



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-April 2024-

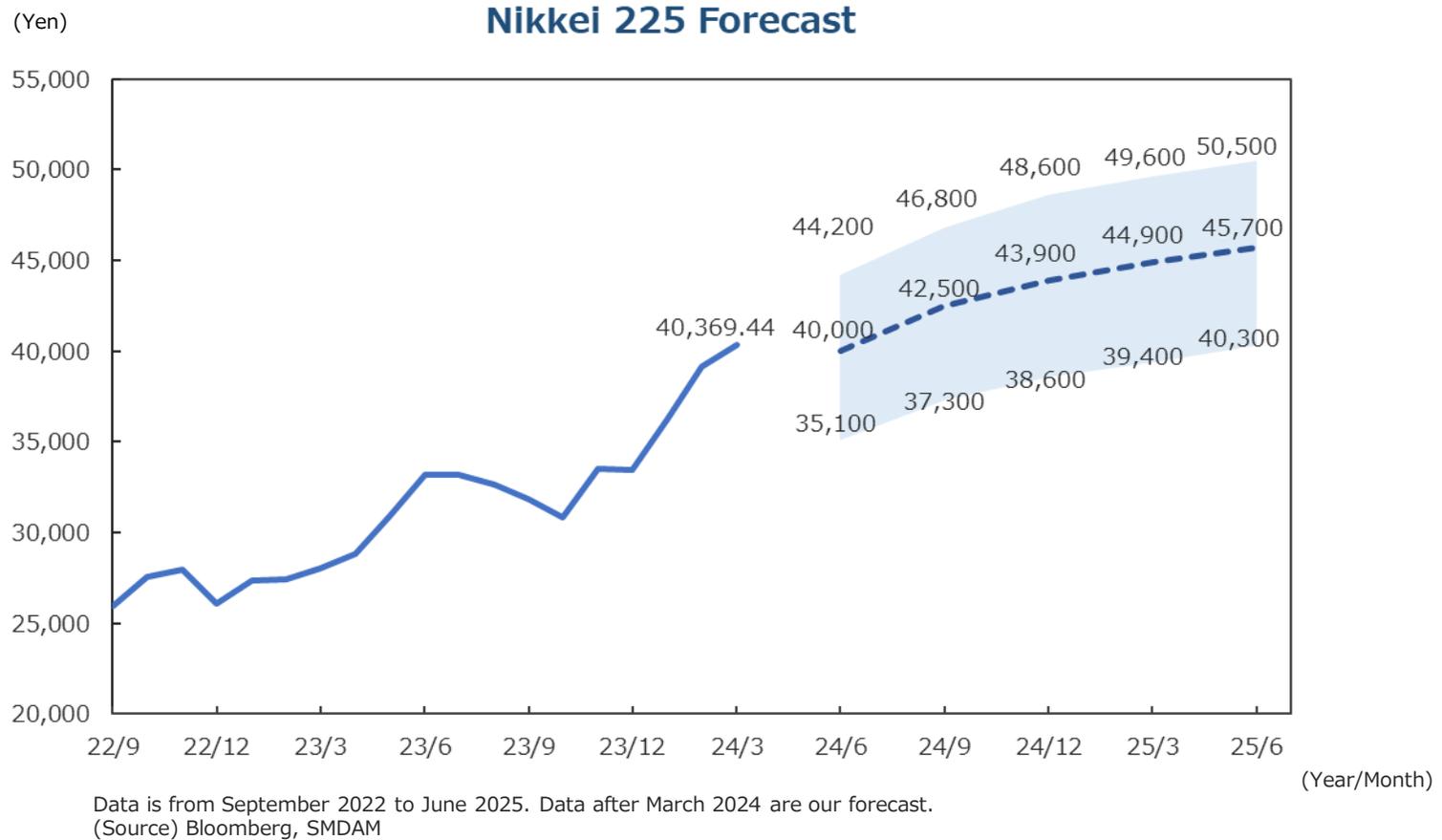


Outlook for Japanese Stock Market

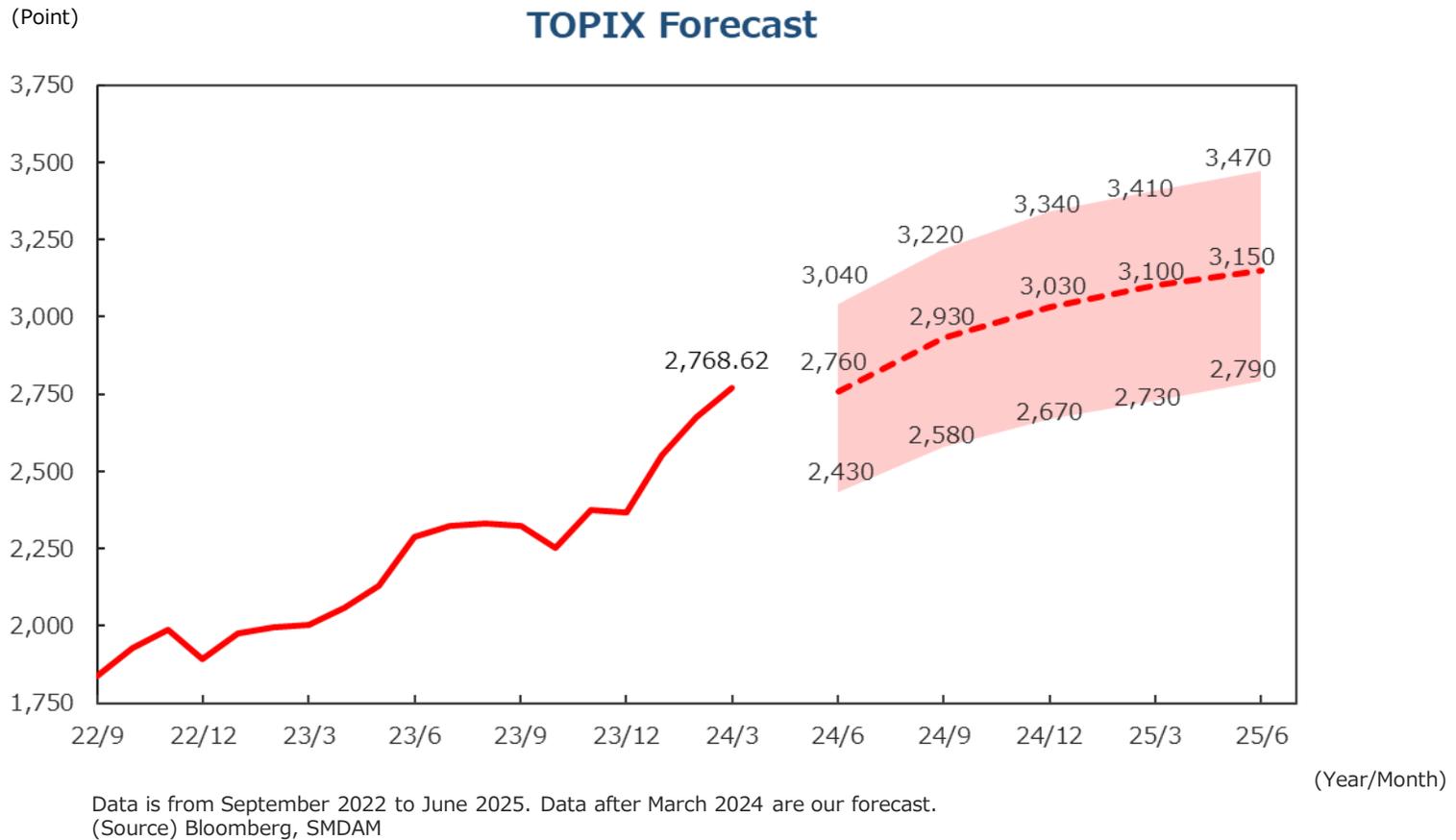
Market Outlook

- We believe the Japanese stock market will continue its encouraging rally going forward driven by EPS growth, thanks to the solid increase in nominal GDP and the accelerating business cycle of manufacturers.
- Our price target for the Nikkei 225 in 2024 is at 43,900, and that for TOPIX at 3,030.
- A virtuous cycle of “wage increase and inflation” and further fiscal expansion, caused by rising tax revenue and the low popularity of the ruling Liberal Democratic Party (LDP), could provide another boost to the equity market.
- In the short term, the market could face increasing volatility if the Bank of Japan decides to exit from the decades-long accommodative monetary policy.

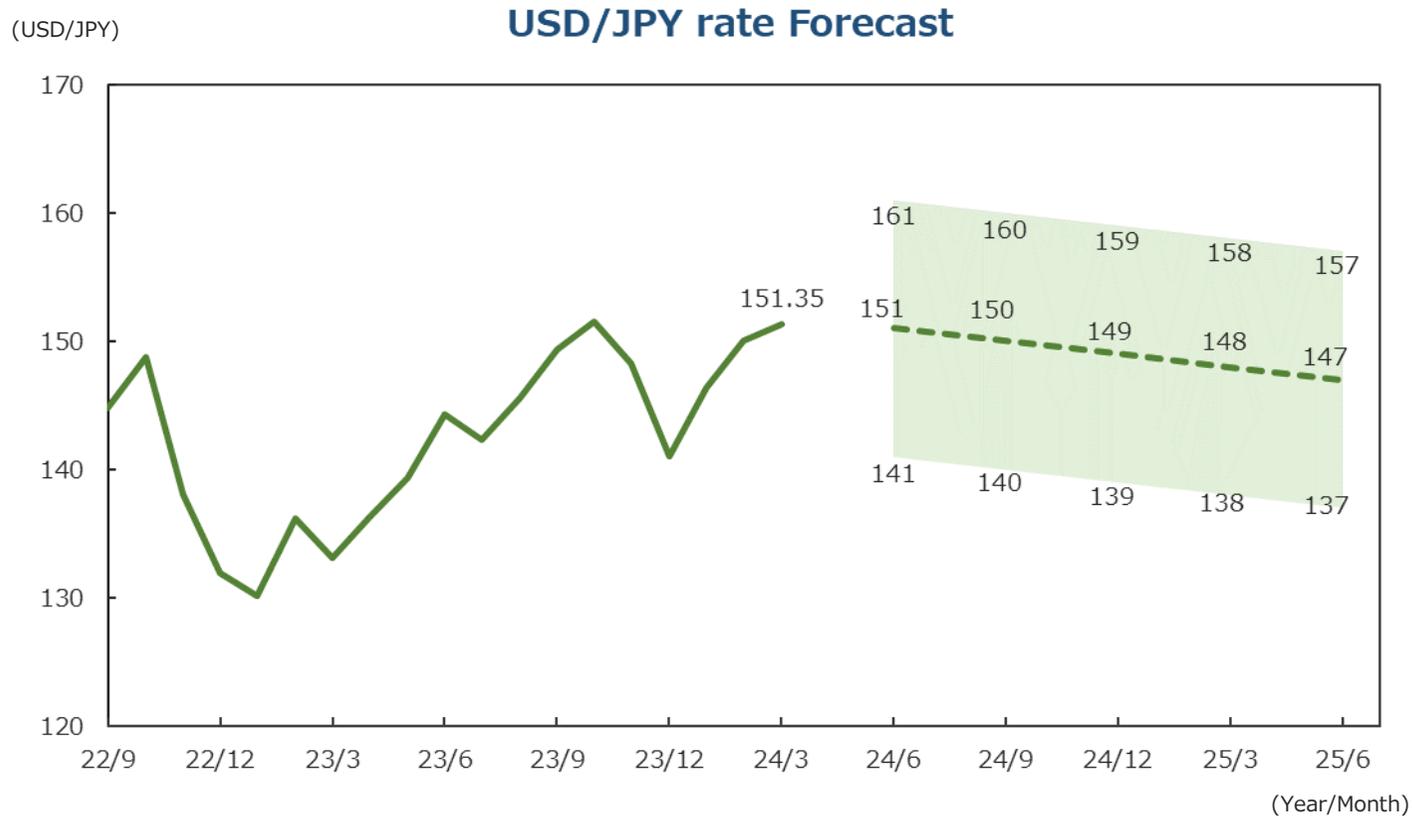
We expect a bullish stock market going forward



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Convergence of monetary policy could weigh on Dollar/Yen rate



