



Japanese Stock Market Outlook

SMAM monthly comments & views
-December 2018 & January 2019-



Sumitomo Mitsui Asset Management

SMAM

Executive summary

➤ Japanese Economy

GDP for Jul-Sep declined by -2.5%, QoQ annualized. This quarterly decline was mostly affected by natural disasters and rebound can be expected. Private consumption recovered in October and also consumer sentiment stays resilient. Capital expenditure by companies declined more than expected in Jul-Sep quarter also due mostly to natural disasters, however, business sentiment might also have been affected by trade disputes and apparent economic slowdown in China.

- After a top meeting between US and China on 1st December, US postponed further imposition of tariff on China until March next year. Battle field between US and China is moving to technology as the CFO of Huawei, a Chinese telecom equipment giant, was arrested in Canada on the request of US, which is said to be on the suspect of breaching US sanction imposed on Iran.
- Large fiscal spending is going to be made in Japan in 2019, which will be supportive for the Japanese economy.

➤ Japanese Stock Markets

Global stock market is driven by fears that US economy could be heading to a cyclical downturn in 2019 and Chinese economy is falling into a serious trouble. Japanese stock market is going to stay volatile. However, current negative sentiment seems a little overdone and stock valuation became too low. Rebound in the stock market seems possible at least for the short term.

- Earnings forecasts for Japanese companies are currently revised downward. Recent corporate earnings results for Jul-Sep quarter were a little disappointing and also concern on the global economy is increasing. Focus is on the direction of EPS forecast going forward, whether it avoids significant decline and start rebounding.
- PE ratio of TOPIX index, which covers all stocks listed on Tokyo Stock Exchange 1st section touched 12 times, which is at the lowest end of the range between 12 times and 16 times since PM Abe took office.

Notes: Macro and market views are as of 10th Dec. 2018, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY18-20

- GDP for Jul-Sep declined by -2.5%, QoQ annualized. At the moment, SMAM keeps forecast for FY2018 unchanged as the recent quarterly decline was affected by natural disasters and rebound can be expected. However, slight down-revision is possible.

(YoY %)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Real GDP growth	1.4%	1.2%	1.6%	1.1%	0.9%	0.6%
Private Consumption Expenditure	0.8%	0.3%	0.8%	0.6%	0.6%	0.5%
Private Housing Investment	3.7%	6.2%	-0.3%	-4.6%	0.2%	-4.8%
Private Capital Investment	2.3%	1.2%	3.1%	4.8%	1.9%	0.5%
Public Consumption Expenditure	1.9%	0.5%	0.7%	0.5%	0.9%	0.8%
Public Capital Investment	-1.6%	0.9%	1.5%	-2.2%	1.8%	0.8%
Net Exports (contrib. to GDP growth)	0.1%	0.8%	0.4%	0.1%	0.1%	0.1%
Exports	0.8%	3.6%	6.3%	2.4%	2.0%	1.3%
Imports	0.4%	-0.8%	4.1%	1.9%	1.2%	0.8%
Nominal GDP	3.0%	1.0%	1.7%	1.0%	1.8%	1.6%
GDP Deflator	1.5%	-0.2%	0.1%	-0.0%	0.9%	1.0%
Industrial Production	-1.4%	1.5%	4.3%	1.3%	1.6%	1.3%
CPI (excl. fresh food)	-0.1%	-0.2%	0.7%	0.8%	0.5%	0.5%

Notes: E=SMAM forecasts. SMAM views are as of 10th Dec. 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

US postponed imposing further tariff on imports from China until 1st March 2019

- After a top meeting between US and China on 1st December, US postponed further imposition of tariff on China until March next year. US President Trump and Chinese leader Xi Jinping agreed to continue negotiation on US claims including such as forced technology transfer and protection of intellectual property.
- US has so far imposed a) 25% tariff on USD 50 billion worth imports from China and b-1) 10% on further USD 200 billion. Additional tariff increase of b-2) raising tariff from 10 to 25% on USD 200 billion and c) new 25% tariff on USD 267 billion were postponed.
- Existing tariff is already hurting Chinese economy and the negative effect is going to become more apparent, however, this time's postponement of further imposition will slightly calm the fear that the global economy could be falling into a recession next year.
- However, working time for negotiation is limited considering holiday period in December and also Chinese new year in February 2019. Pressure is on China.

Simulation of negative effects of US-China tariff increase on global GDP (%)

		China	US	Japan	EURO area	South Korea	Taiwan	ASEAN 6	
Already imposed	a)	US -China 25% mutual tariff imposition on USD 50 bil. imports from the counterpart	-0.13	-0.11	-0.04	-0.02	-0.06	-0.11	-0.04
Partially imposed	b)	US imposing 25% tariff on USD 200 bil. imports and China imposing 15% tariff on USD 60 bil. imports.	-0.53	-0.25	-0.14	-0.06	-0.22	-0.38	-0.15
Not imposed yet	c)	US imposing 25% tariff on USD 267 bil. Imports.	-0.88	-0.26	-0.21	-0.08	-0.36	-0.66	-0.24

Note: This simulation calculates change (decrease) of trading volume for each tariff increase and its impact on GDP.

The impact is for all volume adjustments to be completed, and it takes approximately 1 year and a half on average.

