



# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- August 2016 -



Sumitomo Mitsui Asset Management

SMAM

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## Executive summary

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### ➤ Japanese Economy

PM Abe announced yen 28 trillion fiscal stimulus, among which central and local government budget spending is planned at yen 7.5 trillion. Public sector is going to pull the economy ahead. Private consumption is forecast to show moderate growth whereas private capital investment is forecast to make a solid contribution.

- Inflation expectations are falling and BOJ slightly strengthened monetary easing on 29th of July by doubling the pace of purchasing Japanese equity ETFs, however, other quantitative easing was not expanded and negative interest rate was not touched this time.
- Impact of BREXIT on Japan is expected as limited and manageable as long as Japan's major counter part regions, Asia and US, keep growing rather solidly.

### ➤ Japanese Stock Markets

BOJ's additional easing to double the size of purchasing Japanese Equity ETFs is mildly positive for the stock market, although risk for higher yen remains. Large fiscal spending plan of yen 28 trillion over the coming years will be more or less positive for corporate sentiment.

- After downward revisions for a while, Japanese corporate earnings are expected to hit bottom during Jul-Sep period and start to grow again, which could drive the stock market to move upward. SMAM forecasts recurring profit growth for 218 companies in SMAM's research coverage to be +4.0% in FY2016.
- Global economic growth is gradually stabilizing although close attention is required for what effects Britain's decision to exit from EU brings in. Fiscal stimulus plan this time is over multiple years utilizing loan programs as well as budget spending, which SMAM thinks positive compared to the previous cases, which tended to lack in long-term planning.

Notes: Macro and market views are as of Jul. 29<sup>th</sup> and 20<sup>th</sup>, 2016 respectively, and subject to updates thereafter without notice

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# Outlook for Japanese Economy

## SMAM economic outlook for FY16-17

- PM Abe announced yen 28 trillion fiscal stimulus, among which central and local government budget spending is planned at yen 7.5 trillion. Public sector is going to pull the economy ahead. Private consumption is forecast to show moderate growth whereas private capital investment is forecast to make a solid contribution.
- Inflation expectations are falling and BOJ slightly strengthened monetary easing on 29<sup>th</sup> of July by doubling the pace of purchasing Japanese equity ETFs, however, other quantitative easing was not expanded and negative interest rate was not touched this time.

	FY12	FY13	FY14	FY15	FY16E	FY17E
Real GDP growth	0.9%	2.0%	-0.9%	0.8%	0.7%	0.7%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.2%	0.5%	0.4%
Private Housing Investment	5.7%	8.8%	-11.7%	2.4%	1.5%	1.1%
Private Capital Investment	0.9%	3.0%	0.1%	2.0%	1.5%	1.0%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.5%	1.5%	1.1%
Public Capital Investment	1.0%	10.3%	-2.6%	-2.7%	-0.1%	5.9%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	0.3%	-0.0%
Exports	-1.4%	4.4%	7.9%	0.4%	1.7%	1.4%
Imports	3.6%	6.8%	3.4%	-0.1%	-0.0%	1.8%
Nominal GDP	0.0%	1.7%	1.5%	2.2%	0.7%	0.9%
GDP Deflator	-0.9%	-0.3%	2.4%	1.4%	-0.0%	0.2%

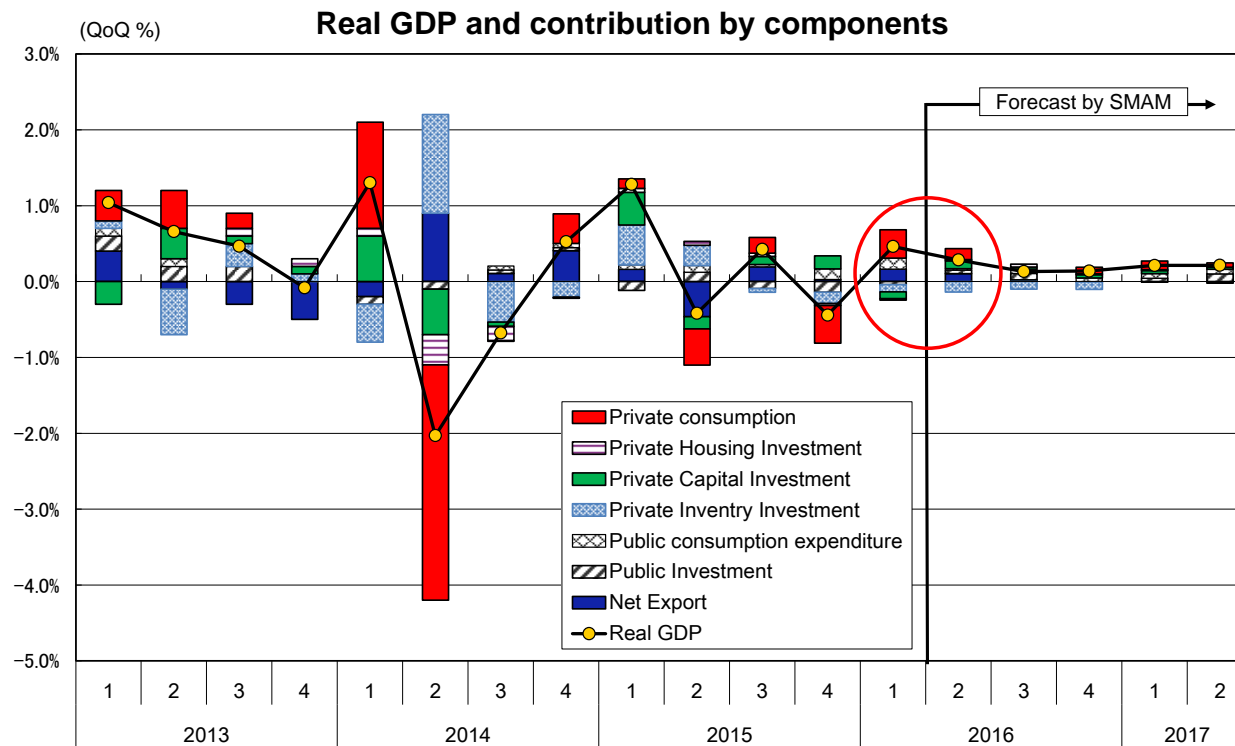
Notes: E=SMAM forecasts. SMAM views are as of Jul. 29<sup>th</sup>, 2016 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