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

Upside / Downside risk scenarios

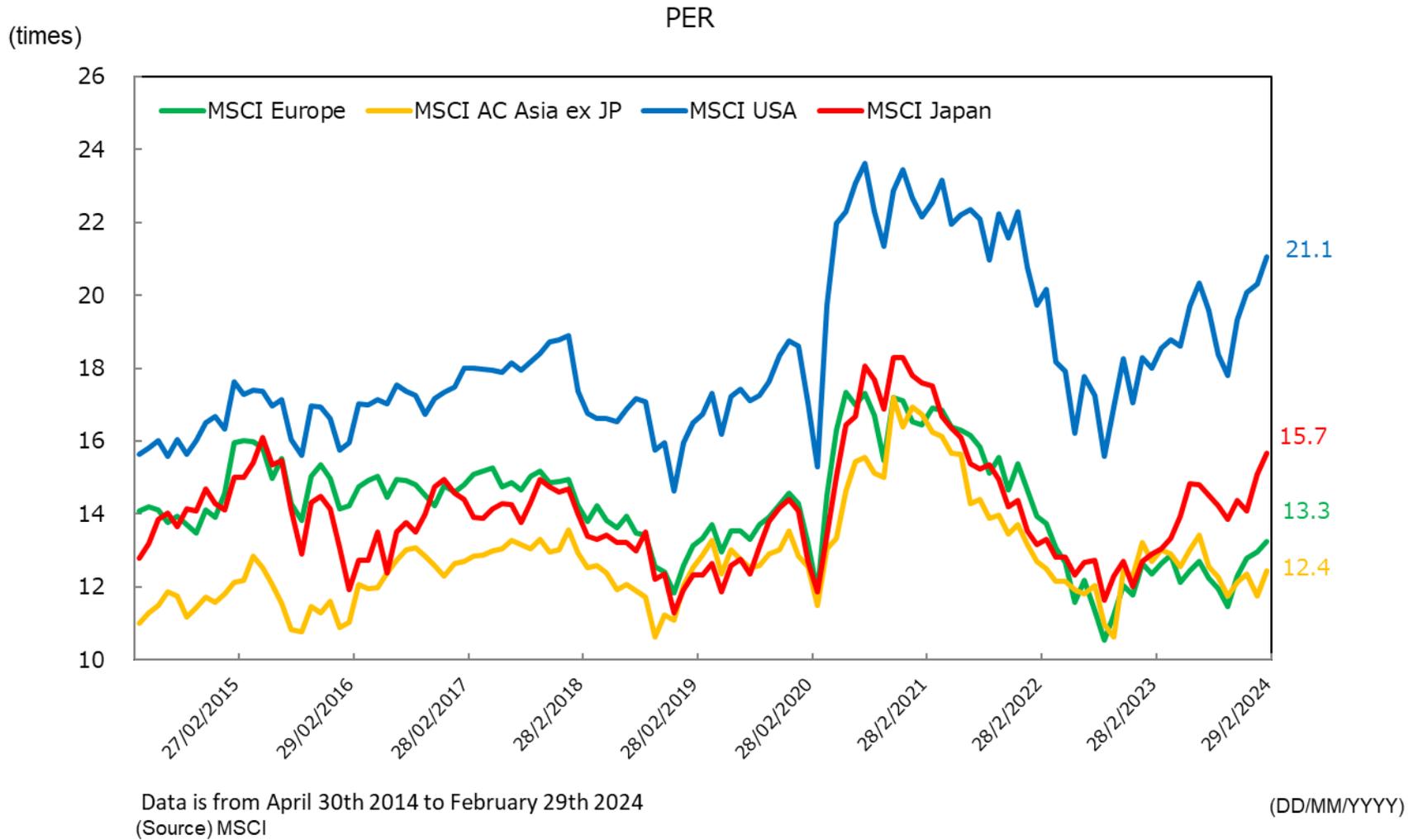
■ Upside Risks

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

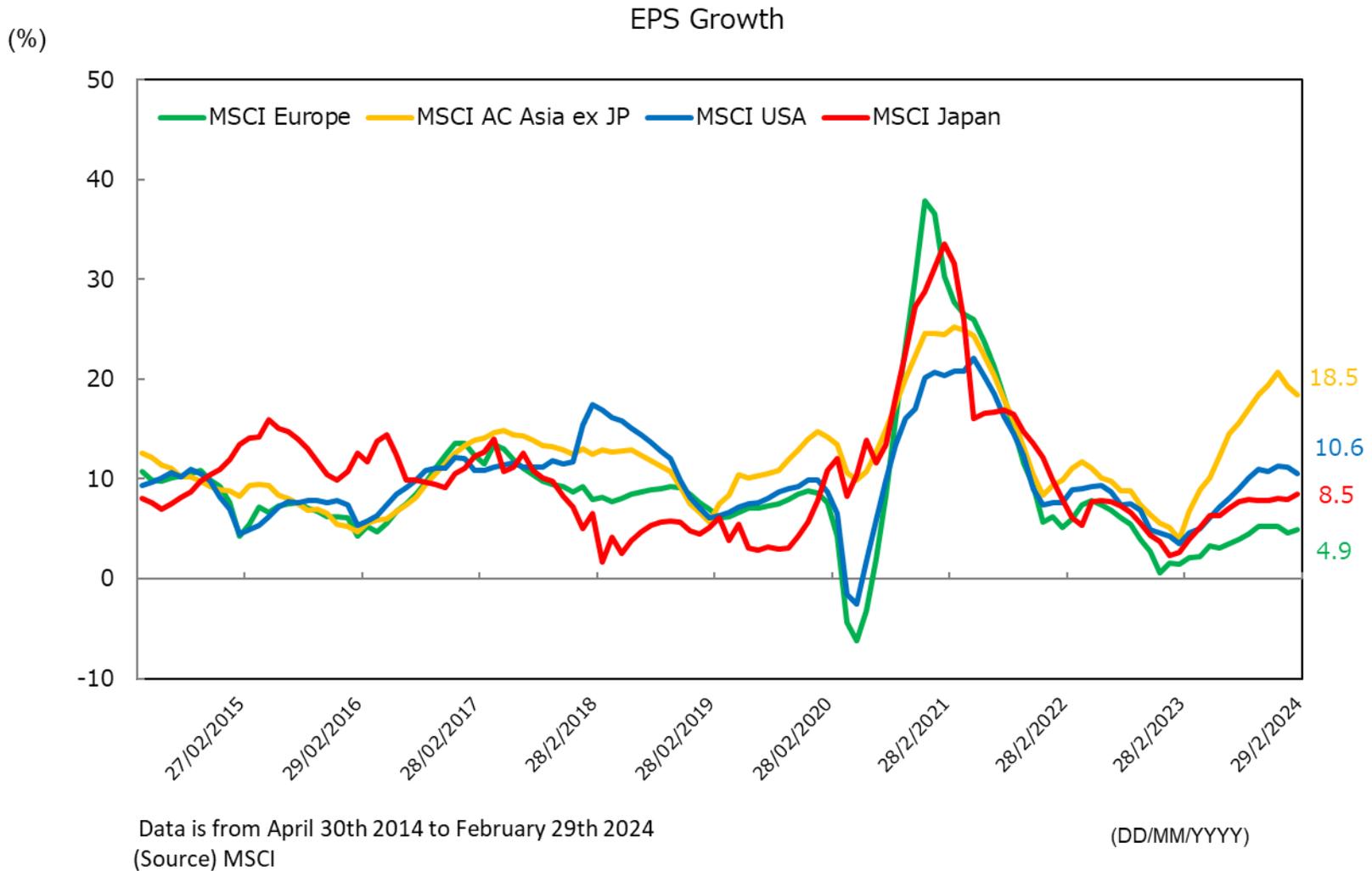
■ Downside Risks

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

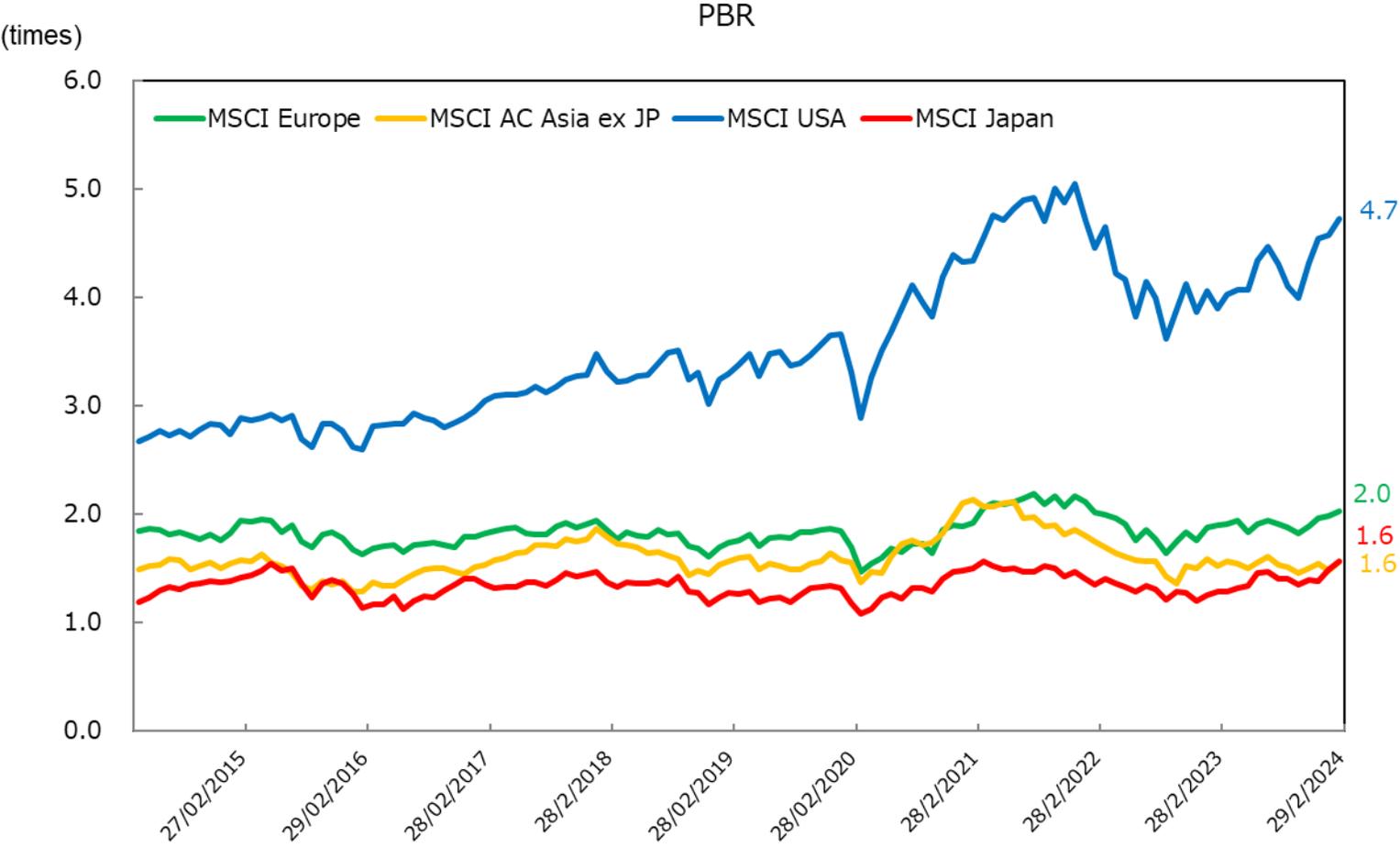
Recent market rally boosts Japan's P/E ratio



Earnings growth outlook remains solid



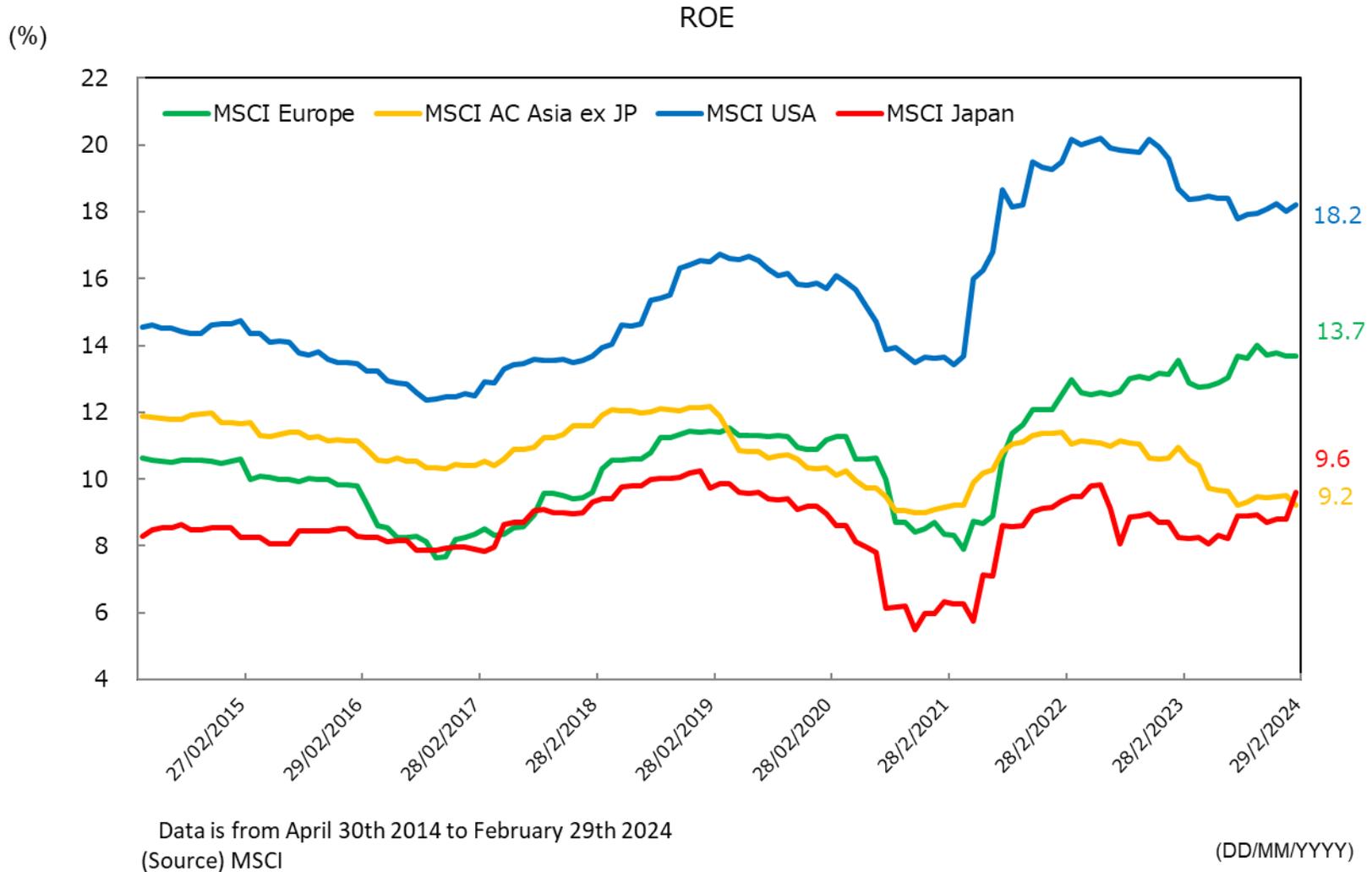
Japan's P/B ratio catching up with Asian peers