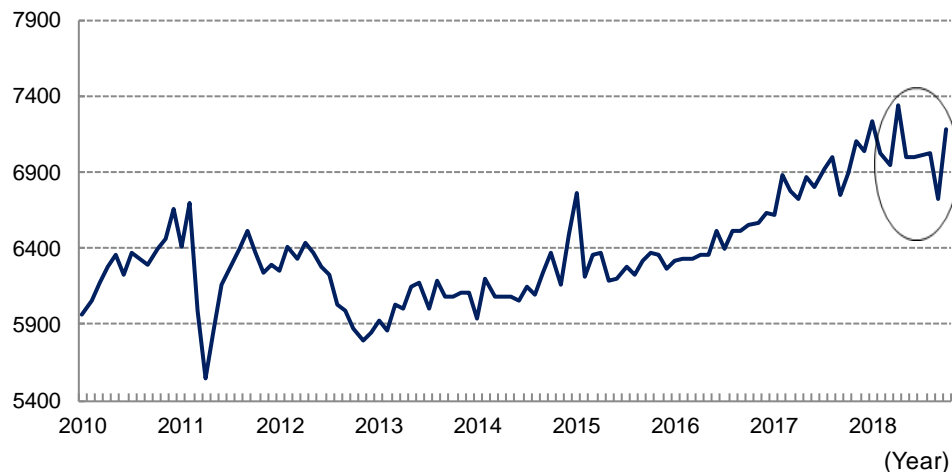
ASEAN 6 countries are Thailand, Malaysia, Philippine, Vietnam, Singapore and Indonesia.

(Source) Simulation was made by SMAM using OECD data.

Export made a recovery in October from typhoon damage in the previous month

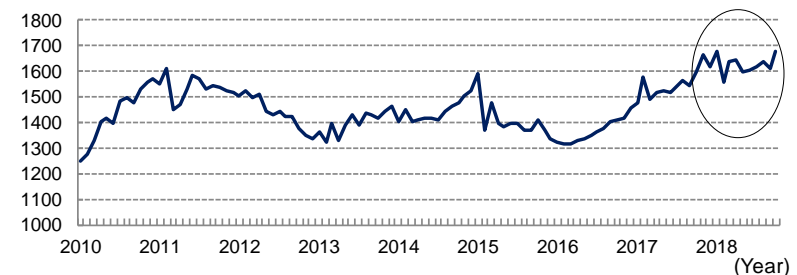
- Total export recovered in October showing the dip in the previous month was temporary caused by typhoon attacks disrupting exports physically.
- Though data is not shown here, global trading activities of China is still strong despite tariff increase between US. Rush trades just before tariff increase probably inflated the trade volume. A repercussion is expected.

Total export volume
(seasonally adjusted, yen billion)

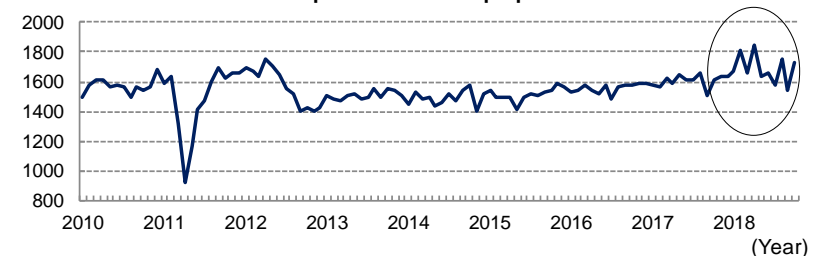


Note: Data is from Jan. 2010 to Oct. 2018.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

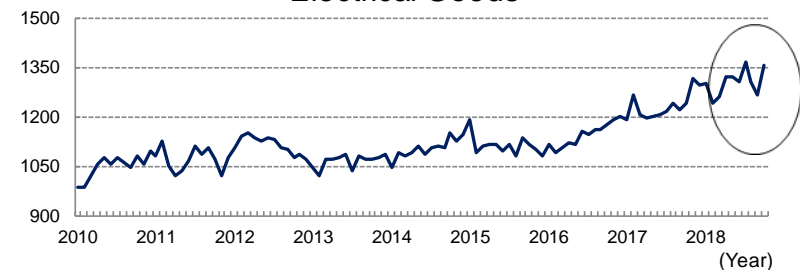
General Machinery



Transportation Equipment



Electrical Goods



Private consumption activity recovered in October after negative effects from natural disasters

- After significant slowdown in September due to many typhoon attacks and large earthquake in Hokkaido, retail sales showed recovery in October.
- In October, sales increased in general except for Food & beverages. Fuel sales increased due to higher fuel price.

Retail sales (MOM%, seasonally adjusted)

(Year / Month)	All retail	General Merchandise								Large scale stores		Convenience stores	
		General Merchandise	Fabrics Apparel & Accessories		Food & Beverages	Others	Motor Vehicles	Machinery & Equipment	Fuel	Medicine & Toiletry Stores	Department stores		Super-markets
2018 1	-1.6	1.2	-3.8	0.1	-1.3	-8.4	2.0	0.4	0.5	0.2	1.9	0.7	
2	0.5	-0.9	-0.3	-0.5	-0.4	-0.6	-5.6	4.0	-1.1	-0.3	-0.6	0.1	
3	-0.6	-1.1	-0.4	0.0	-0.6	-1.8	1.0	-5.3	1.7	0.0	-2.0	0.7	
4	1.3	1.8	3.8	-0.4	2.6	5.3	0.6	3.5	2.0	1.8	1.2	0.6	
5	-1.7	-2.6	-3.8	-0.7	-1.1	-1.0	-1.3	1.8	-1.7	-3.0	-1.5	-2.5	
6	1.4	3.5	0.5	0.1	0.8	-1.2	0.6	1.9	1.4	4.7	1.8	2.0	
7	0.1	-3.5	0.0	1.0	1.2	4.1	1.3	1.9	-0.5	-8.0	2.2	0.1	
8	0.9	1.2	3.1	0.9	0.3	2.9	-1.9	-3.9	0.4	5.6	-1.7	-0.3	
9	0.1	-0.6	-0.7	-0.5	-0.7	-1.2	1.9	1.1	-1.2	-3.7	1.4	2.2	
10	1.2	0.6	1.2	-0.1	3.1	3.9	-0.2	3.0	1.8	4.2	-1.6	-3.9	

