



Japanese Stock Market Outlook

SMAM monthly comments & views
- February 2016 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Although, the global negative head wind is blowing for the Japanese economy and the risk should not be underestimated, Japanese economy is still in a good health compared to other countries. Export and production recovered in the 4Q last year and expected to grow in 1Q 2016, though its sustainability depends on if Chinese economy manage to gradually stabilize.

- Private consumption in 4Q 2015 is estimated to have been flat due to warm winter and GDP estimate was revised from previous +0.5% to +0.1% QoQ annualized. Private capital investment is forecast to make a mild but positive contribution to GDP going forward.
- Wage negotiation for FY2016 has started and its developments are eagerly watched. Labor union's demand for base-pay rise is lower than last year so far affected by global economic concern.

➤ Japanese Stock Markets

Global risk has got higher and Japanese stock market will move within a wide box range. If and when it is confirmed that a) Chinese economy is not going for a hard landing or collapse and start to stabilize, b) US economy regain its solidness and manufacturing sectors start to recover, then expectation for higher interest rates in the US comes back bringing US dollars a little stronger and concern for the earnings growth of Japanese companies could be removed.

- Since January 2013, PER range for TOPIX index has been between 12.5 times and 16 times. At 1370 in TOPIX, PER based on 12 month forward earnings forecast is already 12.5 times. Even considering 5% earnings reduction, 12.5 times PER is at 1300 in TOPIX, which is our current downside of the forecast range for TOPIX though temporary overshooting is possible.

Notes: Macro and market views are as of Jan.18th and 20th 2016 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-16

- GDP forecast remains at +1.0% for both FY2015 and FY2016.
- For FY2016, private sector is expected to show a reasonable growth, consumption at +1.5%, housing investment at +3.3% and capital investment at +2.2%. Contraction in the public capital investment is the main drag, for which “special spending program of reconstruction from the earthquake and tsunami in 2011” comes to an end.

	FY12	FY13	FY14	FY15E	FY16E
Real GDP growth	0.9%	2.0%	-1.0%	1.0%	1.0%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	0.2%	1.5%
Private Housing Investment	5.7%	8.8%	-11.7%	3.0%	3.3%
Private Capital Investment	0.9%	3.0%	0.1%	1.5%	2.2%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.1%	0.1%
Public Capital Investment	1.0%	10.3%	-2.6%	0.1%	-0.6%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	-0.0%
Exports	-1.4%	4.4%	7.8%	1.8%	4.0%
Imports	3.6%	6.7%	3.3%	1.2%	4.9%
Nominal GDP	0.0%	1.7%	1.5%	2.2%	1.6%
GDP Deflator	-0.9%	-0.3%	2.5%	1.2%	0.5%

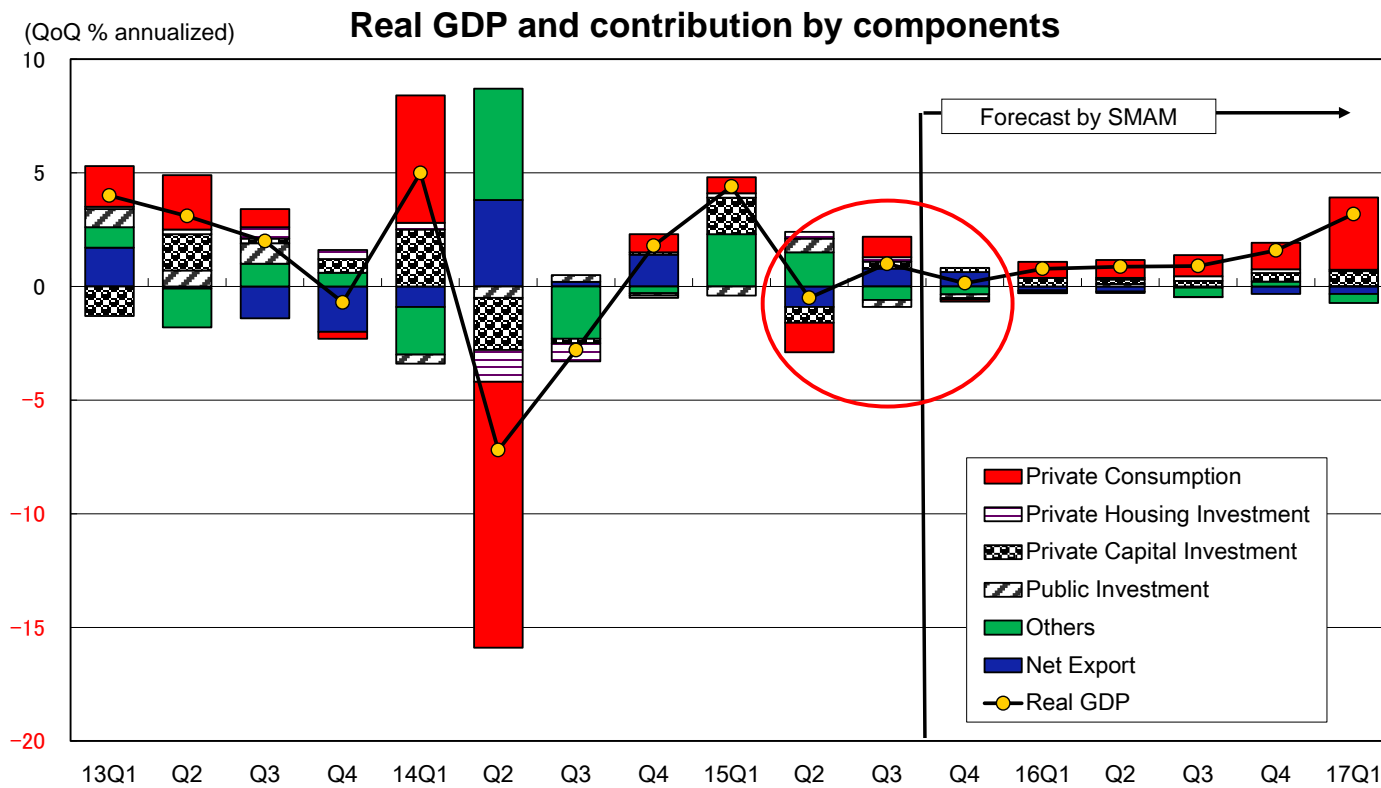
Notes: E=SMAM forecasts. SMAM views are as of Jan. 18th, 2016 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

SMAM economic outlook for FY15-16

- Private consumption in 4Q 2015 is estimated to have been flat due to warm winter and GDP estimate was revised from previous +0.5% to +0.1% QoQ annualized.
- Private capital investment is forecast to make a mild but positive contribution to GDP going forward.

