



# Outlook for Japanese Economy & Stock Market

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Monthly comments & views by  
Sumitomo Mitsui DS Asset Management (SMDAM)

-July 2020-

# Executive summary

## ➤ Japanese Economy

PMI for Japan made a strong rebound in June led by non-manufacturing side. After the nationwide state of emergency was lifted on 25th May, restaurants and shops have been re-opening and restrictions on business hours have been also eased substantially. Cautiousness will stay as long as new COVID-19 infection cases continue, however, activities of Japanese people will keep rising unless 2nd wave pandemic scare becomes more threatening. (Page 10)

- Additional budget spending was approved in June. Total project size is advertised to be 117.1 trillion yen, which is identical to the spending size approved in April. (Page 9)
- Around 37% of workers are on a short-term contract basis and vulnerable to current difficult economic environment. Number of such workers sharply declined in April. This negative impact is expected to gradually ease as economy reopens further and government supports reach hands of businesses and households.(Page 12)

## ➤ Japanese Stock Market

Global liquidity created by massive monetary easing and fiscal aid is lifting stock prices. Stock valuation in PE Ratio for Japanese market is stuck to the upper end of the historical trading range, however, current valuation will be justified by extremely low interest rates and international comparison with other markets such as US. Japanese economy is forecast to continue re-opening and without threatening risk of the 2nd wave of COVID-pandemic, Japanese stock prices will be sustained at such high valuation. (Page 18)

- SMDAM makes earnings forecast for 455 companies excluding financials in its corporate research coverage. In the latest forecast on 5th June, recurring profits are forecast to decline by -10.9% in FY2020 and then recover by 28.2% in FY2021. When indexed with the latest high in FY2018 as 100, level of recurring profit for FY2019, 2020, 2021 are calculated at 78, 69 and 89 respectively. Corporate profits are expected to be 10% below the historical record level even after a robust recovery in FY2021. (“Recurring profits” in Japanese accounting means “earnings from continuous businesses”, which is basically before tax and extraordinary items.) (Page 22)

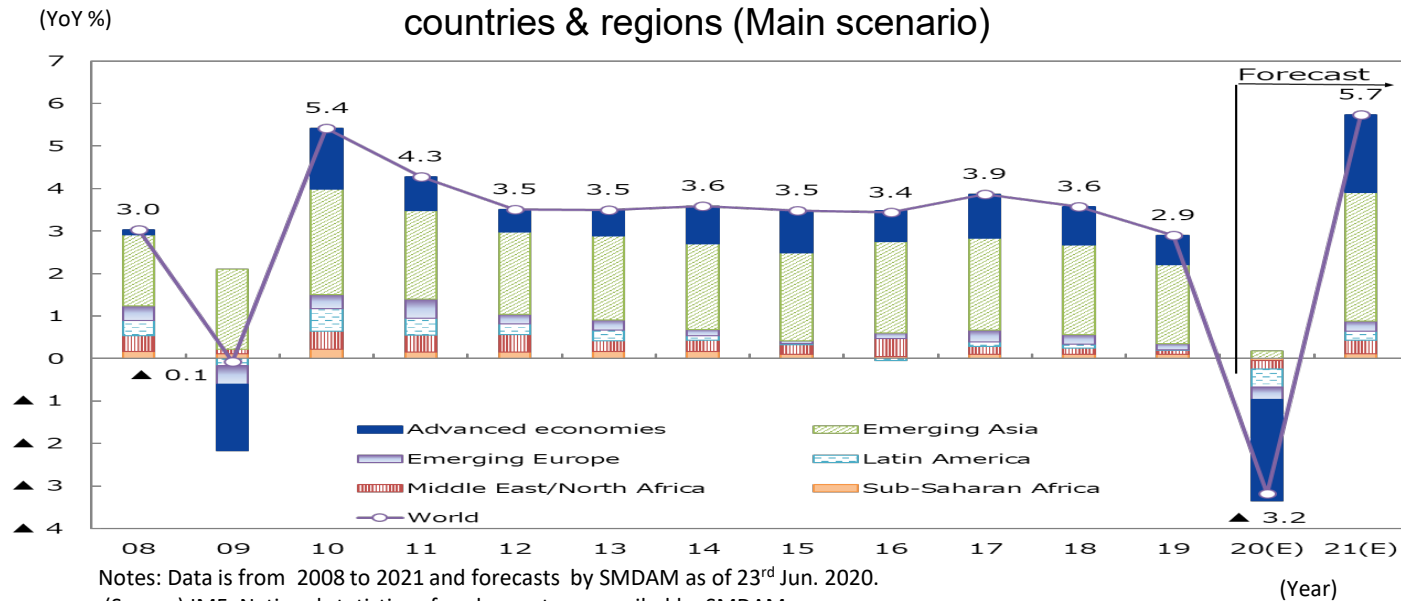


# Outlook for Japanese Economy

# Outlook for the global economy

- SMDAM down-revised global real GDP forecast for 2020 from -3.0% to -3.2% as a main scenario, due mainly to worse than expected emerging economies despite improving prospect for developed economies, for which forecast for Europe was slightly up-revised on the back of more expansionary and unified fiscal policy.
- GDP forecast for 2021 was up-revised from 5.6% to 5.7%.
- Life with COVID-19 continues until effective vaccine is developed and become available worldwide. Global economy is expected to show continuing recovery from June led by developed economies, however, the pace of recovery is going to be affected by sporadic resurgence of COVID-19 infection cases.

Global GDP forecast and contribution by countries & regions (Main scenario)



# Global economy is gradually restarting by lifting of lockdowns

- Apple provides Mobility Index Data, which tracks level of peoples mobility. SMDAM made analysis between this Mobility Index and each nation's released GDP, which is used for estimating the latest GDP status corresponding to the latest Mobility Index Data.
- In this estimation, GDP for top 30 countries (excluding China) hit bottom in 13<sup>th</sup> April deviating -11.9% from the baseline, and then recovered by +8.0% to -3.9% by 8<sup>th</sup> June. People's mobility and estimated GDP are recovering comparatively faster in countries such as France, Germany, Italy and US, which experienced severe impact from COVID-19 and also started lifting of lockdowns relatively early.
- Japan has been forming a bottom from late April and the bottom level, -7.9% was noticeably milder than double digits in other countries, which was because lockdown in Japan was softer than other countries. Recovery of Japan's mobility and GDP is gathering pace after lifting of state of emergency. From 19<sup>th</sup> June, people are allowed to go anywhere in Japan as long as appropriate social distancing is maintained.

## Estimated GDP % change from the baseline before the pandemic (based on Apple Mobility Index)

Estimated GDP % change from the baseline before the pandemic, based on Apple Mobility Index

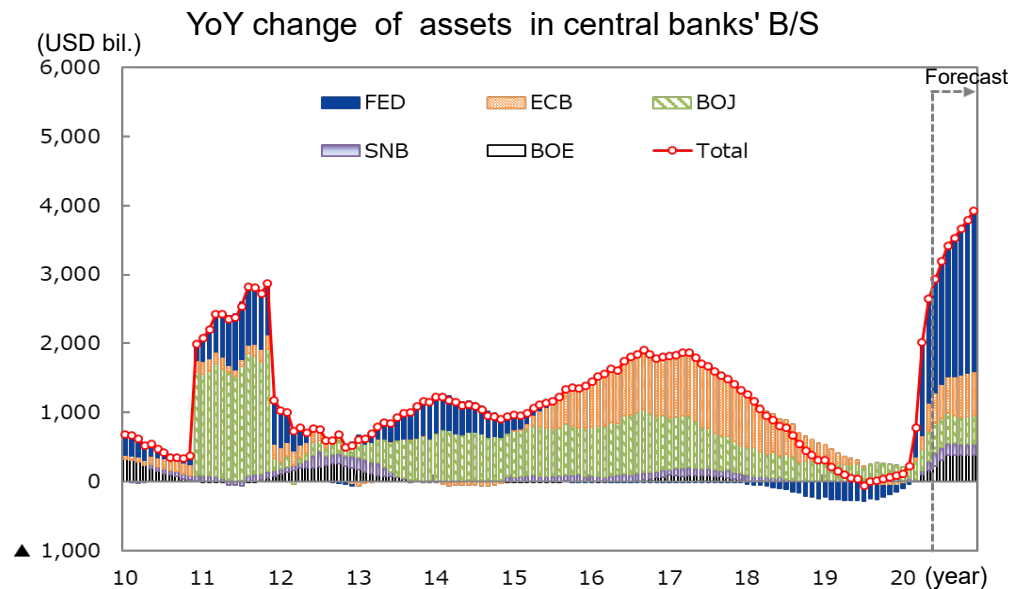
	Top 30 in GDP ex. China	United States	Japan	Germany	United Kingdom	France	India	Italy	Brazil	Spain	South Korea	Australia
Date of bottom (Y/M/D)	2020/4/13	2020/4/5	2020/4/23	2020/3/26	2020/4/2	2020/3/27	2020/4/7	2020/3/28	2020/3/27	2020/4/5	2020/3/5	2020/4/12
a) Bottom (% chg.)	▲ 11.9	▲ 11.4	▲ 7.9	▲ 12.2	▲ 14.3	▲ 16.6	▲ 17.1	▲ 17.1	▲ 14.1	▲ 17.6	▲ 12.0	▲ 13.1
b) 8th Jun (% chg.)	▲ 3.9	▲ 1.7	▲ 2.7	▲ 0.2	▲ 8.3	▲ 3.0	▲ 11.4	▲ 6.0	▲ 10.6	▲ 8.9	▲ 8.9	▲ 5.8
b)-a)	+ 8.0	+ 9.7	+ 5.2	+ 12.0	+ 6.0	+ 13.6	+ 5.7	+ 11.1	+ 3.5	+ 8.7	+ 3.2	+ 7.2