## SMAM quarterly economic outlook

- SMAM revised Real GDP forecast for Apr-Jun from -0.5% to +1.1% (annualized) considering better than anticipated economic indicators released so far such as household survey and private capital investments.



Notes: SMAM views are as of Jul. 29<sup>th</sup>, 2016 and subject to updates thereafter without notice.

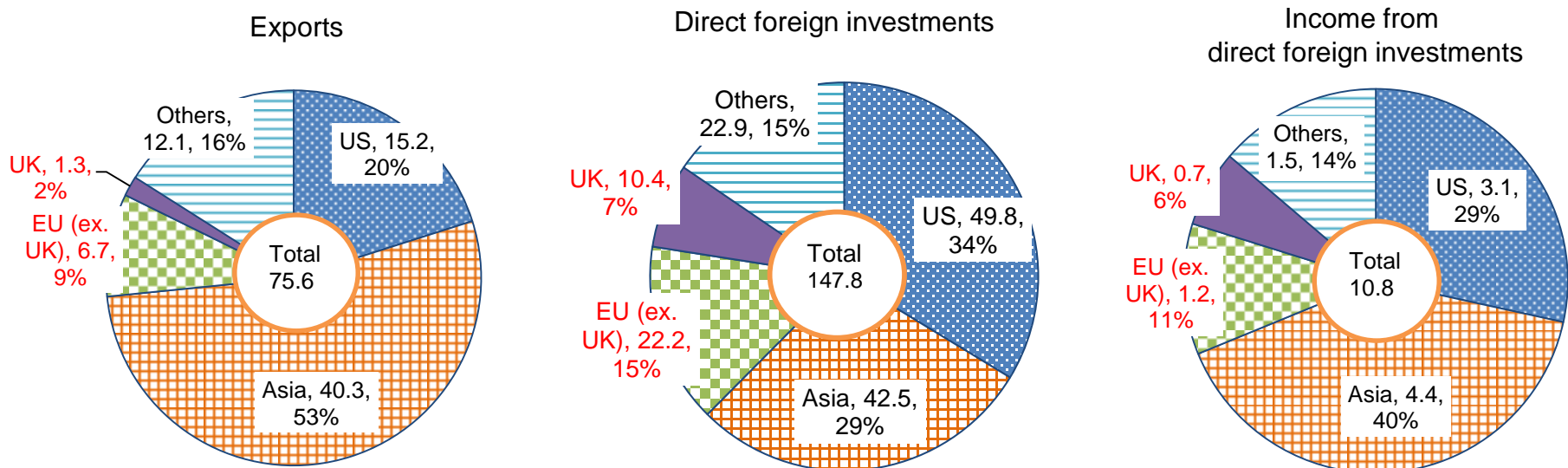
Source: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts.

## Impact of BREXIT on Japan is expected as limited and manageable

- UK accounted for 6% and 7% in foreign direct investments and its income in 2015. EU's share was 15% and 11% respectively. In exports from Japan, UK's share was 2% and EU 9%.
- These numbers are not small, however, Japan's major counter part regions are Asia and US. As long as these two regions keep growing rather solidly, negative impact of BREXIT on Japanese economy will be limited and manageable.

