



Japanese Stock Market Outlook

SMAM monthly comments & views
-July 2018 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

GDP forecast for FY 2018 was slightly upgraded by 0.1% to 1.2% due mainly to higher starting level of the fiscal year after 4Q FY2017 GDP was revised upward. Mild and steady GDP growth is forecast for FY2018 and FY2019, for which continuing private capital investment is one of the drivers.

- Real wage payment as the total Japanese economy has been increasing at around 2% pace since 2015. Despite still modest increase in nominal wage per person, strongly increasing number of employees is the driving factor behind. .
- Nikkei newspaper released recent survey results on June 25th, which showed Abe cabinet's approval rating significantly improving from 42% to 52% meanwhile disapproval rating down from 53% to 42% compared to the previous month.

➤ Japanese Stock Markets

Despite strong economic readings in US, investors are likely to stay on the sidelines for a while due to concerns on intensifying trade disputes between US and its counterparties, however, 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.

- SMAM's forecast of FY2018 recurring profits for 227 companies in the research coverage was upgraded from previous 8.8% YOY growth to 10.0% in June. Forecast for FY 2019 was made for the first time in June, and it predicts 10.2% YOY profit growth.
- ROE rose to 12% in the last FY2017 ended in March 2018, exceeding previous record level reached in FY2007, just before the global financial crisis.

Notes: Macro and market views are as of Jun. 20th, 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-19

- GDP forecast for FY 2018 was slightly upgraded by 0.1% to 1.2% due mainly to higher starting level of the fiscal year after 4Q FY2017 GDP was revised upward.
- Mild and steady GDP growth is forecast for FY2018 and FY2019, for which continuing private capital investment is one of the drivers.

(YoY %)	FY14	FY15	FY16	FY17	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.6%	1.2%	0.9%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	0.9%	0.7%	0.5%
Private Housing Investment	-9.9%	3.7%	6.2%	-0.3%	-2.2%	0.5%
Private Capital Investment	3.3%	2.3%	1.2%	3.2%	2.5%	1.9%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.7%	0.5%	1.2%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.4%	-0.2%	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%	4.4%	2.1%
Imports	4.2%	0.4%	-0.8%	4.0%	2.4%	1.3%
Nominal GDP	2.2%	3.0%	1.0%	1.7%	1.3%	2.1%
GDP Deflator	2.5%	1.5%	-0.2%	0.1%	0.1%	1.1%
Industrial Production	-0.4%	-1.4%	1.5%	4.1%	2.6%	1.8%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	0.8%	0.7%

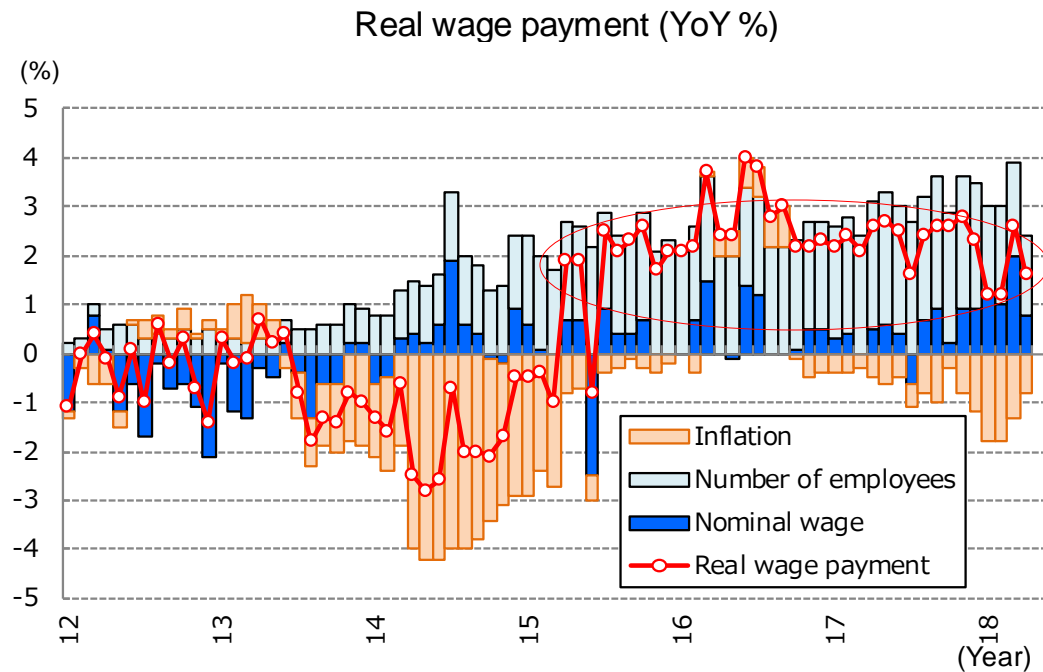
Notes: E=SMAM forecasts. SMAM views are as of June 20th, 2018 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

Increasing number of workers contributes to steady rise of aggregate real wage payment

- Real wage payment as the total Japanese economy has been increasing at around 2% pace since 2015.
- Despite still modest increase in nominal wage per person, strongly increasing number of employees is the driving factor behind.



