



Japanese Stock Market Outlook

SMAM monthly comments & views
- May 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Japan's economic recovery is under way, as robust Exports and Industrial Production are leading the moderate growth. Meantime, faltering Consumption Expenditures are expected to recover due to higher real wages led by nominal wages gain and subdued inflation rate.

- SMAM upgraded real GDP forecast by +0.1ppt to +1.5% in FY2015 and +1.9% in FY2016 respectively.
- Consumption Expenditures are likely to recover going forward due to the increase in real wages, while business confidence still remains mixed in the industries.
- Core-CPI is expected to approach “zero” and BOJ is highly likely to revise its inflation forecast downward, but SMAM does not expect additional monetary easing at this moment.

➤ Japanese Stock Markets

Current TOPIX is slightly above the upper limit of historical P/E range since 2013, however there seems still upside room for the stocks due to very likely up-revisions of corporate profits and possible P/E expansion under global monetary easing.

- FY2015 corporate profits are expected to be revised upward due to weak JPY and low crude oil price.
- The money inflow from public funds such as GPIF is a tailwind on the stock market.
- 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.

Notes: Macro and market views are as of 17th and 20th April 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY14-16

- SMAM revised Real GDP forecast upward to annualized +1.5% from +1.4% for FY2015 and to +1.9% from +1.8% for FY2016 mainly due to recovery in Private Consumption Expenditures (PCE) and Exports.
- PCE forecast is upgraded to +1.7% from +1.5% due to higher real wages led by lower inflation for FY2015.
- SMAM cut Core-CPI forecast to +0.2% from +0.4% YoY for FY2015 and remained at +1.1% for FY2016. The inflation rate is unlikely to reach the BOJ's +2.0% target, however SMAM does not currently expect additional easing within this year.

	FY11	FY12	FY13	FY14E	FY15E	FY16E
Real GDP growth	0.4%	1.0%	2.1%	-1.0%	1.5%	1.9%
Private Consumption Expenditure	1.4%	1.8%	2.5%	-3.0%	1.7%	2.0%
Private Housing Investment	3.2%	5.7%	9.3%	-11.8%	0.3%	4.2%
Private Capital Investment	4.8%	1.2%	4.0%	0.1%	2.7%	3.2%
Public Consumption Expenditure	1.2%	1.5%	1.6%	0.5%	0.9%	0.5%
Public Capital Investment	-3.2%	1.0%	10.3%	3.1%	-1.6%	-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%	5.3%	5.0%
Imports	5.4%	3.6%	6.7%	3.0%	4.0%	5.2%
Nominal GDP	-1.3%	0.1%	1.8%	1.3%	2.1%	2.4%
GDP Deflator	-1.7%	-0.9%	-0.3%	2.3%	0.6%	0.5%

Notes: E=SMAM forecasts. SMAM views are as of 17th April 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: Upward revision for FY2015 real GDP forecasts

- SMAM revised quarterly real GDP forecast upward to annualized +1.6% from +1.4% in April-June, to +1.7% from +1.4% in July-September and to +1.8% from +1.5% in October-December of FY2015.

(QoQ, %)	SMAM Forecast →											
	FY2014			Jan-Mar	FY2015				FY2016			
	Apr-Jun	Jun-Sep	Oct-Dec		Apr-Jun	Jun-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jun-Sep	Oct-Dec	Jan-Mar
Real GDP (Annualized)	-6.4%	-2.6%	1.5%	2.0%	1.6%	1.7%	1.8%	1.8%	1.6%	1.8%	2.3%	2.9%
Private Consumption Expenditures	-5.0%	0.3%	0.5%	0.3%	0.4%	0.5%	0.5%	0.4%	0.4%	0.4%	0.7%	1.4%
Private Housing Investment	-10.3%	-7.0%	-1.2%	0.9%	0.8%	0.8%	0.9%	1.1%	0.5%	2.0%	1.0%	0.7%
Private Capital Investment	-5.0%	-0.2%	-0.1%	1.2%	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%
Government Investment	1.1%	2.1%	0.8%	0.2%	-1.2%	-1.2%	-0.8%	-0.5%	-0.2%	-0.2%	-0.2%	-0.2%
Net Exports (Contribution to GDP)	1.1%	0.1%	0.3%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-0.2%
Exports	-0.3%	1.5%	2.8%	1.0%	1.1%	1.1%	1.1%	1.1%	1.2%	1.3%	1.4%	1.5%
Imports	-5.3%	-1.0%	1.3%	0.8%	0.9%	1.0%	1.0%	1.0%	1.1%	1.2%	1.6%	3.0%
Industrial Production	-3.6%	-1.9%	1.7%	1.3%	1.0%	0.9%	0.9%	0.8%	0.8%	0.8%	1.0%	1.6%
Unemployment Rate	3.7%	3.6%	3.5%	3.5%	3.4%	3.4%	3.4%	3.3%	3.3%	3.3%	3.2%	3.2%
core CPI (excl. tax hike effect)	1.4%	1.1%	0.7%	0.1%	-0.2%	-0.2%	0.3%	0.9%	1.1%	1.1%	1.1%	1.1%
GDP Deflator	2.2%	2.0%	2.4%	2.6%	0.8%	0.8%	-0.1%	0.7%	0.5%	0.5%	0.5%	0.5%

