



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

Hisashi Shiraki
Chief Global Strategist

-June 2023-

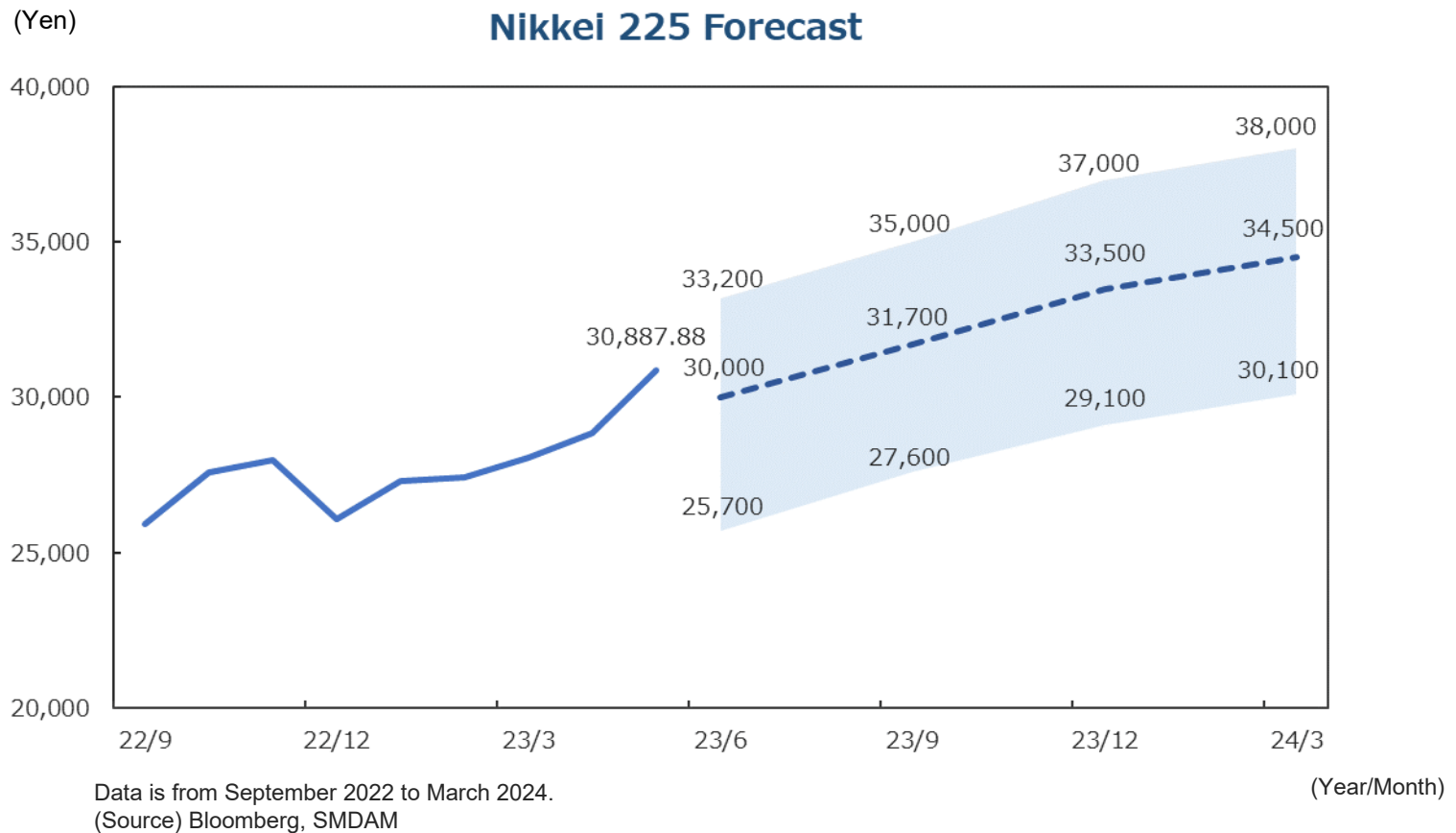


Outlook for Japanese Stock Market

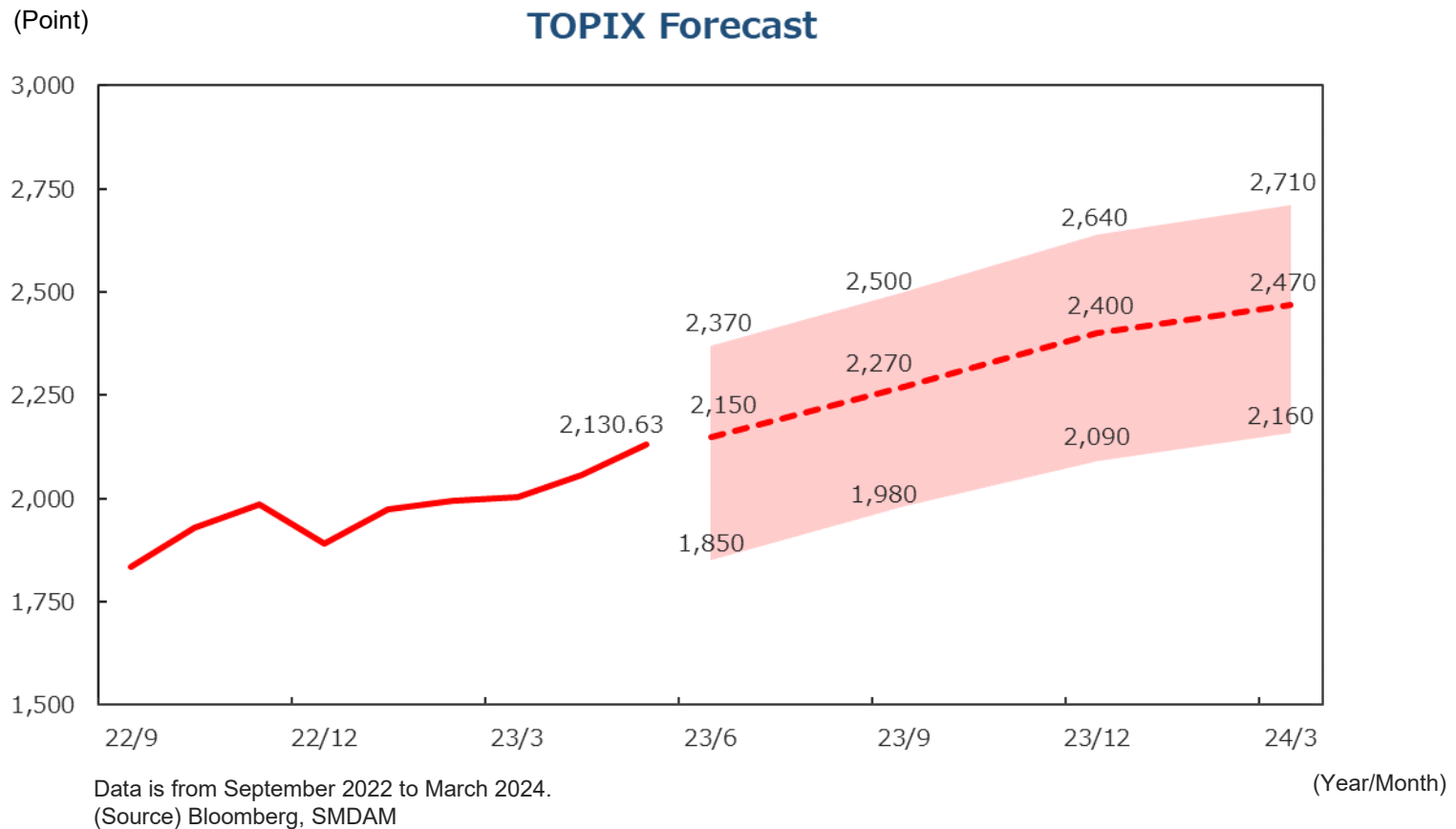
Market Outlook

- We are bullish on the Japanese equity market going forward thanks to the recovery in domestic demand and the normalization of the Chinese economy after the lockdown of “Zero- COVID policy”.
- We expect the market will gain steam with lower volatility after confirming the peak of FED tightening and the trough of the global economic cycle.
- We have maintained our TOPIX price target at 2,470 and that of Nikkei 225 at 34,500 as of the end of March 2024.
- Growing expectation for “the end to deflation” with moderate inflation and rising wages will provide a boost to the Japanese stock market going forward.

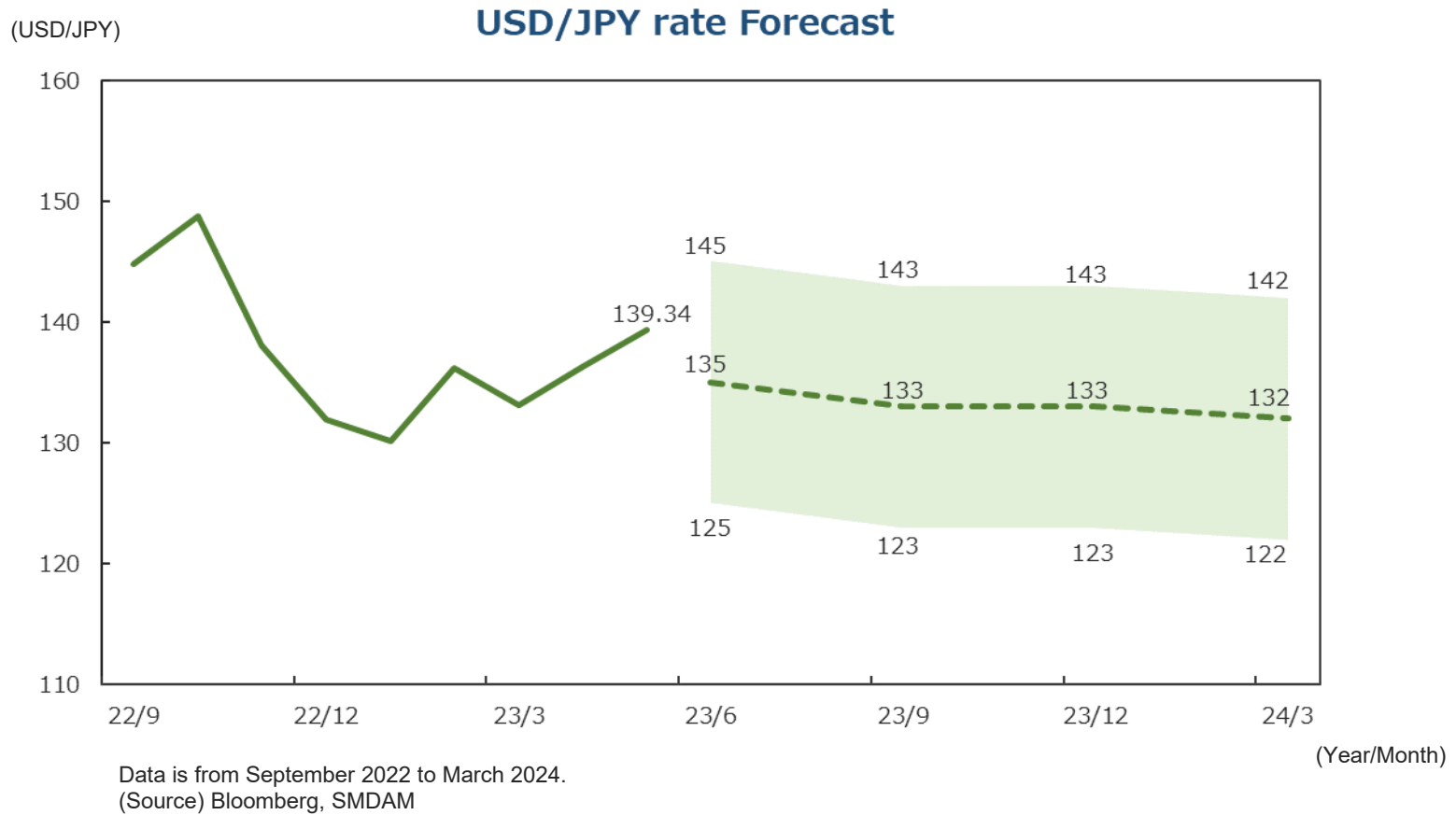
Domestic demand and Chinese recovery to boost equities



Domestic demand and Chinese recovery to boost equities



Upcoming FED pivot to weigh on USD/JPY going forward



Upside / Downside risk scenarios

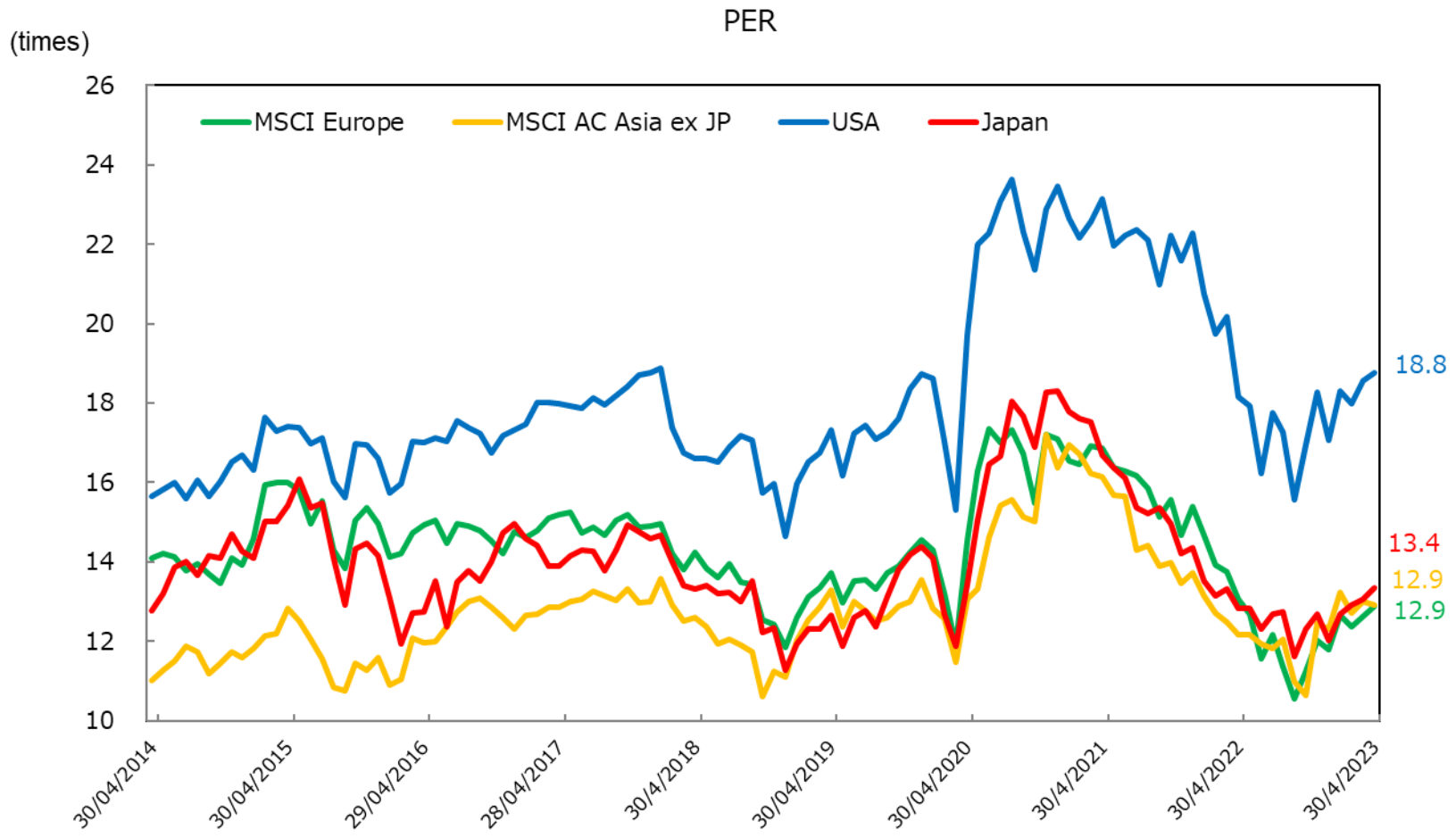
■ Upside Risks

- FED pivot and monetary easing
- Virtuous cycle between mild inflation and wage increase