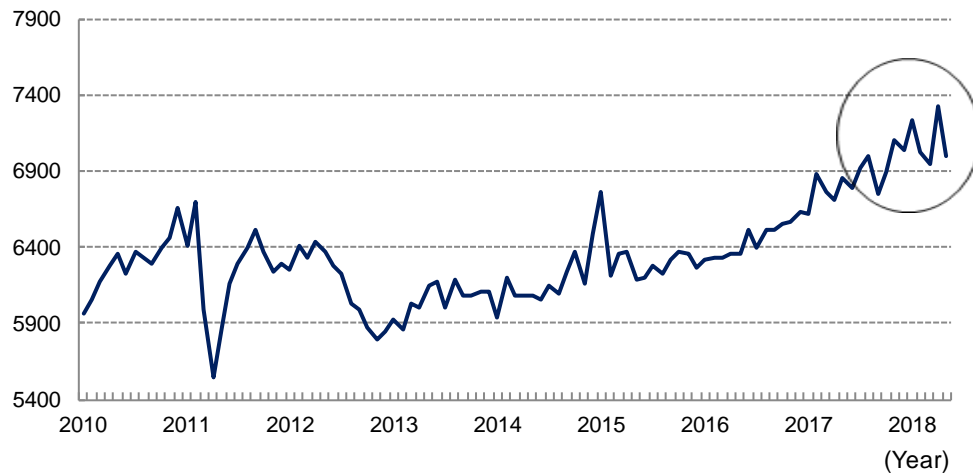
Note: Data is from Jan. 2012 to Apr. 2018.

(Source) Ministry of Health, Labour and Welfare

Export is still holding well

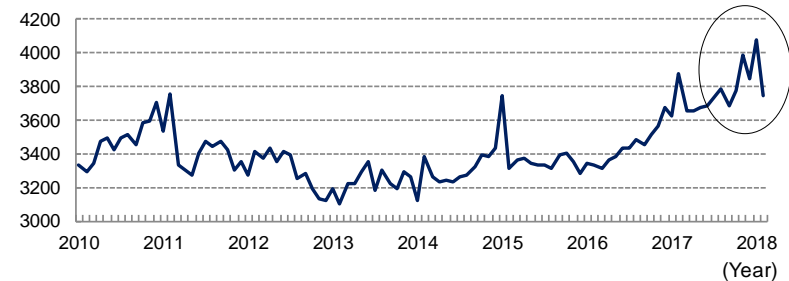
- Export is still on an upward trend when monthly volatility is smoothed out.
- Stay watch out for if and how trade dispute would have real impact going forward.

Total export volume
(seasonally adjusted, yen billion)

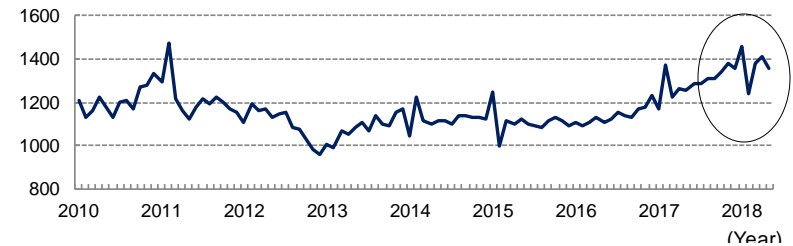


Note: Data is from Jan 2010 to May 2018.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

