



Japanese Stock Market Outlook

SMAM monthly comments & views

- December 2015 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Private consumption recovered in 3Q and also negative effects from slowdown in China seems gradually easing for Japanese economy. Fiscal and monetary measures can be expected in Japan early next year, which should make Japanese economy more light-footed on its recovery path.

- GDP forecast for FY2015 was upgraded from +0.6% to +0.8% on recent observation of rebounds in private consumption and possibly stabilizing exports and industrial production. Forecast for FY2016 was also upgraded from +0.9% to +1.0%.
- 3Q (Jul-Sep) GDP was -0.8% QoQ annualized, for which cut down in inventory and weak private capital investment were main cause. Private consumption has recovered in 3Q and it is expected to lead the GDP growth going forward. GDP is forecast to start growing again from 4Q.

➤ Japanese Stock Markets

Risk-off mode has moderated, which made global markets to rebound. The Japanese stock market will be in a range bound move as US interest rate hike is forecast in Dec. The market will find a more spring in its steps in early next year when fiscal and monetary measures are brought in as expected.

- Markets rebounded from the trough on additional policy measures and confirmation of continuing economic growth in the US. PER for Japan stays low and attractive compared to US and Europe.
- There is a huge potential if shareholder returns from Japanese companies improves to catch up peers in the US and Europe. If such improvements can be achieved, it would make a strong tailwind for Japanese stocks for the long term.

Notes: Macro and market views are as of November 16th and 18st 2015 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY15-16

- GDP forecast for FY2015 was upgraded from +0.6% to +0.8% on recent observation of rebounds in private consumption and possibly stabilizing exports and industrial production. Forecast for FY2016 was also upgraded from +0.9% to +1.0%.
- For FY2016, private sector is expected to show a reasonable growth, consumption at +1.9%, housing investment at +4.1% and capital investment at +1.7%. Contraction in the public capital investment is the main drag, for which “special spending program of reconstruction from the earthquake and tsunami in 2011” comes to an end.

| | FY12 | FY13 | FY14 | FY15E | FY16E |
|--------------------------------------|-------|-------|--------|-------|-------|
| Real GDP growth | 1.0% | 2.1% | -0.9% | 0.8% | 1.0% |
| Private Consumption Expenditure | 1.8% | 2.5% | -3.1% | 0.6% | 1.9% |
| Private Housing Investment | 5.7% | 9.3% | -11.6% | 3.9% | 4.1% |
| Private Capital Investment | 1.2% | 4.0% | 0.5% | -0.2% | 1.7% |
| Public Consumption Expenditure | 1.5% | 1.6% | 0.4% | 1.3% | 0.2% |
| Public Capital Investment | 1.0% | 10.3% | 2.0% | 1.1% | -0.2% |
| Net Exports (contrib. to GDP growth) | -0.8% | -0.5% | 0.6% | 0.0% | -0.2% |
| Exports | -1.4% | 4.4% | 7.9% | 1.2% | 3.1% |
| Imports | 3.6% | 6.7% | 3.6% | 1.2% | 4.6% |
| Nominal GDP | 0.1% | 1.8% | 1.6% | 1.9% | 2.0% |
| GDP Deflator | -0.9% | -0.3% | 2.5% | 1.2% | 0.9% |

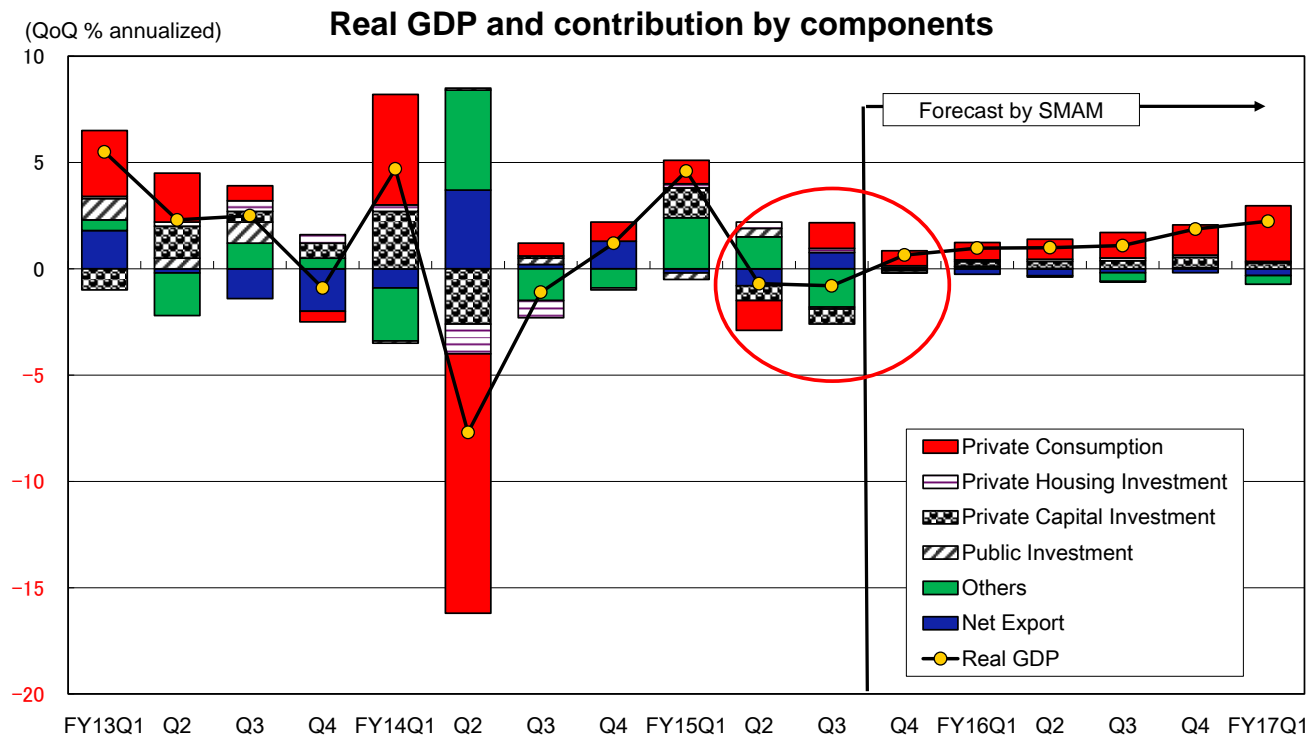
Notes: E=SMAM forecasts. SMAM views are as of Nov. 16th, 2015 and subject to updates thereafter without notice