Note: SMDAM analyzed correlation between Apple's mobility index data and released GDP data, and exponentially estimated the GDP status corresponding to the latest mobility index data in a % change from the baseline GDP, which was the trend line prior to the COVID-19 pandemic.

(Source) Apple, National statistics of each country, estimation by SMDAM

# Global central banks are in emergency mode

- Central banks are determined to do almost everything they can do in order for avoiding financial meltdown stemming from COVID-19 pandemic. Another focus is on providing lifelines to households and businesses gasping for cash in the face of job losses and evaporating sales. FRB started to purchase corporate bonds and facilitated various routes for financing businesses. Governments are taking measures for helping both households and businesses.
- BOJ held extraordinary monetary policy committee meeting on 22<sup>nd</sup> May and decided to add measures for providing funding to businesses through banks. When banks make government initiated zero-interest-rate-unsecured-loans to small & mid businesses, BOJ will give 0.1% interest to each bank and also increase exemption amount from charging negative interest rate. Monetary policies were maintained on 16<sup>th</sup> of June.

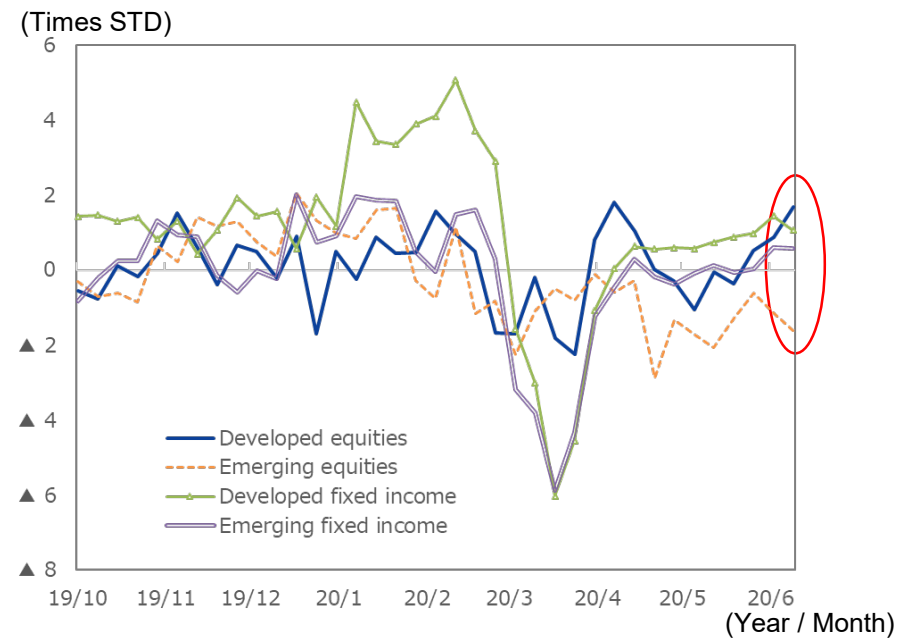
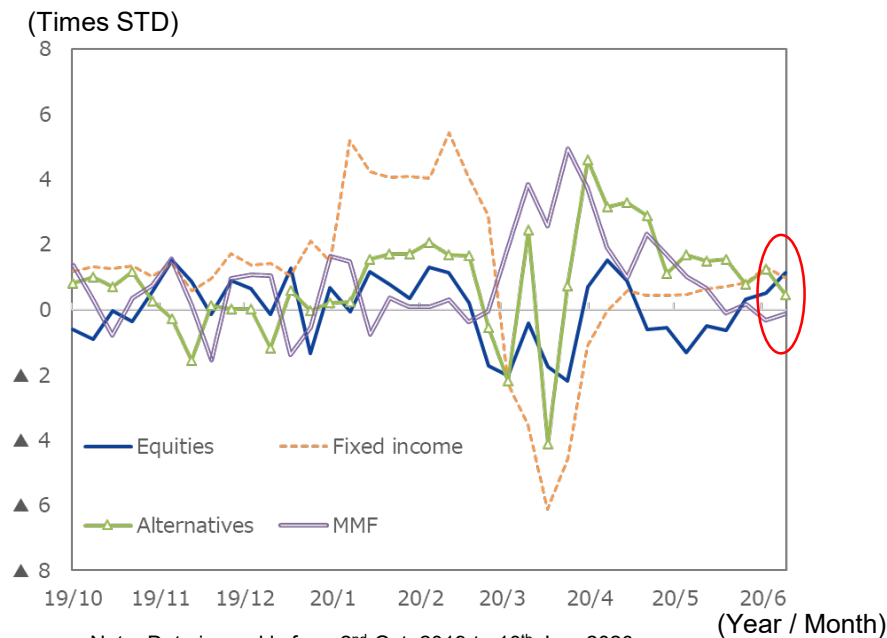


Note: Data is from Jan 2010 to 29<sup>th</sup> May 2020.  
(Source) Bloomberg, each central bank, compiled by SMDAM.

# Capital is flowing back to equities of developed countries

- Capital is flowing back to equities since May 2020 as left hand chart shows. Capital inflow to fixed income continues.
- For equities, inflow is expanding for developed countries, however, emerging equities continue experiencing large capital outflow so far.

Capital flow for Unit trust / Investment trust funds



Note: Data is weekly from 2<sup>nd</sup> Oct. 2019 to 10<sup>th</sup> Jun. 2020.

The figure is calculated by the following formula. ( weekly flow / 1Y moving standard deviation of weekly flows)

(Source) EPFR, compiled by SMDAM Economic Research Department

# SMDAM Japanese economic outlook for FY20-21

- SMDAM up-revised GDP forecast from -6.1% to -5.7% as the global economy is recovering faster than expected. Forecast for FY 2021 was revised upward from +3.6% to +3.7%.
- After the nationwide state of emergency was lifted on 25<sup>th</sup> May, economic activities are coming back led by service sectors, which were hit hard by COVID-19 pandemic. Manufacturing side is forecast to start recovering soon and to lead the economic recovery in FY2021.

