

# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- March 2018 -



Sumitomo Mitsui Asset Management

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## Executive summary

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### ➤ Japanese Economy

Oct-Dec 2017 GDP was slightly lower than expected due to increase in imports, especially smart phones, for which new iphone models were introduced. SMAM reduced GDP growth forecast for FY2017 from 2 % to 1.7 % accordingly, however, private consumption was solidly growing. Economic fundamentals in Japan are still positive.

- BOJ has so far successfully contained the rise in long-term bond yields. Mr. Kuroda is going to be reappointed as BOJ governor and monetary condition in Japan is likely to stay most loose among the major economies even though some policy adjustments could happen going forward.
- US\$ started weakening in December 2017, for which financial money flow going out from US and into emerging countries was observed. More recently, short term investors seem to have sold US\$ against JPY and EUR focusing on possible tapering and monetary tightening in Japan and Europe.

### ➤ Japanese Stock Markets

Global stock market is expected to have a consolidation period for a while digesting risk of faster interest rate hike. However, central banks will move cautiously not to kill economic growth, and Japanese stock market is forecast to gradually return to an upward trend. Current strengthening of Japanese yen will not last long.

- As long as global economy stays strong, Japanese economy and corporate profits are going to have tailwinds. Current valuation level seems reasonably attractive.
- Major risk factors could be conflicts surrounding North Korea after PyeongChang Winter Olympic & Paralympic Games..

Notes: Macro and market views are as of Feb 19<sup>th</sup> 2018, and subject to updates thereafter without notice.

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# Outlook for Japanese Economy

## SMAM economic outlook for FY17-19

- Oct-Dec 2017 GDP was slightly lower than expected due to increase in imports, especially smart phones, for which new iphone models were introduced. SMAM reduced GDP growth forecast for FY2017 from 2 % to 1.7 % accordingly, however, private consumption was solidly growing. Economic fundamentals in Japan are still positive.

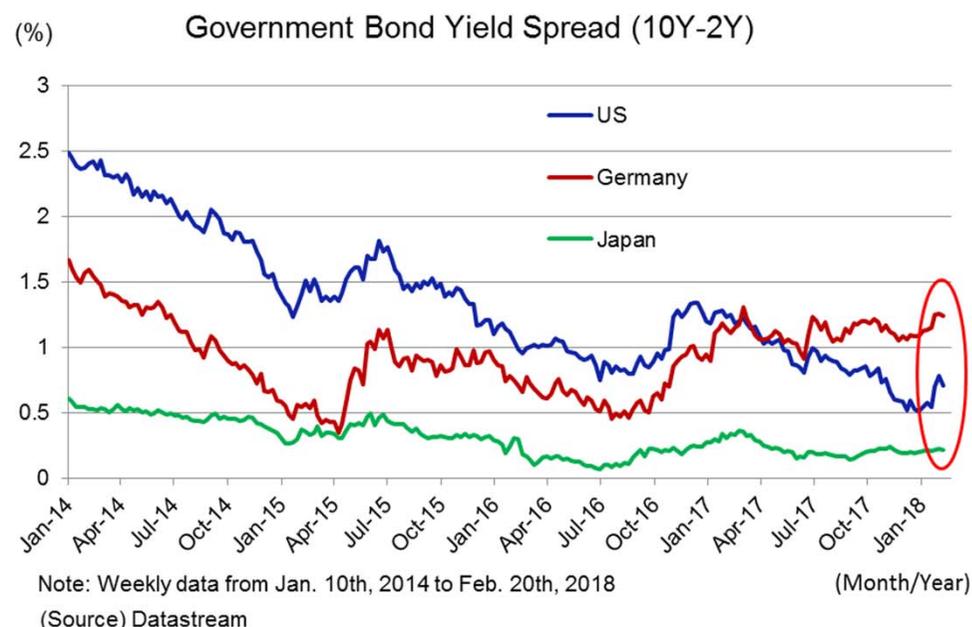
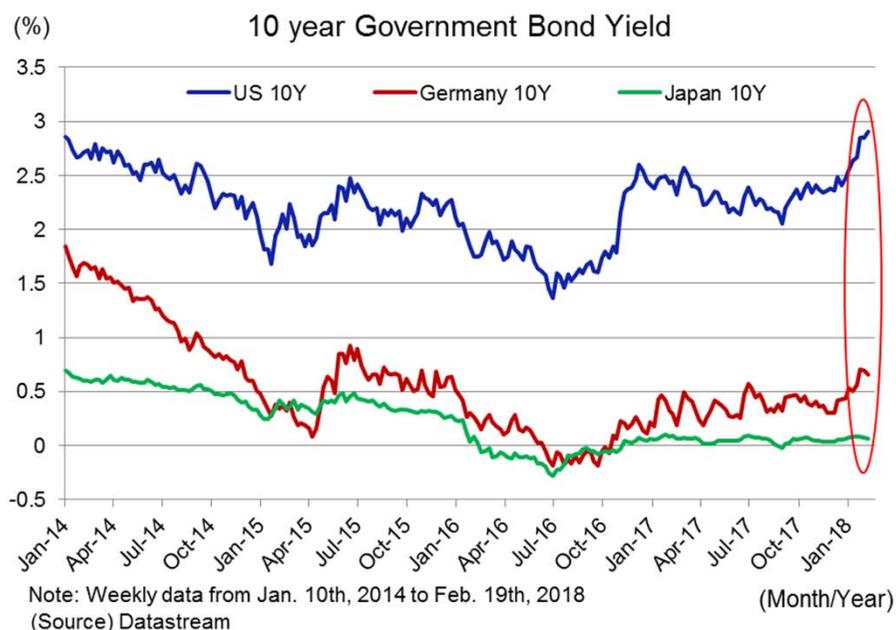
(YoY %)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.7%	1.4%	0.8%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	1.1%	0.9%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	0.2%	-1.4%	1.0%
Private Capital Investment	3.3%	2.3%	1.2%	3.3%	2.7%	1.8%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.4%	0.5%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.2%	-1.3%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.3%	0.4%	0.1%
Exports	8.7%	0.7%	3.4%	6.6%	4.6%	2.0%
Imports	4.2%	0.3%	-1.0%	4.4%	2.2%	1.4%
Nominal GDP	2.2%	3.0%	1.0%	1.6%	1.8%	2.0%
GDP Deflator	2.5%	1.5%	-0.2%	-0.0%	0.4%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.8%	3.2%	2.0%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	1.0%	0.6%

