



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

Hisashi Shiraki
Chief Global Strategist

-January 2023-



Outlook for Japanese Stock Market

Market Outlook

- We expect the market will start rising after range trading in early 2023 thanks to steady earnings growth and the encouraging domestic economy after confirming the peak of US monetary tightening and the bottoming out of the global economic cycle.
- We have slightly lowered our TOPIX target from 2,390 to 2,330 and that of the Nikkei 225 from 34,100 to 32,500 as of the end of 2023 due to revisions of the estimate of the FOREX market and the EPS forecast reflecting the modification of the BOJ's YCC.
- We foresee a strong tail wind to domestic consumer stocks if Chinese travellers will return to Japan after relaxing its “Zero COVID-19” policy.

Upside / Downside risk scenarios

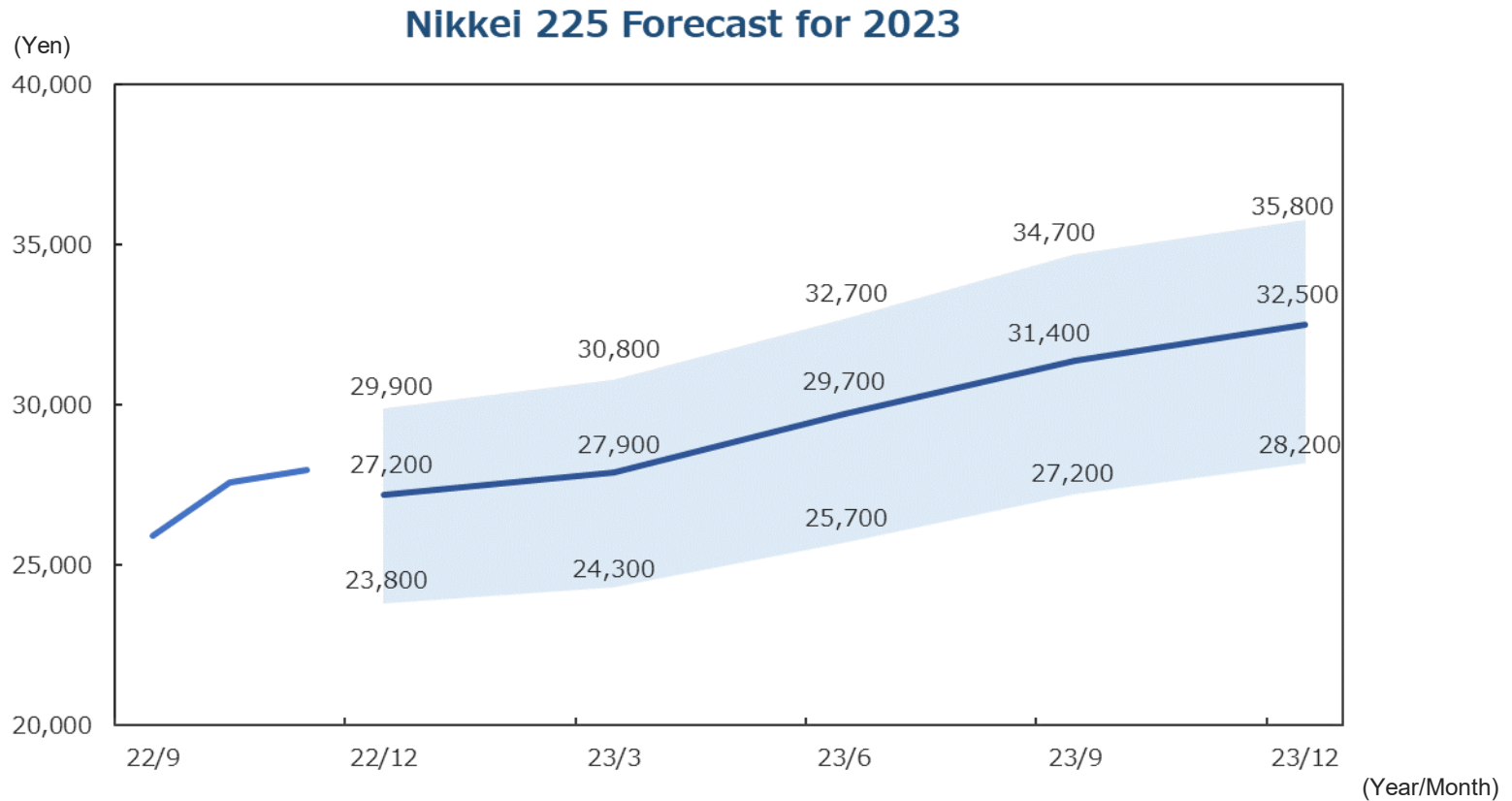
■ Upside Risks

- FED pivot
- Strong recovery in Chinese economy

■ Downside Risks

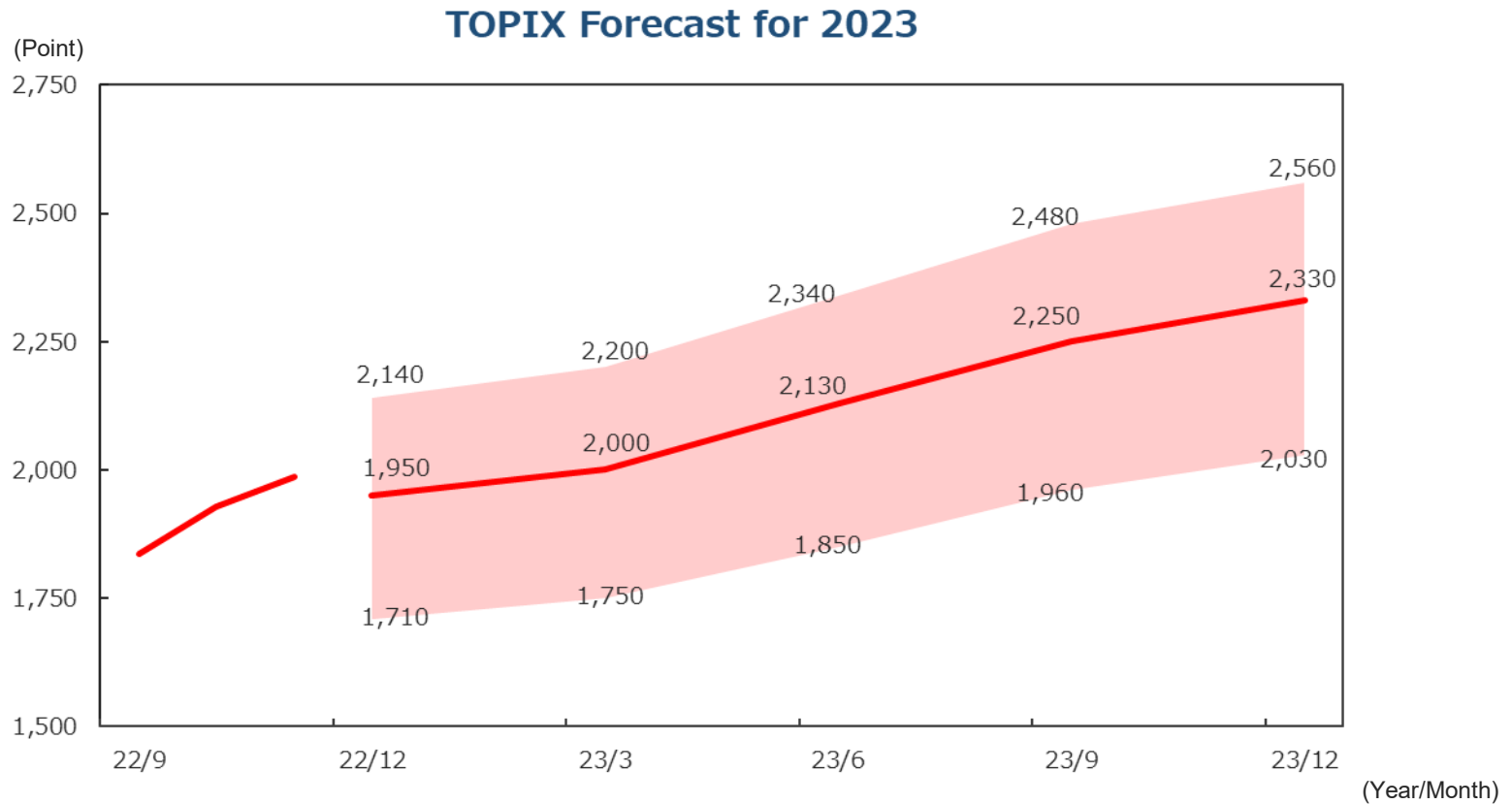
- Yen appreciation and negative impact on corporate earnings
- Financial crisis caused by global monetary tightening
- Fiscal austerity

Equities to resume bullish trend after range trading



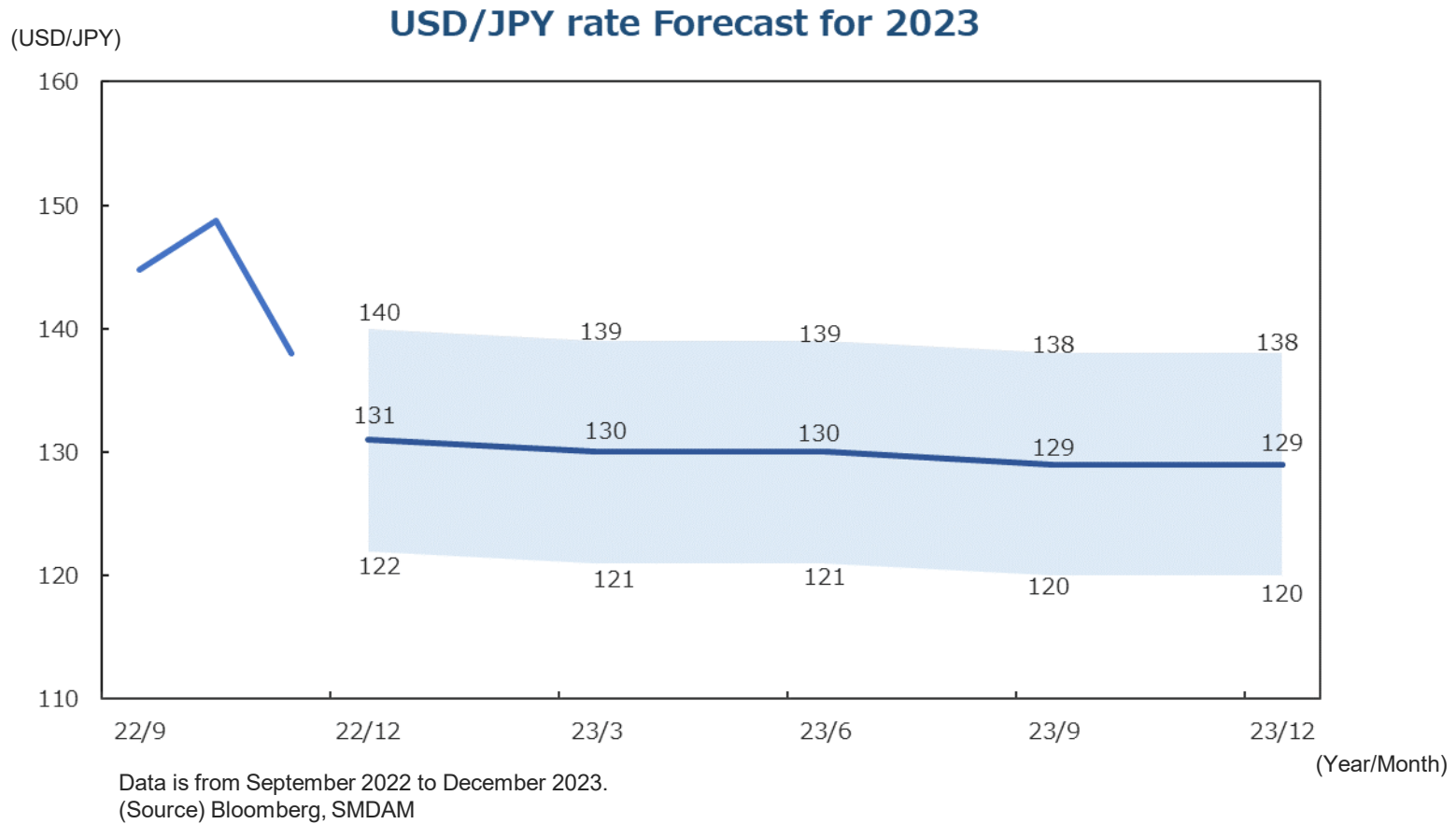
Data is from September 2022 to December 2023.
(Source) Bloomberg, SMDAM

