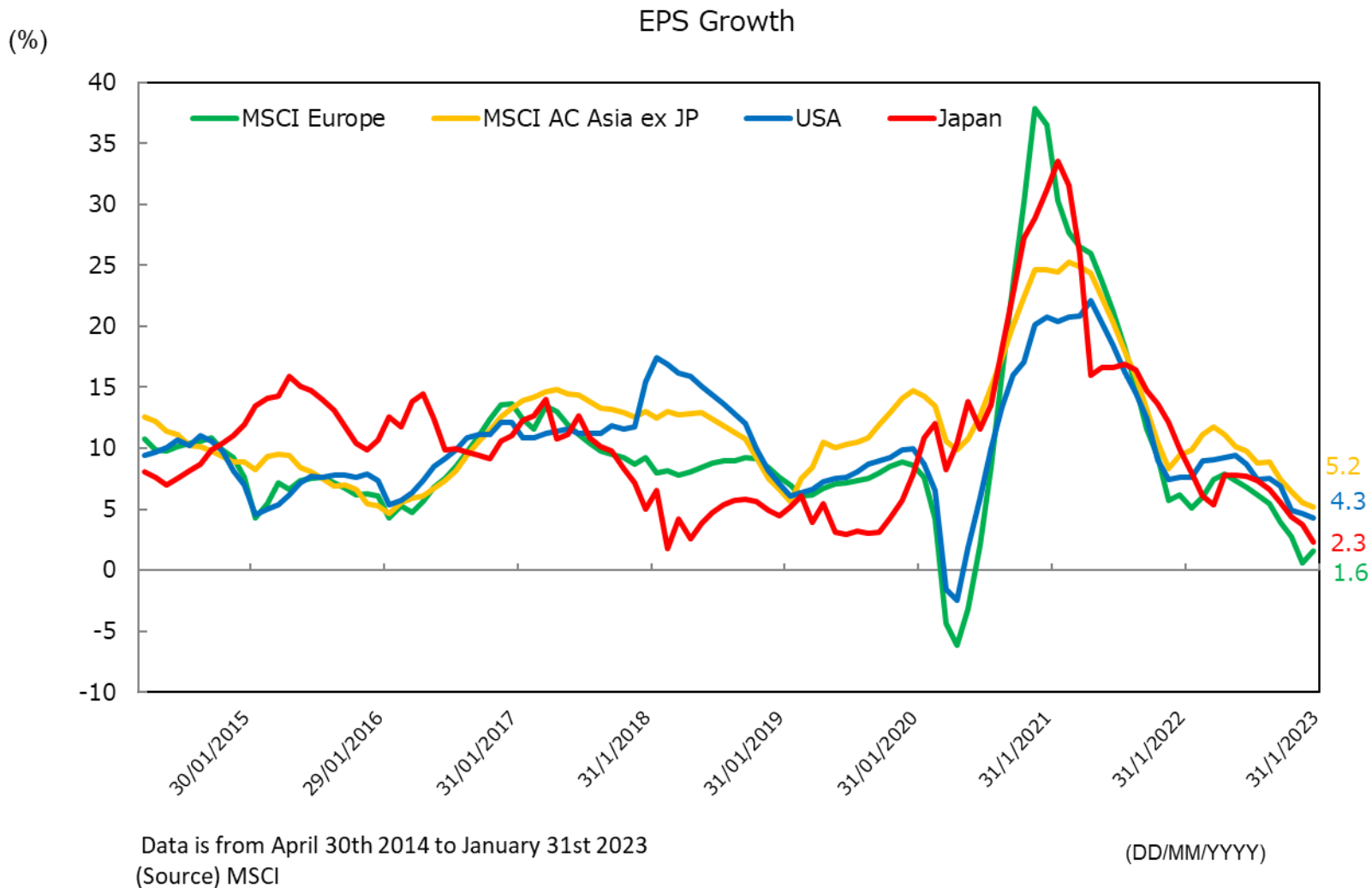
- Excessive JPY appreciation and negative impact on earnings forecasts
- Fiscal austerity
- Slower than expected pace of economic recovery in China

# PERs hit the bottom due to speculation upon FED's pivot

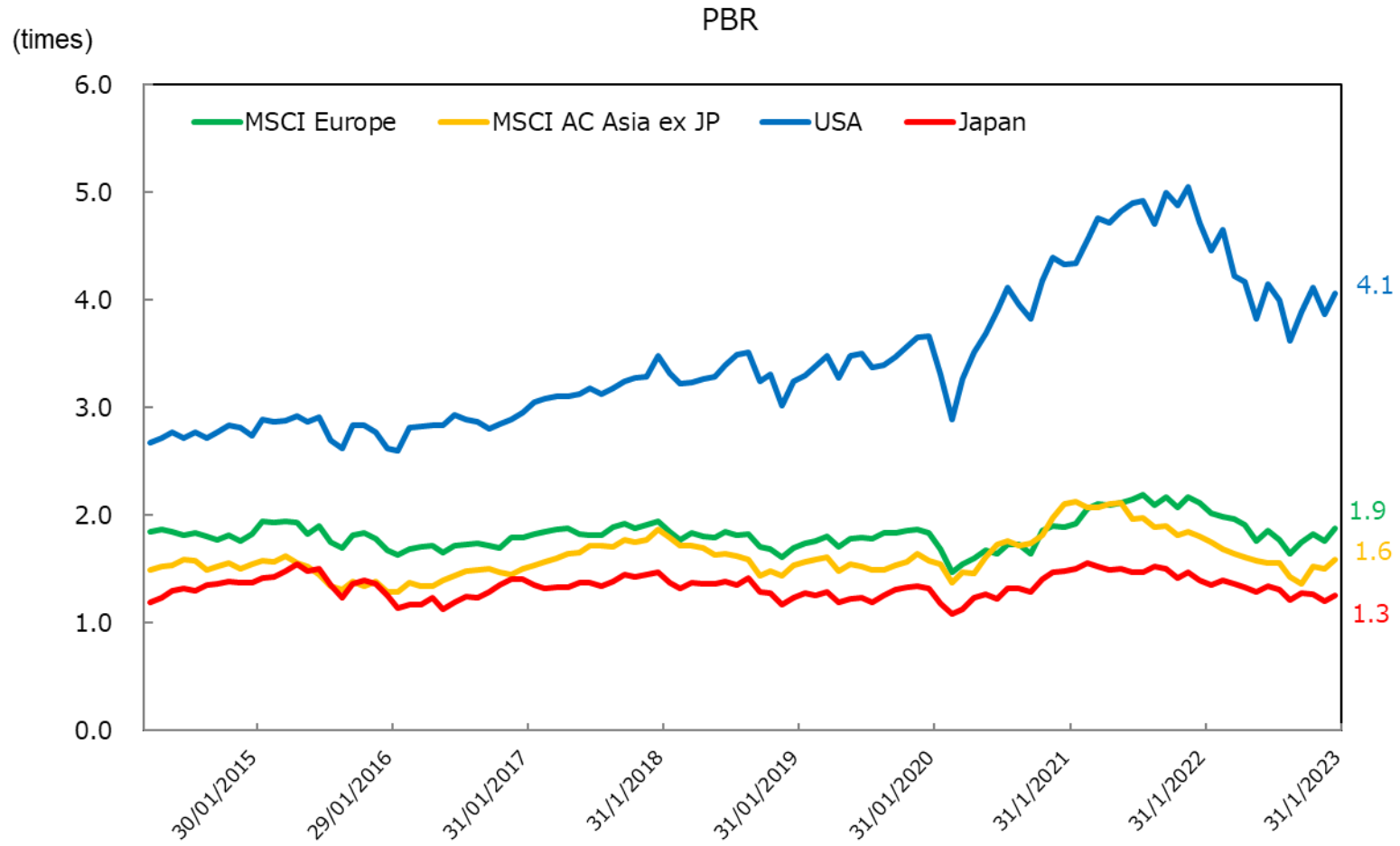




# Sluggishness of global economy weigh on EPS forecasts



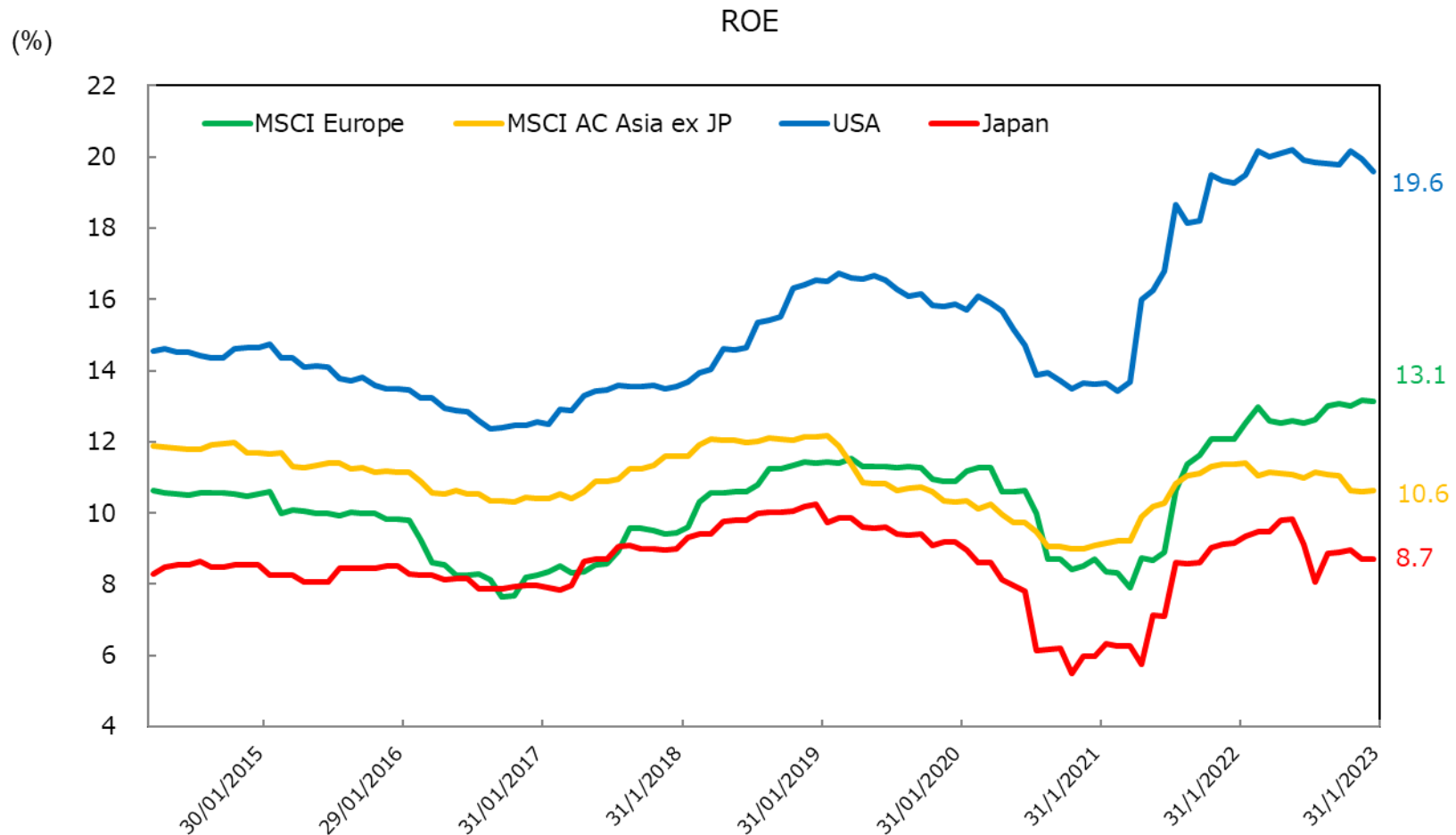
# Tightening of TSE listing rule push low-PBR companies to change



Data is from April 30th 2014 to January 31st 2023  
 (Source) MSCI

(DD/MM/YYYY)

# Tightening of TSE listing rule could push Japan's ROE higher

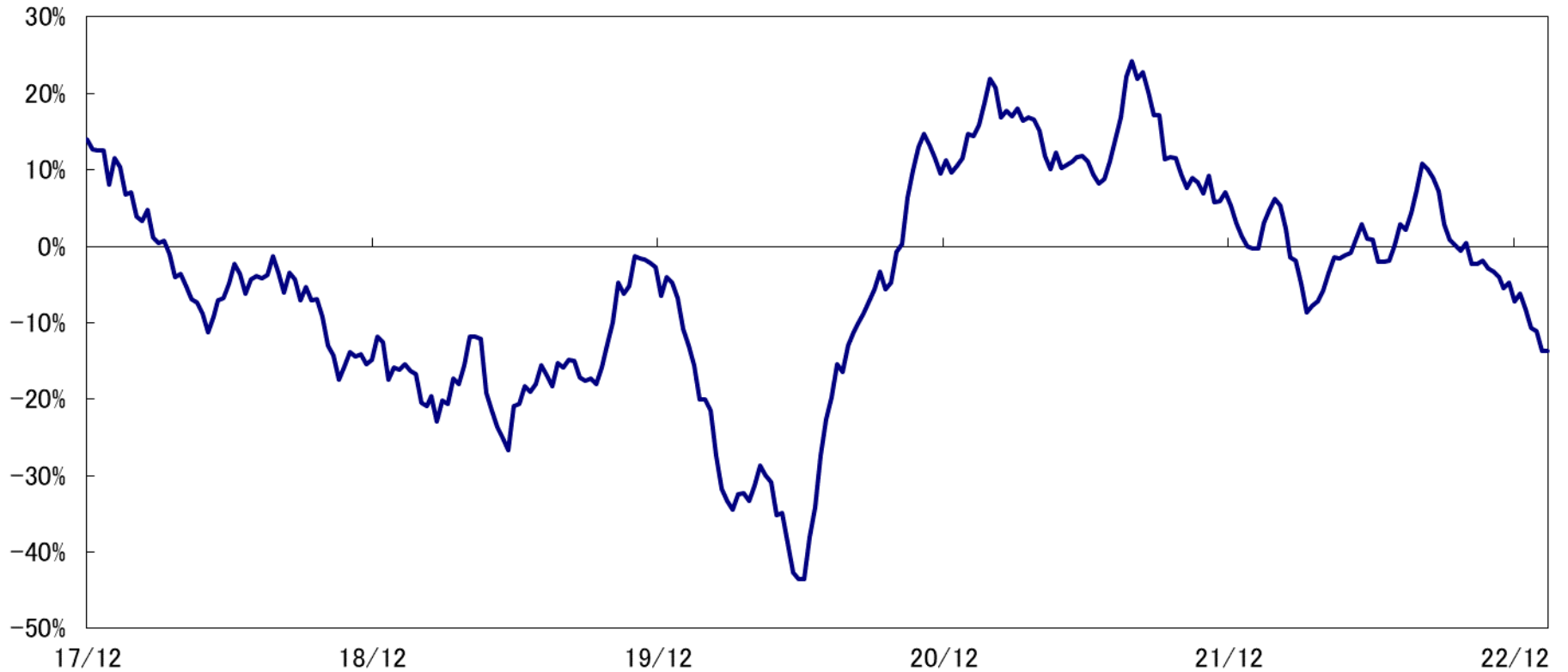


Data is from April 30th 2014 to January 31st 2023  
 (Source) MSCI

(DD/MM/YYYY)