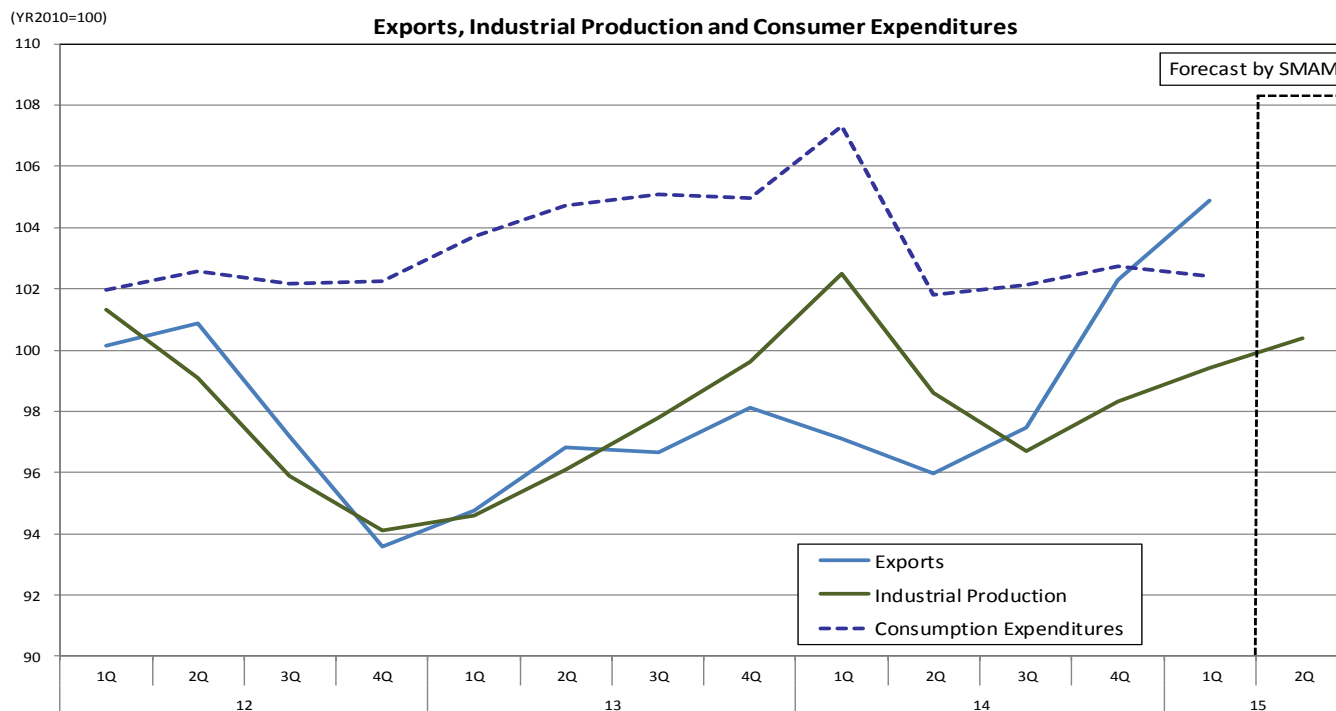
Notes: E=SMAM forecasts. SMAM views are as of 17th April 2015 and subject to updates thereafter without notice

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

The above data is as of 17th April.

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

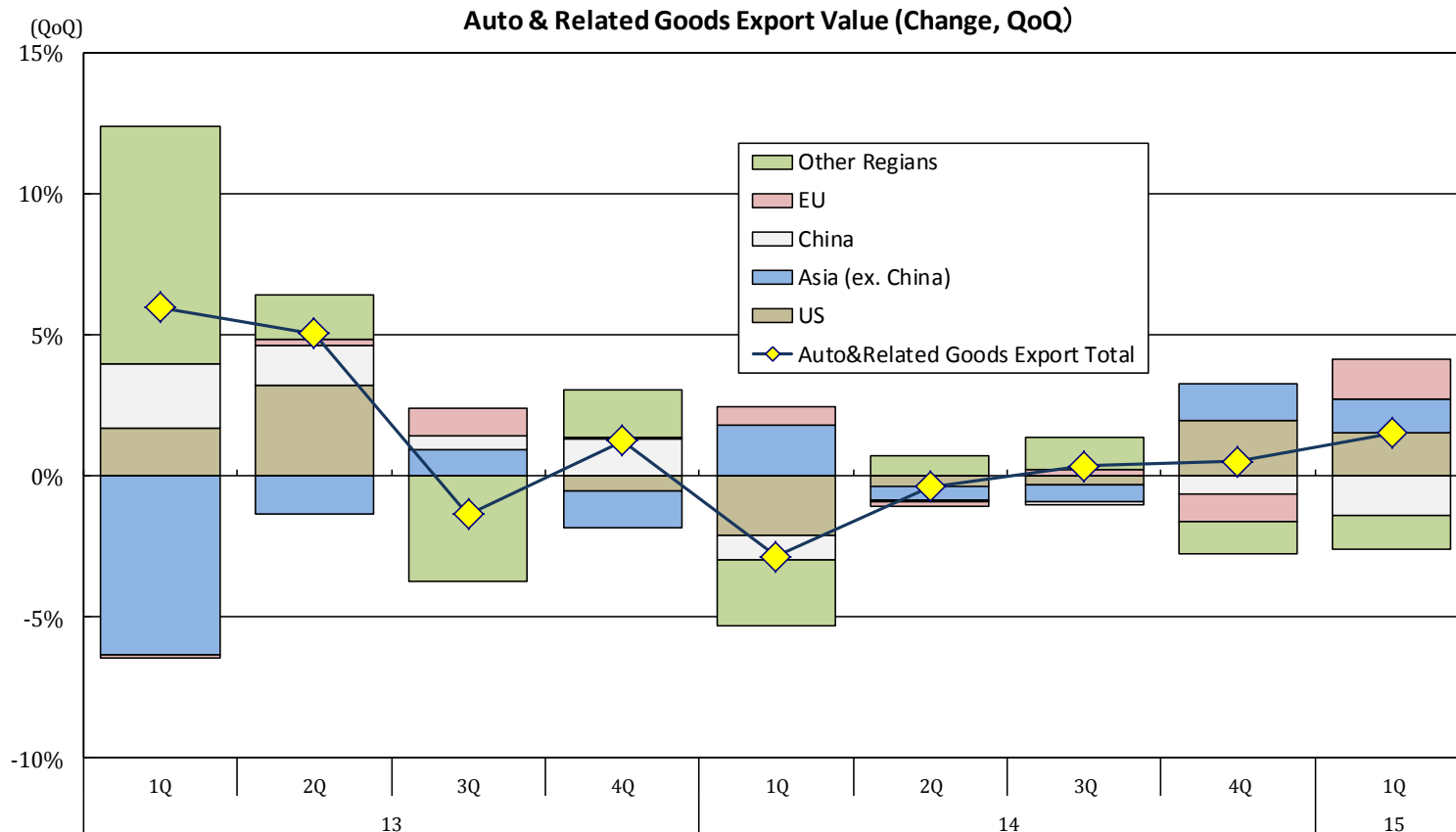
- SMAM forecasts current recovery process in order from Exports to Production and Consumption. The ongoing recovery process is between Confidence and Consumption.
- Stable recovery is highly expected underpinned by robust Exports and Industrial Production, while Consumption is eventually following to recover.
- Private Consumption Expenditures are expected to pick up from April-June buoyed by wealth effect by rising stock prices and real wages growth by higher nominal wages and low inflation, although current consumption data remain still weak.



