



# Outlook for Japanese Stock Market & Economy

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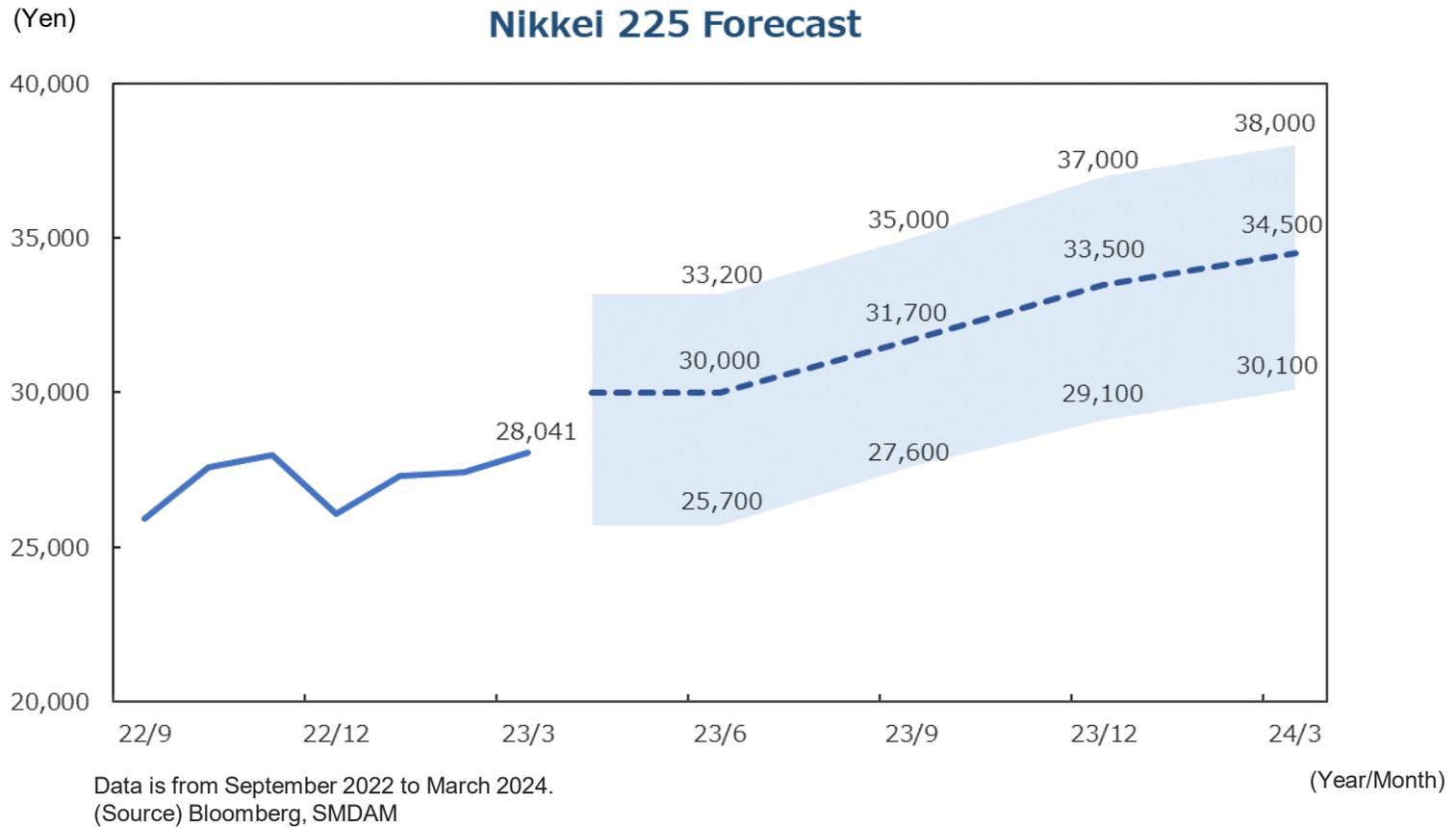
# Outlook for Japanese Stock Market

# Market Outlook

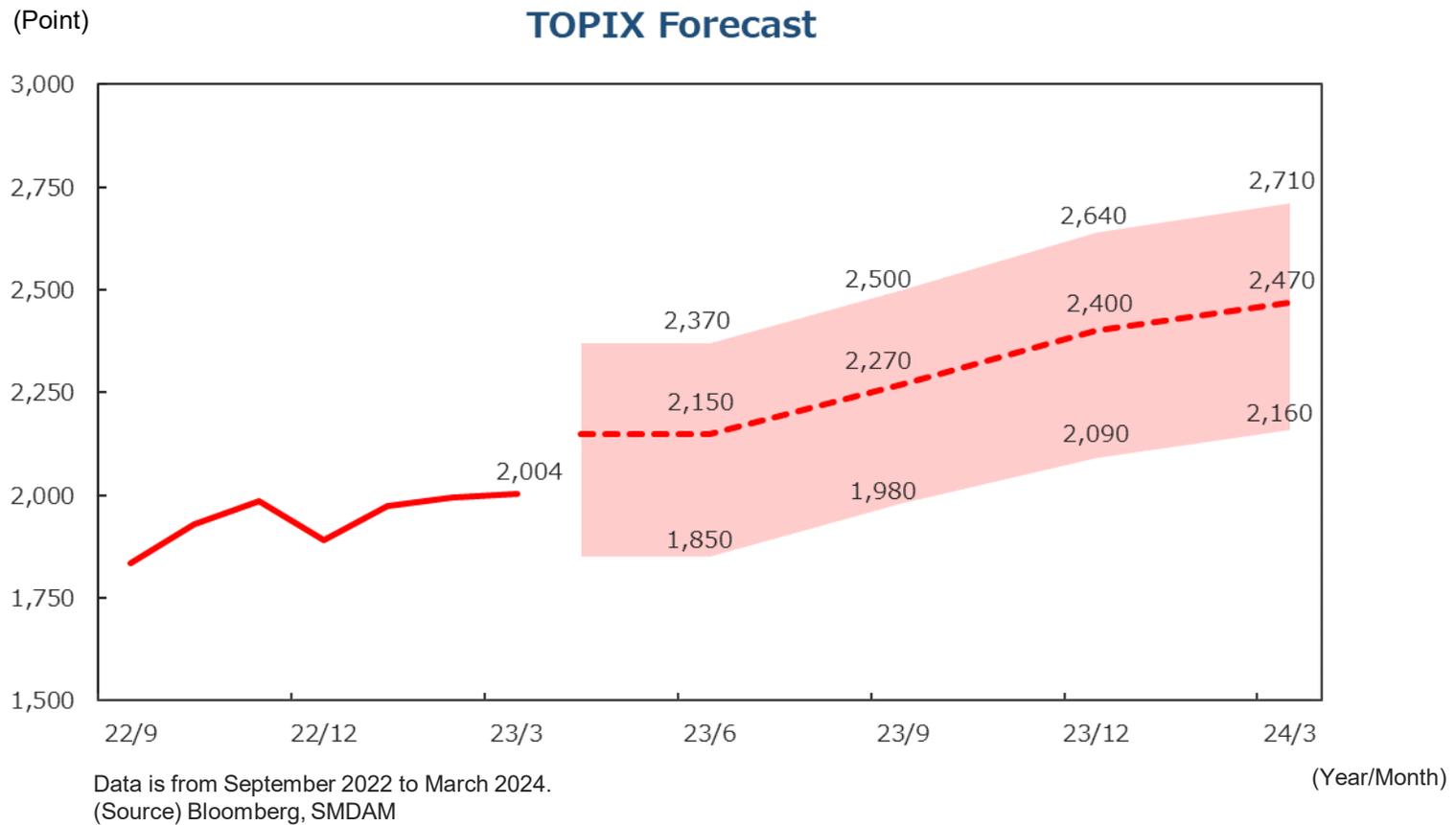
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- We believe the Japanese equity market will resume its bullish trend after confirming the peak of FED tightening and the trough of the global economic cycle. The return of Chinese inbound travelers could be strong tail wind for domestic services and retailers.
- While stable domestic demand and economic recovery in China should support the stock market, concern over the global economy could weigh on sentiment in the near future.
- We have maintained our TOPIX target at 2,400 as of the end of December 2023 and 2,470 as of the end of March 2024. We have also kept our price target for the Nikkei 225 at 33,500 as of the end of CY 2023 and also 34,500 as of the end of FY 2023.
- Higher long term interest rates and the new request by the Tokyo stock exchange, a strong call for disclosure of the analysis and countermeasures of low PBR, could boost investors' appetites for value stocks.

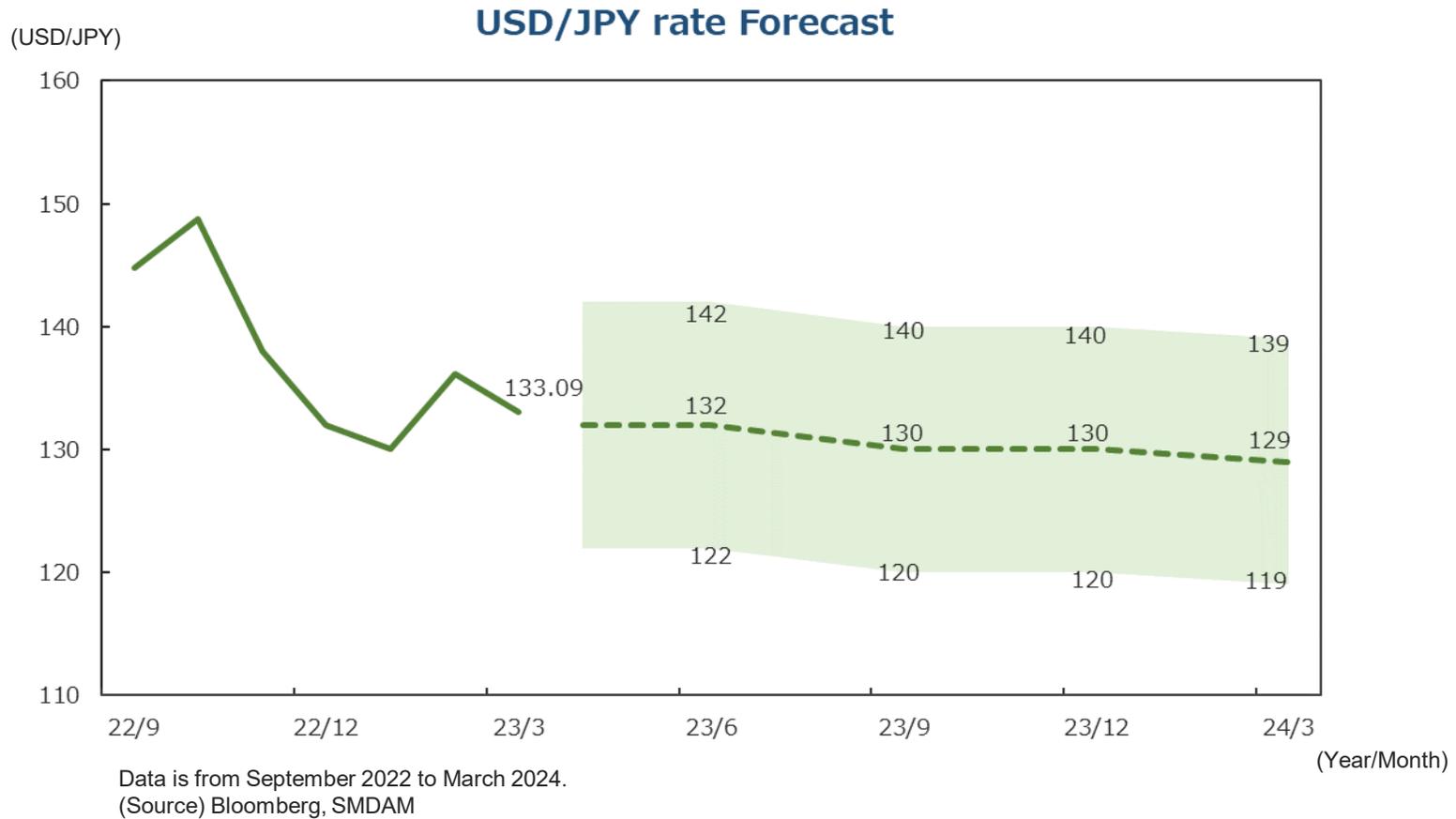
# Equities to resume bullish trend after range trading



# Equities to resume bullish trend after range trading



# USD/JPY to decline gradually due to upcoming FED pivot



# Upside / Downside risk scenarios

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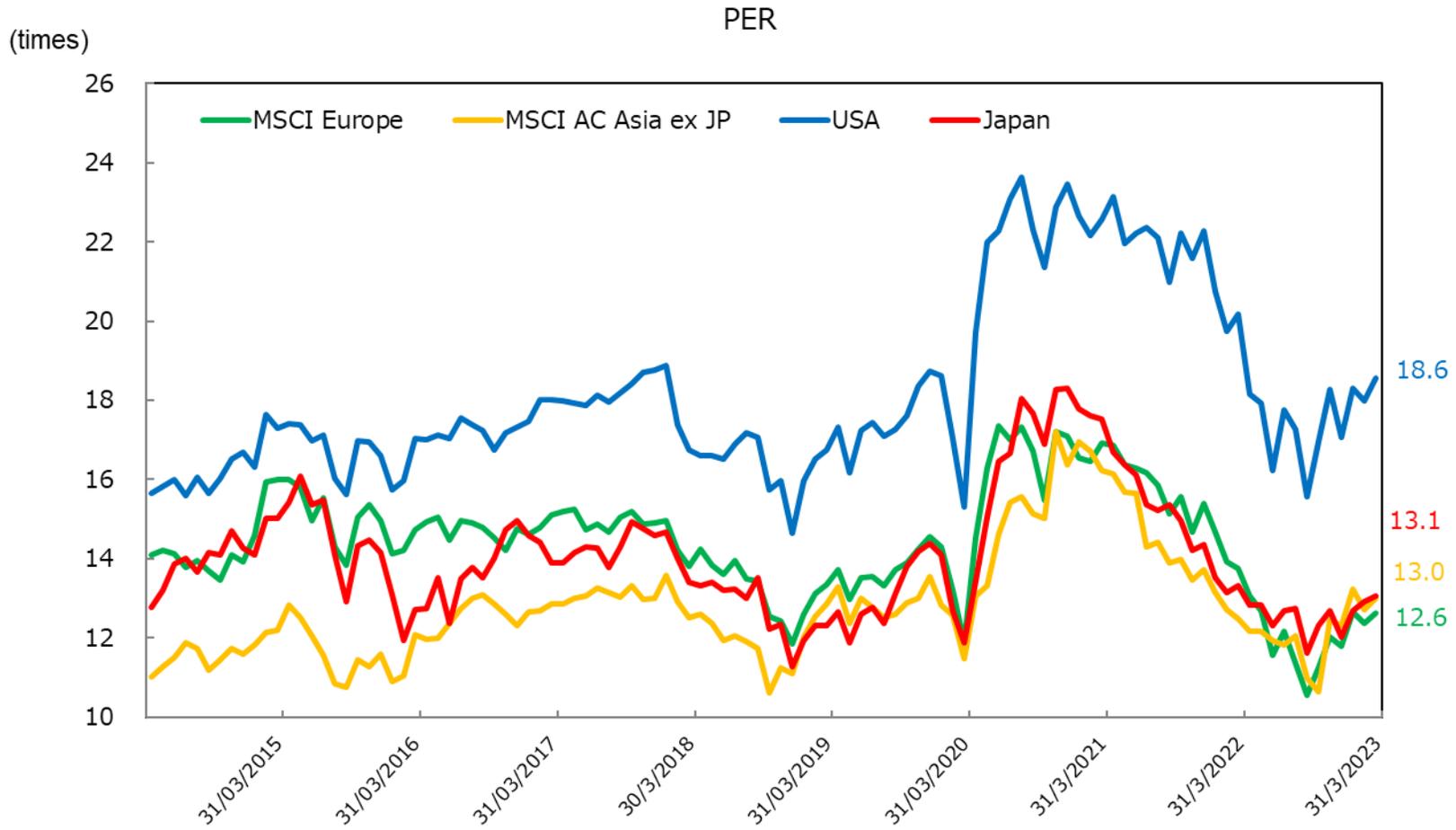
## ■ Upside Risks

