



Japanese Stock Market Outlook

SMAM monthly comments & views
- October 2017 -



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

Next consumption tax hike scheduled in 2018 suddenly became a focus of Japanese politics. PM Abe suggests tax hike as scheduled partly to finance free baby & infantry education. The popular governor of Tokyo now leads a new party and says consumption tax hike should be postponed.

- Japanese GDP is forecast to grow mildly but solidly at 1.4% in FY2017. All economic segments are forecast to make positive growth.
- The private consumption has clearly strengthened in 2017. As long as no serious negative events such as military confrontation with North Korea break, solid consumption is expected to continue, though temporal loosening is possible due to rainy August.

➤ Japanese Stock Markets

Japanese stock market will be weighed on by uncertainties of US politics and North Korean conflicts for a while. Up-scaled spending plan is likely to be ballooned during the general election in October, which might brighten atmosphere. On the other hand, sudden surfacing of the next consumption tax scheduled in 2018 may not be a positive for the market.

- As a baseline, SMAM forecasts 15.1% profit growth in FY2017 for 224 companies in our research coverage, which is higher than the growth forecast of 7.4% made by companies themselves. Upward earnings revisions seem likely.
- The global economy is expected to grow in a steady undertone. Uncertainties surrounding global stock market will be gradually cleared as US politics progresses and North Korean situation stabilizes. Global investors will get back to risk-on mode 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 Sep. 26th 2017, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY17-18

- Good economic fundamentals continue for Japan supported by solid growth by each segment.
- CPI is expected to rise just mildly.

(YoY %)	FY13	FY14	FY15	FY16	FY17E	FY18E
Real GDP growth	2.6%	-0.5%	1.3%	1.3%	1.5%	1.0%
Private Consumption Expenditure	2.7%	-2.6%	0.6%	0.7%	1.4%	0.7%
Private Housing Investment	8.3%	-9.9%	2.8%	6.6%	2.4%	0.2%
Private Capital Investment	7.0%	2.4%	0.6%	2.4%	2.8%	2.7%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.4%	0.7%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	3.4%	-1.4%
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%	2.6%
Imports	7.1%	4.3%	0.2%	-1.4%	3.5%	1.6%
Nominal GDP	2.6%	2.0%	2.7%	1.1%	1.6%	1.6%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	0.1%	0.5%
Industrial Production	3.0%	-0.4%	-1.4%	1.5%	4.5%	2.5%
CPI (excl. fresh food)	0.8%	0.9%	-0.1%	-0.2%	0.6%	0.7%

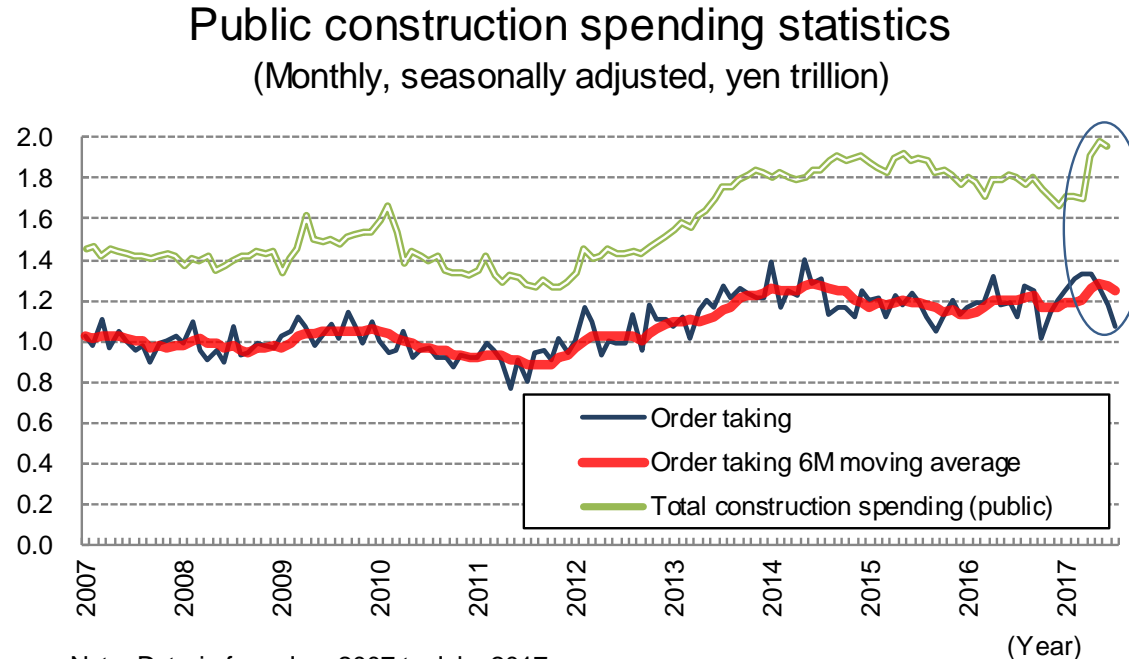
Notes: E=SMAM forecasts. SMAM views are as of Sep. 26^h, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