Data is from April 30th 2014 to February 29th 2024
 (Source) MSCI

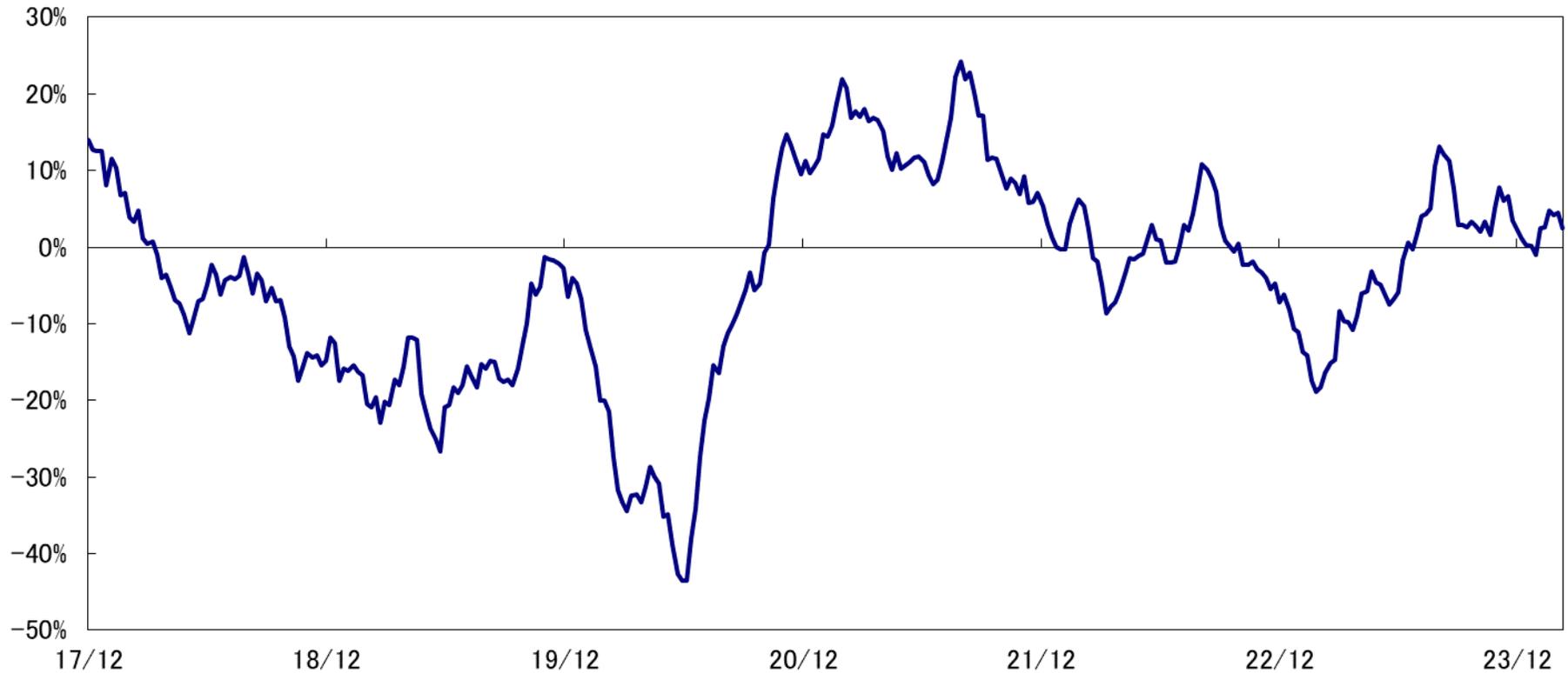
(DD/MM/YYYY)

Japan' ROE surpassed Asian peers



EPS revision remains positive despite lackluster economic data

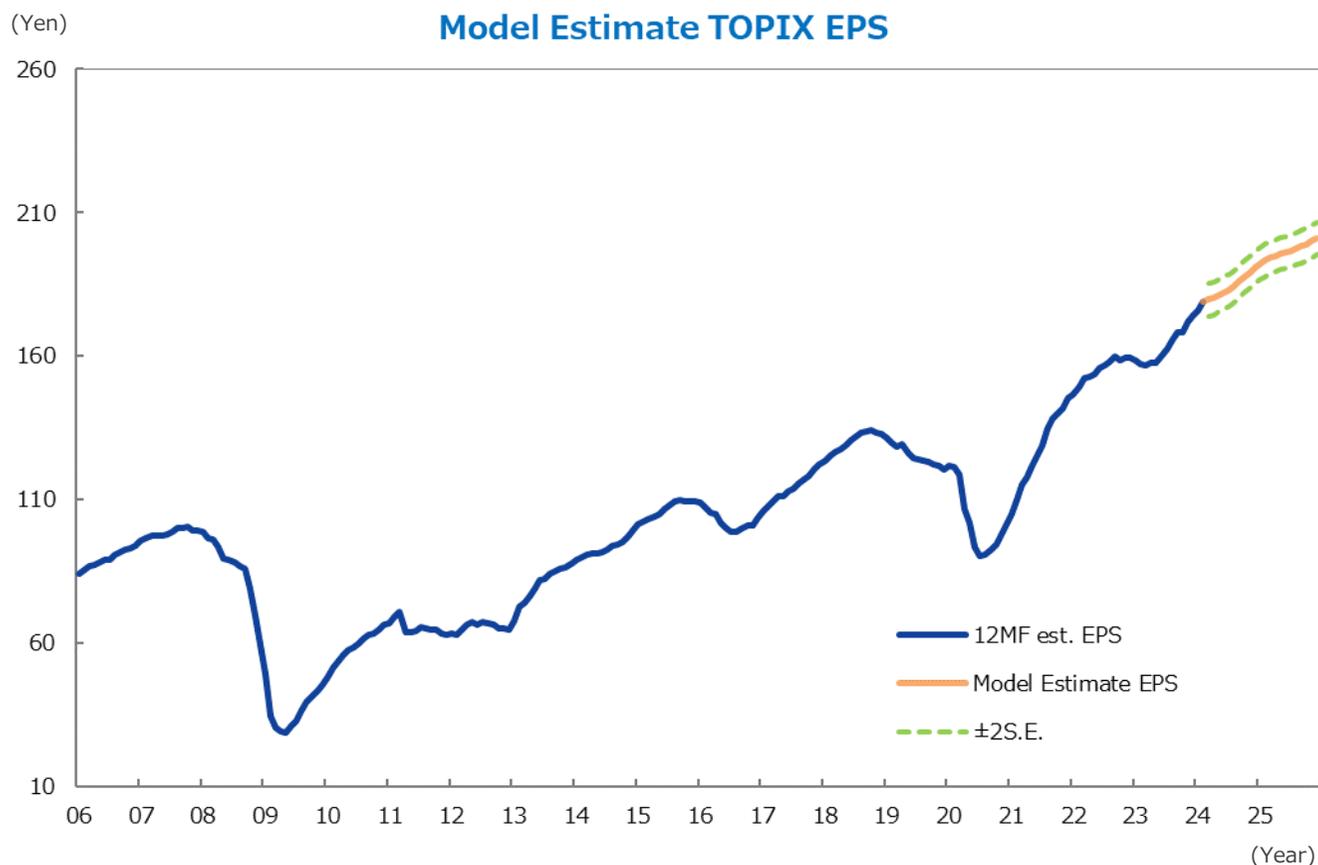
TOPIX Revision Index



Data is from December 28th 2017 to March 7th 2024
(Source) Datastream, IBES

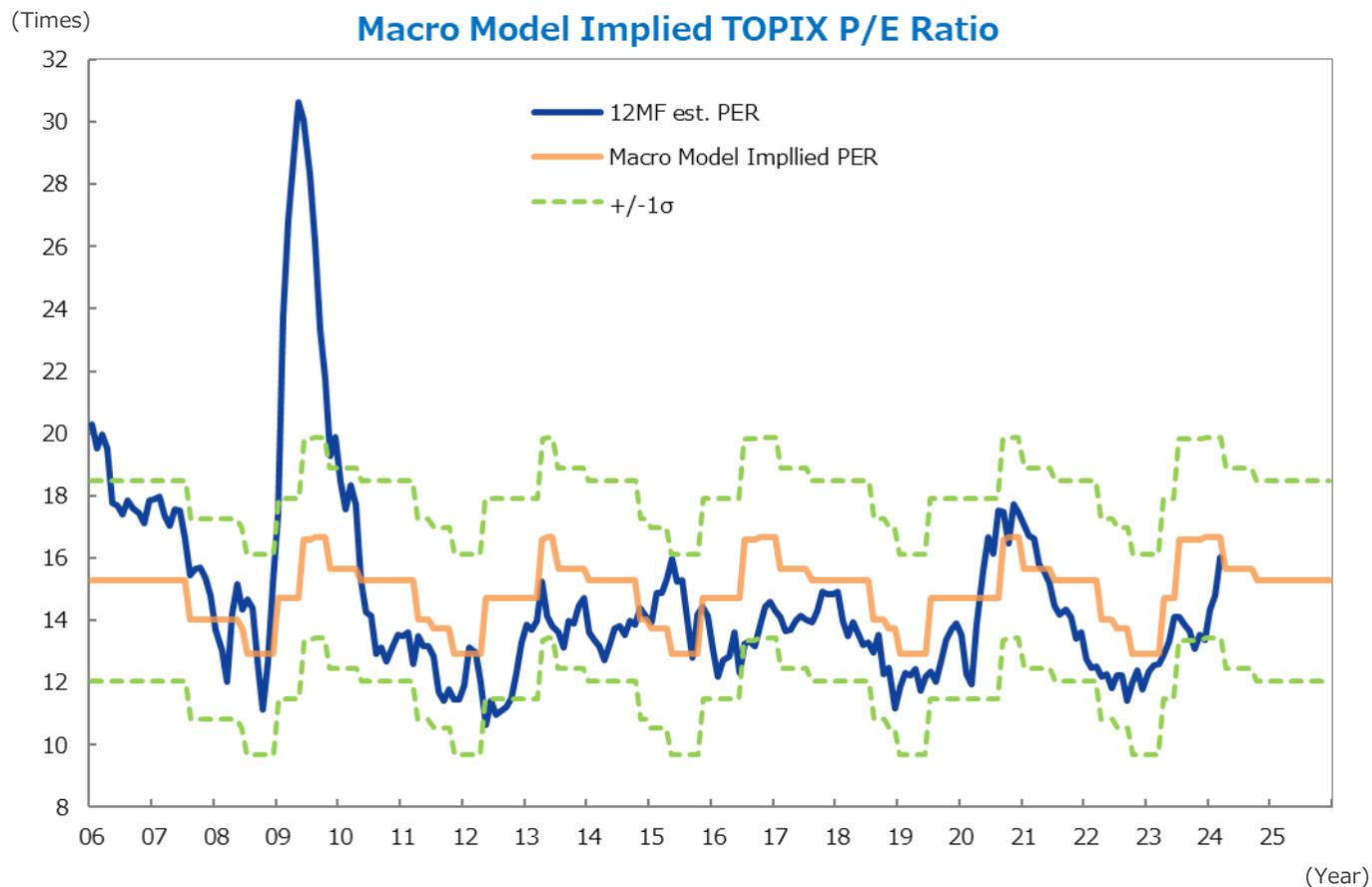
(YY/MM)

Quant model indicates positive earnings outlook going forward



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

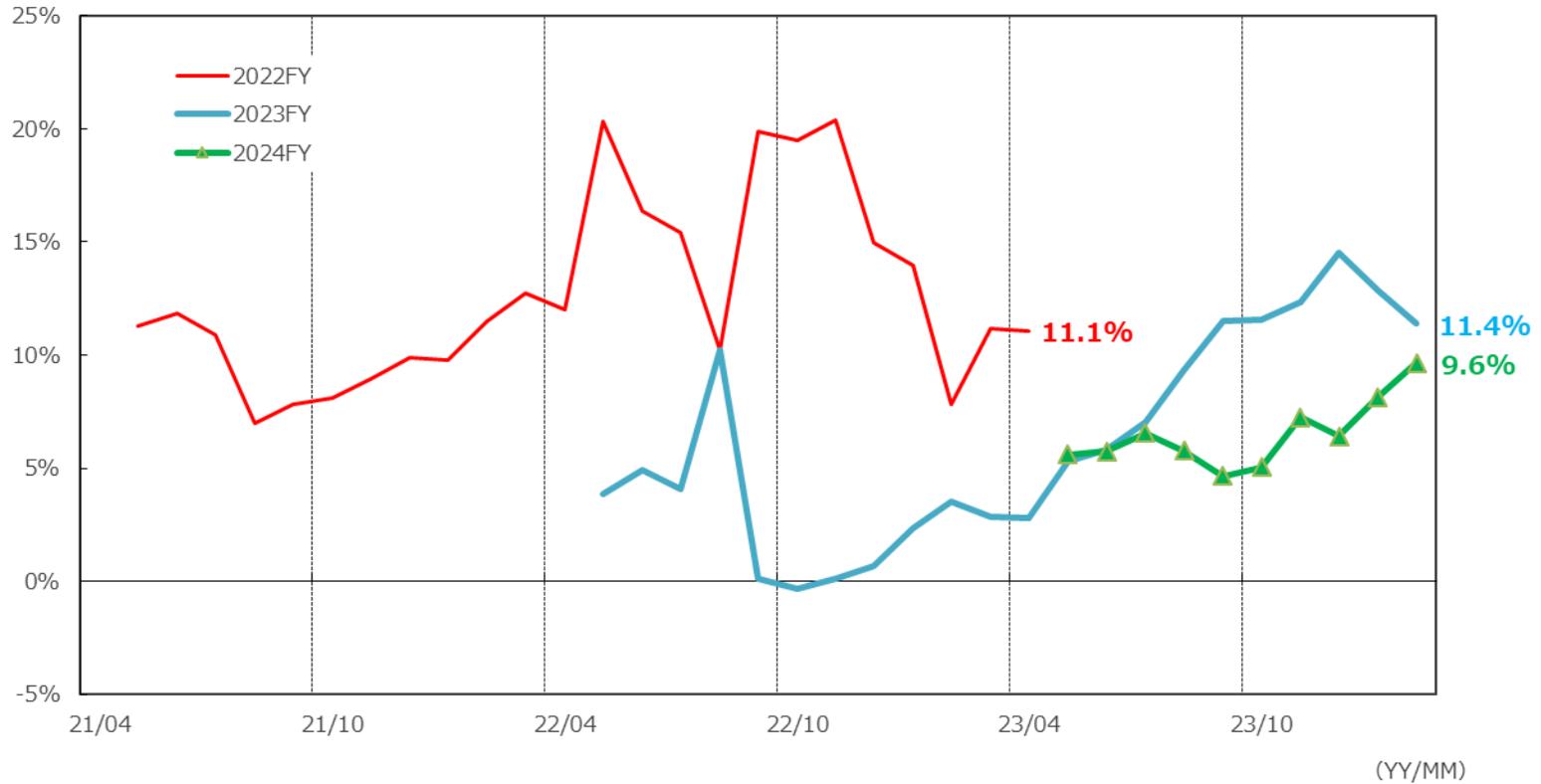
Recent rally boost P/E ratio to the fair value of quant model