Notes: E=SMAM forecasts. SMAM views are as of Feb 19<sup>th</sup>, 2018 and subject to updates thereafter without notice  
 (Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

(%, YoY except Net Exports)

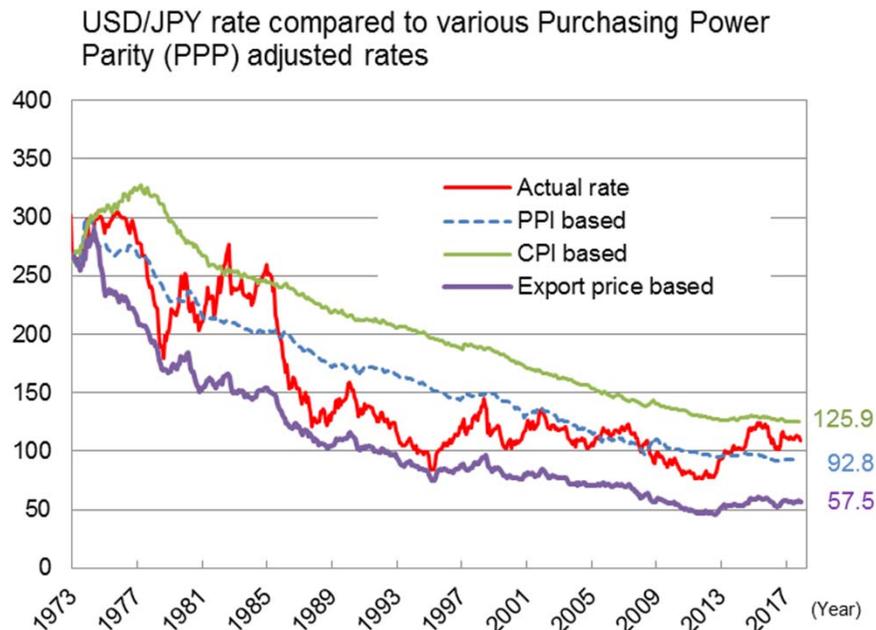
## Monetary condition in Japan is likely to stay most loose among the major economies

- Robust global economic growth is positive for the world and global financial markets.
- Central banks would take cautious move in tightening monetary policies not to kill the economy since they have little bullet left to counter an economic downturn.
- German bond yields are steepening fast as right chart shows. Pressure for tightening or tapering seems to be rising for ECB.
- BOJ has so far successfully contained the rise in long-term bond yields. Mr. Kuroda is going to be reappointed as BOJ governor and monetary condition in Japan is likely to stay most loose among the major economies even though some policy adjustments could happen going forward.

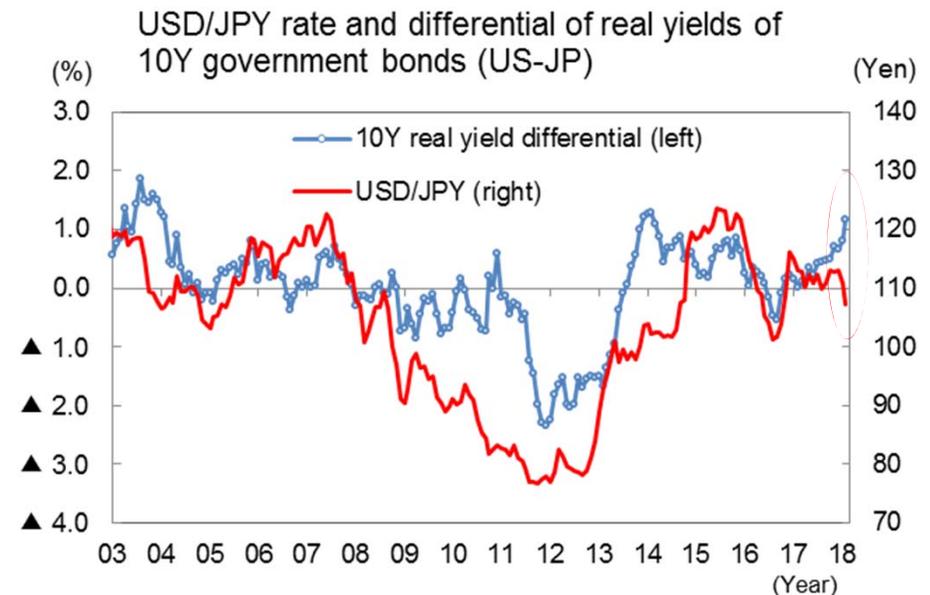


## USD/JPY rate has deviated from the level implied by yield differential

- Despite widening real yield differential between US treasury bond and Japanese government bond, dollar weakened against JPY lately as right chart shows.
- US\$ started weakening in December 2017, for which financial money flow going out from US and into emerging countries was observed. More recently, short term investors seem to have sold UD\$ against JPY and EUR focusing on possible tapering and monetary tightening in Japan and Europe.
- Mr. Kuroda is going to continue another term as the BOJ governor, and no major change in monetary policy is expected at least during 2018, which will make excessive strengthening of JPY unlikely.