Public construction spending increased as expected

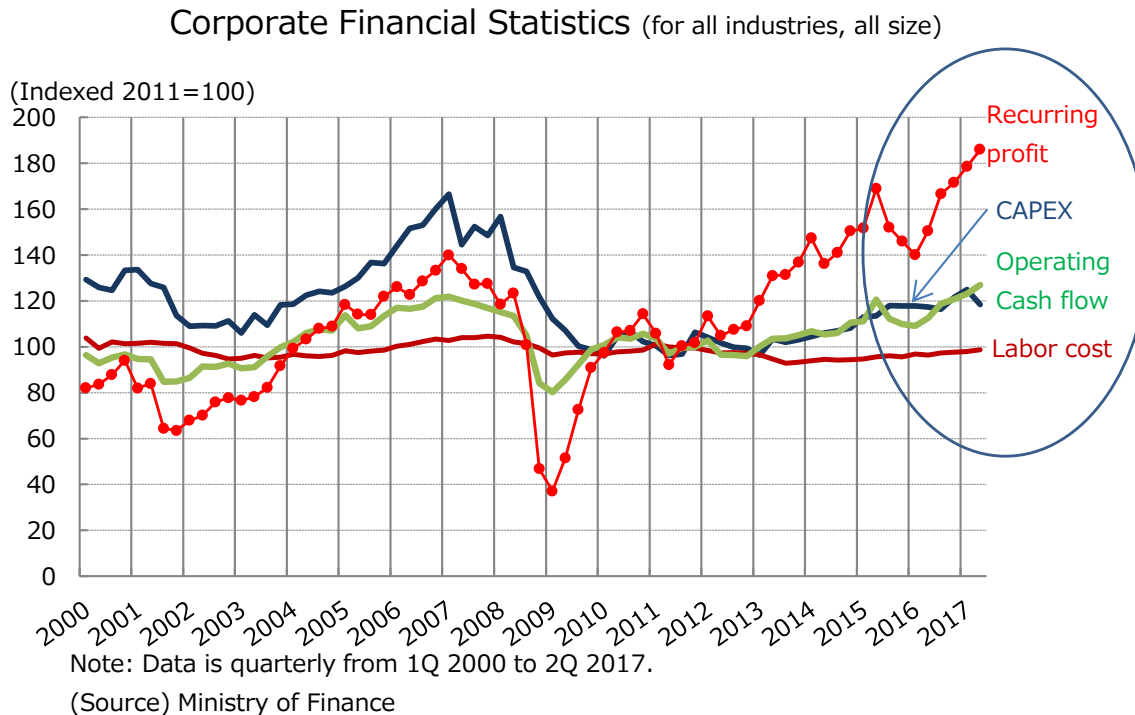
- In the below chart the latest statistics for Total Construction Spending in May showed sizable increase and it stayed high level in June as expected by preceding increase in order takings.
- The latest data for order taking is for July 2017, which shows volatile movement, however, the high level of order taking is expected to continue.



(Source) Cabinet Office, Ministry of Land, Infrastructure, Transport and Tourism, EAST JAPAN CONSTRUCTION SURETY CO., LTD, and compile by SMAM.

Capital expenditure is on the rise in line with the increasing operating cash flow

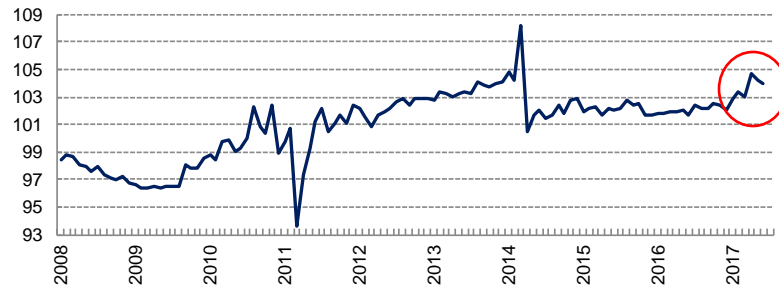
- Corporate Financial Statistics released by Ministry of Finance has a broad coverage of businesses including non-listed companies.
- Rising operating cash flow underpins capital expenditure by companies.
- Restrained labor cost might be positive for shareholders in sharply rising profits, however, labor share should be increased in order for lifting private consumption in Japan.



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, though temporal loosening is possible due to rainy August.

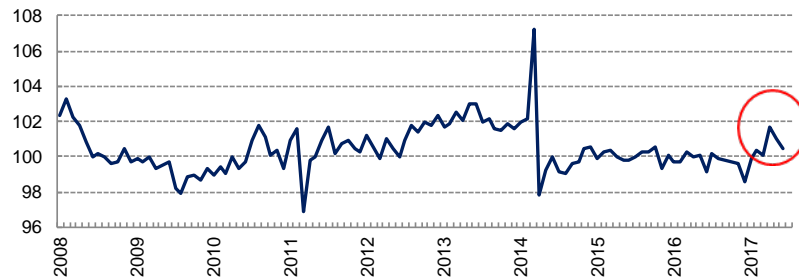
Consumption Activity Index (total)
(2010=100, seasonally adjusted, foreign visitors consumption adjusted)



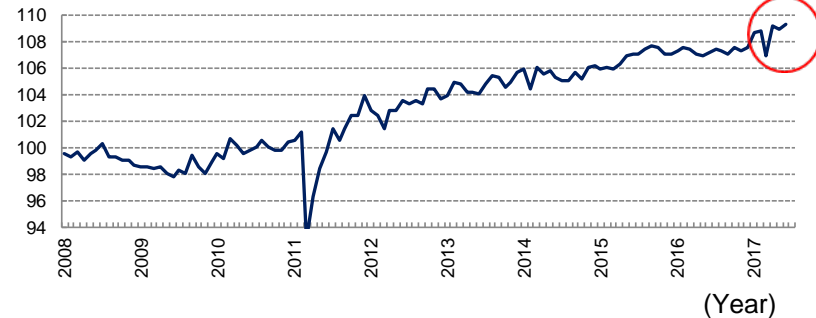
Consumption Activity Index (for durable goods)
(2010=100, seasonally adjusted)



Consumption Activity Index (for non-durable goods)
(2010=100, seasonally adjusted)



Consumption Activity Index (for services)
(2010=100, seasonally adjusted)

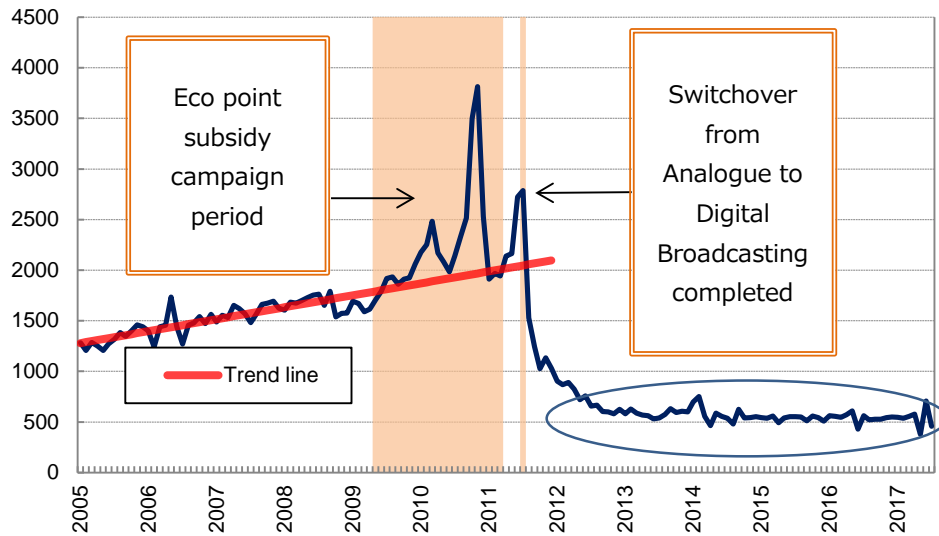


Note: Data is from Jan. 2008 to Jun. 2017
(Source) Bank of Japan

Private consumption for durable goods might be lifted by renewal demands in the near future

