



# Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

-February 2022-



# Outlook for Japanese Stock Market

## Market Outlook

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- We maintain our bullish perspective on the Japanese equity market with the target of TOPIX at 2,230 and Nikkei 225 at 32,000 for CY 2022.
- TOPIX EPS could recover by 43% YOY by the end of FY 2021 to 134 points, an historical high, and continue its double digit growth to 151 points in FY 2022.
- Uncertainty over the monetary policy of US Federal Reserve will continue to weigh on investors' appetite for riskier assets and raise market volatility in the near future.
- We believe the market will resume its bullish trend going forward by reflecting sound fundamentals, such as steady earnings growth and accelerating nominal GDP growth, after digesting the US Fed's tighter monetary policy.

# TOPIX forecast – expect bullish trend ahead



Note: TOPIX data is from Jan. 1st 2016 to Jan. 21st 2022  
(Source) TOPIX: Tokyo Stock Exchange, forecast by SMDAM

(Year/Month)

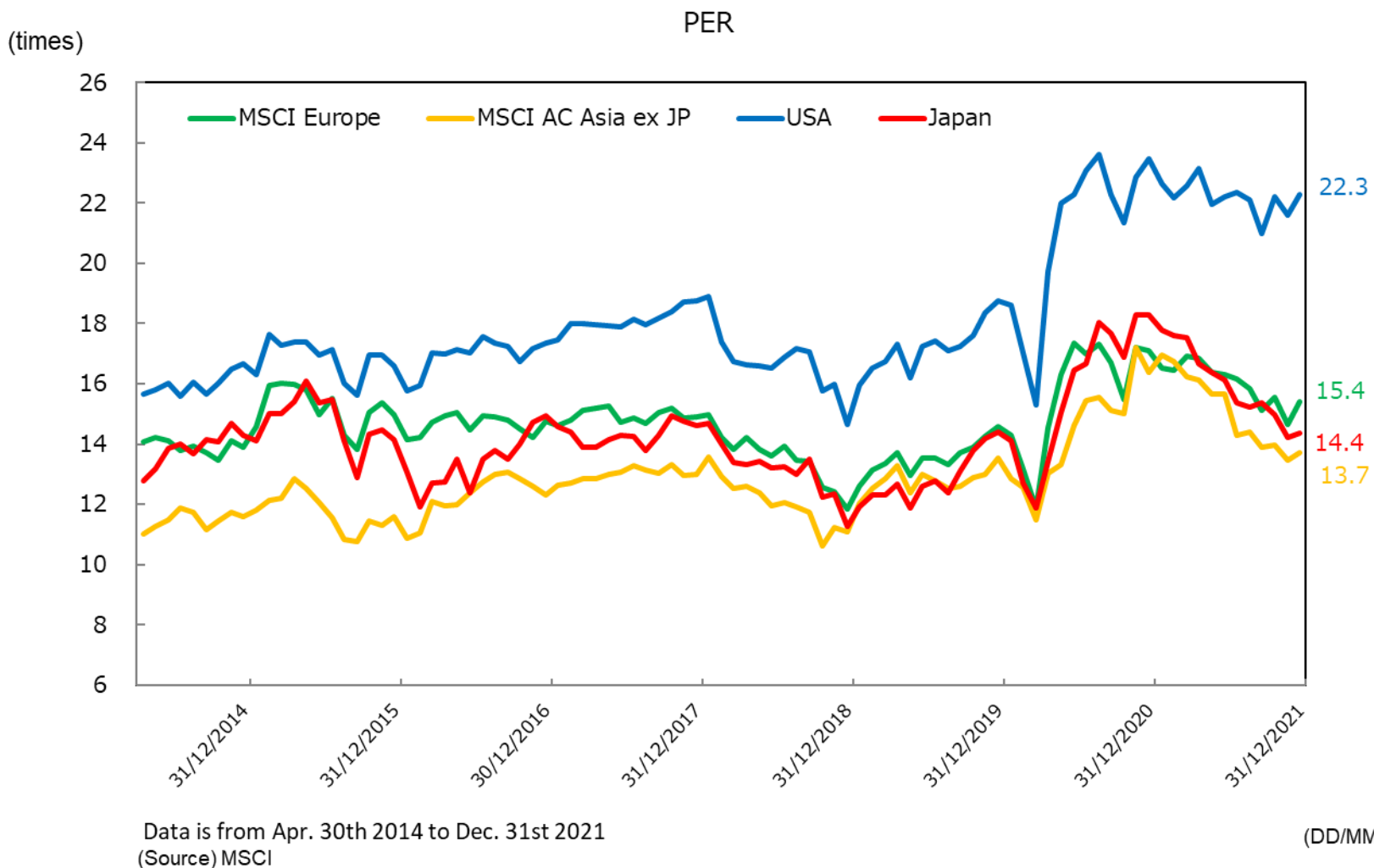
## ■ Upside Risks

- Rapid normalization/ recovery of global economy from COVID-19 pandemic
- Recovery of inbound travel to Japan

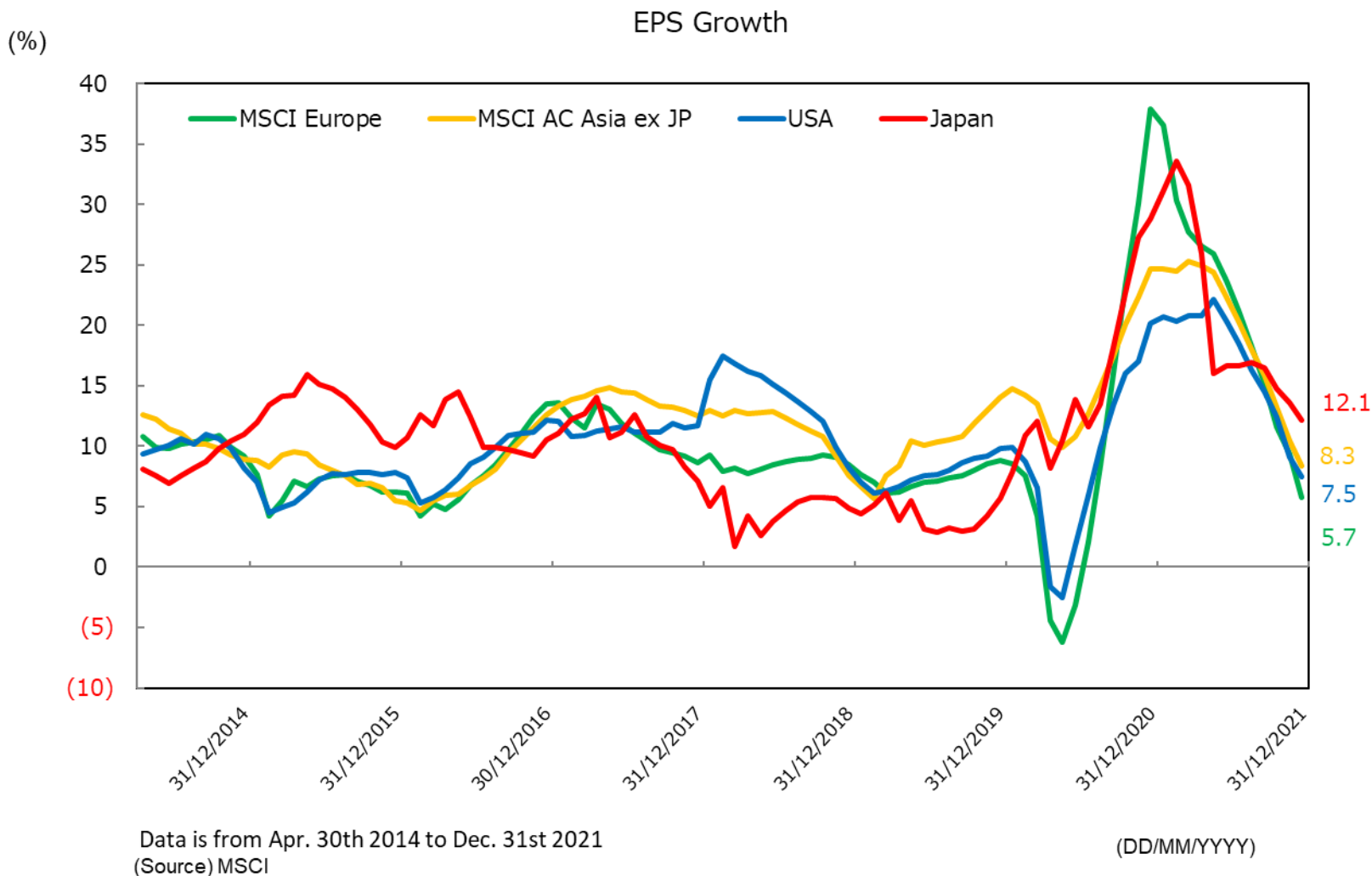
## ■ Downside Risks

- Delay of the normalization of the global economy owing to the spread of the new COVID-19 variant
- Further deterioration of the bottle neck in the global supply chain
- Concern about stagflation

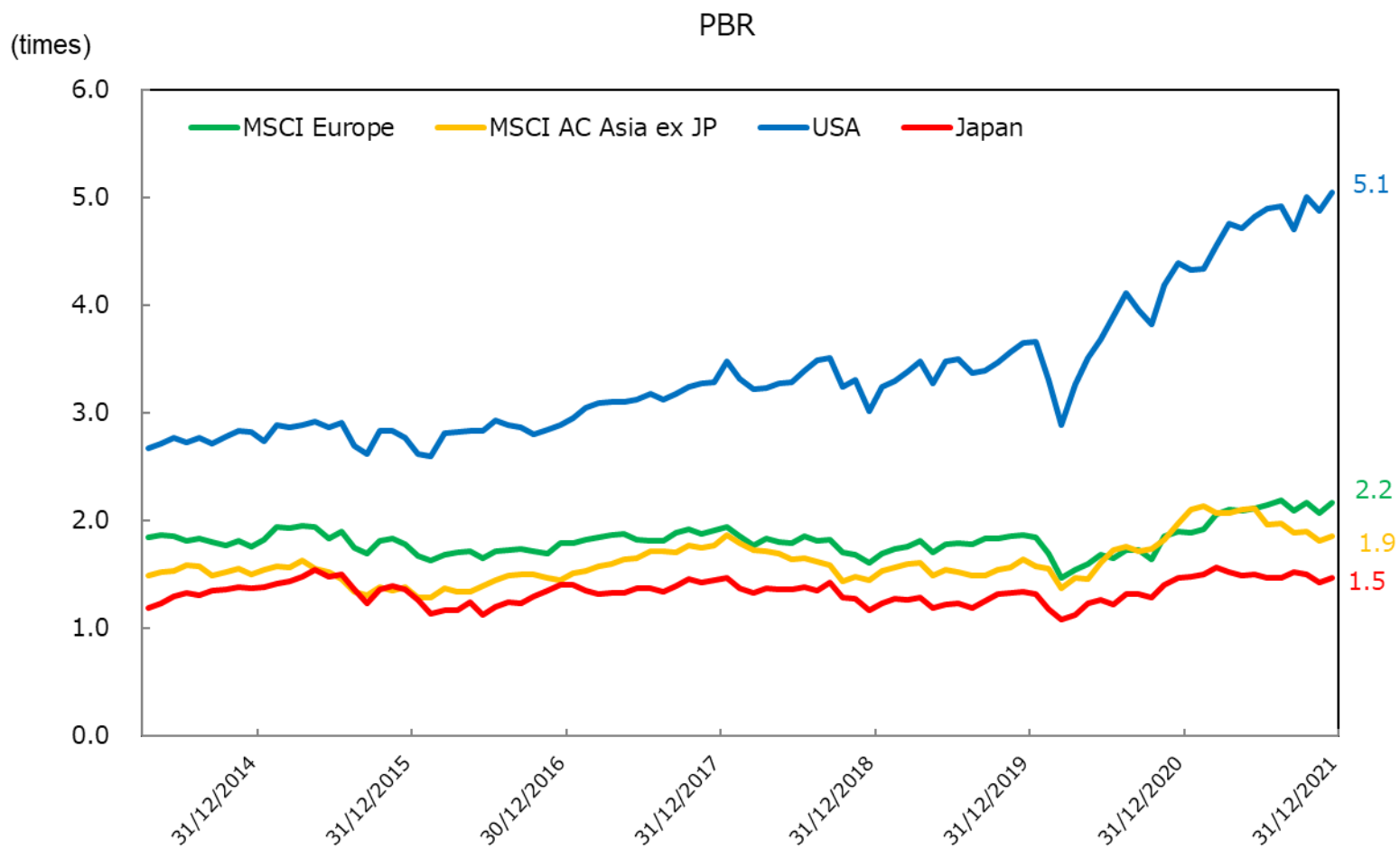
# PER back to normal (excluding US)



