



Outlook for Japanese Stock Market & Economy

Sumitomo Mitsui DS Asset Management

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-June 2024-

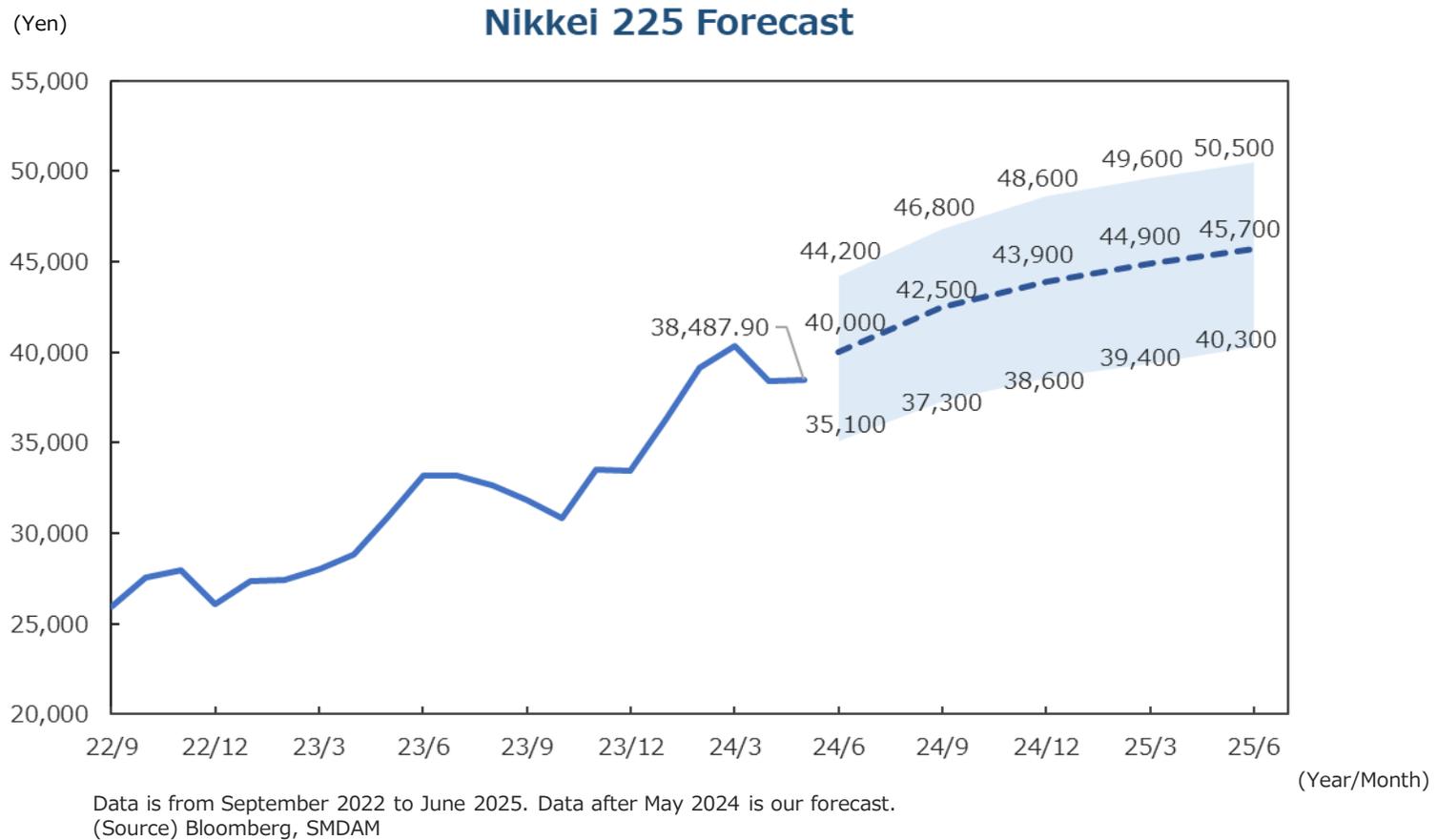


Outlook for Japanese Stock Market

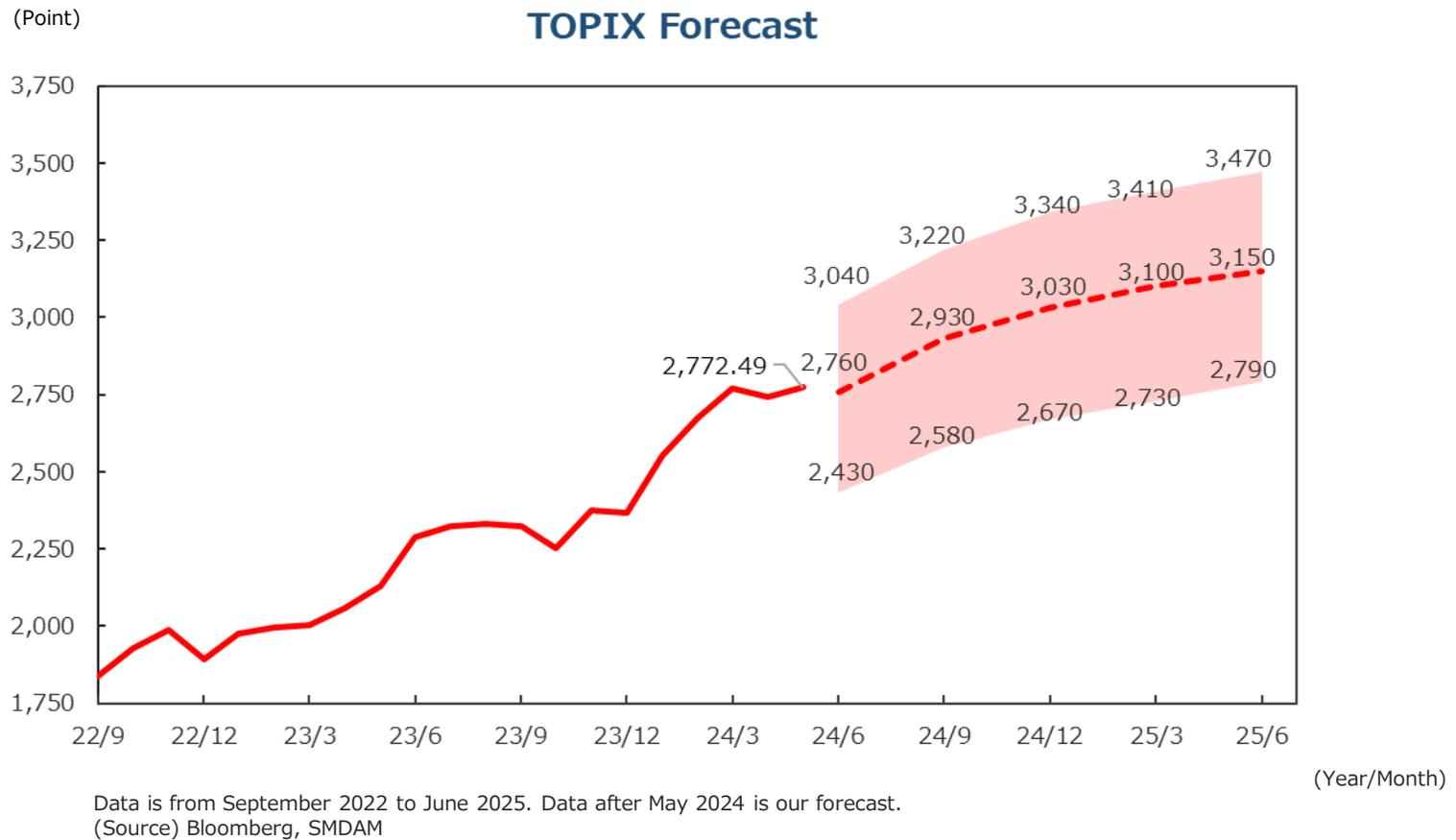
Market Outlook

- We believe corporate earnings and favorable economic conditions will continue to drive the Japanese stock market higher ahead. The solid increase in nominal GDP and the accelerating manufacturers' business cycle could boost EPS in the mid- to long-term.
- We maintain our price target for the Nikkei 225 at 44,900 and that for TOPIX at 3,100 to the end of March 2025.
- This year's wage increase, which was the highest in 33 years, could boost Japanese consumer spending that makes up more than half of the economy.
- In the short term, the market could face increasing volatility owing to speculation over the next actions of the Bank of Japan.

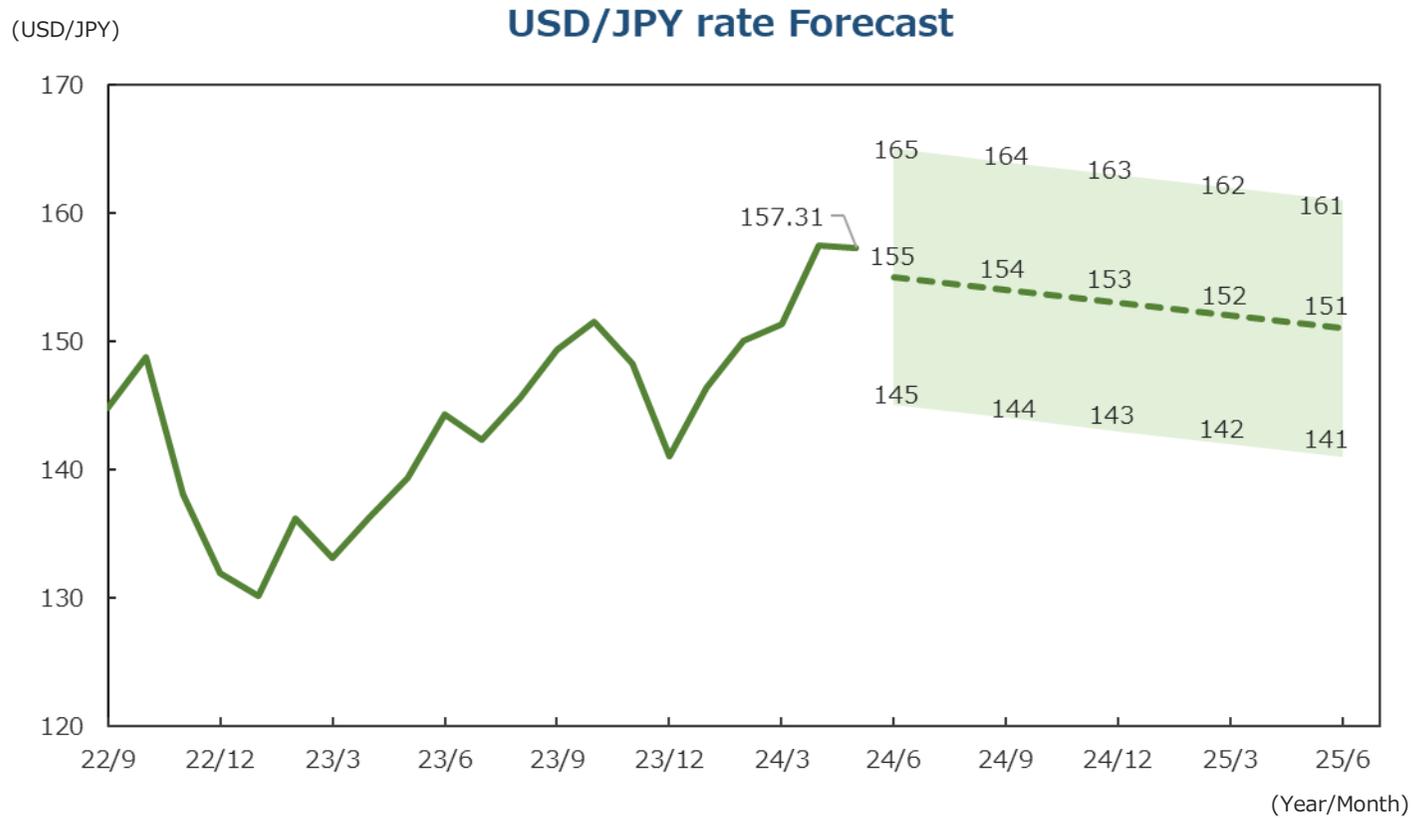
We expect a bullish stock market going forward