# Higher JPY and slowing economy continues to push EPS lower

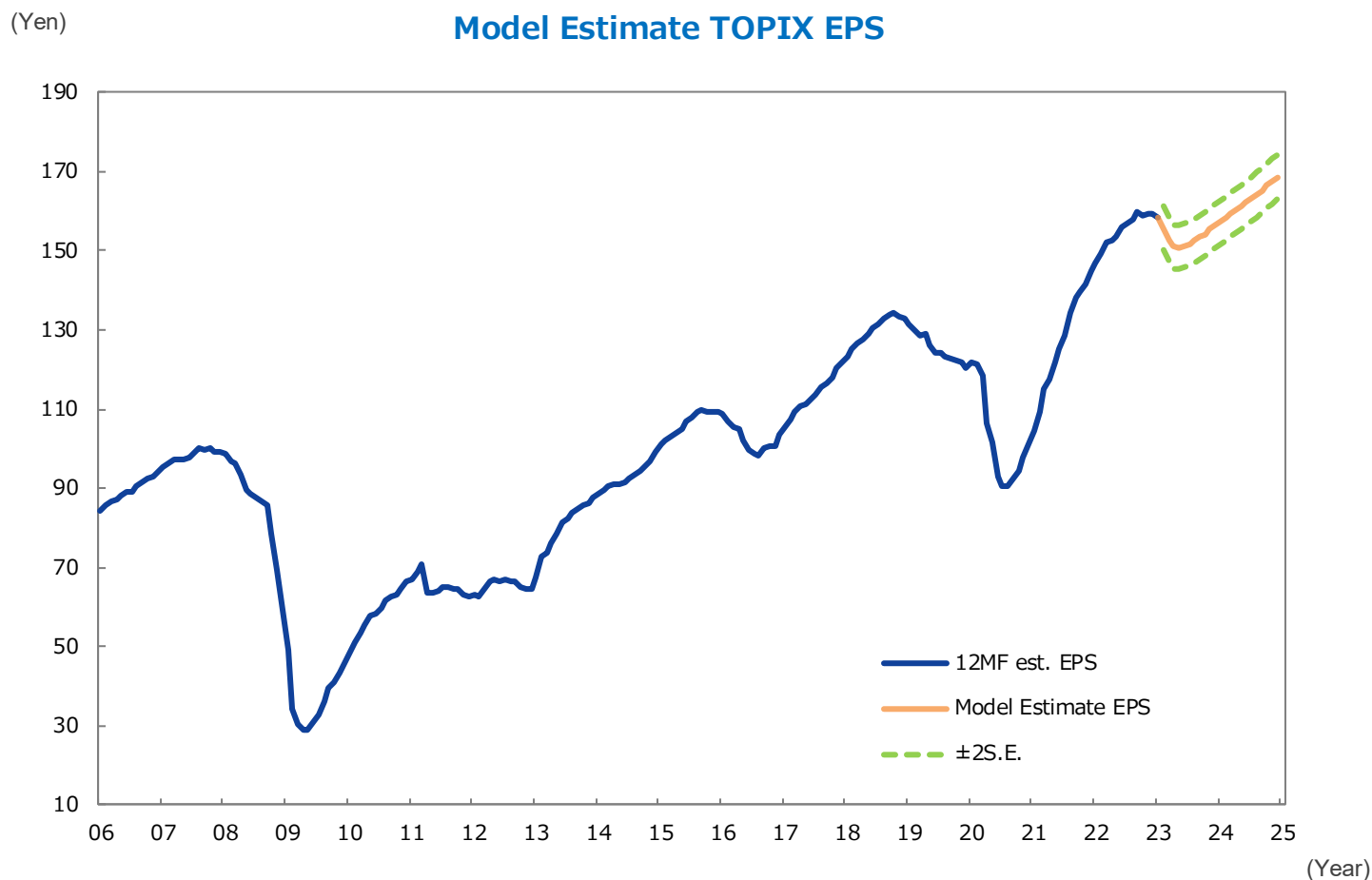
TOPIX Revision Index



Data is from December 28th 2017 to February 9th 2023  
(Source) Datastream, IBES

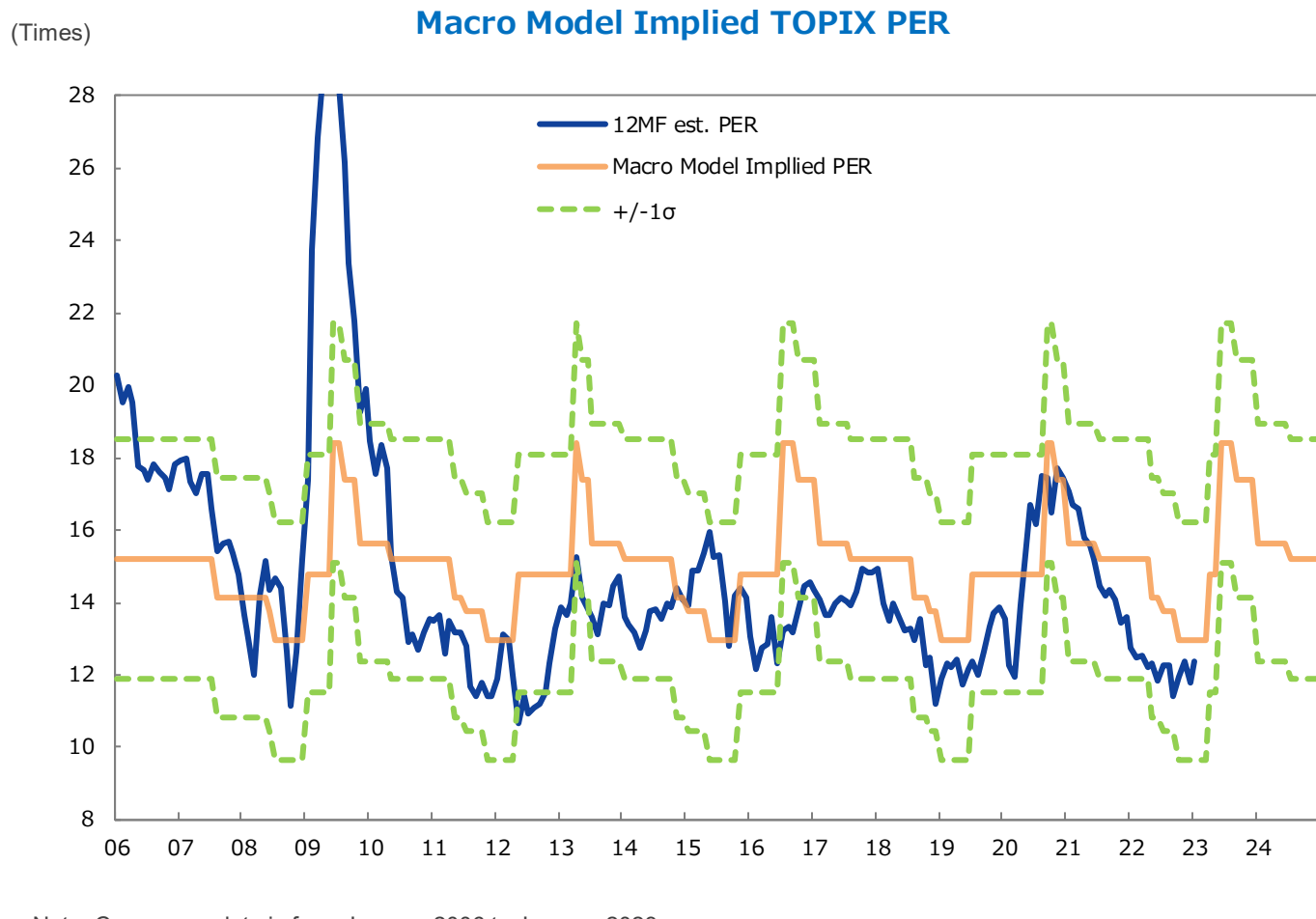
(YY/MM)

# Macro model indicates EPS to recover after temporary pause



Note: Consensus data is from January 2006 to January 2023,  
Model estimate Data is from February 2023 to December 2024.  
Source: SMDAM

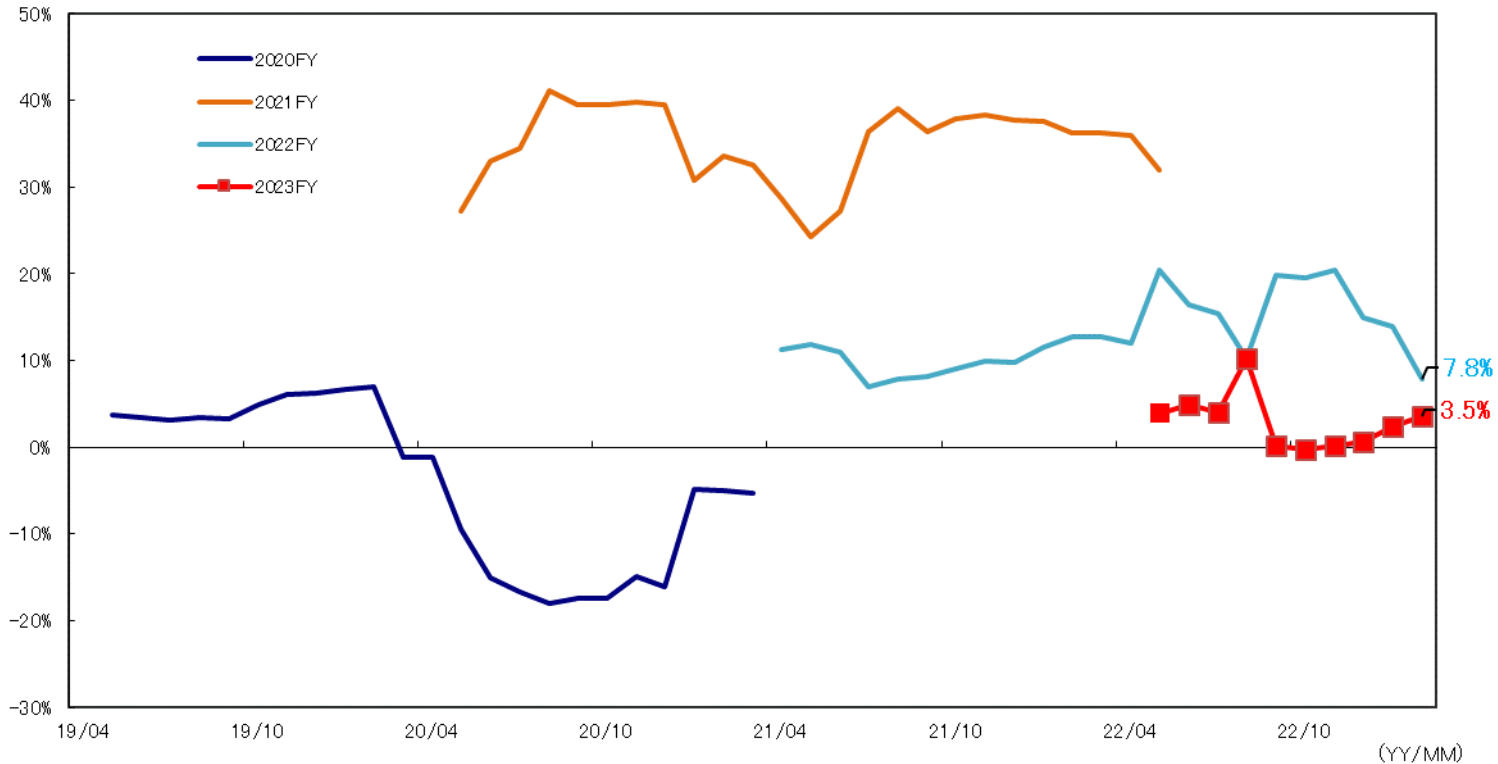
# Model indicates PER to rebound from rock bottom



Note: Consensus data is from January 2006 to January 2023,  
Model estimate Data is from February 2023 to December 2024.  
Source: SMDAM

# Earnings growth of FY2022 deferred to FY2023

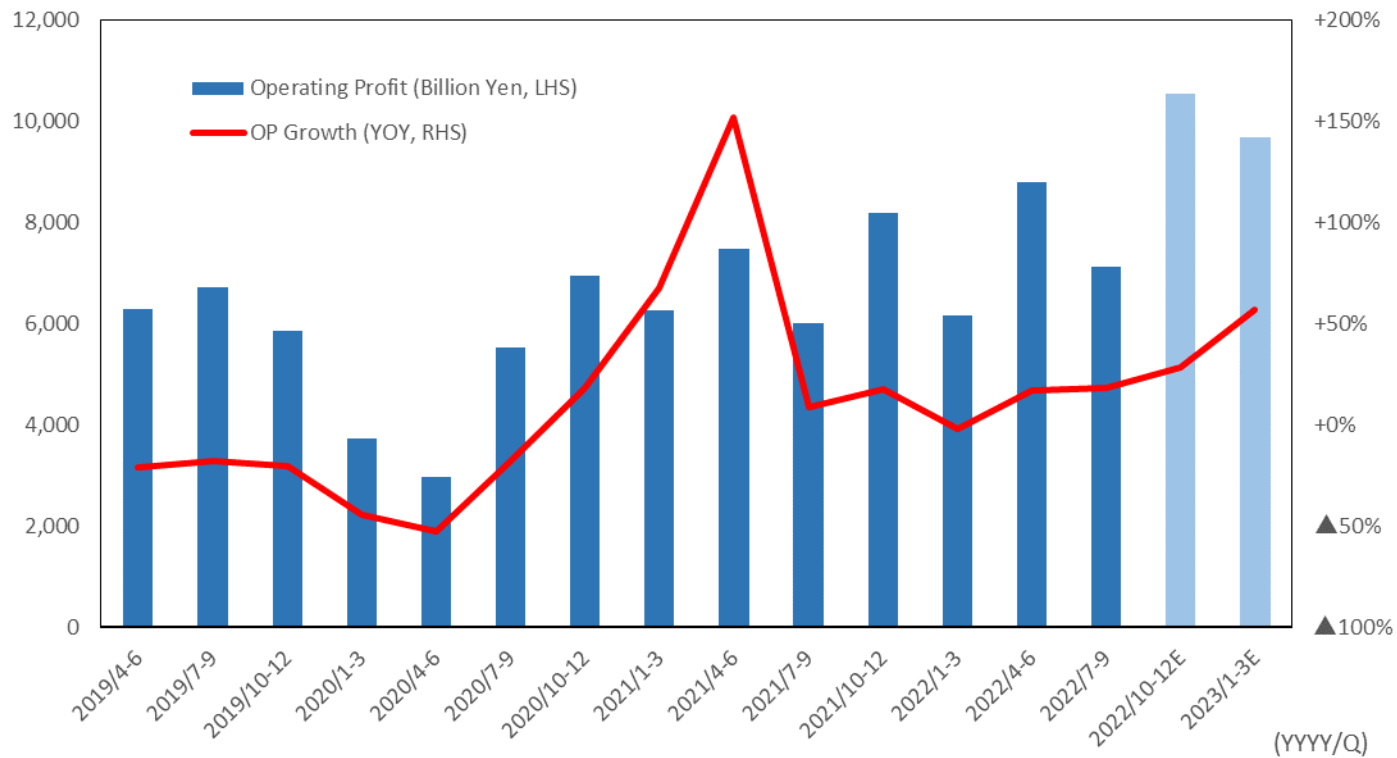
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 13th February 2023, SMDAM Core Universe (Excl. Financials) consists of 407 Japanese companies covered by SMDAM in-house analysts.  
Source: SMDAM

