



# Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

Hisashi Shiraki  
Chief Global Strategist

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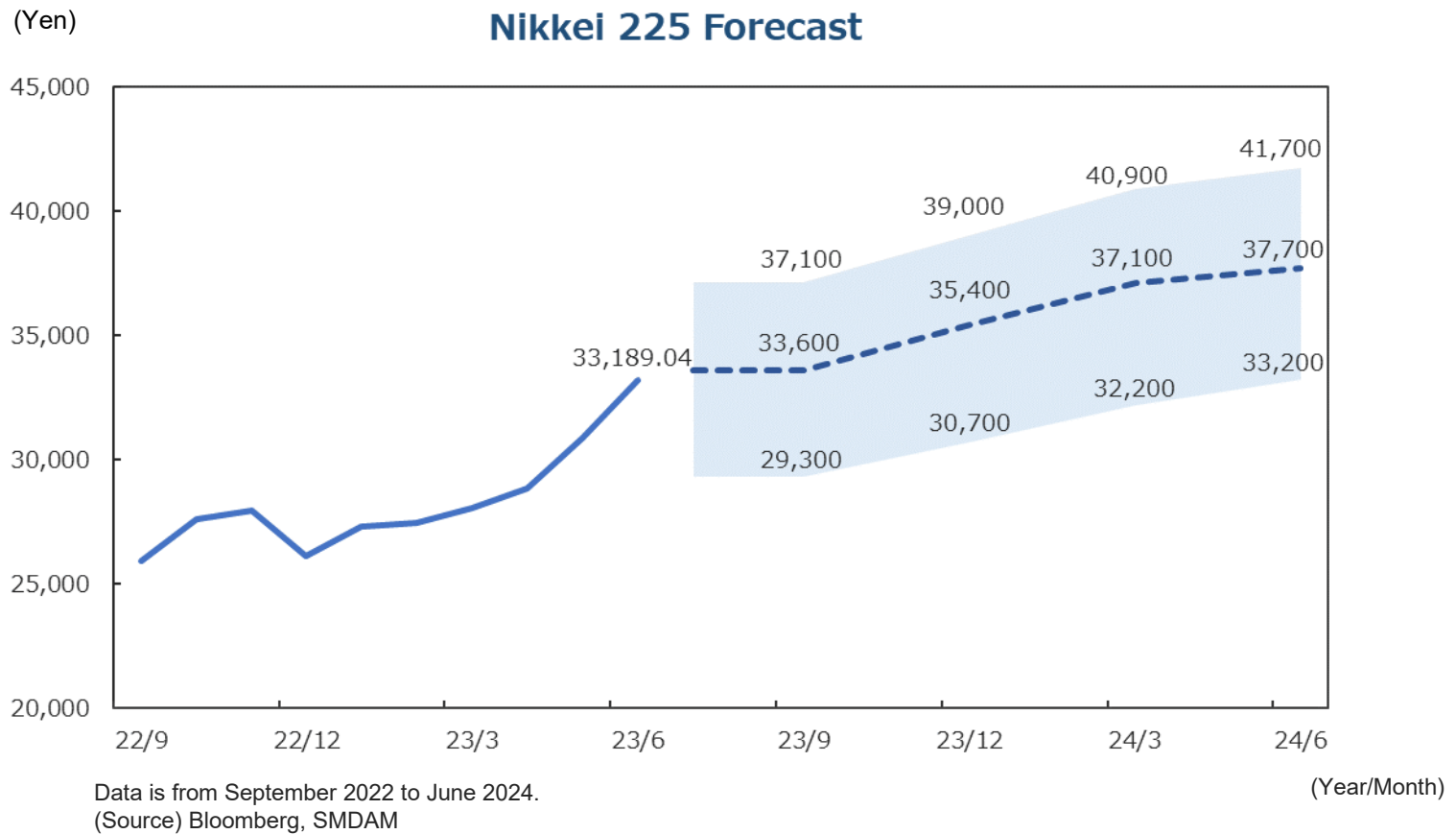
# Outlook for Japanese Stock Market

# Market Outlook

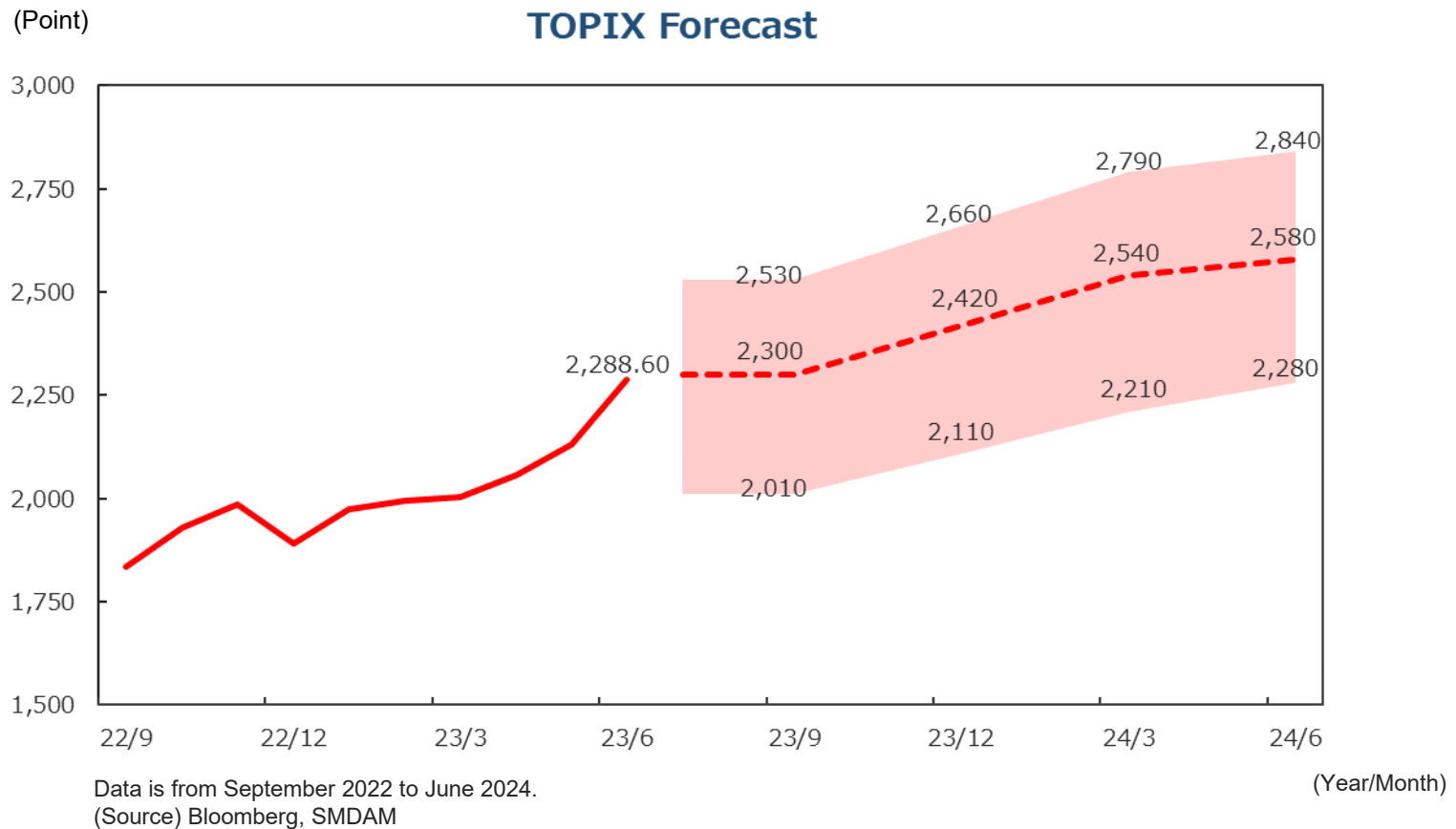
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- We are bullish on the Japanese equity market going forward thanks to the recovery in domestic demand and the normalization of the Chinese economy after the lockdown of “Zero- COVID policy”.
- We expect the market will accelerate its bullish trend after confirming the peak of FED tightening and the trough of the global economic cycle.
- We have raised our TOPIX price target from 2,470 to 2,540 and that of Nikkei 225 from 34,500 to 37,100 as of the end of March 2024.
- Growing expectation for “the end to deflation” with moderate inflation and rising wages which could provide a boost to the Japanese stock market going forward.

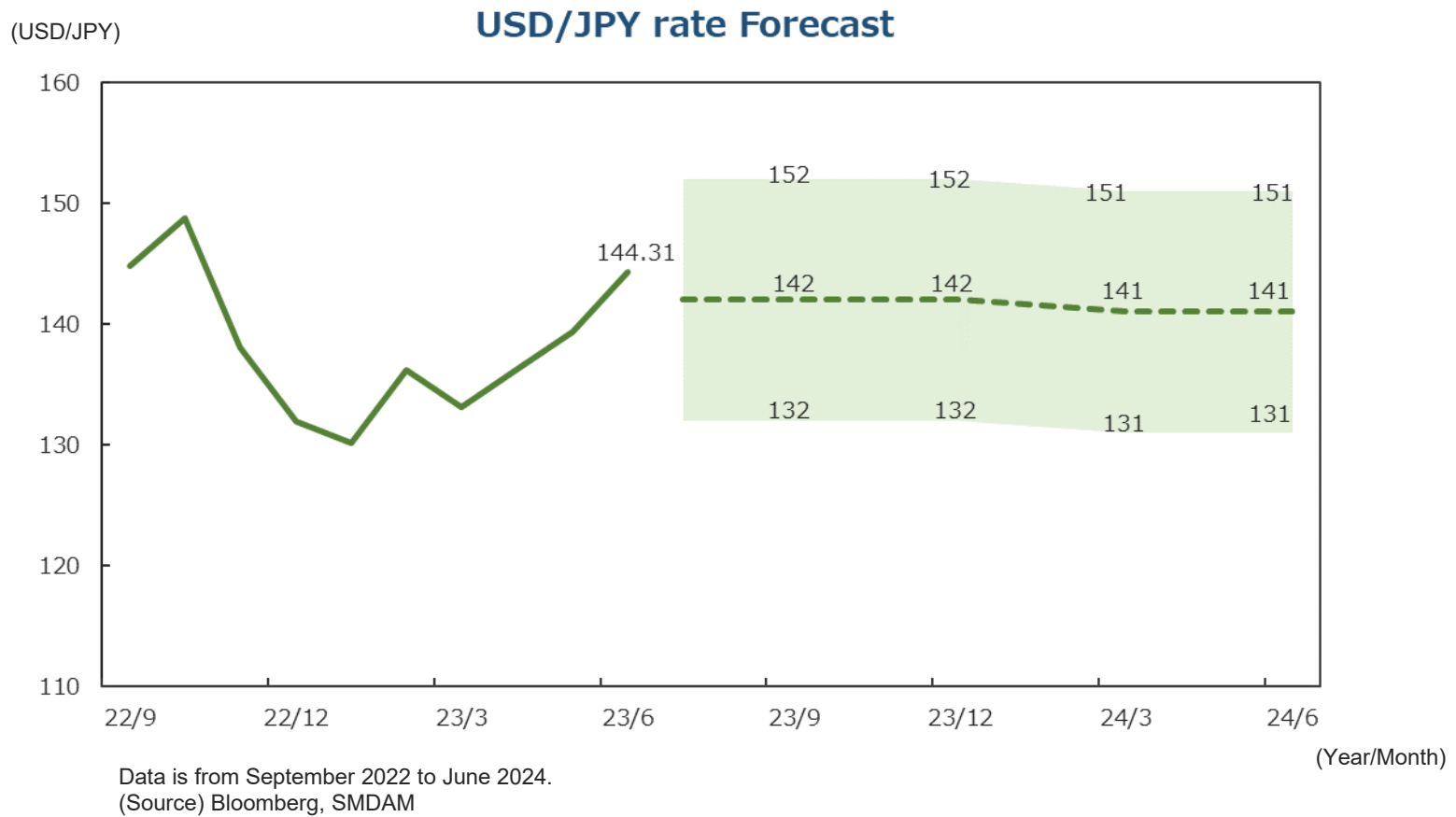
# Domestic demand and Chinese recovery to boost equities



# Domestic demand and Chinese recovery to boost equities



# Postponed FED pivot lifting USD/JPY rate



# Upside / Downside risk scenarios

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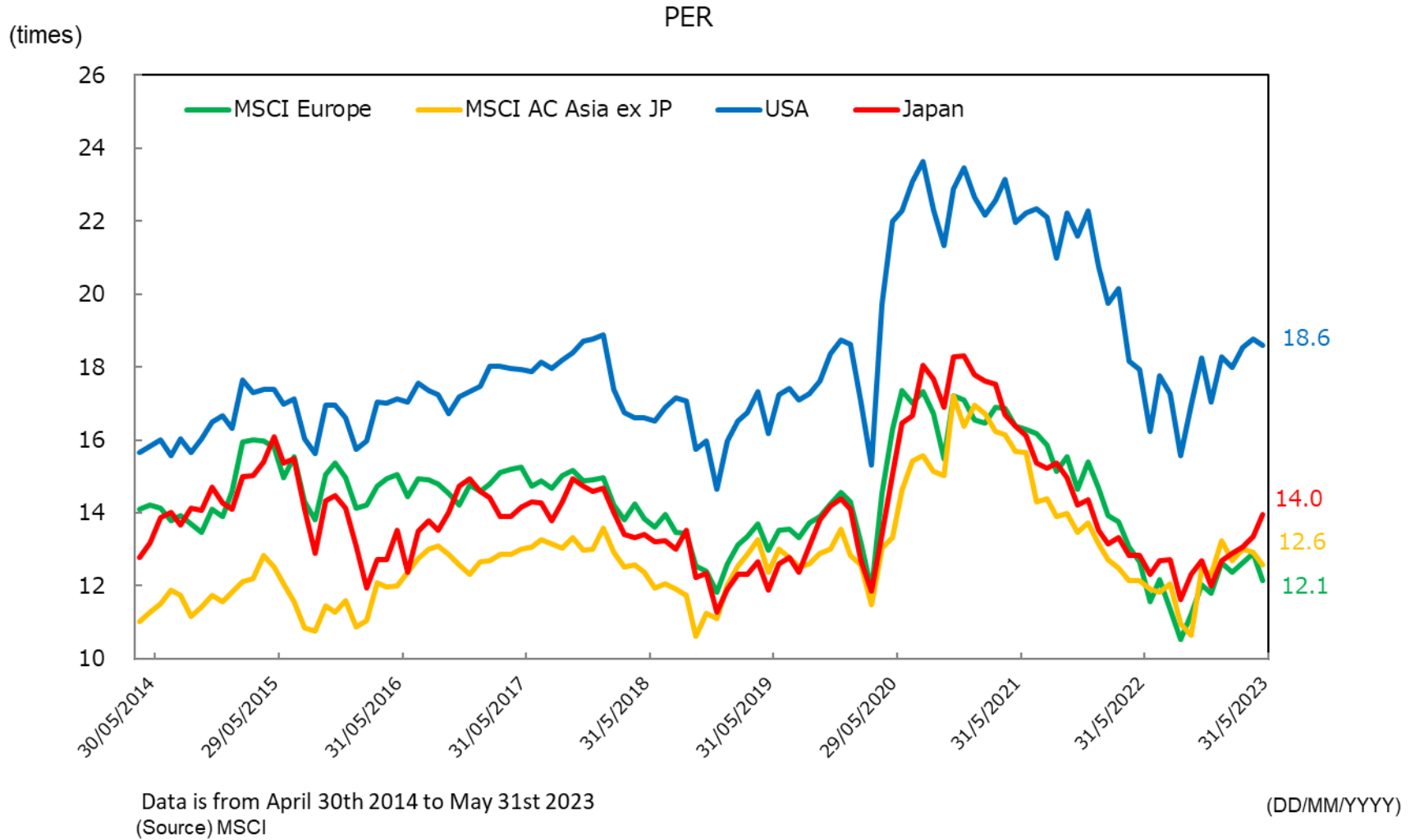
## ■ Upside Risks