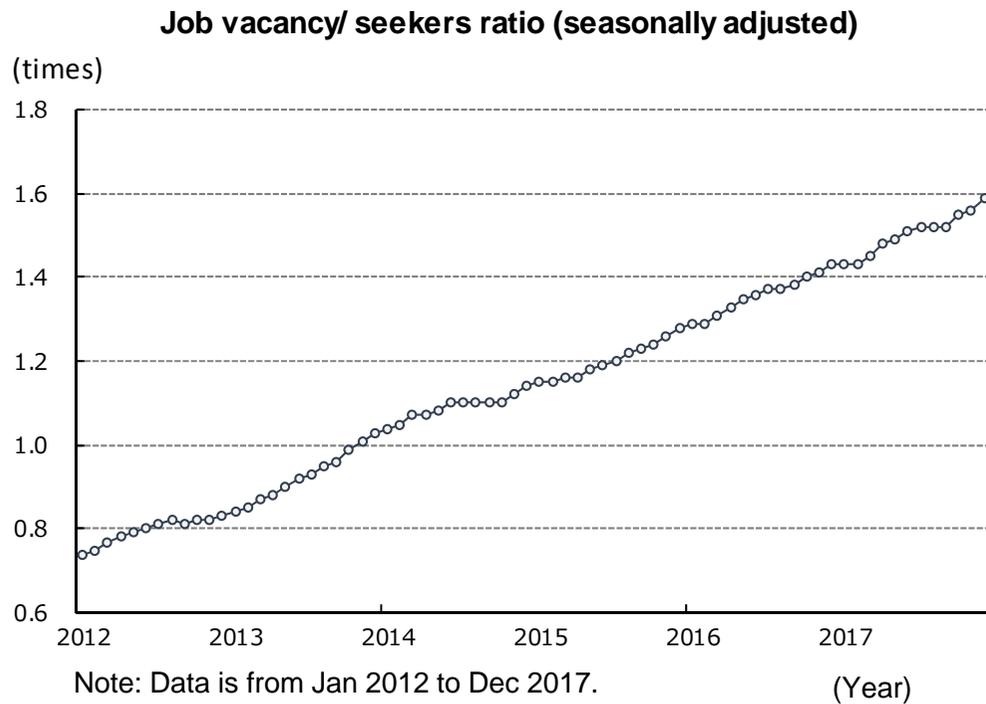
Note: Data is from Mar. 1973 to Dec. 2017.  
 (Source) US Department of Labor, US Department of Commerce, FRB, IMF, Ministry of Internal Affairs and Communications, Bloomberg



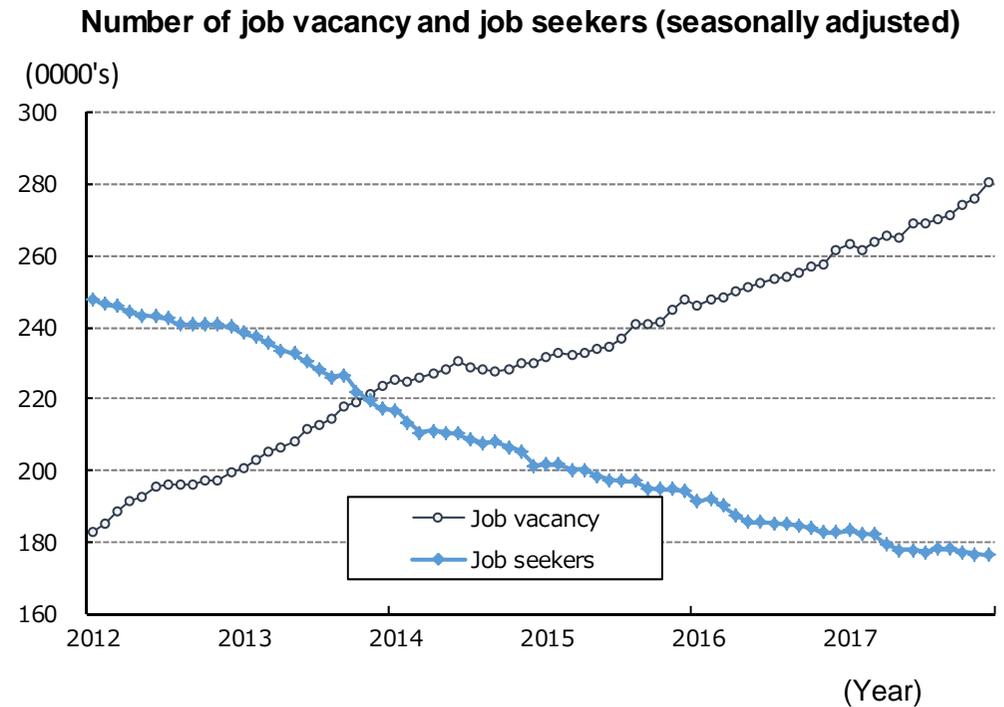
Note: Data is from Jan 31st 2003 to Feb. 22nd 2018.  
 Real yields are adjusted for CPI ex. food & energy  
 (Source) US Department of Labor, Ministry of Internal Affairs and Communications, Bloomberg, compiled by SMAM.

## Labor market gets tighter and tighter

- Number of unfilled job vacancy keeps climbing in the face of decreasing number of job seekers.



Note: Data is from Jan 2012 to Dec 2017.  
(Source) Ministry of Health, Labour and Welfare



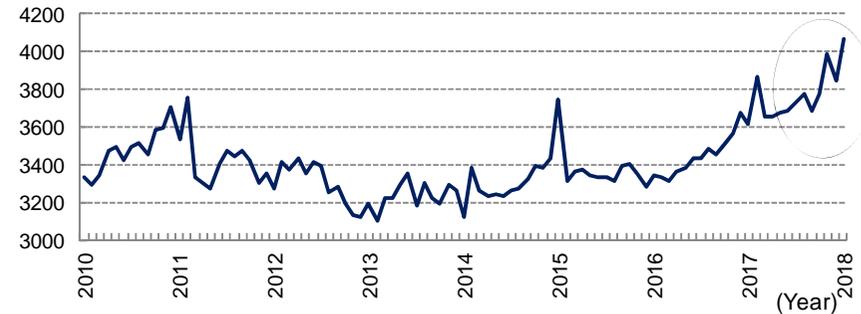
# Robust exports continued to drive Japanese economy

- Robust exports continued in January, for which top two regions, Asia and China lead the increase.

