



Japanese Stock Market Outlook

SMAM monthly comments & views
- February 2017 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

SMAM's GDP growth forecast was unchanged from the last month. Japanese economy historically has a high sensitivity to global economic growth, which is recently gathering steam. Export volume has been in an upward trend since the middle of 2015 and industrial production since mid 2016, however, recent hard comments on US-Japan car trade from US president Trump brought some clouds over exports from Japan. Fiscal plan of Trump Whitehouse is going to be revealed in February.

- SMAM forecasts US\$/yen range between 112 and 122 for 2017 with a risk for the downside to 105 if US moves to cap and reverse the dollar strength considering its negative effects on US industries.
- Europe is going to face important events such as notification of Brexit, elections in France, Germany and other countries.

➤ Japanese Stock Markets

Japanese stock market is anxiously waiting for the actual Trump policies to be confirmed. Current PER around 15x seems a little stretched and the stock market would require some consolidation period waiting for the estimated earnings growth to be actually achieved. Nevertheless strong earnings growth expected in Jan-Mar quarter in Japan and higher US stock prices could lift Japanese stock markets.

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is expected for FY2017. Further fiscal stimulus can be expected in Japan meanwhile BOJ would keep its extra-easy monetary policy. Risks are how protectionist Trump's trade policy could become and possible heightening in geo-political tensions in East Asia due to more confrontational US-China relations.
- After falling for 2 consecutive years in FY2014 and 15, ROE is forecast to recover to 9.2% in FY2016 and to reach 10% mark in FY2017. (for SMAM 221 companies excluding financials)

Outlook for Japanese Economy

Where “America First” policies would lead the world?

- In less than a week after the inauguration as US president, Trump Whitehouse has put forward key policy issues.
- President Trump has signed various Executive Orders such as exiting TPP, allowing Canada-Texas oil pipeline, and stopping Obama care, and also made hard comments against international trade partners of US.
- Trump policies started to take shape, however, it is still uncertain how strong the protectionism could become and how much stimulative fiscal policies could be negotiated with the congress.

<Six top issues>

- **America First Energy Plan:** *Embrace the shale oil and gas revolution to bring jobs and prosperity to millions of Americans.*
 - Green light was given to Canada-Texas oil pipeline project turning over the rejection made by former president Barak Obama.
- **America First Foreign Policy:** *Committed to a foreign policy focused on American interests and American national security.*
- **Bringing Back Jobs And Growth:** *Create 25 million new American jobs in the next decade and return to 4 percent annual economic growth.*
 - Practical tax reduction and fiscal spending plan still need to be negotiated with republican led congress.
- **Making Our Military Strong Again:** *End the defense sequester and submit a new budget to Congress outlining a plan to rebuild our military.*
- **Standing Up For Our Law Enforcement Community:** *Fight for the safety of every American. Building a border wall to stop illegal immigration.*
- **Trade Deals Working For All Americans:** *Tough and fair trade agreements.*
 - Signed to exit TPP. Announced re-negotiating NAFTA. Hard comments on US-Japan car trades. Hard comments against China.

(Source) US Whitehouse and various publications, compiled by SMAM

Political events should gather attention in 2017

- Fiscal plan of Trump Whitehouse is going to be revealed in February.
- Europe is going to face important events such as notification of Brexit, elections in France, Germany and other countries.

Schedule of key events in 2017

Month	Region/Country	Events	Notes
February	Japan	First estimate of 4Q 2016 GDP	
	US	State of the Union Address	
		The Budget Message of The President	Fiscal plan of the Trump whitehouse is going to be revealed.
March	Japan	Convention of the Liberal Democratic Party	Extend maximum party leadership from 2 terms running?
		Spring wage negotiations	
		Budget for FY2017 to be approved	
		Action plan for changing working practice	
	Netherlands	General election	
UK	Notification of exiting EU?	Supreme Court ruling require the government to gain approval of the Parliament.	
April	Japan	BOJ Tankan business report	
		BOJ perspective report	
Apr or May	France	Presidential election	
June	Japan	Ordinary Session of National Diet ends	
	Japan	Election for the Tokyo Metropolitan Assembly	
	France	Lower house election	
July	Global	G20 meeting	
August	Germany	General election	

(Source) Various publications, assembled by SMAM

SMAM economic outlook for FY16-18

- SMAM's GDP growth forecast was unchanged from the last month.
- CPI is forecast to move up to 0.7% both for FY2017 and 2018.

(YoY %)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Real GDP growth	2.6%	-0.4%	1.3%	1.2%	1.1%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.7%	0.6%	0.6%
Private Housing Investment	8.3%	-9.9%	2.7%	5.7%	-0.0%	1.0%
Private Capital Investment	7.0%	2.5%	0.6%	1.4%	1.5%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.7%	1.1%	0.9%
Public Capital Investment	8.6%	-2.1%	-2.0%	0.1%	5.7%	0.2%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.2%	0.4%	0.2%	0.1%
Exports	4.4%	8.7%	0.8%	1.1%	2.4%	1.7%
Imports	7.1%	4.1%	-0.2%	-1.5%	1.2%	1.0%
Nominal GDP	2.6%	2.1%	2.8%	1.3%	1.6%	1.6%
GDP Deflator	0.0%	2.5%	1.4%	0.0%	0.6%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.2%	3.5%	2.5%
CPI (excl. fresh food)	0.8%	0.9%	-0.0%	-0.3%	0.7%	0.7%