- FED pivot and monetary easing
- Growing expectation for mild inflation in Japan

## ■ Downside Risks

- Excessive JPY appreciation and negative impact on corporate earnings
- Renewed concern for financial turmoil
- Prolonged stagnation of the global economy

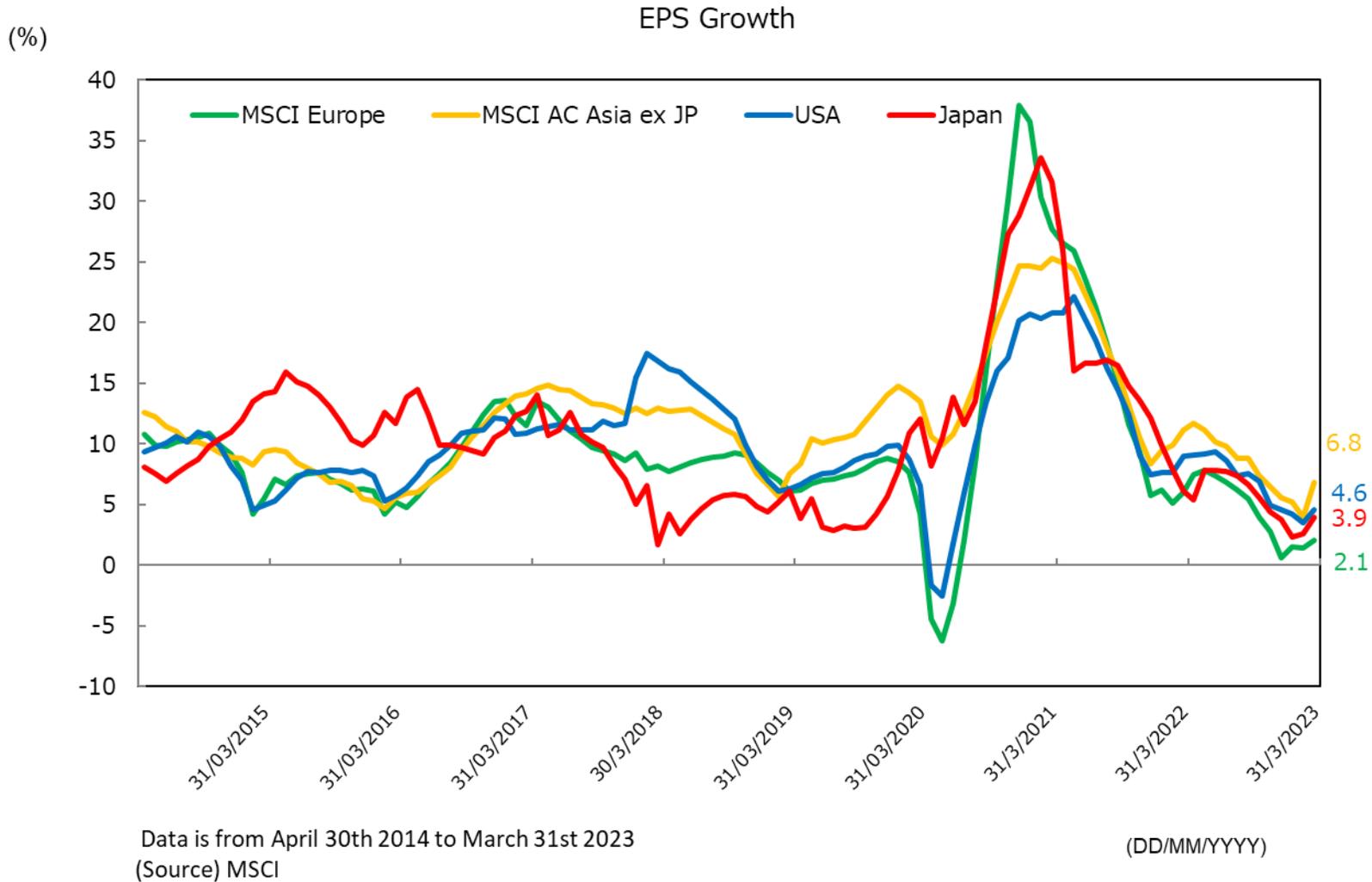
# PERs expand gradually due to turnaround of bond yields



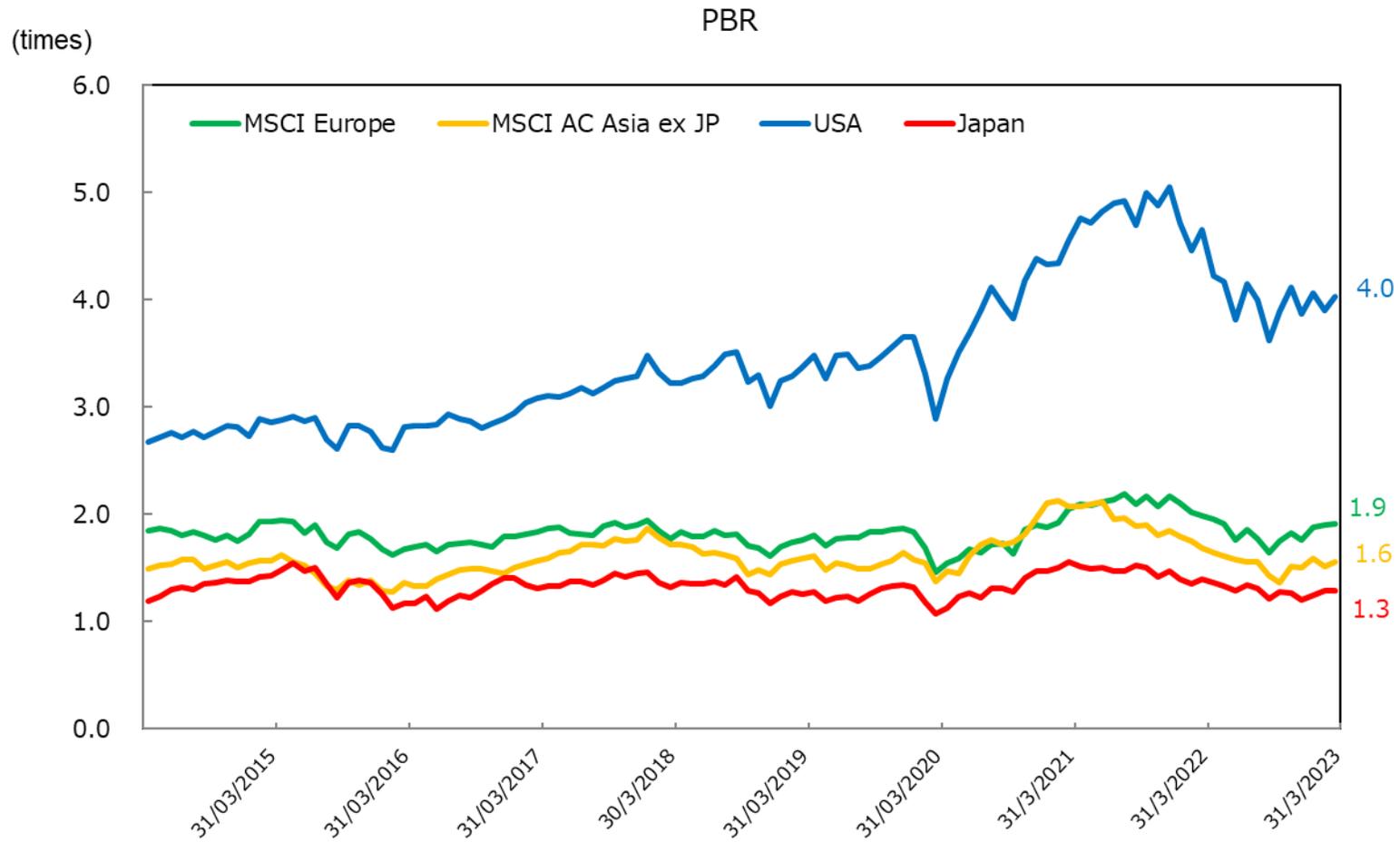
Data is from April 30th 2014 to March 31st 2023  
(Source) MSCI

(DD/MM/YYYY)

# Slowing economy and rising prices weigh on EPS growth



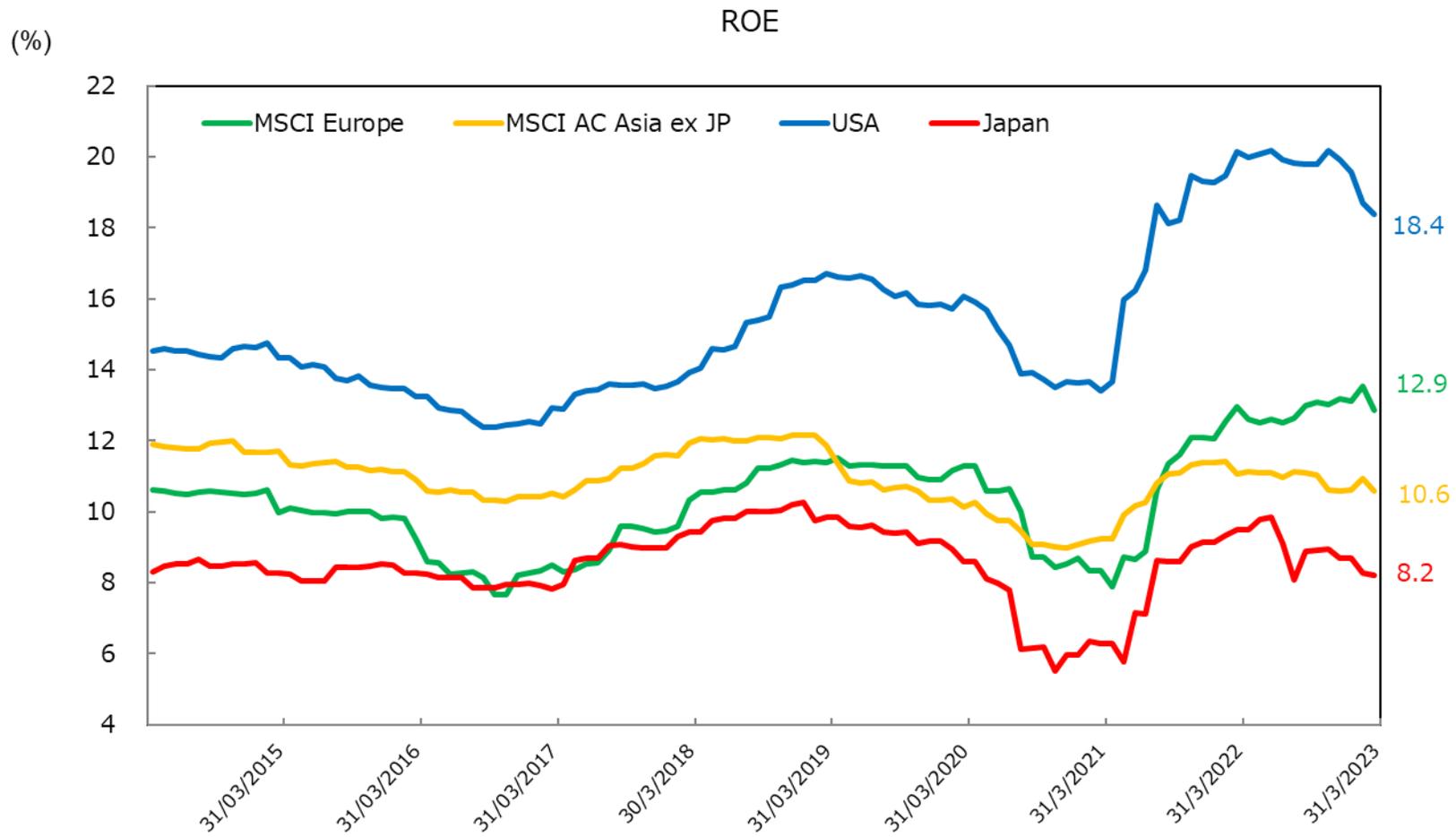
# Mounting pressure on Japanese companies to raise PBR



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

(DD/MM/YYYY)

# Lackluster manufacturers' earnings weigh on Japan's ROE



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

(DD/MM/YYYY)

# Lackluster global outlook still weighing on EPS revision

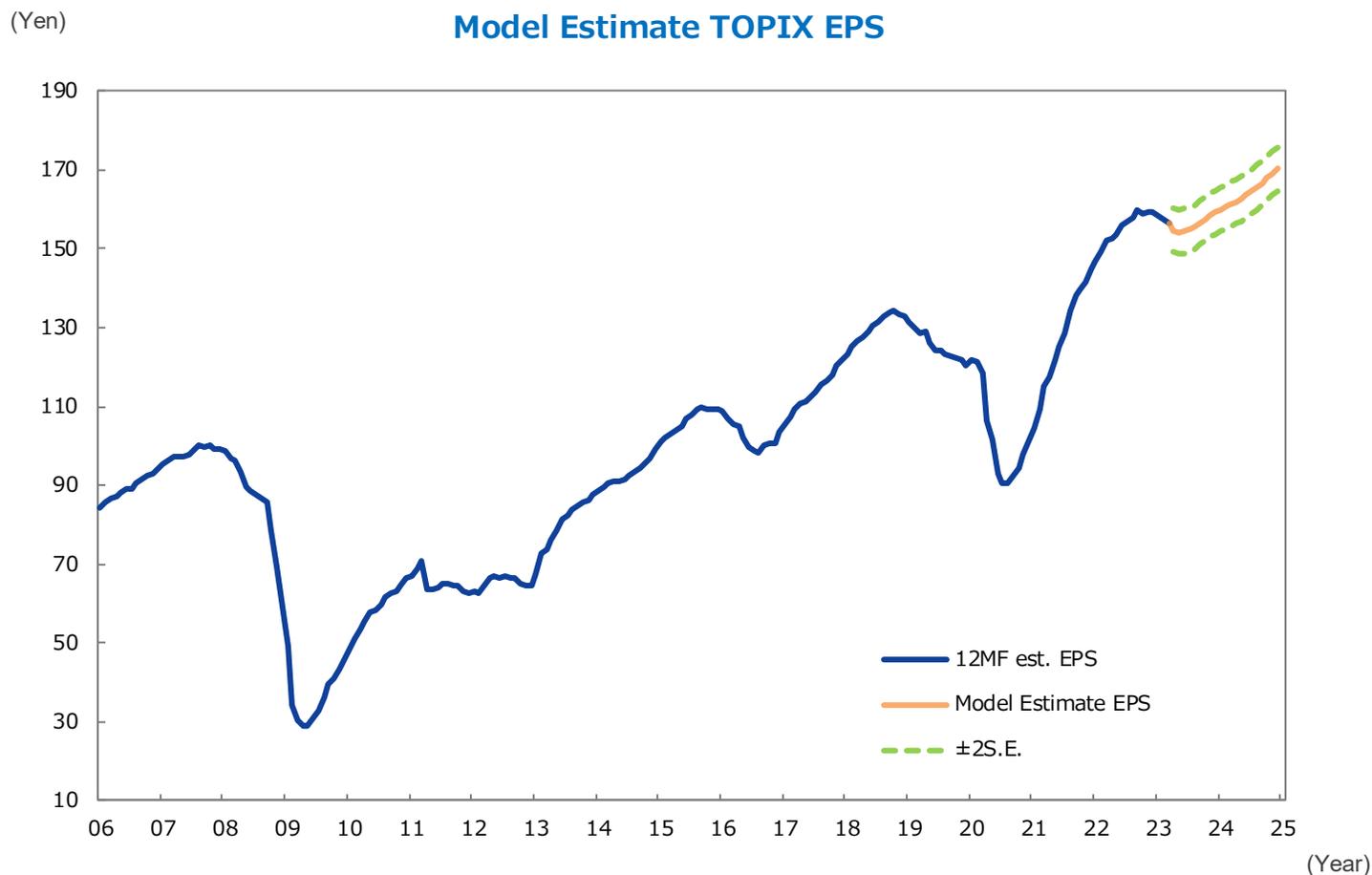
TOPIX Revision Index



Data is from December 28th 2017 to April 13th 2023  
(Source) Datastream, IBES

(YY/MM)