(%, YoY except Net Exports)

Source: Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

SMAM economic outlook for FY15-16

- 3Q (Jul-Sep) GDP was -0.8% QoQ annualized, for which cut down in inventory and weak private capital investment were main cause.
- Private consumption has recovered in 3Q and it is expected to lead the GDP growth going forward. GDP is forecast to start growing again from 4Q.

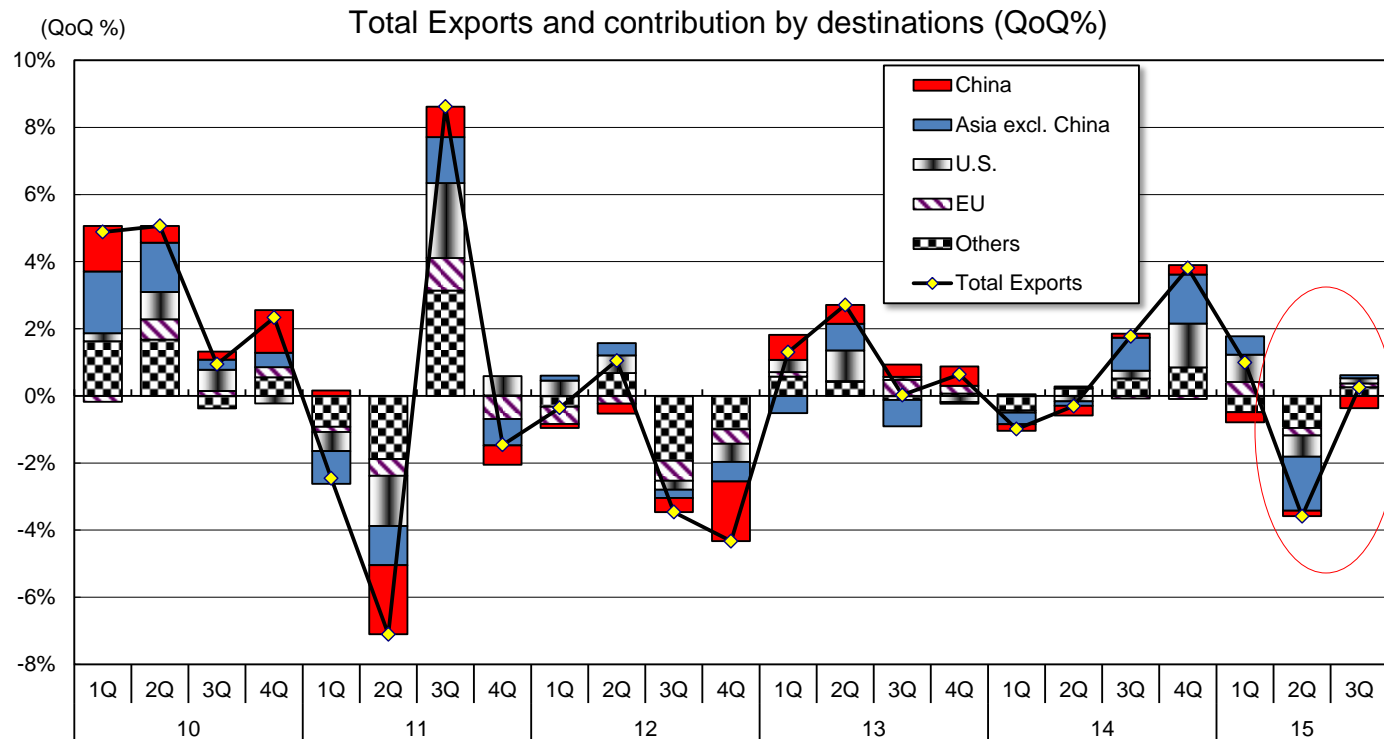


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Source: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts .

Negative effects from global economic deceleration on Japanese exports might be easing

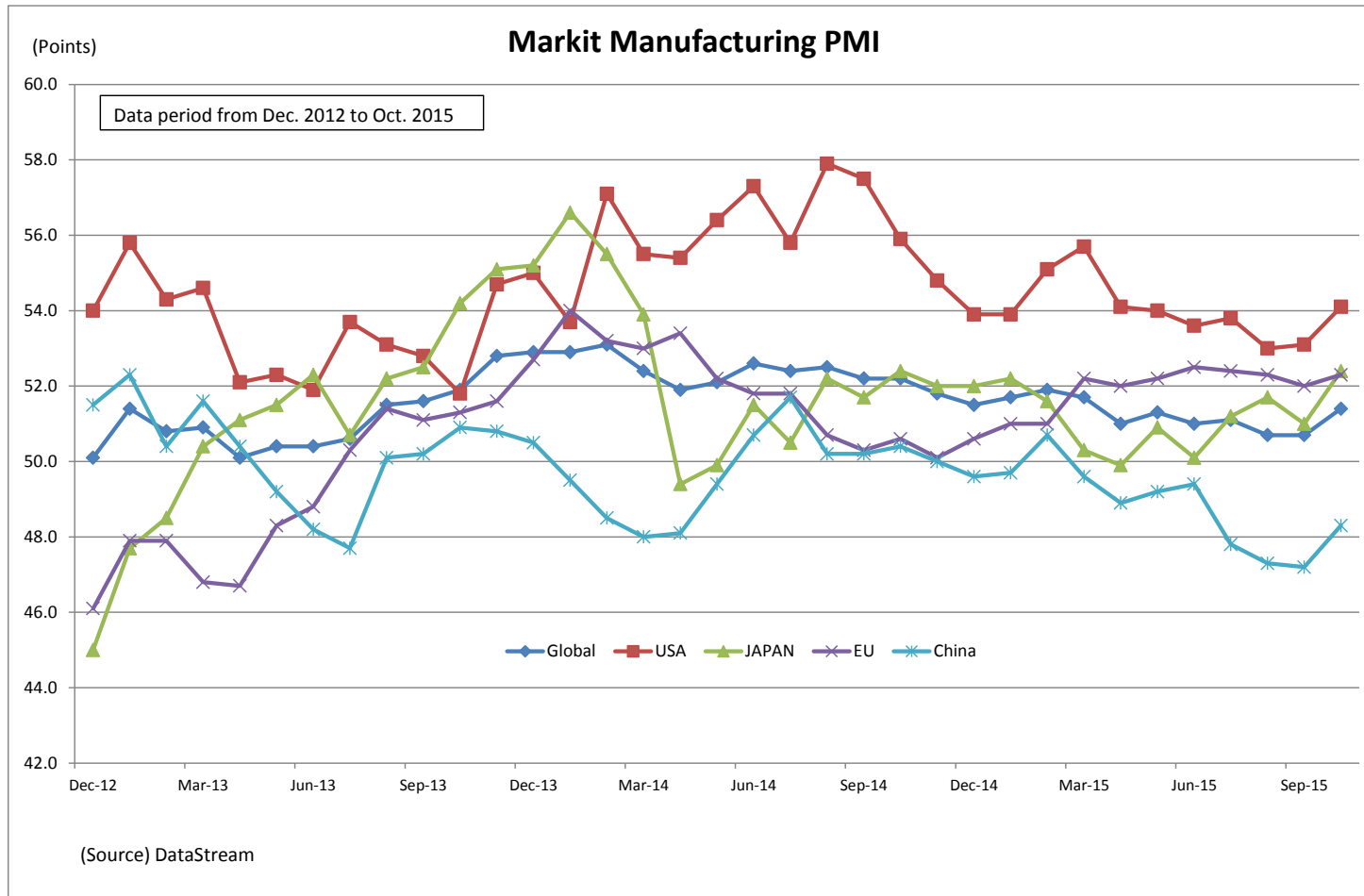
- After a sharp fall in exports in 2Q, total exports from Japan recovered to positive in 3Q, though exports to China was still deteriorating.



(Source) Ministry of Finance and Bank of Japan, compiled by SMAM

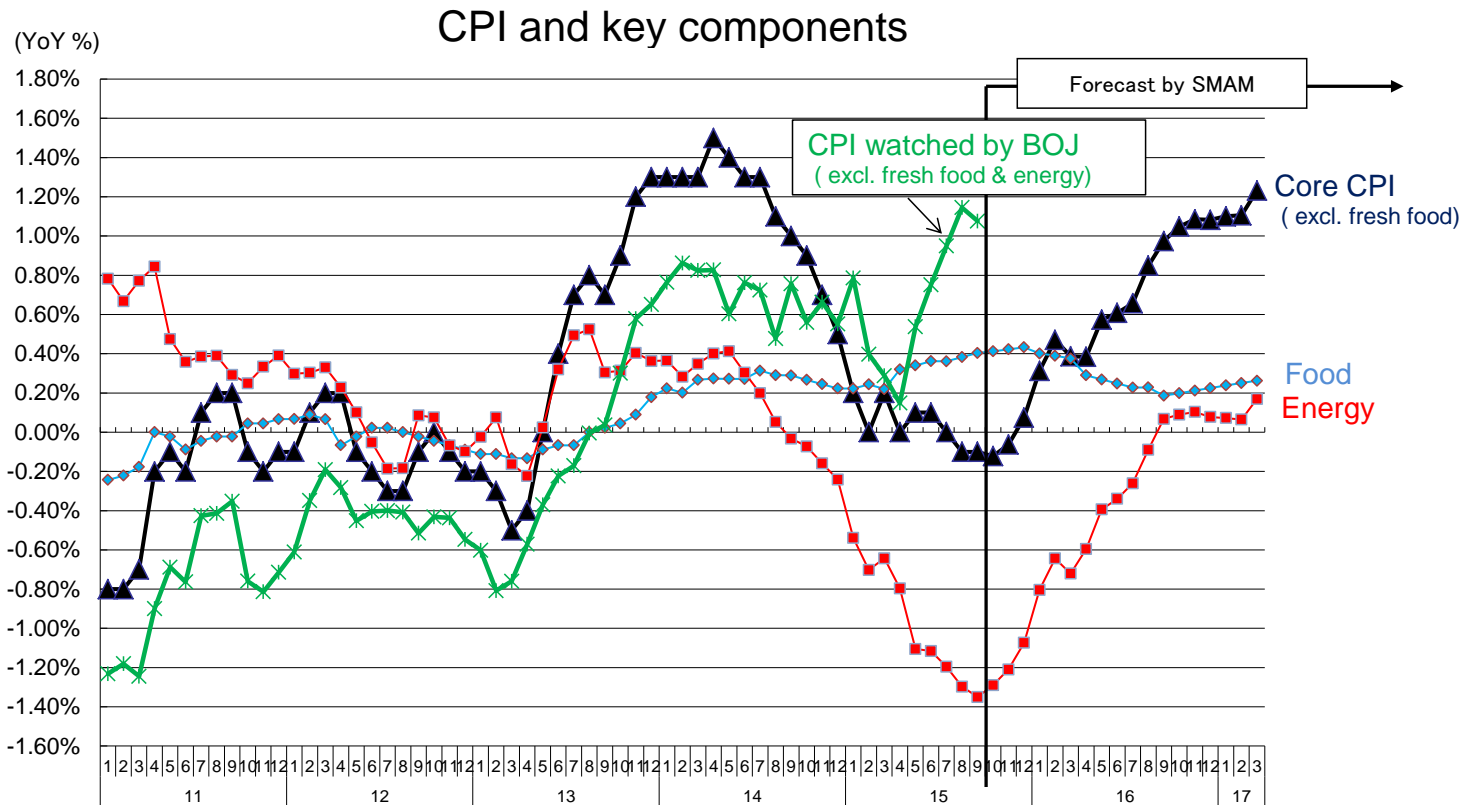
The latest PMI indicates recovery in the global manufacturing sector

