



# Outlook for Japanese Stock Market & Economy

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-January 2024-



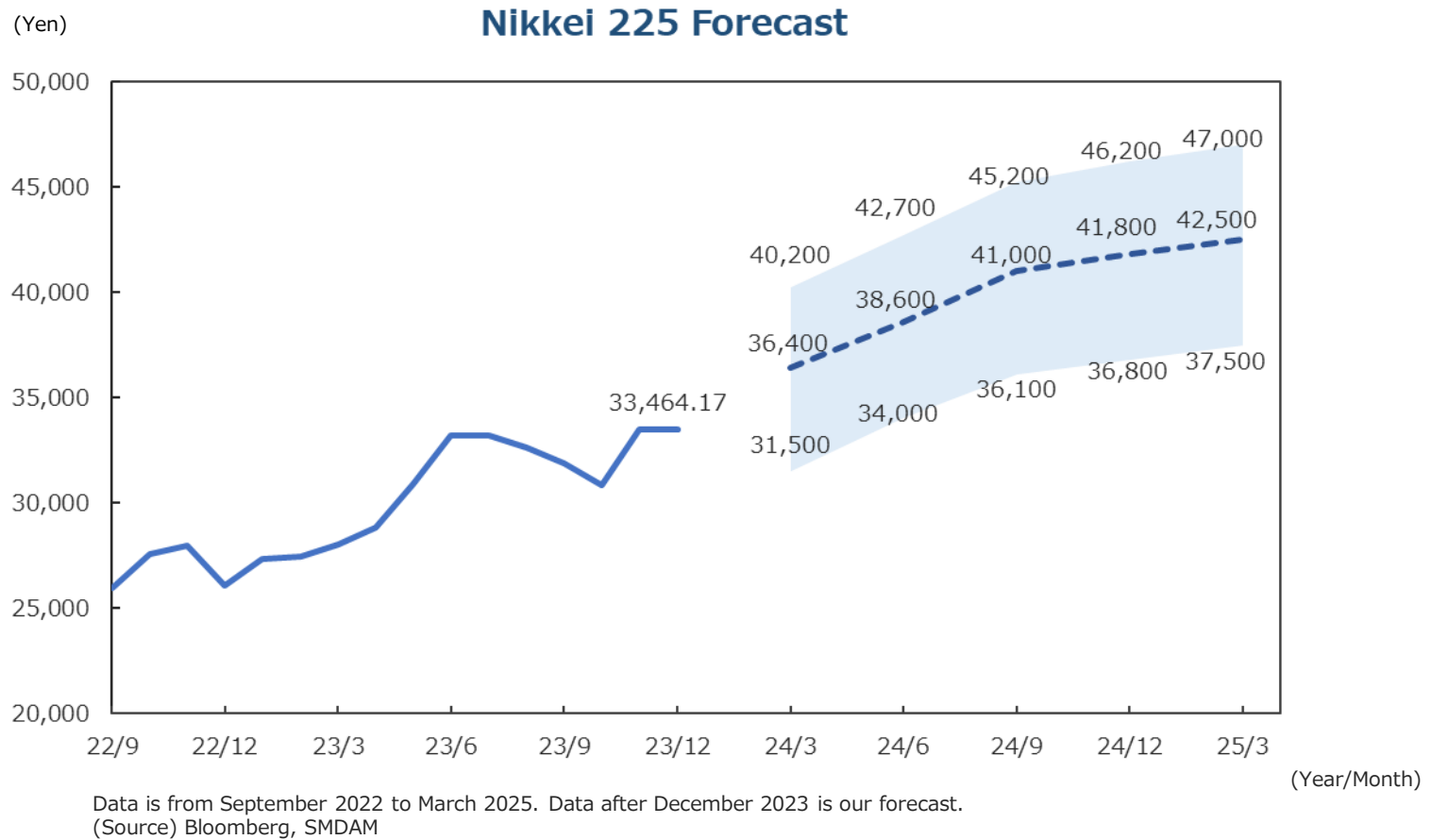
# Outlook for Japanese Stock Market

# Market Outlook

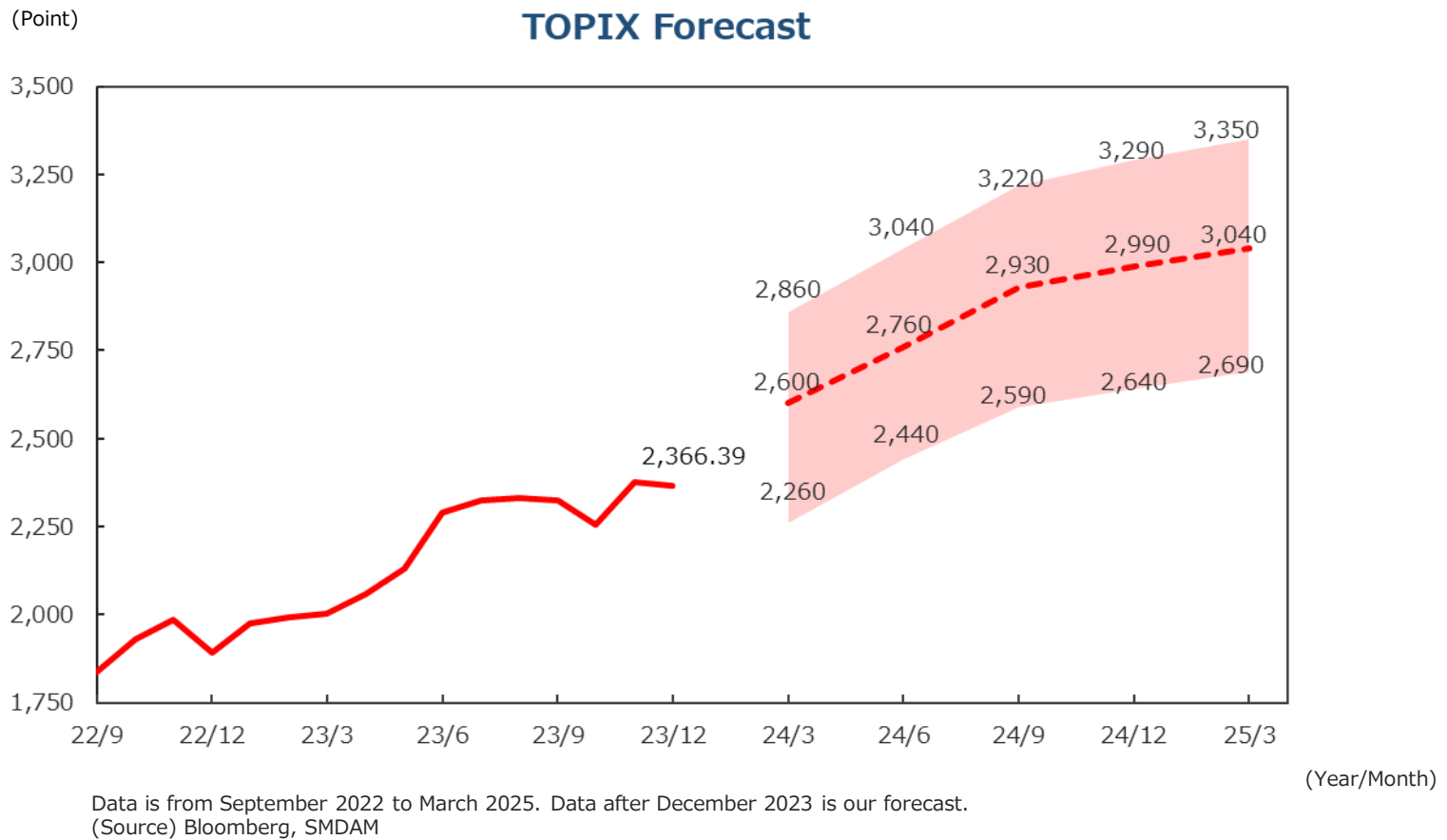
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- We are bullish on the Japanese stock market and expect the Nikkei 225 to reach to an all time high in 2024.
- Major tailwinds for the equity market are the solid increase in nominal GDP, strong corporate earnings, and accelerating business cycle of manufacturers.
- Further fiscal expansion, caused by rising tax revenue and mounting pressure on the ruling Liberal Democratic Party (LDP) before the leadership election of the LDP in September, could be another boost for the market.
- Possible changes to monetary policy could be a tricky factor for the market after decades of an ultra-low interest rate environment in Japan.

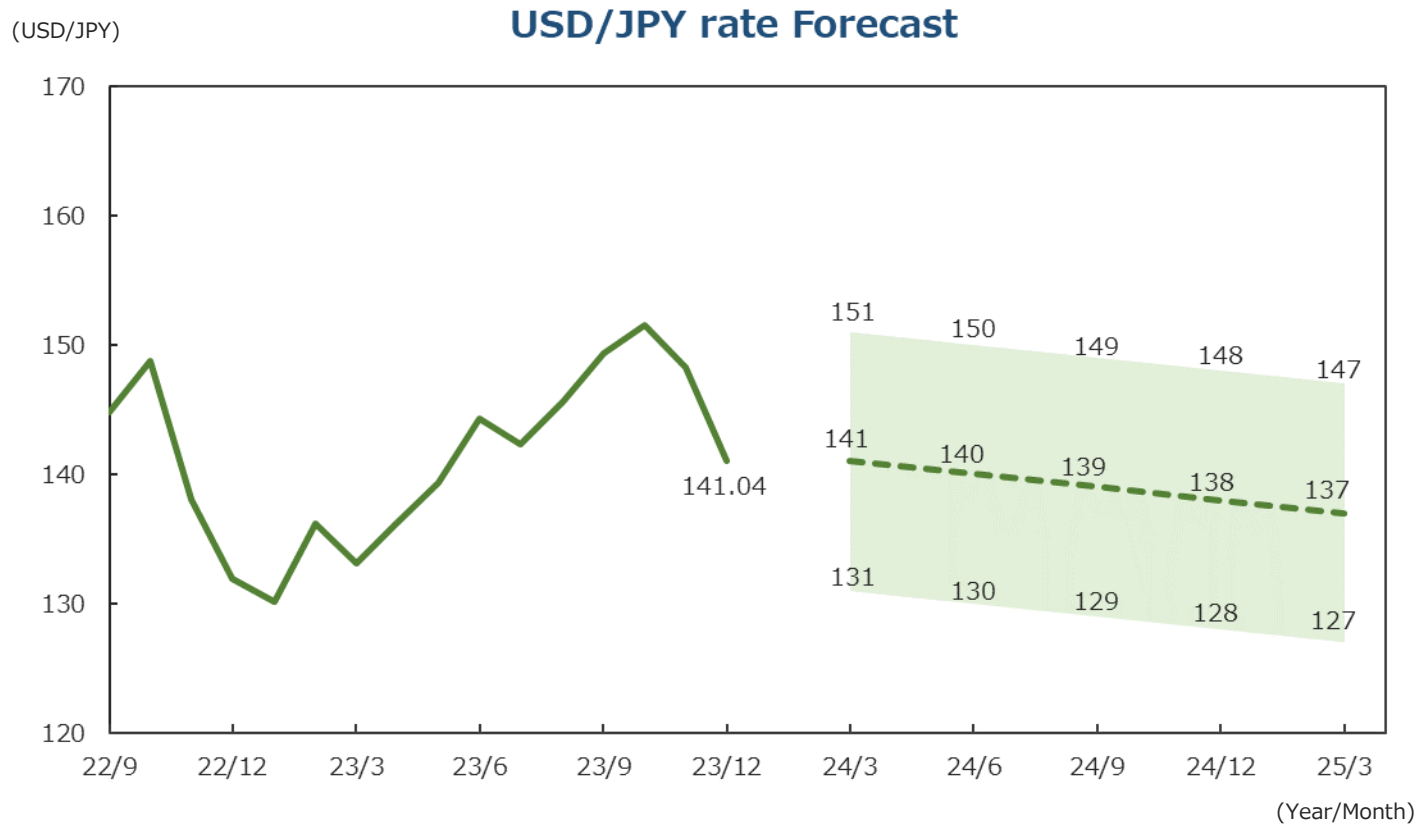
# We expect the bullish stock market to continue



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# Modest JPY appreciation ahead due to FED & BOJ pivot



Data is from September 2022 to March 2025. Data after December 2023 is our forecast.  
(Source) Bloomberg, SMDAM

# Upside / Downside risk scenarios

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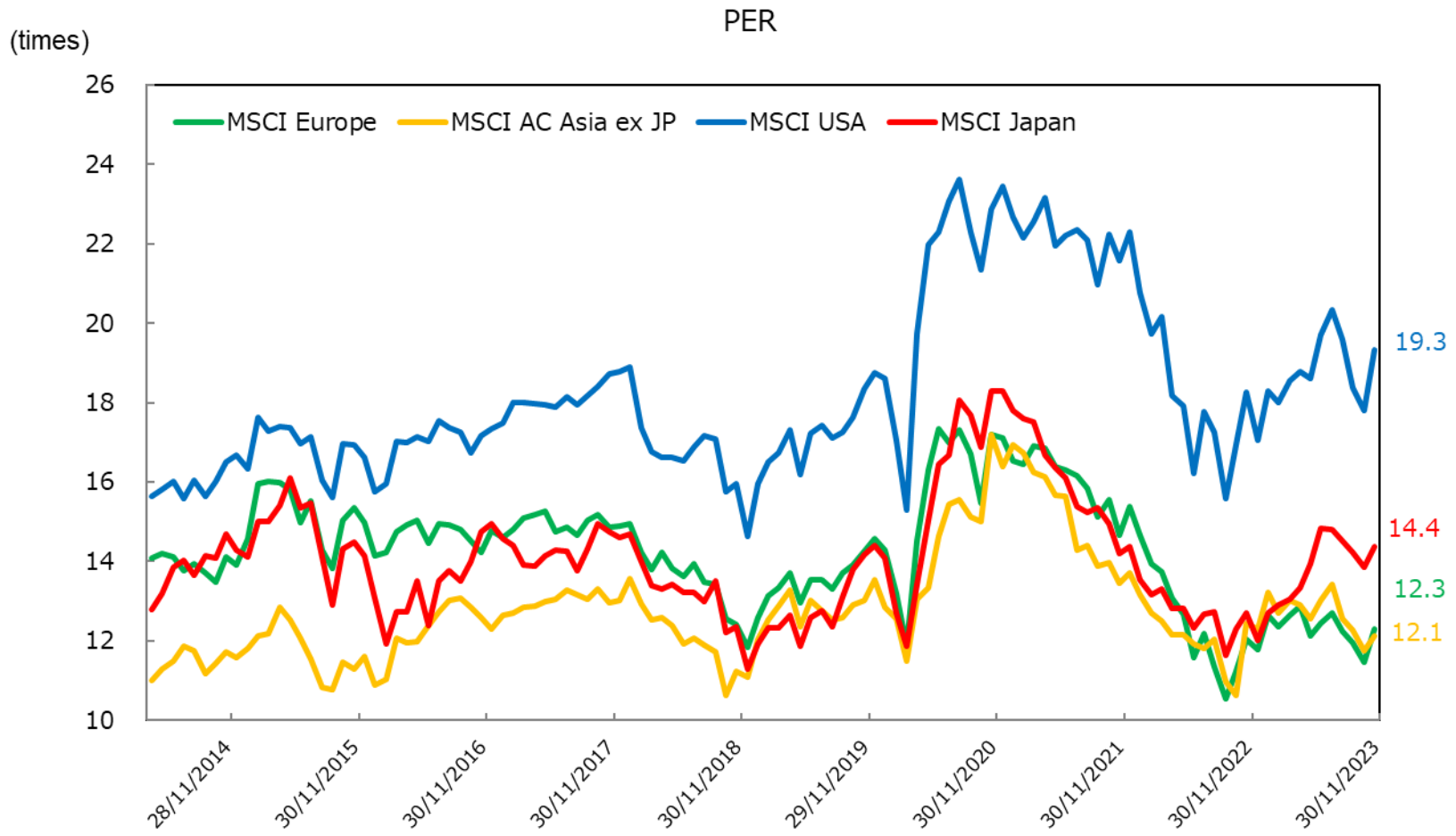
## ■ Upside Risks