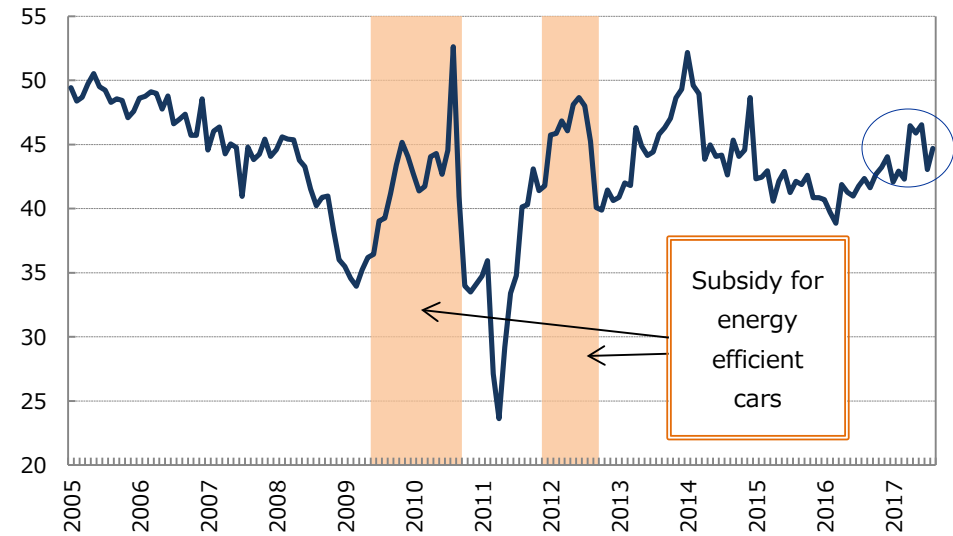
- There are early signs that private consumption for durable goods are increasing.
- After the global financial crisis, Japanese government initiated incentives for purchasing such big ticket items as TV sets and new cars as the shaded period in the charts shows. The demand, however, slumped after the end of such incentives as the blue circle in the left chart shows.
- Average lifetime for such durable goods are between 7 and 10 years, and renewal demands might be appearing.

(yen '00 million) Shipment of Visual Devices in Japan



Note: Data is monthly from Jan. 2005 to Jul. 2017, seasonally adjusted by SMAM. (Year)
 (Source) Japan Technologies and Information Technology Industries Association

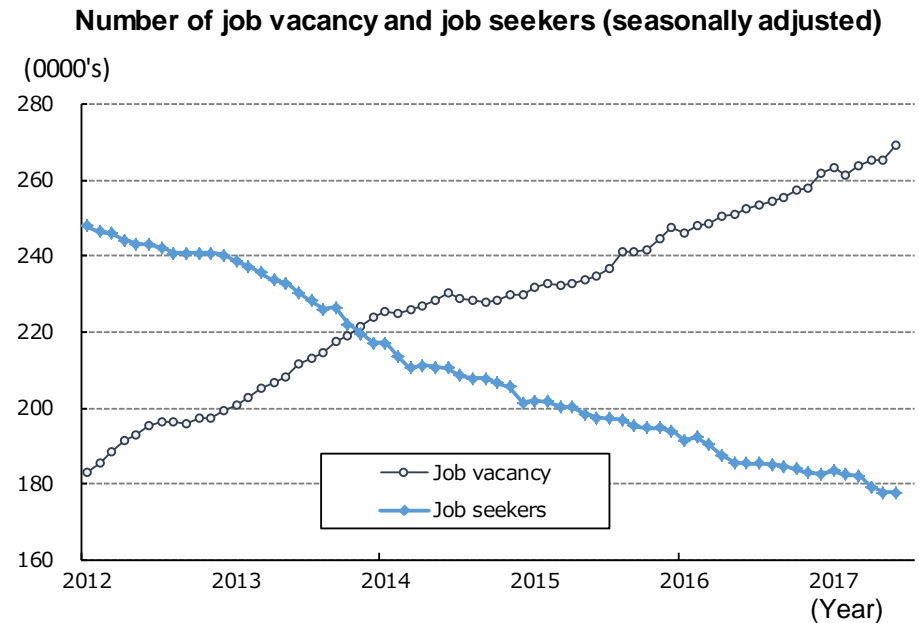
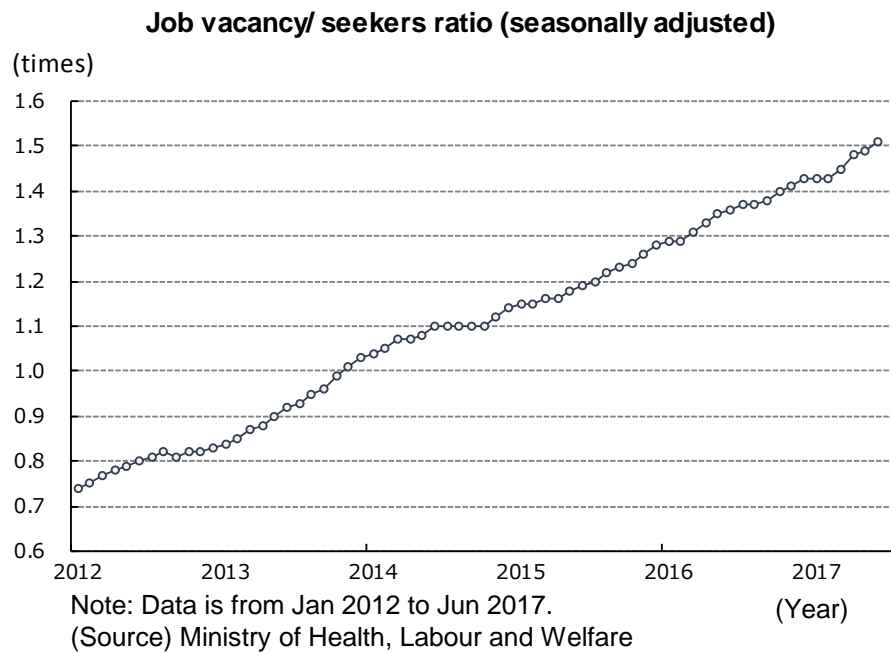
('0000) New Car Registration in Japan