Equities to resume bullish trend after range trading

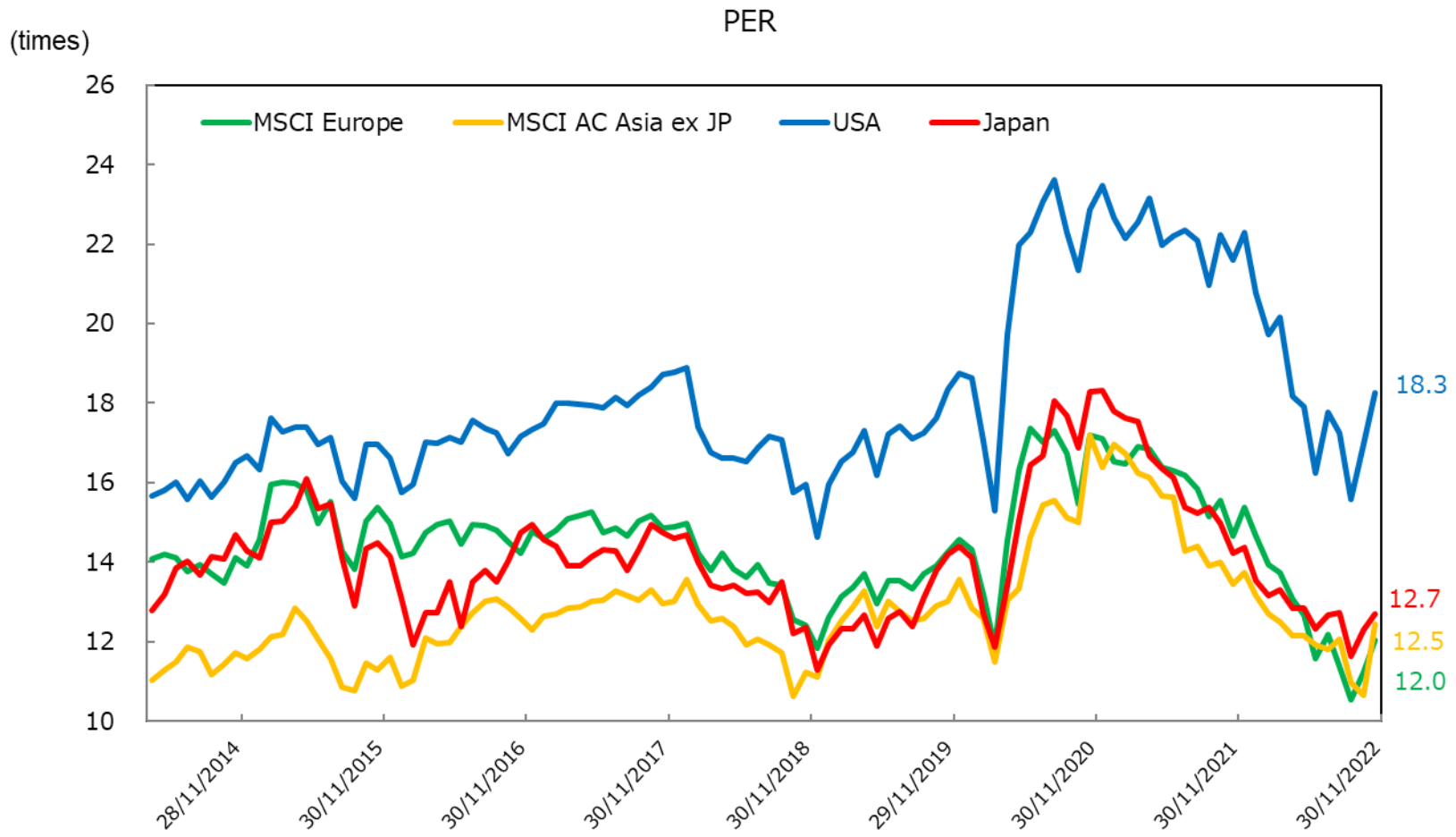


Data is from September 2022 to December 2023.
(Source) Bloomberg, SMDAM

USD/JPY rate to slide gradually in 2023



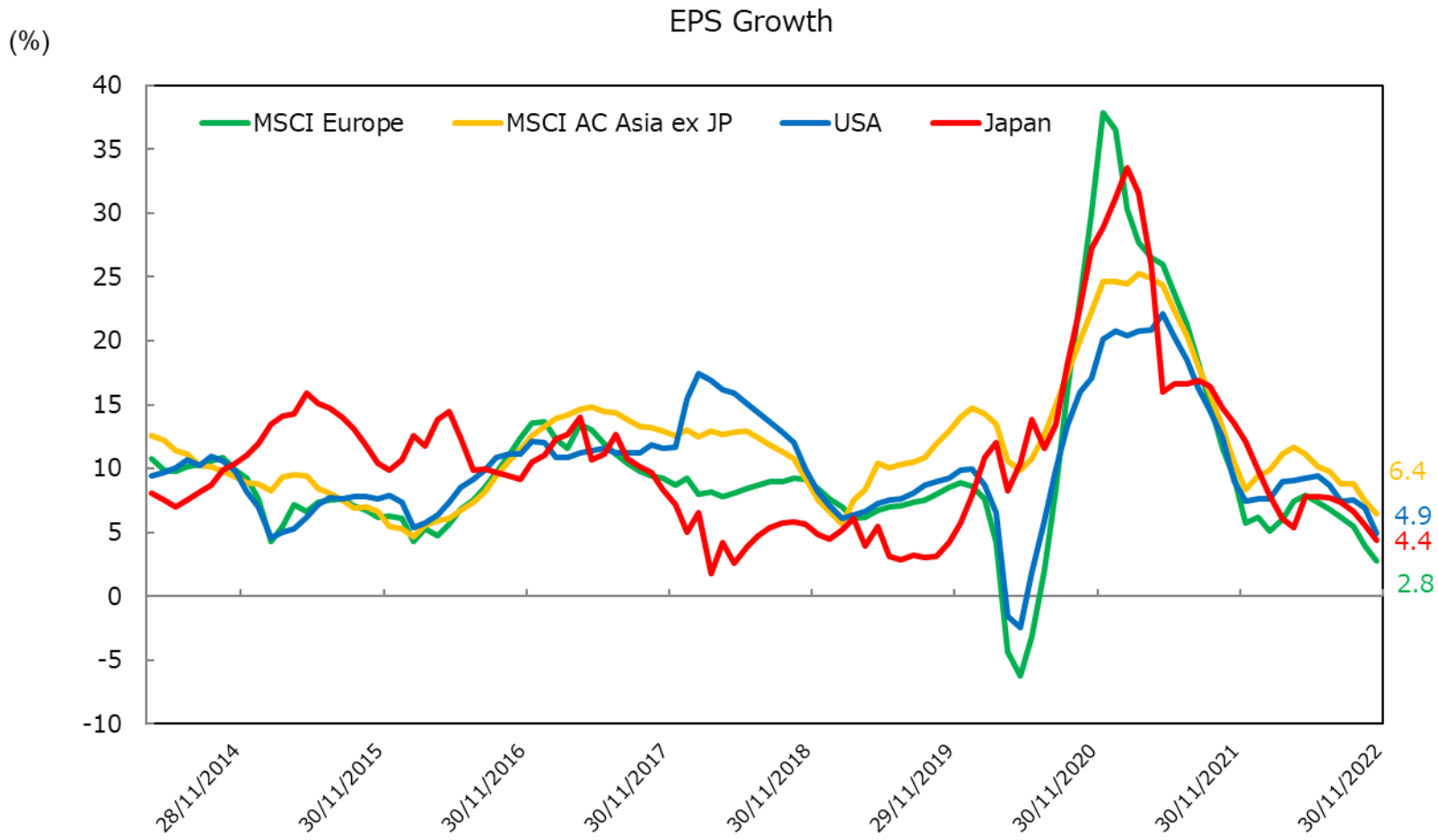
Slowing pace of tightening by FED lifts PERs



Data is from April 30th 2014 to Novemebr 30th 2022
 (Source) MSCI

(DD/MM/YYYY)

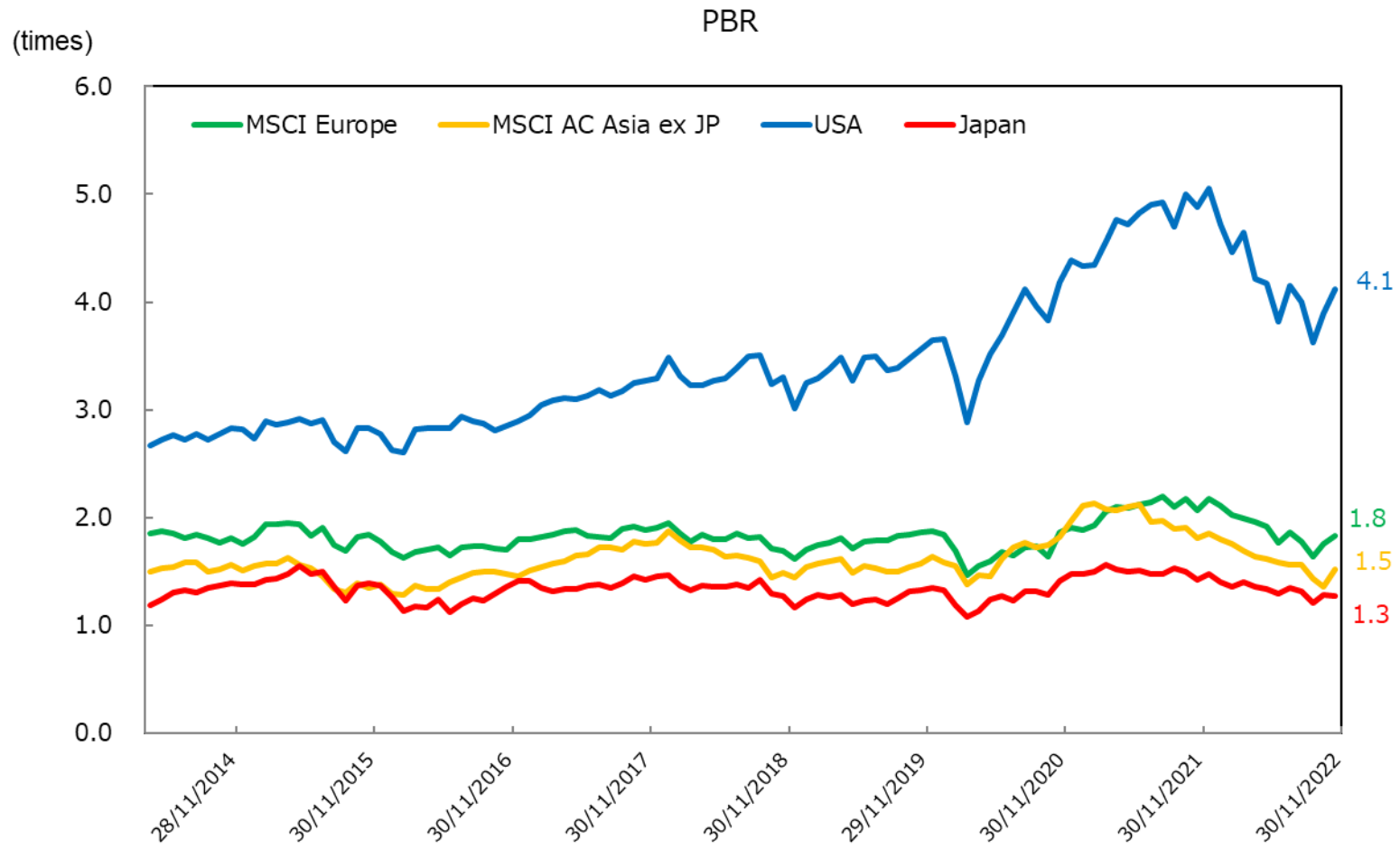
Earnings growth continues to slide due to slowing economy



Data is from April 30th 2014 to Novemebr 30th 2022
 (Source) MSCI

(DD/MM/YYYY)

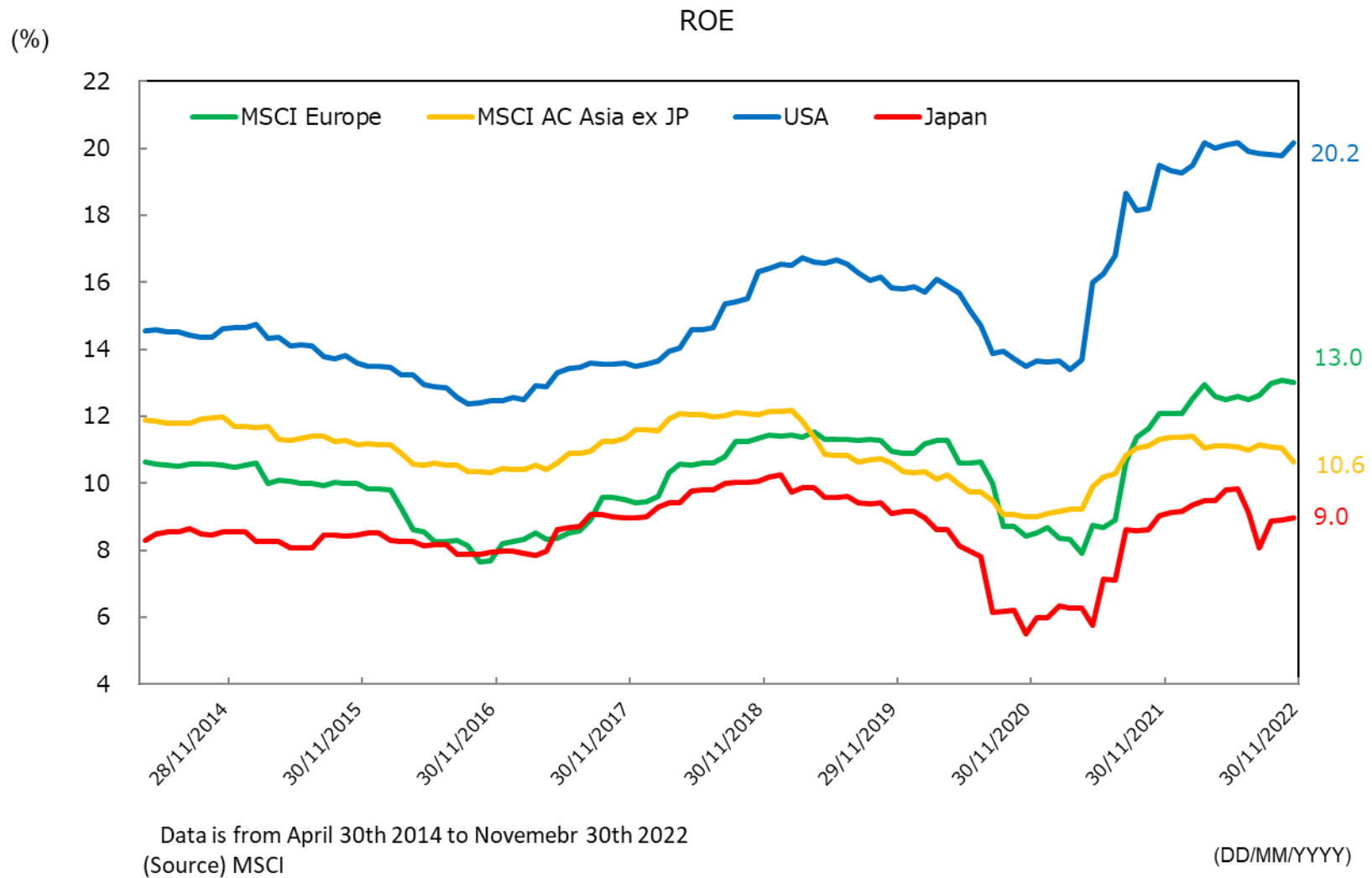
PBRs rebound thanks to recovery of risk appetite



Data is from April 30th 2014 to Novemebr 30th 2022
 (Source) MSCI

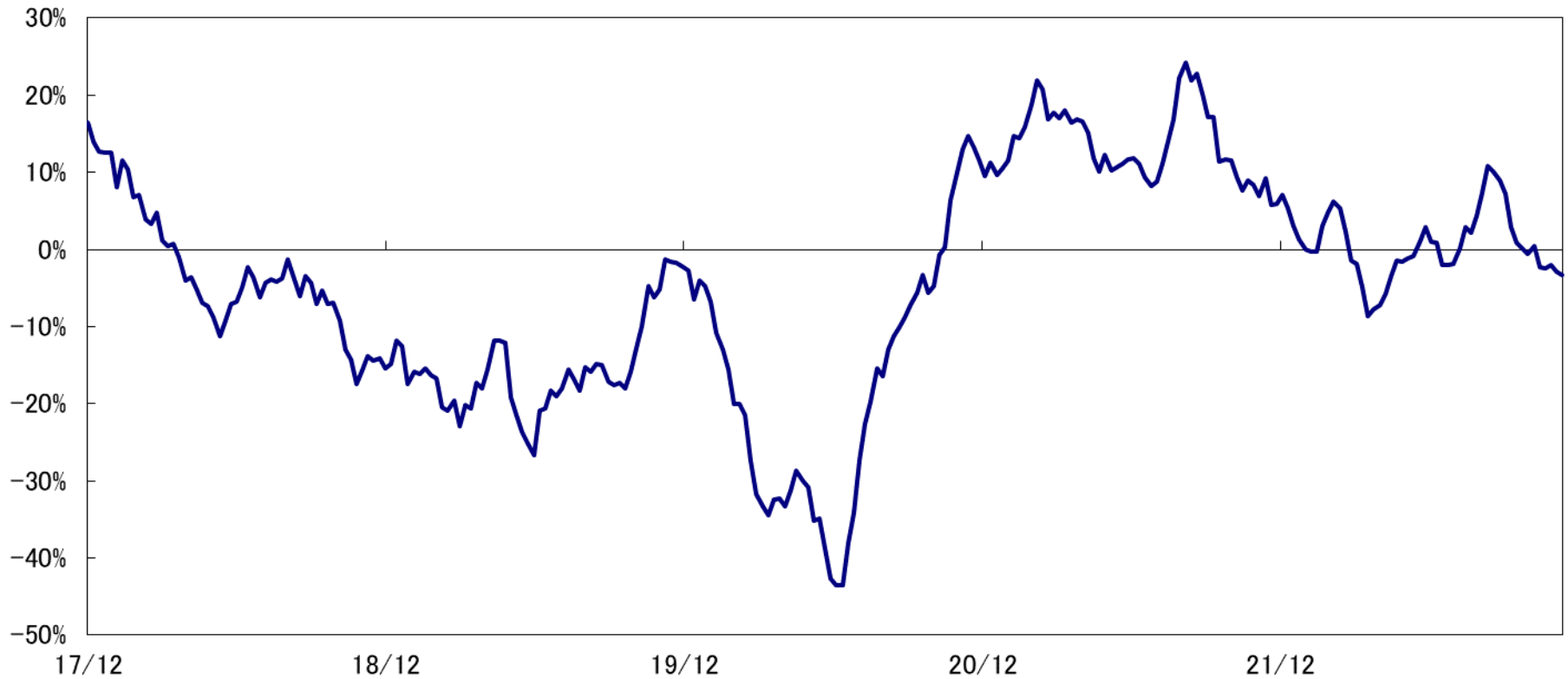
(DD/MM/YYYY)

