



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-December 2023-

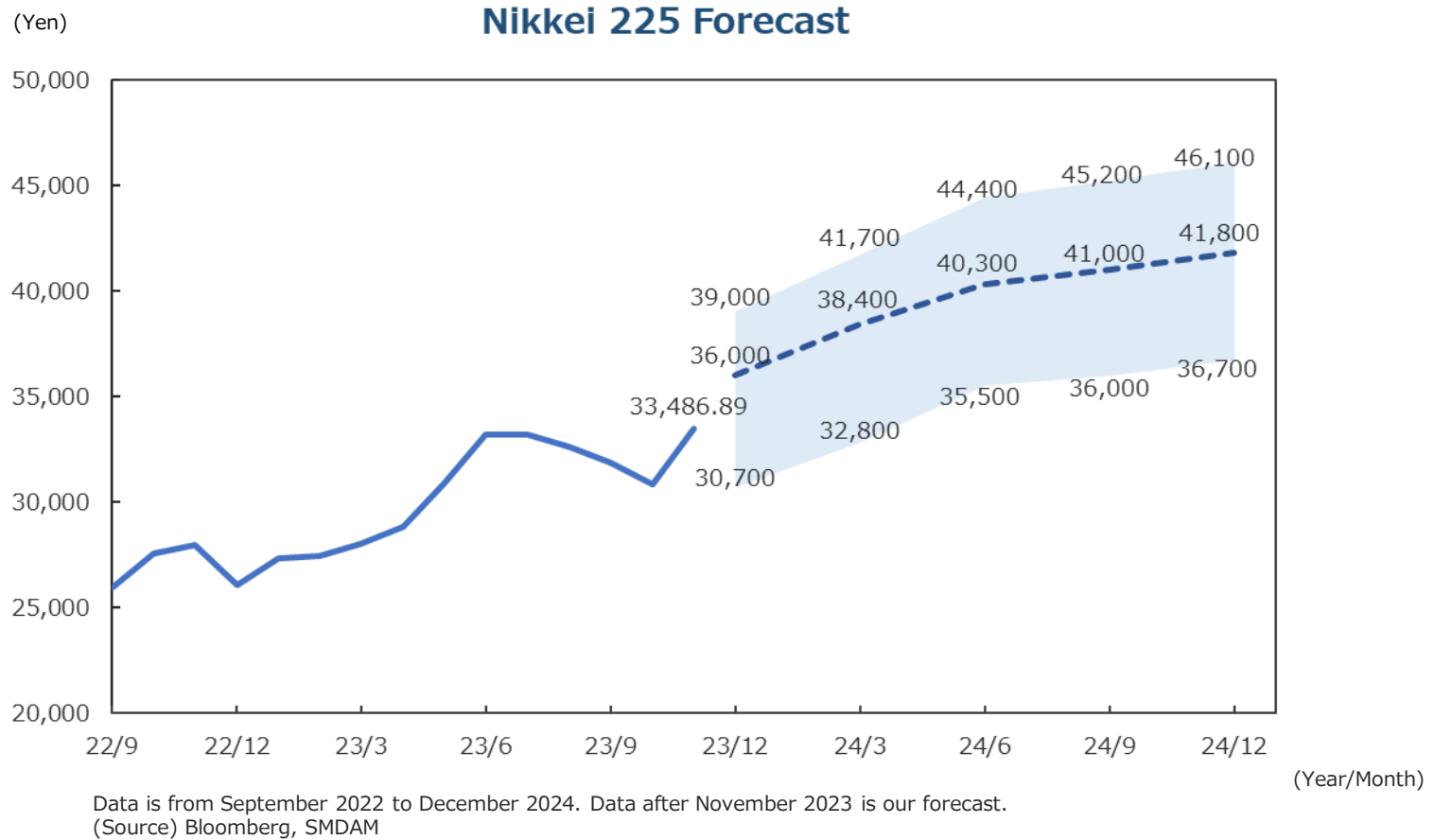


Outlook for Japanese Stock Market

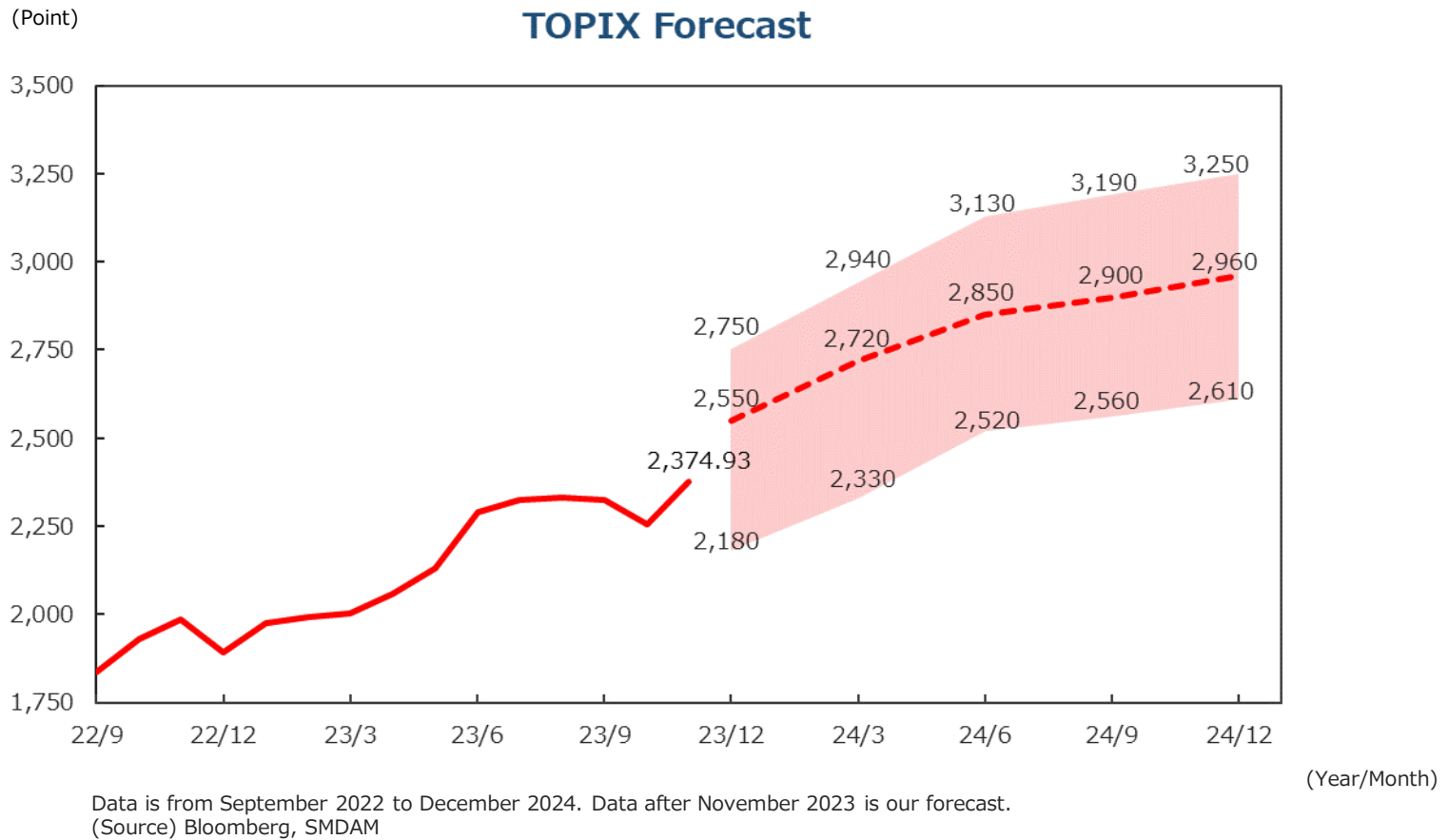
Market Outlook

- We maintain our bullish perspective on the Japanese stock market.
- Major tailwinds for the equity market are the solid increase in nominal GDP, strong corporate earnings, and accelerating business cycle of manufacturers.
- Further fiscal expansion, caused by rising tax revenue and the unpopularity of PM Kishida before the presidential election of the ruling Liberal Democratic Party (LDP) in 2024, could boost the market in the near future.
- Possible change of the monetary policy next spring could be a tricky factor for the market after decades of an ultra-low interest rate environment in Japan.

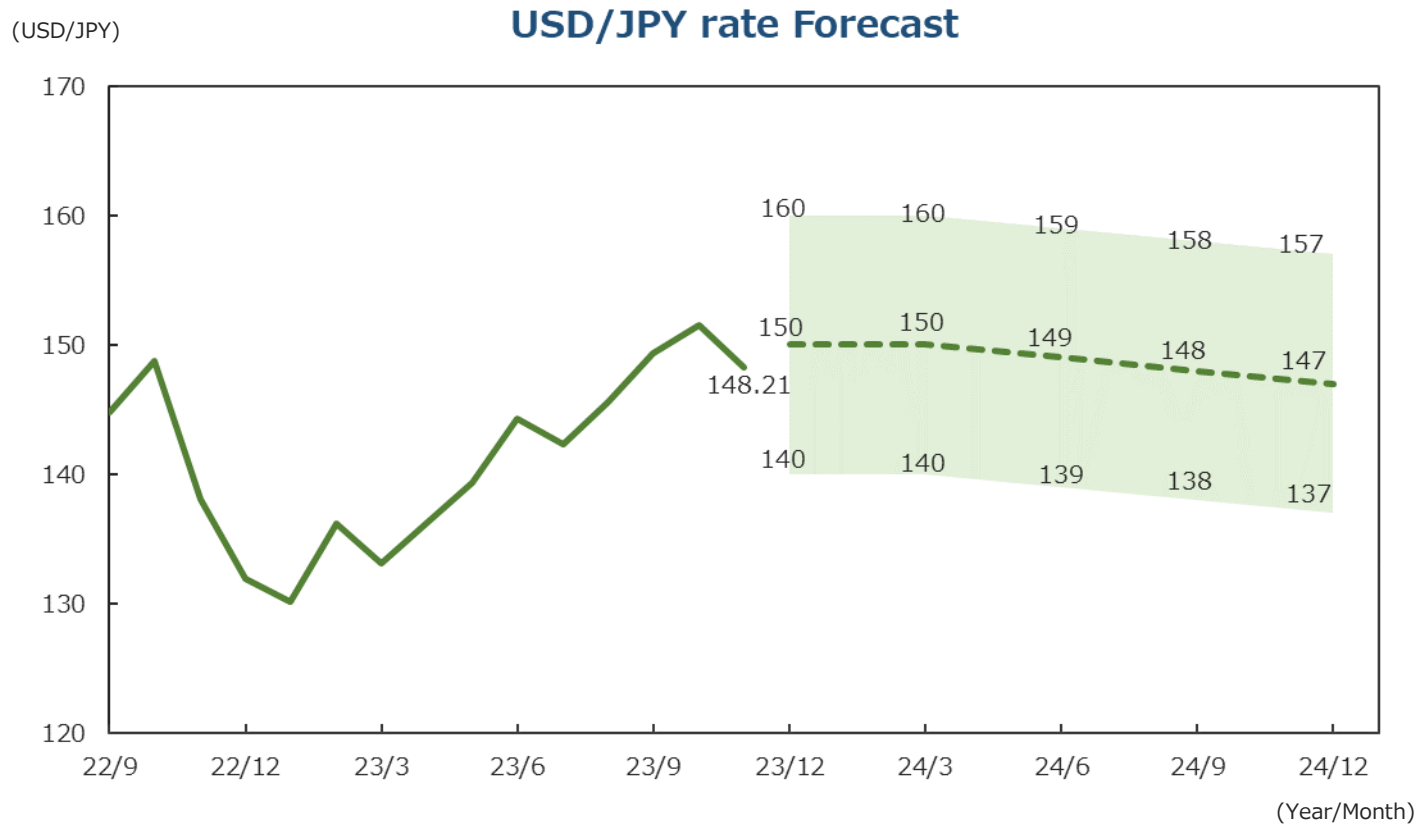
We expect the bullish market to continue ahead



We expect the bullish market to continue ahead



Modest JPY appreciation ahead due to FED & BOJ pivot



Data is from September 2022 to December 2024. Data after November 2023 is our forecast.
(Source) Bloomberg, SMDAM

Upside / Downside risk scenarios

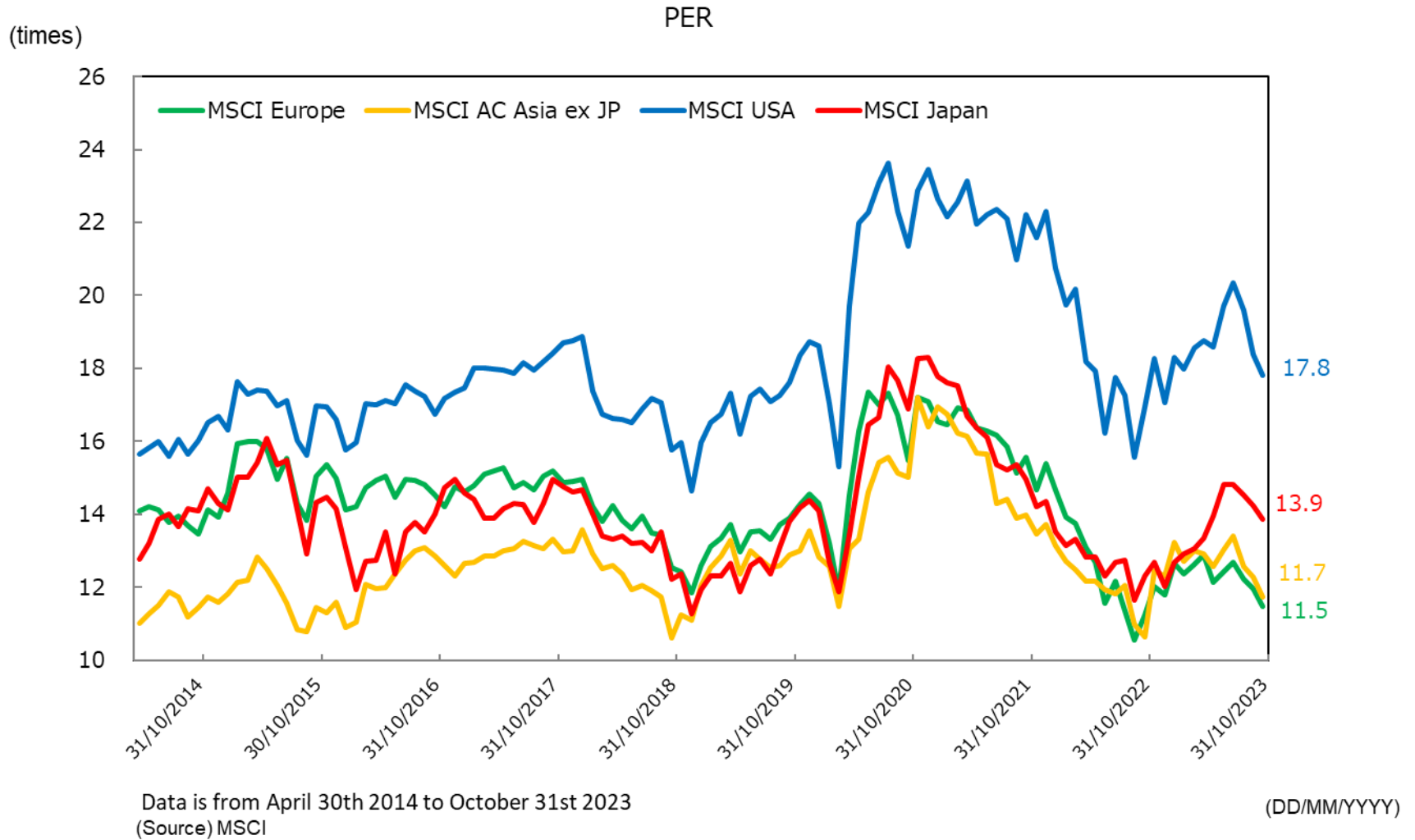
■ Upside Risks

- Growing optimism over mild inflation and wage increases
- The Bank of Japan's patient continuation of accommodative monetary policy

