



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-September 2022-

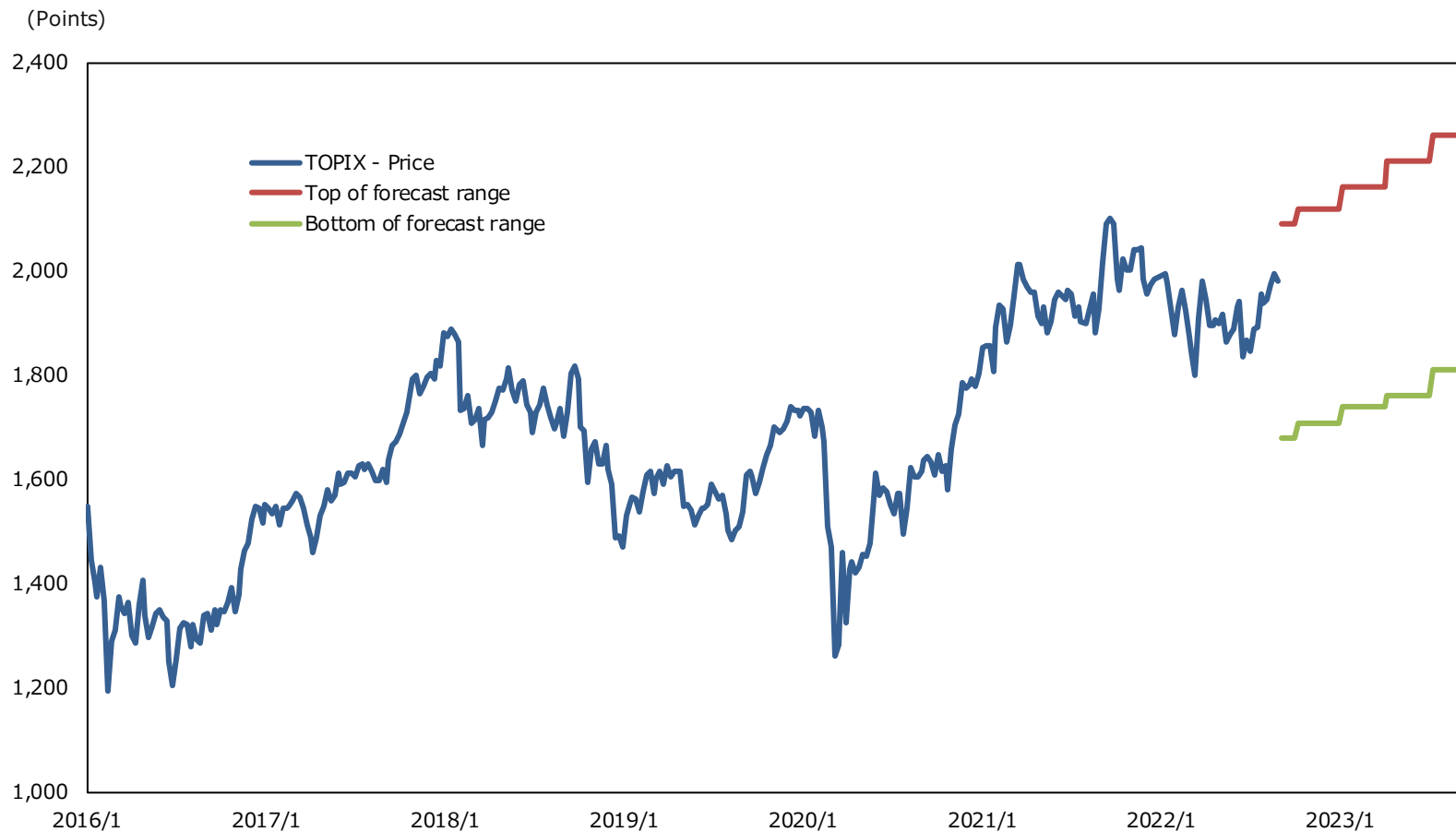


Outlook for Japanese Stock Market

Market Outlook

- We expect range trading in the Japanese stock market to continue in the near future.
- We believe Japanese stocks will resume their bullish trend after the market confirms the level and timing of the peak of the current monetary tightening in the US.
- We have maintained our TOPIX target for FY 2022 at 1,960 and slightly revised up our Nikkei 225 target to 28,400.
- While the downside of the market will be supported by the stable domestic economy and accommodative monetary policy, the upside will be limited owing to prolonged concern about the global economy.

We expect range trading in the near future followed by rally later



Note: TOPIX data is from Jan. 1st 2016 to Aug. 26th 2022
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

(Year/Month)

Upside / Downside risk scenarios

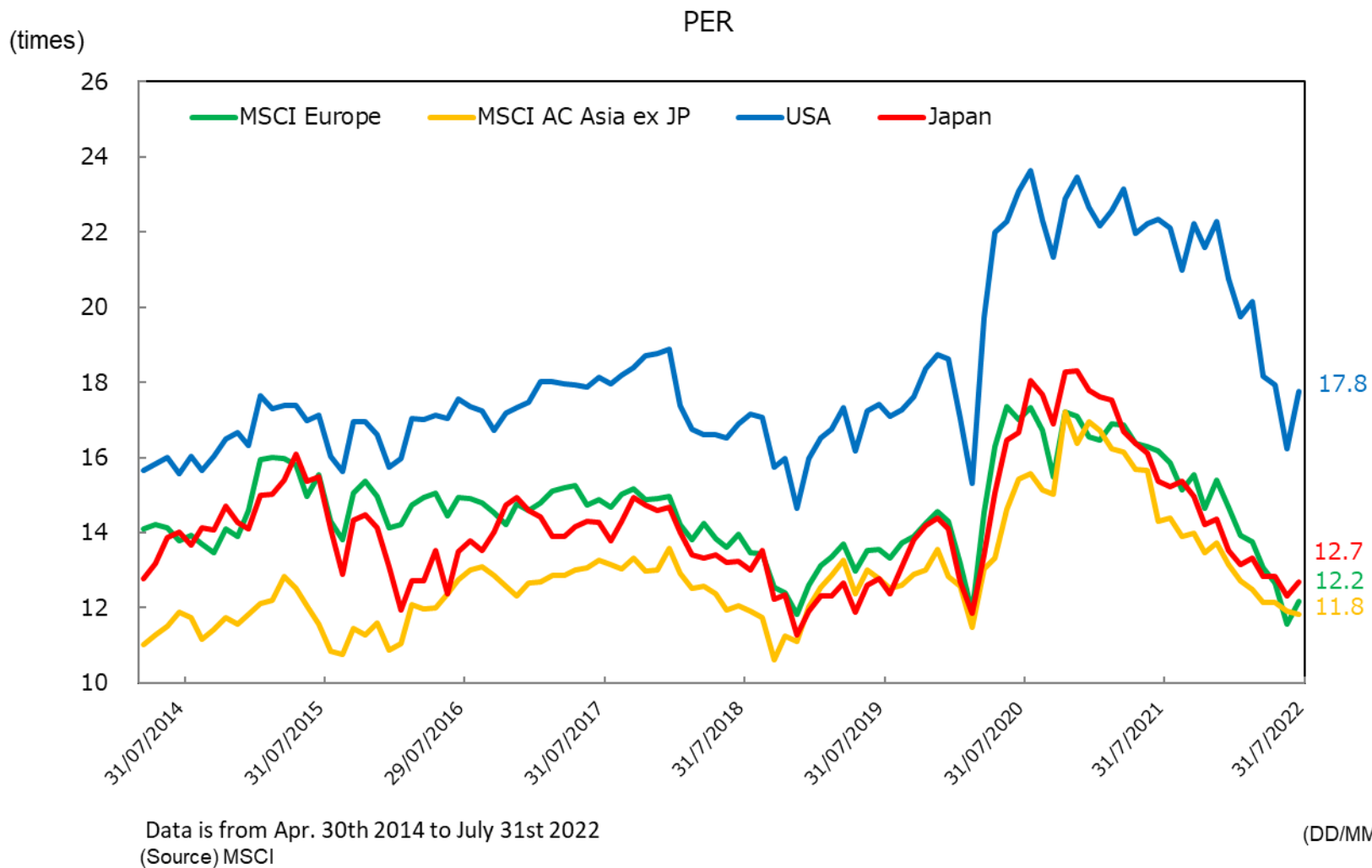
■ Upside Risks

- Recovery of inbound travel from China
- Declining volatility in oil, metal and other commodity markets
- Positive impact from “Doubling Asset-Based Income Plan” by the cabinet

