



# Japanese Stock Market Outlook

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SMAM monthly comments & views  
-September 2018 -



Sumitomo Mitsui Asset Management

SMAM

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## Executive summary

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### ➤ Japanese Economy

Growing uncertainties stemming from trade disputes initiated by US are going to linger on the global economy. Declining global manufacturing momentum and recently found weakness in Chinese economy also weighs on. Japanese economic indicators are going to be distorted for a while due to extraordinary weather and natural disasters such as flood in western Japan. As November mid-term election in US gets closer, current uncertainties are expected to gradually recede.

- SMAM's top line GDP growth forecast is unchanged in August review. Contribution of private consumption was slightly downgraded meanwhile that of private capital investment was revised upward.
- Capital spending is one of the blight spots as Japanese companies are willing to spend for improving labor efficiency. Prince Naruhito is going to become the new emperor in April next year. Japanese calendar is going to be renewed, which should ignite capital spending for adjusting IT systems and printing materials starting this year.

### ➤ Japanese Stock Markets

Fate of trade negotiations between US-Japan as well as US-China will stay as a dominant factor for the Japanese stock market for a while. Despite strong earnings results for Apr-Jun, Japanese companies keep conservative outlook due to uncertainties stemming from trade disputes and apparently declining global manufacturing momentum. On the other hand, strong appetite for CAPEX is an encouraging factor.

- After Bank of Japan (BOJ) changed its monetary policy and made ETF purchasing more flexible, investors' eyes are focusing on how purchasing pace actually changes.
- Current slowdown in global manufacturing activities is expected to turn upwards again probably some time in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies. Trade disputes are forecast to recede gradually after the mid-term election in US in November providing positive momentum to the stock market.

Notes: Macro and market views are as of Aug. 21<sup>st</sup> 2018, and subject to updates thereafter without notice.

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# Outlook for Japanese Economy

## SMAM economic outlook for FY17-19

- Top line GDP growth forecast is unchanged in August review. Contribution of private consumption was slightly downgraded meanwhile that of private capital investment was revised upward.

( YoY %)	FY14	FY15	FY16	FY17	FY18E	FY19E
Real GDP growth	-0.3%	1.4%	1.2%	1.6%	1.1%	0.9%
Private Consumption Expenditure	-2.5%	0.8%	0.3%	0.8%	0.8%	0.6%
Private Housing Investment	-9.9%	3.7%	6.2%	-0.3%	-5.0%	0.6%
Private Capital Investment	3.3%	2.3%	1.2%	3.1%	3.5%	2.2%
Public Consumption Expenditure	0.4%	1.9%	0.5%	0.7%	0.5%	0.9%
Public Capital Investment	-2.0%	-1.6%	0.9%	1.4%	-1.3%	0.3%
Net Exports (contrib. to GDP growth)	0.6%	0.1%	0.8%	0.4%	0.1%	0.1%
Exports	8.7%	0.8%	3.6%	6.3%	3.1%	1.9%
Imports	4.2%	0.4%	-0.8%	4.1%	2.6%	1.3%
Nominal GDP	2.2%	3.0%	1.0%	1.7%	1.2%	2.1%
GDP Deflator	2.5%	1.5%	-0.2%	0.1%	0.1%	1.2%
Industrial Production	-0.4%	-1.4%	1.5%	4.1%	1.9%	1.7%
CPI (excl. fresh food)	0.9%	-0.1%	-0.2%	0.7%	0.8%	0.7%

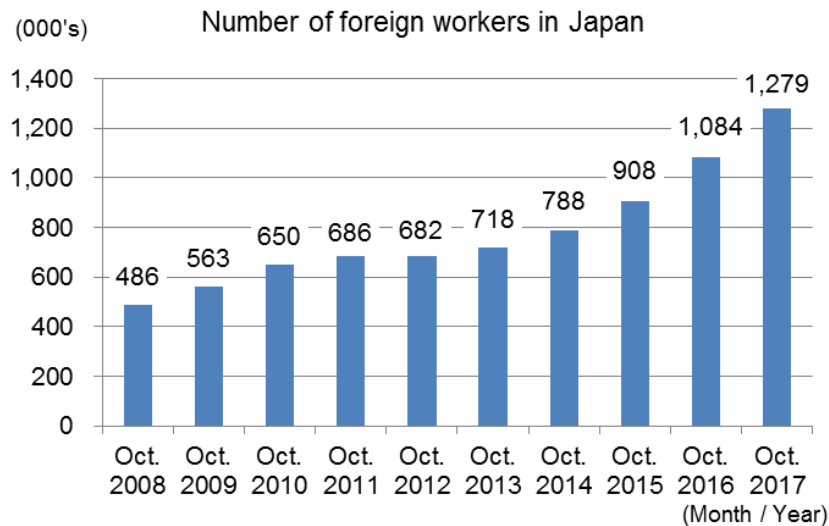
Notes: E=SMAM forecasts. SMAM views are as of August 21<sup>st</sup>, 2018 and subject to updates thereafter without notice

(%, YoY except Net Exports)

