



Japanese Stock Market Outlook

SMAM monthly comments & views

-August 2018 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

BOJ's latest "TANKAN" business survey in June, released in early July, showed business sentiment of Japanese enterprises holding at historically high level. Capital expenditure plan for the current 2018 fiscal year was surprisingly high at 8% increase YoY.

- GDP forecast for FY 2018 was slightly cut by 0.1% to 1.1% due mainly to negative effects from trade dispute and higher oil price. Mild and steady GDP growth is forecast for FY2018 and FY2019, for which continuing private capital investment is a strong driver.
- Real wage payment as the total Japanese economy has been increasing at around 2% pace since 2015. Number of employees continues to increase and also pace of nominal wage increase accelerated a little in March and May this year. Japanese households are feeling better and private consumption will be supported.

➤ Japanese Stock Markets

Apr-Jun 2018 quarter earnings results are going to be announced in August, which is estimated to be about flat or slight growth year on year. Uncertainties deriving from trade disputes will weigh on the Japanese company and stock market for a while. Yen is getting weaker than the presumption by companies, which provides room for upward earnings revisions when uncertainties recedes.

- In addition to BOJ's ETF purchasing, Trust bank, which is regarded as representing pension funds, was another buying power in June and July absorbing the selling by foreign investors.
- As a positive development for the stock market, approval rating for Abe cabinet rose to 44% in June, which surpassed disapproval rating declining to 39% according to NHK. Odds are rising for PM Abe to be reelected as the LDP leader in September.

Notes: Macro and market views are as of Jul. 19th, 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-19

- GDP forecast for FY 2018 was slightly cut by 0.1% to 1.1% due mainly to negative effects from trade dispute and higher oil price.
- Mild and steady GDP growth is forecast for FY2018 and FY2019, for which continuing private capital investment is a strong driver.

| (YoY %) | FY14 | FY15 | FY16 | FY17 | FY18E | FY19E |
|--------------------------------------|-------|-------|-------|-------|-------|-------|
| Real GDP growth | -0.3% | 1.4% | 1.2% | 1.6% | 1.1% | 0.9% |
| Private Consumption Expenditure | -2.5% | 0.8% | 0.3% | 0.9% | 0.5% | 0.5% |
| Private Housing Investment | -9.9% | 3.7% | 6.2% | -0.3% | -0.7% | 0.5% |
| Private Capital Investment | 3.3% | 2.3% | 1.2% | 3.2% | 2.7% | 1.9% |
| Public Consumption Expenditure | 0.4% | 1.9% | 0.5% | 0.7% | 0.5% | 1.2% |
| Public Capital Investment | -2.0% | -1.6% | 0.9% | 1.4% | 0.2% | 0.3% |
| Net Exports (contrib. to GDP growth) | 0.6% | 0.1% | 0.8% | 0.4% | 0.3% | 0.1% |
| Exports | 8.7% | 0.8% | 3.6% | 6.2% | 4.1% | 2.0% |
| Imports | 4.2% | 0.4% | -0.8% | 4.0% | 2.4% | 1.3% |
| Nominal GDP | 2.2% | 3.0% | 1.0% | 1.7% | 1.2% | 2.0% |
| GDP Deflator | 2.5% | 1.5% | -0.2% | 0.1% | 0.1% | 1.2% |
| Industrial Production | -0.4% | -1.4% | 1.5% | 4.1% | 2.7% | 1.7% |
| CPI (excl. fresh food) | 0.9% | -0.1% | -0.2% | 0.7% | 0.8% | 0.7% |

Notes: E=SMAM forecasts. SMAM views are as of June 19th, 2018 and subject to updates thereafter without notice

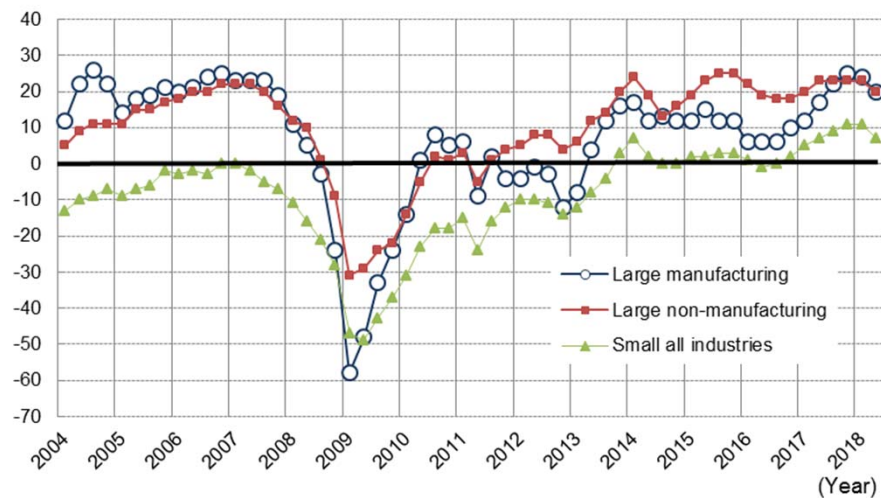
(%, YoY except Net Exports)

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

Business sentiment is still holding despite growing uncertainties

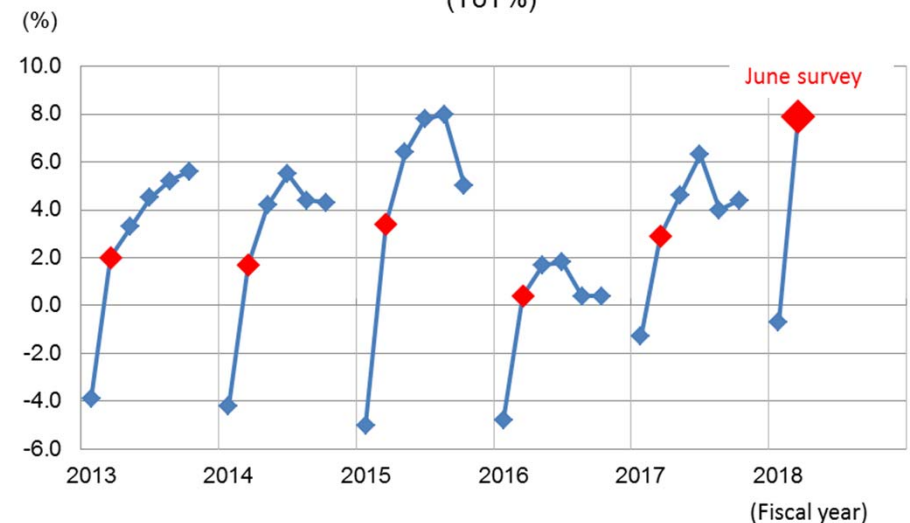
- BOJ's latest "TANKAN" business survey in June showed business sentiment of Japanese enterprises holding at historically high level.
- Capital expenditure plan for the current 2018 fiscal year was very high at 8% increase YoY.