# Outlook for operating profit remains positive

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



Note: Actual data is from Q2 2019 to Q3 2022. Estimate data is from Q4 2022 to Q1 2023.  
Source: SMDAM



# A tide of “Corporate Governance” in Japan

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	203
Insurance companies	24
Pension funds	79
Others	11
<b>Total</b>	<b>323</b>

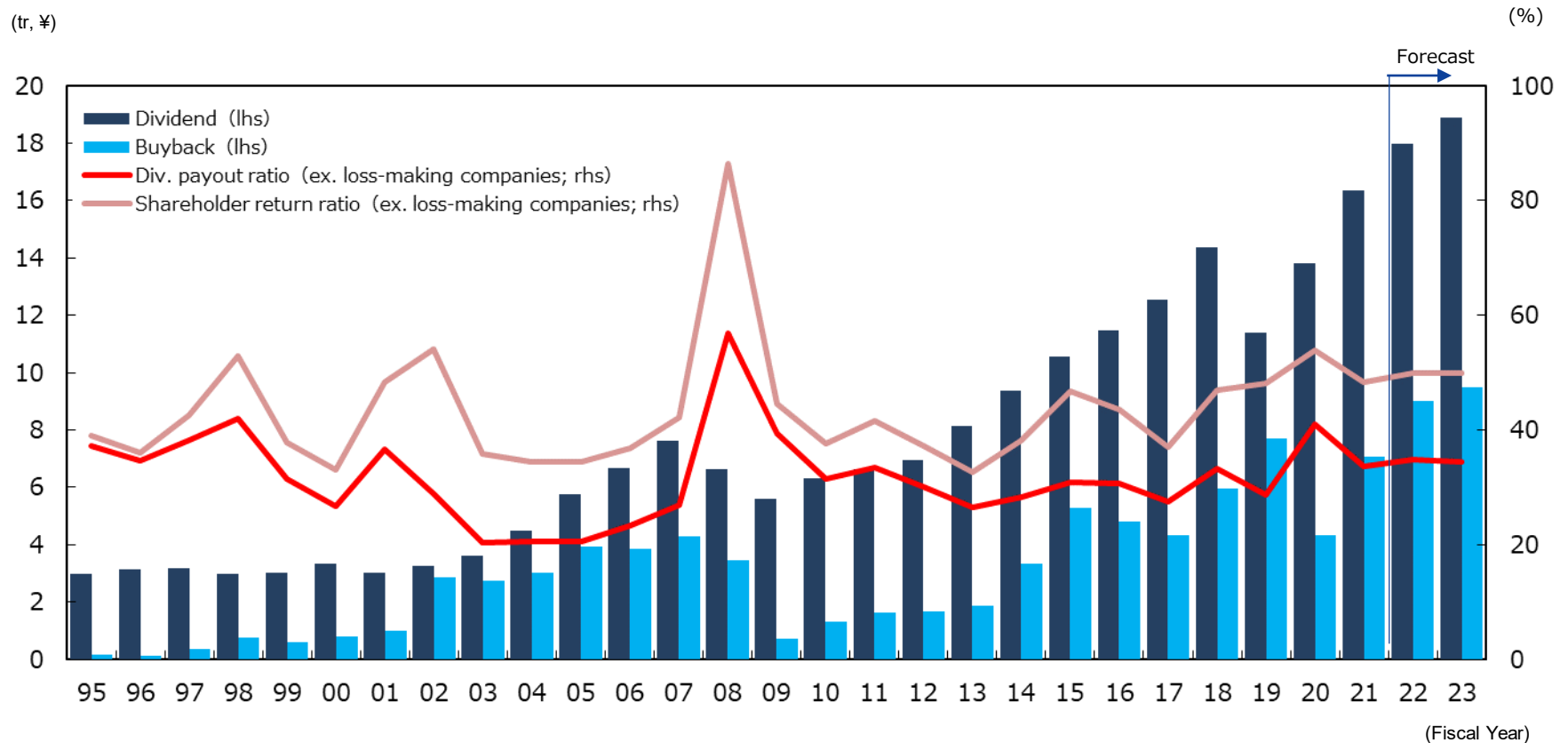
note: As of 31st January 2023

Source: FSA, SMDAM

- The Stewardship Code (SC) was established 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 which 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 a 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. Such holdings 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 continues to rise beyond 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

# Value has returned

## Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
<b>RN Japan Equity</b>	<b>1.28</b>	<b>-0.75</b>	<b>5.40</b>	<b>3.28</b>	<b>1.07</b>	<b>18.36</b>	<b>15.40</b>
Total Value	5.46	4.17	6.18	7.70	16.26	22.41	12.45
Top Cap Value	6.02	5.88	6.40	9.37	23.03	32.10	26.50
Large Cap Value	5.77	4.47	6.58	8.00	18.23	24.28	15.68
Mid Cap Value	5.44	2.64	6.81	6.21	12.43	14.40	1.59
Small Cap Value	4.07	2.86	4.45	6.37	7.75	14.30	-1.16
Micro Cap Value	4.58	3.72	4.72	7.72	8.71	12.83	-1.20
Total Growth	-2.54	-5.31	4.64	-0.77	-11.89	13.07	17.01
Top Cap Growth	-2.11	-5.44	5.99	-2.11	-12.38	15.03	23.43
Large Cap Growth	-2.50	-5.45	5.04	-1.19	-12.17	14.07	19.10
Mid Cap Growth	-3.19	-5.50	3.32	0.48	-11.77	12.27	12.44
Small Cap Growth	-2.89	-4.05	1.66	3.00	-9.13	4.42	0.74
Micro Cap Growth	-1.51	-2.20	2.47	6.77	-10.72	6.11	3.22
Top Cap Total	1.35	-0.58	6.17	2.82	1.80	21.96	23.87
Large Cap Total	1.28	-0.90	5.76	3.01	1.03	19.51	18.05
Mid Cap Total	1.17	-1.39	5.12	3.32	-0.02	16.29	9.99
Small Cap Total	1.27	0.08	3.34	4.81	1.00	11.12	0.49
Micro Cap Total	2.47	1.67	3.95	7.09	2.16	11.52	1.75

Note : As of 17th February 2023  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is recovering.** While goods exports remain weak amid a slowdown in overseas economies, domestic demand remains strong. Companies' attitude toward CAPEX seems to be resilient as pent-up demand, de-carbonization and digitization are working as supporting factors. Since October 2022, border restriction measures have been relaxed and consumption of inbound travelers has bounced back rapidly. Consumer spending is also picking up slowly as the flow of people increases in response to a decline in the number of COVID-19 cases.
- **Inflation is picking up.** The Nationwide core CPI rose +4.0% in December 2022 from +3.7% for the previous month. Tokyo core CPI also rose +4.3% in January 2023 from +3.9% for the previous month. While higher inflation had been driven by rising import prices so far, import prices themselves have already peaked.

## [Outlook]

- ① **We have lowered our real GDP growth forecast for FY 2022 from +1.7% to +1.3%, FY 2023 from +1.1% to +1.0%, and FY 2024 from +1.0% to +0.9%.** The main reason for the downward revisions for FY 2022 and FY 2023 is the actual economic performance in the fourth quarter of 2022. The downward revision for FY 2024 is due to a review of the growth trajectory. Although growth in the fourth quarter of 2022 was lower, it was not seen as a strong economic concern due to the large impact of changes in private sector inventories. The economic recovery is expected to continue for the time being, supported by capital spending, inbound travel consumption and economic stimulus measures. However, for the second half of FY 2023, the economy is expected to soften temporarily due to the economic slowdown in the US. The timing of the economic slowdown has changed from the previous forecast for the first half of FY 2023.
- ② **We have raised our core CPI forecast for FY 2022 from +2.9% to +3.0%, FY 2023 from +2.0% to +2.2% and FY 2024 from +1.1% to +1.2%.** Every forecast year saw upward revisions owing to higher food prices. On the other hand, the cost-push pressure is likely to ease gradually in the future, as measures to reduce the burden of electricity and gas bills have been reflected since February 2023, and the pace of increase in import prices has become clear. Core CPI is expected to slow to below the +2% level next year.

# Current status & Outlook of Japanese economy

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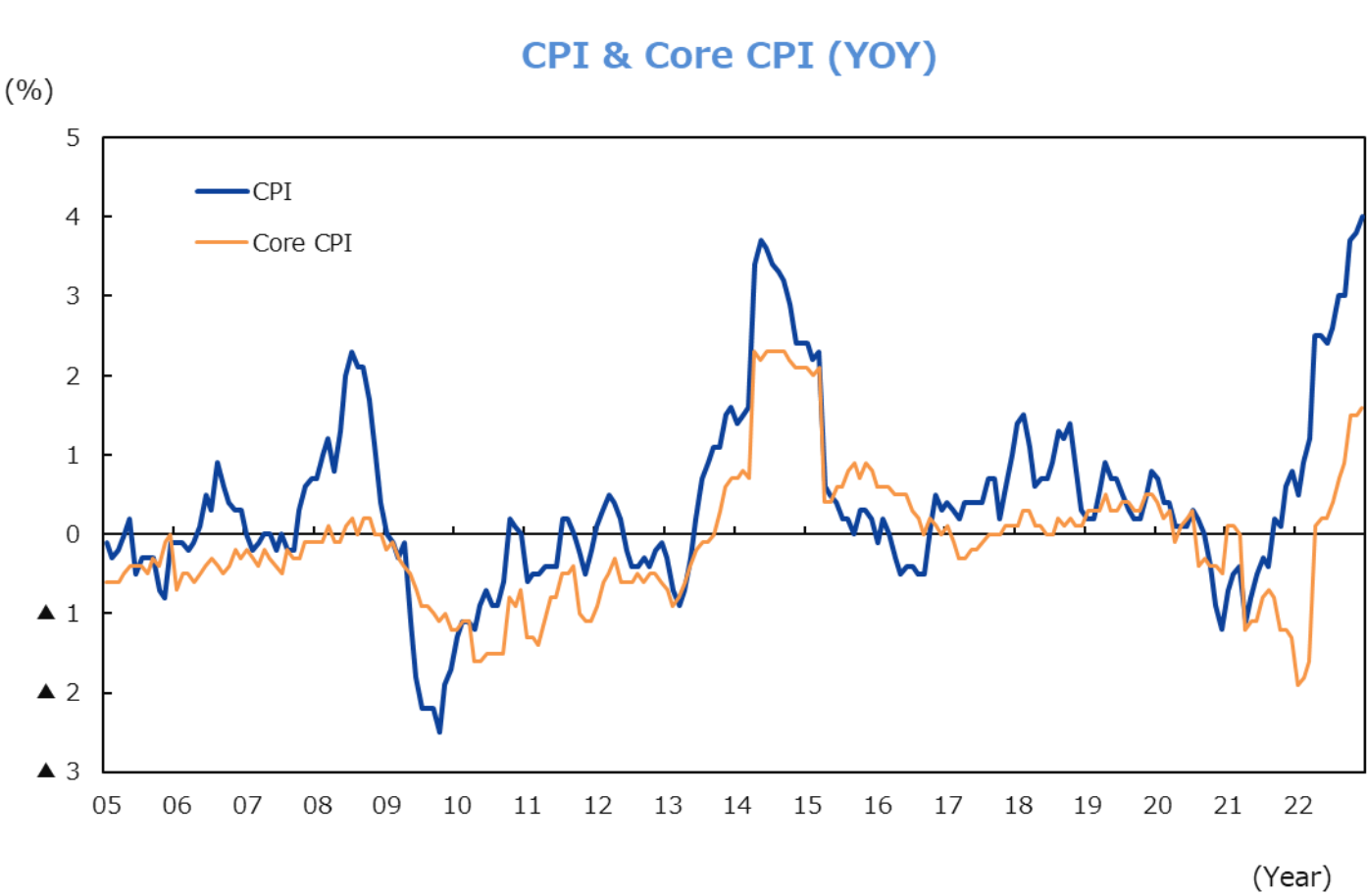
- ③ **PM Kishida seems to maintain his accommodative economic policy.** In October last year, the cabinet approved a comprehensive economic package to overcome high inflation and revive the economy. This was a massive economic package, with national and local government expenditures totaling 37.6 trillion JPY. However, in the medium term, we should pay attention to the risk of raising awareness of fiscal consolidation by PM Kishida's cabinet. The government is now planning to finance part of the increase in defense spending with corporate tax increases.
  
- ④ **The government has proposed a personnel plan to appoint Professor Ueda as the next governor of the Bank of Japan. Under the new regime, the Bank of Japan will maintain its ultra-easy-money policy while the central bank will try to deal with the side-effects of excessive monetary easing. The main scenario is to widen the YCC (yield curve control) range to  $\pm 1\%$  in the second quarter 2023. However, the methods and timelines of policy changes are unclear and subject to change by the governor and vice governors.** The BOJ suddenly widened the YCC range from  $\pm 0.25\%$  to  $\pm 0.5\%$  in December 2022. This sudden policy change is believed to have been motivated by PM Kishida administration's view that rigid monetary easing is problematic. Given the impact of recent policy changes, we expect further policy changes to be unlikely during Mr. Kuroda's term.

# Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	FY24 Est
Real GDP	0.3%	-0.9%	-4.6%	2.5%	1.3%	1.0%	0.9%
Private final consumption expenditure	0.1%	-1.0%	-5.4%	1.5%	2.4%	0.9%	0.8%
Private housing investment	-4.8%	2.5%	-7.8%	-1.1%	-4.6%	-1.1%	-0.4%
Private-sector capital investment	1.5%	-1.7%	-7.7%	2.1%	2.9%	2.4%	2.2%
Public fixed capital formation	0.8%	1.7%	5.1%	-6.4%	-4.1%	1.5%	0.9%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.4%	-0.1%	-0.1%
Exports of goods and services	2.0%	-2.3%	-10.0%	12.3%	5.2%	0.9%	2.2%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.5%	1.6%	2.5%
Nominal GDP	0.2%	0.0%	-3.9%	2.4%	1.8%	2.3%	1.9%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.4%	1.3%	0.9%
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	-0.2%	0.3%	1.9%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.2%	1.2%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.1%	-0.4%	-0.2%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.2%	1.7%	1.9%
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%	2.4%
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.  
Source: 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

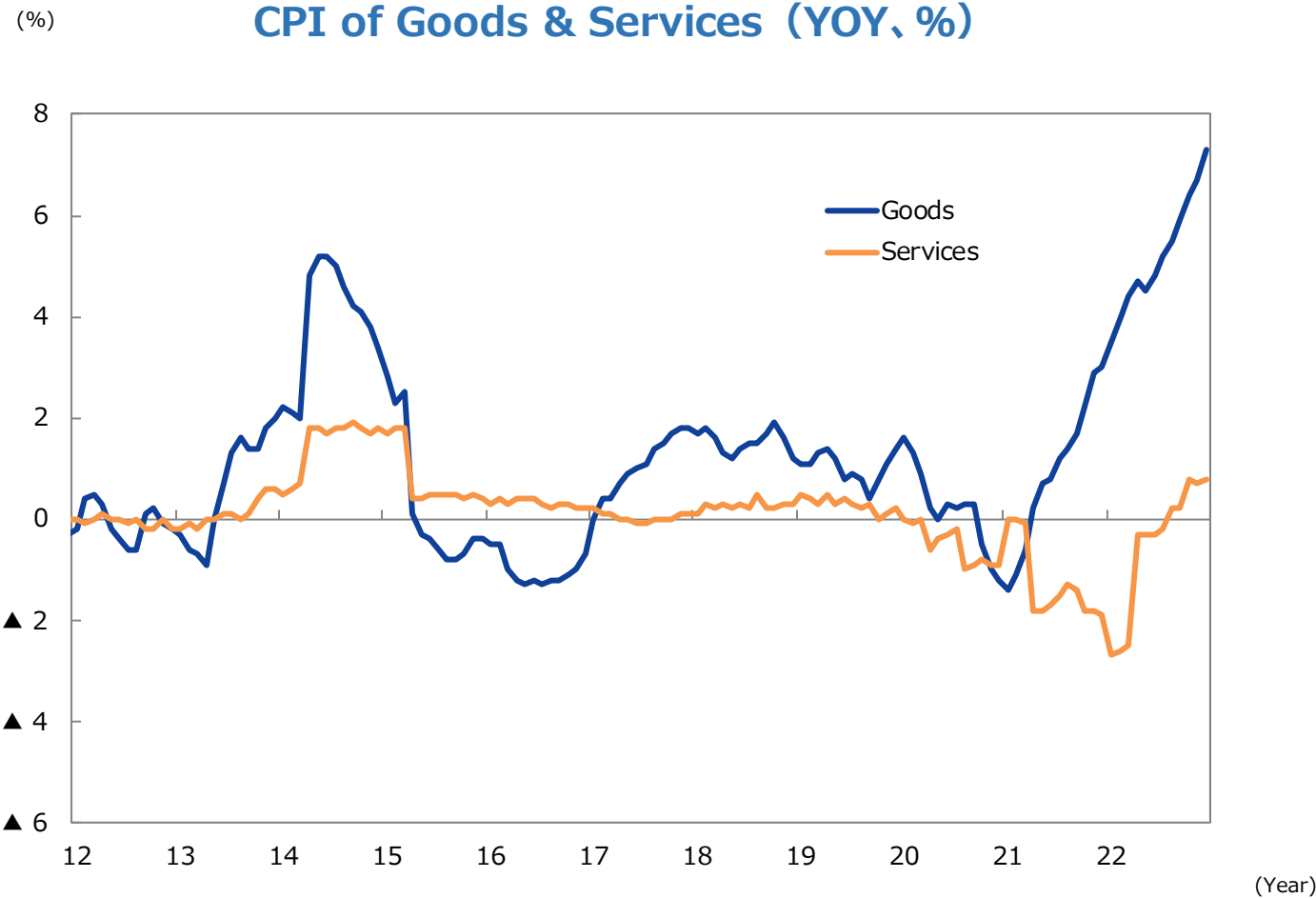
# Food and energy lift inflation to a 41 year high



Note: Data is from January 2005 to December 2022, Core CPI is excluding food, except for alcohol, & energy  
Source: MIAC, Bloomberg, SMDAM



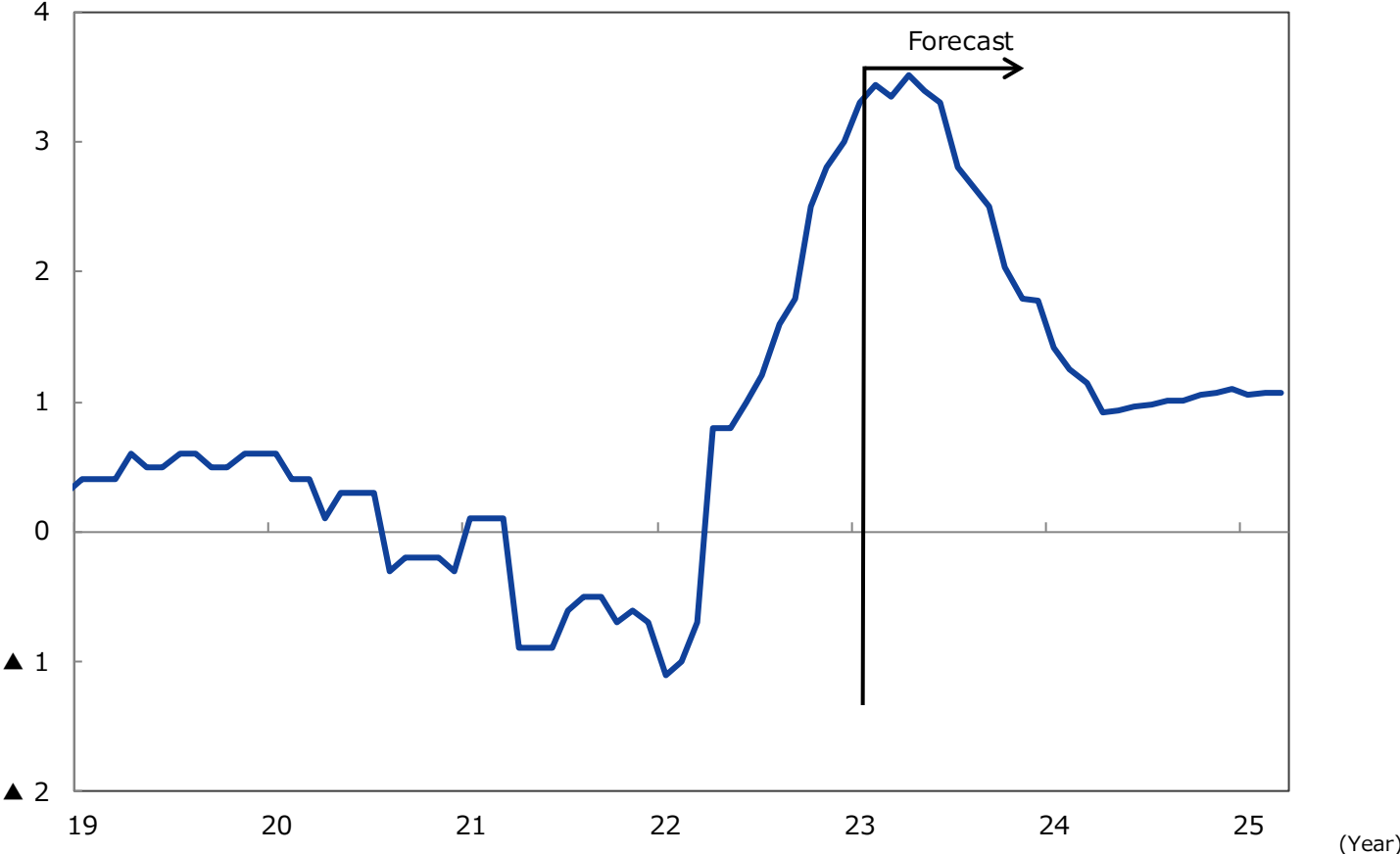
# Goods prices boost CPI despite weakness in services



Note: Data is from January 2012 to December 2022.  
Source: MIAC, Bloomberg, SMDAM

# BOJ expects Core CPI to decline sharply in the near future

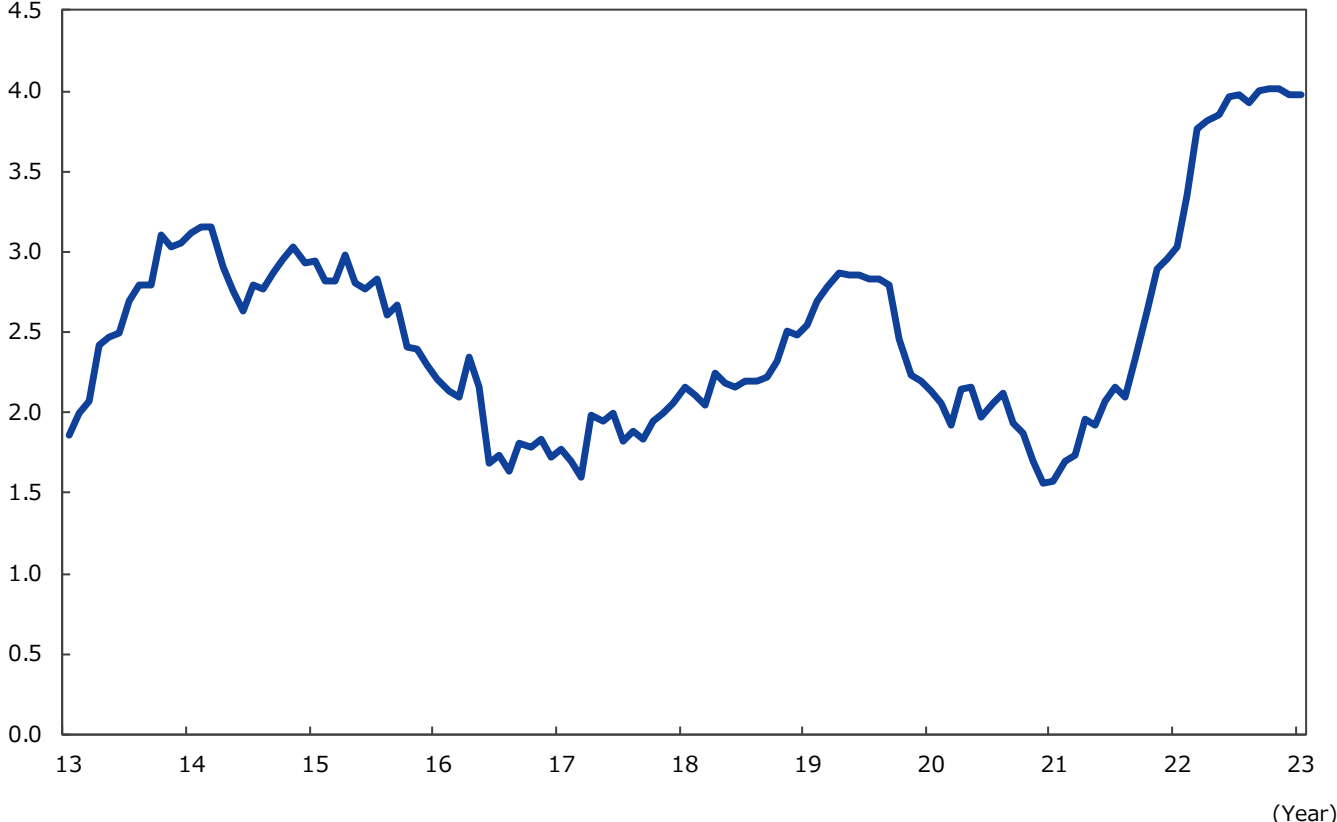
BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's CPI is excluding fresh foods & energy. Data after December 2022 are forecast.  
Source: The Bank of Japan, SMDAM

# Rising foods and energy change people's expectations about inflation

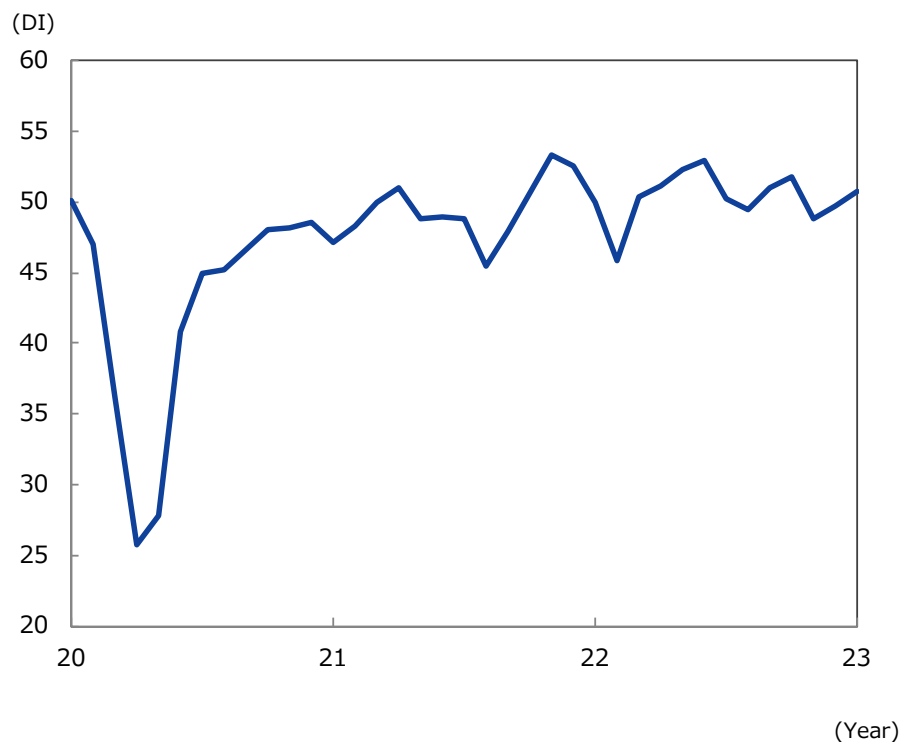
### Consumers' Expectation of Inflation Rate (YOY, %)



