



# Japanese Stock Market Outlook

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SMAM monthly comments & views  
- January 2017 -



Sumitomo Mitsui Asset Management

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## Executive summary

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### ➤ Japanese Economy

SMAM revised GDP growth forecast for FY2016 from +0.9% to +1.2% and for FY2017 from +0.9% to +1.1% due mainly to change in GDP measurement standard, in which Research & Development spending is counted as capital investment, a part of GDP. By the new measurement standard, Real GDP growth has shifted upward by 0.5% on average for the immediate past 3 years from 2013 to 2015. Nominal GDP in 2015 was substantially revised up to 532 trillion yen surpassing previous high of 531 trillion yen recorded in 2007.

- SMAM forecasts US\$/yen range between 112 and 122 for 2017 with a risk for the downside to 105 if US moves to cap and reverse the dollar strength considering its negative effects on US industries.
- According to the latest BOJ Tankan Business Survey, recovering global economy has positively impacted exports and production in Japan leading to the improvement in business sentiments both for manufacturing and non-manufacturing industries.

### ➤ Japanese Stock Markets

After a Trump honeymoon rally lifting Japanese stocks market-wide in late 2016, focus is going to such factors as (a)strong earnings growth expected in Jan-Mar quarter and onwards, and (b)how Trump policies actually develop both on domestic and international fronts. Current PER over 15x seems a little stretched and the stock market would require some breathing period for the expected earnings growth to be actually achieved.

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is expected for FY2017. Further fiscal stimulus can be expected in Japan meanwhile BOJ would keep its extra-easy monetary policy. As a main scenario, Trump's trade policy is expected to focus on bilateral negotiations to open other countries' markets and would not be so protectionist as feared.
- After falling for 2 consecutive years in FY2014 and 15, ROE is forecast to recover to 9.2% in FY2016 and to reach 10% mark in FY2017. ( for SMAM 221 companies excluding financials)

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# Outlook for Japanese Economy

## SMAM economic outlook for FY16-18

- SMAM revised GDP growth forecast for FY2016 from +0.9% to +1.2% and for FY2017 from +0.9% to +1.1% due mainly to change in GDP measurement standard, in which Research & Development spending is counted as capital investment, a part of GDP.
- Forecast for FY2018 was released predicting moderate growth to continue despite plateauing contribution from the public sector.

( YoY %)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Real GDP growth	2.6%	-0.4%	1.3%	1.2%	1.1%	0.9%
Private Consumption Expenditure	2.7%	-2.7%	0.5%	0.7%	0.6%	0.6%
Private Housing Investment	8.3%	-9.9%	2.7%	5.7%	-0.0%	1.0%
Private Capital Investment	7.0%	2.5%	0.6%	1.4%	1.5%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.7%	1.1%	0.9%
Public Capital Investment	8.6%	-2.1%	-2.0%	0.1%	5.7%	0.2%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.2%	0.4%	0.2%	0.1%
Exports	4.4%	8.7%	0.8%	1.1%	2.4%	1.7%
Imports	7.1%	4.1%	-0.2%	-1.5%	1.2%	1.0%
Nominal GDP	2.6%	2.1%	2.8%	1.3%	1.6%	1.6%
GDP Deflator	0.0%	2.5%	1.4%	0.0%	0.6%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	0.9%	3.3%	2.5%
CPI (excl. fresh food)	0.8%	0.9%	-0.0%	-0.3%	0.7%	0.7%

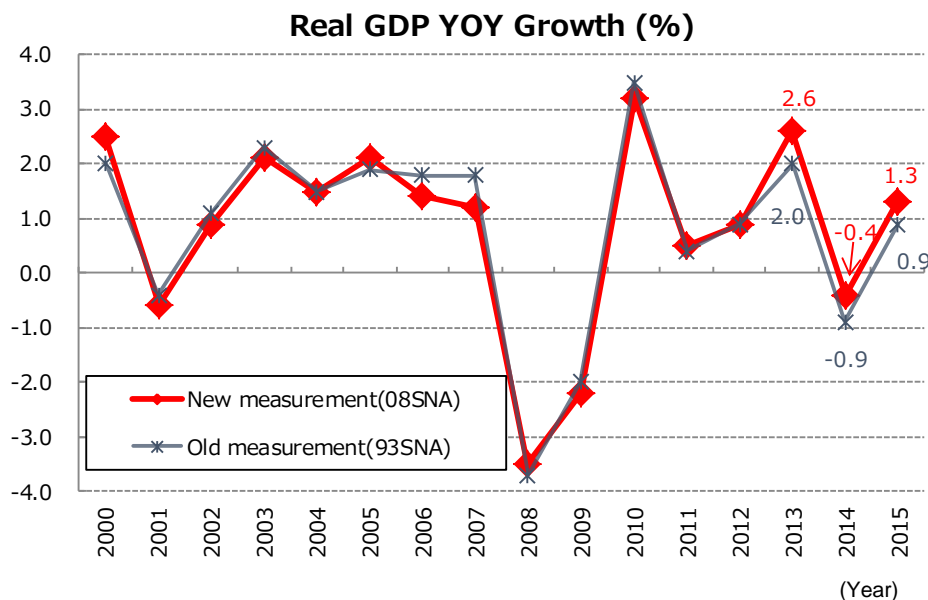
Notes: E=SMAM forecasts. SMAM views are as of Dec 15<sup>th</sup>, 2016 and subject to updates thereafter without notice

(%, YoY except Net Exports)