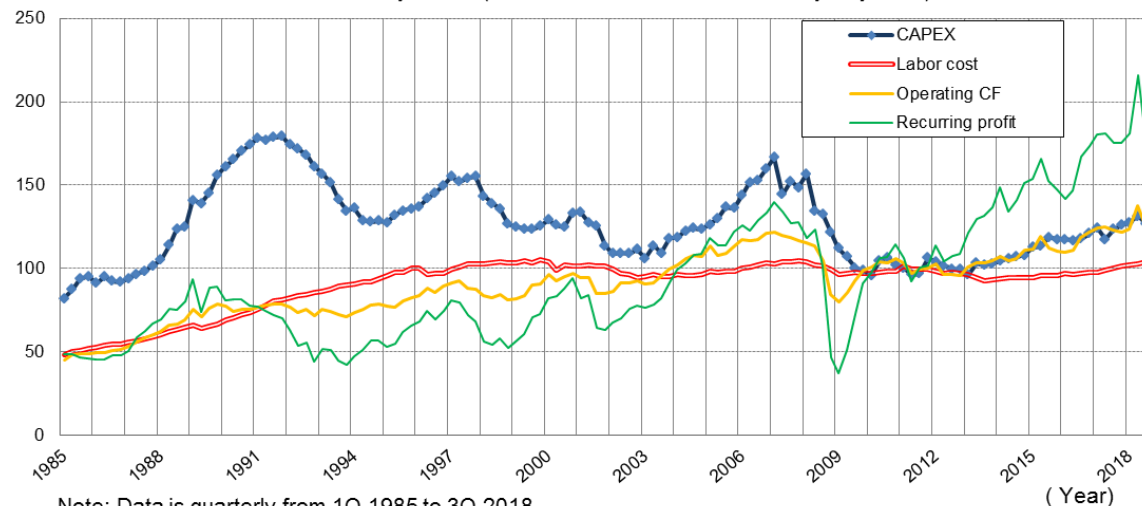
(Source) Ministry of Economy, Trade and Industry

Capital expenditure slowed down in Jul-Sep quarter due partly to natural disasters

- Corporate Financial Statics released by Ministry of Finance is one of the most comprehensive business statistics, which is the estimate for nearly 1 million corporations based on the sample of more than 20,000 companies, large and small in all industries.
- The latest statistics released on 3rd of December showed capital expenditure declining -4% from the elevated previous quarter. It still increased +4.5% year on year basis, however, it was weaker than the consensus forecast. Capital expenditure is expected to rebound from negative effects from natural disasters, typhoons and earthquake going forward.
- Labor cost, which means wage and income for households as well as social insurance cost, is slowly but steadily increasing, however, gap between profit is widening. Low and further declining labor share in corporate earnings is a structural problem in Japan.

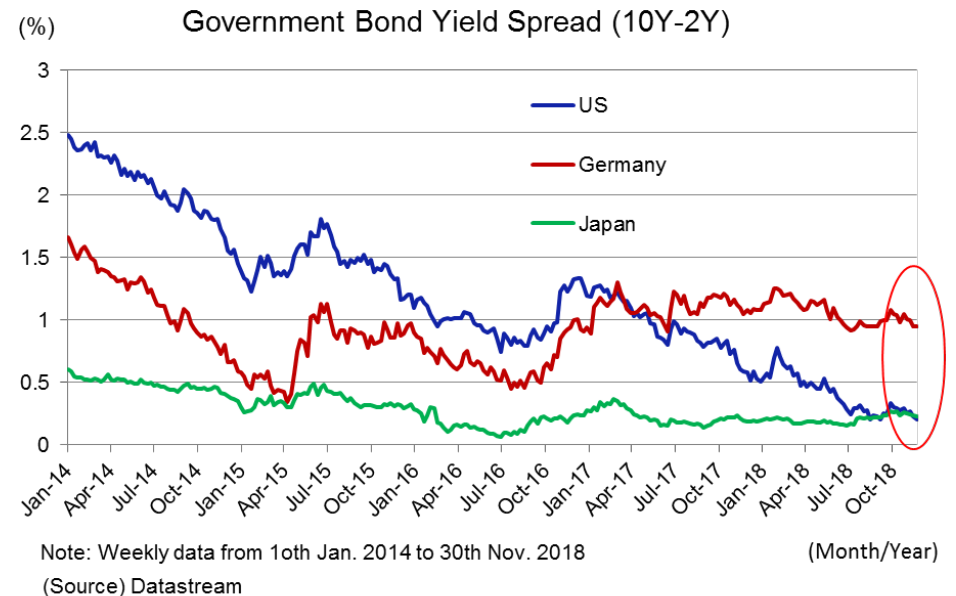
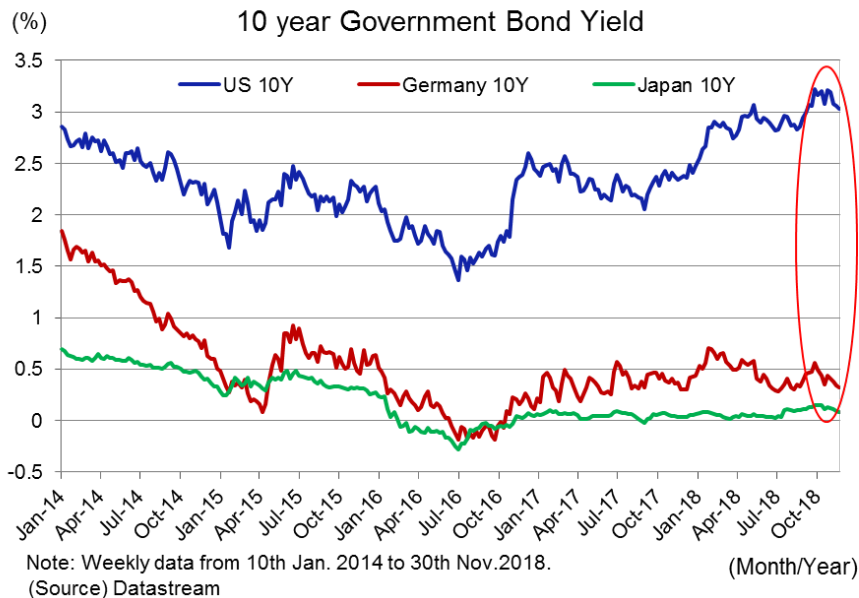
Corporate Financial Statistics

