



Japanese Stock Market Outlook

SMAM monthly comments & views

- December 2017 -



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

SMAM slightly upgraded GDP growth forecast for FY2018 from 1.1% to 1.2 % considering stronger than expected economic growth going on in Japan. Current economic reform, stimulative public spending as well as extra easy monetary policy will continue. Additional budgetary spending such as on education is expected.

- Approval rating for Abe cabinet rose to 46% and disapproval rating fell to 35% in November, as PM Abe carefully avoided sounding complacency after the landslide victory in the last general election in October. Diplomatic activities PM Abe might also have appealed positively.
- SMAM revised CPI forecast upward a little due to higher energy prices.

➤ Japanese Stock Markets

Japanese stock market is recovering to the level, which was seen decades ago. It might take some breather after a strong rally continuing since the latter half of September, however, robust earnings growth is expected to drive the stock market further upward. Apr-Sep interim results are beating consensus estimates.

- Jul-Sep quarter earnings for Japanese companies were robust, especially for manufacturing companies, and much better than the preceding forecasts. Analysts are currently revising earnings forecasts upwards. Both historical EPS and 12M forward EPS are already higher than the last peak in late 2015 and advancing further.
- Risk factors are such as North Korea situation, possible slowdown in Chinese economy, US budget debate and effects of monetary policy change in EU and US.

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

Outlook for Japanese Economy

SMAM economic outlook for FY17-18

- SMAM slightly upgraded GDP forecast for FY2018 from 1.1 to 1.2 %.
- 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%	1.2%
Private Consumption Expenditure	2.7%	-2.6%	0.6%	0.7%	1.1%	0.8%
Private Housing Investment	8.3%	-9.9%	2.8%	6.6%	2.0%	2.2%
Private Capital Investment	7.0%	2.4%	0.6%	2.4%	2.5%	2.6%
Public Consumption Expenditure	1.7%	0.4%	2.0%	0.4%	0.8%	0.7%
Public Capital Investment	8.6%	-2.1%	-1.9%	-3.2%	2.1%	-0.5%
Net Exports (contrib. to GDP growth)	-0.5%	0.6%	0.1%	0.7%	0.4%	0.2%
Exports	4.4%	8.8%	0.7%	3.2%	5.0%	2.9%
Imports	7.1%	4.3%	0.2%	-1.3%	2.6%	1.7%
Nominal GDP	2.6%	2.0%	2.7%	1.1%	1.6%	1.9%
GDP Deflator	0.0%	2.5%	1.5%	-0.2%	0.1%	0.7%
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%	0.7%	0.8%

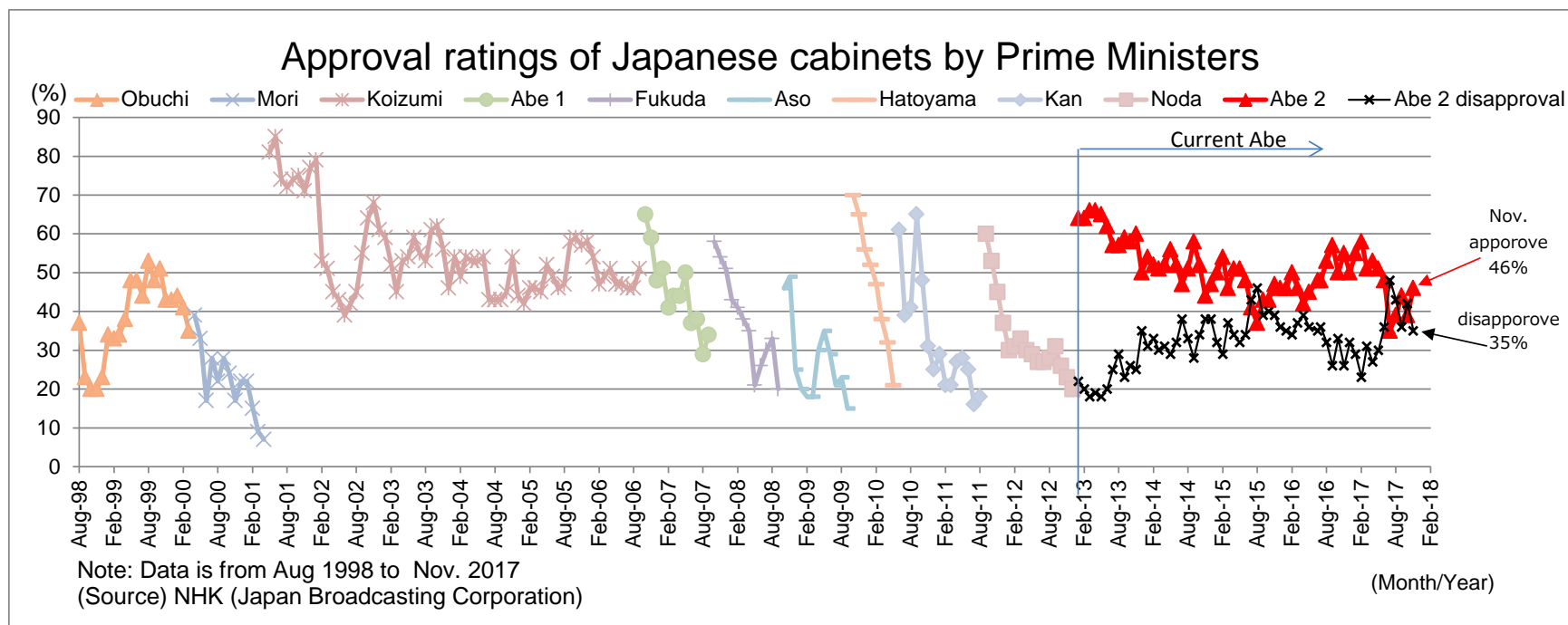
Notes: E=SMAM forecasts. SMAM views are as of Nov. 15th, 2017 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

