



Japanese Stock Market Outlook

SMAM monthly comments & views
-April 2019-



Sumitomo Mitsui Asset Management

Executive summary

➤ Japanese Economy

After the end of Global financial crisis, Japan has experienced 2 and a half mini economic cycles. (Please refer to page 4.) According to this analysis, Japanese economy is currently in a soft patch as in 2015-16 or a mini recession in 2012-13. Before the global financial crisis, positive momentum lasted for a long time, which is not comparable to this time's mini cycle. Possibility of a deep recession seems still remote.

- Export rebounded in February, however, not strong enough to offset sharp decline in January. Asia and China stay as weak spots. Export of Machinery showed sizable rebound. On the other hand, Electrical goods remained subdued.
- Despite stalling Chinese imports and deteriorating global economy, Japanese companies still keep capital expenditure plan at high level, which is required for enhancing labor productivity or updating business software.

➤ Japanese Stock Markets

Severe slowdown in production and capital expenditure in China are negatively affecting Japanese manufacturing companies. Focus is on if and when stimulus measures in China start to take effects bringing tail winds for Japanese companies. Global monetary easing has led the rebounds of the global stock markets so far, however, improvement in real economy and corporate earnings outlook is required for the rebounds to continue.

- Japanese companies are making a historical record of share buyback in the current fiscal year 2018. Dividend amount is also expected to renew the record in FY2018. Combined together, total shareholder return ratio, "(Dividend + Share buyback) / shareholder earnings", is going to rise and renew the record post global financial crisis..
- Downward revision continues for Japanese equity earnings forecast. Similarity can be found between the down-revision in 2016 and the one this time in terms of period and depth. Deteriorating Chinese economy was in the background of the both occasions.

Notes: Macro and market views are as of 26th Mar. 2019, and subject to updates thereafter without notice.

Outlook for Japanese Economy

SMAM economic outlook for FY18-20

- Oct-Dec GDP was revised upward from 1.4% to 1.9% (QoQ annualized) mainly due to stronger private capital expenditure. SMAM slightly adjusted GDP forecast for FY2018 upward by 0.1%.
- Japanese economy is forecast to keep moderate growth going into FY2020.

(YoY %)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Real GDP growth	1.3%	0.9%	1.9%	0.6%	0.5%	0.6%
Private Consumption Expenditure	0.7%	0.0%	1.1%	0.5%	0.4%	0.4%
Private Housing Investment	3.7%	6.3%	-0.7%	-5.2%	-0.4%	-3.2%
Private Capital Investment	1.6%	-0.5%	4.6%	3.2%	1.1%	0.5%
Public Consumption Expenditure	1.9%	0.7%	0.4%	1.0%	1.2%	0.8%
Public Capital Investment	-1.6%	0.6%	0.5%	-4.3%	0.0%	0.8%
Net Exports (contrib. to GDP growth)	0.1%	0.8%	0.4%	-0.2%	-0.1%	0.1%
Exports	0.8%	3.6%	6.4%	1.3%	-0.7%	1.6%
Imports	0.4%	-0.9%	4.0%	2.4%	-0.2%	0.8%
Nominal GDP	2.8%	0.7%	2.0%	0.4%	1.2%	1.2%
GDP Deflator	1.5%	-0.2%	0.1%	-0.1%	0.7%	0.6%
Industrial Production	-0.6%	0.8%	2.9%	-0.1%	-1.0%	1.1%
CPI (excl. fresh food)	-0.1%	-0.2%	0.7%	0.8%	0.1%	0.2%

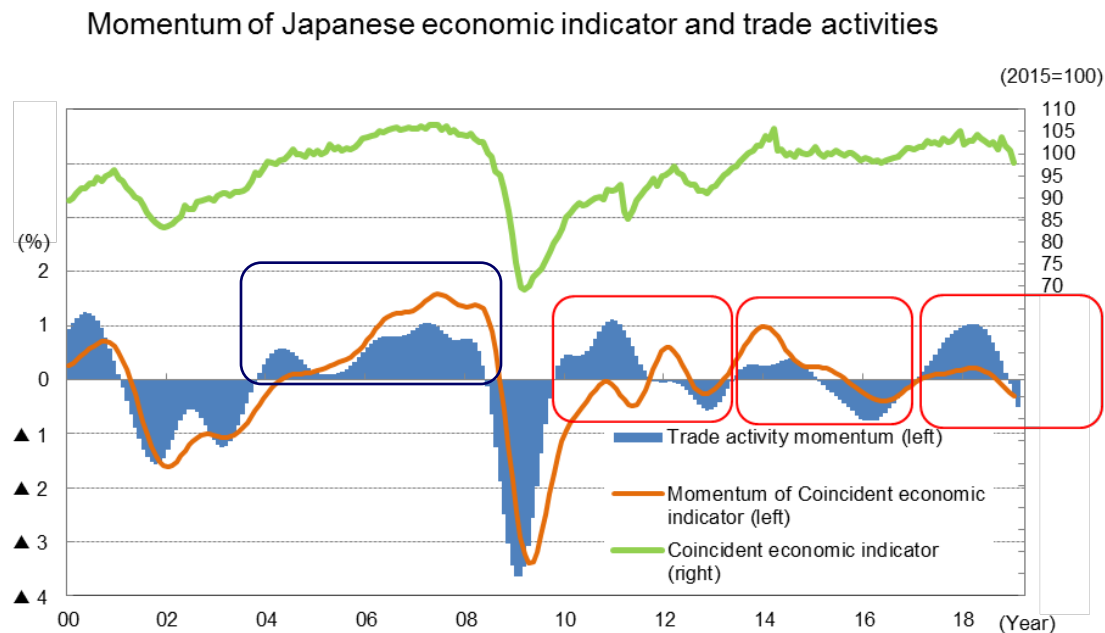
Notes: E=SMAM forecasts. SMAM views are as of 26th Mar. 2019 and subject to updates thereafter without notice

