



# Outlook for Japanese Stock Market & Economy

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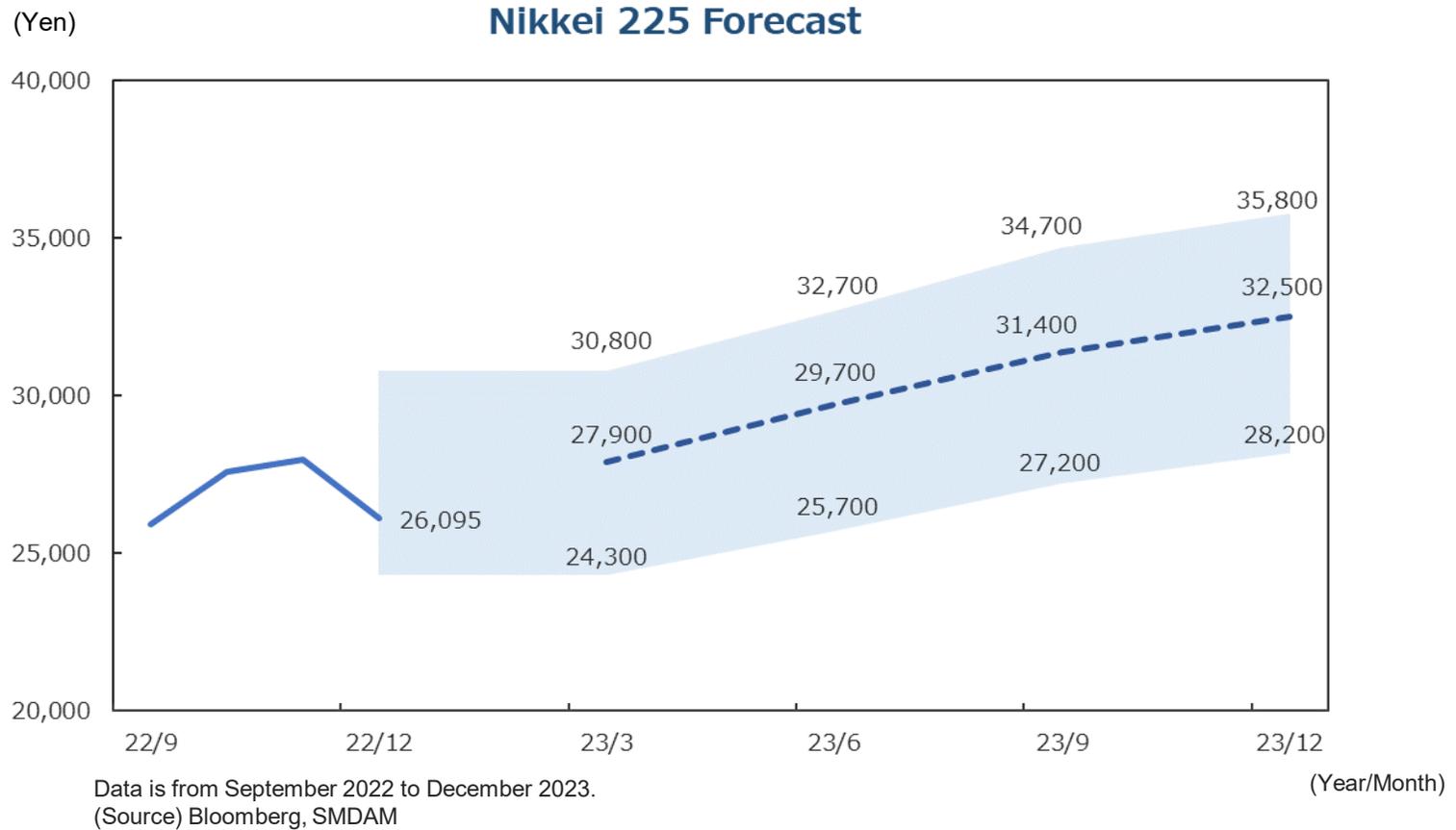
# Outlook for Japanese Stock Market

# Market Outlook

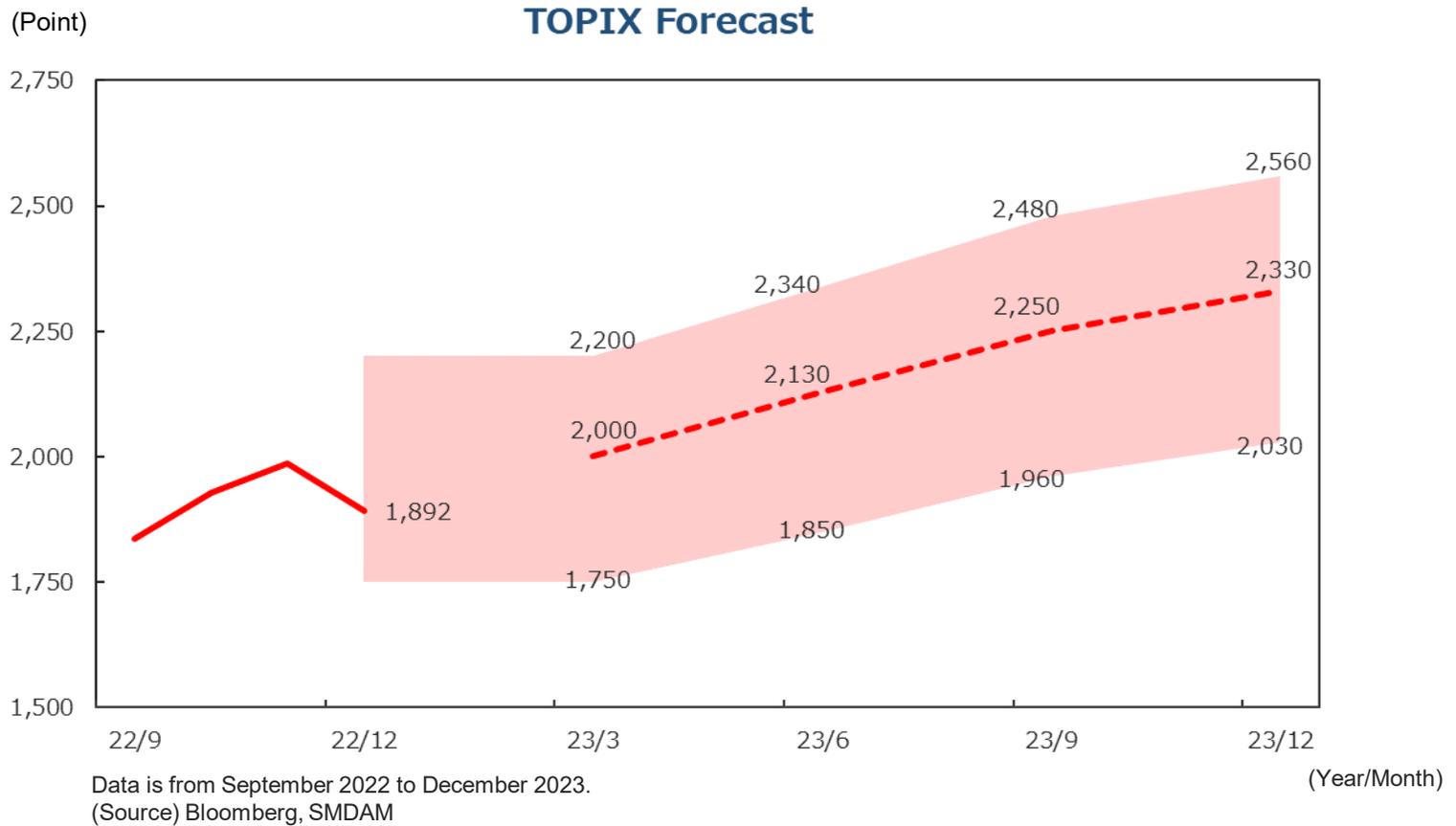
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- We expect the market will resume its bullish trend after confirming the peak of FED tightening and the trough of the global economy.
- We foresee the market will be in a trading range in the near future. While stable domestic demand and the recovery of the Chinese economy could support the market, the sluggish global economy could weigh on investors' appetite for risk taking for some time.
- We have maintained our TOPIX target at 2,330 and that of the Nikkei 225 at 32,500 as of the end of 2023.
- We expect a strong tailwind to the domestic consumer sector if Chinese travellers will come back to Japan after relaxing the “Zero COVID-19 policy” and achieving herd immunity.

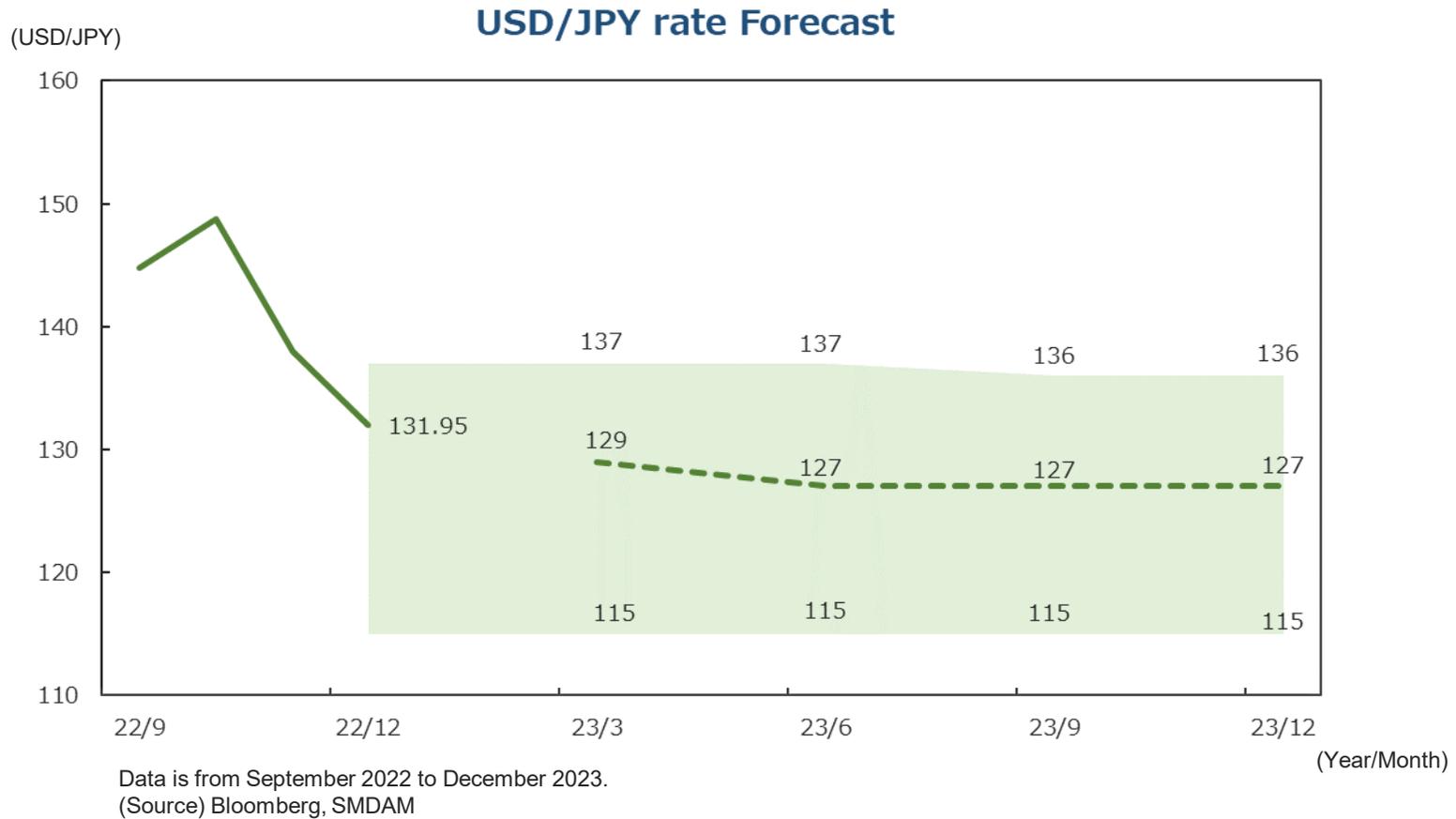
# Equities to resume bullish trend after range trading



# Equities to resume bullish trend after range trading



# End of FED tightening and BOJ policy change push USD lower



# Upside / Downside risk scenarios

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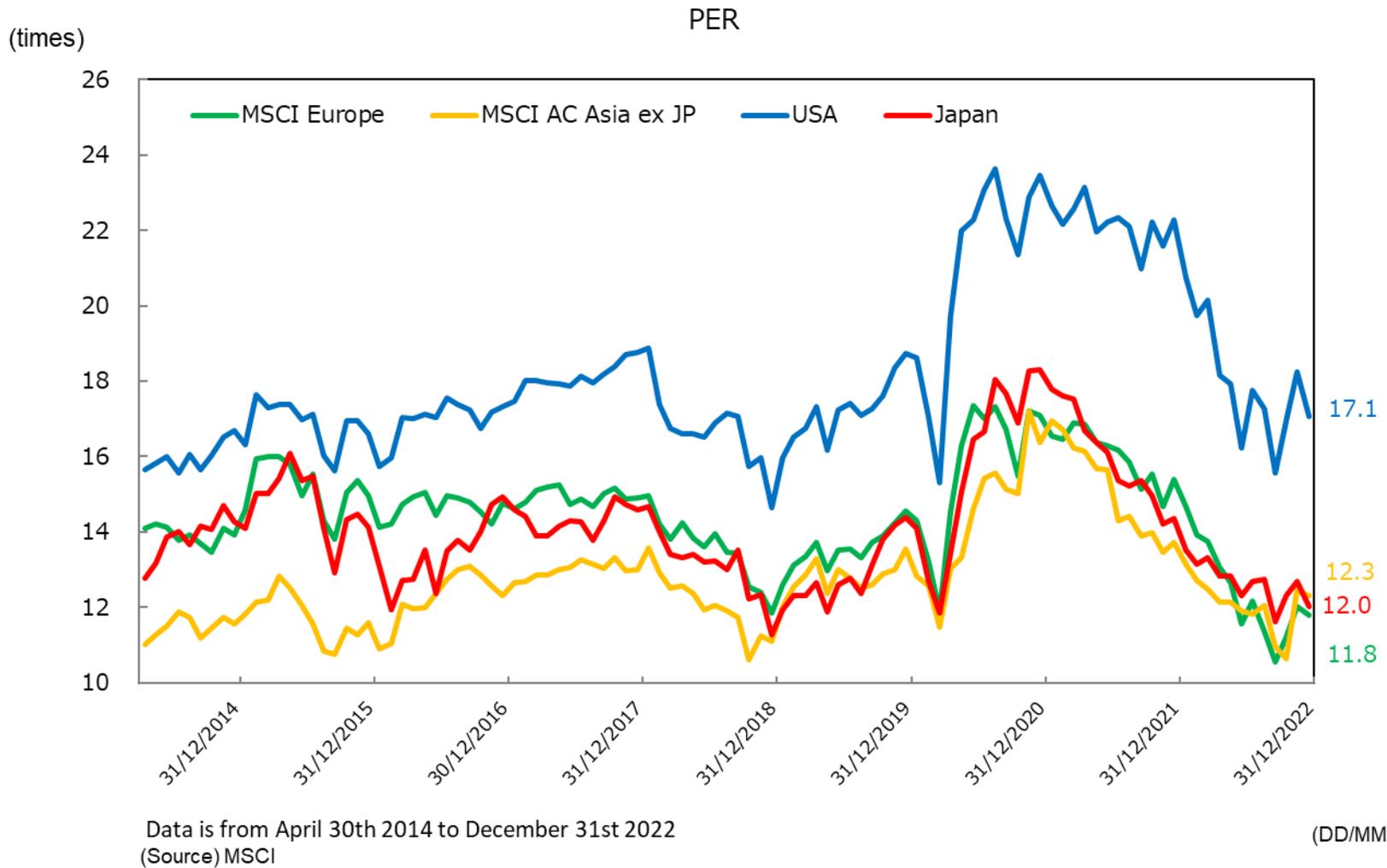
## ■ Upside Risks