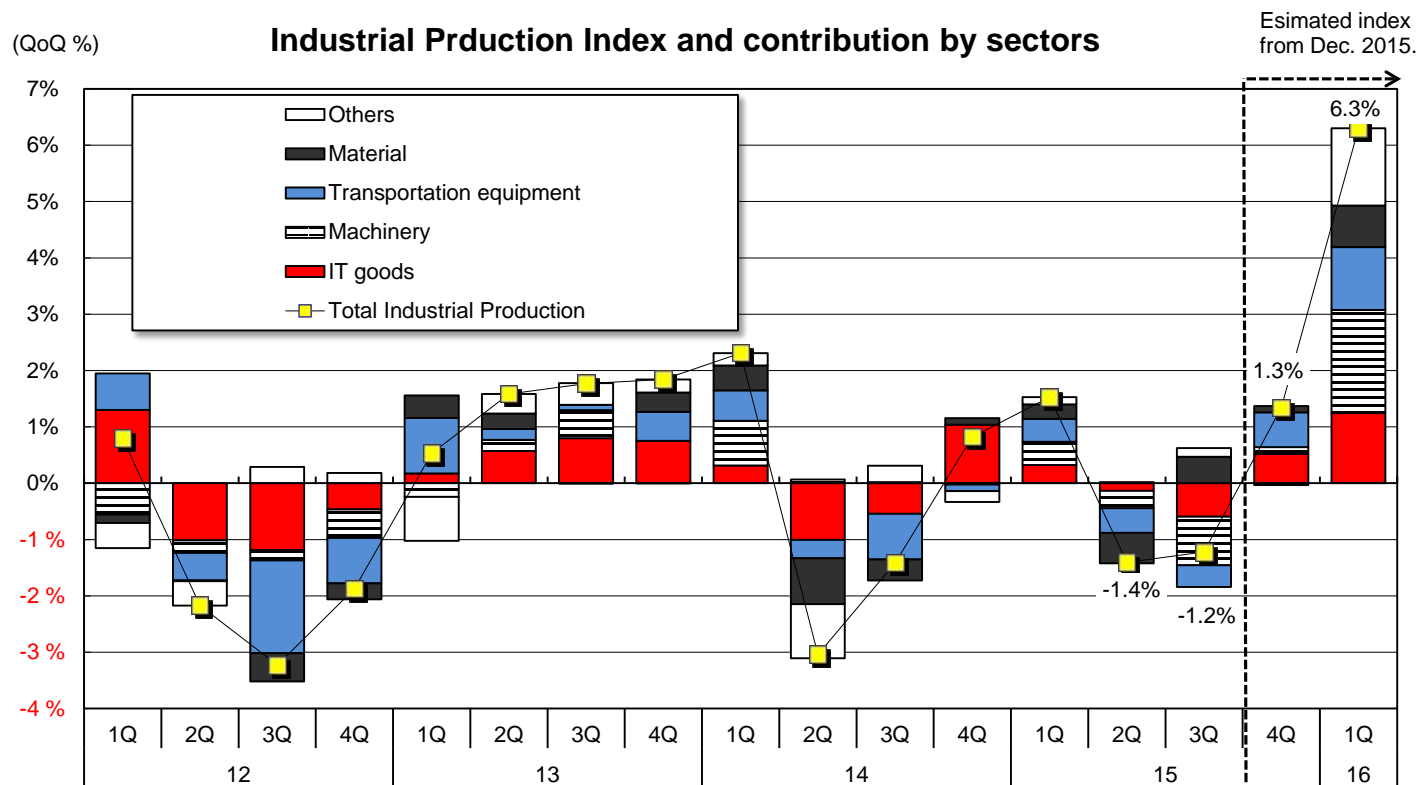


Notes: SMAM views are as of Jan.18th, 2016 and subject to updates thereafter without notice.

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

Industrial production is recovering though estimate for 1Q 2016 looks too optimistic