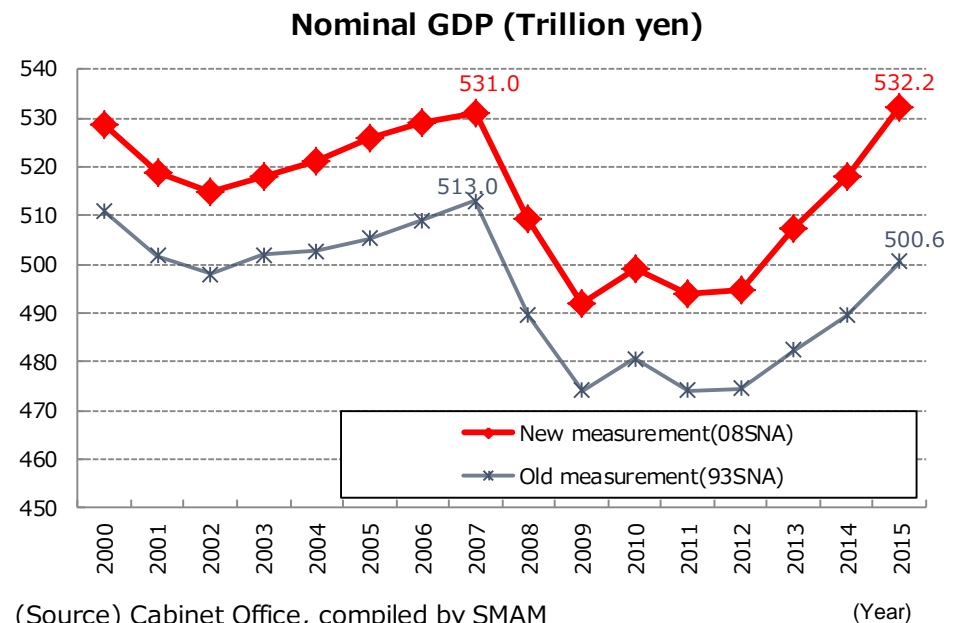
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

## GDP measurement standard has changed making substantially positive impact

- GDP measurement standard has changed this time making clearly positive impact. The biggest change is counting Research & Development spending as capital investment, a part of GDP.
- For the immediate past 3 years from 2013 to 2015, Real GDP growth has shifted upward by 0.5% on average.
- By the new measurement standard, Nominal GDP in 2015 was 532 trillion yen surpassing previous high of 531 trillion yen recorded in 2007.



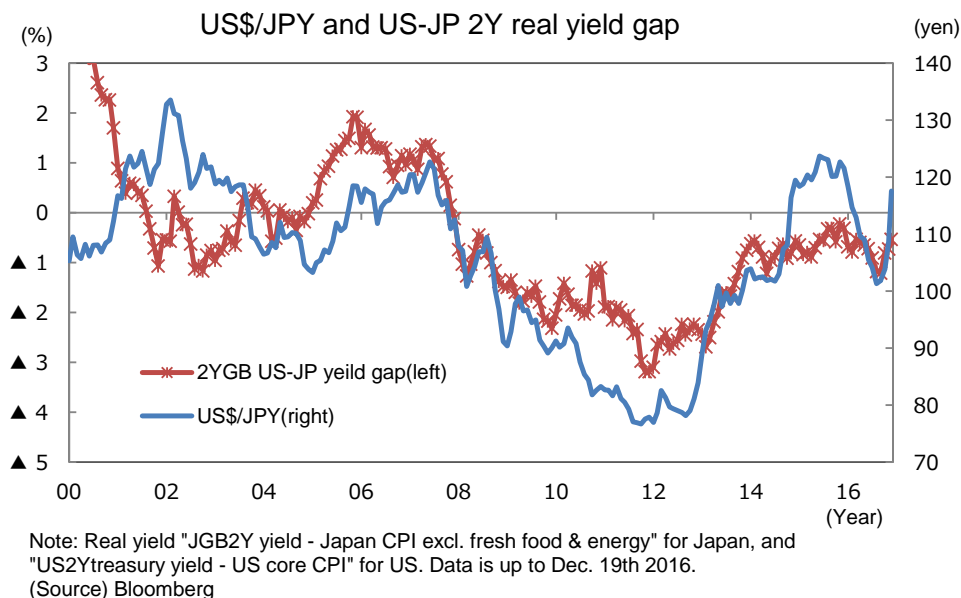
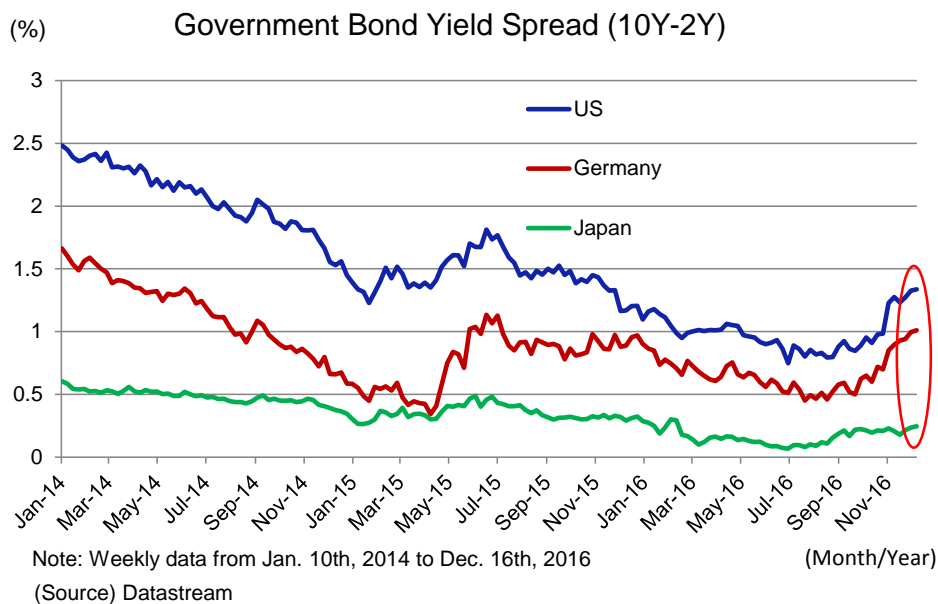
(Source) Cabinet Office, compiled by SMAM