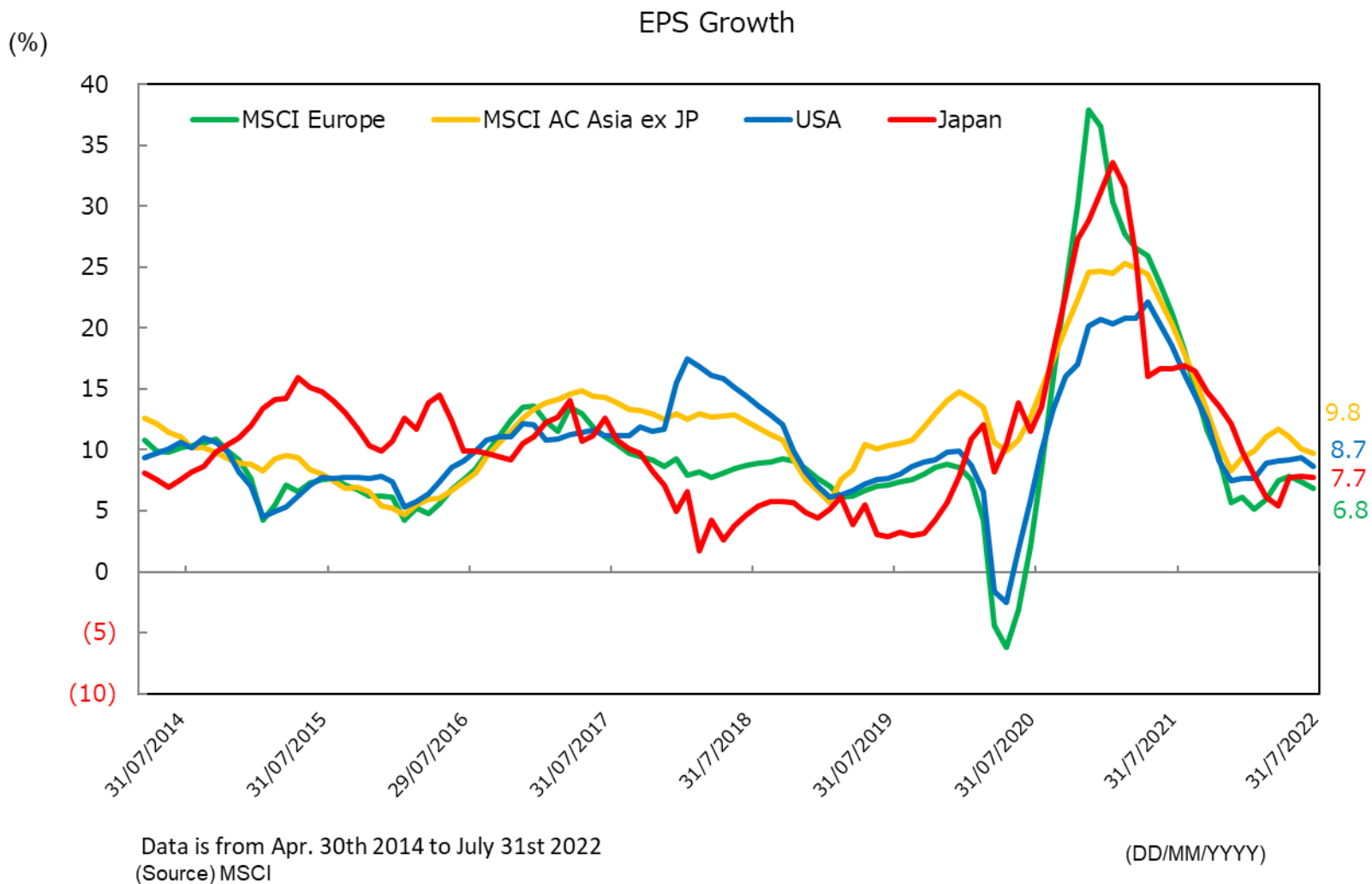
■ Downside Risks

- Concern over fiscal austerity
- Concern over stagflation

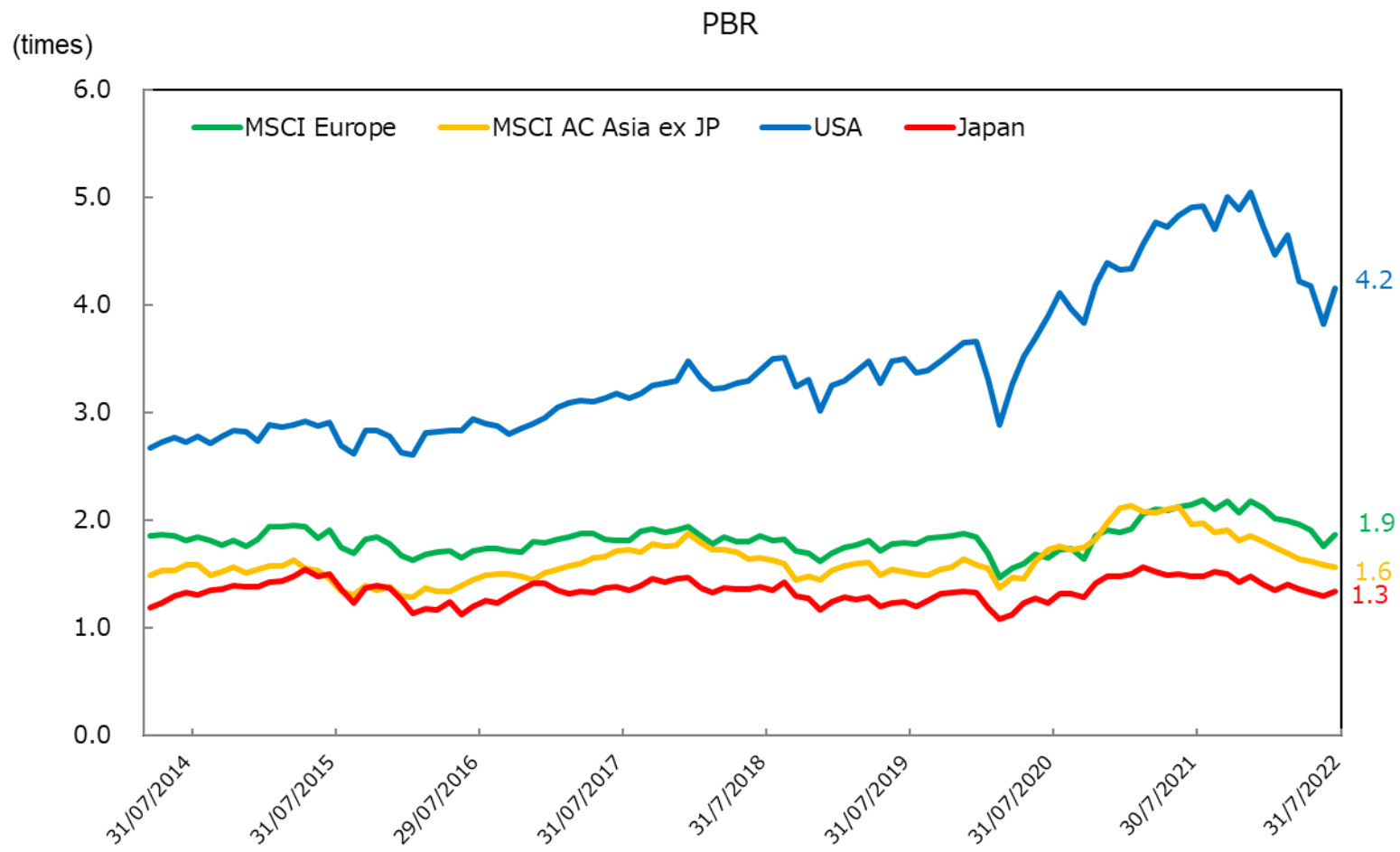
PERs has already hit rock bottom?



Stable EPS outlook despite concern over the economy



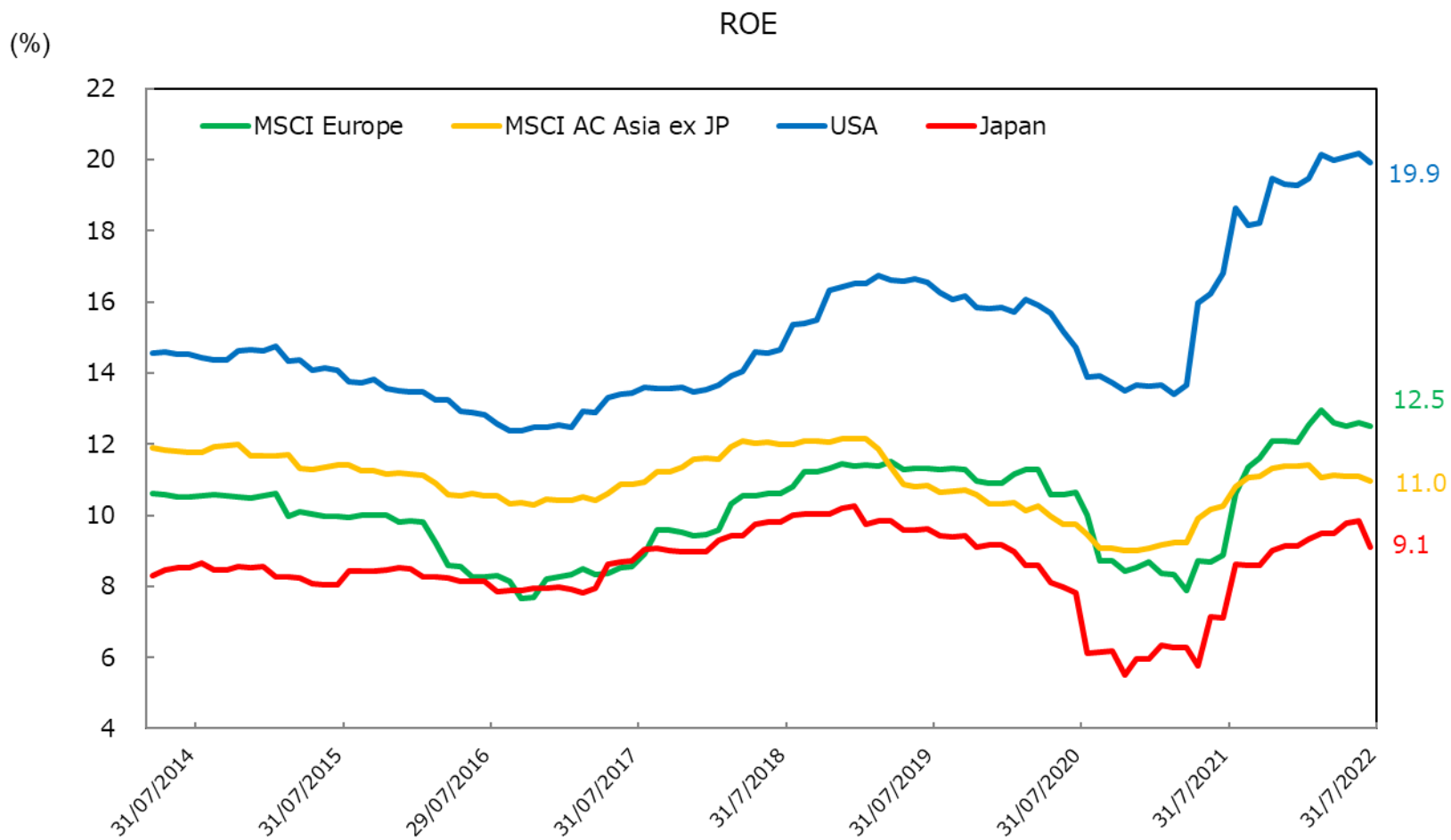
Rebound of growth stocks push US PBR higher



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

(DD/MM/YYYY)

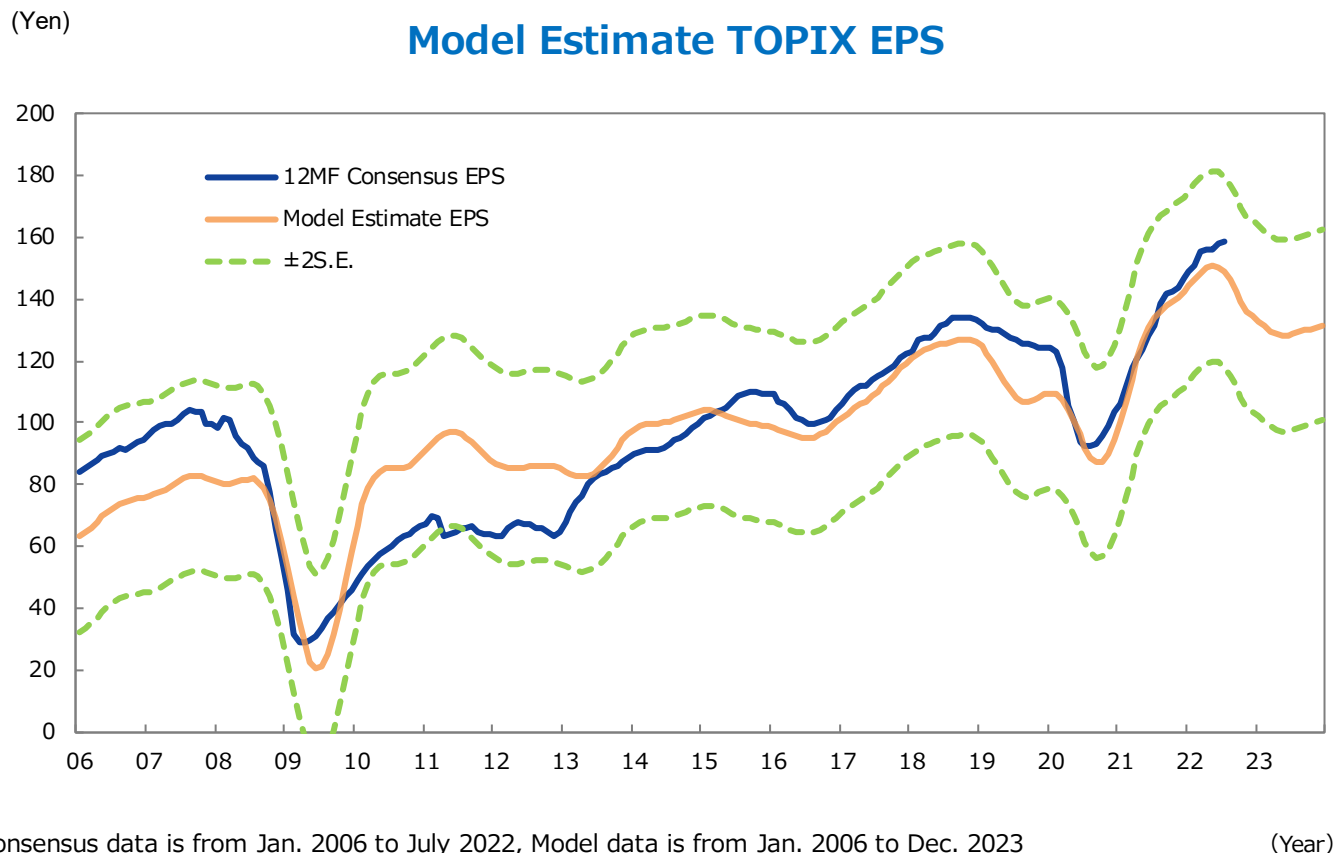
Japan's ROE dip before reaching double digits



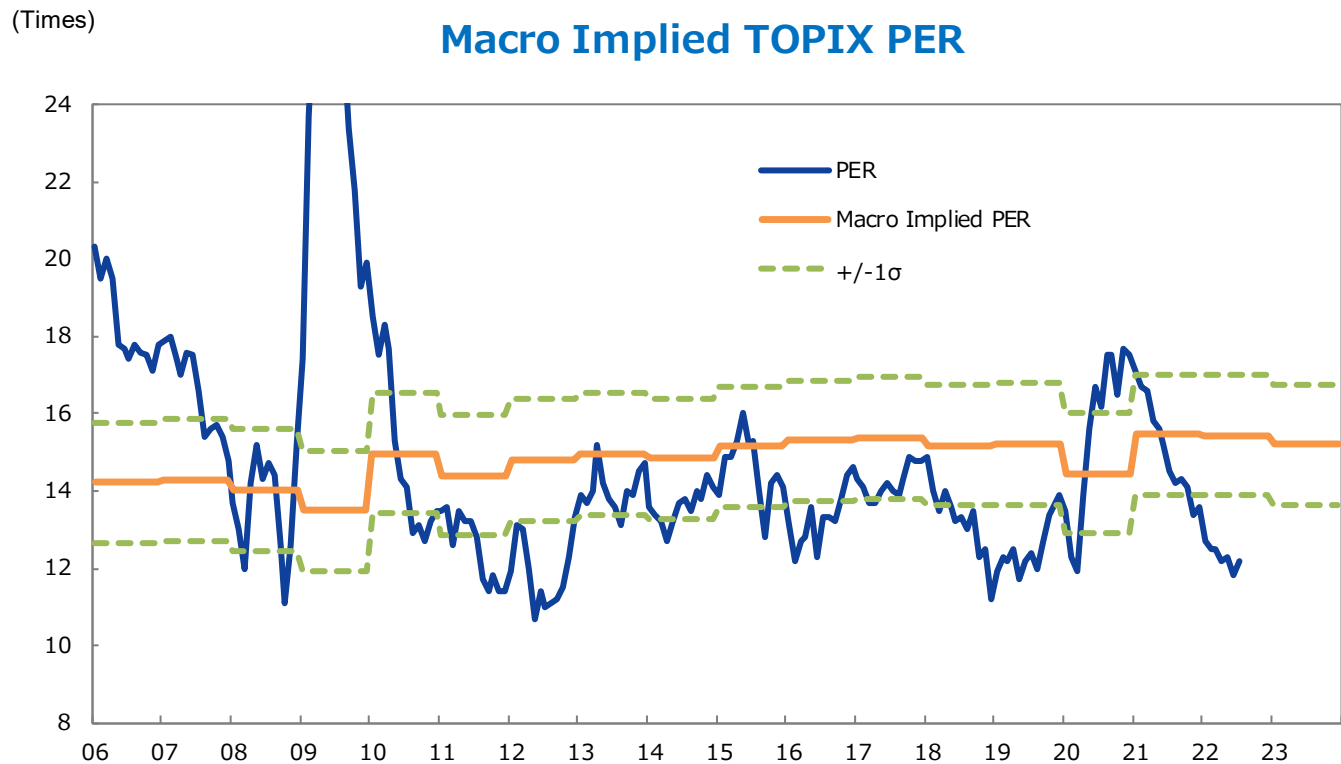
Data is from Apr. 30th 2014 to July 31st 2022
 (Source) MSCI

(DD/MM/YYYY)

