



Japanese Stock Market Outlook

SMAM monthly comments & views

- November 2017 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

PM Abe led governing coalition parties won the lower house election on October 22nd. Current economic reform as well as extra easy monetary policy will continue, though a lot of political power might be consumed for debating the constitutional change. Good economic fundamentals continue for Japan supported by solid growth by each segment.

- BOJ “Tankan” business survey in September showed robust business sentiment for both manufacturing and non-manufacturing companies.
- Both in Purchasing Power Parity and real yield differentials, current USD/JPY exchange rate around 110 seems to be appropriate. Future course will depend on how inflation and interest rates move in both countries.

➤ Japanese Stock Markets

After renewing the record of consecutive days of rising, the Japanese stock market is going to have a breather in the short term. Robust economic and business fundamentals should support the stock prices. The biggest domestic event, general election, is now behind and the focus is back on overseas events such as North Korea and US politics.

- In the long-term, the global economy is expected to grow in a steady undertone. Earnings for the Japanese companies are expected to be revised upward, which will provide the stimulus to the stock market.
- Risk factors are such as North Korea situation, possible slowdown in Chinese economy, US budget debate and effects of monetary policy change in EU and US.

Notes: Macro and market views are as of Oct 23rd 2017, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-18

- Good economic fundamentals continue for Japan supported by solid growth by each segment.
- CPI is expected to rise just mildly.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.3%	1.3%	1.5%	1.1%
Private Consumption Expenditure	2.7%	-2.6%	0.6%	0.7%	1.3%	0.7%
Private Housing Investment	8.3%	-9.9%	2.8%	6.6%	2.4%	2.3%
Private Capital Investment	7.0%	2.4%	0.6%	2.4%	3.0%	2.7%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.4%	0.7%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	3.4%	-1.4%
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%	3.2%	5.1%	3.0%
Imports	7.1%	4.3%	0.2%	-1.4%	3.6%	1.7%
Nominal GDP	2.6%	2.0%	2.7%	1.1%	1.6%	1.7%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	0.1%	0.5%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	4.5%	2.5%
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 Oct. 23rd, 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

IMF revised world economic growth forecast upward in October

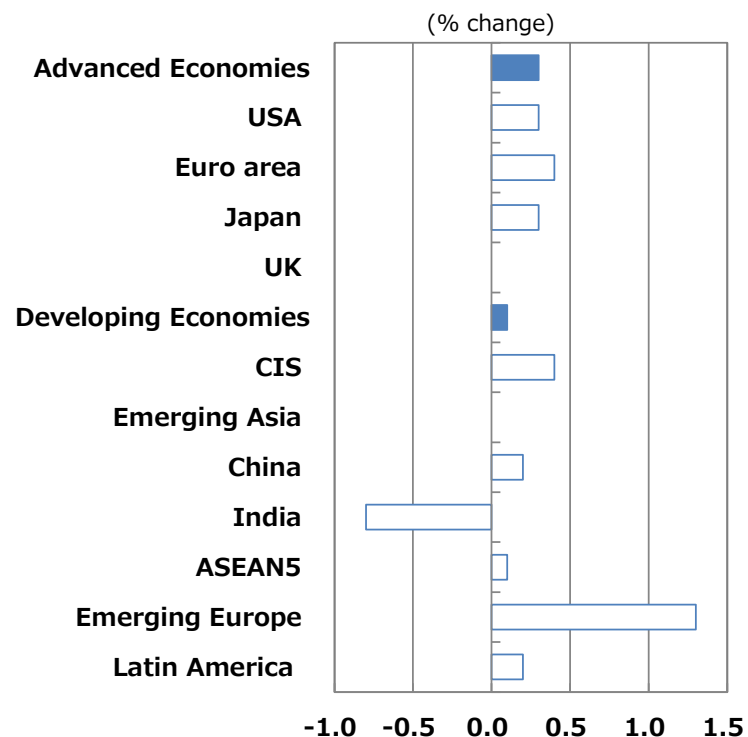
- World economic growth is gathering momentum, which is supportive for the stock markets.

IMF World Economic Outlook

GDP (YOY%)	As of October 2017			Change from the forecast in July	
	2016 (H)	2017 (F)	2018 (F)	2017	2018
World	3.2	3.6	3.7	0.1	0.1
Advanced Economies	1.7	2.2	2.0	0.2	0.1
USA	1.5	2.2	2.3	0.1	0.2
Euro area	1.8	2.1	1.9	0.2	0.2
Japan	1.0	1.5	0.7	0.2	0.1
UK	1.8	1.7	1.5	0.0	0.0
Developing Economies	4.3	4.6	4.9	0.0	0.1
CIS	0.4	2.1	2.1	0.4	0.0
Emerging Asia	6.4	6.5	6.5	0.0	0.0
China	6.7	6.8	6.5	0.1	0.1
India	7.1	6.7	7.4	▲ 0.5	▲ 0.3
ASEAN5	4.9	5.2	5.2	0.1	0.0
Emerging Europe	3.1	4.5	3.5	1.0	0.3
Latin America	▲ 0.9	1.2	1.9	0.2	0.0
Brazil	▲ 3.6	0.7	1.5	0.4	0.2
Mexico	2.3	2.1	1.9	0.2	▲ 0.1

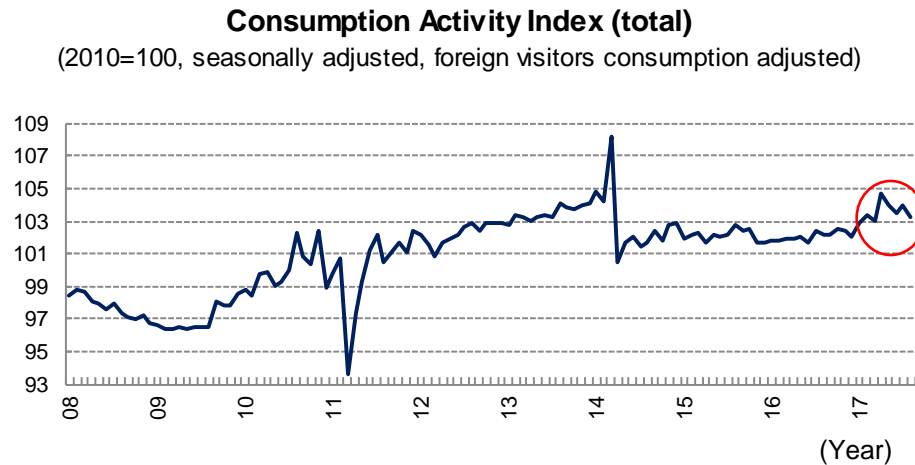
(Source) IMF, compiled by SMAM

Change from the forecast in July
(2017+2018)