(Source) Cabinet Office, compiled by SMAM

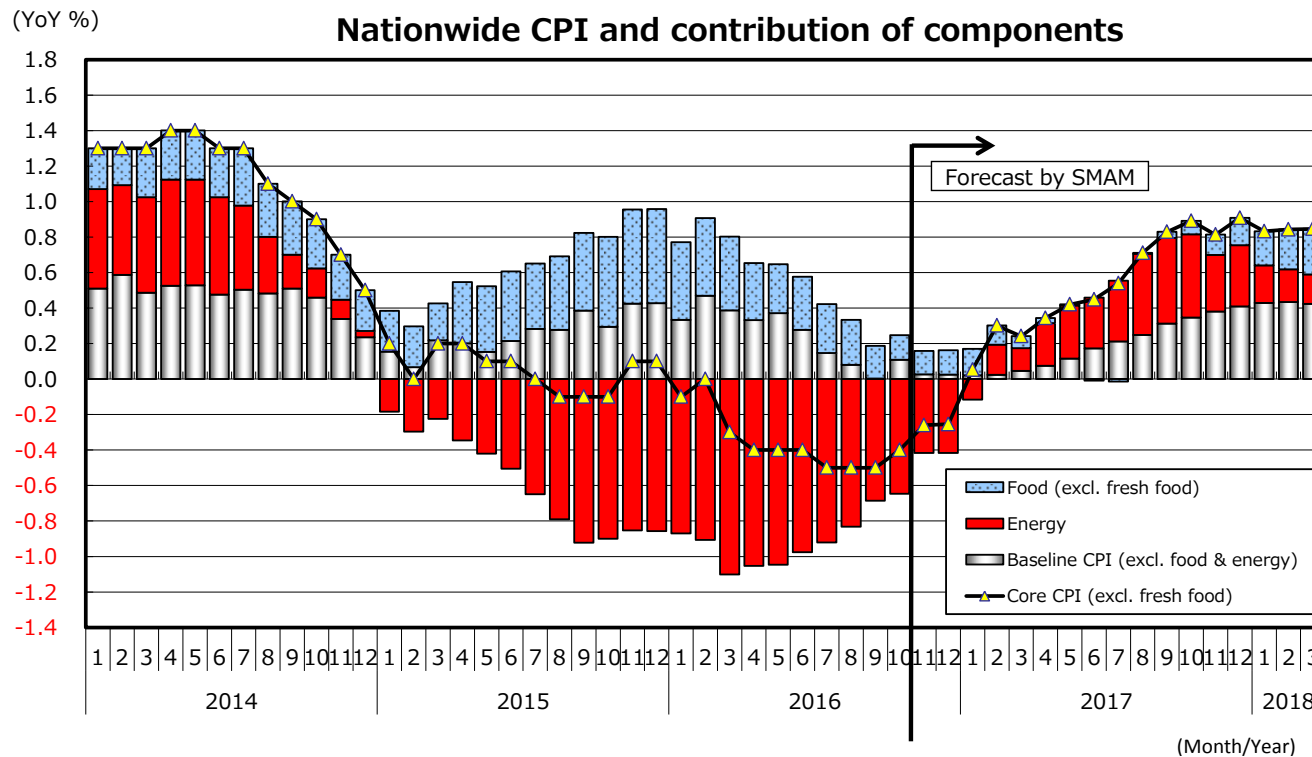
## Widening Interest rate gap is one of the factors behind the strong US\$ against Japanese yen

- Steepening of yield curve continues for US and Europe whereas still kept low in Japan.
- FRB in the US decided to hike its policy rate by 0.25% in December FOMC meeting.
- Widening interest rate gap is one of the reasons why dollar is moving stronger against Japanese yen.
- SMAM forecasts US\$/yen range between 112 and 122 for 2017 with a risk for the downside to 105 if US moves to cap and reverse the dollar strength considering its negative effects on US industries.



## CPI forecast was revised upward

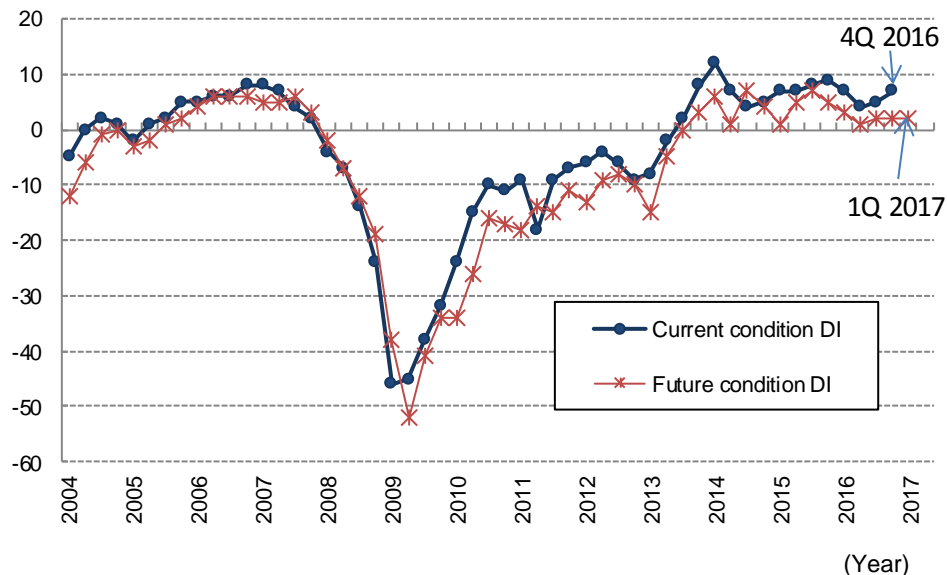
- Due to underlying firm consumer prices and higher oil & commodity prices, SMAM revised CPI forecast upward. Now, CPI is forecast to move up to positive territory during 1Q of 2017, which was previously forecast to be in the middle of 2017.
- CPI is forecast to reach +0.9% by the end of 2017 and BOJ is going to refrain from making additional easing moves in 2017 despite it is still lower than 2% target set by BOJ.



