



Japanese Stock Market Outlook

SMAM monthly comments & views

- April 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Japan's economic recovery is under way, as robust Exports and Industrial Production are leading the moderate growth. Meantime, faltering Consumption Expenditures are finally likely to move to recover spurred by wage gain at the "Spring wage negotiation round" now in full swing

- SMAM expects mild real GDP recovery of +1.4% and +1.8% in FY2015 and FY2016 alongside global growth.
- The "Shunto" wage (pay scale) increase at the "Spring Wage Negotiation Round" is likely to gain +0.8% and the nominal wages are expected to rise +1.4% in FY2015 due to low inflation.
- Core-CPI is expected to approach "zero" and BOJ is highly likely to revise its inflation target rate downward, but SMAM does not expect additional monetary easing at this moment.

➤ Japanese Stock Markets

Considering the highly likely up-revisions of corporate profits, the current stocks are estimated fairly valued. The market is likely to continue rally due to positive corporate earnings and favorable supply-demand balance.

- FY2015 corporate profits are expected to be revised upward due to weak JPY and low crude oil price.
- The money inflow from public funds such as GPIF would support the stock market.
- Downside risk is associated with foreign factors such as geopolitical concerns, unclear monetary policy by Fed and ECB, and possibly negative effects by crude oil price slump.

Notes: Macro and market views are as of 18th and 20th March 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY14-16

- SMAM revised upward Real GDP forecast to annualized +1.4% from +1.2% for FY2015 and to +1.8% from +1.6% for FY2016 mainly due to recovery in Private Consumption Expenditures (PCE) helped by wages gain.
- PCE forecast is upgraded to +1.5% from +1.2% for FY2015 and to +2.0% from +1.7% for FY2016. SMAM remains conservative in forecasting Private Capital Investment as companies are still more likely to retain their earnings rather than invest as CAPEX under difficult-to-find higher return opportunities in domestic market.
- SMAM expects Core-CPI decelerate to +0.4% and +1.1% for FY2015 and FY2016. The 2.0% inflation target for the BOJ might be revised down going forward.

	FY11	FY12	FY13	FY14E	FY15E	FY16E
Real GDP growth	0.4%	1.0%	2.1%	-0.9%	1.4%	1.8%
Private Consumption Expenditure	1.4%	1.8%	2.5%	-3.0%	1.5%	2.0%
Private Housing Investment	3.2%	5.7%	9.3%	-11.8%	0.3%	4.2%
Private Capital Investment	4.8%	1.2%	4.0%	0.1%	2.7%	3.2%
Public Consumption Expenditure	1.2%	1.5%	1.6%	0.5%	0.9%	0.5%
Public Capital Investment	-3.2%	1.0%	10.3%	3.1%	-1.6%	-1.6%
Net Exports (contrib. to GDP growth)	-1.0%	-0.8%	-0.5%	0.7%	0.3%	0.1%
Exports	-1.6%	-1.3%	4.7%	7.3%	5.2%	4.9%
Imports	5.4%	3.6%	6.7%	3.0%	4.0%	5.2%
Nominal GDP	-1.3%	0.1%	1.8%	1.1%	1.4%	2.4%
GDP Deflator	-1.7%	-0.9%	-0.3%	2.1%	0.0%	0.5%

FY starting April and ending March

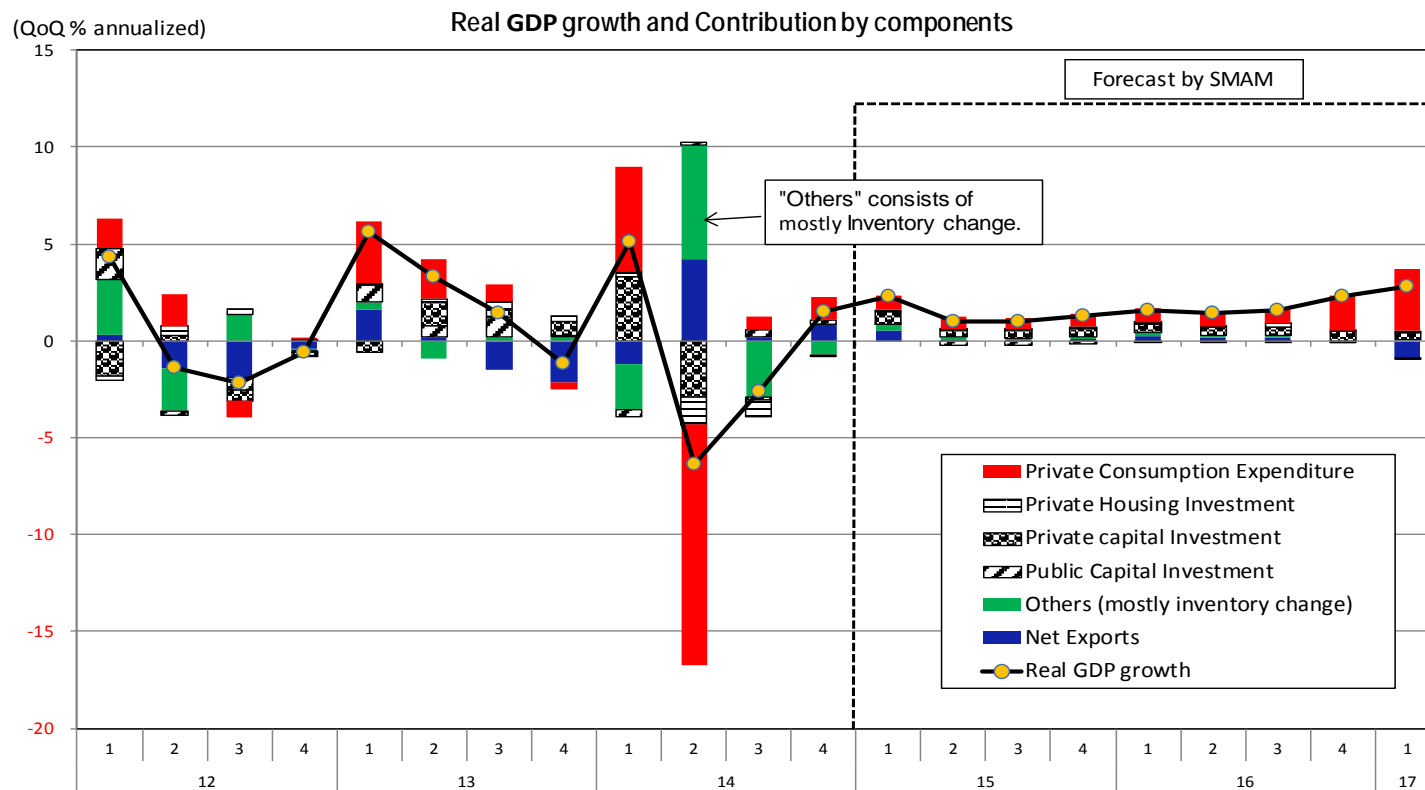
(%, YoY except Net Exports)