■ Downside Risks

- Excessive JPY appreciation and negative impact on corporate earnings
- Renewed concern for global financial turmoil
- Prolonged stagnation of the global economy

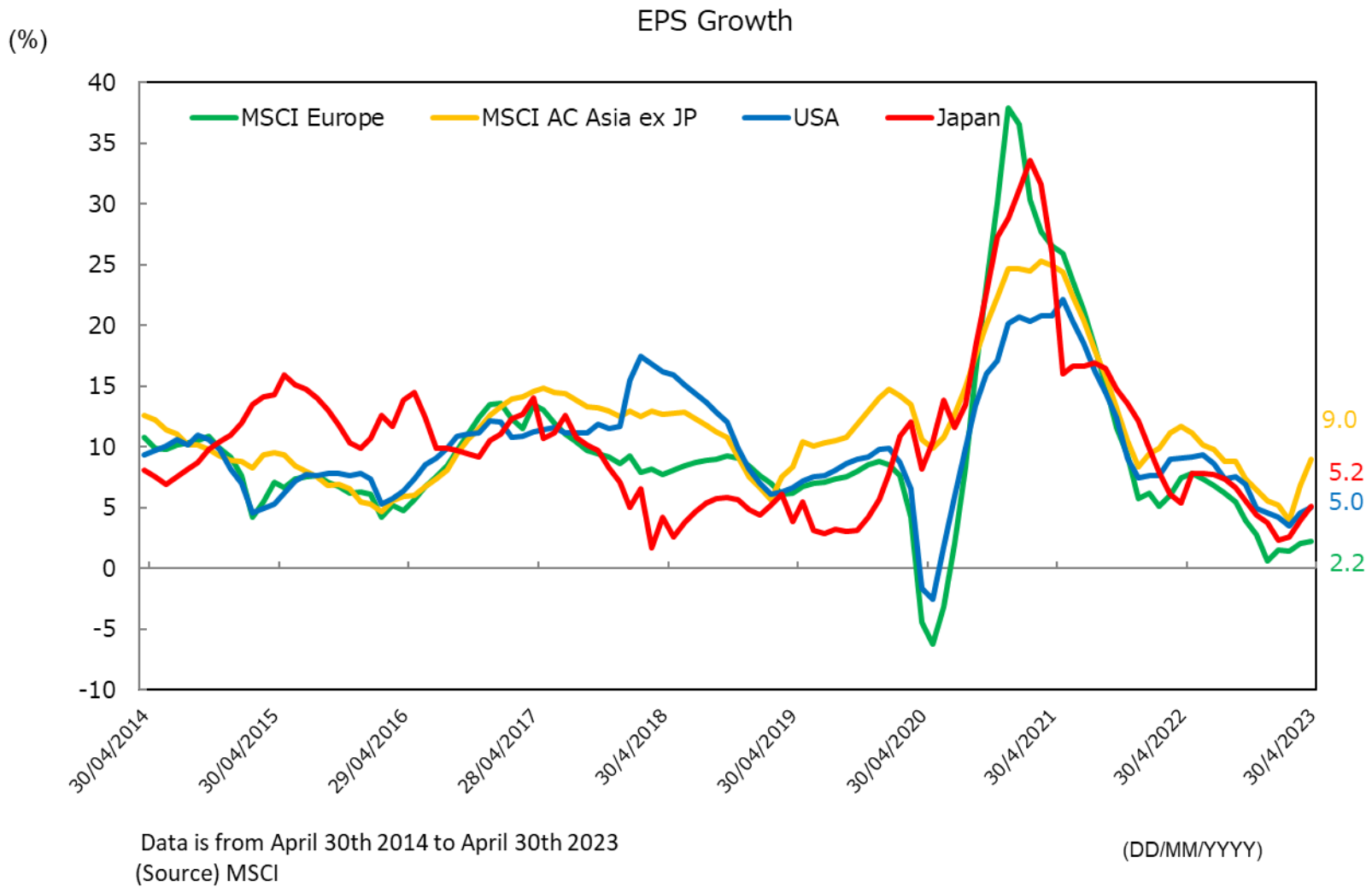
PERs expanding gradually with falling bond yields



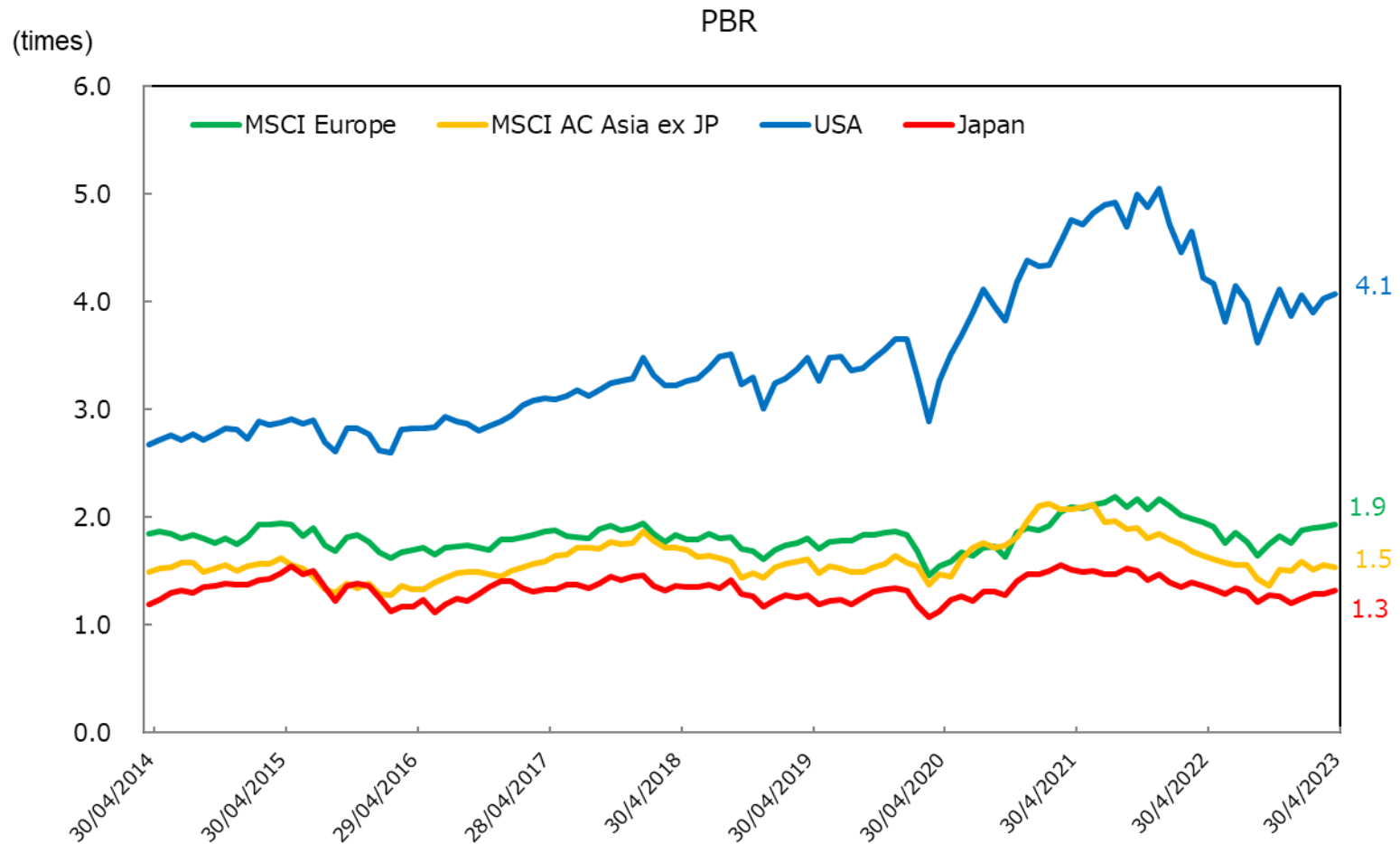
Data is from April 30th 2014 to April 30th 2023
(Source) MSCI

(DD/MM/YYYY)

Earnings outlook getting brighter



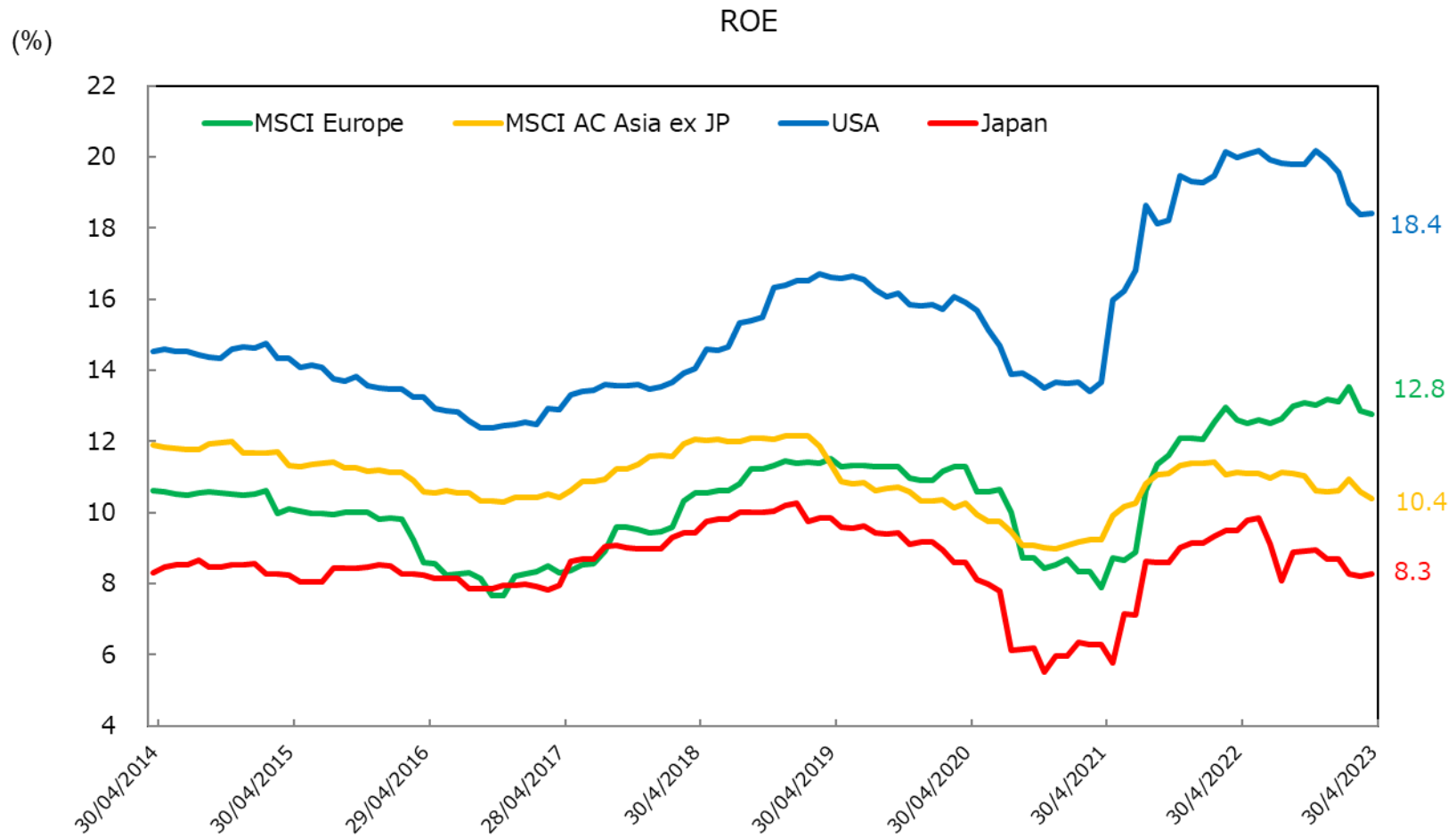
Mounting pressure on Japanese companies to raise PBR



Data is from April 30th 2014 to April 30th 2023
(Source) MSCI

(DD/MM/YYYY)

Lackluster global economy weighing on Japan's ROE

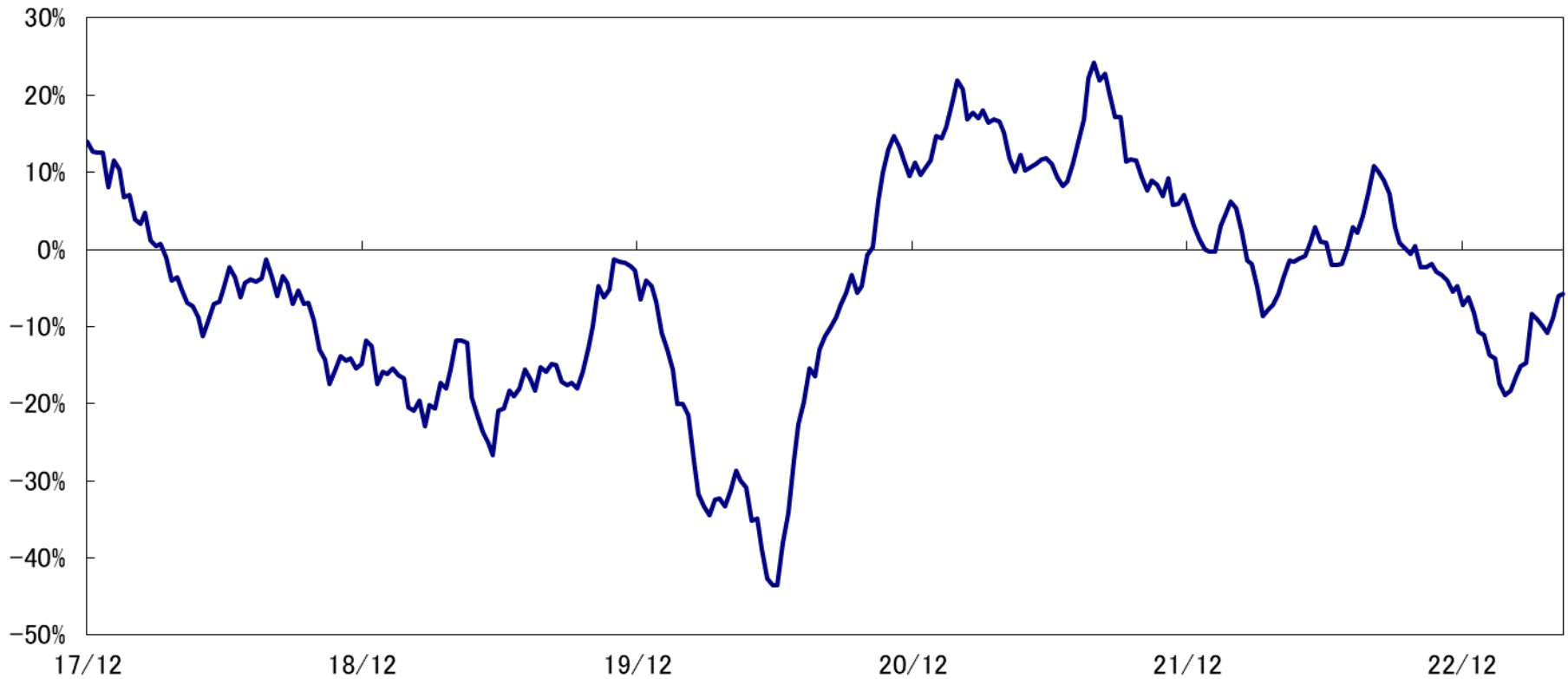


Data is from April 30th 2014 to April 30th 2023
 (Source) MSCI

(DD/MM/YYYY)