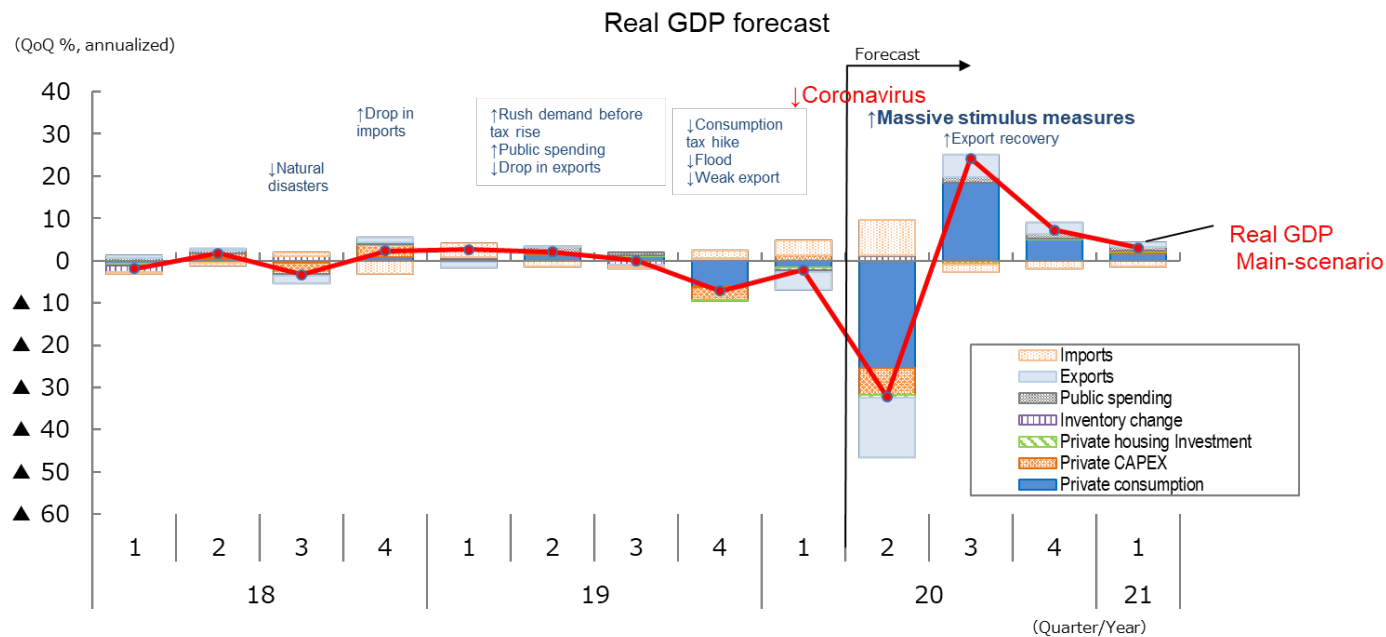
(YoY %)	FY16	FY17	FY18	FY19	FY20E	FY21E
Real GDP growth	0.9%	1.9%	0.3%	0.0%	-5.7%	3.7%
Private Consumption Expenditure	0.0%	1.1%	0.1%	-0.6%	-6.4%	4.2%
Private Housing Investment	6.3%	-1.4%	-4.9%	0.5%	-9.0%	3.4%
Private Capital Investment	-0.4%	4.3%	1.7%	-0.2%	-11.3%	2.8%
Public Consumption Expenditure	0.7%	0.3%	0.9%	2.4%	2.0%	0.9%
Public Capital Investment	0.6%	0.5%	0.6%	3.3%	2.4%	5.3%
Net Exports (contrib. to GDP growth)	0.8%	0.5%	-0.1%	-0.2%	-0.7%	0.4%
Exports	3.7%	6.4%	1.7%	-2.7%	-17.6%	9.8%
Imports	-0.9%	3.9%	2.5%	-1.7%	-13.2%	6.5%
Nominal GDP	0.8%	2.0%	0.1%	0.8%	-4.3%	4.3%
GDP Deflator	-0.2%	0.1%	-0.2%	0.8%	1.4%	0.6%
Industrial Production	0.8%	2.9%	0.3%	-3.6%	-12.7%	7.1%
CPI (excl. fresh food)	-0.2%	0.7%	0.8%	0.4%	-0.5%	0.1%

Note: E=SMDAM forecasts. SMDAM views are as of 23<sup>rd</sup> Jun. 2020 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, SMDAM forecasts



# Japanese GDP is forecast to dip sharply in 2Q of 2020

- SMDAM revised GDP forecast for Apr-Jun quarter (QoQ % annualized) from previous -29.9% to -32.1%, however, pace of recovery in the following quarters were revised upwards resulting in up-revision for FY2020 (ending in March 2021) GDP growth.
- Financial supports from the government were slow to reach hands of businesses and households, however, they are now providing lifelines and amount of supports will be further topped up.



Note: SMDAM views are as of 23<sup>rd</sup> Jun. 2020 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, SMDAM forecasts

# Fiscal stimulus in Japan

- Additional budget spending was approved in June. Total project size is advertised to be 117.1 trillion yen, which is identical to the spending size approved in April.
- 31.9 trillion yen is direct budget spending, among which the largest part is for maintaining employment and businesses. Support for property rents payment was newly added as a program. 10 trillion yen was saved as a reserve preparing for swift actions when required.

## Fiscal stimulus measures in Japan

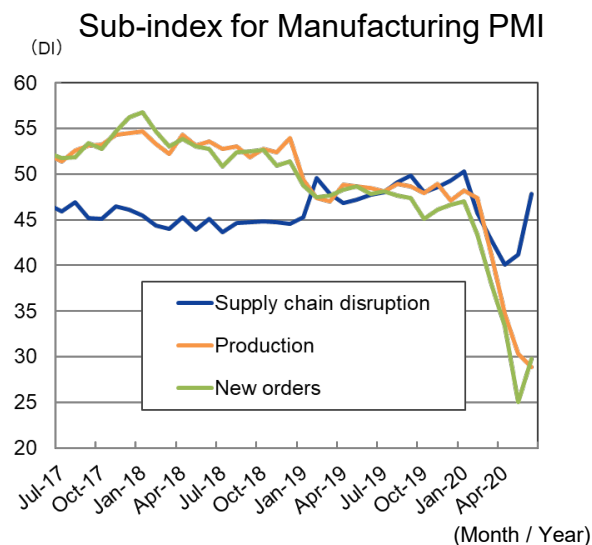
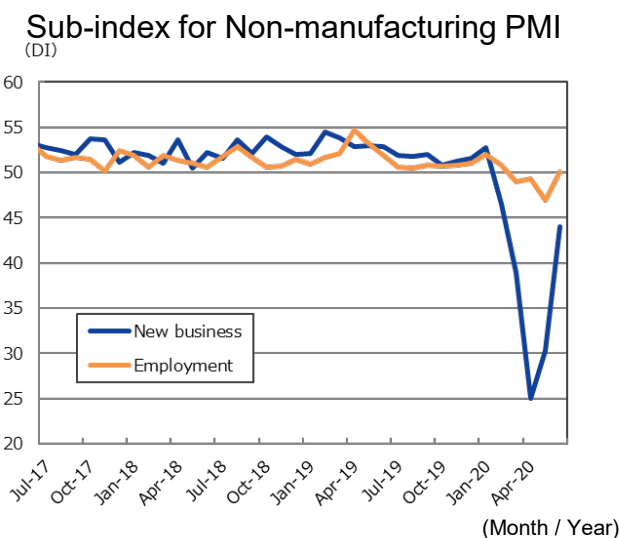
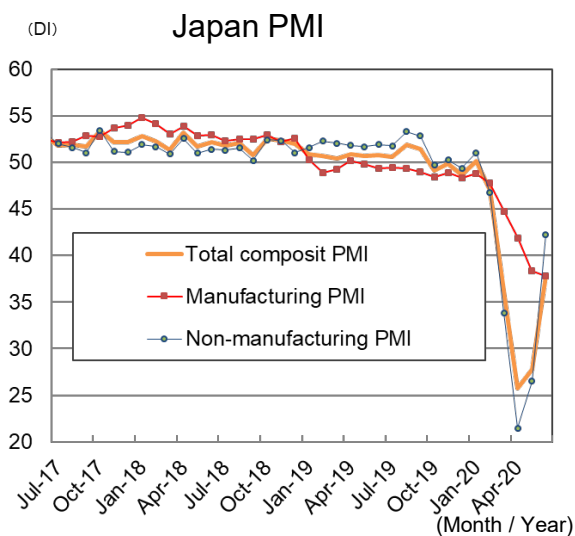
(Trillion yen)	FY2020 1st supplementary budget spending (Approved in April)					FY2020 2nd supplementary budget spending (Approved in June)				
	Total size of the project	Fiscal budget spending	Central & local government budget	FY2020 supple mentary budget	Fiscal Investment & Loan Program	Total size of the project	Fiscal budget spending	Central & local government budget	FY2020 supple mentary budget	Fiscal Investment & Loan Program
1) Enhancing quarantine & medical treatment, and developing drug & vaccine	2.5	2.5	2.5	1.8	-	N/A	N/A	N/A	3.0	N/A
<b>2) Maintaining employment and businesses</b>	<b>80.8</b>	30.8	21.1	<b>19.5</b>	9.7	N/A	N/A	N/A	<b>14.1</b>	N/A
3) Spending for boosting economic recovery	8.5	3.3	2.8	1.8	0.5	N/A	N/A	N/A	4.7	N/A
4) Enhancing economic & social platform	15.7	10.2	8.0	0.9	2.3	N/A	N/A	N/A	-	N/A
5) Reserve for additional measures	1.5	1.5	1.5	1.5	-	N/A	N/A	N/A	10.0	N/A
<b>Total</b>	<b>117.1</b>	48.4	<b>35.8</b>	<b>25.7</b>	12.5	<b>117.1</b>	72.7	<b>33.2</b>	<b>31.9</b>	39.2