We expect a bullish stock market going forward



Monetary policy pivot could affect FX trend ahead



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

Upside / Downside risk scenarios

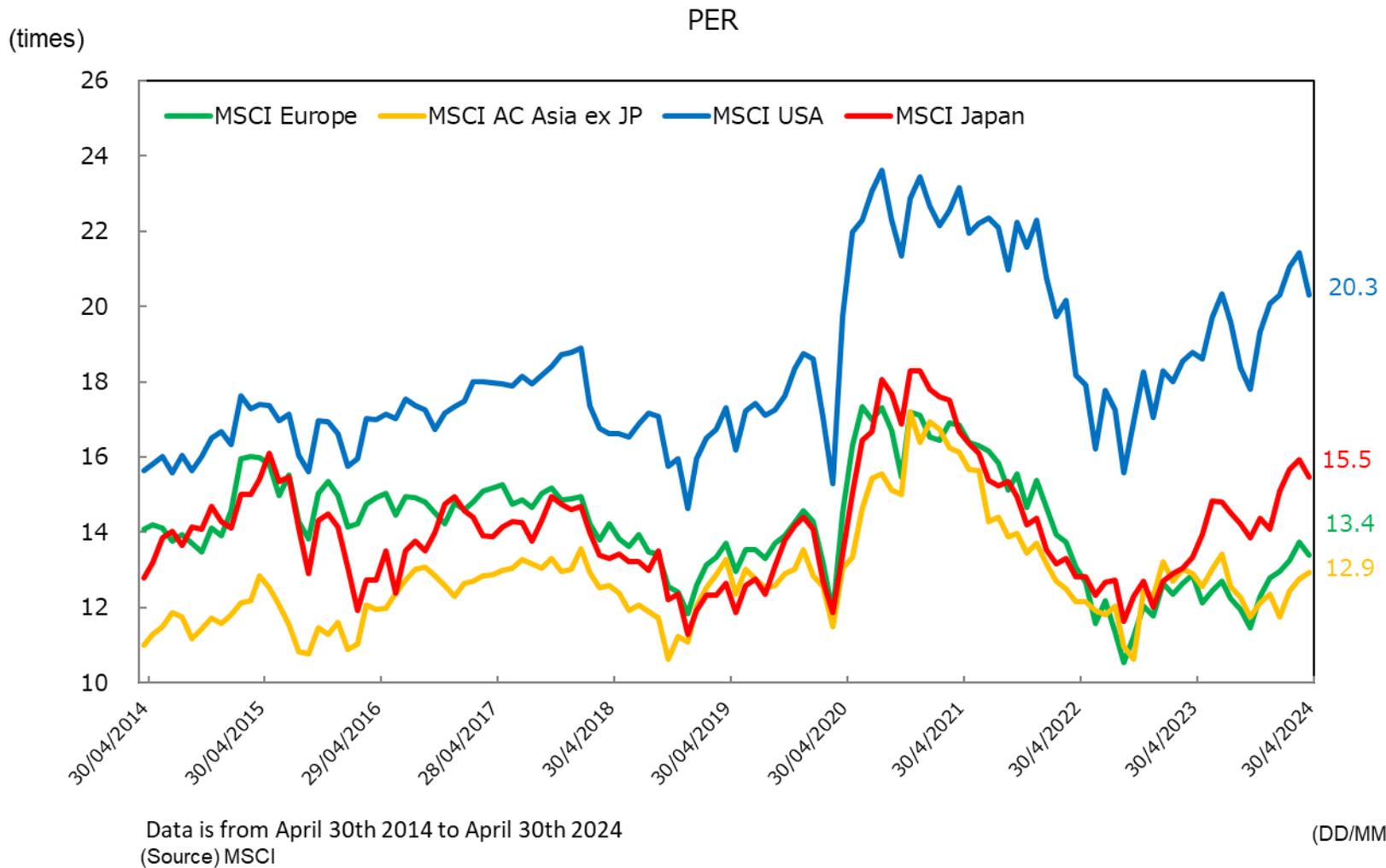
■ Upside Risks

- Growing optimism over virtuous cycle of wage increases and mild inflation
- Prolonged accommodative monetary policy by the Bank of Japan
- Further progress of corporate governance and shareholders' value

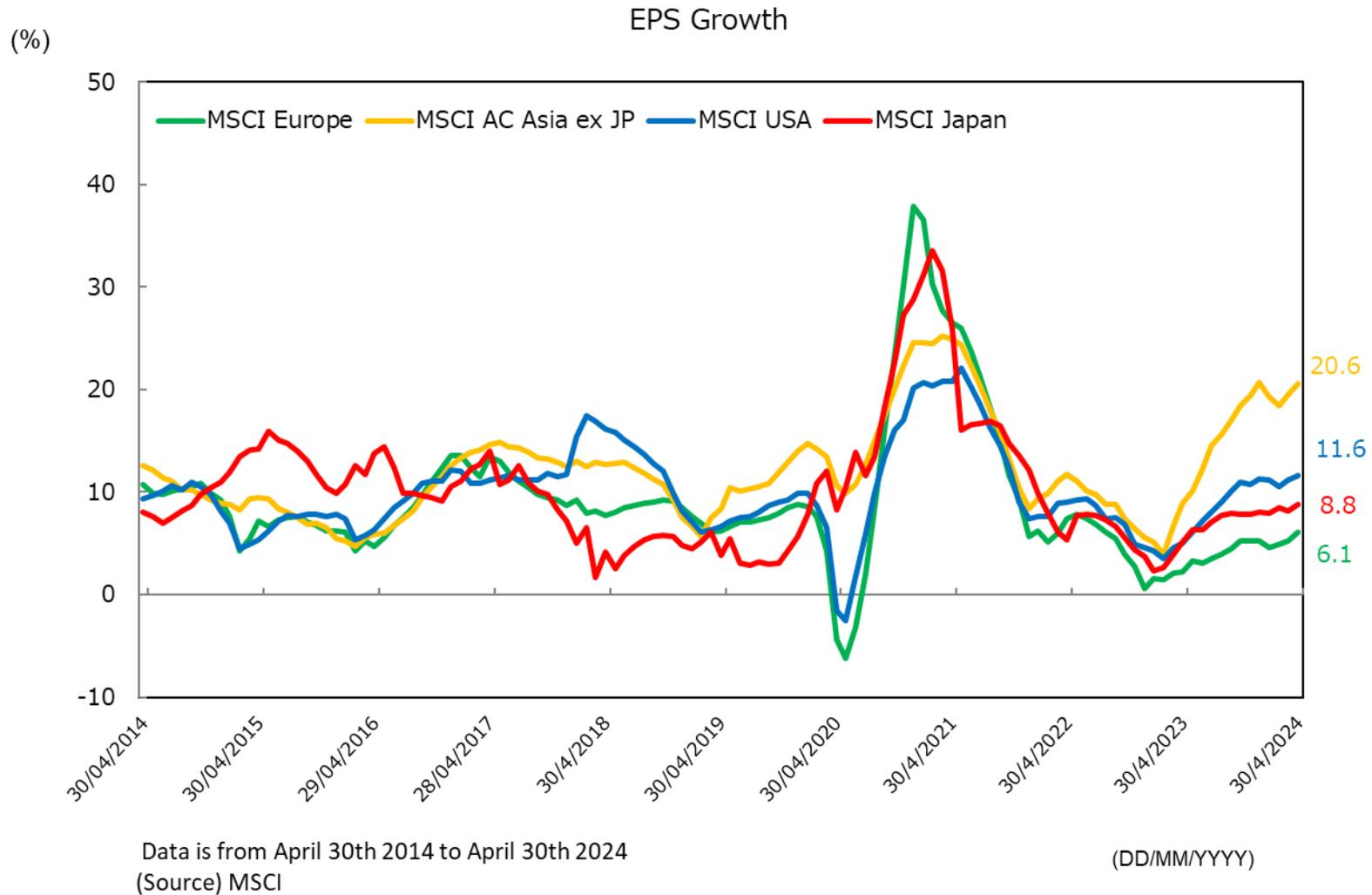
■ Downside Risks

- Excessive and rapid JPY appreciation
- Hasty tightening by the BOJ
- Political turmoil triggered by the split of the ruling Liberal Democratic Party (LDP)

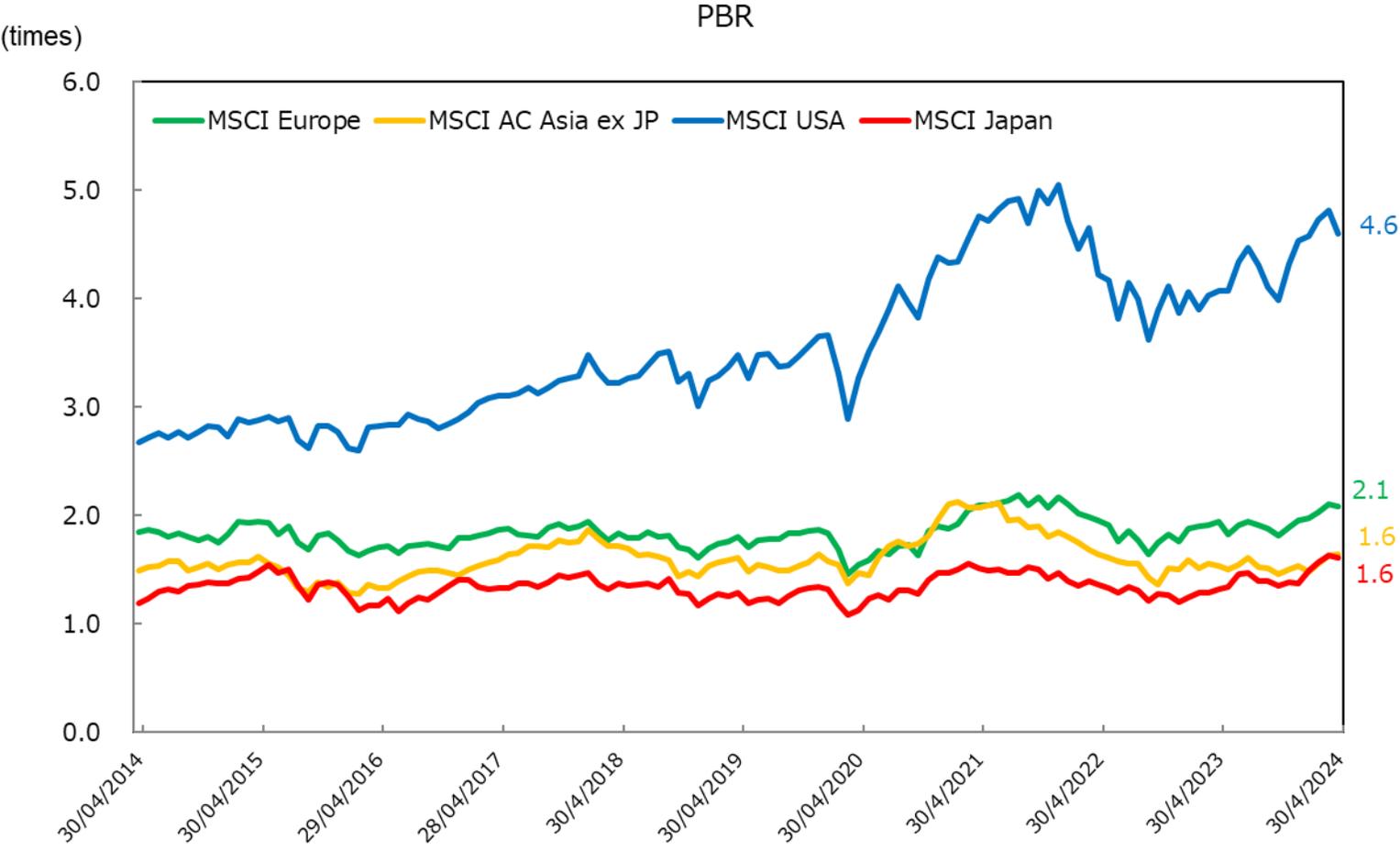
Recent market strength boosts Japan's P/E ratio