EPS forecast remains stronger than macro model estimate



PER hits rock bottom far below normal range

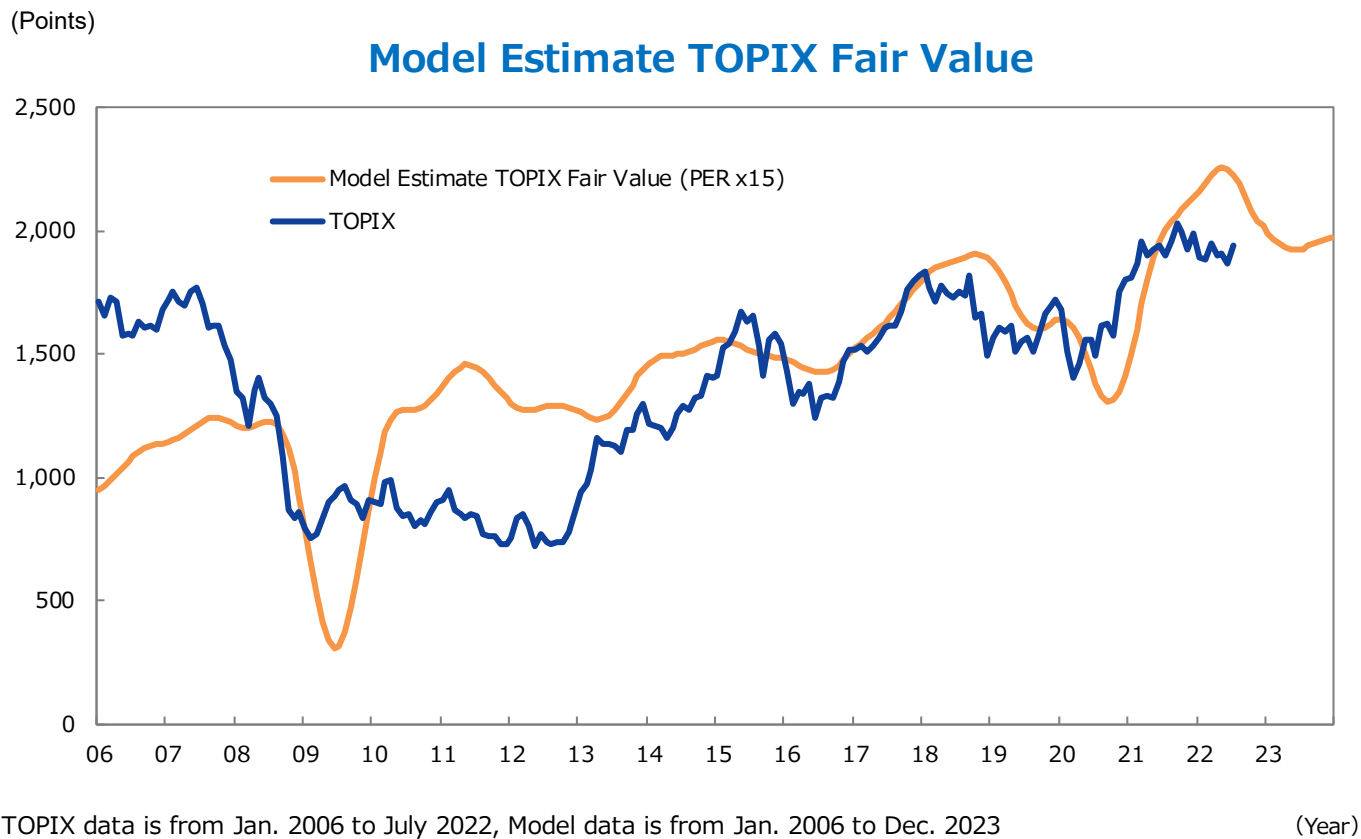


Consensus data is from Jan. 2006 to July 2022, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

Narrowing gap between fair value and market price

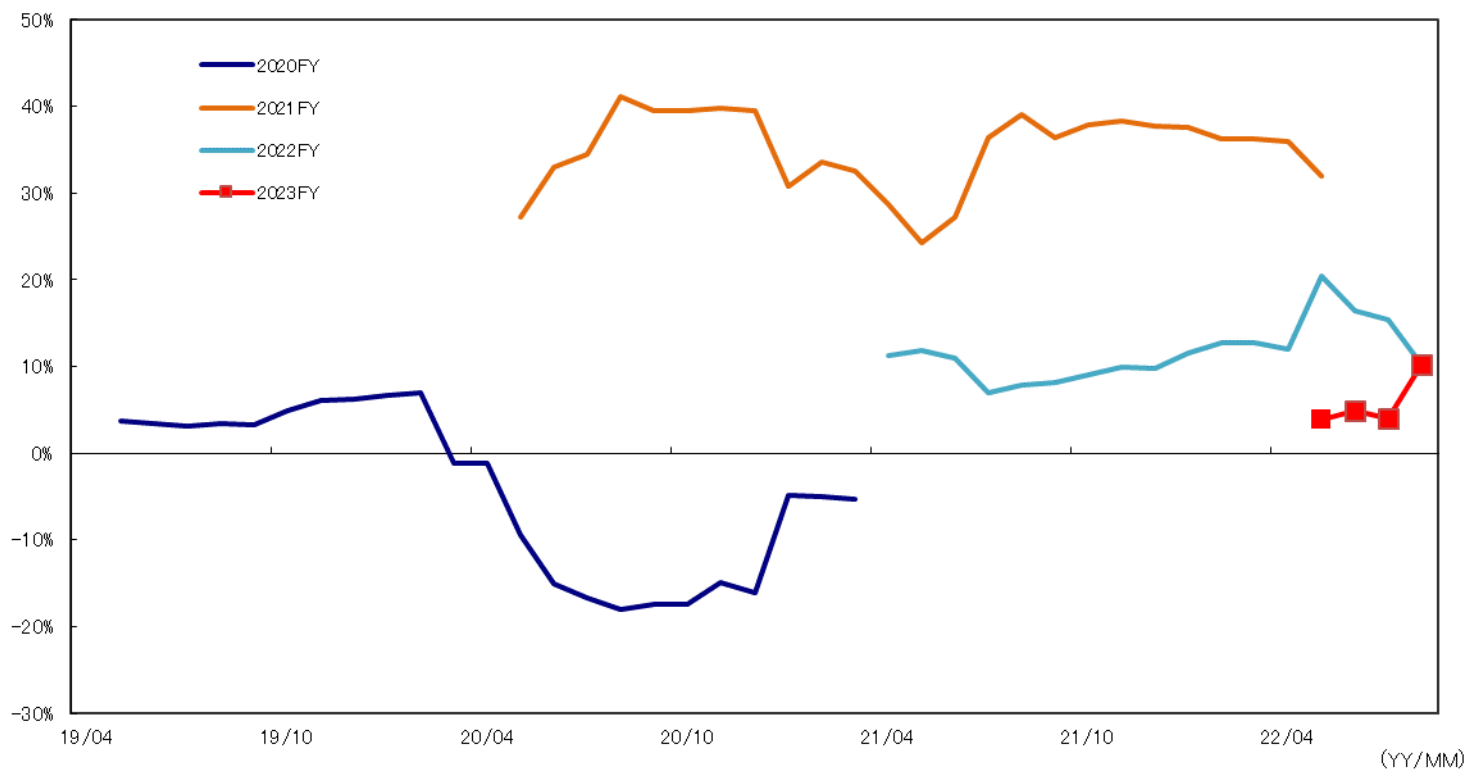


TOPIX data is from Jan. 2006 to July 2022, Model data is from Jan. 2006 to Dec. 2023

(Source) SMDAM

Part of earnings recovery postponed to next year

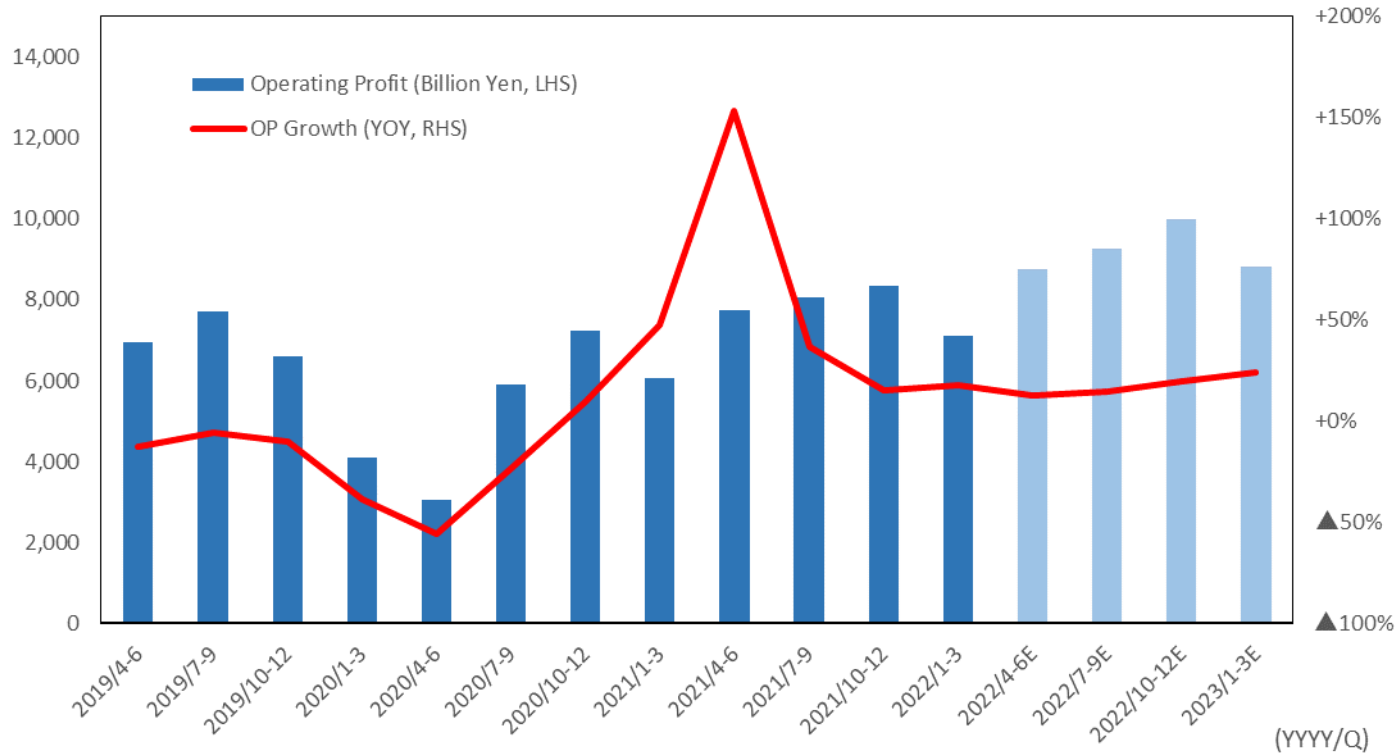
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



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

Bottom up operating earnings forecast 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	202
Insurance companies	24
Pension funds	79
Others	11
Total	322

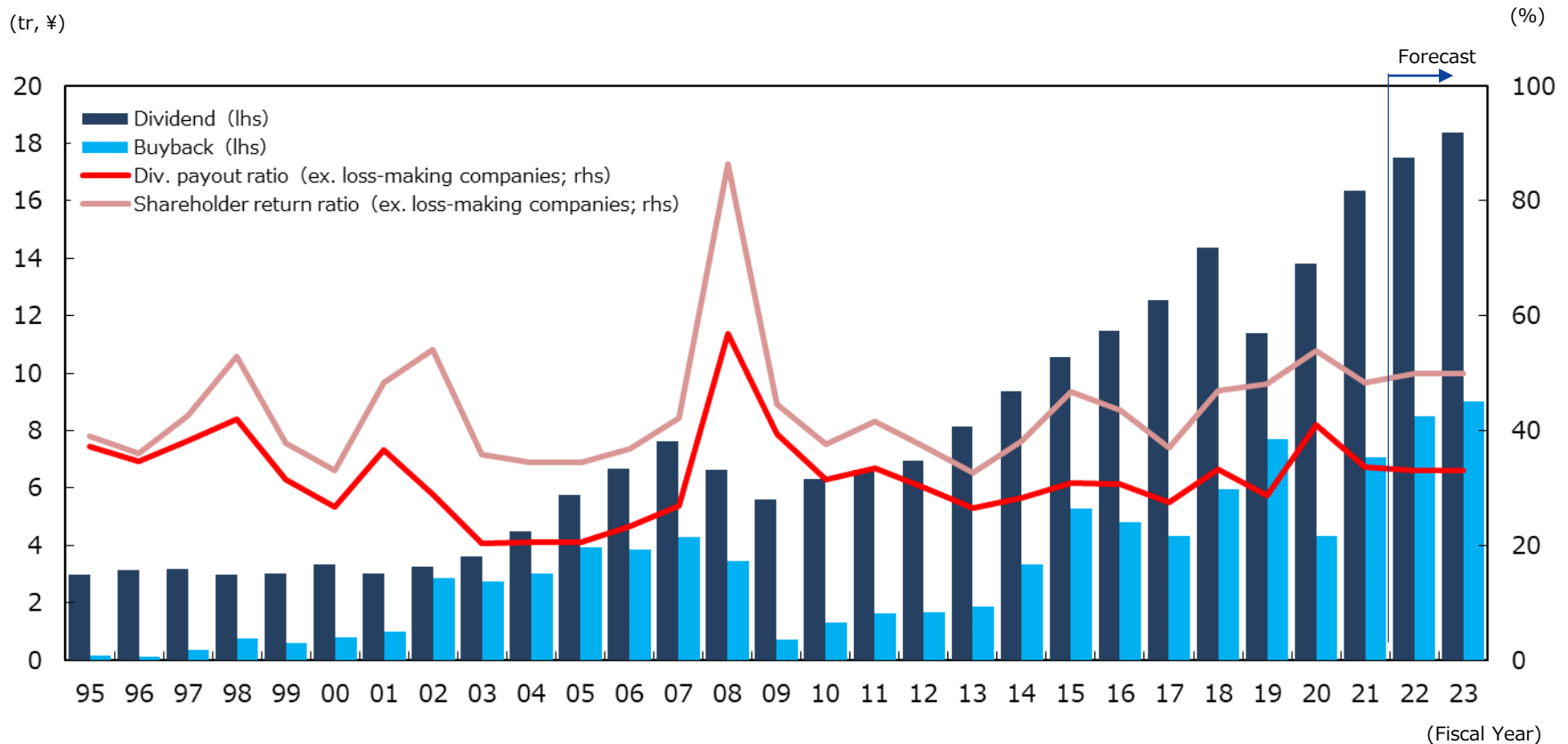
note: As of July 31st 2022

(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.