- Manufacturing Global PMI ticked up in October after 7 consecutive month of decline. Keep watchful eyes for whether this recovery continues.



Japan is in a solid inflationary environment when fresh food and energy were excluded

- Underlying CPI trend is solidly rising when fresh food and energy were excluded, which is watched by BOJ.
- Lower energy prices are helping companies, however, the benefit has not yet reached consumers who are feeling higher cost of living.

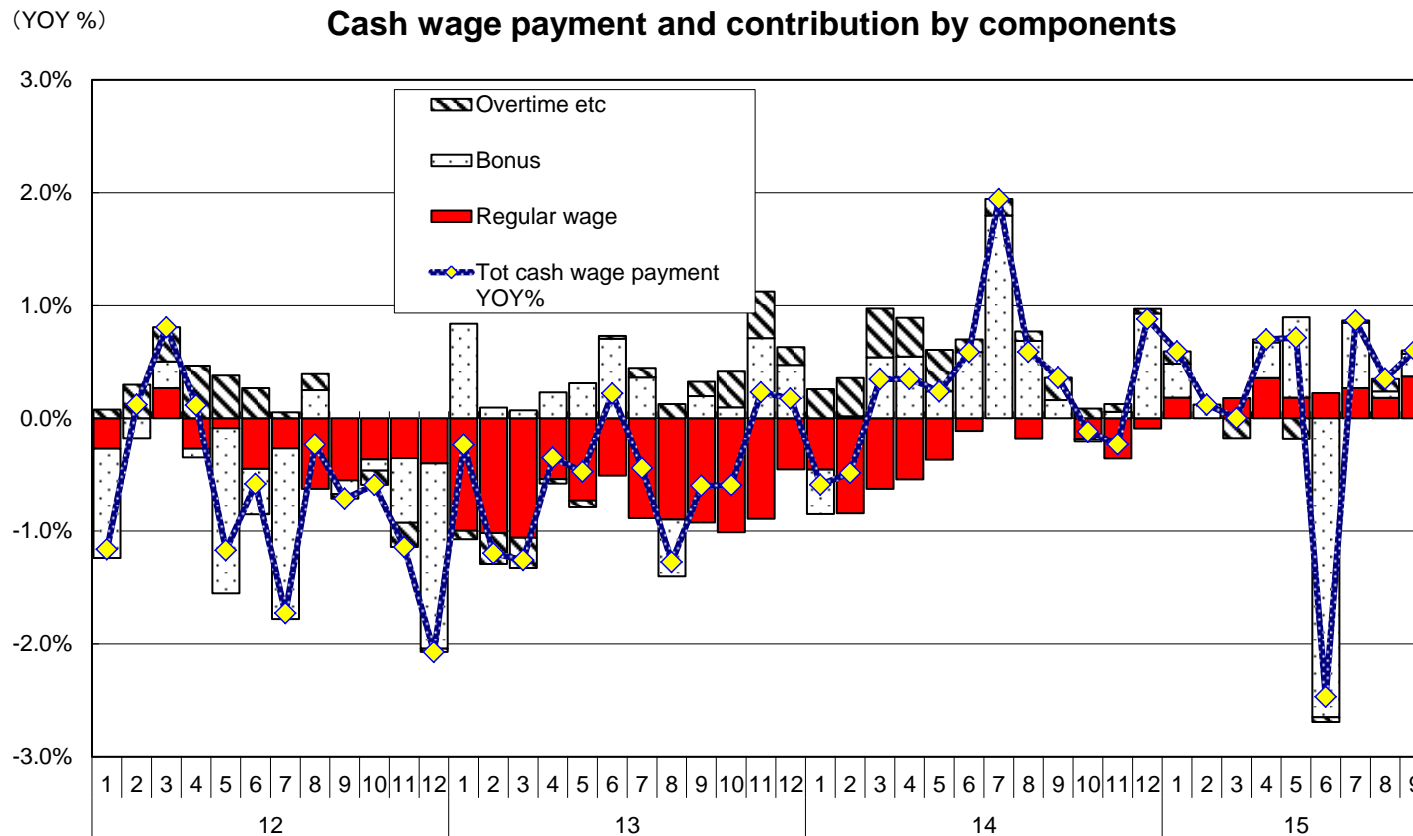


Note: Excluding direct impact from consumption tax hike in April 2014.

