

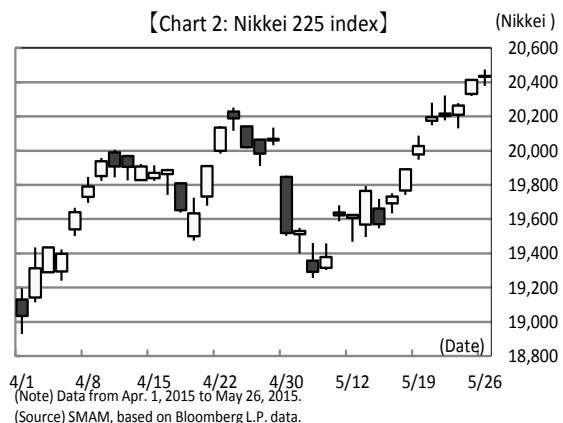
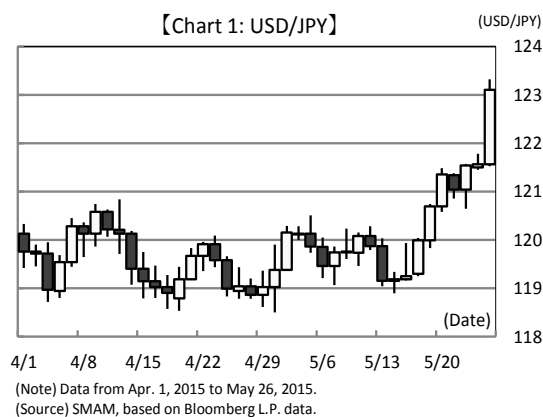
USD/JPY and Japanese Stock Market Outlook

- Higher USD/JPY is led by strong USD rather than weak JPY.
- USD/JPY rally continues but further appreciation over 125 is less likely at this moment.
- My view remains intact the stocks will continue rising with some fluctuation.

Higher USD/JPY is led by strong USD rather than weak JPY

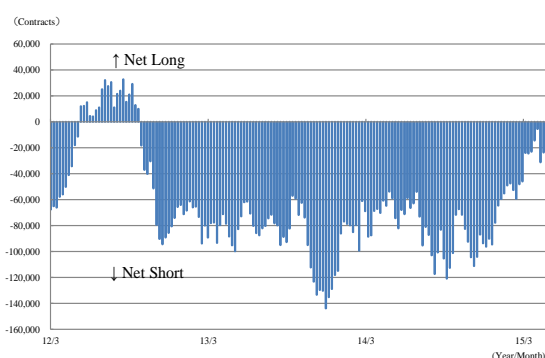
I presented my view on the Japanese stocks in the previous report, SMAM Japan Insights (No.042). Shortly after the release, the investors' attention is increasingly focused on the effect on the stocks by strong USD as USD/JPY rapidly appreciates in this week. Therefore, this report will review the various factors surrounding USD/JPY and Japanese stock market and present the outlook again.

USD/JPY accelerated to surge on May 26, breaking the range between lower-118 yen and 122 yen since February 9 (Chart 1). I believe main theme in the currency market is still "a view of US rate hike." Therefore, it is natural that USD strengthens amid these USD driven market environments, spurred by a higher than expected US CPI growth as well as Federal Reserve chair Janet Yellen's speech that would recall a higher USD. Janet Yellen spoke on May 22, "it will be appropriate at some point this year to take the initial step to raise the federal funds rate target and begin the process of normalizing monetary policy."



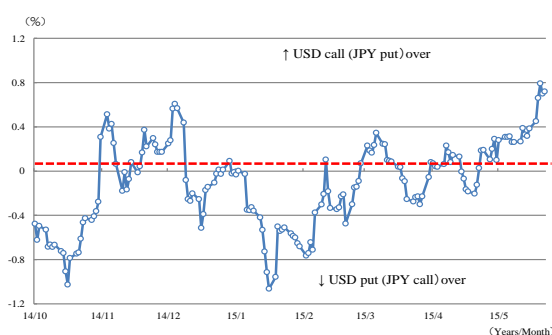
Meanwhile, futures and options markets showed interesting movements before the rapid rise of USD. An open interest of Long USD/JPY substantially decreased in International Monetary Market of Chicago Mercantile Exchange. This indicates fewer participants expect to make money from betting on a stronger USD/JPY but conversely there is further room to increase Long USD/JPY futures position. Also, in currency options market, a risk reversal on USD/JPY showed a large “USD call (JPY put) over” from May as an increasing number of participants bet on a stronger USD/JPY. Thus, in the futures and options markets, market participants would have prepared for the coming USD/JPY development after breaking the trading-range. In fact, I suppose these futures and options traders help USD/JPY to accelerate at this time.

Chart 1 : Speculators' Currency Futures Position (JPY)



(Note) Data period is from March 27, 2012 to May 19, 2015.
1 contract = JPY12.5million
(Source) SMAM, based on Bloomberg L.P. data

Chart 2 : USD/JPY Risk Reversal



(Note) 1. Data period is from October 1, 2014 to May 22, 2015. Calculated based on 1month option with 25% delta.
2. (%) shown on the chart is a volatility differential of USD call and put calculated by "USD call volatility - USD put volatility".
(Source) SMAM, based on Bloomberg L.P. data

(*) Risk Reversal is one of the option strategies which take a position combining out-of-the-money (OTM) call and put options with same maturity date, outstanding notional amount and delta, and trade in the opposite directions. The trading cost for the position is for free, as the option premiums in both put and call are theoretically same, but in the real marketplace, the premiums depend on supply-demand balance and are often priced differently. Those price differences reflect market participants' views.

USD/JPY rally continues but further appreciation over 125 is less likely at this moment

In Japan, the Bank of Japan kept monetary policy unchanged at the Monetary Policy Meeting on May 22 and slightly raised its overall assessment of Japan's economy. In the press conference, Governor Haruhiko Kuroda reiterated that “further easing would not be necessary at this moment.” Additionally, according to the April Trade Statistics (custom base), the improvement in trade balance is on track although it slipped to a slight deficit again from a surplus in March. Considering these things, a significant rise in USD/JPY is less likely for a short run.

Now, USD/JPY seems to advance toward its recent high of 124.14 yen in June 2007 before the financial crisis. However, I think that USD/JPY is likely to rise at a slower speed along with US Fed's rate path that is expected to hike at a slower pace if the liftoff is implemented within this year. In my view, USD/JPY will continue firm but is unlikely to rise over 125 yen so soon.

My view remains intact the stocks will continue rising with some fluctuation

In terms of Japanese stocks, my view remained intact as the comment in the previous report, SMAM Japan Insights (No.042) . The stocks might suffer a temporal downturn following a likely decline in US stocks on a concern over US rate hike and strong USD, but I do not think it is a good idea to be excessively cautious. Needless to say, strong USD would give a negative impact on US stocks marginally for a long run as an upward pressure on USD proves a growth in US economy. Primarily, the domestic environments such as macro economy, supply-demand balance and corporate earnings are still tailwinds on Tokyo stocks. Therefore, my view remains unchanged that Japanese stock market is likely to keep rally with some fluctuation. I think the Nikkei index is likely to head higher to the recent high of 20,833.21 in April 2000 for the time being. Yet, I suppose US initial rate hike is in September, which would put upward pressure on the volatility for Japanese stocks. However, I believe the index will reach 21,000 by the end of September and toward the year end, the stocks would advance beyond the milestone level if the market momentum accelerates.

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