Dividends and buybacks breaking historical highs

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

Big swing to “small growth” from “large value”

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	3.91	4.96	-1.40	2.81	22.86	31.75	24.06
Total Value	3.60	4.96	7.19	10.58	33.85	29.78	16.34
Top Cap Value	2.12	4.41	7.73	12.64	40.72	39.20	30.51
Large Cap Value	2.90	4.85	8.03	11.87	36.34	31.34	19.73
Mid Cap Value	3.92	5.43	8.41	10.94	31.13	20.86	5.49
Small Cap Value	6.68	5.40	3.84	4.97	23.07	22.94	2.05
Micro Cap Value	7.04	5.49	1.41	5.68	20.79	20.92	1.18
Total Growth	4.26	4.97	-9.25	-4.11	12.34	31.87	30.49
Top Cap Growth	2.51	3.70	-11.09	-3.43	16.39	35.85	36.76
Large Cap Growth	4.09	4.63	-9.73	-4.05	13.17	33.95	32.39
Mid Cap Growth	7.05	6.35	-7.19	-5.01	8.16	30.87	25.75
Small Cap Growth	5.64	7.86	-4.96	-4.96	4.85	15.25	14.27
Micro Cap Growth	6.72	10.32	-7.47	-5.24	4.63	15.89	15.30
Top Cap Total	2.33	4.03	-3.28	3.20	26.63	36.88	33.08
Large Cap Total	3.50	4.74	-1.76	3.03	23.88	33.57	26.95
Mid Cap Total	5.33	5.85	0.66	2.89	20.18	29.11	18.48
Small Cap Total	6.33	6.22	0.69	1.14	16.29	20.73	7.87
Micro Cap Total	6.95	6.83	-1.27	2.20	15.70	20.16	7.68

Note : As of Aug. 23rd 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** Though inflation and the increasing number of COVID-19 cases weighs on the economy, resilient consumer spending, stable CAPEX, and recovery of industrial production buoyed economic activities.
- **Inflation is on an upward trend.** Food and energy are major contributors to rising CPI.

[Outlook]

- ① **We have not changed our real GDP growth forecast for FY 2022 at +1.5% and for FY 2023 at +0.7%.** We expect the Japanese economy will continue its recovery in H2 of 2022 thanks to the “re-opening” of the economy from restrictions related to the COVID-19 pandemic, rising CAPEX, and the resumption of automobile productions. We foresee a slow down in economic growth in 2023 owing to the negative impact from sluggishness in the US and other foreign economies.
- ② **We have slightly raised Core CPI forecast for FY 2022 to +2.3% from +2.2% and maintained for FY 2023 at +1.0%.** We have raised our forecast for 2022 due to rising gas prices. While core CPI could accelerate to get closer to 3% in H2 of 2022, it could slow down on/after 2023 thanks to falling energy costs and slowing economy.
- ③ **We expect PM Kishida to maintain his economic policy to boost the economy.** A supplementary budget is likely to be drawn up during the extraordinary session of the Diet in the coming fall. Economic stimulus is expected to be worth 15 trillion yen. However, since the recent reshuffle of cabinet members failed to improve his approval rate, political pressure from the ruling LDP for additional economic measures may intensify if the fall in his approval rate continues. On the other hand, in the long run, PM Kishida and his administration may shift their priority from the economy to fiscal consolidation.
- ④ **We expect the Bank of Japan to maintain its accommodative monetary policy, even after the end of Governor Kuroda’s term in April 2023.** The BOJ regards salary increases as key to the stability and sustainability of healthy/mild inflation and it’s reasonable to continue easy monetary policy to protect the economy. Negative impact from sluggishness in the global economy may also justify the current accommodative monetary policy of the BOJ going forward.

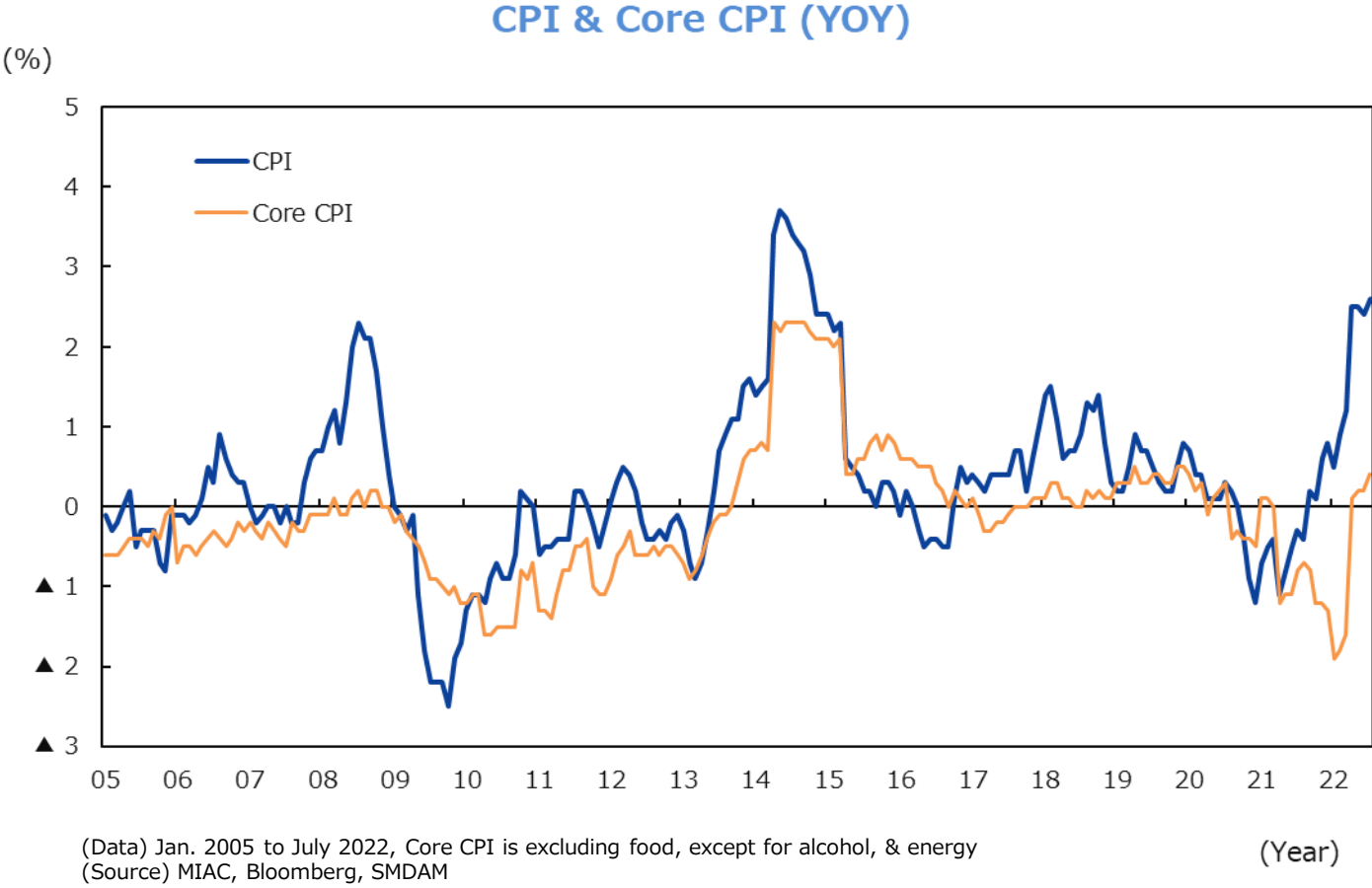
Forecast table for the Japanese economy

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%	1.5%	0.7%
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.4%	2.6%	2.4%	0.9%
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-1.6%	-3.9%	-0.6%
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	0.8%	2.6%	1.0%
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-9.4%	-3.3%	0.5%
Net export contribution	0.4%	-0.2%	-0.5%	-0.6%	0.8%	-0.3%	-0.2%
Exports of goods and services	6.3%	2.0%	-2.3%	-10.2%	12.5%	1.7%	-1.0%
Imports of goods and services	3.8%	3.0%	0.2%	-6.5%	7.2%	3.3%	0.0%
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.2%	1.6%	1.3%
GDP deflator	0.2%	-0.1%	0.8%	0.6%	-1.0%	0.1%	0.6%
Industrial Production Index	2.9%	0.3%	-3.7%	-10.0%	5.9%	-0.2%	0.7%
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	2.3%	1.0%
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.5%	7.0%	6.5%	0.3%
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	1.9%	1.2%
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%
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.

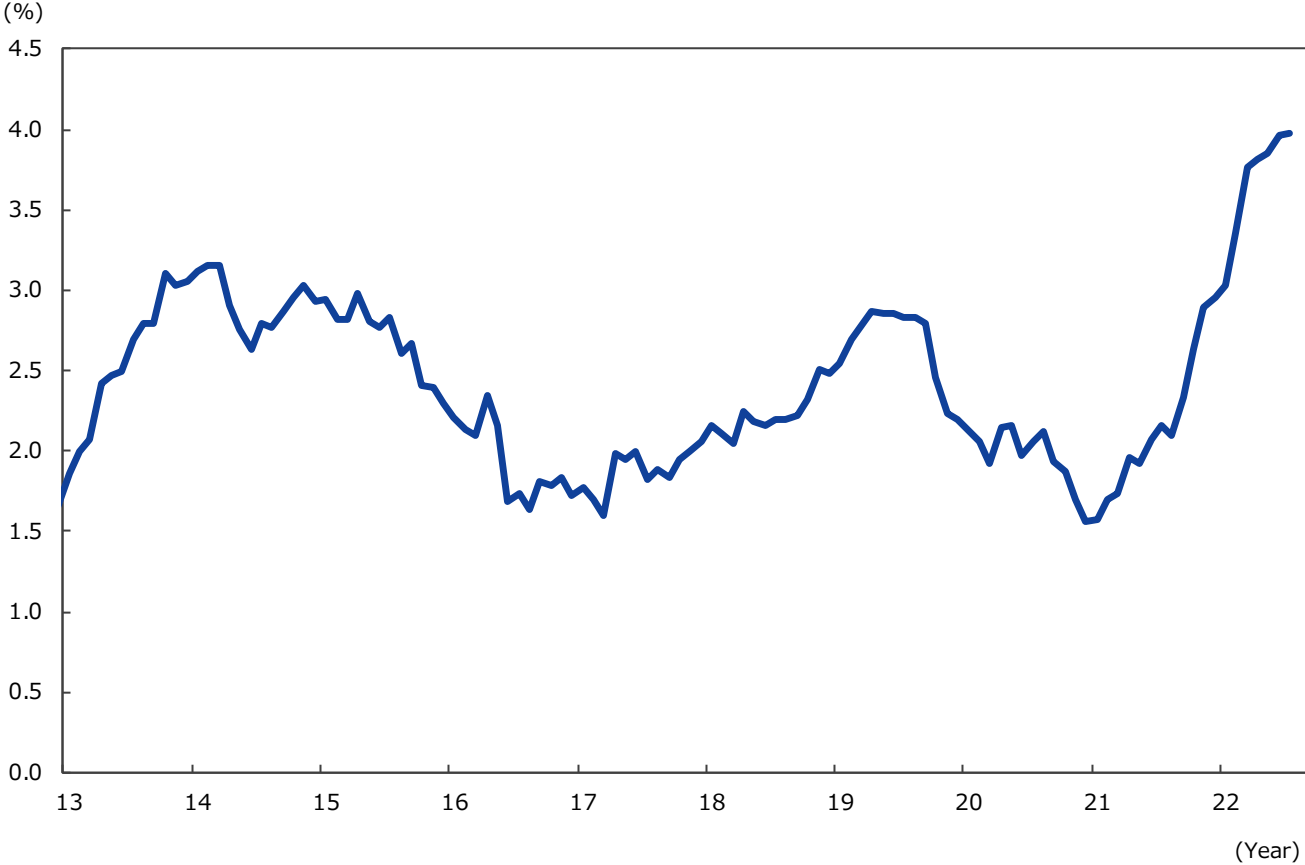
(Source) Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Finally inflation has come back to Japan



