



# Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

-July 2022-



# Outlook for Japanese Stock Market

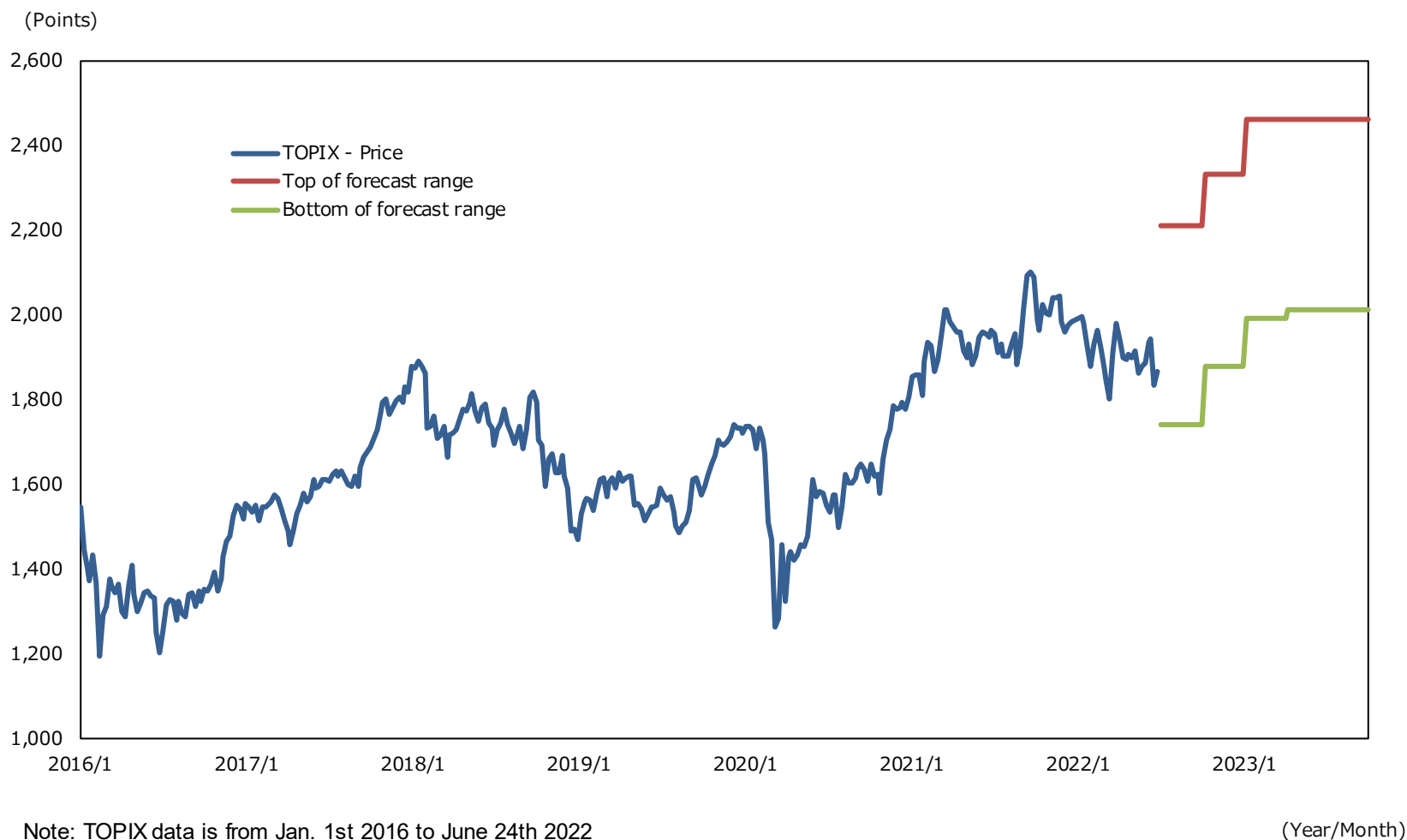
## Market Outlook

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- We are bullish on the Japanese equity market thanks to the brighter outlook of Japanese economy, buoyant corporate earnings, and accommodative monetary policy.
- We have slightly lowered our TOPIX target to 2,230 from 2,300 and Nikkei 225 to 31,600 from 32,300 for March 2023.
- While we have raised our forecast of TOPIX EPS, we have lowered our fair valuation estimate of PER multiple due to uncertainty over the global economy, inflation, and monetary policy of foreign countries going forward.
- We expect the market will resume its upward trend after the market has digested the full scale of ongoing monetary tightening and the risk of recession in the United States.



# We expect a bullish equity market ahead



Note: TOPIX data is from Jan. 1st 2016 to June 24th 2022  
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

# Upside / Downside risk scenarios

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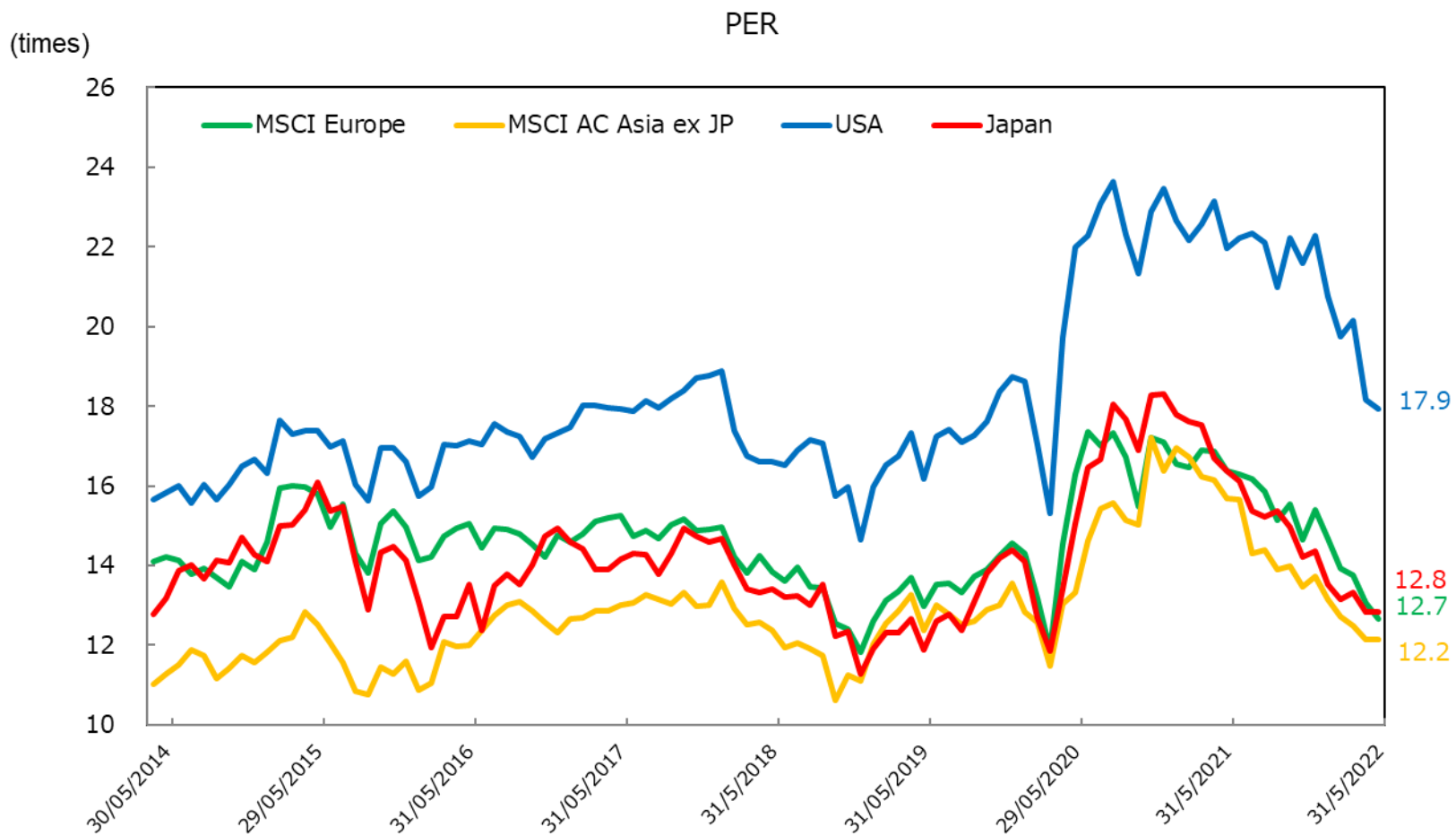
## ■ Upside Risks

- Recovery of inbound travel to Japan from China
- Decline of volatility in oil, metal, and other commodity markets

## ■ Downside Risks

- Concern over fiscal tightening
- Concern over stagflation

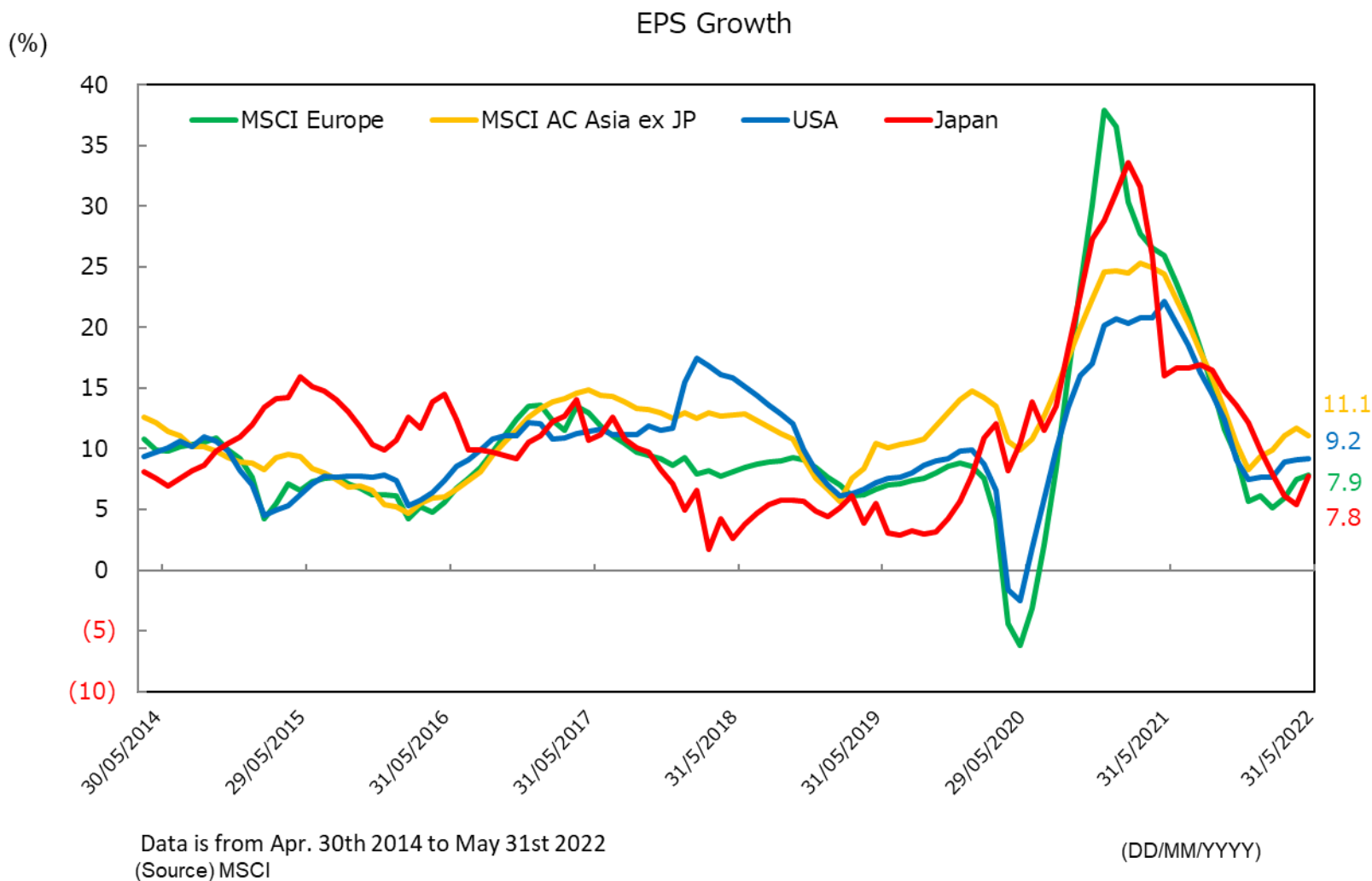
# PERs plunge to the lowest level after COVID-19 pandemic