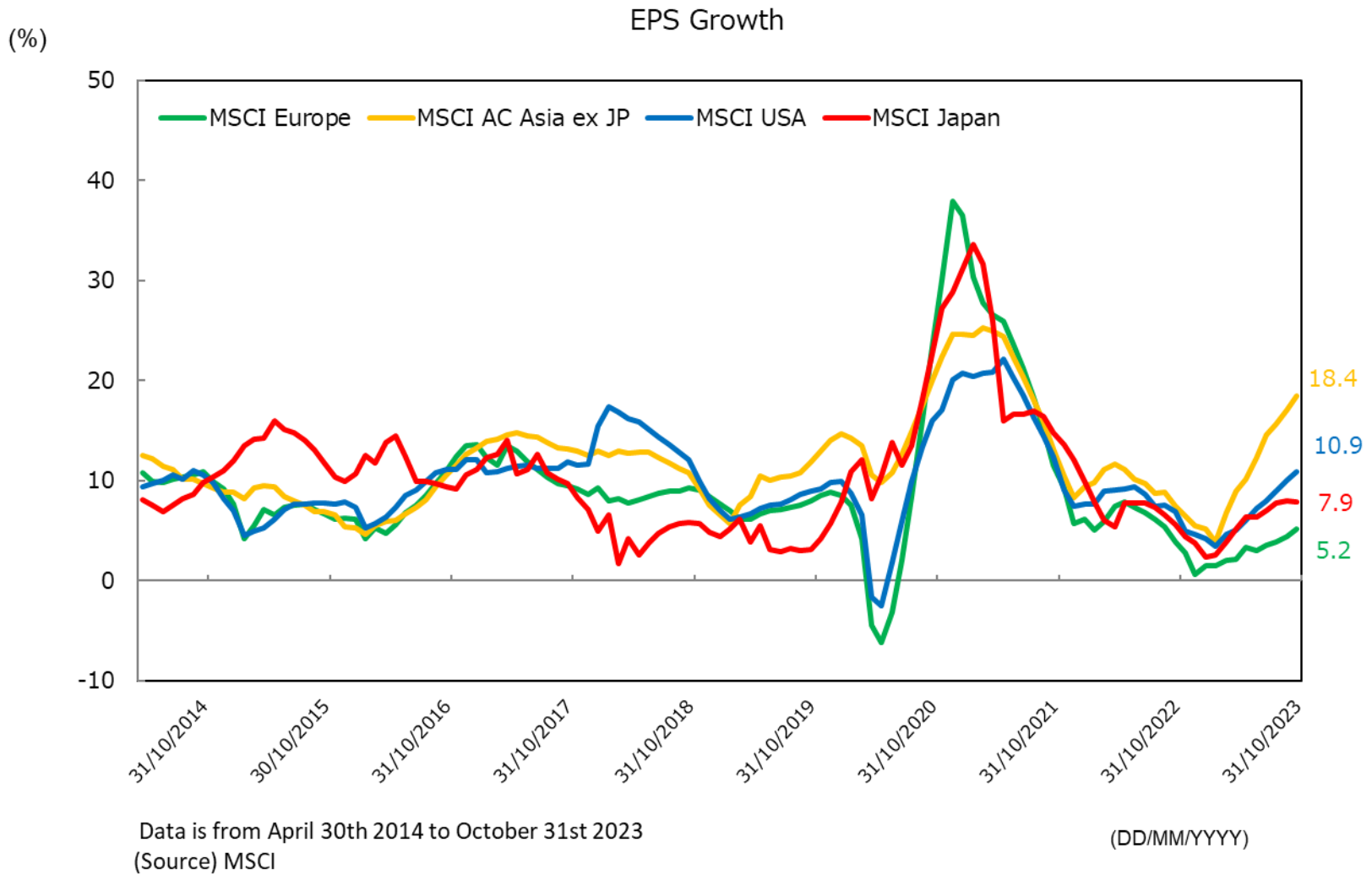
■ Downside Risks

- Excessive JPY appreciation and related negative impact on corporate earnings
- Renewed concern over systemic risk of the global financial system
- Geopolitical risk and its negative influence on the global economy

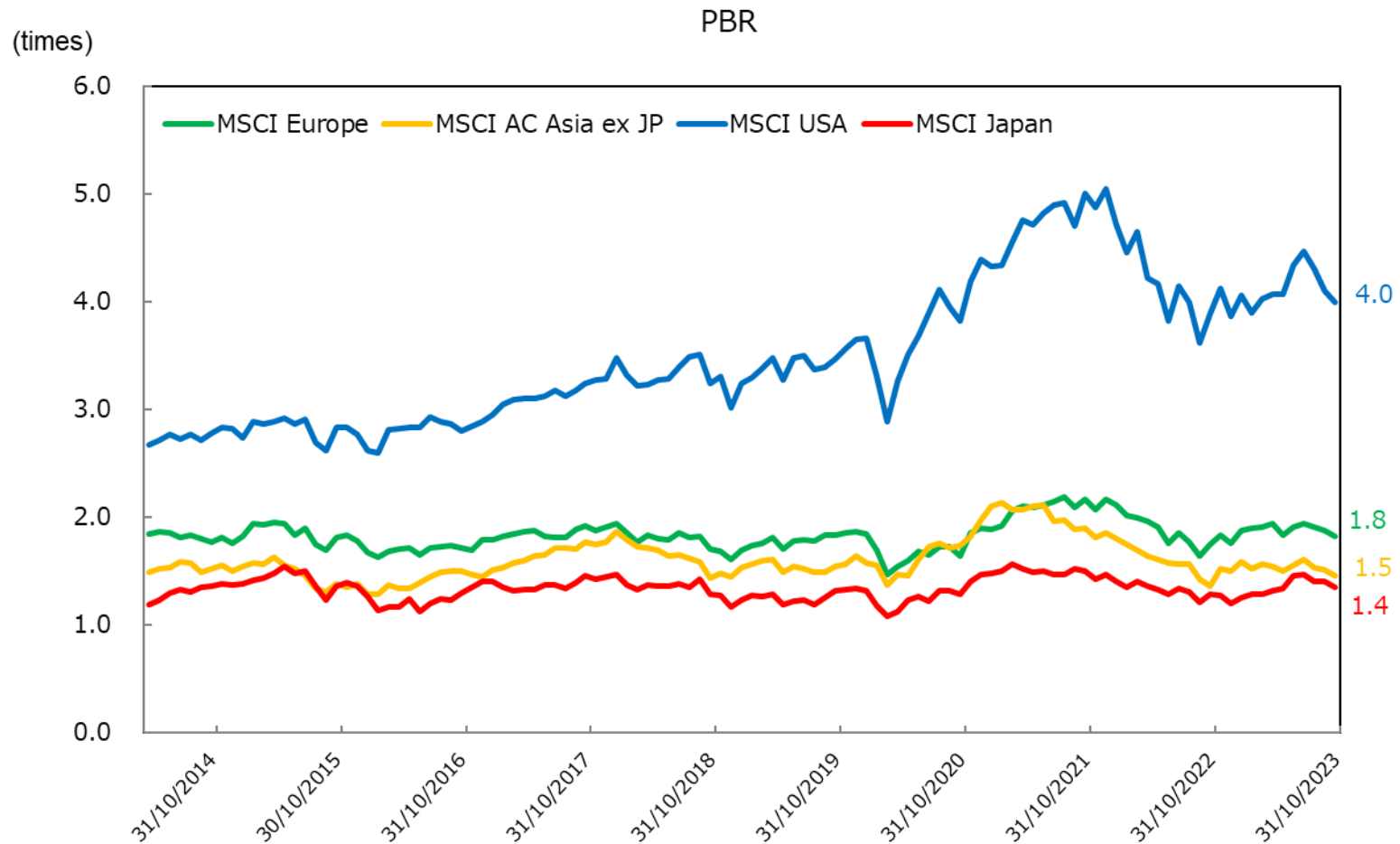
Bond yields impact P/E ratio globally



Earnings outlook increasingly optimistic



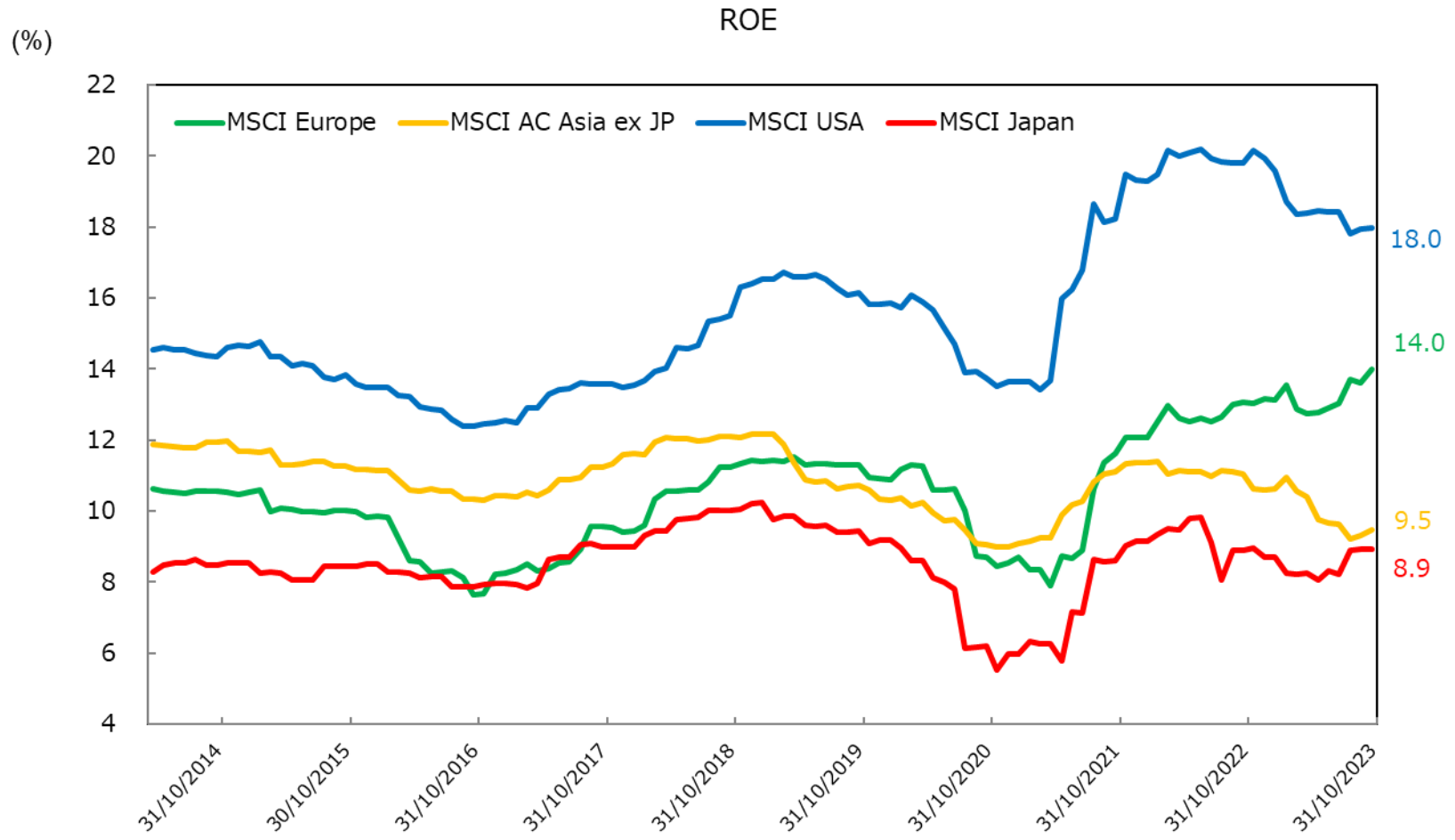
Japan's P/B ratio hit bottom but still lower than peers



Data is from April 30th 2014 to October 31st 2023
(Source) MSCI

(DD/MM/YYYY)

Japanese ROE rising with solid earnings growth

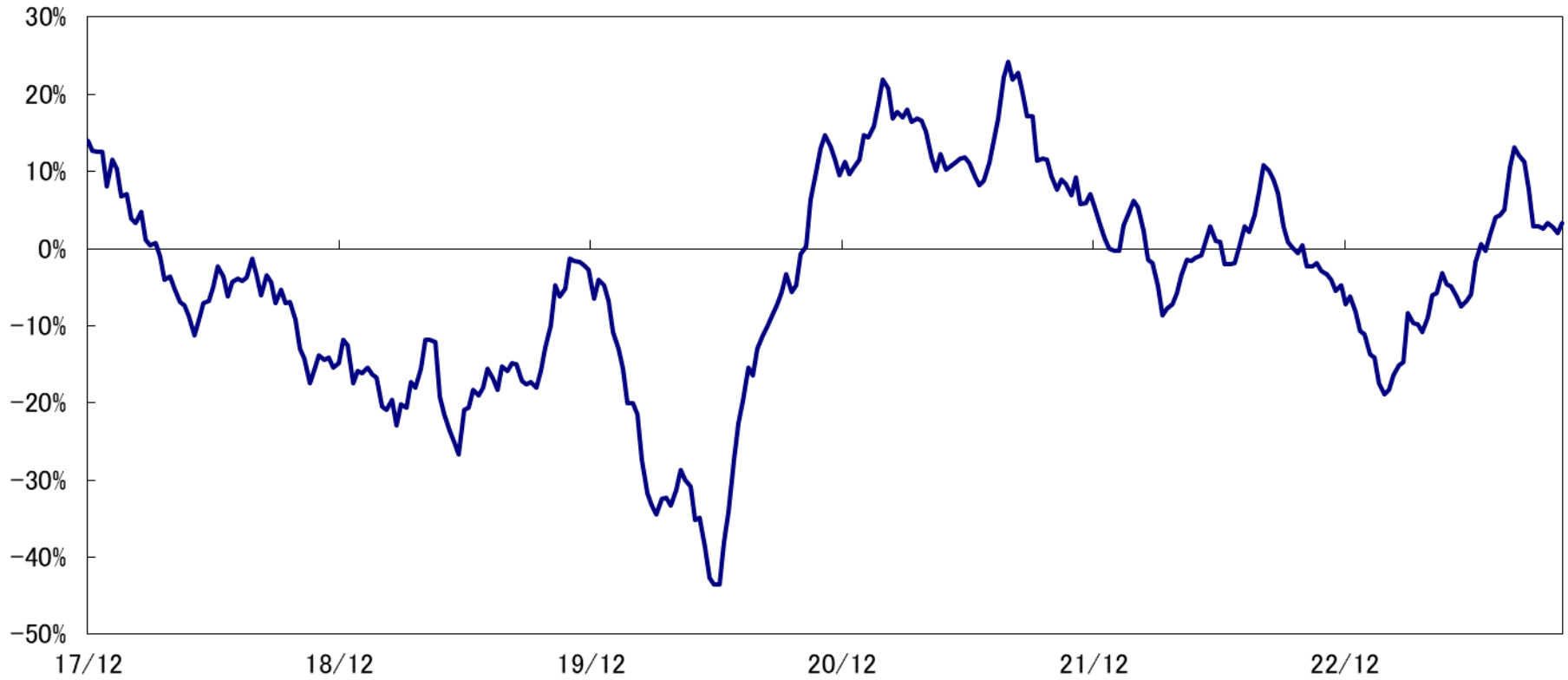


Data is from April 30th 2014 to October 31st 2023
 (Source) MSCI

(DD/MM/YYYY)