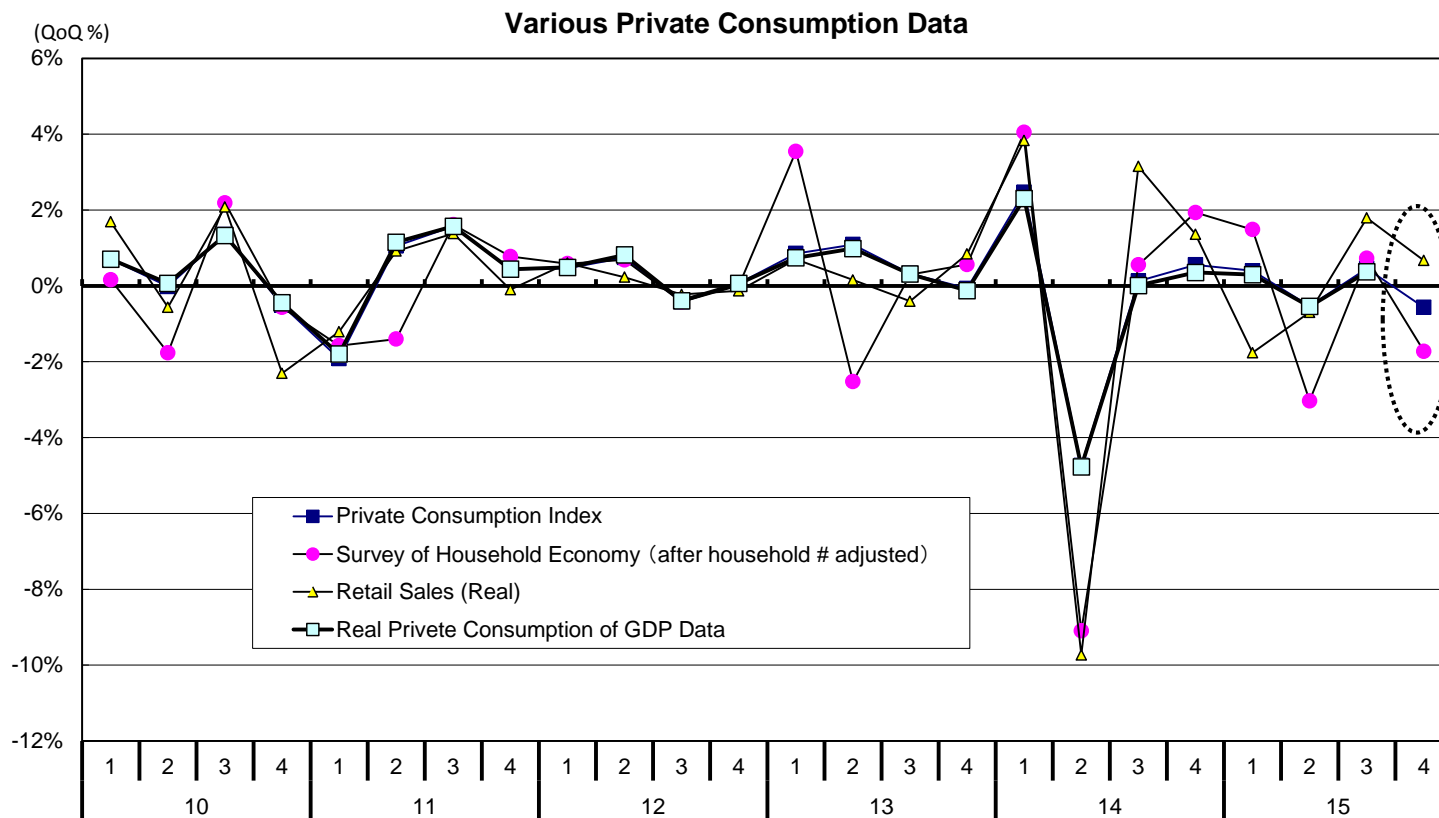
- Industrial production is recovering from the negative effect from global economic slowdown, especially in China. Whether this could be a sustainable recovery largely depends on the course of the Chinese economy from here.
- Estimated index tends to be optimistic from the recent experience and 1Q 2016 could be revised downward, probably due to IT goods and Machinery.



Note: Released Industrial Production Index until November and Estimated Index from December 2015 are used.
 (Source) Ministry of Economy, Trade and Industry

Private Consumption was weak in the 4Q last year probably due to extremely warm weather

- Japan had an extremely warm winter until the beginning of January, which probably dragged private consumption for season items such as winter clothes.
- Consumption is forecast to recover and keep growing, however, its strength will be affected by factors such as pay-rise for FY 2016 and stock market.