# Japan's EPS growing faster than global peers



# PBR – mind the gap between US and others



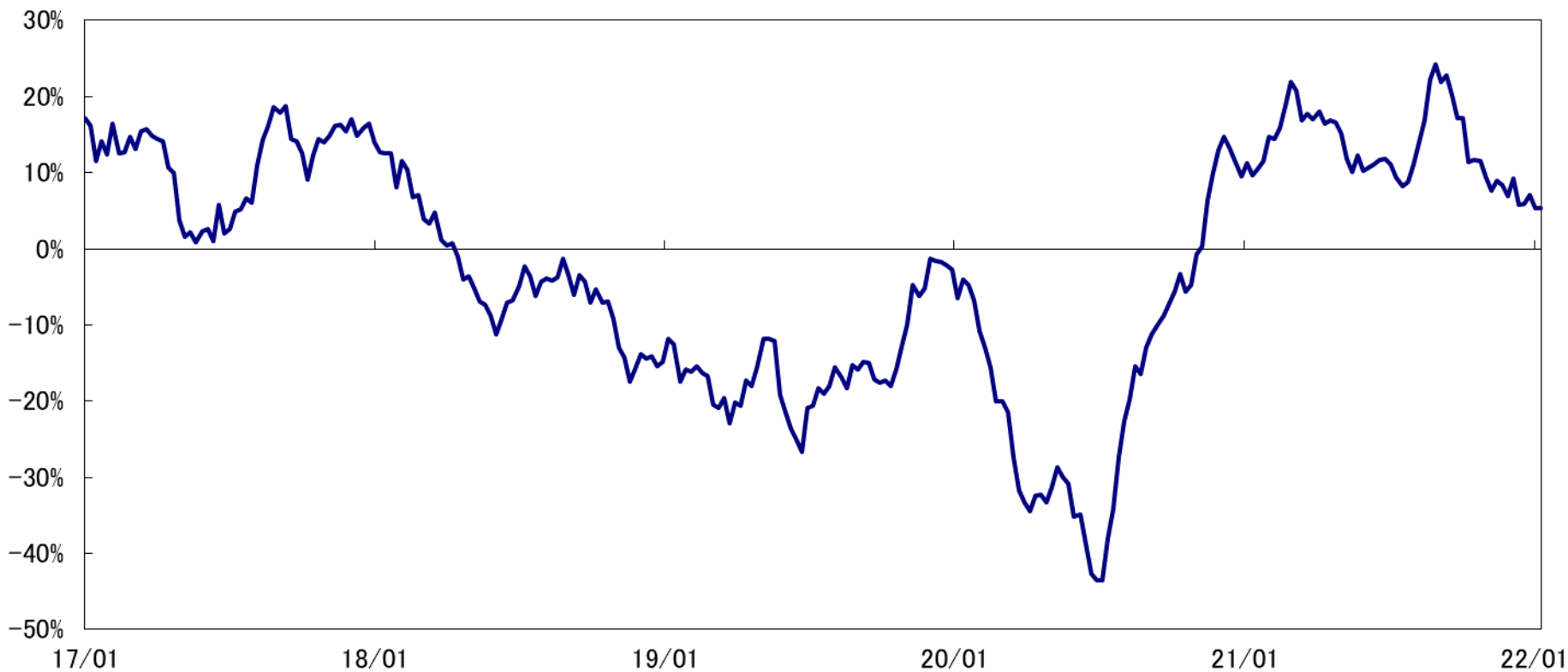
Data is from Apr. 30th 2014 to Dec. 31st 2021  
(Source) MSCI

(DD/MM/YYYY)



# Weakening revision owing to rising material costs

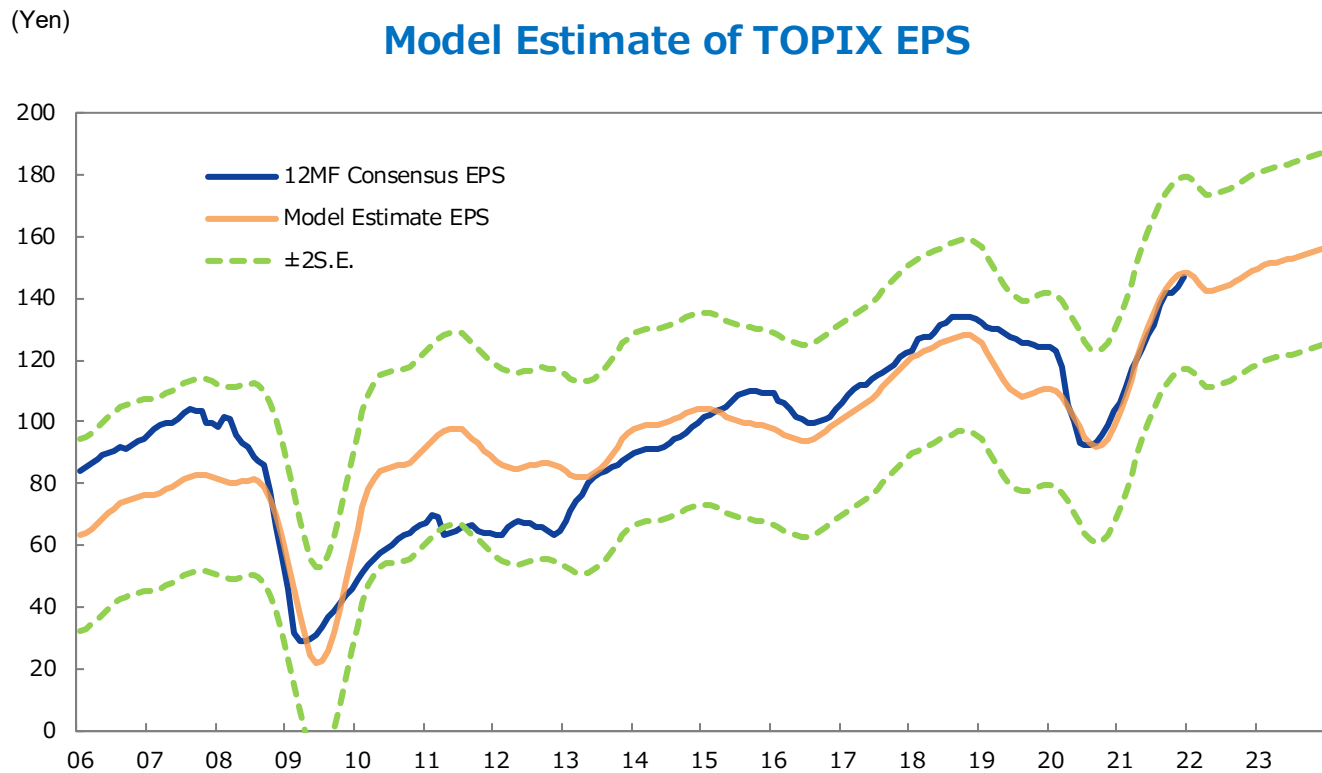
TOPIX Revision Index



Data is from Jan. 2nd 2017 to Jan. 10th 2022  
(Source) Datastream, IBES

(YY/MM)

# Quants estimate EPS reaccelerates after short pause

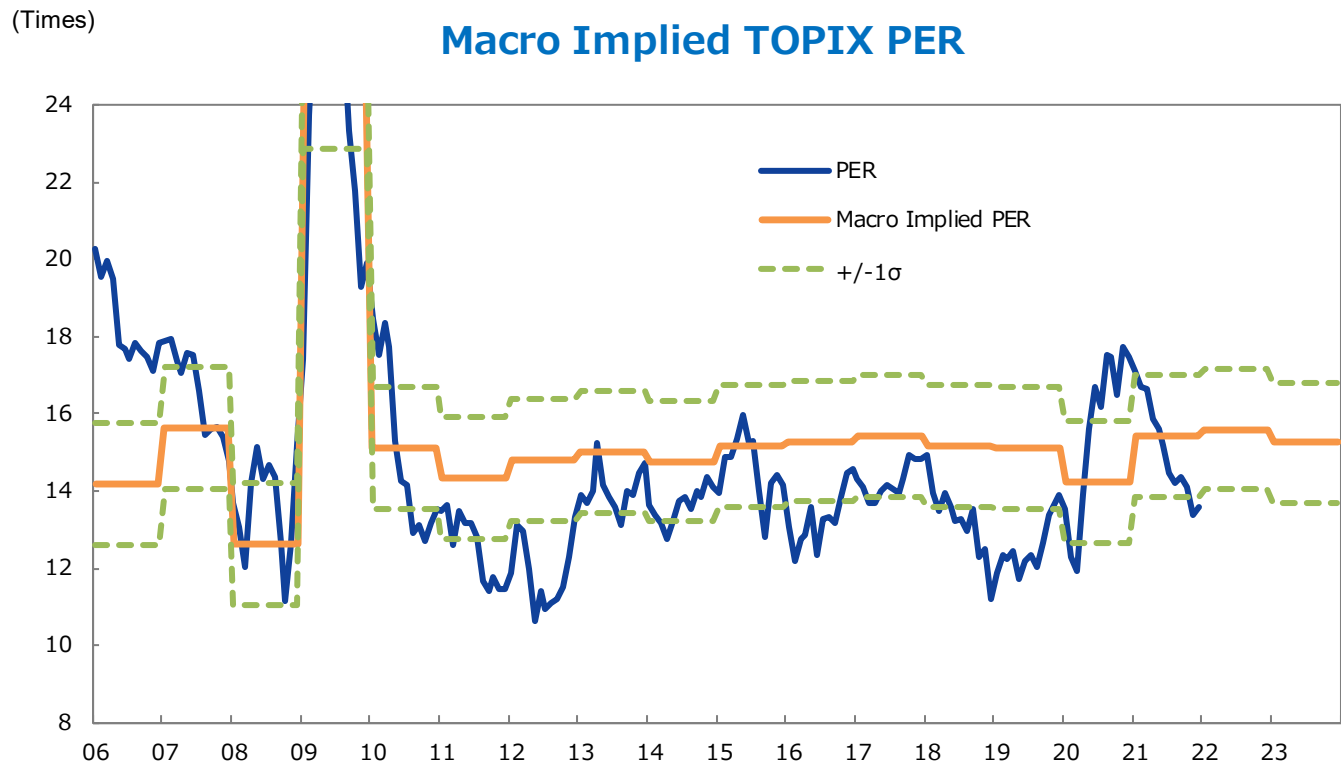


Consensus data is from Jan. 2006 to Dec. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Quants estimate PER sank below bottom of the range

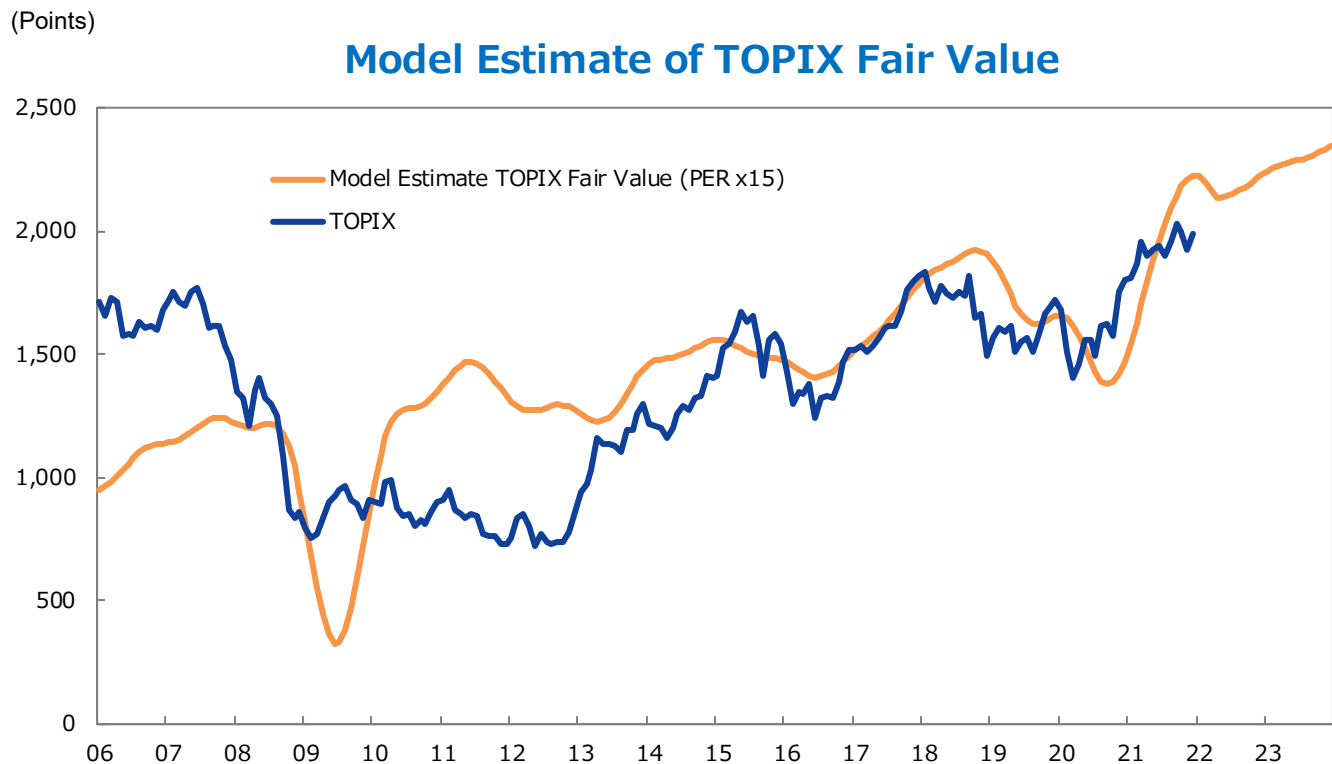


Consensus data is from Jan. 2006 to Dec. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Quants analysis indicates attractive opportunity to accumulate



