



Japanese Stock Market Outlook

SMAM monthly comments & views
- September 2016 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

GDP growth for Apr-Jun quarter was 0.2% QoQ annualized, which was a little stronger than anticipated. Mild economic recovery is expected to continue going into 2017 led by positive effects coming from public spending. Focus is on “comprehensive review on the effectiveness of monetary policy” going to be released by BOJ in September.

- BOJ meets for a Monetary Policy Committee Meeting on 20th and 21st in September. It has already announced that “comprehensive review on the effectiveness of monetary policy” is going to be released then. A lot of speculation is going on about this review. SMAM thinks BOJ will take this occasion to confirm the effectiveness of current 3 dimensional monetary policy.
- One thing worthy of note is the fact that pressure for the stronger yen from the inflation difference has ceased. Inflation rate in Japan has risen while global inflation in general has substantially declined. This is exhibited as sideways move of PPP lines on the chart for the last several years. (Please refer to P9.)

➤ Japanese Stock Markets

For the short-term, Japanese stock markets will be shadowed by risk factors such as US presidential election, uncertainty of US monetary policy and yen’s direction despite positives such as continuing large ETF purchases by BOJ, expected effects from public spending and possible further monetary easing. Around autumn, however, such risk factors are going to recede and Japanese stock market is expected to try upside supported by recovering corporate earnings momentum.

- Underlying growth trend for corporate profits seems rather firm when effects of exchange rate moves are excluded, and expected to be back on YoY growth in the second half of FY2016.
- As of August 12th, PER for TOPX was 13.3x whereas comparative PER for S&P 500 was over 17x. Valuation of Japanese stocks looks attractive compared to US stocks.

Notes: Macro and market views are as of Aug 18th and 22nd, 2016 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY16-17

- PM Abe announced yen 28 trillion fiscal stimulus, among which central and local government budget spending is planned at yen 7.5 trillion. Public sector is going to pull the economy ahead. Private consumption is forecast to show moderate growth whereas private capital investment is forecast to make a solid contribution.
- BOJ meets for a Monetary Policy Committee Meeting on 20th and 21st in September. It has already announced that “comprehensive review on the effectiveness of monetary policy” is going to be released then. A lot of speculation is going on about this review. SMAM thinks BOJ will take this occasion to confirm the effectiveness of current 3 dimensional monetary policy.

	FY12	FY13	FY14	FY15	FY16E	FY17E
Real GDP growth	0.9%	2.0%	-0.9%	0.8%	0.6%	0.7%
Private Consumption Expenditure	1.7%	2.3%	-2.9%	-0.2%	0.5%	0.4%
Private Housing Investment	5.7%	8.8%	-11.7%	2.4%	4.6%	-0.3%
Private Capital Investment	0.9%	3.0%	0.1%	2.1%	0.3%	1.0%
Public Consumption Expenditure	1.5%	1.6%	0.1%	1.6%	1.8%	1.1%
Public Capital Investment	1.0%	10.3%	-2.6%	-2.7%	1.6%	5.7%
Net Exports (contrib. to GDP growth)	-0.8%	-0.5%	0.6%	0.1%	-0.0%	0.0%
Exports	-1.4%	4.4%	7.9%	0.4%	-0.3%	1.6%
Imports	3.6%	6.8%	3.4%	0.0%	-0.2%	1.8%
Nominal GDP	0.0%	1.7%	1.5%	2.2%	0.7%	0.9%
GDP Deflator	-0.9%	-0.3%	2.4%	1.4%	0.2%	0.2%

