



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-September 2023-

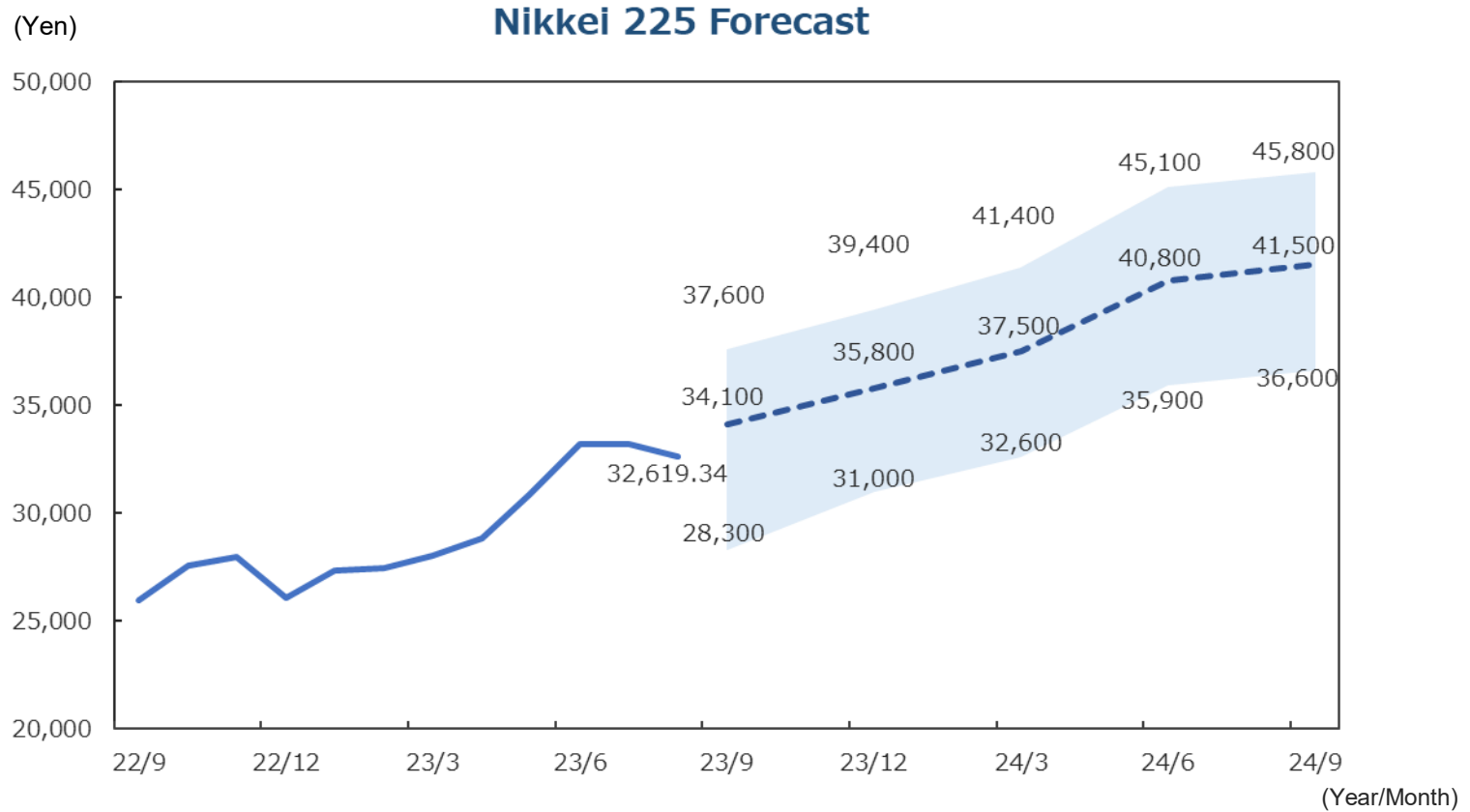


Outlook for Japanese Stock Market

Market Outlook

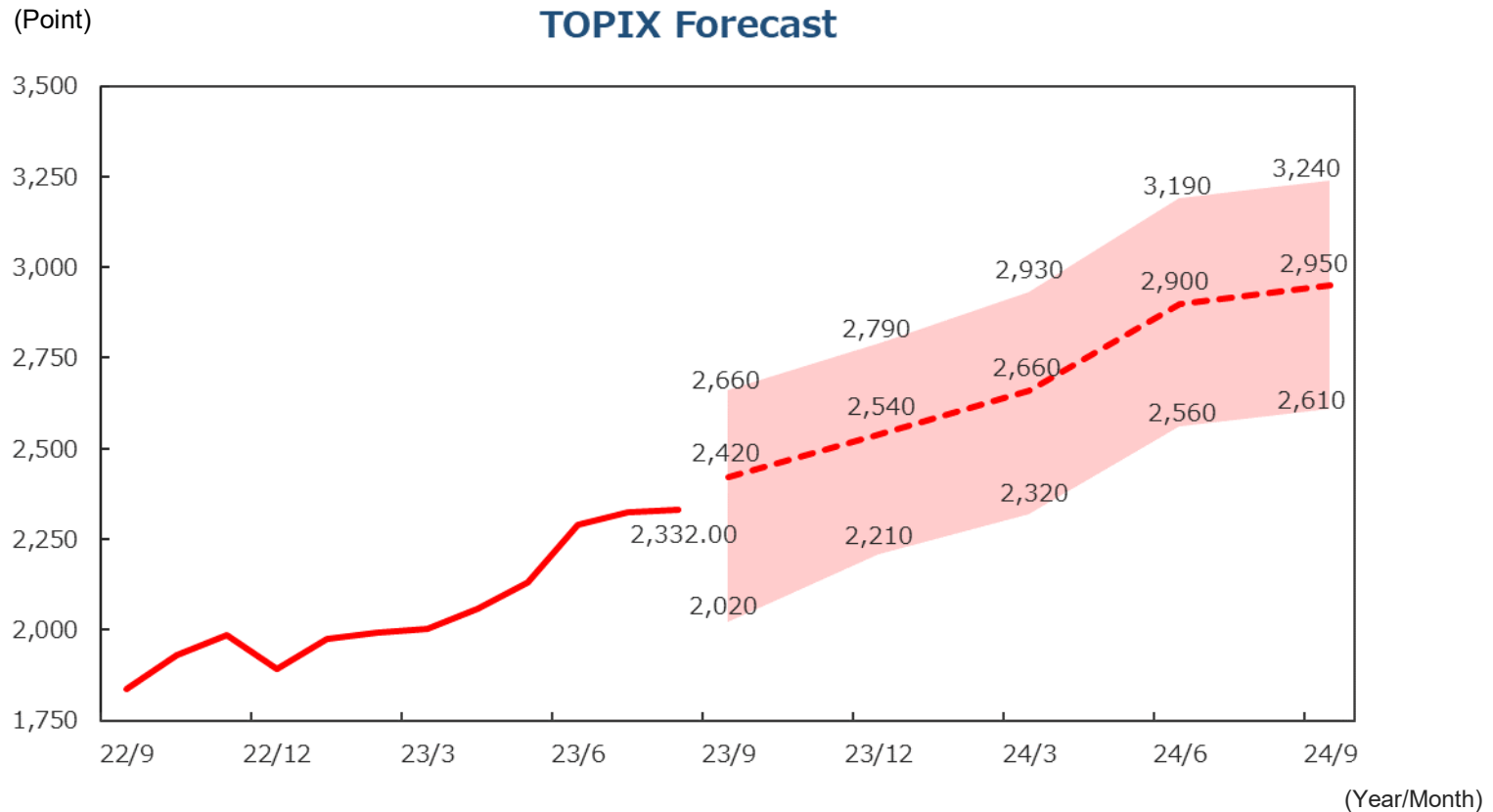
- We are bullish on the Japanese equity market as corporate earnings to be boosted by mild inflation, steady economic growth, and a weakening Japanese yen.
- We expect the market to resume its bullish trend after hitting the peak of the FED's current tightening regime.
- We have raised our TOPIX price target from 2,540 to 2,660 and that of Nikkei 225 from 37,100 to 37,500 as of the end of March 2024 due to upward revision of our earnings forecast.
- Growing confidence over the virtuous cycle between price and wage increases could provide a further boost to the Japanese stock market going forward.

We see bullish market outlook ahead



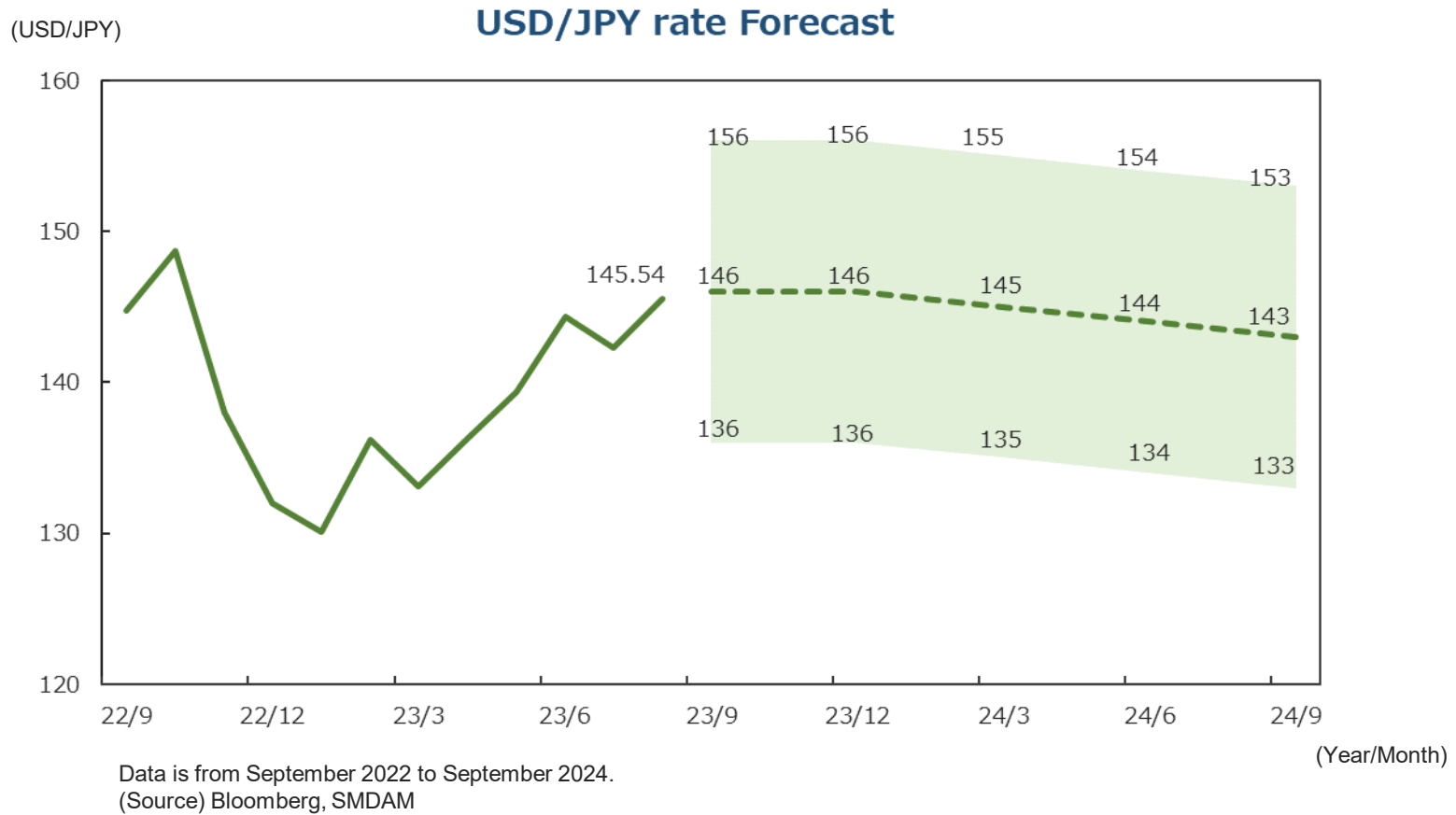
Data is from September 2022 to September 2024.
(Source) Bloomberg, SMDAM

We see bullish market outlook ahead



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

Modest JPY appreciation expected after FED pivot next year



Upside / Downside risk scenarios

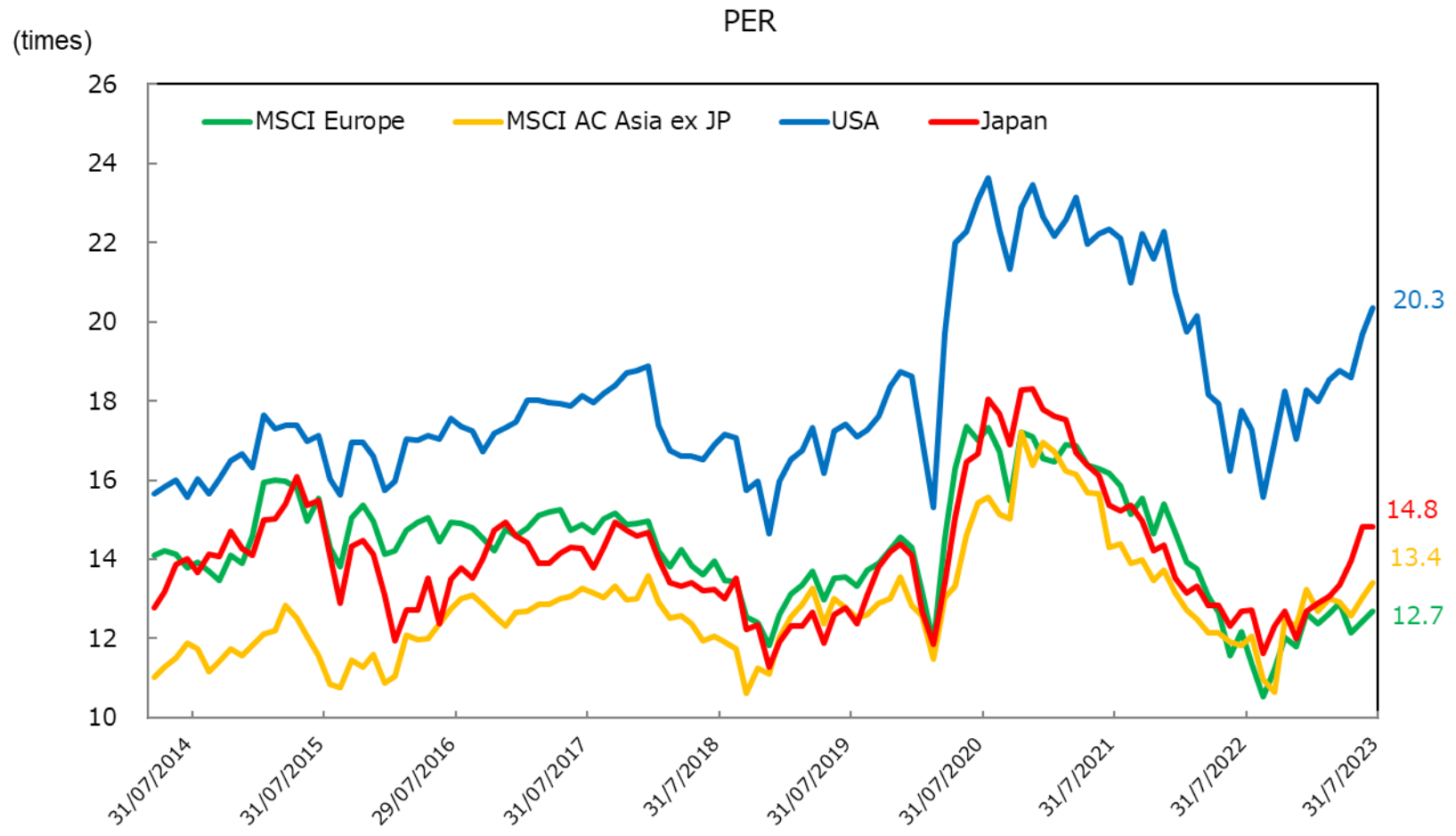
■ Upside Risks

- 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 systemic risk of global financial system
- Prolonged slow growth of the global economy