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

Earnings momentum continues in FY 2024

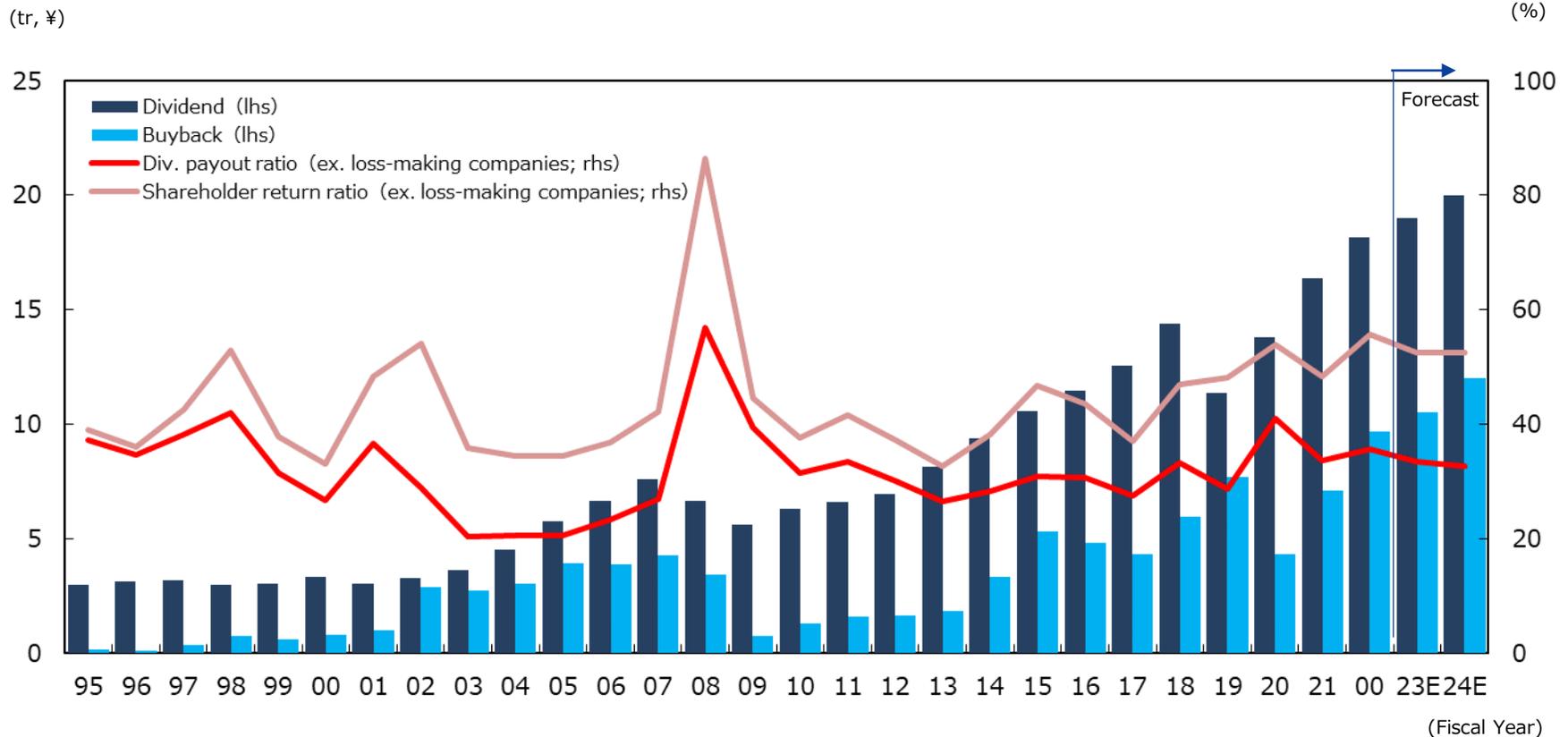
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 7th March 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 investors buying 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	17.70	13.30	16.06	40.25	43.96	36.33	71.86
Total Value	21.36	12.14	19.72	52.11	60.58	58.89	79.90
Top Cap Value	28.88	16.26	27.14	64.87	74.05	80.35	115.20
Large Cap Value	22.88	12.67	21.36	55.30	62.96	64.07	85.60
Mid Cap Value	17.33	9.02	16.01	44.68	50.62	46.42	52.03
Small Cap Value	14.58	9.70	12.39	38.32	49.87	37.13	55.97
Micro Cap Value	13.49	9.74	10.83	35.14	46.71	36.98	55.38
Total Growth	14.53	14.92	12.89	29.49	29.28	17.94	62.16
Top Cap Growth	17.69	19.17	15.86	35.63	33.64	24.72	77.23
Large Cap Growth	15.29	15.83	13.70	31.42	30.87	19.98	67.46
Mid Cap Growth	10.86	9.79	9.68	23.86	25.74	11.83	51.60
Small Cap Growth	8.02	7.37	6.10	14.45	16.83	1.75	23.70
Micro Cap Growth	9.45	9.25	7.18	14.15	18.09	-1.04	25.36
Top Cap Total	21.83	17.44	20.03	47.75	50.19	46.40	91.94
Large Cap Total	18.64	14.05	17.08	42.25	45.24	38.74	76.86
Mid Cap Total	14.36	9.36	13.10	34.58	38.33	28.47	56.91
Small Cap Total	11.96	8.72	9.89	28.75	36.22	21.98	43.88
Micro Cap Total	12.06	9.53	9.55	28.06	36.65	23.41	46.38

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



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is standing still.** Real GDP in Q4 of 2023 was revised upward to show the first positive growth in 2 quarters, but Q1 of 2024 is expected to be negatively affected by the reduction in automobile production owing to the issue of certification test frauds and the Noto Peninsula earthquake. Business and consumer confidence, however, are generally firm and the economy is not in a major slump.
- **Inflation is slowing down.** The nationwide core CPI rose 2.0% YOY in January, slowing from +2.3% in the previous month. On the other hand, the year-on-year rate of increase in the core CPI of Tokyo metropolitan area in February was +2.5%, up from + 1.8% in the previous month. The decline in cost-push pressure from import prices continues to push down the underlying trend of inflation.

[Outlook]

- ① **We have maintained our real GDP growth forecast for FY 2023 at +1.6% and that for FY 2025 at +0.7%, and we have raised our estimate for FY 2024 from +0.6% to +0.7%.** The upward revision in FY 2024 was mainly due to the economic expansion at the end of the fiscal year following the upward revision of GDP in Q4 2023. Q1 of 2024 is likely to show negative growth on the back of the reduction of automobile production due to the problem of illegal certification tests, the Noto Peninsula earthquake, and the decline of IP royalties and receipts of intellectual property rights. After that, it is expected to follow a gradual positive growth trajectory. Against the backdrop of slowing inflation, rising wages and economic measures, domestic demand is expected to gradually recover, avoiding a setback. On the other hand, with the slowdown in the U.S. economy, exports are expected to remain firm while slowing growth.
- ② **While we have maintained our core CPI forecast for FY 2023 at +2.8%, we have raised that for FY 2024 to +2.4% from +2.2% and that for FY 2025 to +2.0% from +1.9% respectively.** The upward revision was primarily due to an increase in the projected wage increase and changes in estimates of inbound travel expenses. The national core CPI is likely to increase once the downward effect of subsidies on electricity and gas bills, which came to an end in February 2024, has passed. After that, the national core CPI is likely to follow a deceleration trend as the cost push pressure, starting from import prices, continues to decline. However, the national core CPI is expected to remain stable at around +2% from 2025 onwards, supported by rising service prices due to wage improvements.
- ③ **We expect the government to continue their accommodative fiscal policy.** In November 2023, Prime Minister Kishida's Cabinet approved "comprehensive economic measures to completely overcome deflation." The measures, which amount 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 further expansion aimed at raising 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 **The Bank of Japan had decided to adjust the existing ultraeasy monetary policy framework in March 2024, including the end of the negative interest rate policy and elimination of the YCC (yield curve control), and we expect further monetary tightening by 0.25% in April 2025 and another 0.25% in October 2025.** The change in negative interest rates policy was brought forward by one month after a larger-than-expected wage increase was confirmed. Further monetary tightening is forecast to take place after April 2025, as it is expected to take a reasonable period of time to assess the impact of the change in monetary policy.



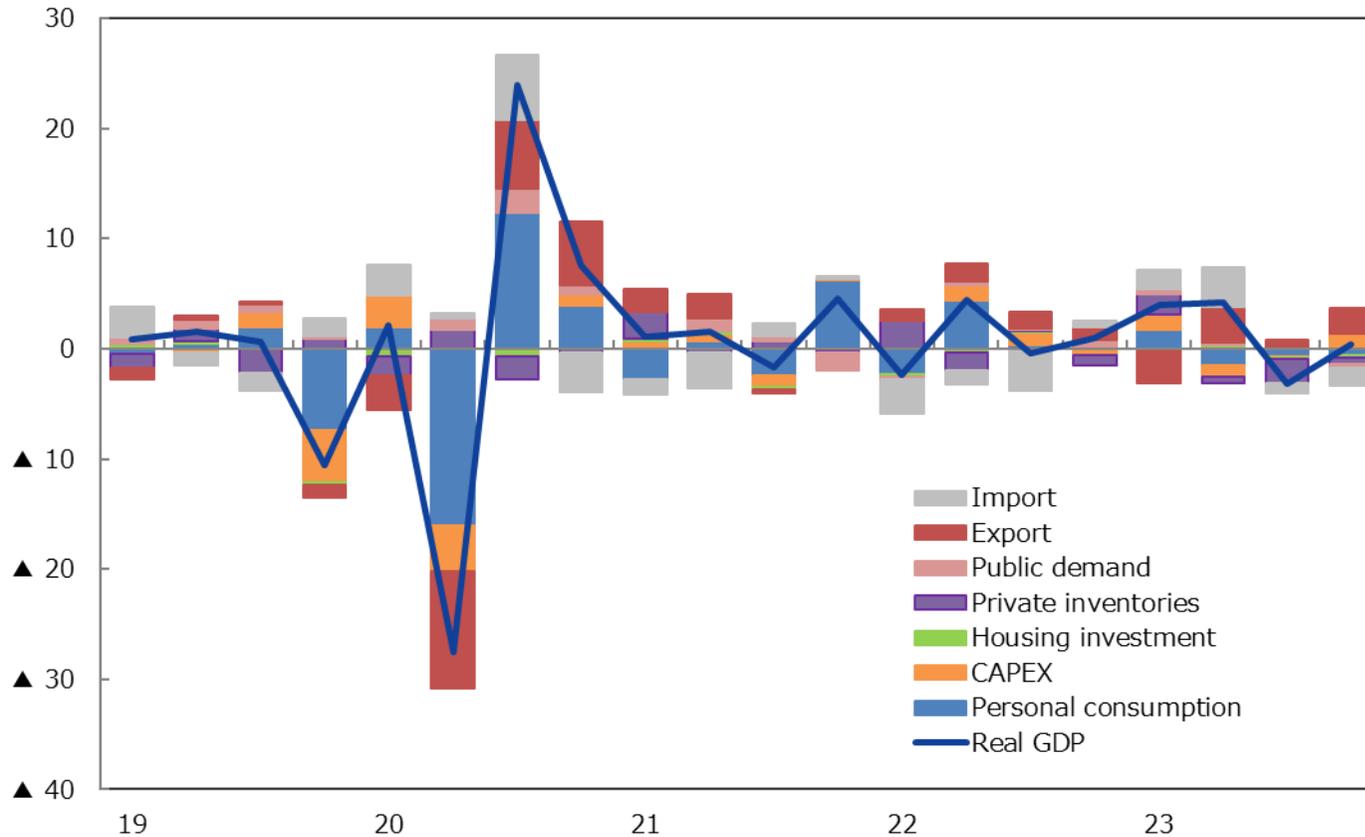
Forecast for the Japanese economy

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%	0.7%	0.7%	
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	-0.5%	0.5%	1.1%	
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%	0.7%	1.5%	1.0%	
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.3%	-0.2%	0.0%	
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	3.0%	0.8%	0.7%	
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.3%	0.0%	-0.2%	
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.8%	2.6%	2.2%	
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-2.8%	2.8%	3.3%	
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.2%	2.6%	2.3%	
GDP deflator	0.8%	0.7%	-0.1%	0.7%	3.9%	1.9%	1.5%	
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-1.8%	1.1%	1.4%	
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.4%	2.0%	
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.2%	1.0%	1.0%	
Employee compensation	2.0%	-1.5%	2.1%	2.0%	1.8%	3.6%	3.6%	
Unemployment rate	2.4%	2.9%	2.8%	2.6%	2.5%	2.5%	2.3%	
Monetary Policy interest rate (Short term)	-0.1%	-0.1%	-0.1%	-0.1%	0-0.1%	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