EPS revision remains positive

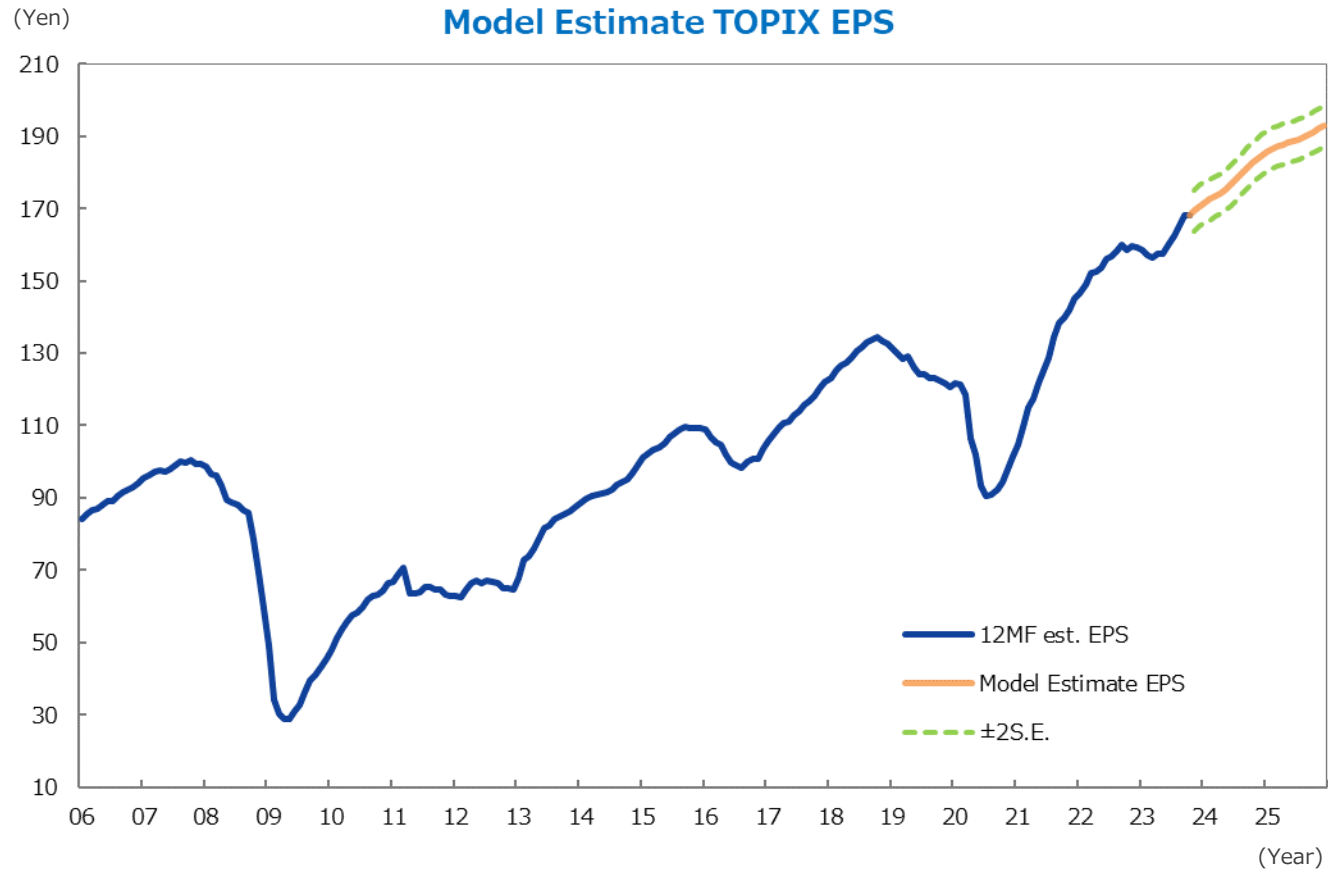
TOPIX Revision Index



Data is from December 28th 2017 to November 9th 2023
(Source) Datastream, IBES

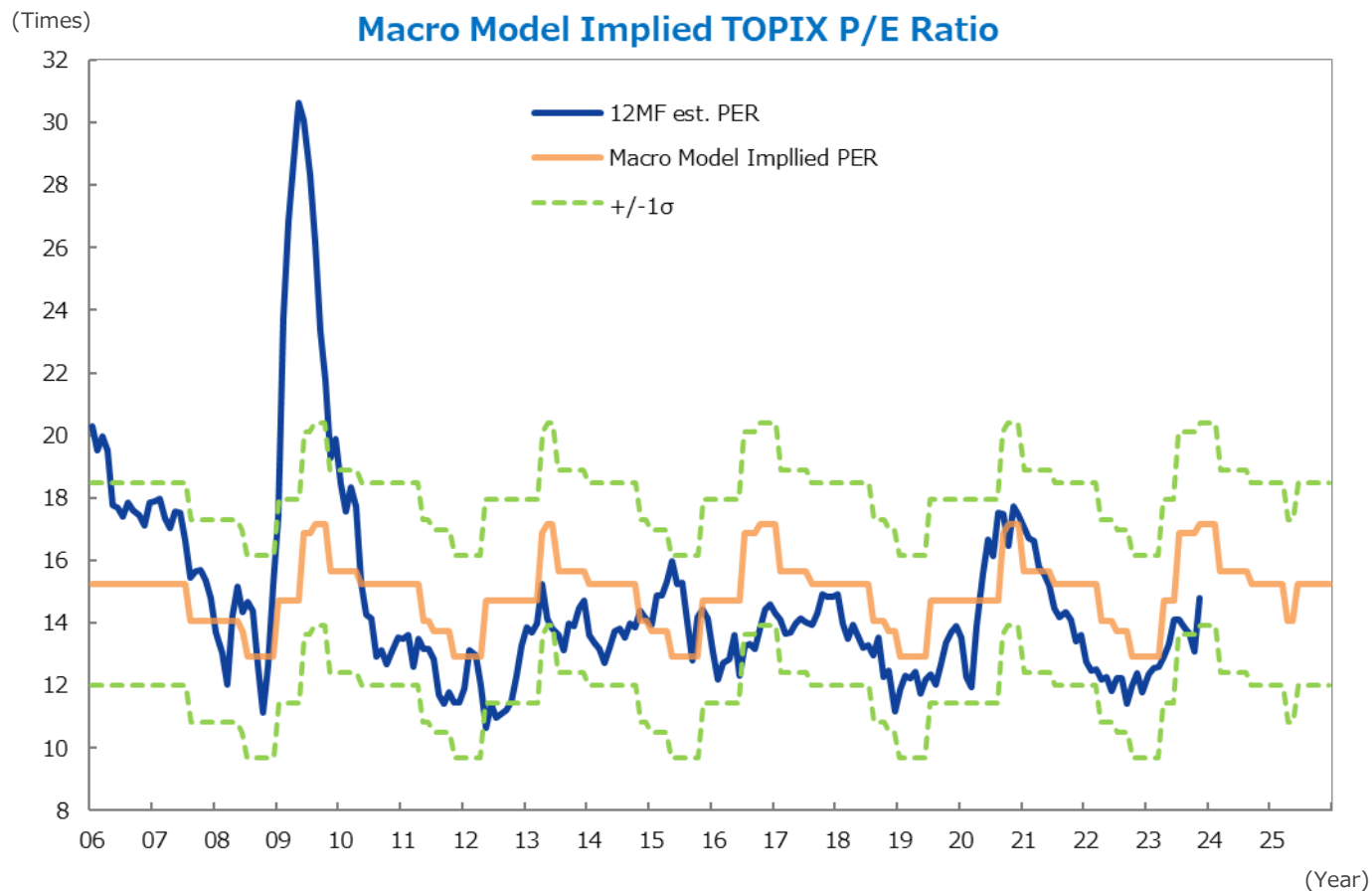
(YY/MM)

Quant model suggests encouraging earnings outlook



Note: Consensus data is from January 2006 to October 2023. Model estimate Data is from November 2023 to December 2025.
Source: SMDAM

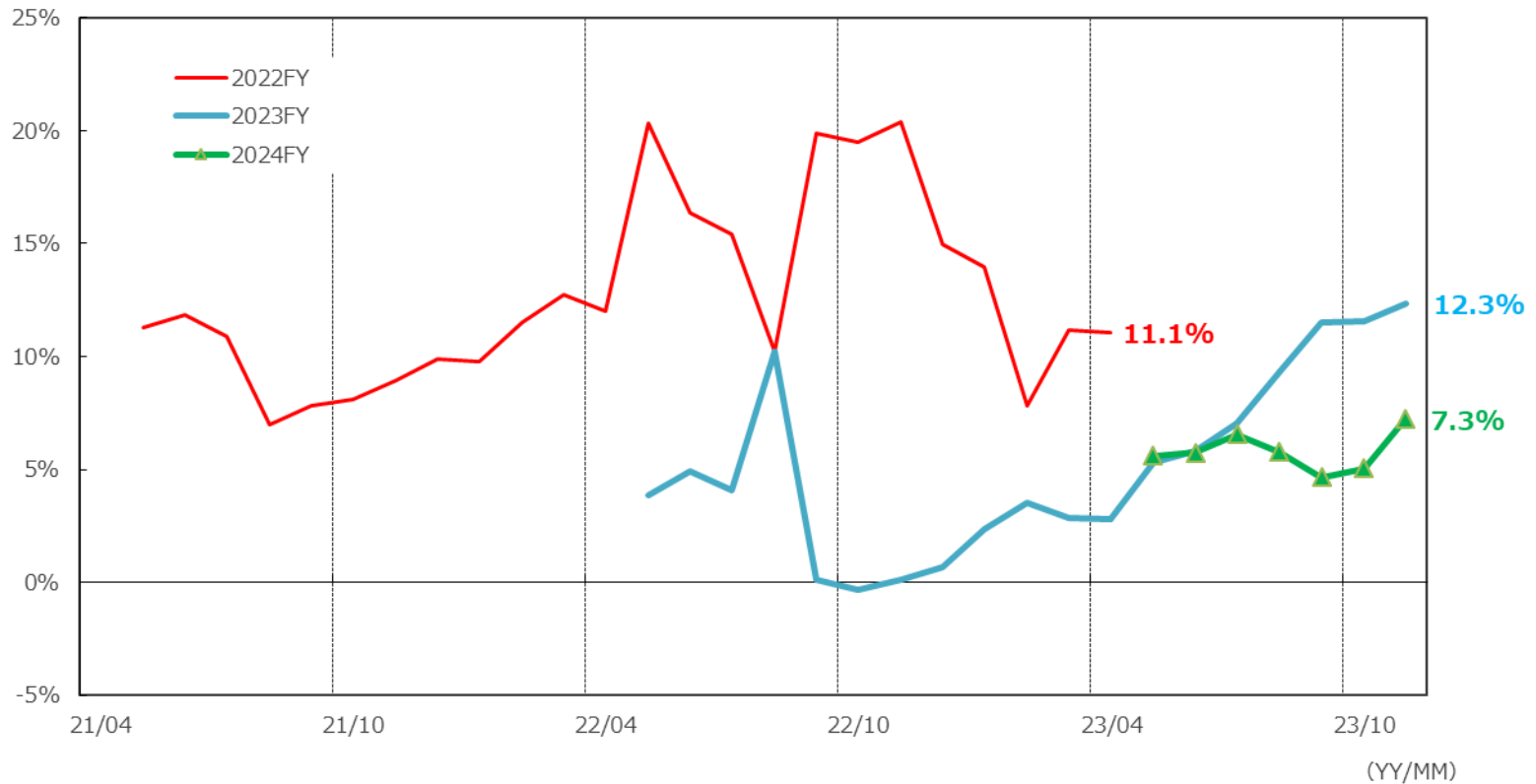
Model still indicates upside potential of P/E ratio



Note: Consensus data is from January 2006 to October 2023, Model estimate Data is from January 2006 to December 2025.
Source: SMDAM

Strong earnings growth to continue into next year

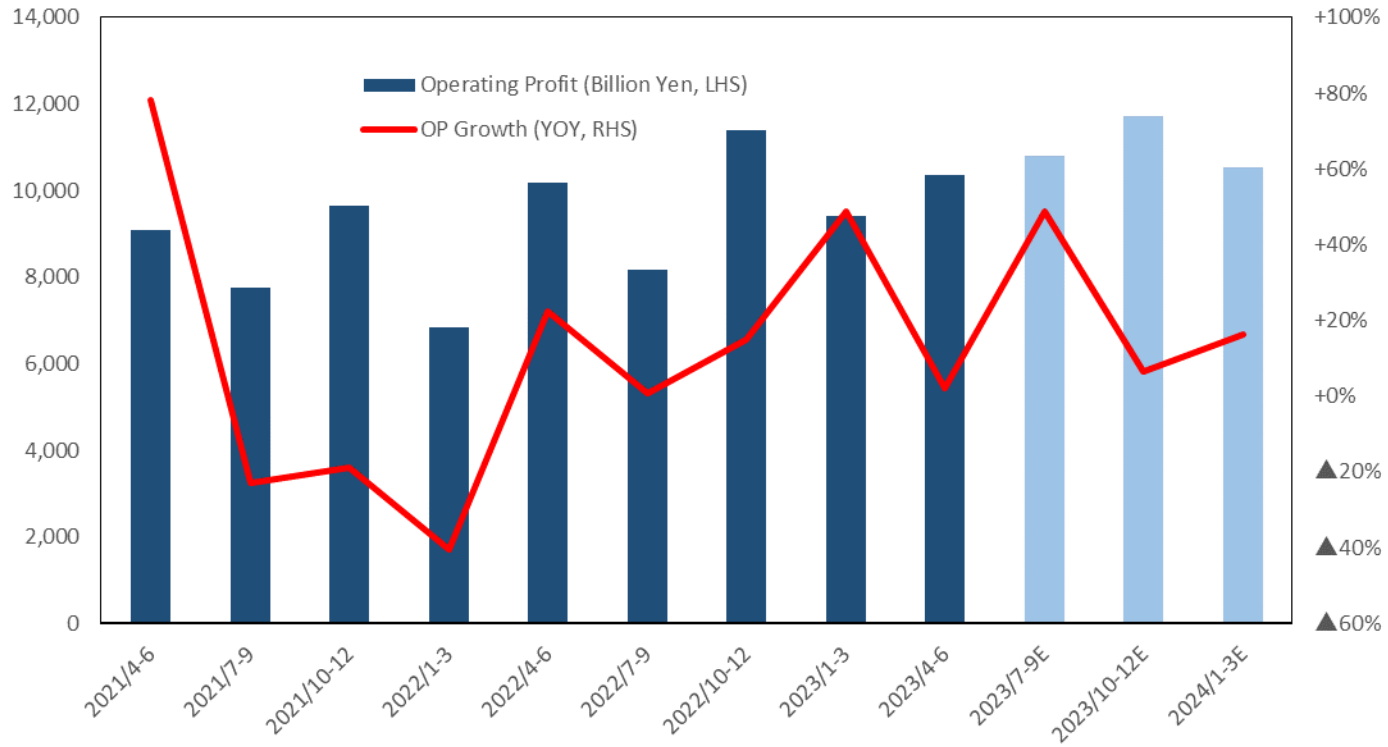
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 10th November 2023, SMDAM Core Universe (Excl. Financials) consists of 397 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Stable operating profit outlook going forward