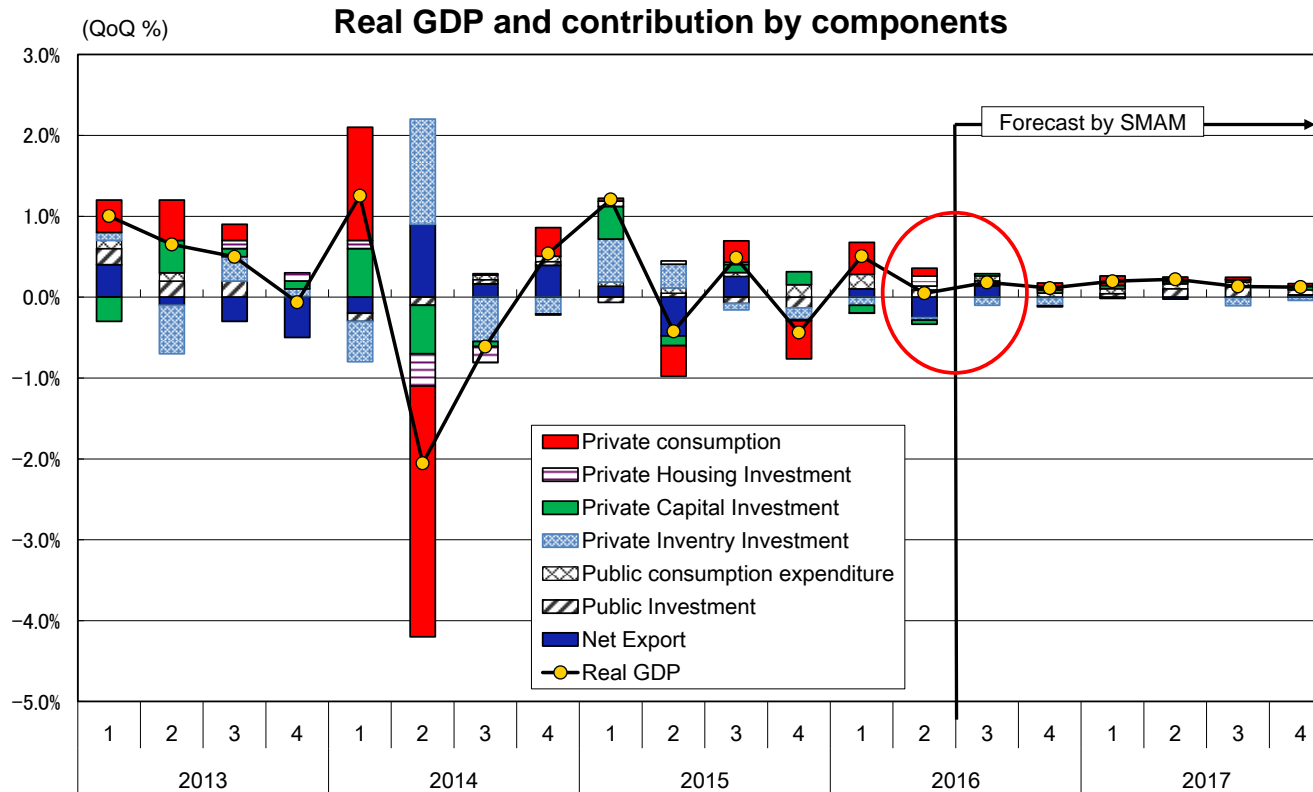
Notes: E=SMAM forecasts. SMAM views are as of Aug. 18th, 2016 and subject to updates thereafter without notice

(%, 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 quarterly economic outlook

- GDP for Apr-Jun quarter was a little stronger than anticipated growing by annualized 0.2% from the previous quarter.
- Mild recovery is expected to continue going into 2017 led by positive effects coming from public spending.



Notes: SMAM views are as of Aug. 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.

Money flow surrounding emerging economies has improved

- After experiencing a period of money out flow in many emerging economies, the flow has improved to show stable inflows in most countries. This is helping currencies of these countries and providing room for monetary easing to stimulate the economy. Delayed next interest hike in the US is one of the factors in this background.
- This brighter outlook for emerging economies is positive for the global economy and probably a sign of receding risk-off mode in the financial markets.

Change in Foreign Reserves of major emerging economies

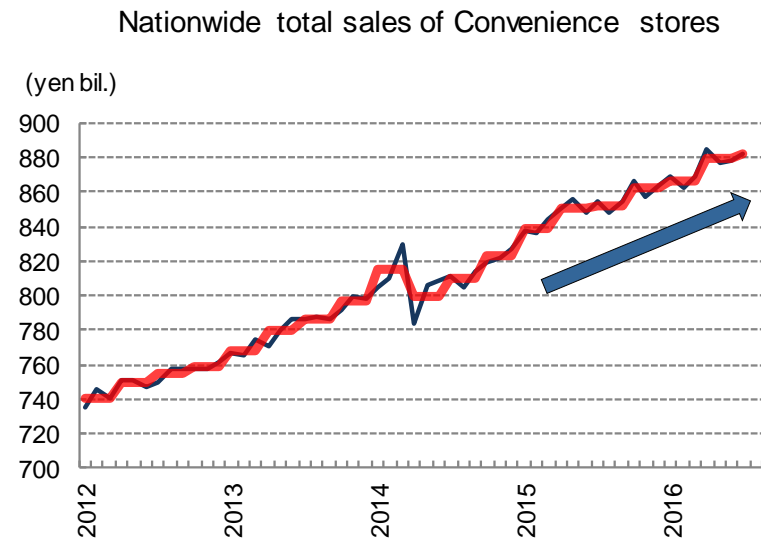
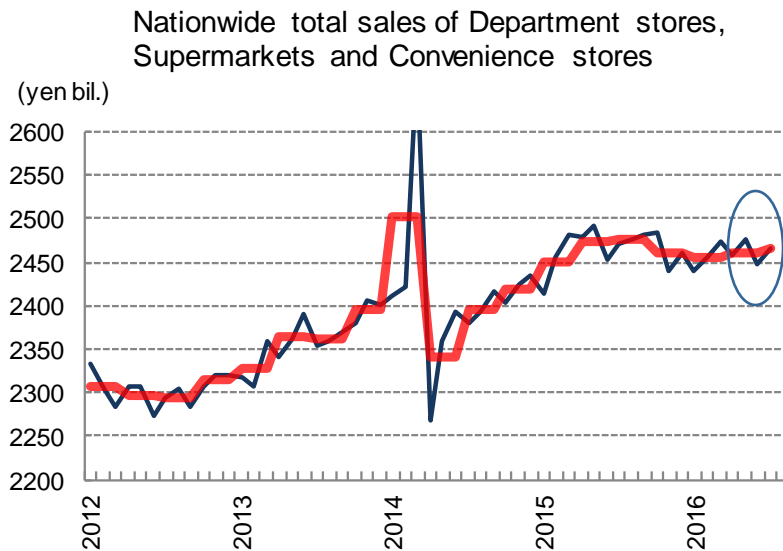
(US\$ bil)