Trend of key items (Indexed, 2011=100, Seasonally adjusted)



Deterioration of economic outlook brought long-term bond yields down

- Outlook of the global economy deteriorated lately.
- FRB in US sounds less hawkish in recent communications by monetary policy committee members.
- Falling oil price made inflation outlook even milder.
- All these factors caused the long-term bond yields to come down.
- In US, yield curve became really flat and occasionally gets inverted at some parts, which is giving negative implications for the outlook of US economy and stock markets.



How trade negotiations between US and China goes by March 2019?

- Temporary 3 months trade truce was made between US and China on 1st December after a top meeting postponing raising tariff until 1st March 2019. Working time is limited considering holidays in December and Chinese new year in February. US keeps putting pressure on China.
- Economic impact of tariff increase has been felt by US as well as China, which is in the background of this time's trade truce. Recent GM's announcement to close some US factories was a blow for Trump.
- Brexit is an important issue for UK and Europe, and also many Japanese companies having major European operating centers located in UK are going to be affected if no-deal exit happens.

Upcoming key events

	Month	Region/Country	Events	Notes
2018	December	EU	13-14 EU summit	
		US	18-19 FOMC	
		Japan	19-20 BOJ monetary policy committee meeting	
			21(?) Government budget for 2019 will be approved by the Cabinet	
		30 TPP (Trans Pacific Partnership) begins without US		
China	Central Economics Work Conference	China is going to discuss how to endure economic slowdown and negative impact from trade sanction by US.		
		(Sometime between Dec-Mar)	It has been delayed for several months and needs to be held to decide policies of the communist party, which is going to be approved by National People's Congress in March 2019.	
2019	January	US	29 State of union address by the President Trump	
		Japan	22-23 BOJ monetary policy committee meeting with perspective report	
	February	China	4-10 Lunar New Year Holidays	
	March	US-China	1 US tariff on China may be imposed after 3 months' postponement	Time limit for trade negotiations between US and China
		China	National People's Congress	China needs to set policies for 2019.
	April	UK & EU	29 UK is going to exit EU.	
		Japan	1 Work style reform/ stricter control of overtime working	
	May	Japan	Prince Naruhito becomes the new emperor. Japanese calendar is set for renewal.	Positive economic effect is expected from celebratory atmosphere and calendar renewal.
	July	Japan	Upper house election	
	October	Japan	Consumption Tax is scheduled to rise from 8% to 10%	
2020	Jul-Aug	Japan	Tokyo Olympic Games	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

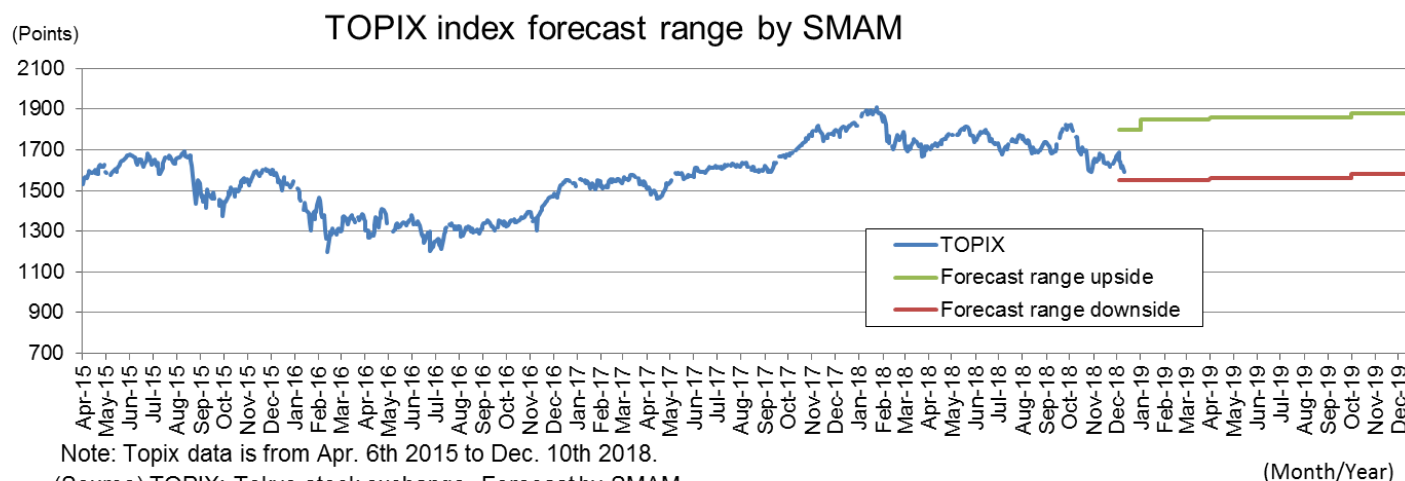
Stock market outlook: Power struggle between US and China weighs on the global stock markets

SMAM short-term view

- Global stock market is driven by fears that US economy could heading to a cyclical downturn in 2019 and Chinese economy is falling into a serious trouble. Japanese stock market is going to stay volatile. However, current negative sentiment seems a little overdone and stock valuation became too low. Rebound in the stock market seems possible at least for the short term.