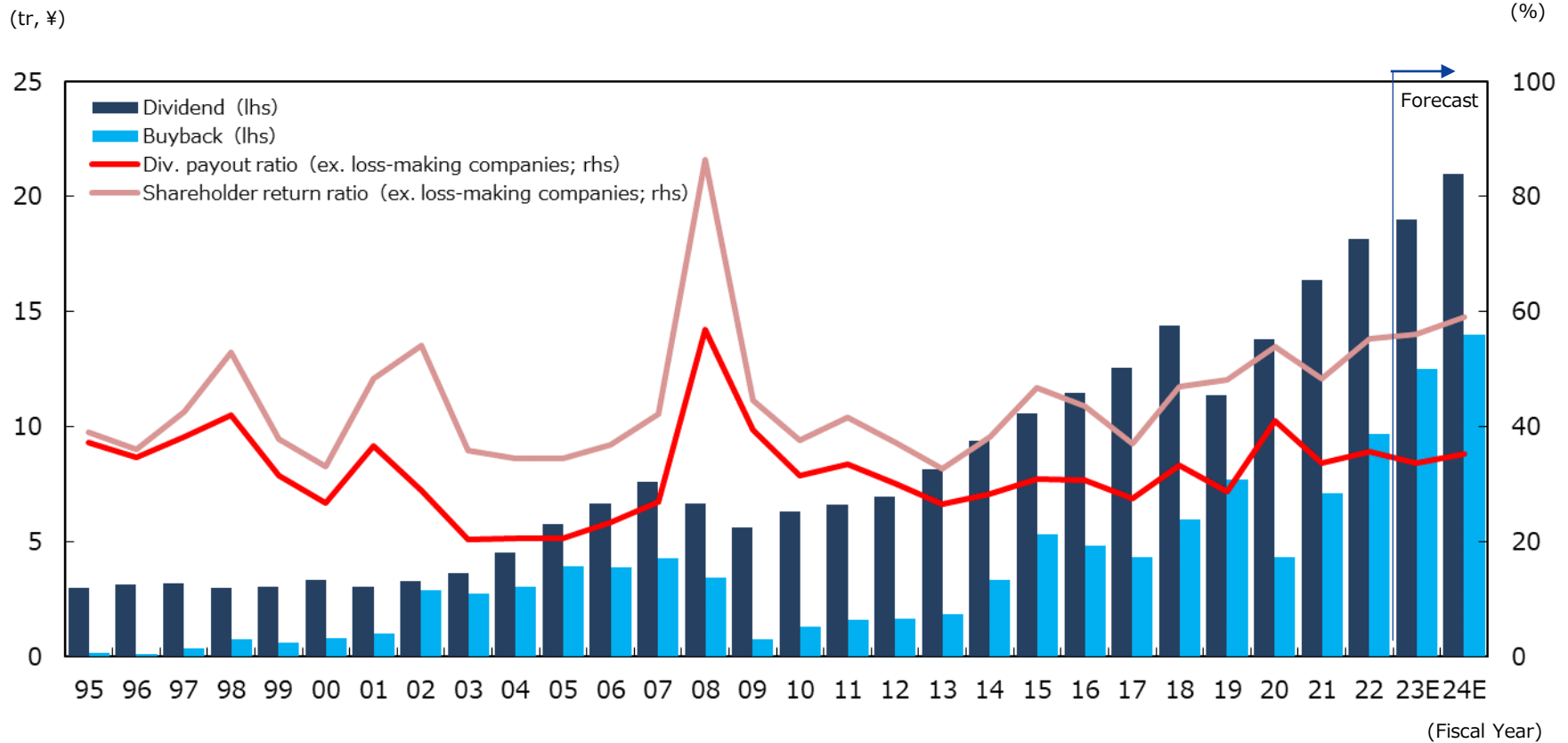
Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q1 2021 to Q2 2023. Estimate data is from Q3 2023 to Q1 2024.
Source: SMDAM

Dividends and buybacks continuing to beat historical highs

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



Note: Data is from FY1995 to FY2024. FY2023 and FY2024 are forecasts by Daiwa Securities.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Large cap value dominates Japanese market

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	5.92	11.86	26.30	21.36	16.57	37.59	47.59
Total Value	7.72	19.12	33.00	32.09	38.71	65.83	48.99
Top Cap Value	9.03	22.95	37.32	36.82	45.61	83.33	73.74
Large Cap Value	8.20	20.58	34.52	33.50	41.00	71.02	53.44
Mid Cap Value	7.05	17.42	30.81	29.13	35.02	56.34	28.45
Small Cap Value	5.52	12.70	26.28	25.83	29.01	44.15	30.31
Micro Cap Value	6.25	13.04	24.91	24.74	27.89	42.14	30.78
Total Growth	4.06	5.02	19.85	11.63	-1.78	14.19	44.30
Top Cap Growth	5.63	6.38	23.18	13.75	-0.91	18.51	54.73
Large Cap Growth	4.54	5.64	21.68	12.95	-0.72	15.83	48.72
Mid Cap Growth	2.60	4.28	19.02	11.51	-0.38	11.42	39.45
Small Cap Growth	0.11	0.01	6.18	1.43	-10.04	1.03	12.52
Micro Cap Growth	0.73	0.12	3.73	-0.31	-14.99	-0.07	11.19
Top Cap Total	7.19	13.54	29.41	23.53	17.51	43.90	61.83
Large Cap Total	6.32	12.55	27.73	22.31	17.19	39.44	51.81
Mid Cap Total	4.96	11.00	25.12	20.41	16.67	33.28	38.02
Small Cap Total	3.51	7.80	18.26	15.90	12.86	26.42	24.35
Micro Cap Total	4.54	8.84	17.70	16.03	12.46	27.23	25.67

Note : As of 17th November 2023
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is stagnant.** Real GDP contracted for the first time in three quarters in the third quarter of 2023 after the high growth in the previous quarter. Soft data, such as PMI and the economic watchers' survey also shows softness of the economy in the near term. Whilst the resumption of economic activity following the COVID-19 pandemic has helped to prop up the economy, the impact of high commodity prices, inventory adjustments, and a slowdown in overseas economies seem to have weighed on the economy.
- **Inflation is slowing down.** The nationwide core CPI grew by 2.8% in September from a year earlier, down from 3.1% a month earlier. Meanwhile, Tokyo metropolitan area core CPI rose 2.7% YOY in October. This is largely due to the reduction of subsidies for utility bills such as electricity and gas. Inflation has slowed down mainly in the price of goods such as food and daily necessities, and the cost pressure from import prices, which was originally a source of high inflation in the current cycle, has been easing.

[Outlook]

- ① **We have reduced our real GDP growth forecast for FY 2023 from +1.9% to +1.4% and that for FY 2024 from +1.2% to +1.1%. We also expect the Japanese economy to grow by +0.7% in FY 2025 in real terms.** The downward revision of FY 2023 forecast was mainly due to the unexpected decline of real GDP growth in Q3 2023. Though the economy is currently stagnating, we expect the economy will resume its moderate upward trend going forward due to the picking up of the economy, falling inflation, and fiscal stimulus. While we expect domestic demand will gradually recover, foreign demand is expected to decline owing to the slowing US economy.
- ② **We have maintained our core CPI forecast for FY 2023 at +2.8% and that for FY 2024 at +2.0%. We forecast core CPI in FY 2025 to increase by +1.7% YOY.** It is highly likely that the core CPI will follow a deceleration trend owing to the decline in cost push pressure from import prices. Although the core CPI will increase once in February 2024 due to the elimination of the subsidy on electricity and gas bills, the cost push pressure is likely to continue to decline. The rise in service prices as wages improve will create upward pressure, but we expect core CPI to fall slightly below 2% from the second half of FY 2024 onwards.
- ③ **PM Kishida and his cabinet will continue their accommodative economic policy.** In November, PM Kishida's Cabinet approved "comprehensive economic measures to completely overcome deflation." This includes fiscal stimulus, such as measures against high prices, support for growth sectors, and enhancing the resilience of infrastructure. The size of the economic measures will be 20.9 trillion yen on a national and local spending basis and it has already been factored into our forecast for GDP growth of up to +1%.
- ④ **With regard to the monetary policy, we anticipate the end of ultra easy monetary policy in April 2024, to include raising the policy rate above 0% and eliminating the YCC, yield curve control.** We expect that the Bank of Japan will revise its outlook report in April after confirming wage increases in the spring wage negotiations in mid-March 2024, and will make changes to its monetary policy by announcing its judgment that the probability of achieving the price stability target has increased. However, if the momentum to wage increase is above current market consensus or if the yen continues to weaken further, policy revisions may be earlier than we anticipate at the moment.

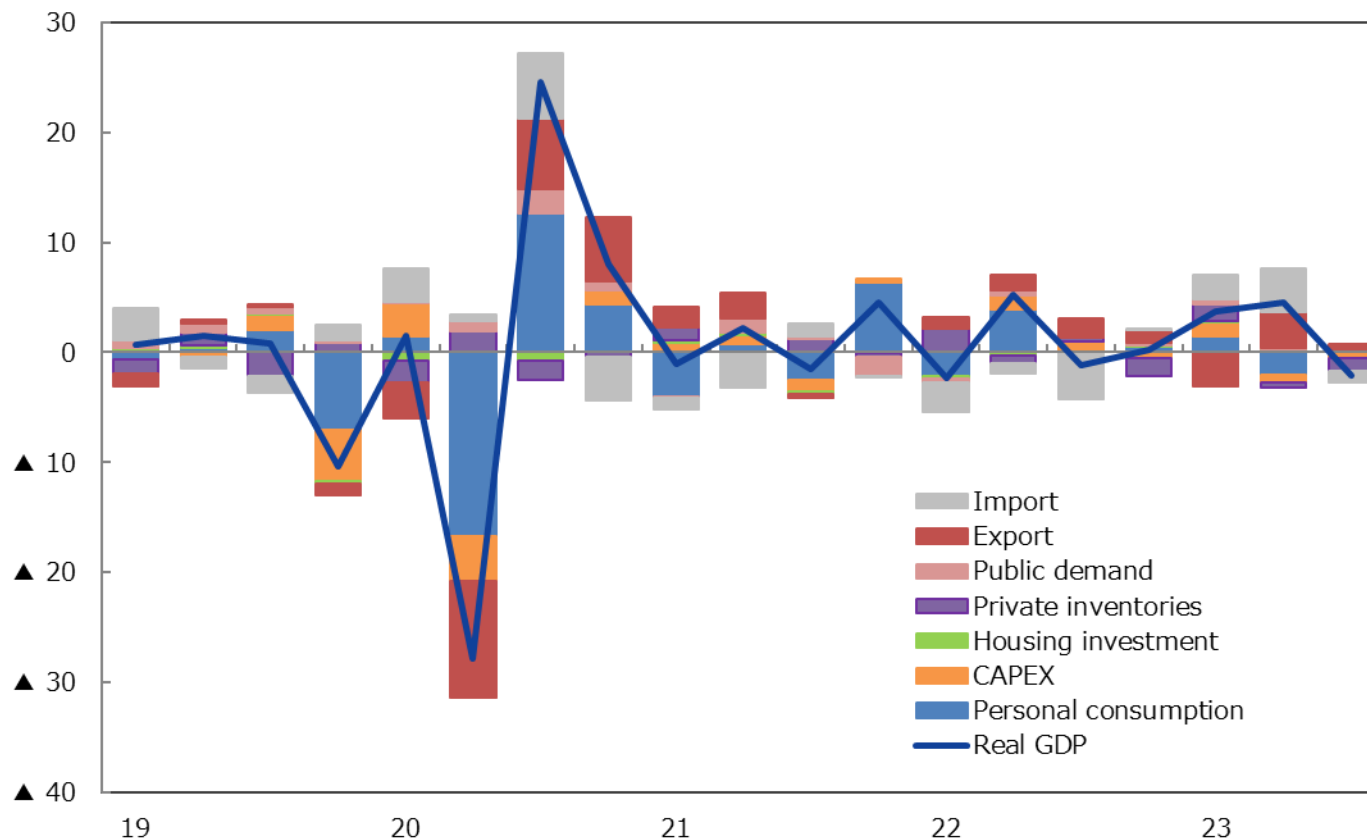
Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown								
Fiscal Year	FY19	FY20	FY21	FY22	FY23 Est	FY24 Est	FY25 Est	
Real GDP	-0.8%	-4.1%	2.7%	1.4%	1.4%	1.1%	0.7%	
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	-0.2%	1.0%	0.6%	
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	2.1%	-0.8%	0.0%	
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	0.1%	1.6%	1.8%	
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.3%	-0.1%	0.0%	
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	1.3%	0.5%	1.0%	
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.3%	0.1%	-0.2%	
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.7%	3.4%	2.0%	
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-2.9%	3.2%	2.9%	
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.1%	2.6%	1.9%	
GDP deflator	0.8%	0.7%	-0.1%	0.7%	3.6%	1.5%	1.2%	
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-0.6%	1.6%	1.3%	
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.0%	1.7%	
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.1%	0.9%	0.8%	
Employee compensation	2.0%	-1.5%	2.1%	2.0%	2.4%	2.6%	2.4%	
Unemployment rate	2.4%	2.9%	2.8%	2.6%	2.6%	2.5%	2.3%	
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	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

Japan's GDP declined in Q3 due to weak personal spending

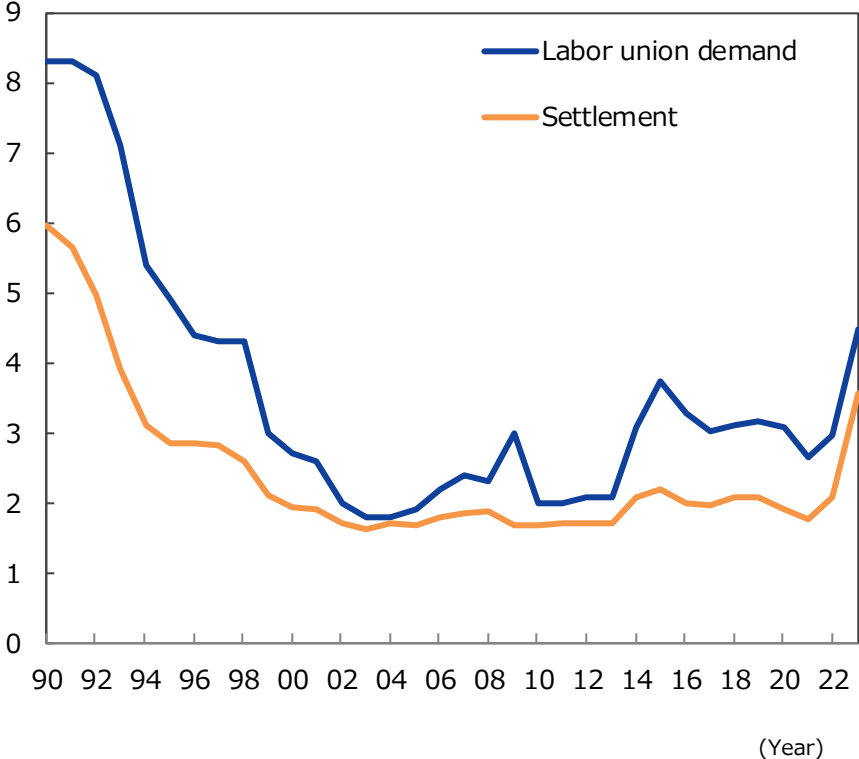
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q3 2023.
Source: Cabinet office, SMDAM

