



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

Hisashi Shiraki
Chief Global Strategist

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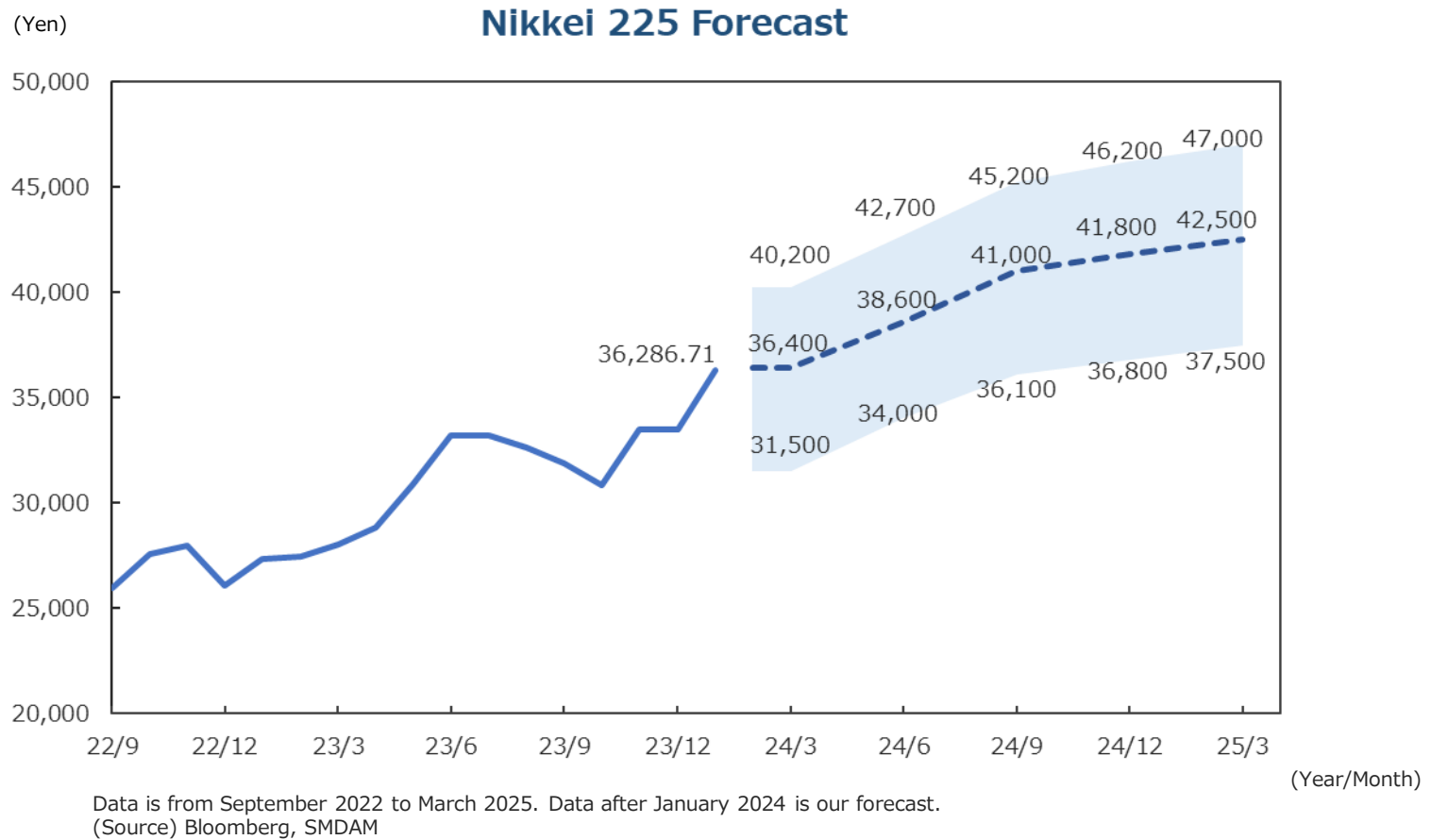


Outlook for Japanese Stock Market

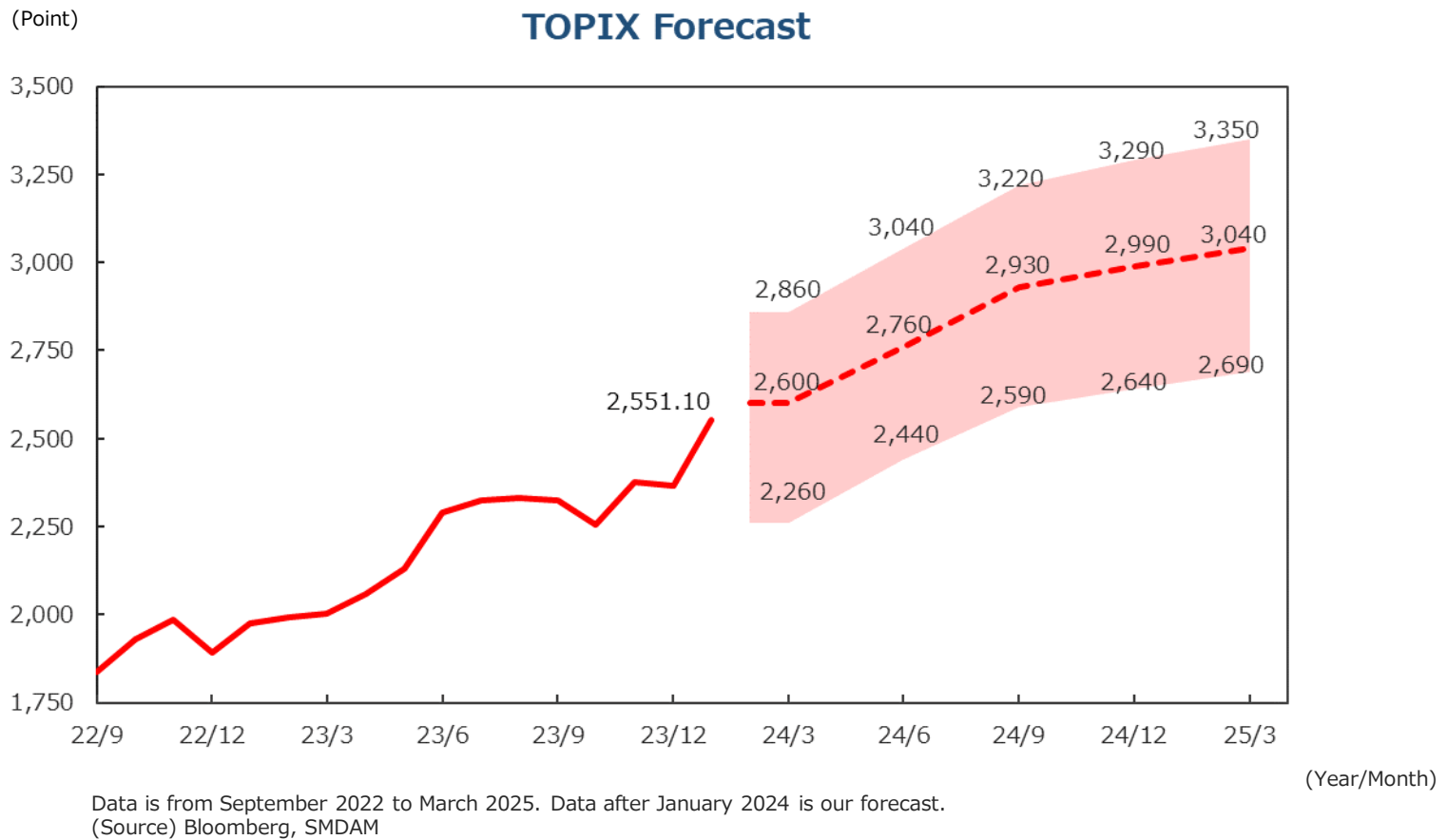
Market Outlook

- We are bullish on the Japanese stock market and expect the Nikkei 225 to surpass its all time high (38,957.44 in December 1989) by the end of Q3 2024.
- Major tailwinds for the equity market include the solid increase in nominal GDP, strong corporate earnings, and accelerating business cycle of manufacturers.
- Further fiscal expansion, caused by rising tax revenue and mounting pressure on the ruling Liberal Democratic Party (LDP) before its leadership election in September, could provide another boost for the market.
- A pivot by the Bank of Japan, which is expected in April, could be a tricky factor for the market in the near future after decades of an ultra-low interest rate environment in Japan.

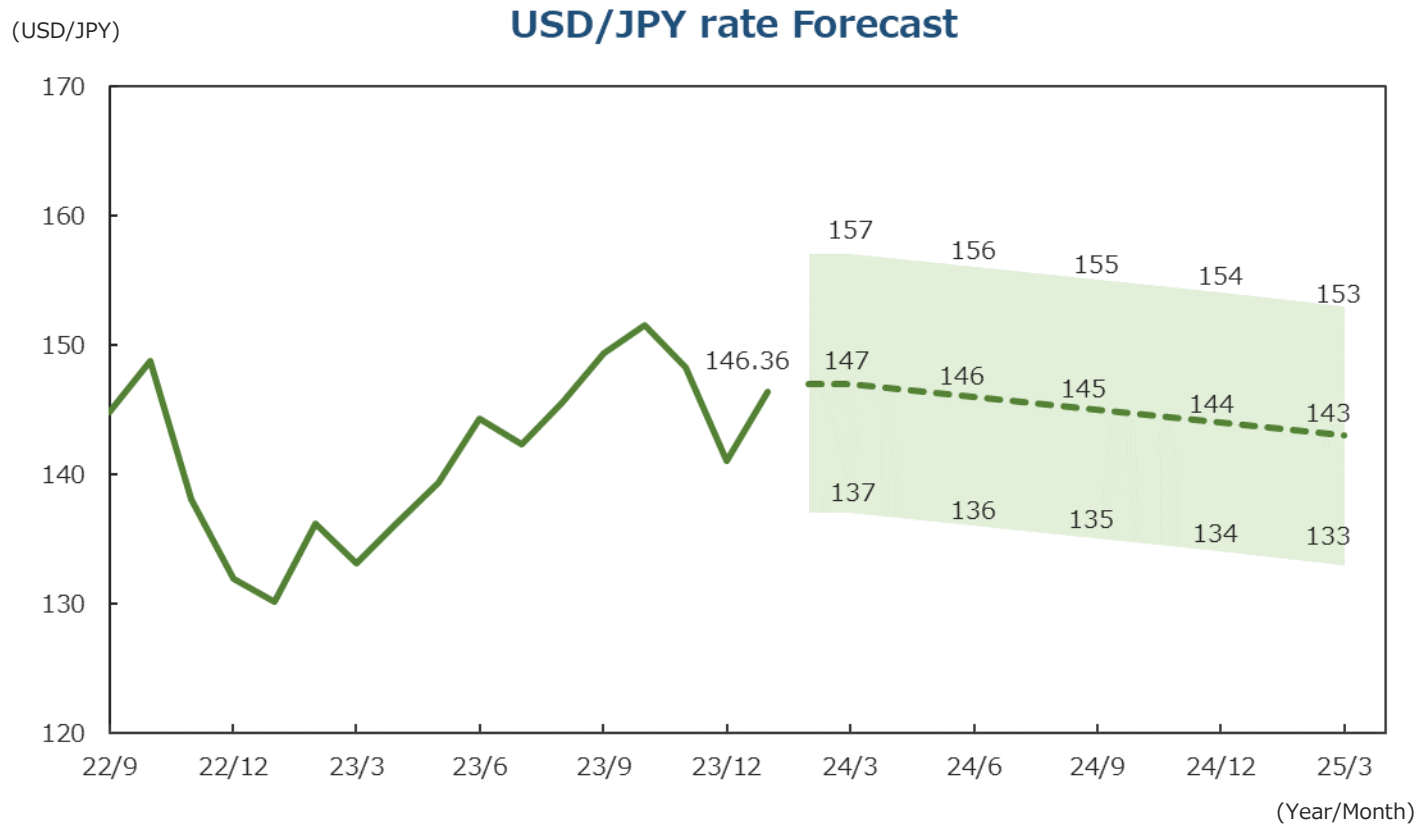
We expect the bullish stock market to continue



We expect the bullish stock market to continue



Modest JPY appreciation ahead due to FED & BOJ pivot



Data is from September 2022 to March 2025. Data after January 2024 is our forecast.
(Source) Bloomberg, SMDAM

Upside / Downside risk scenarios

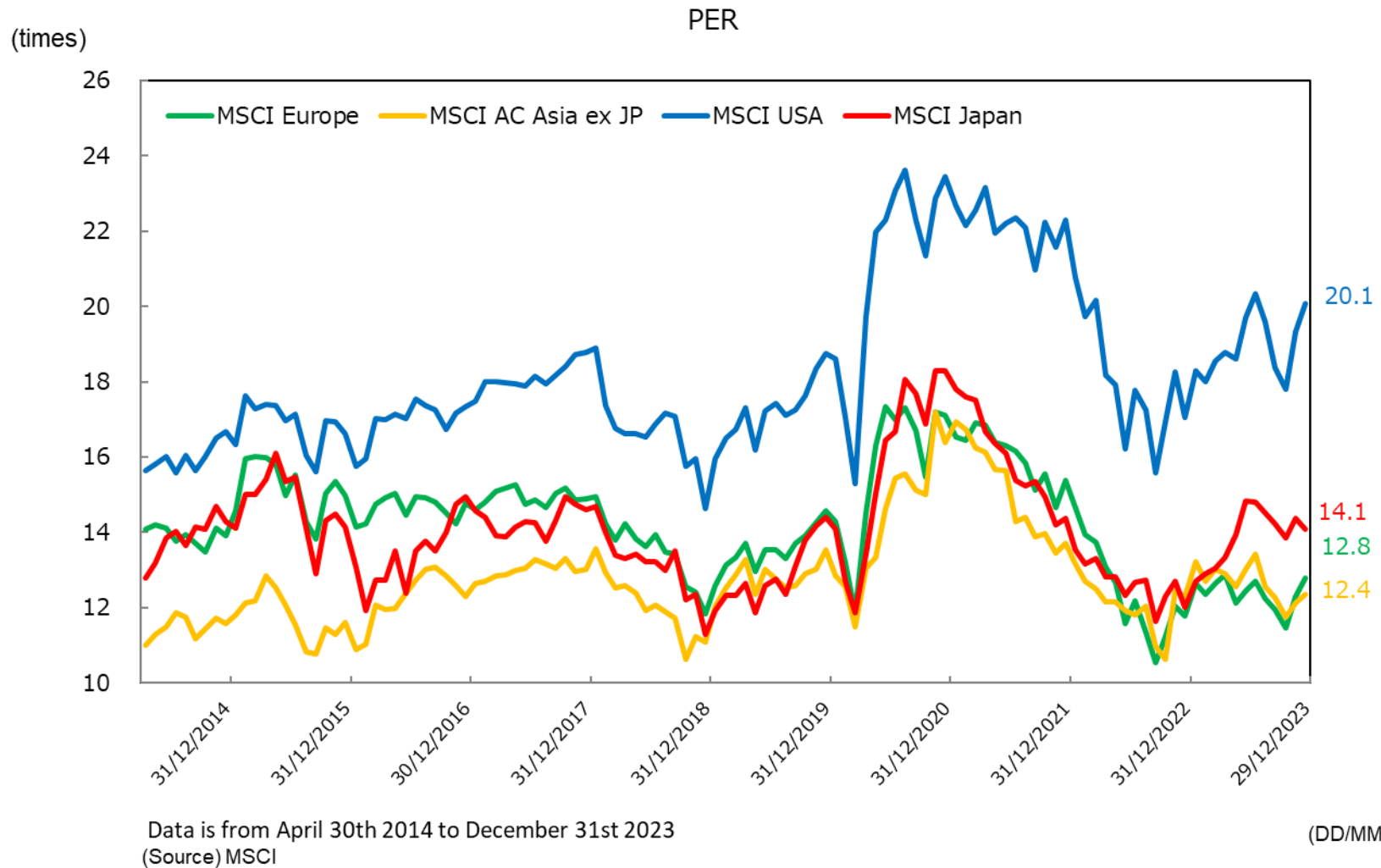
■ Upside Risks

- Growing optimism over virtuous cycle between mild inflation and wage increases
- The Bank of Japan's steady continuation of accommodative monetary policy