Notes: E=SMAM forecasts. SMAM views are as of 18th March 2015 and subject to updates thereafter without notice

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

Quarterly GDP: Accelerating to +2.3% growth in January-March

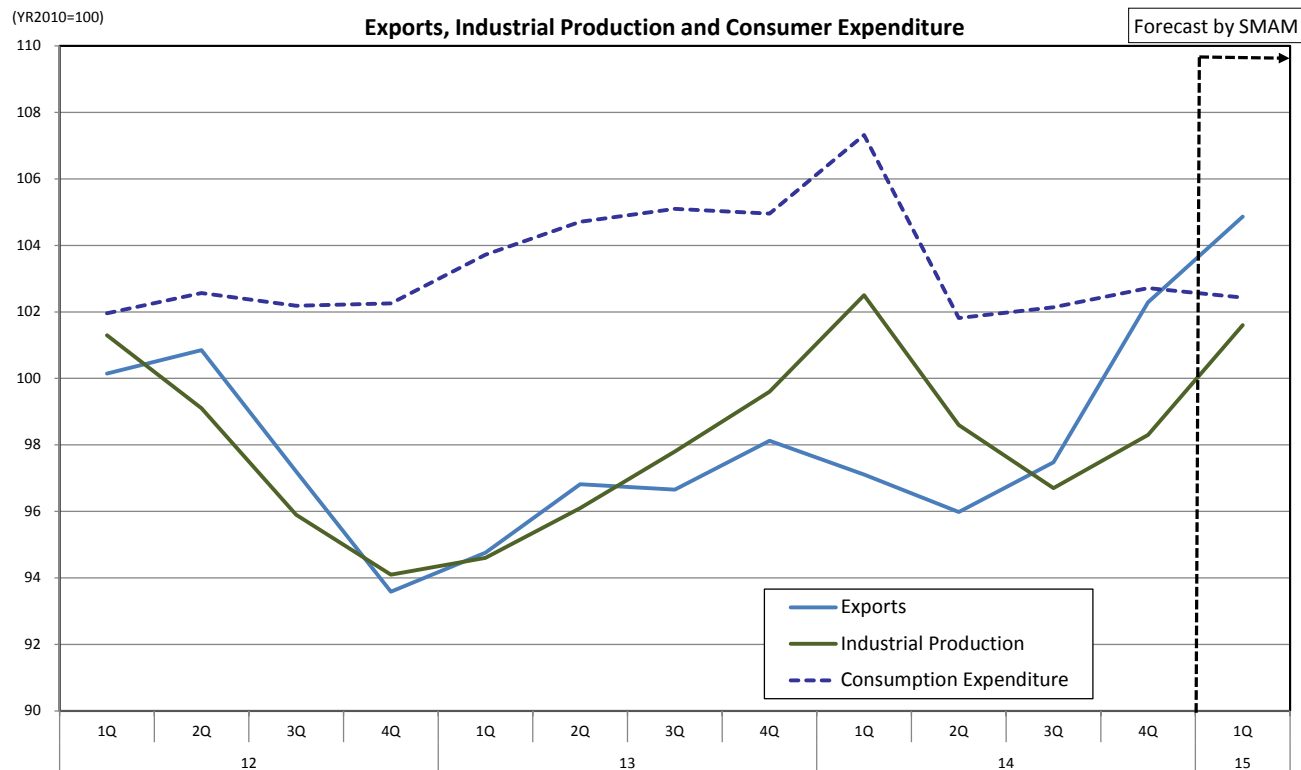
- Official GDP data for October-December 2014 was revised downward to annualized +1.5% from +2.2%. Private Consumption Expenditures (PCE) added by 0.2ppt, while Private Capital Investment (PCI) lost by 0.2ppt from the previous release.
- SMAM revised January-March 2015 GDP forecast upward to annualized +2.3% from +2.2%. PCE was downgraded to +0.3% from +0.4% and PCI was up to +1.2% from +0.9% for the same period.