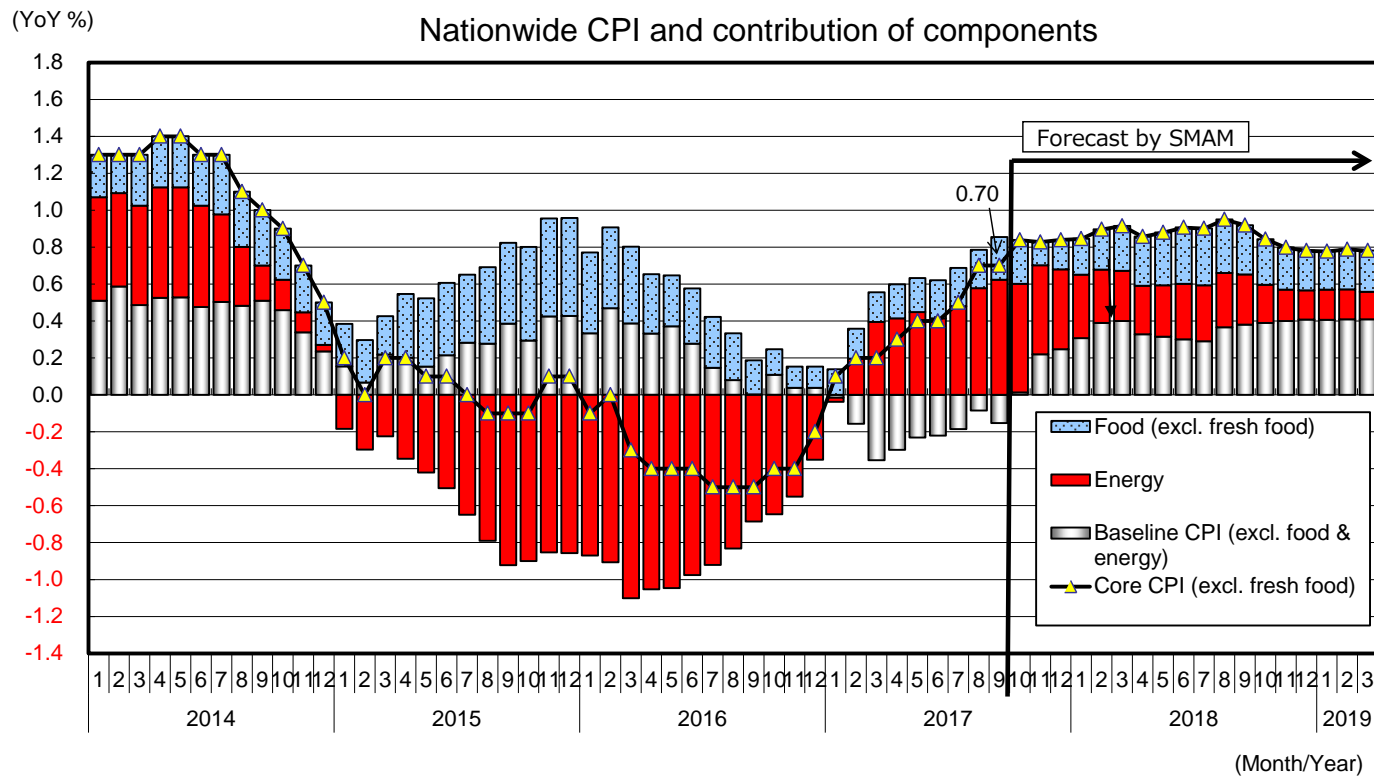
Approval rating for Abe cabinet recovered in November

- Approval rating for Abe cabinet rose to 46% and disapproval rating fell to 35% in November, as PM Abe carefully avoided sounding complacency after the landslide victory in the last general election in October. Diplomatic activities PM Abe also might have appealed positively.
- In the survey in October, disapproval rating was higher than approval rating, which indicated that Japanese people were not as satisfied with PM Abe's leadership as the election results showed.
- Current economic reform, stimulative public spending as well as extra easy monetary policy will continue. Additional budgetary spending such as on education is expected.



CPI is expected to stay just mildly positive

- SMAM revised CPI forecast upward a little due to higher energy prices.
- Core CPI, which excludes fresh food, is going to stay mildly positive for the foreseeable future.
- Extra-easy monetary policy is going to continue in Japan despite expected tapering in Europe and US.

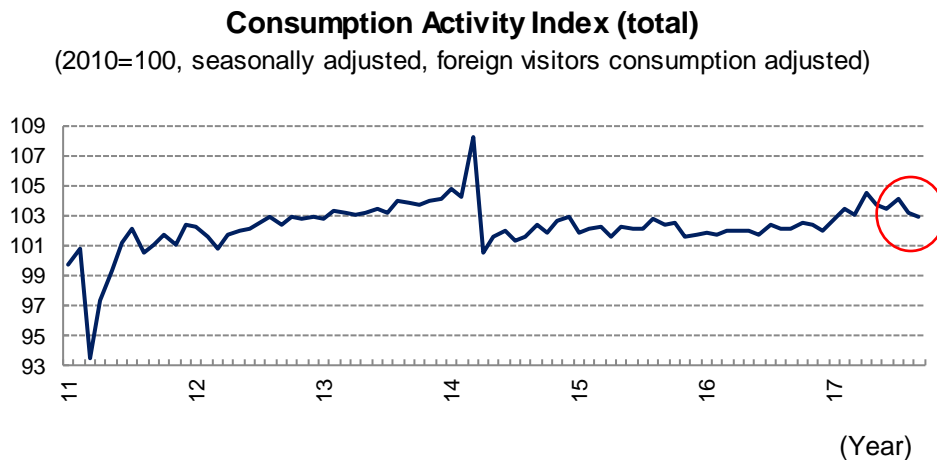


Note: Effect of consumption tax hike in April 2014 is excluded.