Japanese stocks continue solid earnings growth



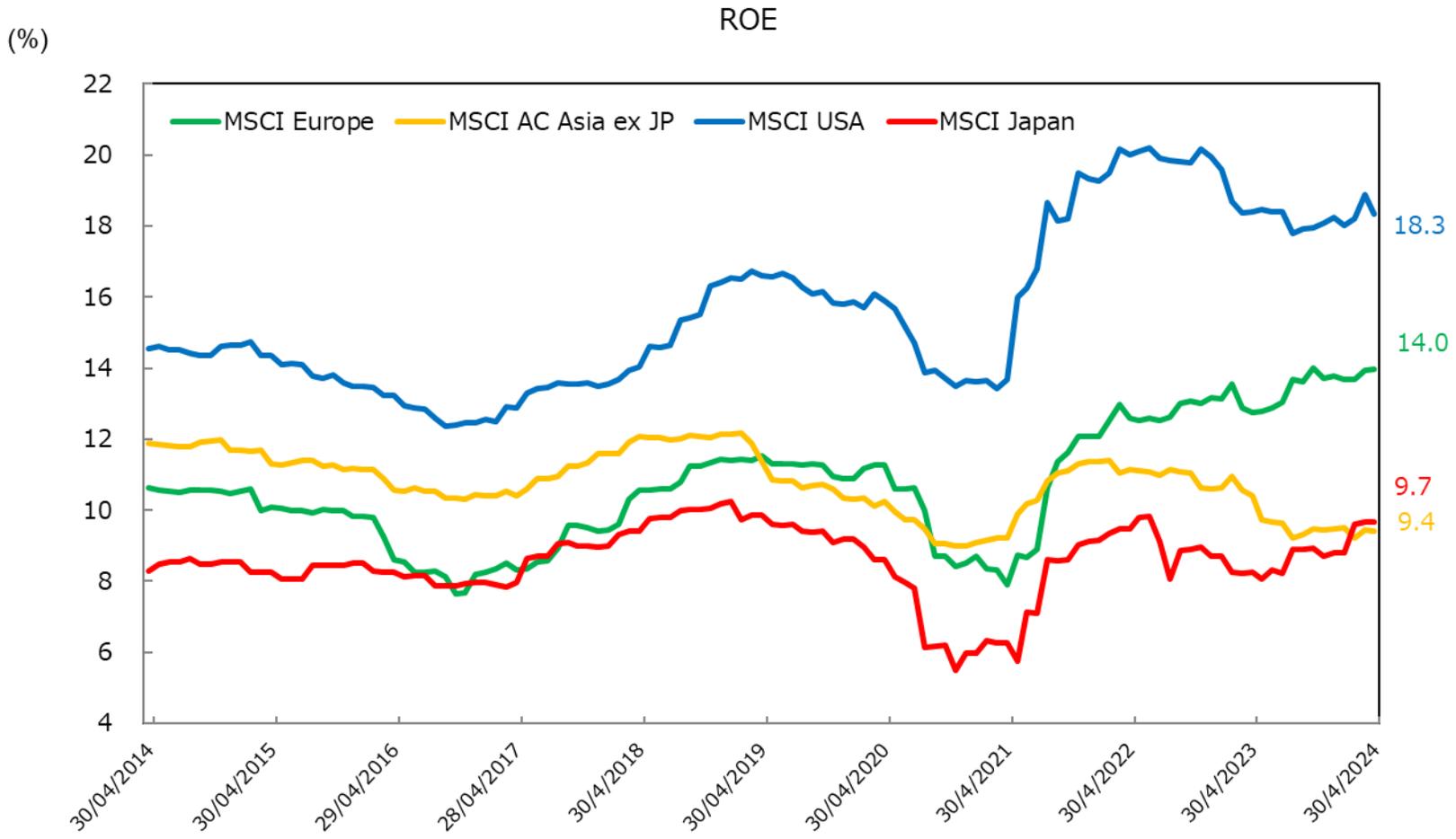
Japan's P/B ratio catching up with Asian peers



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

(DD/MM/YYYY)

Earnings growth lifts Japan's ROE above Asian peers



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

(DD/MM/YYYY)

EPS revision remains positive despite lackluster economic data

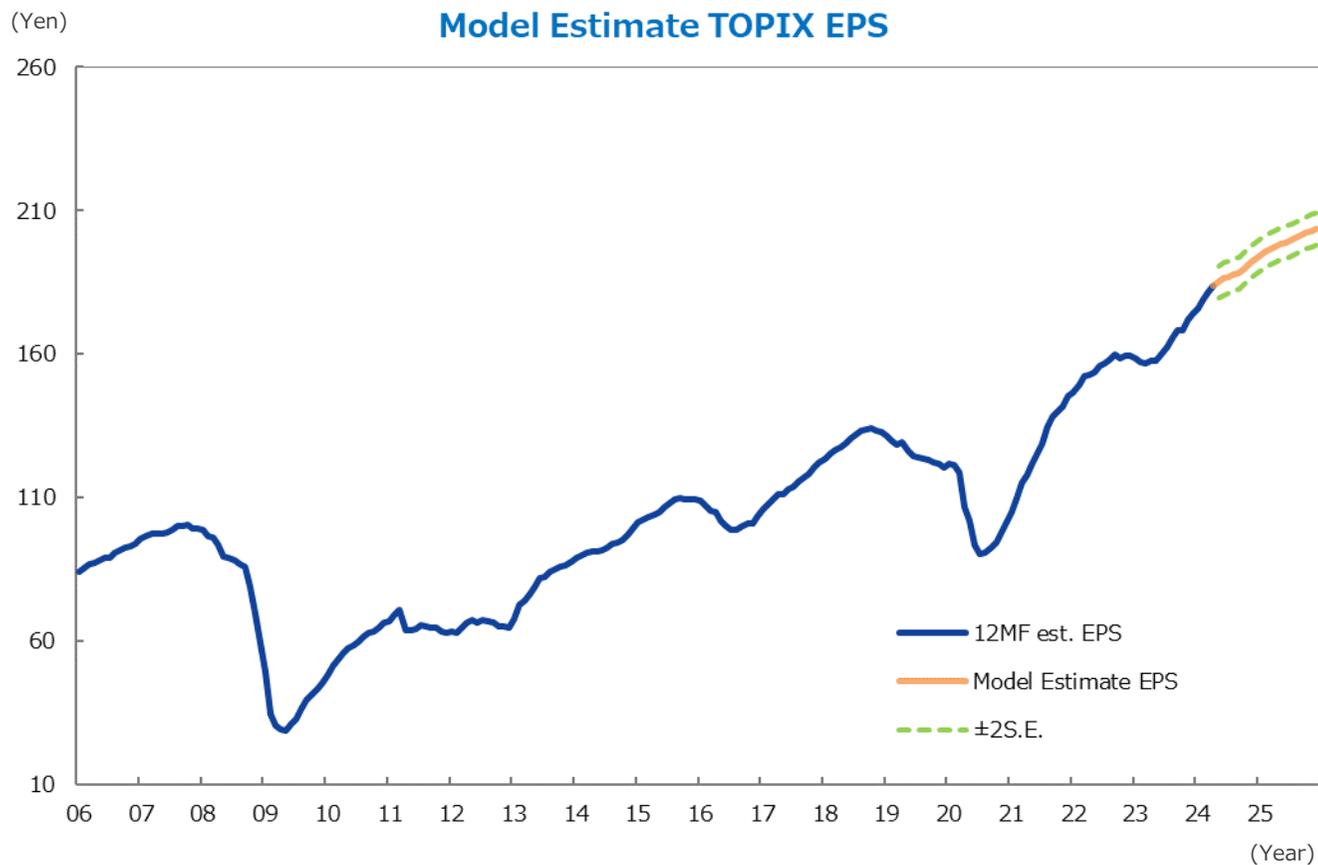
TOPIX Revision Index



Data is from January 2nd 2020 to May 9th 2024
(Source) Datastream, IBES

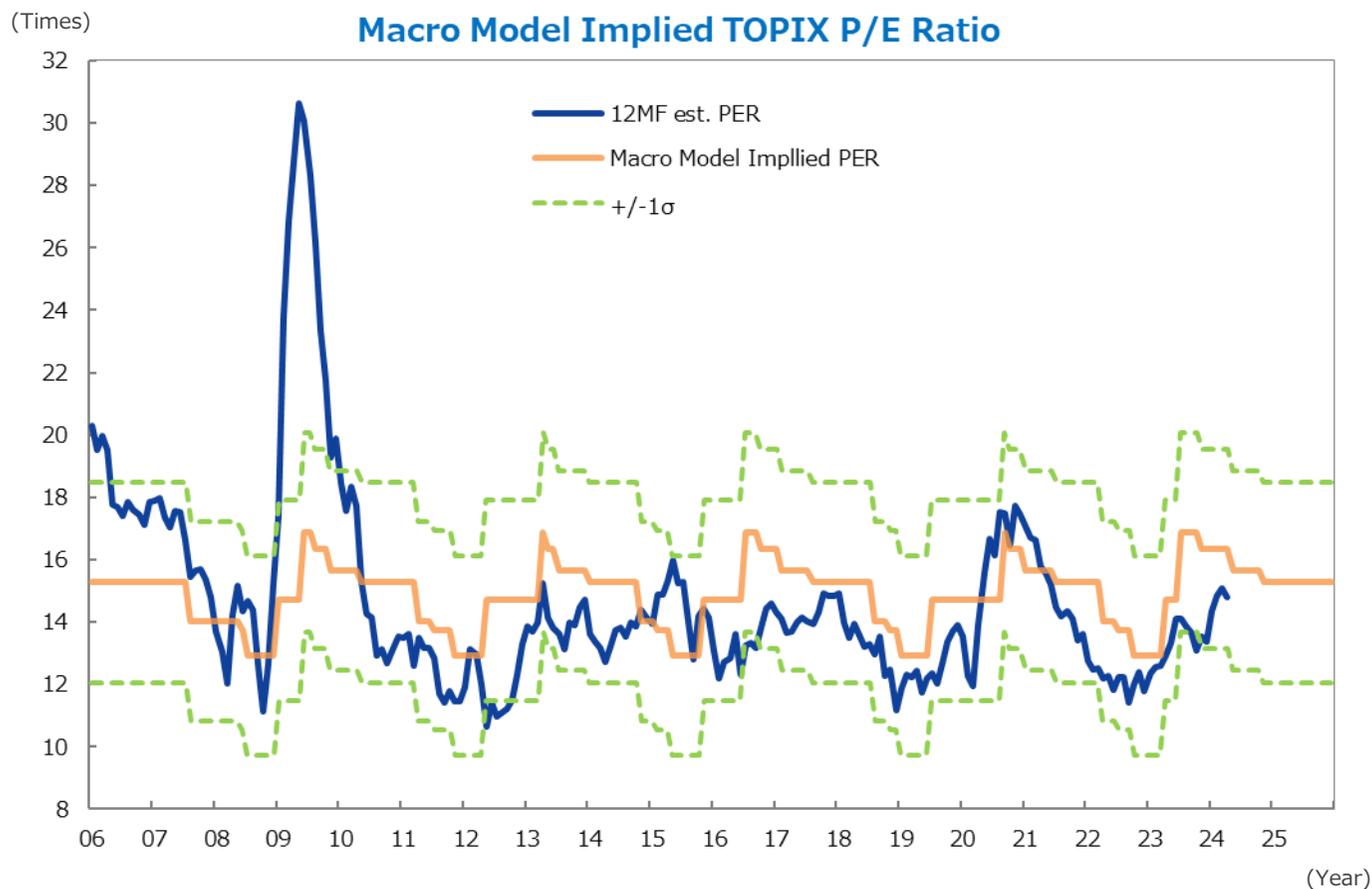
(YY/MM)

Quant model indicates earnings growth to continue going forward



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

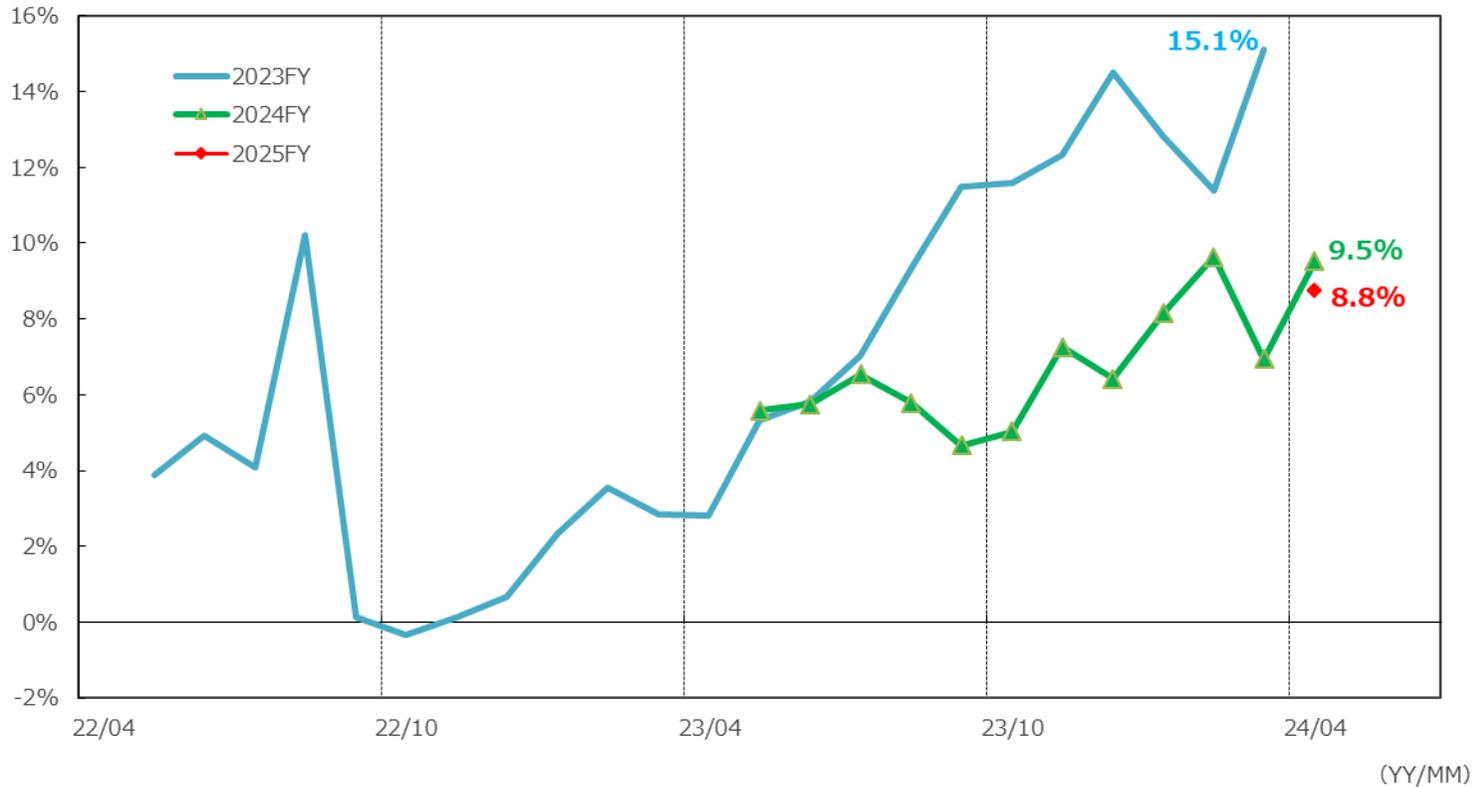
P/E ratio is still below the fair value even after recent rally