(Source) Ministry of Internal Affairs & Communications, forecast by SMAM.

Increase in regular wage has been positive for consumers

- Regular wage payment has been increasing YOY since January 2015, which has been positive for consumers.
- Whether this increasing trend in wage can be sustained in and after FY2016 is quite important for the Japanese economy, and underlying strength in corporate earnings requires close attention.



(Source) Ministry of Health, Labor and Welfare

Outlook for Japanese Stock Markets

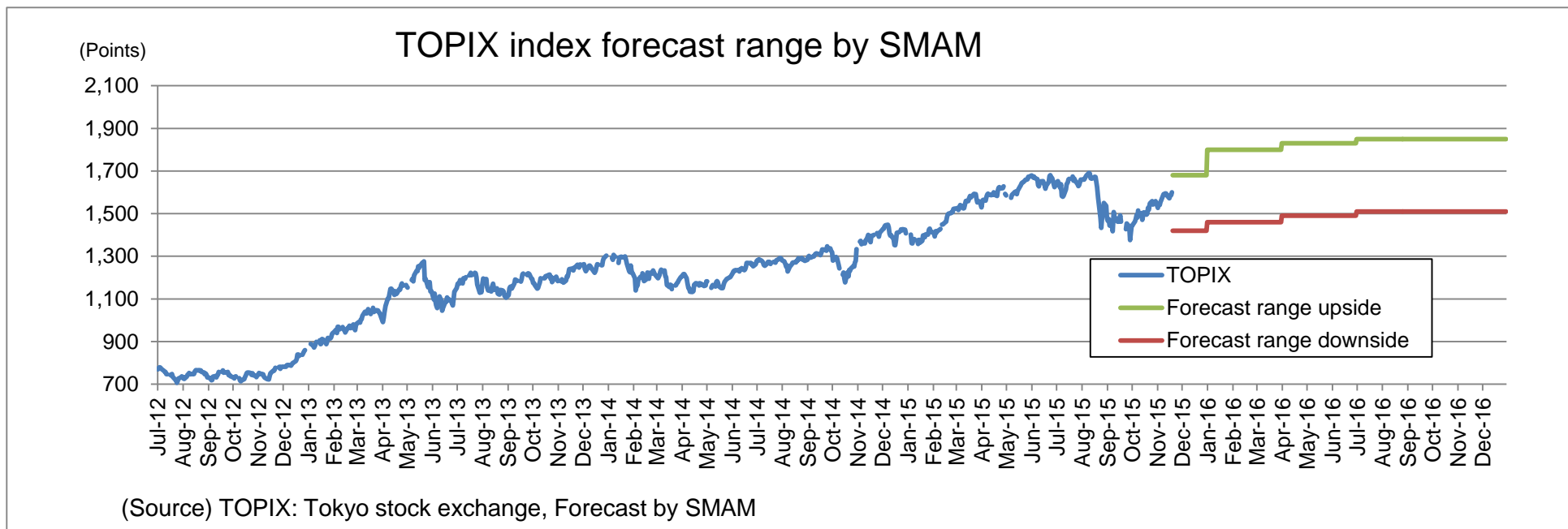
Stock market outlook: The stock market is waiting for further stimulus measures

SMAM short-term view

- Risk-off mode has moderated, which made global markets to rebound. The Japanese stock market will be in a range bound move as US interest rate hike is forecast in Dec. The market will find a more spring in its steps in early next year when fiscal and monetary measures are brought in as expected.

Longer-term outlook (6-months and beyond)

- Chinese economy is expected to gradually stabilize as policy measures buildup further and start to take effect.
- The Japanese stock market will get firmer as fiscal measures and additional monetary stimulus are expected in early next year and further economic policies and initiatives can be announced running up to the upper house election expected in July 2016.



Note: SMAM's Projection is as of November 18st 2015 and subject to updates without notice

