



Japanese Stock Market Outlook

SMAM monthly comments & views

- September 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

SMAM's headline GDP forecasts were revised upward from 1.4% in the previous month to 1.8% in August. This was due to Apr-Jun quarterly GDP coming out very strong at 4% QoQ annualized. All economic sectors are forecast to make positive contributions in FY2017.

- After a robust industrial production growth of 1.9% in 2Q, it is forecast to grow even faster by 2.5% in Jul-Sep quarter (QoQ %, seasonally adjusted) led by very strong production growth of Machinery and Electronic parts & devices.
- Approval rating for the Abe cabinet recovered a little from 32% in July to 35% in August. Probably, Japanese people are getting bored of news papers and TV dwelling too much on scandals surrounding PM Abe. A reshuffle was made for the cabinet bringing in experienced members, which was taken positively by the Japanese people in general.

➤ Japanese Stock Markets

Japanese stock market will be weighed on by uncertainties of US politics and North Korean conflicts for a while. Unless the situation surrounding North Korea escalates to a military confrontation, the current risk-off mode will recede and investors' focus will turn to the good fundamentals of Japanese economy and corporate earnings.

- Corporate earnings for Apr-Jun quarter were better than expected and analysts have been revising earnings forecast upwards.
- The global economy is expected to grow in a steady undertone. Uncertainties surrounding global stock market will be gradually cleared as Republicans grab the control of US congress over receding power of the White House. Global investors will get back to risk-on mode at some point and the good fundamentals of the Japanese stocks will kick in to drive the Japanese stock market upward.

Notes: Macro and market views are as of Aug. 18th and 22nd 2017 respectively, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-18

- SMAM's headline GDP forecasts were revised upward from 1.4% in the previous month to 1.8% in August. This was due to Apr-Jun quarterly GDP coming out very strong at 4% QoQ annualized. All economic sectors are forecast to make positive contributions in FY2017.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.3%	1.3%	1.8%	0.9%
Private Consumption Expenditure	2.7%	-2.6%	0.6%	0.7%	1.5%	0.5%
Private Housing Investment	8.3%	-9.9%	2.8%	6.5%	2.6%	0.2%
Private Capital Investment	7.0%	2.4%	0.6%	2.4%	4.7%	2.0%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.4%	0.6%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	4.4%	-0.3%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.1%	0.7%	0.1%	0.2%
Exports	4.4%	8.8%	0.7%	3.2%	4.0%	2.4%
Imports	7.1%	4.3%	0.2%	-1.4%	3.4%	1.4%
Nominal GDP	2.6%	2.0%	2.7%	1.1%	2.0%	1.5%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	0.1%	0.6%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	4.3%	2.2%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.6%	0.8%

Notes: E=SMAM forecasts. SMAM views are as of Aug. 18th, 2017 and subject to updates thereafter without notice

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

(%, YoY except Net Exports)

SMAM quarterly GDP forecast for FY17-18

- Recently released Apr-Jun 2017 GDP was robust 4% QoQ (annualized). GDP numbers in the past 1 year were revised significantly upwards showing strong fundamentals for the Japanese economy.

		2016			2017		Forecast by SMAM		2018			
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
Real GDP (QoQ annualized)	latest	1.4%	1.3%	1.7%	1.5%	4.0%	0.4%	1.2%	0.7%	0.6%	1.2%	1.1%
	previous month	1.6%	1.0%	1.4%	1.0%	2.6%	0.9%	1.2%	0.7%	0.6%	1.2%	1.1%
Private Consumption (%QoQ)	latest	0.1%	0.4%	0.1%	0.4%	0.9%	0.0%	0.2%	0.2%	0.1%	0.2%	0.2%
	previous month	0.2%	0.4%	0.0%	0.3%	0.6%	0.1%	0.2%	0.2%	0.1%	0.2%	0.2%
Private Housing Investment (%QoQ)	latest	3.2%	2.8%	0.3%	0.9%	1.5%	-0.5%	0.1%	0.1%	0.1%	0.1%	0.1%
	previous month	3.1%	2.6%	0.2%	0.3%	0.0%	-0.2%	0.2%	0.2%	0.2%	0.2%	0.3%
Private Capital Investment (%QoQ)	latest	0.7%	0.0%	2.2%	0.9%	2.4%	0.2%	0.5%	0.4%	0.5%	0.5%	0.6%
	previous month	1.3%	-0.2%	1.9%	0.6%	1.0%	0.2%	0.5%	0.4%	0.5%	0.5%	0.6%
Public Investment (%QoQ)	latest	-0.8%	-0.8%	-2.5%	0.6%	5.1%	1.0%	0.5%	-2.3%	-1.0%	1.7%	1.2%
	previous month	0.7%	-1.3%	-3.0%	-0.1%	4.0%	3.5%	0.5%	-2.3%	-1.0%	1.7%	1.2%
Net Exports (Contribution to GDP)	latest	0.1%	0.4%	0.3%	0.1%	-0.3%	0.0%	0.1%	0.0%	0.0%	0.1%	-0.0%
	previous month	0.0%	0.3%	0.3%	0.1%	-0.2%	-0.0%	0.1%	0.1%	0.0%	0.1%	-0.0%
Exports (%QoQ)	latest	-0.9%	2.1%	3.1%	1.9%	-0.5%	0.5%	0.9%	0.5%	0.6%	0.8%	0.3%
	previous month	-1.4%	1.9%	3.4%	2.1%	0.6%	0.3%	0.9%	0.5%	0.6%	0.8%	0.3%
Imports (%QoQ)	latest	-1.2%	-0.2%	1.4%	1.3%	1.4%	0.3%	0.3%	0.2%	0.4%	0.4%	0.3%
	previous month	-1.1%	-0.2%	1.3%	1.4%	1.5%	0.3%	0.3%	0.2%	0.4%	0.4%	0.3%
Industrial Production (%QoQ)	latest	0.3%	1.6%	1.8%	0.2%	2.1%	0.2%	0.8%	0.5%	0.3%	0.7%	0.7%
	previous month	0.3%	1.6%	1.8%	0.2%	1.9%	0.2%	0.9%	0.7%	0.3%	0.7%	0.7%
Unemployment Rate	latest	3.2%	3.0%	3.1%	2.9%	2.9%	2.7%	2.7%	2.7%	2.6%	2.6%	2.6%
	previous month	3.2%	3.0%	3.1%	2.9%	2.9%	2.7%	2.7%	2.7%	2.6%	2.6%	2.6%
core CPI excl. tax hike effect in Apr.2014	previous month	-0.4%	-0.5%	-0.3%	0.2%	0.4%	0.6%	0.8%	0.8%	0.8%	0.8%	0.7%
	previous month	-0.4%	-0.5%	-0.3%	0.2%	0.4%	0.6%	0.8%	0.8%	0.8%	0.8%	0.7%
GDP Deflator	latest	0.4%	-0.1%	-0.1%	-0.8%	-0.4%	-0.1%	0.3%	0.8%	0.0%	0.8%	0.7%
	previous month	0.4%	-0.1%	0.0%	-0.8%	-1.1%	-0.1%	0.3%	0.8%	0.8%	0.7%	0.7%

