



Japanese Stock Market Outlook

SMAM monthly comments & views

~ October 2014 ~



Sumitomo Mitsui Asset Management

Executive summary

➤ Japan's Economy

Private consumption recovery in Jul-Sep quarter is expected weaker than initial forecasts, for which extremely cold and rainy weather is partly blamed. Nominal wage increase seems to be strengthening and consumer sentiment is holding well so far.

- We reduced FY14 GDP growth forecast to +0.2% from +0.4% reflecting the downward revision made for Apr-Jun quarter. FY2015 forecast was maintained at +1.2%.
- BOJ is communicating more willingness to make additional easing in order to support the economy and also to support the decision for next consumption tax hike scheduled in Oct 2015. Abe government is going for another supplemental budget spending.

➤ Japan's Equity Markets

SMAM revised TOPIX forecast range slightly upward. Japanese stock market will be supported by positive corporate earnings, for which analysts' forecasts keep up-revised on the back of improving economy in US and China as well as rekindled weakness of JPY.

- Abe government is going to make another supplemental budget spending to avoid the economy to stall and BOJ seems more willing to make additional easing if necessary, which are favorable for the stock market.
- For longer-term, we continue to expect the markets to track on a modest uptrend, supported by US-led moderate global growth, solid corporate earnings growth and Japan's admittedly slow but steady reforms.

Outlook for the Japanese Economy

SMAM economic outlook for FY14-15

- We reduced FY14 GDP growth forecast to +0.2% from +0.4% reflecting the downward revision made for Apr-Jun quarter. FY2015 forecast was maintained at +1.2%.
- Private consumption recovery in Jul-Sep quarter is expected weaker than initial forecasts, for which extremely cold and rainy weather is partly blamed. Nominal wage increase seems to be strengthening and consumer sentiment is holding well so far.
- BOJ is communicating more willingness to make additional easing in order to support the economy and also to support the decision for next consumption tax hike scheduled in Oct 2015. Abe government is going for another supplemental budget spending.

(%YoY except Net Exports)

	FY11	FY12	FY13	FY14E	FY15E
Real GDP	0.3%	0.7%	2.3%	0.2%	1.2%
Private Consumption	1.4%	1.5%	2.5%	-2.4%	1.0%
Housing Construction	3.2%	5.4%	9.5%	-7.1%	2.1%
Private Capital Investment	4.8%	0.7%	2.7%	2.7%	2.7%
Public Consumption	1.2%	1.5%	1.8%	0.7%	0.9%
Public Investment	-3.2%	1.3%	15.1%	3.2%	-0.4%
Net Exports (contrib. to growth)	-1.0%	-0.8%	-0.5%	0.5%	0.2%
Exports	-1.6%	-1.3%	4.8%	5.9%	4.2%
Imports	5.3%	3.6%	7.0%	2.8%	3.5%
Nominal GDP	-1.4%	-0.2%	1.9%	2.0%	2.3%
GDP Deflator	-1.7%	-0.9%	-0.4%	1.8%	1.1%

Notes: P=Official preliminary report, E=SMAM forecasts. SMAM views are as at 17 September 2014 and subject to updates thereafter without notice
 Source: Cabinet Office: Government of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

Quarterly Forecasts : Steeper Jul-Sep contraction drags down FY14 growth

- Apr-Jun quarter GDP was revised down to -7.1% from -6.8% due to larger contraction in private capital investment. Forecast for private consumption for Jul-Sep quarter was revised down by 0.7% to 1.1% reflecting the observation of timely economic indicators, which were mostly weaker and probably distorted by miserable weather.
- Jul-Sep GDP is expected to show 2.8% QoQ recovery followed by 2%+ growth quarters during FY 2014 supported by public investments in full motion.