- FED pivot and monetary easing
- Strong recovery in Chinese economy

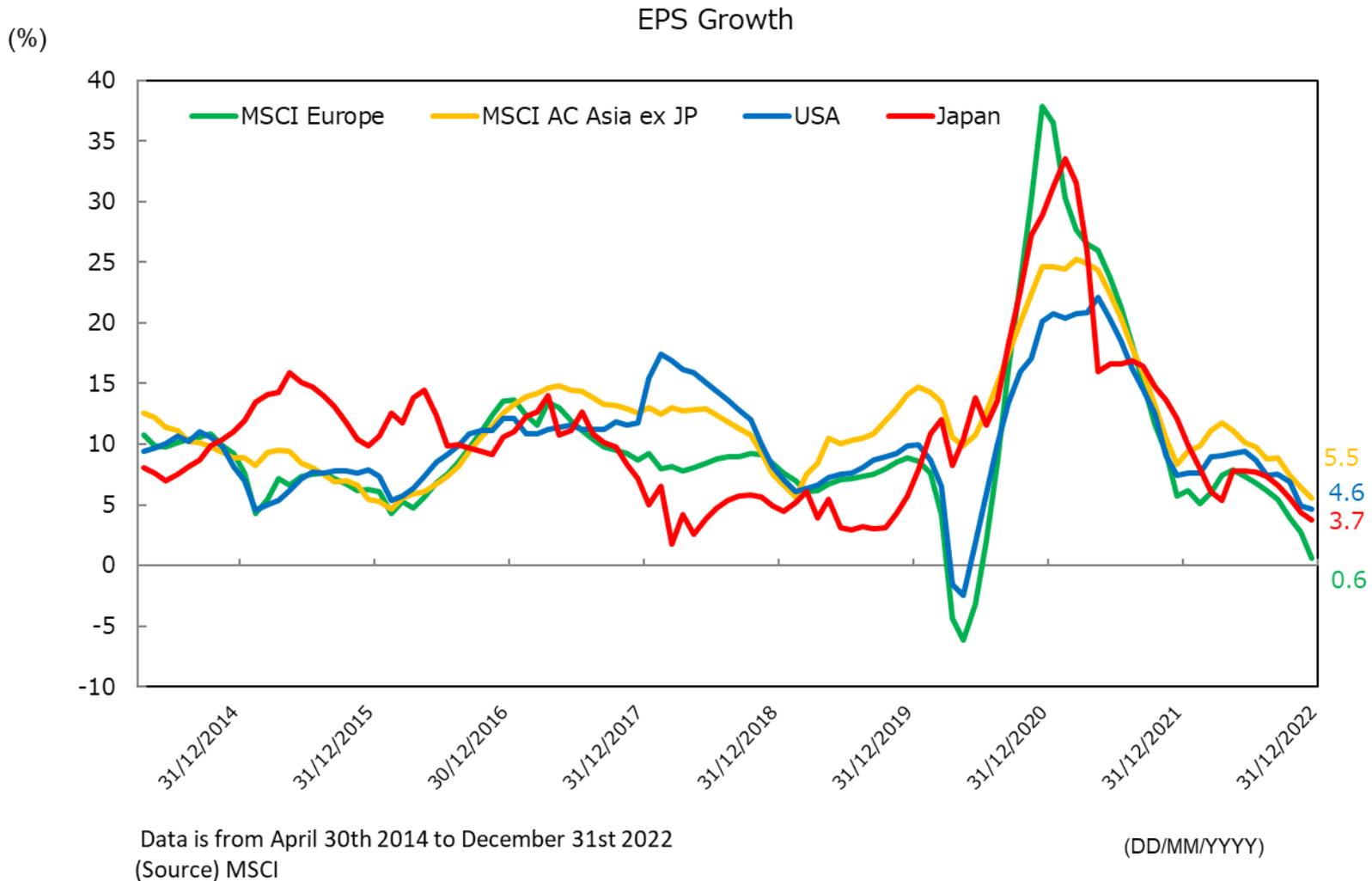
## ■ Downside Risks

- Excessive JPY appreciation and negative impact on earnings forecasts
- Fiscal austerity
- Resurgence of inflation caused by the recovery in Chinese economy

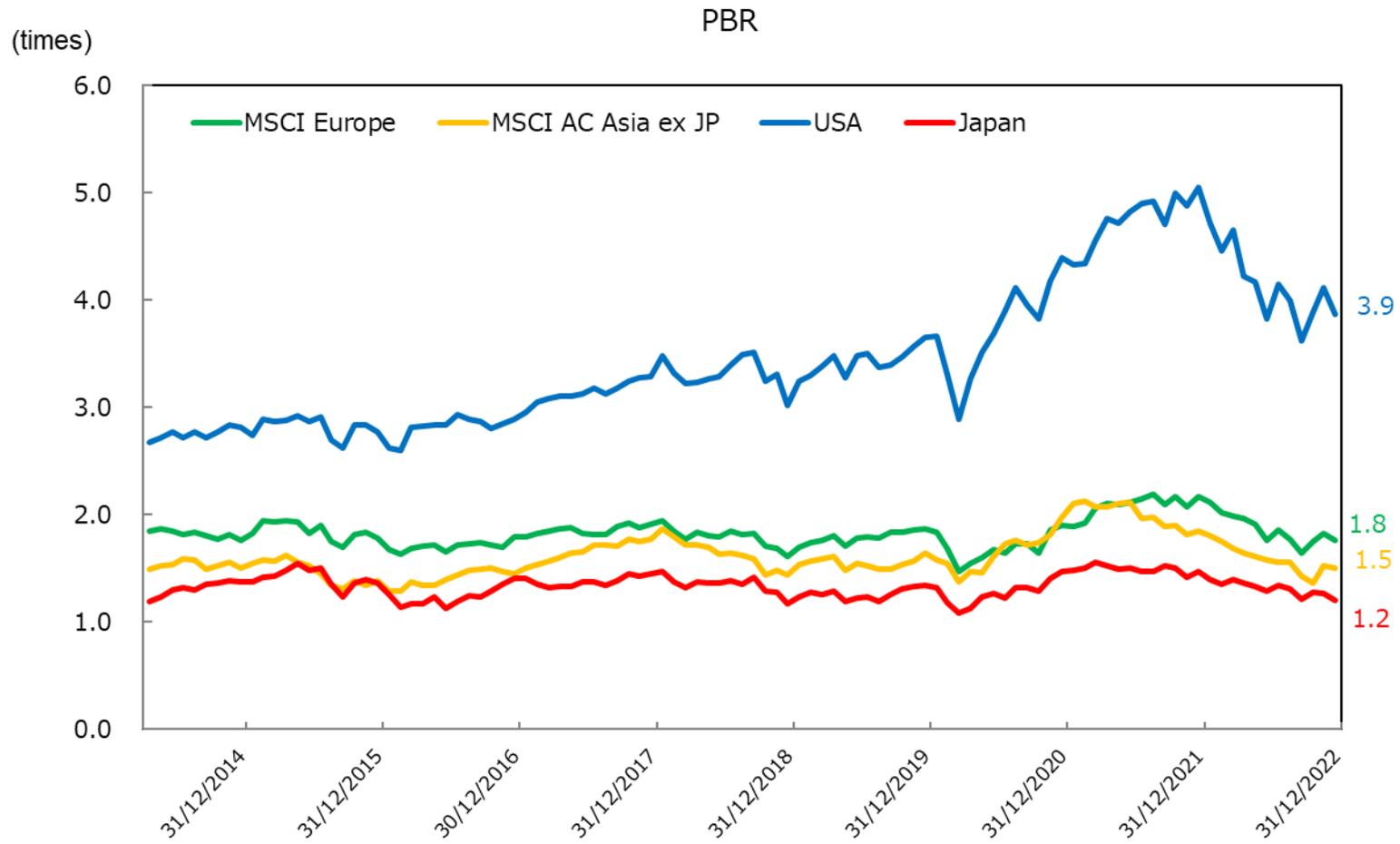
# PER remains at historically low level owing to slowing economy



# USD/JPY correction and gloomy outlook hit EPS growth



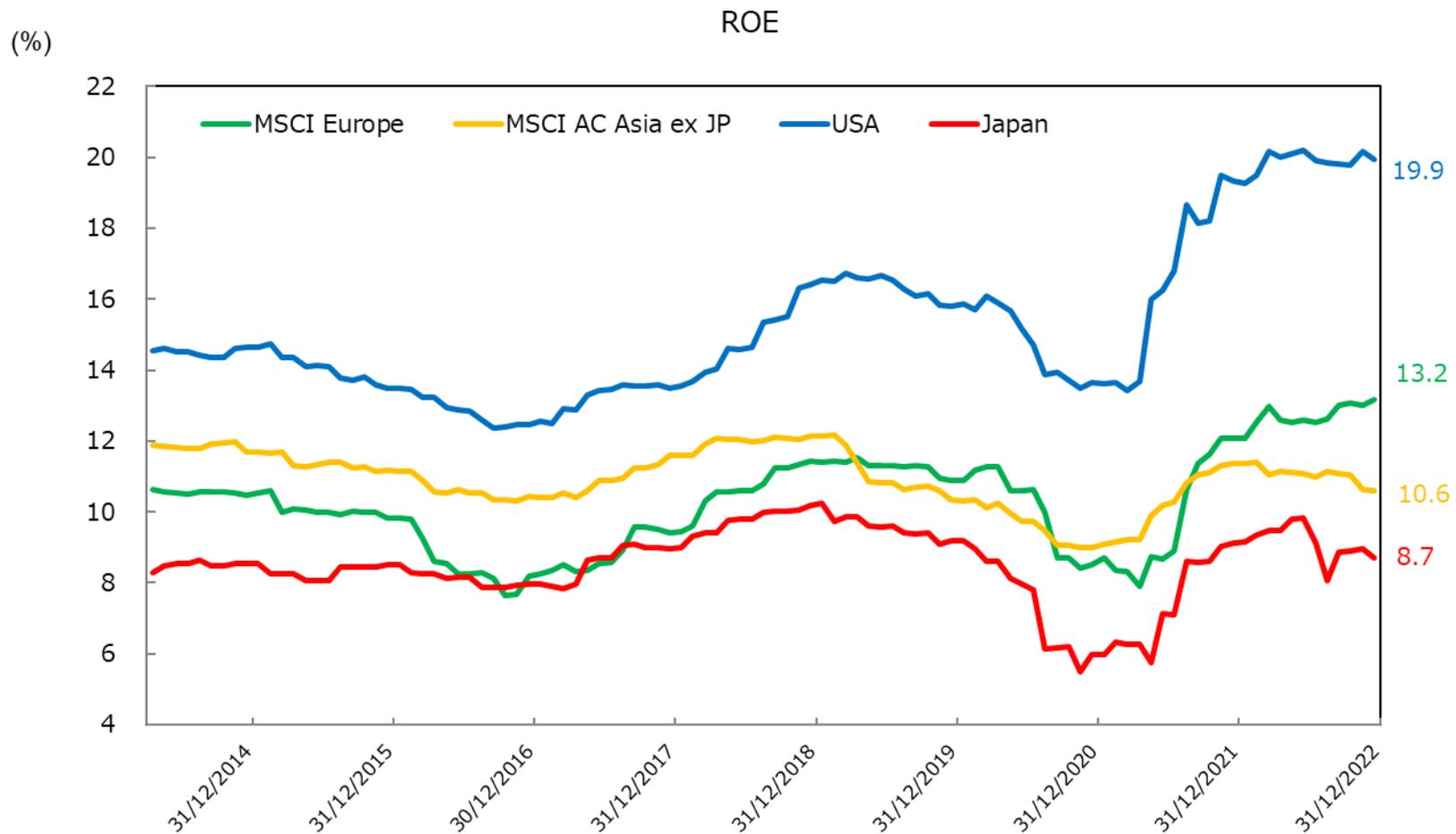
# Gloomy outlook and huge retained profits makes Japan PBR lower



Data is from April 30th 2014 to December 31st 2022  
(Source) MSCI

(DD/MM/YYYY)

# Japan's ROE plateaus after sharp correction of USD/JPY rate



Data is from April 30th 2014 to December 31st 2022  
 (Source) MSCI

(DD/MM/YYYY)

# JPY appreciation and slowing economy pushes EPS revision lower

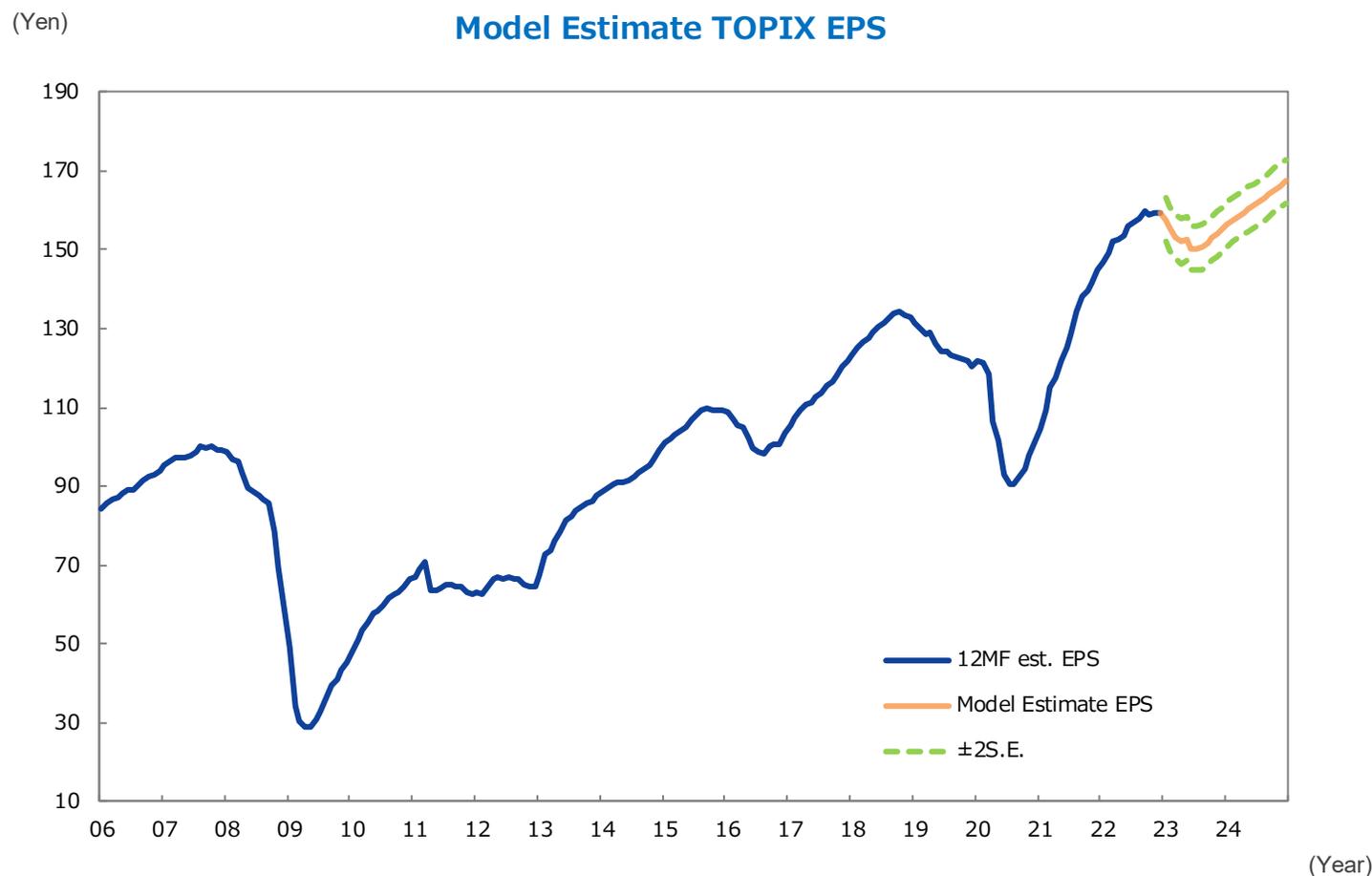
TOPIX Revision Index



Data is from December 25th 2017 to January 16th 2023  
(Source) Datastream, IBES

(YY/MM)