Longer-term outlook (6-months and beyond)

- SMAM's main scenario for the global economy expects that US economy keeps growing in 2019 despite slight slowdown. Increasing fiscal spending on infrastructure can be expected in China, Japan and US, which could extend the current global economic expansion phase. US-China trade dispute goes on and struggles in technology field intensifies, which lingers on the Japanese stock market. Business sentiment in Japan is still resilient and if global economy can avoid a serious downturn, current extremely low stock valuation is going to be adjusted upwards.



Base scenario & Upside / Downside risks for our forecasts

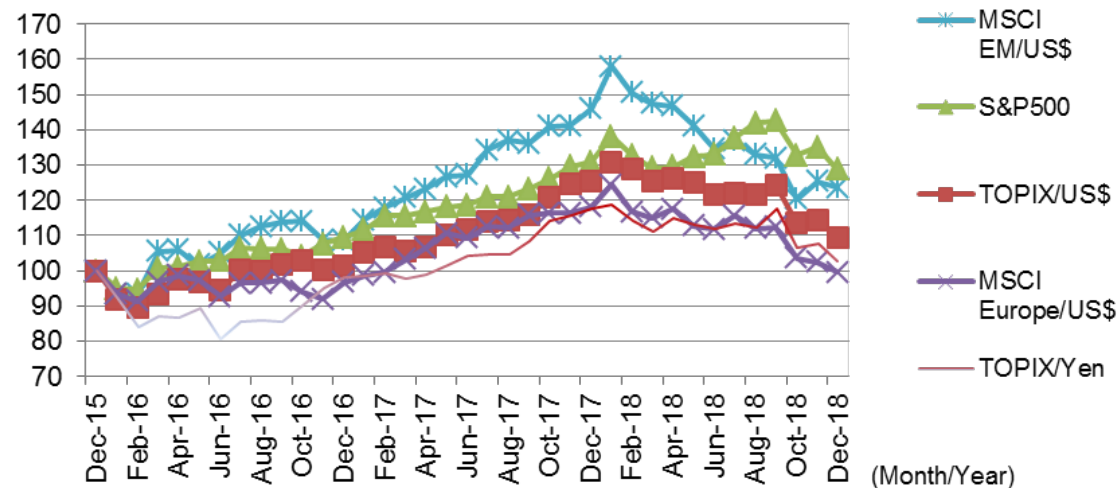
- Our **Base Scenario** is assuming the following views:
 - Severe tensions between US and China goes on, however, US is going to avoid making a fatal blow for the global economy.
 - US economy keeps growing despite possible mild slowdown. Recession in 2019 is avoided.
 - Japan's private consumption grows mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - Tension in the East Asia or Middle East does not get out of control.
 - Central banks avoid killing economic growth and adjust the pace of monetary normalization.
- **Upside Risks** include:
 - China makes significant concession in the trade negotiation with US.
 - Stronger-than-expected global growth.
 - Denuclearization in Korean peninsula makes a visible progress.
 - Japanese economy gets stronger than expected boosted by large fiscal spending.
- **Downside Risks** include:
 - US economy significantly slows down and puts global economy into a recession.
 - Chinese economy falls into a significant slowdown spreading negative shock globally.
 - Trade negotiation between US and China completely breaks up igniting a decades of power struggle.
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Global monetary tightening intensifies to choke global economy.
 - Political turmoil flares up in US over the impeachment of the President Trump.
 - Populism gains in Europe further destabilizing EU.

Note: SMAM's projection is as of 10th Dec. 2018 and subject to updates without notice.

Global stock market declined further on the fear of trade dispute and cyclical economic downturn

- After a brief rebound in November, global stock market declined again in December.
- Optimistic reception of US-China top meeting on 1st December evaporated soon as the CFO of Huawei, a Chinese telecom equipment giant, was arrested in Canada on the request of US, which is said to be on the suspect of breaching US sanction imposed on Iran.
- The stock market fears that the US economy is heading to an economic downturn from 2019, and also the Chinese economy could face a serious trouble caused by trade disruption. Growing exclusion of Chinese telecom equipment by US allies and other western countries is another headache for China.

US\$ based performance of stock markets (Dec 2015=100)

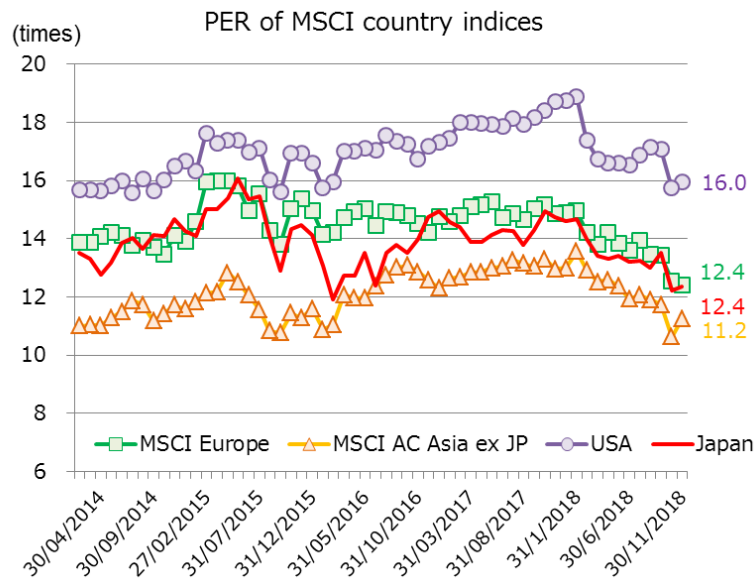


Notes: Data is up to 10th Dec. 2018.

