



Japanese Stock Market Outlook

SMAM monthly comments & views
- March 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Ongoing moderate economic recovery is currently in the middle stage, as robust Exports and Industrial Production is boosting the economy. The other economic growth driver, Consumption Expenditures falters with mixed economic data for solid recovery. Wage increase should help to gain Consumption and consumer confidence, while “Spring wage negotiation round” is in full swing.

- SMAM expects mild real GDP recovery of +1.2% and +1.6% in FY2015 and FY2016 alongside global economic growth.
- Current recovery polarizes upbeat Exports and Industrial Production, and lagging Consumption.
- Core-CPI is expected to fall to “zero” in May and BOJ is likely to revise its target rate downward, but the timing of additional monetary easing is controversial.

➤ Japanese Stock Markets

The market is expected to rally on increasingly positive earnings growth as quite a few up-revisions are expected due to weaker JPY at the full-year corporate performance posting in May.

- Corporate earnings growth momentum is likely to accelerate as double digit profit growth is expected in FY2015 (FY2016/3).
- Downside risk is associated with foreign factors such as geopolitical concerns, unclear monetary policy by Fed and ECB, and possibly negative effects by crude oil price slump.

Outlook for Japanese Economy

SMAM economic outlook for FY14-16

- SMAM newly rated Real GDP forecast of +1.6% for FY2016, while the forecasts were downgraded to -0.8% from -0.6% for FY2014 and to +1.2% from +1.3% for FY2015 respectively.
- Recently released annualized +2.2% October-December GDP data showed mild recovery. Strong Exports spurred to expand Industrial Production, while weak Consumption weighed on the slower-than-expected GDP growth (market consensus of +3.7%) in the quarter.
- The BOJ is highly likely to revise downward its +1.0% inflation forecast for FY2015 as SMAM expects Core-CPI to dip into negative once in May and recover slightly to +0.4% for full FY2015.

	FY11	FY12	FY13	FY14E	FY15E	FY16E
Real GDP growth	0.4%	1.0%	2.1%	-0.8%	1.2%	1.6%
Private Consumption Expenditure	1.4%	1.8%	2.5%	-3.1%	1.2%	1.7%
Private Housing Investment	3.2%	5.7%	9.3%	-11.9%	0.3%	4.2%
Private Capital Investment	4.8%	1.2%	4.0%	0.1%	2.5%	3.2%
Public Consumption Expenditure	1.2%	1.5%	1.6%	0.3%	0.8%	0.6%
Public Capital Investment	-3.2%	1.0%	10.3%	2.9%	-1.7%	-1.6%
Net Exports (contrib. to GDP growth)	-1.0%	-0.8%	-0.5%	0.7%	0.3%	0.1%
Exports	-1.6%	-1.3%	4.7%	7.2%	5.0%	5.0%
Imports	5.4%	3.6%	6.7%	3.0%	4.0%	5.2%
Nominal GDP	-1.3%	0.1%	1.8%	1.2%	1.3%	2.2%
GDP Deflator	-1.7%	-0.9%	-0.3%	2.1%	0.1%	0.5%

FY starting April and ending March

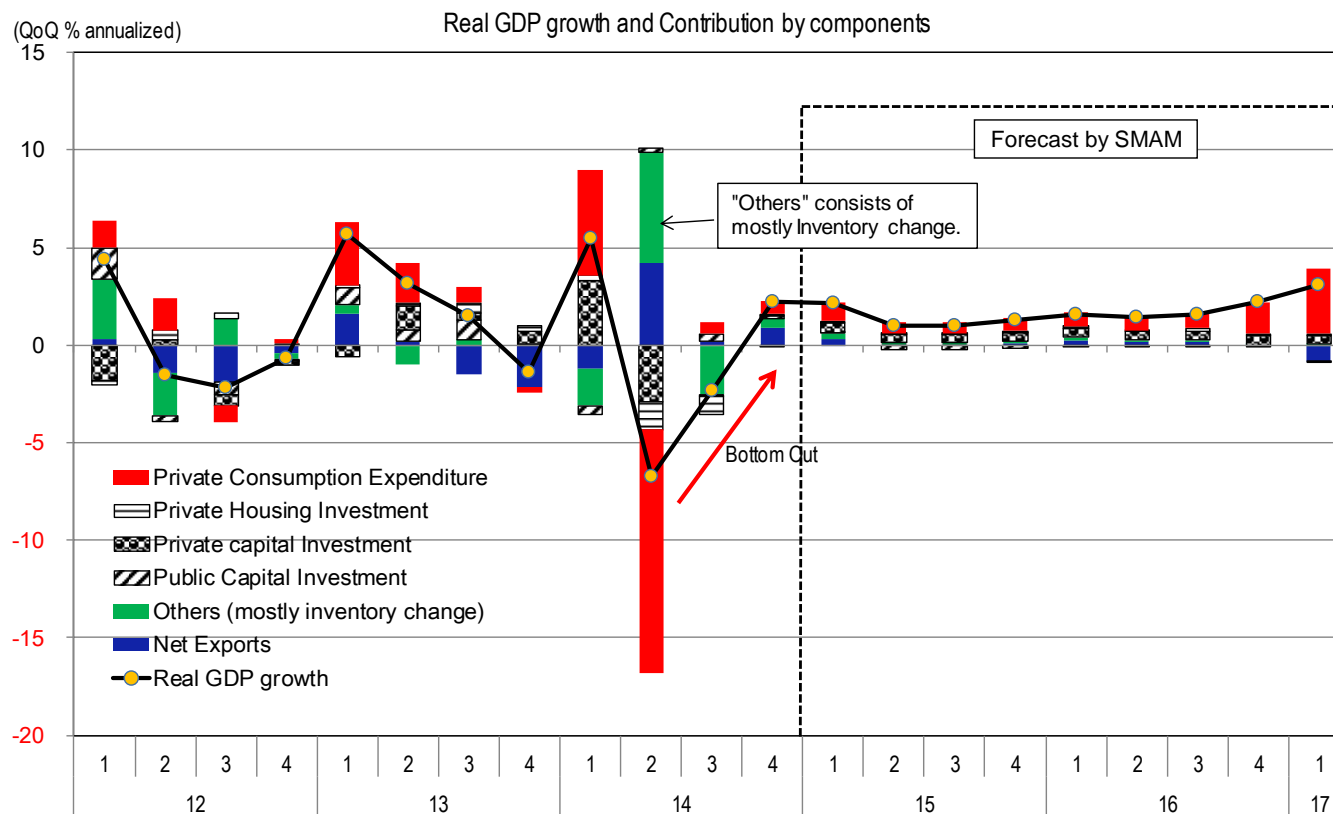
(%, YoY except Net Exports)

