



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

-December 2022-



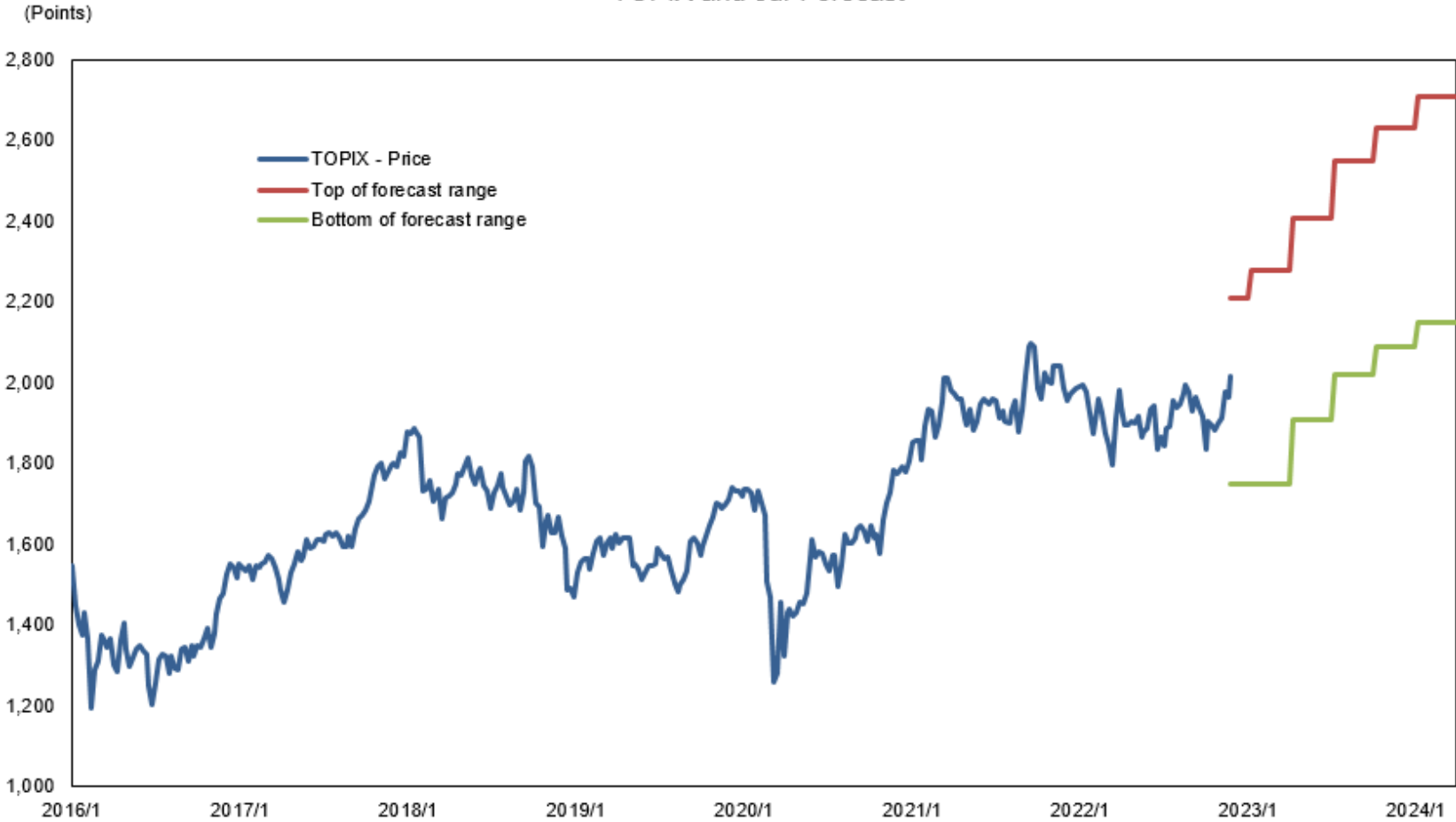
Outlook for Japanese Stock Market

Market Outlook

- We expect the Japanese stock market will shortly resume its bullish trend after range trading.
- We have raised our TOPIX target from 2,190 to 2,390 and that of Nikkei 225 from 31,100 to 34,100 as of the end of year 2023 due to upward revision of the EPS forecast for FY 2023 and FY 2024.
- We expect the market will start rising after confirming the timing of the peak of the US monetary tightening and the bottoming out of the global economic cycle.

We expect a bullish market ahead after range trading

TOPIX and our Forecast



Note: TOPIX Data is from 1 January 2016 to 25 November 2022. Data on or after 26 November 2022 are forecast.

Source: TOPIX – Tokyo Stock Exchange. Forecast – SMDAM

Upside / Downside risk scenarios

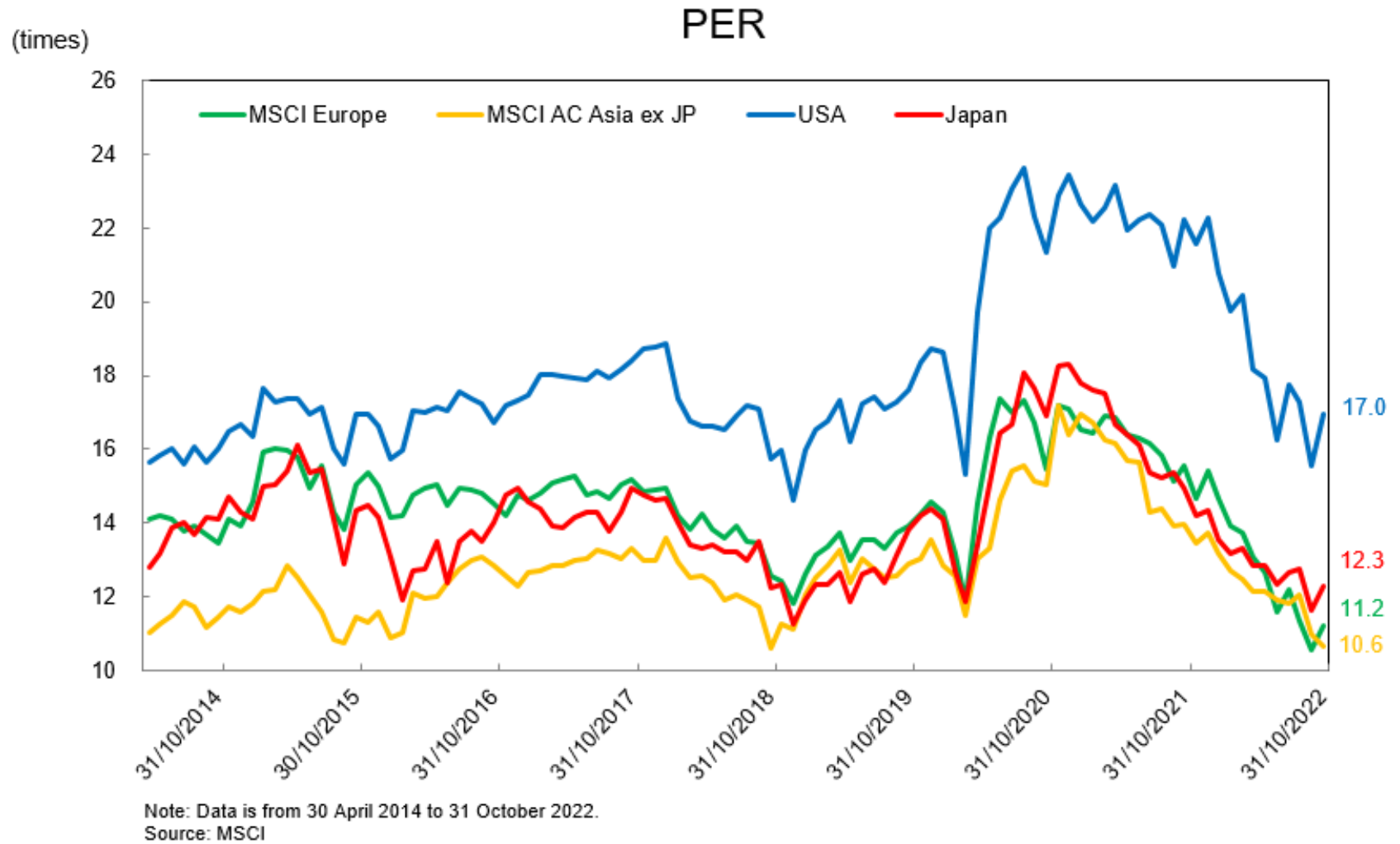
■ Upside Risks

- FED pivot
- Strong recovery in Chinese economy

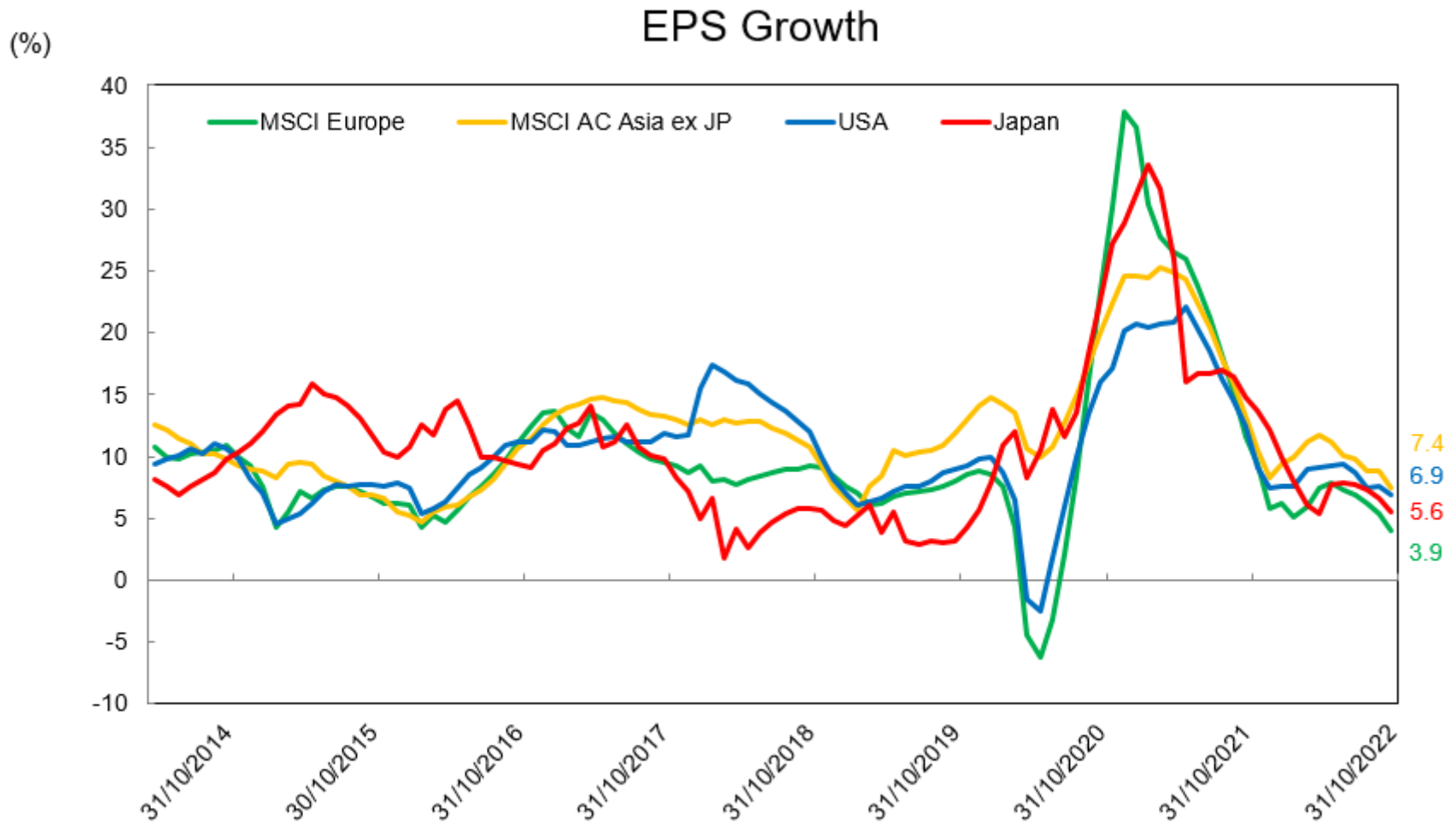
■ Downside Risks

- Yen's appreciation and negative impact on corporate earnings
- Financial crisis caused by global monetary tightening
- Fiscal austerity