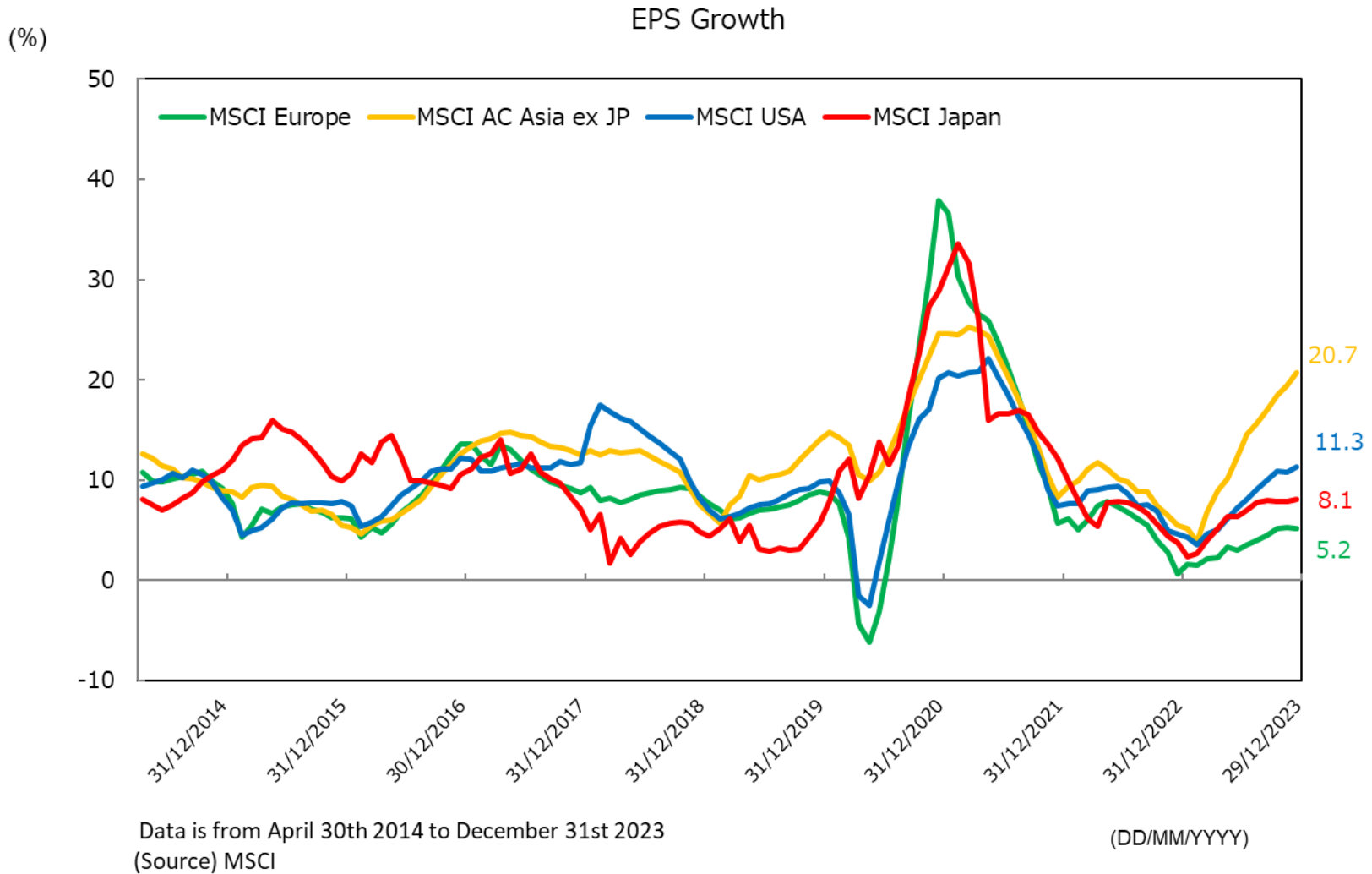
■ Downside Risks

- Excessive & rapid JPY appreciation and its negative impact on corporate earnings
- Hasty & impatient monetary tightening by the Bank of Japan
- Political turmoil caused by the "slush fund scandal" of the ruling LDP

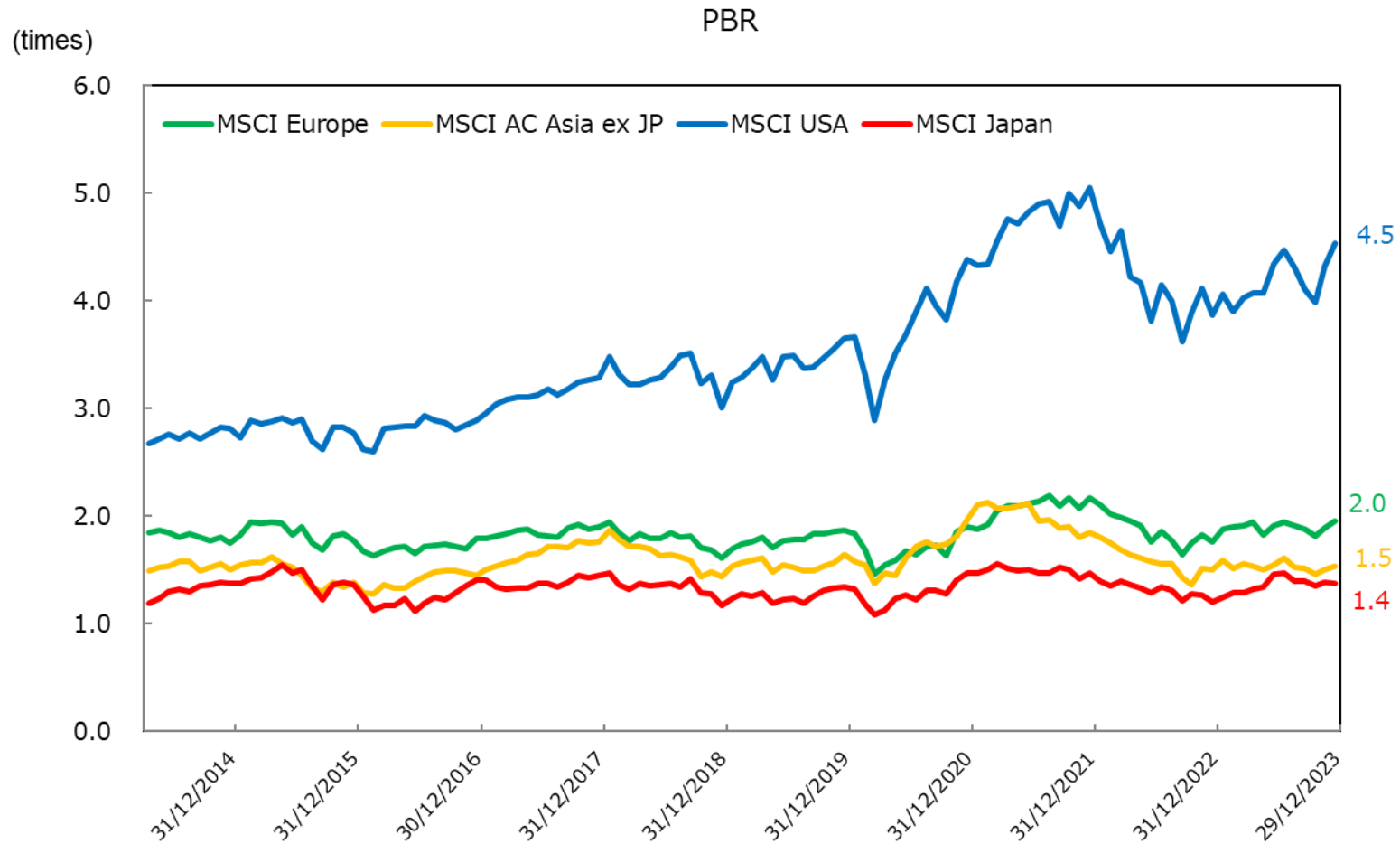
Japan's P/E ratio at around 10 year average



Earnings growth outlook remains solid



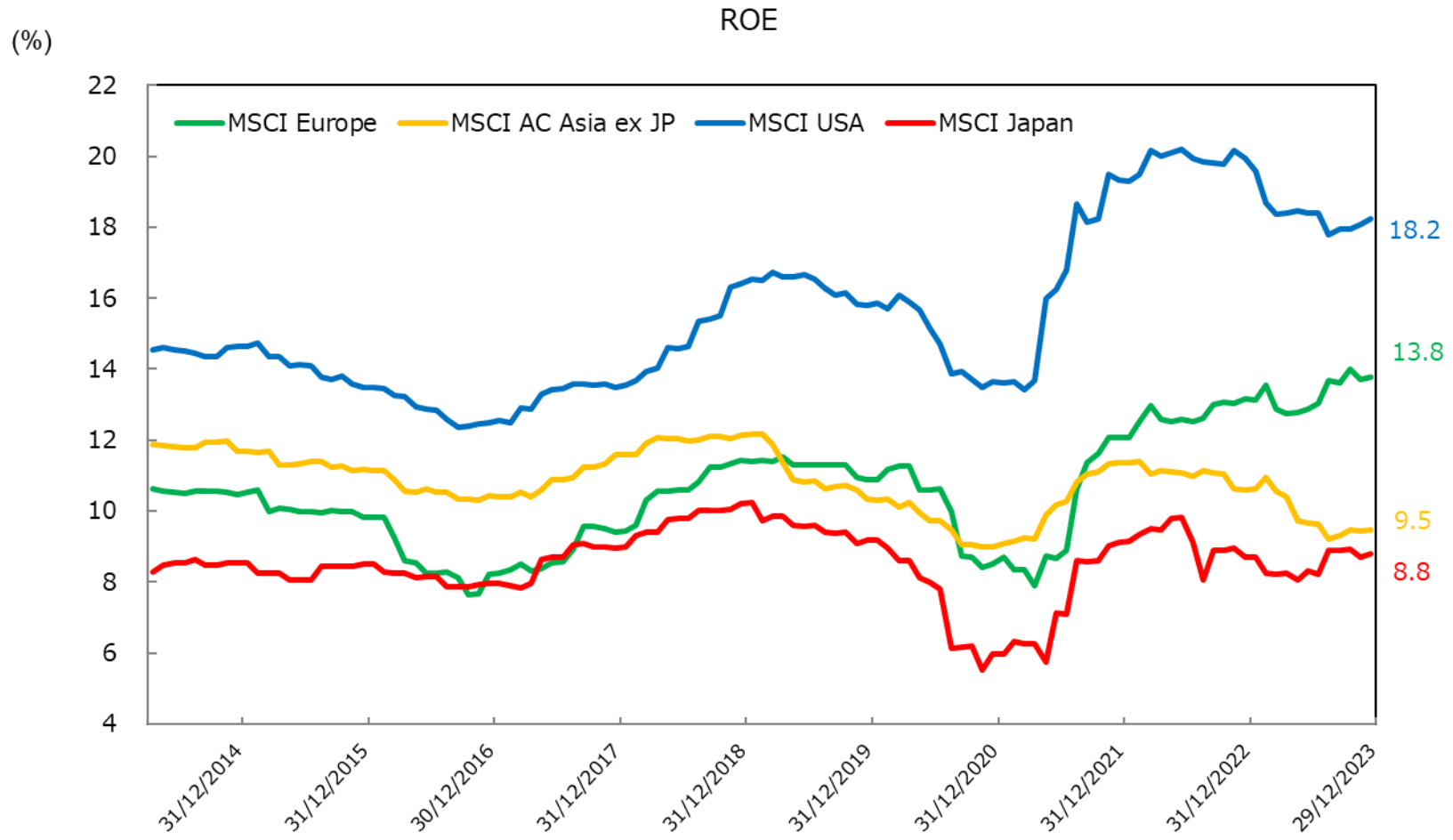
Japan's P/B ratio hits bottom but still lower than peers



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

(DD/MM/YYYY)

Japanese ROE recovering gradually with solid earnings growth

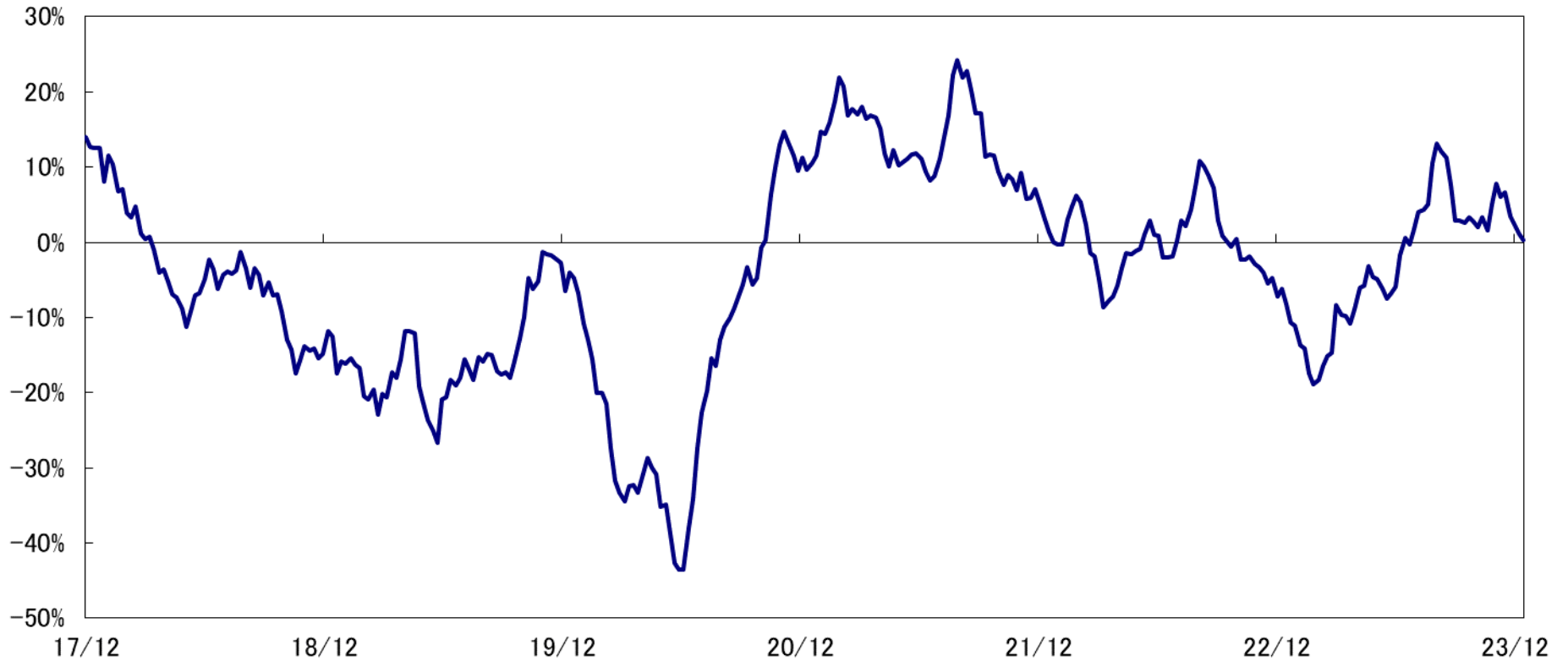


Data is from April 30th 2014 to December 31st 2023
(Source) MSCI

(DD/MM/YYYY)