		FY2013			FY2014				FY2015			
		7-9	10-12	1-3	4-6	7-9E	10-12E	1-3E	4-6E	7-9E	10-12E	1-3E
Real GDP (QoQ annualised)	latest	1.8%	-0.5%	6.0%	-7.1%	2.8%	2.1%	2.3%	1.2%	2.0%	-2.8%	1.1%
	previous				-6.8%	3.3%	2.1%	2.3%	1.2%	1.8%	-2.7%	0.5%
Private Consumption (%QoQ)	latest	0.2%	0.4%	2.0%	-5.1%	1.1%	0.3%	0.3%	0.3%	1.1%	-1.8%	0.5%
	previous				-5.0%	1.8%	0.3%	0.3%	0.3%	1.1%	-1.8%	0.2%
Private Housing Investment (%QoQ)	latest	4.7%	2.4%	2.0%	-10.4%	-1.0%	0.5%	1.5%	2.0%	-3.0%	1.5%	2.0%
	previous				-10.3%	1.0%	1.5%	2.0%	3.0%	-3.0%	1.5%	2.0%
Private Capital Investment (%QoQ)	latest	0.5%	1.0%	7.8%	-5.1%	1.7%	0.6%	0.6%	0.7%	0.8%	0.3%	0.4%
	previous				-2.5%	0.4%	0.4%	0.6%	0.6%	0.6%	0.7%	0.7%
Public Investment (%QoQ)	latest	7.1%	1.4%	-2.5%	-0.5%	2.0%	2.2%	2.4%	-1.5%	-1.5%	-1.5%	-1.5%
	previous				-0.5%	2.0%	2.2%	2.4%	-2.0%	-2.0%	-2.0%	-2.0%
Net Exports (Contrib. to GDP)	latest	-0.4%	-0.6%	-0.2%	0.8%	-0.1%	0.1%	0.1%	0.0%	-0.1%	0.3%	0.0%
	previous				0.8%	-0.1%	0.1%	0.1%	0.0%	-0.1%	0.3%	0.0%
Exports (%QoQ)	latest	-0.7%	0.3%	6.5%	-0.5%	1.0%	1.1%	1.2%	1.0%	0.9%	1.0%	0.9%
	previous				-0.4%	1.0%	1.1%	1.2%	1.0%	0.9%	1.0%	0.9%
Imports (%QoQ)	latest	1.8%	3.7%	6.4%	-5.6%	1.5%	0.8%	0.8%	0.9%	1.8%	-0.8%	0.9%
	previous				-5.6%	1.5%	0.8%	0.8%	0.9%	1.8%	-0.8%	0.9%
Industrial Production	latest	1.7%	1.8%	3.0%	-3.8%	-0.5%	1.9%	0.5%	0.6%	1.5%	-1.4%	0.3%
	previous				-3.8%	0.4%	1.6%	0.7%	0.4%	1.4%	-1.4%	0.3%
Unemployment Rate	latest	4.0%	3.7%	3.6%	3.7%	3.7%	3.6%	3.6%	3.6%	3.5%	3.5%	3.5%
	previous				3.7%	3.6%	3.5%	3.5%	3.5%	3.4%	3.4%	3.4%
core CPI excl. tax hike effect	latest	0.7%	1.1%	1.3%	1.4%	1.1%	0.9%	0.9%	0.8%	0.9%	1.1%	1.2%
	previous				1.4%	1.1%	1.0%	1.0%	0.9%	0.9%	1.1%	1.2%
GDP Deflator	latest	-0.4%	-0.4%	-0.1%	2.0%	1.7%	1.7%	1.6%	-0.0%	0.1%	2.1%	2.3%
	previous				2.0%	1.7%	1.7%	1.6%	0.0%	0.1%	2.1%	2.3%

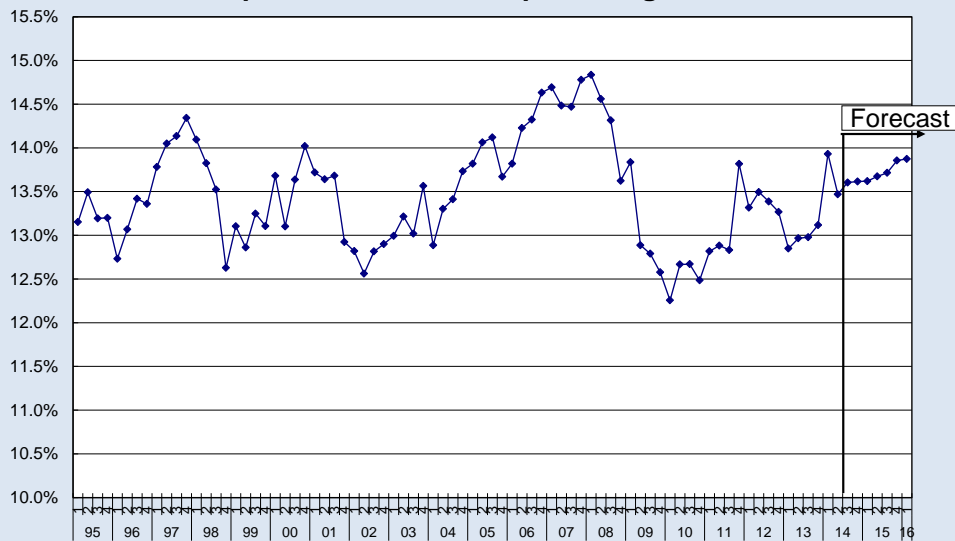
Notes: P=preliminary, E=SMAM forecasts as of 17 September 2014

Source: Cabinet Office: Government of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, E: SMAM forecasts.