Expectation for slowing pace of tightening lifts PERs

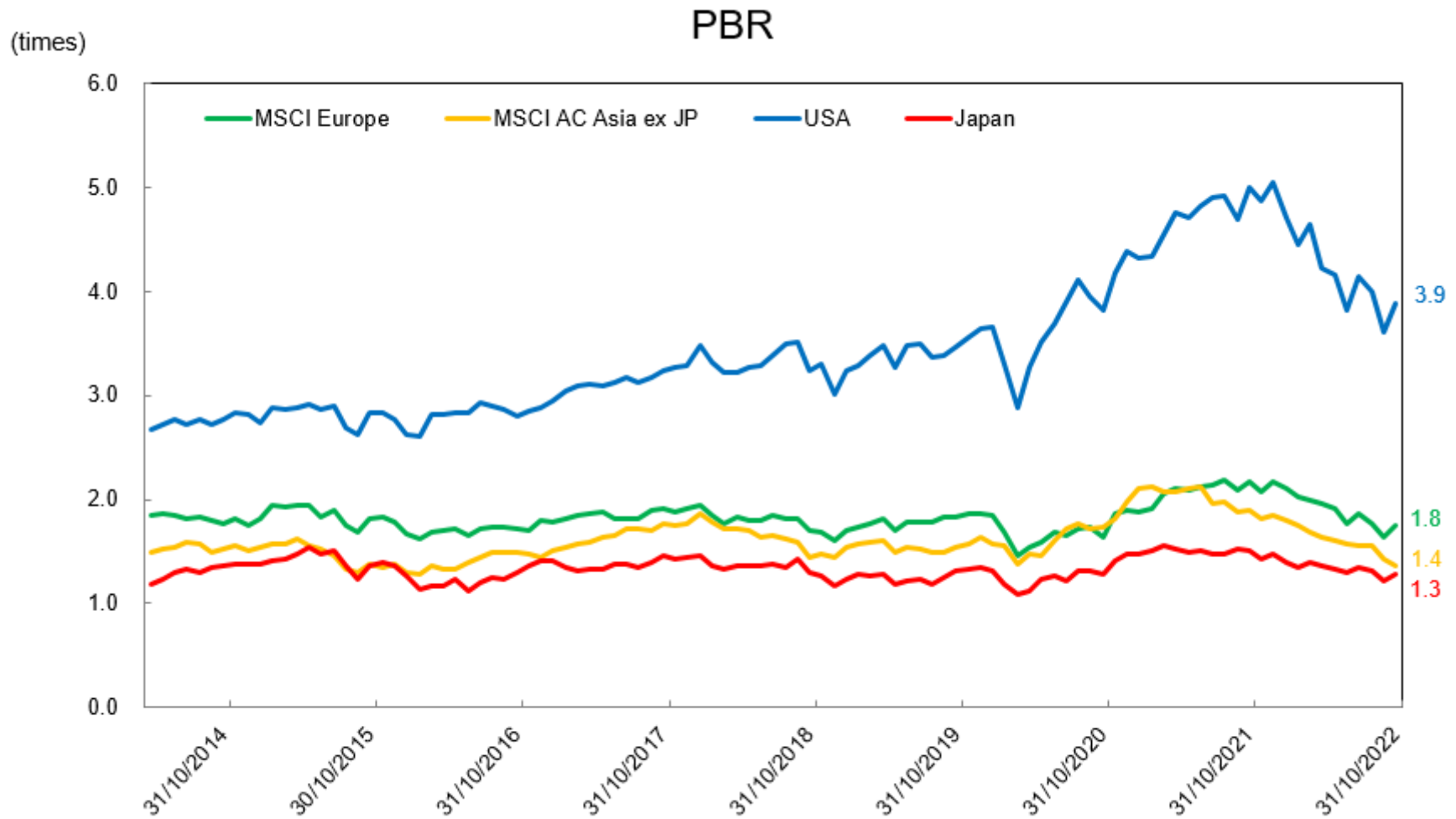


EPS growth losing momentum due to slowing economy



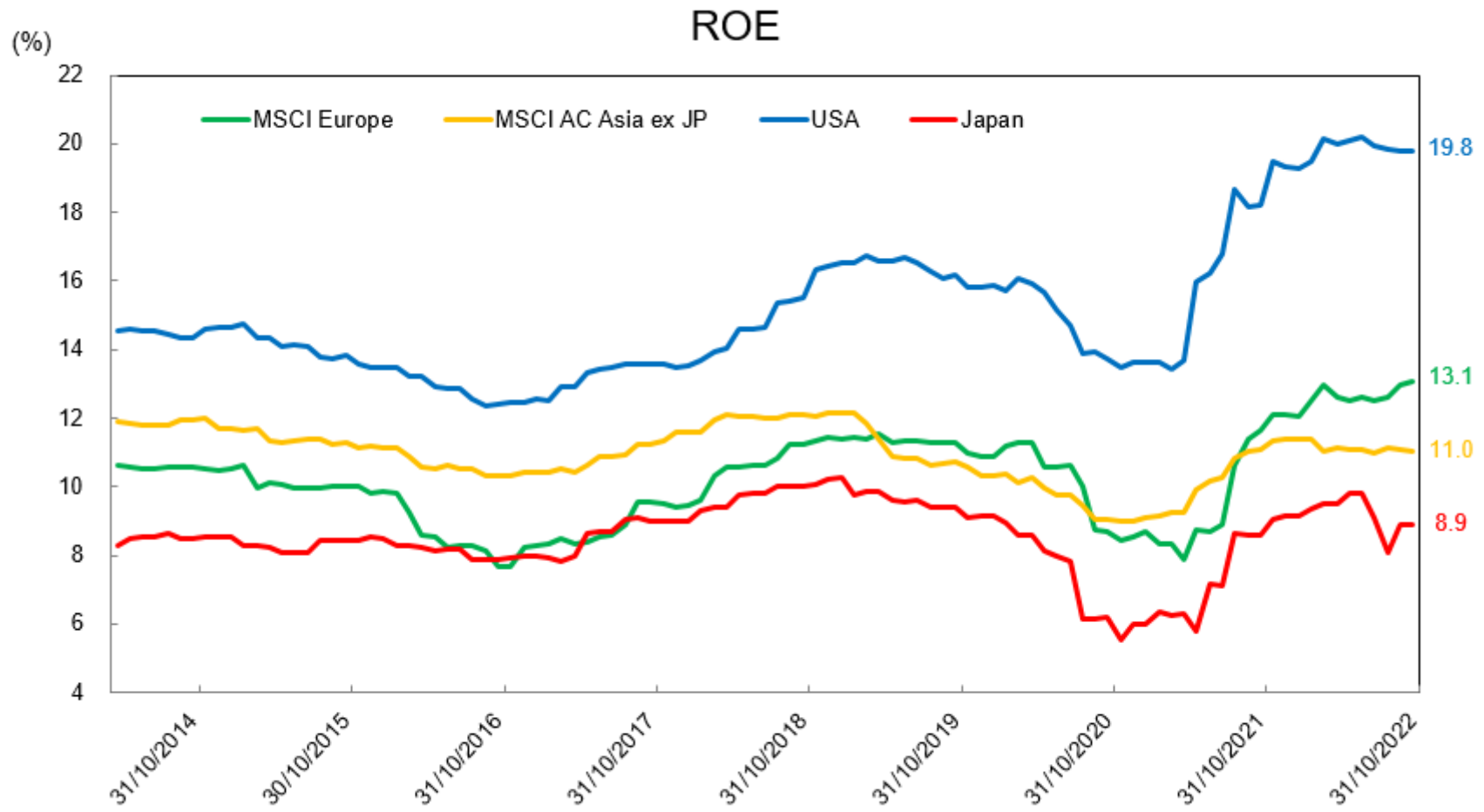
Note: Data is from 30 April 2014 to 31 October 2022.
Source: MSCI

PBRs rebound thanks to recovery of appetite for risk



Note: Data is from 30 April 2014 to 31 October 2022.
Source: MSCI

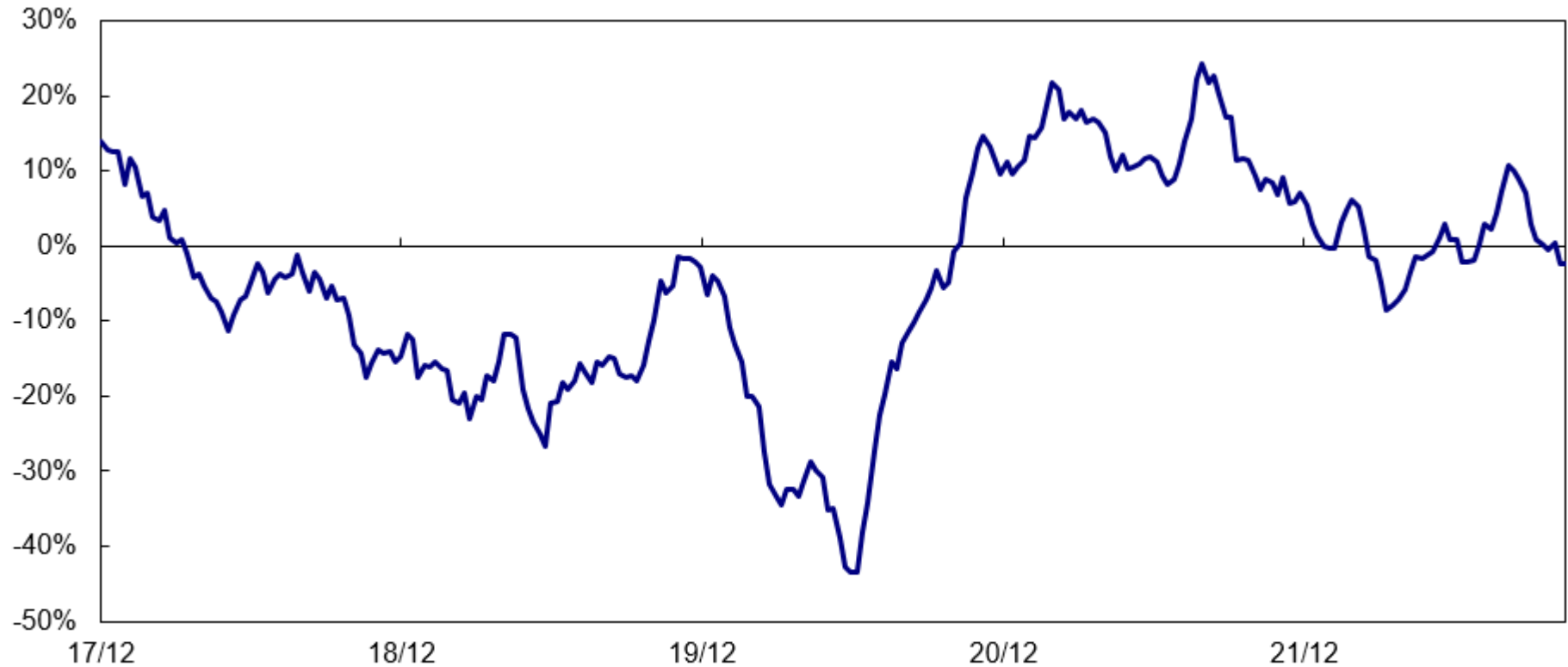
Japan's ROE stops falling thanks to recovery in domestic demand



Note: Data is from 30 April 2014 to 31 October 2022.
Source: MSCI

EPS revision heads south owing to slowing global economy

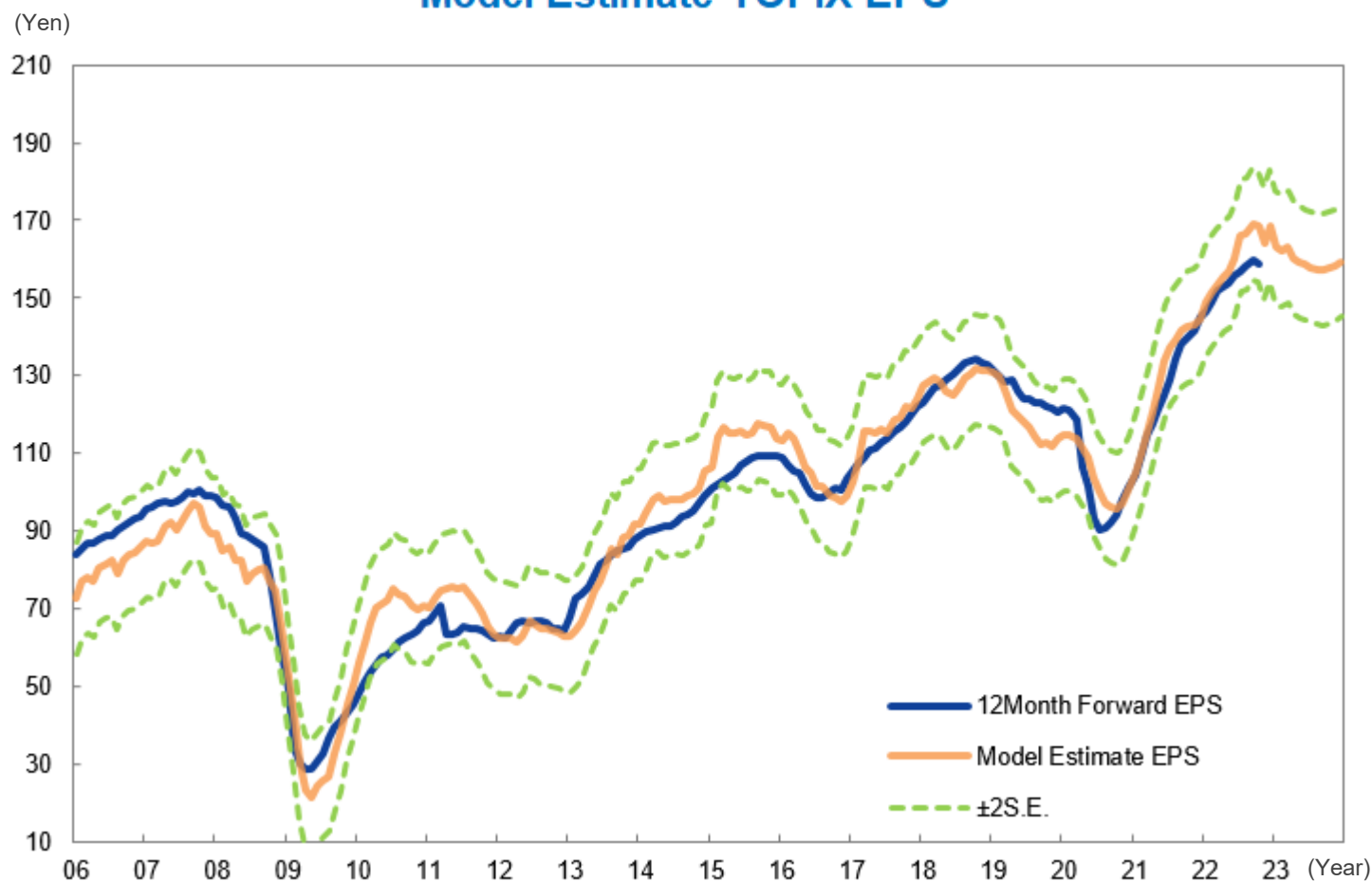
TOPIX Revision Index



Note: Data is from 29 December 2017 to 11 November 2022.
Source: Datastream, IBES