Japan's ROE returns to 9% due to recovery in domestic demand



EPS revision heads south due to slowing global economy

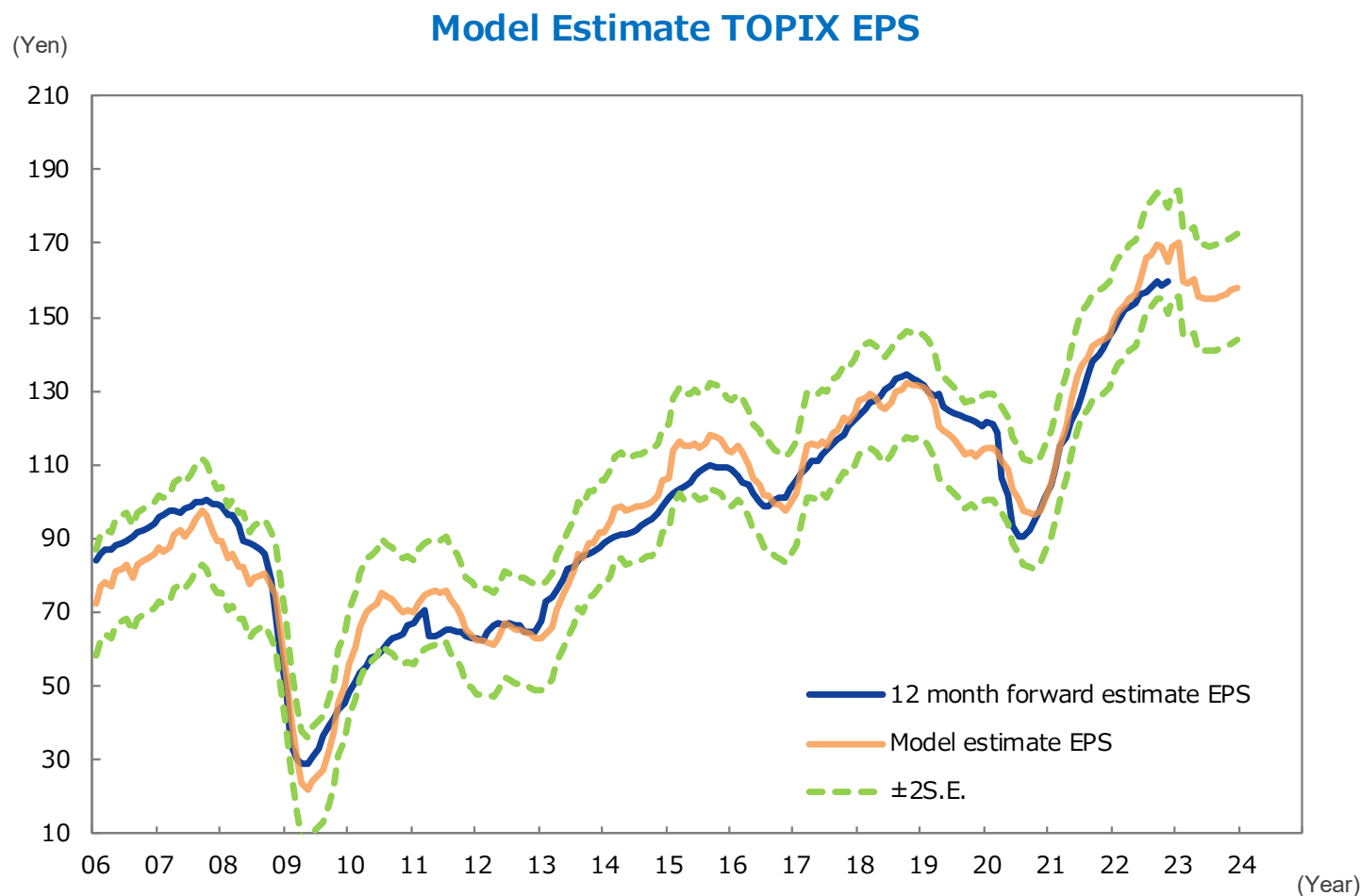
TOPIX Revision Index



Data is from December 27th 2017 to December 7th 2022
(Source) Datastream, IBES

(YY/MM)

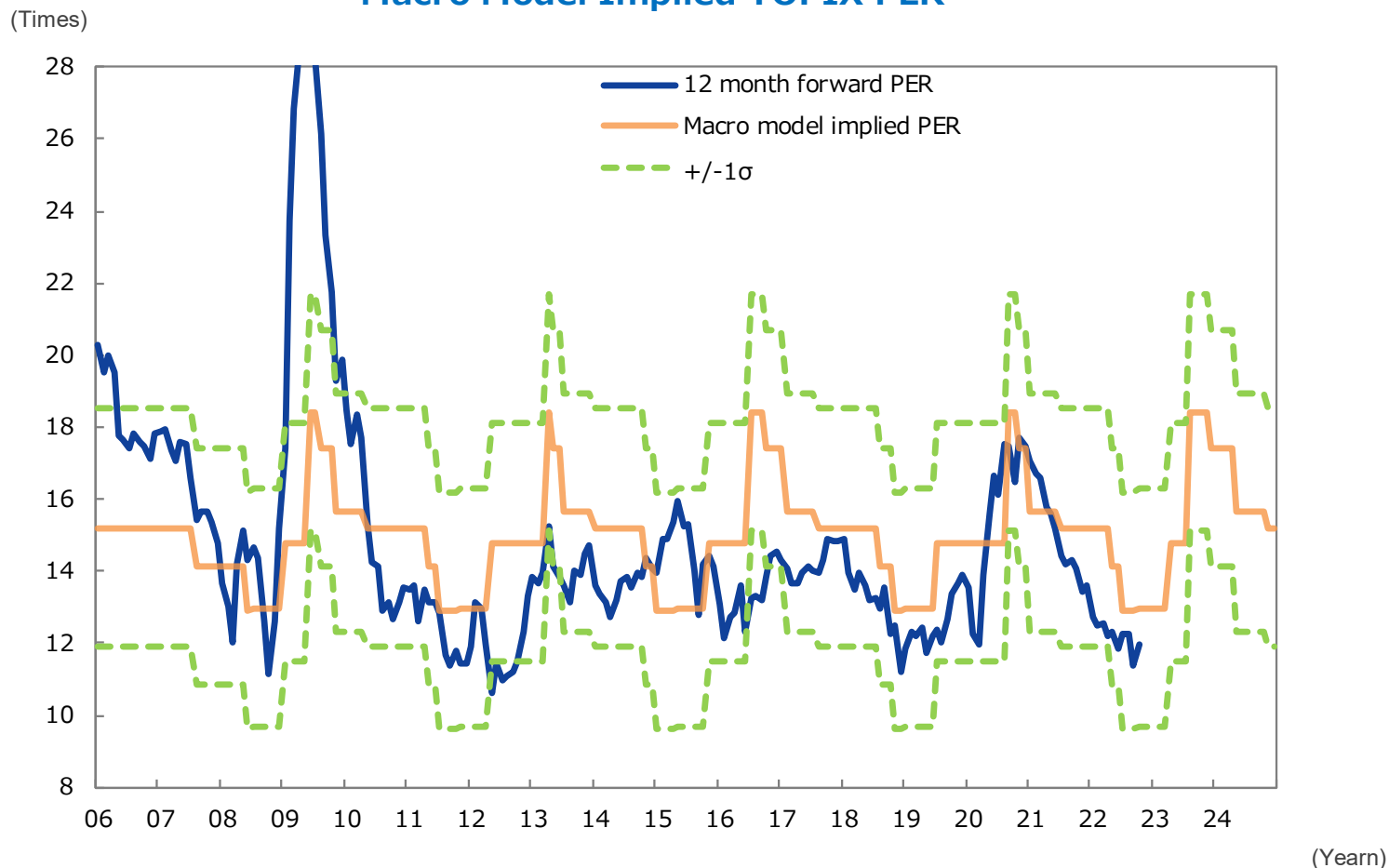
Macro model indicates that EPS is close to its peak



Note: Consensus data is from 1st January 2006 to 30th November 2022,
Model estimate is from 1st January 2006 to 31st December 2023.
Source: SMDAM

Our model indicates PER will bottom out in the near future

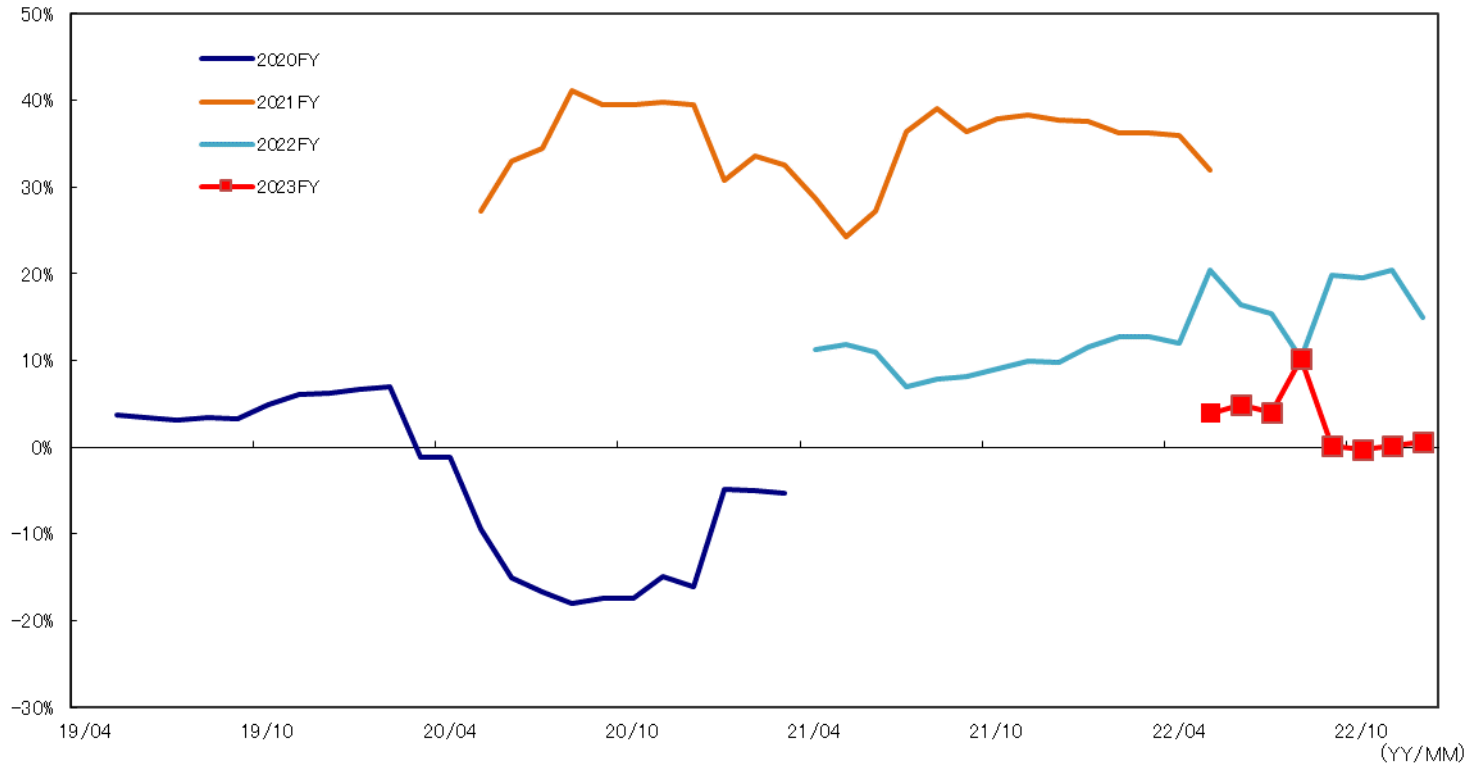
Macro Model Implied TOPIX PER



Note: Consensus data is from 1st January 2006 to 30th November 2022,
Model data is from 1st January 2006 to 31st December 2023.
Source: SMDAM

Bottom up research indicates zero profit growth in FY 2023

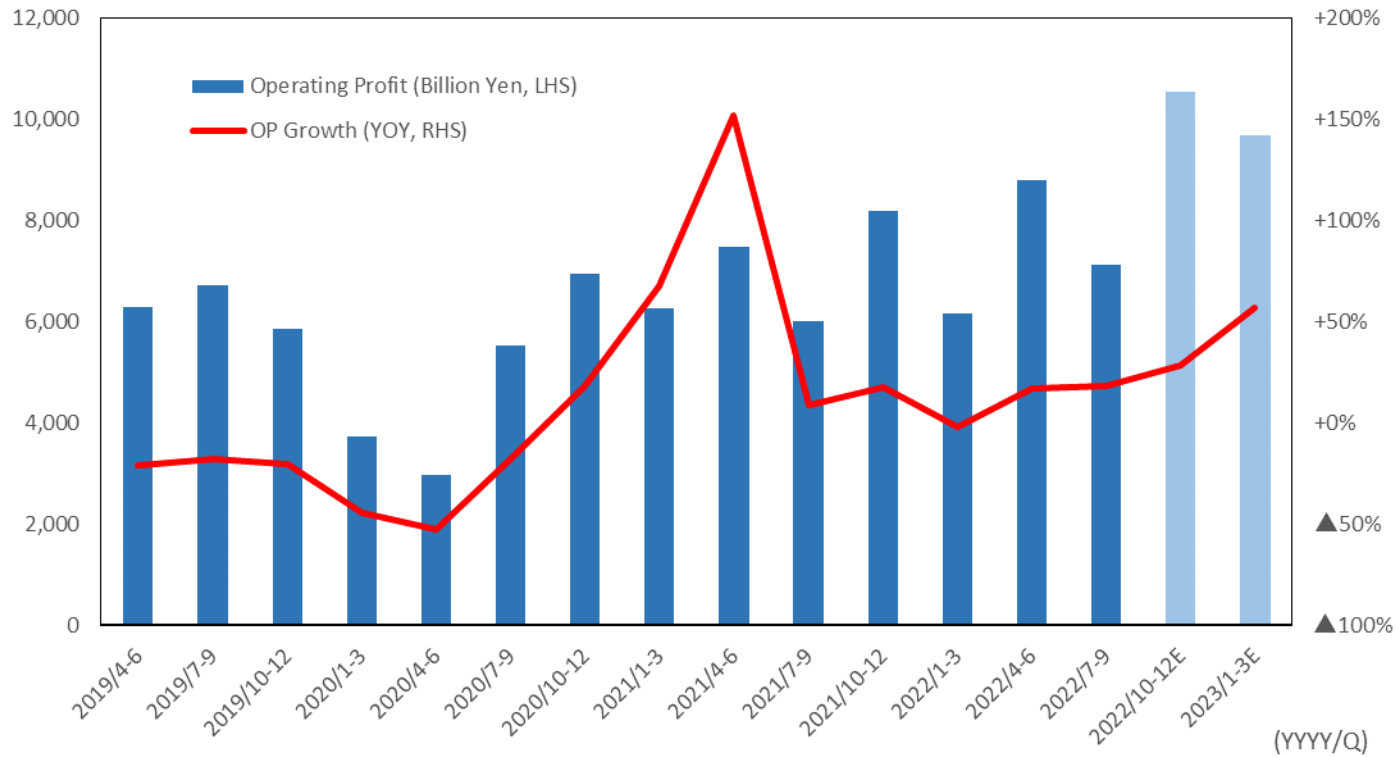
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 13th December 2022, SMDAM Core Universe (Excl. Financials) consists of 407 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Outlook of operating profit remains positive

Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q2 2019 to Q3 2022. Estimate data is from Q4 2022 to Q1 2023.
Source: SMDAM

