



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-August 2023-

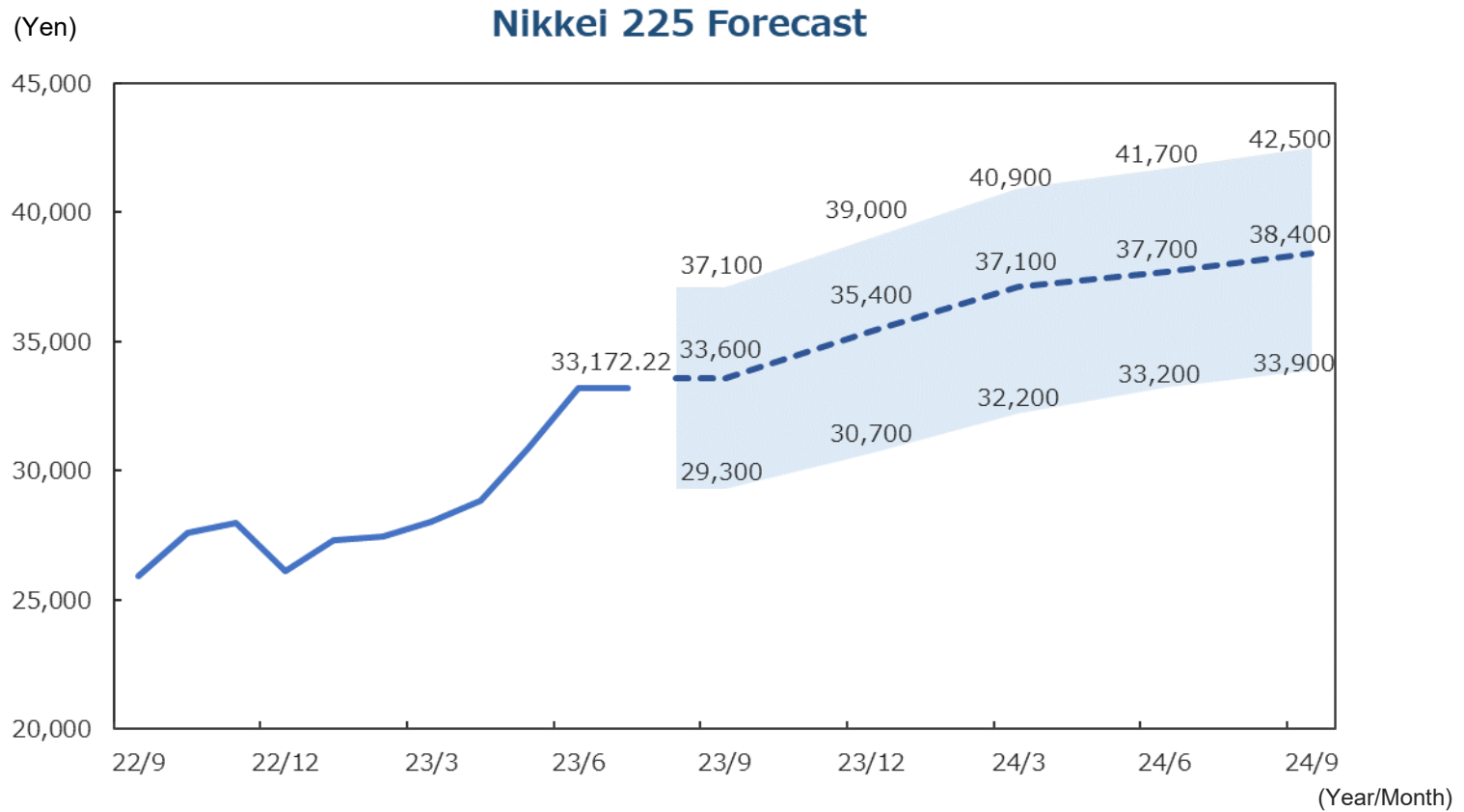


Outlook for Japanese Stock Market

Market Outlook

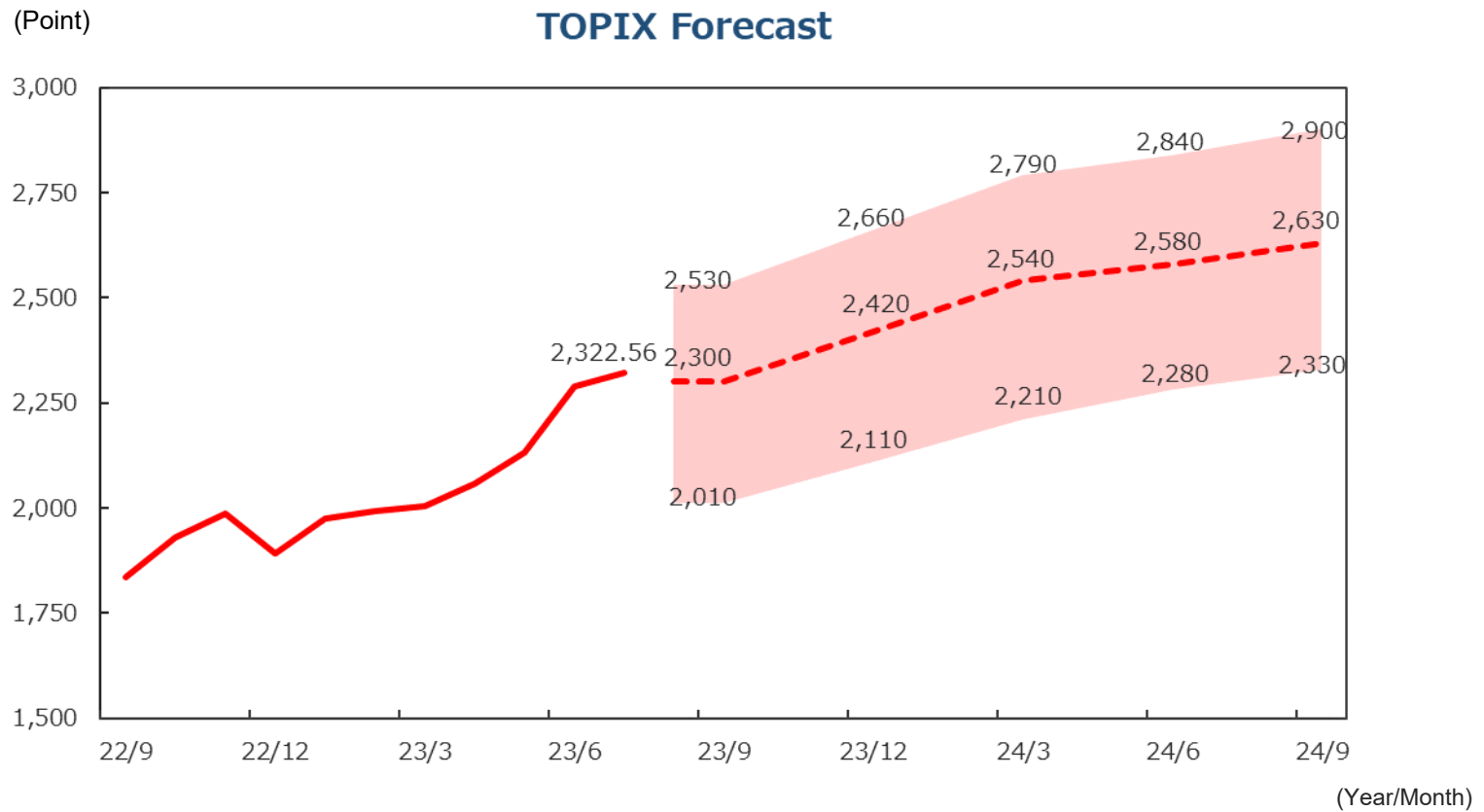
- We are bullish on the Japanese equity market due to ongoing “easy monetary policy” by the BOJ and steady growth of domestic economy.
- We expect the market to re-accelerate its bullish trend after hitting the peak of the FED’s tightening regime and trough of the global economic cycle.
- We maintain our TOPIX price target at 2,540 and that of Nikkei 225 at 37,100 as of the end of March 2024.
- Growing confidence over the virtuous cycle between price and wage increases could provide further boost to the Japanese stock market going forward.

We see bullish market outlook ahead



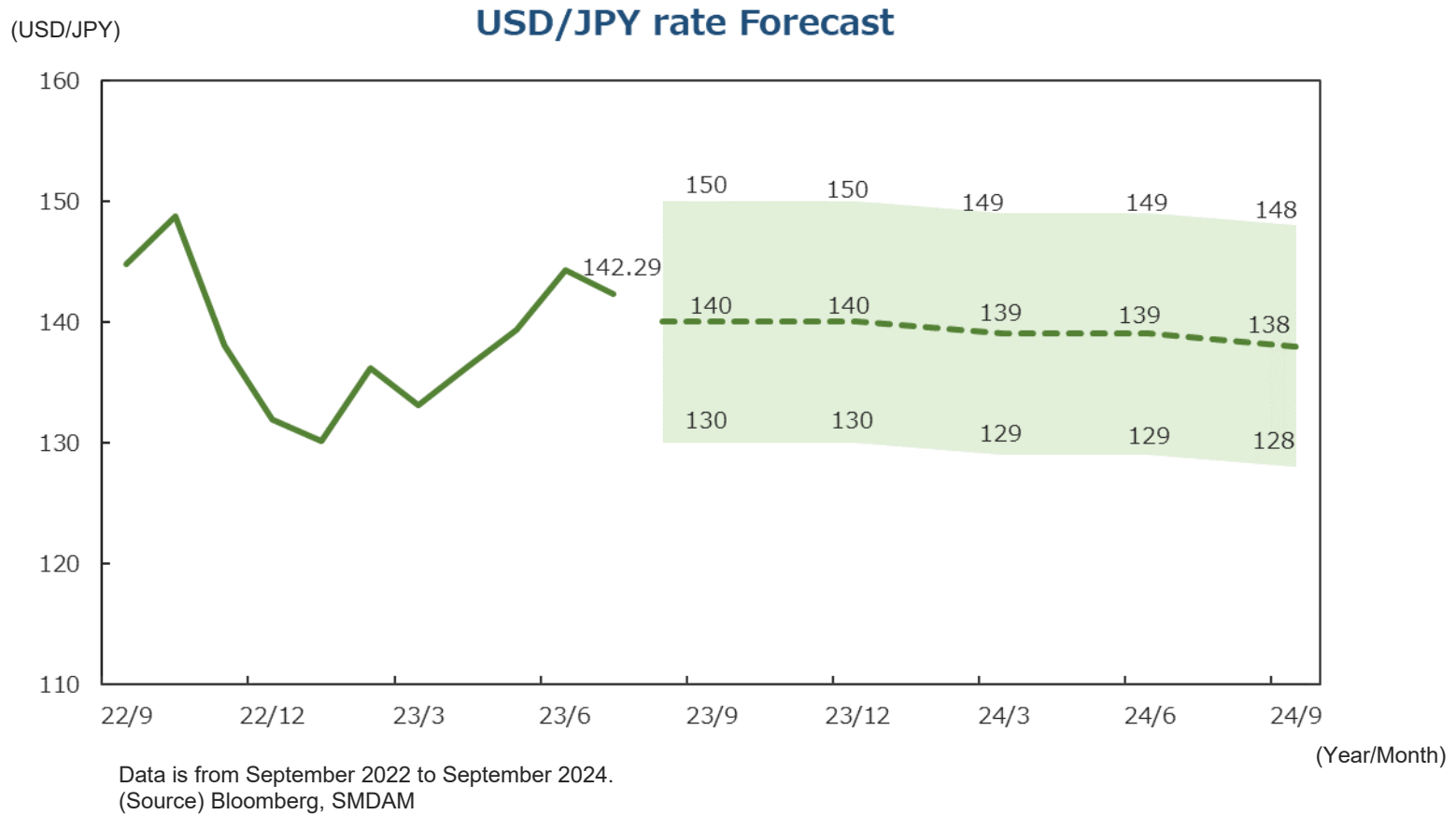
Data is from September 2022 to September 2024.
(Source) Bloomberg, SMDAM

We see bullish market outlook ahead



Data is from September 2022 to September 2024.
(Source) Bloomberg, SMDAM

Modest JPY appreciation after FED pivot next year



Upside / Downside risk scenarios

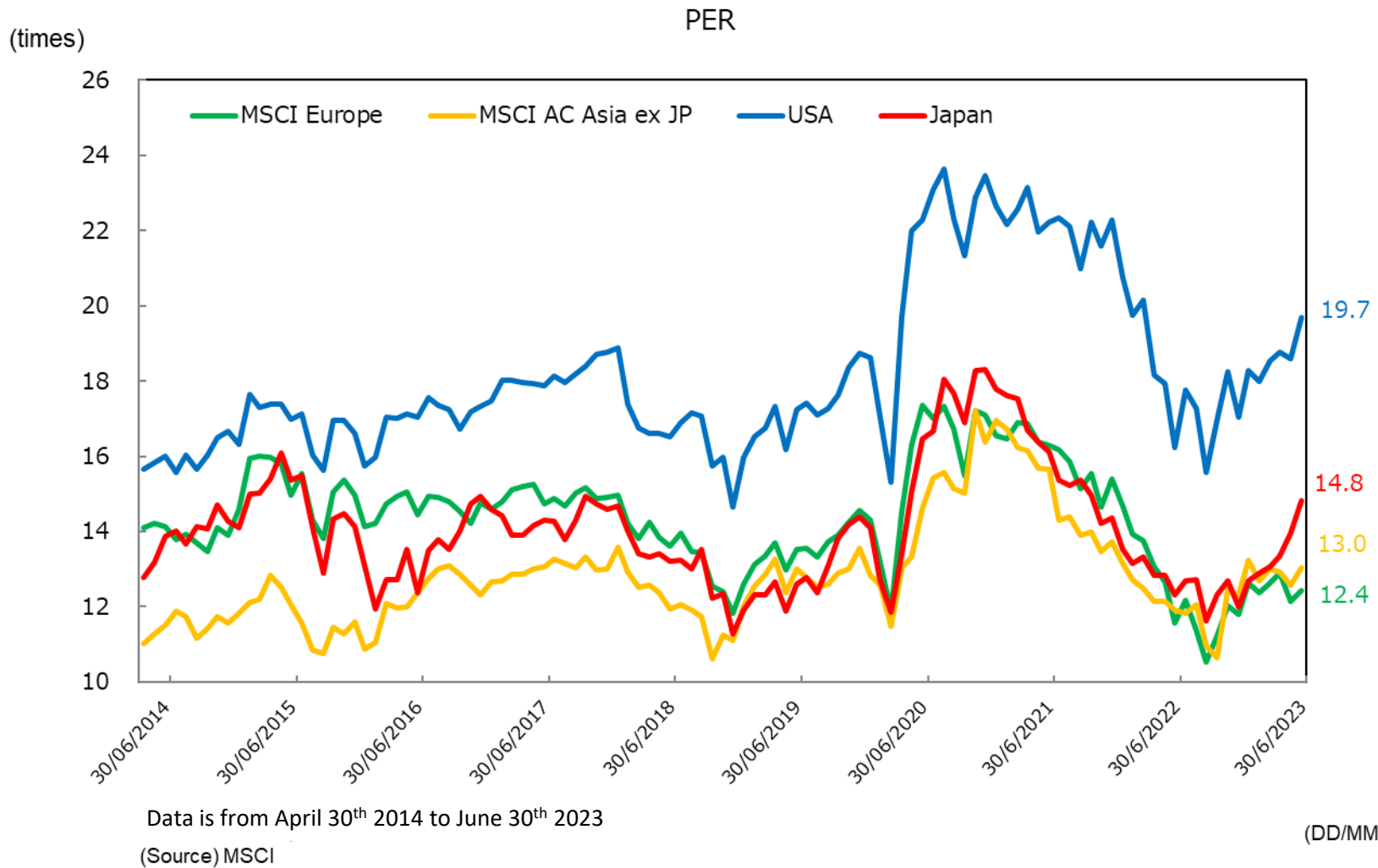
■ Upside Risks

- FED pivot and monetary easing
- Virtuous cycle between mild inflation and wage increase
- Recovery in inbound travel from China

