



Japanese Stock Market Outlook

SMAM monthly comments & views
- April 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Japanese GDP growth is forecast to be faster than estimated potential growth rate around 0.7%. Recovering both private & public capital investments are going to be main drivers. Despite increasing uncertainties, SMAM assumes Trump policies in US to stimulate US economy and spread positive effects to global economies including Japan.

- Abe government is taking initiative of changing working practice in Japan. Limiting monthly overtime to be less than 60 hours is one of the main targets. It has potentially both positive and negative implications for Japanese economy.
- Core CPI returned to a positive territory in January rising by 0.1% YOY. BOJ is holding its extra-easy monetary policies and expected to do so during 2017, however, tapering could gradually come in sight. Purchasing pace of Japanese Government Bonds is expected to decline due to a shortage of circulating issues.

➤ Japanese Stock Markets

Japanese equities will be supported by improving fundamentals in the long-term. Double digit profit growth expected for FY2017 will make the valuation of Japanese stock market attractive. Focal points are such as fate of Trump policies, major elections in Europe and how working practice reform in Japan could affect the sentiment and activities of companies and people in Japan.

- After examining 3QFY2016 results announced by companies, SMAM revised earnings forecasts upwards in March. Compared to the forecast in December, recurring profit forecast was raised from previous +1.8% to +2.2% for FY2016, and from +13.2% to +16.4% for FY2017. Presumption for foreign exchange rates were increased by 5 yen each for US\$ and EUR.

Notes: Macro and market views are as of Mar. 15th and 17th, 2017 respectively, and subject to updates thereafter without notice

Outlook for Japanese Economy

SMAM economic outlook for FY16-18

- SMAM's GDP growth forecast was unchanged from the last month.
- Japanese GDP growth is forecast to be faster than estimated potential growth rate around 0.7%. Recovering both private & public capital investments are going to be main drivers.
- Despite increasing uncertainties, SMAM assumes Trump policies in US to stimulate US economy and spread positive effects to global economies including Japan.

(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%	0.6%	0.5%	0.6%
Private Housing Investment	8.3%	-9.9%	2.7%	6.1%	0.5%	1.0%
Private Capital Investment	7.0%	2.4%	0.6%	2.5%	2.4%	2.1%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.8%	1.1%	0.8%
Public Capital Investment	8.6%	-2.1%	-2.0%	-2.1%	3.7%	0.2%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.2%	0.6%	0.3%	0.2%
Exports	4.4%	8.8%	0.8%	2.6%	3.7%	2.4%
Imports	7.1%	4.2%	-0.2%	-1.0%	1.6%	1.4%
Nominal GDP	2.6%	2.1%	2.8%	1.3%	1.7%	1.6%
GDP Deflator	0.0%	2.5%	1.4%	0.1%	0.6%	0.7%
Industrial Production	3.0%	-0.4%	-1.4%	1.4%	3.4%	2.5%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.7%	0.7%

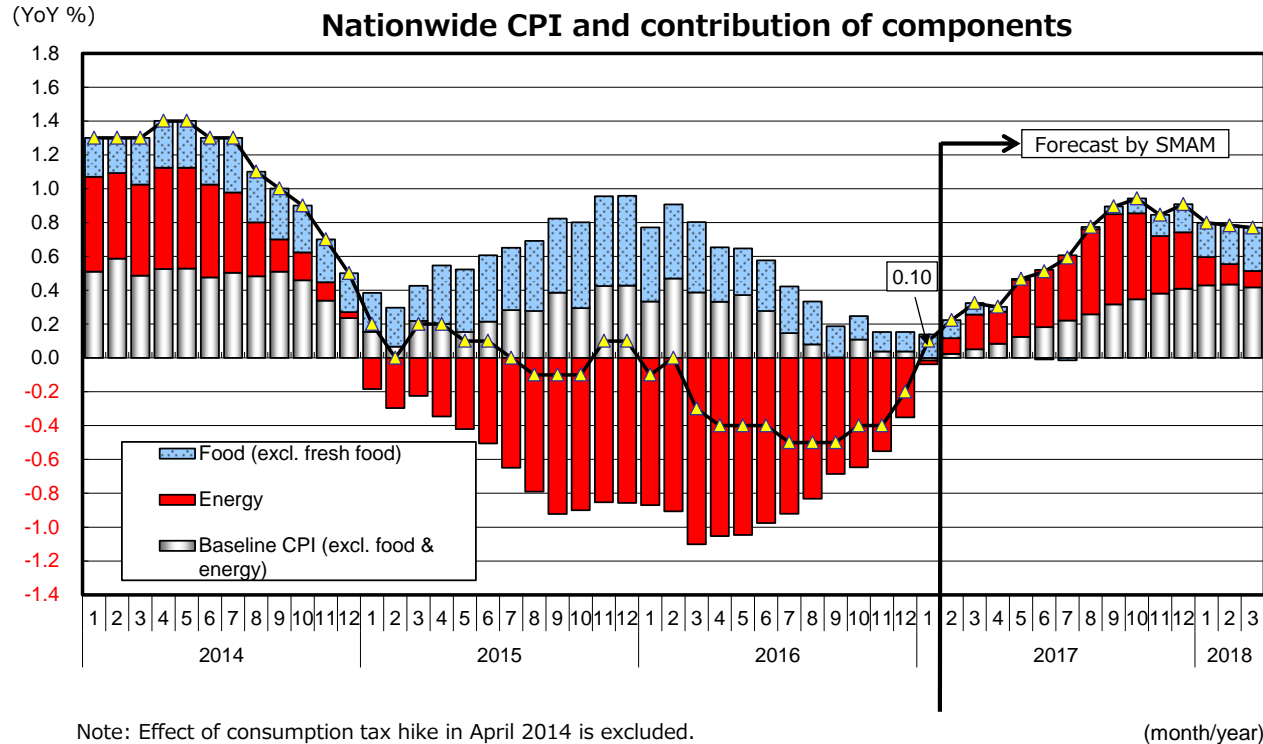
Notes: E=SMAM forecasts. SMAM views are as of Mar. 15th, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

Baseline CPI is forecast to climb to 1% level in late 2017

- Core CPI returned to a positive territory in January rising by 0.1% YOY.
- BOJ is holding its extra-easy monetary policies and expected to do so during 2017, however, tapering could gradually come in sight. Purchasing pace of Japanese Government Bonds is expected to decline due to a shortage of circulating issues.