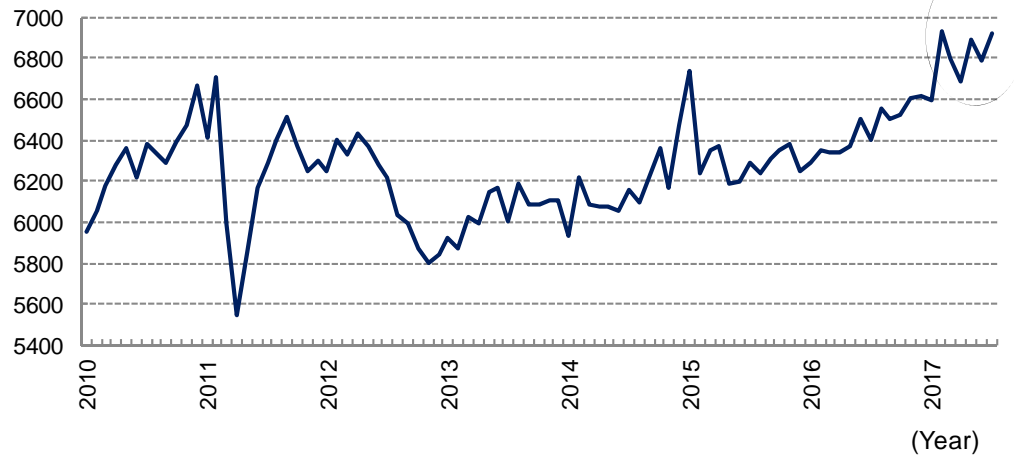
Notes: E=SMAM forecasts. SMAM views are as of Aug. 18th, 2017 and subject to updates thereafter without notice

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

Strong export growth continues to drive the Japanese economy

- Exports to US started to pick up lately meanwhile exports to Asia stays at high level.

Total export volume
(seasonally adjusted, yen billion)



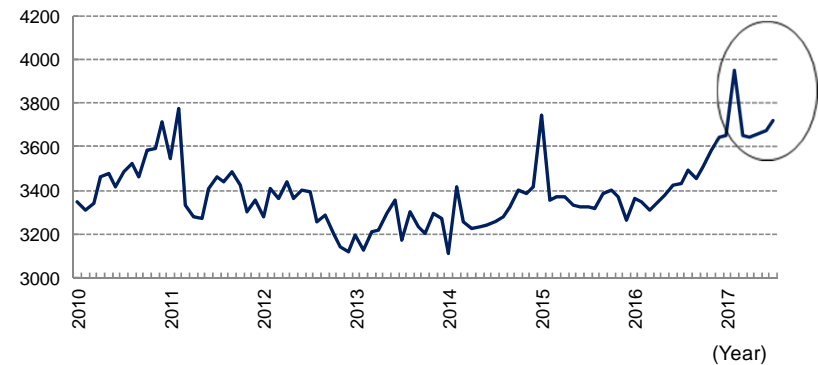
Note: Data is from Jan 2010 to Jul 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Export volume to US
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Jul 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Export volume to Asia
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Jul 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Industrial production is forecast to further accelerate in July-September quarter

- After a robust industrial production growth of 1.9% in 2Q, it is forecast to grow even faster at 2.5% in Jul-Sep quarter. (QoQ %, seasonally adjusted)
- 3Q production is forecast to be very strong for Machinery and Electronic parts & devices.

Industrial production index (seasonally adjusted, % change)

		All Manufacturing industries	Iron and steel	Non-ferrous metals	Fabricated metals	General-purpose, production and business oriented machinery	Electronic parts and devices	Electrical machinery	Information and communication electronics equipment	Transport equipment	Chemicals
QoQ (%)											
2015	1Q	1.2	-1.4	1.7	0.4	2.1	1.6	-0.4	2.9	1.5	1.8
	2Q	-1.4	-3.0	-2.3	-0.7	-0.5	-1.7	-0.8	-1.6	-1.6	-1.4
	3Q	-0.9	-0.8	-0.2	1.1	-4.0	-4.3	-1.9	-4.0	-1.3	3.5
	4Q	0.0	0.0	-2.1	-1.1	-1.6	1.7	1.6	-2.5	2.0	-0.3
2016	1Q	-0.9	-1.2	2.9	1.7	0.0	-5.3	-1.0	3.8	-1.8	-1.2
	2Q	0.2	0.6	0.7	-3.9	0.6	-4.1	-1.0	1.2	1.2	1.4
	3Q	1.5	1.0	0.6	-2.2	1.6	3.8	1.3	3.6	2.7	0.9
	4Q	1.9	1.5	2.7	2.3	3.4	5.3	0.6	-4.0	3.0	1.3
2017	1Q	0.2	0.0	-2.1	1.9	0.8	5.8	-0.4	-5.7	-1.1	1.6
	2Q	1.9	0.5	1.7	-1.4	4.7	1.3	0.7	1.4	3.2	3.1
	3Q forecast	2.5	-0.3	2.3	1.8	6.7	5.9	6.5	0.9	-2.0	0.2
MoM (%)											
2016	6	1.4	0.7	0.8	4.4	0.5	1.6	0.9	0.7	1.1	3.2
	7	0.1	0.3	-1.3	-2.3	0.2	1.6	1.1	0.5	0.6	-0.6
	8	1.3	0.8	2.6	0.0	0.9	3.0	-0.1	7.7	0.1	1.9
	9	0.2	-1.0	0.0	-4.7	2.9	-1.0	0.3	-7.8	2.3	0.6
	10	0.4	1.2	0.5	4.2	-0.4	2.9	-2.6	-0.2	-0.3	-0.7
	11	1.0	0.3	1.3	1.6	2.2	2.3	3.9	1.4	1.8	0.8
	12	0.7	1.5	1.3	0.8	0.4	1.3	1.5	-5.3	1.5	1.2
2017	1	-2.1	-2.0	-6.0	0.1	-1.1	3.5	-4.0	-6.4	-4.9	-3.4
	2	3.1	2.3	3.9	2.2	4.4	3.4	2.5	3.8	4.2	6.4
	3	-1.8	-1.6	0.6	-2.2	-5.9	-4.8	-0.8	4.3	-1.1	-0.4
	4	4.0	3.2	1.4	1.4	8.7	5.2	0.6	-1.3	10.8	1.7
	5	-3.6	-3.2	-2.8	-6.3	-2.6	-1.1	-2.7	-2.8	-13.0	-2.2
	6	1.7	-0.4	1.8	7.1	1.9	-2.6	5.0	1.9	4.2	3.4
	7 forecast	0.8	0.1	1.0	-1.7	2.6	10.0	3.1	-3.1	-1.4	-1.9
8 forecast	3.6	2.0	2.2	2.4	7.3	-3.3	1.8	7.6	3.0	1.4	