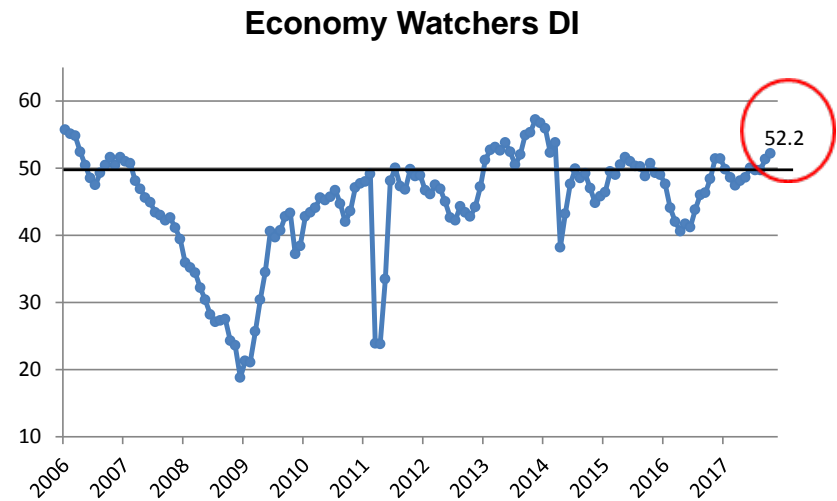
(Source) Ministry of Internal Affairs & Communications

Private consumption growth remains moderate meanwhile consumer sentiment is improving

- After a robust growth in 2Q 2017, private consumption has lost some momentum lately. Extremely rainy August was partly blamed for this slow down.
- However, consumer sentiment actually improved in recent months as Economy Watchers DI showed. Job security in a tight labor condition is one of the positive factors behind.



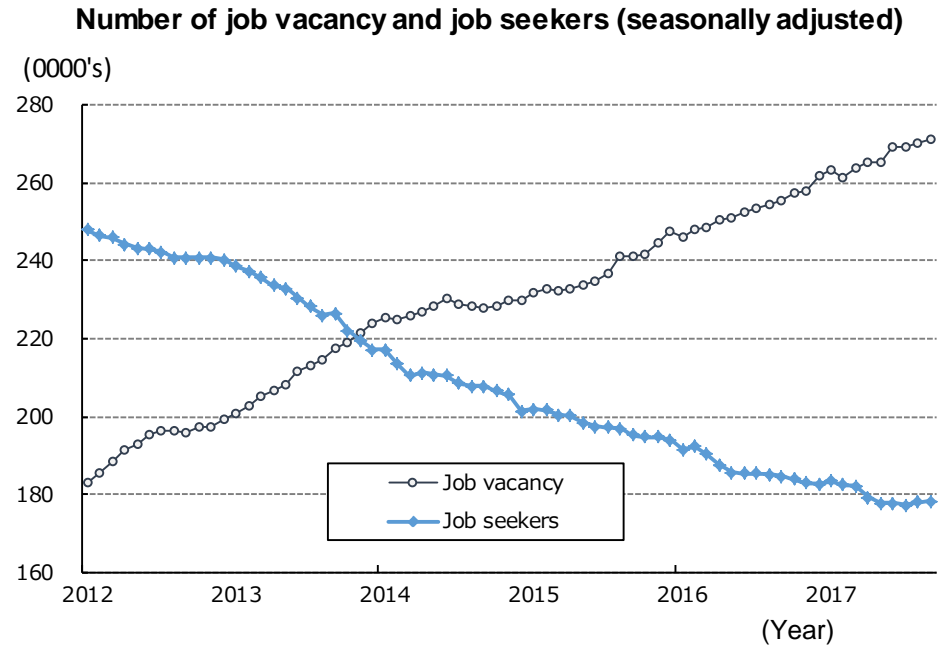
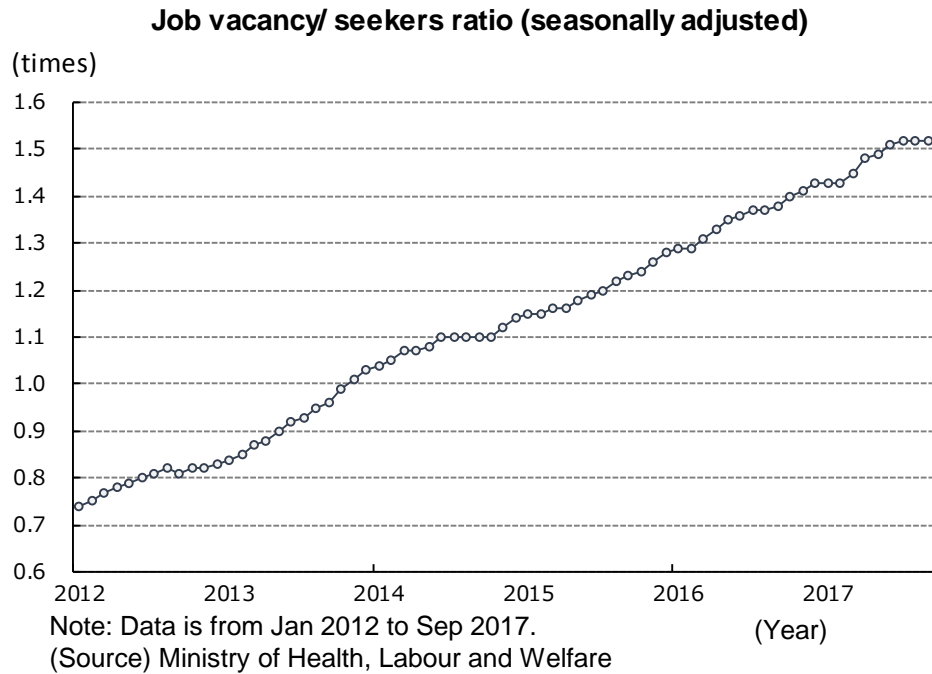
Note: Data is from Jan. 2011 to Sep. 2017
(Source) Bank of Japan



Notes: Diffusion indices of "Economy Watchers Survey". DI above 50 means condition is improving. Data period is from Jan. 2006 to Oct 2017.
(Source) Cabinet Office