## Business sentiment has been noticeably improving

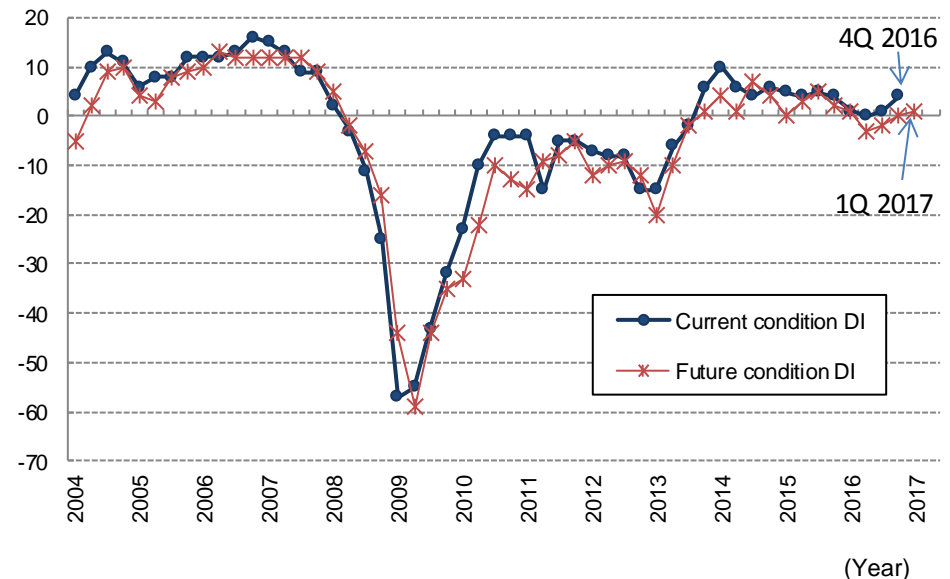
- According to the latest BOJ Tankan Business Survey, recovering global economy has positively impacted exports and production in Japan leading to the improvement in business sentiments both for manufacturing and non-manufacturing industries.
- DI above zero means more respondents are feeling business conditions getting better than getting worse.

BOJ Tankan Business Survey, manufacturing enterprises(all size)



(Source) Bank of Japan

BOJ Tankan Business Survey, Non-manufacturing enterprises(all size)



(Source) Bank of Japan



## Political events should gather attention in 2017

- The most important event should be the inauguration of Mr. Donald Trump as the US president on January 20th. How Trump policies are actually implemented both on domestic side and international trade side can affect global economy and financial markets.
- Europe is going to face important events such as notification of Brexit and elections in France.
- Japan has an advantage of stable politics, and PM Abe has a precious opportunity to impress the world by pushing social reform and growth enhancing strategies forwards.

Schedule of key events in the first half of 2017

Month	Region/Country	Events	Notes
January	Japan	Ordinary Session of National Diet begins	
		BOJ perspective report	
	USA	(20th) Donald Trump becomes US president	
February	Japan	First estimate of 4Q 2016 GDP	
March	Japan	Convention of the Liberal Democratic Party	Extend maximum party leadership from 2 terms running?
		Spring wage negotiations	
		Budget for FY2017 to be approved	
		Action plan for changing working practice	
	Netherlands	General election	
	UK	Notification of exiting EU?	
April	Japan	BOJ Tankan business report	
		BOJ perspective report	
Apr or May	France	Presidential election	
June	Japan	Ordinary Session of National Diet ends	
	Japan	Election for the Tokyo Metropolitan Assembly	
	France	Lower house election	

(Source) Various publications, assembled by SMAM

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# Outlook for Japanese Stock Markets

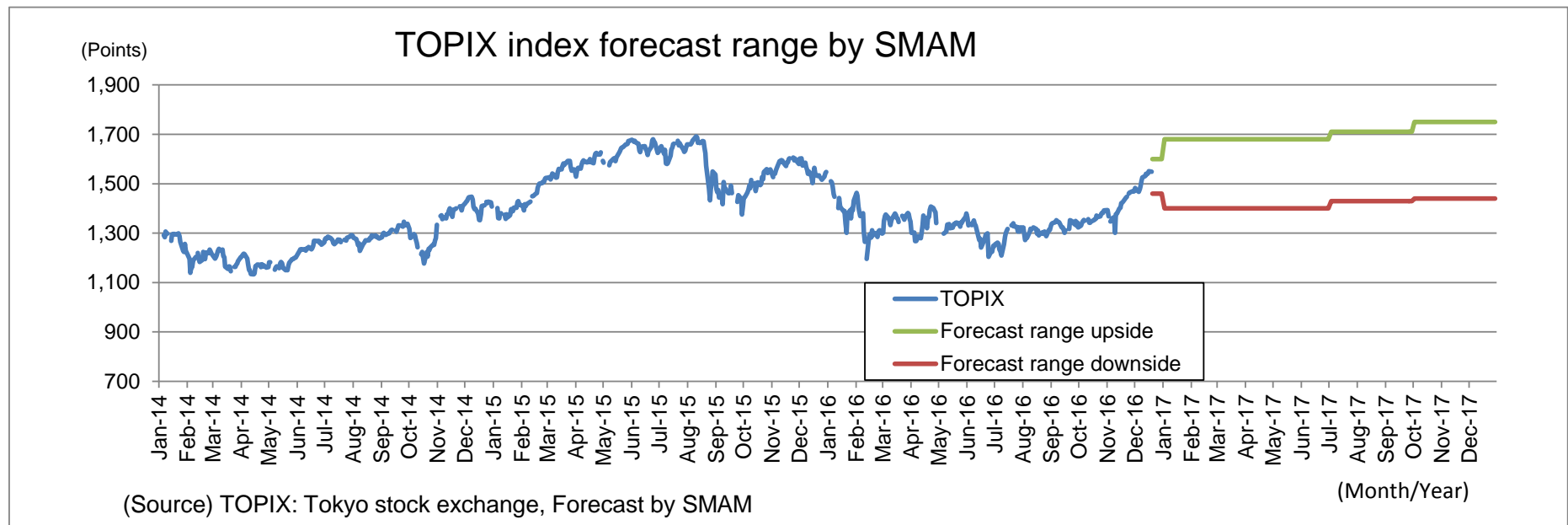
## Stock market outlook: What could happen after Donald Trump becomes US president ?