(Source) Ministry of Economy, Trade and Industry, BOJ, Cabinet Office, SMAM's seasonally adjusted
 *1: Industrial Production for 2Q 2015 is estimated based on the data of Industrial Production Forecast Index.

Exports: Solid growth in Auto & Auto related goods

- Exports of Auto & Auto related goods have been increasing since July-September quarter in FY2014 helped by mild global growth.
- Exports to US, EU and Asia (ex, China) are all contributing positively .



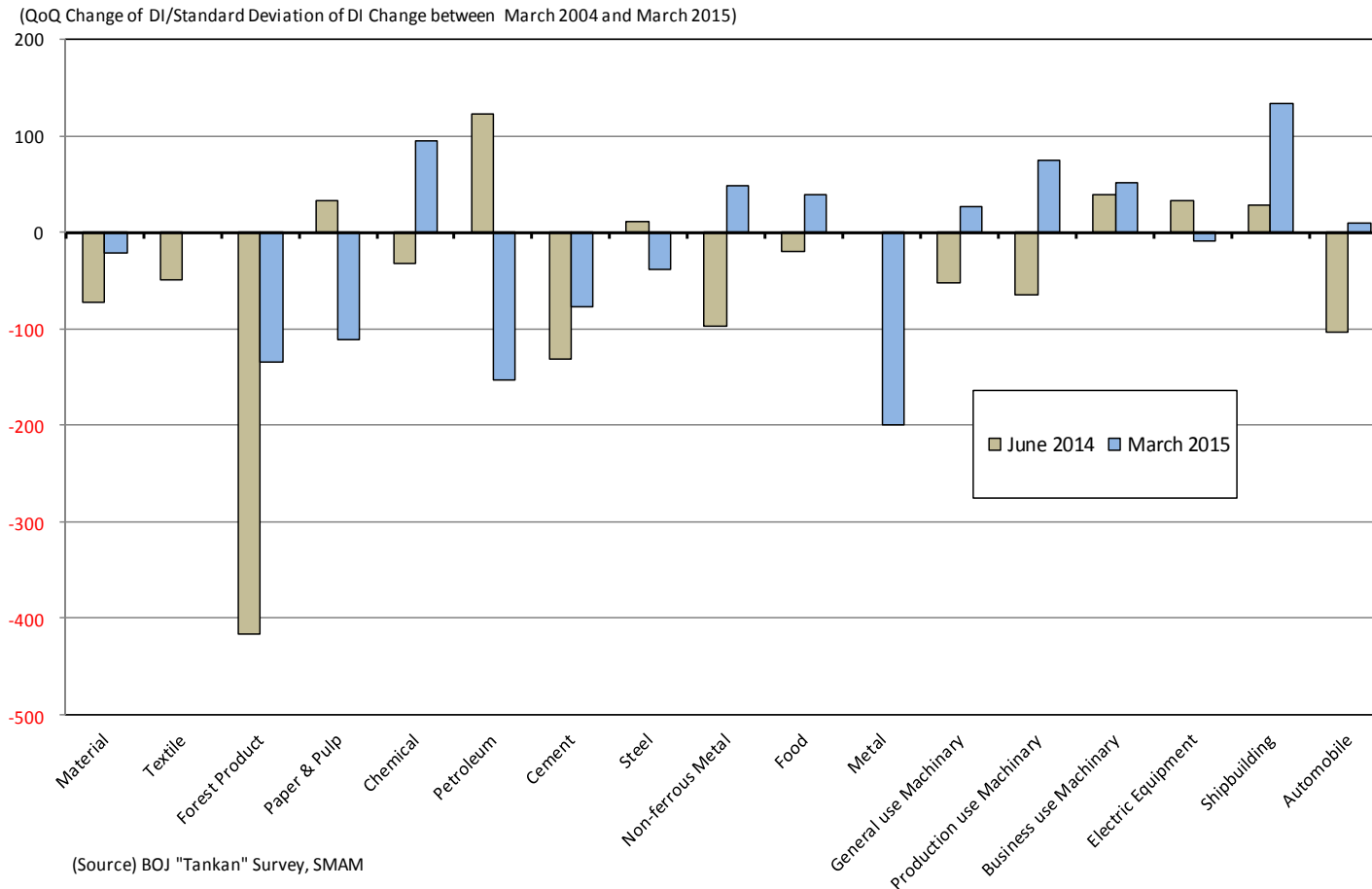
(Note) Seasonally adjusted by SMAM

(Source) Ministry of Finance "Customs clearance based exports"

Business Confidence in Manufactures: Slow recovery in Automobiles

- Automobiles manufacturers see subdued business outlook dragged by weak domestic car sales. New passenger car sales continued negative YoY growth, slightly improving to -17.1% in March from -19.0% in February.