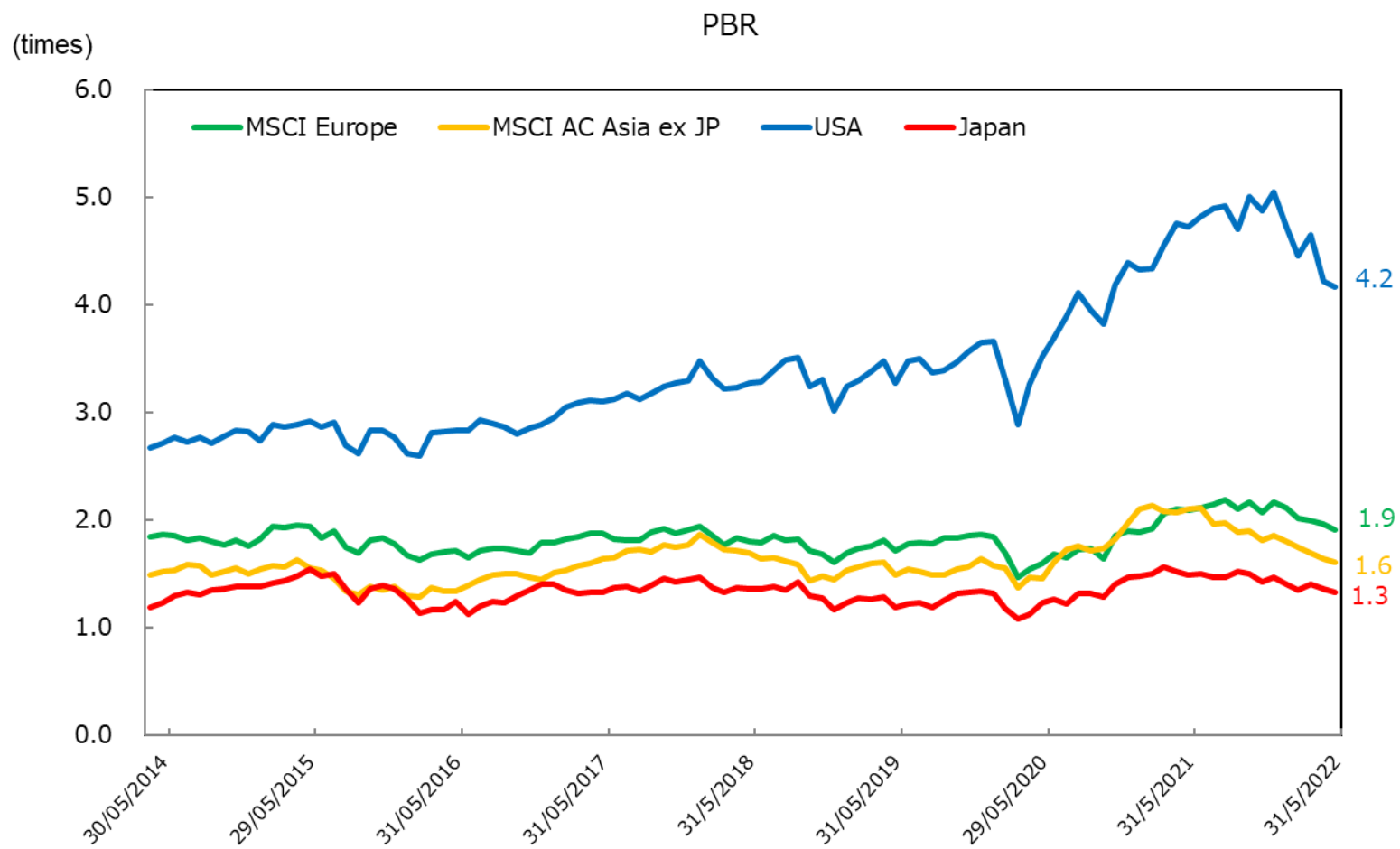
Data is from Apr. 30th 2014 to May 31st 2022  
 (Source) MSCI

(DD/MM/YYYY)

# Uncertainty over global economy weighs on EPS growth



# Mind the PBR gap between US and Japan

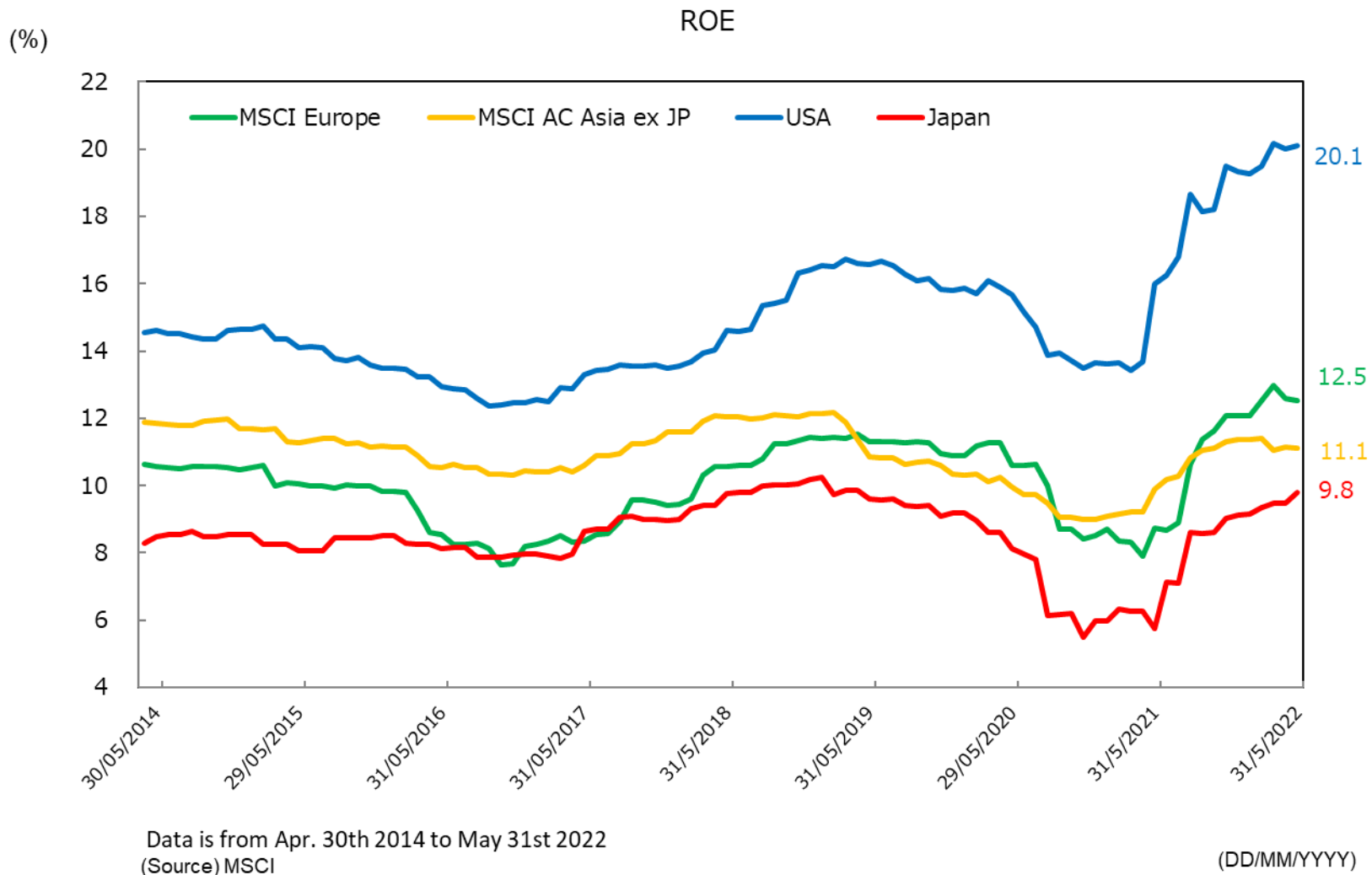


Data is from Apr. 30th 2014 to May 31st 2022  
(Source) MSCI

(DD/MM/YYYY)

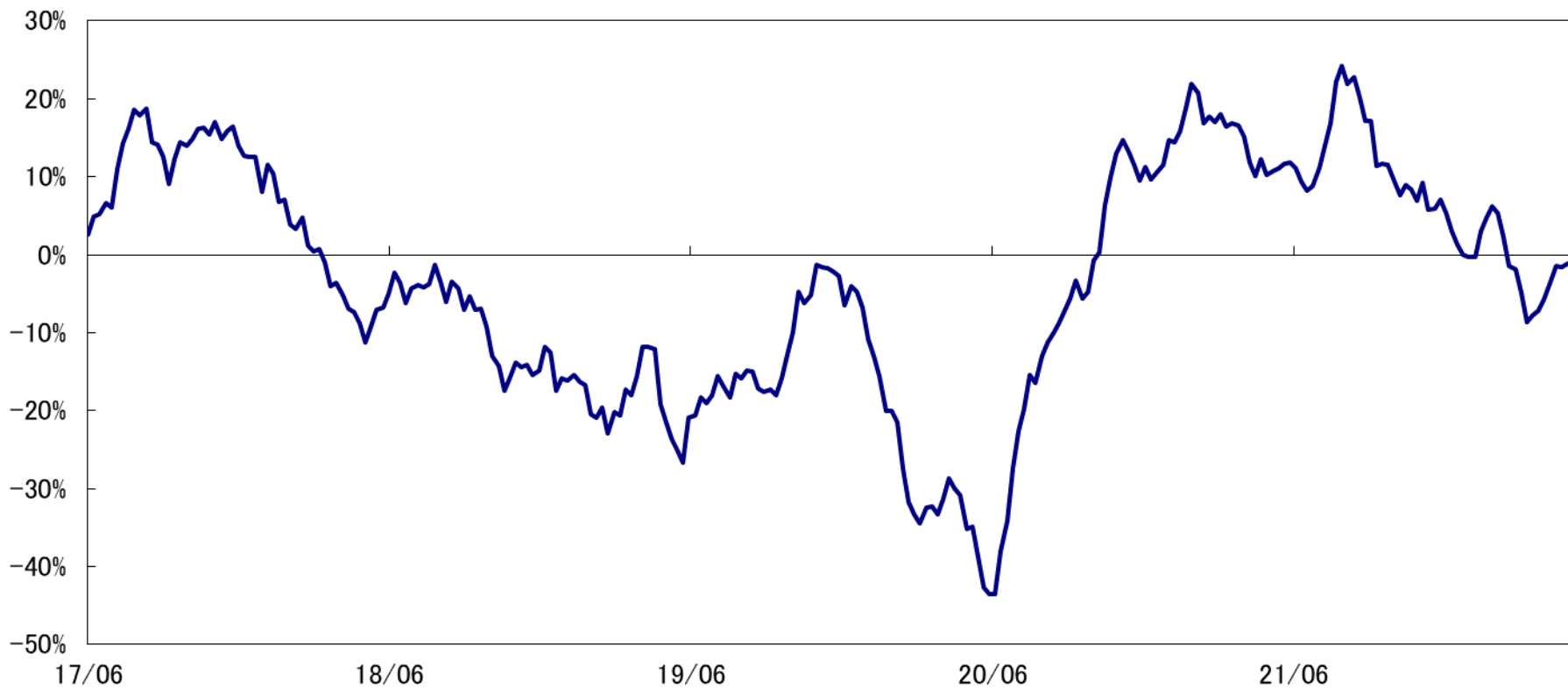


# Japan's ROE approaching double digits



# Earnings revision has hit the bottom despite difficult environment

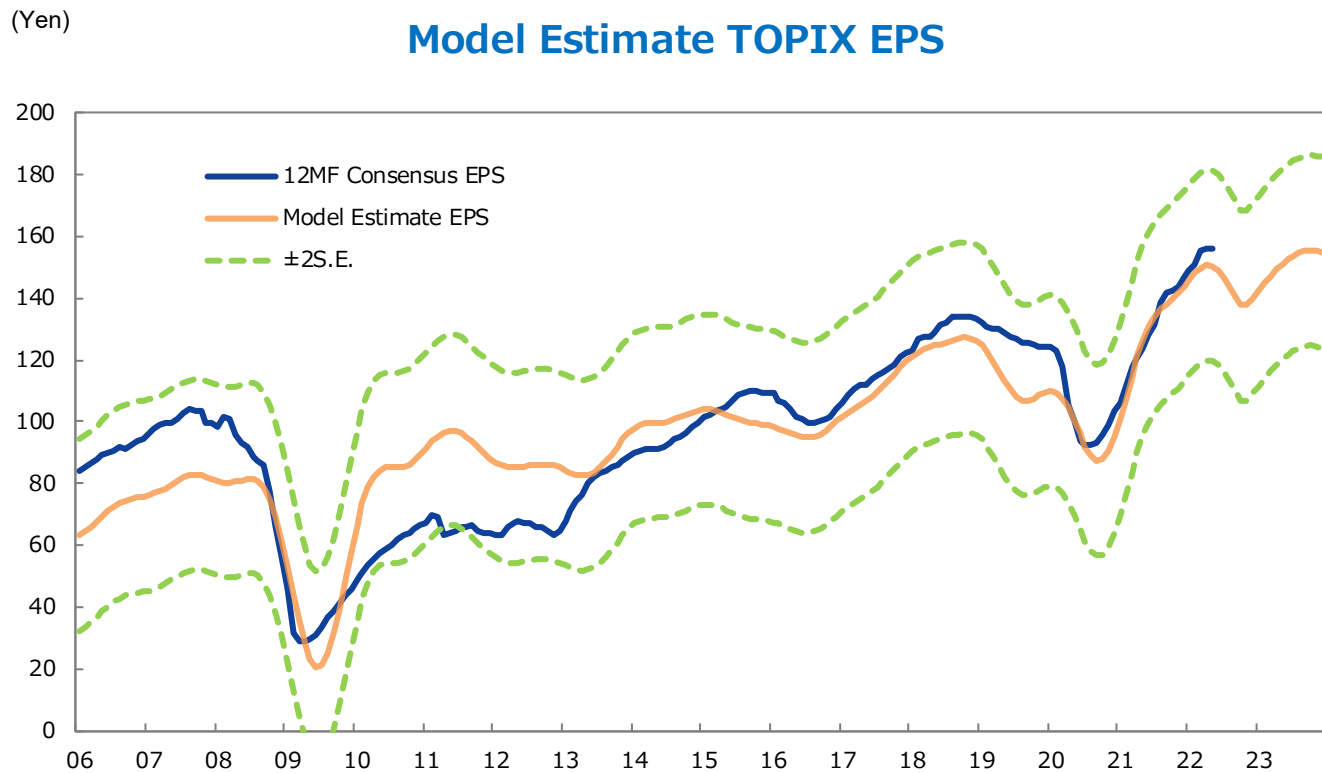
TOPIX Revision Index



Data is from June 30th 2017 to June 10th 2022  
(Source) Datastream, IBES

(YY/MM)