Our macro model indicates EPS close to its peak

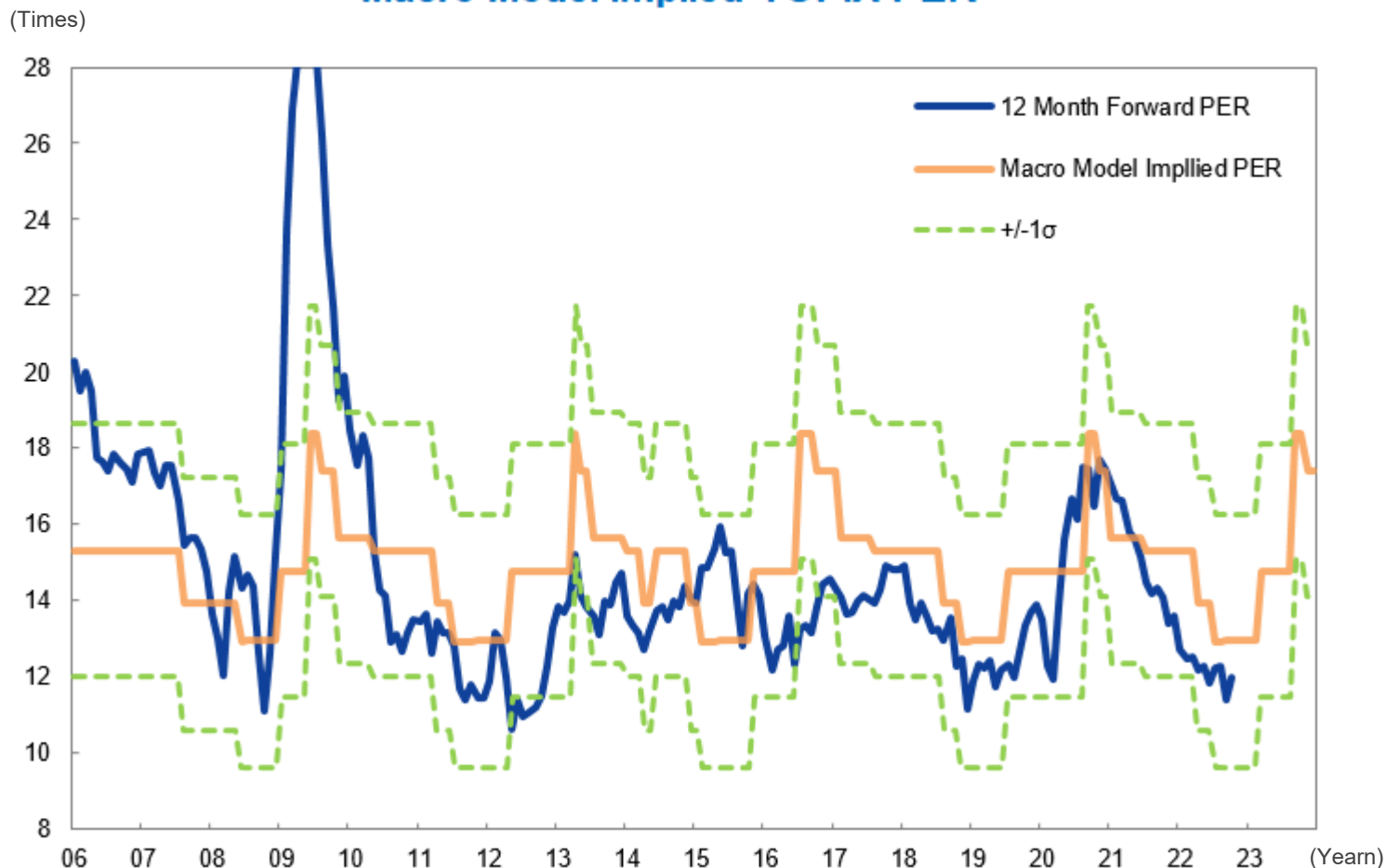
Model Estimate TOPIX EPS



Note: Consensus data is from 1 January 2006 to 31 October 2022, Model data is from 1 January 2006 to 31 December 2022.
Source: SMDAM

Our model indicates PER to bottom out in the near future

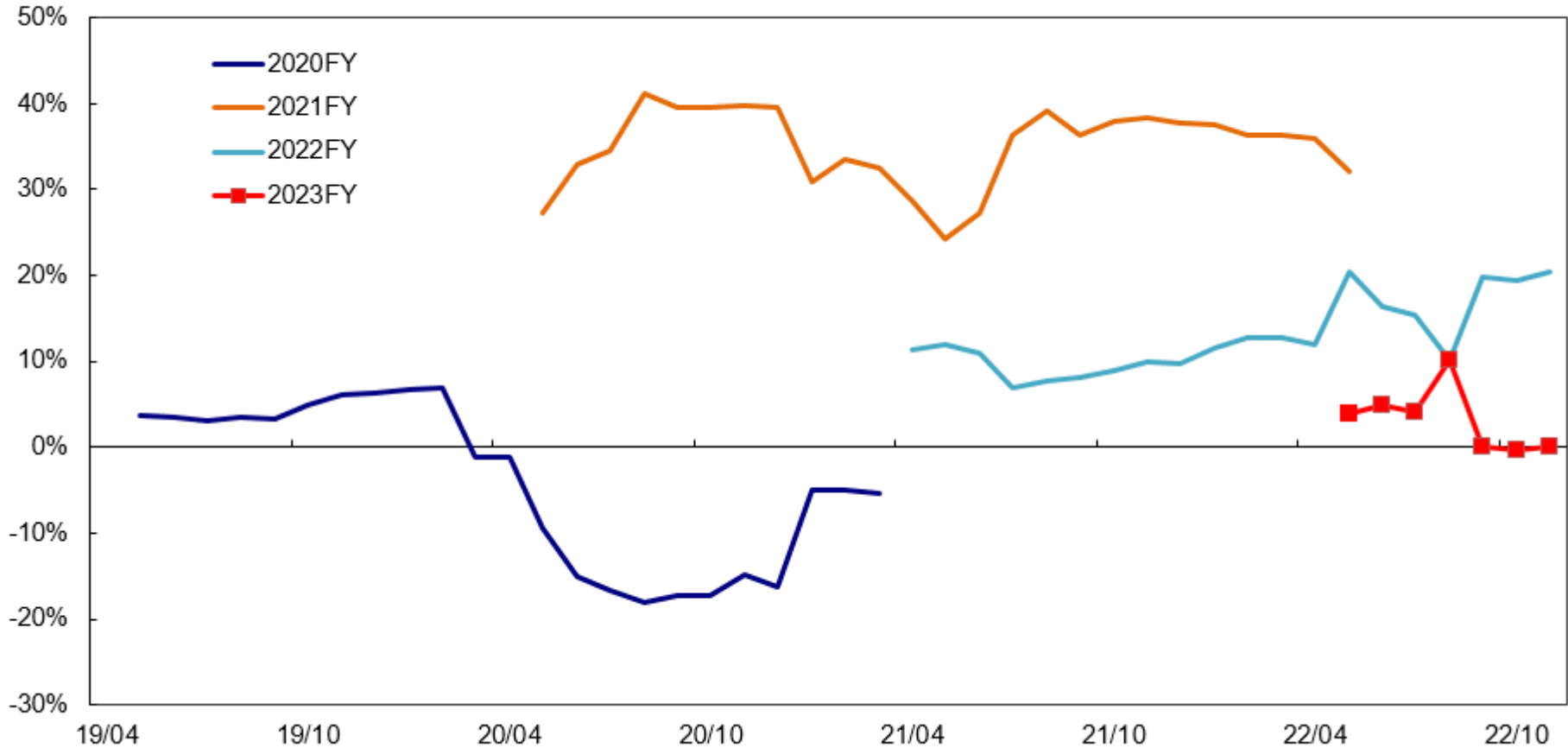
Macro Model Implied TOPIX PER



Note: Consensus data is from 1 January 2006 to 31 October 2022, Model data is from 1 January 2006 to 31 December 2022.
Source: SMDAM

Bottom up research indicates zero profit growth in FY 2023

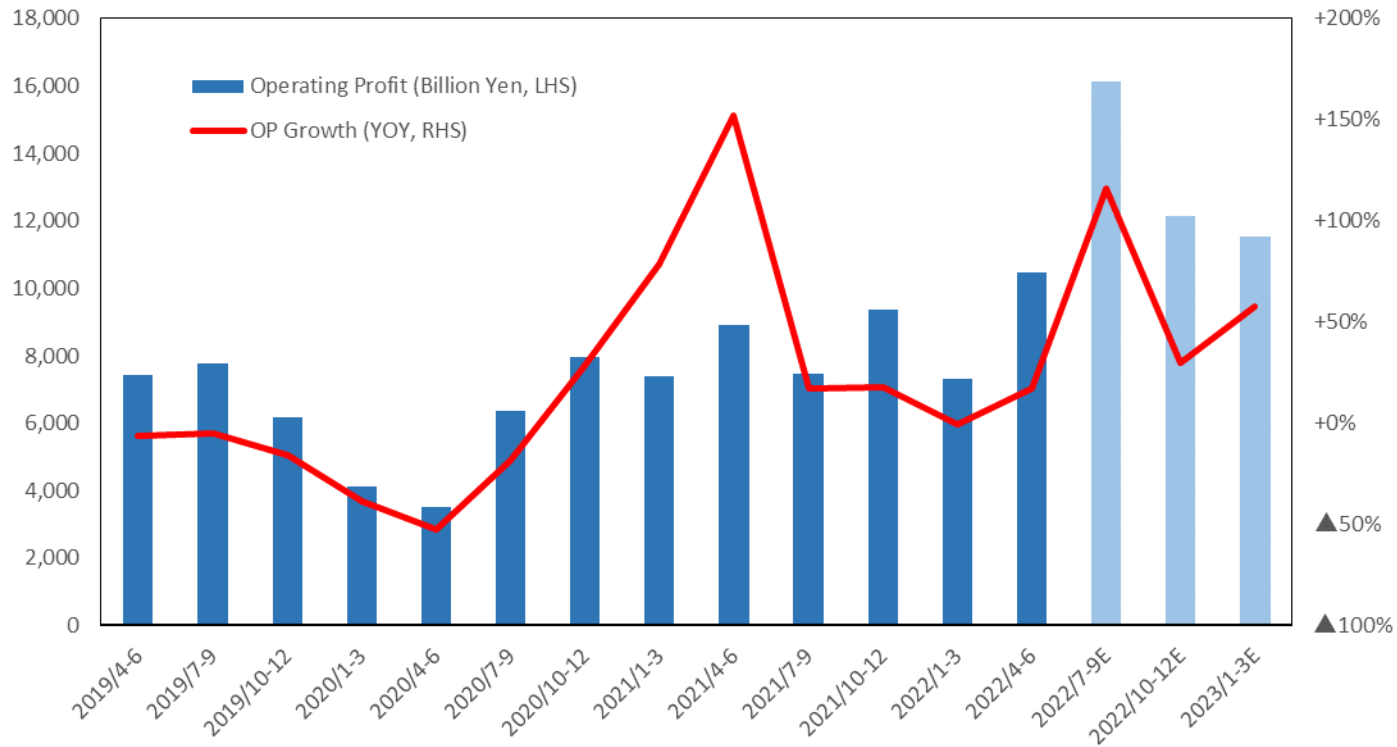
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 11 November 2022, SMDAM Core Universe (Excl. Financials) consists of 399 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

The operating profit remains steady going forward

Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q2 2019 to Q2 2022, estimate data is from Q3 2022 to Q1 2023
 Source: SMDAM

A tide of “Corporate Governance” in Japan

Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	202
Insurance companies	24
Pension funds	79
Others	11
Total	322

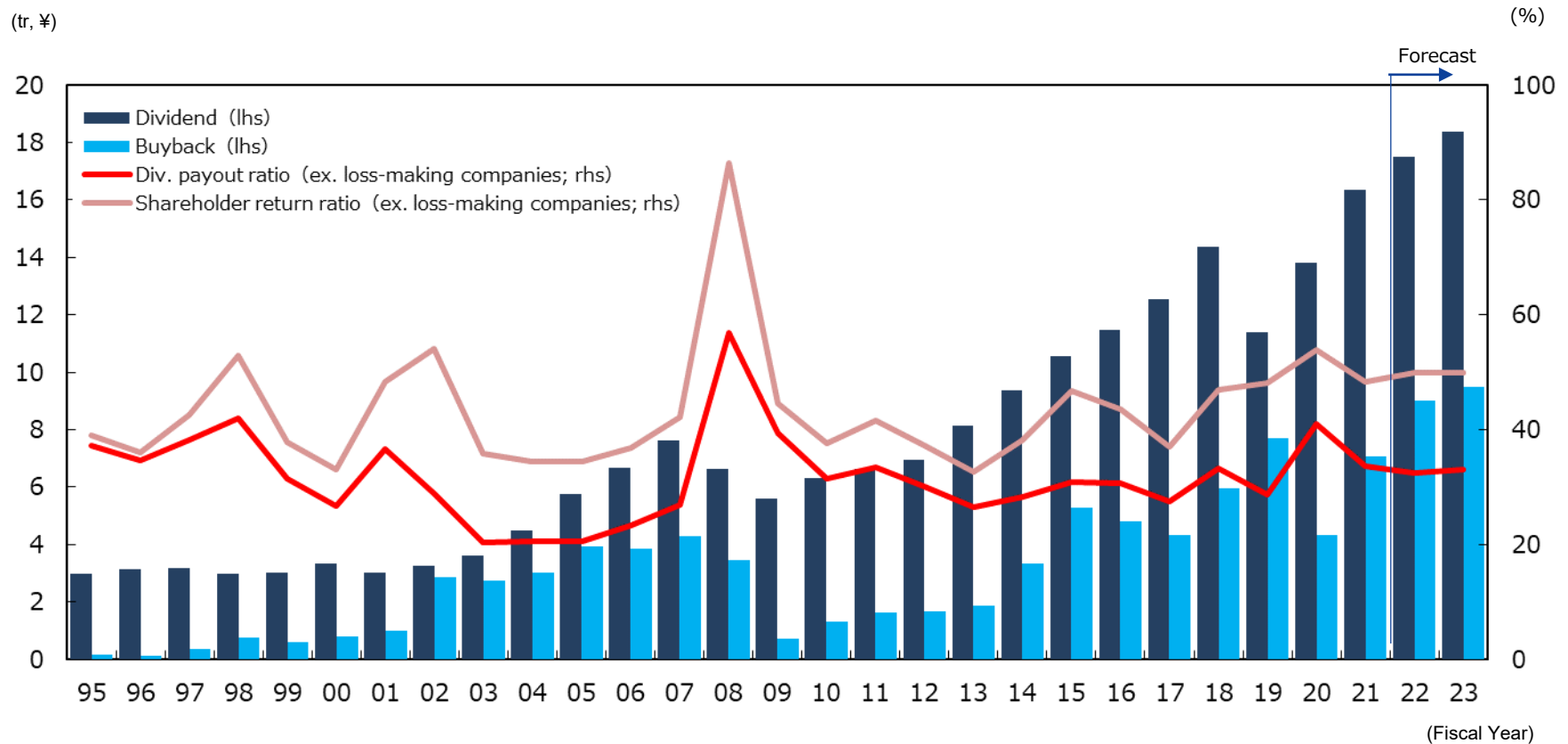
Note: As of 31 October 2022.

