



Outlook for Japanese Stock Market & Economy

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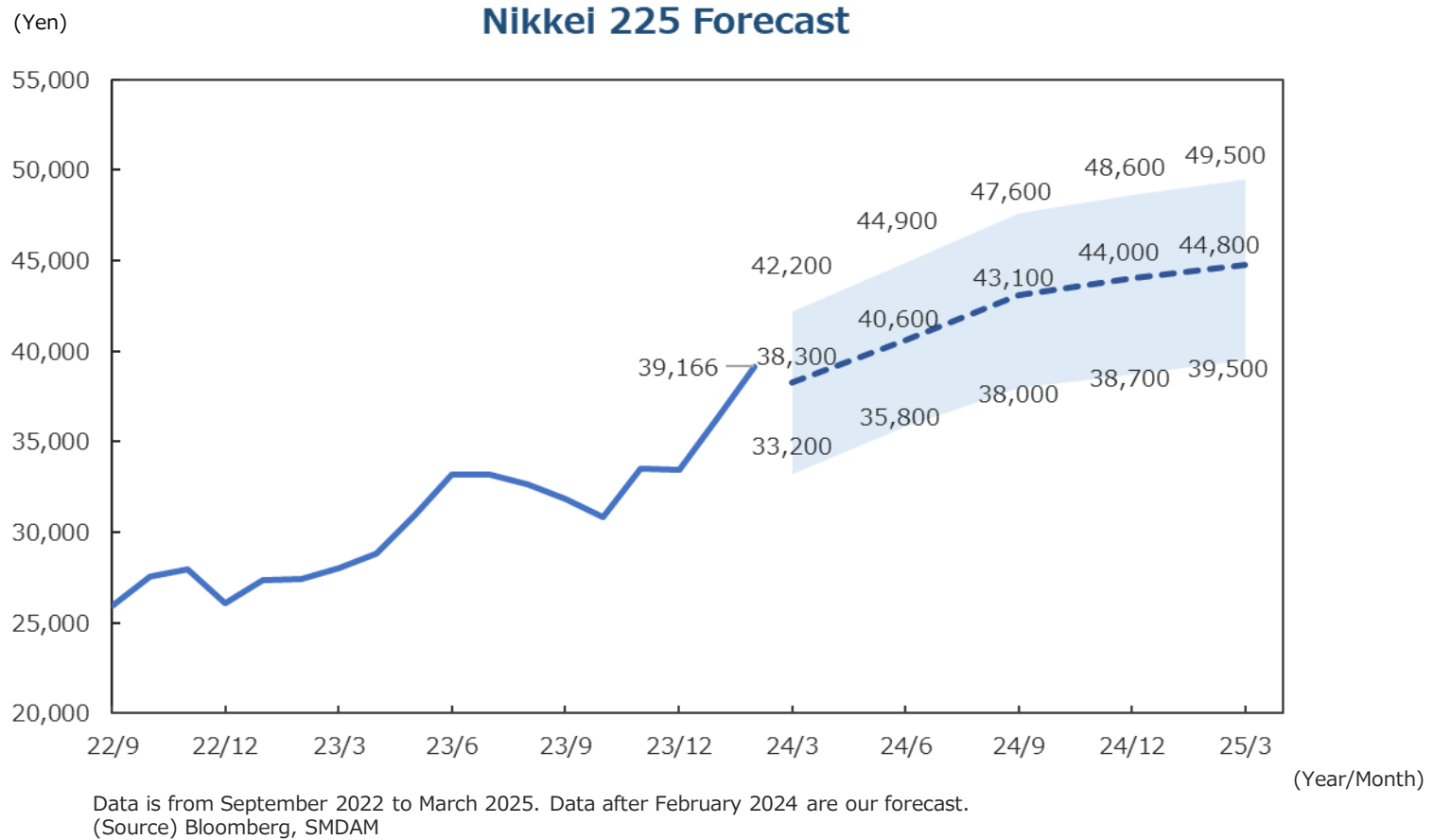
Outlook for Japanese Stock Market

Market Outlook

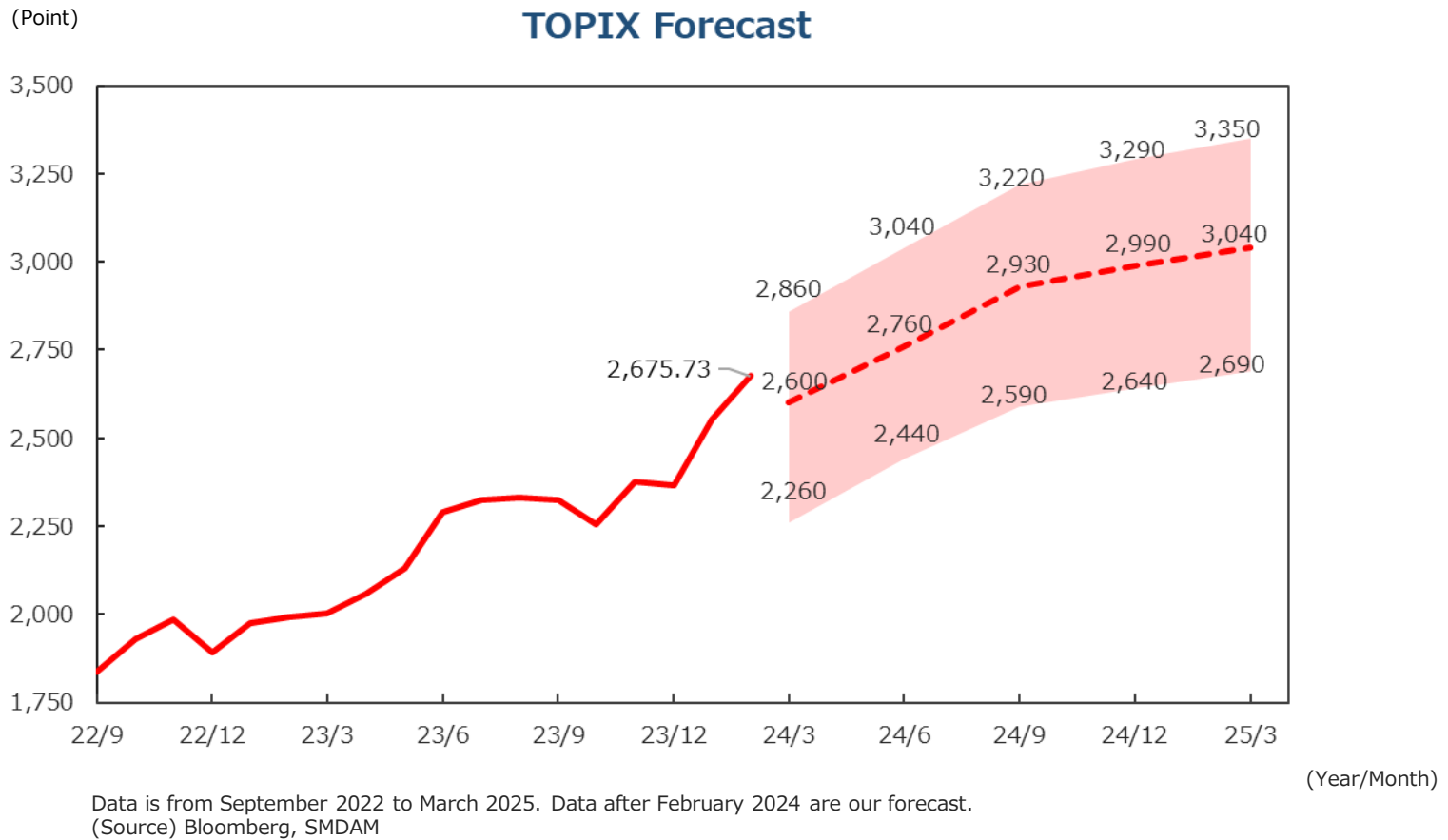
- We are bullish on the Japanese stock market due to the solid increase in nominal GDP, strong corporate earnings, and accelerating business cycle of manufacturers.
- We have raised our target of the Nikkei 225 for the year 2024 from 41,800 to 44,000 due to recent strength of large cap growth names, including semiconductors and exporters.
- Further fiscal expansion, caused by rising tax revenue and the unpopularity of the ruling Liberal Democratic Party (LDP) and its cabinet owing to slush fund allegations, could provide another boost to the equity market.
- A pivot by the Bank of Japan, which is expected in April, could be a tricky factor for the market in the near future after decades of an ultra-low interest rate environment in Japan.



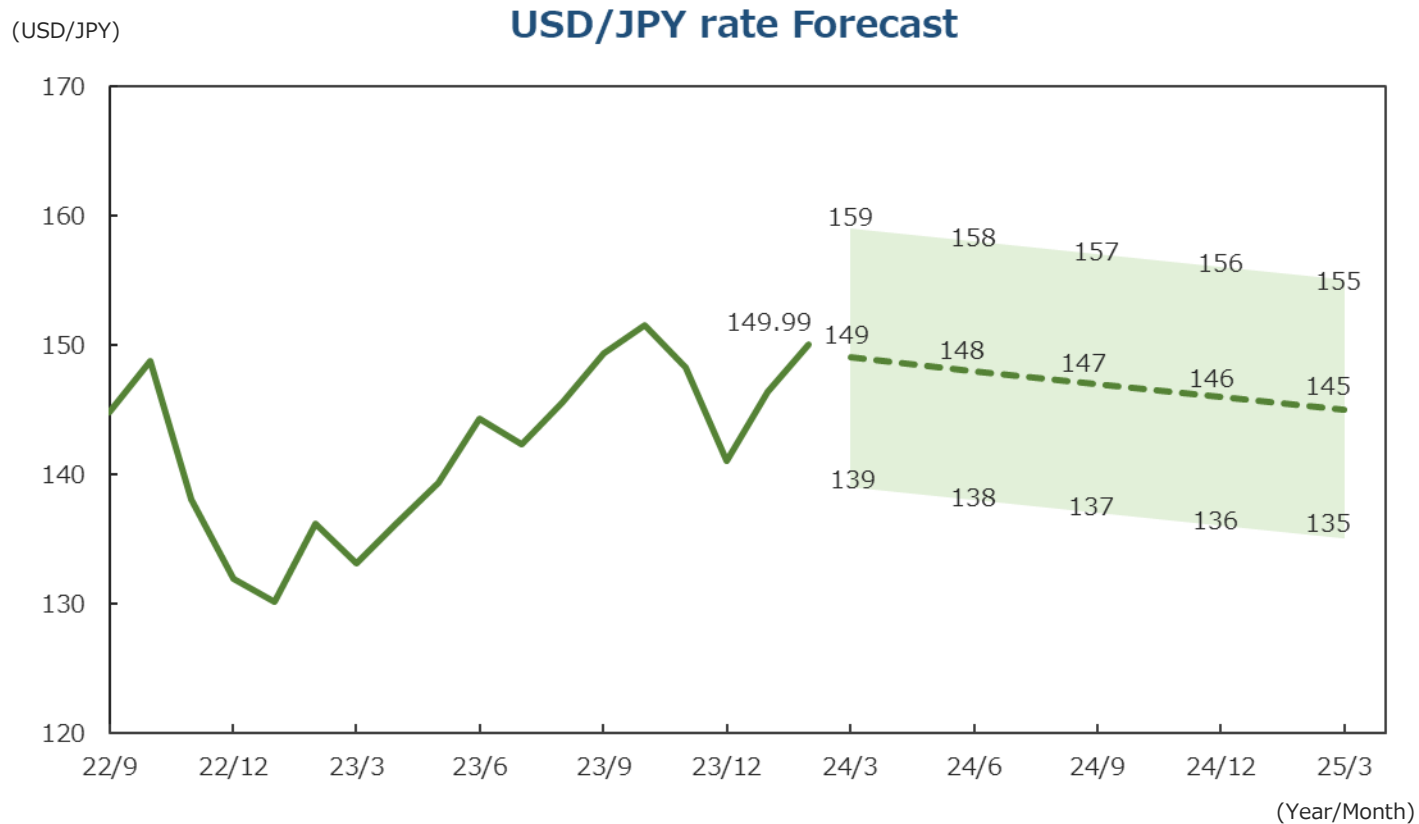
We expect the bullish stock market to continue



We expect the bullish stock market to continue



Modest JPY appreciation expected due to pivot of FED & BOJ



Data is from September 2022 to March 2025. Data after February 2024 are our forecast.
(Source) Bloomberg, SMDAM

Upside / Downside risk scenarios

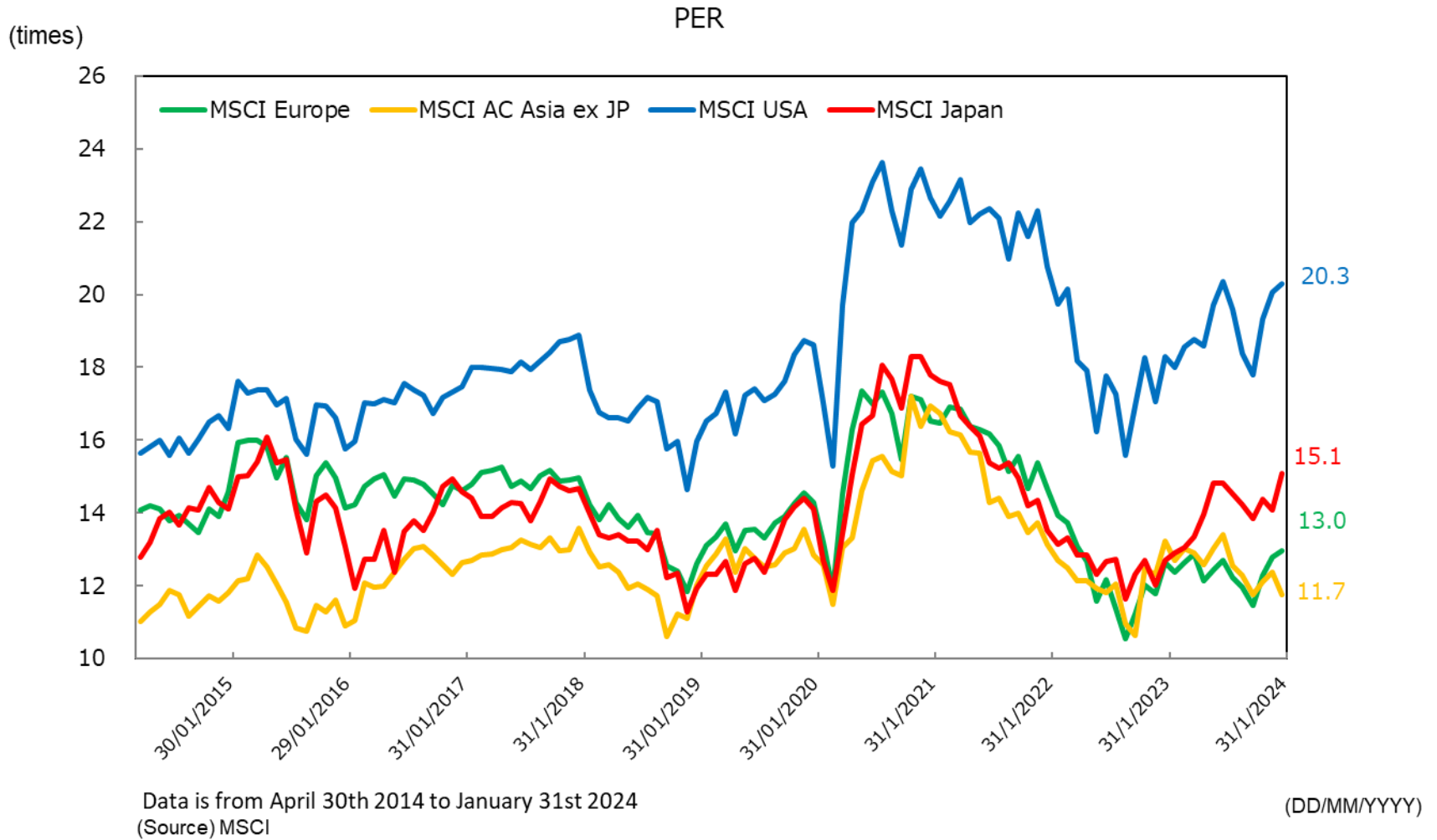
■ Upside Risks

- Growing optimism over virtuous cycle between mild inflation and wage increases
- The Bank of Japan's steady continuation of accommodative monetary policy