Consumers anticipate/ expect higher inflation ahead

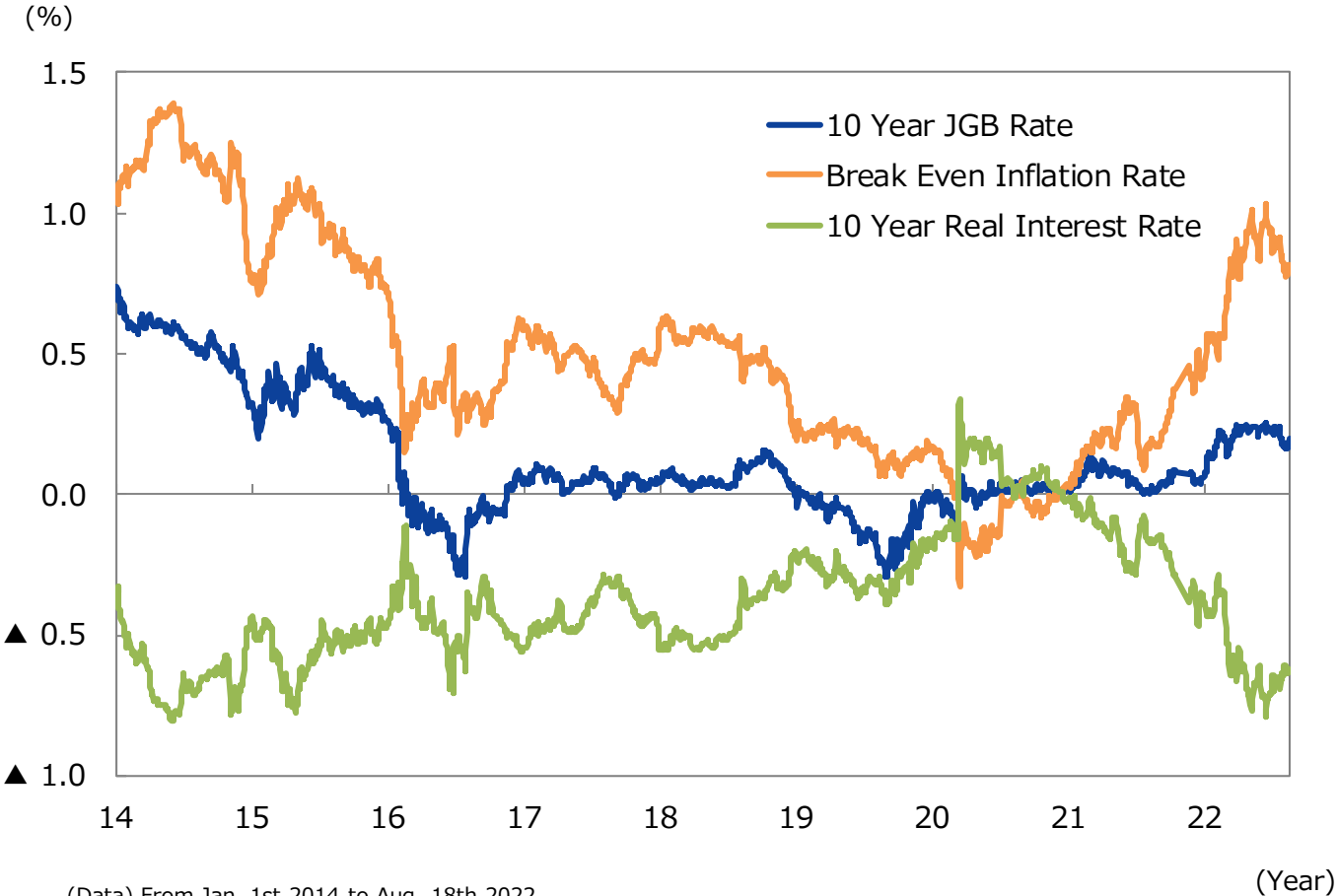
Consumers' Expectation of Inflation Rate (YOY, %)



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

Real interest rate rebound due to slide of BEI

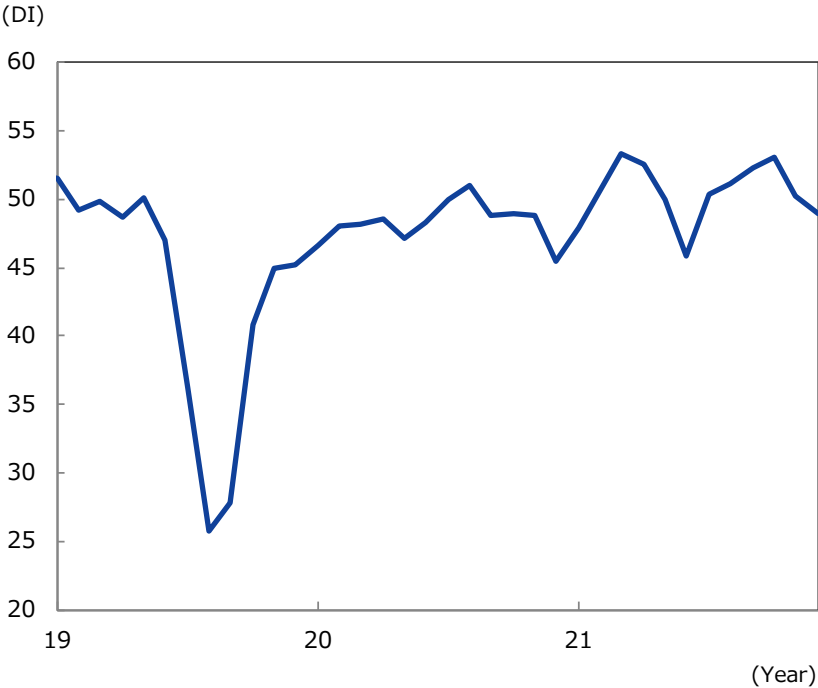
JGB, BEI, and Real Interest rate



(Data) From Jan. 1st 2014 to Aug. 18th 2022
(Source) Bloomberg, SMDAM

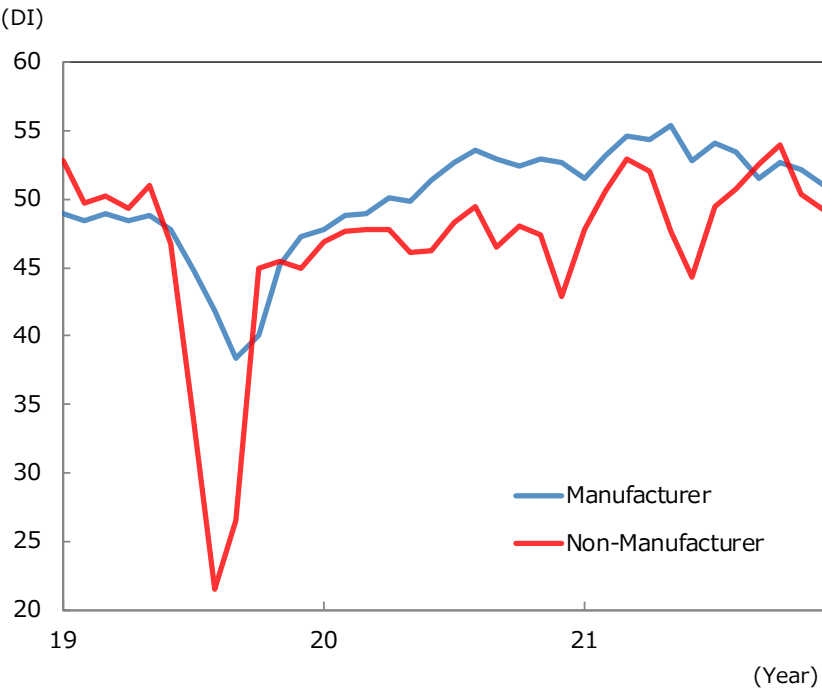
Concern for global economy weighs on business sentiment

Composite PMI



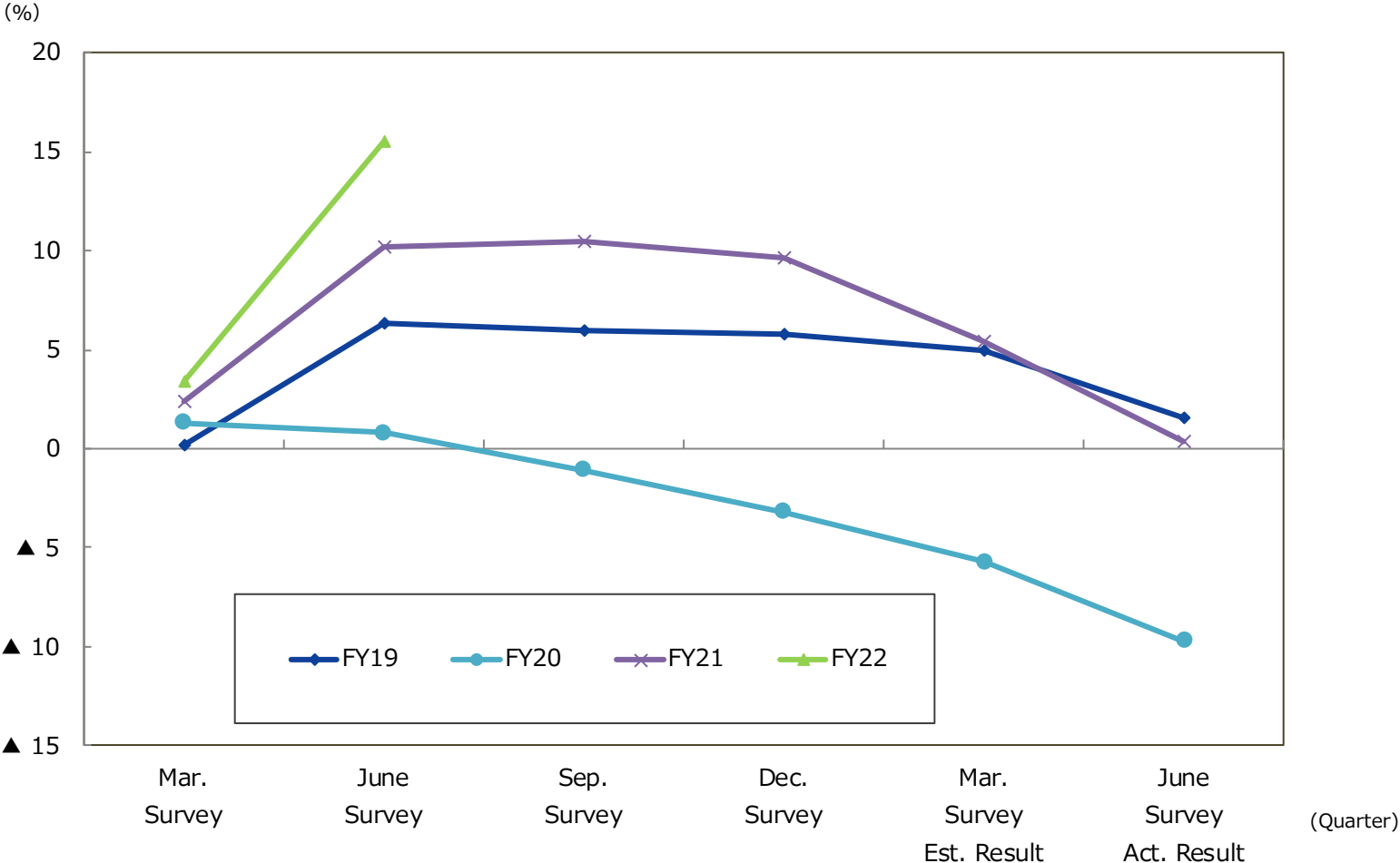
(Data) From Sep. 2019 to Aug. 2022
(Source) Bloomberg, SMDAM

PMI, Manufacturer & Non-Manufacturer



Re-opening of the economy boosts plan of CAPEX

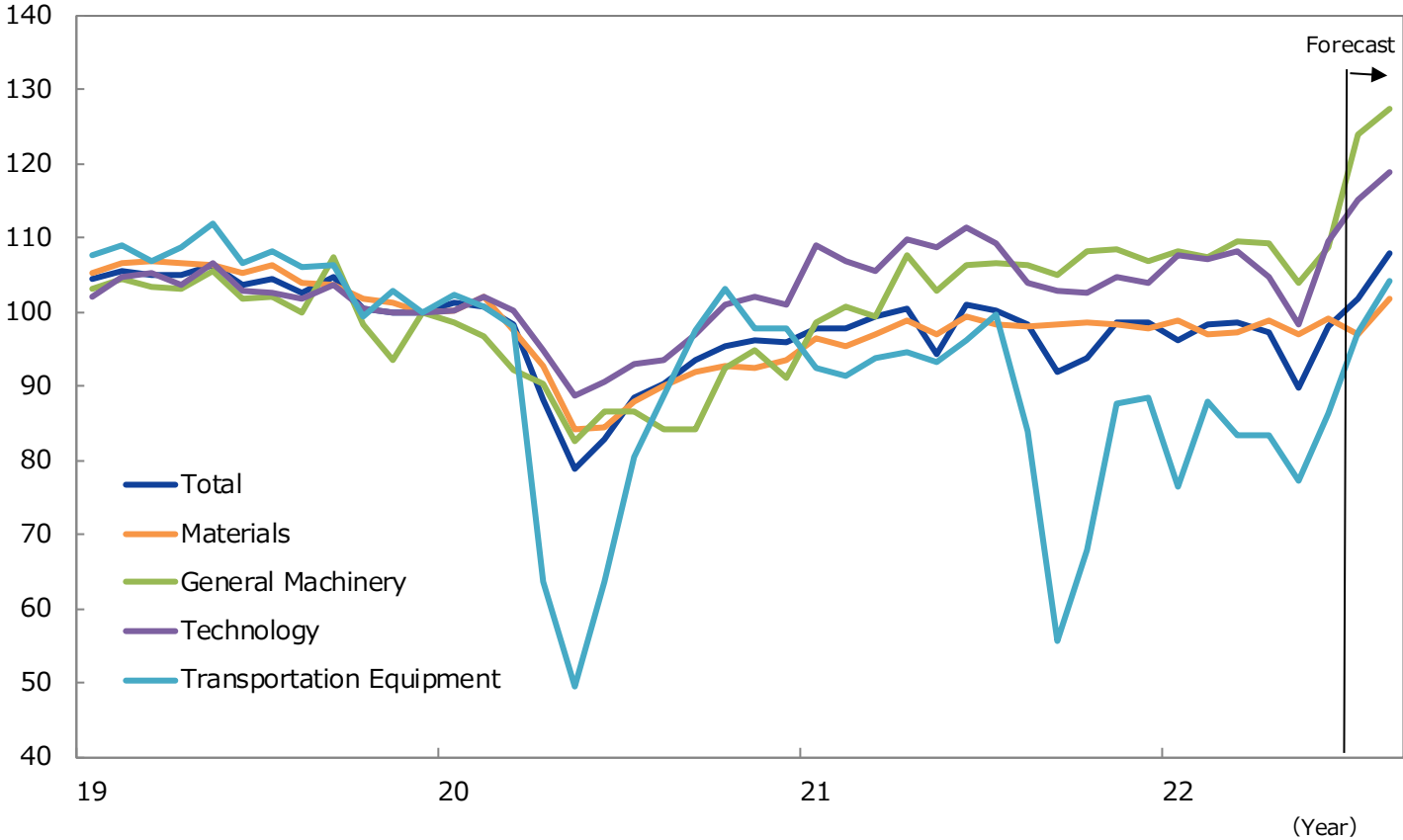
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