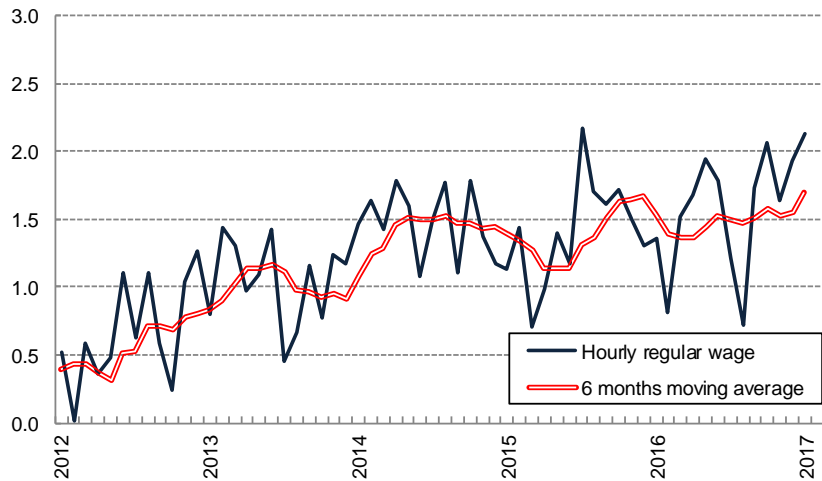


(Source) Ministry of Internal Affairs & Communications

Already severe labor shortage might be getting even more serious

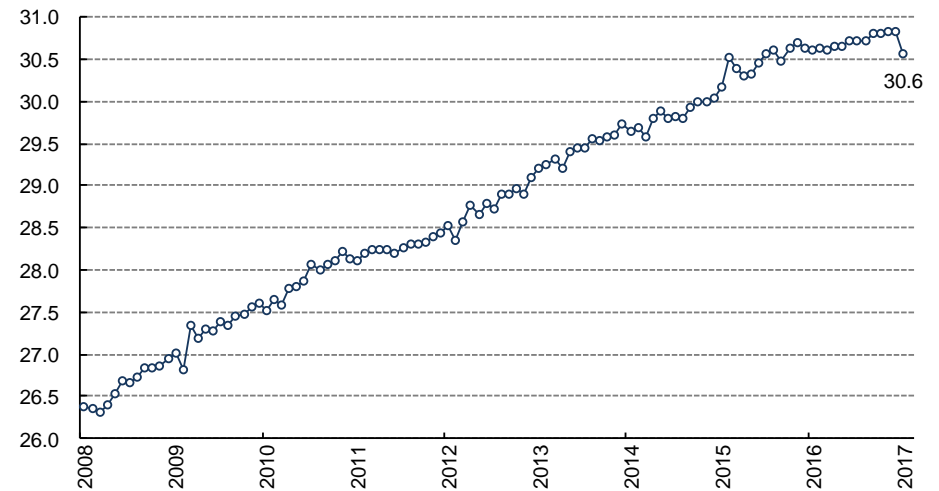
- Companies have increased part time workers responding to improving business demands.
- Part time workers ratio snapped down recently. This might be indicating that reservoir of labor supply is gradually drying out.
- Significant wage increase might be imminent, which could substantially lift the inflation in Japan.

Part time workers, regular wage (YOY %)



Note: Data is monthly from Jan. 2012 to Jan. 2017. (Year)
 (Source) Ministry of Health, Labour & Welfare, compiled by SMAM.