### Regional distribution of Japanese international activities

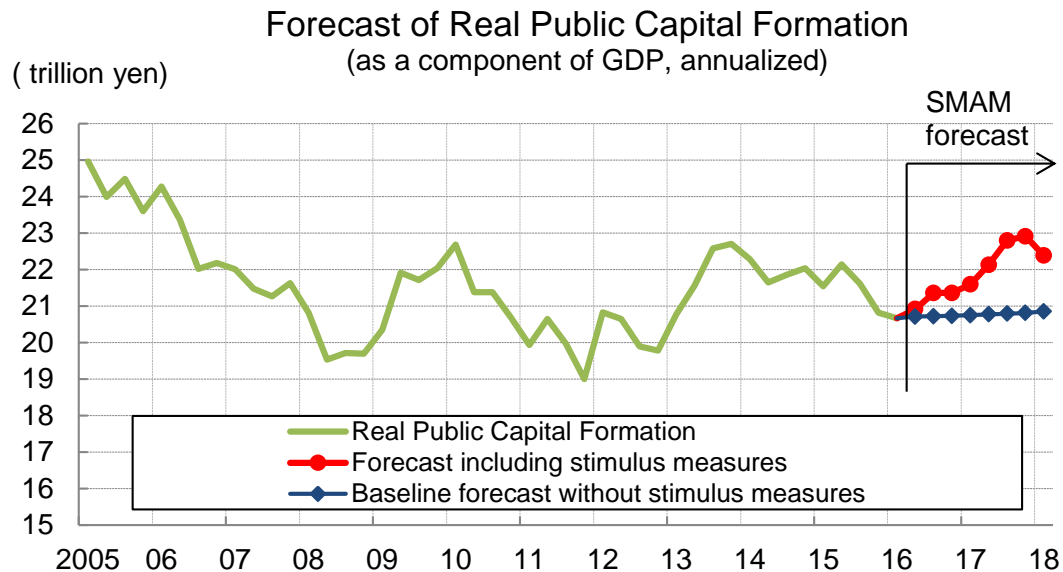
\*Data is for 2015. Exhibited are region, trillion yen, and % of total.



(Source) Ministry of Finance, Bank of Japan, compiled by SMAM

## Positive effect is expected from the fiscal stimulus measures for the medium term

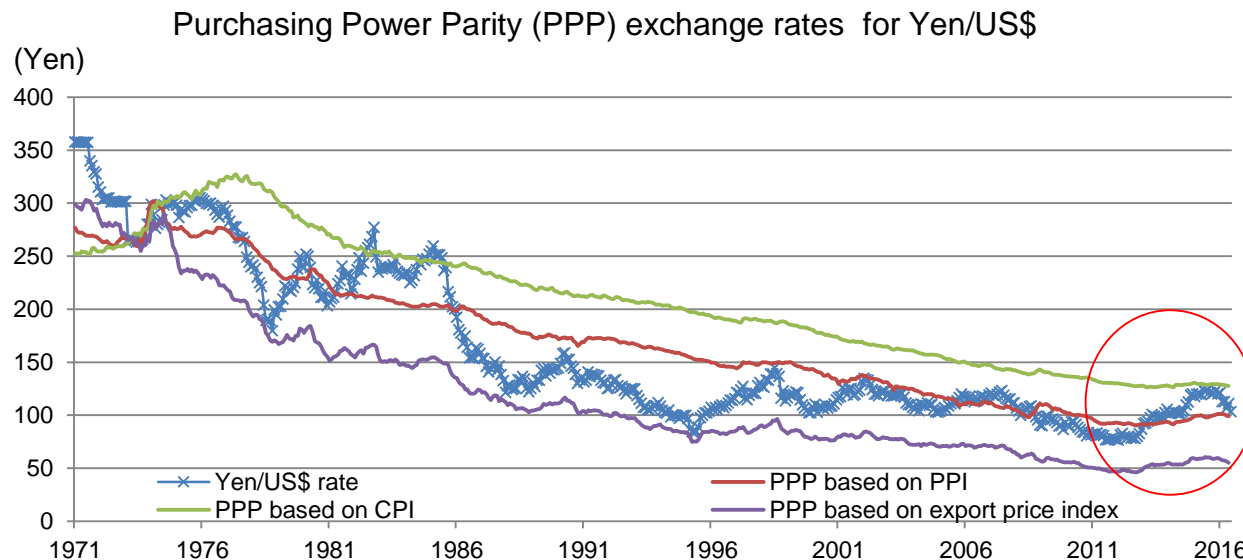
- On 2<sup>nd</sup> August, Cabinet office has decided on the fiscal spending plan to be sent to the next National Diet session for approval. Total size is advertised to be yen 28 trillion, among which yen 7.5 trillion is directly spent by central and local government budgets, and the rest is financed by loan programs.
- Infrastructure spending is going to play a major role with the total size of yen 13.7 trillion, among which a) “21<sup>st</sup> century projects” such as Linier High Speed Train and marine ports for cruise liners take yen 10.7 trillion and b) “recovery from earthquakes and enhancing safety & protection against natural disasters” take yen 3 trillion.
- Other measures include increasing minimum wage, supporting child & elderly care and giving benefit to low income households.