EPS revision still positive but losing momentum

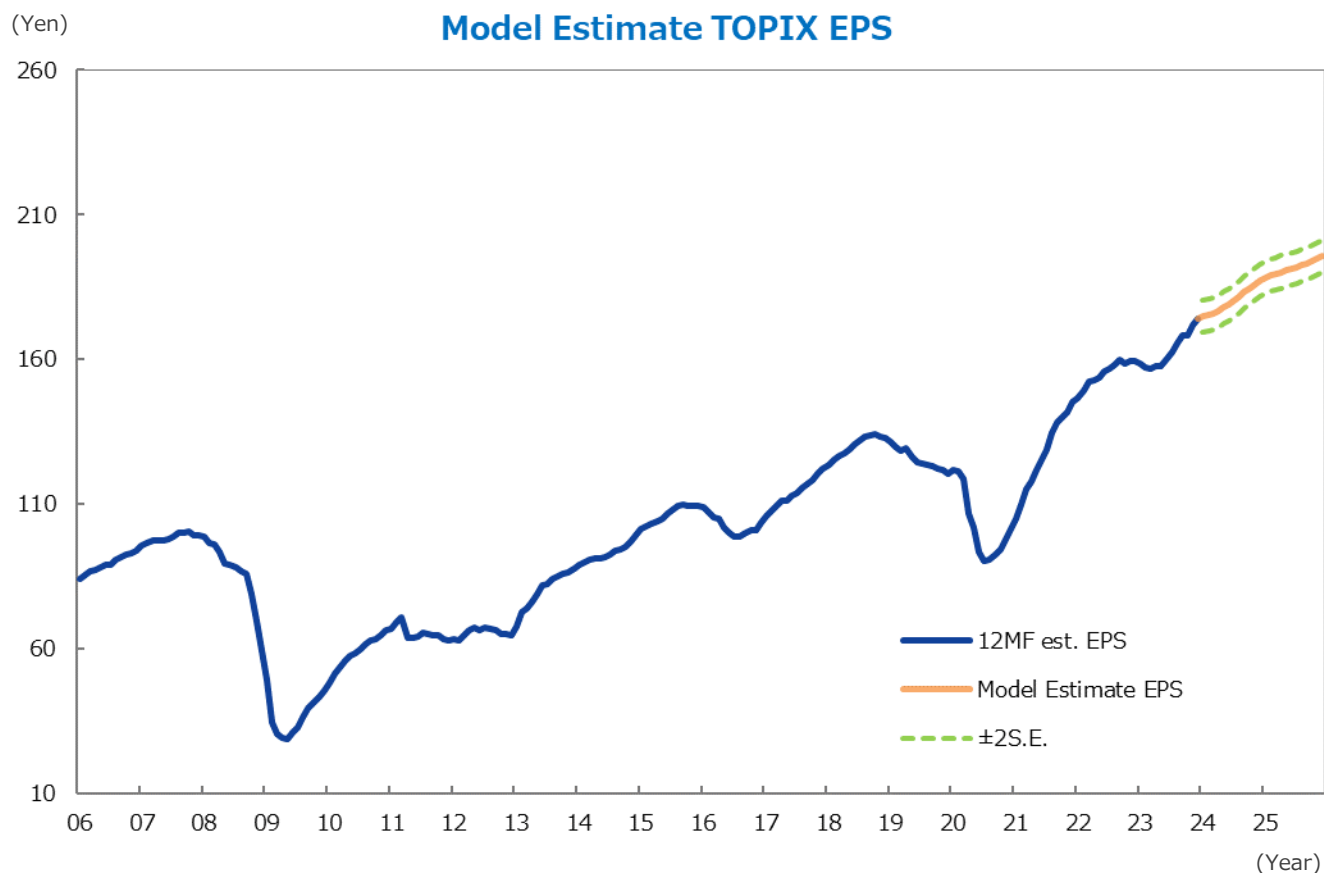
TOPIX Revision Index



Data is from December 28th 2017 to January 11th 2024
(Source) Datastream, IBES

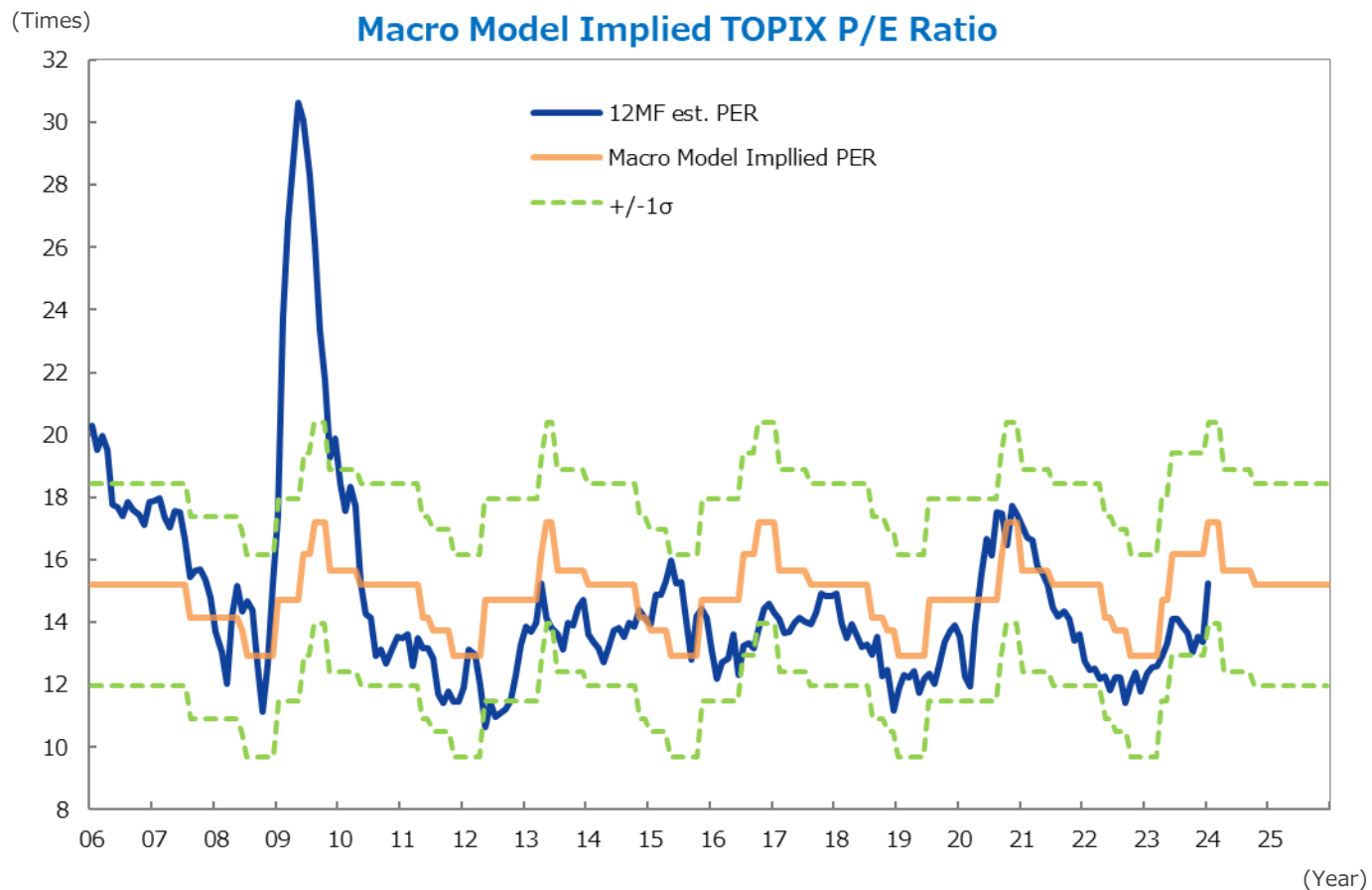
(YY/MM)

Quant model indicates positive earnings outlook going forward



Note: Consensus data is from January 2006 to December 2023. Model estimate Data is from January 2024 to December 2025.
Source: SMDAM

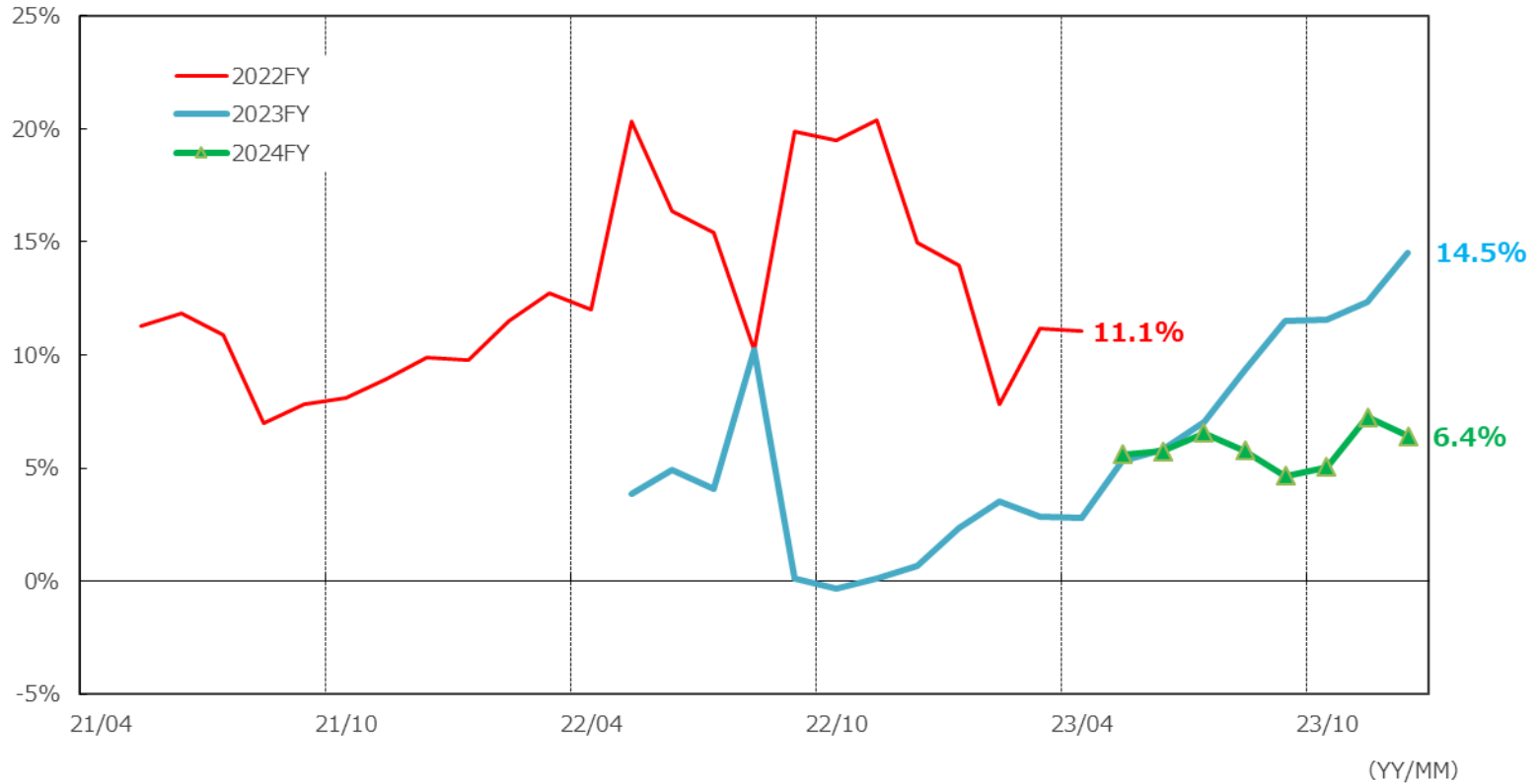
P/E ratio getting closer to fair value of quant model



Note: Consensus data is from January 2006 to December 2023, Model estimate Data is from January 2006 to December 2025.
Source: SMDAM

Current strong earnings growth might slow in 2024

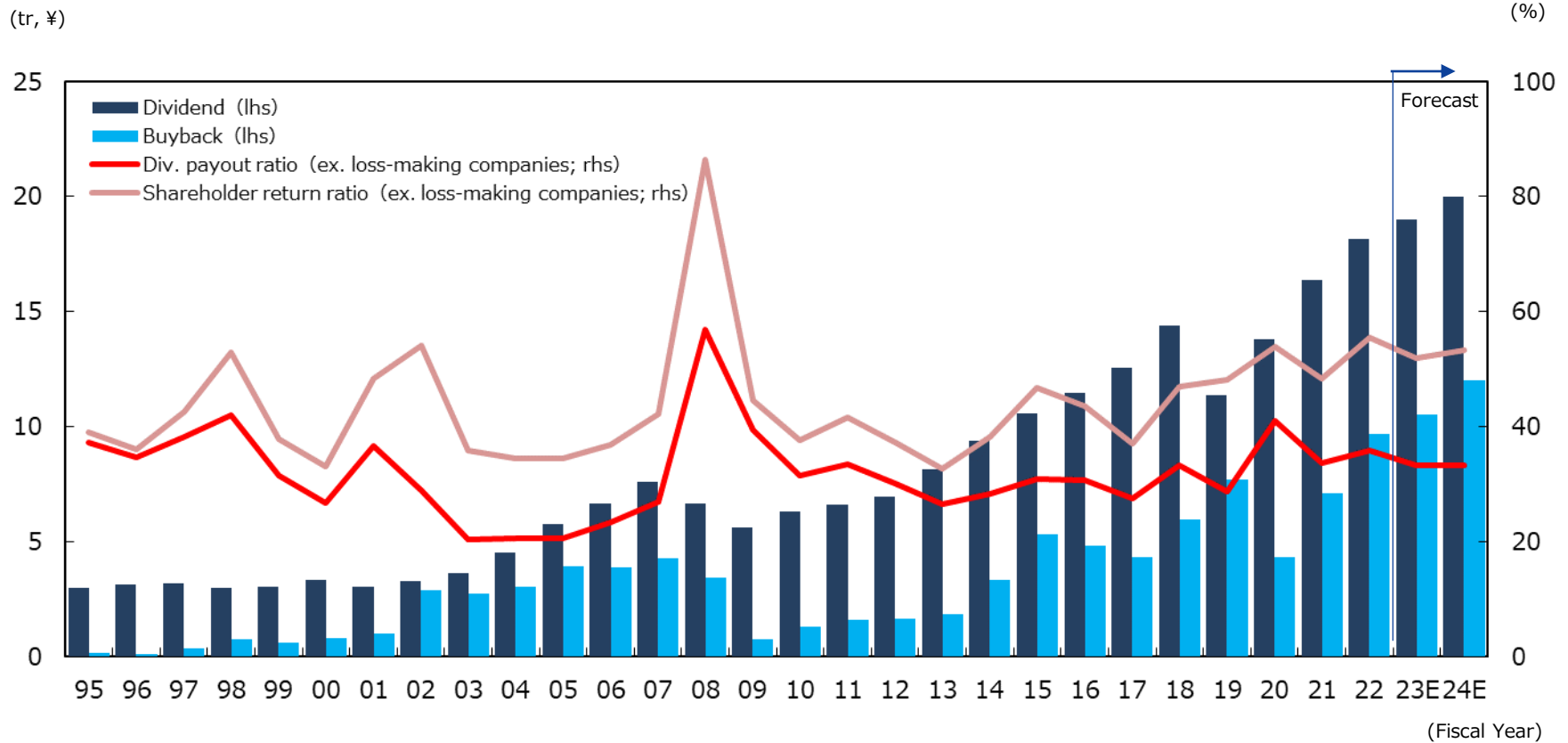
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 15th January 2024, SMDAM Core Universe (Excl. Financials) consists of 402 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Dividends and buybacks beat all time high

