Outlook for Japanese Economy & Stock Market

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

-March 2021-

Sumitomo Mitsui DS Asset Management

Executive summary

➢ Japanese Economy

SMDAM revised GDP forecast for FY2020, 21 and 22 by +0.8%, +0.2% and -0.1% respectively resulting from much stronger than expected GDP for Oct-Dec 2020 quarter. Capital spending was stronger than preceding forecast led by strong demand from overseas. Private consumption was quite robust partly lifted by “Go To campaign”, which was a government incentive for traveling, eating and going events though it has been stopped due to COVID. (Page 9)

- COVID-19 caused a severe negative impact, however, the trade momentum hit bottom in May and substantial recovery is continuing afterwards. Phase analysis shows that the current new cycle is further progressing in Phase 3, in which historically broad range of assets tend to produce significant positive returns. (Page 4)
- Economy Watcher Survey covers people working at economic sensitive jobs. Current condition DI in January dropped to 31.2, which was just as indicated by future condition DI in December. Future condition DI in January is pointing at sharp recovery to 39.9. Winter spread of COVID-19 is gradually calming down and current state of emergency is going to be lifted by early March. (Page 13)

➢ Japanese Stock Market

Corporate earnings for Oct-Dec 2020 quarter came out strongly beating preceding forecasts. Manufacturing industries are showing robust earnings recovery mainly led by strong exports. COVID vaccination is progressing in many countries so far without serious health trouble and new infection cases are coming down noticeably. SMDAM revised forecast range upwards based on higher EPS growth and rising risk appetite of investors. Japanese stocks will attract global money with relatively attractive stock valuation and high sensitivity to the global economy. (Page 20)

- 12M EPS consensus forecast has been bouncing back from September. Latest 12M forward EPS growth forecast for TOPIX rose further to robust 37.6%. (Page 25)
- PE Ratio (PER) and real interest rate (RI) have negative correlation. Take US S&P 500 as a guide for global stock valuation compared to real interest rate, current position looks reasonably valued and it could stay so if RI rises just slowly in line with EPS growth. (Page 22)

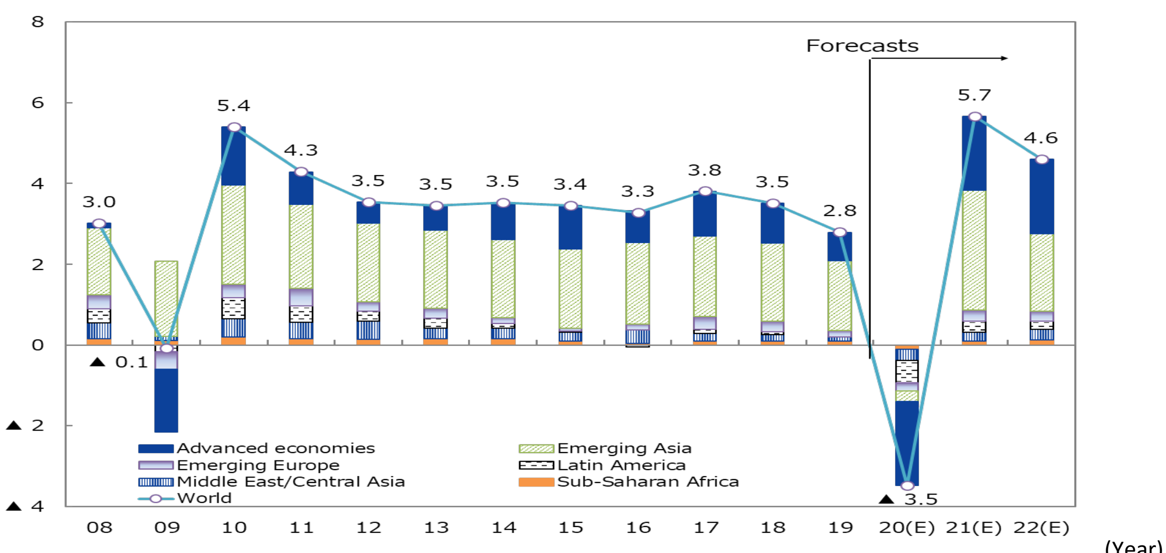
Notes: Macro and market views are as of 16th Feb. 2021, and subject to updates thereafter without notice.

Outlook for Global Economy

Outlook for the global economy

- SMDAM has marginally adjusted GDP forecast for 2020 and 2021 by +0.2% and +0.1% respectively. Fiscal stimulus in US in 2021 is getting larger the expected.
- Global economy is expected to show continuing recovery. Manufacturing industries will be the main driver of the recovery for the coming months. Physical service sectors likely recover from the latter half of 2021.

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

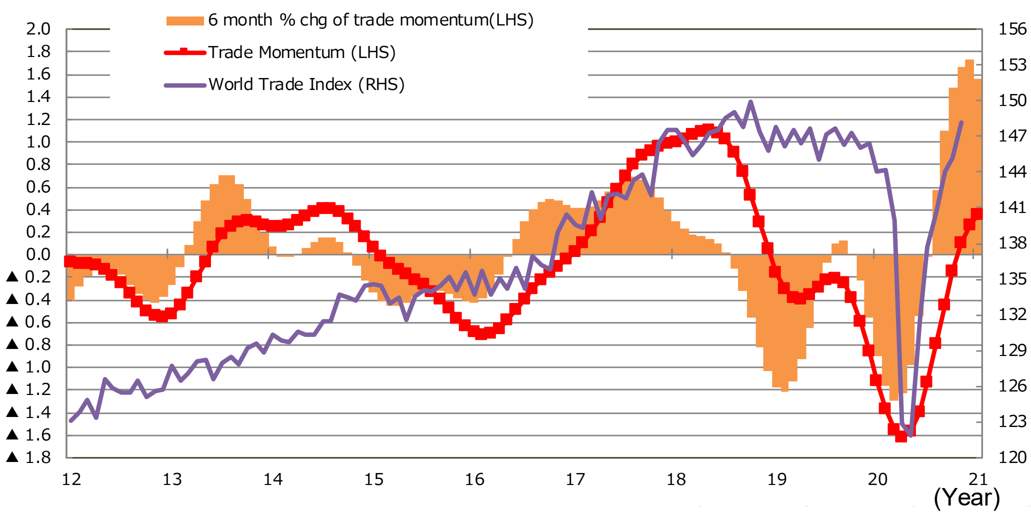


Notes: Data is from 2008 to 2022 and forecasts by SMDAM as of 16th Feb. 2021.
(Source) IMF, National statistics of each country, compiled by SMDAM.

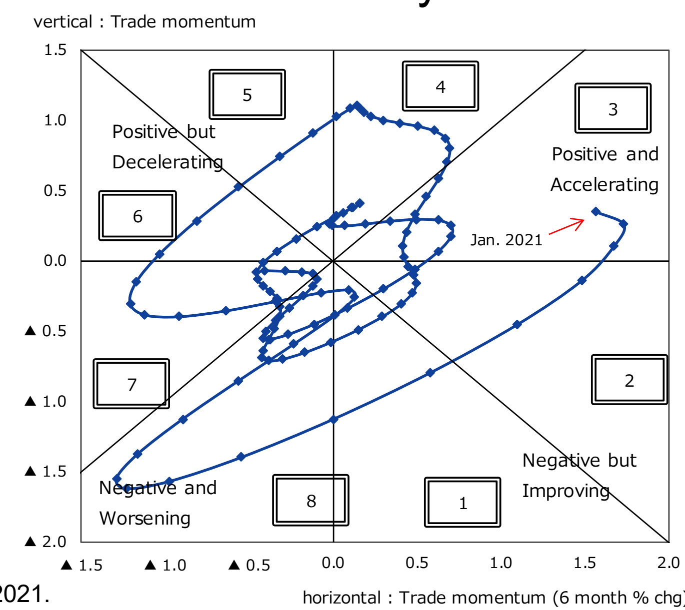
Trade momentum analysis shows a new economic cycle is progressing

- SMDAM has developed trade momentum indicators in order for monitoring economic cycles and estimating in which phase of cycle current position is situated.
- COVID-19 caused a severe negative impact, however, the trade momentum hit bottom in May and substantial recovery is continuing afterwards.
- Phase analysis shows that the current new cycle is further progressing in Phase 3, in which historically broad range of assets tend to produce significant positive returns.