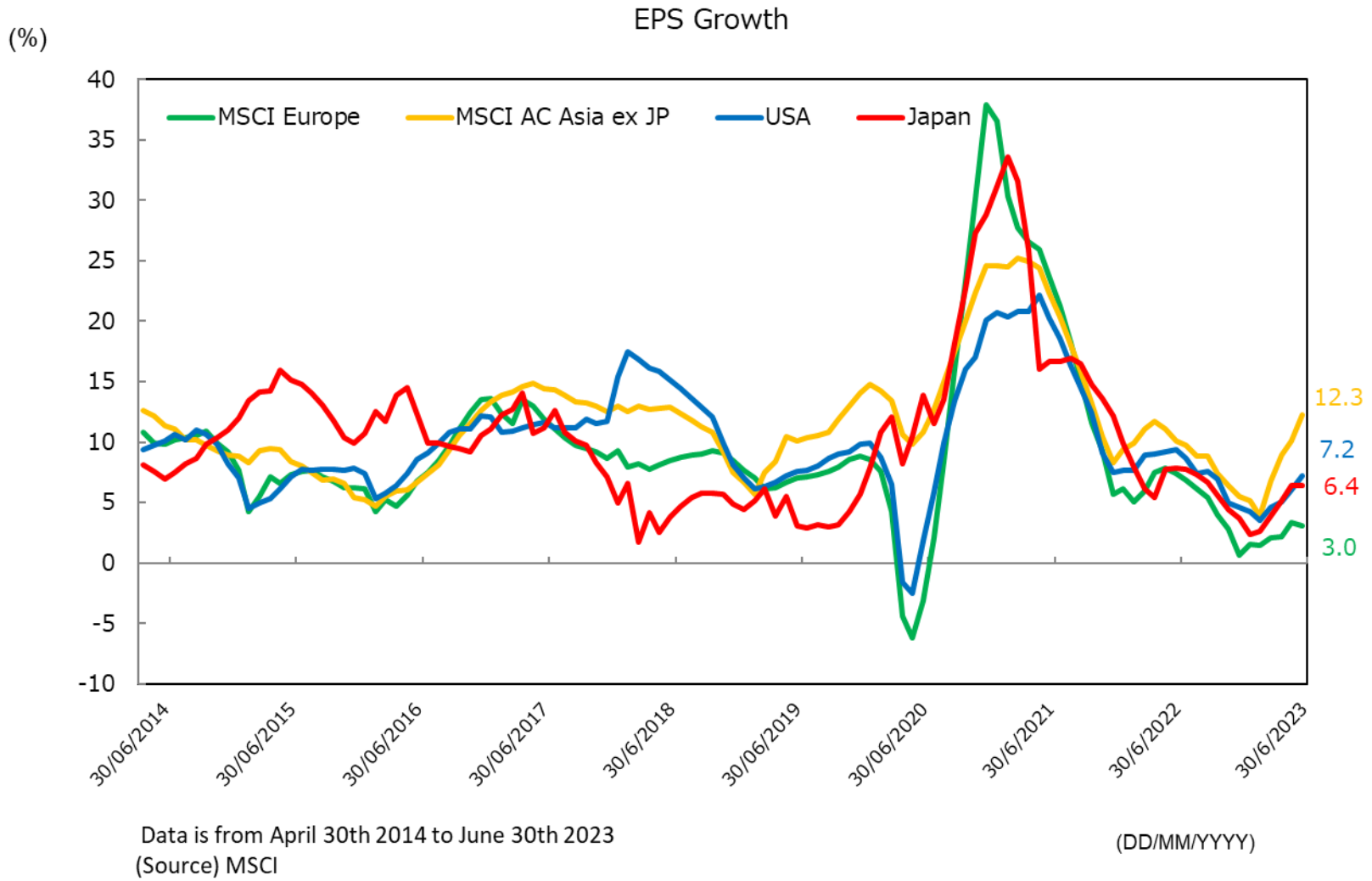
■ Downside Risks

- Excessive JPY appreciation and its negative impact on corporate earnings
- Renewed concern over global financial turmoil
- Prolonged stagnation of the global economy

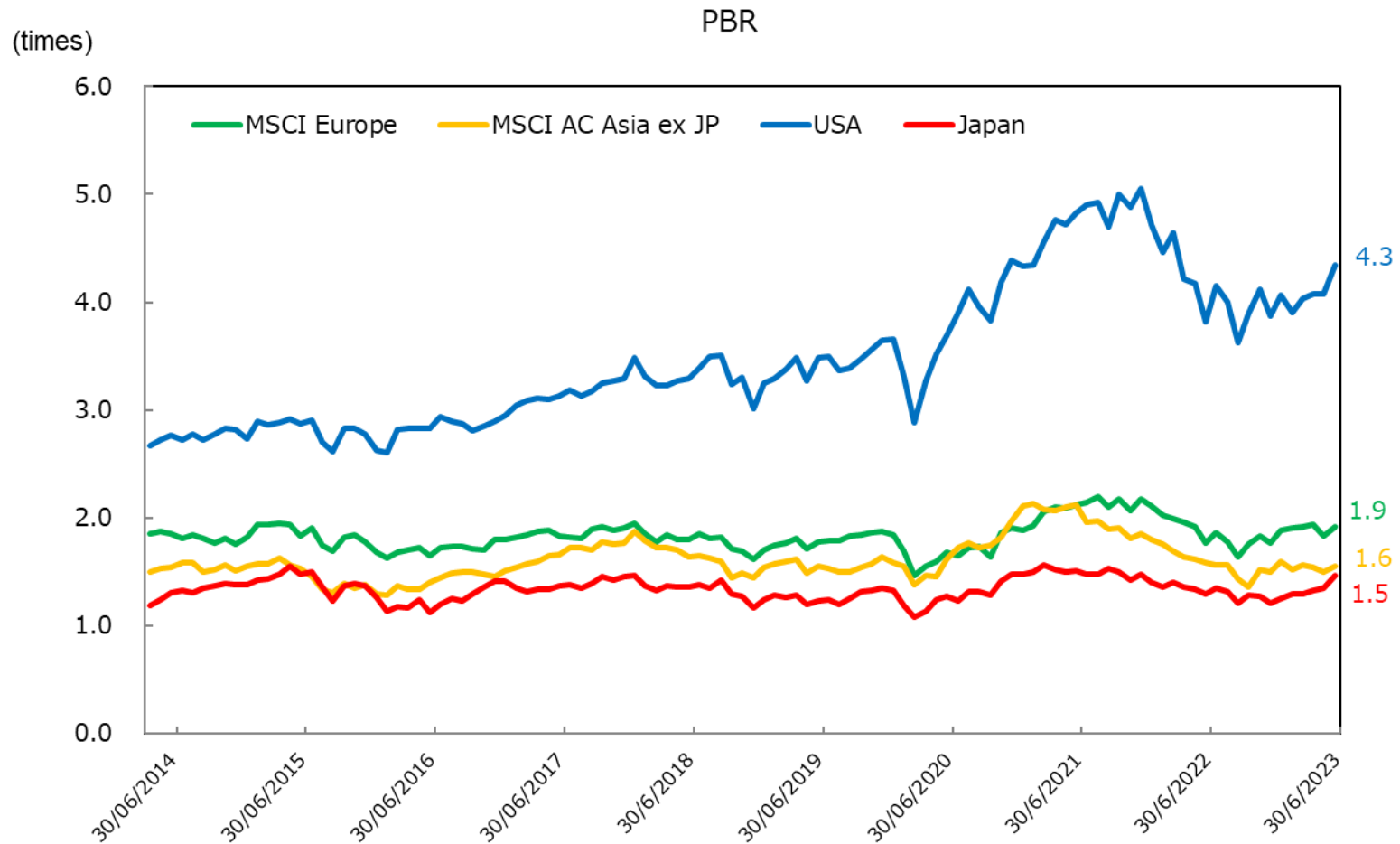
Strong market rally boosts Japan's PER higher



Earnings outlook increasingly optimistic



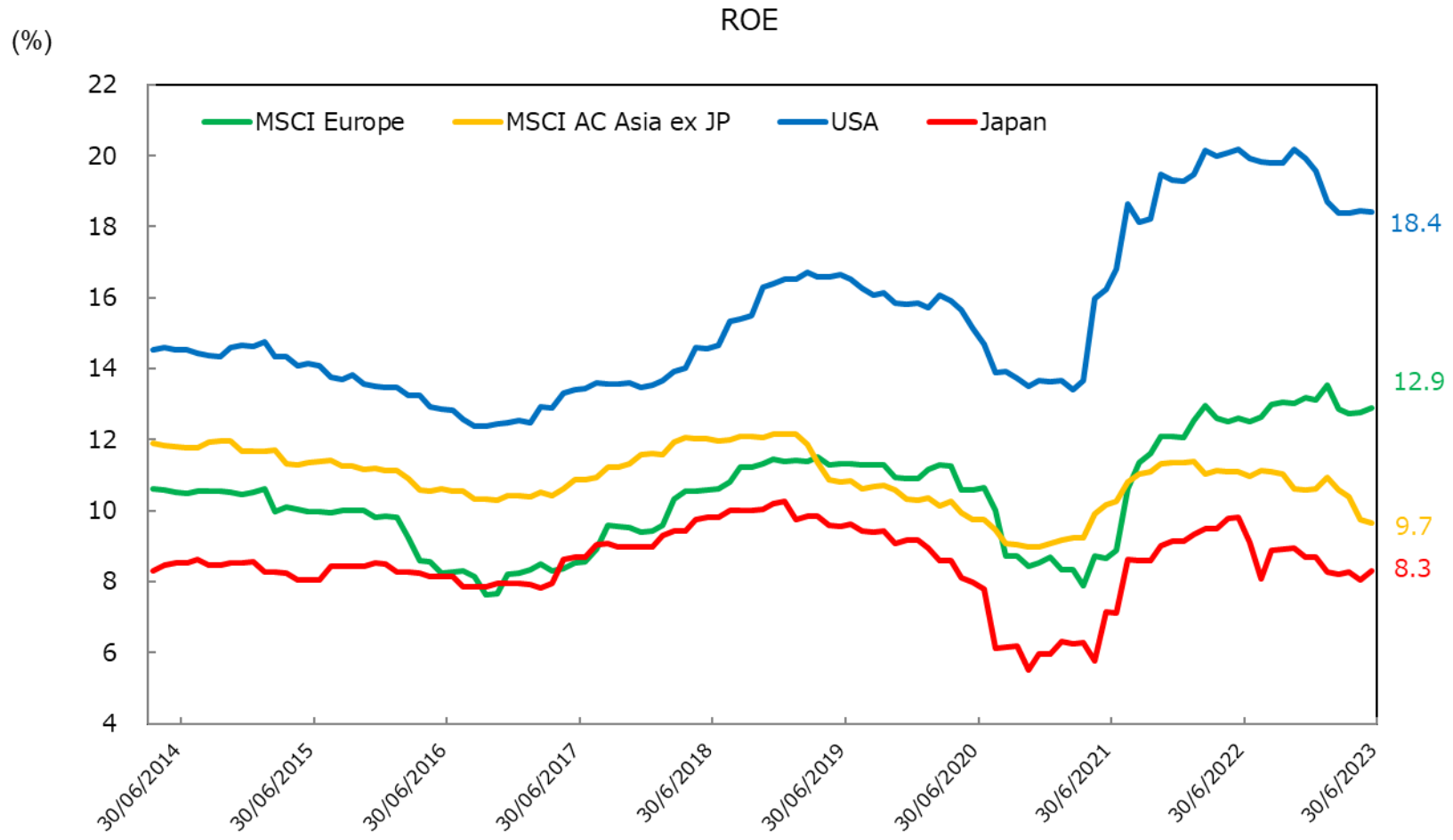
Japan's PBR starts rising gradually but steadily



Data is from April 30th 2014 to June 30th 2023
 (Source) MSCI

(DD/MM/YYYY)

Japanese ROE still lagging behind despite earnings growth



Data is from April 30th 2014 to June 30th 2023
(Source) MSCI

(DD/MM/YYYY)