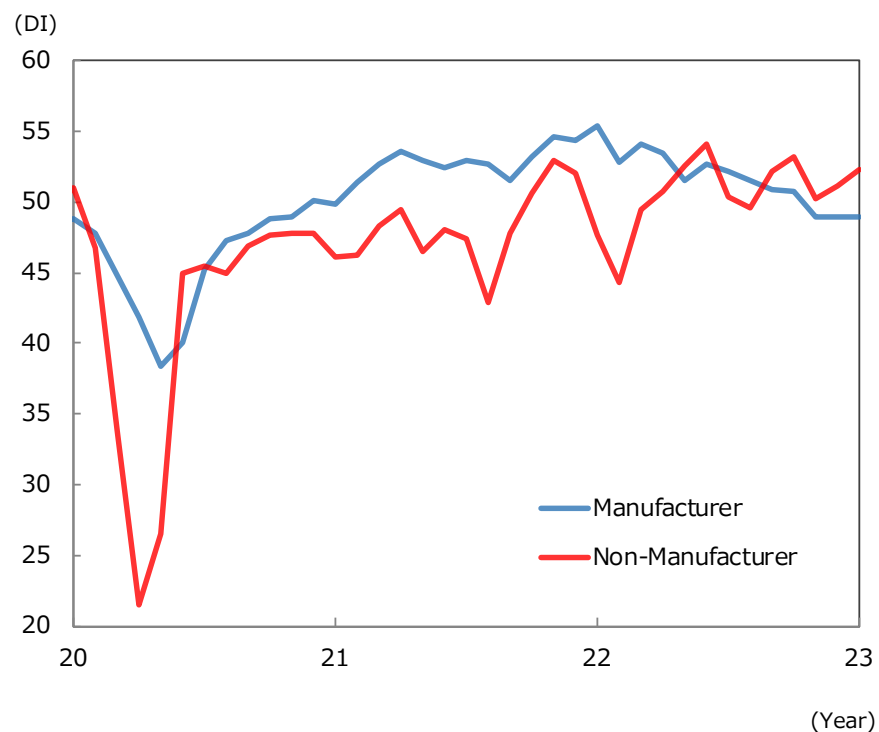
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to January 2023.  
Source: Cabinet Office, SMDAM

# While Non-manufacturers stable, manufacturers feeling cautious

## Composite PMI

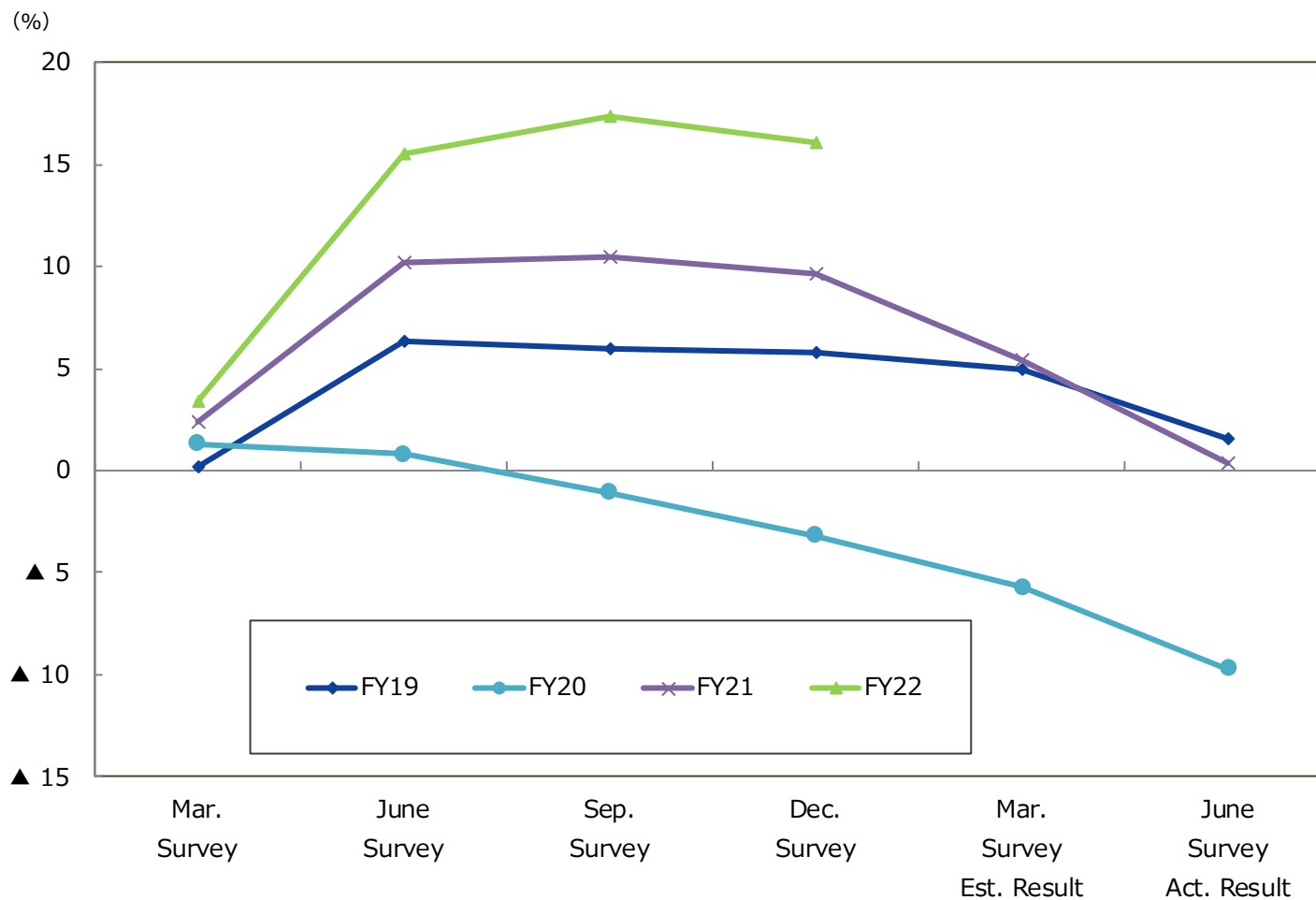


## PMI, Manufacturer & Non-Manufacturer



Note: Data is from January 2020 to January 2023.  
Source: Bloomberg, SMDAM

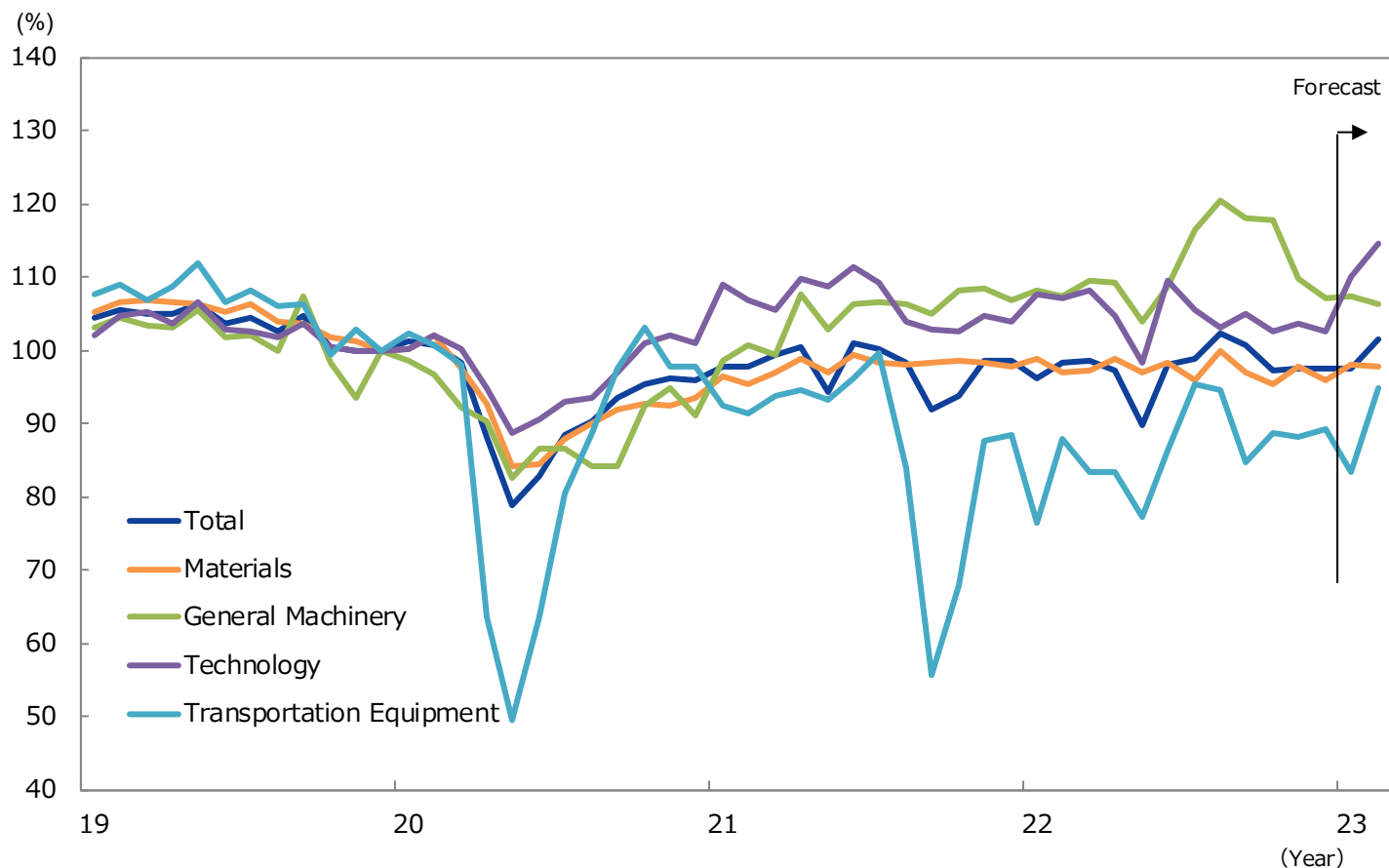
# Weak JPY and deferred spending lift CAPEX going forward



Note: Data is from Q1 FY 2019 to Q4 2022. Data is including software, excluding land and R&D.  
 Source: The Bank of Japan, SMDAM

# Auto & tech to lead recovery in industrial production

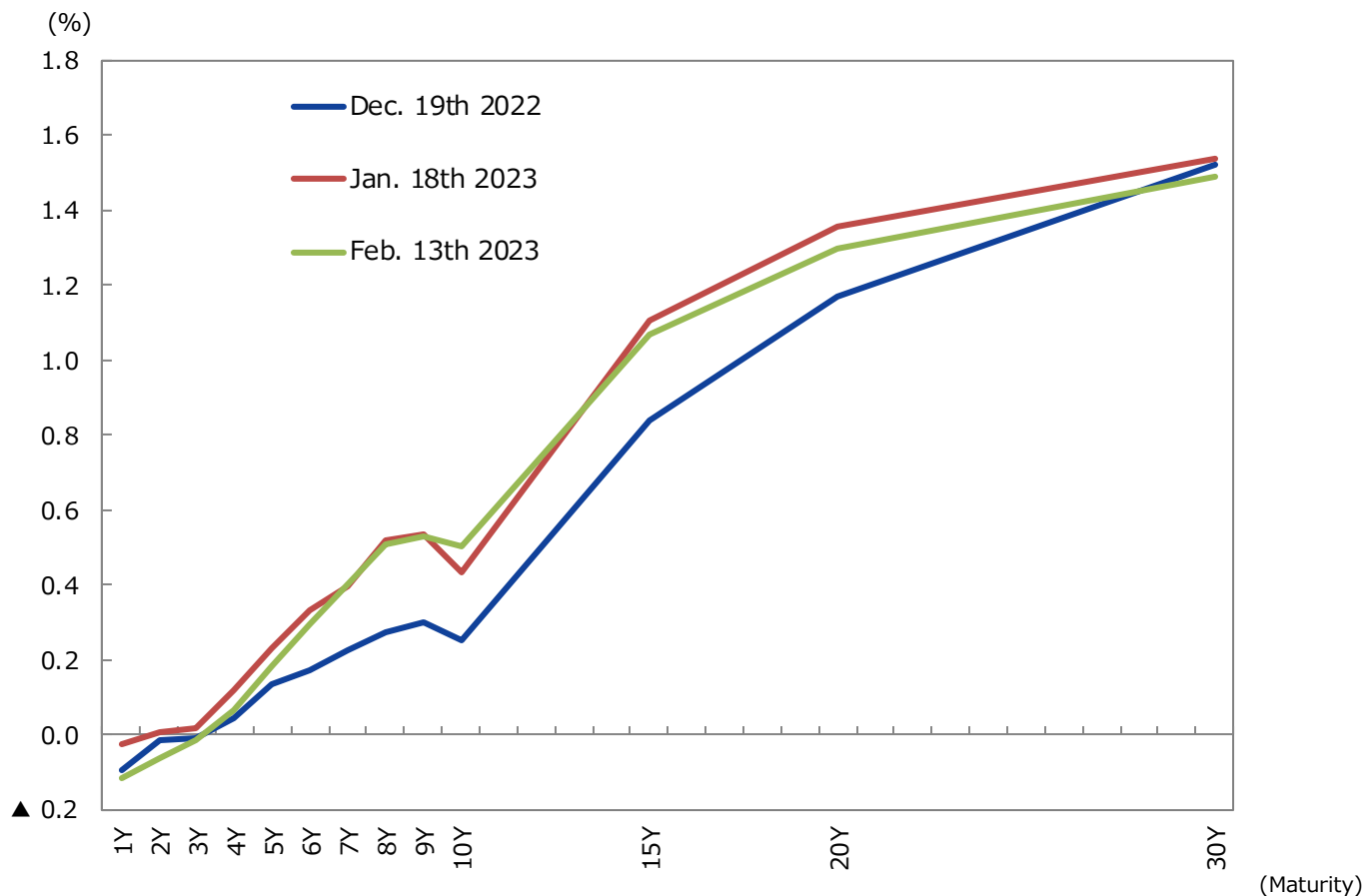
## Industrial Production (Dec. 2019=100)