(%, YoY except Net Exports)

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

Japanese economy is probably in a soft patch

- After the end of Global financial crisis, Japan has experienced 2 and a half mini cycles as indicated in red squares. According to this analysis, currently, Japanese economy is probably in a soft patch as in 2015-16 or a mini recession in 2012-13.
- Before the global financial crisis, positive momentum lasted for a long time as blue square indicates, which is not comparable to this time's mini cycle. Possibility of a deep recession seems still remote and we do not need to be too pessimistic.



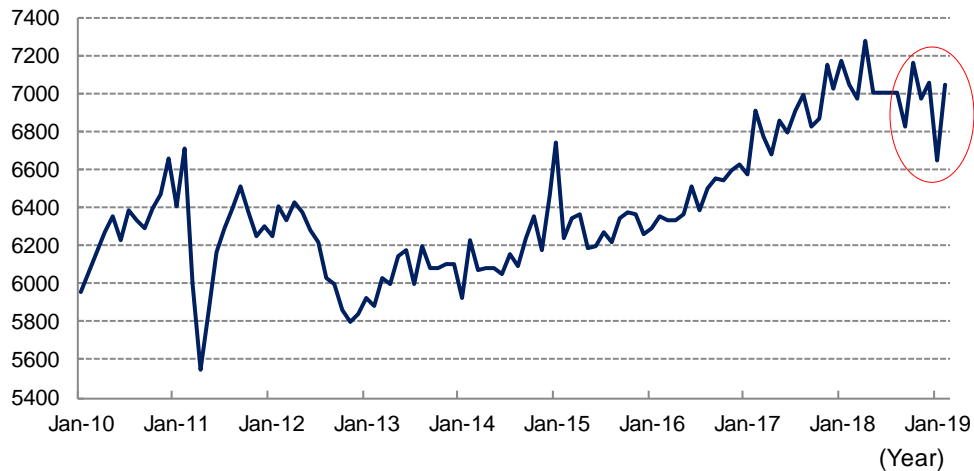
Note: Data is monthly from Jan 2000 to Jan 2019 for coincident economic indicator and to Feb 2019 for trade activity momentum. Trade activity momentum is composed by SMAM using various trade related statistics. Momentum of coincident economic indicator was created by SMAM using coincident economic indicator published by cabinet office.

(Source) Cabinet Office and other various trade related statistics, compiled by SMAM

Export to China and Asia rebounded in February

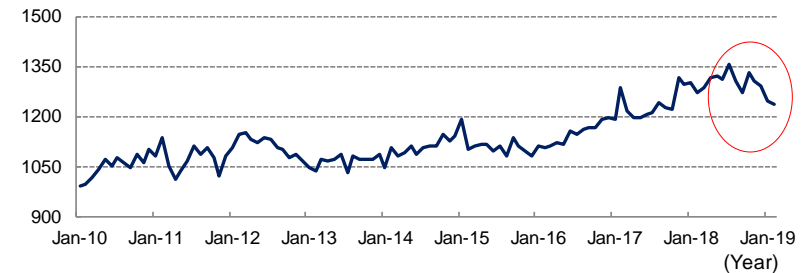
- Export rebounded in February, however, not strong enough to offset sharp decline in January. Asia and China stay as weak spots.
- Export of Machinery showed sizable rebound. On the other hand, Electrical goods remained subdued.

Total export volume
(seasonally adjusted, yen billion)

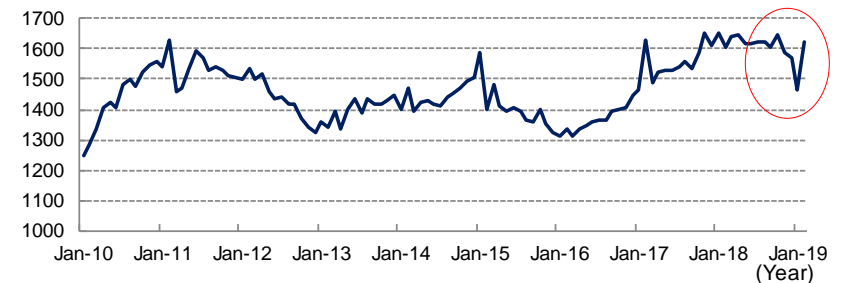


Note: Data is from Jan. 2010 to Feb. 2019.
(Source) Ministry of Finance, Bank of Japan, compiled by SMAM.