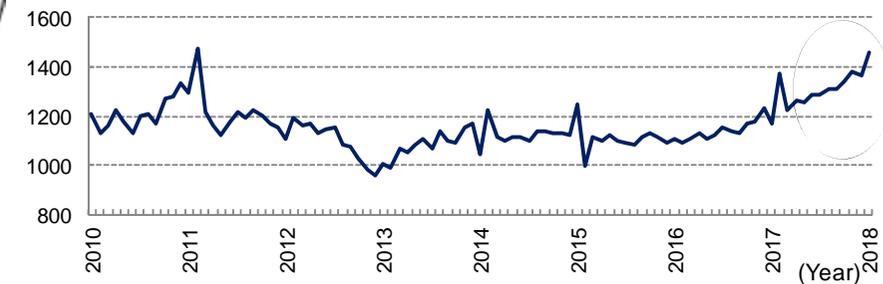
**Total export volume**  
(seasonally adjusted, yen billion)



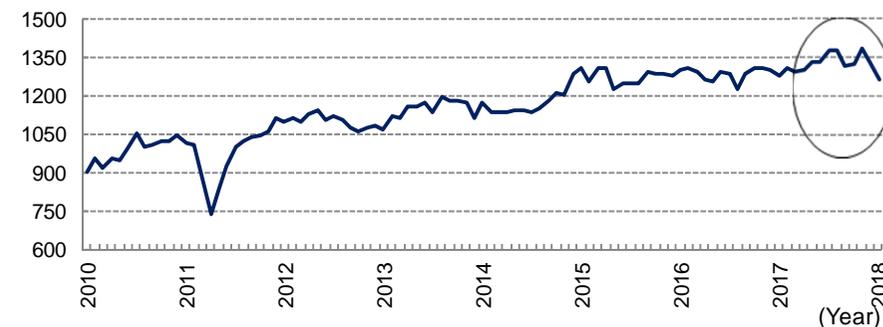
**Export volume to Asia**



**Export volume to China**



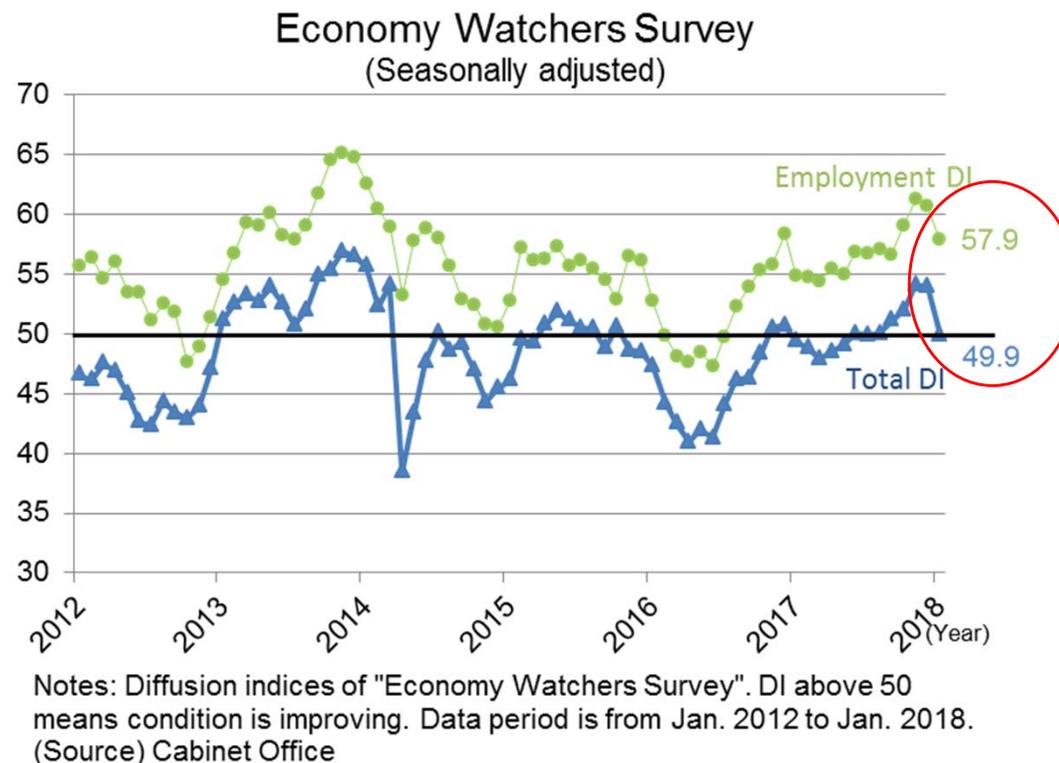
**Export volume to US**



Note: Data is from Jan 2010 to Jan 2018.  
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

## Consumer sentiment declined temporarily in January due to cold weather

- Economy Watchers Survey is based on response from people engaged in economic sensitive jobs on the street such as retail shop and taxi drivers. DI for the current condition in January 2018 declined to 49.9, however, this is supposed to be temporal.
- Examining response from the people surveyed, cold weather and rising prices were most commonly blamed for a deterioration. Words related to geopolitical risks such as North Korea were not frequently mentioned.