Trade momentum as a guide for economic cycle



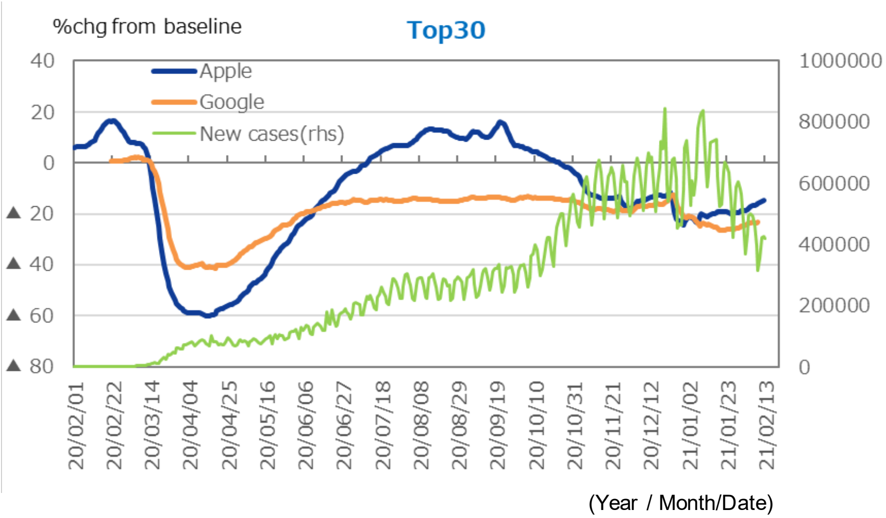
Phase analysis



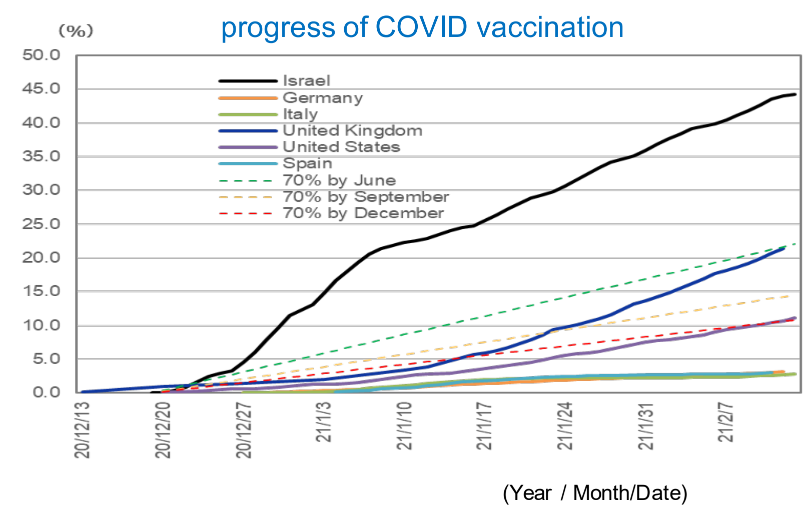
(Notes) Trade momentum is calculated from 16 indicators and compiled by SMDAM. Data is from Jan 2012 to Jan. 2021.
(Source) Bloomberg, Datastream, Netherlands Bureau for Economic Policy Analysis and other National Statistics.

People’s mobility is recovering and vaccination is progressing

- New cases of COVID-19 are declining and lockdowns are gradually loosened. Mobility indices show that people’s activities are coming back.
- Vaccination is progressing. Such countries as Israel, UAE (not shown on the right chart), UK are making good progress and US is expected to pick up the pace going forward. Japan started vaccination for medical staff from 17th February.



Note: Apple and Google’s mobility indices are composed by each sub-indices selected by SMDAM in order for tracking GDP of each country. Top 30 countries by GDP excluding China.
Google’s data is up to 7th February, Apple’s data is up to 12th February and number of new COVID-19 infection cases is up to 12th February.
(Source) Google, Apple, National statistics of each country, estimation by SMDAM

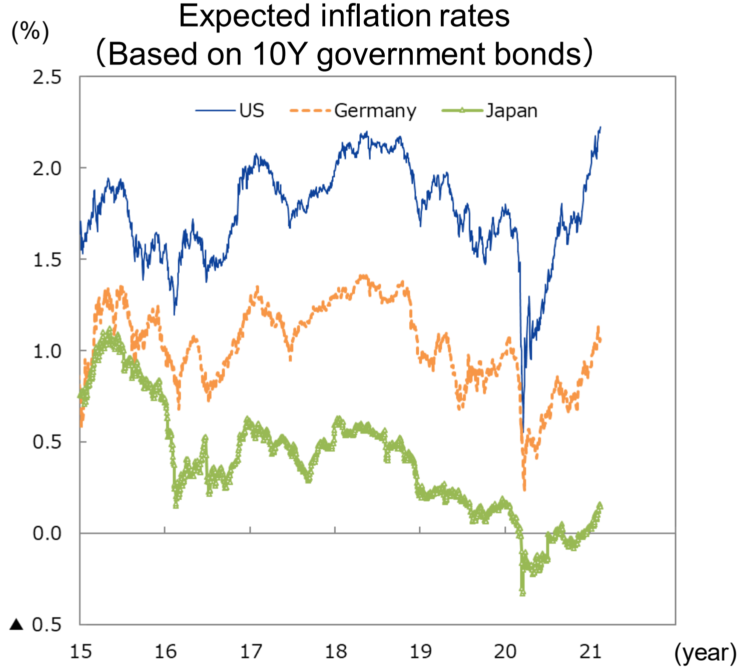


Note: Data is up to 13th February 2021.
Percentage of people who had at least one shot of vaccine among total population of each country.
Each 70% line show the trend to reach 70% of the total population by each month-end.
(Source) National statistics of each country.

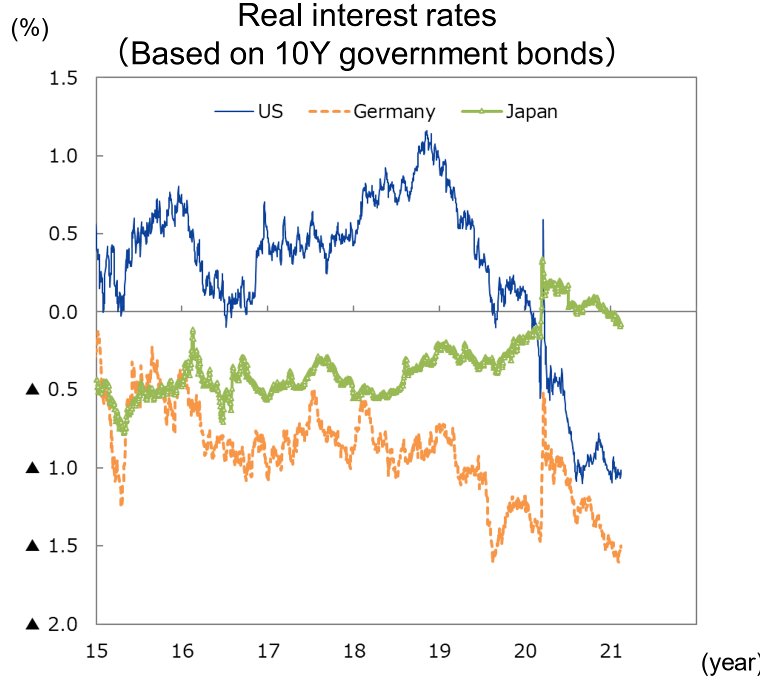
Tapering and guidance to financial markets are key events in 2021(1)

- Expected inflation rates, which are calculated from yields of index linked government bonds and straight bonds, continue rising beyond 2% level in US and also rising in Germany and Japan too.
- Real interest rates are at unprecedented levels in negative territory for US and Europe, which together with quantitative easing could cause bubble in financial markets if they stay too long.
- On the other hand, actual inflation rate is not likely to rise so quickly and 2% target level will not be met soon in 2021.
- Central banks have a very complicated task in maneuvering monetary policies and taming sensitive financial markets.

Expected inflation rates
(Based on 10Y government bonds)



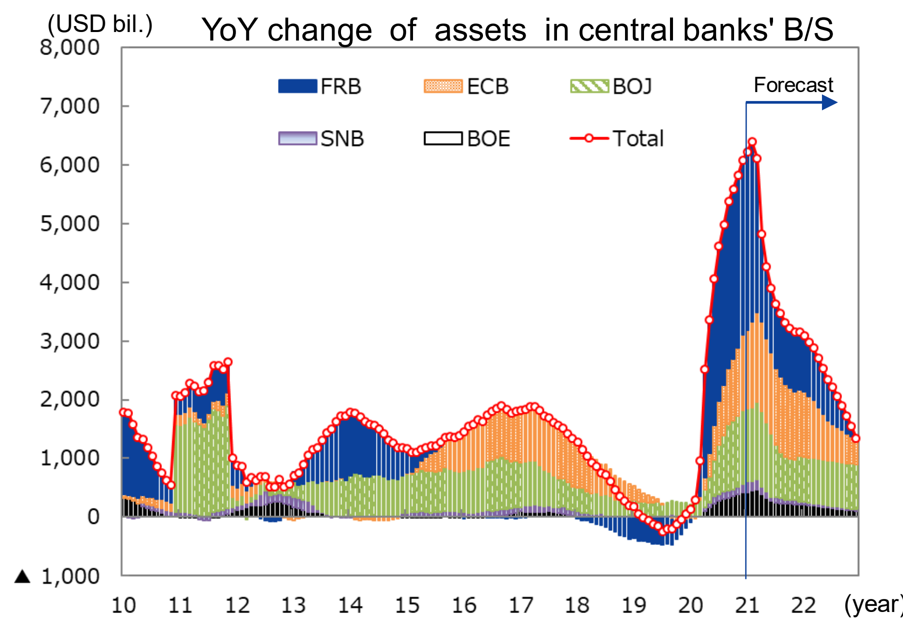
Real interest rates
(Based on 10Y government bonds)



Note: Data is from 1st Jan 2015 to 12th Feb. 2021.
(Source) Bloomberg

Tapering and guidance to financial markets are key events in 2021(2)

- Central banks continue extra-easy monetary policies in order for calming negative impacts caused by the winter spread of Covid-19. They unanimously call for additional fiscal measures to keep economies on a growth path.
- Behind the doors, central banks are discussing how to maneuver tapering of monetary easing in 2021 when the global economy heads for a full recovery. In order for avoiding negative reaction by financial markets, communication and guidance from central banks are quite important.
- BOJ is going to release a review for the overall monetary policy in March, in which policy for purchasing ETF is expected to be made more flexible to be gradually scaled-down.