# Macro model indicates EPS to recover after temporary pause

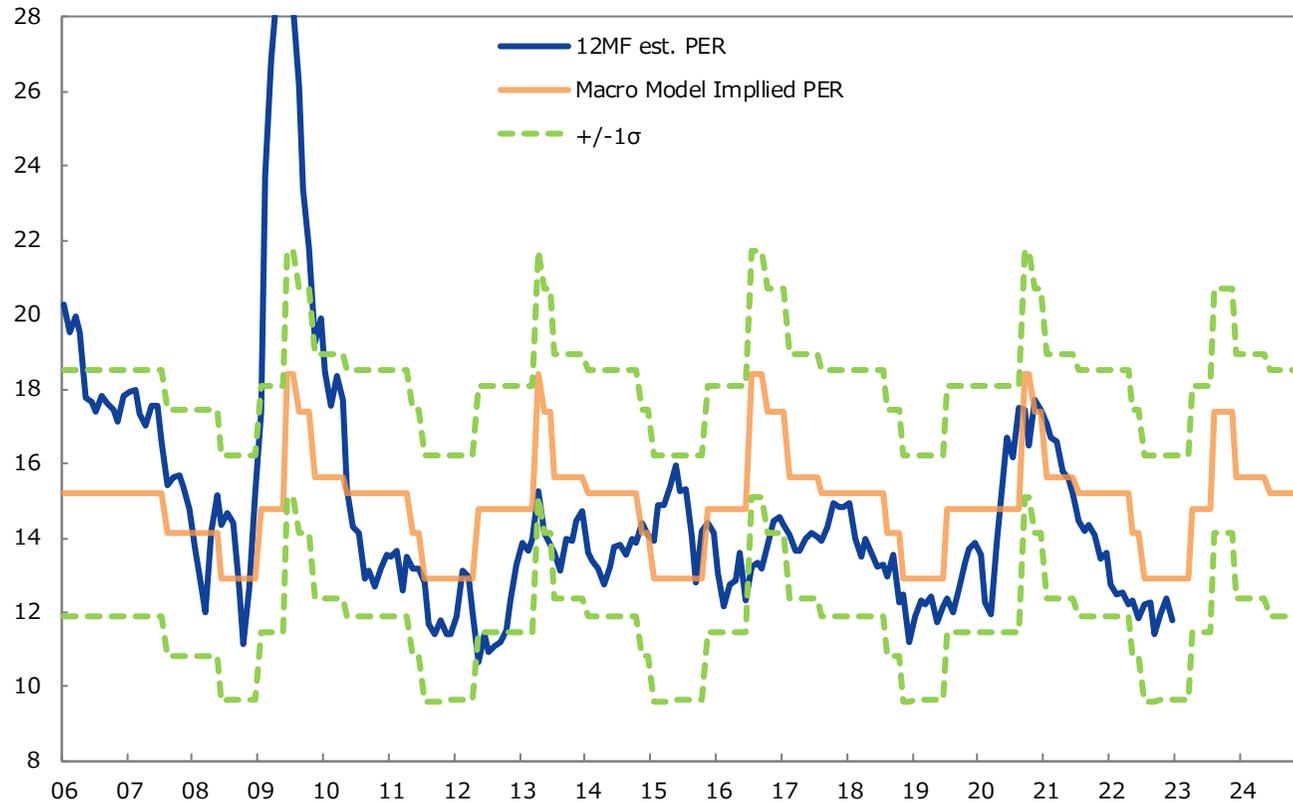


Note: Consensus data is from January 2006 to December 2022,  
Model estimate Data is from January 2023 to December 2024.  
Source: SMDAM

# Model indicates PER to rebound from rock bottom

(Times)

## Macro Model Implied TOPIX PER

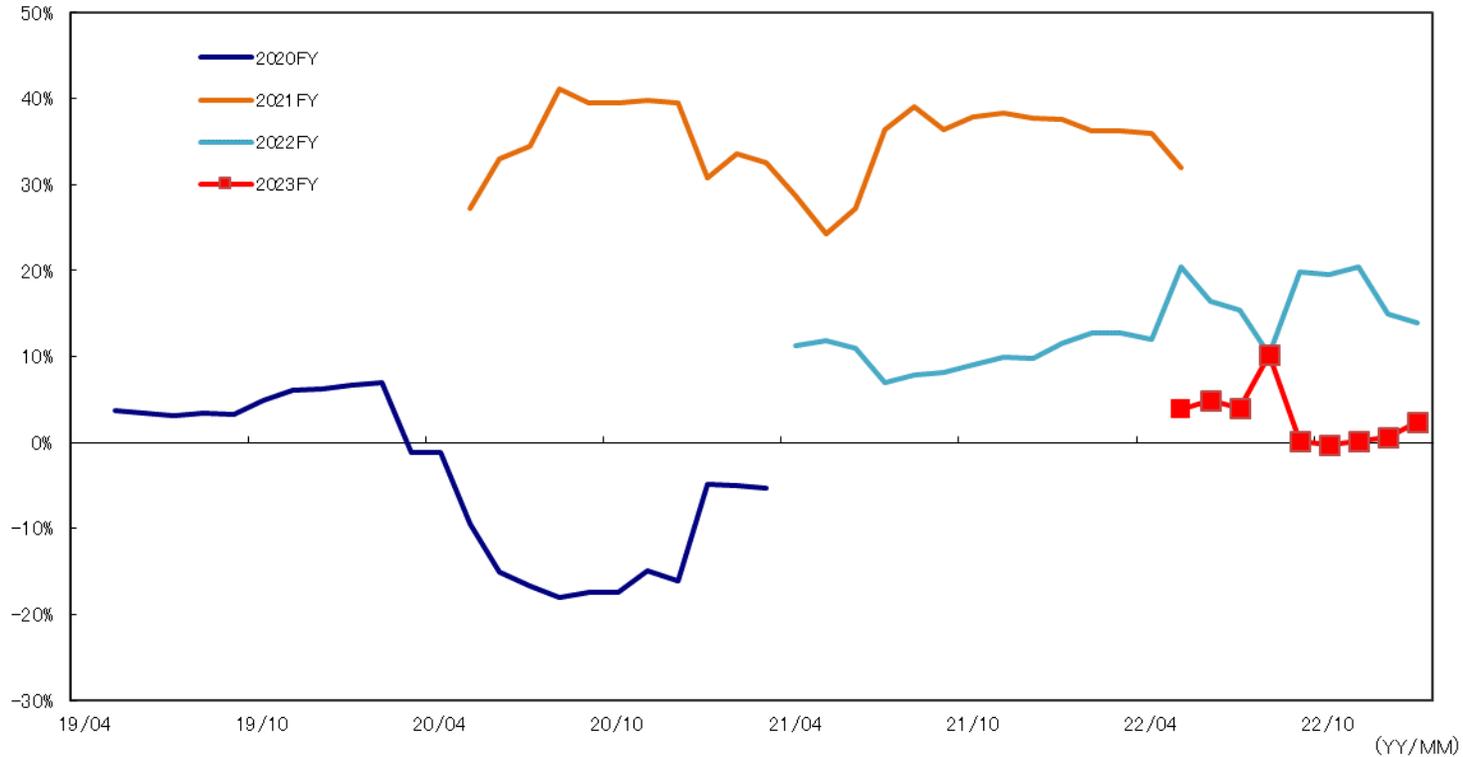


(Year)

Note: Consensus data is from January 2006 to December 2022,  
Model estimate Data is from January 2023 to December 2024.  
Source: SMDAM

# Bottom up research indicates marginal profit growth in FY 2023

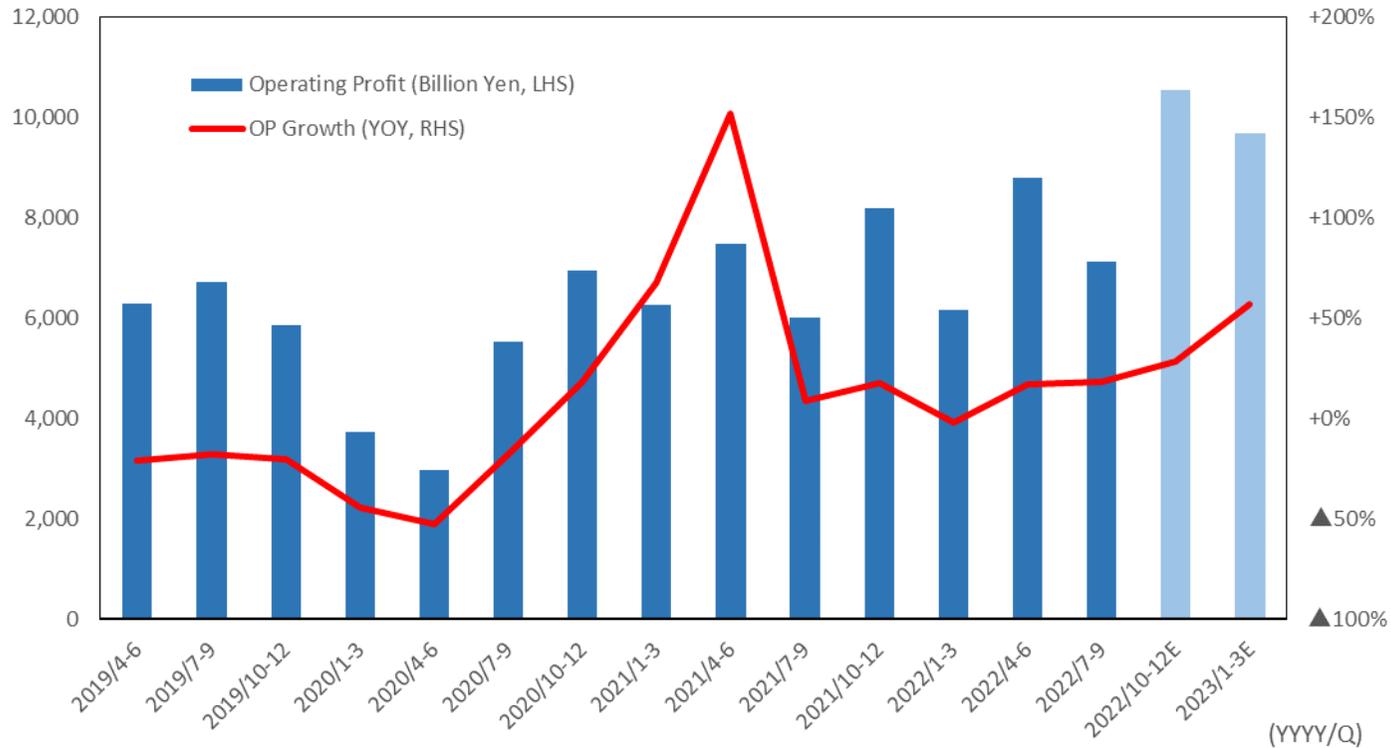
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 16th January 2023, 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
<b>Total</b>	<b>322</b>

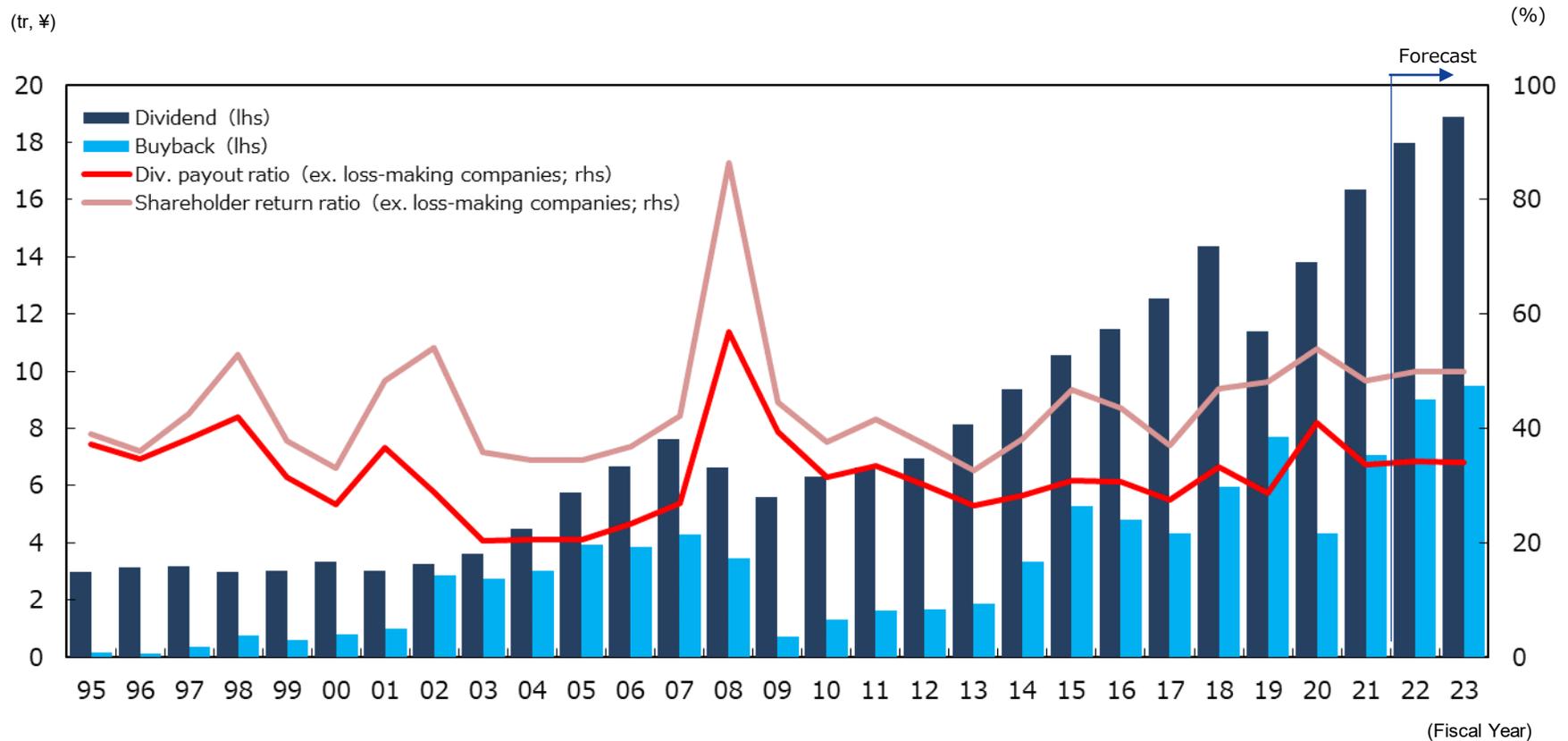
note: As of 31st December 2022

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. Such holdings implicitly provide 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 rising beyond 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

# Expectation of FED pivot lifts large cap growth

## Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
<b>RN Japan Equity</b>	<b>3.44</b>	<b>-0.47</b>	<b>2.91</b>	<b>0.95</b>	<b>4.26</b>	<b>12.80</b>	<b>2.43</b>
Total Value	4.27	1.92	1.95	6.29	20.63	14.76	-2.15
Top Cap Value	6.05	3.62	2.61	7.50	28.77	26.57	10.63
Large Cap Value	4.75	2.14	2.23	6.37	22.83	16.88	0.53
Mid Cap Value	3.05	0.22	1.74	4.89	15.68	4.51	-12.46
Small Cap Value	2.21	0.94	0.69	5.91	11.20	5.63	-13.52
Micro Cap Value	4.19	3.78	1.95	7.42	12.06	4.77	-13.36
Total Growth	2.92	-2.67	3.84	-4.12	-9.77	9.46	5.86
Top Cap Growth	4.45	-3.08	5.25	-6.22	-9.35	12.23	11.69
Large Cap Growth	3.19	-2.99	4.16	-4.82	-10.07	10.78	7.53
Mid Cap Growth	0.97	-2.85	2.20	-2.20	-11.26	8.23	1.12
Small Cap Growth	0.69	0.05	1.44	2.04	-7.01	-1.54	-7.50
Micro Cap Growth	2.37	2.35	2.09	4.10	-7.68	-0.11	-6.47
Top Cap Total	5.00	-0.18	4.08	-0.32	5.89	18.10	10.40
Large Cap Total	3.80	-0.63	3.25	0.36	4.21	14.32	4.68
Mid Cap Total	1.95	-1.33	1.96	1.42	1.84	9.11	-3.24
Small Cap Total	1.51	0.46	0.99	4.39	4.23	3.52	-10.34
Micro Cap Total	3.46	3.17	1.99	6.25	5.51	4.01	-9.73

Note : As of 23rd January 2023  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is picking up.** As Japan shifts to a post-Covid lifestyle, the rising number of infections has had marginal impact on people's activities and consumer spending has been stable. Plans for CAPEX are strong thanks to pent-up demand, "de-carbonisation" and "digitisation". Inbound travellers' consumption has been recovering rapidly since October 22 after relaxing the border restrictions against the patients of Covid-19.
- **Inflation is also picking up.** The nationwide core CPI for November rose +3.7% YoY, up from +3.6% for the previous month. Tokyo Core CPI for December also rose +4.0% YoY from + 3.6% for the previous month. Although import prices have peaked, they are still currently driving cost-push inflation.