Source: FSA, SMDAM

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

Dividends and buybacks breaking historical highs

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2023, FY2022 and FY2023 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Value & Small Cap continues to dominate the market

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	-1.17	4.24	-1.58	-3.77	14.34	16.29	12.20
Total Value	-0.27	4.34	7.22	5.64	27.20	14.20	6.37
Top Cap Value	0.74	4.35	9.10	6.93	35.58	25.55	19.95
Large Cap Value	-0.27	3.65	8.08	6.21	29.79	16.23	9.41
Mid Cap Value	-1.59	2.73	6.75	5.28	22.89	4.11	-4.29
Small Cap Value	-0.25	7.35	3.77	3.30	16.08	5.35	-6.47
Micro Cap Value	-0.24	8.40	1.61	3.00	15.03	3.87	-7.10
Total Growth	-2.12	4.15	-9.62	-12.23	2.74	16.71	16.73
Top Cap Growth	-2.45	1.58	-11.78	-13.26	4.93	20.41	21.15
Large Cap Growth	-2.24	3.69	-10.19	-12.36	3.00	18.33	17.99
Mid Cap Growth	-1.86	7.65	-7.21	-10.72	-0.03	15.05	13.18
Small Cap Growth	-1.09	8.16	-4.56	-11.15	-0.11	3.53	5.45
Micro Cap Growth	-0.75	9.47	-6.66	-15.03	0.23	5.31	7.20
Top Cap Total	-0.99	2.86	-3.12	-4.88	17.58	22.31	19.92
Large Cap Total	-1.28	3.67	-1.99	-4.07	14.97	18.10	14.49
Mid Cap Total	-1.72	4.94	-0.19	-2.78	11.47	12.30	6.97
Small Cap Total	-0.54	7.63	0.78	-2.08	10.11	5.45	-0.90
Micro Cap Total	-0.38	8.71	-0.89	-2.86	10.36	5.39	-0.76

Note: As of 18 November 2022.
Source: Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** While consumer sentiment has been subdued on the back of higher prices, business sentiment has been improving, particularly for the face-to-face service sector, as the seventh wave of the COVID-19 pandemic has subsided. CAPEX has been boosted thanks to pent-up demand after the pandemic, the requirement for carbon neutrality, and digital transformation. Exports have also picked up after the lockdown slump in Shanghai.
- **Inflation is on an upward trend.** CPI is accelerating in Tokyo and nationwide. The cost-push caused by rising import prices and the loss of the impact of last year's mobile phone rate cut have contributed to the acceleration of inflation.

[Outlook]

- ① **We have lowered our real GDP growth forecast for FY 2022 from +2.0% to +1.7%, whilst we have raised our forecast for FY 2023 from +0.7% to +1.0%.** The downward revision for FY 2022 was mainly owing to the slowing economy in the third quarter. The upward revision for FY 2023 was due to the Comprehensive Economic Package. While the eighth wave of the COVID-19 pandemic is highly likely, the negative impact on the economy could be limited as people are getting used to the new lifestyle with COVID. The economic recovery seems to continue in FY 2022, supported by CAPEX and economic stimulus. On the other hand, the economy could slow down in the first half of FY 2023 amid the pronounced impact of the deterioration in overseas economies. After that, we expect gradual growth in the domestic economy as well as a recovery in overseas economies.
- ② **We have maintained the Core CPI forecast for FY 2022 at +2.7%, but we have raised our estimate for FY 2023 from +1.3% to +2.3%.** The main reason for the upward revision of FY 2023 was energy prices. Electricity companies will raise their rate of services in response to the regulated electricity rate discount in the economic stimulus package. In addition, a rise in food prices and a backlash against nationwide travel support also boost inflation. Core CPI could accelerate to the upper 3% range in late FY 2022.

Current status & Outlook of Japanese economy

- ③ **PM Kishida seems to maintain his accommodative economic policy.** The comprehensive economic package approved by the Cabinet turned out to be massive, totaling 37.6 trillion yen on an expenditure basis. The decision could be affected by the falling approval rate of the cabinet and mounting pressure from the ruling LDP. The impact on real GDP growth is expected to be +0.1% in FY 2022 and +0.4% in FY 2023. The Kishida administration continues its pro-business stance for the time being, but over the medium term, it may emphasize fiscal consolidation.

- ④ **The Bank of Japan to maintain its accommodative monetary policy, even after the end of Governor Kuroda's term in April 2023 due to weak wage increases and the negative impact of the slowing global economy. The BOJ regards wage increases and continued monetary easing are the keys to consistently achieving their price target.** While core CPI is likely to remain above 2% in the foreseeable future. The BOJ's assessment that cost-push inflation is temporary is likely to remain unchanged. Though PM Kishida's administration is expected to appoint new BOJ board members with the flexibility to review current monetary policy, it is unlikely to change monetary policy through 2023. BOJ may change its "Yield Curve Control" by relaxing the range of fluctuation of 10-year government bond yield from ± 25 bps to ± 50 bps on or after FY 2024 if foreign economies will stabilize.

Forecast table for the Japanese economy

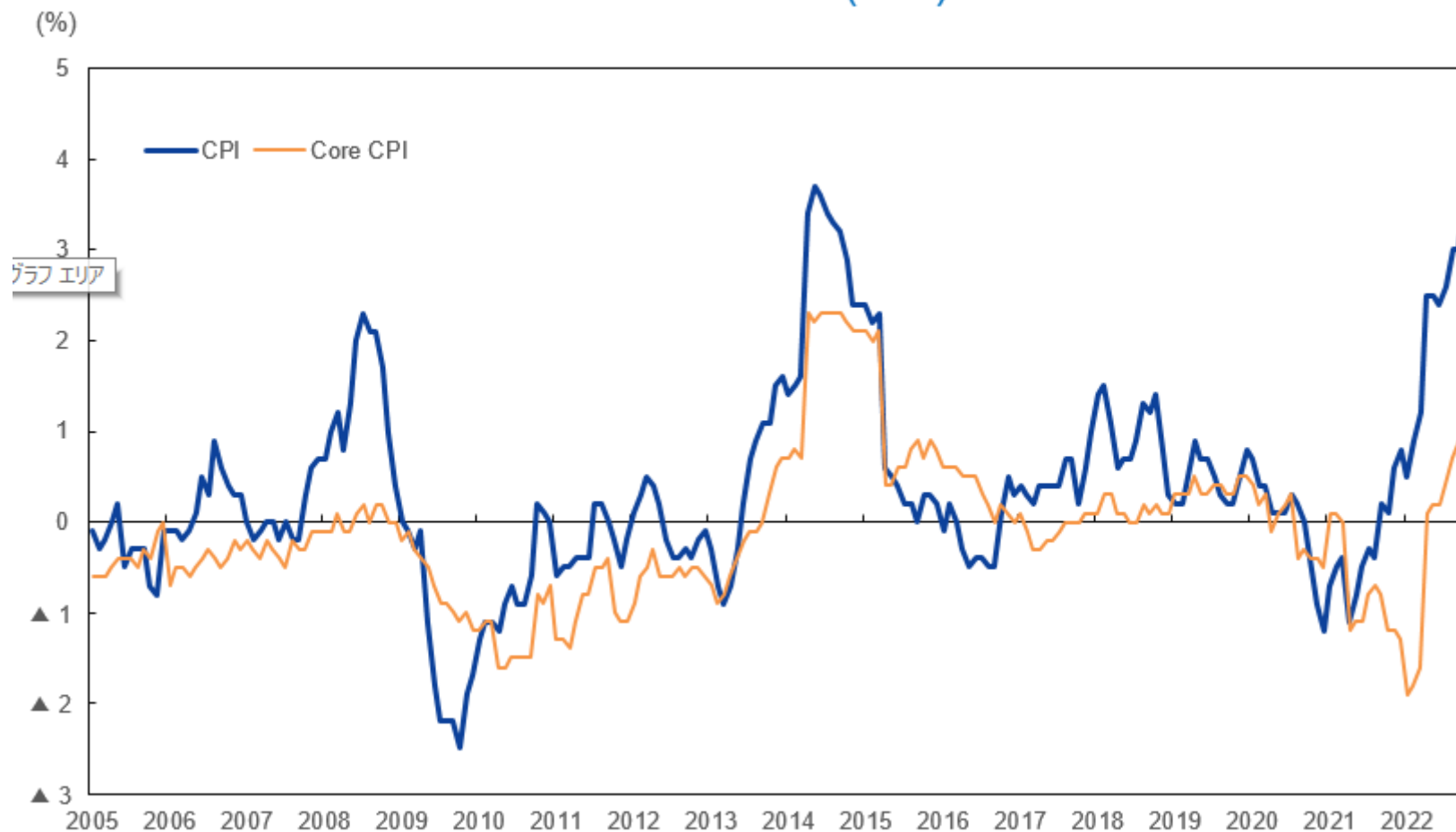
Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	FY24 Est	
Real GDP	0.3%	-0.9%	-4.6%	2.3%	1.7%	1.0%	1.0%	
Private final consumption expenditure	0.1%	-1.0%	-5.4%	2.6%	3.0%	0.6%	0.8%	
Private housing investment	-4.8%	2.5%	-7.8%	-1.7%	-4.2%	-0.8%	0.0%	
Private-sector capital investment	1.5%	-1.7%	-7.7%	0.6%	4.0%	3.1%	3.0%	
Public fixed capital formation	0.8%	1.7%	5.1%	-7.5%	-2.9%	1.6%	0.3%	
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.5%	-0.2%	0.1%	
Exports of goods and services	2.0%	-2.3%	-10.0%	12.4%	4.0%	-0.8%	3.7%	
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	6.6%	0.2%	3.2%	
Nominal GDP	0.2%	0.0%	-3.9%	1.3%	1.7%	2.3%	2.0%	
GDP deflator	-0.1%	0.8%	0.7%	-1.0%	0.0%	1.3%	1.0%	
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	0.8%	1.4%	2.5%	
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	2.7%	2.3%	1.3%	
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	8.3%	1.1%	0.1%	
Employee compensation	3.2%	2.0%	-1.5%	1.8%	1.9%	1.5%	1.9%	
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%	2.4%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

Note: Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education. The forecast is for Sumitomo Mitsui DS Asset Management.

Source: Creation of Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

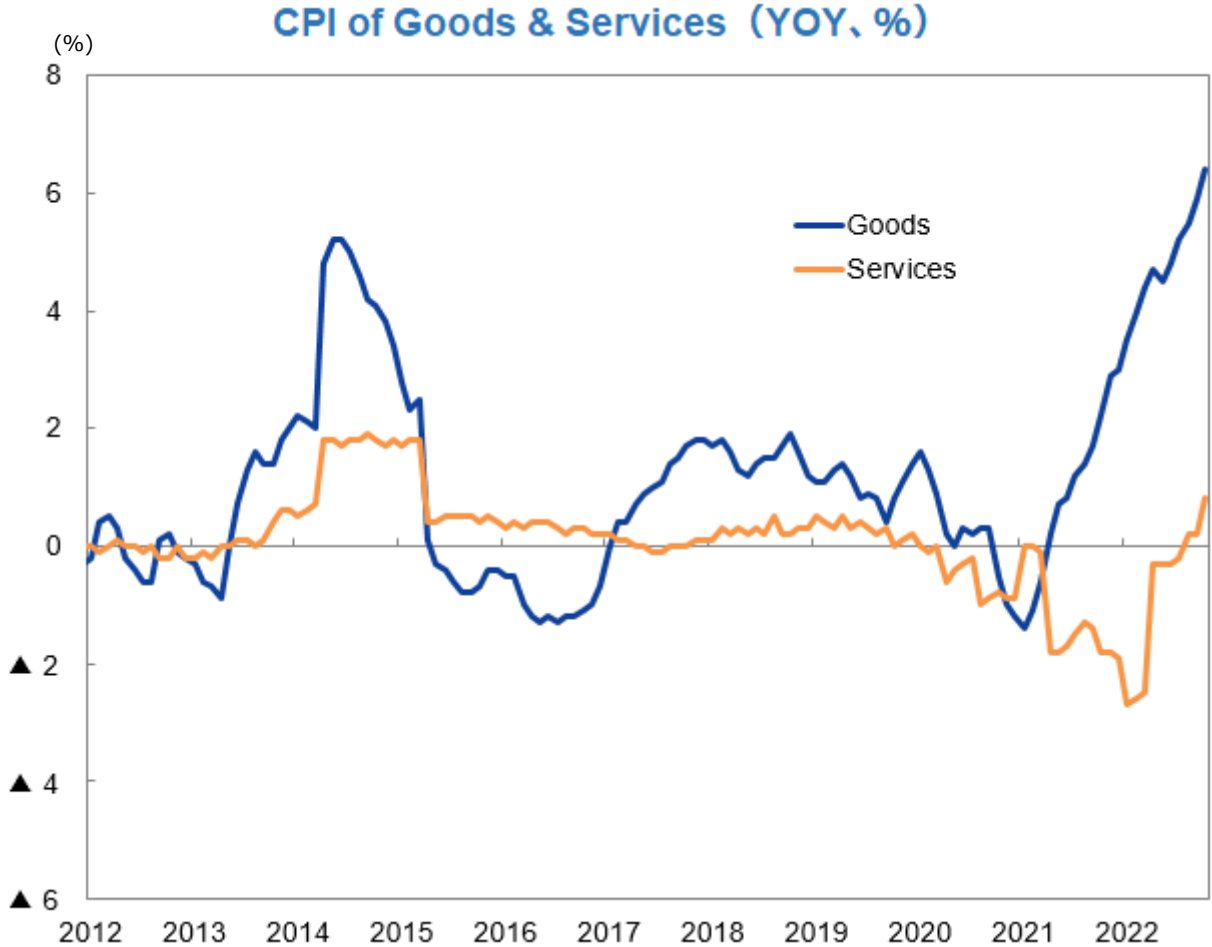
Finally, inflation has come back to Japan

CPI & Core CPI (YOY)