BOJ "TANKAN" business survey, current condition DI



Note: Data is quarterly from Mar. 2004 to Jun. 2018.
Diffusion Index above 0 means condition is improving.
(Source) Bank of Japan

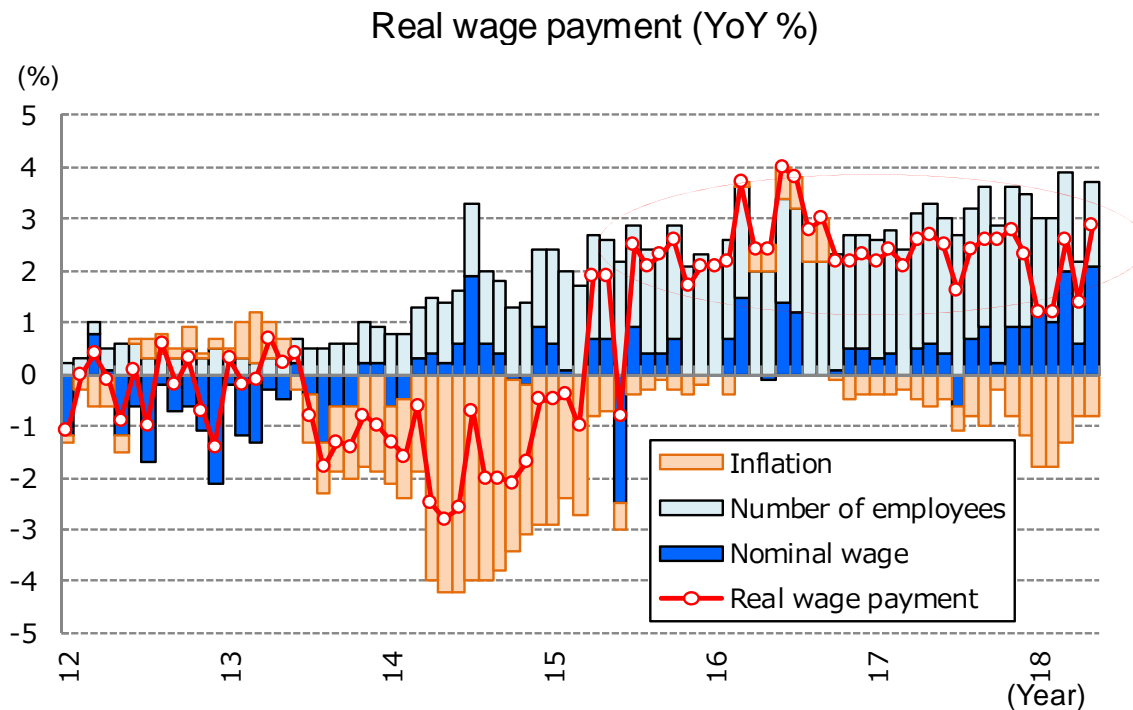
BOJ "TANKAN" business survey, CAPEX plan for fiscal year (YoY%)



Note: For each fiscal year, capital spending plan is exhibited as of March, June, September, December, March next year and actual result.
(Source) Bank of Japan

Increasing number of workers contributes to steady rise of aggregate real wage payment

- Real wage payment as the total Japanese economy has been increasing at around 2% pace since 2015.
- Number of employees continues to increase and also pace of nominal wage increase accelerated a little in March and May this year.
- Japanese households are feeling better and private consumption will be supported.



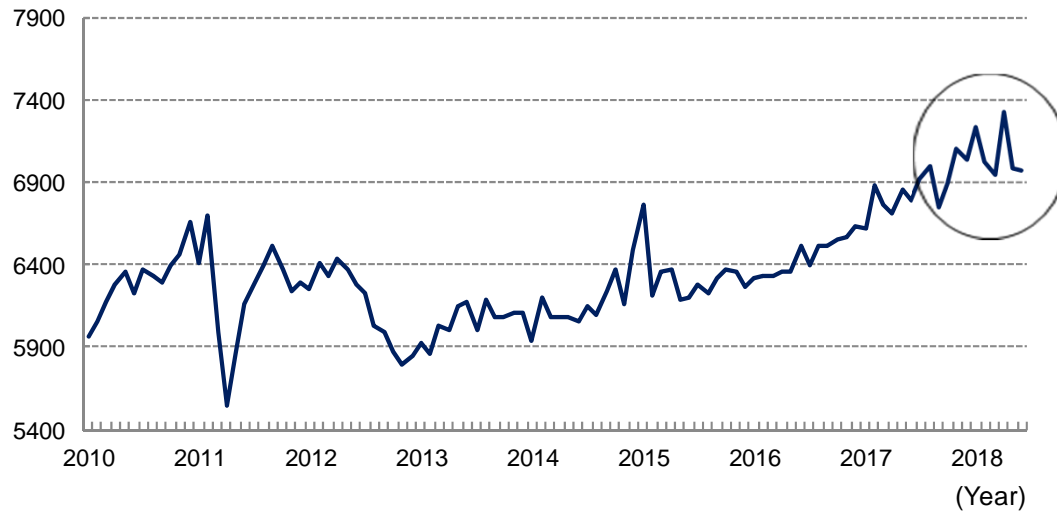
Note: Data is from Jan. 2012 to May. 2018.