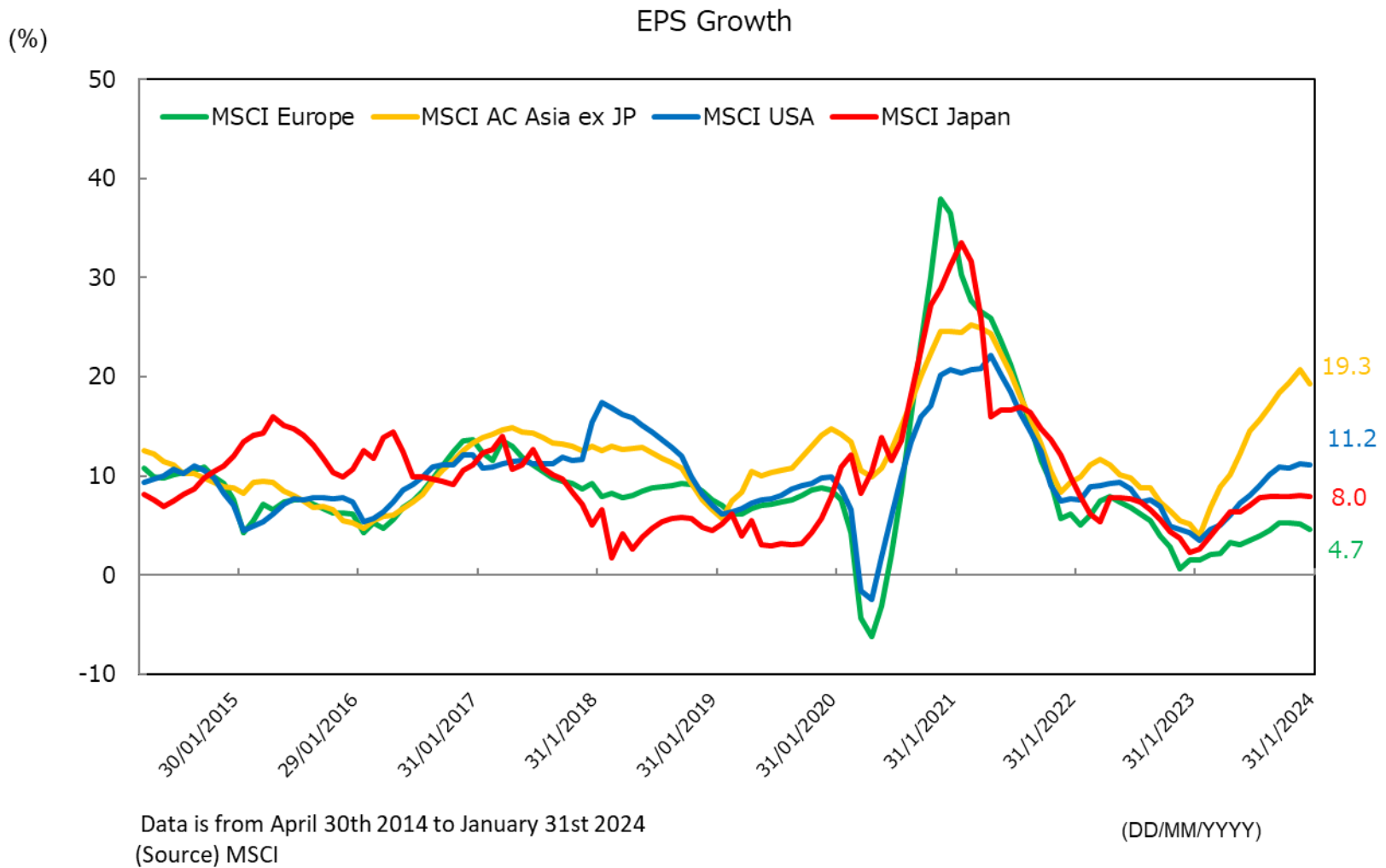
■ Downside Risks

- Excessive & rapid JPY appreciation and its negative impact on corporate earnings
- Hasty & impatient monetary tightening by the BOJ
- Political turmoil triggered by the split of the ruling LDP owing to the "slush fund scandal"

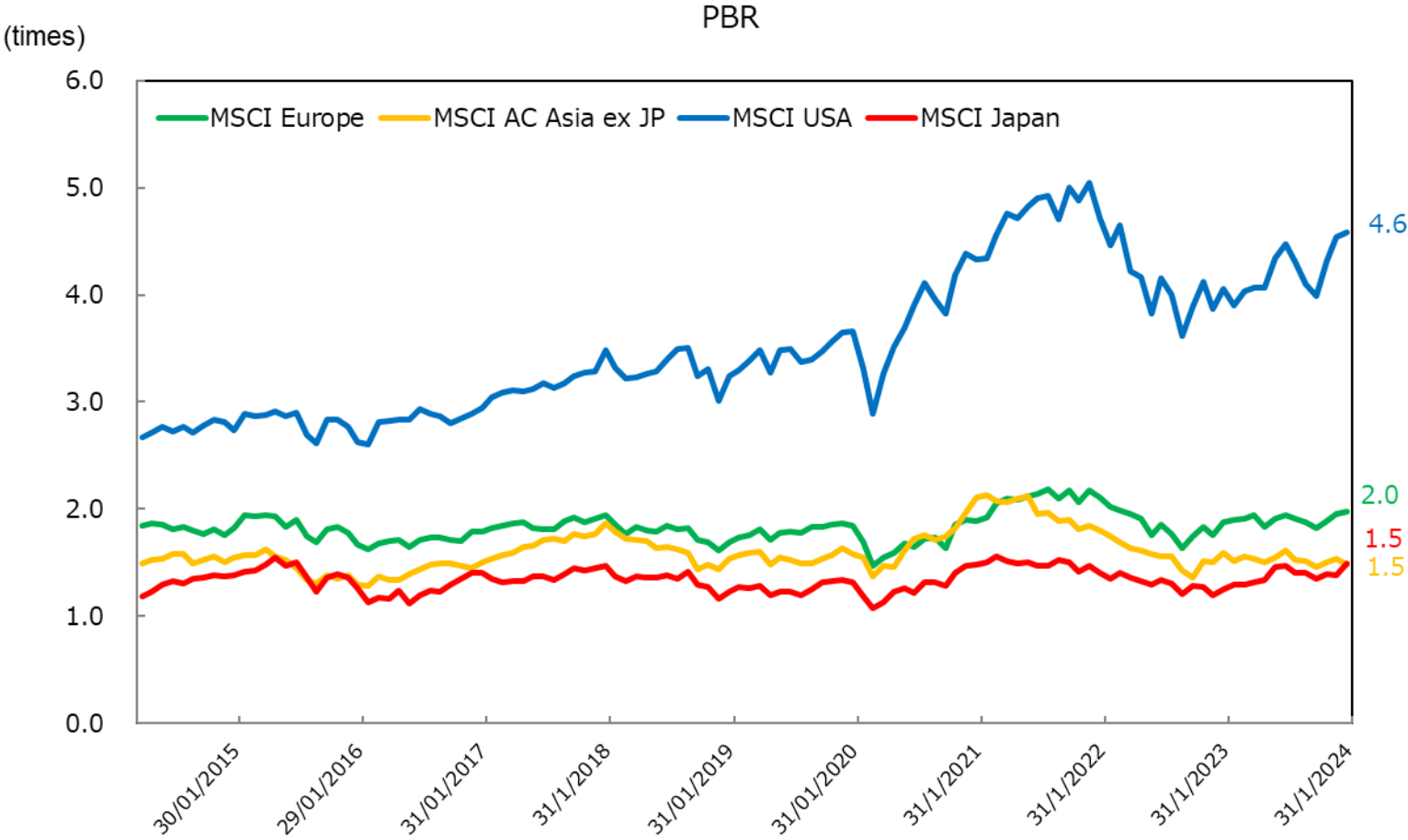
Current market rally boosts Japan's P/E ratio



Earnings growth outlook remains solid



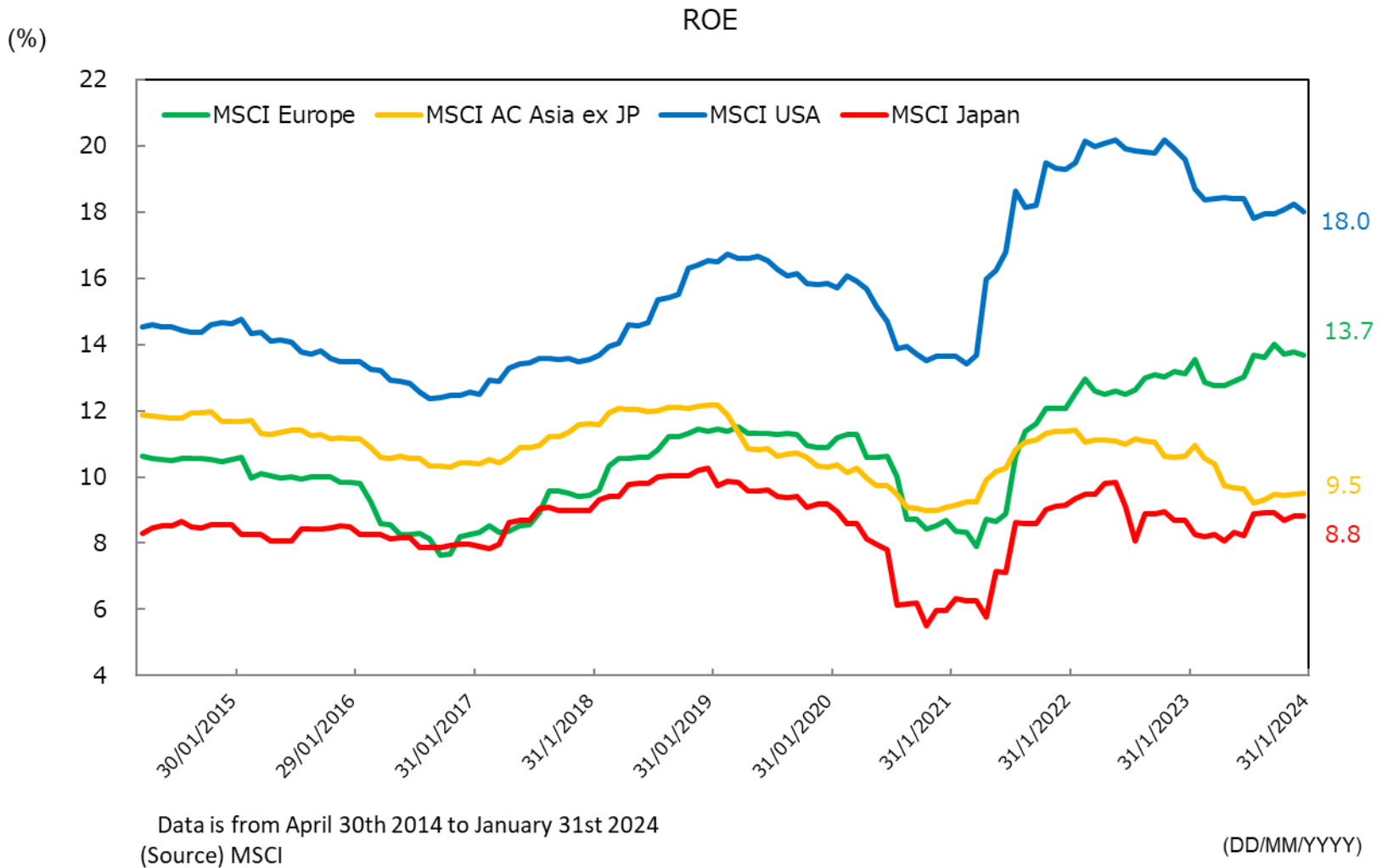
Japan's P/B ratio catching up with Asian peers thanks to recent rally



Data is from April 30th 2014 to January 31st 2024
(Source) MSCI

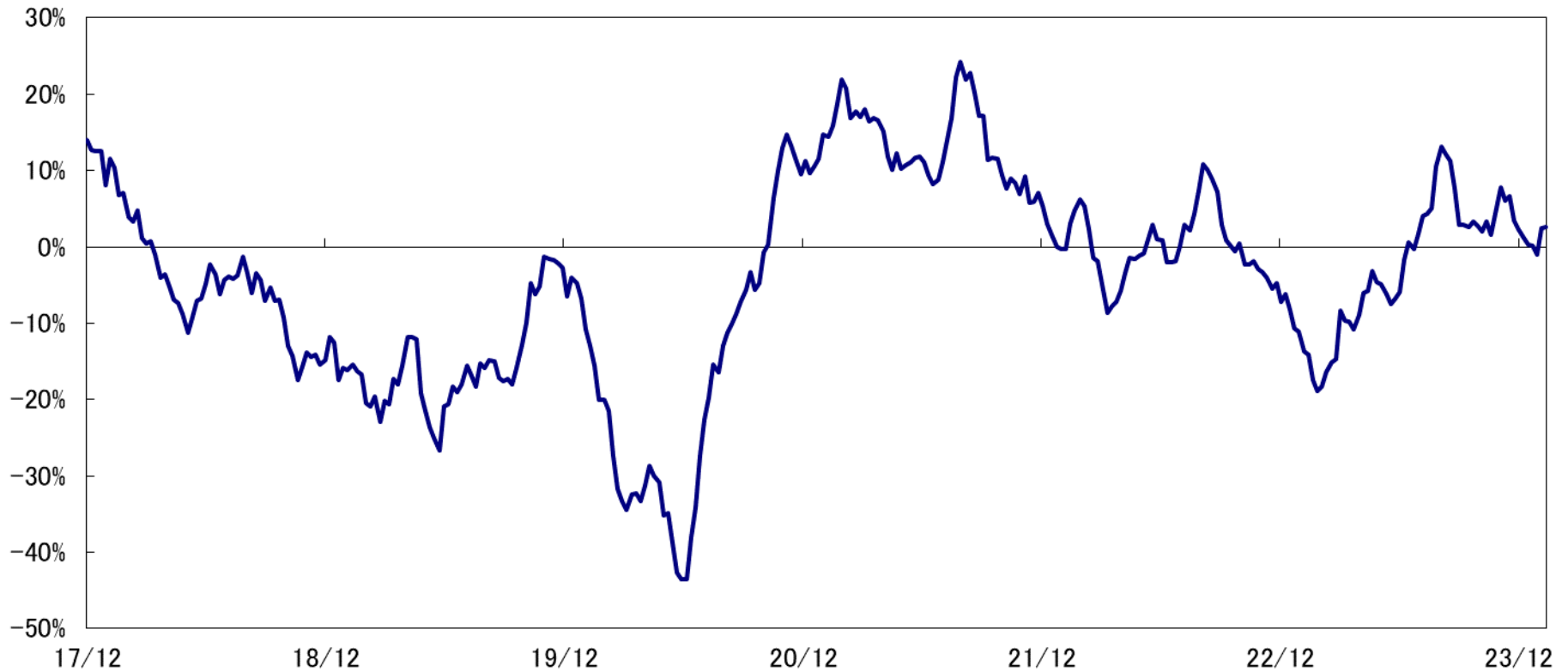
(DD/MM/YYYY)