(Source) Cabinet Office, SMAM forecast

Recovery Process: Exports⇒Production⇒Employment, Confidence⇒Consumption

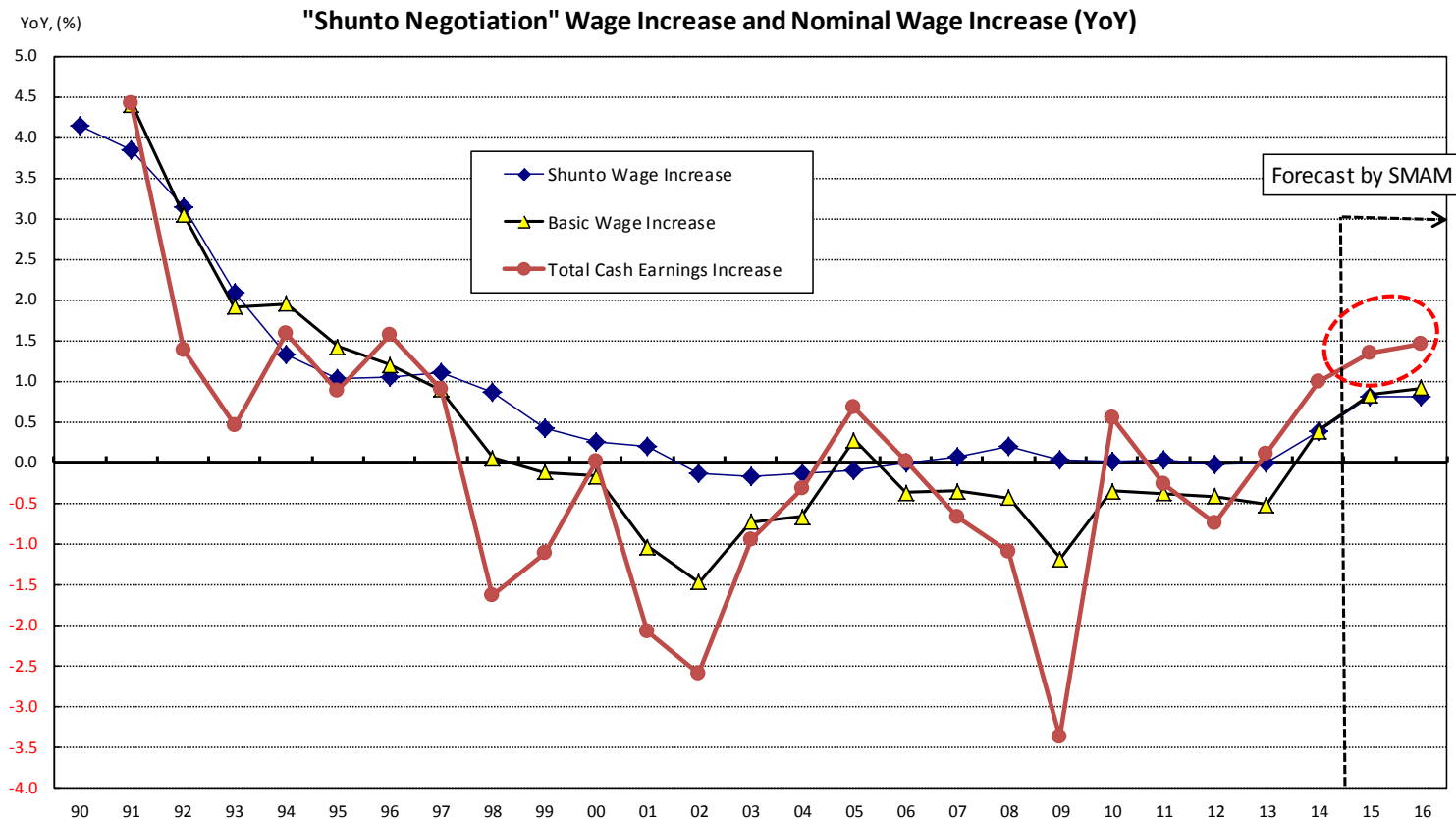
- SMAM forecasts current recovery process in order from Exports to Production and Consumption. The ongoing recovery process is between Production expansion and Employment & Confidence recovery.
- Solid recovery is highly expected due to robust Exports and Industrial Production due to US led global growth.
- The last piece, Consumption Expenditures are expected to improve finally buoyed by wage gain at the “Spring Wage Negotiation Round (Shunto Negotiation)” now in full swing.



(Source) Ministry of Economy, Trade and Industry, BOJ, Cabinet Office, SMAM seasonally adjusted
 *1: Exports for 1Q 2015 are estimated based on the data of first 20 days of the latest month provisional basis.
 *2: Industrial Production for 1Q 2015 is estimated based on the data of Industrial Production Forecast Index.

Close-up (1) Wage-gain: Robust corporate profits are likely to lift nominal wages

- Due to upbeat corporate profits and "Shunto Negotiation," total cash earnings (Nominal wages) are expected to grow +1.4% and +1.5% in FY2015 and FY2016.
- "Shunto wage increase" (Pay scale increase) is expected to gain +0.8% and +0.9% in FY2015 and FY2016.



(Source) Ministry of Health, Labour and Welfare, SMAM

Close-up (3) Wage-gain & PCE: "Shunto wage gain" is likely to spur consumption

- "Shunto wage increase" is the key for recovery in Private Consumption Expenditures (PCE).
- SMAM expects "Shunto wage increase to be +0.8% in FY2015. The pay scale increase at the negotiation round is estimated to raise total cash earnings (Nominal wages) +1.4% and to add PCE by +1.6% for FY2015 (see Case (A): Base Scenario).

Case (A): Base Scenario - "Shunto Wage Increase"(Pay scale increase) gains +0.8% in FY2015 and FY2016.

	FY13	FY14	FY15E	FY16E
Shunto Wage Increase (Pay Scale Increase)	0.0	0.4	0.8	0.8
Basic Wages	-0.5	0.4	0.8	0.9
Total Cash Earnings (Nominal Wages)	0.1	1.0	1.4	1.5
Contribution to PCE	2.5	-3.0	1.6	0.6

Case (B): Better-than-expected Scenario - "Shunto Wage Increase"(Pay scale increase) gains +1.0% in FY2015 and FY2016.