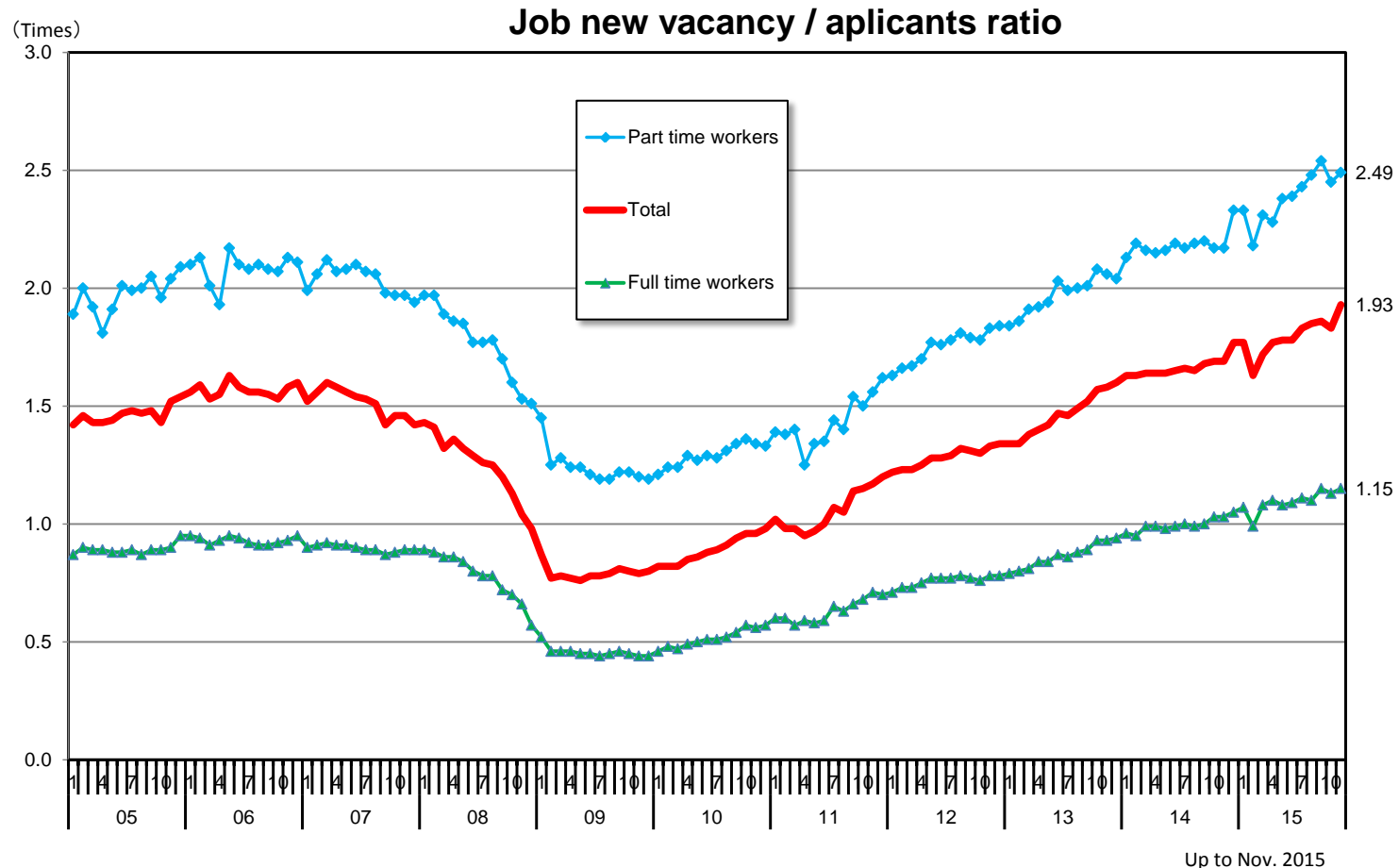


(Note) Data of the latest quarter is based on average of data for latest months.

(Source) Cabinet Office, Ministry of Economy, Trade and Industry, SMAM

Tight labor market continues to push wage higher for the long term

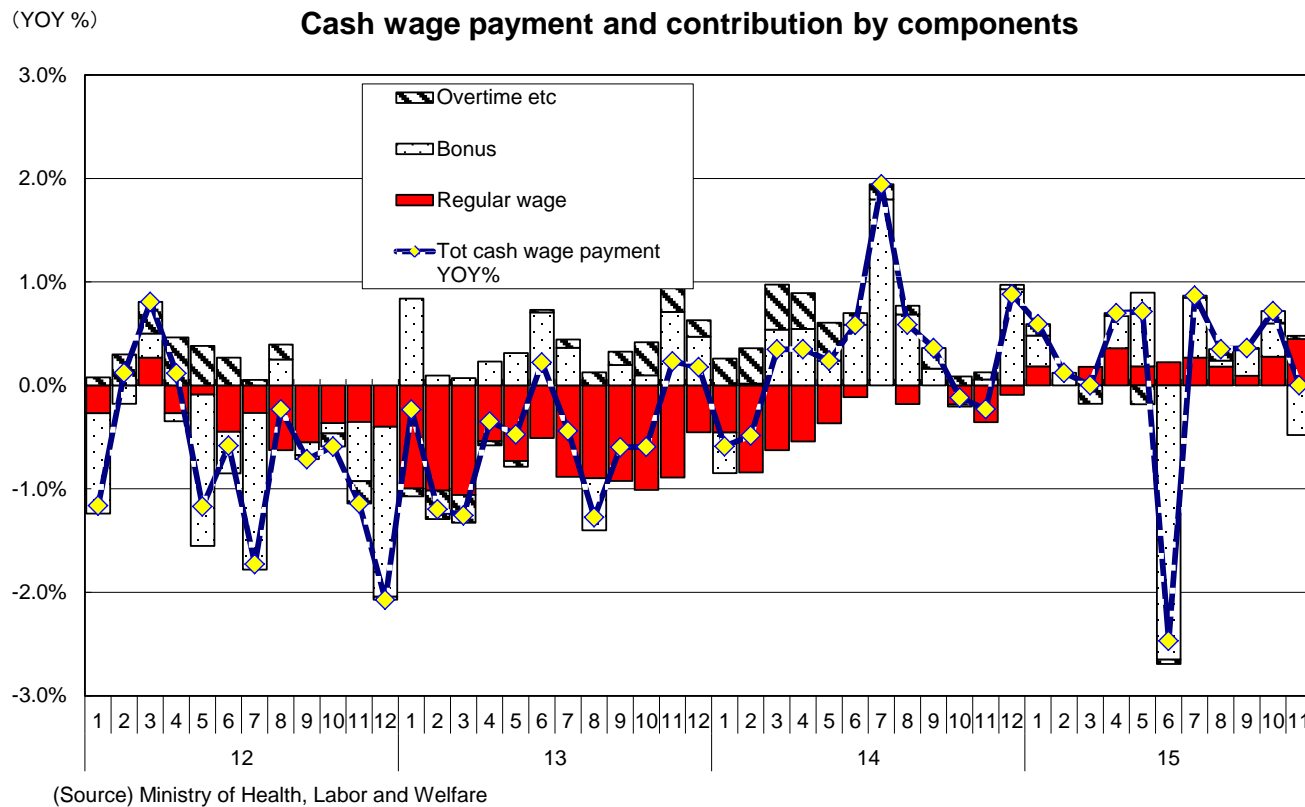
- Tightness of the labor market is more prominent when you look at Job new vacancy and applicants for it.
- Nearly half of the newly advertised vacancy are not filled.