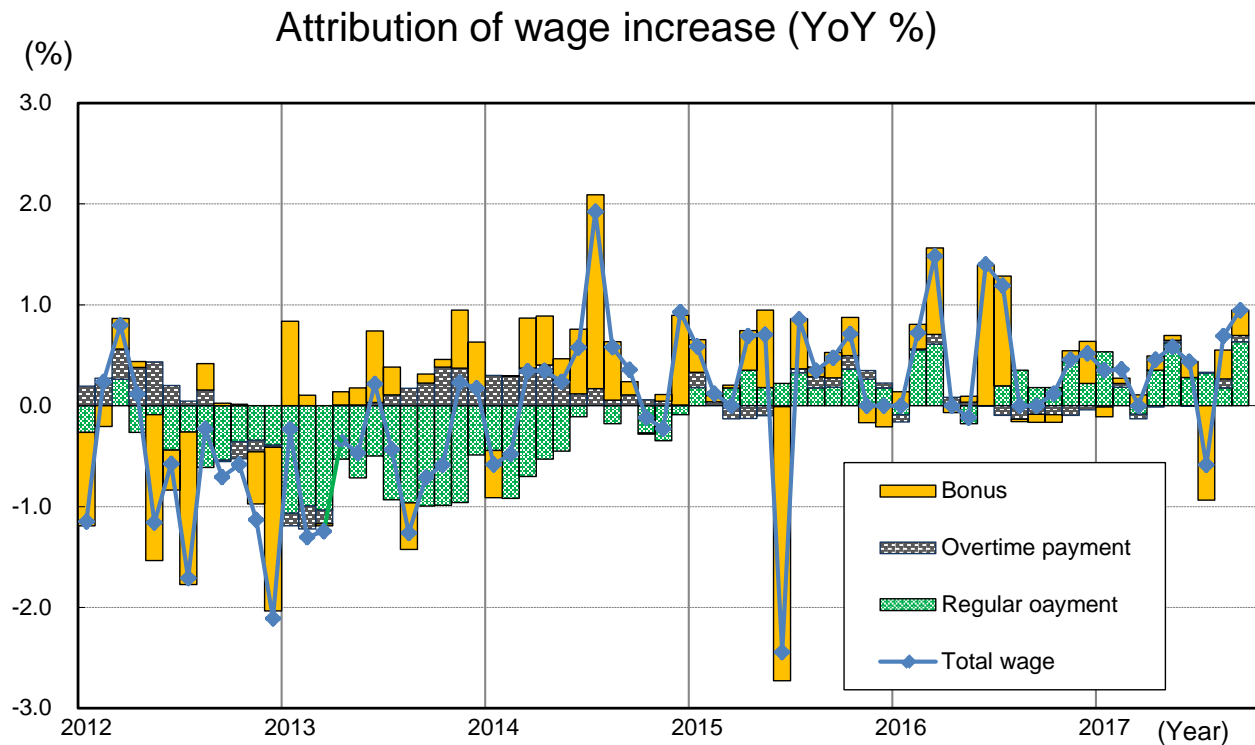
Labor market gets tighter and tighter

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



Wage increase has been at a mild pace, less than 1% YoY

- Nominal wage has been increasing very mildly by less than 1% YoY.
- Bonus in 2018 is likely to see a sizable increase if ongoing strong business performance to continue, which will support the private consumer spending.



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

Outlook for Japanese Stock Markets

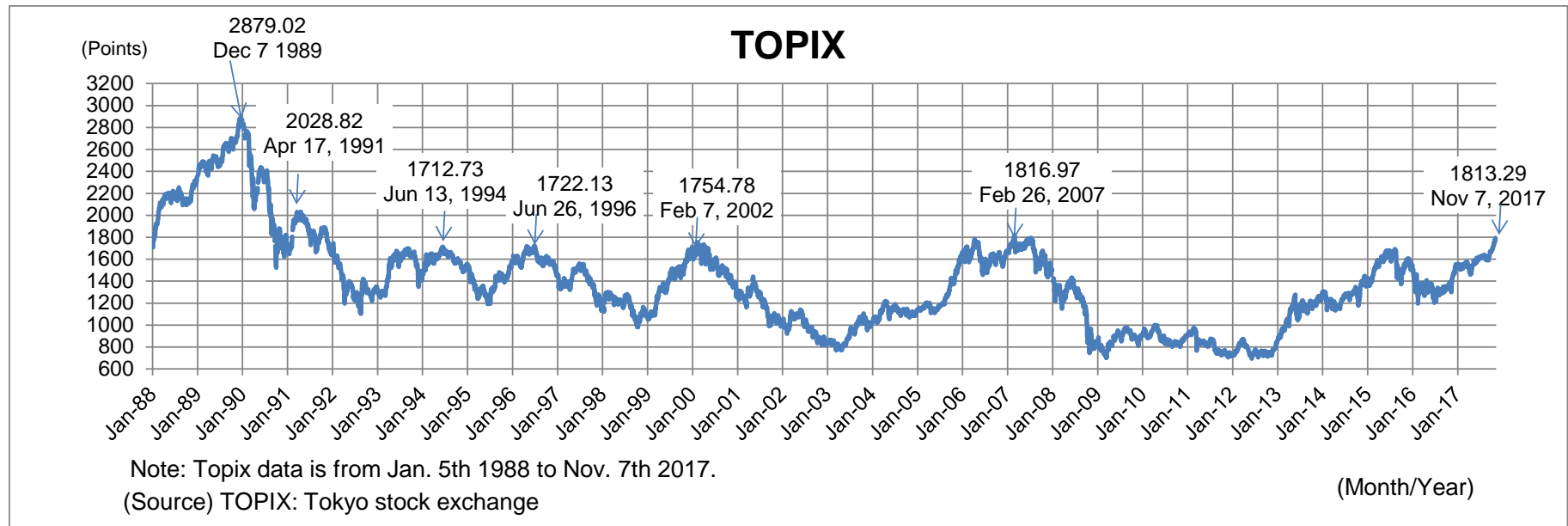
Stock market outlook: Solid footage on good fundamentals with remaining North Korean risk

SMAM short-term view

- Japanese stock market is recovering to the level, which was seen decades ago. It might take some breather after a strong rally continuing since the latter half of September, however, robust earnings growth is expected to drive the stock market further upward. Apr-Sep interim results are beating consensus estimates, especially, for manufacturing companies.