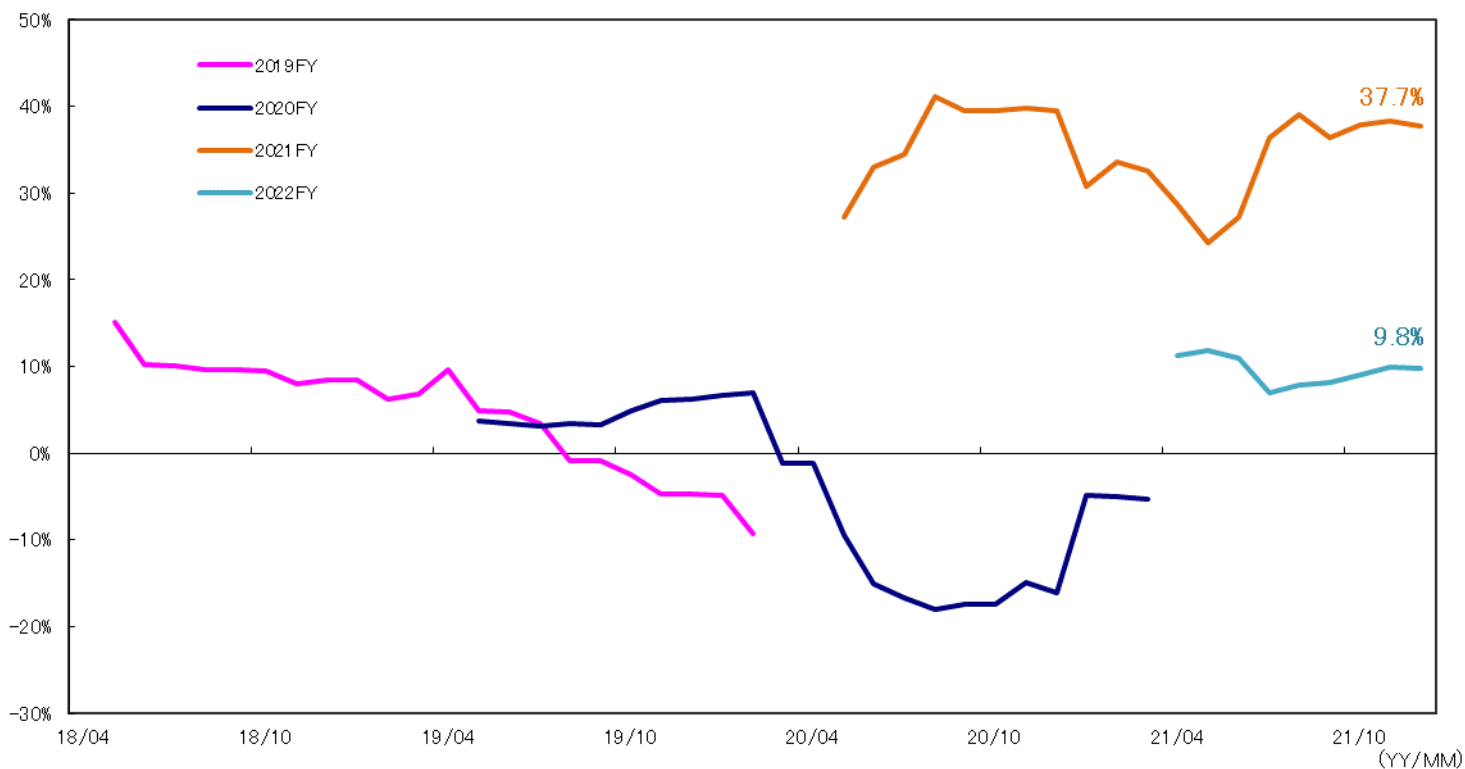
TOPIX data is from Jan. 2006 to Dec. 2021, Model data is from Jan. 2006 to Dec. 2023

(Year)

(Source) SMDAM

# Bottom up estimate – encouraging earnings outlook ahead

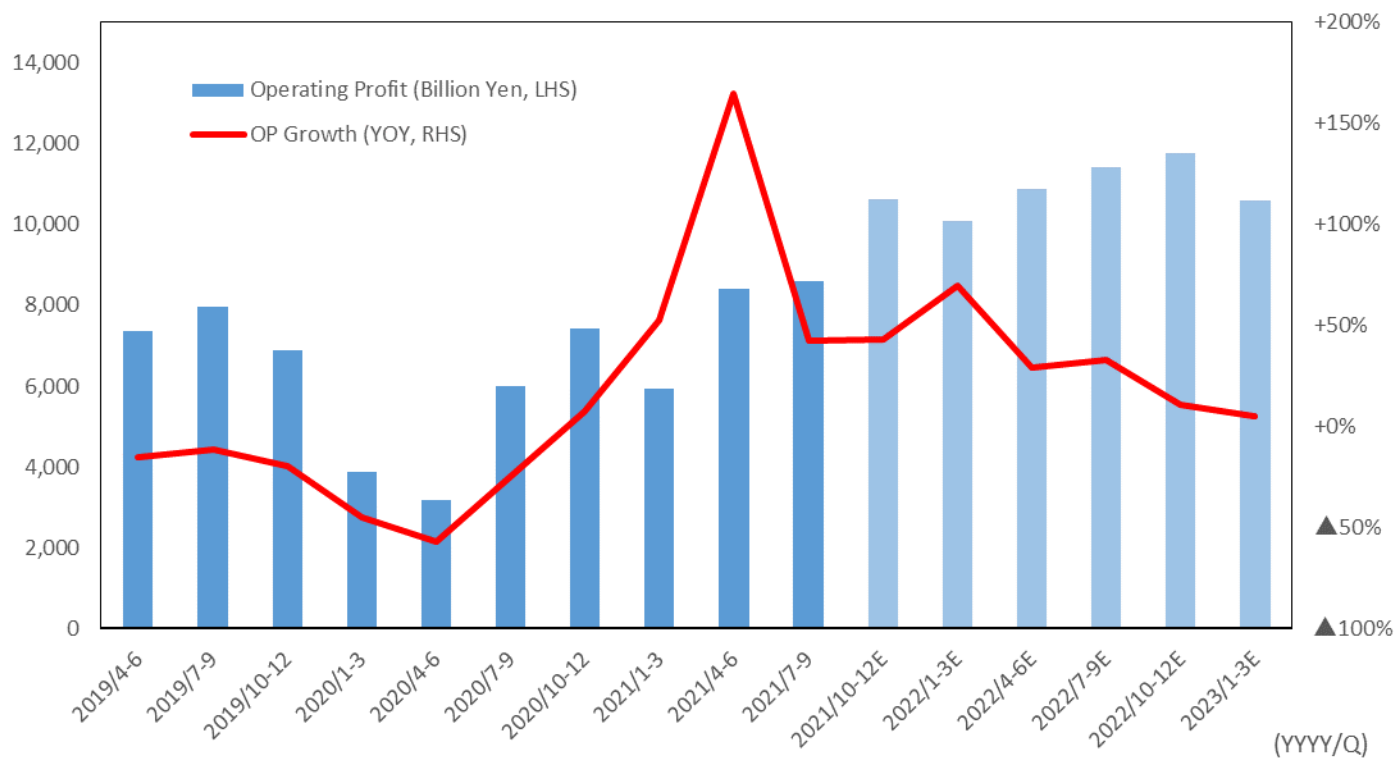
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of Jan. 12<sup>th</sup> 2022, SMDAM Core Universe (Excl. Financials) consists of 452 major Japanese companies covered by SMDAM in-house analysts.  
 (Source) SMDAM

# Bottom up estimate – steady outlook of operating profit

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



Actual data is from Q2 2019 to Q3 2021, estimate data is from Q4 2021 to Q1 2023  
 (Source) SMDAM

# Improving corporate governance enhancing shareholders' value

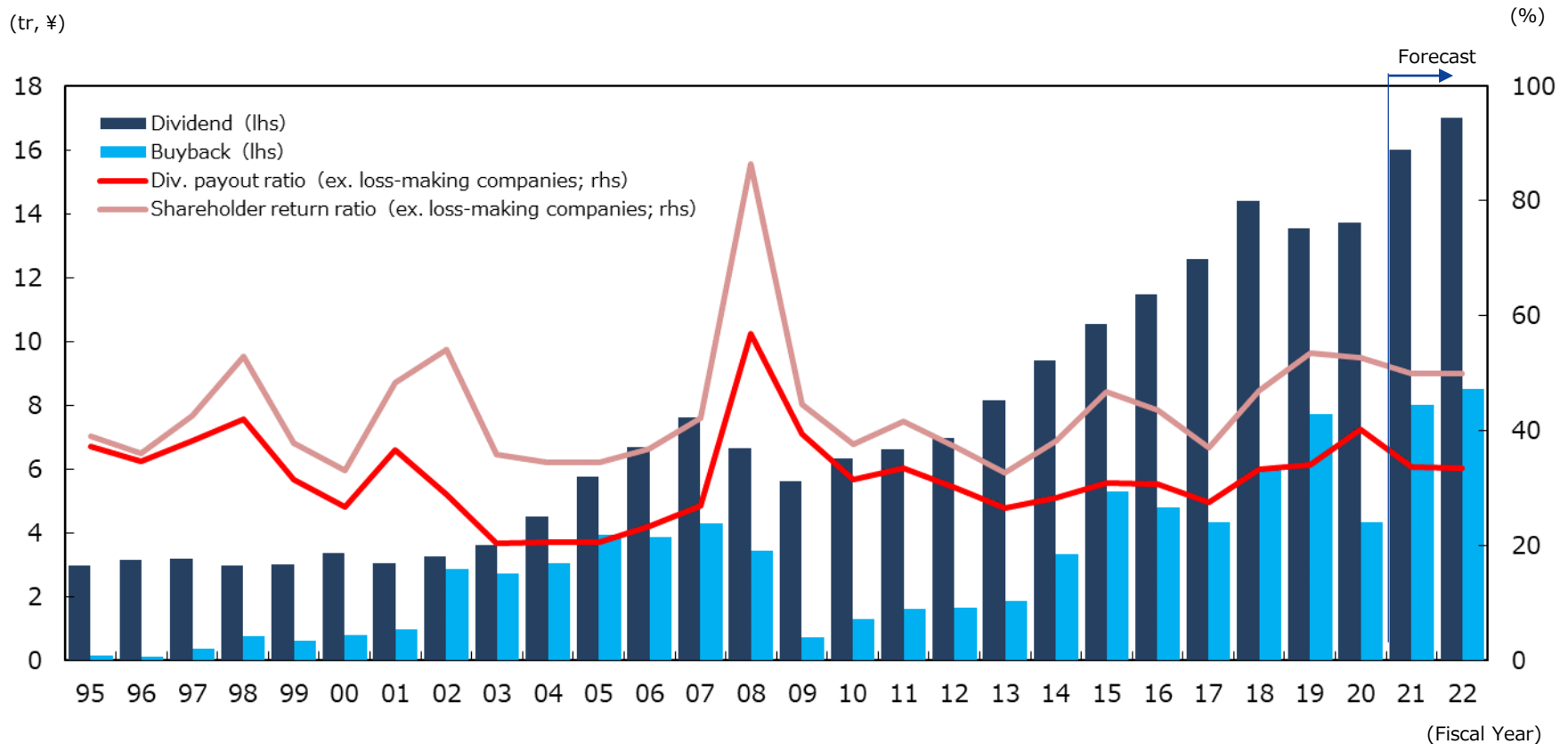
Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	205
Insurance companies	24
Pension funds	74
Others	11
<b>Total</b>	<b>320</b>

note: As of Dec. 31st 2021  
(Source) FSA, SMDAM

- The Stewardship Code (SC) was set 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 that have 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 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, which implicitly provide 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 – increasing shareholders’ returns

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



Note: Data is from FY1995 to FY2022, FY2021 and FY2022 are forecasts from Toyo-Keizai for dividends and from Daiwa Securities for share buybacks.

Source: Toyo Keizai, Quick, and INDB compiled by Daiwa Securities



# Winners and losers, return reversal and size matter

## Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
<b>RN Japan Equity</b>	<b>-5.47</b>	<b>0.53</b>	<b>-3.96</b>	<b>3.02</b>	<b>10.96</b>	<b>24.29</b>	<b>26.70</b>
Total Value	-1.22	4.24	1.78	13.47	7.27	12.37	11.13
Top Cap Value	1.71	7.47	3.61	19.67	17.06	25.60	20.77
Large Cap Value	0.00	5.72	2.85	15.55	9.07	14.25	12.68
Mid Cap Value	-2.15	3.52	1.85	10.58	-1.34	-0.44	1.82
Small Cap Value	-6.44	-2.09	-2.54	4.56	-0.50	4.35	3.78
Micro Cap Value	-5.58	-1.43	-4.30	3.74	-2.17	7.24	7.92
Total Growth	-9.08	-2.48	-9.20	-6.33	13.30	35.80	42.91
Top Cap Growth	-6.21	1.36	-8.73	-3.91	19.15	47.46	51.97
Large Cap Growth	-8.31	-1.54	-9.10	-6.03	15.56	39.12	45.07
Mid Cap Growth	-11.94	-6.43	-9.79	-9.71	9.35	26.28	34.05
Small Cap Growth	-15.87	-10.84	-10.08	-8.55	-4.65	10.59	24.40
Micro Cap Growth	-18.21	-13.63	-12.46	-10.60	-4.45	11.44	30.01
Top Cap Total	-3.04	3.65	-3.61	5.84	17.86	36.06	35.72
Large Cap Total	-4.71	1.52	-3.74	3.58	13.10	27.26	29.19
Mid Cap Total	-7.15	-1.57	-3.93	0.32	6.46	15.19	20.05
Small Cap Total	-10.04	-5.47	-5.24	-0.34	-1.41	7.63	12.32
Micro Cap Total	-9.62	-5.32	-6.77	-0.85	-2.04	9.87	16.89

Note : As of Jan. 18th 2022  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- The pace of economic recovery is slowing. Normalization of the economy is still continuing on the whole, while COVID-19 Omicron variant infections are weighing on consumer sentiment. The employment situation is getting slightly worse as real income is declining and inflation is accelerating owing to rising energy costs.