Note: Data is from Jan 2010 to 31st January 2021. Forecast is up to Dec 2022.
(Source) Bloomberg, each central bank, compiled by SMDAM.

Outlook for Japanese Economy

SMDAM Japanese economic outlook for FY20-22

- SMDAM revised GDP forecast for FY2020, 21 and 22 by +0.8%, +0.2% and -0.1% respectively resulting from much stronger than expected GDP for Oct-Dec 2020 quarter. Capital spending was stronger than preceding forecast led by strong demand from overseas. Private consumption was quite robust partly lifted by “Go To campaign”, which was a government incentive for traveling, eating and going events though it has been stopped due to COVID.
- Expansionary fiscal spending and progress of vaccination are going to lift GDP from the latter half of FY2021.

(YoY %)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Real GDP growth	1.8%	0.3%	-0.3%	-5.0%	4.3%	2.1%
Private Consumption Expenditure	1.0%	0.2%	-1.0%	-6.4%	4.3%	1.5%
Private Housing Investment	-1.8%	-4.9%	2.5%	-7.4%	2.0%	2.2%
Private Capital Investment	2.8%	1.0%	-0.6%	-6.9%	3.9%	5.6%
Public Consumption Expenditure	0.3%	1.1%	2.0%	3.4%	1.5%	0.3%
Public Capital Investment	0.6%	0.8%	1.5%	4.5%	3.7%	1.4%
Net Exports (contrib. to GDP growth)	0.4%	-0.1%	-0.2%	-0.9%	0.9%	0.1%
Exports	6.3%	2.1%	-2.6%	-11.5%	10.3%	6.1%
Imports	3.8%	2.8%	-1.3%	-6.7%	4.7%	5.8%
Nominal GDP	2.0%	0.2%	0.5%	-4.3%	4.1%	2.4%
GDP Deflator	0.2%	-0.1%	0.8%	0.7%	-0.2%	0.3%
Industrial Production	2.9%	0.3%	-3.6%	-10.0%	11.0%	5.3%
CPI (excl. fresh food)	0.7%	0.8%	0.4%	-0.6%	0.3%	0.5%

Note: E=SMDAM forecasts. SMDAM views are as of 16th Feb. 2021 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

Fiscal stimulus in Japan

- Additional fiscal spending plan was created by the cabinet office and approved by the national diet in January. Additional budget spending this time is 40 trillion yen, which is a little smaller than preceding two cases and 10 trillion yen of reserve in June is counted again. SMDAM estimates its impact on Japanese GDP for FY2020,21 and 2022 to be +0.2%, +0.7% and -0.3% respectively.

- Budget plan for FY2021 was also created at massive 106.6 trillion yen.

- Focus of spending is shifting to long term measures for renovating Japanese economy such as digitization and clean energy.

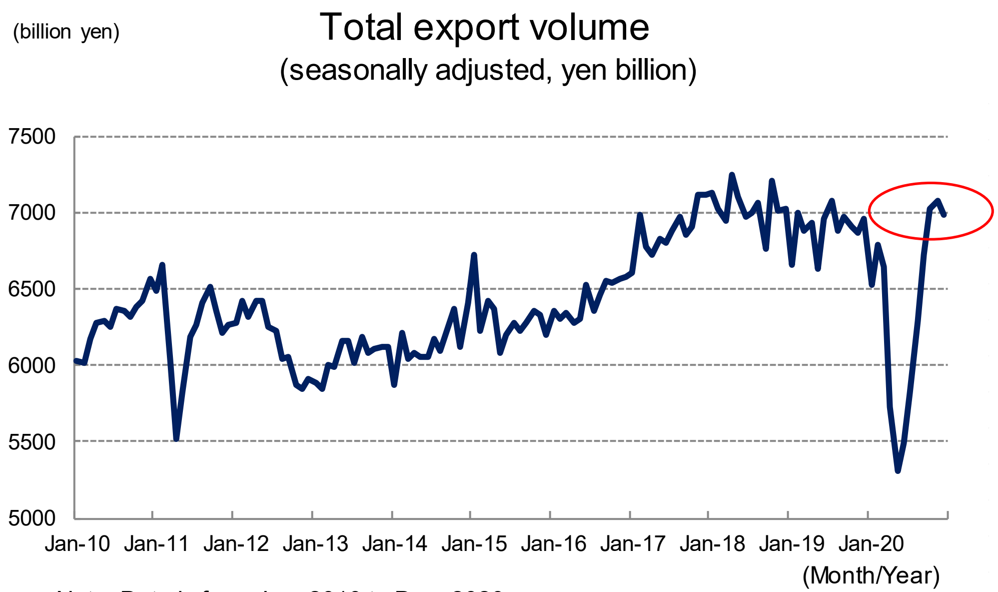
Fiscal stimulus measures in Japan

(Trillion yen)	FY2020 1st supplementary budget spending (Apporoved in April)				FY2020 2nd supplementary budget spending (Approved in June)				FY2020 3rd supplementary budget spending (Approved in January 2021)			
	Total size of the project	Fiscal budget spending	Central & local government budget	Fiscal Investment & Loan Program	Total size of the project	Fiscal budget spending	Central & local government budget	Fiscal Investment & Loan Program	Total size of the project	Fiscal budget spending	Central & local government budget	Fiscal Investment & Loan Program
1) Enhancing quarantine & medical treatment, and developing drug & vaccine	2.5	2.5	2.5	-	N/A	N/A	3.0	N/A	6.0	5.9	4.5	1.4
2) Renovating Japanese economy									**51.7**	**18.4**	13.4	5.0
3) Maintaining employment and businesses	80.8	30.8	21.1	9.7	N/A	N/A	14.1	N/A	N/A	N/A	N/A	N/A
4) Spending for boosting economic recovery	8.5	3.3	2.8	0.5	N/A	N/A	4.7	N/A	N/A	N/A	N/A	N/A
5) Enhancing economic & social platform	15.7	10.2	8.0	2.3	N/A	N/A	-	N/A	5.9	5.6	4.4	1.3
6) Reserve for additional measures	1.5	1.5	1.5	-	N/A	N/A	10.0	N/A	N/A	N/A	N/A	N/A
7) Full usage of reserves for additional measures									10.0	10.0	10.0	
Total	117.1	48.4	35.8	12.5	117.1	72.7	33.2	39.2	**73.6**	**40.0**	**32.3**	**7.7**

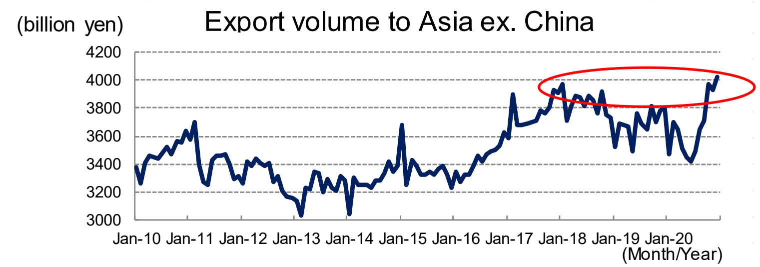
Note: As of 1st Feb 2021
(Source) Cabinet Office, compiled by SMDAM

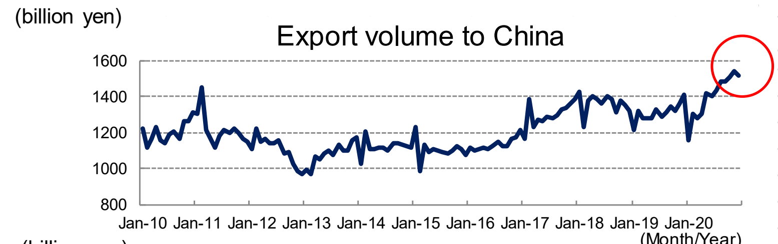
Strong exports are continuing despite a slight decline in Dec 2020

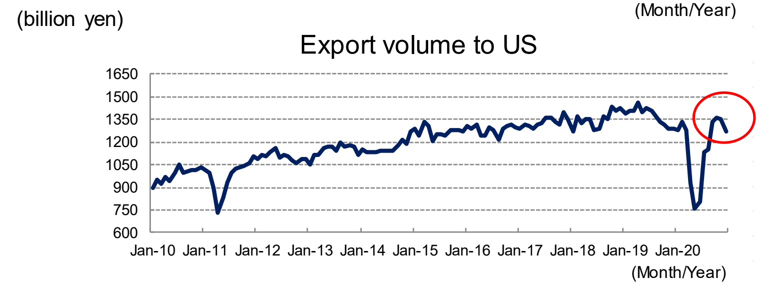
- In December 2020, exports to US notched down and total exports from Japan slightly declined. However, exports to Asia, which is the biggest destination, increased led by machinery and transportation equipment. Exports to China stays strong despite slight decline in December, which is considered to be temporary.
- Manufacturing side of the Japanese economy is going to lead the recovery supported by robust exports.