Note: Data is monthly from Jan. 2005 to Aug. 2017, seasonally adjusted by SMAM. (Year)
 (Source) Japan Automobile Dealers Association, Japan Mini Vehicles Association

Labor market gets tighter and tighter

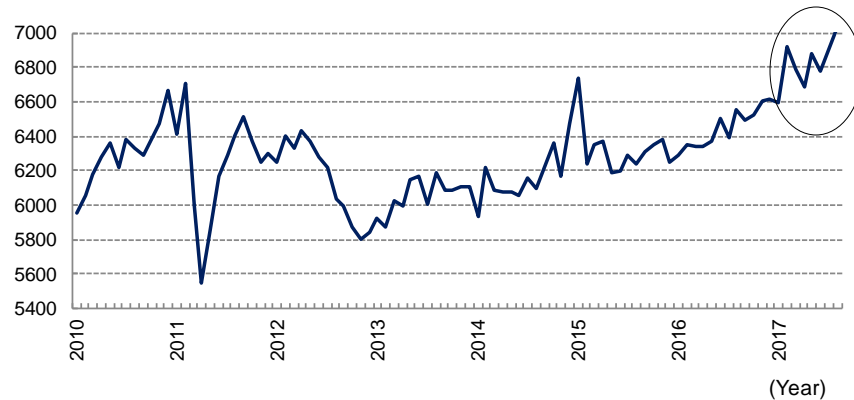
- Number of unfilled job vacancy keeps climbing in the face of decreasing number of job seekers.



Strong export growth continues to drive the Japanese economy

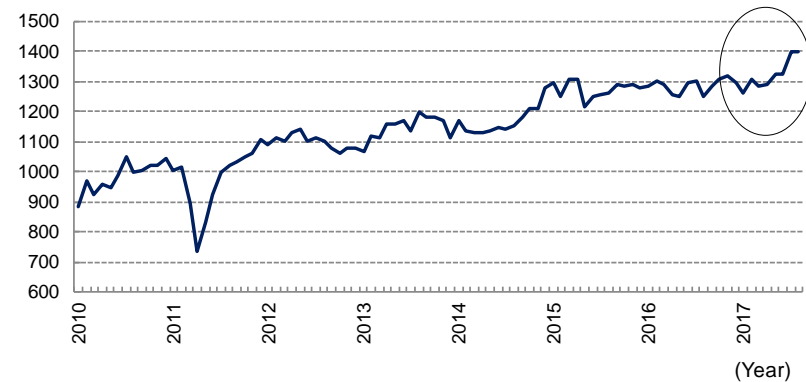
- Exports to US started to pick up lately meanwhile exports to Asia stays at high level.

Total export volume
(seasonally adjusted, yen billion)



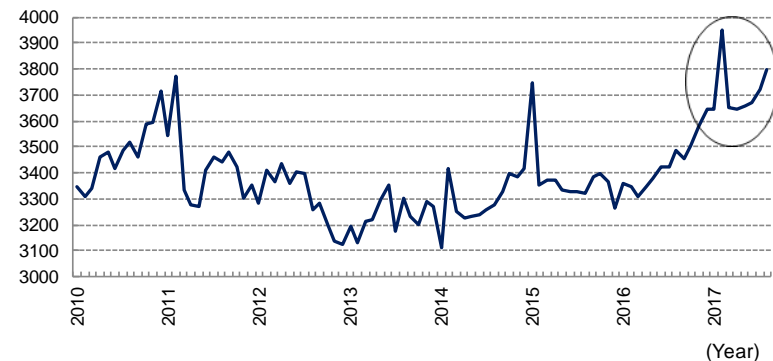
Note: Data is from Jan 2010 to Aug 2017.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

Export volume to US
(seasonally adjusted, yen billion)



Note: Data is from Jan 2010 to Aug 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 Aug 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 2.1% in 2Q, it is forecast to grow even faster at 2.4% in Jul-Sep quarter. (QoQ %, seasonally adjusted)
- Production of electronic parts showed robust 4.3% MoM in July and expected to slow down for a couple of month. Production of machinery is forecast to increase though a little volatile.