(Source) Ministry of Health, Labor and welfare

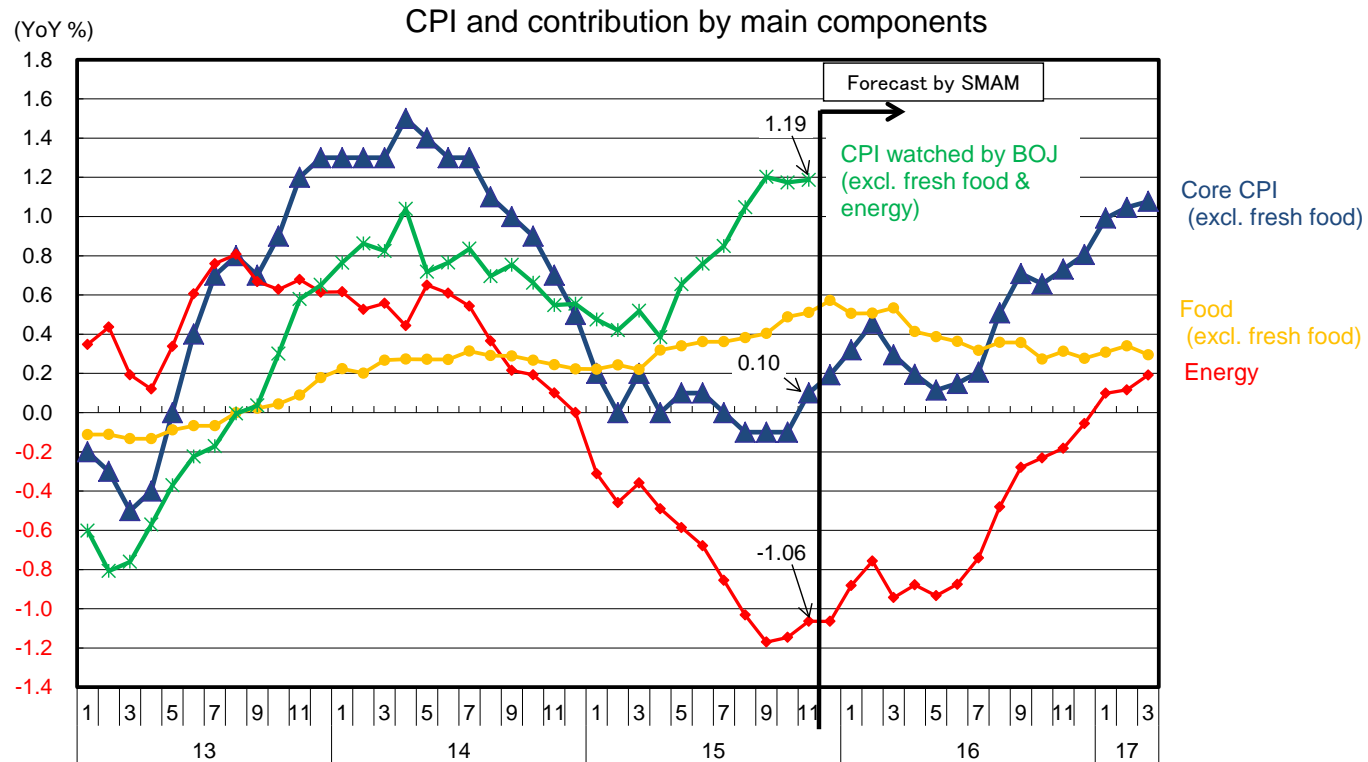
Regular wage continues to increase supporting consumer sentiment

- Despite total cash wage payment was flat year on year in November due to volatile bonus component, regular wage continues to increase which is supportive for the consumers.
- Wage negotiation for FY2016 has started and its developments are eagerly watched. Labor union's demand for base-pay rise is lower than last year so far affected by global economic concern.



Underlying trend of inflation looks OK when excluding fresh food & energy

- Underlying CPI trend moved sideways for 3 months when fresh food and energy were excluded, which is watched by BOJ.
- Due to limited room for further expanding quantitative easing, BOJ is expected to hold the fire unless it becomes really necessary to prevent the economy falling back into deflation.



Note: Excluding direct impact from consumption tax hike in April 2014.

(Source) Ministry of Internal Affairs & Communications, forecast by SMAM.

Outlook for Japanese Stock Markets

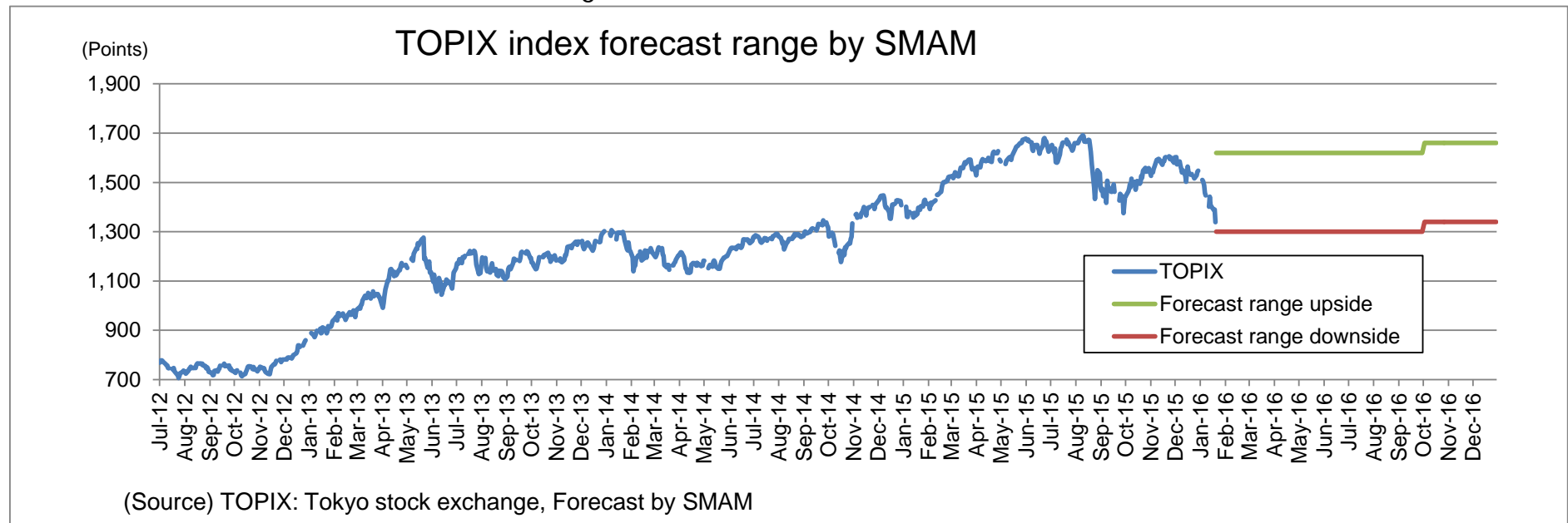
Stock market outlook: The stock market is waiting for further stimulus measures

SMAM short-term view

- Uncertainties surrounding the stock market, will linger for some time, Chinese economy, Oil price, US slowdown, strong yen, possible earnings setback and so on. Japanese stock market is expected to move within a wide box range with high volatility for the short term.