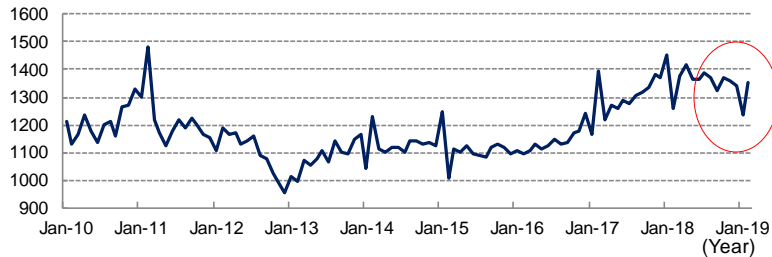
Electrical Goods



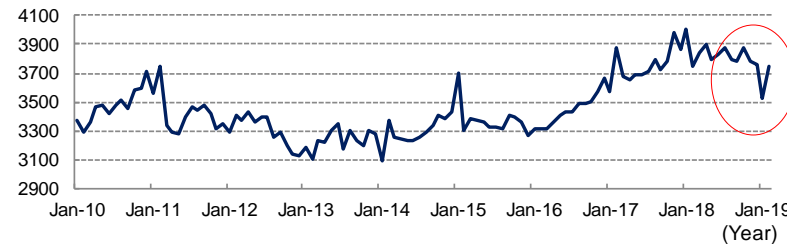
General Machinery



China

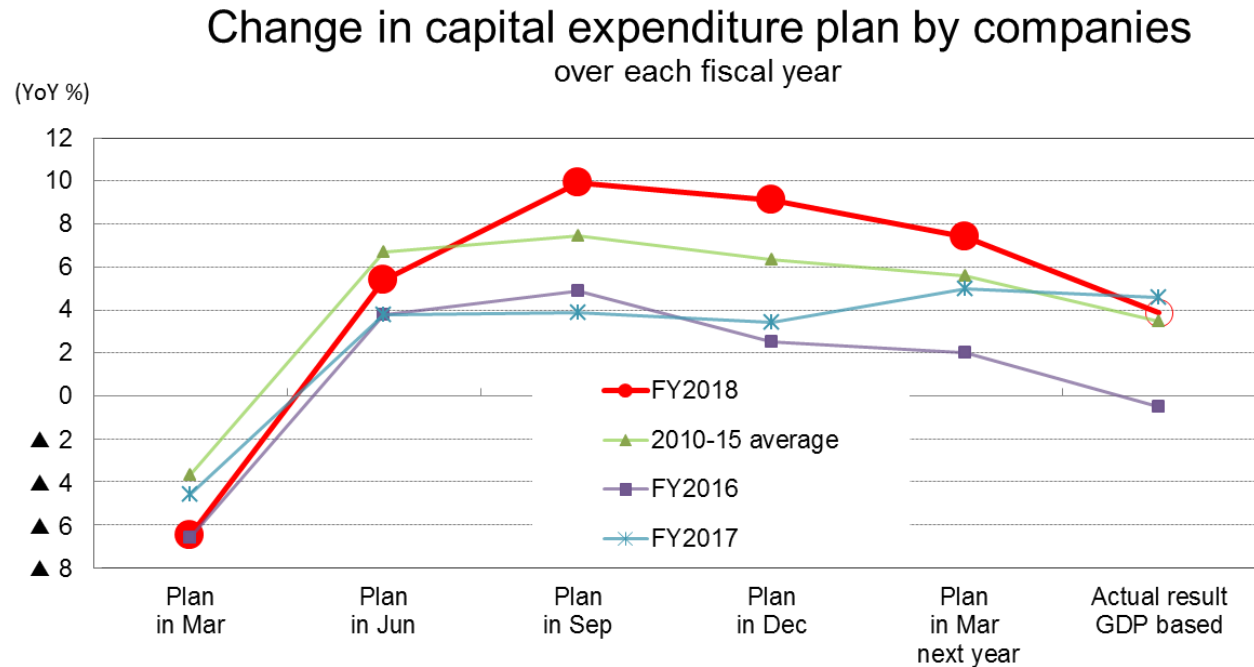


Asia ex. China



Japanese companies' appetite for capital expenditure is still high

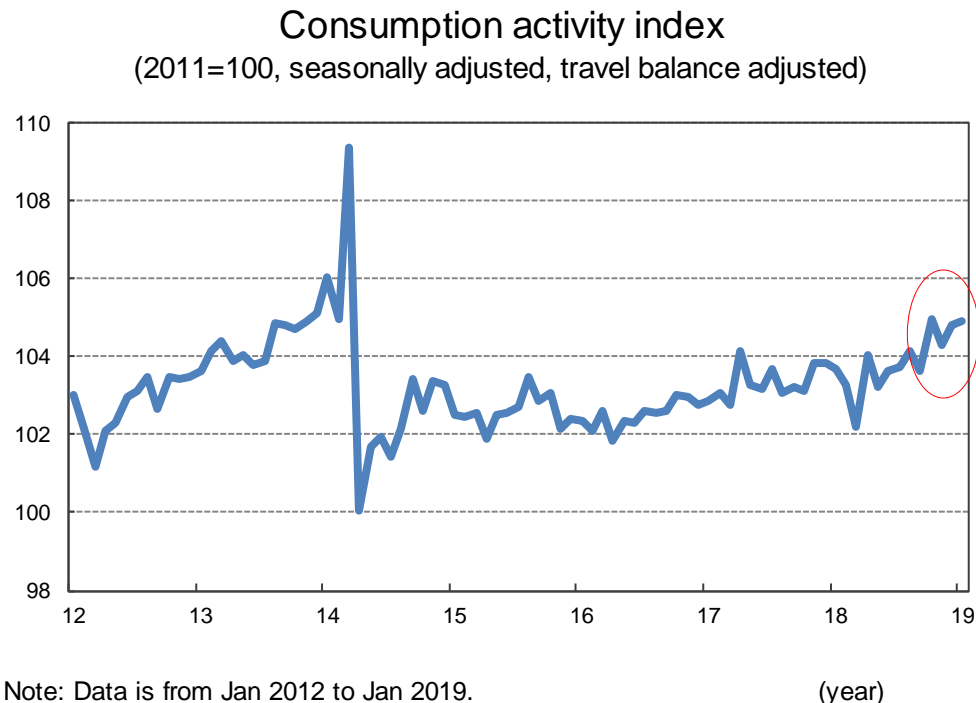
- Despite stalling Chinese imports and deteriorating global economy, Japanese companies still keep capital expenditure plan at high level, which is required for enhancing labor productivity or updating business software.
- However, related statistics for Jan-Mar 2019 quarter such as machinery orders for January and February show receding appetite for capital expenditure.