Notes: E=SMAM forecasts. SMAM views are as at 16 February 2015 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

Quarterly GDP: +2.2% GDP growth after 2 straight quarters slowdown

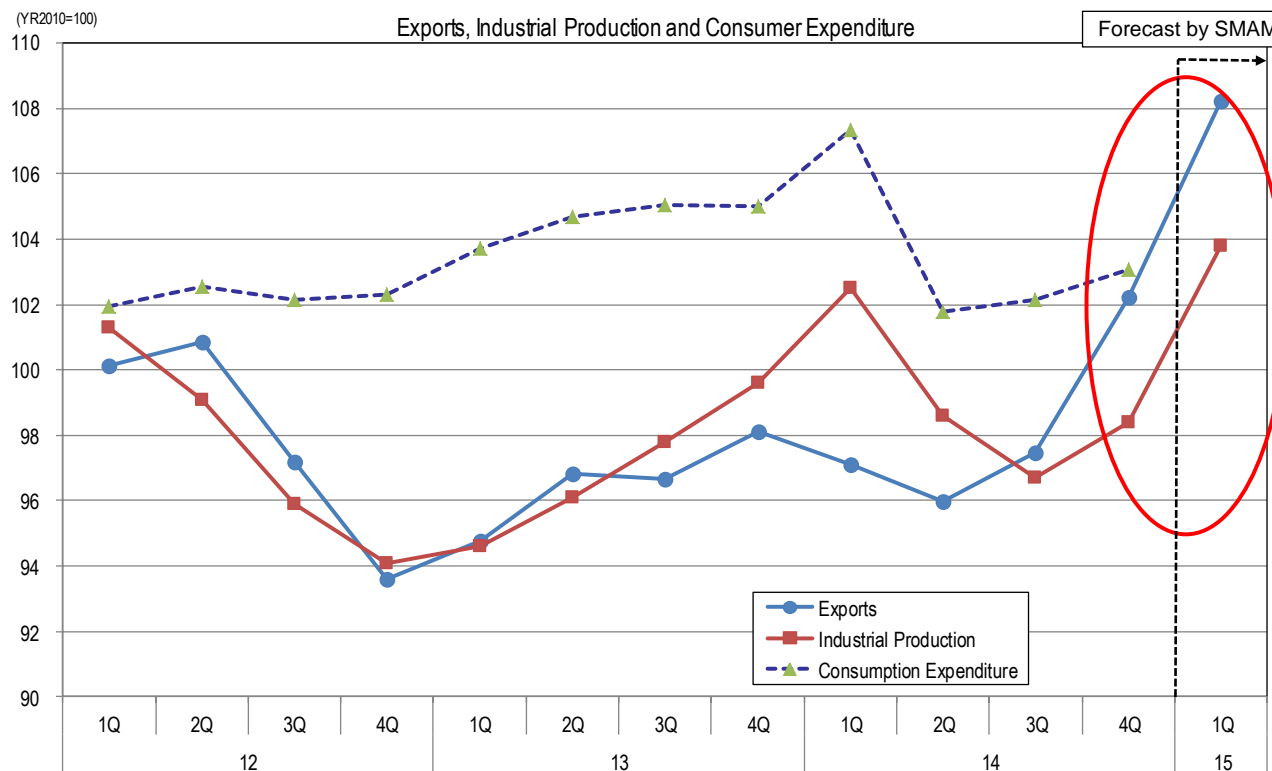
- October-December GDP grew annualized +2.2%, bottoming out after 2 consecutive quarters slowdown.
- Industrial Production has geared up again since October-December quarter, spurred by upbeat Exports, while Consumption Expenditures are still improving at slower pace.



(Source) Cabinet Office, SMAM forecast

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

- SMAM forecasts this recovery process in order from Exports to Production and Consumption. Now it is the middle stage of Production expansion.
- Stable economic recovery is expected at this time underpinned by robust Exports and Industrial Production due to US led global economic growth.
- Lagging Consumption Expenditures should be buoyed by improvement in Consumer Confidence.