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

Bottom up research shows earnings growth to continue ahead

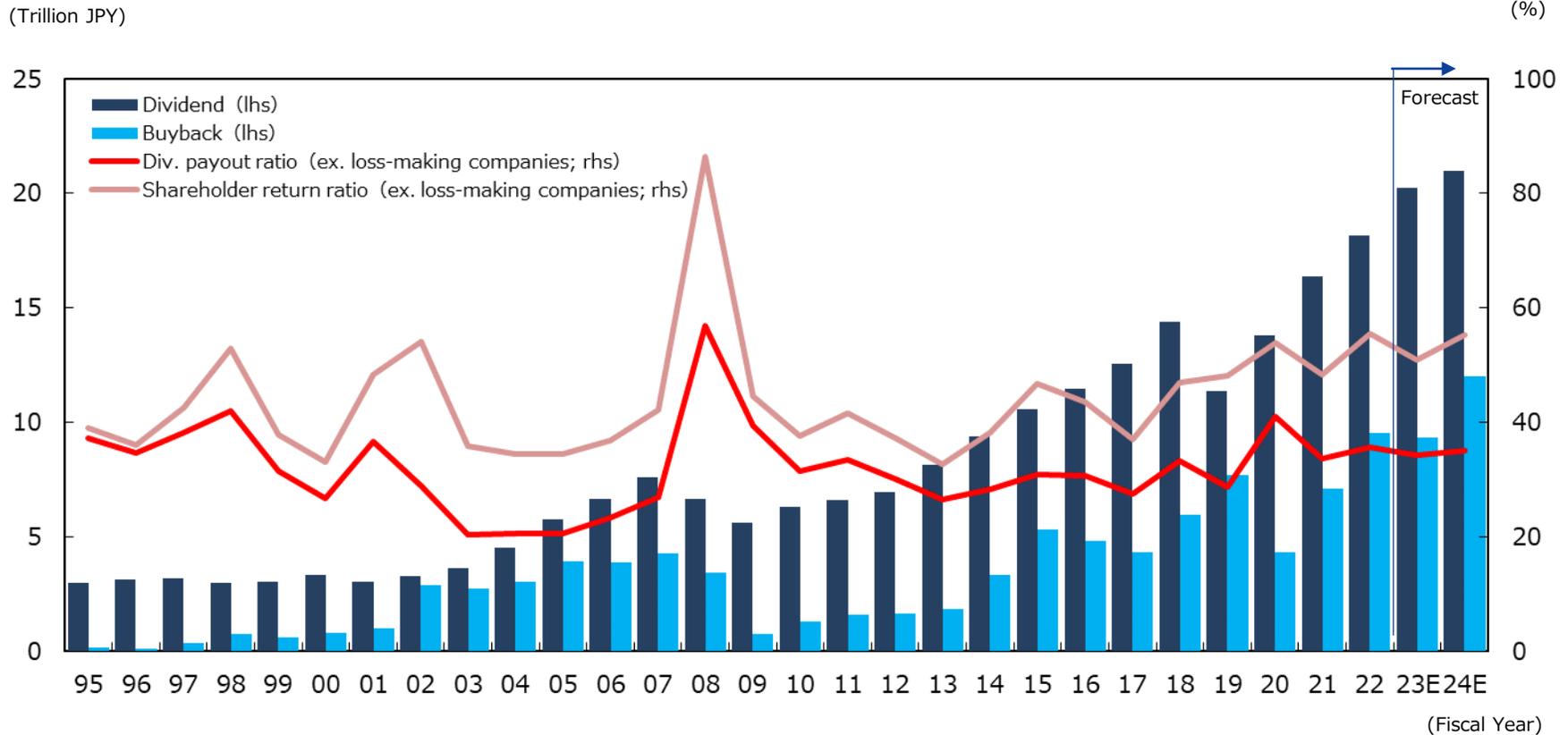
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 13th May 2024, SMDAM Core Universe (Excl. Financials) consists of 373 Japanese companies covered by SMDAM in-house analysts.
 Source: SMDAM

Streak of record-breaking 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

Large cap value still dominating Japanese market

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	5.15	16.72	16.85	27.86	47.18	45.66	78.91
Total Value	7.78	20.26	22.25	41.13	64.03	71.76	93.97
Top Cap Value	9.05	25.13	30.94	51.16	77.14	93.20	130.05
Large Cap Value	8.17	21.15	24.13	43.76	66.06	77.07	100.20
Mid Cap Value	7.28	17.32	17.84	35.91	54.02	59.64	66.83
Small Cap Value	5.91	16.11	13.83	29.54	54.57	49.40	67.76
Micro Cap Value	5.06	14.03	11.50	27.27	52.08	48.17	64.30
Total Growth	2.77	13.56	12.18	16.14	32.58	24.72	63.16
Top Cap Growth	4.08	18.36	16.27	21.46	37.47	32.59	78.69
Large Cap Growth	3.26	14.56	13.39	17.57	34.83	27.31	69.04
Mid Cap Growth	1.66	7.66	8.04	10.51	29.82	18.04	52.89
Small Cap Growth	-1.63	4.88	1.89	4.19	14.83	4.22	20.70
Micro Cap Growth	-2.52	5.97	2.34	5.97	15.81	1.16	21.48
Top Cap Total	6.00	20.96	21.69	33.53	53.48	55.86	98.62
Large Cap Total	5.48	17.53	18.14	29.28	48.70	48.30	84.24
Mid Cap Total	4.74	12.87	13.33	23.45	42.13	38.08	65.23
Small Cap Total	2.97	11.66	9.07	19.32	37.93	29.91	48.98
Micro Cap Total	2.43	11.24	8.30	20.00	39.07	31.03	50.08

Note : As of 20th May 2024
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is standing still.** The economy contracted for the first time in 2 quarters in Q1 2024, partly due to a reduction in the production of automobiles due to the illegal certification test scandal, the Noto Peninsula earthquake, and a reactionary decline in royalties received by pharmaceutical companies. Regarding soft data for the economy, there was a mixed picture in April 2024. While the composite PMI improved, the economic watchers' survey and the consumer sentiment index were weak.
- **Inflation is slowing down.** The nationwide core CPI rose +2.6% YOY in March, slowing down from +2.8% a year earlier. Tokyo Metropolitan Area Core CPI in April rose +1.6% YOY, sharply declining from +2.4% last month. Even if we exclude the effect of effectively free tuition for high school, there is a slowdown in inflation in the Tokyo area.

[Outlook]

- ① **While we have slightly lowered our real GDP growth forecast for FY 2024 to +0.4% from +0.5%, we have maintained that for FY 2025 at +0.7%.** The 2024 forecast was slightly lower because of the economic contraction in Q1 2024 due to the earthquake and other special factors. We expect the economy to resume its moderate growth trend in and after Q2 2024. The economy is expected to gradually recover, avoiding a setback, as the negative impact from a reduction in automobile production, the Noto Peninsula earthquake, and a decrease in the receipt of royalties for intellectual property rights by pharmaceutical companies will disappear. In addition, wage increase, economic stimulus, including flat-rate tax cuts, and solid overseas economic trends could support the economy going forward.
- ② **While we have lowered our core CPI forecast for FY 2024 to +2.6% from +2.8% and that for FY 2025 to +2.0% from +2.1%.** The main reason for the downward revision was a decline in the Tokyo Metropolitan CPI in April 2024 and a reduction in the crude oil price assumption. In the short term, the core CPI is expected to accelerate again to the upper +2% range from the previous year due to the increase in the renewable energy levy and the end of subsidies for electricity and gas tariffs. After that, the core CPI is likely to slow down against the background of a decline in the cost push pressure starting from import prices and a stabilizing of energy prices. However, the core CPI is expected to remain stable at around +2% YOY from around the second half of 2025, supported by the rise in service prices associated with wage increases.
- ③ **We expect the government to continue their accommodative fiscal policy.** In November 2023, Prime Minister Kishida's Cabinet approved "comprehensive economic measures to overcome deflation." The measures, which amount to 20.9 trillion yen on a national and local spending basis, include 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 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 owing to the slush fund scandal.
- ④ **We expect the Bank of Japan policy rate will change to 0.25% in October 2024, from a range of 0-0.15%, to 0.5% in April 2025, and to 0.75% in October 2025.** The Bank of Japan Governor Ueda indicated that the results of the spring wage increase could be reflected in price developments this summer and fall, leading to a decision of further rate hikes going forward. The central bank is expected to raise interest rates again in October 2024, after assessing the impact of wages on prices. The BOJ is then expected to raise the benchmark interest rate once every six months while closely monitoring the impact of the monetary tightening. The risk of our scenario could be an earlier rate hike owing to concerns over a weaker yen and its impact on inflation.

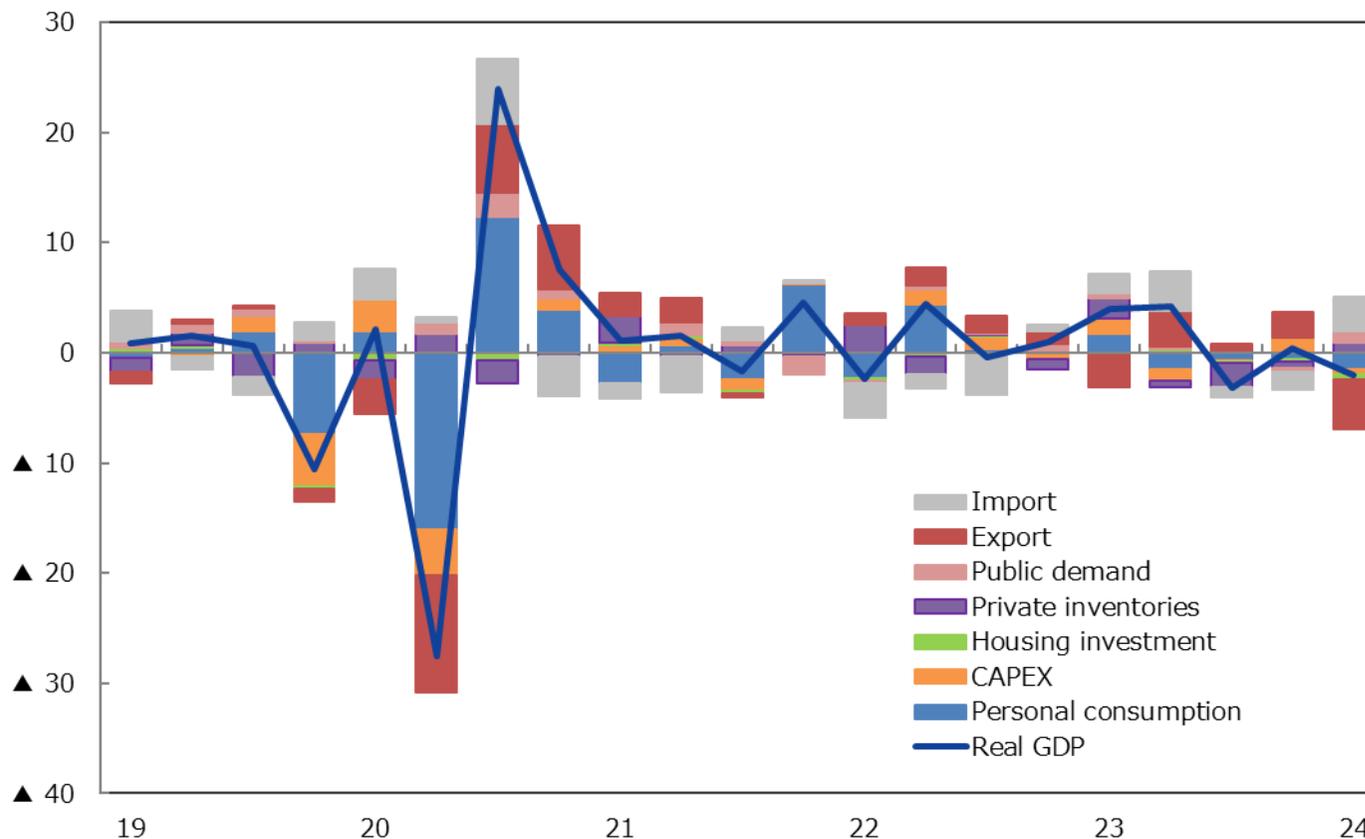
Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown							
Fiscal Year	FY19	FY20	FY21	FY22	FY23	FY24 Est	FY25 Est
Real GDP	-0.8%	-4.1%	2.7%	1.4%	1.2%	0.4%	0.7%
Private final consumption expenditure	-0.9%	-5.1%	1.5%	2.5%	-0.6%	0.0%	1.0%
Private housing investment	2.5%	-7.2%	-0.6%	-3.0%	0.6%	-2.3%	-1.0%
Private-sector capital investment	-1.2%	-5.4%	2.3%	3.1%	0.4%	1.9%	0.8%
Private inventory investment	-0.2%	-0.3%	0.4%	0.2%	-0.3%	-0.1%	0.0%
Public fixed capital formation	1.6%	4.9%	-6.5%	-3.1%	4.1%	2.8%	0.7%
Net export contribution	-0.5%	-0.6%	0.8%	-0.6%	1.5%	-0.1%	-0.1%
Exports of goods and services	-2.3%	-9.9%	12.4%	4.5%	3.0%	2.0%	2.6%
Imports of goods and services	0.2%	-6.3%	7.1%	7.2%	-3.3%	2.4%	3.3%
Nominal GDP	0.0%	-3.4%	2.5%	2.0%	5.3%	2.8%	2.3%
GDP deflator	0.8%	0.7%	-0.1%	0.7%	4.1%	2.4%	1.6%
Industrial Production Index	-3.6%	-9.7%	5.7%	-0.3%	-1.9%	1.5%	1.2%
Consumer Price Index (Core)	0.4%	-0.6%	0.1%	3.0%	2.8%	2.6%	2.0%
Domestic corporate goods price index	0.1%	-1.5%	7.1%	9.4%	2.3%	1.4%	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%	2.6%	2.5%	2.3%
Monetary Policy interest rate (Short term)	-0.10%	-0.10%	-0.10%	-0.10%	0-0.10%	0.25%	0.75%