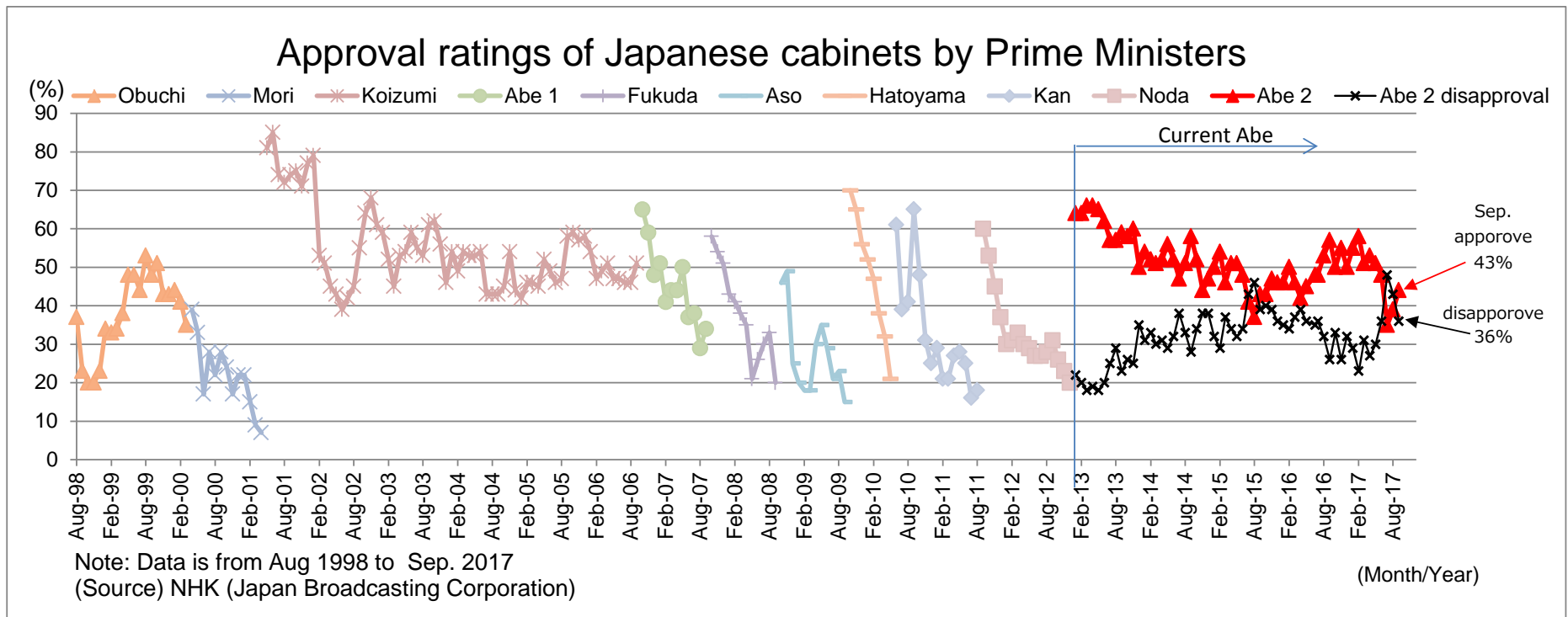
Industrial production index (seasonally adjusted, % change)

		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
2017	4Q	1.9	1.5	2.7	2.3	3.4	5.3	0.6	-4.0	3.0	1.3
	1Q	0.2	0.0	-2.1	1.9	0.8	5.8	-0.4	-5.7	-1.1	1.6
	2Q	2.1	0.6	1.9	-1.3	4.8	1.3	1.0	1.4	3.7	3.1
3Q forecast		2.4	1.7	1.5	4.1	1.9	0.2	2.8	-0.7	1.1	3.6
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
2017	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
	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	2.1	-0.3	2.4	7.2	2.2	-2.5	5.9	1.9	5.6	3.4
	7	-0.7	-1.6	-0.2	0.1	-2.5	4.3	-2.9	-3.6	-0.7	-1.4
8 forecast		6.0	6.8	3.3	2.5	11.0	-1.7	5.6	10.8	4.4	4.0
9 forecast		-3.1	0.6	-3.4	-0.5	-9.1	-2.5	-2.6	-12.1	0.0	2.8

Note: Forecast for August and September 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.

What will be the outcome in the coming general election in October

- Approval rating for the Abe cabinet recovered from 35% in August to 43% in September.
- PM Abe decided to dissolve the lower house and hold a general election on the 22nd of October.
- The governing party LDP plans to raise consumption tax in 2018 and use the tax income to make baby & infant education free for the age under 6. The emerging new opposition party led by popular governor Yuriko Koike says the next consumption tax hike should be postponed.



Politics and anticipated tapering by both FRB and ECB could affect financial markets

- US political battle will intensify heading to the end of CR in December, which was extended 3 month in emergency caused by hurricanes.
- Apart from the result of general election, another important factor for the Japanese stock market is how situation surrounding North Korea develops, which can not be put in the table below.

Schedule of key events

Month	Region/Country	Events	Notes
2017 September	US	19-20 FOMC	Tapering is going to start
	France	24 Upper house election	
	Germany	24 Federal election	
October	Spain	1 Referendum in Catalonia for independence	
	Japan	22 General election	How many seats GOP can keep?
		30-31 BOJ Monetary Policy Committee Meeting/ Perspective report	
	EU	26 ECB policy meeting	Start of tapering?
	China	19th National People's Congress	Who are next leading figures?
November	Middle East	30 OPEC meeting	
	US/Asia	US president Trump is expected to visit Asia incl. Japan	
December	US	12-13 FOMC	Rate hike?
		15 3 month extended CR (temporary government budget) ends	Political battle in US congress
	Korea	20 Presidential election	
2018 January	Japan	National Diet ordinary session begins	
		22-23 BOJ Monetary Policy Committee Meeting/ Perspective report	
March	Japan	19 Two deputy governors' term ends	
April	Japan	8 BOJ governor Kuroda's term ends	Who is next BOJ governor?
September	Japan	30 Current term of GOP leader Abe ends	Abe takes one more term?

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

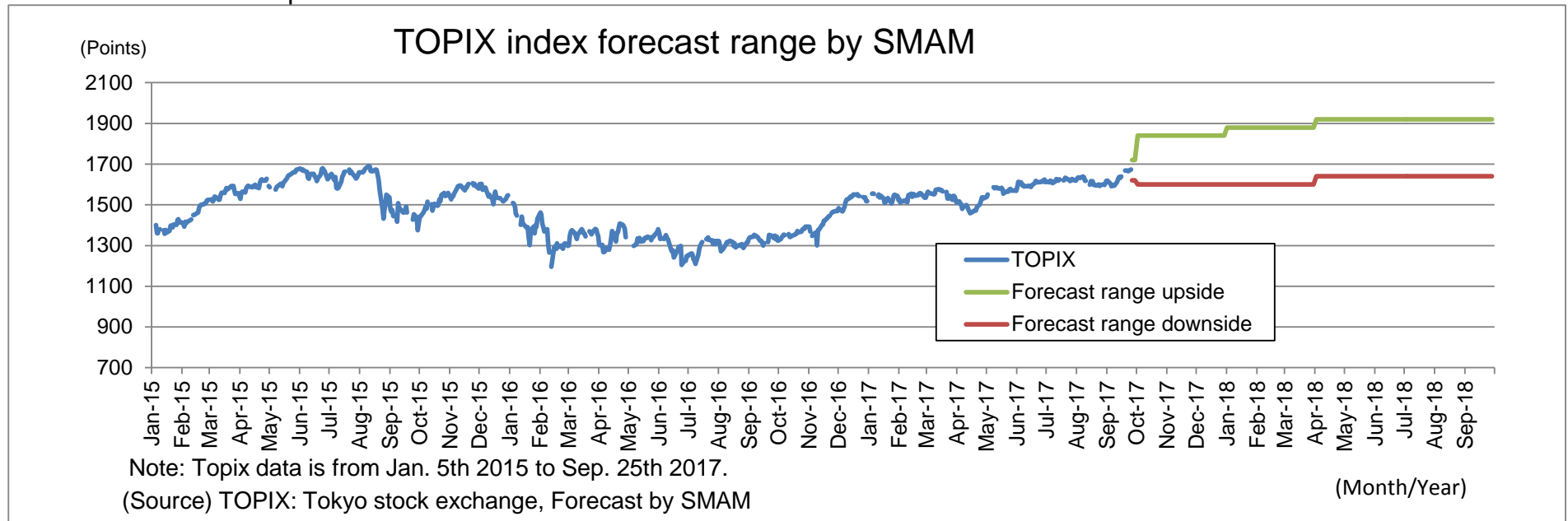
Stock market outlook: Good fundamentals are overshadowed by politics and North Korea risk