## [Outlook]

- ① **We have revised down real GDP growth forecast for FY 2021 to +2.5% from +2.7%, while we have raised our forecast for FY 2022 to +3.0% from +2.9%. We have not changed our estimate for FY 2023 at +1.2%.** We have lowered our growth forecast for Q1 2022 owing to the steep increase of Covid-19 Omicron infections. We expect the pace of economic growth to re-accelerate in Q2 and Q3 2022 after a short pause in Q1.
- ② **We have revised our Core CPI forecast upward to +0.1% from 0% for FY 2021, +1.0% from +0.7% for FY 2022, and +0.8% from +0.6% for FY 2023 respectively.** The major reasons for the changes are revisions to the crude oil price assumption and foreign exchange rate. Inflation rate might be boosted to mid 1% level, then decelerate due to receding impact from the energy price hike.
- ③ **We expect PM Kishida and his cabinet to maintain the existing policy mix, including fiscal and monetary policy.** If the economy will slow further owing to Covid-19 Omicron infections, the government will provide additional fiscal stimulus before the Upper House election in summer 2022.
- ④ **The current accommodative monetary policy of the BOJ will be maintained for the foreseeable future.** However, we should be cautious about the possibility of policy discussions aimed at normalizing the monetary policy because of the negative effects of rising prices and the yen's depreciation on households. In addition, since Governor Kuroda's term will end in April 2023, his resignation could be a turning point in the current accommodative monetary policy.

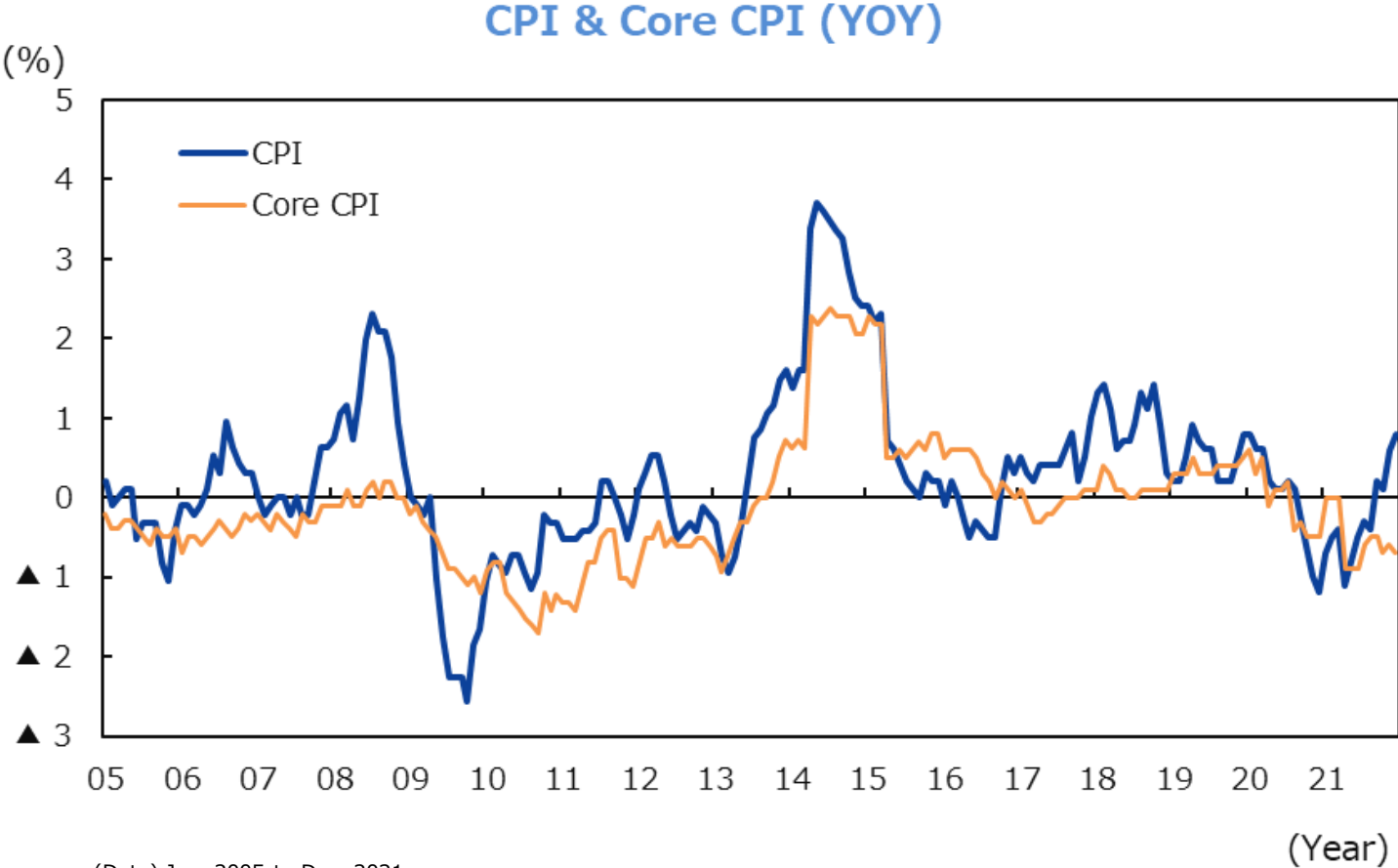
# Forecast table for Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY17	FY18	FY19	FY20	FY21 Est	FY22 Est	FY23 Est
Real GDP	1.8%	0.2%	-0.7%	-4.5%	2.5%	3.0%	1.2%
Private final consumption expenditure	1.0%	0.1%	-1.0%	-5.5%	2.2%	3.0%	1.0%
Private housing investment	-1.8%	-4.9%	2.6%	-7.8%	-0.6%	0.0%	0.1%
Private-sector capital investment	2.8%	1.2%	-0.6%	-7.5%	1.2%	3.8%	3.2%
Public fixed capital formation	0.6%	0.9%	1.6%	5.1%	-4.5%	1.0%	0.2%
Net export contribution	0.4%	-0.2%	-0.4%	-0.7%	1.0%	0.3%	0.1%
Exports of goods and services	6.3%	2.0%	-2.2%	-10.5%	12.1%	4.6%	4.2%
Imports of goods and services	3.8%	3.0%	0.2%	-6.6%	6.1%	3.0%	3.8%
Nominal GDP	2.0%	0.1%	0.2%	-3.9%	1.6%	3.3%	1.7%
GDP deflator	0.2%	-0.1%	0.8%	0.7%	-0.9%	0.3%	0.4%
Industrial Production Index	2.9%	0.3%	-3.7%	-9.9%	6.8%	4.9%	2.8%
Consumer Price Index (Core)	0.7%	0.8%	0.4%	-0.6%	0.1%	1.0%	0.8%
Domestic corporate goods price index	2.7%	2.2%	0.1%	-1.4%	6.8%	2.4%	0.2%
Employee compensation	2.0%	3.2%	2.0%	-1.5%	1.7%	1.8%	1.2%
Unemployment rate	2.7%	2.4%	2.4%	2.9%	2.8%	2.7%	2.6%
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

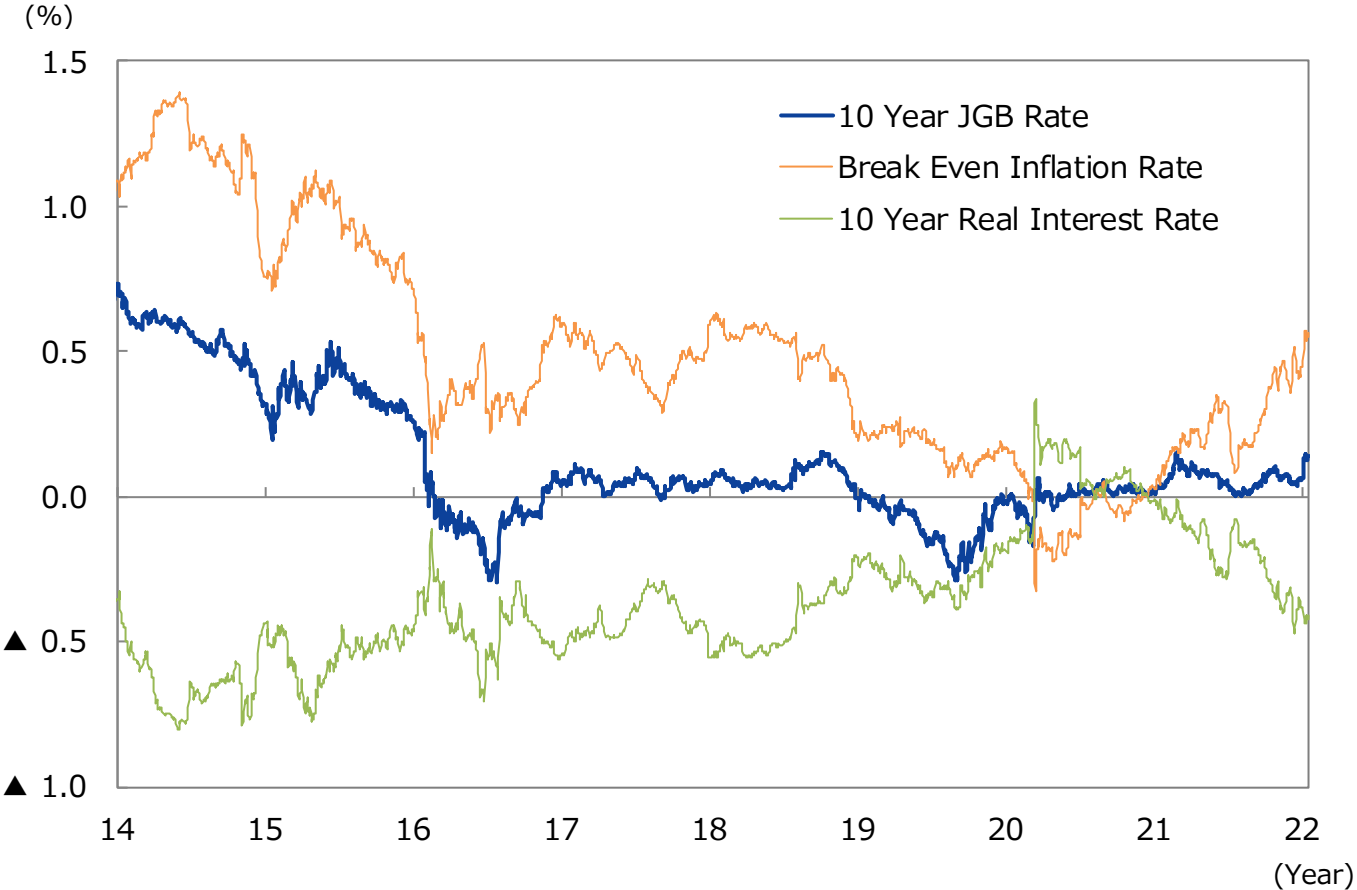
# Energy cost drives divergence between CPI & Core CPI