Note: Capital expenditure includes software and excludes land purchase. GDP based actual figure for FY2018 is for the period from April to December.
(Source) Ministry of Finance

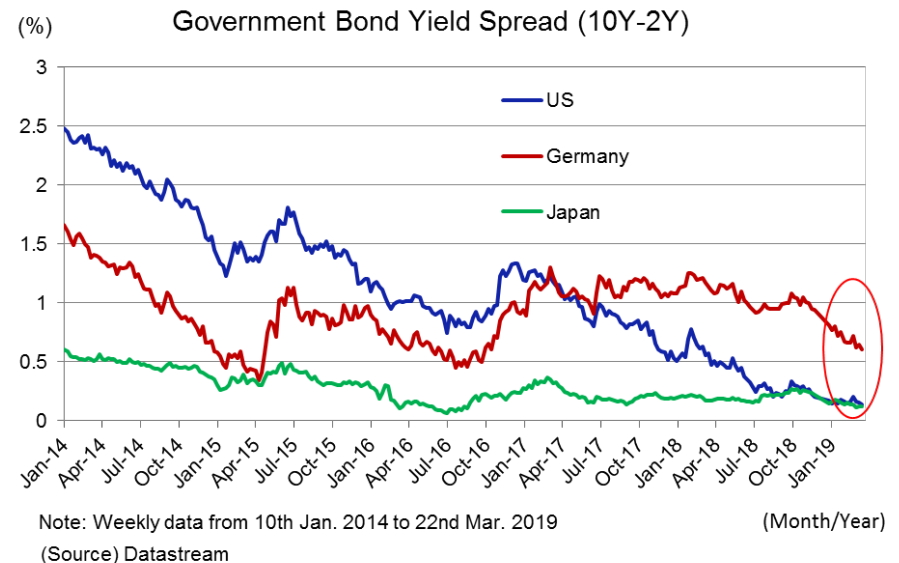
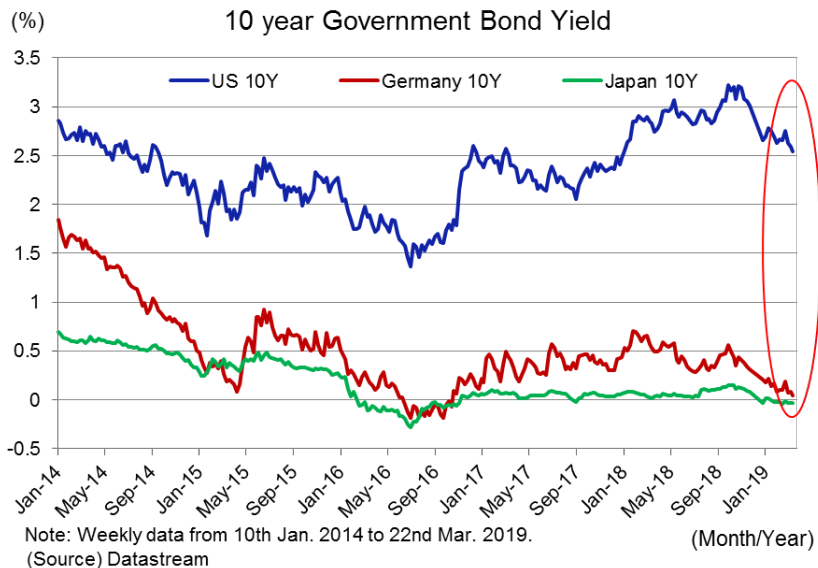
Consumption activities are showing resilience

- Private consumption is rather strong despite recent deterioration in global economy.
- Labor shortage continues in Japan providing job security and mildly rising wage for workers. Labor force is still expanding despite aging population. Stock prices have rebounded. All these factors are behind this resilience.



Global long term bond yields continued to decline

- Deteriorating outlook for the global economy is bringing global bond yields down. Japanese 10Y government bond yield became negative.
- Yield curve flattening continues globally in which some part of US yield curve becomes occasionally inverted.



Deteriorating outlook for the global economy is making monetary policies easy again

- Central banks in US and Europe shifted monetary policies to dovish side. Bank of Japan (BOJ) keeps current extra easy policy stance. BOJ lately mentioned possible options for additional easing.
- Turmoil surrounding Brexit is causing extra concern on European economy in addition to apparent slowdown in manufacturing industries in Europe.
- In Japan, important elections are scheduled in April and in July. Nation-wide voting for local elections is in April and Upper House Election is held in July. PM Abe's government will take an extra care to keep Japanese economy going in order for avoiding any possible setback in these elections.