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

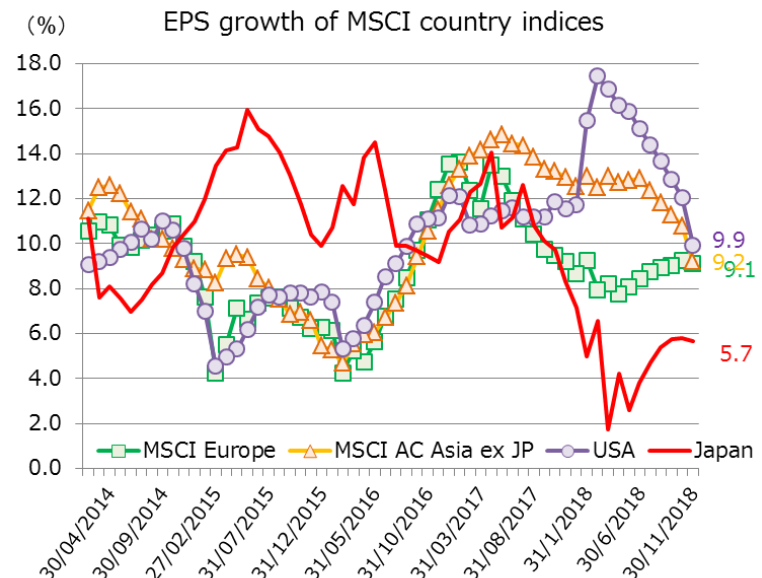
PE ratio is at reasonable level except for US, meanwhile earnings momentum declined

- PE ratio for US at 16 times looks expensive. Earnings growth forecast is declining for US partly because positive effect of corporate tax reduction is going behind, however, recent sharp decline down to 9.9 % indicates that analysts are weaving in US economic slowdown in the coming years.
- Except for US, PE ratio looks reasonable if EPS growth does not fall significantly further.
- Recent weak earnings momentum is a little worrisome.



Note: PER is based on 12M forward EPS forecast.
Data is up to 30th Nov 2018.
(Source) MSCI

(DD/MM/YYYY)

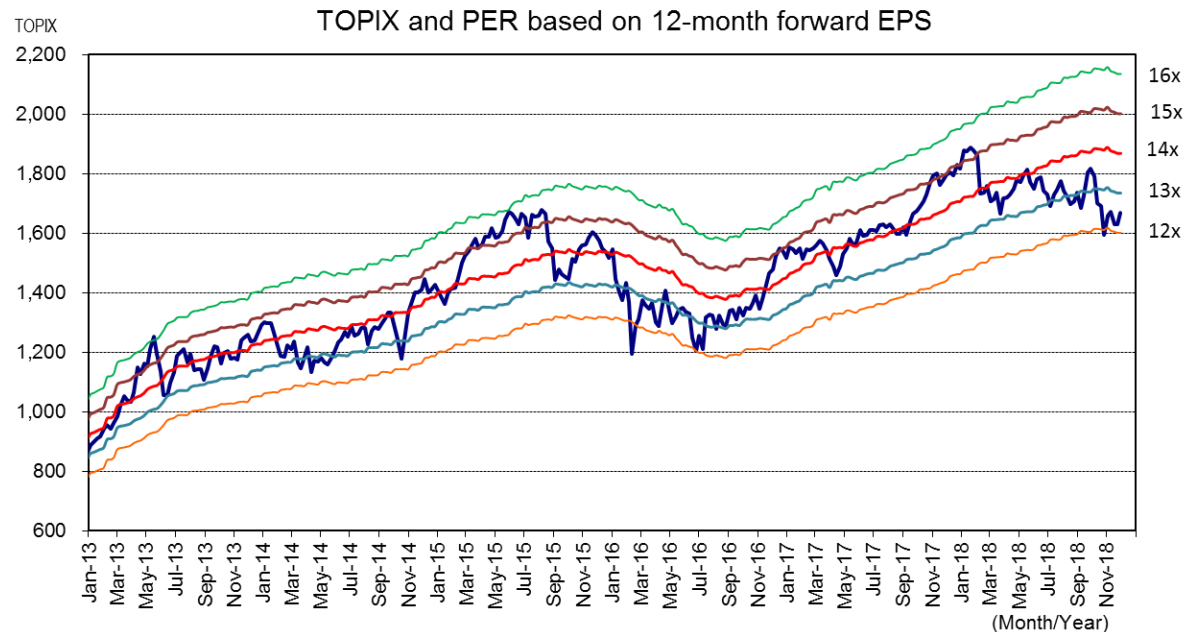


Note: Growth is for 12M forward EPS forecast.
Data is up to 30th Nov 2018.
(Source) MSCI

(DD/MM/YYYY)

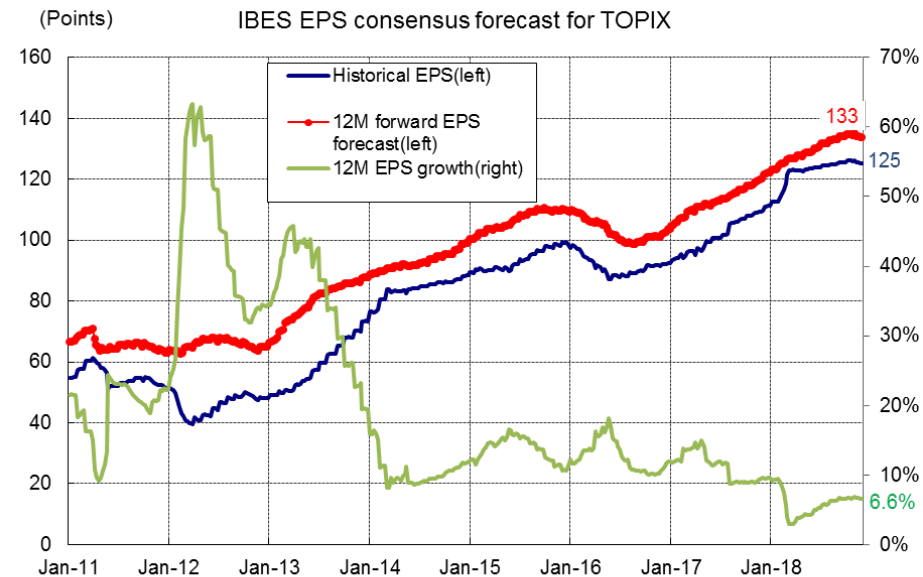
PE ratio for Japan is at low end of the historical range