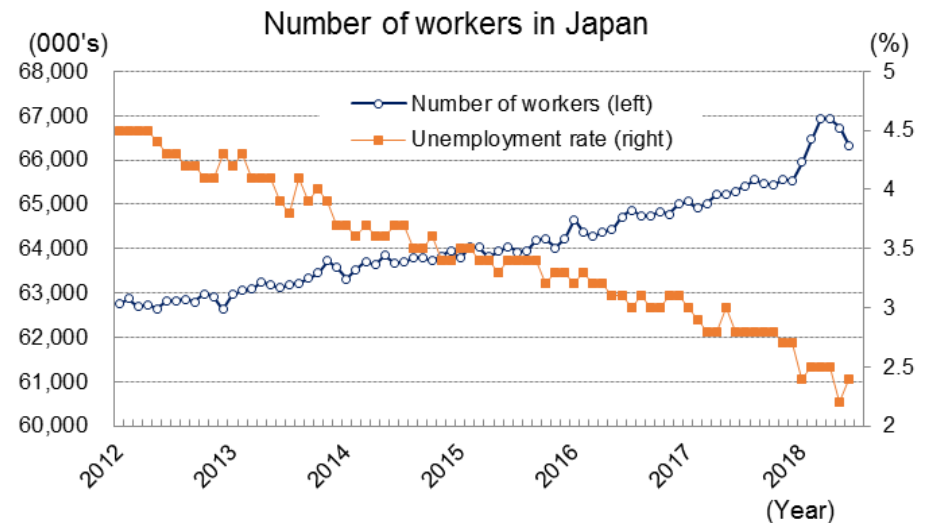
(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMAM forecasts

## Number of foreign workers in Japan has been increasing steadily

- In two years from November 2015 to October 2017, number of foreign workers in Japan increased by the pace of 200 thousands per year. For the same period, number of total workers in Japan increased by the pace of 615 thousands per year.
- These two statistics are based on different surveys, however, it can be said that foreign workers are already playing a substantial part in filling labor shortages.
- Intensifying labor shortage is pushing the government to open the gate even wider for the foreign workers.



(Source) Ministry of Health, Labour and Welfare



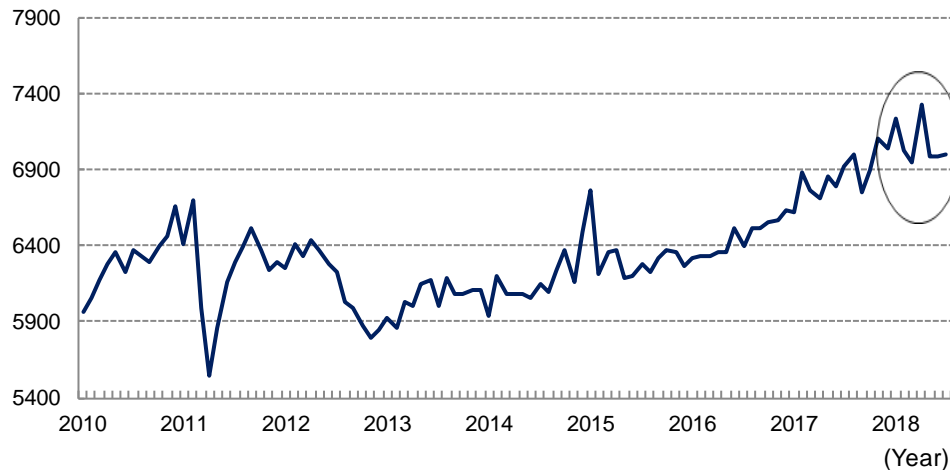
Note: Data is from Jan. 2002 to Jun. 2018

(Source) Ministry of Internal Affairs & Communications

## Export is still holding

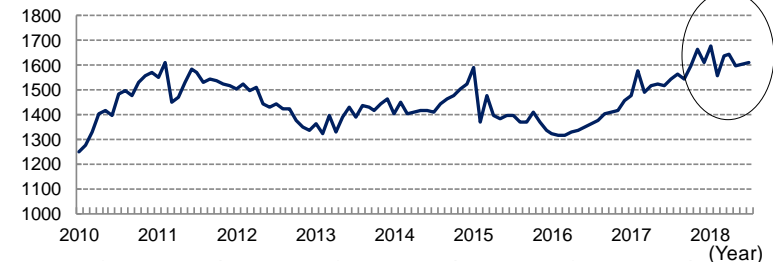
- Export of transportation equipment such as cars and trucks declined in July. Typhoon attacks in Japan were said to have stopped shipping of exports.
- Export of electrical goods is increasing strongly, which is probably due to such factors as starting production of new smart phone models and also underlying strong demand coming from developing new technologies.

Total export volume  
(seasonally adjusted, yen billion)

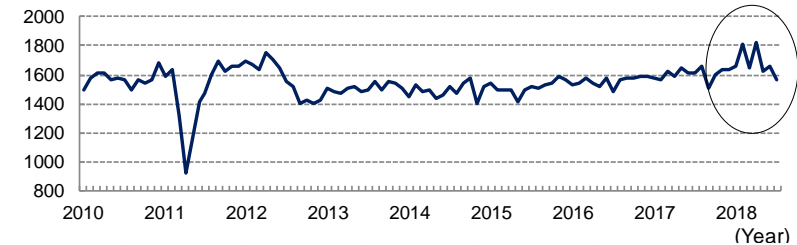


Note: Data is from Jan. 2010 to Jul. 2018.  
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