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

FED pivot boosts large cap growth

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	11.02	9.88	6.00	31.04	30.70	34.65	62.45
Total Value	7.86	12.36	6.39	37.57	44.04	63.44	61.86
Top Cap Value	6.71	10.61	7.96	39.09	47.43	76.43	85.18
Large Cap Value	7.94	12.50	7.12	38.63	45.13	67.69	65.80
Mid Cap Value	9.09	14.57	6.35	37.31	41.39	56.35	40.76
Small Cap Value	7.50	11.72	3.17	32.79	39.07	45.41	45.12
Micro Cap Value	8.84	12.43	3.31	30.81	38.38	43.55	48.41
Total Growth	14.27	7.17	5.67	24.60	18.40	10.90	60.79
Top Cap Growth	17.68	10.27	7.39	28.86	19.50	14.83	76.21
Large Cap Growth	14.83	7.80	6.21	26.38	19.21	12.02	65.84
Mid Cap Growth	9.72	3.35	4.04	21.90	18.62	7.10	49.80
Small Cap Growth	9.60	2.02	1.06	10.89	12.35	2.74	24.24
Micro Cap Growth	9.82	2.07	0.81	8.43	11.47	-0.35	24.23
Top Cap Total	12.95	10.94	7.60	33.94	31.86	39.55	79.41
Large Cap Total	11.48	10.18	6.61	32.25	31.10	35.79	66.83
Mid Cap Total	9.37	9.17	5.28	29.83	30.09	30.51	49.85
Small Cap Total	8.24	8.04	2.33	24.02	28.18	27.75	37.96
Micro Cap Total	9.12	9.11	2.43	23.18	28.99	27.90	41.73

Note : As of 19th January 2024
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is standing still.** The contraction in real GDP in Q3 2023 was due to a recoil of higher growth in H1 of 2023 and lackluster domestic demand. Since Q4 of 2023, domestic demand has been sluggish due to the negative impact of high prices, but business sentiment has generally remained strong.
- **Inflation is slowing down.** The nationwide core CPI rose by 2.5% in November YOY and the pace of inflation slows from previous month at 2.9%. The Tokyo metropolitan area core CPI also rose by 2.1% in December, down from 2.3% a month earlier. Inflation has been slowing, mainly in goods prices. A reduction in cost-push pressure from import prices, has contributed to lower inflation recently.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2023 at +1.6%, that for FY 2024 at +1.1%, and that for FY 2025 at +0.8%.** Although "the Noto Peninsula earthquake" occurred in the west coast of Japan on 1st January, the impact on economic growth is expected to be limited based on past analysis. The economy is expected to return to a moderate recovery. Against the backdrop of a resumption of economic activity, slowing inflation, rising wages and economic measures, domestic demand is expected to avoid a setback and gradually recover. On the other hand, though exports will slow due to the slowdown in the U.S. economy, we expect the economy will remain firm as a trend.
- ② **While we have raised our core CPI forecast for FY 2023 from +2.7% to +2.8%, we have maintained that for FY 2024 and FY 2025 at +2.0% and +1.7% respectively.** The downward revision of core CPI in FY 2023 was based on minor adjustments reflecting the most recent results. Core CPI growth is likely to pick up from February 2024 as the downward impact of government subsidies on electricity and gas bills will disappear. However, it is highly likely that the core CPI will follow a deceleration trend as the cost push pressure from import prices, continues to decline. Core CPI is expected to fall below 2% in the second half of FY 2024 and beyond, although rising service prices due to improved wages are expected to support prices.
- ③ **We expect the government will continue their accommodative economic policy.** In November 2023, Prime Minister Kishida's Cabinet approved "comprehensive economic measures to completely overcome deflation." The measure, which amounts to 20.9 trillion yen on a national and local spending basis, includes measures to counter high prices, support for growth sectors, and national infrastructure resilience. Tax cuts are expected to take effect in June 2024. Regarding the "Noto Peninsula earthquake", the cabinet decided to double the reserve fund for FY 2024 to 1 trillion yen. We should pay close attention to the risk of fiscal expansion, aimed at improving the approval ratings of the Cabinet and the ruling Liberal Democratic Party, which have declined as a result of the party ticket and slush fund scandal.
- ④ **We expect the end of ultra-easy monetary policy in April 2024 to include raising the policy rate to 0% and eliminating the YCC (yield curve control).** The Bank of Japan is expected to revise its economic outlook report in April after confirming the results of the unions' spring wage talks, which will be released in mid-March, and judge the probability of achieving the price stability target. After that, monetary policy is expected to remain unchanged for the time being. Given the possibility of inflation falling below 2% and the risk of a stronger yen, the BOJ is likely to be cautious about raising interest rates further.

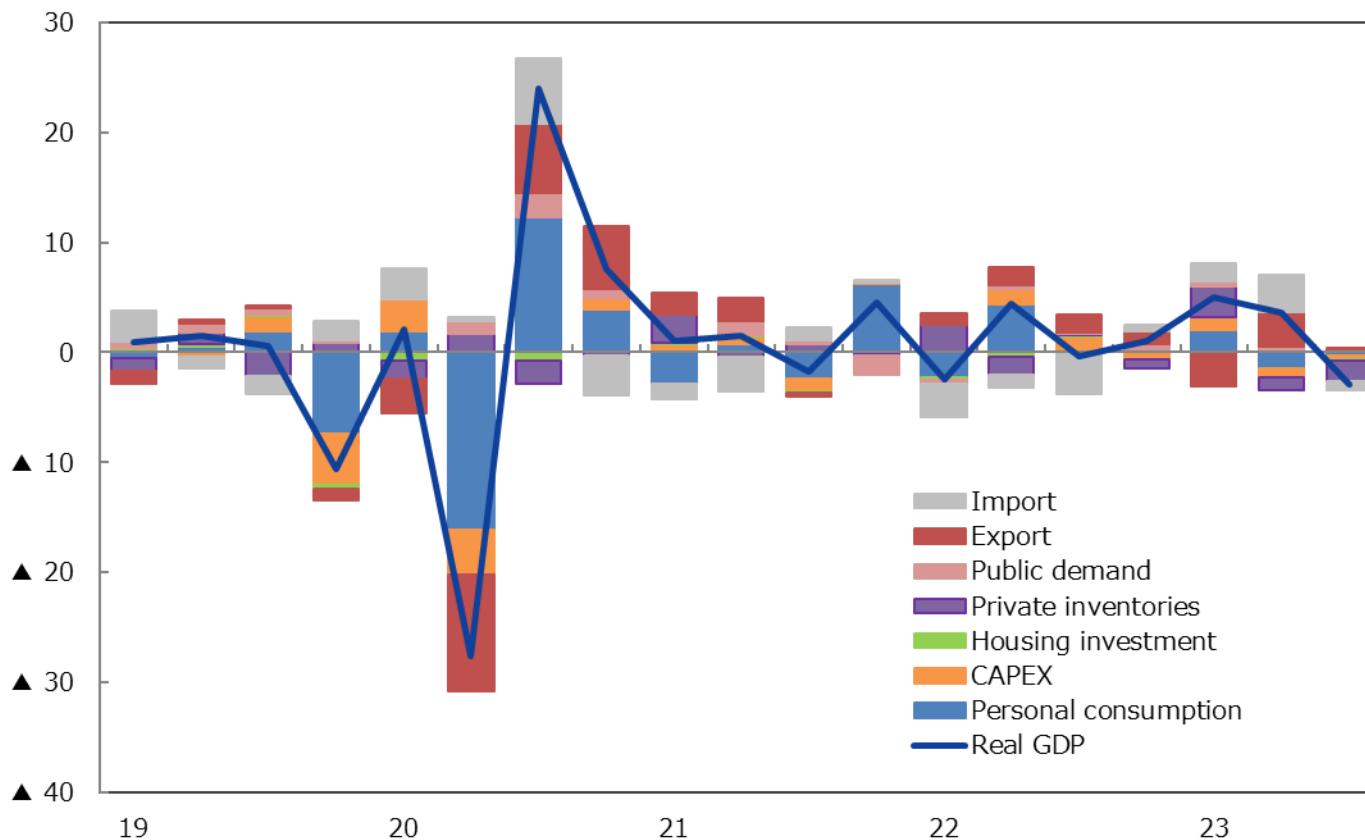
Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est	FY25 Est	
Real GDP	-0.8%	-4.1%	2.7%	1.4%	1.6%	1.1%	0.8%	
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	0.0%	1.1%	0.9%	
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	1.6%	-0.4%	-0.2%	
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	-0.1%	1.6%	1.8%	
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.2%	-0.1%	0.0%	
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	2.4%	0.7%	0.7%	
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.3%	0.0%	-0.2%	
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.9%	2.9%	1.7%	
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-2.7%	3.3%	3.1%	
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.6%	2.6%	2.0%	
GDP deflator	0.8%	0.7%	-0.1%	0.7%	3.9%	1.6%	1.2%	
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-1.1%	1.6%	1.4%	
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.0%	1.7%	
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.0%	0.5%	0.8%	
Employee compensation	2.0%	-1.5%	2.1%	2.0%	2.3%	3.2%	3.0%	
Unemployment rate	2.4%	2.9%	2.8%	2.6%	2.6%	2.4%	2.3%	
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	0.0%	0.0%	

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's GDP declined in Q3 due to weak personal spending

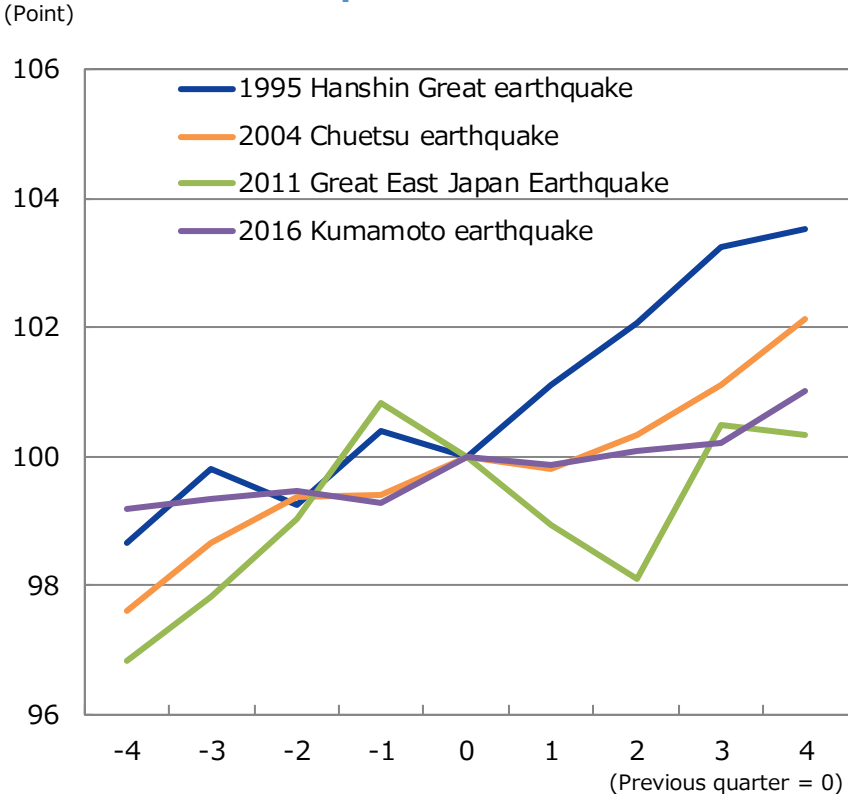
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q3 2023.
Source: Cabinet office, SMDAM

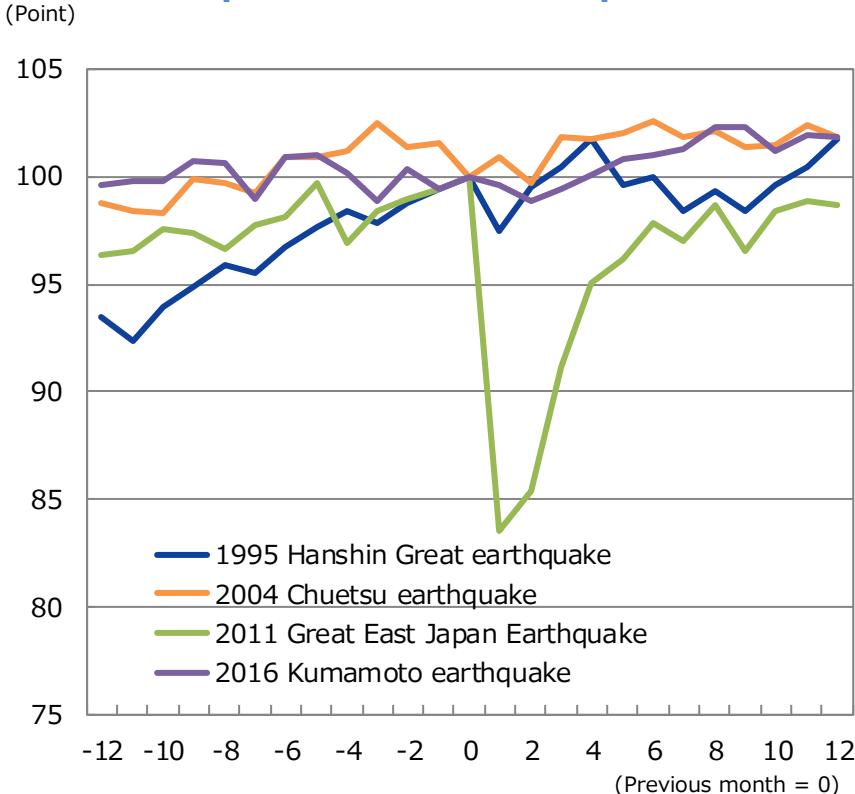
Earthquakes have limited impact on economy historically

Earthquake & Real GDP



Note: Data of the previous quarter of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

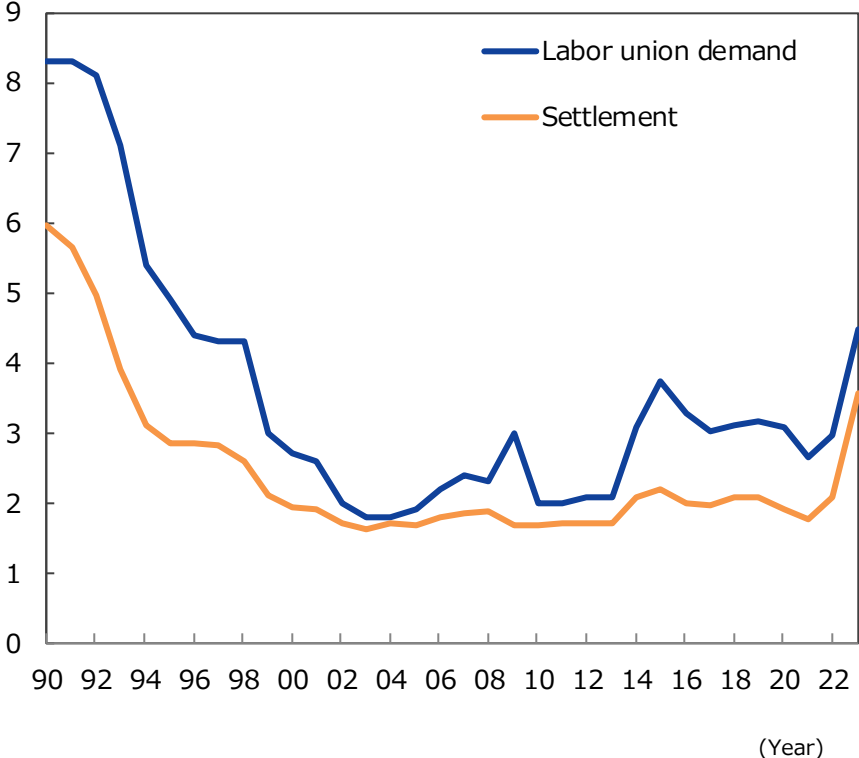
Earthquake & Industrial production



Note: Data of the previous month of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