### SMAM short-term view

- After a Trump honeymoon rally lifting Japanese stocks market-wide in late 2016, focus is going to such factors as (a) strong earnings growth expected in Jan-Mar quarter and onwards, and (b) how Trump policies actually develop both on domestic and international fronts. Current PER over 15x seems a little stretched and the stock market would require some breathing period for the expected earnings growth to be actually achieved.

### Longer-term outlook (6-months and beyond)

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit earnings growth is expected for FY2017. Further fiscal stimulus can be expected in Japan meanwhile BOJ would keep its extra-easy monetary policy. As a main scenario, Trump's trade policy is expected to focus on bilateral negotiations to open other countries' markets and would not be so protectionist as feared.



Note: SMAM's projection is as of Dec. 19<sup>th</sup>, 2016 and subject to updates without notice

## Base scenario & Upside / Downside risks for our forecasts

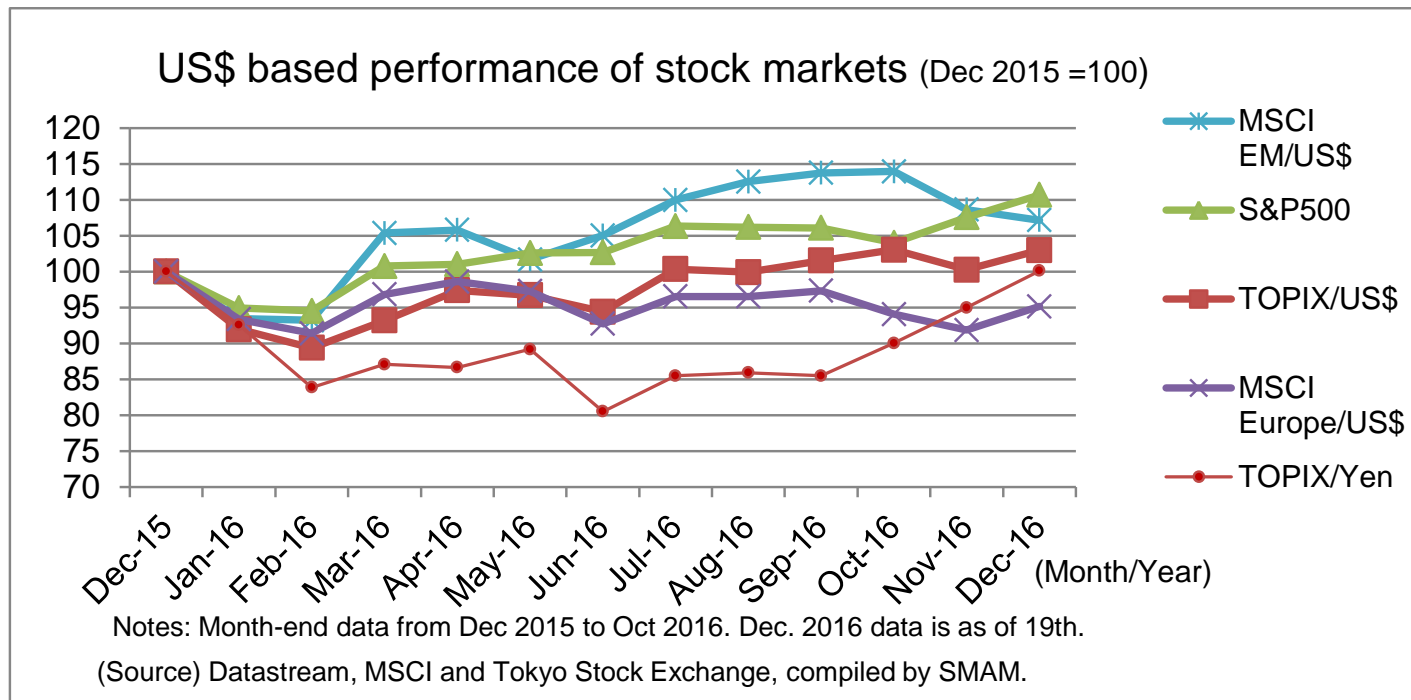
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- Our **Base Scenario** is assuming the following views:
  - Global economy keeps on its growth path.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
  - Fiscal stimulus and further monetary easing will be made to sustain economic growth in Japan.
  
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - Stronger-than-expected measures by the Abe government.
  
- **Downside Risks** include:
  - Confrontational foreign policies taken by Trump presidency shake global trades and deepen geo-political tensions.
  - Populism gains in Europe further stabilizing EU.
  - Unexpectedly large impact from the process of US monetary policy normalization.
  - Concern over emerging economies including China.

SMAM's forecasts as of December 2016

## Share prices rose to more than offset currency weakness for Europe and Japan in December

- US stocks continues rallying. Yen based Japanese stock prices also rallied substantially, however, it has not enough to catch up with yen's weakening against US\$ since US presidential election in November.
- Emerging equity markets are having difficult times from stronger US\$.



## SMAM forecast 21.8% YOY profit increase for Sep 2016-Mar 2017 period

- At the announcement of 2Q results, companies were implicitly forecasting +10.7% profit growth for the following 6 months between Sep 2016 and Mar 2017.
- Yen has substantially depreciated since then and global economy has picked up. SMAM now forecasts YOY recurring profit growth of 21.8% for the latter half of FY2016 and 11.3% for entire FY2017.