## [Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2022 at +1.7%, whilst we have reduced our forecasts for FY 2023 from +1.3% to +1.0% and FY 2024 from +1.2% to +1.0% respectively.** The downward revisions for FY 23 and FY 24 mainly reflect changes in foreign exchange assumptions (from 137.5 JPY per 1 USD to 127.5 JPY) and reductions in assumptions for inbound consumption. Although we have lowered the forecast for the annual growth rate, we have maintained our qualitative view of the economy. We expect the economic recovery will continue in FY 22 thanks to CAPEX, inbound consumption and economic stimulus measures. On the other hand, the economy is expected to slow in the first half of FY 23 due to the worsening overseas economy. After that, we expect a gradual recovery in the domestic economy as well as a recovery in overseas economies.
- ② **We have raised our core CPI forecast for FY 2022 from +2.7% to +2.9%, while we have lowered our estimate for FY 2023 from +2.1% to +2.0% and that for FY 2024 from +1.3% to +1.1%.** The upward revision for FY 22 takes into account higher food prices. On the other hand, the downward revisions for FY 23 and FY 24 were mainly due to changes in foreign exchange assumptions. Core CPI is likely to rise to the 4% level for the time being. However, the government will implement measures to reduce the burden of electricity and gas bills from February 2023 and cost-push pressures are likely to ease gradually. We maintain our view that core CPI will slow and fall below +2%.

# Current status & Outlook of Japanese economy

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- ③ **PM Kishida seems to maintain his accommodative economic policy.** In October last year, the cabinet approved a comprehensive economic package to overcome high inflation and revive the economy. This was a massive economic package, with national and local government expenditures totaling 37.6 trillion JPY. However, in the medium term, we should pay attention to the risk of raising awareness of fiscal consolidation by PM Kishida's cabinet. The government is now planning to finance part of the increase in defence spending with corporate tax increases.
  
- ④ **We expect the Bank of Japan will change its yield curve control policy (YCC), by widening the control range from  $\pm 0.5\%$  to  $\pm 1.0\%$  in the second quarter of FY 2023 after Governor Kuroda's term ends.** The BOJ widened its YCC range in December 2022 from  $\pm 0.25\%$  to  $\pm 0.5\%$ . The abrupt policy change is believed to have been motivated by PM Kishida's administration, which views rigid monetary easing as problematic. The BOJ is expected to carefully monitor the effects of the recent change in monetary policy until April 2023, when Kuroda's tenure will end. The possibility of abolishing the YCC in the near future is not likely owing to the absence of prospects for achieving the 2% price stability target.

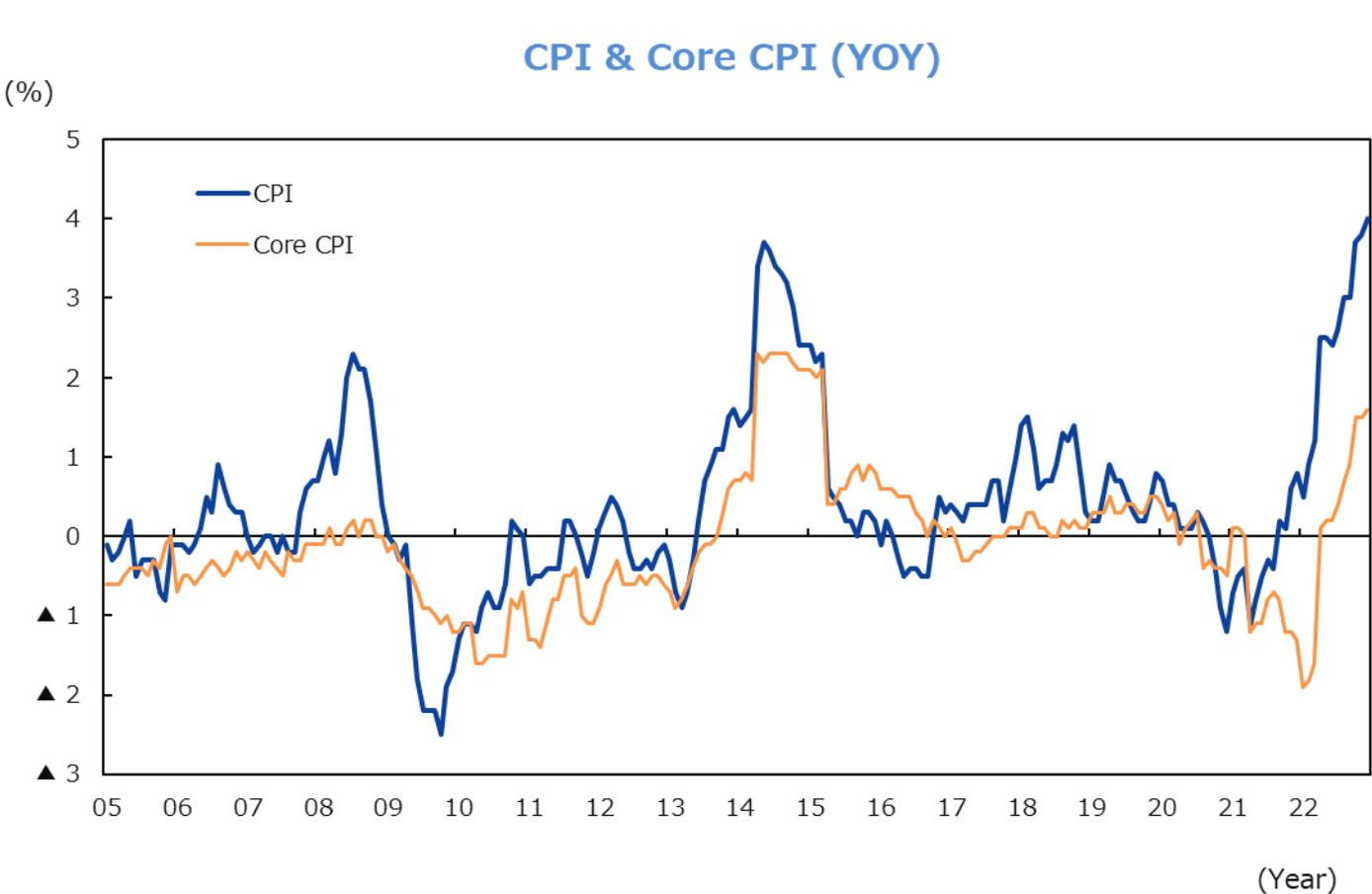
# Forecast table for the Japanese economy

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%	1.1%	1.0%	
Private final consumption expenditure	0.1%	-1.0%	-5.4%	1.5%	2.6%	0.8%	0.8%	
Private housing investment	-4.8%	2.5%	-7.8%	-1.1%	-4.6%	-1.0%	-0.4%	
Private-sector capital investment	1.5%	-1.7%	-7.7%	2.1%	3.4%	2.5%	2.4%	
Public fixed capital formation	0.8%	1.7%	5.1%	-6.4%	-3.7%	1.8%	0.9%	
Net export contribution	-0.2%	-0.5%	-0.6%	0.8%	-0.4%	-0.2%	0.0%	
Exports of goods and services	2.0%	-2.3%	-10.0%	12.3%	4.4%	-0.8%	3.4%	
Imports of goods and services	3.0%	0.2%	-6.3%	7.1%	6.8%	0.5%	3.4%	
Nominal GDP	0.2%	0.0%	-3.9%	2.4%	1.9%	2.3%	1.9%	
GDP deflator	-0.1%	0.8%	0.7%	-0.1%	0.2%	1.2%	0.9%	
Industrial Production Index	0.3%	-3.7%	-10.0%	5.9%	0.0%	0.8%	2.1%	
Consumer Price Index (Core)	0.8%	0.4%	-0.6%	0.1%	2.9%	2.0%	1.1%	
Domestic corporate goods price index	2.2%	0.1%	-1.5%	7.1%	8.9%	-0.6%	-0.2%	
Employee compensation	3.2%	2.0%	-1.5%	2.1%	2.0%	1.6%	1.9%	
Unemployment rate	2.4%	2.4%	2.9%	2.8%	2.5%	2.5%	2.4%	
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	

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.

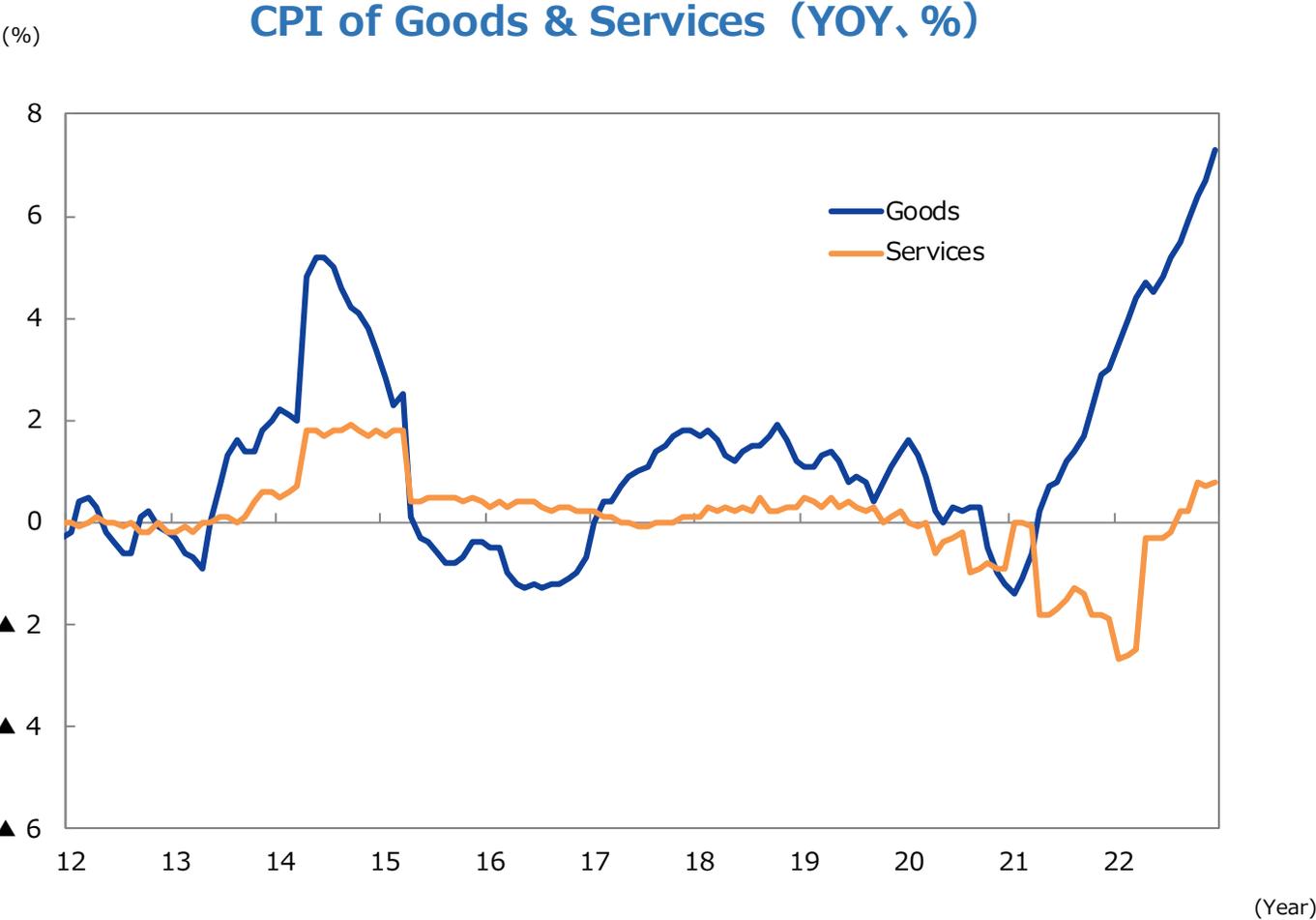
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

# Food and energy lift inflation to the highest in 41 years



Note: Data is from January 2005 to December 2022, Core CPI is excluding food, except for alcohol, & energy  
Source: MIAC, Bloomberg, SMDAM

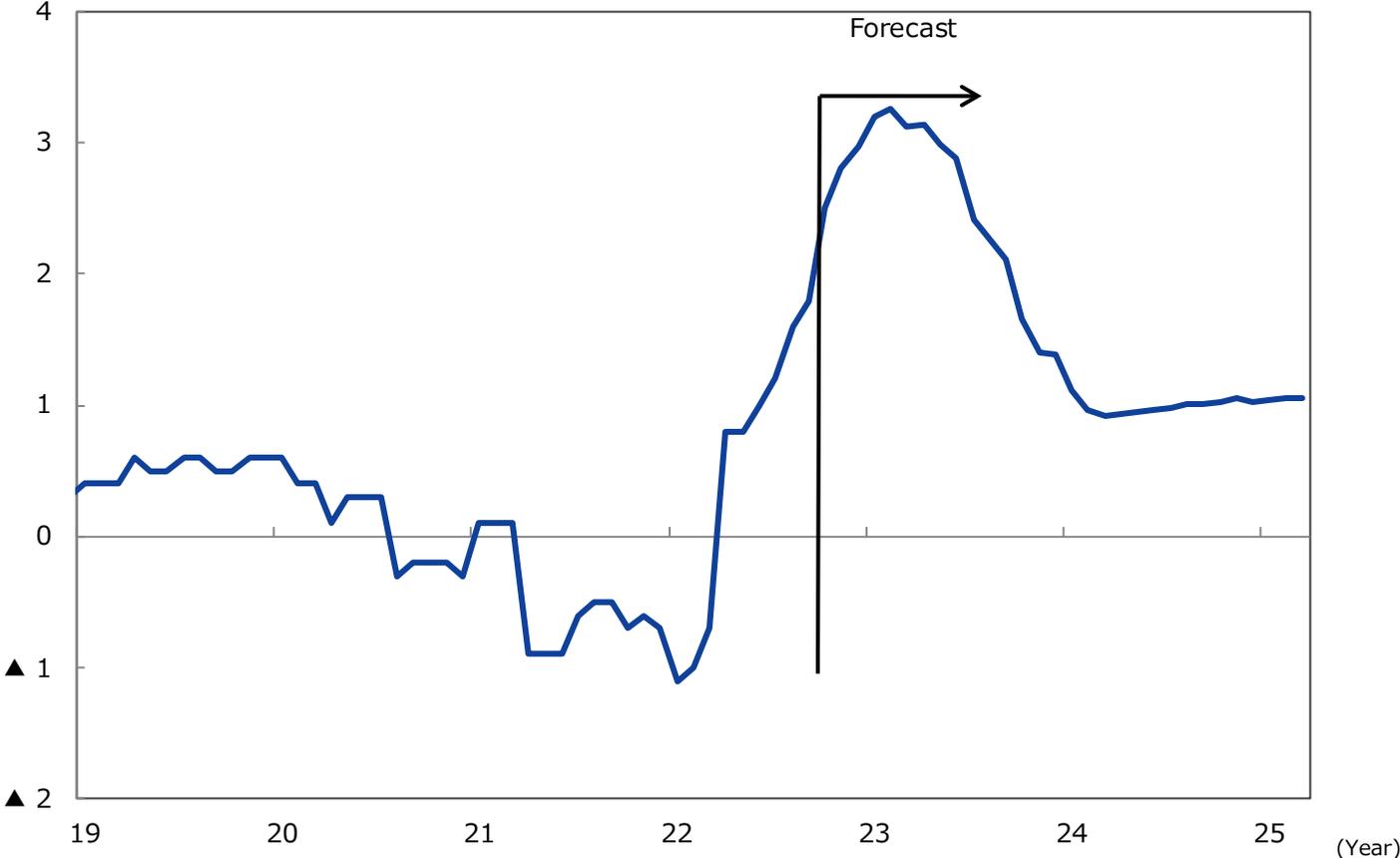
# Goods prices boost CPI despite weakness in services