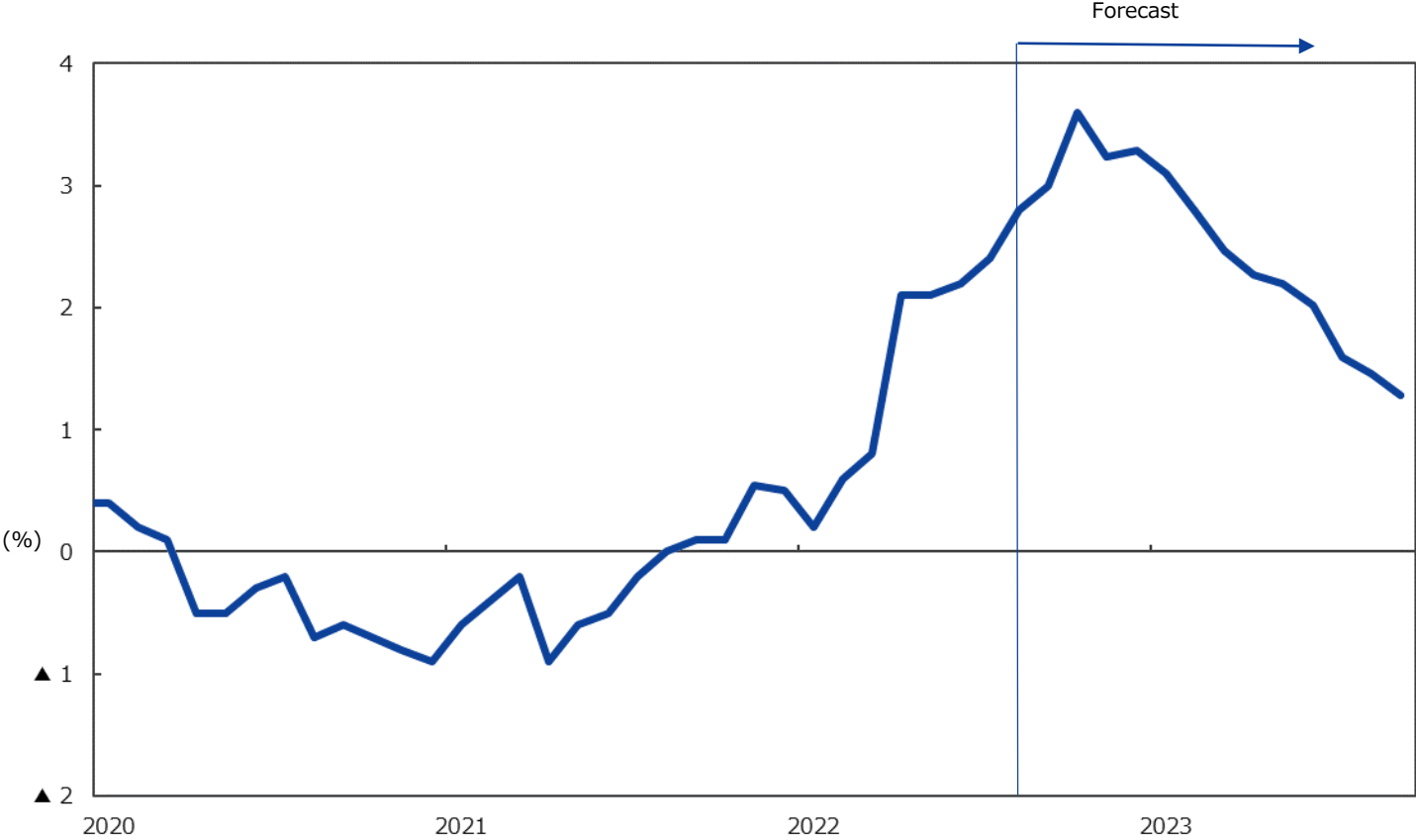
Note: Data is from January 2005 to October 2022, Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Bloomberg, SMDAM

Goods prices lift CPI despite weakness in services



Note: Data is from 1 January 2012 to 1 October 2022.
Source: MIAC, Bloomberg, SMDAM

CPI excluding foods is about to peak



Note: Data is from 1 January 2020 to 30 September 2023. Data after 1 October 2022 are forecast. Forecast is based on the assumption of foreign exchange rate at 1 USD = 140 JPY and crude oil at 95 USD per barrel as of 30 September 2022.
Source: Cabinet Office, SMDAM

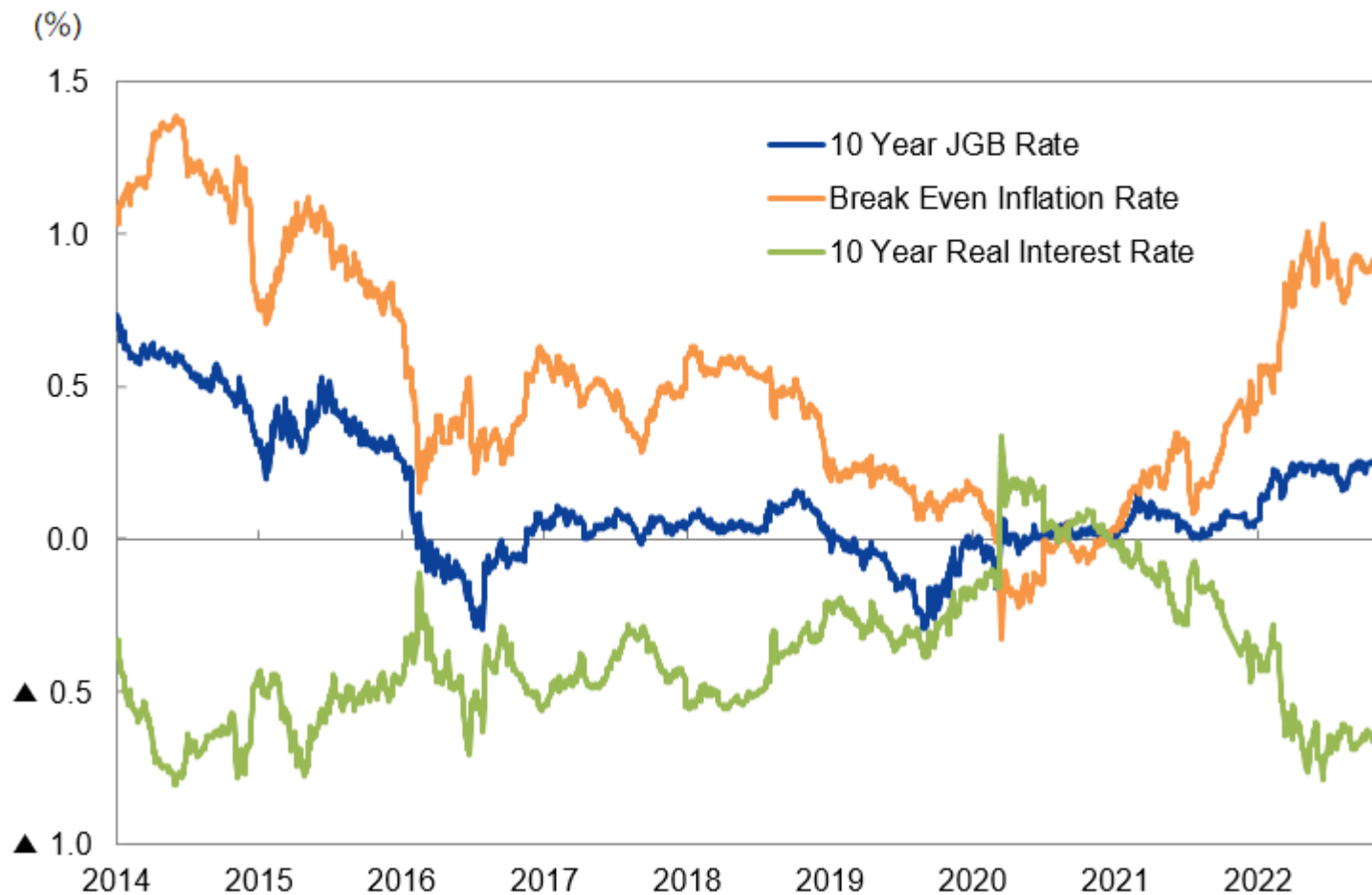
Energy costs boost peoples' expectations for inflation



Note: Weighted average of inflation forecast of "Consumer Confidence Survey".
Data is from 1 January 2013 to 31 October 2022.
Source: Cabinet Office, SMDAM

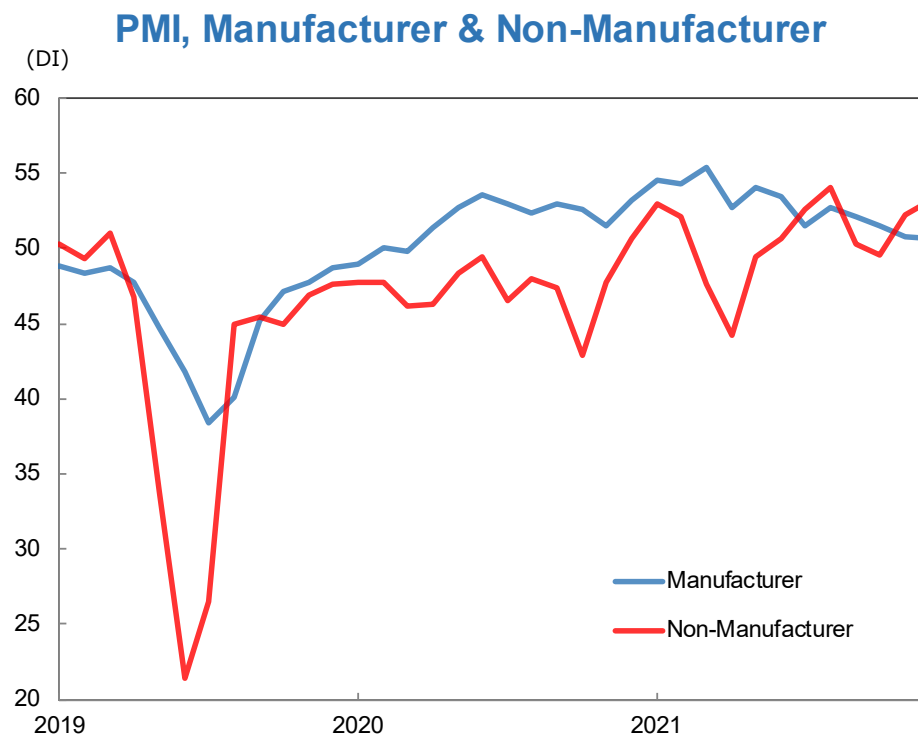
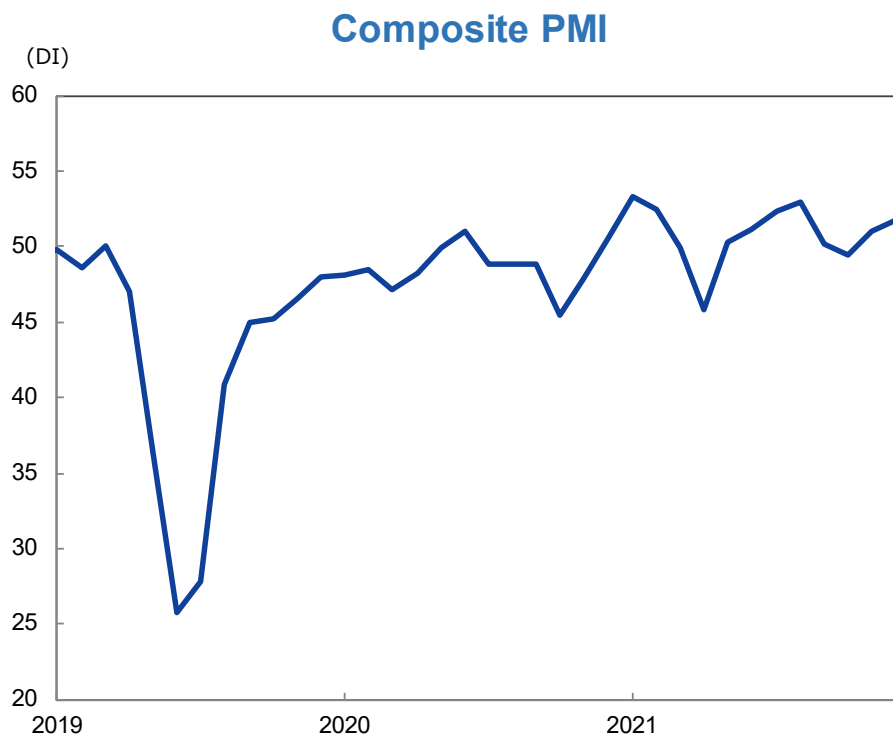
Yield curve control by the central bank pushes real interest rate lower

JGB, BEI, and Real Interest rate



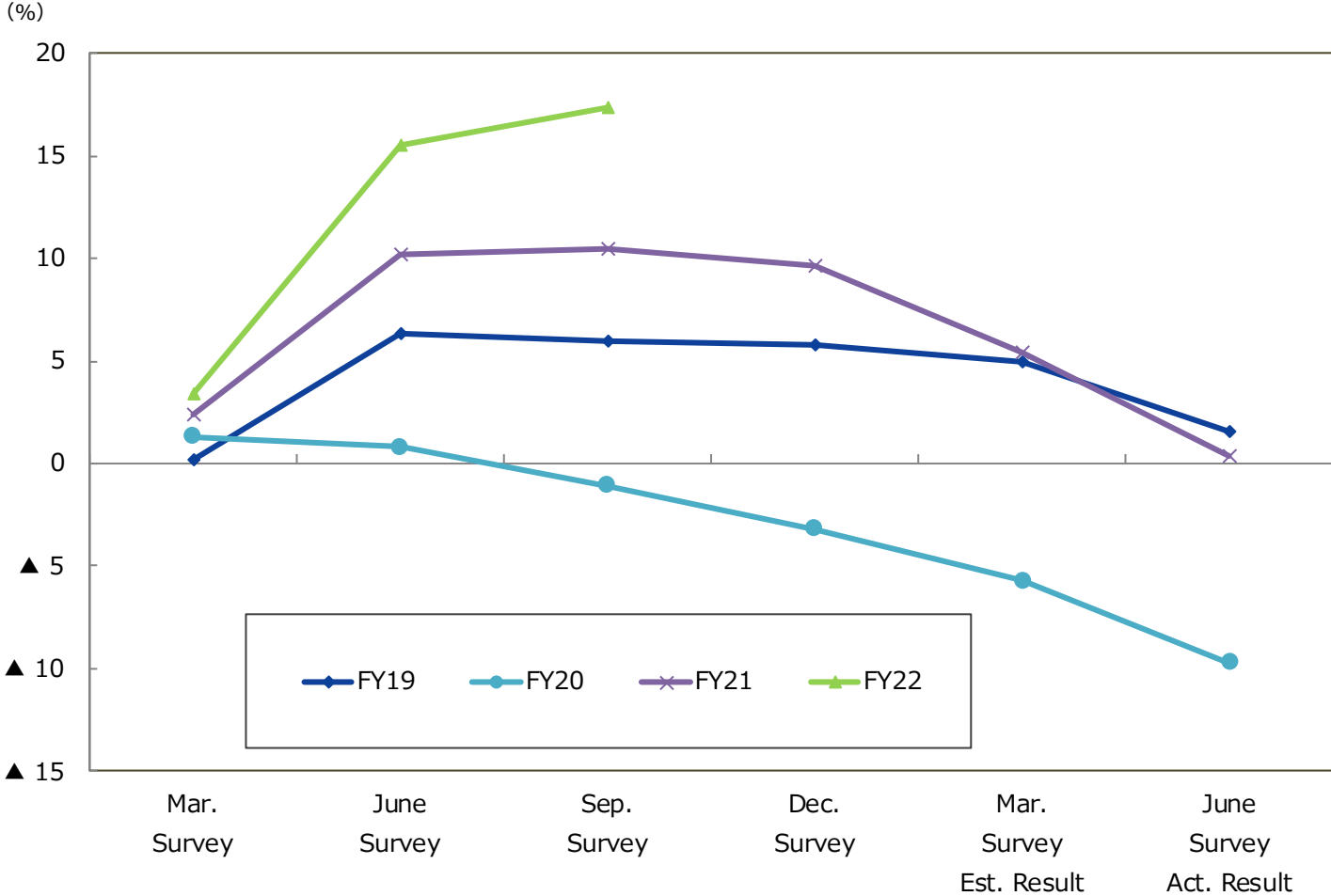
Note: Data is from 1 January 2014 to 17 November 2022.
Source: Bloomberg, SMDAM

