

Japanese corporate earnings forecast

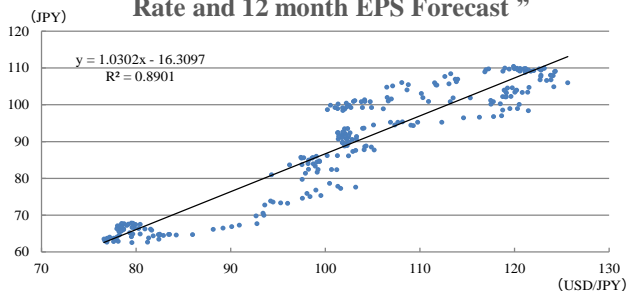
- Japanese corporate earnings forecast is steadily getting rid of negative factors as EPS forecast has moderately improved by weakening of JPY.
- Recurring profit forecast of corporations included in SMAM’s research universe is +1.8% YoY for FY2016 and +13.2% YoY for FY2017.
- Key to determine possibility of stock market rise in future depends on expansion of circulatory stock selection following improvement of corporate earnings.

Japanese corporate earnings forecast is steadily getting rid of negative factors as EPS forecast has moderately improved by weakening of JPY

12 month EPS Forecast of corporates comprising Tokyo Stock Price Index (TOPIX) tends to be strongly influenced by USD/JPY rate. Chart 1 illustrates how EPS forecast reacts to change of USD/JPY rate. It is correct to consider JPY depreciation as a tailwind to Japanese corporate earnings forecast, as EPS forecast almost increases (decreases) by JPY 1 whenever the Japanese currency weakens (strengthens) by JPY 1 for the past 5 years.

In fact, we can observe moderate recovery of 12 month EPS forecast of TOPIX due to recent JPY depreciation (Chart 2). As a result, TOPIX’s revision index obviously entered into positive territory as ratio of corporates comprising TOPIX revising their earnings forecast has increased. Hence, Japanese corporate earnings forecast is steadily getting rid of negative factors as EPS forecast has moderately improved by weakening of JPY.

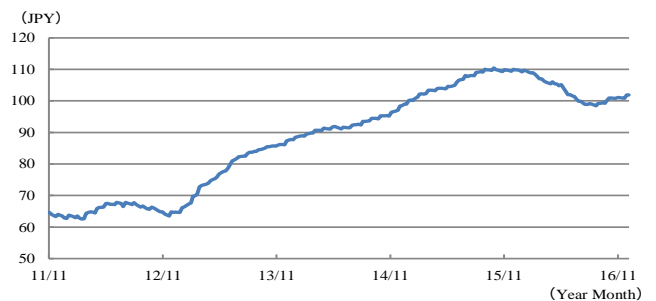
“Chart 1: Single Regression Analysis of USD/JPY Rate and 12 month EPS Forecast”



(Note) Data period is from 3rd November 2011 to 8th December 2016. Vertical axis is 12 month EPS forecast of TOPIX and horizontal axis is USD/JPY rate. Used weekly data for single regression analysis. Standard error of 0.0222 and “t” value of 46.3371 for regression coefficient of 1.0302. Standard error of 2.2852 and “t” value of -7.1371 for constant term of -16.3097.

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

“Chart 2 : 12 month EPS Forecast”



(Note) Data period is from 3rd November 2011 to 8th December 2016. 12 month EPS forecast of TOPIX.

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

Recurring profit forecast of corporations included in SMAM's research universe is +1.8% YoY for FY2016 and +13.2% YoY for FY2017

In these circumstances, we have revised corporate earnings forecast of 221 companies included in SMAM's "Core Research Universe 221 companies (excluding financials)". Recurring profit of FY2016 was revised up to +1.8% YoY from our previous forecast of -1.6% YoY (as of September 2016), a turn around of forecast from negative to positive. Also, FY2017 recurring profit forecast was revised up to +13.2% YoY from +11.3% YoY.

While recurring profit forecasts of manufacturers (137 companies) are -2.6% YoY (September forecast: -6.5% YoY) for FY2016 and +16.2% (September forecast: +12.4%) for FY2017, those of non-manufacturers (84 companies) are +9.2% YoY (September forecast: +6.5% YoY) for FY2016 and +8.8% (September forecast: +9.8%) for FY2017. Foreign exchange rates used this time were; (i) USD/JPY rate : JPY110 (September forecast: JPY100) and (ii) EUR/JPY rate: JPY115 (September forecast: JPY115).

Key to determine possibility of stock market rise in future depends on expansion of circulatory stock selection following improvement of corporate earnings

Price earnings ratio (P/E ratio) is used to measure whether stock price is undervalued or overvalued. In general, smaller (bigger) number is deemed undervalued (overvalued). Latest P/E ratio of TOPIX is trending upward. According to Datastream, latest 12 month P/E ratio forecast of TOPIX is 14.4 times which is higher than that of 5 year average of 13.4 times. However, as explained before, rise of P/E ratio can be justified by improvement of earnings forecast so far.

Following so called Trump Rally, Japanese stock market saw a sharp rise in cyclical sectors such as financials, energy related and export related. On 13th December 2016, sectors relatively underperformed market during Trump Rally, such as Fishery, Agriculture & Forestry, Pharmaceutical, Information & Communication were bought. Since earnings forecast is improving, key to determine possibility of stock market rise in future depends on expansion of circulatory stock selection as seen on 13th December.

*** Please note that this report is a translation of Japanese report written on 13th December, 2016.**

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui Asset Management Company, Ltd. (hereinafter "SMAM"), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- ☐ The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMAM's judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMAM's authorization, or from disclosing this material to a third party.

Registered Number: Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui Asset Management Company, Limited