	FY13	FY14	FY15E	FY16E
Shunto Wage Increase (Pay Scale Increase)	0.0	0.4	1.0	1.0
Basic Wages	-0.5	0.4	1.0	1.1
Total Cash Earnings (Nominal Wages)	0.1	1.0	1.5	1.6
Contribution to PCE	2.5	-3.0	1.8	0.8

Case (B): Extreme Scenario - "Shunto Wage Increase"(Pay scale increase) gains +2.0% in FY2015 and FY2016.

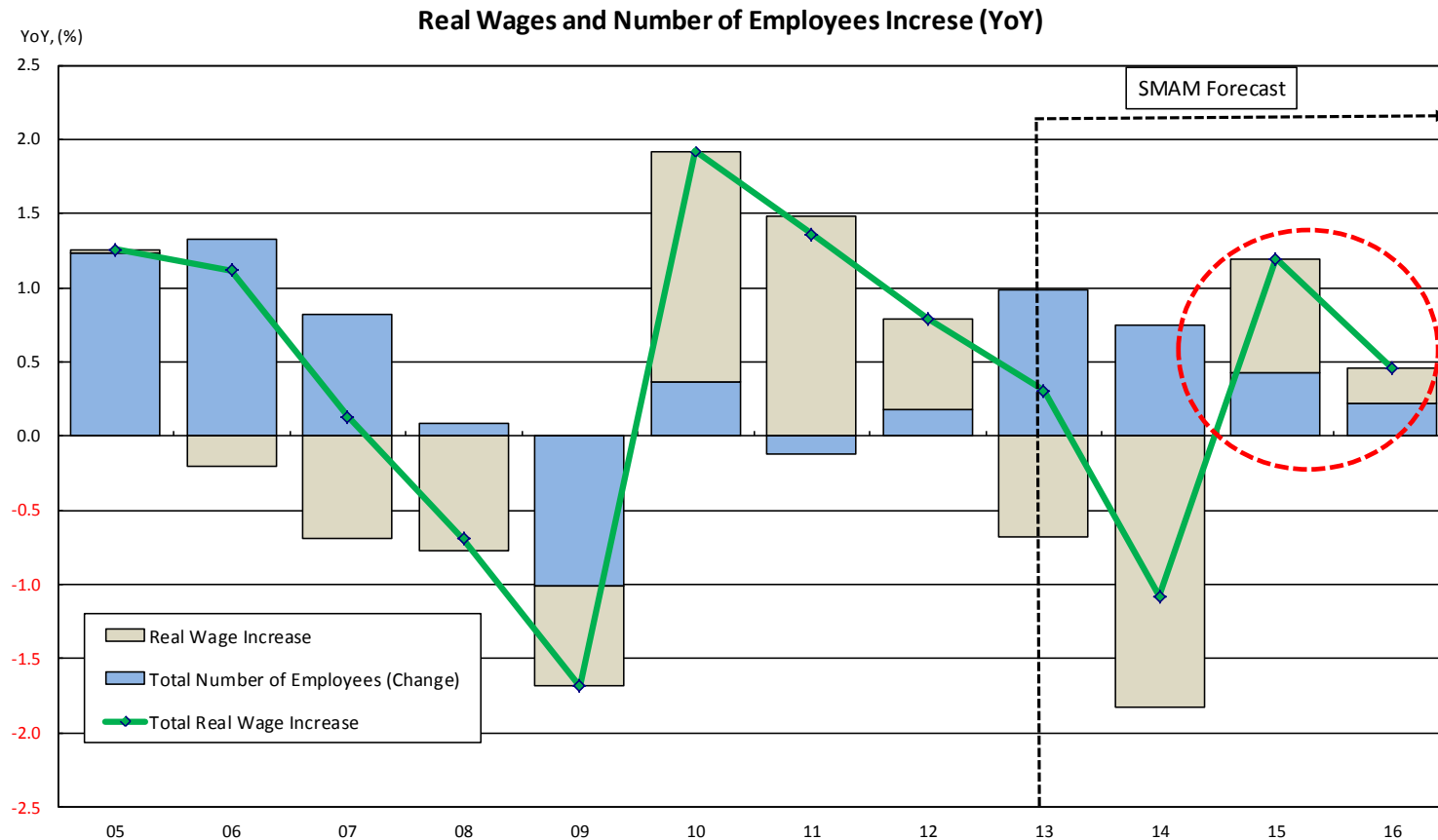
	FY13	FY14	FY15E	FY16E
Shunto Wage Increase (Pay Scale Increase)	0.0	0.4	2.0	2.0
Basic Wages	-0.5	0.4	1.8	1.9
Total Cash Earnings (Nominal Wages)	0.1	1.0	2.3	2.4
Contribution to PCE	2.5	-3.0	2.7	1.8