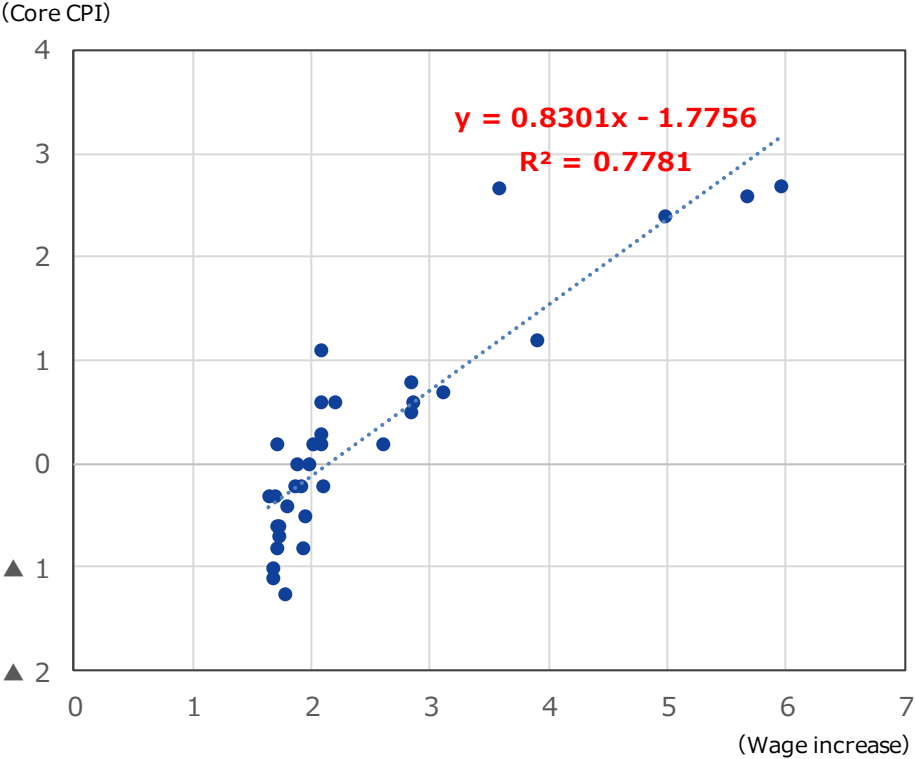
Start of a virtuous cycle to overcome deflation

Wage increase demand & settlement (YOY, %)



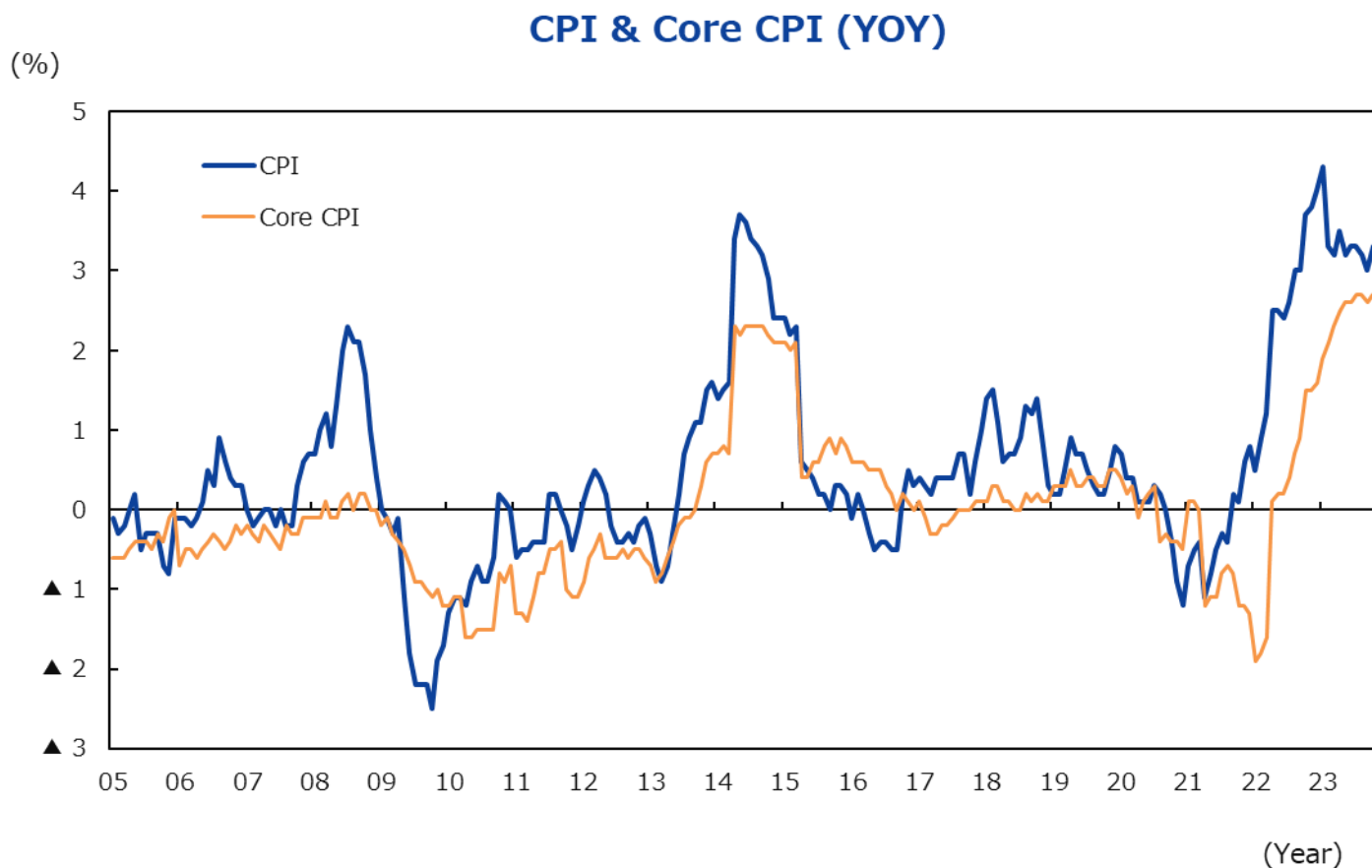
Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

Wage increase & Core CPI (YOY, %)



Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

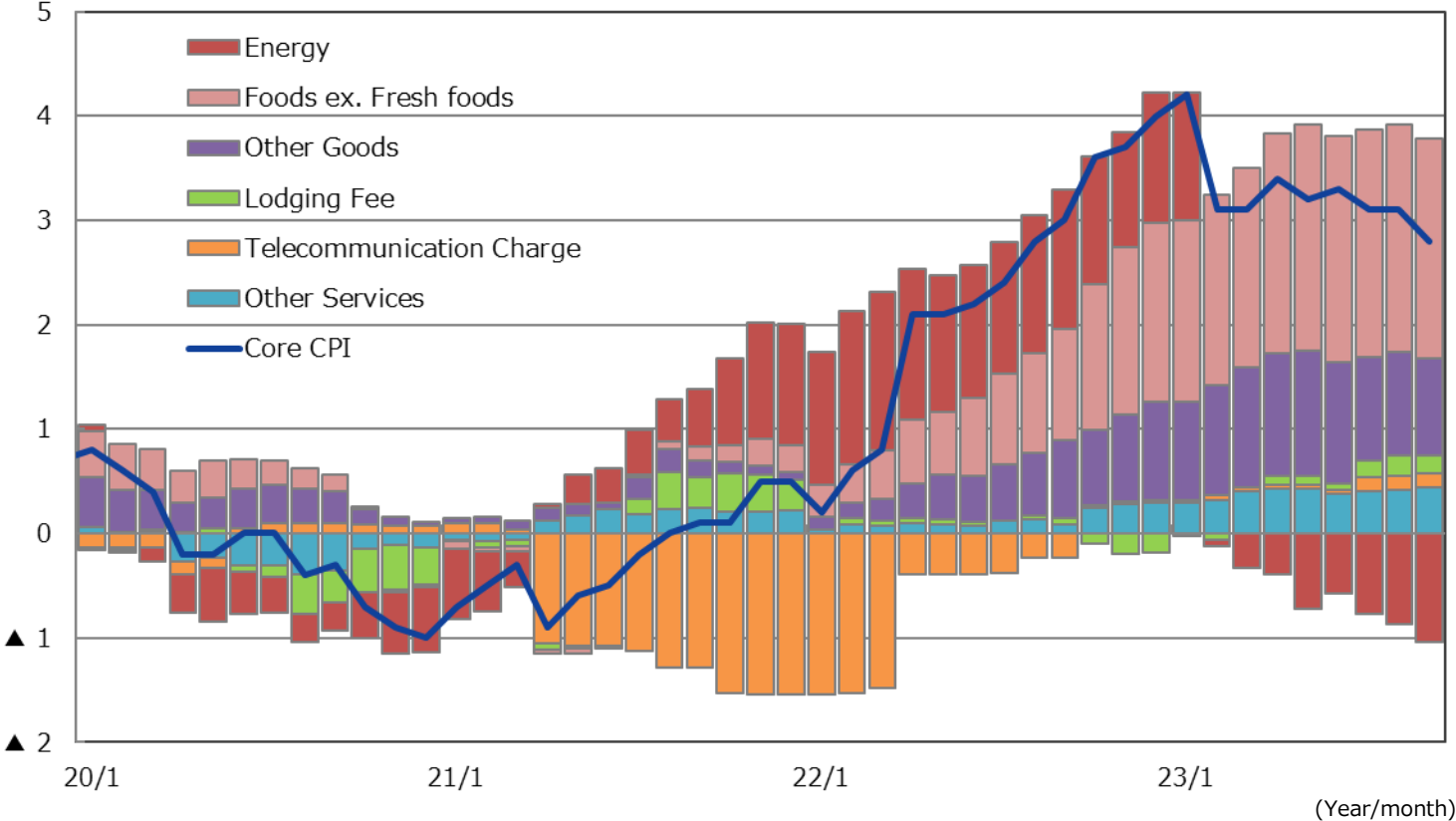
Japan's CPI shows unexpected stickiness



Note: Data is from January 2005 to October 2023, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

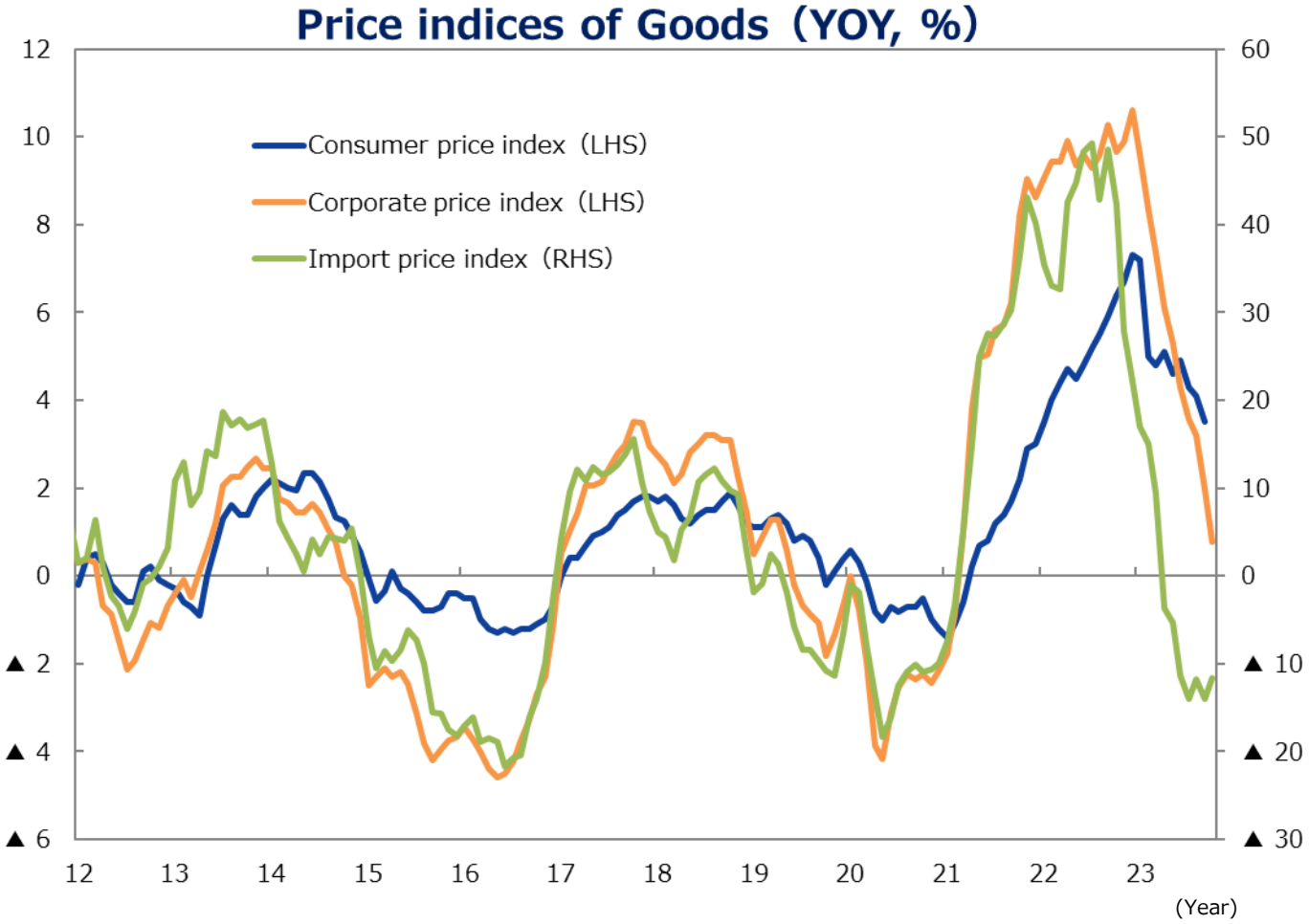
Foods and goods keep Japan's inflation high

Breakdown of CPI (YOY, %)