Re-opening halts EPS revision falling

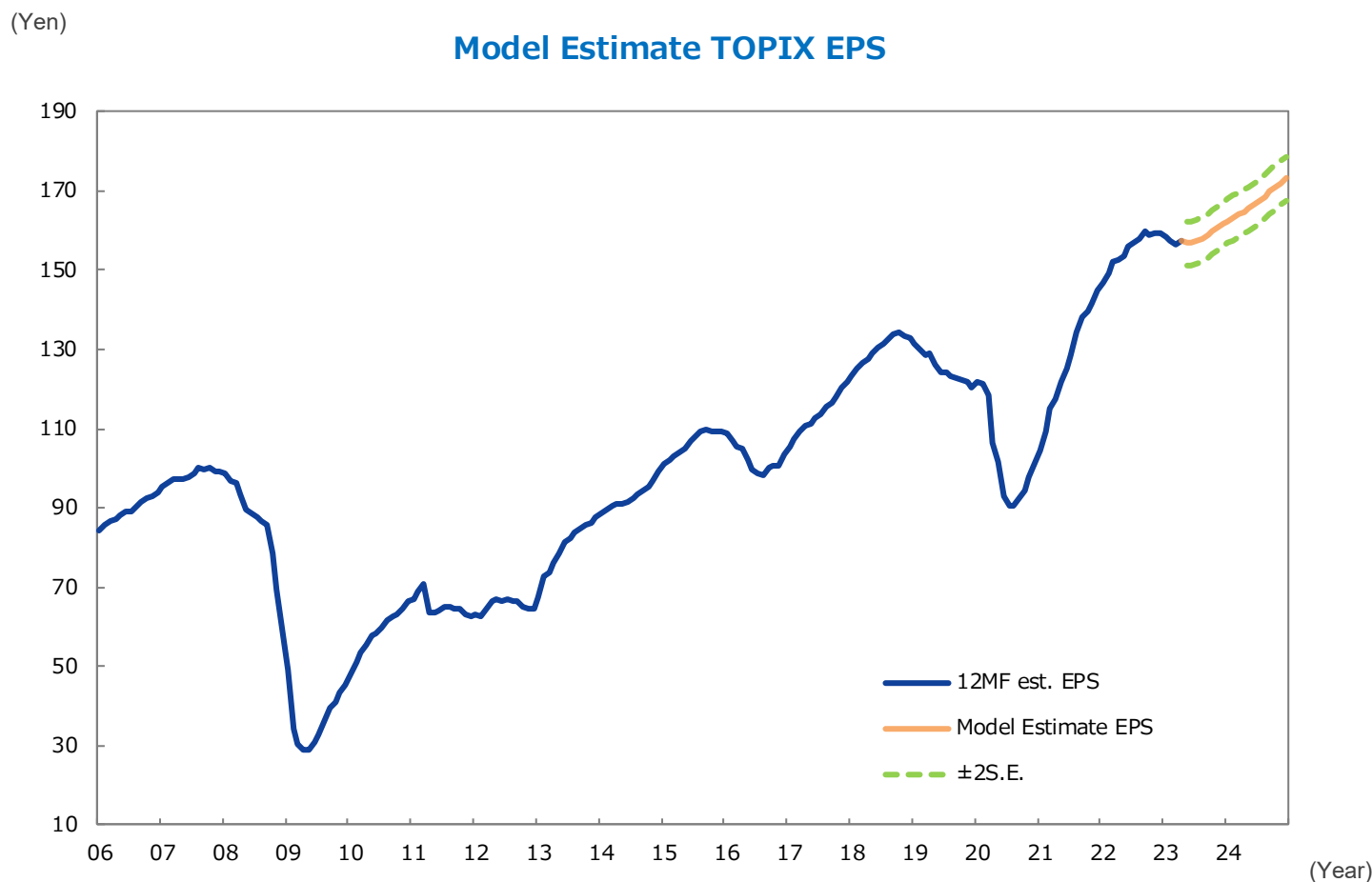
TOPIX Revision Index



Data is from December 28th 2017 to May 11th 2023
(Source) Datastream, IBES

(YY/MM)

Quant model indicates EPS to start recovering going forward

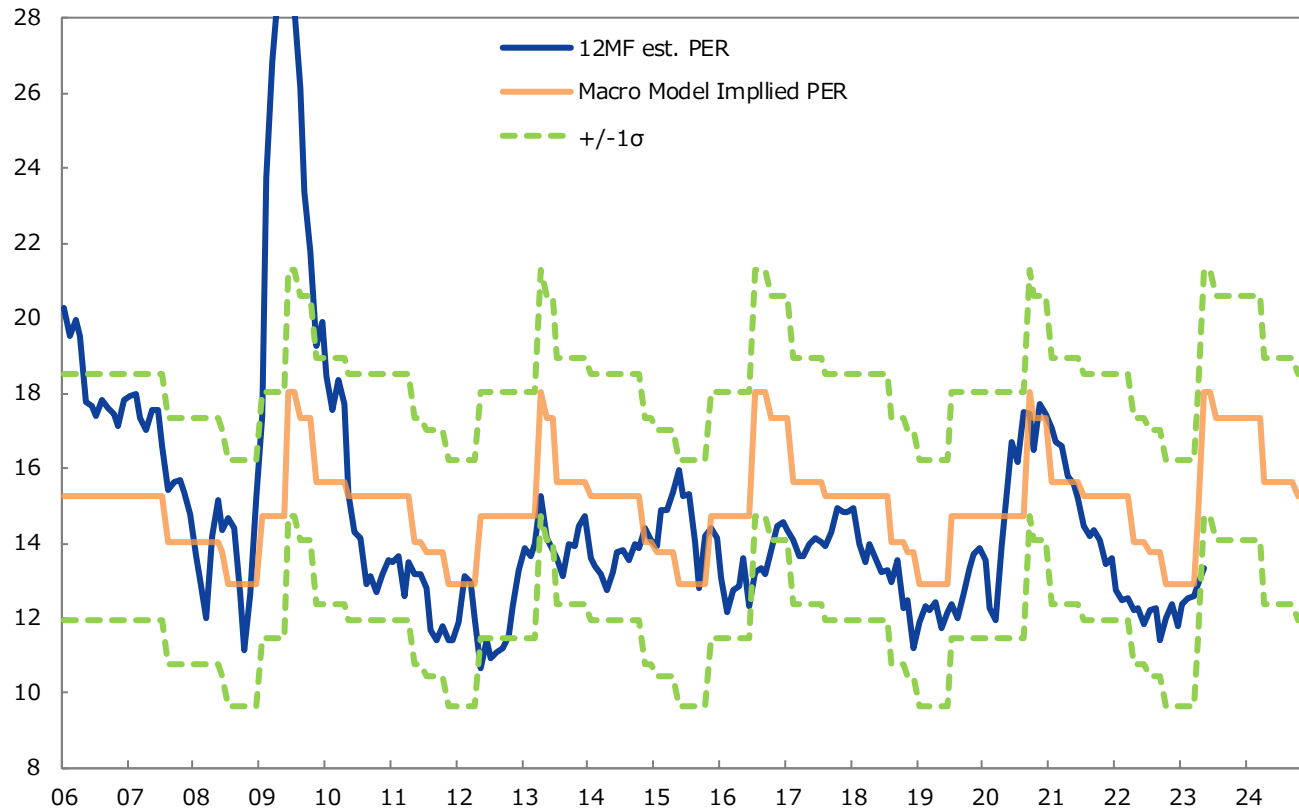


Note: Consensus data is from January 2006 to April 2023. Model estimate Data is from May 2023 to December 2024.
Source: SMDAM

Model indicates PER to rebound from rock bottom

(Times)

Macro Model Implied TOPIX PER

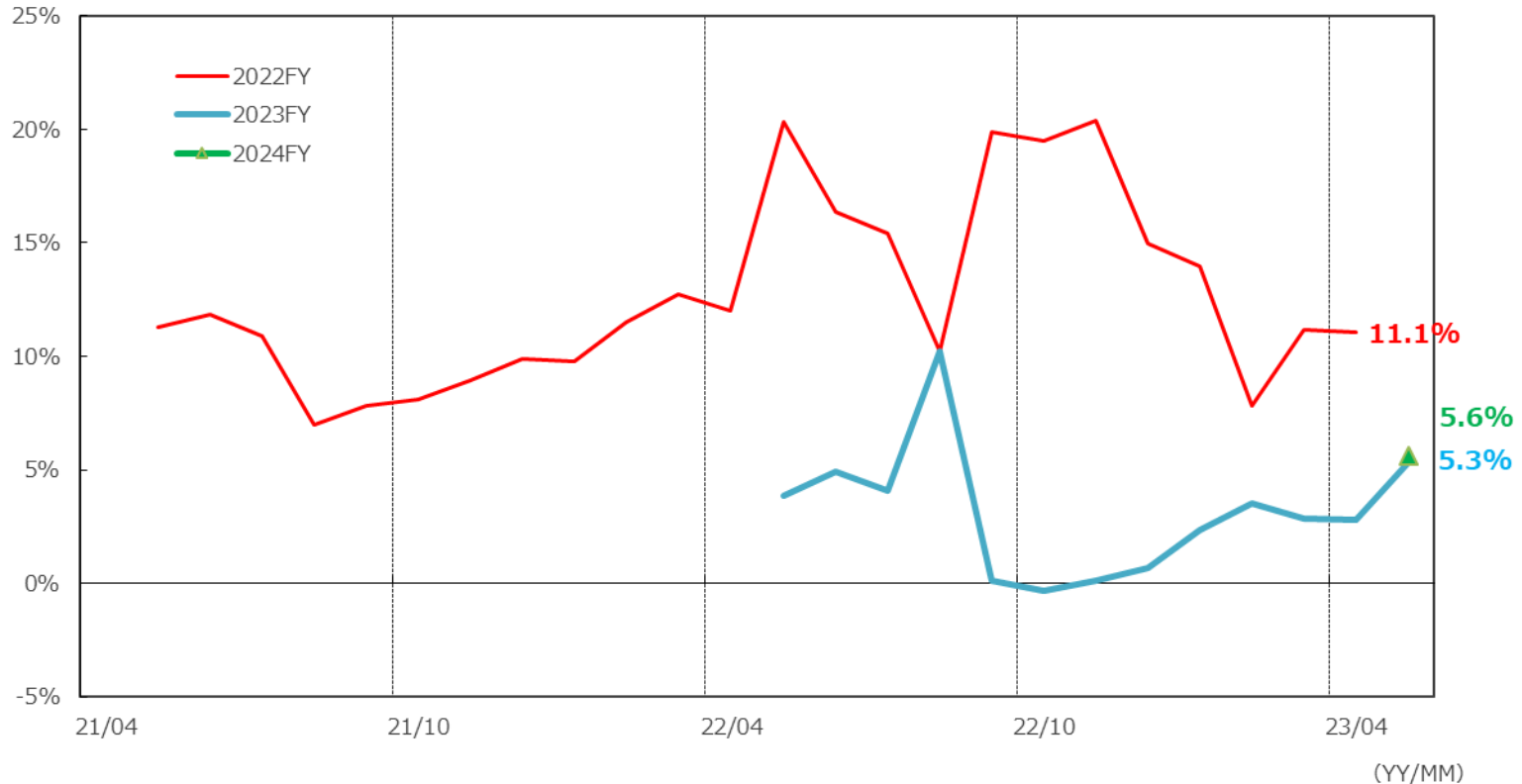


(Year)

Note: Consensus data is from January 2006 to April 2023,
Model estimate Data is from May 2023 to December 2024.
Source: SMDAM

Earnings outlook getting brighter

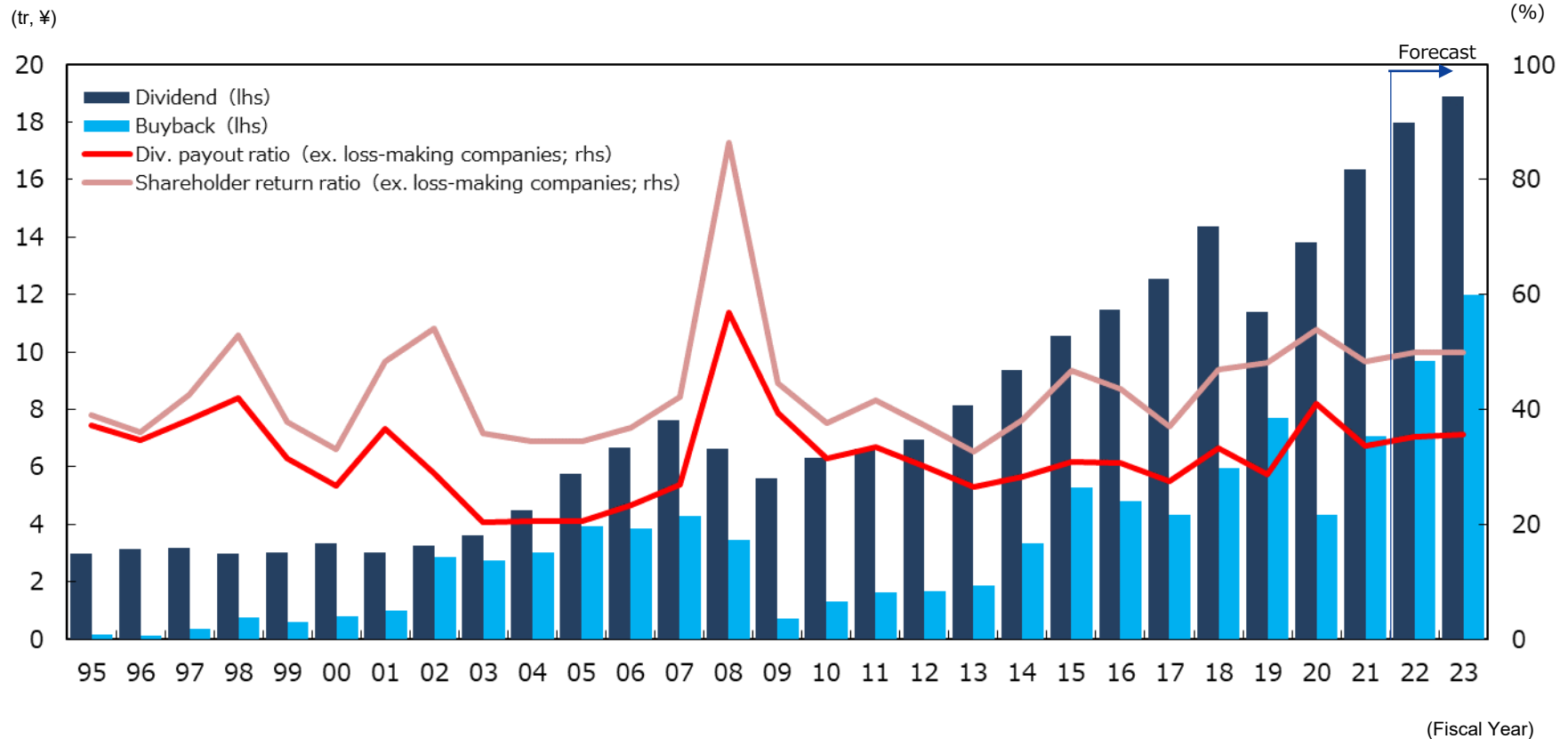
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th May 2023, SMDAM Core Universe (Excl. Financials) consists of 408 Japanese companies covered by SMDAM in-house analysts.
 Source: SMDAM

Dividends and buybacks continue to rise beyond 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