(Source) Ministry of Health, Labour and Welfare

Export is still holding

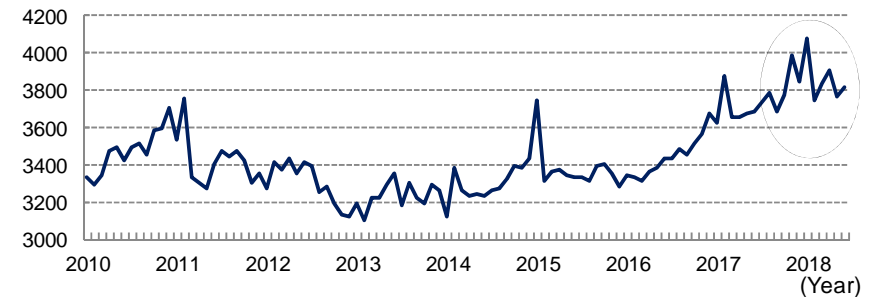
- Export is still holding at high level.
- US-Japan trade war is still a remote scenario, however, Japanese exports to US via China or NAFTA are under a threat.

Total export volume
(seasonally adjusted, yen billion)

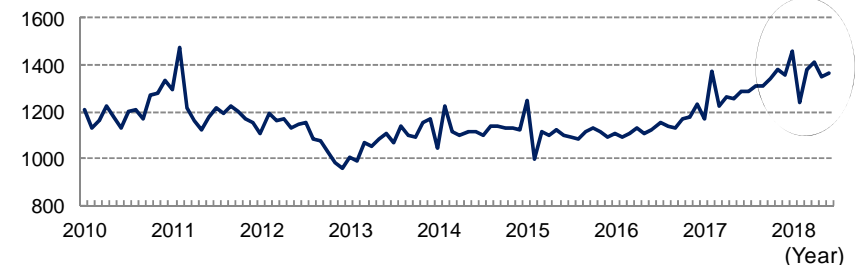


Note: Data is from Jan. 2010 to Jun. 2018.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

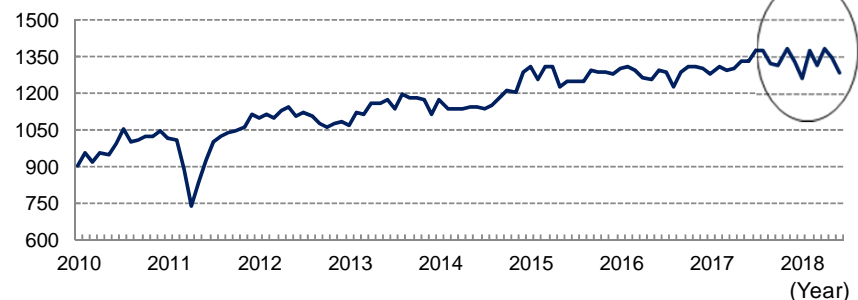
Export volume to Asia



Export volume to China

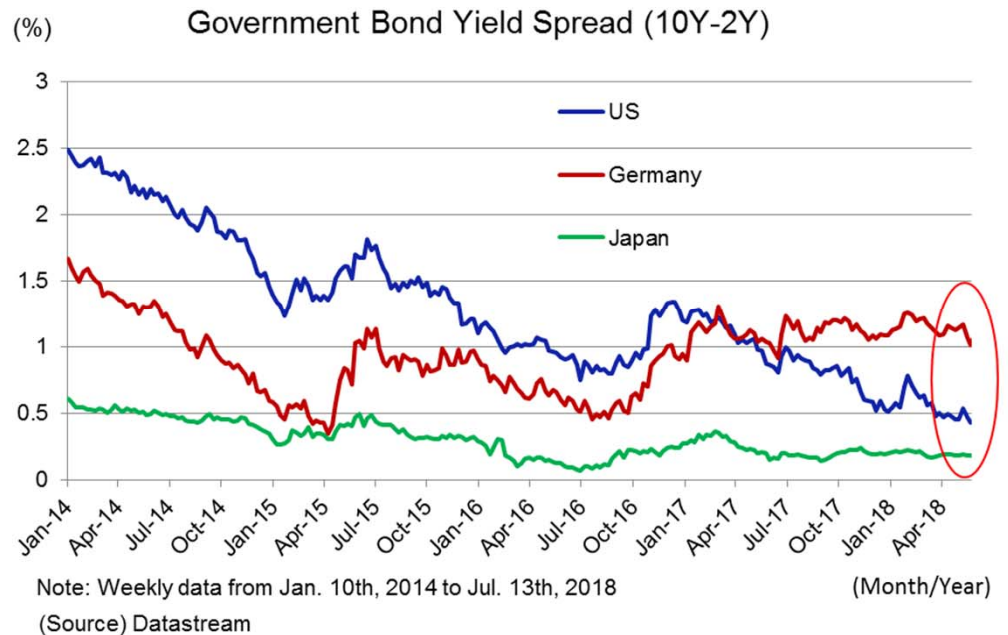
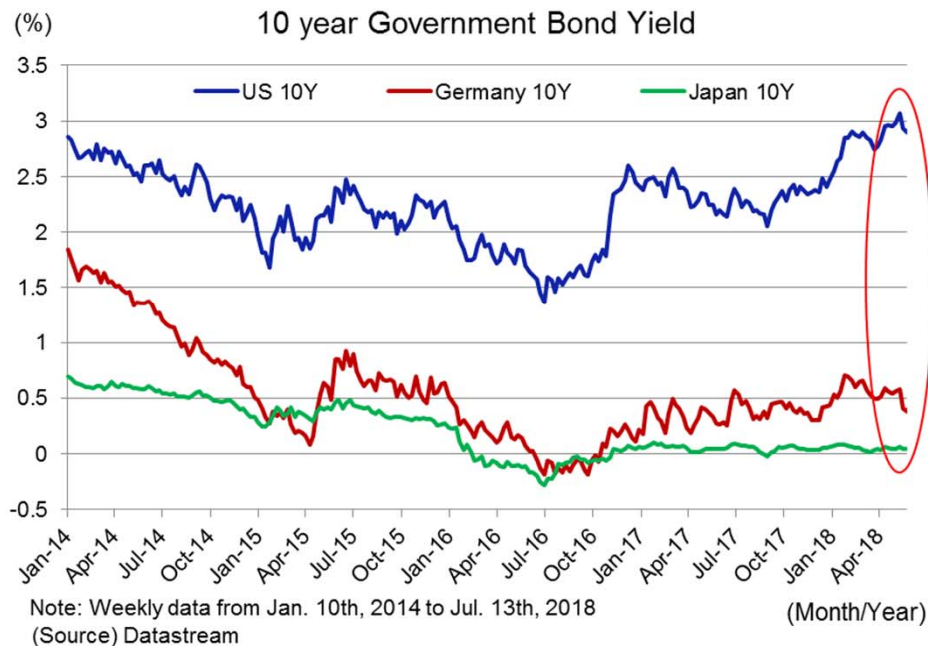