Capital investment is expected to moderately contribute to GDP growth going forward

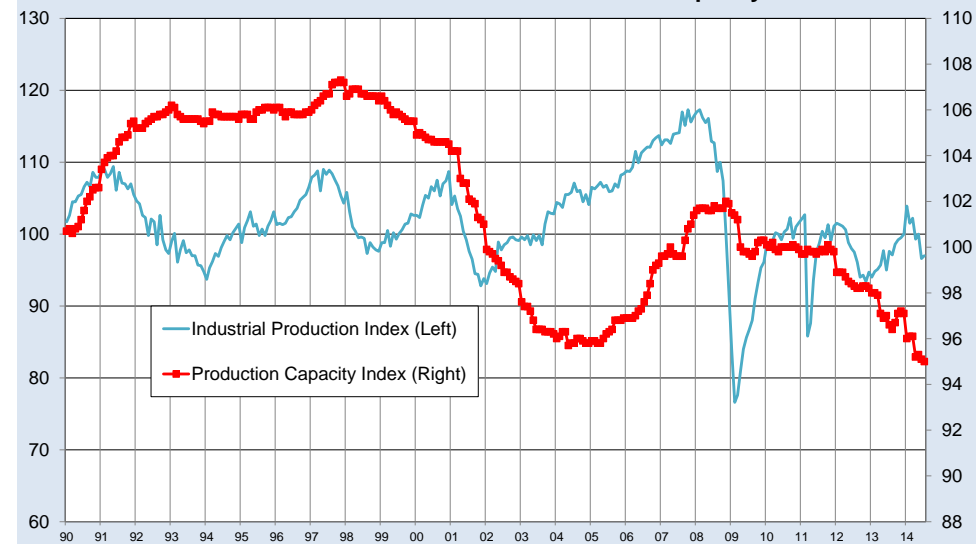
- Capital investment as % of GDP has been recovering since 2010 and expected to rise moderately making positive contribution to GDP growth.
- However, total production capacity in Japan has been in declining trend since 2009, which indicates that capital investment in Japan has been mostly renewal and replacement purposes so far.
- Japanese companies have substantially increased overseas production and this move would not easily be turned around, which is why export volume growth has been sluggish despite weak JPY.

Capital Investments as percentage of GDP



(Source) Cabinet Office and Forecast by SMAM

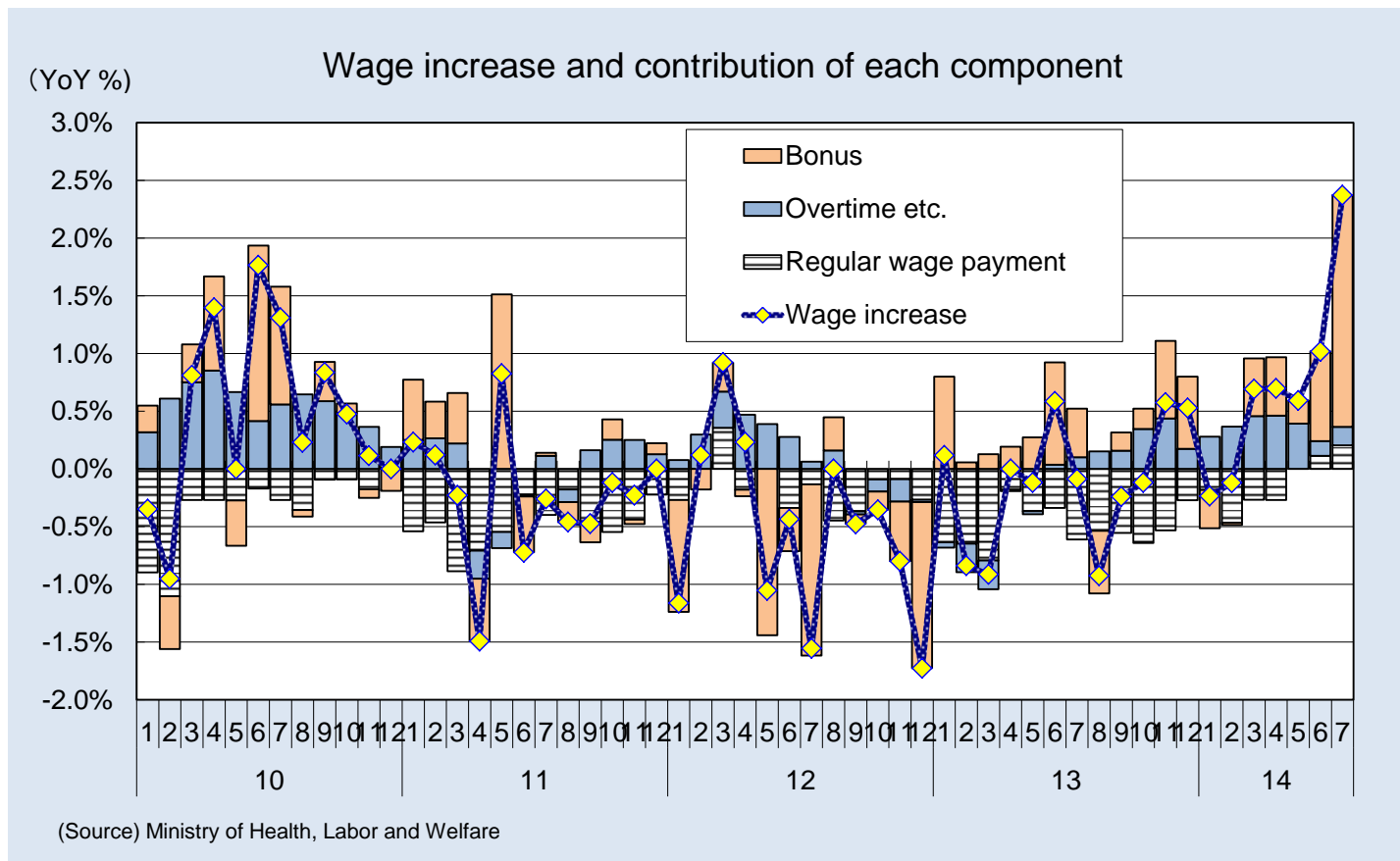
Industrial Production Index & Production Capacity Index