A tide of “Corporate Governance” in Japan

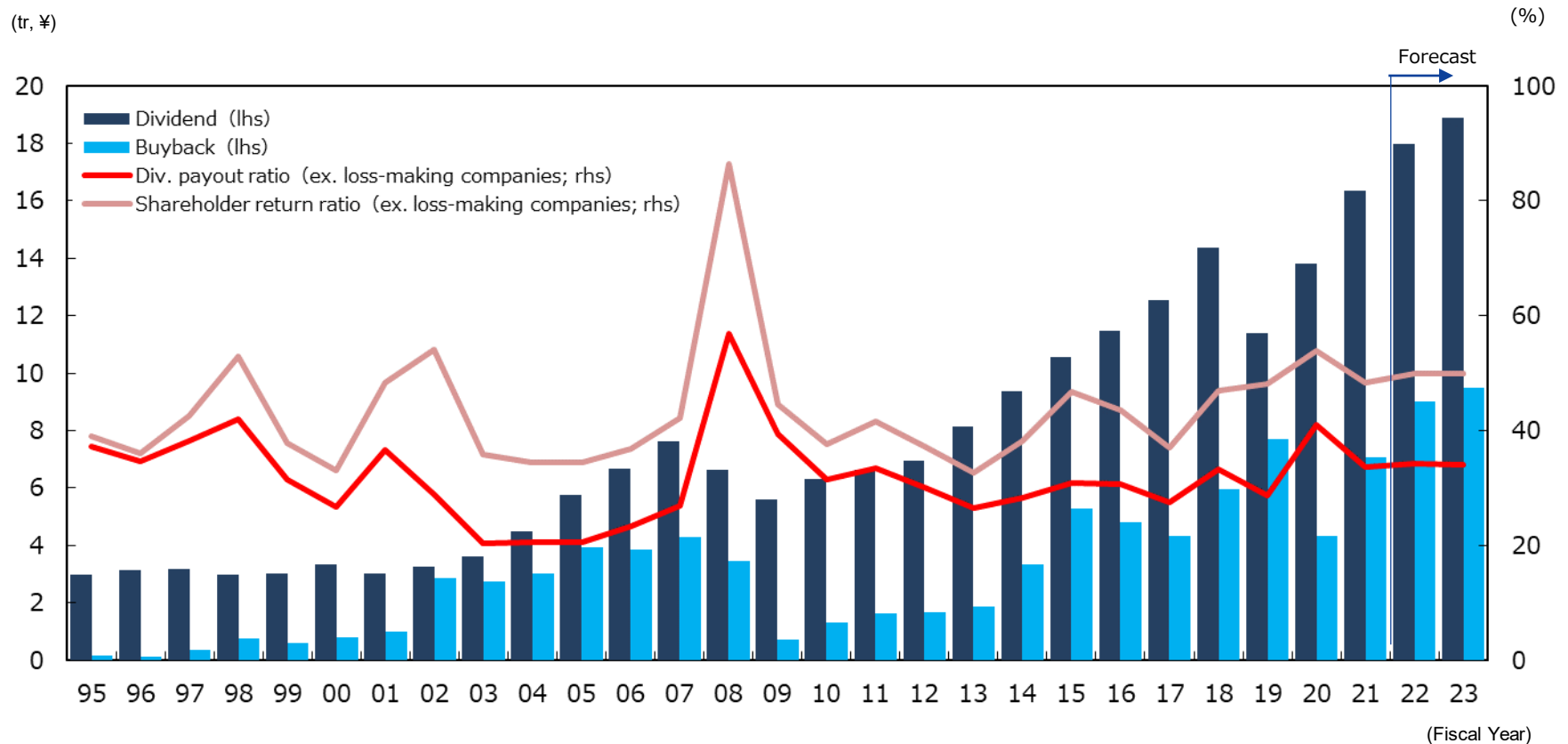
Investors that have signed up to the Principles for Responsible Institutional Investors	
Trust banks	6
Investment managers	202
Insurance companies	24
Pension funds	79
Others	11
Total	322

note: As of November 30th 2022
(Source) FSA, SMDAM

- The Stewardship Code (SC) was established in February 2014. Investors are taking a more proactive approach in talking to companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors which publicly accepted the SC.
- After the inception of the Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve their governance, efficiency, and shareholder returns.
- These two codes have been progressively reviewed and enhanced, and are making a visible impact on corporate behavior and investors' attitudes as shareholders.
- In a recent amendment of the CGC, companies are required to explain the rationale of “cross holdings” or “strategic holdings” of other companies' shares. It implicitly provides protection against takeovers and hostile shareholder actions and is often negative for achieving shareholder value.
- The SC was reinforced in March 2020 to require investors to evaluate ESG factors.

Dividends and buybacks breaking historical highs

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2023, FY2022 and FY2023 are forecasts.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Slowing pace of tightening lifts growth stocks

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	0.66	4.47	-2.44	-3.40	9.09	12.77	9.54
Total Value	0.48	2.58	7.62	6.68	23.66	12.23	4.03
Top Cap Value	1.87	3.00	9.79	8.60	31.65	24.33	18.34
Large Cap Value	0.59	2.05	8.64	7.56	26.44	14.48	7.33
Mid Cap Value	-1.07	0.81	7.13	6.20	20.20	1.71	-6.85
Small Cap Value	0.01	4.84	3.52	3.08	11.83	2.54	-9.76
Micro Cap Value	1.12	6.69	1.55	1.97	10.35	0.81	-10.59
Total Growth	1.08	6.90	-11.43	-12.39	-3.65	11.79	13.83
Top Cap Growth	0.91	4.85	-13.81	-14.43	-2.51	14.03	19.88
Large Cap Growth	1.25	6.58	-12.04	-12.93	-3.69	13.14	15.71
Mid Cap Growth	1.86	9.80	-8.72	-10.15	-5.48	11.68	9.48
Small Cap Growth	-0.28	9.57	-6.05	-7.67	-3.73	0.55	-0.97
Micro Cap Growth	0.84	11.28	-7.39	-7.94	-4.46	2.46	0.72
Top Cap Total	1.23	3.83	-4.14	-4.98	11.36	18.16	18.38
Large Cap Total	0.81	4.15	-2.86	-3.84	9.54	14.48	12.24
Mid Cap Total	0.18	4.66	-0.81	-2.02	7.09	9.42	3.81
Small Cap Total	-0.17	6.30	0.00	-0.89	5.93	2.51	-5.44
Micro Cap Total	1.00	7.92	-1.20	-1.10	5.57	2.35	-5.36

Note : As of December 16th 2022
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** Business sentiment generally improved on the back of the resumption of economic activity. The Bank of Japan's Tankan assessment shows that overall business sentiment is improving thanks to a clear improvement in non-manufacturing sectors despite the marginal deterioration of the manufacturing sector owing to the overseas economic slowdown. Planned CAPEX is also still strong, with pent-up demand and de-carbonization and digitization likely to be a tailwind. Inbound consumption is also recovering as border control measures are eased.
- **Inflation is on an upward trend.** CPI is accelerating in Tokyo and nationwide. Though rising import prices have been a major driver of higher inflation, the pace of increase of import prices is slowing recently.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2022 at +1.7%, whilst we have raised our forecast for FY 2023 from +1.0% to +1.3% and that for FY 2024 from +1.0% to +1.2% respectively.** The upward revisions for FY 23 and FY 24 mainly reflect an increase in the assumption of inbound consumption and an increase in defense spending. The economic recovery is expected to continue in FY 22 supported by capital investment, economic stimulus measures and inbound consumption. On the other hand, the economy is expected to slow down in the first half of FY 23 due to the impact of deteriorating overseas economies. After that, we expect a gradual recovery in the domestic economy as well as a recovery in overseas economies.
- ② **We have maintained our Core CPI forecast for FY 2022 at +2.7%. We have lowered our estimate for FY 2023 from +2.3% to +2.1% and maintained the estimate for FY 2024 at 1.3%.** The main reason for the downward revision for FY 23 was a review of the dollar-yen rate and crude oil prices. Core CPI in FY 22 is likely to remain in the upper 3% range from the previous year. On the other hand, core CPI is expected to decelerate from FY 23 onward on the back of easing cost-push pressure.

Current status & Outlook of Japanese economy

- ③ **PM Kishida seems to maintain his accommodative economic policy.** The comprehensive economic package approved by the Cabinet turned out to be massive, totaling 37.6 trillion yen on an expenditure basis. The impact on real GDP growth is expected to be + 0.1% in FY 2022 and +0.4% in FY 2023. The Kishida administration continues its pro-business stance for the time being, but over the medium term, it may emphasize fiscal consolidation. The government plans to finance part of the increase in defense spending with a tax hike.

- ④ **The Bank of Japan had decided modify its yield curve control at the monetary policy meeting in December 2022 by widening the control range of 10 year JGB yield from 0% \pm 0.25% to 0 \pm 0.5%. We believe the decision is the start of a gradual correction of the current bold monetary easing and after Governor Kuroda steps down in April 2023, we expect the new governor will end the “negative interest rate policy” in June 2023.** While it is unlikely that the BOJ will radically revise its policy target of achieving “2% inflation”, it is more likely that BOJ will loosen its commitments to the policy target. On the other hand, given the economic environment, which is far from inflation with wage increases and economic recovery, it is unlikely that the BOJ will turn to full-fledged monetary tightening.

Forecast table for the Japanese economy

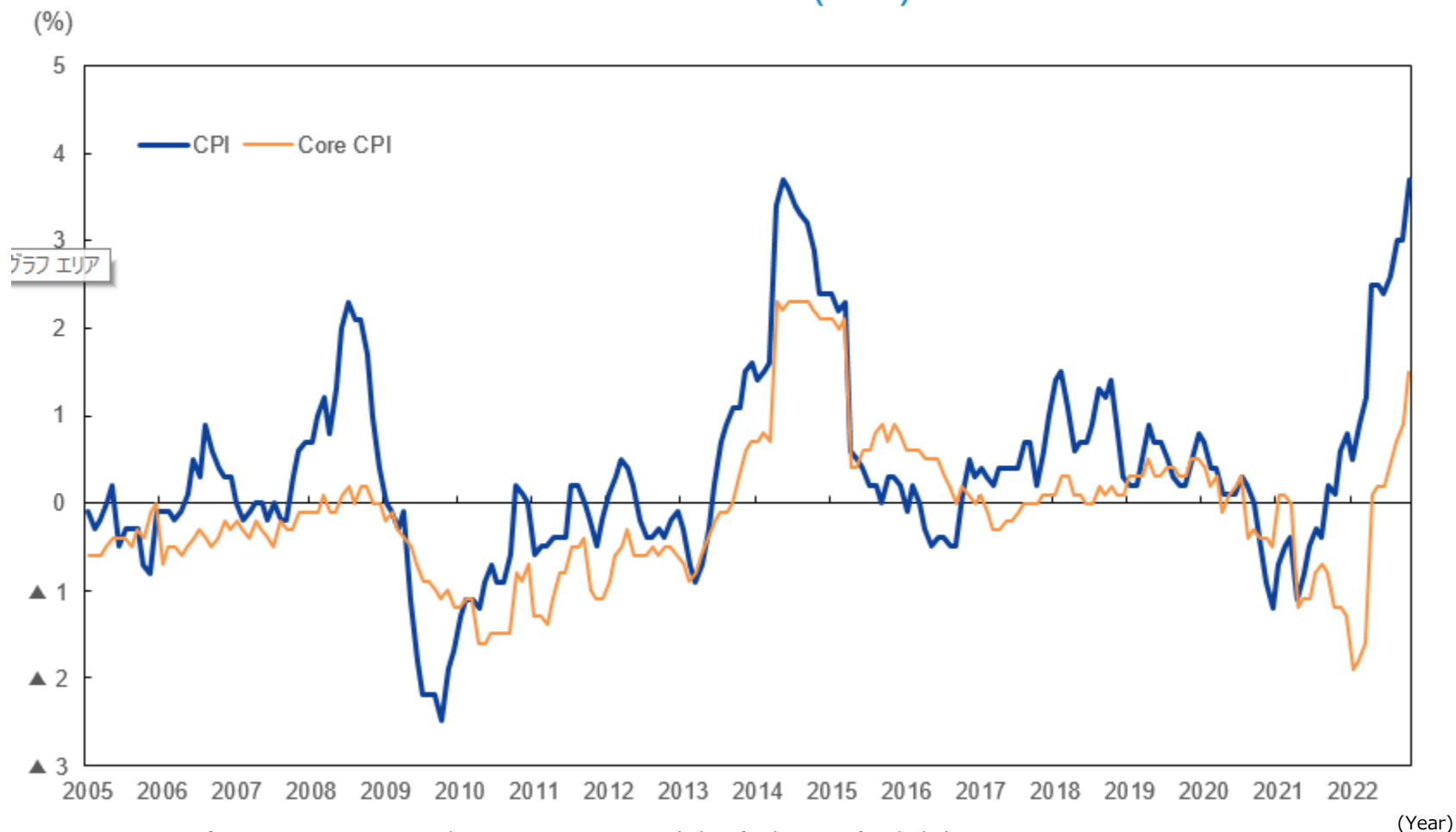
Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY18	FY19	FY20	FY21	FY22 Est	FY23 Est	FY24 Est
Real GDP	0.3%	-0.9%	-4.6%	2.5%	1.7%	1.3%	1.2%
Private final consumption expenditure	0.1%	-1.0%	-5.4%	1.5%	2.5%	0.7%	0.8%
Private housing investment	-4.8%	2.5%	-7.8%	-1.1%	-4.5%	-0.8%	0.0%
Private-sector capital investment	1.5%	-1.7%	-7.7%	2.1%	3.7%	3.1%	2.8%
Public fixed capital formation	0.8%	1.7%	5.1%	-6.4%	-3.4%	2.0%	0.9%
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.5%	-0.1%	0.1%
Exports of goods and services	2.0%	-2.3%	-10.0%	12.3%	4.3%	0.4%	4.3%
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	6.8%	0.7%	3.6%
Nominal GDP	0.2%	0.0%	-3.9%	2.4%	1.8%	2.5%	2.2%
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.0%	1.2%	1.0%
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	0.6%	1.6%	2.7%
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	2.7%	2.1%	1.3%
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	8.4%	0.0%	0.0%
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.1%	1.6%	2.0%
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%	2.3%
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	0.0%	0.0%	0.0%

Note: Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (Core) excludes the effects of the consumption tax and free education.

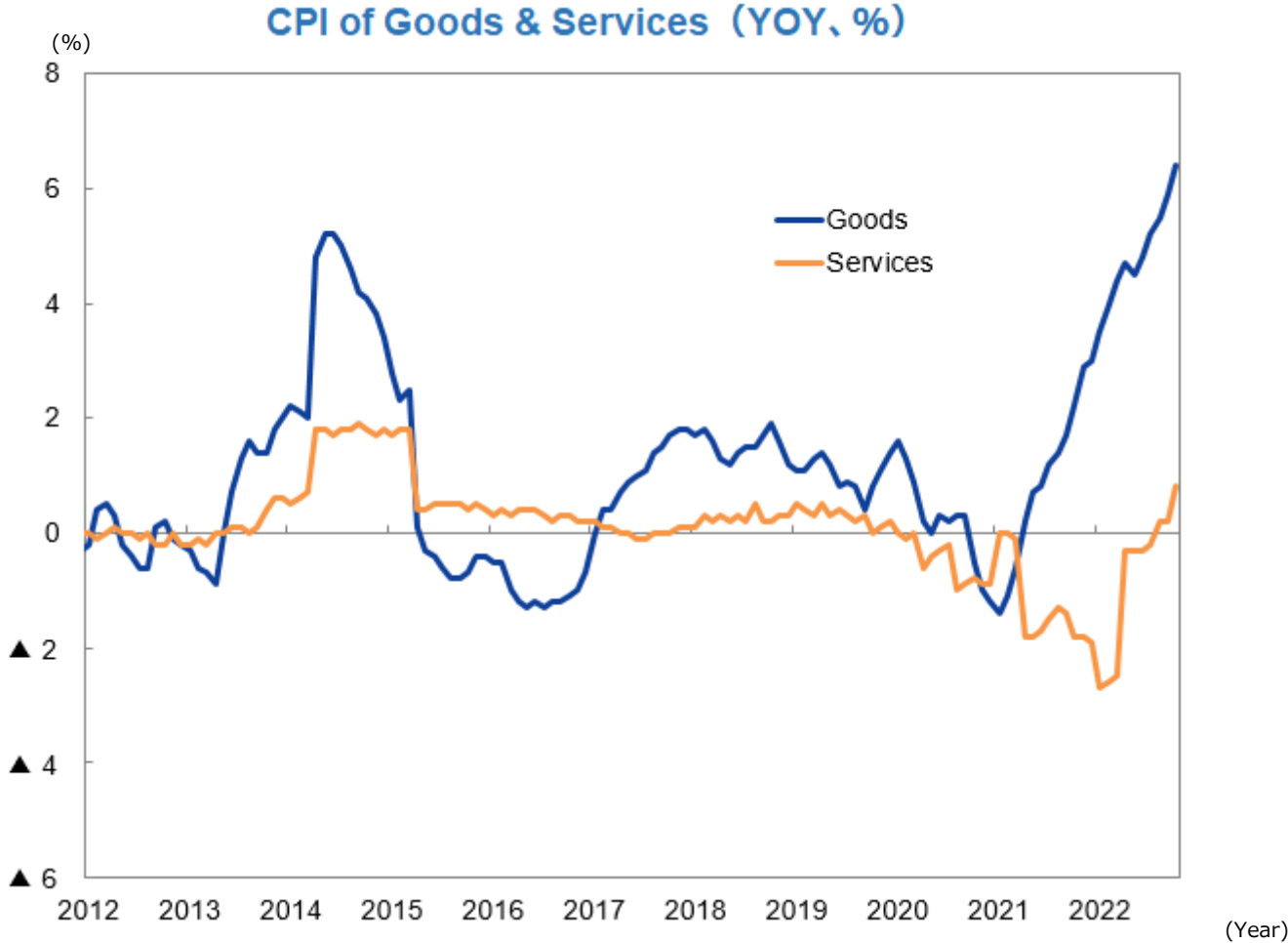
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Finally, inflation has come back to Japan