# Quant model indicates EPS to pick up after temporary pause

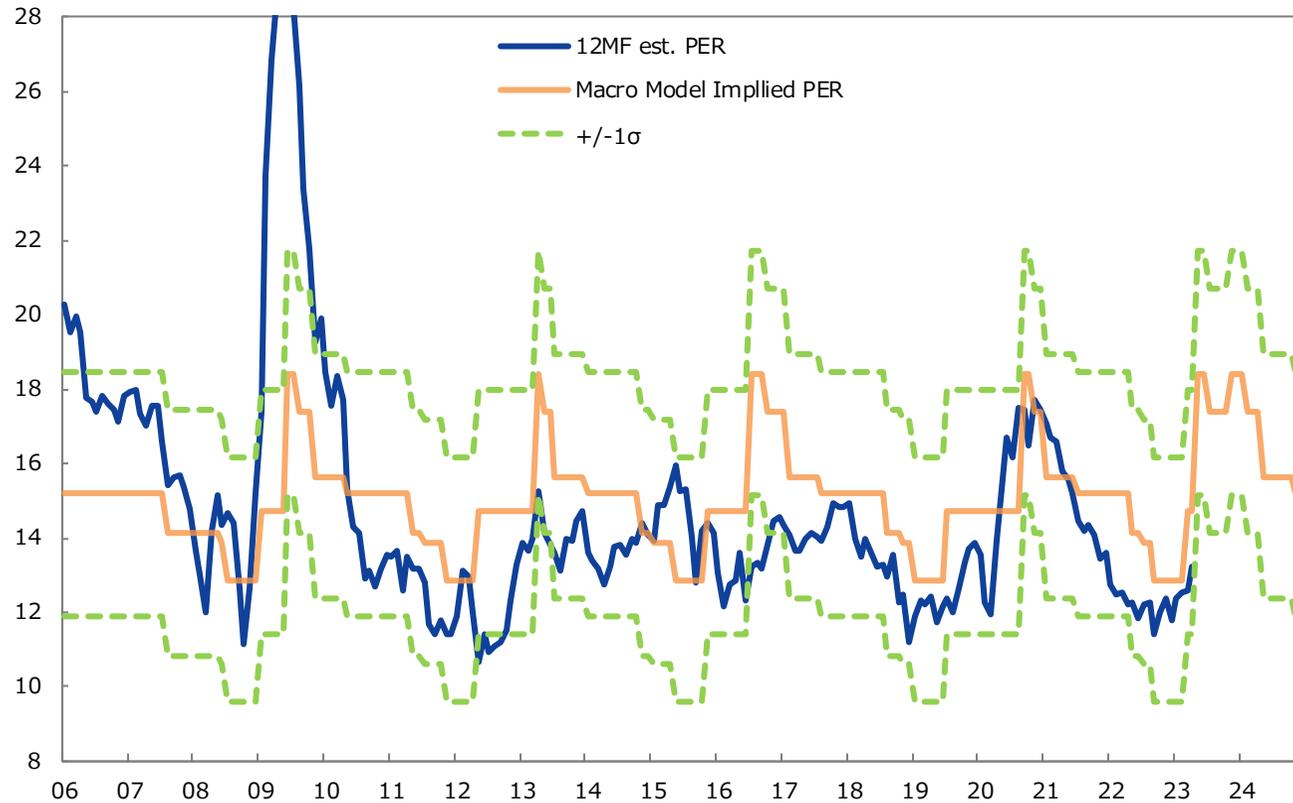


Note: Consensus data is from January 2006 to March 2023,  
Model estimate Data is from February 2023 to December 2024.  
Source: SMDAM

# Model indicates PER to rebound from rock bottom

(Times)

## Macro Model Implied TOPIX PER

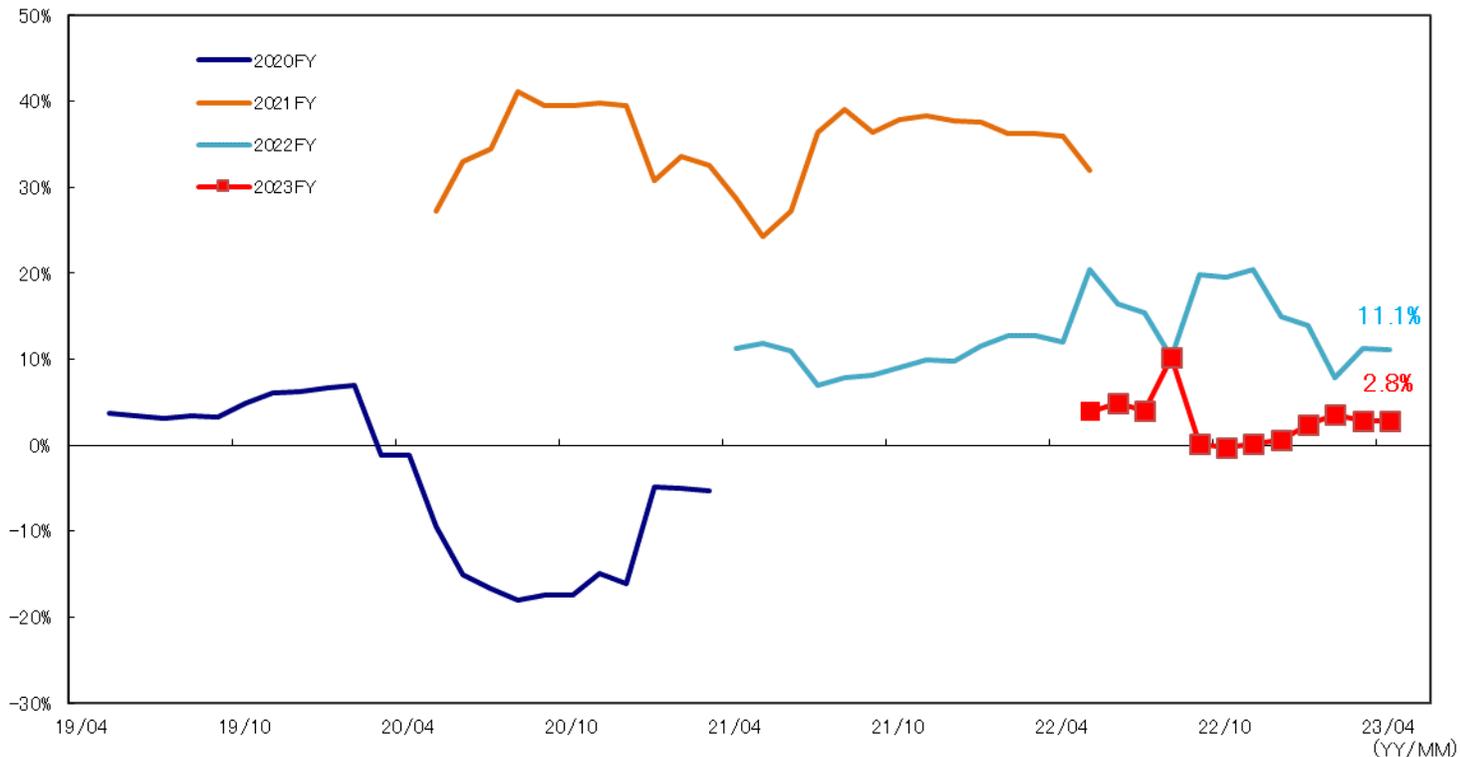


(Year)

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

# Earnings growth to slow next fiscal year

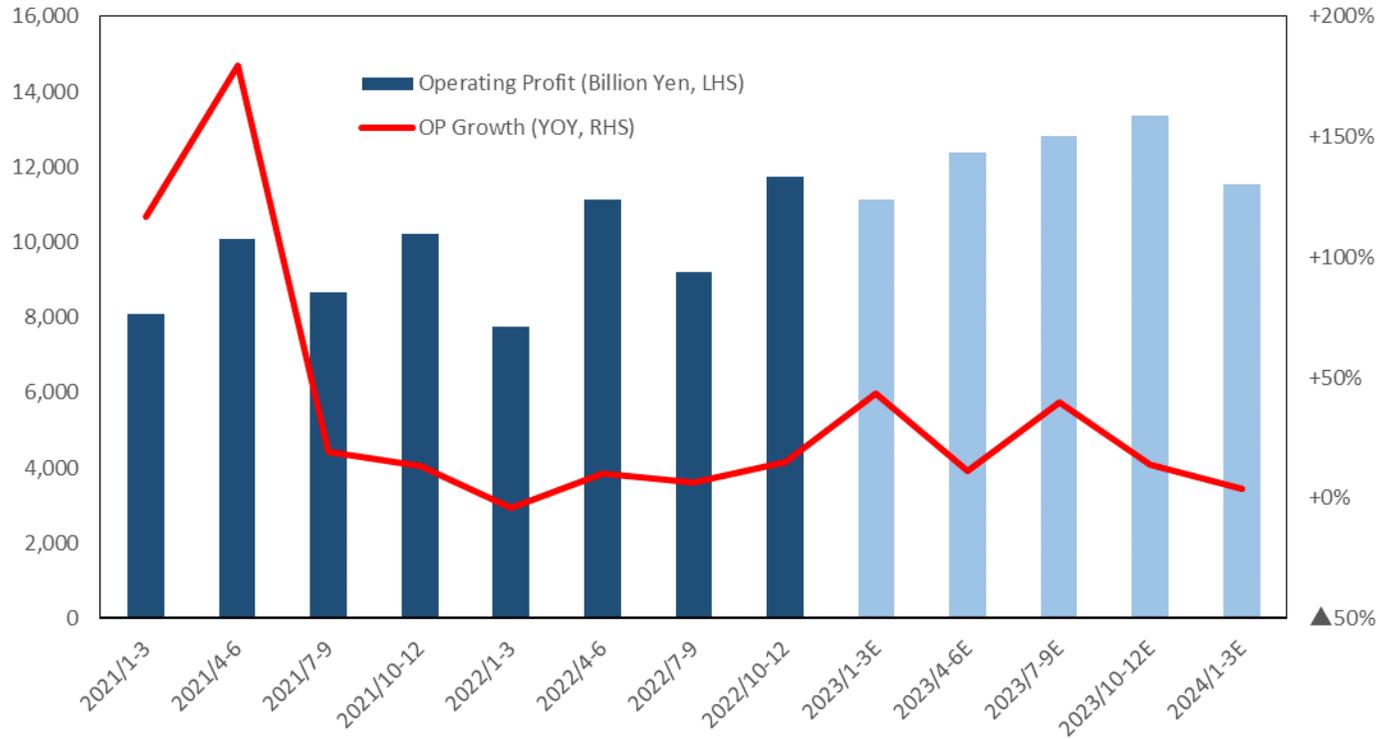
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th April 2023, SMDAM Core Universe (Excl. Financials) consists of 408 Japanese companies covered by SMDAM in-house analysts.  
Source: SMDAM

# Outlook for operating profit remains stable

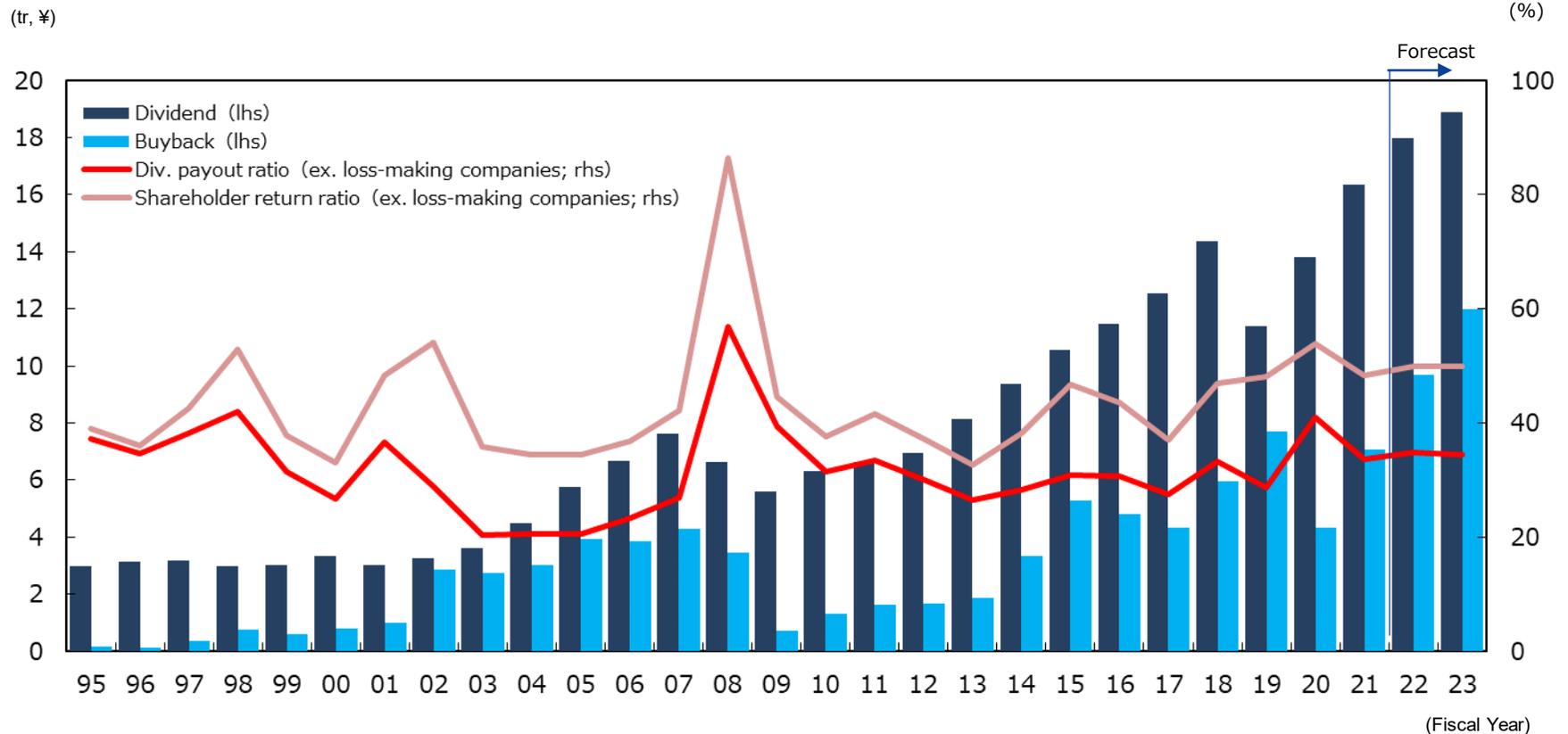
Operating Profit (All Industries Excl. Financials and Softbank Group)



Note: Actual data is from Q1 2021 to Q4 2022. Estimate data is from Q1 2023 to Q1 2024.  
Source: SMDAM