(Source) Ministry of Economy, Trade and Industry

Sizable bonus in summer was confirmed by national statistics in July

- Total wage increased by 2.4 % YoY in July, for which contribution from bonus, overtime and regular payment were 2%, 0,2% and 0.2% respectively.
- Increase in regular payment is still small and subject to revisions afterwards, however, this could be an important step for achieving sustainable growth in wages.



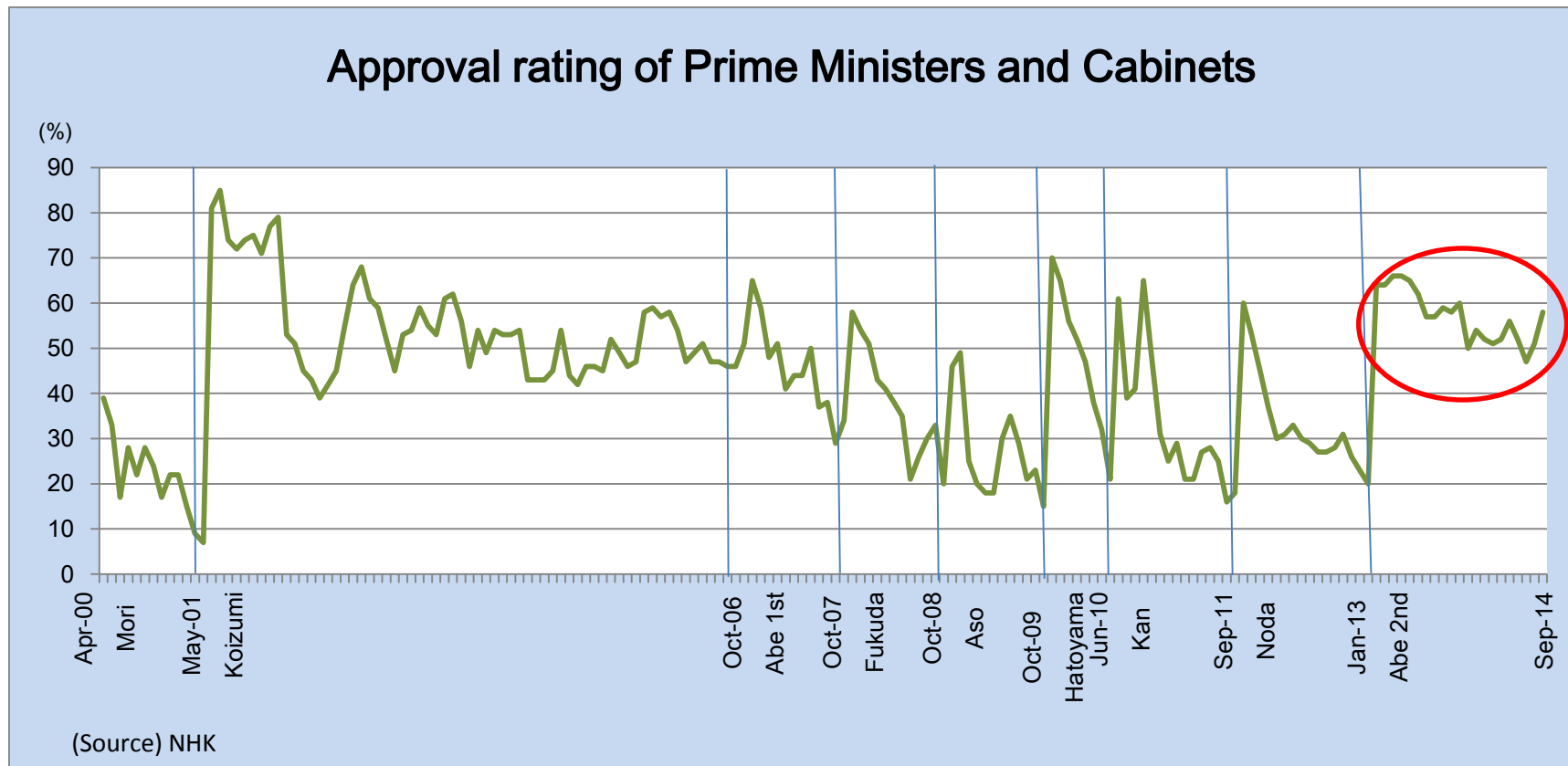
Consumer sentiment is recovering from post tax hike low