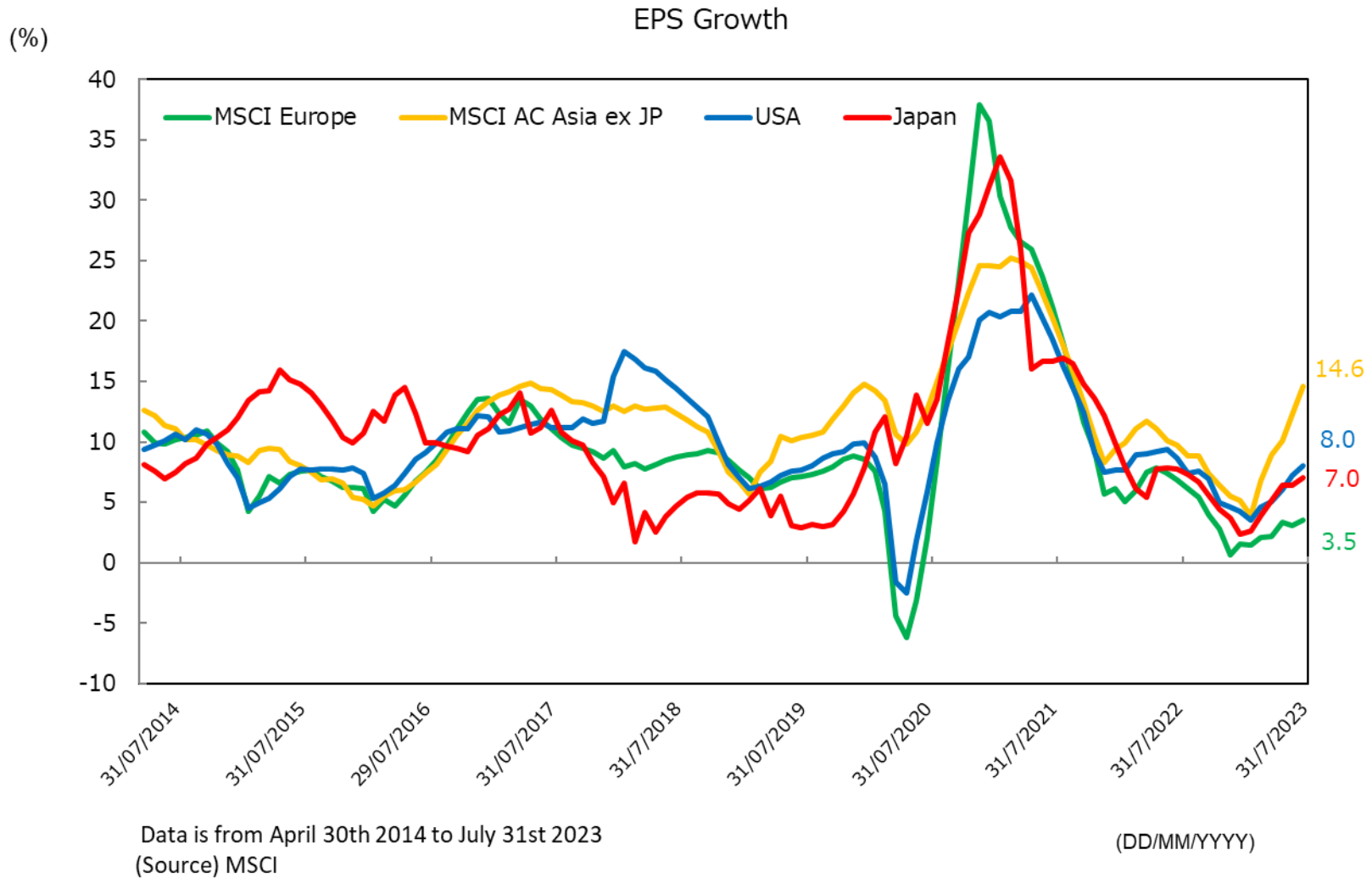
Growth expectations cause multiple expansion in Japan



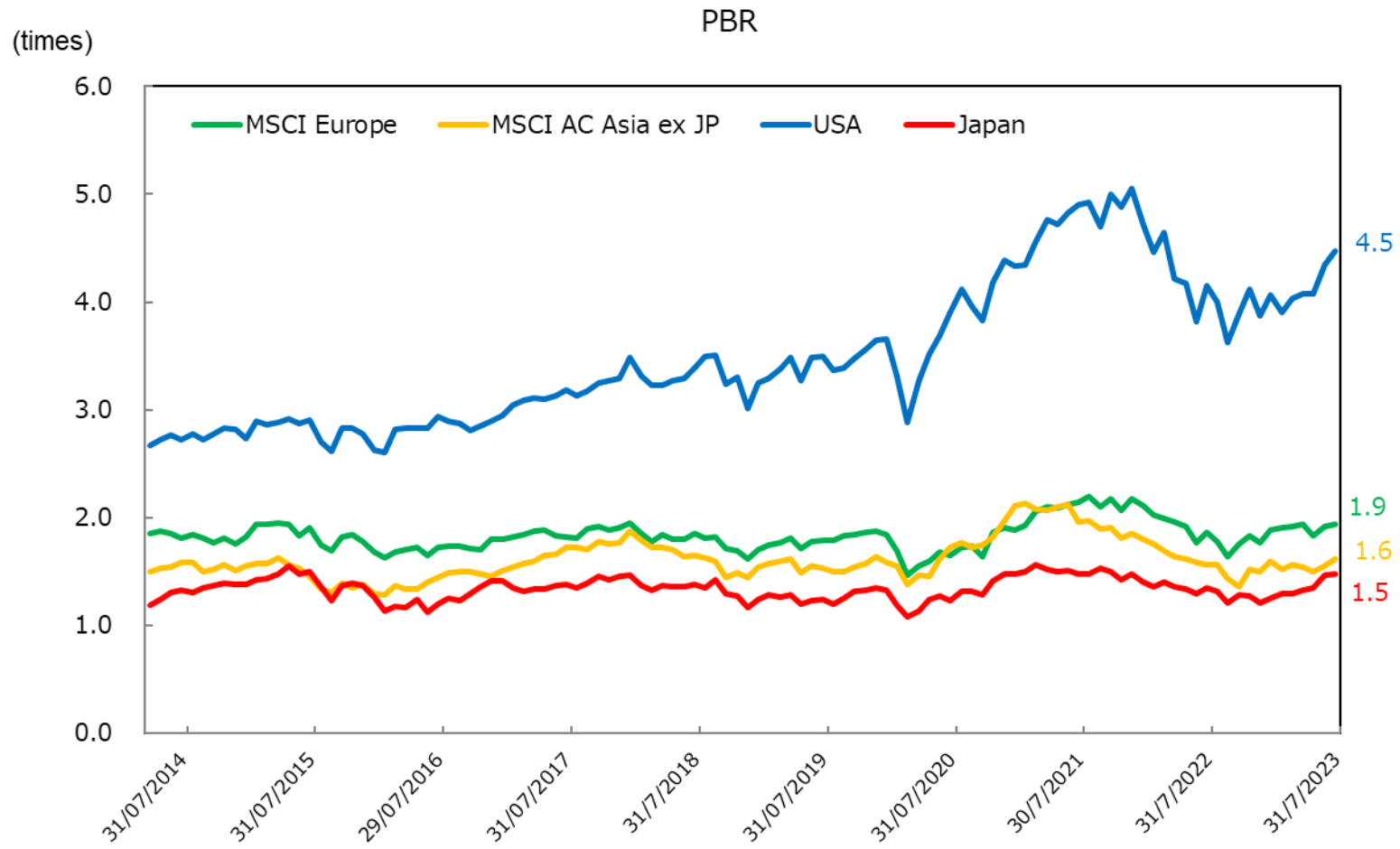
Data is from April 30th 2014 to July 31st 2023
 (Source) MSCI

(DD/MM/YYYY)

Corporate earnings outlook increasingly optimistic



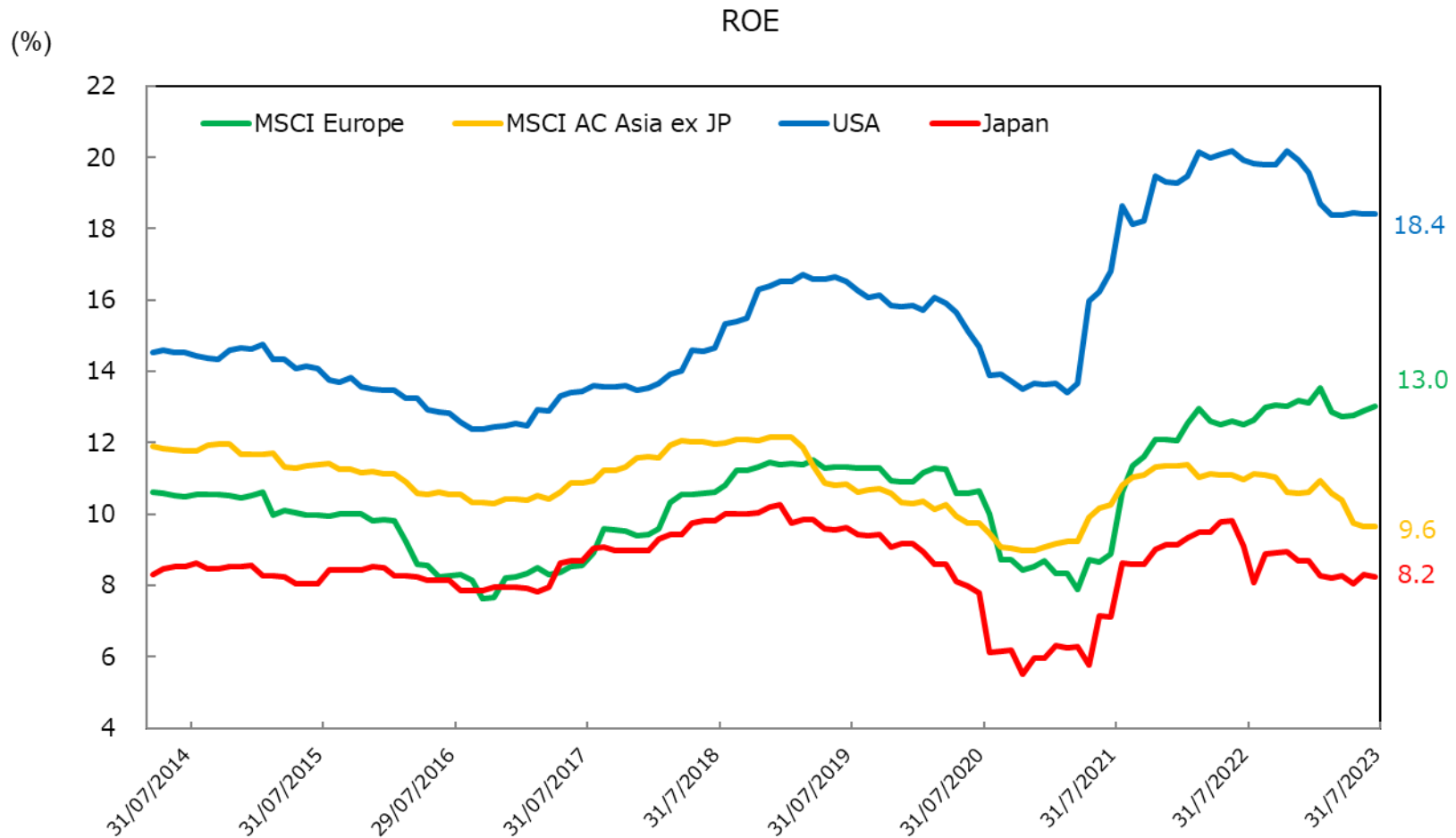
Expectations for improving governance lift Japan's PBR higher



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

(DD/MM/YYYY)

Japanese ROE still lagging behind despite earnings growth

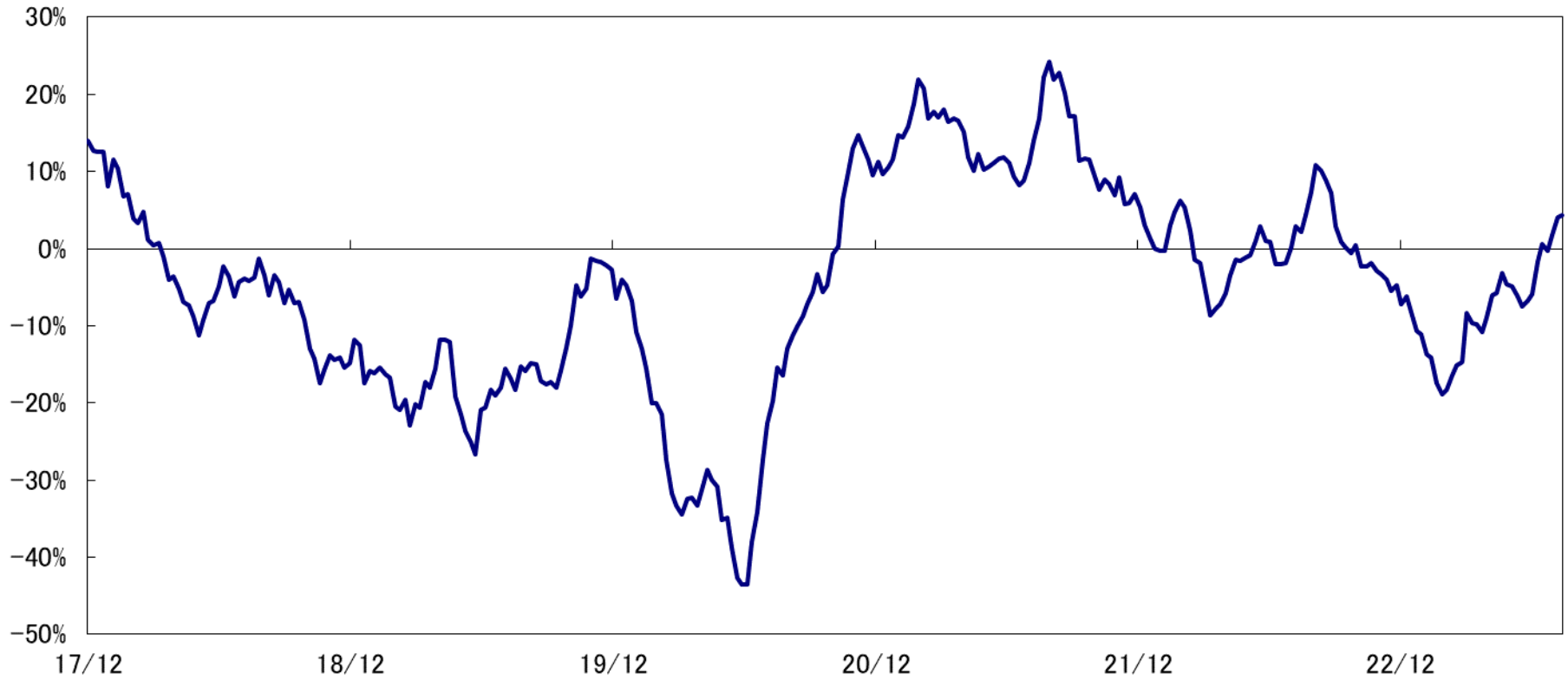


Data is from April 30th 2014 to July 31st 2023
 (Source) MSCI

(DD/MM/YYYY)