# Dividends and buybacks continue to rise 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

# Big swing between Value and 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>5.88</b> | <b>7.71</b> | <b>7.90</b> | <b>6.58</b> | <b>5.40</b> | <b>42.81</b> | <b>17.36</b> |
| Total Value            | 5.91        | 8.80        | 7.22        | 8.92        | 16.76       | 55.48        | 12.83        |
| Top Cap Value          | 4.62        | 9.55        | 6.73        | 7.39        | 23.10       | 65.04        | 27.31        |
| Large Cap Value        | 5.47        | 8.91        | 7.12        | 7.68        | 18.45       | 58.21        | 16.07        |
| Mid Cap Value          | 6.61        | 8.06        | 7.65        | 8.06        | 12.84       | 50.25        | 1.49         |
| Small Cap Value        | 7.89        | 8.39        | 7.68        | 14.51       | 9.36        | 43.63        | -0.87        |
| Micro Cap Value        | 6.51        | 8.95        | 7.42        | 15.02       | 11.05       | 39.61        | -0.95        |
| Total Growth           | 5.84        | 6.97        | 8.55        | 4.50        | -4.43       | 30.29        | 20.55        |
| Top Cap Growth         | 5.61        | 8.29        | 9.87        | 2.80        | -3.87       | 32.76        | 28.87        |
| Large Cap Growth       | 6.24        | 7.65        | 9.32        | 4.55        | -4.07       | 31.18        | 23.57        |
| Mid Cap Growth         | 7.39        | 6.53        | 8.34        | 7.81        | -4.32       | 28.56        | 15.67        |
| Small Cap Growth       | 2.86        | 1.63        | 2.78        | 4.30        | -7.62       | 22.41        | -1.25        |
| Micro Cap Growth       | 1.10        | 1.66        | 1.74        | 4.91        | -11.02      | 23.03        | -0.38        |
| Top Cap Total          | 5.18        | 8.69        | 8.48        | 4.75        | 7.14        | 46.18        | 27.24        |
| Large Cap Total        | 5.87        | 8.10        | 8.28        | 5.93        | 5.83        | 43.88        | 20.57        |
| Mid Cap Total          | 6.98        | 7.22        | 7.98        | 7.80        | 4.05        | 40.97        | 11.40        |
| Small Cap Total        | 5.89        | 5.55        | 5.73        | 10.42       | 2.41        | 35.86        | -0.12        |
| Micro Cap Total        | 4.66        | 6.32        | 5.48        | 11.51       | 3.48        | 34.91        | 0.68         |

Note : As of 20th April 2023  
(Source) Bloomberg



# Outlook for Japanese Economy

# Current status & Outlook of Japanese economy

## [Current Status]

- **The economy is picking up.** Goods exports and production have been sluggish amid a slowdown in overseas economies. The Bank of Japan's "Tankan" DI has shown a sharp decline in business confidence/conditions of the manufacturers, while domestic demand has remained solid. CAPEX has been persistent thanks to pent-up demand and new types of investment demand, such as "de-carbonization" and "digitization". Despite the headwinds of higher inflation, consumer spending has remained stubborn amid the reopening of the economy. Inbound consumption has also been recovering after lifting the ban on foreign travelers.
- **Inflation is heading south.** The Nationwide core CPI for February rose 3.1% from a year earlier, down sharply from 4.2% YOY for January mainly due to measures to reduce the burden of electricity and gas bills. In March, Tokyo core CPI was up 3.2% year on year, down from 3.3% the previous month mainly due to falling energy costs. The slowdown in import prices, the starting point of the cost push inflation, has been becoming more apparent.

## [Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2022 at 1.3%, while we have lowered our estimate for FY 2023 from +1.2% to +1.1% and FY 2024 from +1.0% to +0.9%.** The downward revisions for FY 2023 and FY 2024 reflect the worsening business conditions in the manufacturing sector and the downward revision of overseas economic forecasts. The economic recovery is expected to continue for the foreseeable future, supported by the increase of CAPEX, consumer spending, inbound consumption and also fiscal stimulus. While the economy will soften temporarily owing to the slowdown in the US economy in the second half of FY 2023, the economy will be expected to recover thereafter as the US economy will avoid a serious setback.
- ② **We have maintained our core CPI forecast for FY 2022 at +3.0%, for FY 2023 at +2.7%, and for FY 2024 at +1.5%.** While the regulated electricity price will be raised in the near future, as cost-push inflation could diminish in response to a slowdown in import prices, core CPI is highly likely to follow a downward trend. However, supported by higher wages, a core CPI below + 2% is not expected to take root until the middle of 2024.
- ③ **PM Kishida's cabinet will continue its accommodative economic policy.** In October last year, the Cabinet approved a comprehensive economic package to overcome high inflation and revive the economy. It was a massive economic package of 37.6 trillion yen in national and local expenditures and additional economic measures are likely to be taken if the economy undergoes a downturn. On the other hand, the government is now paying more attention to the financial soundness of the state regarding increases in spending related to national security and countermeasures to the falling birthrate. The former will be partly financed by a corporate tax increase. Regarding the latter, some of the ruling LDP members have called for securing a stable source of revenue through measures such as raising social insurance premiums.
- ④ **We have modified our view regarding the timing of the correction of monetary policy, widening the YCC (yield curve control) range from  $\pm 0.5\%$  to  $\pm 1\%$ , from April to July 2023.** The option to correct the current YCC remains unchanged, but the timing has been pushed back from April this year. Though BOJ's new governor Ueda doesn't rule out side effects of YCC, due to the downside risks to the economy, the possibility of rushing to review the YCC seems to have declined. On the other hand, as the governor regards the negative interest rate as the basis for the current monetary policy, it is highly likely to keep it despite the side effects of massive easing.

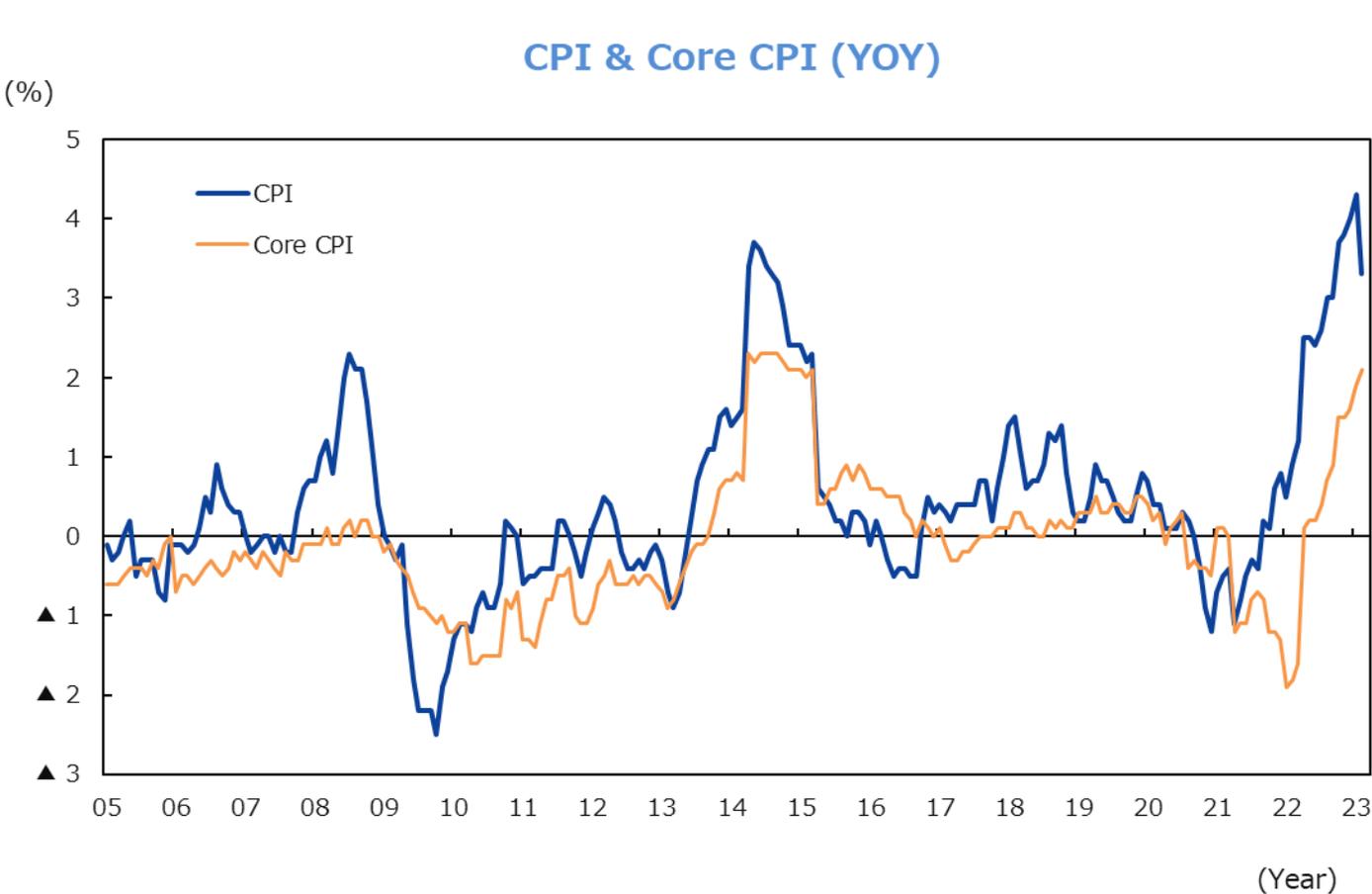
# Forecast table for the Japanese economy

| 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%  | 1.3%     | 1.1%     | 0.9%     |
| Private final consumption expenditure                | 0.1%  | -1.0% | -5.4%  | 1.5%  | 2.3%     | 1.1%     | 0.9%     |
| Private housing investment                           | -4.8% | 2.5%  | -7.8%  | -1.1% | -4.5%    | -0.9%    | -0.2%    |
| Private-sector capital investment                    | 1.5%  | -1.7% | -7.7%  | 2.1%  | 2.9%     | 2.1%     | 2.2%     |
| Public fixed capital formation                       | 0.8%  | 1.7%  | 5.1%   | -6.4% | -4.0%    | 1.7%     | 0.7%     |
| Net export contribution                              | -0.2% | -0.5% | -0.6%  | 0.8%  | -0.4%    | 0.0%     | -0.1%    |
| Exports of goods and services                        | 2.0%  | -2.3% | -10.0% | 12.3% | 4.4%     | -0.5%    | 2.0%     |
| Imports of goods and services                        | 3.0%  | 0.2%  | -6.3%  | 7.1%  | 6.7%     | -0.3%    | 2.5%     |
| Nominal GDP                                          | 0.2%  | 0.0%  | -3.9%  | 2.4%  | 1.8%     | 2.7%     | 2.0%     |
| GDP deflator                                         | -0.1% | 0.8%  | 0.7%   | -0.1% | 0.5%     | 1.6%     | 1.1%     |
| Industrial Production Index                          | 0.3%  | -3.7% | -10.0% | 5.9%  | -0.4%    | -0.6%    | 1.8%     |
| Consumer Price Index (Core)                          | 0.8%  | 0.4%  | -0.6%  | 0.1%  | 3.0%     | 2.7%     | 1.5%     |
| Domestic corporate goods price index                 | 2.2%  | 0.1%  | -1.5%  | 7.1%  | 9.4%     | 0.1%     | 0.0%     |
| Employee compensation                                | 3.2%  | 2.0%  | -1.5%  | 2.1%  | 2.1%     | 2.6%     | 2.3%     |
| Unemployment rate                                    | 2.4%  | 2.4%  | 2.9%   | 2.8%  | 2.6%     | 2.4%     | 2.3%     |
| 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

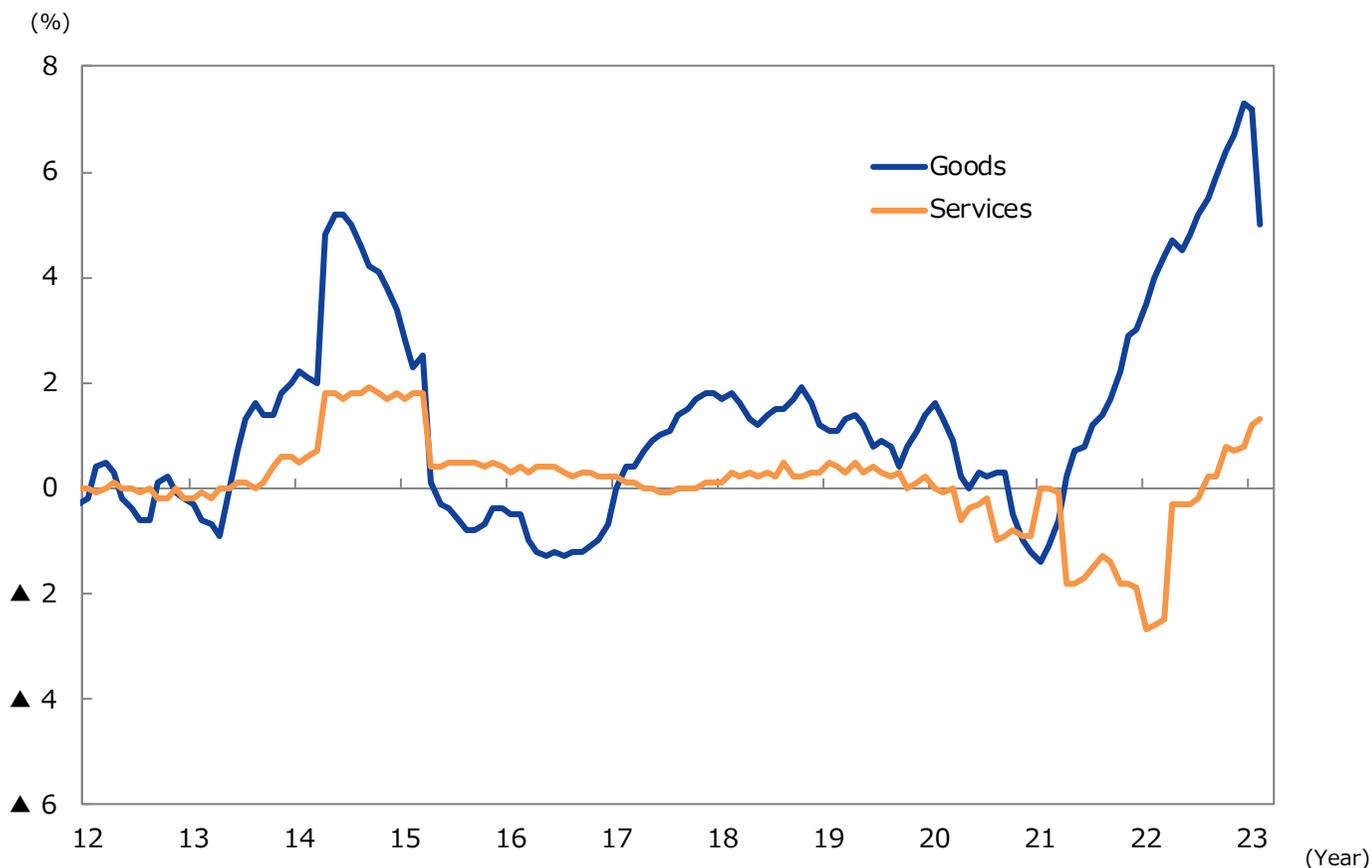
# Headline rate starts declining despite sticky core inflation



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

# While goods prices are turning south, services continues rising

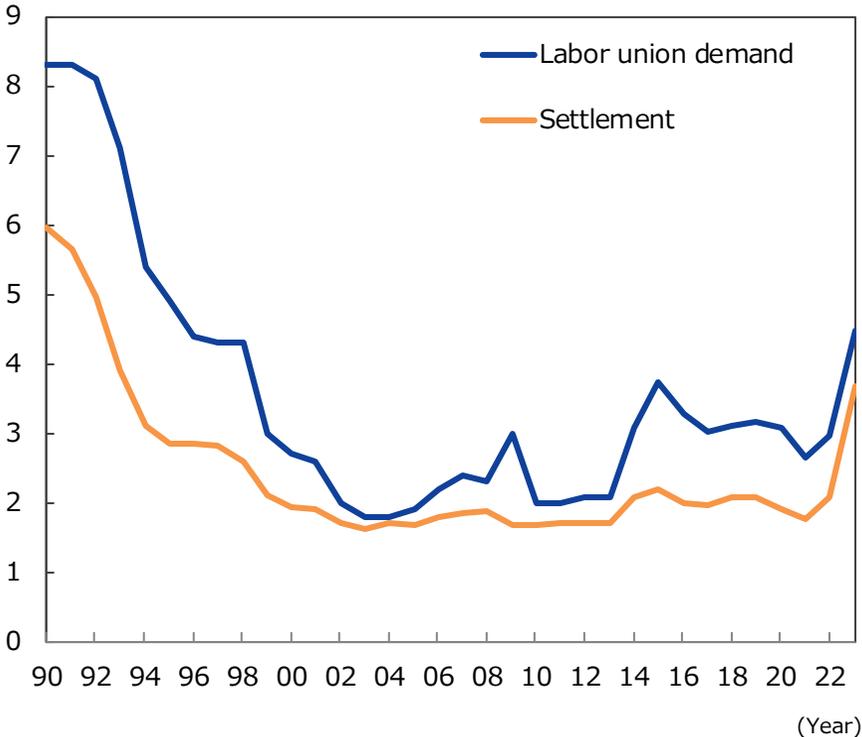
## CPI of Goods & Services (YOY, %)