(Source) SMAM estimated

FY starts in April and ends in March. FY2014 end is March 2015

Close-up (2) Wage-gain: Low CPI is likely to help real wages gain

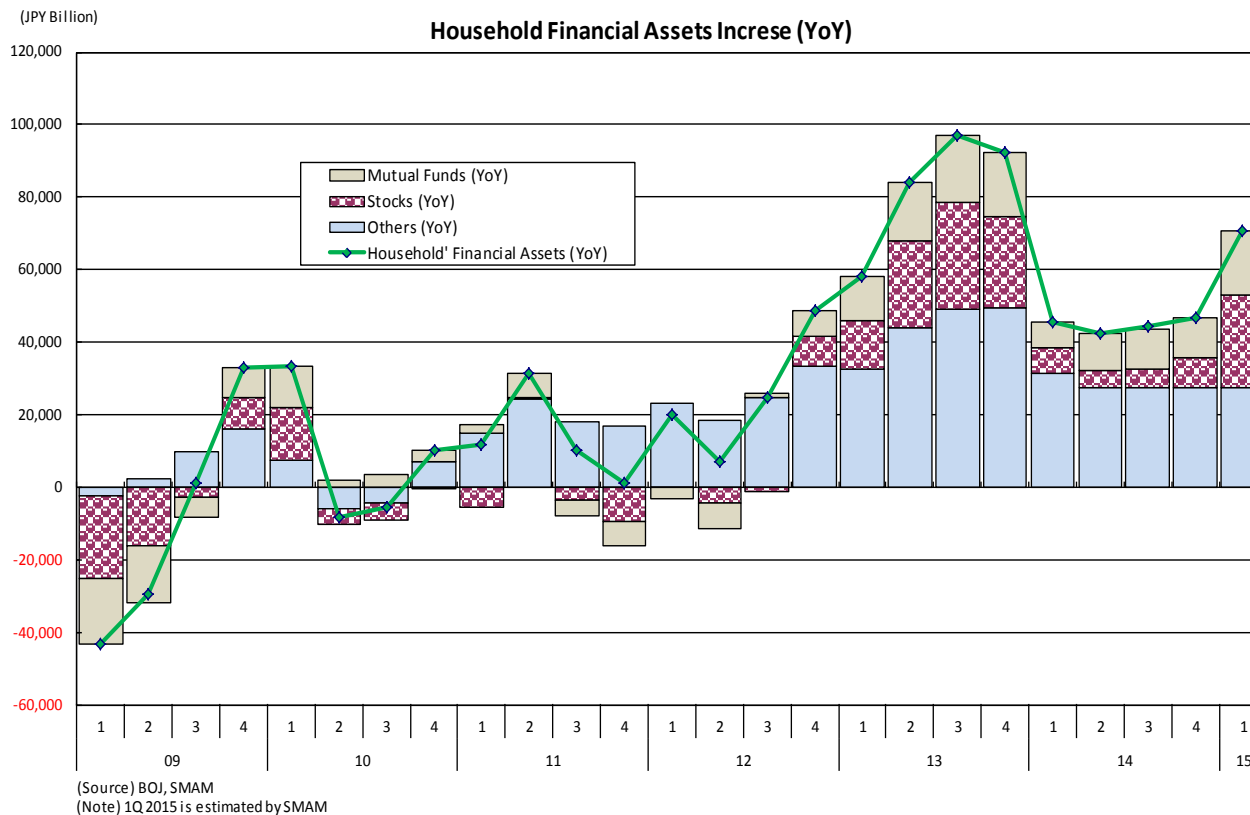
- Due to low inflation, total real wages are expected to rise +1.2% in FY2015.
- Core CPI is expected to be slower rise of +0.4% and +1.1% in FY2015 and FY2016.



(Source) Caabinet Office, Ministry of Internal Affairs and Communications , Ministry of Health, Labour and Welfare , SMAM

Close-up (4) Wage-gain, Wealth effect & PCE: Higher stock prices are likely to push up consumption

- +1,000 higher Nikkei index is likely to lift Private Consumption Expenditures (PCE) by 0.2% for the next fiscal year.
- PCE is estimated to rise by +0.2% to +2.6% from +2.4% for FY2015, provided that “Shunto wage increase” is settled at +0.8% and Nikkei rises +1,000 to 20,000 from 19,000 at FY2014 end.



Outlook for Japanese Stock Markets

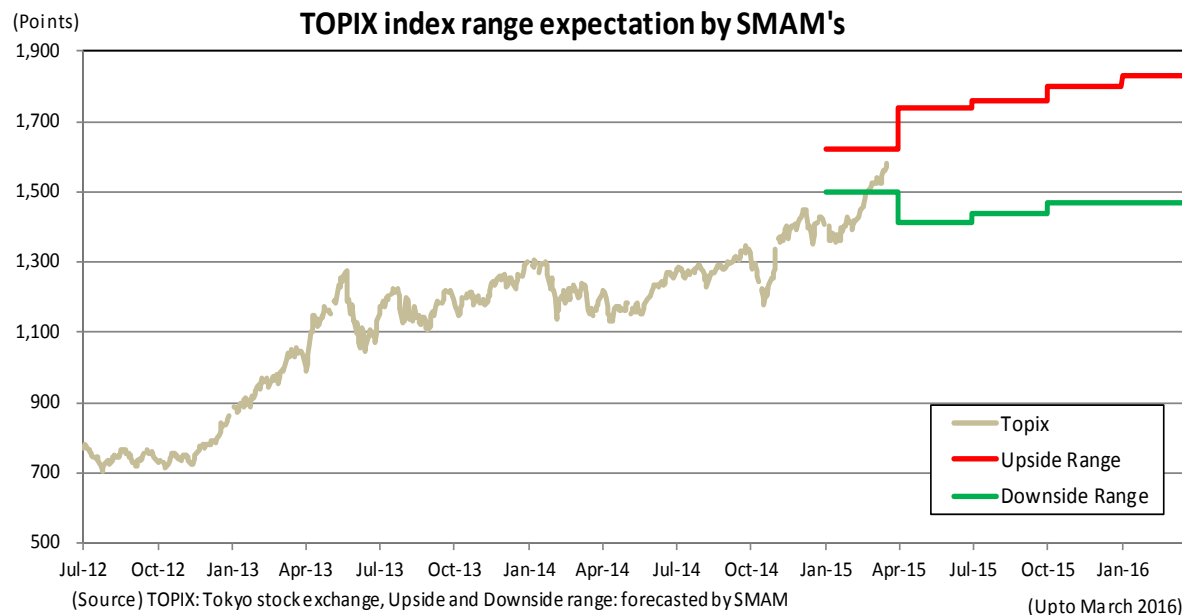
Stock market outlook: Earnings growth prospects should help the stock market

SMAM short-term view

- Due to mild growth in Production and Exports as well as high expectation for recovery in Consumption spurred by wage gains, Japan's equity market is expected to continue rally on upbeat corporate profits.
- The stock market is expected to continue advancing due to expectation on later rate hikes by Fed and favorable supply and demand balance led by money inflow from public funds and BOJ. However, a temporary setback might be possible in April due to profit taking at the beginning of new fiscal year.