Note: Data is from January 2020 to September 2023,.
Source: MIAC, SMDAM

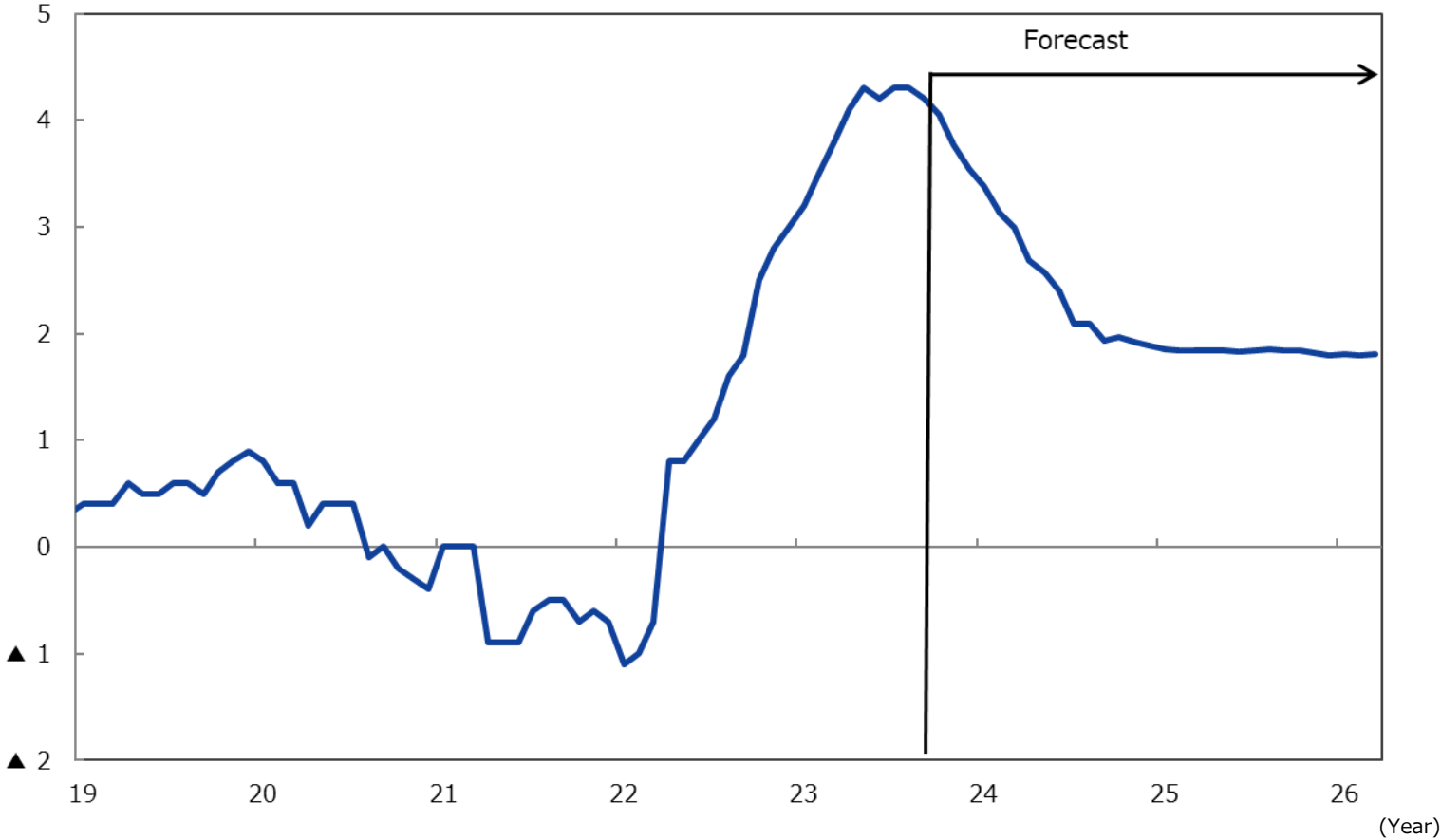
Profit margin improving thanks to falling input prices



Note: Data is from January 2012 to October 2023.
Source: MIAC, Bloomberg, SMDAM

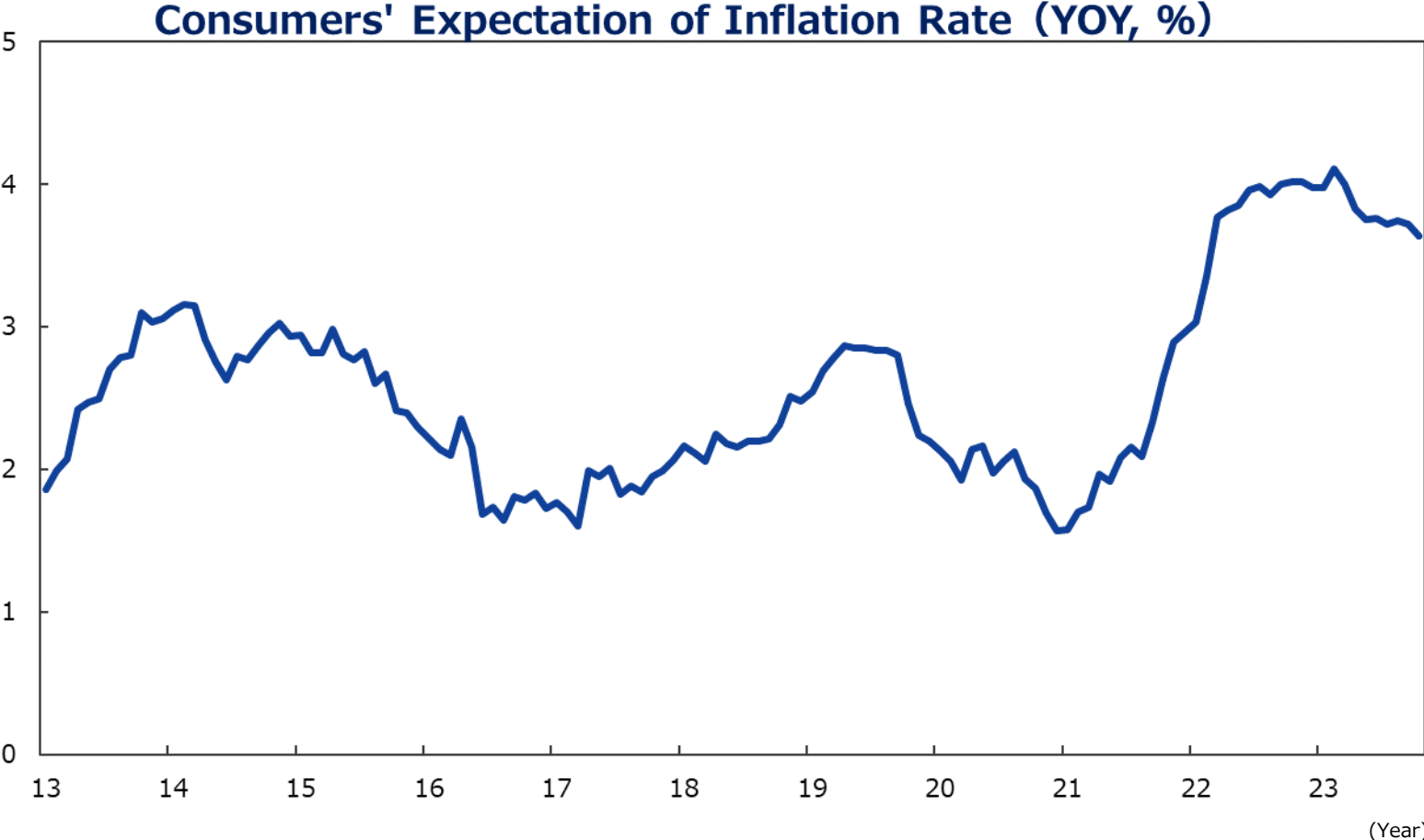
BOJ expects inflation to decline gradually towards 2%

BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2026. BOJ's Core CPI is excluding fresh foods & energy. Data from October 2023 are forecasts.
Source: The Bank of Japan, SMDAM

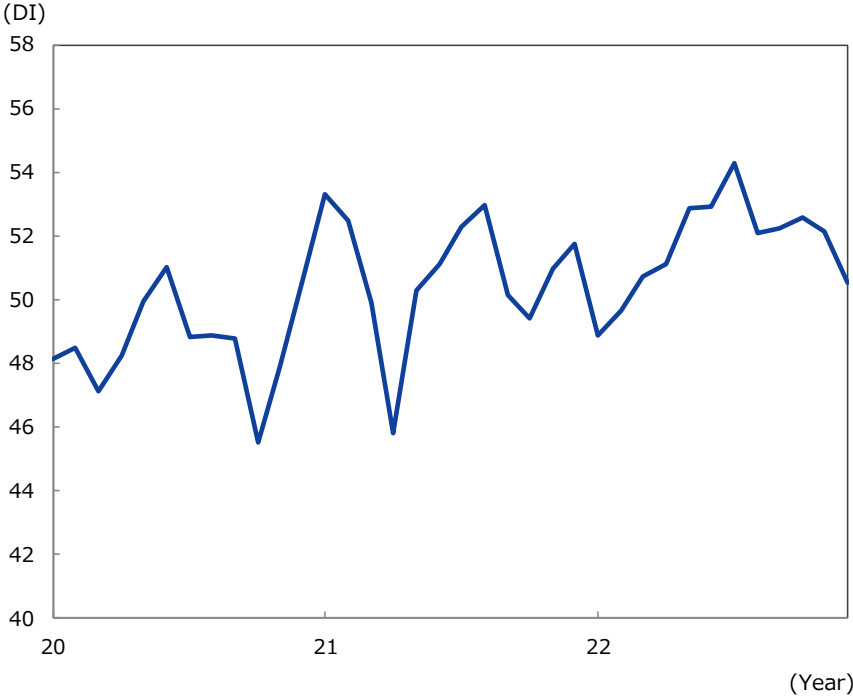
Japanese people expect “high & sticky” inflation ahead



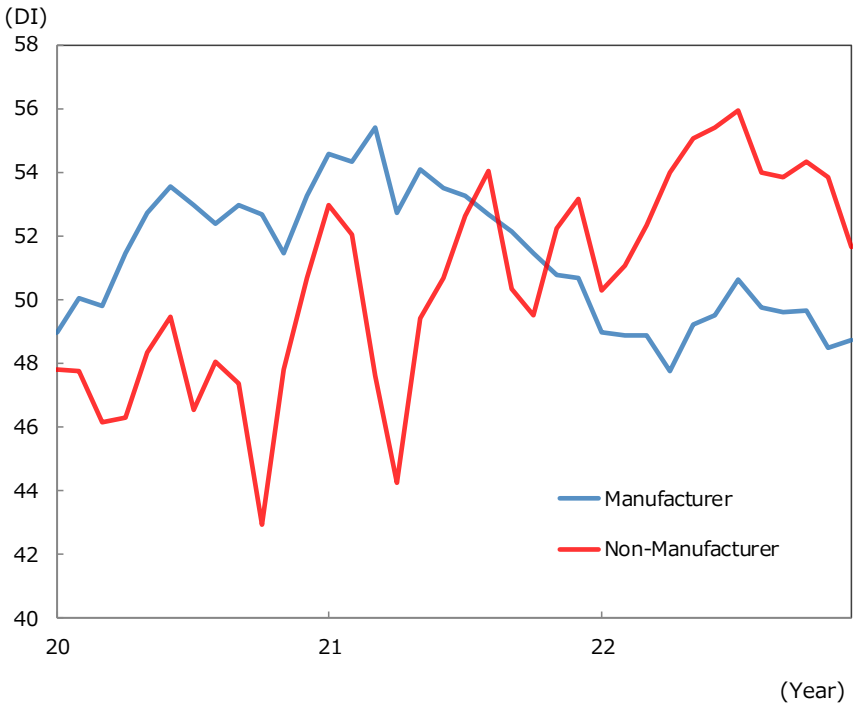
Note: Weighted average of inflation forecast of “Consumer Confidence Survey”. Data is from January 2013 to October 2023.
Source: Cabinet Office, SMDAM