Radical measures could be required to improve Japanese ROE



EPS revision remains positive despite weak economic data

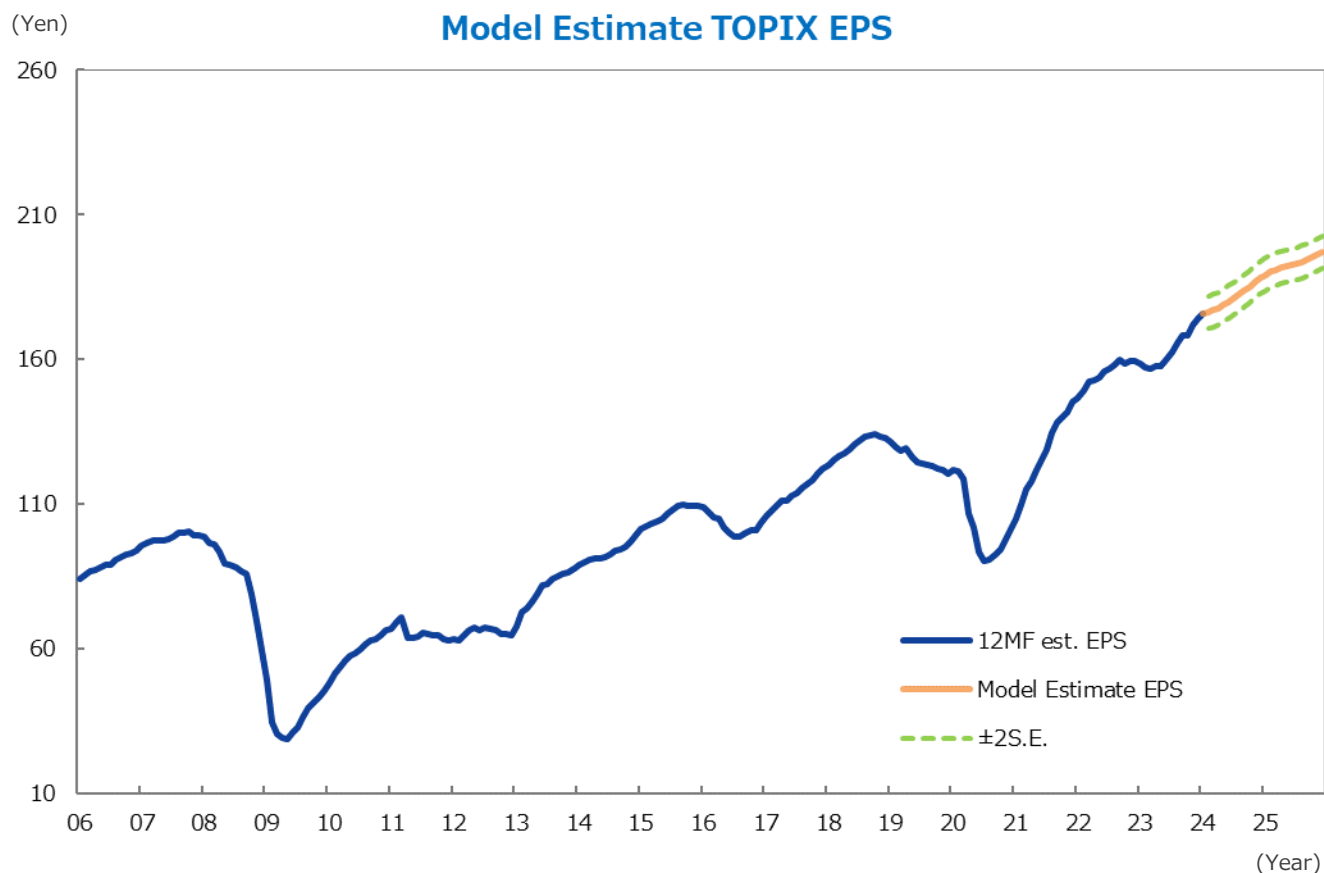
TOPIX Revision Index



Data is from December 28th 2017 to February 8th 2024
(Source) Datastream, IBES

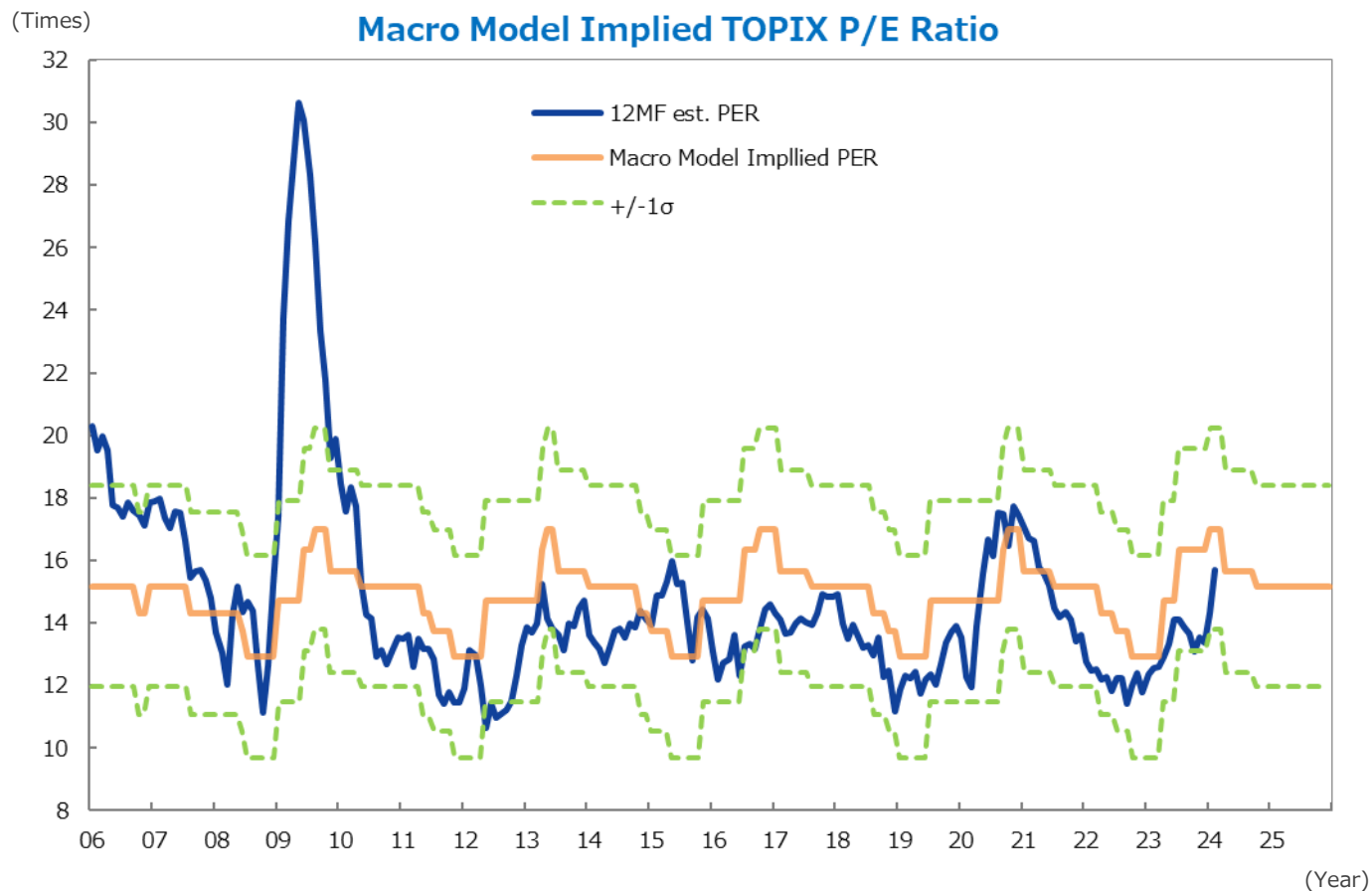
(YY/MM)

Quant model indicates positive earnings outlook going forward



Note: Consensus data is from January 2006 to January 2024. Model estimate Data is from February 2024 to December 2025.
Source: SMDAM

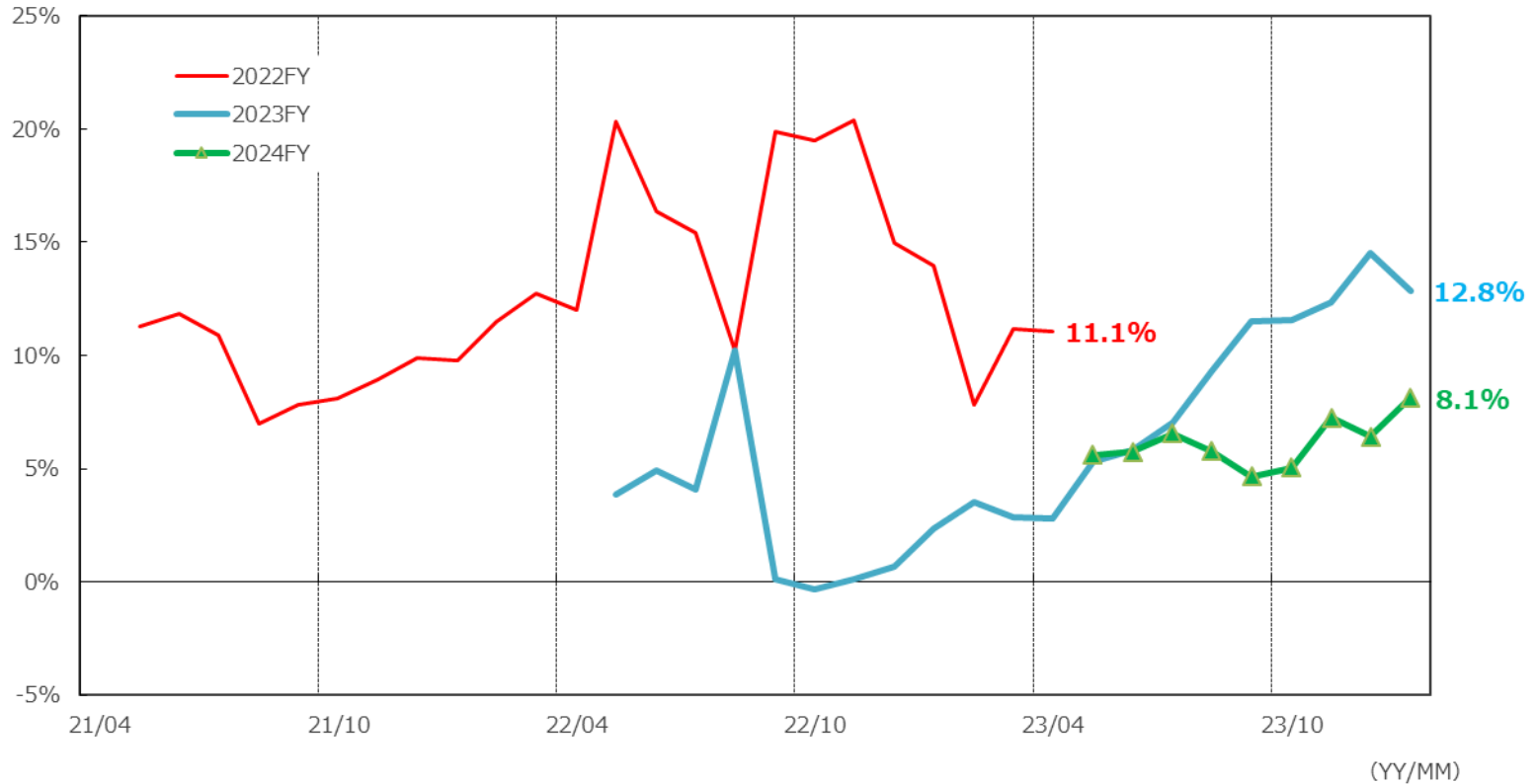
P/E ratio getting closer to fair value of quant model



Note: Consensus data is from January 2006 to January 2024, Model estimate Data is from February 2006 to December 2025.
Source: SMDAM

Encouraging earnings momentum to continue in 2024

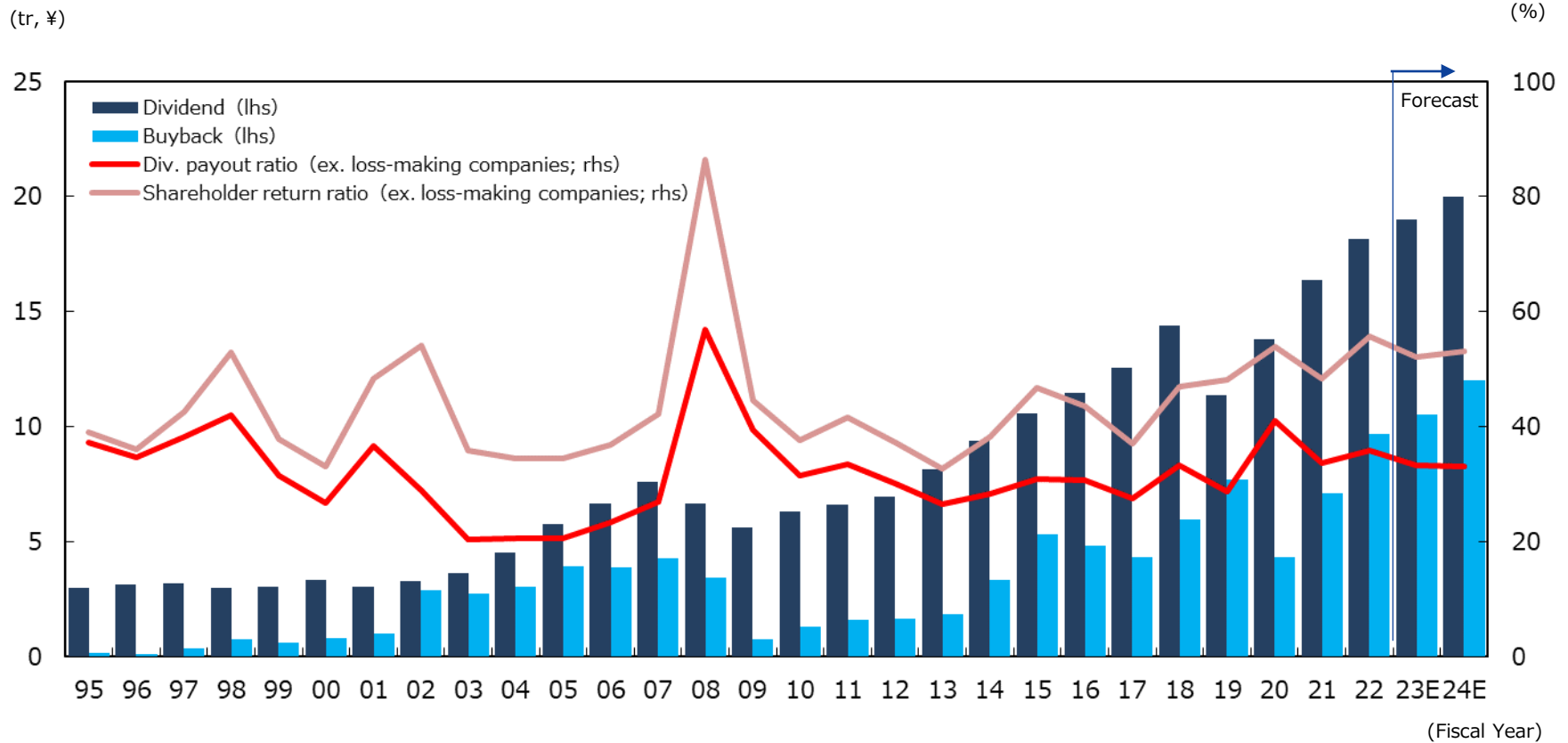
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 14th February 2024, SMDAM Core Universe (Excl. Financials) consists of 402 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Record-breaking high of dividends and buybacks

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

Size matters – non-domestic buying spree boosts large caps

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	10.51	17.84	11.44	32.43	37.31	36.08	65.36
Total Value	11.11	20.40	13.90	39.17	50.27	65.47	70.02
Top Cap Value	14.61	25.47	20.76	47.91	61.99	85.59	103.66
Large Cap Value	11.59	21.36	15.27	40.84	52.40	70.25	75.37
Mid Cap Value	8.68	17.13	10.18	33.09	41.73	53.46	43.30
Small Cap Value	8.91	16.02	7.82	31.68	40.80	45.28	47.54
Micro Cap Value	7.83	15.48	6.37	28.62	39.23	43.46	47.46
Total Growth	9.98	15.31	9.30	25.96	25.66	12.14	58.77
Top Cap Growth	12.94	20.10	11.90	31.25	29.58	16.04	73.74
Large Cap Growth	10.35	16.20	9.97	27.84	27.02	13.34	63.87
Mid Cap Growth	5.64	9.26	6.39	21.69	22.29	8.44	48.06
Small Cap Growth	6.70	7.96	3.67	11.44	15.15	3.44	21.88
Micro Cap Growth	8.66	10.47	4.83	9.99	17.71	0.21	24.16
Top Cap Total	13.58	22.41	15.17	38.44	43.09	42.90	85.24
Large Cap Total	10.91	18.65	12.31	33.94	38.50	37.45	70.22
Mid Cap Total	7.29	13.43	8.44	27.69	32.12	30.00	50.41
Small Cap Total	8.04	12.96	6.17	23.64	30.18	27.77	38.31
Micro Cap Total	8.11	13.96	5.83	22.41	31.64	28.11	41.09

Note : As of 19th February 2024
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is standing still.** Real GDP fell in the fourth quarter of 2023, marking the second consecutive quarter of negative growth. Domestic demand is sluggish, with declines in consumer spending and capital investment. As for the start of 2024, although there are negative factors such as the suspension of automobile production due to inspection frauds by some manufacturers and the Noto Peninsula earthquake, business sentiment remains firm and the economy will avoid a serious slowdown.
- **Inflation is slowing down.** The nationwide core CPI rose by 2.3% in December 2023 from a year earlier and the pace of inflation slowed from 2.5% in November. The Tokyo Metropolitan Area core CPI also rose 1.6% in January, down from 2.1% the previous month. Inflation has been slowing, mainly in goods prices, and the decline in cost-push pressure, starting with import prices, has pushed down inflation.