CPI & Core CPI (YOY)



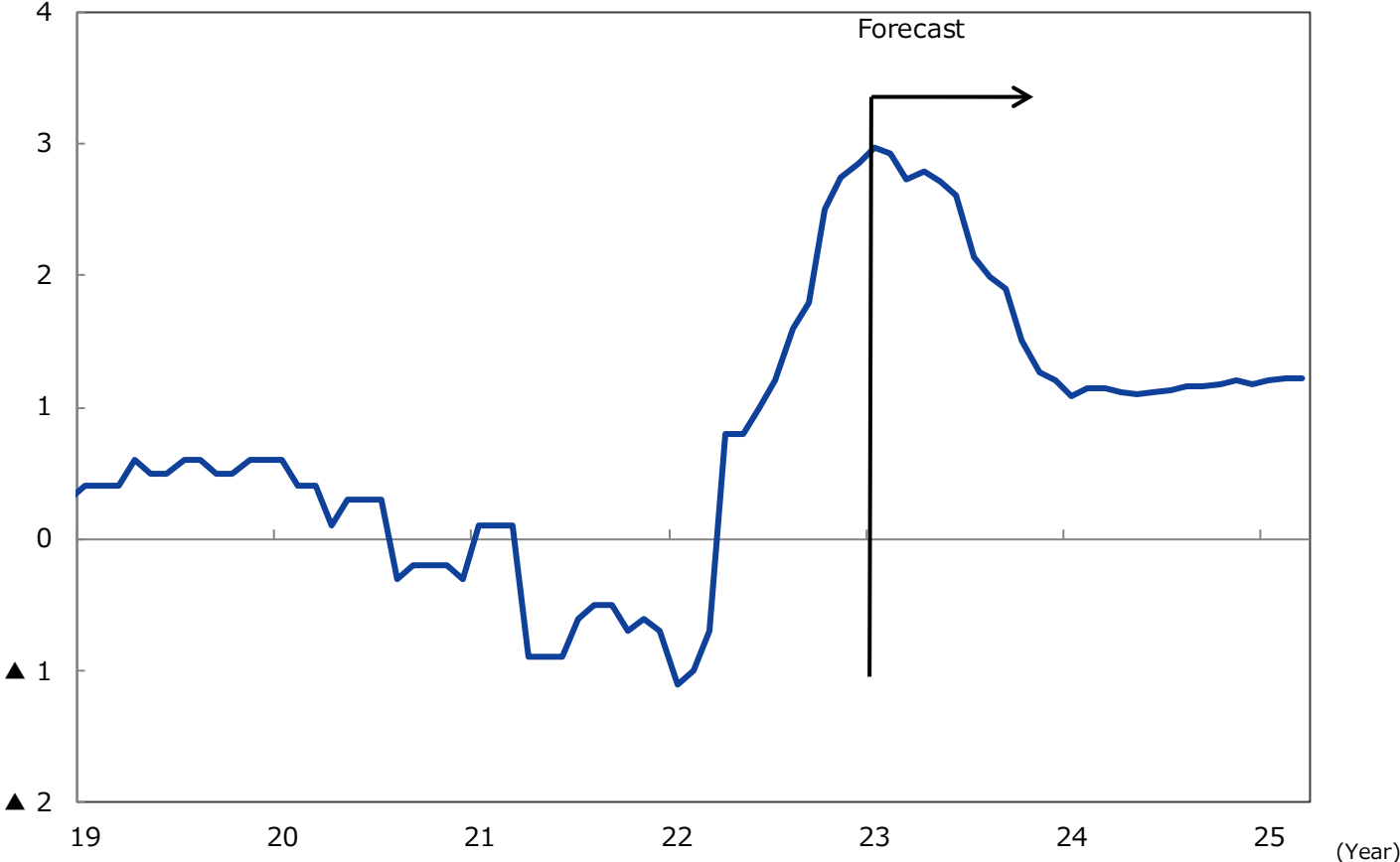
Goods prices lift CPI despite weakness in services



Note: Data is from 1 January 2012 to 1 October 2022.
Source: MIAC, Bloomberg, SMDAM

Core CPI is about to peak

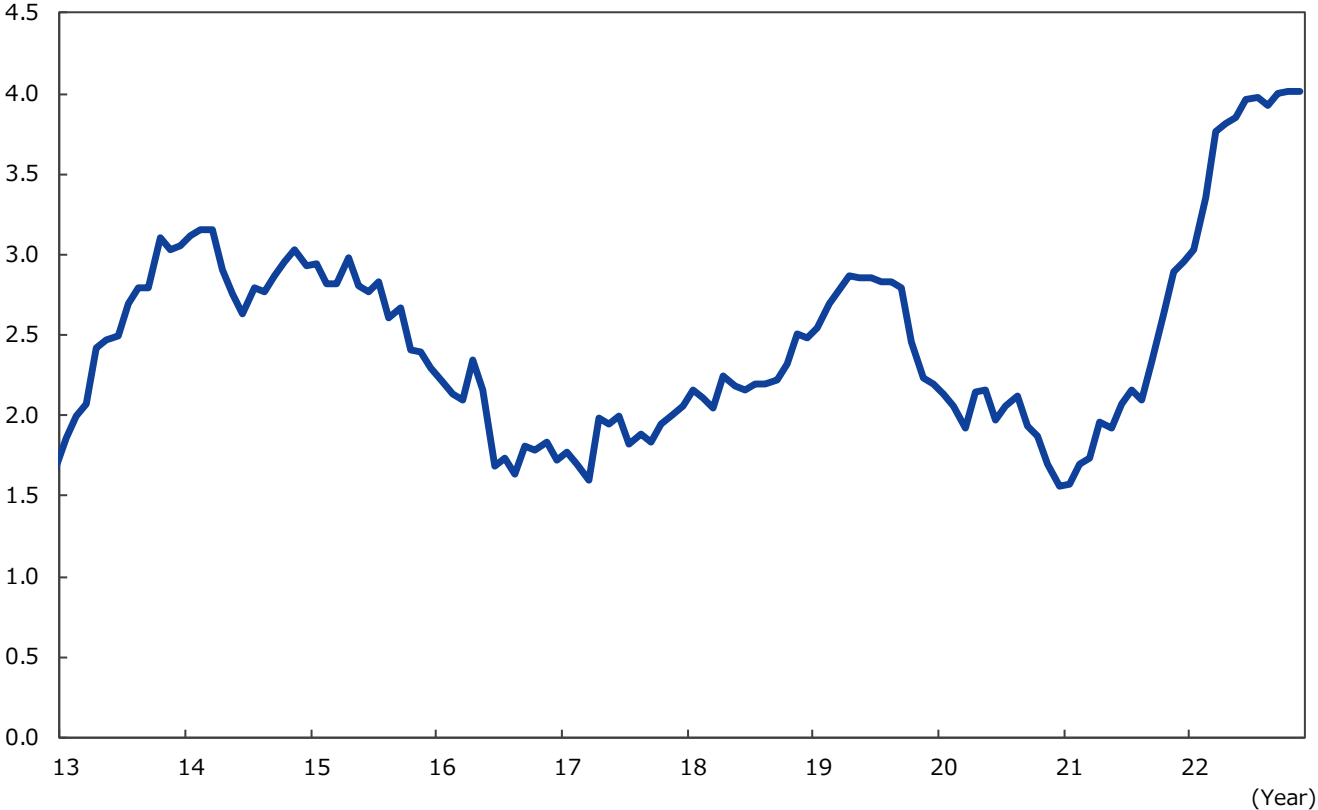
BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's CPI is excluding fresh foods & energy. Data after October 2022 are forecast.
Source: The Bank of Japan, SMDAM

Rising import prices boost peoples' expectations for inflation

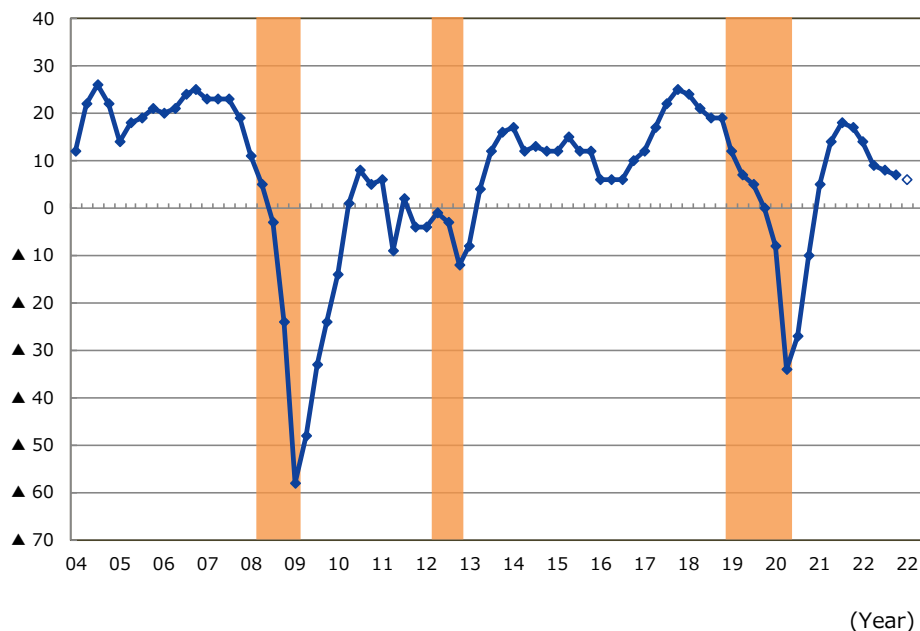
Consumers' Expectation of Inflation Rate (YOY, %)



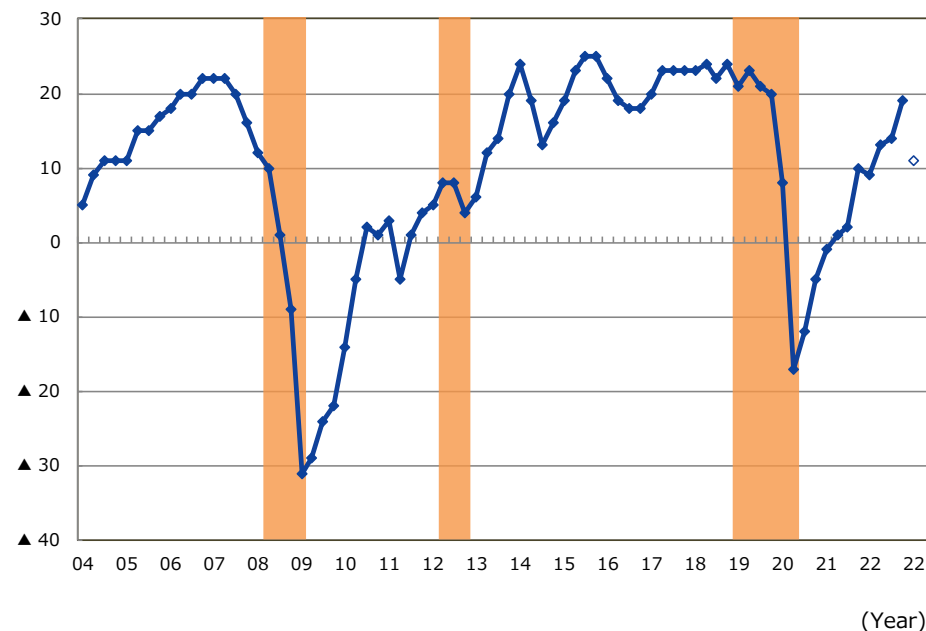
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to November 2022.
Source: Cabinet Office, SMDAM

While the service sector is improving, manufacturers are mixed

BOJ business condition DI Large manufacturers (%)



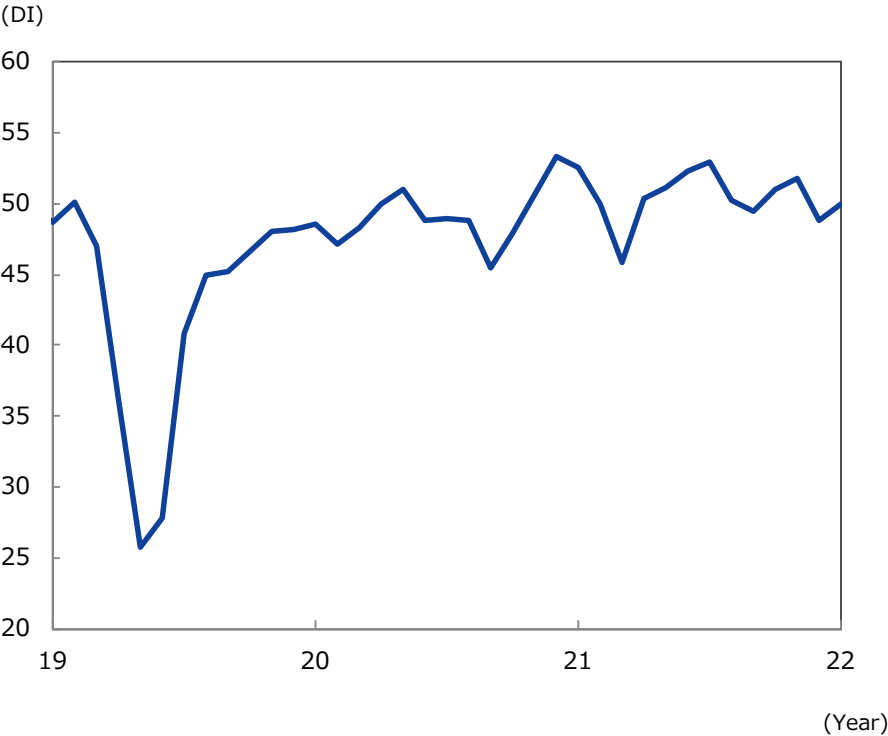
BOJ business condition DI Large non-manufacturers (%)



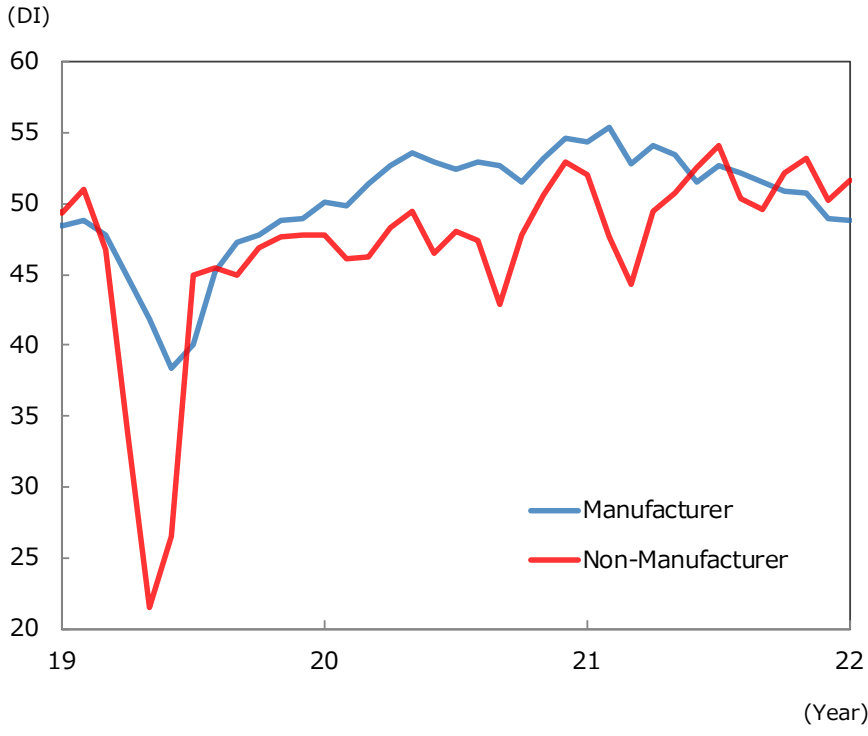
Note: Data is from Q1 2004 to Q4 2022. The periods with orange shadow are periods of economic recession.
Source: The Bank of Japan, SMDAM