SMAM short-term view

- Japanese stock market will be weighed on by uncertainties of US politics and North Korean conflicts for a while. Up-scaled spending plan is likely to be ballooned during the general election in October, which might brighten atmosphere. Sudden surfacing of the next consumption tax scheduled in 2018 may not be a positive for the market.

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 US politics progresses and North Korean situation stabilizes. Global investors will get back to risk-on mode 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 Sep. 26th 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.

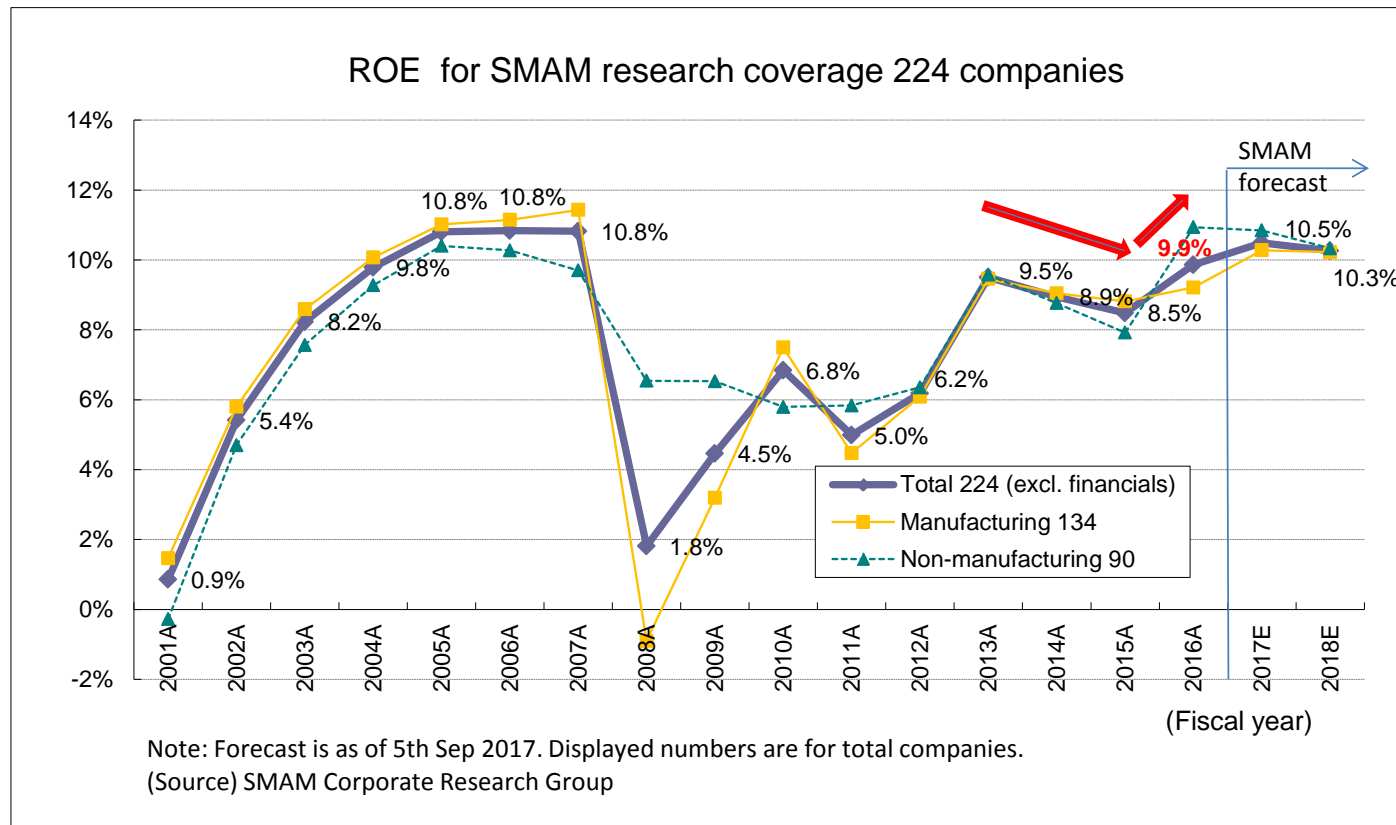
- **Upside Risks** include:
 - Stronger-than-expected global growth.
 - Stronger-than-expected measures by the Abe government.

- **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 Sep. 26th 2017 and subject to updates without notice.

Increasing shareholder returns lifted ROE to 9.9% in FY 2016

- ROE rose to 9.9% in FY2016 from 8.5% recorded in FY2015. EPS rose by 18.3%.
- After hitting the previous high of 9.5% in FY2013, ROE actually declined due to rapidly accumulating capital despite EPS growth. However, growth of shareholder capital in FY 2016 was controlled at 5.7% owing partly to increasing dividend and share buybacks. Profit margin improvement was also positive for ROE.



SMAM forecasts 15% profit growth in FY2017

- Apr-Jun quarterly earnings were upbeat and SMAM revised FY2017 profit growth forecasts from previous 12.1% to 15.1% in recurring profits.
- Forecasts made by companies stay at 7.4%. SMAM is expecting this guidance to be revised upward as the year progresses.