- Growing optimism over mild inflation and wage increases
- The Bank of Japan's patient continuation of accommodative monetary policy

## ■ Downside Risks

- Excessive & rapid JPY appreciation and its negative impact on corporate earnings
- Monetary tightening by the Bank of Japan at a faster pace than anticipated
- Political turmoil caused by divisions within the LDP

# Falling US bond yield lifts P/E ratio

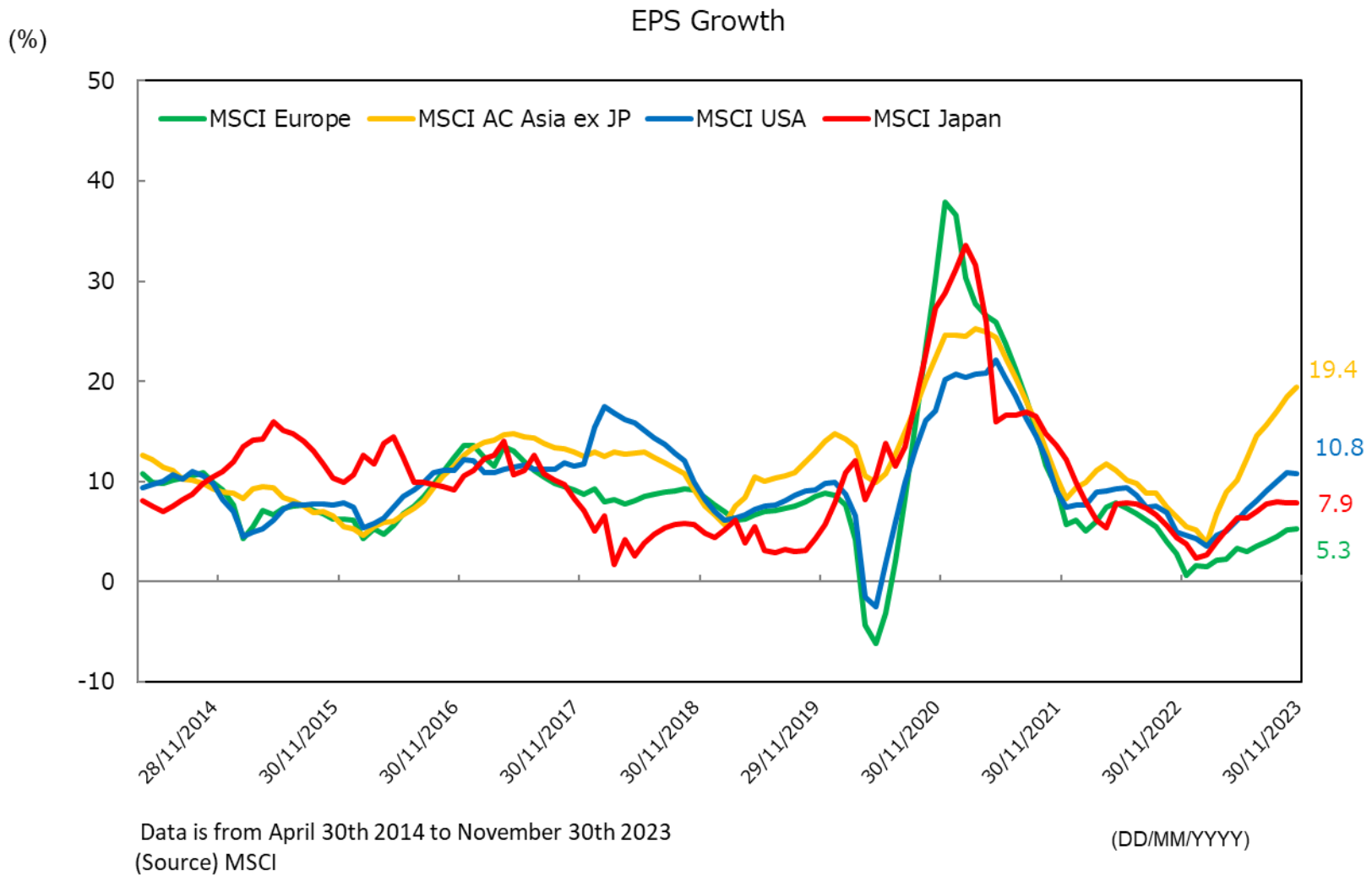


Data is from April 30th 2014 to November 30th 2023  
(Source) MSCI

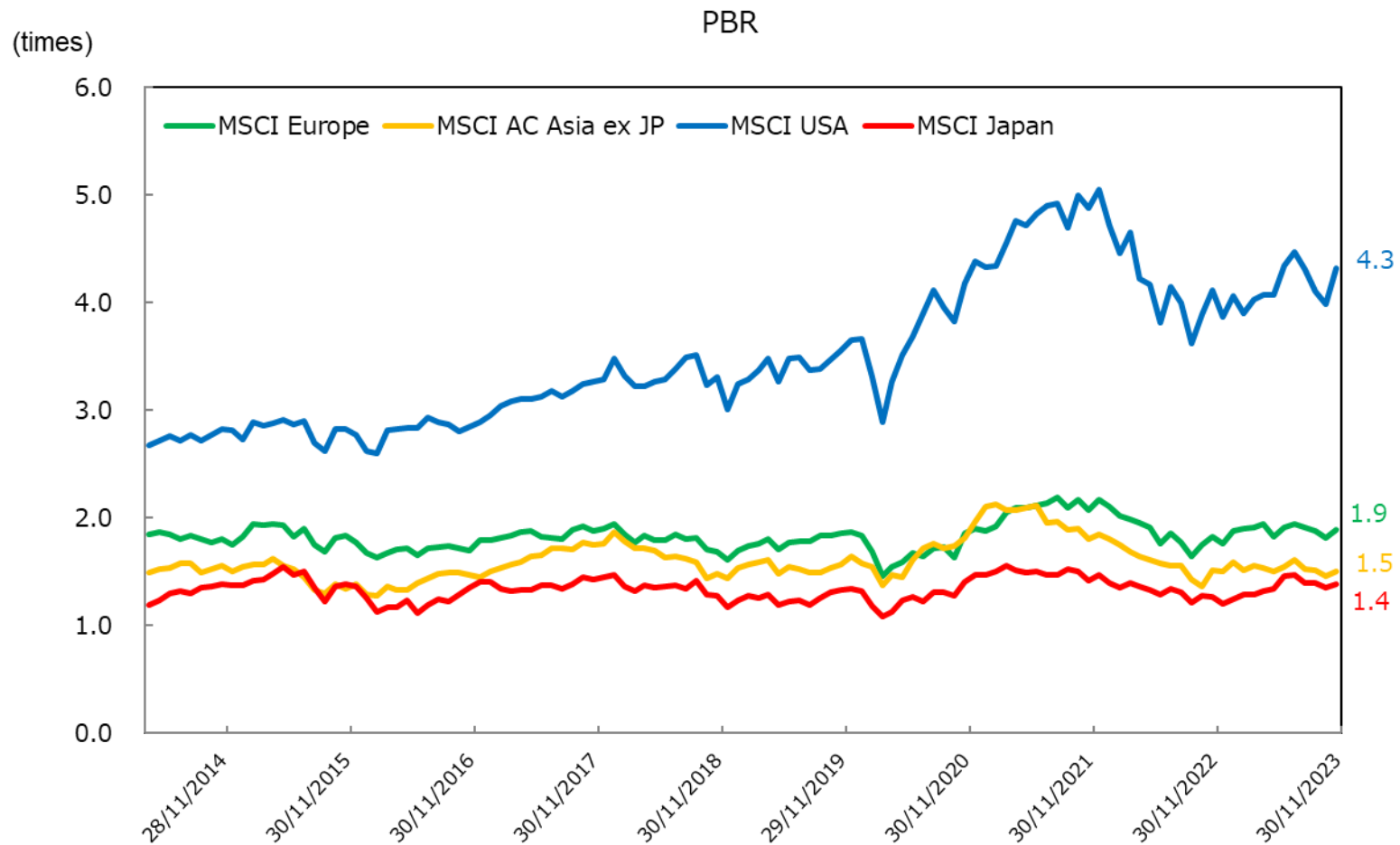
(DD/MM/YYYY)



# Earnings growth outlook remains solid



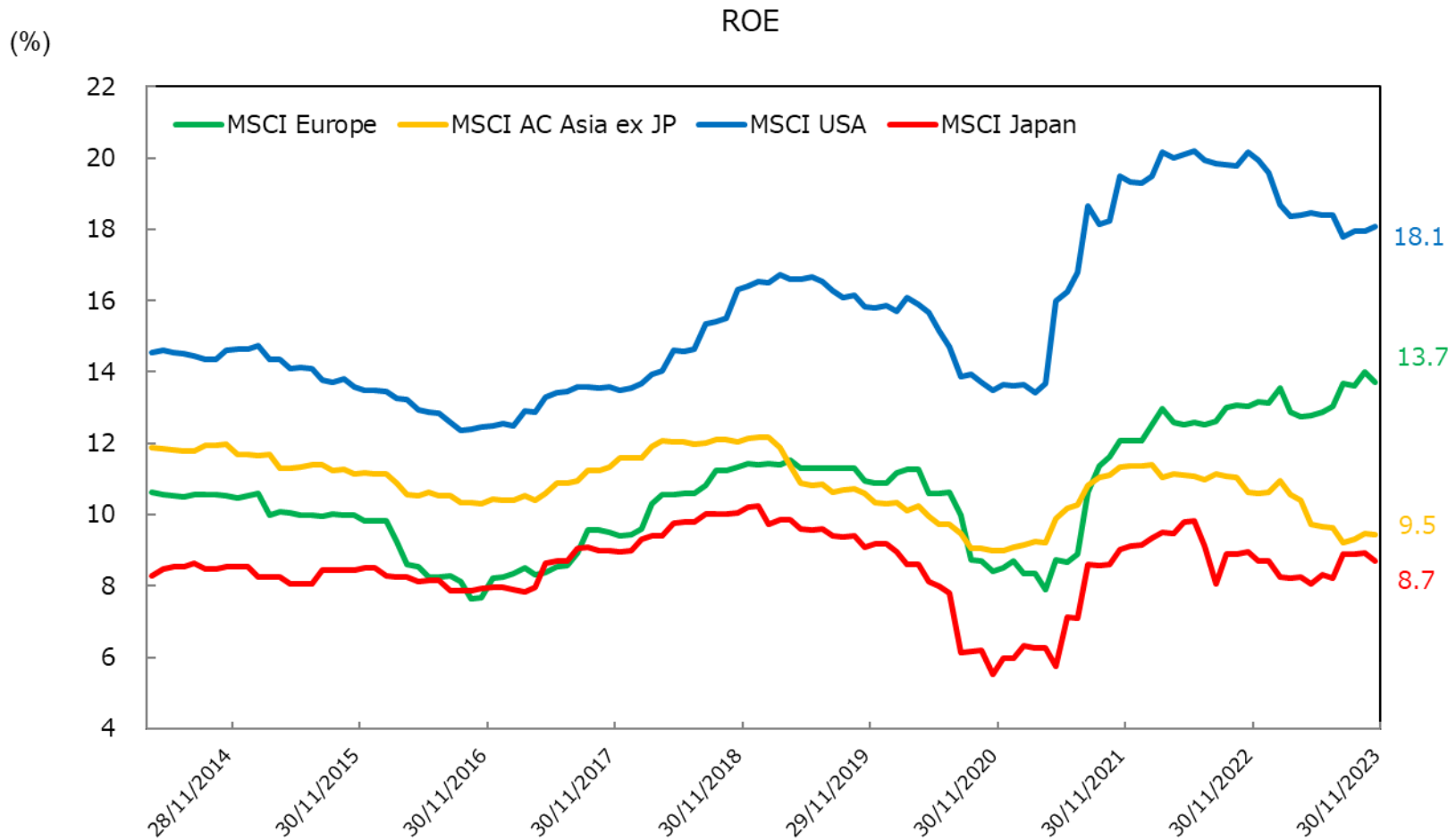
# Japan's P/B ratio hits bottom but still lower than peers



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

(DD/MM/YYYY)

# Japanese ROE rising with solid earnings growth

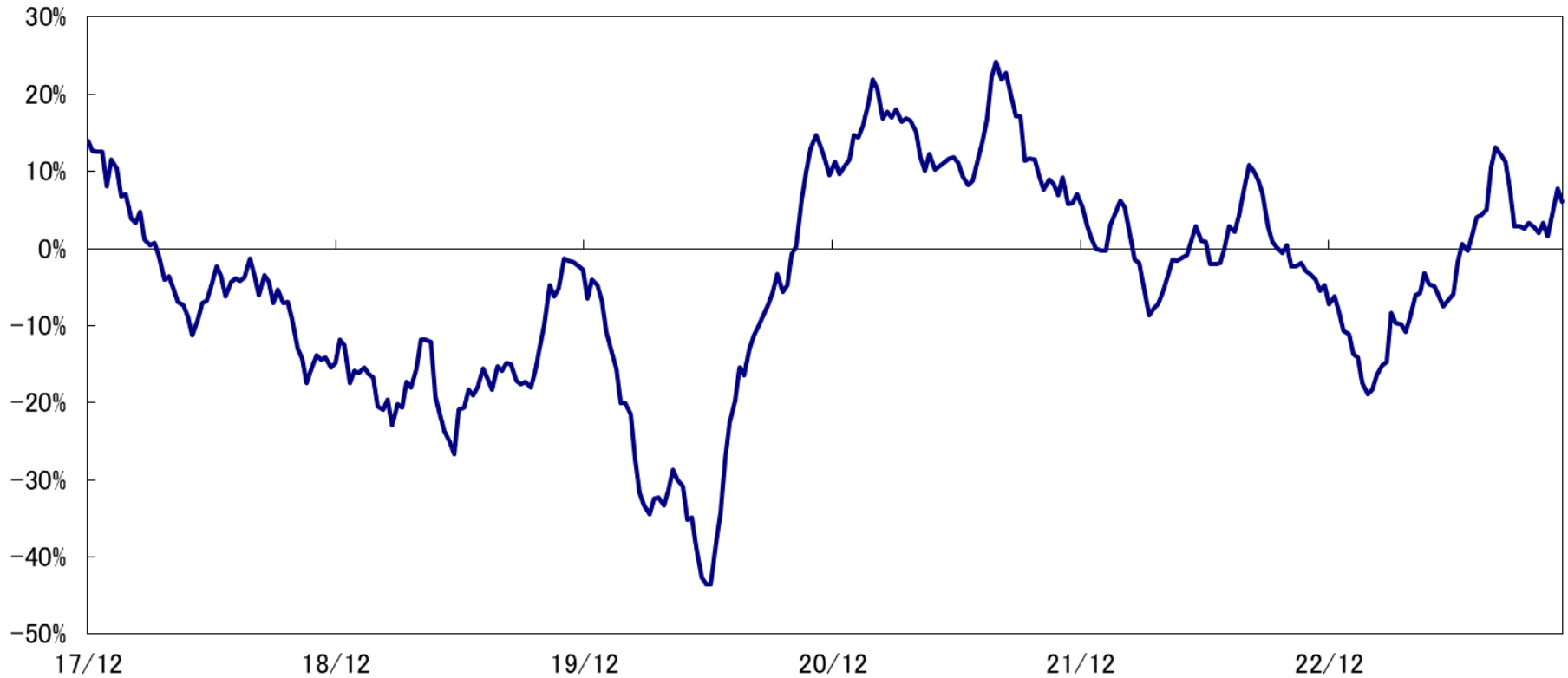


Data is from April 30th 2014 to November 30th 2023  
 (Source) MSCI

(DD/MM/YYYY)

