



Japanese Stock Market Outlook

SMAM monthly comments & views
- August 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Japan's economic recovery is on track, as robust Exports and Industrial Production lead the moderate growth. Meantime, faltering Consumption is likely to recover on higher nominal wages gain.

- SMAM cut real GDP forecast from +1.6% to +1.5% in FY2015 and from +1.9% to +1.8% in FY2016.
- Exports and Industrial Production in April-June are expected to grow at slower pace, and accelerate from 2H 2015 alongside moderate global recovery.
- Private Consumption data shows still soggy, however Consumption will accelerate from July-September led by higher nominal wages growth.
- SMAM raised Core-CPI forecast from +0.2% to +0.3% for FY2015 and maintained at +1.1% for 2016, which is far below the inflation forecast by BOJ (+0.7% for FY2015 and +1.9% for FY2016), but the bank is less likely to move to additional easing.

➤ Japanese Stock Markets

Current stocks are fairly valued on upbeat corporate earnings. There would be still some room for upward revision in profit forecast based on current currency rates.

- FY2015 corporate profits are expected to be revised upward due to weak JPY.
- Overseas investors were accumulating Japanese equities.
- Downside risk is associated with foreign factors such as geopolitical concerns, uncertainties surrounding monetary policy by Fed and ECB, and possibly negative effects by crude oil price slump.

Notes: Macro and market views are as of July 16th and 22th, 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-16

- SMAM cut real GDP forecast from +1.6% to +1.5% for FY2015 and from +1.9% to +1.8% for FY2016.
- Net Exports forecast for FY2015 were revised downward from +0.3ppt to +0.2ppt on weak Exports in April-June quarter. Industrial Production forecasts were also downgraded from +2.3% to +0.7% for FY2015 and from +3.7% to +3.5% for FY2016.

	FY12	FY13	FY14	FY15E	FY16E
Real GDP growth	1.0%	2.1%	-0.9%	1.5%	1.8%
Private Consumption Expenditure	1.8%	2.5%	-3.1%	1.4%	2.0%
Private Housing Investment	5.7%	9.3%	-11.7%	1.3%	4.4%
Private Capital Investment	1.2%	4.0%	0.4%	3.5%	3.2%
Public Consumption Expenditure	1.5%	1.6%	0.4%	0.7%	0.5%
Public Capital Investment	1.0%	10.3%	2.0%	-3.3%	-1.6%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.2%	0.1%
Exports	-1.4%	4.4%	8.0%	5.4%	5.0%
Imports	3.6%	6.7%	3.7%	4.9%	5.2%
Nominal GDP	0.1%	1.8%	1.6%	2.2%	2.4%
GDP Deflator	-0.9%	-0.3%	2.5%	0.8%	0.5%

FY starting April and ending March

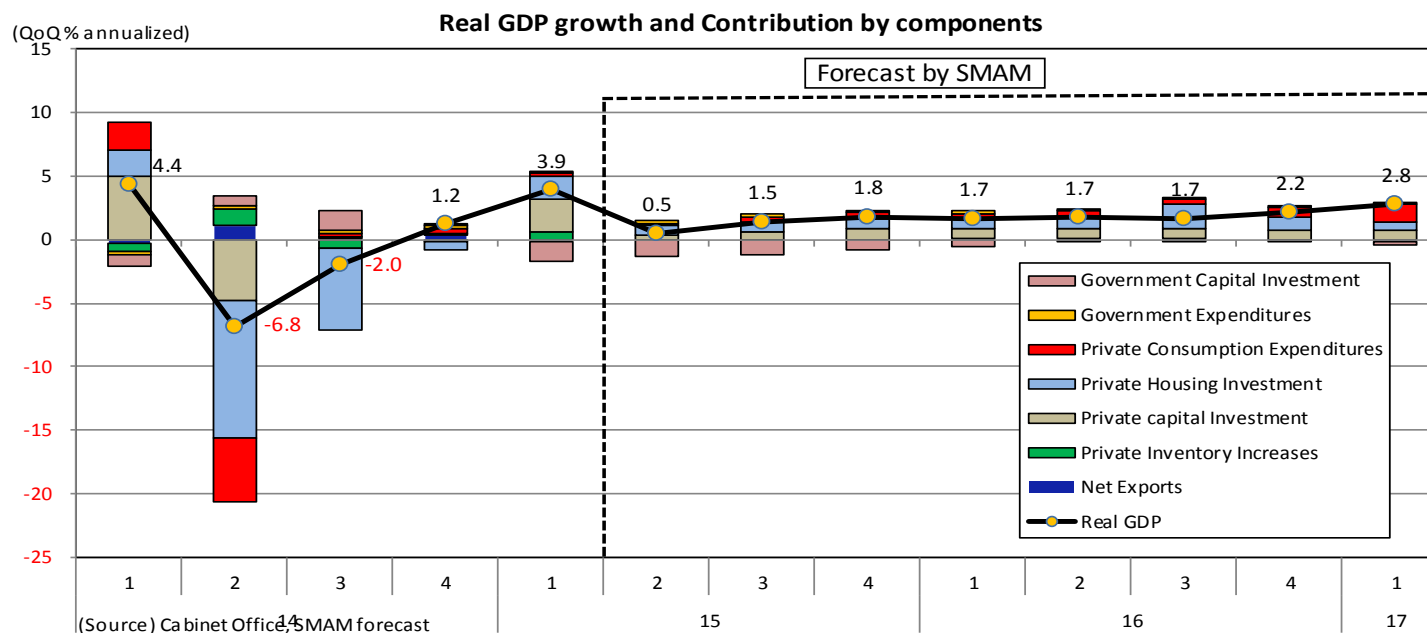
Notes: E=SMAM forecasts. SMAM views are as of July 16th, 2015 and subject to updates thereafter without notice

(%, YoY except Net Exports)

