



Japanese Stock Market Outlook

SMAM monthly comments & views
- August 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

SMAM's headline GDP forecasts are unchanged from the previous month. Increase in Public Capital Investment and Private Capital Investment as well as steady growth of Private Consumption will drive the Japanese economy. CPI is forecast to rise at the pace less than 1%. BOJ conceded the timing to achieve 2% target from 2018 to 2019. Extra-easy monetary policy is going to continue in Japan despite possible tapering in Europe and US.

- Real disposable income is forecast to grow mildly assuming low inflation less than 1%. Wage growth needs to outpace the scheduled increase in social insurance costs and inflation so that positive growth in real disposable income continues.
- Approval rating for the Abe cabinet fell sharply from 48% to 35% in July. Disapproval rating is now jumped from 36% to 48%. However, approval of the leading opposition party has not picked up at all, which makes the toppling over of PM Abe's cabinet still unlikely.

➤ Japanese Stock Markets

SMAM expects upbeat earnings for Apr-Jun quarter to be announced between late July and August, which should lift the Japanese stock markets. PER (Price Earnings Ratio) for TOPIX index based on 12M forward earnings is just above 14x, which seems attractive compared to near 18x for US and around 15x for Europe.

- Continuing expansion of global economy and corporate earnings would support the Japanese stock market in the long term. Expected capital investment by companies to improve productivity is also a long-term positive.
- Major risks are such as historically high stock valuation for US markets, deterioration of PM Abe's political power, deepening confusion in US politics and geo-political risk in East Asia.

Notes: Macro and market views are as of Jul. 14th and 19th 2017 respectively, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-18

- SMAM's headline GDP forecasts are unchanged from the previous month. Increase in Public Capital Investment and Private Capital Investment as well as steady growth of Private Consumption will drive the Japanese economy.
- CPI is forecast to rise at the pace less than 1%. BOJ conceded the timing to achieve 2% target from 2018 to 2019. Extra-easy monetary policy is going to continue in Japan despite possible tapering in Europe and US.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.2%	1.2%	1.4%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.6%	1.0%	0.6%
Private Housing Investment	8.3%	-9.9%	2.8%	6.3%	1.0%	0.8%
Private Capital Investment	7.0%	2.4%	0.6%	2.5%	2.9%	2.0%
Public Consumption Expenditure	1.7%	0.4%	2.1%	0.4%	0.6%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	4.3%	0.3%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.1%	0.7%	0.2%	0.2%
Exports	4.4%	8.8%	0.7%	3.1%	5.2%	2.3%
Imports	7.1%	4.3%	0.2%	-1.3%	3.6%	1.4%
Nominal GDP	2.6%	2.0%	2.7%	1.0%	1.3%	1.6%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	-0.0%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	3.8%	2.1%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.6%	0.7%

Notes: E=SMAM forecasts. SMAM views are as of Jul. 14th, 2017 and subject to updates thereafter without notice

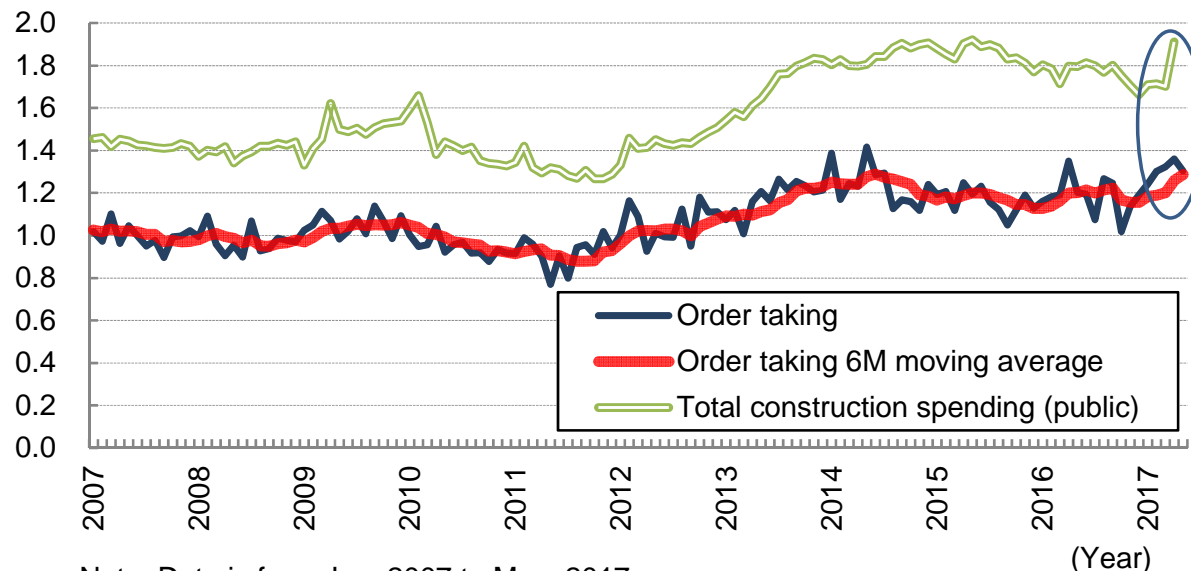
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

(%, YoY except Net Exports)

Public construction spending increased in April as expected

- In the below chart the latest statistics for Total Construction Spending in April showed sizable increase as expected by preceding increase in order takings.
- The latest data for order taking is for May 2017 and it has been rising after hitting bottom in October 2016. Further increase in the actual construction spending is expected.