# EPS revision maintains positive trend

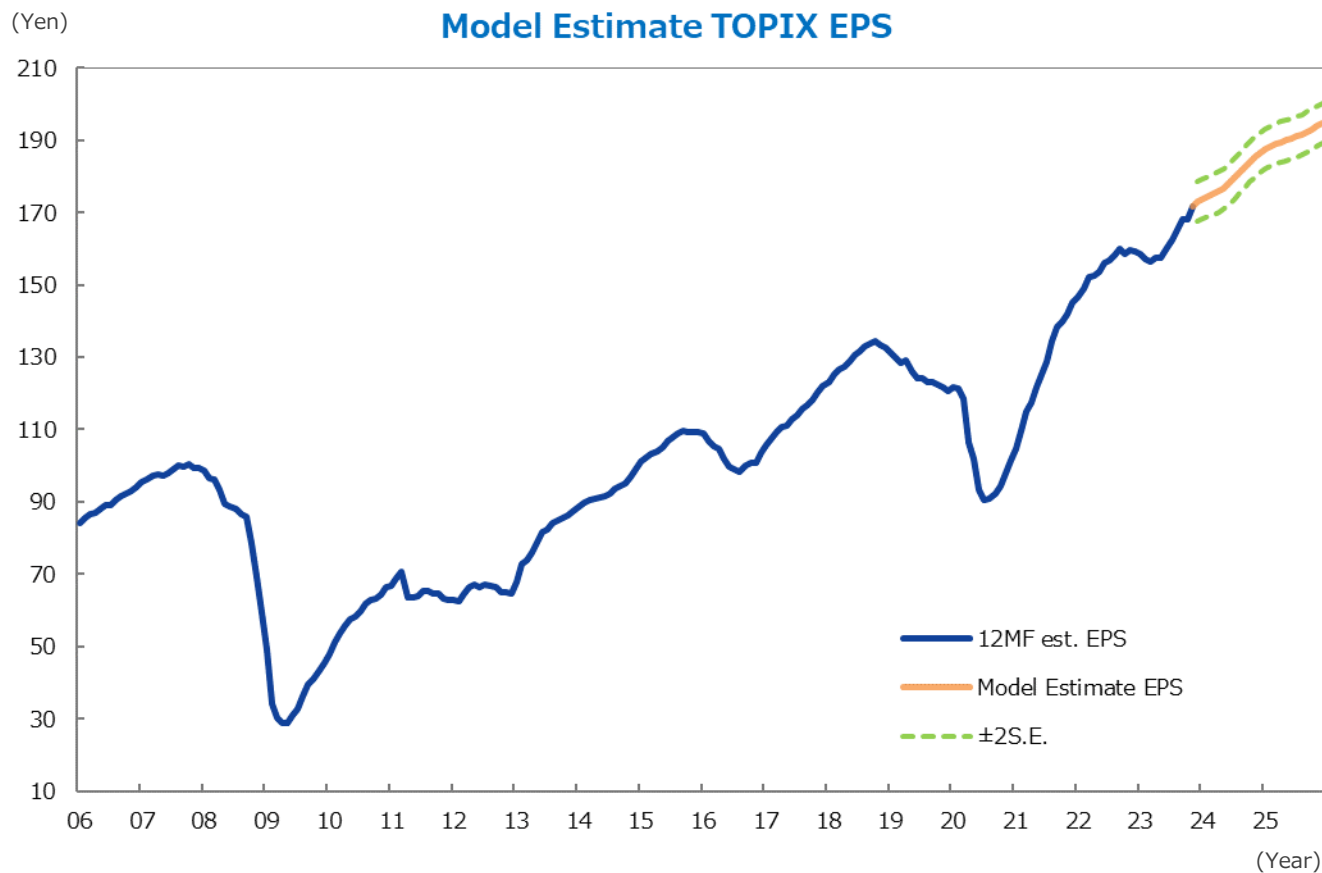
TOPIX Revision Index



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

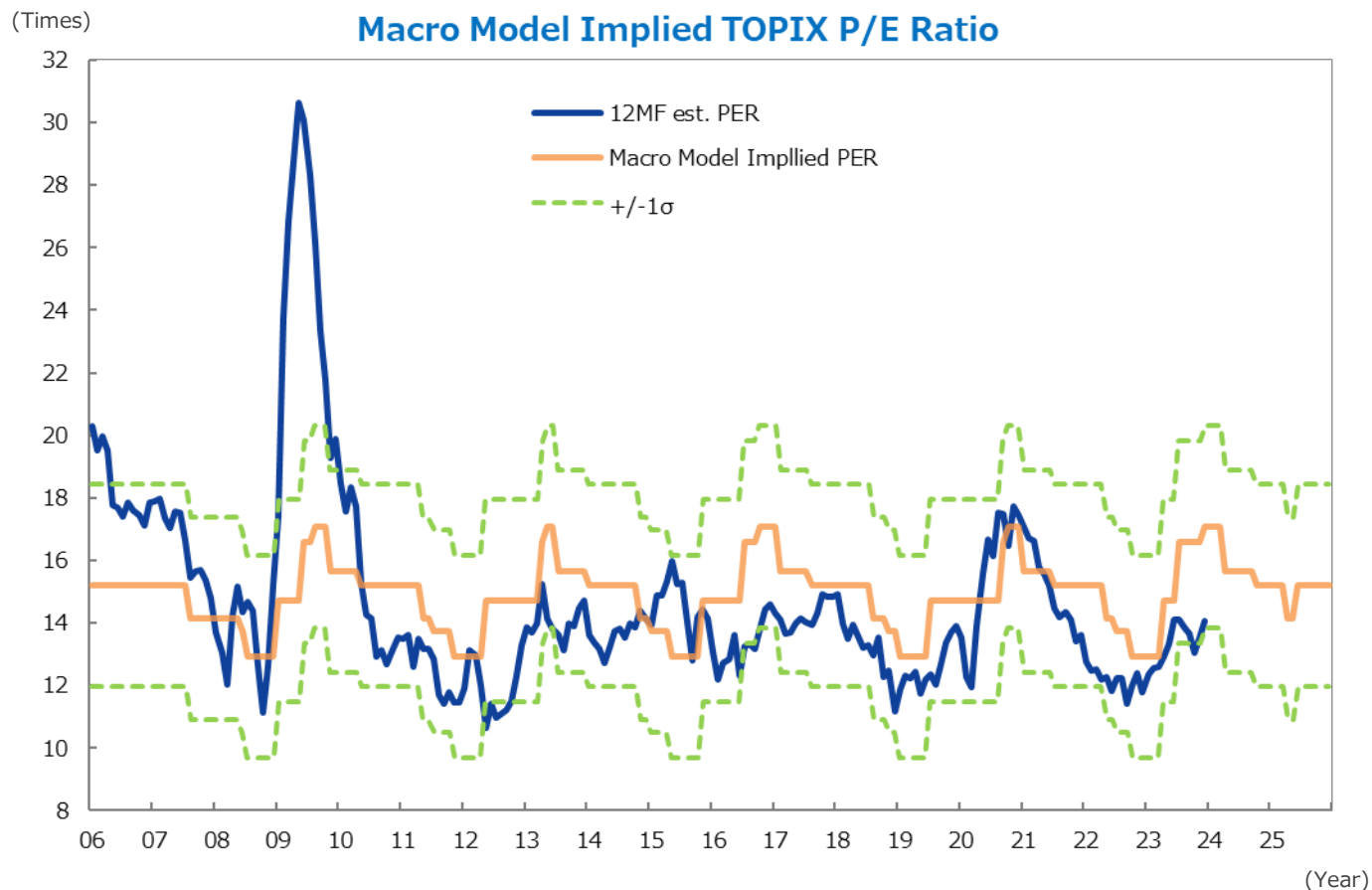
(YY/MM)

# Quant model indicates positive earnings outlook going forward



Note: Consensus data is from January 2006 to November 2023. Model estimate Data is from December 2023 to December 2025.  
Source: SMDAM

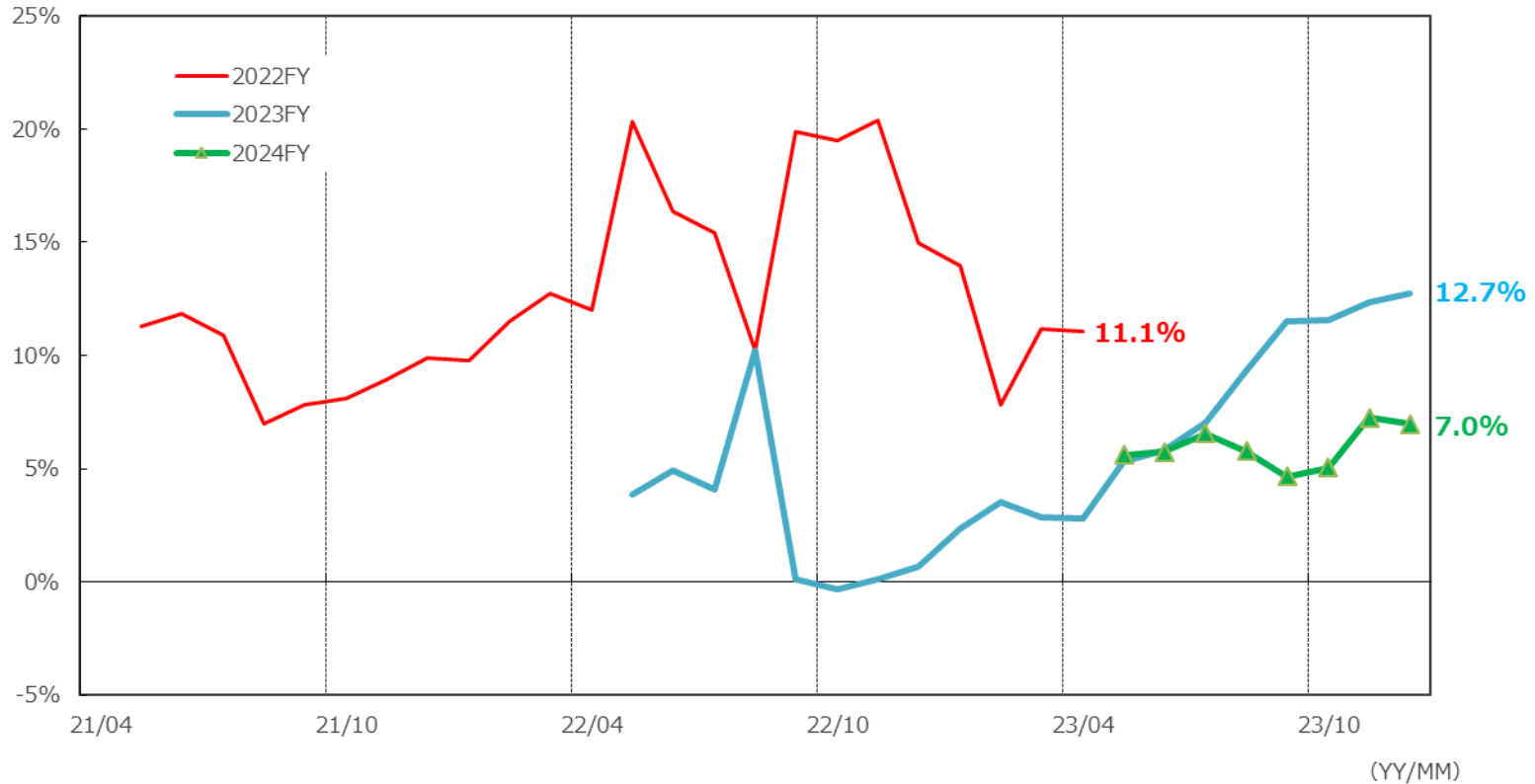
# Model still indicates upside potential of P/E ratio



Note: Consensus data is from January 2006 to November 2023, Model estimate Data is from January 2006 to December 2025.  
Source: SMDAM

# Strong earnings growth in 2023 to continue into 2024

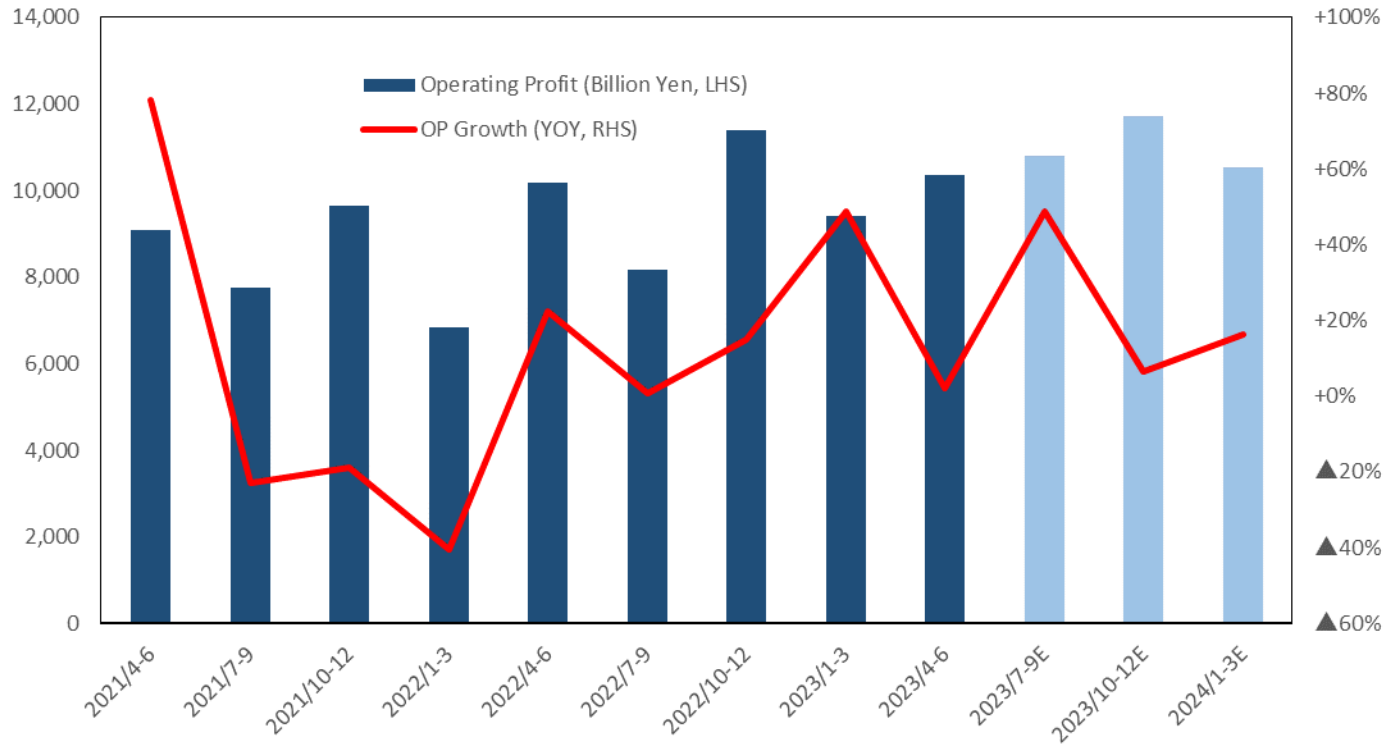
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 11th December 2023, SMDAM Core Universe (Excl. Financials) consists of 402 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)