Export volume to US



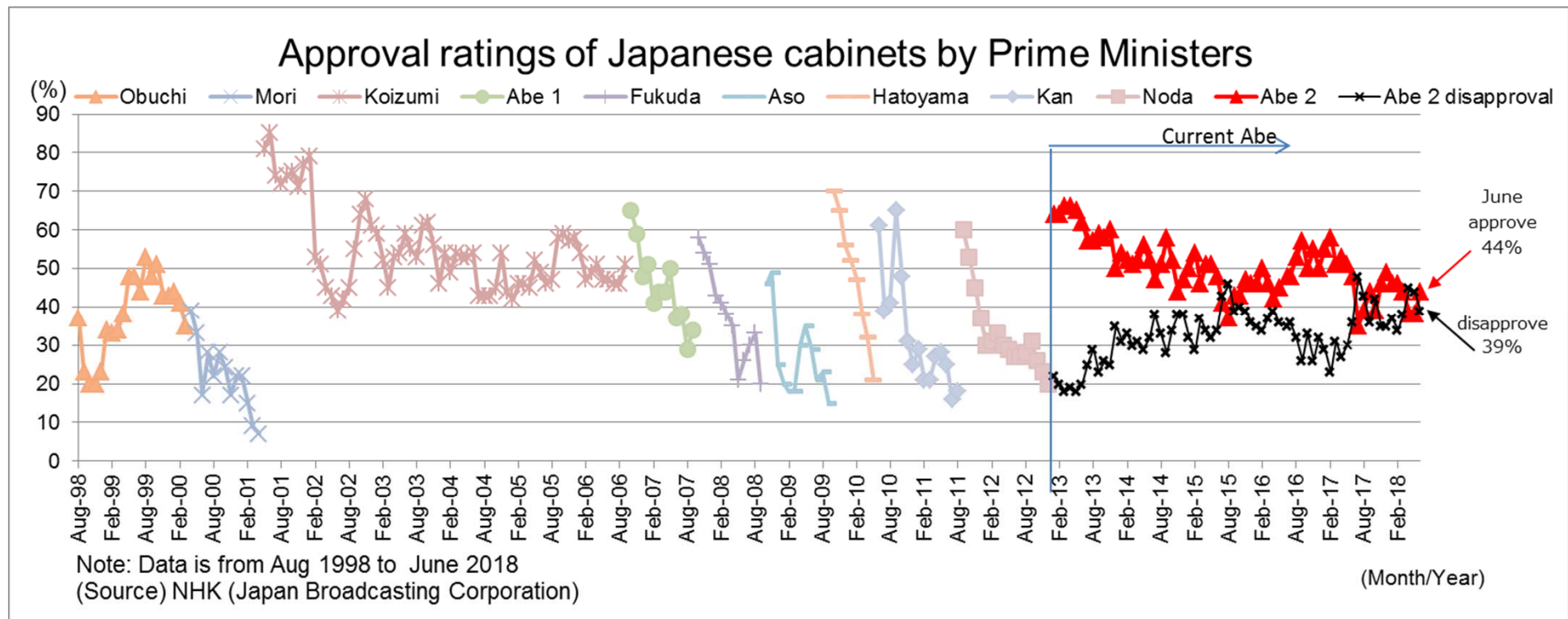
Yield curve flattening continues both in US and Europe

- Long term bond yields declined recently overshadowed by growing fear of trade war hurting global economy.
- Flattening of yield curve is continuing both in US and Europe, which could potentially put pressure on the economy, combined with monetary normalization moves by central banks.
- On the other hand, upward pressure on Japanese interest rates is not found yet.



Approval rating for Abe cabinet is on a recovery

- According to NHK, Approval rating for Abe cabinet rose to 44% in June, which surpassed disapproval rating declining to 39%. Odds are rising for PM Abe to be reelected as the LDP leader in September.



Trade disputes seem to be the most influential event for the global economy

- In August, USTR in US is going to hold public hearing for imposing extra tariff on imports from China.
- In Japan, LDP leader election is expected on 20th September, for which candidacy declaration will be closed on 7th September although these dates are speculation and not called yet.

Upcoming key events

| Month | Region/Country | Events | Notes |
|-----------|----------------|--|---------------------------------|
| July | Japan | 30-31 BOJ Monetary Policy Committee Meeting & perspective report | |
| | US | 31-1 FOMC | |
| | EU | 26 ECB Monetary Policy Meeting | |
| August | US-China | 30 End of USTR's public hearing and taking opinions about imposing extra tariff on Chinese imports | Where the trade battle goes? |
| | US-Iran | 6 1st part of US sanctions on Iran is set to begin | |
| September | Japan | 18-19 BOJ Monetary Policy Committee Meeting | |
| | | 20 PM Abe's leadership of LDP is set for renewal or expiration | LDP leadership election is due. |
| | EU | 26 ECB Monetary Policy Meeting | |
| | EU/UK | 30 Target date for deciding Brexit conditions | |
| November | US | 6 Mid-term election for US congress | |
| | US-Iran | 8 2nd part of US sanctions on Iran is set to begin | |
| | Middle East | OPEC meeting | |