Big swing from Value to Large Cap Growth

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	8.61	9.96	14.47	16.18	13.99	45.89	20.15
Total Value	5.84	11.32	12.38	17.27	21.48	58.36	13.54
Top Cap Value	6.09	12.35	12.89	18.68	27.24	72.12	29.11
Large Cap Value	5.51	11.33	12.45	16.66	22.78	62.19	16.85
Mid Cap Value	4.73	9.99	11.87	14.03	17.27	49.99	1.18
Small Cap Value	7.33	11.26	12.10	19.91	15.84	42.11	-0.44
Micro Cap Value	5.93	10.53	10.94	20.41	17.18	37.79	-0.76
Total Growth	11.31	8.73	16.48	15.26	7.77	33.58	25.45
Top Cap Growth	12.28	10.21	19.01	14.28	9.57	39.29	35.39
Large Cap Growth	12.12	9.56	17.77	15.72	8.63	35.58	29.24
Mid Cap Growth	11.82	8.37	15.54	18.38	7.07	29.63	19.92
Small Cap Growth	5.12	2.42	6.87	11.85	0.72	17.56	-1.08
Micro Cap Growth	1.33	0.15	3.84	11.05	-3.80	16.09	-2.10
Top Cap Total	9.54	11.12	16.30	16.22	16.69	53.03	31.60
Large Cap Total	8.98	10.37	15.26	16.11	14.70	48.07	23.87
Mid Cap Total	8.10	9.19	13.64	15.92	11.87	41.22	13.23
Small Cap Total	6.46	7.66	10.02	16.55	9.44	32.81	0.21
Micro Cap Total	4.39	6.90	8.52	17.05	9.93	31.05	0.18

Note : As of 19th May 2023
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is picking up.** While exports have been sluggish due to slowing overseas economies, domestic demand has supported the economy. Attitudes towards CAPEX has been persistent thanks to pent-up demand and investment related to “de-carbonization” and “digitization”. Despite the headwinds of higher prices, consumer spending has increased under the reopening of the economy. A recovery in inbound consumption and an easing of constraints of the supply side have also supported the economy.
- **Inflation has been mixed.** The Nationwide core CPI for March was up 3.1% year on year, unchanged from the previous month. However, given that the core CPI for Tokyo in April was up 3.5% from a year earlier, a reacceleration from 3.2% the previous month, the national core CPI is likely to rise again. Meanwhile, the slowdown in import prices, the starting point of the cost push inflation, has become even more pronounced.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2023 at +1.1% and for FY 2024 at +0.9% respectively.** We expect the economic recovery to continue for the foreseeable future supported by consumer spending, CAPEX, inbound consumption and the easing constraint of supply side of the economy. For the first half of CY 2024, the economy is expected to get somewhat slower owing to a slowdown in the US economy. Subsequently, Japan's economy is expected to gain momentum as we expect the US economy will avoid severe recession in CY 2024.
- ② **We have lowered our core CPI forecast for FY 2023 from +2.7% to +2.5% and maintained our estimate for FY 2024 at +1.5%.** The downward revision for FY 2023 was mainly due to the reduction in the crude oil price and electricity rates forecasts. Although regulated electricity rates are expected to increase in June 23, the core CPI is likely to follow a decelerating trend, given the possibility that cost-push pressure will subside due to a slowdown in import prices. However, with some support from wage hikes, the core CPI below +2% is not expected to take root until the middle of CY 2024.
- ③ **PM Kishida and his cabinet will continue its accommodative economic policy.** In October last year, the Cabinet approved a comprehensive economic package to overcome high inflation and revive the economy. It was a massive economic package of 37.6 trillion yen in national and local expenditures and additional economic measures are going to be taken in case of further economic slowdown. On the other hand, the government is now paying more attention to the financial soundness of the state regarding increases in spending related to national security and countermeasures to the falling birthrate. The former will be partly financed by a corporate tax increase and the latter could be also covered with a stable source of revenue through measures such as raising social insurance premiums.
- ④ **We expect the range of the YCC, yield curve control, will be widened from $\pm 0.5\%$ to $\pm 1\%$ in July 2023.** As “the goal of price stability” is out of sight in the foreseeable future, new Bank of Japan (BOJ) Governor Ueda has said the central bank would continue its easy monetary policy. On the other hand, as the bank has taken some steps to increase the flexibility of monetary policy, such as changing “forward guidance”, we expect the YCC will be corrected if downside risks of the economy ease. Regarding the negative interest rate policy, it is likely to remain in place because the governor sees it as the basis for monetary easing. The BOJ has decided to conduct a review of its monetary policy over one to one-and-a-half years, and a prolonged failure to meet its price target could trigger the start of an in-depth debate over the side effects of current monetary easing.

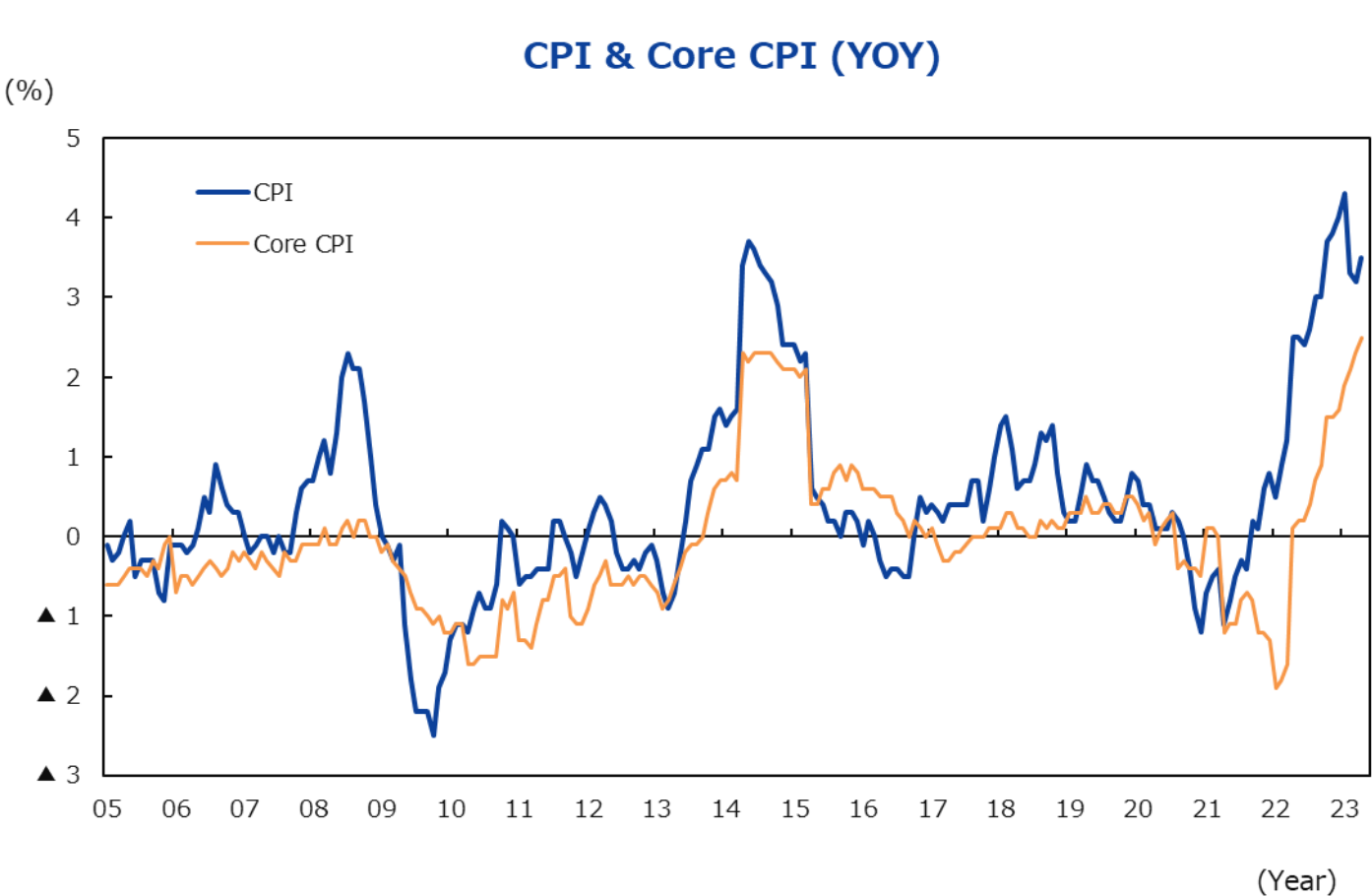
Forecast table for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY18	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est
Real GDP	0.3%	-0.9%	-4.6%	2.5%	1.2%	1.1%	0.9%
Private final consumption expenditure	0.1%	-1.0%	-5.4%	1.5%	2.4%	1.4%	1.0%
Private housing investment	-4.8%	2.5%	-7.8%	-1.1%	-4.4%	-0.1%	-0.2%
Private-sector capital investment	1.5%	-1.7%	-7.7%	2.1%	3.0%	2.2%	2.1%
Public fixed capital formation	0.8%	1.7%	5.1%	-6.4%	-2.6%	2.6%	0.5%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	-0.2%	-0.1%
Exports of goods and services	2.0%	-2.3%	-10.0%	12.3%	4.4%	-0.4%	1.7%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.1%	0.5%	2.3%
Nominal GDP	0.2%	0.0%	-3.9%	2.4%	1.9%	3.1%	2.0%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.7%	2.0%	1.1%
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	-0.2%	0.3%	1.5%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.5%	1.5%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	0.2%	0.0%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	2.6%	2.3%
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.6%	2.6%	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.

Source: 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

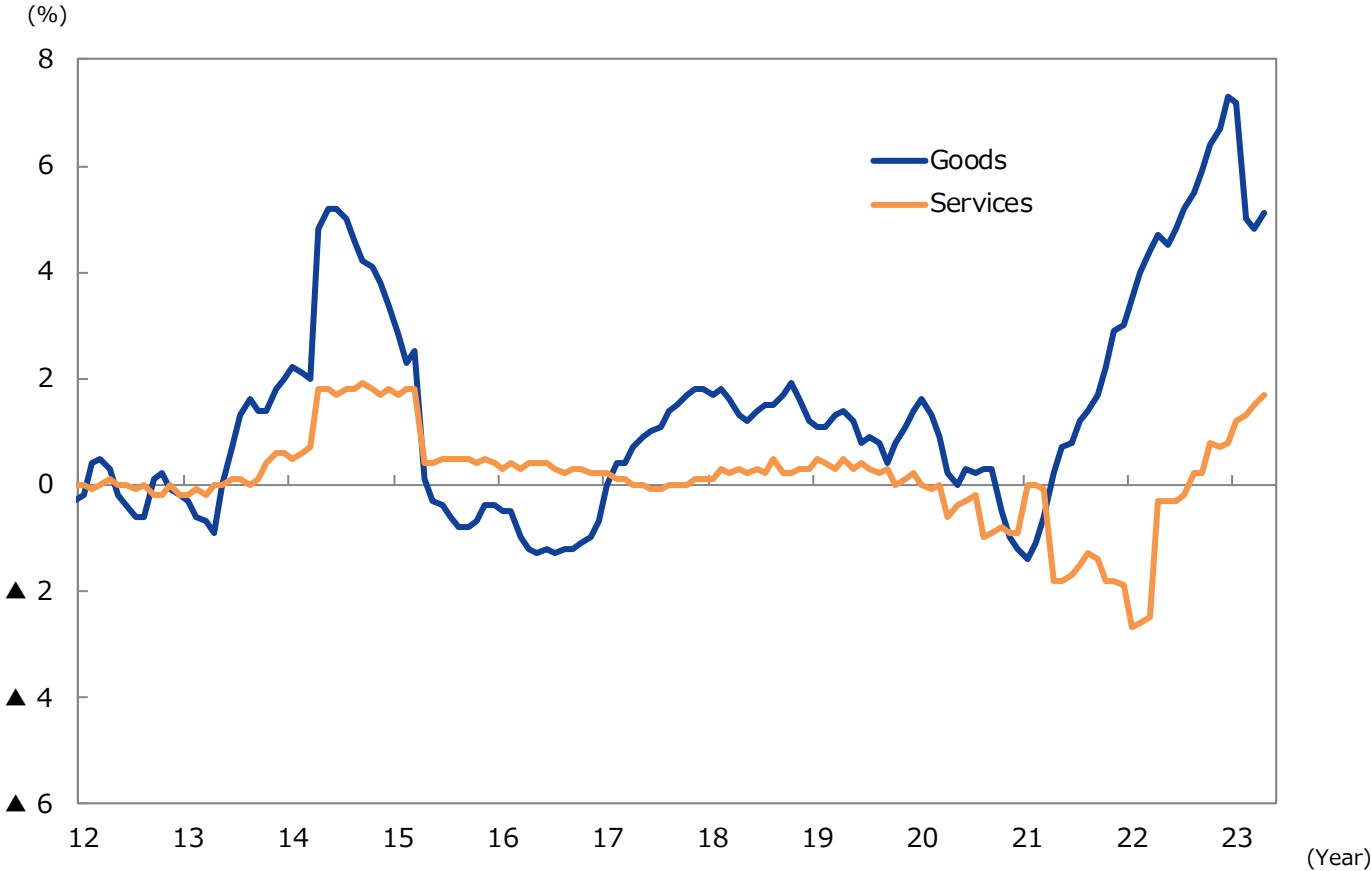
Core inflation continues to rise despite the slowing headline rate



Note: Data is from January 2005 to April 2023, Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Bloomberg, SMDAM

Source of inflation switching from goods to services

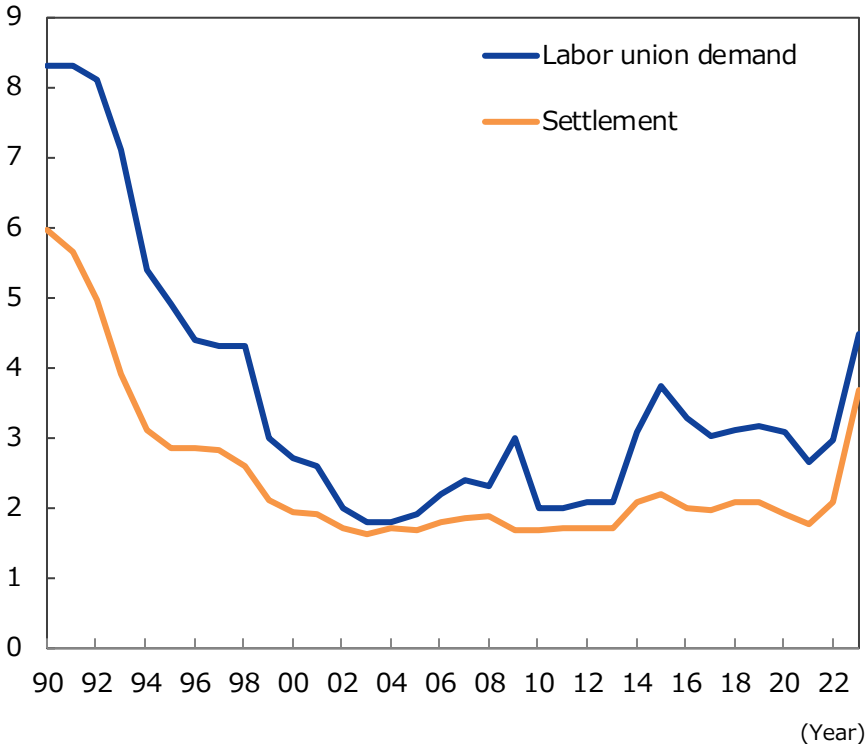
CPI of Goods & Services (YOY, %)



Note: Data is from January 2012 to April 2023.
Source: MIAC, Bloomberg, SMDAM

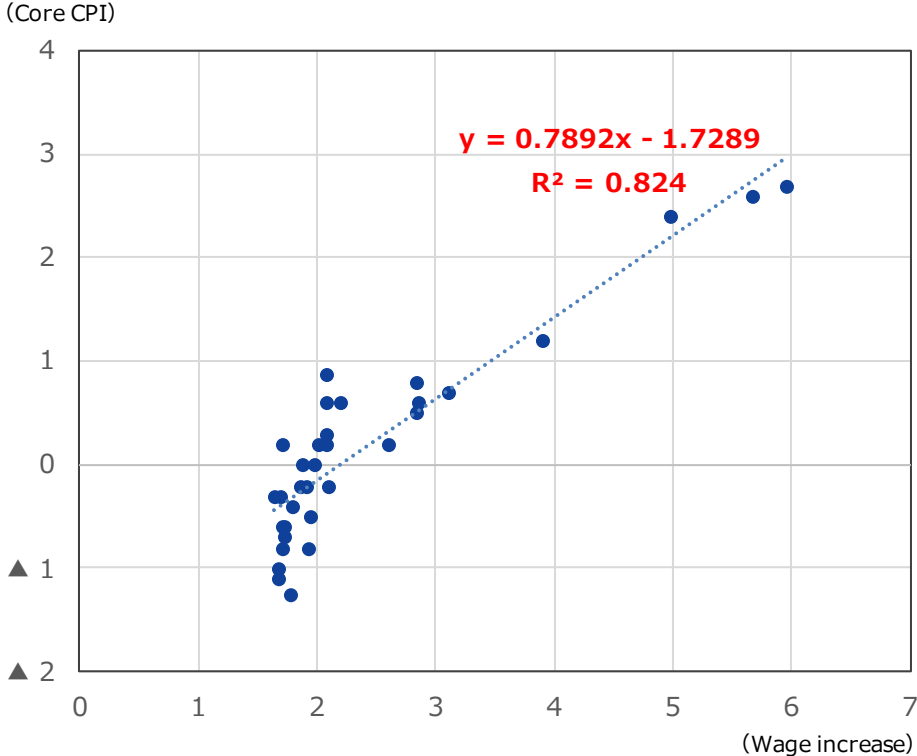
Start of a virtuous cycle?