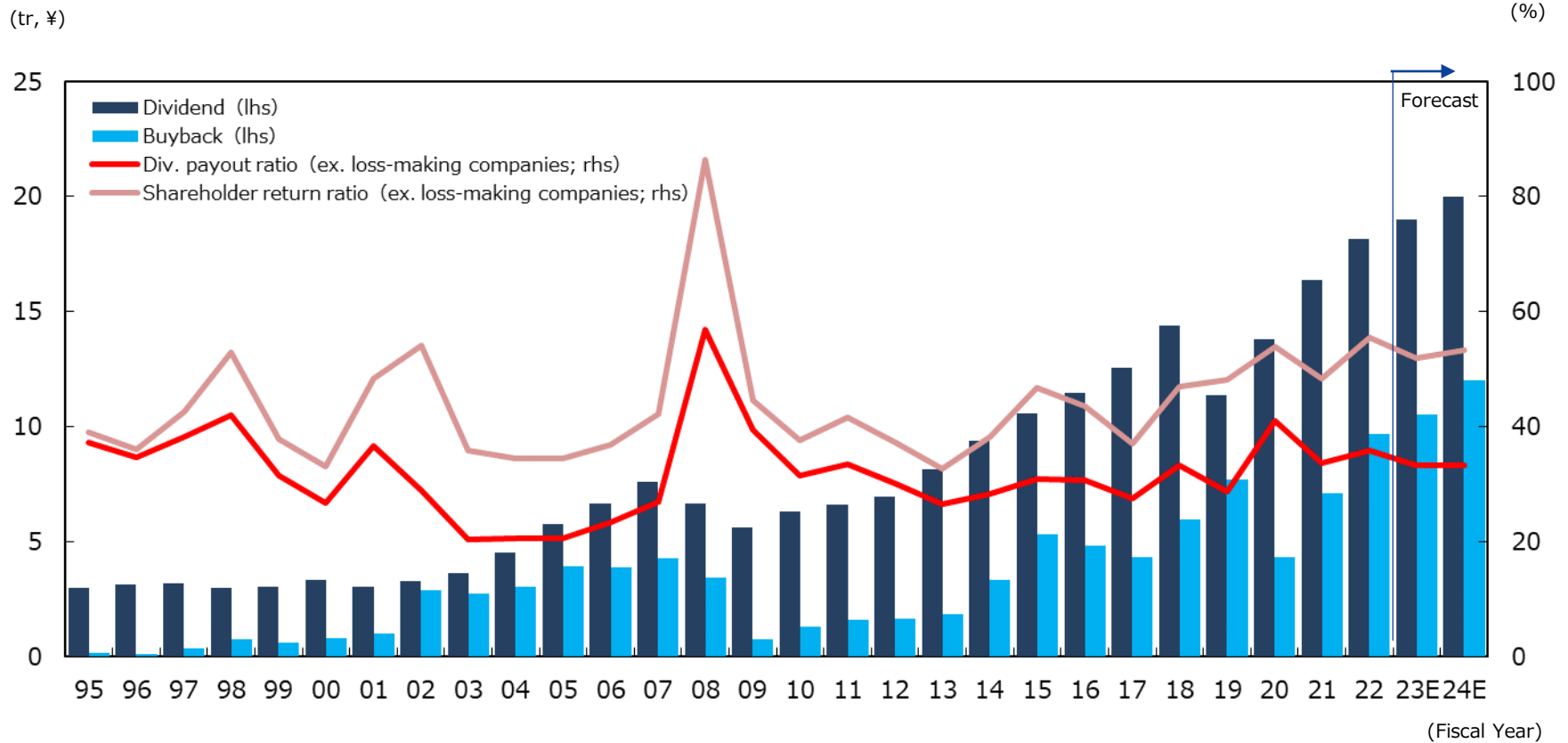


Note: Actual data is from Q1 2021 to Q2 2023. Estimate data is from Q3 2023 to Q1 2024.  
Source: SMDAM



# Dividends and buybacks beat all time high

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

# Growth comes back after long losing streak

## 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>-3.74</b>	<b>1.76</b>	<b>23.50</b>	<b>20.61</b>	<b>17.32</b>	<b>30.00</b>	<b>51.37</b>
Total Value	-7.60	5.66	27.99	27.00	35.74	56.36	51.87
Top Cap Value	-9.79	2.30	28.57	27.85	39.21	66.81	71.56
Large Cap Value	-8.31	5.10	28.62	27.49	37.25	60.23	54.97
Mid Cap Value	-7.08	8.13	27.56	25.90	33.53	50.94	32.65
Small Cap Value	-4.26	8.21	25.13	24.77	29.43	39.90	38.50
Micro Cap Value	-3.30	8.60	23.66	23.43	26.69	36.79	38.97
Total Growth	0.34	-2.25	18.87	14.33	1.34	8.01	48.62
Top Cap Growth	1.26	-1.84	22.39	17.21	1.45	11.50	60.53
Large Cap Growth	0.47	-2.20	20.42	15.55	1.71	8.99	52.44
Mid Cap Growth	-0.97	-2.84	16.92	12.55	2.17	4.82	40.24
Small Cap Growth	-0.60	-2.66	7.35	5.16	-1.23	0.36	20.34
Micro Cap Growth	-0.18	-3.13	5.30	2.99	-3.34	-2.15	21.14
Top Cap Total	-3.60	0.49	25.74	22.42	17.23	33.94	64.91
Large Cap Total	-3.87	1.39	24.47	21.26	17.37	31.01	54.70
Mid Cap Total	-4.36	2.77	22.42	19.37	17.48	26.77	40.61
Small Cap Total	-2.89	4.07	18.12	16.94	17.07	23.71	32.44
Micro Cap Total	-2.26	4.85	17.54	16.51	16.41	23.14	34.64

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



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is standing still.** Real GDP of Q3 2023 contracted for the first time in three quarters. Major reasons for the economic contraction were lackluster domestic demand and a rebound from high growth in the previous quarter. While the resumption of economic activity after the COVID-19 pandemic has been supportive of the economy, the slowdown in demand due to high prices, inventory adjustments and a slowdown in overseas economies have been weighing on the economy. However, the Bank of Japan's Tankan Survey, released in December, confirmed that business confidence had been solid thanks to improving corporate earnings and firm CAPEX projections.
- **Inflation is slowing down.** The nationwide core CPI rose by 2.9% in October and accelerated from 2.8% increase last month. However, this is largely due to policy factors such as the reduction of subsidies for electricity and gas and the backlash from national travel support. In November, the Tokyo metropolitan area core CPI rose by 2.3% from a year earlier, down from +2.7% a month earlier. Cost pressure has been easing from import goods and inflation has been slowing in food, energy and commodities.

## [Outlook]

- ① **While we have raised our real GDP growth forecast for FY 2023 from +1.4% to +1.6% and that for FY 2025 from +0.7% to +0.8%, we have maintained our forecast for FY 2024 at +1.1%.** The change in the outlook for the economy this month was only a minor one, reflecting a carry over effect of GDP and the impact of wage increases. The upward revision in FY 2023 was largely due to a carry over effect of GDP growth, and the upward revision in FY 2025 was largely due to wage increases. The downward revision in FY 2024 was largely offset by a decline in carry over effect of GDP and an upward revision from wage increases. The economy is currently stagnating, but is expected to return to a moderate recovery trend. Against the backdrop of a resumption of economic activity, slowing inflation, rising wages and economic measures, domestic demand is expected to avoid a setback and gradually recover. On the other hand, exports are expected to remain firm despite a slowdown in growth in the US economy.
- ② **While we have cut our core CPI forecast for FY 2023 from +2.8% to +2.7%, we have maintained that for FY 2024 and FY 2025 at +2.0% and +1.7% respectively.** The downward revision in FY 2023 was due to changes in recent CPI results and forecasts for foreign exchange and crude oil. In relation to FY 2024 and FY 2025, the increase in wages was a positive factor, but other factors were negative. Looking ahead, the core CPI is expected to continue on a decelerating trend due to the decline in cost push pressure from import prices. Although the core CPI will increase once in February 2024 due to the elimination of the negative effect of the subsidies for utility bills, cost push pressure is likely to continue to decline. Though rising service prices with wage increases will support inflation, the core CPI is expected to decline below 2% from the second half of FY 2024.
- ③ **PM Kishida and his cabinet will continue their accommodative economic policy.** In November, PM Kishida approved a package of economic measures totaling 20.9 trillion yen, including countermeasures for inflation, support for growth sectors and strengthening infrastructure. The flat-rate tax cut is expected to take effect in June 2024. As the Cabinet and the ruling LDP's approval ratings have slumped due to suspicions over political funds, we should pay close attention to the risk of fiscal expansion to gain political popularity.
- ④ **Regarding monetary policy, we anticipate the end of ultra-easy monetary policy in April 2024 to include raising the policy rate to 0% and eliminating the YCC (yield curve control).** The Bank of Japan will revise its economic outlook report in April after confirming the results of the union's spring meeting, which will be released in mid-March, and judge the probability of achieving the price stability target. After the change in April, monetary policy is expected to remain unchanged for the foreseeable future. Given the possibility of inflation falling below 2% and the risk of a strong yen, the BOJ is likely to be cautious about raising interest rates further.



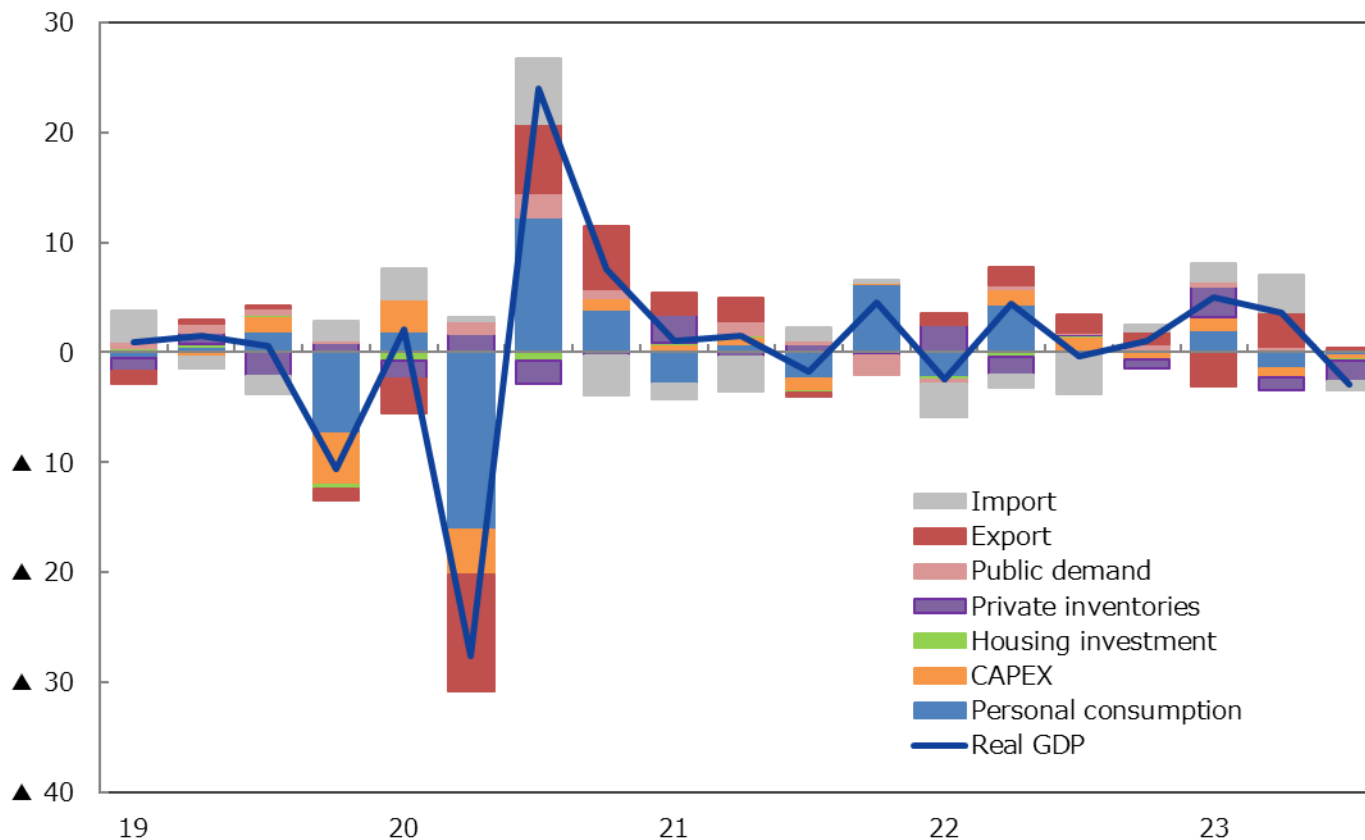
# Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est	FY25 Est
Real GDP	-0.8%	-4.1%	2.7%	1.4%	1.6%	1.1%	0.8%
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	0.1%	1.3%	0.9%
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	1.5%	-0.7%	0.0%
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	0.0%	1.6%	1.8%
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.2%	-0.1%	0.0%
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	2.5%	0.4%	1.0%
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.2%	-0.1%	-0.3%
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.5%	3.1%	1.7%
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-2.3%	3.6%	3.1%
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.5%	2.6%	2.0%
GDP deflator	0.8%	0.7%	-0.1%	0.7%	3.9%	1.6%	1.2%
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-0.7%	1.8%	1.4%
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.7%	2.0%	1.7%
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.0%	0.4%	0.8%
Employee compensation	2.0%	-1.5%	2.1%	2.0%	2.2%	3.2%	3.0%
Unemployment rate	2.4%	2.9%	2.8%	2.6%	2.6%	2.5%	2.3%
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	0.0%	0.0%

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's GDP declined in Q3 due to weak personal spending

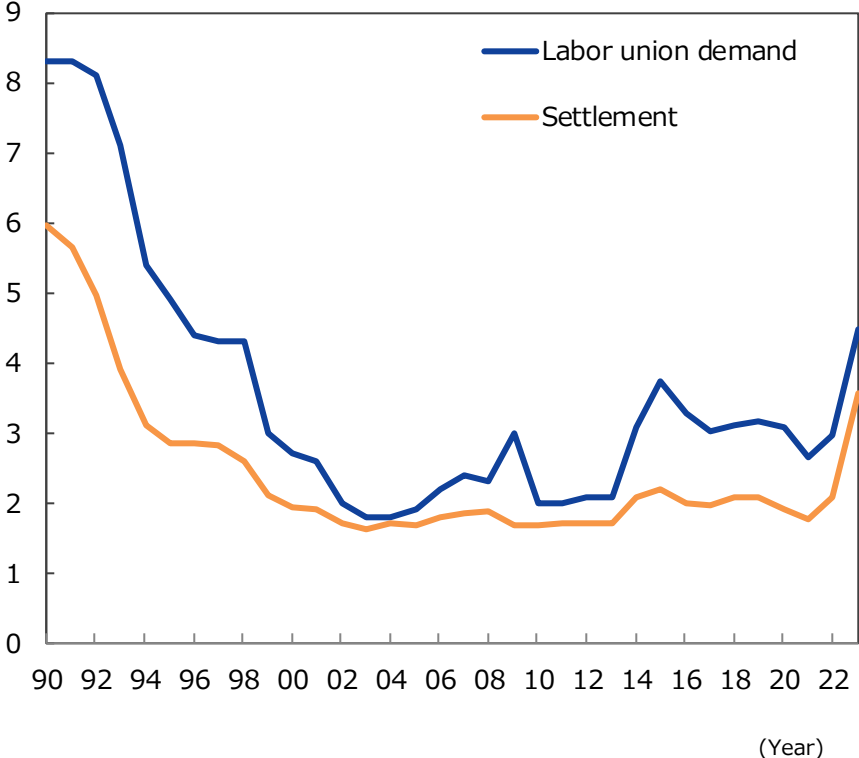
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q3 2023.  
Source: Cabinet office, SMDAM