Public construction spending statistics
(Monthly, seasonally adjusted, yen trillion)

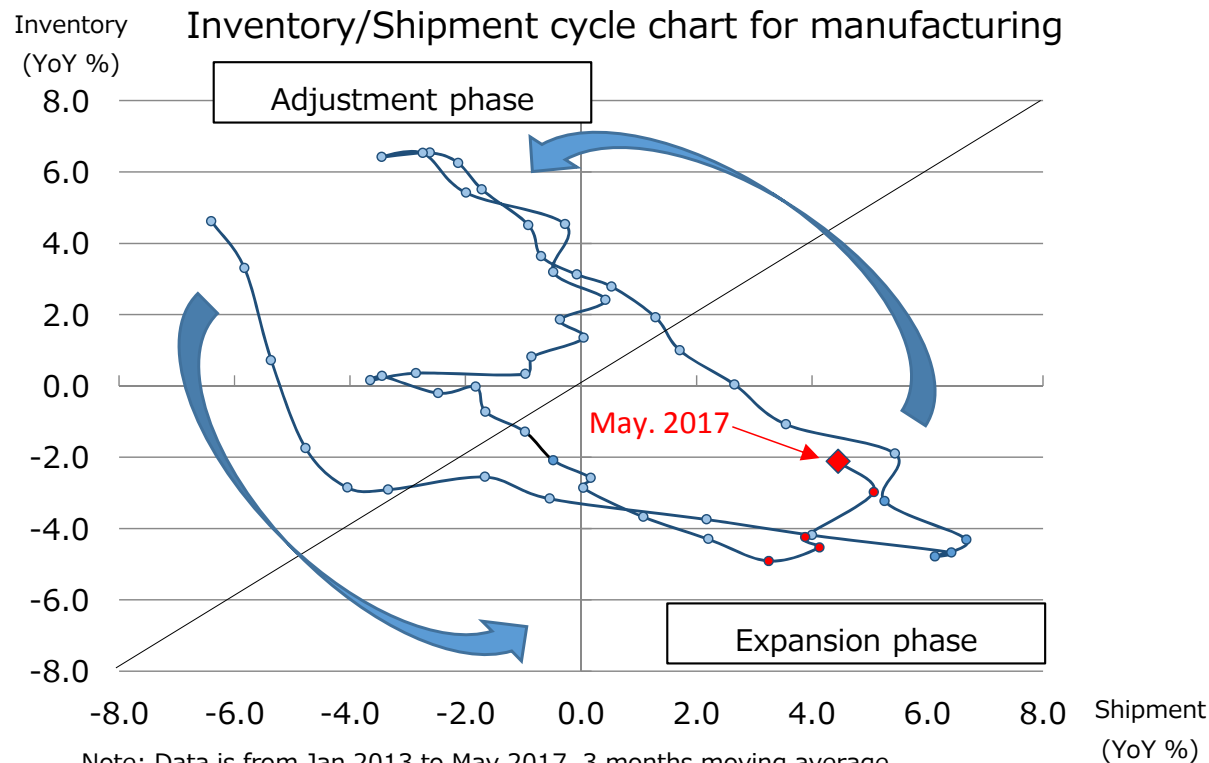


Note: Data is from Jan. 2007 to May. 2017

(Source) Cabinet Office, Ministry of Land, Infrastructure, Transport and Tourism, EAST JAPAN CONSTRUCTION SURETY CO., LTD, and compile by SMAM.

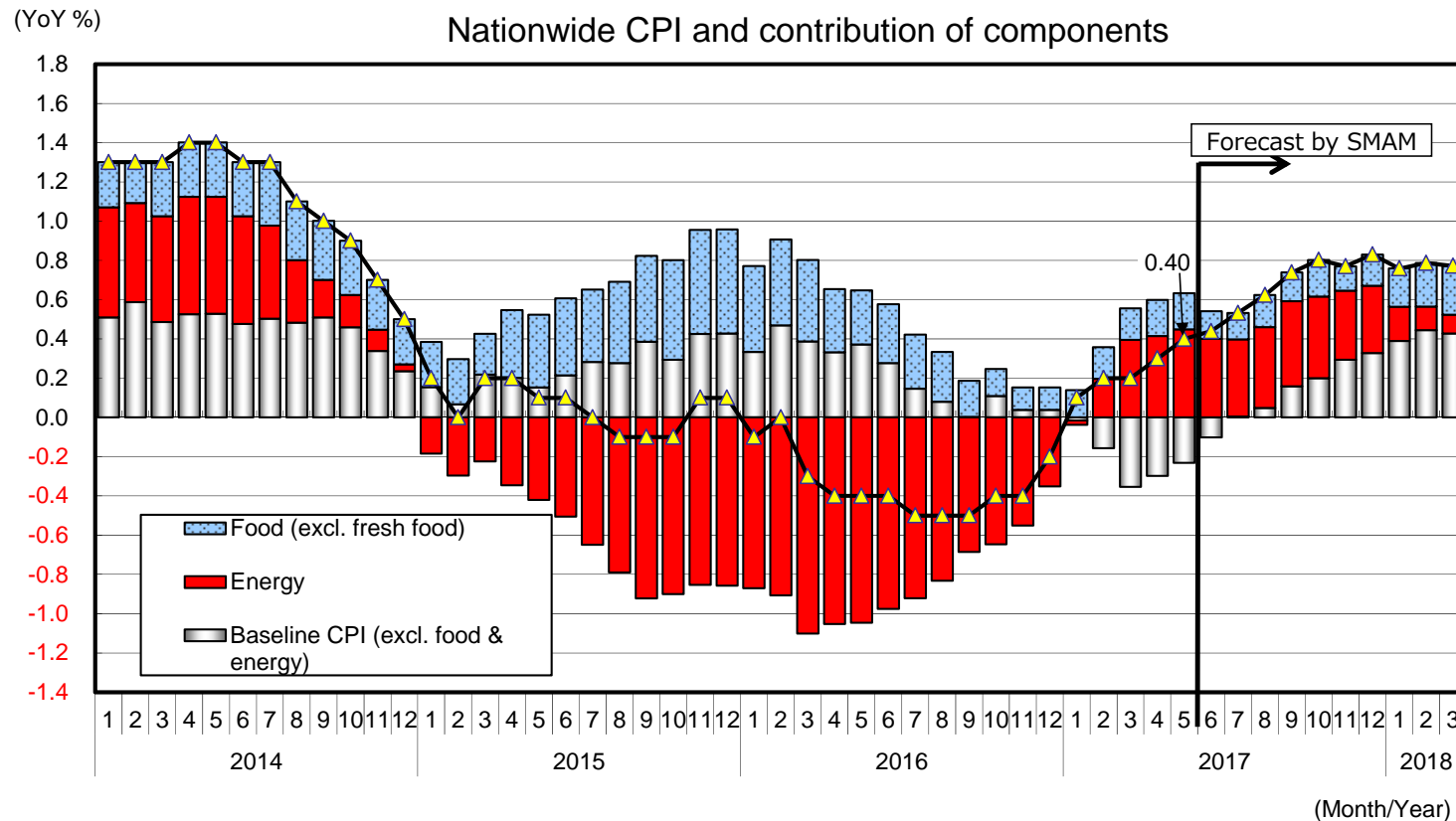
Inventory / shipment cycle is progressing