Note: Forecast for July and August are officially released data. Forecast for 3Q was made by SMAM based on available monthly forecast data.

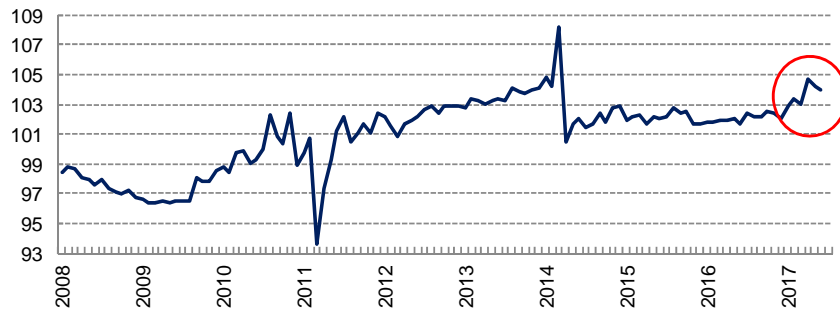
(Source) Ministry of Economy, Trade and Industry, compiled by SMAM.

Private consumption has been gathering strength since the beginning of 2017

- The private consumption has clearly strengthened in 2017.
- As long as no serious negative events such as military confrontation with North Korea break out overseas, solid consumption is expected to continue.

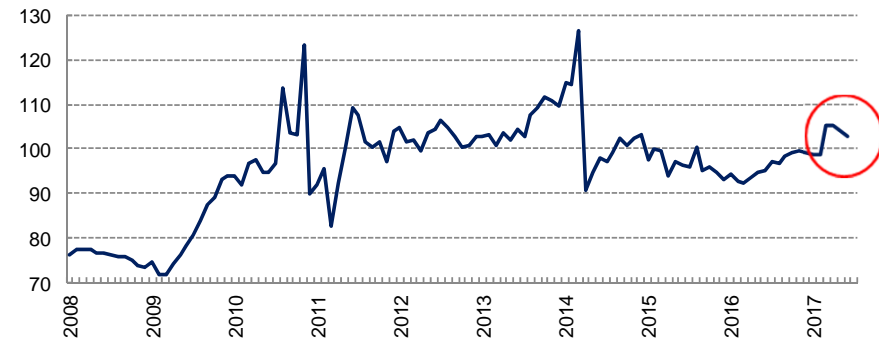
Consumption Activity Index (total)

(2010=100, seasonally adjusted, foreign visitors consumption adjusted)



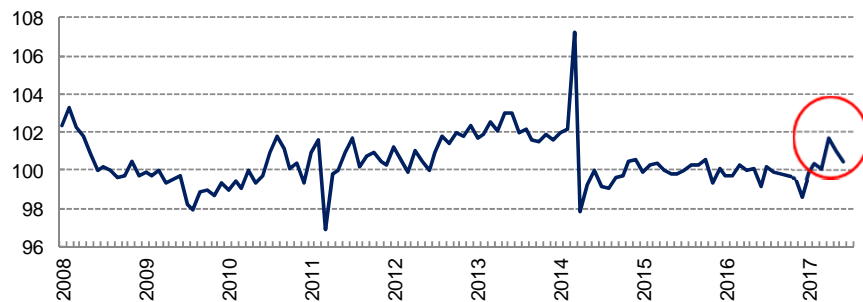
Consumption Activity Index (for durable goods)

(2010=100, seasonally adjusted)



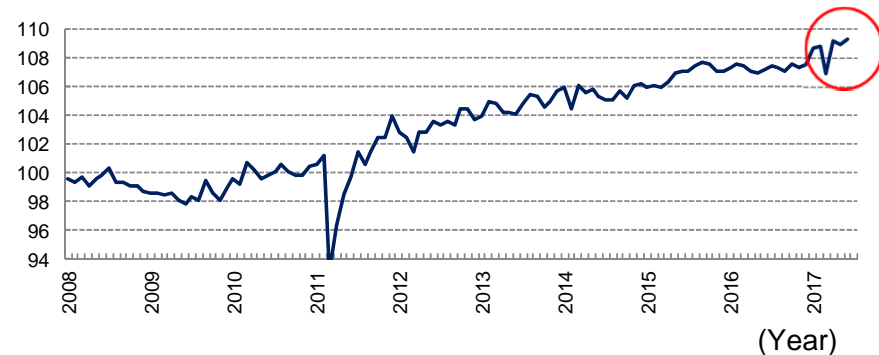
Consumption Activity Index (for non-durable goods)

(2010=100, seasonally adjusted)



Consumption Activity Index (for services)

(2010=100, seasonally adjusted)