Note: 100% = December 2019. Data is from January 2019 to February 2023. Data after December 2022 are forecasts.  
Source: METI, SMDAM

# Speculation regarding policy change pushing yield curve higher

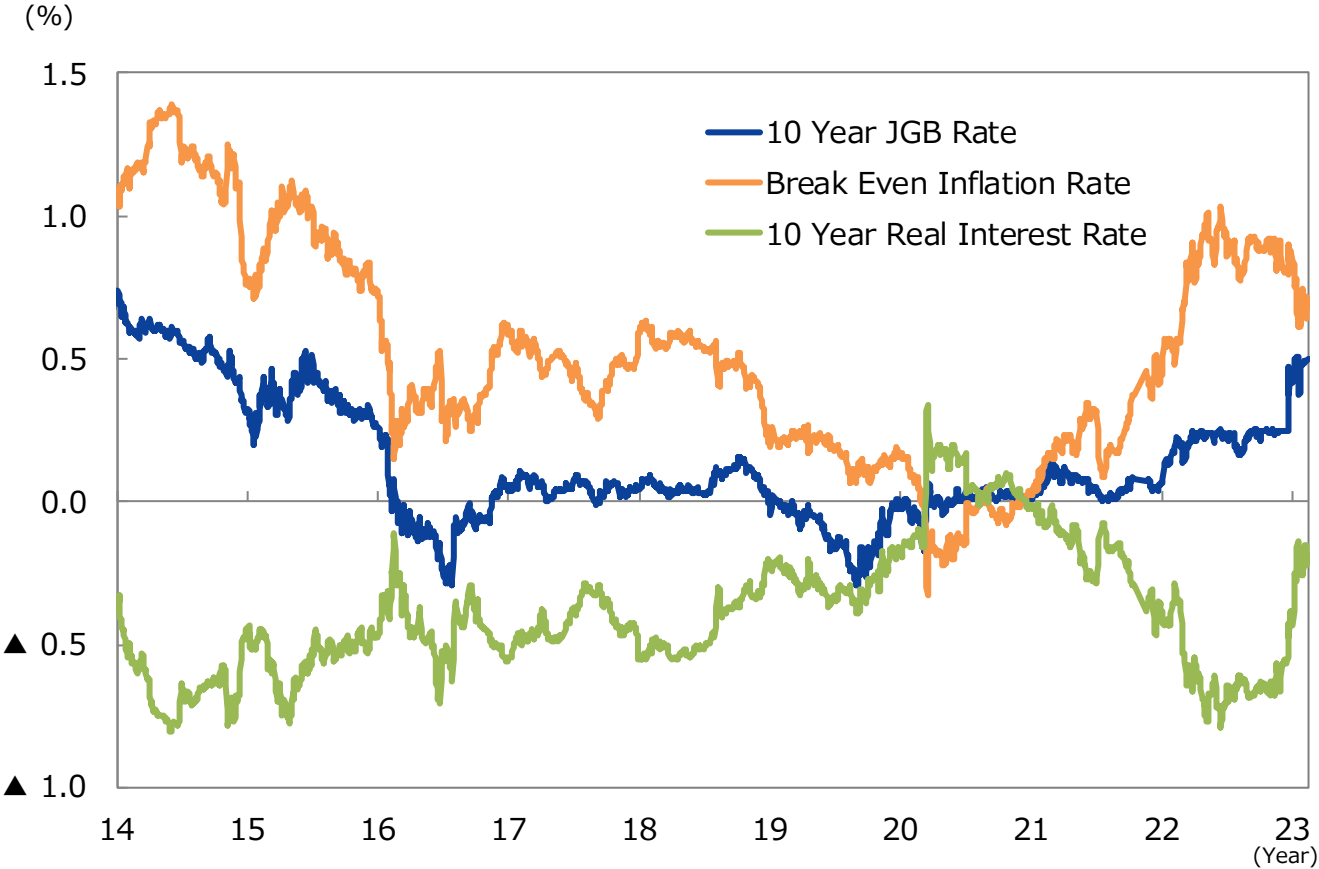
## Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

# BOJ's review of YCC raised real interest rate higher

## JGB, BEI, and Real Interest rate

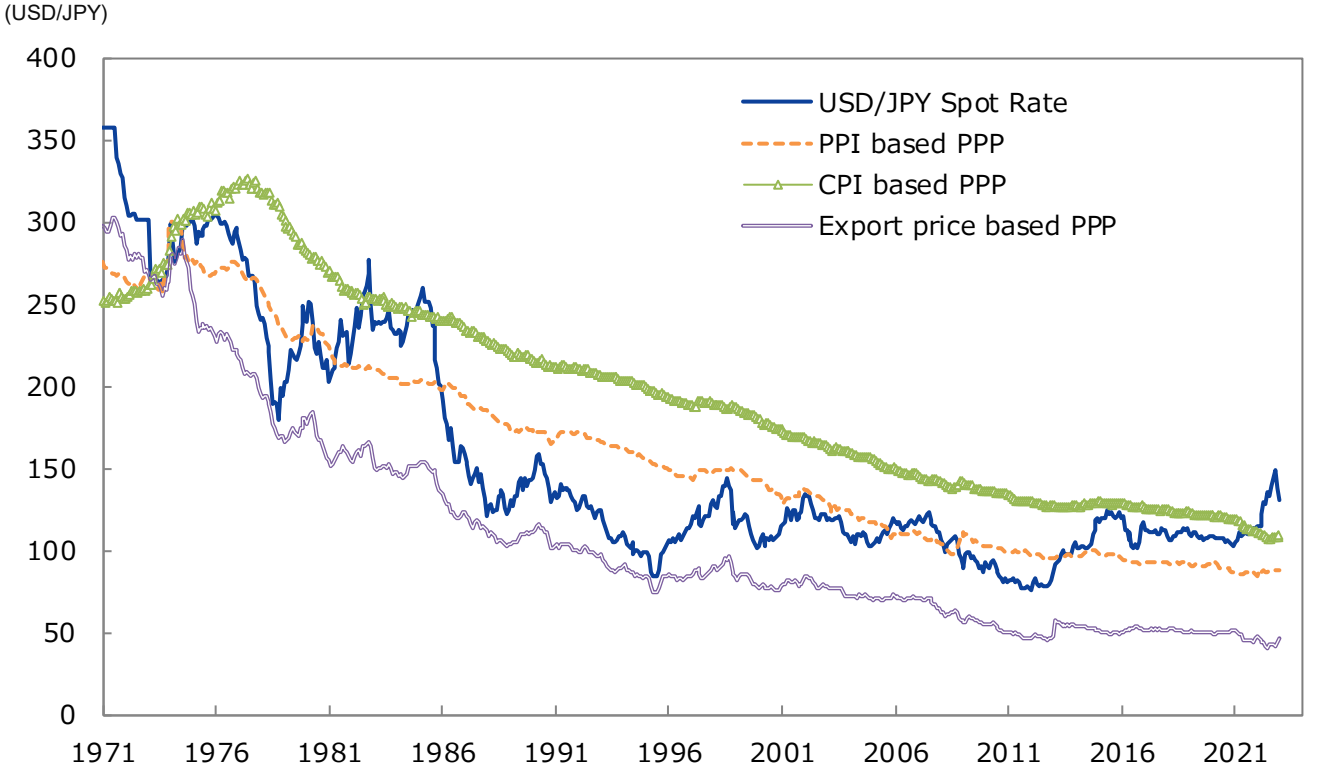


Note: Data is from 1st January 2014 to 16th February 2023.  
Source: Bloomberg, SMDAM



# USD/JPY rate starts swinging back to purchasing power parity

## Purchasing Power Parity of USD/JPY Rate

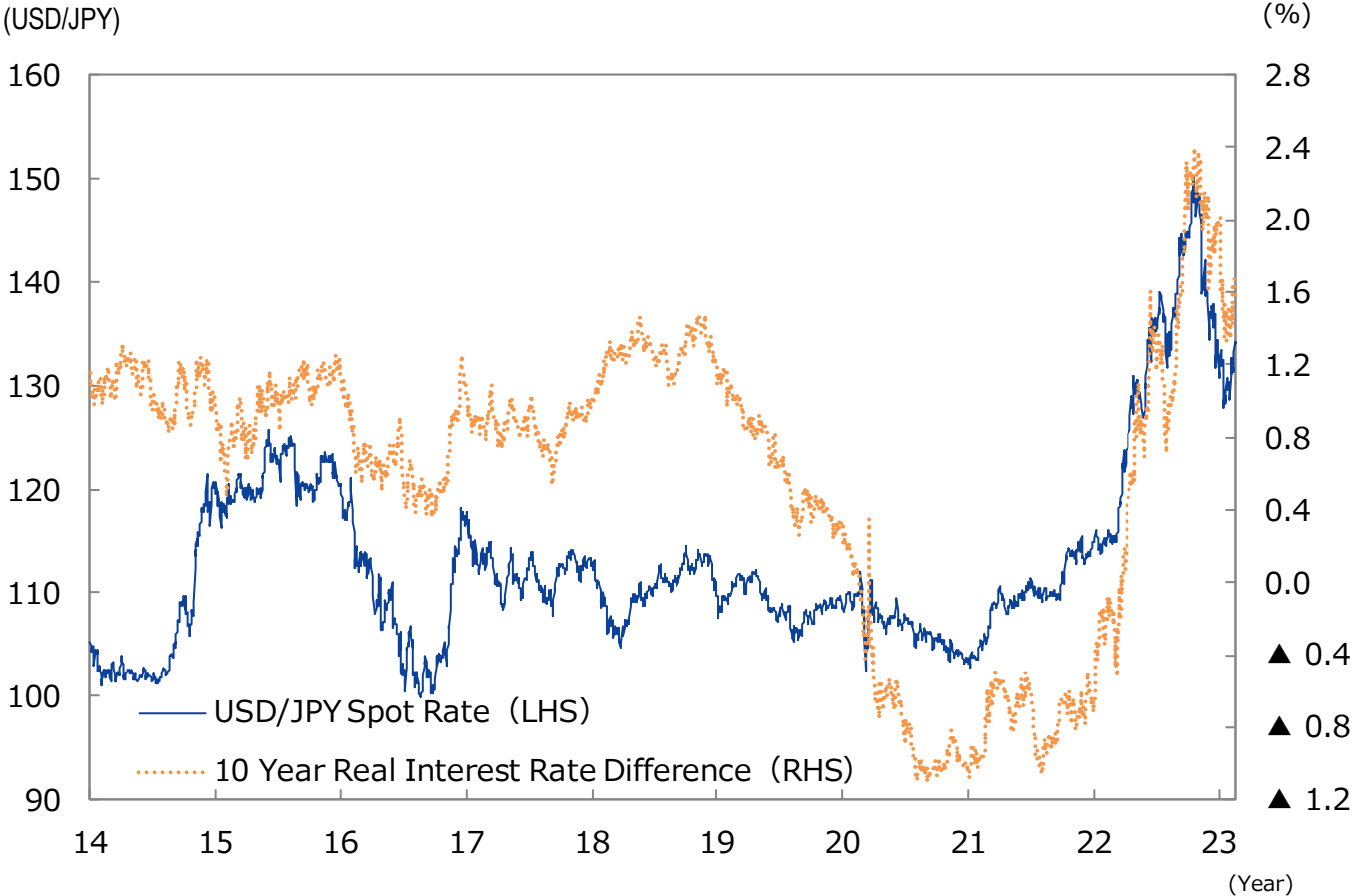


Note: Data is from January 1971 to December 2022.  
Source: DOL, Bank of Japan, SMDAM

(Year)

# USD/JPY stopped falling due to strong economic data in the US

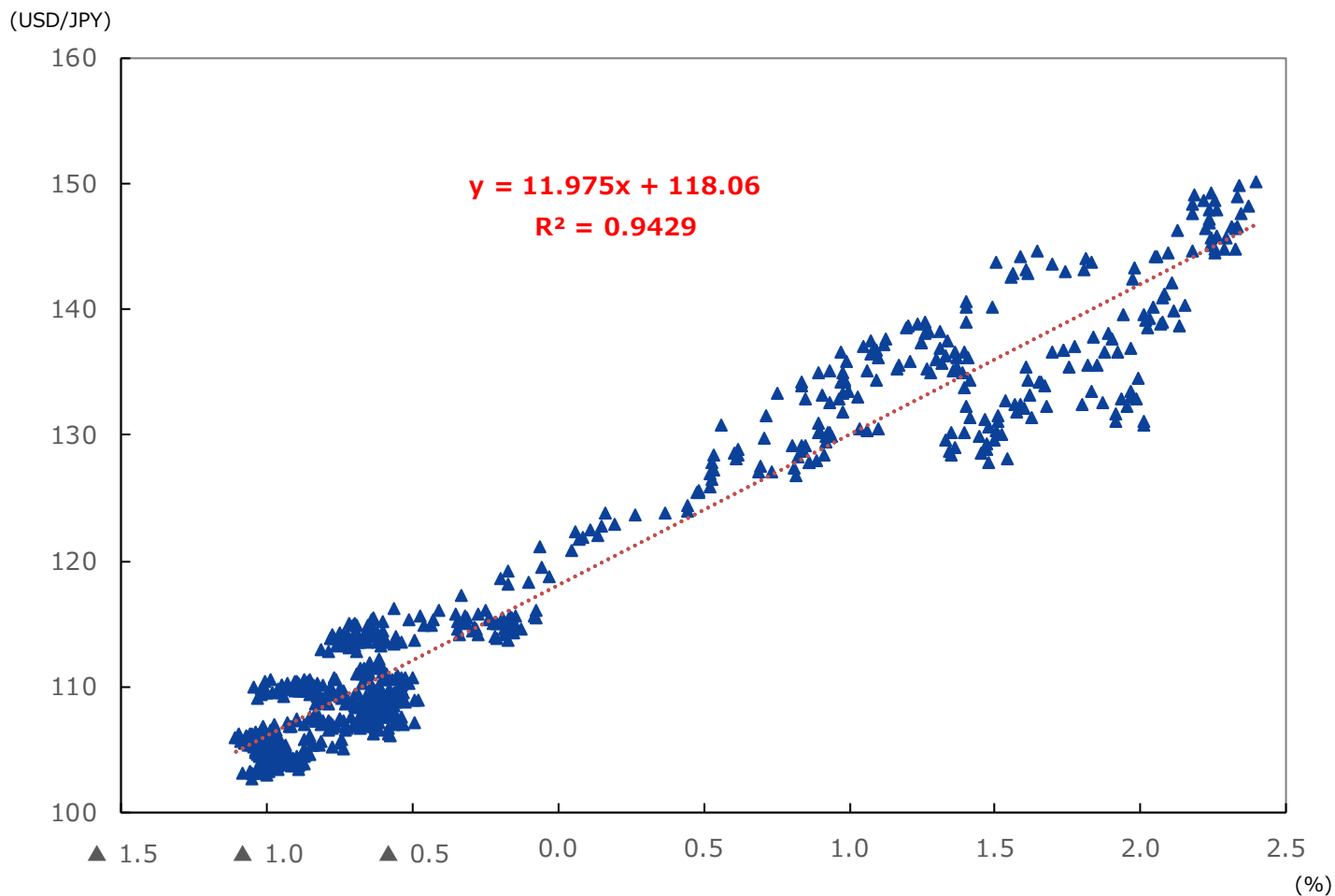
## Real Interest Rate Gap & USD/JPY Exchange rate