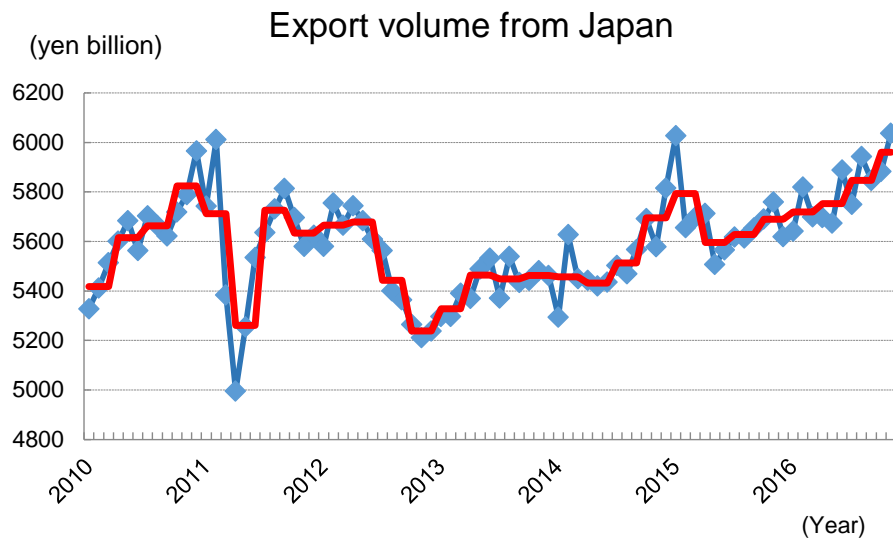
Notes: E=SMAM forecasts. SMAM views are as of Jan 18th, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

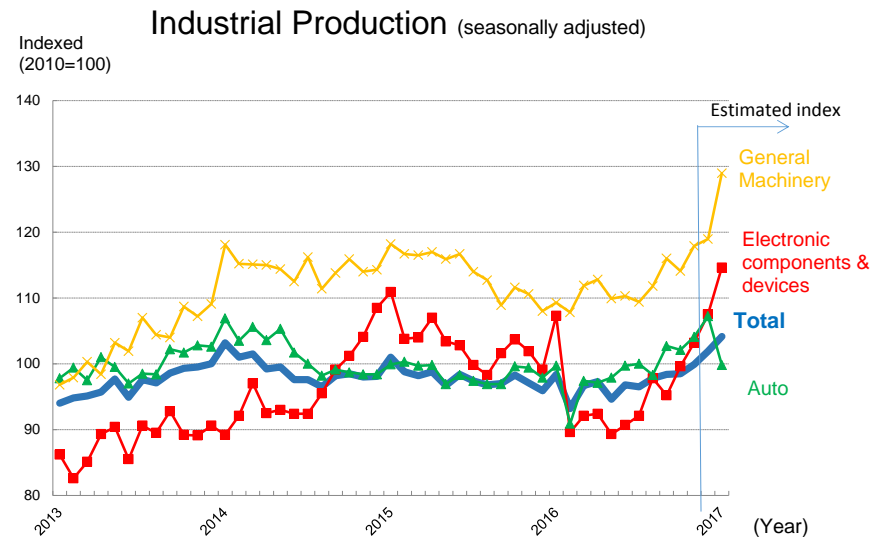
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

Recovery in global economy has supported exports from and industrial production in Japan

- Japanese economy historically has a high sensitivity to global economic growth, which is recently gathering steam.
- Export volume has been in an upward trend since the middle of 2015 and industrial production since mid 2016.
- Recent hard comments on US-Japan car trade from US president Trump brought some clouds over exports from Japan.



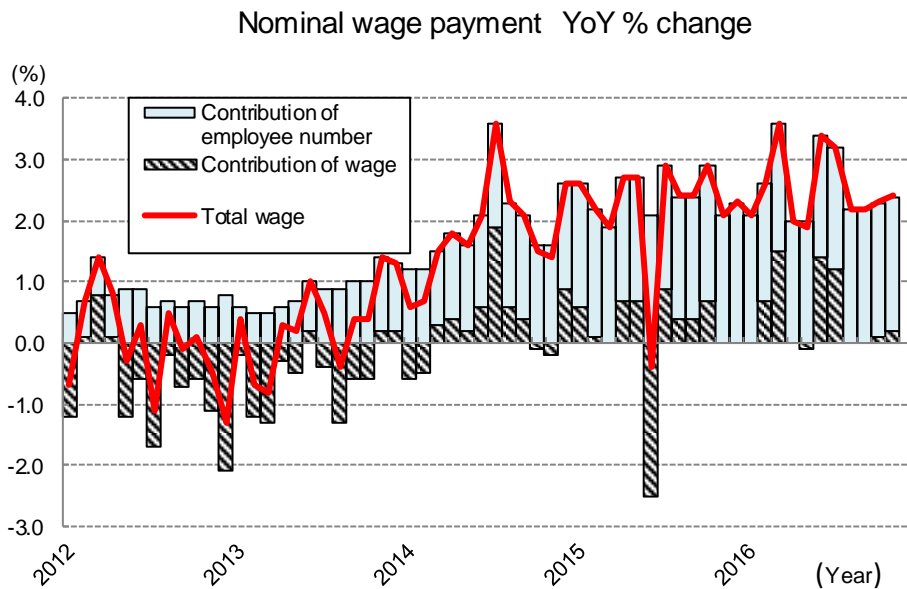
Note: Blue lines are for monthly and red lines are for quarterly data.
Data is monthly from Jan 2010 to Nov 2016.
(Source) Ministry of Finance, Bank of Japan