(Data) Jan. 2005 to Dec. 2021  
(Source) MIAC, Bloomberg, SMDAM

# Inflation expectations push real interest rate lower

## JGB, BEI, and Real Interest rate

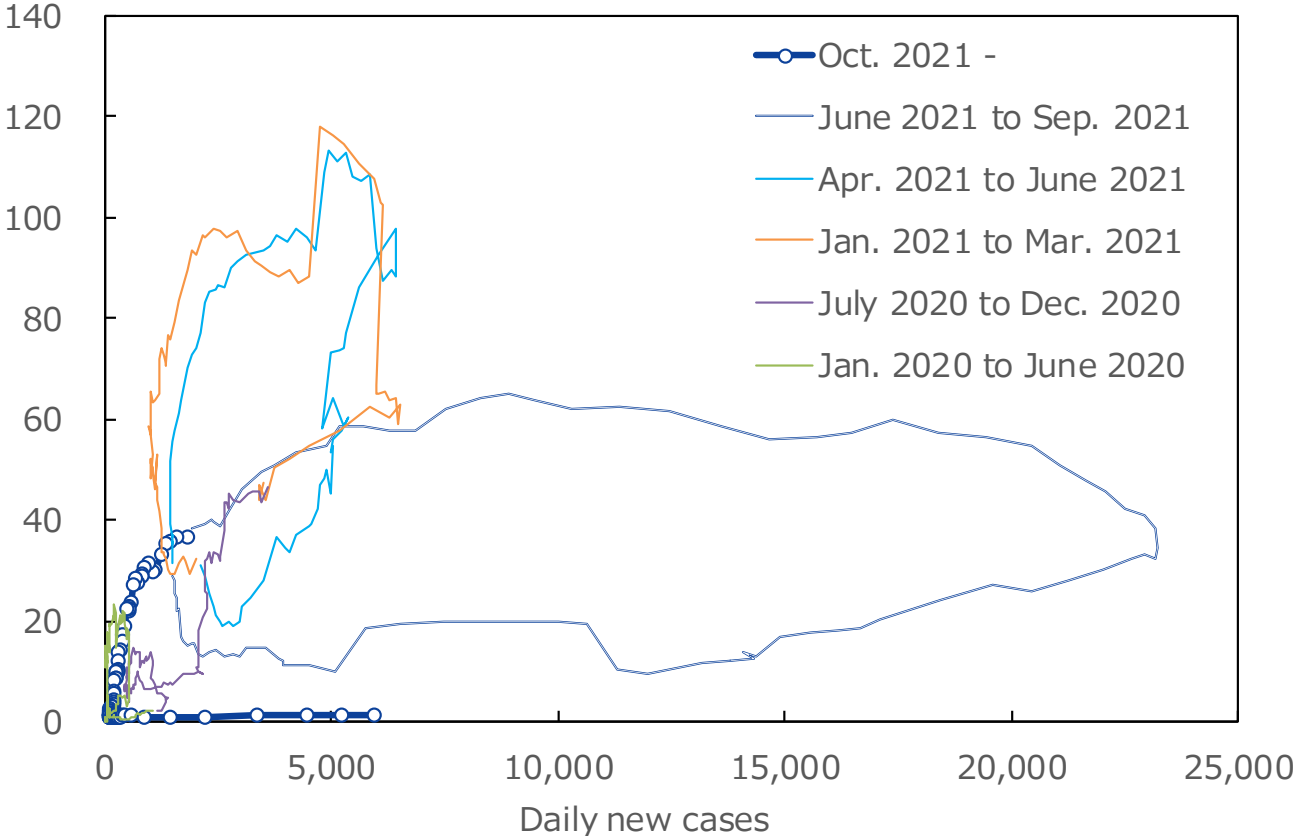


(Data) From Jan. 1st 2014 to Jan. 18th 2022  
(Source) Bloomberg, SMDAM

# New COVID infections rising sharply without increase of death

## COVID-19 New patients and confirmed deaths in Japan

Daily Death

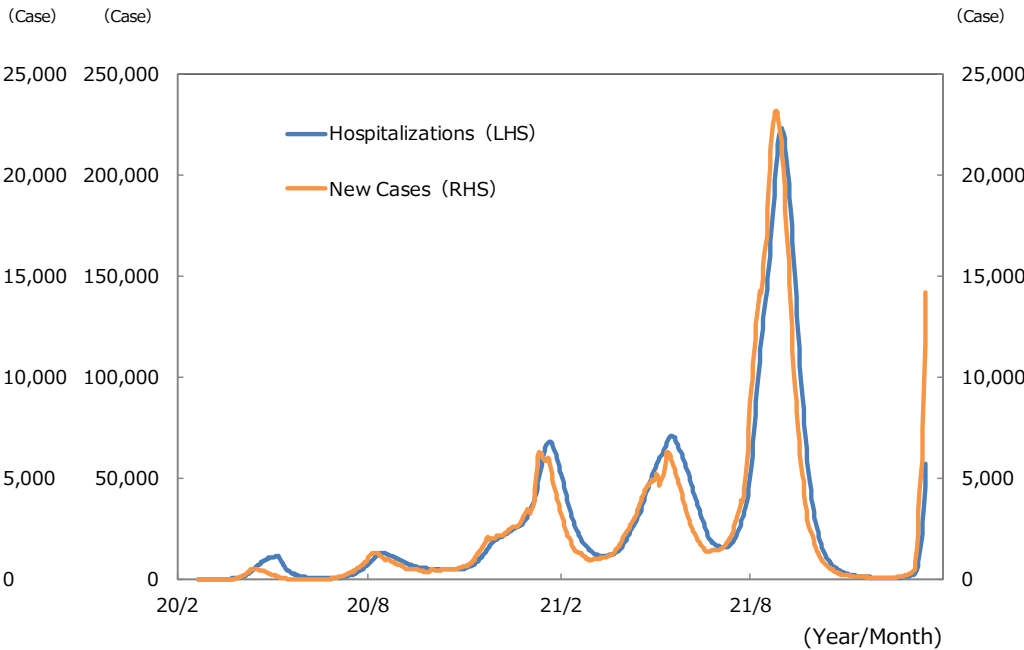
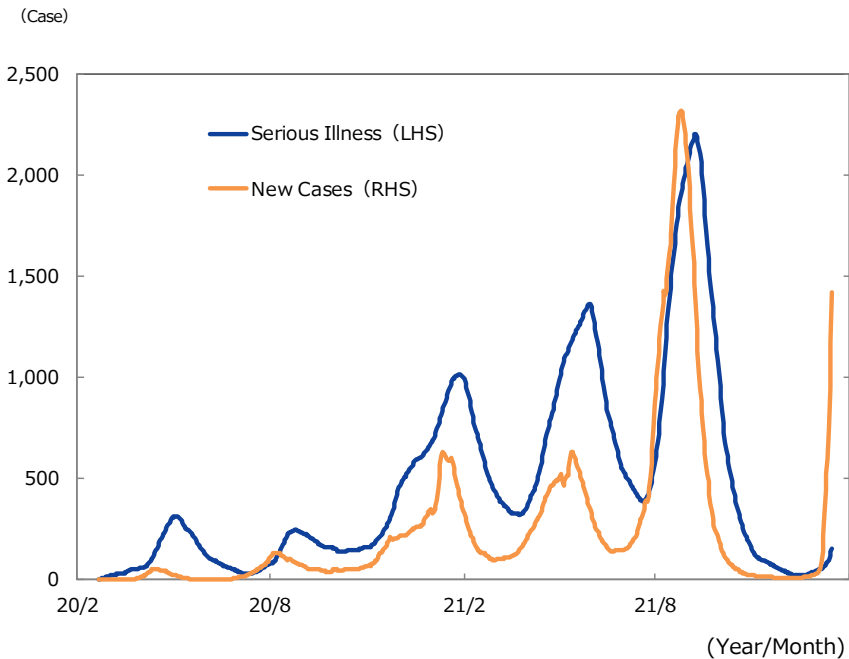


(Data) 7 days moving average, From Jan. 1st 2020 to Jan. 11th 2022  
(Source) Bloomberg, SMDAM

# Omicron causes big divergence between new cases and serious illness

### COVID-19 New Cases and Serious Illness

### COVID-19 New Cases and Hospitalizations

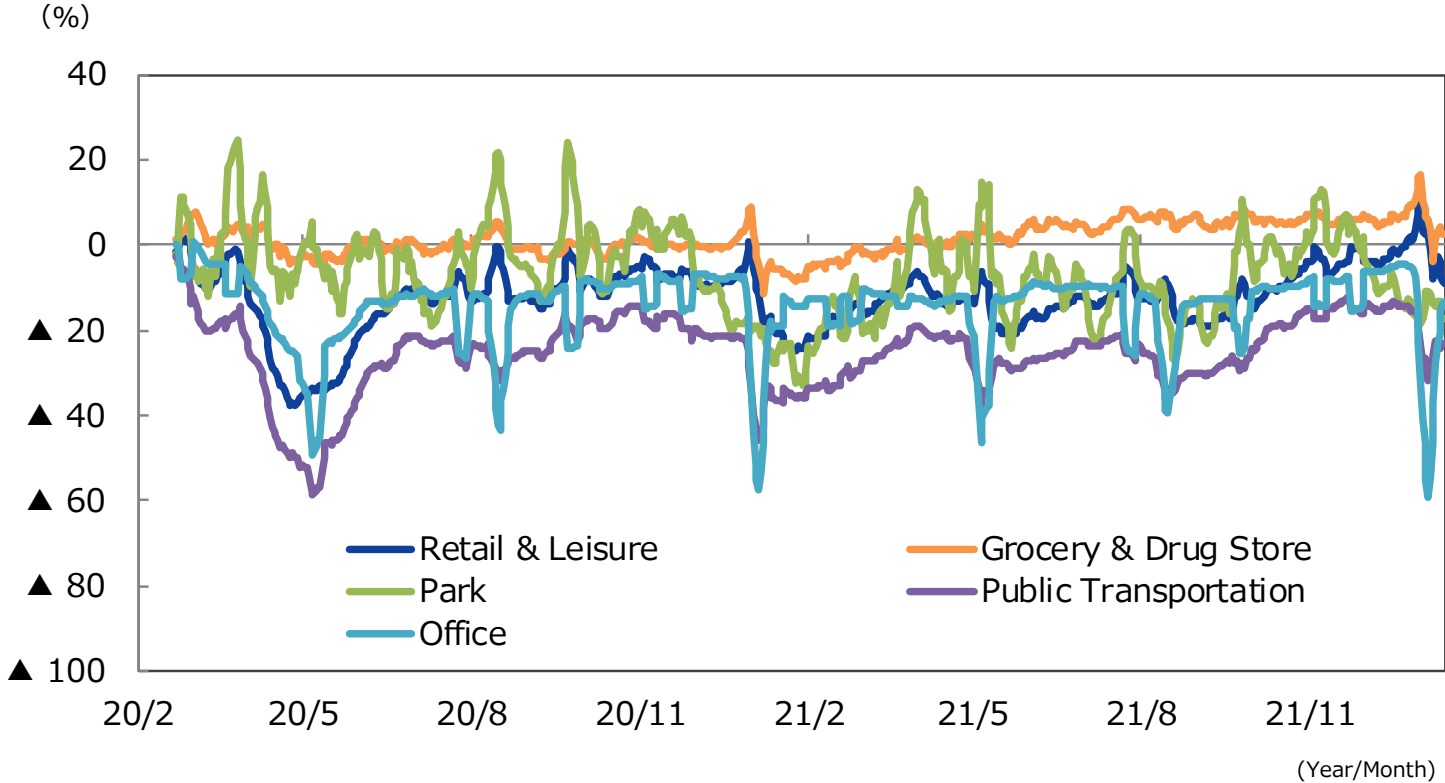


(Data) 7 days moving average. From Feb. 21st 2020 to Jan. 15<sup>th</sup> 2022  
(Source) MHLW, NHK, SMDAM



# Omicron hit mobility severely but short lived

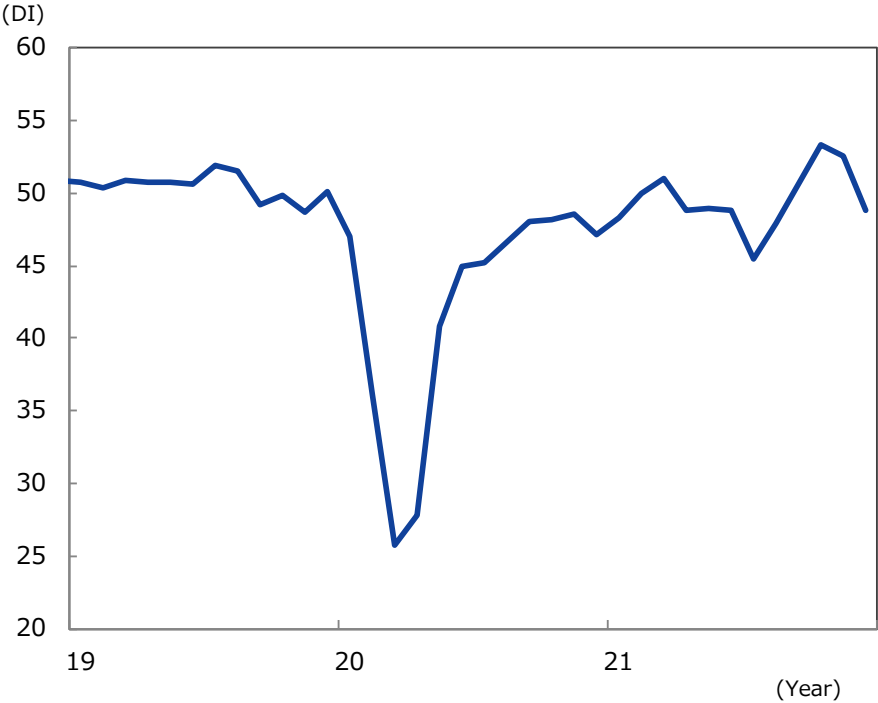
## Google Community Mobility Report, Japan