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

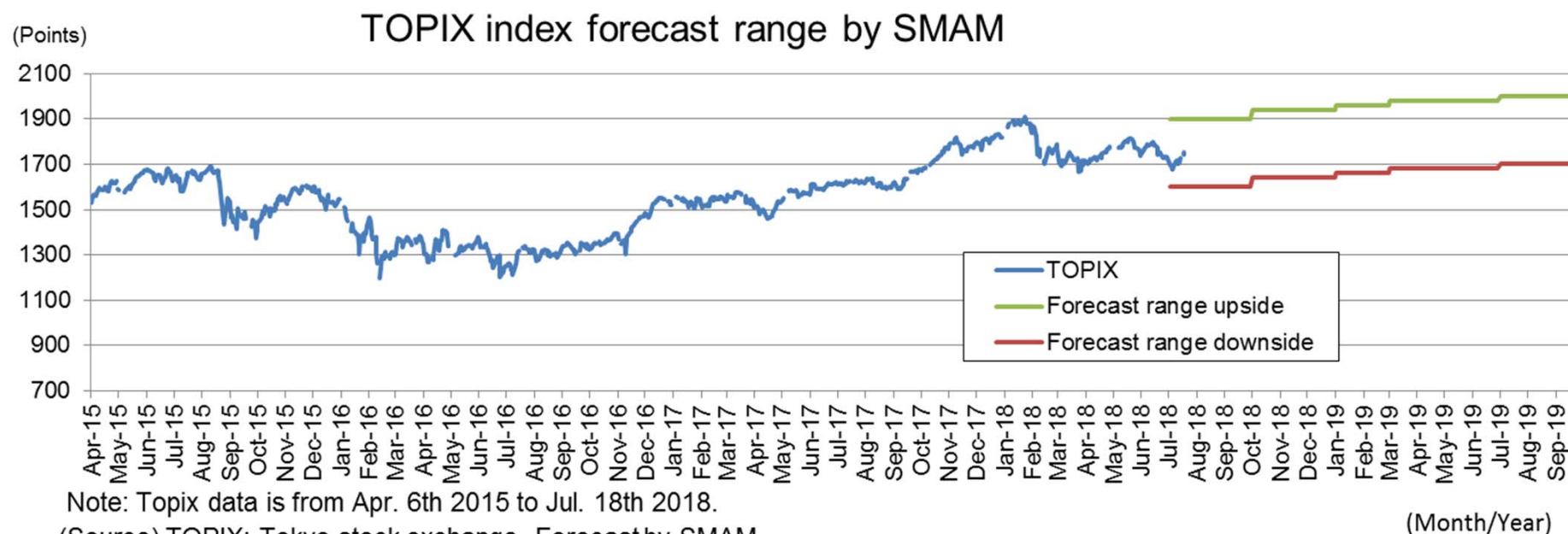
Stock market outlook: Fear of trade war weighs on the stock market

SMAM short-term view

- Apr-Jun 2018 quarter earnings results are going to be announced in August, which is estimated to be about flat or slight YoY growth. Uncertainties deriving from trade disputes will weigh on the Japanese company and stock market. Yen is getting weaker than the presumption by companies, which provides room for upward earnings revisions when uncertainties recedes.

Longer-term outlook (6-months and beyond)

- Current slowdown in global manufacturing activities is expected to turn upwards again probably some time in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies. Trade disputes are forecast to recede gradually after the mid-term election in US in November providing positive momentum to the stock market.



Note: SMAM's projection is as of Jul. 19th, 2018 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Uncertainties of world trade disputes will recede post mid-term election in US in November.
 - US economy keeps growing.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - PM Abe's survival is in a little doubt, however, current policies continues even by the successor.
 - Tension in the East Asia does not ignite a war.
 - Central banks gradually move to normalize monetary policies and avoid killing economic growth.

- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Denuclearization in Korean peninsula makes a visible progress.
 - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.

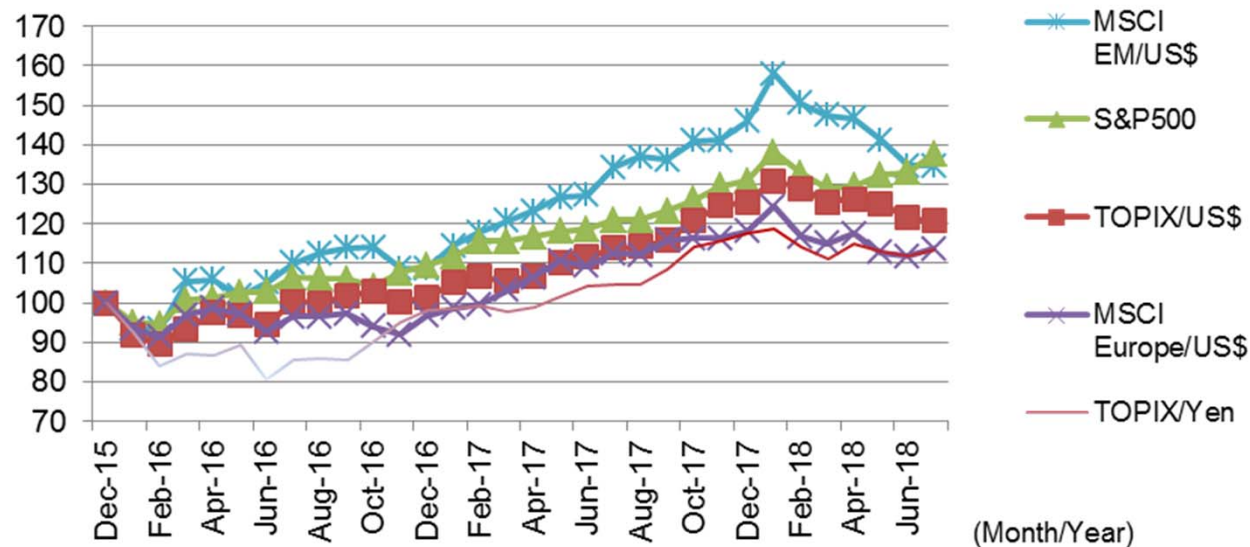
- **Downside Risks** include:
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - Global monetary tightening intensifies to choke global economy.
 - Confrontational foreign policies taken by Trump presidency igniting a trade war.
 - "Russia-gate" scandal flares up.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Jul. 19th, 2018 and subject to updates without notice.

