

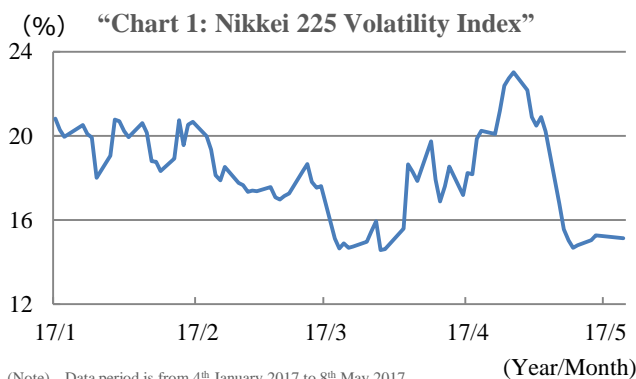
Nikkei 225 and watershed level of 20,000

- Nikkei 225 is likely to face sell-off before reaching 20,000 level after sharp rise in a short period, however, environment surrounding the Japanese equity market has significantly improved.
- Possible upward earnings revision due to weaker yen compared to presumed exchange rates of Japanese corporations was one of the reasons behind stock price rise.
- We expect Nikkei 225 to recover 20,000 level absorbing selling pressure, however, market needs to assess US president Donald Trump’s policies in order to rise even higher.

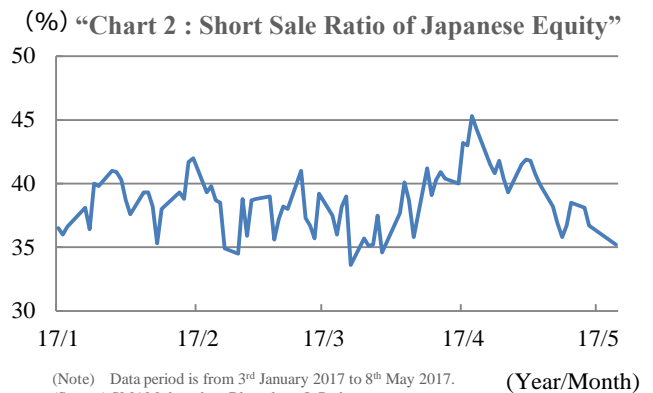
Nikkei 225 is likely to face sell-off before reaching 20,000 level after sharp rise in a short period, however, environment surrounding the Japanese equity market has significantly improved

Currently, Nikkei 225 is approaching the watershed level of 20,000 as USD/JPY rate recovered JPY113 level due to temporal retreat of geopolitical risk surrounding North Korea and political risk in Europe. However, we believe that the market is likely to face short term selling for a while as Nikkei 225 had risen as much as JPY1,560 from 14th April to 8th May (14 working days) based on closing price.

Nikkei 225 Volatility Index declined to 15% level recently which was over 20% in the middle of April this year. This indicates that future uncertainty has subsided to some extent (Chart 1). Also, Short Sale Ratio of Japanese Equity declined to 35% level recently which used to stay above 40% level between March and April this year. This indicates that investors seeking to profit from stock price fall are taking a breather.



(Note) Data period is from 4th January 2017 to 8th May 2017.
 (Source) SMAM, based on Bloomberg L.P. data.



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Possible upward earnings revision due to weaker yen compared to presumed exchange rates of Japanese corporations was one of the reasons behind stock price rise

Japanese corporations are currently announcing financial result for the fiscal year 2017 ending this March. Its peak will be on 12th May 2017. Market continues to focus on new financial year's i) earnings guidance and ii) presumed exchange rate by corporations. So far, earnings guidance seems to be rather conservative in general as expected. Meanwhile, presumed exchange rates of USD/JPY by Japanese corporations were mostly 105 or 110 according to Nikkei newspaper (aggregation of 110 corporations which had announced their business results ending in March on and before 1st of May 2017).

We believe that recent Nikkei 225 hike was due to expectation for upward earning revision from the current conservative guidance as currently USD/JPY exchange rate is higher than these presumed level of 110 or 105. According to "Trading by type of investors" announced by Tokyo Stock Exchange, Foreign investors were buying Japanese stocks for 3 consecutive weeks till third week of April, and expected to have continued buying so far in May.

We expect Nikkei 225 to recover 20,000 level absorbing selling pressure, however, market needs to assess US president Donald Trump's policies in order to rise even higher

Based on SMAM's Core Research Universe (221 Japanese listed companies excluding financials), recurring profit of financial year ending March 2018 is expected to rise +13% YoY (Exchange rate assumption: USD/JPY 110, EUR/JPY 115). Expectation of double digit profit increase and relatively undervalued Japanese stock prices will likely underpin Japanese stock market for the time being.

We expect Nikkei 225 to recover 20,000 level absorbing selling pressure going forward. However, Japanese equity market may experience volatility from time to time, as risk stays in Europe, in North Korea and also in crude oil price. Therefore, timing of Nikkei 225 renewing its historical high of June 2015 (JPY20,952.71) will possibly be after June 2017 when outline of 2018 US Federal Budget and Tax Reform will be announced that can determine impact of US president Donald Trump's policies to the Japanese corporations.

*** Please note that this report is a translation of Japanese report written on 9th May, 2017.**

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