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

# BOJ expects Core CPI to decline sharply in the near future

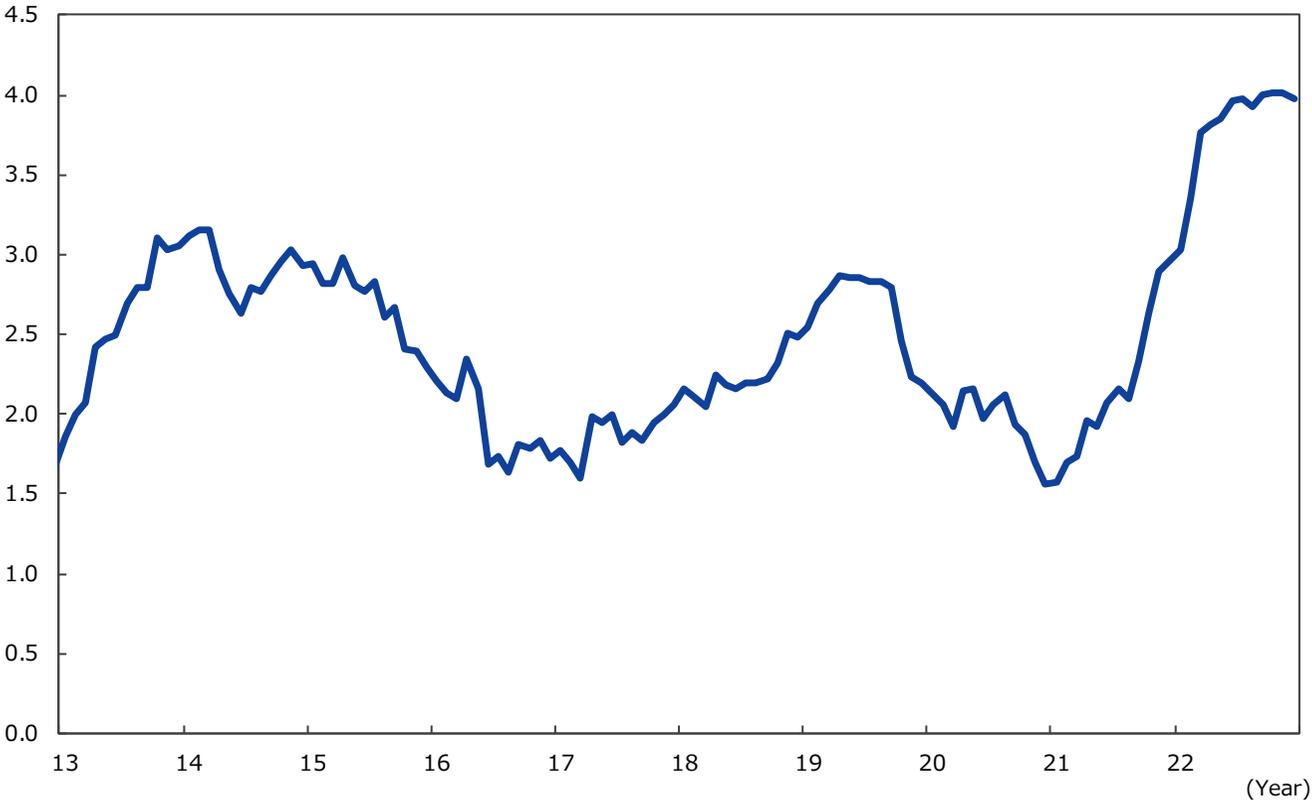
BOJ's Core CPI forecast (YOY, %)



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 food and utility bills change people's minds about inflation

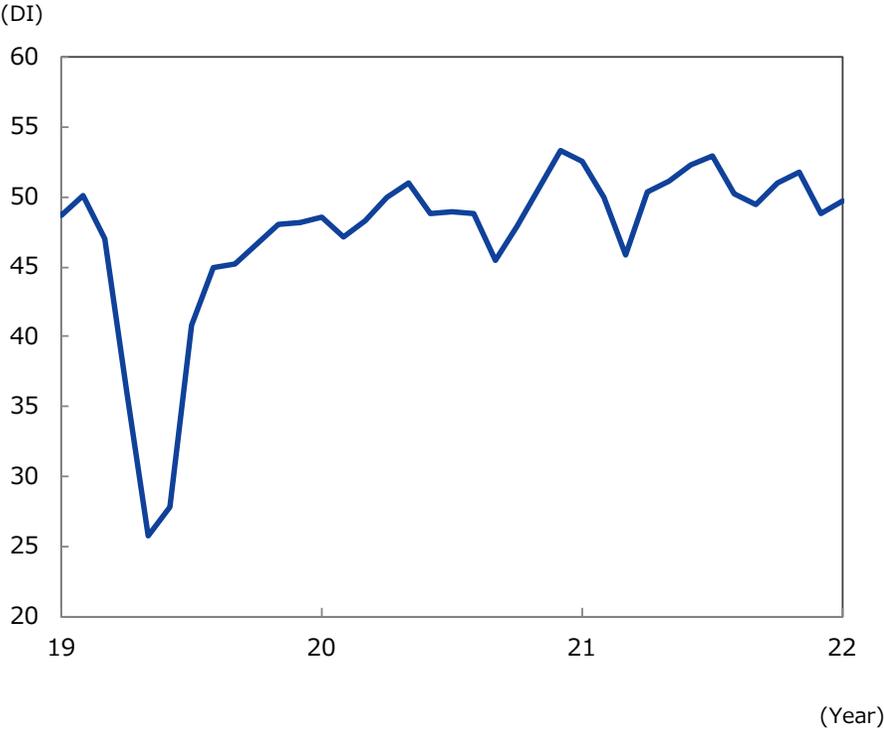
### Consumers' Expectation of Inflation Rate (YOY, %)



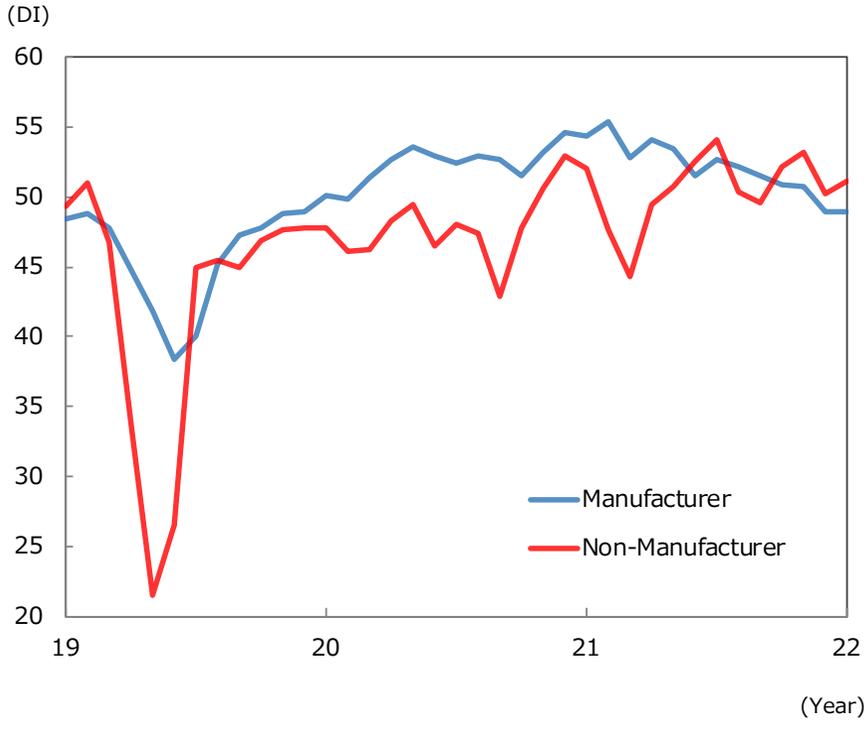
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to December 2022.  
Source: Cabinet Office, SMDAM

# Manufacturers' sentiment gradually declining

### Composite PMI



### PMI, Manufacturer & Non-Manufacturer



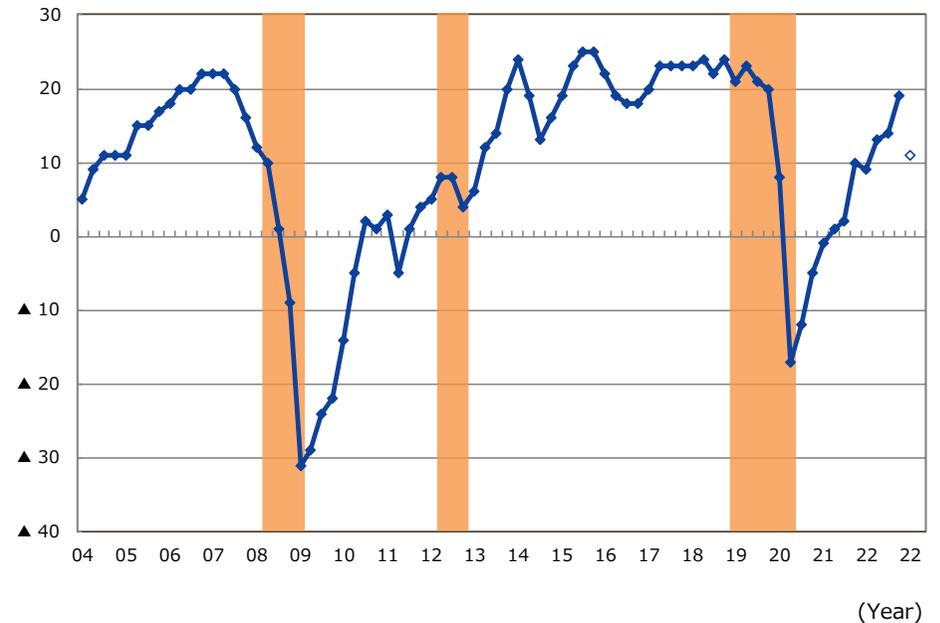
Note: Data is from December 2019 to December 2022.  
Source: Bloomberg, SMDAM

# While the service sector is improving, manufacturers are mixed

BOJ business condition DI Large manufacturers (%)

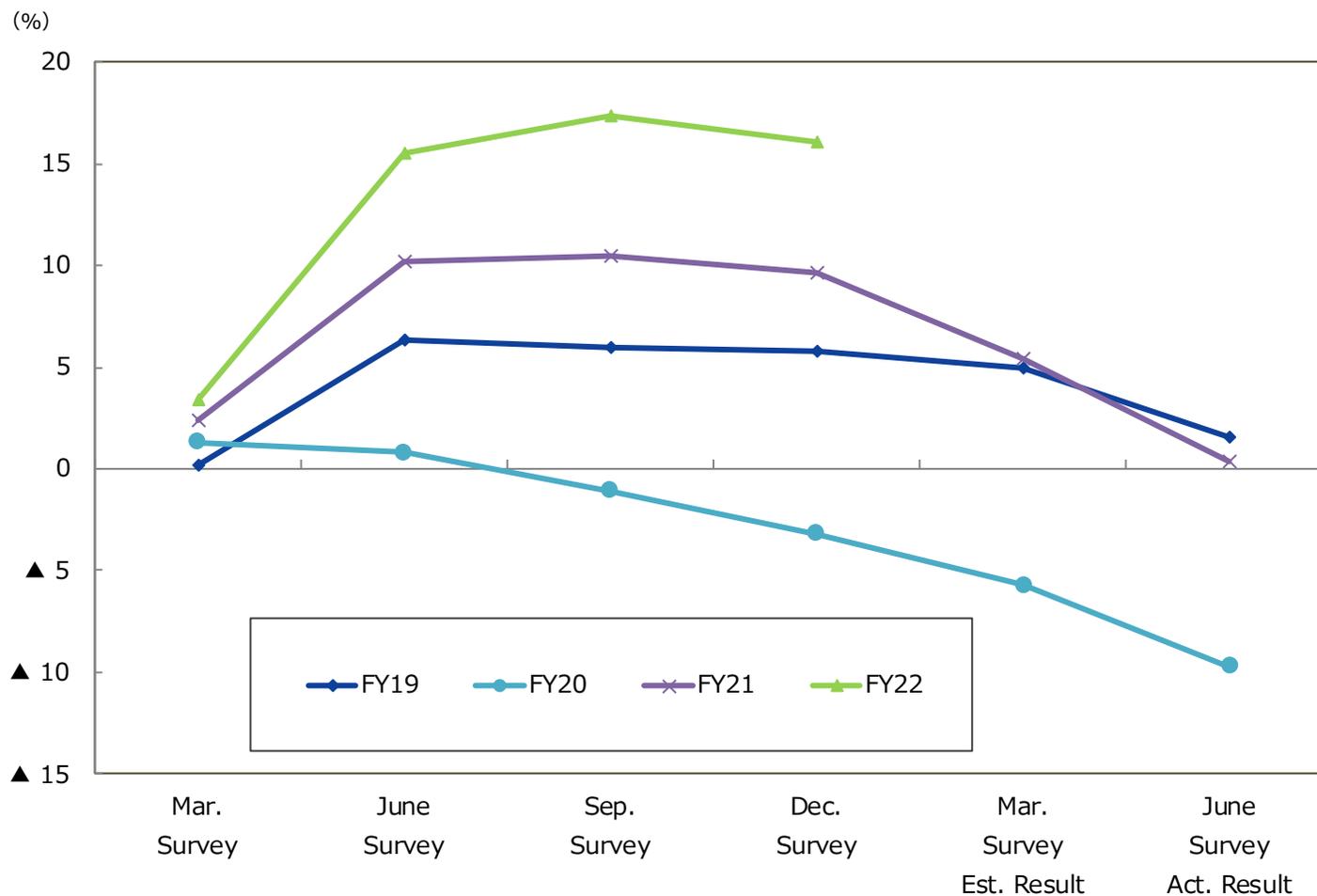


BOJ business condition DI Large non-manufacturers (%)