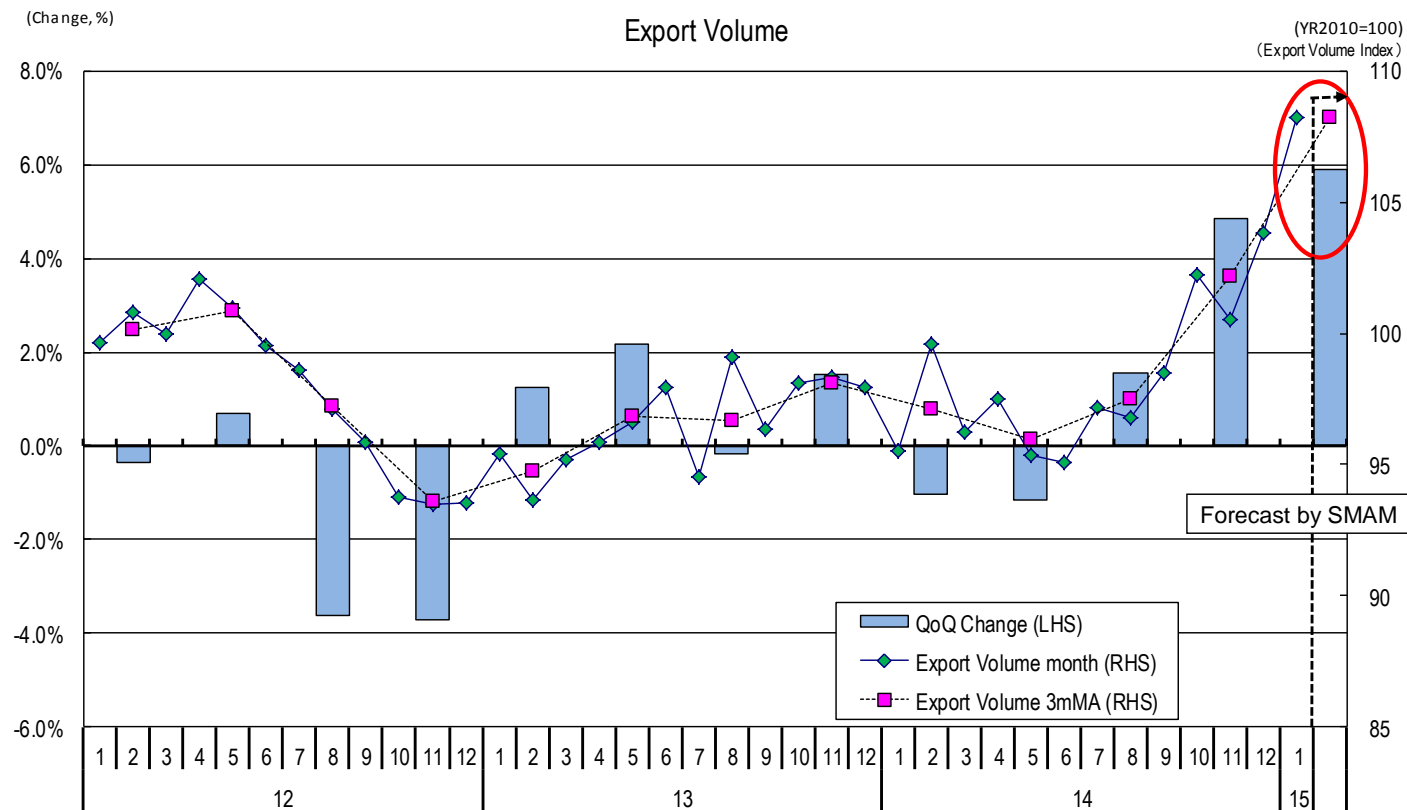
(Source) Ministry of Economy, Trade and Industry, BOJ, Cabinet Office, SMAM seasonally adjusted

*1: Exports for 1Q 2015 are estimated based on the data of first 20 days January provisional basis.

*2: Industrial Production for 1Q 2015 is estimated based on the data of Industrial Production Forecast Index.

Exports: Favorably growing Exports in January

- October-December Export volume accelerated to expand to +2.7% QoQ from +1.6% QoQ in July-September.
- Exports FOB value basis favorably rose by 14.8% in January (First 20 days Provisional).