EPS revision continues positive trend

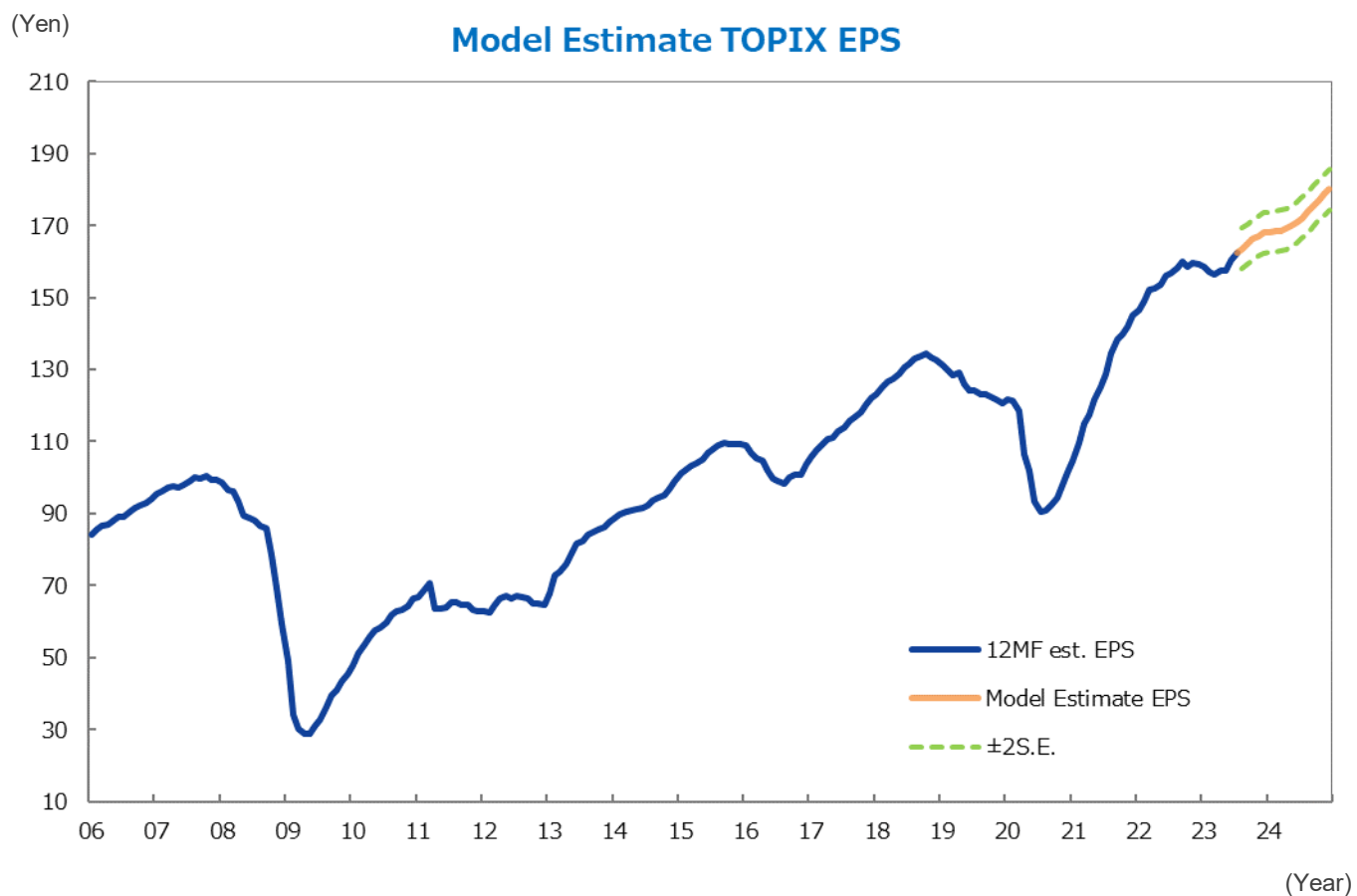
TOPIX Revision Index



Data is from December 28th 2017 to August 10th 2023
(Source) Datastream, IBES

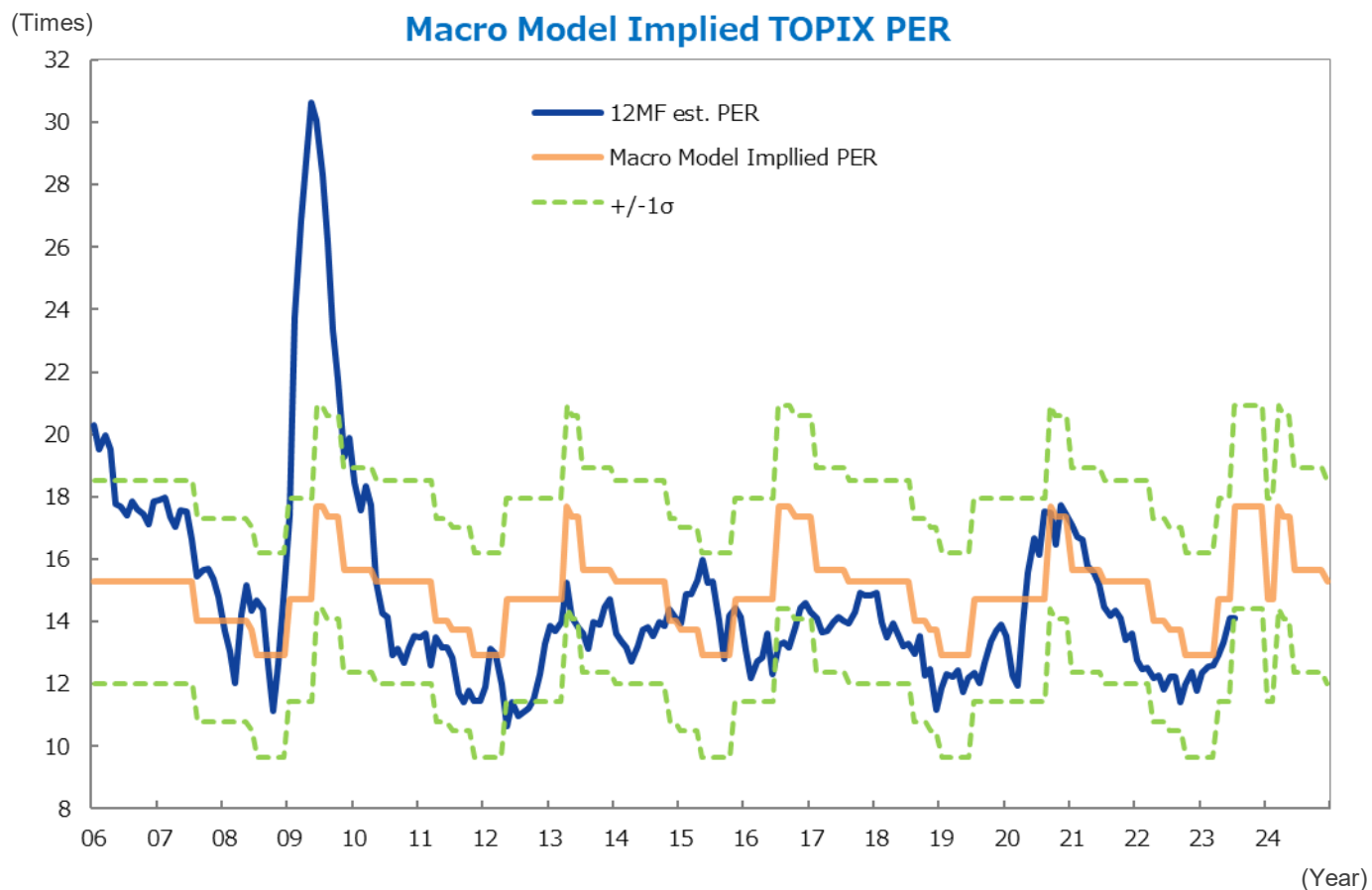
(YY/MM)

Quant model indicates encouraging earnings outlook



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

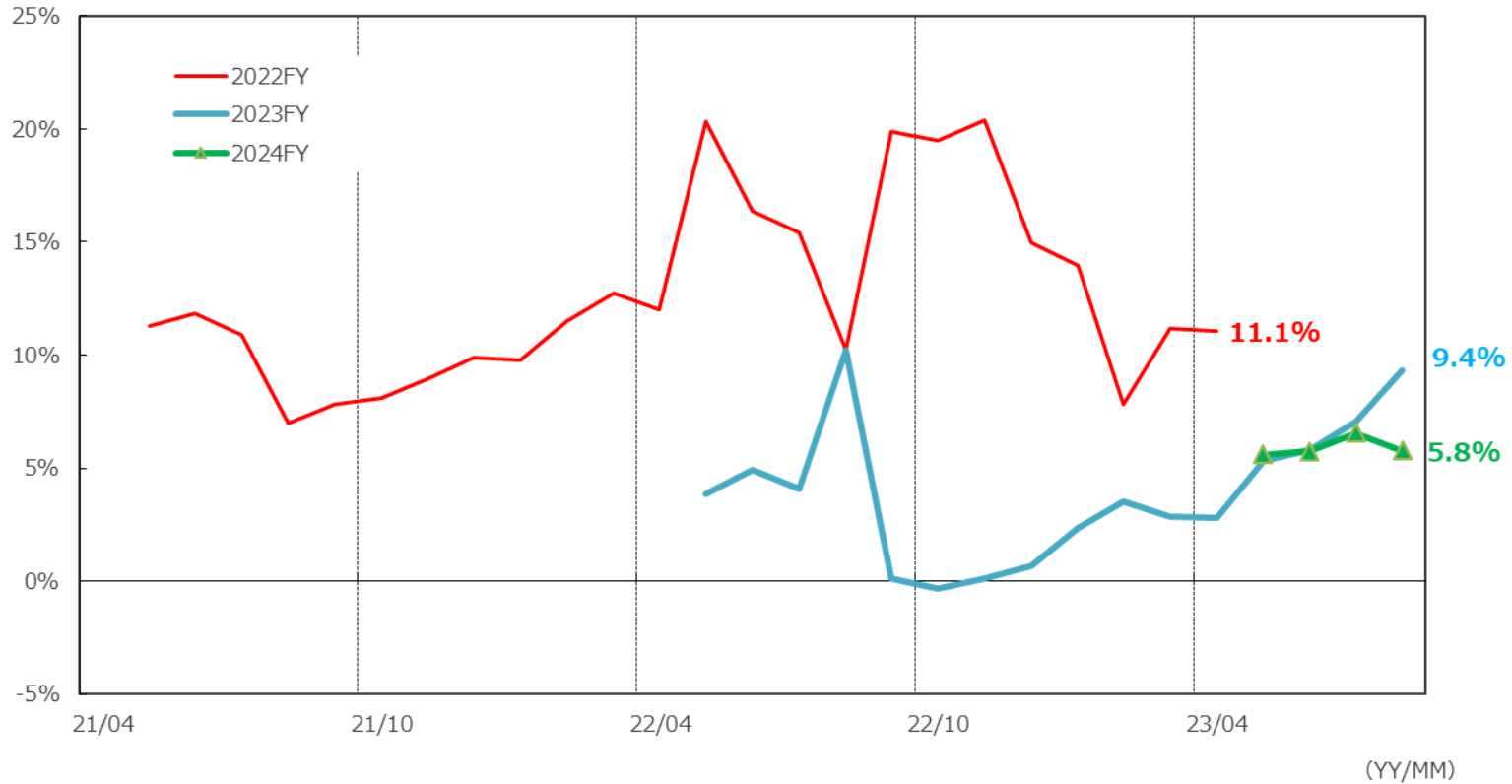
Model indicates current PER is still below fair value



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

Bottom up earnings outlook gaining momentum

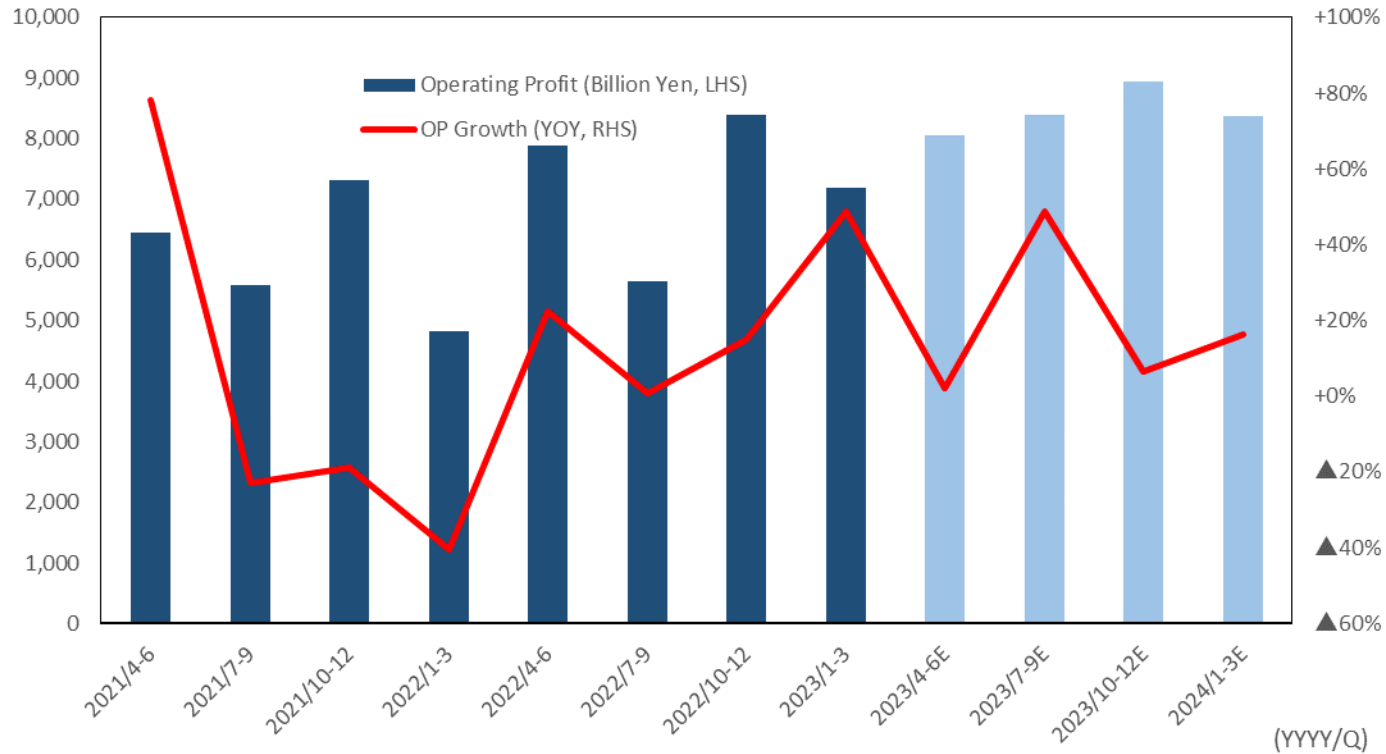
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th August 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

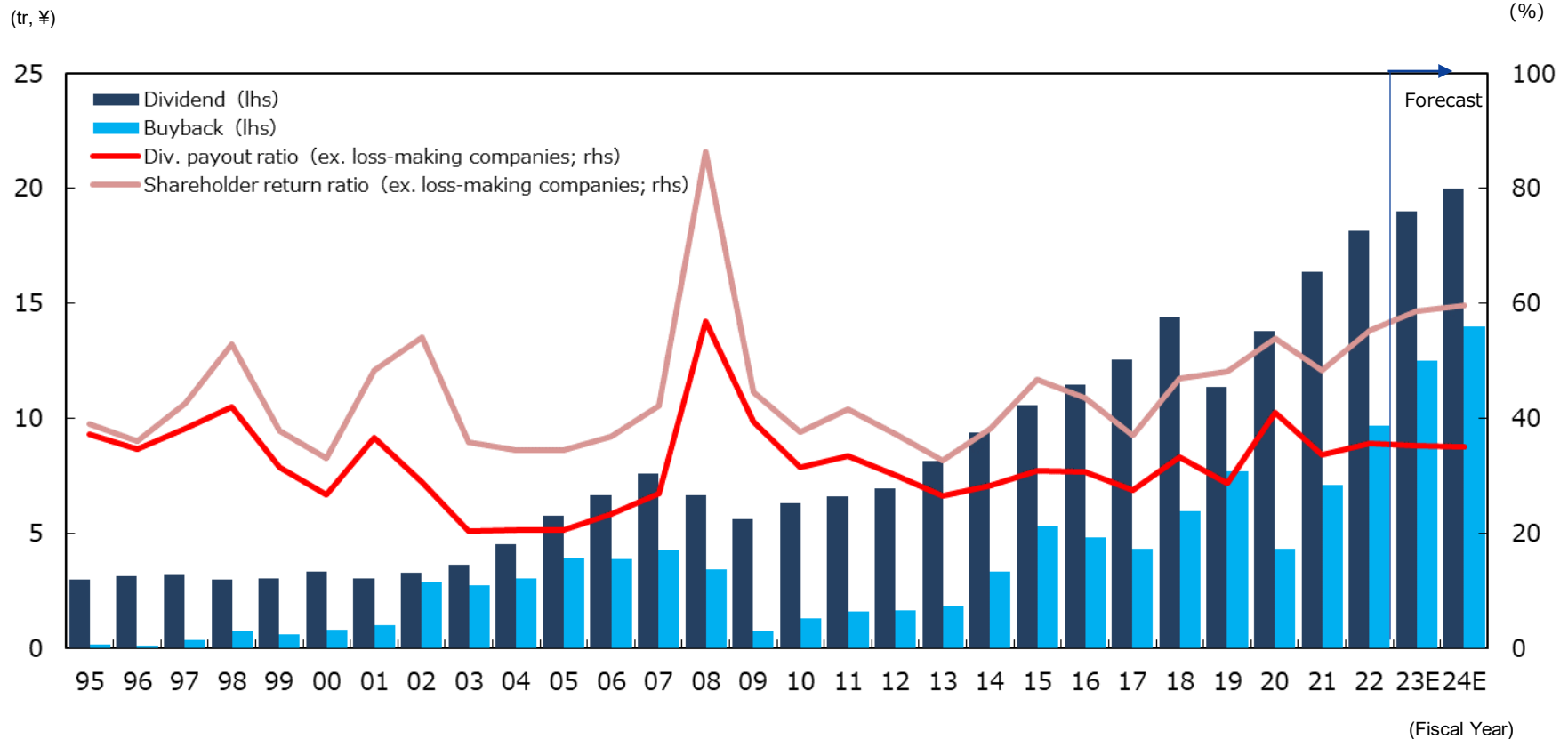
Operating Profit (All Industries Excl. Financials and Softbank Group)