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

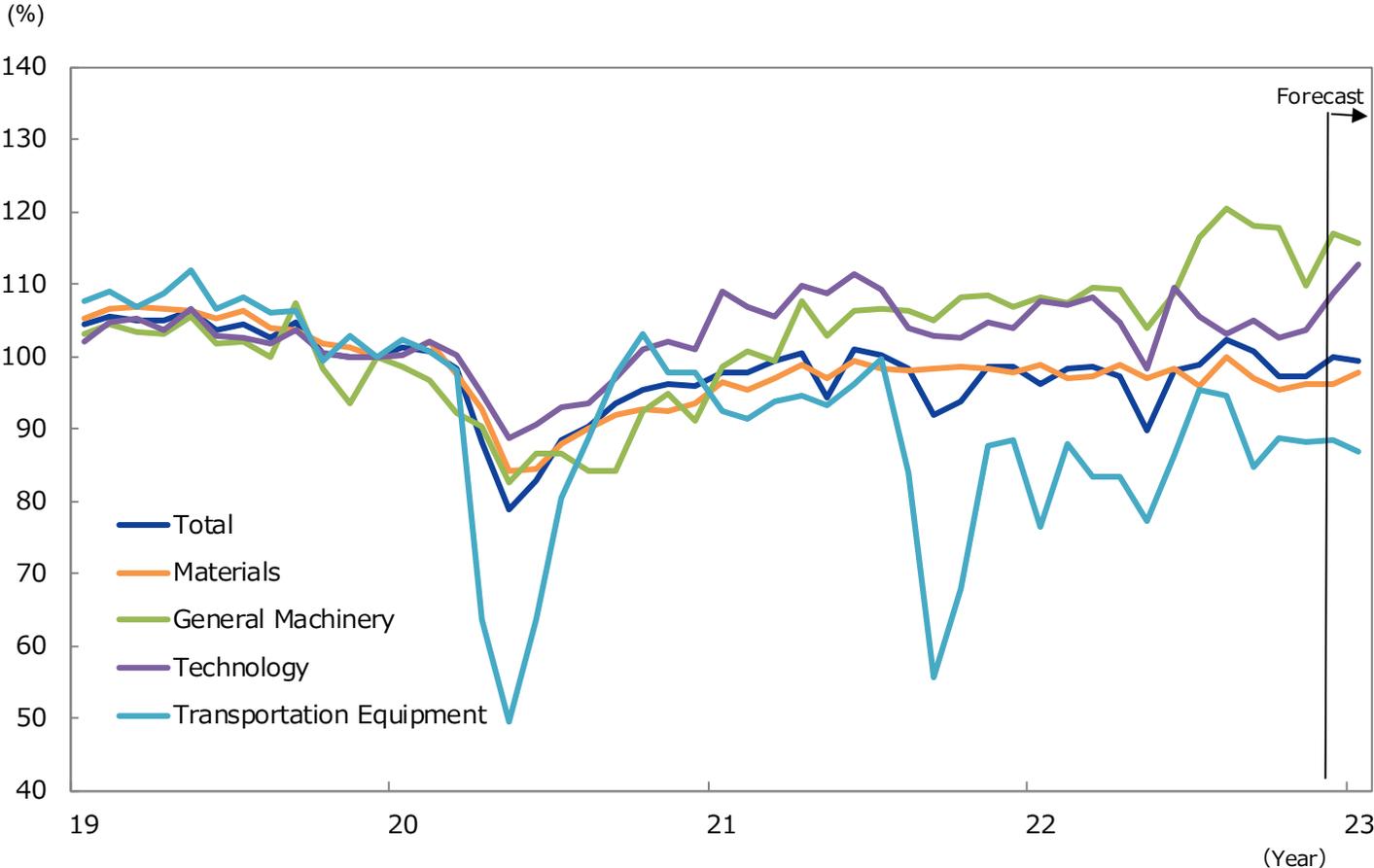
# Weak JPY and deferred spending boosts CAPEX in Japan



Note: Data is from Q1 FY 2019 to Q4 2022. Data is including software, excluding land and R&D.  
 Source: The Bank of Japan, SMDAM

# Industrials losing momentum due to slowing automobile sector

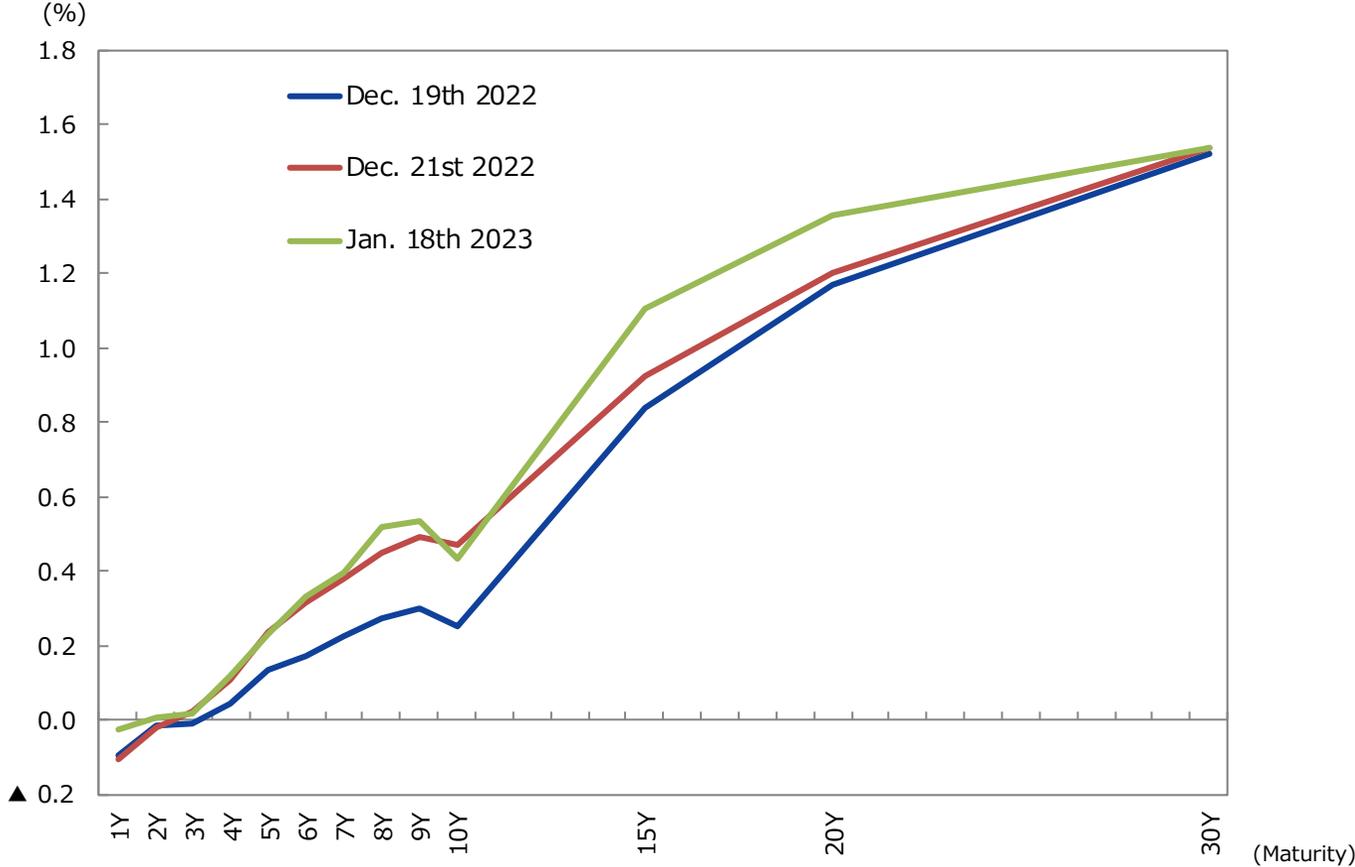
## Industrial Production (Dec. 2019=100)



Note: 100% = December 2019. Data is from January 2019 to January 2023. Data from December 2022 are forecasts.  
Source: METI, SMDAM

# Correction of YCC fuels speculation for further policy changes

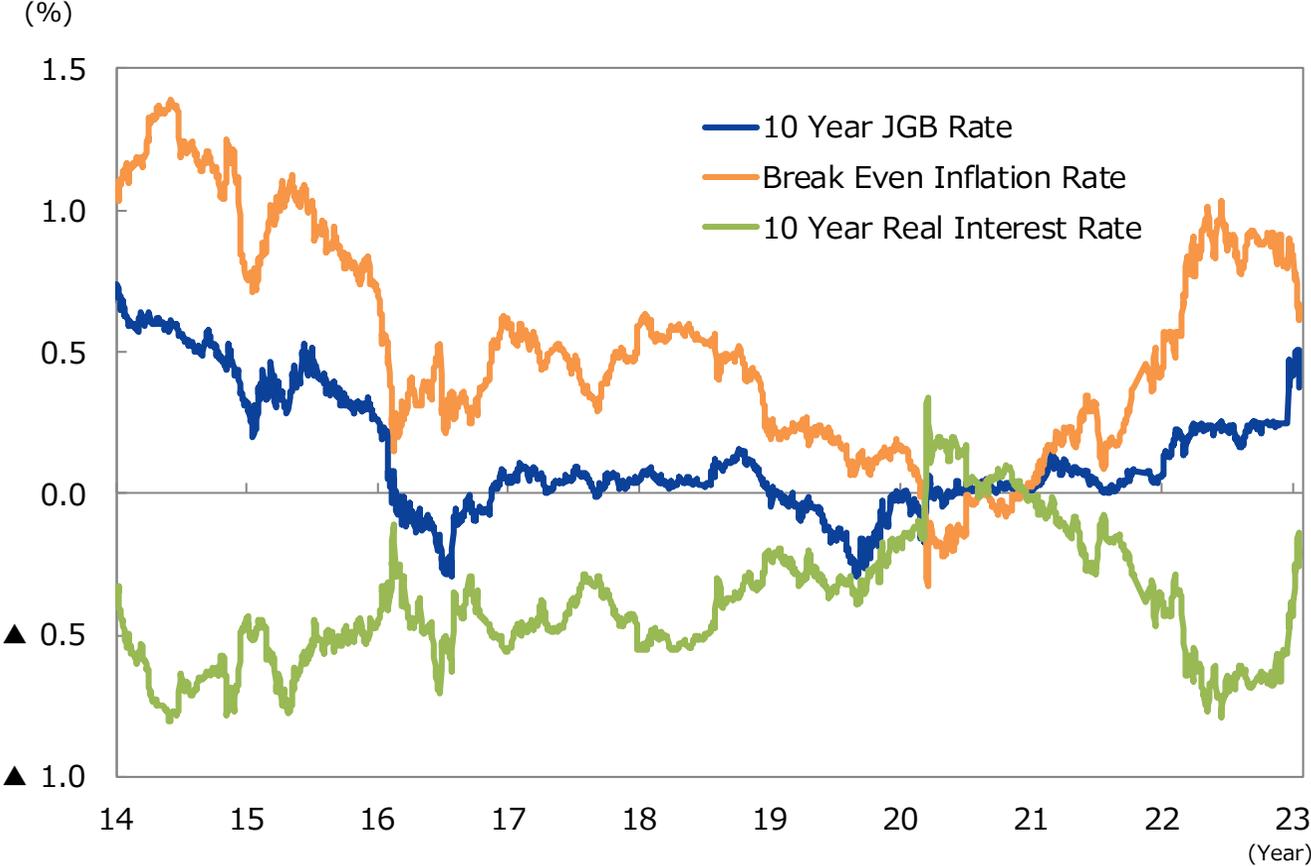
## Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

# Correction of YCC pushed real interest rate sharply higher

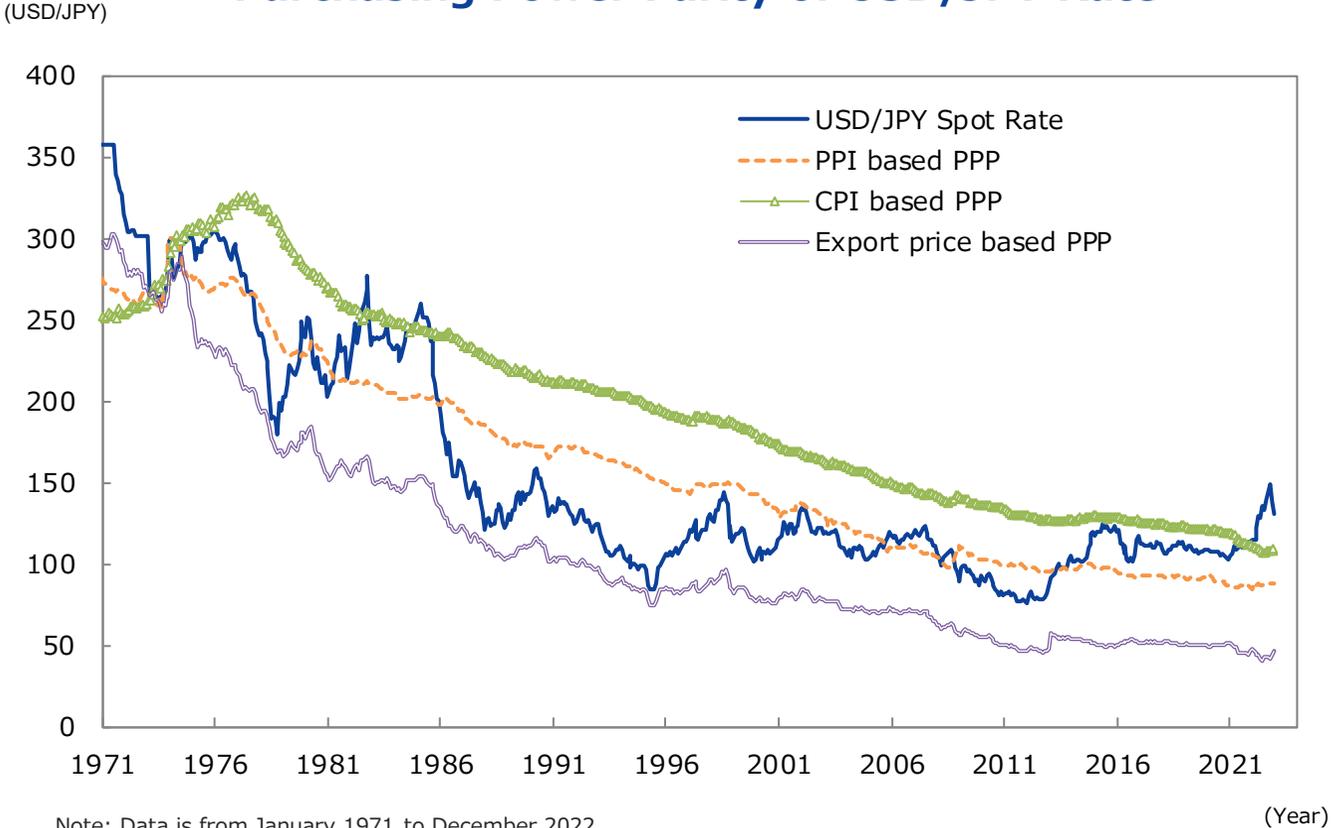
## JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 20th January 2023.  
Source: Bloomberg, SMDAM

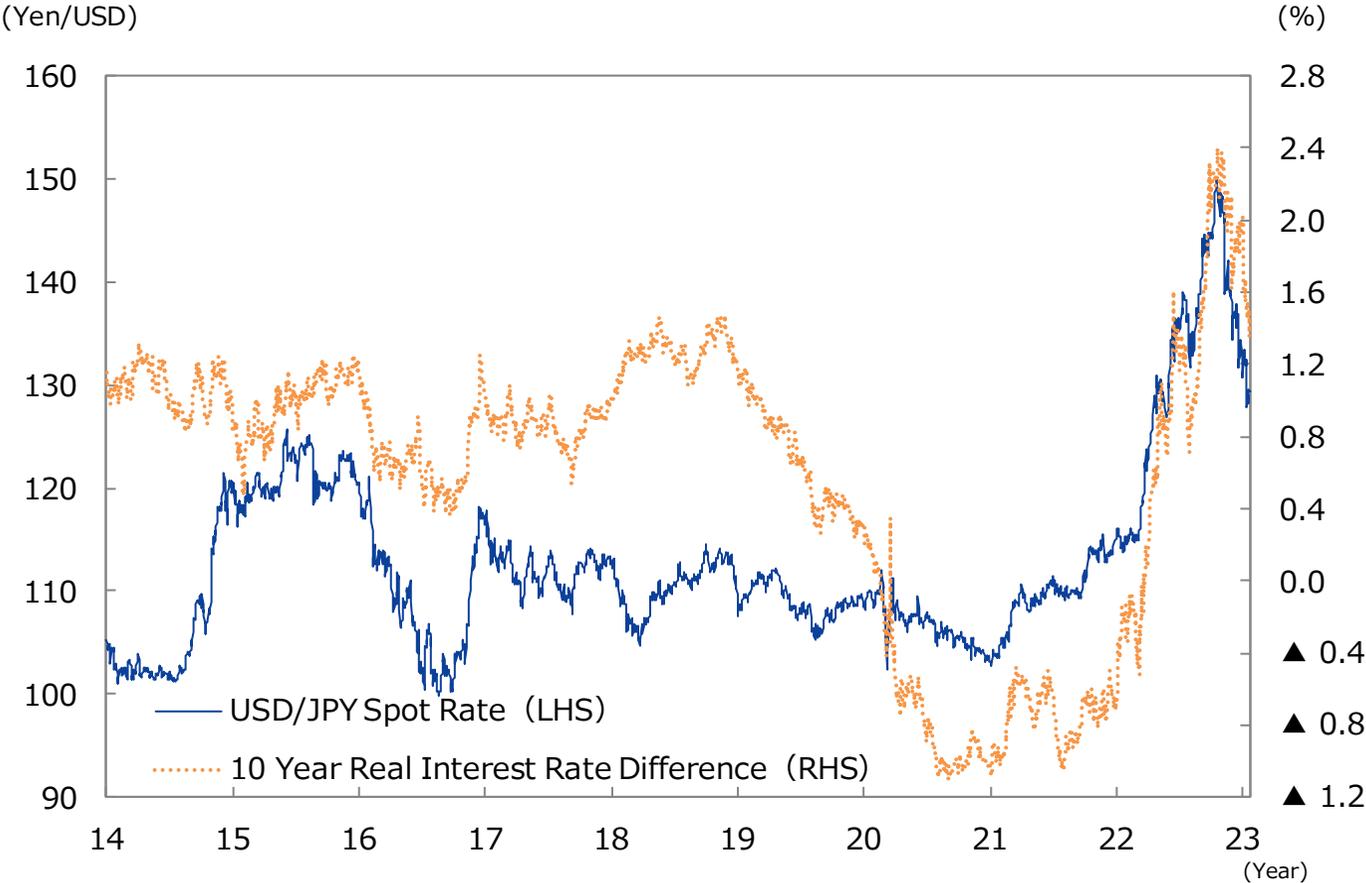
# USD/JPY rate starts swinging back to purchasing power parity