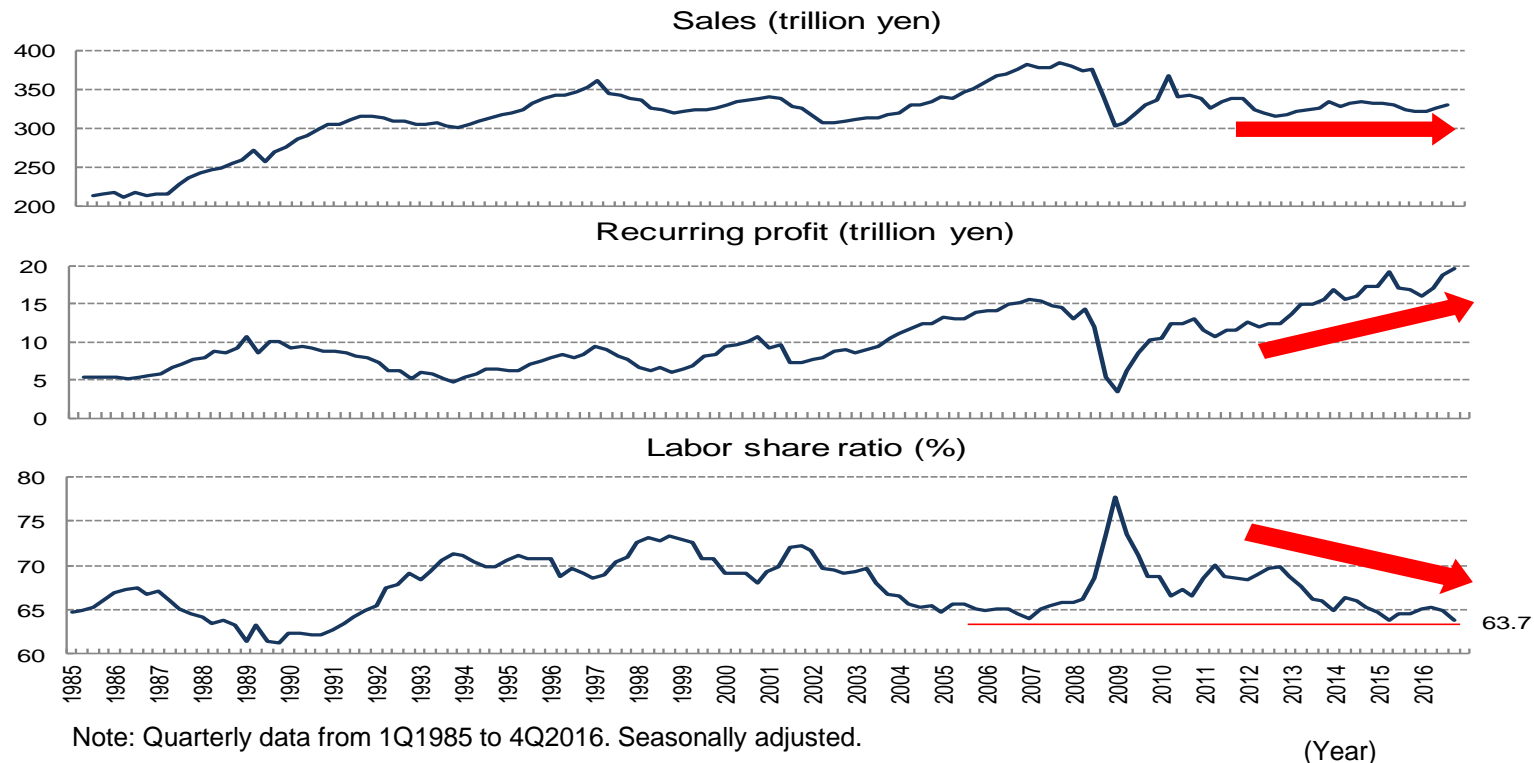
Part time workers ratio (seasonally adjusted %)



Note: Data is monthly from Jan. 2008 to Jan. 2017. (Year)
 (Source) Ministry of Health, Labour & Welfare, compiled by SMAM.

Rising wage pressure will be beneficial for the Japanese economy

- Rising wage could be negative for the profitability of Japanese companies.
- However, workers have not been rewarded enough despite the profit recovery to the historical record level. Labor share ratio stays very low, which is one of the major reasons behind the lackluster private consumption.
- The benefit of stimulating private consumption is expected to be larger than the negative impact on companies when considering overall Japanese economy.



Note: Quarterly data from 1Q1985 to 4Q2016. Seasonally adjusted.

(Source) Ministry of Finance, corporate statistics

Working practice reform in Japan

- Abe government is taking initiative of changing working practice in Japan. Limiting monthly overtime to be less than 60 hours is one of the main targets.
- It has potentially both positive and negative implications for Japanese economy.
- Positive implications are; a) increase in efficiency and productivity of labor and b) stimulating private consumption with increased leisure time. Negative implications are; 1) cut in business hours, 2) reduction of household overtime income and 3) increase in labor cost of employers.

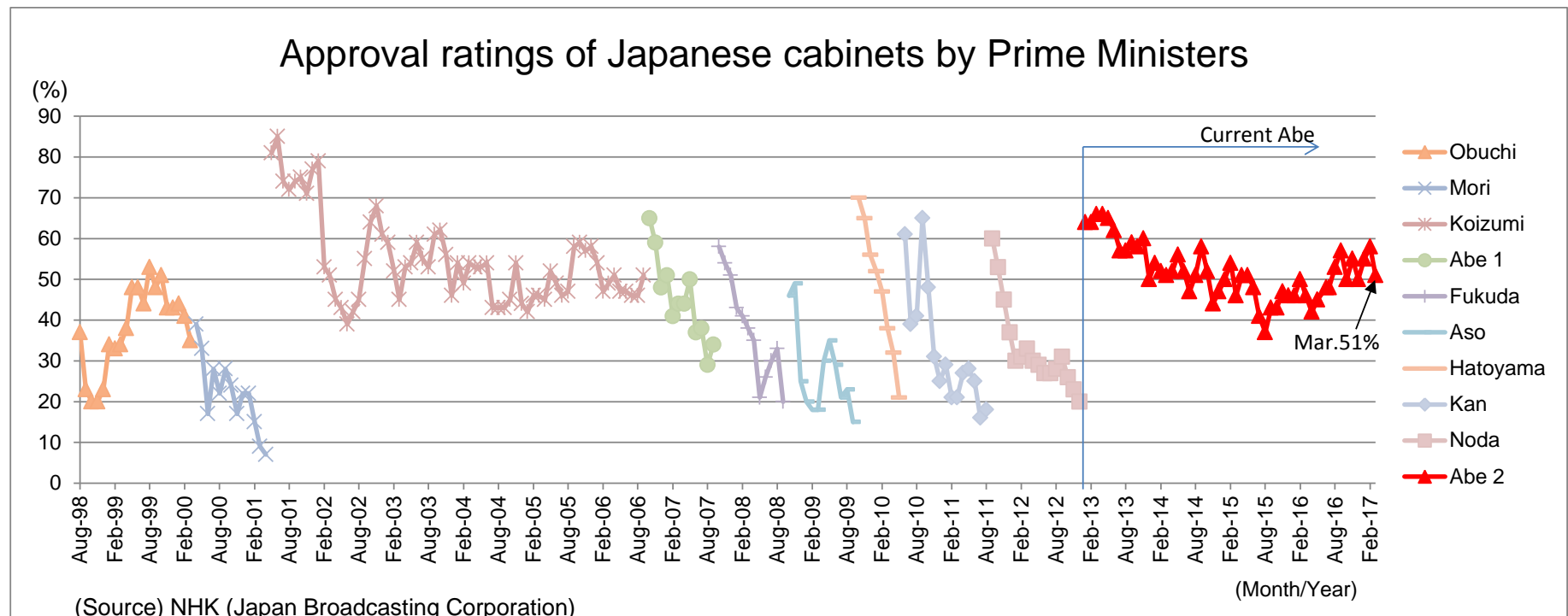
Industries	% of workers experiencing over 60h/month overtime in 2016
Agriculture&Forestry	15.3
Construction	15.3
Manufacturing	10.6
Electricity, Gas&Water	6.9
Information&Communication	11.6
Transportation&Postal service	24.0
Retail& Wholesale	12.2
Financials	8.7
Property&Leasing	9.7
Academic research & service	12.7
Hotel, Restaurants	15.1
Entertainment	15.0
Education	14.7
Medical&Welfare service	5.8
Public	10.9
All industries	11.9