- The chart is supposed to show anticlockwise movement. When it crosses the 45 degree line from left to right, the cycle shifts from adjustment phase to expansion phase.
- The cycle has been in an expansion phase for 11 months as of May 2017.
- It seems the cycle has run a half way through the current expansion phase. Momentum of positive contribution from the inventory buildup might gradually slow down .



CPI is creeping up, but not strong enough for BOJ to feel confidence

- CPI is slowly rising led by positive change in energy prices. Baseline CPI was still negative in May, which is expected to become positive around Summer this year.
- In the latest perspective report released on July 20th, BOJ conceded the timing to achieve 2% target from 2018 to 2019. Extra-easy monetary policy is going to continue in Japan despite possible tapering in Europe and US.

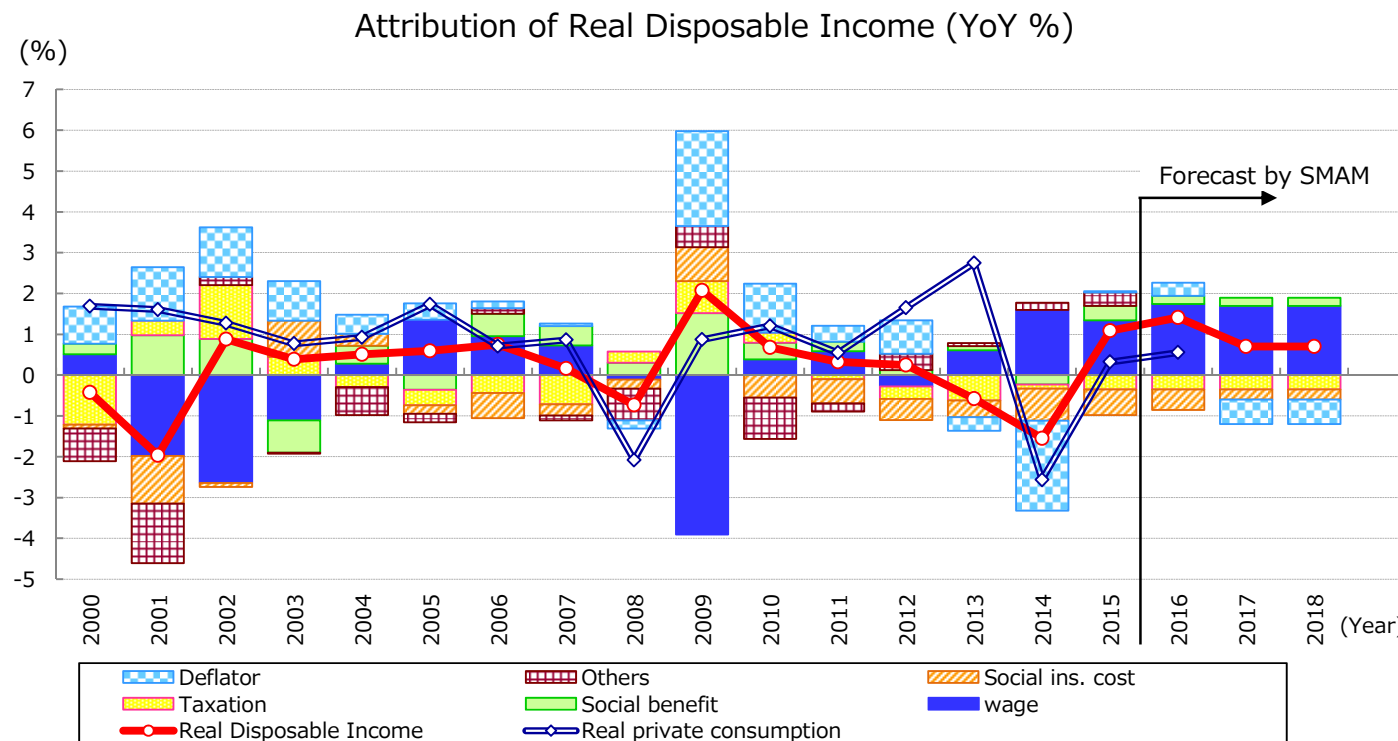


Note: Effect of consumption tax hike in April 2014 is excluded.