# Quants model suggests temporary pause of earnings growth ahead

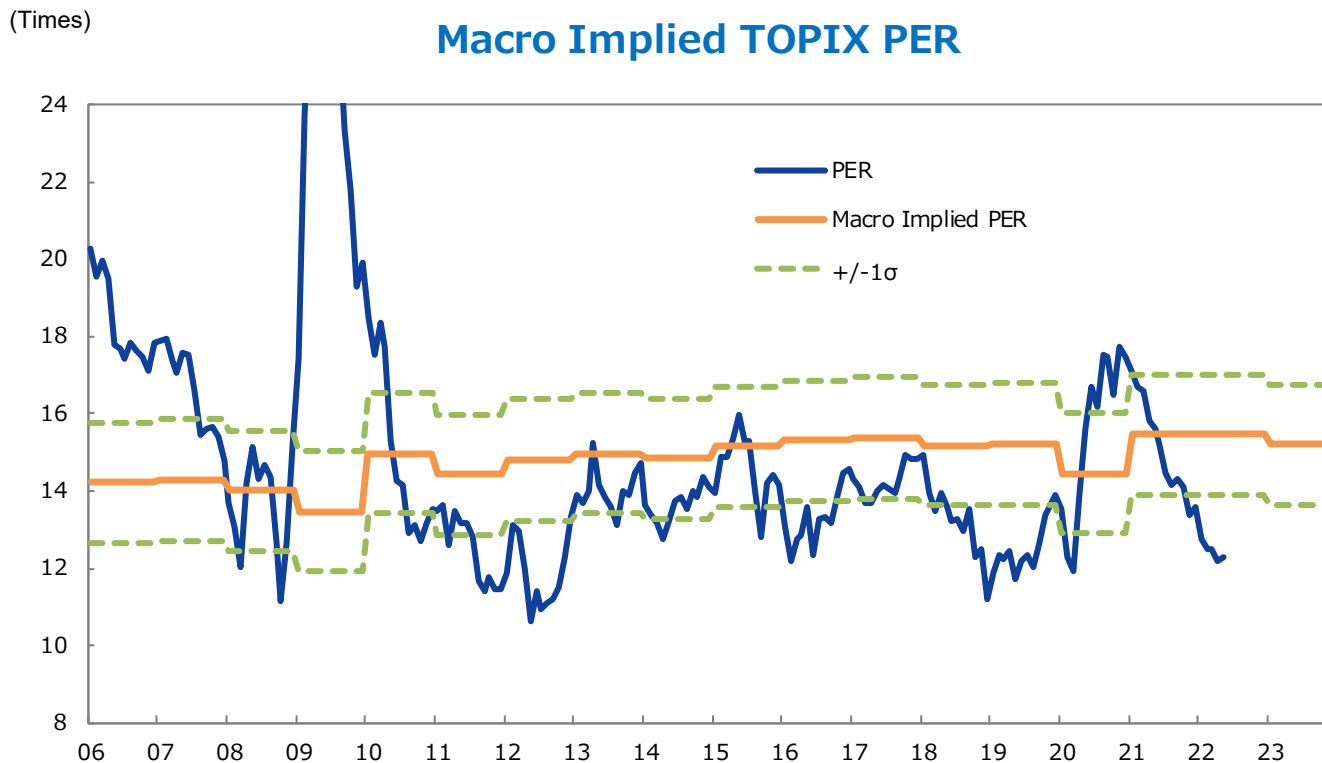


Consensus data is from Jan. 2006 to May 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# PER sank far below the bottom of the normal range

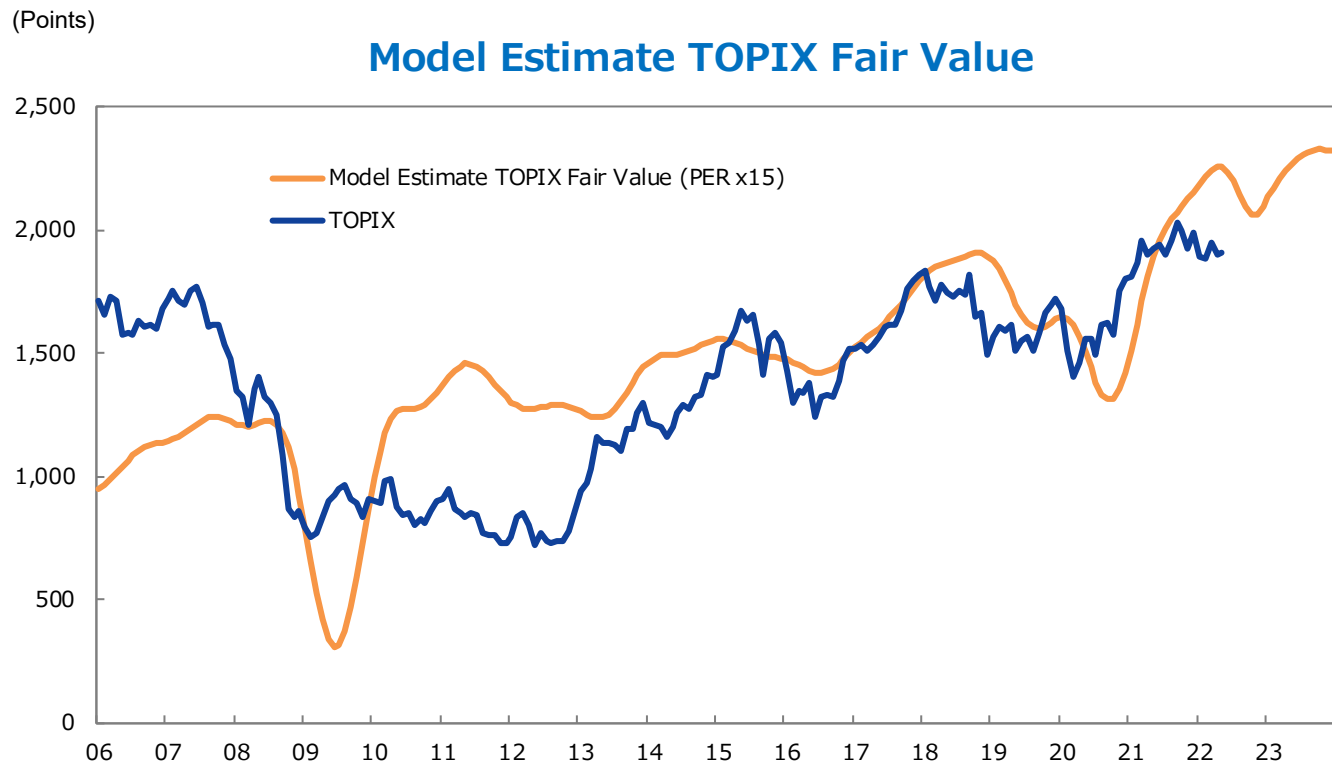


Consensus data is from Jan. 2006 to May 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Quants model indicates opportunity to accumulate



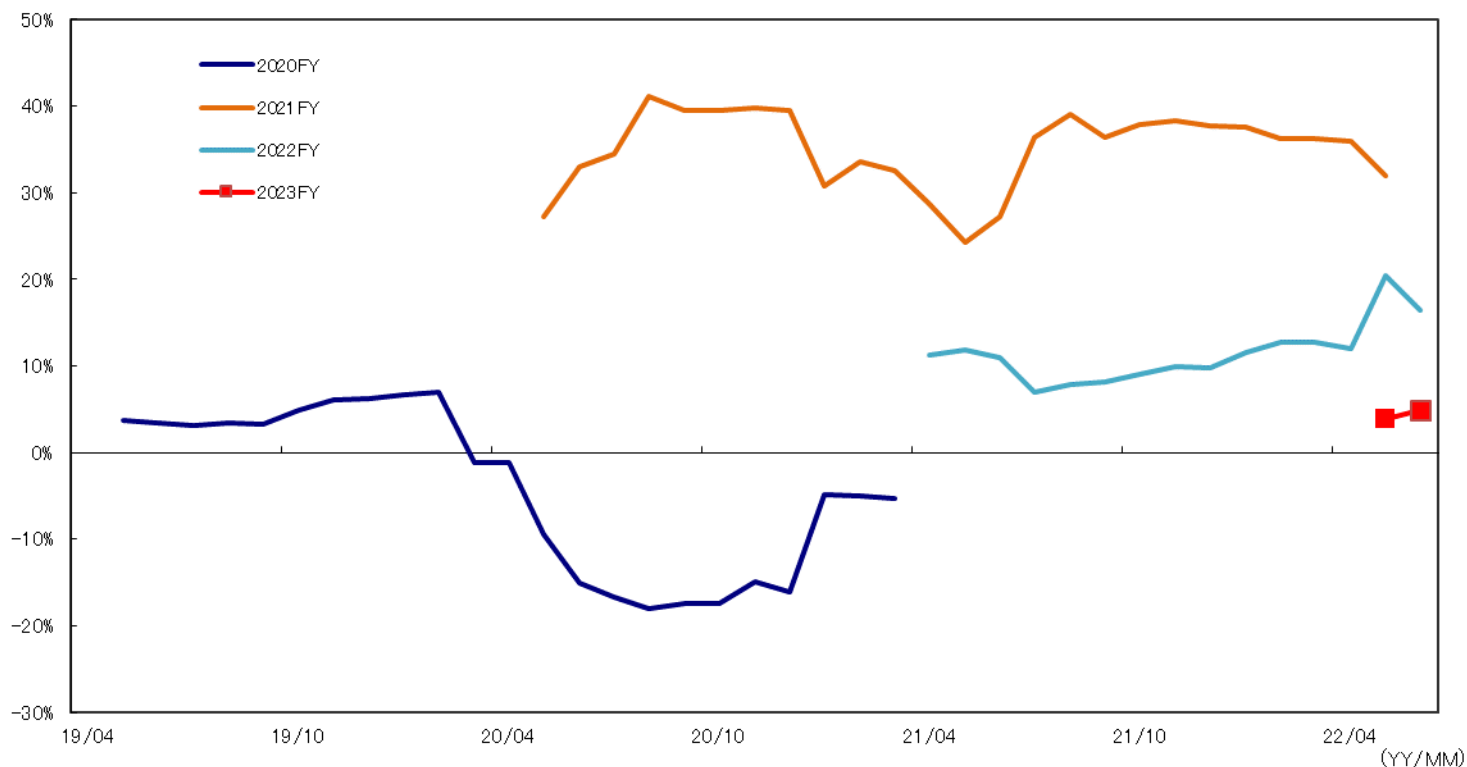
TOPIX data is from Jan. 2006 to May 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Bottom up forecasts are mixed owing to gloomy environment

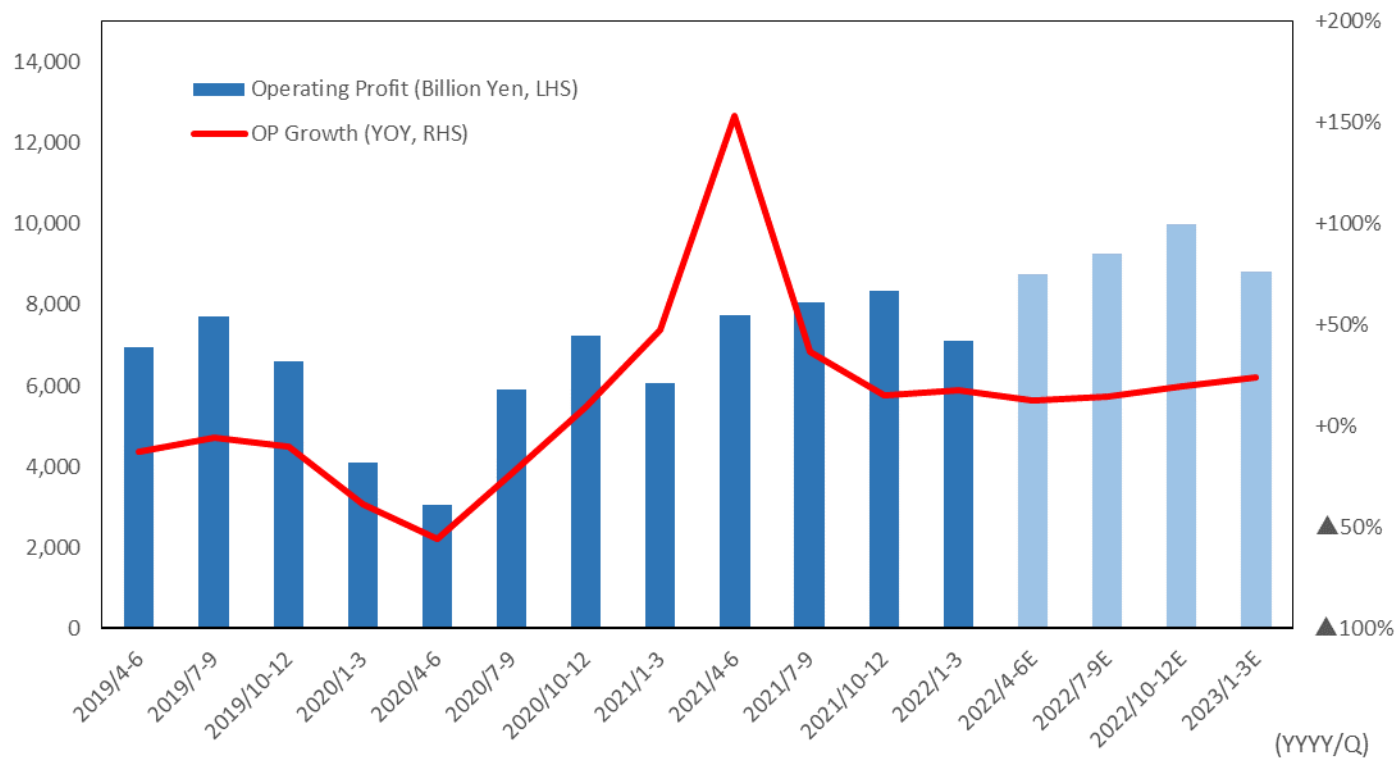
## SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of June 10<sup>th</sup> 2022, SMDAM Core Universe (Excl. Financials) consists of 407 Japanese companies covered by SMDAM in-house analysts.  
(Source) SMDAM