Source: Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

Quarterly GDP: Mid-to-high-1% growth after a strong growth in January-March

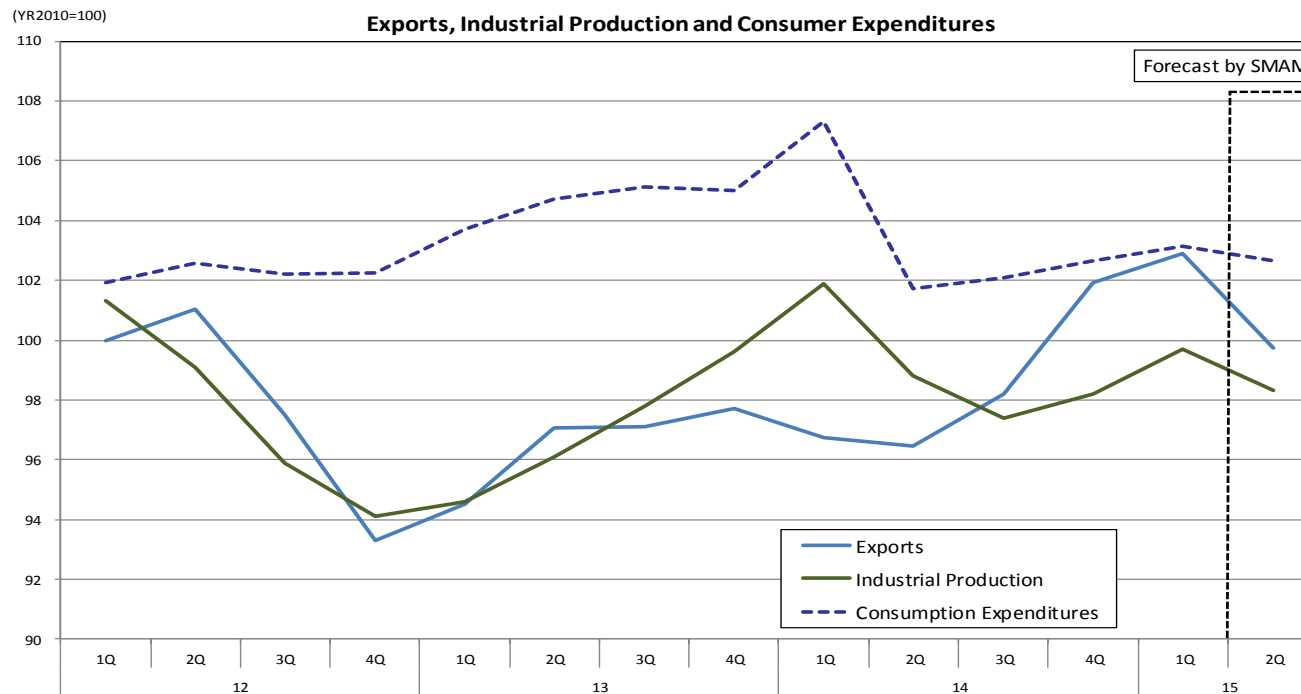
- SMAM revised real GDP forecast downward from +0.8% to +0.5% for April-June.
- The economy is likely to stay soft in April-June after the strong growth in January-March. SMAM expects the economy to keep a mid-to-high-1% growth after a temporary softening in April-June on solid domestic demands and recovery of Exports. Industry Production and Exports will recover from July-September led by US growth as ISM data in US has been improving.



Notes: E=SMAM forecasts. SMAM views are as of July 16th, 2015 and subject to updates thereafter without notice
 Source: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts. The above data is as of July 16th, 2015.

Recovery Process: Exports⇒Production⇒Employment, Confidence⇒Consumption

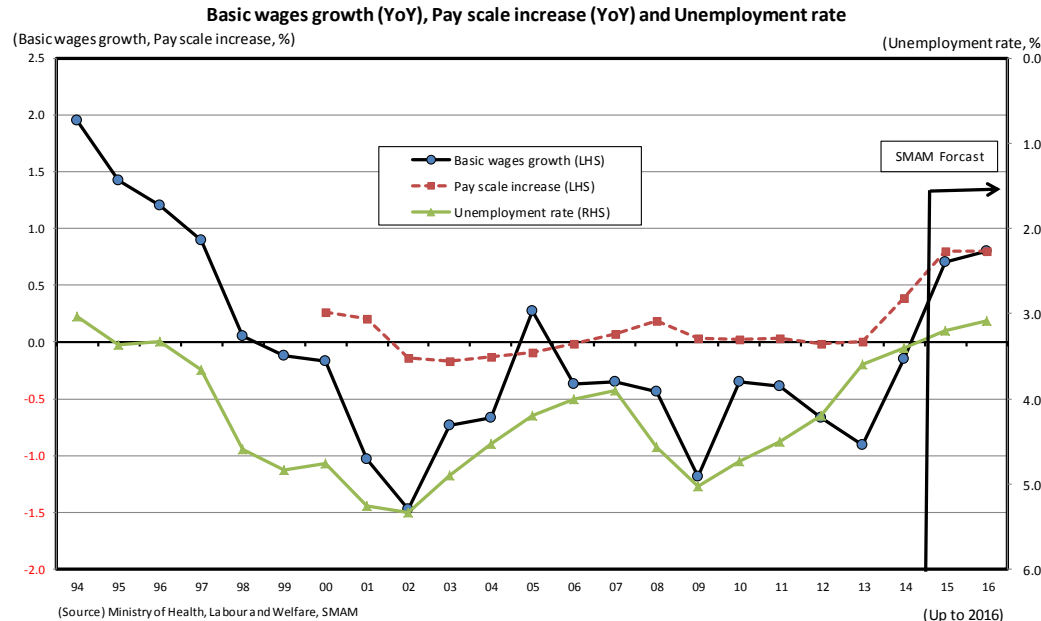
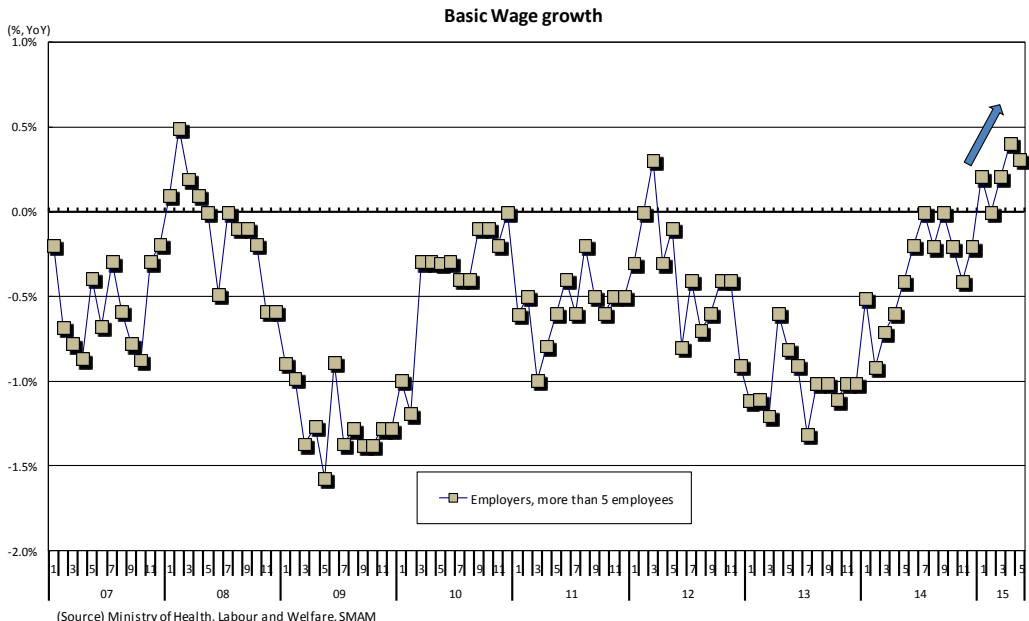
- SMAM forecasts current recovery process in order from Exports to Production and Consumption. The ongoing recovery is at the final stage of Consumption.
- Exports and Industrial Production continue stable growth, and Consumption is eventually picking up.
- April-June three data (IP, Exports and Consumption) show a respite in recovery.
- SMAM expects Private Consumption Expenditures to recover from July-September quarter although current consumption data remain weak. Wealth effect by rising stock prices and real wages growth will push the Consumption higher.