(Data) Data is from Q1 FY 2019 to Q2 FY 2022
 (Source) The Bank of Japan, SMDAM

Re-opening of the economy boosting industrial production

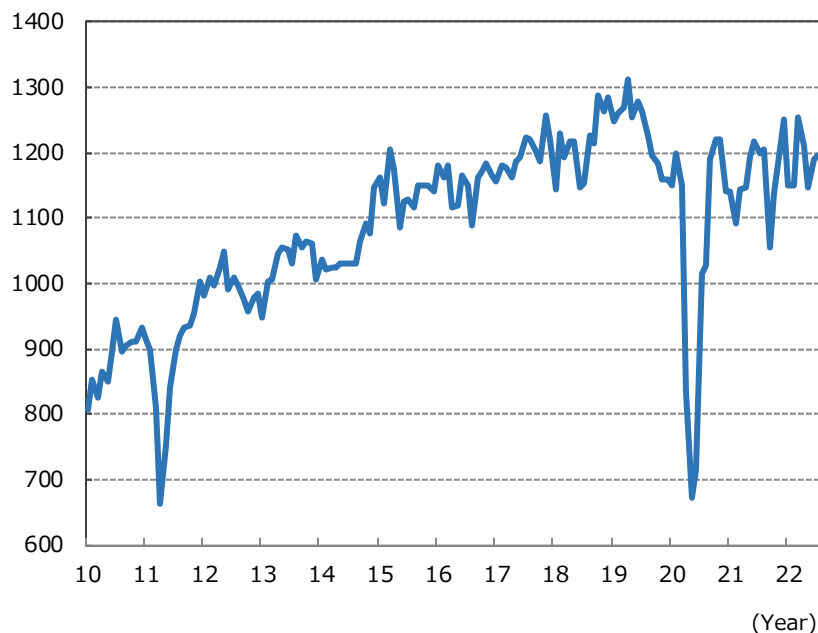
Industrial Production (Dec. 2019=100)



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

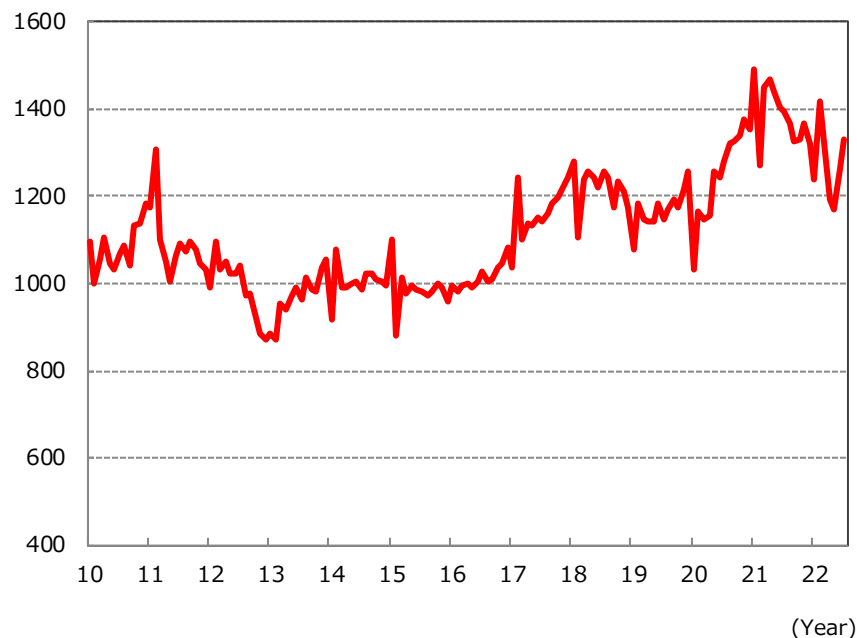
Japan's export to China rebound after re-opening of Shanghai

Real Export to US (SA, Billion Yen)



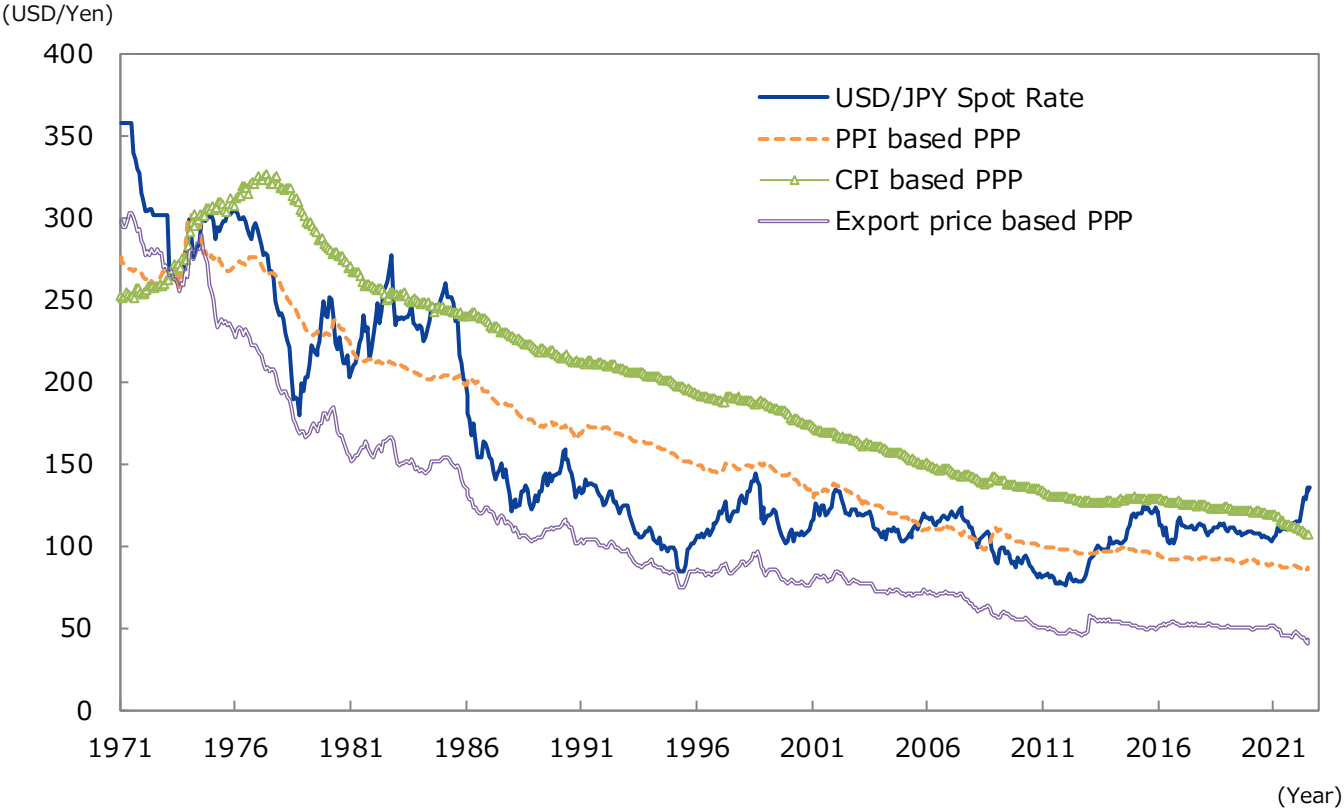
(Data) From Jan. 2010 to July 2022.
(Source) MOF, Bank of Japan, SMDAM

Real Export to China (SA, Billion Yen)