“Re-opening” lifts sentiment of service sector



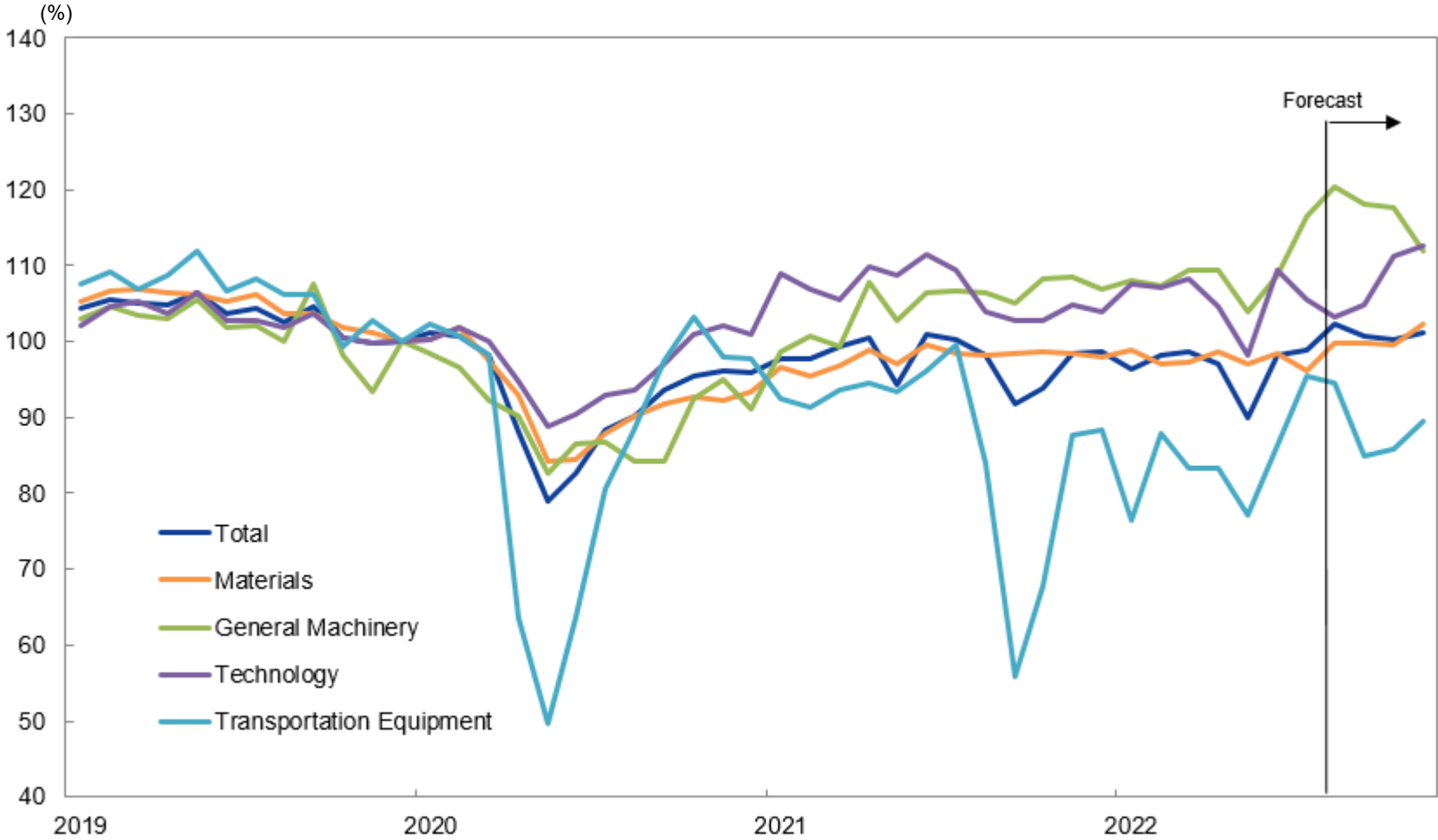
Note: Data is from 1 November 2019 to 31 October 2022.
Source: Bloomberg, SMDAM

Double-digit CAPEX growth in Japan thanks to weaker Yen



Note: Data is from Q1 FY 2019 to Q3 FY 2022
 Source: The Bank of Japan, SMDAM

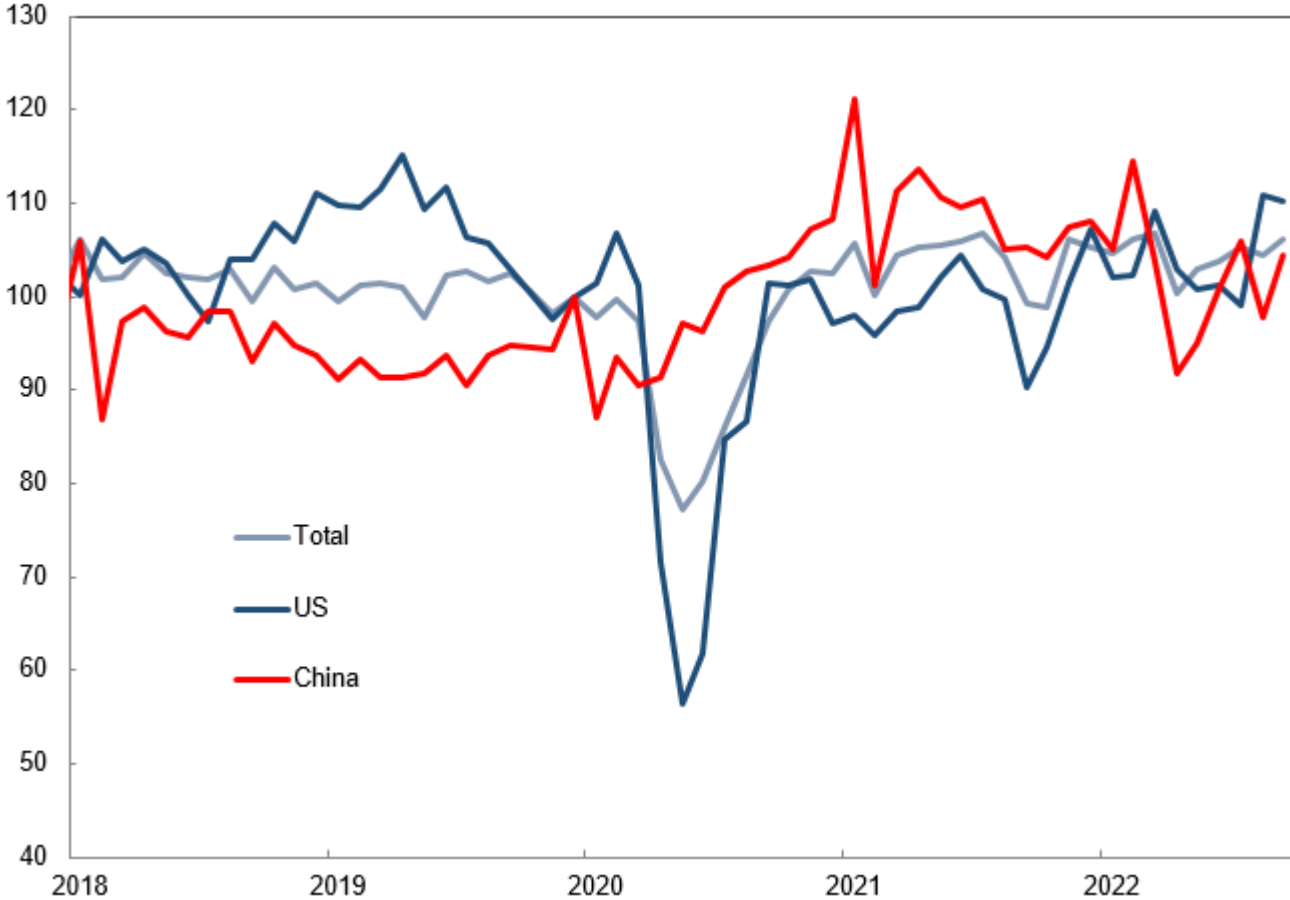
General machinery is slowing due to the global weakness



Note: 100% = 31 December 2019. Data is from 1 January 2019 to 30 November 2022. October and November 2022 are forecasts.
 Source: METI, SMDAM

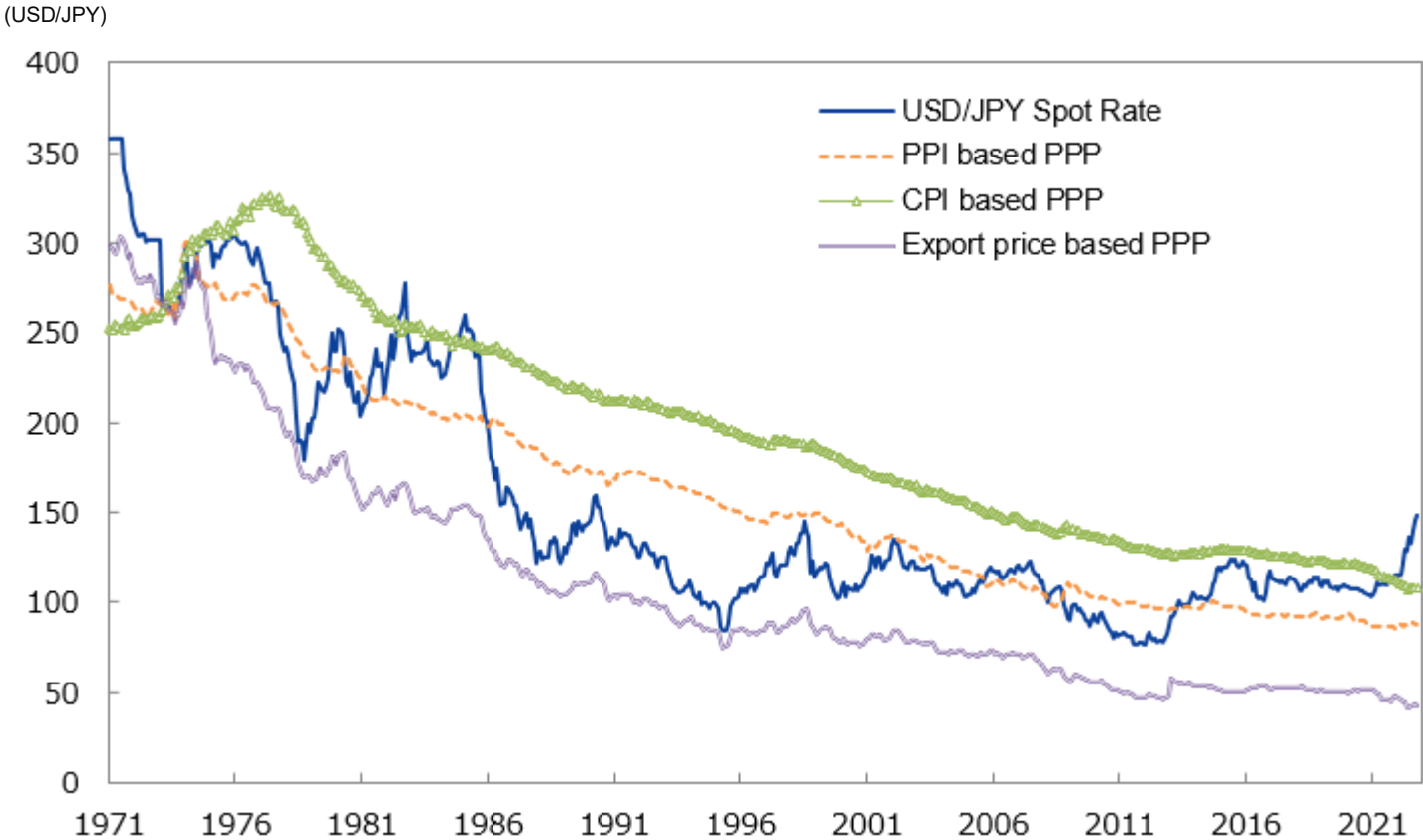
Export to China is coming back slowly after the lockdown

Real Export (Dec. 2019 = 100)