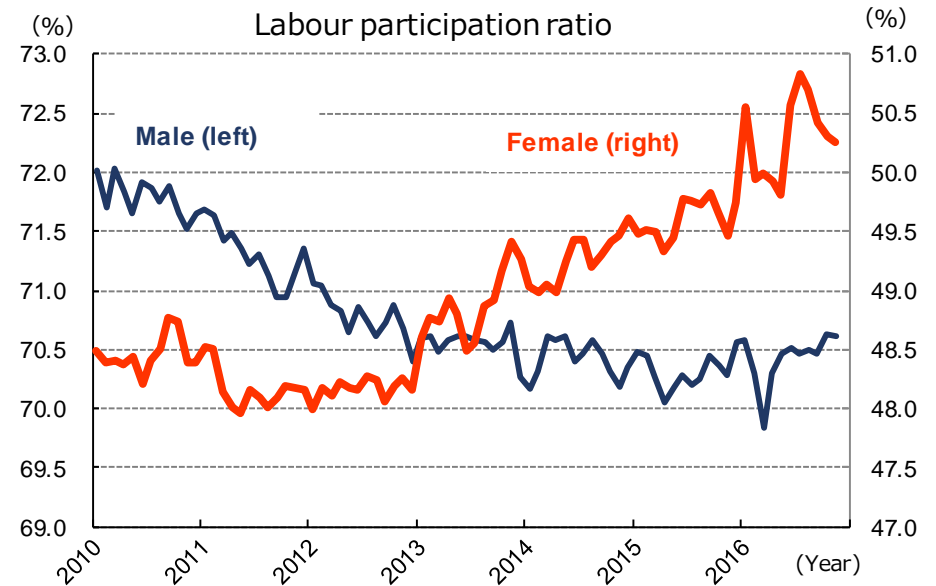
Note: Data is monthly from Jan 2013 to Jan 2017 where Dec 2016 & Jan 2017 data is estimated index as of Nov 2016.
(Source) Ministry of Economy, Trade and Industry

Japanese consumption is mildly recovering partly helped by expansion of female workers

- Japanese private consumption is mildly recovering.
- In this backgrounds are probably mildly increasing number of employees lead by expanding female workers.



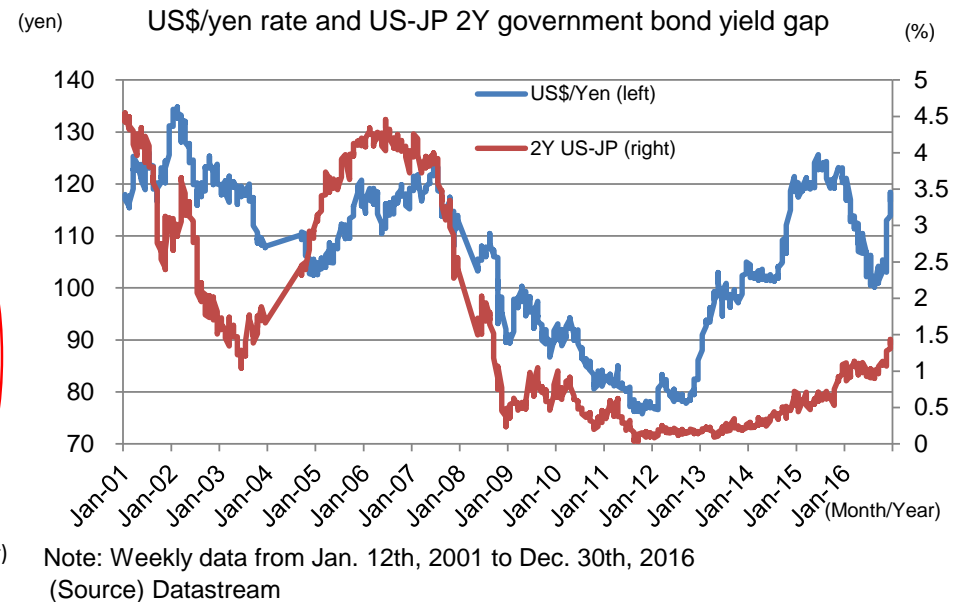
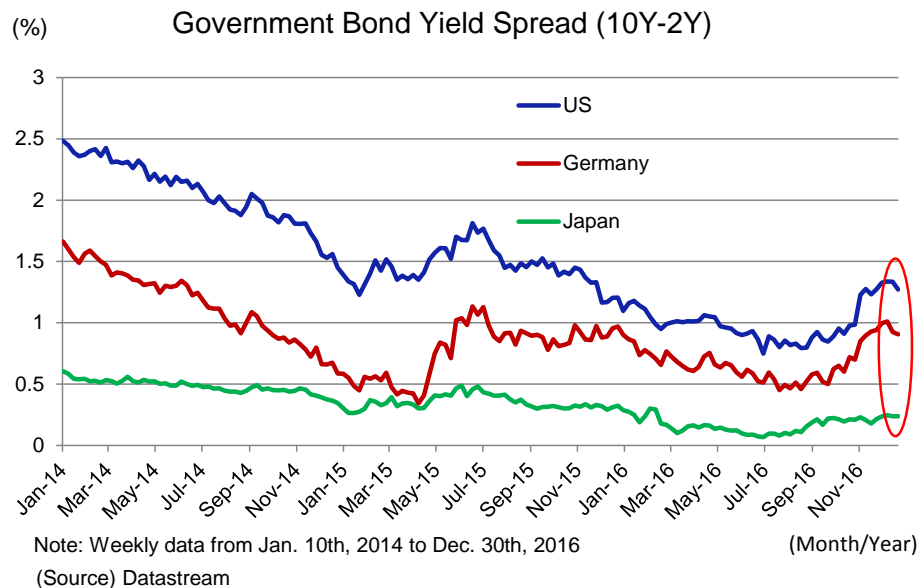
Note: Data is monthly Mar.2012 to Nov 2016
 (Source) Ministry of Health, Labour & Welfare



Note: Data is monthly from Jan 2010 to Nov 2016. Seasonally adjusted.
 (Source) Ministry of Internal Affairs & Communications, compiled by SMAM

Expected stimulative Trump policies in US should make US\$ fundamentally strong

- Rally in US\$ halted responding to protectionist sounding comments from US president Trump.
- US government may not be in favor of strong US\$, however, expected stimulative policies would make US\$ strong.