## Monetary policies and geopolitical tensions are going to be main focus

- SMAM currently forecasts ECB to start tapering QE this year and to raise interest rates in 2019. FRB's pace of tightening is one of the main focus. BOJ will stay most loose among the three central banks.
- Politics in Europe face important tests in early March. Also, geo-political tensions surrounding North Korea and Middle East are major risks.

### Upcoming key events

Month	Region/Country	Events	Notes
March	Japan	19 Two deputy governors' term ends	No surprise in two nominees.
		Spring wage negotiation rounds	Substantial wage hike achievable?
	US	5 DACA expires	
		20-21 FOMC	Another rate hike?
	EU	8 ECB Monetary Policy Meeting	
	Germany	4 SPD members vote on CDU-SPD alliance	
	Italy	4 General election	
South Korea	9-18 PyeongChang Paralympic games	What happens in N Korea after the games?	
	China	China National People's Congress	
April	Japan	8 BOJ governor Kuroda's term ends	Kuroda was nominated to continue.
		26-27 BOJ Monetary Policy Committee Meeting & perspective report	
	EU	27 ECB Monetary Policy Meeting	
May	US	1-2 FOMC	
June	Japan	Japanese government releases a) updated growth strategy b) plan of a revolution in human resources development and c) Basic Policies for Economic and Fiscal Management and Structural Reform	
	US	12-13 FOMC	
	EU	14 ECB Monetary Policy Meeting	
July	Japan	30-31 BOJ Monetary Policy Committee Meeting & perspective report	
	US	31-1 FOMC	
	EU	26 ECB Monetary Policy Meeting	
September	Japan	18-19 BOJ Monetary Policy Committee Meeting	
		PM Abe's leadership of LDP is set for renewal or expiration	LDP leadership election is due
	EU	26 ECB Monetary Policy Meeting	
November	US	Mid-term election for US congress	

(Source) Various publications, assembled by SMAM

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# Outlook for Japanese Stock Markets

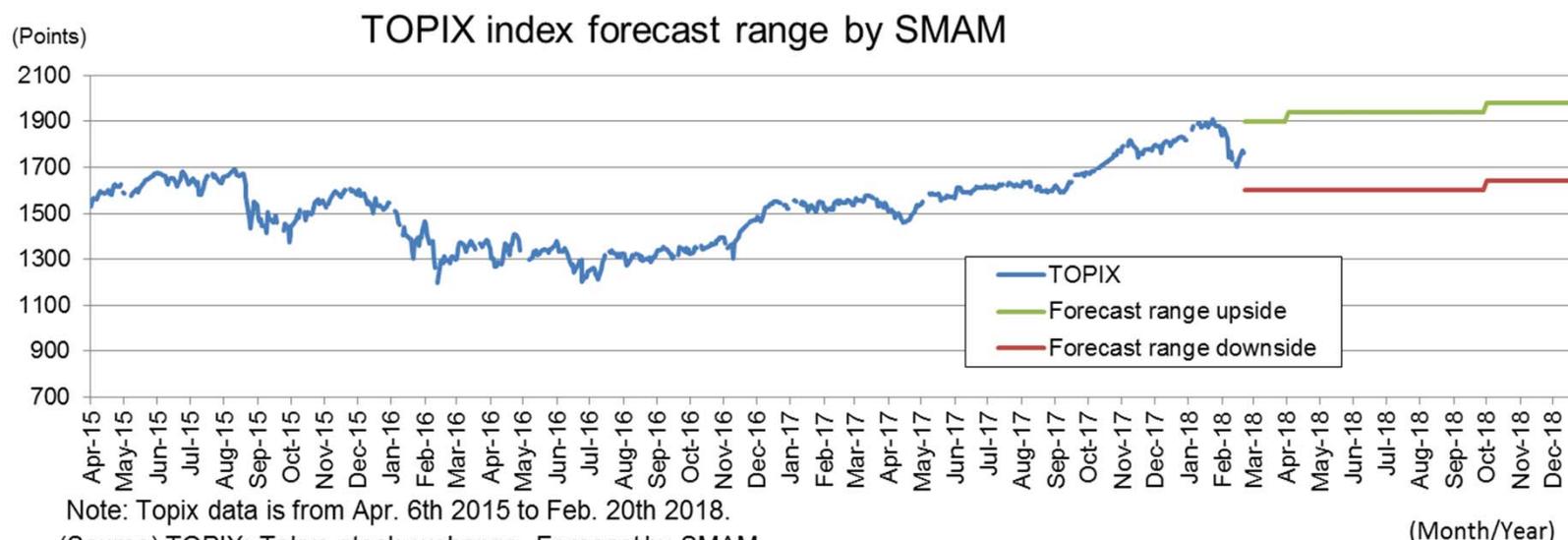
## Stock market outlook: Expected to gradually return to an upward trend

### SMAM short-term view

- Global stock market is expected to have a consolidation period for a while digesting risk of faster interest rate hike. However, central banks will move cautiously not to kill economic growth, and Japanese stock market is forecast to gradually return to an upward trend. Current strengthening of Japanese yen will not last long. Major risk factors could be conflicts surrounding North Korea after PyeongChan Winter Olympic & Paralympic Games.

### Longer-term outlook (6-months and beyond)

- Robust global economic growth is expected to continue, which should provide strong corporate earnings growth to Japanese companies blowing tailwinds to the Japanese stock market. If sizable wage increase can be achieved on the back of record high corporate earnings, increasing business confidence as well as ever tighter labor market, virtuous economic cycle with higher inflation might be kicked in. Major risks will be such as geo-political risks and unexpectedly hawkish monetary policy by central banks.



Note: Topix data is from Apr. 6th 2015 to Feb. 20th 2018.

(Source) TOPIX: Tokyo stock exchange, Forecast by SMAM

Note: SMAM's projection is as of JFeb 19<sup>th</sup> 2018 and subject to updates without notice.