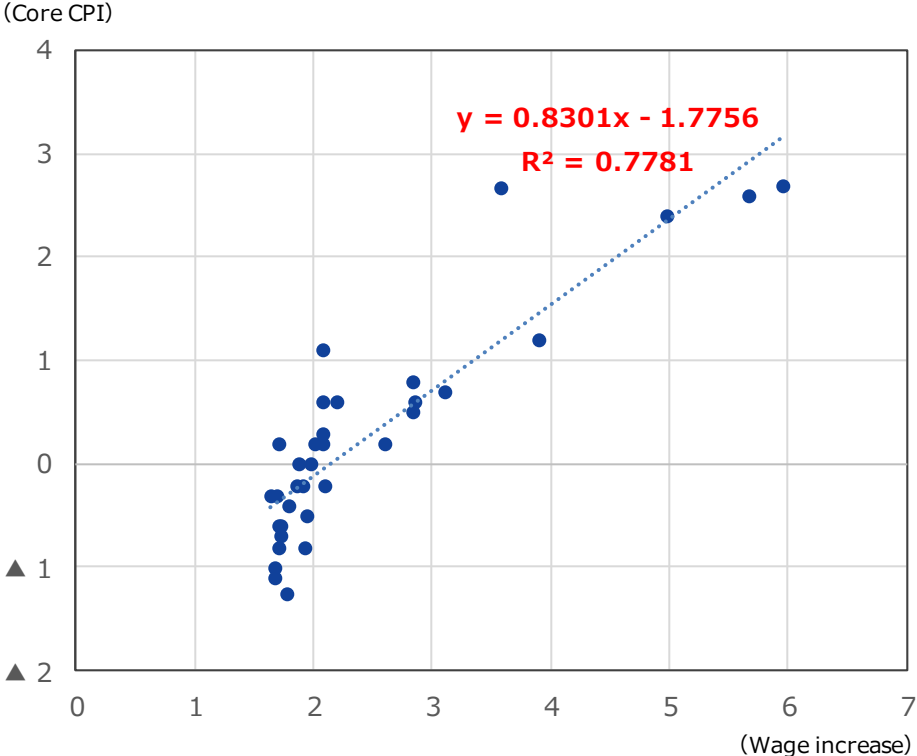
Start of a virtuous cycle of wage increase & mild inflation

Wage increase demand & settlement (YOY, %)



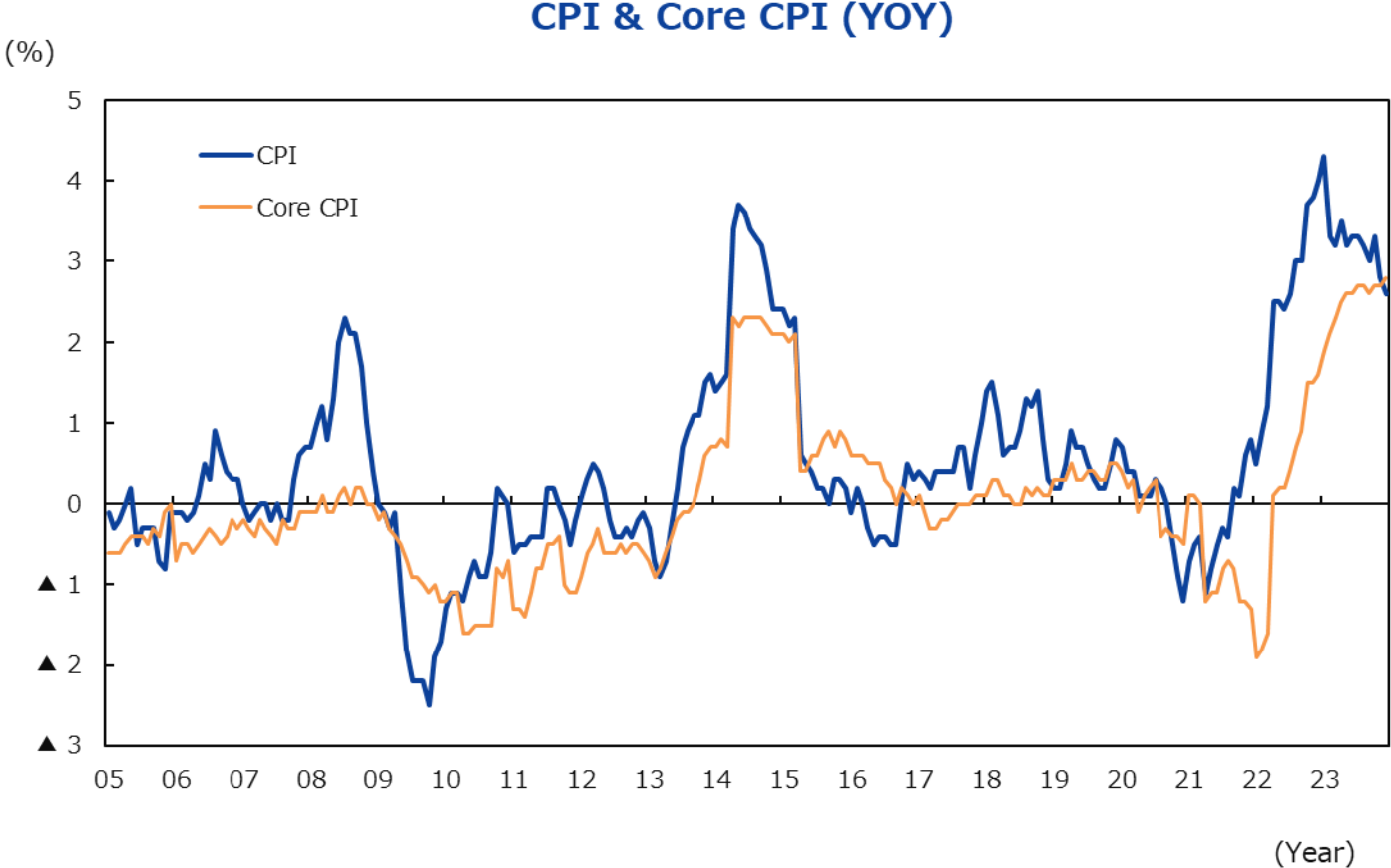
Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

Wage increase & Core CPI (YOY, %)



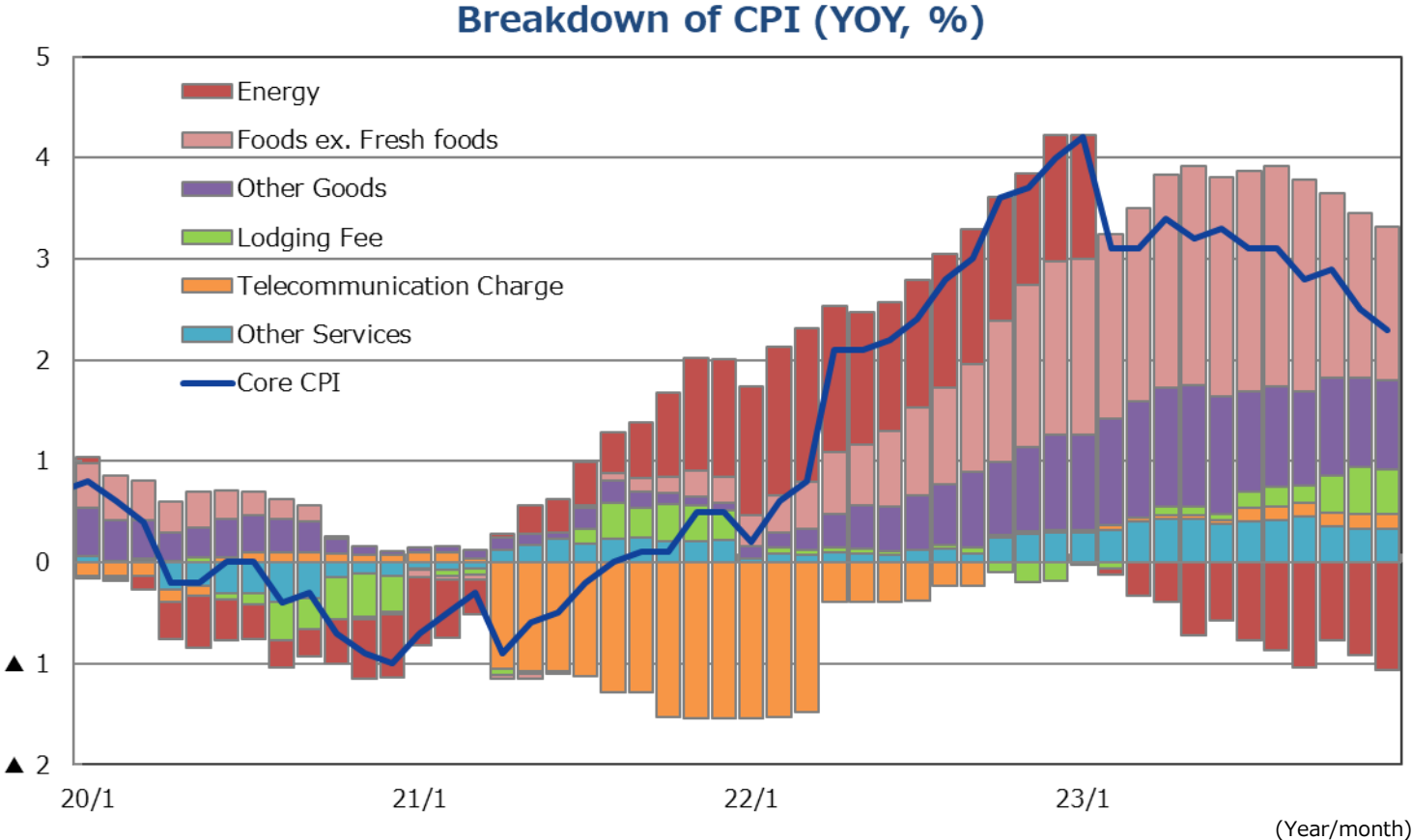
Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

Sticky core CPI exceeds headline inflation



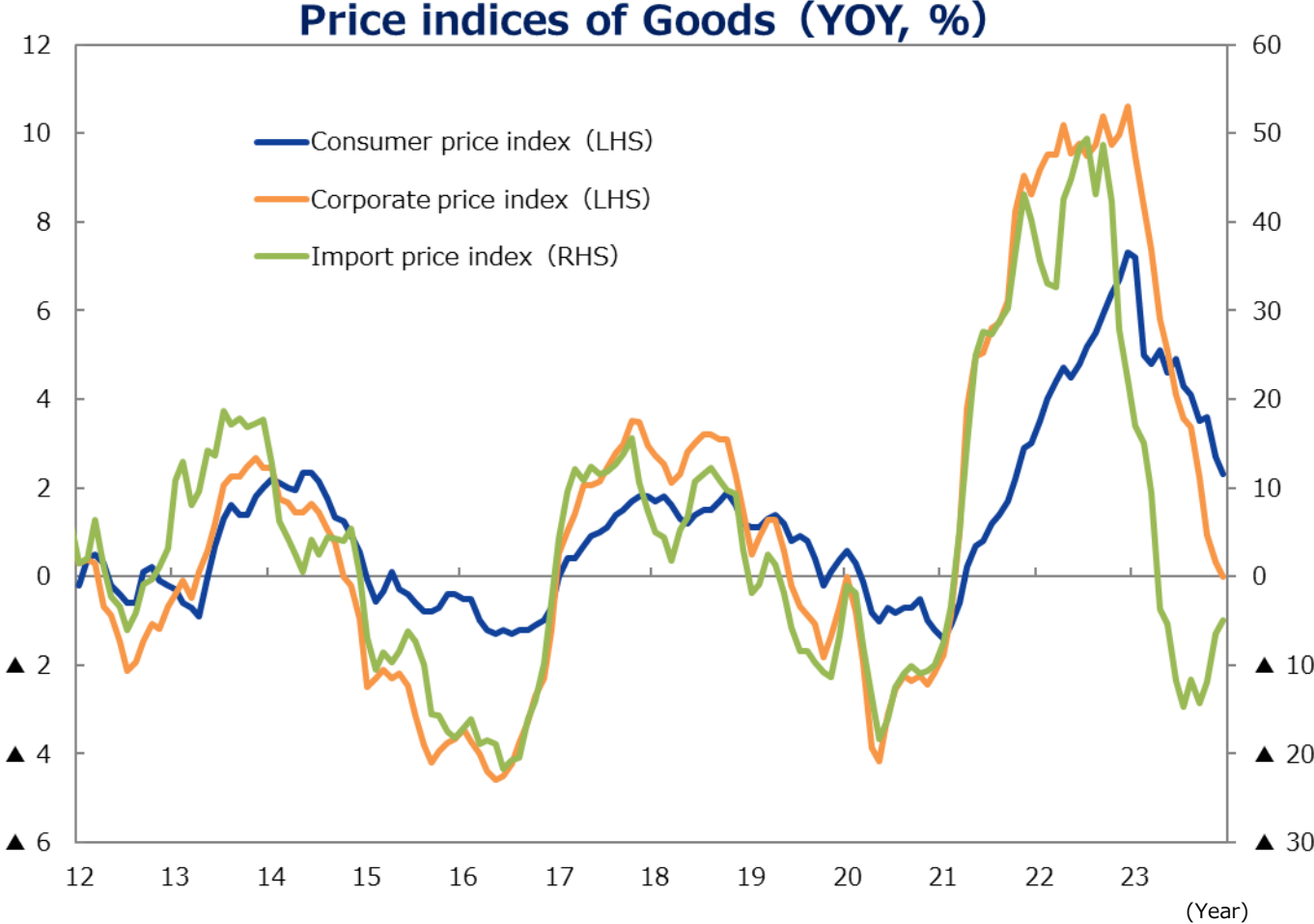
Note: Data is from January 2005 to December 2023, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