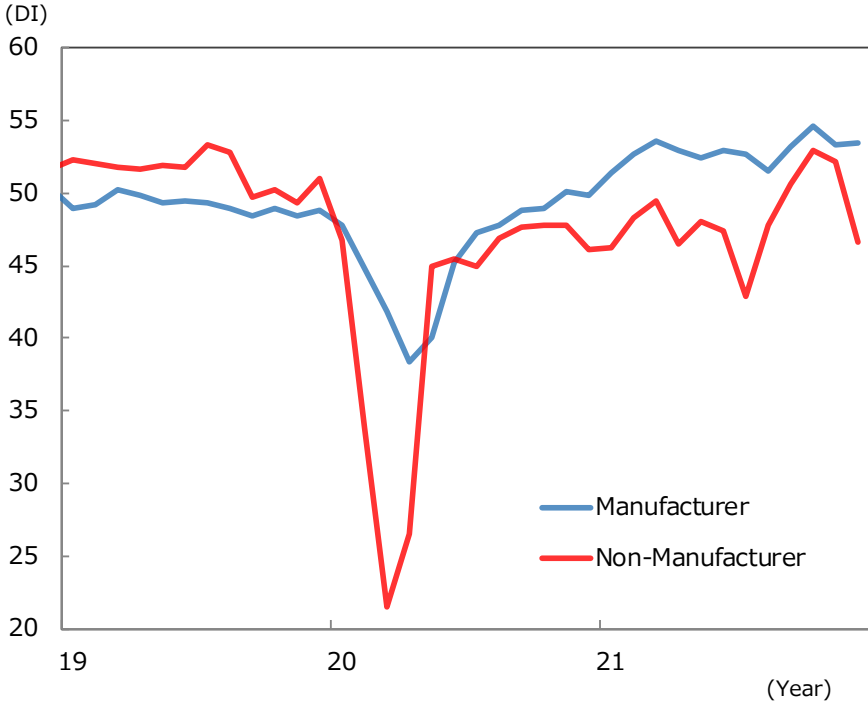
(Data) 7 Days moving average, From Feb. 21<sup>st</sup> 2020 to Jan. 13<sup>th</sup> 2022  
(Source) Google, SMDAM

# Omicron weighs on sentiment of non-manufacturers

### Composite PMI



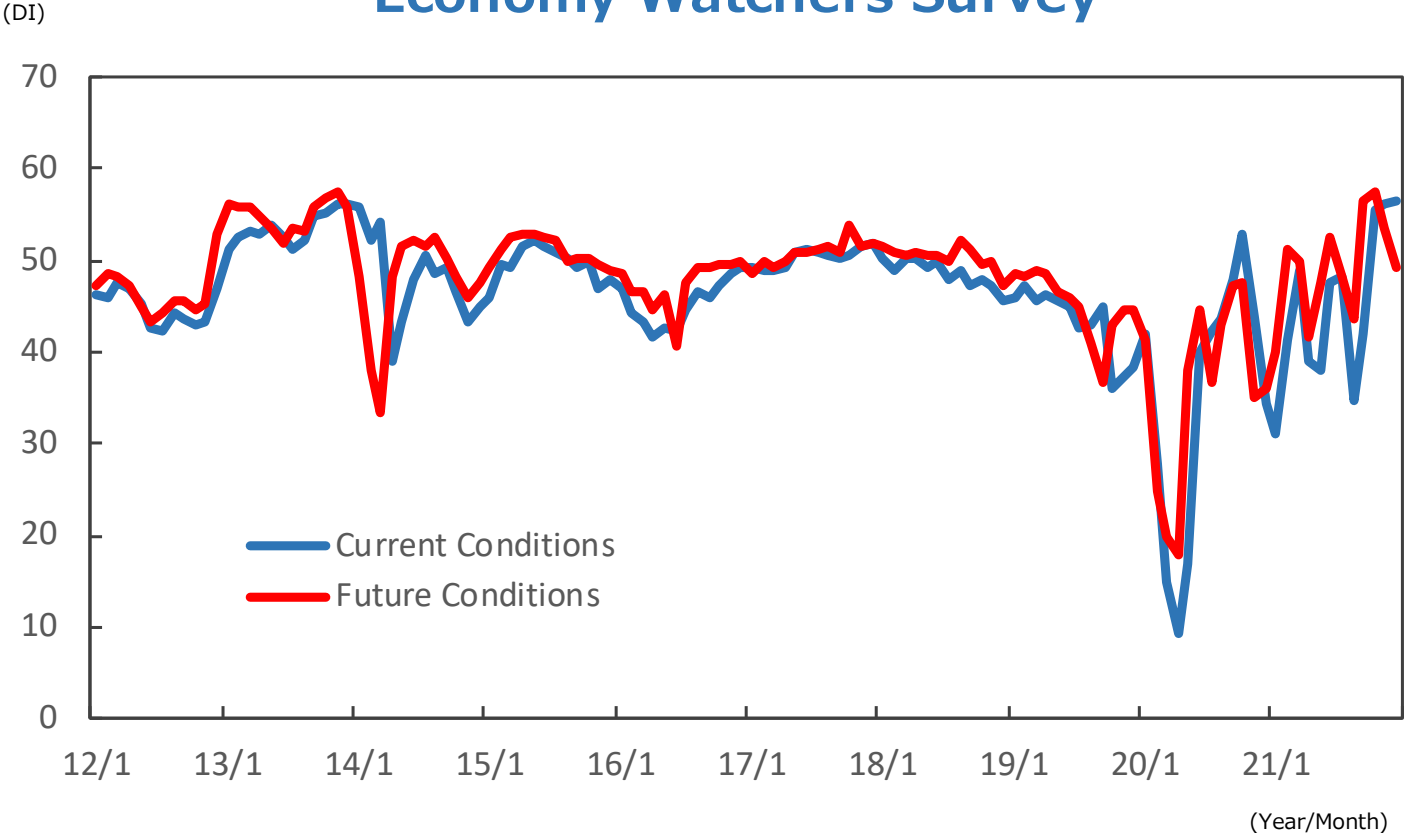
### PMI, Manufacturer & Non-Manufacturer



(Data) From Feb. 2019 to Jan. 2022  
(Source) Bloomberg, SMDAM

# Growing concern for consumer activities ahead

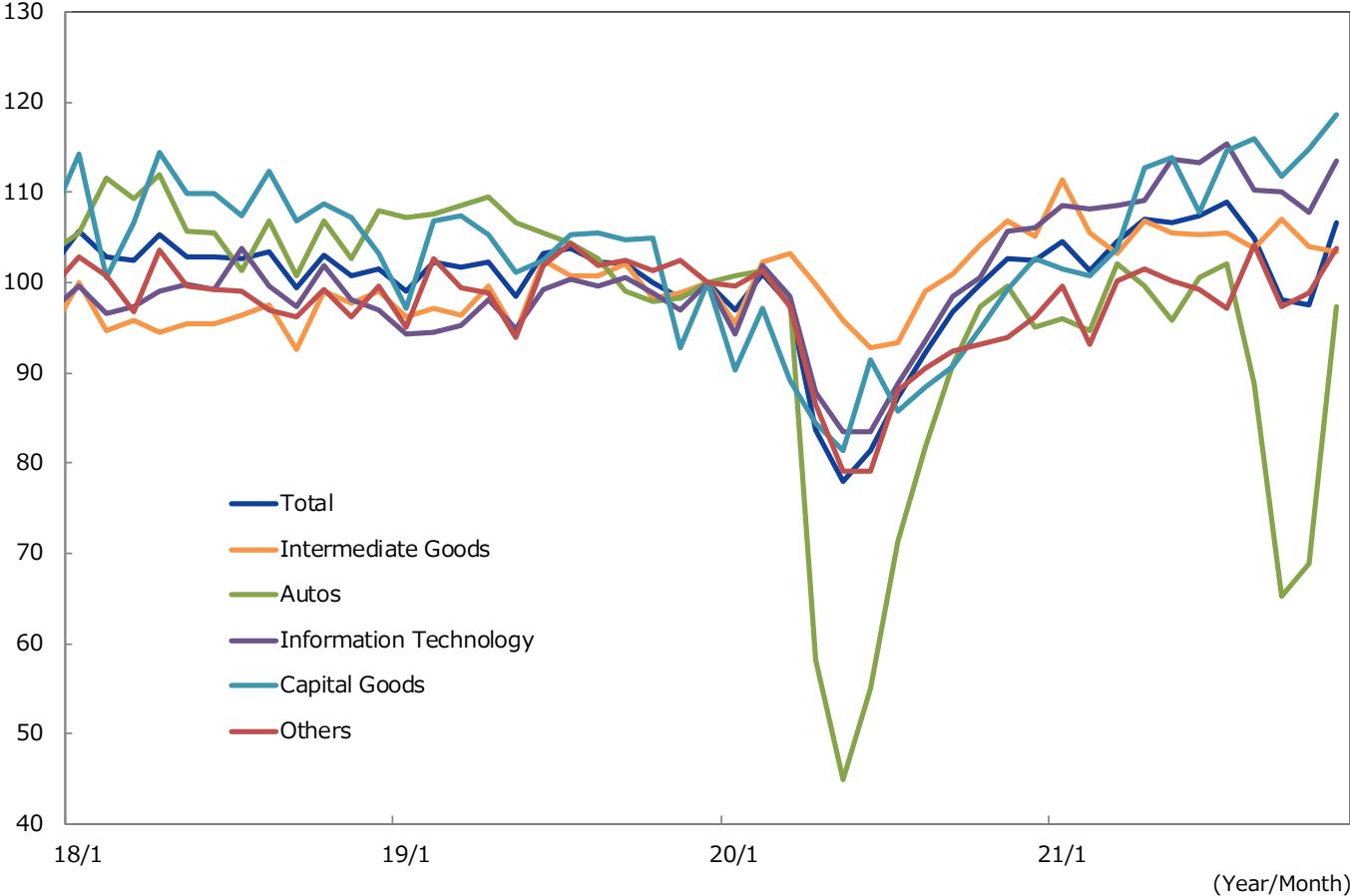
## Economy Watchers Survey



(Data) From Jan. 2012 to Dec. 2021  
(Source) Cabinet Office, SMDAM

# Auto exports coming back after shortage of semiconductor eases

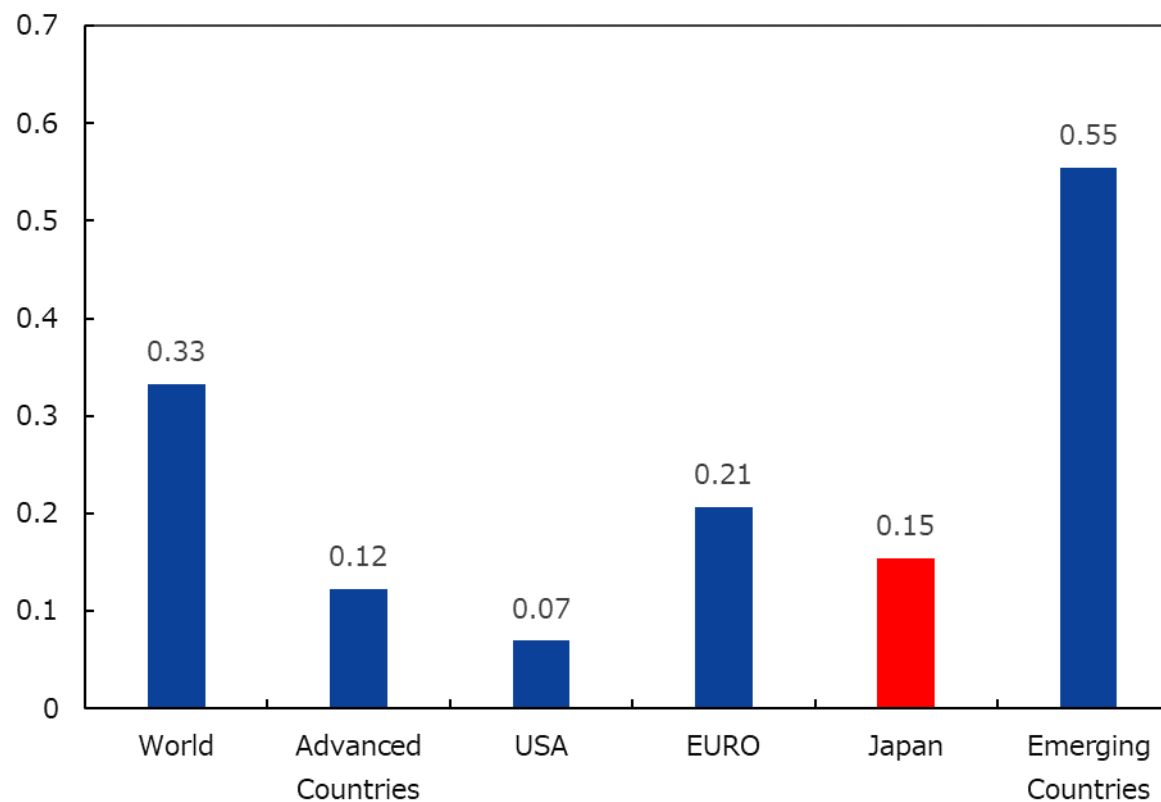
Real Export (Dec. 2019=100)



(Data) From Jan. 2018 to Nov. 2021  
(Source) Bank of Japan, SMDAM

# Slowing Chinese economy has limited impact on Japan

Elasticity Coefficient to Chinese Industrial Production



(Data) Estimate period is from Jan. 2015 to July 2021  
(Source) Centraal Bureau voor de Statistiek, SMDAM

# Economic stimulus – larger than anticipated

## Size of Economic Stimulus (Trillion Yen)

	Emergency Economic Measures for COVID-19 Infections	Second Supplementary Budget for FY 2020	Comprehensive Economic Measures for People's Lives and Livelihoods	New Economic Measures of PM Kishida Cabinet
<b>Date of Decision</b>	20/04/2020	27/05/2020	08/12/2020	<b>19/11/2021</b>
<b>Size of Stimulus</b>	117.1	117.1	73.6	<b>78.9</b>
<b>Fiscal Spending</b>	48.4	72.7	40.0	<b>55.7</b>
<b>Expenditure of Government</b>	35.8	33.2	32.3	<b>49.7</b>
<b>FILP</b>	12.5	39.3	7.7	<b>6.0</b>