- PE ratio of TOPIX index, which covers all stocks listed on Tokyo Stock Exchange 1st section, touched 12 times, which is at the lowest end of the range between 12 times and 16 times since PM Abe took office.
- Judging from this low stock valuation, current Japanese stock market seems to have weaved in fair part of the event risks such as tough trade negotiation of Japan with US and long lasting power struggle between US and China.
- Current negative sentiment seems a little overdone and stock valuation became too low. Rebound in the stock market seems possible at least for the short term.



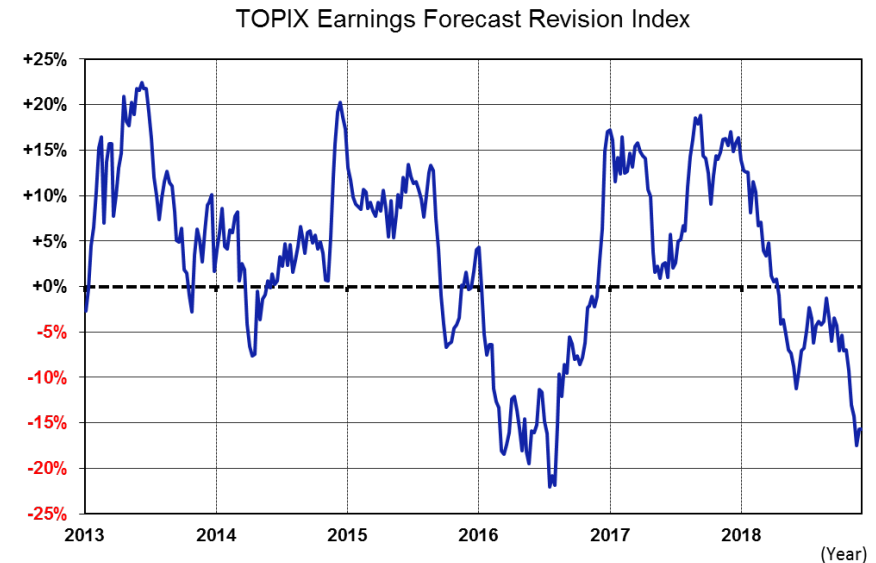
Consensus forecast for Japanese corporate earnings are facing down-revision

- 12M EPS growth forecast for Japan stays at 6.6%.
- However, earnings revision index, which compares number of up-revisions and down-revisions, fell further in negative territory. Recent corporate earnings results for Jul-Sep quarter were a little disappointing.
- Focus is on the direction of EPS forecast going forward, whether it avoids significant decline and start rebounding.



Note: Weekly data from 7th Jan. 2011 to 30th Nov. 2018. (Month/Year)

(Source) Datastream, IBES



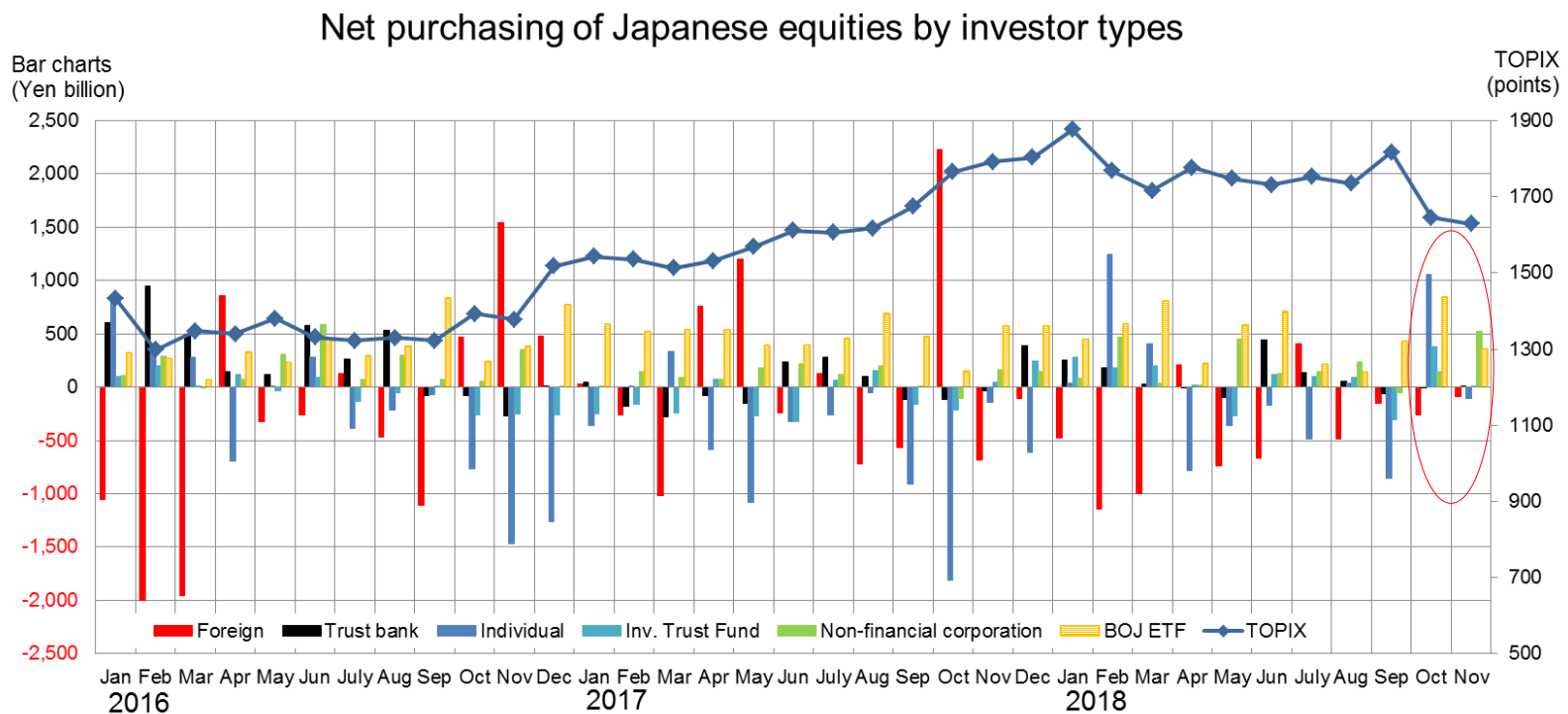
Notes: Revision index= % of Analyst upgrades out of total Topix firms - % of downgrades.