(Source) Ministry of Economy, Trade and Industry, BOJ, Cabinet Office, SMAM's seasonally adjusted
*1: Industrial Production for 2Q2015 is estimated based on the data of Industrial Production Forecast Index.

Wages: Basic Wages keep growing

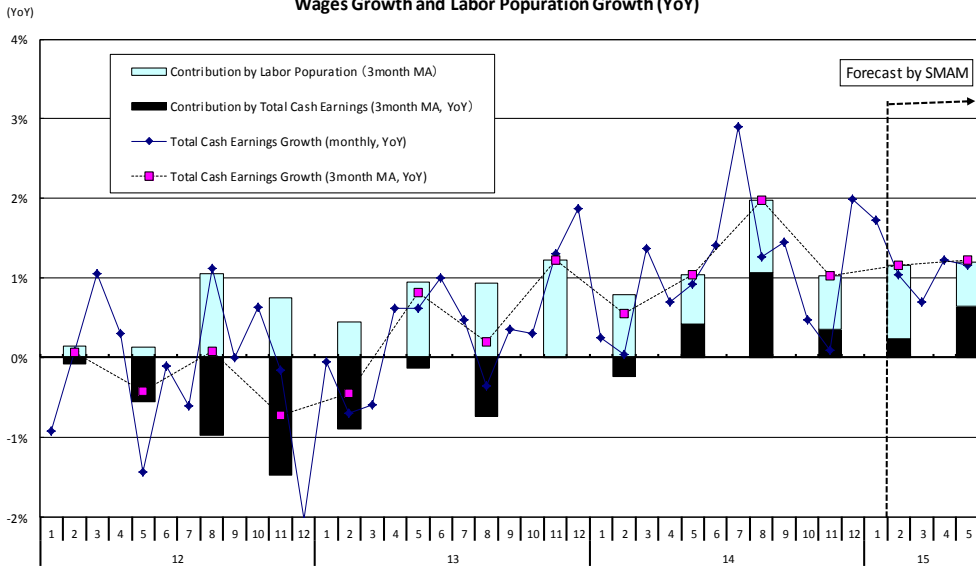
- Basic wages continue increasing at a moderate pace. Pay scale increase by “Shunto negotiation” accelerate the wages growth from June.
- SMAM expects Basic wages to grow at +0.7% YoY and total nominal wages to grow +1.1% in FY2015.



Wages: Pay increase will push incomes higher

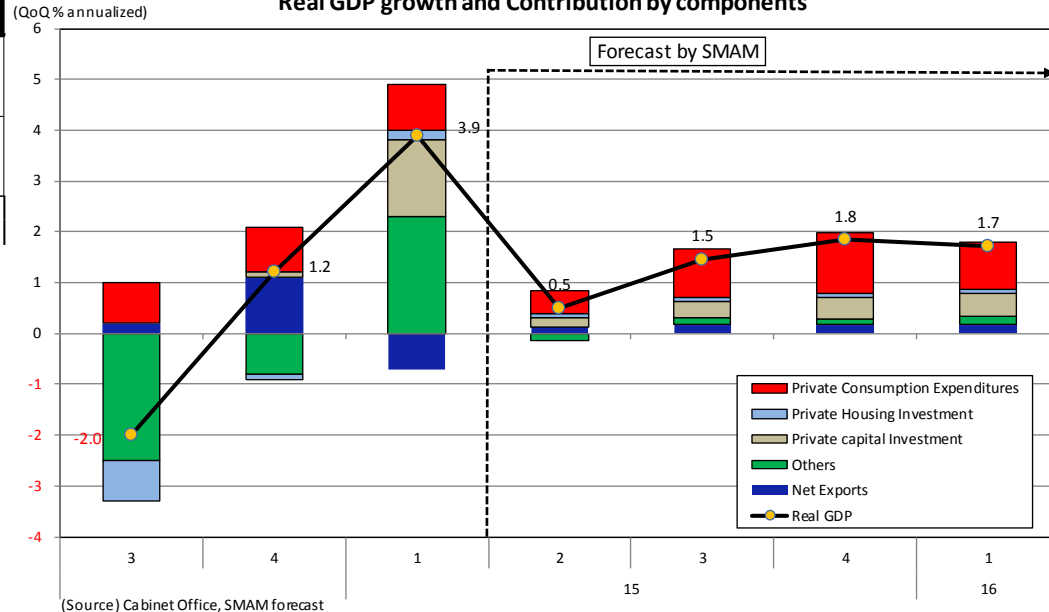
- Wages are expected to continue growing as job market remains tight and labor resource remains limited to grow. Wages gain will push up incomes and this will support Private Consumption Expenditures (PCE) to recover. SMAM expects PCE to contribute to the GDP growth largely in FY2015 and 2016.