# Bottom up earnings estimate remains positive

Operating Profit (All Industries Excl. Financials and Softbank Group)



Actual data is from Q2 2019 to Q1 2022, estimate data is from Q2 2022 to Q1 2023  
 (Source) SMDAM

# Tide of “Corporate Governance” in Japan

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	204
Insurance companies	24
Pension funds	77
Others	11
<b>Total</b>	<b>322</b>

note: As of May 31st 2022

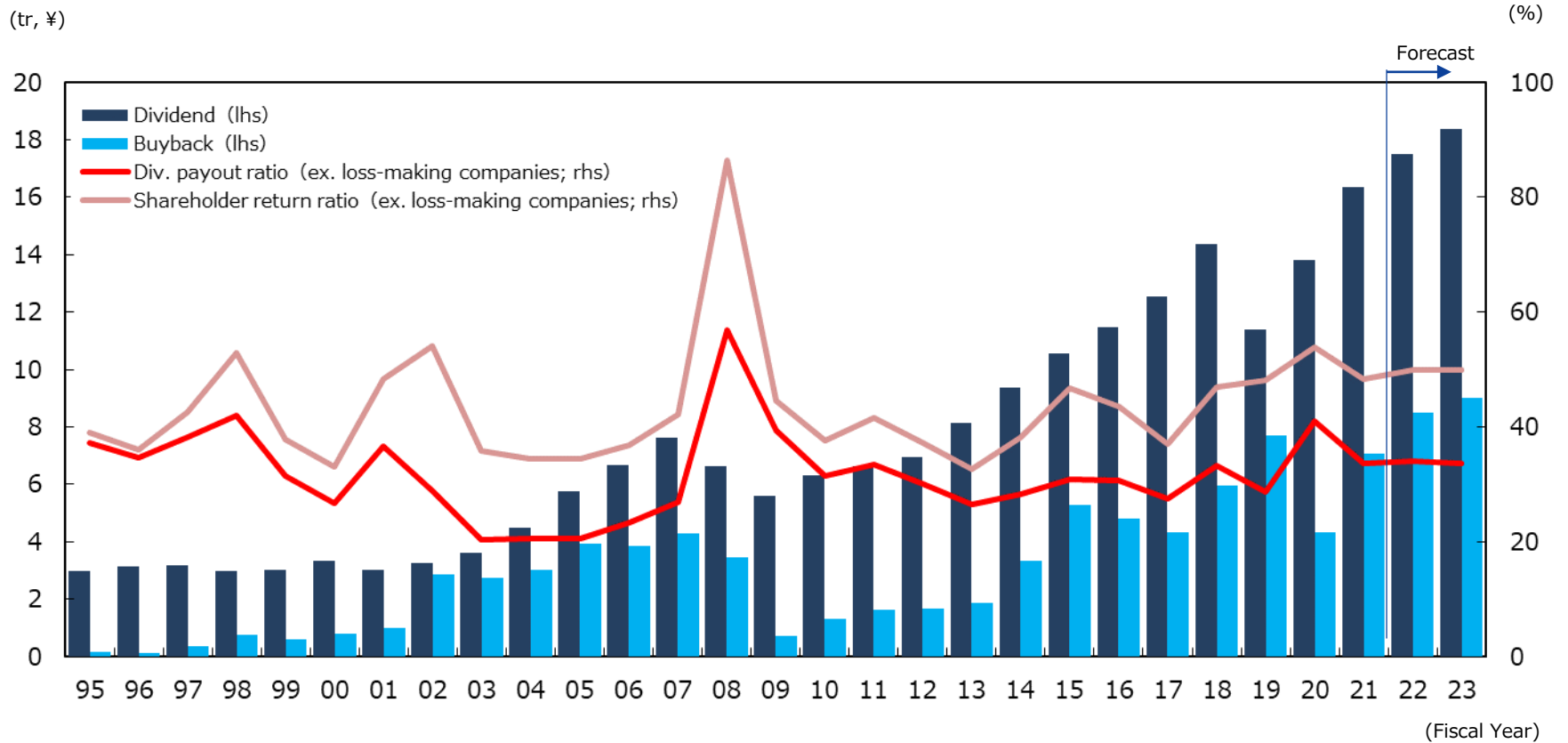
(Source) FSA, SMDAM

- The Stewardship Code (SC) was set in February 2014. Investors are taking a more proactive approach in talking to companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors that have publicly accepted the SC.
- After the inception of the Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve their governance, efficiency and shareholder returns.
- These two codes have been progressively reviewed and enhanced, and are making visible impact on corporate behavior and investors' attitudes as shareholders.
- In a recent amendment of the CGC, companies are required to explain the rationale of “cross holdings” or “strategic holdings” of other companies' shares, which implicitly provide protection against takeovers and hostile shareholder actions, and is often negative for achieving shareholder value.
- The SC was reinforced in March 2020 to require investors to evaluate ESG factors.



# Upward trend of dividends and buybacks continues

## Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2023, FY2022 and FY2023 are forecasts.  
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

# Value dominates recent market

## Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
<b>RN Japan Equity</b>	<b>-4.79</b>	<b>-6.66</b>	<b>-9.10</b>	<b>-6.85</b>	<b>14.86</b>	<b>17.12</b>	<b>13.18</b>
Total Value	-0.73	4.43	1.98	2.34	27.61	17.04	10.18
Top Cap Value	0.53	6.13	3.91	5.88	37.43	28.08	24.13
Large Cap Value	-0.34	5.74	3.42	4.01	31.07	19.26	13.62
Mid Cap Value	-1.46	5.23	2.77	1.69	23.09	7.67	-0.14
Small Cap Value	-2.40	-0.91	-3.84	-4.67	13.16	7.68	-4.25
Micro Cap Value	-4.29	-3.60	-7.31	-5.21	8.87	6.69	-4.45
Total Growth	-9.08	-16.83	-19.22	-15.13	2.40	15.07	14.26
Top Cap Growth	-9.16	-17.26	-20.02	-13.73	6.67	20.30	20.91
Large Cap Growth	-9.20	-17.12	-19.52	-14.87	3.31	17.19	15.83
Mid Cap Growth	-9.27	-16.88	-18.60	-16.81	-2.11	12.06	7.99
Small Cap Growth	-8.04	-14.25	-16.52	-17.67	-5.65	-1.47	0.72
Micro Cap Growth	-8.05	-15.84	-19.22	-20.12	-6.10	-1.48	2.43
Top Cap Total	-4.76	-7.49	-10.09	-5.58	19.60	23.41	21.77
Large Cap Total	-4.88	-6.82	-9.23	-6.43	16.23	19.17	15.66
Mid Cap Total	-5.05	-5.77	-7.85	-7.59	11.63	13.33	7.23
Small Cap Total	-4.33	-5.71	-8.39	-9.60	6.45	5.13	-0.90
Micro Cap Total	-5.36	-7.31	-10.92	-9.94	4.58	5.01	-0.11

Note : As of June 20th 2022  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- The economy is recovering thanks to the normalization of the domestic economy after the COVID-19 pandemic has begun to settle. In addition to the improvement of consumer demand, CAPEX is also expected to rebound. While the employment situation is improving and personal income is also increasing gradually, real income is declining owing to higher inflation. Inflation is flat as upward pressure from rising food prices has been offset by slowing energy inflation.

## [Outlook]

- ① **We have slightly lowered our real GDP growth forecast for FY 2022 to +2.0% from +2.1% and revised our forecast up for FY 2023 to +1.5% from +1.3%.** We expect the economy to return to a growth trend from Q2 of 2022 thanks to the re-opening from COVID-19 restrictions. Though prolonged concern about the Ukraine war and rising price of commodities weigh on the economy, pent-up demand and fiscal stimulus could boost the economy.
- ② **We have revised up our Core CPI forecast for FY 2022 to +2.3% from +1.8% and for FY 2023 to +1.2% from +1.1%.** We have raised our forecast for FY 2022 due to the change in our estimate of foreign exchange rate and crude oil price. We expect core CPI will accelerate further from +2.1% in April to mid 2% temporarily in the near future.
- ③ **We expect PM Kishida's cabinet to maintain its economic policy to boost the economy.** As the government set back its austerity target due to the pressure from ruling LDP, we have raised our assumption of the size of fiscal stimulus to 15 trillion yen from 10 trillion yen.
- ④ **During governor Kuroda's term by April 2023, we believe it is highly likely that the bank of Japan will keep its accommodative monetary policy and its framework unchanged against cost-push inflation. We expect the BOJ could change its monetary policy after Kuroda's resignation by changing the cap of 10 year JGB yield to 0.5% from 0.25%.**

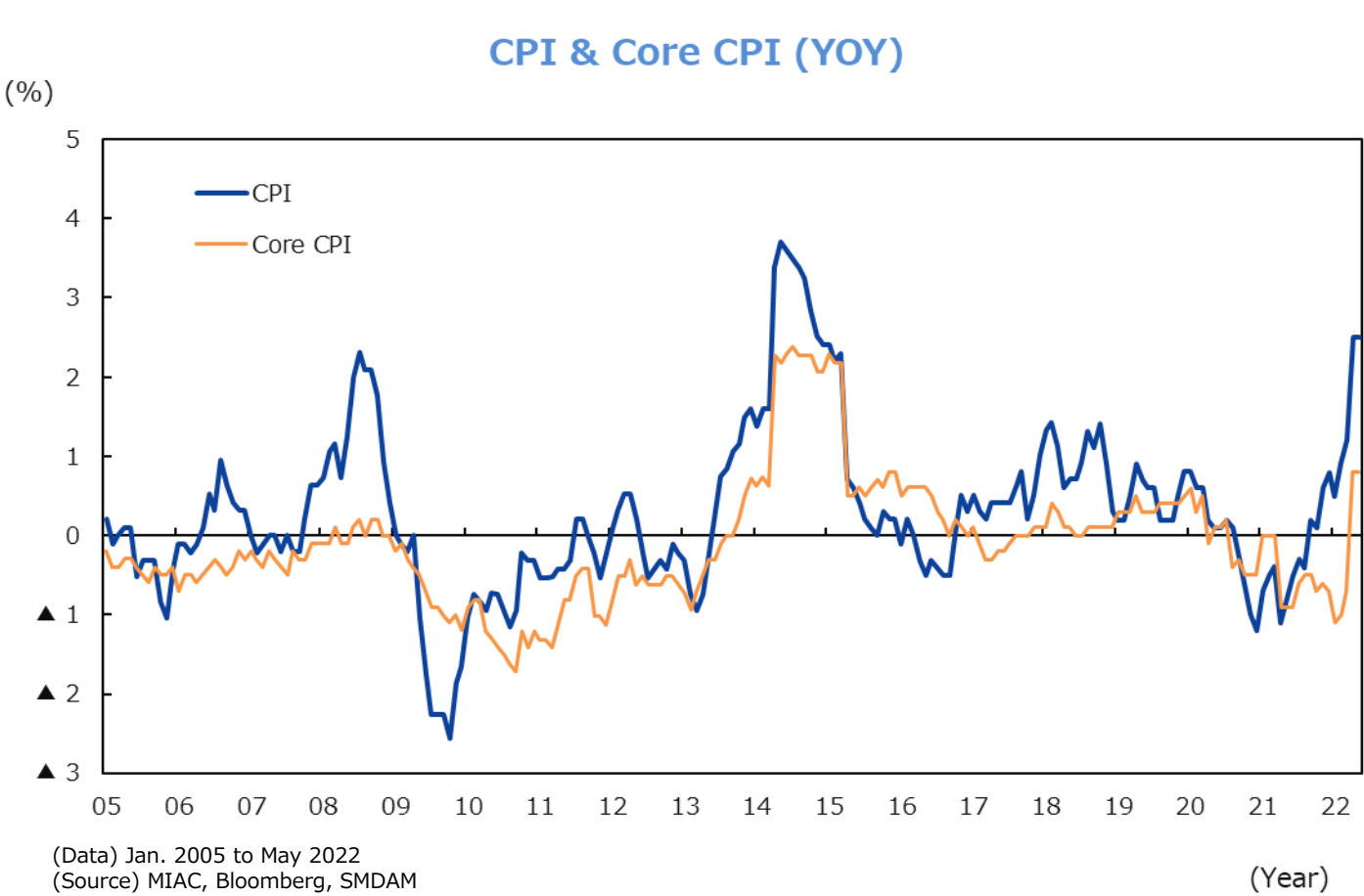
# Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY17	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.2%	2.0%	1.5%	
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.6%	2.5%	1.2%	
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.6%	-1.2%	0.1%	
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	0.8%	1.6%	3.5%	
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-9.4%	-3.5%	0.6%	
Net export contribution	0.4%	-0.2%	-0.5%	-0.6%	0.8%	0.0%	0.0%	
Exports of goods and services	6.3%	2.0%	-2.3%	-10.2%	12.5%	1.2%	3.9%	
Imports of goods and services	3.8%	3.0%	0.2%	-6.5%	7.2%	1.4%	3.9%	
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.2%	2.0%	2.0%	
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.0%	0.1%	0.5%	
Industrial Production Index	2.9%	0.3%	-3.7%	-10.0%	5.9%	2.5%	3.6%	
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	2.3%	1.2%	
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.5%	7.0%	7.1%	0.7%	
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	1.9%	1.5%	
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.5%	2.3%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