- *Hard overtime working practice is found in labor intensive industries.*
- *Especially, Transportation & Postal service is in a severe labor shortage in the face of a huge increase in deliveries due to thriving e-commerce sales.*
- *As much as 11.9% of the total workers experienced more than 60 hours/ month of overtime work in 2016.*

(Source) Ministry of Internal Affairs & Communications

Current National Diet session is hampered by a minor looking “Moritomo scandal”

- Much of the current National Diet session has been wasted on debates over “Moritomo scandal”, an allegation for PM Abe and his wife to have influenced a selling of a nationally owned land to Moritomo School, with which they seem to have some private relationship.
- At the moment, it is unlikely that this scandal would make a fatal blow to Abe government . The approval rating for Abe cabinet retreated a little down to 51%.



Political events should gather attention in 2017

- In the US, Obama Care reform bill was withdrawn before the lower house voting in the face of opposition among republicans. Clouds have darkened on Trump fiscal policies.
- Europe is going to face important events such as notification of Brexit, elections in France, Germany and other countries.

Schedule of key events in 2017

Month	Region/Country	Events	Notes
March	US	The Budget Message of The President	Only the outline was released. Obama care reform was withdrawn.
	Japan	Convention of the Liberal Democratic Party	Maximum consecutive party leadership was extended to 3 terms.
		Spring wage negotiations	Base pay rise is going to be lower than in 2016.
		Budget for FY2017 to be approved	
		Action plan for changing working practice	Limit the monthly overtime. Encourage people to leave office early and spend.
	Netherlands	General election	Feared surge of right wing was avoided.
UK	Notification of exiting EU	What kind of a deal UK can extract from EU?	
April	Japan	BOJ Tankan business report	
		BOJ perspective report	
	US	(28th) Temporal budget for 2017 needs renewal	Can President trump & US congress work together?
Apr & May	France	Presidential election	
June	Japan	Ordinary Session of National Diet ends	
	Japan	Election for the Tokyo Metropolitan Assembly	
	France	Lower house election	
July	Global	G20 meeting	
August	Germany	General election	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

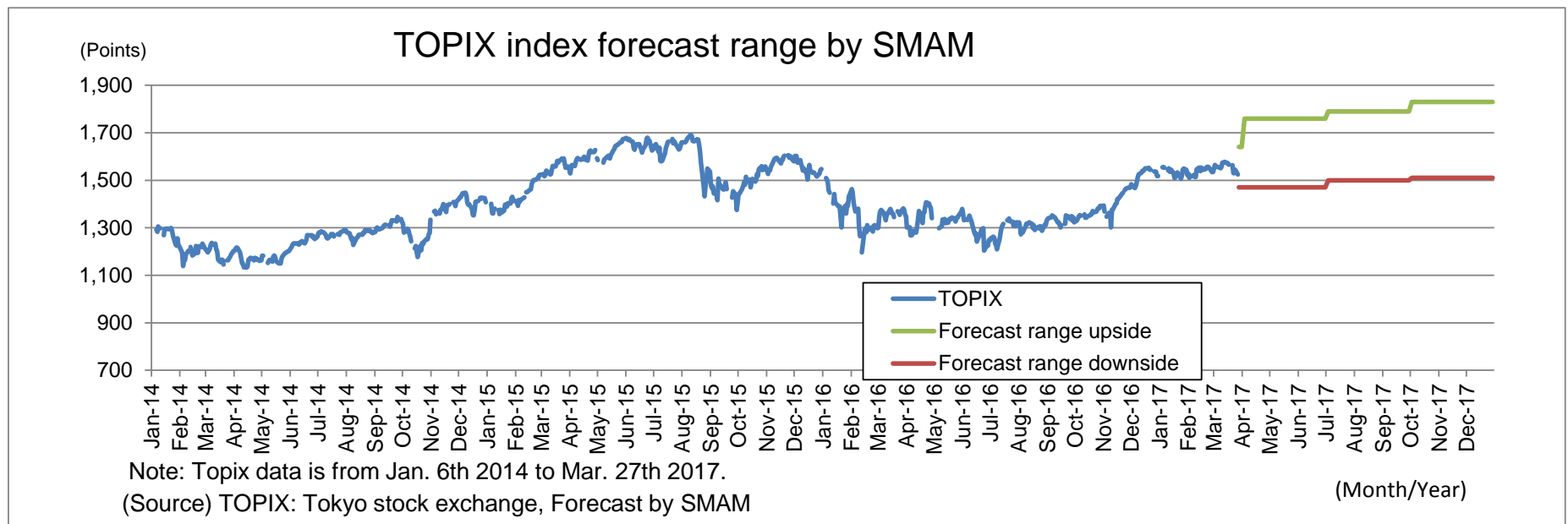
Stock market outlook: Waiting for the real Trump policies to take shape

SMAM short-term view

- Chinese economy is getting firmer and US is growing solidly. Global economy is growing at a stronger pace than forecast, which should support the stock market to gradually move up. Expected tough negotiation of fiscal policies between Trump White House and US congress will be a source of volatility for the stock market.