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

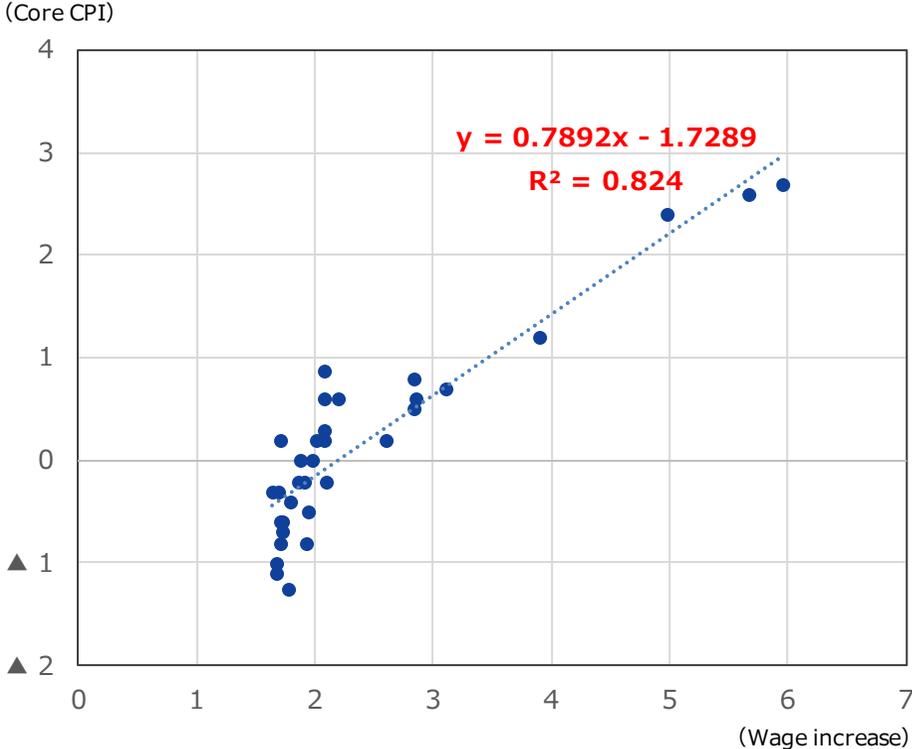
# Start of a virtuous cycle?

### Wage increase demand & settlement (YOY, %)



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

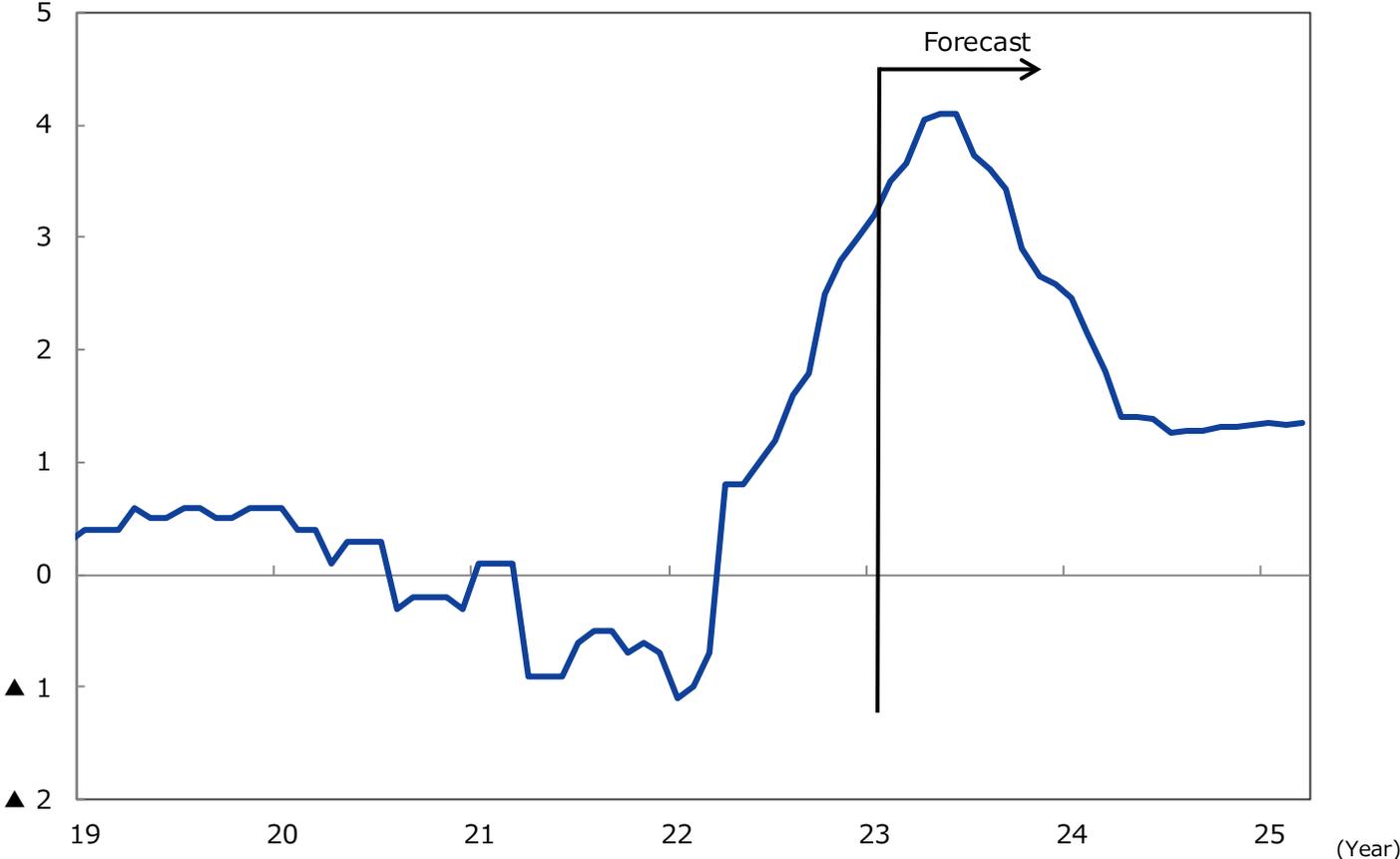
### Wage increase & Core CPI (YOY, %)



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

# BOJ estimates Core CPI to peak in June

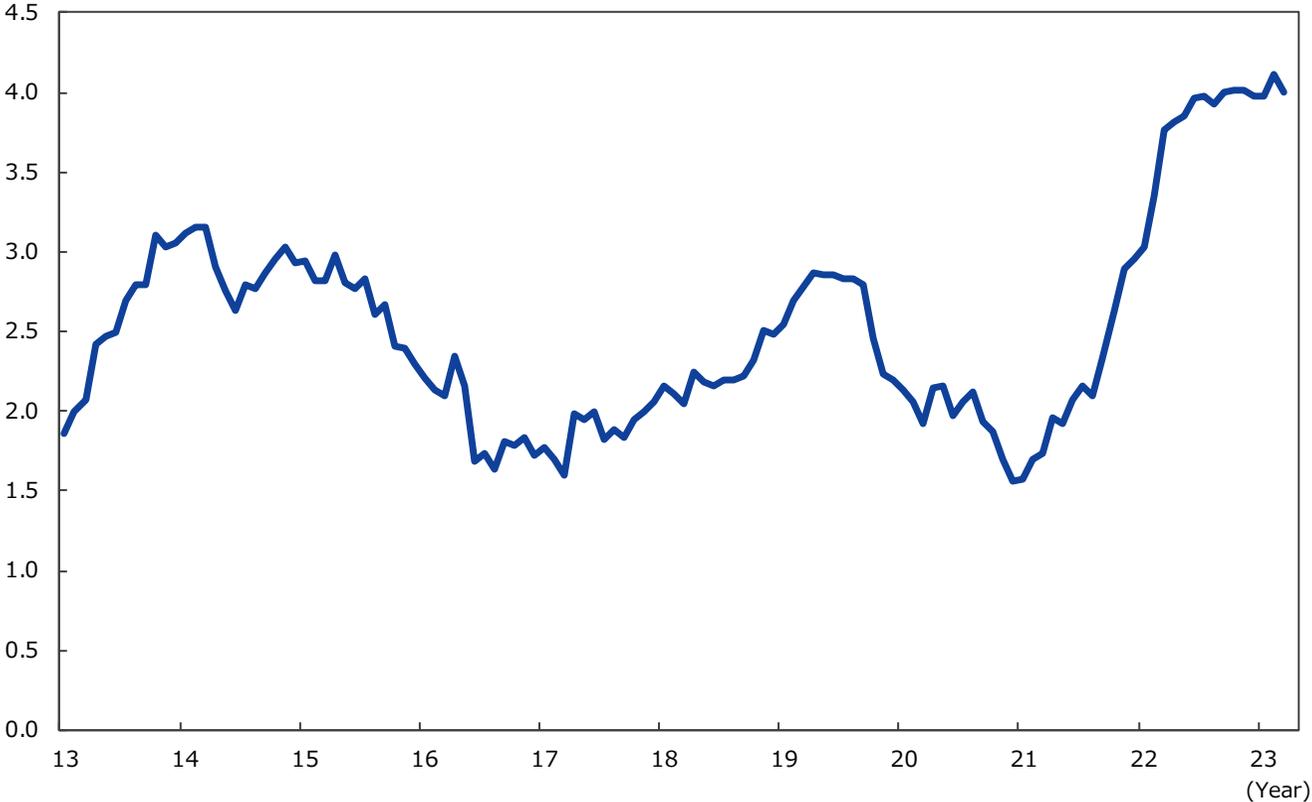
### BOJ's Core CPI forecast (YOY, %)



Note: Data is from January 2019 to March 2025. BOJ's CPI is excluding fresh foods & energy. Data after February 2023 are forecast.  
Source: The Bank of Japan, SMDAM

# People expect higher inflation to continue going forward

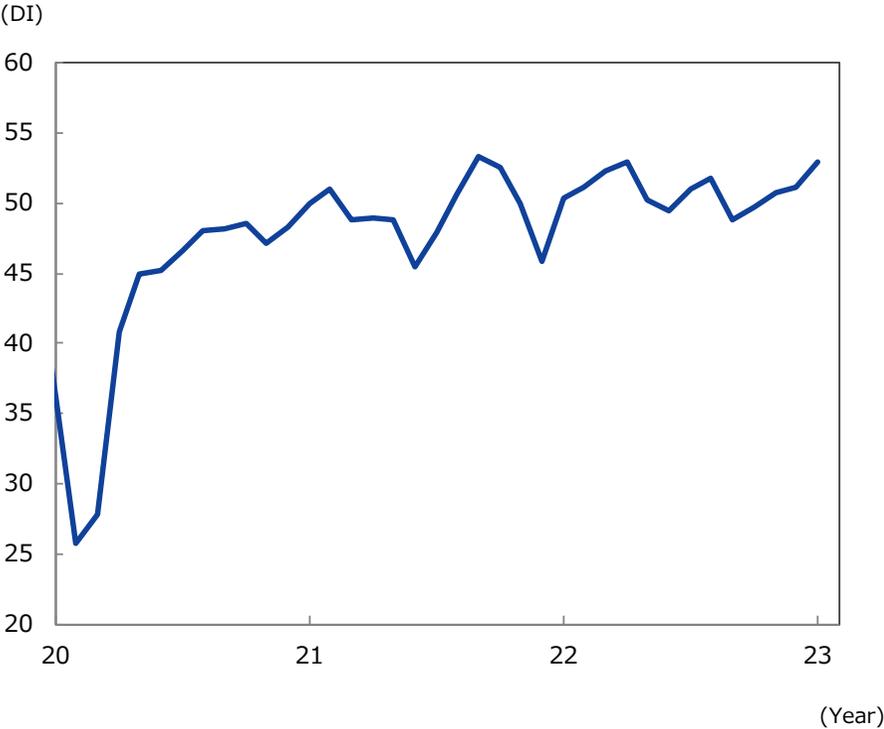
### Consumers' Expectation of Inflation Rate (YOY, %)



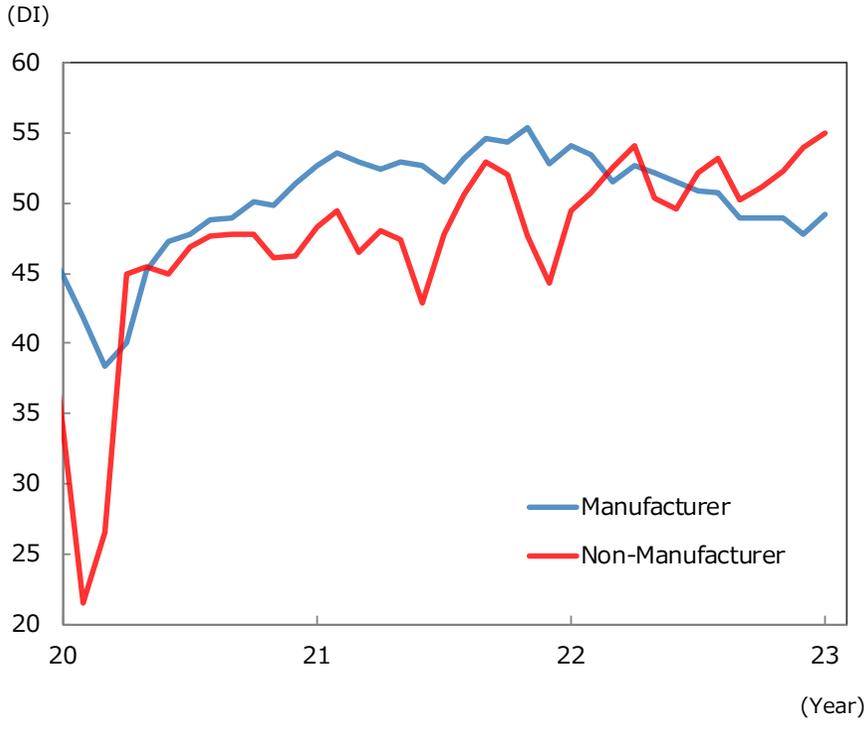
Note: Weighted average of inflation forecast of "Consumer Confidence Survey". Data is from January 2013 to March 2023.  
Source: Cabinet Office, SMDAM

# Service sector pushes business sentiment higher

### Composite PMI



### PMI, Manufacturer & Non-Manufacturer



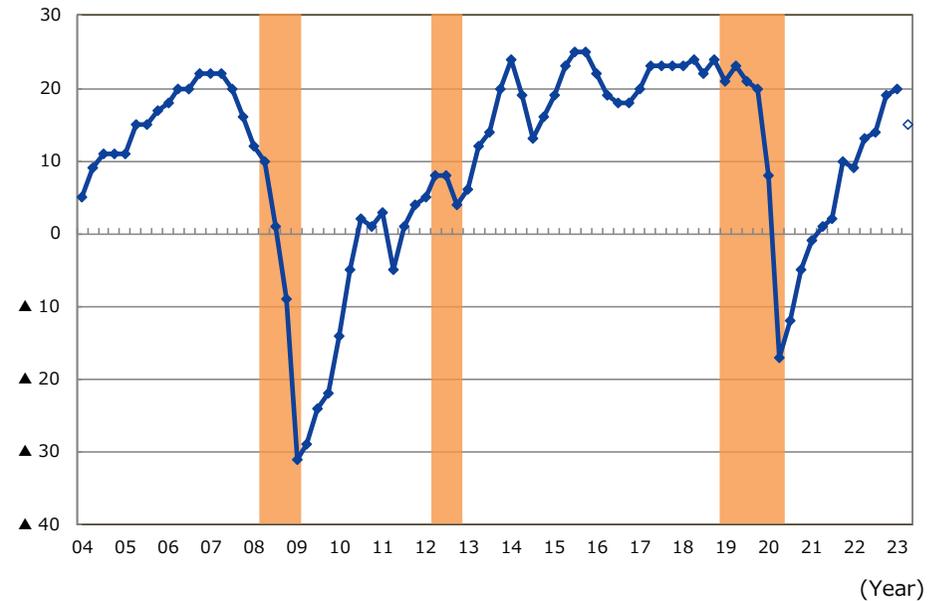
Note: Data is from March 2020 to March 2023.  
Source: Bloomberg, SMDAM