Wages Growth and Labor Population Growth (YoY)



(Note) Data of the latest quarter is based on average of data for latest months.
 (Source) Ministry of Health, Labour and Welfare, SMAM

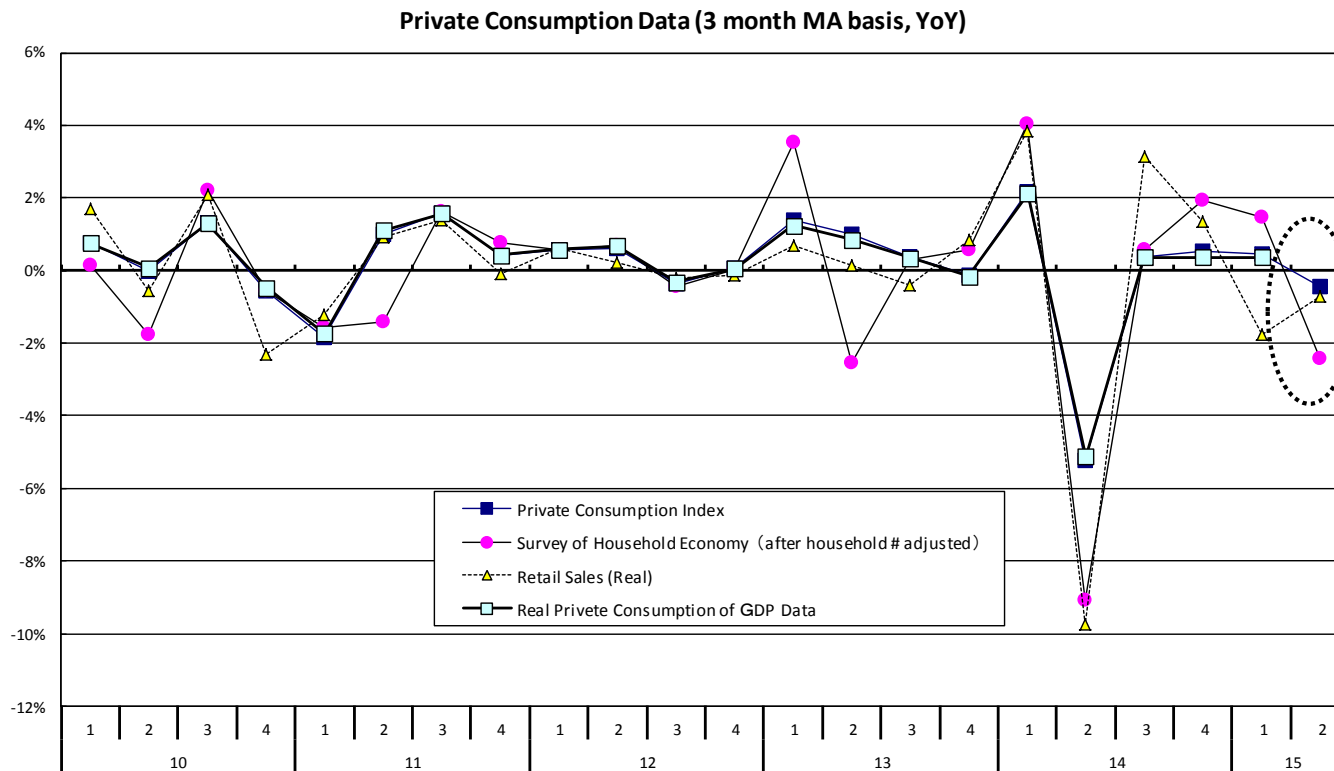
Real GDP growth and Contribution by components



(Source) Cabinet Office, SMAM forecast

Private Consumption: Anemic Private Consumption in April-June

- Private consumption data on a 3 month MA basis showed anemic recovery until April-June. Private Consumption Index, Household Survey and Retail Sales in April-June lost 0.5%, 2.4% and 0.7% respectively.
- However SMAM expects PCE to maintain +0.2% growth in April-June with a recovery in month by month (see next page).