Business sentiment slightly lower, led by manufacturers

Composite PMI

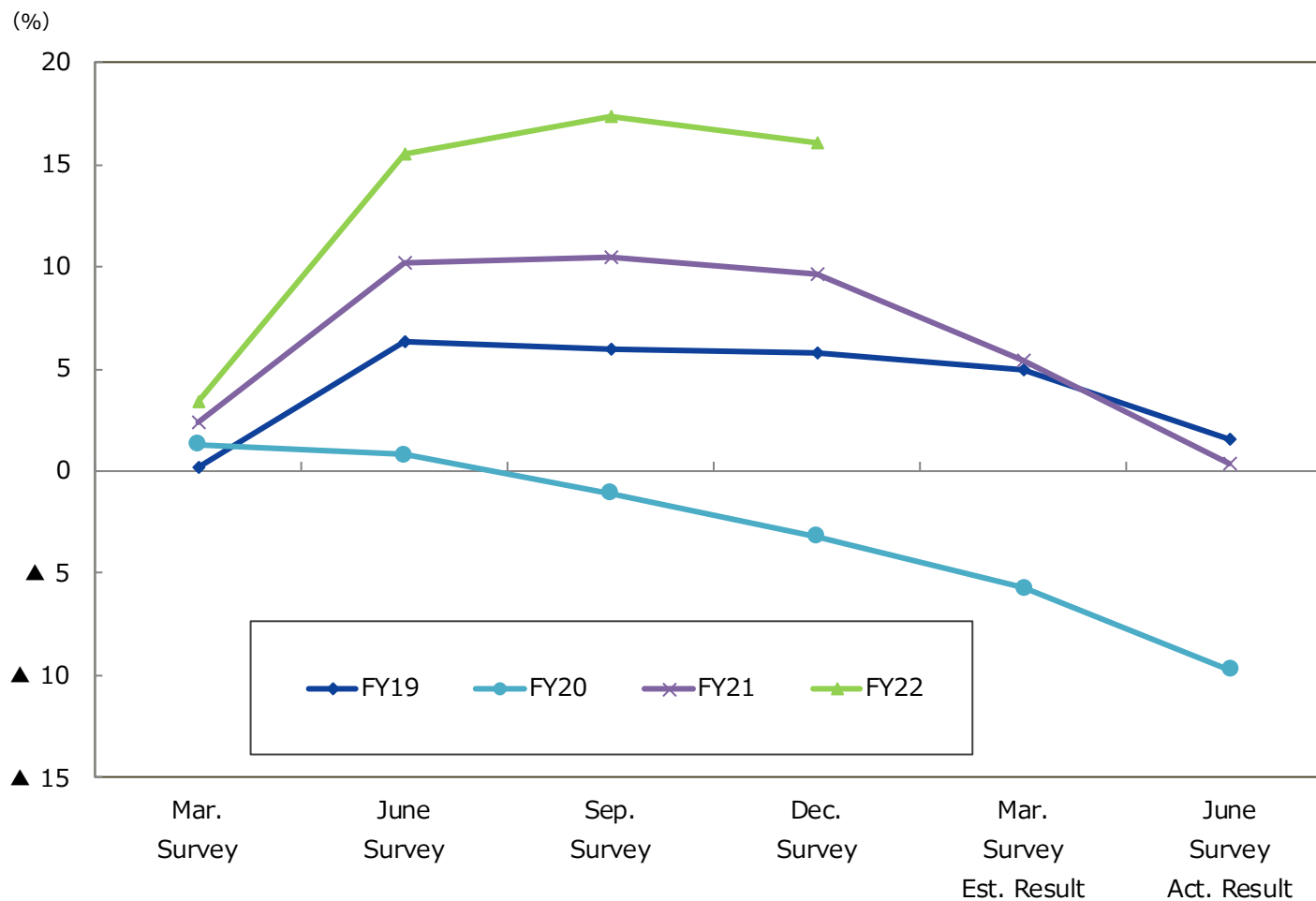


PMI, Manufacturer & Non-Manufacturer



Note: Data is from December 2019 to December 2022.
Source: Bloomberg, SMDAM

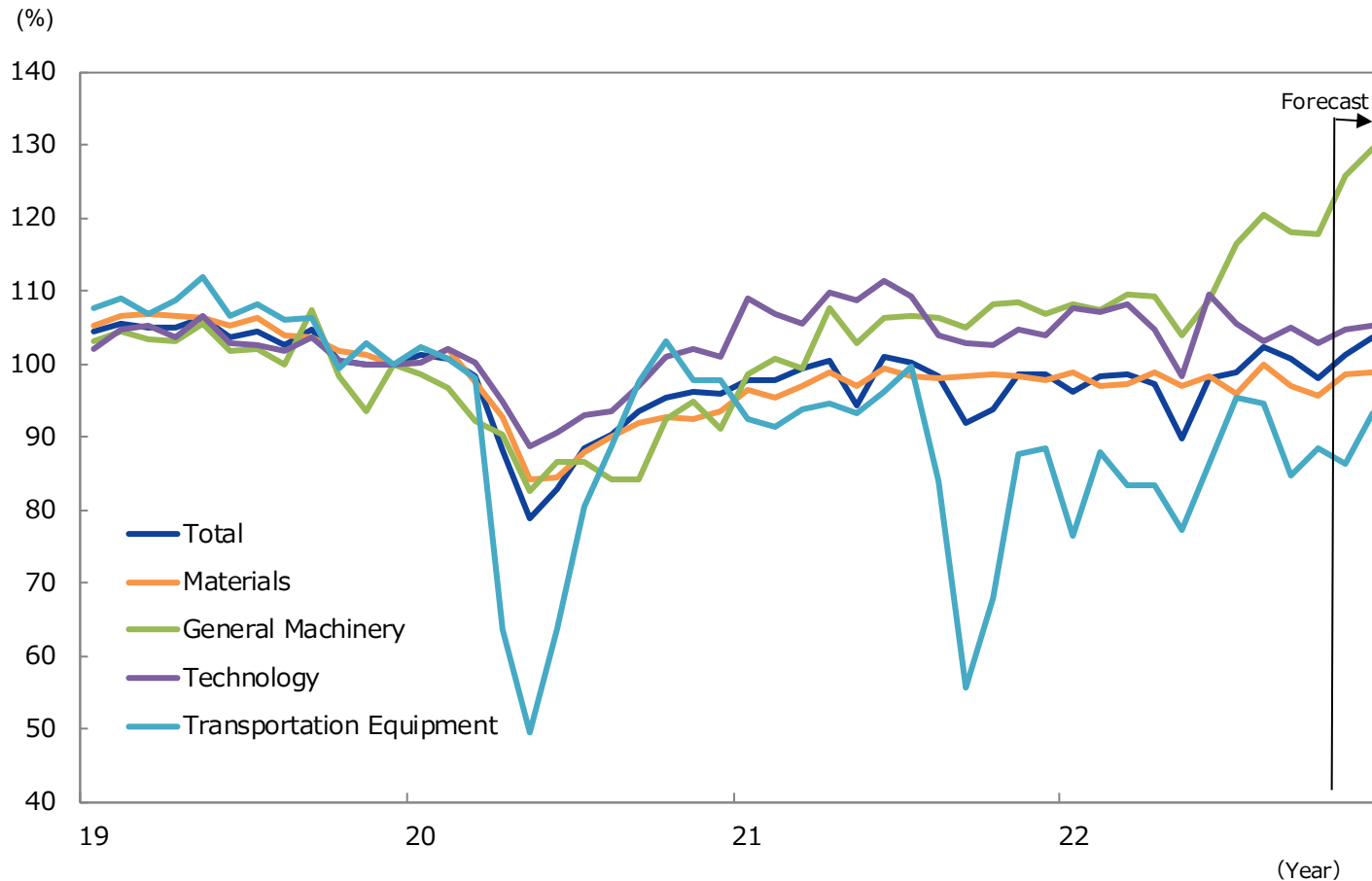
Weak JPY boosts CAPEX despite global weakness



Note: Data is from Q1 FY 2019 to Q4 2022.
Source: The Bank of Japan, SMDAM

Auto and general machinery lift industrial production higher

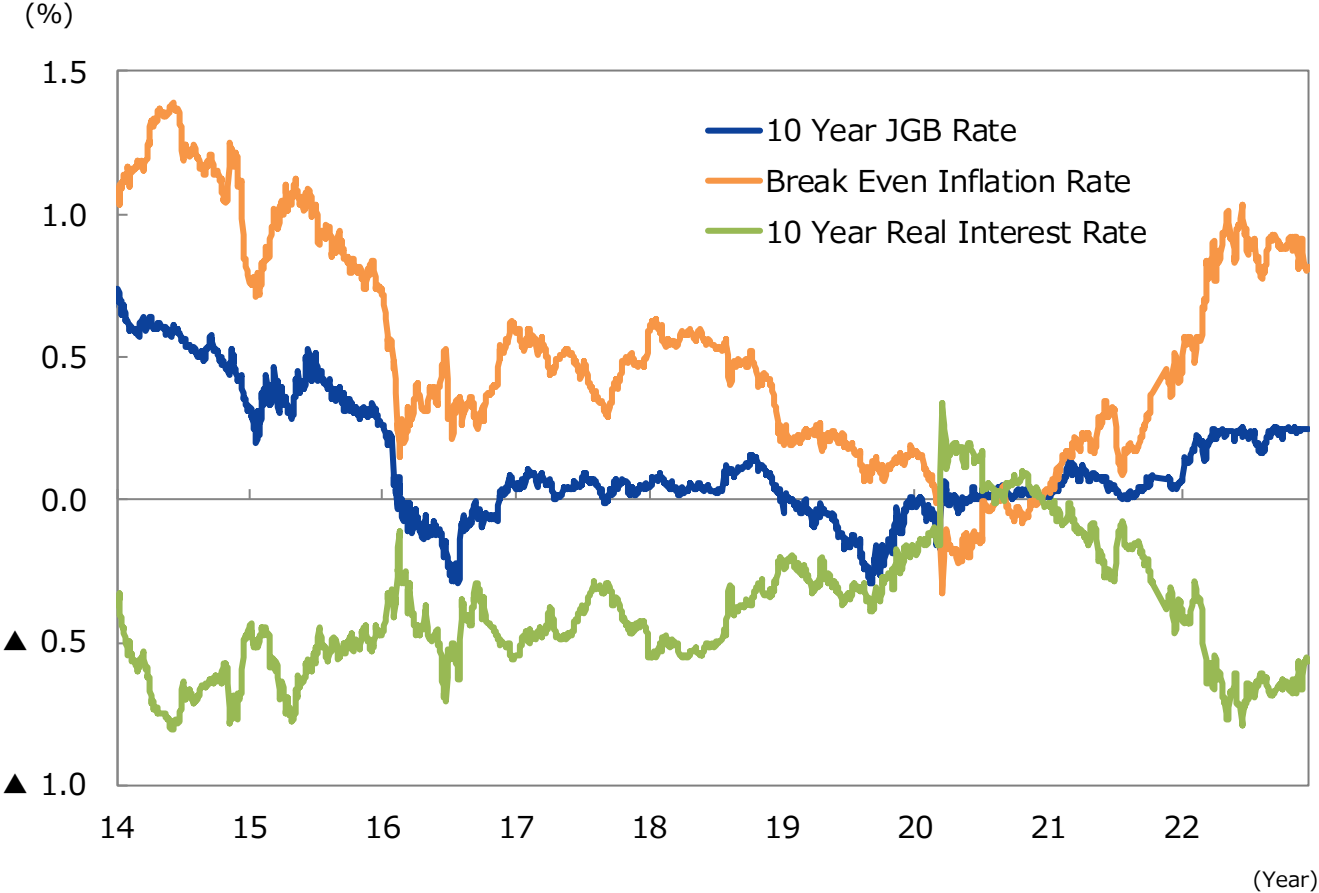
Industrial Production (Dec. 2019=100)



Note: 100% = December 2019. Data is from January 2019 to December 2022. November and December 2022 are forecasts.
Source: METI, SMDAM

Negative real interest rate pushes BOJ to modify its YCC

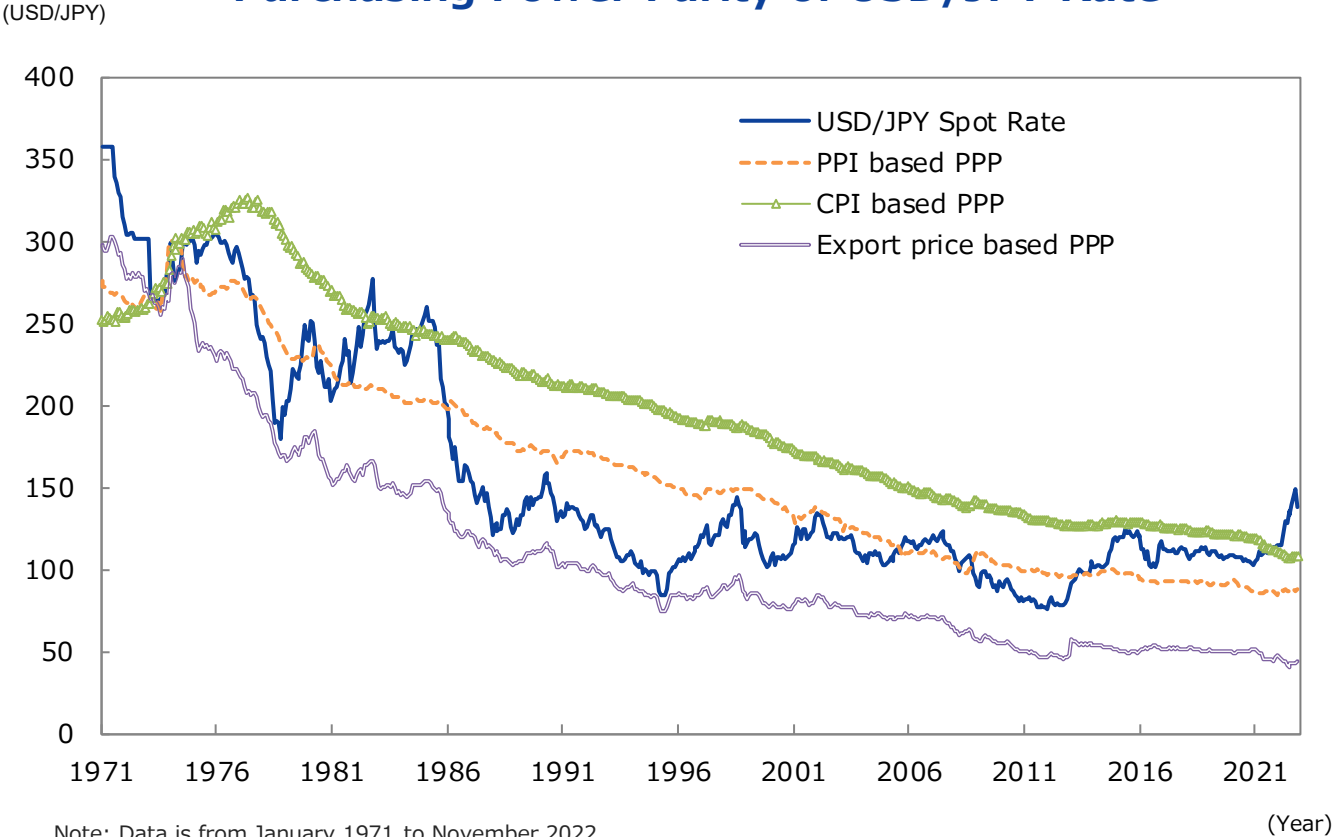
JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 16th December 2022.
Source: Bloomberg, SMDAM