## Base scenario & Upside / Downside risks for our forecasts

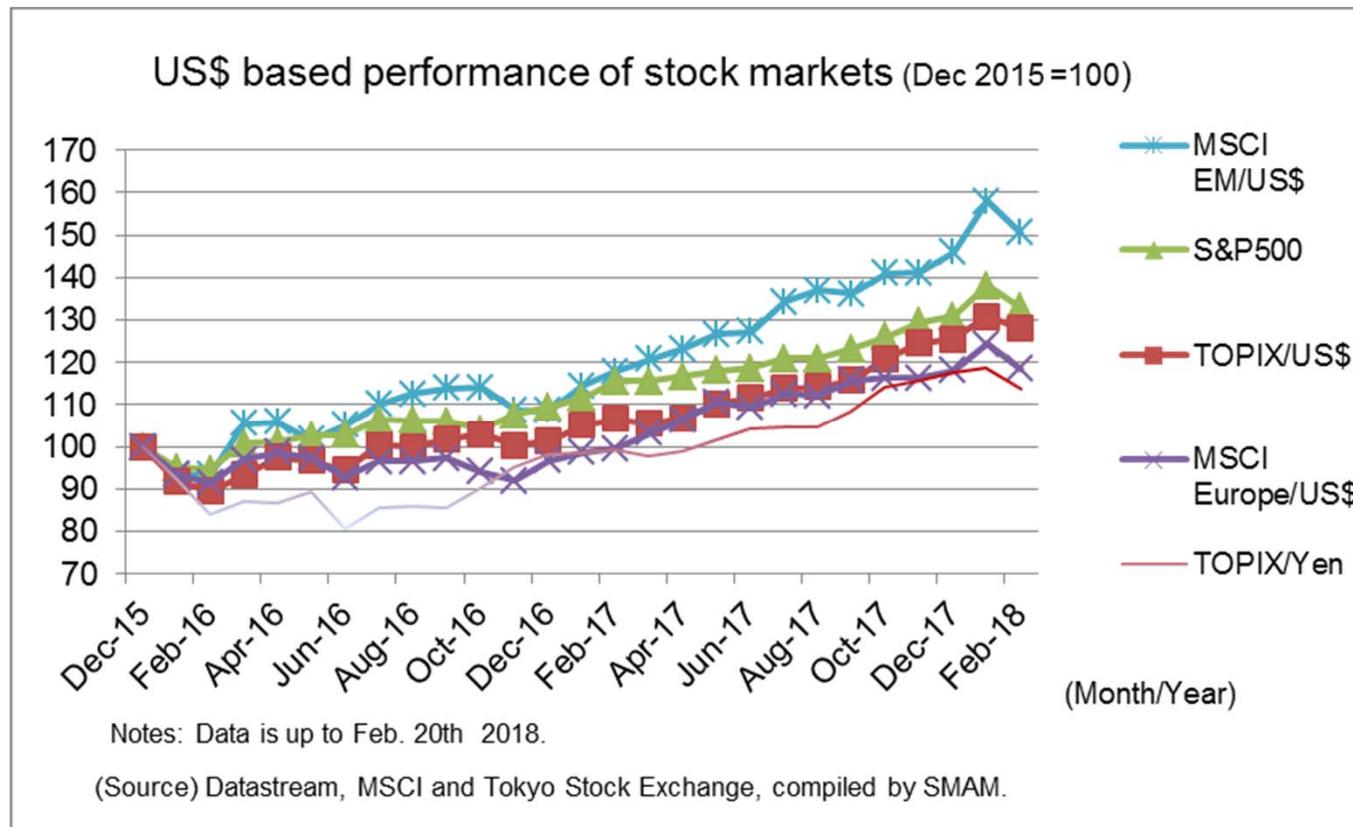
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- Our **Base Scenario** is assuming the following views:
  - Practical Trump trade policies are made and serious trade disputes can be avoided.
  - US economy keeps growing.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
  - Further fiscal stimulus will be made and extra easy monetary policy should sustain economic growth in Japan.
  - Tension in the East Asia does not ignite a war.
  - Central banks gradually move to normalize monetary policies and avoid killing economic growth.
  
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - North Korea abandons nuclear arms development.
  - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.
  
- **Downside Risks** include:
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - Global monetary tightening intensifies to choke global economy.
  - Confrontational foreign policies taken by Trump presidency shake global trades.
  - "Russia-gate" scandal flares up.
  - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Feb. 19<sup>th</sup> 2018 and subject to updates without notice.