SMAM Corporate Earnings forecasts (224 Companies research coverage excl. financials)

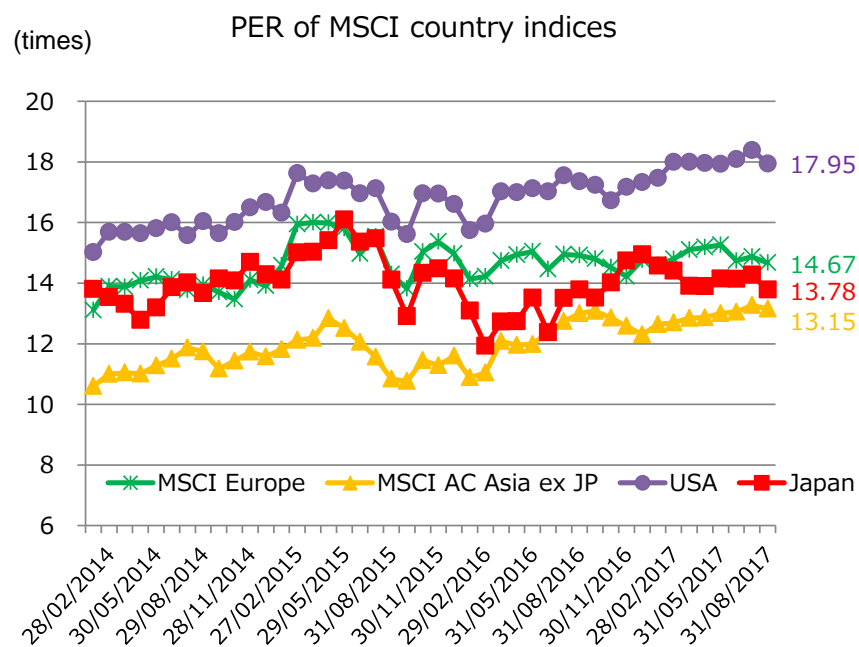
Fiscal year	FY 2015	FY 2016	FY 2017E	FY 2018E
Date of forecast	Actual	Actual	as of 5th Sep 2017	as of 5th Sep 2017
Revenue (YoY %)	0.7%	-3.4%	6.4%	2.1%
Operating Profits (YoY %)	11.8%	-1.3%	14.3%	8.2%
Recurring Profits (YoY %)	4.5%	2.1%	15.1%	8.3%
Net Profits (YoY %)	-0.6%	18.3%	10.1%	7.9%
Recurring profits (YoY %)				
Manufacturing 134 companies	3.5%	-3.5%	16.9%	9.4%
Non-manufacturing 90 companies	6.2%	11.4%	12.5%	6.5%
Self guidance by 224 companies			7.4%	

Note: Key assumptions for the forecasts for FY 2017, Yen/US\$ 110.4, Yen/EUR 128.8

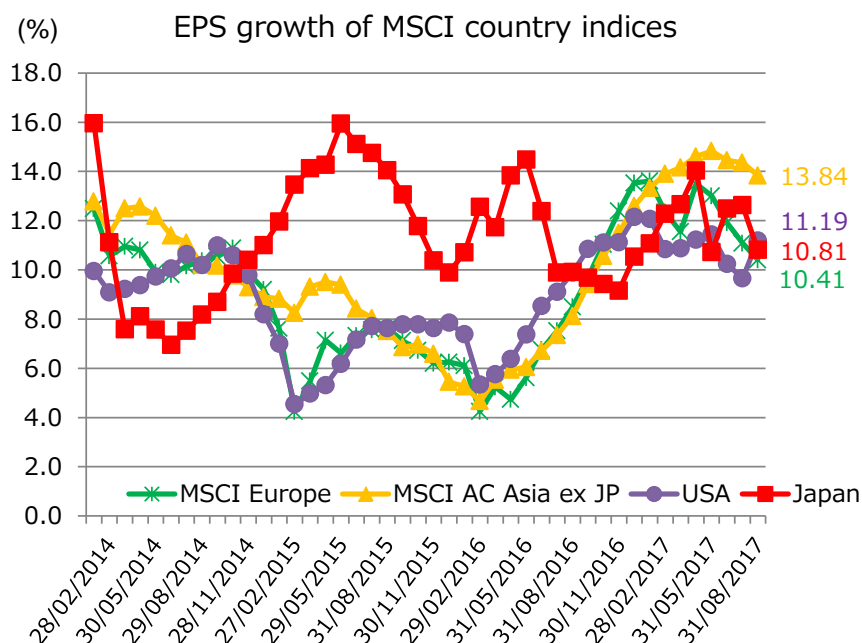
(Source) SMAM Corporate Research Group, Toyo Keizai

Comparing EPS growth and PER, US looks expensive

- Asia looks attractive with the highest EPS growth and the lowest PER among 4 indices, though risk needs to be put into consideration as well.
- US looks expensive. Japan looks more attractive than Europe with higher EPS growth and lower PER, though the difference is not large.