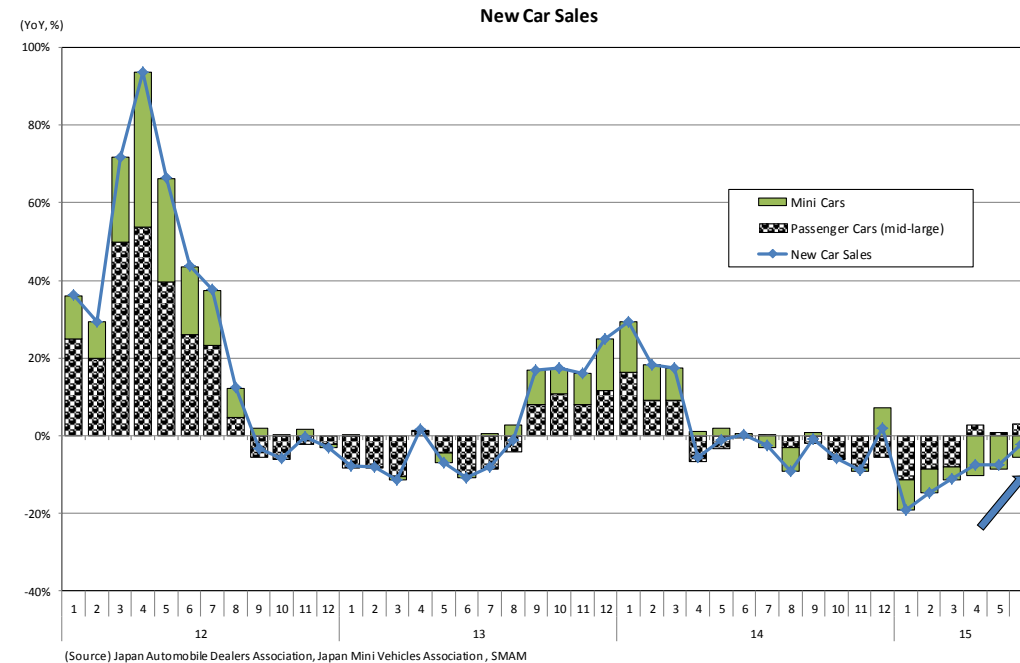
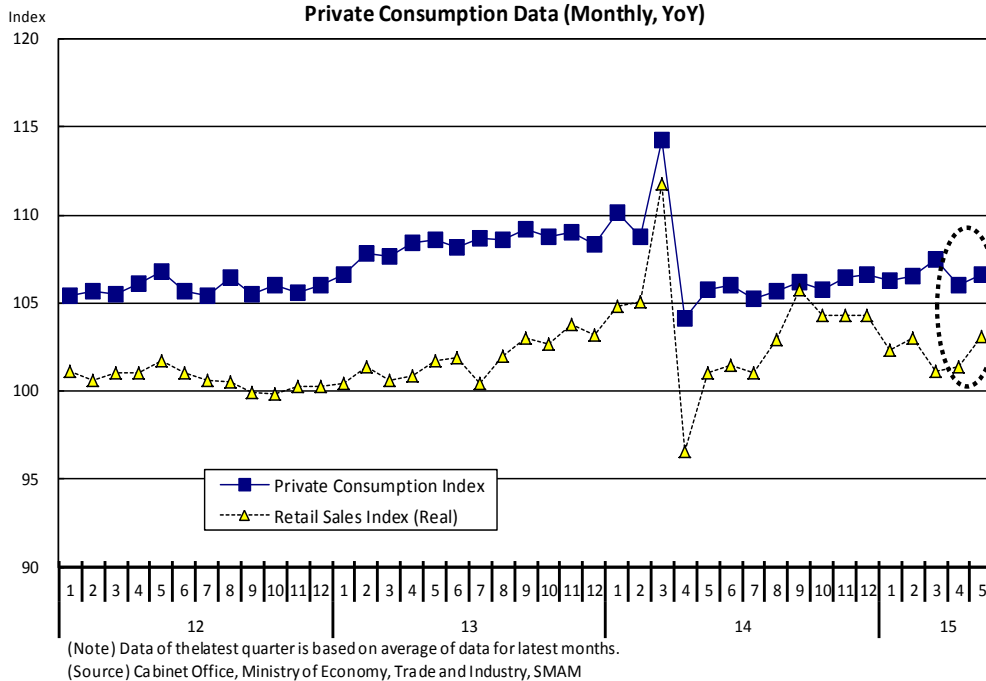


(Note) Data of the latest quarter is based on average of data for latest months.

(Source) Cabinet Office, Ministry of Economy, Trade and Industry, SMAM

Private Consumption: Monthly data show “Recovery”

- Monthly PCE data shows a sign of recovery. Both of Private Consumption Index and Retail sales rose in May. New Car Sales have been bottoming out since January. SMAM expects PCE to resume growing at faster pace from July-September.



Outlook for Japanese Stock Markets

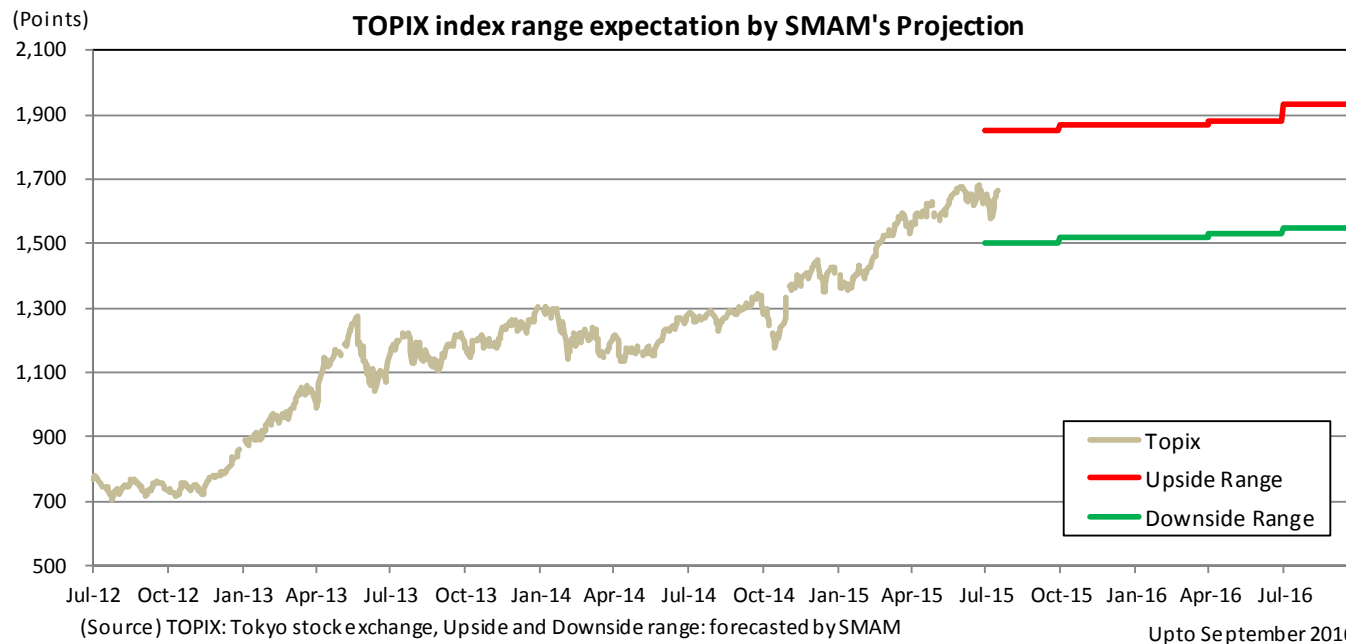
Stock market outlook: Earnings growth prospects should help the stock market

SMAM short-term view

- In addition to moderate growth in Production and Exports, Consumption recovery would lift the macro economy. Corporate earnings are expected to continue double digit growth in FY2015.
- The stock market is expected to keep advancing as Japan's reflation policy is very likely to continue until next consumption tax hike in 2017. Increasing expectation for dovish US rate hike should also support the market.