(Source) SMDAM

# PM Kishida's economic policy – “growth and distribution”

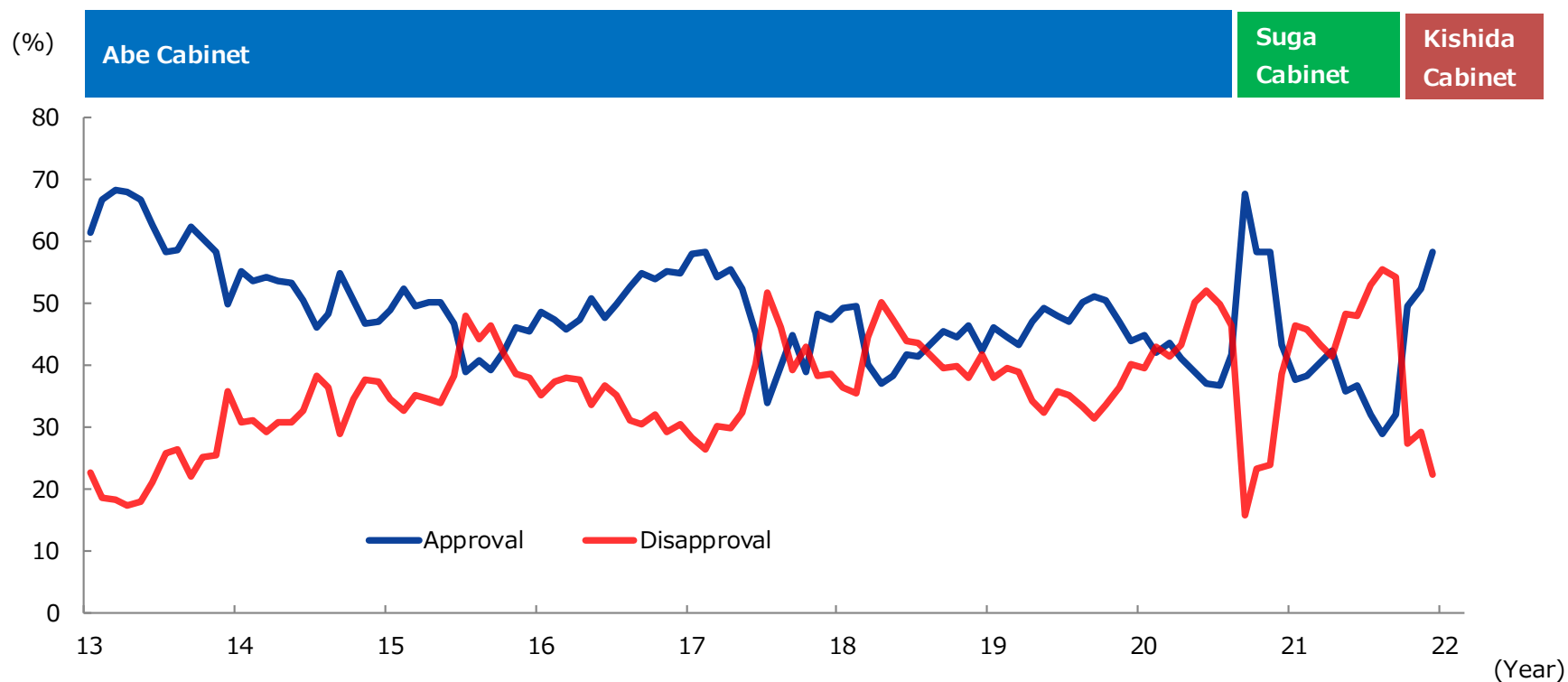
## Leader of Ruling LDP and His Economic Policy

Name	Fumio Kishida
<b>Political Career</b>	Former Political Chairman of LDP Former Chairman of the Diet Affairs Committee of LDP Former Minister of Defense Former Minister for Foreign Affairs
<b>Faction</b>	Kishida
<b>Policy overview</b>	<ul style="list-style-type: none"> <li>■ New Japanese-style capitalism based on the virtuous cycle of growth and distribution</li> <li>■ Transformation from Neoliberalism</li> </ul>
<b>Orientation of Economic Policy</b>	<ul style="list-style-type: none"> <li>■ Rectifying Economic Disparities</li> </ul>
<b>Economic Policy</b>	<ul style="list-style-type: none"> <li>■ "Growth Strategy with Four Tactics"                             <ul style="list-style-type: none"> <li>▪ Science &amp; Technology Nation (10 trillion yen university endowment fund)</li> <li>▪ Economical National Security (promote free and reliable data flow)</li> <li>▪ Digital Rural City-State Vision (early rollout of 5G)</li> <li>▪ Support for Aging Society (universal social insurance)</li> </ul> </li> <li>■ Income Doubling &amp; Distribution-Oriented Policy</li> </ul>

(Source) SMDAM

# Approval rate of PM Kishida - so far so good

## Cabinet approval rate



(Data) From Jan. 2013 to Dec. 2021

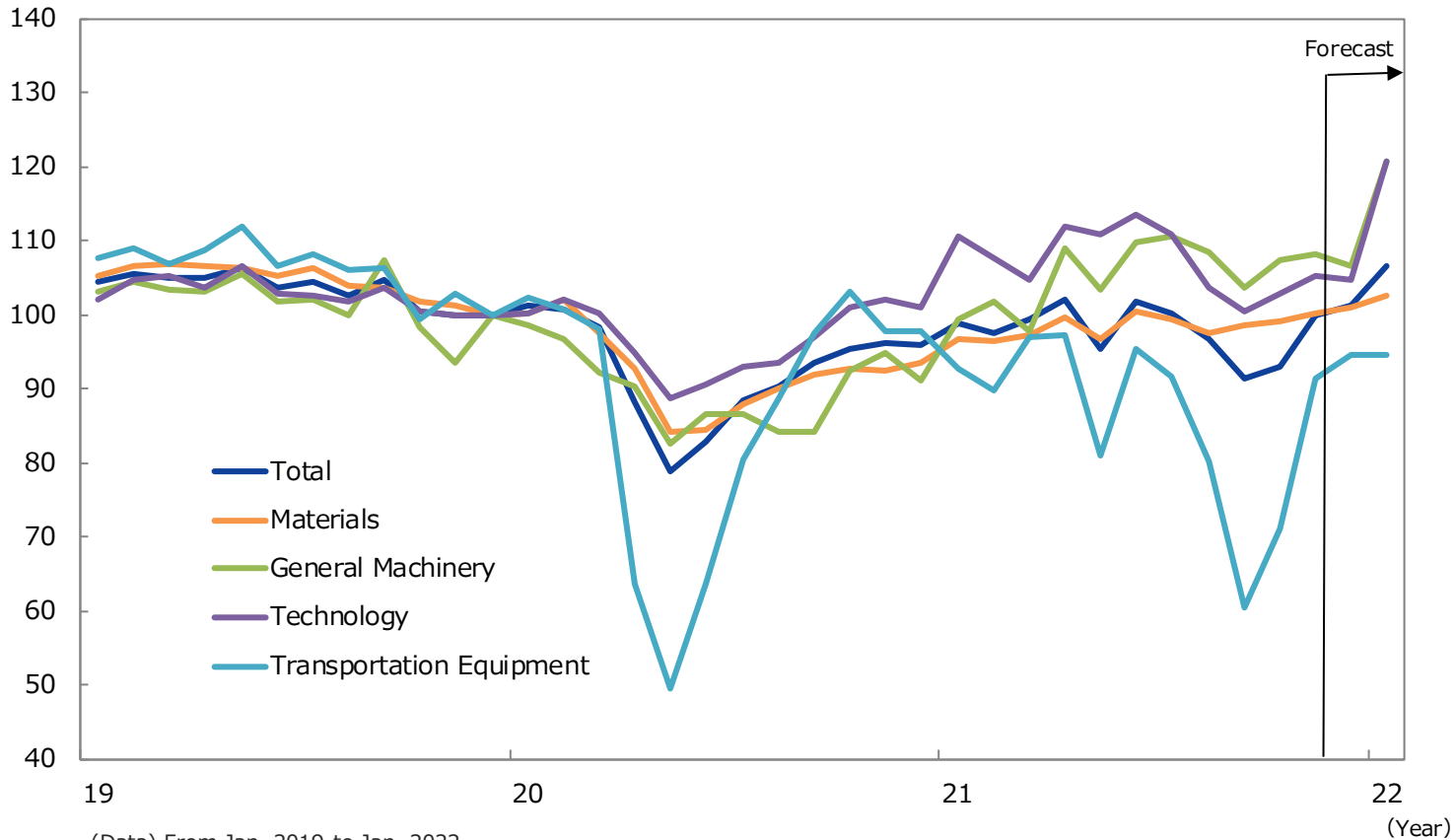
(Source) NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM



# Tech accelerating production, while Autos losing momentum

## Industrial Production (Monthly)

(Dec. 2019 = 100)