Base scenario & Upside / Downside risks for our forecasts

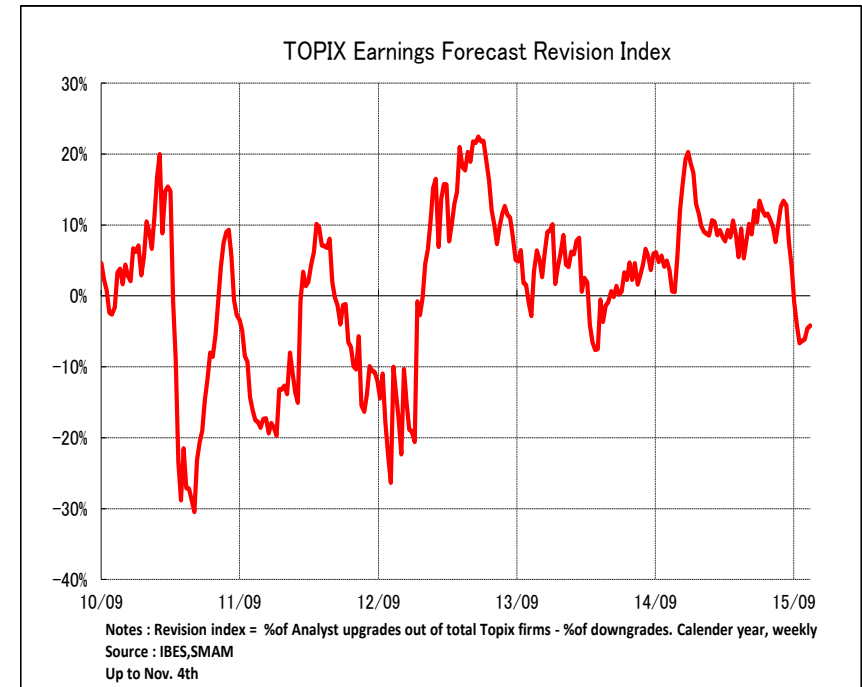
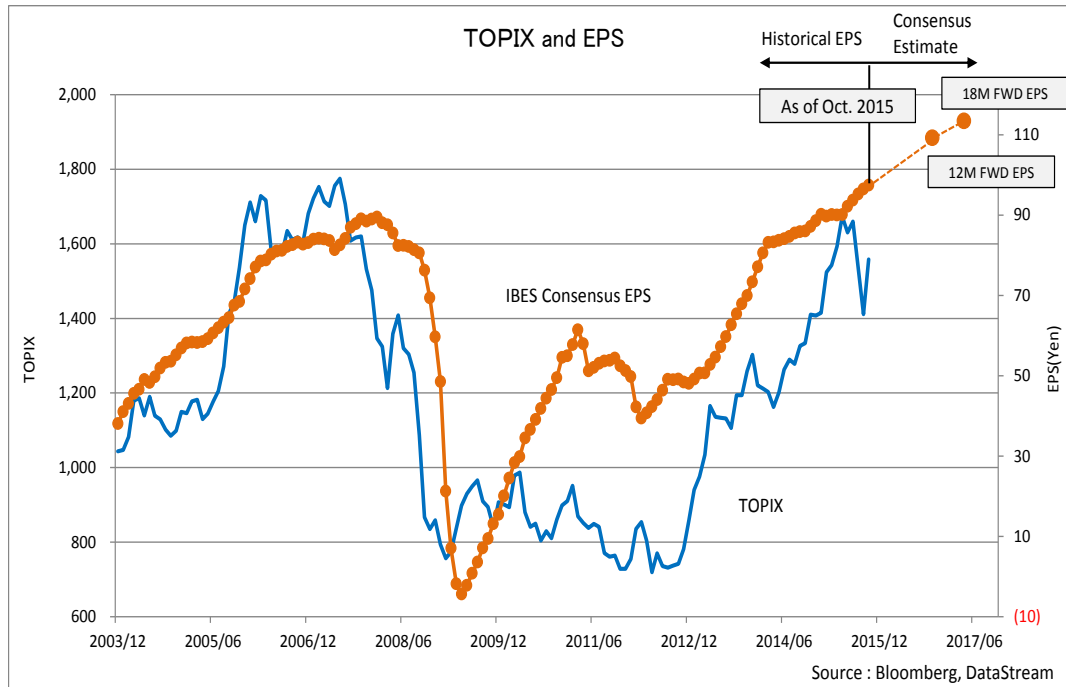
- Our **Base Scenario** is assuming the following views:
 - Global economic recovery to be sustained led by strong US economy
 - Japan's private consumption to grow though mildly supported by higher real wages growth
 - Growing expectation for positive corporate earnings revisions due to weaker JPY
 - Reflationary policy to be continued toward the next consumption tax hike

- **Upside Risks** include:
 - Stronger-than-expected global growth
 - Stronger-than-expected measures by Abe government

- **Downside Risks** include:
 - Unexpectedly large impact from the process of US monetary policy normalization
 - Concern over emerging economies including China
 - Increasing geopolitical concerns

Earnings growth is expected to continue for Japan with a caution for down-revisions

- Corporate earnings are expected to keep growing despite increasing pressure on top-line sales. Lower costs such as energy and materials have been supportive so far.
- Some caution is required as analysts are revising earnings forecasts more often downward than upward recently.



Huge potential for improving total shareholder returns

- There is a huge potential if shareholder returns from Japanese companies improve to catch up peers in the US and Europe.
- If such improvements can be achieved, it would make a strong tailwind for Japanese stocks for the long term.