Longer-term outlook (6-months and beyond)

- When global uncertainties are gradually cleared, especially the Chinese economy, the Japanese stock market will make recovery and start to build grounds for the upside trial.
- Since January 2013, PER range for TOPIX index has been between 12.5 times and 16 times. Even considering 5% earnings reduction from the current forecast, 12.5 times PER is at 1300 in TOPIX, which is our current downside of the forecast range for TOPIX.



Note: SMAM's Projection is as of Jan. 20th 2016 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

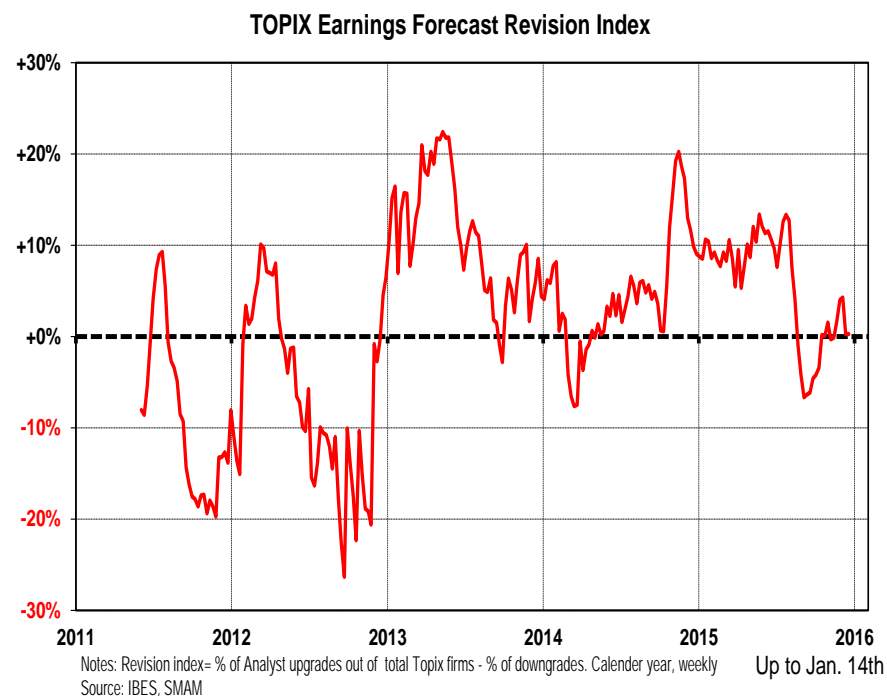
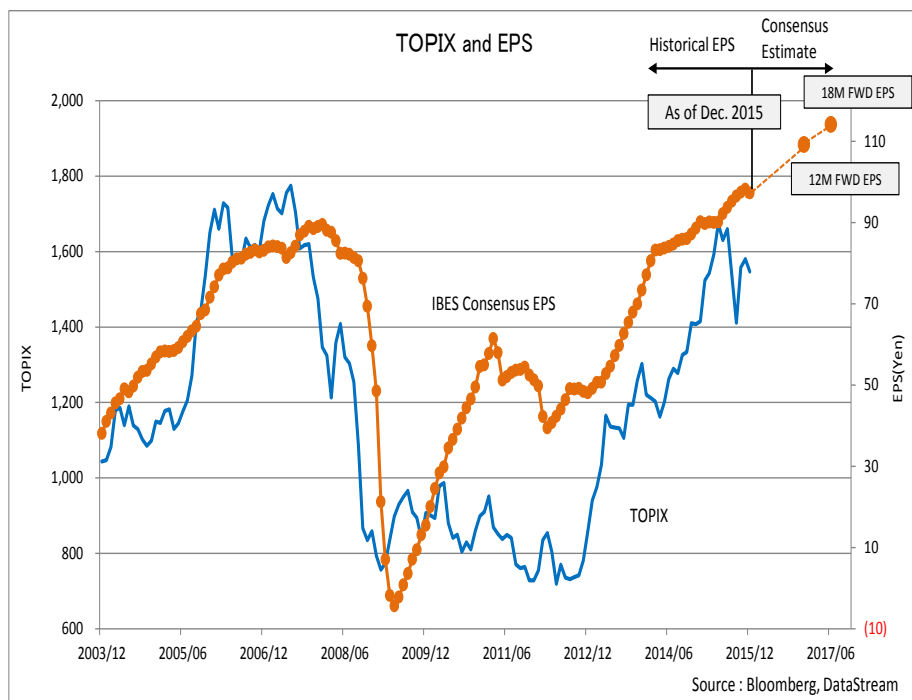
- Our **Base Scenario** is assuming the following views:
 - Global economy does not enter into a recession.
 - Japan's private consumption to grow mildly supported by higher real wages growth.
 - Japanese corporate earnings keep growing at higher pace than in peer countries.
 - Reflationary policy to 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:
 - Unexpectedly large impact from the process of US monetary policy normalization.
 - Concern over emerging economies including China.
 - Falling oil price causes disastrous problem for oil producing countries.
 - Increasing geopolitical concerns.