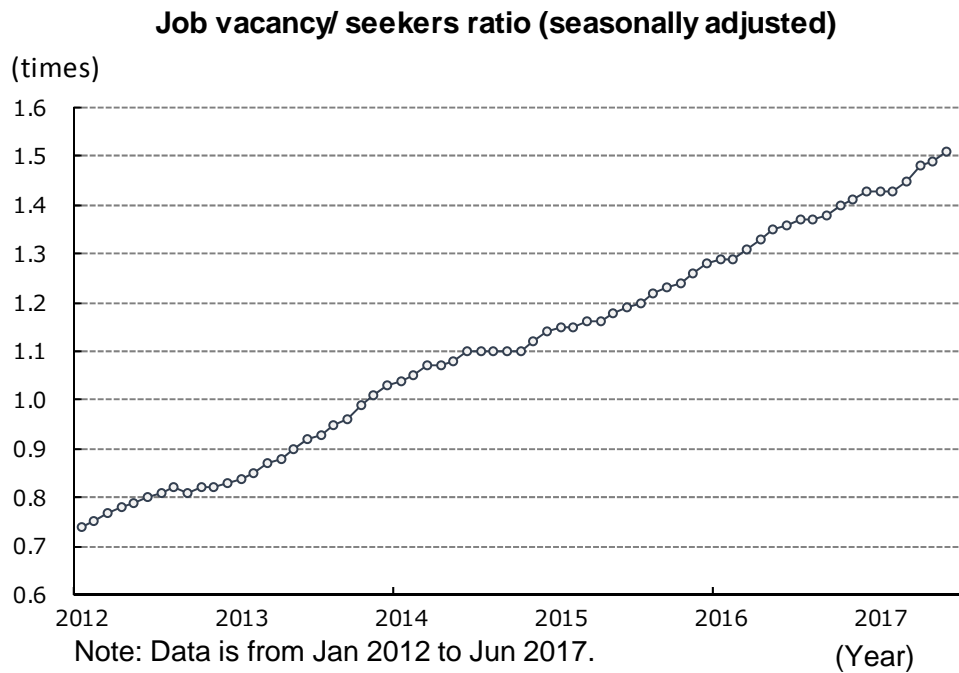


Note: Data is from Jan. 2008 to Jun. 2017

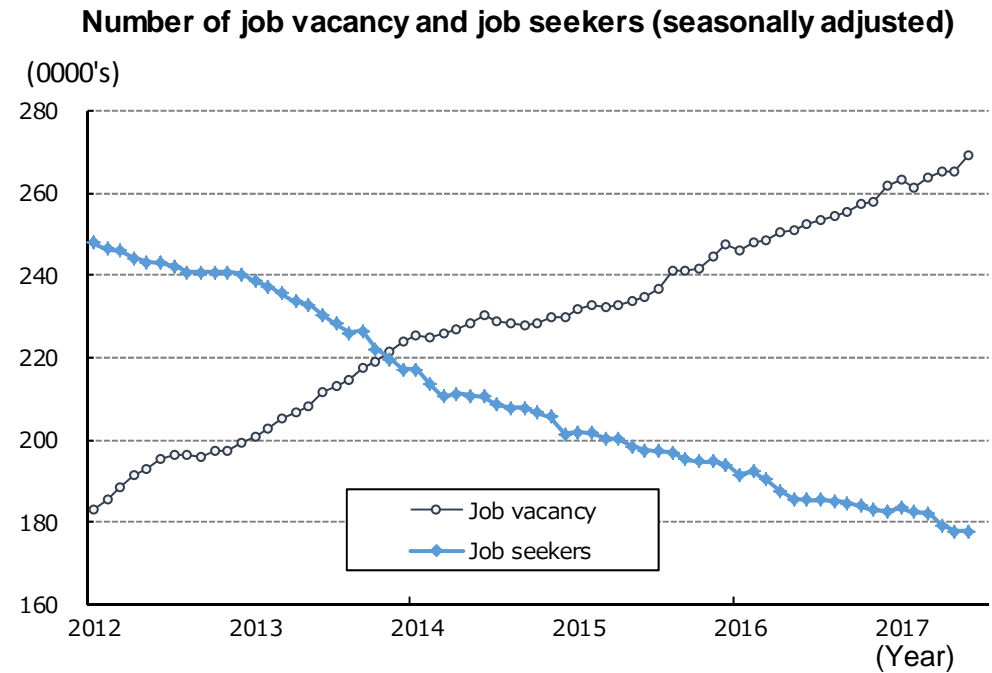
(Source) Bank of Japan

Labor market gets tighter and tighter

- Number of unfilled job vacancy keeps climbing in the face of decreasing number of job seekers.

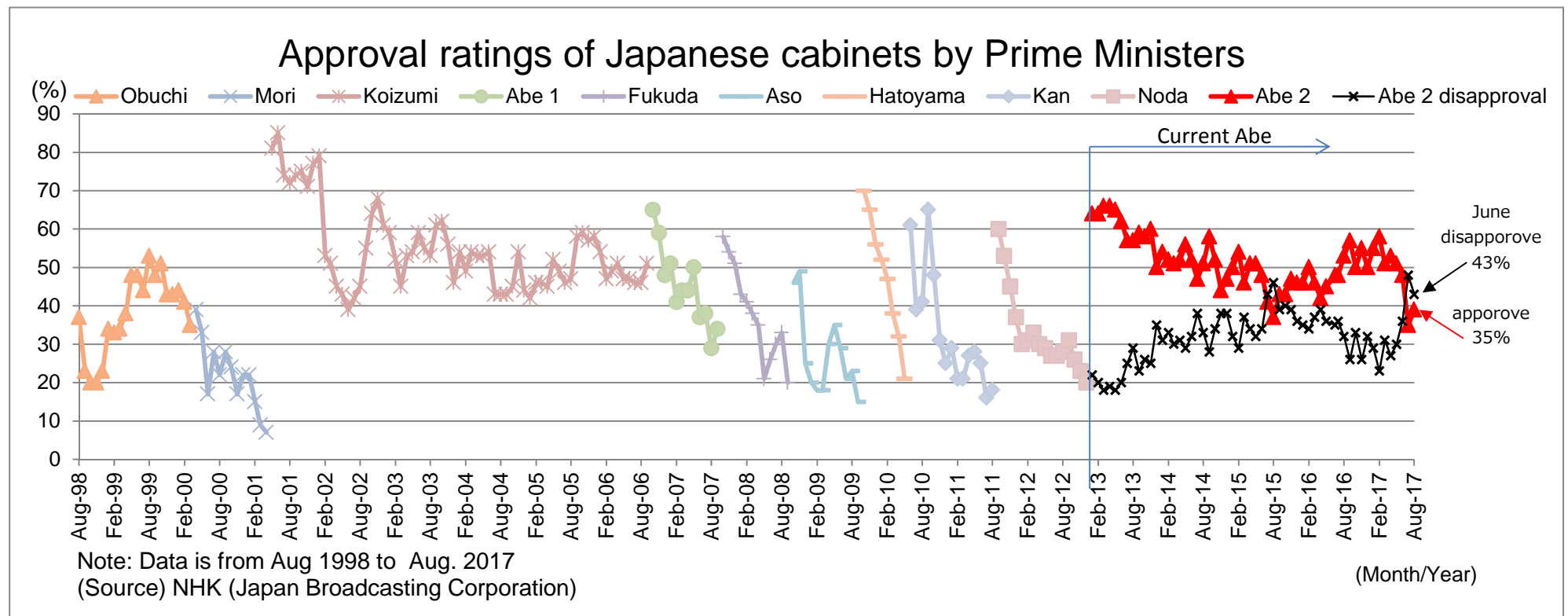


Note: Data is from Jan 2012 to Jun 2017.
(Source) Ministry of Health, Labour and Welfare