## Purchasing Power Parity of USD/JPY Rate



# USD/JPY slides sharply along with narrowing interest rate gap

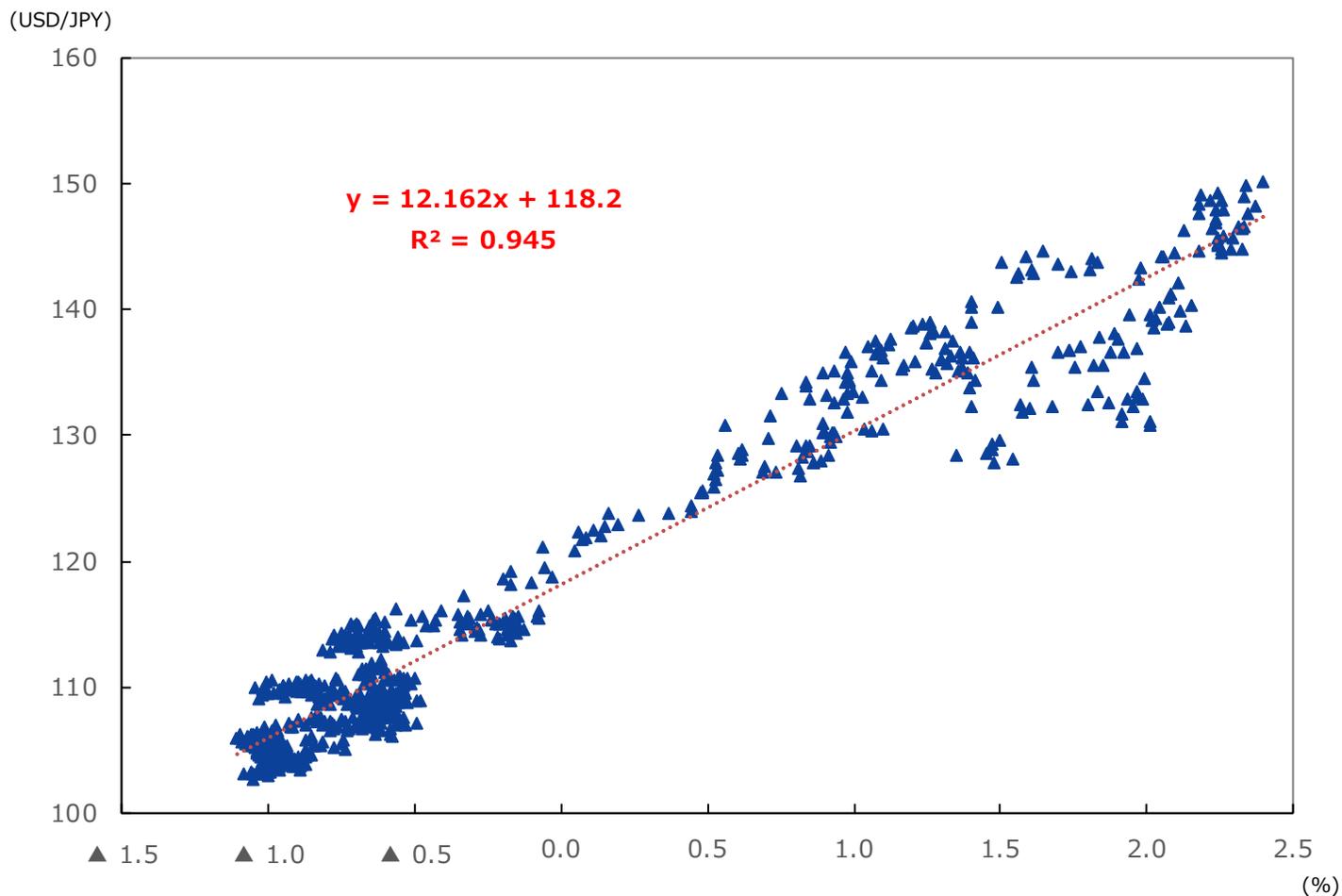
## Real Interest Rate Gap & USD/JPY Exchange rate



Note: Data is from 1st January 2014 to 20th January 2023.  
 Source: Bloomberg, SMDAM

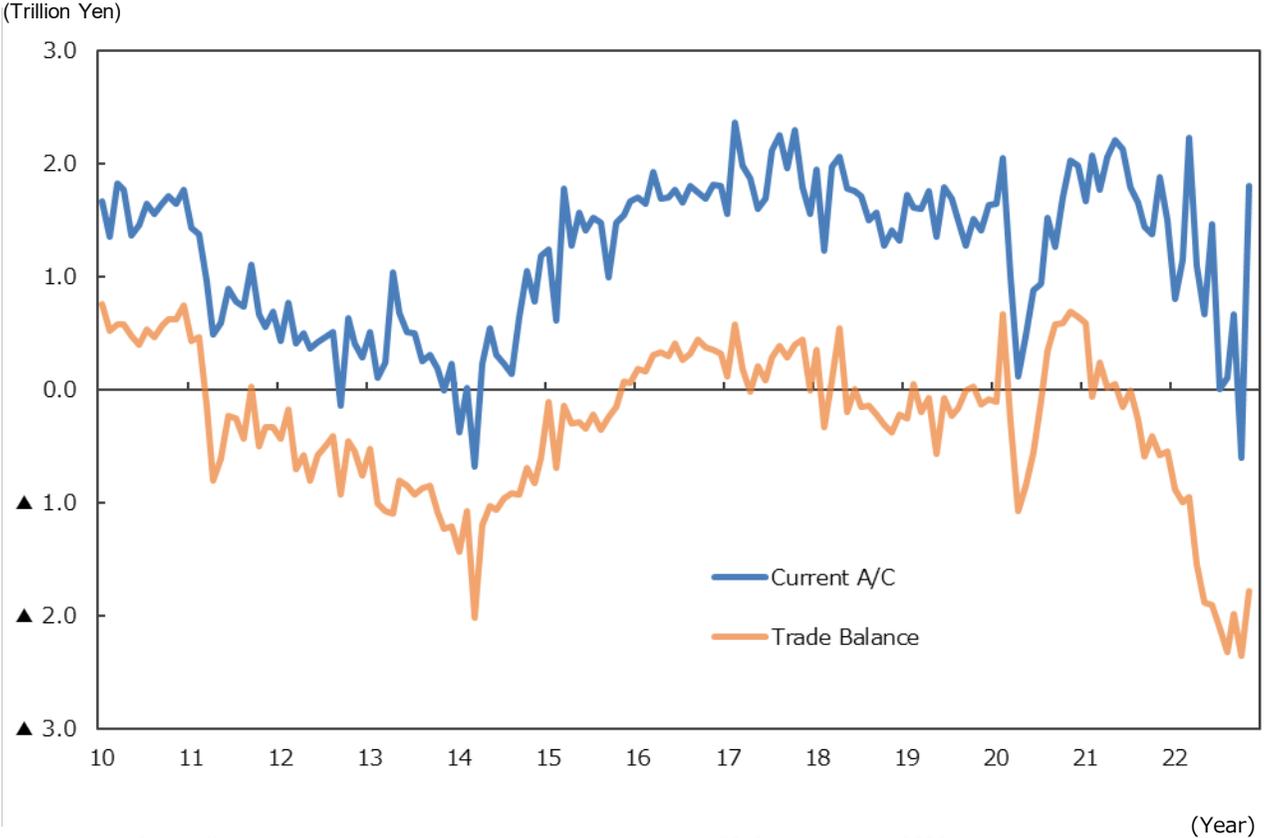
# Interest rate gap dominates USD/JPY rate

## Correlation between Real Interest Rate Gap & USD/JPY



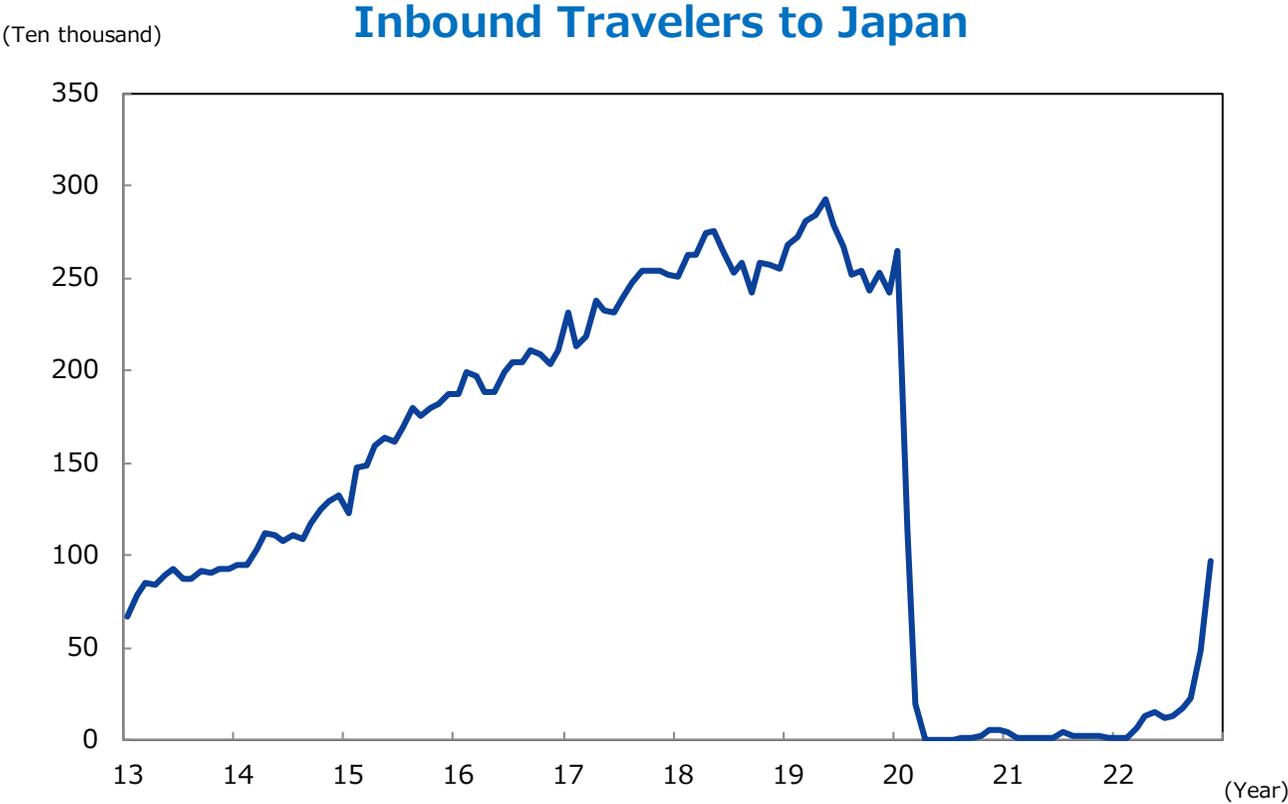
Note: Real interest rates are 10 year government bonds. Data is from 1st April 2020 to 20th January 2023.  
Source: Bloomberg, SMDAM

# Foreign business profit and inbound travel boost current A/C surplus



Note: Data is Seasonally adjusted. Current account is from January 2010 to November 2022. Trade balance is from January 2010 to December 2022.  
 Source: MOF, SMDAM

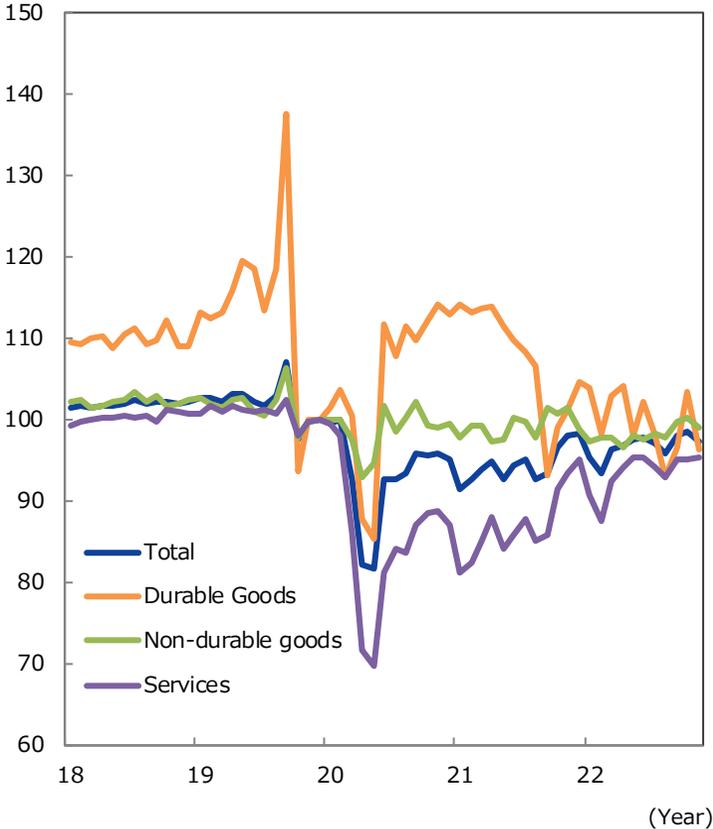
# Re-opening boosts recovery of inbound travel



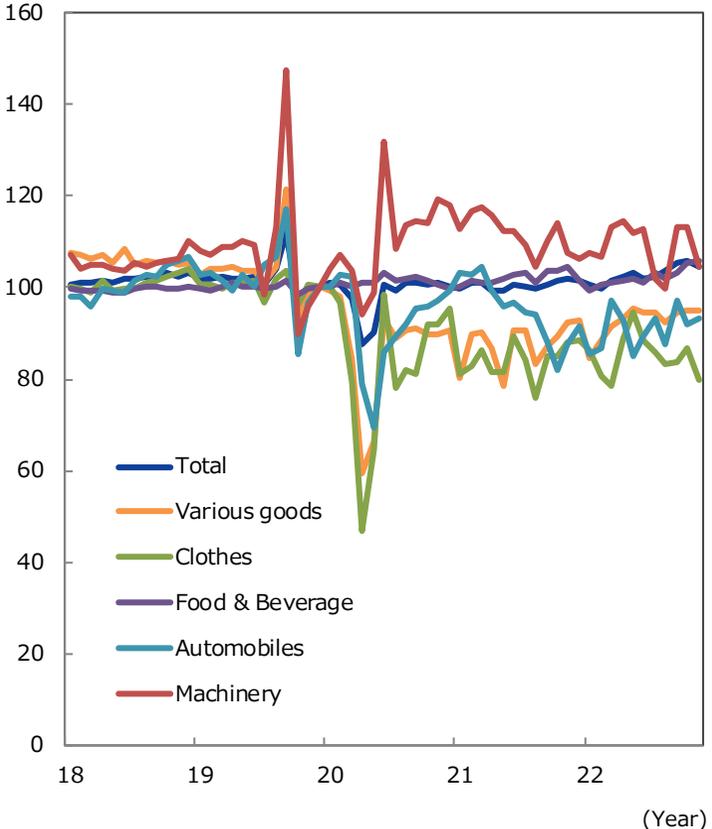
Note: Data is from January 2013 to November 2022. Data is seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Consumer activity mixed; pent-up demand offset by higher inflation