Longer-term outlook (6-month and beyond)

- For longer-term, we continue to expect the market to track on a modest uptrend, underpinned by US-led global growth, solid corporate earnings and strengthened reflationary policies in Japan.



Base scenario & Upside / Downside risks for our forecasts

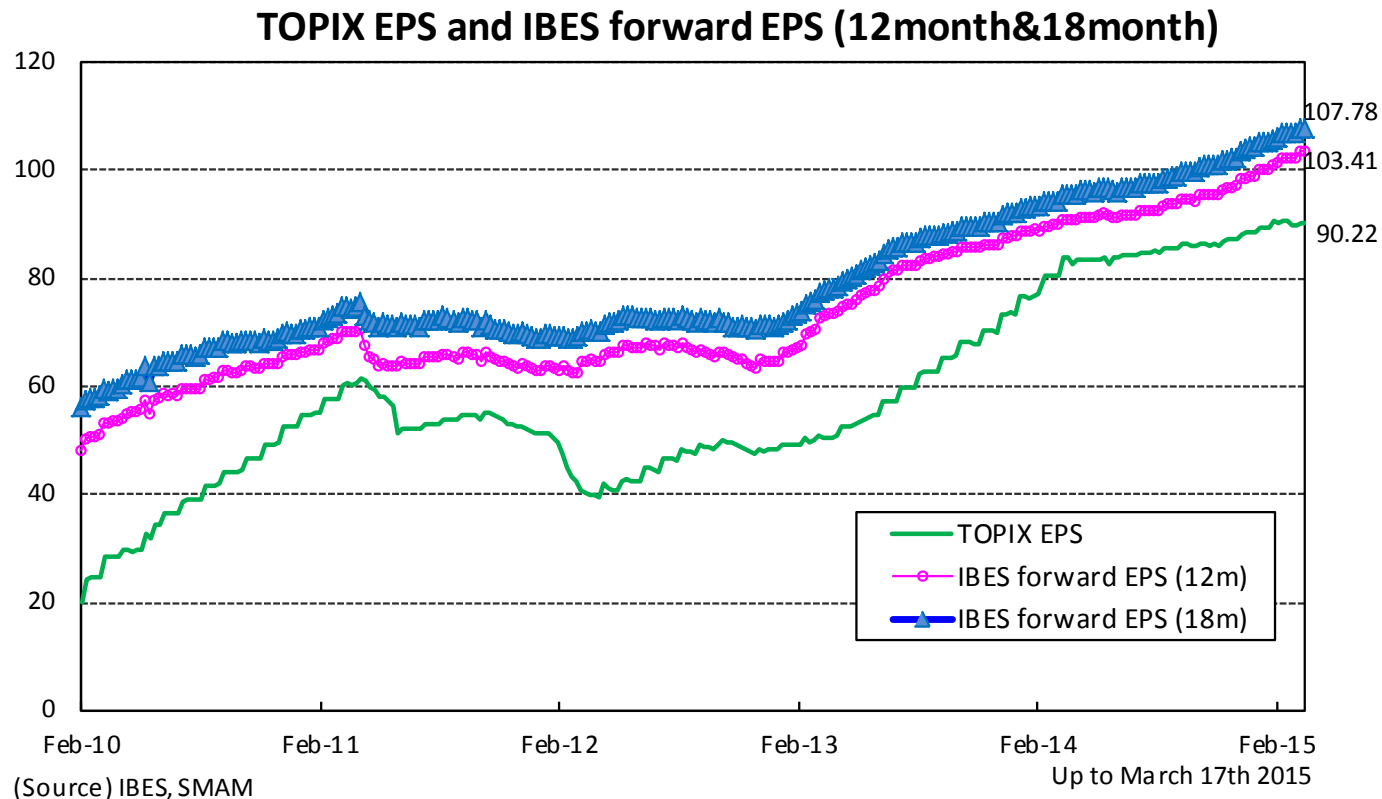
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's mild recovery from tax-hit weak demand buoyed by rescheduled next tax hike until 2017
 - Growing expectation for positive corporate earnings revisions due to weaker JPY
 - Reflationary policy to be continued toward the next consumption tax hike

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

- **Downside Risks** include:
 - Slowdown in global economy
 - Concern over global deflation
 - Increasing geopolitical concerns