Note: Data is from Jan. 2010 to Dec. 2020.
(Source) Ministry of Finance, Bank of Japan, compiled by SMDAM.



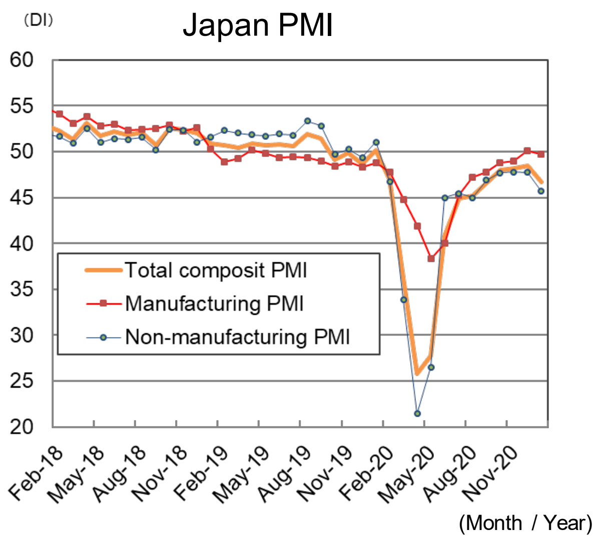


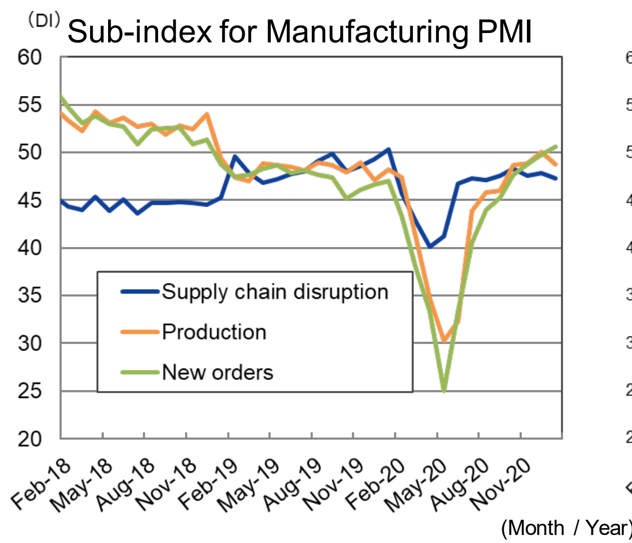


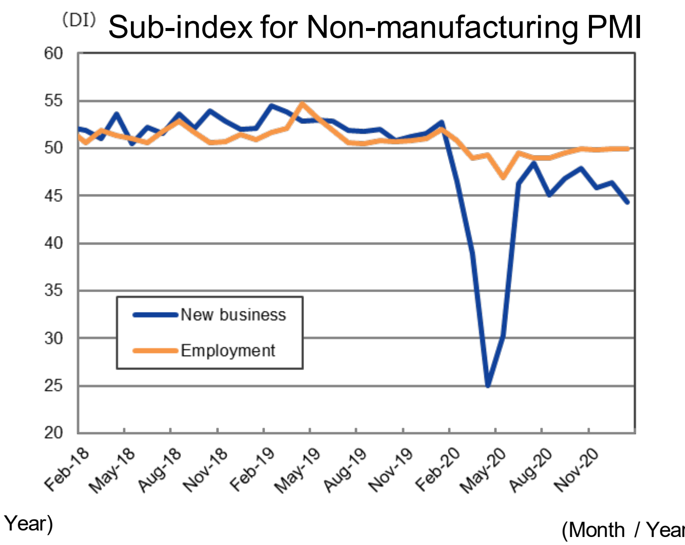
Business sentiment declined in January under a new state of emergency

- PMI for Japan declined in January from 48.5 in the previous month to 46.7. Non-manufacturing side is suffering from a new state of emergency declaration and restriction on businesses.

- PMI for manufacturing sector showed resilience declining just by -0.3%. Also, sub-index shows solid recovery in new orders in January, which is encouraging for the prospect of manufacturing activities.



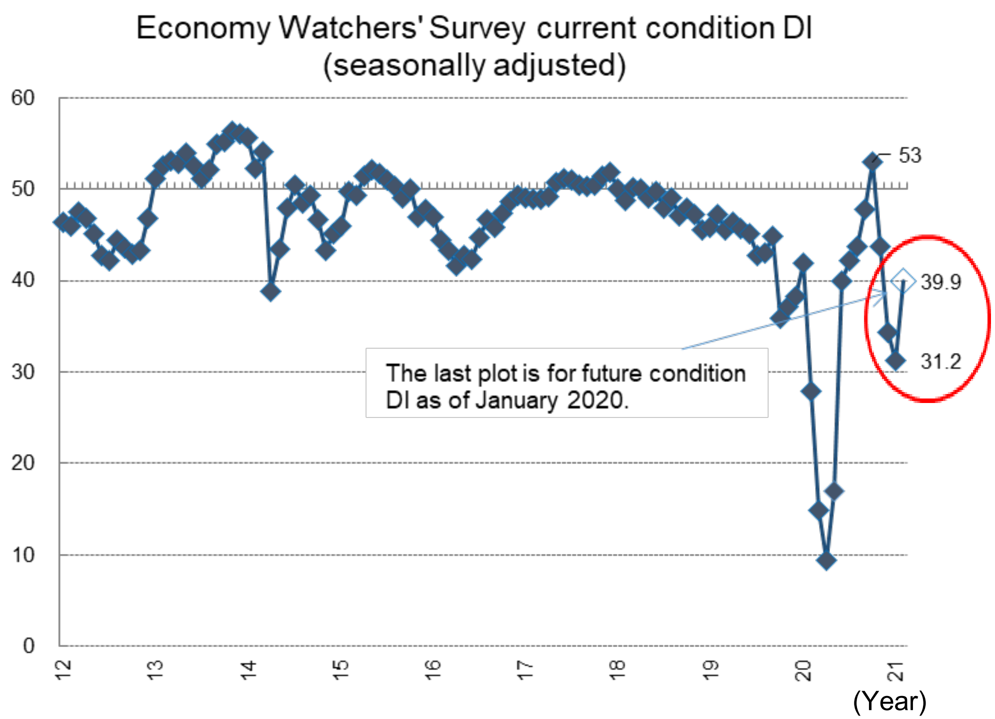




Note: Data is from Feb. 2018 to Jan. 2021.
Source: IHS Markit, BOJ, compiled by SMDAM.

Economic sentiment is forecast to bounce back going forward

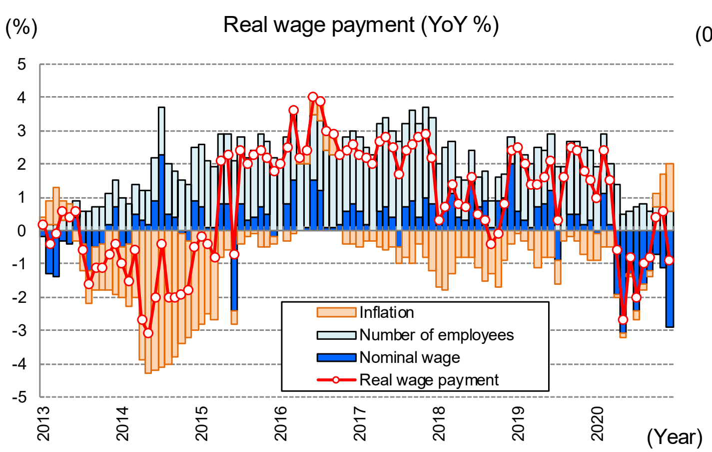
- Economy Watcher Survey covers people working at economic sensitive jobs. Current condition DI in January dropped to 31.2, which was just as indicated by future condition DI in December. Future condition DI in January is pointing at sharp recovery to 39.9.
- Winter spread of COVID-19 is gradually calming down and current state of emergency is going to be lifted by early March.