Food and goods make Japanese inflation stickier



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

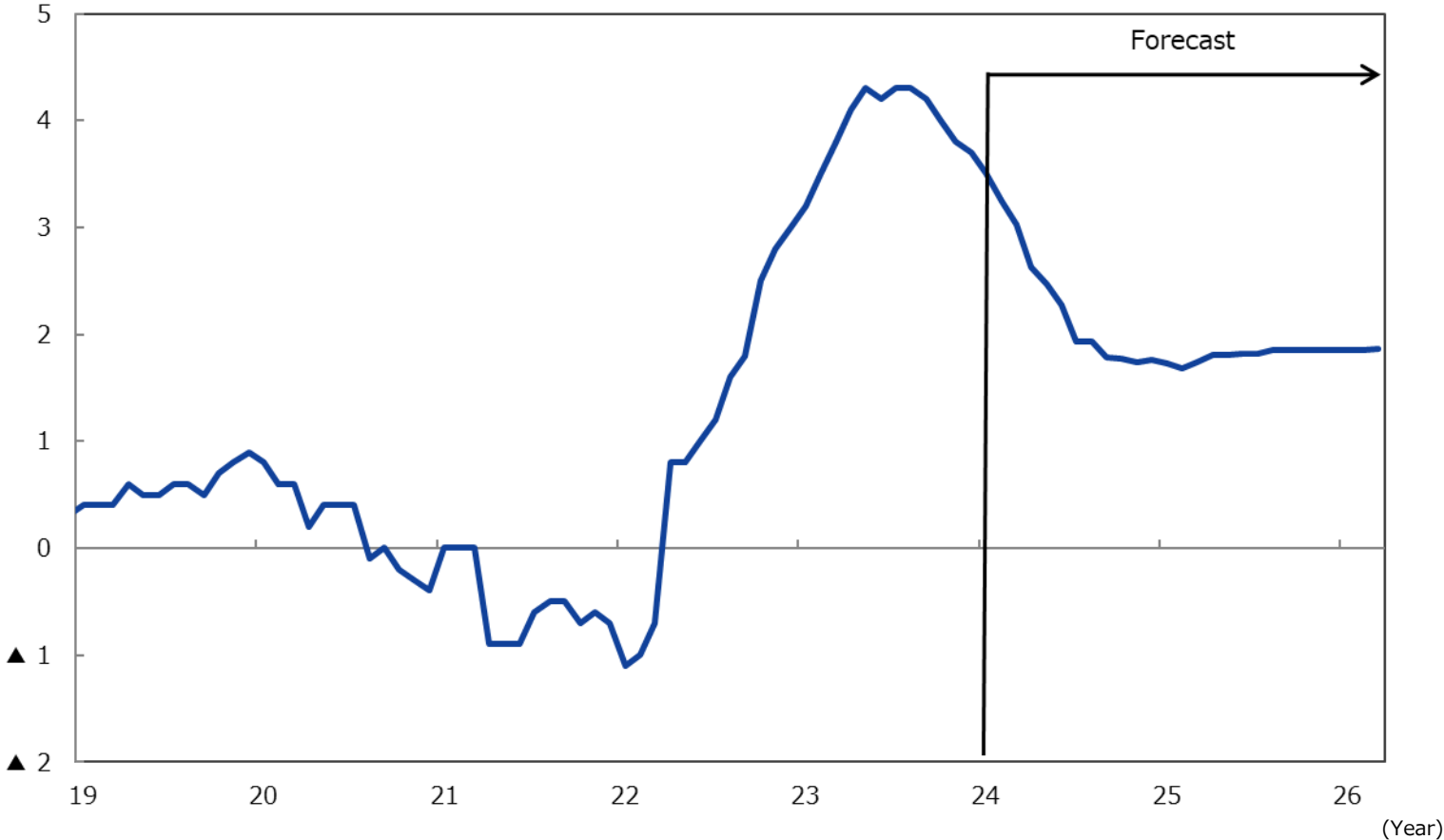
Slower decline of consumer prices boost profit margin



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

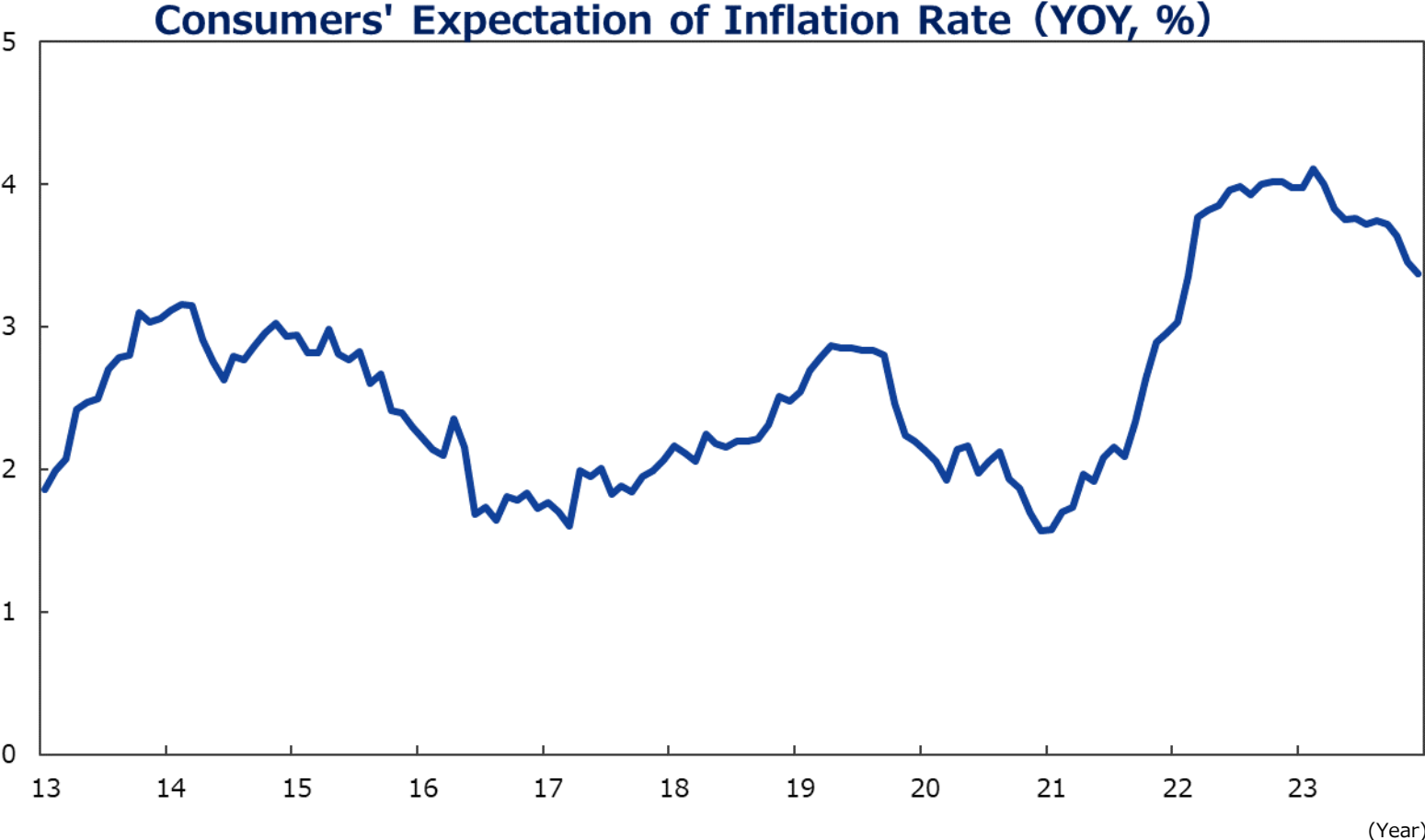
BOJ expects inflation to decline below 2% in H2 of 2024

BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2026. BOJ's Core CPI is excluding fresh foods & energy. Data from January 2024 is forecasts.
Source: The Bank of Japan, SMDAM

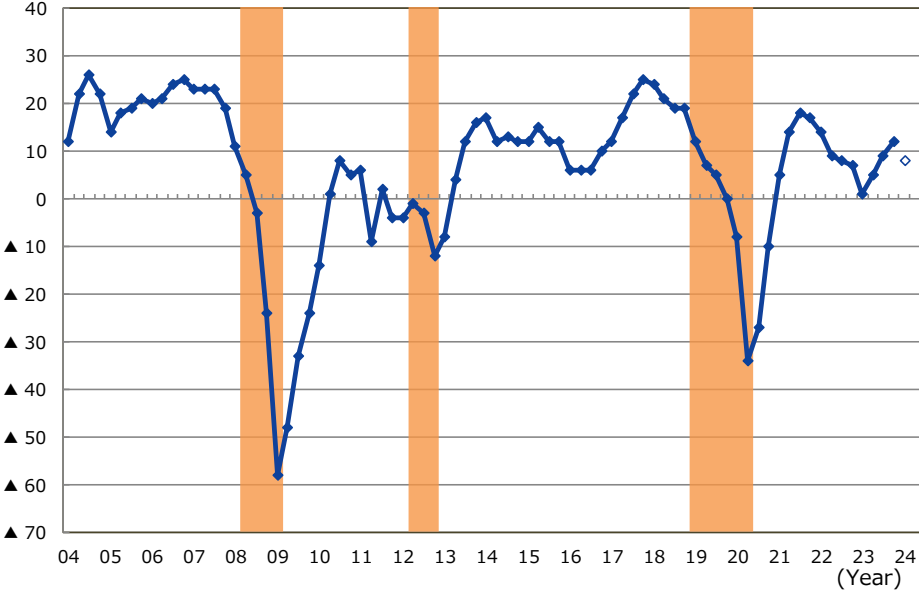
Consumers expect inflation to be higher & stickier



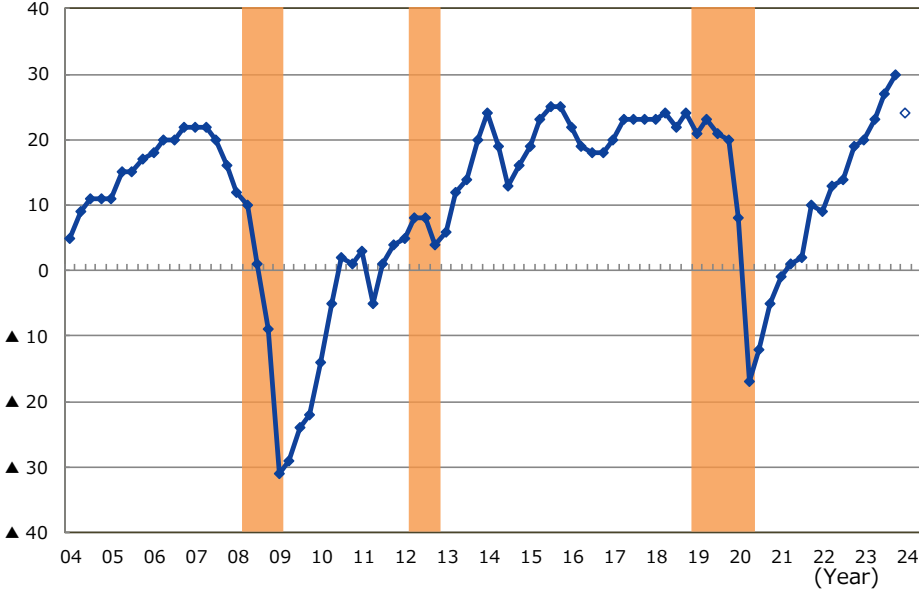
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to January 2024.
Source: Cabinet Office, SMDAM

Business sentiment remains positive but caution ahead

BOJ business condition DI Large manufacturers (%)



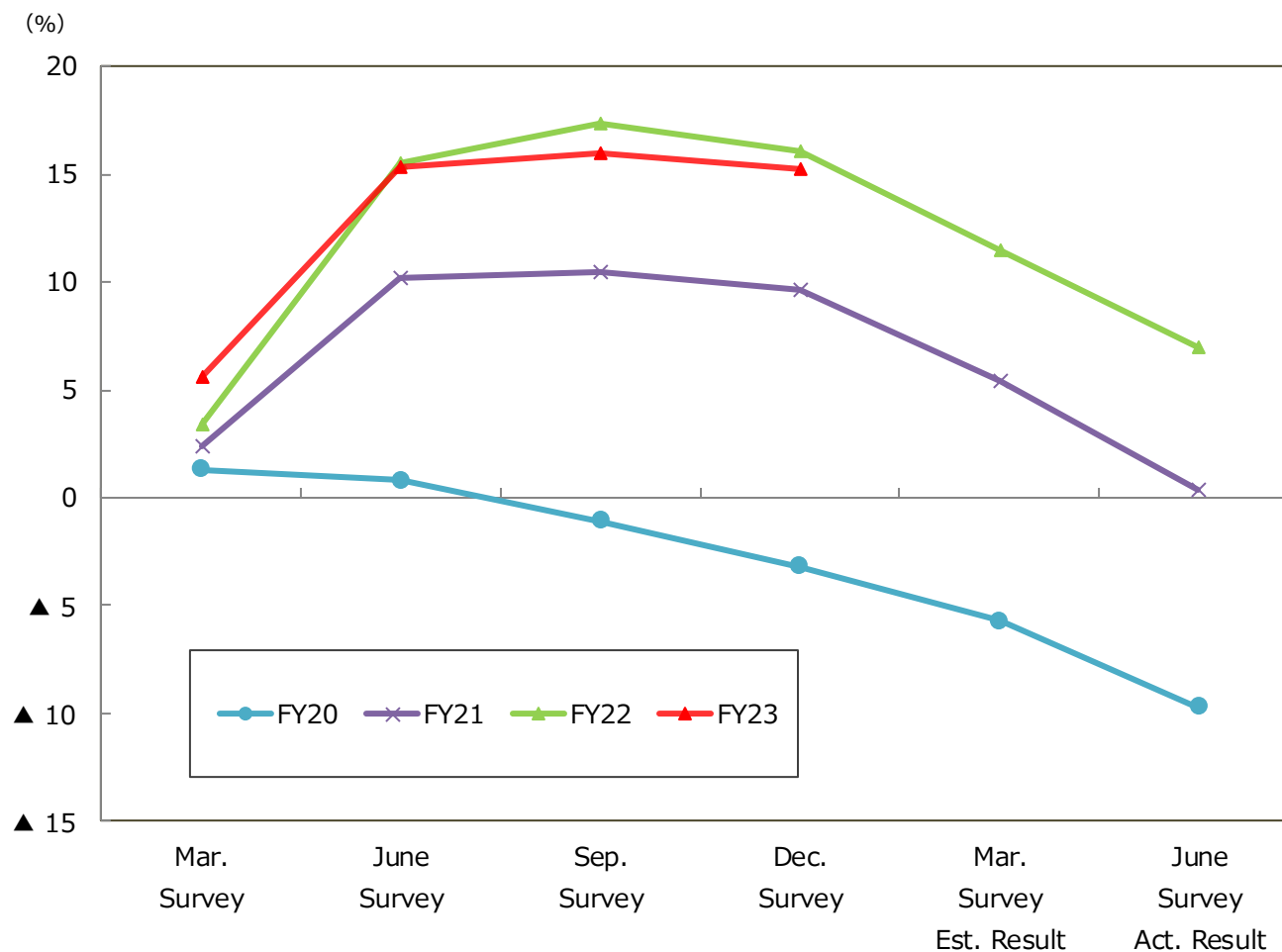
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q4 2023. The orange shadow are periods of economic recession.
 Source: The Bank of Japan, SMDAM