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

Temporary factors^{※1} brought Japanese GDP back to negative

Real GDP growth rate (YOY, %)

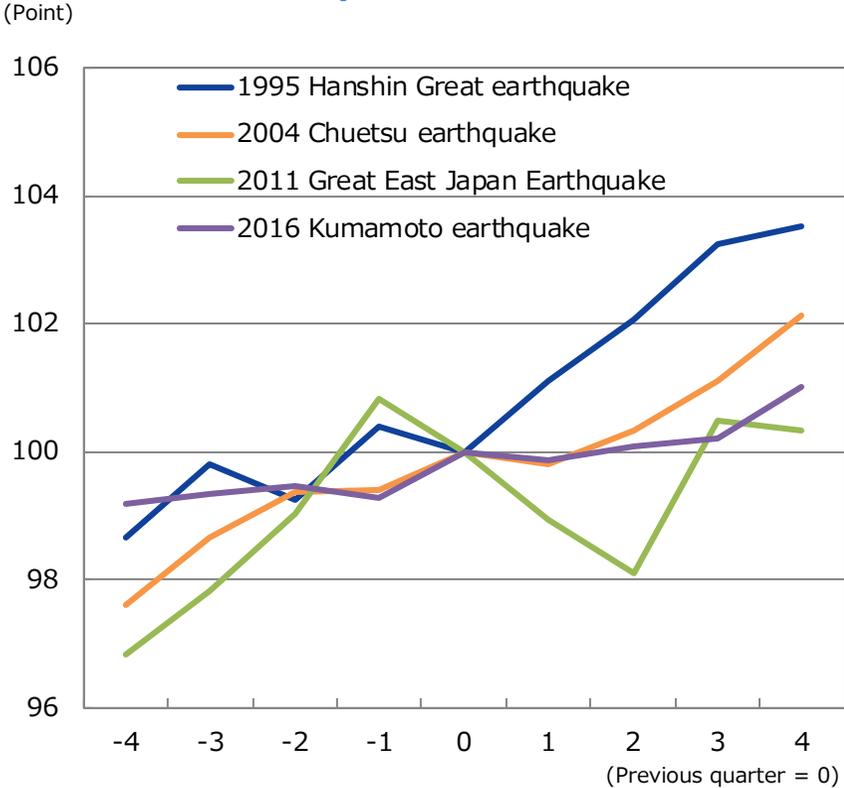


Note: Data is from Q1 2019 to Q1 2024.
Source: Cabinet office, SMDAM

※1: Please refer to page 18 for details.

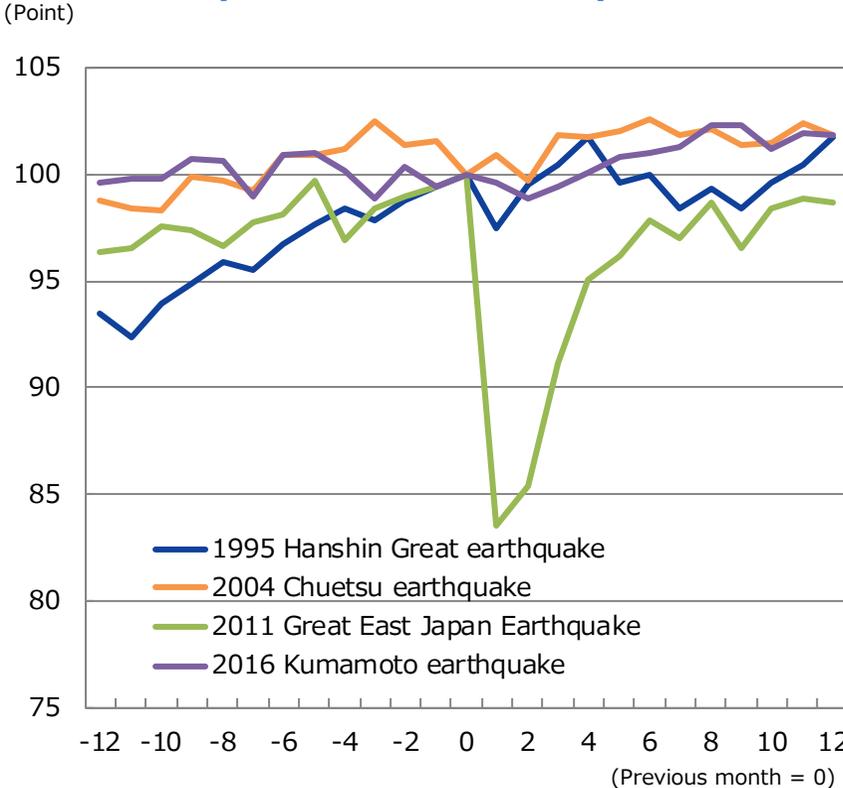
Earthquakes had historically marginal impact on the economy

Earthquake & Real GDP



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

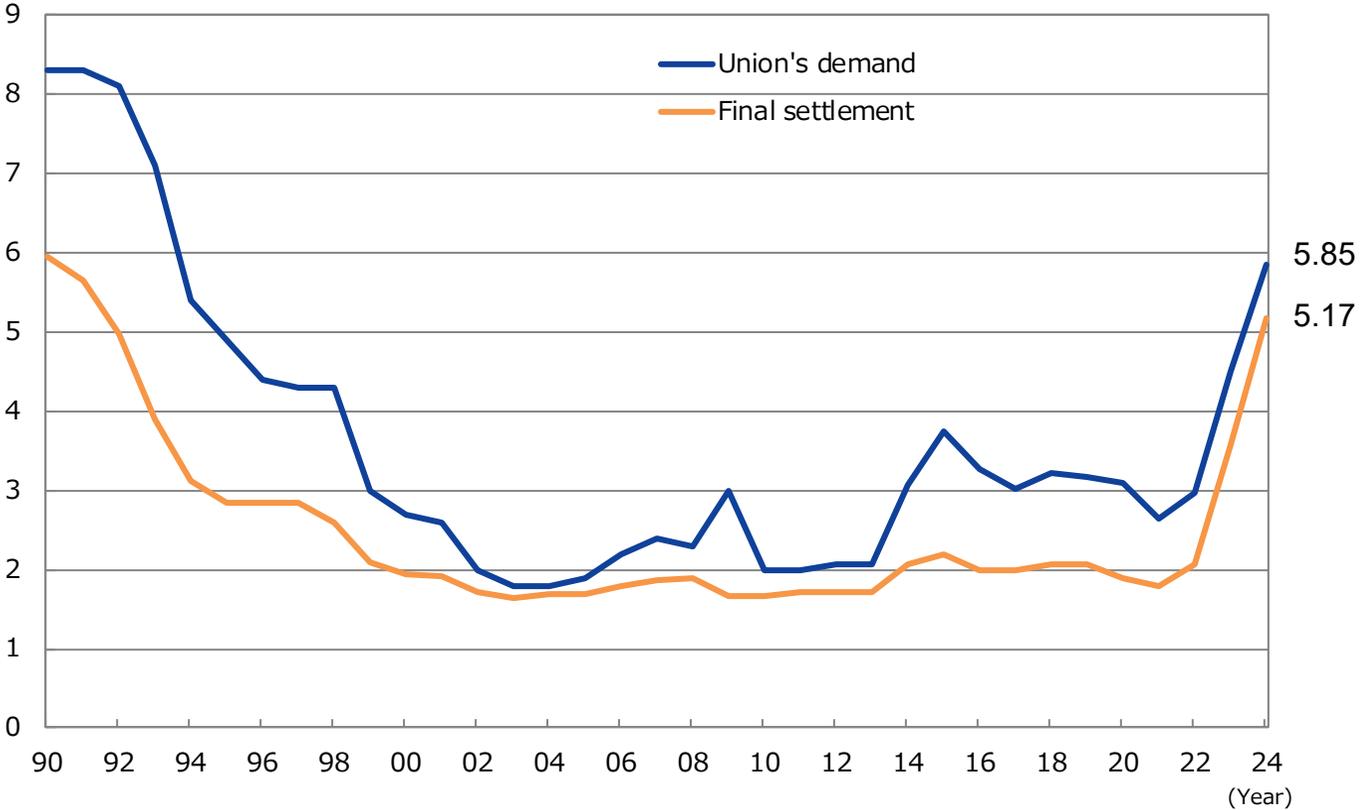
Earthquake & Industrial production



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

Highest wage increase in 33 years in Japan

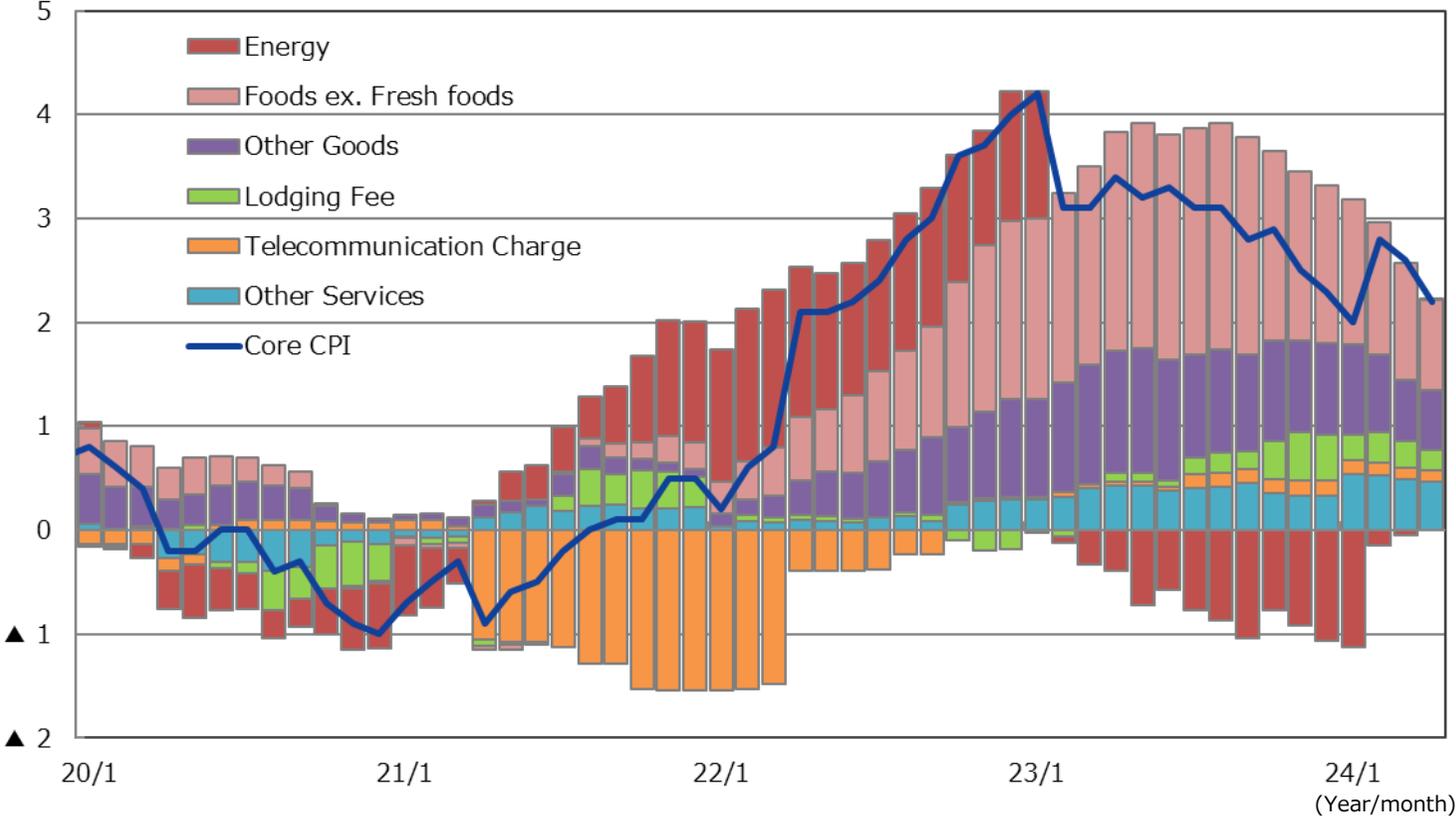
Wage increase (YOY, %)