	Brazil	Russia	India	Saudi Arabia	China	Taiwan	Hong Kong	Korea	Singapore	Thailand	Indonesia
(QoQ change)											
2014 Q1	1.4	-27.6	7.8	7.9	126.8	2.4	5.7	7.9	-0.1	0.2	3.2
Q2	3.3	-8.2	12.4	8.7	45.1	4.3	4.0	12.2	5.0	0.7	5.1
Q3	-4.8	-19.0	-1.4	2.5	-105.5	-2.8	4.9	-2.1	-11.8	-6.6	3.5
Q4	-1.7	-68.3	8.0	-12.6	-44.7	-1.7	2.7	-0.8	-9.3	-4.5	0.7
2015 Q1	-3.0	-27.7	20.8	-34.4	-113.0	-4.3	3.7	-0.8	-8.5	-0.8	-0.3
Q2	1.1	1.2	14.3	-22.5	-36.2	6.7	8.6	12.0	4.9	4.0	-3.5
Q3	-1.6	6.5	-3.9	-21.0	-179.7	4.9	5.0	-6.6	-1.6	-4.7	-6.3
Q4	-1.9	1.7	2.6	-38.1	-183.8	-0.3	13.0	-0.2	-3.9	1.0	4.2
2016 Q1	6.5	13.3	3.0	-29.3	-117.8	5.6	3.2	1.9	-1.6	18.6	1.6
Q2	1.5	11.6	4.4	-17.0	-7.4	1.9	-1.3	0.1	2.7	3.6	2.2
(MoM change)											
2016 1	1.0	1.1	-2.6	-14.4	-99.5	-0.0	-1.8	-0.7	-2.9	3.6	-3.8
2	1.9	8.5	-1.6	-9.4	-28.6	2.8	3.0	-1.5	-0.8	7.9	2.4
3	3.5	3.7	7.1	-5.6	10.3	2.8	2.0	4.1	2.2	7.1	3.0
4	1.5	6.6	6.9	-6.4	7.1	1.6	-1.2	2.6	4.2	3.5	0.2
5	-2.1	-1.1	-2.8	0.6	-27.9	0.3	-0.5	-1.6	-3.2	-3.1	-4.1
6	2.1	6.1	0.4	-11.2	13.4	0.1	0.4	-1.0	1.7	3.2	6.2
7	0.8	-0.6	4.5		-4.1	0.5	2.2	1.5	2.6	1.5	1.6

(Source) National statistics of each country, compiled by SMAM.

Private consumption in July bounced back indicating mild recovery trend

- Nationwide sales of 3 major store segments bounce back in July due to sunny and hot weather. Convenience store sales show continuing strong sales growth.
- Private consumption could be in a mild recovery trend as quarterly line on the left hand chart shows.
- Real wage has been growing though mildly due to nominal wage growth and recent negative CPI, which is helping consumers.



Notes: Seasonary adjusted by SMAM. Red line is for quarter average. Data is up to July 2016.

(Source) Japan Department Stores Association, Japan Chain Stores Association and Japan Franchise Association, compiled by SMAM.

Monetary policy is coming into focus in Japan

- BOJ meets for a Monetary Policy Committee Meeting on 20th and 21st in September. It has already announced that “comprehensive review on the effectiveness of monetary policy” is going to be released then.
- A lot of speculation is going on about this review. SMAM thinks BOJ will take this occasion to confirm the effectiveness of current 3 dimensional monetary policy.
- Possible policy changes are such as a) slight expansion of negative interest rate from -0.1% to -0.2%, b) elimination of 2 years as a targeted period for achieving 2% inflation and c) slightly expanding quantitative easing or making the purchasing pace more flexible. However, nothing is certain yet and you should keep watchful eyes on it.

Major event schedule		
2016 Sep.	8th 20-21st middle?	1st revision for 2Q 2016 GDP BOJ's Monetary Policy Committee Meeting - "Comprehensive review on the effectiveness of monetary policy" is released. Extraordinary session of National Diet begins
Oct.	3rd 23rd 31st to 1st Nov.	Bank of Japan "Tankan" business survey is released. Lower house election for vacant seats in Tokyo & Fukuoka BOJ's Monetary Policy Committee Meeting - "Tenbou" economic perspective report is released.
Nov.	14th	1st preliminary 3Q 2016 GDP
Dec	8th 14th 19th, 20th Latter half 4th to 5th week 4th to 5th week In the month	1st revision for 3Q 2016 GDP Bank of Japan "Tankan" business survey is released. BOJ's Monetary Policy Committee Meeting Final GDP for FY 2015 Cabinet office will approve government budget plan for 2017 to be sent to Diet. Government debt issuance plan for FY2017 Guidelines of Tax plan for FY2017
2017 Jan.	In the month In the month	Ordinary session of National Diet begins Assembly of Liberal Democratic Party - Possible discussion on extending the maximum limit on years of party leaders?

(Source) various publications and compiled by SMAM

Historical developments of BOJ's monetary policy

- The table shows developments of Bank of Japan's assumptions and monetary policies. Consensus forecast by economists is provided to be compared with BOJ's assumptions. Downward revision for BOJ's CPI forecast seems inevitable.