Outlook for Japanese Stock Markets

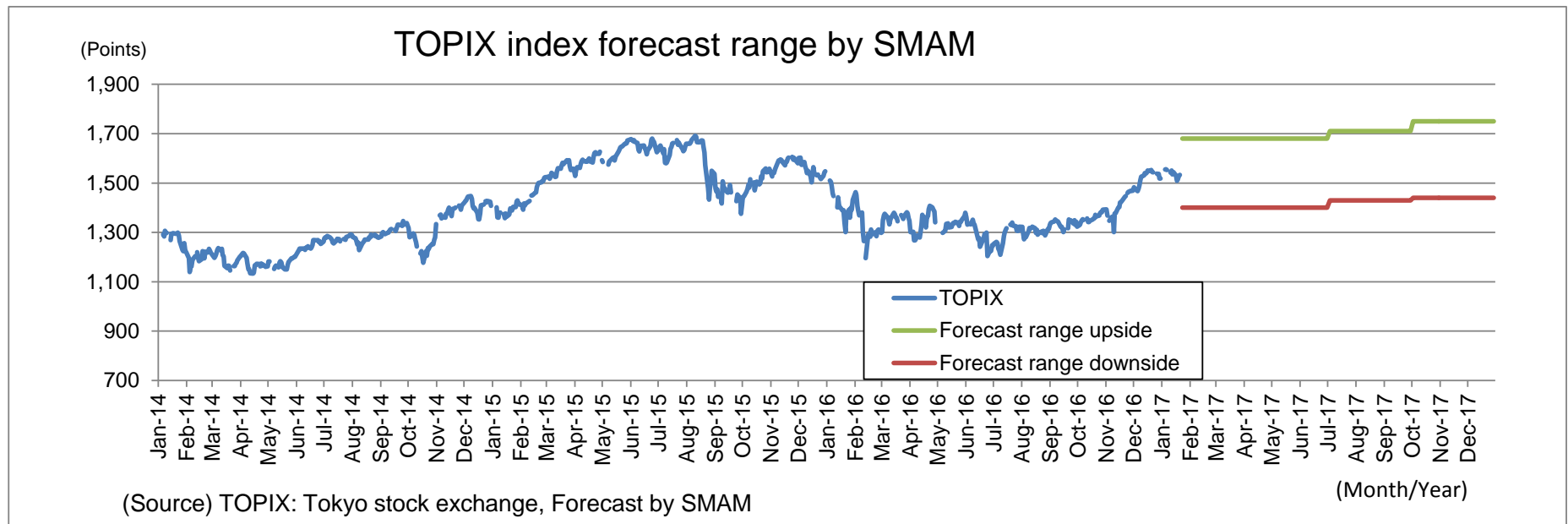
Stock market outlook: Waiting for the real Trump policies to take shape

SMAM short-term view

- Japanese stock market is anxiously waiting for the actual Trump policies to be confirmed. Current PER around 15x seems a little stretched and the stock market would require some consolidation period waiting for the estimated earnings growth to be actually achieved. Nevertheless strong earnings growth expected in Jan-Mar quarter in Japan and higher US stock prices could lift Japanese stock markets.

Longer-term outlook (6-months and beyond)

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is expected for FY2017. Further fiscal stimulus can be expected in Japan meanwhile BOJ would keep its extra-easy monetary policy. Risks are how protectionist Trump's trade policy could become and possible heightening in geo-political tensions in East Asia due to more confrontational US-China relations.



Note: SMAM's projection is as of Jan. 18th, 2017 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Practical Trump trade policies are made and serious trade disputes can be avoided.
 - Expansionary policies in US keep global economies keep on a growth path.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - Further fiscal stimulus will be made and extra easy monetary policy should sustain economic growth in Japan.