Approval rating for Abe cabinet recovered a little in August

- Approval rating for the Abe cabinet recovered a little from 32% in July to 35% in August.
- Probably, Japanese people are getting bored of scandals surrounding PM Abe.
- A reshuffle was made for the cabinet bringing in experienced members, which was taken positively by the Japanese people in general.



Outlook for Japanese Stock Markets

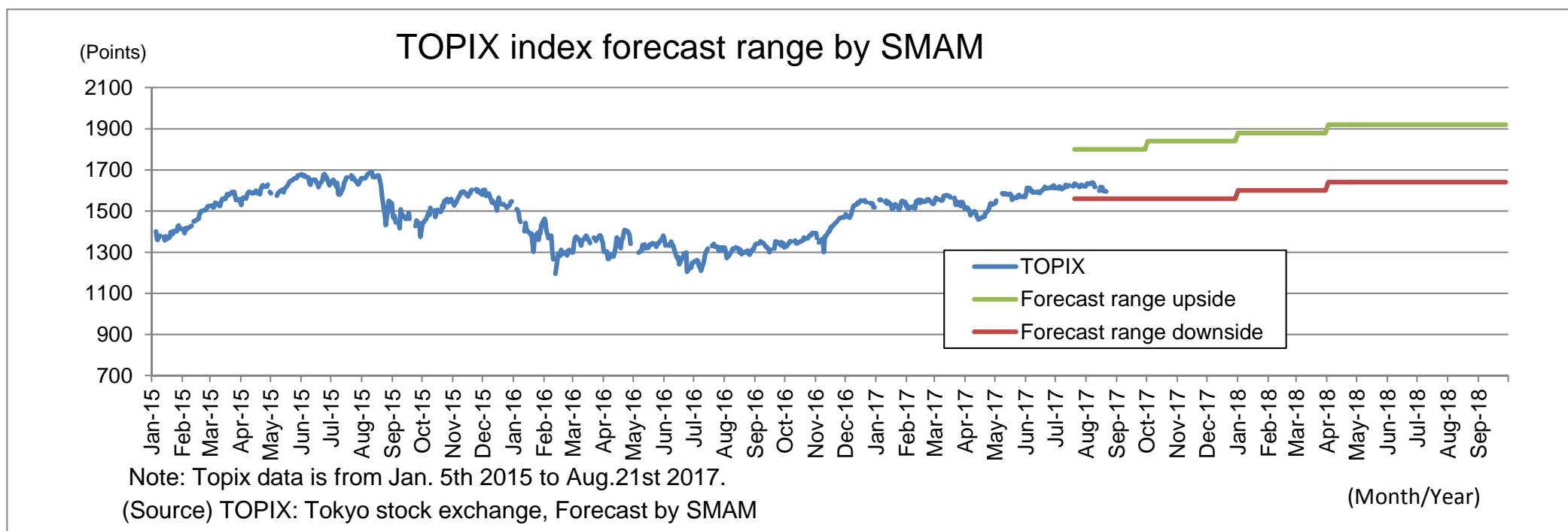
Stock market outlook: Good fundamentals are overshadowed by US politics and North Korea risk

SMAM short-term view

- Japanese stock market will be weighed on by uncertainties of US politics and North Korean conflicts for a while. Unless the situation surrounding North Korea escalates to a military confrontation, the current risk-off mode will recede and investors' focus will turn to the good fundamentals of Japanese economy and corporate earnings.

Longer-term outlook (6-months and beyond)

- The global economy is expected to grow in a steady undertone. Uncertainties surrounding global stock market will be gradually cleared as Republicans grab the control of US congress over receding power of the White House. Global investors will get back to risk-on mode at some point and the good fundamentals of the Japanese stocks will kick in to drive the Japanese stock market upward.



Note: SMAM's projection is as of Aug. 22nd, 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.
 - US economy keeps growing despite delay in Trump stimulus policies.
 - 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.
 - Tension in the East Asia does not ignite a war.