Money is flowing to US

- Recent recovery of Japanese stock prices has been offset by weaker yen so far in July.
- US stock market is showing exceptional strength compared to unexciting performance of other stock markets.
- Repatriation of profits retained outside US is helping financial markets in US. And also, so-called platform companies such as “FANNG” are mostly in US and they are favored by stock investors, who are searching for stocks relatively immune from possible trade wars.

US\$ based performance of stock markets (Dec 2015=100)

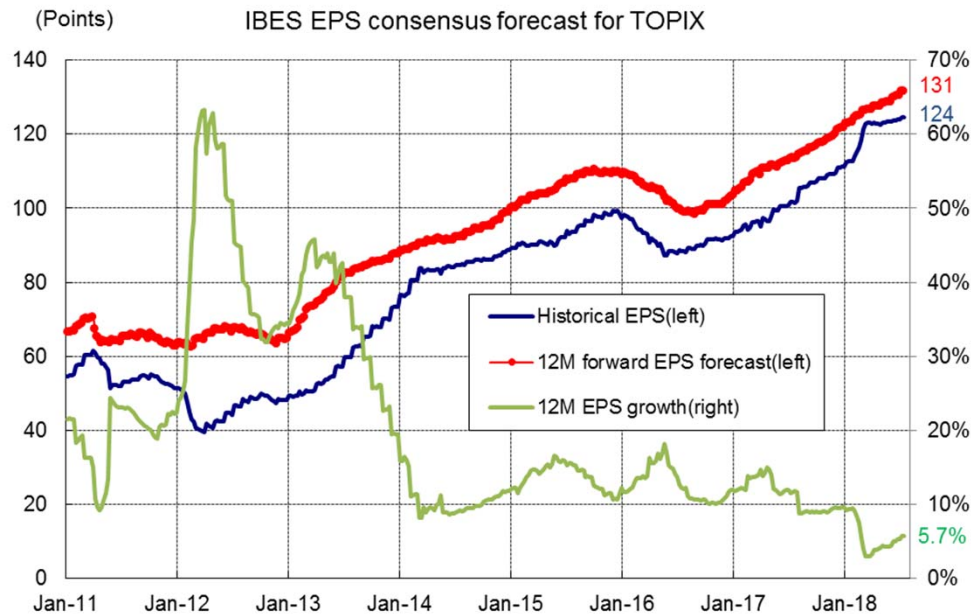


Notes: Data is up to Jul. 18th 2018.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.

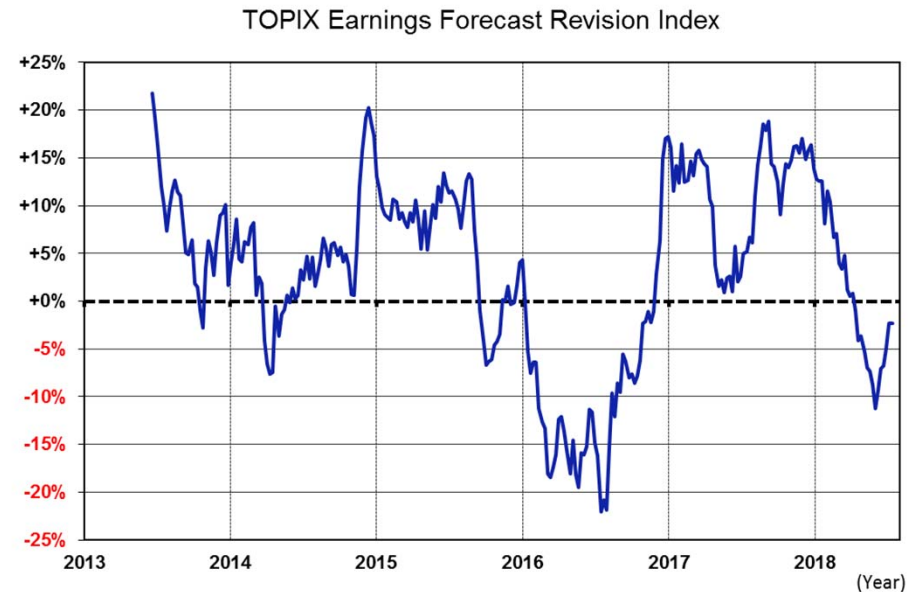
Japanese EPS growth forecast slightly recovered, yet not enough to substantially lift stock prices

- Latest 12M forward EPS growth forecast rose slightly to 5.7%.
- Earnings revision index, which shows how many % of companies had earnings forecast revised upward (revision index becomes positive) or downward (revision index becomes negative). Revision index has been on a recovery to the neutral level from a brief period of downward revisions.