Japanese economy avoids technical recession

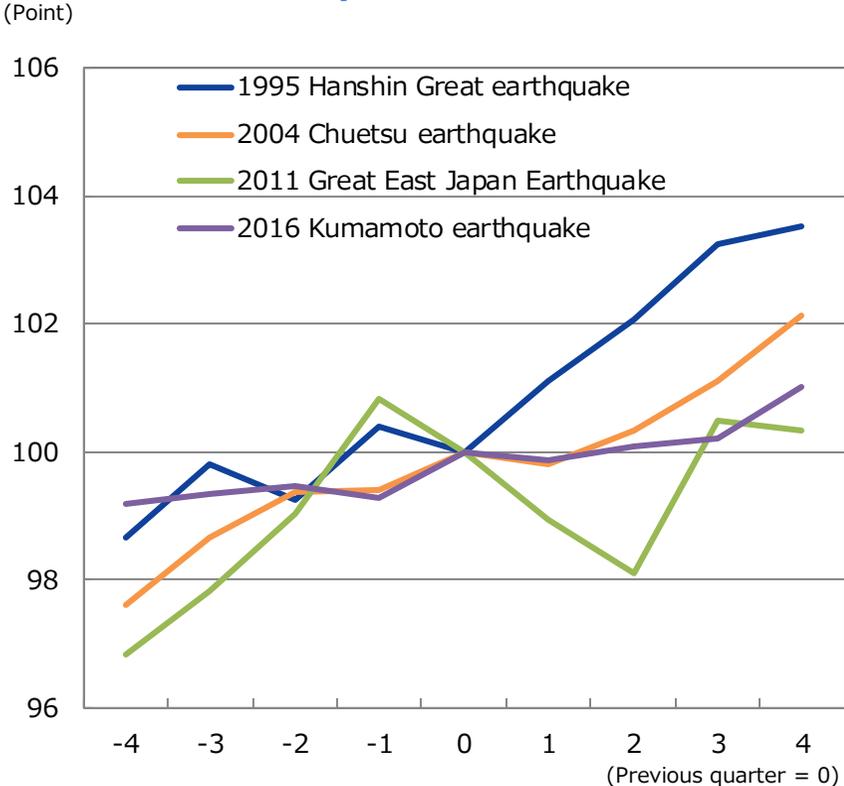
Real GDP growth rate (YOY, %)



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

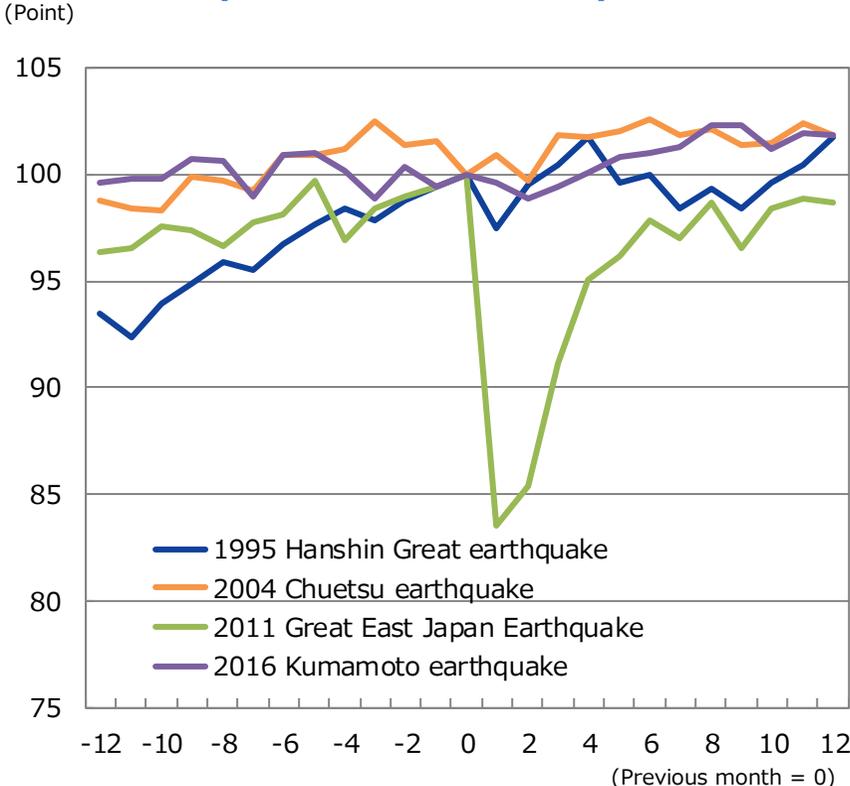
Earthquakes have historically marginal impact on the economy

Earthquake & Real GDP



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

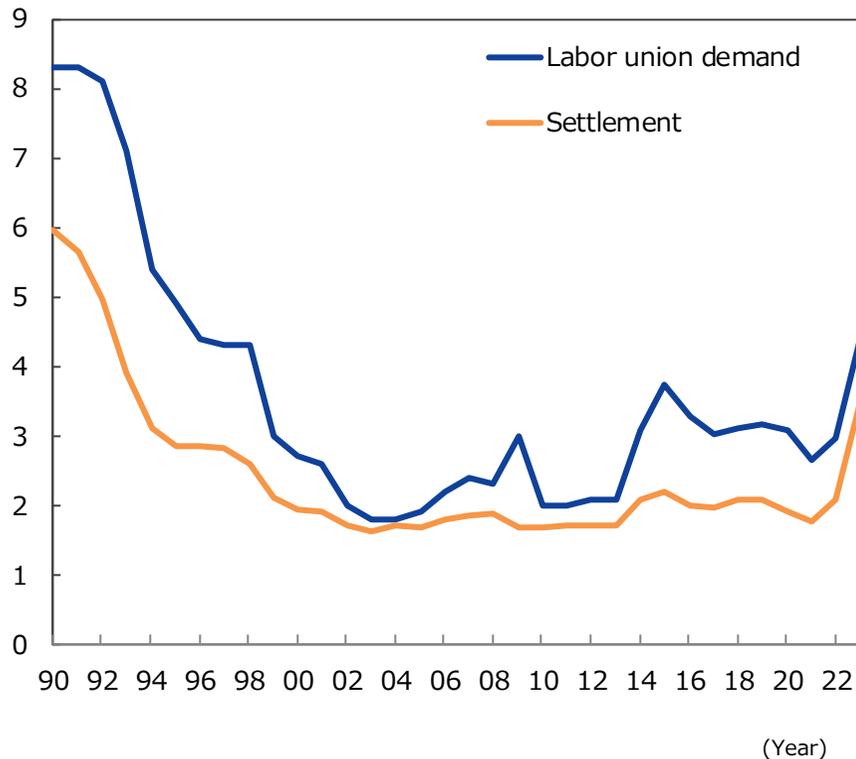
Earthquake & Industrial production



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

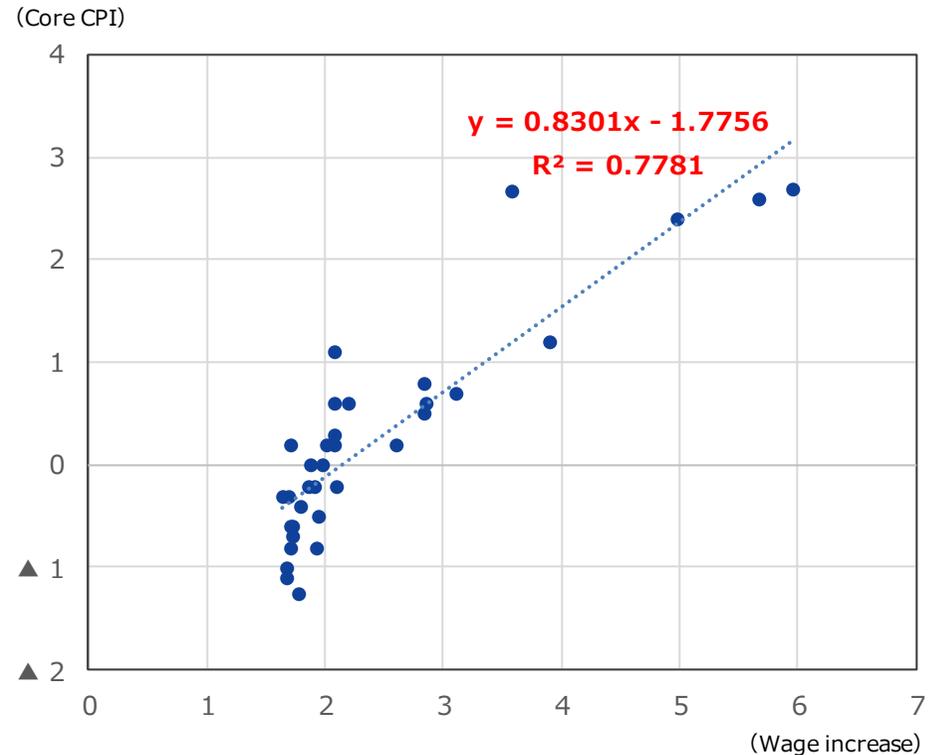
Why we expect a virtuous cycle of wage hike & inflation in Japan

Wage increase demand & settlement (YOY, %)



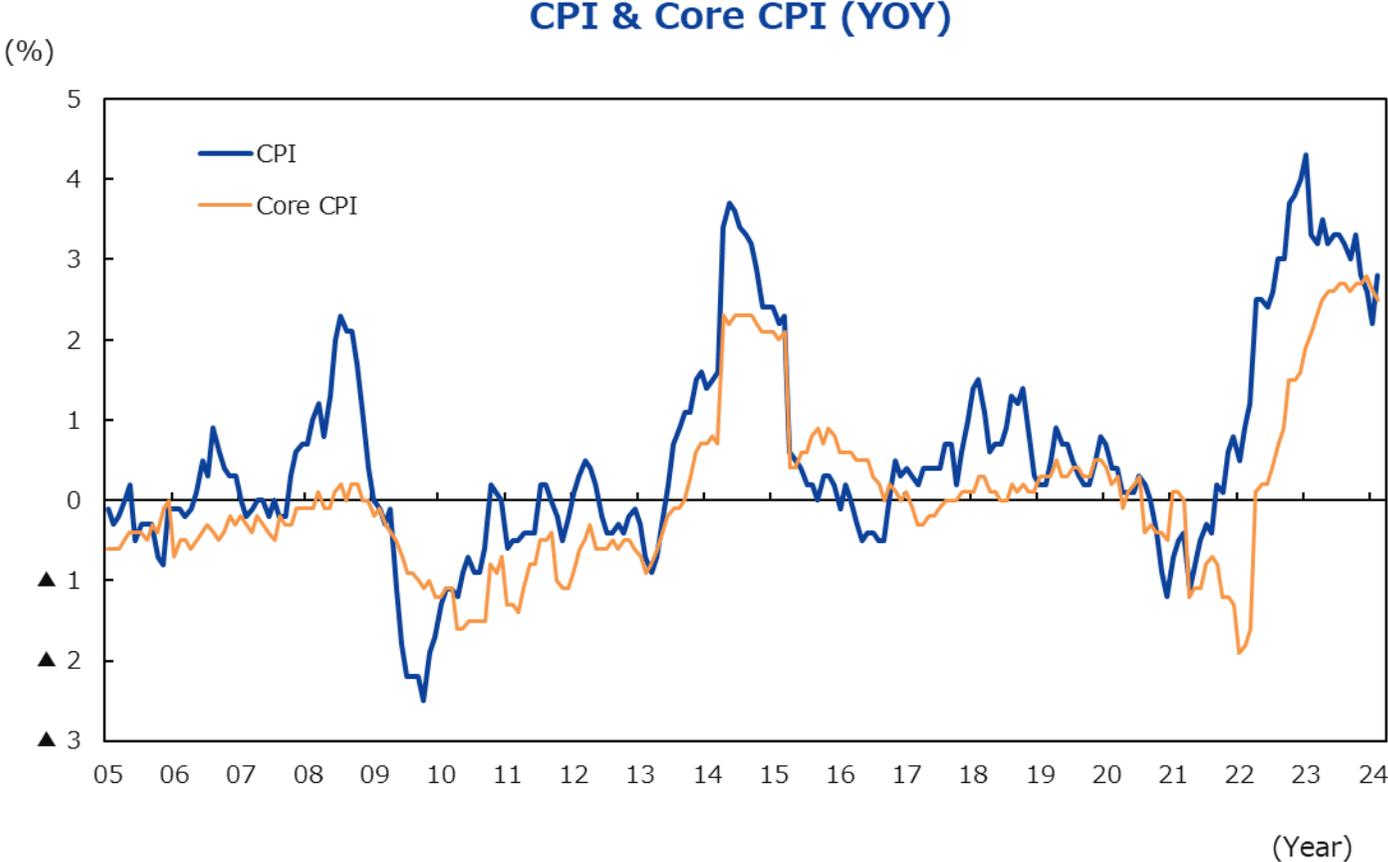
Note: Data is from FY 1990 to FY 2023.
Source: Japanese Trade Union Confederation, SMDAM

Wage increase & Core CPI (YOY, %)