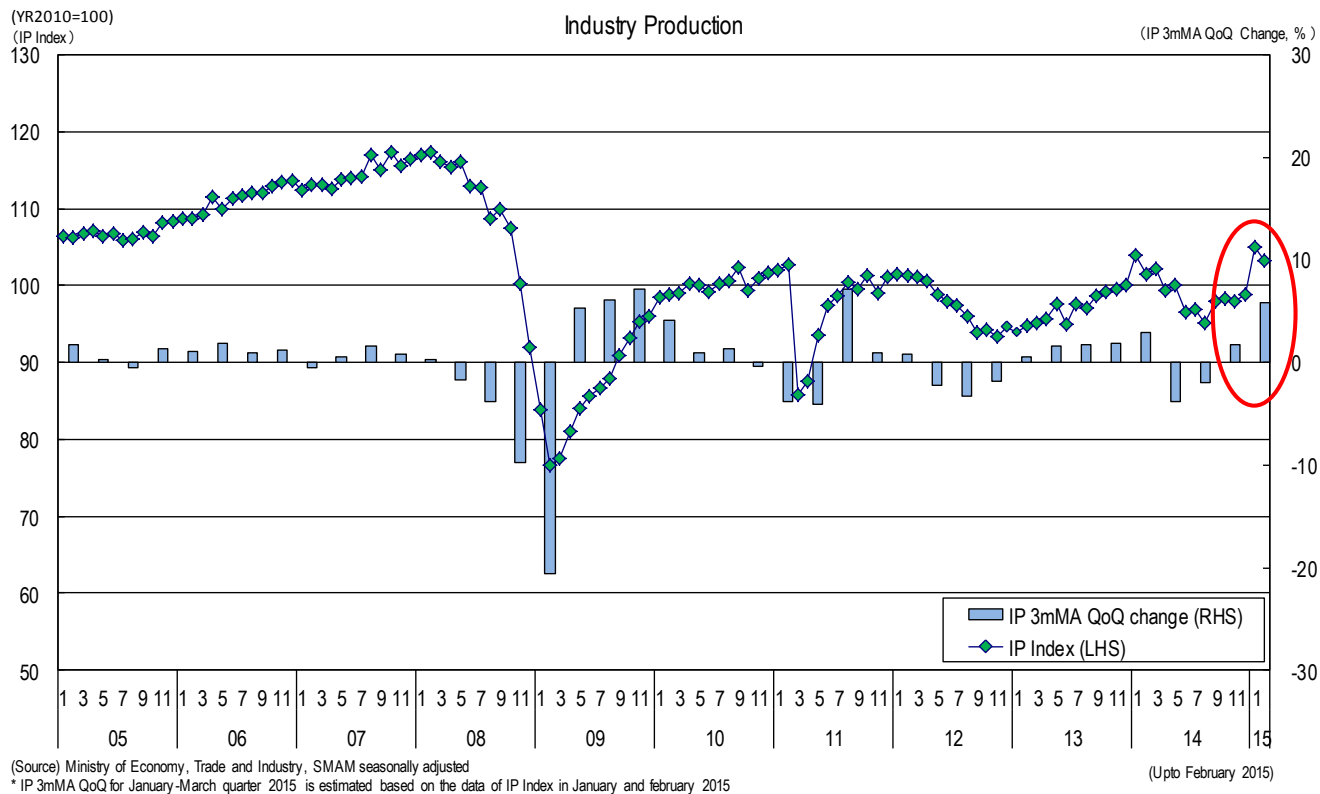


(Source) Bank of Japan, SMAM seasonally adjusted

* QoQ Change and Export Volume 3mMA for January-March quarter 2015 are estimated based on the data of first 20 days January

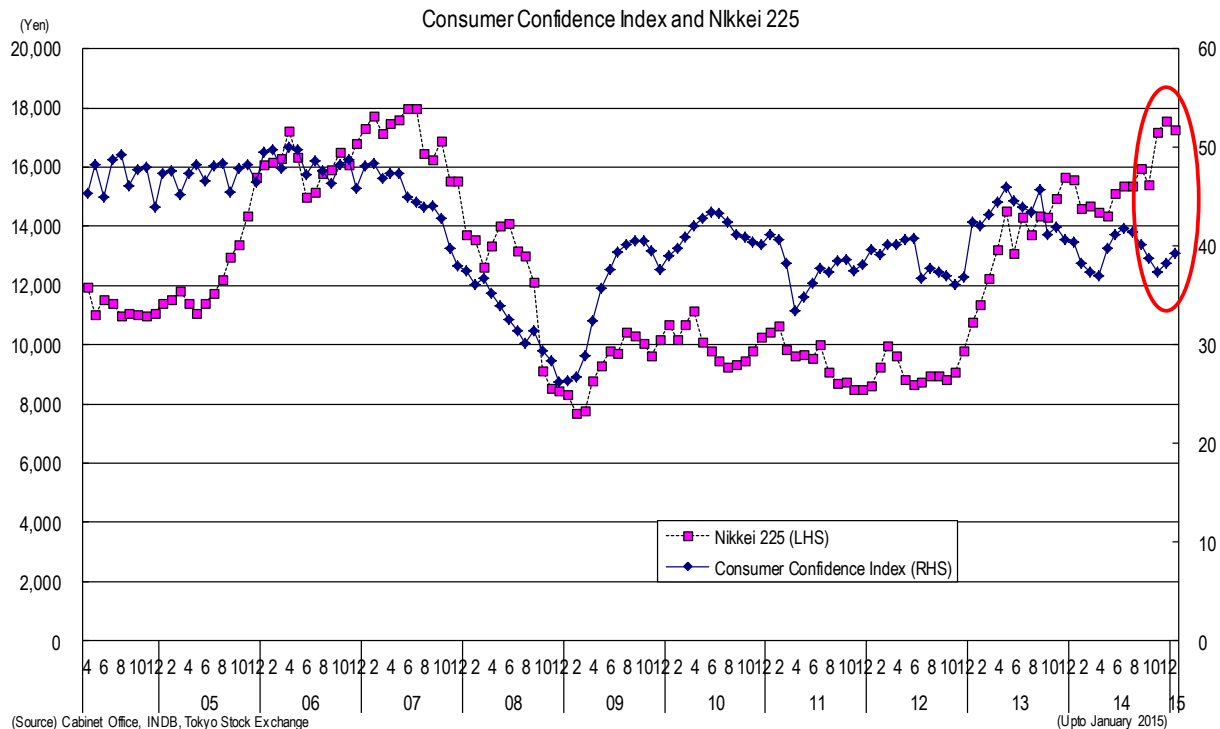
Production: Mild sustainable IP recovery to be expected

- October-December Industrial Production recovered by +1.8% QoQ for the first time in 3 quarters.
- Production Forecast Index shows robust growth of +6.3% MoM in January and -1.8% MoM in February.