Longer-term outlook (6-months and beyond)

- Japanese equities will be supported by improving fundamentals in the long-term. Double digit profit growth expected for FY2017 will make the valuation of Japanese stock market attractive. Focal points are such as fate of Trump policies, major elections in Europe and how working practice reform in Japan could affect the sentiment and activities of companies and people in Japan.



Note: SMAM's projection is as of Mar. 17th, 2017 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Practical Trump trade policies are made and serious trade disputes can be avoided.
 - Expansionary policies in US keep global economies on a 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\$.
 - Further fiscal stimulus will be made and extra easy monetary policy should sustain economic growth in Japan.

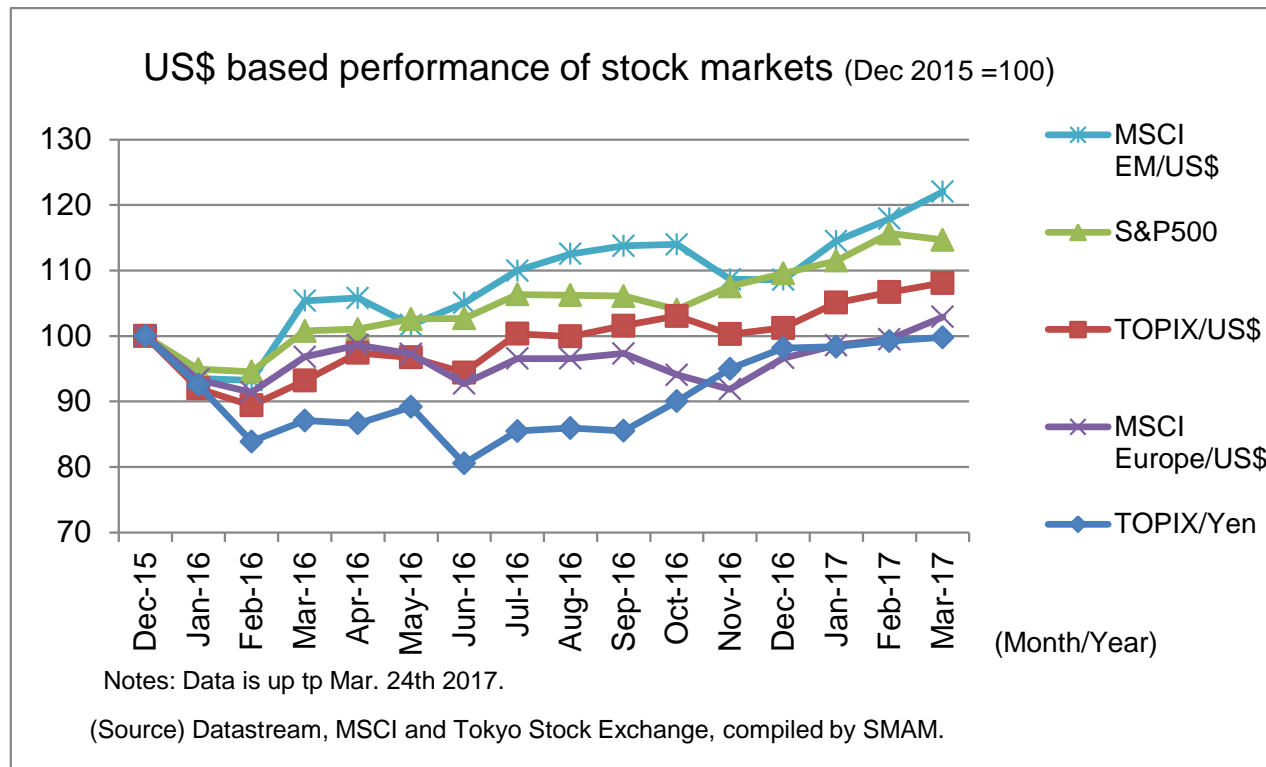
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

- **Downside Risks** include:
 - Confrontational foreign policies taken by Trump presidency shake global trades.
 - Trump policies for stimulating US economy fail to pass US congress.
 - Populism gains in Europe further destabilizing EU.
 - Heightening geo-political tensions in Middle East & East Asia.
 - Rekindled concern over emerging economies including China.
 - "Moritomo scandal" makes a fatal blow to PM Abe.

Note: SMAM's projection is as of Mar. 17th, 2017 and subject to updates without notice.

Emerging stock markets continue to rise supported by recovering Chinese economy

- US stock market retreated a little in March on uncertainties surrounding US fiscal policies.
- Emerging market showed a solid performance, Japan and Europe also gained in March.



SMAM raised earnings forecast for FY 2016 and FY2017

- After examining 3QFY2016 results announced by companies, SMAM revised forecasts upwards in March.
- Compared to the forecast in December, recurring profit forecast was raised from previous +1.8% to +2.2% for FY2016, and from +13.2% to +16.4% for FY2017. Presumption for foreign exchange rates were increased by 5 yen each for US\$ and EUR.