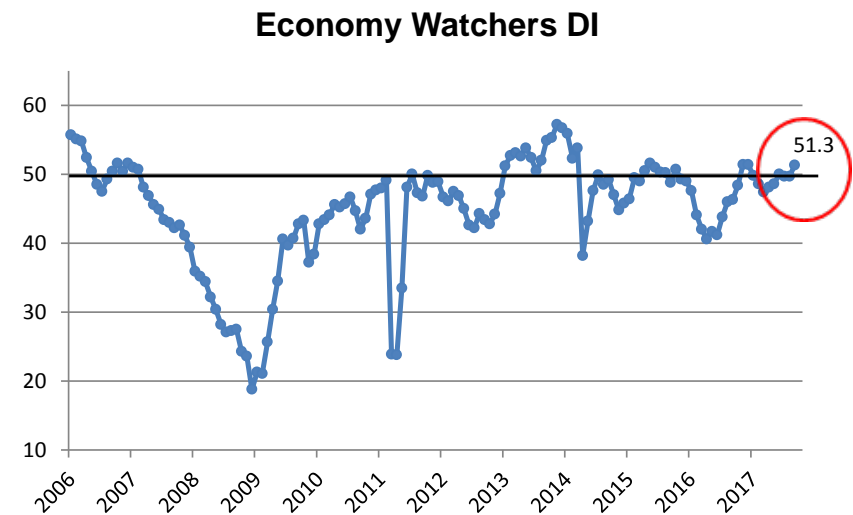


Private consumption growth remains moderate meanwhile consumer sentiment is improving

- After a robust growth in 2Q 2017, private consumption has lost some momentum lately. Extremely rainy August was partly blamed for this slow down.
- However, consumer sentiment actually improved in recent months as Economy Watchers DI showed. Job security in a tight labor condition is one of the positive factors behind.



Note: Data is from Jan. 2008 to Aug. 2017
(Source) Bank of Japan

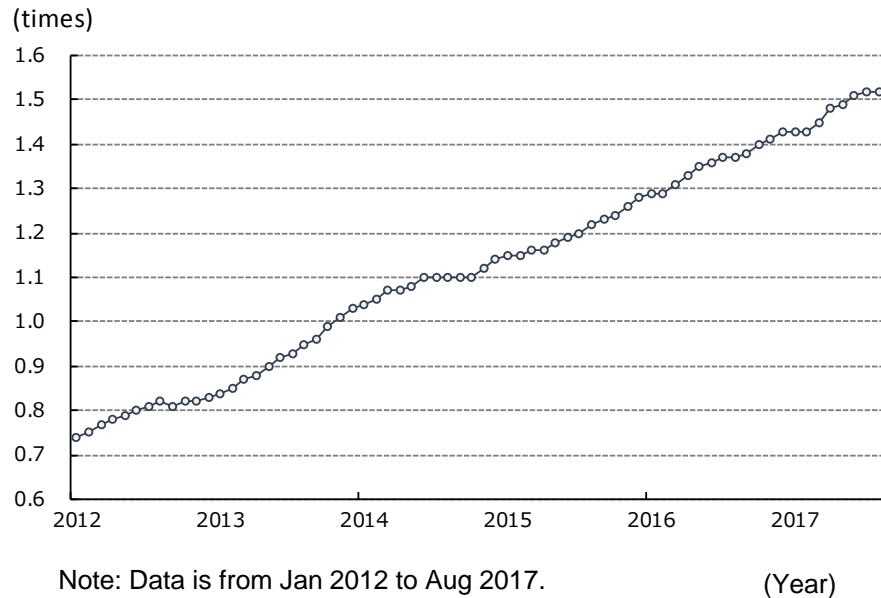


Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is improving. Data period is from Jan. 2006 to Sep 2017.
(Source) Cabinet Office

Labor market gets tighter and tighter

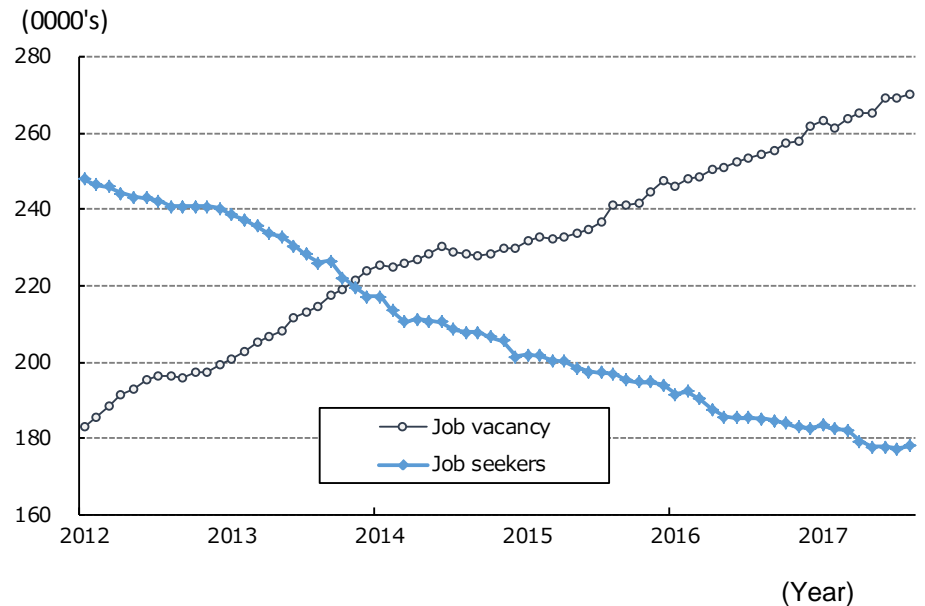
- Number of unfilled job vacancy keeps climbing in the face of decreasing number of job seekers.

Job vacancy/ seekers ratio (seasonally adjusted)



Note: Data is from Jan 2012 to Aug 2017.
(Source) Ministry of Health, Labour and Welfare

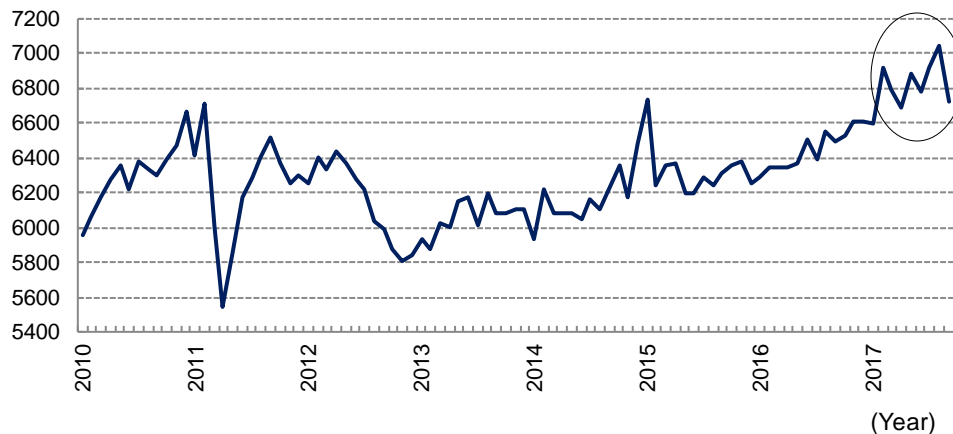
Number of job vacancy and job seekers (seasonally adjusted)



Strong export growth continues to drive the Japanese economy

- Drop in export volume in September is going to be temporary due to such as hurricanes in US and a reversal from extremely strong August results.