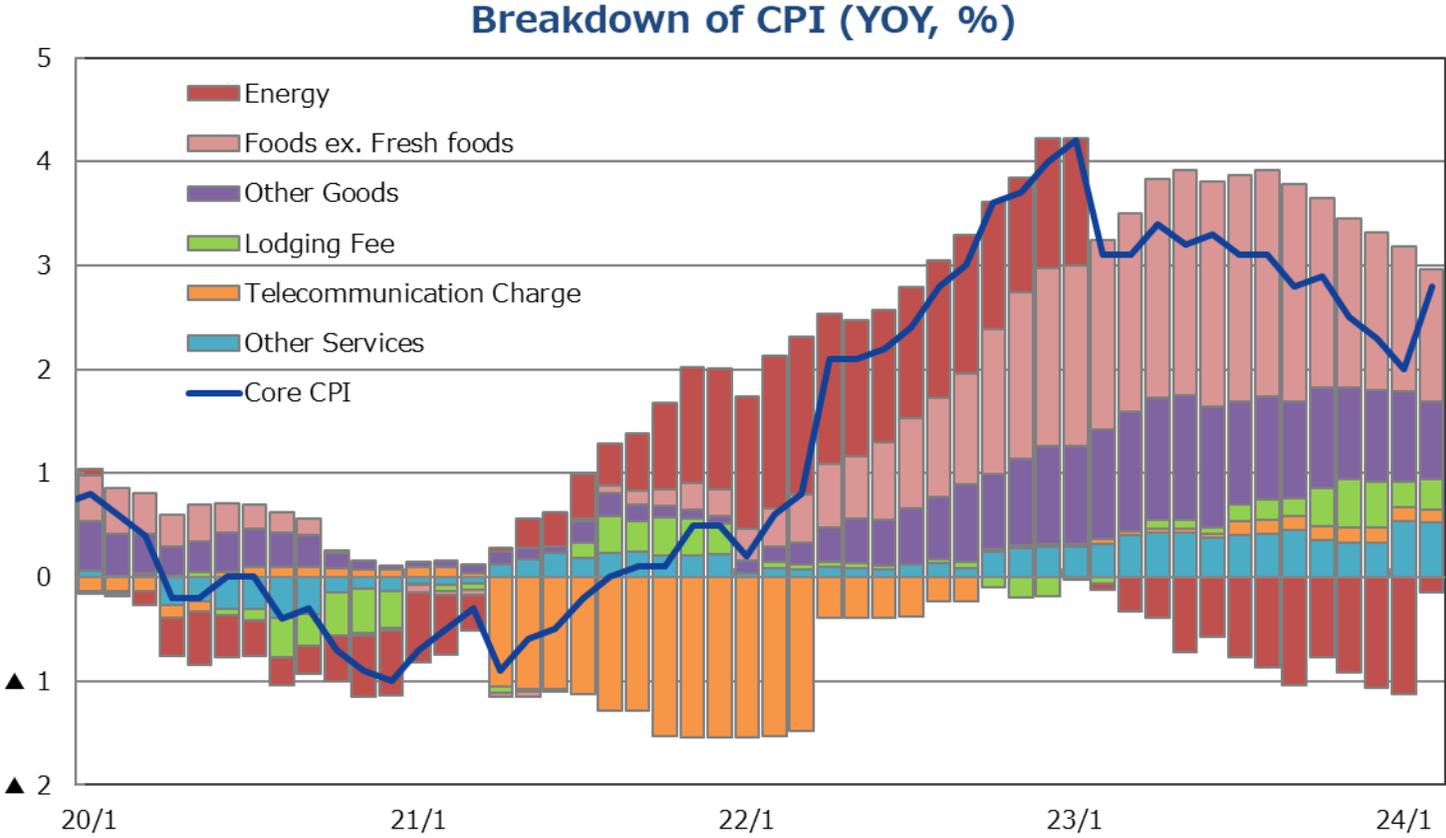
Note: Data is from FY 1990 to FY 2022. Core CPI is excluding food, except for alcohol, & energy
Source: MIAC, Japanese Trade Union Confederation, SMDAM

Core CPI shows extraordinary stickiness after falling import prices



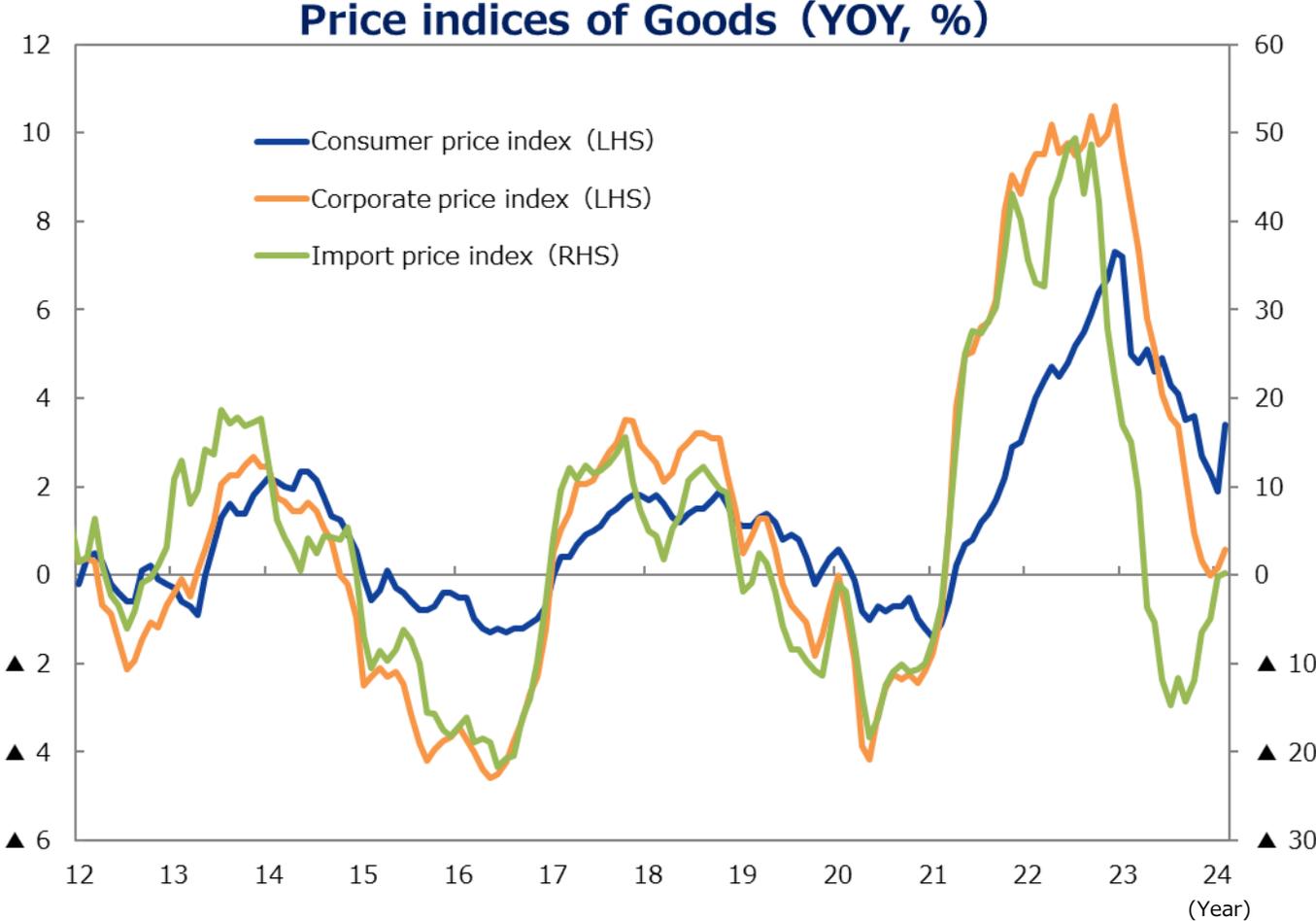
Note: Data is from January 2005 to February 2024, Core CPI is excluding food, except for alcohol, & energy.
Source: MIAC, Bloomberg, SMDAM

Goods and services make Japanese inflation stickier



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

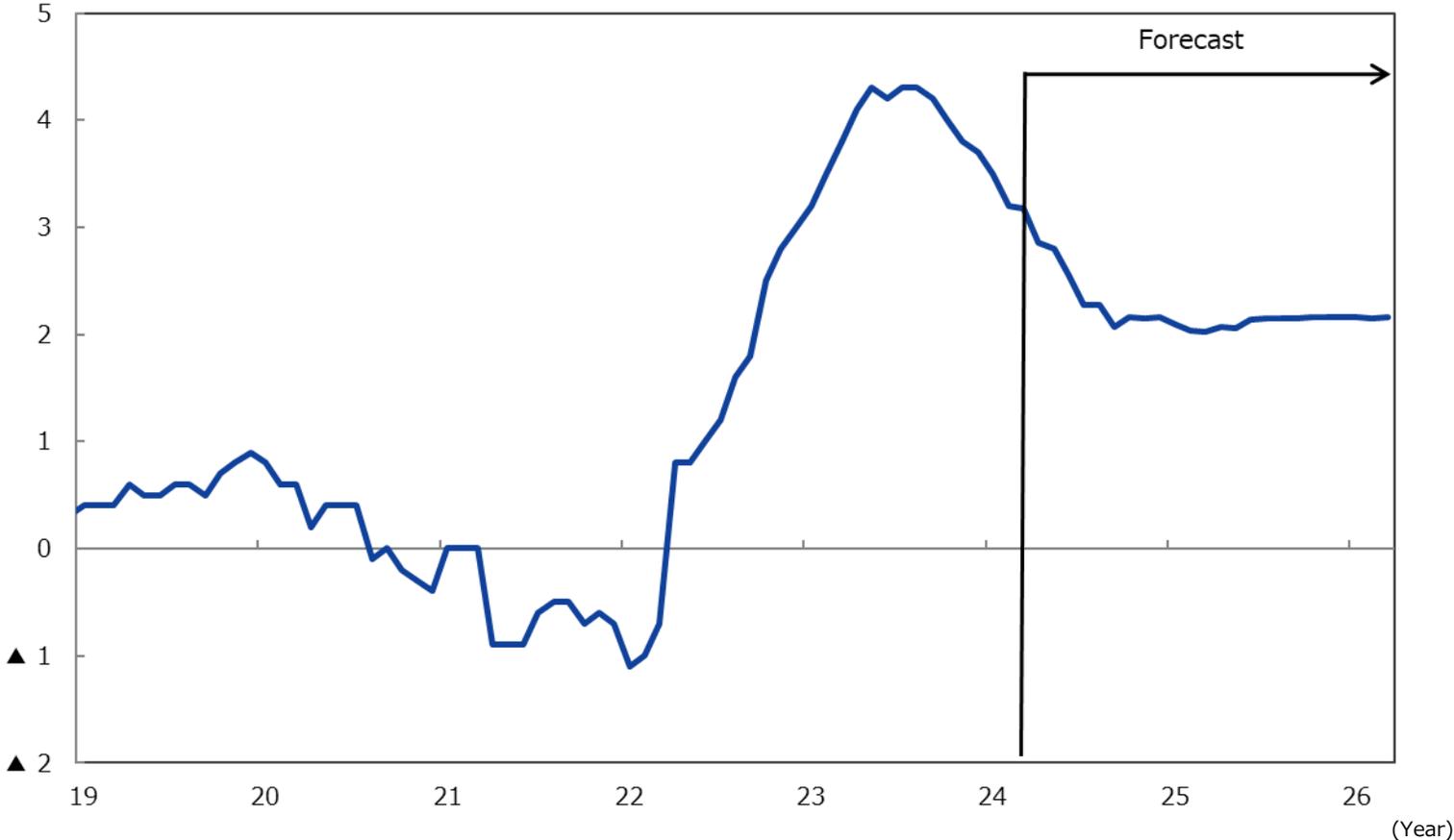
Sticky CPI improves profit margin



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

BOJ changes their long term inflation forecast above 2%

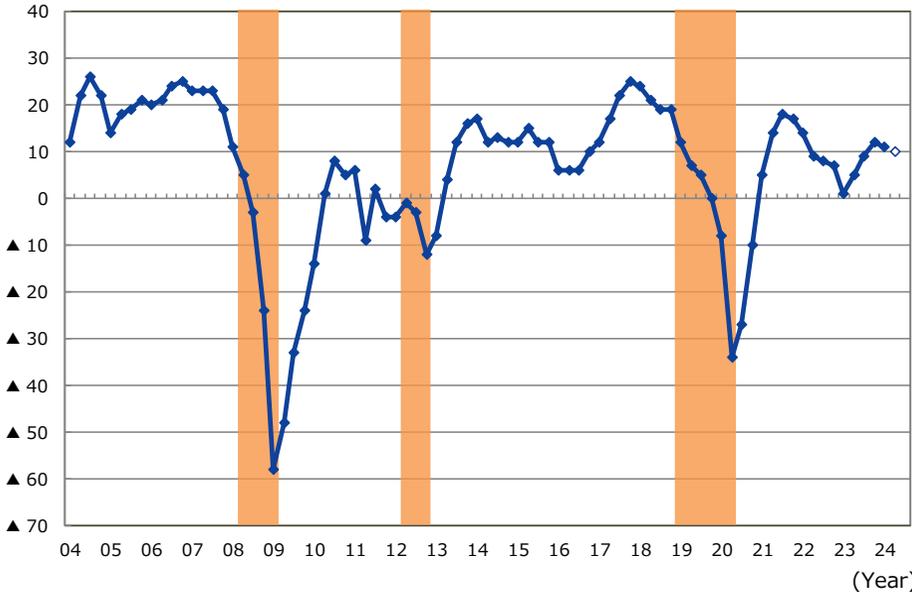
BOJ's Core CPI forecast (YOY, %)



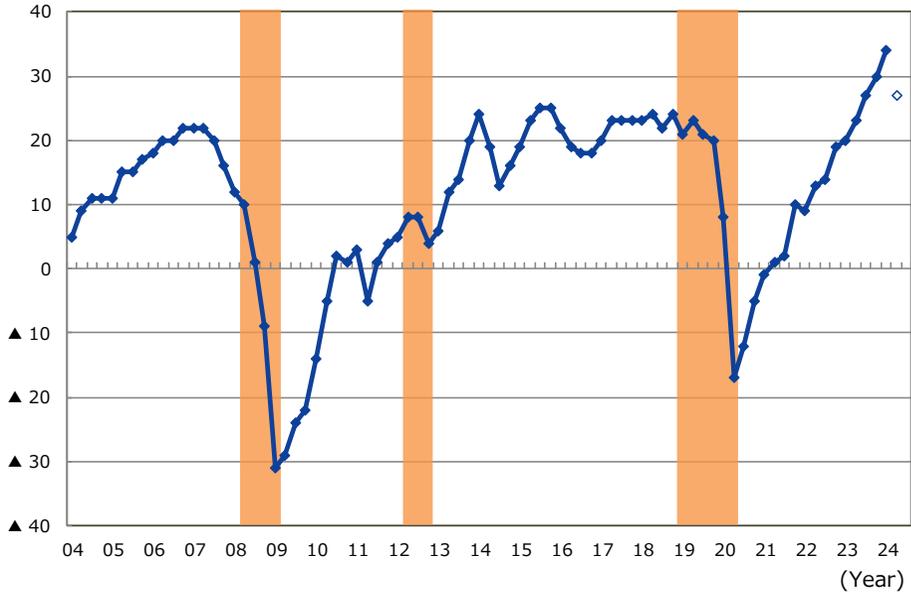
Note: Data is from January 2019 to March 2026. BOJ's Core CPI is excluding fresh foods & energy. Data from March 2024 is forecasts.
Source: The Bank of Japan, SMDAM