Note: As of 24<sup>th</sup> Apr. 2020

(Source) Cabinet Office, compiled by SMDAM

# Business sentiments rebounded sharply led by non-manufacturing side

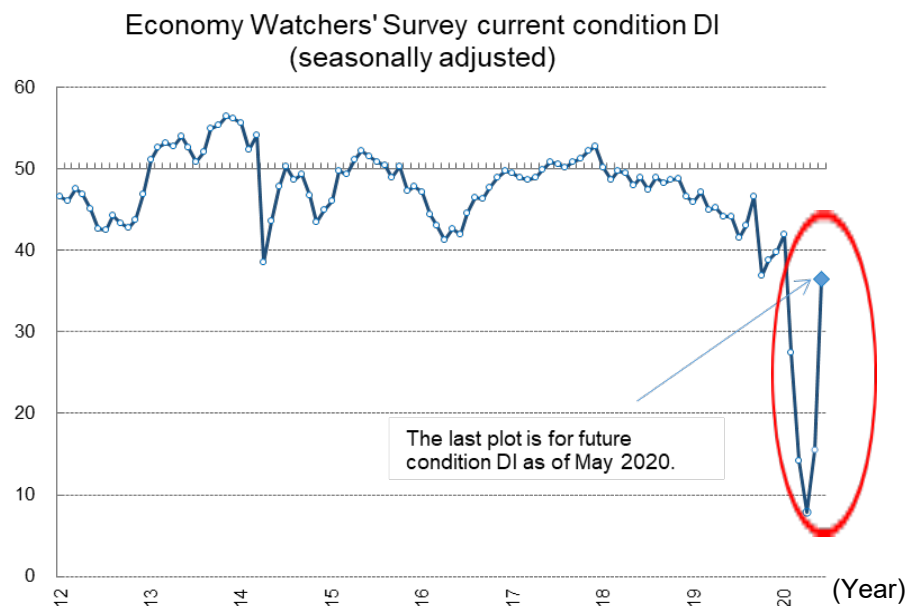
- PMI for Japan made a strong rebound in June led by non-manufacturing side. After the nationwide state of emergency was lifted on 25<sup>th</sup> May, restaurants and shops have been re-opening and restrictions on business hours have been also eased substantially. Cautiousness will stay as long as new COVID-19 infection cases continue, however, activities of Japanese people will keep rising unless 2<sup>nd</sup> wave pandemic scare becomes more threatening.
- For non-manufacturing side, PMI for new businesses made a sharp recovery and also PMI for employment recovered to above 50 level, which means condition is "good" rather than "bad", in June first time in the last 4 months.
- Manufacturing side is lagging in recovery as PMI for production dipped further, which will probably be the bottom as PMI for new orders started to recover.



Note: Data is from Jul. 2017 to Jun. 2020.  
Source: IHS Markit, BOJ, compiled by SMDAM.

# Economy Watcher Survey is going to make a v-shaped recovery

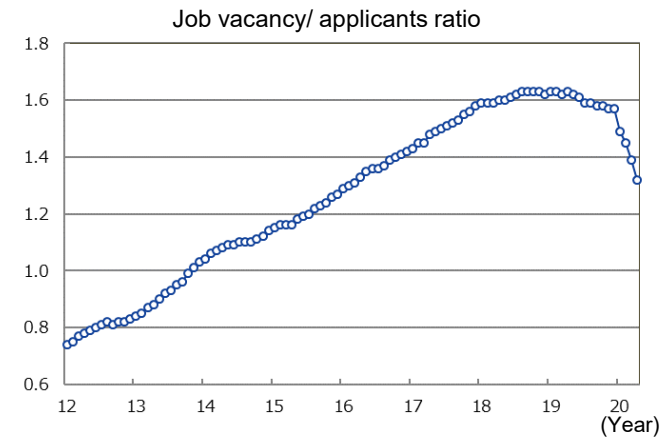
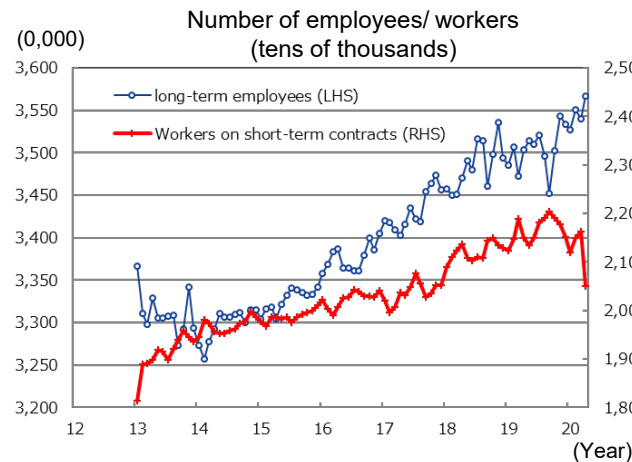
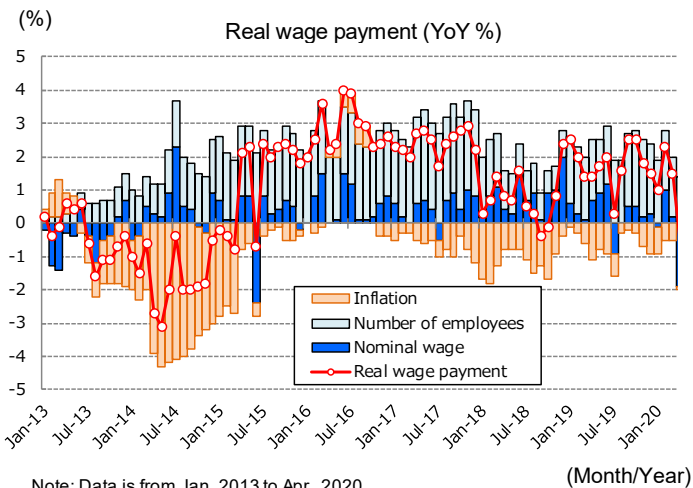
- Economy Watcher Survey covers people working at economic sensitive jobs. Current condition DI showed a bounce-back in May after 3 consecutive month of sharp decline.
- Future condition DI in May was sharply higher than the current condition DI, which implies that people are expecting substantial improvement in economic environments in the coming 2 to 3 months.



Note: Data is from Jan. 2012 to May. 2020. DI above 50 means condition is better than preceding 2 to 3 months.  
(Source) Cabinet Office

# Negative impact of COVID-19 appeared in labor statistics in Japan

- As a long-term trend, total wage payment in Japan keeps growing due mainly to increasing number of employees. Number of female workers are further increasing and also elder people are extending retirement age. This picture has not changed so far until April despite the fact that Japan has been in an economic contraction since October last year due to consumption tax hike and natural disasters.
- However, COVID-19 has caused a severe economic contraction and employment is under a strong stress. Job vacancy / applicants ratio further declined in April as a worrying sign.
- Around 37% workers are on a short-term contract basis and vulnerable to current difficult economic environment. Number of such workers sharply declined in April. This negative impact is expected to gradually ease as economy reopens further and government supports reach hands of businesses and households.



# US presidential campaign is going to gather pace

- US presidential election is probably the most important among scheduled events below.
- How the recovery from COVID-19 pandemic progresses and if the global leaders and central banks can keep making preemptive actions are most influential factors for the global economy.