[Outlook]

- ① **We have lowered our real GDP growth forecast for FY 2023 from +1.6% to +1.3%, that for FY 2024 from +1.1% to +0.6%, and that for FY 2025 from +0.8% to +0.7%.** The downward revision to the growth forecast was mainly due to a prolonged suspension of automobile production due to inspection frauds, as well as a slowdown of economic growth in H2 of FY 2023. The downward revision in FY 2024 was due to the impact of the economic slowdown toward the end of the previous fiscal year and the impact of the rate hike in FY 2025. The economy is expected to return to a moderate recovery led by domestic demand thanks to slowing inflation, rising wages and the government's economic stimulus. On the other hand, we believe that exports will remain firm despite slowing growth in the wake of a future slowdown in the US economy.
- ② **While we have maintained our core CPI forecast for FY 2023 at +2.8%, we have raised that for FY 2024 from +2.0% to +2.2% and that for FY 2025 from +1.7% to +1.9% respectively.** The upward revisions to FY 2024 and FY 2025 were mainly due to an increase in the salary base and an increase in the assumption of US dollar-yen rate. It is highly likely that the national core CPI will increase once the downward effect of subsidies on electricity and gas bills will be eliminated in February 2024, but after that, the national core CPI is likely to follow a deceleration trend and fall below 2% at the beginning of 2025 due to the reduction of cost push pressure starting from import prices. However, the national core CPI is expected to remain stable, not significantly down from 2%, as the rise in service prices due to the improvement in wages.
- ③ **We expect the government will continue their accommodative fiscal policy.** In November 2023, Prime Minister Kishida's Cabinet approved "comprehensive economic measures to completely overcome deflation." The measures, which amounts to 20.9 trillion yen on a national and local spending basis, includes measures to counter high prices, support for growth sectors, and national infrastructure resilience. Flat rate tax cuts are expected to take effect in June 2024. Regarding the "Noto Peninsula earthquake", the cabinet decided to double the reserve fund for FY 2024 to 1 trillion yen. In fiscal policy we should pay close attention to the risk of fiscal expansion, aimed at improving the approval ratings of the Cabinet and the ruling Liberal Democratic Party, which have declined significantly as a result of the party ticket and "slush fund scandal".
- ④ **We expect the end of ultra-easy monetary policy in April 2024, including the exit from the negative policy and elimination of the YCC (yield curve control).** The Bank of Japan is expected to revise its economic outlook report in April after confirming the results of the unions' spring wage talks, which will be released in mid-March, and judge the probability of achieving the price stability target. The BOJ is expected to raise its policy rate from -0.1% to the range of 0 to 0.1% in April 2024. After that, we expect the BOJ will raise its policy rate by 0.25% in April 2025 and October 2025 respectively.

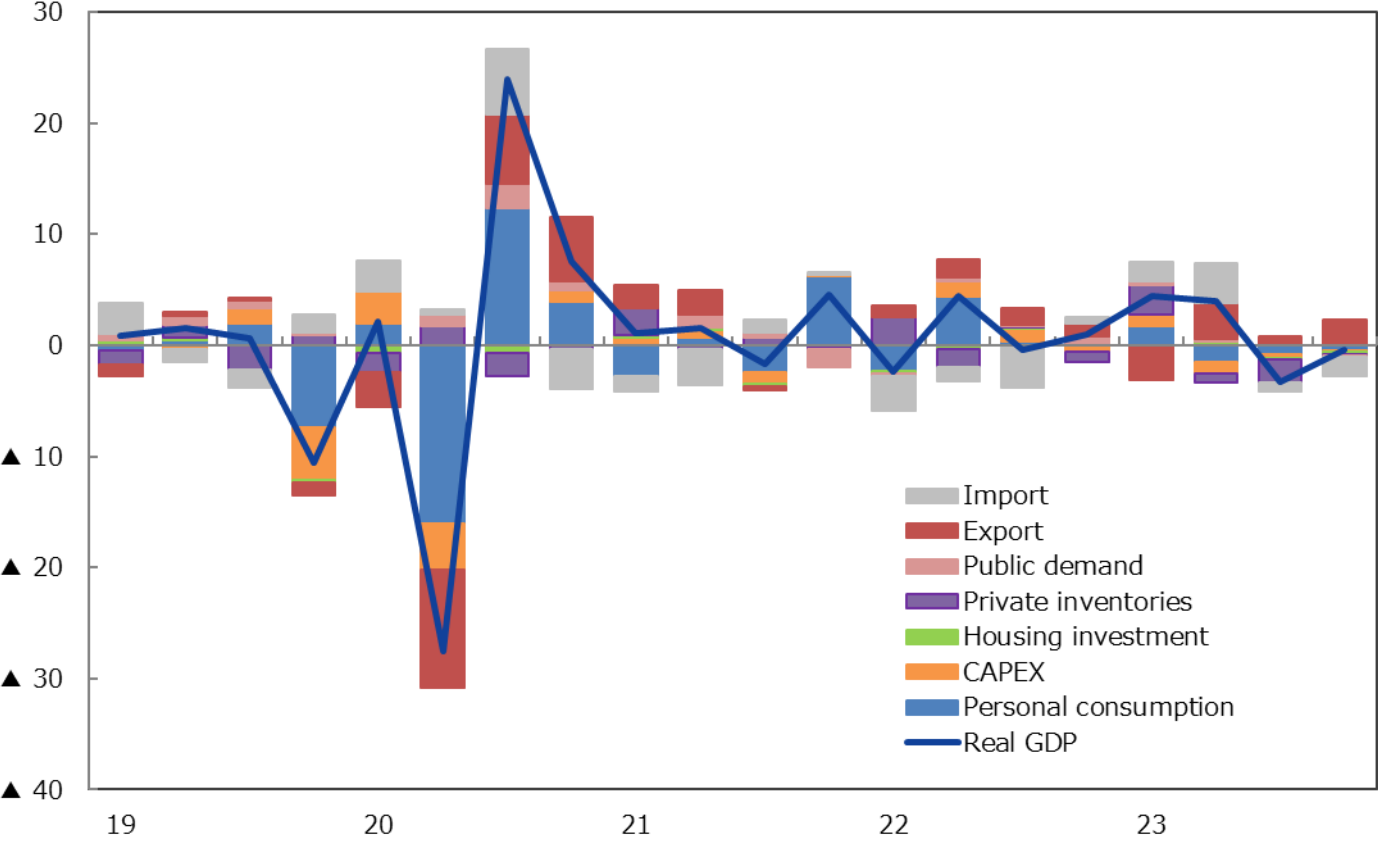
Forecast for the Japanese economy

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%	1.3%	0.6%	0.7%	
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	-0.4%	0.7%	1.0%	
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	1.5%	0.0%	-0.8%	
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	-0.6%	1.1%	1.1%	
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.2%	-0.1%	0.0%	
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	3.1%	0.7%	0.7%	
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%	4.0%	2.8%	2.2%	
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-2.4%	3.6%	3.1%	
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.2%	2.2%	2.1%	
GDP deflator	0.8%	0.7%	-0.1%	0.7%	3.9%	1.7%	1.4%	
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-1.7%	1.2%	1.3%	
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.2%	1.9%	
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.3%	1.0%	1.0%	
Employee compensation	2.0%	-1.5%	2.1%	2.0%	1.9%	3.3%	3.3%	
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%	0-0.1%	0.5%	

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

Real GDP contracted for two consecutive quarters

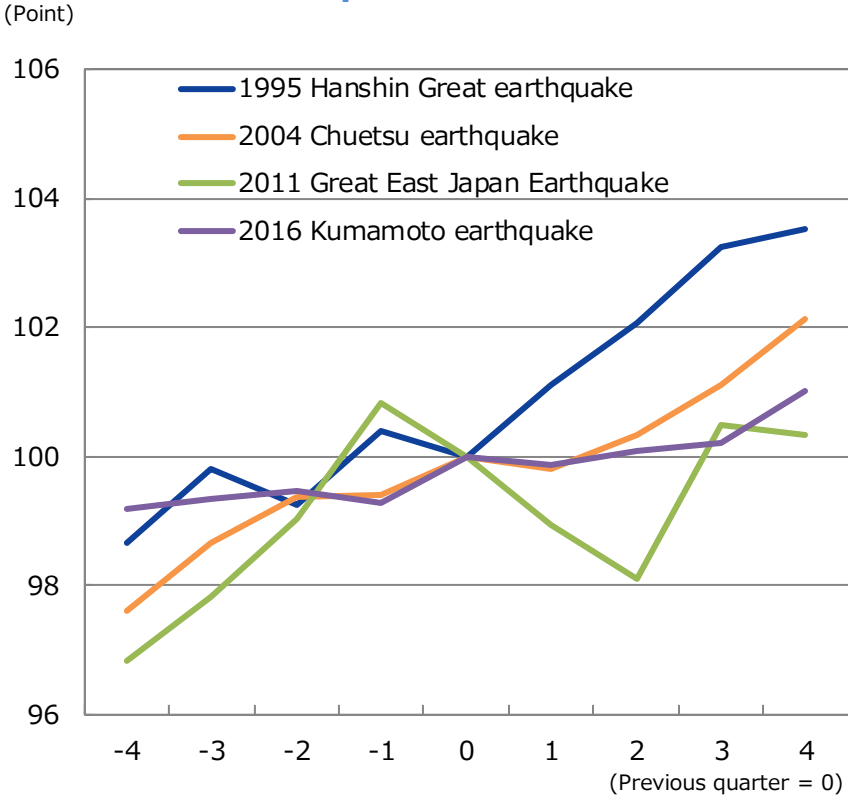
Real GDP growth rate (YOY, %)



Note: Data is from Q1 2019 to Q4 2023.
Source: Cabinet office, SMDAM

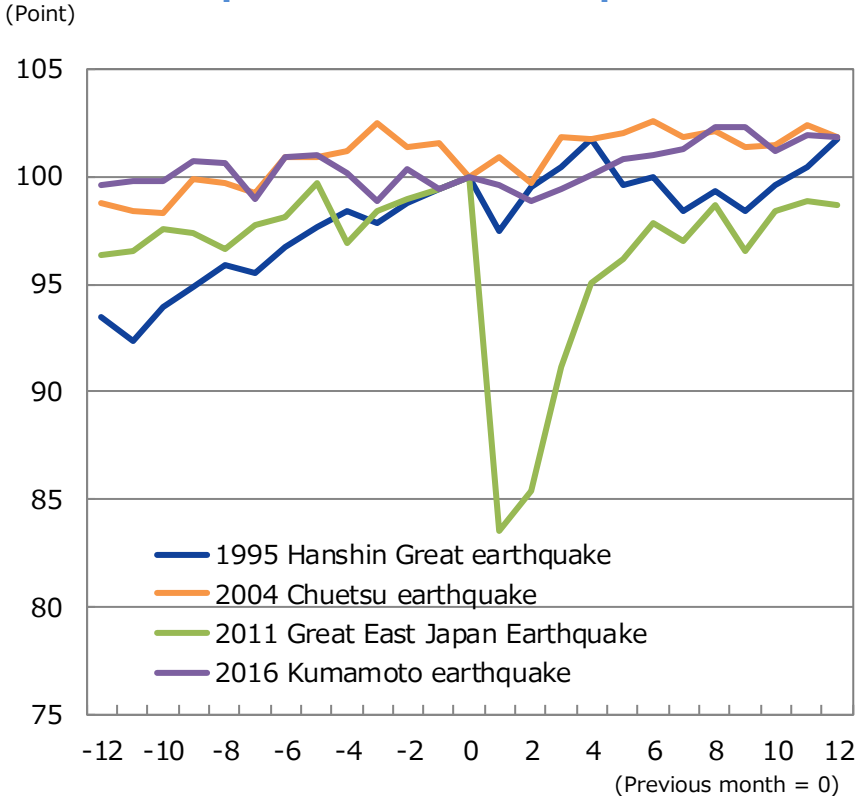
Earthquakes have not shaken the economy so far

Earthquake & Real GDP



Note: Data of the previous quarter of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

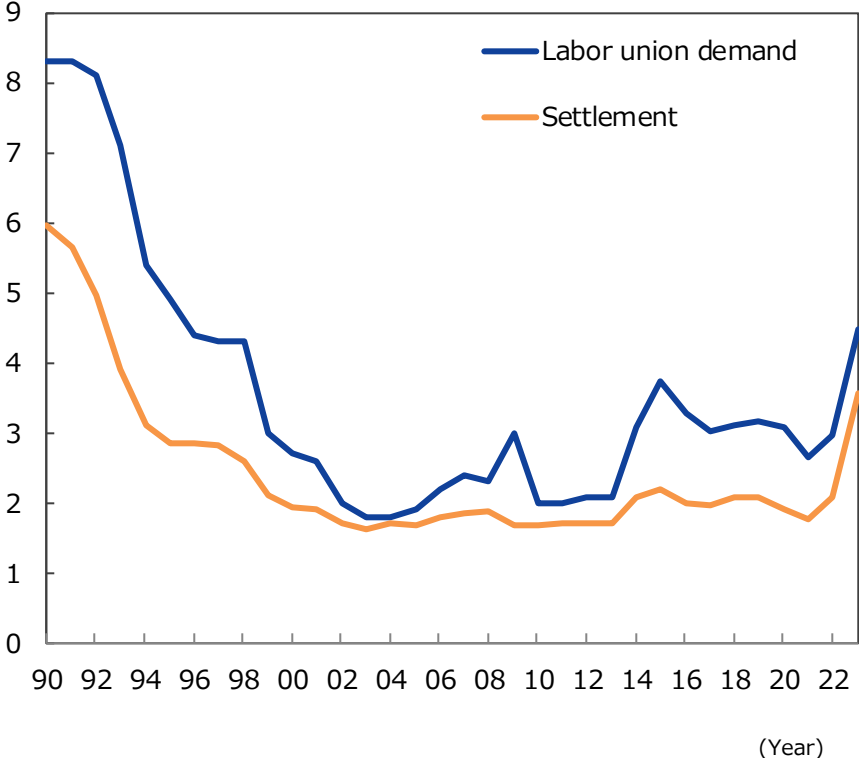
Earthquake & Industrial production



Note: Data of the previous month of the earthquake was indexed as 100.
Source: Cabinet office, METI, SMDAM