Divergence of business sentiment between manufacturers and services

BOJ business condition DI Large manufacturers (%)



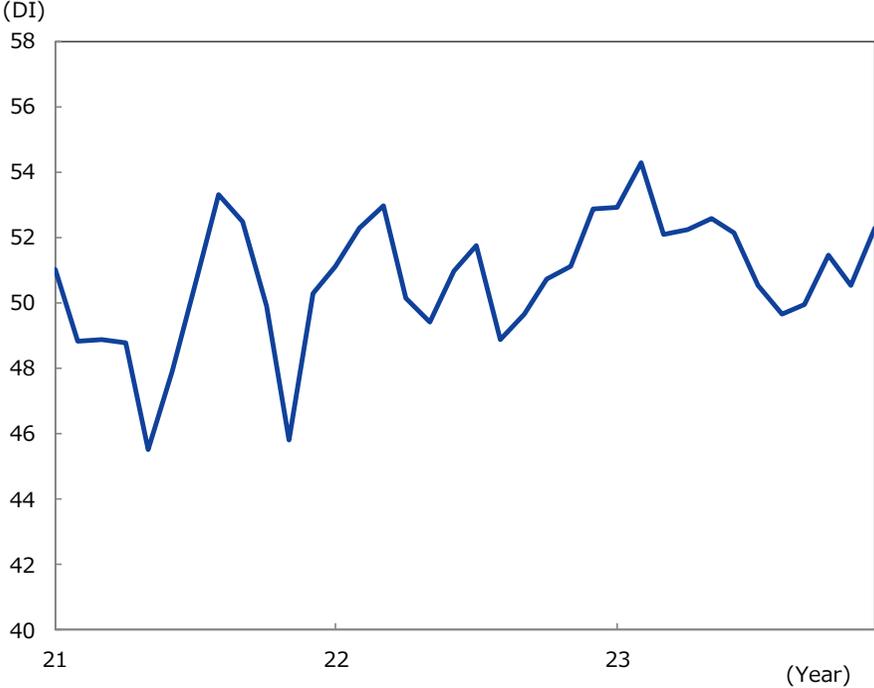
BOJ business condition DI Large non-manufacturers (%)



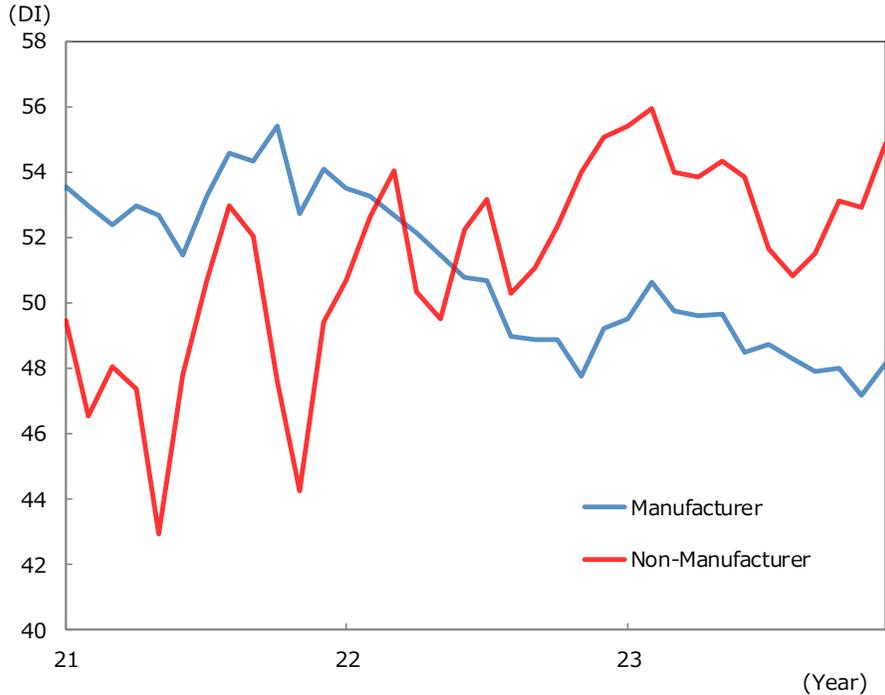
Note: Data is from Q1 2004 to Q1 2024. The orange shadow are periods of economic recession.
 Source: The Bank of Japan, SMDAM

Divergence of business sentiment between manufacturers and services

Composite PMI



PMI, Manufacturer & Non-Manufacturer



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

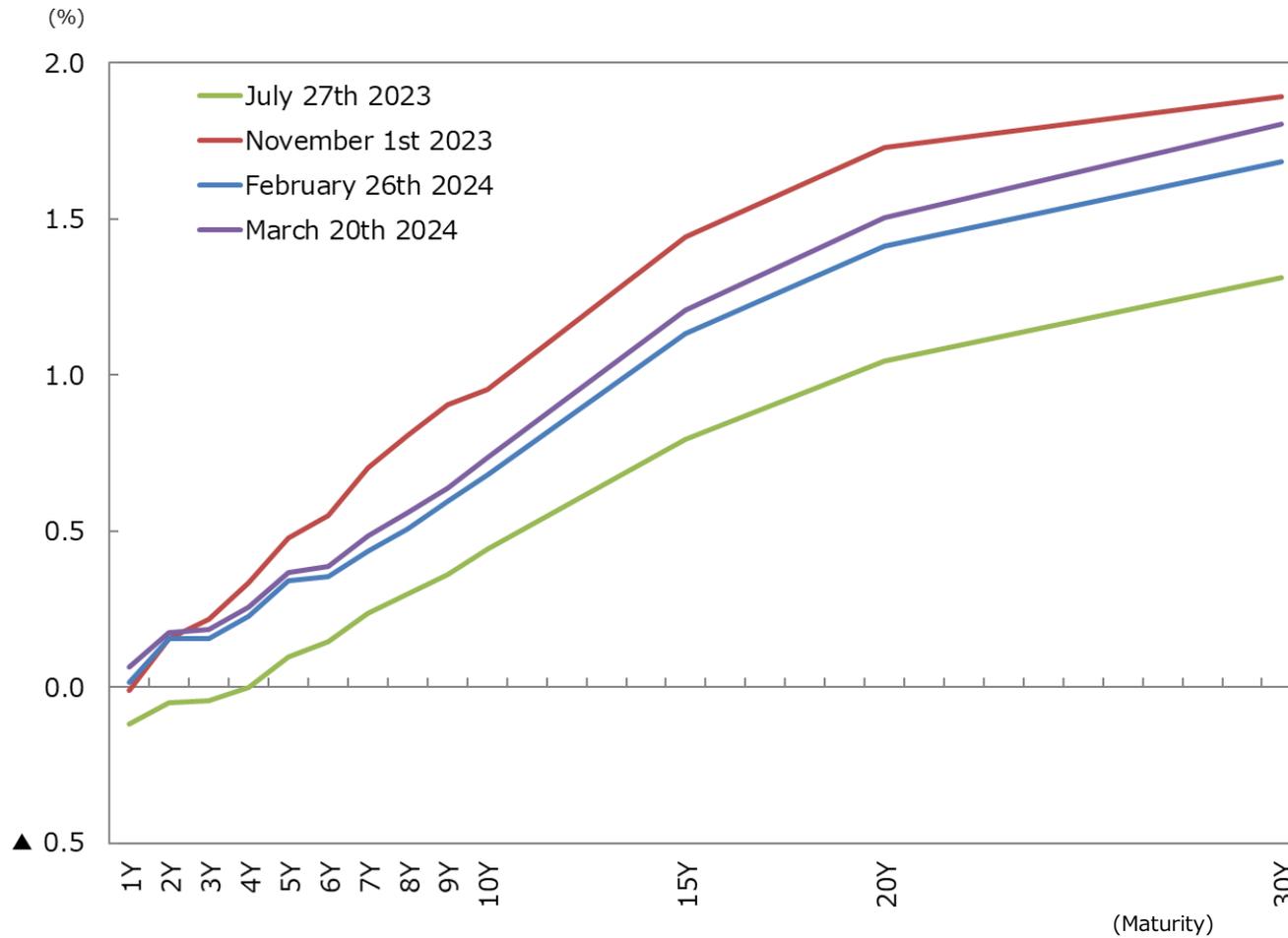
Auto production is expected to normalize in the near future

Industrial Production (Dec. 2019=100)



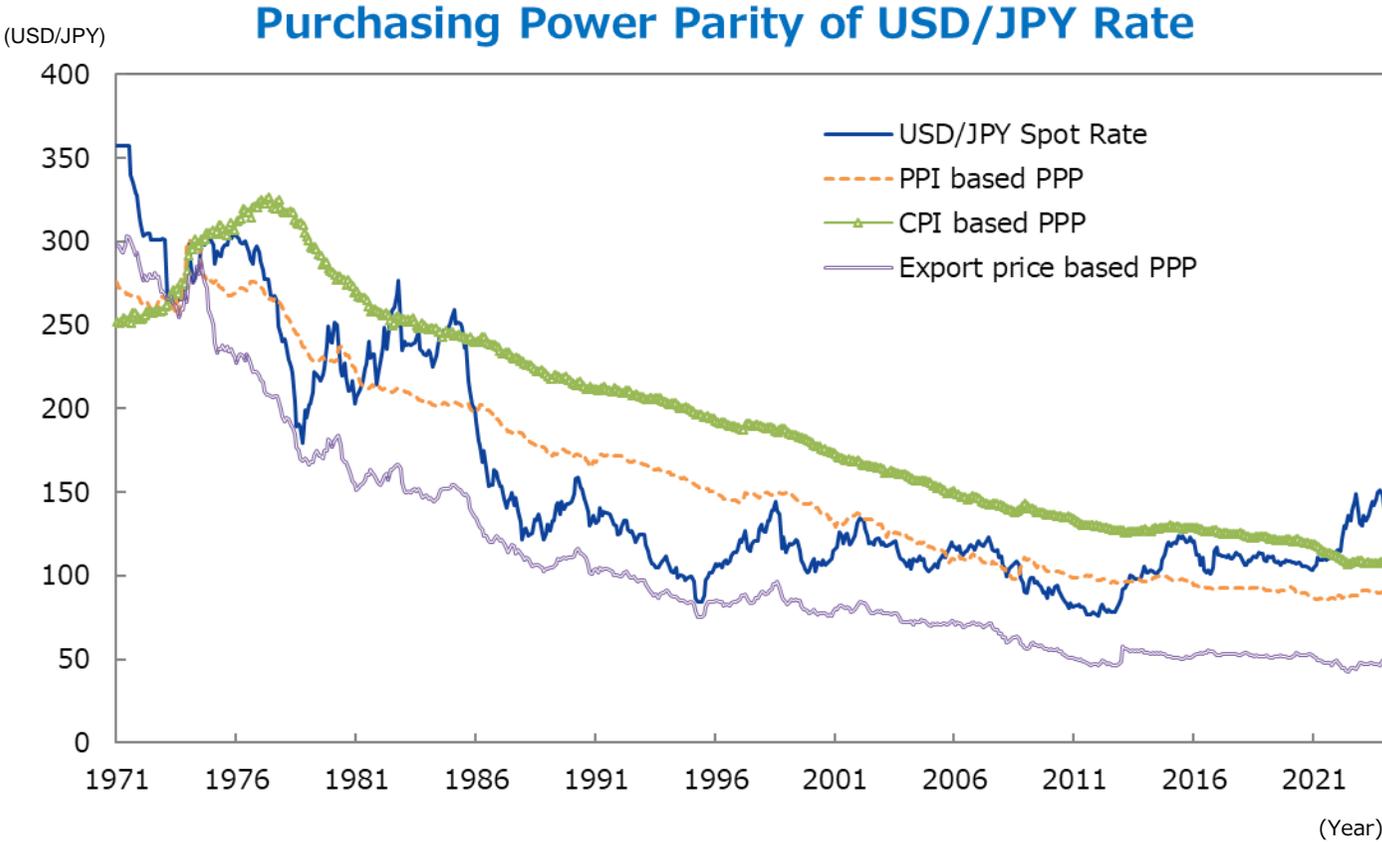
Note: Data is from January 2019 to February 2024. Data after February 2024 are forecasts.
Source: METI, SMDAM