Longer-term outlook (6-months and beyond)

- For longer-term, we continue to expect the market to track on a modest uptrend, underpinned by US-led global growth, solid corporate earnings and strengthened reflationary policies in Japan. Investors are more likely to focus on earnings upward revision after April-June company reports.



Base scenario & Upside / Downside risks for our forecasts

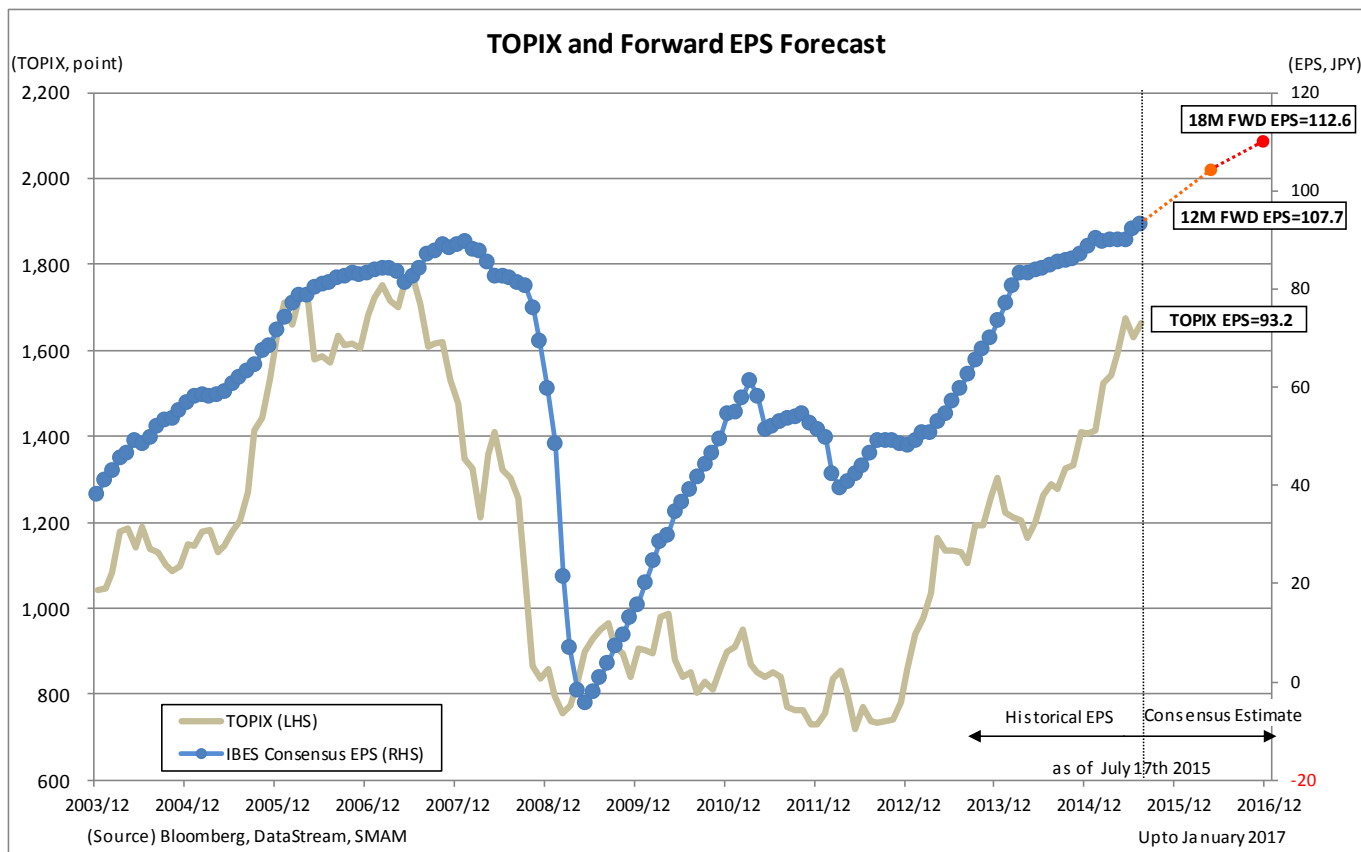
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's mild recovery from tax-hit weak demand buoyed by higher real wages growth
 - Growing expectation for positive corporate earnings revisions due to weaker JPY
 - Reflationary policy to be continued toward the next consumption tax hike

- **Upside Risks** include:
 - Stronger-than-expected global growth
 - Stronger-than-expected measures by Abe government

- **Downside Risks** include:
 - Slowdown in global economy
 - Concern over global deflation
 - Increasing geopolitical concerns