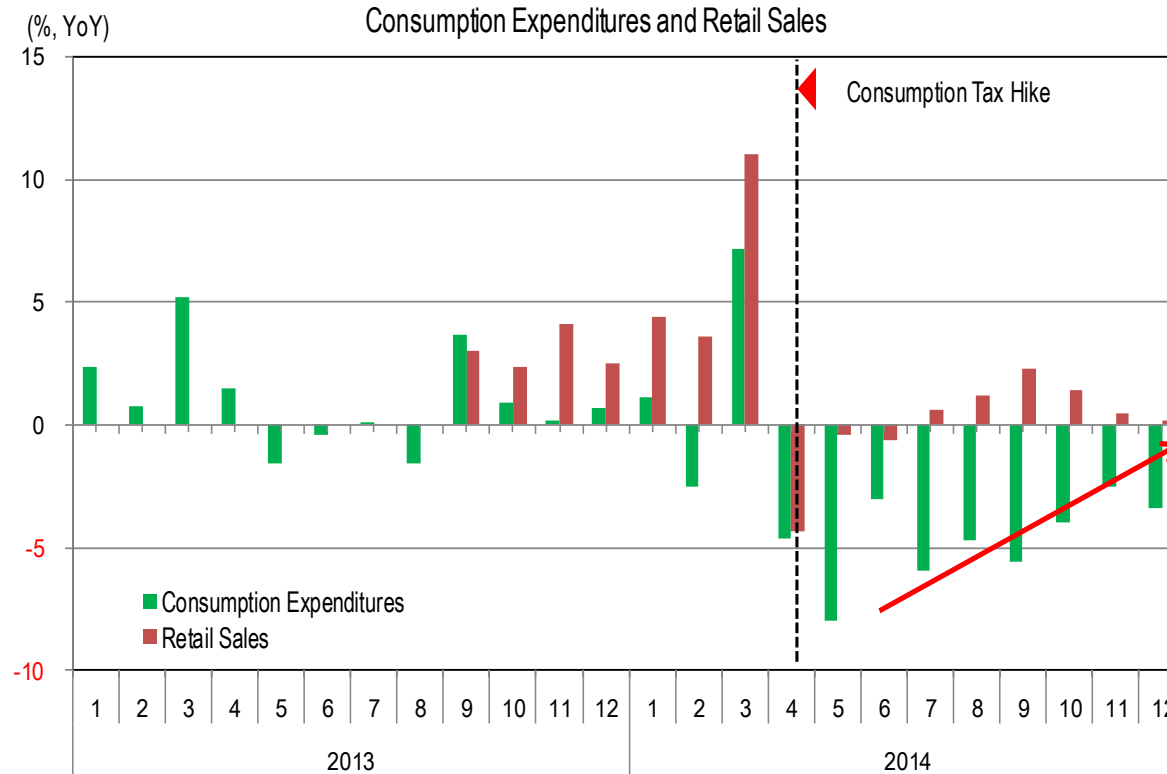
Consumer Confidence: Slight improvement in Consumer Sentiment

- Consumer Confidence Index rebounded for 2 consecutive months by +1.1% MoM in December and +0.3% MoM in January.
- Consumer Sentiment is anticipated to improve, supported by tight labor market. December unemployment rate fell to 3.4% of the full-employment.
- Slower growth in real wages weighs on recovery in Consumption as Scheduled cash earnings (fixed salary) has not grown much from the previous year. Considerable wage hike is the key for improving consumer confidence.



Consumption: Mixed Consumption data showing weak recovery

- December Retail Sales slightly rose by +0.2% YoY, while Consumer Expenditures lost by 3.4% YoY in December.
- Consumption tax hike seems to affect more on Consumer Discretionary. December New car sales slumped by -18.9% YoY.
- Mixed Consumption data shows Consumption seems to be still in the middle of full-recovery.



(Source) Ministry of Internal Affairs and Communications

Outlook for Japanese Stock Markets

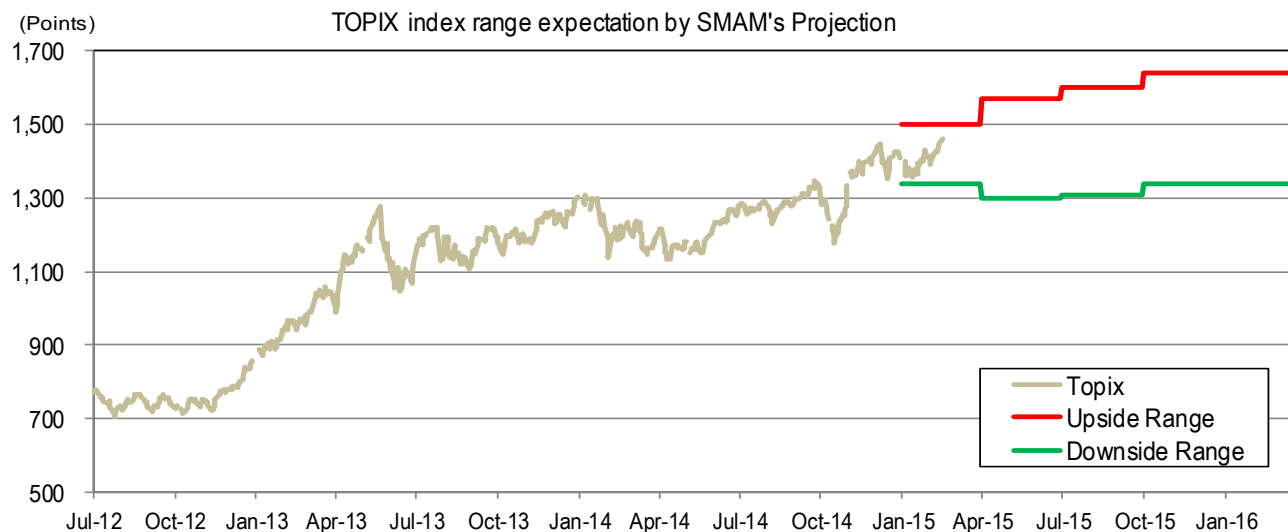
Stock market outlook: Earnings growth prospects should lift up the stock market