Sign of slowing business activities in services

Composite PMI



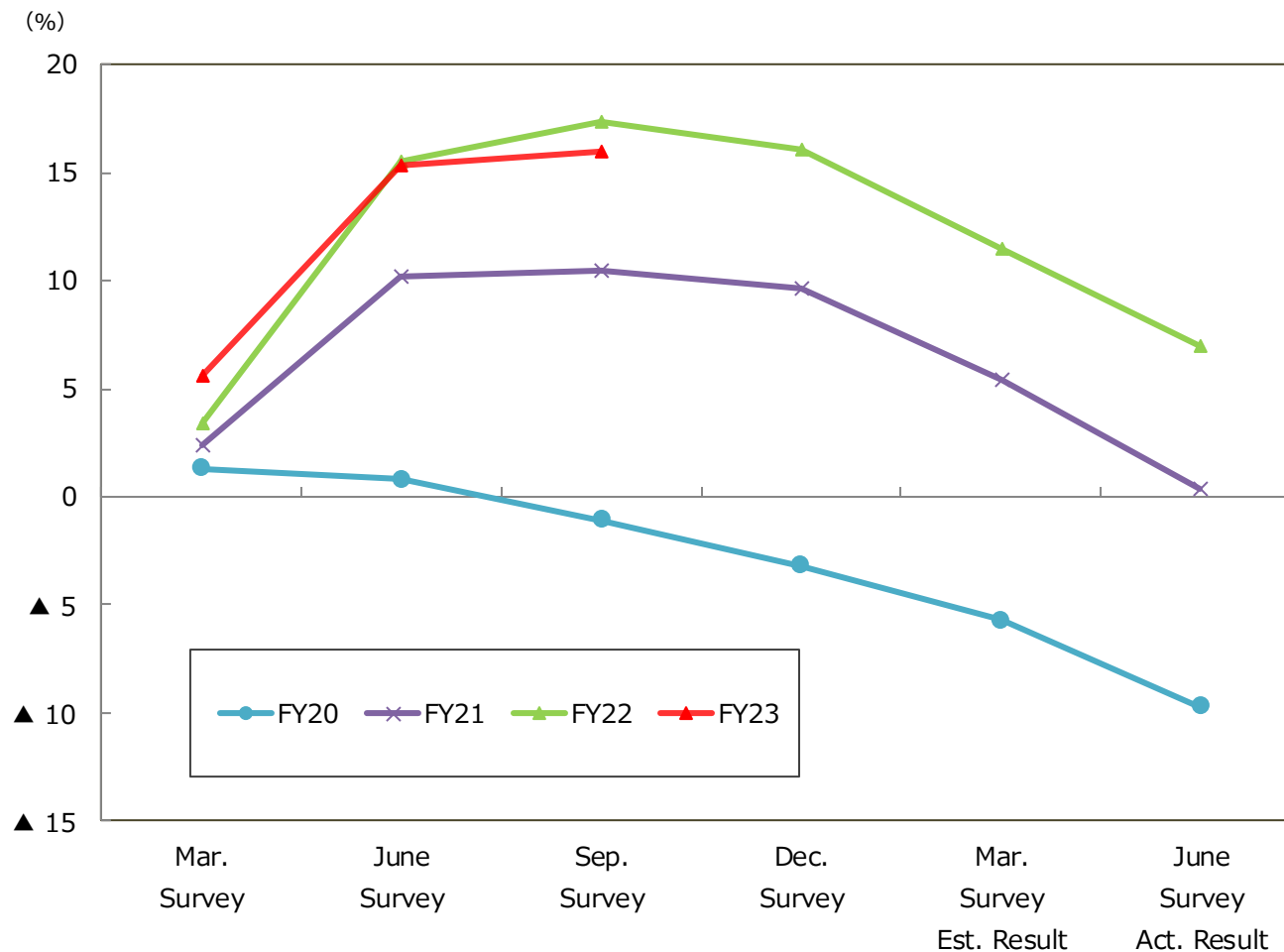
PMI, Manufacturer & Non-Manufacturer



Note: Data is from November 2020 to October 2023.
Source: Bloomberg, SMDAM

Weakening Yen and de-risking lift CAPEX in Japan

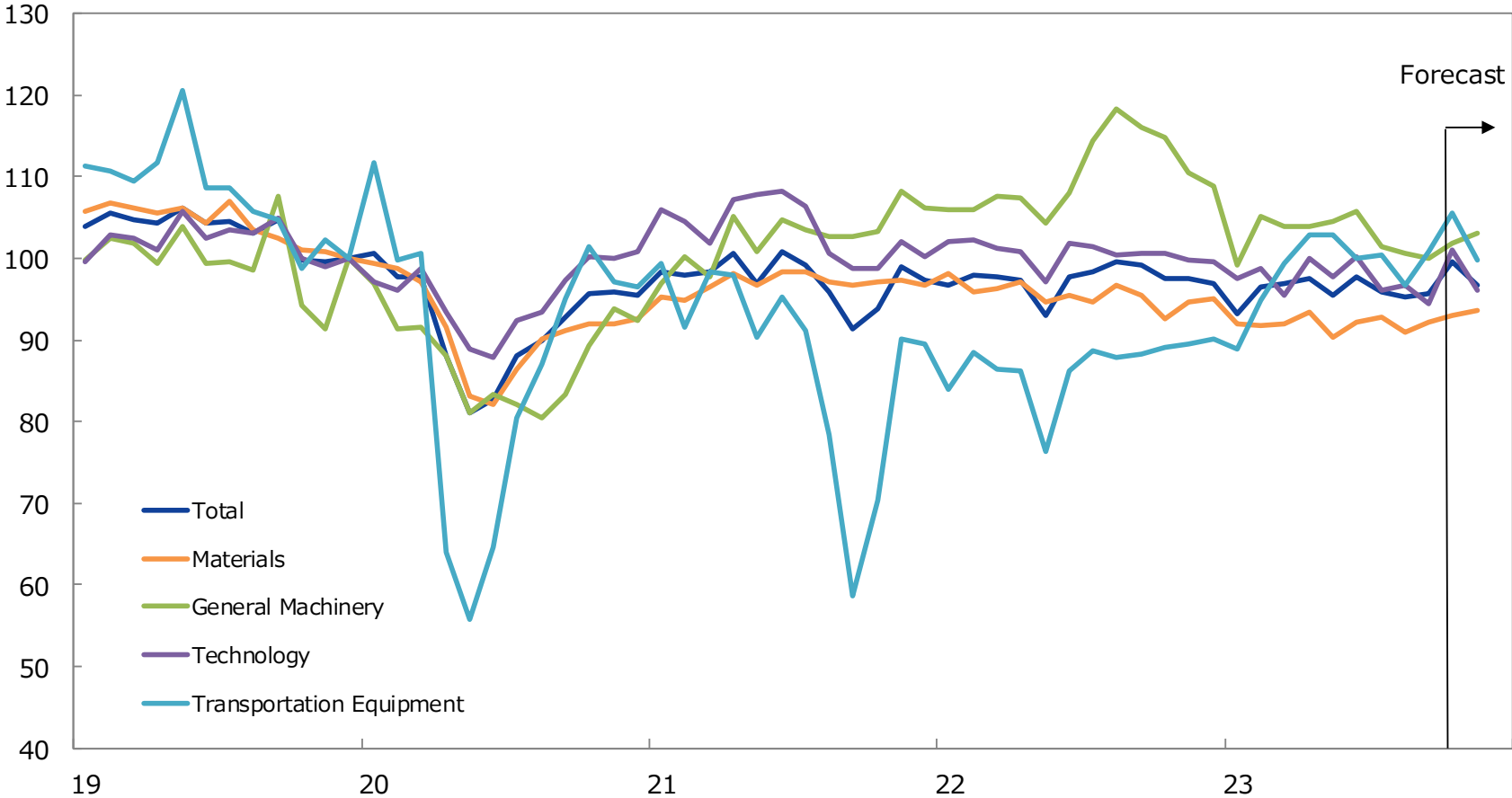
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



Note: Data is from Q1 FY2020 to Q3 FY2023.
Source: The Bank of Japan, SMDAM

Slowing auto & tech to weigh on industrial production ahead

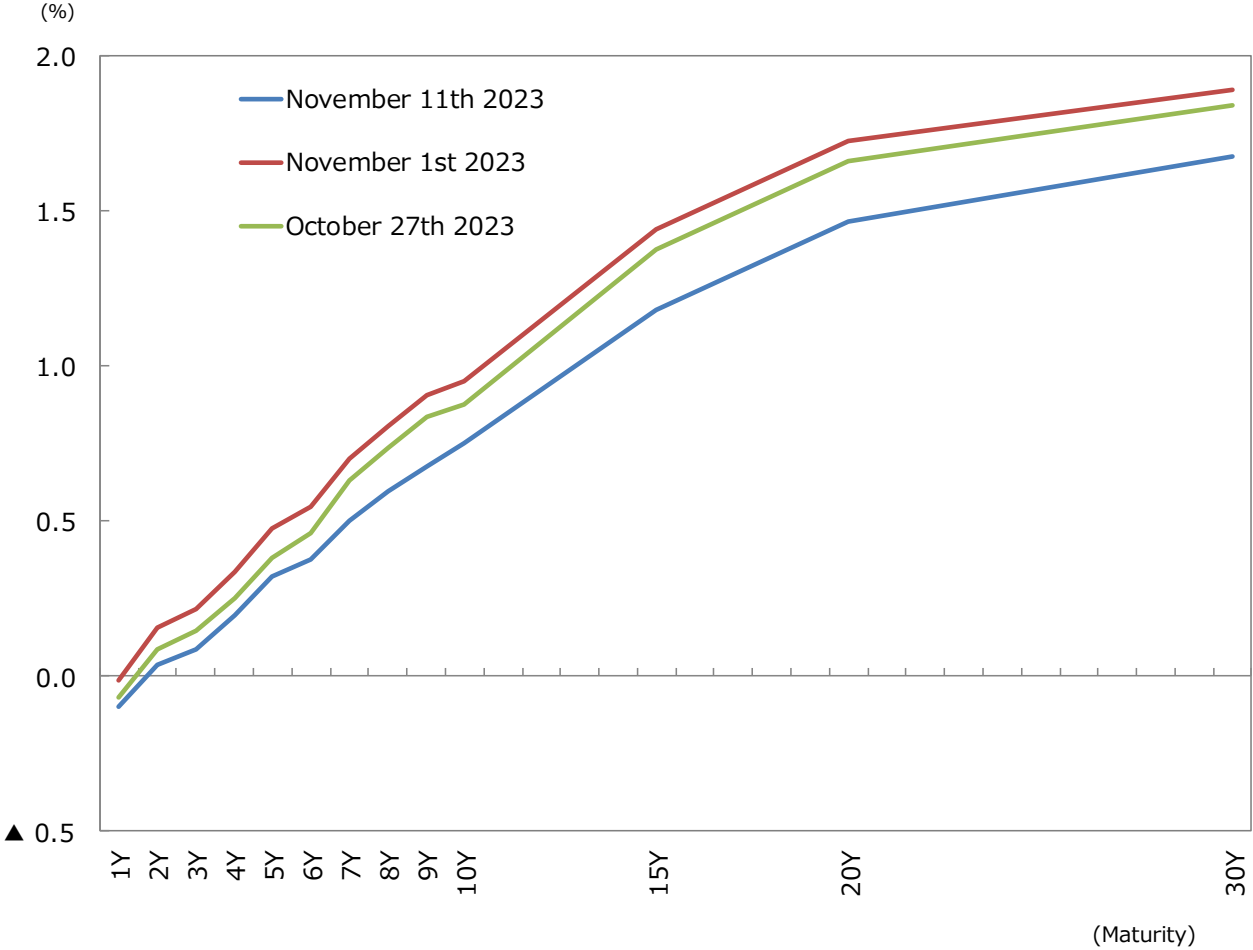
Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to November 2023. Data after October 2023 are forecasts.
Source: METI, SMDAM

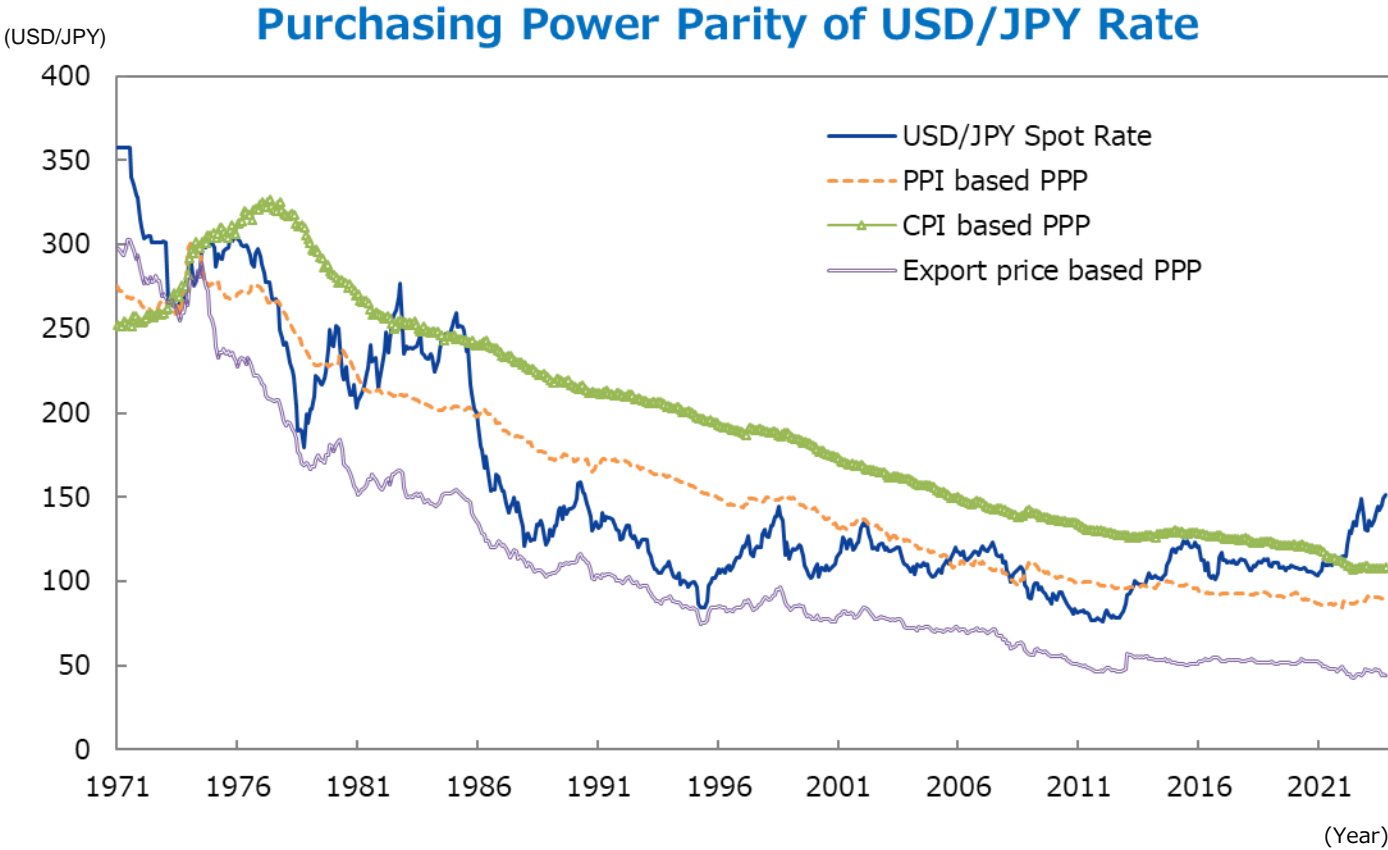
“Bull flattening” owing to speculation over FED’s pivot