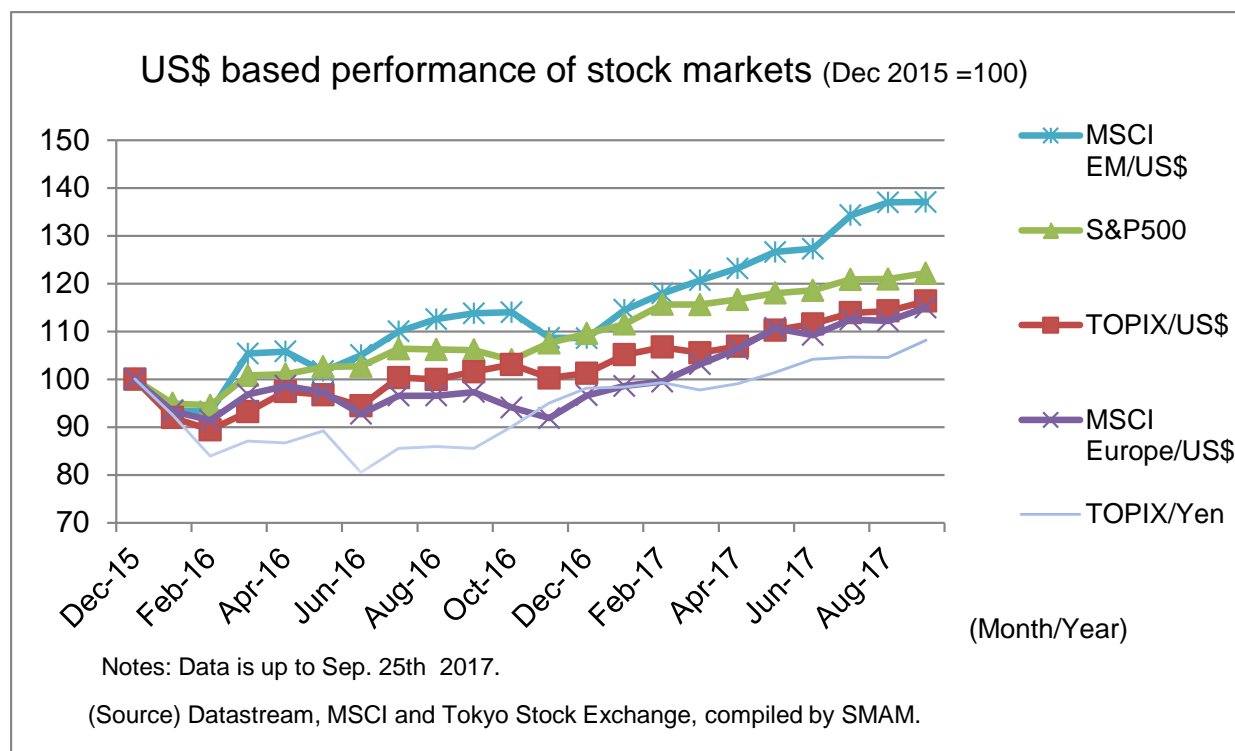
Note: PER is based on 12M forward EPS forecast. (DD/MM/YYYY)
Data is up to 31st Aug 2017.
(Source) MSCI



Note: Growth is for 12M forward EPS forecast. (DD/MM/YYYY)
Data is up to 31st Aug 2017.
(Source) MSCI

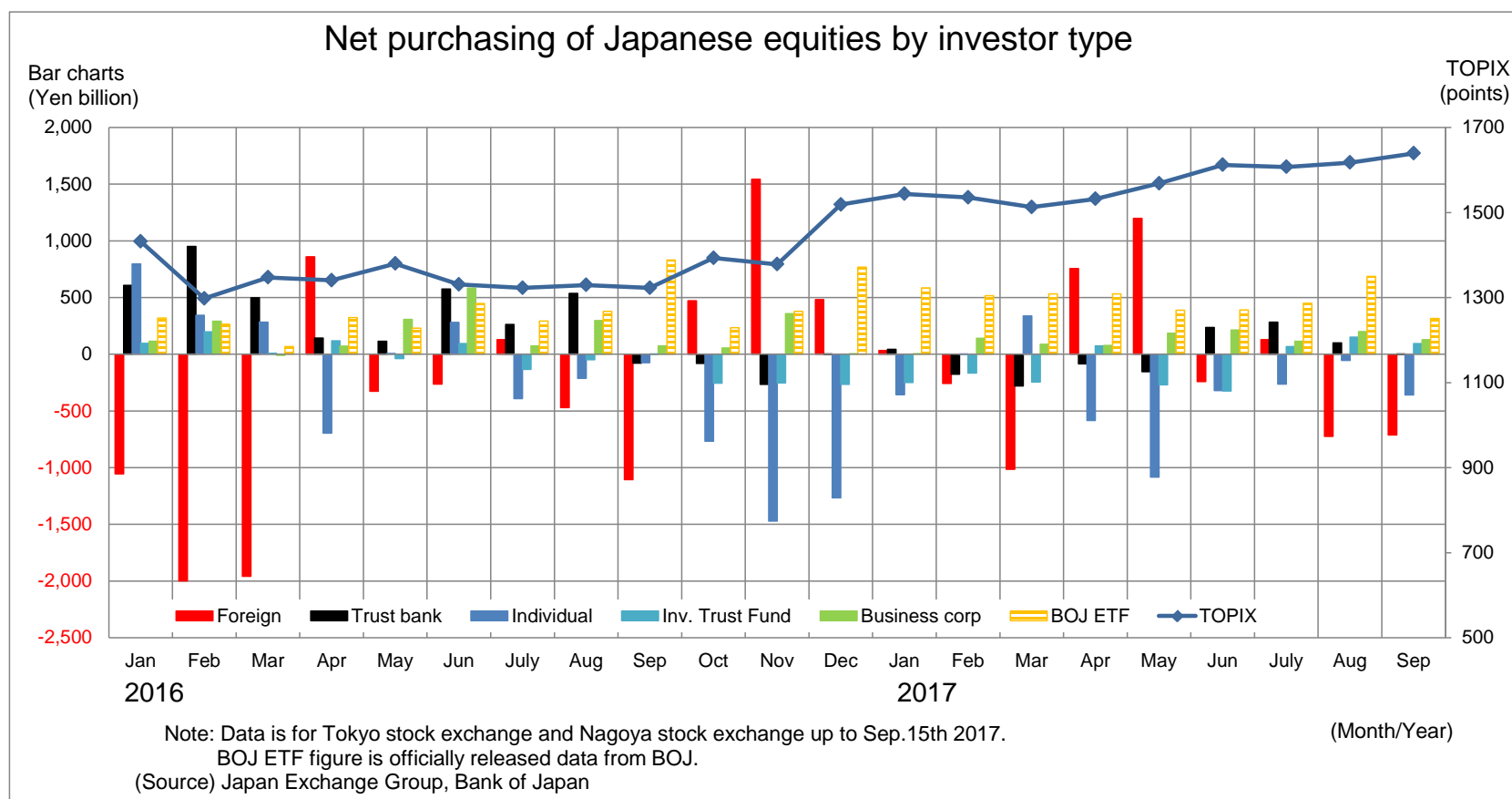
Global stock markets retreated in August on uncertainties in US politics and North Korean risk

- 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.



Foreign investors turned to sellers in August

- Foreign investors resumed selling of Japanese equities in August and in the first half of September.
- BOJ's constant purchasing of equity ETF has provided continuous support for the stock market.
- Japanese stock market has been skewed small caps' favor due to index purchasing by BOJ through ETFs since impact on share price is generally higher for small caps with less liquidity.



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