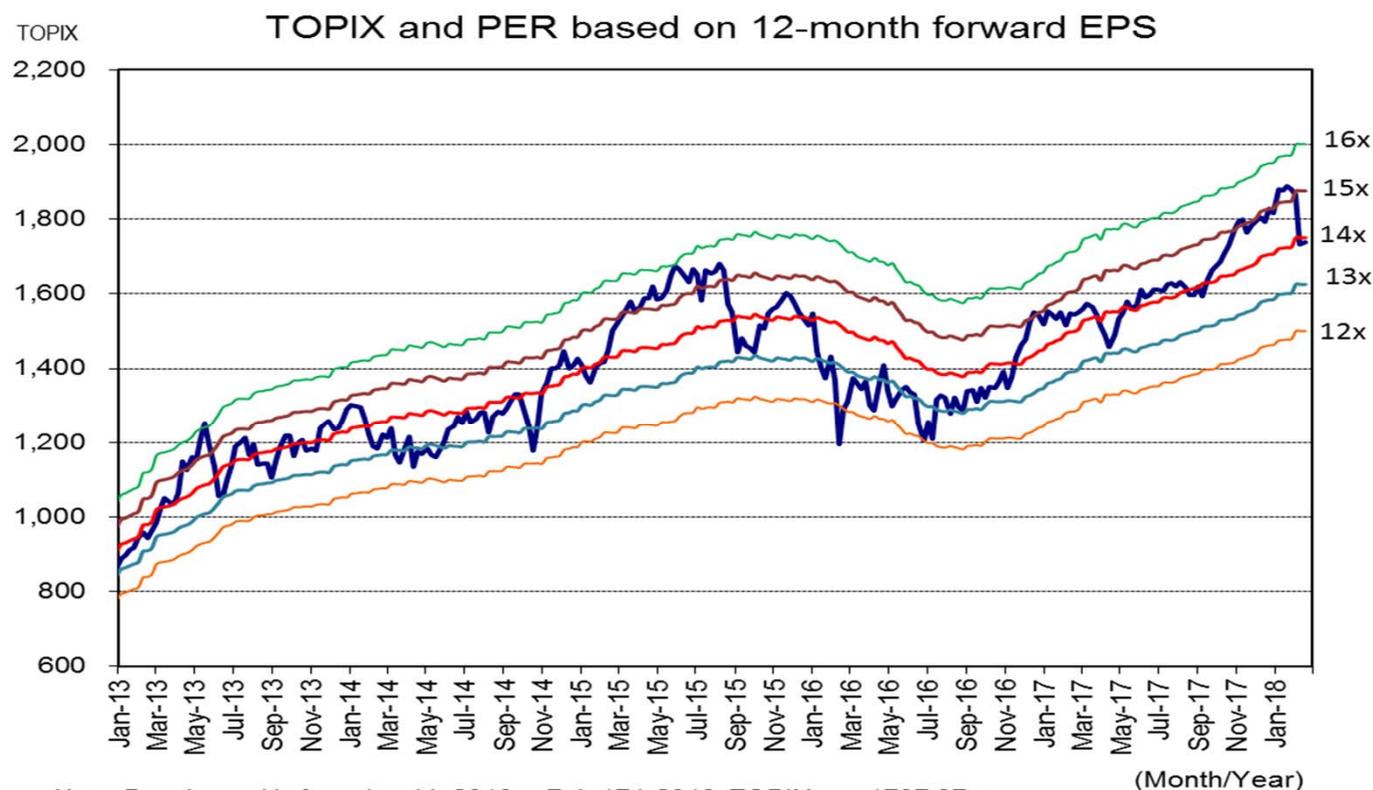
## Global market made a synchronized decline in February

- Global stock markets fell in tandem ignited by rekindled fear of rising interest rates.
- In US\$ terms, strong yen has softened the stock price decline of Japanese stocks.



## PER for TOPIX index fell to the mid level since PM Abe took helm in 2013

- PER for TOPIX index fell just below 14 times, which has been the middle of the range after PM Abe took helm in 2013.
- As long as global economy stays strong, Japanese economy and corporate profits are going to have tailwinds. Current valuation level seems reasonably attractive.

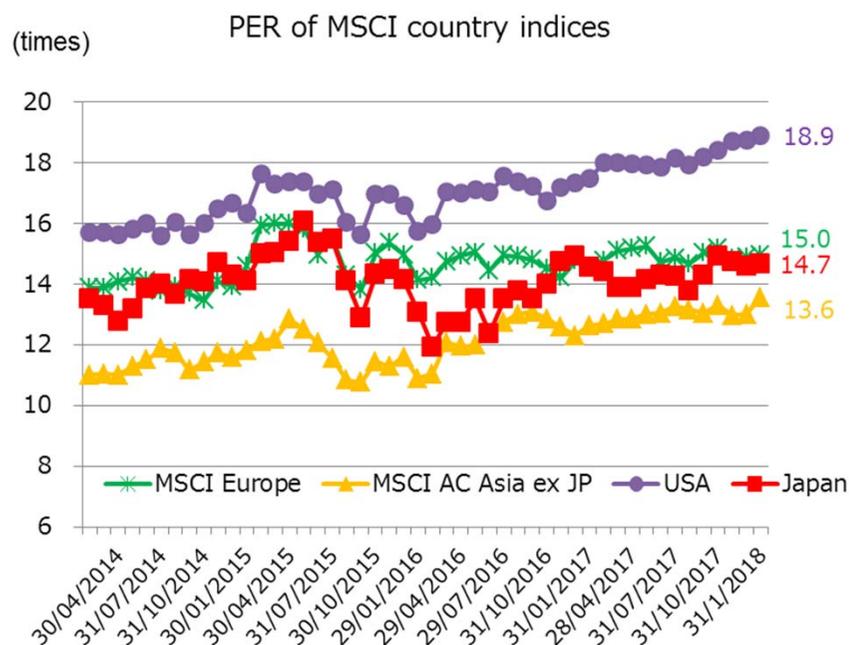


Note: Data is weekly from Jan.4th 2013 to Feb.17th 2018. TOPIX was 1737.37 at the end of the period.

(Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

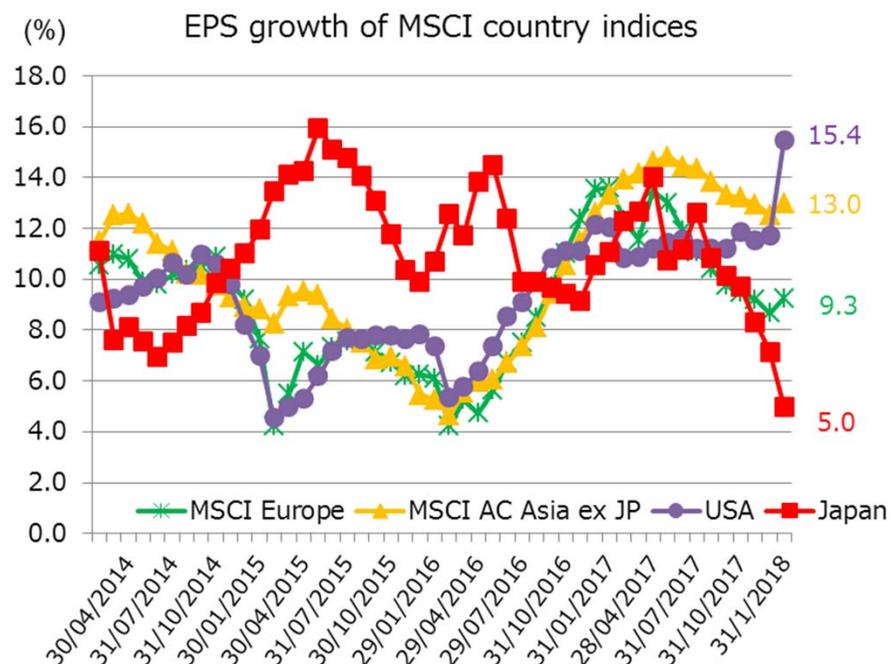
## 12M forward EPS growth forecast jumped up for US due to tax cut effect

