



Japanese Stock Market Outlook

SMAM monthly comments & views

- June 2018 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Extremely cold winter and early spring ended in Japan. Consumer sentiment was negatively affected by inactivity due to coldness and high price of food such as fresh vegetables. The weather turned hot from April and sentiment is expected to improve.

- GDP for FY 2017 was 1.5% slightly weaker than the previous estimate of 1.8% due to weak preliminary estimate of -0.6% (annualized QoQ%) for Jan-Mar 2018, and also downward revision made for Oct-Dec 2017. Mild and steady GDP growth is forecast for FY2018 and FY2019.
- According to NHK, Approval rating for Abe cabinet was 38% in May unchanged from April. Disapproval rating marginally fell from 45% to 44%. Odds for PM Abe's survival is increasing.

➤ Japanese Stock Markets

After making recovery in April and May, risk events such as the fate of US-North Korea top negotiations would weigh on the Japanese stock market for a while. Positive results of such events will lift stock prices. Earnings results for FY 2017 are coming out in May, however, companies stay conservative on future guidance in general.

- After declining for two months, Global Manufacturing PMI rebounded in April. A brief retreat from one-off reconstruction demand from hurricane damage in US seems to have ended and to be heading upward again. Japanese stock market has a very high positive correlation with this Global PMI.
- PER for TOPIX index is around 14 times, which has been the middle of the range after PM Abe took helm in 2013.

Notes: Macro and market views are as of May 22nd, 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-19

- GDP for FY 2017 was 1.5% slightly weaker than the previous estimate of 1.8% due to weak preliminary estimate of -0.6% (annualized QoQ%) for Jan-Mar 2018, and also downward revision made for Oct-Dec 2017.
- Mild and steady GDP growth is forecast for FY2018 and FY2019.

(YoY %)	FY14	FY15	FY16	FY17	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.5%	1.1%	0.9%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	0.8%	0.7%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	-0.3%	-4.3%	0.5%
Private Capital Investment	3.3%	2.3%	1.2%	3.0%	2.2%	1.9%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.4%	0.4%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.5%	-0.1%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.4%	0.3%	0.2%
Exports	8.7%	0.8%	3.6%	6.2%	4.2%	2.1%
Imports	4.2%	0.4%	-0.8%	4.0%	2.4%	1.3%
Nominal GDP	2.2%	3.0%	1.0%	1.6%	1.2%	2.1%
GDP Deflator	2.5%	1.5%	-0.2%	0.1%	0.2%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.1%	3.2%	1.8%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	0.8%	0.7%

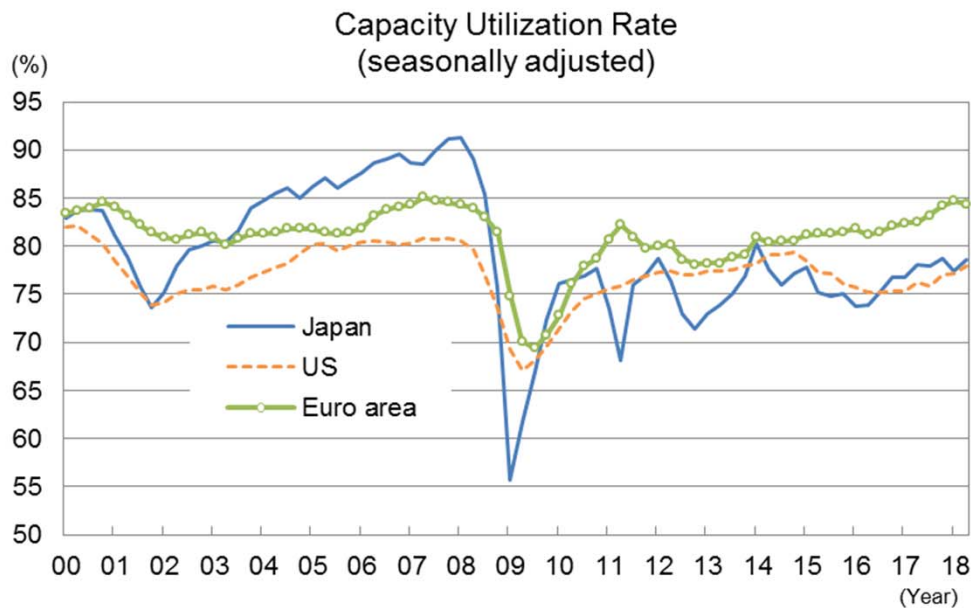
Notes: E=SMAM forecasts. SMAM views are as of May 22nd, 2018 and subject to updates thereafter without notice

(%, YoY except Net Exports)

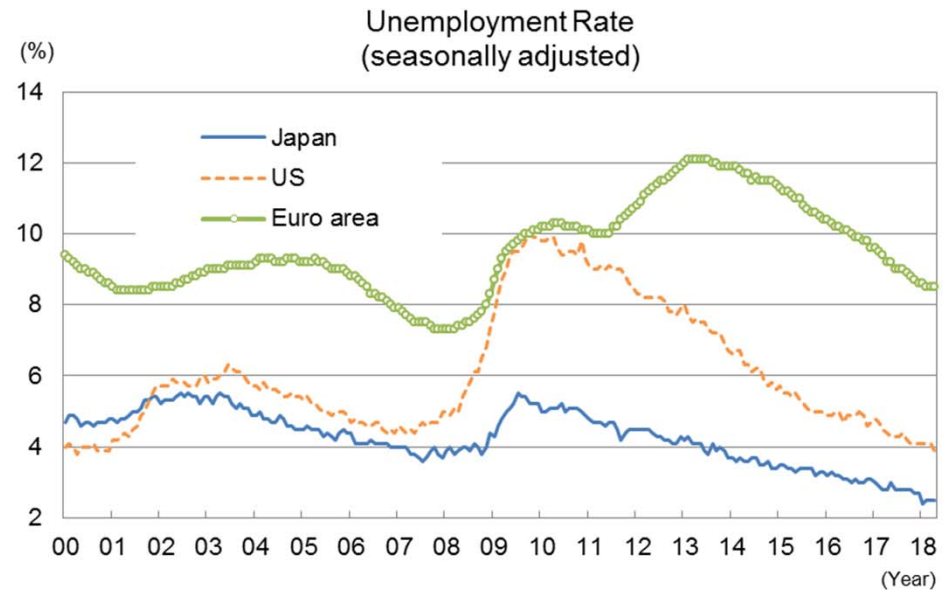
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

Supply side of the developed countries continues to get tighter

- Capacity utilization continues to improve. Japan and US still have upside room when compared to the level prior to the global financial crisis in 2008.
- Tightness in the labor market is reaching almost unprecedented level in Japan and US.
- Euro area shows a little different picture. Capacity utilization might have hit a ceiling at around 85 % level just as it did in 2000 and 2007, whereas unemployment rate is still higher than the level in 2007.