(Source) Cabinet Office, compiled by SMAM

## Where the yen is heading ?

- One thing worthy of note is the fact that pressure for the stronger yen from the inflation difference has ceased. Inflation rate in Japan has risen while global inflation in general has substantially declined. This is exhibited as sideways move of PPP lines on the chart for the last several years.
- Historically, PPP based on CPI worked as the weaker end for Yen against US dollars, which was also the case this time after the beginning of Abenomics so far.
- Yen/Dollar rate seems to have been moving around PPI based PPP rate for the last 15 years and current rate is also close to it.



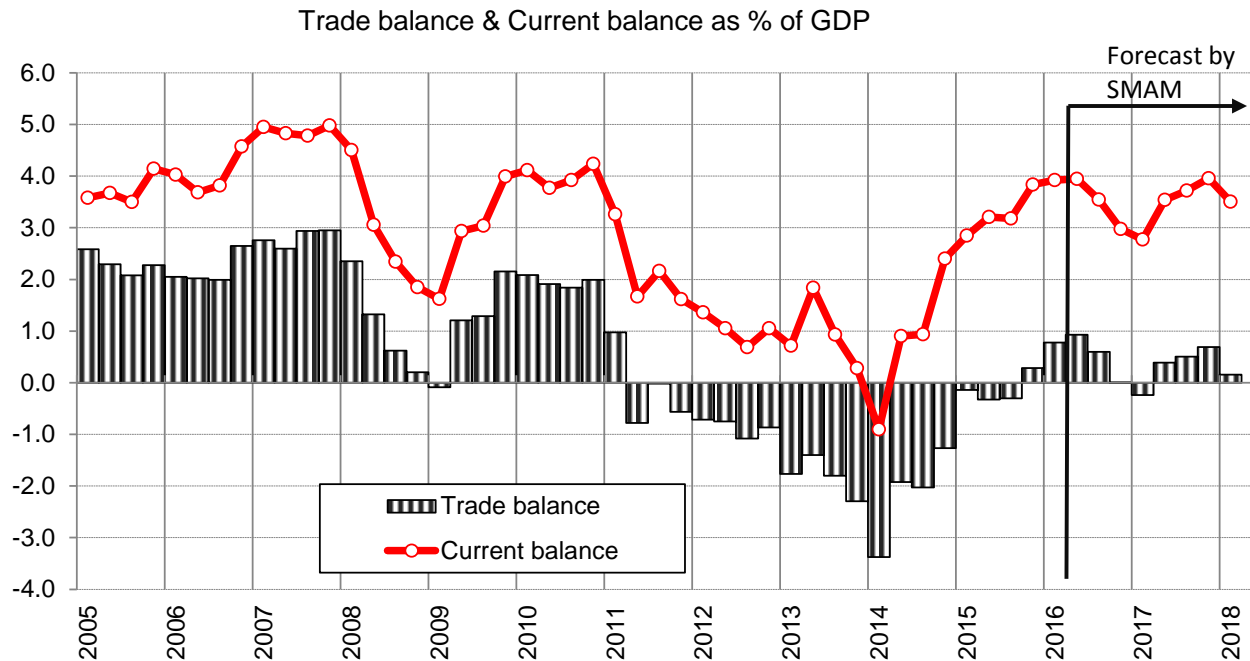
Note: PPP rates are calculated based on the yen/US\$ rate of 265.96 as of Mar. 1973 and each price indices in Japan and US.

(Source) US Department of Labor, US Department of Commerce, FRB, Bank of Japan, Ministry of Internal Affairs and Communication, and IMF, compiled by SMAM



## Current balance is going to stay substantially positive in spite of only mild trade surplus

- Current balance of Japan has almost recovered to historically high level, which is positive for the strength of national finance.
- Compared to 2000's, trade surplus stays very mild this time, which is not a bad sign as recent current surplus is sustained by income from foreign investments rather than massive exports since the latter could potentially cause fragility to external economic shocks.