(Note) Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

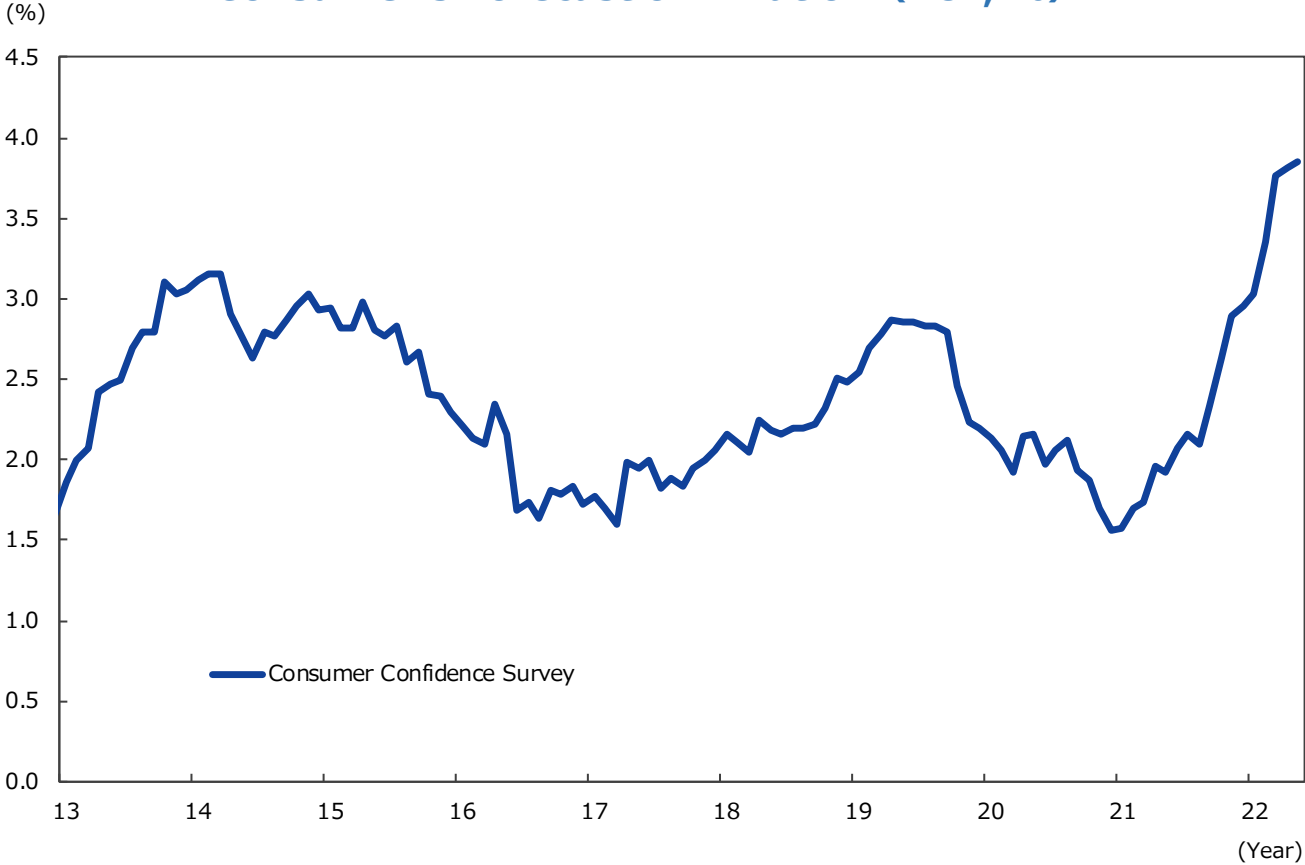
(Source) Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

# Inflation finally returns to Japan



# Consumers expect further inflation ahead

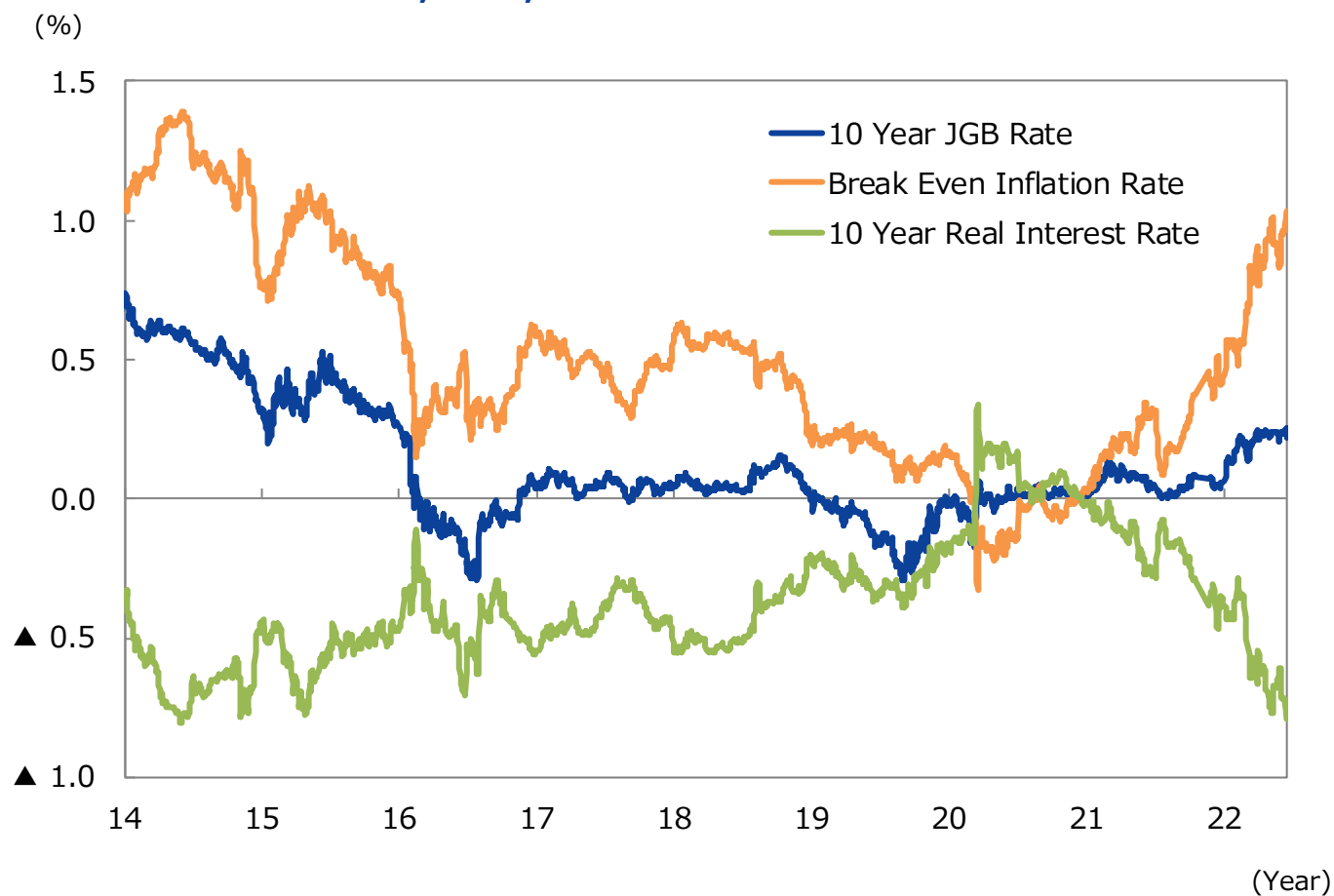
### Consumer's Forecast of Inflation (YOY, %)



(Data) Weighted average of inflation forecast of "Consumer Confidence Survey".  
Data is from Jan. 2013 to May 2022.  
(Source) Cabinet Office, SMDAM

# Yield curve control of BOJ pushes real interest sharply lower

## JGB, BEI, and Real Interest rate

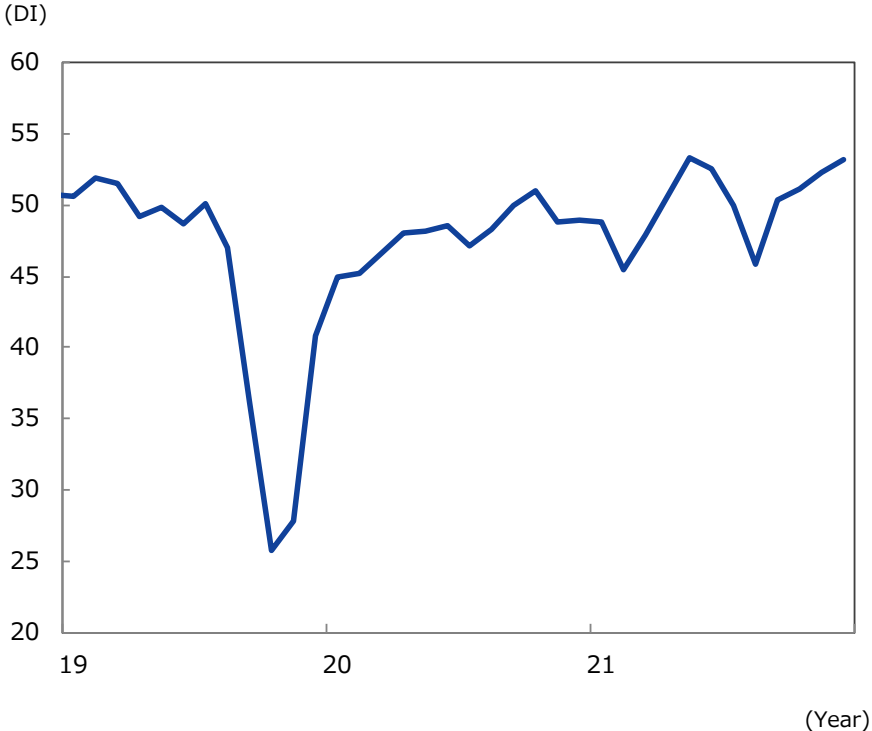


(Data) From Jan. 1st 2014 to June 17th 2022  
(Source) Bloomberg, SMDAM

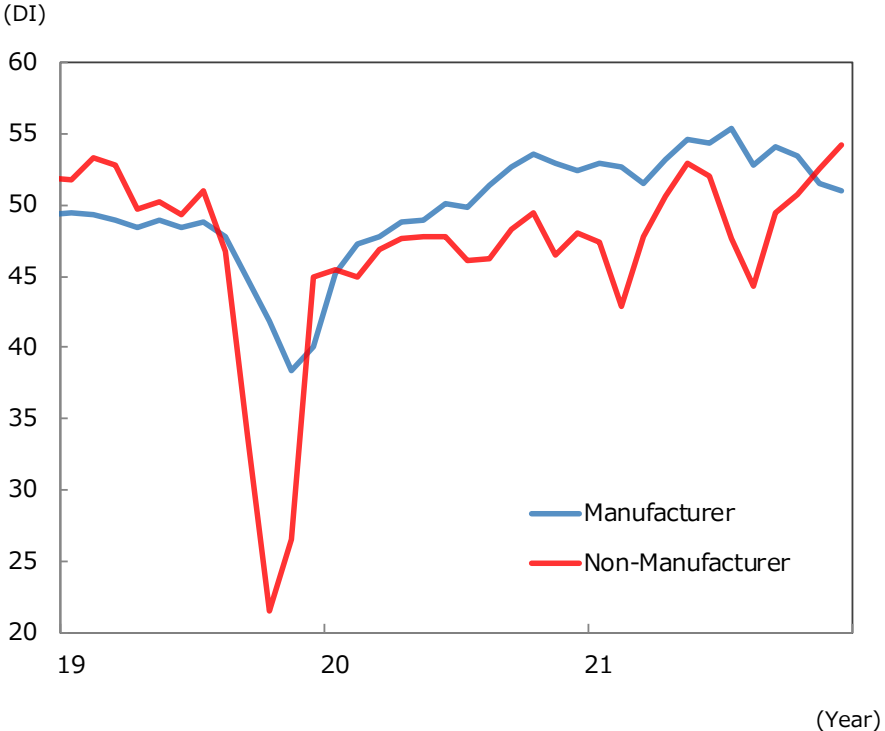


# “Re-opening” boosts sentiment of service businesses

### Composite PMI



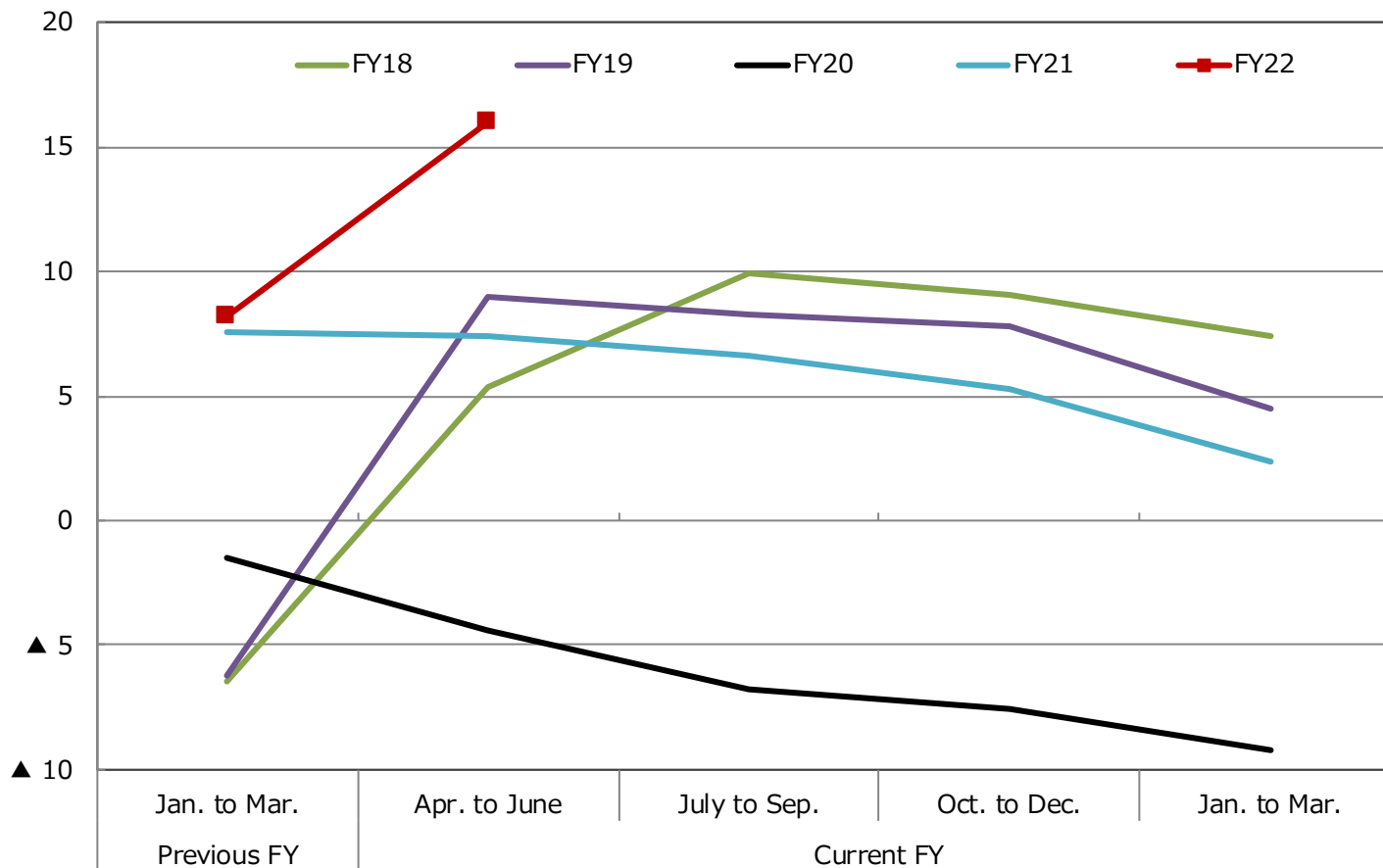
### PMI, Manufacturer & Non-Manufacturer