Consumer Activity Index (Dec. 2019 = 100)



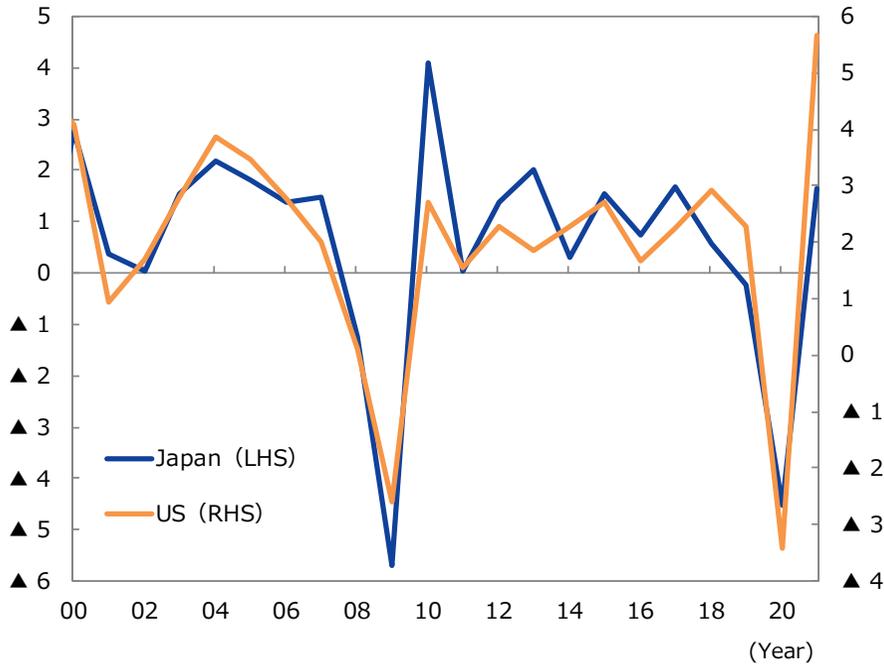
Retail Sales (Dec. 2019 = 100)



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

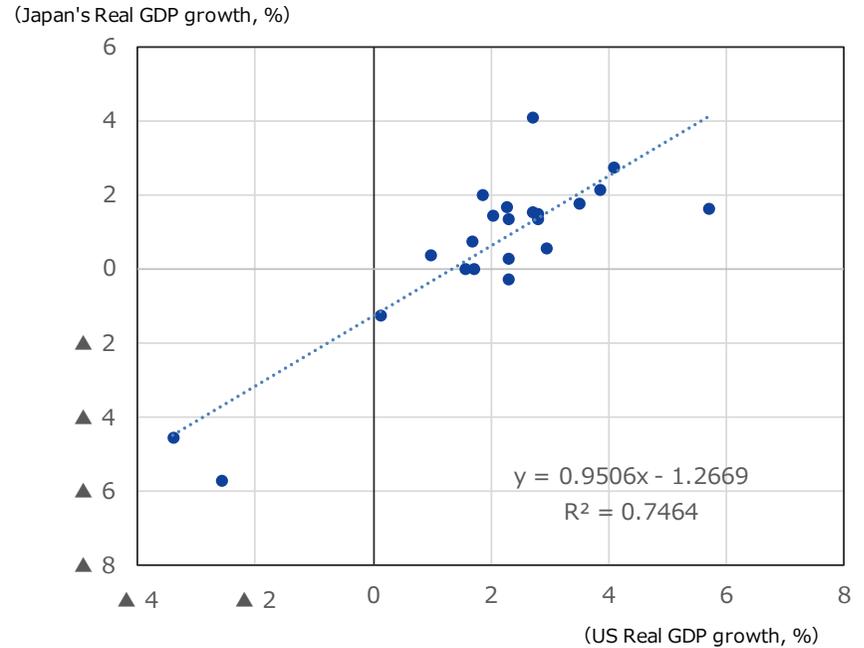
# Strong correlation between US and Japan economic growth

## Real GDP Growth (YOY, %)



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

## Correlation of Real GDP Growth



# Japan's marginal exposure to Russia

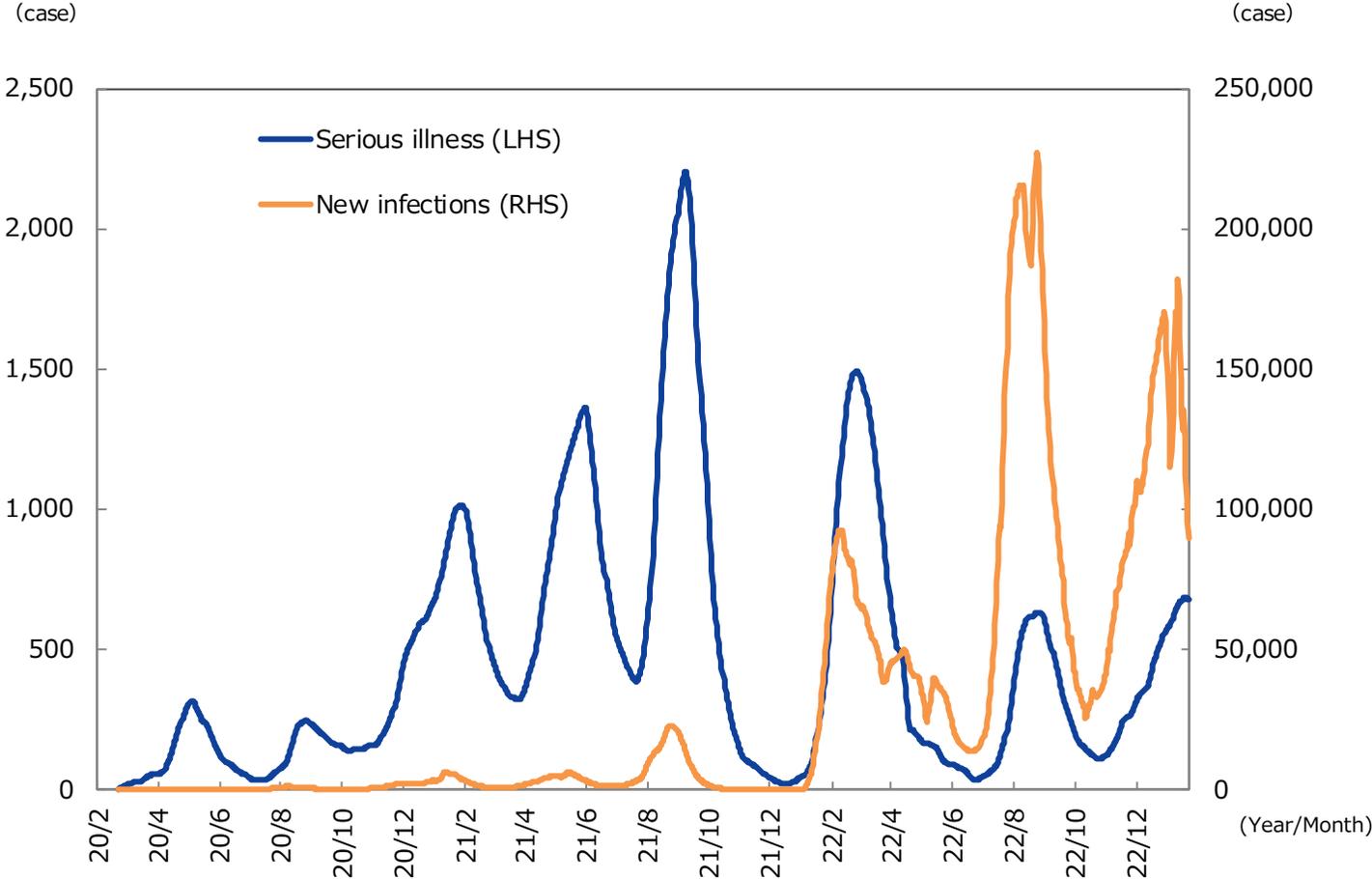
(%)

	Export		Import	
	Weight of Total Export	Weight of GDP	Weight of Total Import	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 in Japan

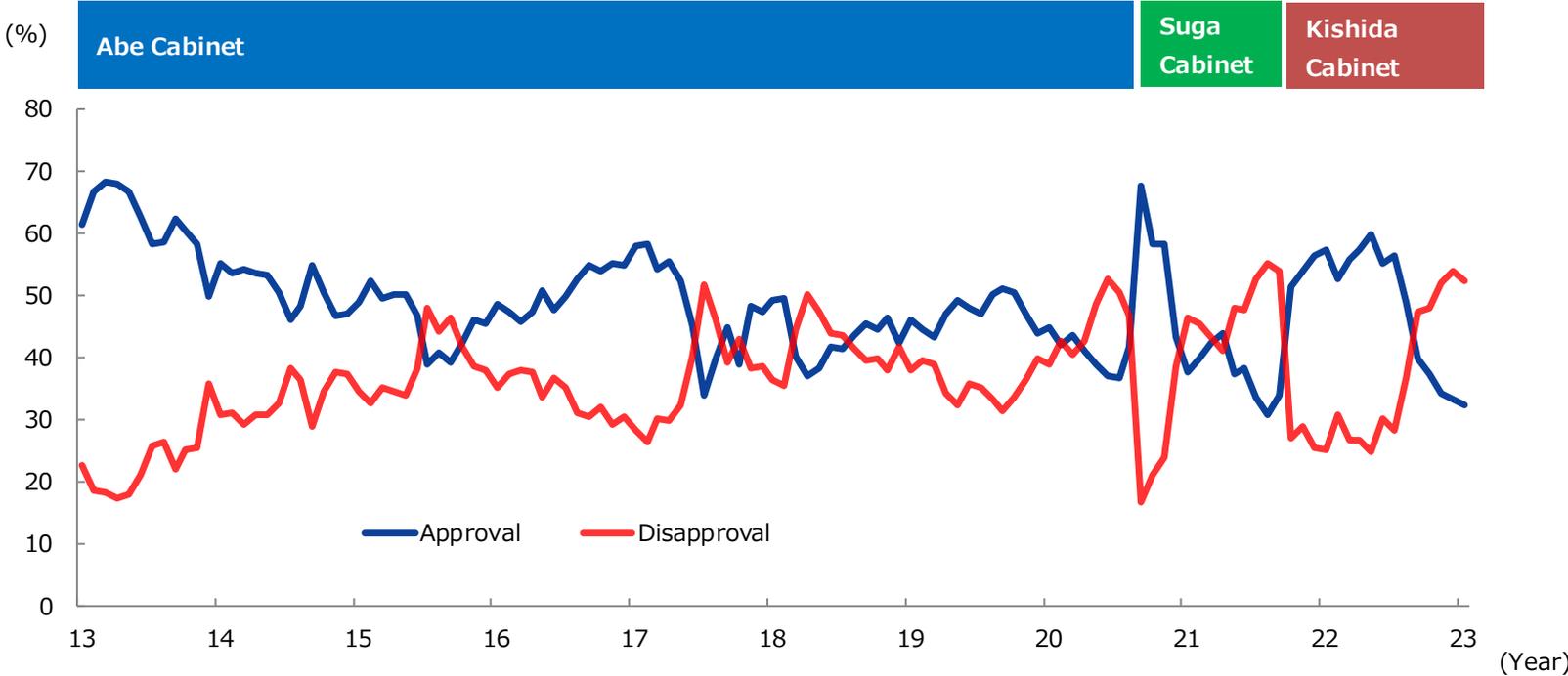
## COVID-19 New Infections and Serious Illness



Note: 7 days moving average. Data is from 21st February 2020 to 22nd January 2023.  
Source: MHLW, NHK, SMDAM

# Inflation and planned tax increase hit approval rating

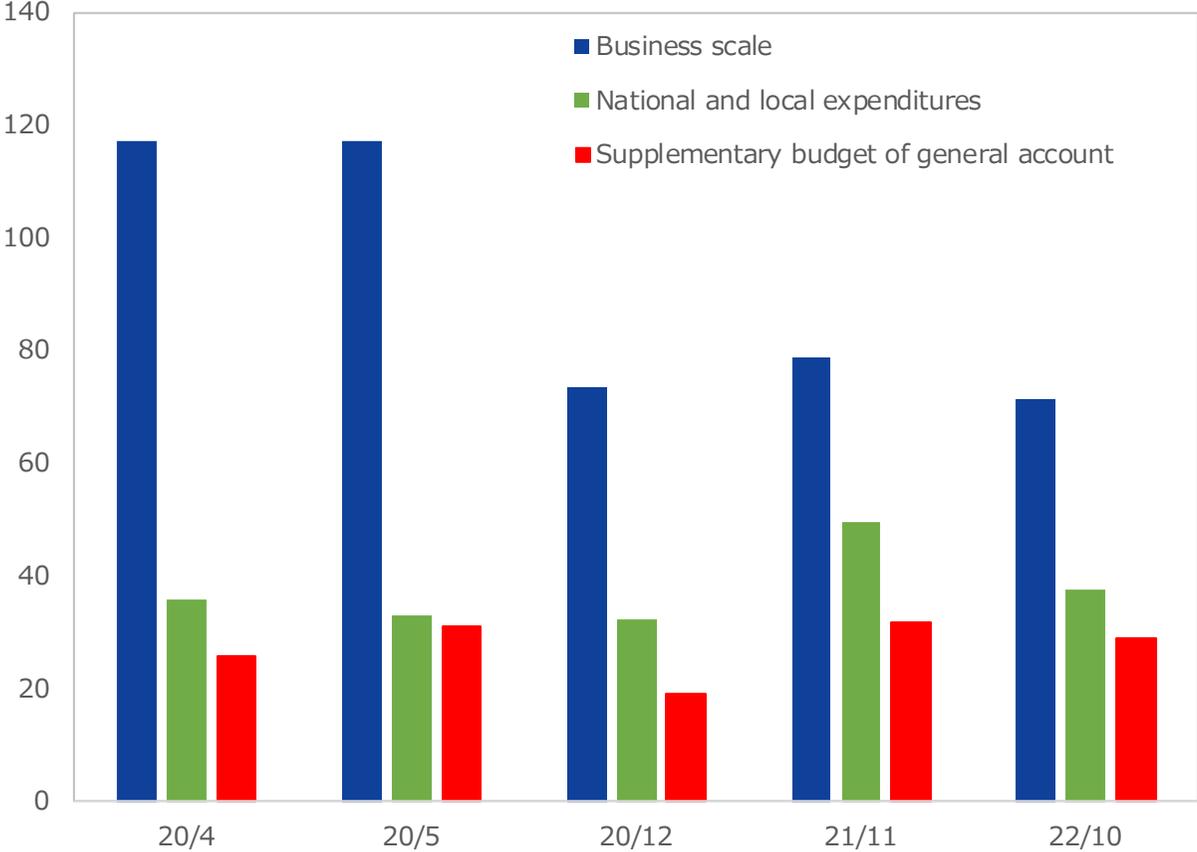
## Cabinet approval rate



Note: Data is from January 2013 to January 2023.  
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	February	14	Release of CY 2022 Q4 GDP Submission of the Plan for the next Bank of Japan Governor to the Diet
	March	9	Revision of CY 2022 Q4 GDP
		9-10	Monetary Policy Meeting
		19	Term expiration of the BOJ vice governor Amemiya and Wakatabe Compilation of proposals to strengthen measures to combat the declining birthrate 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
		21	End of the ordinary Diet session Big-boned policy decisions Formulation of guidelines for the facilitation of labor mobility
	July	27-28	Monetary Policy Meeting
	August		
	September	9-10	G20 Summit in India
21-22		Monetary Policy Meeting Appointment of key posts 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	

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