(Source) Ministry of Internal Affairs & Communications

Real disposable income is forecast to grow on a fine balance

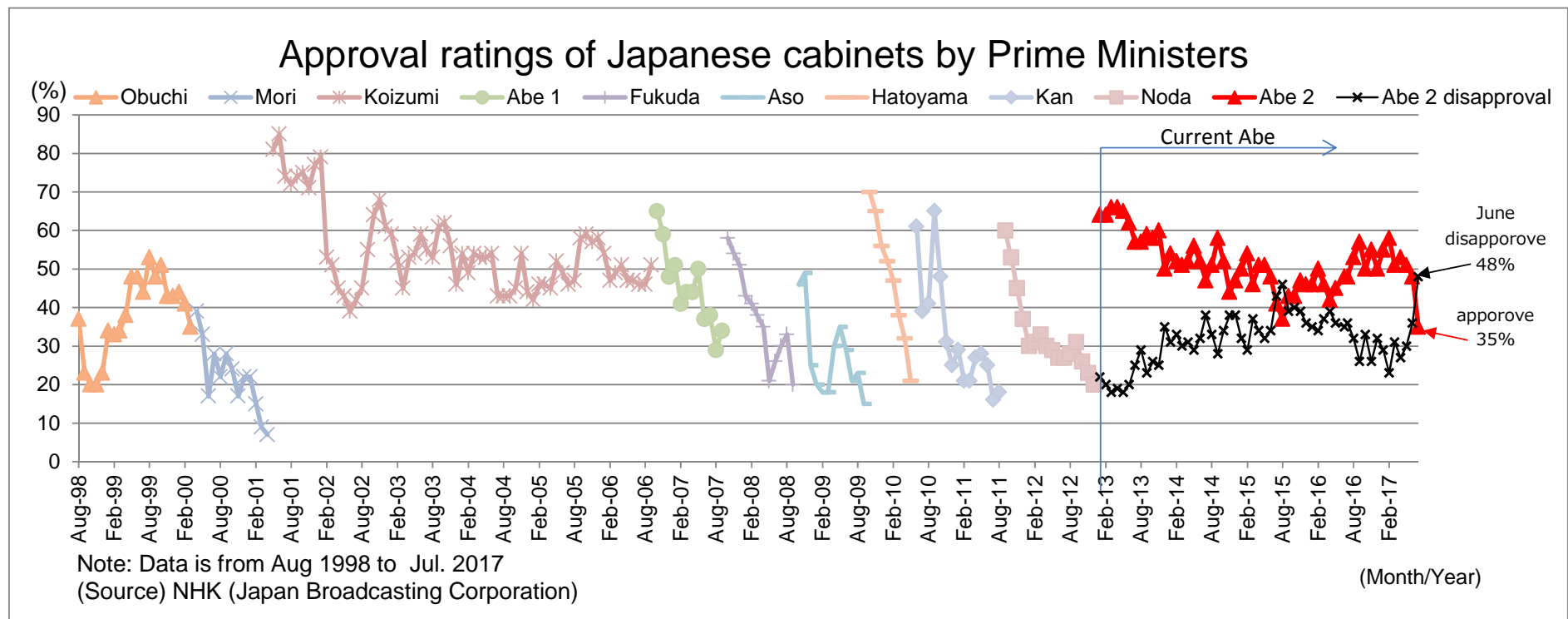
- Real disposable income is forecast to grow mildly assuming low inflation less than 1%.
- Wage growth needs to outpace the scheduled increase in social insurance costs and inflation so that positive growth in real disposable income continues.



(Source) Cabinet Office, compiled by SMAM

Approval rating for Abe cabinet is deteriorating

- Approval rating for the Abe cabinet fell sharply from 48% to 35% in July. Disapproval rating is now Jumped from 36% to 48%.
- “Kake-school scandal” is causing a damage to PM Abe’s reputation. He is suspected to have benefitted one of his closest friends in gaining approval of opening a school for a feline practitioner. Arrogantly looking passage of the counter conspiracy bill was also negative.
- However, approval of the leading opposition party has not picked up at all, which makes the toppling over of PM Abe’s cabinet still unlikely.



Outlook for Japanese Stock Markets

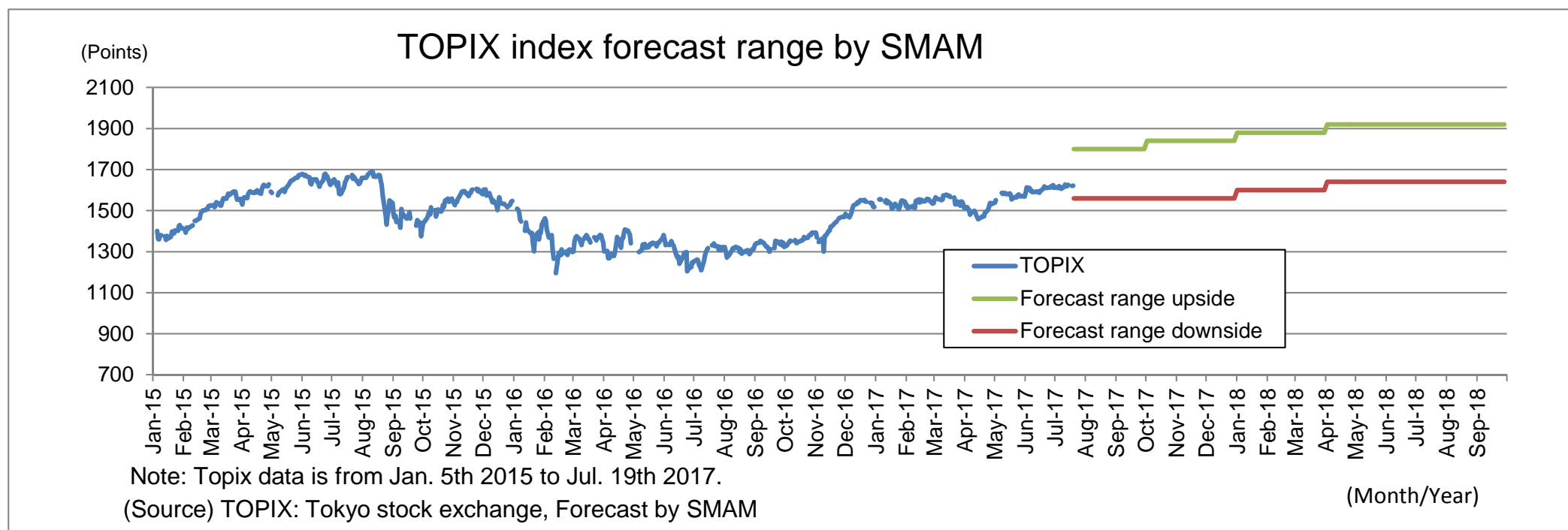
Stock market outlook: SMAM expects upbeat Apr-Jun quarterly earnings to lift the stock market