USD/JPY exchange rate breaks 30+ years resistance of PPP

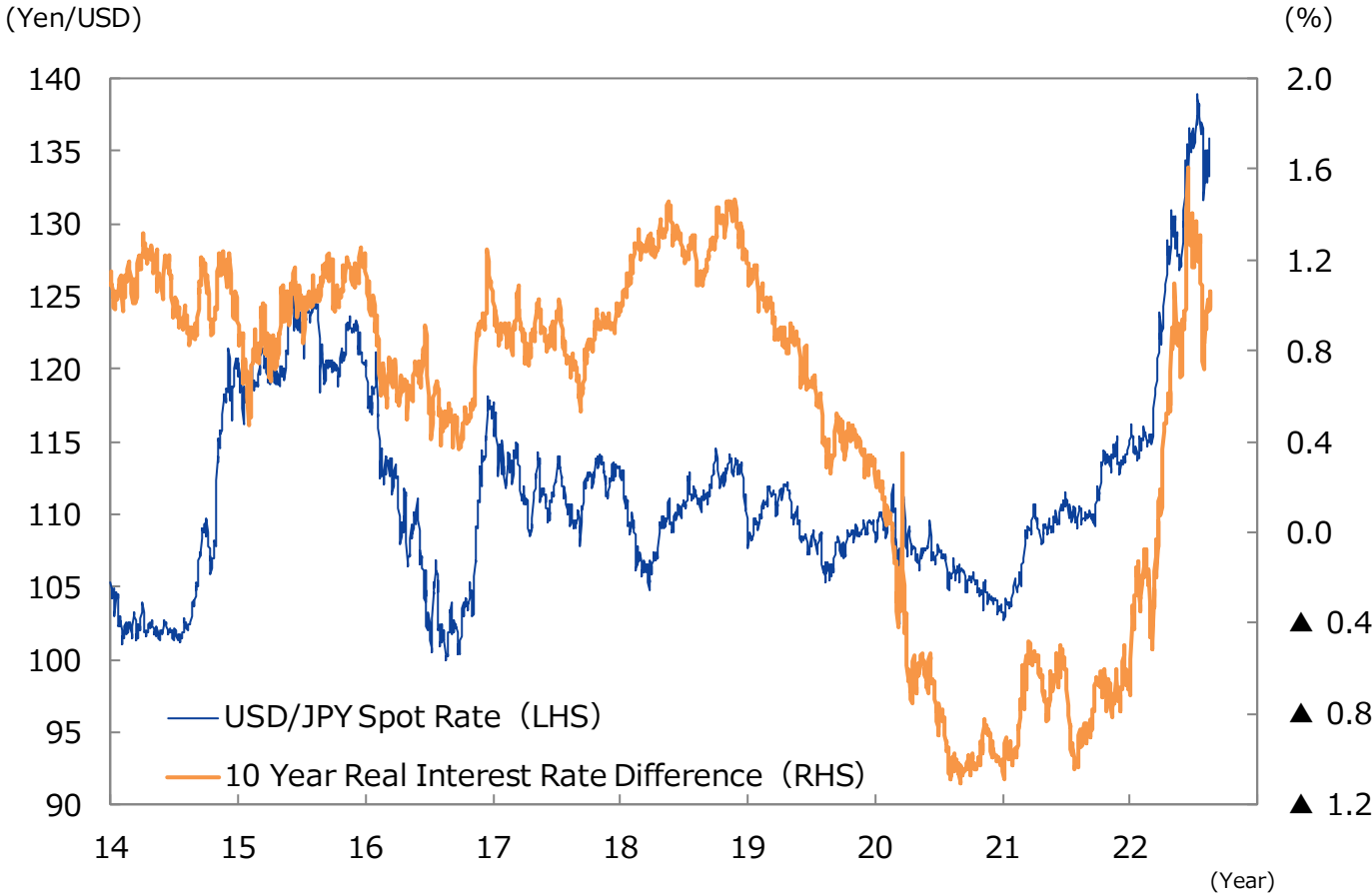
Purchasing Power Parity of USD/JPY Rate



(Data) Data is from Jan. 1971 to July 2022.
(Source) DOL, Bank of Japan, SMDAM

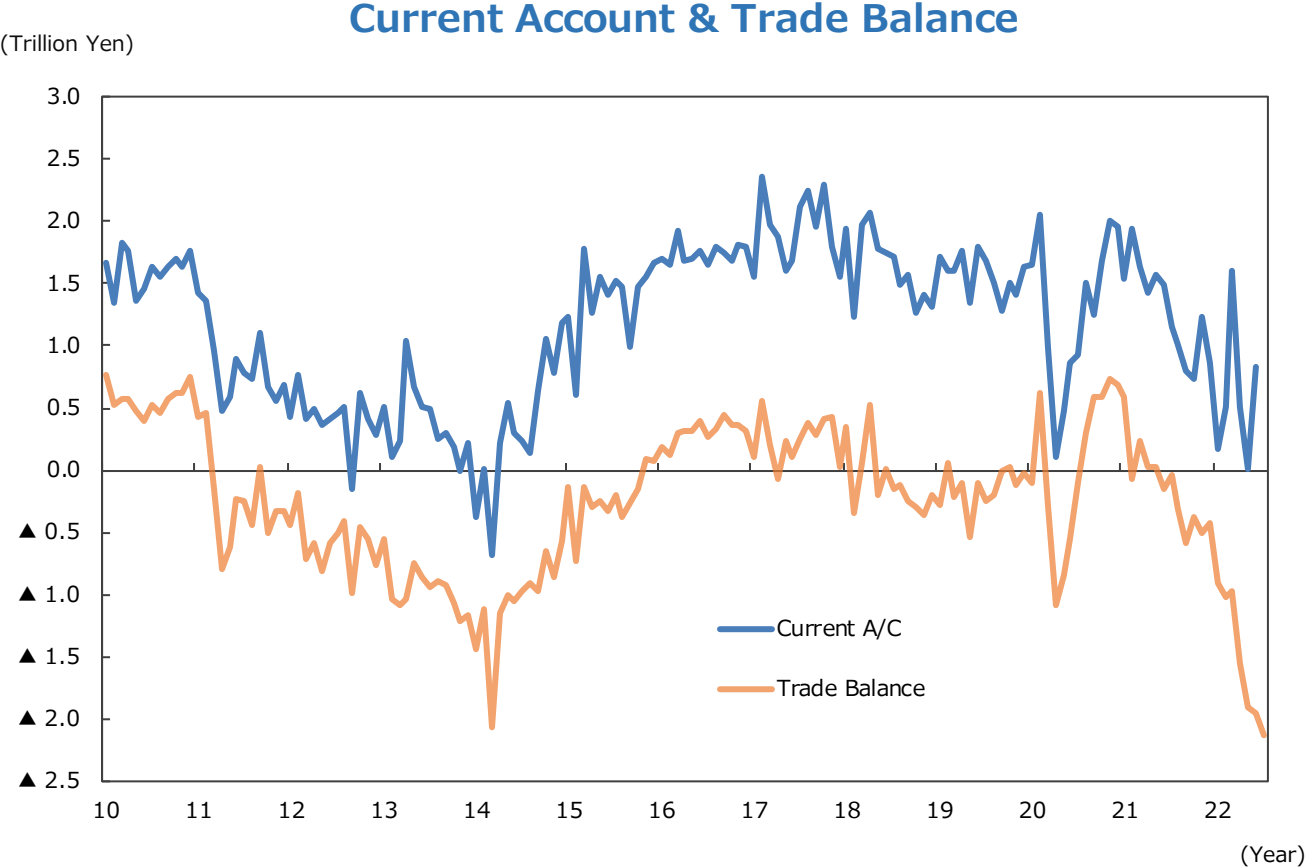
USD/JPY rate stop rising as interest rate gap narrows

Real Interest Rate Gap & USD/JPY Exchange rate



(Data) From Jan. 1st 2014 to Aug. 18th 2022.
(Source) Bloomberg, SMDAM

Rising energy price brought huge trade deficit



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

Japan's marginal exposure to Russian business

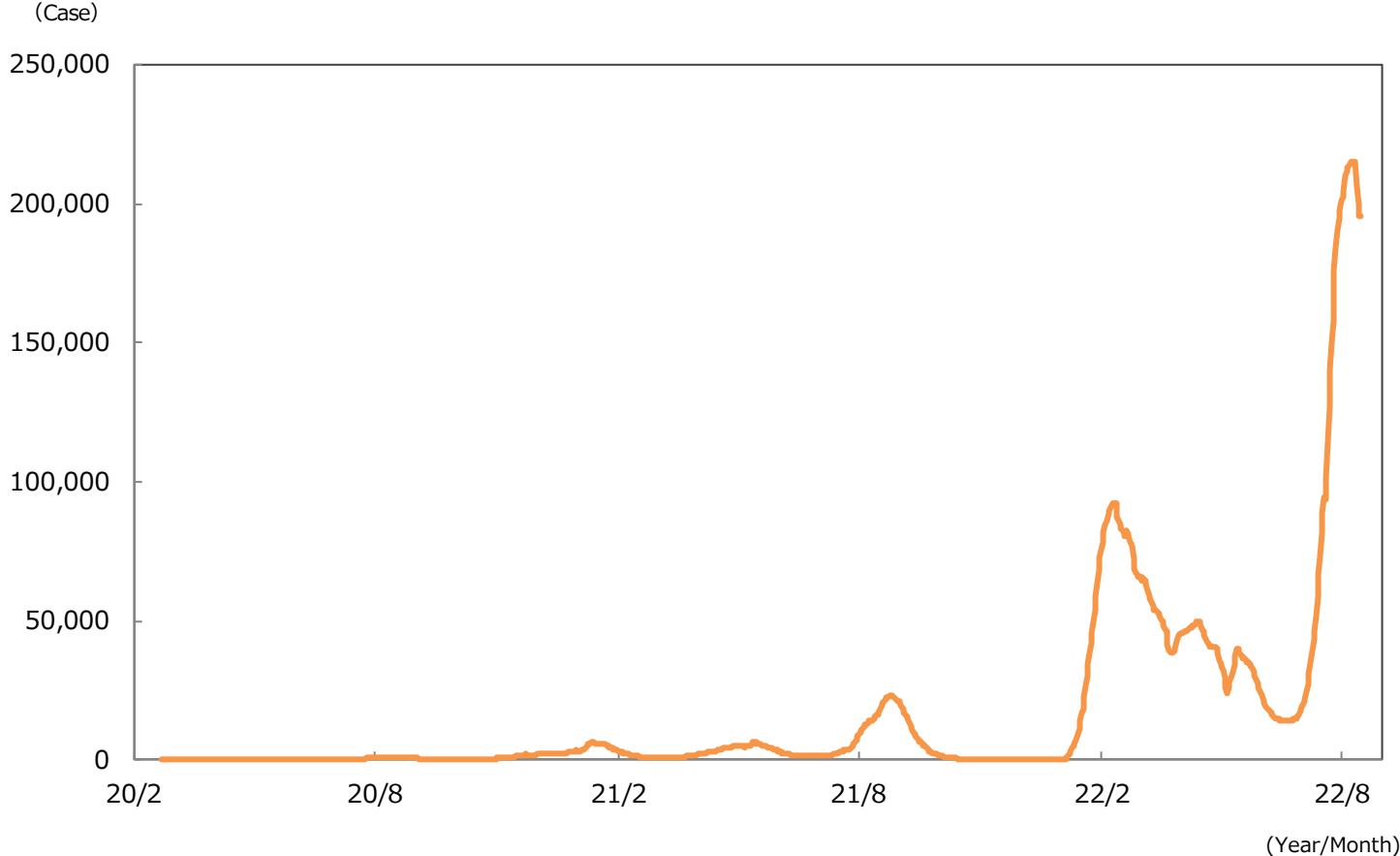
Trade Exposure to Russia (%)

	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 in Japan reaches the highest in the world

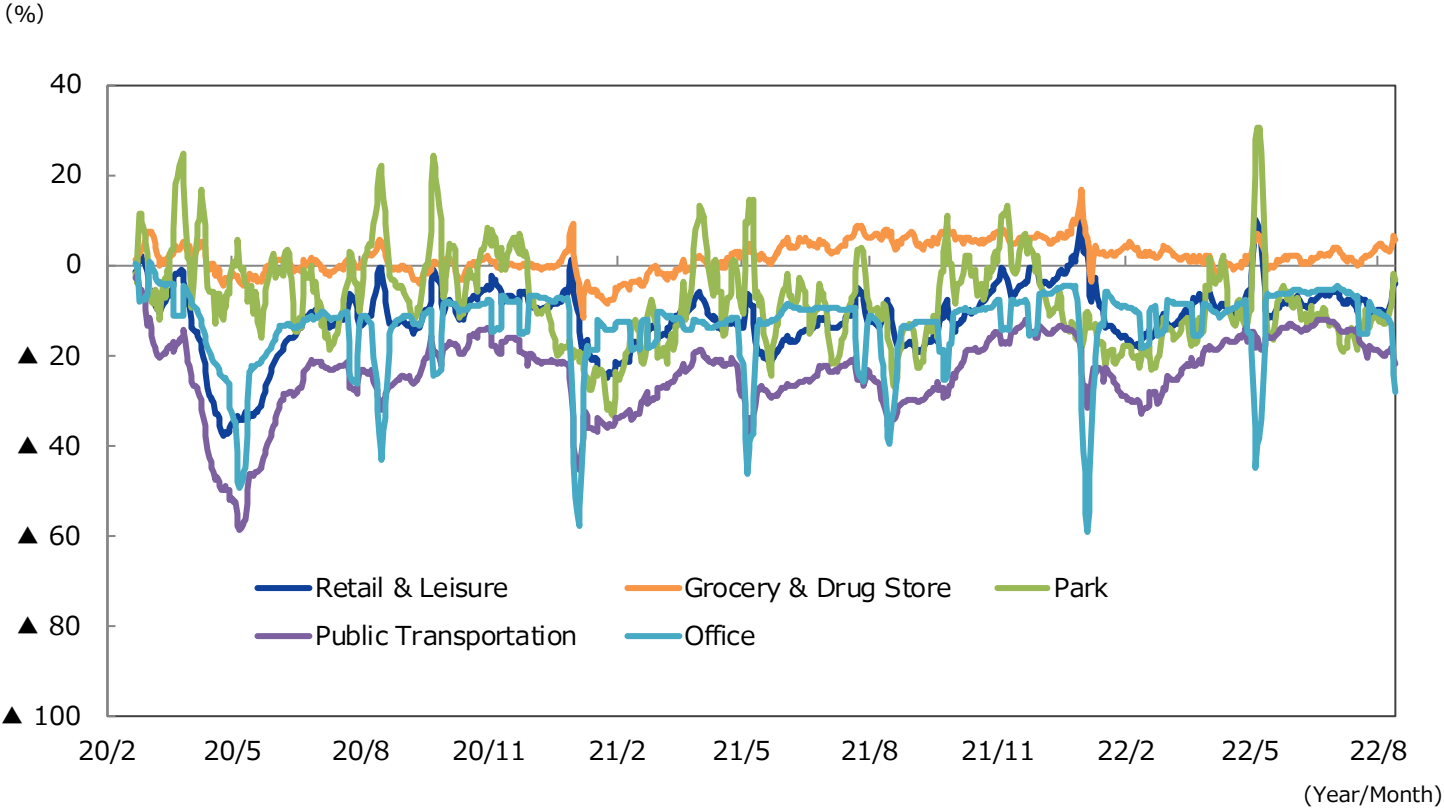
COVID-19 New Cases



(Data) 7 days moving average. From Feb. 21st 2020 to Aug. 15th 2022.
(Source) MHLW, NHK, SMDAM

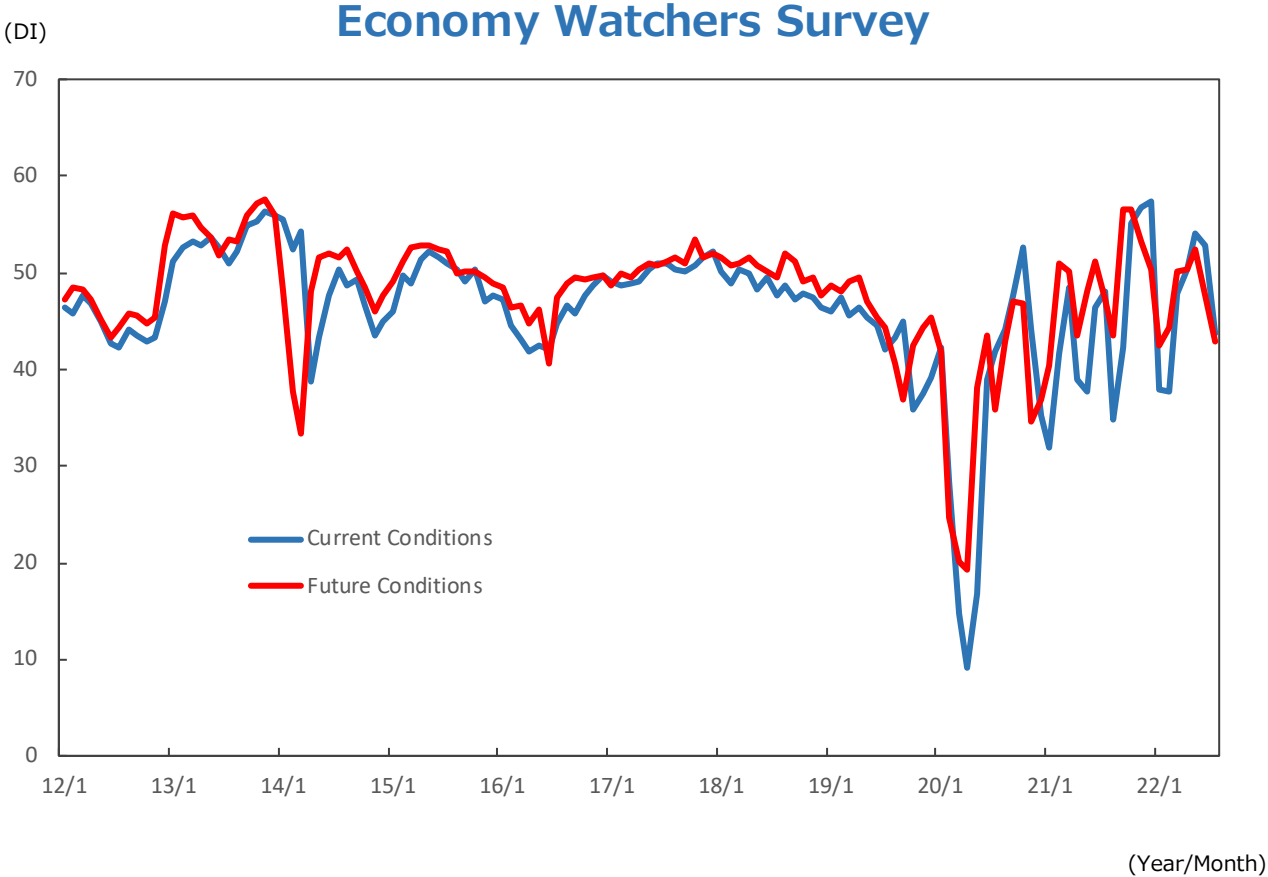
Mobility stabilizes while office data slides due to holiday season