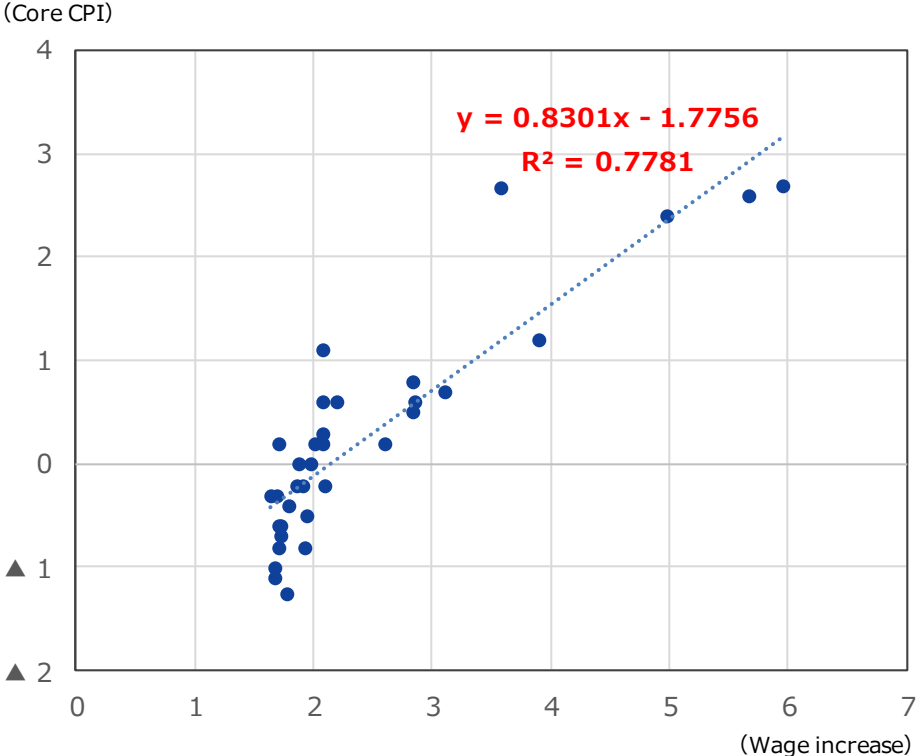
Start of a virtuous cycle of wage increase & mild inflation

Wage increase demand & settlement (YOY, %)



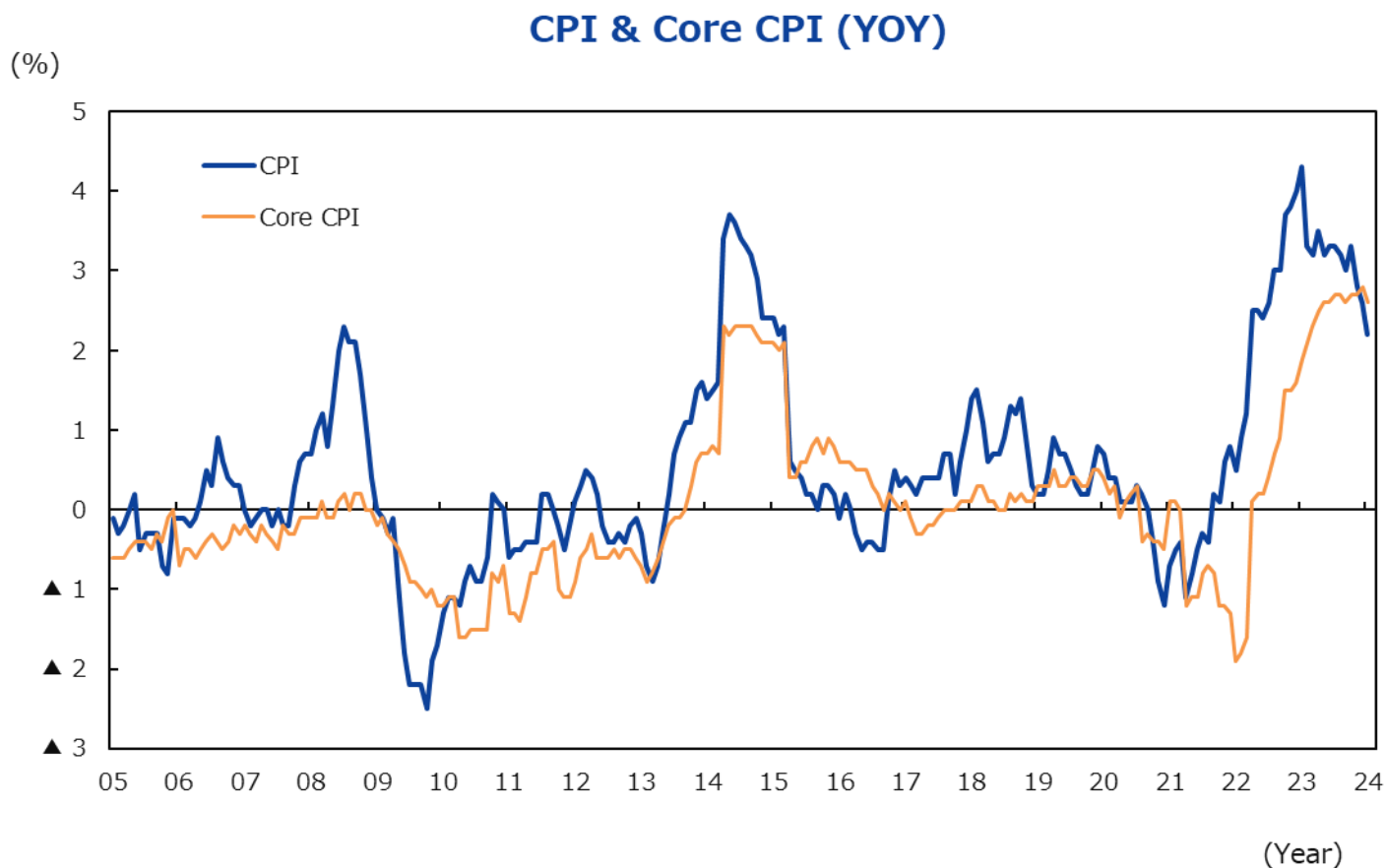
Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

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

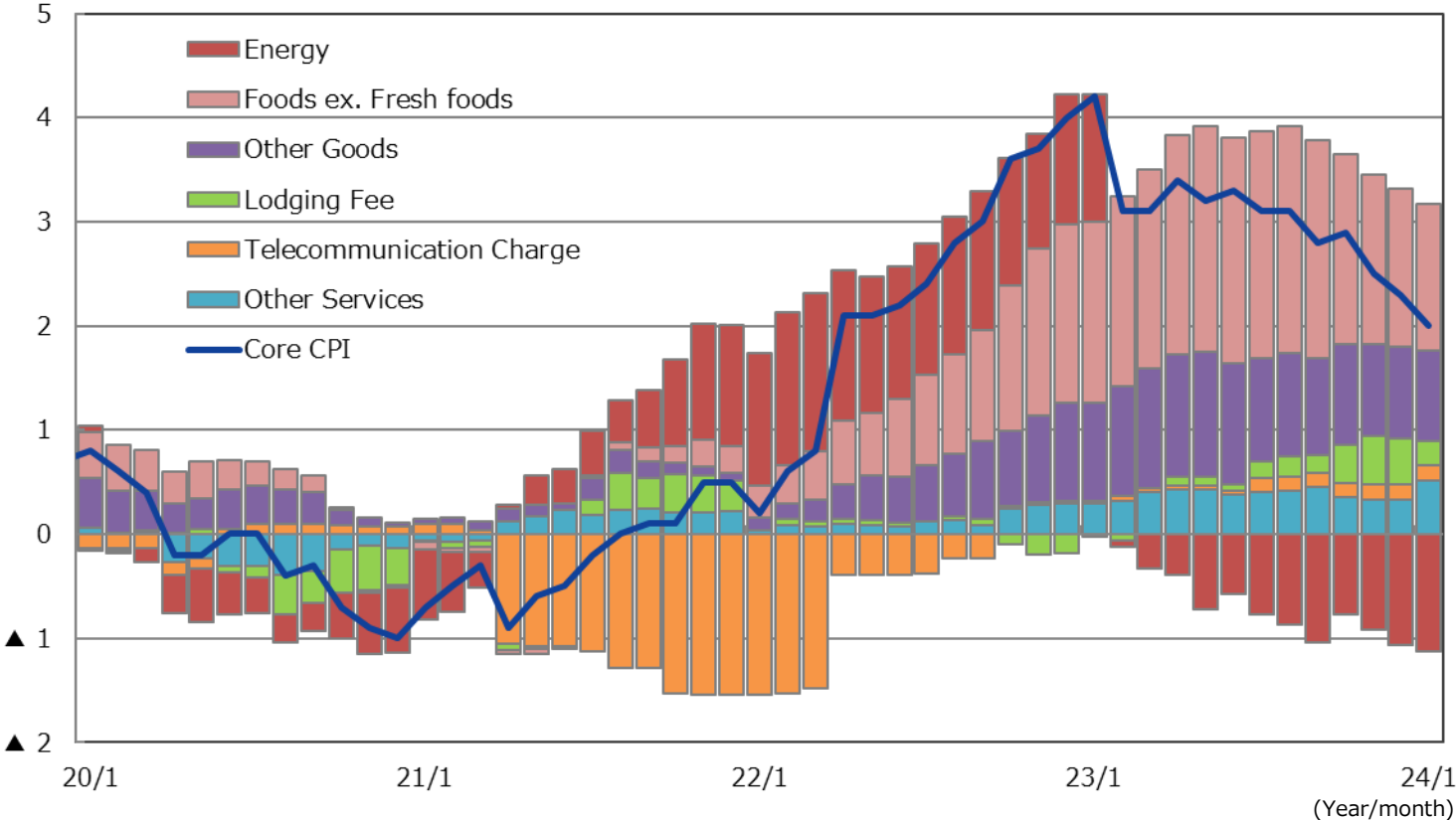
Sticky core CPI exceeds headline inflation



Note: Data is from January 2005 to January 2024, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

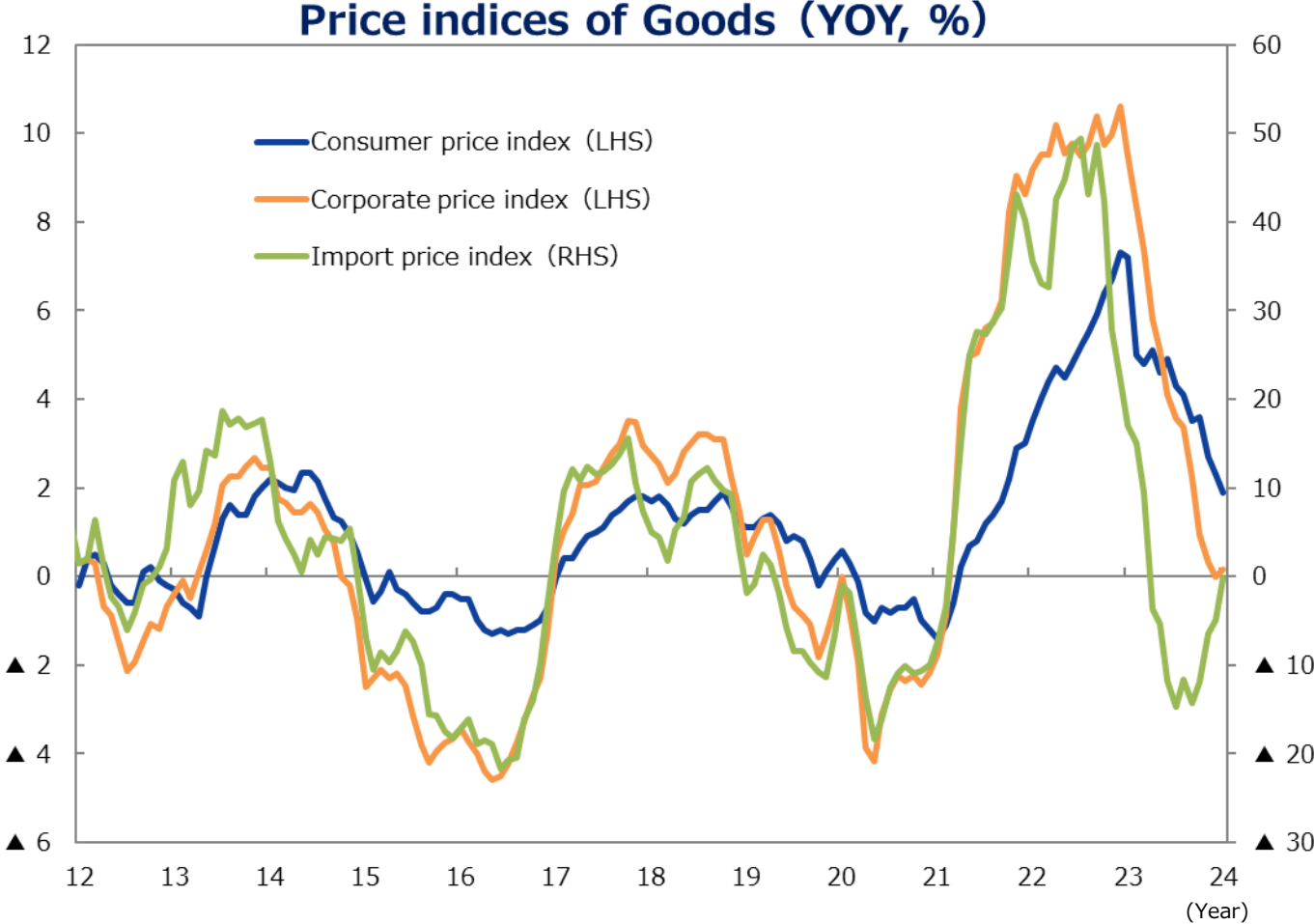
Goods and services make Japanese inflation stickier

Breakdown of CPI (YOY, %)