Upcoming key events

Month	Region/Country	Events	Notes
2019 April	Japan	1 New labor legislations begin. Stricter control of overtime working, high skilled professional exemption and widening foreign workers acceptance.	
		7, 21 Nation-wide voting for local elections.	
		26-27 Bank of Japan Monetary Policy Committee Meeting & Perspective Report for economy & inflation	
May	Japan	1 Prince Naruhito becomes the new emperor. Japanese calendar is set for renewal.	Positive economic effect is expected from celebratory atmosphere and calendar renewal.
	US-Japan	26 US president Trump is going to visit Japan to be the first foreign leader to meet the new emperor.	Diplomatic agenda to be discussed.
	US	18 Limit for deciding US action on car tariffs	
June	US	18-19 FOMC meeting	
	Japan	14-15 Bank of Japan Monetary Policy Committee Meeting	
	Global	28-29 G20 top meeting in Osaka, which PM Abe chairs	
July	Japan	Upper house election	
September	Japan	18-19 Bank of Japan Monetary Policy Committee Meeting	
October	Japan	1 Consumption Tax is scheduled to rise from 8% to 10% Rakuten begins mobile carrier business as the 4th company in Japan	
December	Japan	19-20 Bank of Japan Monetary Policy Committee Meeting	
2020 Jul-Aug	Japan	Tokyo Olympic Games	

(Source) Various publications, assembled by SMAM

Outlook for Japanese Stock Markets

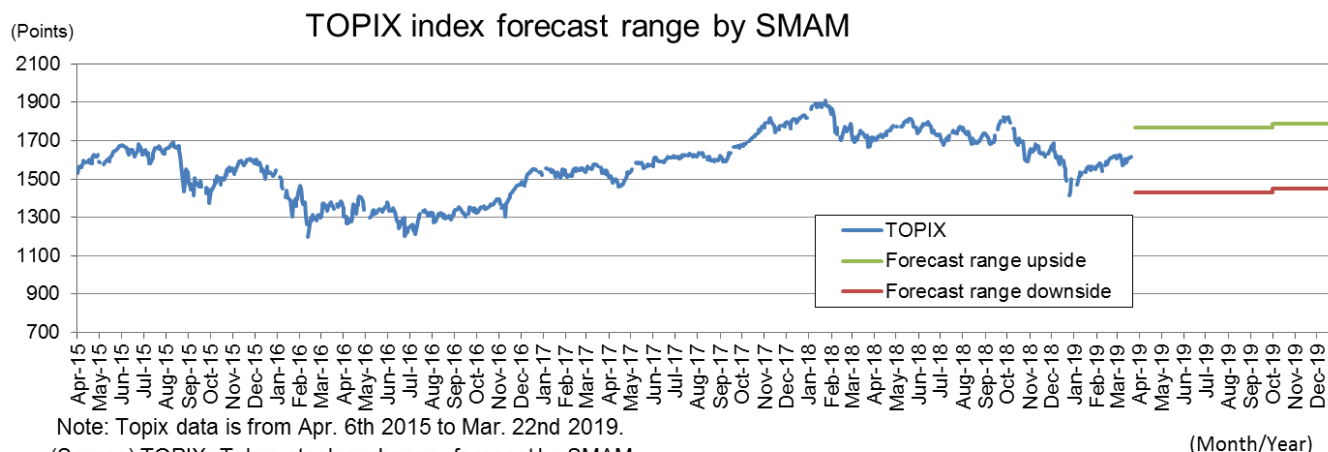
Stock market outlook: Focus is on if and when earnings momentum recovers for Japanese companies

SMAM short-term view

- Severe slowdown in production and capital expenditure in China are negatively affecting Japanese manufacturing companies. Focus is on if and when stimulus measures in China start to take effects bringing tail winds for Japanese companies. Global monetary easing has led the rebounds of the global stock markets so far, however, improvement in real economy and corporate earnings outlook is required for the rebounds to continue.

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 moderates, however, struggles in technology field goes on. Current low stock valuation has room to be adjusted upward if global economic growth gains strength again.



Note: SMAM's projection is as of 26th Mar. 2019 and subject to updates without notice.

Base scenario & Upside / Downside risks for our forecasts

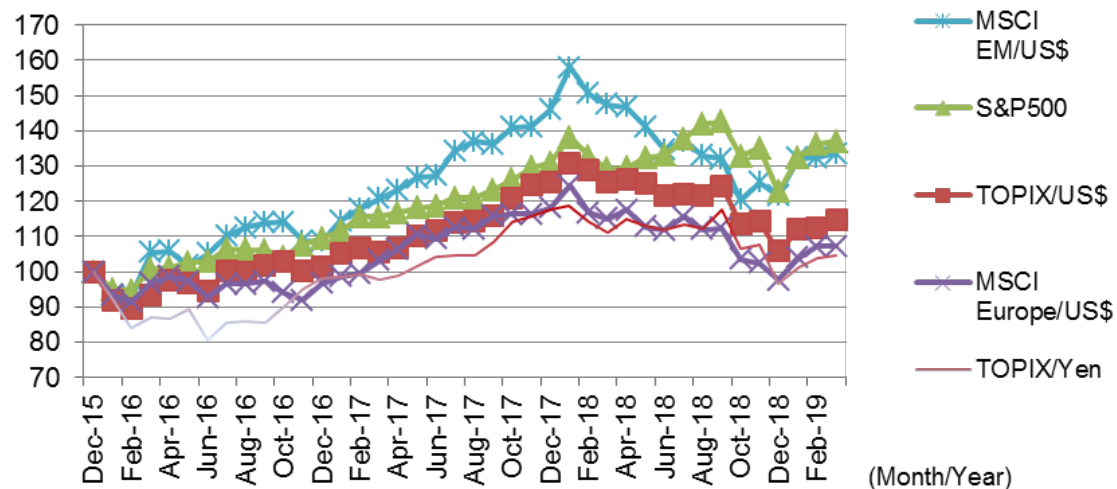
- Our **Base Scenario** is assuming the following views:
 - Severe tensions between US and China goes on, however, US is going to avoid making a fatal blow for the global economy.
 - US economy keeps growing despite possible mild slowdown. Recession in 2019 is avoided.
 - Japan's private consumption 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 26th Mar. 2019 and subject to updates without notice.