# While services improving, manufacturers weakening

BOJ business condition DI Large manufacturers (%)



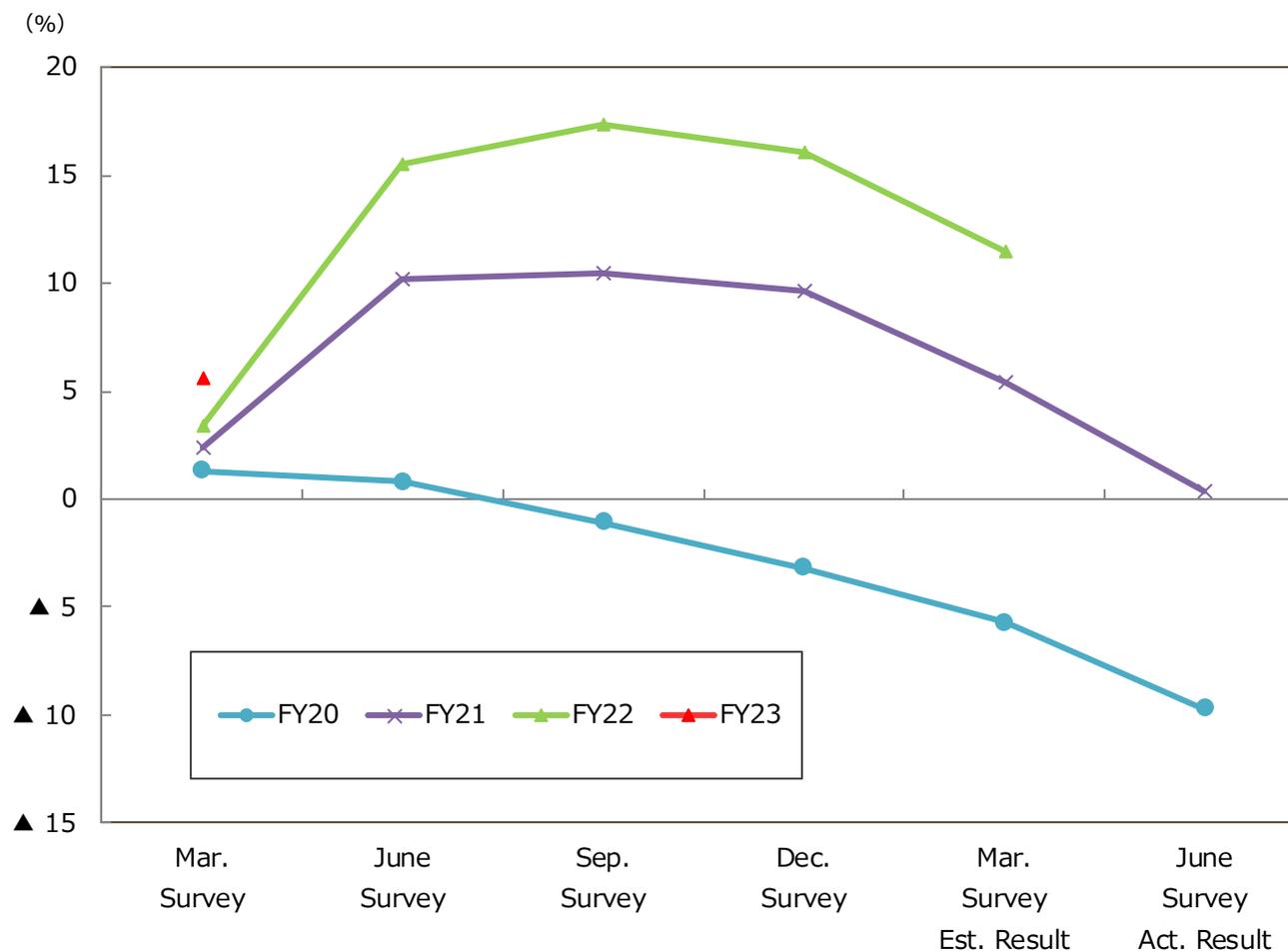
BOJ business condition DI Large non-manufacturers (%)



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

# Weak JPY and growing conflict between US-China boosts CAPEX

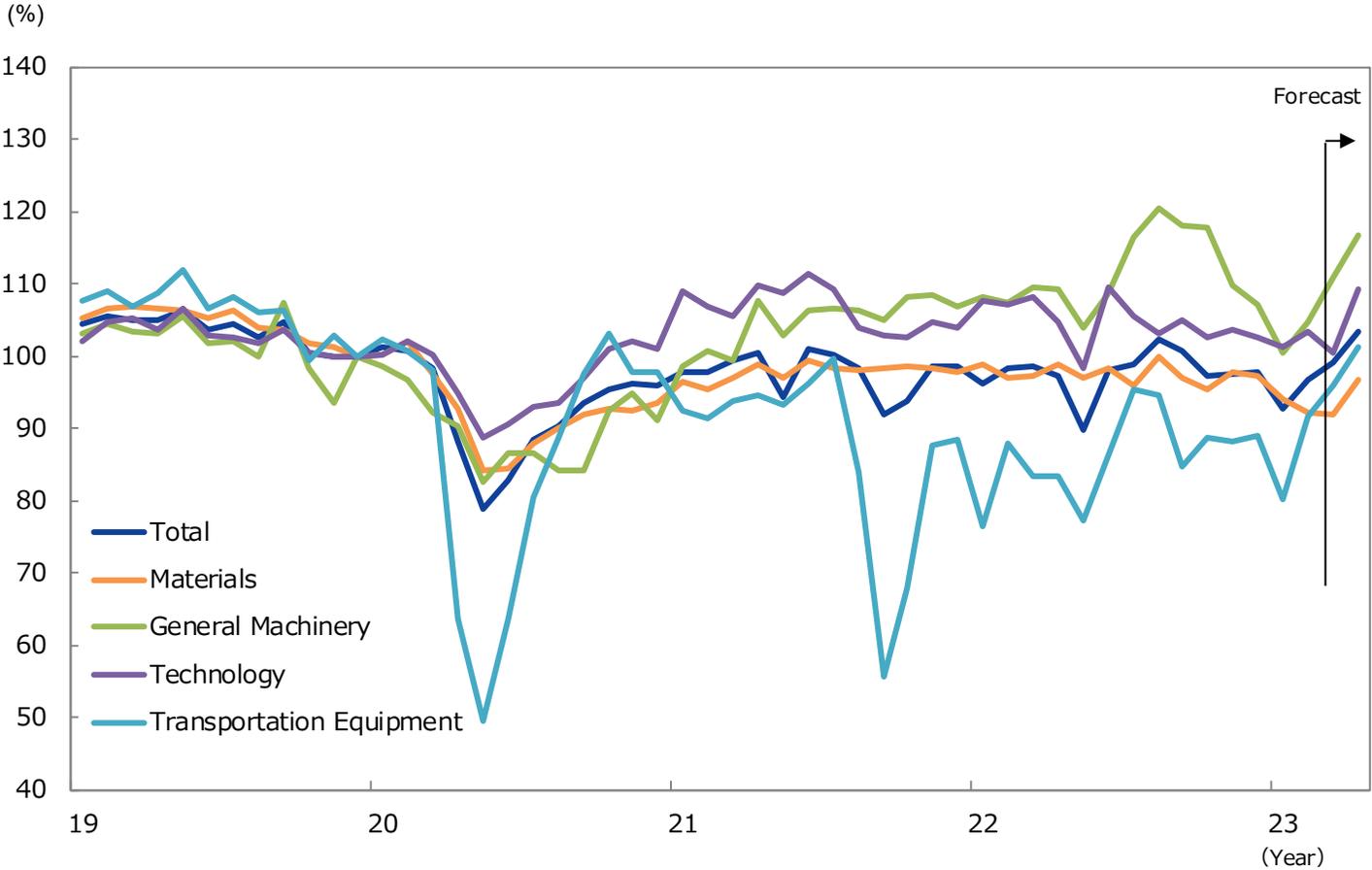
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



Note: Data is from Q1 FY 2020 to Q1 2023.  
Source: The Bank of Japan, SMDAM

# Resolution of semiconductor shortage lifts industrial production

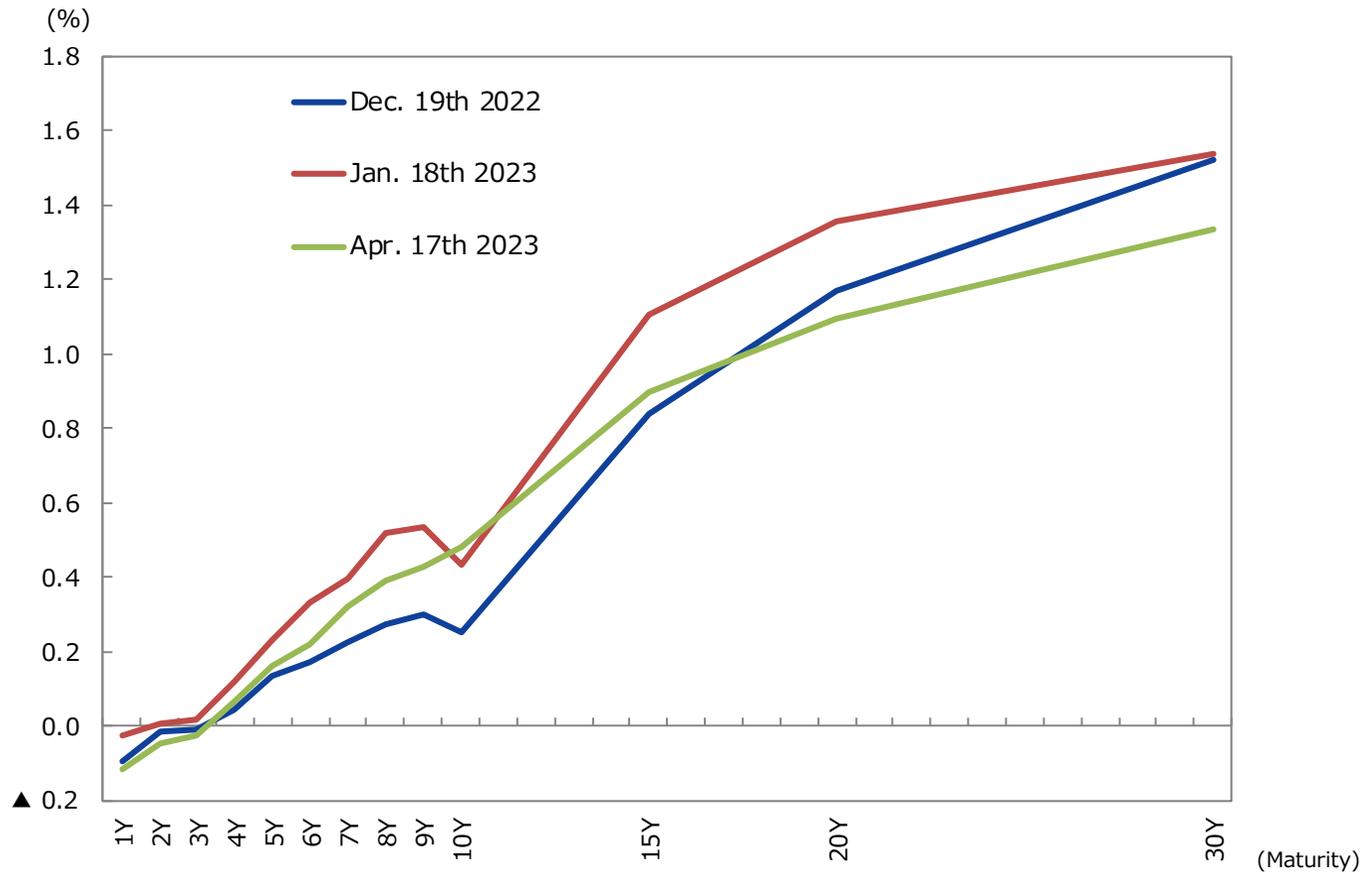
## Industrial Production (Dec. 2019=100)



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

# Speculators attacking BOJ routed after short squeeze

## Yield Curve of Japanese Sovereign



Source: Bloomberg, SMDAM

# Falling BEI and rising bond yield lifts real interest rate higher

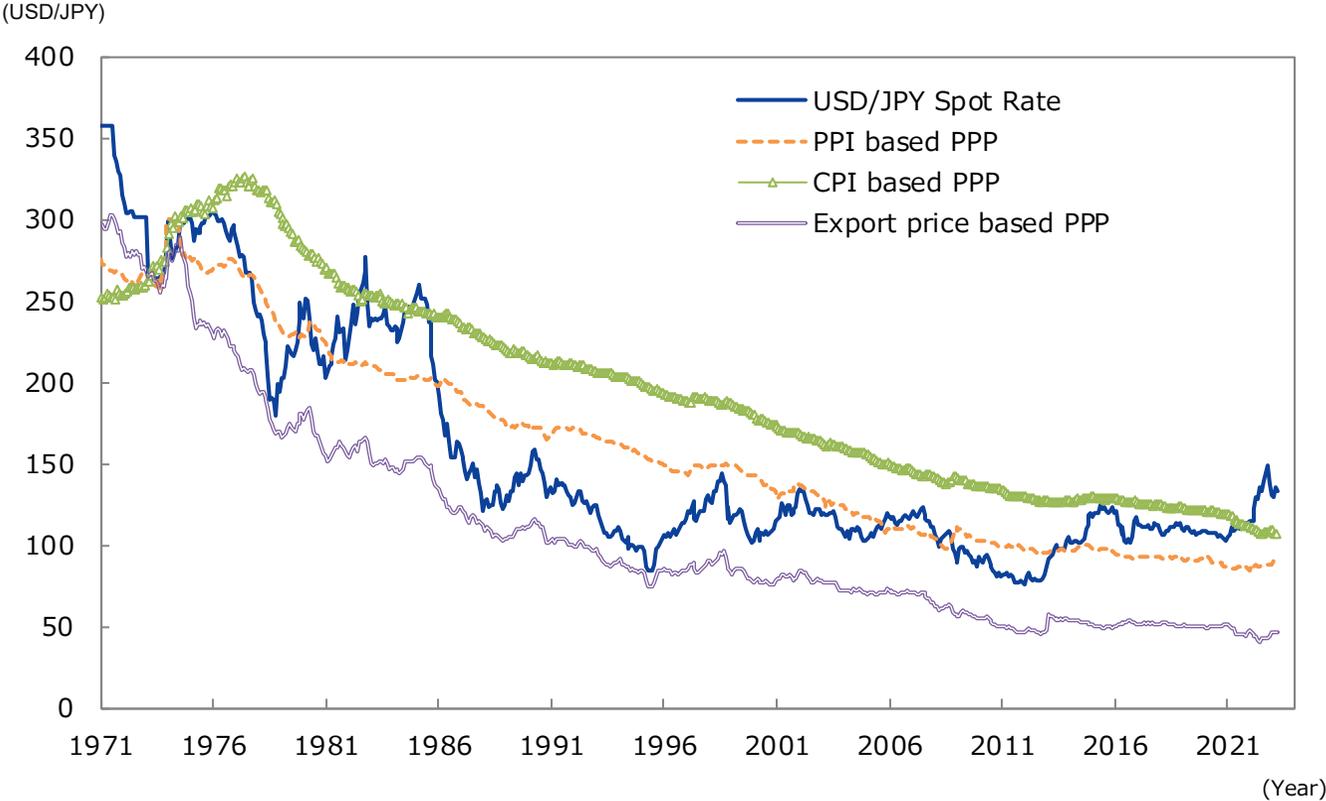
## JGB, BEI, and Real Interest rate



Note: Data is from 1st January 2014 to 18th April 2023.  
Source: Bloomberg, SMDAM