(Note: \*Numbers are for 221 companies in SMAM research coverage excluding financials.)

### Recurring profits forecast by companies as of the end of 2Q 2016

SMAM research coverage of 221 companies excluding financials											SMAM forecast as of Dec. 5th 2016	
(yen bil. %)	FY2015 (from Apr2015 to Mar2016)					FY2016 (from Apr2016 to Mar2017)					FY2016	FY2017
	FY2015 total					FY2016 total						
	1Q (Apr-Jun)	2Q	3Q	4Q		1Q (Apr-Jun)	2Q	3Q	4Q			
Recurring profits	9,066	8,264	7,695	4,348	29,365	7,541	7,697	-	-	28,571	29,907	33,841
YoY%	28.60%	0.40%	1.10%	-26.50%	2.50%	-16.80%	-6.86%	-	-	-2.71%	1.84%	11.30%
3Q to 4Q tot.			12,043					13,333			14,669	-
YoY%			-11.0%					10.7%			21.8%	-
US\$/yen Month end average (actual)	121.9	121.7	121.2	115.4	120.1	106.8	102.3	112.37*	?	?	107.2**	110**

Yen appreciated by 19%

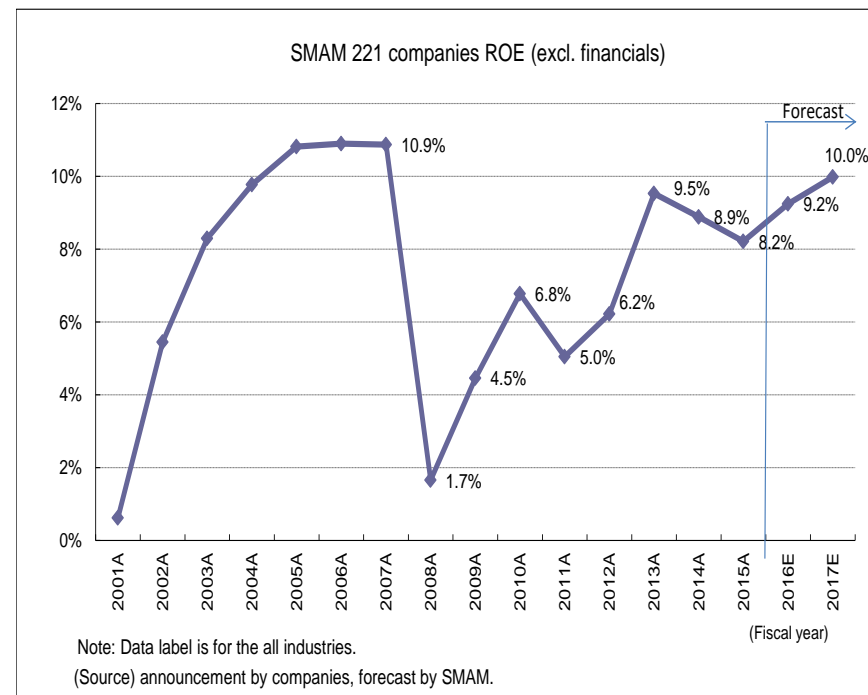
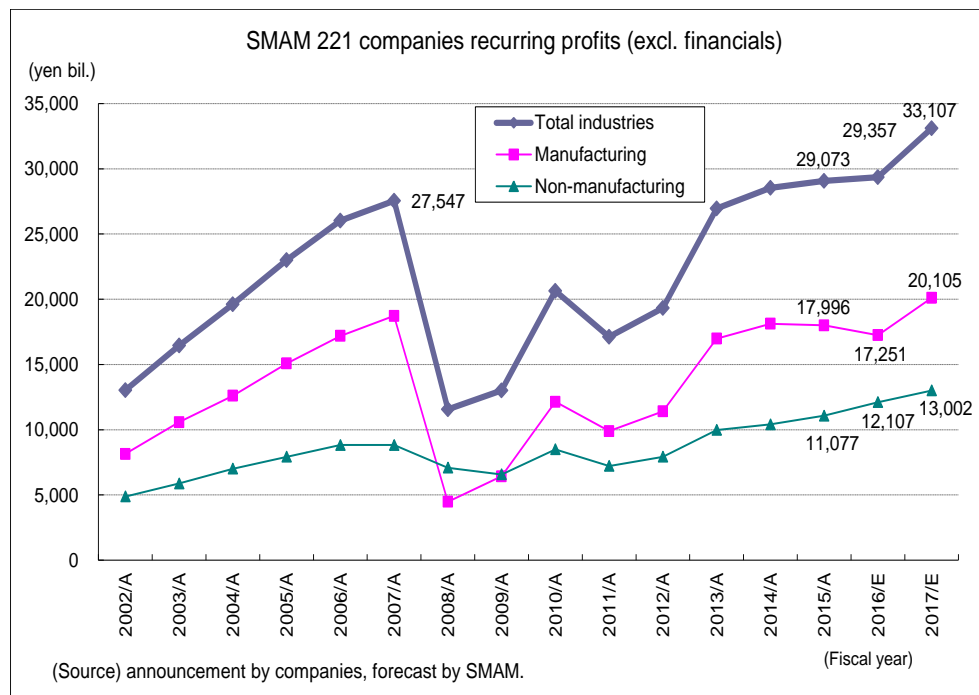
\*As of Dec20th      \*\*Assumption for SMAM forecast