Total export volume
(seasonally adjusted, yen billion)



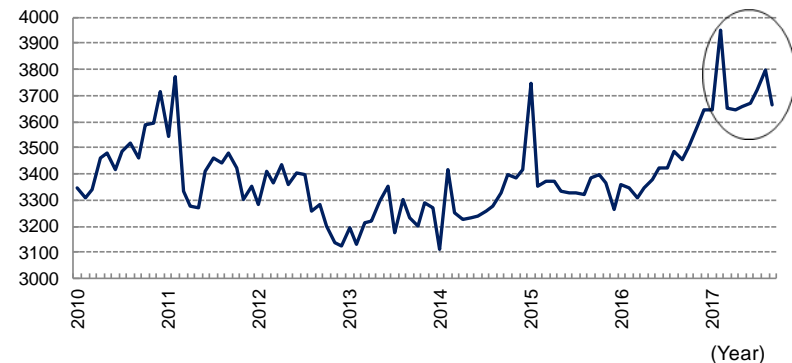
Note: Data is from Jan 2010 to Sep 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Export volume to US
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Sep 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

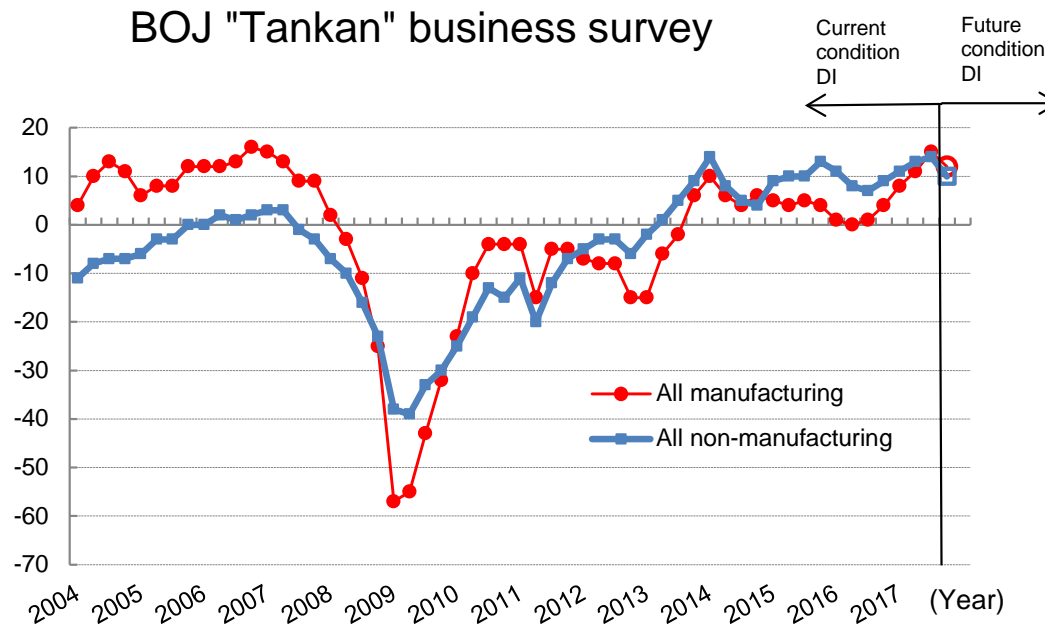
Export volume to Asia
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Sep 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Business sentiment is at a historically high level for both manufacturing & non-manufacturing

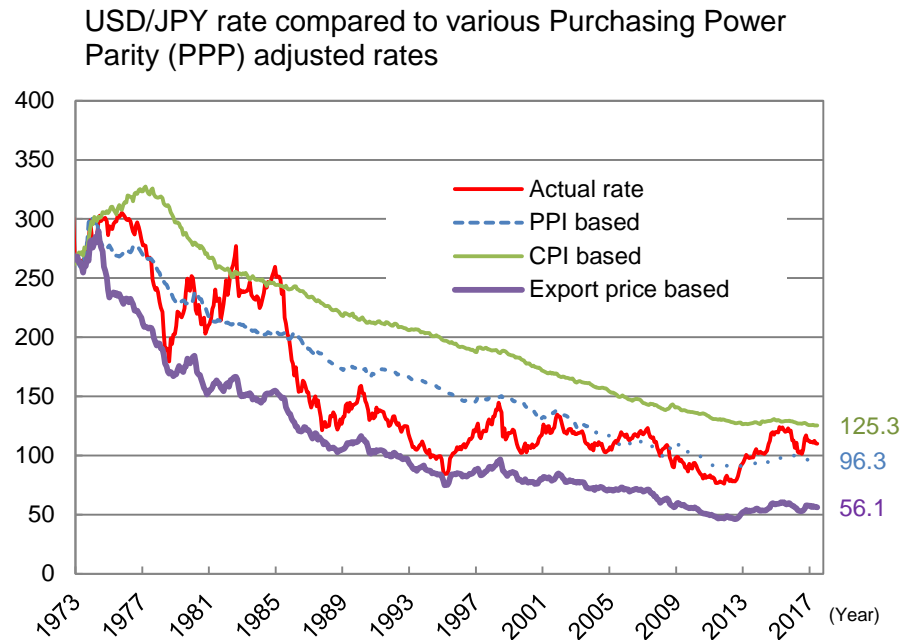
- BOJ "Tankan" business survey in September showed robust business sentiment for both manufacturing and non-manufacturing companies.
- The DI for the current condition was 15 and 14 for manufacturing and non-manufacturing respectively, rising from the previous survey.



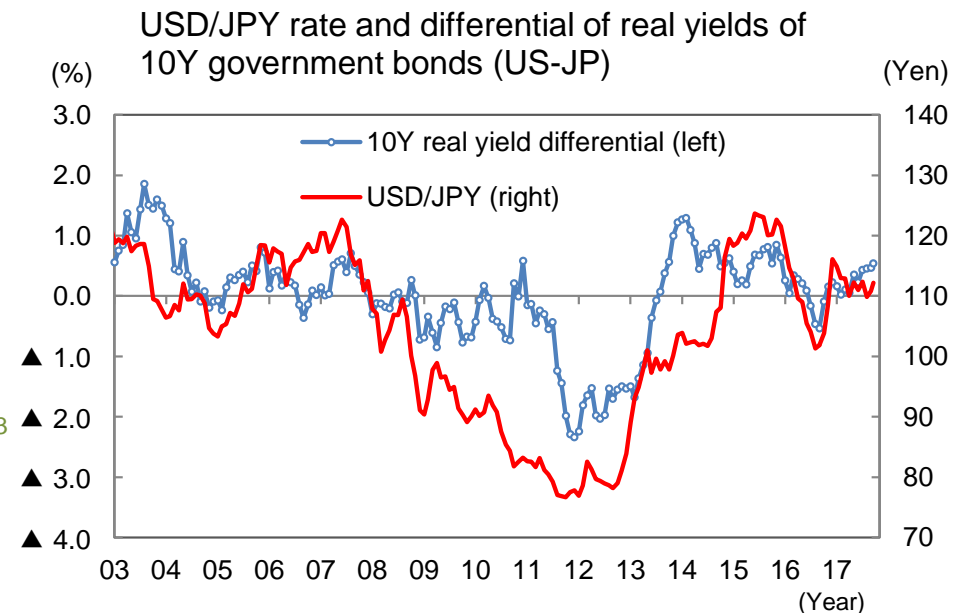
Notes: Data is quarterly from 1Q 2004 to 3Q 2017. DI above 0 means the condition is improving.
(Source) Bank of Japan