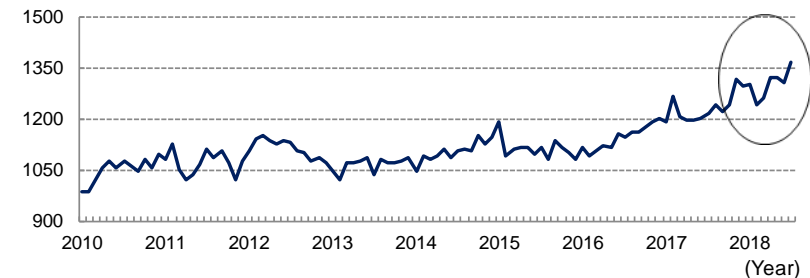
General Machinery



Transportation Equipment

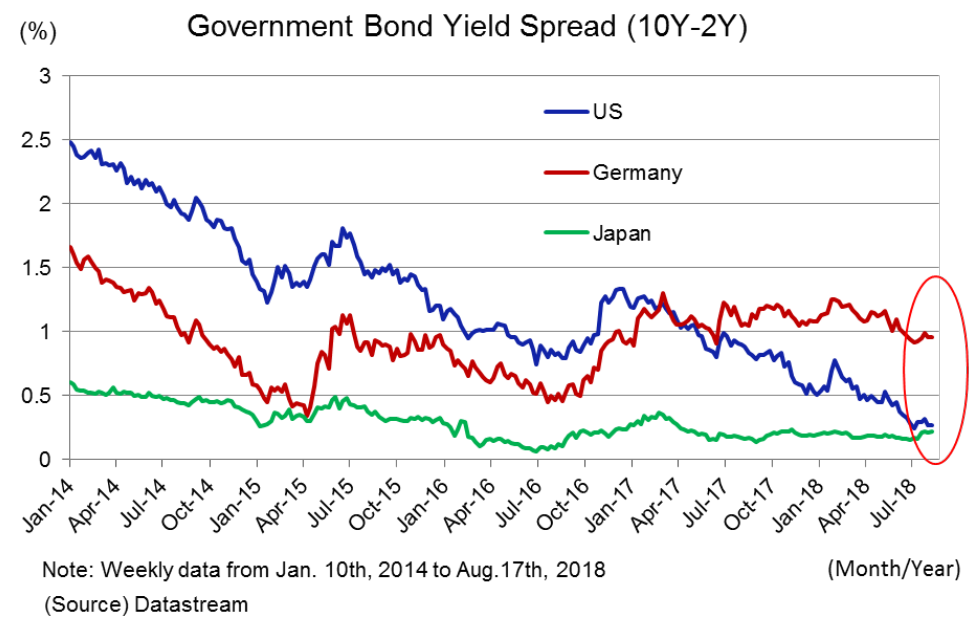
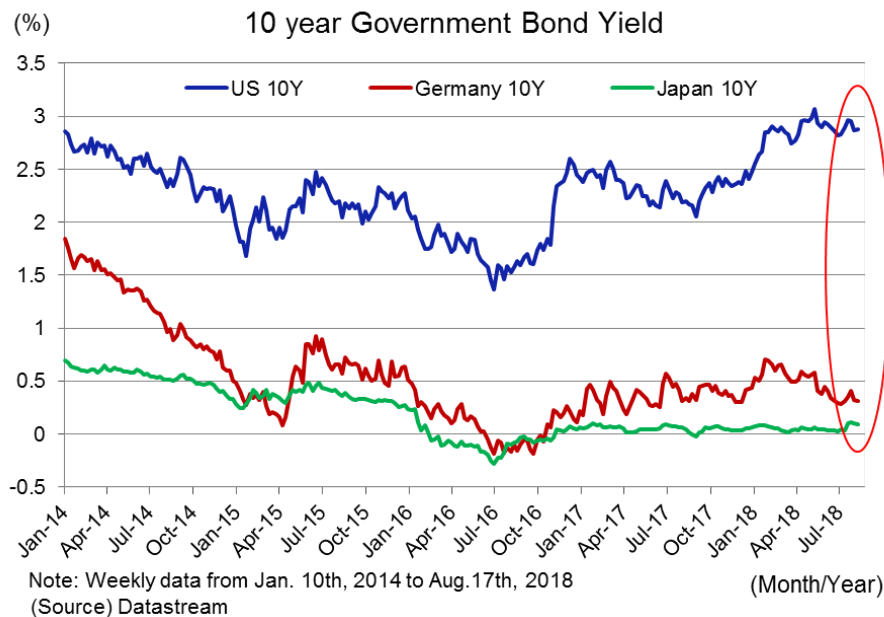