EPS revision coming up to the positive area

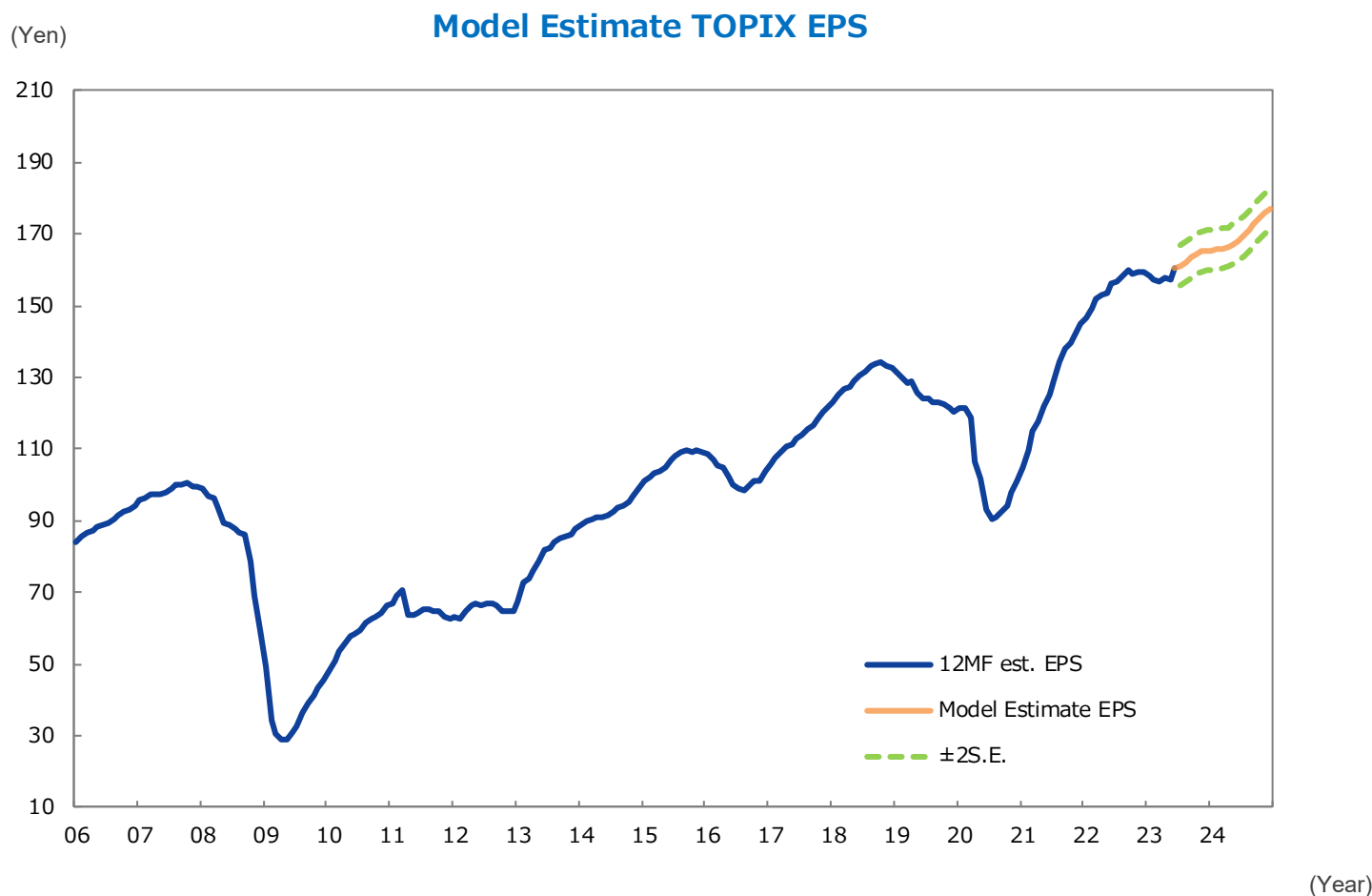
TOPIX Revision Index



Data is from December 28th 2017 to July 13th 2023
(Source) Datastream, IBES

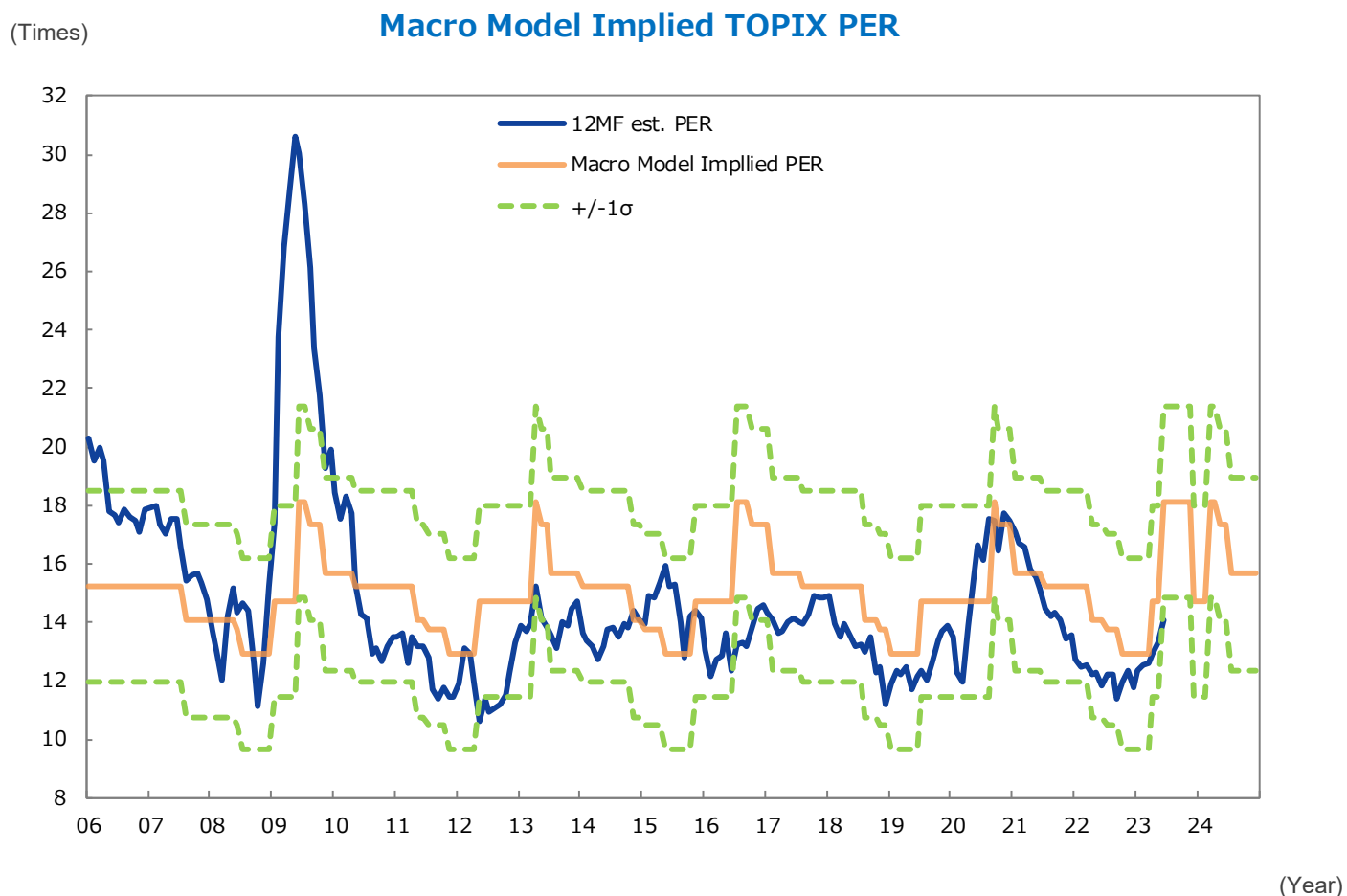
(YY/MM)

Quant model indicates optimistic corporate earnings outlook



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

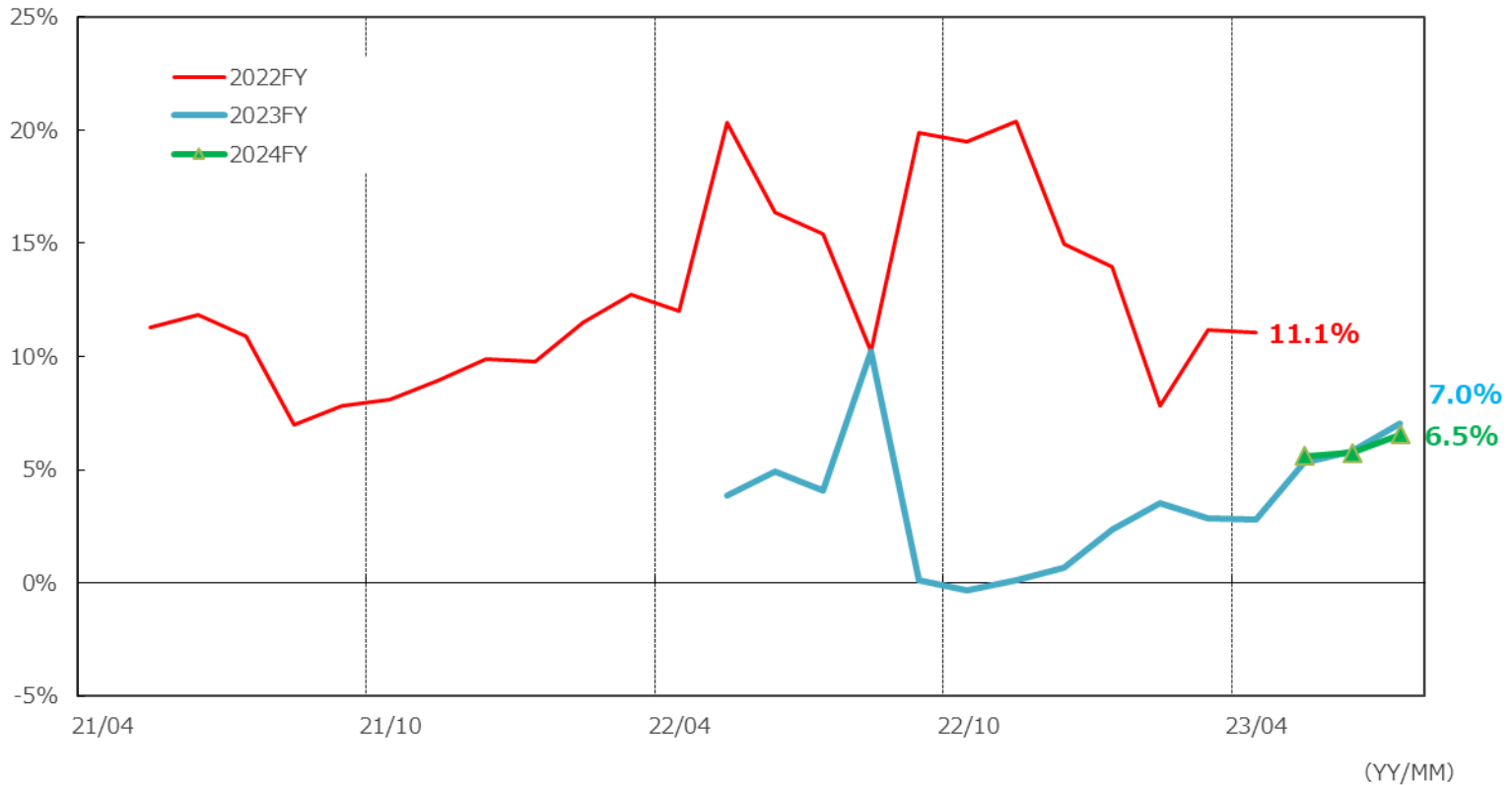
Model indicates further room for PER expansion



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

Bottom up earnings outlook increasingly positive

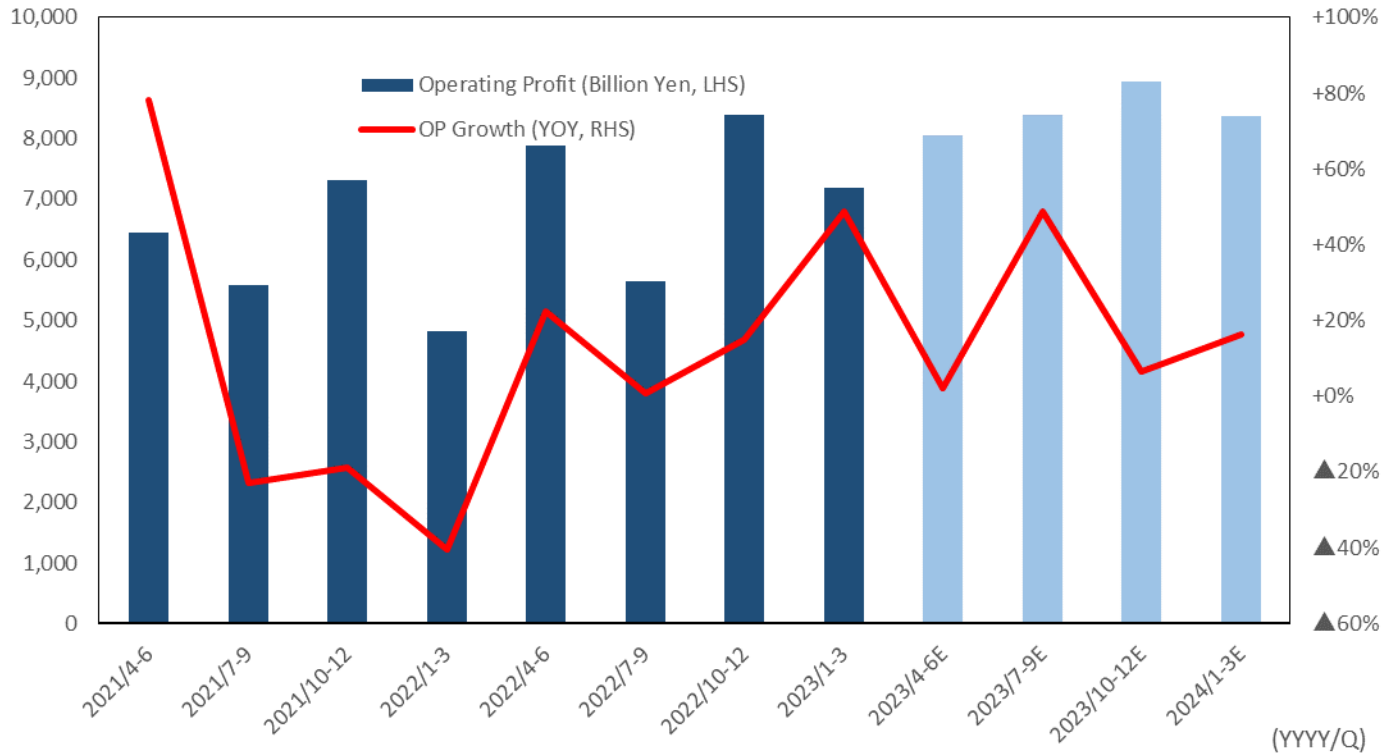
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th July 2023, SMDAM Core Universe (Excl. Financials) consists of 409 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Outlook for operating profit remains stable