Current USD/JPY rate is at a theoretically appropriate level

- Both in Purchasing Power Parity and real yield differentials, current USD/JPY exchange rate around 110 seems to be appropriate. Future course will depend on how inflation and interest rates move in both countries.
- Japan suffered from deflation for a long time while the rest of the world was more or less having inflation, which drove JPY stronger. However, after BOJ started bold monetary easing in 2013, deflation in Japan stopped and inflation in the rest of the world dramatically declined



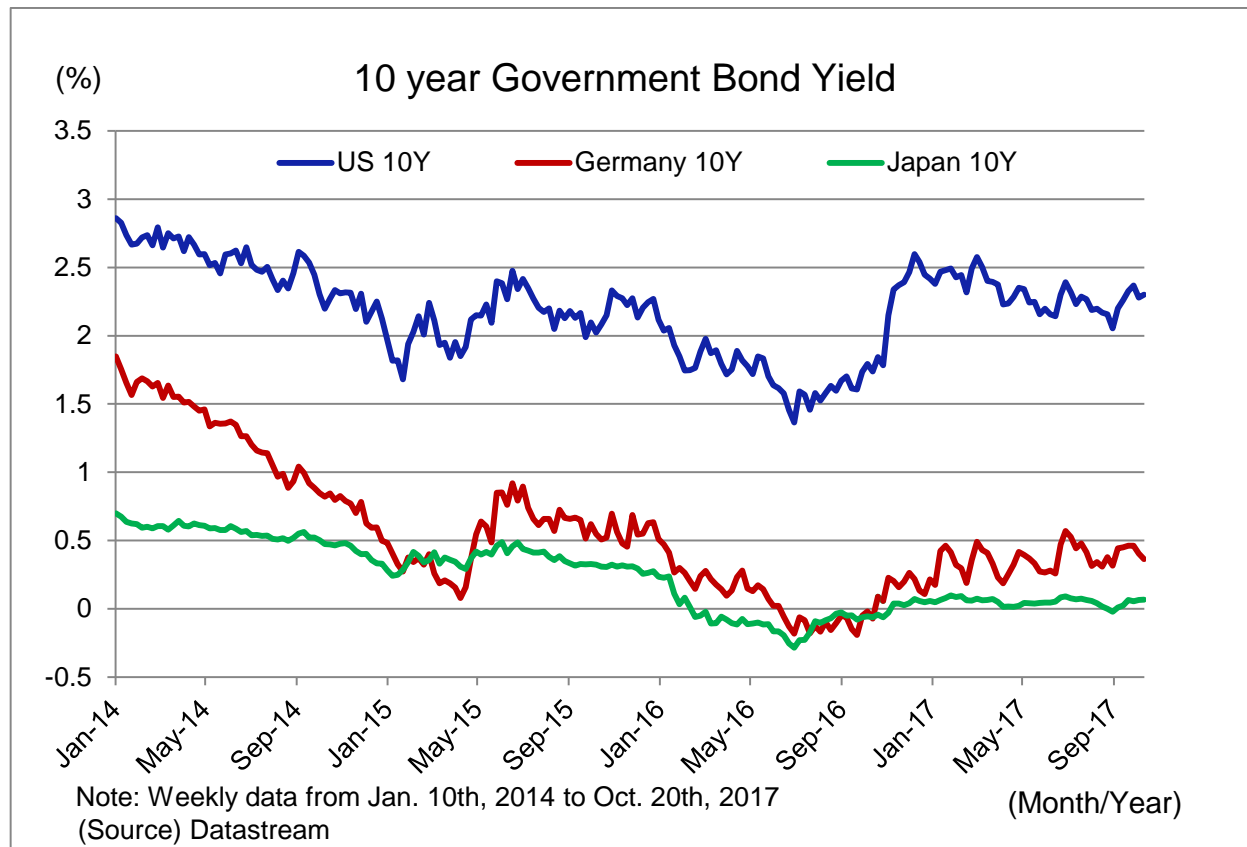
Note: Data is from Mar. 1973 to Aug. 2017
 (Source) US Department of Labor, US Department of Commerce, FRB, IMF, Ministry of Internal Affairs and Communications, Bloomberg



Note: Data is from Jan 31st 2003 to Oct 16th 2017.
 Real yields are adjusted for CPI ex. food & energy
 (Source) US Department of Labor, Ministry of Internal Affairs and Communications, Bloomberg, compiled by SMAM.

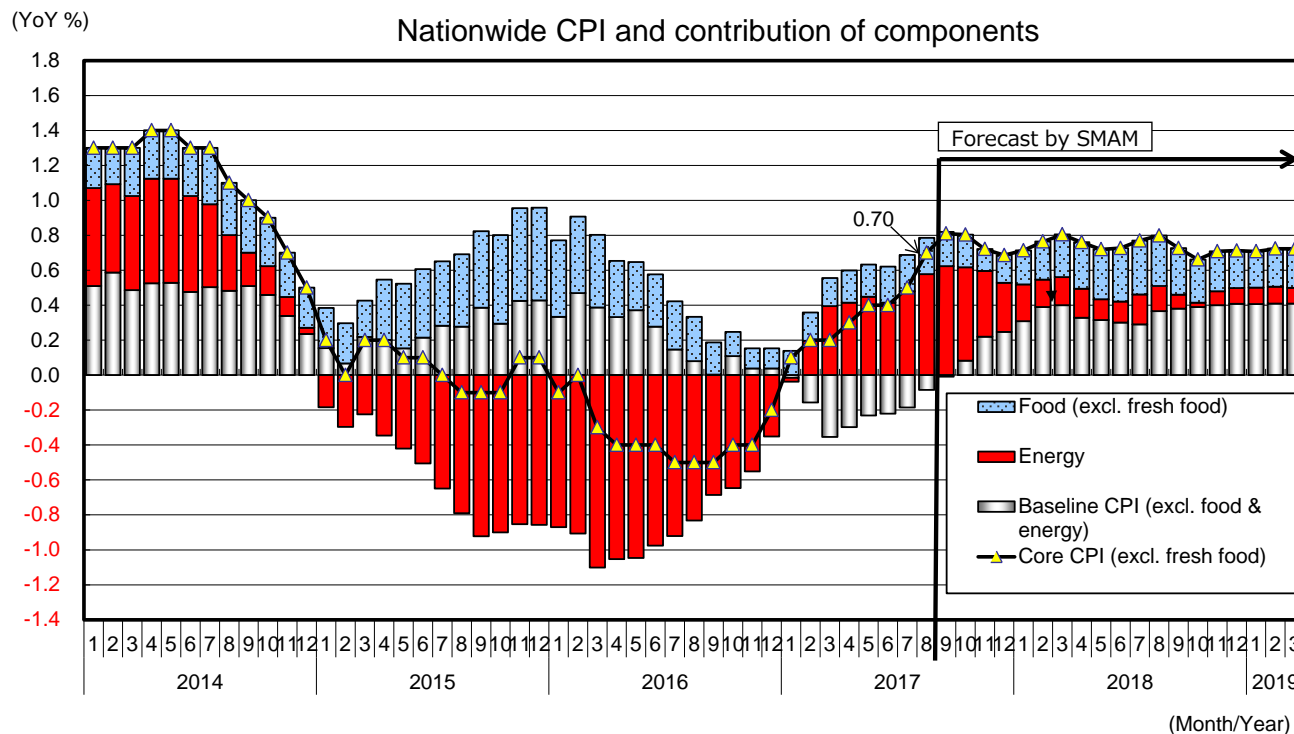
Long bond yields have not headed upward yet despite robust economic growth

- Despite robust economic growth, long-term bond yields are not rising yet on the back of low inflation.