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 to beat historical highs

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



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

Blue chip value dominates Japanese 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	4.07	14.79	19.93	13.77	20.40	41.29	34.44
Total Value	10.09	17.56	24.62	22.38	38.77	65.26	36.17
Top Cap Value	12.18	20.66	27.57	27.07	47.55	80.92	57.01
Large Cap Value	10.84	18.34	25.63	23.27	41.57	69.66	40.47
Mid Cap Value	9.05	15.29	23.05	18.37	34.09	56.22	19.73
Small Cap Value	6.74	14.08	20.15	18.44	26.81	46.66	18.18
Micro Cap Value	5.85	11.89	18.07	16.98	26.38	42.38	17.03
Total Growth	-1.53	12.04	15.41	5.93	5.00	20.54	31.15
Top Cap Growth	-2.56	11.97	16.76	5.70	5.91	24.87	36.16
Large Cap Growth	-1.60	12.84	16.64	6.51	5.72	22.18	34.20
Mid Cap Growth	0.17	14.42	16.44	7.97	5.54	18.10	31.31
Small Cap Growth	-0.94	5.97	6.21	1.55	-0.79	7.17	8.06
Micro Cap Growth	-0.60	2.33	3.68	0.66	-2.22	5.55	7.81
Top Cap Total	3.76	15.84	21.53	14.76	22.51	47.28	44.19
Large Cap Total	4.12	15.47	20.88	14.15	21.20	43.05	37.89
Mid Cap Total	4.70	14.89	19.86	13.22	19.37	37.24	29.13
Small Cap Total	3.77	10.94	14.59	11.55	15.35	30.54	15.21
Micro Cap Total	3.75	8.72	13.17	11.26	16.32	29.50	15.54

Note : As of 22nd August 2023
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** Exports of goods have increased on the back of the resilience of overseas economies, particularly the United States. Corporate capital spending attitudes persist, due to strong pent-up demand, de-carbonization and digitalization investment needs. Consumer spending has been lackluster due to headwinds in the face of high prices, but household sentiment has not.
- **Inflation is slowing.** The national core CPI rose by 3.1% in July from the previous year, down from 3.3% a month earlier. After rising to 3.4% in April, the pace of price increases has slowed, albeit with fluctuations. The decline in import prices, which is the starting point of cost push inflation, has become more pronounced, and it seems to have spread to domestic goods prices.

[Outlook]

- ① **We have raised our real GDP growth forecast for FY 2023 from +1.2% to +2.5% and maintained that for FY 2024 at +1.1%.** The primary reason for the upward revision in FY 2023 was the unexpectedly strong growth in Q2 FY 2023. In addition, we have raised our forecast for exports due to a strong US economy and resuming inbound travel from China. With regard to the outlook for the economy, we expect domestic demand to increase, particularly personal consumption and capital investment thanks to the re-opening of the economy after the COVID-19 pandemic. Consumer spending, which has been lackluster, is expected to recover thanks to receding negative impact from price hikes. Exports are also expected to remain stable.
- ② **We have maintained our core CPI forecast for FY 2023 at +2.8% and raised that for FY 2024 from +1.7% to +1.8%.** The main reasons for the upward revision to FY 2024 CPI forecast was an increase in the outlook for economic growth and a change in the exchange rate assumption (from 135 yen to 137.5 yen to the dollar). In the future, it is likely that the cost push pressure will decrease and the core CPI will follow a deceleration trend. However, due in part to support from wage increases, the timing for core CPI to fall below 2% from the previous year is expected to be deferred to the second half of FY 2024.
- ③ **We expect PM Kishida's cabinet will continue its accommodative economic policy.** The ruling LDP is expected to raise the issue of extending measures to counter higher inflation. As for the sources of the funds, the government will avoid preparing a supplementary budget and consider using reserve funds. If the Kishida administration faces a snap election or if the economy slows down from its current steady pace, there is the risk that economic measures with a supplementary budget will be taken.
- ④ **The Bank of Japan's monetary policy is expected to remain unchanged for the foreseeable future.** In July, the Bank of Japan flexed its yield-curve-control operations, effectively raising the cap of 10-year treasury yield to 1%. As a result, the YCC has become a dead letter and the need to revise the YCC has been reduced. On the other hand, the possibility of achieving the price stability target is low, and short-term policy rate and the QQE framework with YCC is expected to remain in place. However, the risk of changes in current monetary policies (such as eliminating negative interest rates) will increase if the BOJ is concerned about the side effects of ongoing accommodative monetary policy through the deepening discussion of its multi-faceted review.

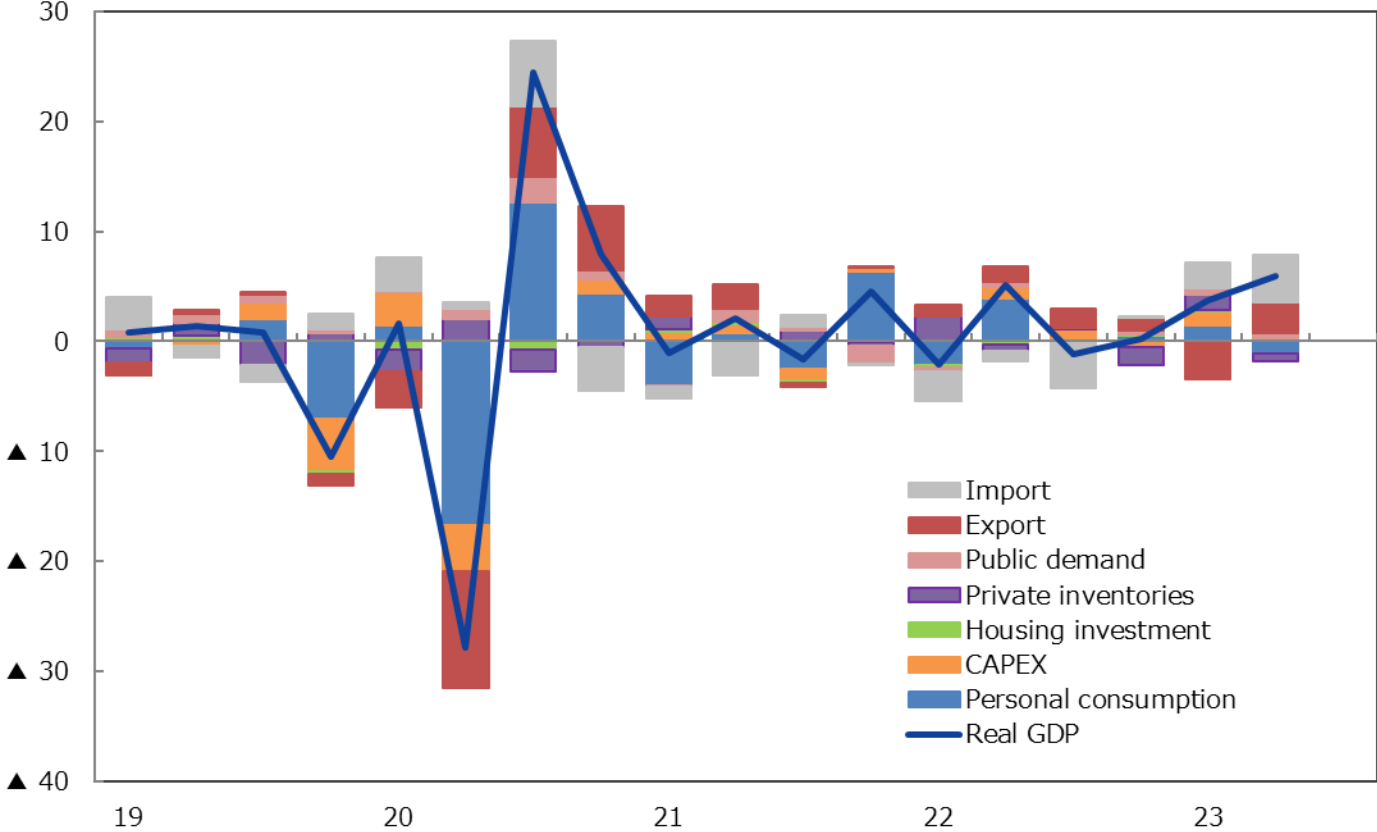
Forecast table for the Japanese economy

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%	2.7%	1.4%	2.5%	1.1%
Private final consumption expenditure	0.1%	-0.9%	-5.1%	1.5%	2.5%	0.3%	0.9%
Private housing investment	-4.8%	2.5%	-7.2%	-0.6%	-3.0%	1.9%	-0.4%
Private-sector capital investment	1.6%	-1.2%	-5.4%	2.3%	3.1%	2.5%	2.2%
Private inventory investment	0.1%	-0.2%	-0.3%	0.4%	0.2%	-0.1%	0.0%
Public fixed capital formation	0.9%	1.6%	4.9%	-6.5%	-3.1%	3.0%	0.0%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	1.3%	0.2%
Exports of goods and services	2.0%	-2.3%	-9.9%	12.4%	4.5%	3.7%	3.8%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.2%	-3.0%	3.1%
Nominal GDP	0.2%	0.0%	-3.4%	2.5%	2.0%	5.6%	2.3%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.7%	3.0%	1.2%
Industrial Production Index	-0.1%	-3.6%	-9.7%	5.7%	-0.3%	-0.5%	1.9%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.8%	1.8%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	1.5%	0.0%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	2.8%	2.5%
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

Net export boosts Japan's GDP

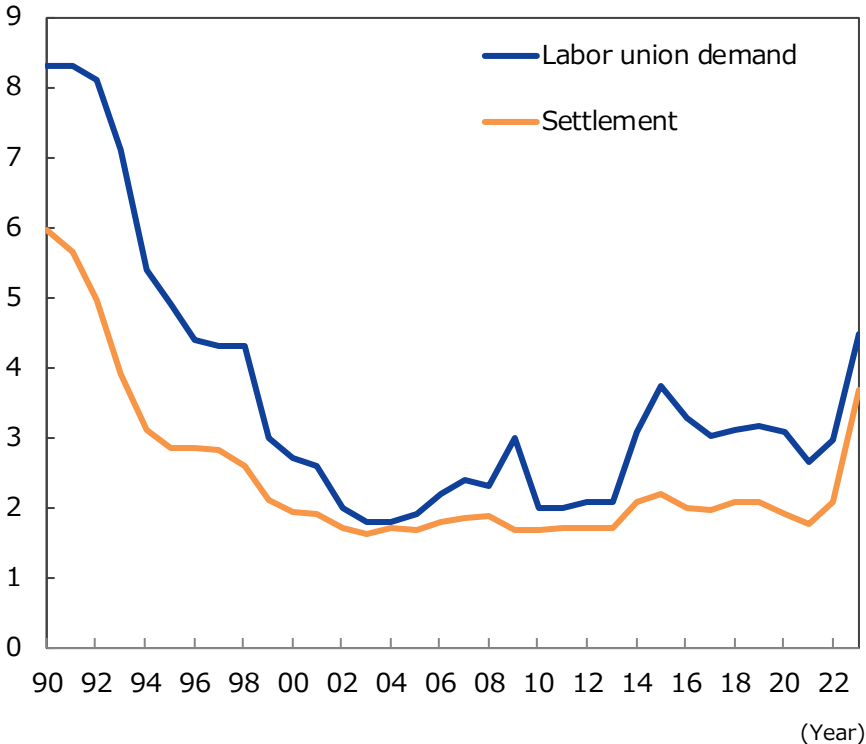
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q2 2023.
 Source: Cabinet office, SMDAM

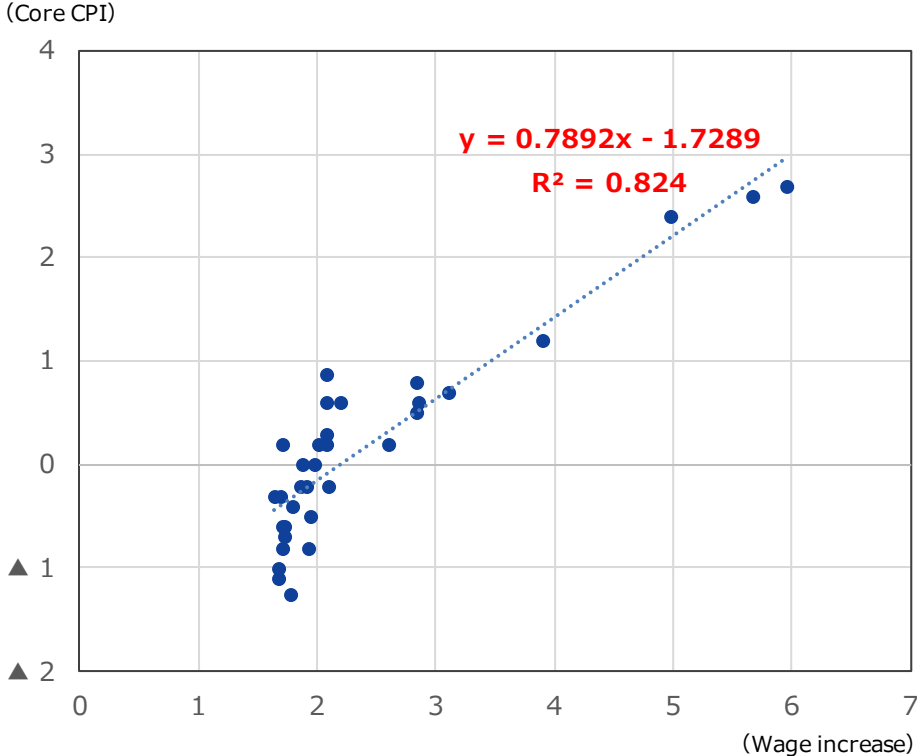
Start of a virtuous cycle to overcome deflation?