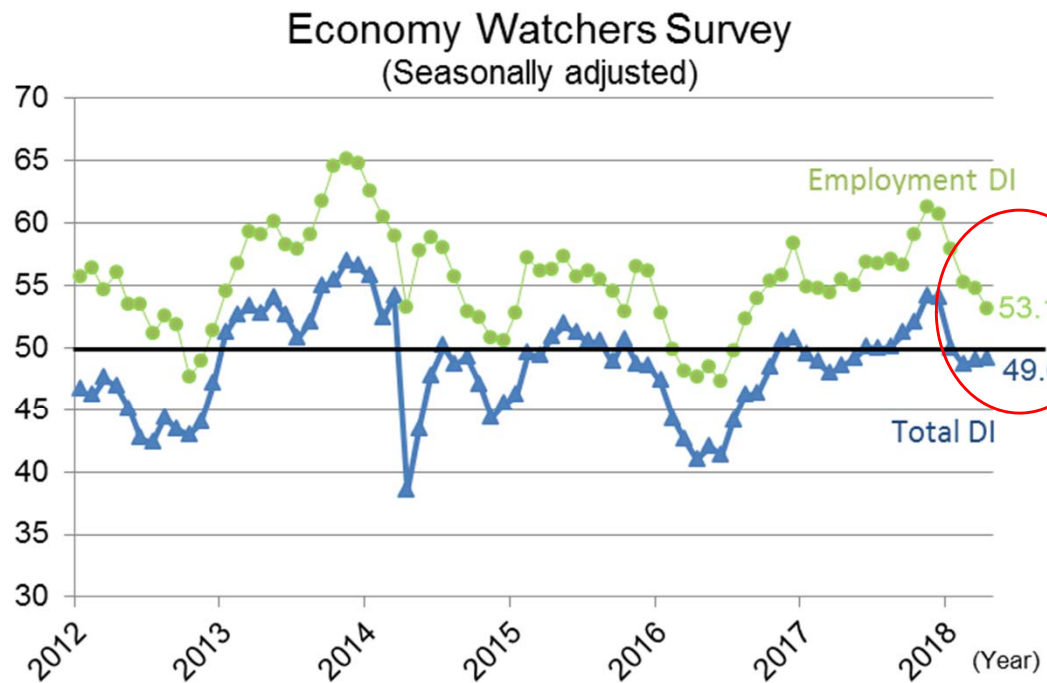
Notes: Data is from Jan. 2000 to Apr. 2018.
(Source) Bloomberg, compiled by SMAM



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(Source) Bloomberg, compiled by SMAM

Consumer sentiment is expected to improve after the end of extremely cold weather

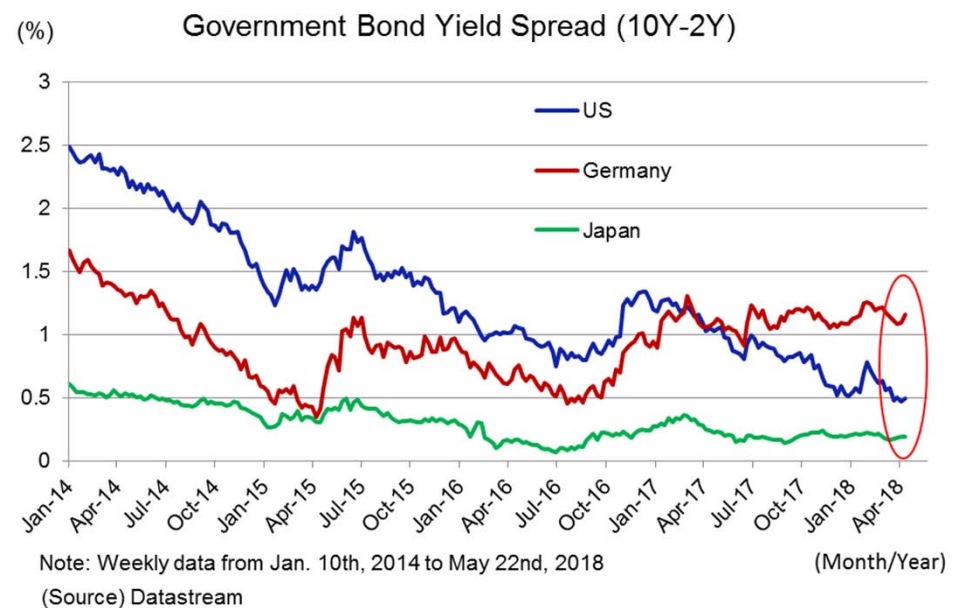
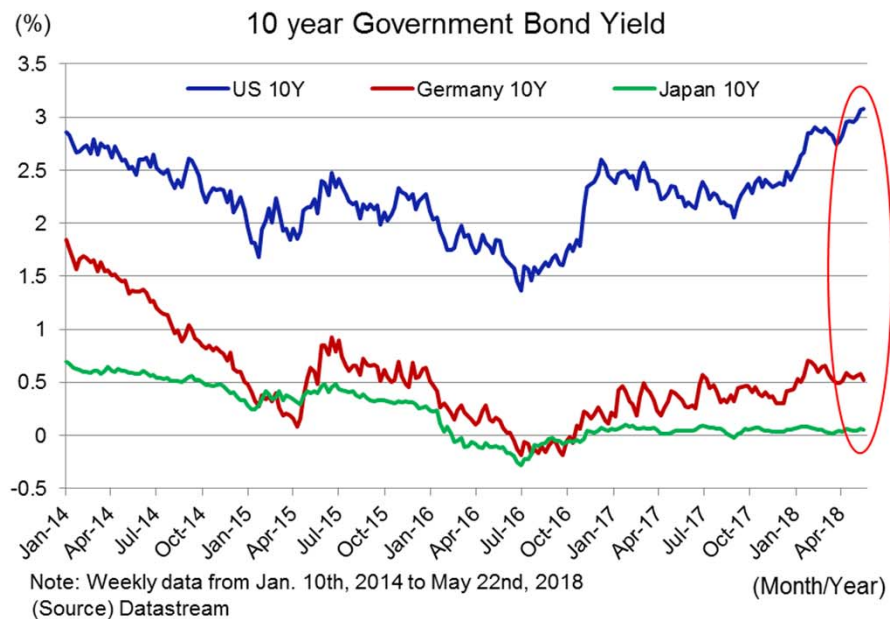
- Extremely cold winter and early spring ended in Japan. Consumer sentiment was negatively affected by inactivity due to coldness and high price of food such as fresh vegetables. The weather turned hot from April and sentiment is expected to improve.
- Declining employment DI is probably due to seasonal factors even after adjustment was made. Other labor statistics show continuing tightness.



Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is improving. Data period is from Jan. 2012 to Apr. 2018.
(Source) Cabinet Office

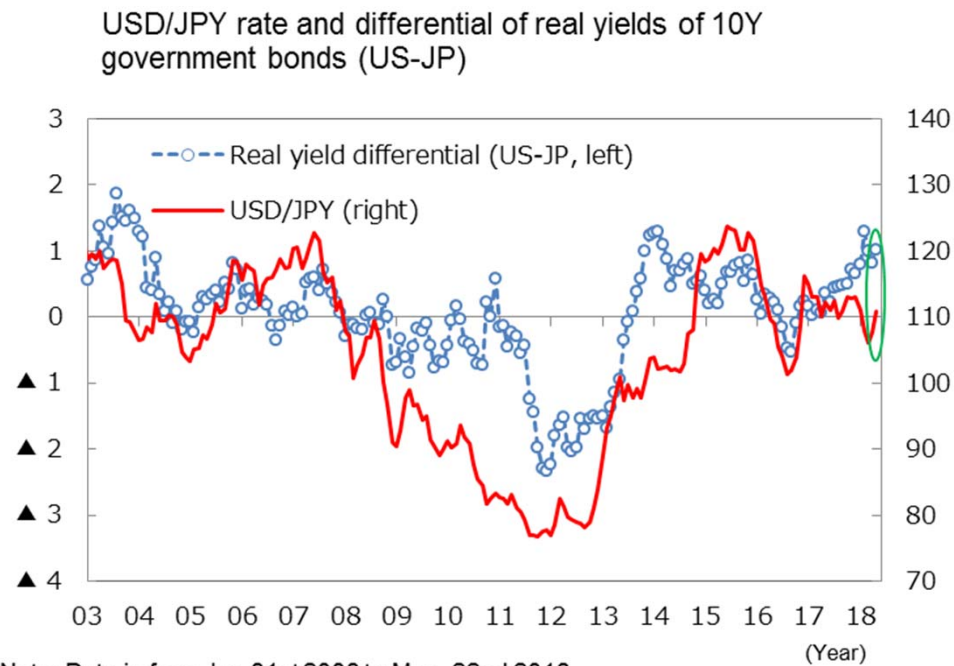
Monetary normalization continues in US

- US long term bond yield is rising rather rapidly.
- Short term bond yield is rising even faster than the long term bonds, which is causing the flattening of US yield curve.
- US budget spending is going to expand stimulating economy, however, it could put extra upward pressure on interest rates.



US-JP yield differential seems to be regaining influence on USD/JPY exchange rate

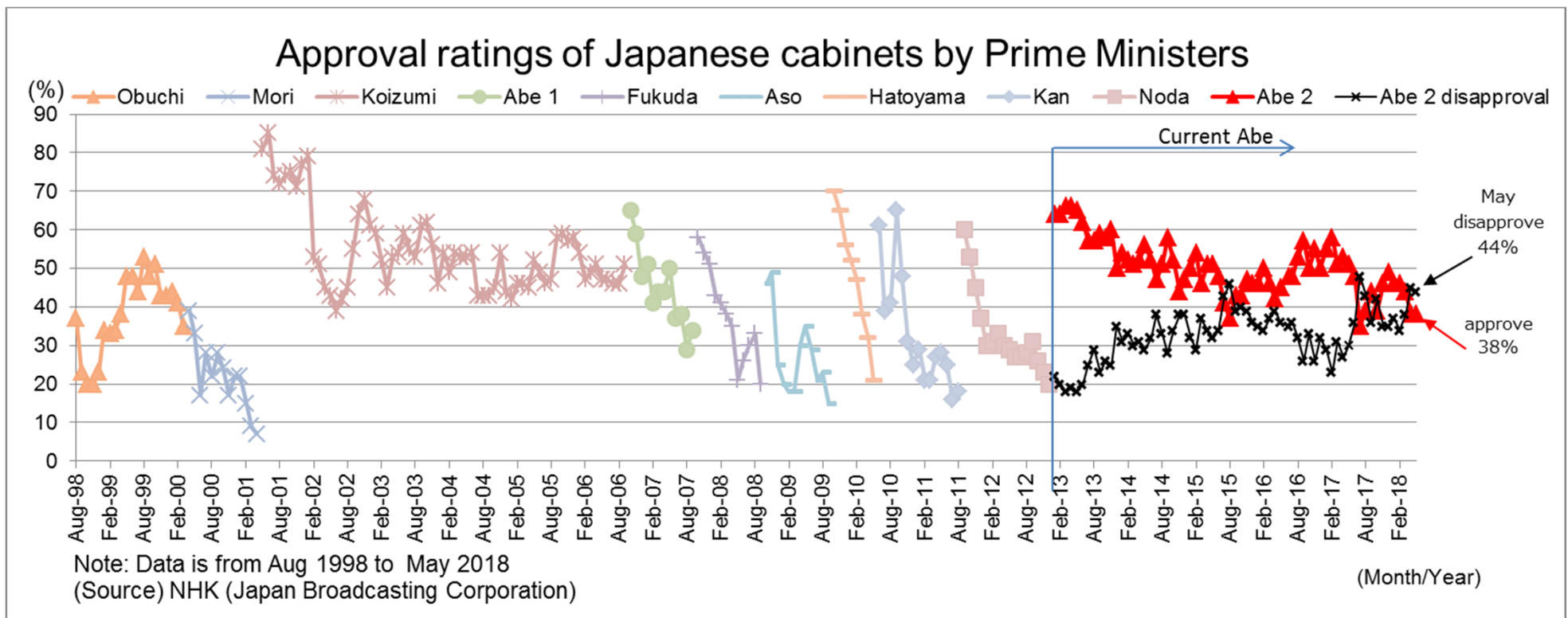
- US dollars recently turned to get stronger.
- Widening yield gap between USD and JPY seems to be influencing exchange rates again.