- A survey over about 2000 workers showed current condition DI is recovering from post tax hike low.
- Future condition DI stays just above 50, which means people are expecting mild improvement in economic conditions.



Approval rating of Abe cabinet is holding well

- Approval ratings of PM Abe is holding well compared to the cabinets in the past and this is implying that Japanese people stay hopeful for Abenomics.
- The latest reshuffle in the cabinet in early September lifted the ratings by 7 points to 58% from the survey in August.



Outlook for the Japanese Stock Markets

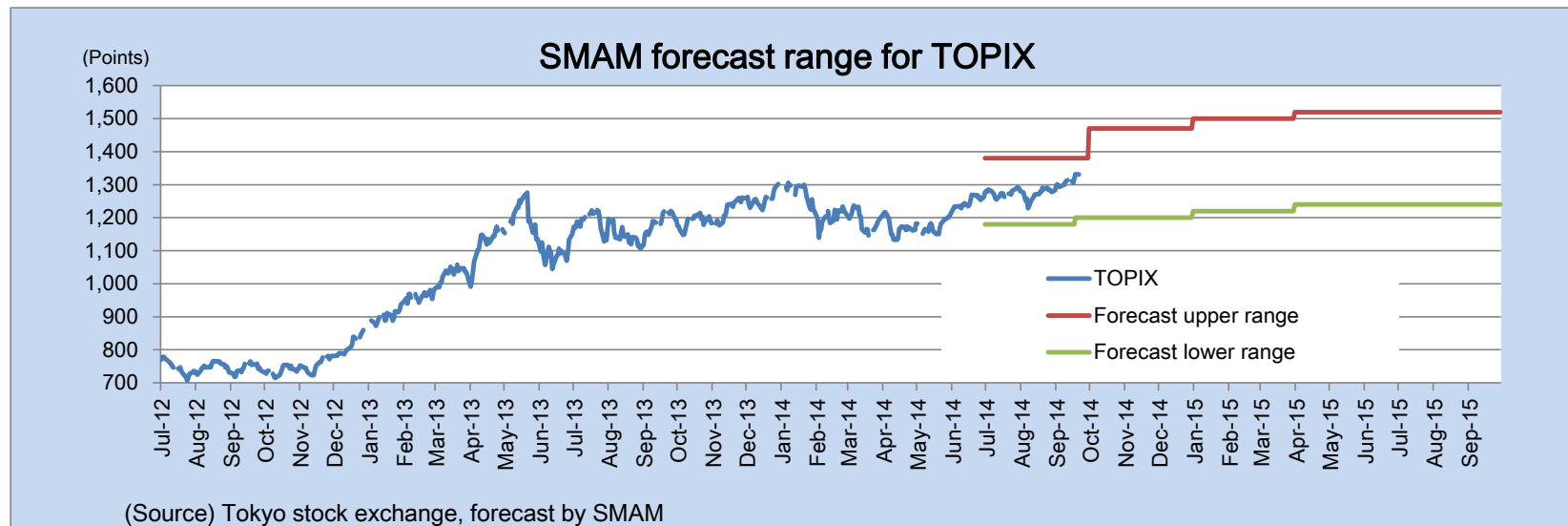
Stock market outlook: Long term upward trend intact while some caution on overseas factors

SMAM short-term view

- SMAM revised TOPIX forecast range slightly upward. Japanese stock market will be supported by positive corporate earnings, for which analysts' forecasts keep revised upward on the back of improving economy in US and China as well as rekindled weakness of JPY.
- Abe government is going to make another supplemental budget spending to avoid the economy to stall and BOJ seems more willing to make additional easing if necessary, which are favorable for the stock market.
- Risks would be such as unexpected scale of shock coming from ending QE3 in the US and escalating geopolitical conflicts.

Longer-term outlook (6-month and beyond)

- For longer-term, we continue to expect the markets to track on a modest uptrend, supported by US-led moderate global growth, solid corporate earnings growth and Japan's admittedly slow but steady reforms.