Bank of Japan "TENBOU" Economic Perspective Report (%)																
		2013				2014				2015				2016		
		January	April	July	October	January	April	July	October	January	April	July	October	January	April	July
2014	GDP	0.8	1.4	1.3	1.5	1.4	1.1	1.0	0.5	-0.5	-0.9					
	CPI	0.9	1.4	1.3	1.3	1.3	1.3	1.3	1.2	0.9	0.8					
2015	GDP		1.6	1.5	1.5	1.5	1.5	1.5	1.5	2.1	2.0	1.7	1.2	1.1	0.7	
	CPI		1.9	1.9	1.9	1.9	1.9	1.9	1.7	1.0	0.8	0.7	0.1	0.1	0.0	
2016	GDP						1.3	1.3	1.2	1.6	1.5	1.5	1.4	1.5	1.2	1.0
	CPI						2.1	2.1	2.1	2.2	2.0	1.9	1.4	0.8	0.5	0.1
2017	GDP										0.2	0.2	0.3	0.3	0.1	1.3
	CPI										1.9	1.8	1.8	1.8	1.7	1.7
2018	GDP														1.0	0.9
	CPI														1.9	1.9
Oil price assumption	US\$/barrel									Between 50 and 70	Between 50 and early 70's	Between 60 and 70's	Between 50 and early 60's	Between 35 and upper 40's	Between 35 and upper 40's	Between 45 and 50
When 2% inflation will be achieved			Between 2013 and latter half of 2015		Between 2013 and latter half of 2015		Between 2014 and middle of 2016		Around 2015		Around the first half of 2016		Around the second half of 2016	Around the first half of 2017	During 2017	During 2017
Change in monetary policy			The first implementation of QQE						QQE enhanced					Negative interest rate started		ETF purchasing enhanced

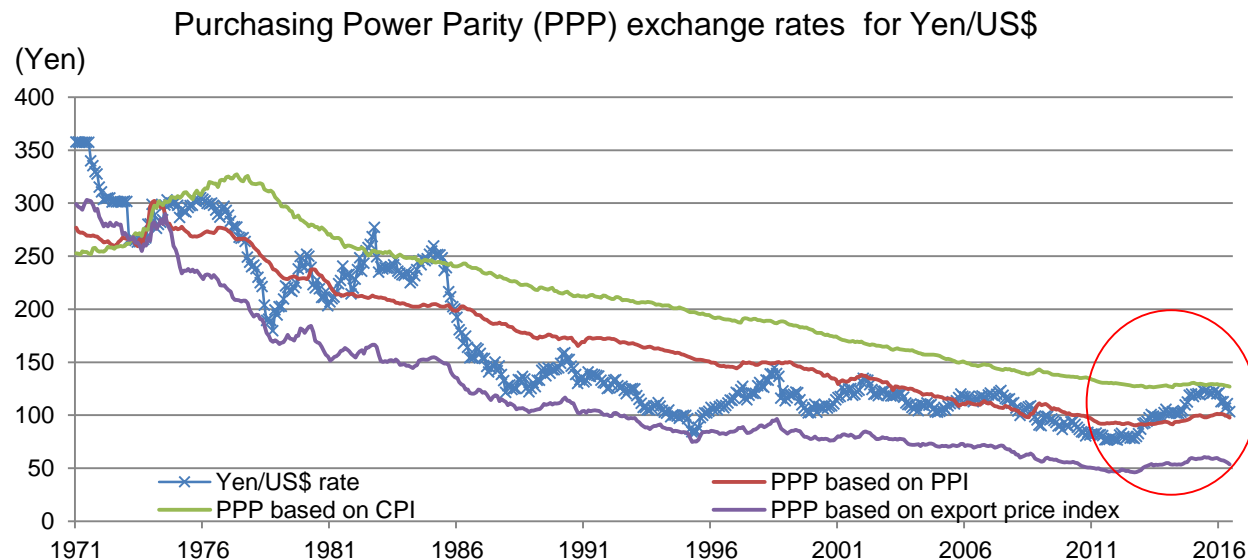
(Source) Bank of Japan, compiled by SMAM

Consensus forecast by economists: ESP survey (%)																
		2013				2014				2015				2016		
		January	April	July	October	January	April	July	October	January	April	July	October	January	April	July
2014	GDP	0.2	0.3	0.6	0.7	0.8	0.7	0.9	0.3	-0.6	-1.0					
	CPI	0.3	0.5	0.7	0.8	0.9	1.0	1.1	1.2	1.0	0.8					
2015	GDP			1.3	1.3	1.4	1.3	1.4	1.3	1.8	1.8	1.4	1.0	1.1	0.7	
	CPI			1.0	0.9	1.0	1.0	1.1	1.2	0.8	0.4	0.3	0.2	0.1	0.0	
2016	GDP							1.2	1.2	1.6	1.7	1.6	1.6	1.4	0.9	0.6
	CPI							1.3	1.3	1.3	1.2	1.2	1.0	0.8	0.2	0.0
2017	GDP											0.1	0.1	0.1	0.0	0.8
	CPI											1.3	1.2	1.1	0.9	0.7

(Source) Japan Center for Economic Research, compile by SMAM

Where the yen is heading ?