# USD/JPY keeps hovering above purchasing power parity

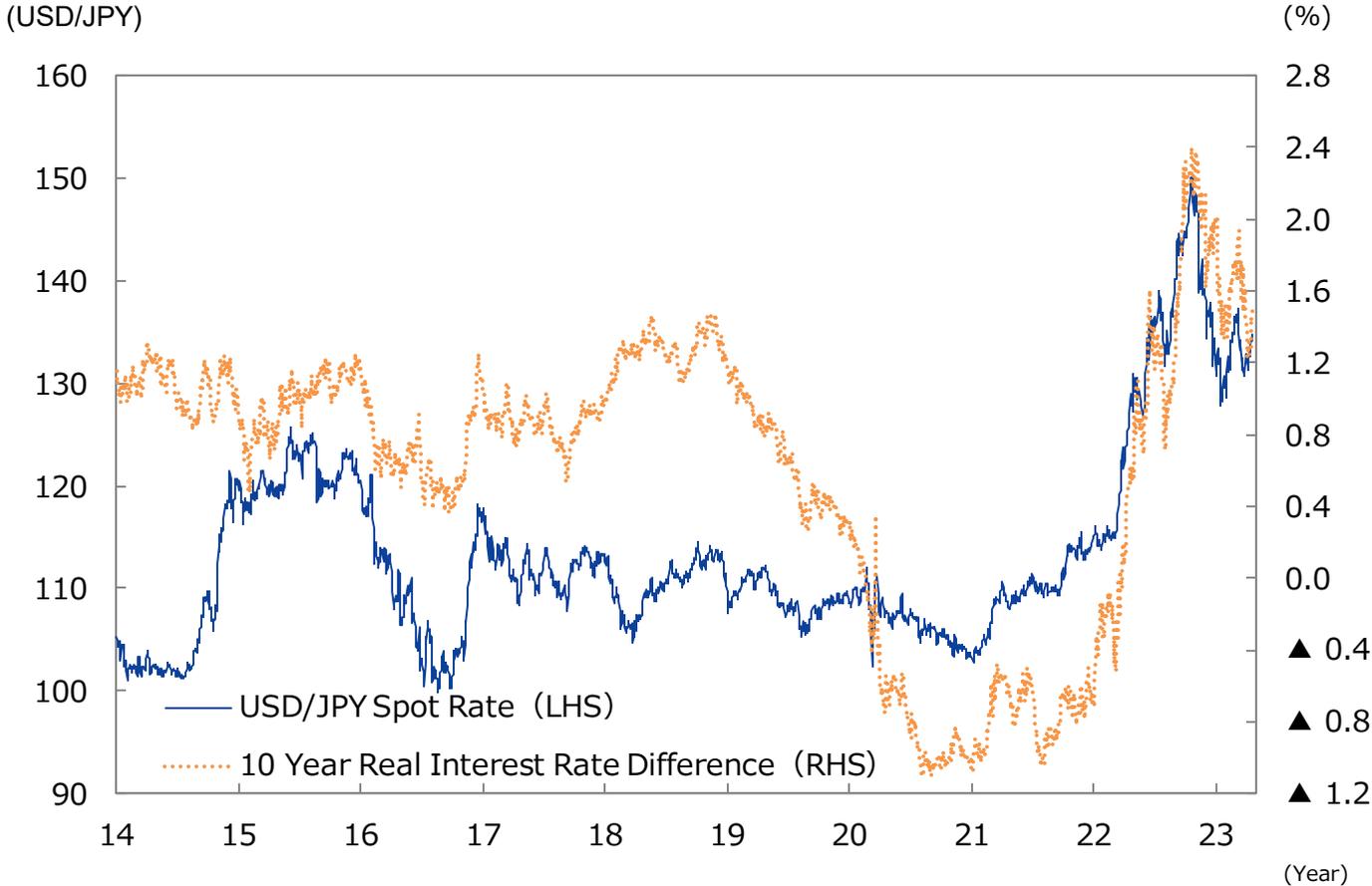
## Purchasing Power Parity of USD/JPY Rate



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

# Real yield gap keeps dominating USD/JPY rate

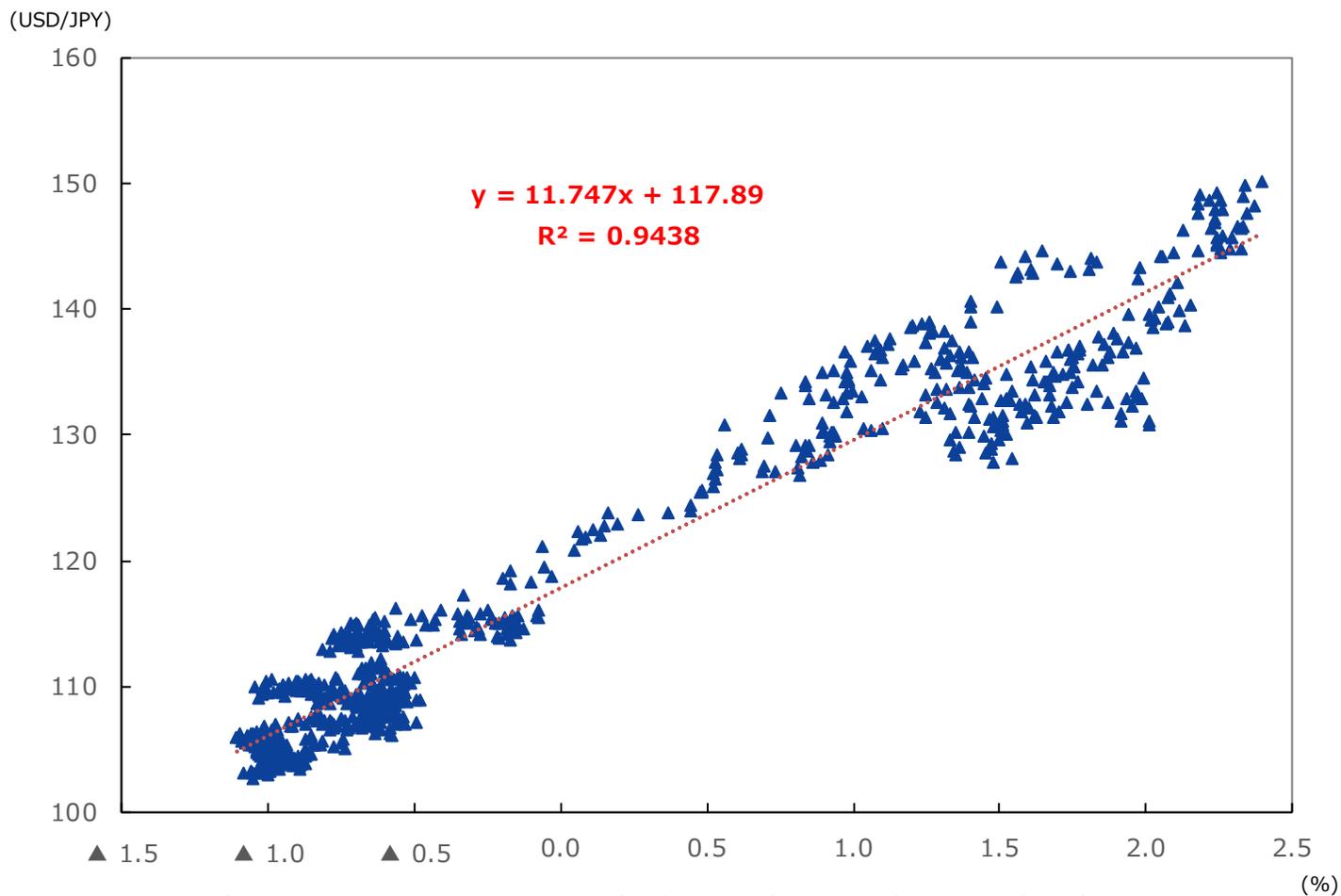
## Real Interest Rate Gap & USD/JPY Exchange rate



Note: Data is from 1st January 2014 to 19th April 2023.  
Source: Bloomberg, SMDAM

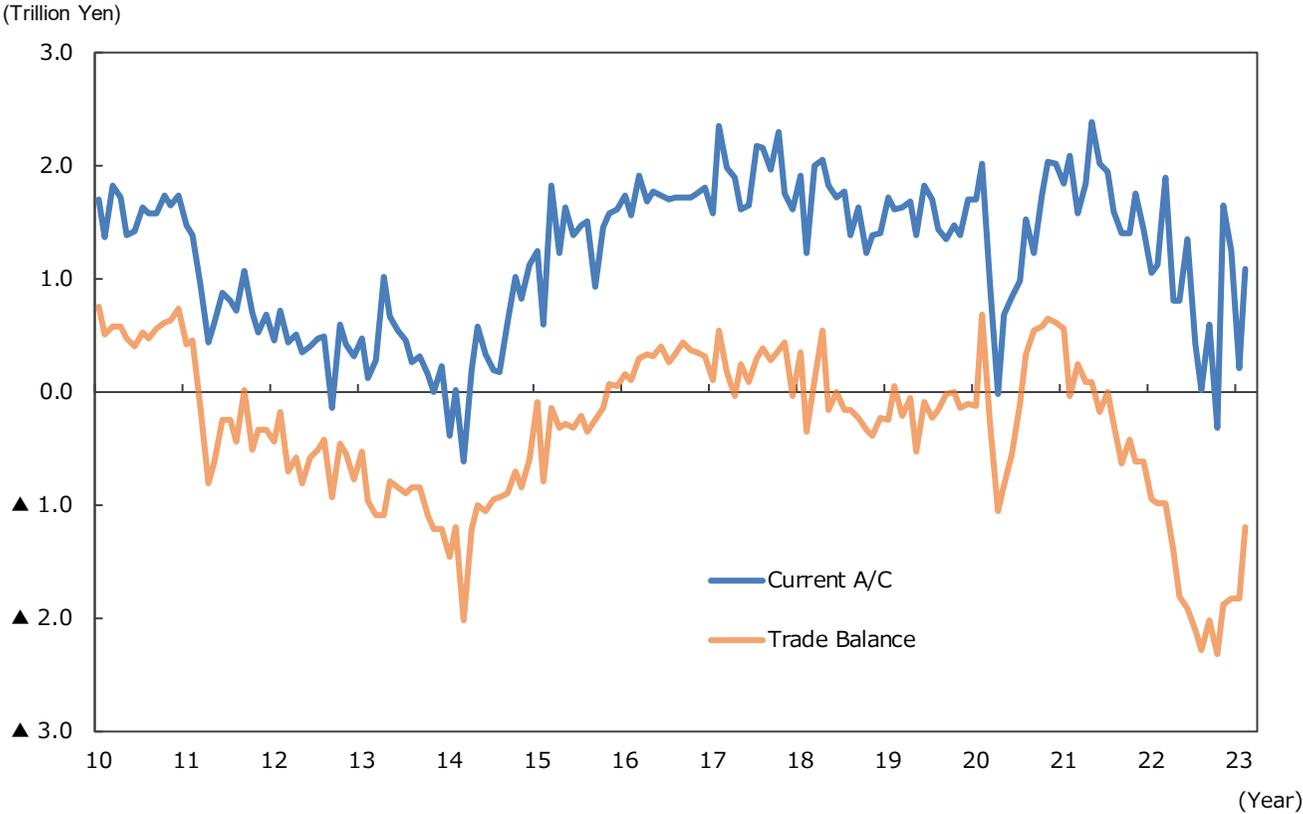
# Real yield gap keeps dominating USD/JPY rate

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



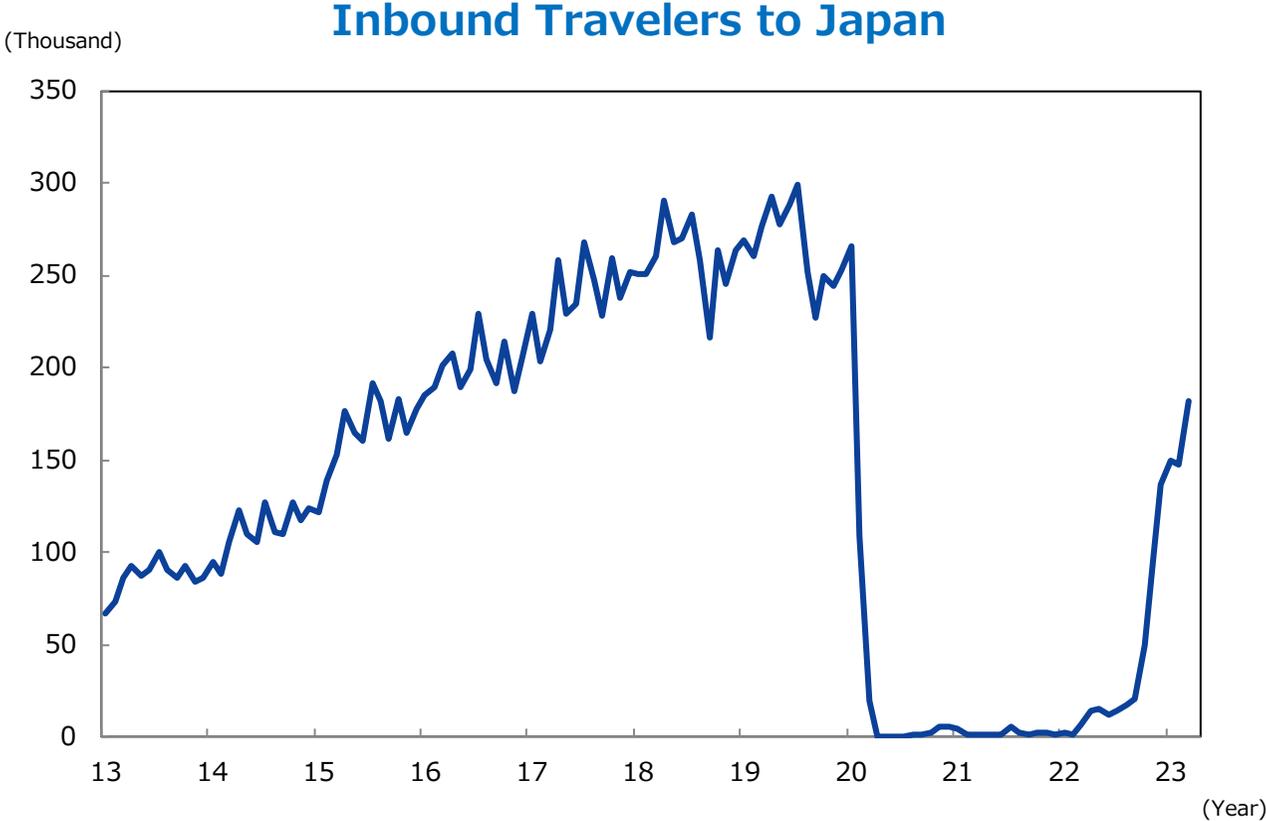
# Trade deficits may hit the bottom due to falling energy prices