Wage increase demand & settlement (YOY, %)



Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

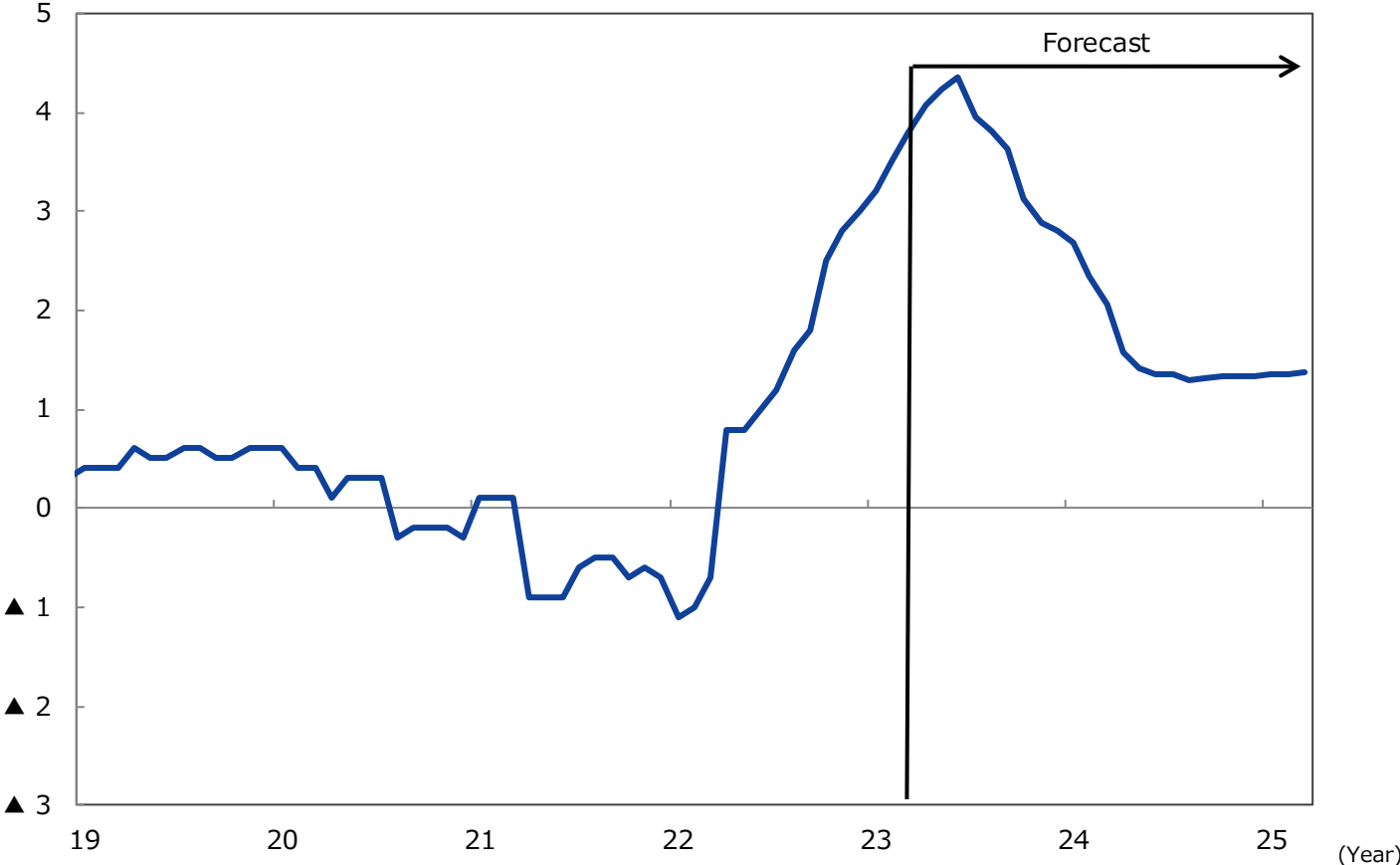
Wage increase & Core CPI (YOY, %)



Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

BOJ estimates Core CPI to peak in the near future

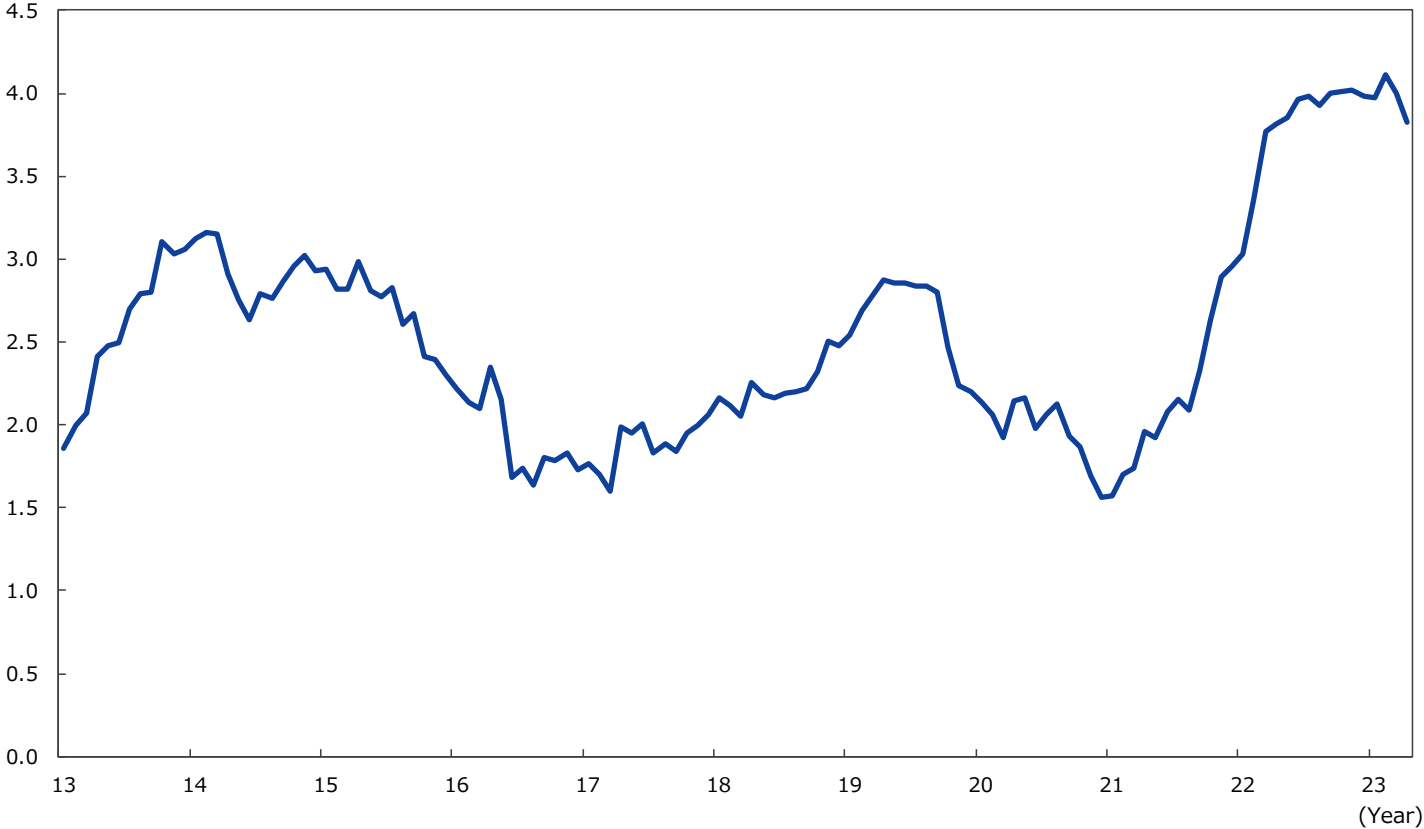
BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's Core CPI is excluding fresh foods & energy. Data from April 2023 are forecasts.
Source: The Bank of Japan, SMDAM

Expectation for higher inflation may have peaked

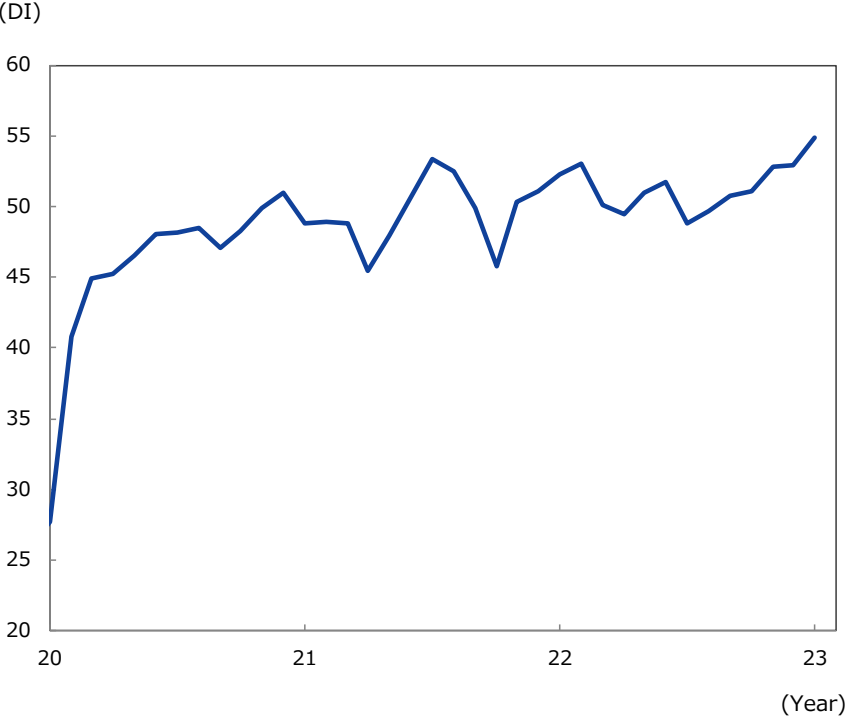
Consumers' Expectation of Inflation Rate (YOY, %)



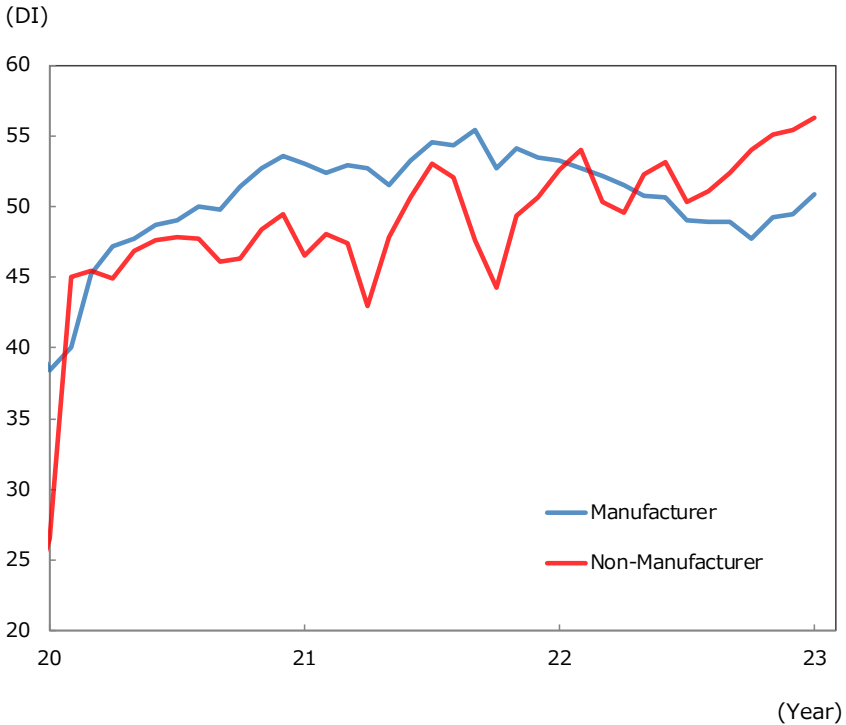
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to April 2023.
Source: Cabinet Office, SMDAM

Business sentiment of services gaining momentum

Composite PMI



PMI, Manufacturer & Non-Manufacturer



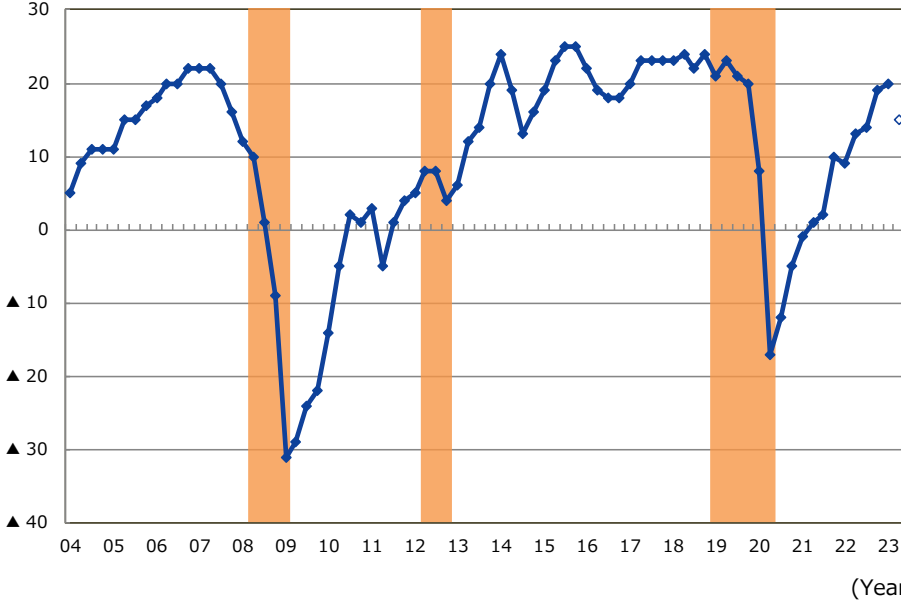
Note: Data is from May 2020 to May 2023.
Source: Bloomberg, SMDAM