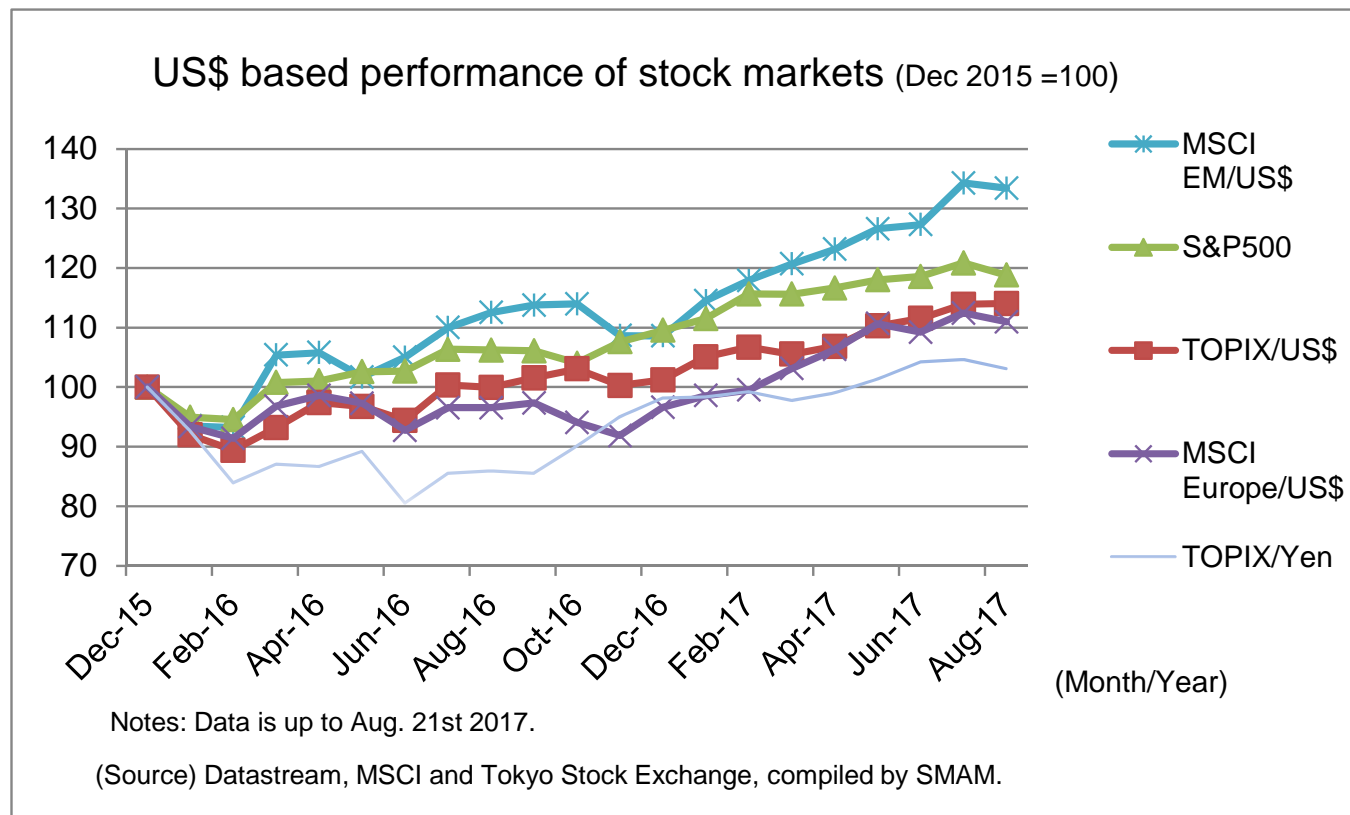
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

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

Note: SMAM's projection is as of Aug. 22nd 2017 and subject to updates without notice.

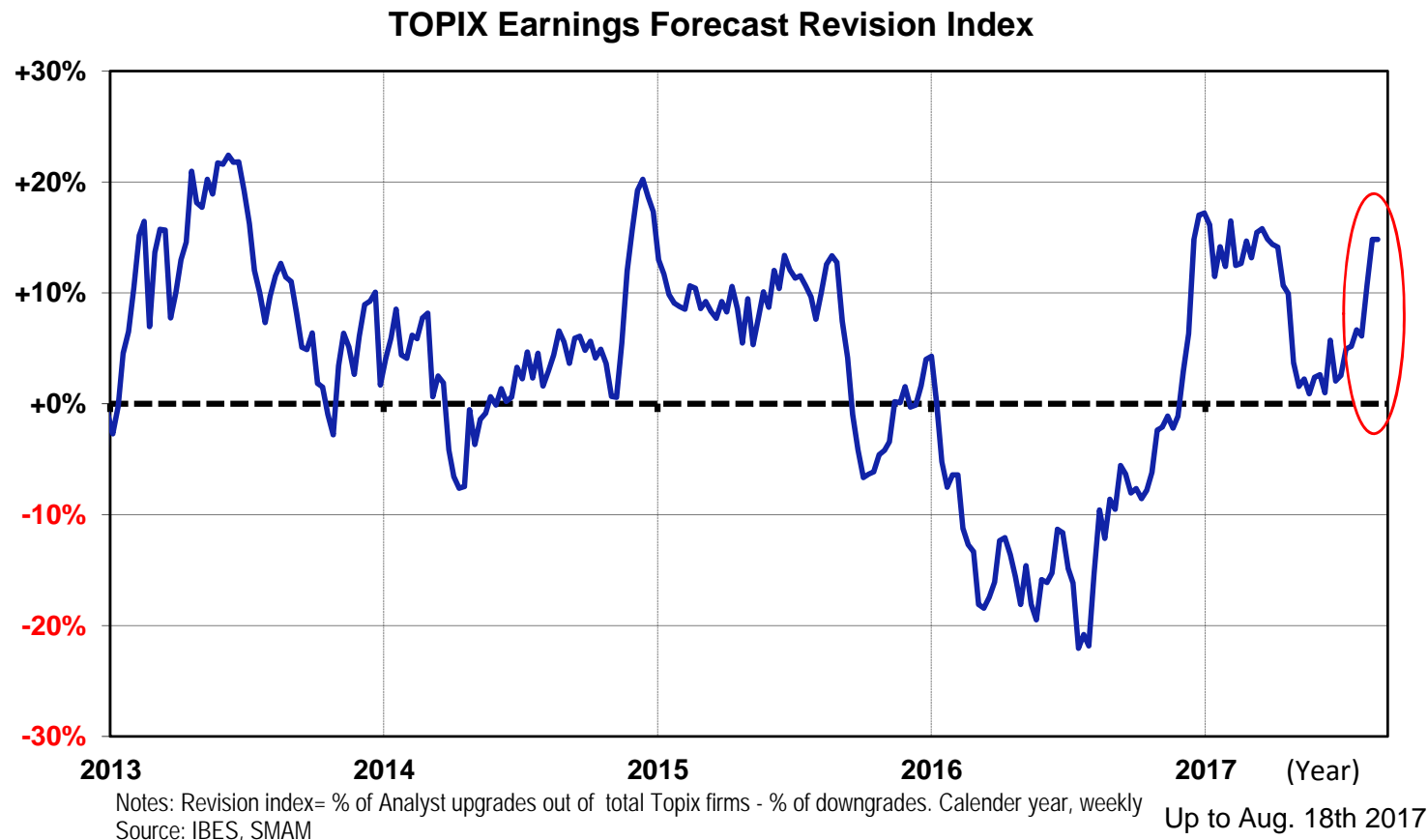
Global stock markets retreated in August on uncertainties in US politics and North Korean risk

- US stock market led the decline of global stock markets in August.
- Japanese stock index in US dollars moved sideways as stronger Japanese yen offset the decline in local currency based stock prices.