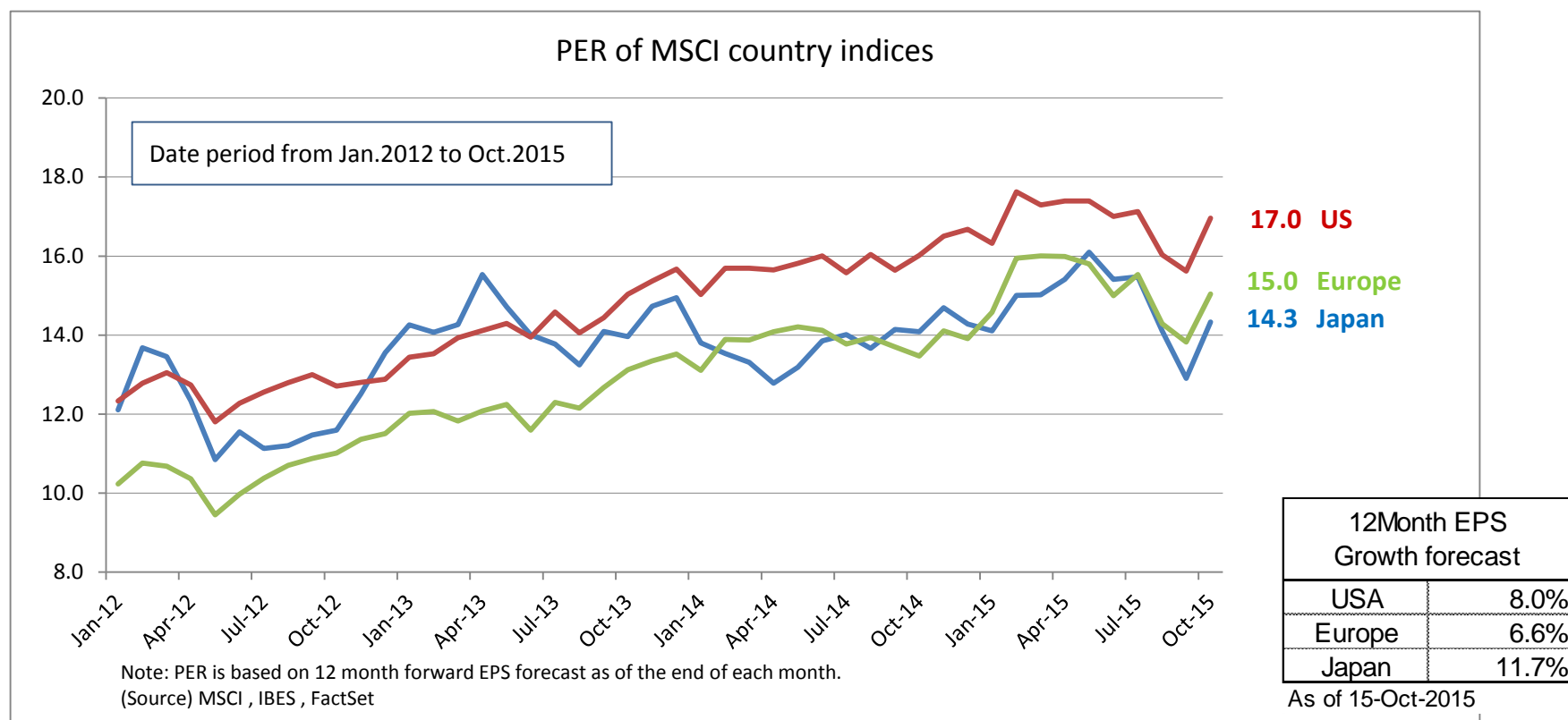
Comparison of shareholder returns among major stock markets

| | Total shareholder return ratio a) + b) | Dividend payout ratio a) | Share buyback/ Shareholder earnings b) |
|--------|---|-----------------------------|--|
| Japan | 36.2% | 25.9% | 10.3% |
| USA | 85.7% | 34.7% | 51.0% |
| Europe | 84.1% | 62.6% | 21.4% |

Notes: Data is for 2013. TOPIX for Japan, S&P500 for USA and STOXX Europe 600 for Europe.
(Source) FactSet, compiled by SMAM.

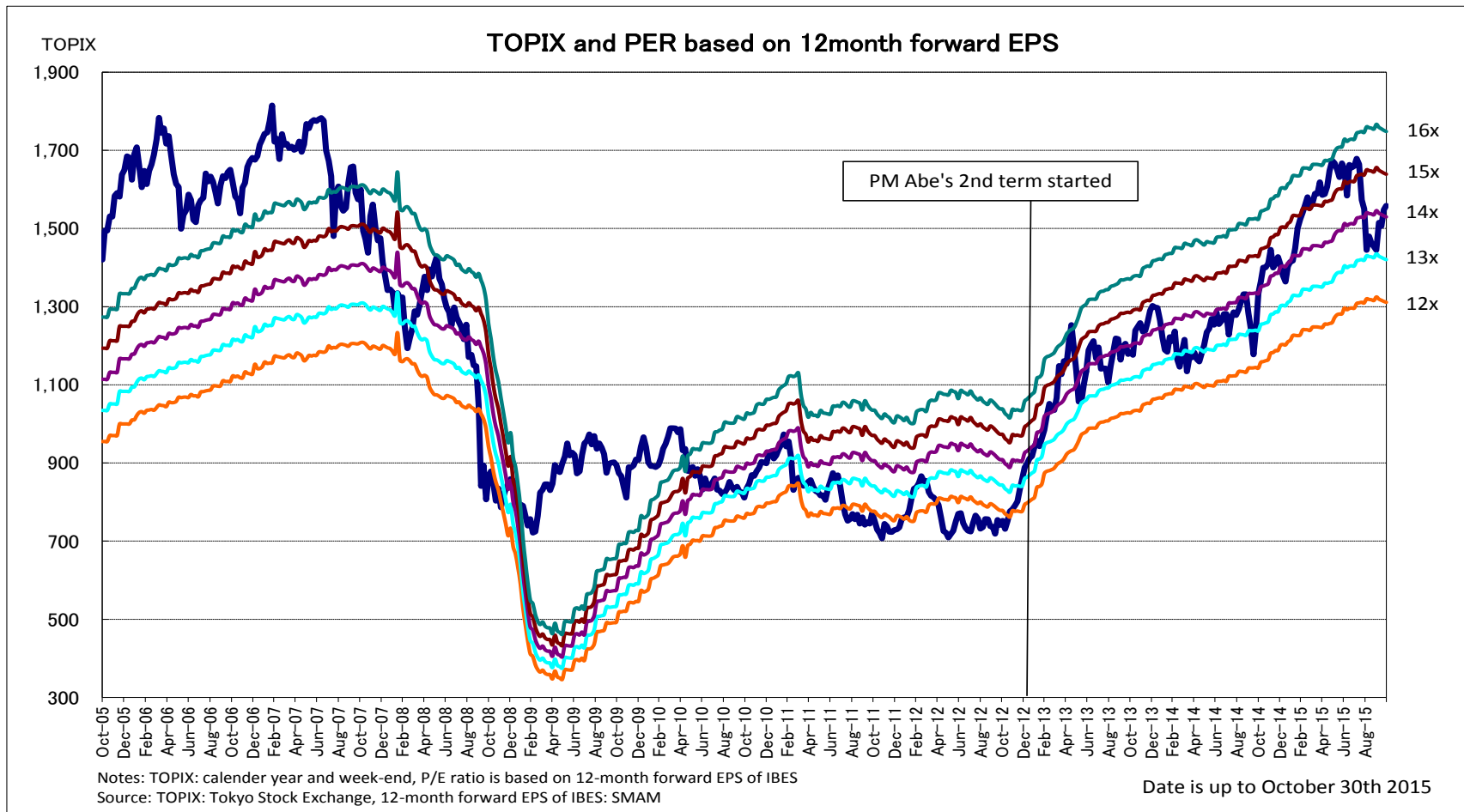
PER has fallen globally and relative attractiveness for Japan still holds