Electrical Goods



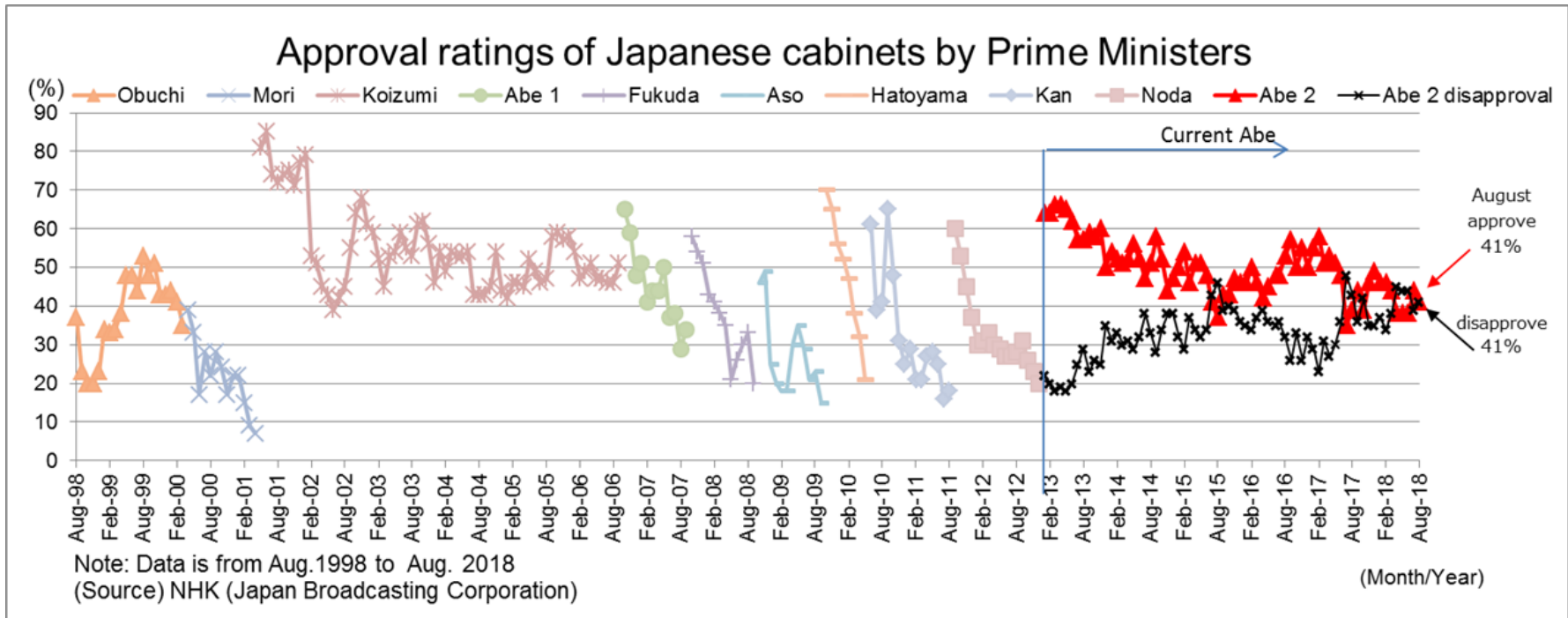
## Yield curve continues flatten in US, meanwhile long-term bond yield edged up in Japan

- Bank of Japan (BOJ) adjusted its monetary policy at the monetary policy committee meeting on 31<sup>st</sup> of July, allowing slightly wider range for long-term bond yields.
- BOJ also made purchasing pace of Japanese equity ETF a little more flexible, which could be a start of a stealth tapering as the stock market speculates.
- BOJ said this time's policy adjustment is to make the current easing more durable. BOJ is probably testing the water how financial markets react to such policy change, which could be leading to future policy normalization even though it still seems remote.



## Approval rating for PM Abe's cabinet slightly deteriorated in August

- According to NHK, Approval rating for PM Abe's cabinet fell slightly from 44% to 41% in August, meanwhile disapproval rating edged up from 39% to 41%.
- LDP leadership election is going to be held in September, for which odds are increasing for Mr. Abe to be re-elected.





## Trade disputes seem to be the most influential event for the global economy

- Trade disputes, US-China and US-Japan, are going to be the most influential events for the Japanese stock market for a while.
- In Japan, LDP leader election is going to be held on September 20<sup>th</sup> for which candidacy declaration will be closed on September 7<sup>th</sup>. Only Mr. Ishiba, former defense minister, is expected to challenge Mr. Abe, which makes odds for Mr. Abe's re-election as the party leader in favor.
- As another note for Japan, Prince Naruhito is going to become the new emperor in April next year. Japanese calendar is going to be renewed, which should ignite capital spending for adjusting IT systems and printing materials starting this year.

### Upcoming key events

Month	Region/Country	Events	Notes
August	US-China	30 End of USTR's public hearing and taking opinions about imposing extra tariff on Chinese imports	Where the trade battle goes?
September	Japan	18-19 BOJ Monetary Policy Committee Meeting	
	Japan	20 LDP leadership election	
	US-Japan	US-Japan trade talks, 2nd round	
	EU	26 ECB Monetary Policy Meeting	
	EU/UK	30 Target date for deciding Brexit conditions	
November	US	6 Mid-term election for US congress	
	US-Iran	8 2nd part of US sanctions on Iran is set to begin	
	Japan	14 BOJ Monetary Policy Committee Meeting (Quarterly perspective report)	
	Middle East	OPEC meeting	
2019			
April	Japan	Prince Naruhito becomes the new emperor. Japanese calendar is set for renewal.	Positive economic effect is expected from celebratory atmosphere and calendar renewal.
October	Japan	Consumption Tax is scheduled to rise from 8% to 10%	

(Source) Various publications, assembled by SMAM

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# Outlook for Japanese Stock Markets