- One thing worthy of note is the fact that pressure for the stronger yen from the inflation difference has ceased. Inflation rate in Japan has risen while global inflation in general has substantially declined. This is exhibited as sideways move of PPP lines on the chart for the last several years.
- Historically, PPP based on CPI worked as the weaker end for Yen against US dollars, which was also the case this time after the beginning of Abenomics so far.
- Yen/Dollar rate seems to have been moving around PPI based PPP rate for the last 15 years and current rate is also close to it.



Note: PPP rates are calculated based on the yen/US\$ rate of 265.96 as of Mar. 1973 and each price indices in Japan and US. Data is monthly and up to June 2016.

(Source) US Department of Labor, US Department of Commerce, FRB, Bank of Japan, Ministry of Internal Affairs and Communication, and IMF, compiled by SMAM

Outlook for Japanese Stock Markets

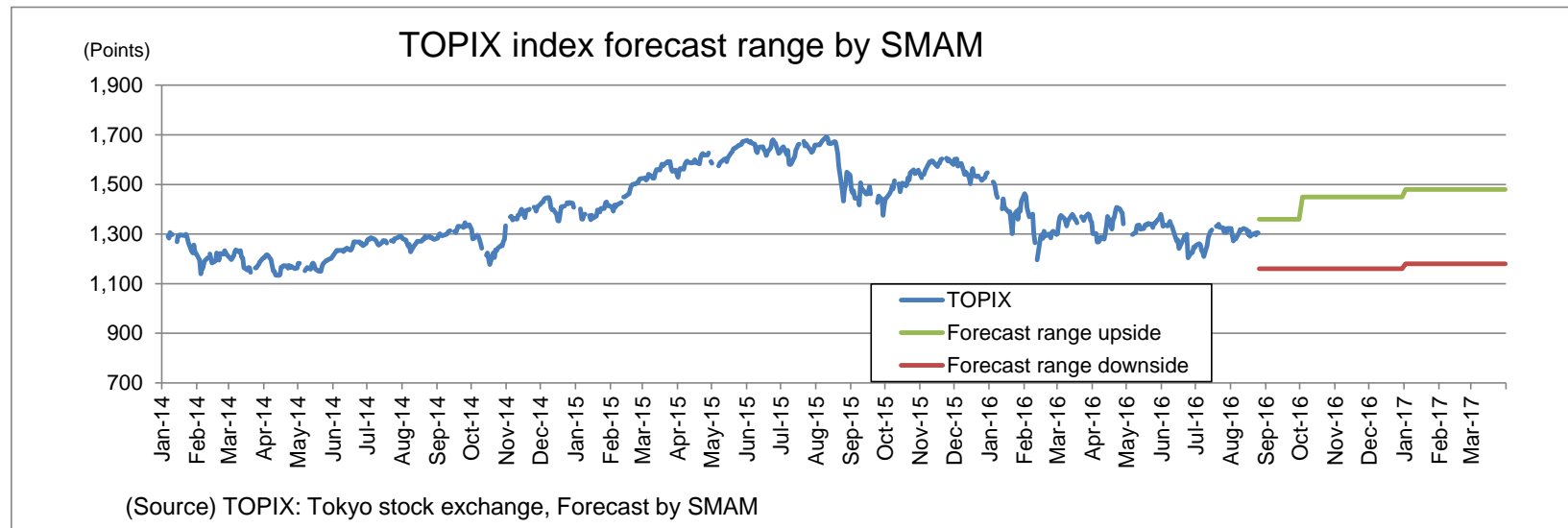
Stock market outlook: waiting for effects of fiscal stimulus while strong yen poses risks

SMAM short-term view

- For the short-term, positive factors will be shadowed by risk factors. Positives are such as continuing large ETF purchases by BOJ, expected effects from public spending and possible further monetary easing. On the other hand, risk factors will be such as US presidential election, uncertainty of US monetary policy and yen's direction.

Longer-term outlook (6-months and beyond)

- Aforementioned risk factors are going to recede around autumn and Japanese stock market is expected to try upside supported by such factors as recovering corporate earnings momentum and anticipation for positive effects from public spending.



Note: SMAM's projection is as of Aug. 22nd 2016 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