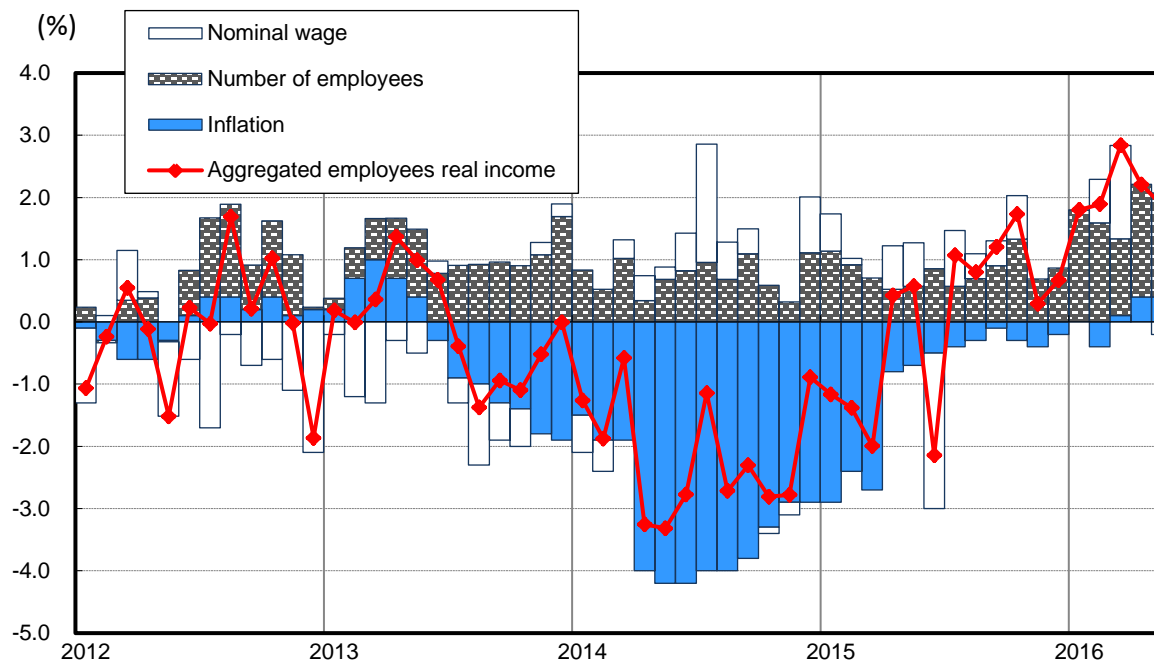


(Source) Ministry of Finance, Bank of Japan

## Increase in number of employees is driving the growth in aggregated real income

- Nominal wage increase seems to be in declining momentum recently, probably due to the rising cautiousness among management of companies in global uncertainties.
- If you look at it from a different angle, however, aggregated real income has been increasing rather solidly driven by increase in number of employees, which is surely one of the underlying strengths of the Japanese economy.

Aggregated employees' real income and contribution by components (YoY%)



(Source) Ministry of Health, Labor and Welfare

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# Outlook for Japanese Stock Markets

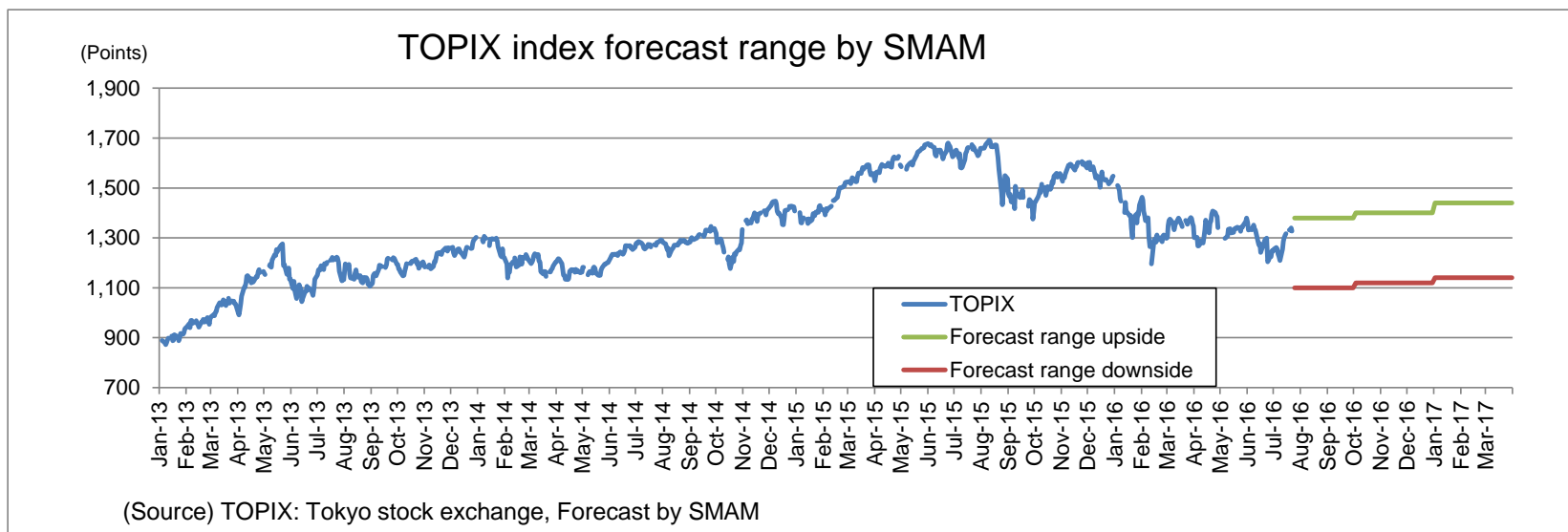
## Stock market outlook: waiting for effects of fiscal stimulus and global economic recovery

### SMAM short-term view

- BOJ made additional easing on 29<sup>th</sup> July by doubling the size of purchasing Japanese Equity ETFs to annual yen 6 trillion, which is mildly positive for the stock market, although risk for higher yen remains. Large fiscal spending plan advertised to be yen 28 trillion will be more or less positive for corporate sentiment.