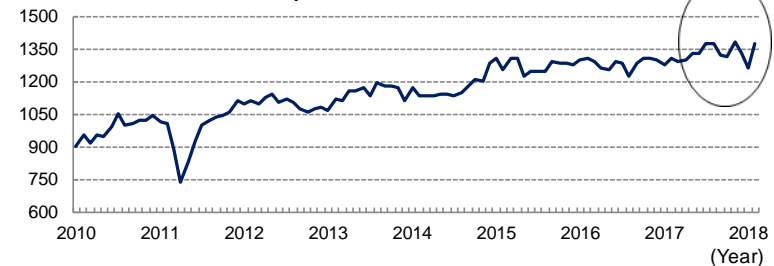
Export volume to Asia



Export volume to China

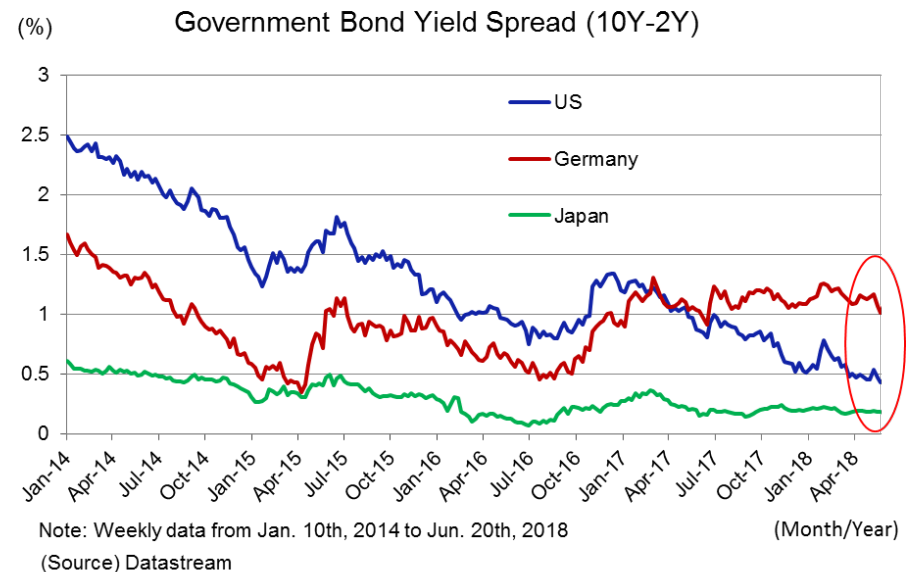
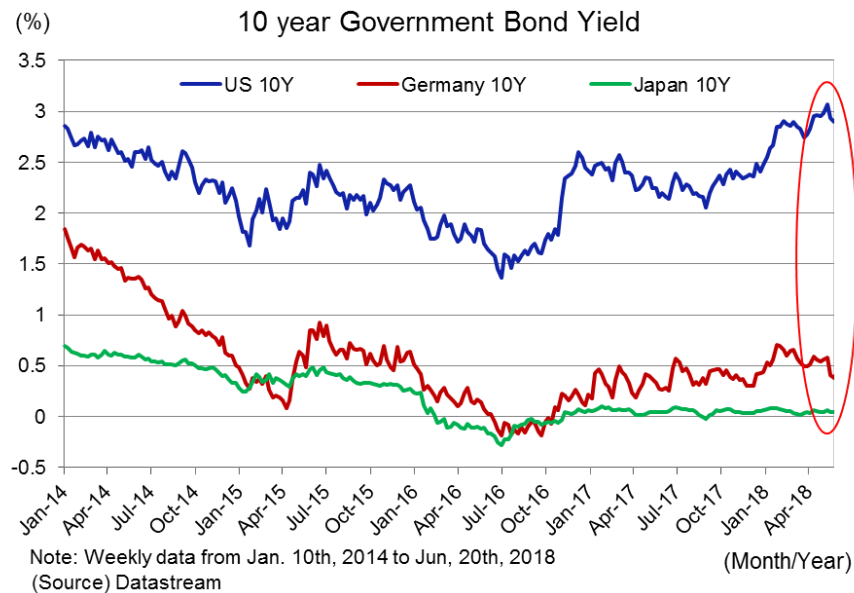


Export volume to US



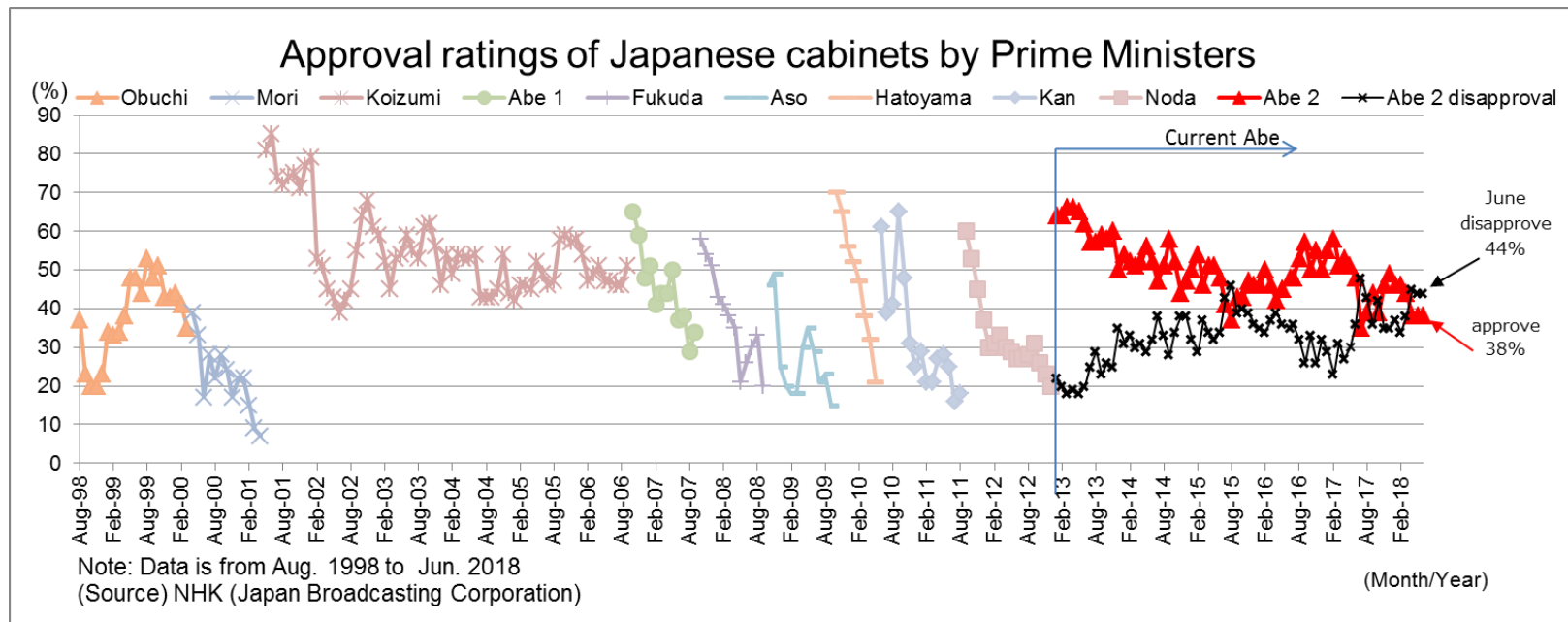
Yield curve flattening continues both in US and Europe