SMAM Corporate Earnings forecasts (221 Companies research coverage excl. financials)

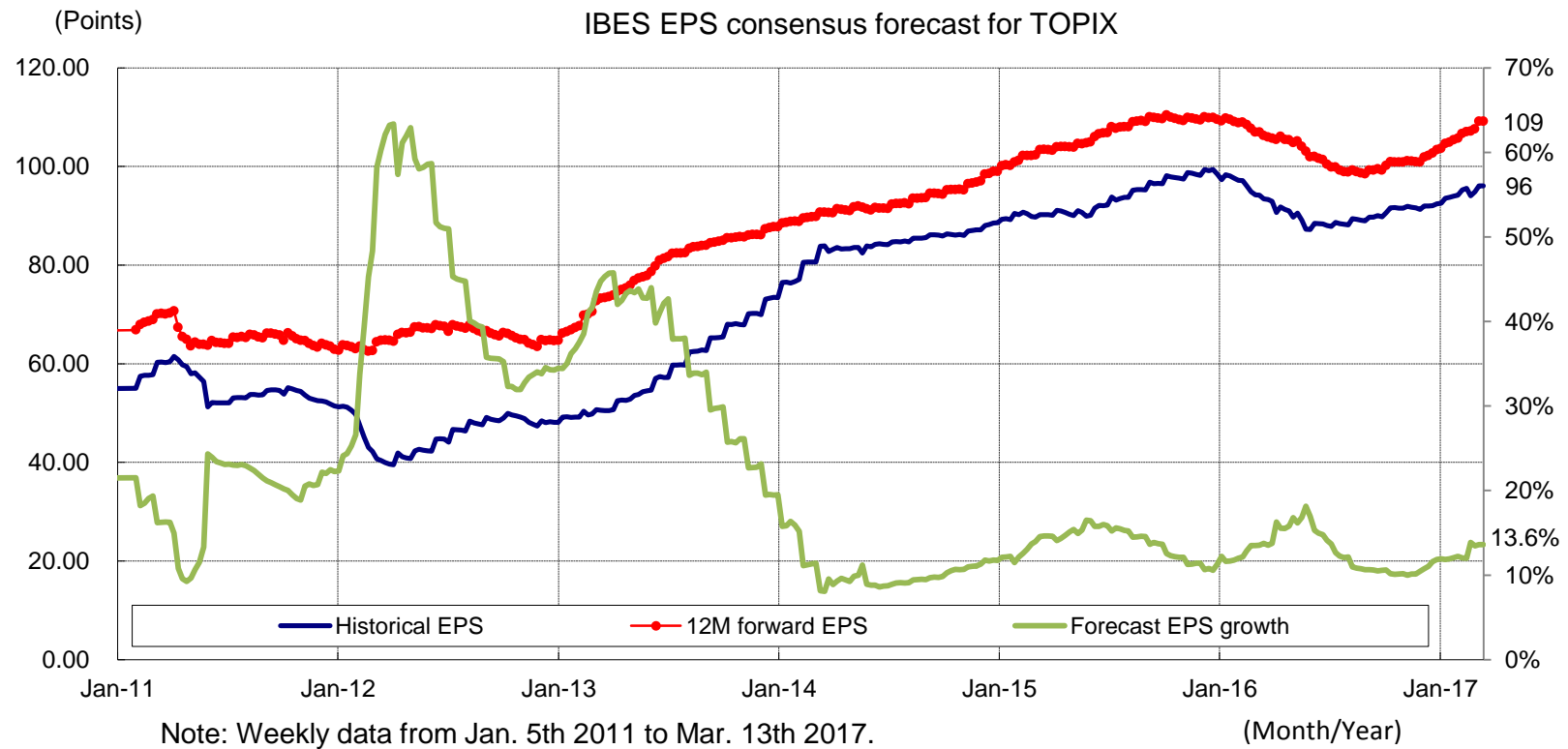
Fiscal year	FY 2014	FY 2015	FY 2016E	FY 2017E
Date of forecast	Actual	Actual	as of 15th Mar 2017	as of 15th Mar 2017
Revenue (YoY %)	3.9%	0.1%	-3.1%	5.3%
Operating Profits (YoY %)	3.1%	9.1%	-2.4%	15.7%
Recurring Profits (YoY %)	4.5%	2.5%	2.2%	16.4%
Net Profits (YoY %)	5.4%	-3.2%	12.6%	17.2%
Recurring profits (YoY %)				
Manufacturing 137 companies	4.1%	0.2%	2.3%	21.7%
Non-manufacturing 84 companies	5.2%	6.5%	6.7%	9.0%

Note:Key assumptions for the forecasts, Yen/US\$ 115, Yen/EUR 120, Crude oil \$55/barrel