SMAM short-term view

- Due to lack of major concern over domestic factors, Japanese equity market is anticipated to sustain to rally. SMAM forecasts positive corporate earnings prospects due to weaker JPY.
- Downside risk includes foreign factors such as geopolitical concerns over Greek negotiation and Russia/Ukraine cease-fire, uncertain monetary policy in Fed and ECB, and possibly negative effects to global economy and capital market led by crude oil price plunge.

Longer-term outlook (6-month and beyond)

- For longer-term, we continue to expect the market to track on a modest uptrend, underpinned by US-led moderate global growth, solid corporate earnings growth and strengthened reflationary policies in Japan.



(Source) TOPIX: Tokyo stock exchange, Upside and Downside range: forecasted by SMAM

Note: SMAM's Projection is as at 18 February 2015 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

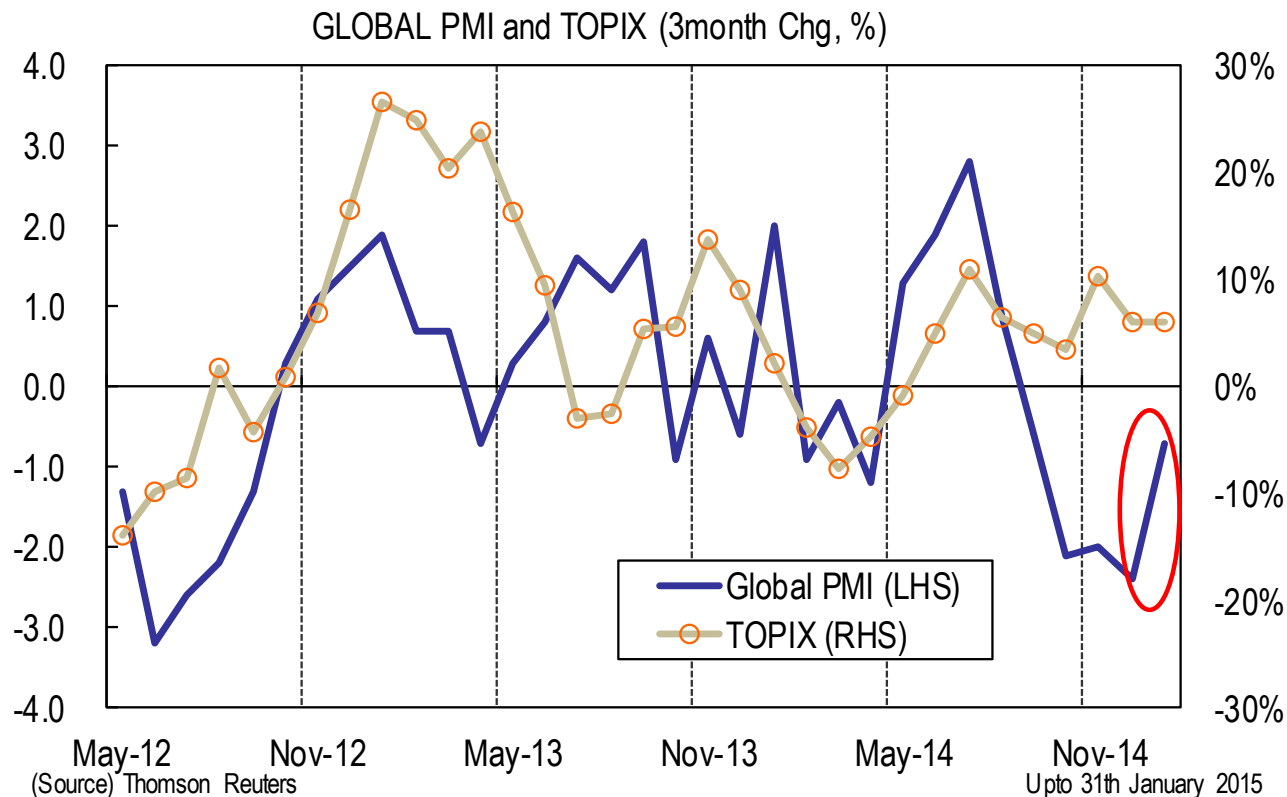
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's mild recovery from tax-hit weak demand buoyed by rescheduled next tax hike until 2017
 - Growing expectation for positive corporate earnings revisions due to weaker 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