Weakening yen and de-risking lift CAPEX in Japan

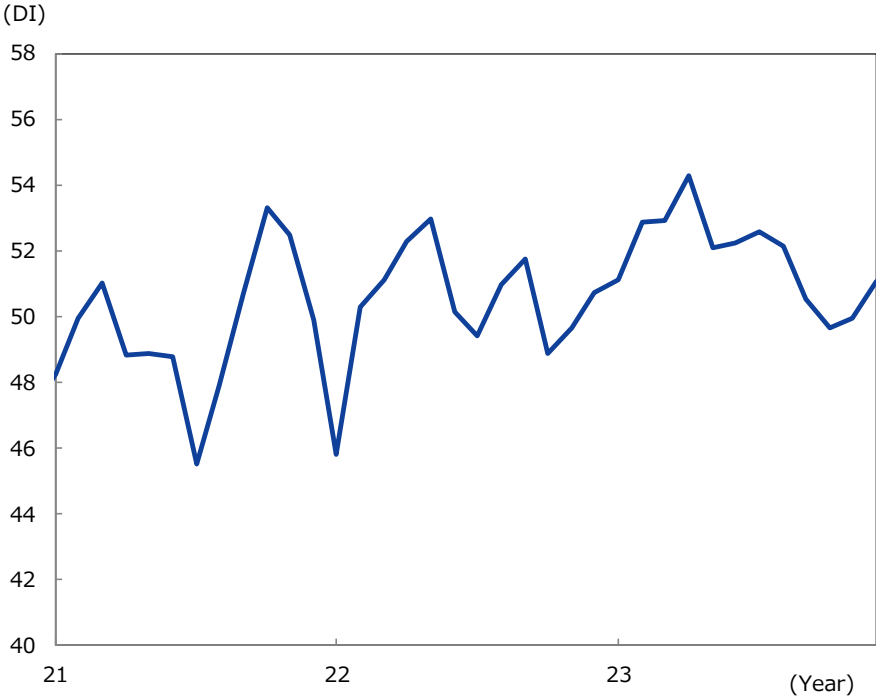
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



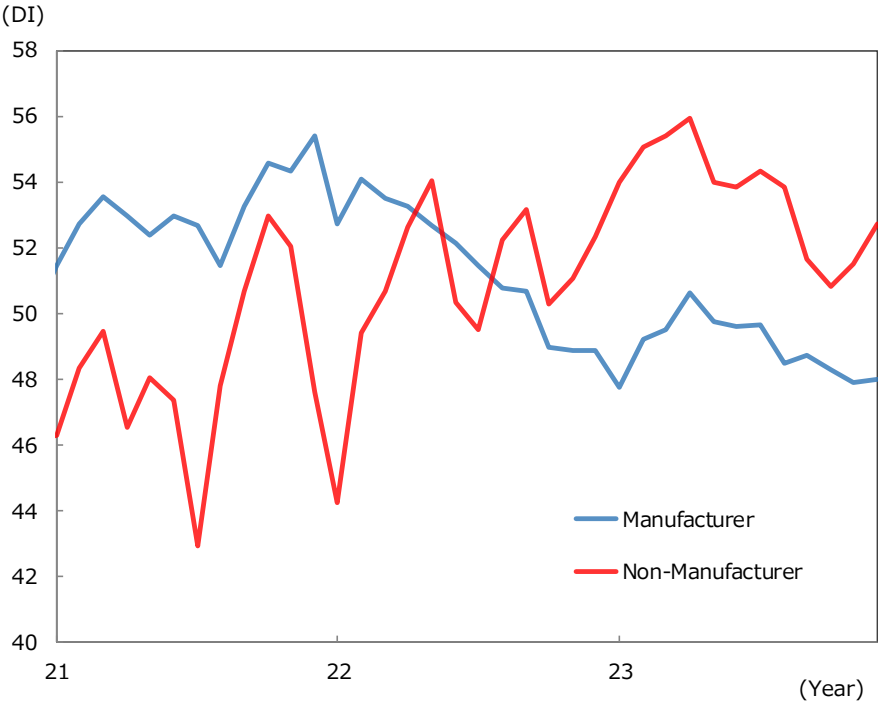
Note: Data is from Q1 FY2020 to Q4 FY2023.
Source: The Bank of Japan, SMDAM

Divergence of sentiment between manufacturers and services

Composite PMI



PMI, Manufacturer & Non-Manufacturer



Note: Data is from February 2021 to January 2024.
Source: Bloomberg, SMDAM

Industrial production moves back and forth

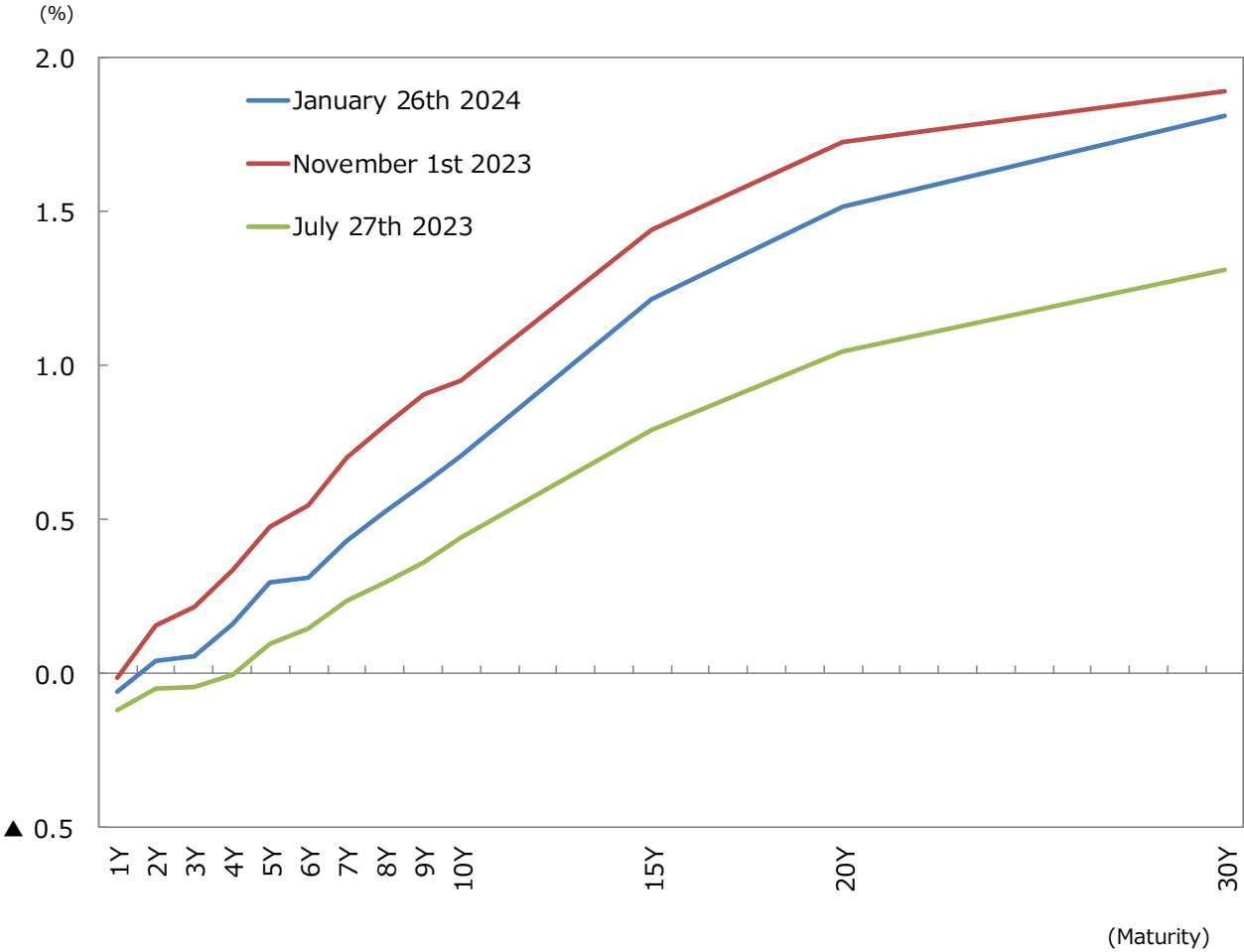
Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to January 2024. Data after December 2023 are forecasts.
Source: METI, SMDAM

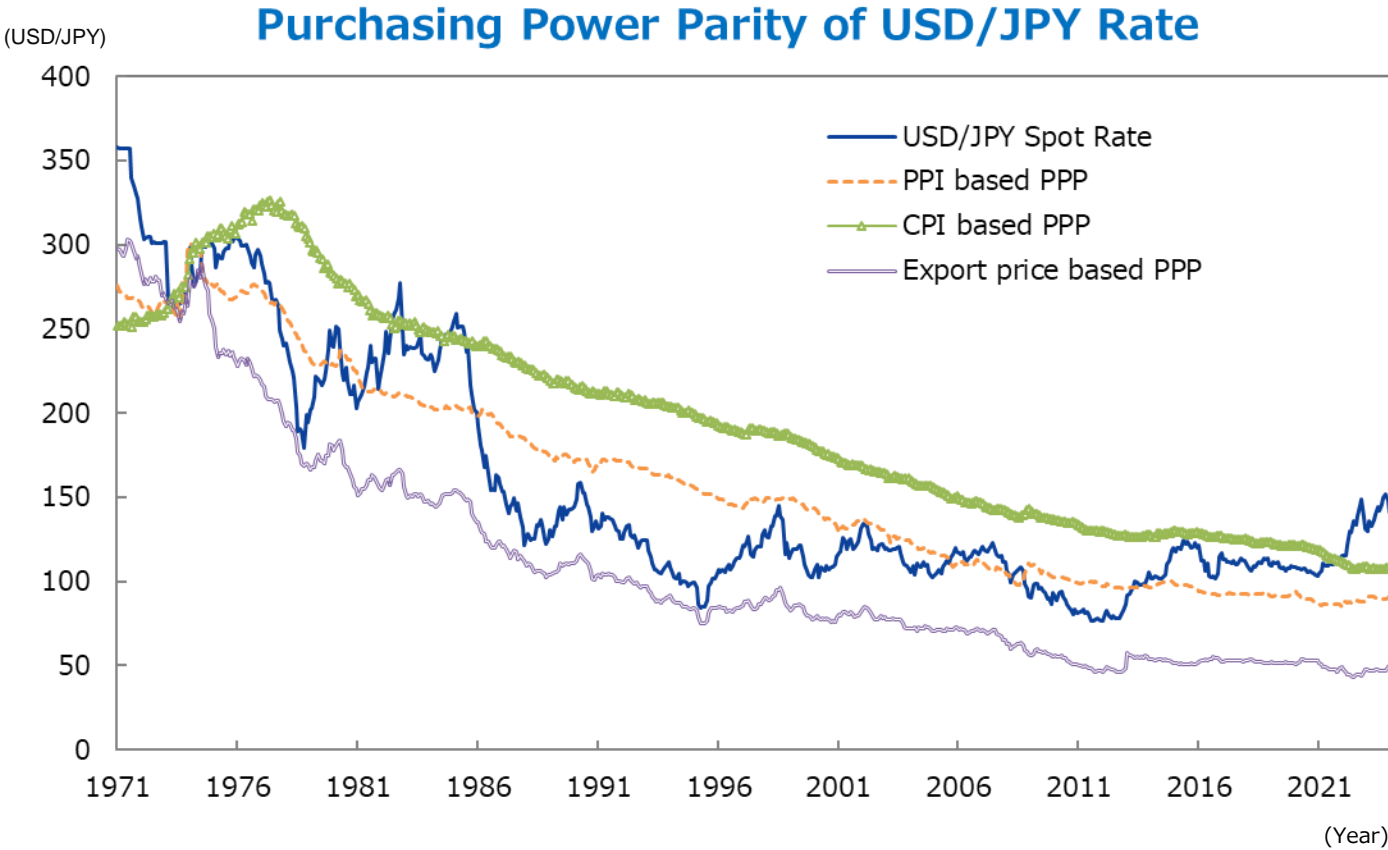
Speculation over BOJ's pivot makes big swing of the curve