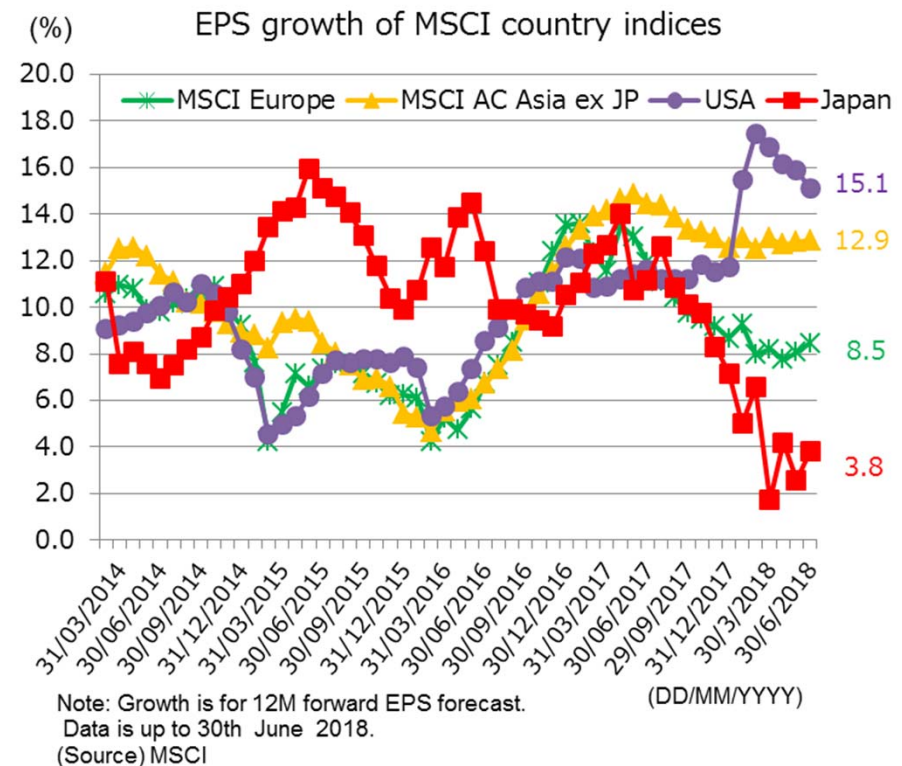
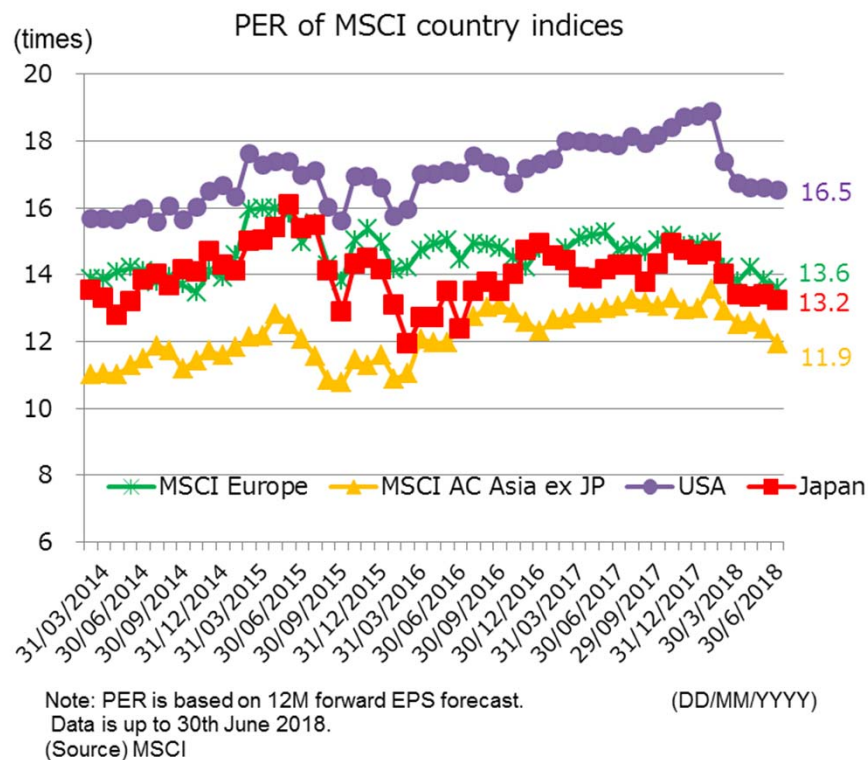
Note: Weekly data from Jan. 6th 2011 to Jul. 12th 2018. (Month/Year)