(Source) SMAM

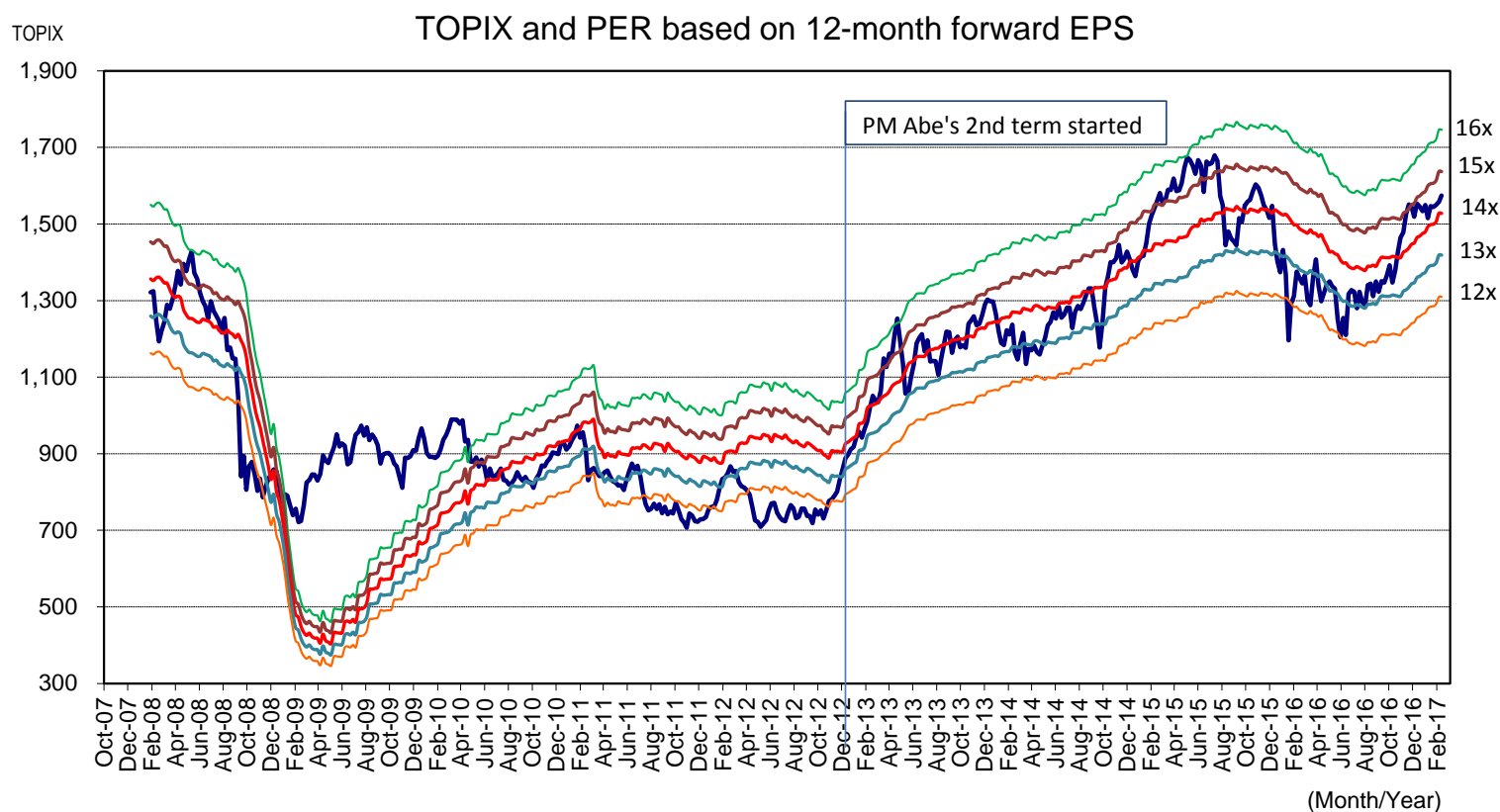
EPS forecasts by analysts continue to expand

- Latest 12M forward EPS forecast is over 109, and it is less than 1 point from the highest level reached in December 2015.
- 13.6% EPS growth is forecast in the coming 12 months.



PER (Price Earnings Ratio) at 14x looks not too expensive

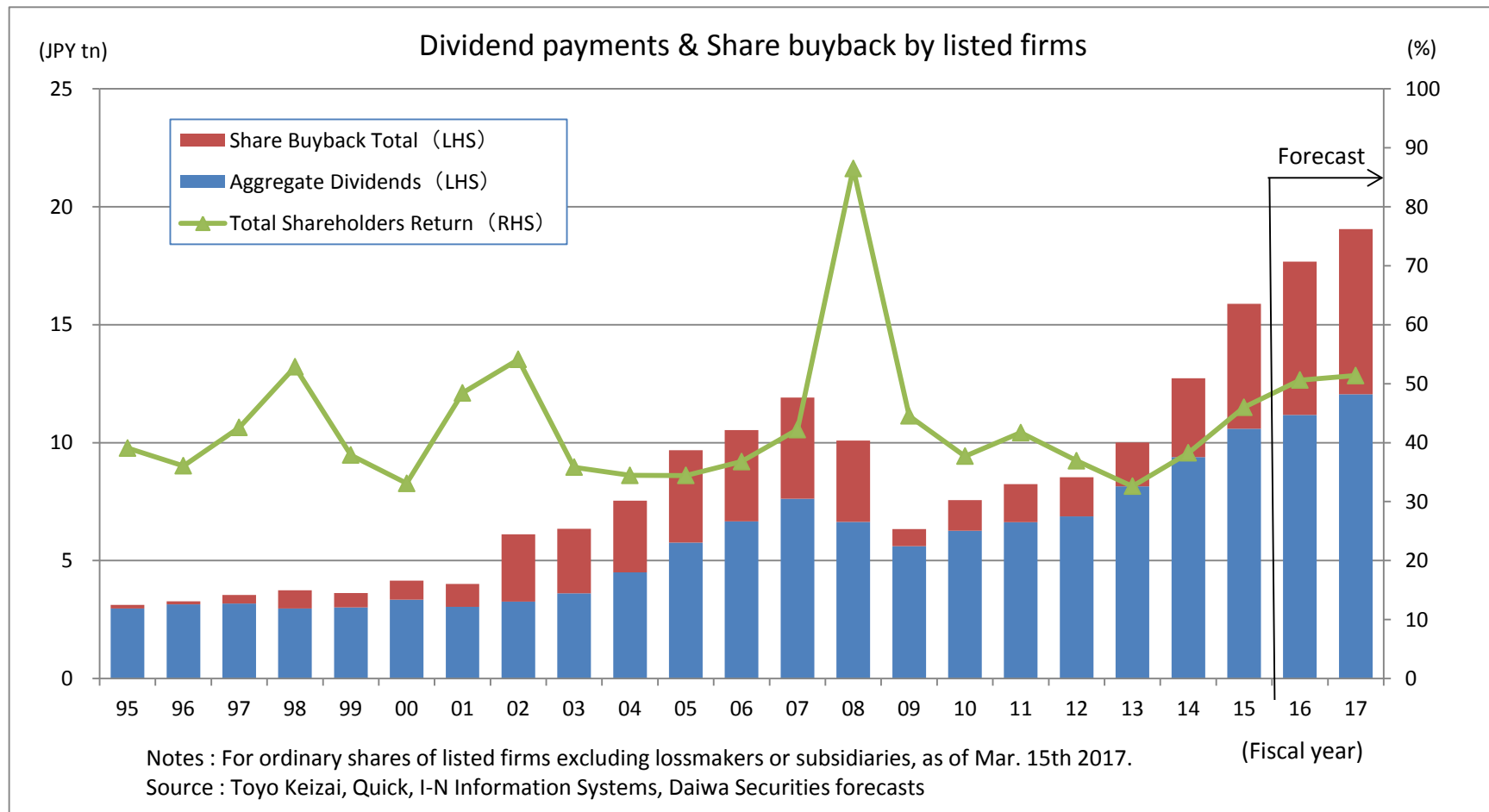
- Based on 12M forward EPS of 109, TOPIX level corresponding to 14x is 1526, 15x is 1635 and 16x is 1744.
- Japanese stock market valuation in TOPIX is at the middle of the range between 12x and 16x after PM Abe's second term began.