Easing monetary policy and US\$ stopped strengthening supported US & emerging stock markets

- Easing monetary policy has driven rebounds for the global stock markets. FRB's dovish stance stopped US\$ from strengthening, which led money flow back into emerging markets.
- Earnings revision for US stocks stopped deteriorating, however, it continues deteriorating for Japanese companies, which is supposed to be the main reason behind the difference of the stock market performance between the two countries.

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

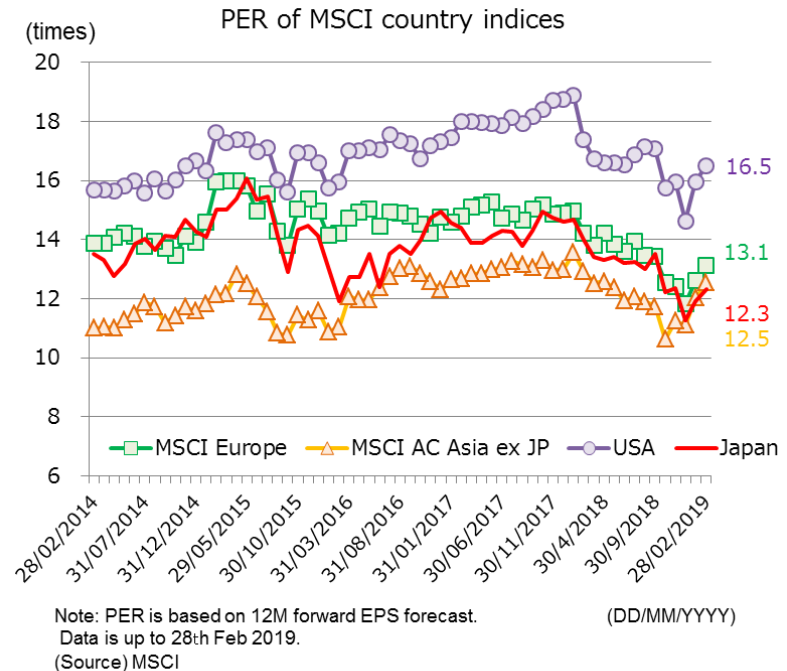
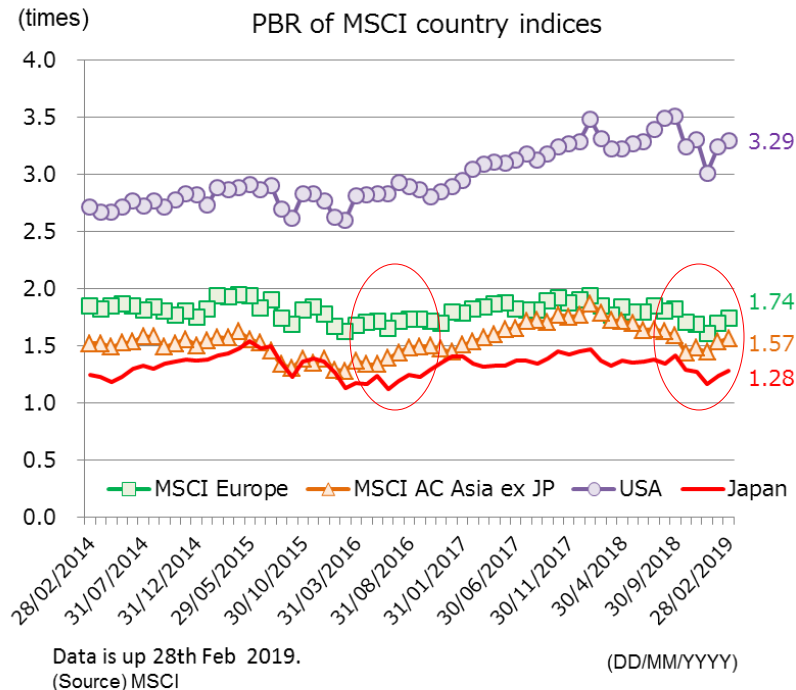


Notes: Data is up to 22nd Mar. 2019.