(Data) From July 2019 to June 2022  
(Source) Bloomberg, SMDAM

# “Re-opening” may lift CAPEX to five-year high

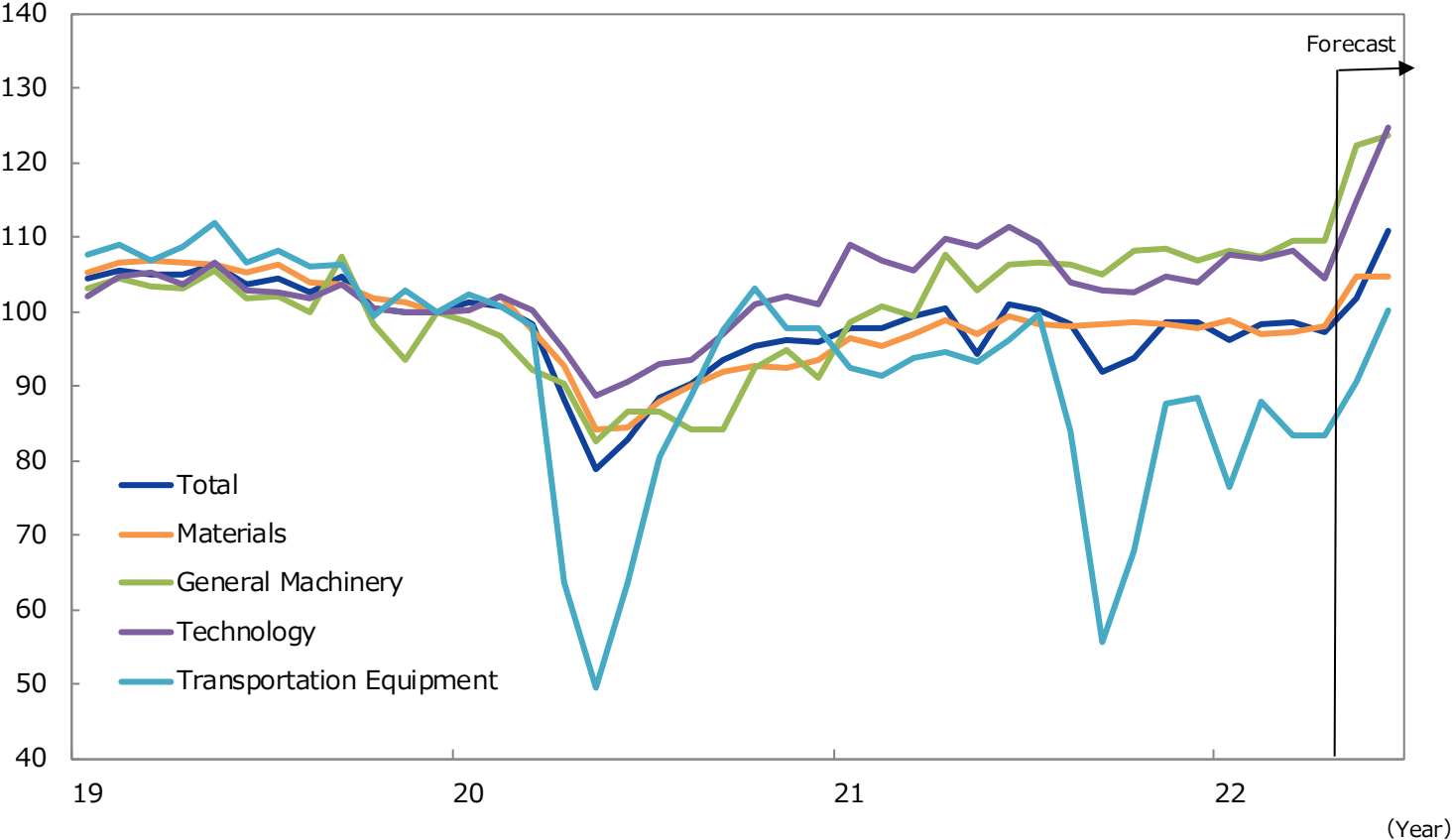
## Plan of CAPEX (YOY)



(Data) All industries, all sizes, including software, excluding land and R&D, from Q1 2018 to Q2 2022  
 (Source) Cabinet Office, SMDAM

# “Re-opening” also boosts industrial production

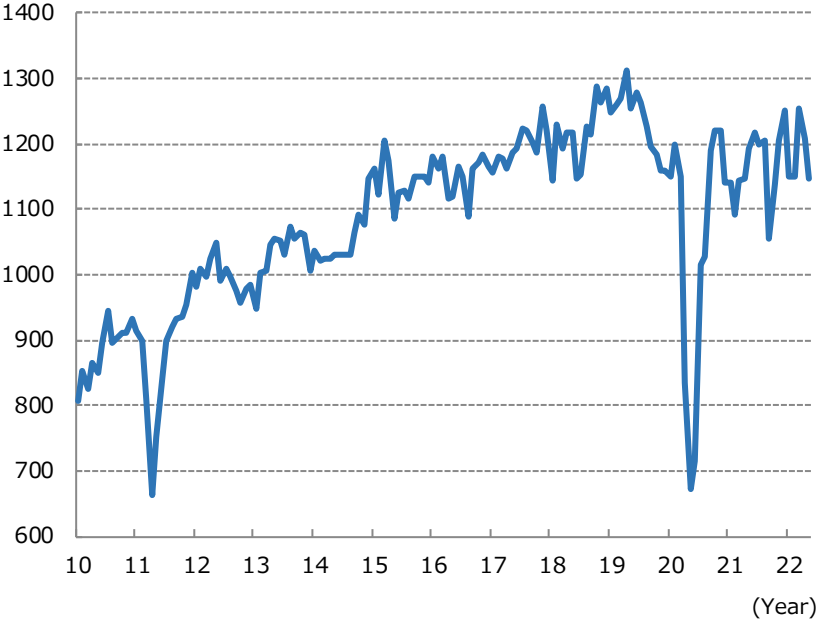
## Industrial Production (Dec. 2019=100)



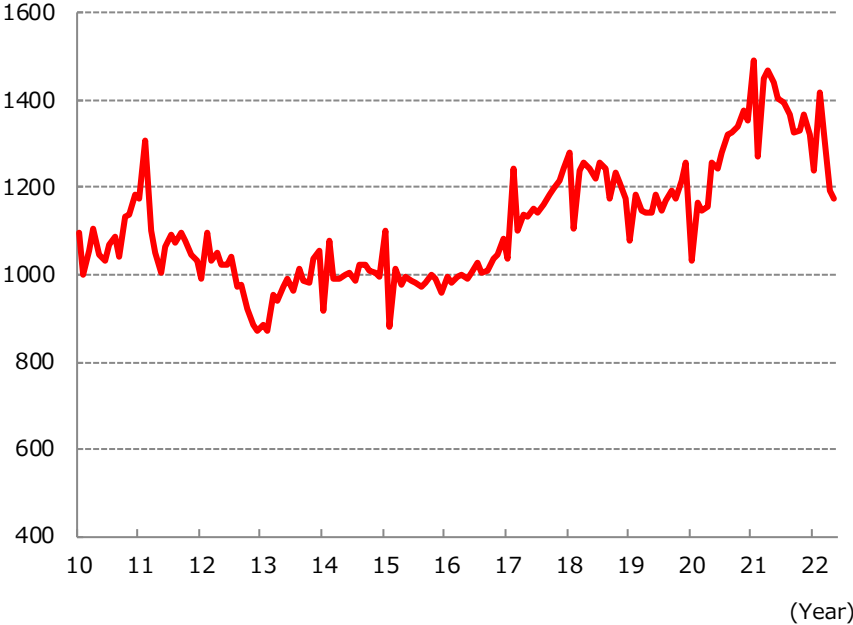
(Data) From Jan. 2019 to June 2022.  
(Source) METI, SMDAM

# Lockdown in Shanghai depresses Japan's export to China

### Real Export to US (SA, Billion Yen)



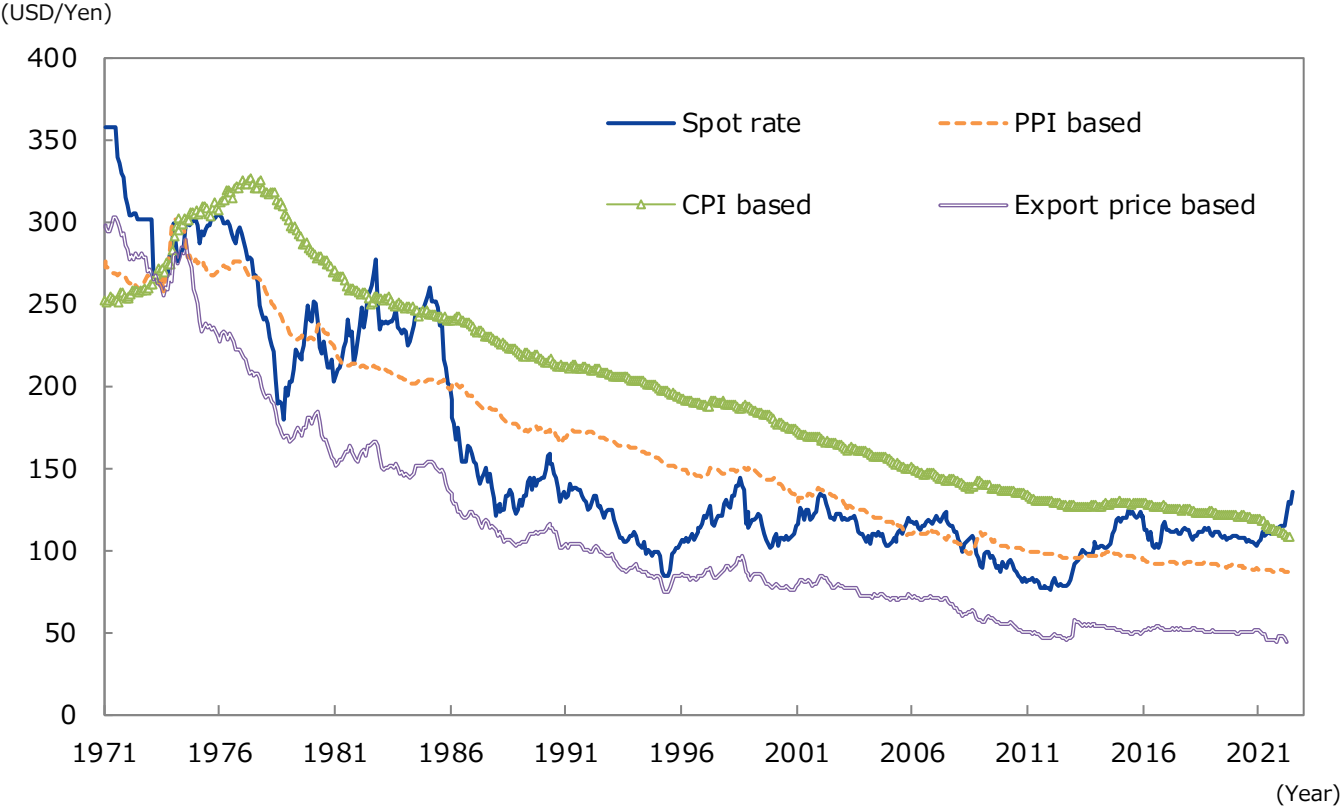
### Real Export to China (SA, Billion Yen)