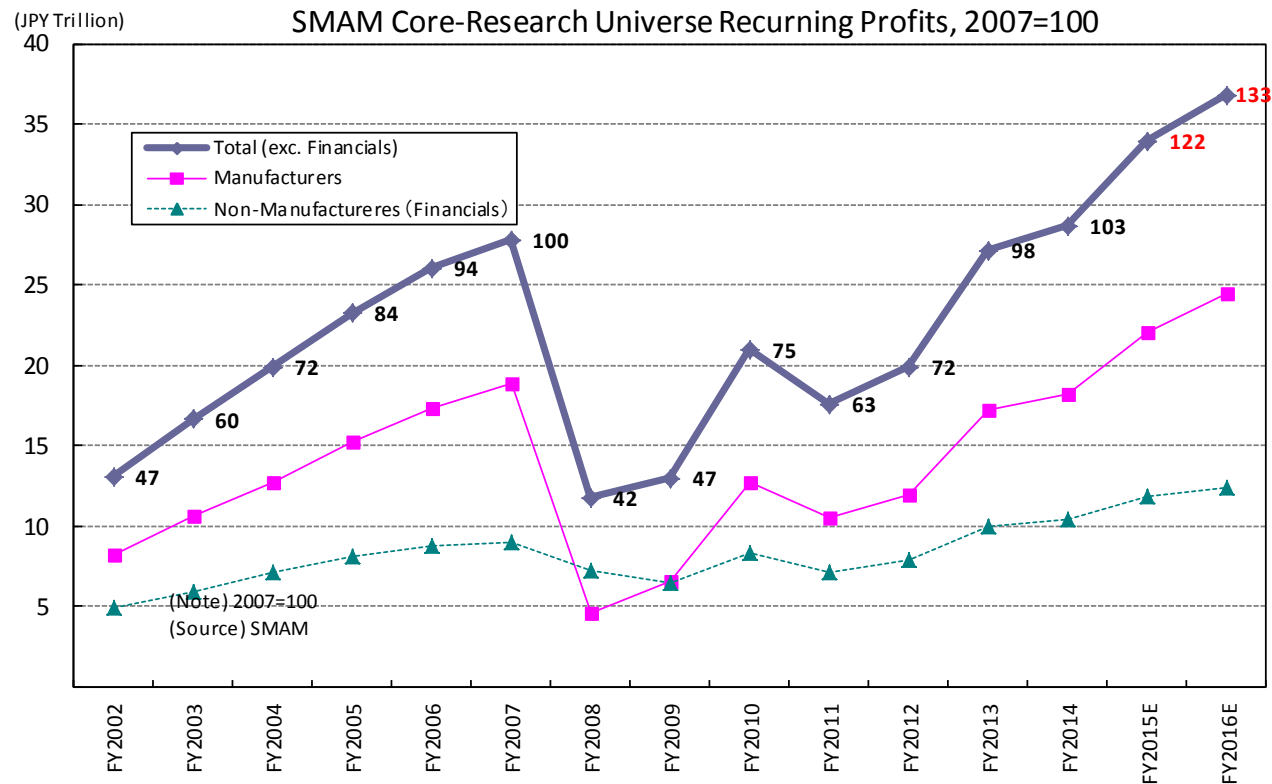
TOPIX / EPS forecast: Fairly valued on upbeat forward EPS

- IBES consensus EPS continues rising supported by solid growth prospects. IBES 12 month and 18 month forward EPS are JPY107.7 and JPY112.6 respectively, while TOPIX EPS is currently JPY93.2 as of July 17th.
- TOPIX of 1,662.94 as of July 17th seems fairly valued as the current P/E's are 14.7x and 15.4x based on the IBES 18 month and 12 month forward EPS forecasts.



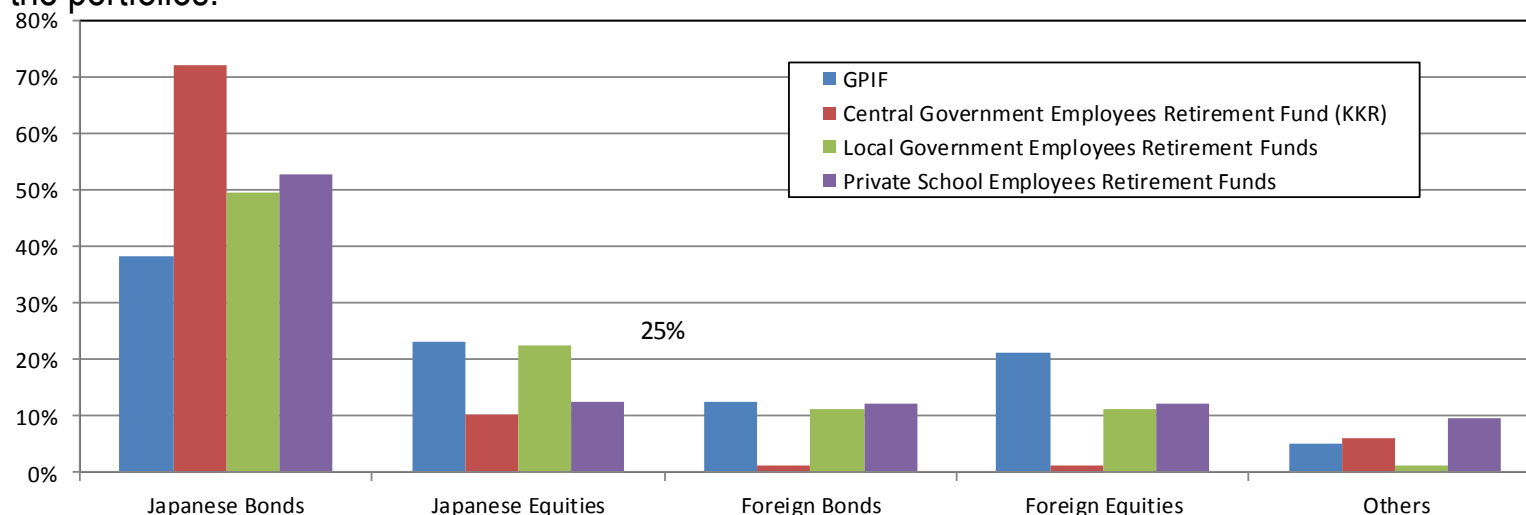
Corporate earnings : SMAM forecasting upbeat earnings growth

- For FY2016, the recurring profits are expected to continue to grow by +8.5% YoY for SMAM core research universe (216 companies).
- Provided the recurring profits for FY2007 are set at 100, the profits are expected to keep growing to 122 and 133 for FY2015 and FY2016 after renewing the record highs in FY2014.