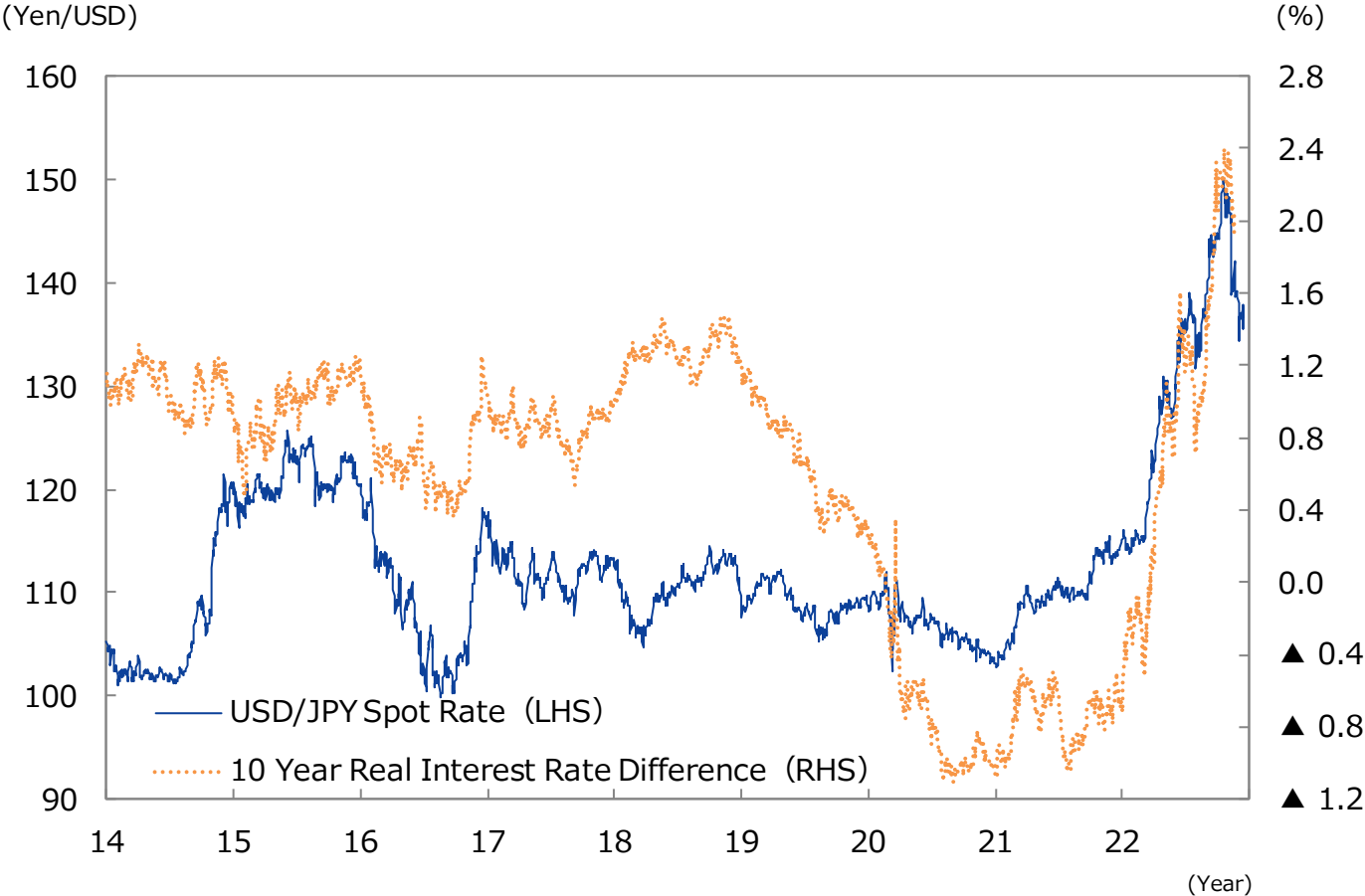
USD/JPY rate breaks 30+ years' PPP resistance

Purchasing Power Parity of USD/JPY Rate



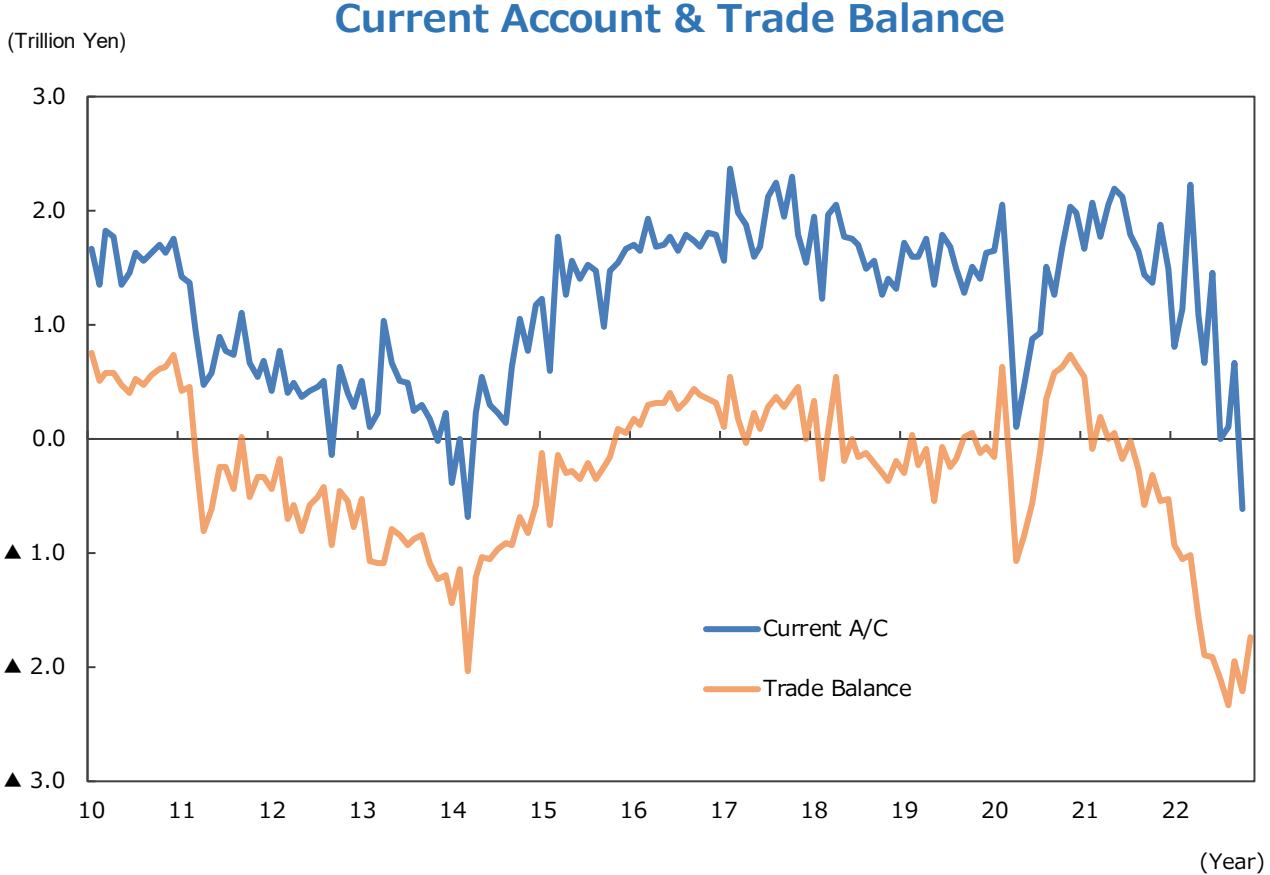
USD/JPY slides due to slowing monetary tightening by FED

Real Interest Rate Gap & USD/JPY Exchange rate



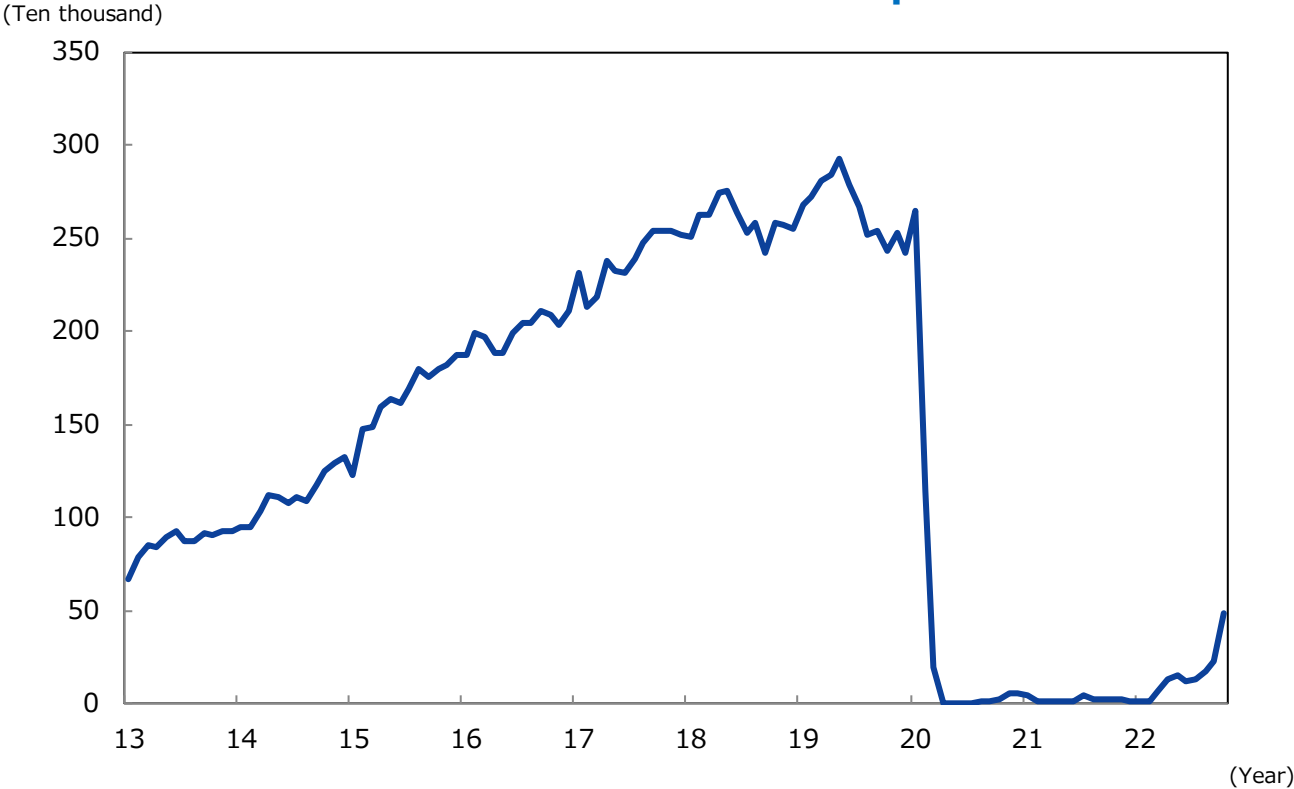
Note: Data is from 1st January 2014 to 16th December 2022.
Source: Bloomberg, SMDAM

Current A/C turns to negative for the first time in eight years



Inbound travel starts recovering

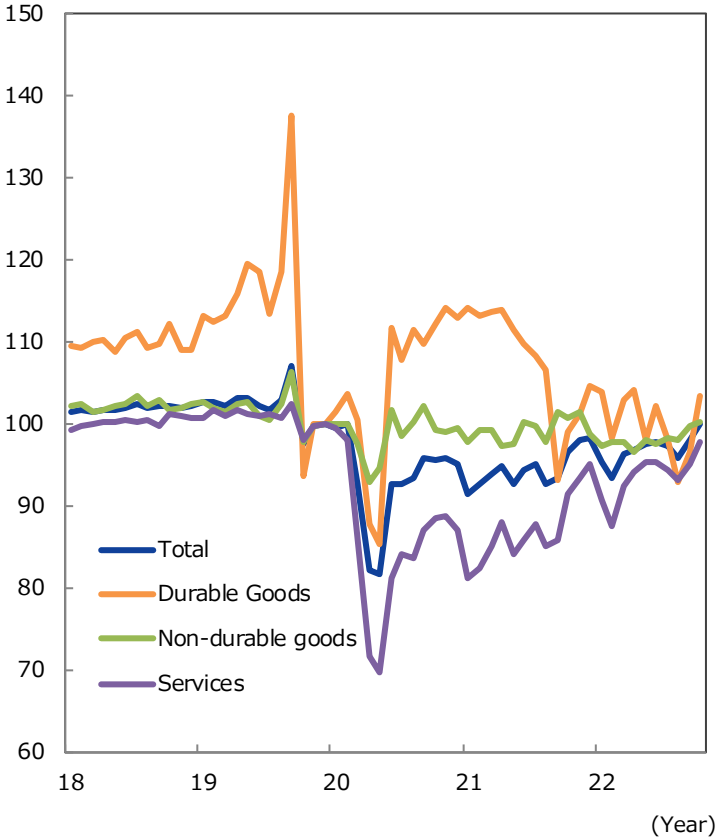
Inbound Travelers to Japan



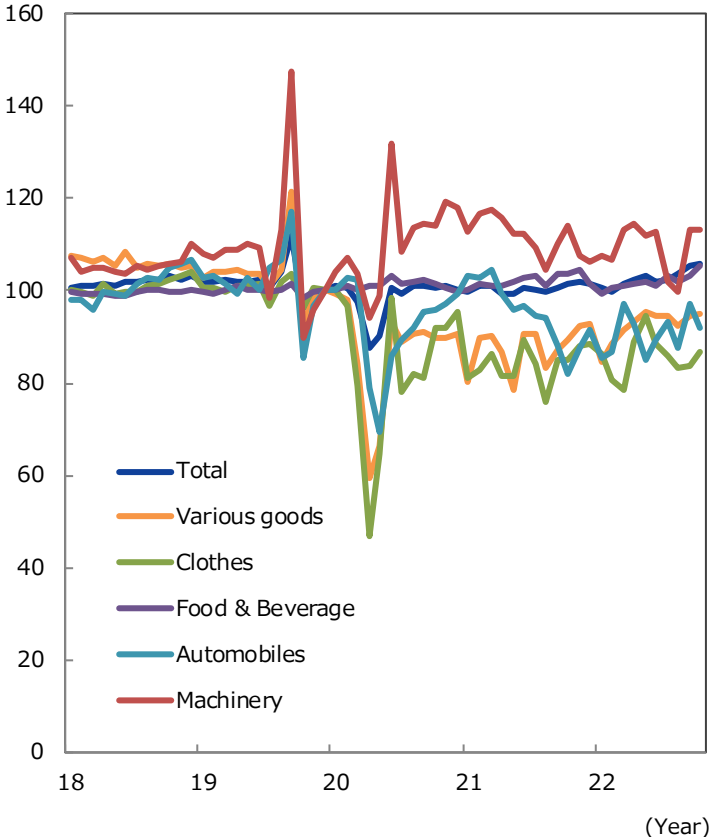
Note: Data is from January 2013 to October 2022. Data is seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumers gain momentum after the economy re-opens

Consumer Activity Index (Dec. 2019 = 100)



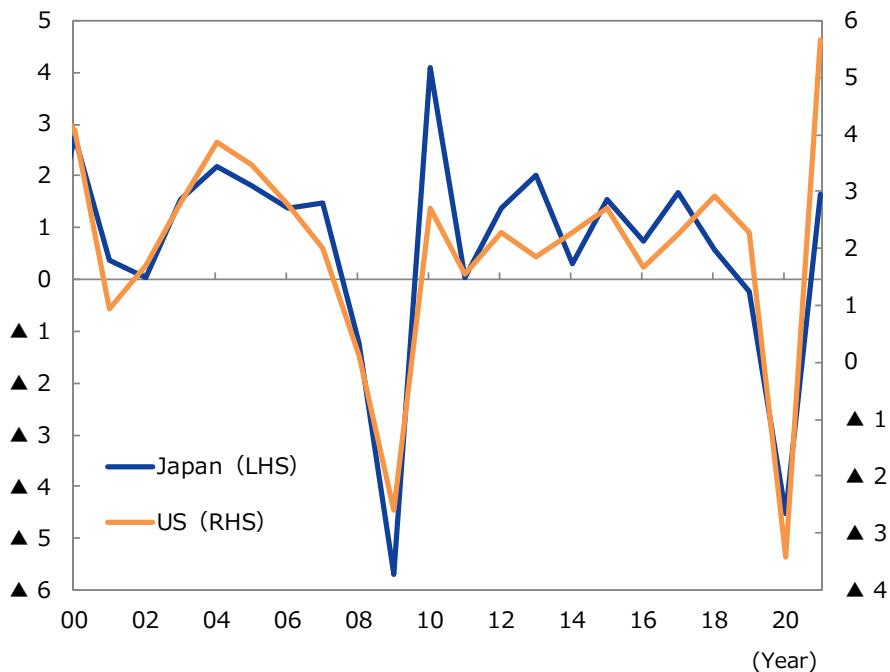
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to October 2022.
Source; Bank of Japan, METI, and SMDAM