Note: Data is from FY 1990 to FY 2024.
Source: Japanese Trade Union Confederation, SMDAM

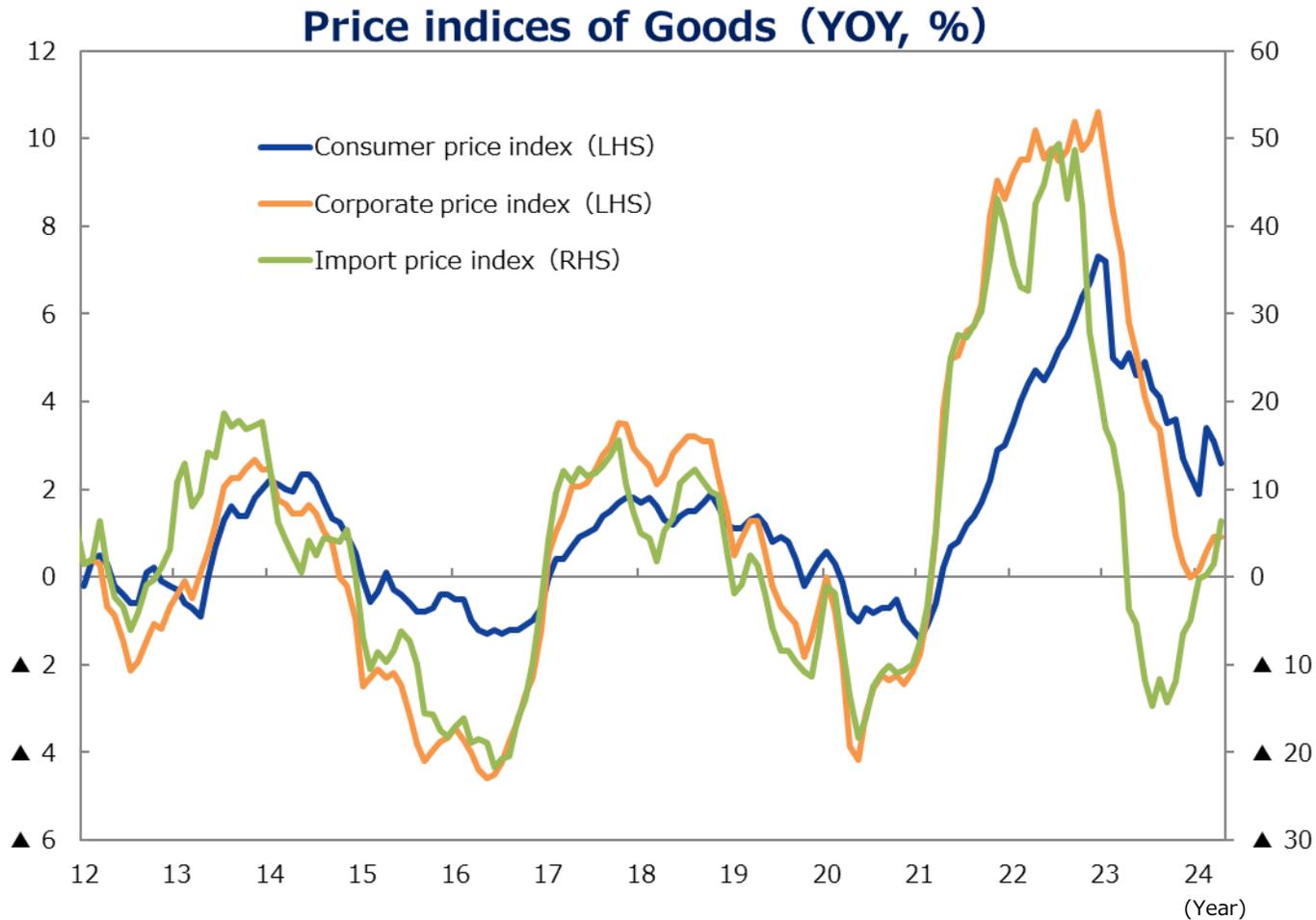
End of utility bill subsidies will lift CPI temporarily

Breakdown of CPI (YOY, %)



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

Amber light? Convergence of CPI and input prices



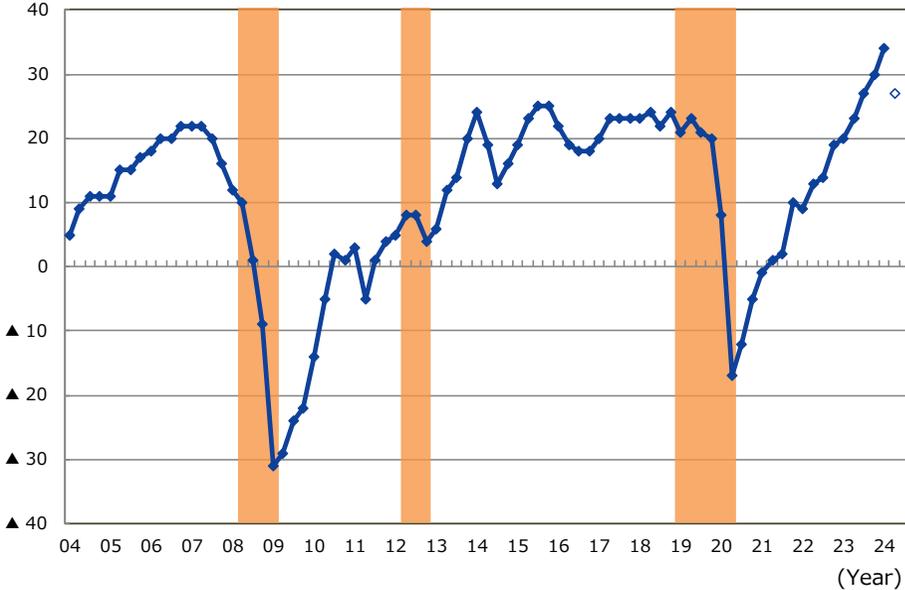
Note: Data is from January 2012 to April 2024.
Source: MIAC, Bloomberg, SMDAM

Non-manufacturers doing well but cautious ahead

BOJ business condition DI Large manufacturers (%)



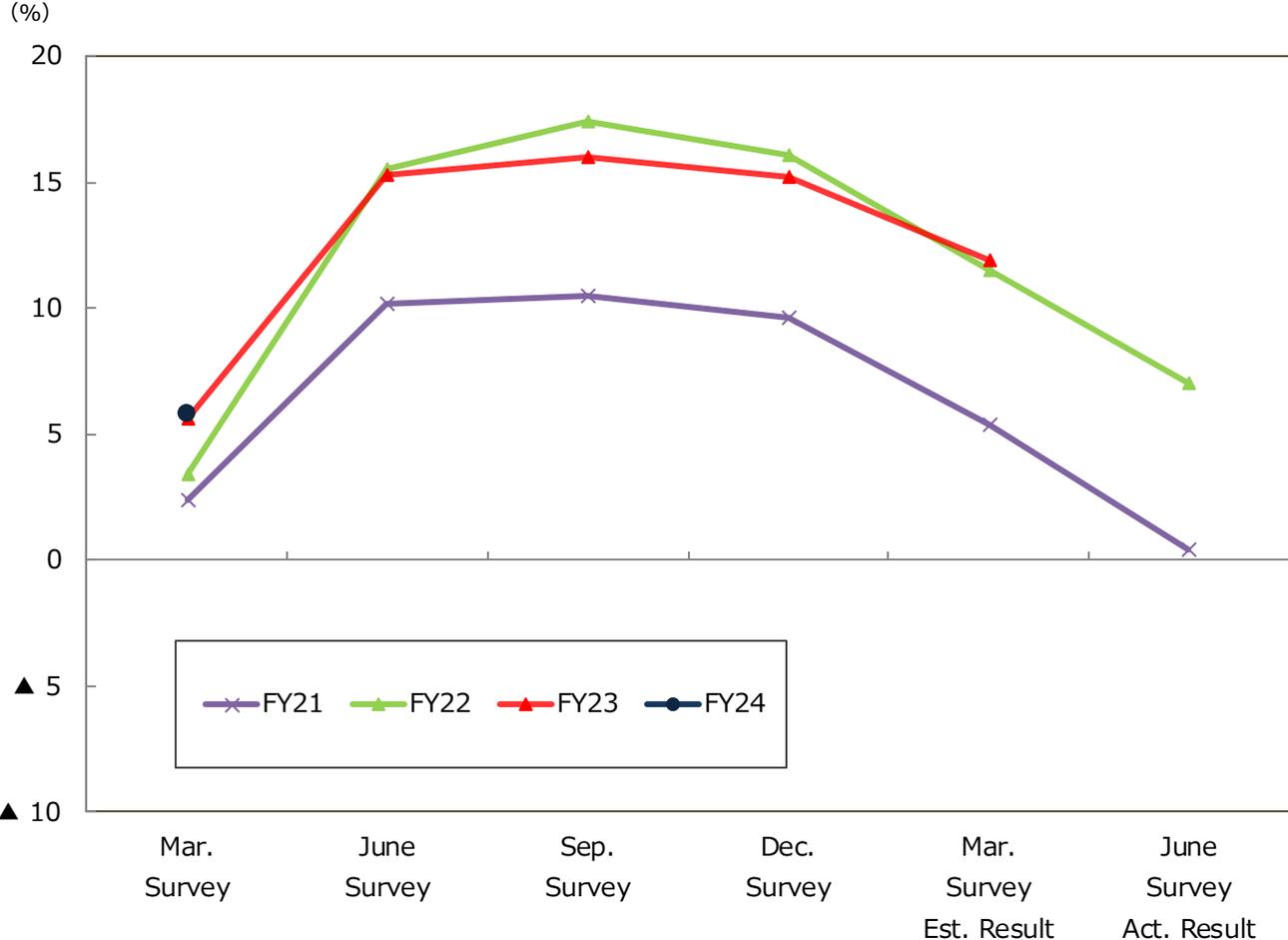
BOJ business condition DI Large non-manufacturers (%)



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

CAPEX maintains a brighter outlook in 2024

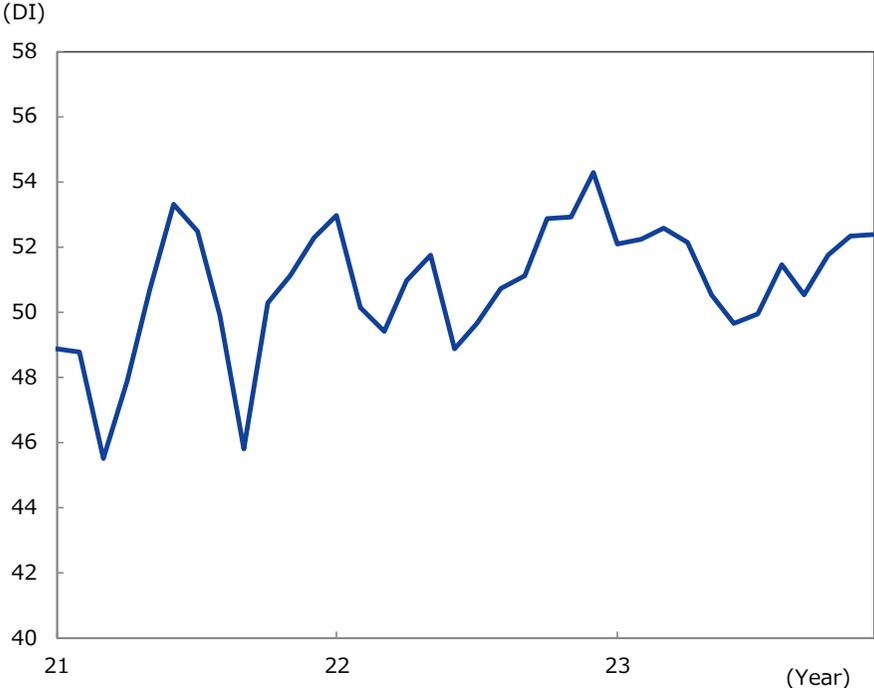
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