(Source) Datastream, IBES



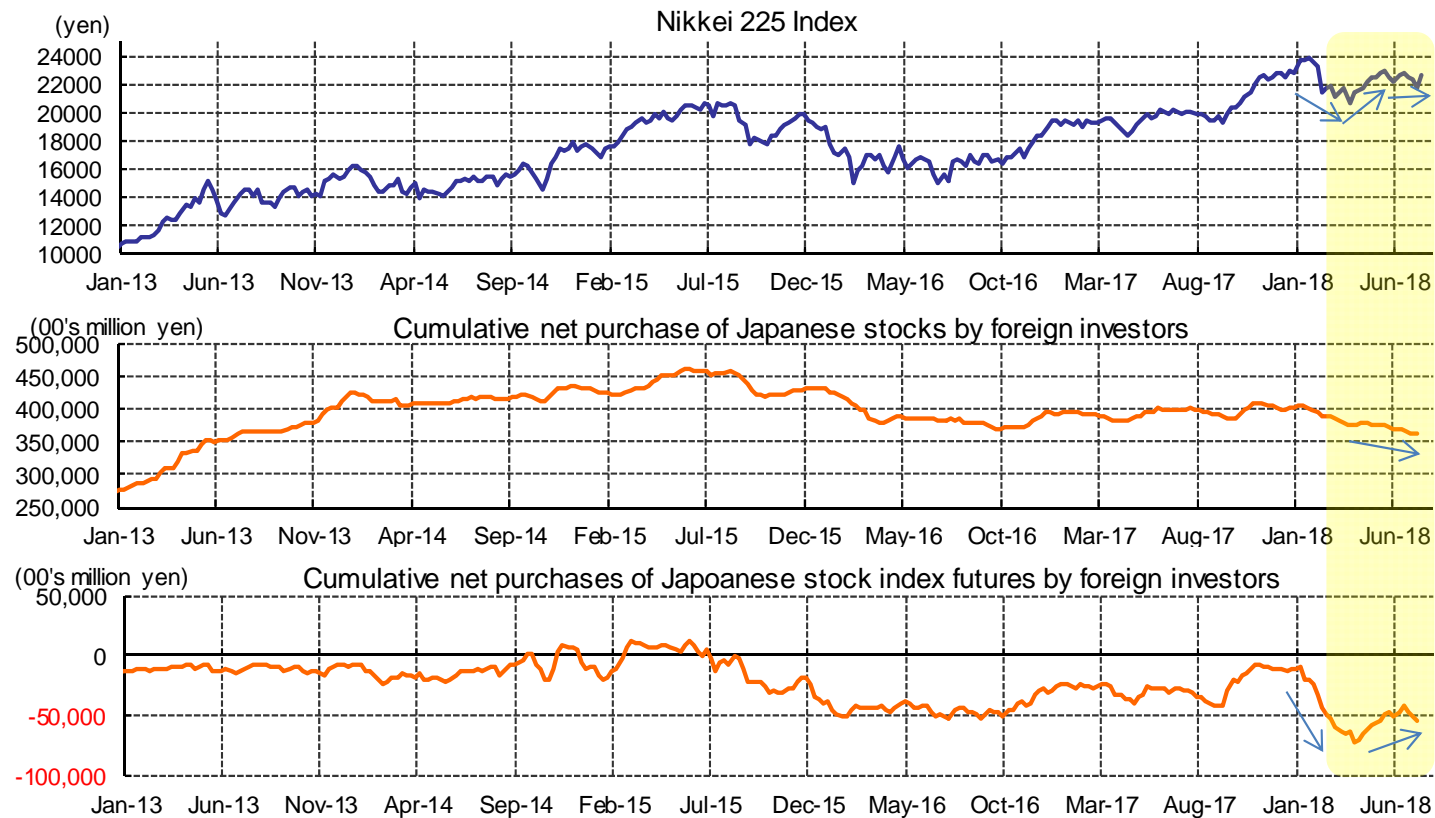
PE ratio is at reasonable levels

- Comparing PE ratio and EPS growth forecasts for global stock markets, a market with higher EPS growth is given higher stock valuation in terms of PE ratio.
- One exception is Asia. If current 13% growth forecast is going to be achieved, current PE ratio below 12 times looks attractive.



Foreign investors has been selling Japanese stocks

- Foreign investors bought back Japanese stock index futures, however, not cash equities yet.
- This is probably due to continuing uncertainties on world trade disputes, and how Japan is going to be affected.



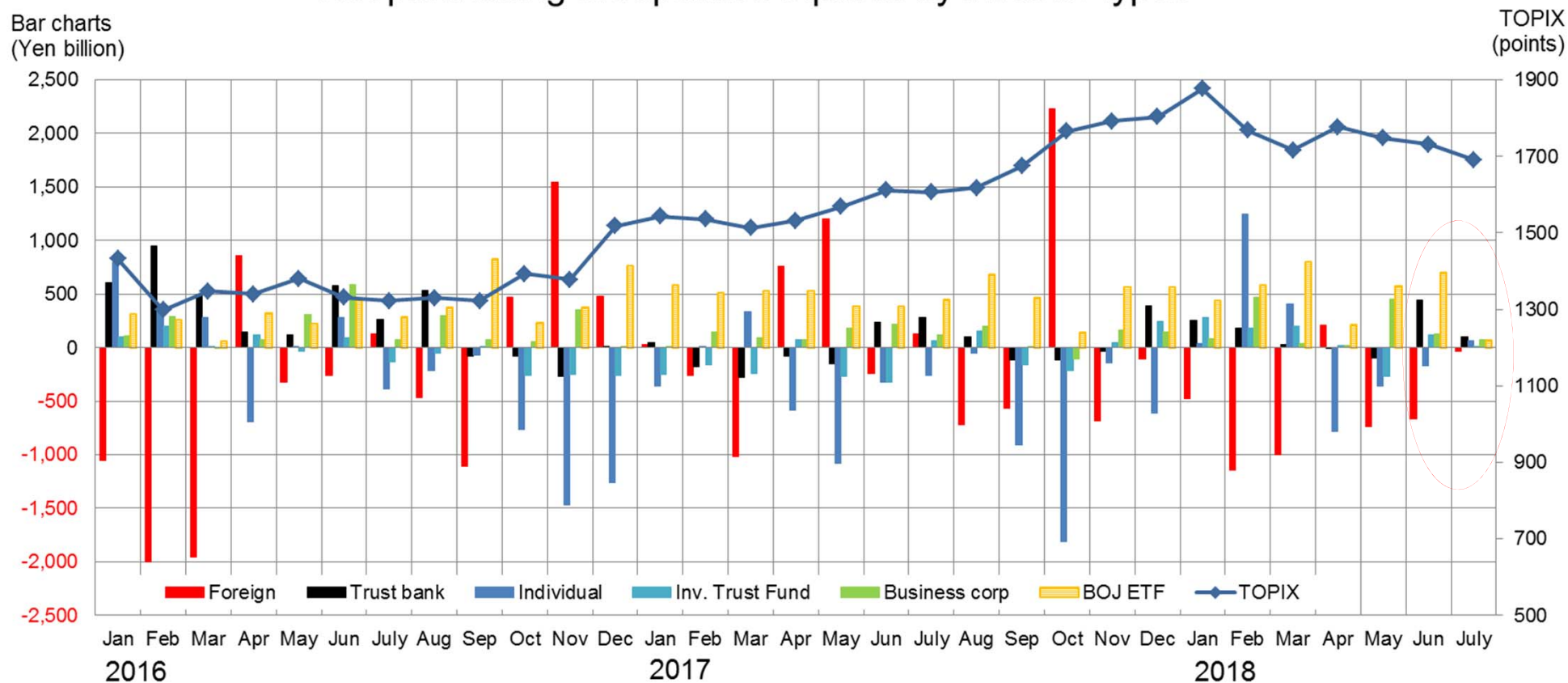
Notes: Data is from Jan, 4th 2013 to Jul. 6th 2018. Cumulative from Jan. 4th 2005.

(Source) Bloomberg, Japan Exchange Group, compiled by SMAM.

Pension funds and BOJ were main buyers of the Japanese stocks in June and so far in July

- In addition to BOJ's ETF purchasing, Trust bank, which is regarded as representing pension funds, was another buying power .

Net purchasing of Japanese equities by investor types



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to Jul.7th 2018.
BOJ ETF figure is officially released data from BOJ.

(Source) Japan Exchange Group, Bank of Japan

(Month/Year)

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