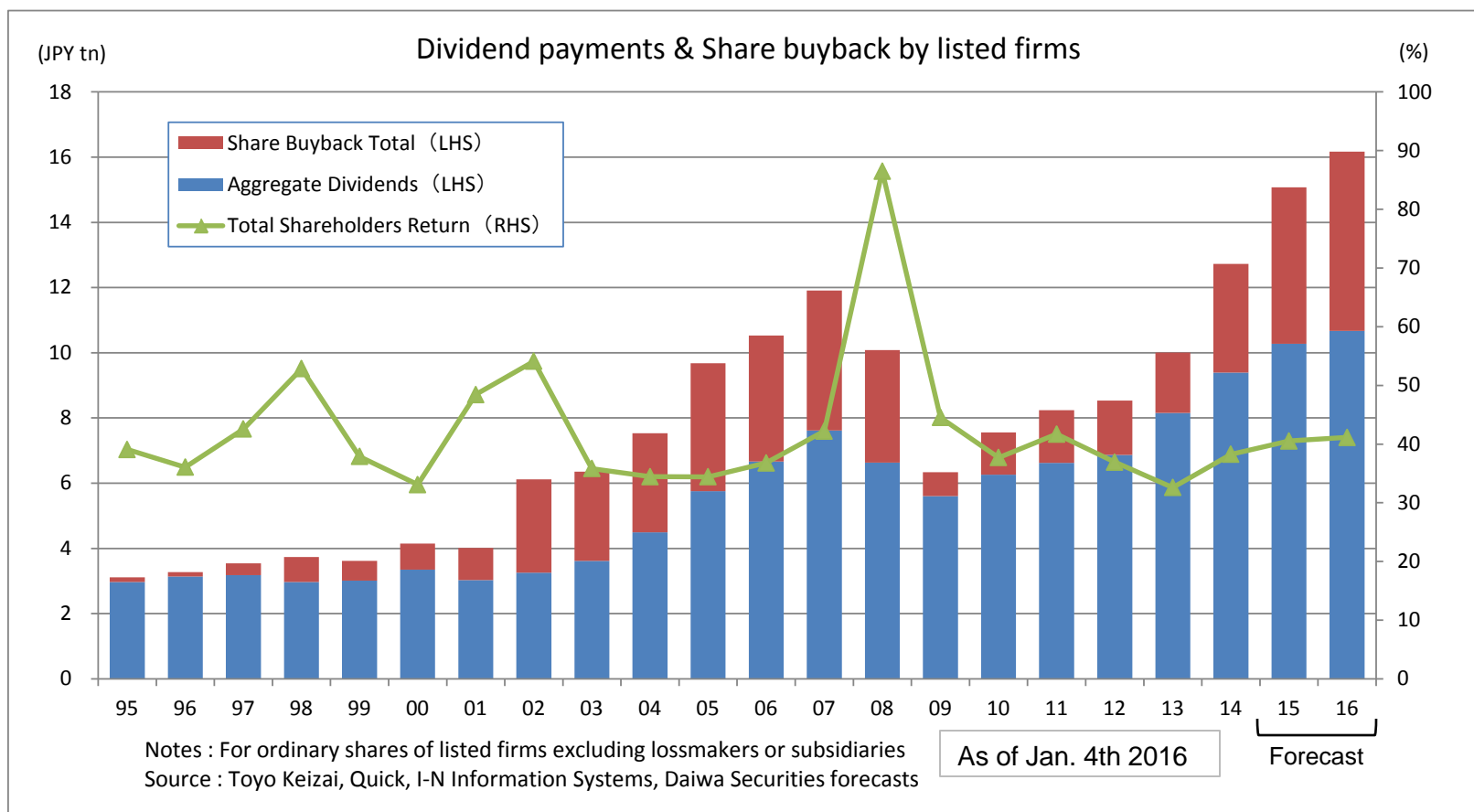
Earnings growth is expected to continue for Japan

- According to IBES, analysts are forecasting EPS to grow by 12.2% in the 12 months from December 2015.
- SMAM forecasts recurring profit growth for 216 non-financial companies covered by its own equity analysts, +14% in FY2015 and +7.3% in FY2016 assuming USD/JPY rate of 120.
- If yen stays stronger than 117-118 yen against USD, which is the presumption for earnings forecast by companies, risk of downward revision should increase.



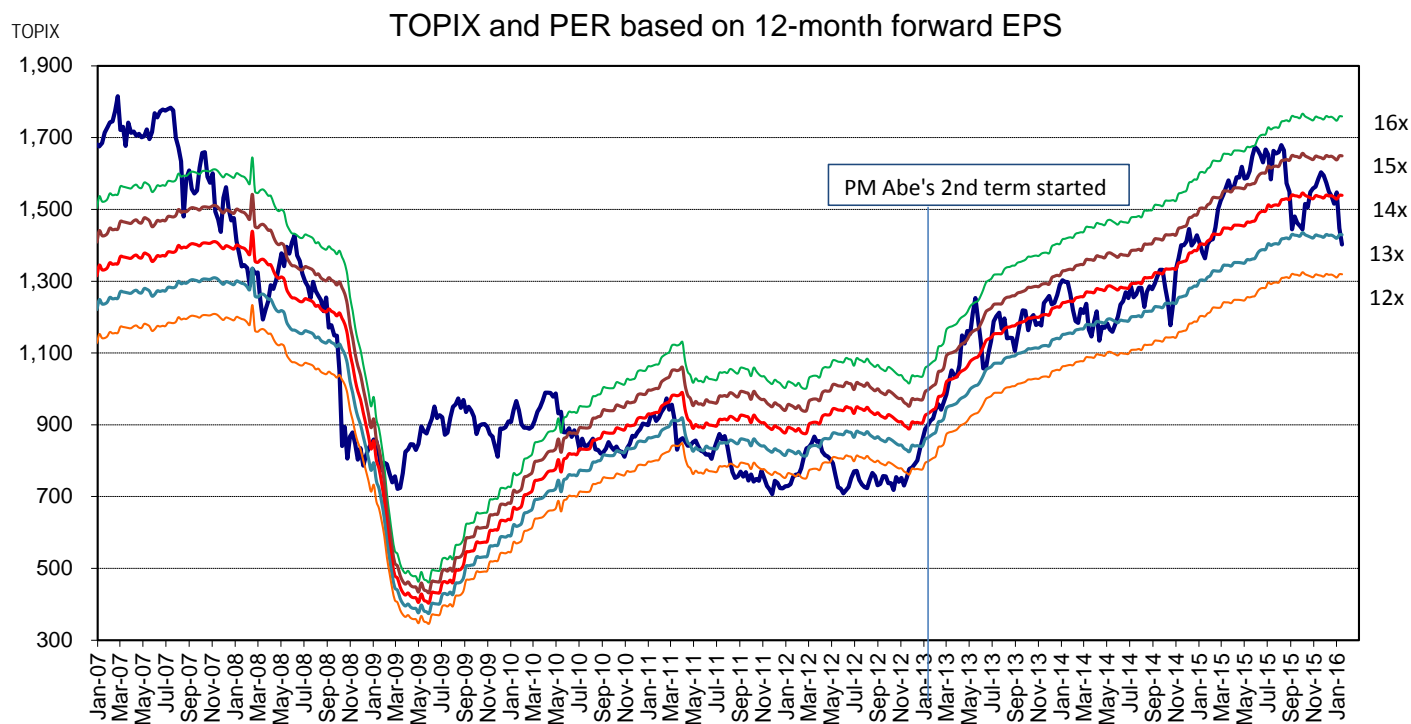
Huge potential for improving total shareholder returns