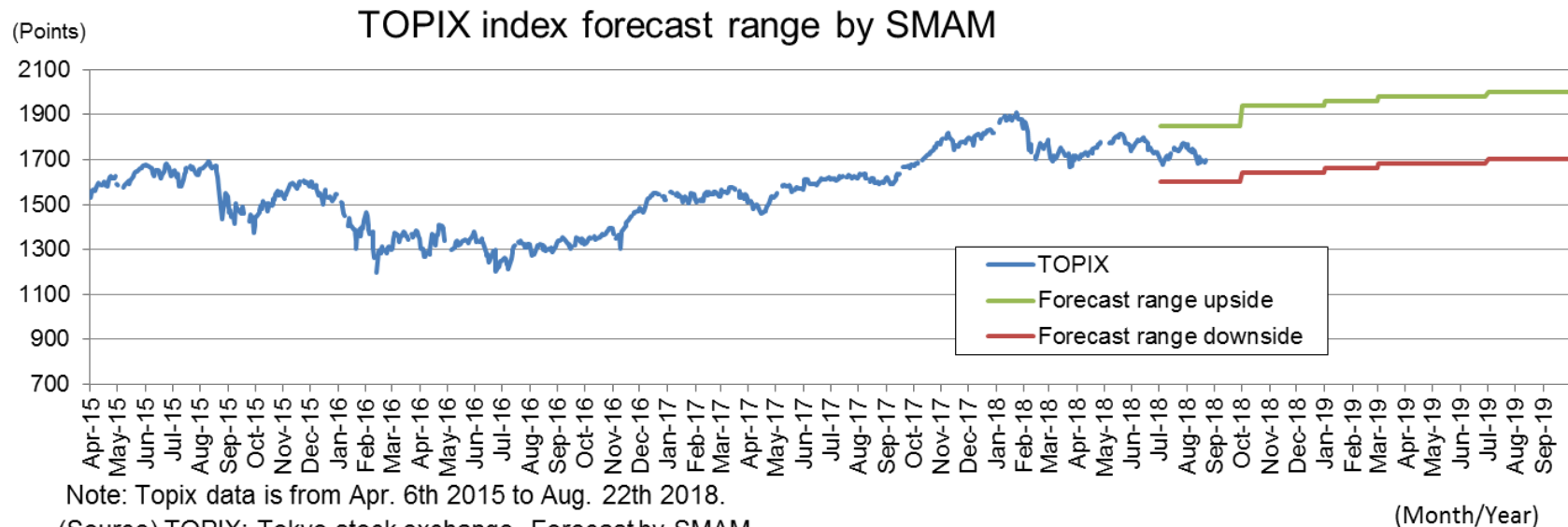
## Stock market outlook: Fear of trade war weighs on the stock market

### SMAM short-term view

- Fate of trade negotiations between US-Japan as well as US-China will stay as a dominant factor for the Japanese stock market for a while. Despite strong earnings results for Apr-Jun, Japanese companies keep conservative outlook due to uncertainties stemming from trade disputes and apparently declining global manufacturing momentum. On the other hand, strong appetite for CAPEX is an encouraging factor.

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

- Current slowdown in global manufacturing activities is expected to turn upwards again probably some time in the latter half of 2018, which is going to lift the earnings forecasts and also stock prices of the Japanese companies. Trade disputes are forecast to recede gradually after the mid-term election in US in November providing positive momentum to the stock market.



Note: SMAM's projection is as of Aug. 21<sup>st</sup>, 2018 and subject to updates without notice.

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

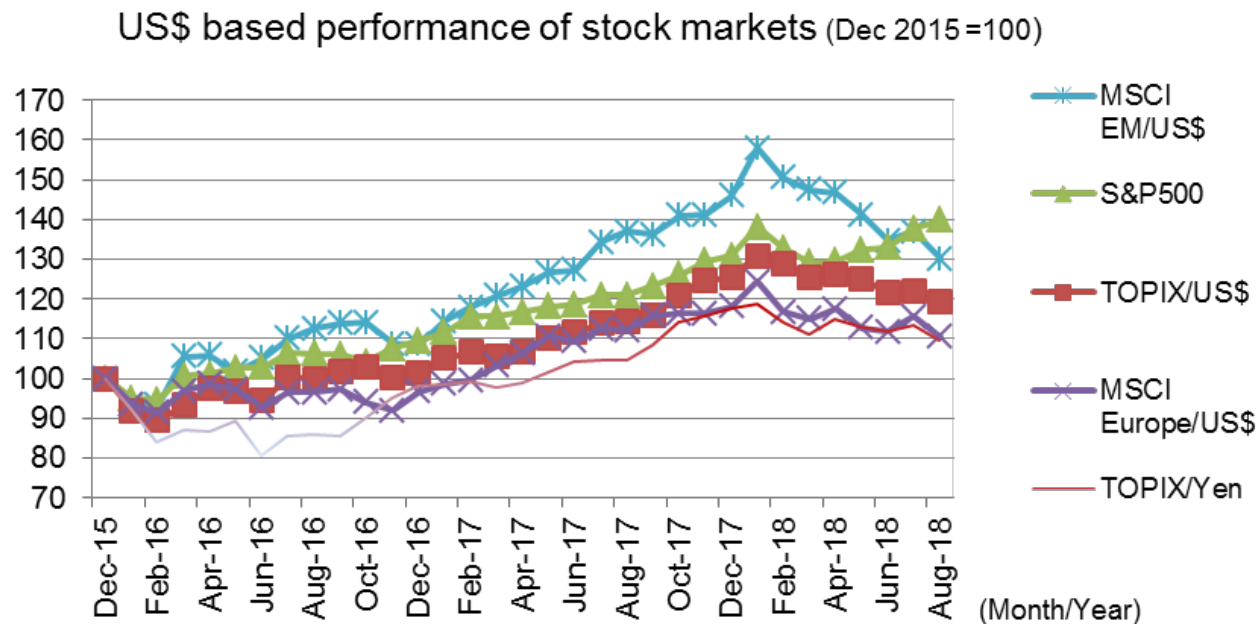
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- Our **Base Scenario** is assuming the following views:
  - Uncertainties of world trade disputes will recede post mid-term election in US in November.
  - US economy keeps growing.
  - Japan's private consumption to grow mildly supported by wage growth.
  - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
  - PM Abe's survival is in a little doubt, however, current policies continues even by the successor.
  - Tension in the East Asia does not ignite a war.
  - Central banks gradually move to normalize monetary policies and avoid killing economic growth.
  