Note: SMAM forecasts are as at 19 September 2014 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

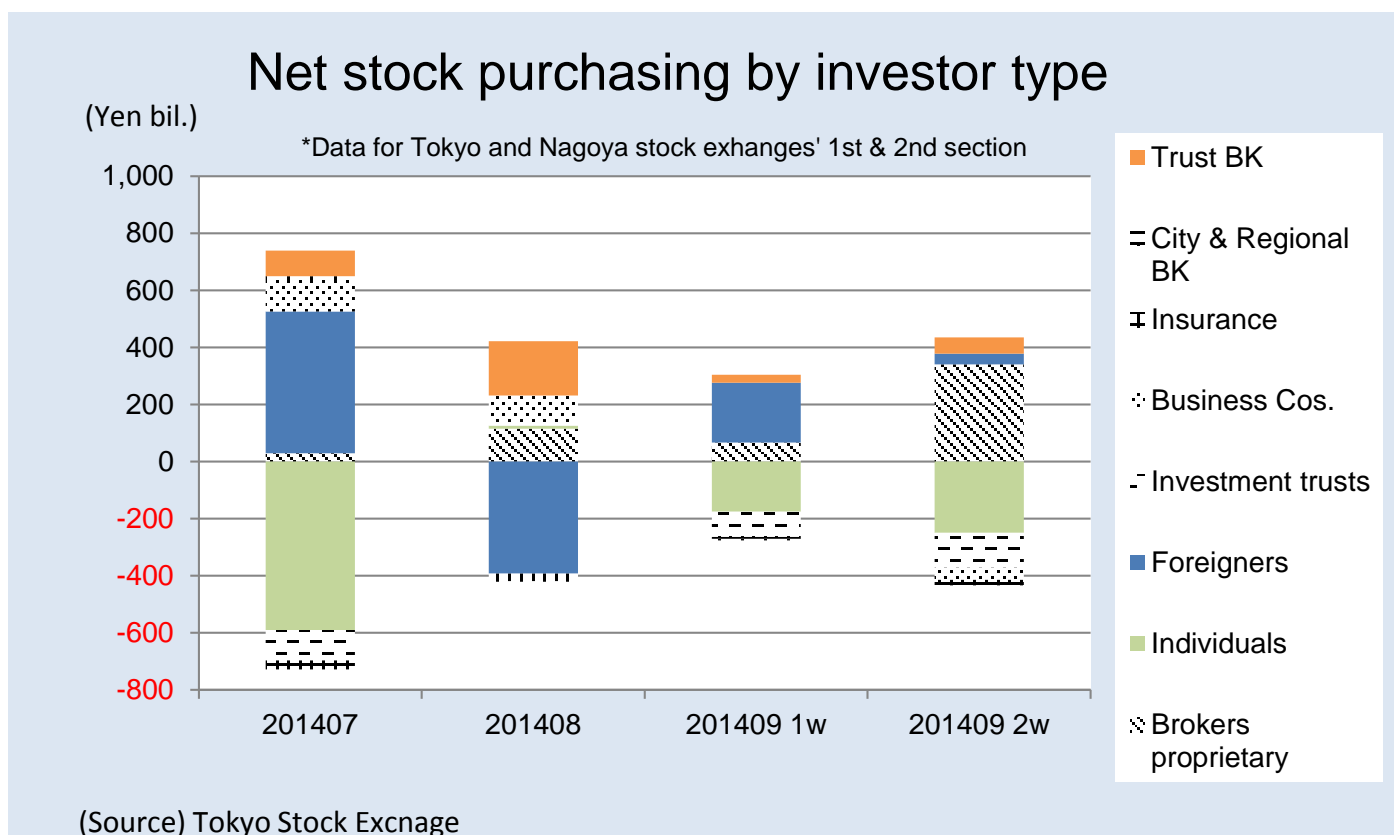
- Our **Base Scenario** is assuming the following views:
 - Global economy to pick up gradually
 - Japan's recovery from tax-hit weak demand
 - Political supports including reasonably effective growth strategies
 - Growing expectations for positive earnings revisions by corporates

- **Upside Risks** include:
 - Weaker JPY than a base assumption (USD=JPY108 at CY14 end)
 - Stronger global growth
 - More powerful measures by Japanese authorities

- **Downside Risks** include:
 - Unsatisfactory earnings revisions by corporates
 - Markets to turn around to deeper risk-off mode, should geopolitical tensions grow
 - China's economy to slow further
 - Growing disappointment, if any, to Abenomics

Purchasing by Trust Banks and Foreigners were behind the recent stock market rally

- Trades from pension funds are major source for “Trust Bank”, which has been purchasing Japanese stocks.
- After selling in August, foreign investors turned back to net buyers in the beginnings of September.
- Individuals were taking profits on balance, however, they are expected to put some money back as they have unused CY2014 allowance for NISA, a tax exempt personal savings account, expiring at the year end.