By Sector Current Business Confidence Diffusion Index Comparison: June 2014 vs. March 2015

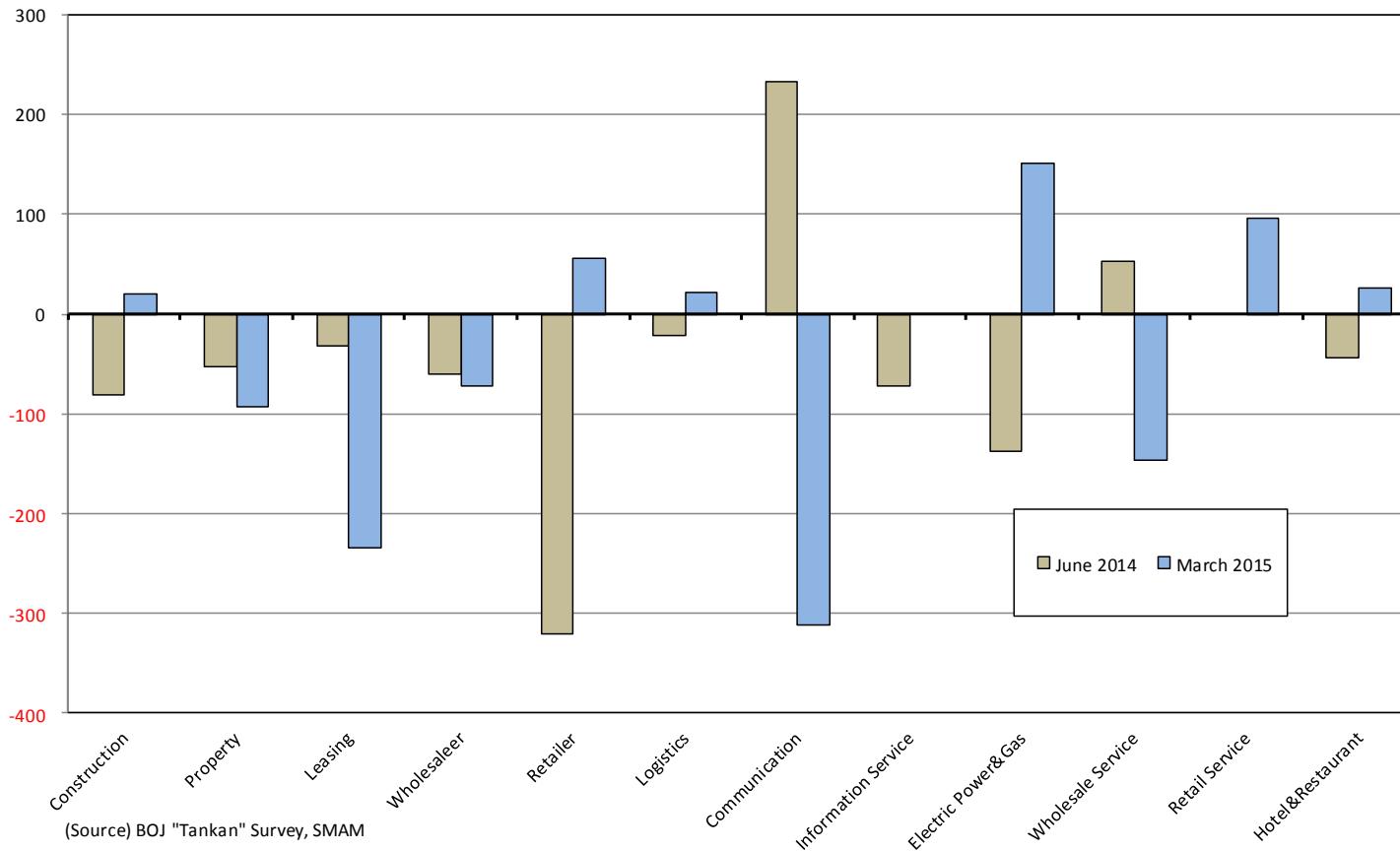


Business Confidence in Non-Manufactures: Showing a recovery sign

- A recovery sign was shown in Retailers, Retail Service and Hotel & Restaurant among mixed sentiment in non-manufacturers.

By Sector Current Business Confidence Diffusion Index Comparison: June 2014 vs. March 2015