- **Upside Risks** include:
  - Stronger-than-expected global growth.
  - Denuclearization in Korean peninsula makes a visible progress.
  - Extremely tight labor condition in Japan finally ignite substantial wage growth leading to higher inflation.
  
- **Downside Risks** include:
  - Seriously escalating geo-political tensions in Middle East & East Asia.
  - Rekindled concern over emerging economies including China.
  - Global monetary tightening intensifies to choke global economy.
  - Confrontational foreign policies taken by Trump presidency igniting a trade war.
  - "Russia-gate" scandal flares up.
  - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of Aug. 21<sup>st</sup>, 2018 and subject to updates without notice.

## Uneasiness grew further for emerging markets

- Trade disputes are hurting global stock markets, except US.
- Emerging markets had another blow as Turkish currency and stocks fell sharply on rising tensions with US.

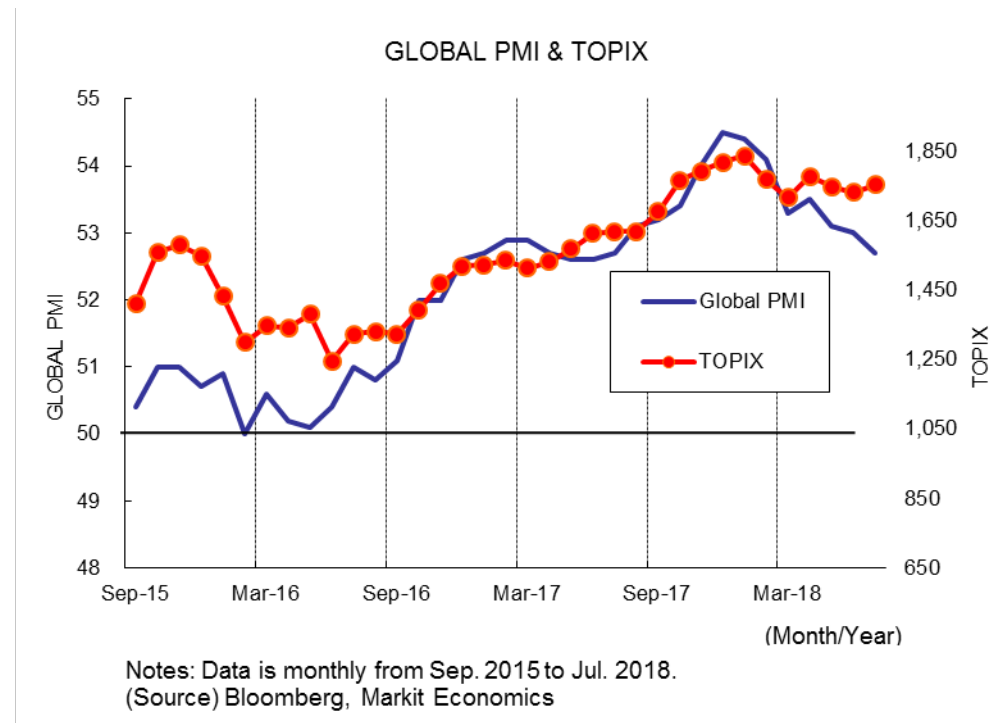


Notes: Data is up to Aug. 20th 2018.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.

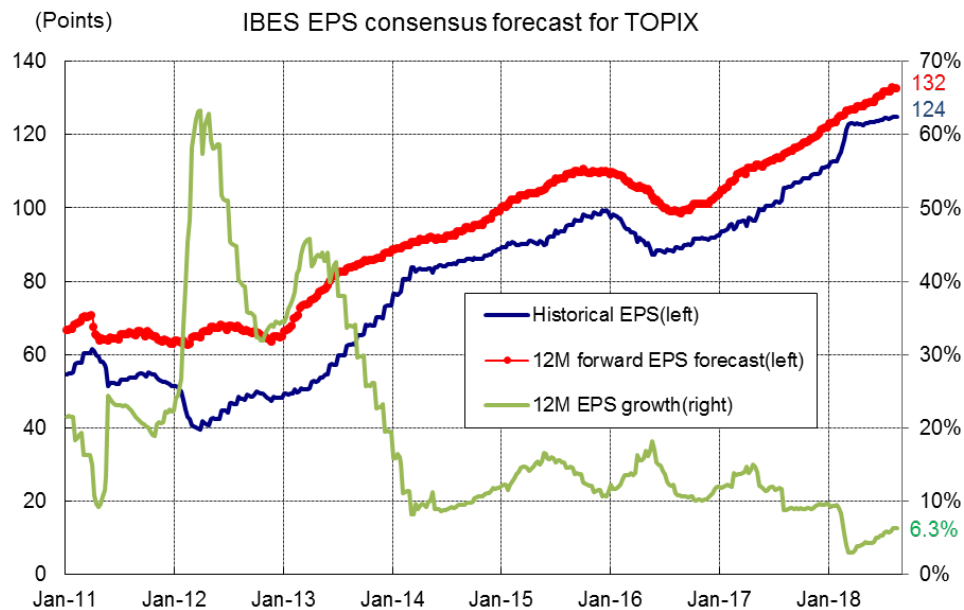
## Momentum of global manufacturing activity continues to decline

- Momentum continues to decline for the global manufacturing activities though PMI is still well over 50, which indicates manufacturing environments are getting better.
- Japanese stock market is highly correlated with global PMI.