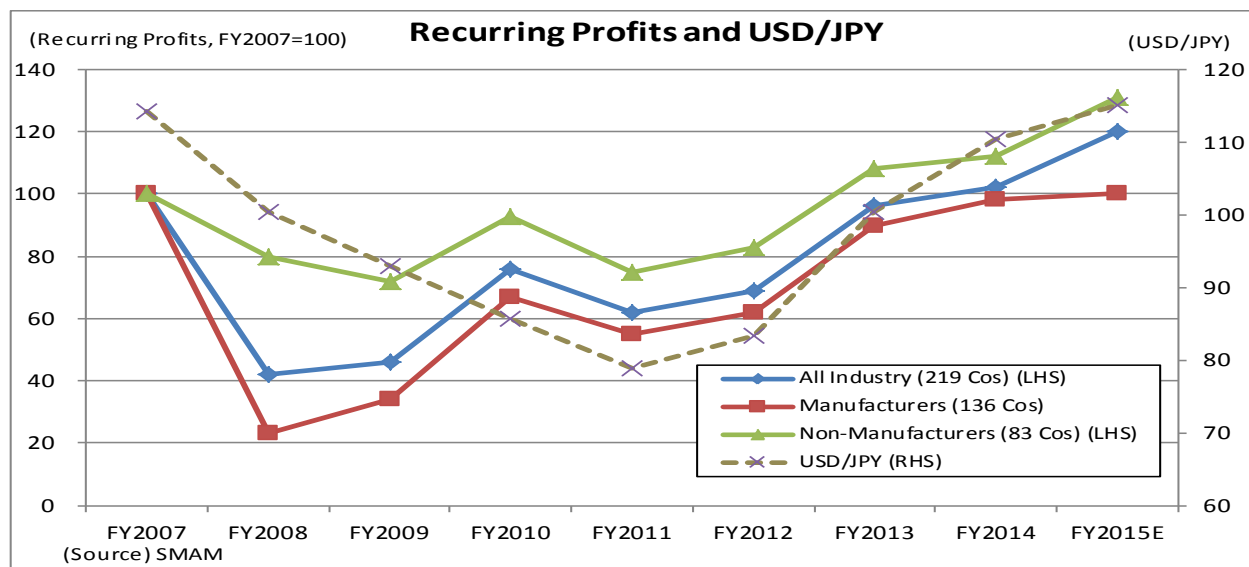
EPS forecasts: Upbeat IBES forward EPS consensus

- IBES consensus EPS continues rising supported by solid growth prospects. IBES 12 month and 18 month forward EPS are 103.41 and 107.78 respectively, while TOPIX EPS is currently 90.22 as of 17th March.



SMAM Core Research Forecast: Upbeat FY2015 profits plus highly likely up-revision

- SMAM expects +17% profit growth for the research universe 200 companies (ex. Financials) in FY2015 based on conservative assumption in exchange rates and energy prices such as USD/JPY=115 and crude oil=USD50.



Corporate Earnings Outlook of SMAM's Core-Research Universe 219 Companies (excl. financials)

	FY	Sales	YoY	Operating Profit	YoY	Recurring Profit	YoY	Net Profit	YoY
All Industry (219 Cos)	FY2012	347,271	3.5%	19,454	6.8%	19,347	9.9%	8,799	28.0%
	FY2013	394,059	13.5%	26,291	35.1%	27,007	39.6%	16,344	35.4%
	FY2014	407,824	3.5%	27,325	4.0%	28,876	6.9%	17,843	9.4%
	FY2015E	414,513	1.6%	32,640	19.4%	33,799	17.0%	21,303	19.4%
Manufacturers (136 Cos)	FY2012	221,694	4.1%	12,228	10.5%	11,782	13.4%	5,439	41.1%
	FY2013	250,132	12.7%	16,930	38.4%	17,211	46.1%	10,304	89.8%
	FY2014	257,611	3.0%	17,911	5.8%	18,666	8.5%	11,625	12.8%
	FY2015E	262,143	1.8%	21,359	19.2%	21,904	17.3%	13,900	19.6%
Non-Manufacturers (83 Cos)	FY2012	125,387	2.7%	7,225	0.9%	7,565	4.8%	3,369	11.9%
	FY2013	143,927	14.8%	9,351	29.4%	9,797	29.5%	6,010	78.4%
	FY2014	150,213	4.4%	9,414	0.7%	10,210	4.2%	6,218	3.5%
	FY2015E	152,370	1.4%	11,281	19.8%	11,896	16.5%	7,402	19.0%

*IFRS adopted companies are amended based on their actual results retroactively

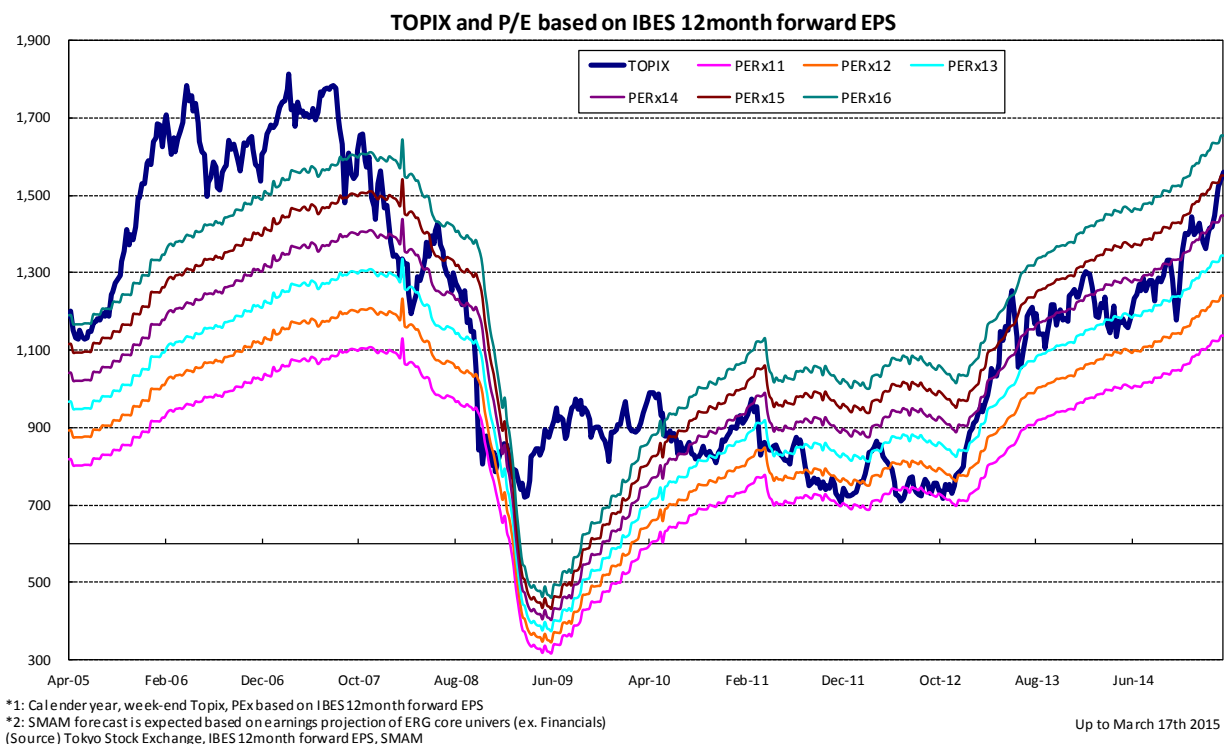
*Fiscal year starts from April and ends March.