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

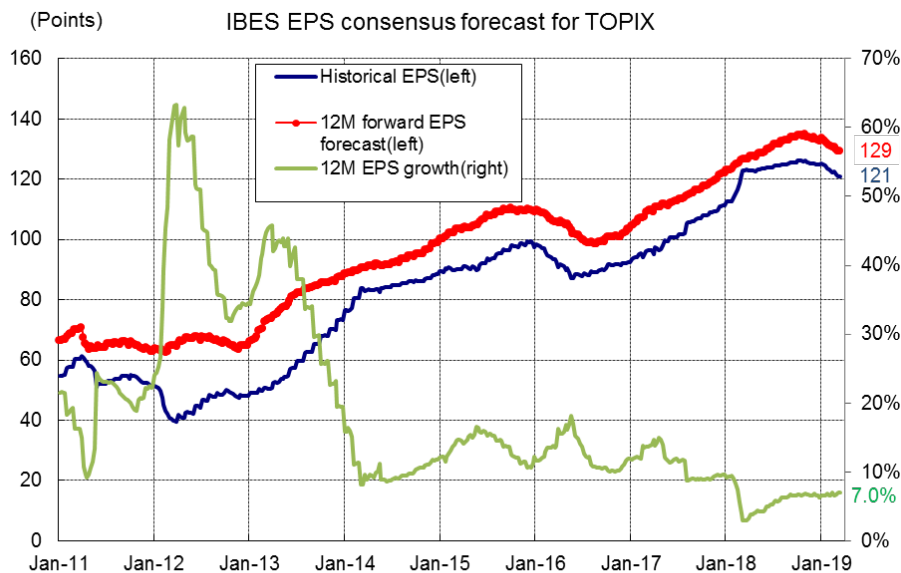
Valuation has come down to similar levels as experienced in the previous downturn in 2016

- PBR bounced back a little in February as share price rebounded.
- PER also rebounded and back into the range between 12 times and 16 times established after PM Abe took office in December 2012. This was due to declining EPS as well as rebounding share price.



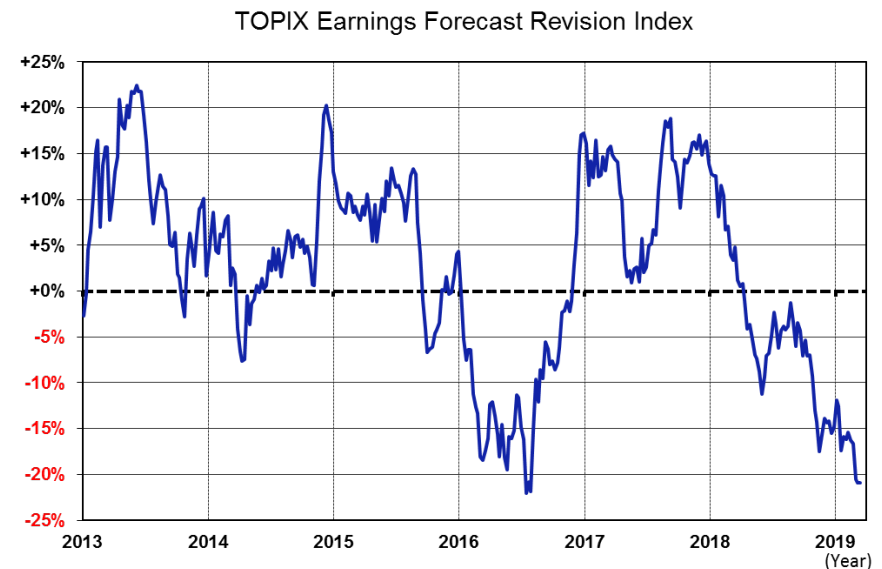
Downward revision continues for Japanese corporate earnings forecast

- Downward revision continues for consensus forecast for Japanese corporate earnings. Similarity can be found between the down-revision in 2016 and the one this time in terms of period and depth. Deteriorating Chinese economy was in the background of the both occasions.
- 12 months forward EPS forecast is coming down in parallel with historical earnings, which keeps EPS growth forecast at 7% .



Note: Weekly data from 6th Jan. 2011 to 14th Mar. 2019. (Month/Year)