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

- After downward revisions for a while, Japanese corporate earnings are expected to hit bottom during Jul-Sep period and start to grow again, which could drive the stock market to move upward. SMAM forecasts recurring profit growth for 218 companies in SMAM's research coverage to be +4.0% in FY2016.
- Global economic growth is gradually stabilizing although close attention is required for what effects Britain's decision to exit from EU brings in. Fiscal stimulus plan this time is over multiple years, which SMAM thinks positive compared to the previous cases, which tended to lack in long-term planning.



Note: SMAM's projection is as of Jul. 20<sup>th</sup> 2016 and subject to updates without notice

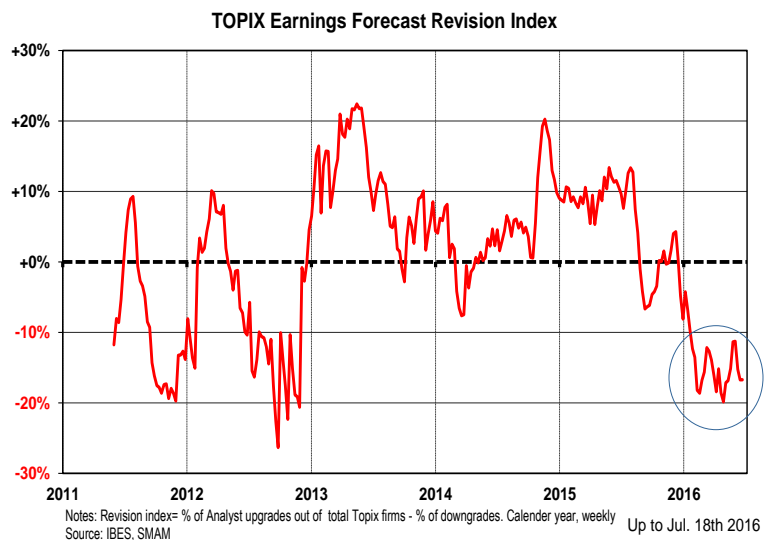
## Base scenario & Upside / Downside risks for our forecasts

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- Our **Base Scenario** is assuming the following views:
  - Global economy does not enter into a recession.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese corporate earnings growth to gradually recover from the negative shock of stronger yen.
  - Fiscal stimulus and further monetary easing will be made to sustain economic growth in Japan.
  
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - Stronger-than-expected measures by the Abe government.
  
- **Downside Risks** include:
  - Britain's decision to exit from EU deeply confuses politics and economies in Europe.
  - Unexpectedly large impact from the process of US monetary policy normalization.
  - Concern over emerging economies including China.
  - Falling oil price causes disastrous problem for oil producing countries.
  - Increasing geopolitical concerns.

## Currently, downward earnings forecast revisions are continuing probably adjusting to stronger yen

- According to IBES, downward earnings revision is continuing at the moment. This is probably because the current yen/dollar rate at around 105 is stronger than the assumptions for the exchange rate used in forecasting earnings.



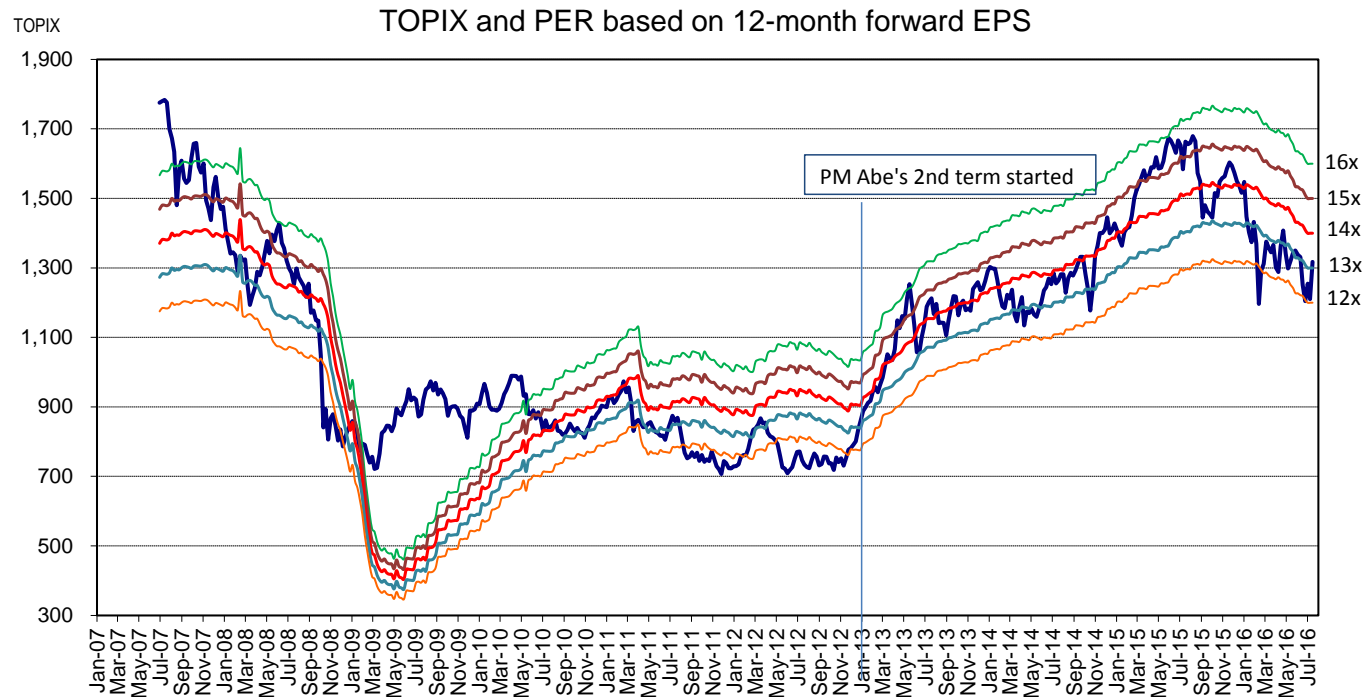
SMAM Corporate Earnings forecasts (218 Companies research coverage excl. financials)