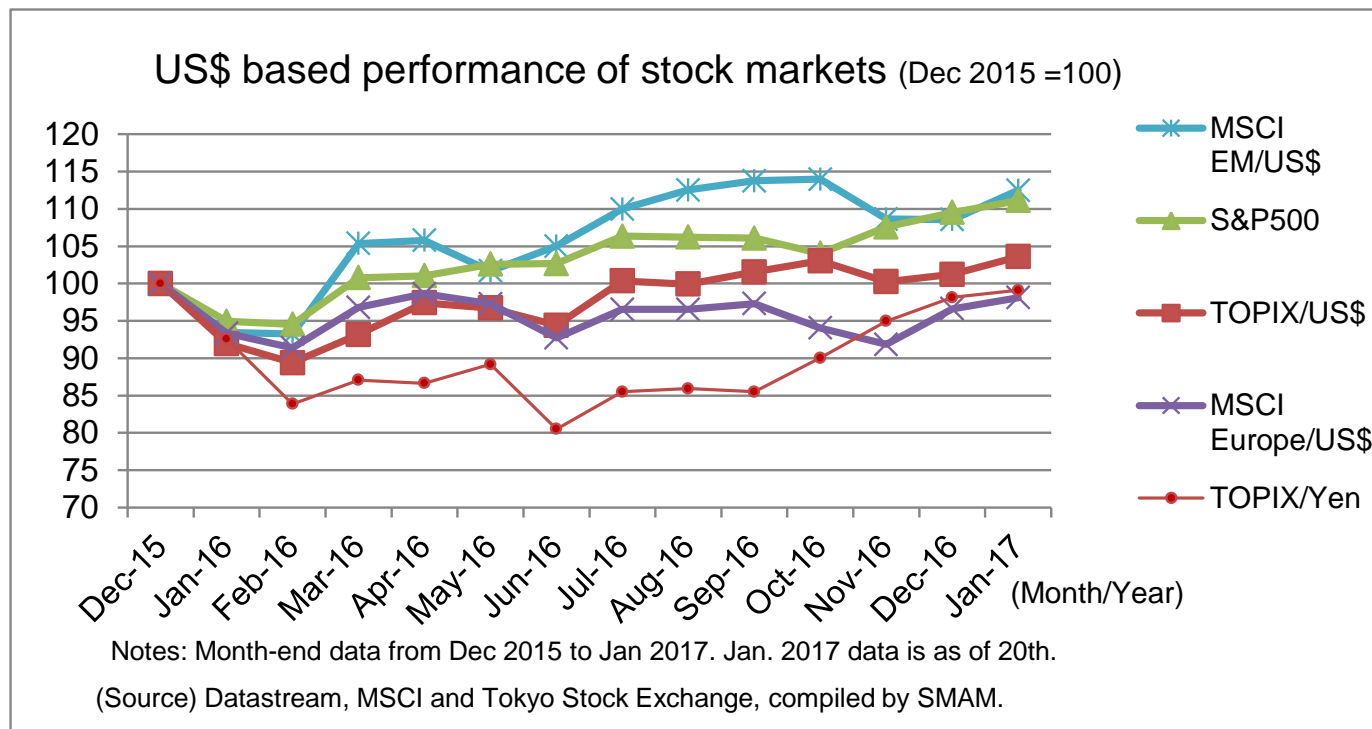
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

- **Downside Risks** include:
 - Confrontational foreign policies taken by Trump presidency shake global trades and deepen geo-political tensions.
 - Populism gains in Europe further unstabilizing EU.
 - Unexpectedly large impact from the process of US monetary policy normalization.
 - Concern over emerging economies including China.

SMAM's forecasts as of January 2017.

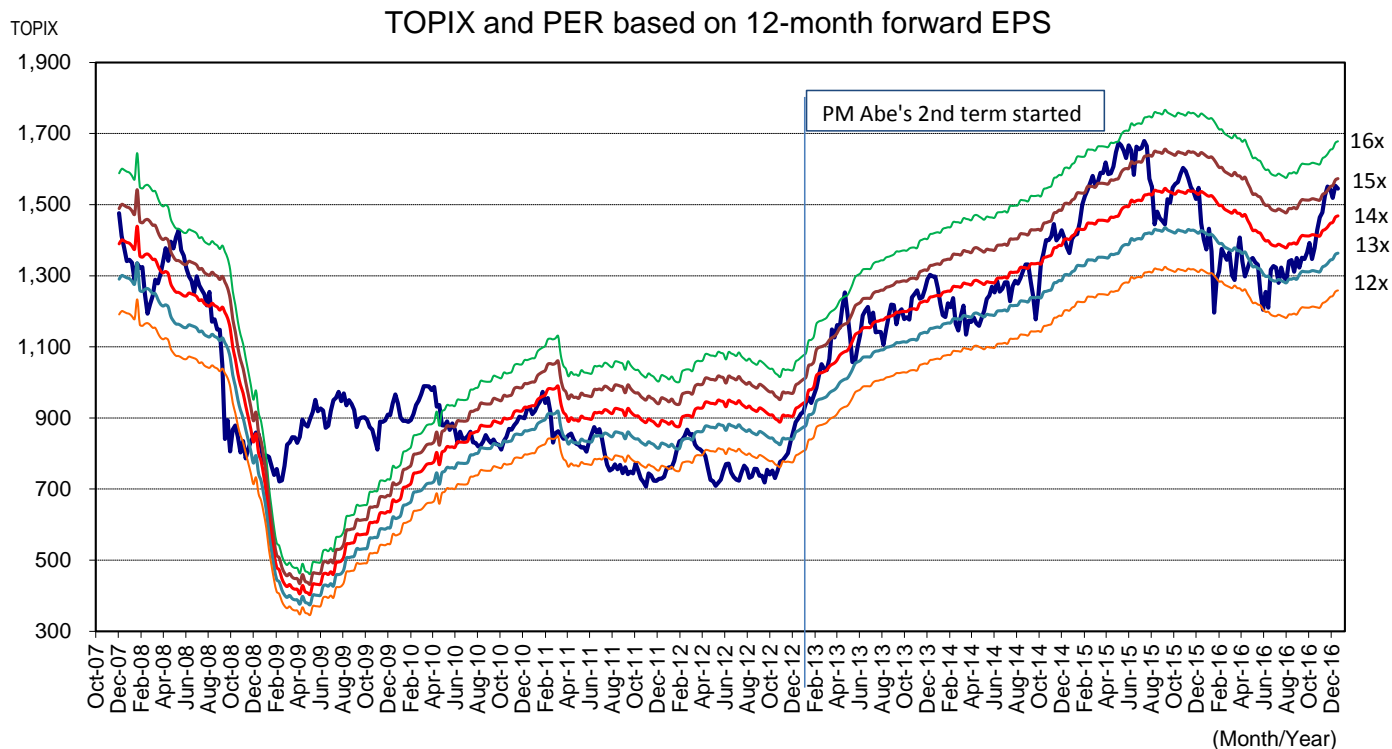
Rally in global stock markets continued before the inauguration of US president Trump

- Emerging market stabilized in December and made recovery in January.
- Global stock markets continued to rally running up to the inauguration of 45th US president Donald Trump.