Note: Data is from Jan 31st 2003 to May. 22nd 2018.
Real yields are adjusted for CPI ex. food & energy
(Source) US Department of Labor, Ministry of Internal Affairs and Communications, Bloomberg, compiled by SMAM.

Approval rating for Abe cabinet is holding

- According to NHK, Approval rating for Abe cabinet was 38% in May unchanged from April. Disapproval rating marginally fell from 45% to 44%. Odds for PM Abe's survival is increasing.
- Japanese people are losing interests to the debates about school scandals, which opposition parties are pursuing at the current National Diet session.



It's going to be an eventful months ahead, trade negotiations, US-North Korea top meeting, etc.

- Tensions are rising again for US-North Korea conflicts heading to the summit meeting scheduled on June 12th in Singapore.
- Trade negotiation between US and China was put on hold for a while, probably US considered China's role in negotiations with North Korea.

Upcoming key events

Month	Region/Country	Events	Notes
May	US	1-2 FOMC 15 USTR public hearing on raising tariff 21 US Department of the Treasury proposes on investment by China Time limit for lifting economic sanction on Iran	
June	North Korea	12 Meeting is going to be held between US president Trump and North Korea's leader Kim Jong-un by May.	Let's hope that the bomb can be defused.
	Japan	Japanese government releases a) updated growth strategy b) plan of a revolution in human resources development and c) Basic Policies for Economic and Fiscal Management and Structural Reform	
	US	12-13 FOMC Time limit for trade negotiation on tariff	
	EU	14 ECB Monetary Policy Meeting	
July	Japan	30-31 BOJ Monetary Policy Committee Meeting & perspective report	
	US	31-1 FOMC	
	EU	26 ECB Monetary Policy Meeting	
August	US-Iran	6 1st part of US sanctions on Iran is set to begin	
September	Japan	18-19 BOJ Monetary Policy Committee Meeting PM Abe's leadership of LDP is set for renewal or expiration	LDP leadership election is due
	EU	26 ECB Monetary Policy Meeting	
November	US	6 Mid-term election for US congress	
	US-Iran	8 2nd part of US sanctions on Iran is set to begin	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

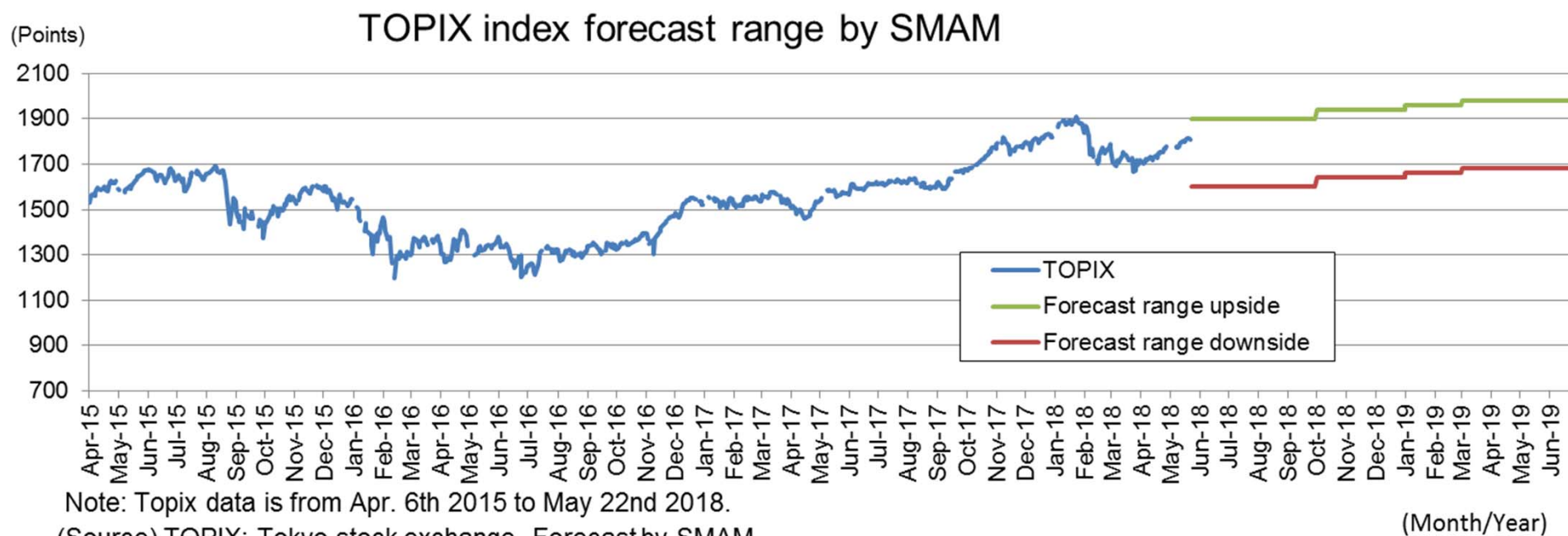
Stock market outlook: An eventful period ahead. Volatility will stay in the stock market.