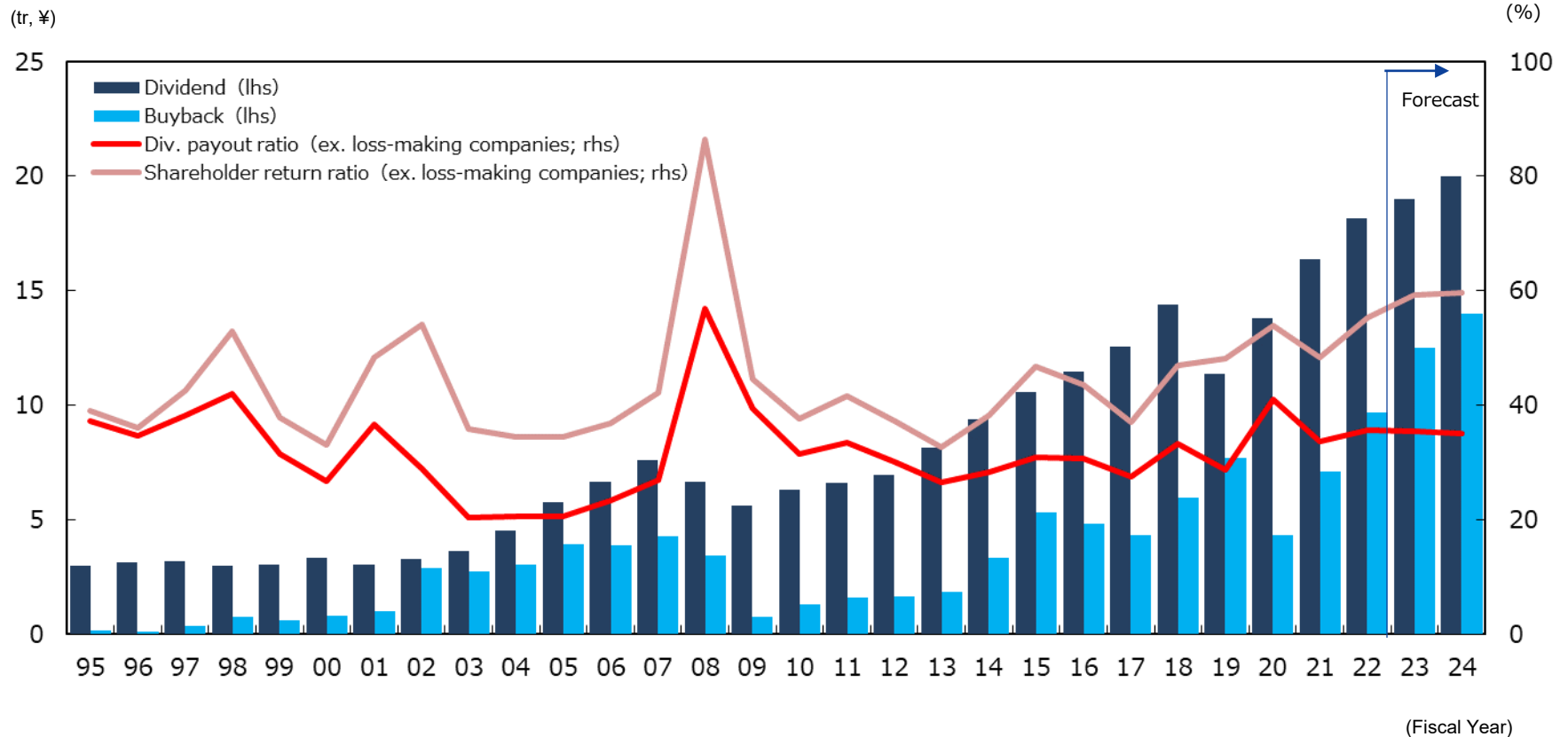
Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q1 2021 to Q1 2023. Estimate data is from Q2 2023 to Q1 2024.
Source: SMDAM

Dividends and buybacks continuing upbeat trends

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



Note: Data is from FY1995 to FY2024. FY2023 and FY2024 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Blue chip value dominates Japan 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	11.07	17.60	19.85	16.50	19.74	43.39	30.77
Total Value	14.12	20.87	22.37	22.33	34.61	63.68	31.25
Top Cap Value	18.53	24.00	26.50	27.45	43.87	81.56	52.53
Large Cap Value	15.32	21.63	23.53	23.19	37.47	68.60	36.01
Mid Cap Value	11.10	18.44	19.59	17.64	29.37	53.06	15.42
Small Cap Value	8.87	17.46	17.23	18.46	22.43	43.06	11.55
Micro Cap Value	7.71	14.73	15.70	18.75	21.63	38.30	11.38
Total Growth	8.17	14.49	17.41	11.23	7.20	25.24	28.83
Top Cap Growth	8.90	15.01	19.65	11.09	9.52	29.26	36.96
Large Cap Growth	8.67	15.44	18.80	11.78	8.32	26.83	32.39
Mid Cap Growth	8.25	16.25	17.28	13.04	6.40	22.90	25.43
Small Cap Growth	4.22	7.20	7.12	7.12	-2.02	12.26	3.03
Micro Cap Growth	3.37	4.51	5.17	7.09	-5.47	11.99	4.72
Top Cap Total	13.08	18.94	22.67	18.04	23.25	50.29	42.74
Large Cap Total	11.77	18.34	21.03	16.97	20.94	45.46	34.78
Mid Cap Total	9.72	17.39	18.48	15.29	17.57	38.76	23.74
Small Cap Total	7.06	13.37	13.20	13.73	12.38	30.99	9.01
Micro Cap Total	6.29	11.25	12.12	14.57	12.19	29.79	10.53

Note : As of 20th July 2023
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is picking up.** Exports of goods have remained robust thanks to easing supply chain constraints. Business investment attitudes are persistent, and pent-up demand and requirements for de-carbonization and digitization are supporting appetite for CAPEX. Despite price hike headwinds, consumer spending has showed its resilience so far under the resumption of economic activities. Business sentiment and consumer confidence are stable and good.
- **Inflation has been mixed.** While nationwide core CPI in May had slowed to +3.2% YOY from +3.4% in the previous month, the core CPI in the Tokyo metropolitan area in June had accelerated to +3.2% YOY from +3.1% in May. The decline in import prices, which is the source of the recent cost push, has become more pronounced and has spread to the domestic corporate price index.

[Outlook]

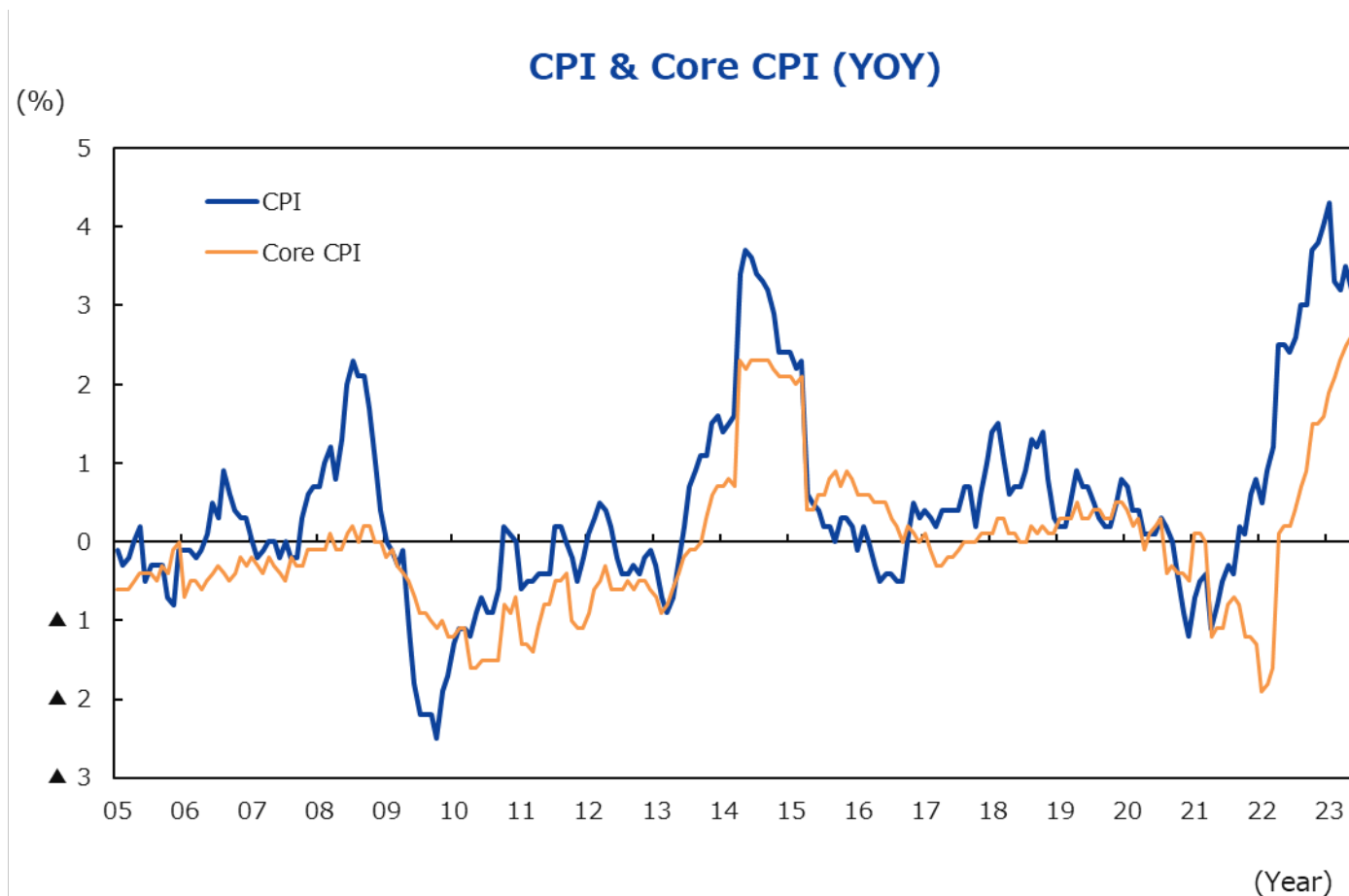
- ① **As we had expected, the BOJ had decided to widen the range of the YCC, yield curve control, from $\pm 0.5\%$ to $\pm 1\%$ in July 2023 practically.** According to a Bloomberg survey, about 80% of respondents expected the status quo to remain the same, a surprise in the market. As a result of the decision, the BOJ kept its YCC range $\pm 0.5\%$ as a “target” and newly set the ceiling of yield with limit operation at 1%. The BOJ said in a statement “It is not possible at the moment to achieve the price stability target of 2% in a sustainable and stable manner, and it is necessary to continue monetary easing persistently.” Therefore, **this policy response should not be regarded as a first step of the “exit strategy” of current monetary easing.**
- ② **We have raised our real GDP growth forecast for FY 2023 from +1.1% to +1.2% and that for FY 2024 from +1.0% to +1.1%.** The upward revision was mainly due to the strength of the CAPEX and the revision of the exchange rate assumption in the direction of the depreciation of the yen. (From 130 yen to 135 yen per dollar). Looking ahead, the overall economic recovery is expected to continue on the back of support from consumer spending, CAPEX, inbound consumption and the easing of supply constraints. For the first half of 2024, a slowdown in the U.S. economy is expected to undercut the economy, but the slowdown will be small and the impact on the domestic economy will be limited.
- ③ **We have raised our core CPI forecast for FY 2023 from +2.7% to +2.8% and that for FY 2024 from +1.6% to +1.7% respectively.** Both upward revisions were mainly due to the change in foreign exchange assumptions (from 130 yen to 135 yen per dollar). Going forward, the core CPI is likely to follow a deceleration trend due to easing cost push pressure from import prices. However, the core CPI is expected to keep above 2% YOY until the middle of fiscal 2024, as the spread of wage increases affects broader price trends.
- ④ **We expect PM Kishida and his cabinet will continue its accommodative economic policy.** In the “Comprehensive Economic Measures to Overcome High Prices and Achieve Economic Revitalization” approved by the Cabinet in October 2022, the government implemented a massive economic stimulus package of 37.6 trillion yen based on national and local expenditures. If the economy falters, keep an eye on the possibility of additional stimulus measures. If a snap general election is held in the future, we are wary of the risk of fiscal expansion in order to raise approval ratings.

Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY18	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est
Real GDP	0.2%	-0.8%	-4.1%	2.6%	1.4%	1.2%	1.1%
Private final consumption expenditure	0.1%	-0.9%	-5.1%	1.5%	2.4%	1.0%	0.9%
Private housing investment	-4.8%	2.5%	-7.6%	-1.1%	-4.4%	-0.8%	0.4%
Private-sector capital investment	1.6%	-1.2%	-5.7%	2.1%	3.1%	3.0%	2.2%
Private inventory investment	0.1%	-0.2%	-0.3%	0.4%	0.2%	-0.2%	0.0%
Public fixed capital formation	0.8%	1.6%	4.9%	-6.4%	-3.0%	2.2%	0.2%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	0.0%	0.0%
Exports of goods and services	2.0%	-2.3%	-9.9%	12.4%	4.4%	0.6%	2.6%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.2%	0.3%	2.5%
Nominal GDP	0.2%	0.0%	-3.5%	2.4%	2.0%	3.6%	2.3%
GDP deflator	-0.1%	0.8%	0.7%	-0.2%	0.6%	2.4%	1.2%
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	-0.2%	1.1%	1.9%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.8%	1.7%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	1.2%	0.0%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	2.7%	2.4%
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.6%	2.5%	2.4%
Monetary Policy interest rate (Short term)	-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

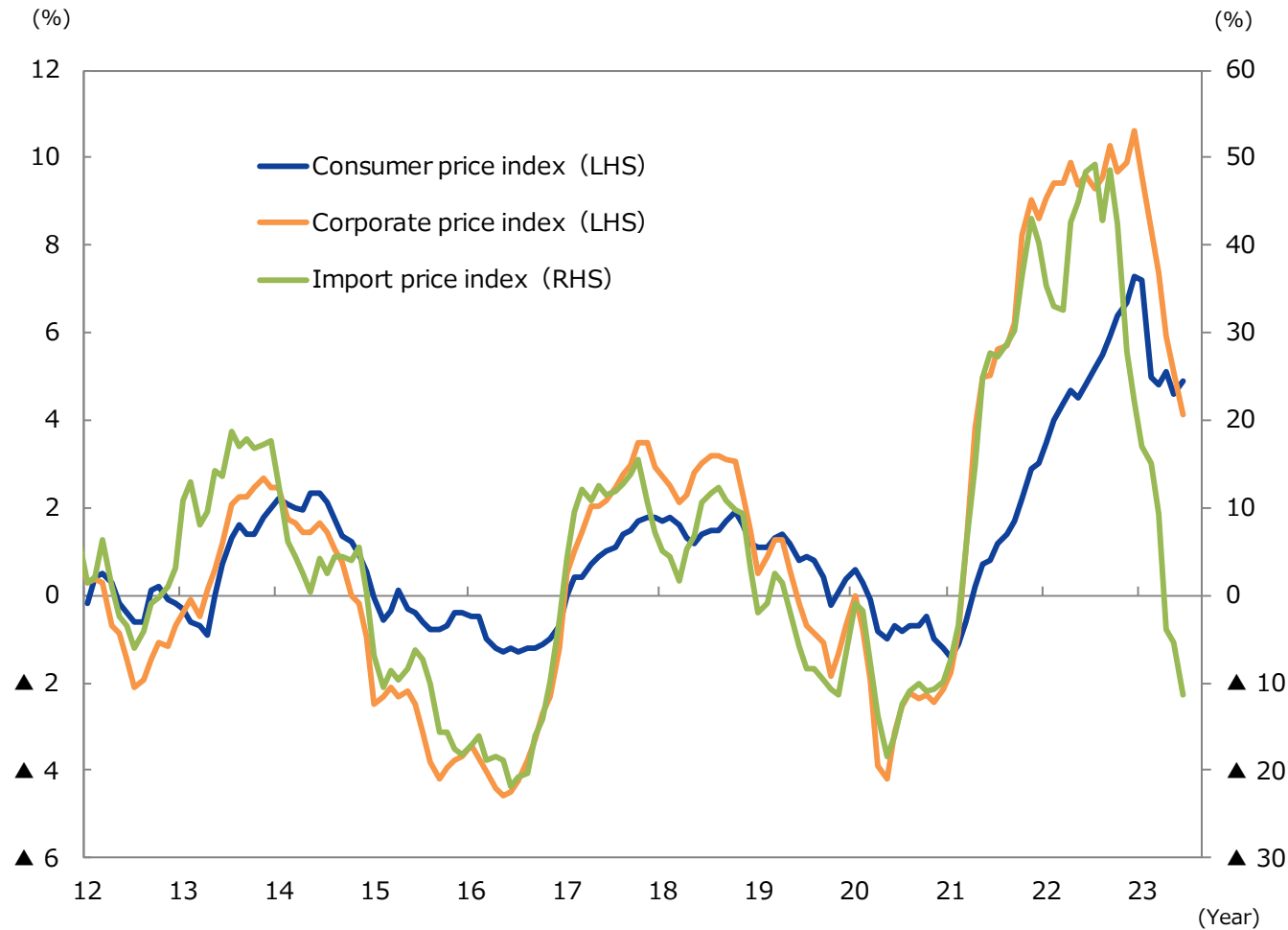
Japan faces sticky core inflation despite falling import energy prices