PER (Price Earnings Ratio) is hovering around 15 times level

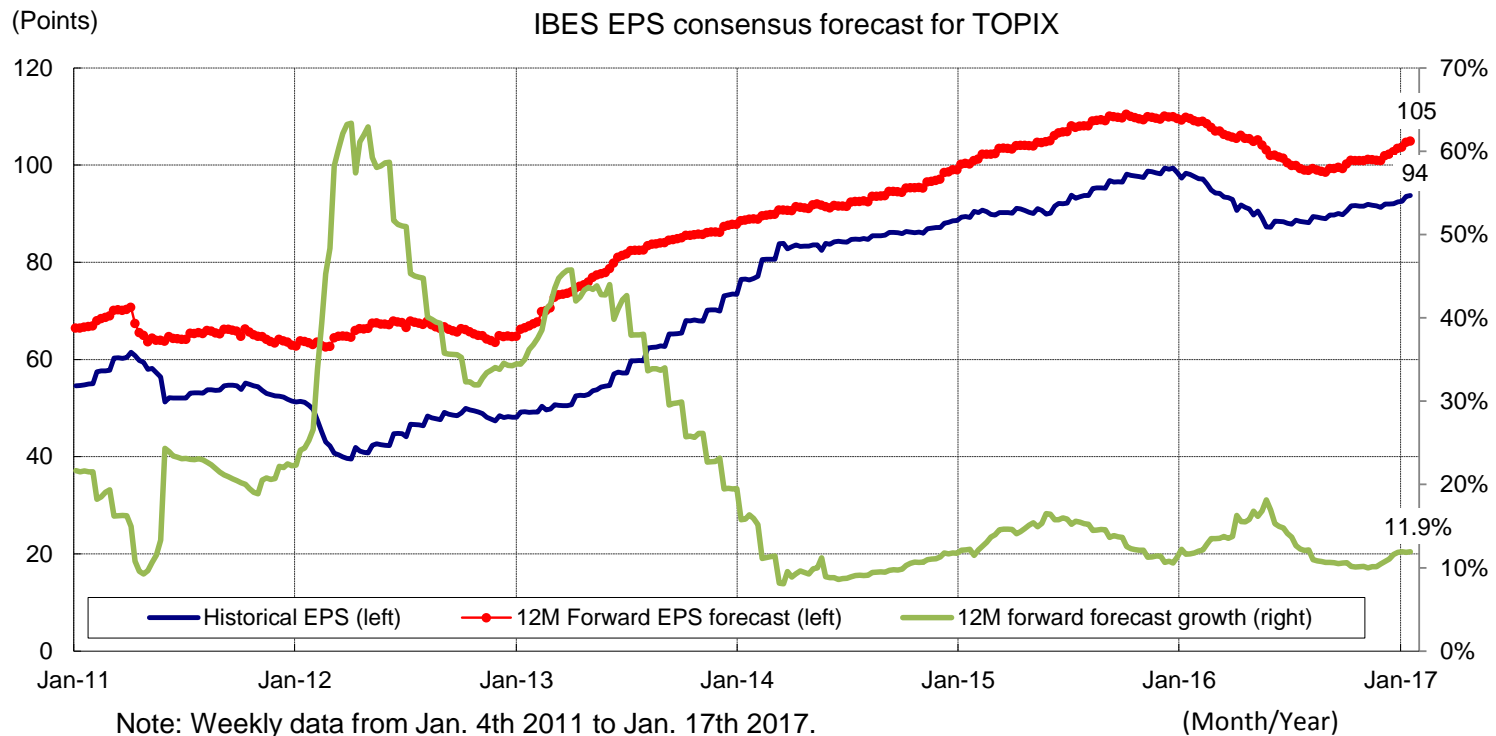
- Since Abenomics started, PER for Japanese stock market, TOPIX index-wise, has been in a range between 12x and 16x except for temporary overshooting.
- As of January 13th, PER for TOPIX was 14.73x based on 12M forward. Stock market is expected to consolidate for a while waiting for the EPS to catch up to justify further upward move.



Note: Data is weekly from Oct. 26th 2007 to Jan. 13th 2017. TOPIX was 1544.89 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

EPS forecasts by analysts continue to expand

- 12M forward EPS forecast provided by IBES shows continuing expansion, which lately forecasts 11.9% growth.