## Upcoming key events

Month	Region/Country	Events
2020 July	Japan	1 BOJ TANKAN business survey (June survey)
		5 Election for Tokyo Metropolitan Governor
		21-22 BOJ Monetary Policy Committee Meeting & perspective report
August	US	National Convention (17-20 Democrats, 24-27 Republicans)
September	US	Debates begin between US presidential candidates
	Japan	16-17 BOJ Monetary Policy Committee Meeting
	G7	G7 summit meeting in US
October	Japan	1 BOJ TANKAN business survey (September survey)
		28-29 BOJ Monetary Policy Committee Meeting
November	US	US presidential election

(Source) Various publications, assembled by SMDAM

# Japan is still competitive in innovation, but has some weaknesses

- According to World Economic Forum, Japan was ranked 8th in innovation among 137 economies, which is still competitive, however on a moderate declining trend. As a strength, R&D in Japan is largely led by companies and producing the largest number of patents in this ranking.
- On the weak side, however, this company led R&D tends to be “progressive” rather than “innovative” and often lacks in global collaboration. Government initiative on innovation is stronger in economies such as US, Germany, Singapore and China.
- Facing with strong global competition in developing key technologies such as AI or Autonomous Driving Technology, Japanese companies are changing approach to more open and more collaborating with global partners.

Global Competitiveness Ranking of Innovation among 137 economies

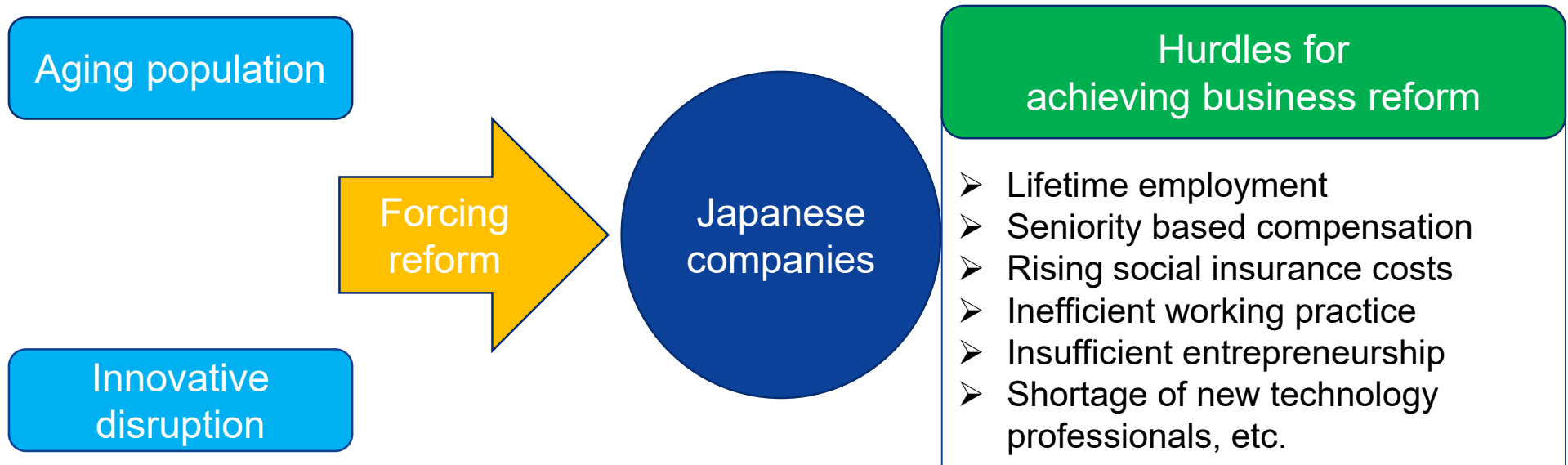
	Switzerland	U.S.	Israel	Finland	Germany	Netherlands	Sweden	Japan	Singapore	Denmark	China
Innovation total	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	28th
a) Capacity for innovation	1	2	3	7	5	6	4	21	23	16	44
b) Quality of scientific research institutions	1	5	3	8	11	4	13	14	12	16	36
c) Company spending on R&D	1	2	3	7	4	8	6	5	17	16	21
d) University-industry collaboration in R&D	1	2	3	4	7	5	10	23	8	21	28
e) Gov't procurement of advanced technology products	37	2	11	20	6	19	17	23	5	39	10
f) Availability of scientists and engineers	12	2	6	1	11	19	20	8	9	44	29
g) PCT patents	3	10	6	4	7	9	2	1	12	8	30

Note: All numbers are rankings among 137 economies. Top 10 rankings are highlighted in green. Japan's relative weakness is highlighted in orange.

(Source): World Economic Forum, The Global Competitiveness Report 2017–2018

# Japanese society is changing slowly but steadily

- It may look slow or even stagnant from outside, but Japanese society is making necessary reforms.
- Many problems are stemming from deep rooted Japanese culture & social practice, which became apparent in the face of “aging population” and “innovative disruption”.
- Change of the deep rooted culture & practice should take time, however, it is making progress, and will eventually put Japan in an advantage over other advanced economies, which also have aging population lagging Japan.





# Japanese society is changing slowly but steadily

## ■ Examples of long-term social challenges and progressing solutions

Source of problems	Challenges	Solutions
1. Aging population	a) Pension system reform	<ul style="list-style-type: none"> <li>● Unconventional "macro-slide" has been implemented to curb pension payment increase referring to "low birth rate" and so on.</li> <li>● Encourage people to continue working into 70's.</li> <li>● Encourage people to shift saving to investments. (NISA*, DC)</li> </ul>
	b) Labor shortage	<ul style="list-style-type: none"> <li>● Capital investment for enhancing labor efficiency. (FA, AI, IoT, autonomous driving car, renovating software, etc. )</li> <li>● Allowing more foreign workers.</li> <li>● Encourage people to delay retirement.</li> <li>● Support female workers. (increase nursery, etc.)</li> </ul>
2. Weak consumption propensity	c) Clearing peoples worry for the future life	<ul style="list-style-type: none"> <li>● Pension system reform.</li> <li>● Gradual adjustment of seniority based wage system to shift compensation from elderly to younger workers.</li> <li>● Increase of new generation companies.</li> <li>● Increase of young people working with non-seniority wage system.</li> </ul>
3. Rigid employment practice	d) Encouraging business structure reform	<ul style="list-style-type: none"> <li>● Elder people to retire or continue working at lower wage.</li> <li>● Gradual adjustment of seniority based wage system.</li> <li>● More fluid labor market enabling companies to make restructuring.</li> <li>● Young people are not expecting lifetime employments and focusing on building own career (already progressing).</li> </ul>
4. Inefficient working practice	e) Enhancing labor efficiency	<ul style="list-style-type: none"> <li>● Work style reform to progress.</li> </ul>
5. Insufficient entrepreneurship 6. Shortage of new technology professionals	f) Enhancing "challenge spirit" g) Education reform	<ul style="list-style-type: none"> <li>● Increase of successful new generation companies.</li> <li>● Increase of young people with skills of new technologies.</li> <li>● Young and talented people choose new generation companies rather than old &amp; large firms (already progressing).</li> </ul>

Note: \*NISA is "Nippon Individual Savings Account". (Source) SMDAM



# Outlook for Japanese Stock Market

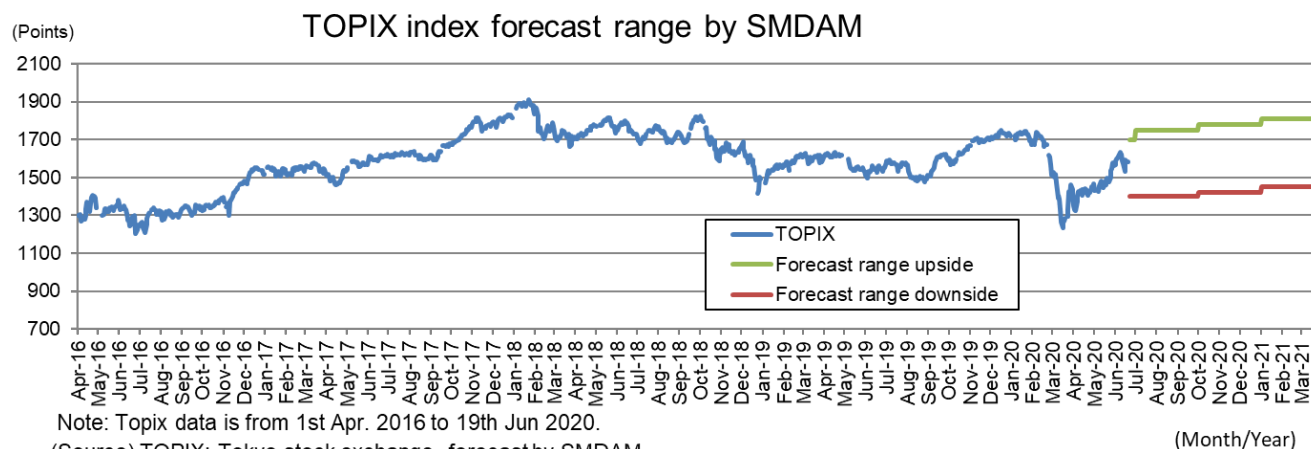
# High stock valuation will be supported by low interest rates and global comparison

## ■ SMDAM short-term view

➤ Global liquidity created by massive monetary easing and fiscal aid is lifting stock prices. Stock valuation in PE ratio for Japanese market is stuck to the upper end of the historical trading range, however, current valuation will be justified by extremely low interest rates and international comparison with other markets such as US. Japanese economy is forecast to continue re-opening and without threatening risk of the 2<sup>nd</sup> wave of COVID-pandemic, Japanese stock prices will be sustained at such high valuation.