Non-manufacturers lead economic recovery

BOJ business condition DI Large manufacturers (%)



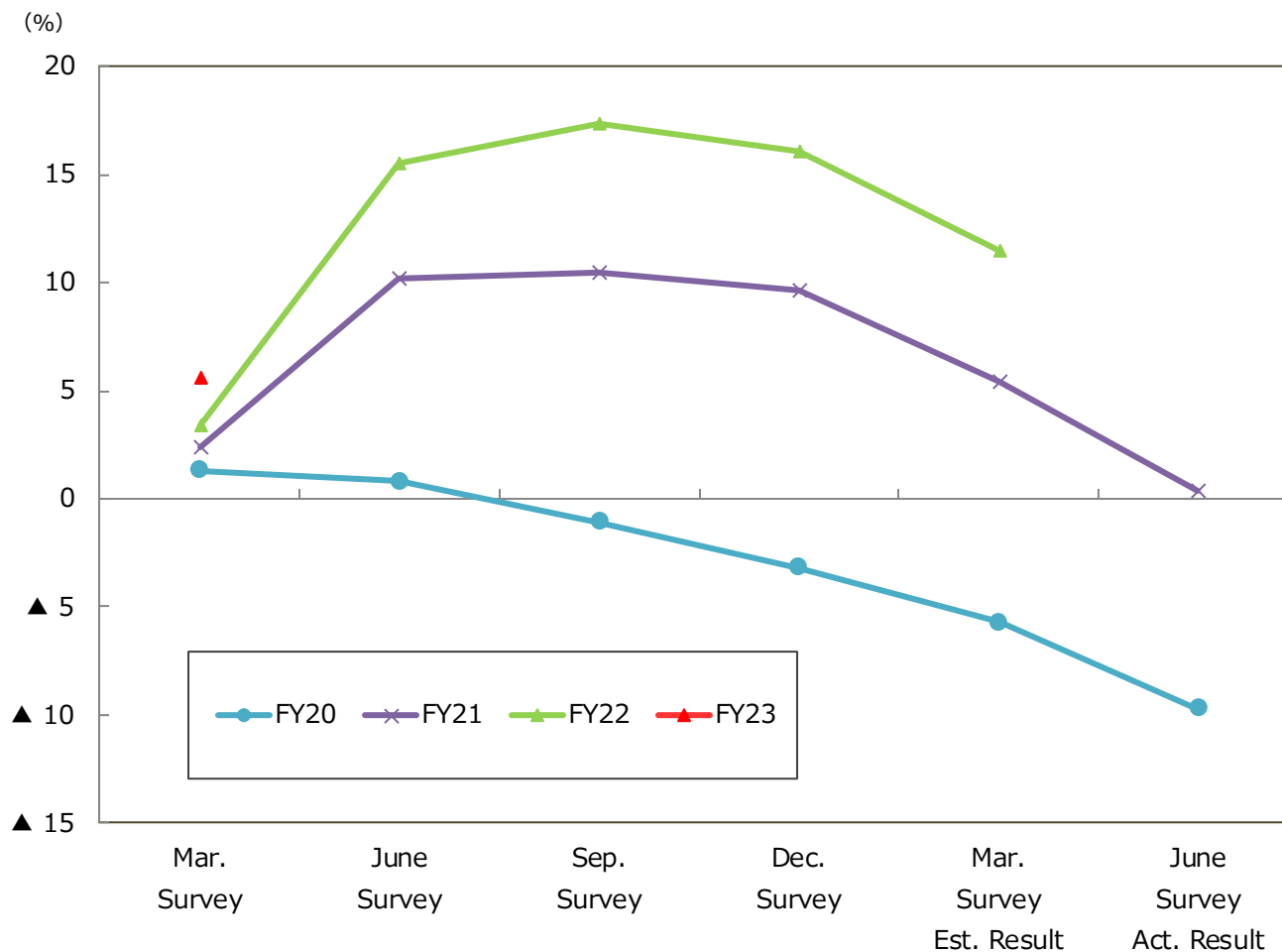
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q1 2023. The orange shadow are periods of economic recession.
 Source: The Bank of Japan, SMDAM

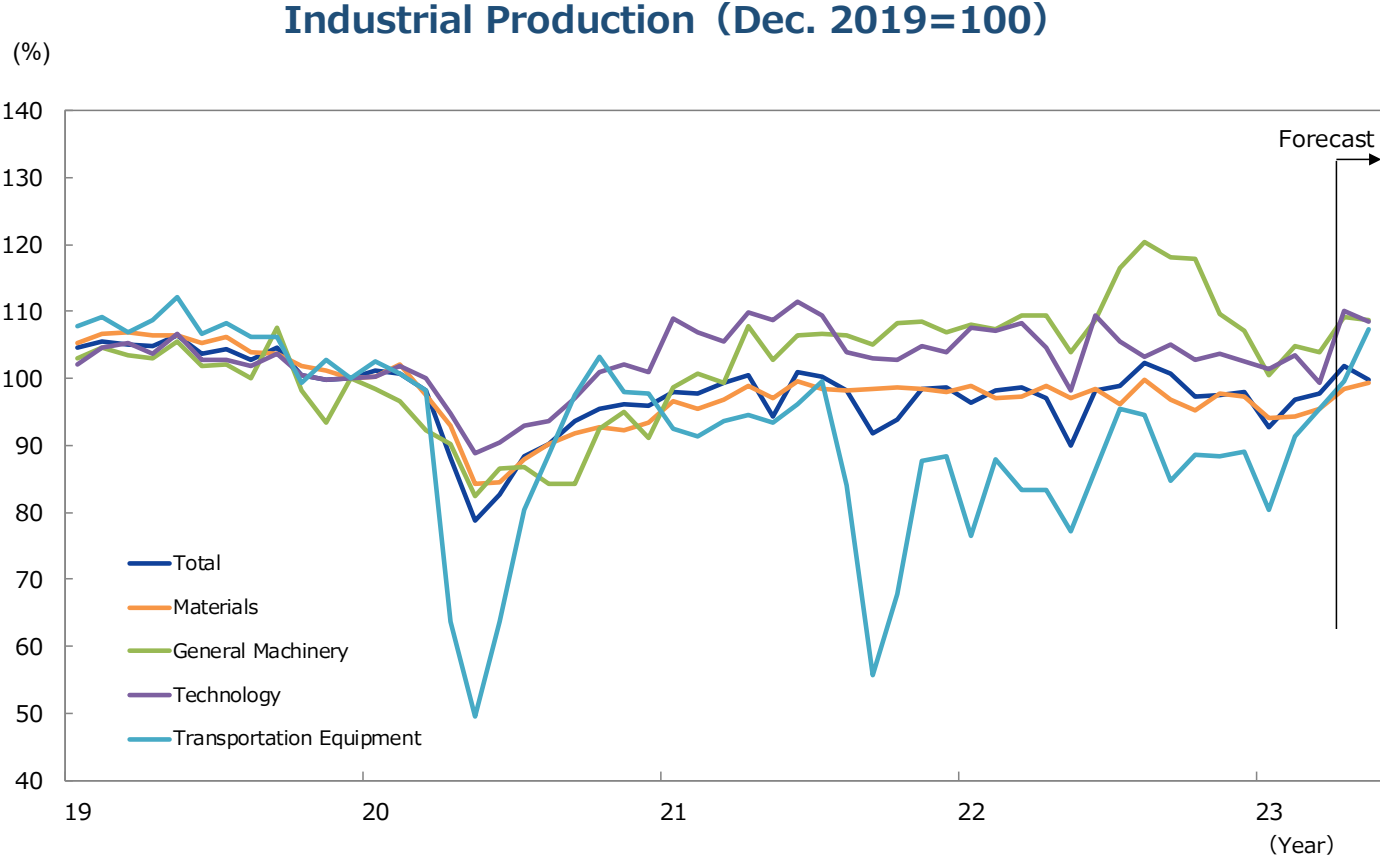
Weak JPY and “de-risking” boost investment in Japan

Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



Note: Data is from Q1 FY2020 to Q1 FY2023.
Source: The Bank of Japan, SMDAM

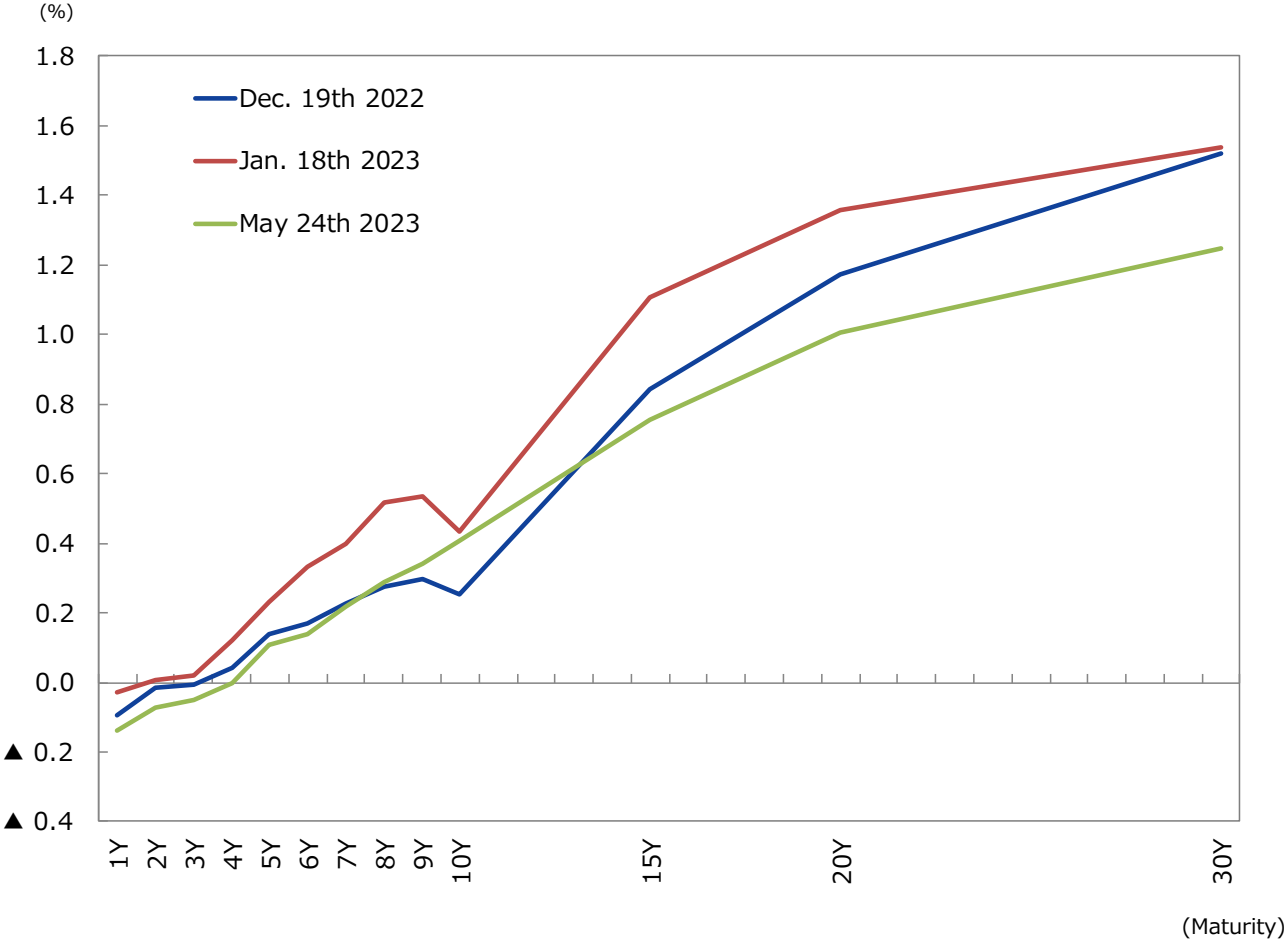
Resolution of semiconductor shortage lifts auto production



Note: 100% = December 2019. Data is from January 2019 to May 2023. Data after March 2023 are forecasts.
Source: METI, SMDAM

Governor's dovish comments make yield curve normal

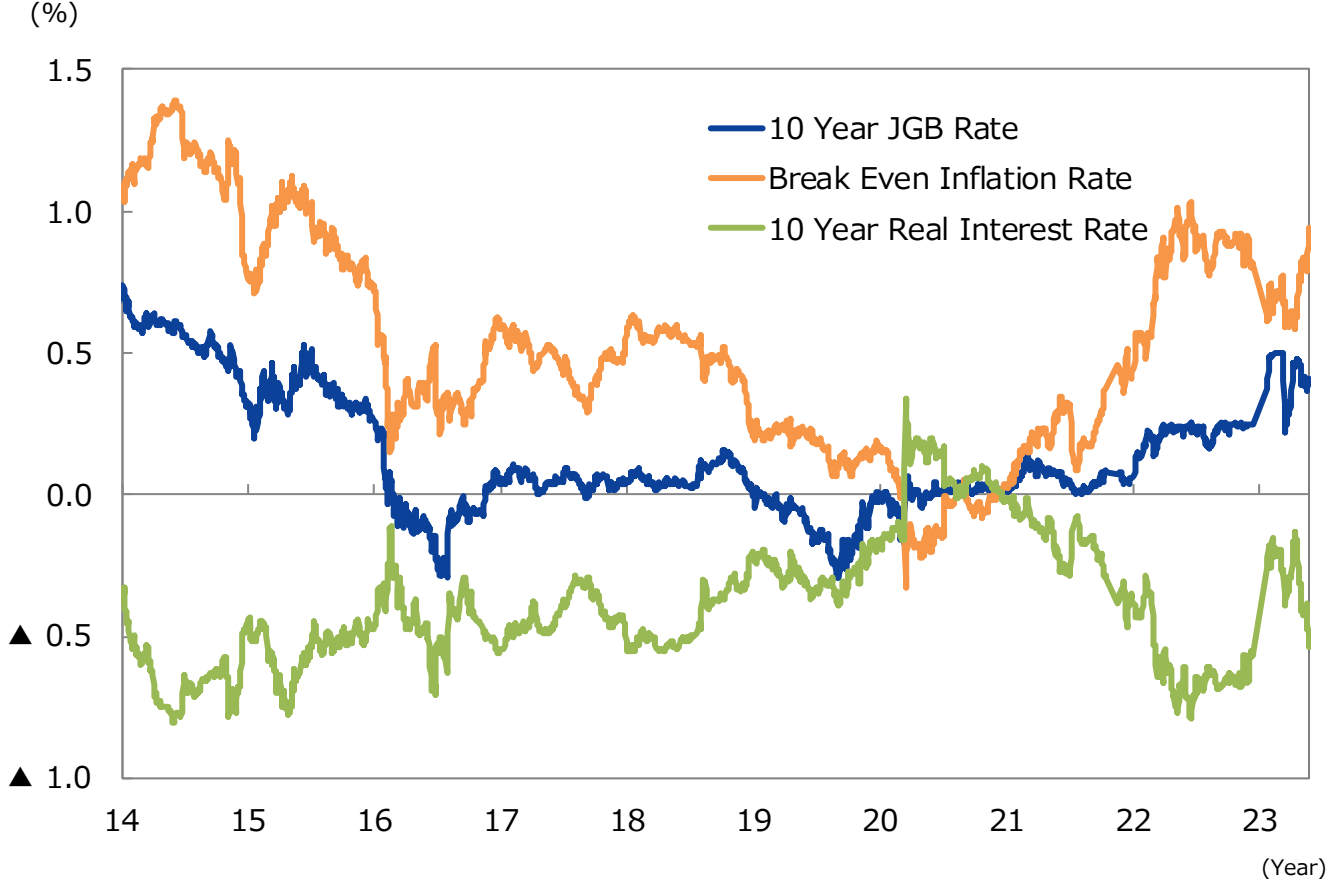
Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