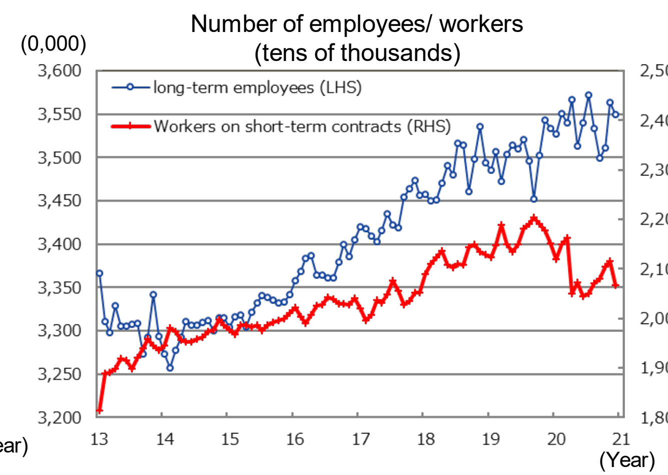
Note: Data is from Jan. 2012 to Jan. 2021. DI above 50 means condition is better than preceding 2 to 3 months.
(Source) Cabinet Office

Labor market stopped deteriorating despite continuing COVID impact

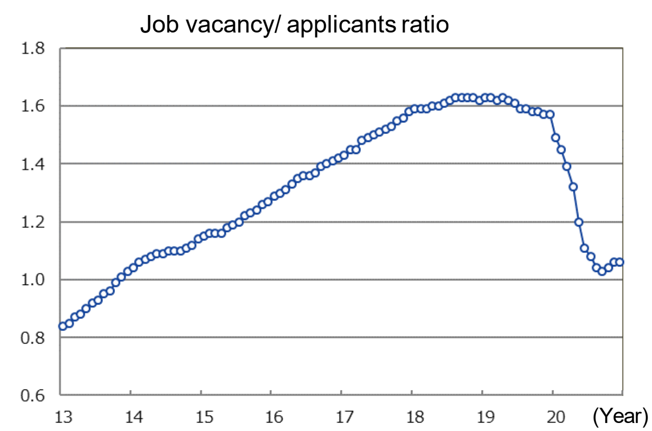
- Job vacancy / applicants ratio stopped deteriorating for the last three months until December last year. Further deterioration might be coming for Jan-Mar quarter under a new state of emergency declaration though impact is going to be smaller than the previous state of emergency in April and May in 2020. This time, restrictions are mostly on restaurants & bars at night and other activities are still going. Theaters are open with limit of half capacity, shops are open with earlier closing time and people are still moving.
- In December, aggregated real wage declined due to large drop in nominal wage, which was caused by decline of bonus and over-time working.



Note; Data is from Jan. 2013 to Dec. 2020. Continuous sample basis.
(Source) Ministry of Health Labour and Welfare



Note; Data is from Jan. 2013 to Dec. 2020.
(Source) Ministry of Finance



Note; Data is from Jan. 2013 to Dec. 2020.
(Source) Ministry of Finance

Fiscal & monetary policies are key events in 2021

- US fiscal policy under the blue wave and monetary policies are most important events to watch.
- Other focal points will be how Joe Biden and his team approach China.
- Also important events not listed here would be how quickly COVID-19 vaccination will progress.

Upcoming key events

	Month	Region/Country	Events	Notes
2021	March	US	16-17 FOMC meeting	
		Japan	18-19 BOJ Monetary Policy Committee Meeting	
		China	National People's Congress	
		EU	11 ECB Monetary Policy Meeting	
	April	US	27-28 FOMC meeting	
		Japan	26-27BOJ Monetary Policy Committee Meeting	
		EU	22 ECB Monetary Policy Meeting	
		G20	7-8 G20 meeting by finance ministers & heads of central banks	
	May	Japan	1st preliminary estimate for Apr-Jun- 2021 GDP	
	July	Japan	23 Tokyo Olympic Games (to 8th Aug)	
	September	Japan	30 LDP leader Suga's current term ends	
	October	Japan	Limit for the lower house general 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.

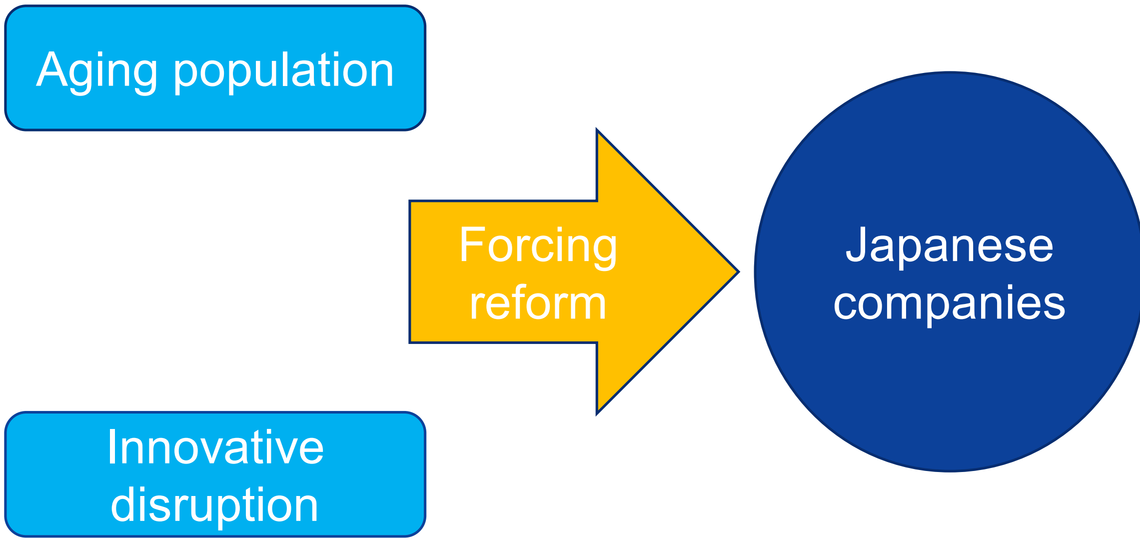
Global Competitiveness Ranking of Innovation among 137 economies

		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.



Hurdles for achieving business reform

- Lifetime employment
- Seniority based compensation
- Rising social insurance costs
- Inefficient working practice
- Insufficient entrepreneurship
- Shortage of new technology professionals, etc.

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	● Unconventional "macro-slide" has been implemented to curb pension payment increase referring to "low birth rate" and so on. ● Encourage people to continue working into 70's. ● Encourage people to shift saving to investments. (NISA*, DC)
	b) Labor shortage	● Capital investment for enhancing labor efficiency. (FA, AI, IoT, autonomous driving car, renovating software, etc.) ● Allowing more foreign workers. ● Encourage people to delay retirement. ● Support female workers. (increase nursery, etc.)
2. Weak consumption propensity	c) Clearing peoples worry for the future life	● Pension system reform. ● Gradual adjustment of seniority based wage system to shift compensation from elderly to younger workers. ● Increase of new generation companies. ● Increase of young people working with non-seniority wage system.
3. Rigid employment practice	d) Encouraging business structure reform	● Elder people to retire or continue working at lower wage. ● Gradual adjustment of seniority based wage system. ● More fluid labor market enabling companies to make restructuring. ● Young people are not expecting lifetime employments and focusing on building own career (already progressing).
4. Inefficient working practice	e) Enhancing labor efficiency	● Work style reform to progress.
5. Insufficient entrepreneurship 6. Shortage of new technology professionals	f) Enhancing “challenge spirit” g) Education reform	● Increase of successful new generation companies. ● Increase of young people with skills of new technologies. ● Young and talented people choose new generation companies rather than old & large firms (already progressing).

Note: *NISA is “Nippon Individual Savings Account”. (Source) SMDAM

Outlook for
Japanese Stock Market

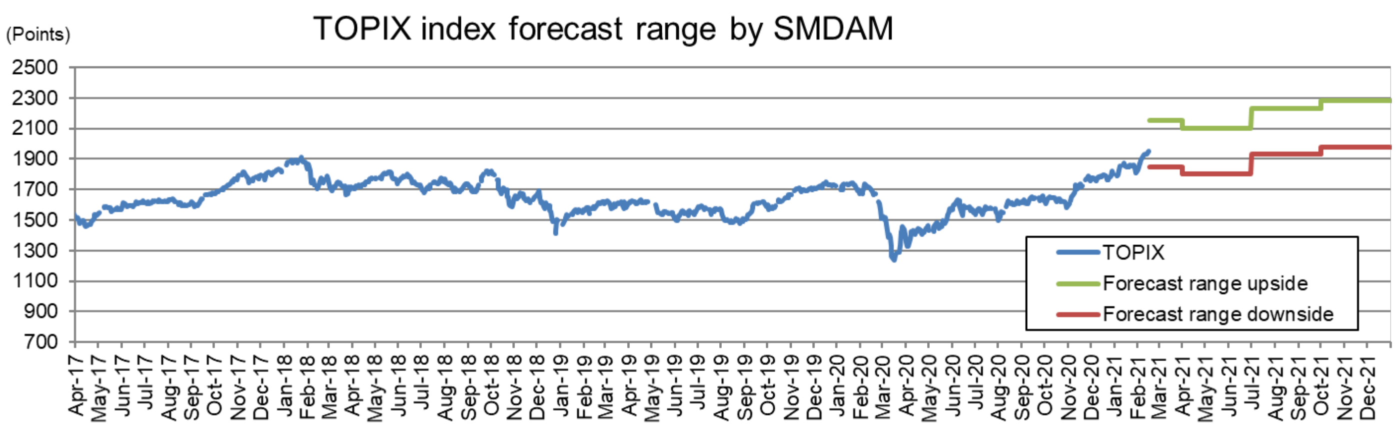
Investors' keep focusing on strong economic recovery

SMDAM short-term view

- Corporate earnings for Oct-Dec 2020 quarter came out strongly beating preceding forecasts. Manufacturing industries are showing robust earnings recovery mainly led by strong exports. COVID vaccination is progressing in many countries so far without serious health trouble and new infection cases are coming down noticeably. SMDAM revised forecast range upwards based on higher EPS growth and rising risk appetite of investors. Japanese stocks will attract global money with relatively attractive stock valuation and high sensitivity to the global economy.