The pivot of BOJ has not shaken bond market so far



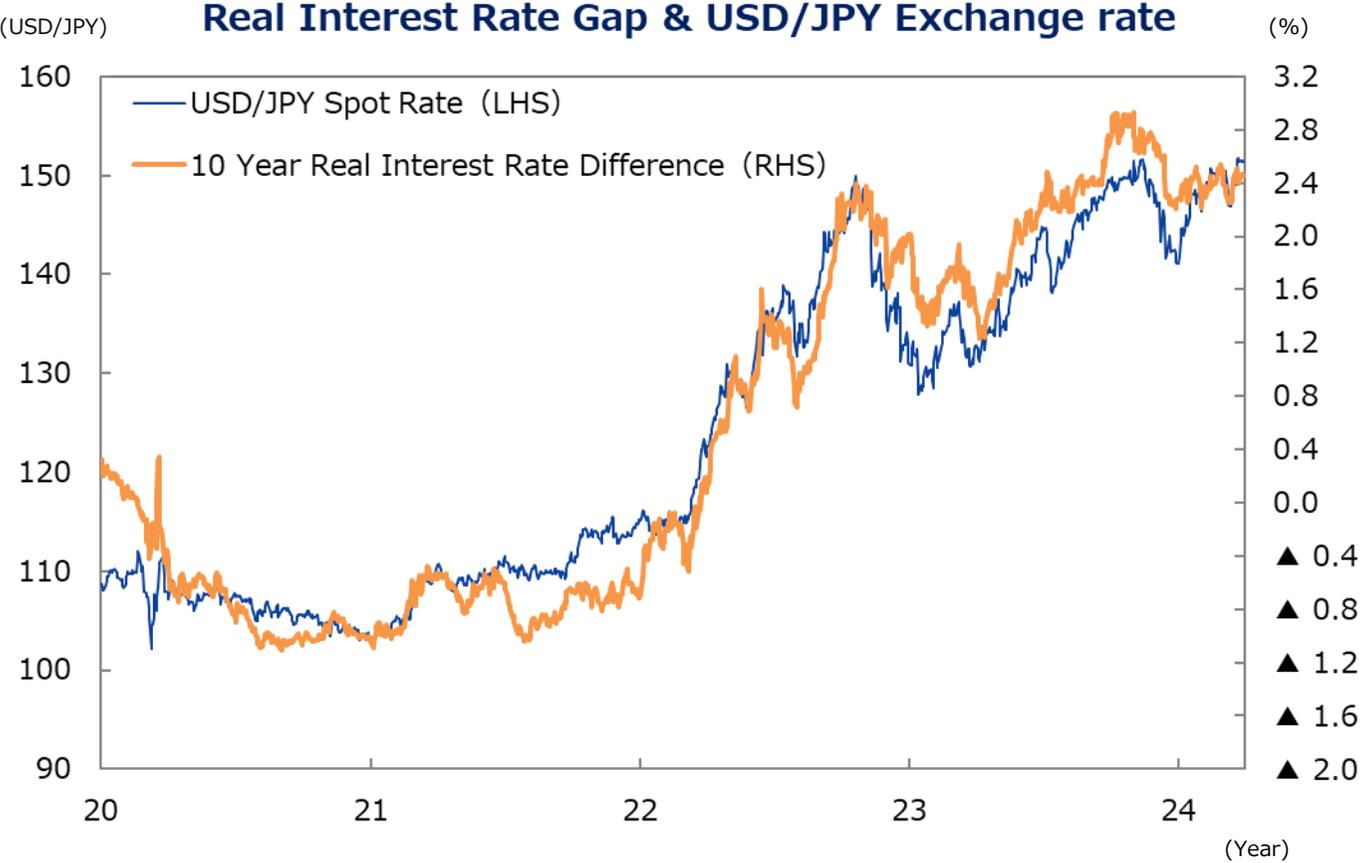
Source: Bloomberg, SMDAM

USD/JPY continues to diverge from purchasing power parity



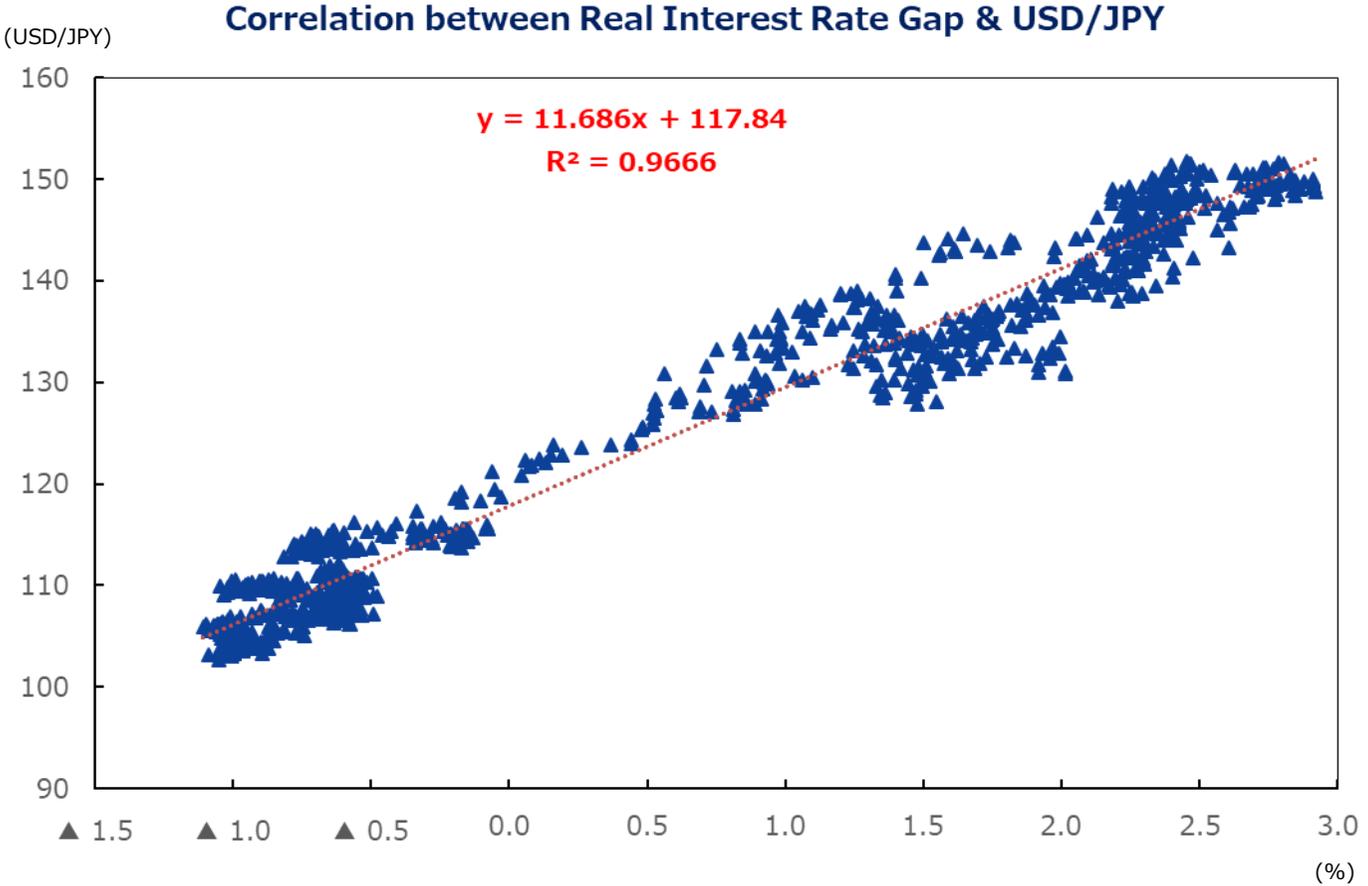
Note: Data is from January 1971 to February 2024.
Source: DOL, Bank of Japan, SMDAM

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 March 2024.
Source: Bloomberg, SMDAM

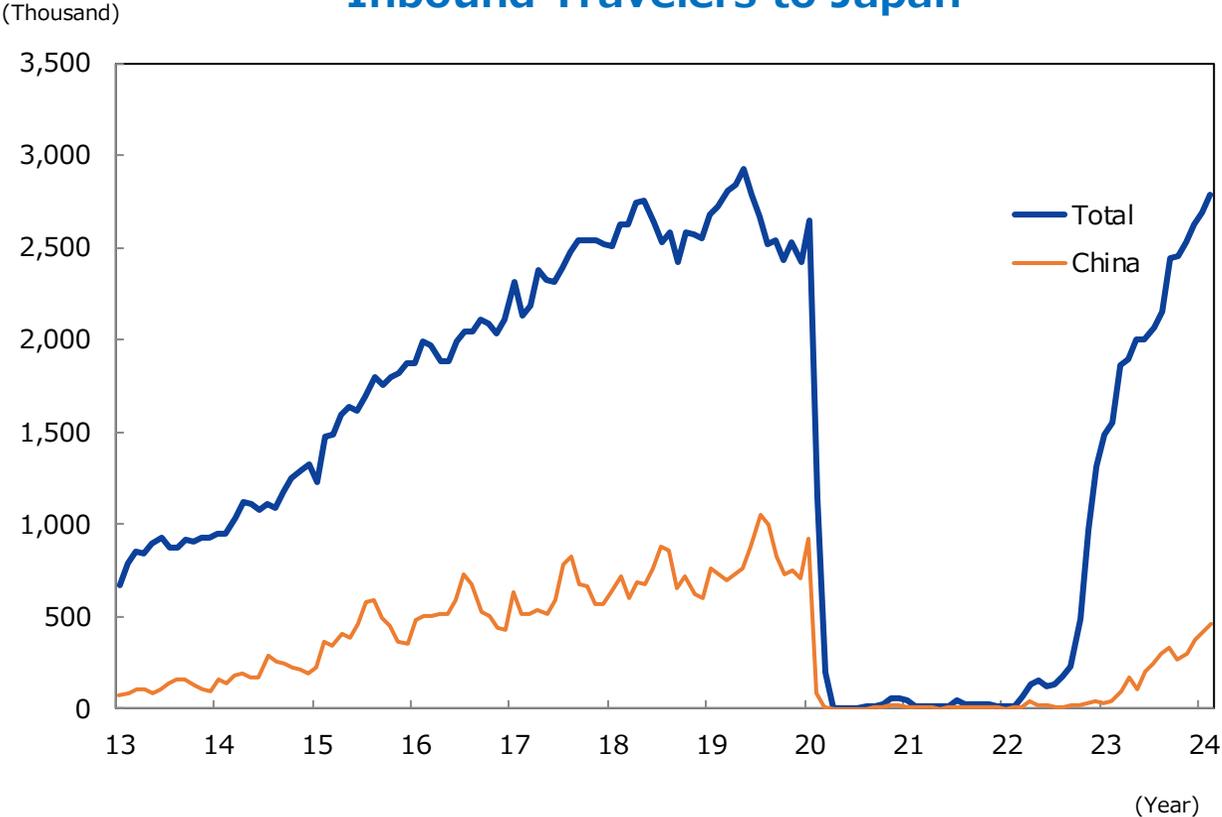
Real yield gap still dominates USD/JPY rate



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

Inbound travel returned to a historical high level

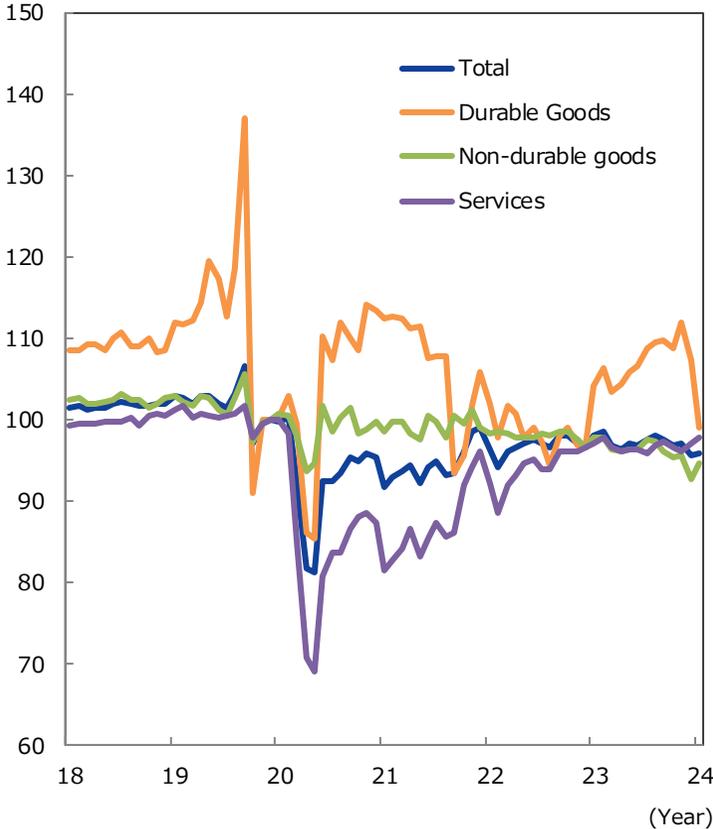
Inbound Travelers to Japan



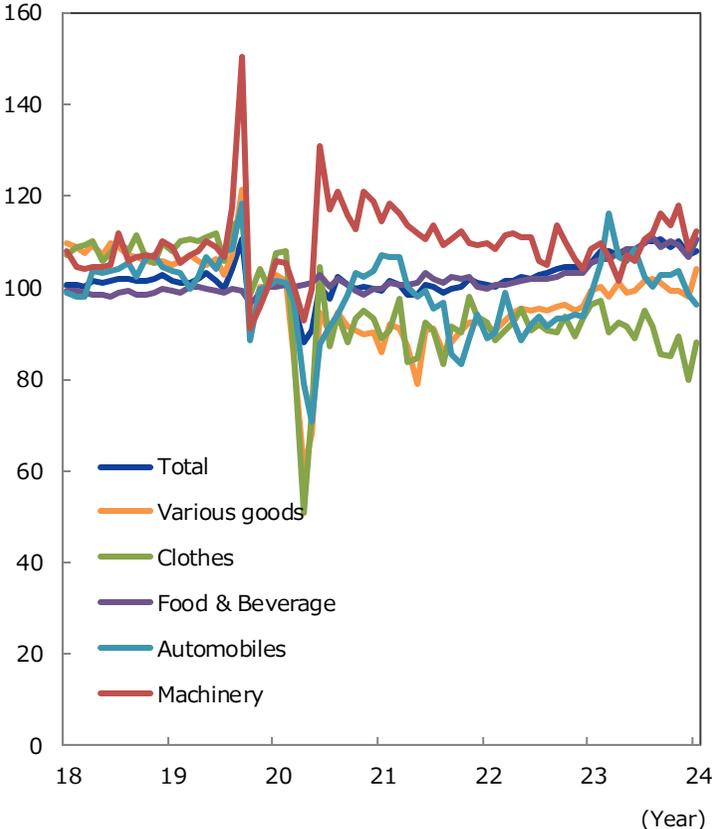
Note: Data is from January 2013 to February 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Suspension of auto shipment weighs on retail sales

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to January 2024.
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 March 2024.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2024	April	1	Start of restrictions on overtime work (logistics, construction, & medical care)
		10	US-Japan summit meeting
		25-26	Monetary Policy Meeting
		28	House of Representatives by-election
			Release of BOJ view report
	May		Release of Q1 GDP
			Multi-faceted review of Second workshop
	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)
August	15	Release of Q2 GDP	
September	19-20 30	Monetary Policy Meeting Termination of the presidency of the LDP	
October	30-31	Monetary Policy Meeting	
November	15	Release of Q3 GDP	
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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