Rising inflation expectations bring real interest rate lower

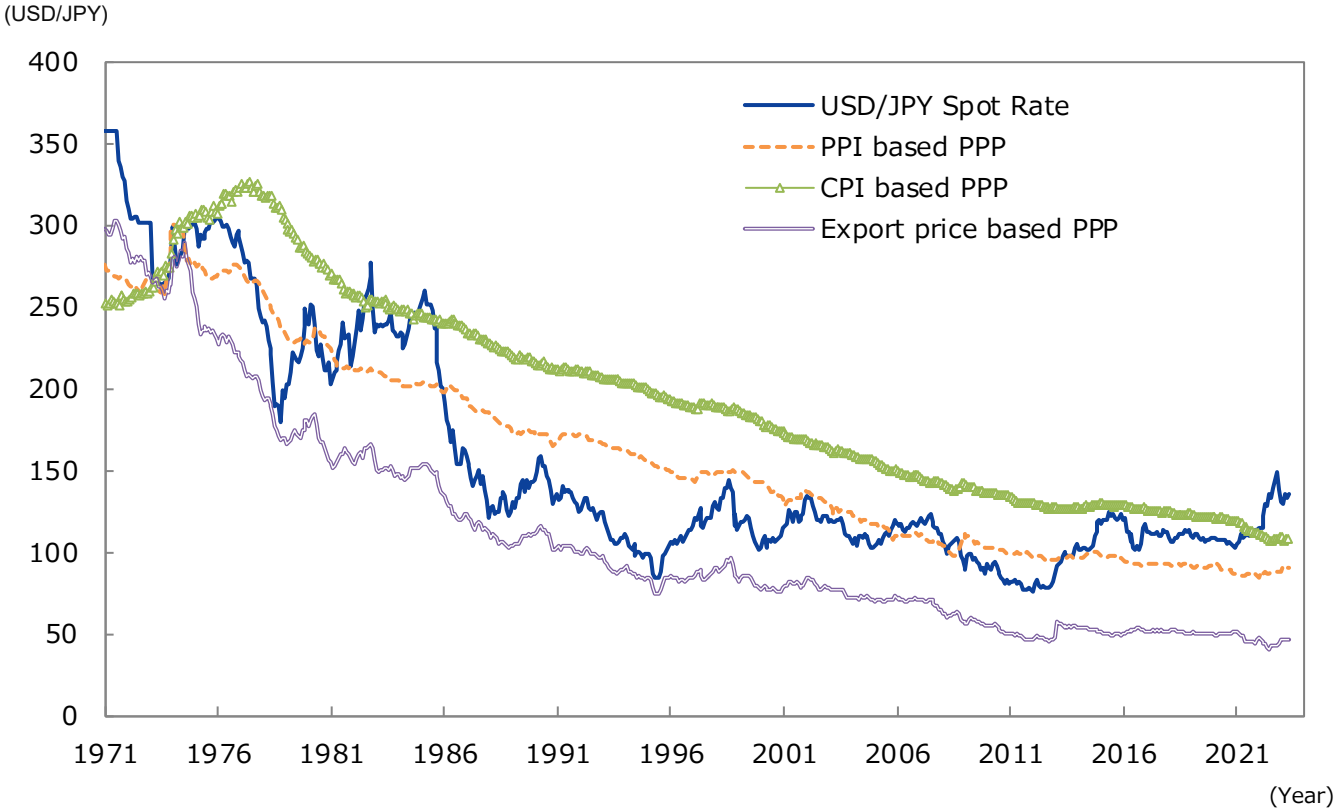
JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 24th May 2023.
Source: Bloomberg, SMDAM

USD/JPY rate keeps hovering above purchasing power parity

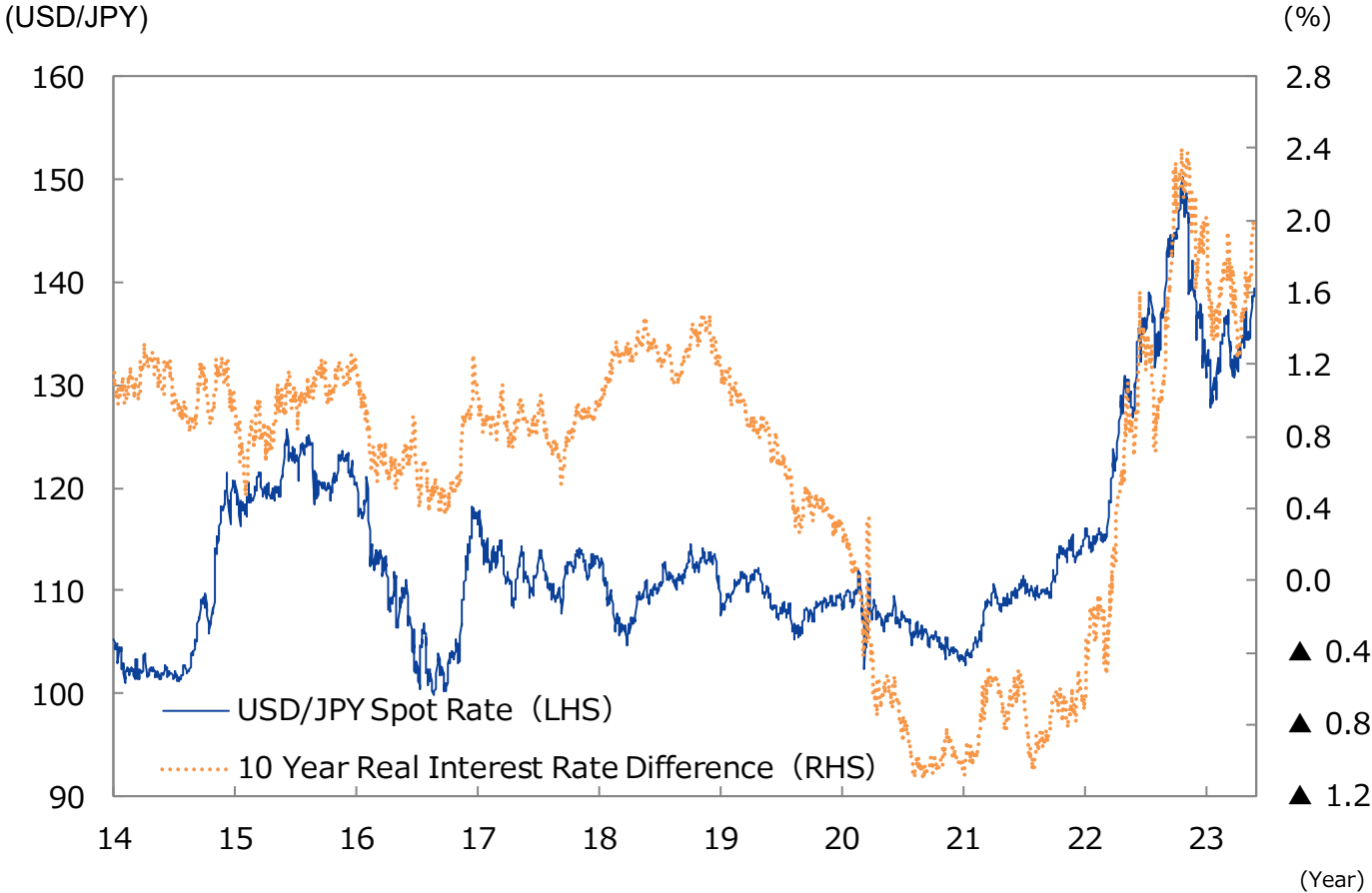
Purchasing Power Parity of USD/JPY Rate



Note: Data is from January 1971 to April 2023.
Source: DOL, Bank of Japan, SMDAM

Real yield gap dominates USD/JPY rate

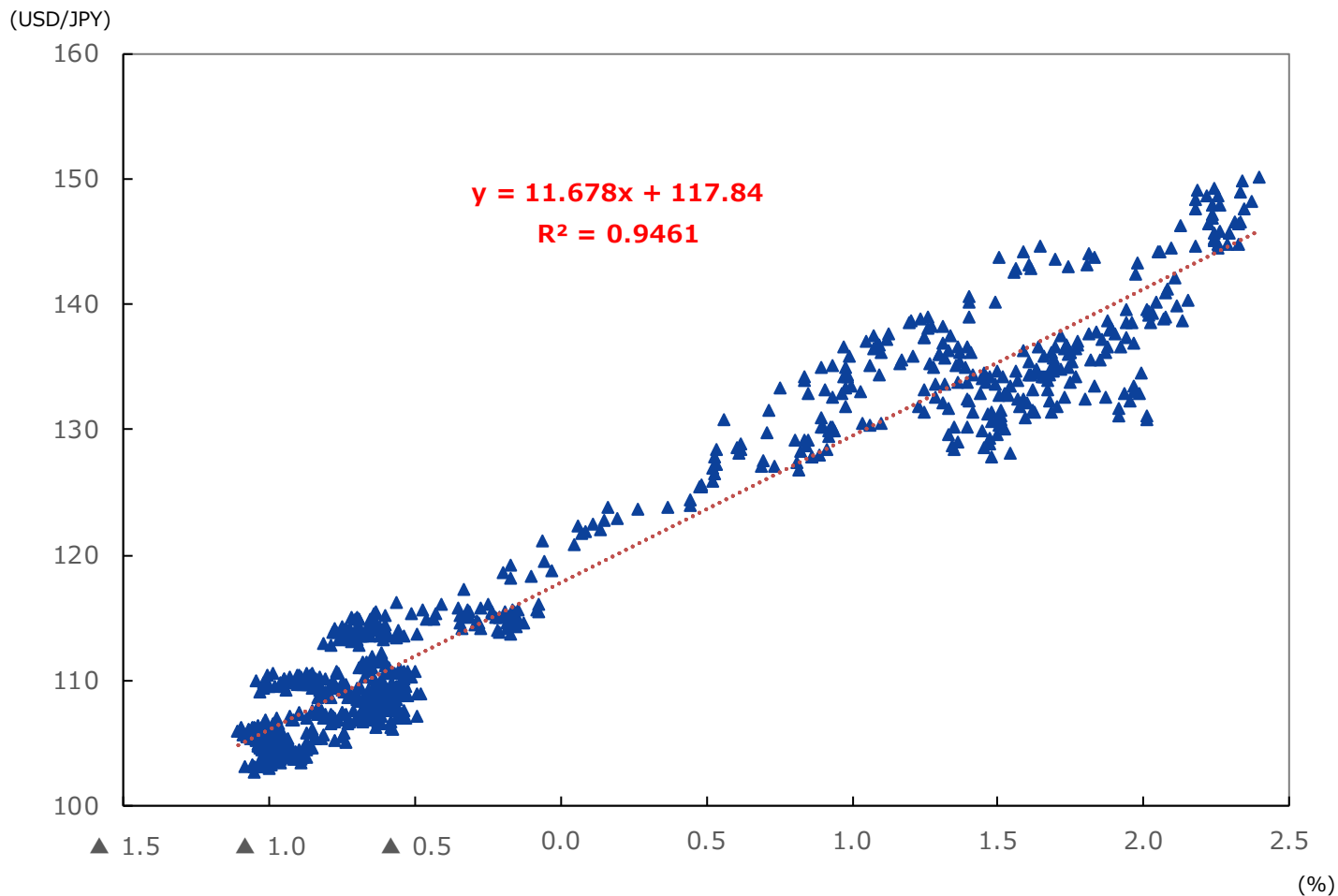
Real Interest Rate Gap & USD/JPY Exchange rate



Note: Data is from 1st January 2014 to 24th May 2023.
Source: Bloomberg, SMDAM

Real yield gap dominates USD/JPY rate

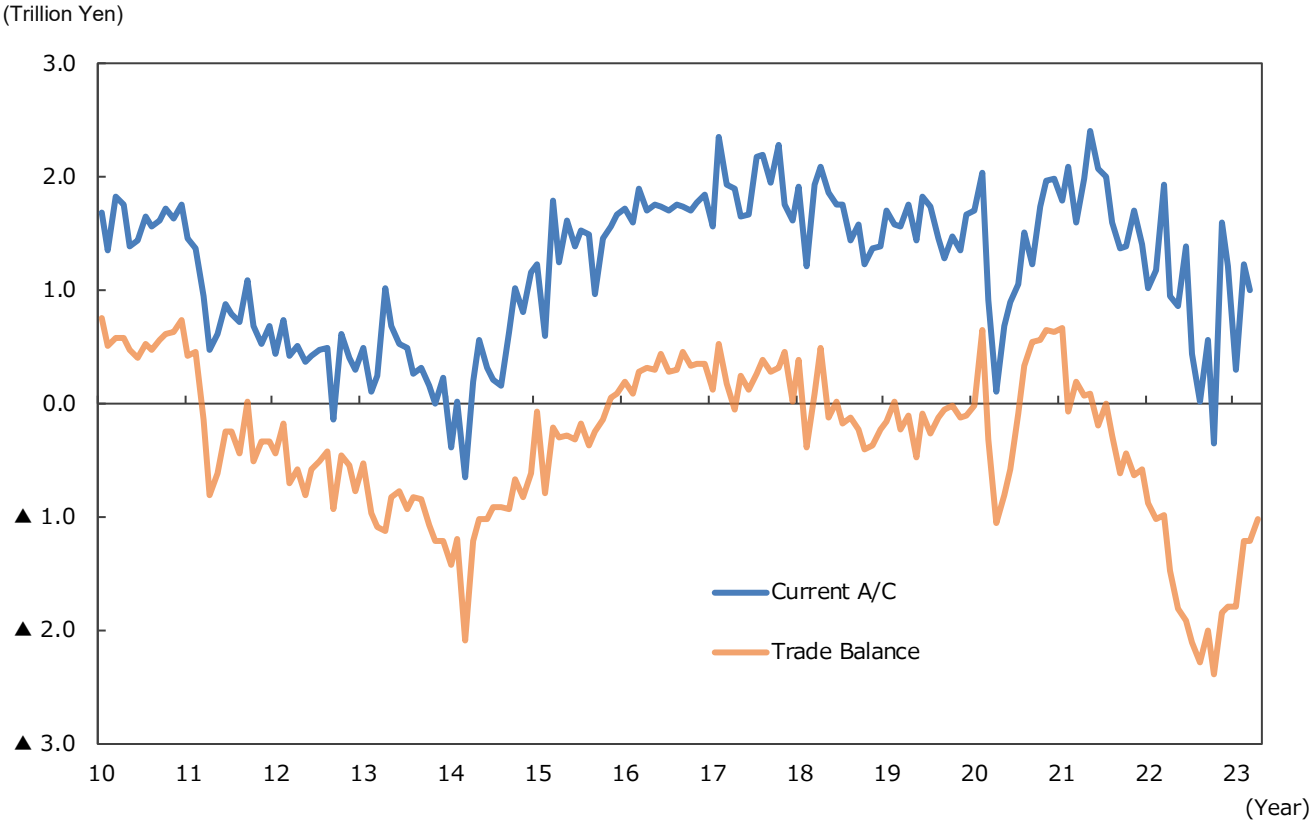
Correlation between Real Interest Rate Gap & USD/JPY



Note: Real interest rates are 10 year government bonds. Data is from 1st April 2020 to 24th May 2023.
Source: Bloomberg, SMDAM