SMAM short-term view

- SMAM expects upbeat earnings for Apr-Jun quarter to be announced between late July and August, which should lift the Japanese stock markets. PER (Price Earnings Ratio) for TOPIX index based on 12M forward earnings is just above 14x, which seems attractive compared to near 18x for US and around 15x for Europe.

Longer-term outlook (6-months and beyond)

- Continuing expansion of global economy and corporate earnings would support the Japanese stock market in the long term. Expected capital investment by companies to improve productivity is also a long-term positive. Major risks are such as historically high stock valuation for US markets, deterioration of PM Abe's political power, deepening confusion in US politics and geo-political risk in East Asia.



Note: SMAM's projection is as of Jul. 19th, 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.
- US economy keeps growing despite delay in Trump stimulus policies.
- 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.
- Tension in the East Asia does not ignite a war.

■ **Upside Risks** include:

- Stronger-than-expected global growth.
- Stronger-than-expected measures by the Abe government.

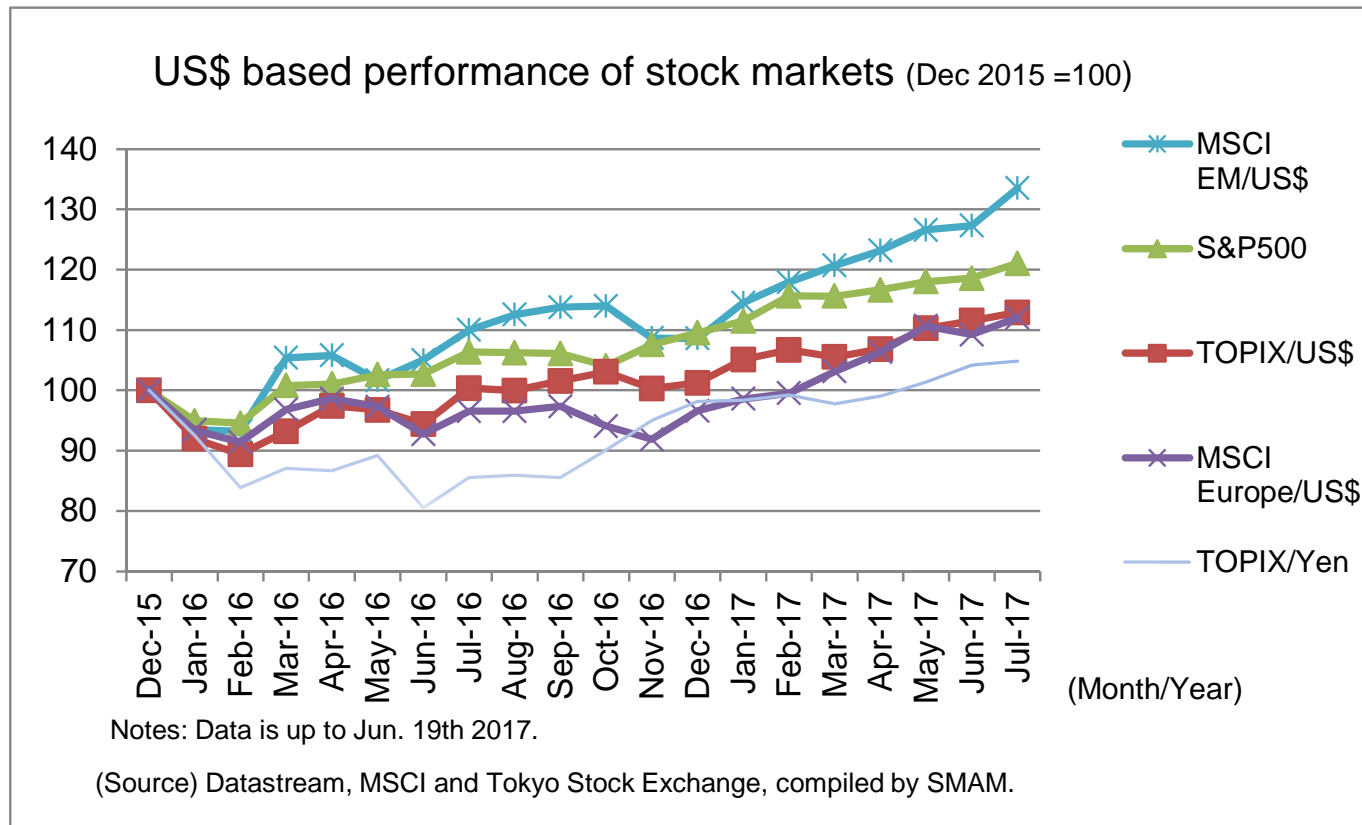
■ **Downside Risks** include:

- Confrontational foreign policies taken by Trump presidency shake global trades.
- Trump policies for stimulating US economy fail to pass US congress.
- "Russia-gate" scandal flares up.
- Populism gains in Europe further destabilizing EU.
- Heightening geo-political tensions in Middle East & East Asia.
- Rekindled concern over emerging economies including China.
- "Moritomo" and "Kake" scandals make a fatal blow to PM Abe.

Note: SMAM's projection is as of Jul.19th, 2017 and subject to updates without notice.