Note: Data is from 1 January 2018 to 30 September 2022.
Source: BOJ, SMDAM

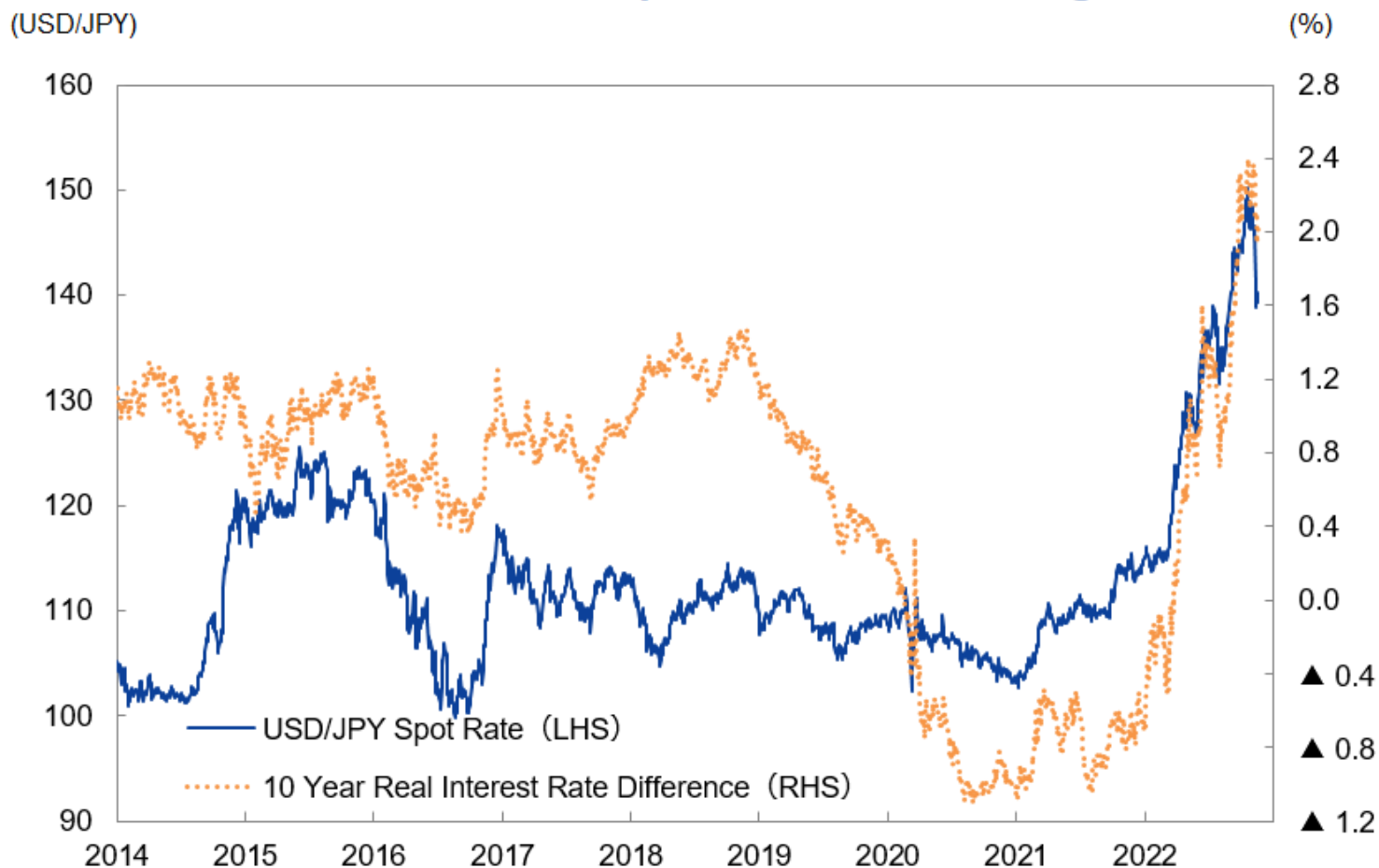
USD/JPY rate breaks 30+ years' PPP resistance



Note: Data is from 1 January 1971 to 31 October 2022.
Source: DOL, Bank of Japan, SMDAM

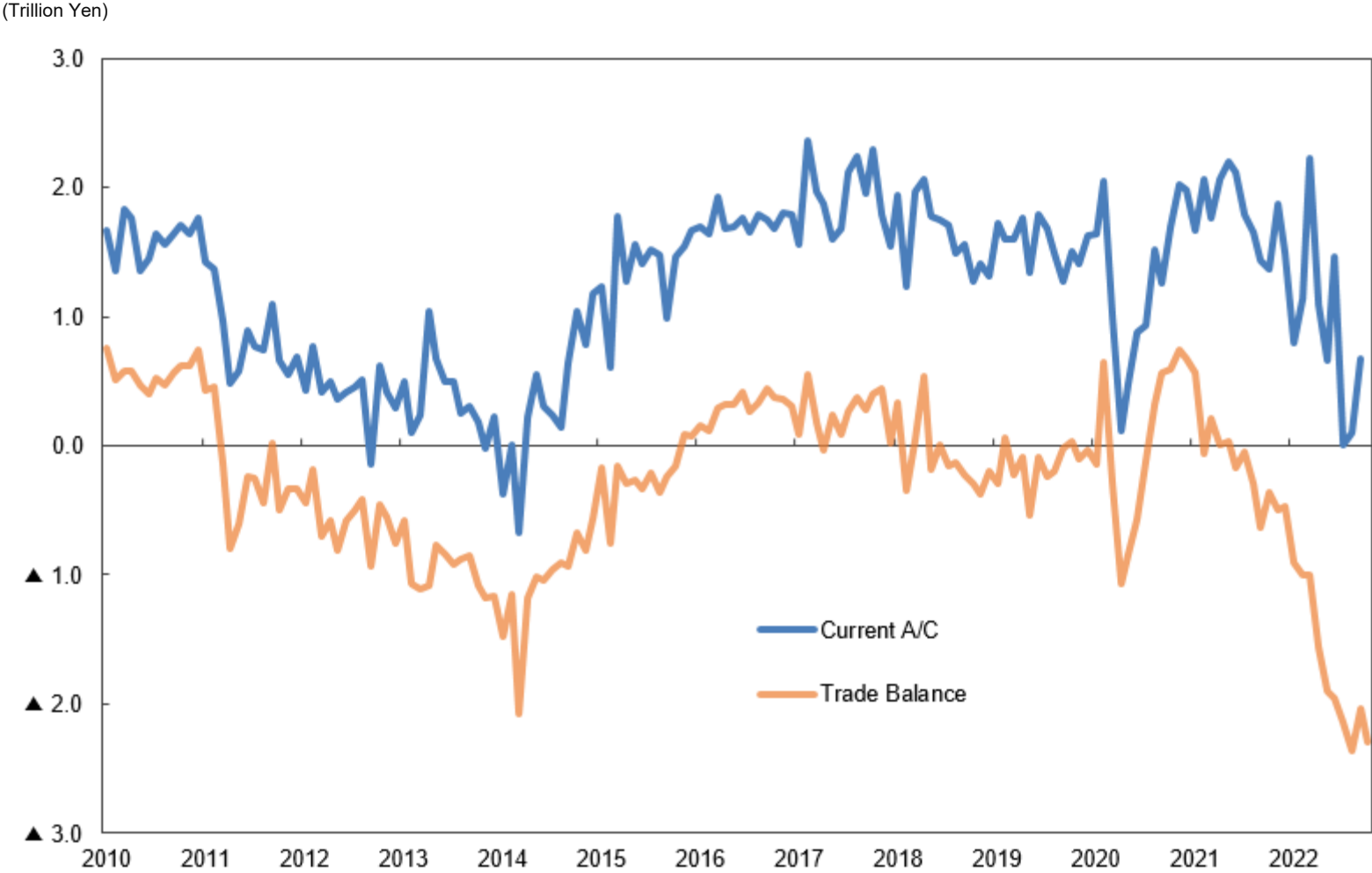
USD/JPY slides due to expectation for slowing monetary tightening

Real Interest Rate Gap & USD/JPY Exchange rate



Note: Data is from 1 January 2014 to 17 November 2022.
Source: Bloomberg, SMDAM

Rising import prices boost trade deficit



Note: Seasonally adjusted. Current account is from 1 January 2010 to 30 September 2022.
Trade balance is from 1 January 2010 to 31 October 2022.
Source: MOF, SMDAM

Japan's marginal exposure to Russian business

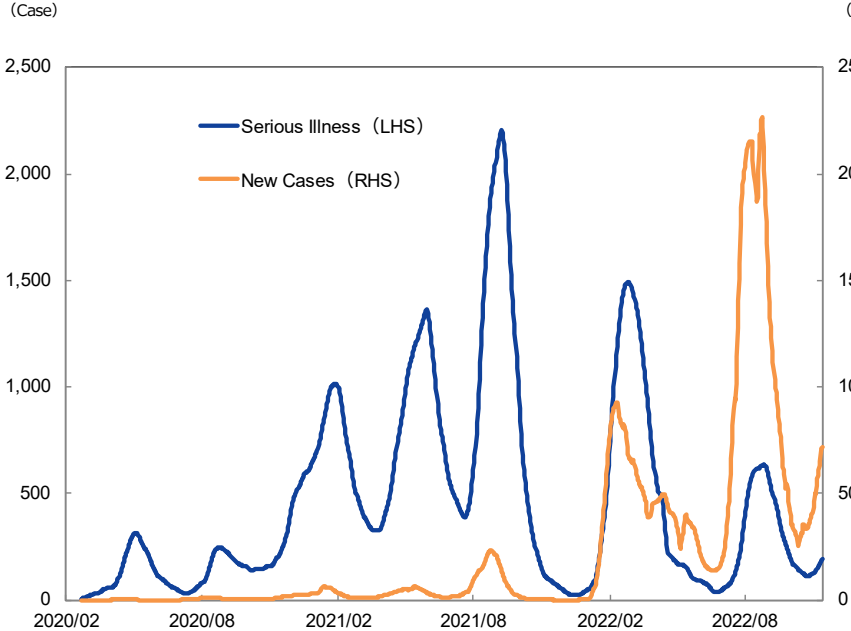
(%)

	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Export	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01	0.00
Electronics	0.07	0.01	0.00	0.00
Transportation Equipment	0.56	0.09	0.00	0.00
Others	0.07	0.01	0.00	0.00

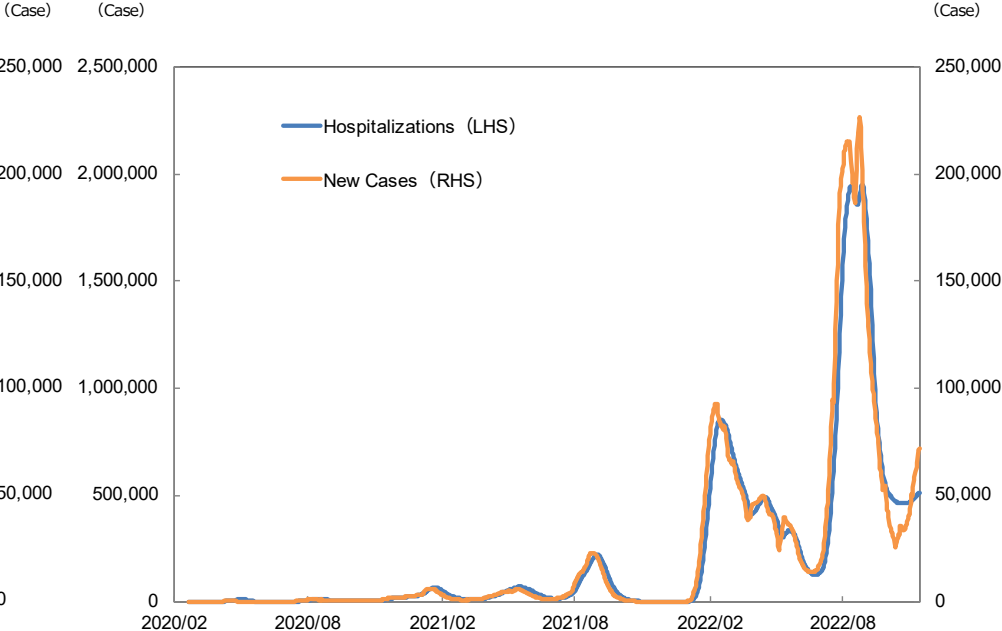
Note: As of year 2021.
Source: MOF, SMDAM

Signs of the eighth wave of COVID-19 infections?

COVID-19 New Cases and Serious Illness



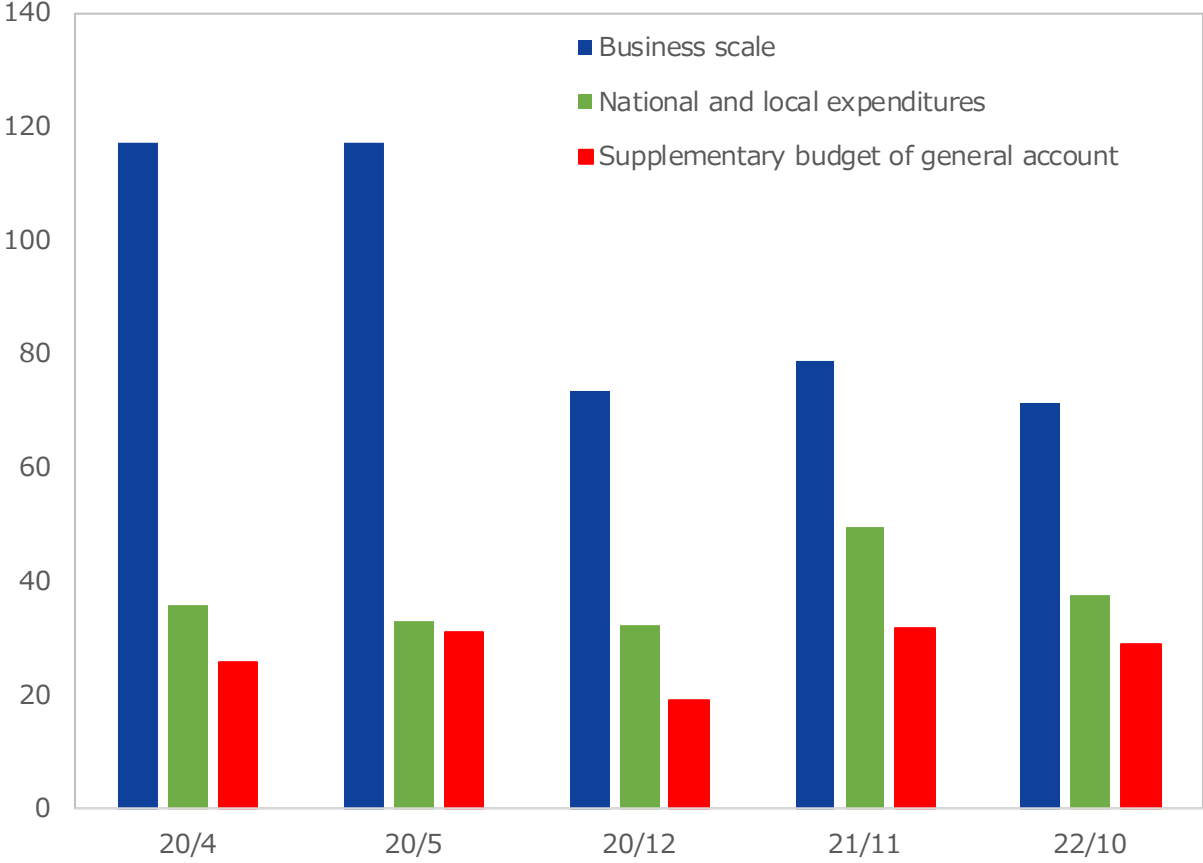
COVID-19 New Cases and Hospitalizations



Note: 7 days moving average. Data is from 21 February 2020 to 13 November 2022.
 Source: MHLW, NHK, SMDAM