Note: Data is from January 2020 to January 2024.
Source: MIAC, SMDAM

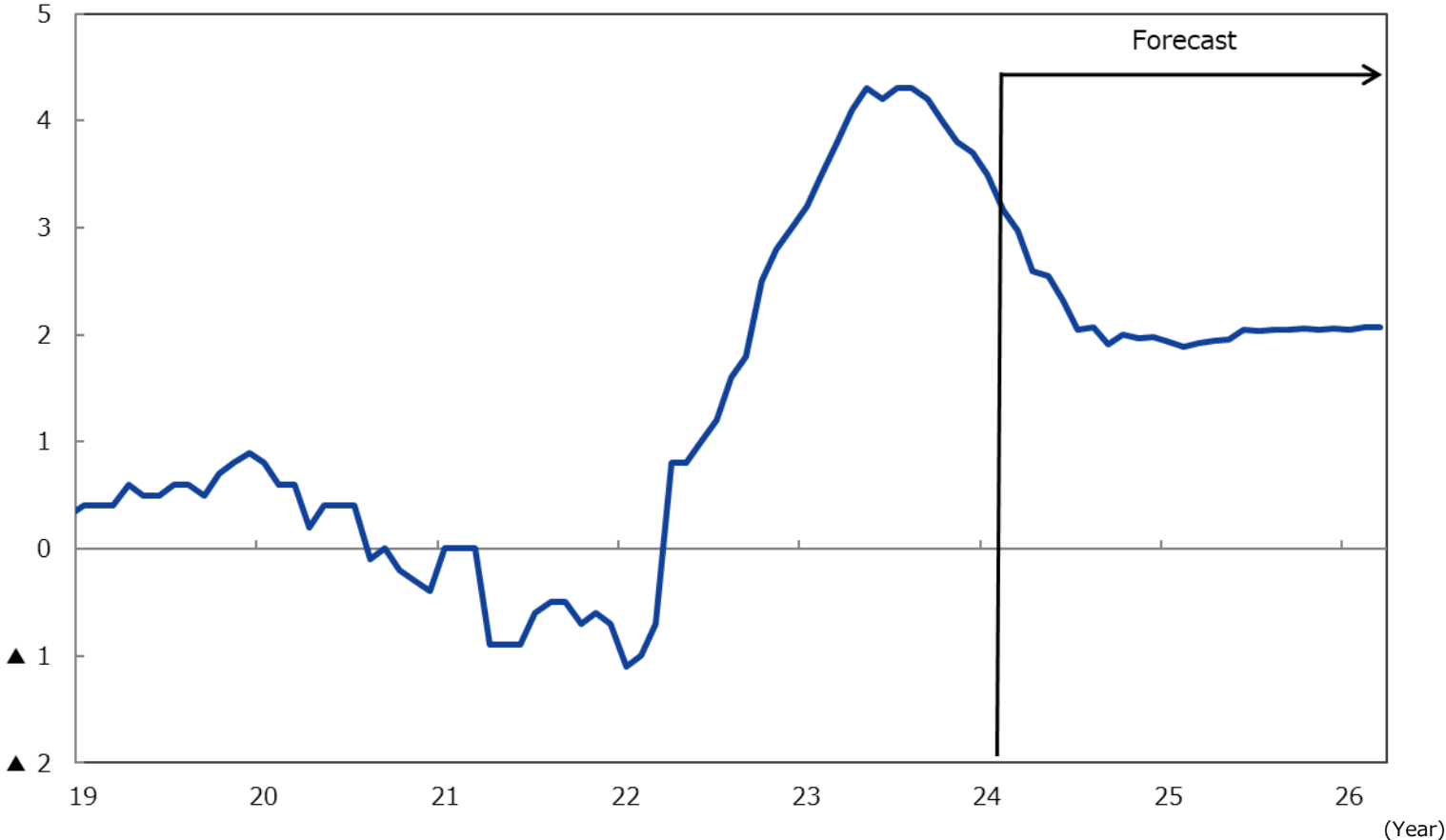
Sticky CPI improves profit margin



Note: Data is from January 2012 to January 2024.
Source: MIAC, Bloomberg, SMDAM

BOJ forecasts inflation to fall below 2% in 2024 temporarily

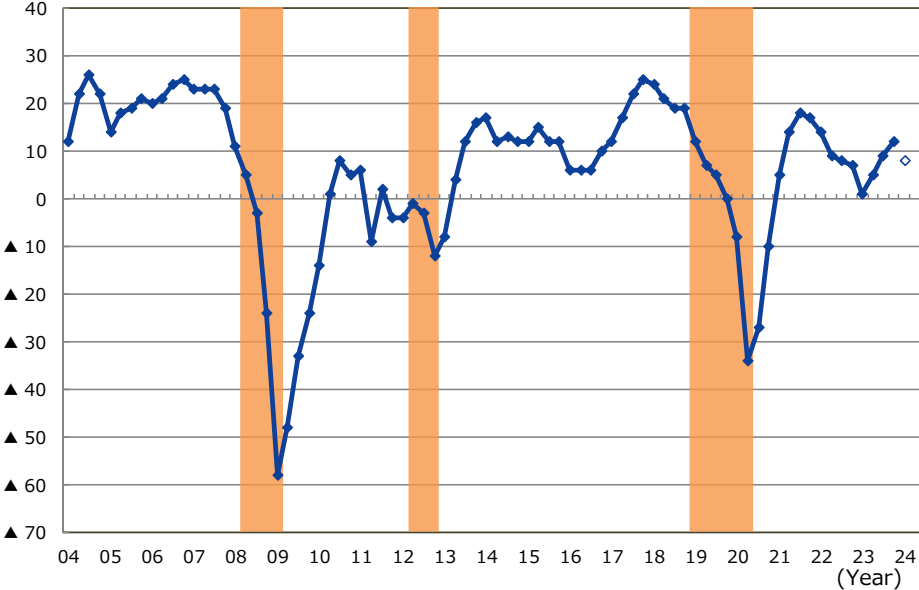
BOJ's Core CPI forecast (YOY, %)



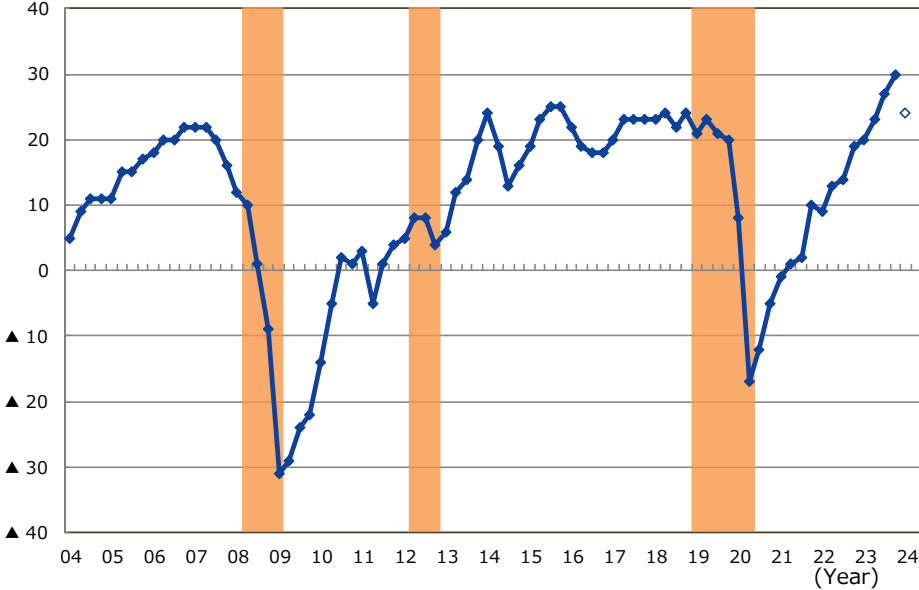
Note: Data is from January 2019 to March 2026. BOJ's Core CPI is excluding fresh foods & energy. Data from February 2024 is forecasts.
Source: The Bank of Japan, SMDAM

Business sentiment remains positive but cautious ahead

BOJ business condition DI Large manufacturers (%)



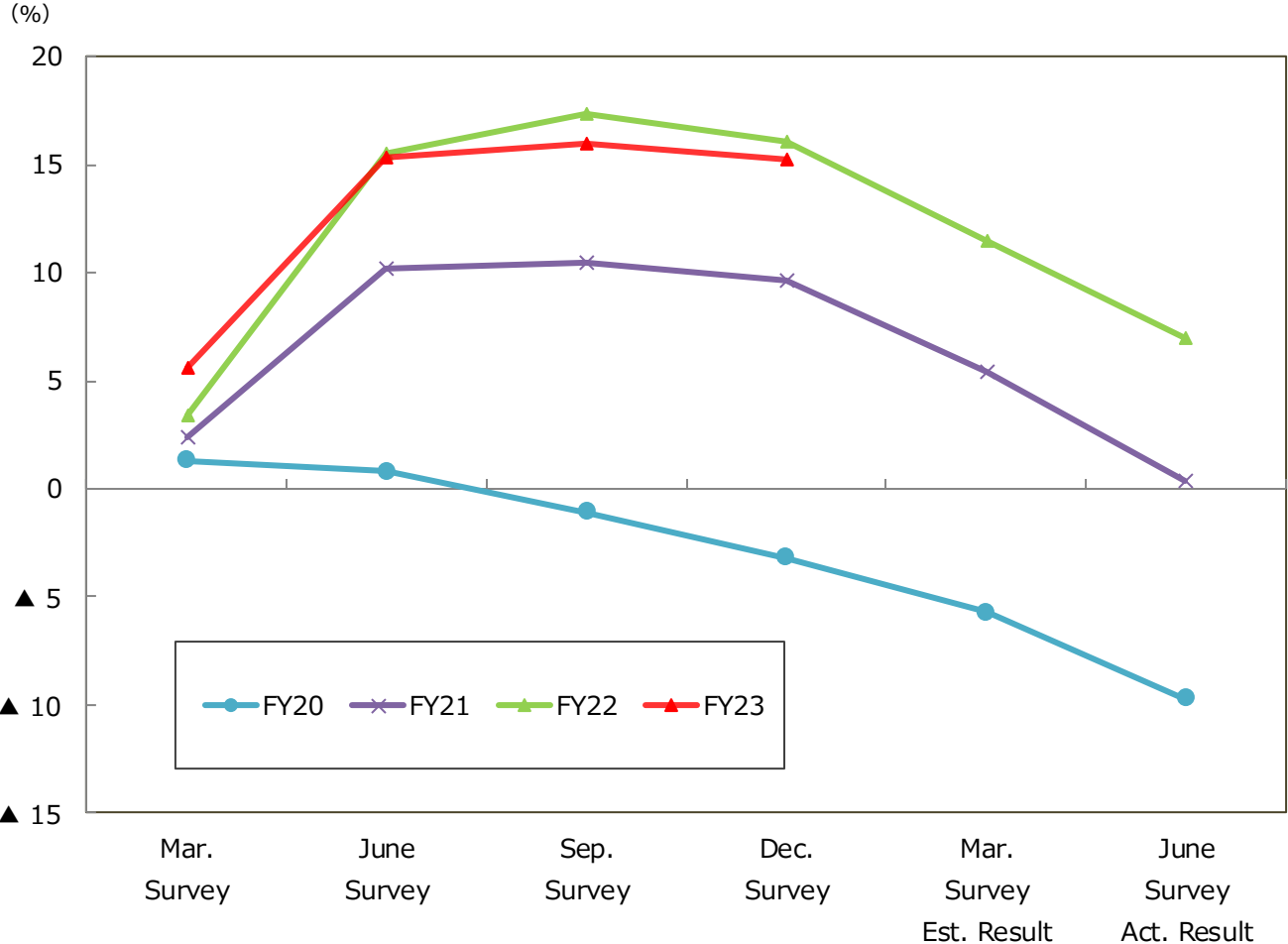
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q4 2023. The orange shadow are periods of economic recession.
 Source: The Bank of Japan, SMDAM

Encouraging CAPEX outlook despite recent weakness in GDP data

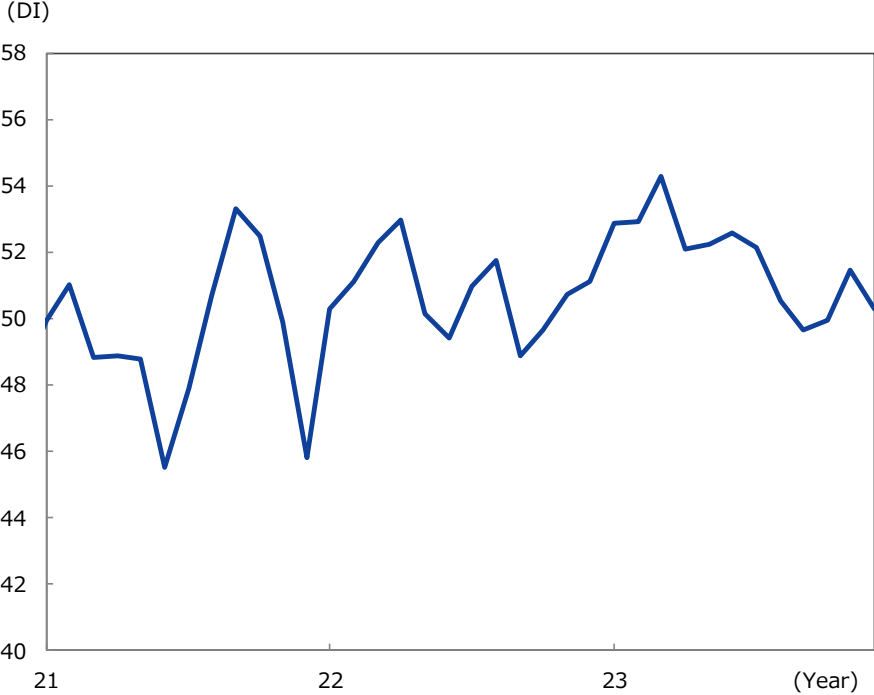
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



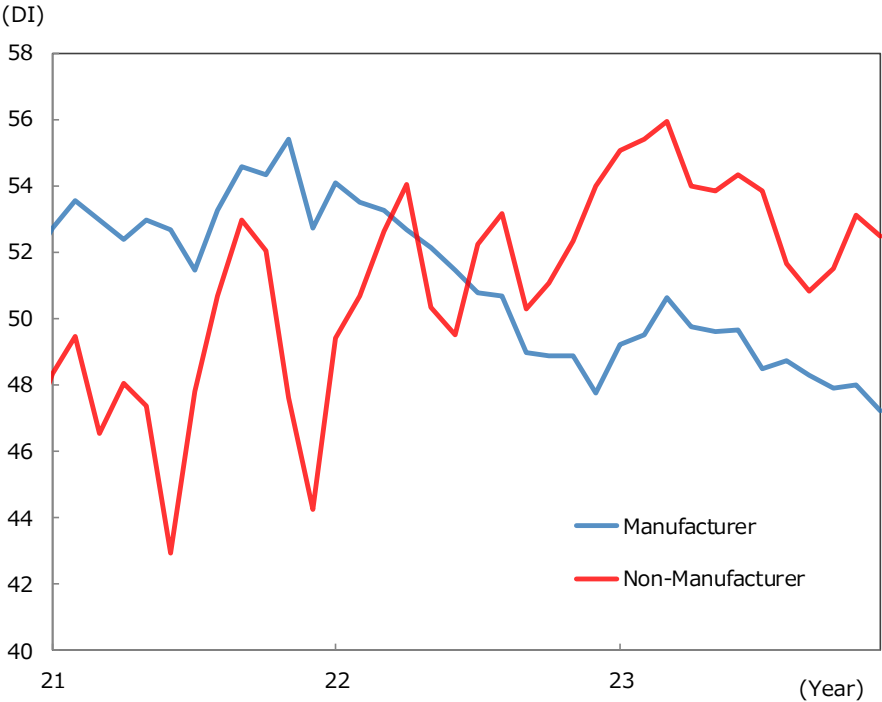
Note: Data is from Q1 FY2020 to Q4 FY2023.
 Source: The Bank of Japan, SMDAM