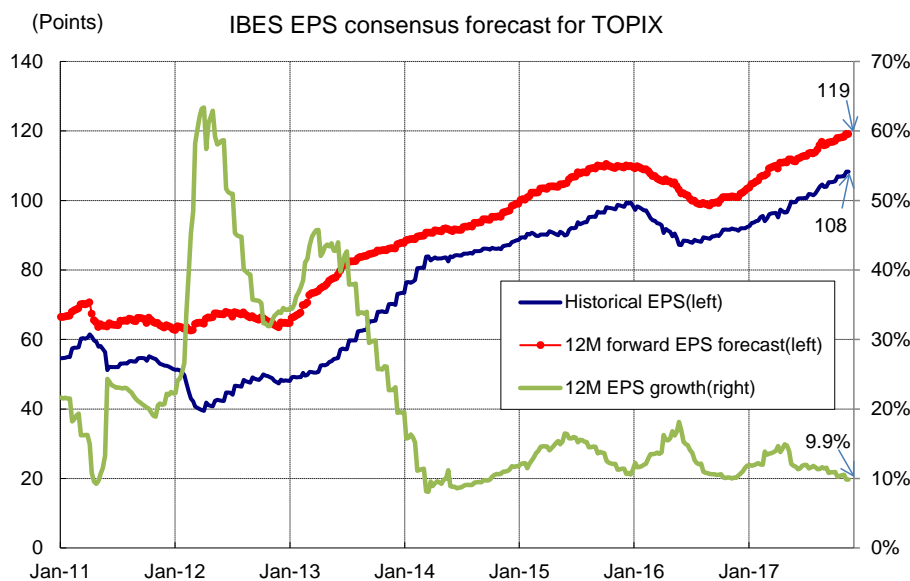
Longer-term outlook (6-months and beyond)

- Upward revision of earnings growth forecasts will continue to underpin the strong performance of the stock prices. Pro-growth economic policy is going to continue under re-strengthened political backing of PM Abe and his government, which is also positive for the Japanese economy and stock market. Major risk factors will be such as unexpected slowdown in global economy, unexpected hawkish shift in monetary policy by central banks and geopolitical risk especially surrounding North Korea.



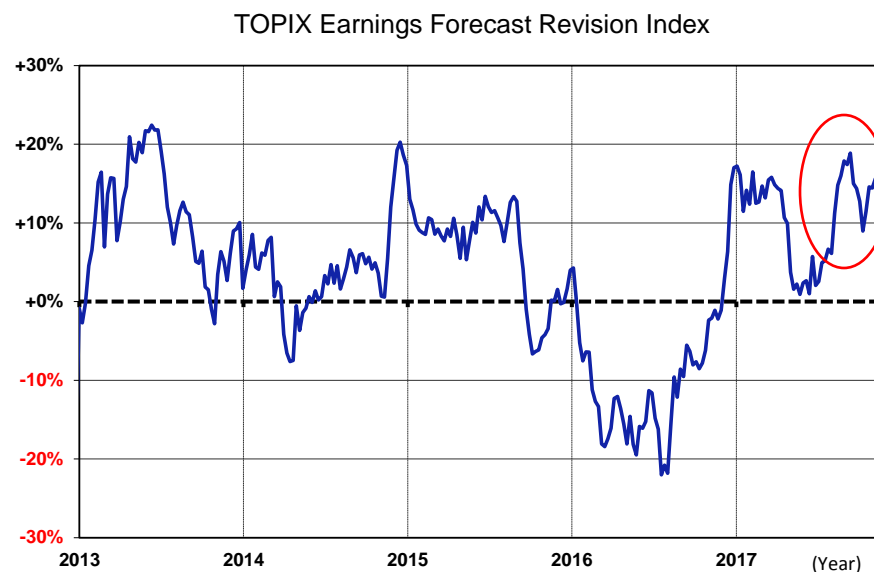
Upward revisions of EPS forecasts are currently going on for Japanese companies

- Jul-Sep quarter earnings for Japanese companies were robust and much better than the preceding forecasts.
- Analysts are currently revising earnings forecasts upwards as shown in the revision index chart.
- Both historical EPS and 12M forward EPS are already higher than the last peak in late 2015 and advancing further.



Note: Weekly data from Jan. 3th 2011 to Nov. 13th 2017. (Month/Year)