CPI is expected to stay just mildly positive

- Core CPI, which excludes fresh food, is going to stay mildly positive for the foreseeable future.
- Extra-easy monetary policy is going to continue in Japan despite expected tapering in Europe and US.



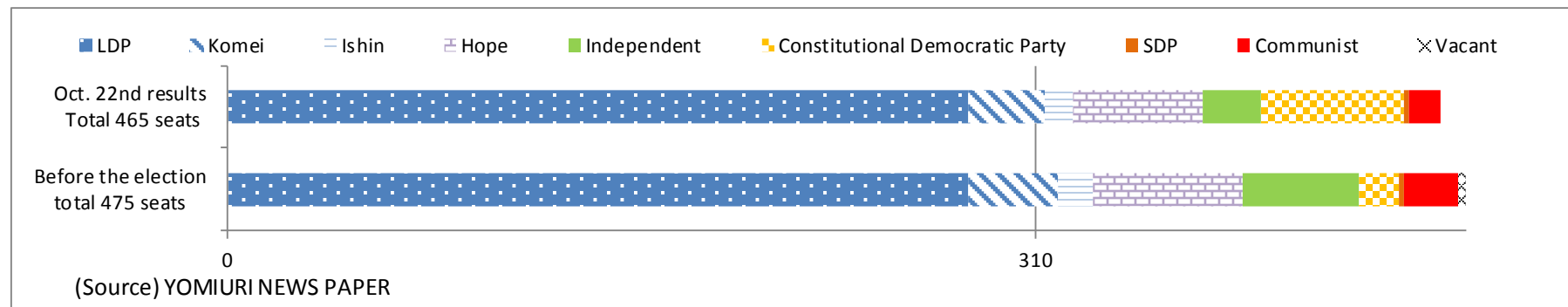
Note: Effect of consumption tax hike in April 2014 is excluded.

(Source) Ministry of Internal Affairs & Communications

The governing coalition parties got credentials from the Japanese people at the general election

- PM Abe led governing coalition parties won the lower house election on October 22nd.
- Not only securing majority by winning more than 233 seats, LDP and Komeito together maintained more than two thirds (310) of the total seats, which is required for proposing constitutional change. The party of hope and Ishin are also pro-constitutional-change parties, which gets this sensitive agenda more likely to move forward.
- Current economic reform as well as extra easy monetary policy will continue, though a lot of political power might be consumed for debating the constitutional change.

	LDP	Komei	Ishin	Hope	Independent	Constitutional Democratic Party	SDP	Communist	Vacant	Total
Oct. 22nd results Total 465 seats	284	29	11	50	22	55	2	12	0	465
Before the election total 475 seats	284	34	14	57	45	15	2	21	3	475



Politics and anticipated tapering by both FRB and ECB could affect financial markets

- US political battle including the budget for the next fiscal year will intensify heading to the end of CR in December.
- PM Abe has a new credentials from Japanese people now. Constitutional change is going to be the biggest political agenda for PM Abe, meanwhile economic policies need to be pushed forward more aggressively.

Schedule of key events

Month	Region/Country	Events	Notes
October	Spain	1 Referendum in Catalonia for independence	
	Japan	22 General election	Governing coalition won the election.
		30-31 BOJ Monetary Policy Committee Meeting/ Perspective report	
	EU	26 ECB policy meeting	Start of tapering?
	China	19th National People's Congress	
November	Middle East	30 OPEC meeting	
	US/Asia	US president Trump is expected to visit Asia incl. Japan	
December	US	12-13 FOMC	Rate hike?
		15 3 month extended CR (temporary government budget) ends	Political battle in US congress
	Korea	20 Presidential election	
2018 January	Japan	National Diet ordinary session begins	
		22-23 BOJ Monetary Policy Committee Meeting/ Perspective report	
February	US	3 FRB chair Yellen's term ends	Who are the next candidates?
March	Japan	19 Two deputy governors' term ends	
April	Japan	8 BOJ governor Kuroda's term ends	Who is next BOJ governor?

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

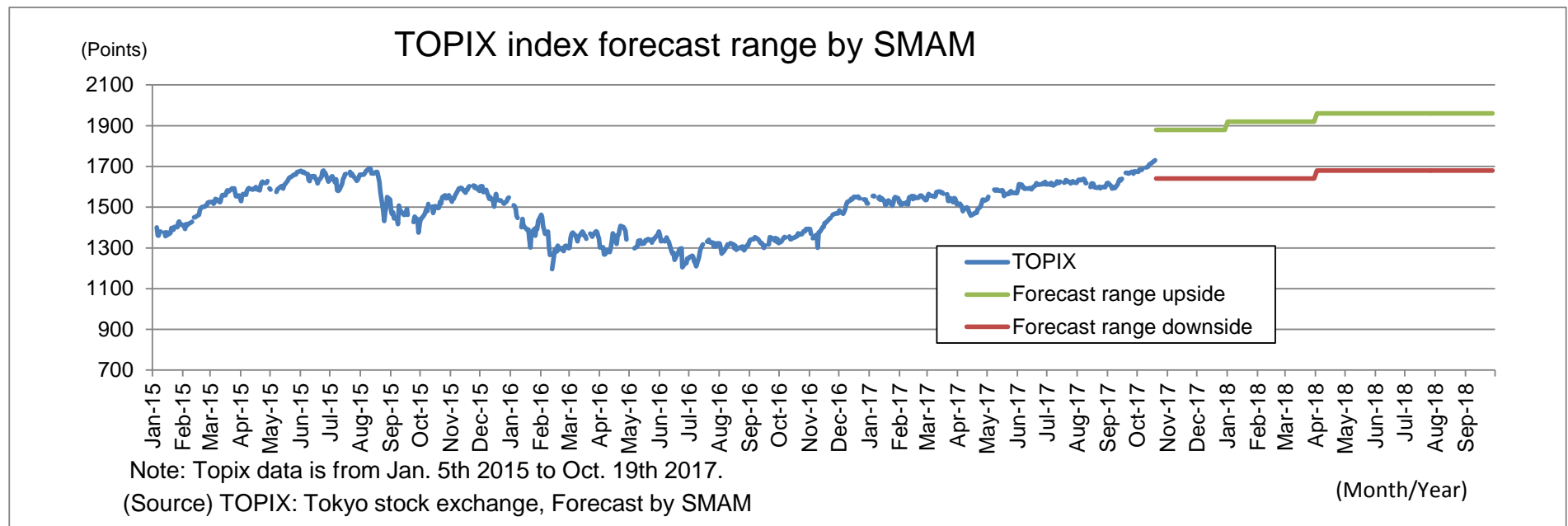
Stock market outlook: Solid footage on good fundamentals with North Korean risk remains

SMAM short-term view

- After renewing the record of consecutive days of rising, the Japanese stock market is going to have a breather in the short term. Robust economic and business fundamentals should support the stock prices. The biggest domestic event, general election, is now behind and the focus is back on overseas events such as North Korea and US politics.