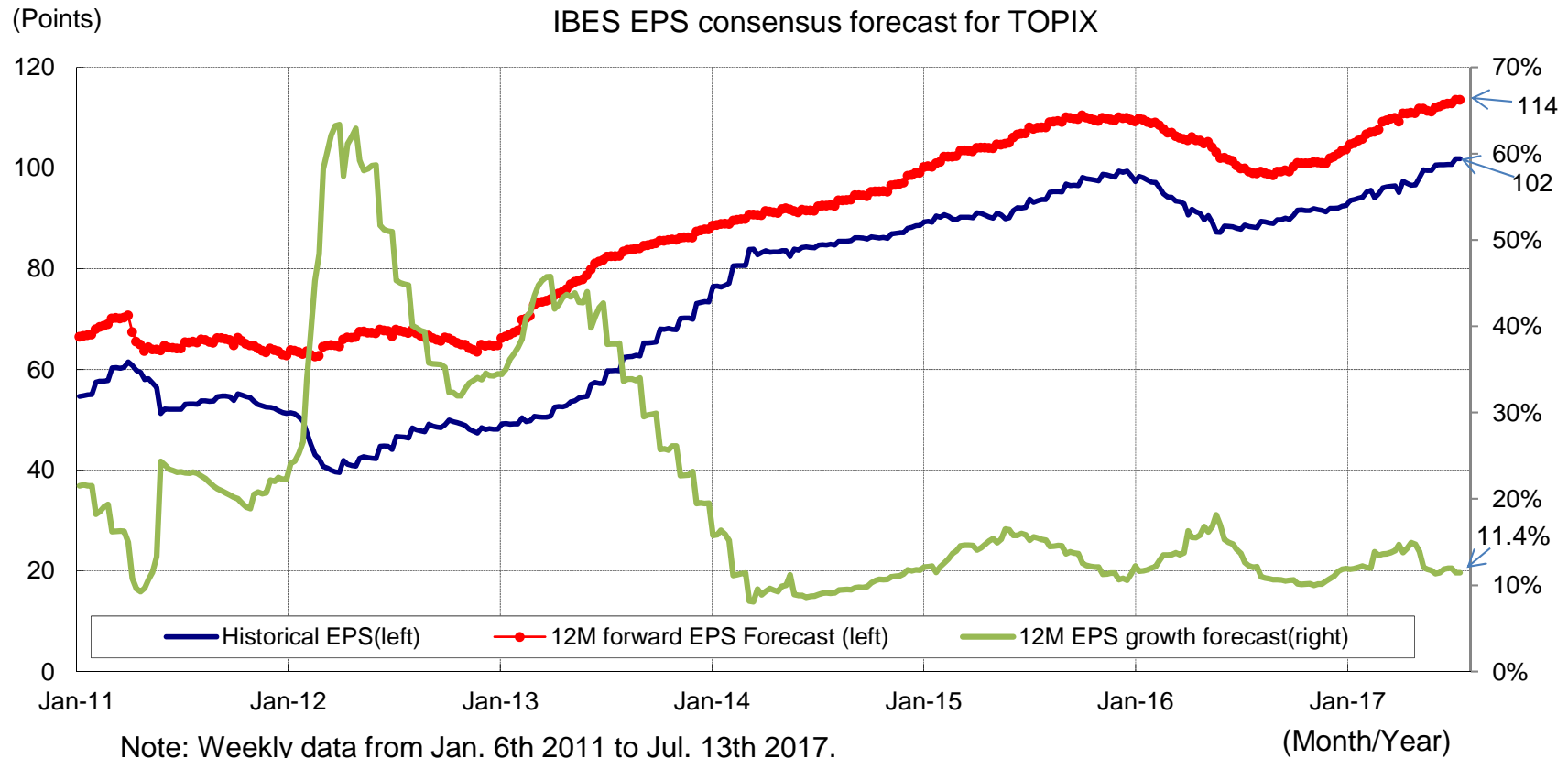
Japanese stock market is slightly lagging other developed markets lately

- Emerging stock markets made a strong rally in the first half of July.
- Japanese stock market is gathering strength, however, slightly lagging other developed markets.