Google Community Mobility Report, Japan



(Data) 7 Days moving average, From Feb. 21st 2020 to Aug. 13th 2022
(Source) Google, SMDAM

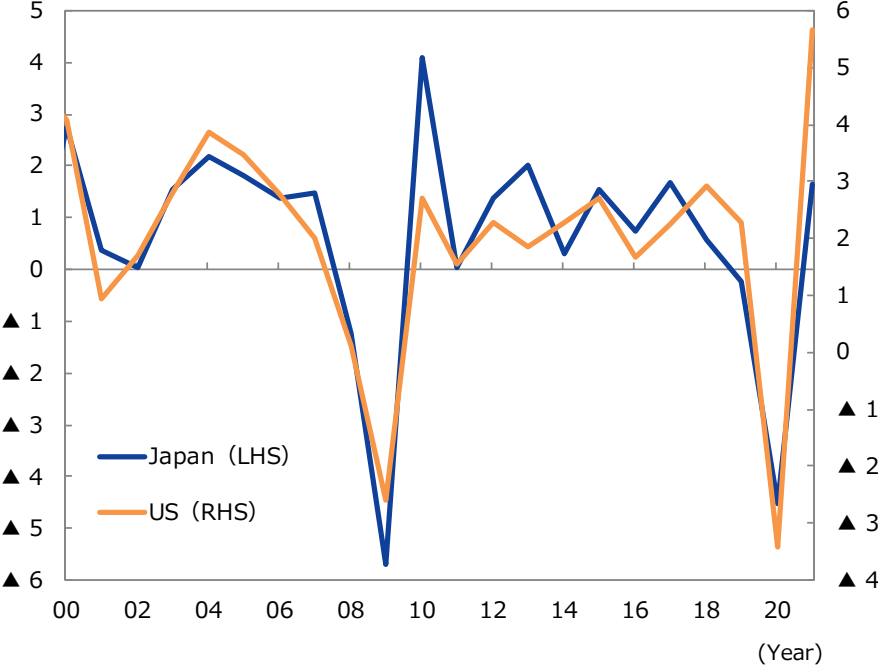
Inflation and COVID-19 infections drag down consumer activities



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

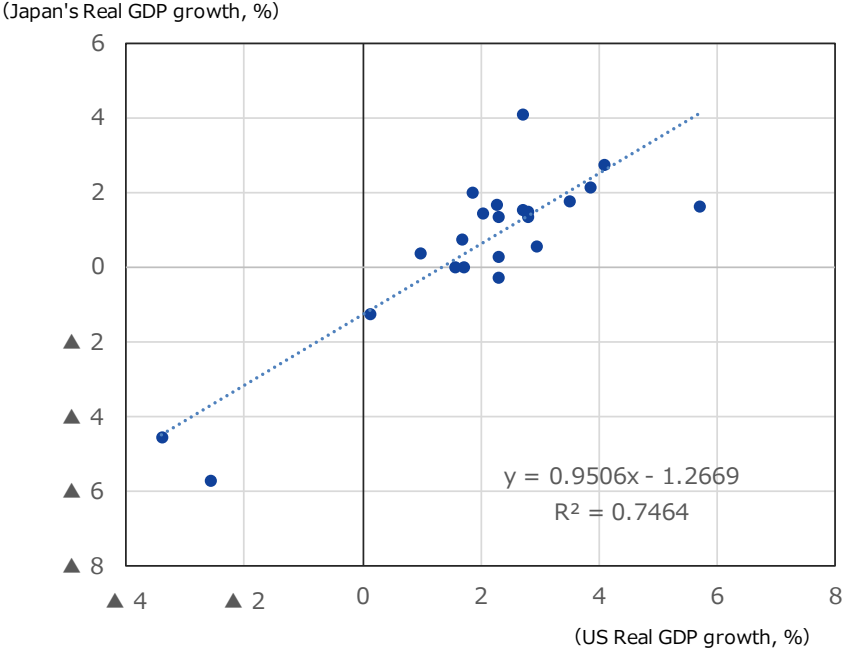
Strong correlation of GDP growth between US and Japan

Real GDP Growth (YOY, %)



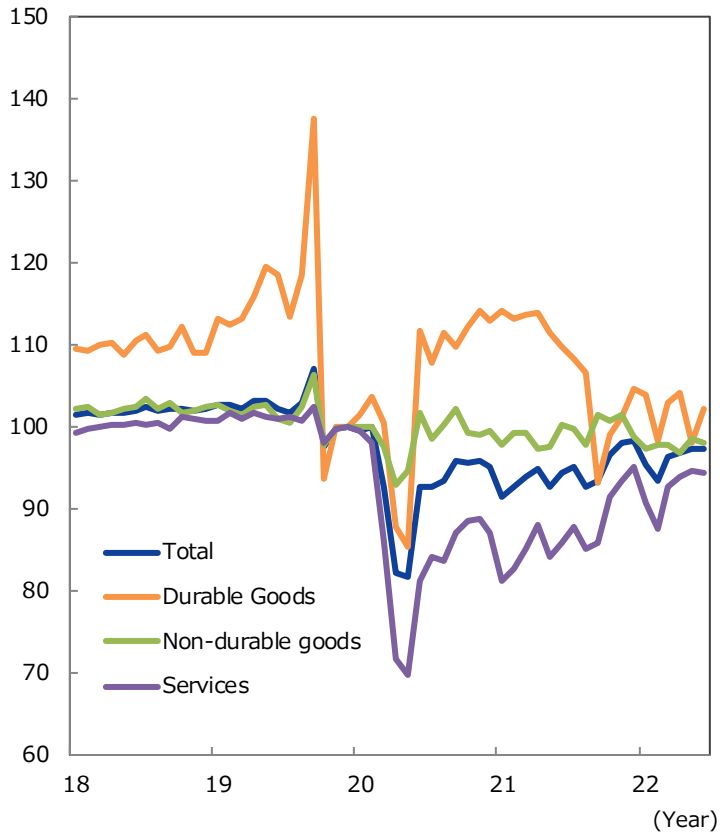
(Data) From 2000 to 2021
 (Source) IMF, SMDAM

Correlation of Real GDP Growth

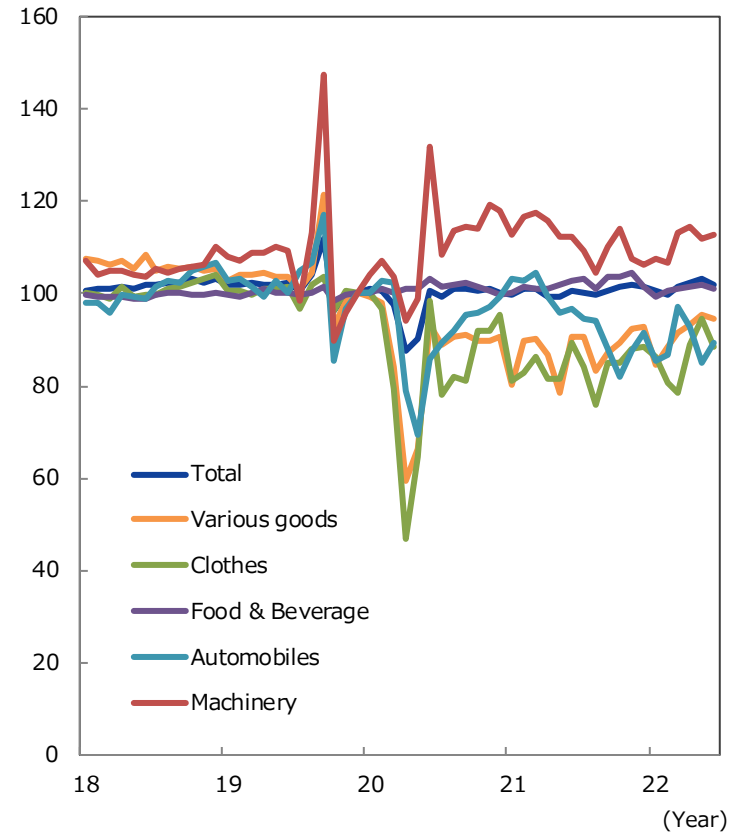


Auto and clothes sales struggle to recover

Consumer Activity Index (Dec. 2019 = 100)



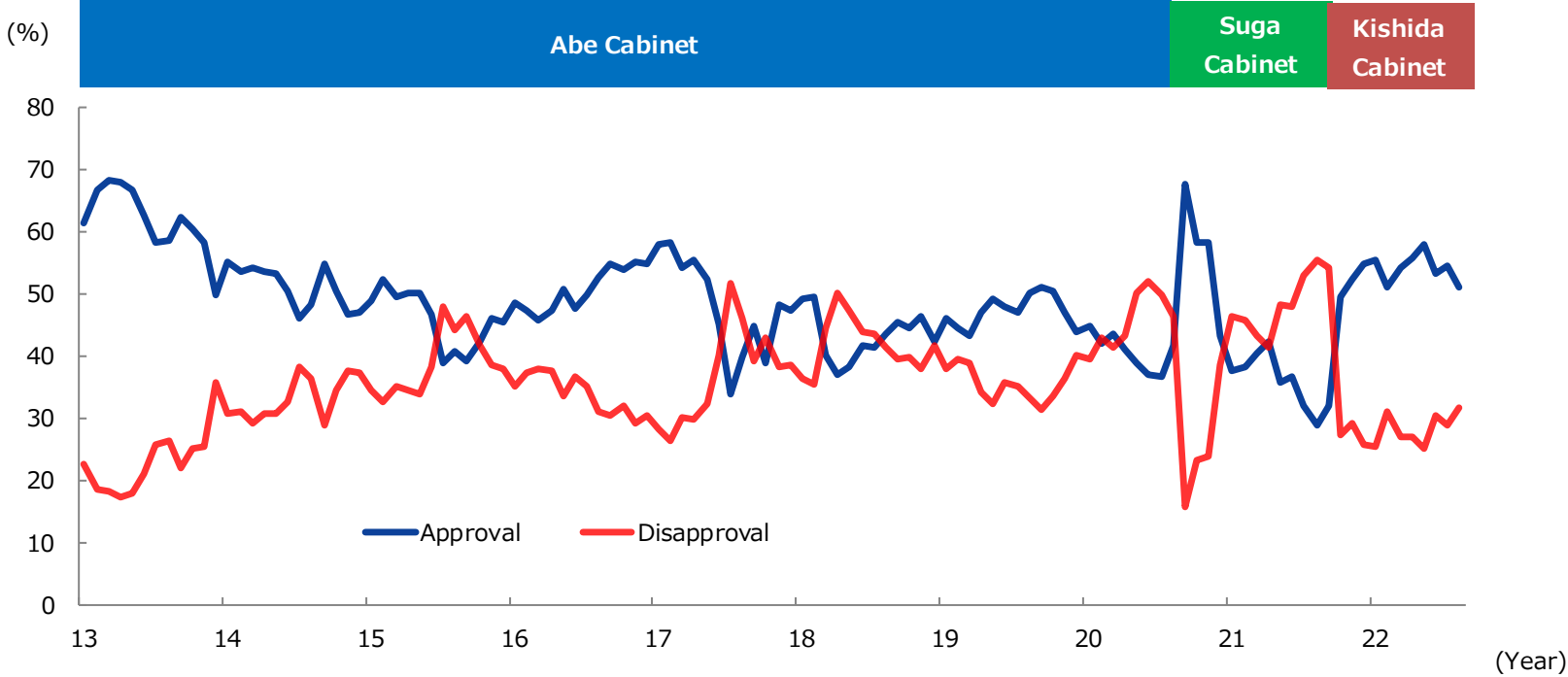
Retail Sales (Dec. 2019 = 100)



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

“Unification Church” issue a serious/grave blow to PM Kishida and LDP

Cabinet approval rate



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

Schedule of major events

Schedule of Major Domestic Events			
2022	September	8	Revision of CY 2022 Q2 GDP
		21-22	Monetary Policy Meeting
		27	State funeral for former Prime Minister Abe
	October	27-28	Monetary Policy Meeting
		30	G20 Summit in Indonesia
	November	15	Release of CY 2022 Q3 GDP
2022	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
2023	January	17-18	Monetary Policy Meeting Convocation of the ordinary diet
	February	14	Release of CY 2022 Q4 GDP
	March	9	Revision of CY 2022 Q4 GDP
		9-10	Monetary Policy Meeting
		19	Term expiration of the BOJ vice governor Amemiya and Wakatabe Enactment of the budget and tax reform bill of FY 2023
	April	8	Term expiration of the BOJ governor Kuroda
		27-28	Monetary Policy Meeting Nationwide local elections
May	19-21	G7 Summit in Japan	
June	15-16	Monetary Policy Meeting Big-boned policy decisions End of the ordinary Diet session	

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

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