Longer-term outlook (6-months and beyond)

- The global economy is expected to grow in a steady undertone. Earnings for the Japanese companies are expected to be revised upward, which will provide stimulus to the stock market. Risk factors are such as North Korea situation, possible slowdown in Chinese economy, US budget debate and effects of monetary policy change in EU and US.



Note: SMAM's projection is as of Oct. 23rd 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.

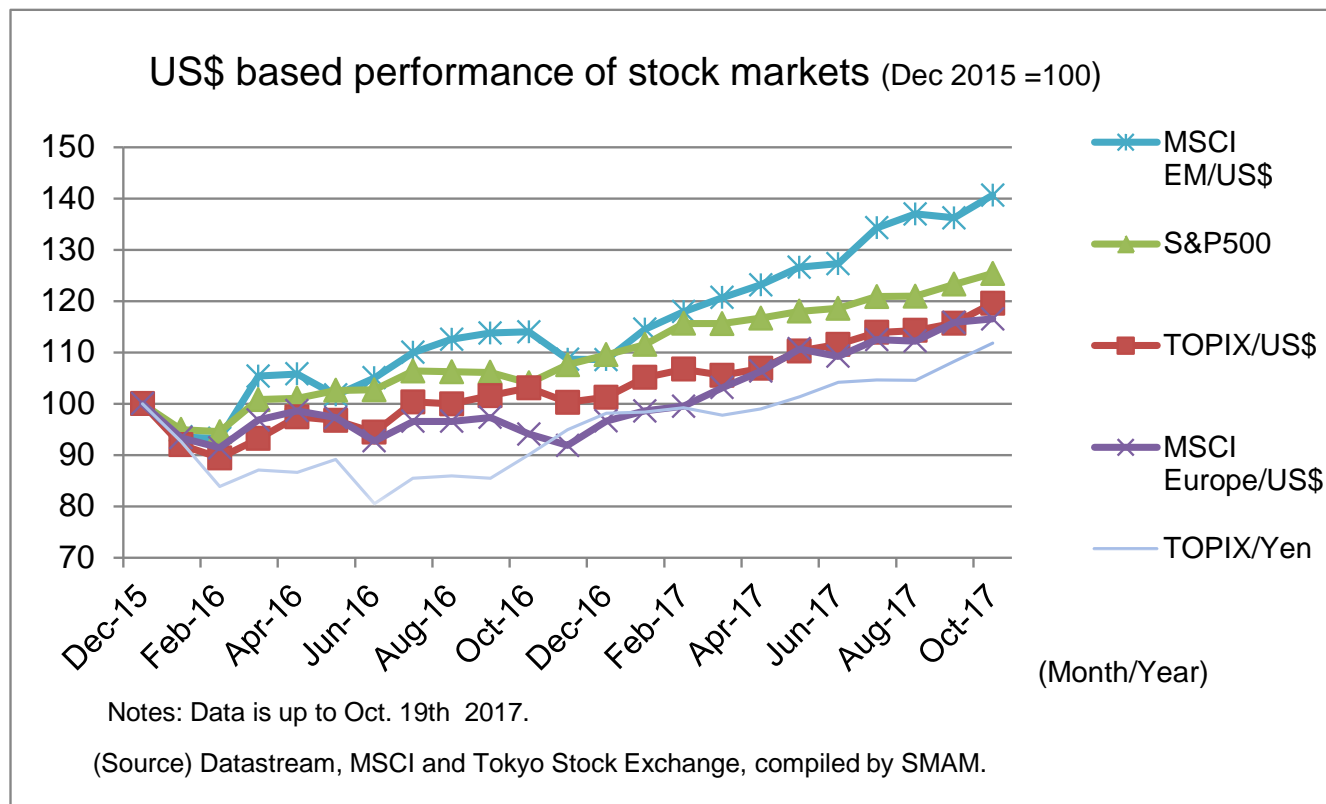
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

- **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.

Note: SMAM's projection is as of Oct. 23rd 2017 and subject to updates without notice.

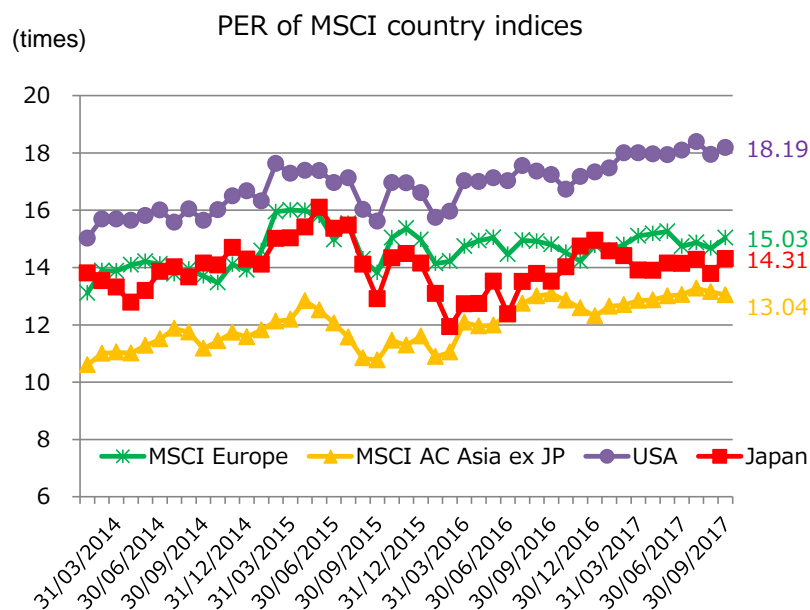
Japanese stock market made a catch-up move lately meanwhile emerging market leads the league

- Emerging market continued to rise strongly.
- Japanese stock prices in US dollars rose to make a catch-up move to US peers.



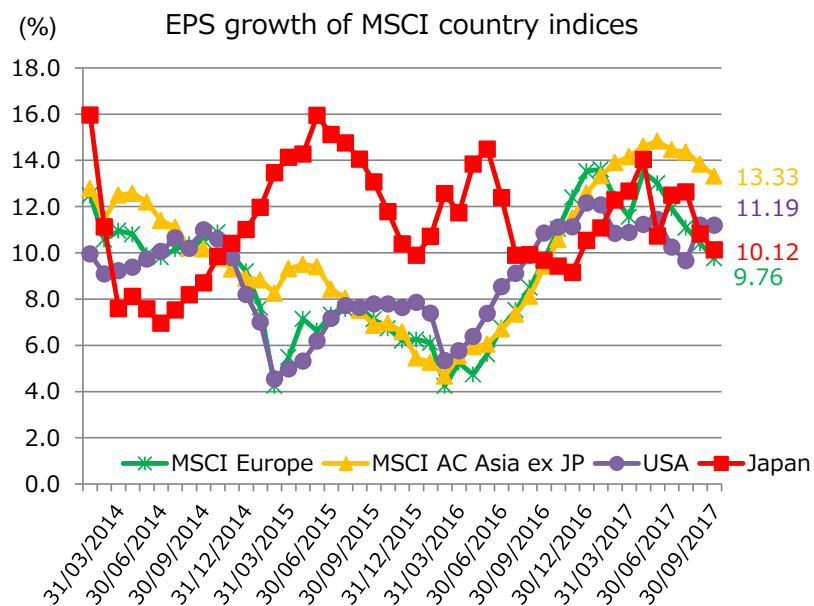
Comparing EPS growth and PER, US looks expensive

- PER rose in September due to rise in share price, meanwhile 12M forward EPS forecast declined after robust EPS growth in 2Q 2017 went behind.
- Asia looks attractive with the highest EPS growth and the lowest PER among 4 indices, though risk needs to be put into consideration as well.
- US looks expensive. Japan looks more attractive than Europe with higher EPS growth and lower PER, though the difference is not large.