- Rise in long term bond yields had a brief pause in June, especially in Europe where sudden weakness in its economy emerged.
- Flattening of yield curve is continuing both in US and Europe, which could potentially put pressure on the economy, combined with monetary normalization moves implied by central banks.
- On the other hand, upward pressure on Japanese interest rates is not found in Japan yet.



Approval rating for Abe cabinet is on a recovery

- According to NHK, Approval rating for Abe cabinet was 38% in June unchanged for the last three months. Disapproval rating was also unchanged at 44%. The survey was made before the historic top meeting between US and North Korea.
- Nikkei newspaper released more recent survey results on June 25th, which showed Abe cabinet's approval rating significantly improving from 42% to 52% meanwhile disapproval rating down from 53% to 42% compared to the previous month.
- Japanese people are losing interests to the debates about school scandals, which opposition parties are pursuing at the current National Diet session. PM Abe's survival seems to be improving.



Real outcome is yet to be seen after the historical top meeting between US and North Korea

- Historical meeting between US President Trump and North Korean leader Kim Jong-un gave mixed reaction among politicians as well as world financial markets. Real outcome is yet to be seen.
- Trade disputes are feared to be intensifying between US and its counterparties, especially China. Uncertainties are likely to remain until the US mid-term election in November.

Upcoming key events

Month	Region/Country	Events	Notes
June	North Korea	12 A top meeting was made between US president Trump and North Korea's leader Kim Jong-un. Real achievement is yet to be seen.	When PM Abe is going to meet Kim Jong-un?
	Japan	Japanese government released 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	Many policies are succession from the former releases, however, the government is going to widen a gate for less skilled foreign workers coming to Japan.
	US	12-13 FOMC	Another rate hike was made.
	EU	14 ECB Monetary Policy Meeting	Tapering is going to start.
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	
	EU/UK	30 Target date for deciding Brexit conditions	
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

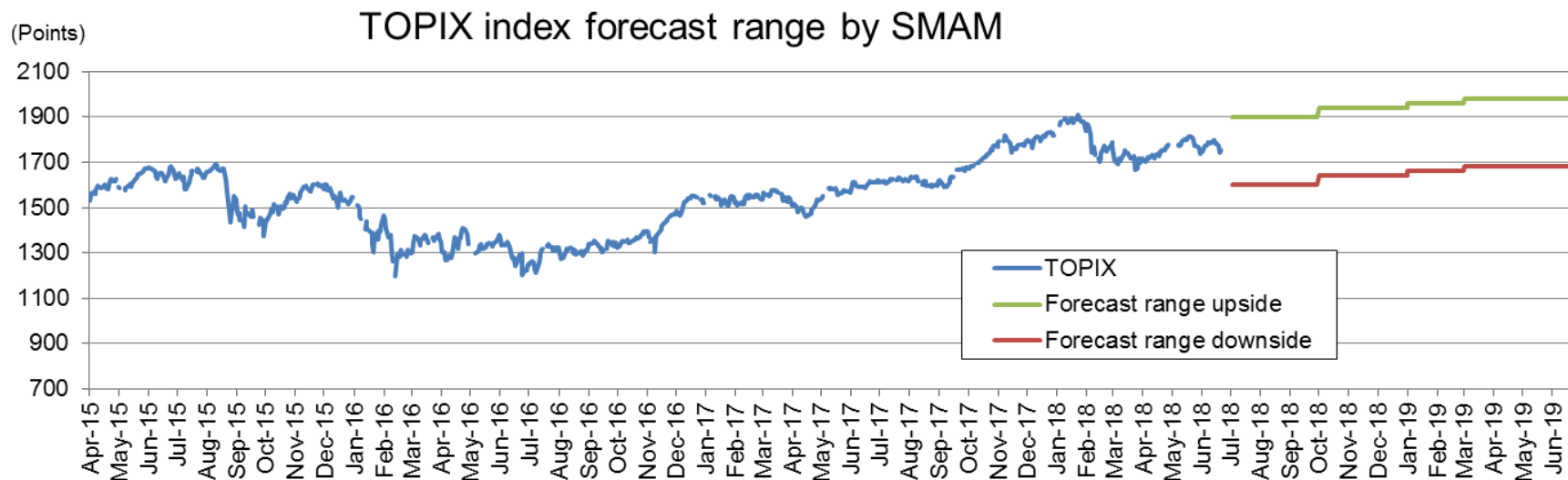
Stock market outlook: Investors stay on the sidelines for a while

SMAM short-term view

- Despite strong economic readings in US, investors are likely to stay on the sidelines for a while due to concerns on intensifying trade disputes between US and its counterparties. Japanese companies are making conservative earnings guidance for FY 2018 and upward earnings forecast revision seems to be required for igniting the stock market.