(Source) Toyo Keizai, announcement of each company, compiled by SMAM

## ROE is on a recovering path to 10% mark expected in 2017

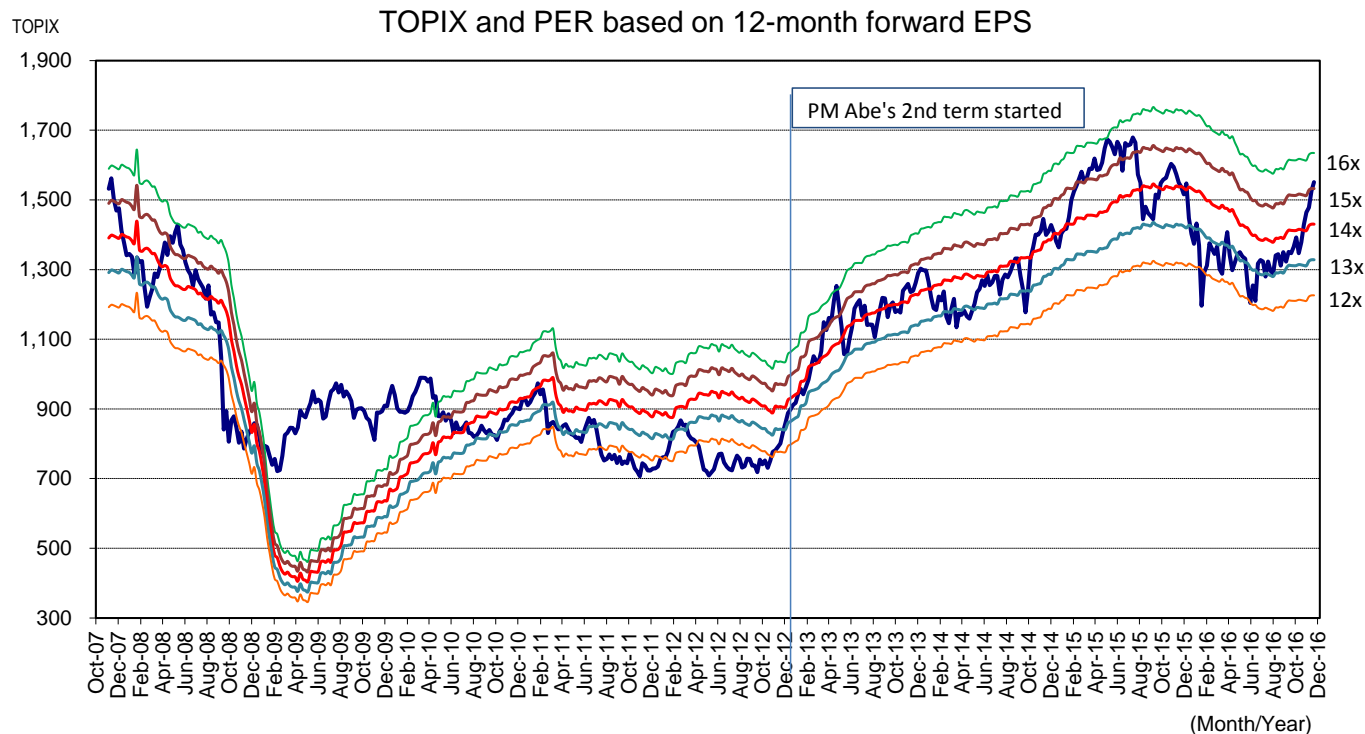
- SMAM forecasts consecutive years of profit growth since FY2013 can be maintained for FY2016 and 17. For FY 2016, profit of Non-manufacturing sector is forecast to grow by 9.3% to offset the decline in Manufacturing sector of -4.1%.
- After falling for 2 consecutive years in FY2014 and 15, ROE is forecast to recover to 9.2% in FY2016 and to reach 10% mark in FY2017.

(Note: \*Numbers are for 221 companies in SMAM research coverage excluding financials.)



## PER (Price Earnings Ratio) seems stretched over 15x

- Since Abenomics started, PER for Japanese stock market, TOPIX index-wise, has been in a range between 12x and 16x except for temporary overshooting.
- As of December 16th, PER for TOPIX was 15.18x based on 12M forward EPS and 14.5x using higher 18M forward EPS. Stock prices might need breathing space to wait for the estimated earnings growth to be actually achieved and earnings forecast to be lifted further.