Longer-term outlook (6-months and beyond)

- Global economy will gather strength after spring supported by calming down of COVID-19 infection and recently approved fiscal stimulus to make positive effects on the economy. SMDAM expects strong stock markets in 2021 meanwhile momentum could slow down a little. Monetary policy will stay expansionary, however, central banks will start contemplating how to implement tapering of monetary easing without causing hiccup in financial markets although BOJ will be the last among central banks to consider tapering.



Note: Topix data is from 1st Apr. 2017 to 15th Feb. 2021.
(Source) TOPIX: Tokyo stock exchange, forecast by SMDAM

Note: SMDAM's projection is as of 15th Feb. 2021 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- **Our Base Scenario** is assuming the following views**:**
  - Progressing vaccination of COVID-19 calms down infection and economic recovery gathers pace in the latter half of 2021.
  - Severe tensions between US and China go on, however, US is going to avoid making a fatal blow to the global economy.
  - Global economy sustains recovery path into 2021 and 2022.
  - 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 easing policies and avoid causing taper tantrum.

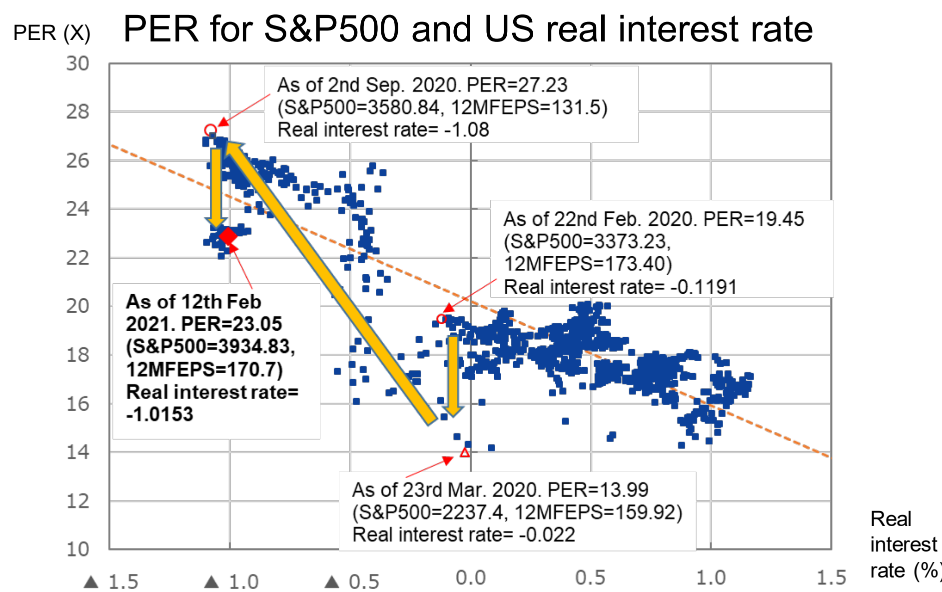
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - US and China make significant concessions in the trade negotiations.
  - Japanese economy gets stronger than expected boosted by large fiscal spending and strong exports.

- **Downside Risks** include:
  - Vaccination proves slow in taking effects of containing COVID-19 and restrictions on activities continue.
  - Tensions between US and China escalate to ignite severe disruption in global trades.
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Joe Biden fails to lead divided party and congress to achieve aggressive fiscal spending plan.
  - Populism gains in Europe further destabilizing EU.
  - Central banks start tapering of easy monetary policy causing negative shock to financial markets.

Note: SMDAM's projection is as of 15th Feb. 2021 and subject to updates without notice.

Current stock valuation for US looks still reasonable

- PE Ratio (PER) and real interest rate (RI) have negative correlation, which is shown on the chart below.
- Just before the stock prices collapsed due to COVID-19, PER was 19.45, 12M forward EPS (EPS) was 173.4 and RI was -0.12%. It was close to the regression line. In September, COVID brought EPS down to 131.5, on the contrary stock prices bounced back strongly, which combined together made PER rising to 27, which was the peak of PER.
- Lately, PER was 23 based on EPS of 170, which almost recovered to the level before the COVID. Current position on the chart looks reasonably valued and it could stay so if RI rises just slowly in line with gradual EPS growth.

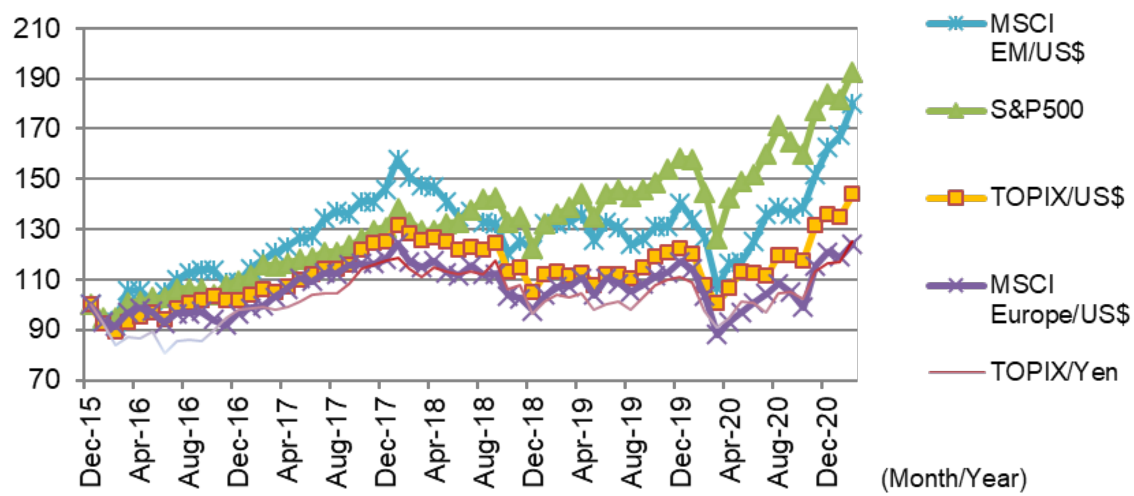


Note: Data is from 2nd Jan. 2017 to 12th Feb 2021. PER is based on 12M forward EPS forecast.
Real interest rates are calculated from Index linked US treasury bond and straight bond both 10Y maturity.
(Source) Bloomberg

Stock markets keep rising strongly

- Emerging markets continue strong rally.
- US market continue to rise renewing historical high.
- In Japan, Nikkei 225 index (not shown on the chart) reached above 30,000yen, which was the first time after 30 years. TOPX index also reached a level recorded in June 1991, almost 30 years ago.

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

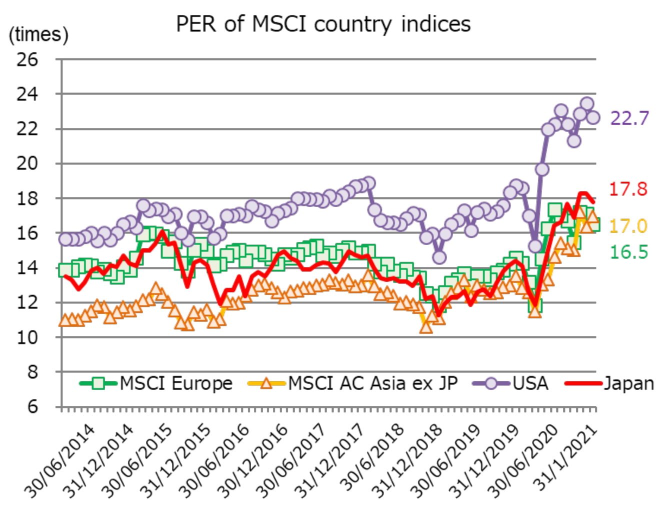


Notes: Data is up to 12th Feb. 2021.

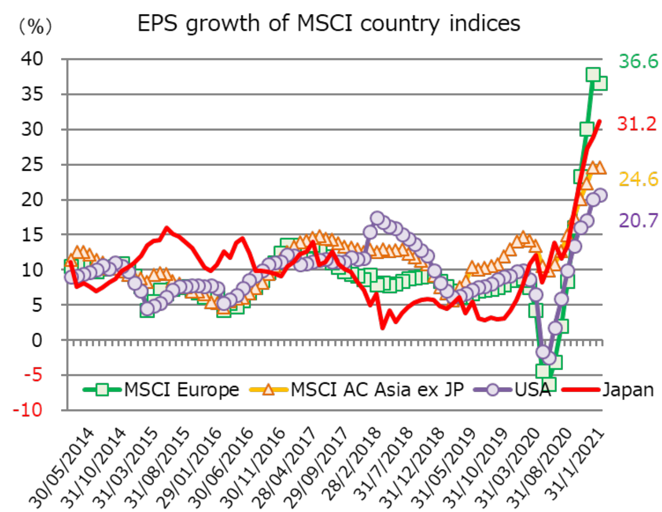
(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMDAM.