Note: Data is from January 2005 to June 2023, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

Japan faces sticky inflation despite falling import energy prices

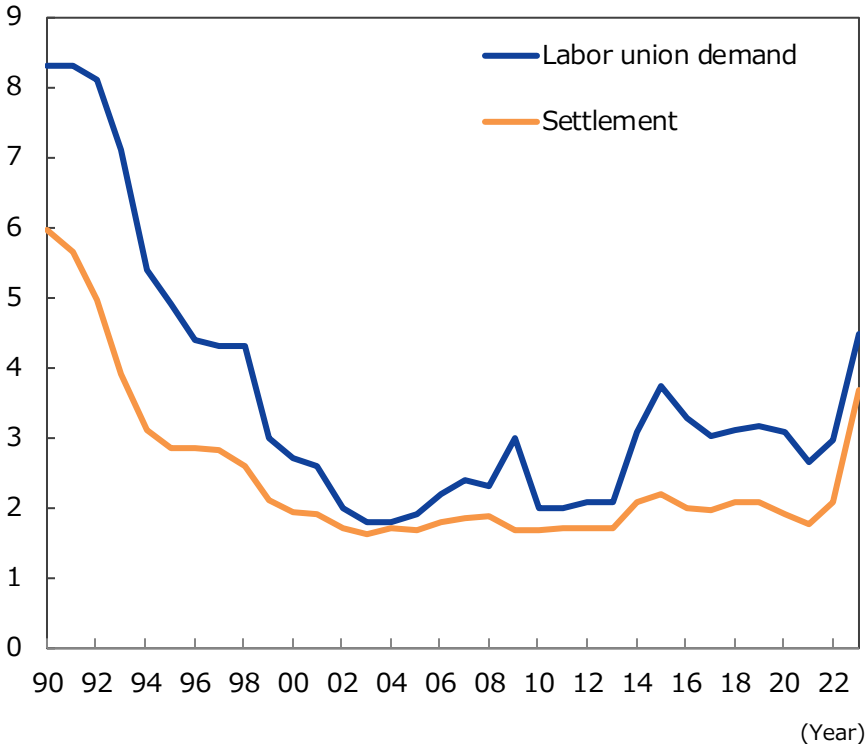
Price indices of Goods (YOY, %)



Note: Data is from January 2012 to June 2023.
Source: MIAC, Bloomberg, SMDAM

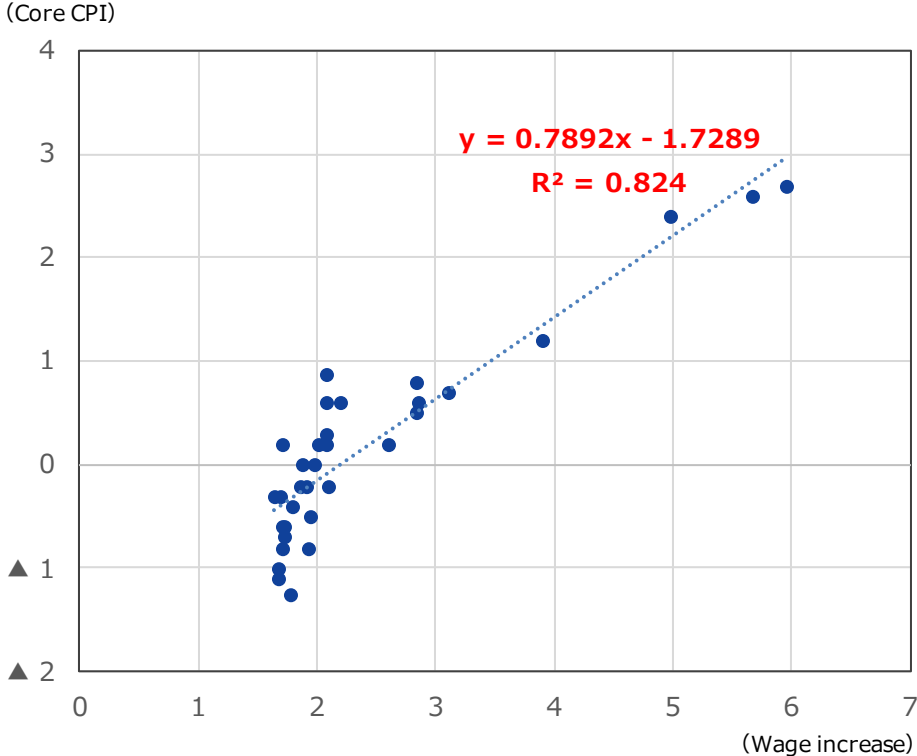
Start of a virtuous cycle to overcome deflation?

Wage increase demand & settlement (YOY, %)



Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

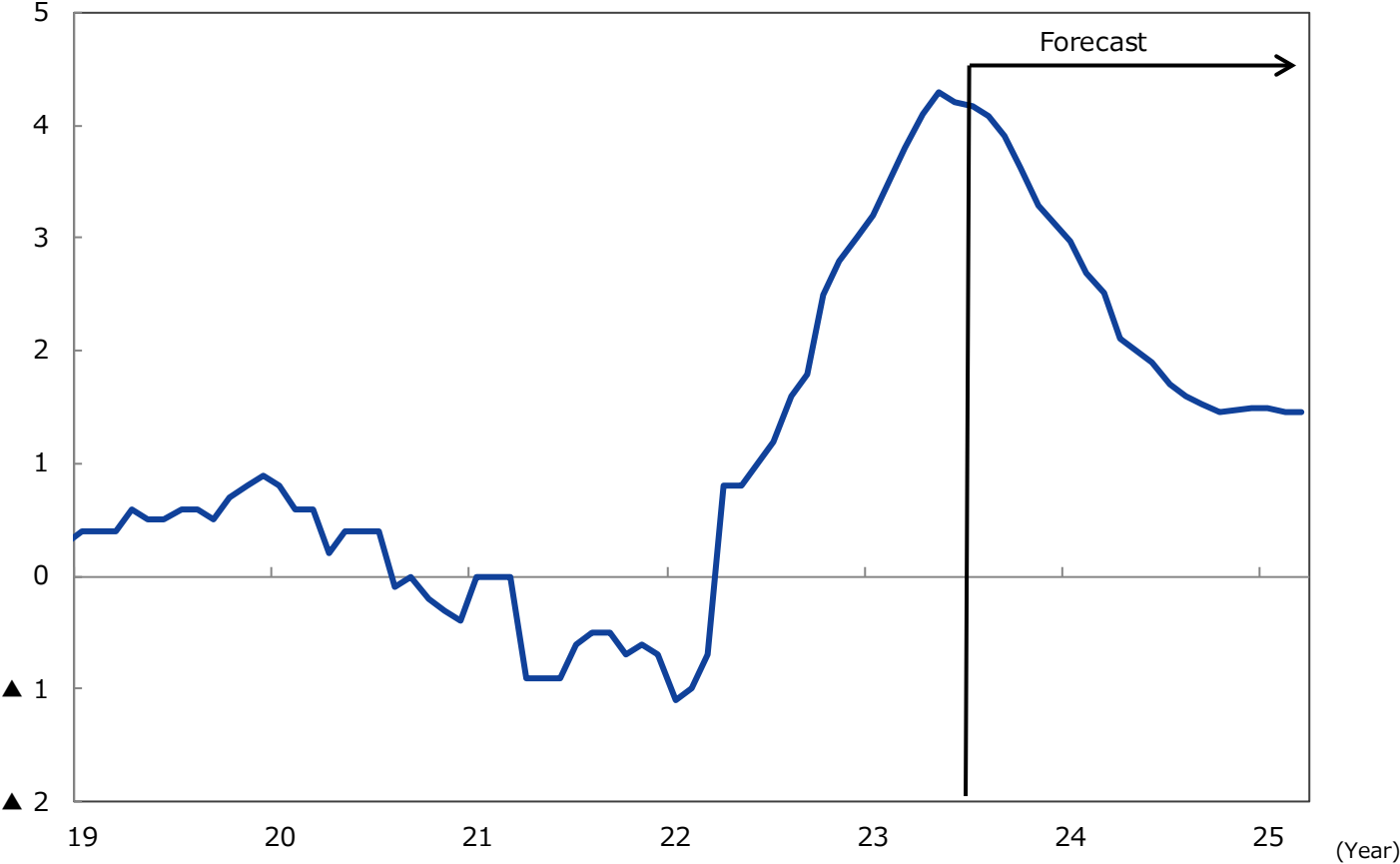
Wage increase & Core CPI (YOY, %)



Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

BOJ's estimate of the CPI peak deferred again

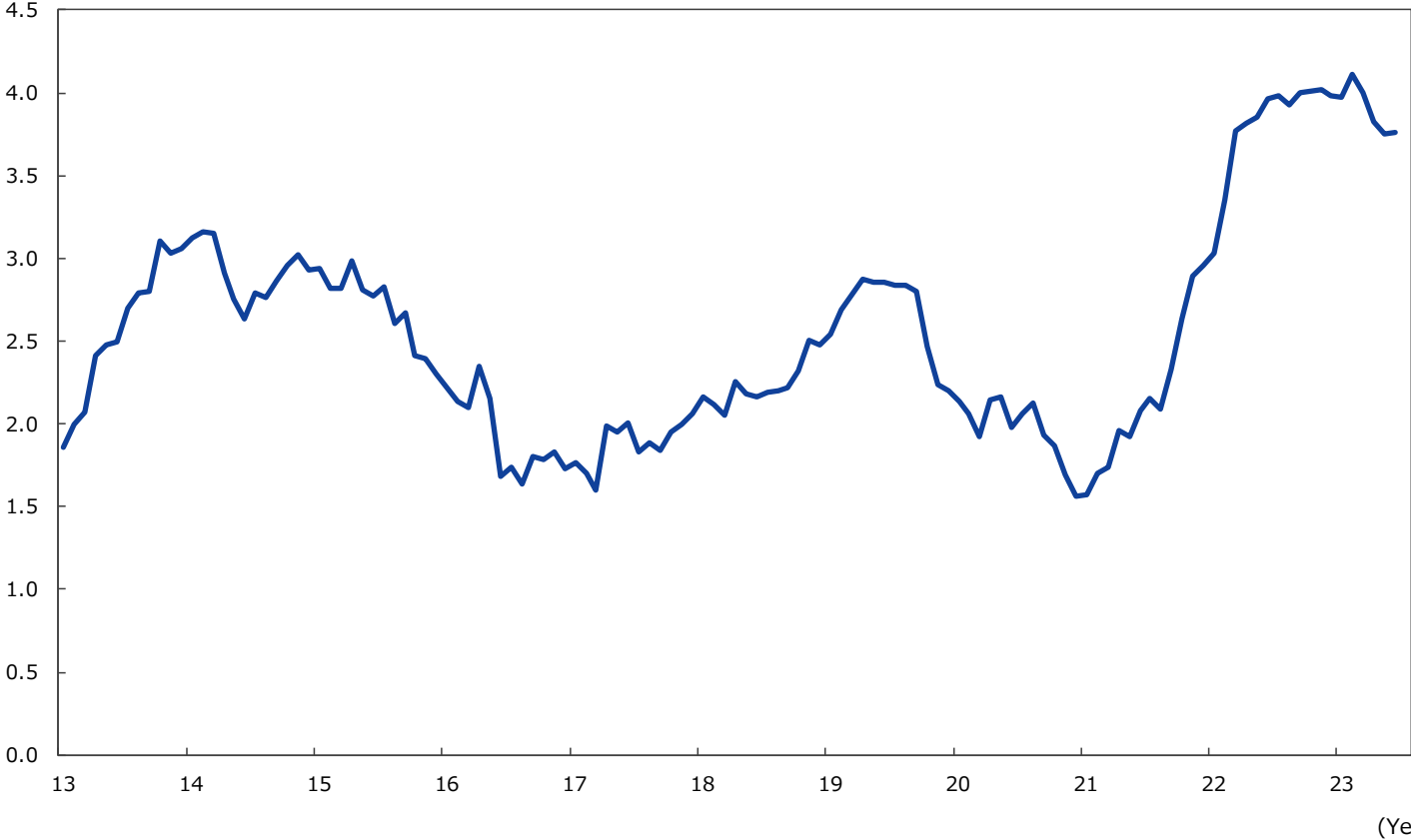
BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's Core CPI is excluding fresh foods & energy. Data from July 2023 are forecasts.
Source: The Bank of Japan, SMDAM

People's expectations for inflation remains high

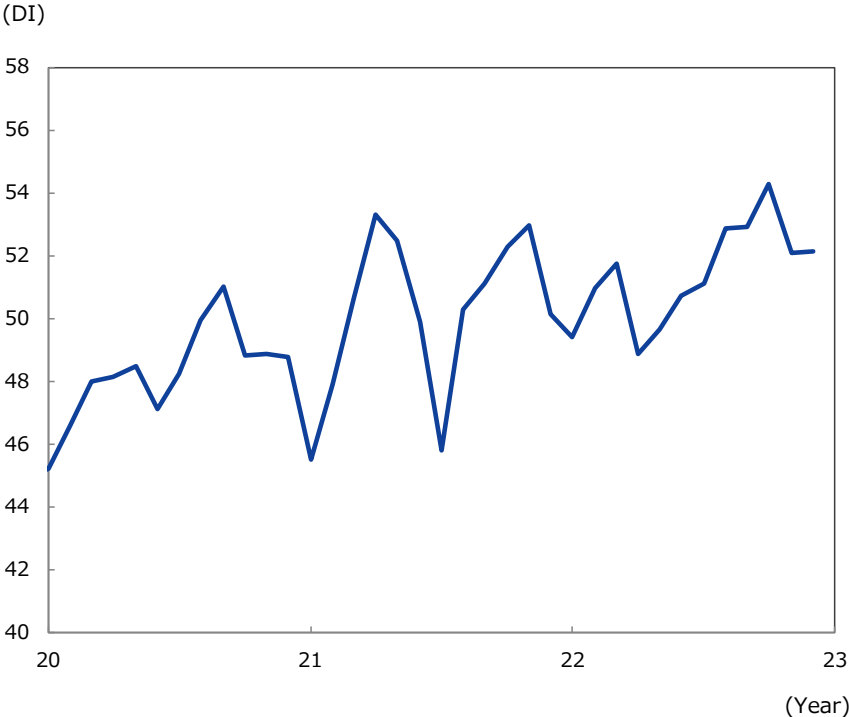
Consumers' Expectation of Inflation Rate (YOY, %)