Yield Curve of Japanese Sovereign



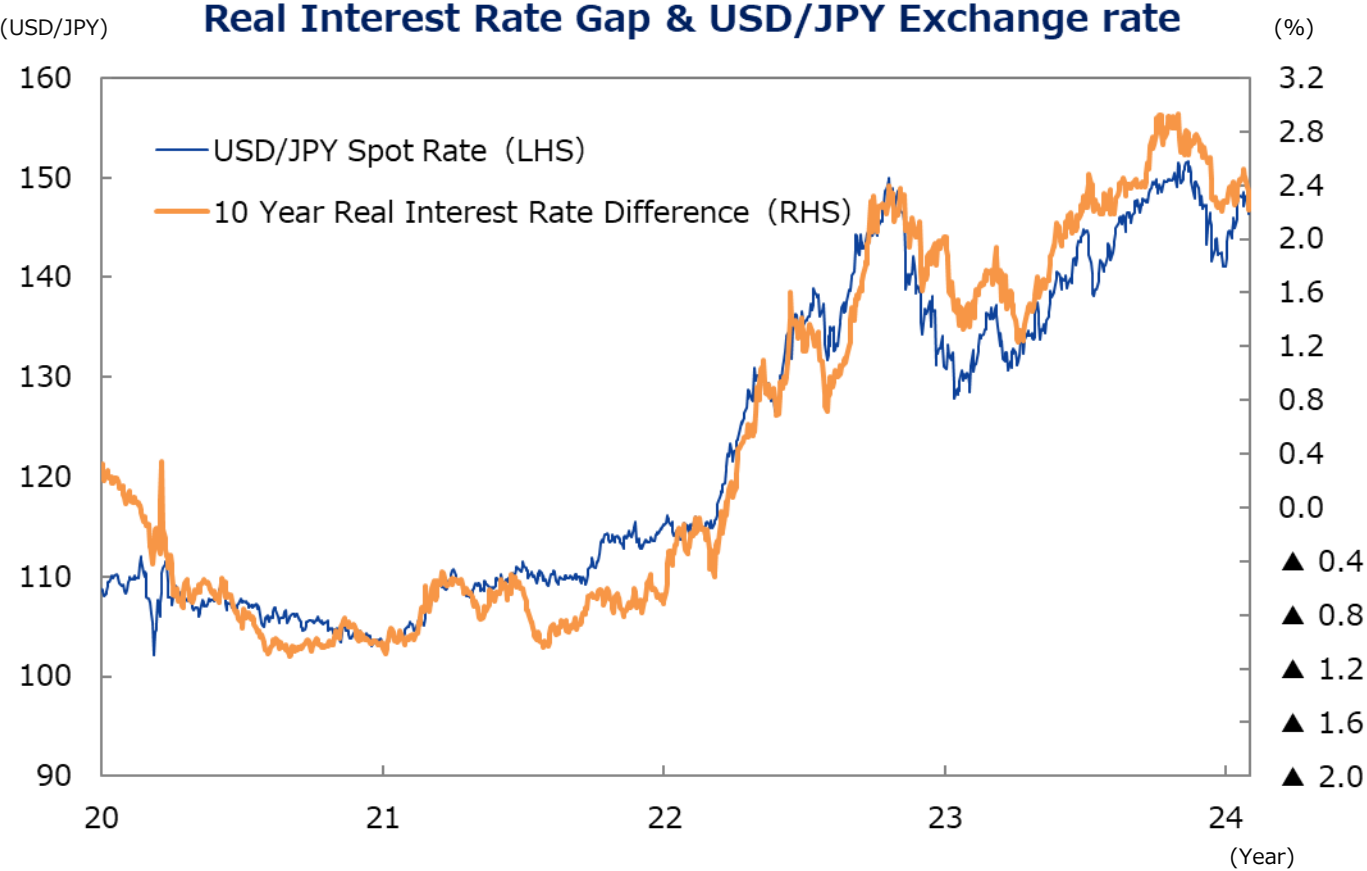
Source: Bloomberg, SMDAM

USD/JPY diverges from range of purchasing power parity



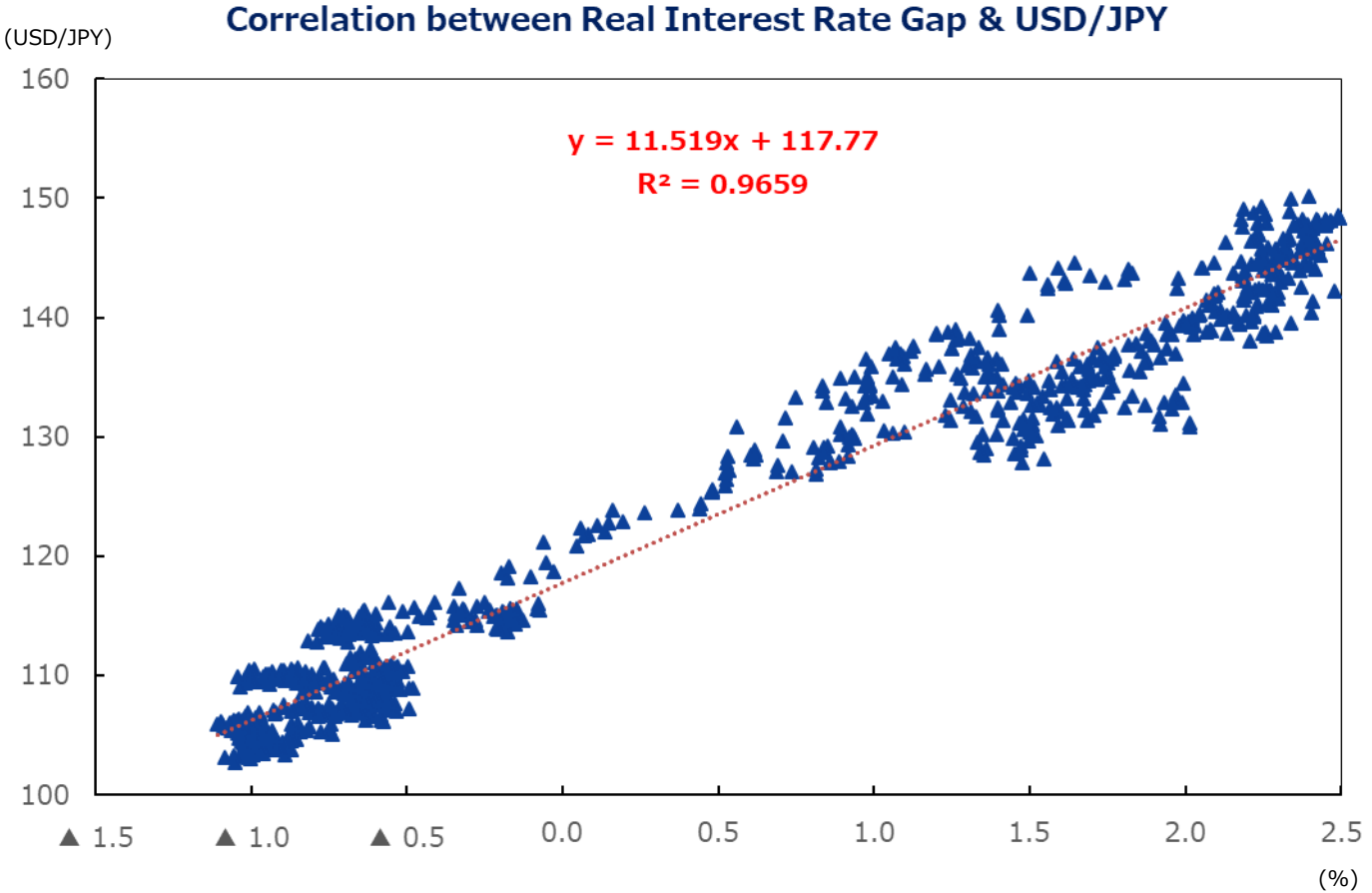
Note: Data is from January 1971 to December 2023.
Source: DOL, Bank of Japan, SMDAM

Real yield gap dominates USD/JPY rate



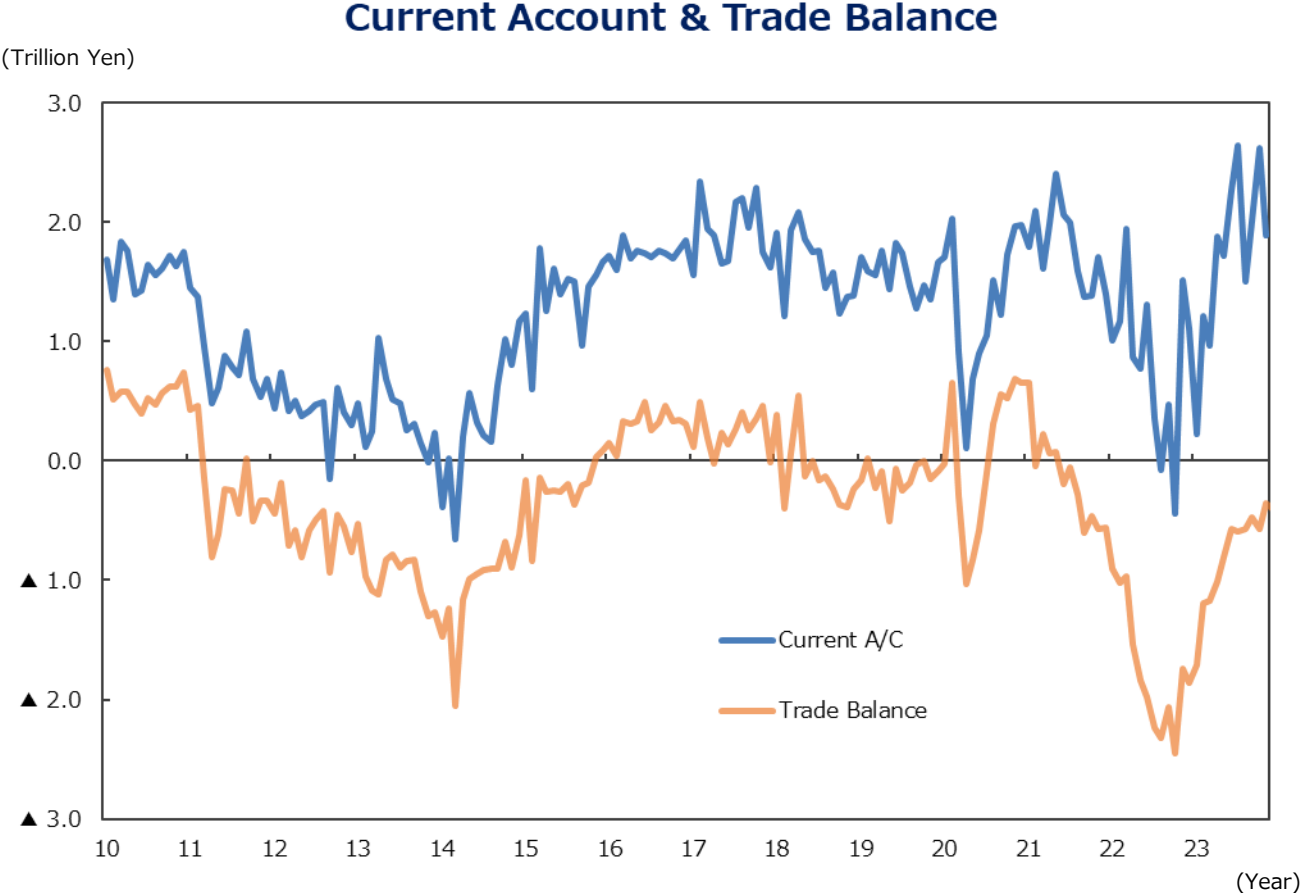
Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 31st January 2024.
Source: Bloomberg, SMDAM

Real yield gap dominates USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 31st January 2024.
Source: Bloomberg, SMDAM

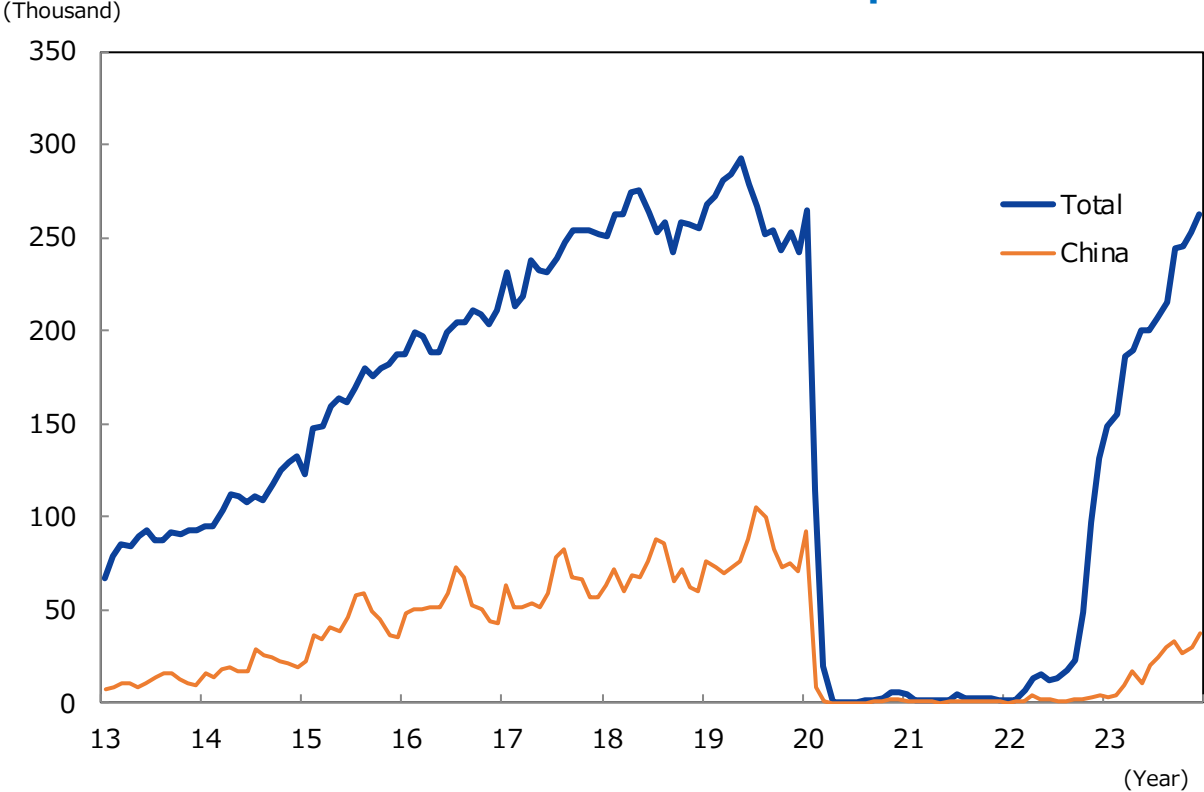
Trade deficits shrank due to falling energy prices



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

Inbound travel keeps rising without major recovery from China

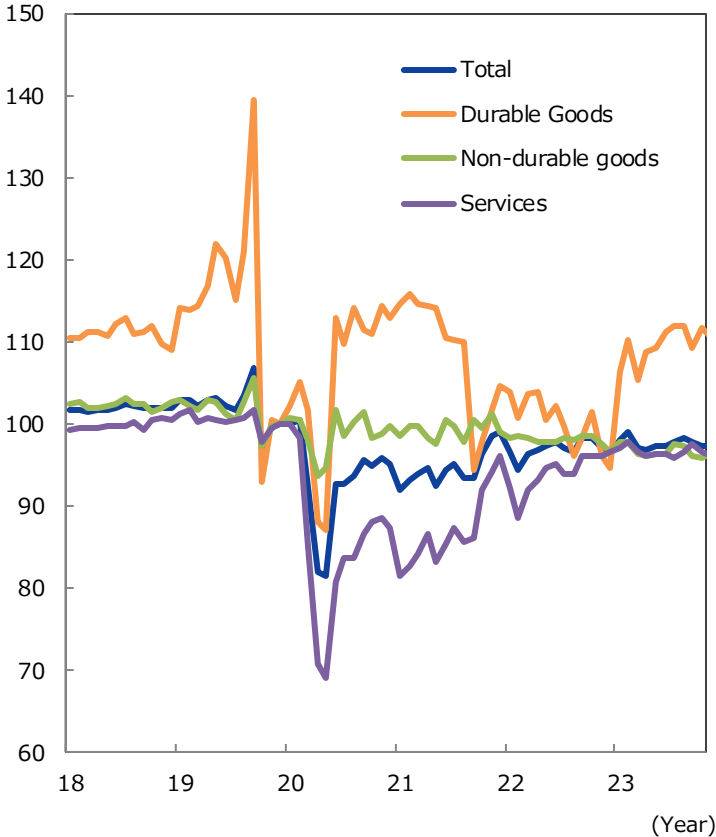
Inbound Travelers to Japan



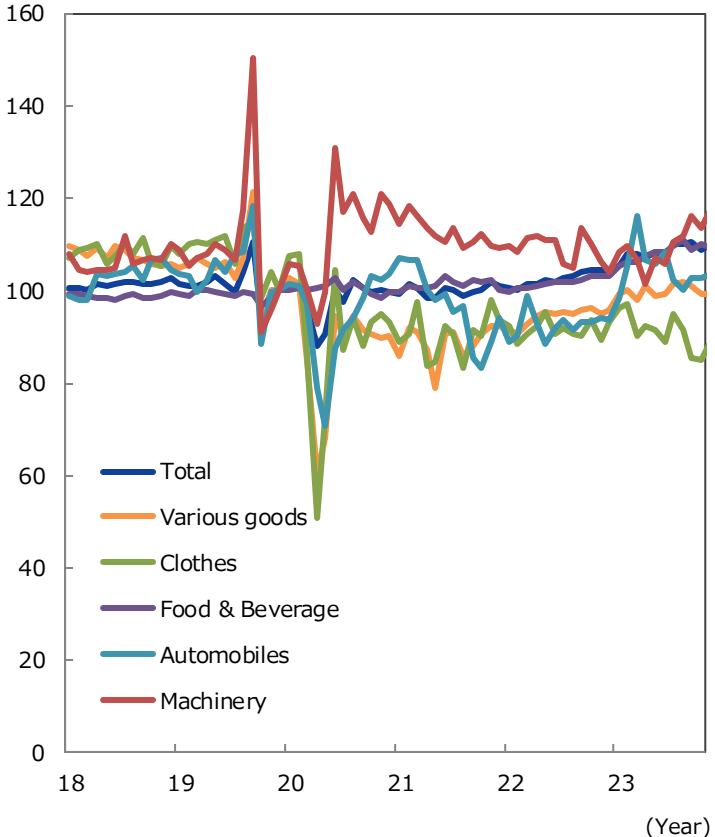
Note: Data is from January 2013 to December 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Durable goods boosts retail sales

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



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

Alleged violation of Funding Law could be the final blow

Cabinet approval rate



Note: Data is from January 2013 to January 2024.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2024	February	15	Release of CY 2023 Q4 GDP
	March	11	Revision of CY 2023 Q3 GDP
		15	Summation of annual spring labourer offensive (first session)
		18-19	Monetary Policy Meeting Enactment of FY 2024 budget and tax reform bills
	April	1	Start of restrictions on overtime work (logistics, construction, & medical care)
		25-26	Monetary Policy Meeting
		28	House of Representatives by-election Release of BOJ view report
	May		Multi-faceted review of Second workshop
	June	13-14	Monetary Policy Meeting Cabinet decision on the broad policy End of the ordinary Diet session
	July	30-31	Monetary Policy Meeting Summation of annual spring labourer offensive (final session)
September	19-20	Monetary Policy Meeting	
	30	Termination of the presidency of ruling LDP	
October	30-31	Monetary Policy Meeting	
December	18-19	Monetary Policy Meeting	
		Cabinet approval of the initial budget for FY 2025 and the outline for tax reform	

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

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