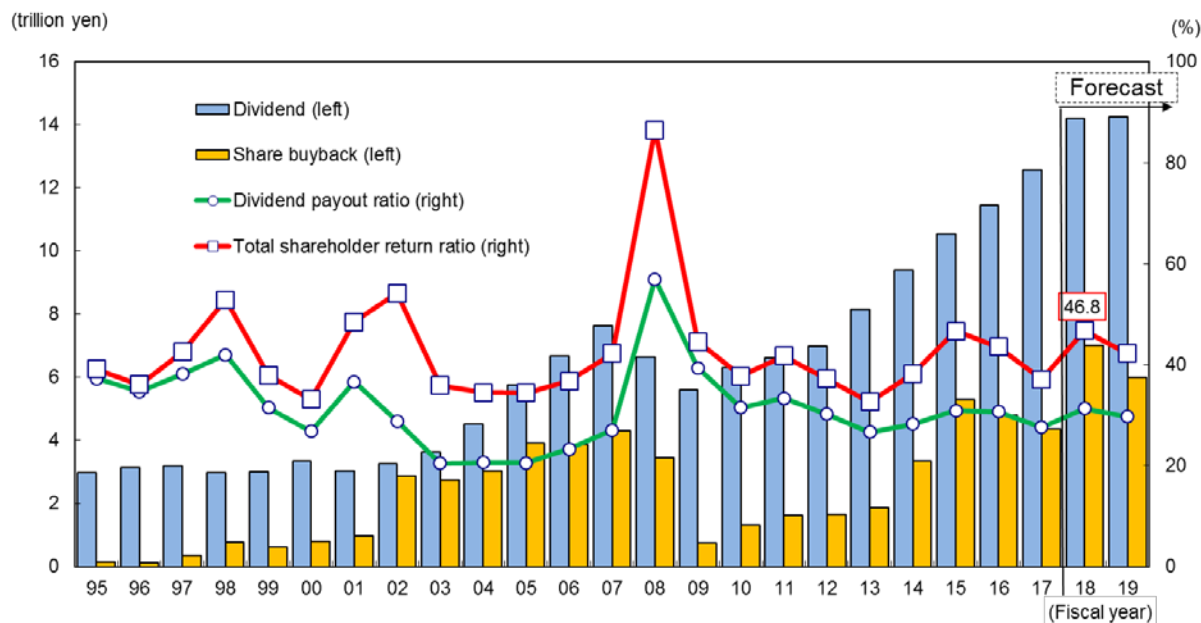
(Source) Datastream, IBES



Share buyback has already made a historical record in the current fiscal year 2018

- Japanese companies are making a historical record of share buyback in the current fiscal year 2018. Dividend amount is also expected to renew the record in FY2018.
- Combined together, total shareholder return ratio, “(Dividend + Share buyback) / shareholder earnings”, is going to rise and renew the record post global financial crisis.
- Corporate governance is surely improving for the Japanese company, though total shareholder return ratio is forecast to decline slightly in the next fiscal year 2019 on a presumption that the amount of share buyback is going to decrease.

Shareholder return (dividend + share buyback)

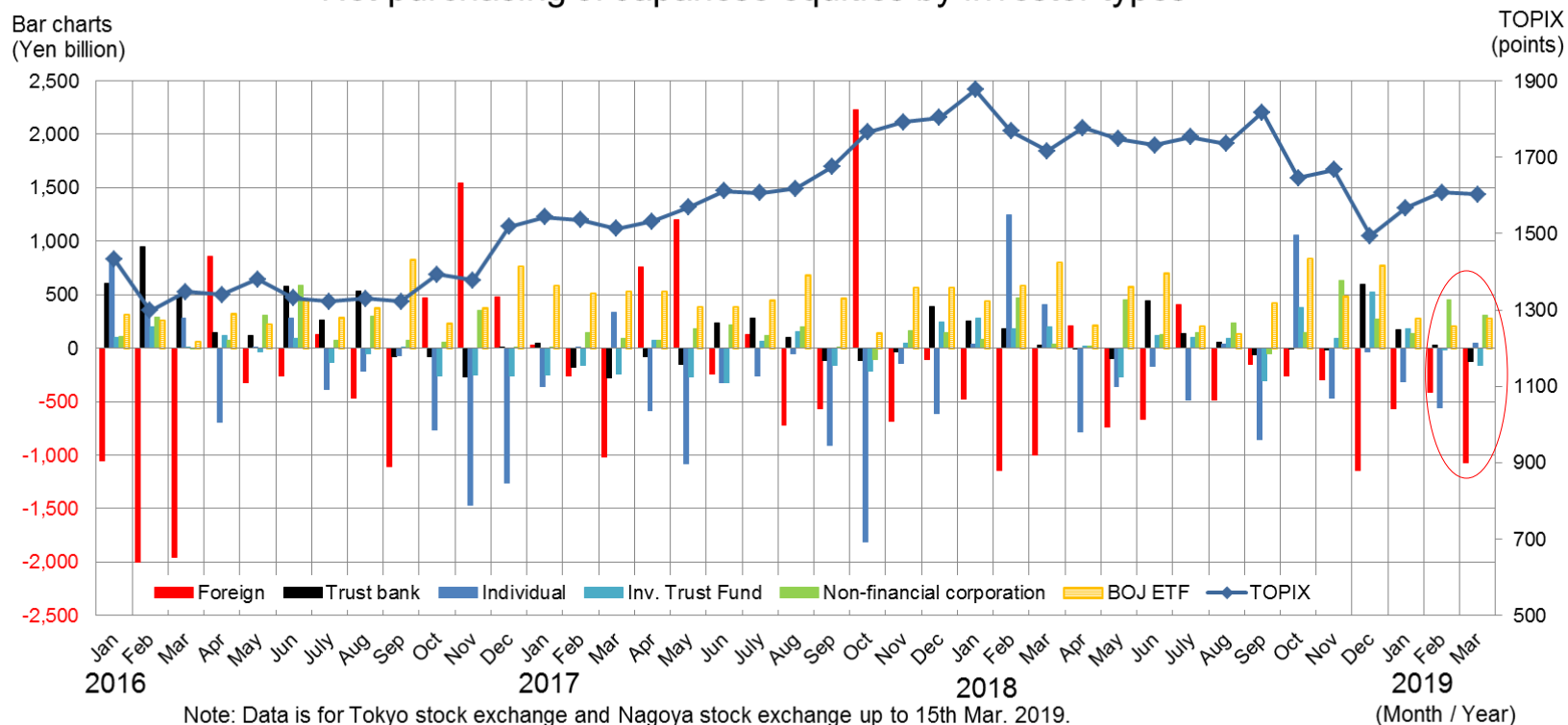


(Source) Daiwa Securities, Quick, Toyo Keizai, INDB

Share buyback by companies and BOJ's ETF buying are supporting the market

- Selling by foreign investors intensified in March. Pension funds are selling Japanese equities preparing for the fiscal year end in March.
- Share buyback by companies and BOJ's ETF purchasing have been two main forces supporting the Japanese stock market.

Net purchasing of Japanese equities by investor types



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