- PER has fallen globally on decelerating economic growth and concern for further deterioration.
- Markets rebounded from the trough on additional policy measures and confirmation of continuing economic growth in the US. PER for Japan stays low and attractive compared to US and Europe.
- Better fundamentals in Japan, such as faster earnings growth and improving corporate governance should be favorable for Japanese equities.



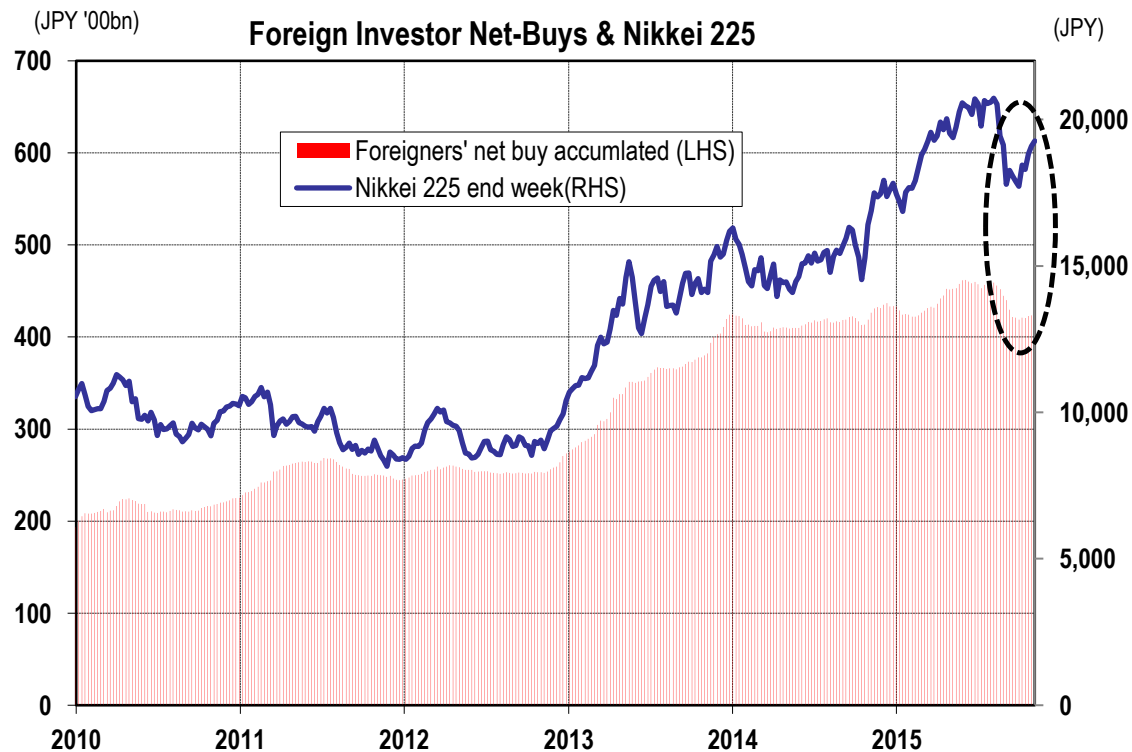
PER for Japanese stock market seems attractive in historical comparison

- Since Abenomics started, PER for Japanese stock market, in TOPIX index, has been in a range between 13x and 16x.
- Current PER around 14x is in a lower side of this range and downside for the stock market seems limited.



Supply-Demand balance: Foreign investors turned to purchasing Japanese equities

- Since late October, foreign investors stopped selling and turned to purchasing Japanese equities.
- Listing of three Japan Post companies on November 4th was a success. A lot of Japanese private investors participated shifting money mainly from deposits and made a handsome profit on rising share prices.



Notes: Calendar year, weekly. Foreign investors' net purchase of TSE listed stocks
Source: Tokyo Stock Exchange, SMAM

Up to Nov. 6th

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