Wage increase demand & settlement (YOY, %)



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

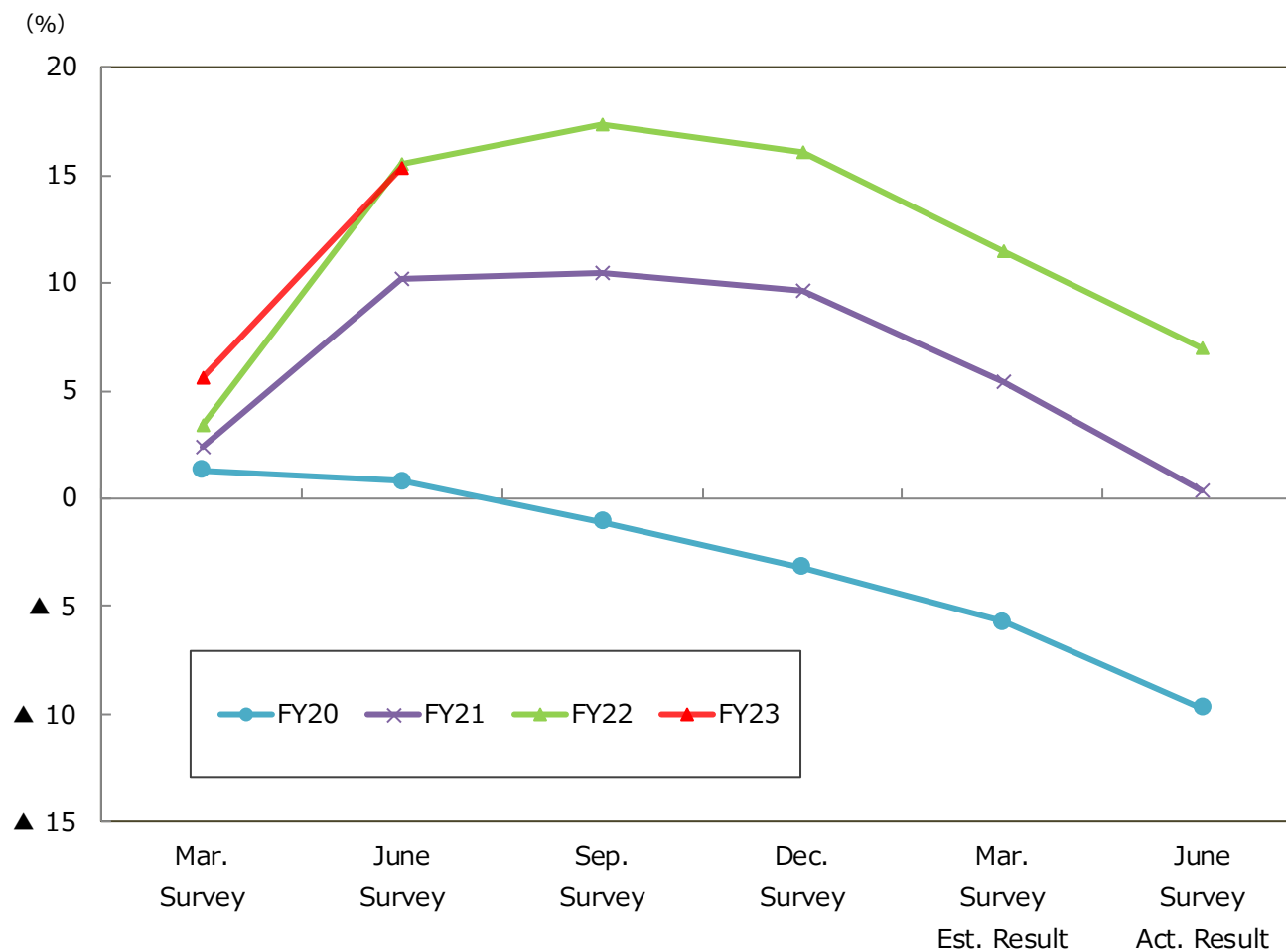
Wage increase & Core CPI (YOY, %)



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

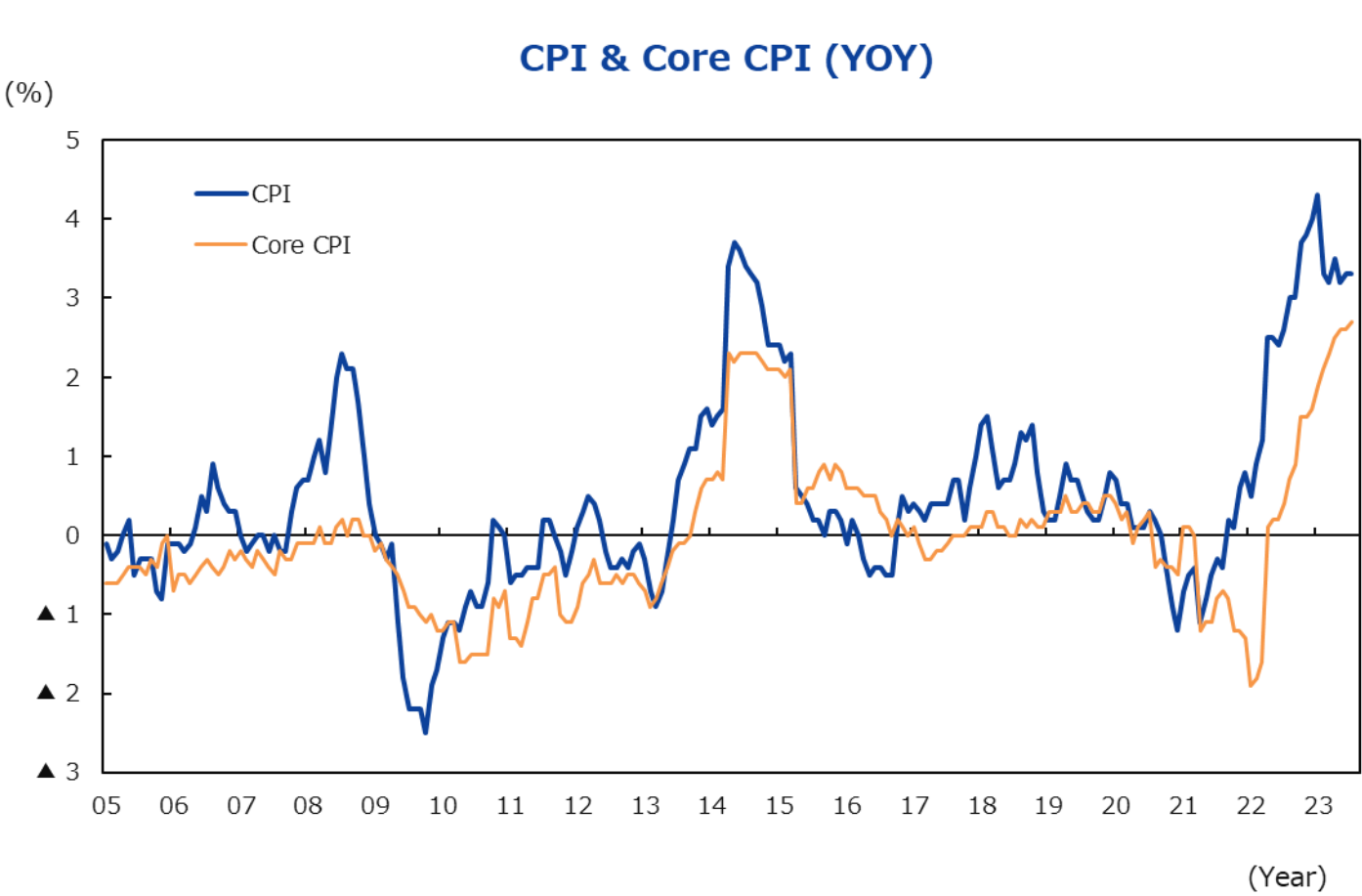
Weaker Yen and steady growth lift CAPEX in Japan

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



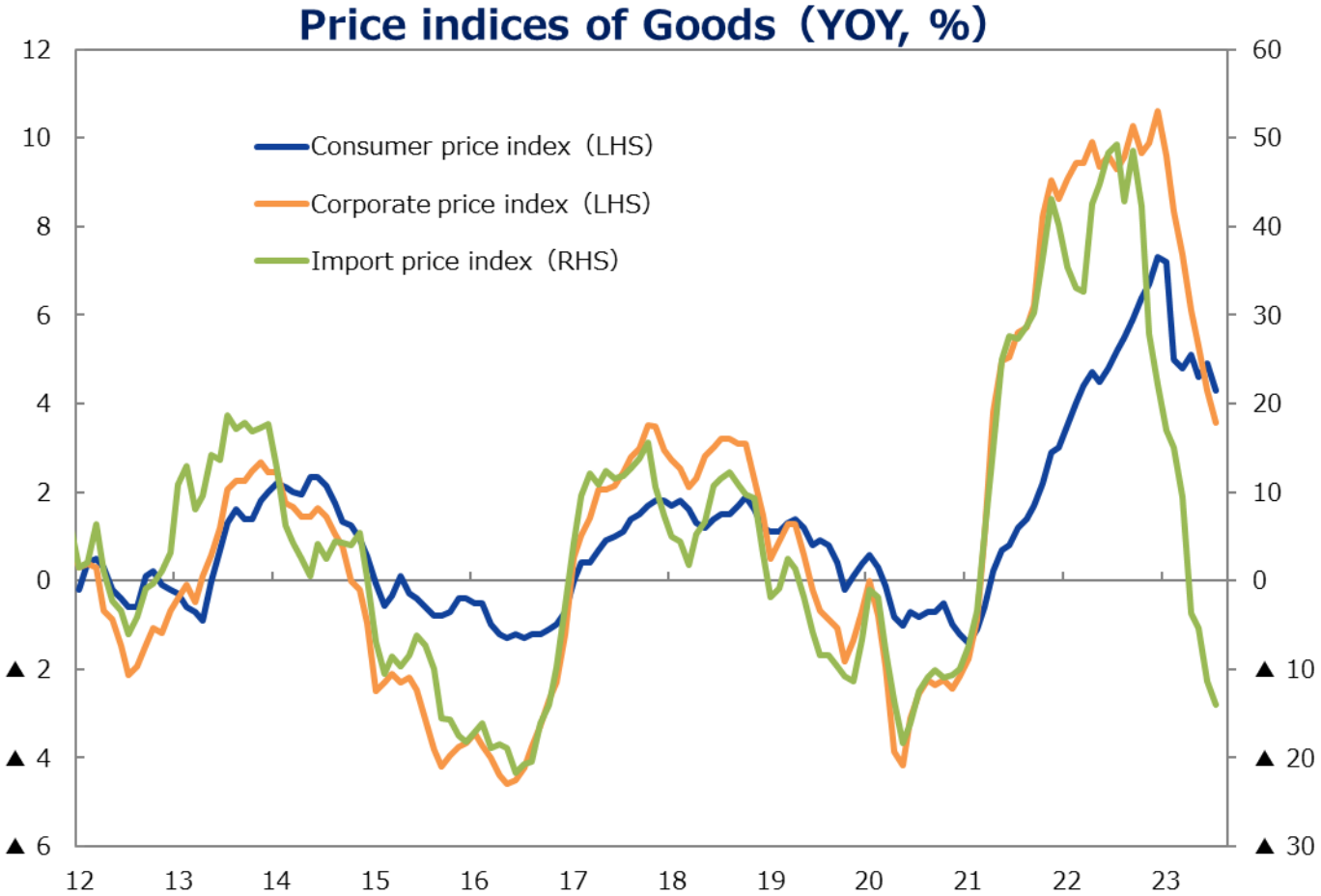
Note: Data is from Q1 FY2020 to Q2 FY2023.
Source: The Bank of Japan, SMDAM

Sticky core inflation despite falling energy prices



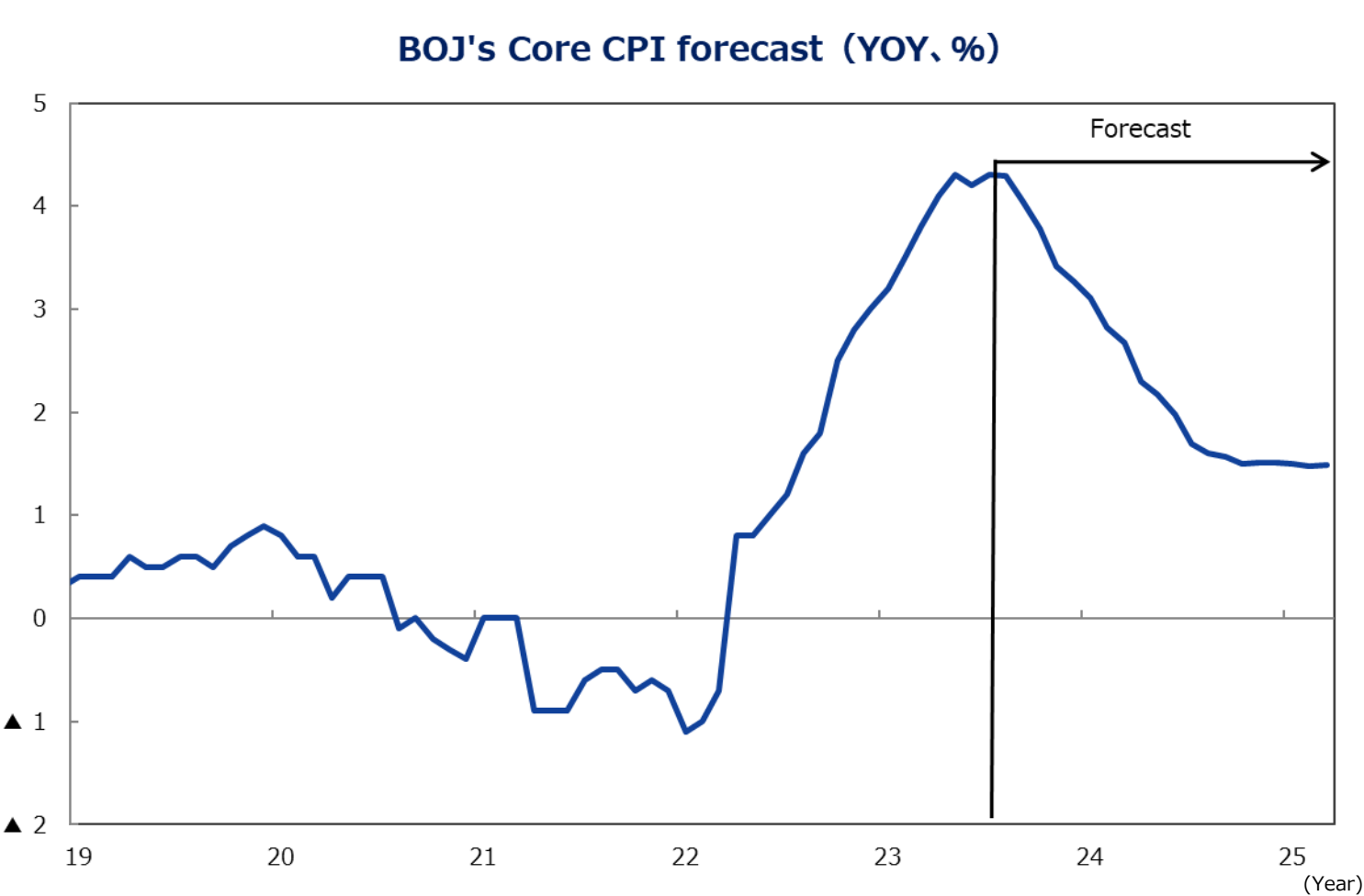
Note: Data is from January 2005 to July 2023, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