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. Trade disputes are forecast to recede gradually after the mid-term election in US in November providing positive momentum to the stock market.



Note: Topix data is from Apr. 6th 2015 to Jun. 21st 2018.

(Source) TOPIX: Tokyo stock exchange, Forecast by SMAM

(Month/Year)

Note: SMAM's projection is as of Jun. 20th, 2018 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Uncertainties of world trade disputes will recede post mid-term election in US in November.
 - 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.
 - Denuclearization in Korean peninsula makes a visible progress.
 - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.

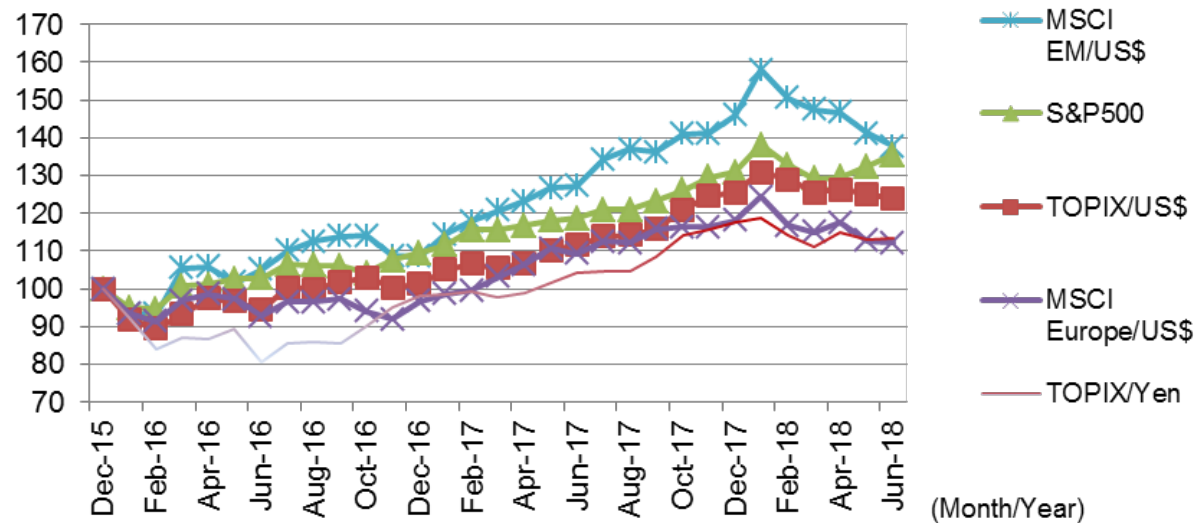
- **Downside Risks** include:
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - Global monetary tightening intensifies to choke global economy.
 - Confrontational foreign policies taken by Trump presidency igniting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

Note: SMAM's projection is as of Jun 20th, 2018 and subject to updates without notice.

Money is flowing to US

- US stock market is showing resilience meanwhile global stock markets are generally declining.
- Intensifying trade disputes are hurting the confidence of investors.
- Repatriation of profits retained outside US is helping financial markets in US. And also, so-called platform companies such as “FANG” are mostly in US and they are favored by stock investors, who are searching for stocks relatively immune from possible trade wars.

US\$ based performance of stock markets (Dec 2015=100)



Notes: Data is up to Jun. 20th 2018.

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

Two fiscal years of consecutive double digit profit growth is forecast for Japanese companies

- SMAM's forecast of FY2018 recurring profits for 227 companies in the research coverage was upgraded from previous 8.8% YOY growth to 10.0% in June.
- Companies' self-guidance on recurring profits for FY 2018 is conservative 3.7% YOY growth, and this is likely to be revised upward as the time progresses.
- Forecast for FY 2019 was made for the first time in June, and it predicts 10.2% YOY profit growth.

SMAM Corporate Earnings forecasts (227 Companies research coverage excl. financials)