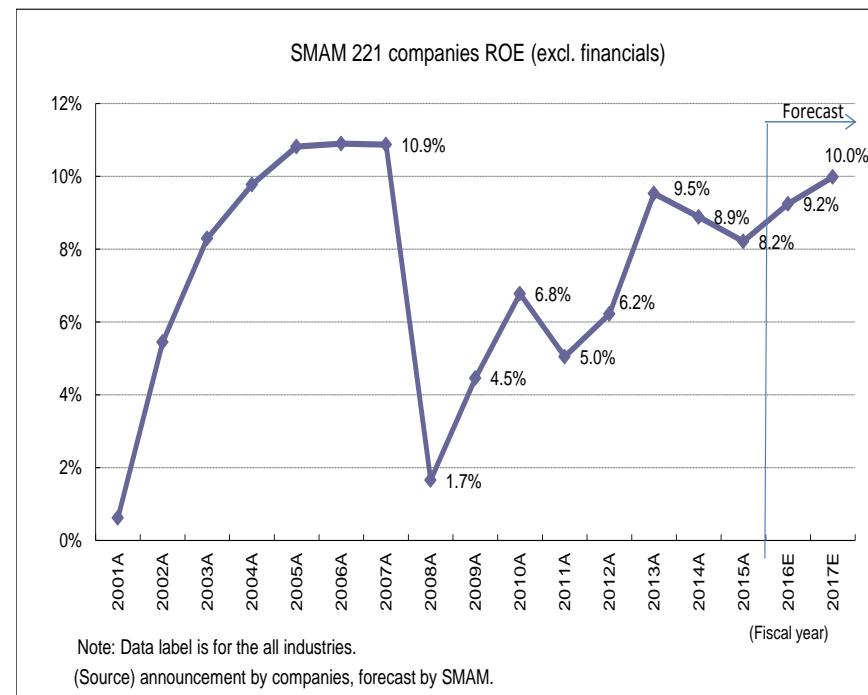
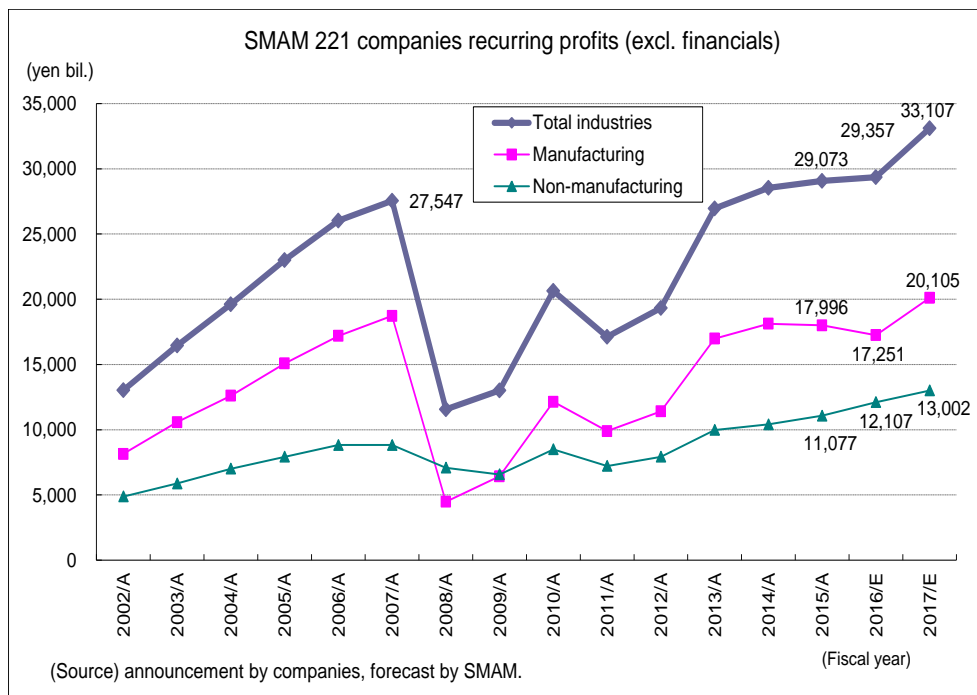


(Source) Datastream, IBES

ROE is on a recovering path to 10% mark expected in 2017

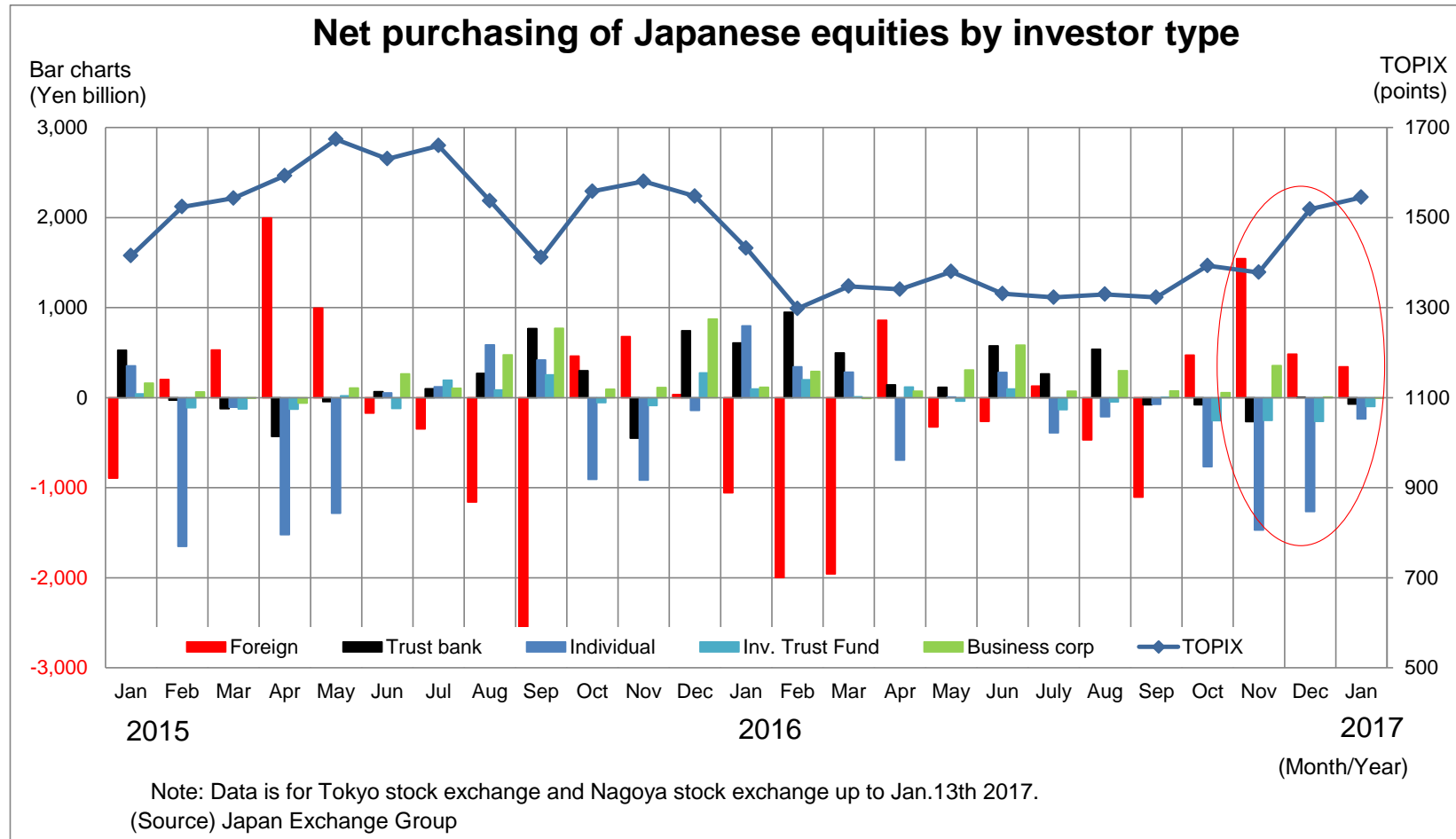
- SMAM forecasts consecutive years of profit growth since FY2013 can be maintained for FY2016 and 17. For FY 2016, profit of Non-manufacturing sector is forecast to grow by 9.3% to offset the decline in Manufacturing sector of -4.1%.
- After falling for 2 consecutive years in FY2014 and 15, ROE is forecast to recover to 9.2% in FY2016 and to reach 10% mark in FY2017.