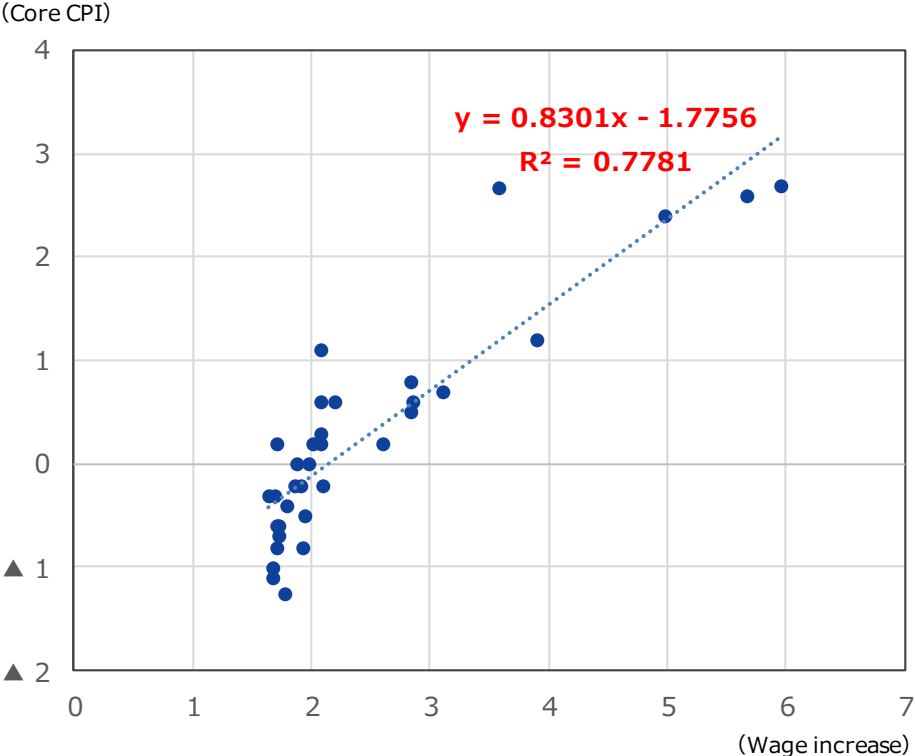
# Start of a virtuous cycle of wage increase & mild inflation

Wage increase demand & settlement (YOY, %)



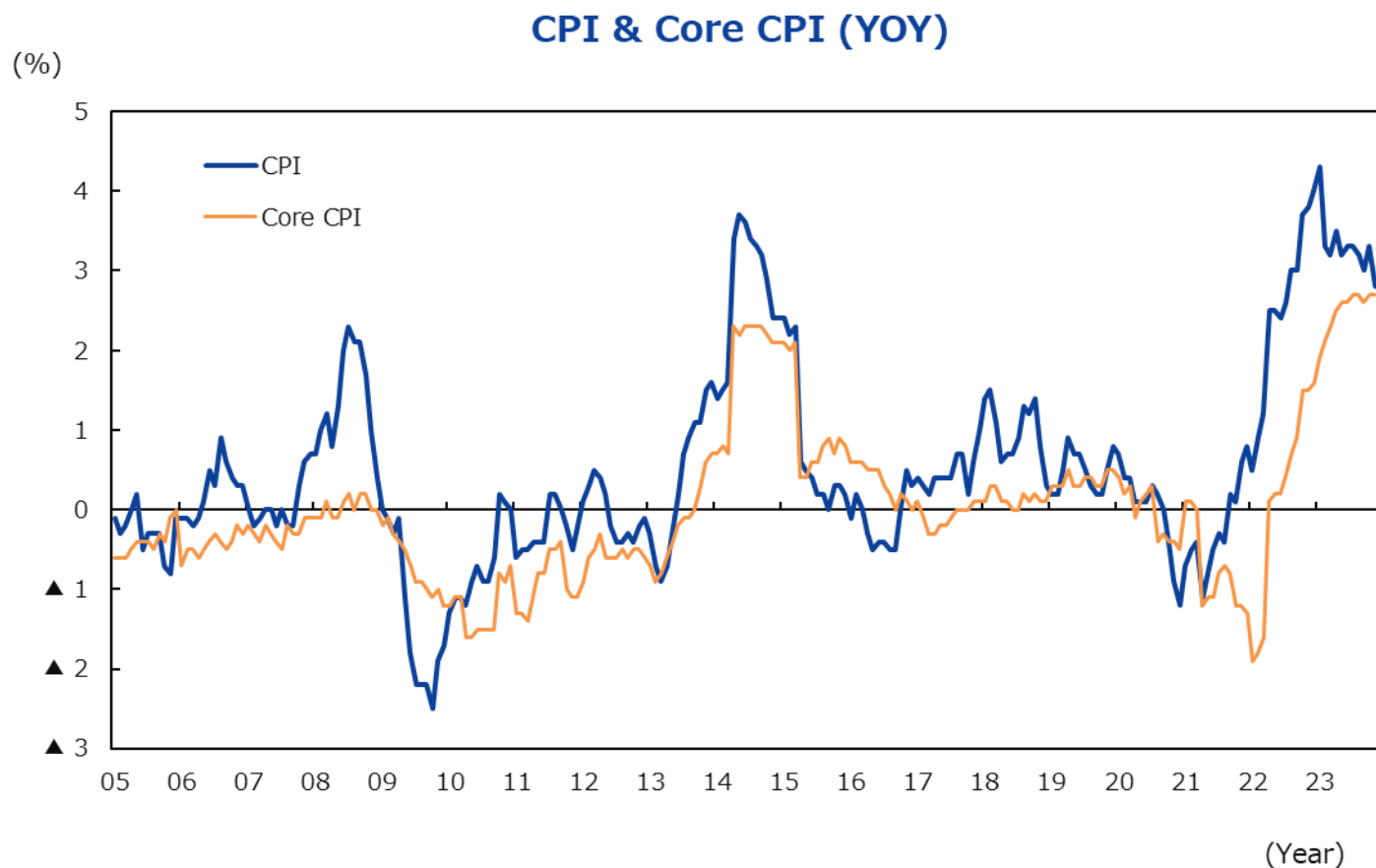
Note: Data is from FY 1990 to FY 2023.  
Source: Japanese Trade Union Confederation, SMDAM

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

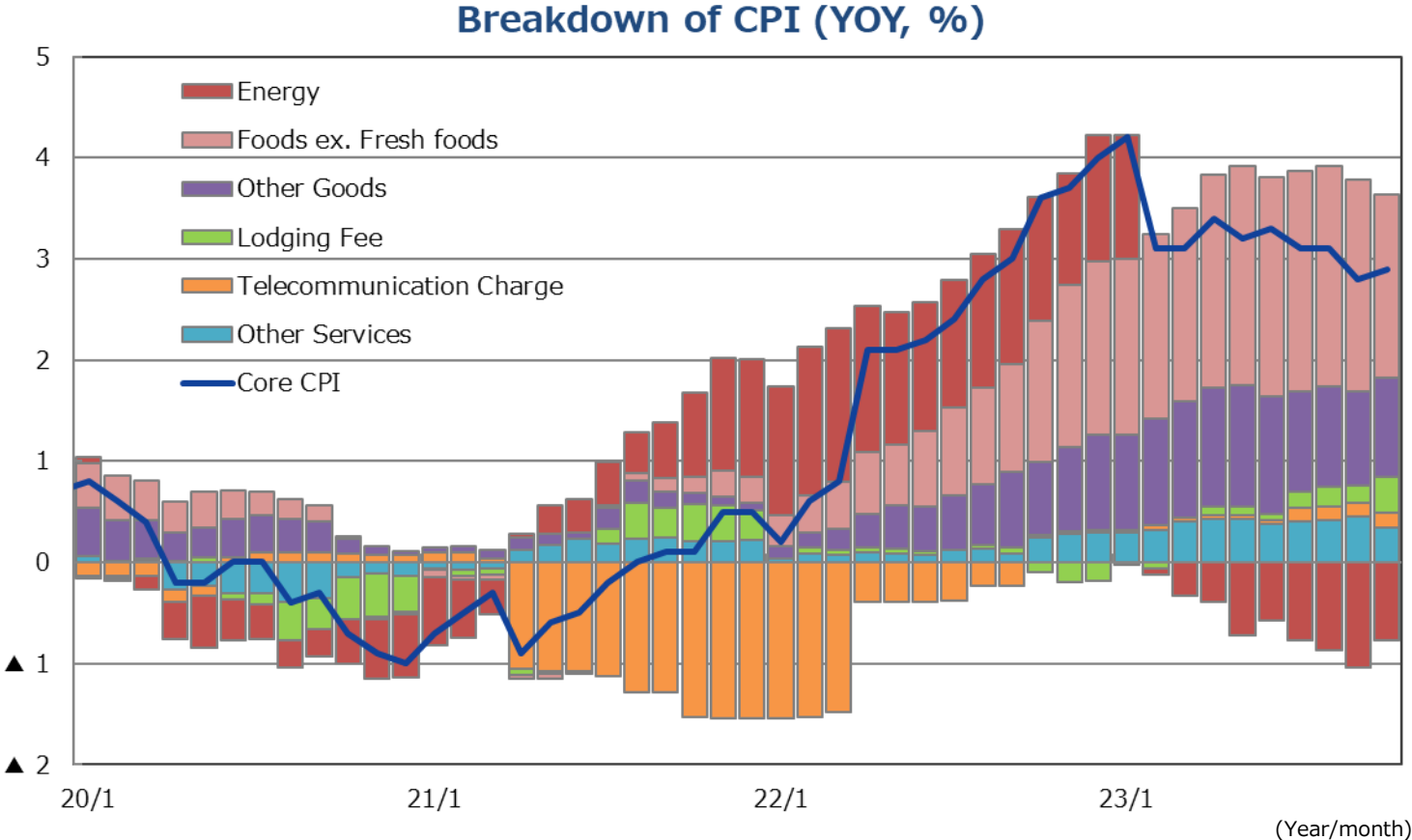
# Japan's core CPI shows unexpected stickiness



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

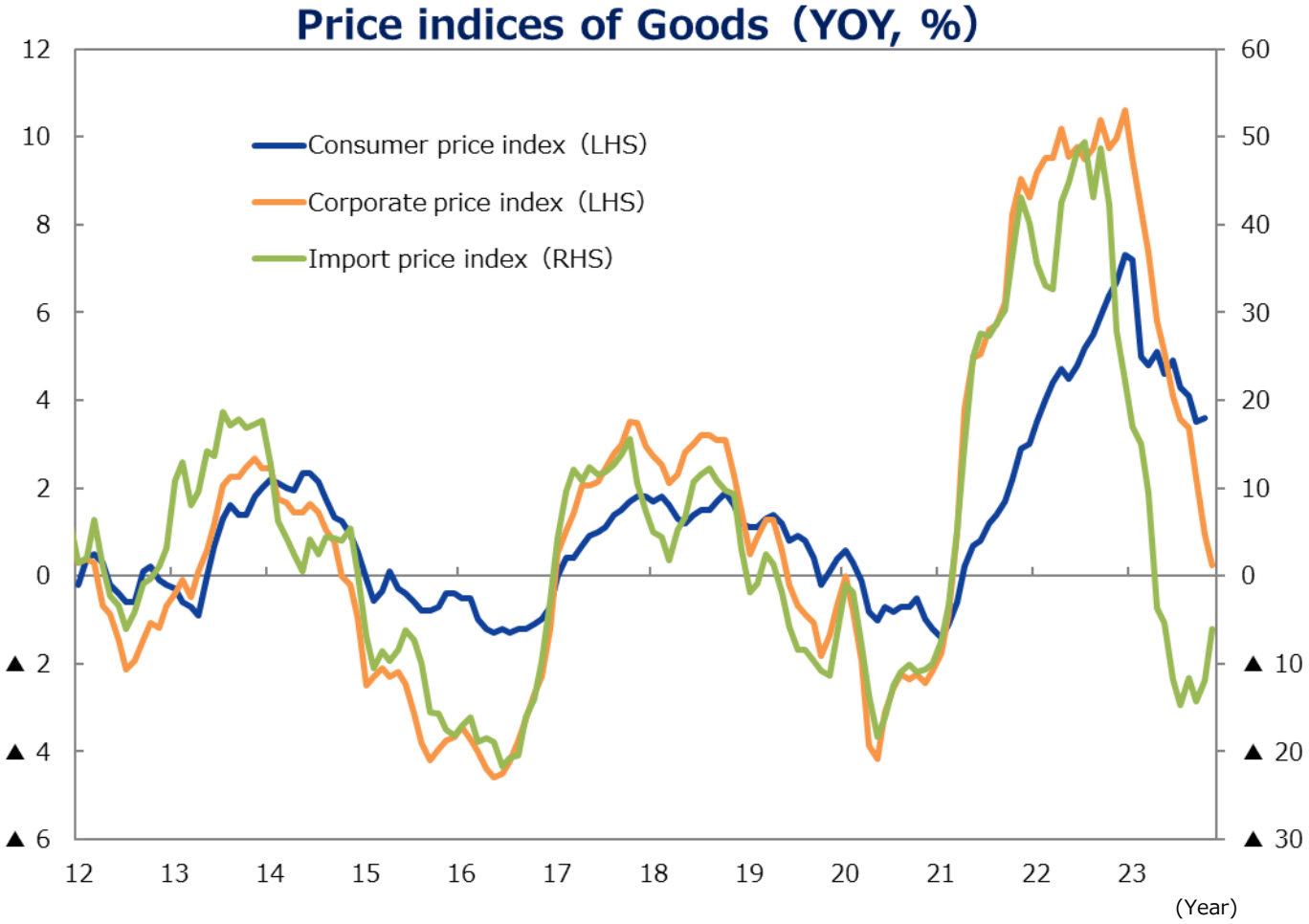


# Food and goods keep Japanese inflation higher for longer



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

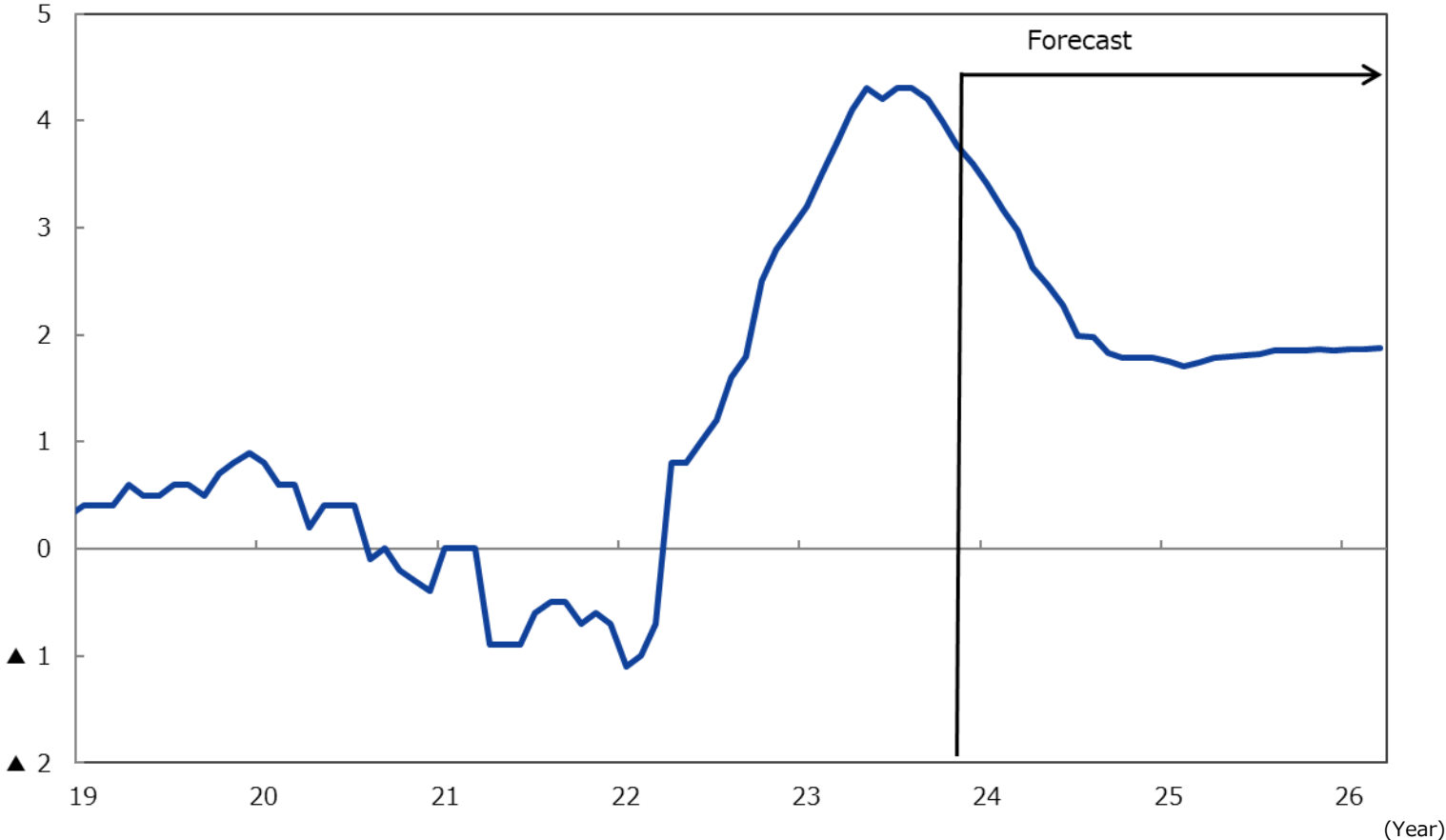
# Profit margin improving thanks to falling input prices