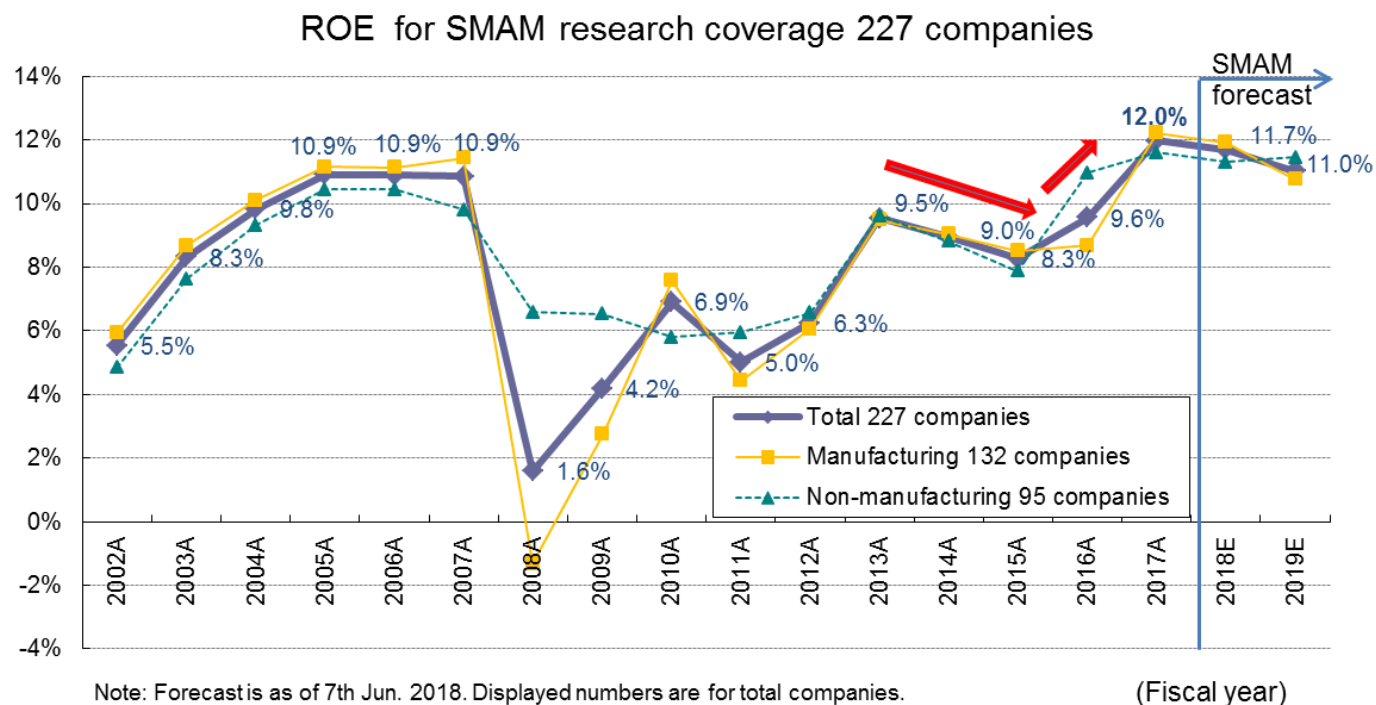
Fiscal year	FY 2016	FY 2017	FY 2018E	FY 2019E
Date of forecast	Actual	Actual	as of 7th Jun. 2018 (as of 5th Mar 2017)	as of 7th Jun. 2018
Sales (YoY %)	-3.8%	9.3%	5.9% (3.1%)	2.7%
Operating Profits (YoY %)	4.9%	15.6%	10.2% (8.2%)	7.3%
Recurring Profits (YoY %)	6.6%	17.8%	10.0% (8.8%)	10.2%
Net Profits (YoY %)	17.3%	35.1%	1.7% (2.2%)	5.6%
Recurring profits (YoY %)				
Manufacturing 132 companies	2.6%	21.3%	9.3%	8.1%
Non-manufacturing 95 companies	12.8%	12.7%	11.1%	13.2%
Self guidance by 227 companies			3.7%	

Note: Key assumptions for the Jun. forecasts for FY 2017 & 2018 are Yen/US\$ 108 and Yen/EUR 130.