Fiscal year	FY 2014	FY 2015	FY 2016E	FY 2017E
Date of forecast	Actual	Actual	as of 10th Jun 2016	as of 10th Jun 2016
Revenue (YoY %)	3.9%	0.1%	-0.8%	2.7%
Operating Profits (YoY %)	3.1%	9.1%	0.6%	9.4%
Recurring Profits (YoY %)	4.5%	2.5%	4.0%	10.1%
Net Profits (YoY %)	5.4%	-3.2%	12.5%	11.4%
Recurring profits (YoY %)				
Manufacturing 135 companies	4.1%	0.2%	2.3%	11.1%
Non-manufacturing 83 companies	5.2%	6.5%	6.7%	8.4%

Note: Key assumptions for the forecasts, Yen/US\$ 110, Yen/EUR 125, Crude oil \$45/barrel  
(Source) SMAM

## PER is in the lower half of the range for the current PM Abe's tenure

- Since Abenomics started, PER for Japanese stock market, TOPIX index-wise, has been in a range between 12x and 16x except for temporary overshooting.
- Even considering further down-revision in earnings, current TOPIX level does not look expensive.

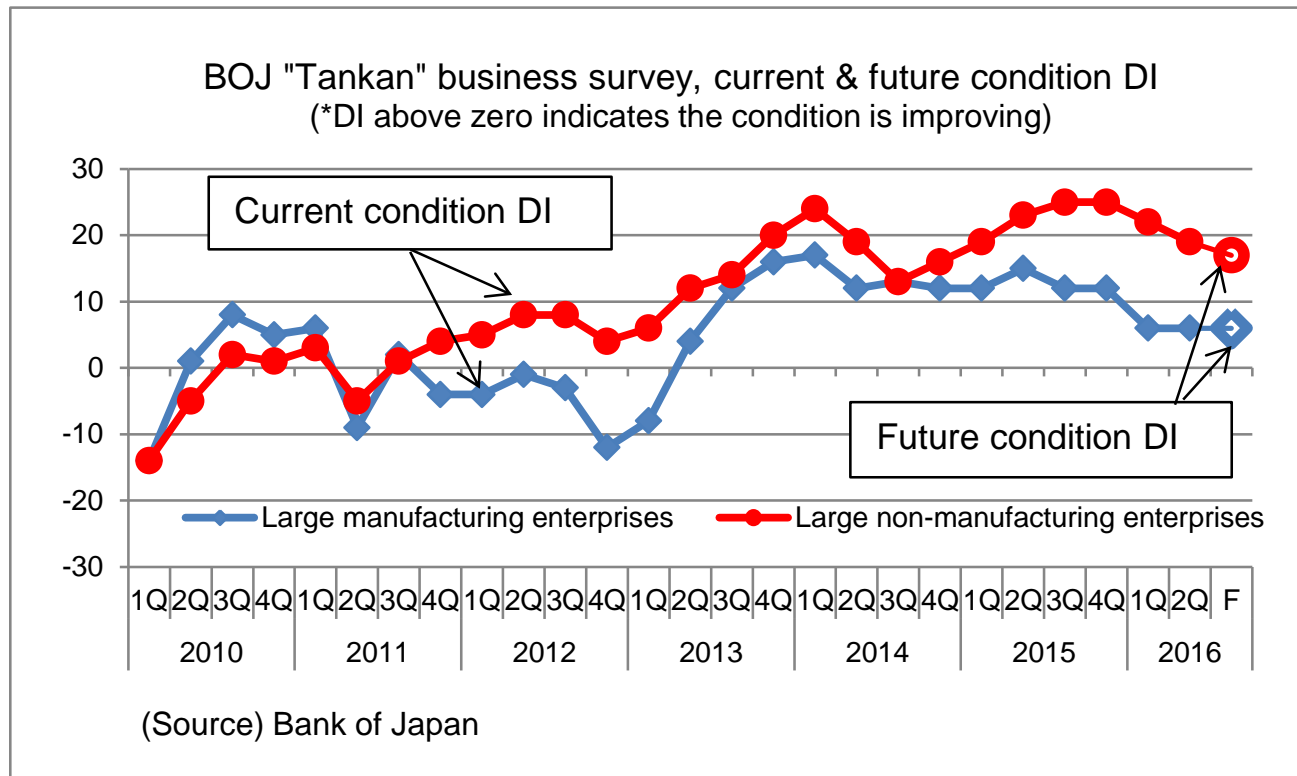


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES  
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Jul.15th 2016 when TOPIX was 1317.10