SMAM short-term view

- After making recovery in April and May, risk events such as the fate of US-North Korea top negotiations would weigh on the Japanese stock market for a while. Positive results of such events will lift stock prices. Earnings results for FY 2017 is coming out in May, however, companies stay conservative on future guidance in general.

Longer-term outlook (6-months and beyond)

- Current slowdown in global manufacturing activities is expected to turn upwards again probably in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies.



Note: SMAM's projection is as of May 22nd, 2018 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Despite scare of raising tariff, US is going to make a deal with it's counterparties and trade war can be avoided.
 - US economy keeps growing.
 - Japan's private consumption to grow mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - PM Abe's survival is in a little doubt, however, current policies continues even by the successor.
 - Tension in the East Asia does not ignite a war.
 - Central banks gradually move to normalize monetary policies and avoid killing economic growth.

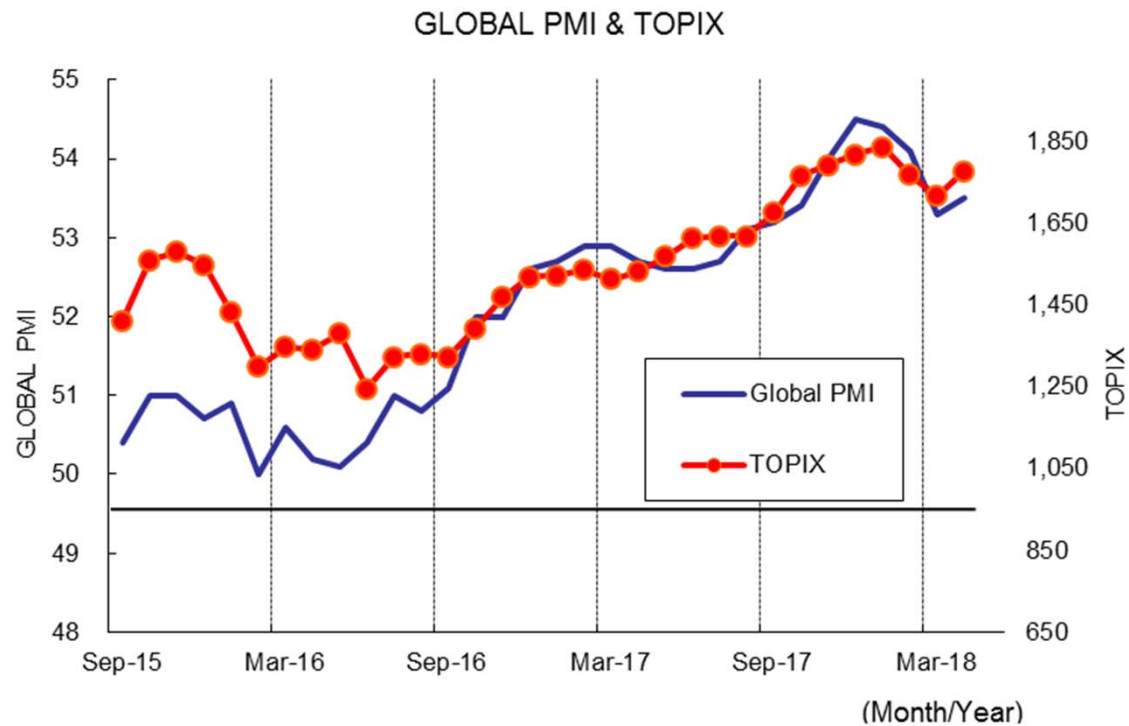
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - North Korea abandons nuclear arms development.
 - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.

- **Downside Risks** include:
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - Global monetary tightening intensifies to choke global economy.
 - Confrontational foreign policies taken by Trump presidency igniting a trade war.
 - "Russia-gate" scandal flares up.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of May 22nd, 2018 and subject to updates without notice.

Global manufacturing activities rebounded in April

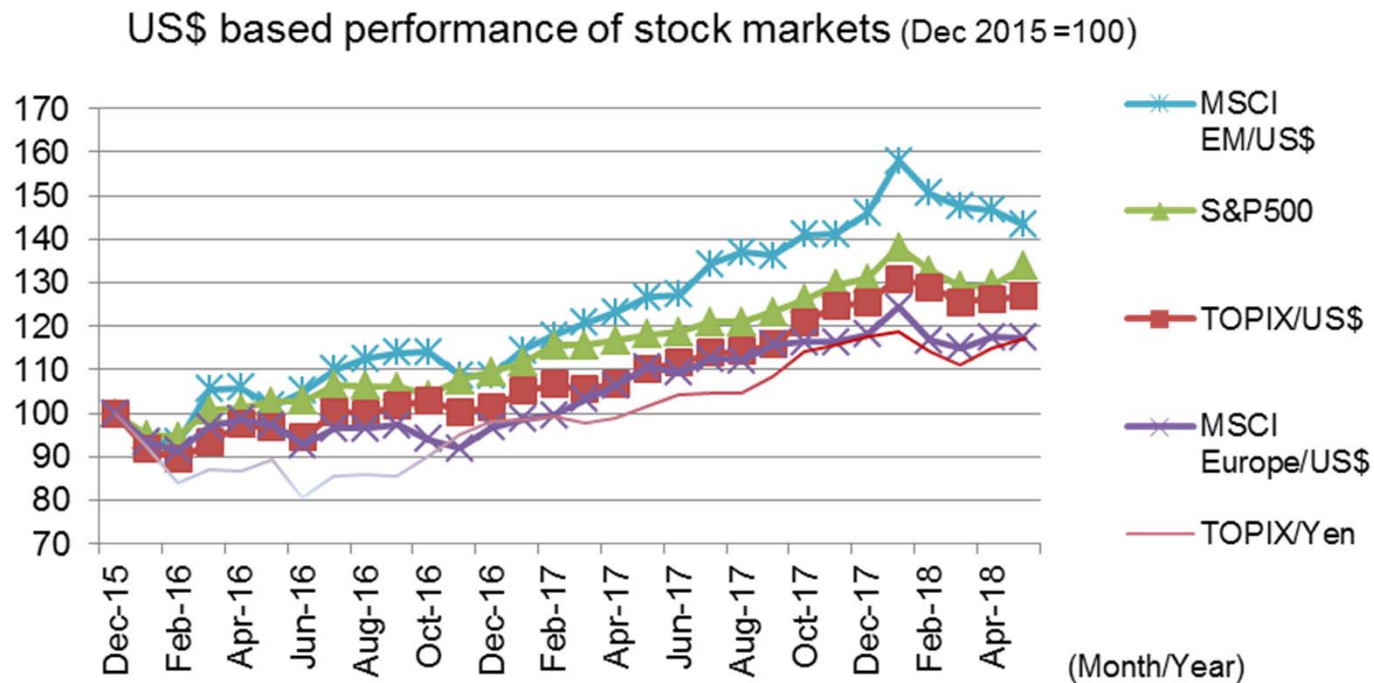
- After declining for two months, Global Manufacturing PMI rebounded in April. A brief retreat from one-off reconstruction demand from hurricane damage in US seems to have ended.
- Japanese stock market has a very high positive correlation with this Global PMI as the chart shows.