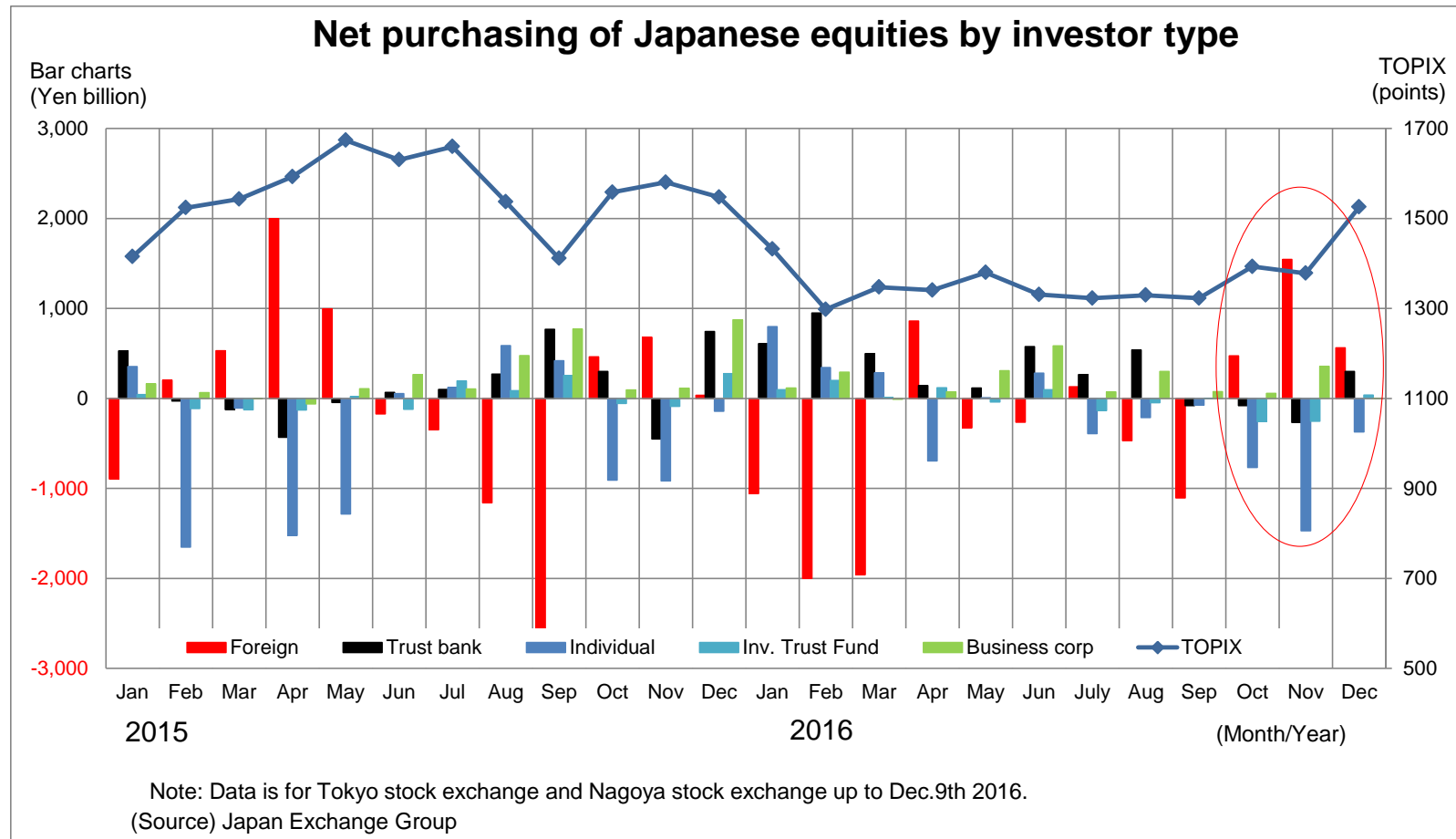


Note: Data is weekly from Oct. 26th 2007 to Dec. 16th 2016. TOPIX was 1550.67 at the end of the period.  
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM



## Foreign investors purchasing continues to lift stock prices

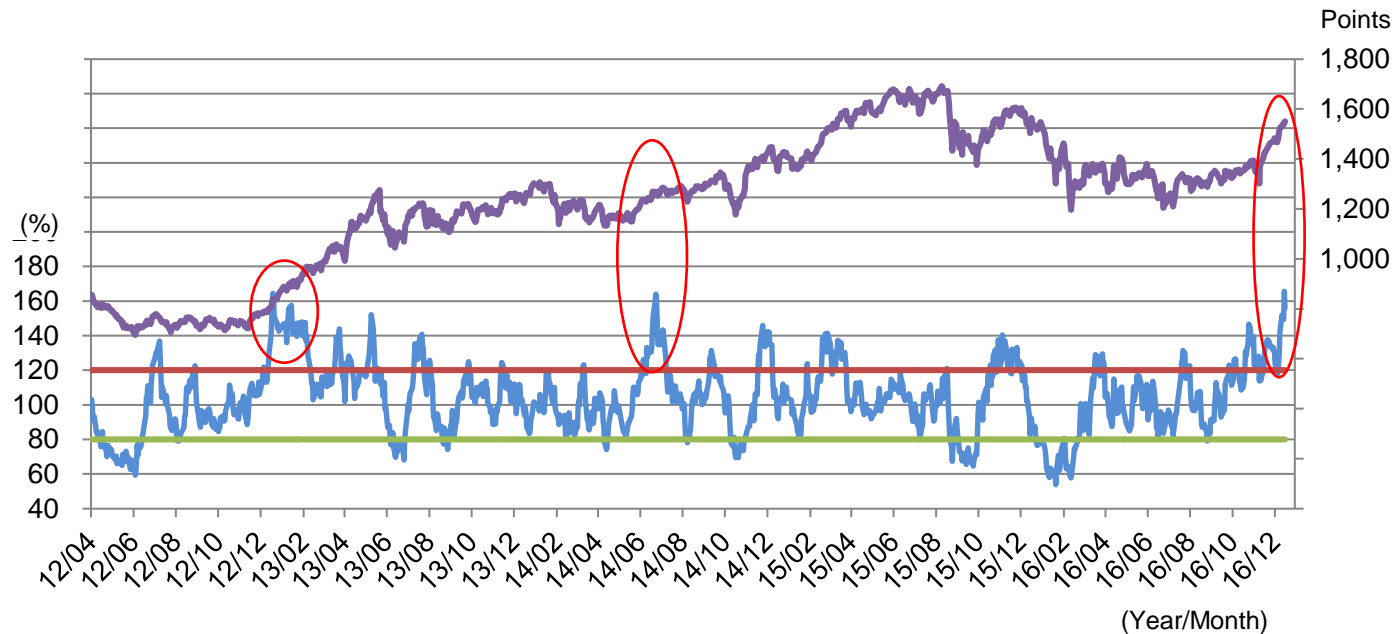
- Foreign investors purchased Japanese stocks by as much as 1.54 trillion yen in November.
- Japanese individual investors were selling Japanese stocks as stock prices recovered.



## Japanese stock market is technically overheated

- Gainers/Losers ratio is regarded as an indicator for the temperature of stock markets. Over 120% typically shows the market is overheated. The ratio went up above 160% on 15<sup>th</sup> December first time since June 2014.
- It's natural to expect for a breathing period for a while, however, in the previous comparable cases in the beginning of 2013 and in June 2014, the stock prices did not take visible breaks while this ratio gradually calmed down.

Gainers/Losers ratio(left axis) and TOPIX(right axis)



Notes Gainers/Losers ratio = No. of stocks with rising share price / No. of stocks with falling share price (%)  
 Source: Tokyo Stock Exchange, SMAM

Up to Dec. 16th 2016

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