## ■ Longer-term outlook (6-months and beyond)

➤ Unless effective vaccines become available worldwide, life with COVID-19 continues, and there could be a resurgence of infection cases, which could cause fear of 2<sup>nd</sup> wave of pandemic to rise. Current stock market is weaving in the best scenario, in which economic recovery continues without a serious setback and volatility could come back from time to time. However in the long-term, COVID-19 will be conquered and recovery in economy and stock prices will continue into a new expansion phase after a short but deep recession, which is just ending.



Note: SMDAM's projection is as of 23<sup>rd</sup> Jun. 2020 and subject to updates without notice.

# Base scenario & Upside / Downside risks for our forecasts

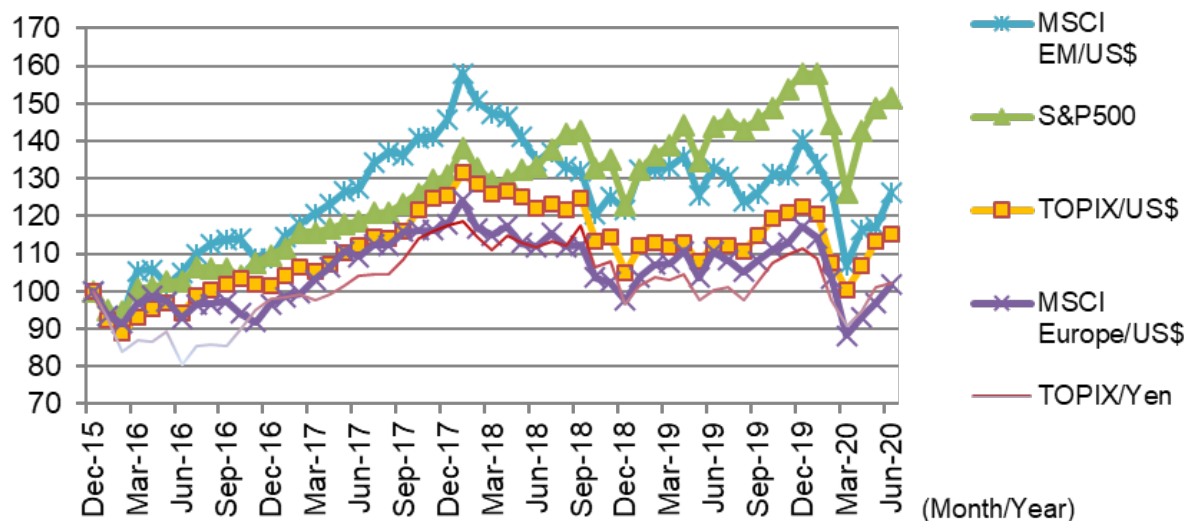
- Our **Base Scenario** is assuming the following views:
  - Another global hard lockdown caused by 2<sup>nd</sup> wave of COVID-19 pandemic can be avoided.
  - Severe tensions between US and China go on, however, US is going to avoid making a fatal blow to the global economy.
  - US economy contracts in 2Q and start to make recovery from 3Q 2020.
  - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
  - Tension in the East Asia or Middle East does not get out of control.
  - Central banks continue massive monetary easing and also large fiscal spending is made and topped up when necessary.
- **Upside Risks** include:
  - Outlook for COVID-19 pandemic gets brighter by such as progress in developing vaccine or drugs.
  - US and China make significant concessions in the trade negotiations.
  - Stronger-than-expected global growth.
  - Denuclearization in Korean peninsula makes a visible progress.
  - Japanese economy gets stronger than expected boosted by large fiscal spending.
- **Downside Risks** include:
  - 2<sup>nd</sup> wave of COVID-19 pandemic emerges and lockdowns cause severe economic disruption globally.
  - Global economy falls into a serious and long lasting depression.
  - Trade negotiation between US and China completely breaks up igniting a decades of power struggle.
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Political turmoil flares up in US running up to US presidential election in 2020.
  - Populism gains in Europe further destabilizing EU.

Note: SMDAM's projection is as of 23<sup>rd</sup> Jun. 2020 and subject to updates without notice.

# Global stock markets continued recovering on re-opening economy

- Global stock markets continued recovering on faster than expected pace of re-opening economy
- Emerging markets made a catch-up move so far in June. Many emerging countries are facing serious spread of COVID-19 infection, however, they cannot endure severe economic impacts from lockdowns anymore.

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

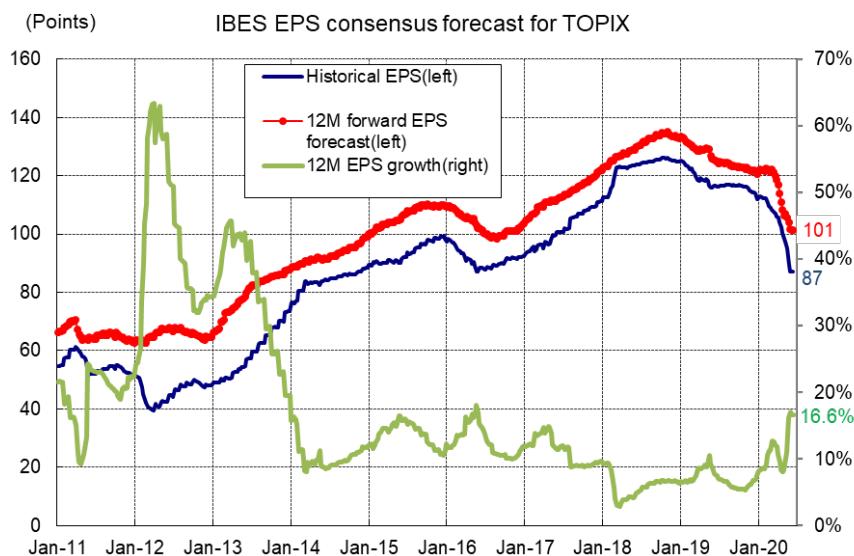


Notes: Data is up to 19th Jun 2020.

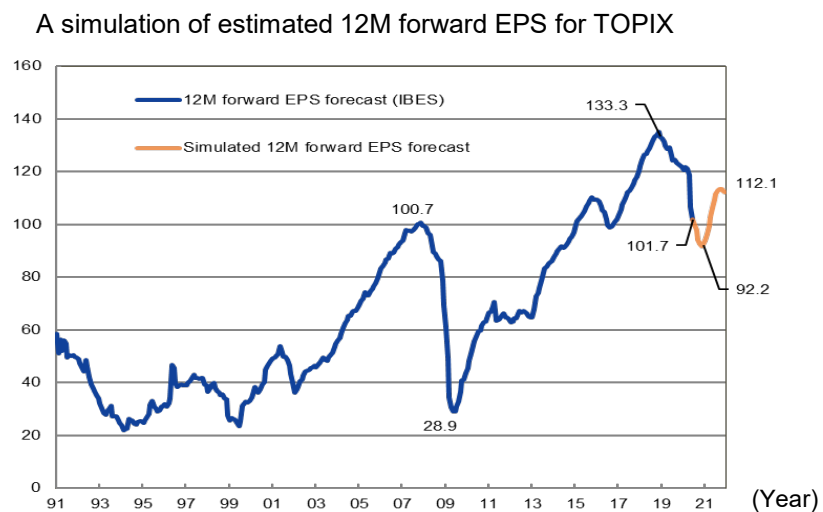
(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMDAM.