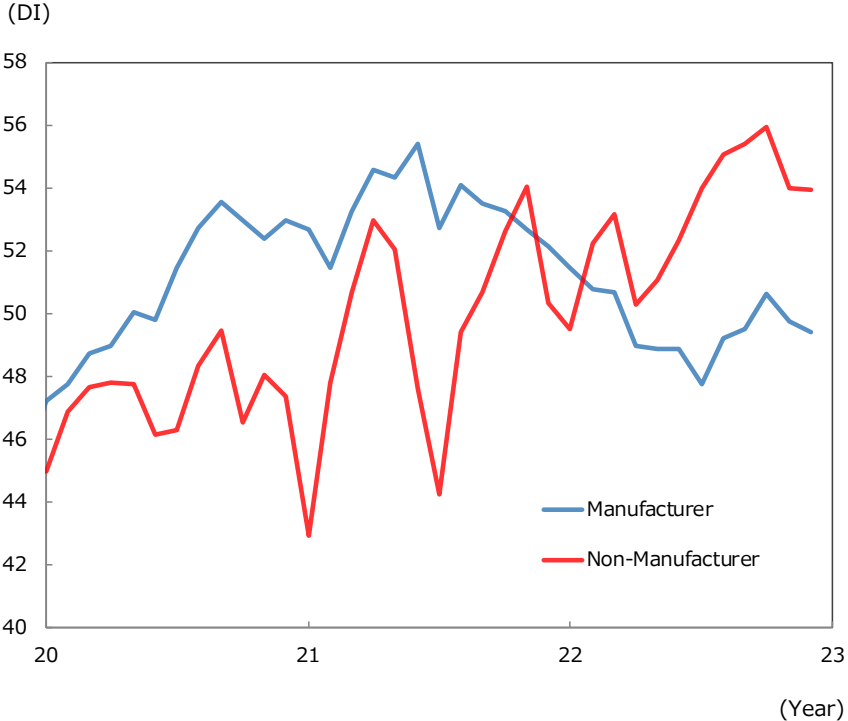
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to June 2023.
Source: Cabinet Office, SMDAM

Soft data shows mixed business sentiment

Composite PMI



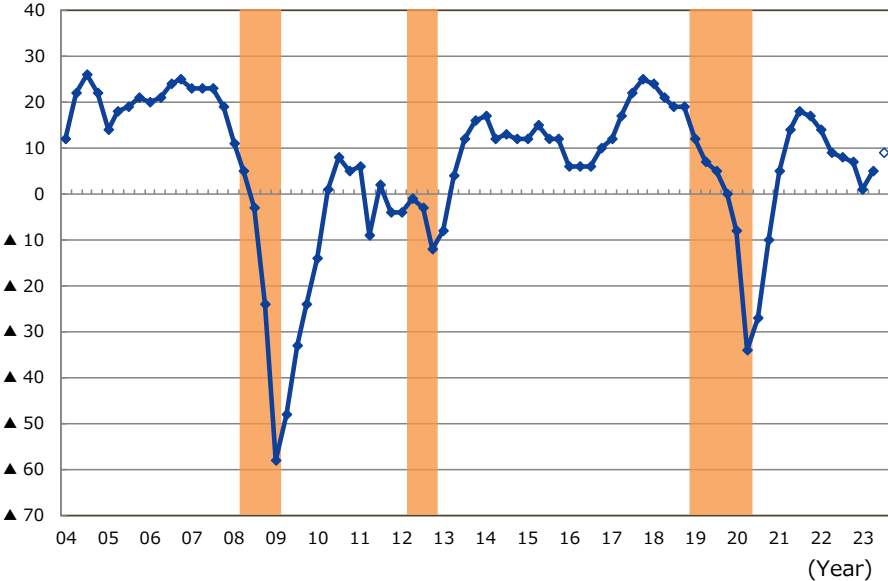
PMI, Manufacturer & Non-Manufacturer



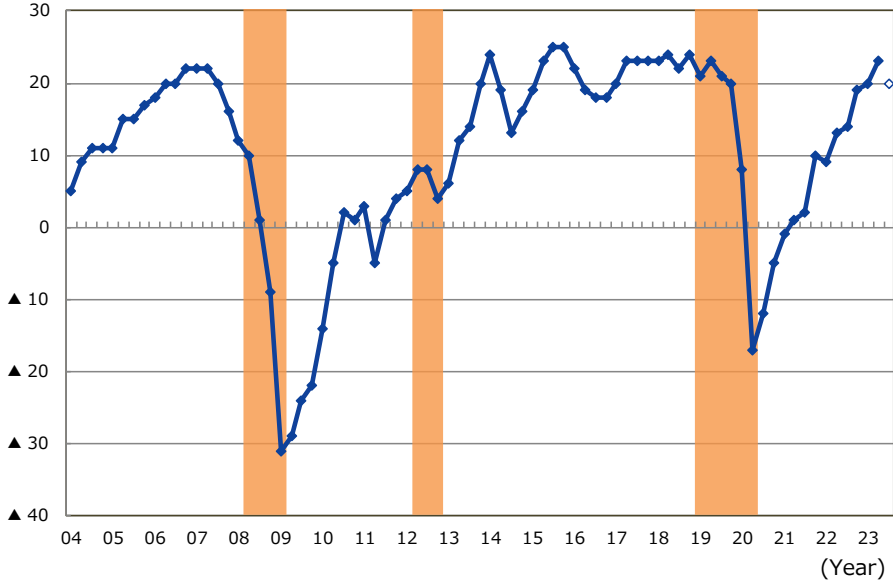
Note: Data is from August 2020 to July 2023.
Source: Bloomberg, SMDAM

Manufacturers start chasing non-manufacturers' recovery

BOJ business condition DI Large manufacturers (%)



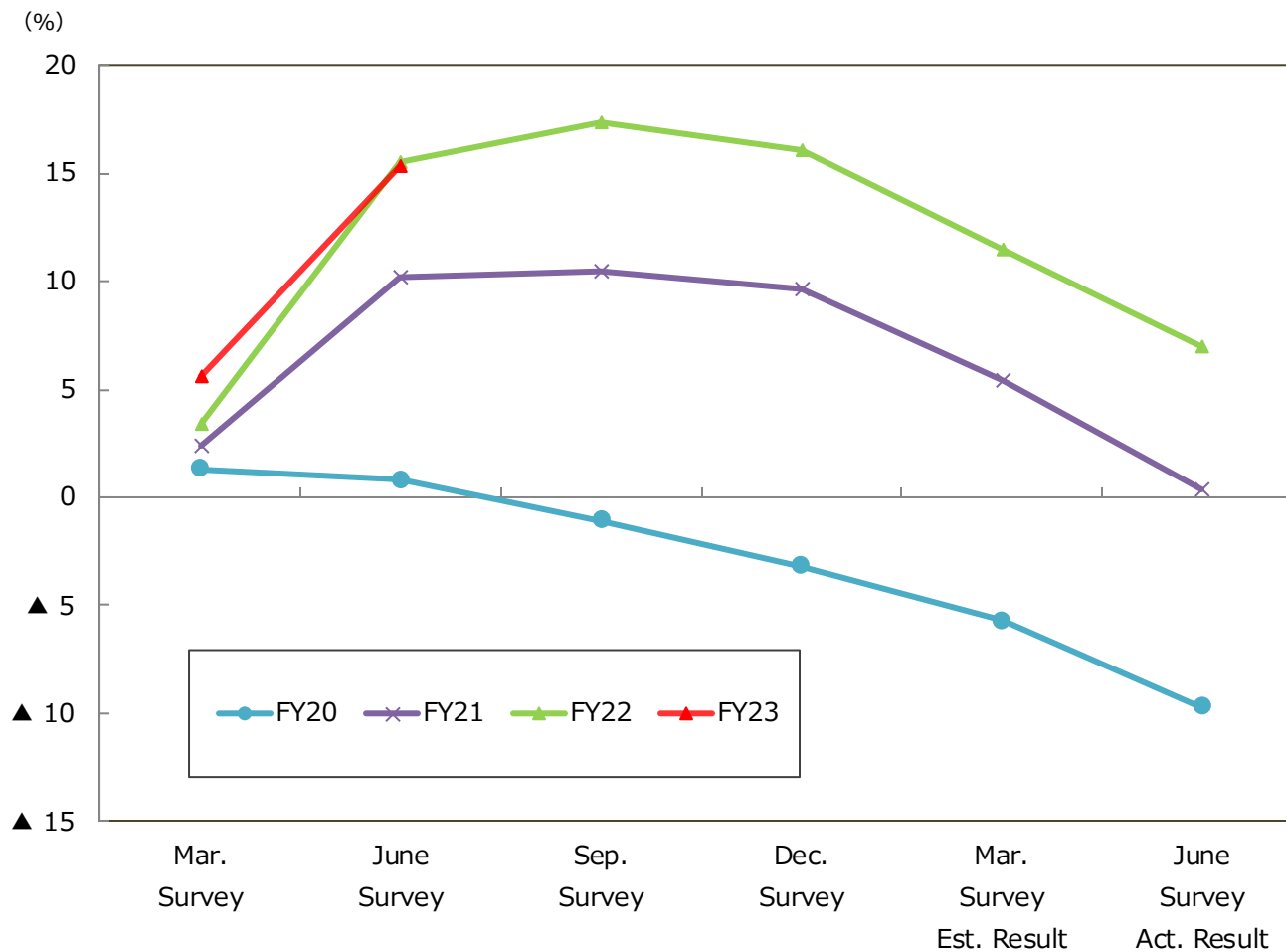
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q2 2023. The orange shadow are periods of economic recession.
 Source: The Bank of Japan, SMDAM

Weaker Yen and steady domestic economy to boost CAPEX

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



Note: Data is from Q1 FY2020 to Q2 FY2023.
Source: The Bank of Japan, SMDAM

Recovery in autos to be fully realised

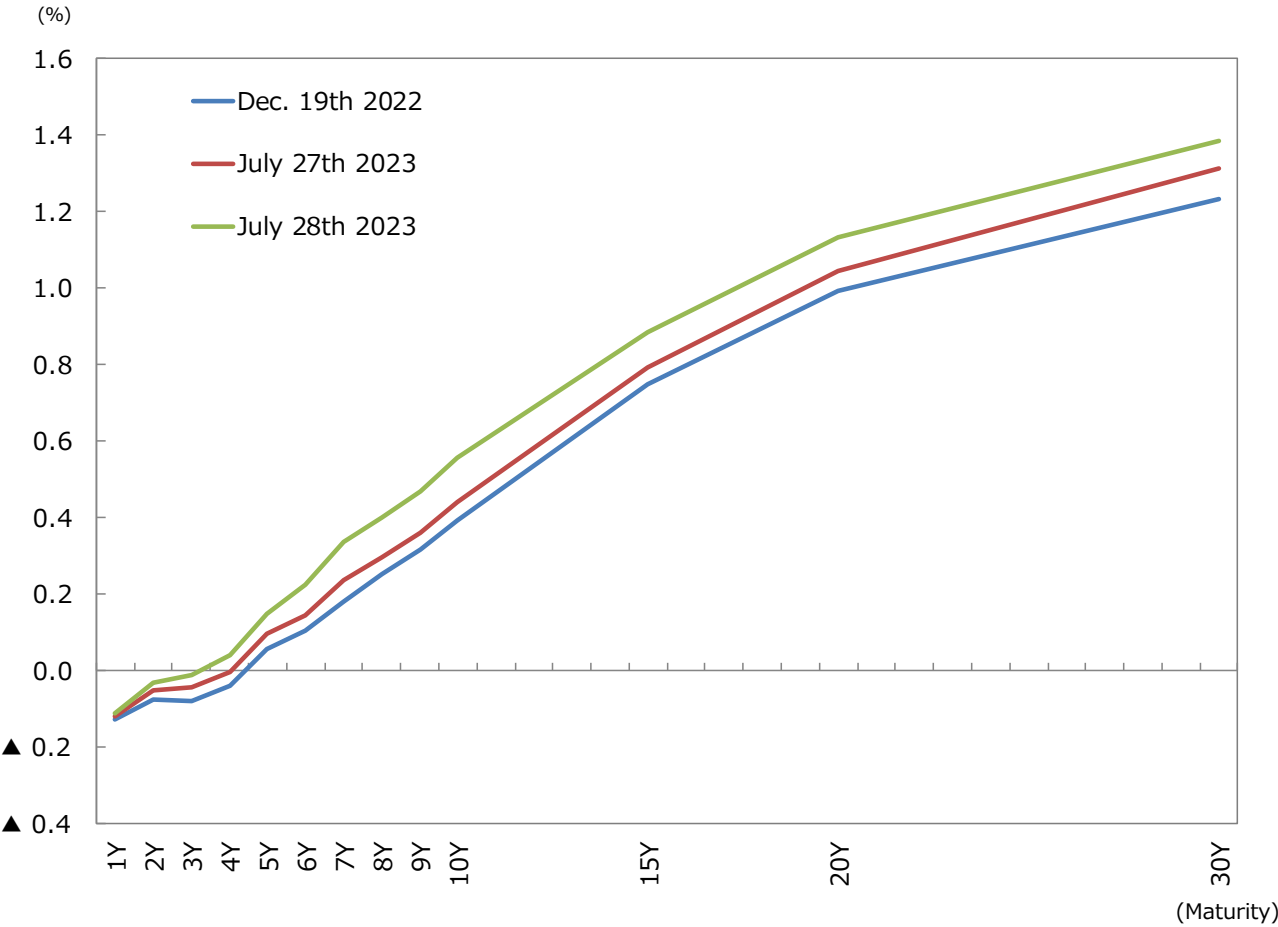
Industrial Production (Dec. 2019=100)