Note: Data is weekly from Oct. 26th 2007 to Mar. 10th 2017. TOPIX was 1574.01 at the end of the period.
 (Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

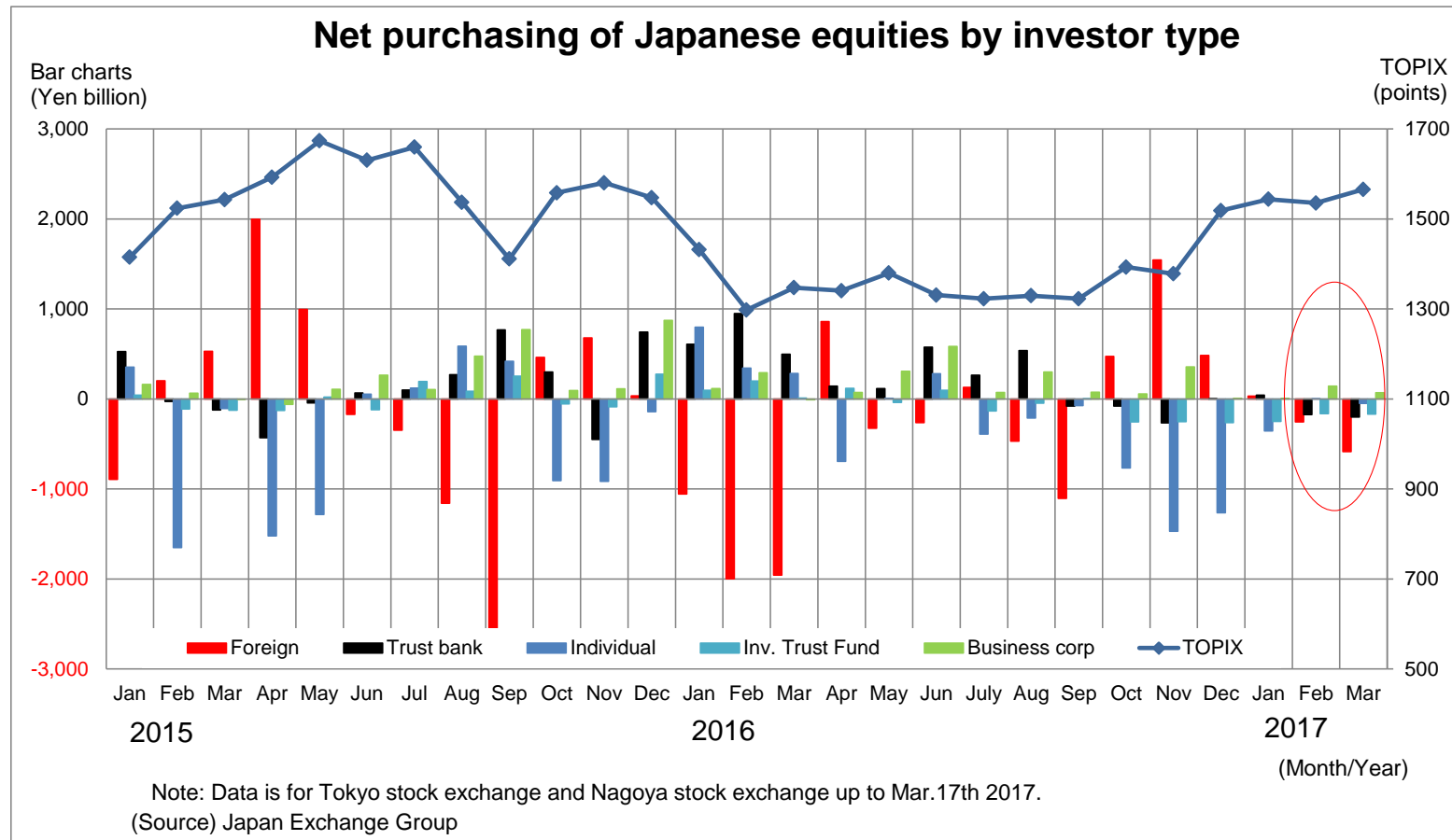
Corporate governance & shareholder returns are making a solid gain

- Total shareholder return ratio is forecast to rise above 50% in FY 2016.



Foreign investors turned to sellers in February and March.

- After the Trump rally, investors are waiting for how the real Trump policies can be negotiated in US congress.



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