Trade deficits start shrinking due to falling energy prices

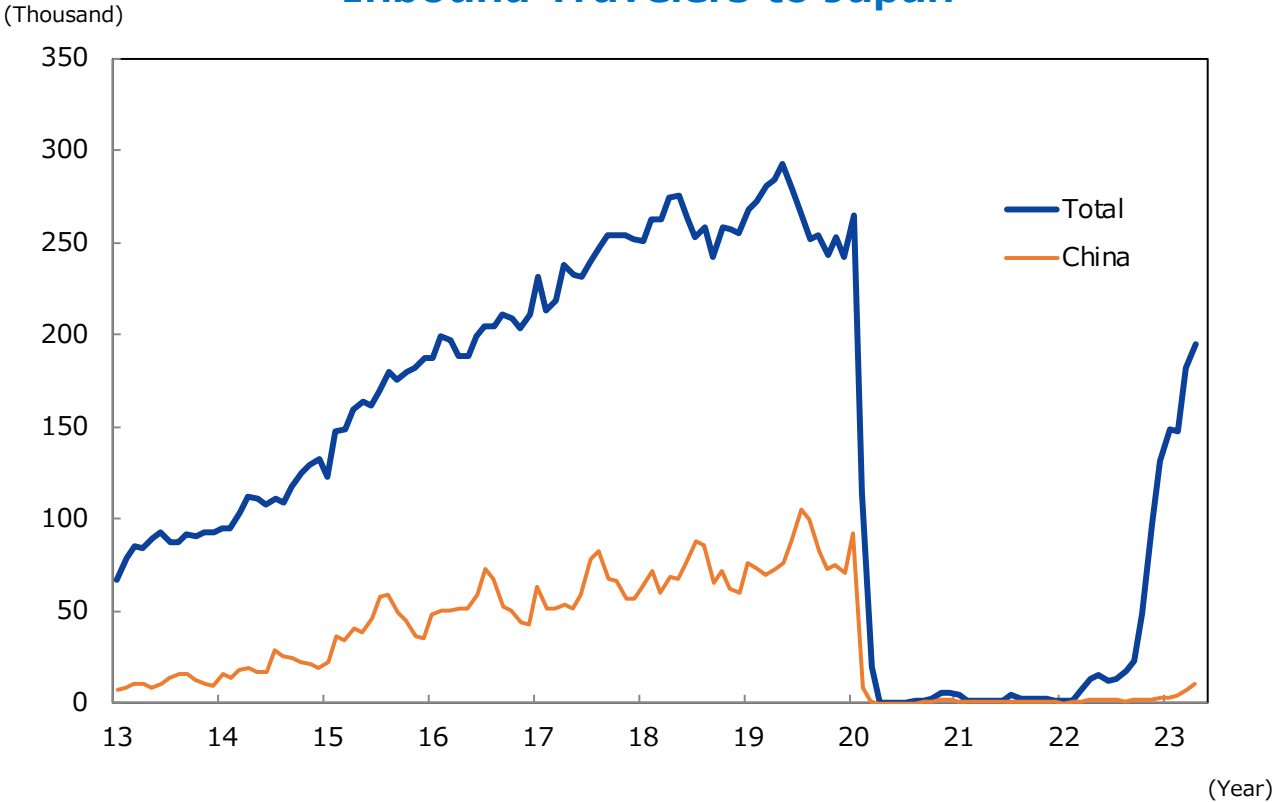
Current Account & Trade Balance



Note: Data is Seasonally adjusted. Data for current account is from January 2010 to March 2023. Data for trade balance is from January 2010 to April 2023.
Source: MOF, SMDAM

Inbound travelers come back sharply without recovery from China

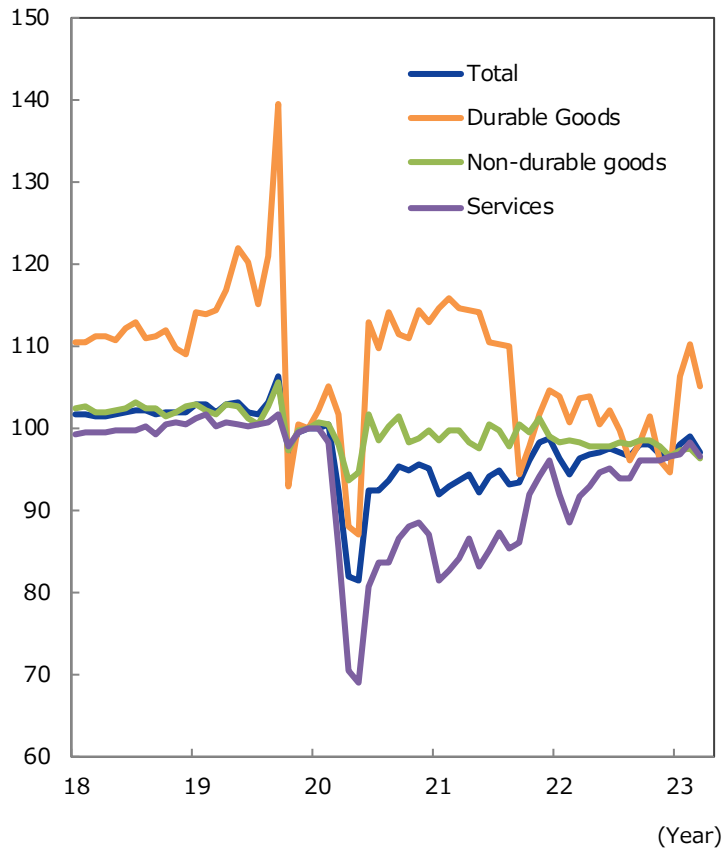
Inbound Travelers to Japan



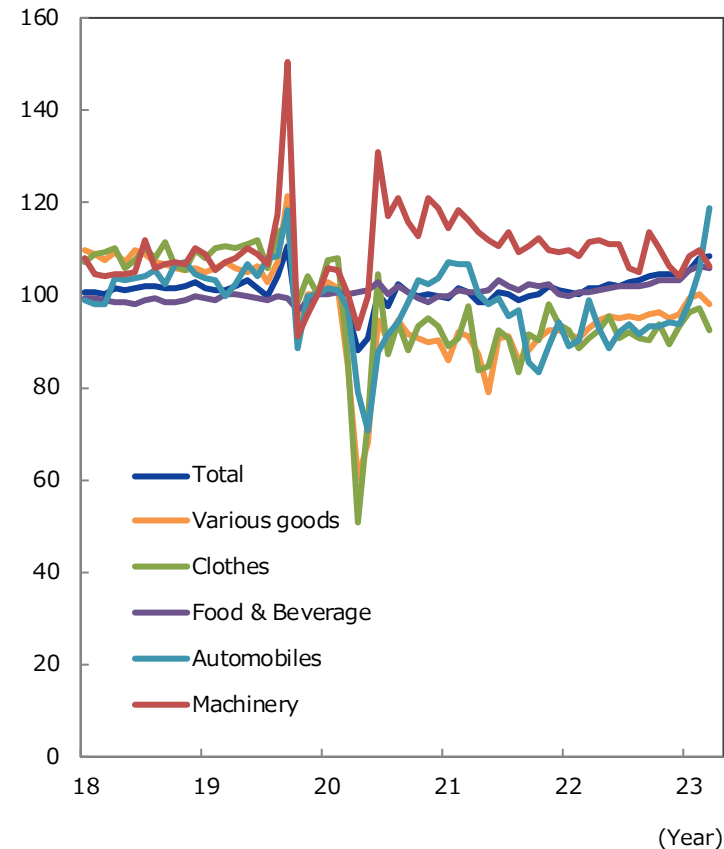
Note: Data is from January 2013 to April 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Auto sales rebound sharply after resuming semiconductor shortage

Consumer Activity Index (Dec. 2019 = 100)



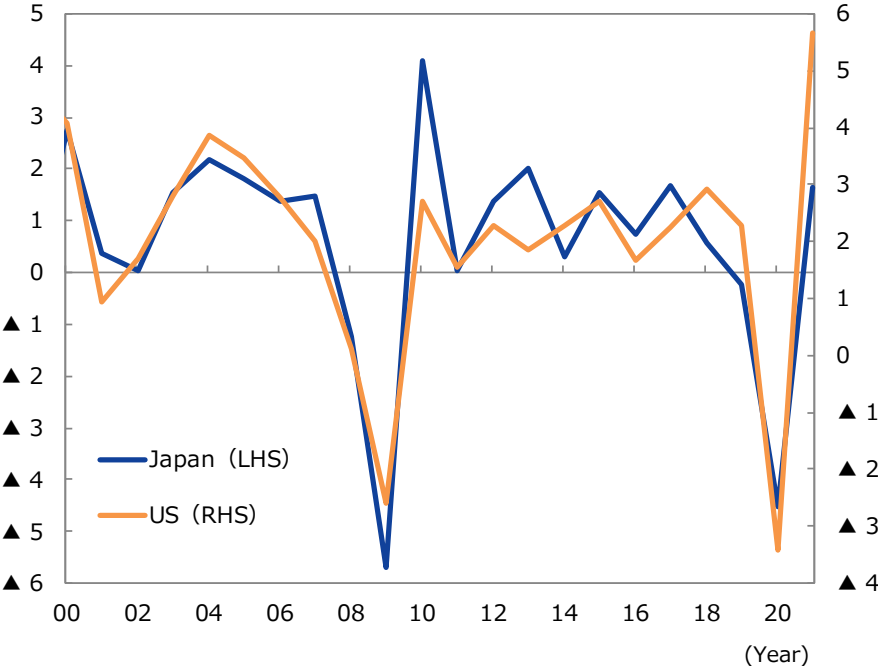
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to March 2023.
Source; Bank of Japan, METI, and SMDAM

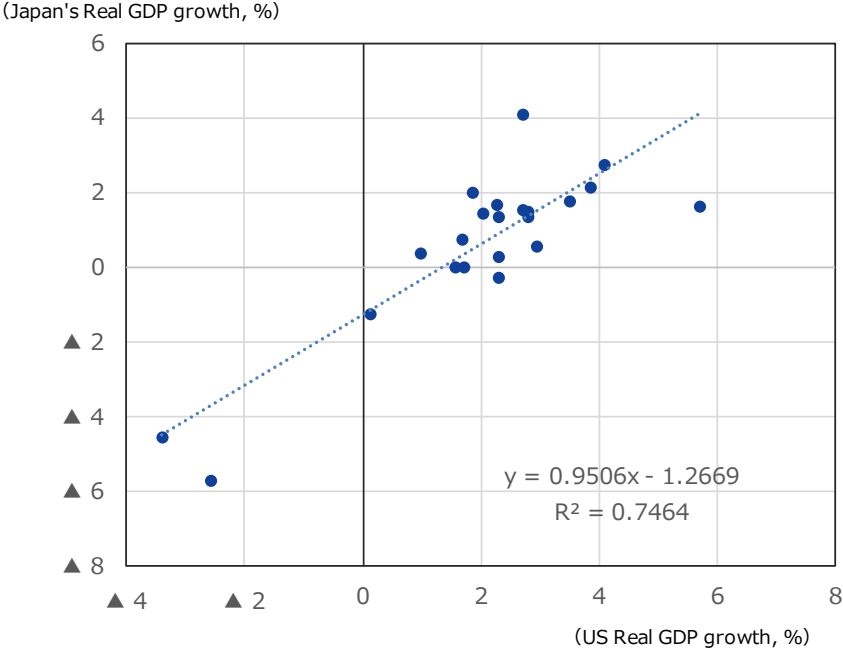
Strong correlation between US and Japanese economic growth

Real GDP Growth (YOY, %)



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

Correlation of Real GDP Growth



Japan's marginal exposure to Russian businesses

(%)

	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Import	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

Rising approval rate fuels speculation for snap general election

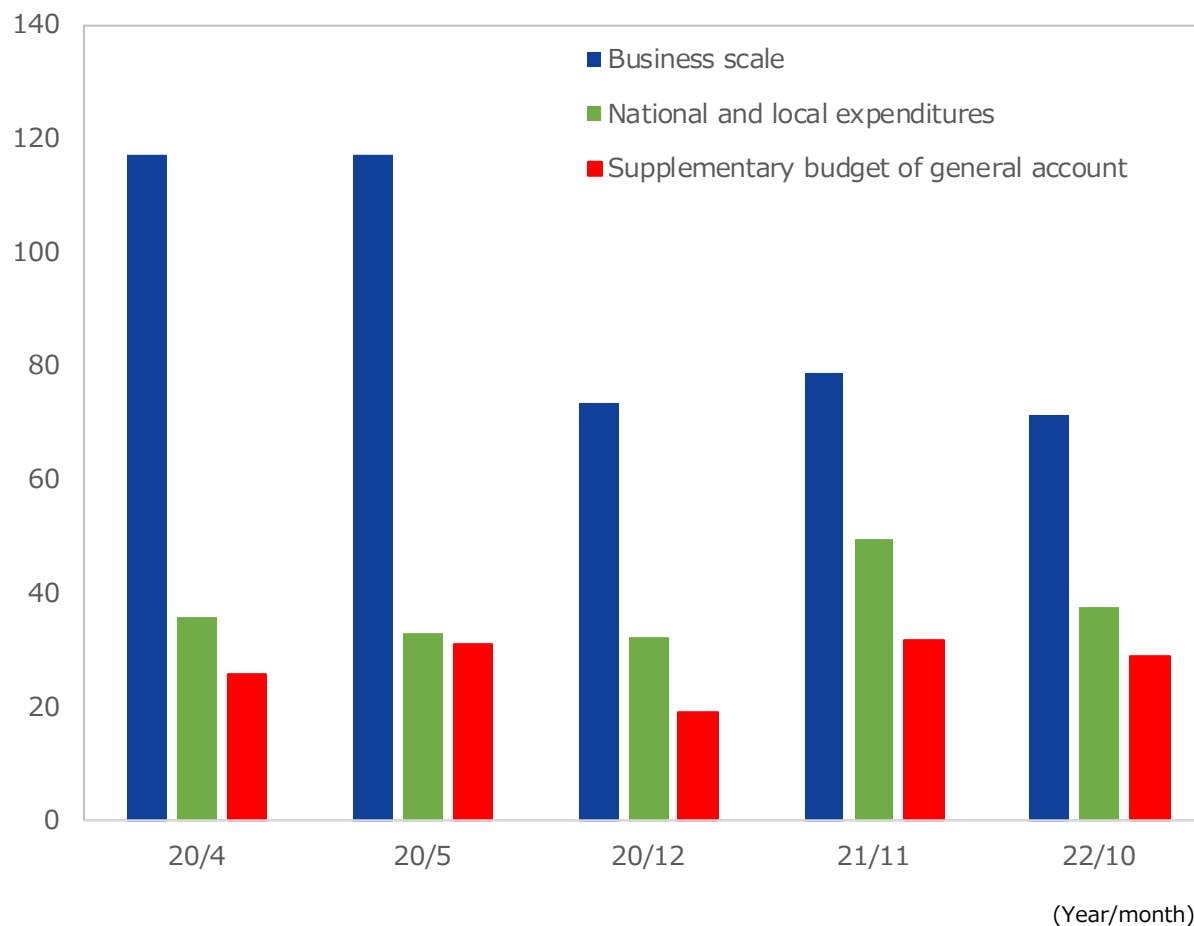
Cabinet approval rate



Note: Data is from January 2013 to May 2023.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Size of fiscal stimulus

Size of Fiscal Stimulus (trillion yen)



Source: MOF, SMDAM

Schedule of major events

Year	Month	Date	Event
2023	June	8	Revision of CY 2023 Q1 GDP
		15-16	Monetary Policy Meeting
		21	End of the ordinary Diet session
			Big-boned policy decisions Formulation of guidelines for the facilitation of labor mobility
	July	27-28	Monetary Policy Meeting
	August	15	Release of CY 2023 Q2 GDP
	September	8	Revision of CY 2023 Q2 GDP
		9-10 21-22	G20 Summit in India Monetary Policy Meeting Appointment of key posts of ruling Liberal Democratic Party
October	1	Start of the qualified invoice-based method	
	30-31	Monetary Policy Meeting	
November	15	Release of CY 2023 Q3 GDP	
December	8	Revision of CY 2023 Q3 GDP	
	18-19	Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline	

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

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