Data is weekly from 7th Jan. 2013 to 30th Nov. 2018.

(Source): IBES, SMAM

Domestic investors came in for bargain hunting

- Domestic investors, both individual and institutional, were buying Japanese equities as the stock market fell.
- Going forward, SoftBank Group's mobile business unit is set for an IPO and going to be separately listed on Tokyo stock exchange on 19th December. The IPO is estimated to raise around 22 to 25 billion US dollars and majority will be taken by domestic individual investors, which could limit domestic investors' purchasing of other stocks in December.



Note: Data is for Tokyo stock exchange and Nagoya stock exchange up to 23rd Nov. 2018.

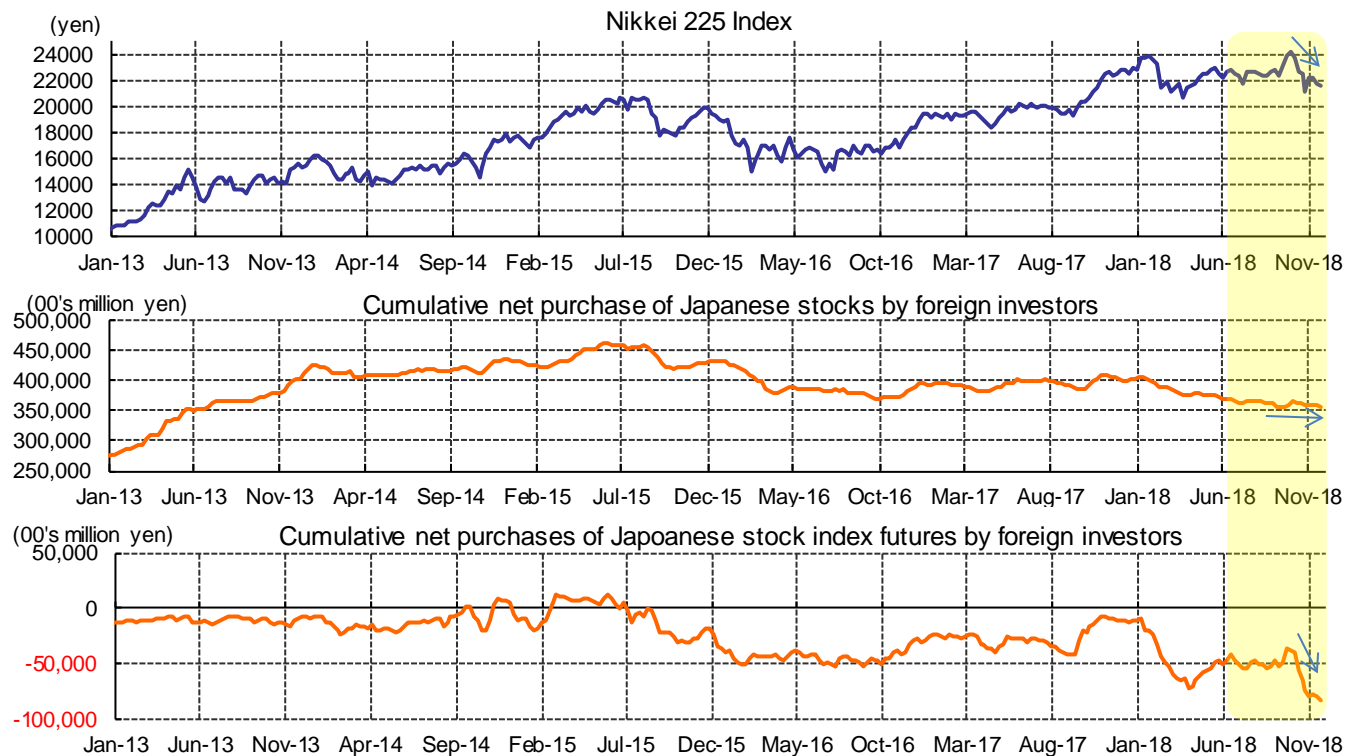
BOJ ETF figure is officially released data from BOJ.

(Source) Japan Exchange Group, Bank of Japan

(Month / Year)

Activity of foreign investors seems calm lately

- Foreign investors sold Japanese equities both in cash equities (equities traded on stock exchanges) and future contracts until 23rd of November.



Notes: Data is from 4th Jan. 2013 to 23rd Nov. 2018. Cumulative from 4th Jan. 2005.

(Source) Bloomberg, Japan Exchange Group, compiled by SMAM.

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