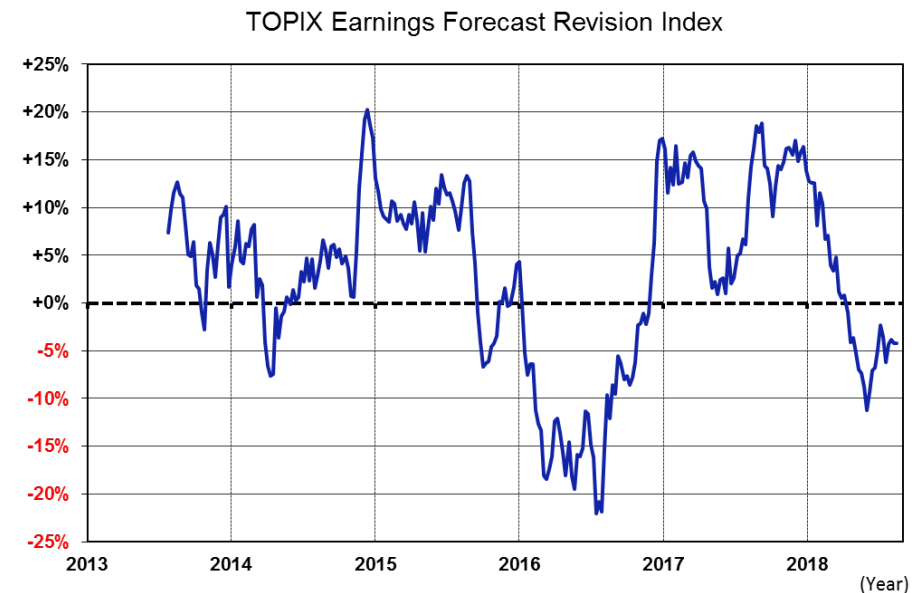
## 12M forward EPS forecast continue to edge up

- Latest 12M forward EPS growth forecast rose slightly further to 6.3% according to IBES consensus forecast.
- Apr-Jun quarterly earnings growth were generally strong and better than preceding forecast, especially for manufacturing companies. However, companies stay conservative in predicting earnings for entire FY2018. Earnings revision index is not yet turned positive.



Note: Weekly data from Jan. 6th 2011 to Aug. 16th 2018. (Month/Year)

(Source) Datastream, IBES



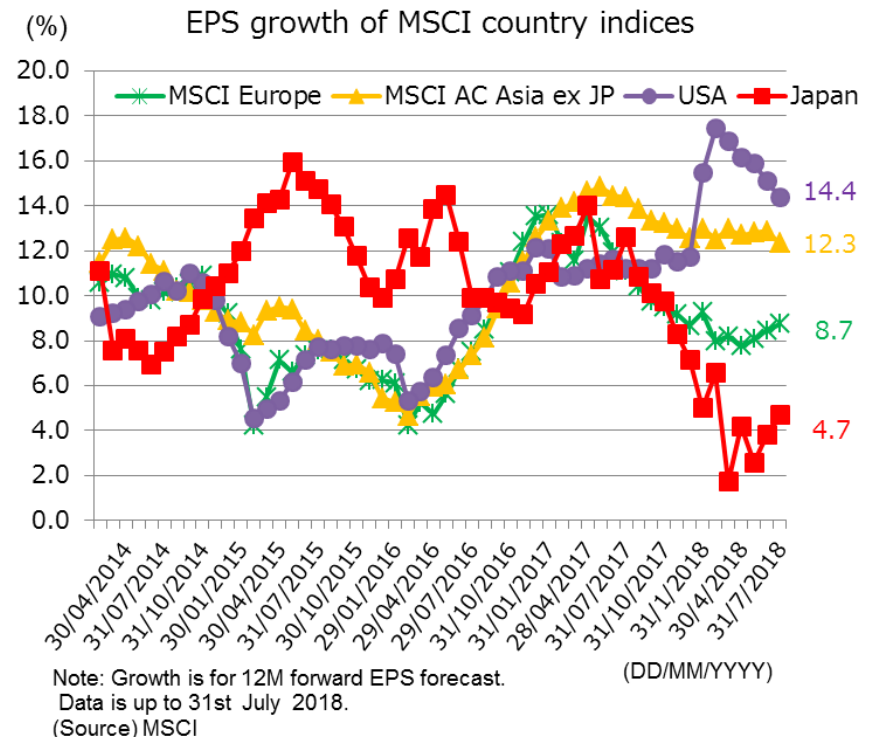
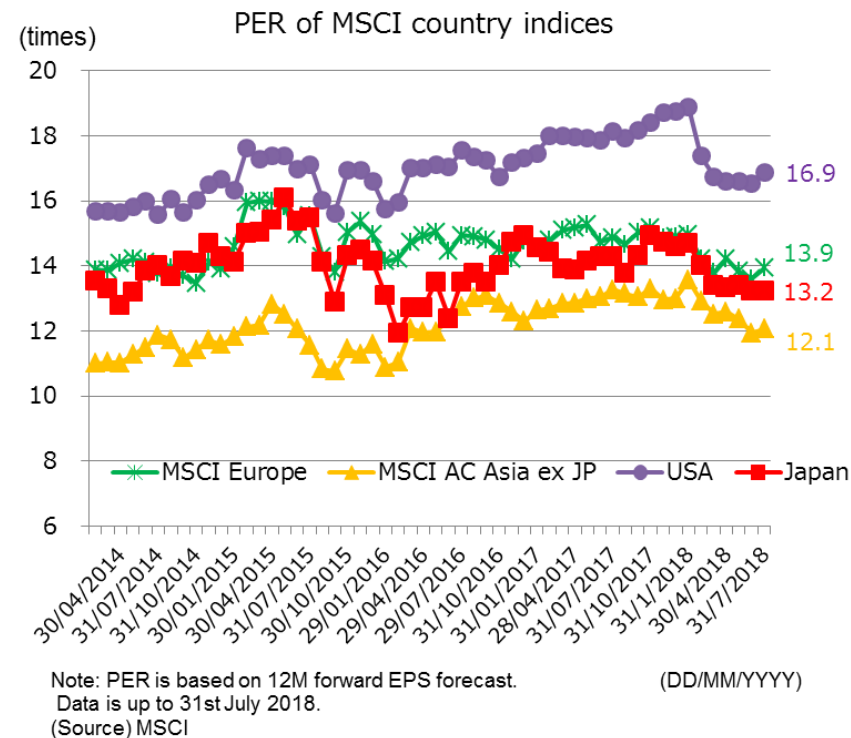
Notes: Revision index= % of Analyst upgrades out of total Topix firms - % of downgrades.