Falling approval rate lifts the size of economic stimulus

Size of Fiscal Stimulus (trillion yen)

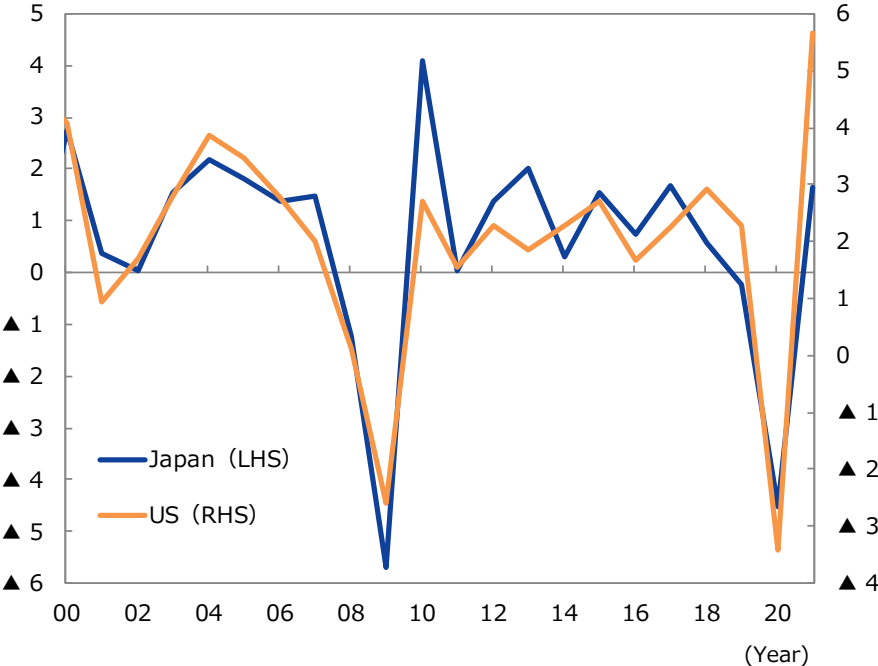


Source: MOF, SMDAM

(Year/month)

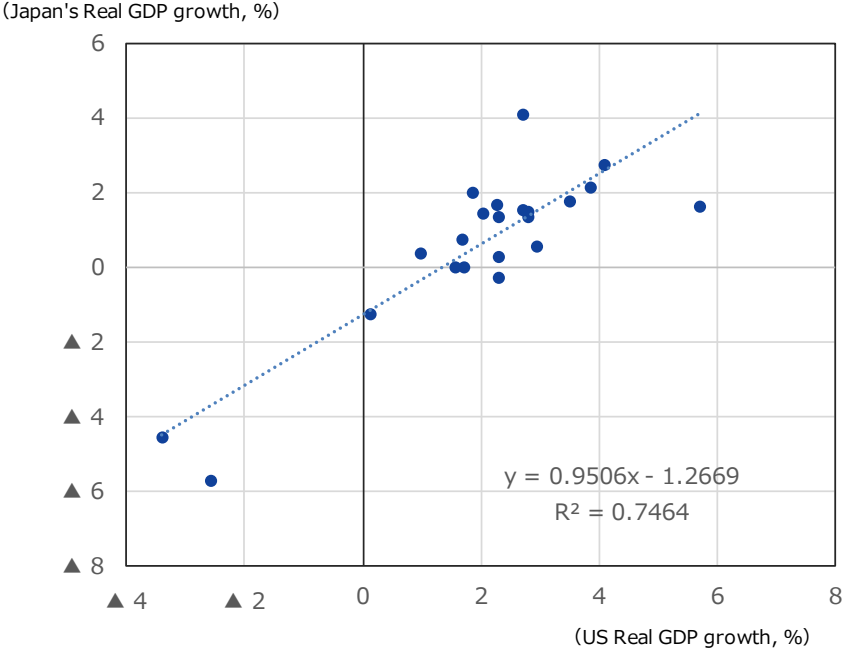
Strong correlation of GDP growth between the US and Japan

Real GDP Growth (YOY, %)



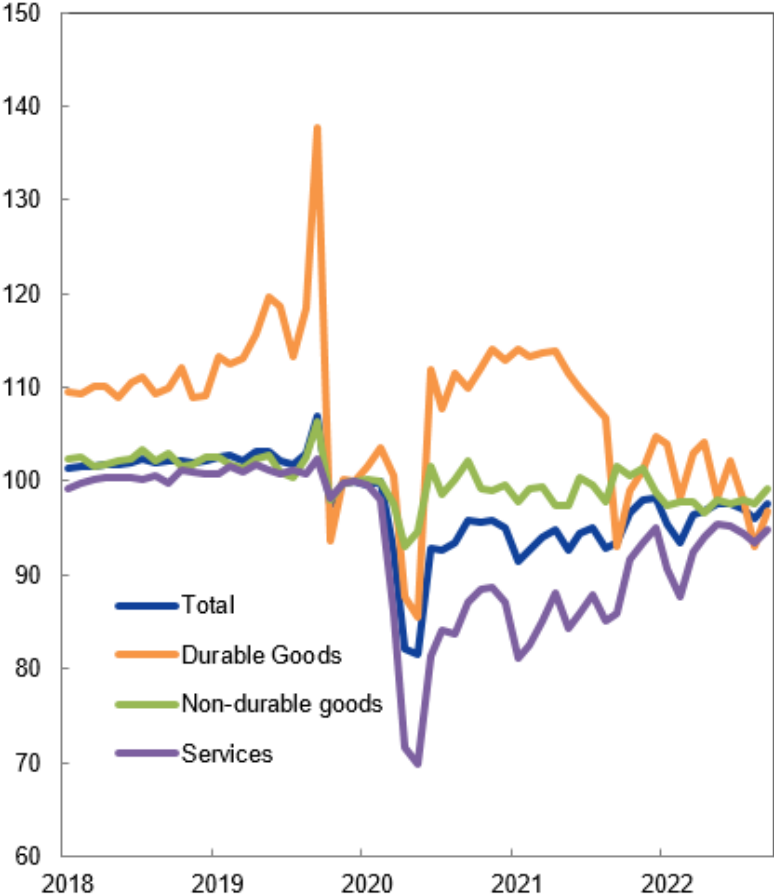
Note: Data is from 2000 to 2021
Source: IMF, SMDAM

Correlation of Real GDP Growth

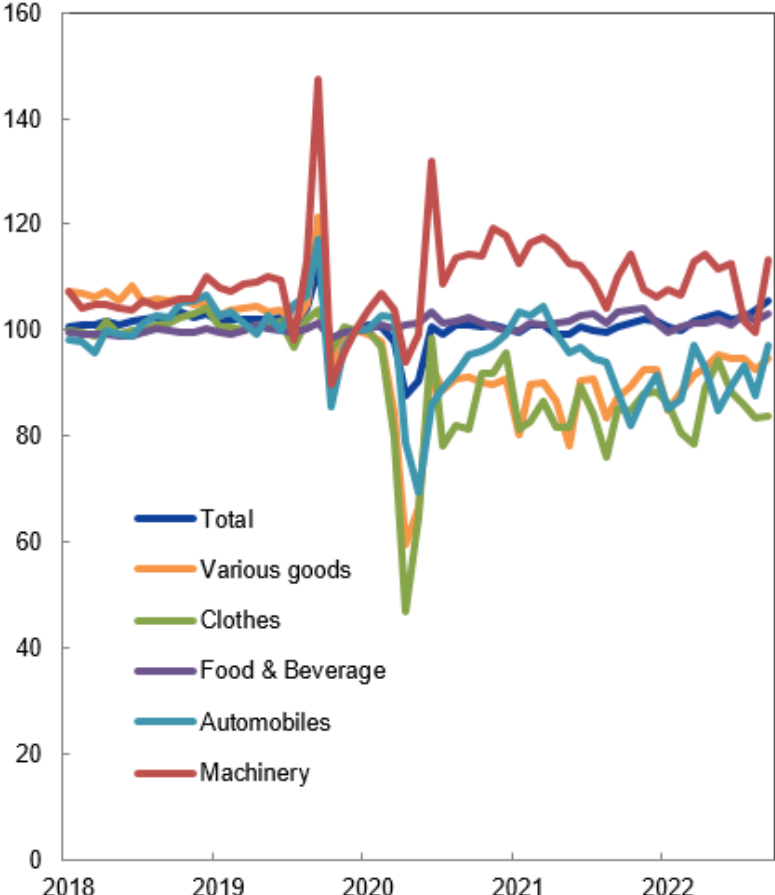


Consumers come back after the seventh wave of infections

Consumer Activity Index (Dec. 2019 = 100)



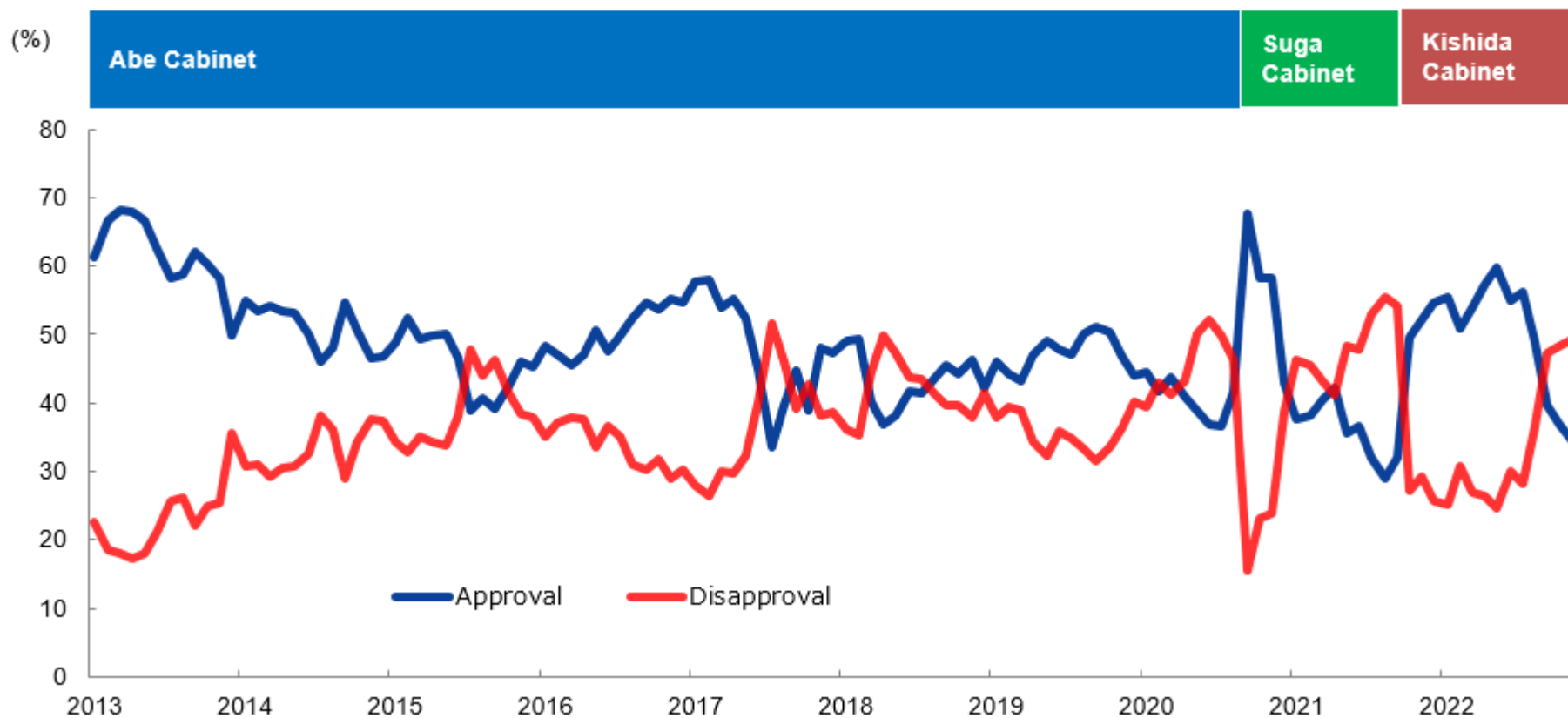
Retail Sales (Dec. 2019 = 100)



Note: Data is from 1 January 2018 to 30 September 2022.
 Source; Bank of Japan, METI, and SMDAM

Approval rate continues to slide owing to “Unification Church” issue

Cabinet approval rate



Note: Data is from 1 January 2013 to 30 November 2022.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Schedule of Major Domestic Events			
2022	December	8	Revision of CY 2022 Q3 GDP
		10	End of extraordinary session
		19-20	Monetary Policy Meeting
			Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023
2023	January	17-18	Monetary Policy Meeting Convocation of the ordinary diet
	February	14	Release of CY 2022 Q4 GDP
	March	9	Revision of CY 2022 Q4 GDP
		9-10	Monetary Policy Meeting
		19	Term expiration of the BOJ vice governor Amemiya and Wakatabe Enactment of the budget and tax reform bill of FY 2023
	April	8	Term expiration of the BOJ governor Kuroda
		27-28	Monetary Policy Meeting Nationwide local elections
May	19-21	G7 Summit in Japan	
June	15-16	Monetary Policy Meeting Big-boned policy decisions Formulation of guidelines for the facilitation of labor mobility End of the ordinary Diet session	

Source: Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui DS Asset Management Company, Limited (hereinafter “SMDAM”), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMDAM’s judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMDAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMDAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMDAM’s authorization, or from disclosing this material to a third party.

Registration Number: The Director of Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui DS Asset Management Company, Limited