- Share buyback in 2015 is expected to surpass the previous record in 2007. Total shareholder return amount (dividend + share buyback) renewed the previous record in 2014 and forecast to keep increasing.
- There is a substantial room for Japanese companies to increase shareholder returns if they catch up peers in US and Europe.



Current PER indicates the stock prices have already discounted lots of pessimism.

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 12.5x and 16x. TOPIX has come down to this bottom of the range, which was briefly touched last time in October 2014 before the Halloween-easing surprise by BOJ.
- Current IBES 12 month forward EPS is about 109 for TOPIX. Even assuming -5% EPS forecast reduction and 12.5x PER, TOPIX level is calculated at 1306.

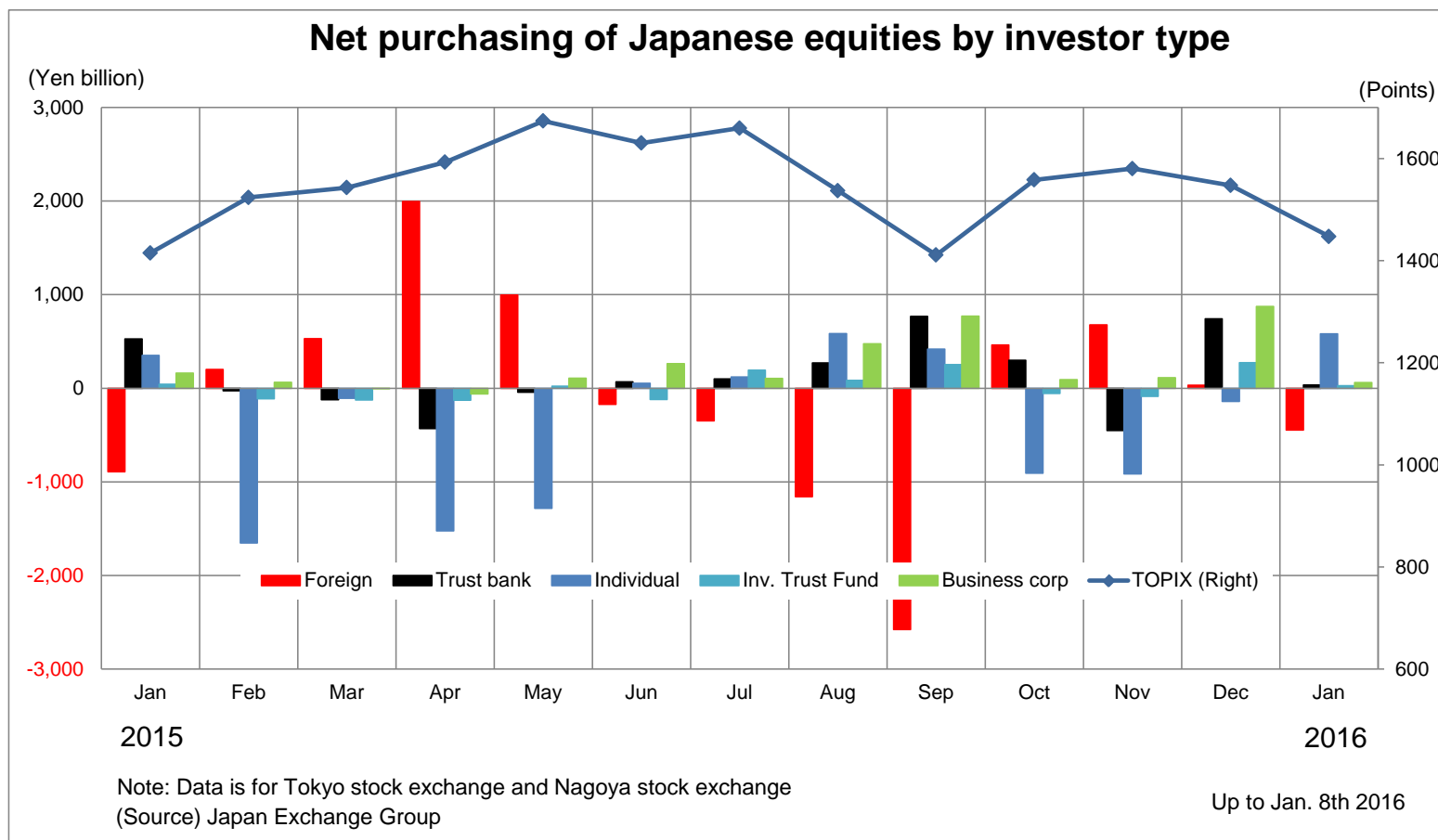


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Jan. 14th 2016 when TOPIX was 1406.55

Supply-Demand balance: Foreign investors selling is pulling the stock prices down

- From the start of the new year, Foreign investors turned to sellers, which brought down the stock market.
- Individuals have been buying mainly via investment trust funds in January.



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