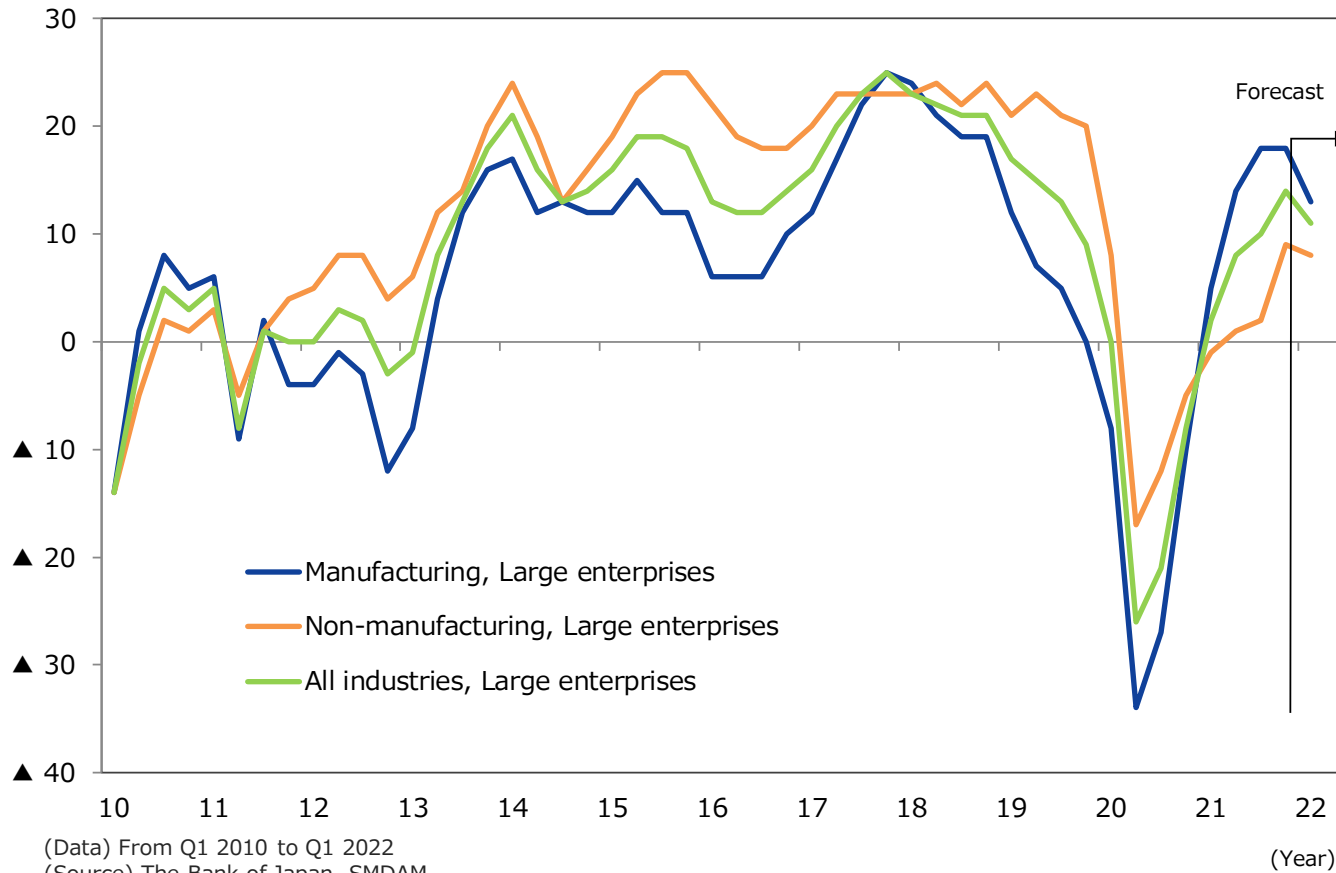


(Data) From Jan. 2019 to Jan. 2022  
(Source) METI, SMDAM

# Japanese companies see bumpy outlook ahead

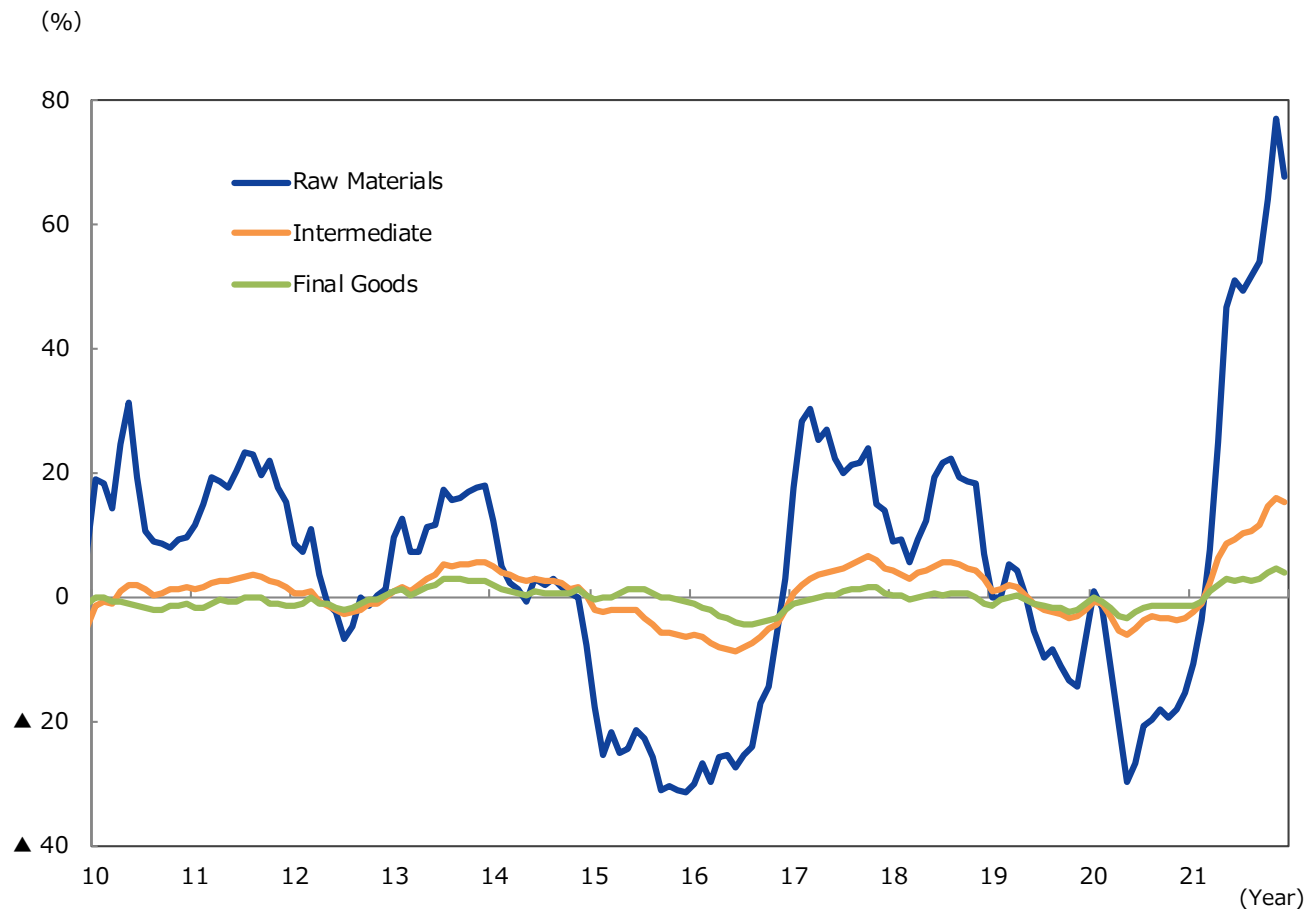
## Bank of Japan "Tankan" Economic Survey (Large Enterprises)

(DI, "Good"- "Bad")



# Japanese companies facing margin squeeze

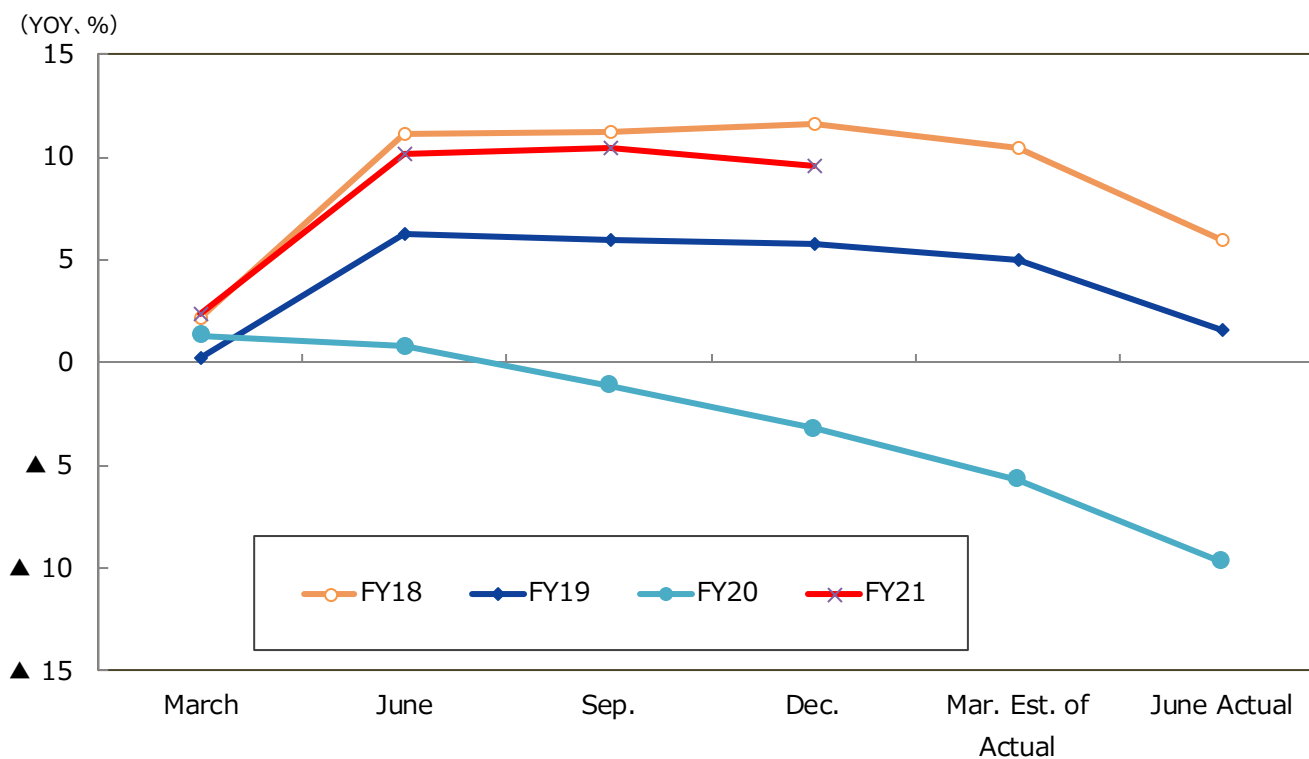
## Corporate Price Index (YOY)



(Data) From Jan. 2010 to Dec. 2021  
(Source) The Bank of Japan, SMDAM

# Japanese companies cutting size of CAPEX slightly

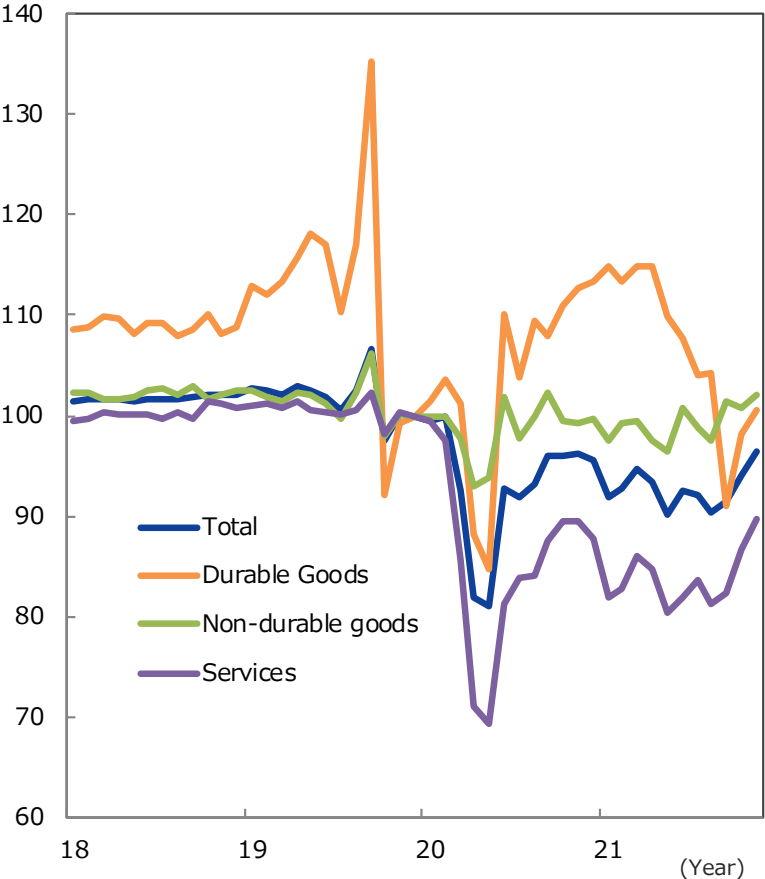
## Plan of CAPEX, Inc. Software, Ex. Land and R&D



(Source) The Bank of Japan, SMDAM

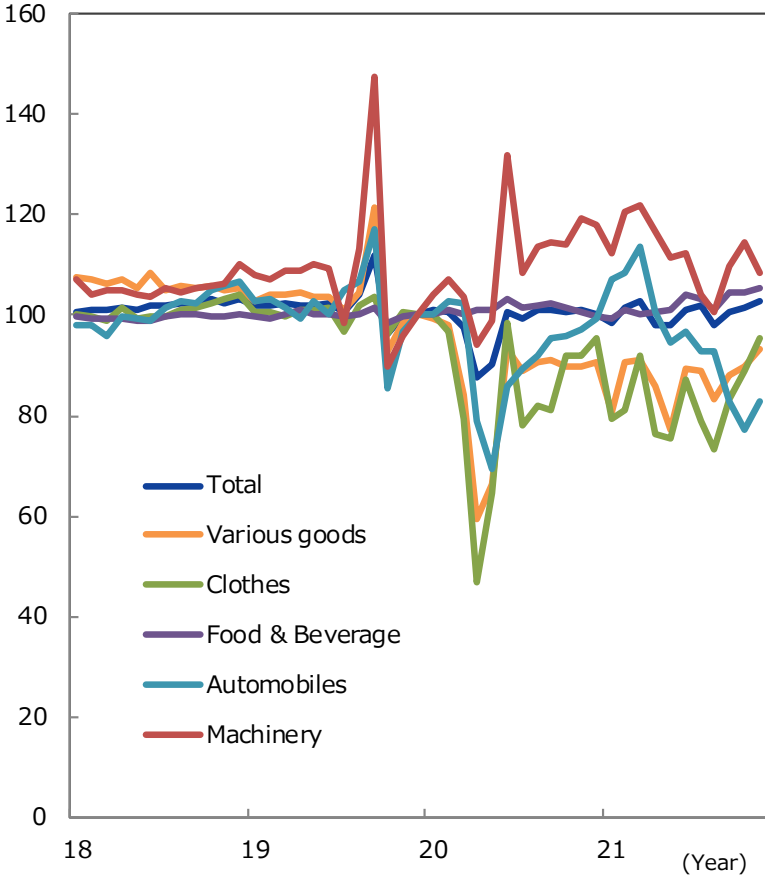
# Consumer activities picking up including autos

Consumer Activity Index (Dec. 2019 = 100)



(Data) From Jan. 2018 to Nov. 2021  
 (Source) BOJ, METI, and SMDAM

Retail Sales (Dec. 2019 = 100)



# Schedule of major events

2022	February	15	Release of CY 2021 Q4 GDP
	March	9 17-18	Revision of CY 2021 Q4 GDP Monetary Policy Meeting Establish Initial Budget of FY 2022
	Spring		Release of Grand Design of "New Capitalism Realization Conference"
	April	27-28	Monetary Policy Meeting
	May	mid	Release of CY 2022 Q1 GDP
	Summer		Release of Execution Plans and Schedules of "New Capitalism Realization Conference"
	June	8 15 16-17	Revision of CY 2022 Q1 GDP End of Ordinary Diet Session Monetary Policy Meeting Cabinet Decision on Bold Economic Policy and Growth Strategy G7 Summit in Germany
	July	20-21 23 25	Monetary Policy Meeting End of the Term of two members of the BOJ Monetary Policy Committee End of the Term of House of Councilors
	August	mid	Release of CY 2022 Q2 GDP
	September	early 21-22	Revision of CY 2022 Q2 GDP Monetary Policy Meeting Change of Top Party Officials of LDP
	October	27-28 30	Monetary Policy Meeting G20 Summit in Indonesia
	November	mid	Release of CY 2022 Q3 GDP
	December	early 19-20	Revision of CY 2022 Q3 GDP Monetary Policy Meeting Outline of Tax Reform of FY 2023 Cabinet Decision on the Budget of FY 2023

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

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