# Downward earnings revision continues

- Analysts are down-revising EPS forecast and the consensus forecast by IBES fell to 101 for TOPIX as of 11<sup>th</sup> June, which is shown on the left hand chart.
- On the right hand chart, SMDAM has made a top down estimation of how 12M-EPS could move until Dec 2021 based on SMDAM's main economic scenario, which assumes that economic recovery continues despite lingering scare of COVID-19 resurgence. Result of the simulation could vary widely depending on the applied economic scenario, however, as an example, 12M-EPS is estimated to decline to 92.2 in December 2020 and then start to make recovery. Simulated 12M-EPS is 112.1 for Dec 2021. This estimation could be a little too pessimistic since it depends on momentum of global trades, which is currently lagging the recovery of domestic activities in Japan.



Note: Weekly data from 6th Jan. 2011 to 11th Jun. 2020. (Month/Year)  
 (Source) Datastream, IBES



Note: The simulation is based on SMDAM original trade momentum index and IBES consensus 12M forward EPS forecast. Future EPS forecast was exponentially estimated by the course of future trade momentum set by SMDAM's economists using main economic scenario. IBES data is as of 1<sup>st</sup> Jun 2020.  
 (Source) IBES, simulation by SMDAM

## SMDAM's corporate earnings forecasts

- SMDAM makes earnings forecast for 455 companies excluding financials in its corporate research coverage.
- In the latest forecast on 5<sup>th</sup> June, recurring profits are forecast to decline by -10.9% in FY2020 and then recover by 28.2% in FY2021. When indexed with the latest high in FY2018 as 100, level of recurring profit for FY2019, 2020, 2021 are calculated at 78, 69 and 89 respectively. Corporate profits are expected to be 10% below the historical record level even after a robust recovery in FY2021. (“Recurring profits” in Japanese accounting means “earnings from continuous businesses”, which is basically before tax and extraordinary items.)

SMDAM Corporate Earnings forecasts (455 Companies research coverage excl. financials)

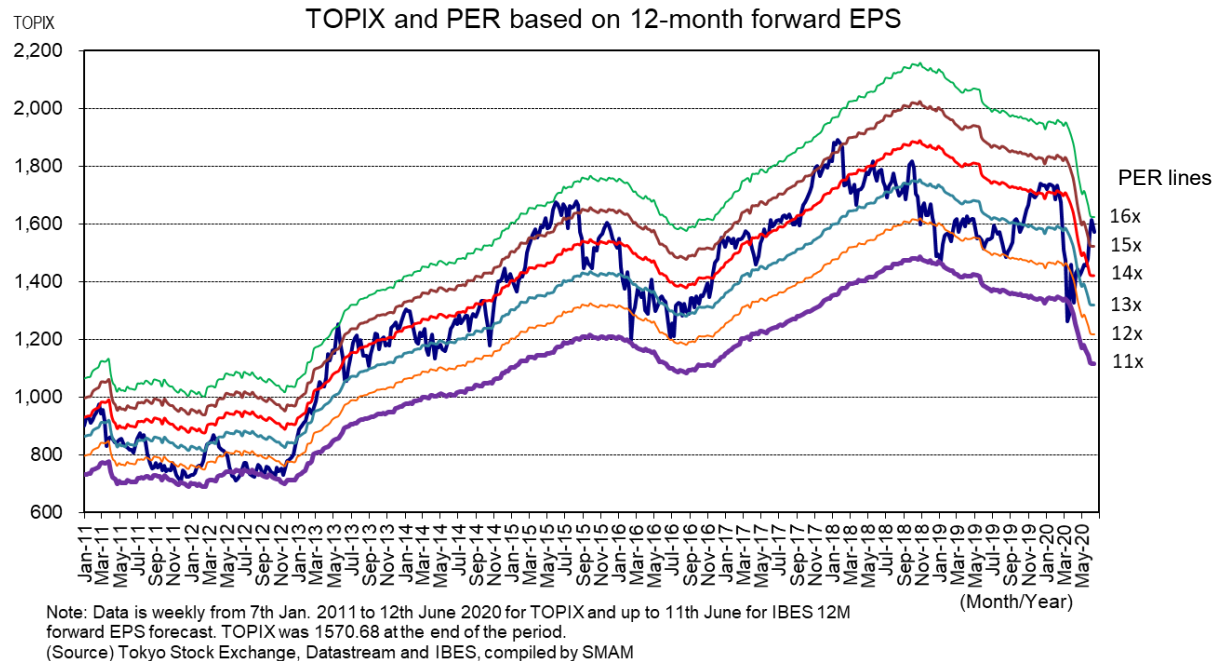
Fiscal year	FY 2019	FY 2020E	FY 2021E
Date of forecast	Actual	as of 5th Jun. 2020	as of 5th Jun. 2020
Sales (YoY %)	-2.5%	-8.6%	5.5%
Operating Profits (YoY %)	-25.0%	-10.4%	29.2%
<b>Recurring Profits (YoY %)</b>	-22.4%	-10.9%	28.2%
Net Profits (YoY %)	34.7%	-2.5%	33.5%
Recurring profits (YoY %)			
Manufacturing 260 companies	-25.7%	-10.1%	32.5%
Non-manufacturing 195 companies	-17.8%	-11.7%	22.8%

Note: Key assumptions for FY2019 & 2020 are Yen/US\$ 108 and Yen/EUR117.

(Source) SMDAM Corporate Research Department, Toyo Keizai

# PER stock valuation for Japanese stocks is stuck to the upper end of the historical range

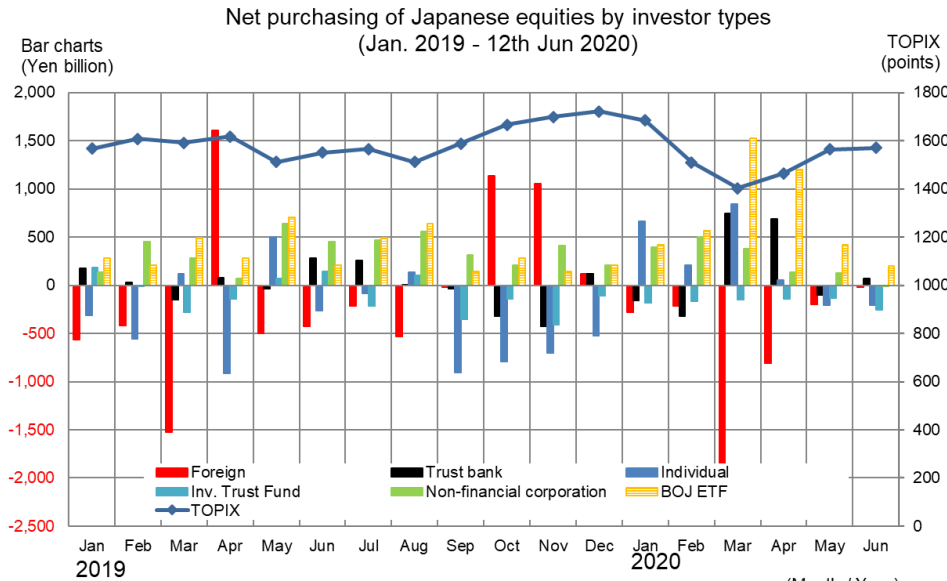
- Recovery in stock prices in the face of continuing down-revision of earnings made the stock valuation in PE Ratio (PER) stuck to the high end of the historical range, which has been between 11 times and 16 times as shown on the chart.
- Globally, PER is at high level, which is supported by massive quantitative easing and significant decline in interest rates, especially in US after COVID-19 pandemic.
- Japanese stock valuation does not look expensive when compared with other stock markets such as US.



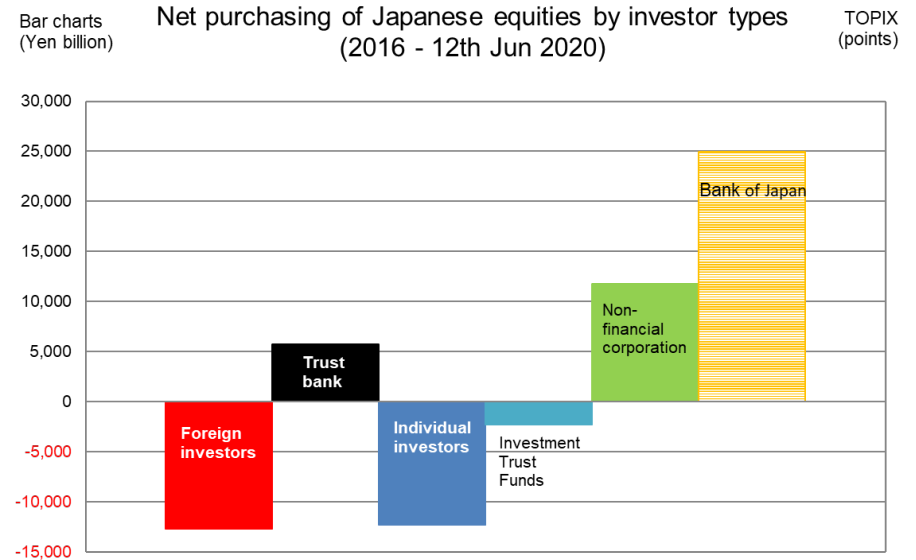


# Trading activities were relatively calm in May and June

- In terms of the net trading activities by investor types, no category showed significant move in May and June.
- In a long-term since 2016, ETF purchasing by BOJ and share buy-back by companies are two main purchasers.
- Selling by individual investors gets smaller if purchasing via IPO is included.