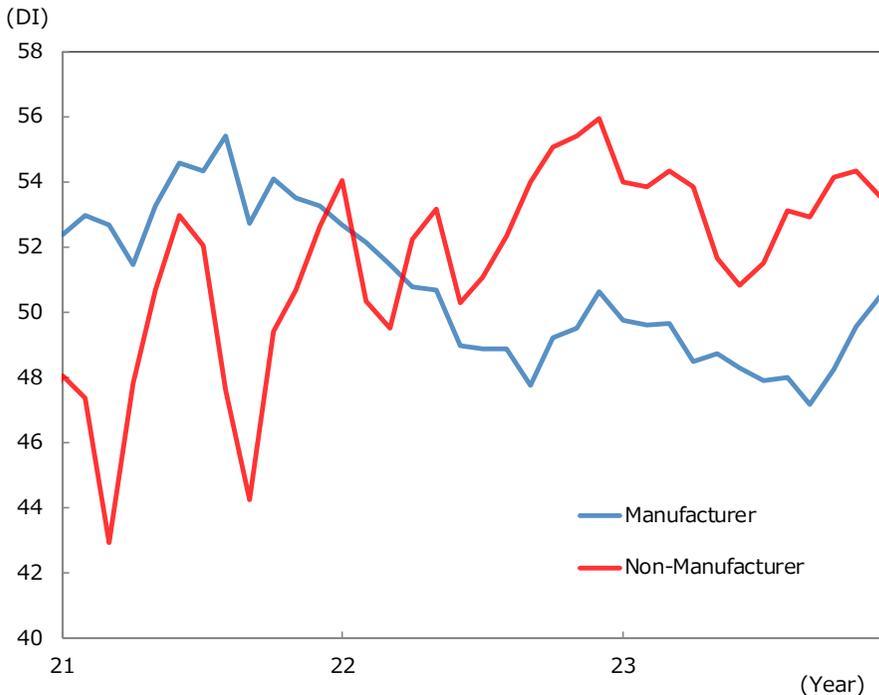
Note: Data is from Q1 FY2020 to Q1 FY2024.
 Source: The Bank of Japan, SMDAM

Recovery in auto production lift manufacturers' PMI

Composite PMI



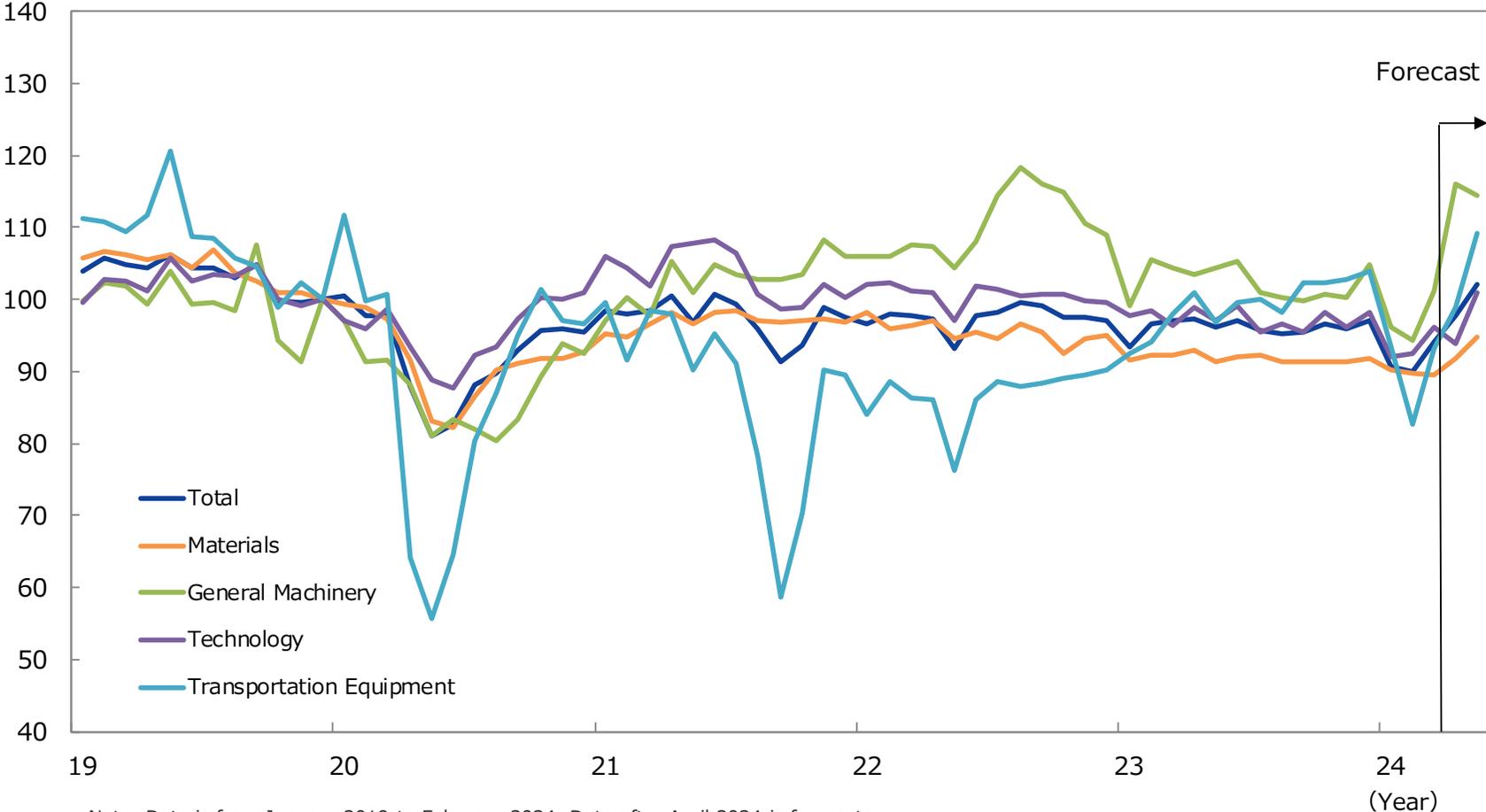
PMI, Manufacturer & Non-Manufacturer



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

Recovery in auto production to lift industrial production ahead

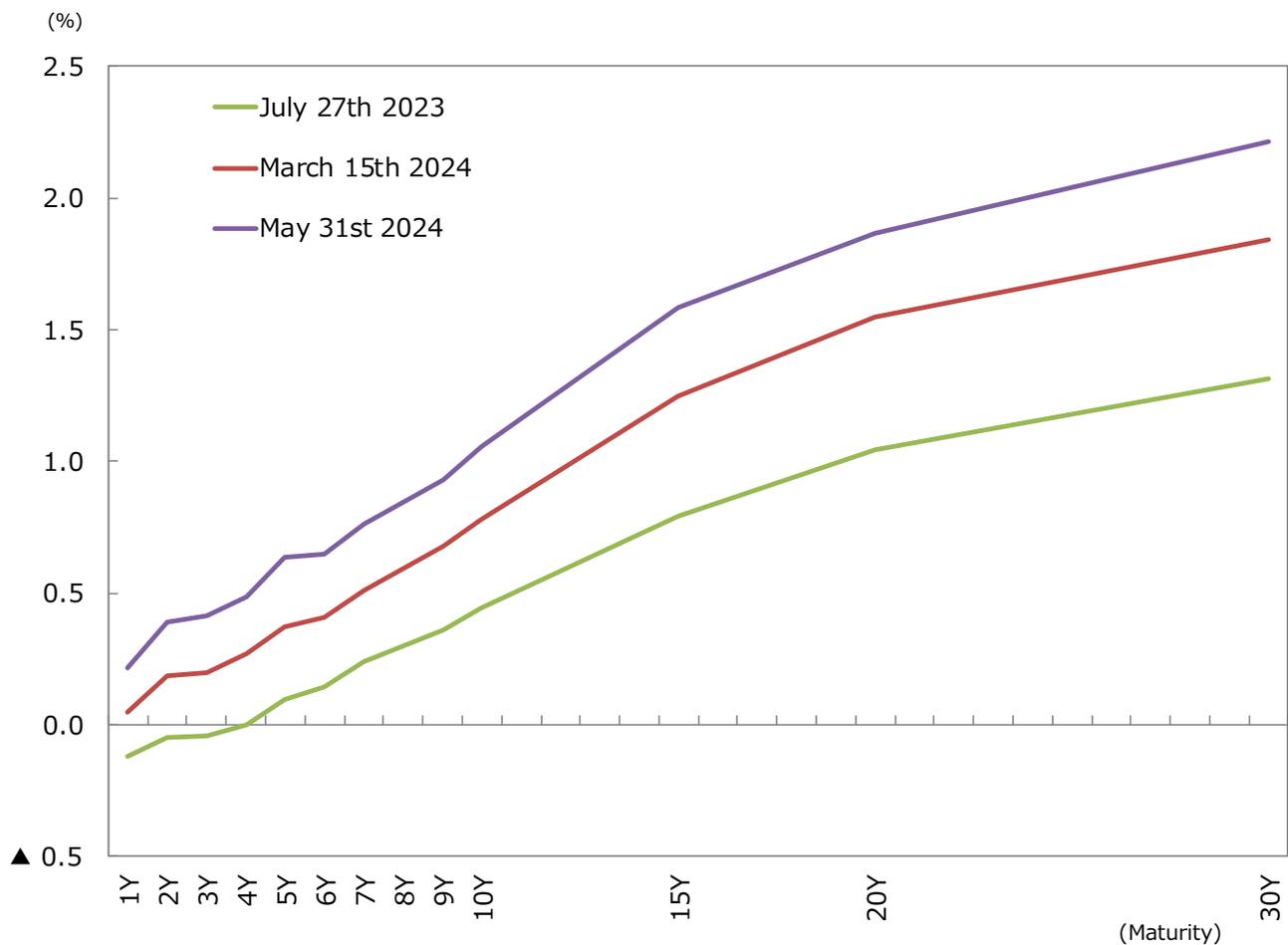
Industrial Production (Dec. 2019=100)



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

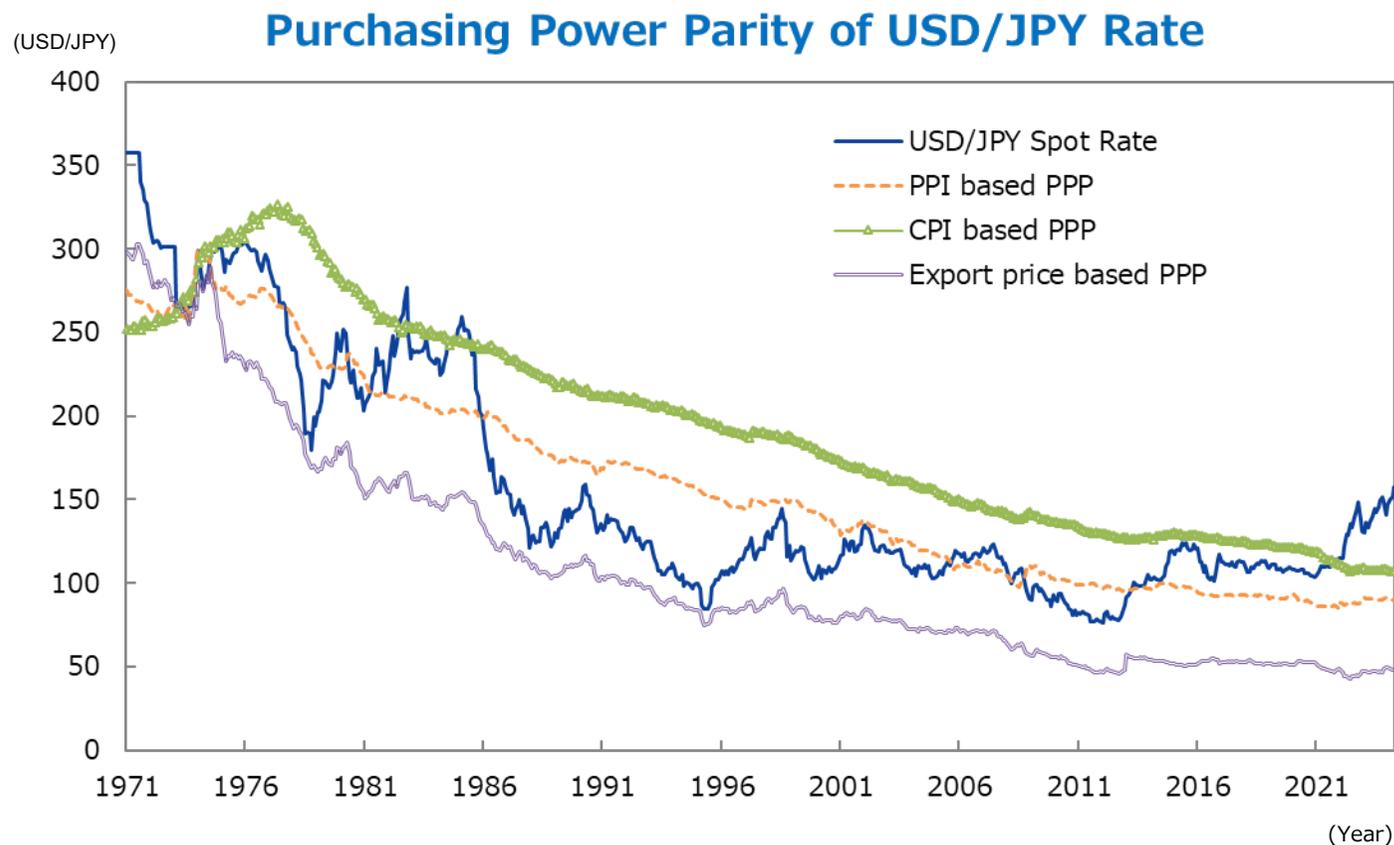
JGB yield curve pricing further tightening by the BOJ

