

Japanese Equity Market – What to Focus on from here

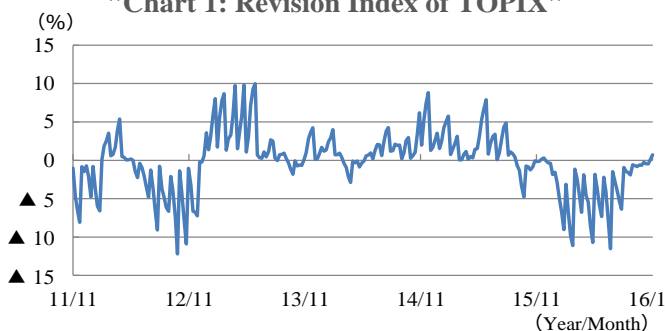
- The Trump rally in the stock markets may level off in December, as it might be getting difficult to justify this expectation-driven rally as time proceeds.
- However, upward trend of the Japanese equity market will likely to continue despite the Trump rally taking a breather, as Japanese corporate's earning forecast is improving.
- We need to be prepared for a possible reaction of the Japanese financial market if currently high expectation for the Trump policy is proved to be disappointing. US's currency policy is also an important factor to be watched.

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On 1st December 2016, Nikkei 225 Index touched intra day's high of JPY 18,746 as JPY weakened against USD to latter part of JPY 114 and the Organization of the Petroleum Exporting Countries (OPEC) reached agreement to cut oil production. Nikkei 225 index rose more than JPY 2,600 within less than a month from the latest bottom of JPY 16,111.81 marked on 9th November 2016. I would like to think over what we need to watch out from here after in regard to Japanese equity market that has already rallied sharply.

We believe that Nikkei 225 index surged by positively reacting to rising US equity market and long-term bond's yield as well as stronger USD, on the back of "expectation" towards US President-elect Mr. Donald Trump's policies. However, it will become more difficult to justify this equity market rally based only on "expectation" as time proceeds. Also, the Trump rally may possibly take a breather in December when market participants taking holidays increase, and also market theme could change as the month turns.

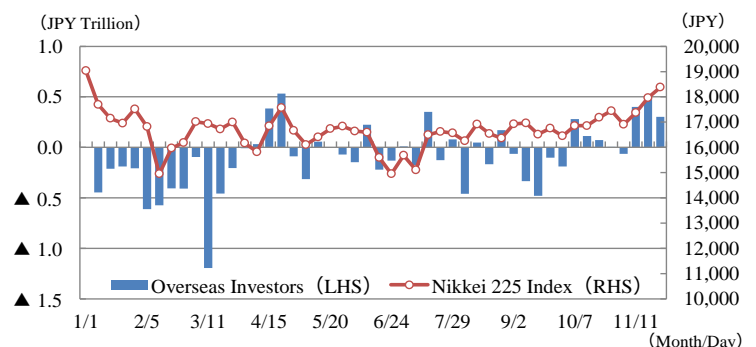
"Chart 1: Revision Index of TOPIX"



(Note) Data period is from 29th Nov. 2011 to 29th Nov. 2016. Bigger numbers are shown if more 12 months forecast of earnings per share (EPS) of constituent companies of Tokyo Stock Exchange 1st Section Index (TOPIX) were revised upward, while smaller numbers if more companies were revised downward.

(Source) SMAM, based on Datastream data.

"Chart 2: Japanese Equity Trading by Overseas Investors"



(Note) Data period is from week ending on 1st January 2016 to that ending on 25th November 2016. Japanese equity trading by overseas investors published by Tokyo Stock Exchange.

(Source) SMAM, based on Bloomberg L. P. data.

However, upward trend of the Japanese equity market will likely to continue despite the Trump rally taking a breather, as Japanese corporate's earning forecast is improving

Now, I would like to examine earnings forecast of Japanese corporations. According to revision index of Tokyo Stock Price Index (TOPIX), it has come back into positive territory (Chart 1). This indicates the number of companies that revised their earnings upward is increasing compared to those revised downward. Therefore, Japanese corporate earnings are starting to show signs of improvement, for which weakening JPY might have started working positively.

Next, I would like to examine trading activities of overseas investors in Japanese equity market. According to Tokyo Stock Exchange data (Chart 2), overseas investors were net buyers of Japanese equities for the past 3 weeks starting from the second week of November (7th to 11th November) when US presidential election was held, till the fourth week of November (21st to 25th November). This indicates overseas investors have switched to purchasing Japanese equity market. We therefore believe that rising trend of Japanese equity market will be maintained despite the Trump rally taking a breather in December.

We need to be prepared for a possible reaction of the Japanese financial market if currently high expectation for the Trump policy is proved to be disappointing. US's currency policy is also an important factor to be watched

However, we have to be cautious that market's "expectation" for US President-elect Mr. Donald Trump's policy is far too high. Therefore, negative reaction on Japanese stock markets and JPY could be magnified if in any reason the Trump policy is deemed disappointing. In addition, although the new US Treasury Secretary Mr. Steven Mnuchin has not yet indicated clear policy on foreign exchange, if he moves to prevent extremely strong USD, we believe, Japanese equity market will be influenced negatively by USD/JPY rate fluctuation.

*** Please note that this report is a translation of Japanese report written on December 2nd, 2016.**

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