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

## ■ Downside Risks

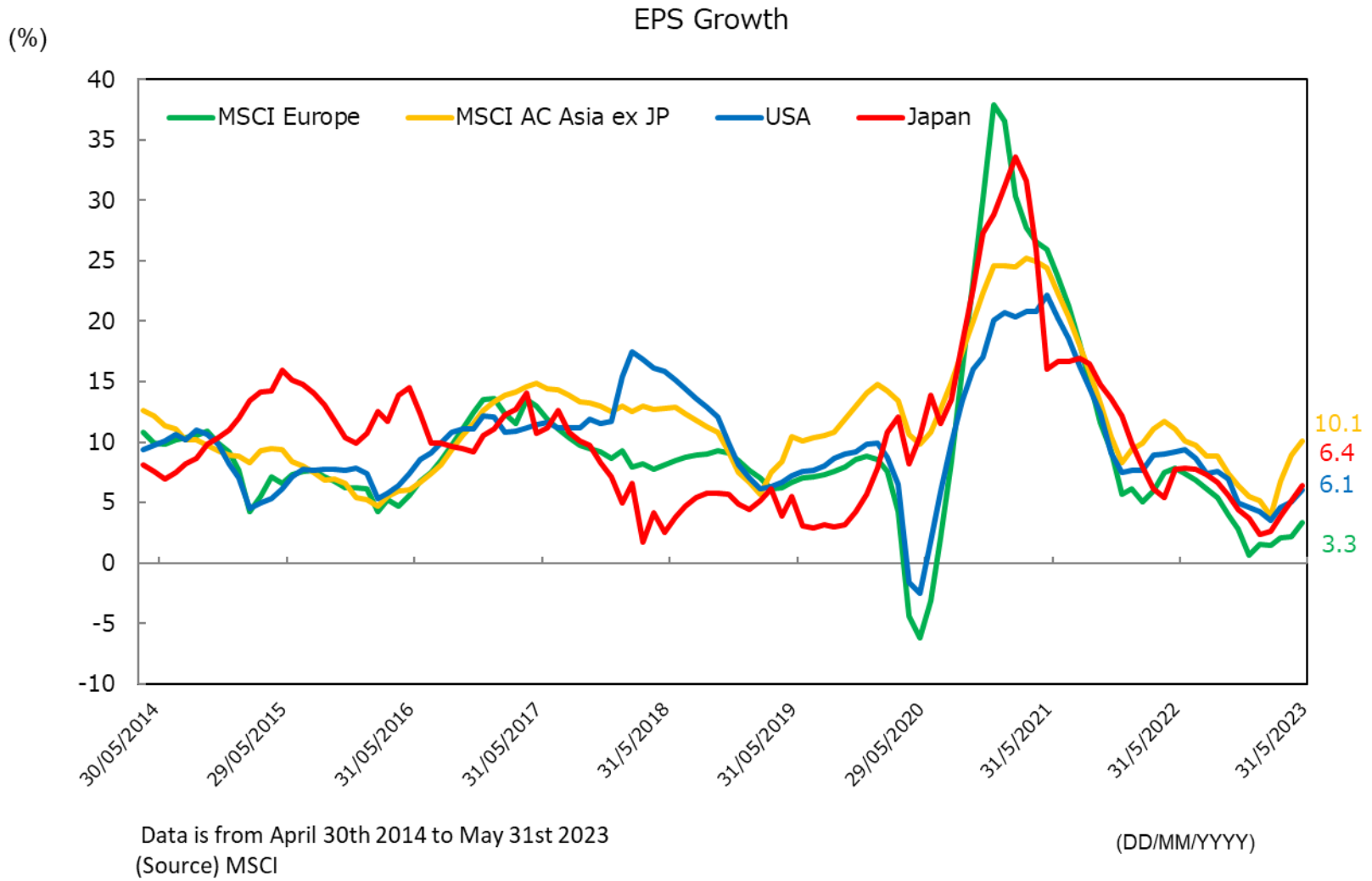
- Excessive JPY appreciation and negative impact on corporate earnings
- Renewed concern for global financial turmoil
- Prolonged stagnation of the global economy

# Strong rally boosts Japan's PER higher

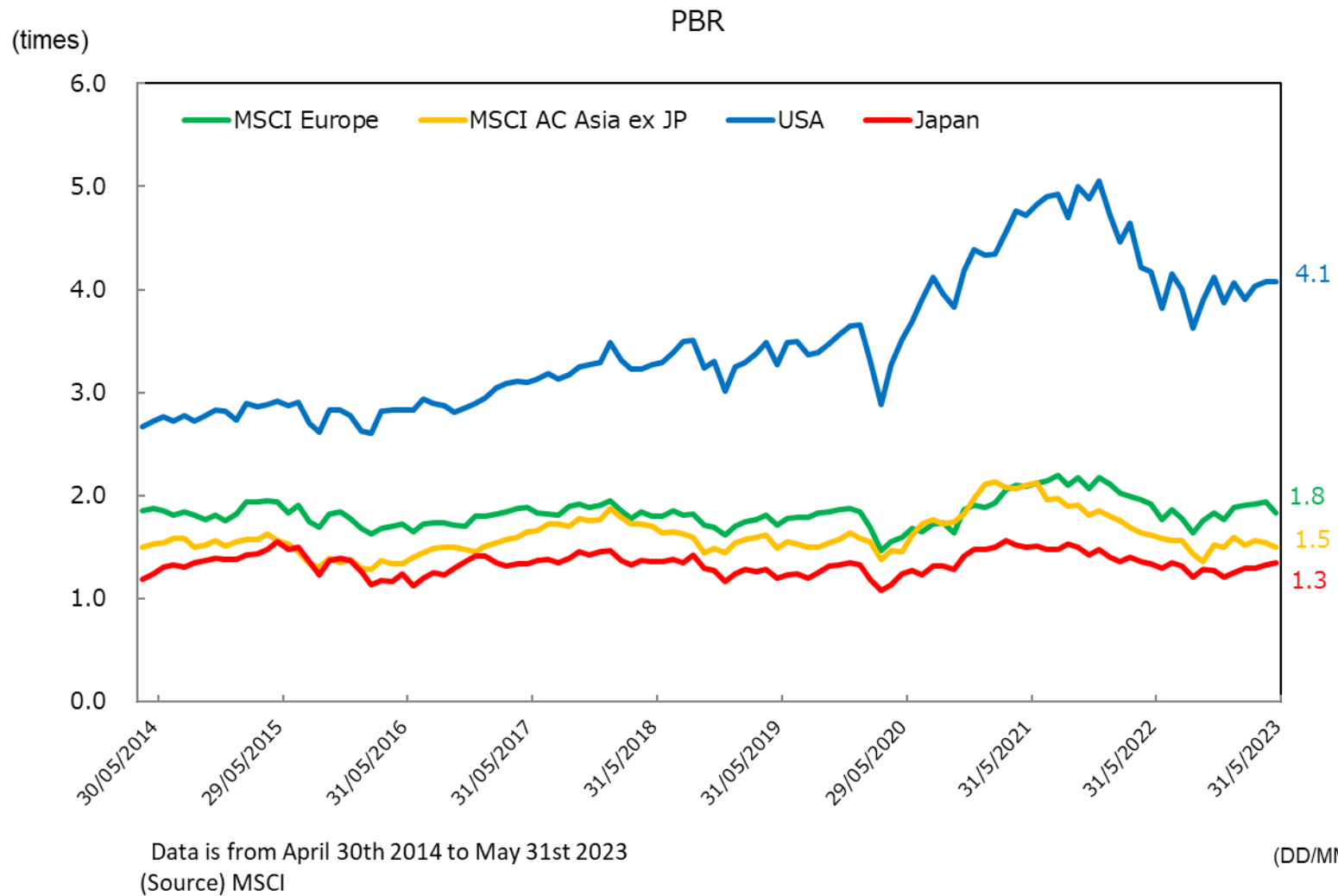




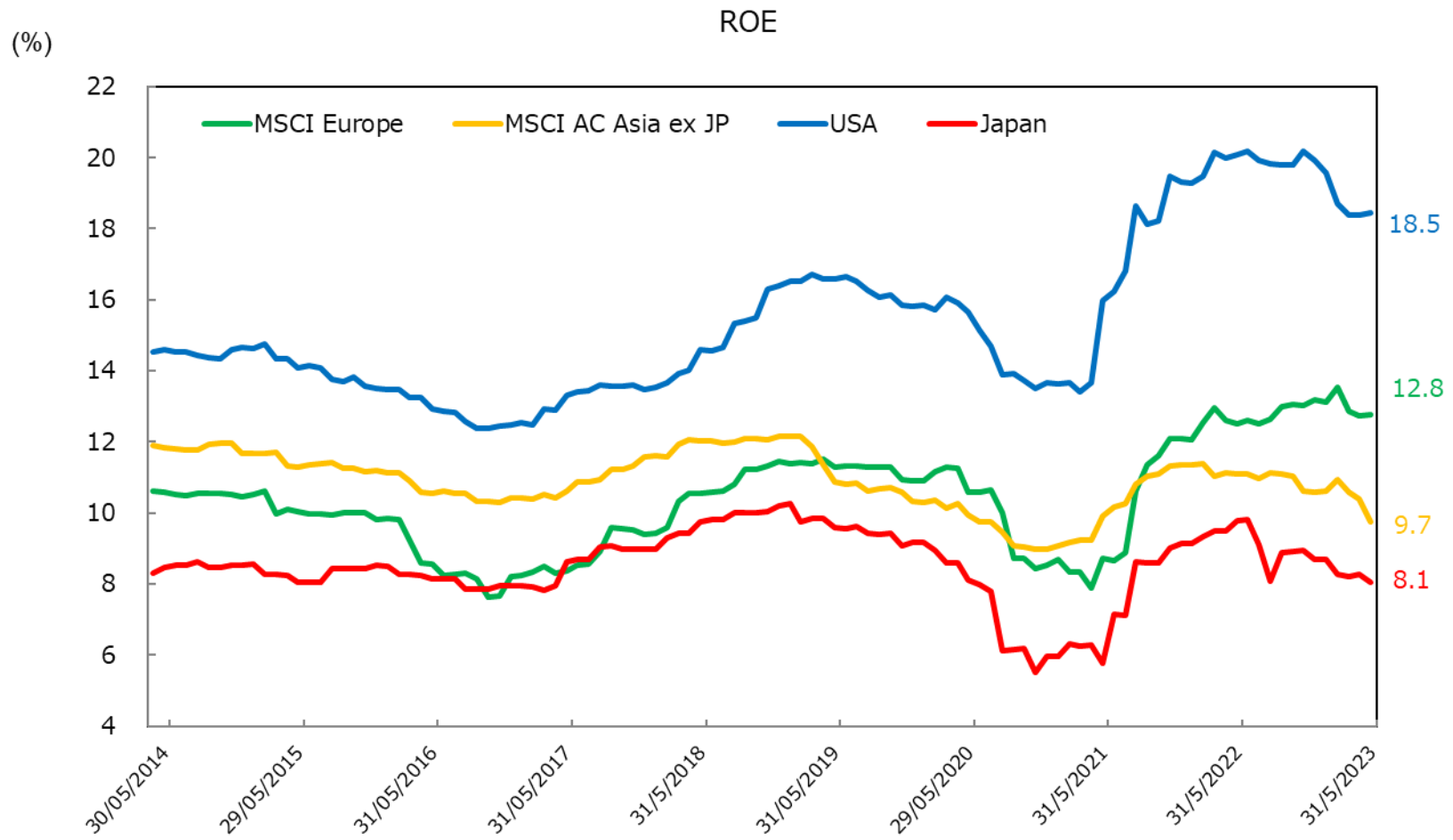
# Earnings outlook getting brighter



# Japan's PBR rising gradually due to mounting pressure



# Japanese companies still struggling to raise ROE



Data is from April 30th 2014 to May 31st 2023  
 (Source) MSCI

(DD/MM/YYYY)

