



Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

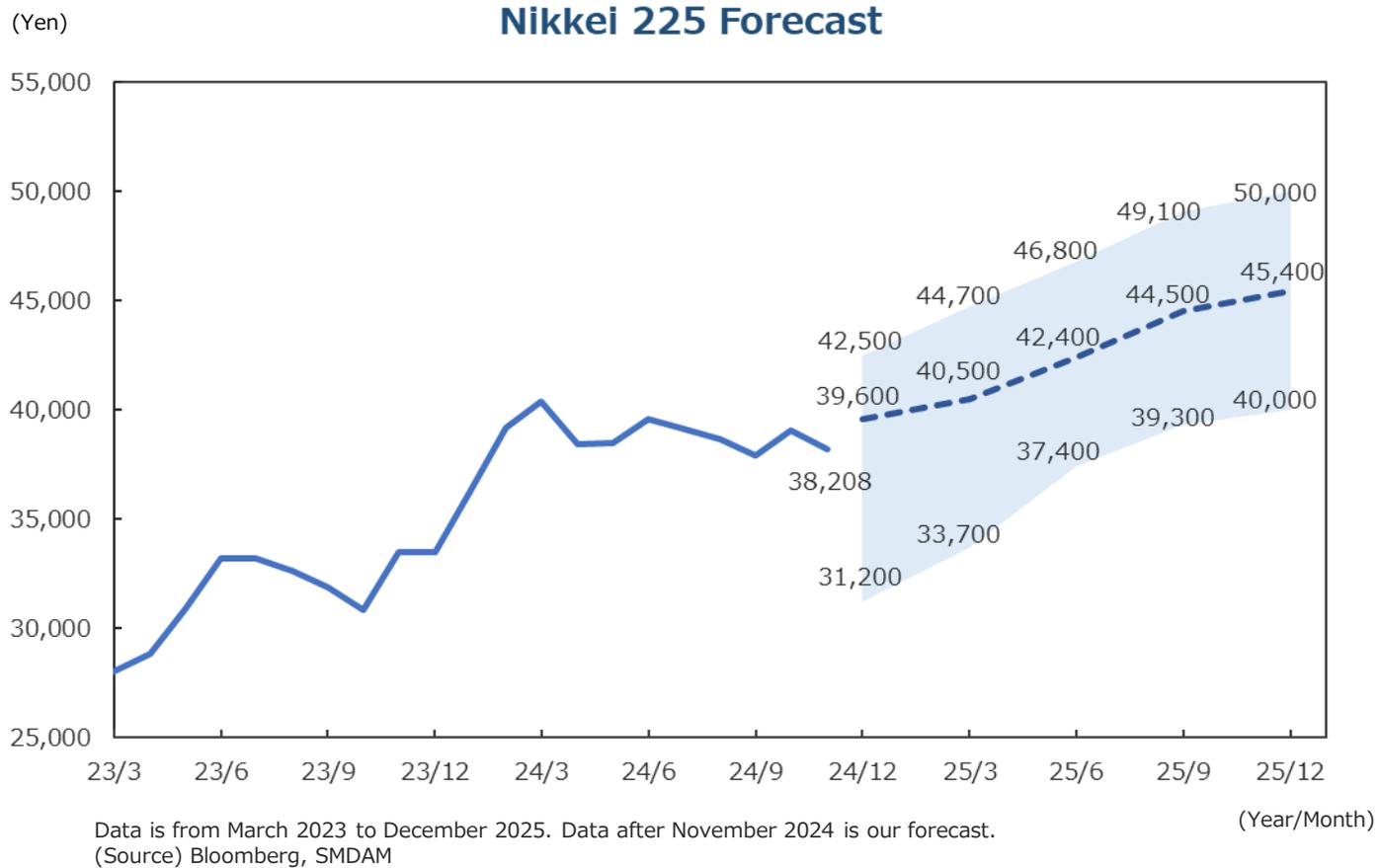


Outlook for Japanese Stock Market

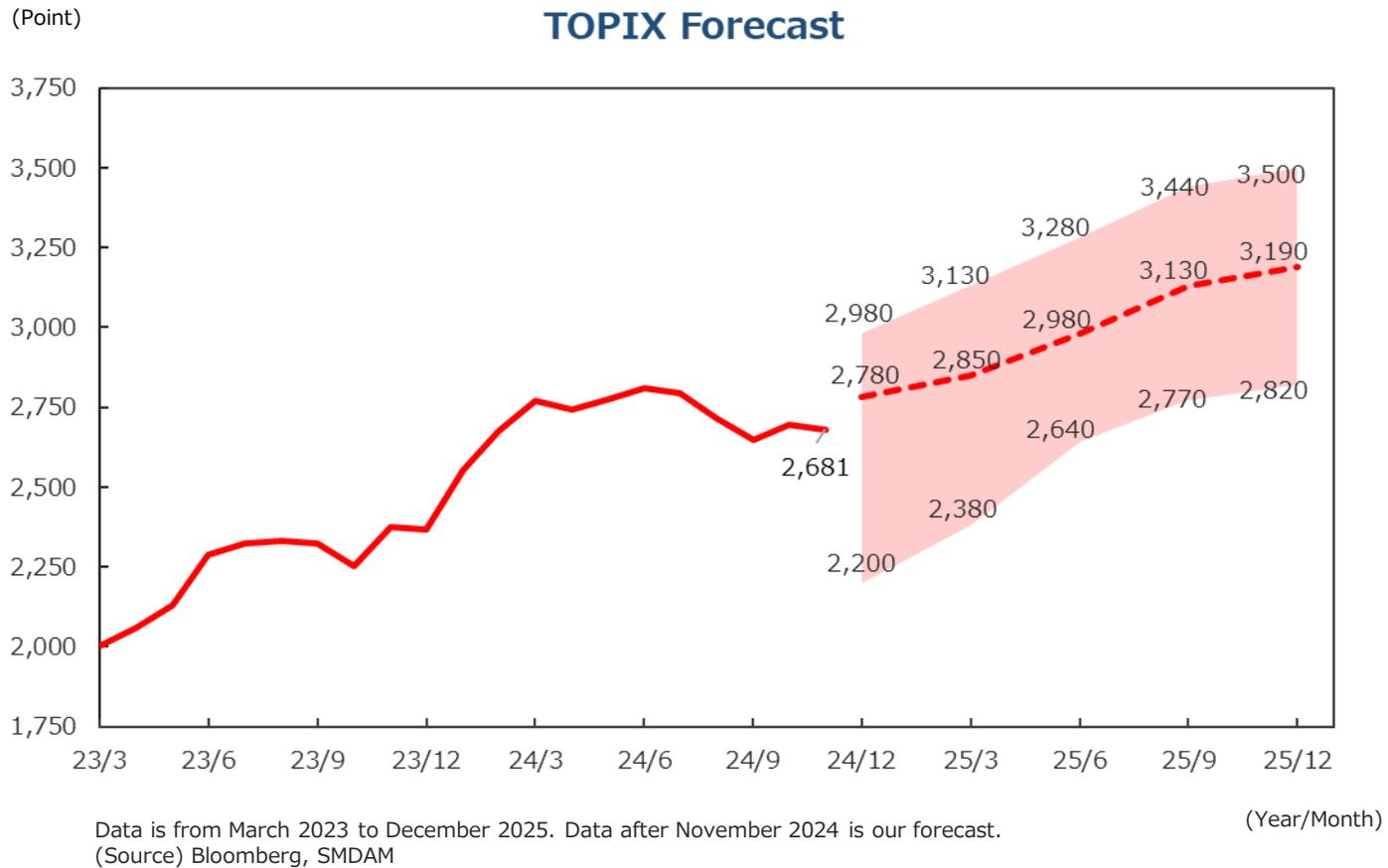
Market Outlook

- We are bullish on the Japanese stock market in the long term due to steady growth of corporate earnings, the virtuous cycle of “wage increase and mild inflation”, and improving corporate governance.
- We expect the recent range trading to continue in the short term until the future path of US monetary policy becomes clearer and market volatility will settle.
- We expect the Nikkei 225 will surpass the 40,000 mark again in the near future and reach 45,000 by the end of CY 2025.
- Although foreign investors’ appetite for Japanese stocks looks sluggish, a massive amount of share buybacks in the corporate sector could support the stock market going forward.