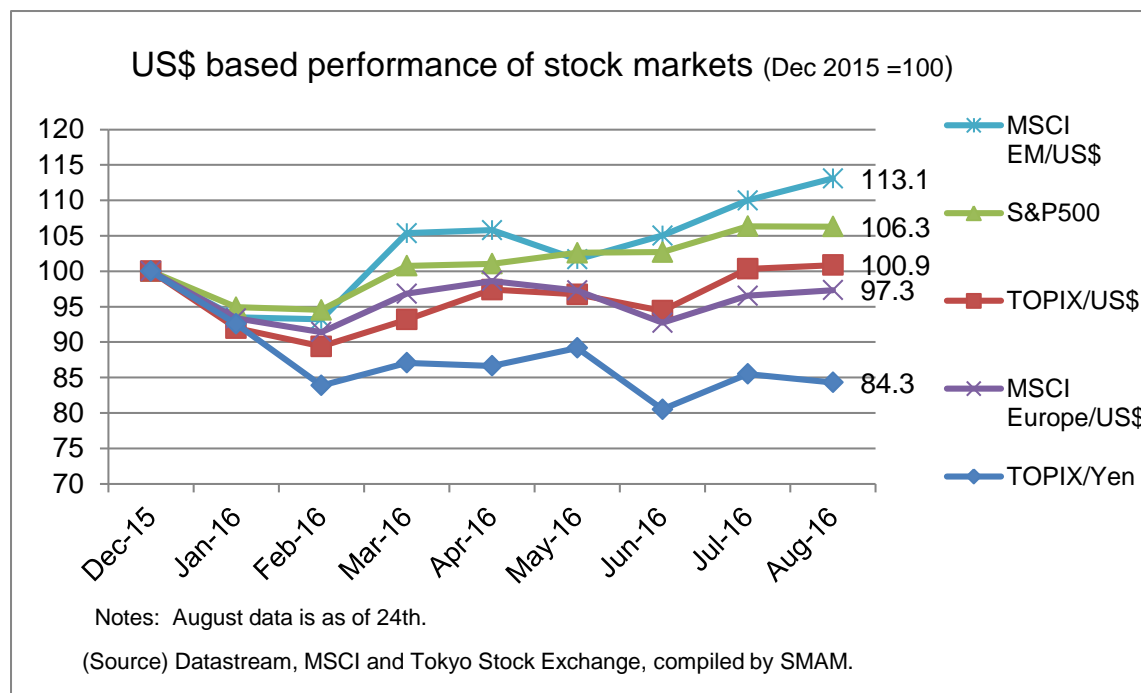
- Our **Base Scenario** is assuming the following views:
 - Global economy does not enter into a recession.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese corporate earnings growth to gradually recover from the negative shock of stronger yen.
 - Fiscal stimulus and further monetary easing will be made to sustain economic growth in Japan.

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

- **Downside Risks** include:
 - Britain's decision to exit from EU deeply confuses politics and economies in Europe.
 - 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.

US\$ based performance comparison among stock markets by countries & regions

- Japanese stock market performed poor in yen terms this year falling by -15.7% as of August 24th, however, in US\$ basis, TOPIX performance in the same period was +0.09% , which was not too far behind of US S&P 500 of +6.3% . Europe was lagging behind at -2.7%.
- So far this year, money is flowing back to emerging markets and MSCI EM index was at +13.1% higher this year as of August 24th. Delayed interest rate hike in US is provably supporting this relative strength of EM stocks.
- When prospect for US interest rate hike increases again, relative attractiveness of Japanese stocks could improve due to better prospect for earnings growth helped by weaker yen.



Companies were implicitly forecasting 2.5% Year on Year profit growth for Jul-Mar period

- At the announcement of 1Q results, aggregated earnings guidance for FY2016 by companies* was standing at -3.5%. After the actual profits achieved in 1Q, companies were implicitly forecasting +2.5% profit growth for 3 quarters between July 2016 and March 2017.

(Note: *Numbers are for 218 companies in SMAM research coverage excluding financials.)

- For this profit forecast for FY2016, assumption for US\$/yen is estimated to be between 105 and 110, which means risk of downgrading profit forecast remains.
- However, underlying growth trend for profits seems rather firm when effects of exchange rate moves are excluded. YoY profit change will improve quarter by quarter, showing positive momentum.

Recurring profits forecast by companies as of the end of 1Q 2016
SMAM research coverage of 218 companies excluding financials

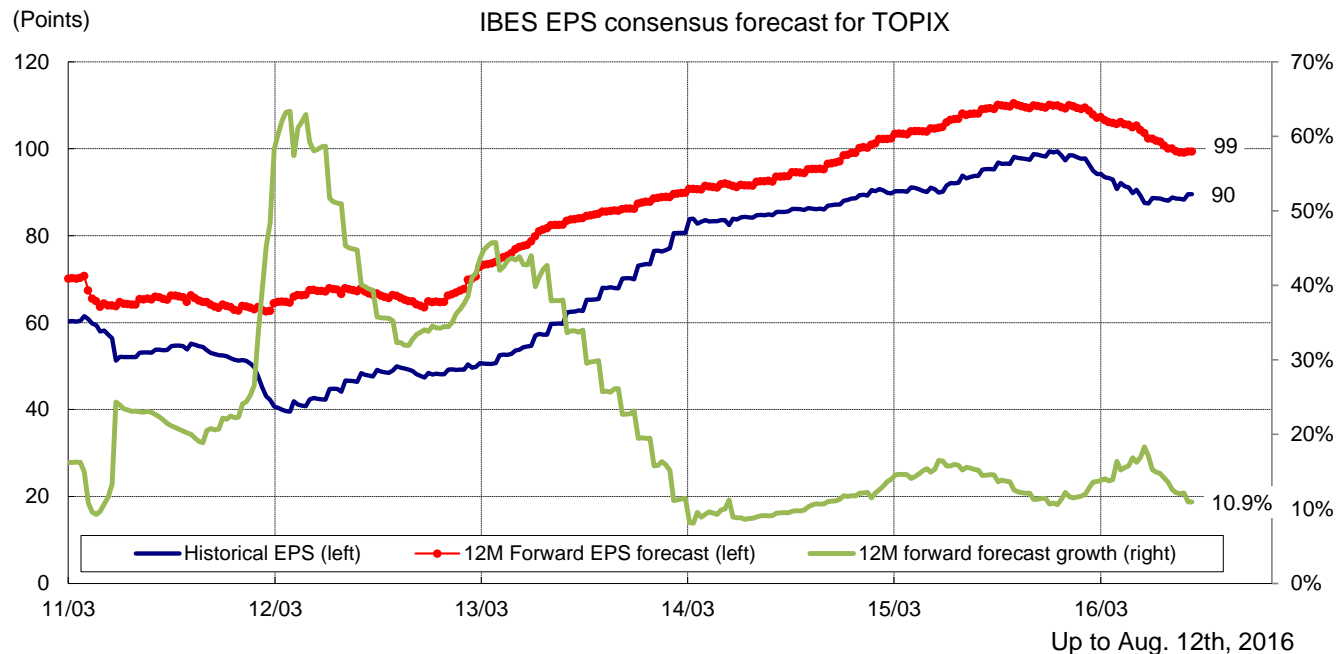
(yen bil. %)	FY2015 (from Apr2015 to Mar2016)					FY2016 (from Apr2016 to Mar2017)				
	1Q(Apr-Jun)	2Q	3Q	4Q	FY2015 total	1Q(Apr-Jun)	2Q	3Q	4Q	FY2016 total
Recurring profits	9,066	8,264	7,695	4,348	29,365	7,541	-	-	-	28,351
YoY%	28.60%	0.40%	1.10%	-26.50%	2.50%	-16.80%	-	-	-	-3.50%
2Q to 4Q tot.		20,307				20,810				
YoY%		-6.7%				2.5%				
US\$/yen Month end average (actual)	121.9	121.7	121.2	115.4	120.1	106.8	?	?	?	?