Good earnings growth and expectation for its upward revisions should be supportive

- SMAM upgraded recurring profit growth forecasts for FY2014 from previous 6.0% to 7.1%, which will break the previous record high in FY2007. Profits are expected to accelerate to double digit growth in FY2015.
- The current forecast is based on conservative FX assumptions of 100 yen/\$, which provides considerable room for future upward revisions. If yen becomes 1 yen weaker both for US\$ and Euro, recurring profits growth will approximately increase by 0.5%.

Earnings Tabulations (SMAM Core Research Universe excl. financials)

(% change)	FY 2012 (Actual)	FY 2013 (Actual)	Forecasts for FY 2014		Forecasts for FY 2015	
			as of Jun 2014	as of 3rd Sep 2014	as of Jun 2014	as of 3rd Sep 2014
Timing of the forecasts made	-	-				
Revenue	3.5%	13.3%	2.1%	3.2%	3.1%	3.3%
Operating Profits	6.8%	34.2%	7.8%	7.4%	12.4%	12.2%
Recurring Profits	9.9%	39.2%	6.0%	7.1%	13.0%	12.6%
Net Earnings	28.0%	85.2%	5.8%	7.5%	15.4%	14.7%

*Assumptions for forecasts:

As of Sep 2014

FX rate (¥/\$) 100¥/\$

FX rate (¥/€) 140¥/€

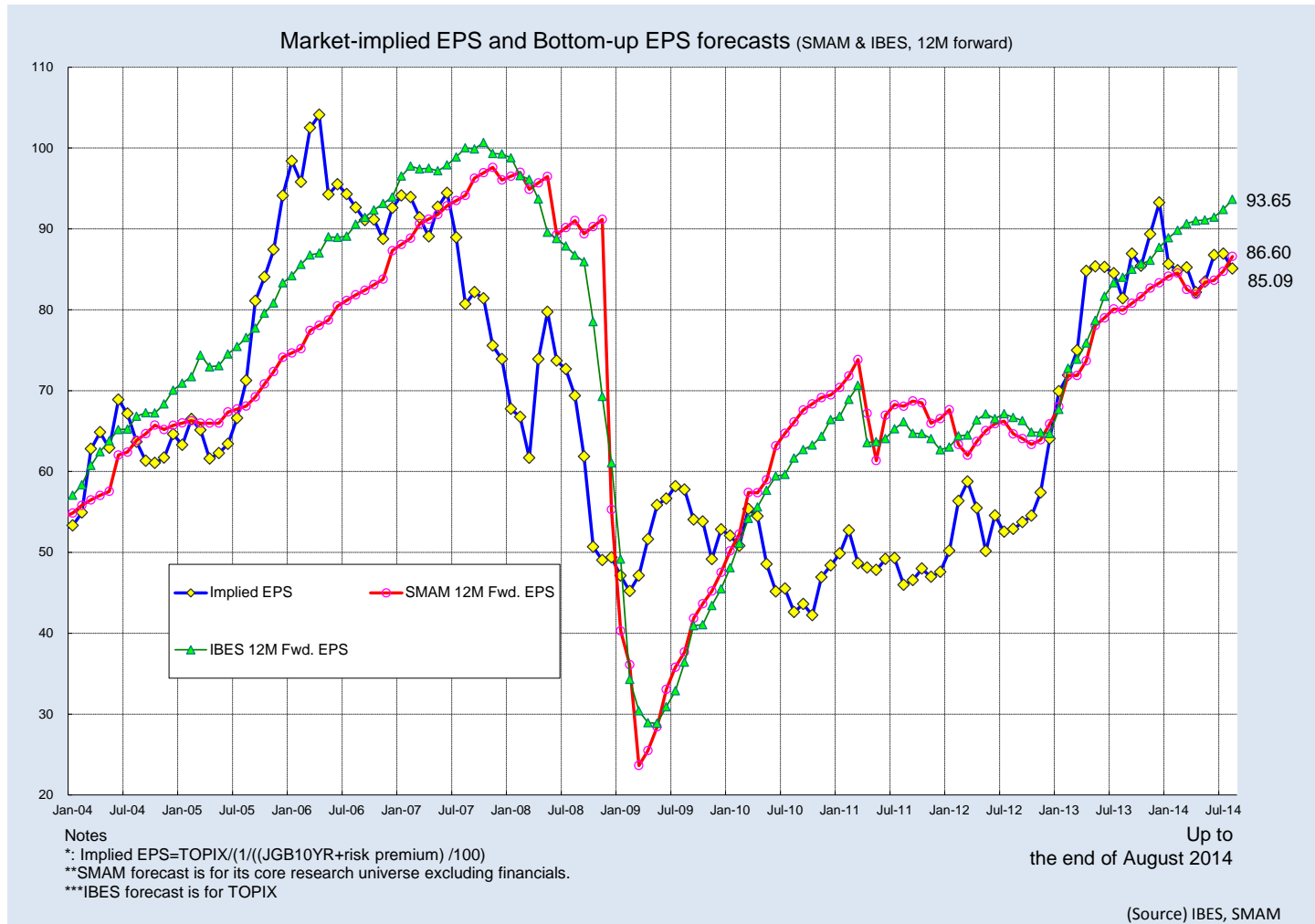
Crude Oil CIF (Japan) \$105/barrel

*Figures show bottom-up yoy annual growth forecasts by SMAM equity analysts.