Sticky inflation despite falling import prices



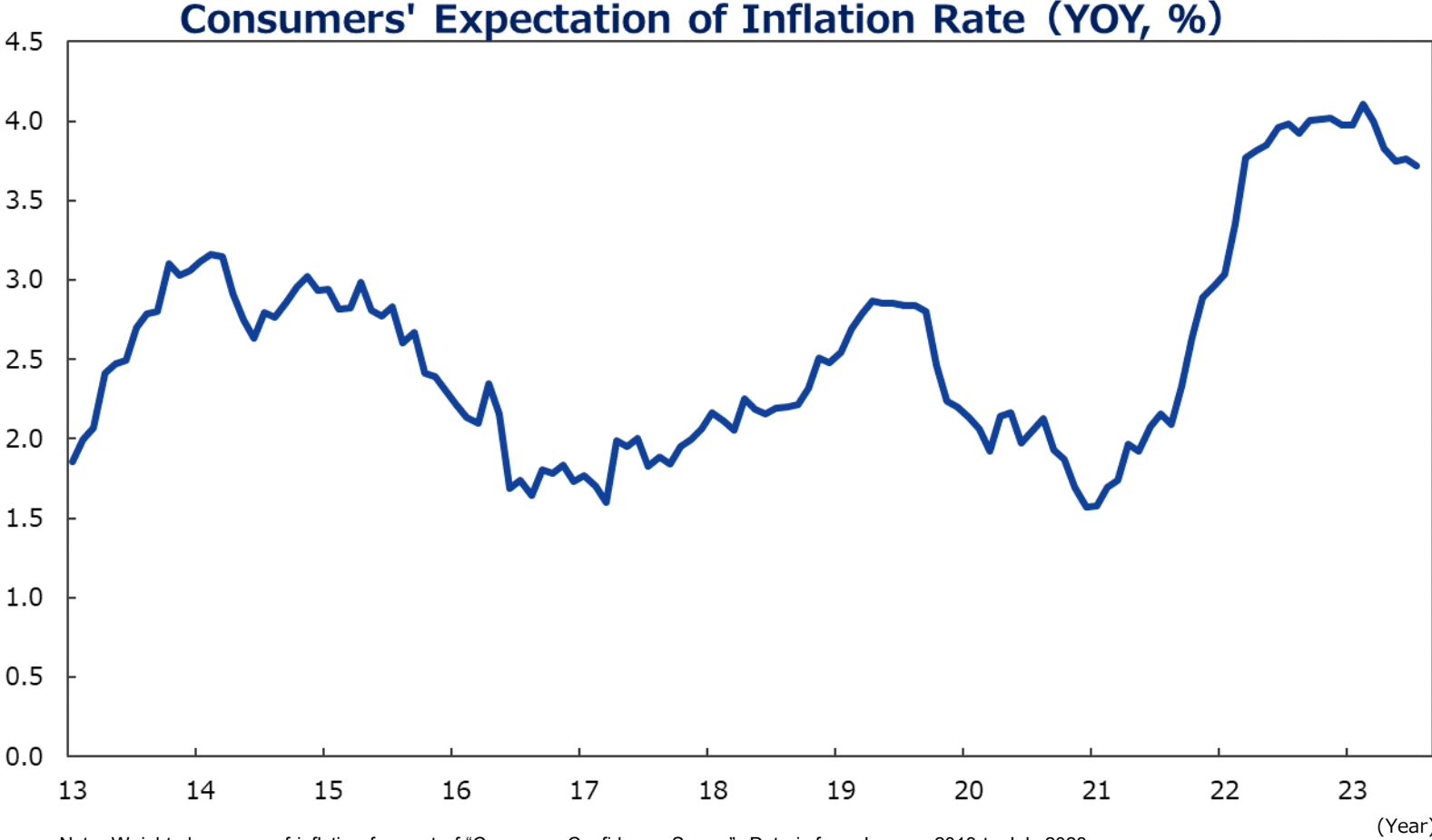
Note: Data is from January 2012 to July 2023.
Source: MIAC, Bloomberg, SMDAM

BOJ continues its dovish policy despite stickier inflation data



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

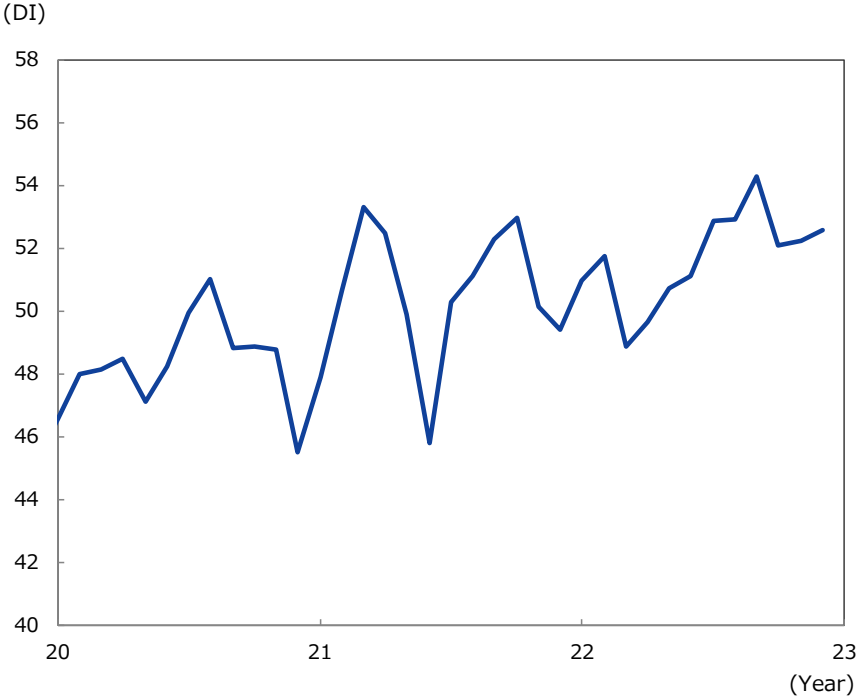
Expectations for inflation remain high



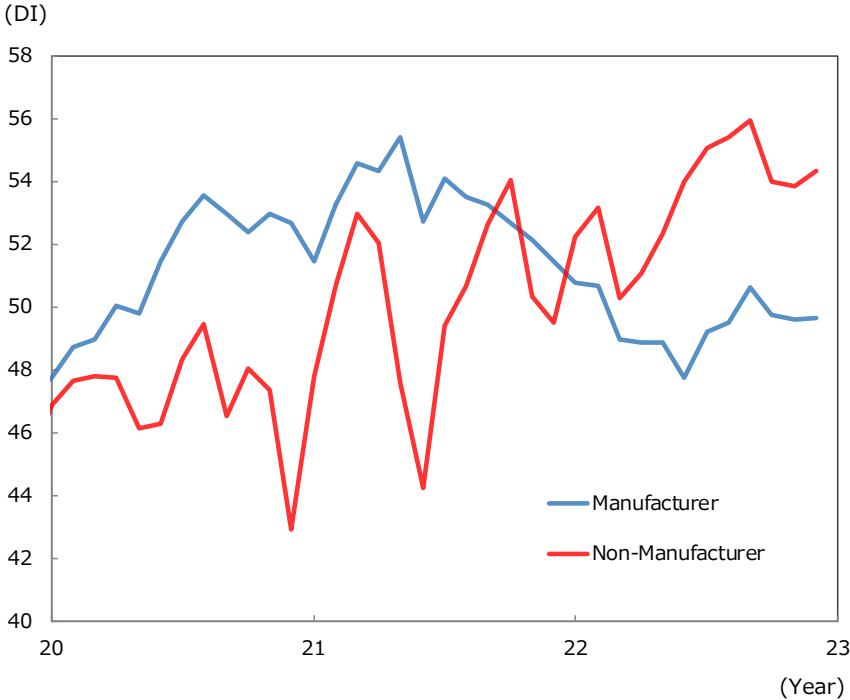
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to July 2023.
Source: Cabinet Office, SMDAM

Soft data shows resilience in service sector

Composite PMI



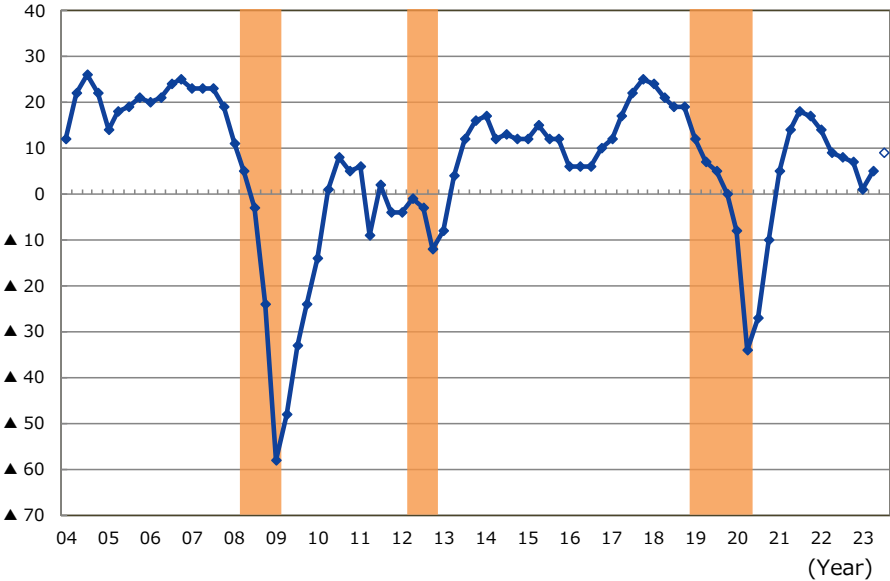
PMI, Manufacturer & Non-Manufacturer



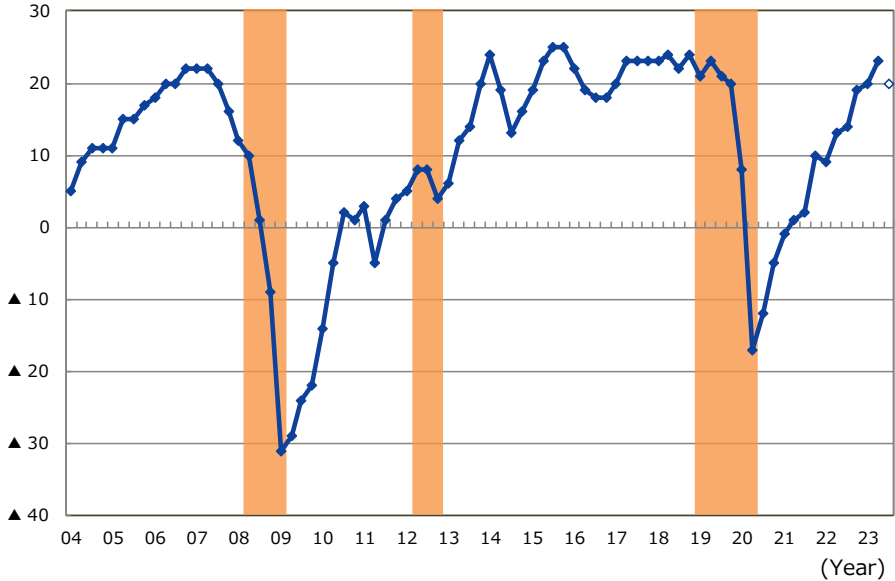
Note: Data is from September 2020 to August 2023.
Source: Bloomberg, SMDAM

Manufacturers start chasing non-manufacturers' recovery

BOJ business condition DI Large manufacturers (%)

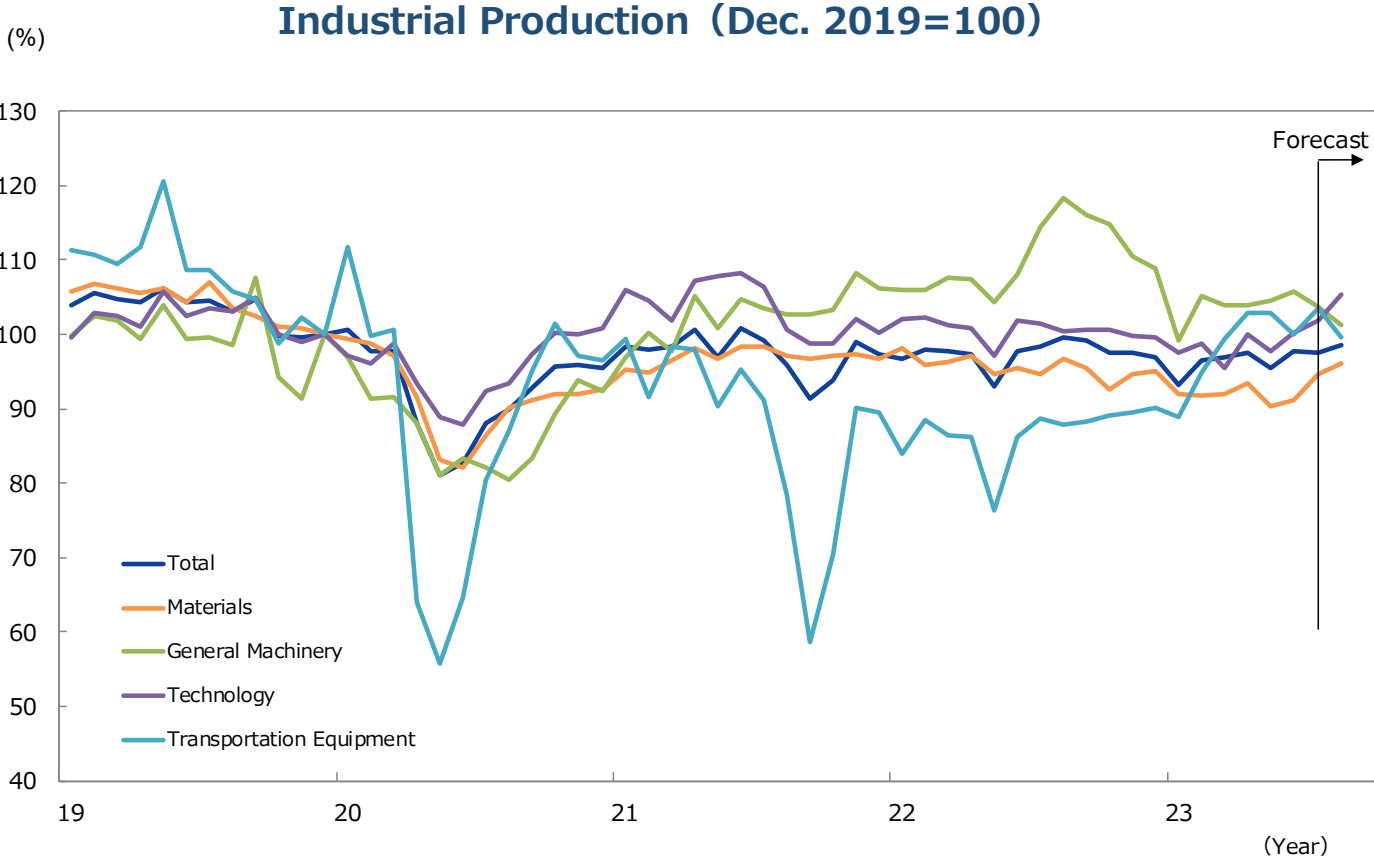


BOJ business condition DI Large non-manufacturers (%)



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

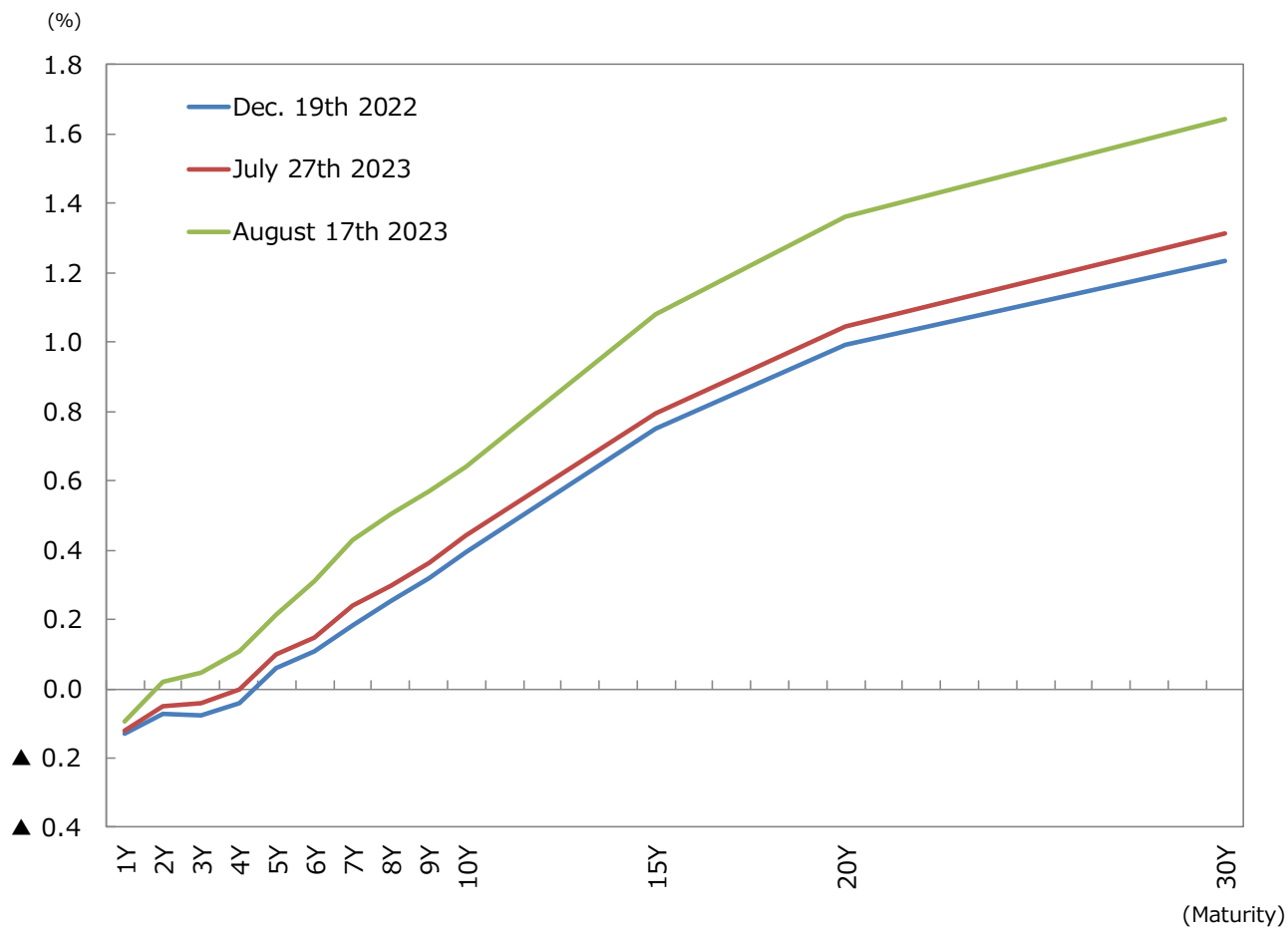
Recovery in autos to be fully realised



Note: Data is from January 2019 to August 2023. Data after July 2023 are forecasts.
 Source: METI, SMDAM