EPS forecasts by analysts continue to expand

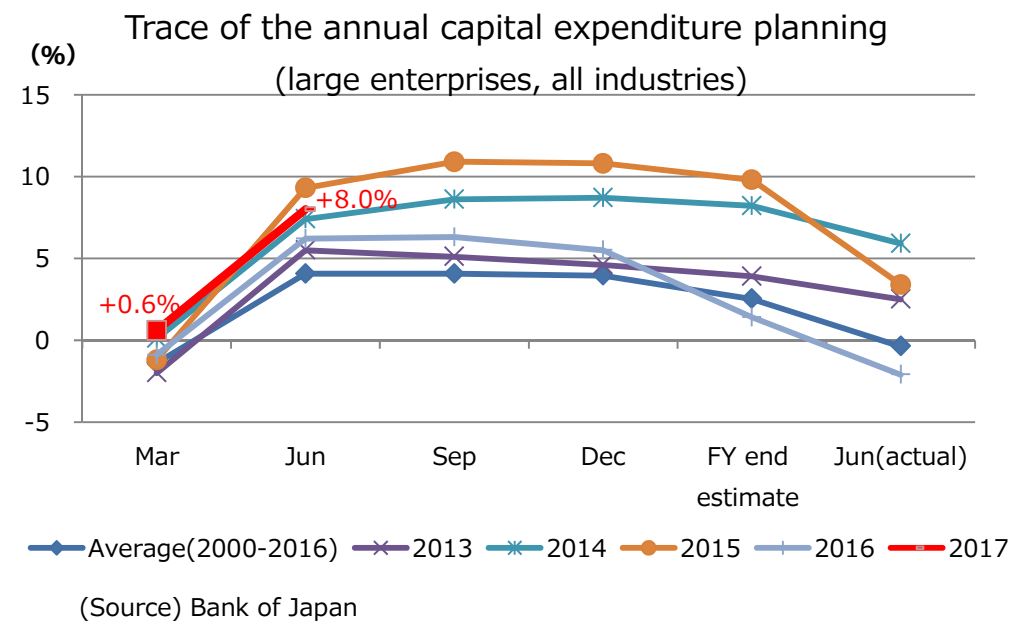
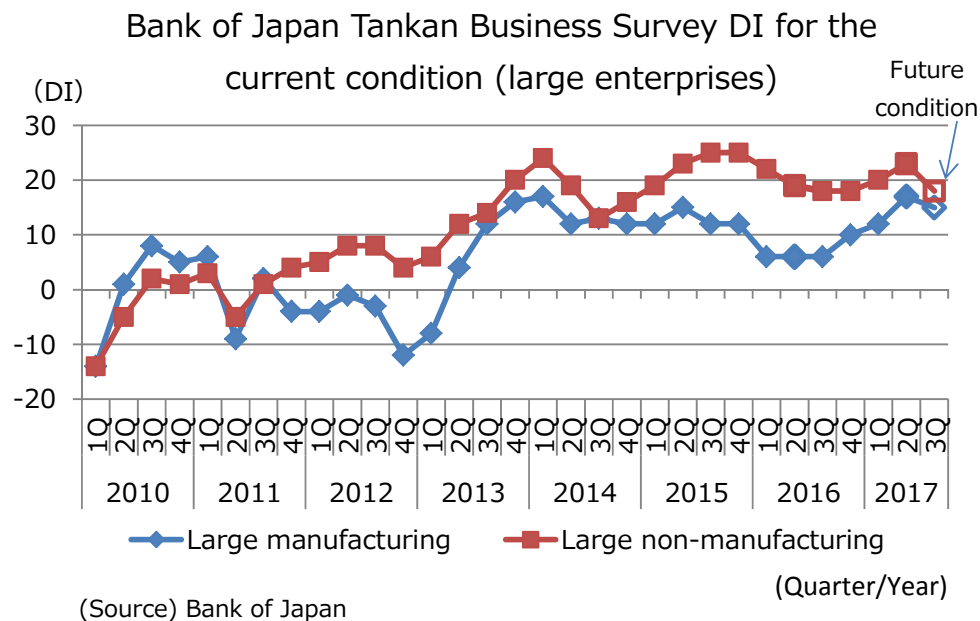
- The latest 12M forward EPS forecast for TOPIX advanced steadily to 114. Historical EPS also advanced.
- 11.4% EPS growth is forecast in the coming 12 months.



(Source) Datastream, IBES

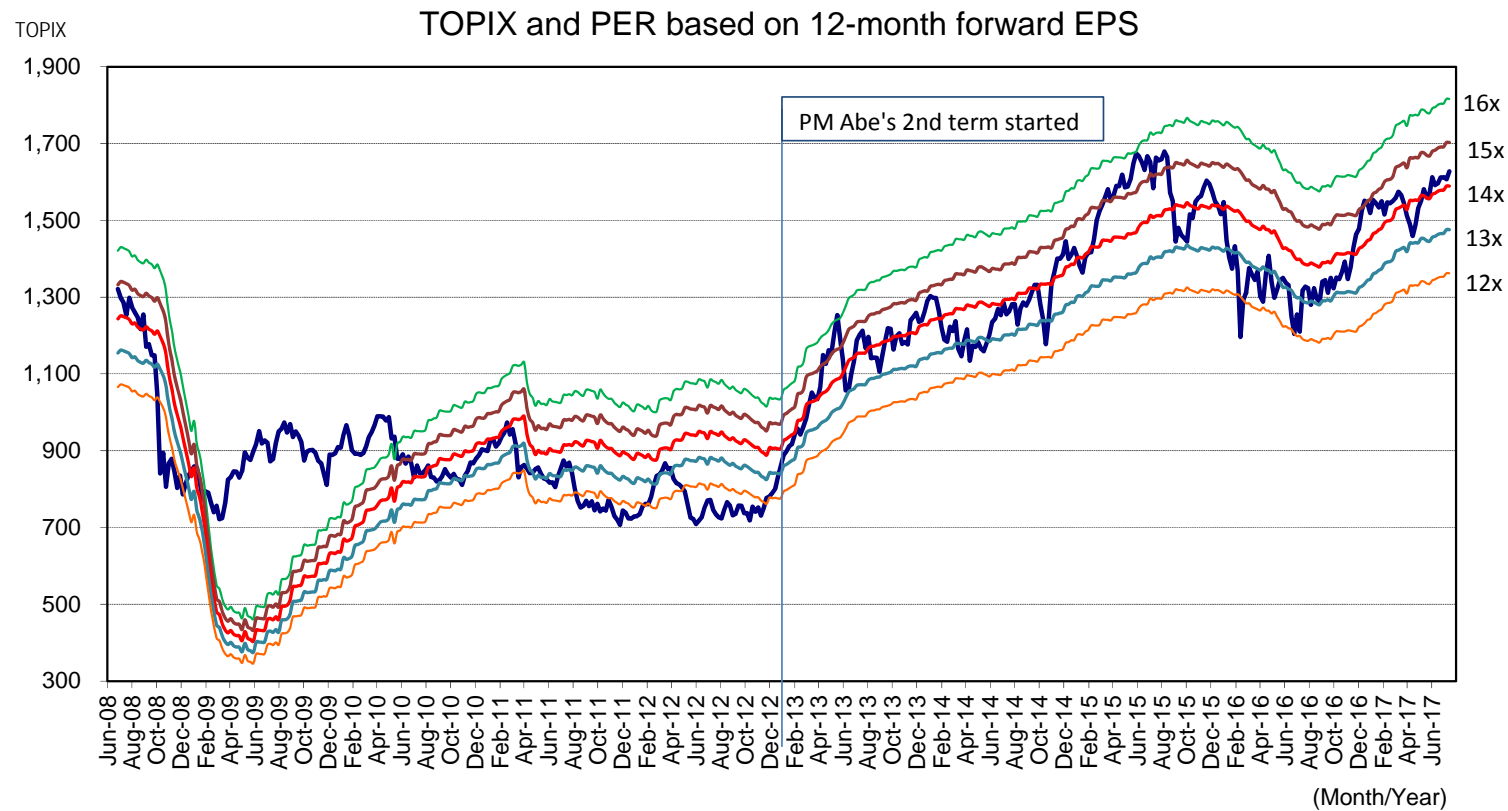
Japanese companies are maintaining positive sentiment