*A Japanese Fiscal Year is from April to March the following year.

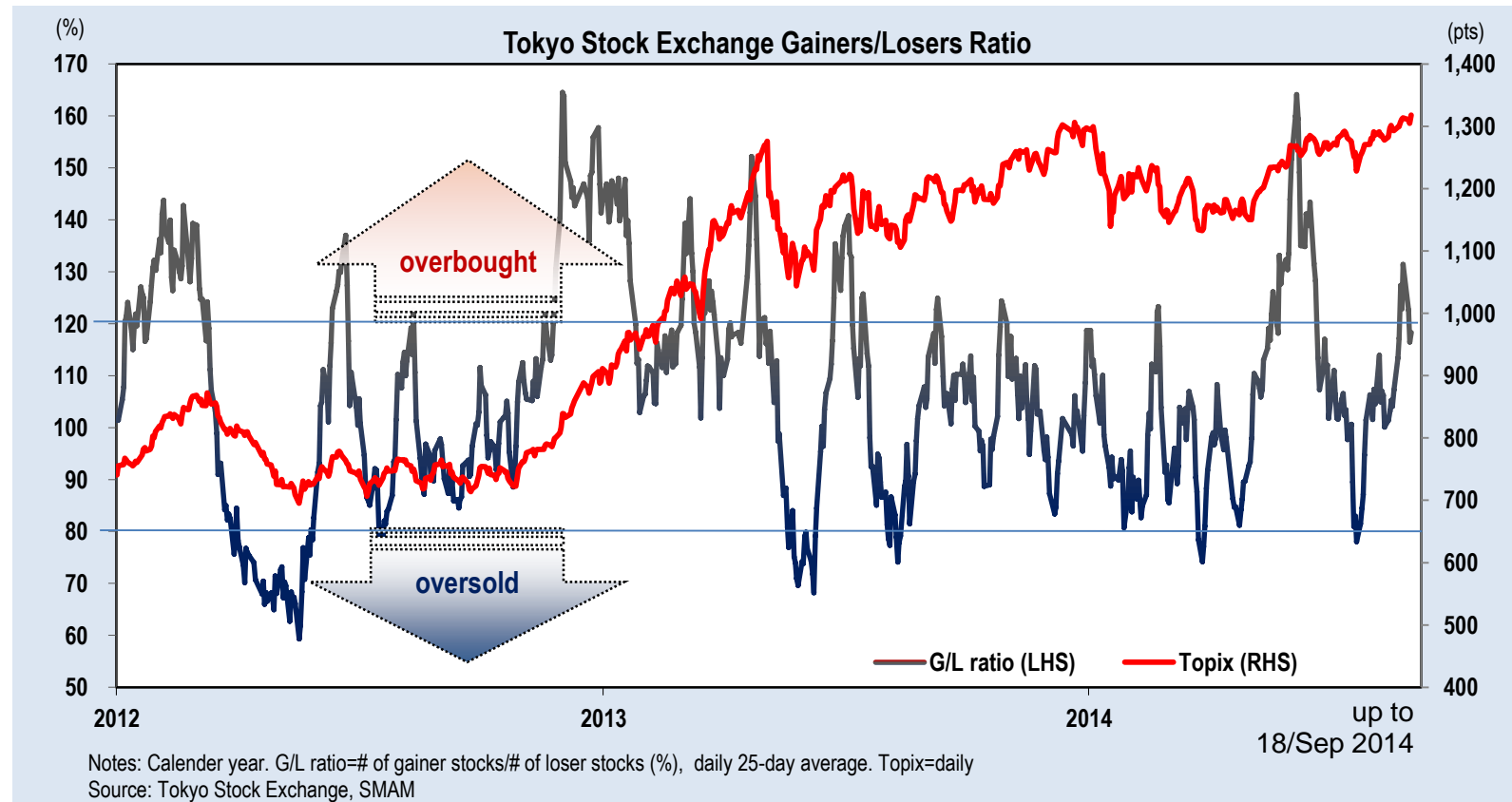
Analysts are up-revising earnings forecasts

- EPS forecasts both by IBES and SMAM have been revised upward, meanwhile market implied EPS is moving in sideways channel recently, which could make room for the market to catch up.



Japanese market is just below overheated territory in the short term

- The ratio of number of stocks rose vs. fell is commonly used for monitoring heat in the stock market. The ratio over 120% is regarded as overheated.
- The ratio came back below 120% recently ,however, technical consolidation might be required in the short term.



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