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

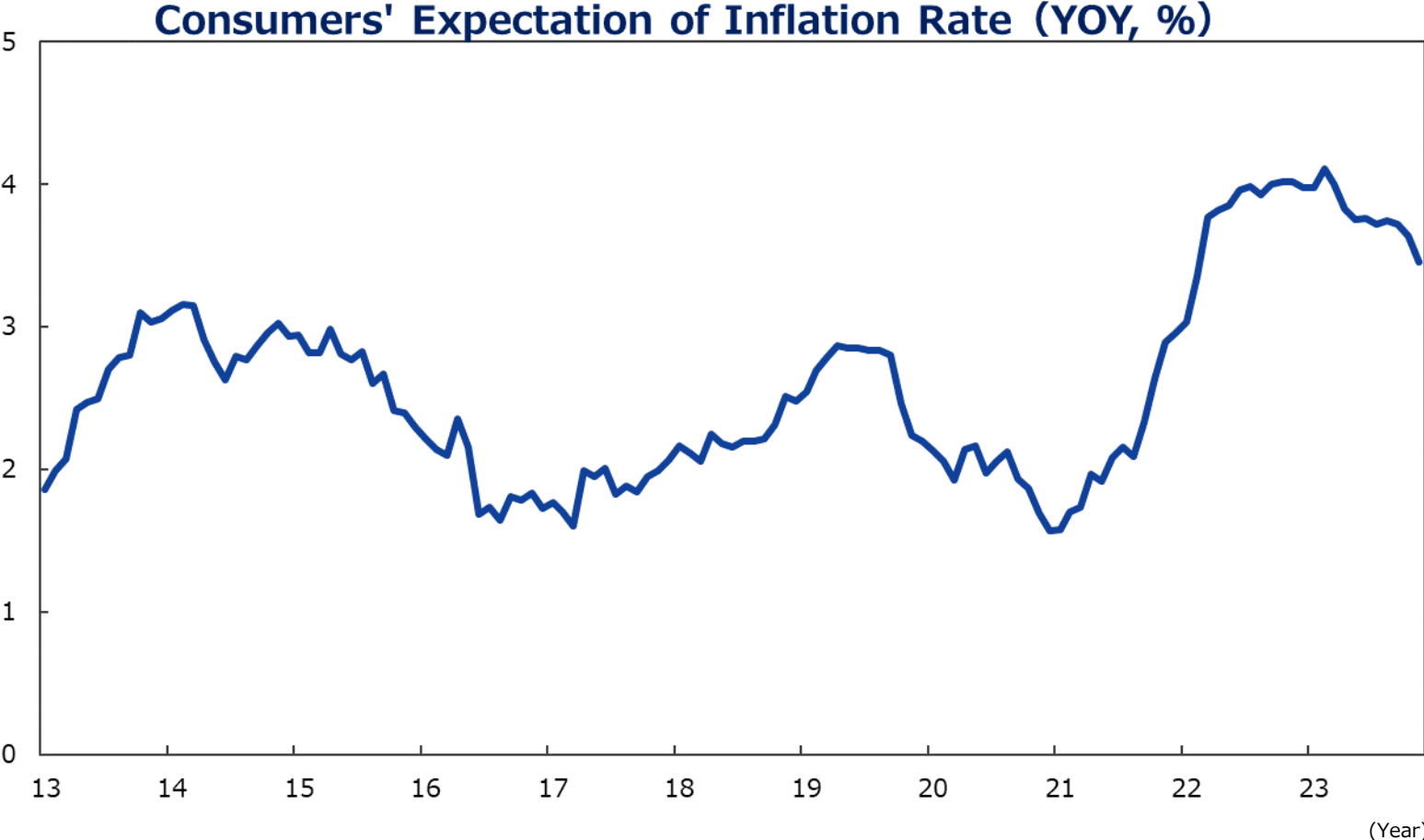
# BOJ expects inflation to decline gradually towards 2%

BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2026. BOJ's Core CPI is excluding fresh foods & energy. Data from November 2023 are forecasts.  
Source: The Bank of Japan, SMDAM

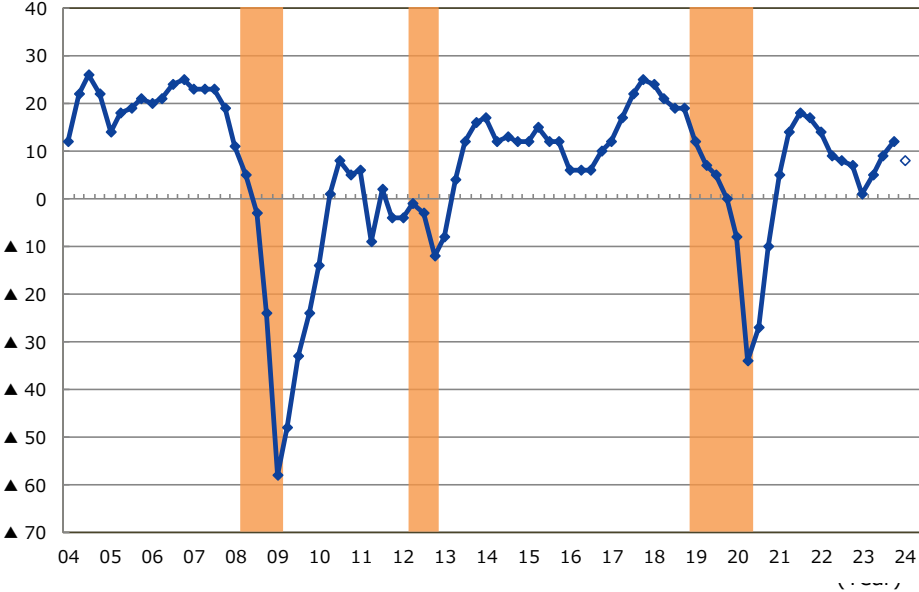
# Consumer's inflation expectation gradually falling



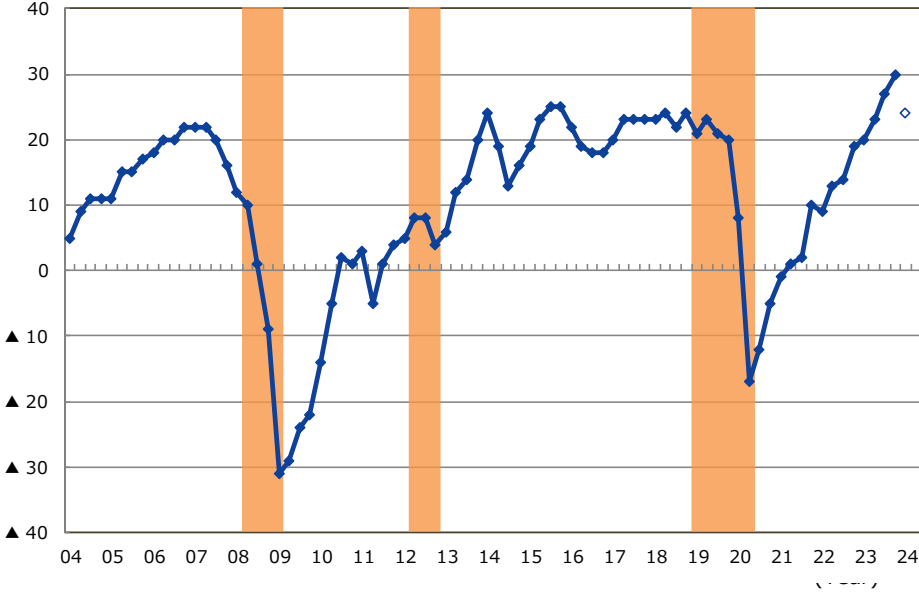
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to November 2023.  
Source: Cabinet Office, SMDAM

# Business sentiment remains positive but cautious ahead

BOJ business condition DI Large manufacturers (%)



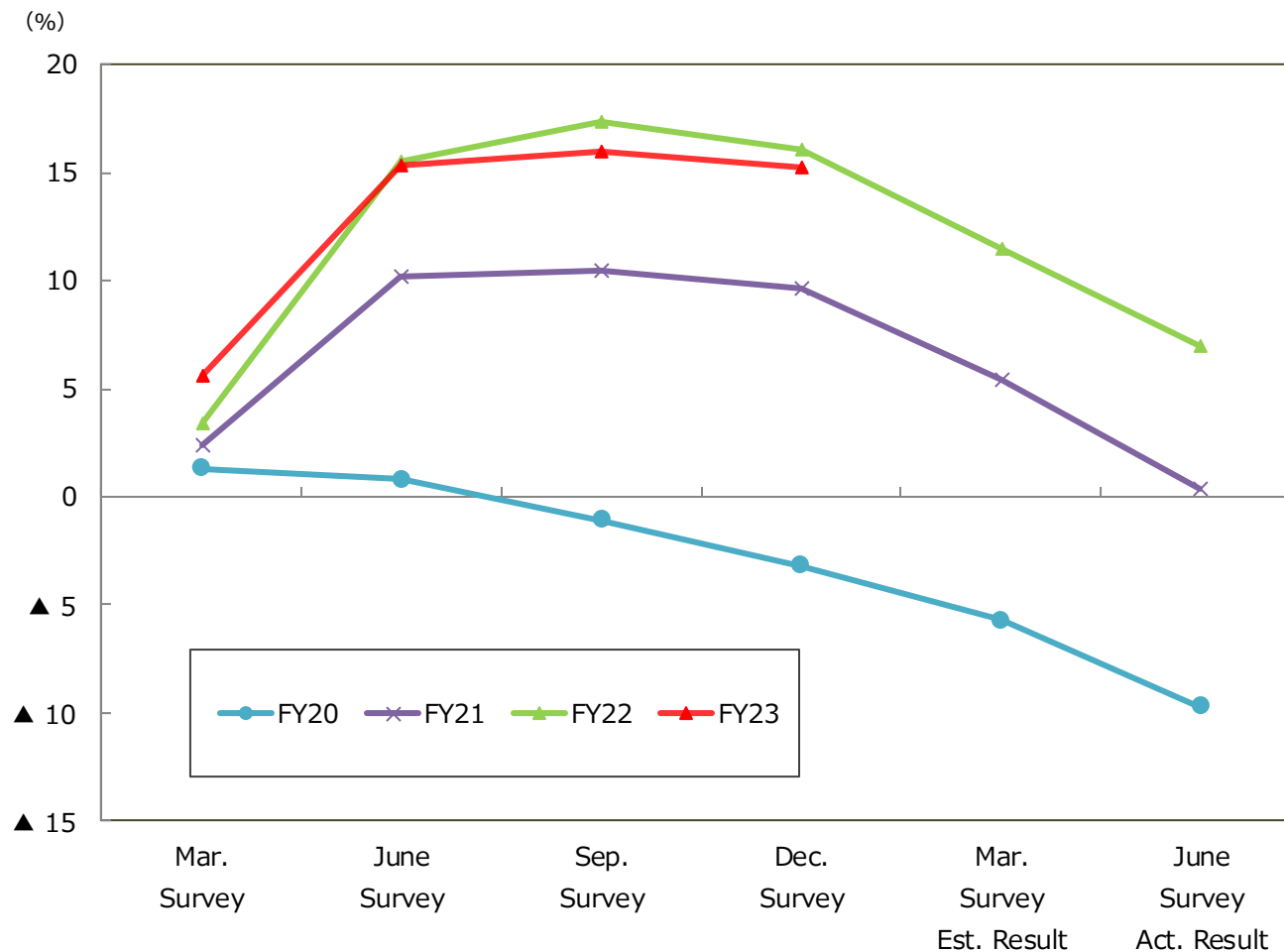
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q4 2023. The orange shadow are periods of economic recession.  
 Source: The Bank of Japan, SMDAM

# Weakening yen and de-risking lift CAPEX in Japan

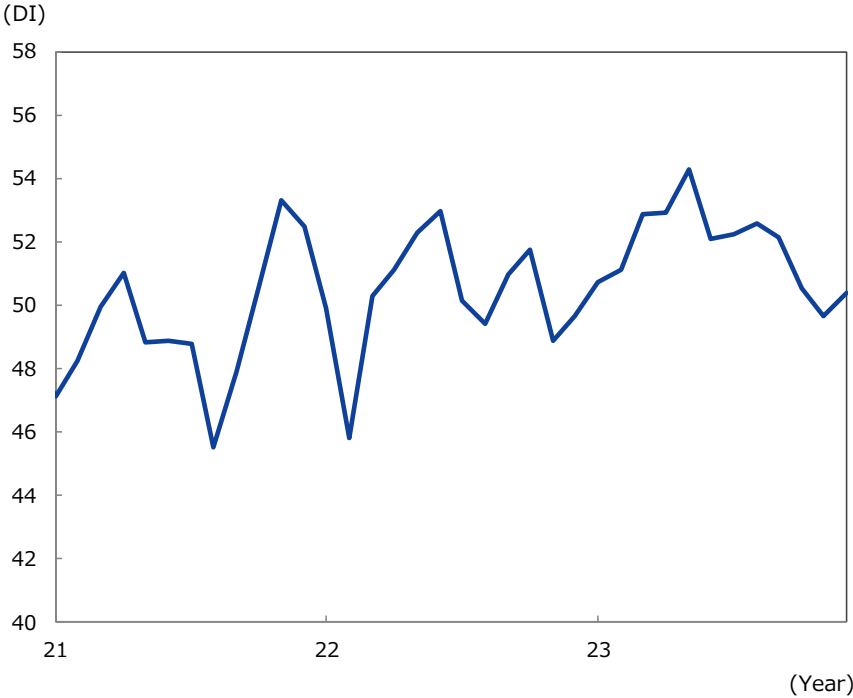
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



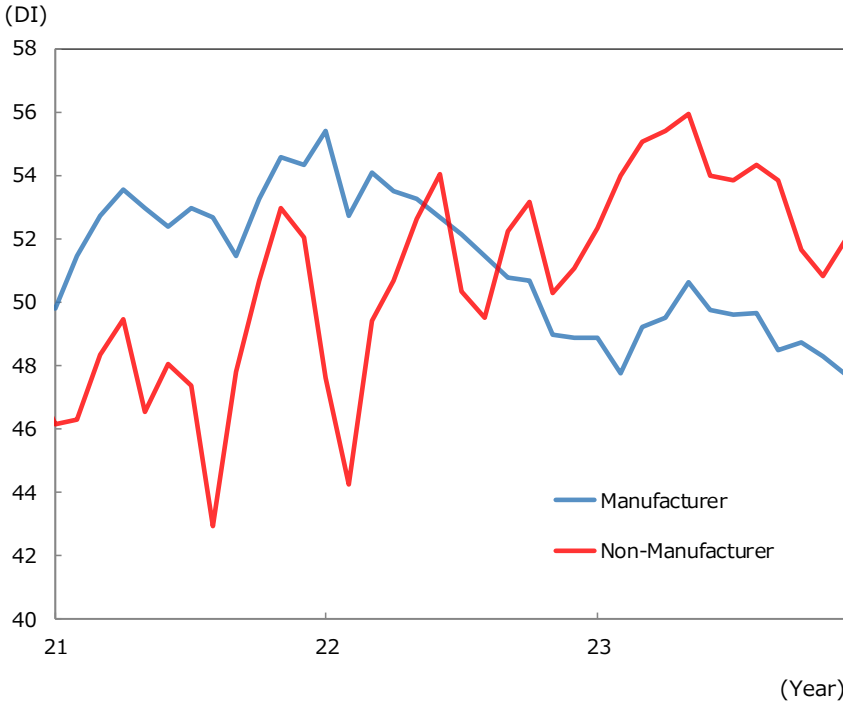
Note: Data is from Q1 FY2020 to Q4 FY2023.  
Source: The Bank of Japan, SMDAM