Yen appreciated by 14%

(Source) Toyo Keizai, announcement of each company, compiled by SMAM

EPS forecast by analysts seems to be bottoming out

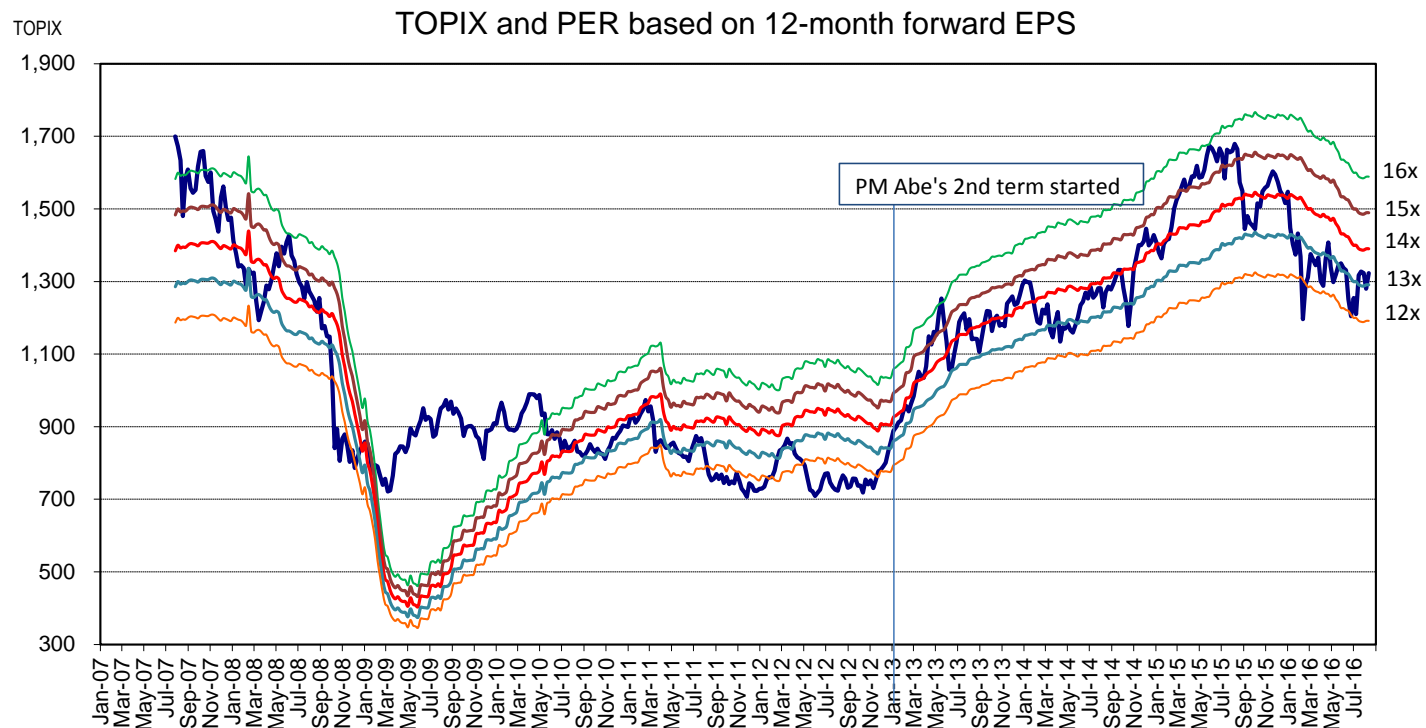
- The blue line in the chart, 12 month trailing EPS or historical EPS, has been recovering since June after the negative factors such as sharp appreciation of yen and heavy impairment costs of commodity related assets went behind. The red line, 12M forward EPS forecast, ticked up lately, which might indicate bottoming out move.
- 10.9% of 12M forward EPS growth is forecast . FY2016 growth for EPS is higher than that for recurring profit in general because extraordinary costs such as aforementioned impairment costs affects EPS but not recurring profits.