EPS growth forecasts for the coming 12 months are rising sharply

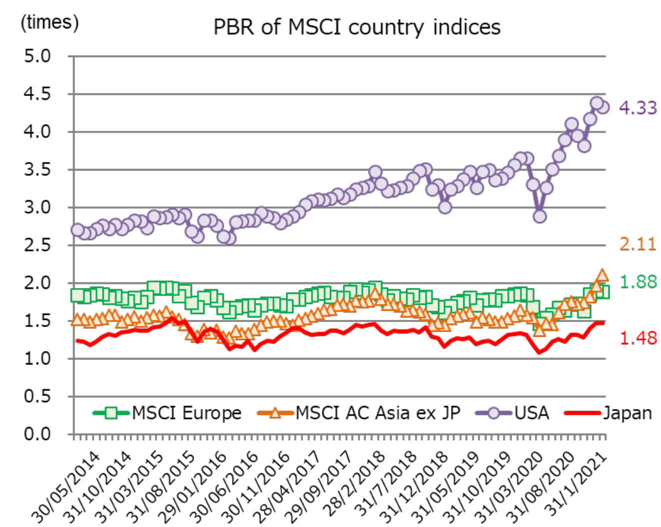
- EPS growth forecasts are rising to a quite high level for all countries and regions, which are in the backgrounds of the continuing rally in the global stock markets. Japan showed the strongest growth momentum in January.
- PE Ratio (PER) looks a little stretched, even after considering above mentioned EPS growth. How far US interest rates are going to rise is an important factor if such elevated valuation levels can be sustained.
- Difference in PBR reflects gap in ROE, however, Japan's PBR at 1.48 looks attractive if corporate activities for improving governance and shareholder return resume when economic environments gradually normalize.



Note: PER is based on 12M forward EPS forecast.
Data is up to 31st Jan 2021.
(Source) MSCI
(DD/MM/YYYY)



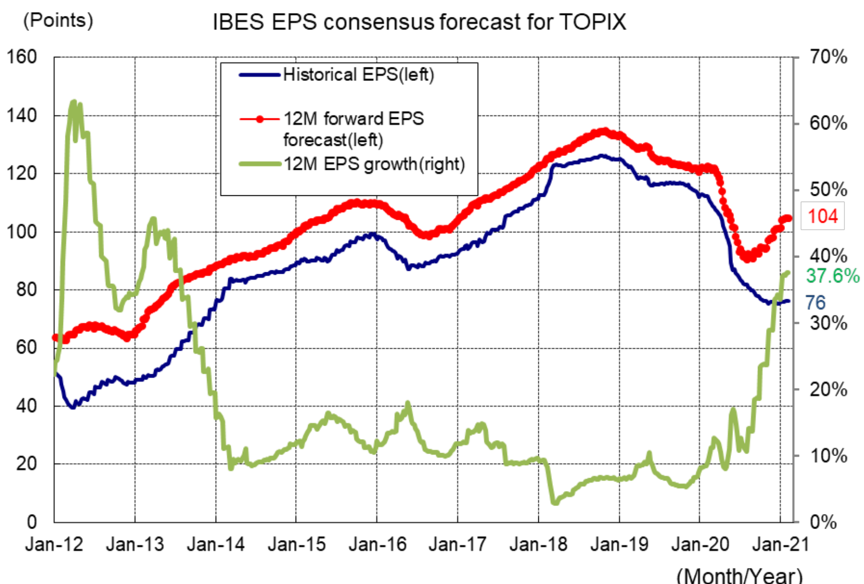
Note: Growth is for 12M forward EPS forecast.
Data is up to 31st Jan 2021.
(Source) MSCI
(DD/MM/YYYY)



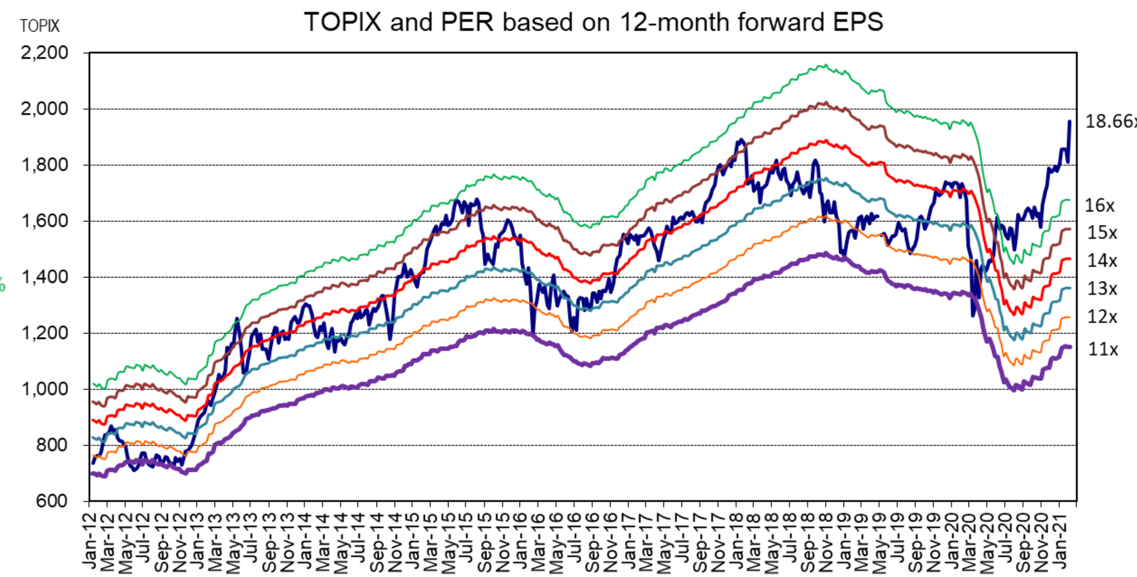
Data is up 31st Jan 2021.
(Source) MSCI
(DD/MM/YYYY)

Current high PER requires rapid EPS growth to materialize

- 12M EPS consensus forecast has been bouncing back from September. Latest 12M forward EPS growth forecast for TOPIX rose further to robust 37.6%.
- Given the latest EPS forecast of 104, TOPIX at 1950 corresponds to PER of 18.7, which is much higher than the historical range between 11 times and 15 times. This was initially caused by even more extreme valuation for US stock prices, which was created by massive liquidity pumped in by central banks and sharp fall in bond yields. Current high PER is assuming strong and sustainable recovery of economy and corporate earnings in 2021, and PER will gradually come down to the normal range as such expectations materialize.



Note: Weekly data from 6th Jan. 2012 to 5th Feb. 2021.
(Source) Datastream, IBES



Note: Data is weekly from 13th Jan. 2012 to 15th Feb. 2021 for TOPIX and up to 5th Feb. 2021 for IBES 12M forward EPS forecast. TOPIX was 1953.94 at the end of the period.
(Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

SMDAM’s corporate earnings forecasts

- SMDAM makes earnings forecast for 485 companies excluding financials in its corporate research coverage.
- In the latest forecast on 4th December, recurring profits are forecast to decline by -14.2% in FY2020 and then recover by 38.6% in FY2021. When indexed with the latest high in FY2018 as 100, level of recurring profit for FY2019, 2020, 2021 are calculated at 77, 66 and 91 respectively. (“Recurring profits” in Japanese accounting means “earnings from continuous businesses”, which is basically before tax and extraordinary items.)
- In FY2021, profit recovery is forecast to be led by such industries as Railways, Auto, Wholesale Trading, Auto Parts and Transportation, which are all forecast to show strong recovery from FY2020 results hit hard by COVID-19.

SMDAM Corporate Earnings forecasts (485 Companies research coverage excl. financials)

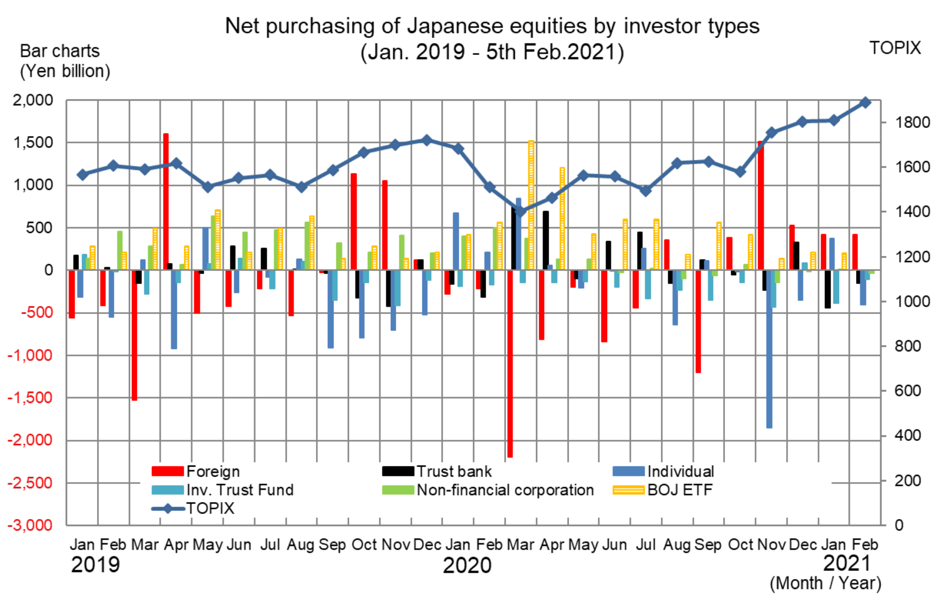
Fiscal year	FY 2019	FY 2020E	FY 2021E
Date of forecast	Actual	as of 4th Dec. 2020	as of 4th Dec. 2020
Sales (YoY %)	-2.4%	-9.7%	7.2%
Operating Profits (YoY %)	-25.4%	-13.1%	38.1%
Recurring Profits (YoY %)	-23.2%	-14.2%	38.6%
Net Profits (YoY %)	-35.5%	-8.2%	48.7%
Recurring profits (YoY %)			
Manufacturing 289 companies	-27.4%	-8.4%	39.0%
Non-manufacturing 196 companies	-17.4%	-21.0%	38.0%

Note: Key assumptions for FY2020 & 2021 are Yen/US$ 105 and Yen/EUR 124.