Yield Curve of Japanese Sovereign



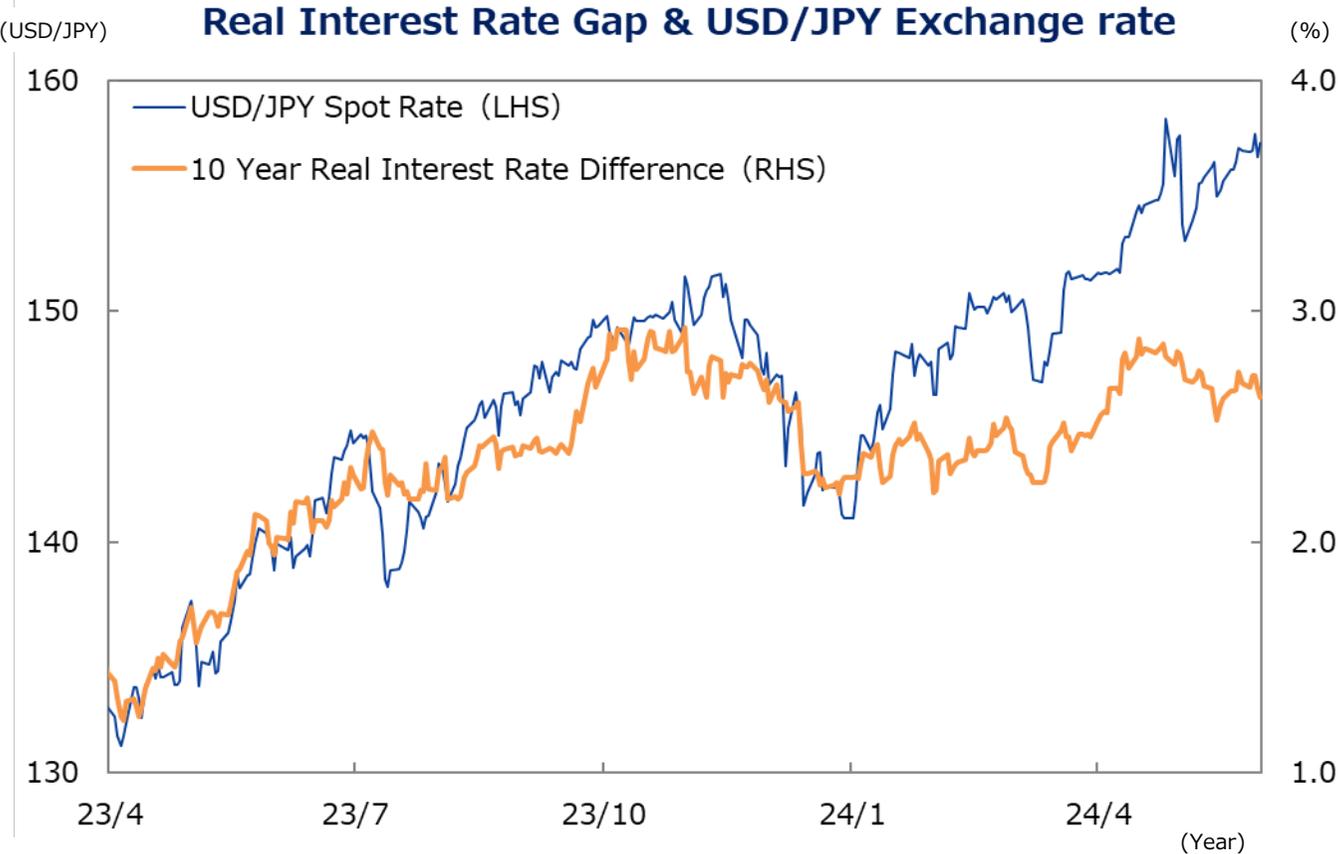
Source: Bloomberg, SMDAM

Weakening JPY diverges from purchasing power parity



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

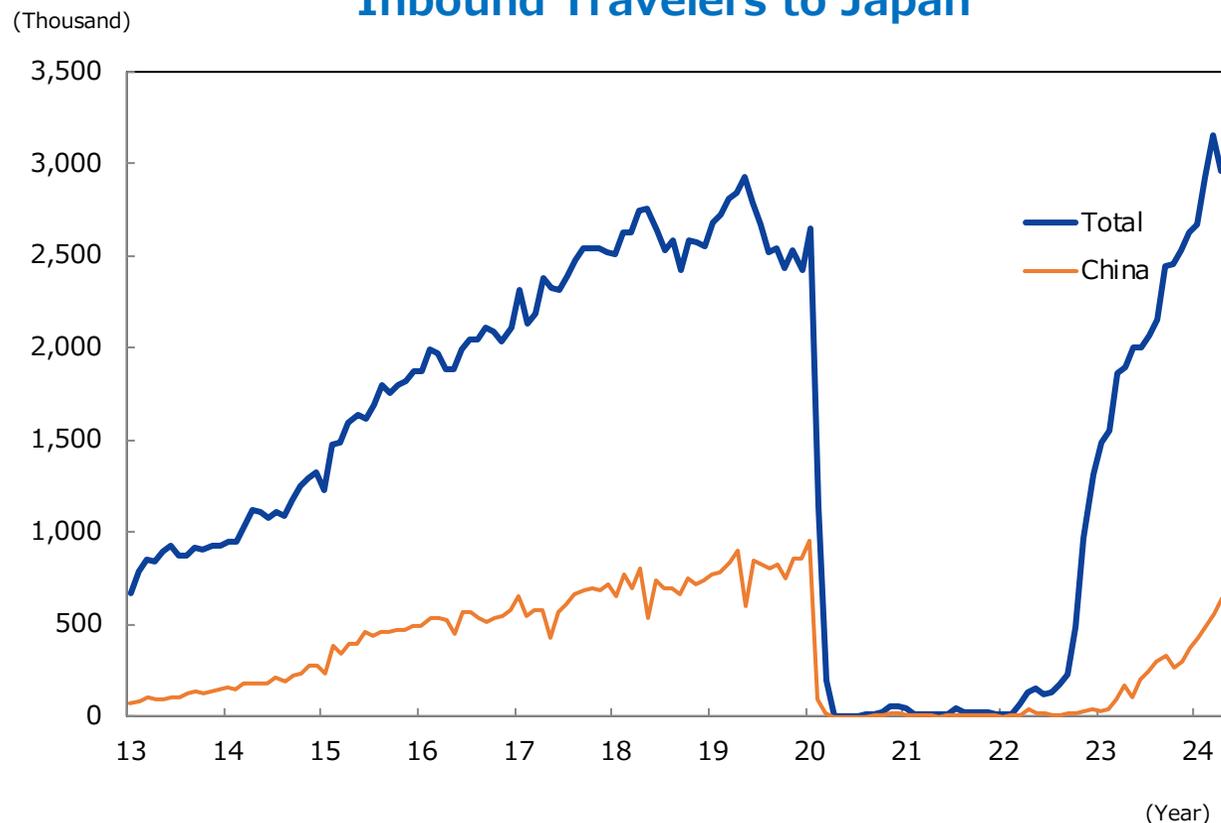
Real interest rate gap starts losing correlation with USD/JPY rate



Note: Real interest rates are 10 year government bond yields. Data is from 1st April 2023 to 31st May 2024.
Source: Bloomberg, SMDAM

Weakening JPY boosts Inbound travel

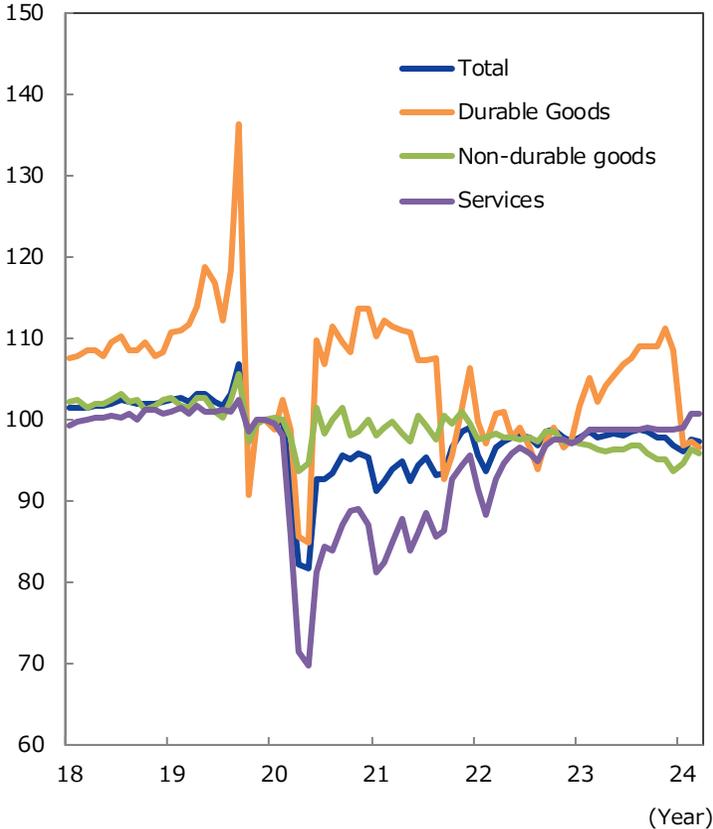
Inbound Travelers to Japan



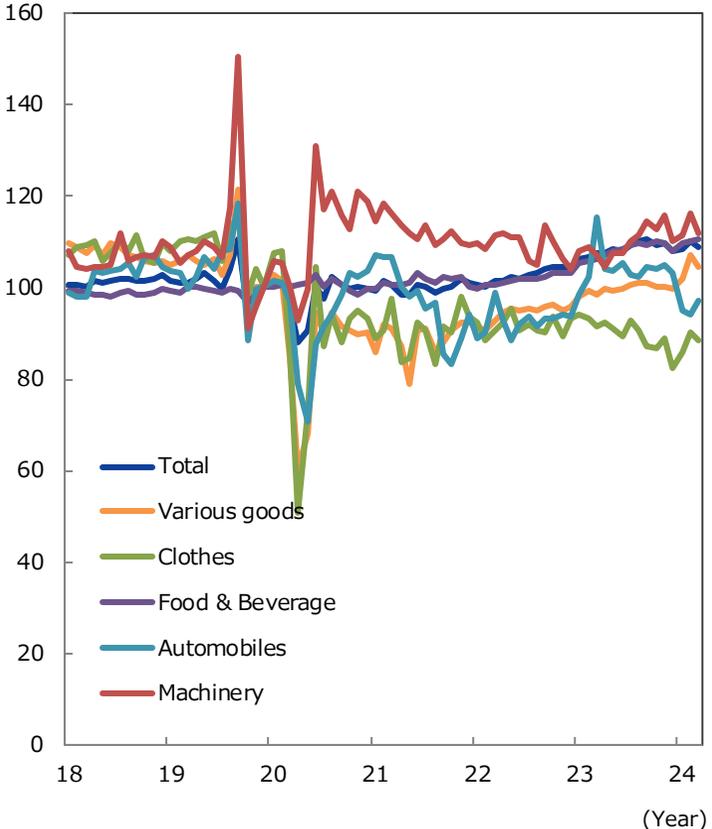
Note: Data is from January 2013 to April 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Suspension of auto production pushed down durable goods sales

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to March 2024.
 Source; Bank of Japan, METI, and SMDAM

PM Kishida losing cohesive power within the ruling LDP

Cabinet approval rate



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

Schedule of major events

Year	Month	Date	Event
2024	June	10	Revision of Q1 GDP
		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	9	Revision of Q2 GDP
		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	9	Revision of Q3 GDP	
	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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