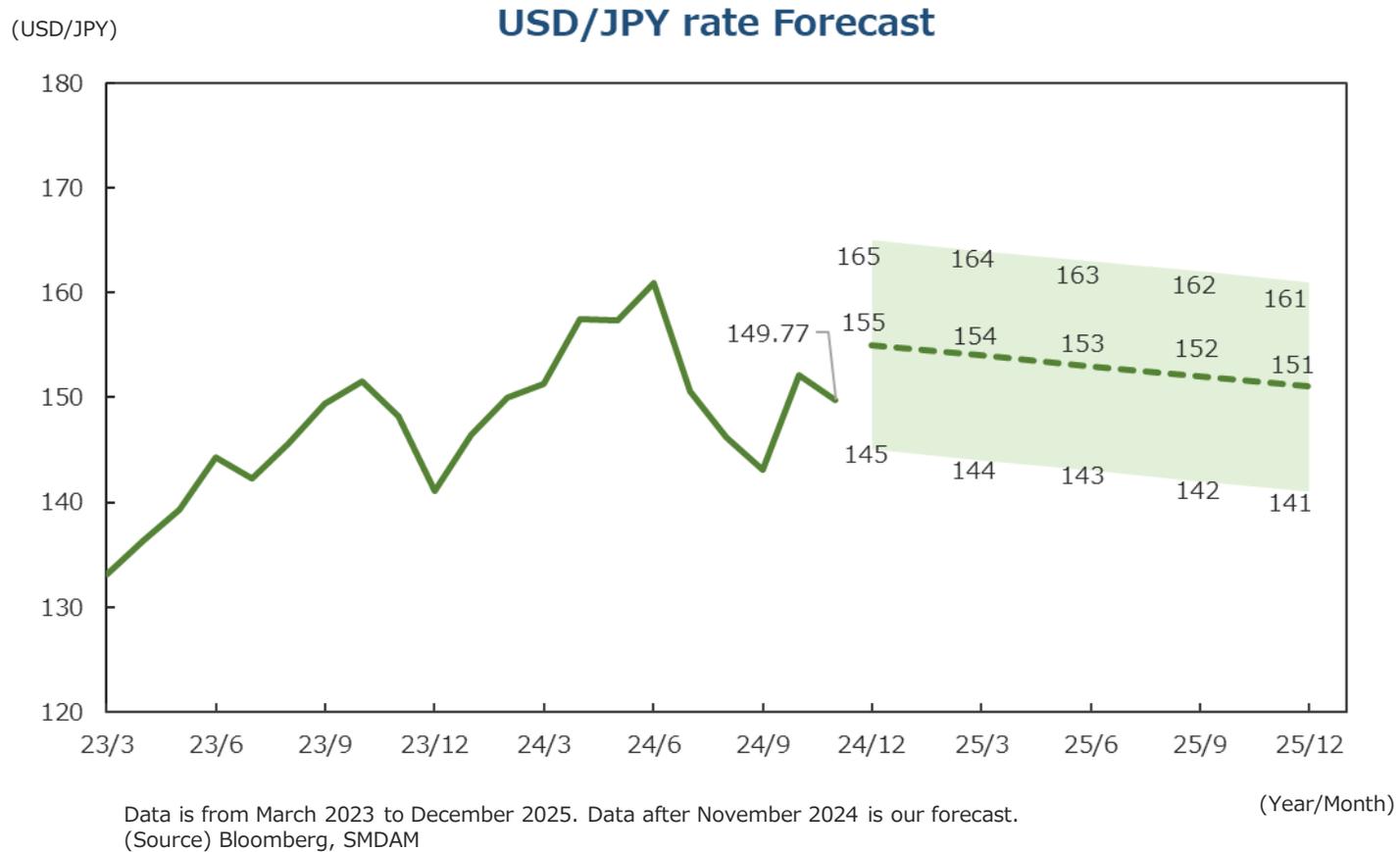
We are bullish on Japanese equities



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Narrowing interest rate gap weighing on USD/JPY rate ahead