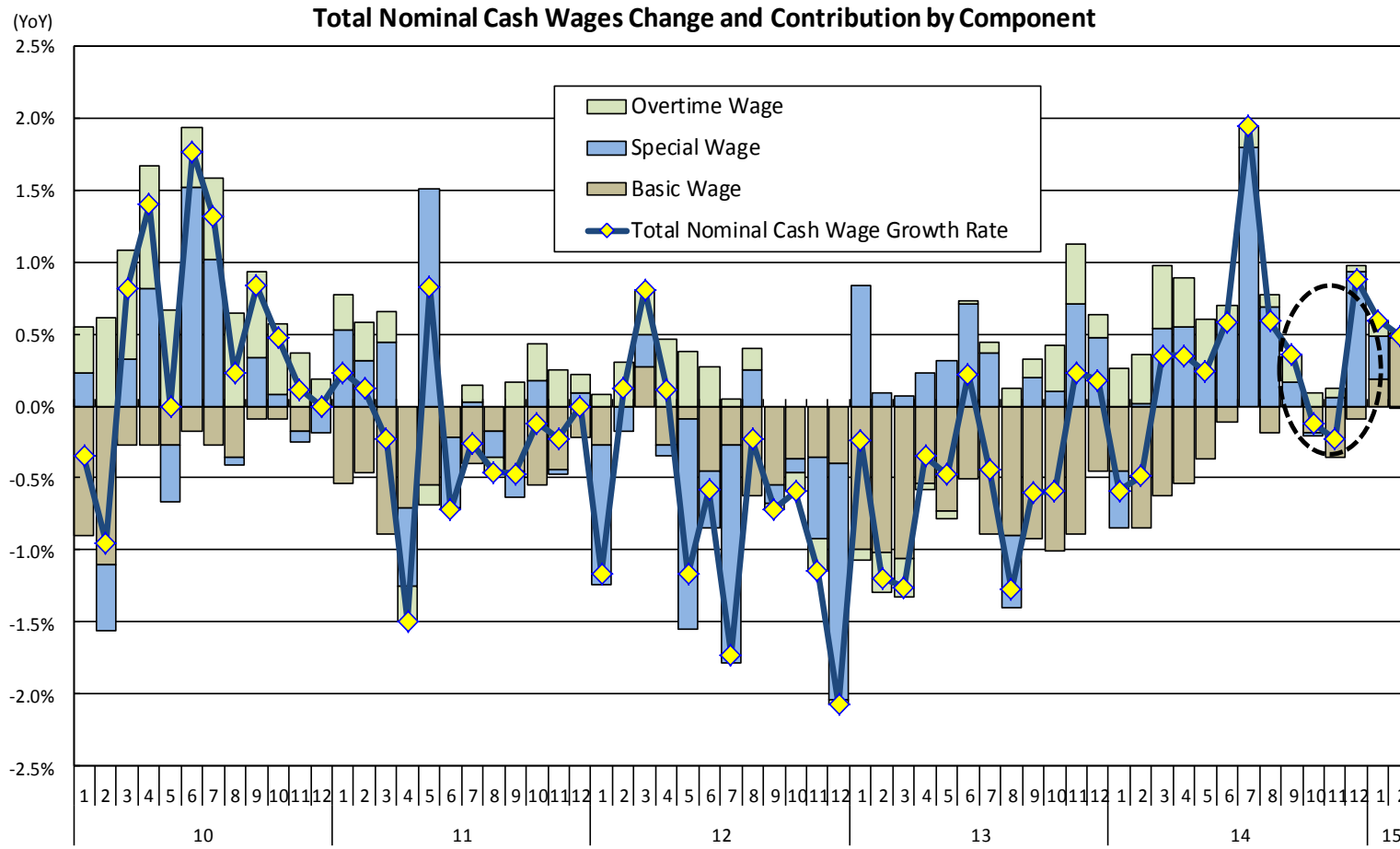
(QoQ Change of DI/Standard Deviation of DI Change between March 2004 and March 2015)



(Source) BOJ "Tankan" Survey, SMAM

Wages: Good news of rising Basic wage

- Basic wage has resumed to increase at a moderate pace.



(Source) Ministry of Health, Labour and Welfare, SMAM

Outlook for Japanese Stock Markets

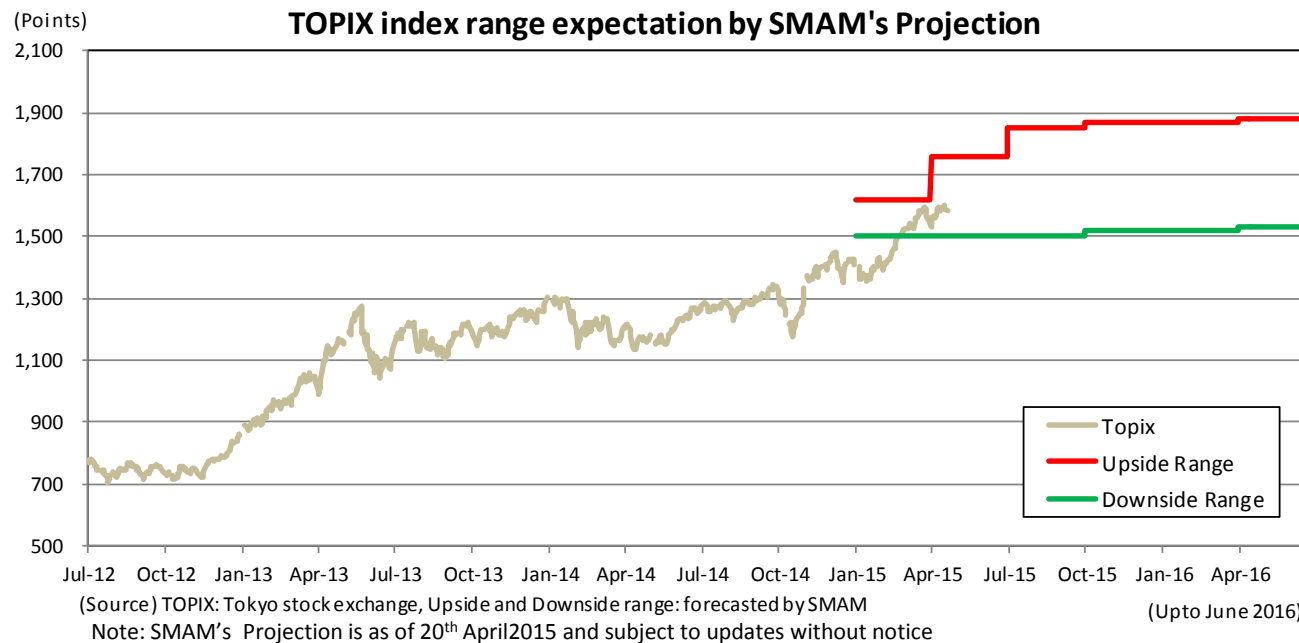
Stock market outlook: Earnings growth prospects should help the stock market

SMAM short-term view

- Due to mild growth in Production and Exports as well as high expectation for recovery in Consumption spurred by wage gains, Japan's equity market is expected to continue rally on upbeat corporate profits.
- The stock market is expected to continue advancing due to expectation on later rate hikes by Fed and favorable supply and demand balance led by money inflow from public funds and BOJ. However, a temporary setback or respite would be possible for the time being after sharp rise since late February.

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 global growth, solid corporate earnings and strengthened reflationary policies in Japan.