(Source) SMAM Corporate Research Group, Toyo Keizai

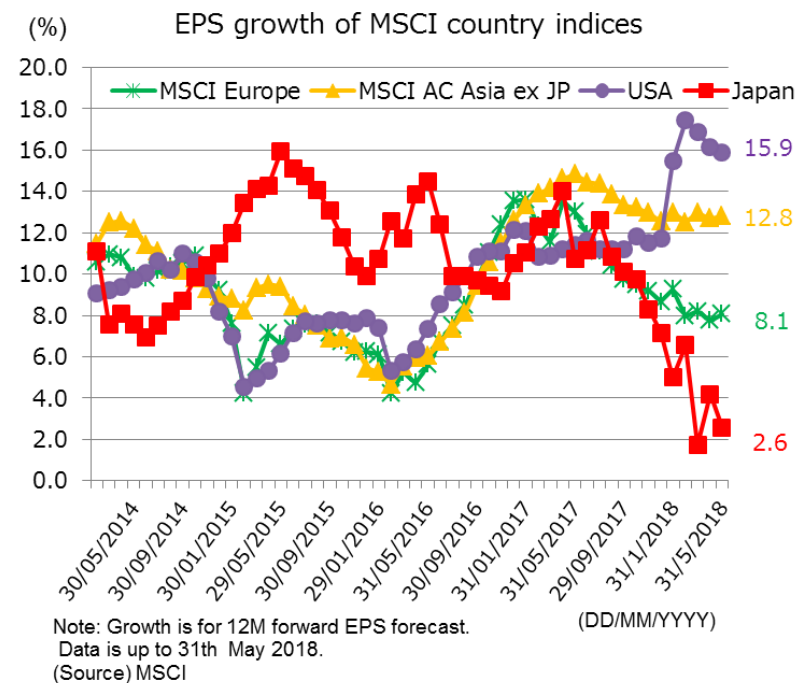
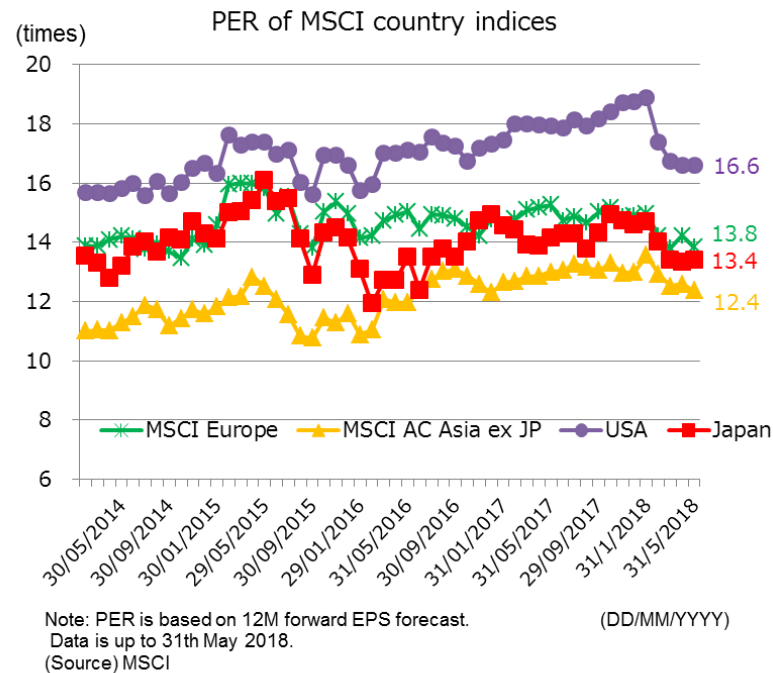
ROE rose to 12%, a historical record level, in FY2017

- ROE rose to 12% in the last FY2017 ended in March 2018, exceeding previous record level reached in FY2007, just before the global financial crisis.
- In FY2017, ROE was a little inflated by a one-off benefit coming from US corporate tax reduction, which led to a compression of deferred corporate tax accounts. ROE is forecast to slightly decline to 11.7% in FY2018.



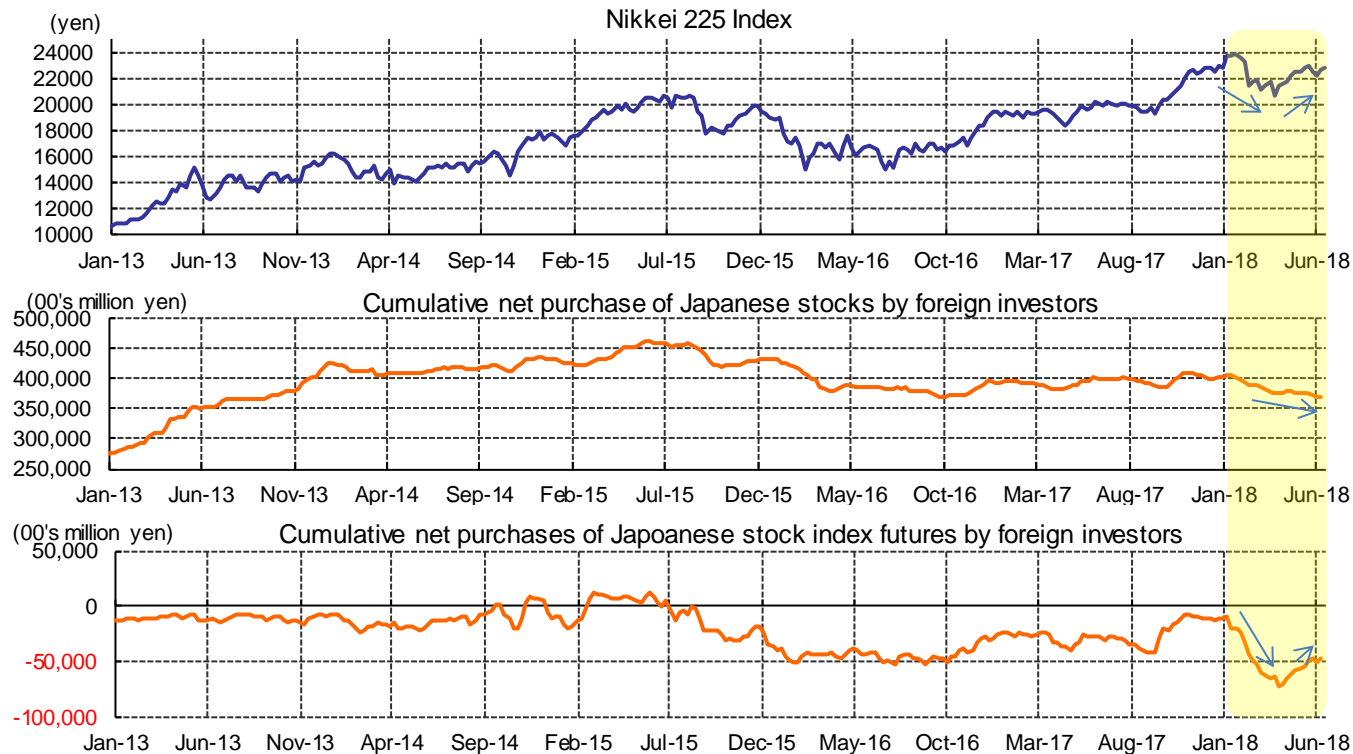
PE ratio is at reasonable levels

- PE ratio stays around the same level in May moving sideways from April.
- Another round of EPS upward revision is required for lifting the 12M forward EPS.