## Is declining business momentum going turn around on much awaited fiscal spending plan?

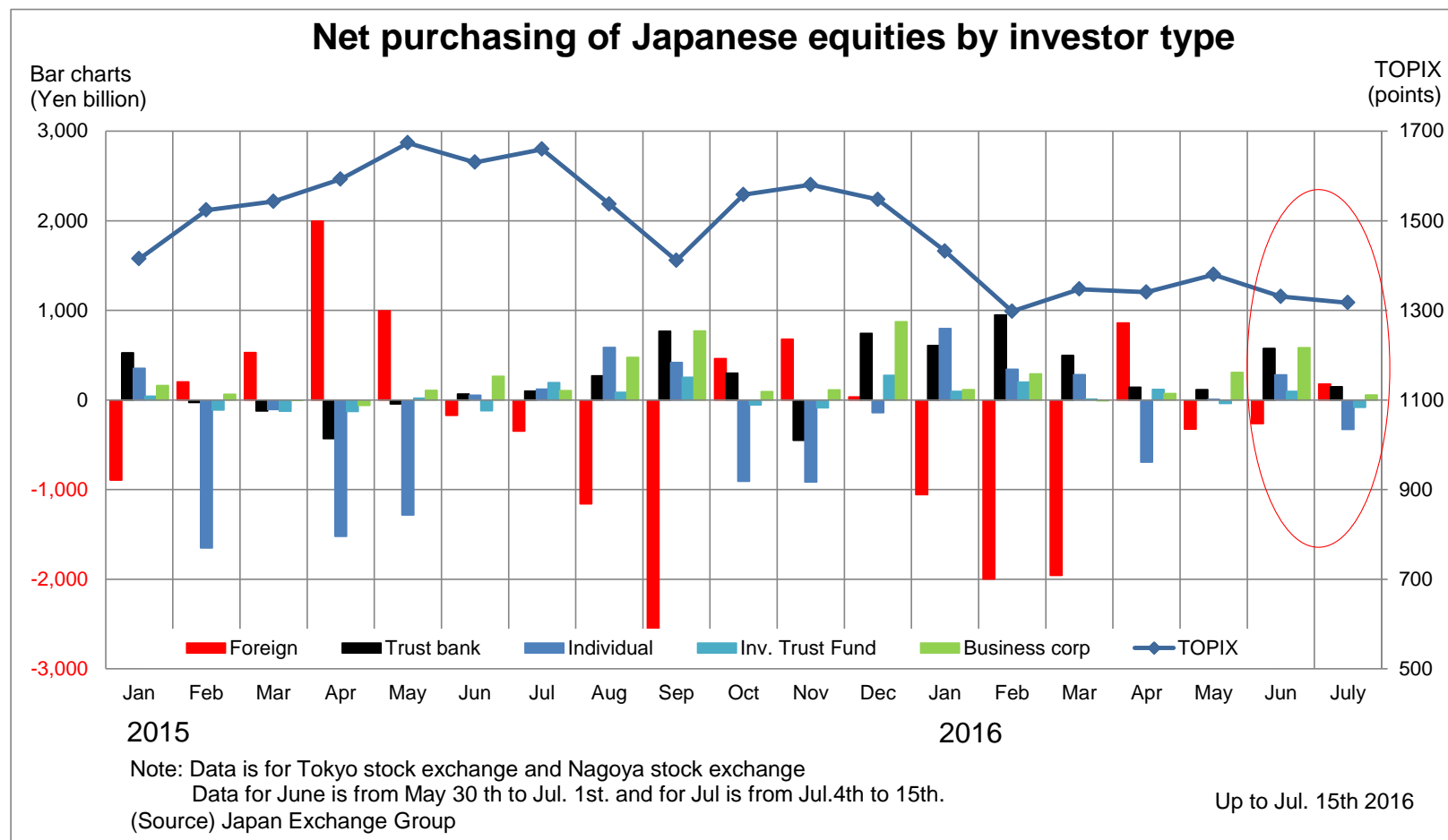
- BOJ makes broad based business survey every quarter and releases its result in early Jan. Apr. Jul. and Oct.
- Manufacturing sector is showing some resilience after the decline in 1Q this year. On the other hand, robust sentiment of non-manufacturing sector is gradually losing steam.
- If the next fiscal spending plan can boost business sentiment again or not is important for the Japanese economy and corporate earnings.





## Domestic investors were buying in June. Foreign investors turned net buyers in July.

- Selling from foreign investors ceased and net purchasing was observed in the 1st half of July.
- Domestic investors such as pension funds, business corporations have been constantly buying equities.



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