Data is weekly from Jan. 7th 2013 to Aug. 16th 2018.

(Source): IBES, SMAM

## PE ratio is at reasonable levels

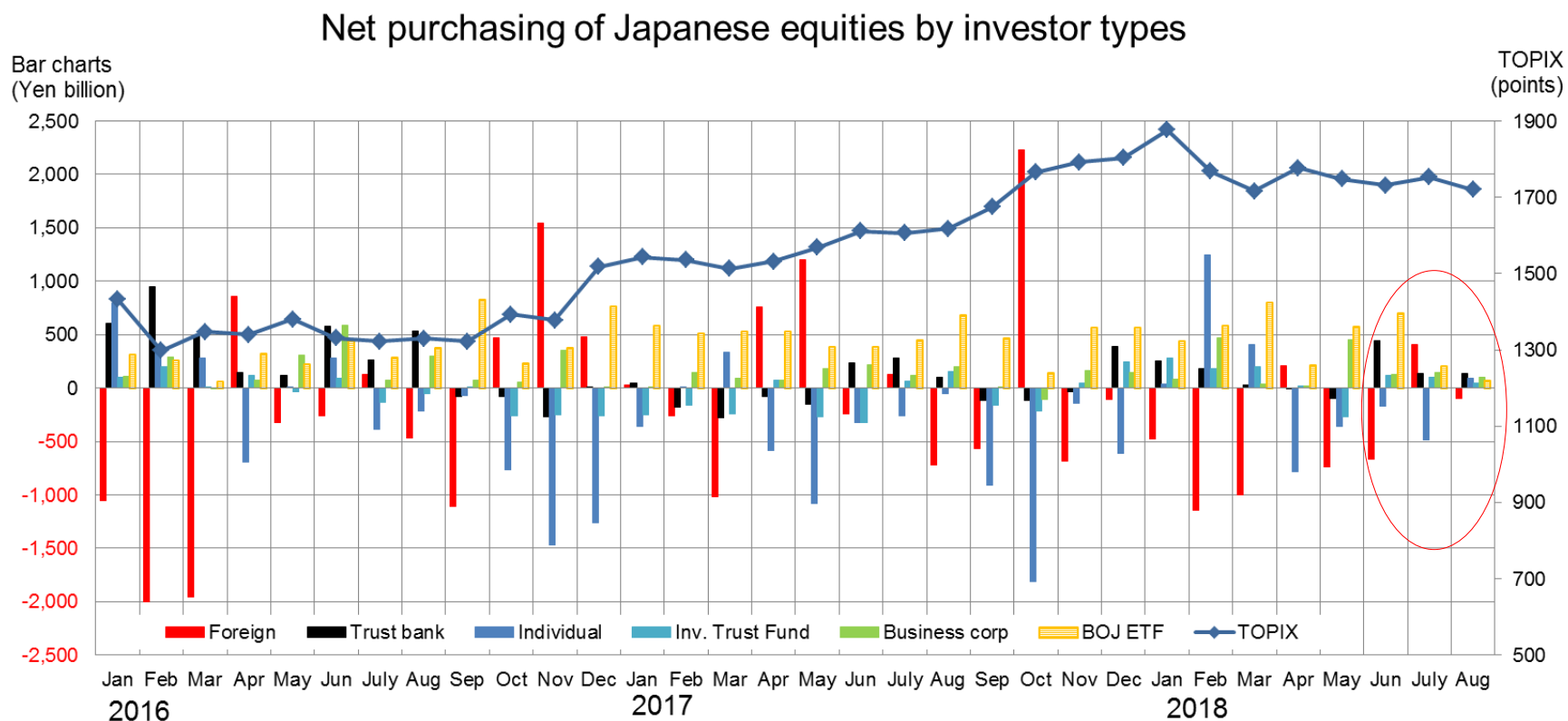
- Comparing PE ratio and EPS growth forecasts for global stock markets, a market with higher EPS growth is given higher stock valuation in terms of PE ratio.
- One exception is Asia. If current 12% growth forecast is going to be achieved, current PE ratio at 12 times looks attractive.





## BOJ's ETF purchasing might be gradually slowing down

- After BOJ changed its monetary policy and made ETF purchasing more flexible, investors' eyes are focusing on how purchasing pace actually changes.



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to Aug.10th 2018.  
 BOJ ETF figure is officially released data from BOJ.  
 (Source) Japan Exchange Group, Bank of Japan

(Month/Year)

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