Foreign investors keep buying back futures from April

- Foreign investors are buying back Japanese stock index futures, however, not cash equities yet.
- This is probably due to continuing uncertainties on world trade disputes, and how Japan is going to be affected. Prospects for future trade negotiations between US and Japan are still unclear.



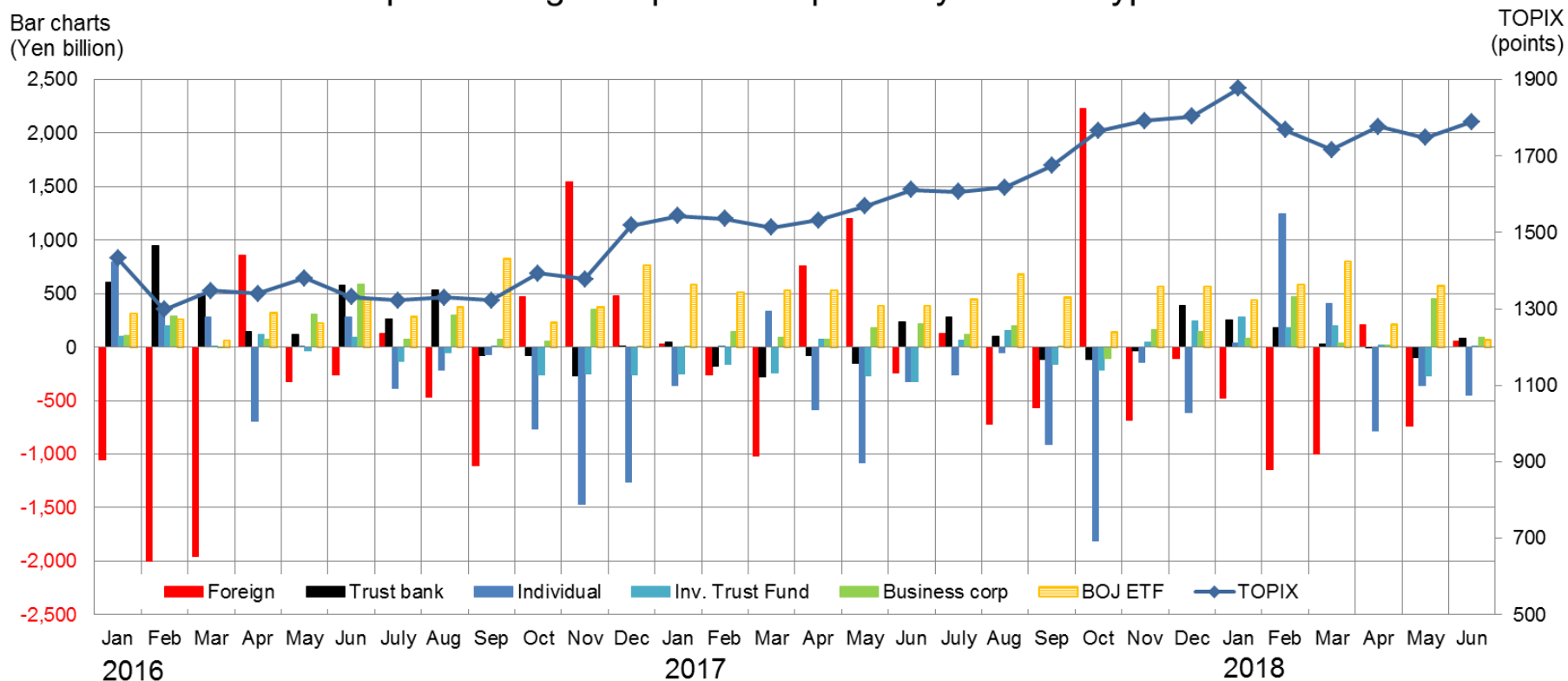
Notes: Data is from Jan, 4th 2013 to Jun. 8th 2018. Cumulative from Jan. 4th 2005.

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

Share buy-back and BOJ's ETF purchasing absorbed selling by other investors in May & June

- Investors stayed cautious under growing uncertainties of trade disputes and geo-political uncertainties.
- Share buy-back by companies were prominent in May & June so far, early months of the new fiscal year.

Net purchasing of Japanese equities by investor types



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to Jun.15th 2018.
BOJ ETF figure is officially released data from BOJ.
(Source) Japan Exchange Group, Bank of Japan

(Month/Year)

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