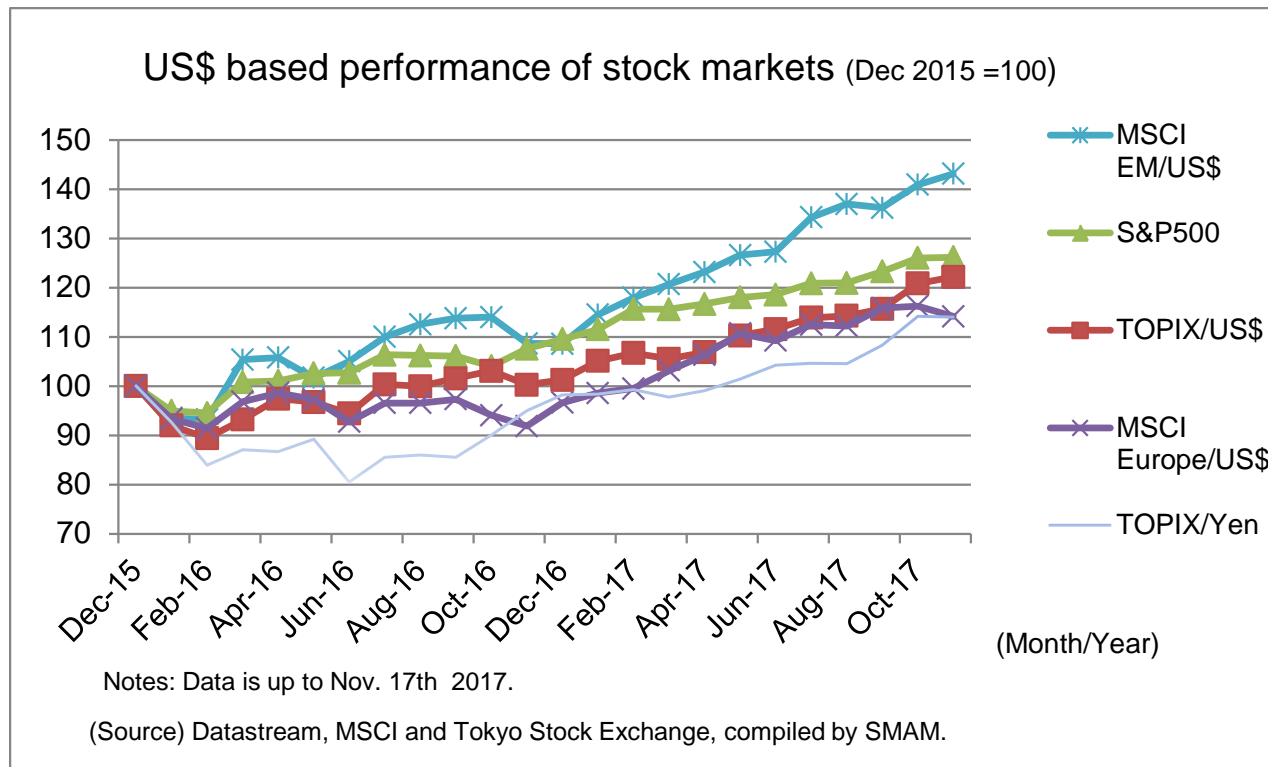
(Source) Datastream, IBES



Notes: Revision index= % of Analyst upgrades out of total Topix firms - % of downgrades.
Data is weekly from Jan. 7th 2013 to Nov. 13th 2017.
(Source): IBES, SMAM

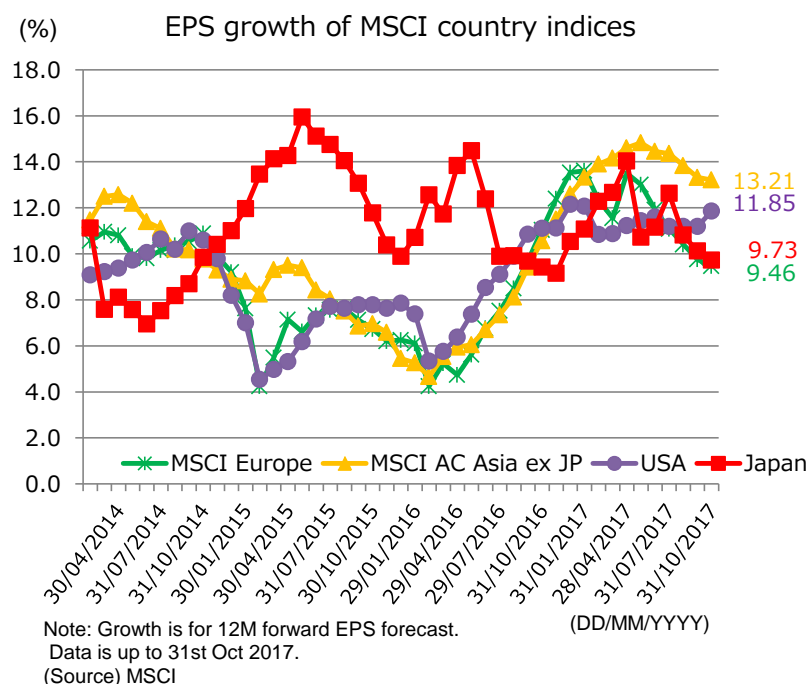
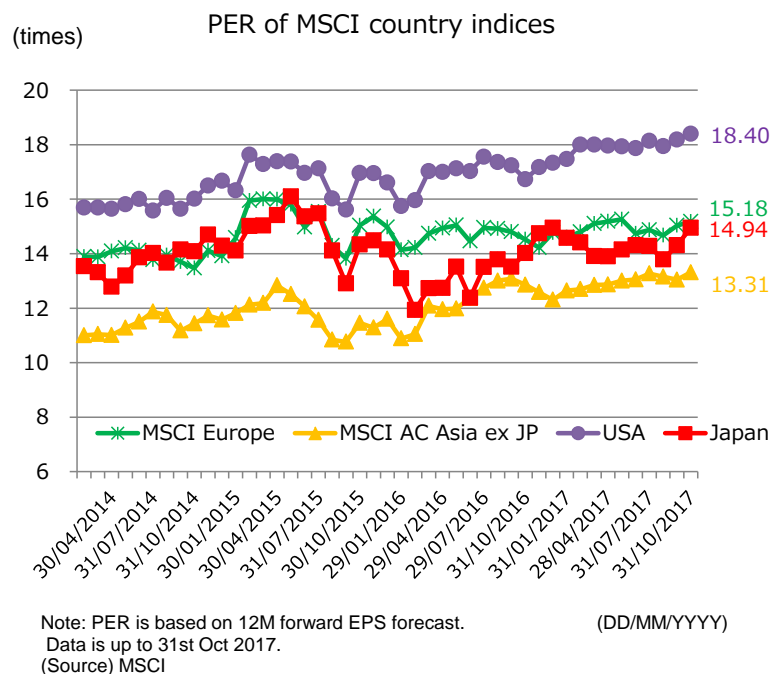
Japanese stock market made a catch-up move lately meanwhile emerging market leads the league

- Emerging market continued to rise strongly.
- Japanese stock prices in US dollars rose to make a catch-up move to US peers.