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

“Bear steepening” after BOJ’s decision to widen YCC range

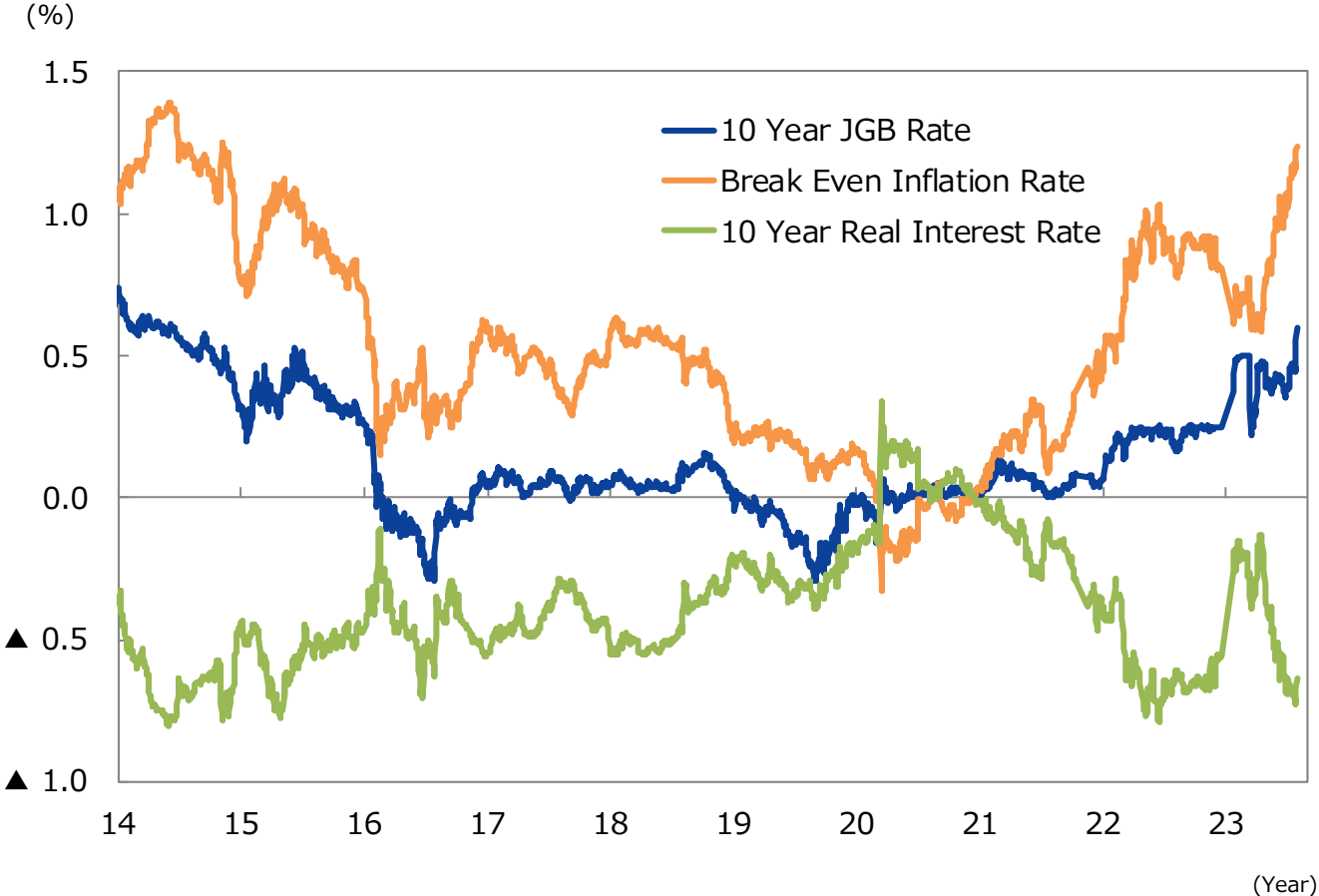
Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

Rising inflation expectation brings real interest rate lower

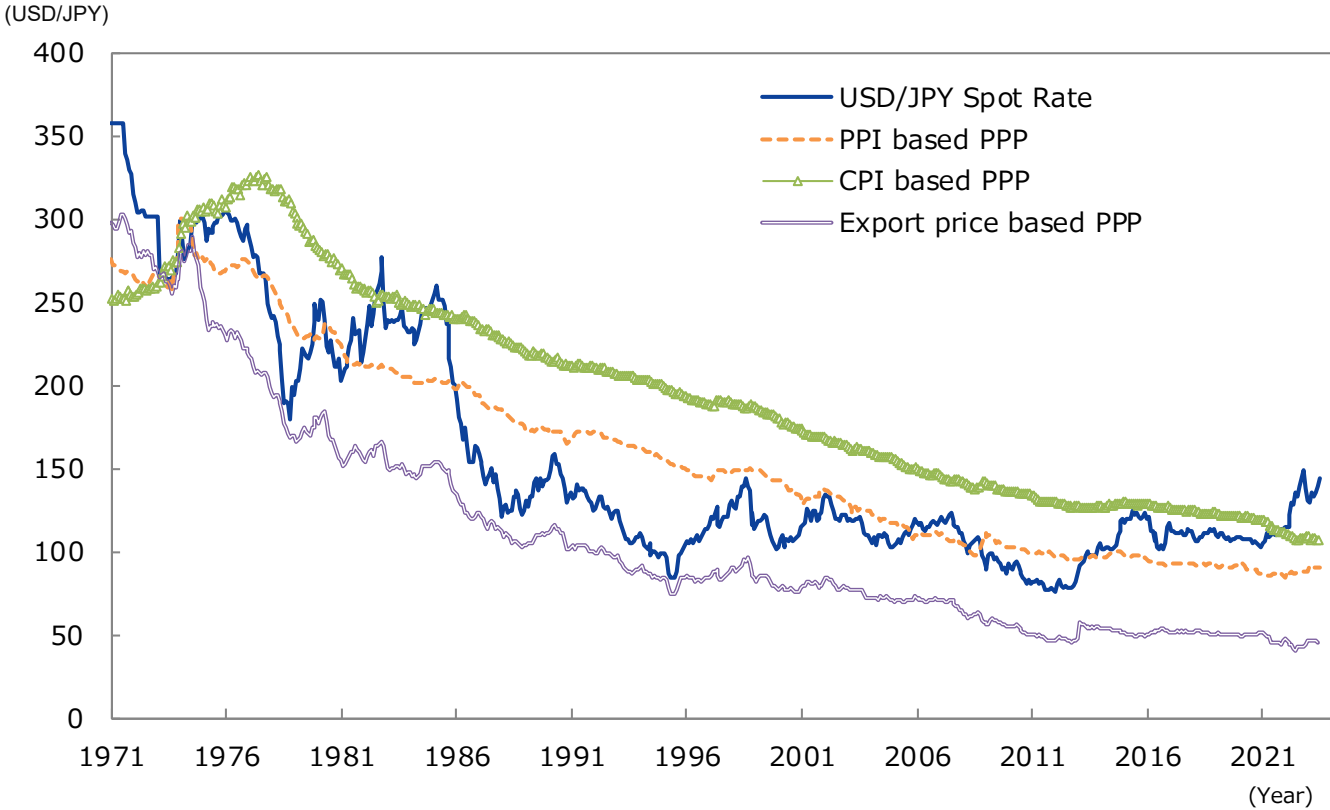
JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 30th July 2023.
Source: Bloomberg, SMDAM

USD/JPY continues to stay far above purchasing power parity

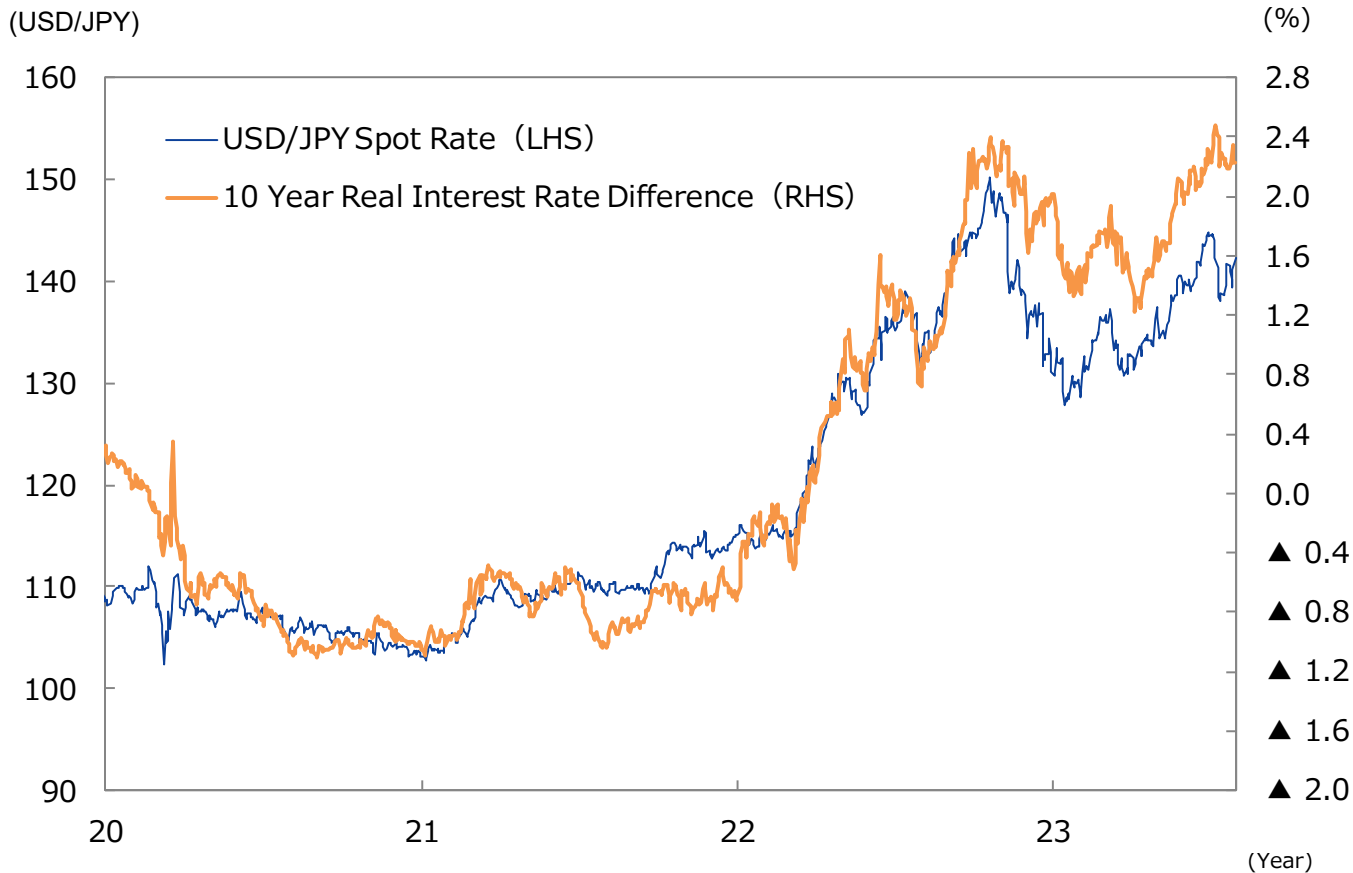
Purchasing Power Parity of USD/JPY Rate



Note: Data is from January 1971 to June 2023.
Source: DOL, Bank of Japan, SMDAM

Real yield gap still dominating USD/JPY rate

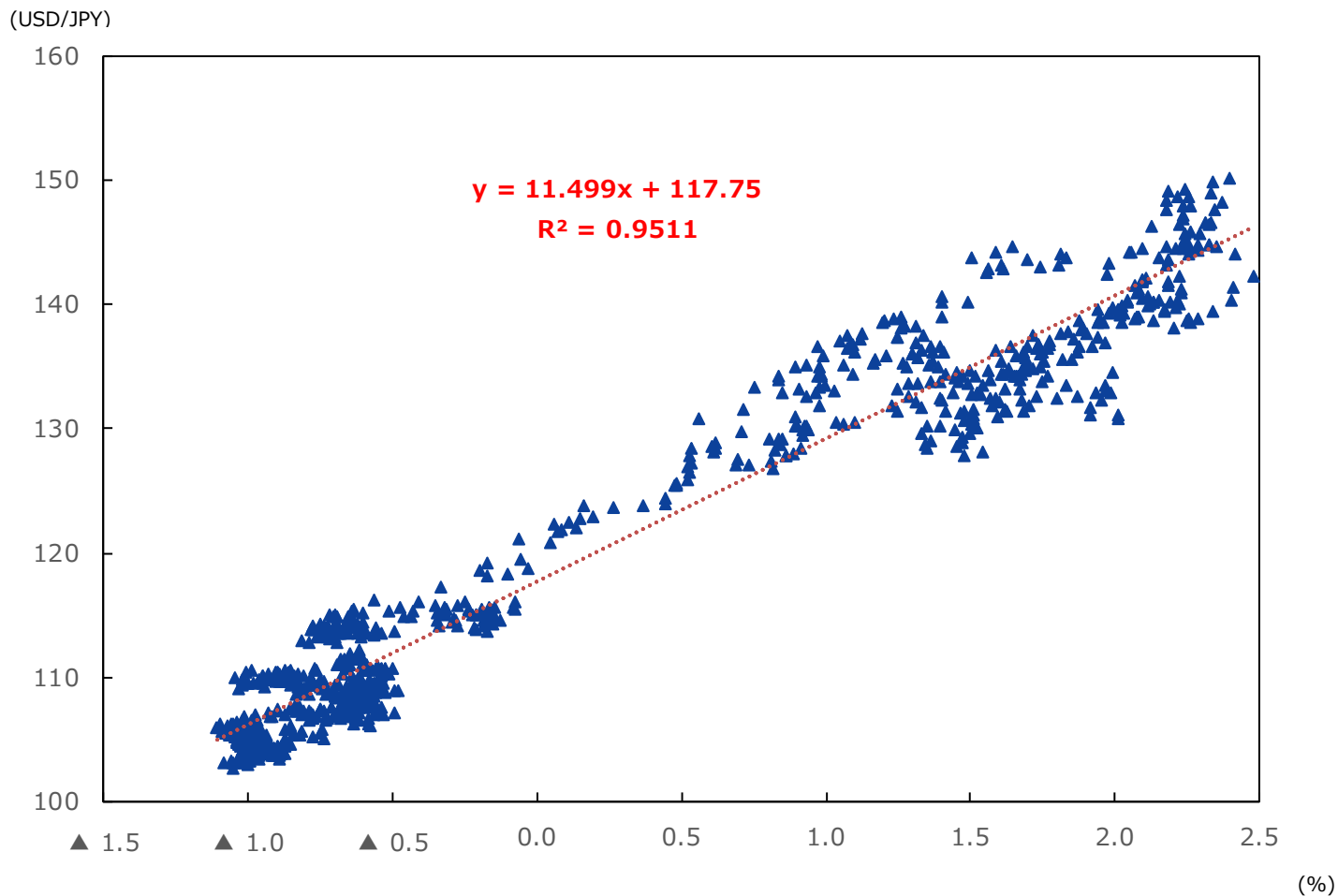
Real Interest Rate Gap & USD/JPY Exchange rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 31st July 2023.
Source: Bloomberg, SMDAM