Supply-Demand balance ①: Public pensions raising Japanese stocks

- Three large pensions such as Central Government Employees Retirement Fund (KKR), Local Government Employees Retirement Funds and Private School Employees Retirement Funds are raising Japanese equities, following the largest pension of GPIF.
- All four pensions are estimated to buy another JPY5.3 trillion if they increase Japanese equities to 25% weight in the portfolios.



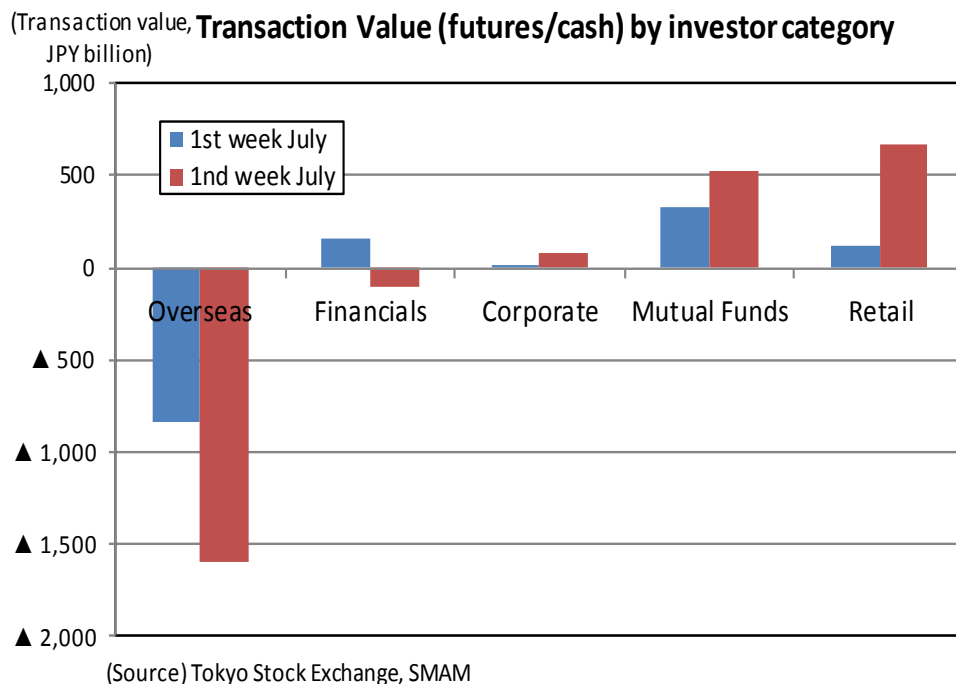
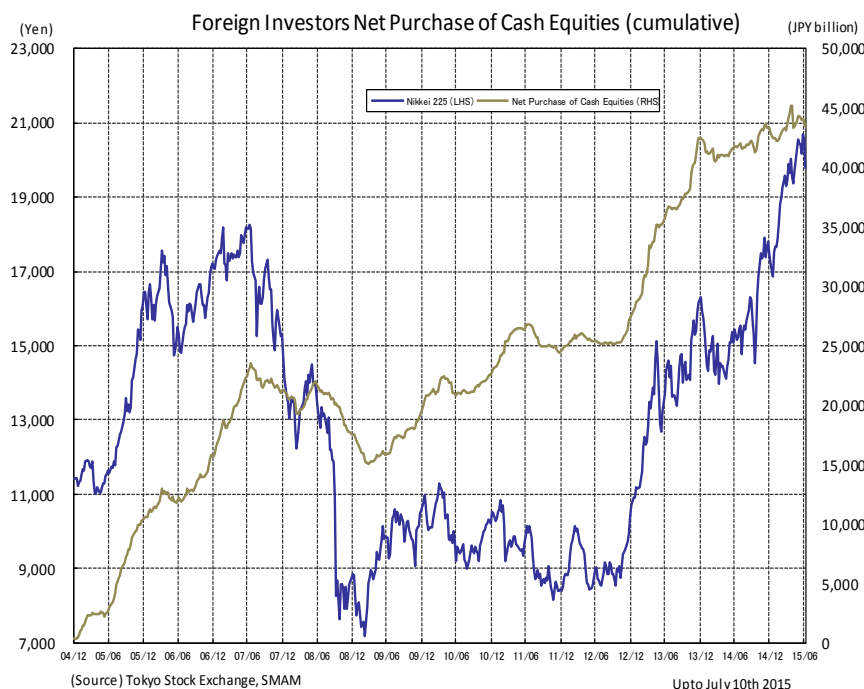
Asset Allocation	allocation weight/total portfolio (%) as of June 2015					
	Total	Japanese Bonds	Japanese Equities	Foreign Bonds	Foreign Equities	Others
GPIF	100.0%	38.4%	23.0%	12.5%	21.1%	5.0%
Central Government Employees Retirement Fund (KKR)	100.0%	72.2%	10.3%	1.4%	1.4%	6.0%
Local Government Employees Retirement Funds	100.0%	49.7%	22.5%	11.3%	11.3%	1.3%
Private School Employees Retirement Funds	100.0%	52.8%	12.5%	12.2%	12.2%	9.7%
Average	100.0%	41.6%	22.1%	11.9%	11.9%	4.7%
*Target allocation weight (estimated)	100.0%	35.0%	25.0%	15.0%	25.0%	0.0%

(Source) GPIF, Central Government Employees Retirement Fund (KKR), Local Government Employees Retirement Funds, Private and School Employees Retirement Funds and Nomura estimated

(Note) The above estimates are subject to updates thereafter without notice.

Supply-Demand balance②: Domestic investors raised positions on weakness

- Overseas investors temporarily liquidated Nikkei futures positions for the 1st and 2nd week of July when Nikkei Index dropped to below 20,000 on a plunge in Chinese stocks. The net sale for futures increased to JPY1,186 billion, whereas that for cash positions remained relatively stable at JPY682 billion in net sale.
- Meantime, domestic investors raised Japanese stocks on weakness in market. Mutual funds and retail investors bought JPY854 billion and JPY796 billion respectively during the same period.



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