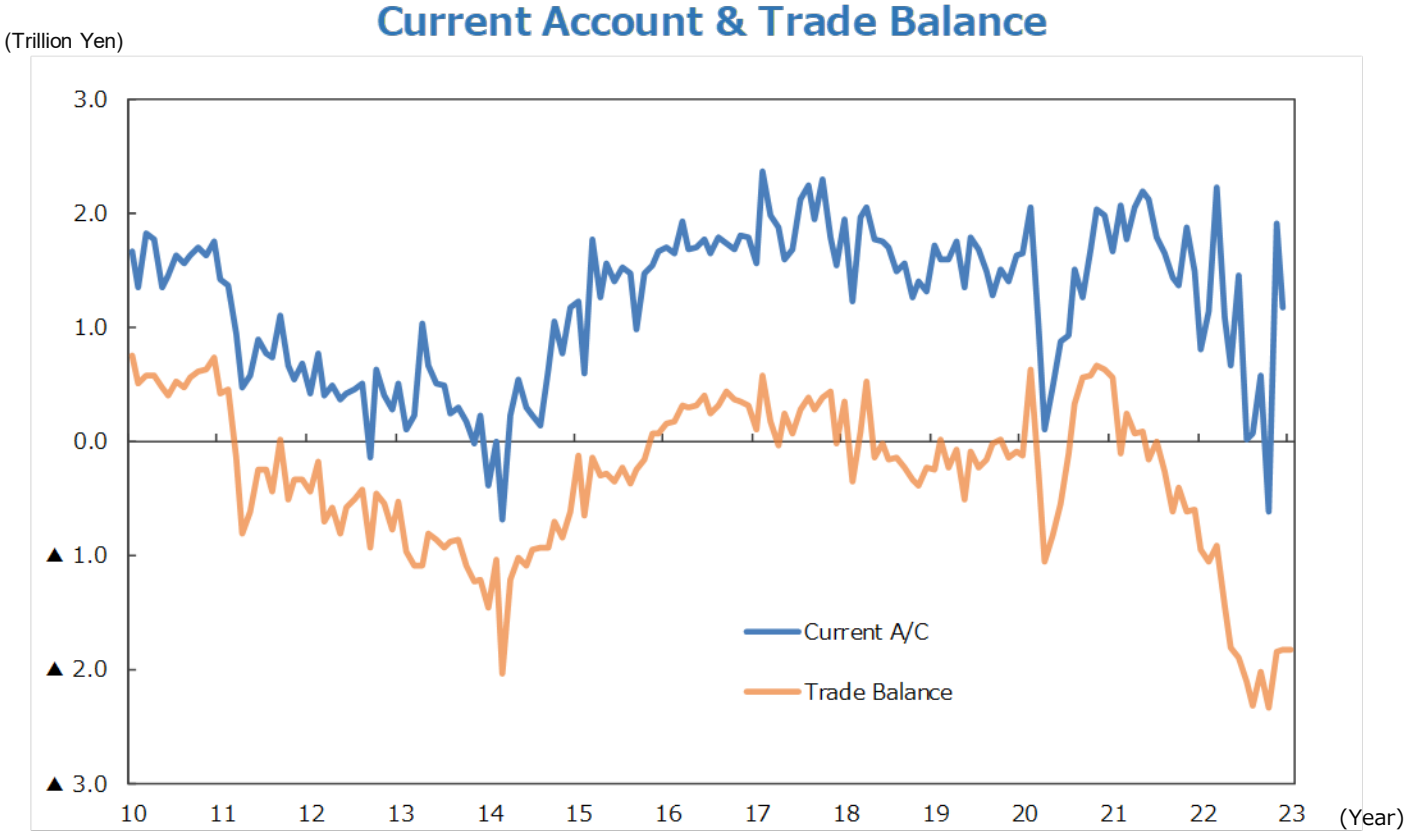
Note: Data is from 1st January 2014 to 17th February 2023.  
Source: Bloomberg, SMDAM

# Interest rate gap keeps dominating USD/JPY rate

## Correlation between Real Interest Rate Gap & USD/JPY



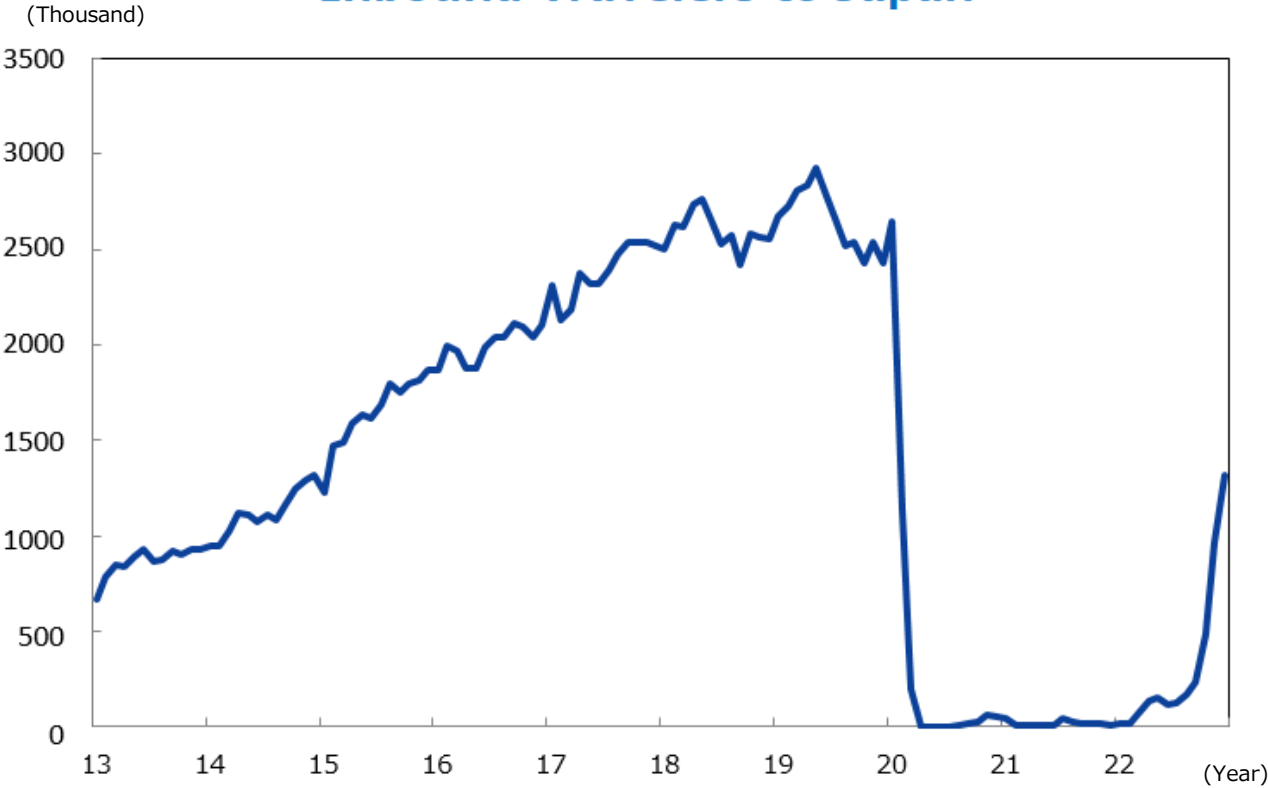
# Foreign investment profit drives recovery in current A/C surplus



Note: Data is Seasonally adjusted. Current account is from January 2010 to December 2022. Trade balance is from January 2010 to January 2023.  
Source: MOF, SMDAM

# “Re-opening” boosts recovery of inbound travel

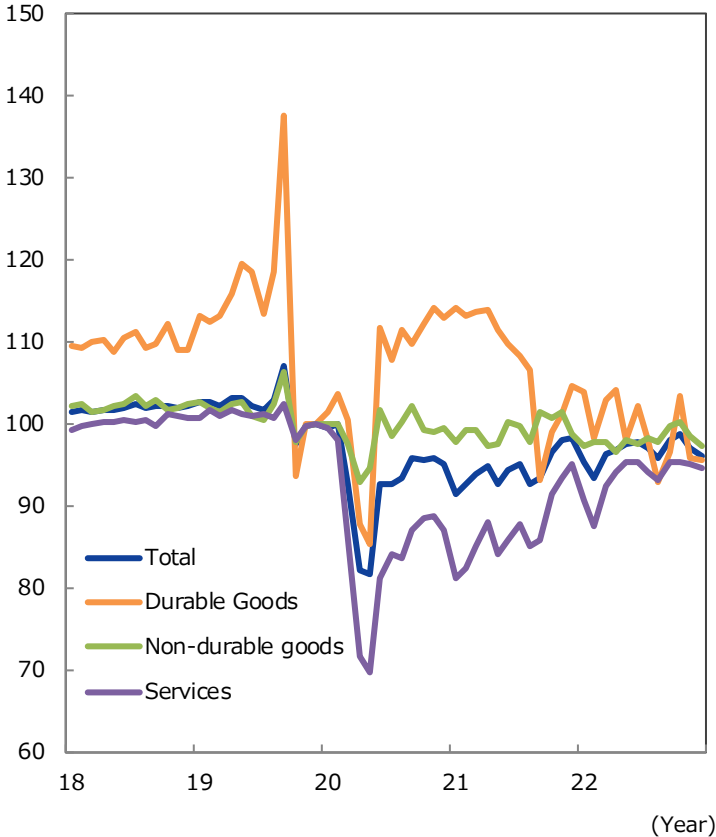
## Inbound Travelers to Japan



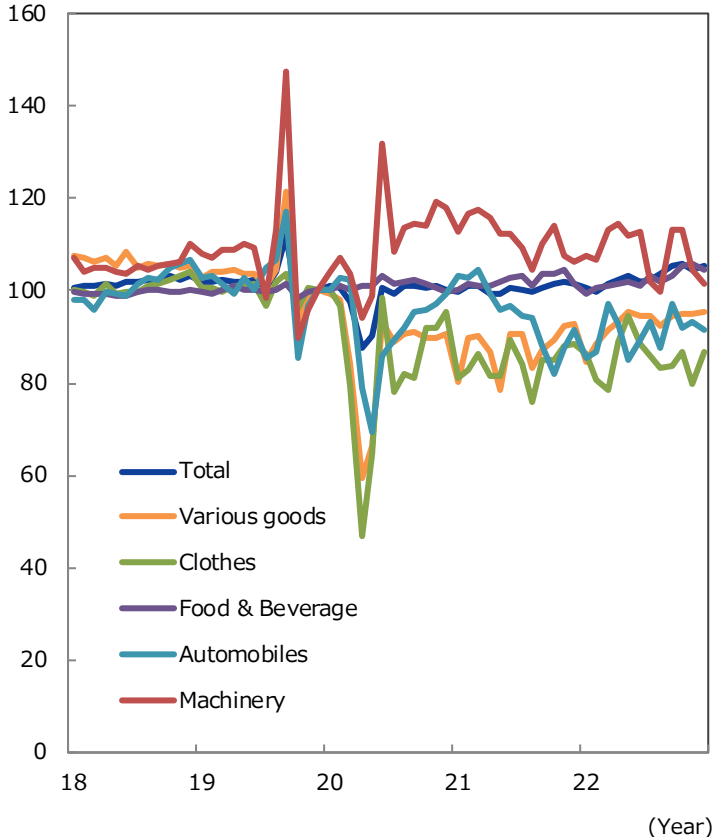
Note: Data is from January 2013 to December 2022. Data is seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Consumer activities back to normal

Consumer Activity Index (Dec. 2019 = 100)



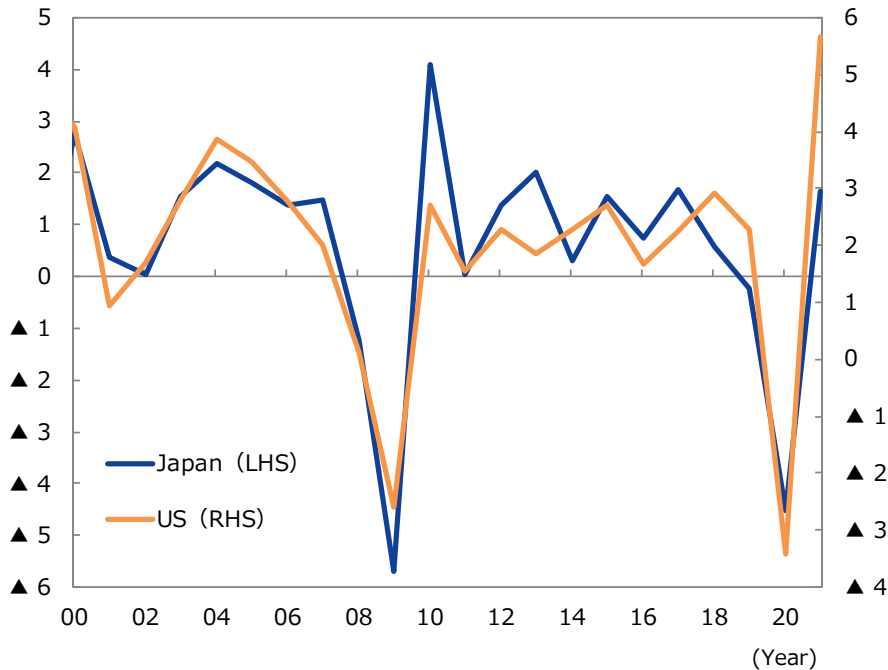
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to December 2022.  
 Source; Bank of Japan, METI, and SMDAM