☞ Figures show bottom-up yoy annual growth forecasts by SMAM equity analysts
(Source) SMAM

As of March 4th 2015	
FX rate (Yen/US\$)	115
FX rate (Yen/€)	140
Crude Oil CIF (Japan)	\$50/barrel

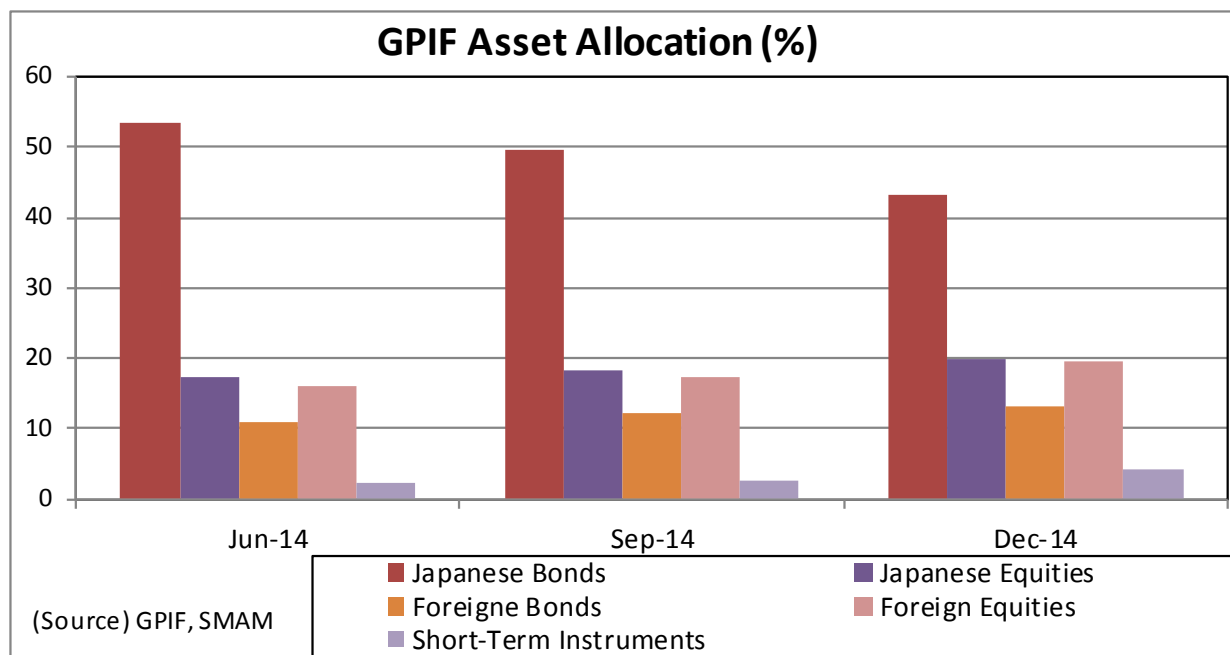
TOPIX range forecast: Fairly valued supported due to positive earnings momentum

- IBES 12 month forward EPS forecast for TOPIX was JPY103.41 as of March 17th 2015. The P/E has ranged between 13x and 15x since Abe government resumed. Based on these values, TOPIX is estimated to be between 1,344 and 1,551. This shows current Japanese stocks and TOPIX of 1,570 as of March 17th trade slightly above the upper limit of this range.
- SMAM estimates the stocks are fairly valued, taking into account the upside potential in corporate profits for FY2015 due to conservative assumption, as shown on the previous page.



Supply-Demand balance: Inflow from public funds is likely to support the market

- The stock market is expected to continue favorable supply-demand balance as other public funds are likely to raise the investment in Japanese equities, following GPIF.



Money Inflow Potential from Public Funds into Japanese Equities

Public Funds	AUM (JPY trillion)	(a) Japanese Equities Allocation (%) as of December 2014	(b) Japanese Equities Policy Asset Mix (%)	Money Inflow Potential (b)-(a)	
				(%)	Amount (JPY trillion)
GPIF	137	19.80%	25%	5%	7.1
3 Retirement Funds (Central Government Employees, Local Government and Private School)	30	10% -15%	25%	10-15%	3.4
Other Local Government Retirement Funds	21		25%		
Kanpo Life Insurance	83	0.90%	5%	4%	3.4
Japan Post Bank	205	0%	5%	5%	10.3
Bank of Japan					3.0

(Source) GPIF, Japan Post Bank, Kanpo Insurance, BOJ and UBS estimated

(Note) The above estimates are subject to updates thereafter without notice.

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