(Note: *Numbers are for 221 companies in SMAM research coverage excluding financials.)



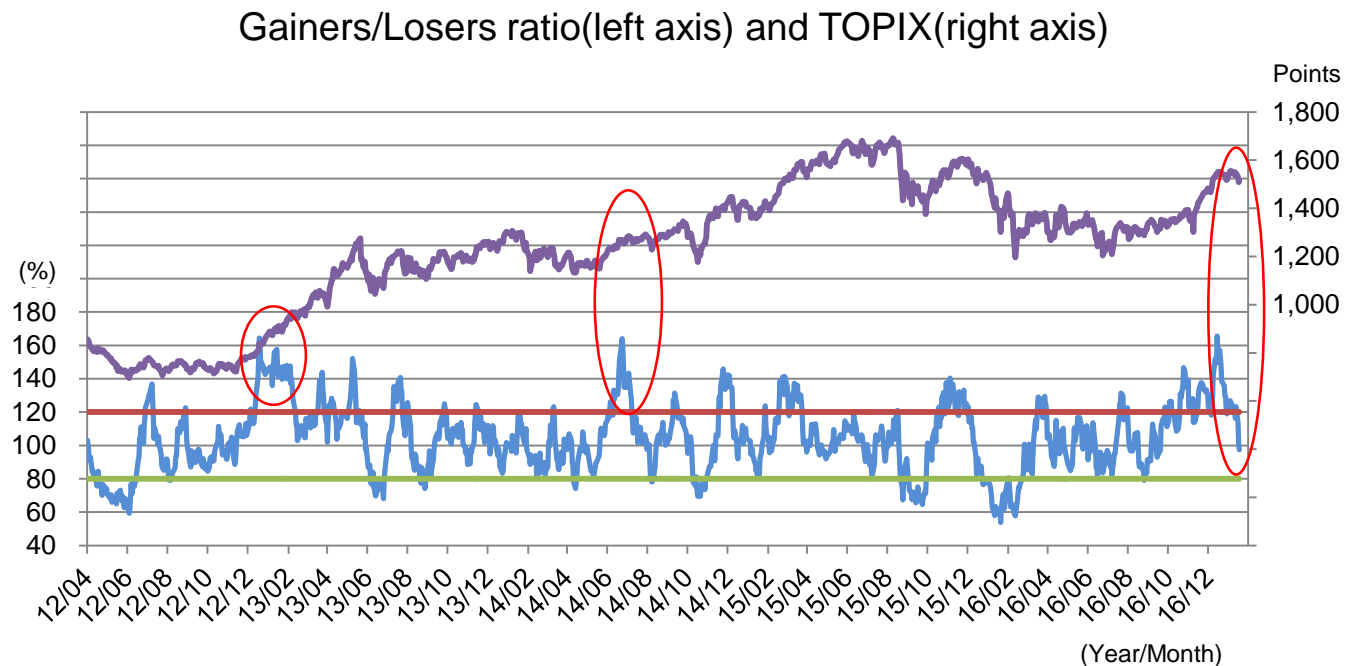
Foreign investors purchasing continues to lift stock prices

- Foreign investors continue purchasing Japanese stocks.
- Japanese individual investors were selling Japanese stocks as stock prices recovered.



Overheat in Japanese stock market calmed down to a normal level

- Gainers/Losers ratio is regarded as an indicator for the temperature of stock markets. Over 120% typically shows the market is overheated. The ratio went up above 160% on 15th December 2016 first time since June 2014.
- Japanese stock market shifted to a consolidation mode afterwards and overheat calmed down to a normal level in mid January.



Notes Gainers/Losers ratio = No. of stocks with rising share price / No. of stocks with falling share price (%)

Source: Tokyo Stock Exchange, SMAM

Up to Jan. 18th 2017

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