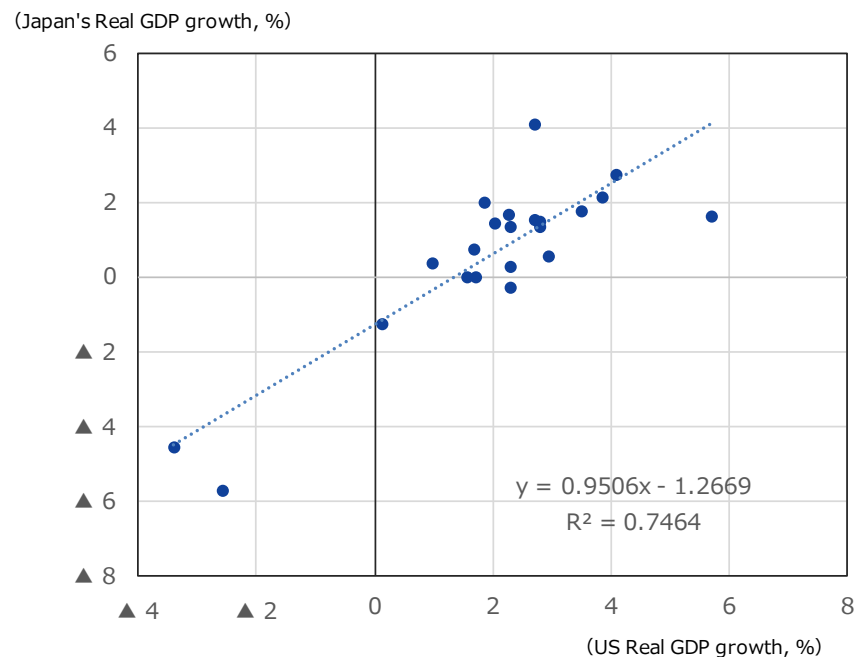
Strong correlation of GDP growth between the US and Japan

Real GDP Growth (YOY, %)



Note: Data is from 2000 to 2021
Source: IMF, SMDAM

Correlation of Real GDP Growth



Japan's marginal exposure to Russian business

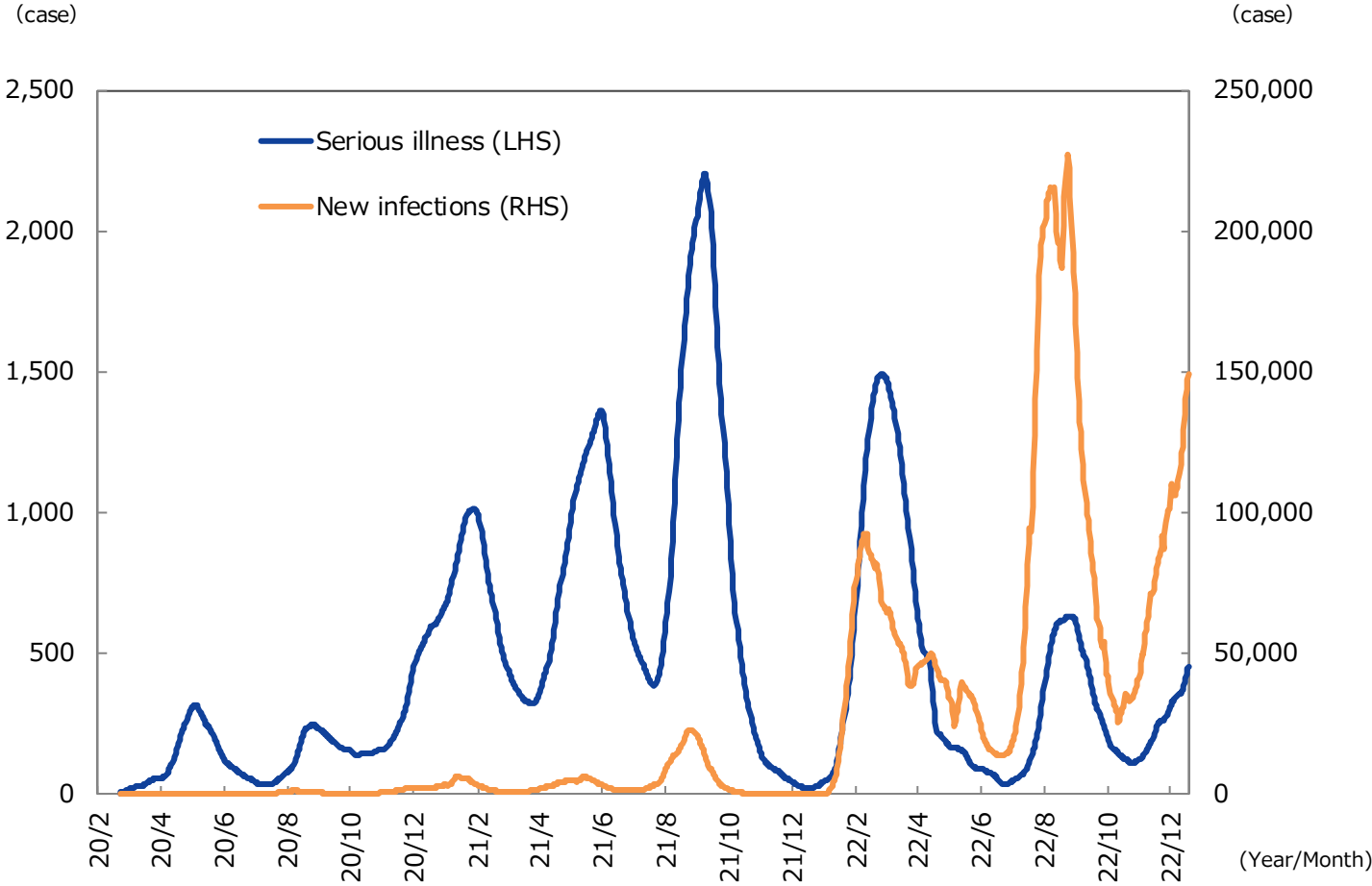
(%)

	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Export	Weight of GDP
Total	1.04	0.16	1.82	0.28
Foods	0.01	0.00	0.17	0.03
Raw Materials	0.00	0.00	0.09	0.01
Mineral Fuel	0.01	0.00	1.12	0.17
Chemicals	0.03	0.00	0.02	0.00
Material Products	0.09	0.01	0.41	0.06
Machinery	0.21	0.03	0.01	0.00
Electronics	0.07	0.01	0.00	0.00
Transportation Equipment	0.56	0.09	0.00	0.00
Others	0.07	0.01	0.00	0.00

Note: As of year 2021.
Source: MOF, SMDAM

Eighth wave of COVID-19 infections in Japan

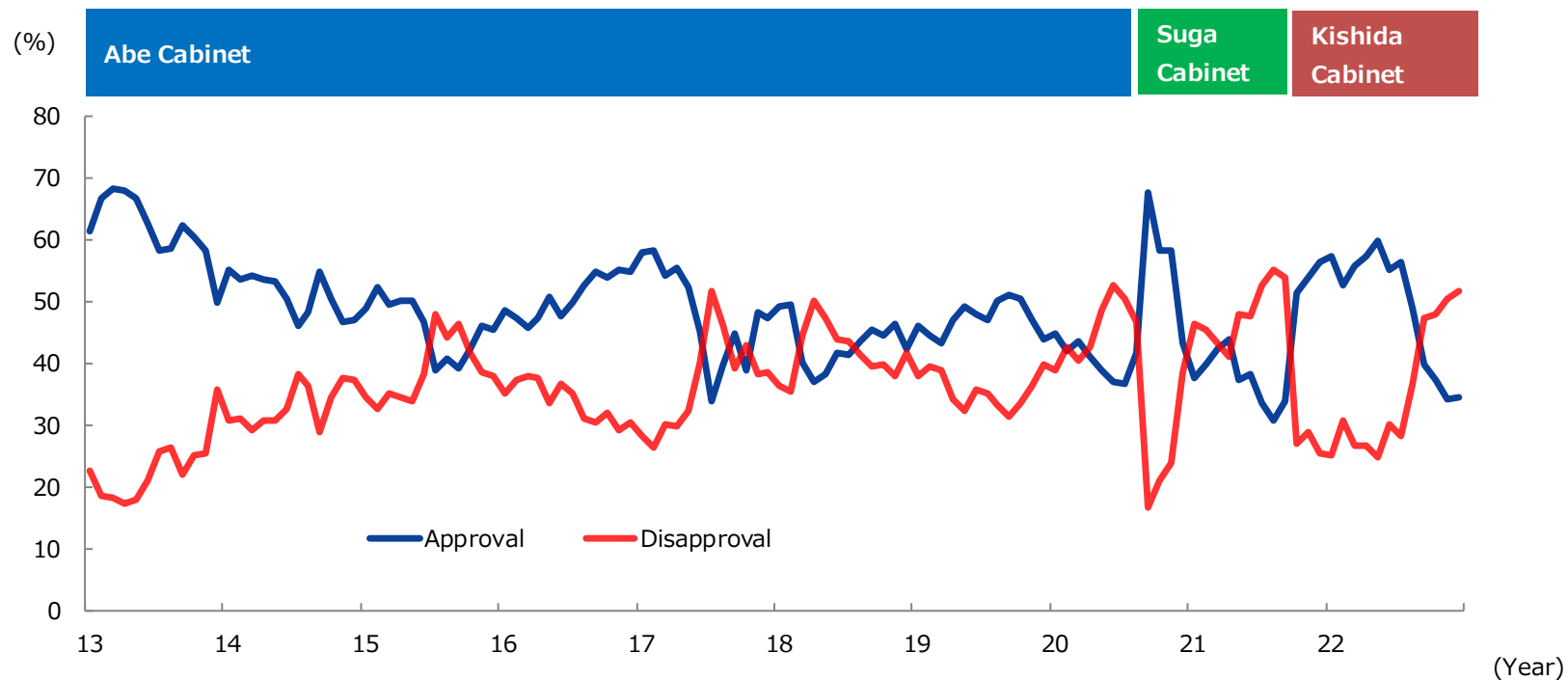
COVID-19 New Infections and Serious Illness



Note: 7 days moving average. Data is from 21st February 2020 to 18th December 2022.
Source: MHLW, NHK, SMDAM

Approval / disapproval rate approaching dangerous levels

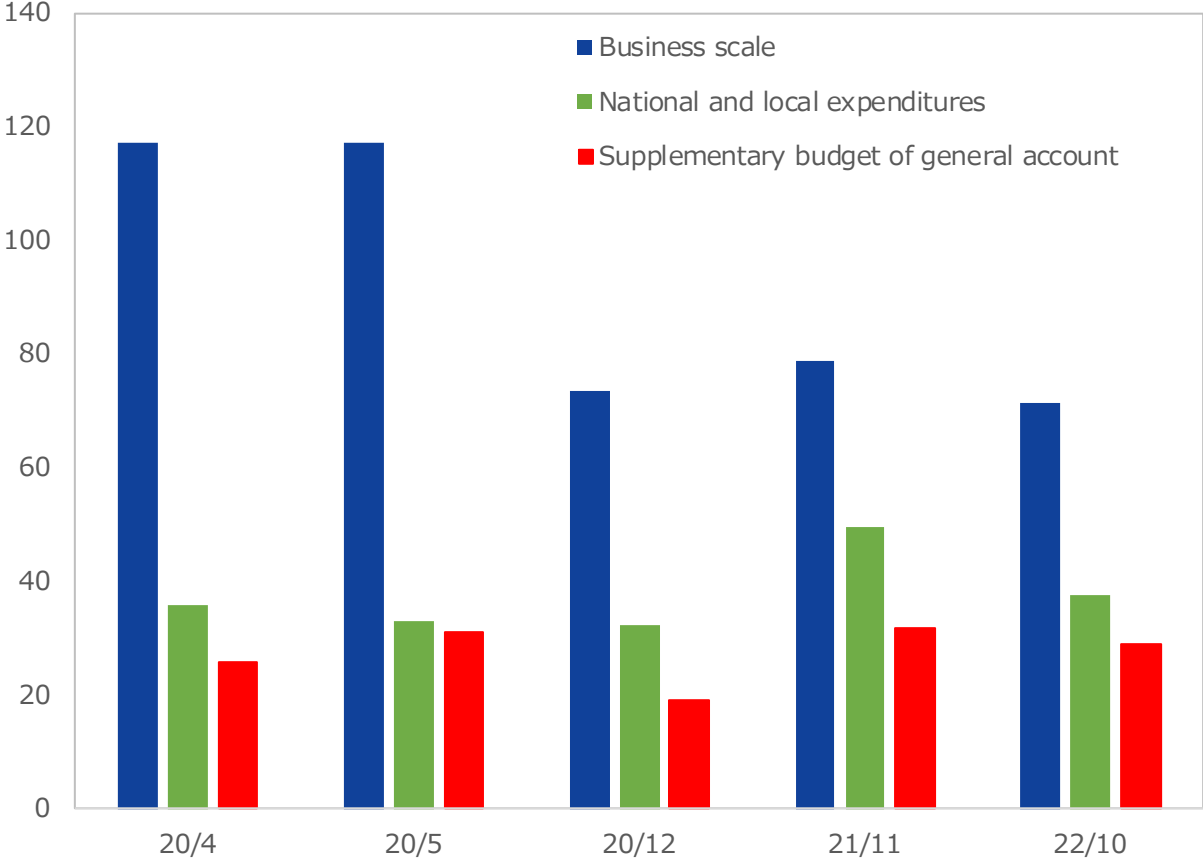
Cabinet approval rate



Note: Data is from January 2013 to December 2022.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Falling approval rate lifts the size of economic stimulus

Size of Fiscal Stimulus (trillion yen)



Source: MOF, SMDAM

(Year/month)

Schedule of major events

Year	Month	Date	Event
2023	January	17-18	Monetary Policy Meeting Convocation of the ordinary diet
	February	14	Release of CY 2022 Q4 GDP
	March	9	Revision of CY 2022 Q4 GDP
		9-10	Monetary Policy Meeting
		19	Term expiration of the BOJ vice governor Amemiya and Wakatabe Enactment of the budget and tax reform bill of FY 2023
	April	8	Term expiration of the BOJ governor Kuroda
		27-28	Monetary Policy Meeting Nationwide local elections
	May	19-21	G7 Summit in Japan
	June	15-16	Monetary Policy Meeting Big-boned policy decisions Formulation of guidelines for the facilitation of labor mobility End of the ordinary Diet session
	July	27-28	Monetary Policy Meeting
	August		
	September	9-10	G20 Summit in India
		21-22	Monetary Policy Meeting Appointment of key officers of ruling Liberal Democratic Party
October	1	Start of the qualified invoice-based method	
	30-31	Monetary Policy Meeting	
November			
December	18-19	Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline	

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

Disclaimer

Please read this disclaimer carefully.

- This material is for non-Japanese institutional investors only.
- The research and analysis included in this report, and those opinions or judgments as outcomes thereof, are intended to introduce or demonstrate capabilities and expertise of Sumitomo Mitsui DS Asset Management Company, Limited (hereinafter “SMDAM”), or to provide information on investment strategies and opportunities. Therefore this material is not intended to offer or solicit investments, provide investment advice or service, or to be considered as disclosure documents under the Financial Instruments and Exchange Law of Japan.
- The expected returns or risks in this report are calculated based upon historical data and/or estimated upon the economic outlook at present, and should be construed no warrant of future returns and risks.
- Past performance is not necessarily indicative of future results.
- The simulated data or returns in this report besides the fund historical returns do not include/reflect any investment management fees, transaction costs, or re-balancing costs, etc.
- The investment products or strategies do not guarantee future results nor guarantee the principal of investments. The investments may suffer losses and the results of investments, including such losses, belong to the client.
- The recipient of this report must make its own independent decisions regarding investments.
- The opinions, outlooks and estimates in this report do not guarantee future trends or results. They constitute SMDAM’s judgment as of the date of this material and are subject to change without notice.
- The awards included in this report are based on past achievements and do not guarantee future results.
- The intellectual property and all rights of the benchmarks/indices belong to the publisher and the authorized entities/individuals.
- This material has been prepared by obtaining data from sources which are believed to be reliable but SMDAM can not and does not guarantee its completeness or accuracy.
- All rights, titles and interests in this material and any content contained herein are the exclusive properties of SMDAM, except as otherwise stated. It is strictly prohibited from using this material for investments, reproducing/copying this material without SMDAM’s authorization, or from disclosing this material to a third party.

Registration Number: The Director of Kanto Local Finance Bureau (KINSHO) No.399

Member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association

© Sumitomo Mitsui DS Asset Management Company, Limited