Base scenario & Upside / Downside risks for our forecasts

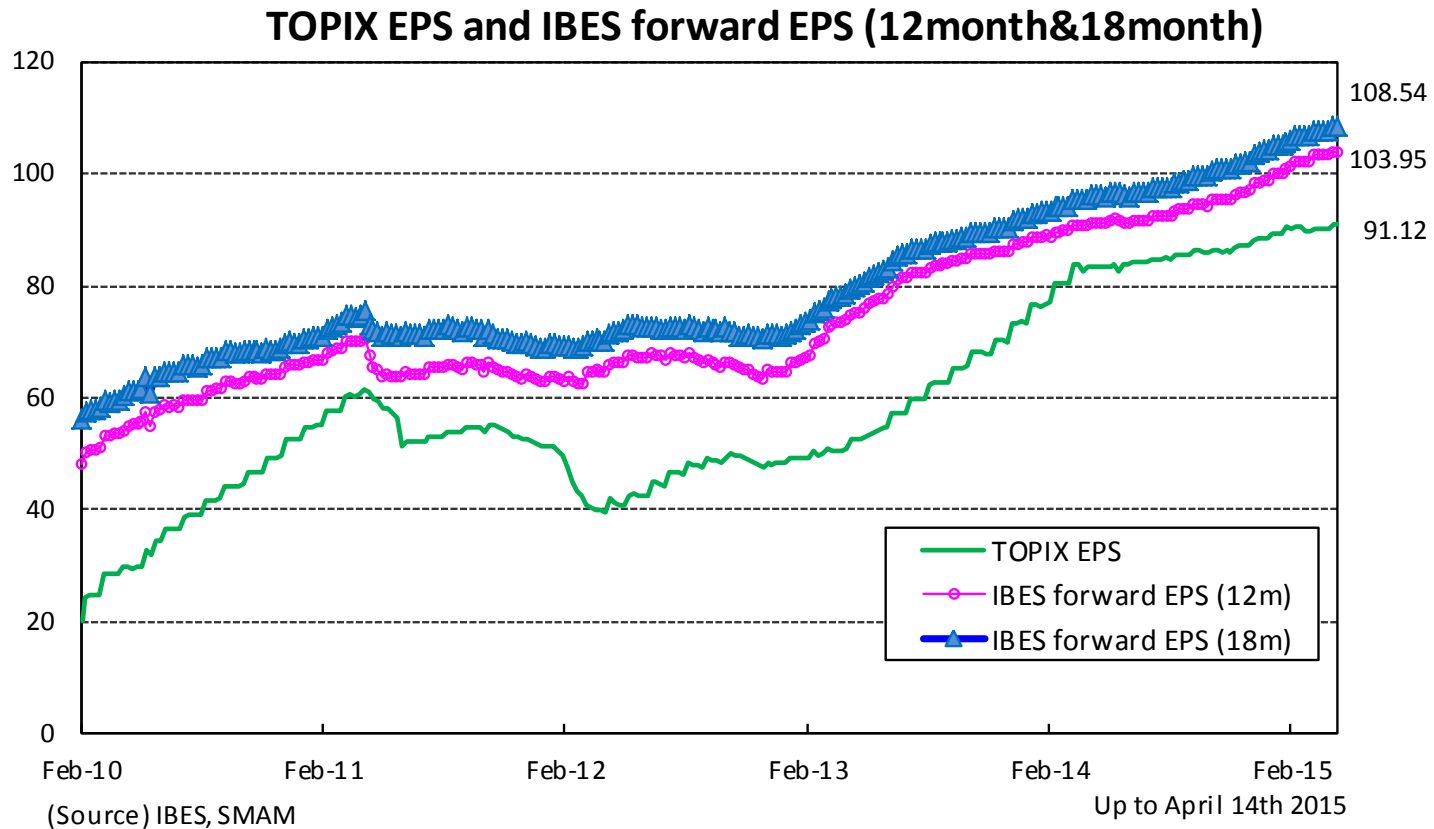
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's mild recovery from tax-hit weak demand buoyed by reschedule of next tax hike until 2017
 - Growing expectation for positive corporate earnings revisions due to weaker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

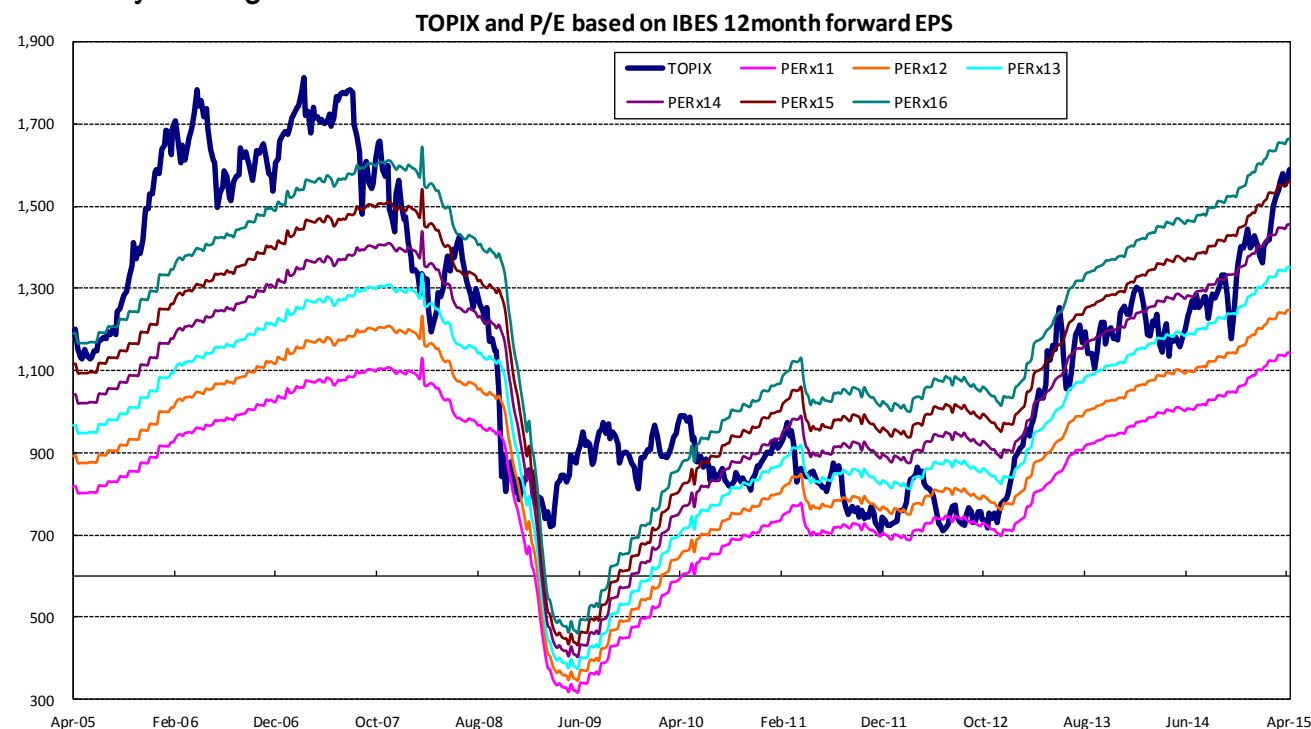
EPS forecasts: Upbeat IBES forward EPS consensus