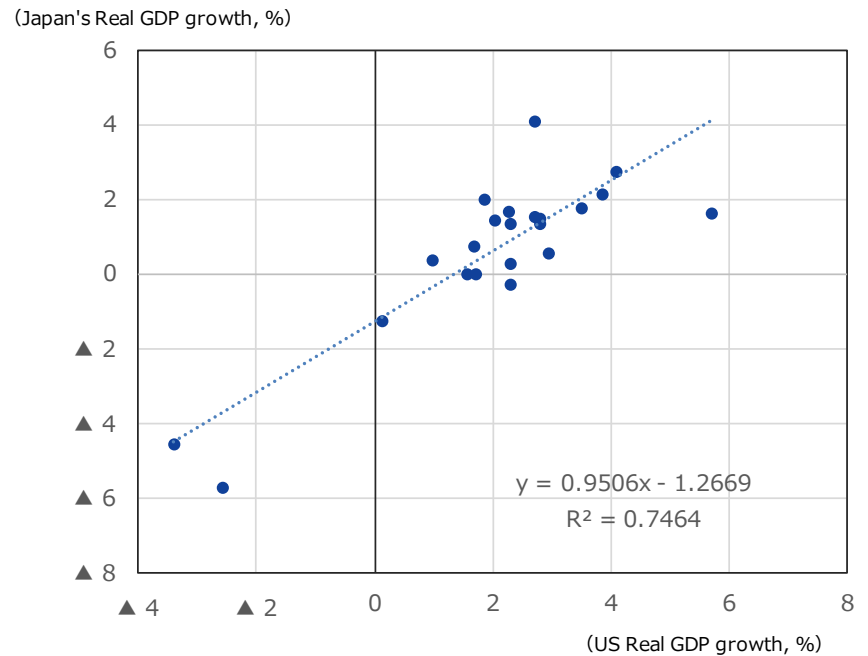
# Strong correlation between US and Japanese economic growth

## Real GDP Growth (YOY, %)



Note: Data is from 2000 to 2021  
Source: IMF, SMDAM

## Correlation of Real GDP Growth



# Japan's marginal exposure to Russian businesses

(%)

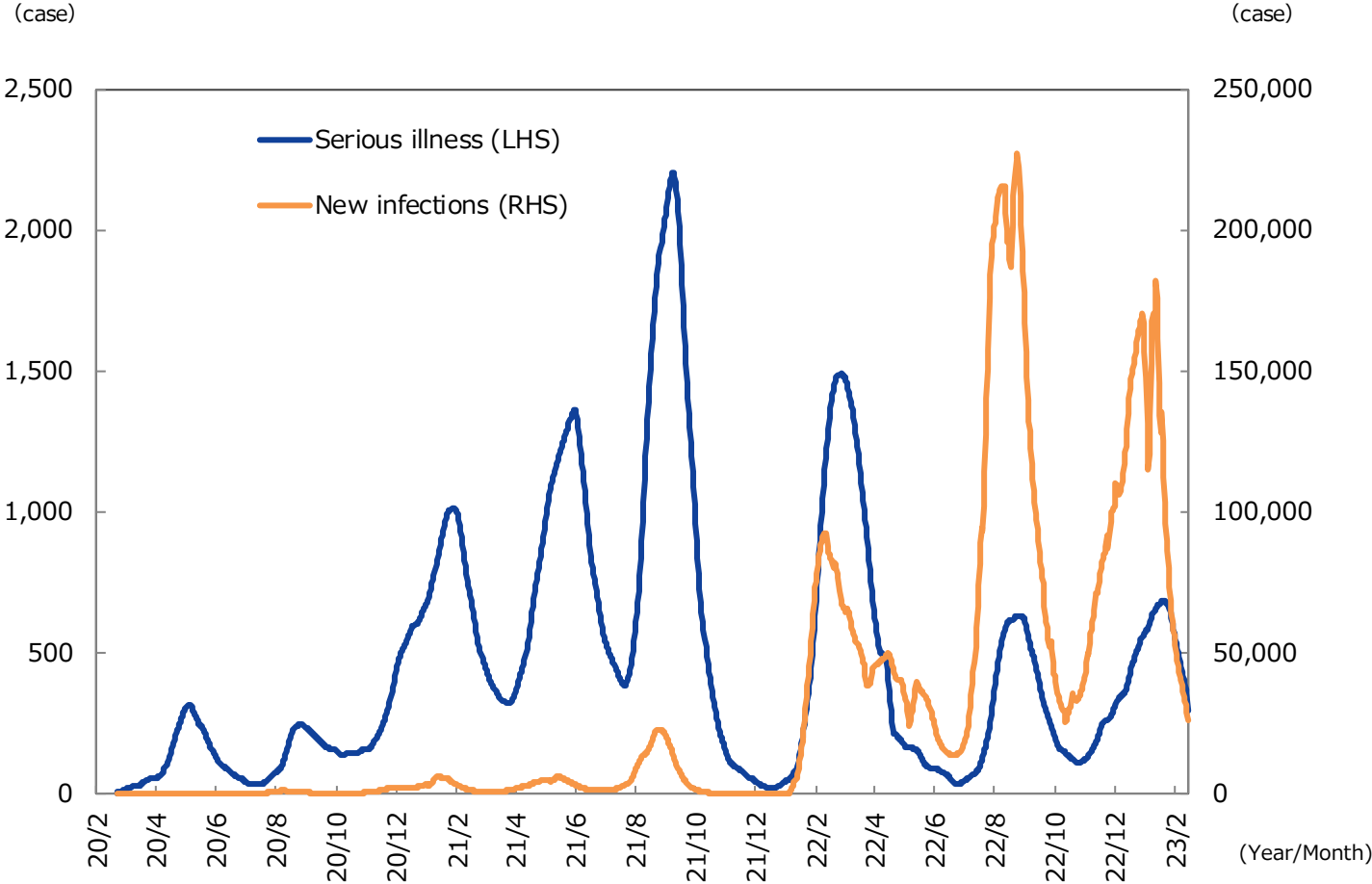
	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Import	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01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

Note: As of year 2021.  
Source: MOF, SMDAM



# Eighth wave of COVID-19 infections fading sharply

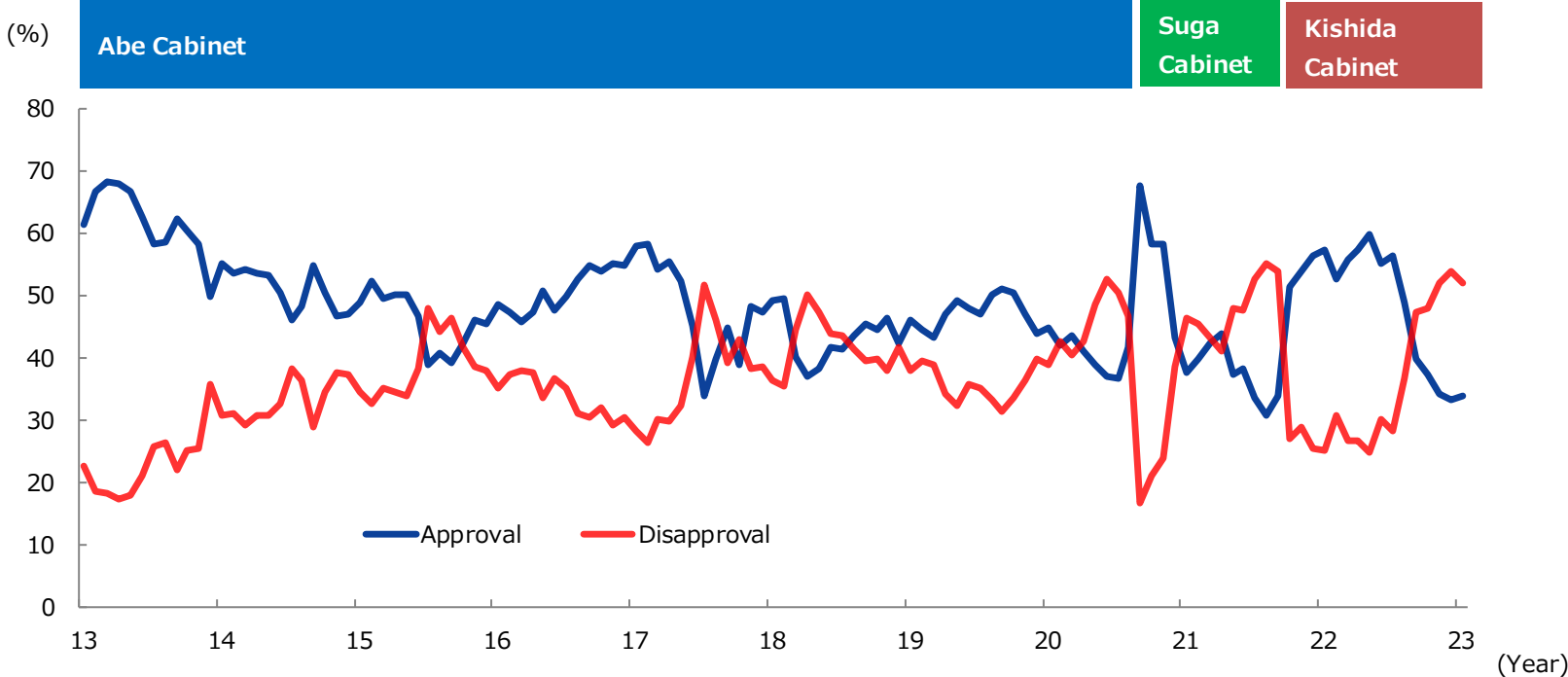
## COVID-19 New Infections and Serious Illness



Note: 7 days moving average. Data is from 21st February 2020 to 13th February 2023.  
Source: MHLW, NHK, SMDAM

# Approval rate may hit the bottom as issue of Unification church fades

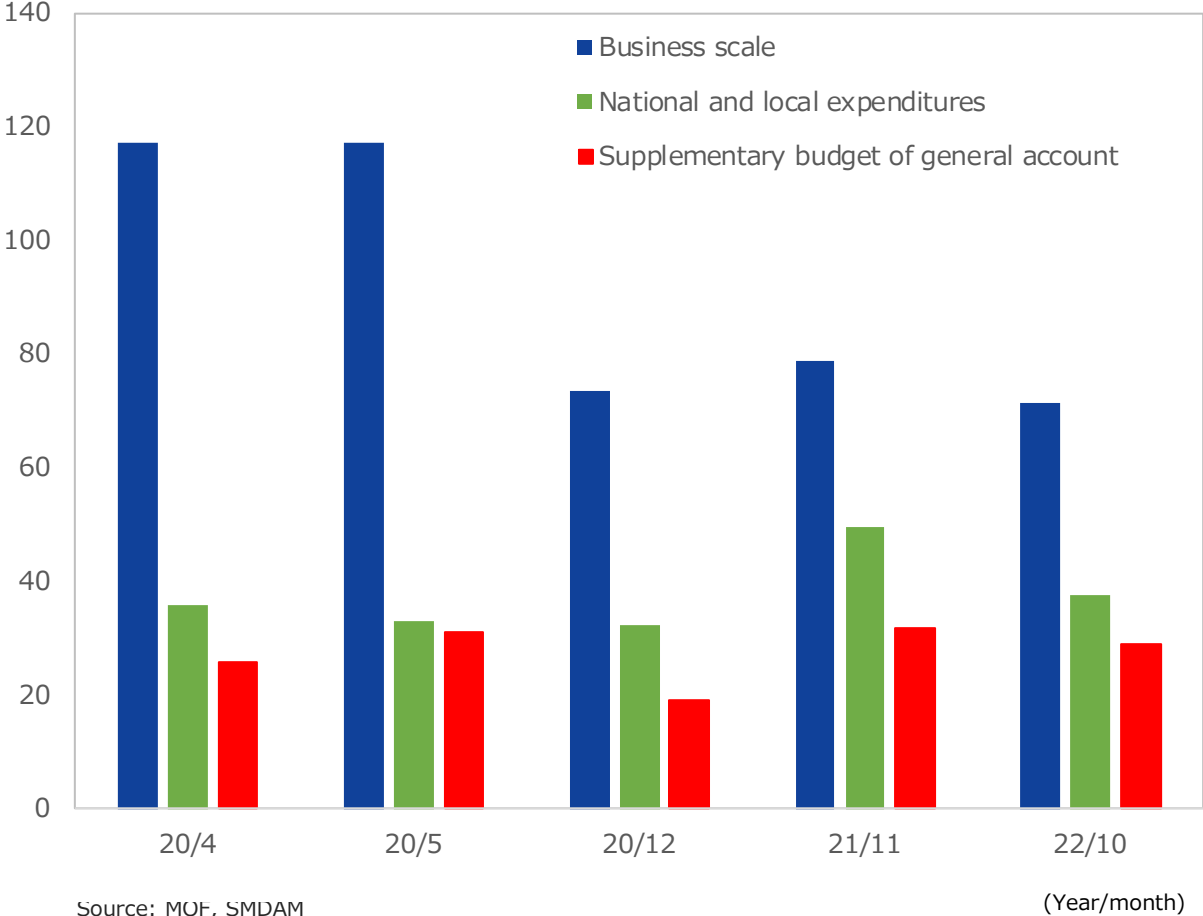
## Cabinet approval rate



Note: Data is from January 2013 to January 2023.  
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

# Falling cabinet approval rate lifted the size of economic stimulus

## Size of Fiscal Stimulus (trillion yen)



# Schedule of major events

Year	Month	Date	Event
2023	March	9	Revision of CY 2022 Q4 GDP
		9-10	Monetary Policy Meeting
		19	Term expiration of the BOJ vice governor Amemiya and Wakatabe
		20	Appointment of New BOJ vice governors
			Compilation of proposals to strengthen measures to combat the declining birthrate
			Enactment of the budget and tax reform bill of FY 2023
	April	8	Term expiration of the BOJ governor Kuroda
		9	Appointment of New BOJ governor
		9, 23	Nationwide local elections
		23	By-elections for the House of Representatives and the House of Councilors
	May	27-28	Monetary Policy Meeting
		19-21	G7 Summit in Japan
	June	15-16	Monetary Policy Meeting
		21	End of the ordinary Diet session
		Big-boned policy decisions Formulation of guidelines for the facilitation of labor mobility	
July	27-28	Monetary Policy Meeting	
August			
September	9-10	G20 Summit in India	
	21-22	Monetary Policy Meeting Appointment of key posts of ruling Liberal Democratic Party	
October	1	Start of the qualified invoice-based method	
	30-31	Monetary Policy Meeting	
November			
December	18-19	Monetary Policy Meeting	
		Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline	

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