Real yield gap still dominating USD/JPY rate

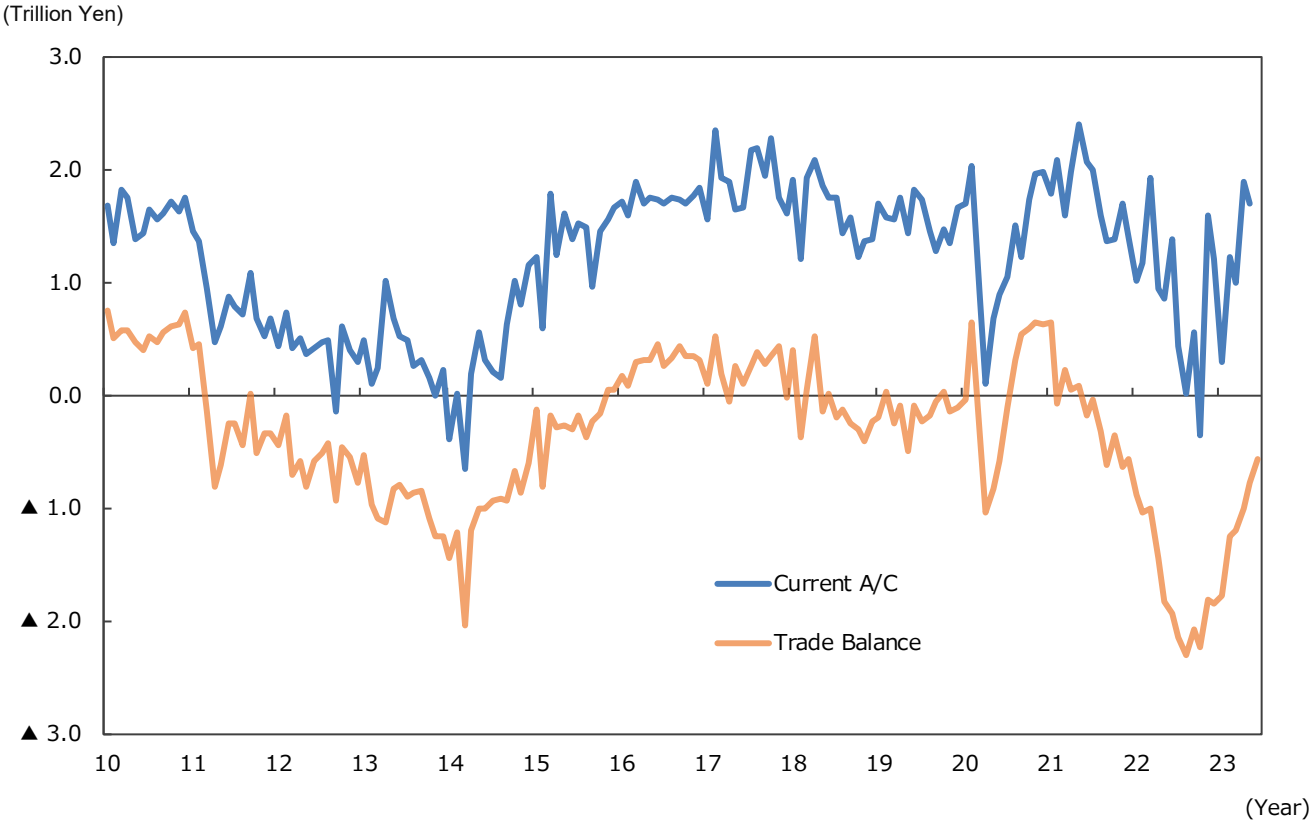
Correlation between Real Interest Rate Gap & USD/JPY



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 31st July 2023.
Source: Bloomberg, SMDAM

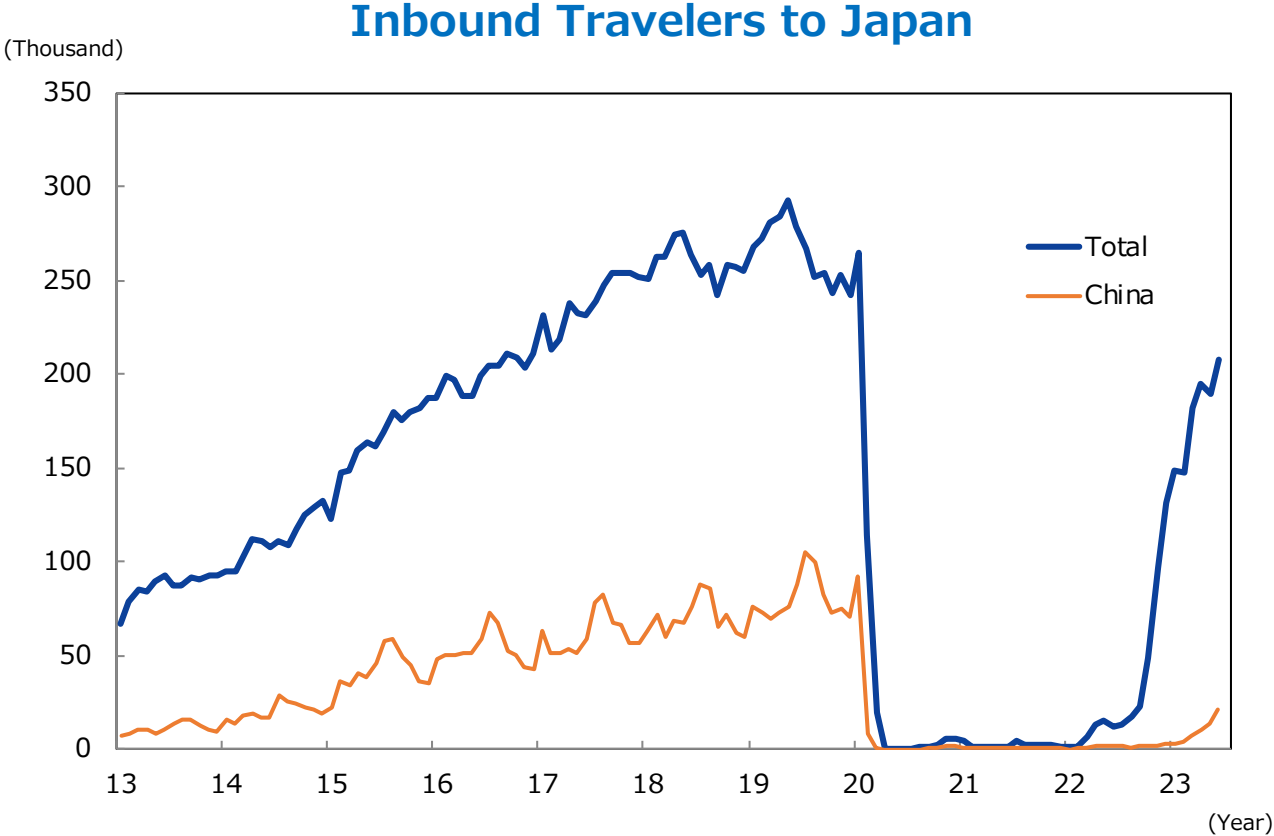
Trade deficits shrinking sharply due to falling energy prices

Current Account & Trade Balance



Note: Data is Seasonally adjusted. Data for current account is from January 2010 to May 2023. Data for trade balance is from January 2010 to June 2023.
Source: MOF, SMDAM

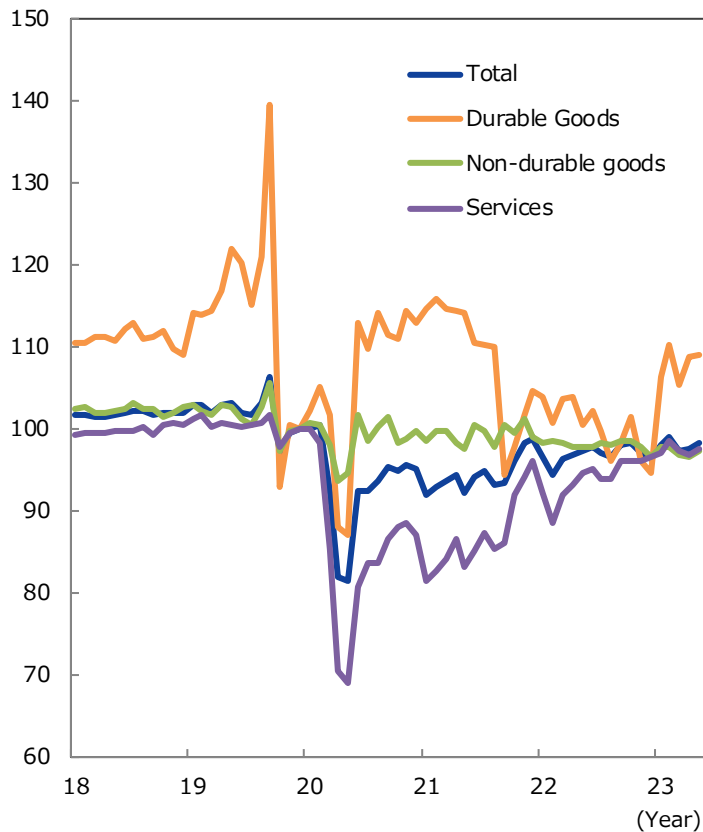
Chinese inbound travelers start recovering gradually



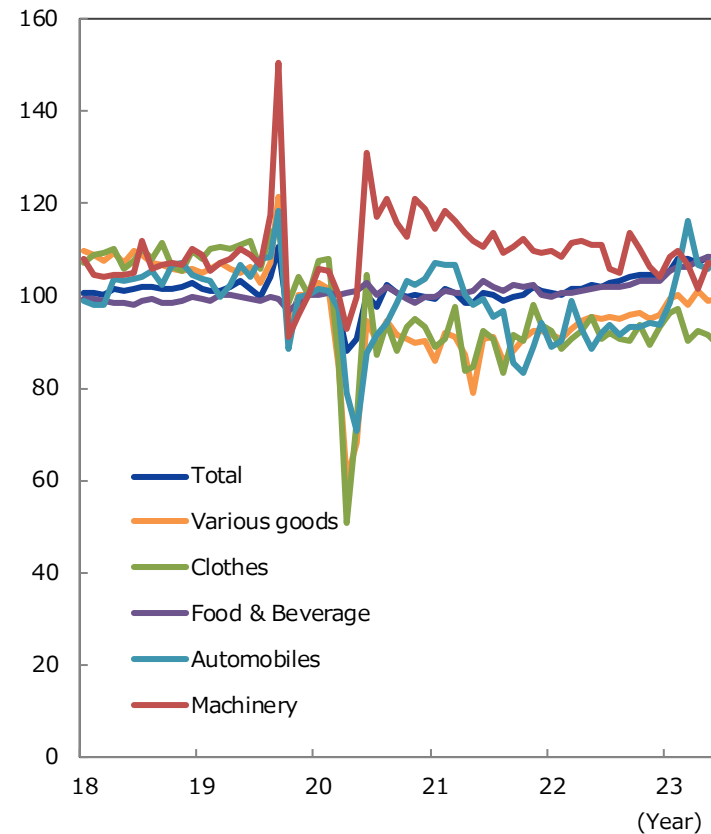
Note: Data is from January 2013 to June 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Auto sales continues steady recovery

Consumer Activity Index (Dec. 2019 = 100)



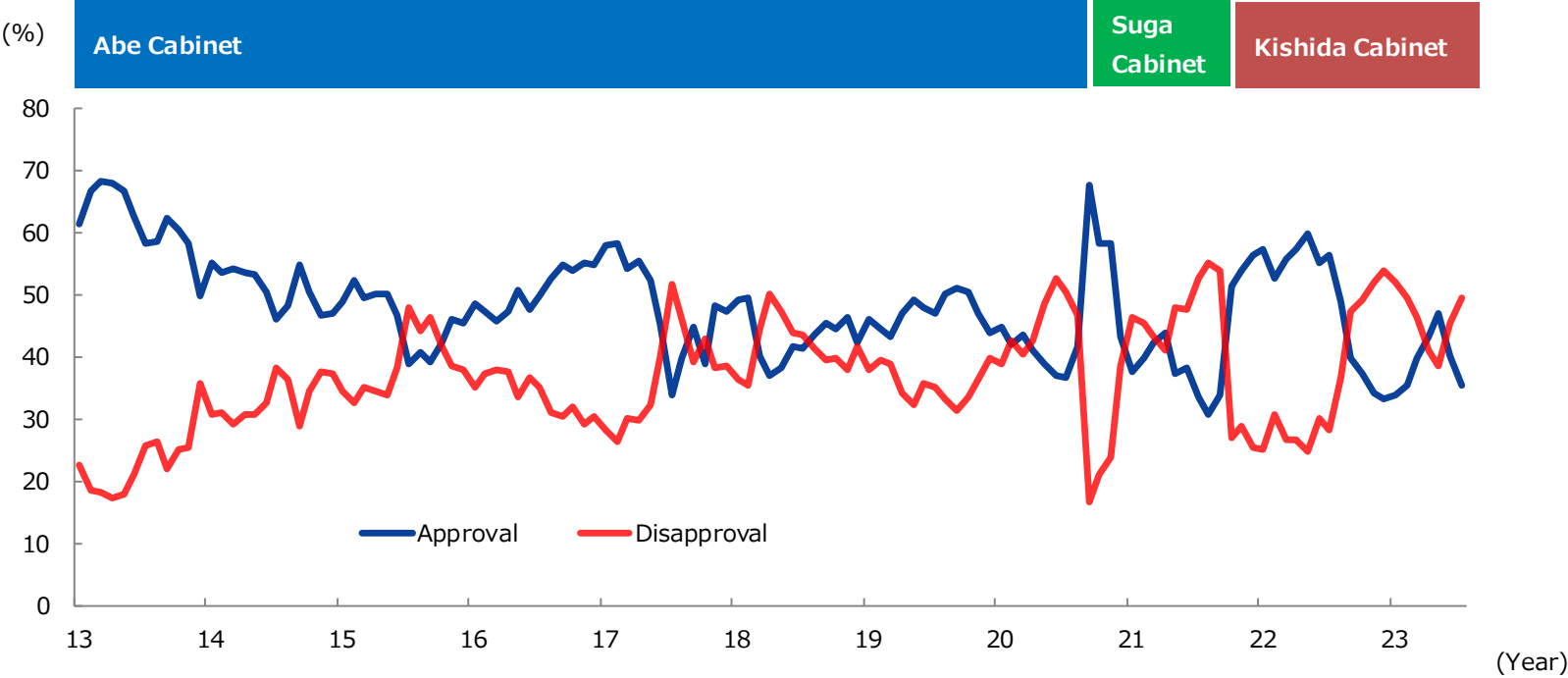
Retail Sales (Dec. 2019 = 100)



Note: Data for consumer activity index is from January 2018 to May 2023. Data for retail sales is from January 2018 to June 2023.
Source; Bank of Japan, METI, and SMDAM

PM Kishida losing public support owing to “Social security card” issue

Cabinet approval rate



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

Schedule of major events

Year	Month	Date	Event
2023	August	15	Release of CY 2023 Q2 GDP
	September	8	Revision of CY 2023 Q2 GDP
		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	15	Release of CY 2023 Q3 GDP	
December	8	Revision of CY 2023 Q3 GDP	
	18-19	Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline	

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

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