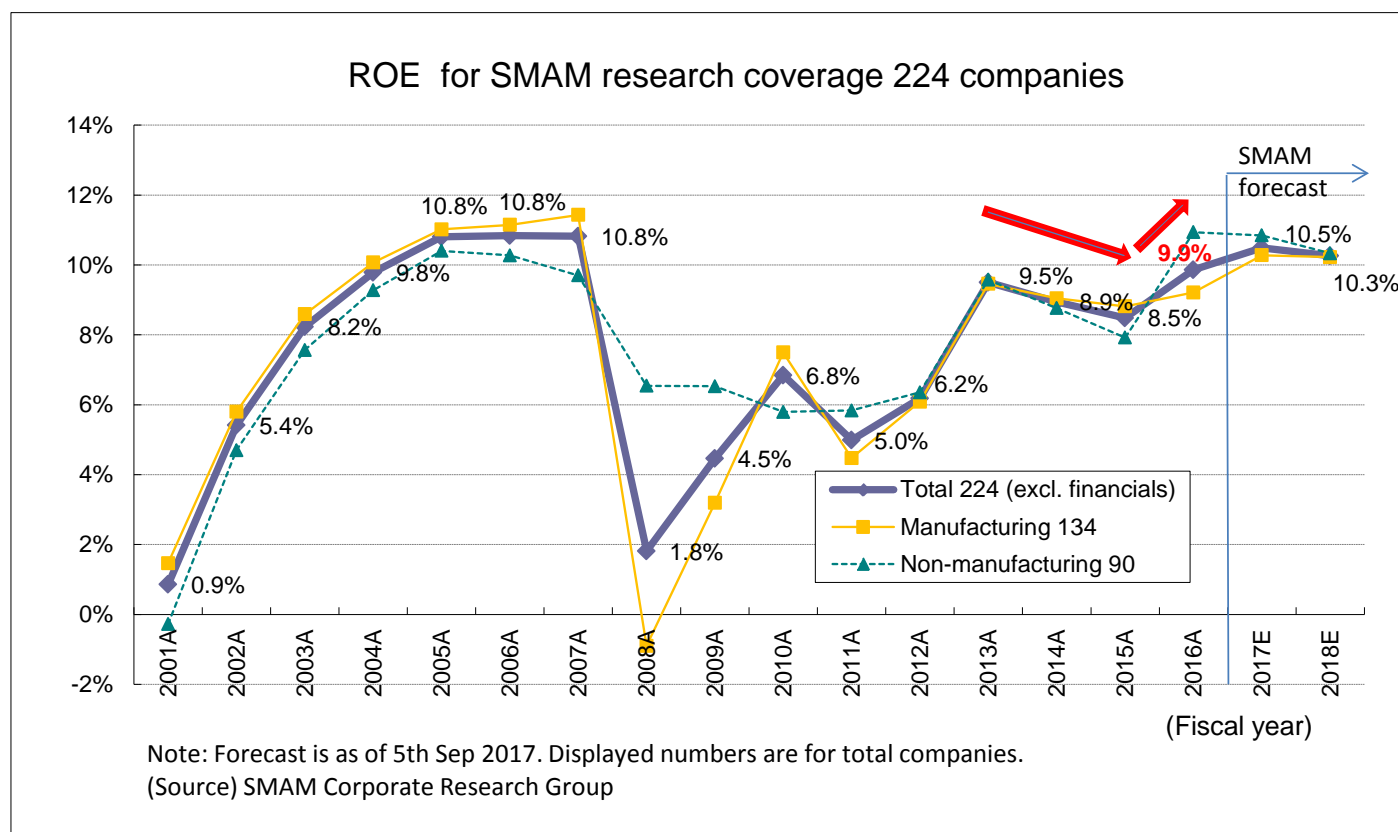
Comparing EPS growth and PER, US looks expensive

- PER rose in October due to rise in share price, meanwhile 12M forward EPS forecast declined after robust EPS growth in 2Q 2017 went behind.
- 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 in PER, but EPS growth forecast was upgraded. Japan looks more attractive than Europe with higher EPS growth and lower PER, though the difference is not large.



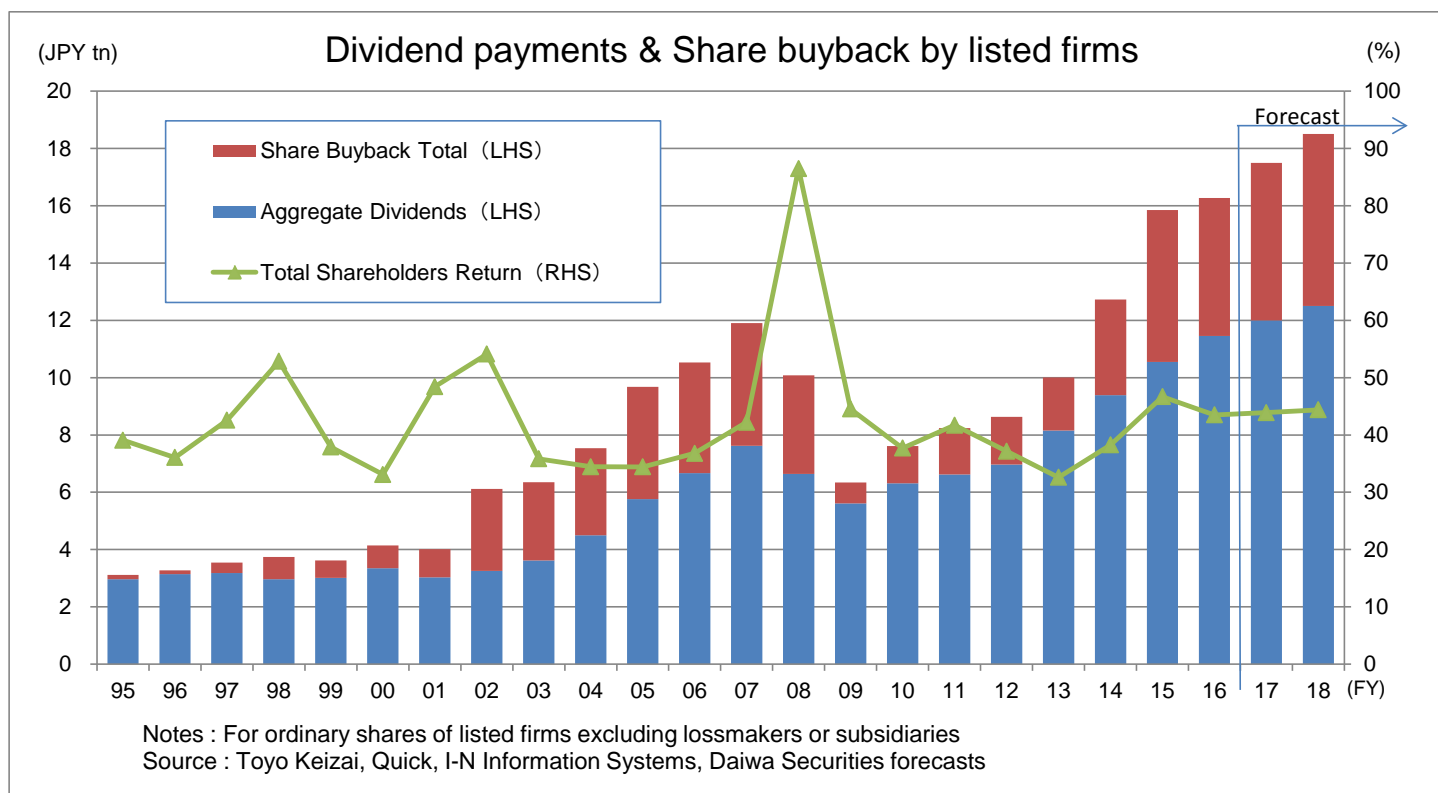
Increasing shareholder returns lifted ROE to 9.9% in FY 2016