(Data) From Jan. 2010 to May 2022.  
(Source) MOF, Bank of Japan, SMDAM

# USD/JPY exchange rate breaks 30+ years' resistance

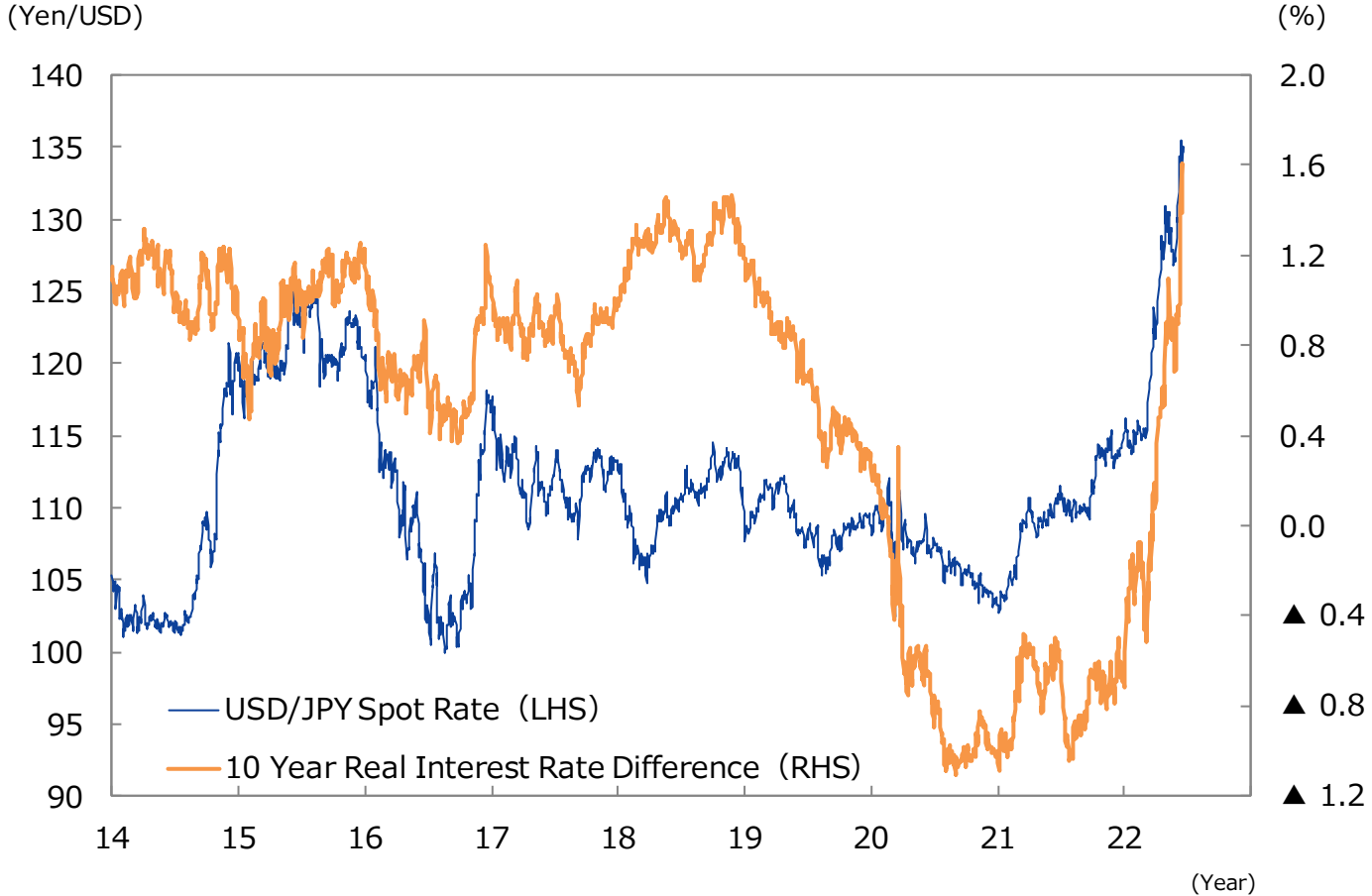
## Purchasing Power Parity of USD/JPY Rate



(Data) Spot Rate is from Jan. 1971 to June 2022, PPP is from Jan. 1971 to May 2022.  
(Source) DOL, Bank of Japan, SMDAM

# Real interest rate gap drives JPY weaker

## Real Interest Rate Difference & USD/JPY Exchange rate

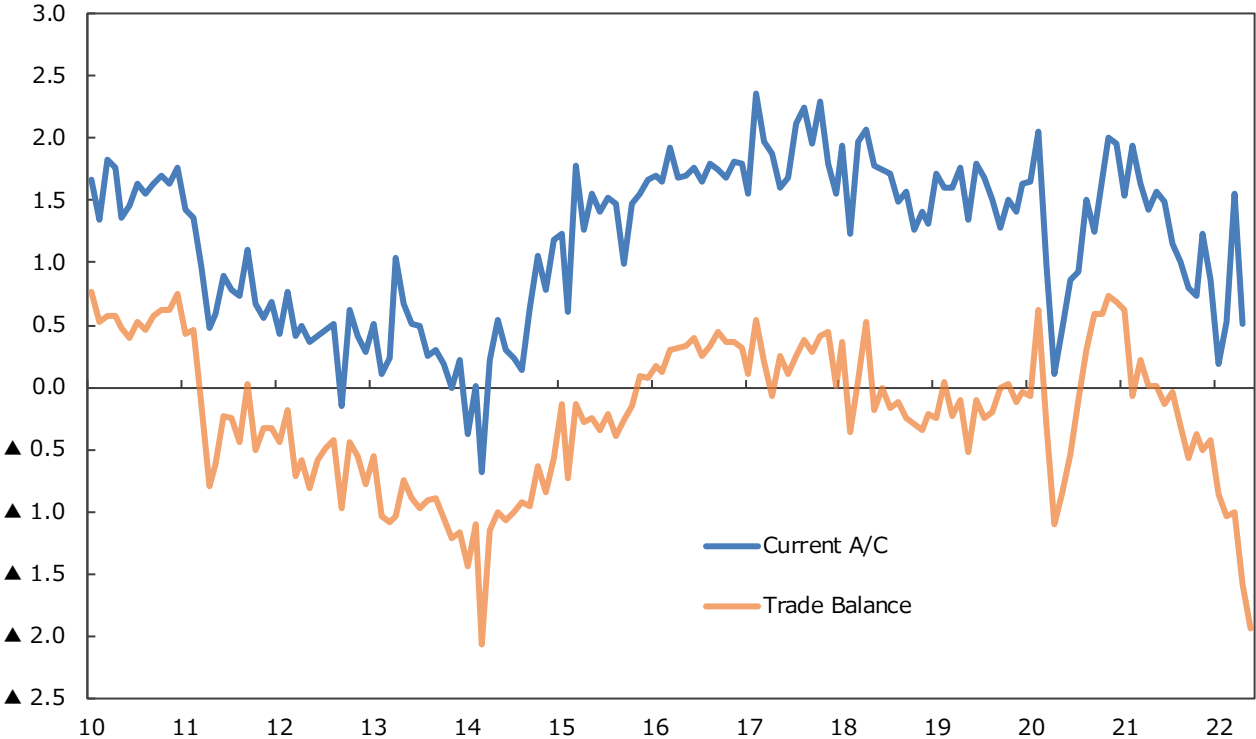


(Data) From Jan. 1<sup>st</sup> 2014 to June 17th 2022.  
(Source) Bloomberg, SMDAM

# Rising energy brought huge deficit of trade balance

(Trillion Yen)

## Current Account & Trade Balance



(Data) Seasonally adjusted. Current account is from Jan. 2010 to Apr. 2022.  
Trade balance is from Jan. 2010 to May 2022.  
(Source) MOF, SMDAM

# Japan's marginal exposure to Russian business

## Trade Exposure to Russia (%)

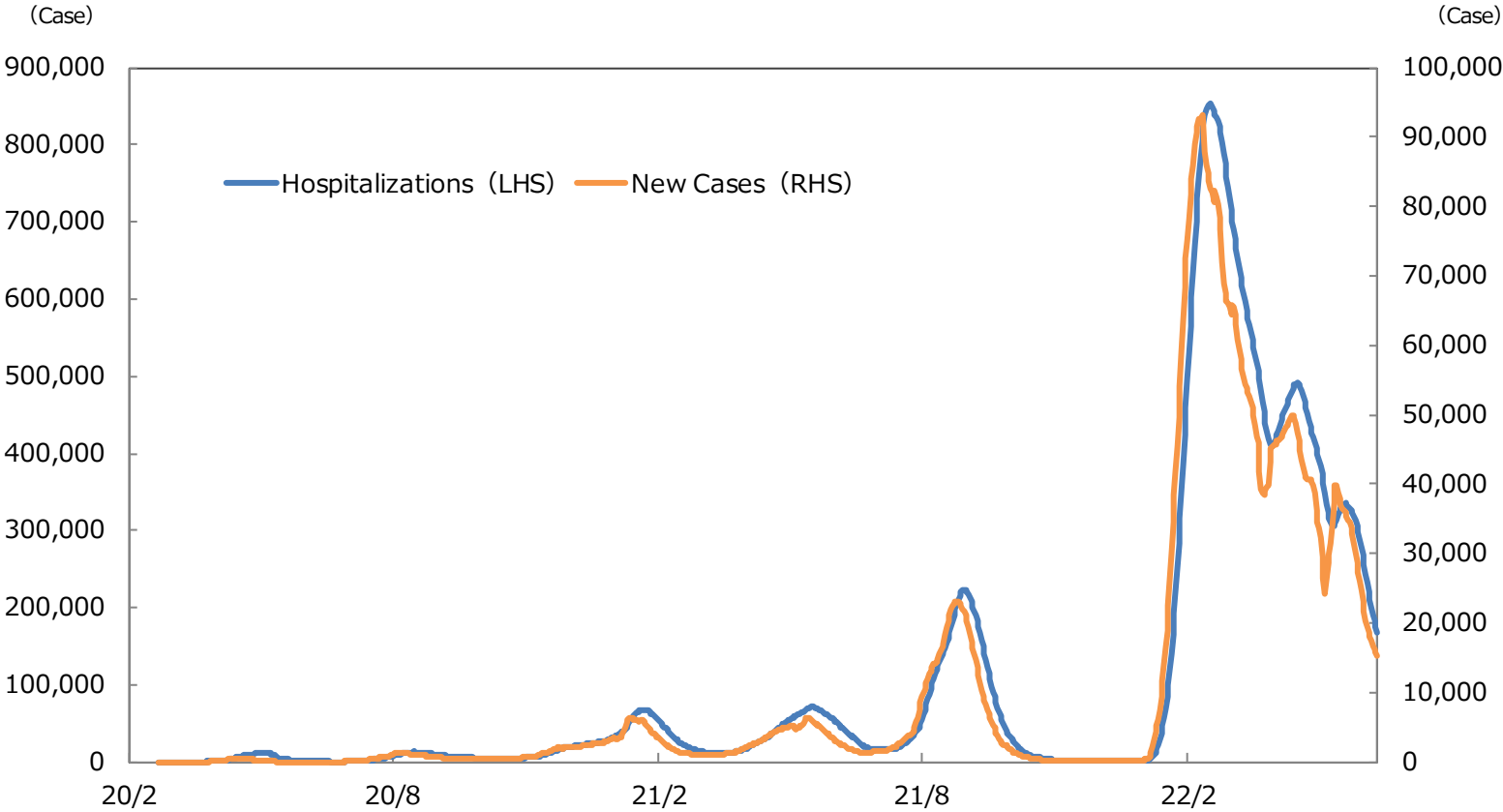
	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Export	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01	0.00
Electronics	0.07	0.01	0.00	0.00
Transportation Equipment	0.56	0.09	0.00	0.00
Others	0.07	0.01	0.00	0.00

(Data) As of year 2021.  
 (Source) MOF, SMDAM



# COVID-19 infections past peak

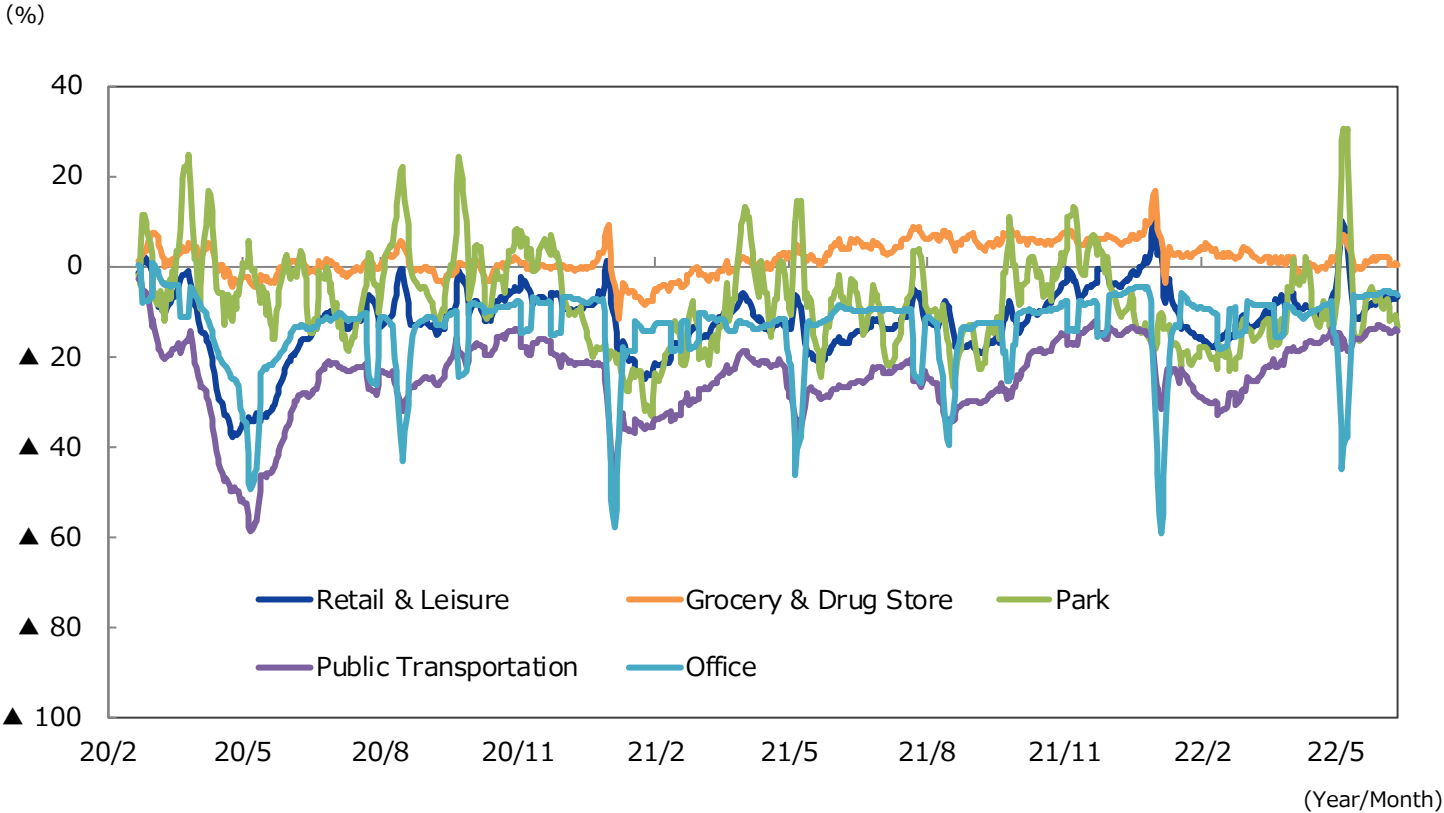
## COVID-19 New Cases and Hospitalizations