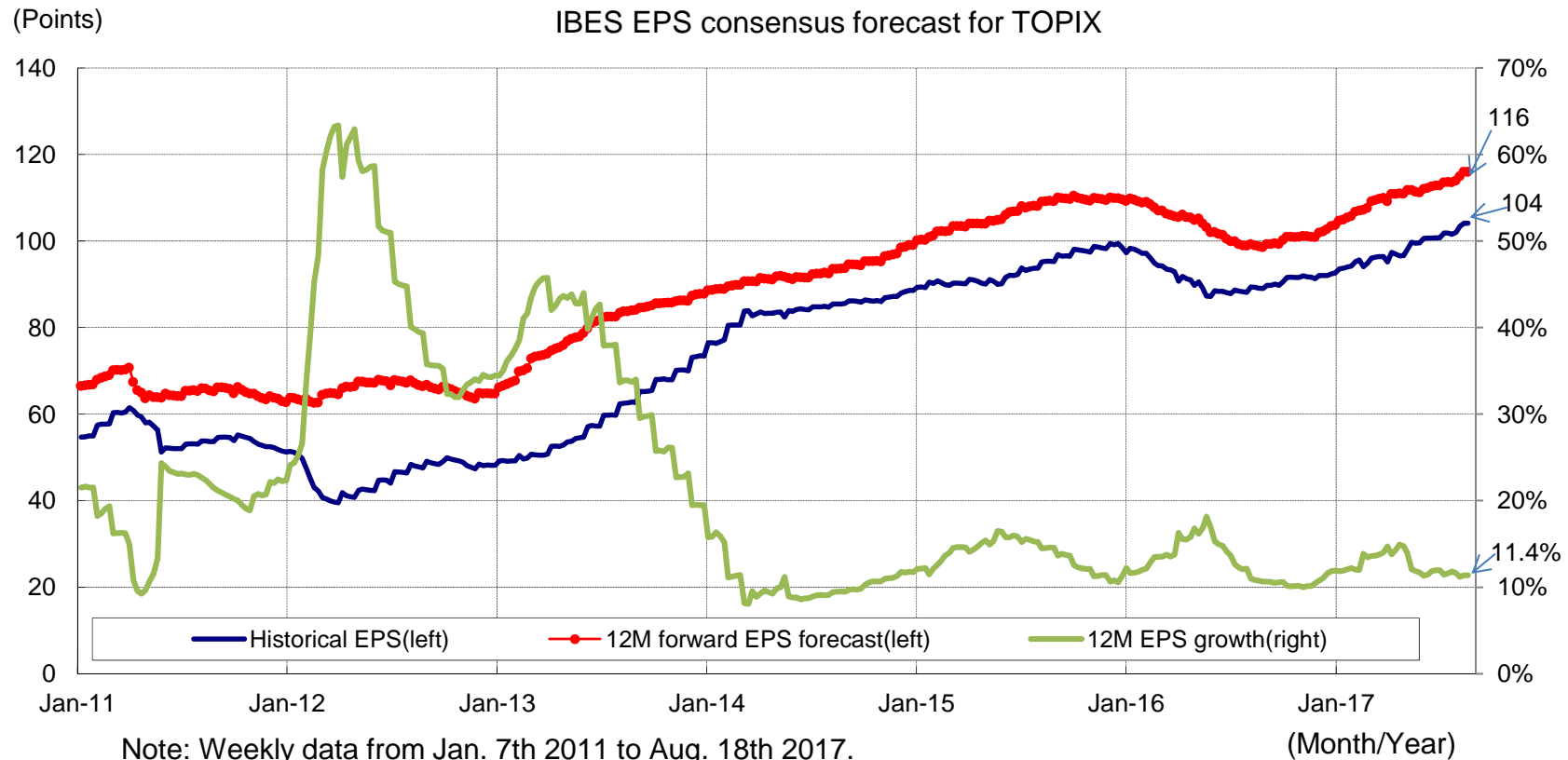
Good Apr-Jun quarter earnings of Japanese companies ignited upward revisions lately

- Analysts are revising earnings forecast upwards following better than expected earnings results for Apr-Jun quarter.



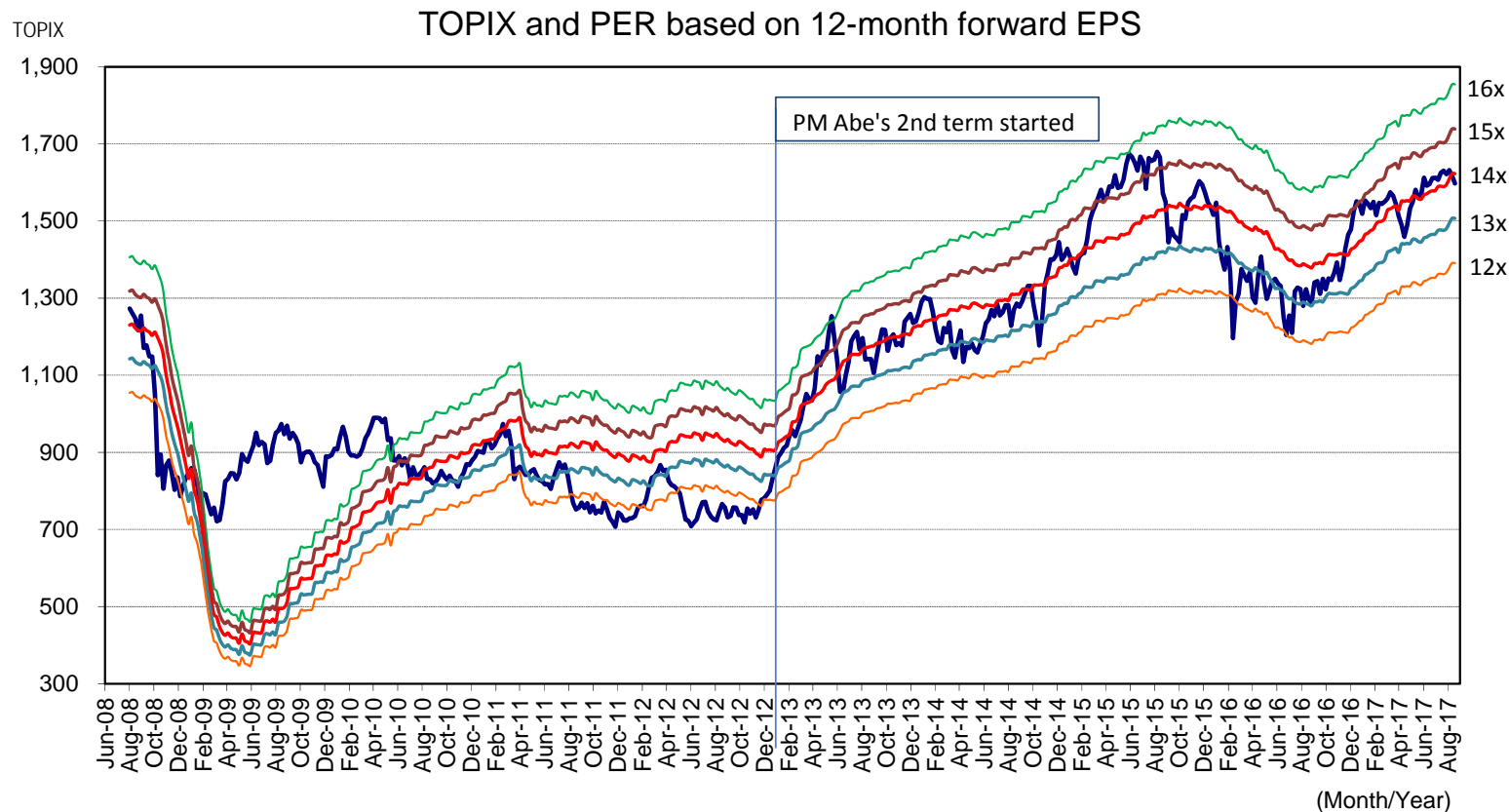
Double digit earnings growth is forecast for the coming 12 months