Upside / Downside risk scenarios

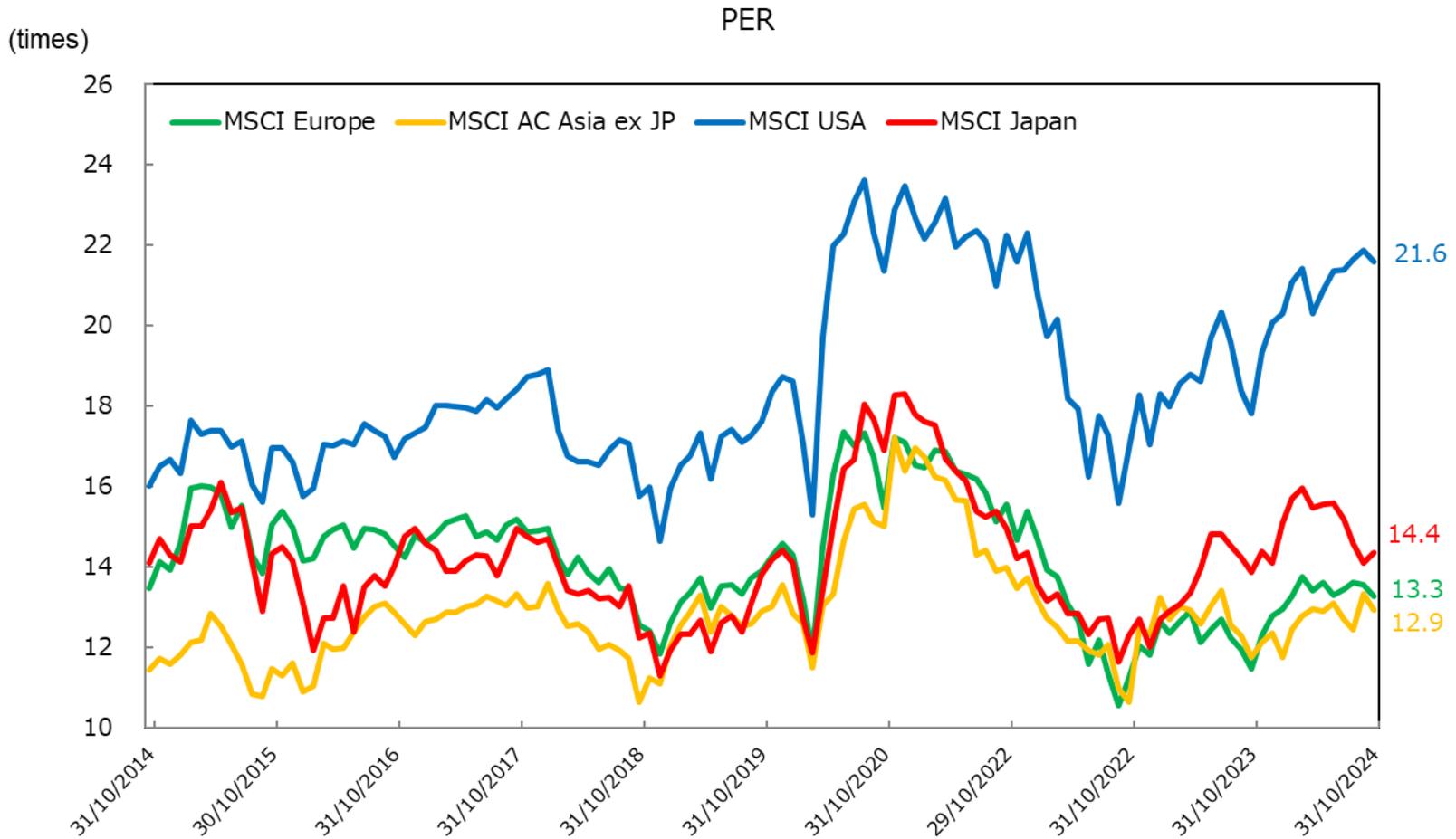
■ Upside Risks

- Increase in terminal rate of economic growth due to the end of deflation
- Further improvements of corporate governance, led by Tokyo Stock Exchange