(Data) 7 days moving average. From Feb. 21st 2020 to June 11th 2022.  
(Source) MHLW, NHK, SMDAM

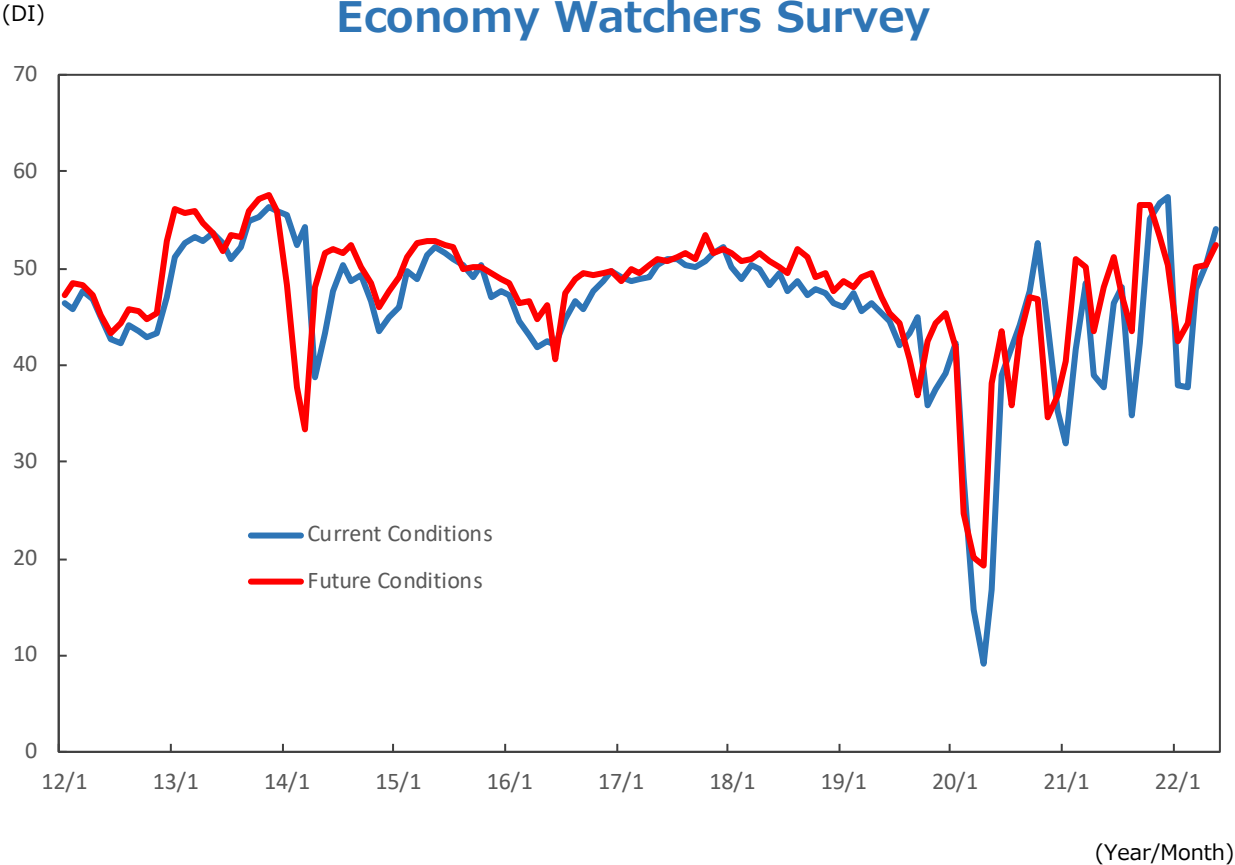
# Mobility stabilizes at the level of “New Normal”

## Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21<sup>st</sup> 2020 to June 11th 2022  
(Source) Google, SMDAM

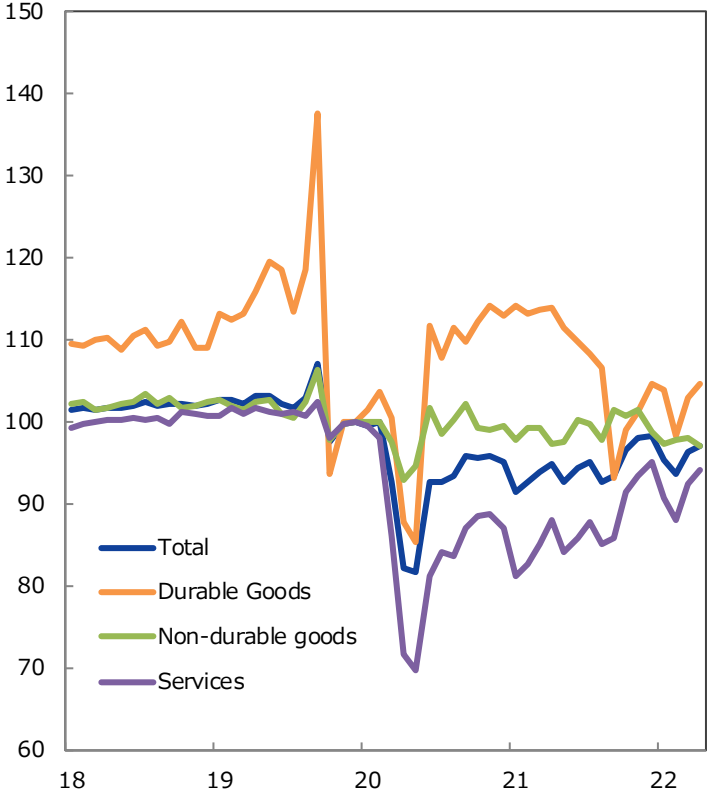
# Consumers come back after “Re-opening”



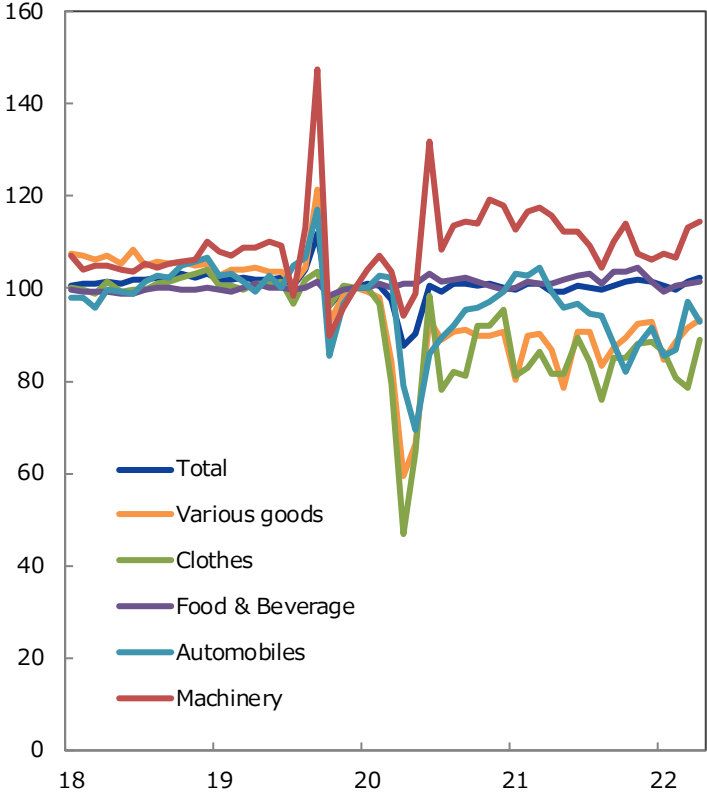
(Data) From Jan. 2012 to May 2022  
(Source) Cabinet Office, SMDAM

# Retail sales come back slowly but steadily

Consumer Activity Index (Dec. 2019 = 100)



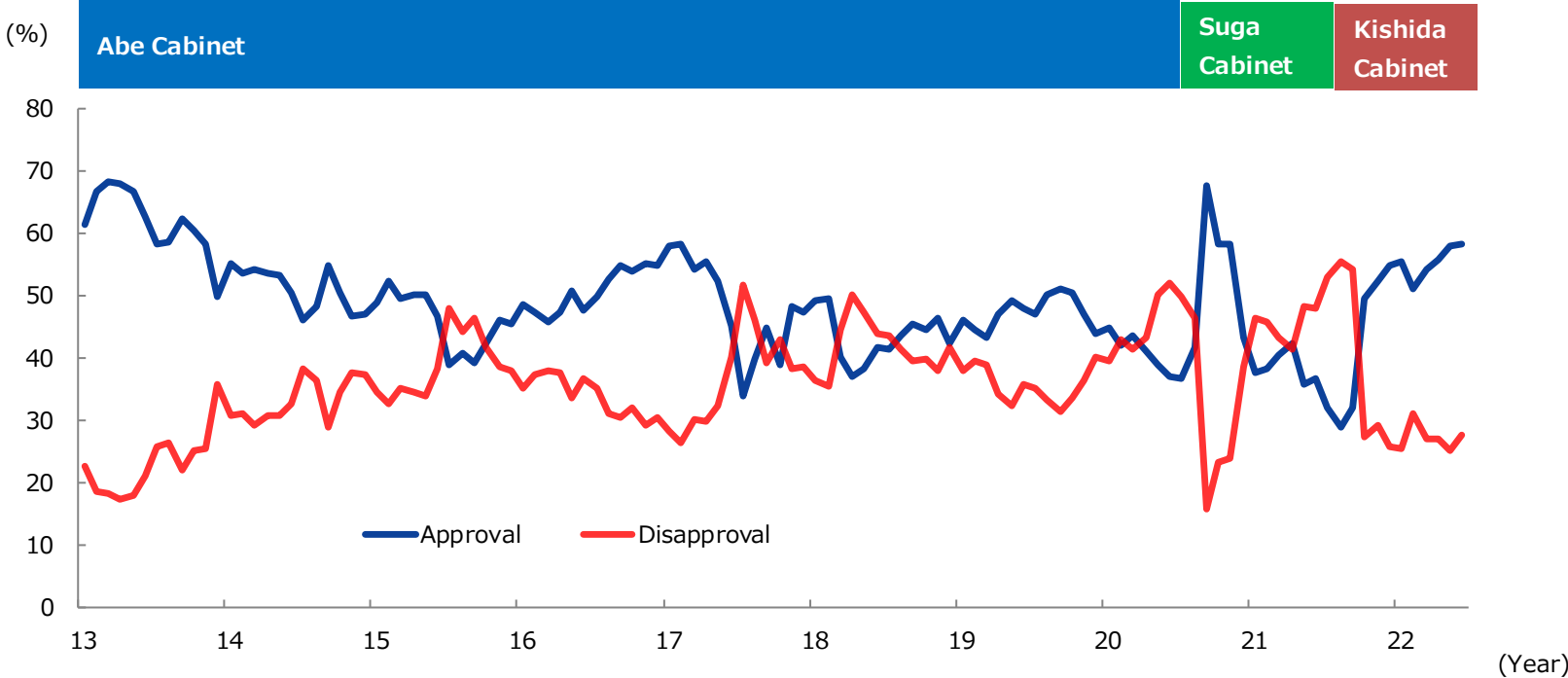
Retail Sales (Dec. 2019 = 100)



(Data) From Jan. 2018 to Apr. 2022.  
 (Source) Bank of Japan, METI, and SMDAM

# PM Kishida keeps high approval rate

## Cabinet approval rate



(Data) From Jan. 2013 to June 2022  
(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

# Six trillion yen economic package

## Emergency Economic Measures (Trillion Yen)

	National Expense			Size of Measures
		Reserve Fund	Supplementary budget	
Counter measures against rising crude oil	1.5	0.3	1.2	1.5
Stabilize supply of raw materials and foods	0.5	0.1	-	2.4
Support for SMEs affected by high raw material prices	1.3	0.1	-	6.5
Support for people in need	1.3	1.0	-	1.3
Securing reserve funds	1.5	-	1.5	1.5
<b>Total</b>	<b>6.2</b>	<b>1.5</b>	<b>2.7</b>	<b>13.2</b>

(Source) SMDAM

## Schedule of major events

Schedule of Major Domestic Events			
2022	July	10	House of Councilors Election Polling Day
		20-21	Monetary Policy Meeting
		23	End of the Term of two members of the BOJ Monetary Policy Committee
	August	15	Release of CY 2022 Q2 GDP
	September	8	Revision of CY 2022 Q2 GDP
		21-22	Monetary Policy Meeting Change of Top Party Officials of LDP
	October	27-28	Monetary Policy Meeting
30		G20 Summit in Indonesia	
November	15	Release of CY 2022 Q3 GDP	
December	8	Revision of CY 2022 Q3 GDP	
	19-20	Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023	

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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