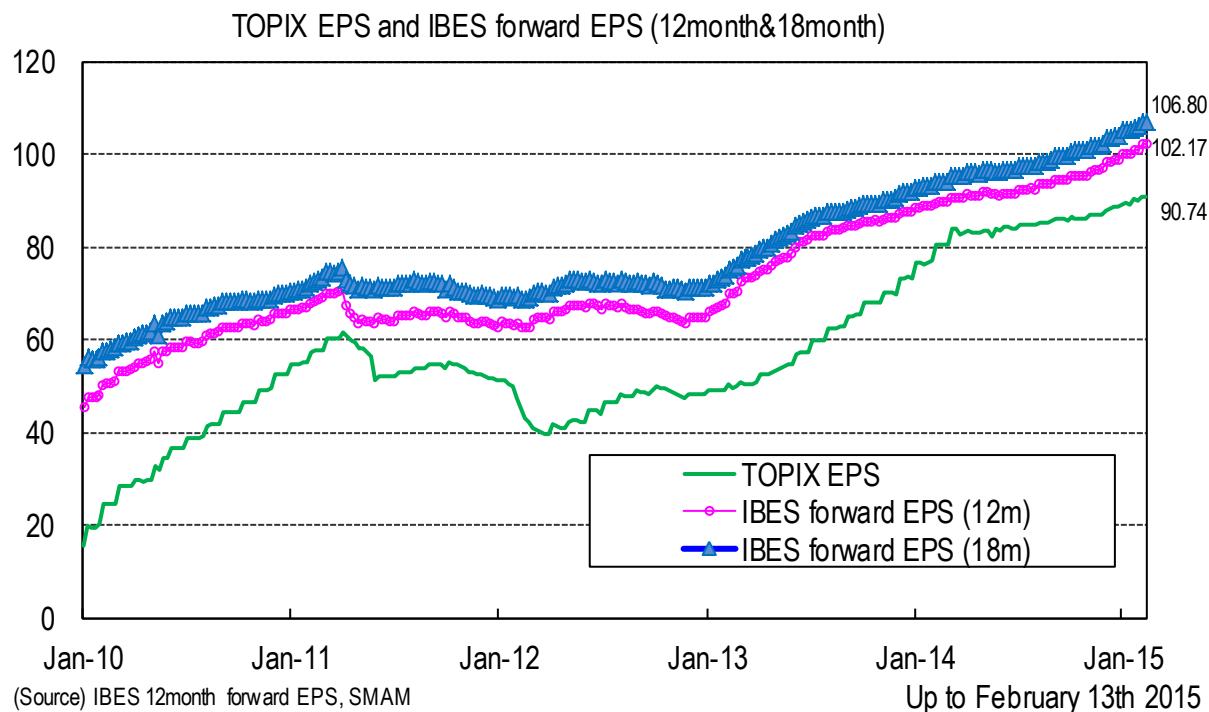
Global recovery: Global PMI Vs. TOPIX

- PMI is often used as a leading economic indicator. There seems some correlation between TOPIX and Global PMI as many Japanese companies increase their profits while global economy are growing.
- Recent sharp improvement in Global PMI would help to lift up the Japanese equity market index although corporate profits are often lagging to grow from the economic data.