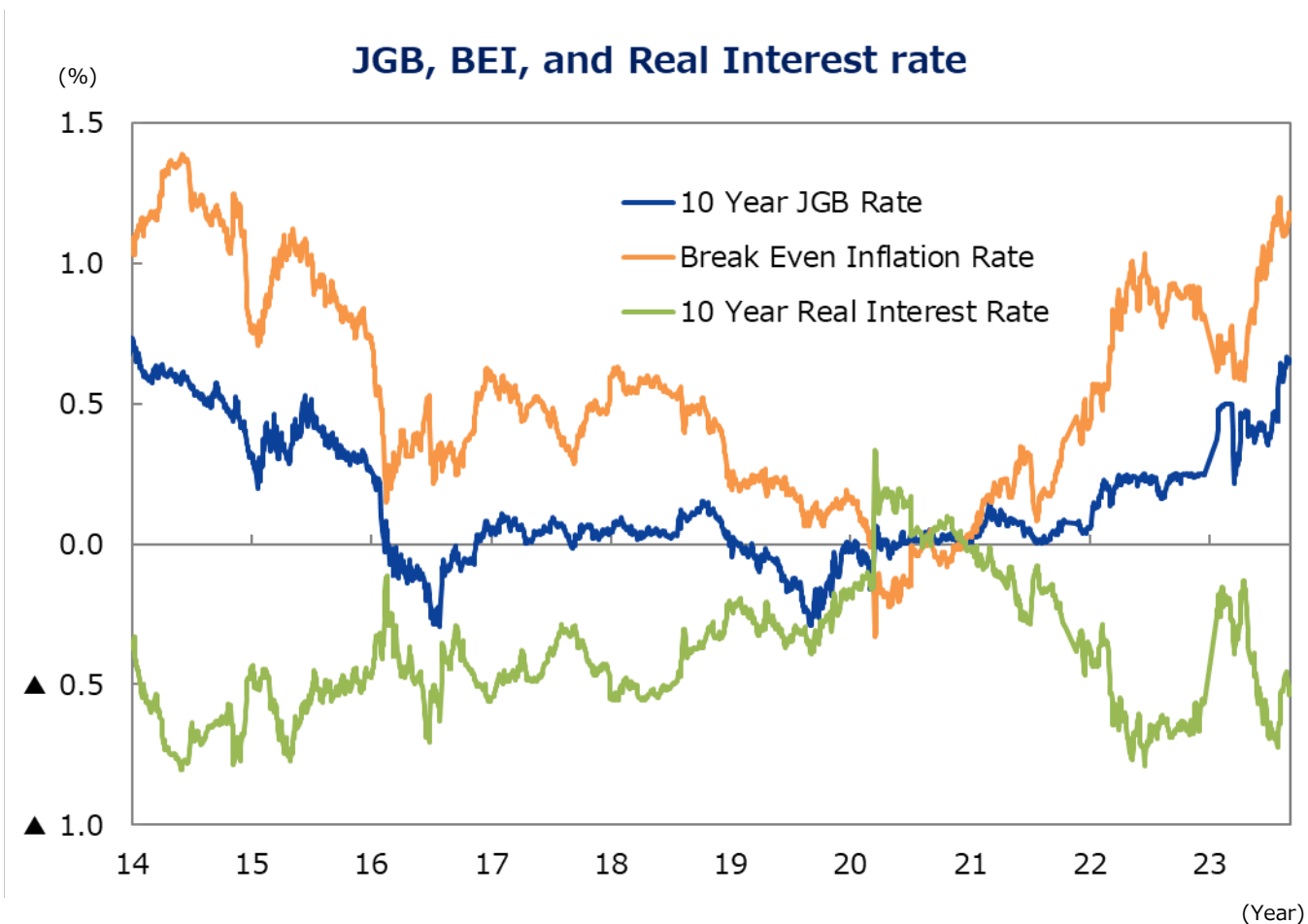
“Bear steepening” after BOJ’s decision to widen YCC range

Yield Curve of Japanese Sovereign



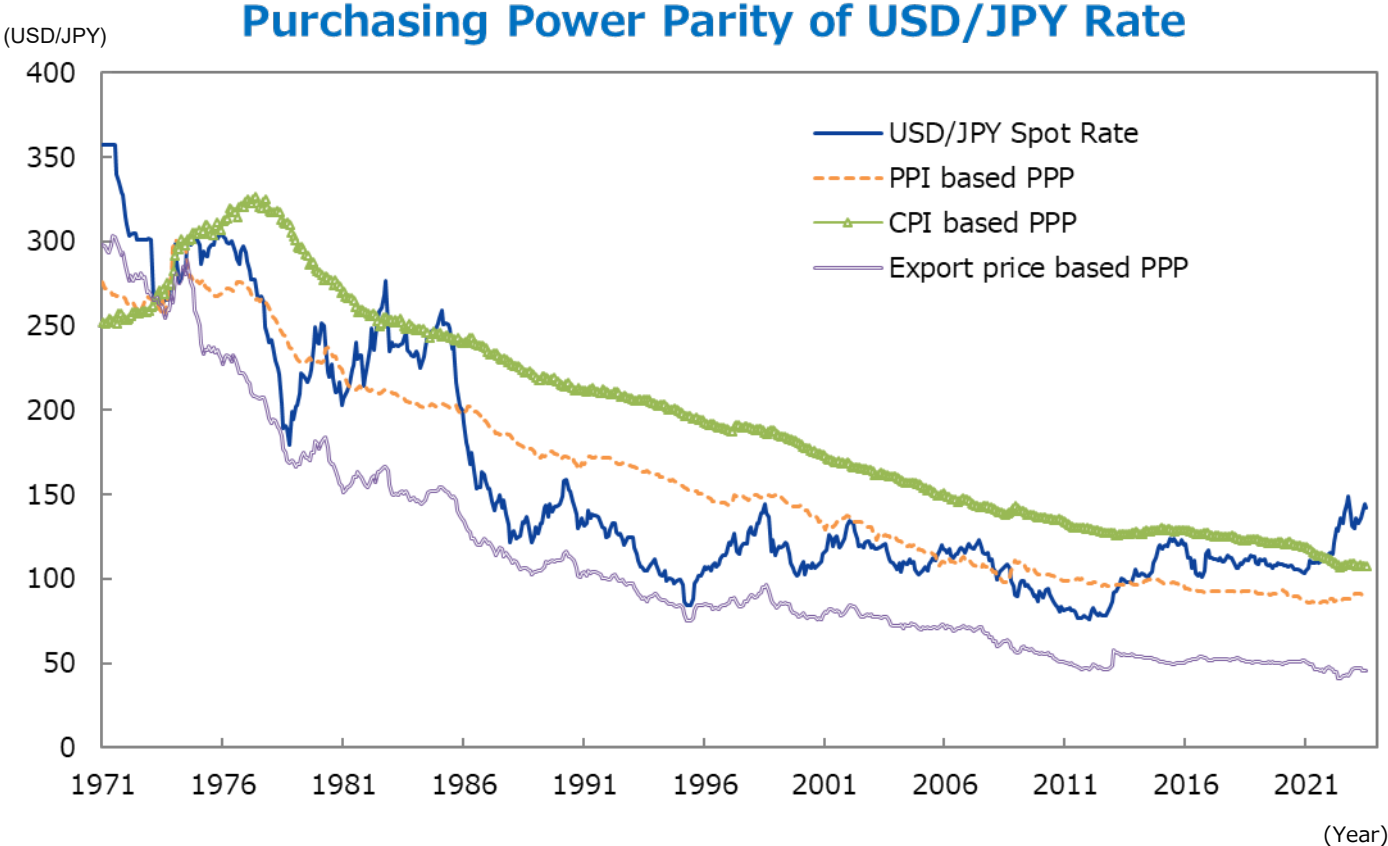
Source: Bloomberg, SMDAM

JGB yield & BEI getting higher after change in YCC range



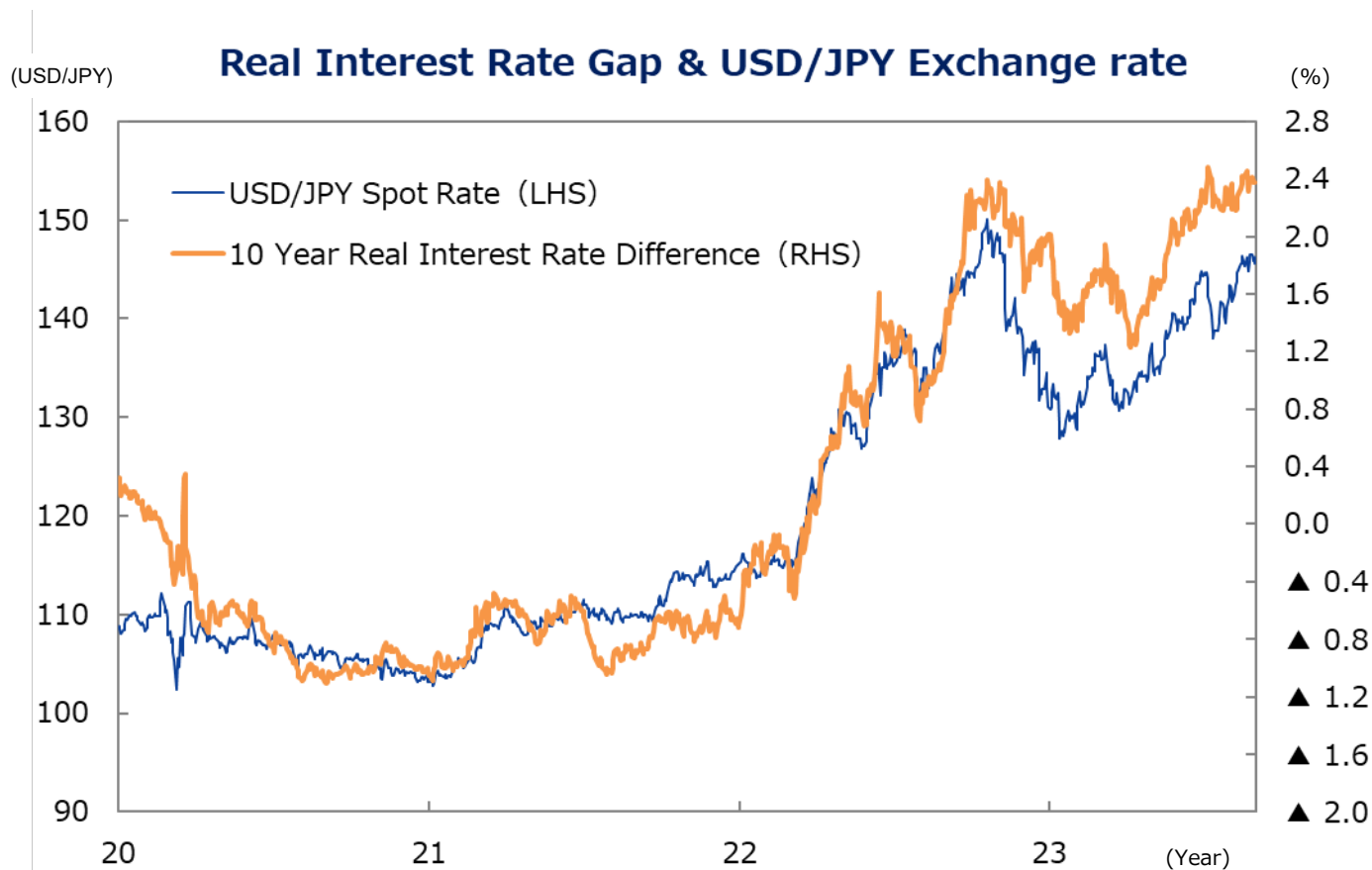
Note: Data is from 1st January 2014 to 31st August 2023.
Source: Bloomberg, SMDAM

USD/JPY continues to stay far above purchasing power parity



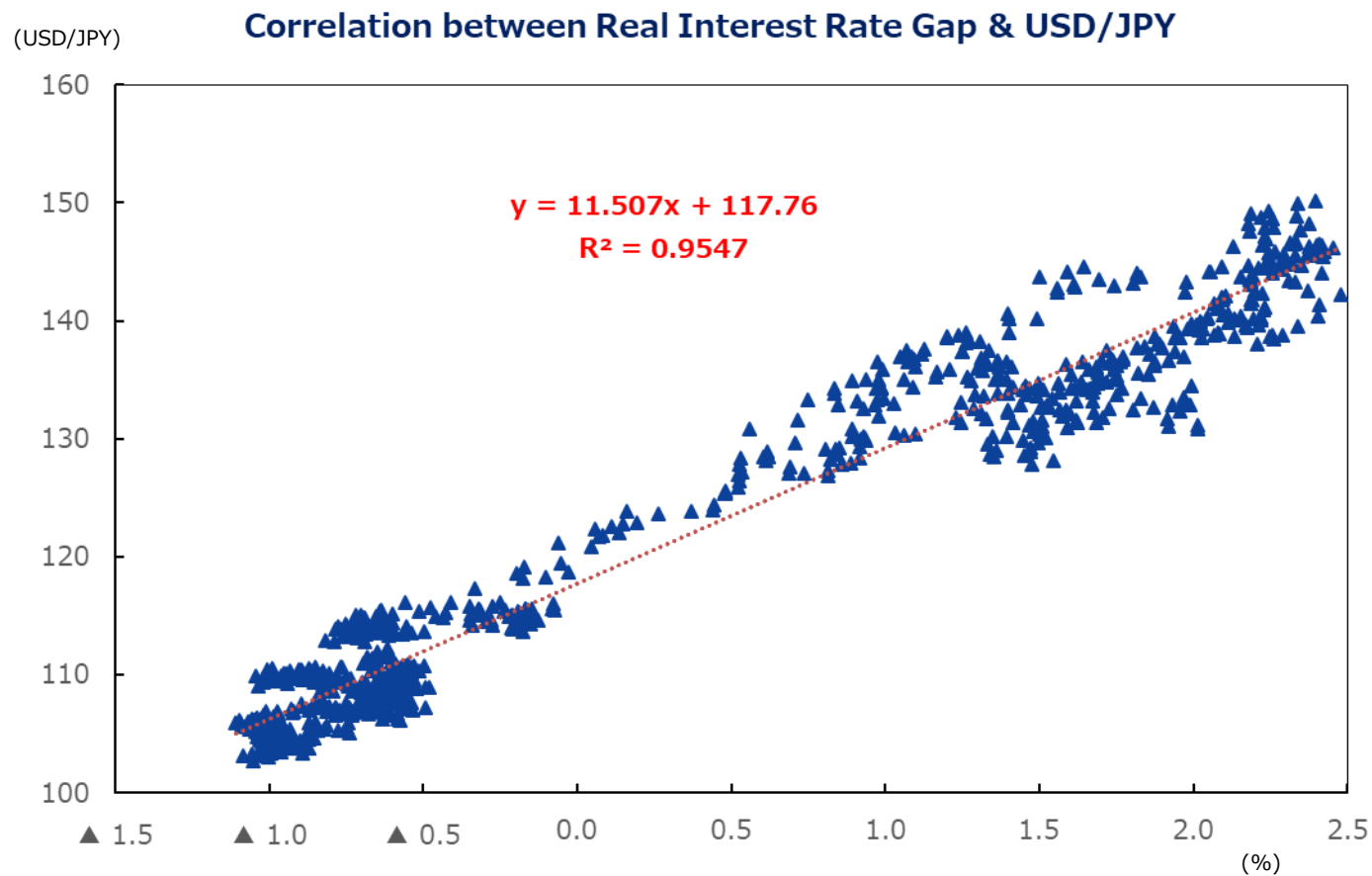
Note: Data is from January 1971 to July 2023.
Source: DOL, Bank of Japan, SMDAM