- 12M EPS growth forecast for US jumped up to 15.4% in January due to coming corporate tax reduction. Even based on this high EPS forecast, PE ratio was elevated at 18.9 times, which led to a significant fall in stock prices in February.
- 12M EPS growth forecast for Japan declined to 5% in January as robust ongoing business results were reflected as historical EPS. Upward EPS revision is going on for Japan, which could lift EPS growth forecast again unless excessively strong yen undermines corporate earnings.



Note: PER is based on 12M forward EPS forecast.  
Data is up to 31st Jan 2018.  
(Source) MSCI

(DD/MM/YYYY)

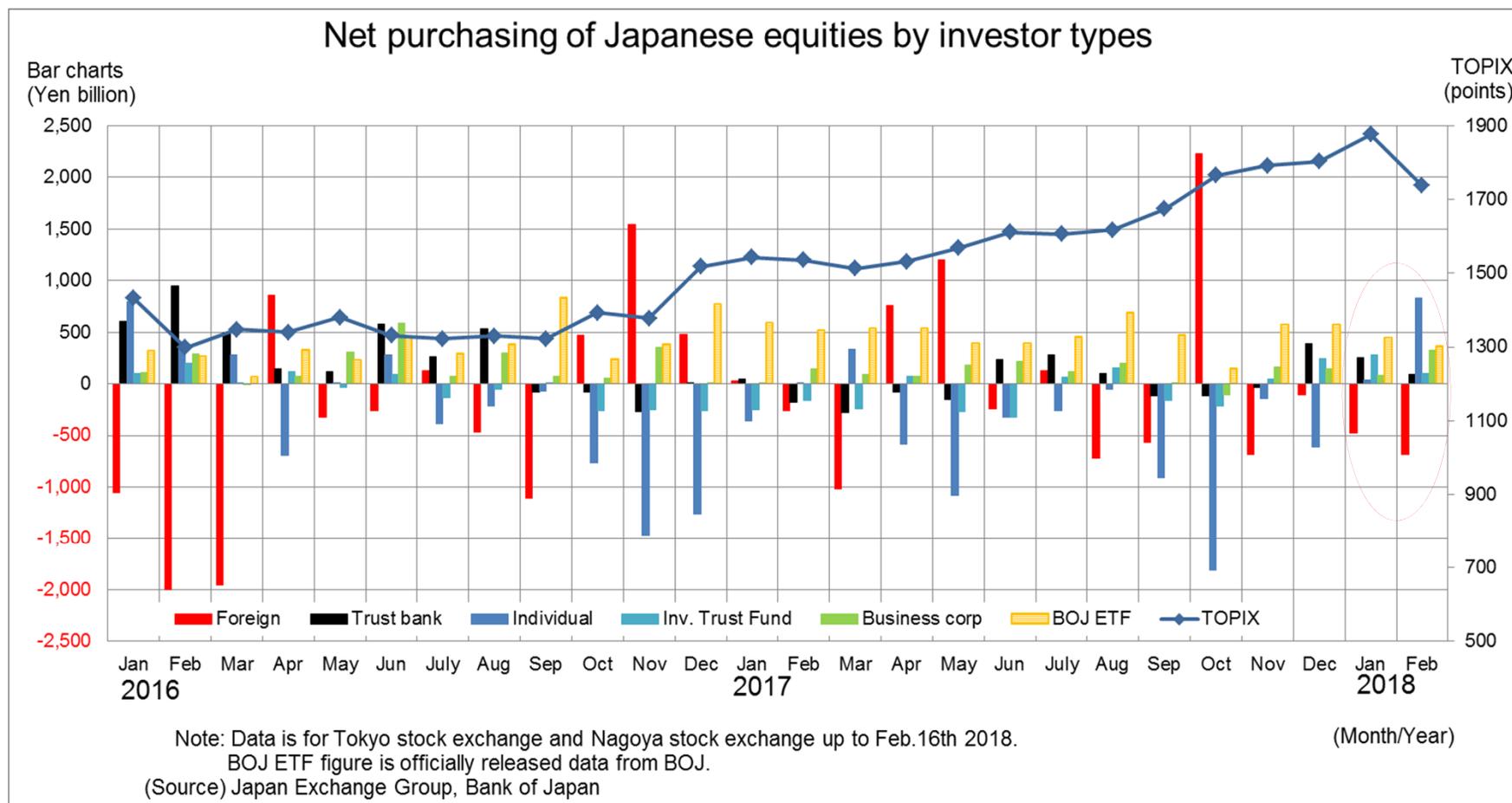


Note: Growth is for 12M forward EPS forecast.  
Data is up to 31st Jan 2018.  
(Source) MSCI

(DD/MM/YYYY)

## Net purchasing of Japanese investors is on the rise

- Net purchasing by individuals including investment trust fund is increasing noticeably.
- Share buybacks by business corporations also picked up in February.
- Foreign investors sold Japanese shares so far this year.



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