(Source) Datastream, IBES

PER is in the lower half of the range for the current PM Abe's tenure

- Since Abenomics started, PER for Japanese stock market, TOPIX index-wise, has been in a range between 12x and 16x except for temporary overshooting.
- As of August 12th, PER for TOPX was 13.3x whereas comparative PER for S&P 500 was over 17x. Relative valuation of Japanese stocks looks attractive compared to US stocks.

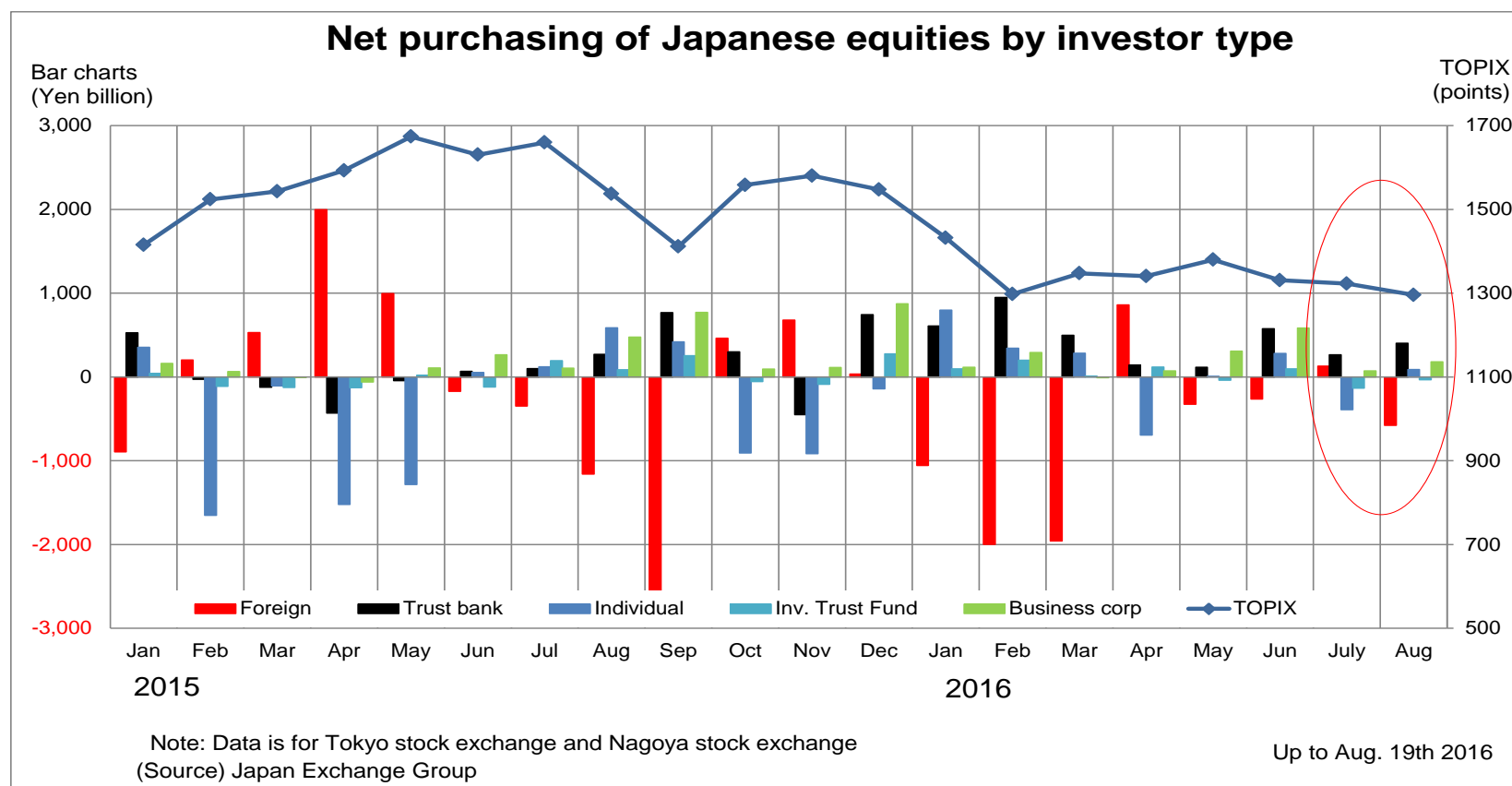


Notes: TOPIX: calendar year and week-end, P/E ratio is based on 12-month forward EPS of IBES
Source: TOPIX: Tokyo Stock Exchange, 12 month forward EPS of IBES: SMAM

Data is up to Aug.12th 2016 when TOPIX was 1323.22

Purchasing by Trust Bank is going to increase by doubling ETF buying by BOJ

- BOJ's purchase of ETF is counted as Trust Bank.
- BOJ doubled annual pace of purchasing Japanese equity ETFs to 6 trillion yen in July and such purchasing through trust banks is going to provide a strong support to the Japanese stock market.



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