# EPS revision moving below the surface despite weaker Yen

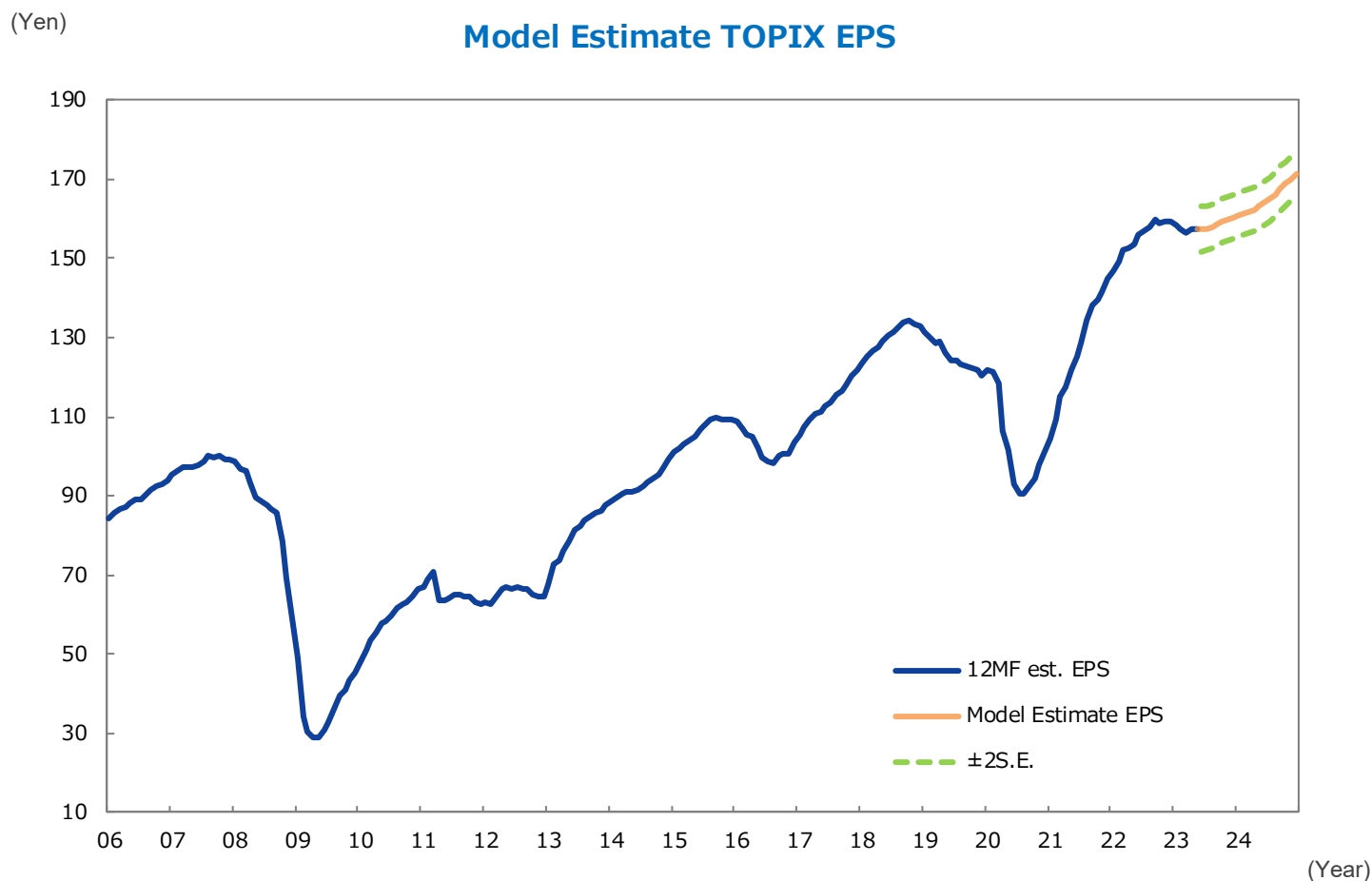
TOPIX Revision Index



Data is from December 28th 2017 to June 15th 2023  
(Source) Datastream, IBES

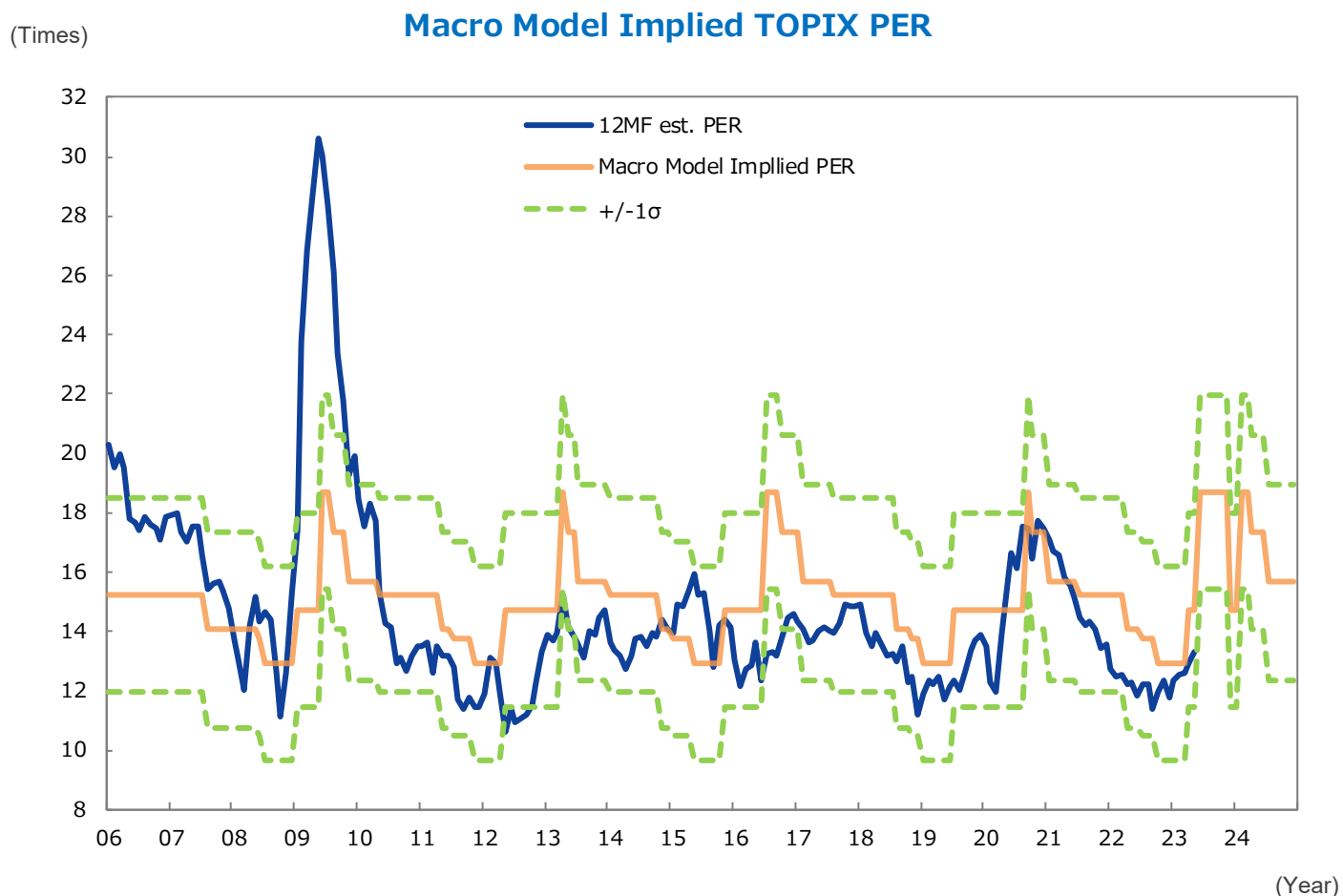
(YY/MM)

# Quant model indicates EPS to start recovering going forward



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

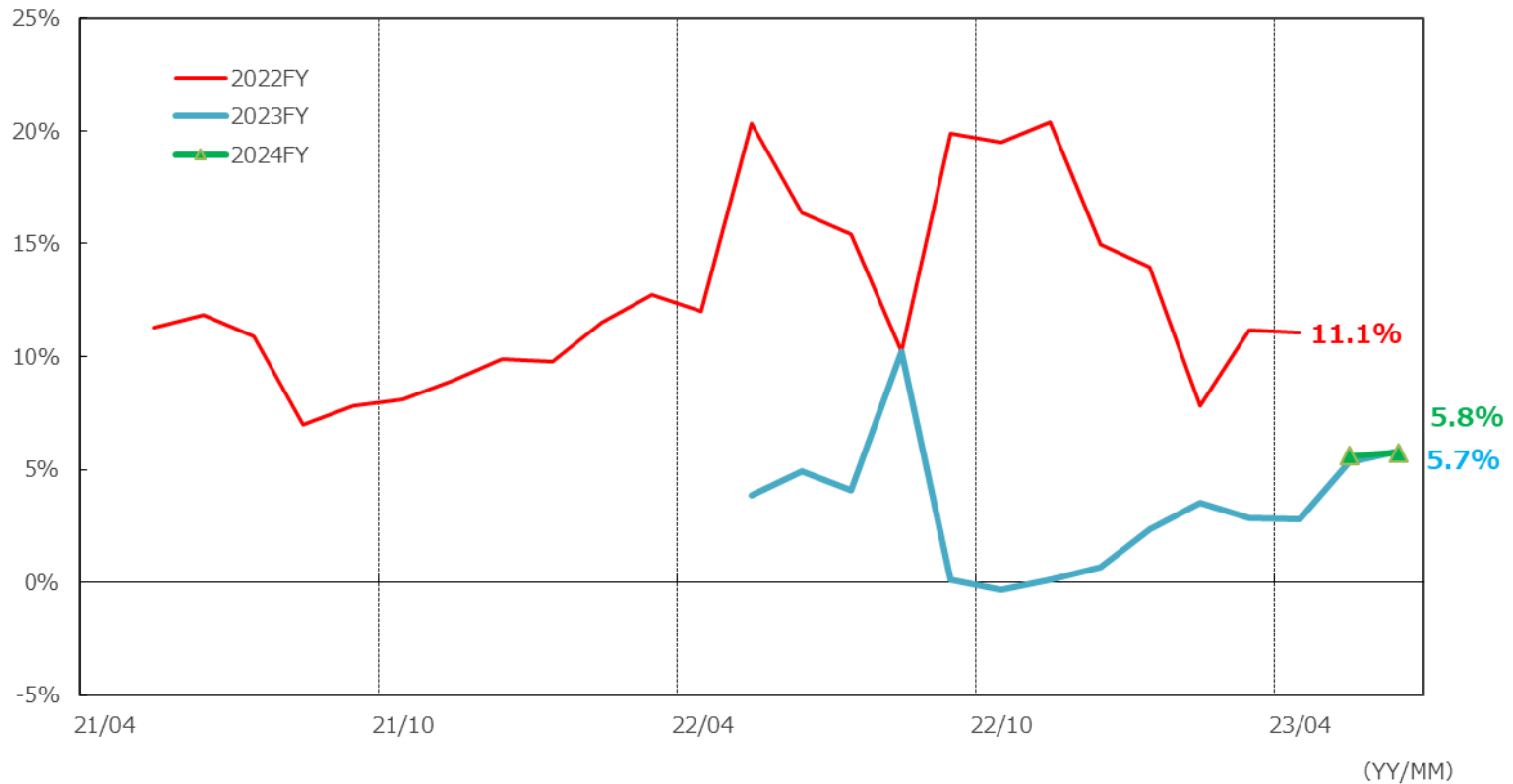
# Model indicates PER to rise further



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

# Bottom up earnings outlook getting brighter

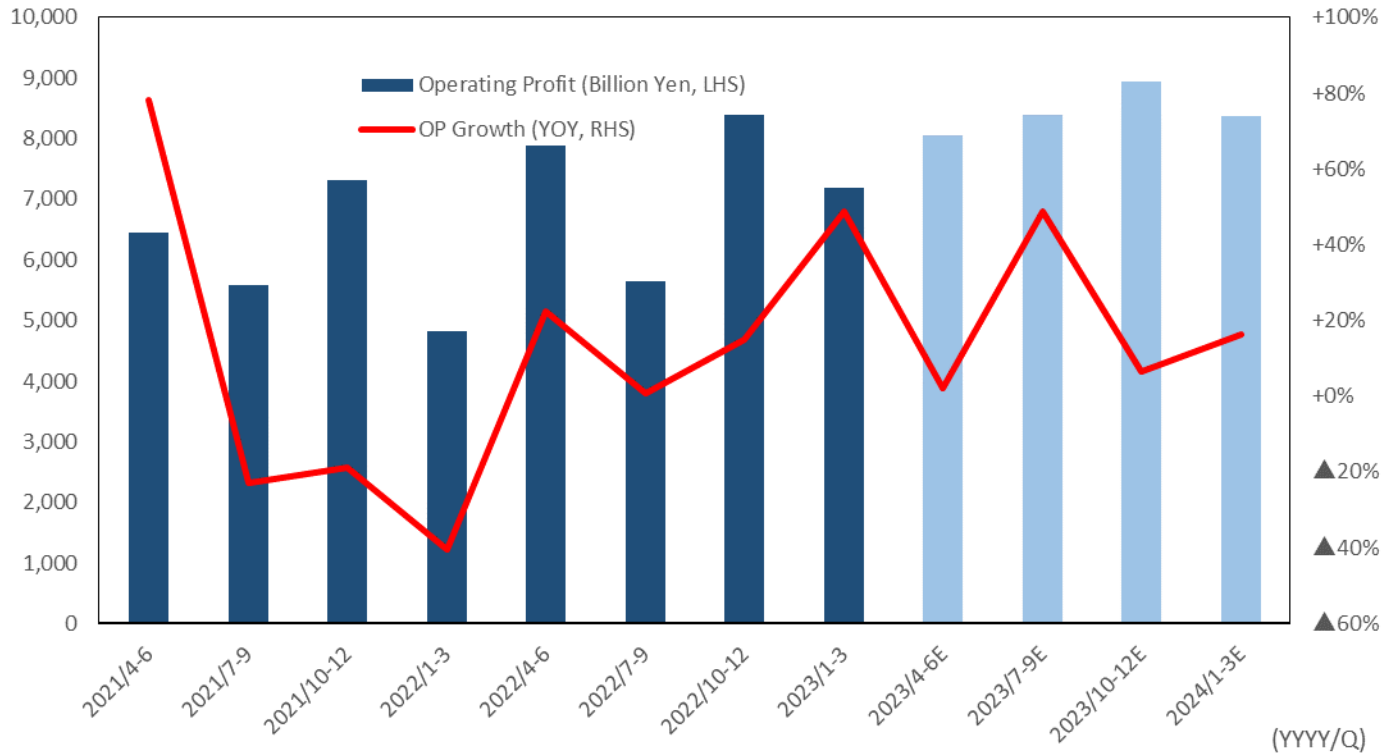
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th June 2023, SMDAM Core Universe (Excl. Financials) consists of 409 Japanese companies covered by SMDAM in-house analysts.  
 Source: SMDAM

# Outlook for operating profit remains stable

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

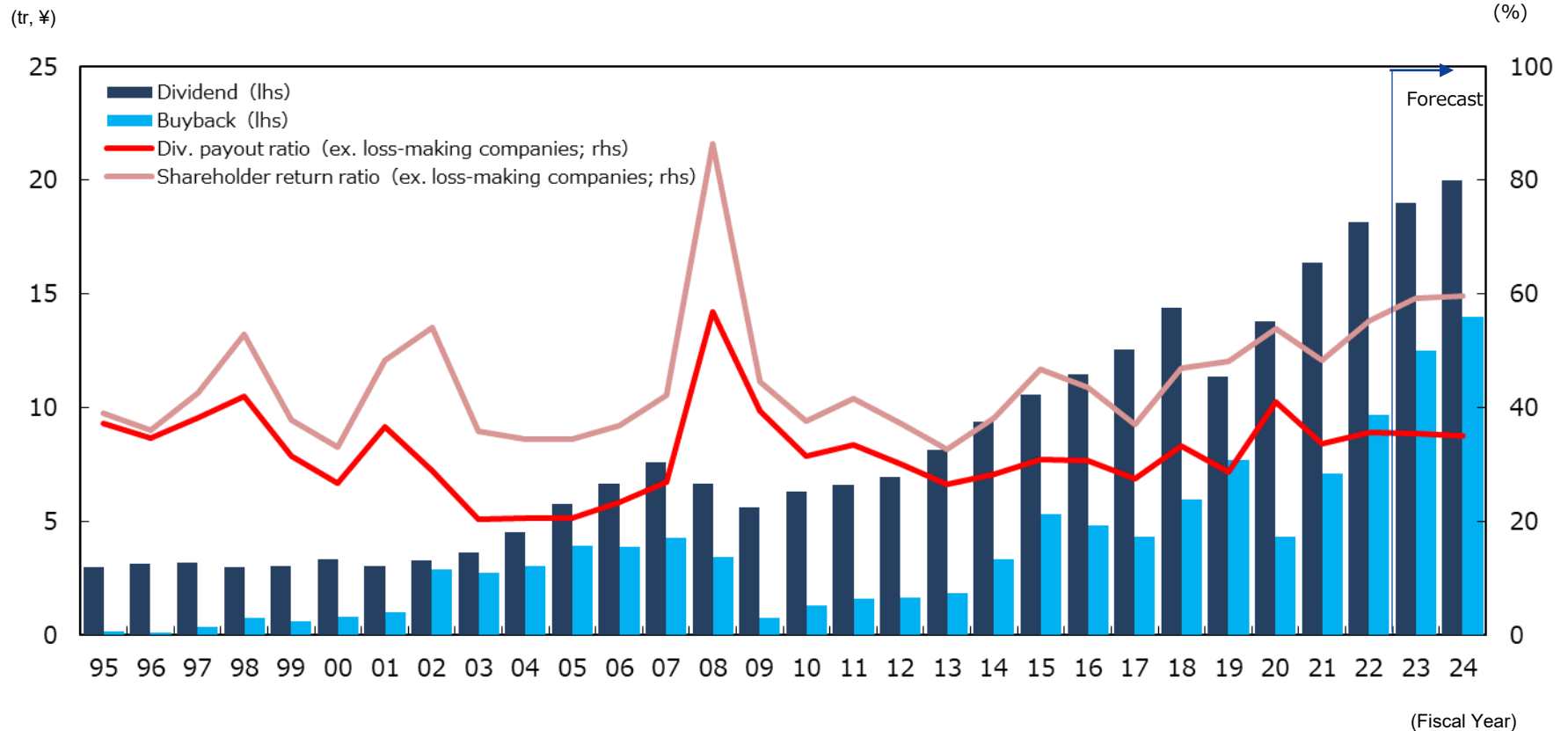


Note: Actual data is from Q1 2021 to Q1 2023. Estimate data is from Q2 2023 to Q1 2024.  
Source: SMDAM



# Dividends and buybacks continue their upward trend going forward

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



Note: Data is from FY1995 to FY2024. FY2023 and FY2024 are forecasts.  
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

# Fund flows from abroad favour blue chips

## 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>15.57</b>	<b>21.26</b>	<b>21.26</b>	<b>22.65</b>	<b>17.62</b>	<b>46.99</b>	<b>33.44</b>
Total Value	18.56	22.52	22.52	25.10	30.96	66.54	32.06
Top Cap Value	24.89	27.27	27.27	31.43	41.13	87.25	56.00
Large Cap Value	20.15	23.77	23.77	25.92	33.70	72.06	37.41
Mid Cap Value	14.01	19.12	19.12	18.82	24.40	53.62	14.61
Small Cap Value	11.66	17.03	17.03	21.32	19.29	43.65	10.18
Micro Cap Value	9.28	15.10	15.10	21.77	19.49	38.37	9.01
Total Growth	12.77	20.04	20.04	20.80	6.32	29.41	33.29
Top Cap Growth	14.24	23.06	23.06	22.28	8.85	35.08	44.59
Large Cap Growth	13.60	21.63	21.63	21.95	7.57	31.40	37.72
Mid Cap Growth	12.42	19.07	19.07	21.33	5.45	25.49	27.32
Small Cap Growth	6.25	8.14	8.14	11.93	-3.98	13.44	2.71
Micro Cap Growth	4.77	6.67	6.67	11.84	-6.89	13.17	3.57
Top Cap Total	18.80	24.91	24.91	26.05	21.80	56.10	48.53
Large Cap Total	16.63	22.64	22.64	23.58	18.91	49.57	38.26
Mid Cap Total	13.24	19.10	19.10	19.75	14.66	40.39	24.20
Small Cap Total	9.54	13.48	13.48	17.31	9.78	31.82	8.03
Micro Cap Total	7.78	12.22	12.22	18.19	10.36	30.21	8.45

Note : As of 30th June 2023  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is picking up.** Exports of goods have remained robust thanks to easing supply chain constraints. Business investment attitudes are persistent, and pent-up demand and requirement for de-carbonization and digitization are supporting appetite for CAPEX. While consumer spending has slowed somewhat amid headwinds from higher prices, sentiment among households and businesses has been favorable amid the resumption of economic activity.
- **Inflation has been mixed.** Nationwide core CPI rose 3.4% in April from 3.1% the previous month. On the other hand, the core CPI for the Tokyo metropolitan area in May was up 3.2% from 3.5% the previous month. The decline in the import price index, which is the starting point of the cost push, has become more pronounced and has spread to the domestic corporate price index.