# Manufacturers sentiment losing momentum

### Composite PMI



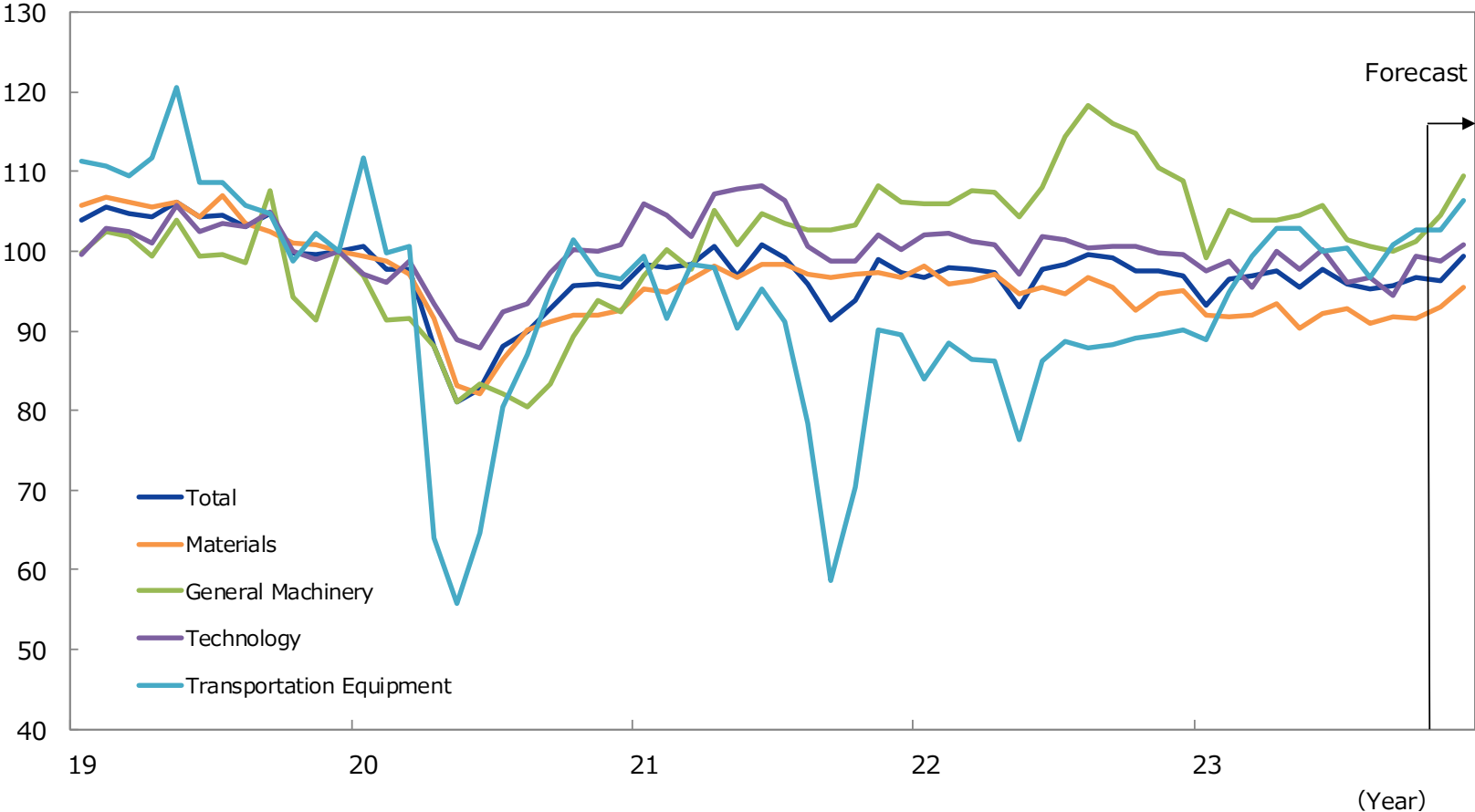
### PMI, Manufacturer & Non-Manufacturer



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

# Industrial production gaining momentum

## Industrial Production (Dec. 2019=100)

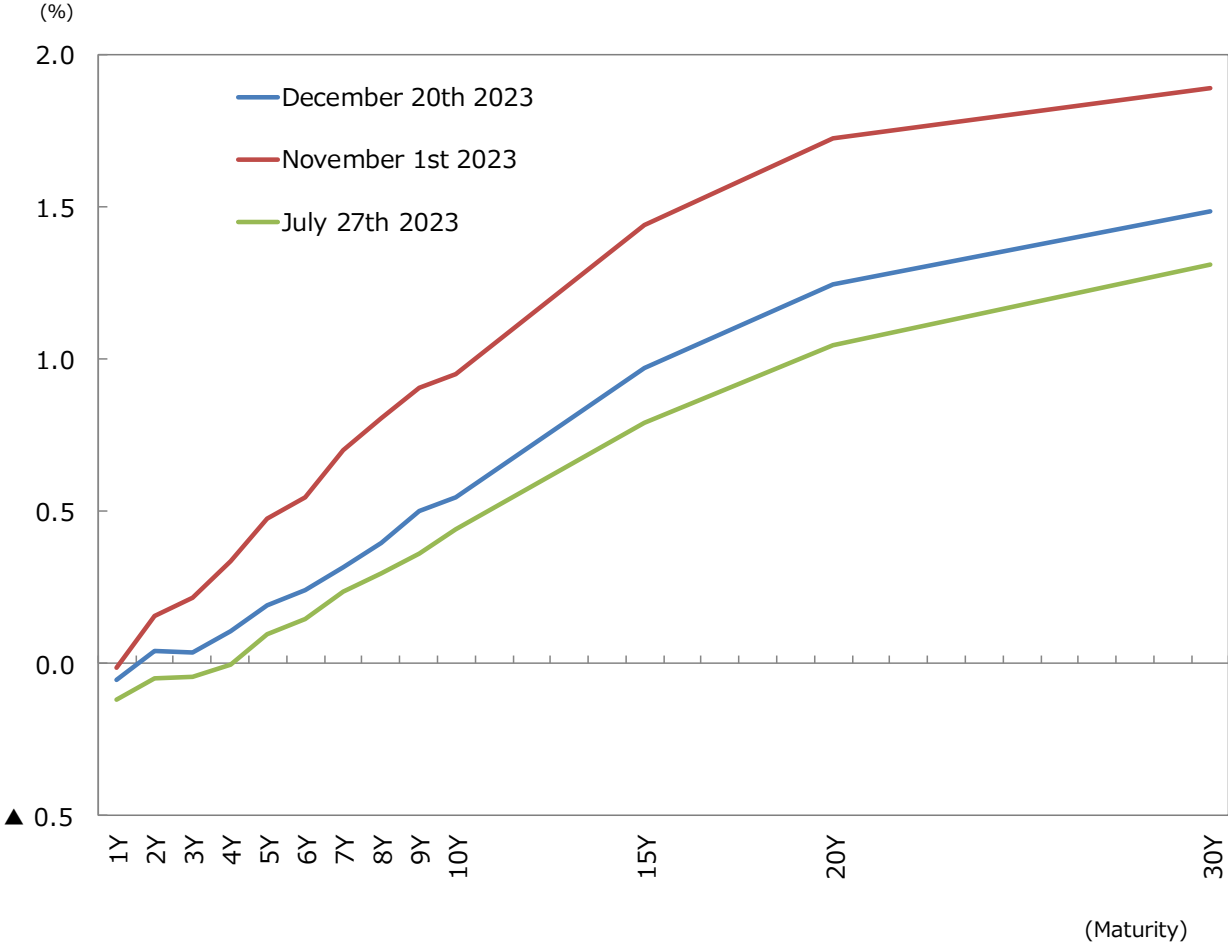


Note: Data is from January 2019 to December 2023. Data after November 2023 are forecasts.  
 Source: METI, SMDAM



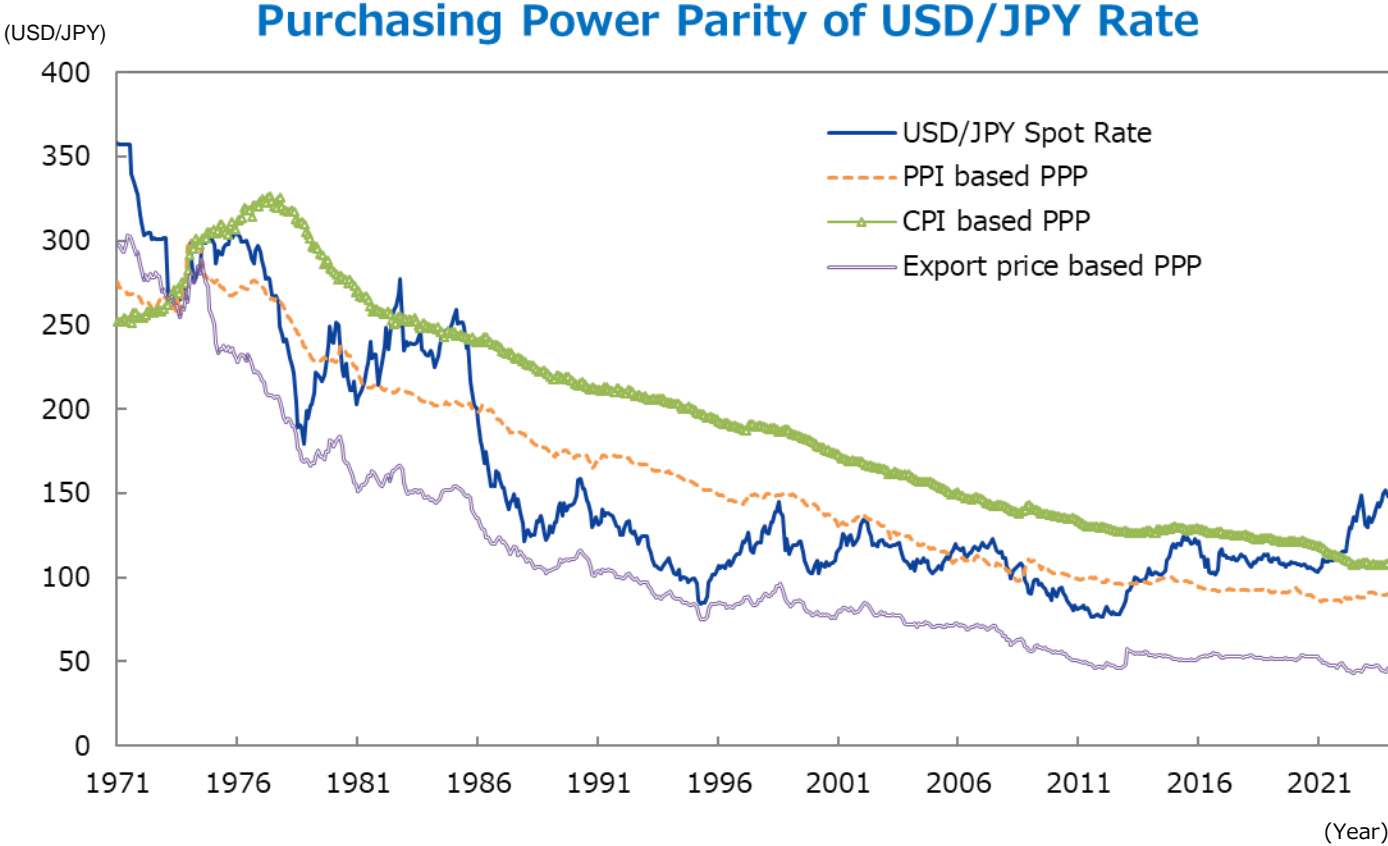
# Big swing of the yield curve due to speculation over BOJ's exit