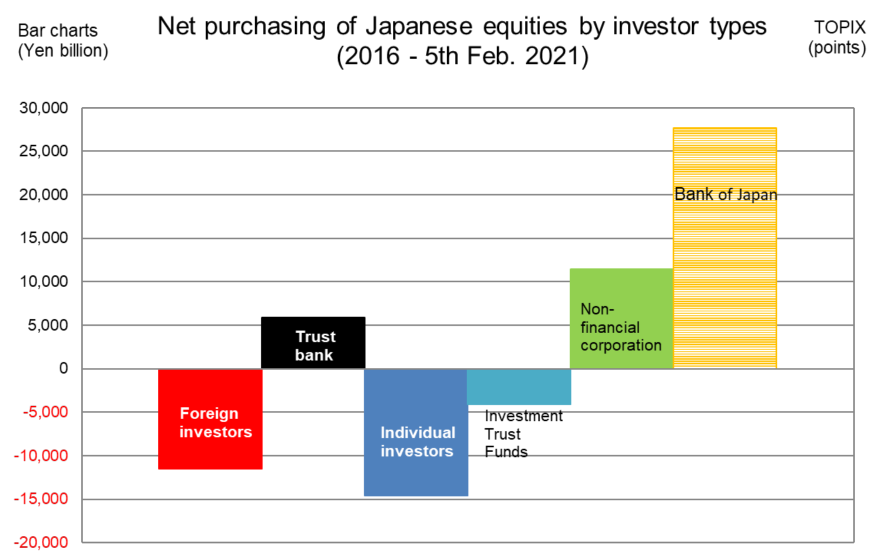
(Source) SMDAM Corporate Research Group

Foreign investors continue purchasing Japanese equities

- Foreign investors continued purchasing Japanese equities since October last year.
- ETF purchasing by BOJ shrank on the back of strong stock market. BOJ is going to release a review for the overall monetary policy in March, in which policy for purchasing ETF is expected to be made more flexible to be gradually scaled-down.
- Many companies are postponing share buy-backs this fiscal year in the face of adverse business environments caused by COVID-19. Share buy-backs are expected to recover in FY2021, which starts from April this year.



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to 5th Feb. 2021..
BOJ ETF figure is officially released data from BOJ.
(Source) Japan Exchange Group, Bank of Japan



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to 5th Feb. 2021.
BOJ ETF figure is officially released data from BOJ.
(Source) Japan Exchange Group, Bank of Japan

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.

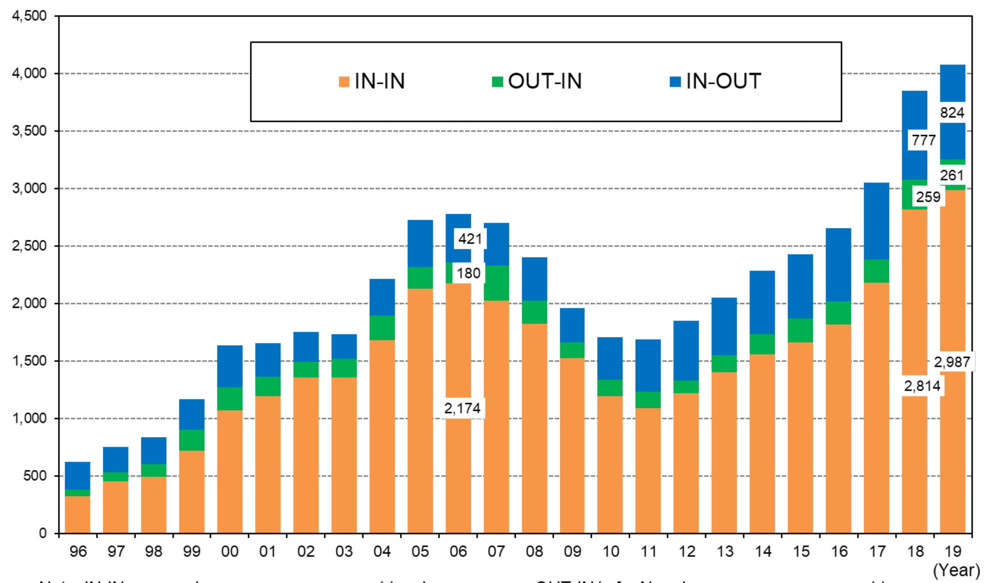
Total number of institutional investors, which publicly declared acceptance of the stewardship code	
Trust banks	6
Investment management companies	191
Insurance companies	23
Pension funds	53
Others (include proxy voting advising companies)	7
Total	280

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.

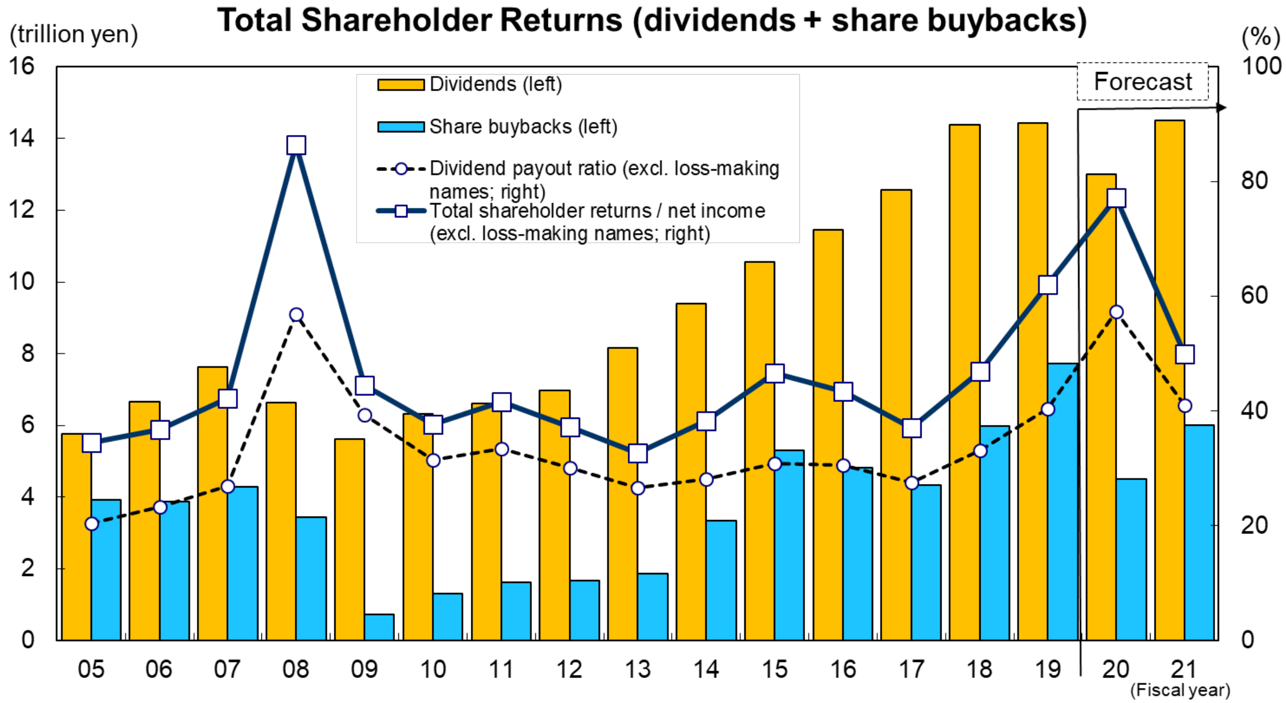
Number of M&A deals involving Japanese companies
(Excluding transactions among the same business group)



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. After recording a historical high in FY2019, share buy-backs are constrained by COVID-19 impact in FY2020 and FY2021.
- Dividends also renewed historical record in FY2019. After a setback in FY2020 due to COVID-19, dividends are forecast to make a quick recovery in FY2021.



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

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