USD/JPY rate chasing real yield gap



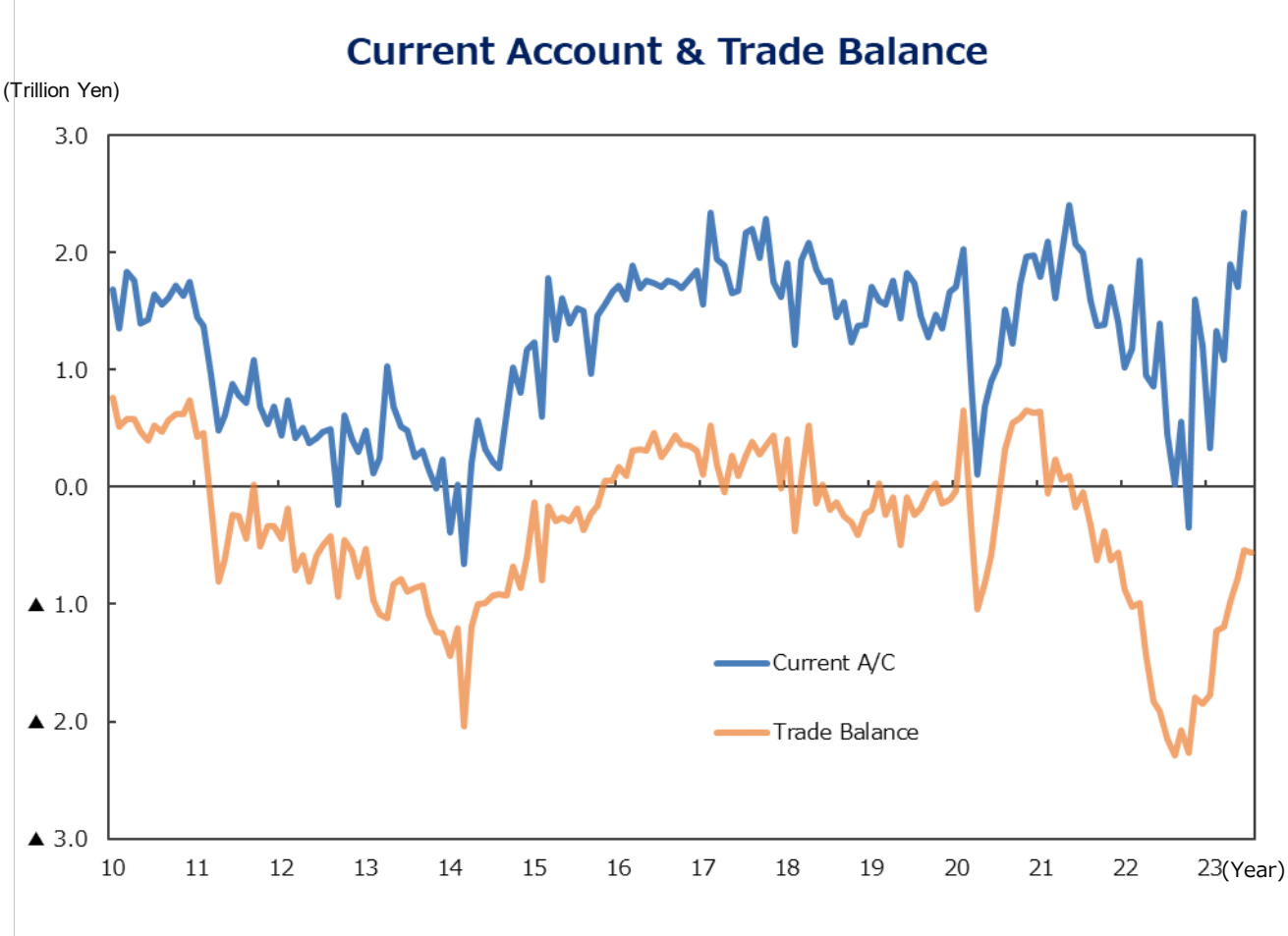
Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 31st August 2023.
Source: Bloomberg, SMDAM

Real yield gap dominating USD/JPY rate



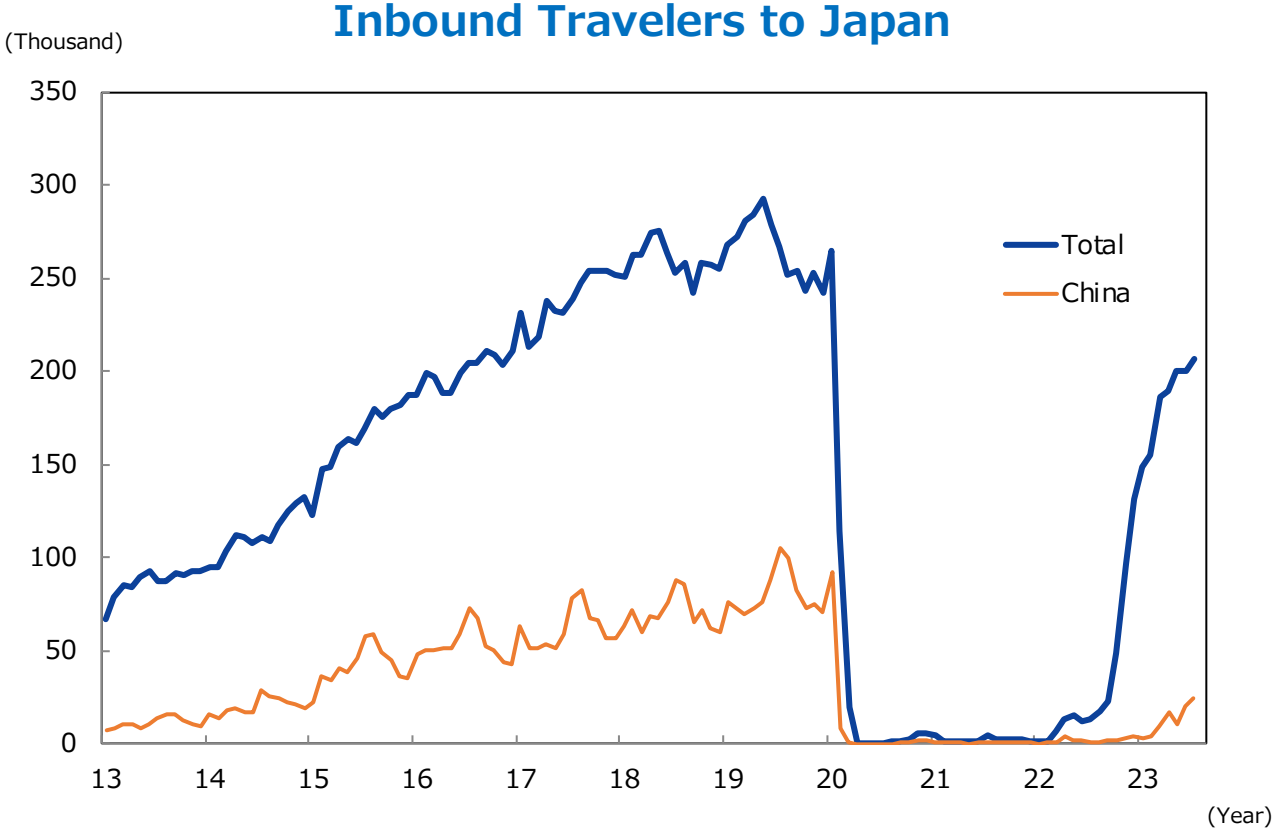
Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 31st August 2023.
Source: Bloomberg, SMDAM

Current A/C surplus surges due to shrinking trade deficit



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

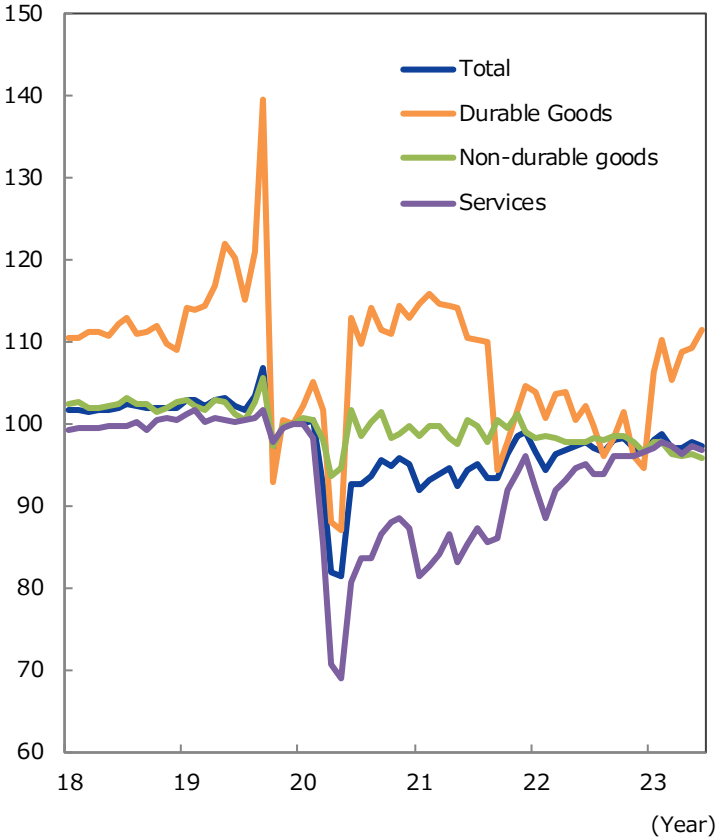
Chinese inbound travel has started recovering slowly



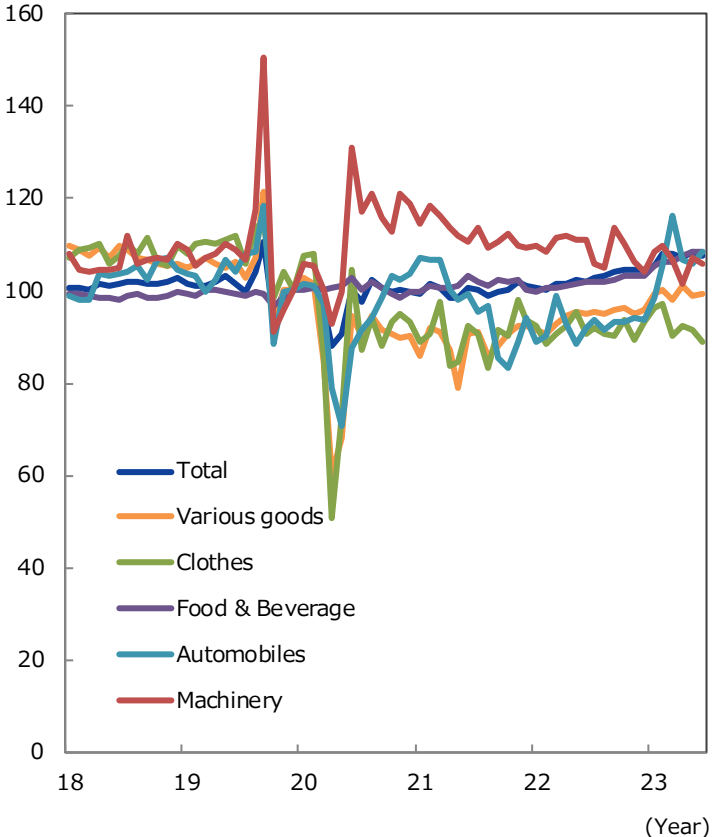
Note: Data is from January 2013 to July 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Normalization of auto production lifts durable goods sales

Consumer Activity Index (Dec. 2019 = 100)



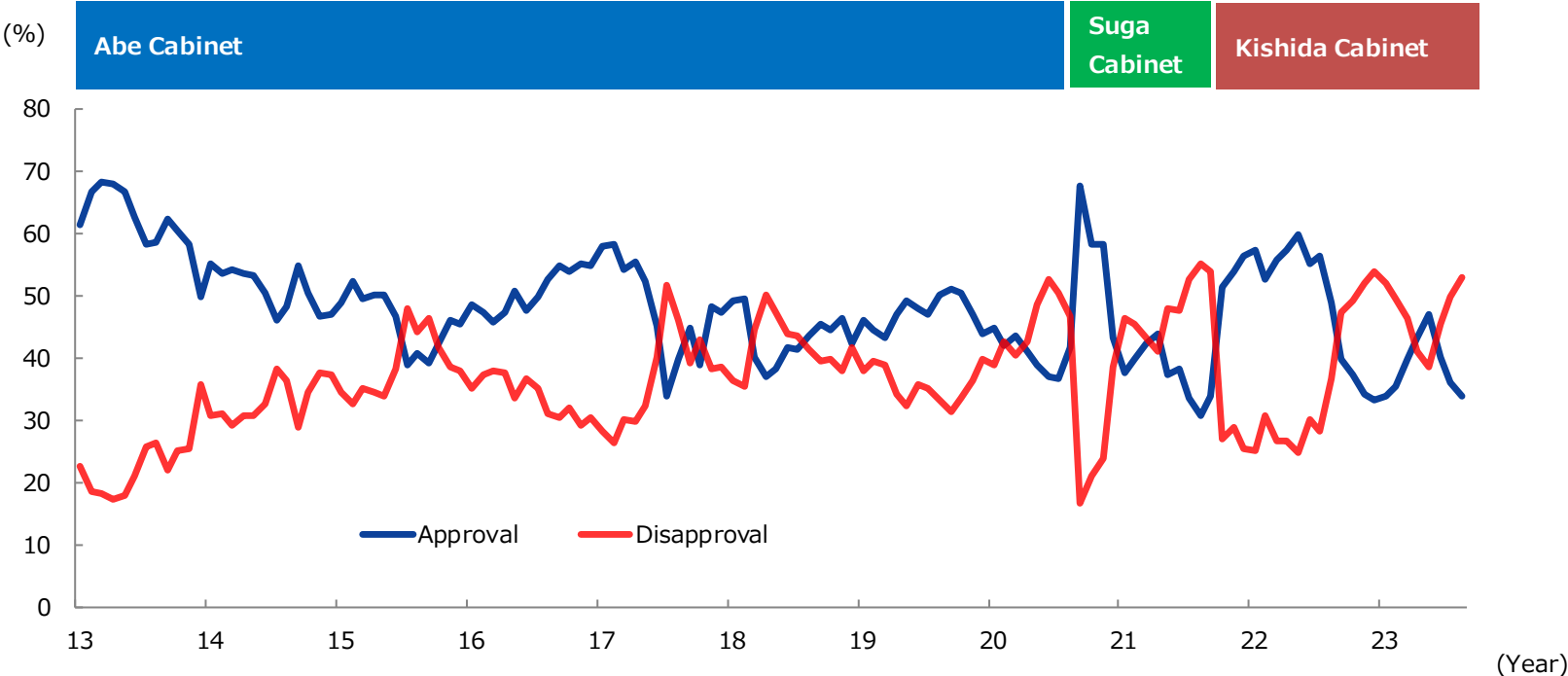
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to June 2023.
 Source; Bank of Japan, METI, and SMDAM

Falling approval rate could be negative for the stock market ahead

Cabinet approval rate



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

Schedule of major events

Year	Month	Date	Event
2023	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
		1	Start of the qualified invoice-based method
2023	October	30-31	Monetary Policy Meeting
		15	Release of CY 2023 Q3 GDP
2023	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
2024	January	1	Start of new NISA (Nippon Individual Savings Account)
		22-23	Monetary Policy Meeting Release of BOJ view report
		15	Release of CY 2023 Q4 GDP
	March	11	Revision of CY 2023 Q3 GDP
		18-19	Monetary Policy Meeting
	April	25-26	Monetary Policy Meeting Release of BOJ view report
May			
June	13-14	Monetary Policy Meeting	

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

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