## Current Account & Trade Balance



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

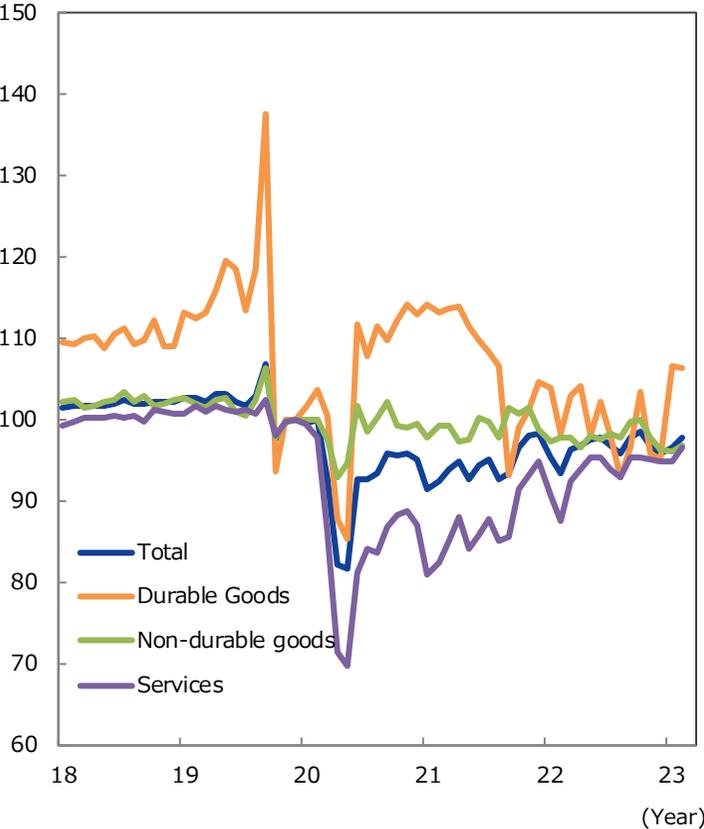
# Inbound travelers coming back sharply after “Re-opening”



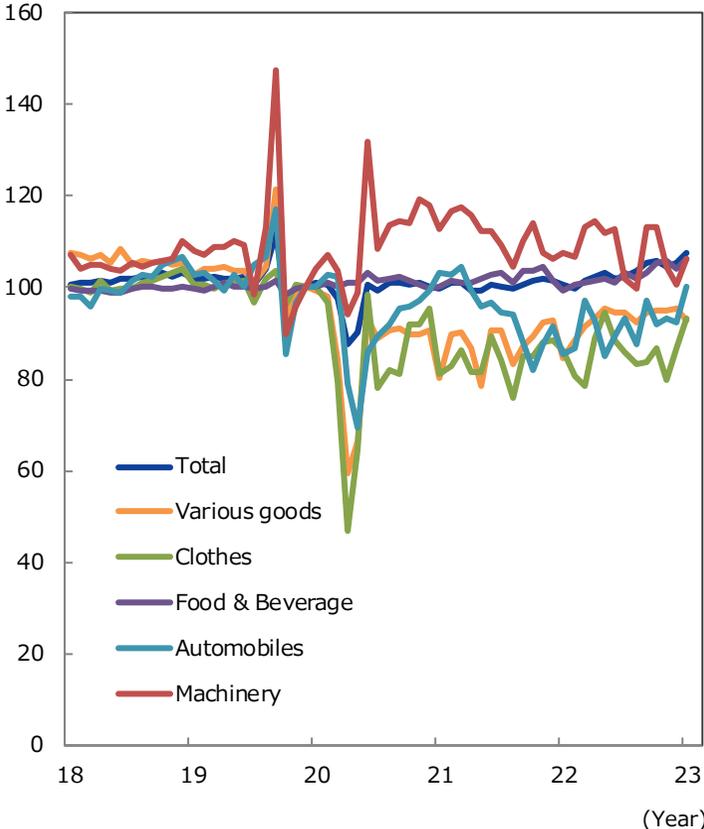
Note: Data is from January 2013 to March 2023. Data is non-seasonally adjusted.  
Source: Japan National Tourism Organization, SMDAM

# Consumer activities back to normal

Consumer Activity Index (Dec. 2019 = 100)



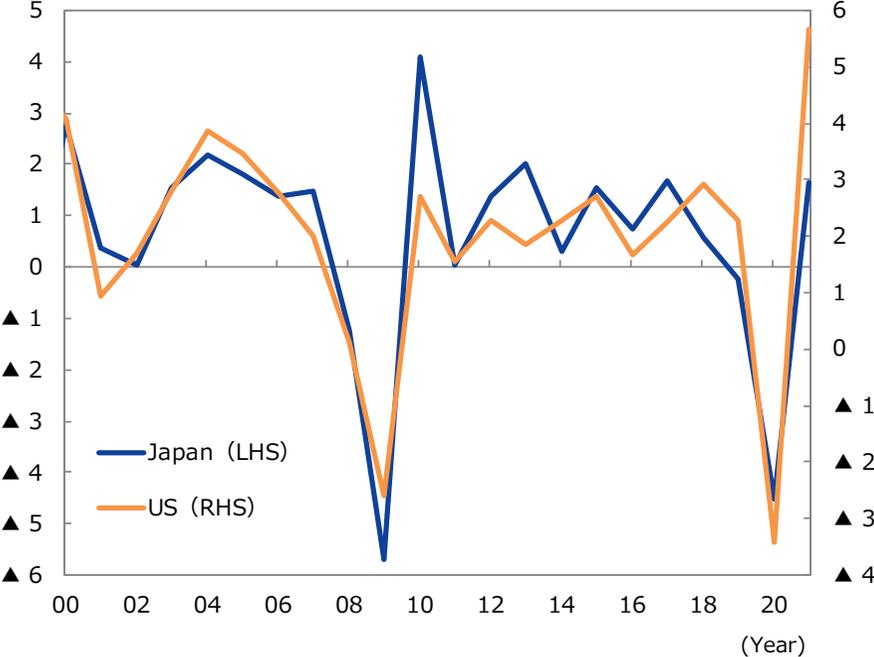
Retail Sales (Dec. 2019 = 100)



Note: Consumer activity index is from January 2018 to February 2023. Retail sales is from January 2018 to January 2023  
 Source; Bank of Japan, METI, and SMDAM

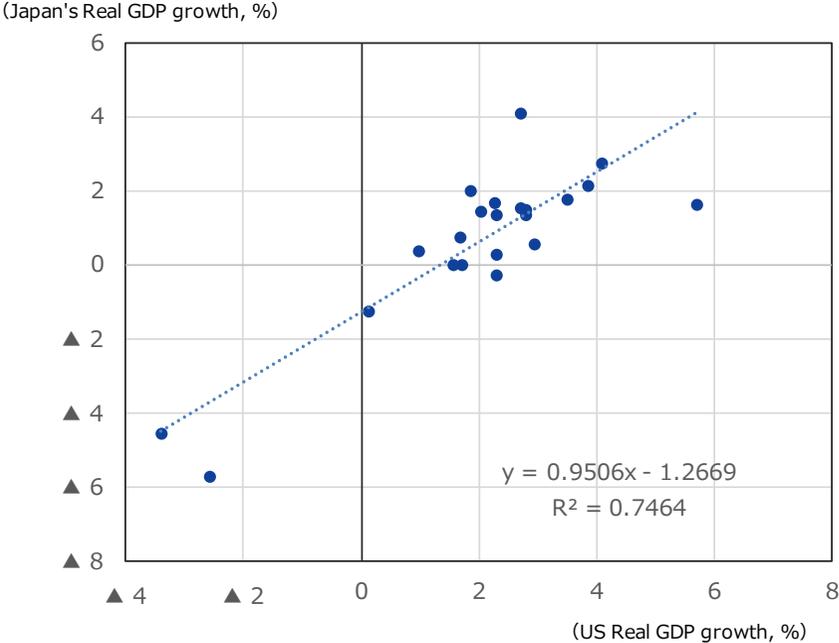
# Strong correlation between US and Japanese economic growth

Real GDP Growth (YOY, %)



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

Correlation of Real GDP Growth



# Japan's marginal exposure to Russian businesses

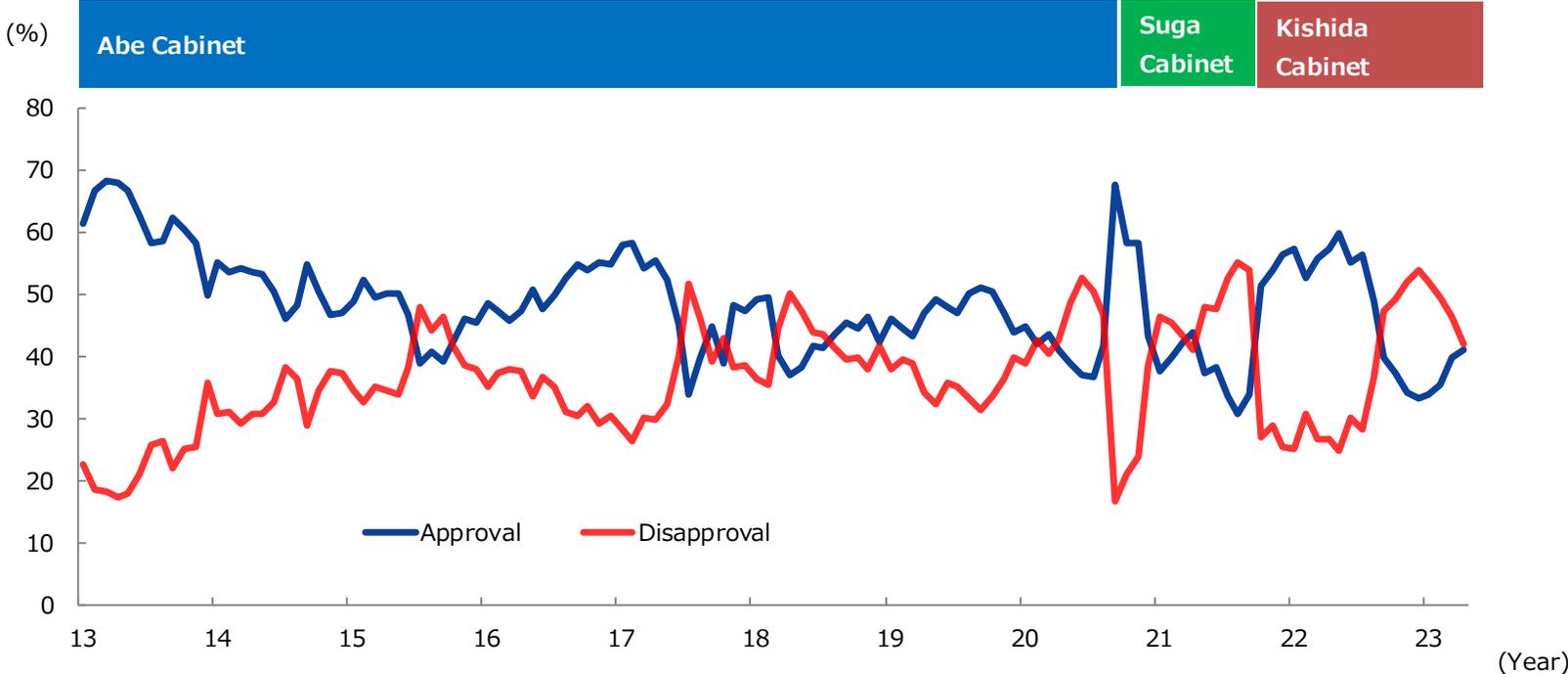
(%)

|                          | 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

# Rising approval rate fuels speculation for snap general election

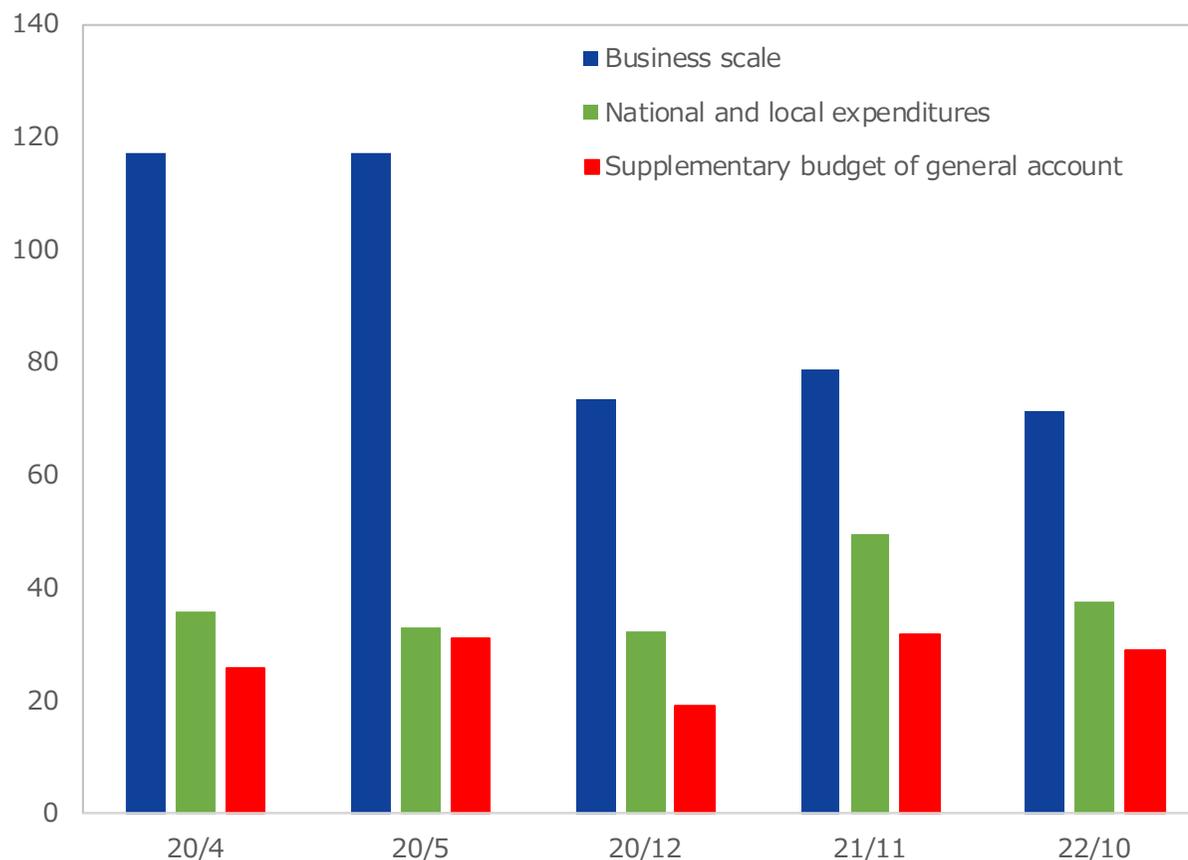
## Cabinet approval rate



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

# Size of fiscal stimulus

## Size of Fiscal Stimulus (trillion yen)



Source: MOF, SMDAM

(Year/month)

## Schedule of major events

| Year     | Month     | Date                                                                                                         | Event                                                                                                                              |
|----------|-----------|--------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------|
| 2023     | May       | 17                                                                                                           | Release of CY 2023 Q1 GDP                                                                                                          |
|          |           | 19-21                                                                                                        | G7 Summit in Japan                                                                                                                 |
|          | June      | 8                                                                                                            | Revision of CY 2023 Q1 GDP                                                                                                         |
|          |           | 15-16                                                                                                        | Monetary Policy Meeting                                                                                                            |
|          |           | 21                                                                                                           | End of the ordinary Diet session<br>Big-boned policy decisions<br>Formulation of guidelines for the facilitation of labor mobility |
|          | July      | 27-28                                                                                                        | Monetary Policy Meeting                                                                                                            |
|          | August    | 15                                                                                                           | Release of CY 2023 Q2 GDP                                                                                                          |
|          | September | 8                                                                                                            | Revision of CY 2023 Q2 GDP                                                                                                         |
|          |           | 9-10                                                                                                         | G20 Summit in India                                                                                                                |
| 21-22    |           | Monetary Policy Meeting<br>Appointment of key posts of ruling Liberal Democratic Party                       |                                                                                                                                    |
| October  | 1         | Start of the qualified invoice-based method                                                                  |                                                                                                                                    |
|          | 30-31     | Monetary Policy Meeting                                                                                      |                                                                                                                                    |
| November | 15        | Release of CY 2023 Q3 GDP                                                                                    |                                                                                                                                    |
| December | 8         | Revision of CY 2023 Q3 GDP                                                                                   |                                                                                                                                    |
|          | 18-19     | Monetary Policy Meeting<br>Cabinet approval of the initial budget for fiscal 2024 and the tax reform outline |                                                                                                                                    |

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