Note: PER is based on 12M forward EPS forecast.
Data is up to 30th Sep 2017.
(Source) MSCI

(DD/MM/YYYY)

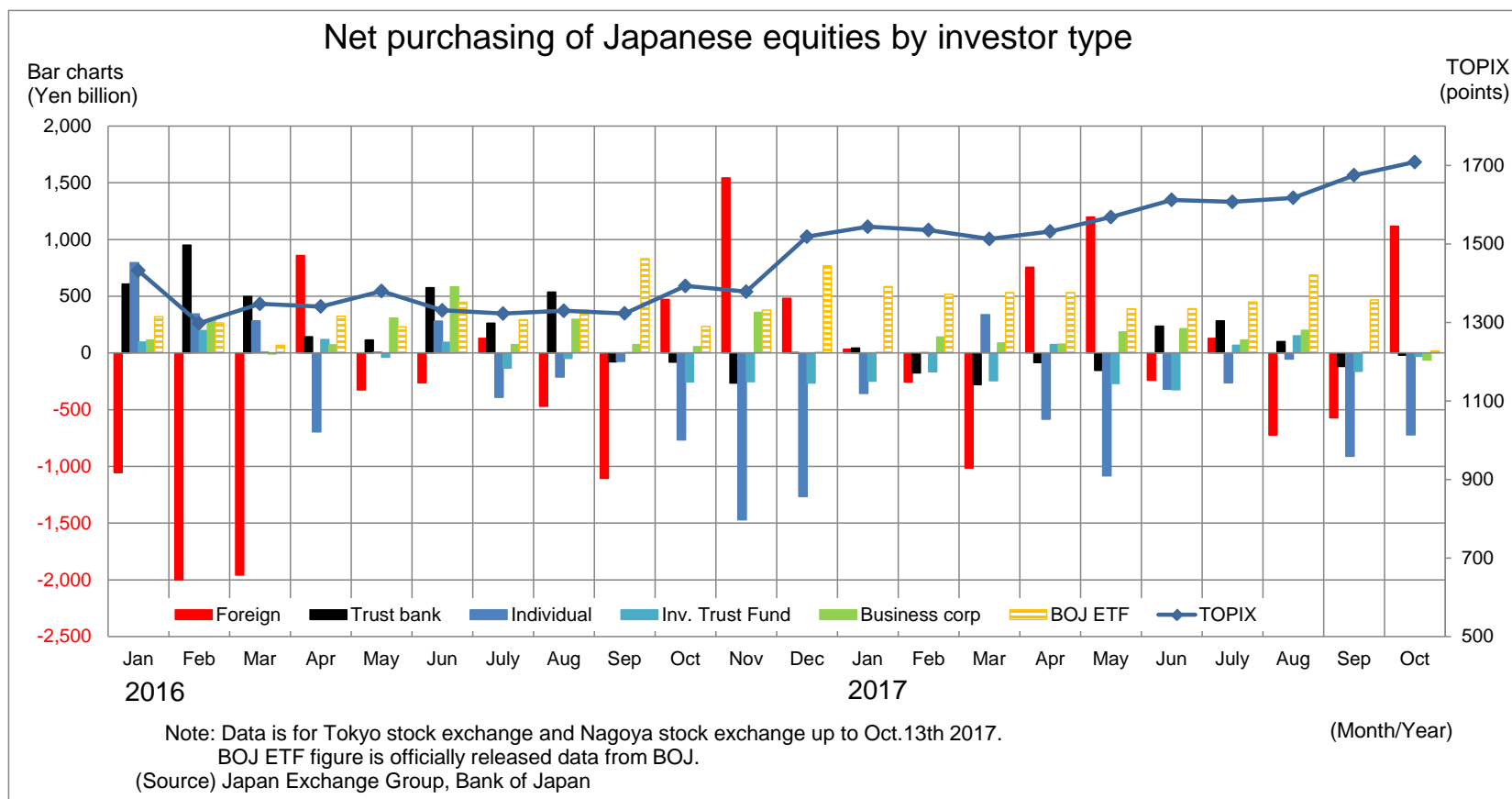


Note: Growth is for 12M forward EPS forecast.
Data is up to 30th Sep 2017.
(Source) MSCI

(DD/MM/YYYY)

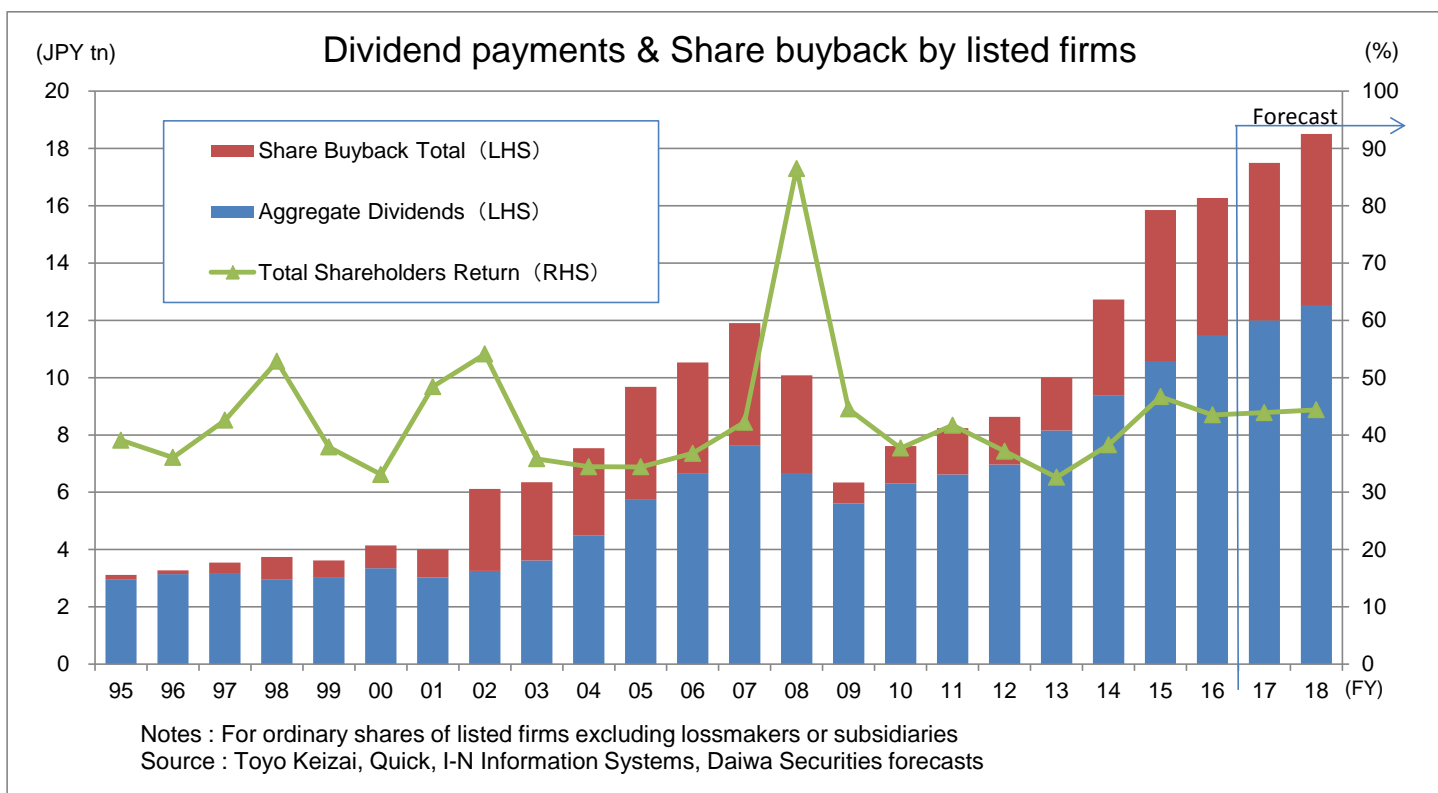
Foreign investors bought back Japanese shares in October