Notes: Data is monthly from Sep. 2015 to Apr. 2018.
(Source) Bloomberg, IHS Markit

Rising US interest rates brought emerging market equities down

- Emerging market equities were negatively affected by rising US interest rates. Weak economies with large US dollar debts and large current deficits were hit harder, however, healthier countries are holding well both in equity prices and currency.
- Stock markets of developed countries are moving sideways watching out for the developments of such risk events as trade negotiations, North Korea and Iran.

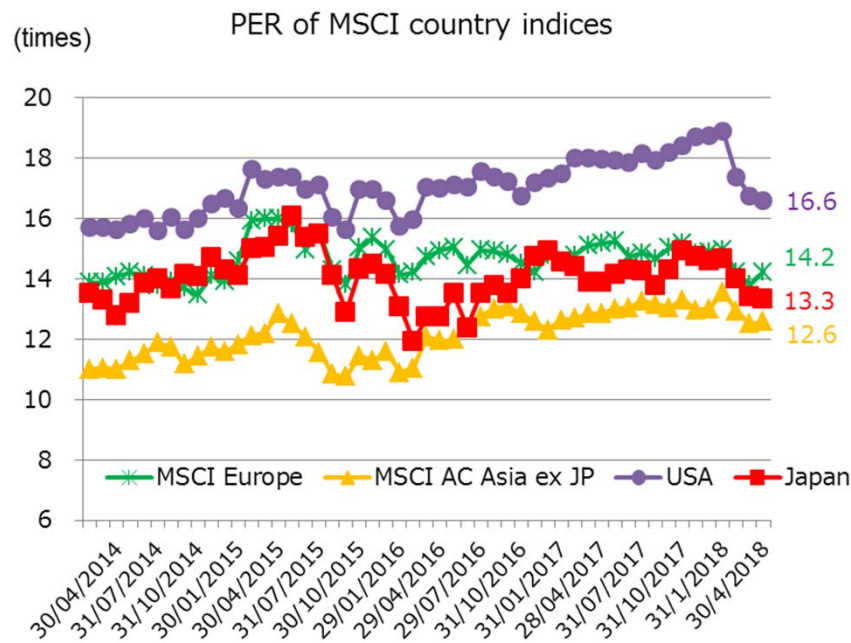


Notes: Data is up to May 21st 2018.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.

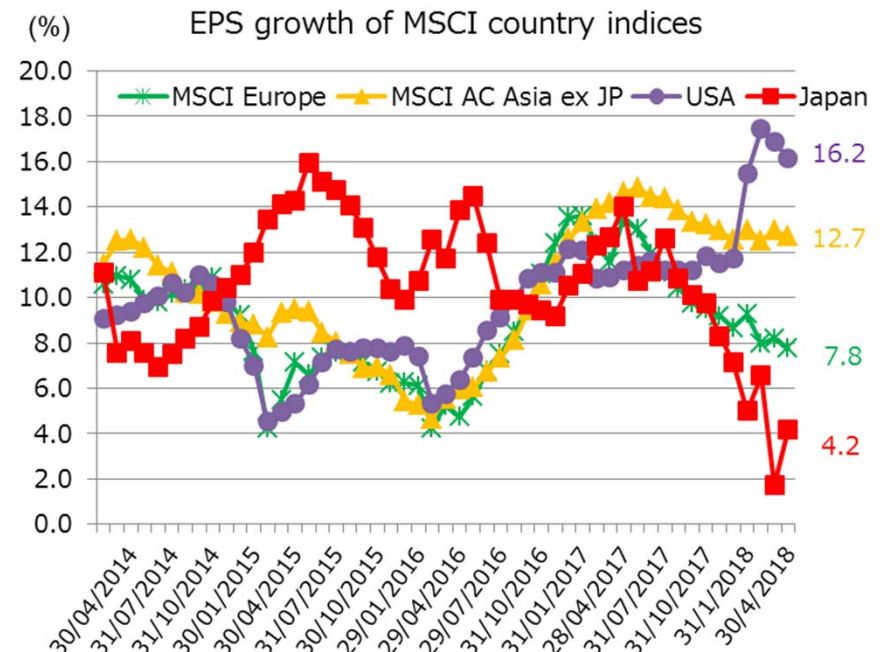
PE ratio declined to more reasonable level

- PE ratio was at normal level in April.
- After rapid earnings growth for FY2017 was all reflected in the EPS, 12M forward EPS forecast for Japan declined in March. It slightly recovered in April.
- Another round of EPS upward revision is required for lifting the 12M forward EPS, however, companies are making conservative earnings guidance for FY2018 when announcing financial results for FY2017.