- IBES consensus EPS continues rising supported by solid growth prospects. IBES 12 month and 18 month forward EPS are 103.95 and 108.54 respectively, while TOPIX EPS is currently 91.12 as of 14th April.



TOPIX range forecast: P/E 15x on forward EPS

- TOPIX is currently traded at 14.6x and 15.3x based on the IBES 18 month and 12 month forward EPS forecast of JPY108.54 and JPY103.95 as of April 14th 2015.
- Upbeat corporate earnings is likely to lift the EPS forecasts as SMAM expects +17% YoY growth for FY2015. Weak JPY and low crude oil price are tailwind on upward revision of the earnings.
- There would be some room for upside for the stocks as P/E is anticipated to stretch due to excess liquidity under global monetary easing.

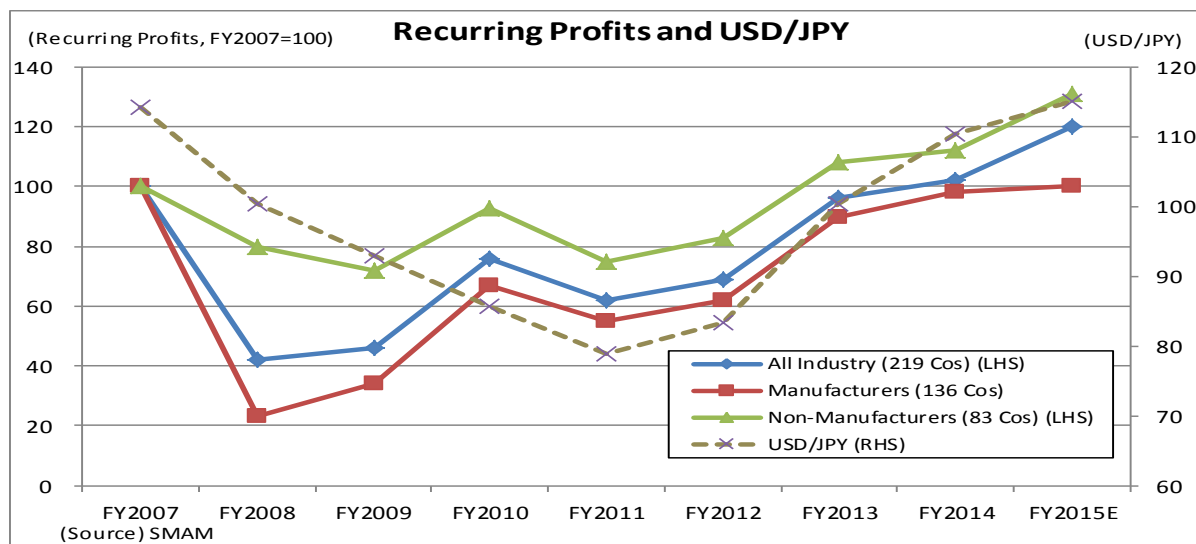


*1: Calendar year, week-end Topix, P/E based on IBES 12month forward EPS
 *2: SMAM forecast is expected based on earnings projection of ERG core univ. (ex. Financials)
 (Source) Tokyo Stock Exchange, IBES 12month forward EPS, SMAM

Up to April 14th 2015

SMAM Core Research Forecast: Upbeat FY2015 profits plus highly likely up-revision

- SMAM expects corporate profits to accelerate to +17.0% YoY in FY2015 from +6.9% YoY in FY2014 for the research universe 219 companies (ex. Financials).
- The postings of business result and guidance are full swing. Many of guidance are likely to be conservative, which are based on assumption in exchange rates such as USD/JPY=115.



Corporate Earnings Outlook of SMAM's Core-Research Universe 219 Companies (excl. financials)

	FY	Sales	YoY	Operating Profit	YoY	Recurring Profit	YoY	Net Profit	YoY
All Industry (219 Cos)	FY2012	347,271	3.5%	19,454	6.8%	19,347	9.9%	8,799	28.0%
	FY2013	394,059	13.5%	26,291	35.1%	27,007	39.6%	16,344	85.4%
	FY2014	407,824	3.5%	27,325	4.0%	28,876	6.9%	17,843	9.4%
	FY2015E	414,513	1.6%	32,640	19.4%	33,799	17.0%	21,303	19.4%

*IFRS adopted companies are amended based on their actual results retroactively

*Fiscal year starts from April and ends March.