Yield Curve of Japanese Sovereign



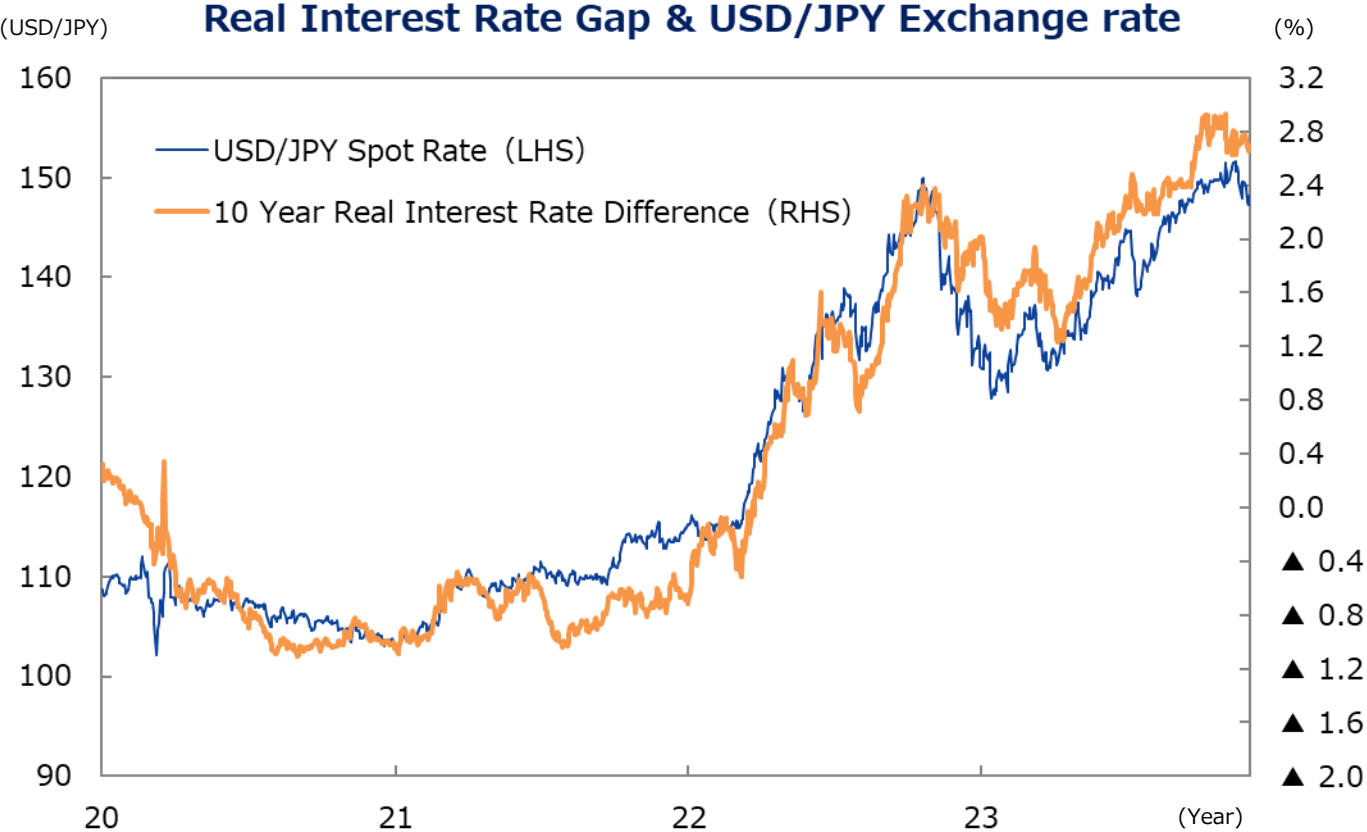
Source: Bloomberg, SMDAM

USD/JPY diverges from range of purchasing power parity



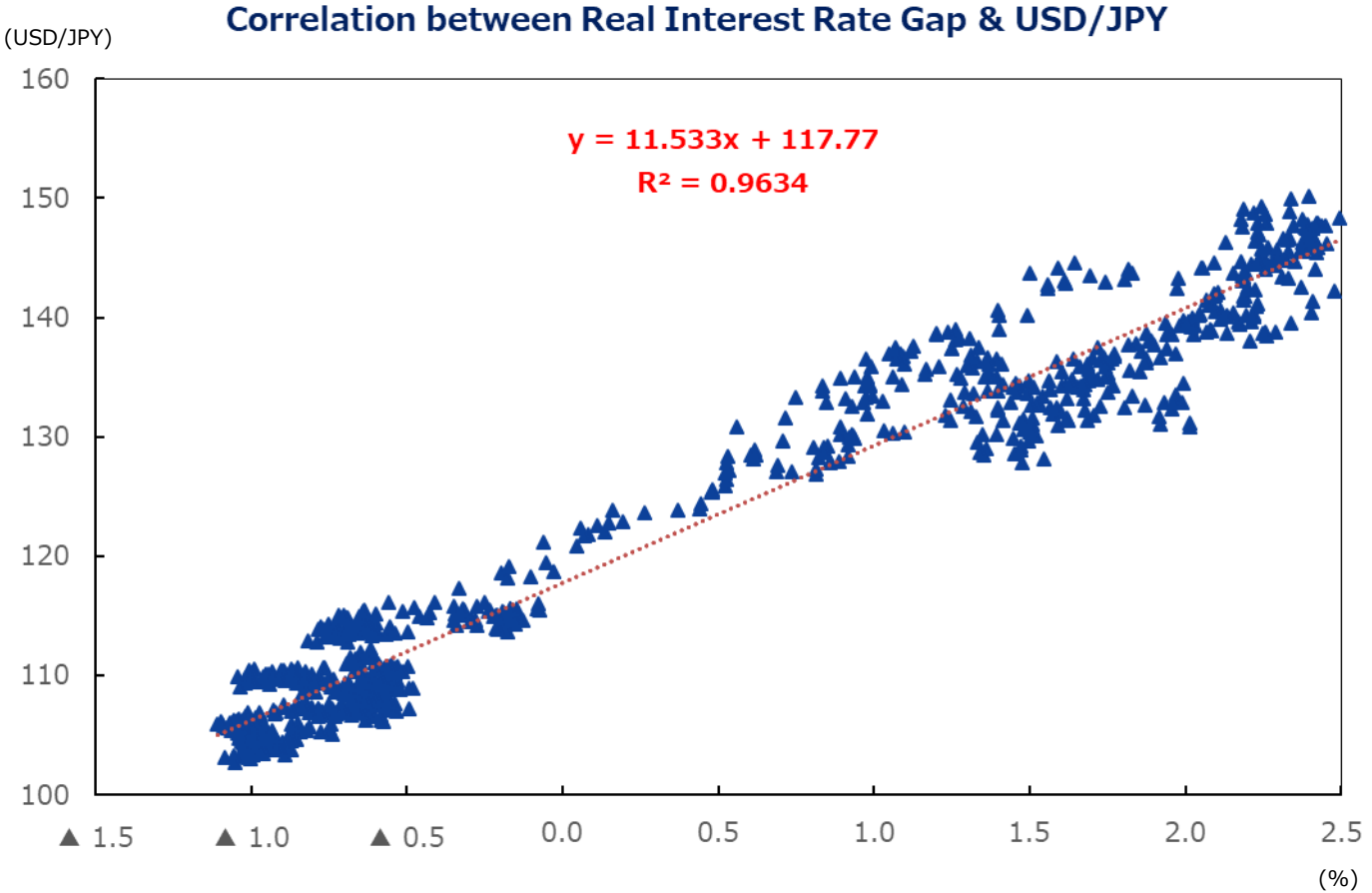
Note: Data is from January 1971 to October 2023.
Source: DOL, Bank of Japan, SMDAM

Real yield gap dominates USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 30th November 2023.
Source: Bloomberg, SMDAM

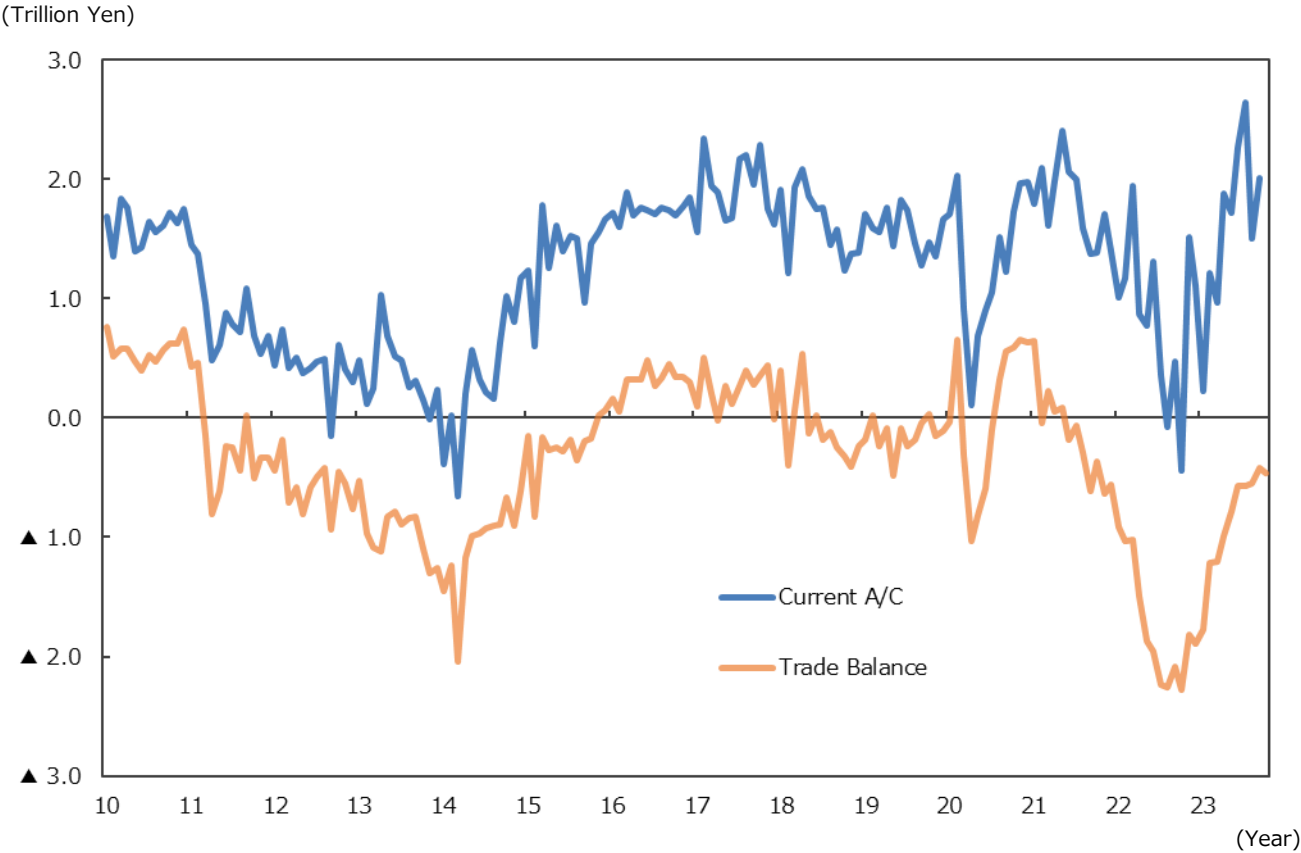
Real yield gap dominates USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 30th November 2023.
Source: Bloomberg, SMDAM

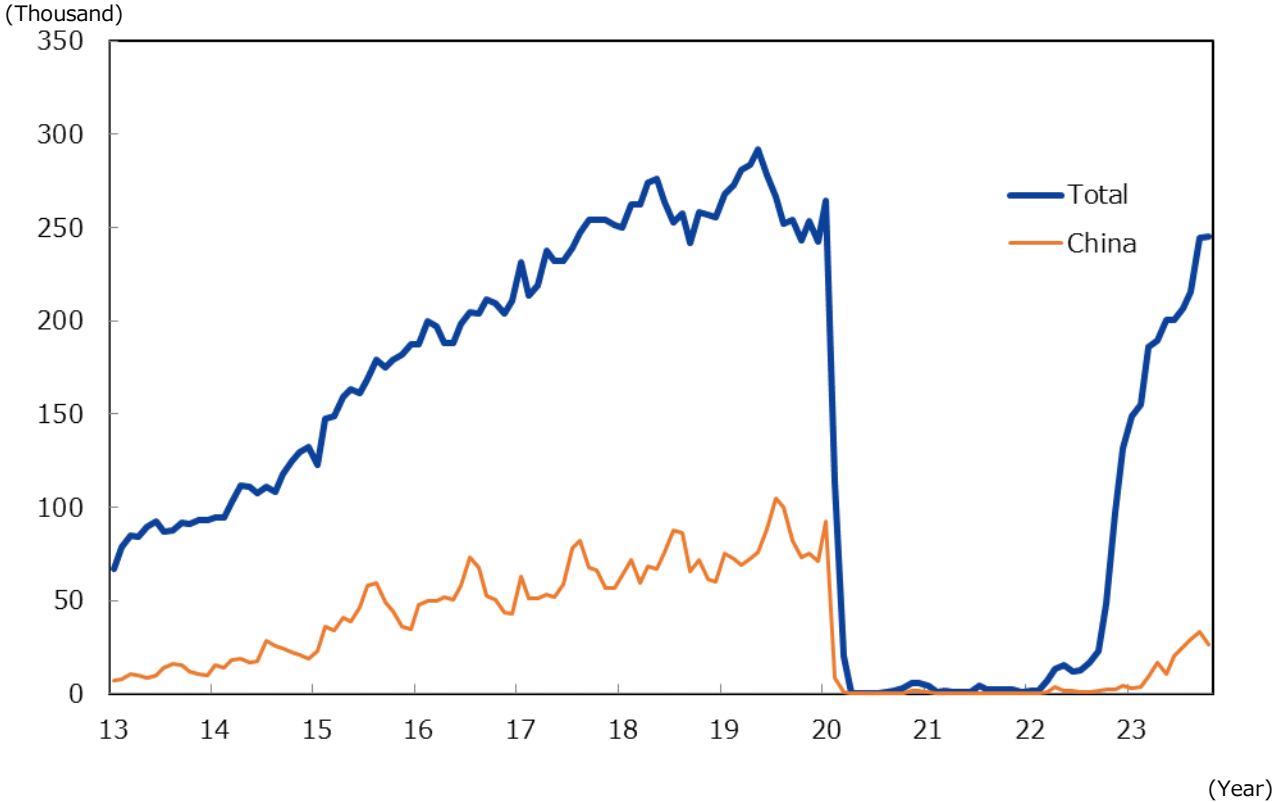
Trade deficits shrank due to falling energy prices

Current Account & Trade Balance



Note: Data is Seasonally adjusted. Current account is from January 2010 to September 2023. Trade balance is from January 2010 to October 2023. Source: MOF, SMDAM

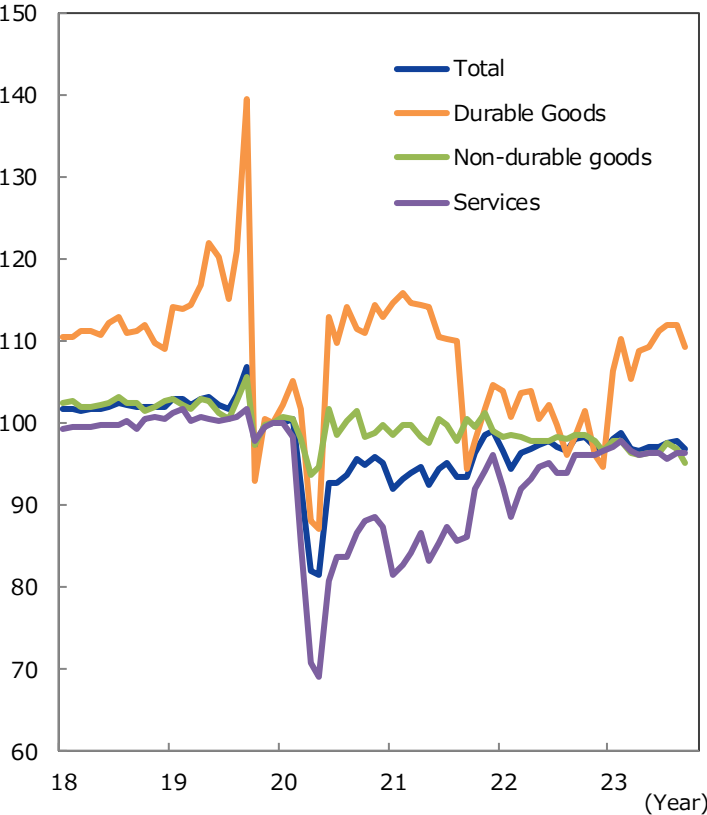
Inbound travel surging sharply without recovery from China



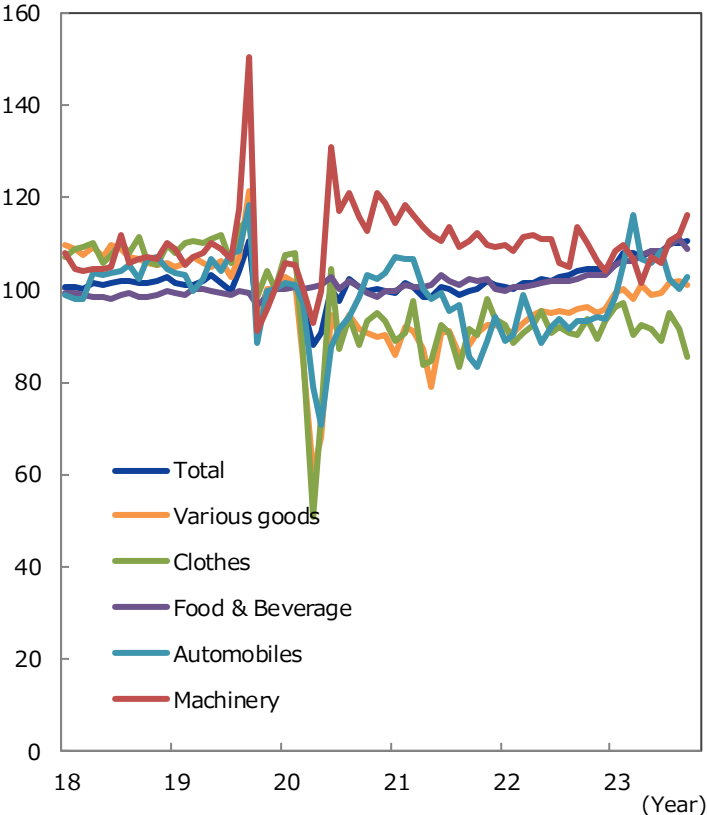
Note: Data is from January 2013 to October 2023. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Has the momentum of the normalization of economy peaked?

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to September 2023.
Source; Bank of Japan, METI, and SMDAM

PM's approval rate coming closer to the "danger zone"

Cabinet approval rate



Note: Data is from January 2013 to November 2023.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2023	December	8	Revision of CY 2023 Q3 GDP
		18-19	Monetary Policy Meeting Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline
2024	January	1	Start of new NISA (Nippon Individual Savings Account)
		22-23	Monetary Policy Meeting Convening of the ordinary Diet session
		15	Release of CY 2023 Q4 GDP
	March	11	Revision of CY 2023 Q3 GDP
		18-19	Monetary Policy Meeting Enactment of FY 2024 budget and tax reform bills
	April	25-26	Monetary Policy Meeting Release of BOJ view report
	May		Multi-faceted review of Second workshop
	June	13-14	Monetary Policy Meeting Cabinet decision on the broad policy End of the ordinary Diet session
		30-31	Monetary Policy Meeting
	September	19-20	Monetary Policy Meeting
30		Termination of the presidency of ruling LDP	
October	30-31	Monetary Policy Meeting	
December	18-19	18-19	Monetary Policy Meeting
			Cabinet approval of the initial budget for FY 2025 and the outline for tax reform

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

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