## [Outlook]

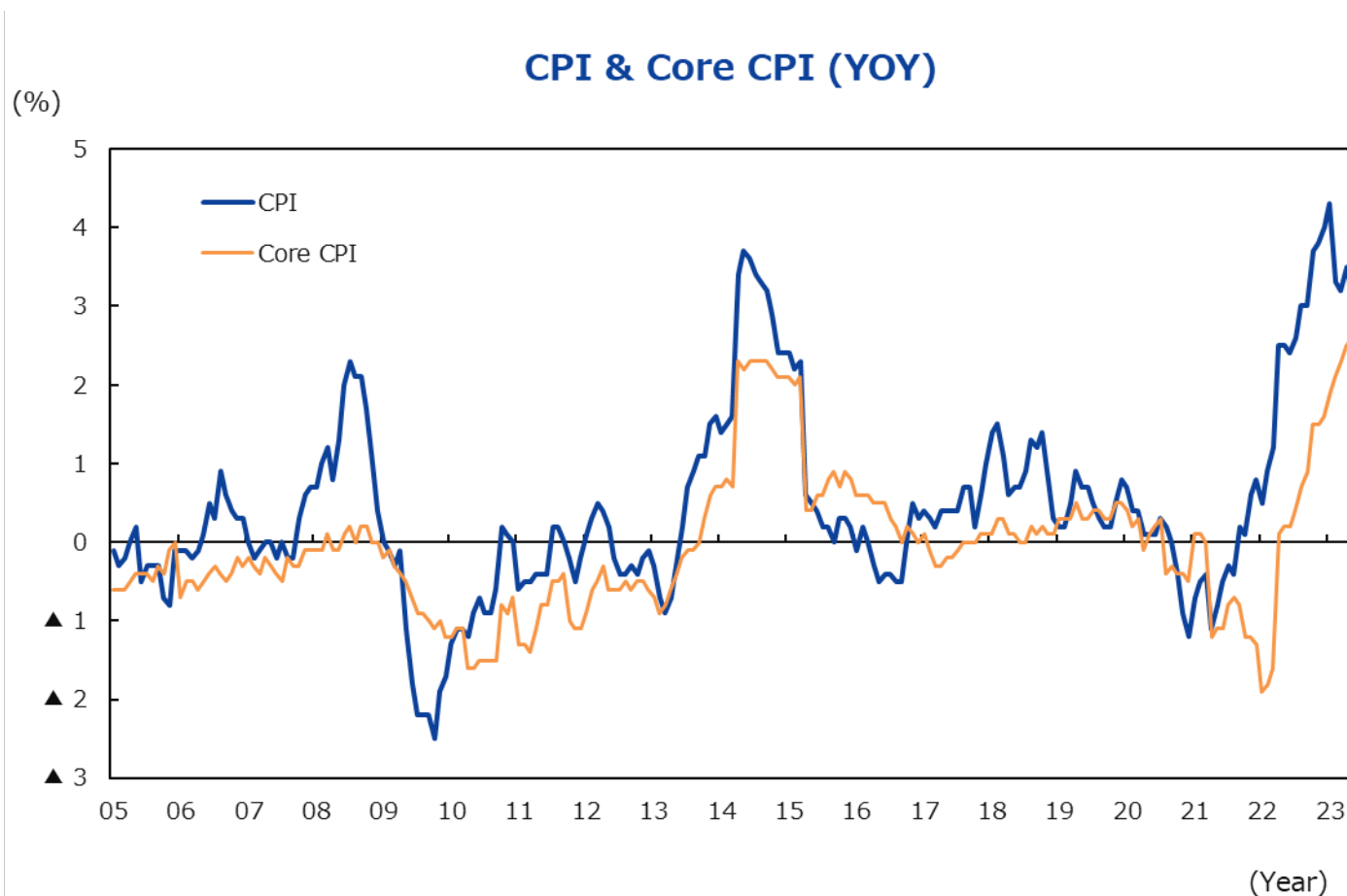
- ① **We have maintained our real GDP growth forecast for FY 2023 at +1.1% and have raised our estimate for FY 2024 from +0.9% to +1.0%.** The main reason for the upward revision in fiscal 2024 is stronger than expected overseas outlook. Looking ahead, we expect the overall economic recovery to continue, supported by consumer spending, capital investment, inbound consumption and easing supply constraints. For the first half of 2024, we expect growth to slow slightly against the backdrop of a slowdown in the U.S. economy, but we moderated the slowdown slightly.
- ② **We have raised our core CPI forecast for FY 2023 from +2.5% to +2.7% and that for FY 2024 from +1.5% to +1.6% respectively.** Both revisions were mainly due to a change in currency assumptions toward a weaker yen and the end of gasoline subsidies. The core CPI is likely to follow a decelerating trend, given that the cost-push pressure may diminish in response to a slowdown in import prices, despite the increase in electricity regulatory rates in June 2023. However the core CPI is not expected to fall below 2% year on year until the middle of next year, partly due to support from higher wage increases.
- ③ **We expect PM Kishida and his cabinet will continue its accommodative economic policy.** In the Comprehensive Economic Measures to Overcome High Prices and Achieve Economic Revitalization approved by the Cabinet in October 2022, the government implemented a massive economic stimulus package of 37.6 trillion yen based on national and local expenditures. If the economy falters, keep an eye on the possibility of additional stimulus measures. In addition, a dissolution of the House of Representatives in the ordinary session of the Diet was shelved, but if a snap general election is held in the future, we are wary of the risk of fiscal expansion in order to raise approval rate.
- ④ **We expect the range of the YCC, yield curve control, will be widened from  $\pm 0.5\%$  to  $\pm 1\%$  in July 2023.** We expect the BOJ to maintain its easy monetary policy stance while adjusting its policy to deal with side effects. This is because as the U.S. economy recedes, side effects such as a weaker yen and dysfunctional bond markets will be more likely to intensify. As for the negative interest rate policy, we believe that it is likely to be maintained because governor Ueda values it as the basis for monetary easing. We are watching for the possibility of a deepening debate over the side effects of monetary easing through a review of economic conditions in the event of a prolonged failure to meet the price stability target.

# 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	0.2%	-0.8%	-4.1%	2.6%	1.4%	1.1%	1.0%
Private final consumption expenditure	0.1%	-0.9%	-5.1%	1.5%	2.4%	1.3%	1.0%
Private housing investment	-4.8%	2.5%	-7.6%	-1.1%	-4.4%	-0.6%	0.1%
Private-sector capital investment	1.6%	-1.2%	-5.7%	2.1%	3.1%	2.6%	2.1%
Private inventory investment	0.1%	-0.2%	-0.3%	0.4%	0.2%	-0.2%	0.0%
Public fixed capital formation	0.8%	1.6%	4.9%	-6.4%	-3.0%	1.8%	0.5%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	0.0%	-0.1%
Exports of goods and services	2.0%	-2.3%	-9.9%	12.4%	4.4%	0.2%	2.1%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.2%	0.3%	2.4%
Nominal GDP	0.2%	0.0%	-3.5%	2.4%	2.0%	3.4%	2.1%
GDP deflator	-0.1%	0.8%	0.7%	-0.2%	0.6%	2.3%	1.1%
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	-0.2%	0.1%	1.8%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.7%	1.6%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	0.6%	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%
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%

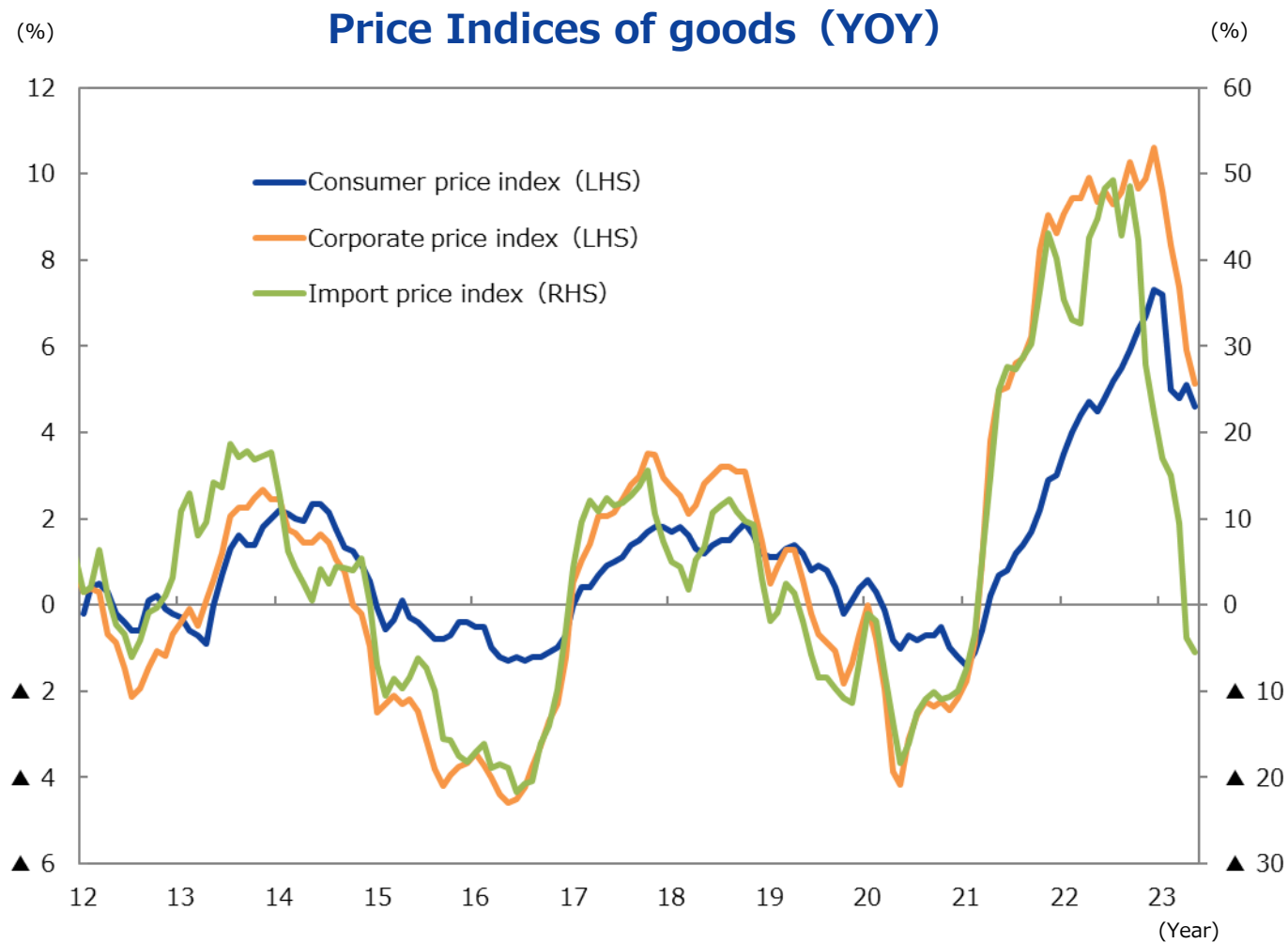
Note: Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education.  
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

# Japan faces stickier core inflation despite falling energy costs



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

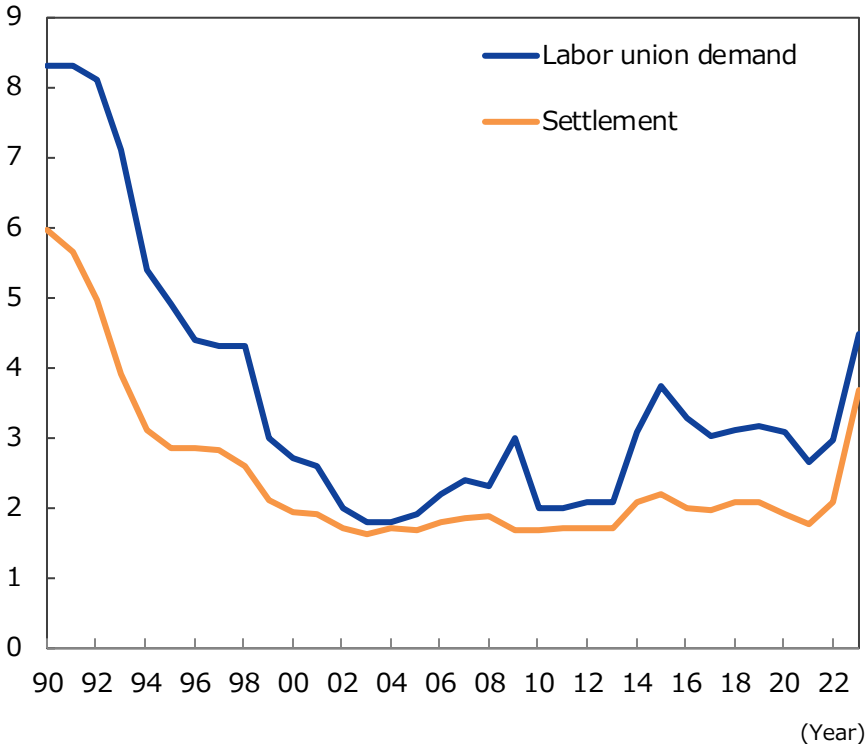
# Japan faces sticky inflation despite sharp decline of import prices



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

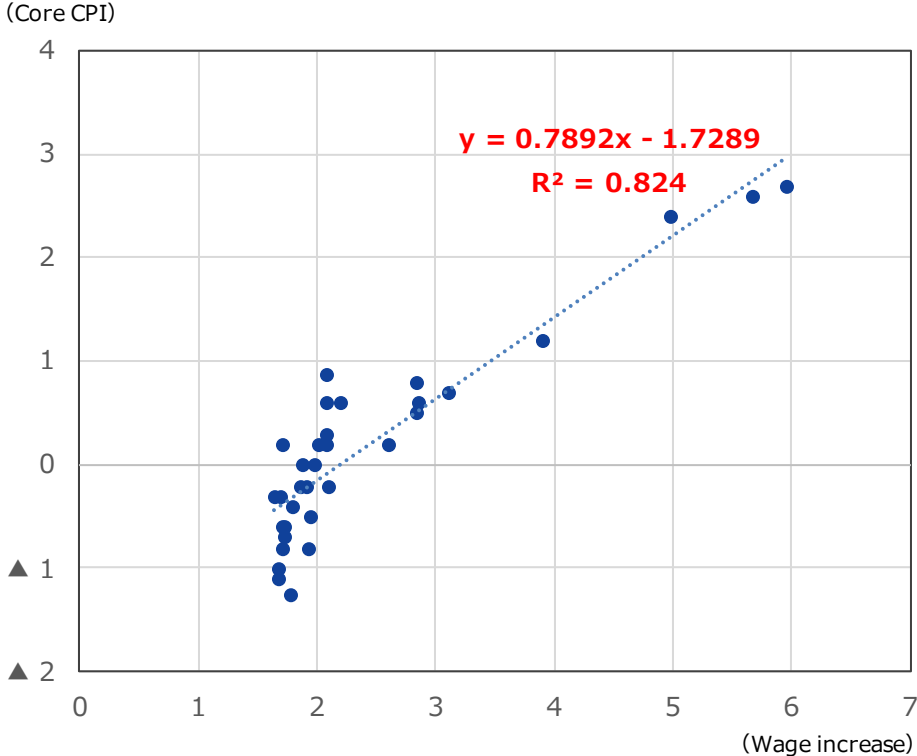
# Start of a virtuous cycle to overcome deflation?

### 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, %)

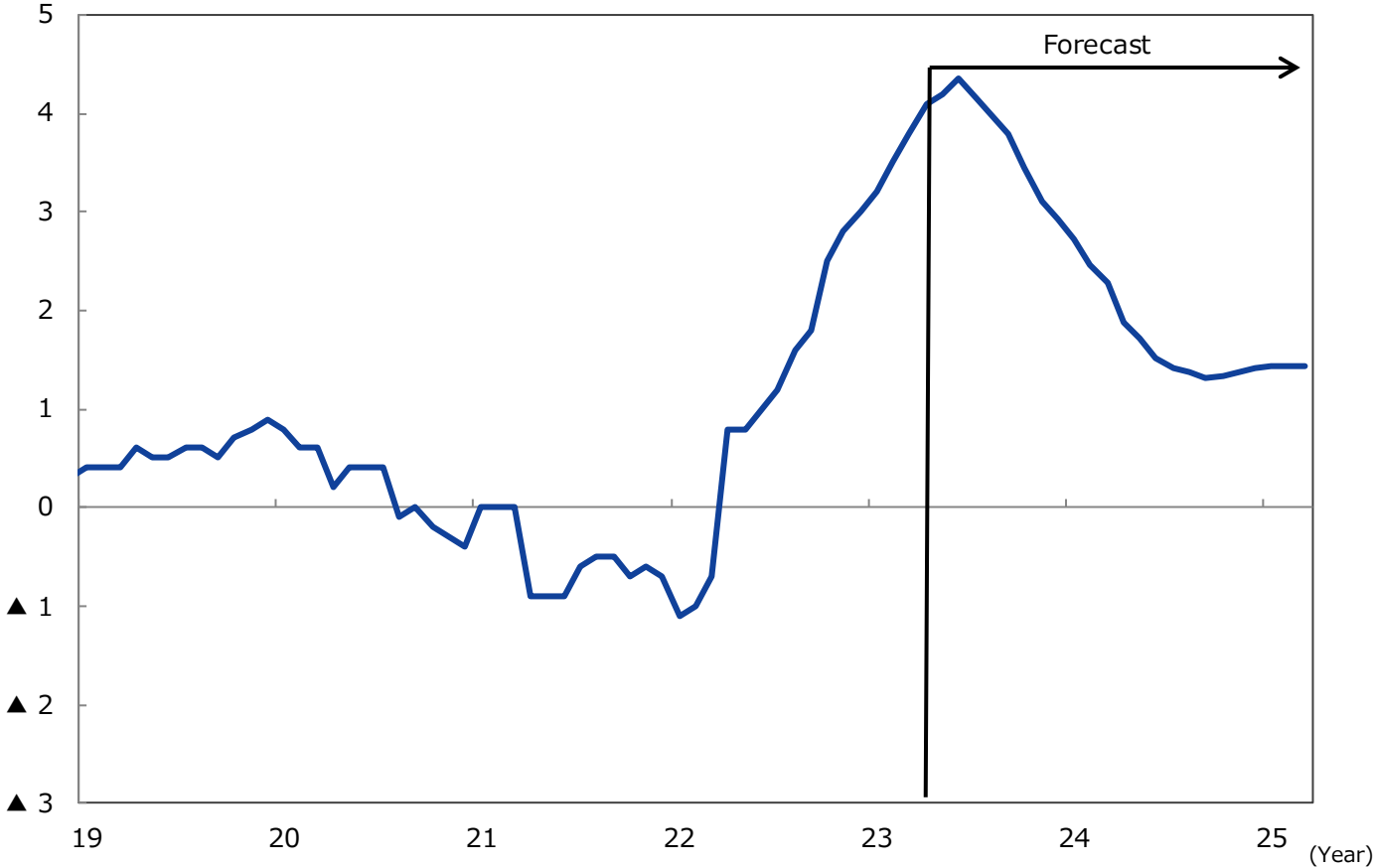


Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy  
Source: MIAC, Japanese Trade Union Confederation, SMDAM



# BOJ's peak estimate have raised and deferred repeatedly

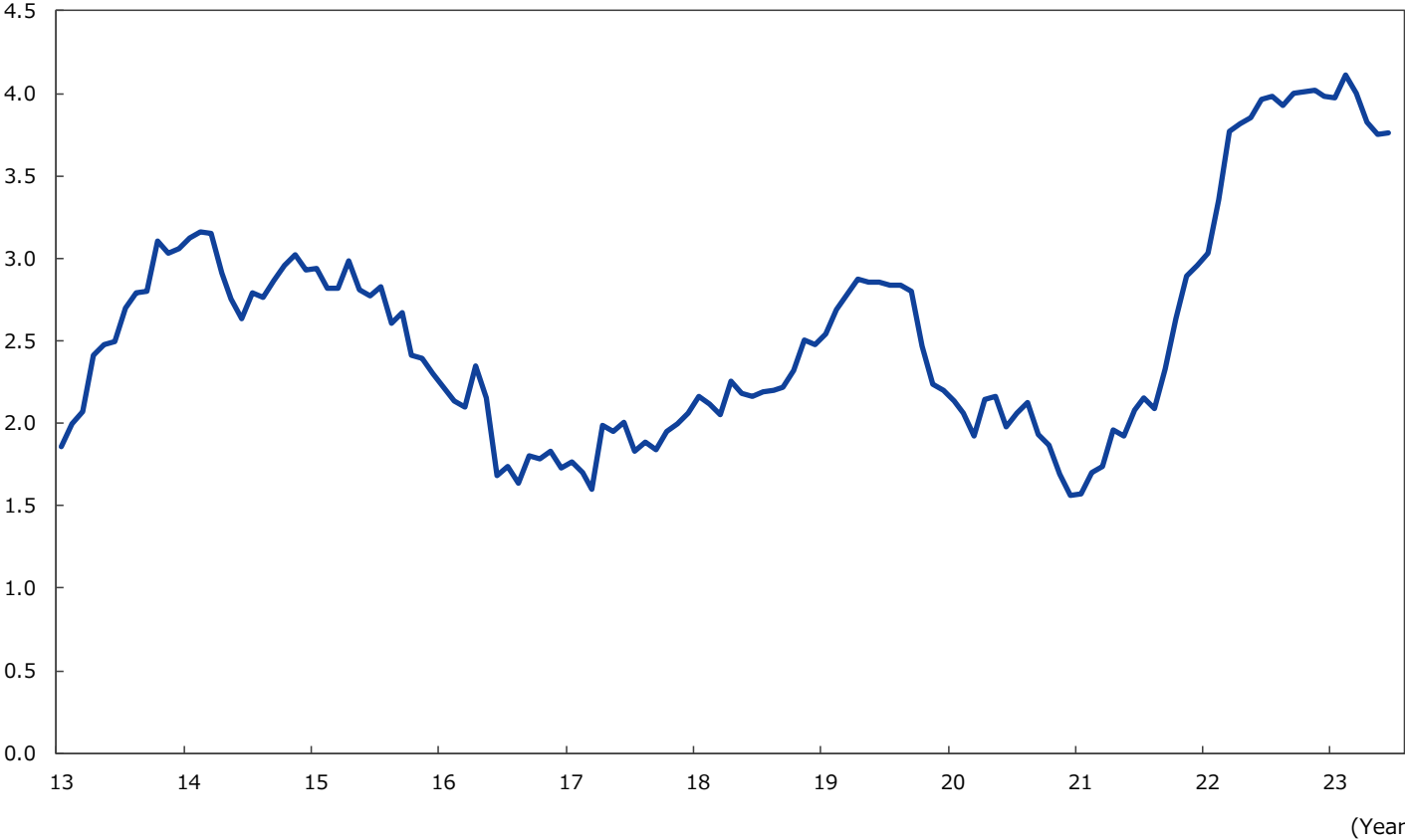
BOJ's Core CPI forecast (YOY, %)



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

# People's expectation for inflation to stop declining

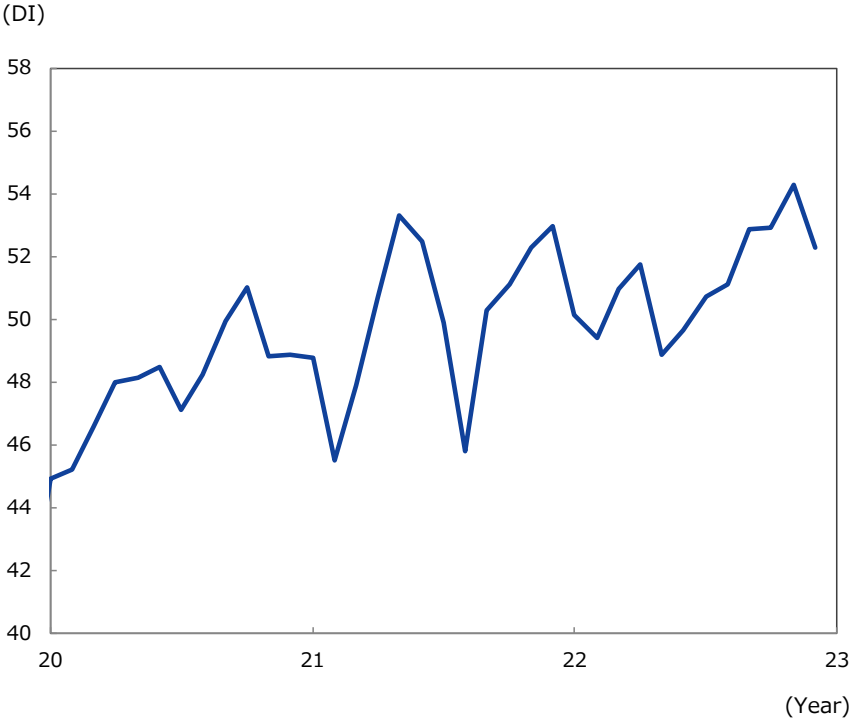
Consumers' Expectation of Inflation Rate (YOY, %)



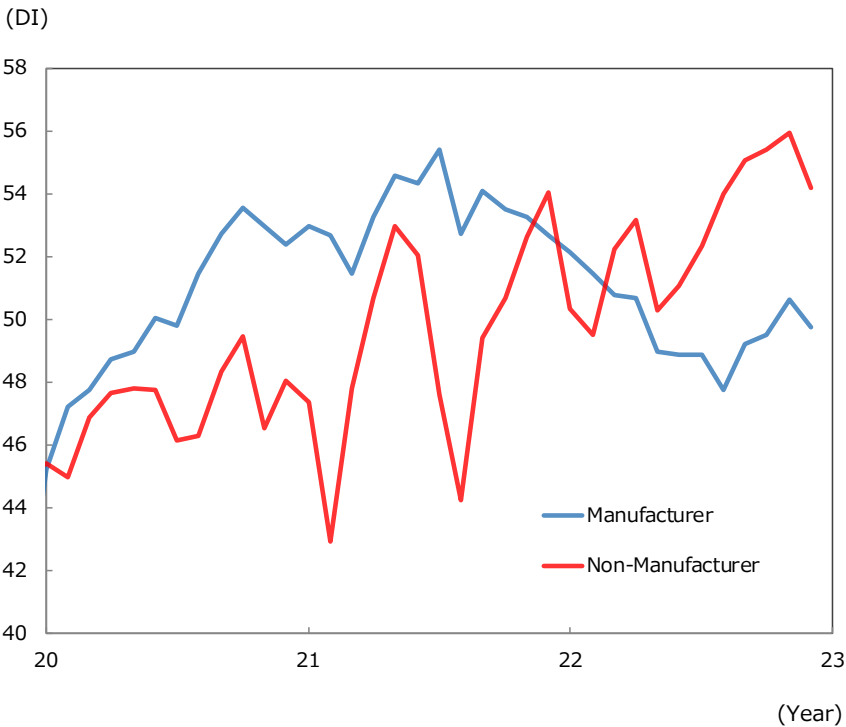
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to June 2023.  
Source: Cabinet Office, SMDAM

# Soft data shows first decline since November 2022

### Composite PMI



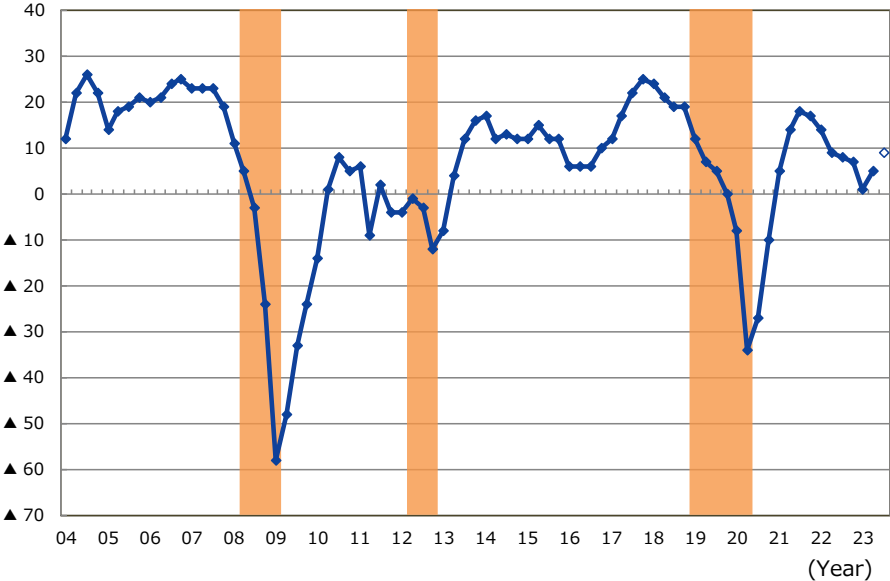
### PMI, Manufacturer & Non-Manufacturer



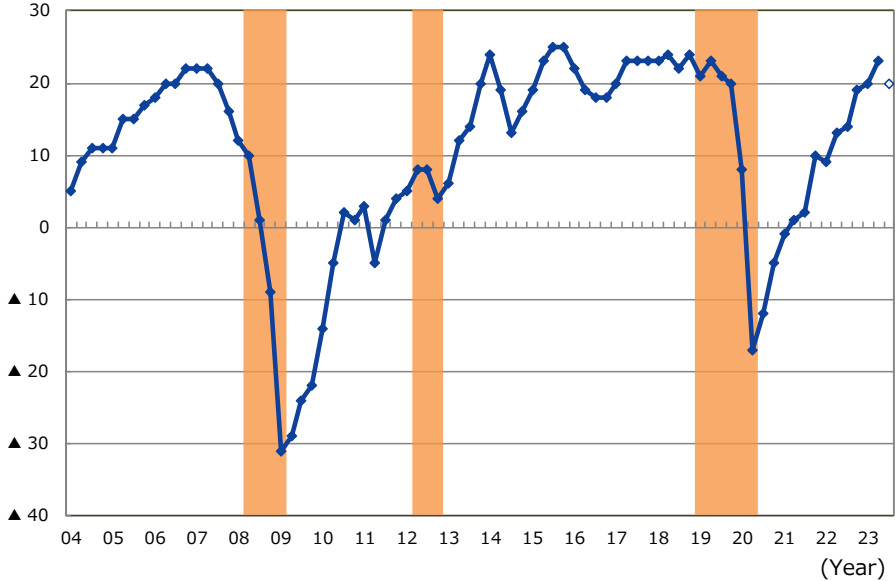
Note: Data is from July 2020 to June 2023.  
Source: Bloomberg, SMDAM

# Manufacturers start chasing non-manufacturers' recovery

BOJ business condition DI Large manufacturers (%)



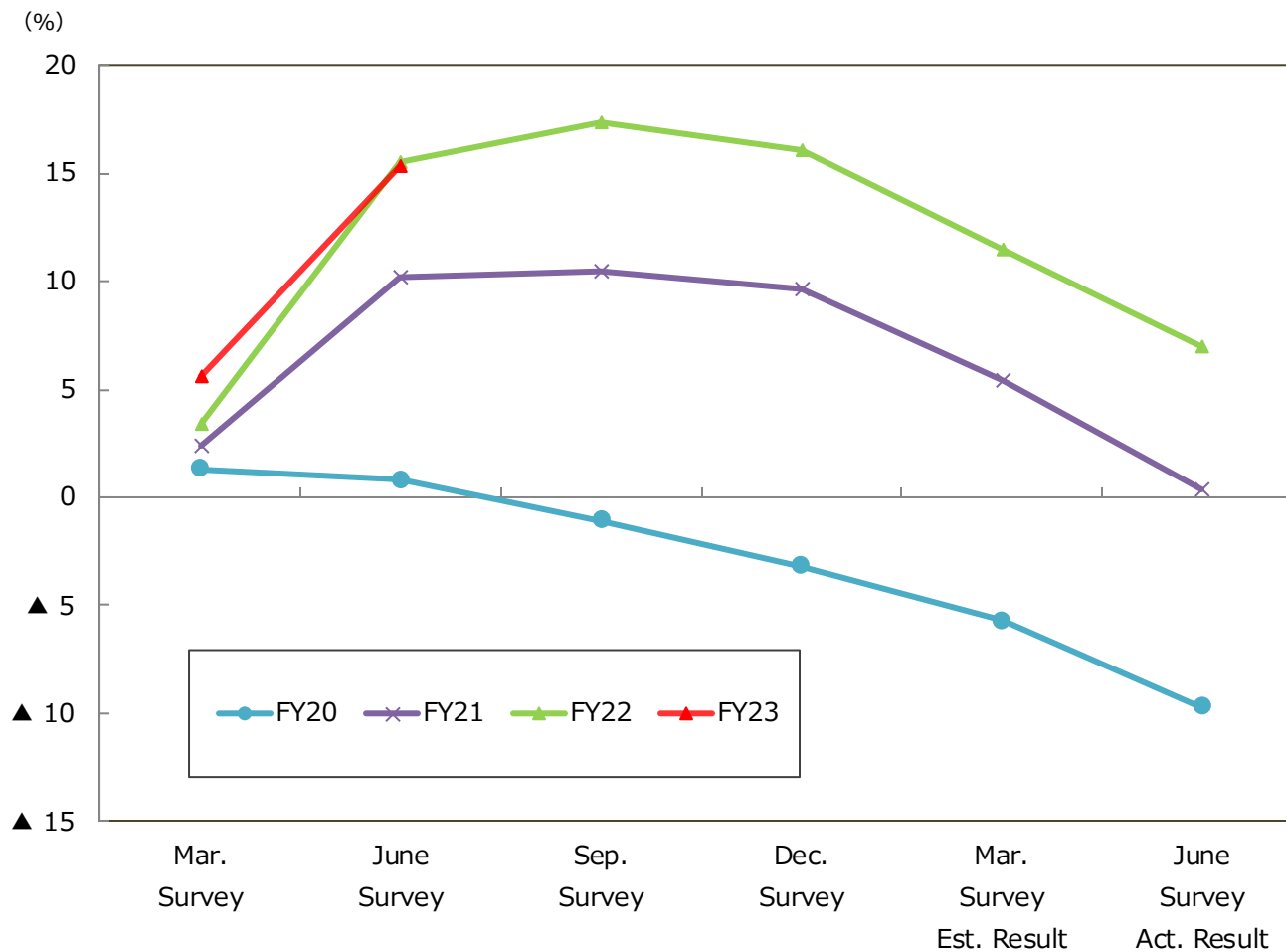
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q2 2023. The orange shadow are periods of economic recession.  
 Source: The Bank of Japan, SMDAM

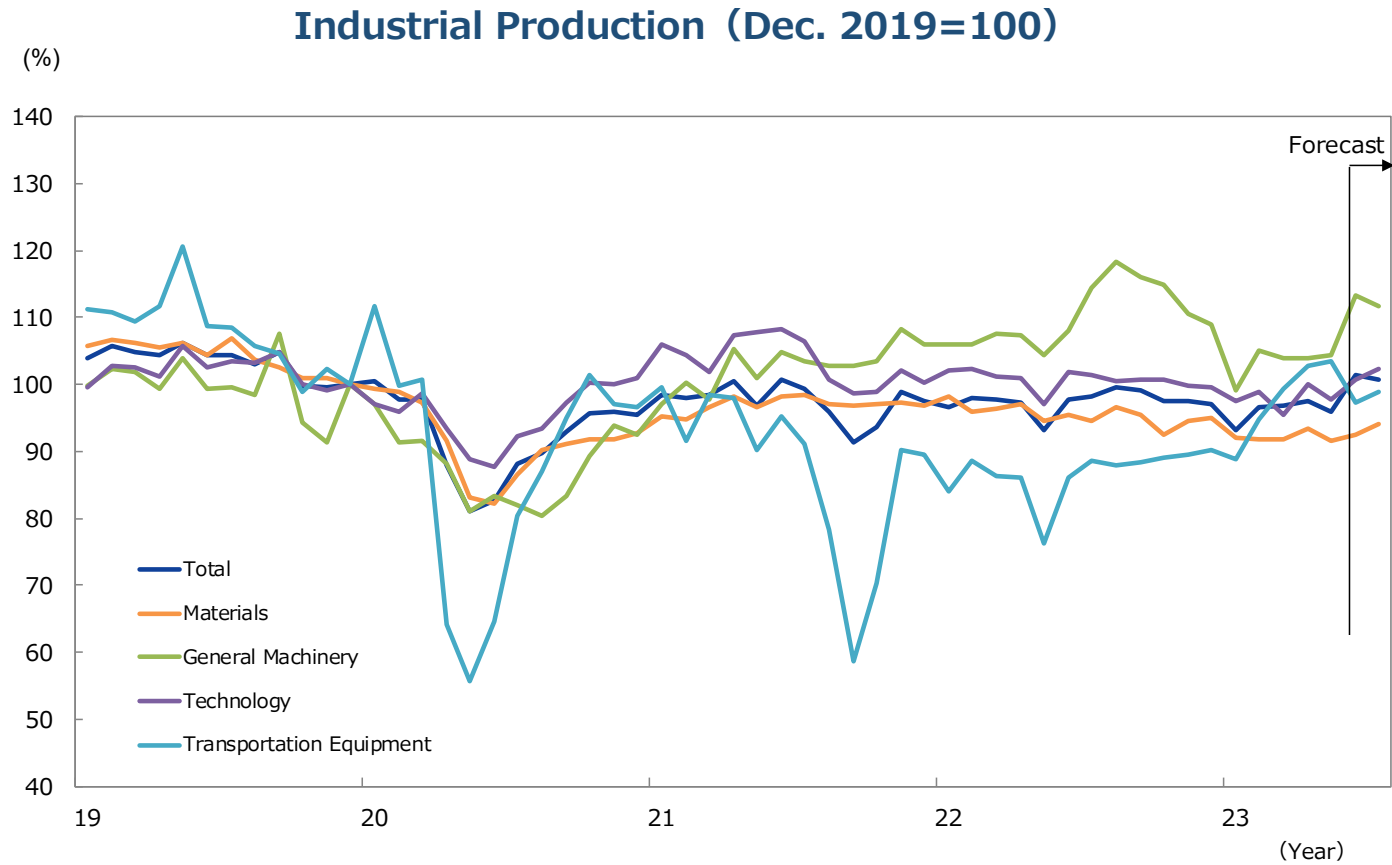
# Weaker JPY and “de-risking” boost CAPEX in Japan

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



Note: Data is from Q1 FY2020 to Q2 FY2023.  
Source: The Bank of Japan, SMDAM

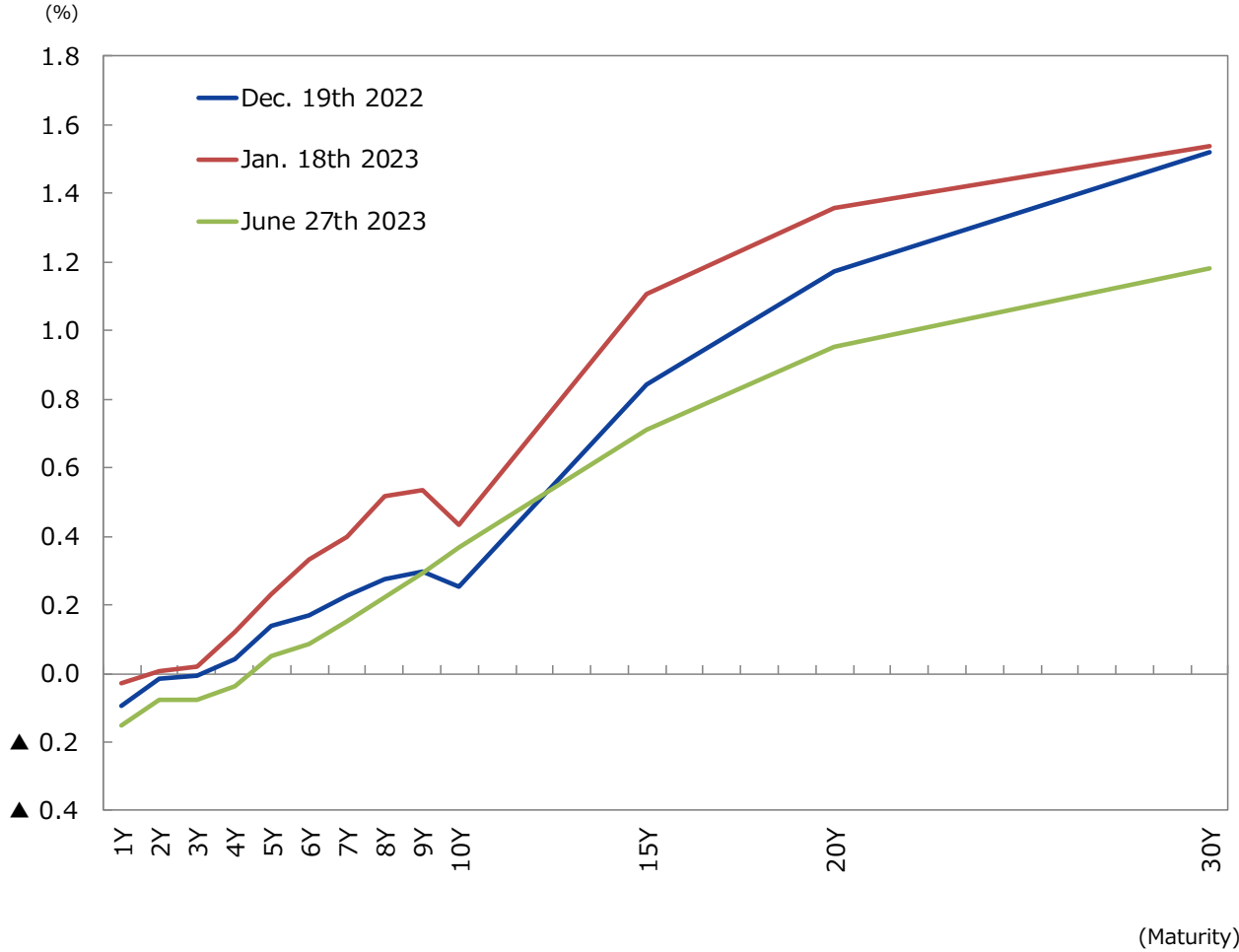
# Tailwind from normalization of auto production



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

# Governor's dovish comments brought yield curve back to normal

## Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

# BOJ governor confirms dovish monetary policy ahead

## Summary of BOJ governor Ueda's Regular Press Conference (June 16th)

### Monetary policy

Expectations for the rate of inflation are bound to vary considerably. **Monetary policy is determined** not only by the median forecast but also **how confident we are in the outlook**. The risk that prudence will lead to excessive inflation is not zero. If we compare what we can do when inflation overshoots with what we can do when inflation falls before we reach our target, **we conclude that undershooting is more difficult to deal with**.

### Prices and wages

Looking ahead, we expect that the impact of price pass-through will diminish and the positive margin will narrow toward the middle of this fiscal year. Recent data suggests that we are now in a downward phase, but that the downturn is a little slower than we thought. We think that we are still at the beginning of a downward phase. Going forward, it will drop further into the middle of fiscal 2023. At that stage, there is a high degree of uncertainty over whether the economy will continue to move above the April forecast, or whether it will rapidly decline in a way that eliminates the portion that has been slightly above the forecast. **There are signs of changes in the way companies set prices and wages. However, there is a lot of uncertainty about its durability.** We would like to deepen our analysis and gain more awareness about whether this is a long-term move. Prices for food, daily necessities and lodging are rising at a high rate. We believe that the movement to pass on higher prices of raw materials and energy is stronger than expected, but we would like to analyze it a little more.

Wages should also be rising when the 2% price target is met. We have to add to that by raising productivity, but it's hard to say in advance. You don't have a target for wages and change policy when it's achieved.

### Yield Curve Control, YCC

**Indicators of market functioning have improved, and the side effects of YCC have subsided somewhat recently. It is undeniable that side effects may be noticeable when inflation expectations rise at home or interest rates rise abroad.** We can't know in advance, but **we decide by comparing the effects and side effects at that time.** We think it is inevitable that there will be some surprises, including the fact that new data and information will come in at every decision meeting, and based on that, the results will be different from the previous meeting.

### Foreign exchange rate

There are a variety of sectors that will be positively or negatively affected by a weaker yen. We believe it is important for the exchange rate to move stably in line with fundamentals.

### Review

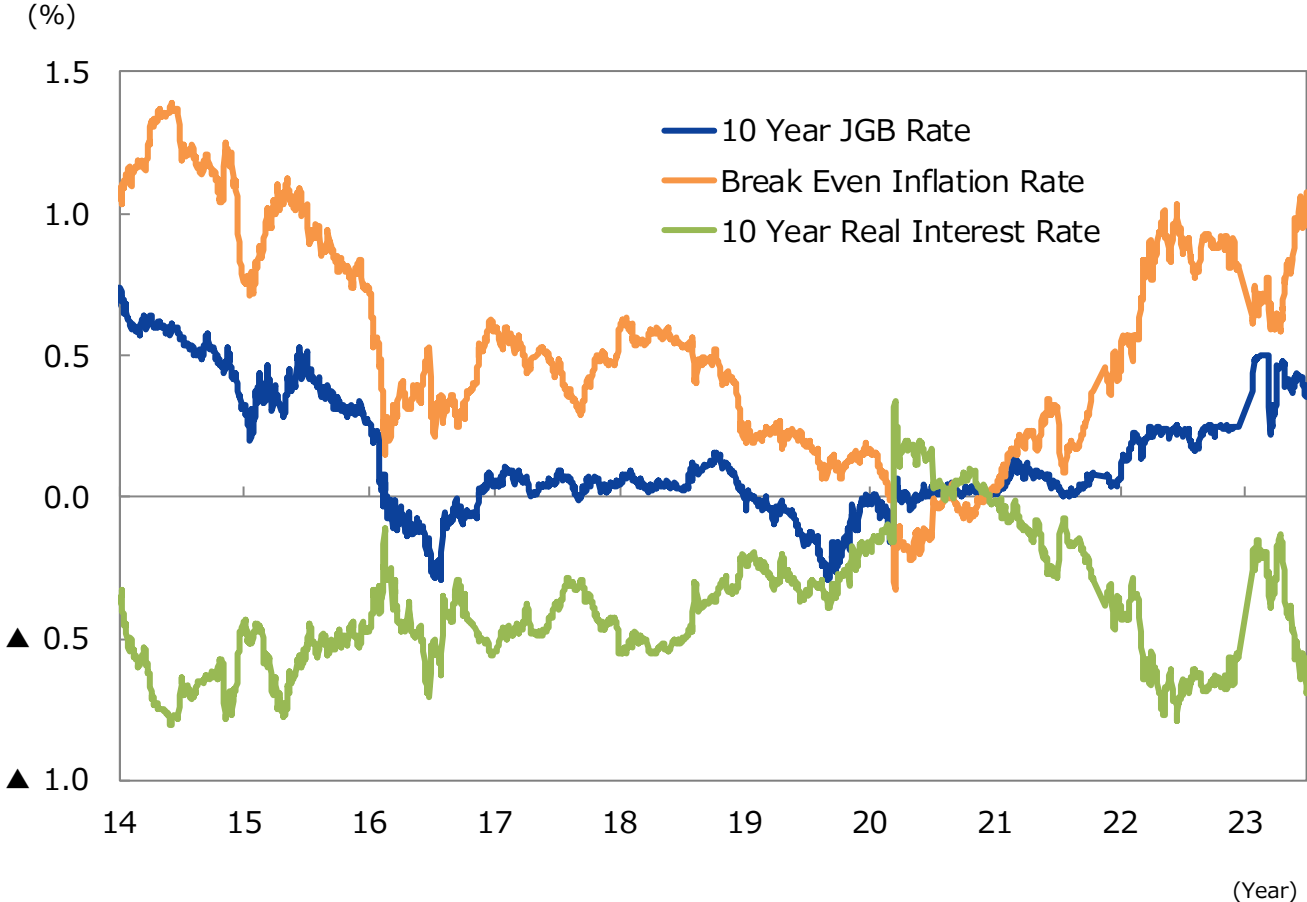
We want to be flexible in our analysis themes. First, we would like to understand the effects of various unconventional policy tools implemented over the past 25 years in relation to economic and price developments, and analyze their impact on financial markets, including side effects. We are considering conducting existing surveys, hearings at the head office and branch offices, financial and economic roundtables, and public comments on publications. We will also run workshops inviting academics and experts. A special page will be set up on the Bank of Japan's website within the next month for reviews, which will be posted on a rolling basis.

Source: SMDAM



# Rising inflation expectation brings real interest rate lower

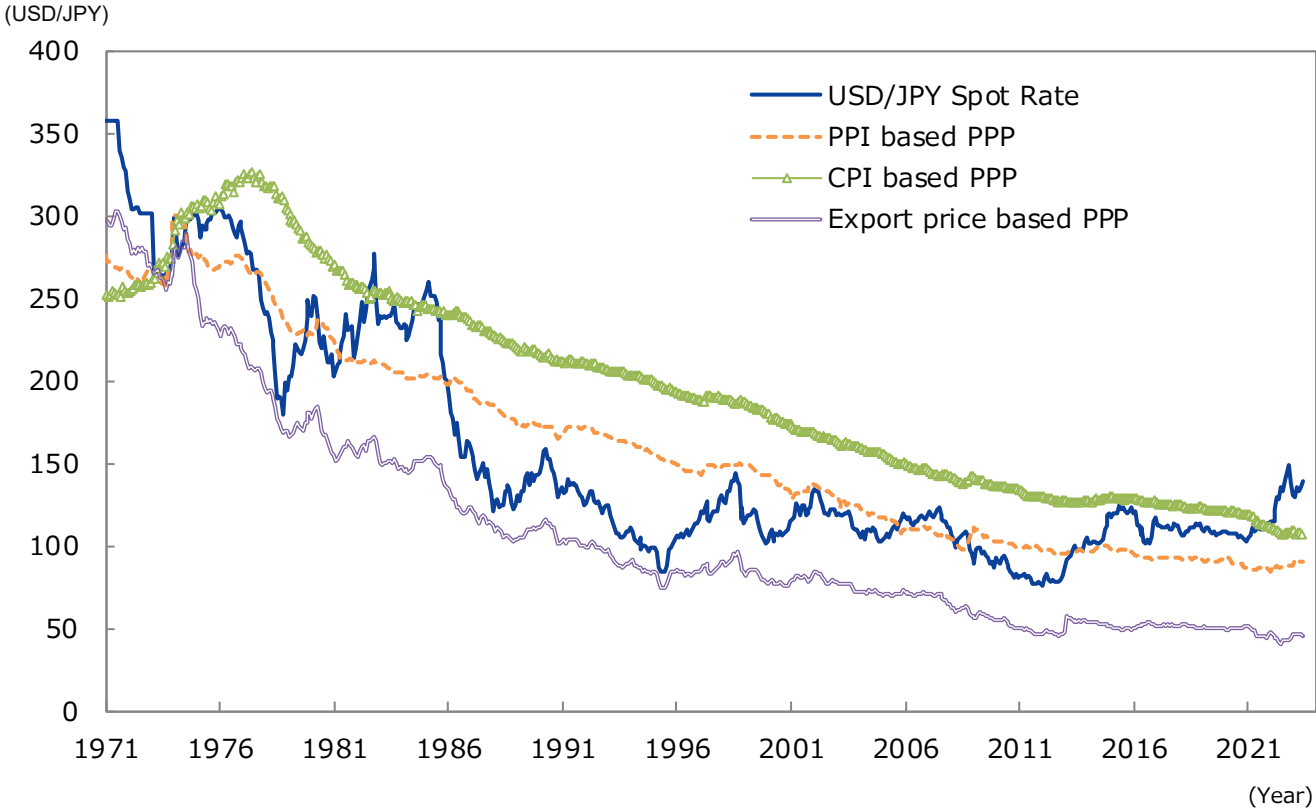
## JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 30th June 2023.  
Source: Bloomberg, SMDAM

# USD/JPY clearly breaks trend of purchasing power parity

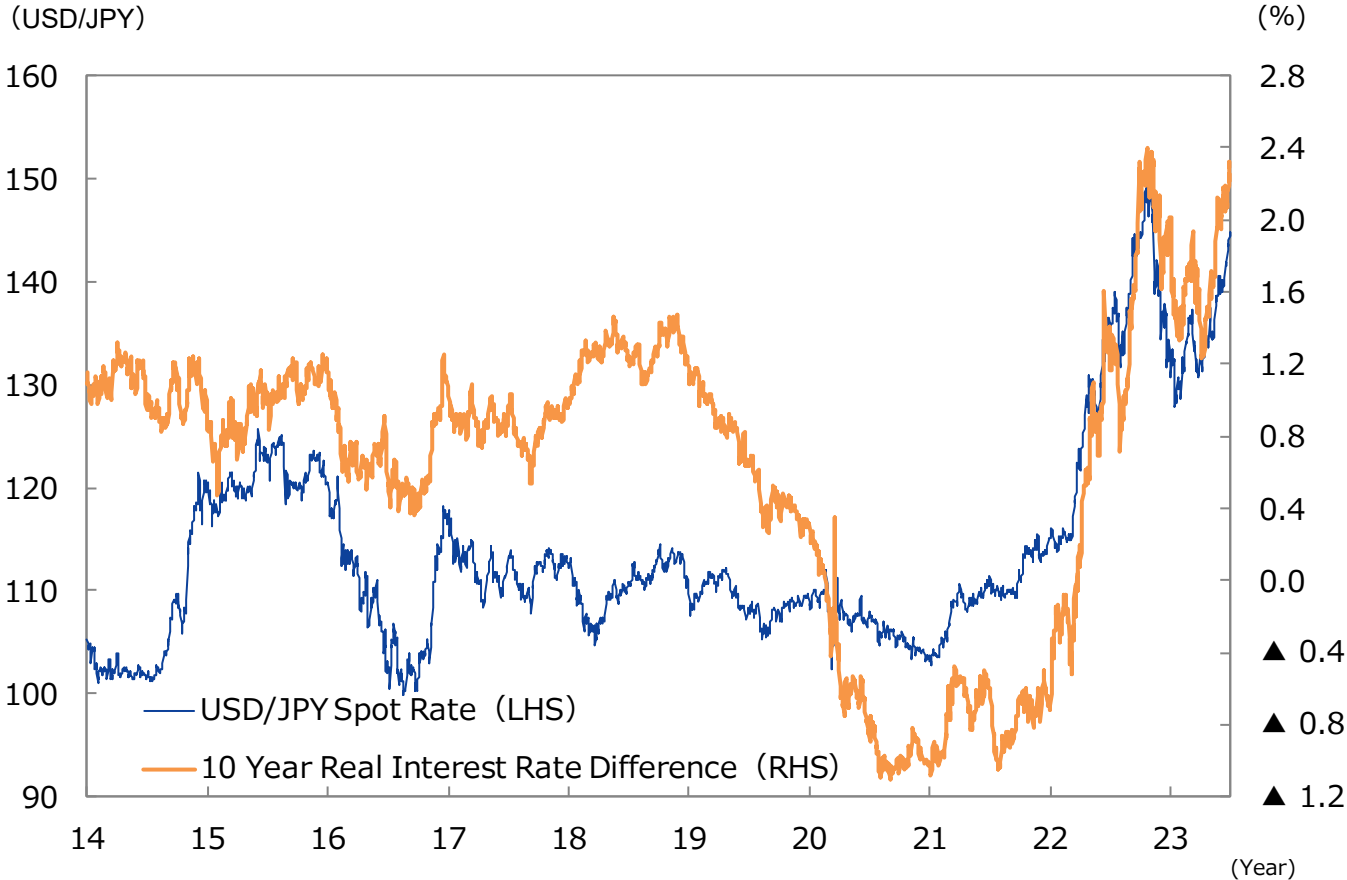
## Purchasing Power Parity of USD/JPY Rate



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

# Real yield gap still dominating USD/JPY rate

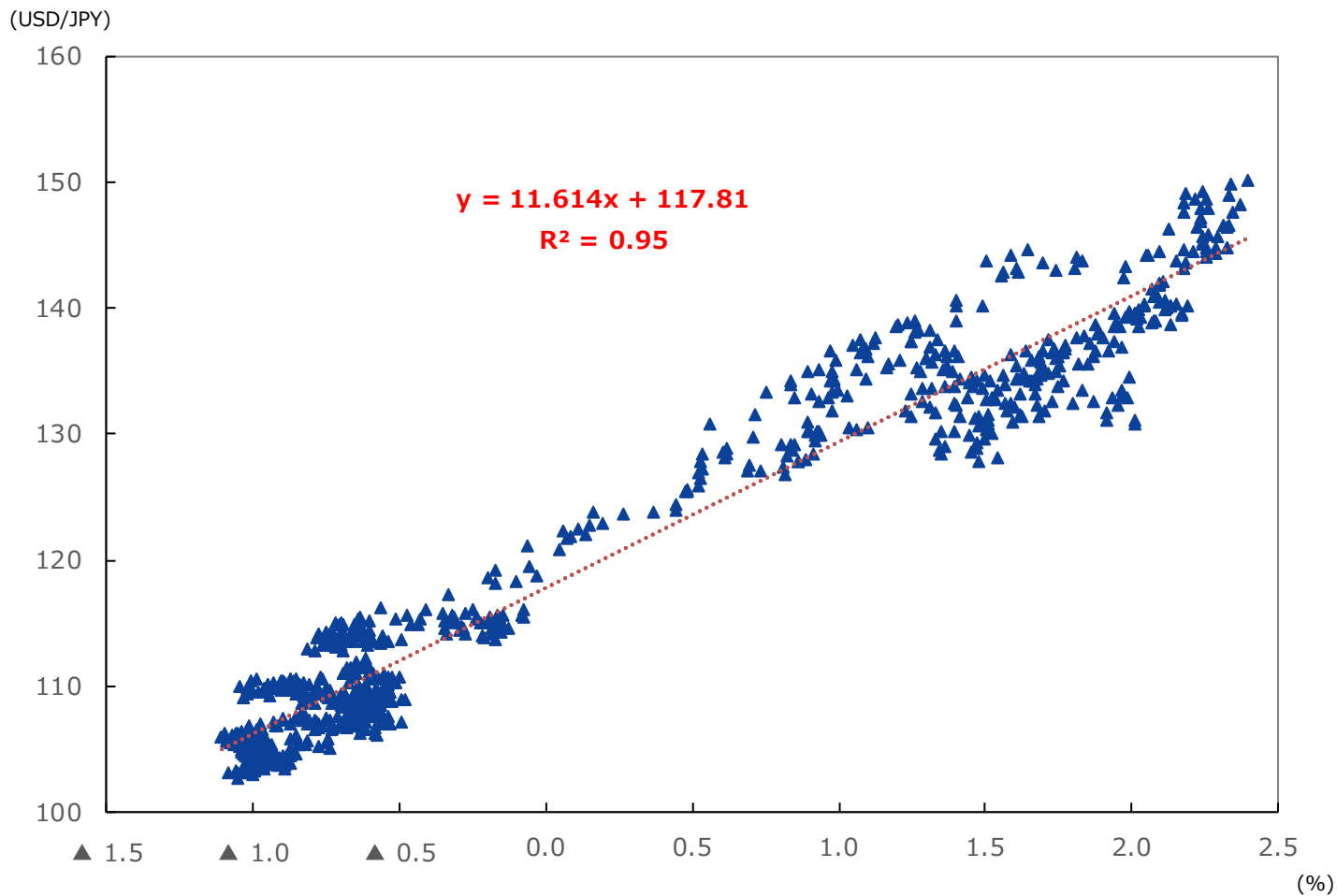
## Real Interest Rate Gap & USD/JPY Exchange rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2014 to 30th June 2023.  
Source: Bloomberg, SMDAM

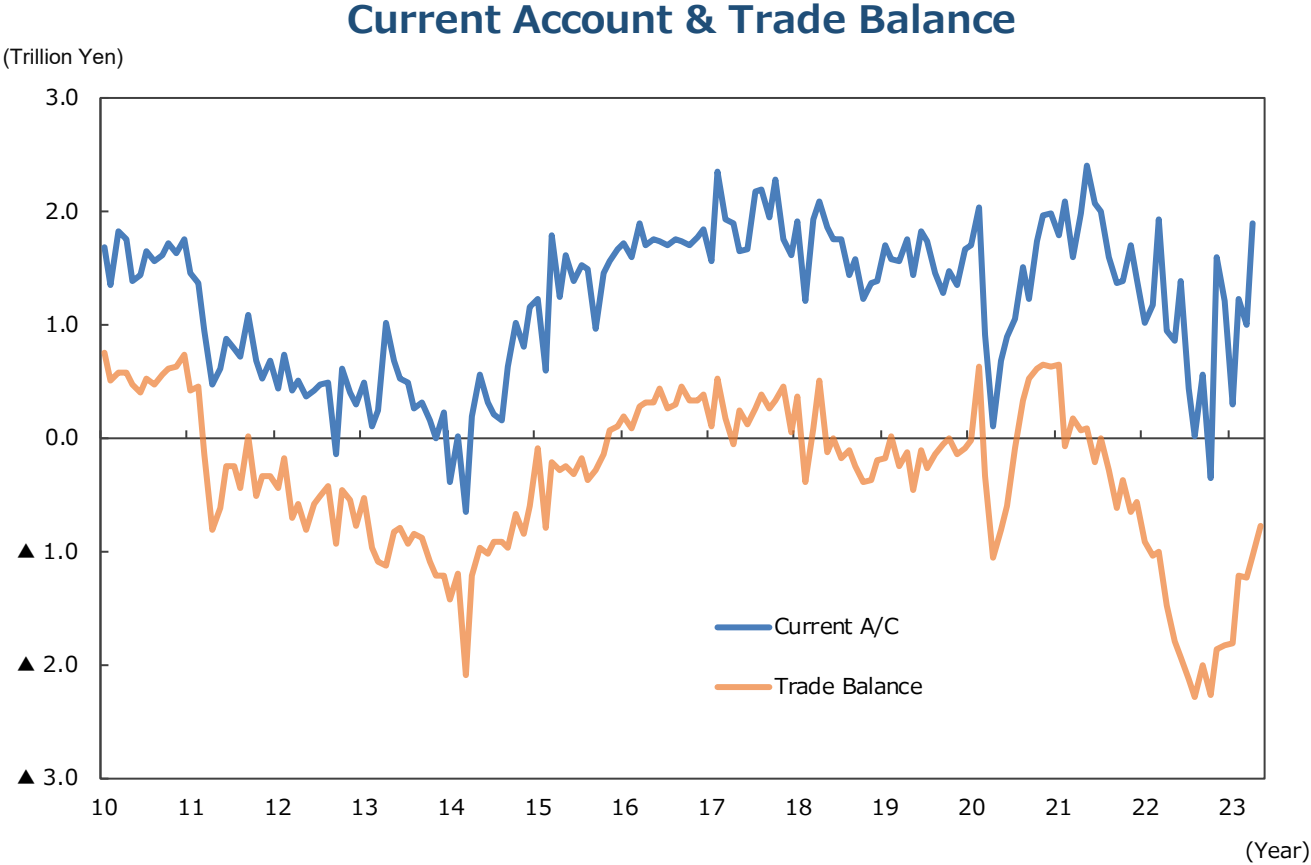
# Real yield gap still dominating USD/JPY rate

## Correlation between Real Interest Rate Gap & USD/JPY



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 30th June 2023.  
Source: Bloomberg, SMDAM

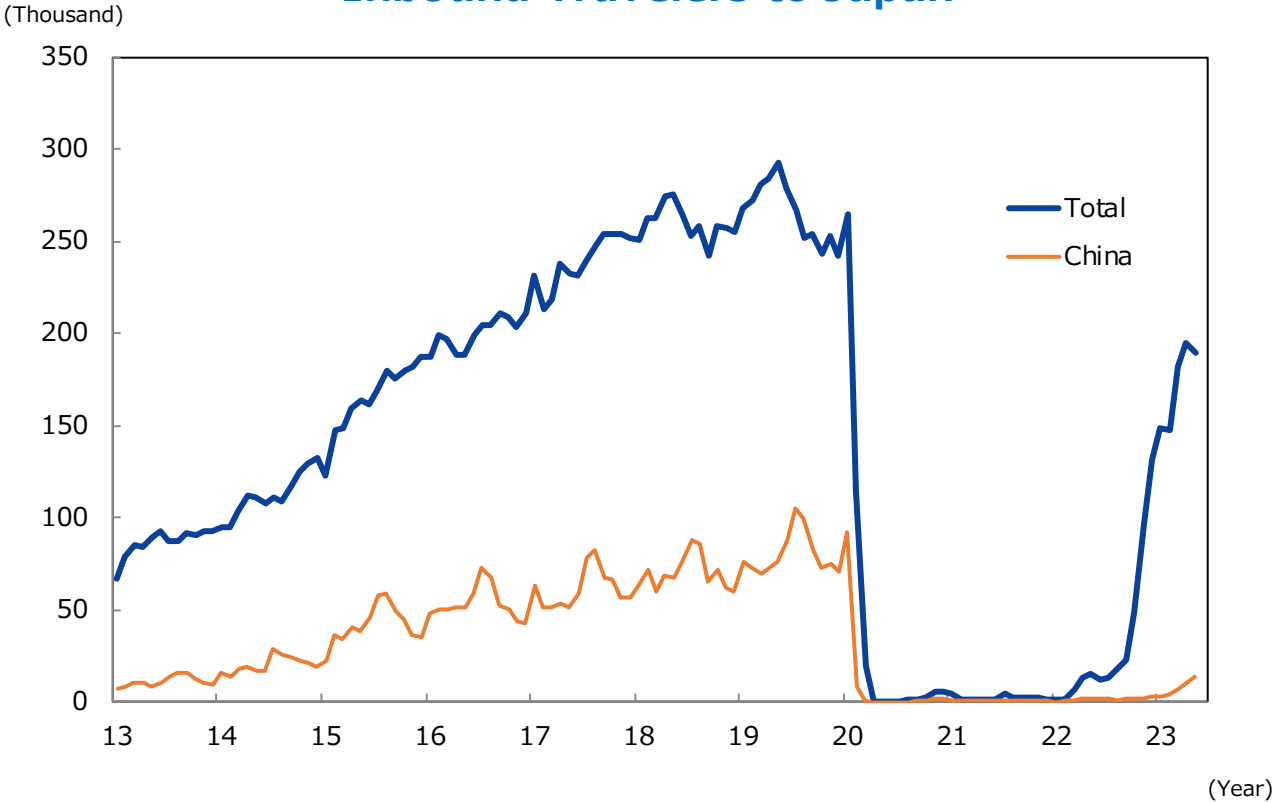
# Trade deficits shrinking sharply due to falling energy prices



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

# Chinese inbound travelers start recovering

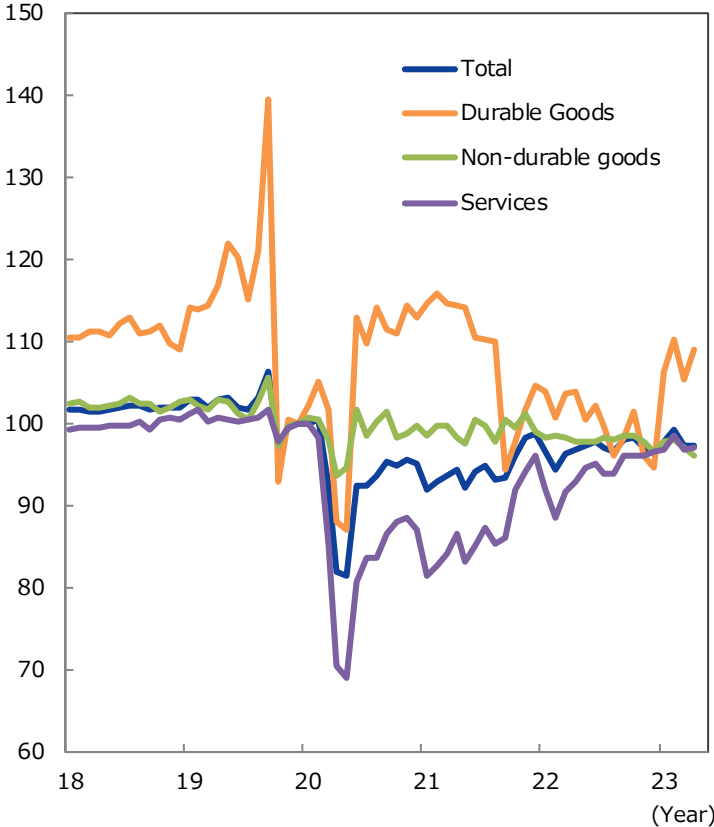
## Inbound Travelers to Japan



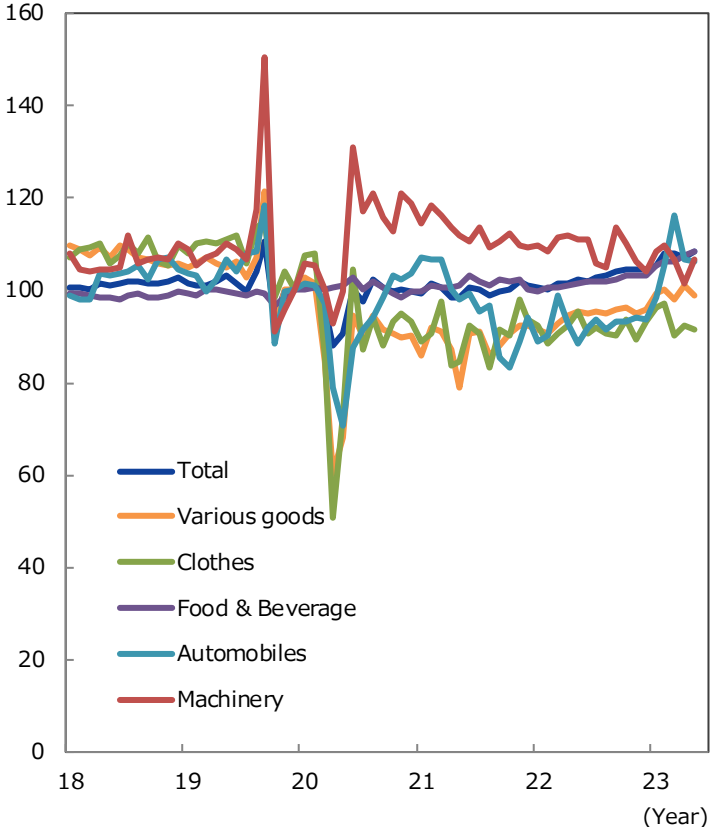
Note: Data is from January 2013 to May 2023. Data is non-seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Normalization of auto sales coming closer to completion

Consumer Activity Index (Dec. 2019 = 100)



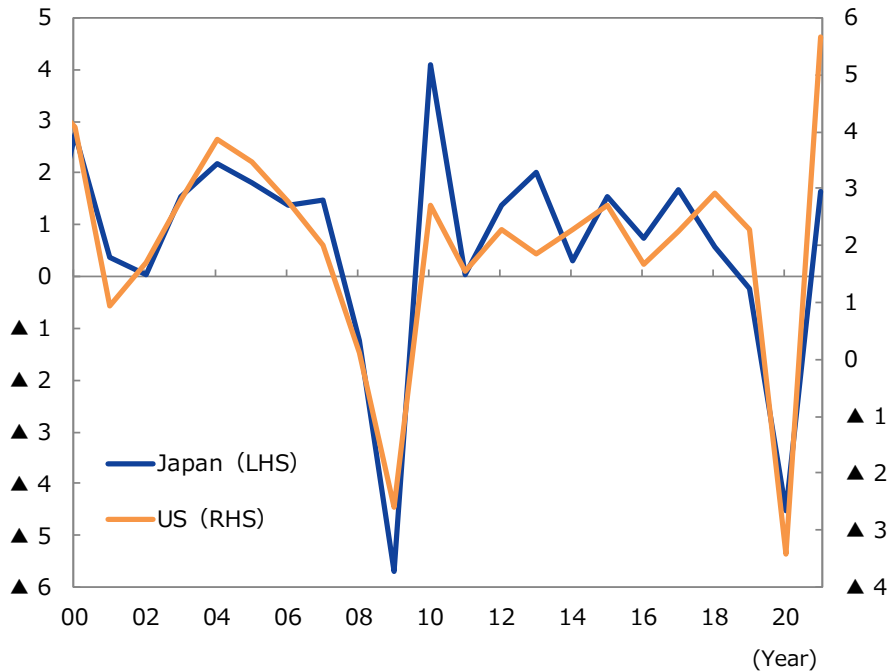
Retail Sales (Dec. 2019 = 100)



Note: Data for consumer activity index is from January 2018 to April 2023. Data for retail sales is from January 2018 to May 2023. Source; Bank of Japan, METI, and SMDAM

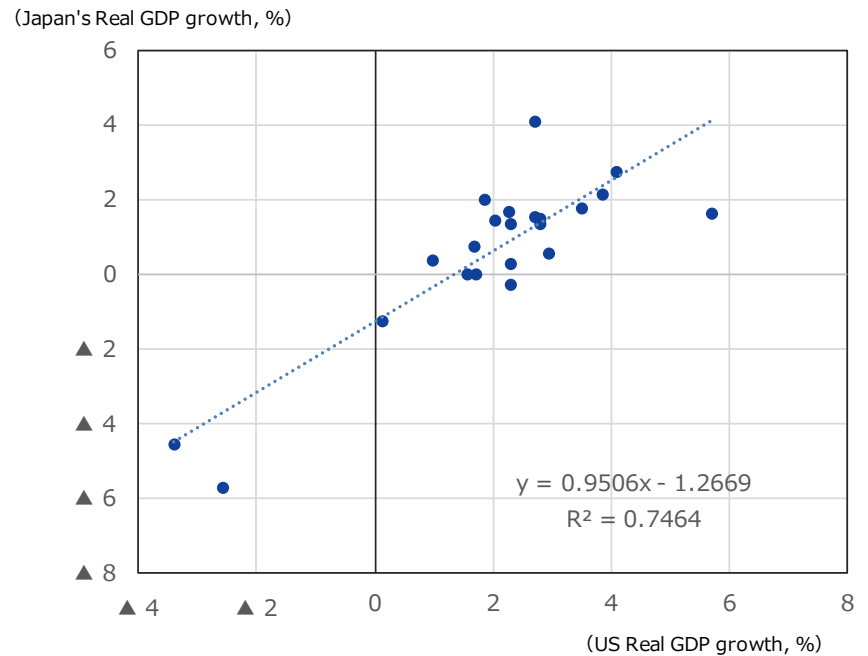
# Strong correlation between US and Japanese economic growth

## 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

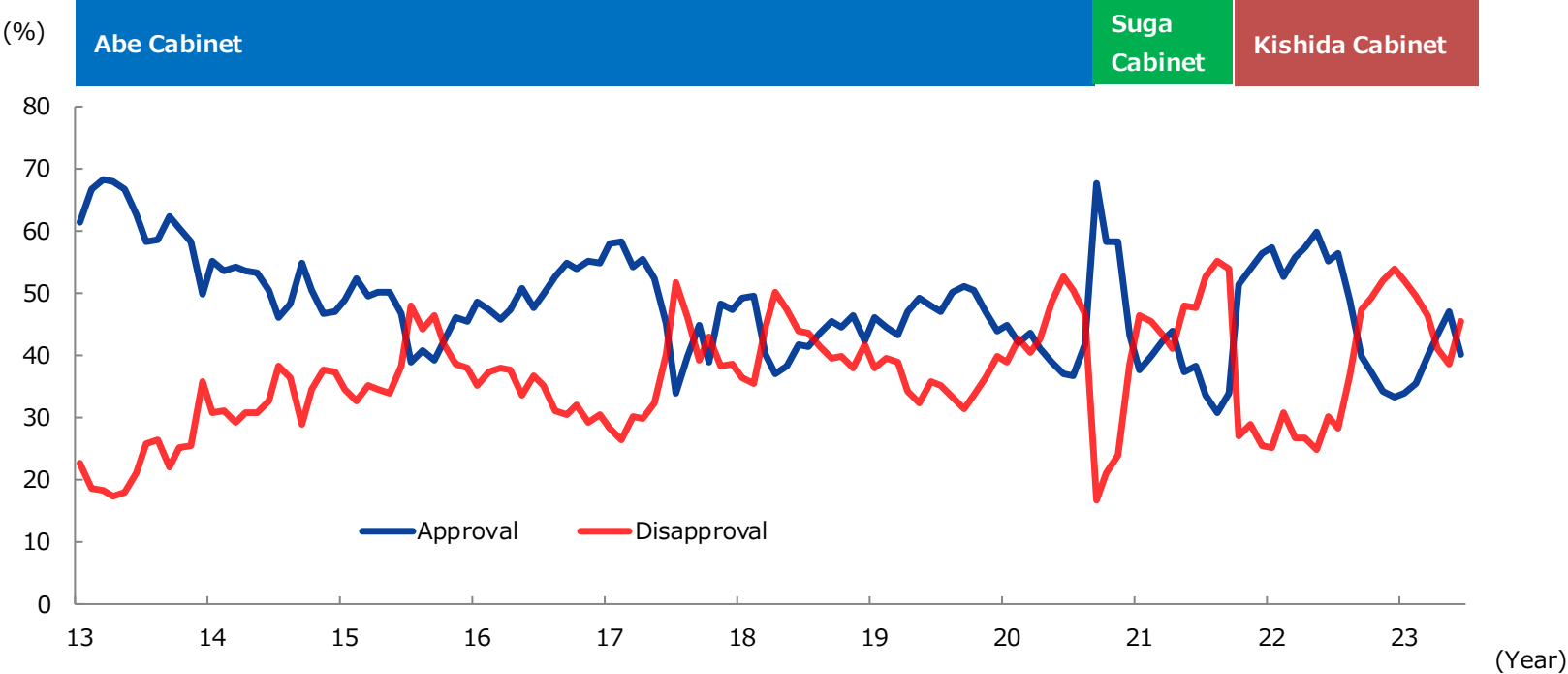
(%)

	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

# “Social security card” confusion pushes approval rate sharply lower

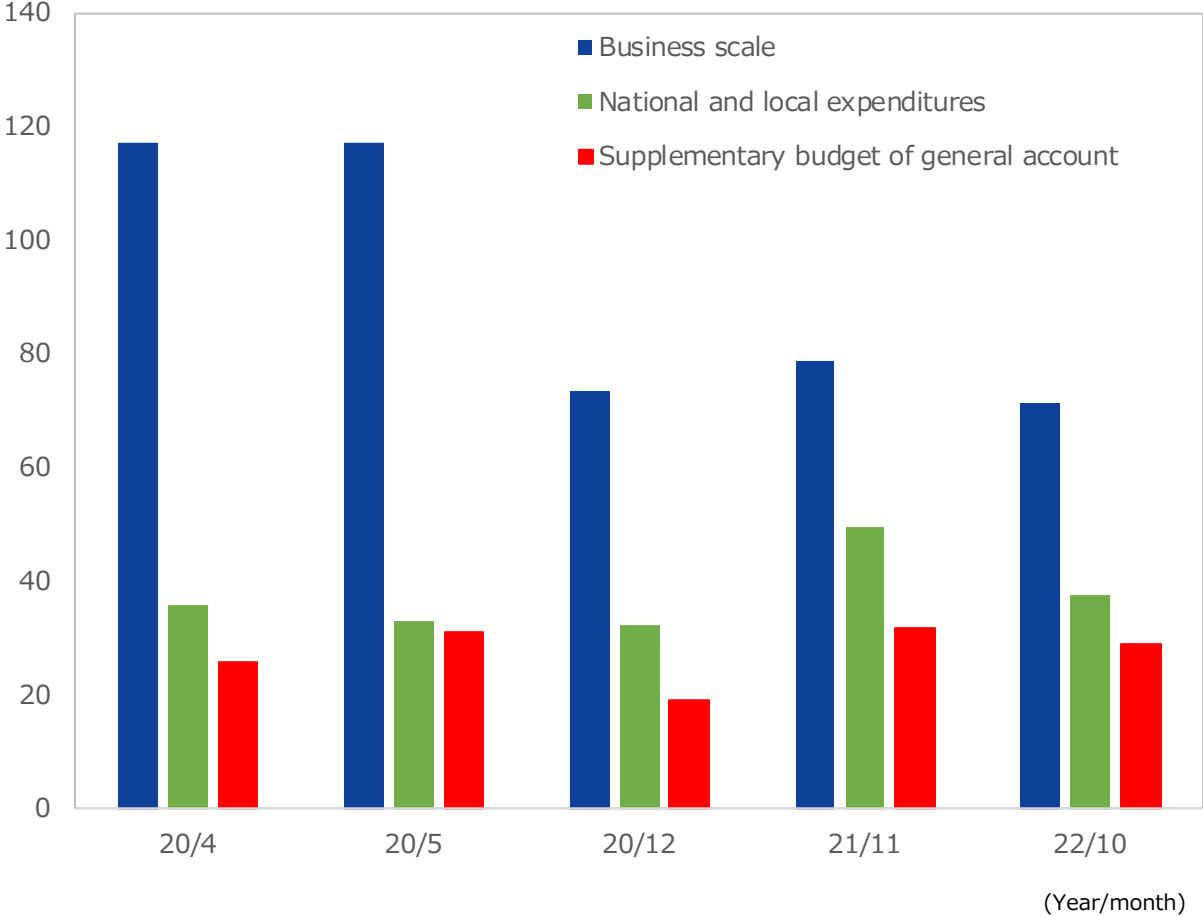
## Cabinet approval rate



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

# Size of recent fiscal stimulus

## Size of Fiscal Stimulus (trillion yen)



Source: MOF, SMDAM

## Schedule of major events

Year	Month	Date	Event
2023	July	27-28	Monetary Policy Meeting
	August	15	Release of CY 2023 Q2 GDP
	September	8	Revision of CY 2023 Q2 GDP
		9-10	G20 Summit in India
		21-22	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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