- 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.



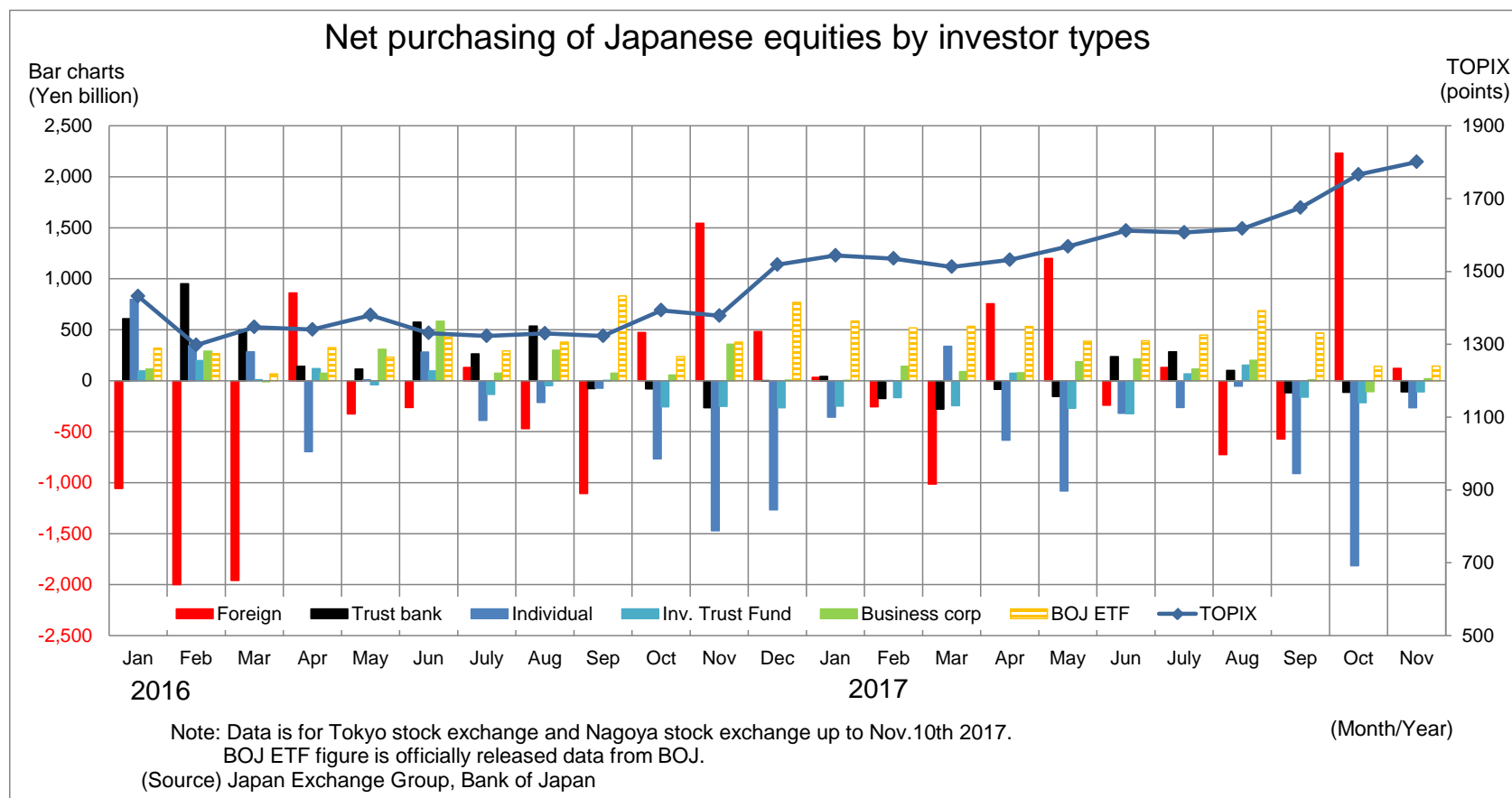
Japanese companies are increasing dividends and share buybacks

- Total of dividend and share buyback amount renewed a historical record in FY2016 and expected to rise further.
- Total shareholder return, which is the percentage of shareholder earnings returned to shareholders by way of dividend & share buyback, was 43.5% in FY2016, which is expected to increase just marginally in FY2017 and FY2018.



Foreign investors bought back Japanese shares in October

- Foreign investors turned to purchasing Japanese shares in October meanwhile individuals were the largest sellers.
- BOJ's ETF purchasing slowed lately in a strong performance of stock prices.



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