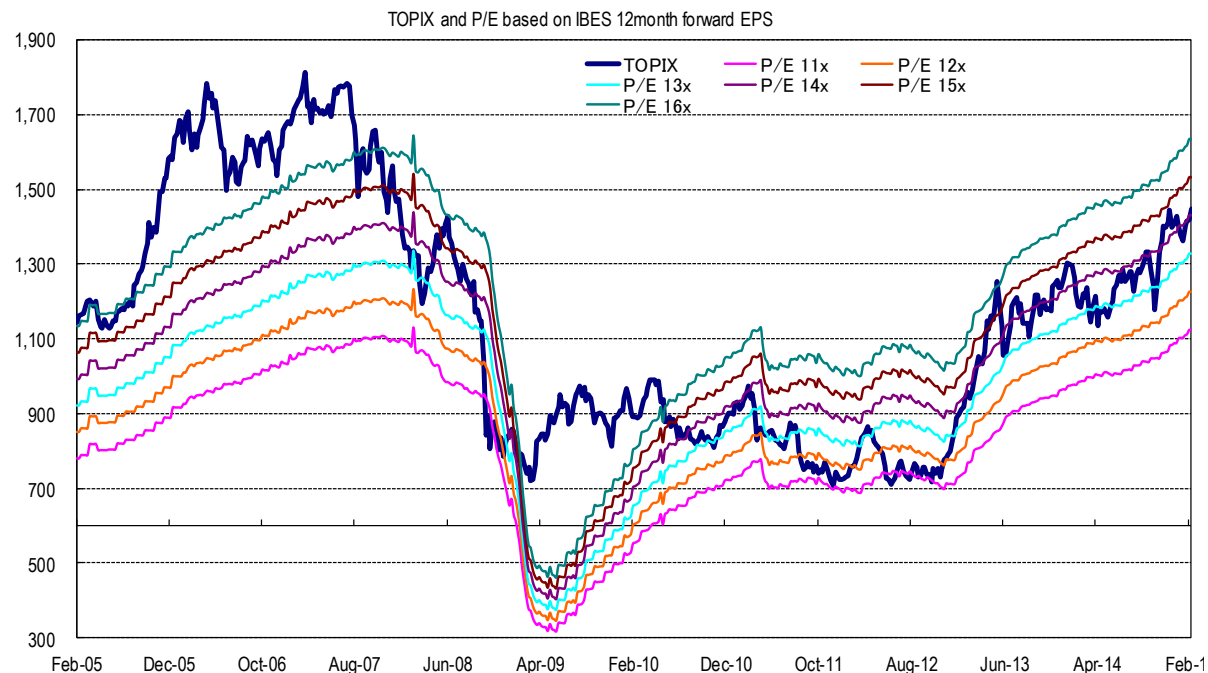
EPS forecasts: Upbeat EPS forecasts

- IBES consensus EPS continues rising supported by solid growth prospects. IBES 12 month forward EPS and 18 month forward EPS are 102.17 and 106.80, while TOPIX EPS is currently 90.74 as of 13th February.
- SMAM revised down corporate profit growth to +7.6% YoY from +11.2% YoY for its research universe 200 companies (ex. Financials) for FY2014 as resource businesses such as petroleum and mining posted write-off in October-December quarter led by lower oil price.
- However, SMAM expects +14.8% profit growth in FY2015 as corporate earnings are expected to continue solid recover due to global economic growth and stabilized oil prices.



TOPIX range forecast: Fairly valued but profit growth momentum accelerated

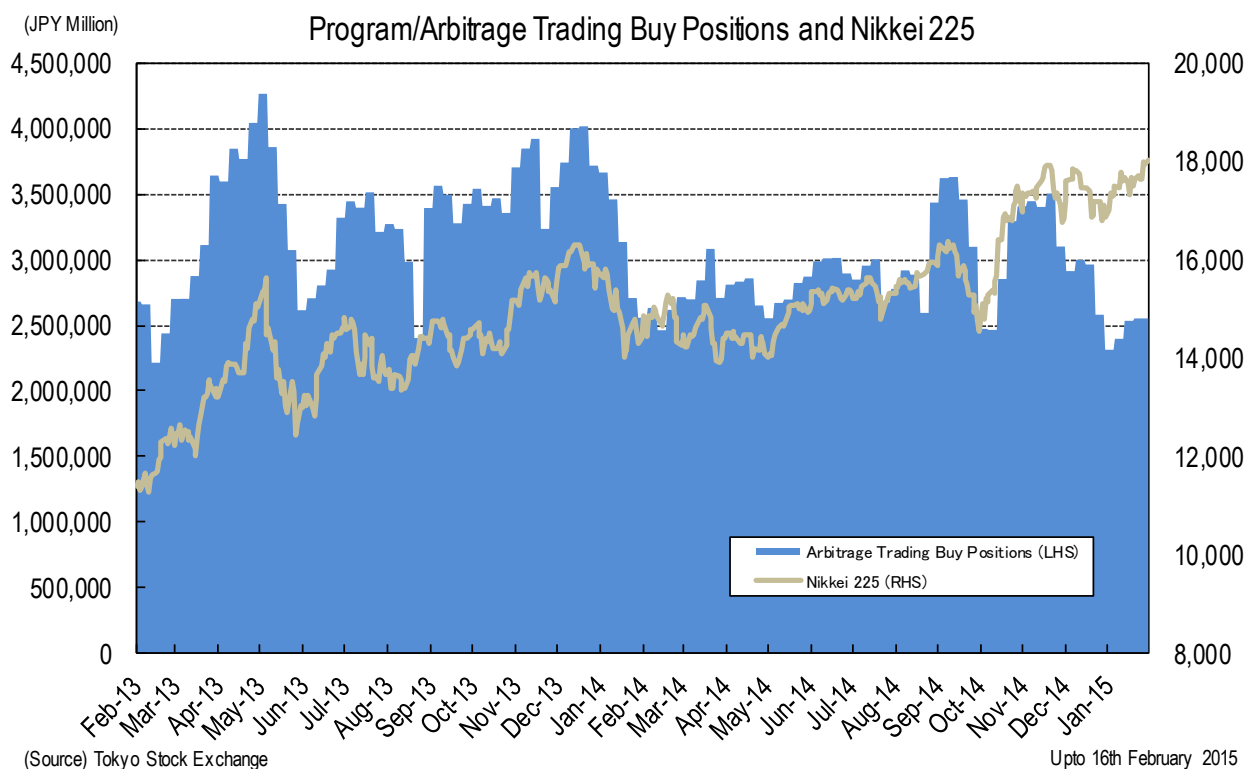
- IBES 12 month forward EPS forecast for TOPIX was JPY102.17 as of February 13 2015. P/E has ranged between 13x and 15x since Abe government resumed. Based on these values, TOPIX is estimated to be between 1,328 and 1,532. This shows current Japanese stocks and TOPIX of 1,482 as of February 18 are fairly valued within this range.
- SMAM expects +7.6% and +14.8% profit growth in FY2014 and FY2015 for the research universe 200 companies (ex. Financials). Corporate profit growth momentum is going to accelerate.



*1: Calendar year, week-end Topix, P/E based on IBES 12month forward EPS
 *2: SMAM forecast is expected based on earnings projection of ERG core univers (ex. Financials)
 (Source) Tokyo Stock Exchange, IBES 12month forward EPS, SMAM

Supply / Demand analysis: Program / Arbitrage trading buy positions Vs. Nikkei 225

- The stock market would often advance while the buy positions for Program / Arbitrage trading (=cash and carry positions) are increasing. Many of those positions are closed by reversing sell transactions and the market would often decline.
- The Chart shows Nikkei 225 Index gained alongside the increasing in Program / Arbitrage buy positions for the period 2013-2014. However, Nikkei is moving higher, while the buy positions are growing little in 2015. Current rally is likely to continue under the light selling pressure.



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