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to 12th Jun. 2020.  
BOJ ETF figure is officially released data from BOJ.  
(Source) Japan Exchange Group, Bank of Japan



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# Advancing Corporate Governance Code and Stewardship Code

- Stewardship Code (SC) was set in February 2014. Investors are taking more pro-active approach in talking to the companies and exercising proxy voting rights. Financial Services Agency discloses the name of institutional investors, which publicly accepted SC.
- After inception of Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve its governance, efficiency and shareholder returns.
- These two codes have been progressively reviewed and enhanced, and making visible impact on the corporate behavior and investors' attitudes as shareholders.
- In the recent amendment of CGC, companies are required to explain the rationale of “cross holdings” or “strategic holdings” of other companies' shares, which implicitly provide protection against takeovers and hostile shareholder actions, and is often negative for achieving shareholder value.
- SC was reinforced in March 2020 requiring investors to evaluate ESG factors.

Total number of institutional investors, which publicly declared acceptance of the stewardship code	
Trust banks	6
Investment management companies	191
Insurance companies	23
Pension funds	53
Others (include proxy voting advising companies)	7
Total	280

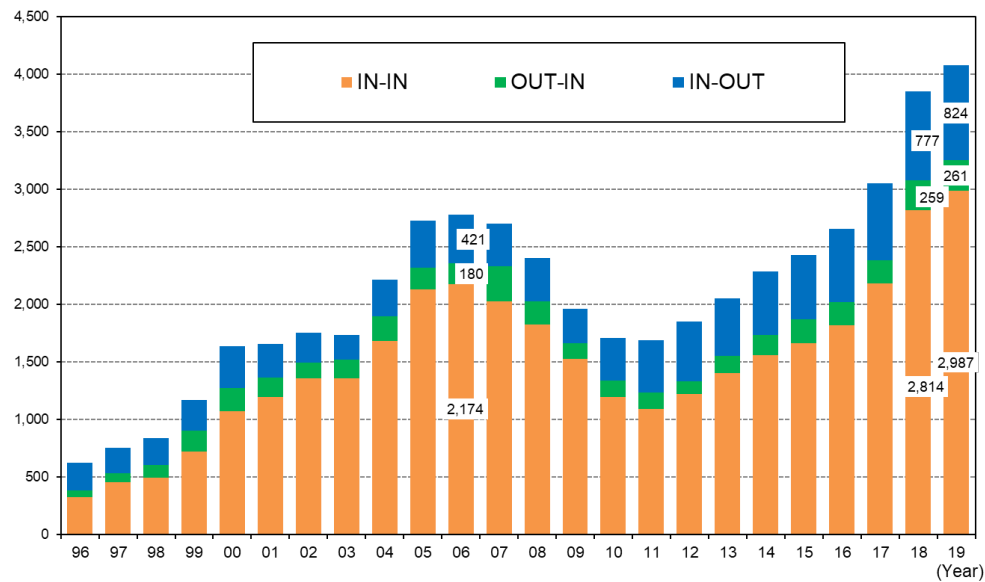
Note: As of 13th Mar. 2020.

(Source) Financial Services Agency

# Business restructuring is progressing for Japanese companies

- Japanese companies are getting more and more willing to make positive business restructuring.
- Number of M&A deals between Japanese companies (IN-IN) rose from 2,174 in 2006 to 2,814 in 2018 and further to 2,987 in 2019, which is an evidence that business restructuring is progressing in Japan.
- Number of the deals of Japanese companies acquiring overseas businesses (IN-OUT) also rose from 421 in 2006 to 777 in 2018 and further to 824 in 2019.

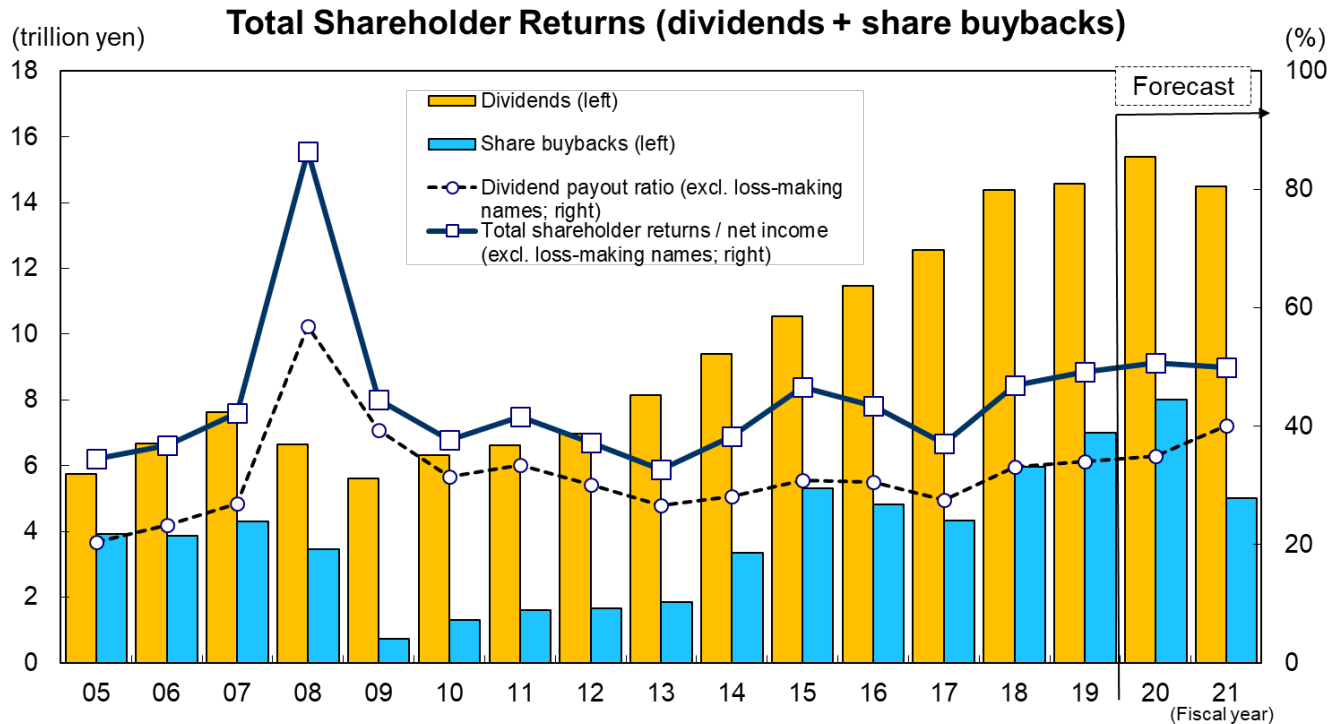
Number of M&A deals involving Japanese companies  
(Excluding transactions among the same business group)



Note: IN-IN means Japanese company acquiring Japanese one, OUT-IN is for Non-Japanese company acquiring Japanese company, and IN-OUT is for Japanese company acquiring non-Japanese company.  
(Source) RECOF and SMBC NIKKO Securities.

# Behavior of Japanese companies are making positive changes

- Share buyback is getting popular among Japanese companies as one of the powerful tools for disposing of accumulated liquidity in the B/S and enhancing EPS growth as well as ROE.
- Dividends also renewed historical record in FY2019 and expected to increase further in FY2020. Dividend and share buyback are forecast to decline in FY2021 due to COVID-19 impact.



Note: All listed firms. Dividend projections are Toyo Keizai estimates, share buybacks forecast is by Daiwa Securities. Data as of June 2020.  
 (Source) Toyo Keizai, QUICK, INDB, compiled by Daiwa Securities.

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