- Foreign investors turned to purchasing Japanese shares in October.
- BOJ's ETF purchasing has been absent so far in October meanwhile individuals are still selling shares.



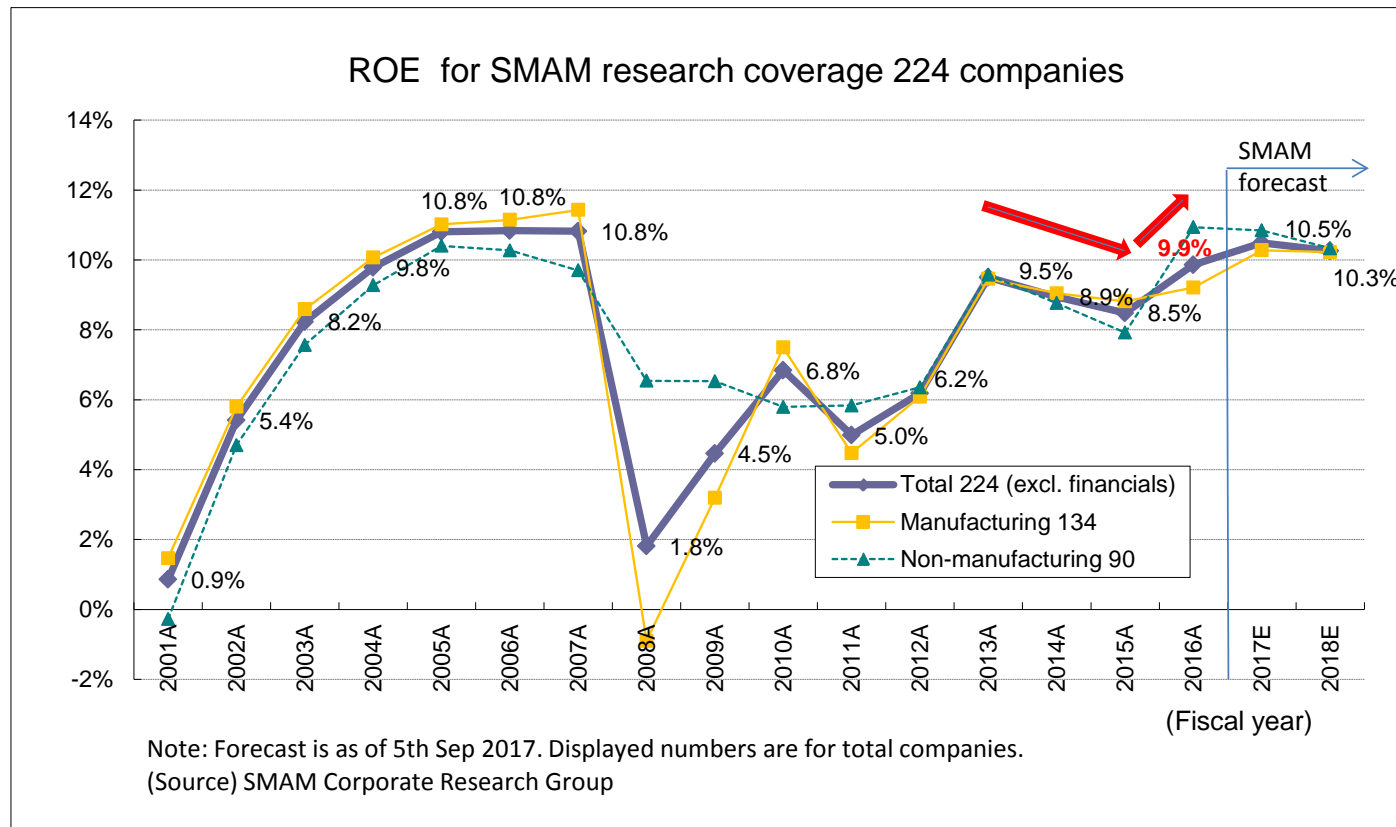
Japanese companies are increasing dividends and share buybacks

- Total of dividend and share buyback amount renewed a historical record in FY2016 and expected to rise further.
- Total shareholder return, which is the percentage of shareholder earnings returned to shareholders by way of dividend & share buyback, was 43.5% in FY2016, which is expected to increase just marginally in FY2017 and FY2018.



Increasing shareholder returns lifted ROE to 9.9% in FY 2016

- ROE rose to 9.9% in FY2016 from 8.5% recorded in FY2015. EPS rose by 18.3%.
- After hitting the previous high of 9.5% in FY2013, ROE actually declined due to rapidly accumulating capital despite EPS growth. However, growth of shareholder capital in FY 2016 was controlled at 5.7% owing partly to increasing dividend and share buybacks. Profit margin improvement was also positive for ROE.



SMAM forecasts 15% profit growth in FY2017

- Apr-Jun quarterly earnings were upbeat and SMAM revised FY2017 profit growth forecasts from previous 12.1% to 15.1% in recurring profits.
- Forecasts made by companies stay at 7.4%. SMAM is expecting this guidance to be revised upward as the year progresses.
- Jul-Sep quarterly earnings results are going to be announced from late October to November.

SMAM Corporate Earnings forecasts (224 Companies research coverage excl. financials)

Fiscal year	FY 2015	FY 2016	FY 2017E	FY 2018E
Date of forecast	Actual	Actual	as of 5th Sep 2017	as of 5th Sep 2017
Revenue (YoY %)	0.7%	-3.4%	6.4%	2.1%
Operating Profits (YoY %)	11.8%	-1.3%	14.3%	8.2%
Recurring Profits (YoY %)	4.5%	2.1%	15.1%	8.3%
Net Profits (YoY %)	-0.6%	18.3%	10.1%	7.9%
Recurring profits (YoY %)				
Manufacturing 134 companies	3.5%	-3.5%	16.9%	9.4%
Non-manufacturing 90 companies	6.2%	11.4%	12.5%	6.5%
Self guidance by 224 companies			7.4%	

Note: Key assumptions for the forecasts for FY 2017, Yen/US\$ 110.4, Yen/EUR 128.8

(Source) SMAM Corporate Research Group, Toyo Keizai

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter “SMAM”), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM's judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM's authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited