



# Outlook for Japanese Stock Market & Economy

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-October 2023-



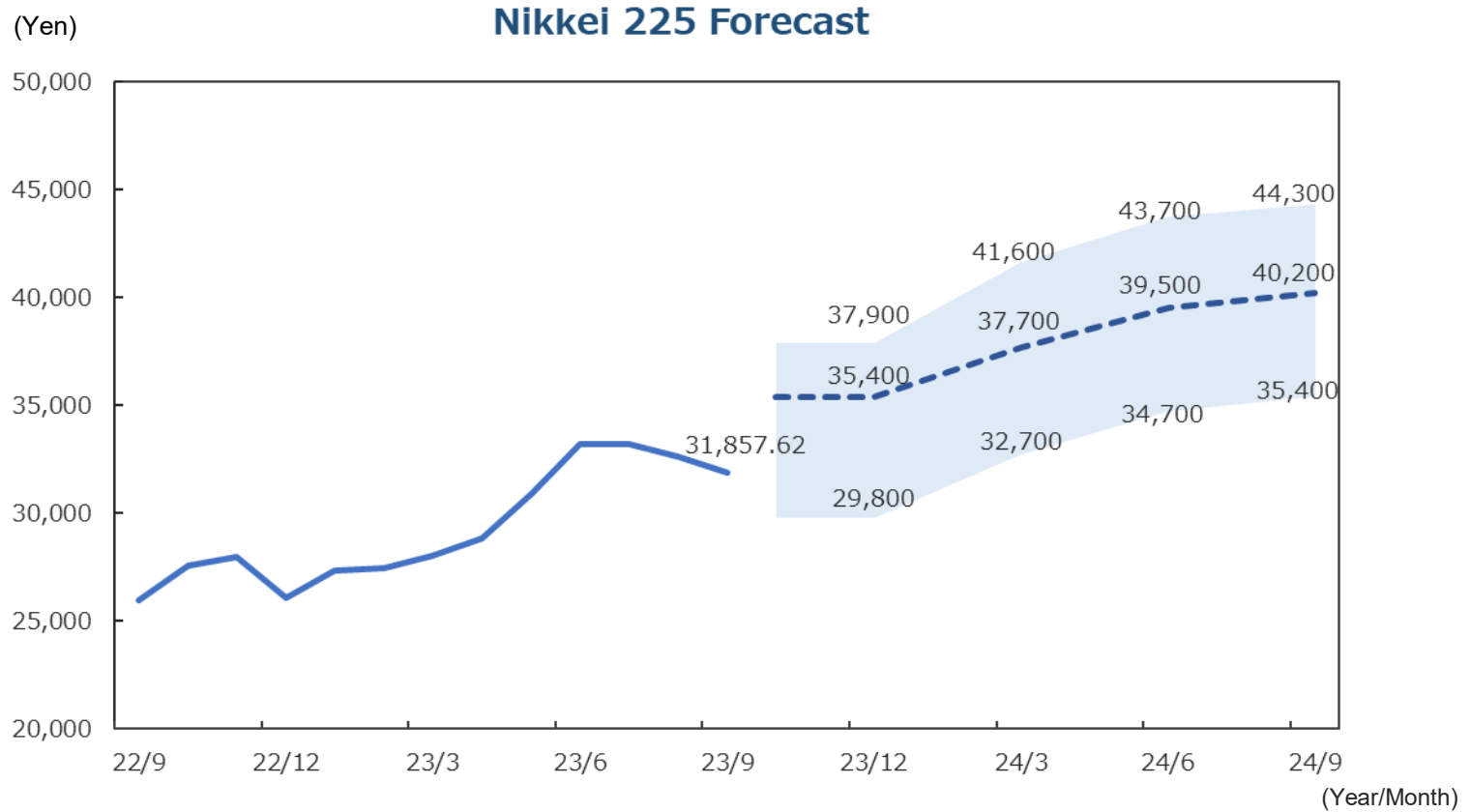
# Outlook for Japanese Stock Market

# Market Outlook

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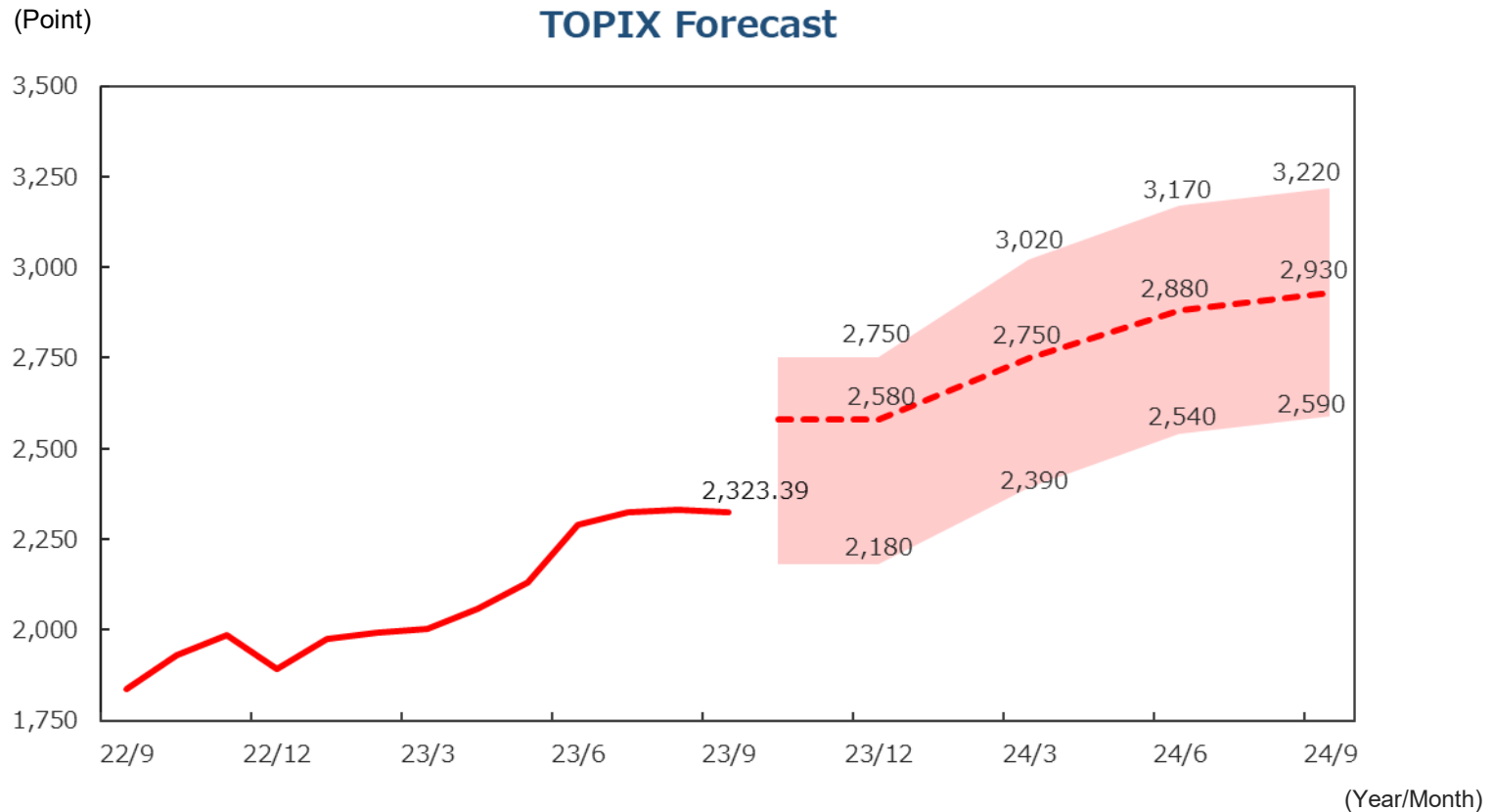
- We are bullish on the Japanese equity market as corporate earnings could be boosted by mild inflation, steady economic growth, and a weakening Japanese yen.
- We expect the volatile market caused by uncertainty over the global economy in the short term to be followed by steady market recovery after hitting the peak of the current monetary tightening cycle in the US and Europe.
- We foresee TOPIX index reaching 2,980 and Nikkei 225 reaching 40,900 by the end of next year.
- Growing confidence over the virtuous cycle between “price and wage increases” could provide a further boost to the Japanese stock market going forward.

# We see bullish market outlook ahead



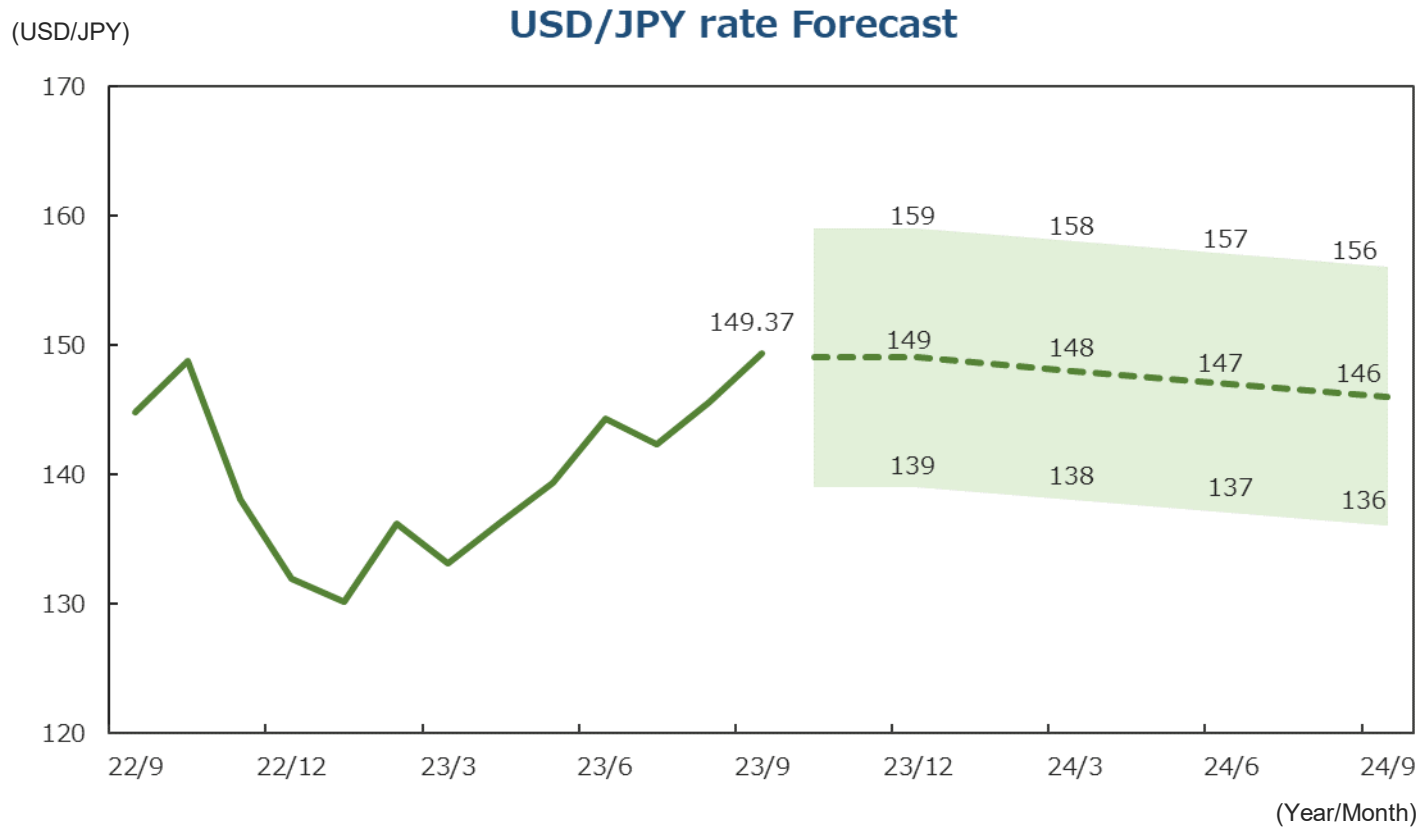
Data is from September 2022 to September 2024.  
(Source) Bloomberg, SMDAM

# We see bullish market outlook ahead



Data is from September 2022 to September 2024.  
(Source) Bloomberg, SMDAM

# Modest JPY appreciation expected after FED pivot next year



Data is from September 2022 to September 2024.  
(Source) Bloomberg, SMDAM

# Upside / Downside risk scenarios

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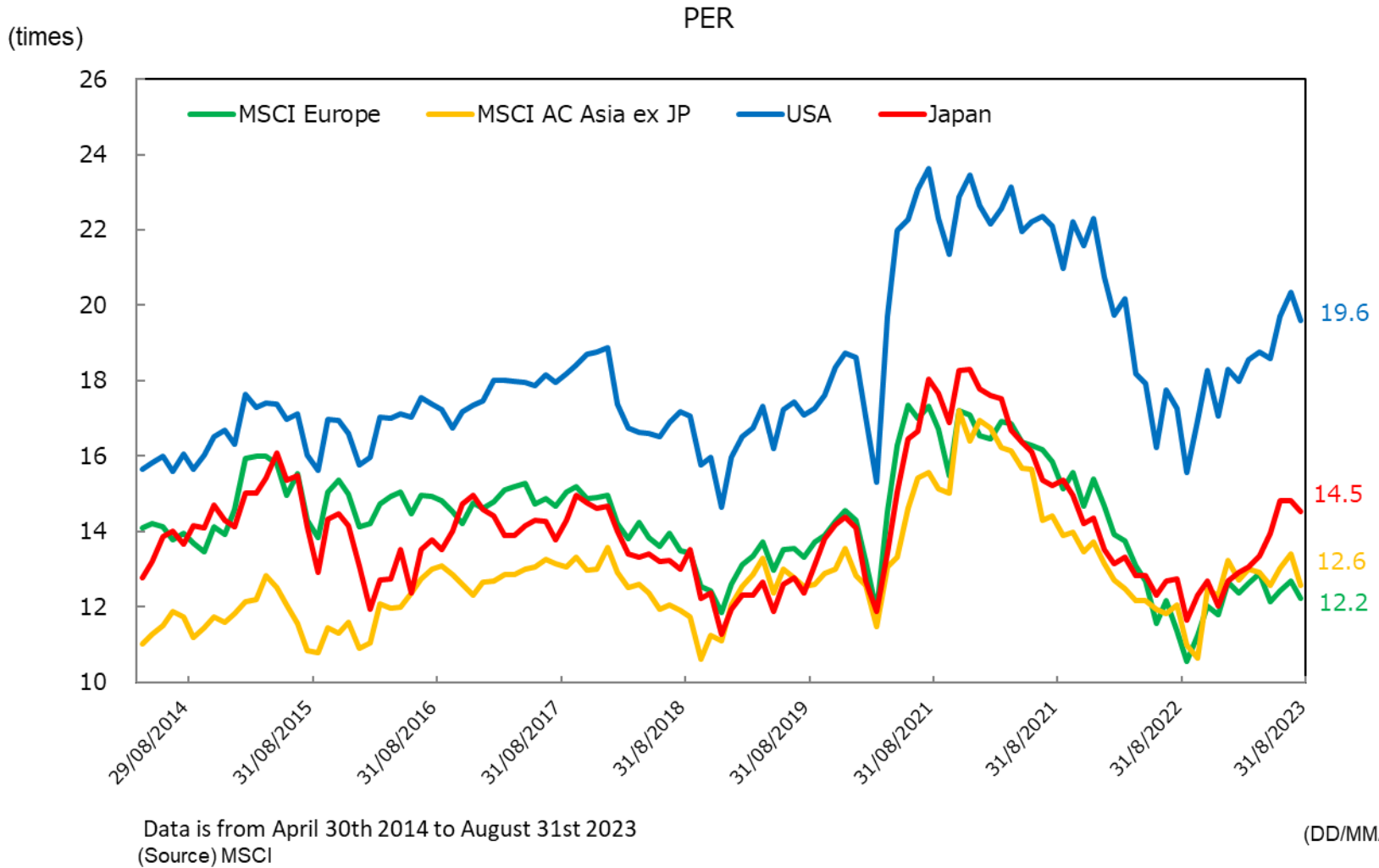
## ■ Upside Risks

- FED pivot and monetary easing
- Growing optimism over mild inflation and wage increases
- Recovery of inbound travel from China

## ■ Downside Risks

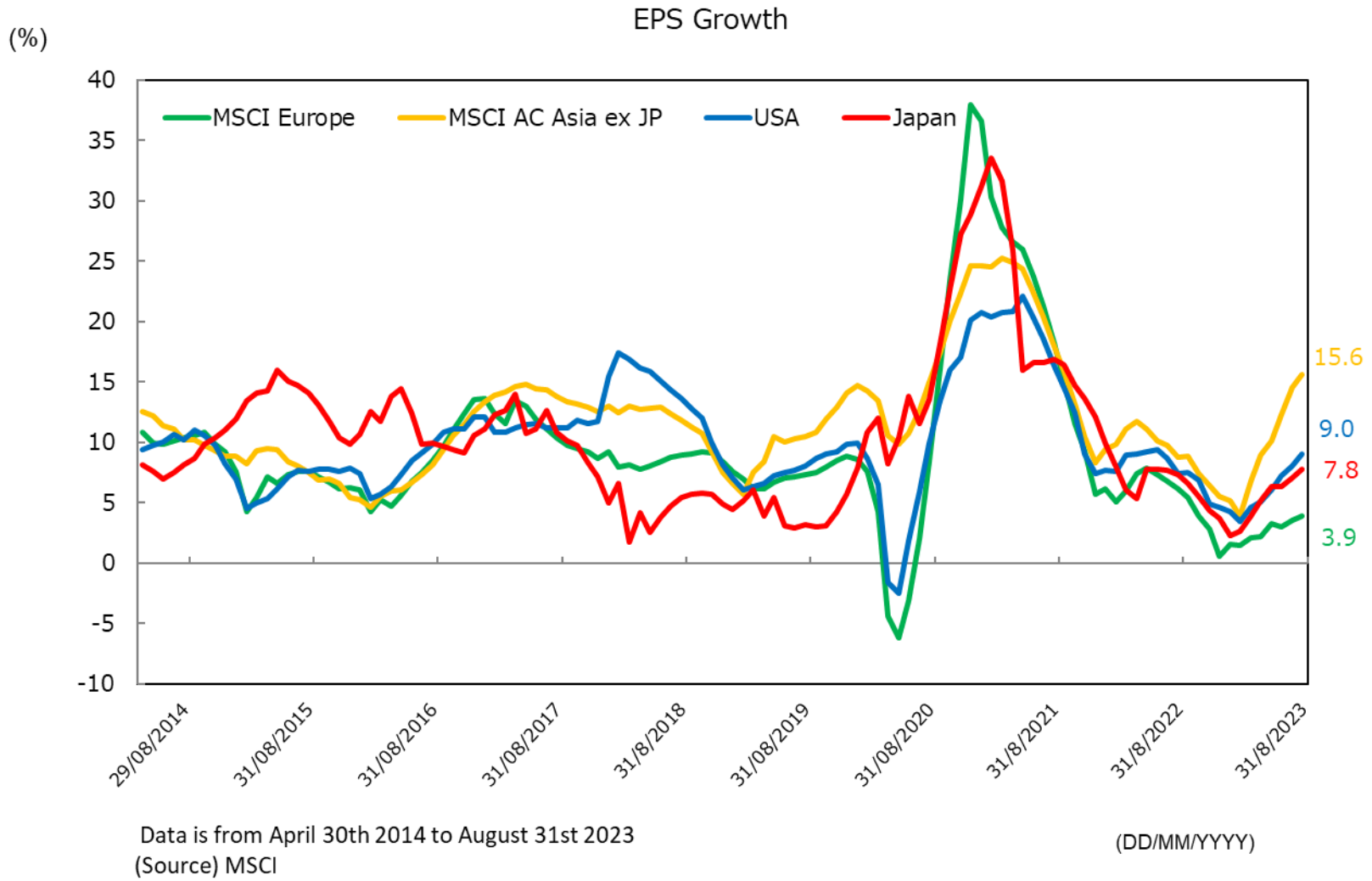
- JPY appreciation and its negative impact on corporate earnings
- Renewed concern over systemic risk of global financial system
- Prolonged slow growth of the global economy

# Growth expectation boosts PER multiple in Japan

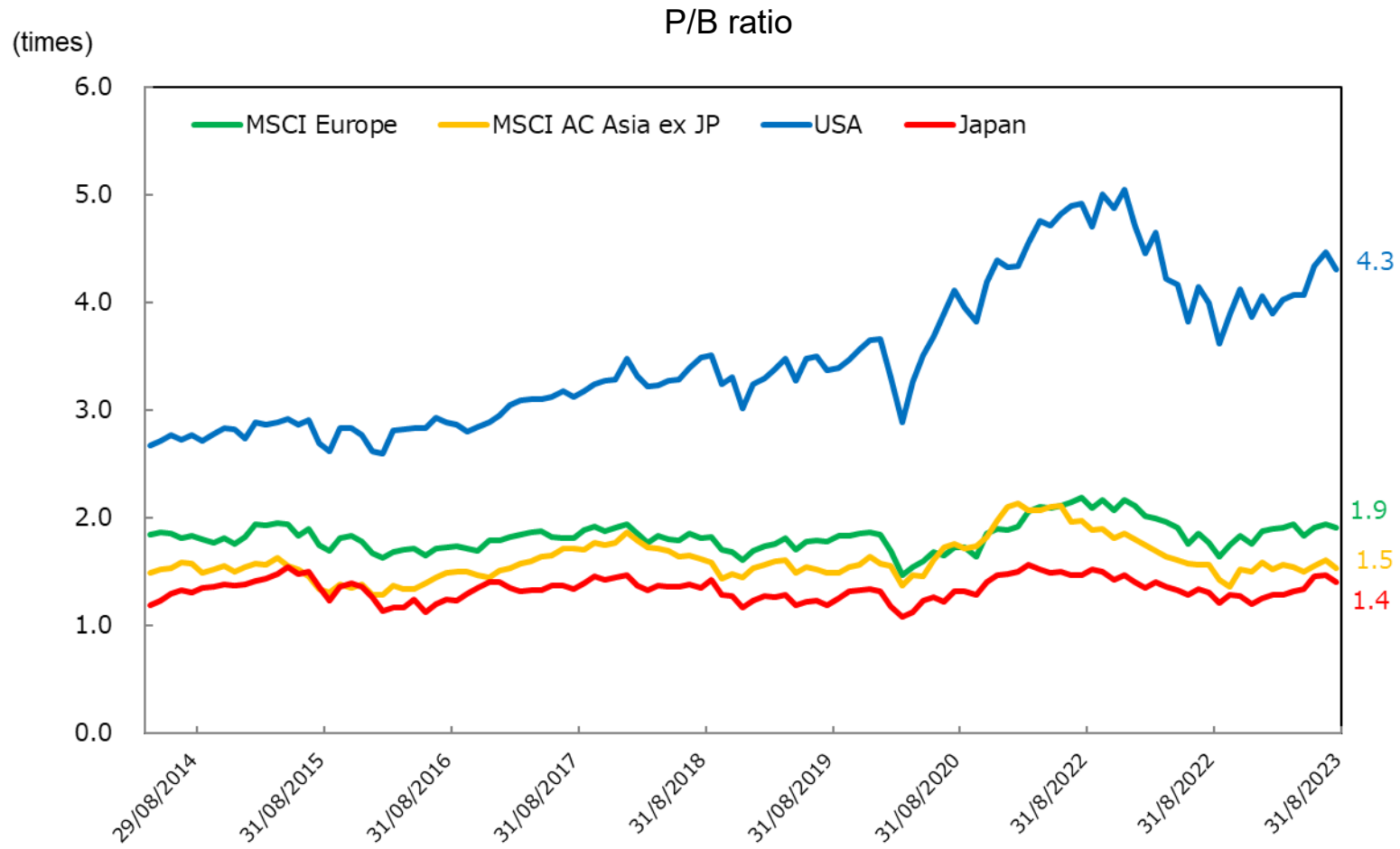




# Corporate earnings outlook increasingly optimistic



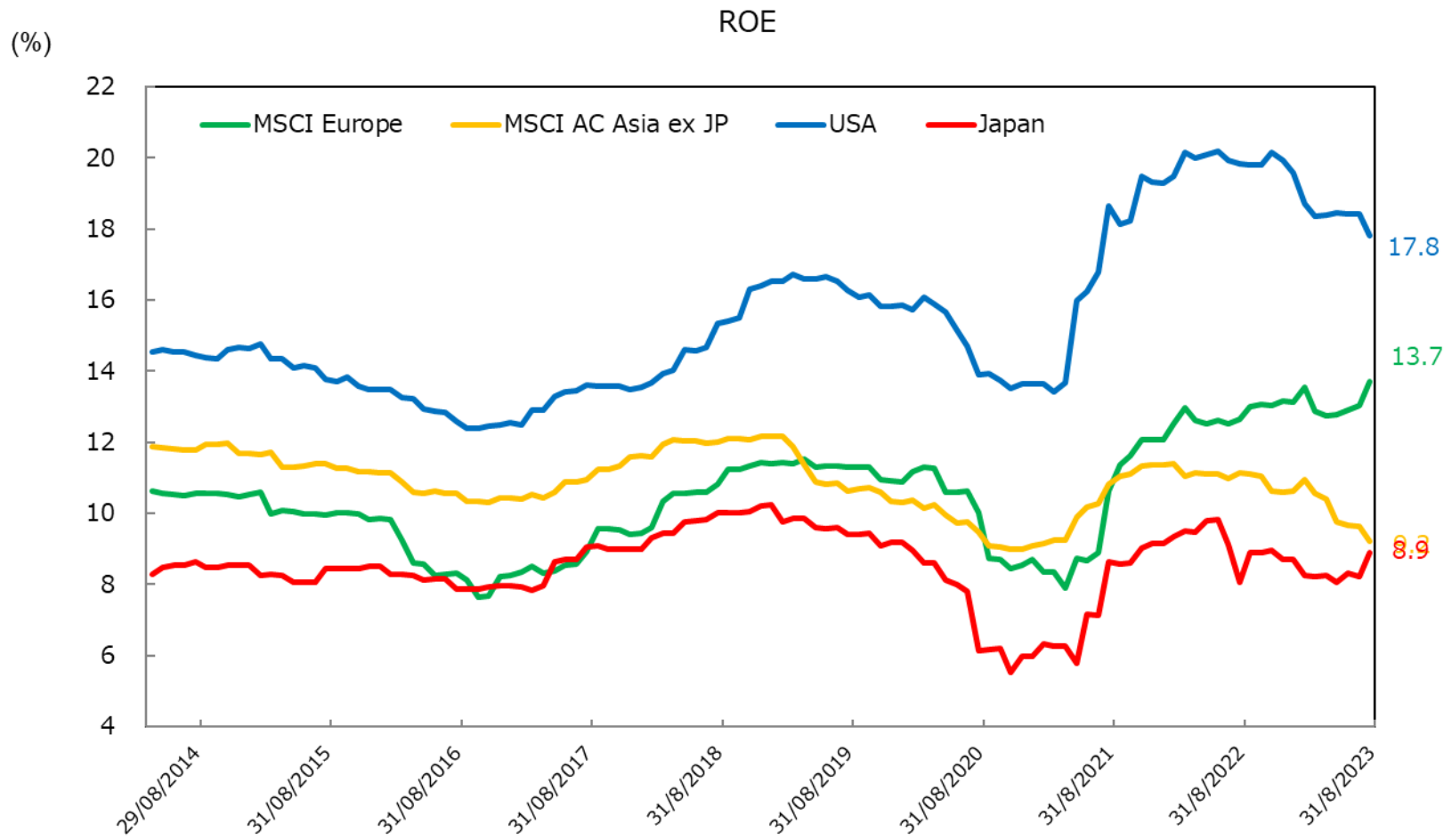
# Japan's P/B ratio hit bottom but still lower than peers



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

(DD/MM/YYYY)

# Japanese ROE getting closer to Asian peers

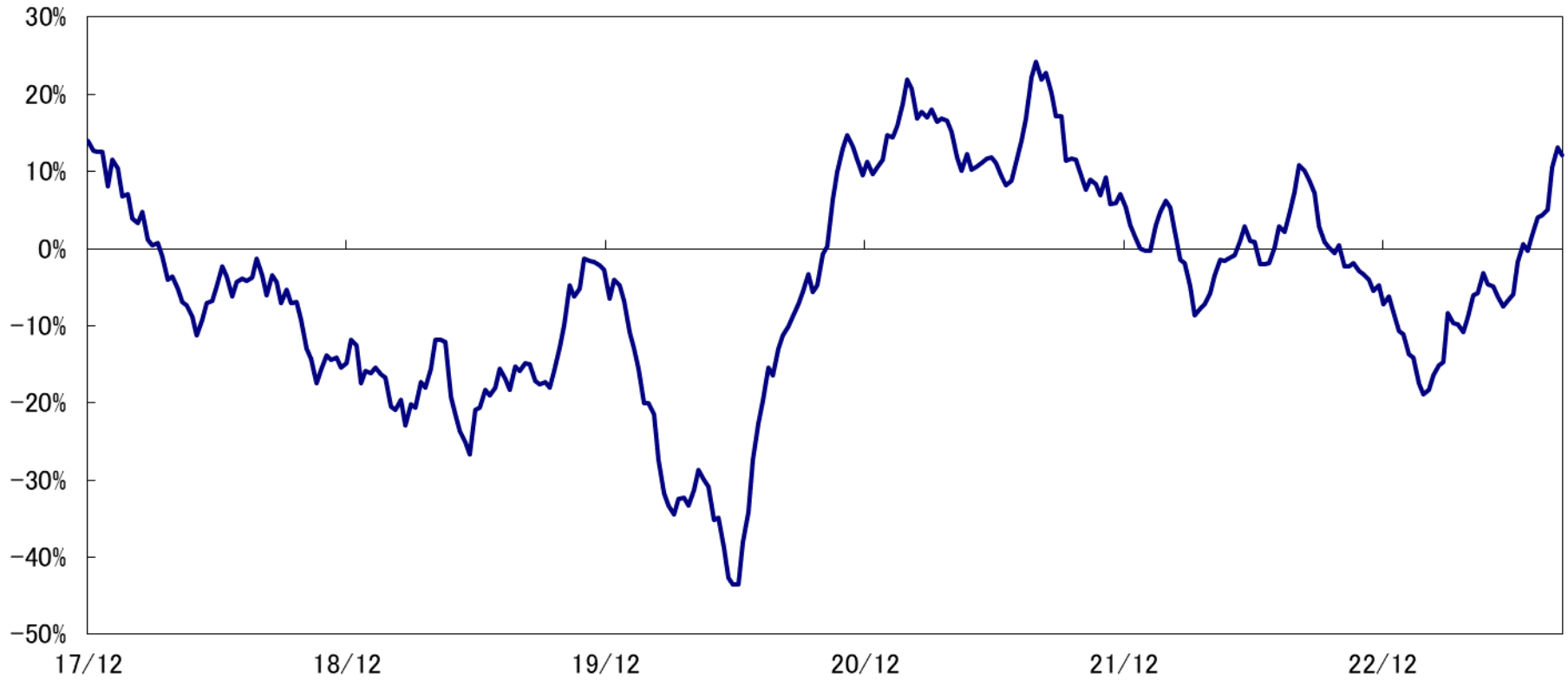


Data is from April 30th 2014 to August 31st 2023  
 (Source) MSCI

(DD/MM/YYYY)

# EPS revision gaining momentum

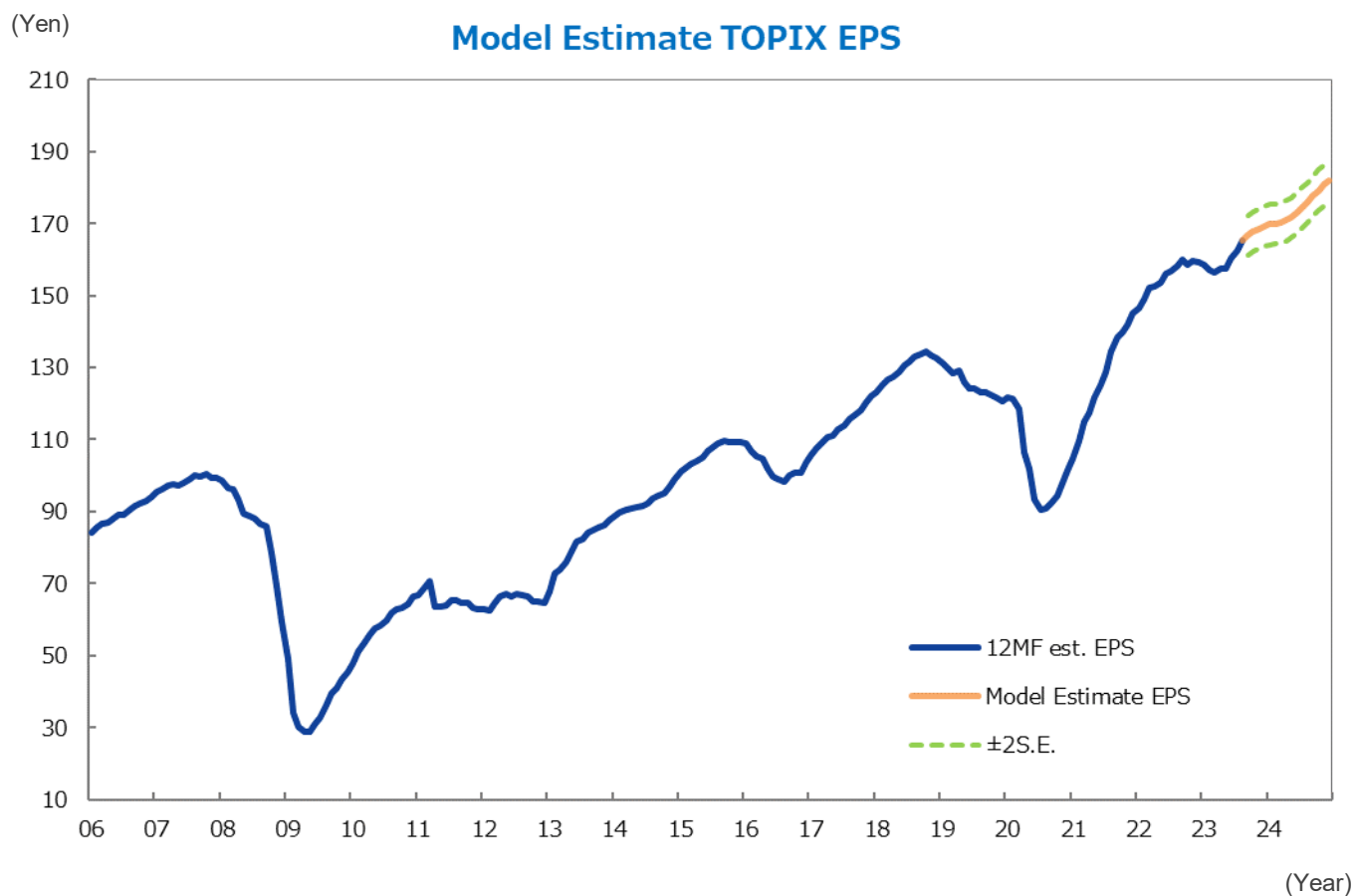
TOPIX Revision Index



Data is from December 28th 2017 to September 7th 2023  
(Source) Datastream, IBES

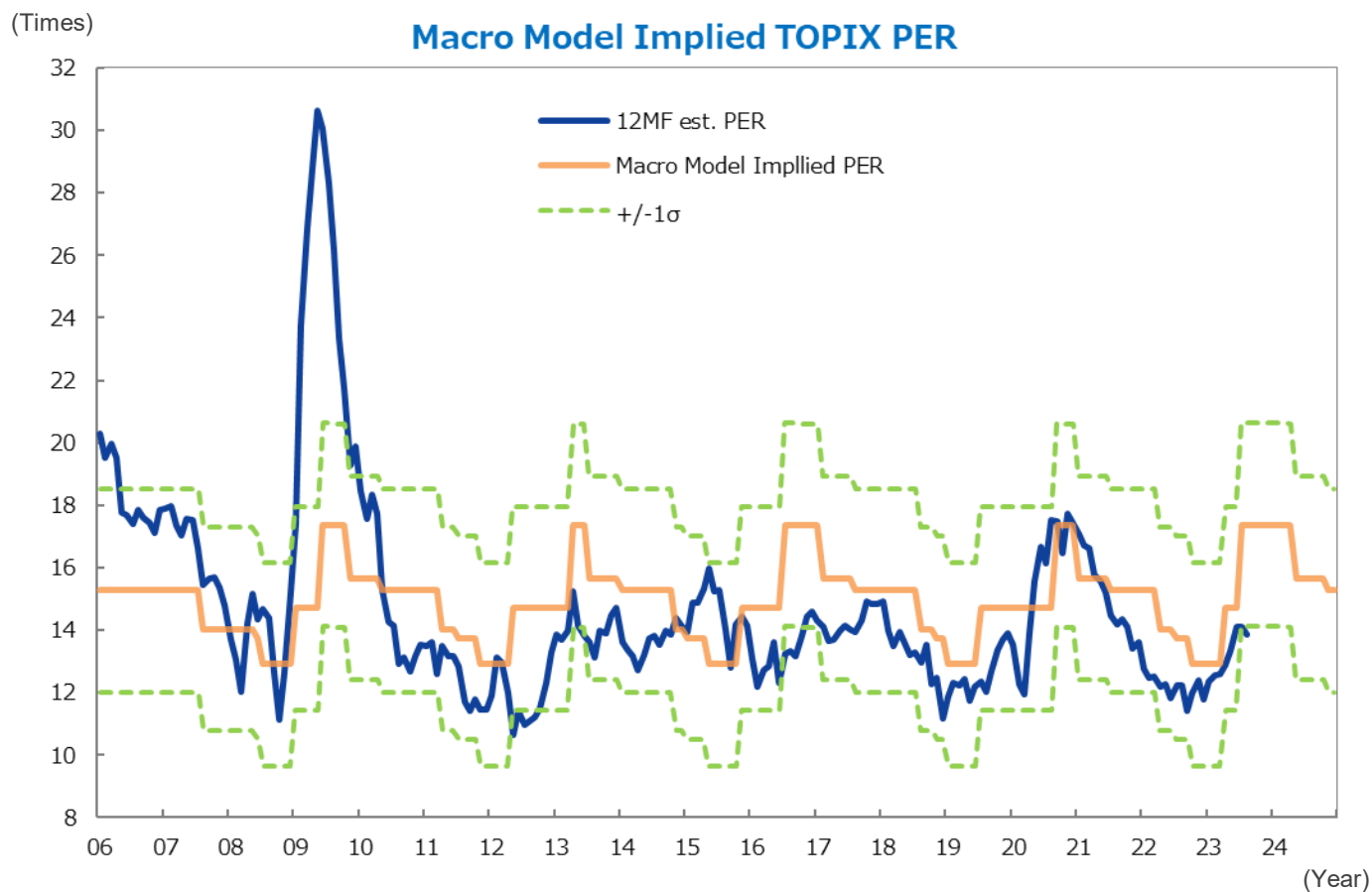
(YY/MM)

# Quant model indicates encouraging earnings outlook



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

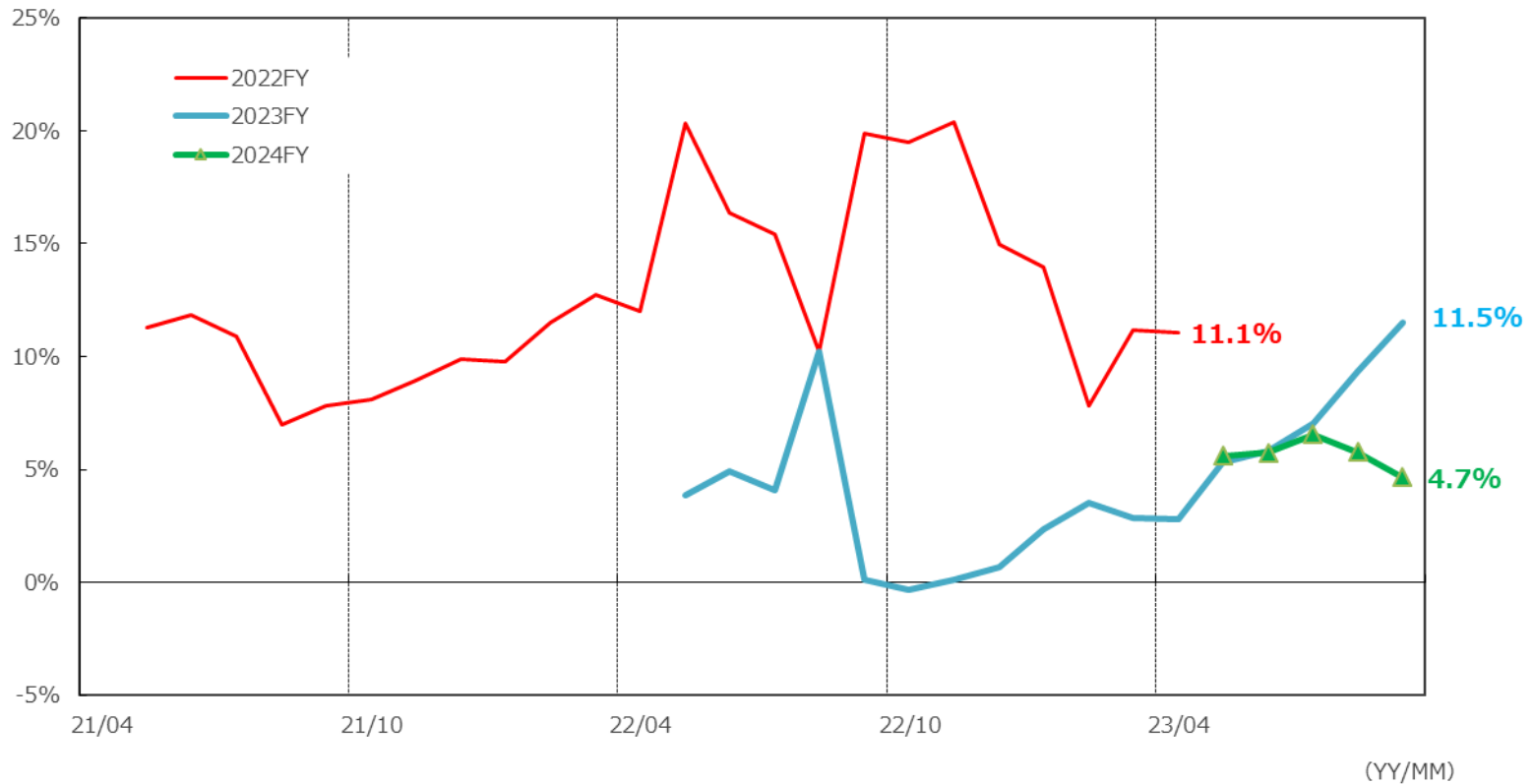
# Model suggests upside potential of PER



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

# Strong earnings outlook followed by modest growth next year

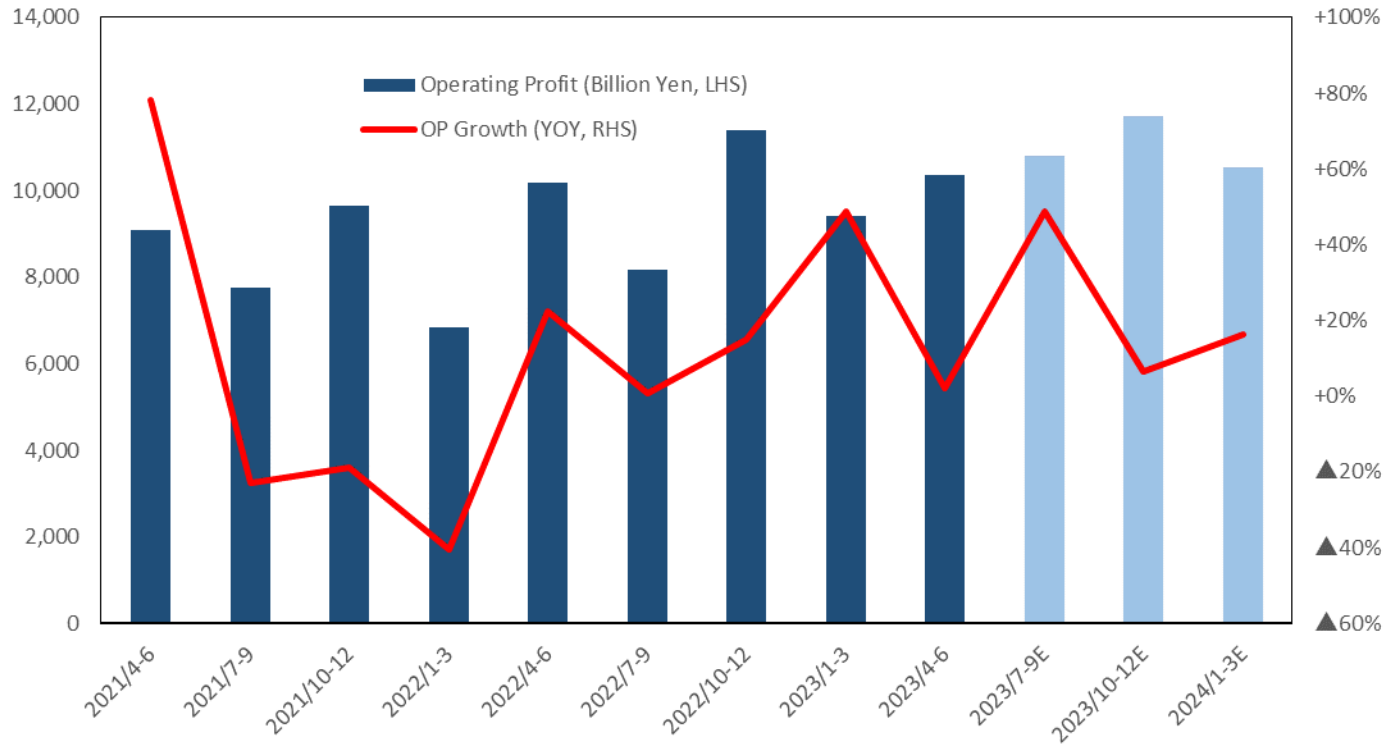
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th September 2023, SMDAM Core Universe (Excl. Financials) consists of 397 Japanese companies covered by SMDAM in-house analysts.  
Source: SMDAM

# Stable operating profit outlook going forward

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

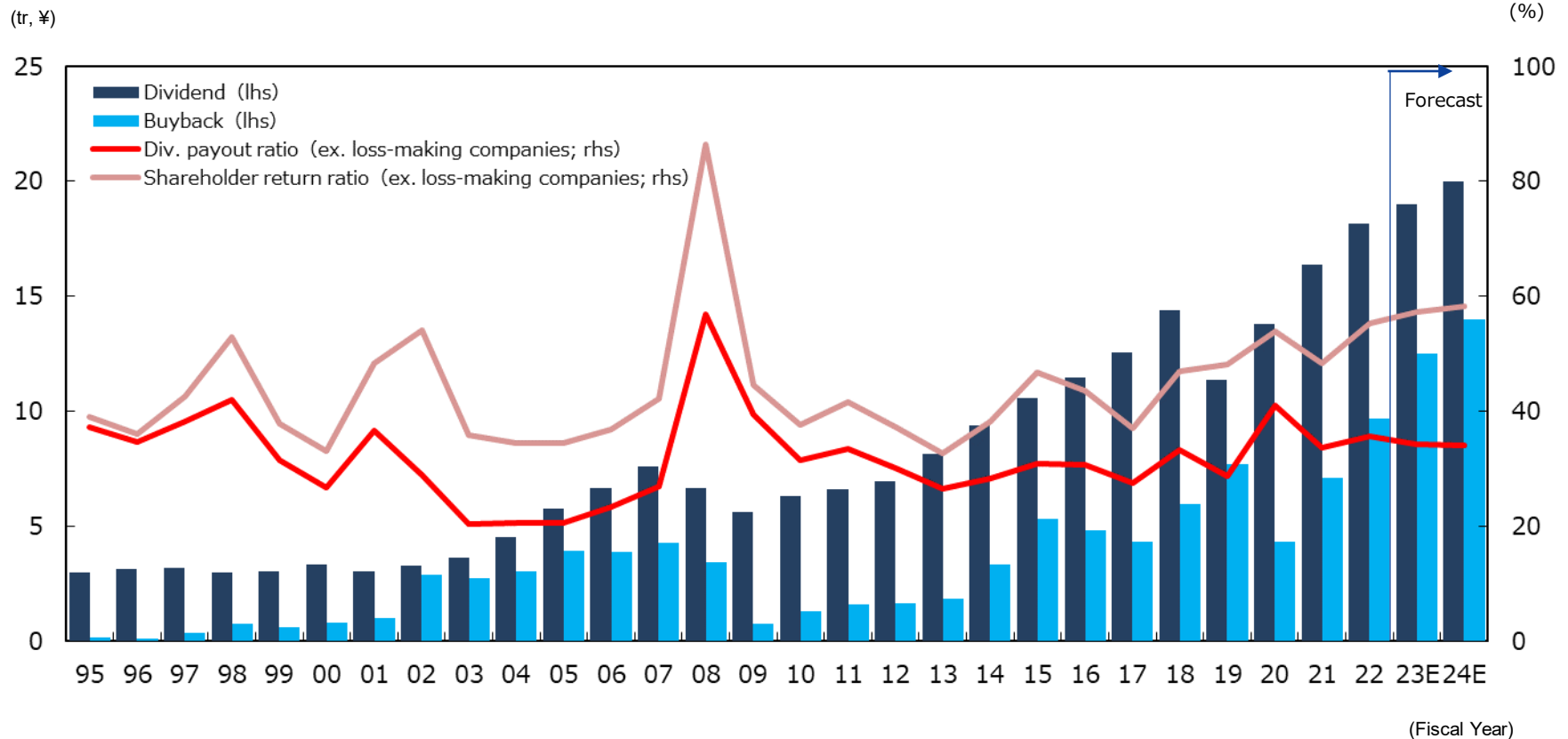


Note: Actual data is from Q1 2021 to Q2 2023. Estimate data is from Q3 2023 to Q1 2024.  
Source: SMDAM



# Dividends and buybacks continuing to beat historical highs

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



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

# Large cap value dominates Japanese market

## 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>4.99</b>	<b>24.51</b>	<b>27.08</b>	<b>23.42</b>	<b>14.10</b>	<b>46.08</b>	<b>35.42</b>
Total Value	13.36	36.33	36.97	35.01	38.02	76.92	42.24
Top Cap Value	12.29	42.42	41.13	41.36	48.34	98.46	64.77
Large Cap Value	13.73	38.61	38.81	36.80	41.64	84.10	47.38
Mid Cap Value	15.78	33.66	35.72	30.94	33.32	66.47	25.59
Small Cap Value	11.64	26.43	28.84	27.06	22.63	47.70	20.88
Micro Cap Value	10.61	23.41	25.97	25.86	20.61	42.08	19.42
Total Growth	-3.05	13.45	17.53	12.87	-5.59	19.95	27.00
Top Cap Growth	-3.31	14.24	19.98	14.50	-3.81	26.64	33.78
Large Cap Growth	-3.05	14.14	18.98	14.10	-4.74	22.22	30.23
Mid Cap Growth	-2.57	13.96	17.18	13.37	-6.25	15.47	24.72
Small Cap Growth	-3.02	8.01	6.76	3.52	-12.44	2.23	2.91
Micro Cap Growth	-4.34	5.84	4.19	2.33	-15.05	0.24	2.23
Top Cap Total	3.63	26.28	29.32	25.91	16.73	54.98	46.17
Large Cap Total	4.83	25.43	28.33	24.47	15.08	49.02	39.15
Mid Cap Total	6.81	24.10	26.77	22.27	12.73	40.71	29.39
Small Cap Total	5.95	19.21	20.03	17.43	8.05	28.98	14.78
Micro Cap Total	5.68	17.58	18.55	17.64	7.93	27.39	15.13

Note : As of 20th September 2023  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is recovering.** Exports of goods have increased on the back of the resilience of overseas economies led by the United States. CAPEX has remained strong, supported by pent-up demand, labor shortages and demand for de-carbonization and digitalization. Although consumer spending has been lackluster due to the headwinds of high prices, it is on a recovery trend.
- **Inflation is slowing down.** The nation-wide core CPI rose by 3.1% in July from a year earlier, down from 3.3% a month earlier. The nation-wide core CPI has been on a decelerating trend with fluctuations. The Tokyo metropolitan area core CPI rose by 2.8% in August, down from 3.0% a month earlier and below 3% for the first time in nearly a year. The import price index, which is the starting point of cost push inflation, is falling, which is spreading to domestic goods prices.

## [Outlook]

- ① **We have reduced our real GDP growth forecast for FY 2023 from +2.5% to +1.9% and that for FY 2024 from +1.1% to +1.0%.** The main reason for the change in the forecast is a downward revision to the second preliminary GDP report for the April-June quarter 2023. In addition to that, a decline in inbound travelers from China and boycotts of Japanese products in China, which were triggered by rising anti-Japanese sentiment, are also taken into account. However, overall economic recovery is expected to be sustained. Under the resumption of economic activity, domestic demand is expected to increase, mainly through private consumption and capital investment. As for private consumption, the negative effects of high prices are likely to ease. Capital investment is supported by labor shortages, de-carbonization, and demand for digitalization. The outlook for exports was slightly lower but expected to remain firm.
- ② **We have lowered our core CPI forecast for FY 2023 from +2.8% to +2.7% and maintained that for FY 2024 at +1.8%.** In addition to reviewing crude oil and foreign exchange assumptions, the main reasons for the lower inflation outlook in FY 2023 were the recent downturn in Tokyo metropolitan area CPI, the extension of gasoline subsidies by the government, and the lower economic growth outlook. Looking ahead, the core CPI is likely to follow a deceleration trend given the reduction in cost push pressure starting from import prices. However, due to support from wage hikes and disruptions caused by measures to tackle higher prices, the core CPI is expected to fall below 2% year-on-year by the second half of FY 2024.
- ③ **We expect PM Kishida and his cabinet will continue its accommodative economic policy.** PM Kishida has said he will work out economic measures by October. Our economic outlook is based on the assumption that the size of the economic measures will be around 10 trillion yen. Given the shift of the Category of COVID-19 from 2 (serious infectious disease) to 5 (same as seasonal flu) and the shrinking GDP gap, the scale of economic measures is likely to be less drastic than in recent years. On the other hand, as the Prime Minister has described the coming measures as "drastic", we are closely watching as there is a risk that the measures may surpass our assumptions.
- ④ **The Bank of Japan's monetary policy is expected to remain unchanged in the scope of our forecast as "the price stability target" is unlikely to be realized.** In an interview with a newspaper, BOJ governor Ueda mentioned the possibility of lifting negative interest rates, which would increase the flexibility to revise monetary policy. On the other hand, Governor Ueda did not say whether the probability of achieving "the price stability target" had increased. For this reason, we do not believe that Governor Ueda has already made any significant moves to revise the policy, and we expect that he will assess the future price and wage data and the momentum for wage increases. In addition, based on the meeting between PM Kishida and Governor Ueda and the tone of the Ministry of Finance's verbal intervention on the exchange rate level, the interview with Governor Ueda may have aimed at keeping the yen from weakening.

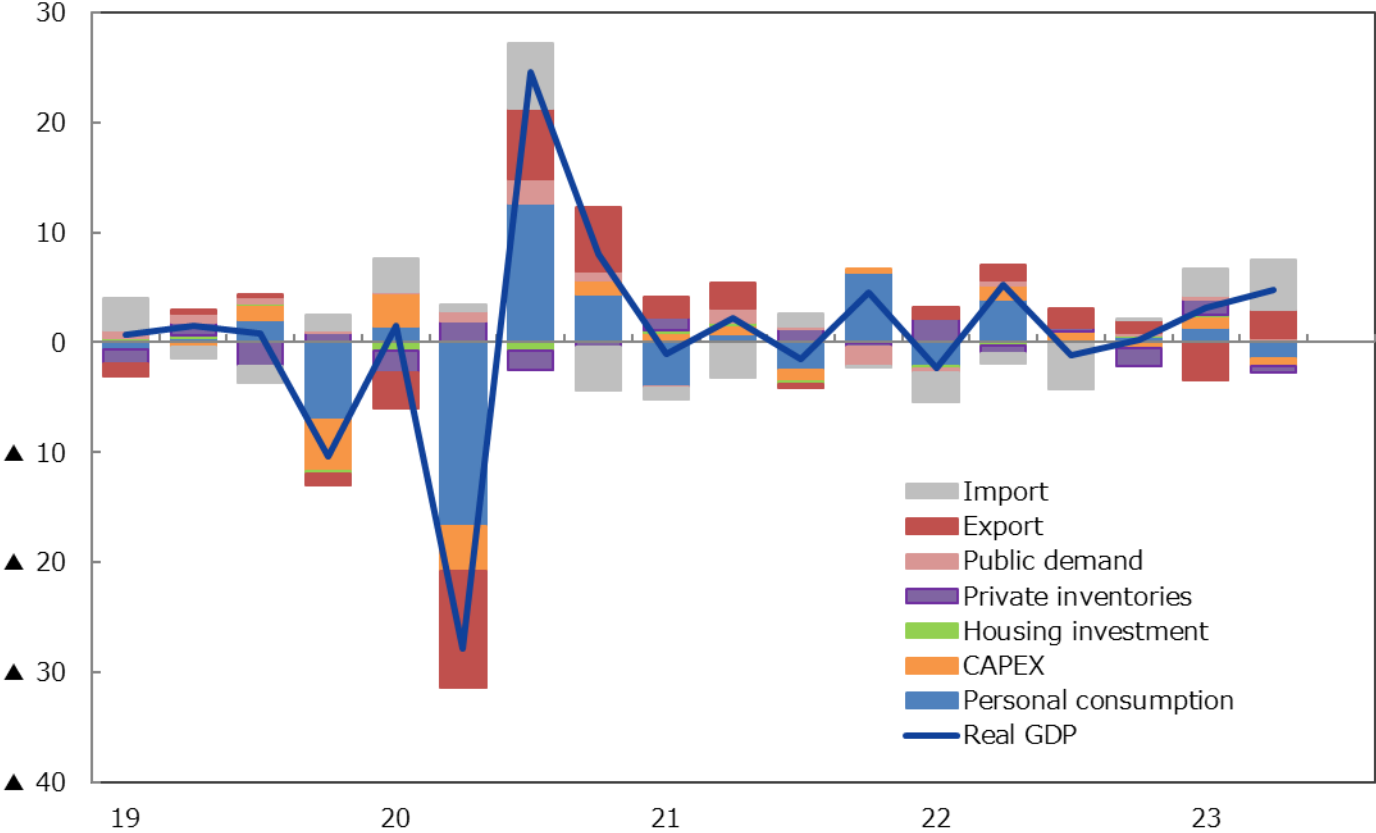
# Forecast table for the Japanese economy

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%	2.7%	1.4%	1.9%	1.0%
Private final consumption expenditure	0.1%	-0.9%	-5.1%	1.5%	2.5%	0.1%	0.9%
Private housing investment	-4.8%	2.5%	-7.2%	-0.6%	-3.0%	2.0%	-0.4%
Private-sector capital investment	1.6%	-1.2%	-5.4%	2.3%	3.1%	1.1%	2.1%
Private inventory investment	0.1%	-0.2%	-0.3%	0.4%	0.2%	-0.1%	0.0%
Public fixed capital formation	0.9%	1.6%	4.9%	-6.5%	-3.1%	1.9%	0.2%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.6%	1.3%	0.0%
Exports of goods and services	2.0%	-2.3%	-9.9%	12.4%	4.5%	2.9%	3.2%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	7.2%	-3.4%	3.2%
Nominal GDP	0.2%	0.0%	-3.4%	2.5%	2.0%	5.0%	2.1%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.7%	3.0%	1.1%
Industrial Production Index	-0.1%	-3.6%	-9.7%	5.7%	-0.3%	-0.8%	1.7%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	3.0%	2.7%	1.8%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	9.4%	1.8%	0.4%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	2.8%	2.5%
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

# Net export boosts Japan's GDP despite slowing consumption

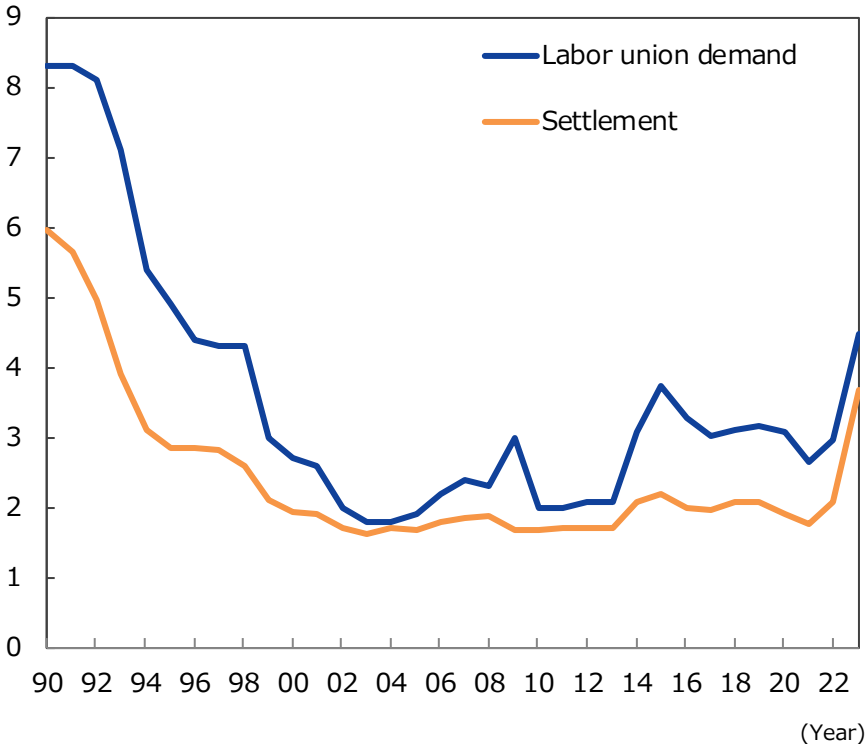
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q2 2023.  
 Source: Cabinet office, SMDAM

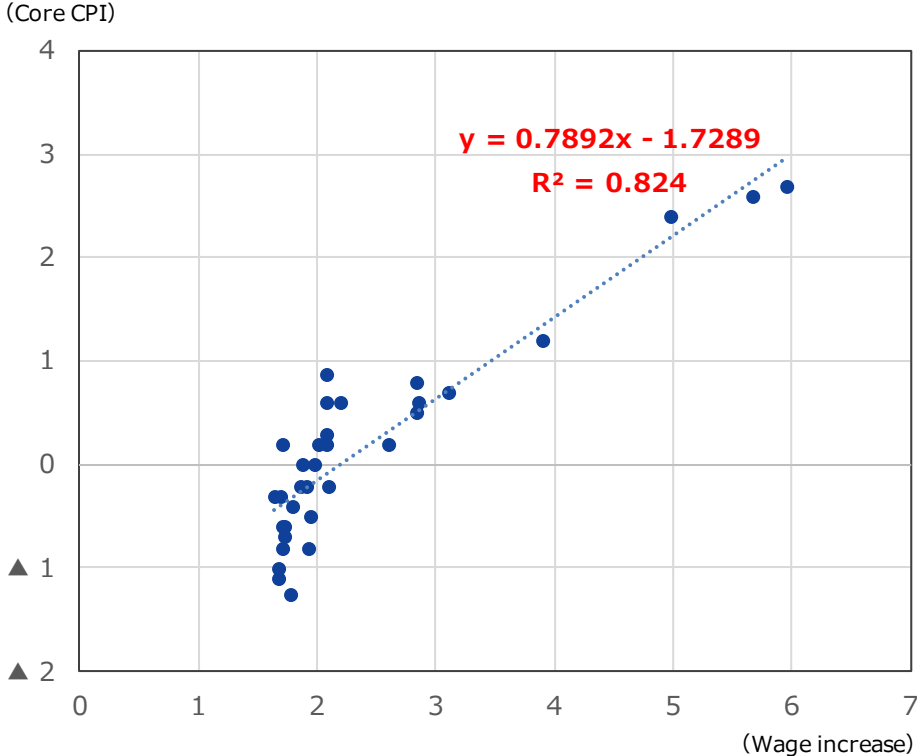
# Start of a virtuous cycle to overcome deflation

### Wage increase demand & settlement (YOY, %)



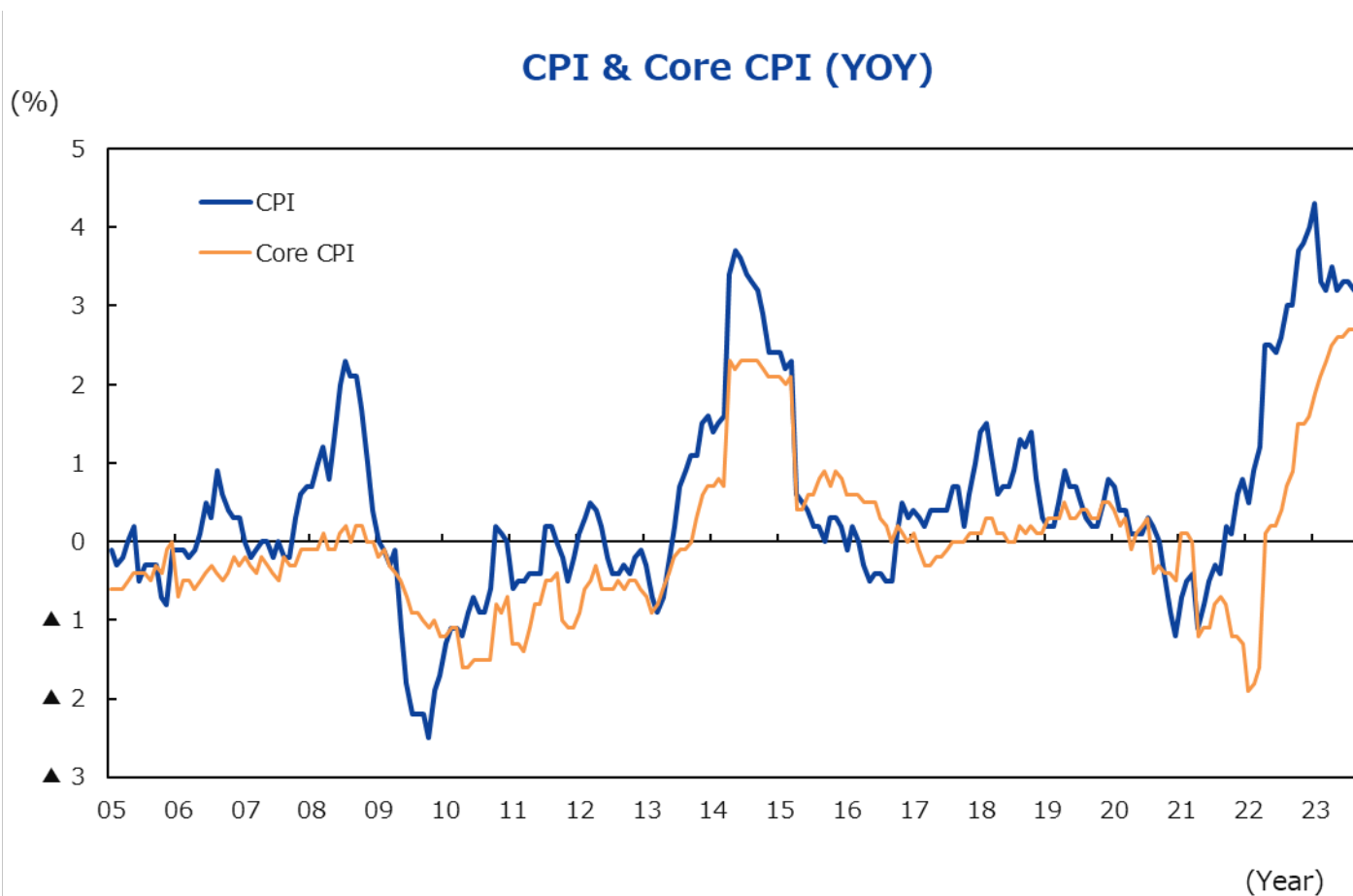
Note: Data is from FY 1990 to FY 2023.  
Source: Japanese Trade Union Confederation, SMDAM

### 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

# Sticky core inflation despite falling energy prices

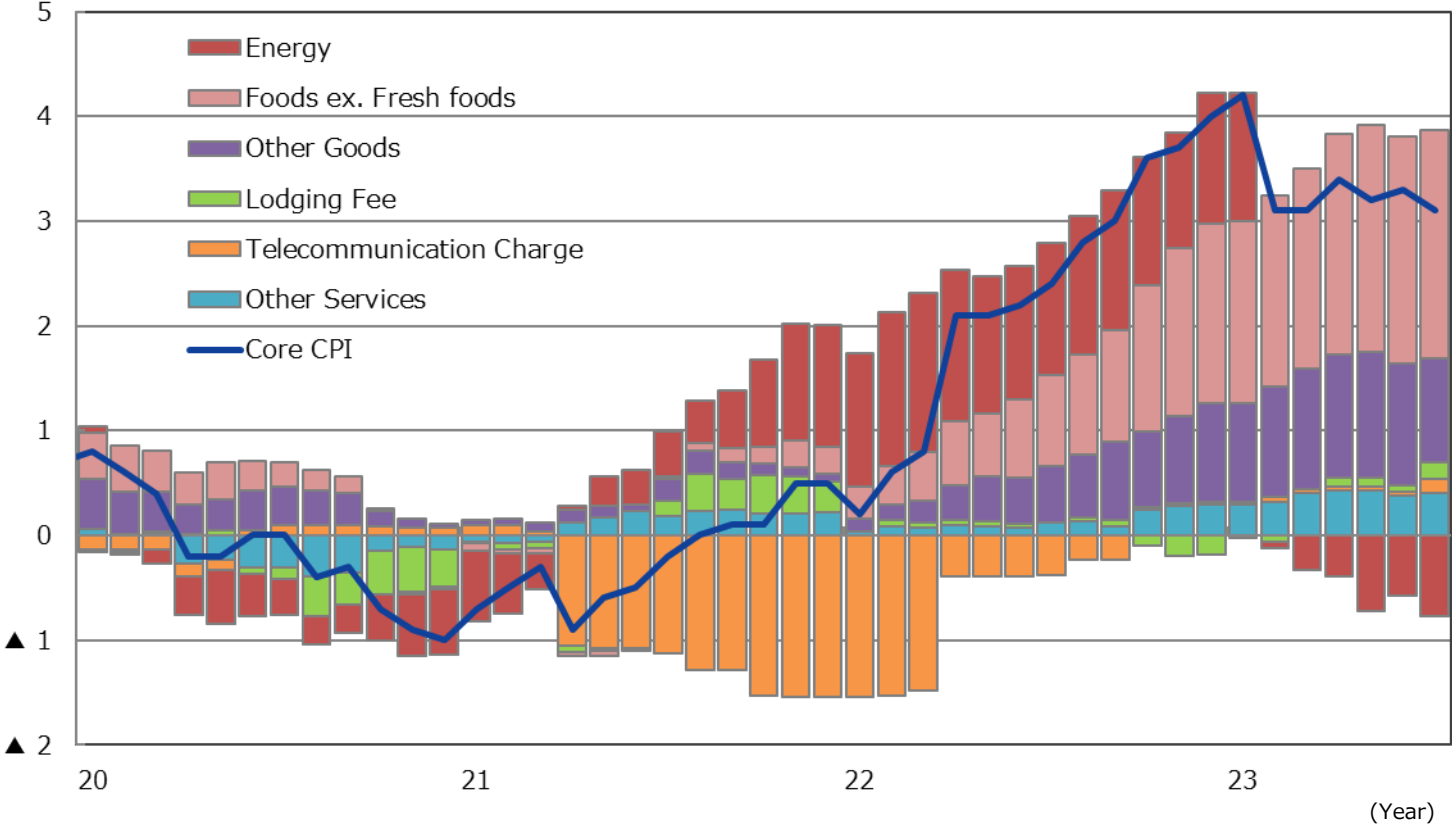


Note: Data is from January 2005 to August 2023, Core CPI is excluding food, except for alcohol, & energy.  
Source: MIAC, Bloomberg, SMDAM



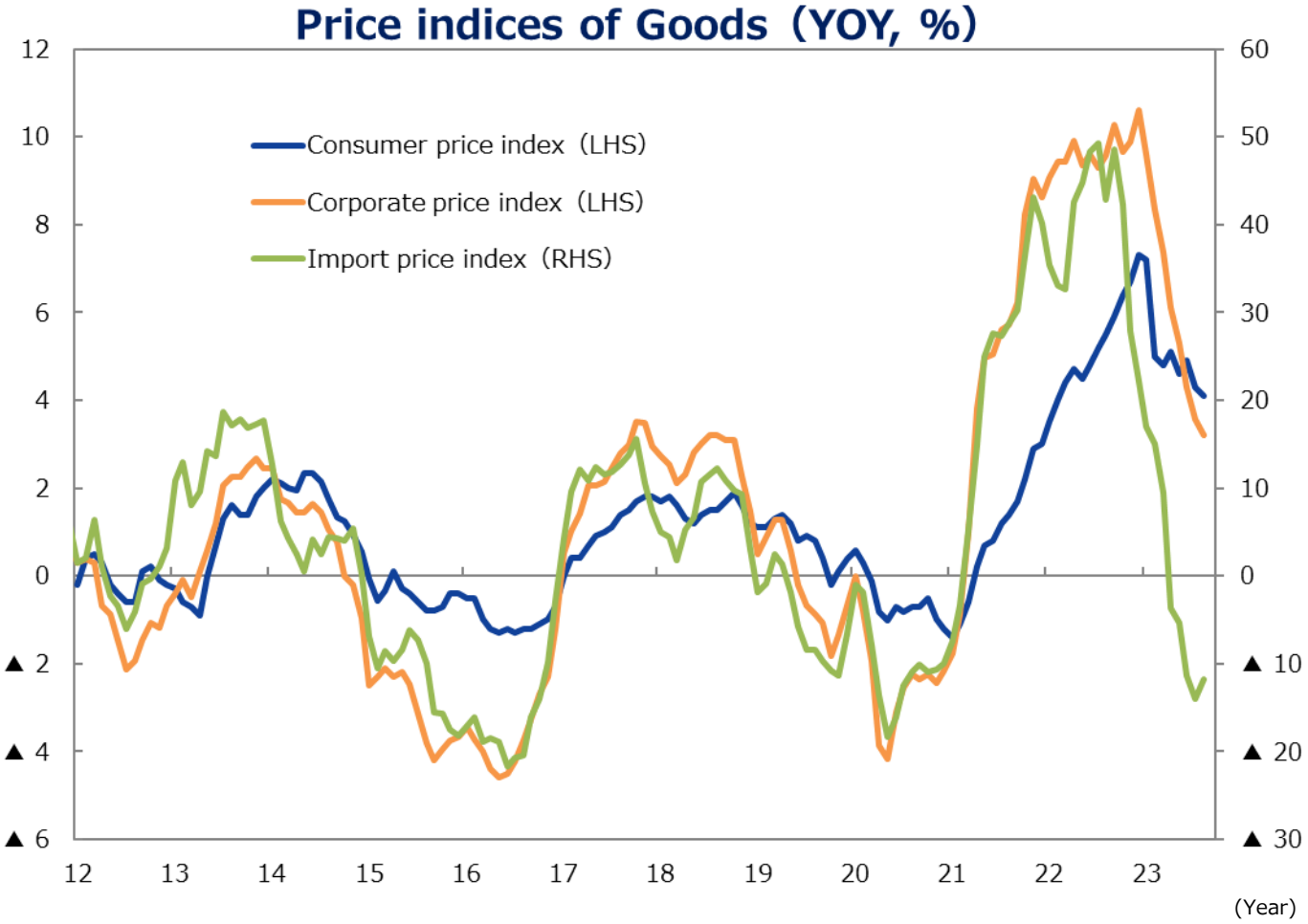
# Foods and goods boost inflation in Japan

Breakdown of CPI (YOY, %)



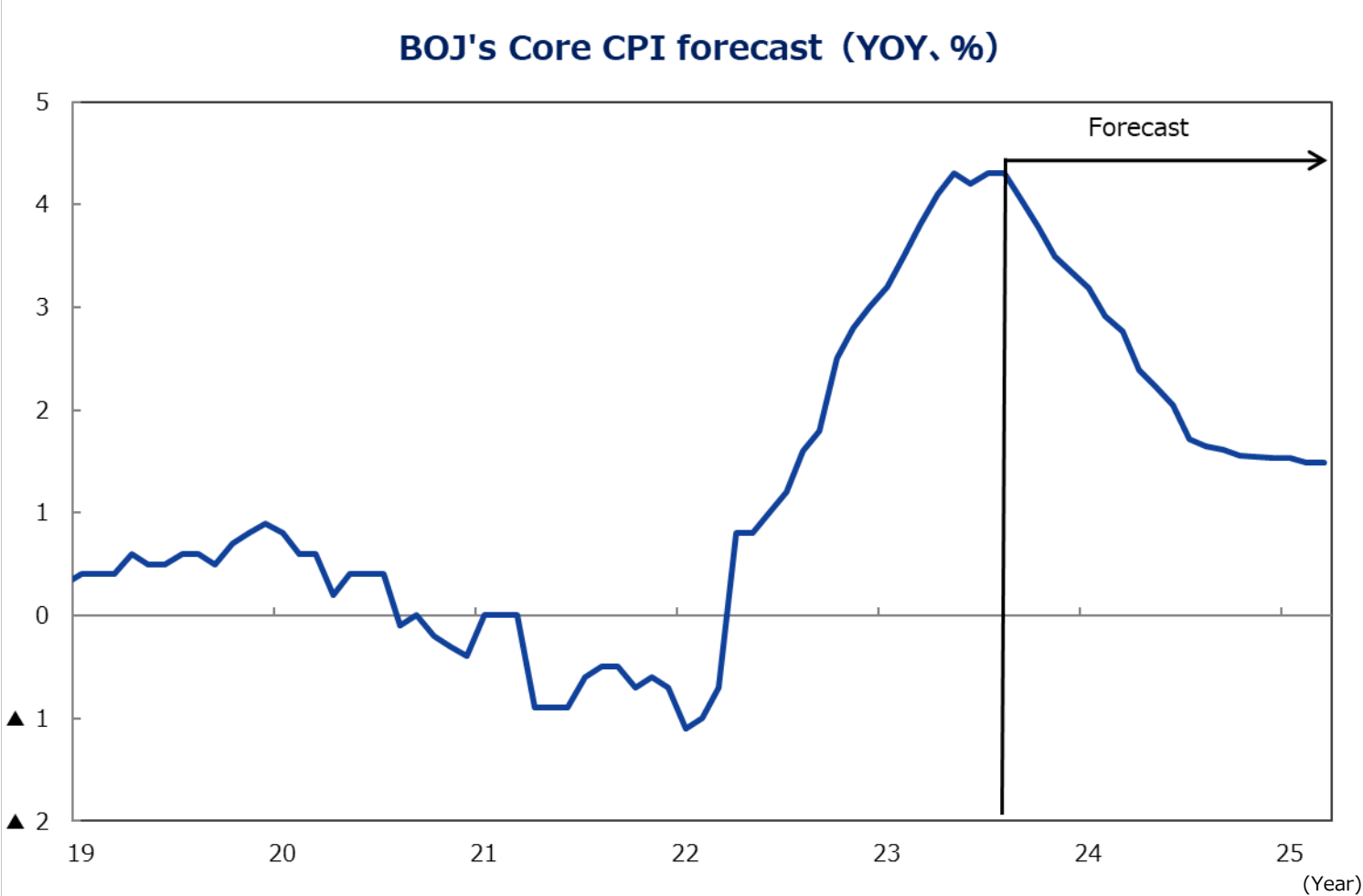
Note: Data is from January 2020 to July 2023,.  
Source: MIAC, SMDAM

# Profit margin improving thanks to falling input prices



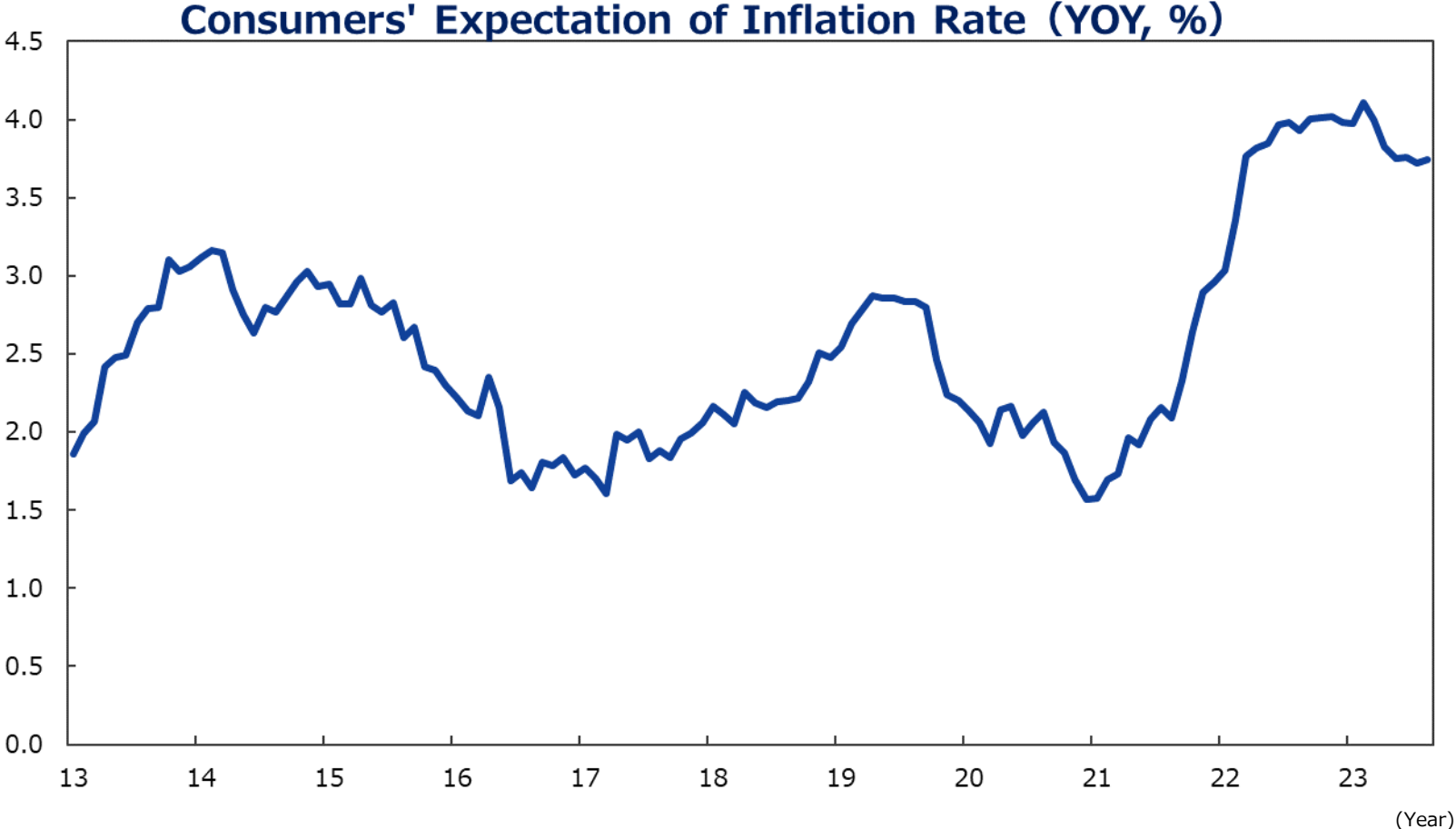
Note: Data is from January 2012 to August 2023.  
Source: MIAC, Bloomberg, SMDAM

# BOJ stick to less sticky inflation forecast



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

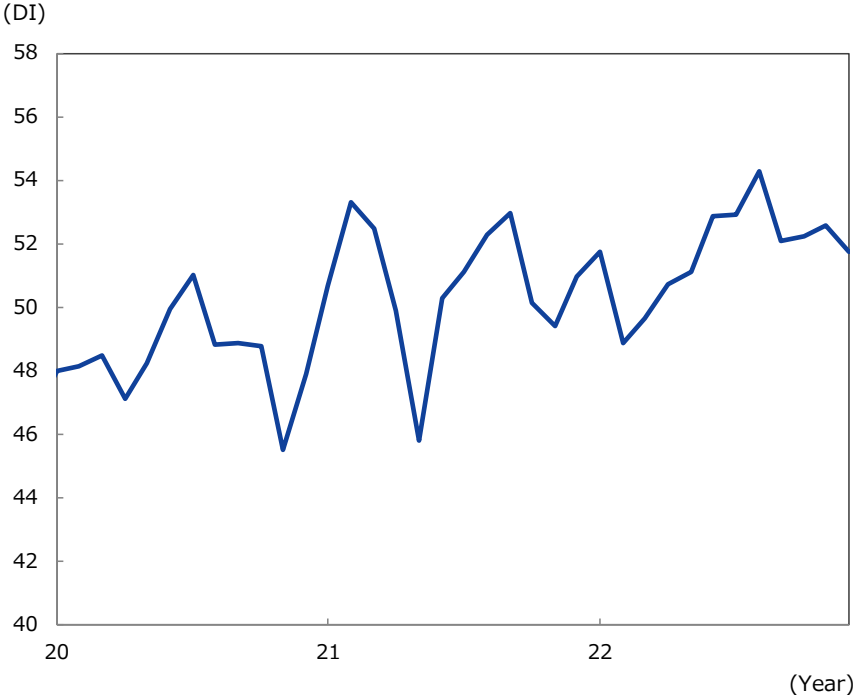
# People expect high & sticky inflation going forward



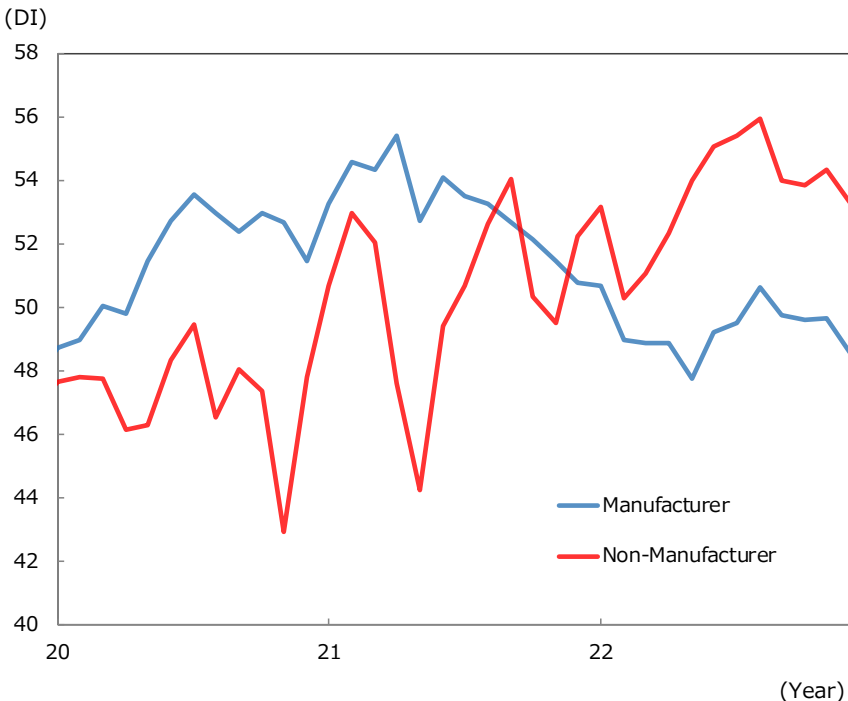
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to August 2023.  
Source: Cabinet Office, SMDAM

# Soft data shows sign of slowing business activities

### Composite PMI

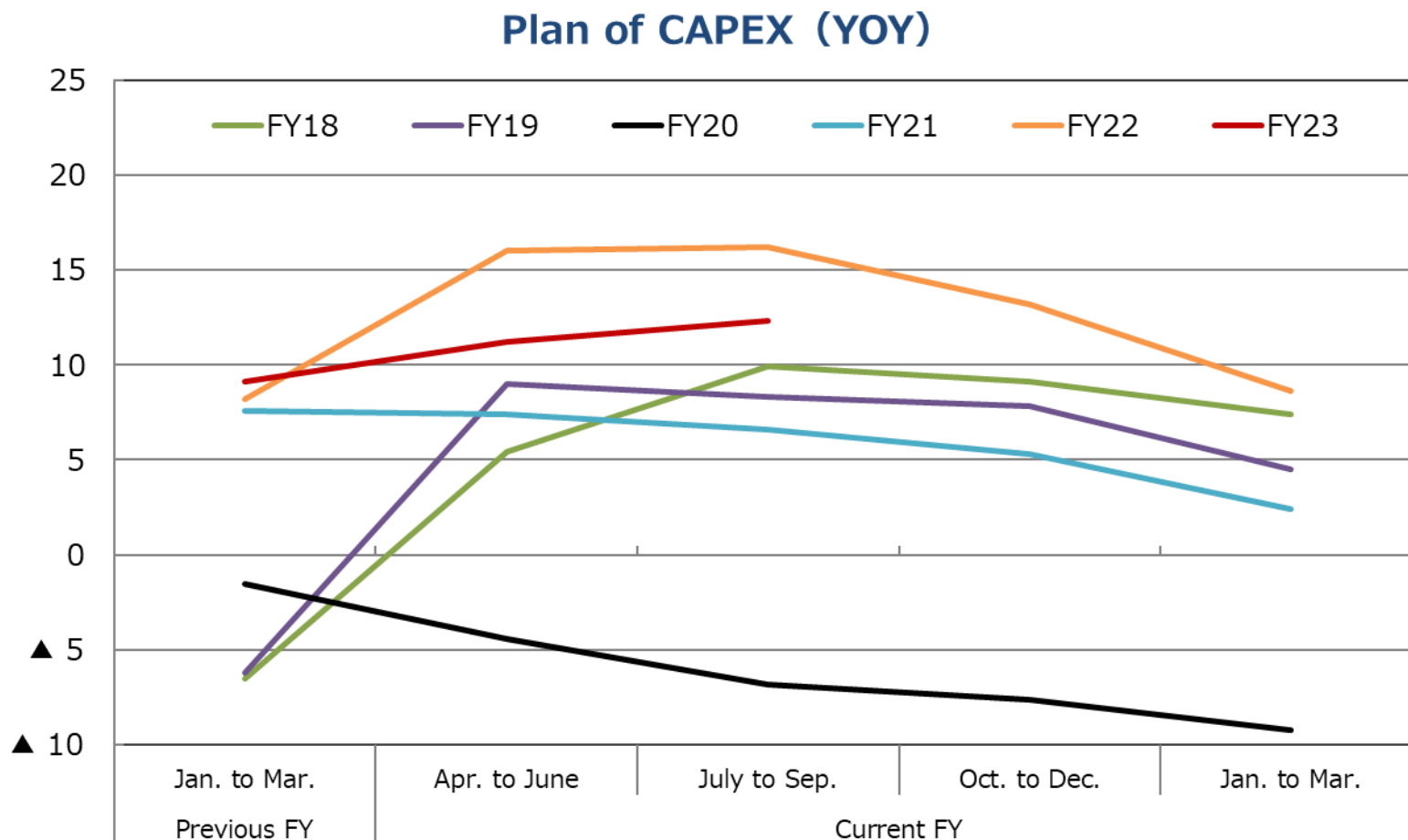


### PMI, Manufacturer & Non-Manufacturer



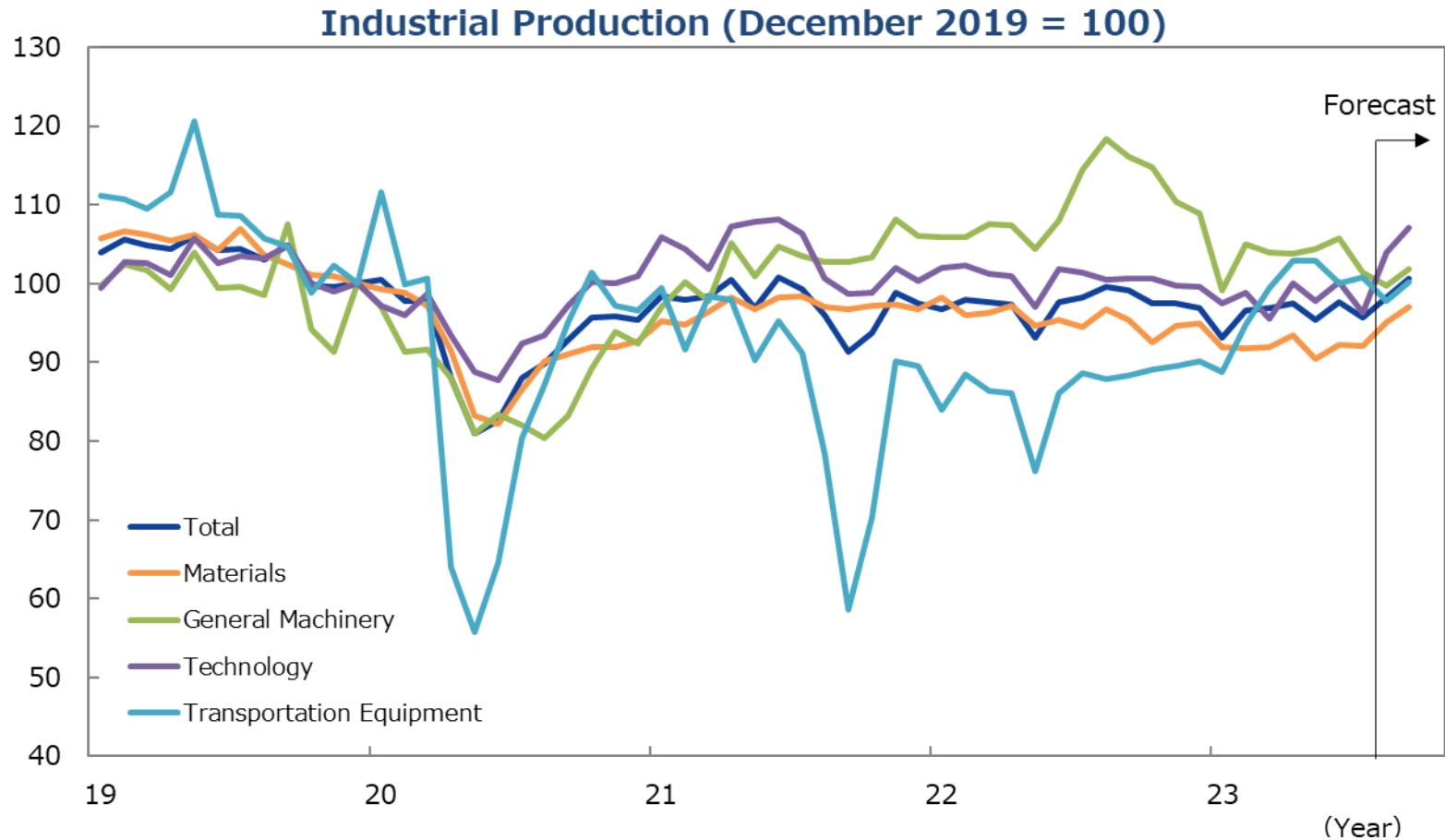
Note: Data is from October 2020 to September 2023.  
Source: Bloomberg, SMDAM

# Weaker yen, inflation and “de-risking” lift CAPEX in Japan



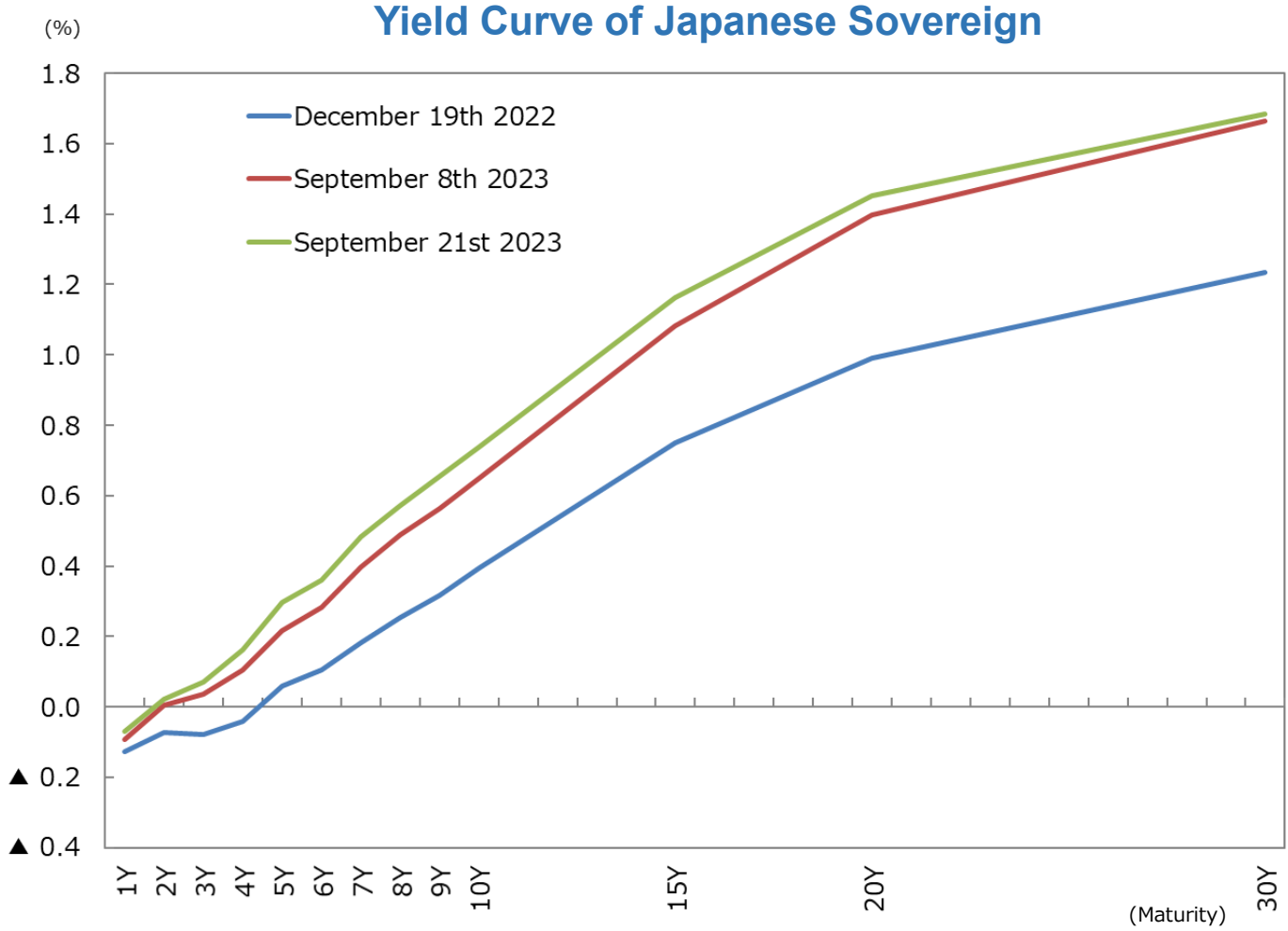
Note: Data is from Q1 FY2018 to Q3 FY2023. All industries, all sizes, including software, excluding land and R&D  
 Source: Cabinet Office, SMDAM

# Weaker yen and steady CAPEX lift industrial production ahead



Note: Data is from January 2019 to September 2023. Data after August 2023 are forecasts.  
Source: METI, SMDAM

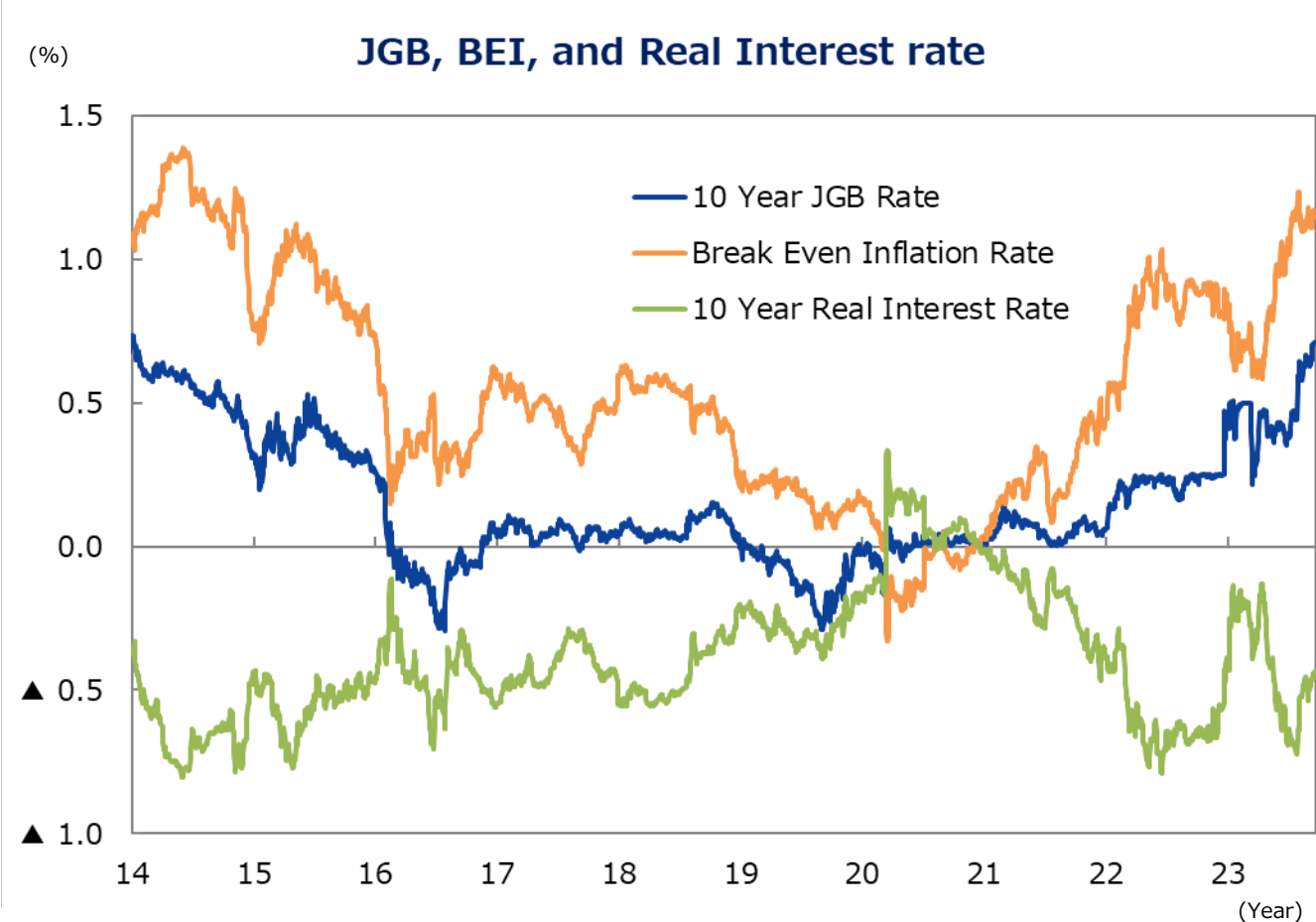
# Further “Bear steepening” after governor’s hawkish comments



Source: Bloomberg, SMDAM

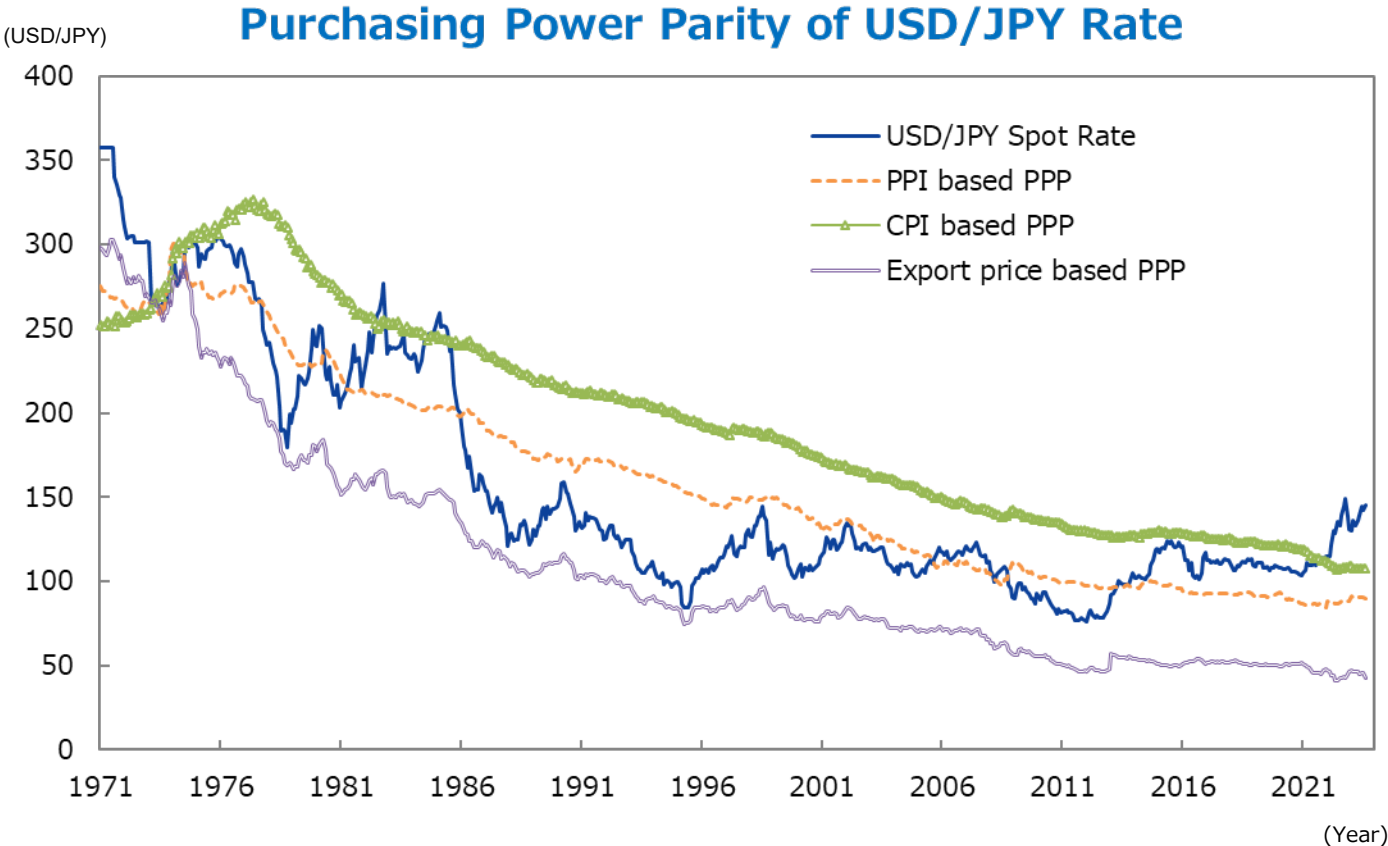


# Speculation for policy change lift real & nominal interest rate



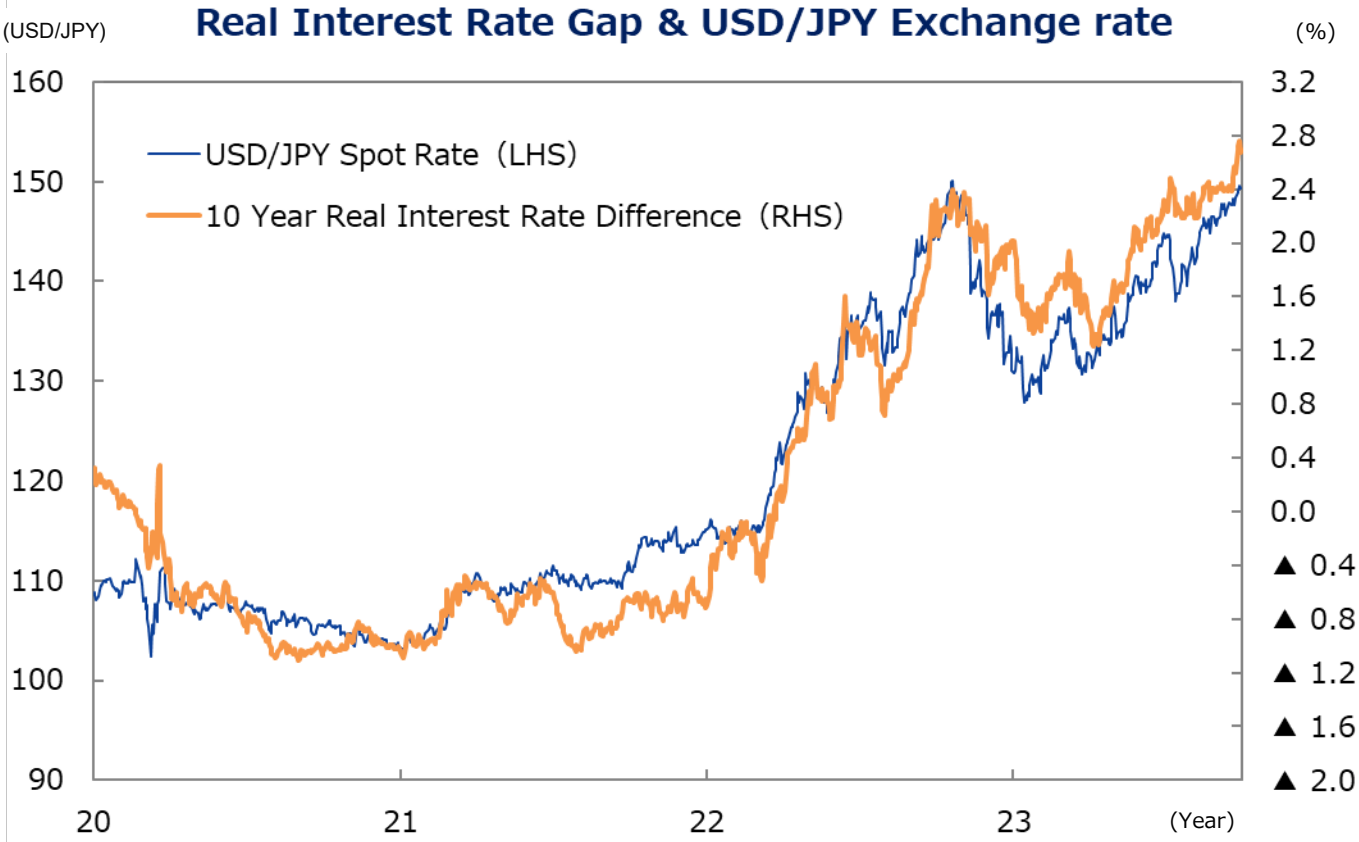
Note: Data is from 1st January 2014 to 19th September 2023.  
Source: Bloomberg, SMDAM

# USD/JPY widen its divergence from purchasing power parity



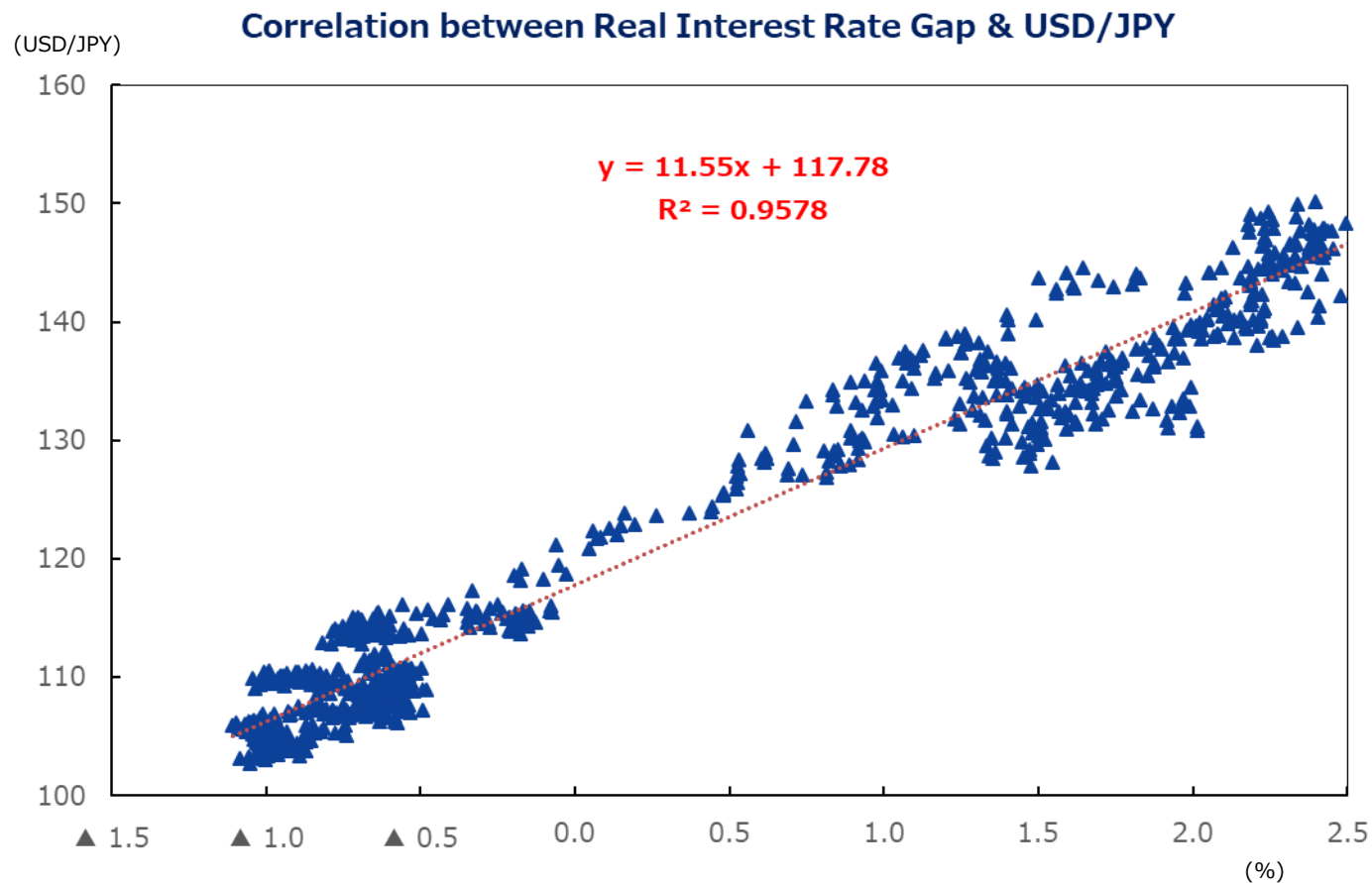
Note: Data is from January 1971 to August 2023.  
Source: DOL, Bank of Japan, SMDAM

# USD/JPY rate chasing real yield gap



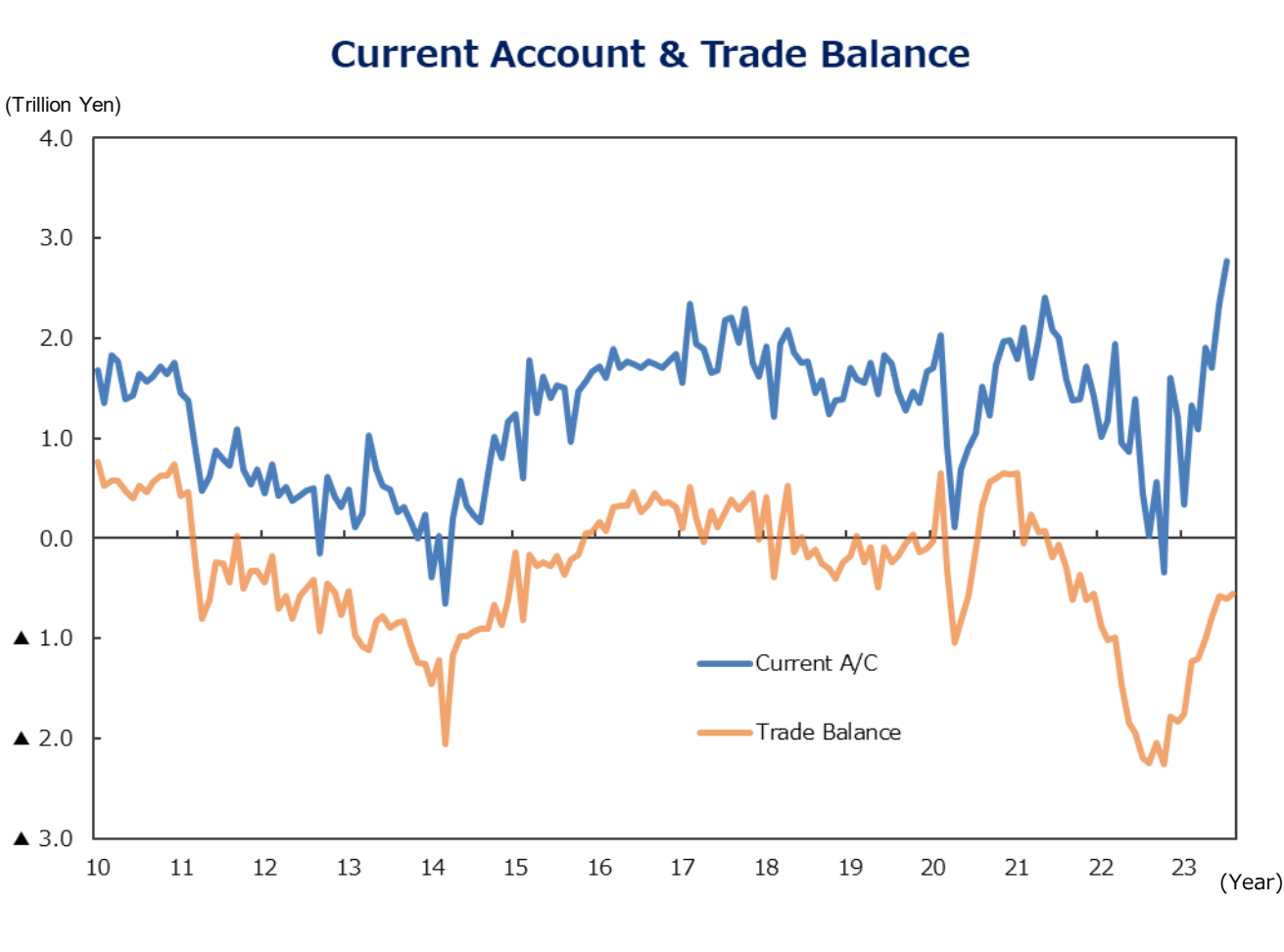
Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 29th September 2023.  
Source: Bloomberg, SMDAM

# Real yield gap dominating USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 29th September 2023.  
Source: Bloomberg, SMDAM

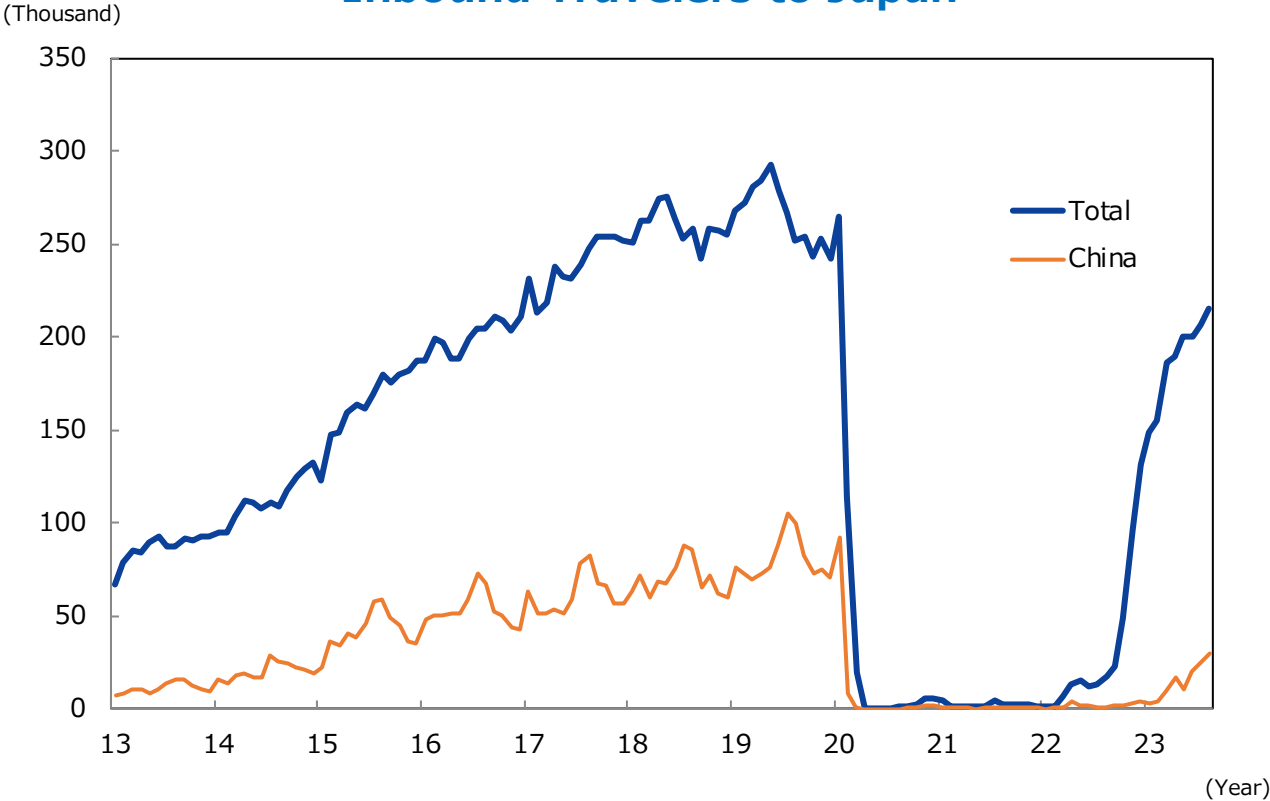
# Current A/C surplus surges due to shrinking trade deficit



Note: Data is Seasonally adjusted. Current account is from January 2010 to July 2023. Trade balance is from January 2010 to August 2023.  
Source: MOF, SMDAM

# Inbound travelers recovering without Chinese visitors

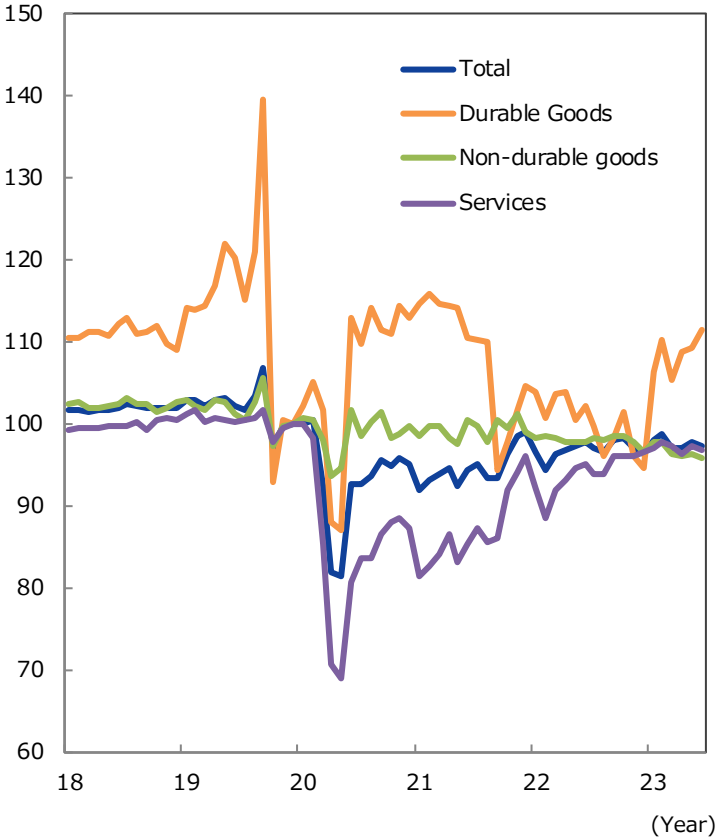
## Inbound Travelers to Japan



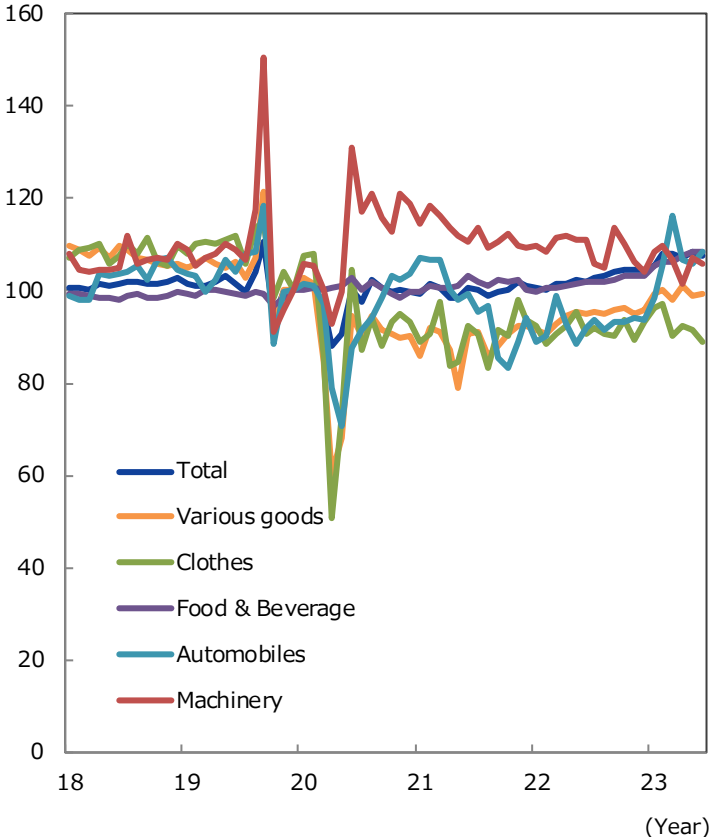
Note: Data is from January 2013 to August 2023. Data is non-seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Normalization of auto production lifts durable goods sales

Consumer Activity Index (Dec. 2019 = 100)



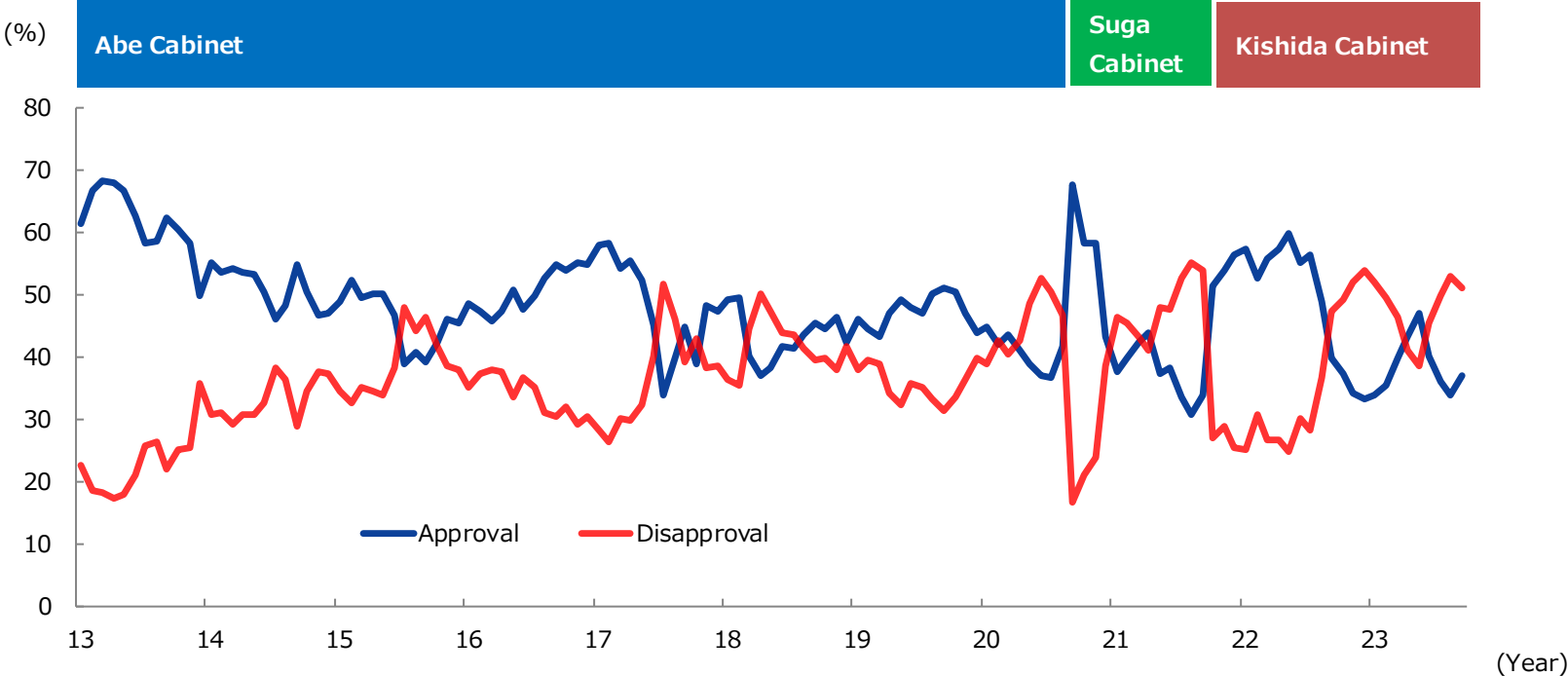
Retail Sales (Dec. 2019 = 100)



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

# PM's approval rate fell due to high inflation and tax hike

## Cabinet approval rate



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



## Schedule of major events

Year	Month	Date	Event
2023	October	1 30-31	Start of the qualified invoice-based method Monetary Policy Meeting
	November	15	Release of CY 2023 Q3 GDP
	December	8 18-19	Revision of CY 2023 Q3 GDP Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline
2024	January	1 22-23	Start of new NISA (Nippon Individual Savings Account) Monetary Policy Meeting Release of BOJ view report
	February	15	Release of CY 2023 Q4 GDP
	March	11 18-19	Revision of CY 2023 Q3 GDP Monetary Policy Meeting
	April	25-26	Monetary Policy Meeting Release of BOJ view report
	May		
	June	13-14	Monetary Policy Meeting

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

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