- The latest 12M forward EPS forecast for TOPIX advanced steadily to 116. Historical EPS also advanced.
- 11.4% EPS growth is forecast in the coming 12 months.



PER (Price Earnings Ratio) below 14x looks attractive

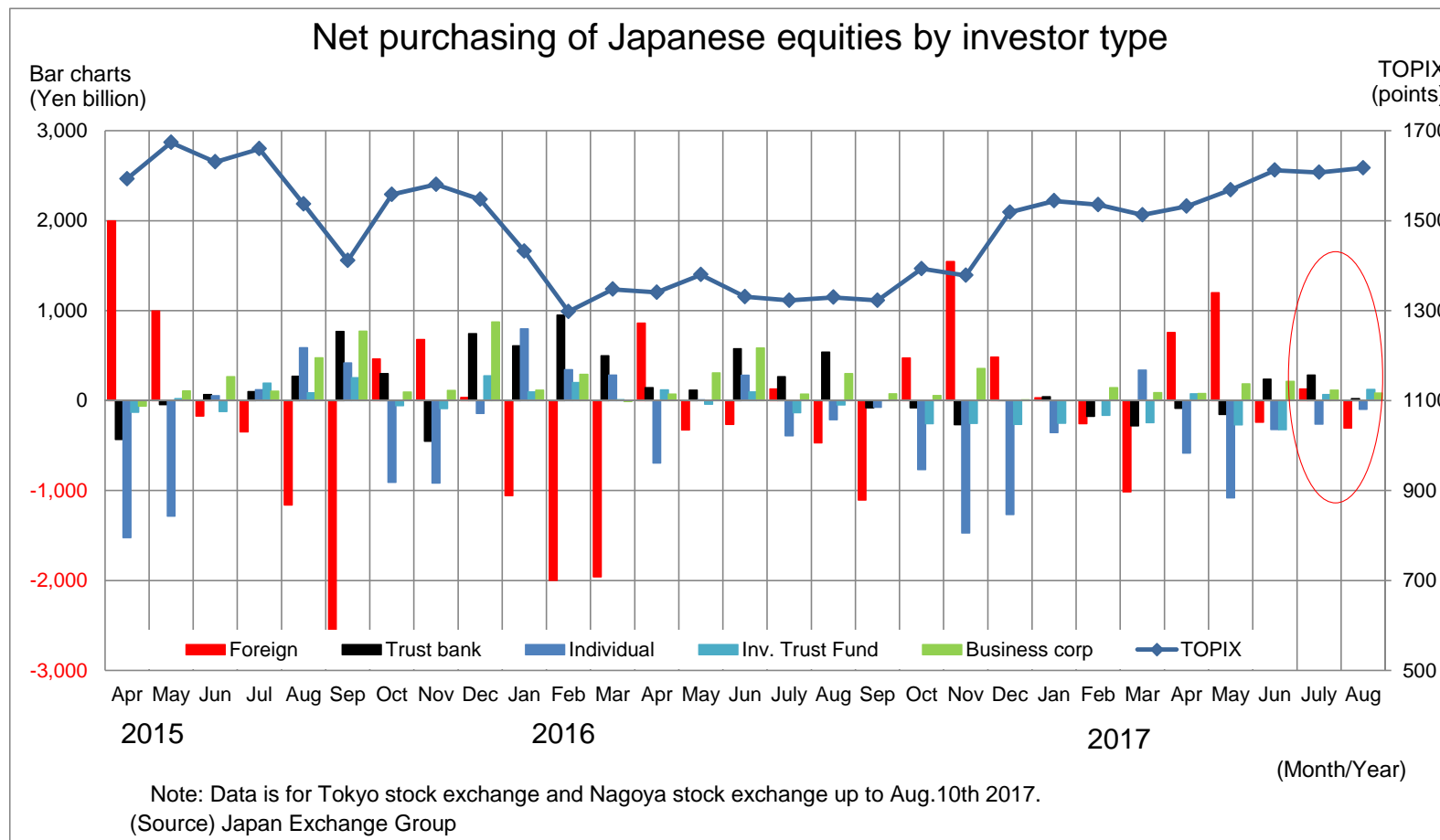
- PER for TOPIX index based on 12M forward EPS dipped below 14x, which is in the lower half of the PER range between 12 and 16x since the current tenure by PM Abe started.
- PER for MSCI US index is around 18x and for MSCI Europe is just under 15x, which make Japanese stock market look attractive in global comparison .



Note: Data is weekly from Aug.1st 2008 to Aug.18th 2017. TOPIX was 1597.36 at the end of the period.
(Source) Tokyo Stock Exchange, Datastream and IBES, compiled by SMAM

Foreign investors turned to sellers in August

- Foreign investors resumed selling of Japanese equities in August.
- In the backgrounds are increasing tension between US allies and North Korea, and also growing confusion in US politics and society caused by erratic comments and moves by President Trump.



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