- The latest BOJ TANKAN survey shows that Japanese businesses are in an upbeat sentiment.
- Annual CAPEX plan for FY2017 rose in the June survey to +8% YOY increase, which is a strong reading even after considering seasonal pattern of increase from March.



PER (Price Earnings Ratio) at 14x looks cheap compared to other markets

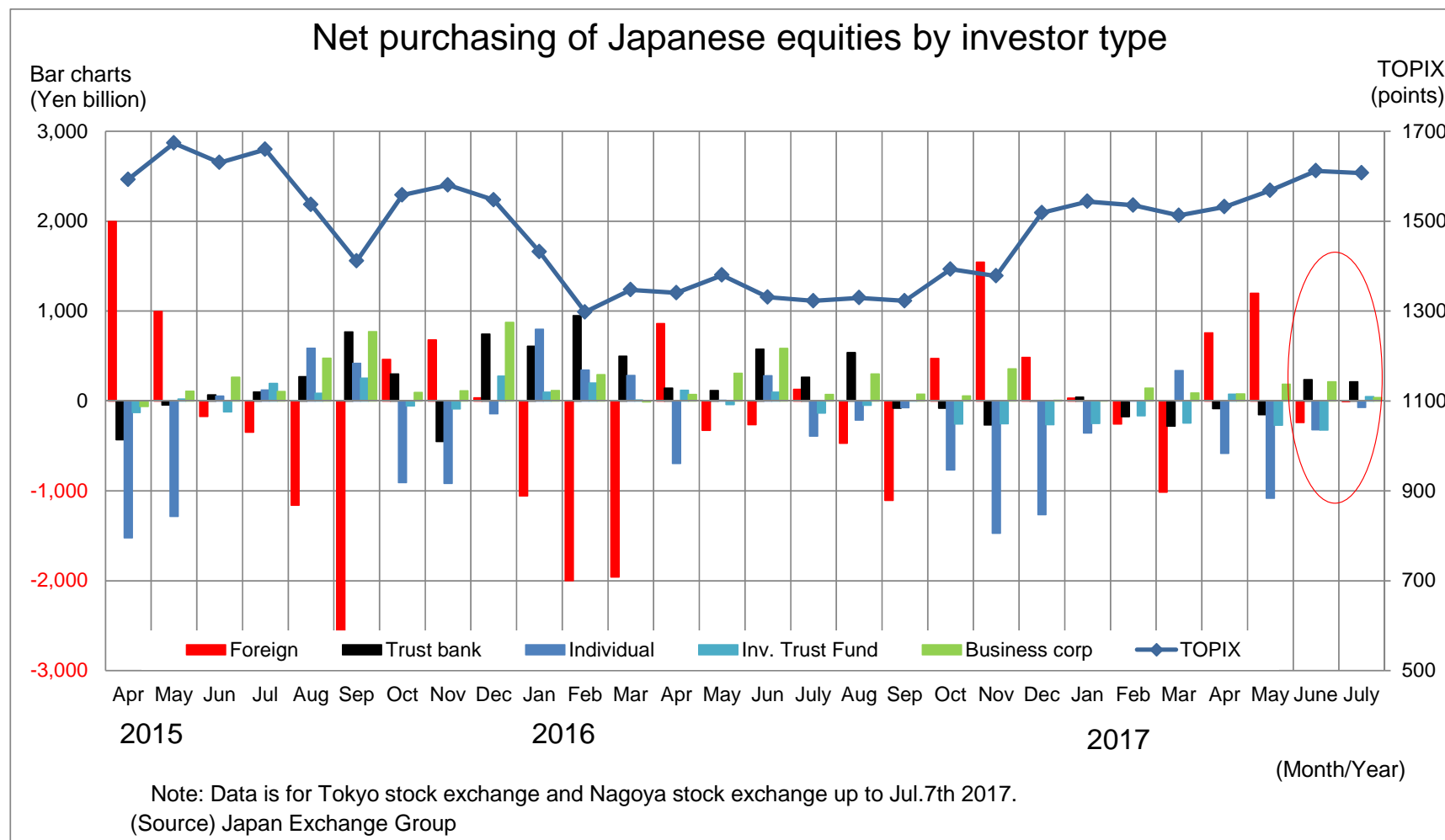
- EPS forecast for TOPIX is constantly rising, which keeps PER at around 14x in spite of the rising stock prices.
- Based on 12M forward EPS of 114, TOPIX PER is calculated at 14.27x with TOPIX at 1627.75 as of July 14th.
- PER for MSCI US index is 18x and for MSCI Europe is just under 15x, which makes Japanese stock market look attractive in global comparison .



Note: Data is weekly from Jun. 27th 2008 to Jul. 14th 2017. TOPIX was 1627.75 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

Investors' activity has calmed down in June and July

- Foreign investors' activity shrank since June, whereas trust banks were buyers, which might be a seasonality after the start of the new fiscal year.
- Individuals are still selling Japanese equities in a market recovery.



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