Shutdown of auto production hit manufacturers

Composite PMI



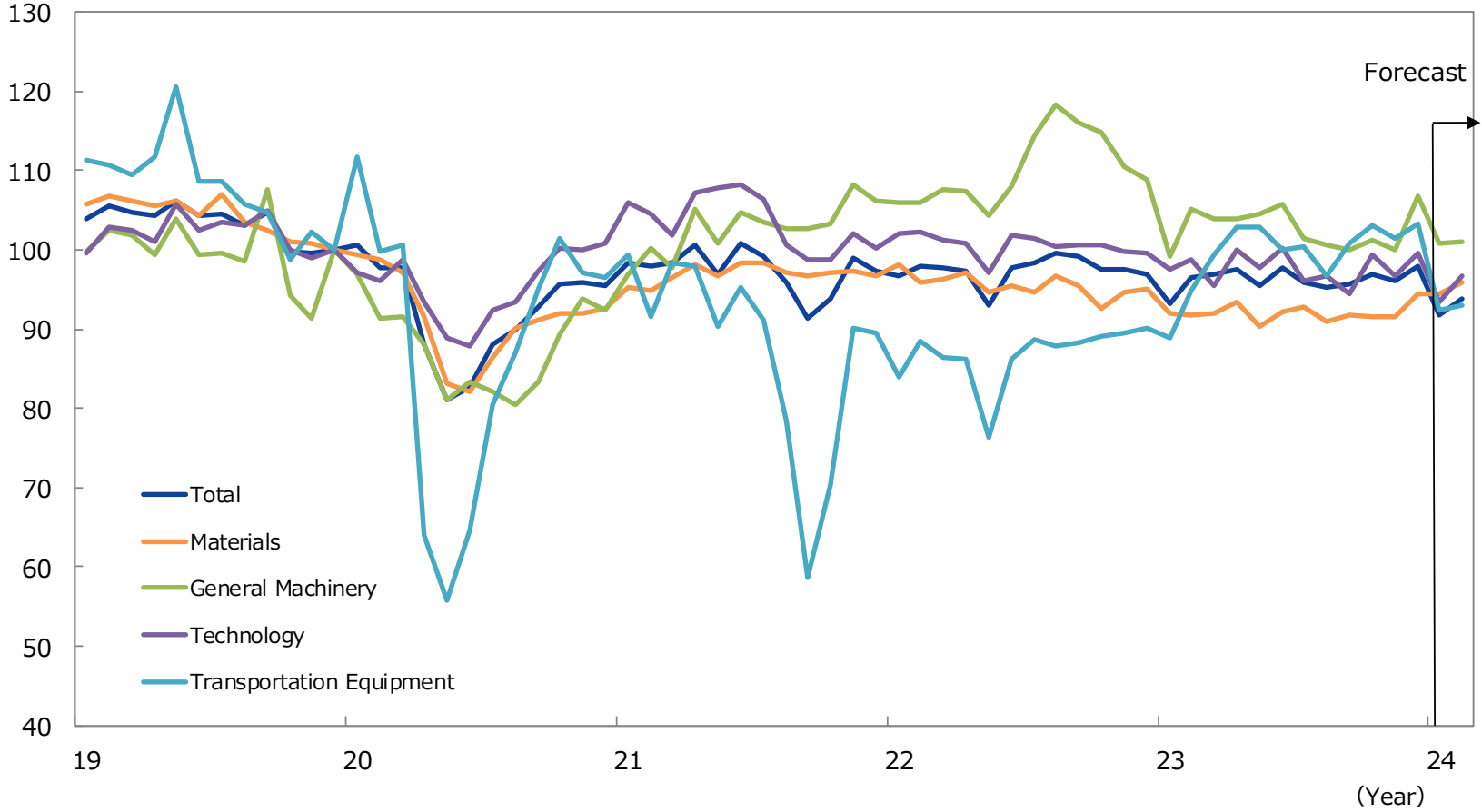
PMI, Manufacturer & Non-Manufacturer



Note: Data is from March 2021 to February 2024.
Source: Bloomberg, SMDAM

Shutdown of auto production hit manufacturers

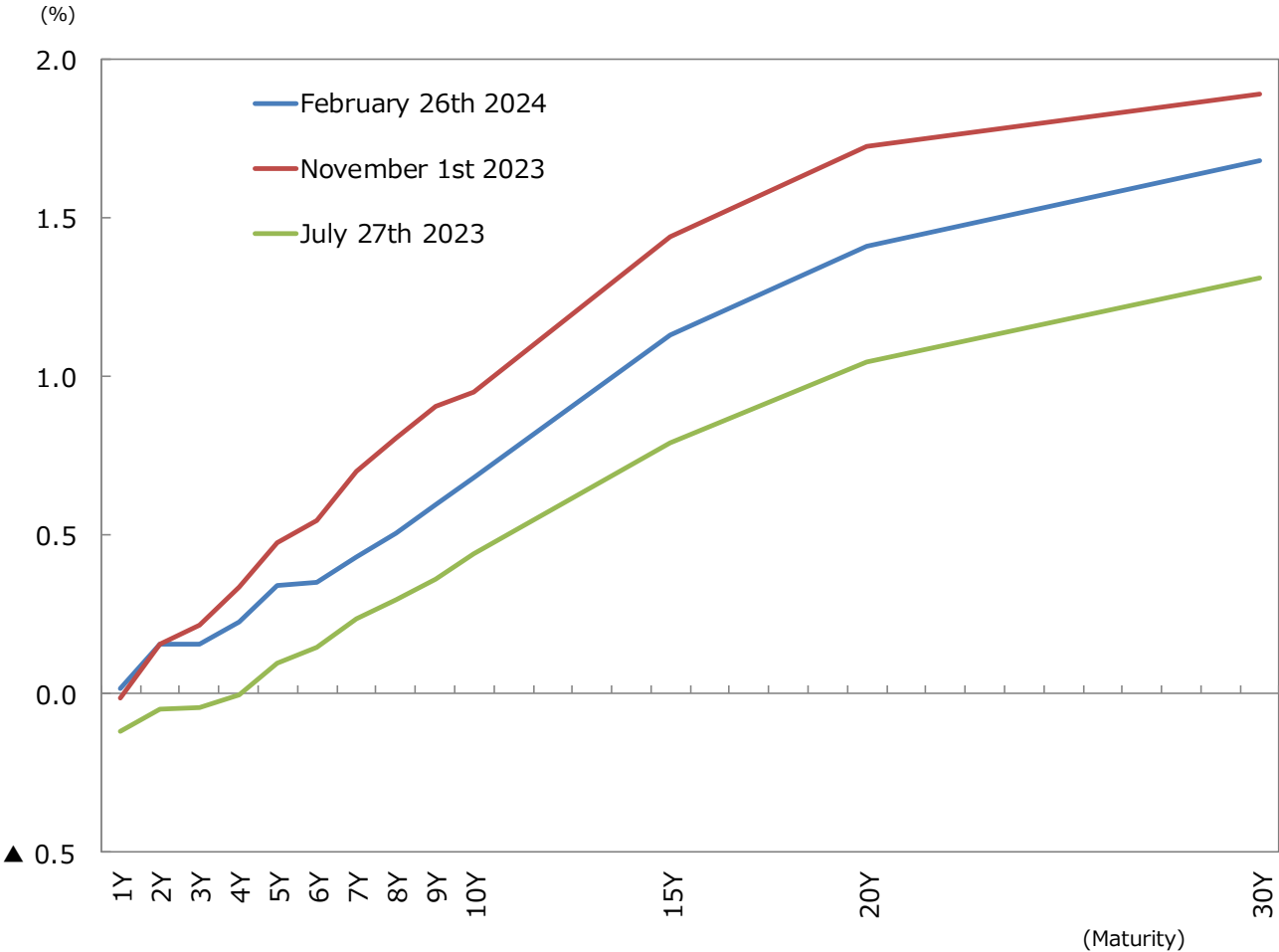
Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to February 2024. Data after January 2024 are forecasts.
Source: METI, SMDAM

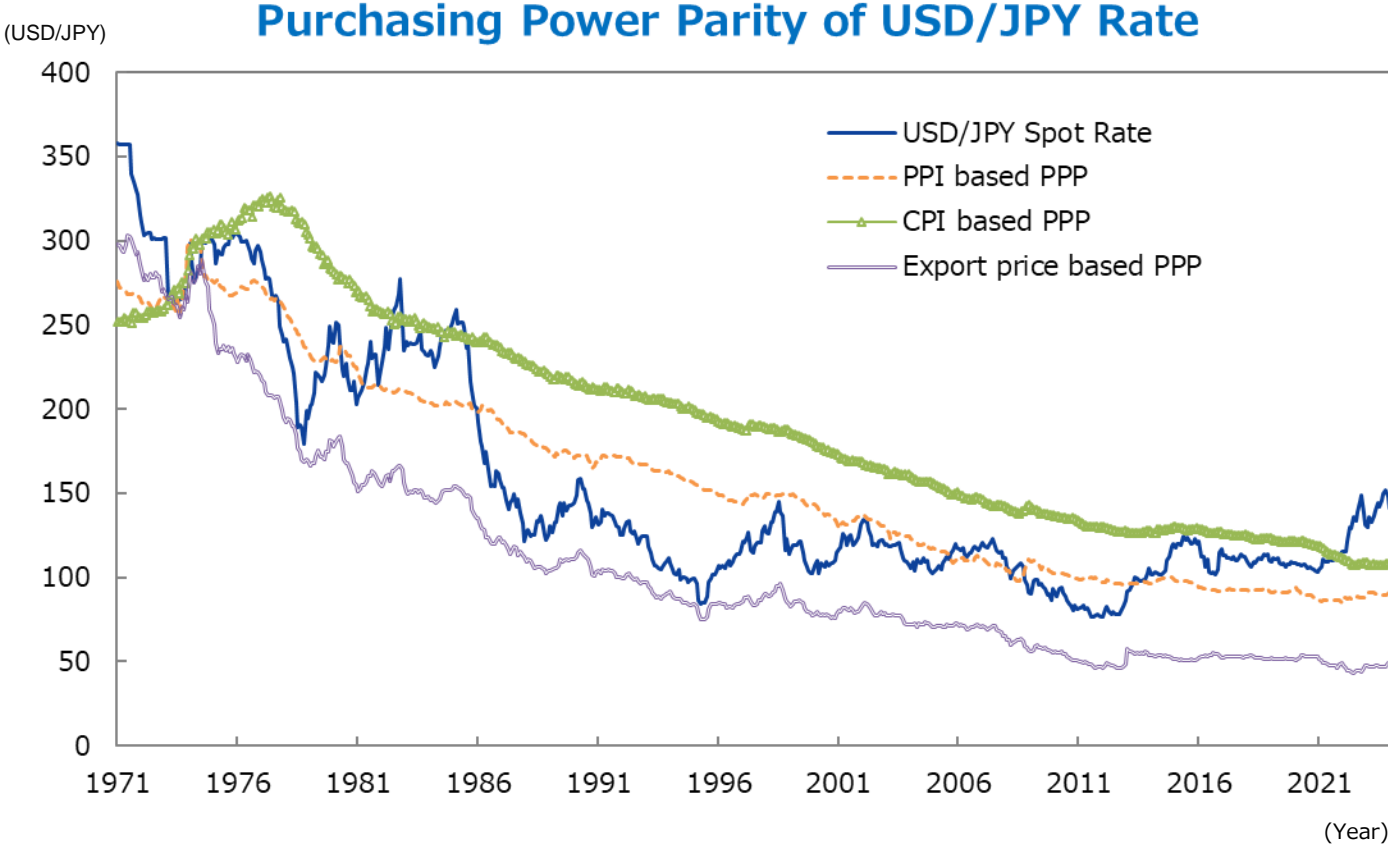
Speculation over BOJ's pivot creates a big swing in the curve

Yield Curve of Japanese Sovereign



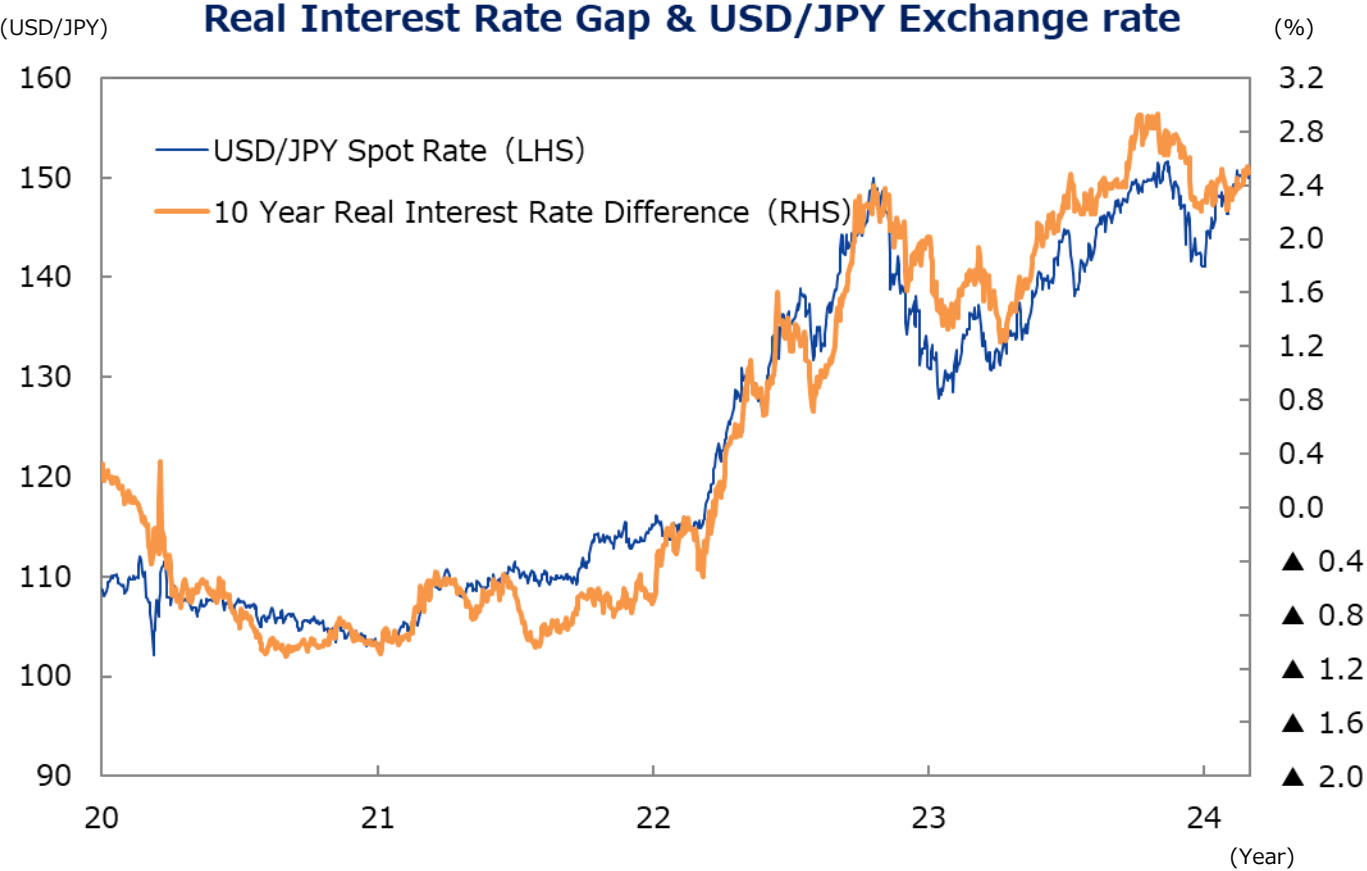
Source: Bloomberg, SMDAM

USD/JPY continues to diverge from purchasing power parity



Note: Data is from January 1971 to January 2024.
Source: DOL, Bank of Japan, SMDAM

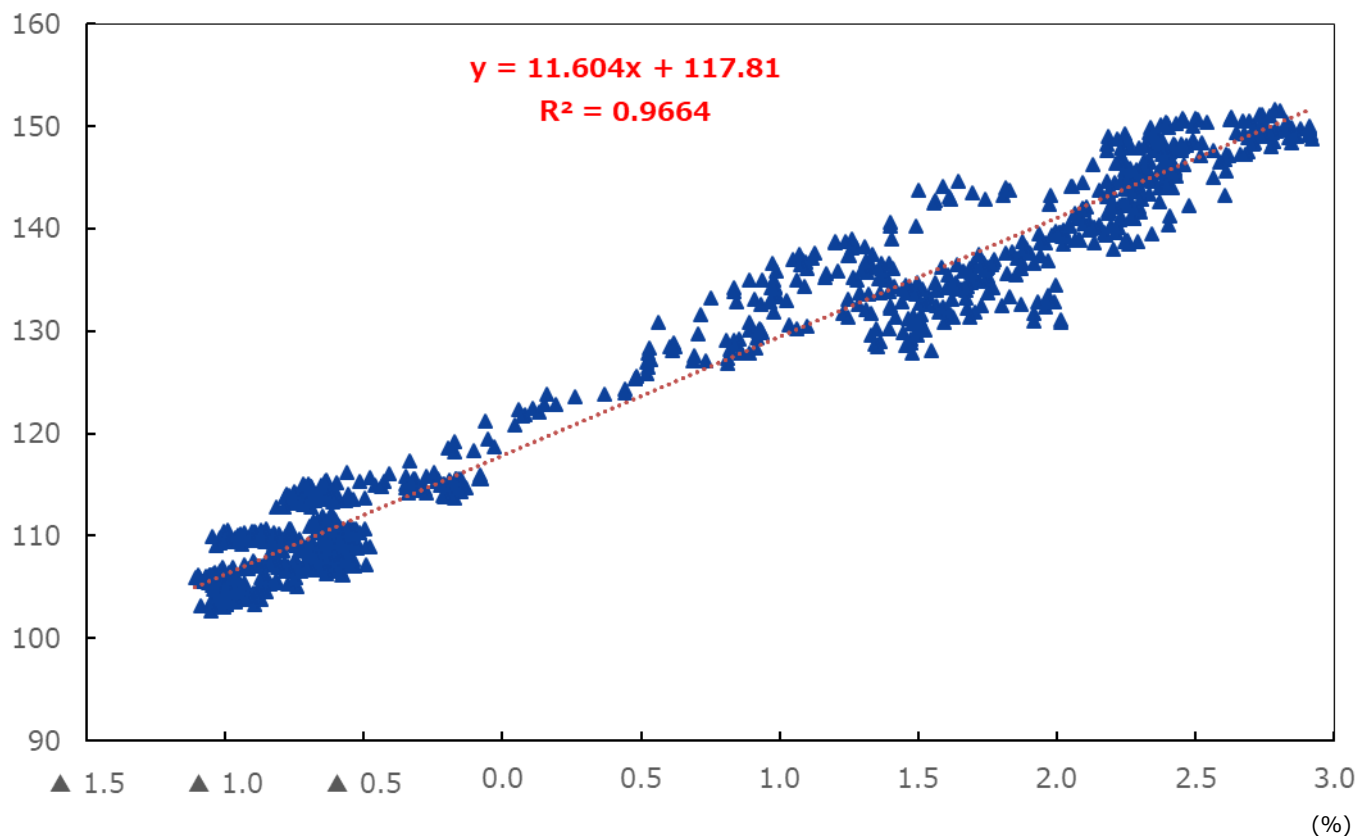
Real yield gap still dominates USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st January 2020 to 29th February 2024.
 Source: Bloomberg, SMDAM