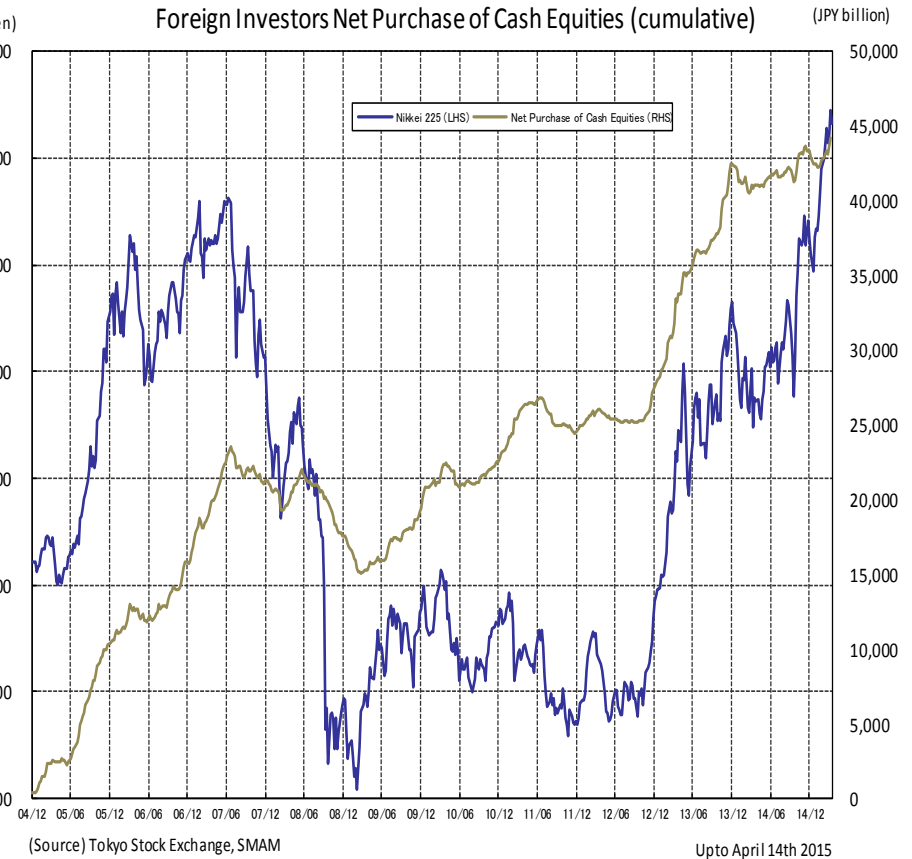
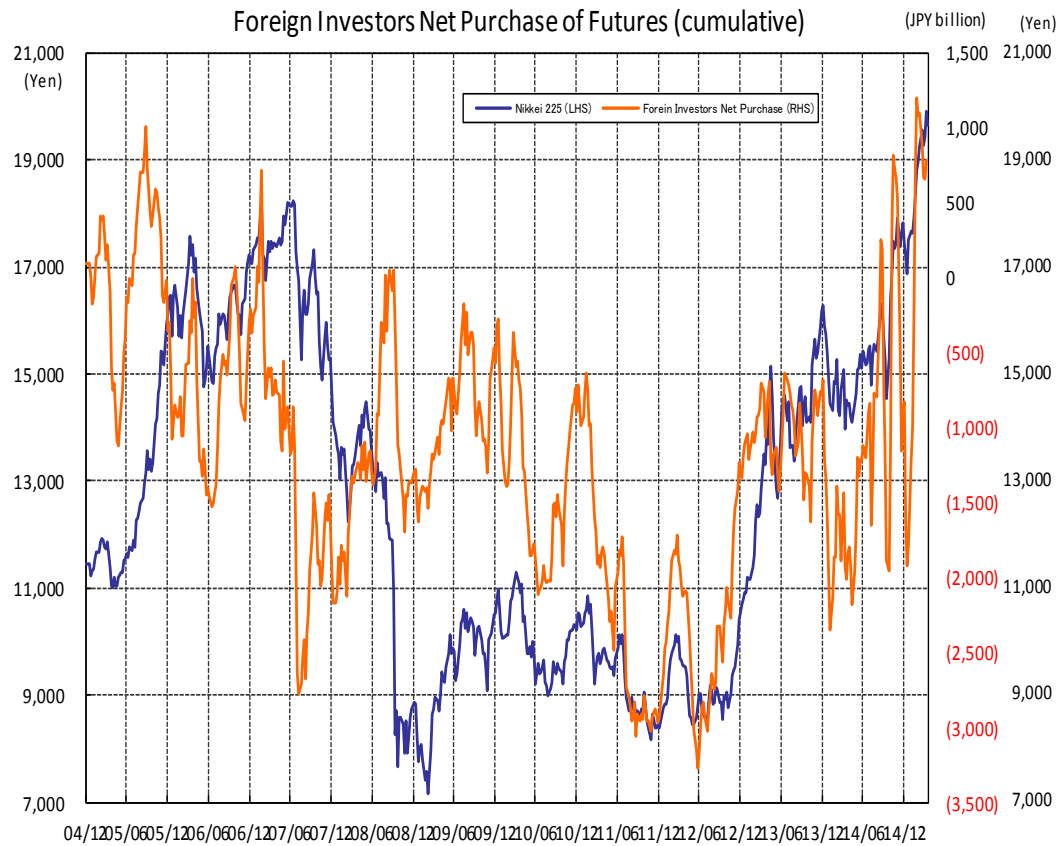
☞ Figures show bottom-up yoy annual growth forecasts by SMAM equity analysts

(Source) SMAM

As of March 4th 2015	
FX rate (Yen/US\$)	115
FX rate (Yen/€)	135
Crude Oil CIF (Japan)	\$50/barrel

Supply-Demand balance: Continuing overseas investor's buying

- Overseas investors turned to a net long in week of February 20th and continue buying Japanese stocks and futures.



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