Note: PER is based on 12M forward EPS forecast.
Data is up to 30th Apr 2018.
(Source) MSCI

(DD/MM/YYYY)

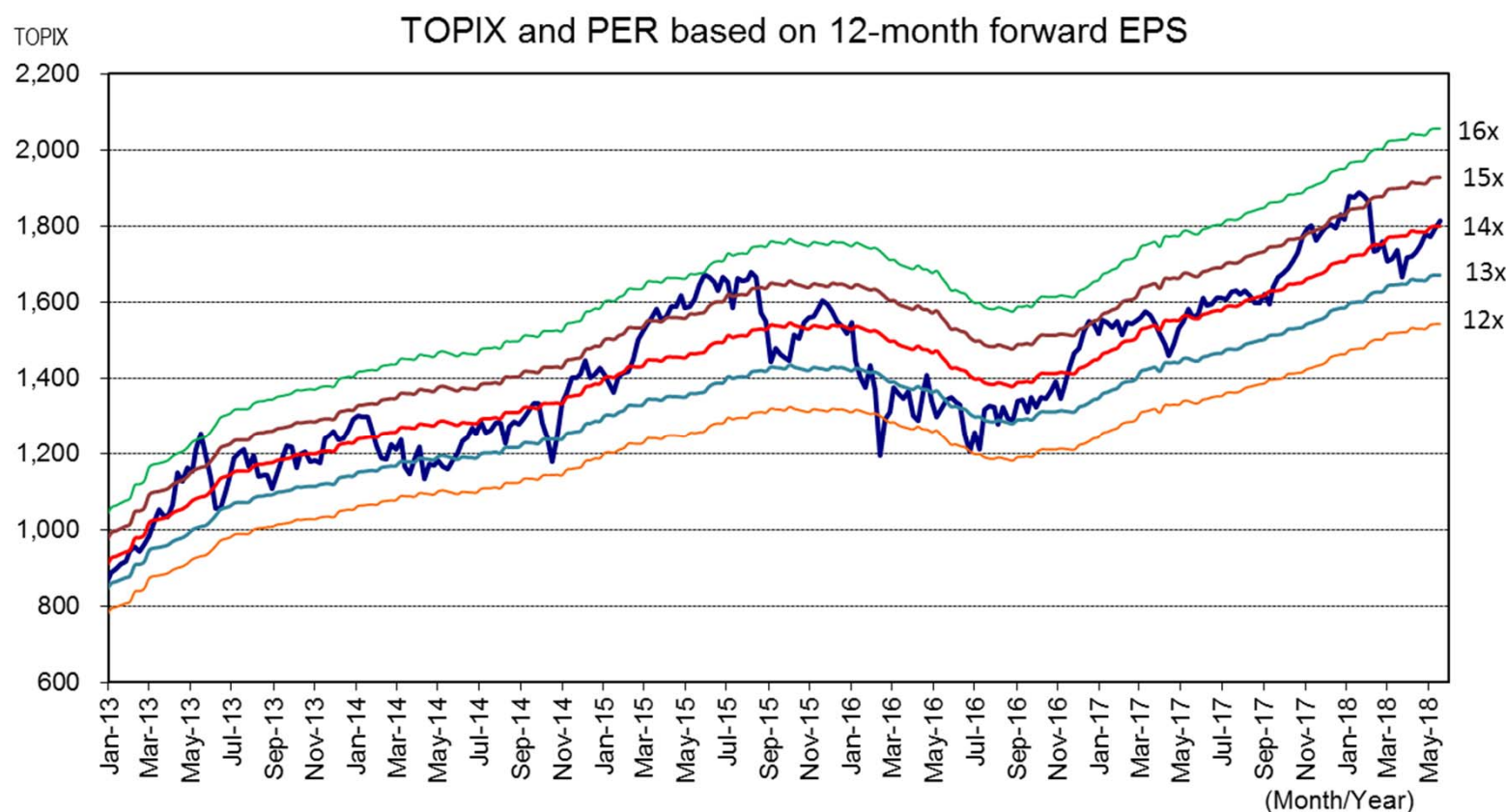


Note: Growth is for 12M forward EPS forecast.
Data is up to 30th Apr 2018.
(Source) MSCI

(DD/MM/YYYY)

PER for TOPIX index is at the mid level since PM Abe took helm in 2013

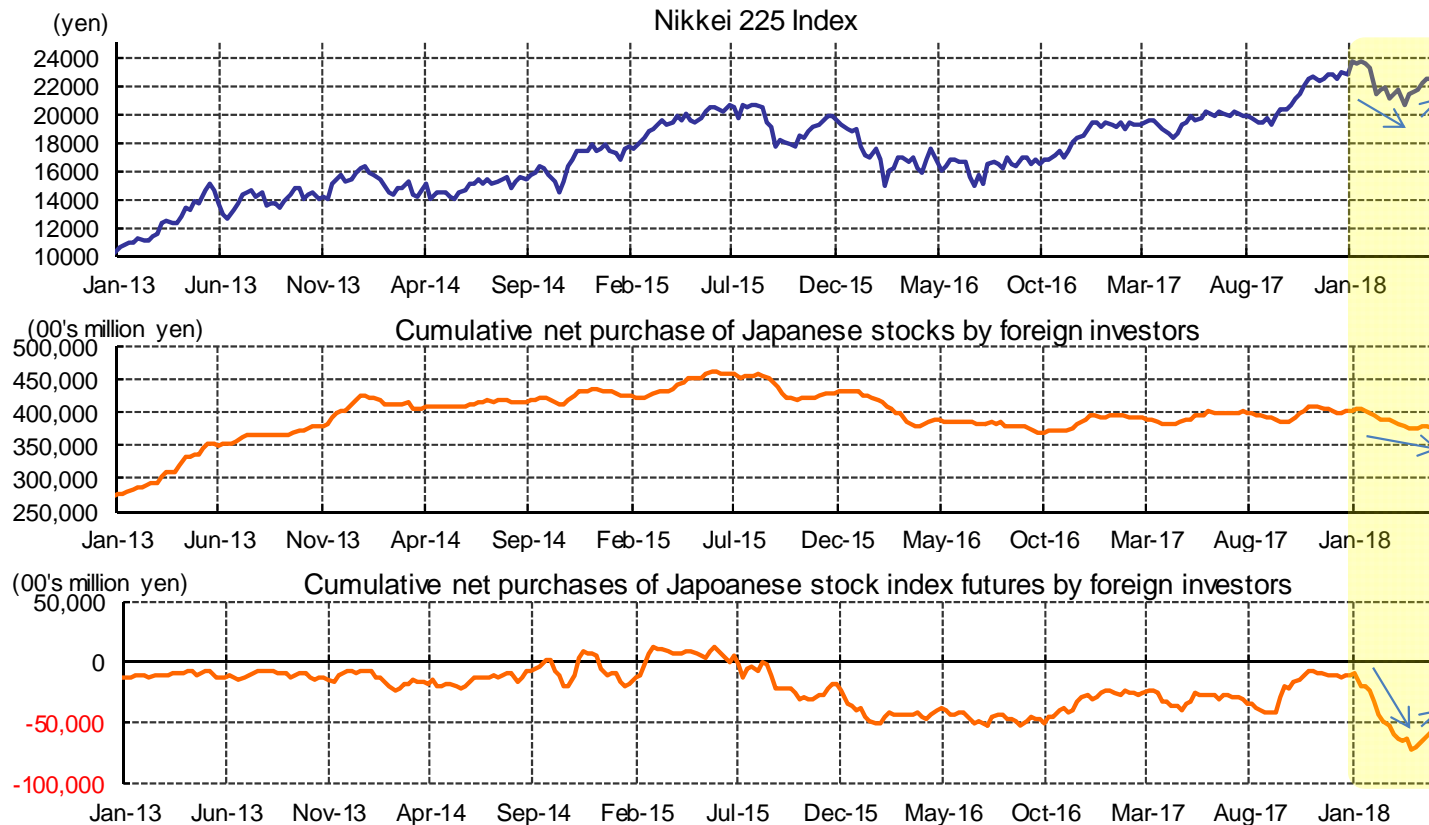
- PER for TOPIX index is around 14 times, which has been the middle of the range after PM Abe took helm in 2013.
- Currently slowing momentum of earnings growth is a little worrying, however, if concern on global trade and economy gradually recedes, recovering earnings forecast could make the current valuation level attractive to investors.



Note: Data is weekly from Jan.4th 2013 to May18th 2018. TOPIX was 1729.98 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

Foreign investors bought back futures from April

- Foreign investors bought back Japanese equities futures from April as the bottom chart shows. This action supported the stock prices to make recovery.
- However, foreign investors are not buying cash equities as the middle chart shows, probably due to ongoing risks such as North Korea, PM Abe's survival and trade deals with US.



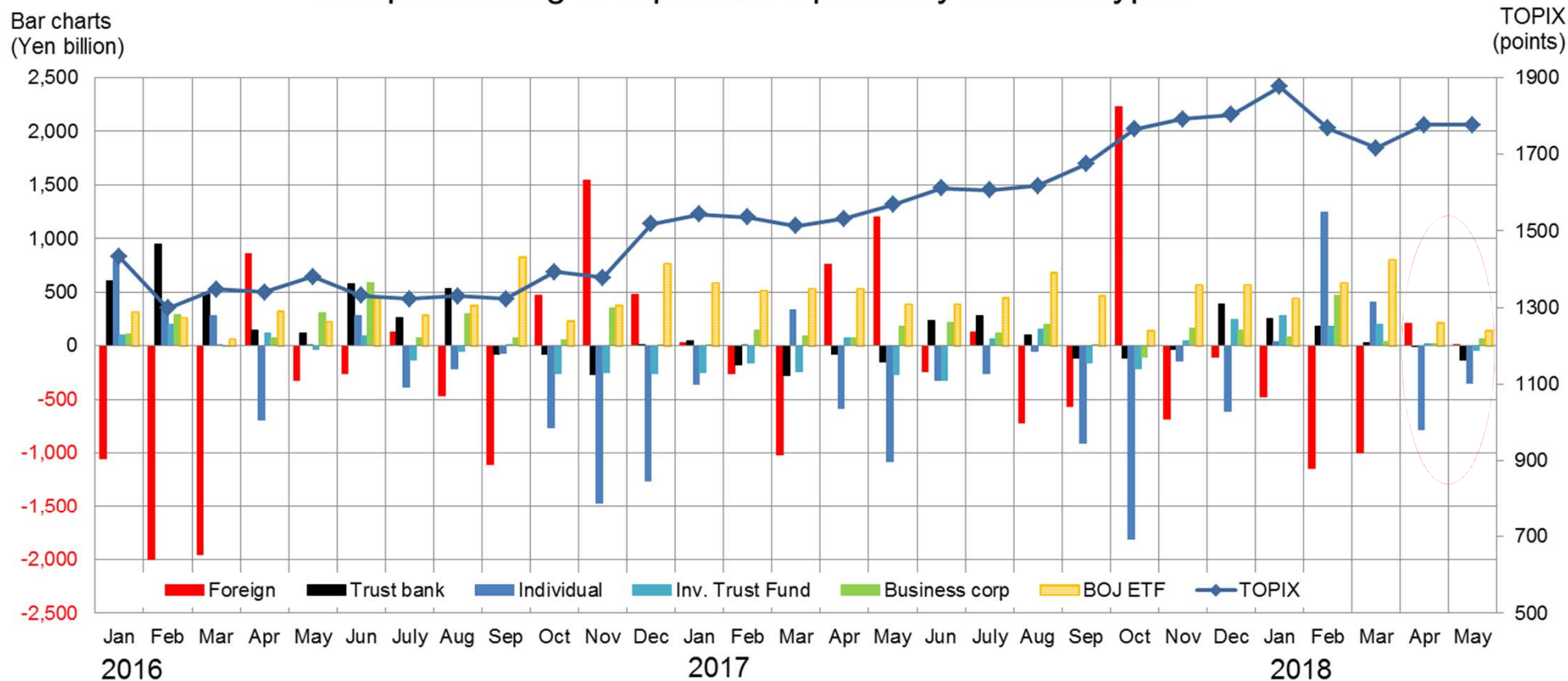
Notes: Data is from Jan, 4th 2013 to May 11th 2018. Cumulative from Jan 4th 2005.

(Source) Bloomberg, Japan Exchange Group, compiled by SMAM.

Investors activities slowed in April and May

- Investors' activities slowed in April and so far in May.
- Individuals sold stocks in a market recovery.

Net purchasing of Japanese equities by investor types



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to May.11th 2018.
BOJ ETF figure is officially released data from BOJ.
(Source) Japan Exchange Group, Bank of Japan

(Month/Year)

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