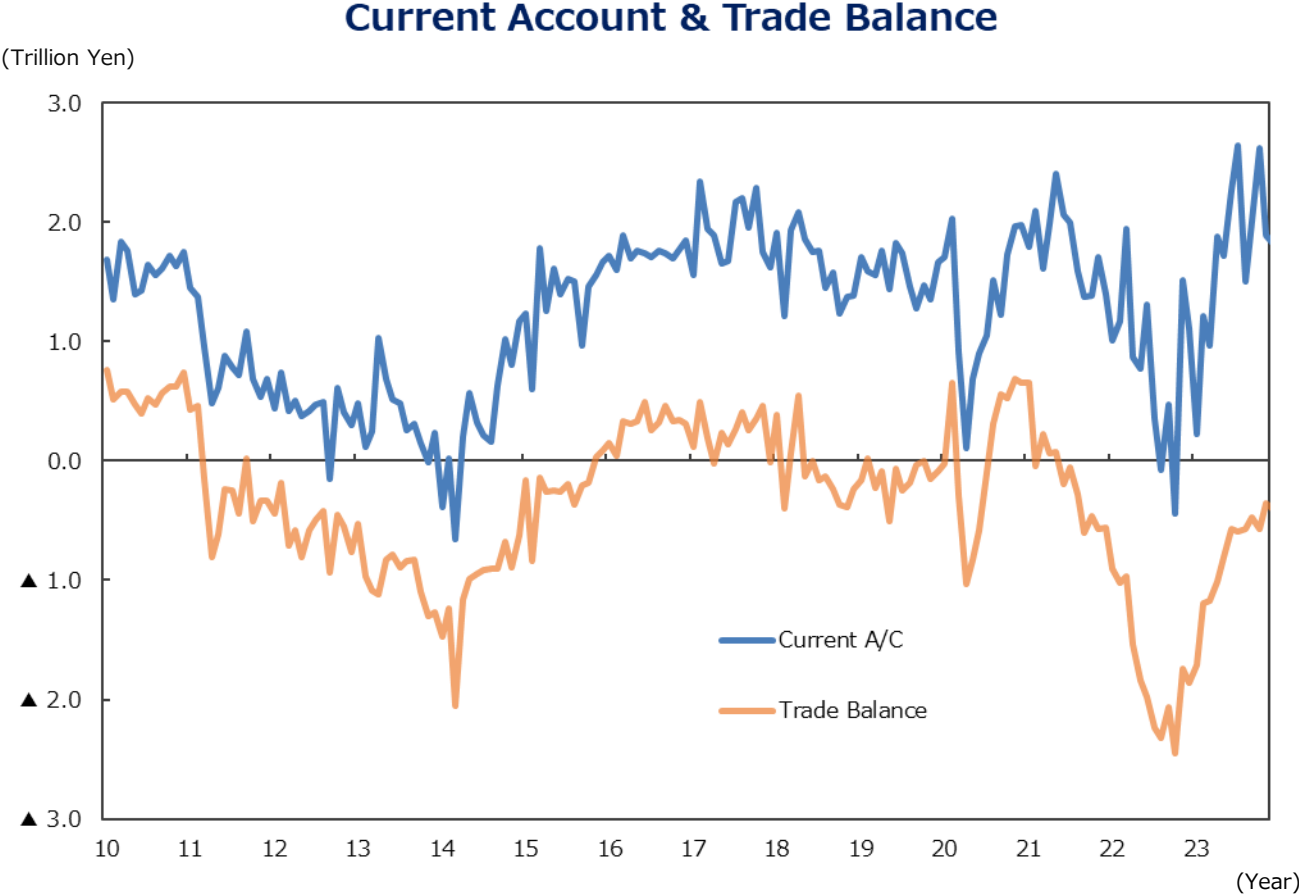
Real yield gap still dominates USD/JPY rate

Correlation between Real Interest Rate Gap & USD/JPY



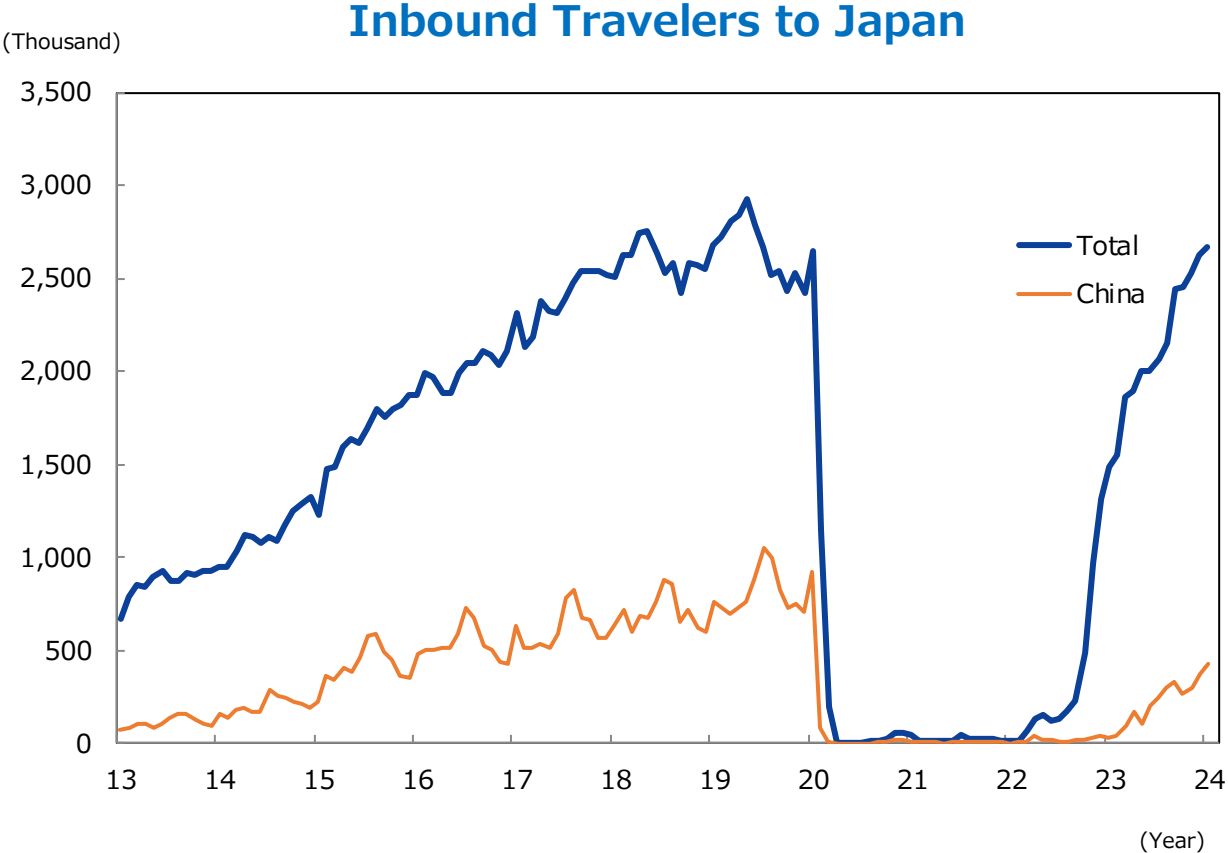
Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2020 to 29th February 2024.
Source: Bloomberg, SMDAM

Trade deficits shrank thanks to falling energy prices



Note: Data is Seasonally adjusted. Data is from January 2010 to December 2023.
Source: MOF, SMDAM

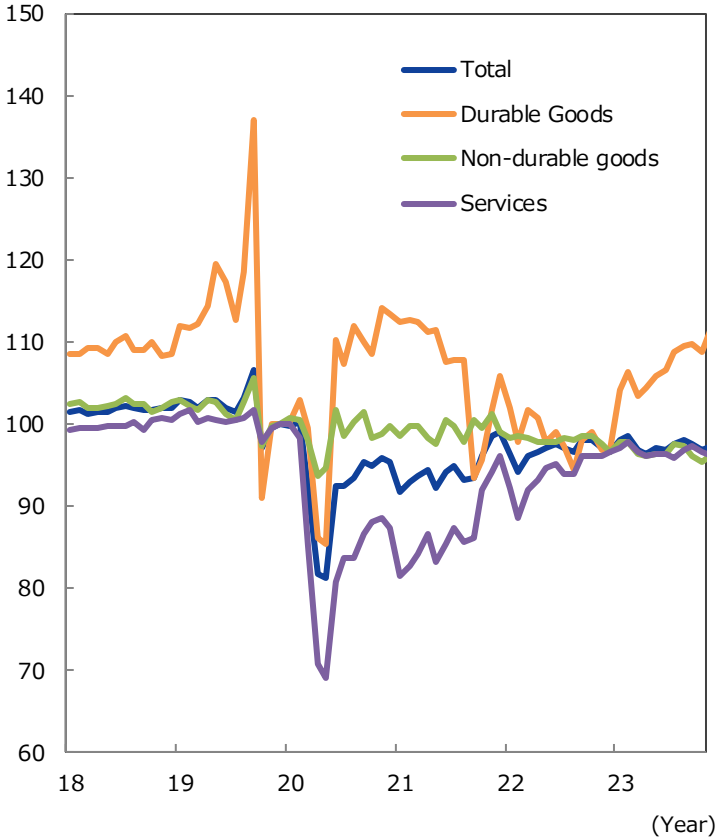
Inbound travel returned to the historical high level



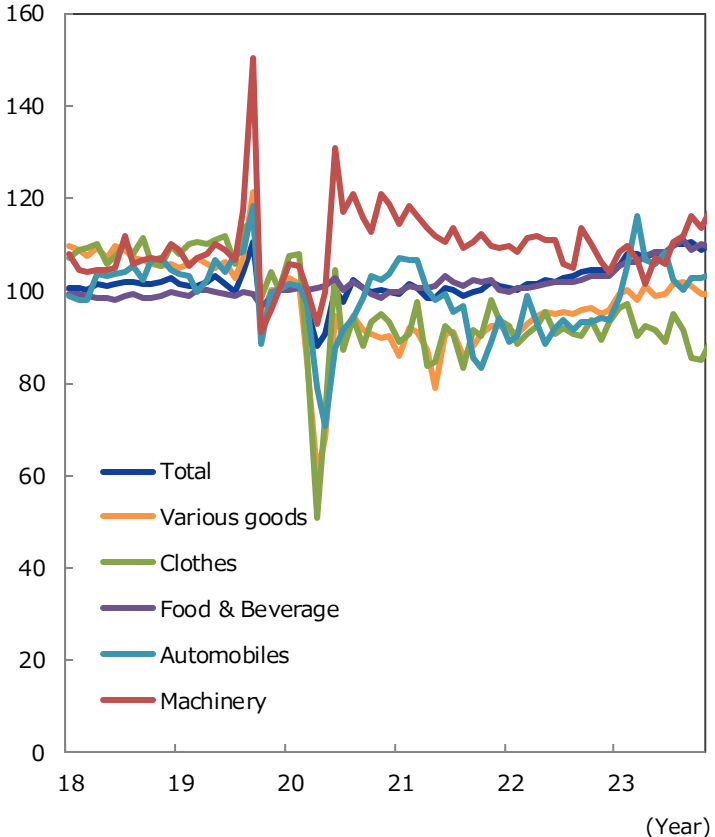
Note: Data is from January 2013 to January 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumers activity lacks momentum owing to falling real income

Consumer Activity Index (Dec. 2019 = 100)



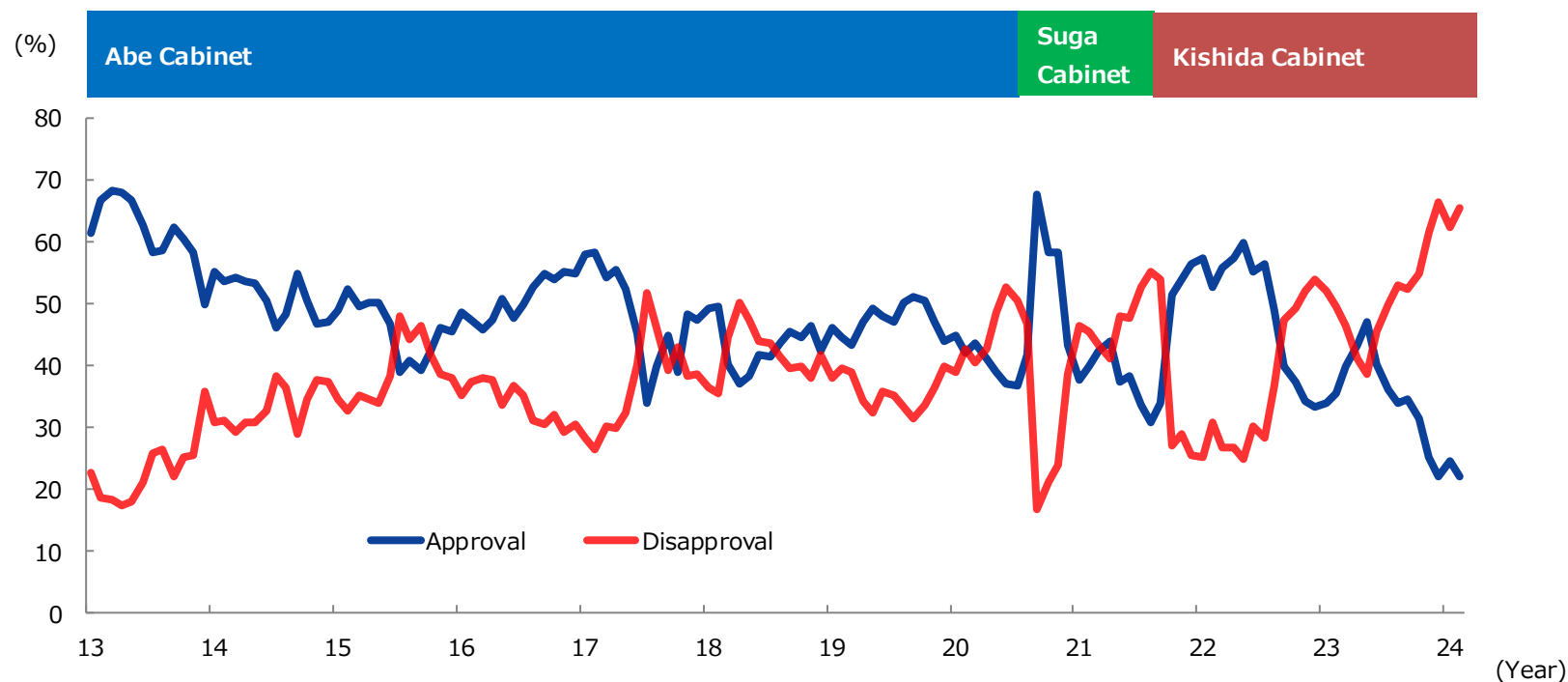
Retail Sales (Dec. 2019 = 100)



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

Alleged violation of Funding Law could be the final blow

Cabinet approval rate



Note: Data is from January 2013 to February 2024.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2024	March	11	Revision of CY 2023 Q3 GDP
		15	Summation of annual spring wage negotiations (first session)
		18-19	Monetary Policy Meeting Enactment of FY 2024 budget and tax reform bills
		1	Start of restrictions on overtime work (logistics, construction, & medical care)
	April	25-26	Monetary Policy Meeting
		28	House of Representatives by-election Release of BOJ view report
			Multi-faceted review of Second workshop
	May		
	June	13-14	Monetary Policy Meeting Cabinet decision on the broad policy End of the ordinary Diet session
July	30-31	Monetary Policy Meeting Summation of annual spring wage negotiations (final session)	
September	19-20	Monetary Policy Meeting	
		30	Termination of the presidency of the LDP
October	30-31	Monetary Policy Meeting	
December	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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