## Yield Curve of Japanese Sovereign



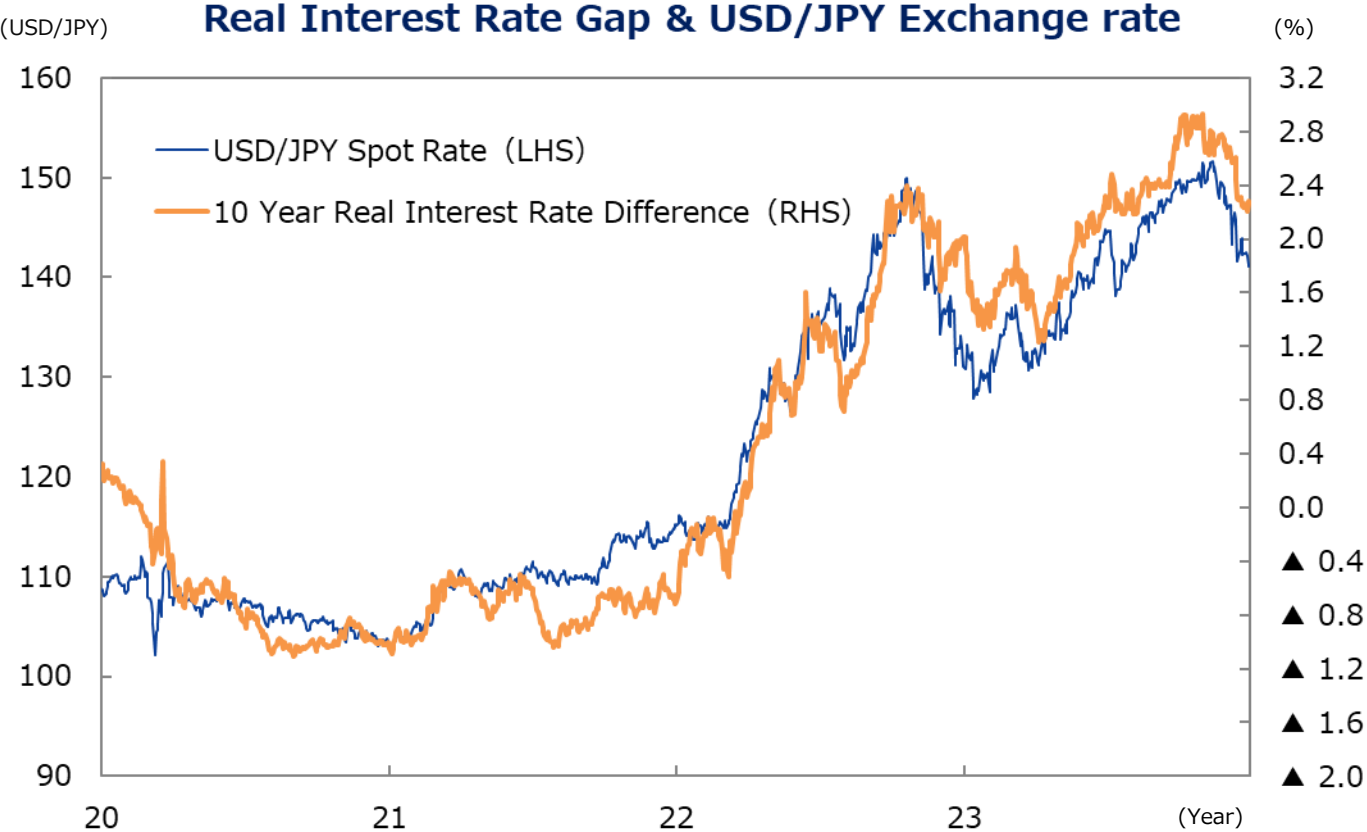
Source: Bloomberg, SMDAM

# USD/JPY diverges from range of purchasing power parity



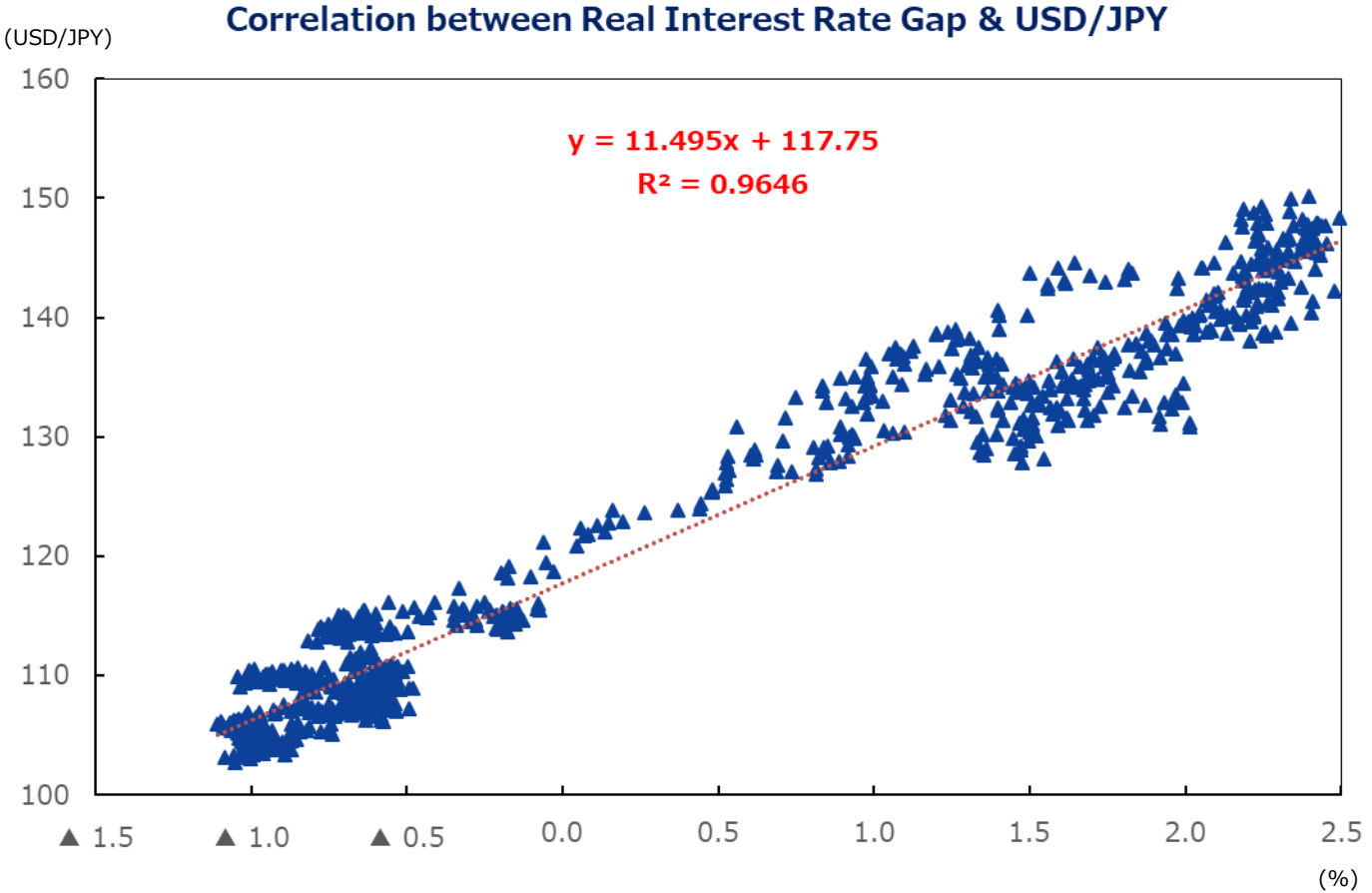
Note: Data is from January 1971 to November 2023.  
Source: DOL, Bank of Japan, SMDAM

# Real yield gap still dominates USD/JPY rate



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

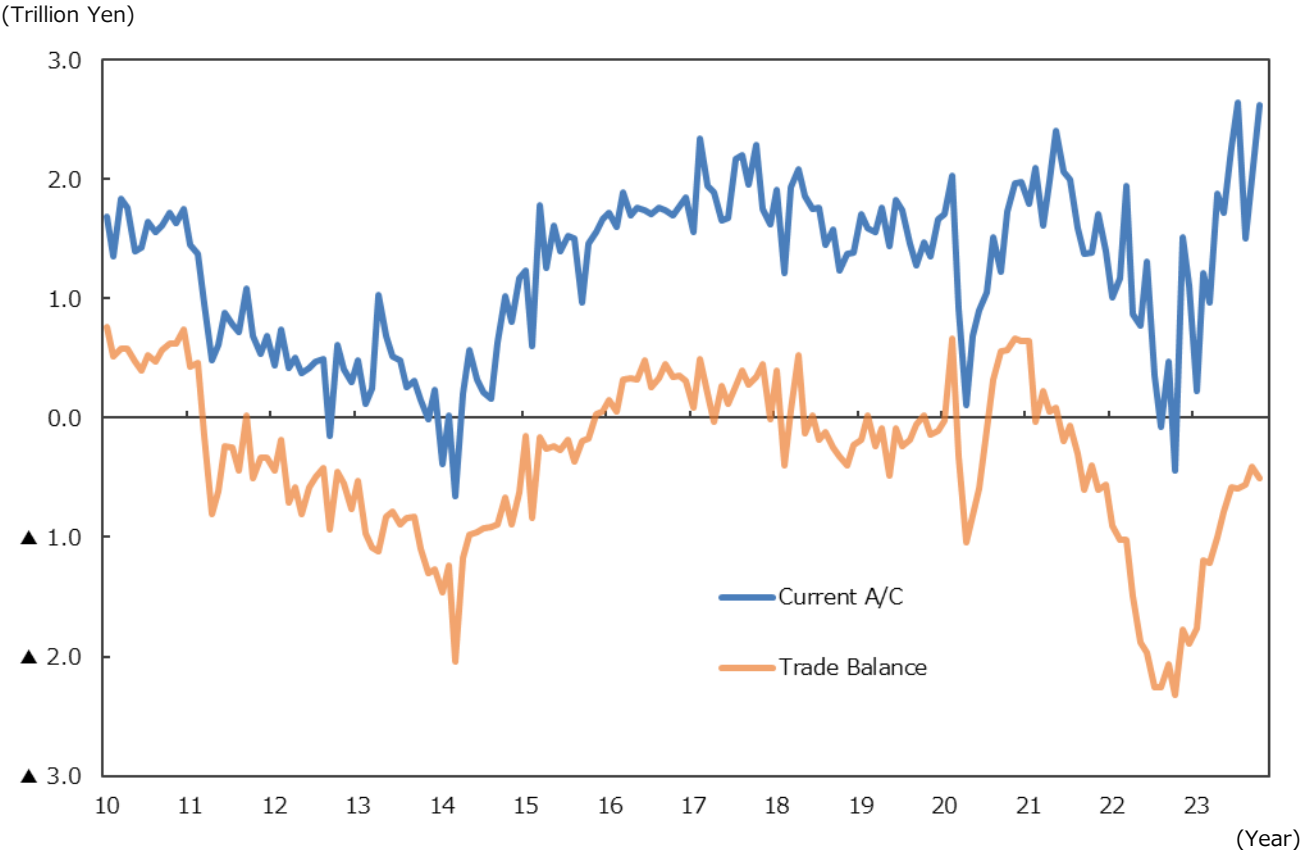
# Real yield gap still dominates USD/JPY rate



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

# Trade deficits shrank due to falling energy prices

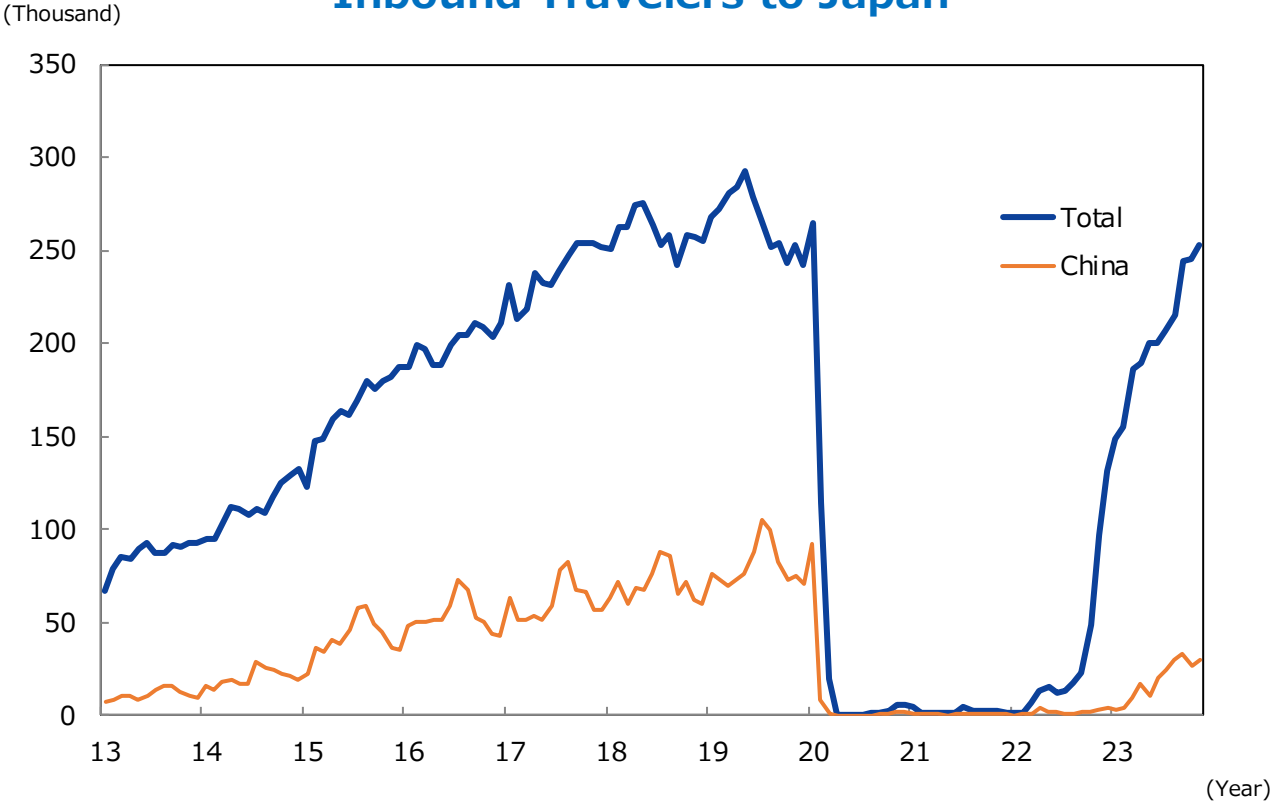
## Current Account & Trade Balance



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

# Inbound travel continues upward trend even after peak season

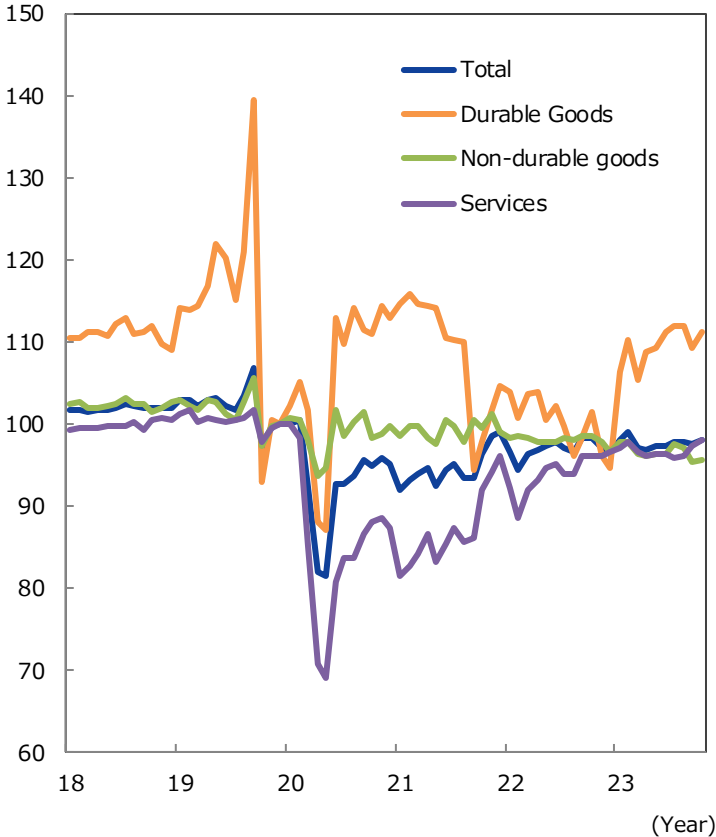
## Inbound Travelers to Japan



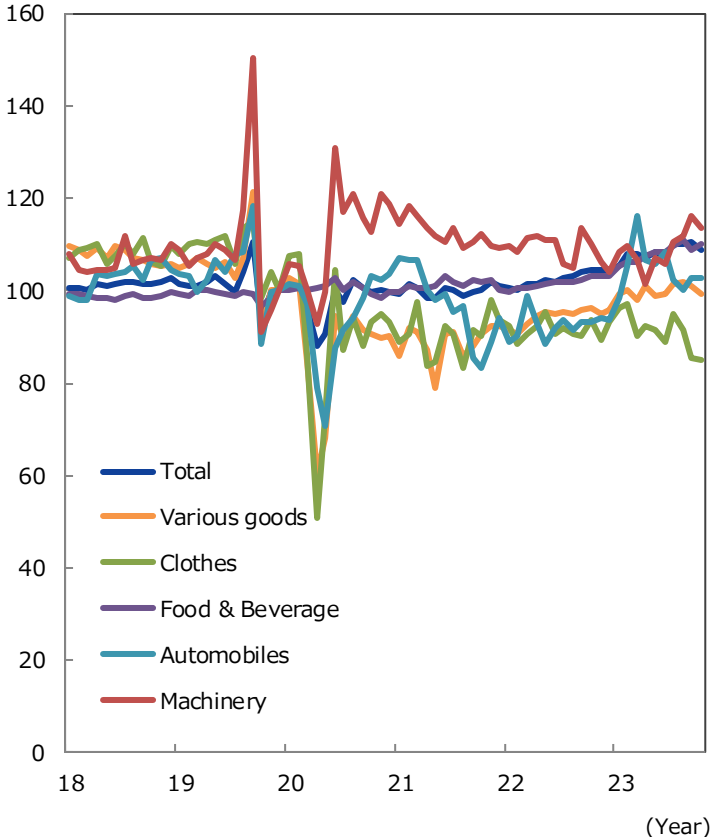
Note: Data is from January 2013 to November 2023. Data is non-seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Retail sales, excluding clothes, looks stable

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



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

# Alleged violation of Funding Law could be the final blow

## Cabinet approval rate



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



## Schedule of major events

Year	Month	Date	Event
2024	January	1	Start of new NISA (Nippon Individual Savings Account)
		22-23	Monetary Policy Meeting Convening of the ordinary Diet session
		15	Release of CY 2023 Q4 GDP
	March	11	Revision of CY 2023 Q3 GDP
		18-19	Monetary Policy Meeting Enactment of FY 2024 budget and tax reform bills
	April	25-26	Monetary Policy Meeting Release of BOJ view report
	May		Multi-faceted review of Second workshop
	June	13-14	Monetary Policy Meeting Cabinet decision on the broad policy End of the ordinary Diet session
	July	30-31	Monetary Policy Meeting
	September	19-20	Monetary Policy Meeting
30		Termination of the presidency of ruling LDP	
October	30-31	Monetary Policy Meeting	
December	18-19	18-19	Monetary Policy Meeting
			Cabinet approval of the initial budget for FY 2025 and the outline for tax reform

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

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