■ Downside Risks

- Tighter fiscal policy aimed at achieving a primary surplus
- Excessive and rapid appreciation of the JPY, impacting corporate earnings
- Growing political uncertainty

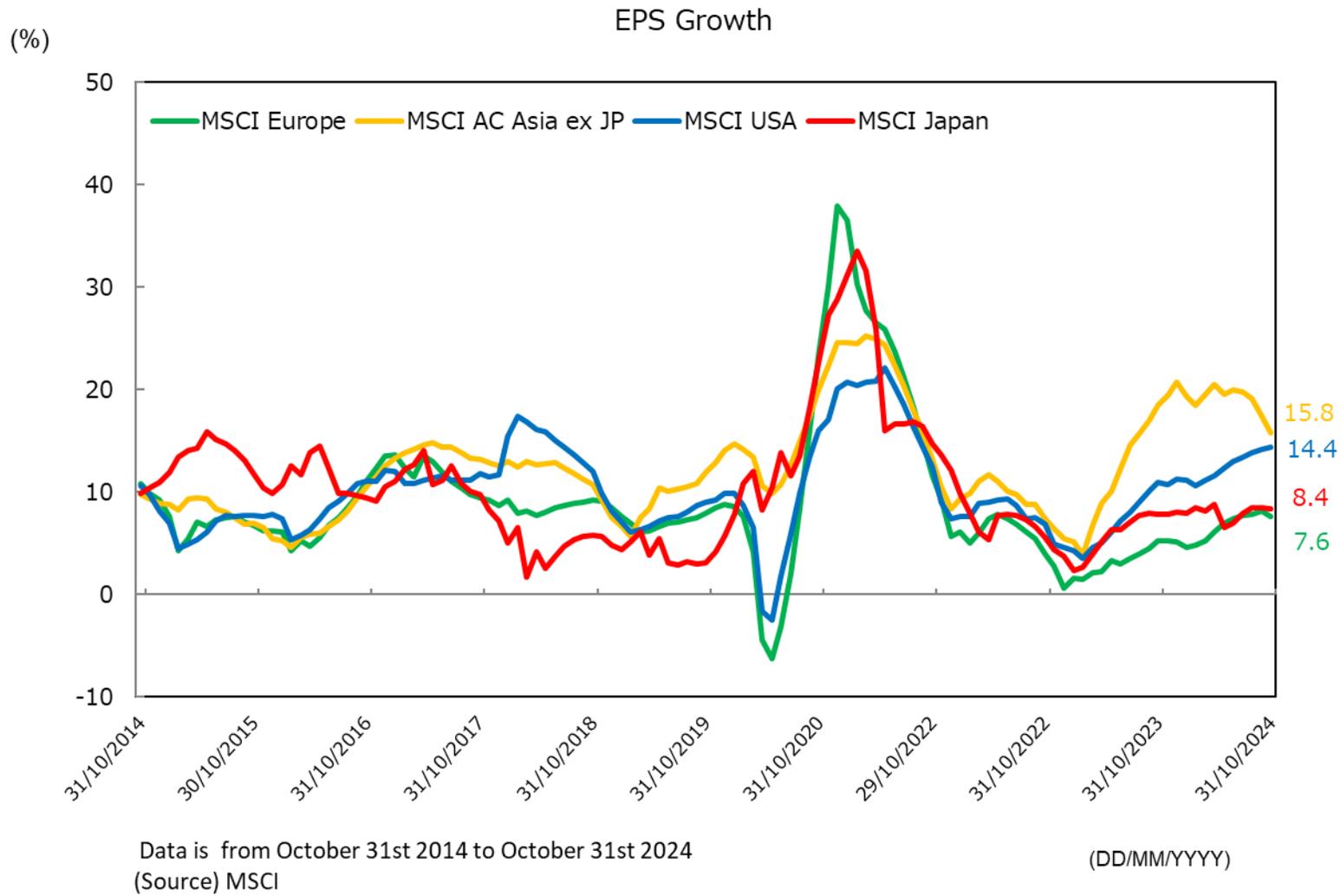
P/E ratio declined sharply after market correction in summer



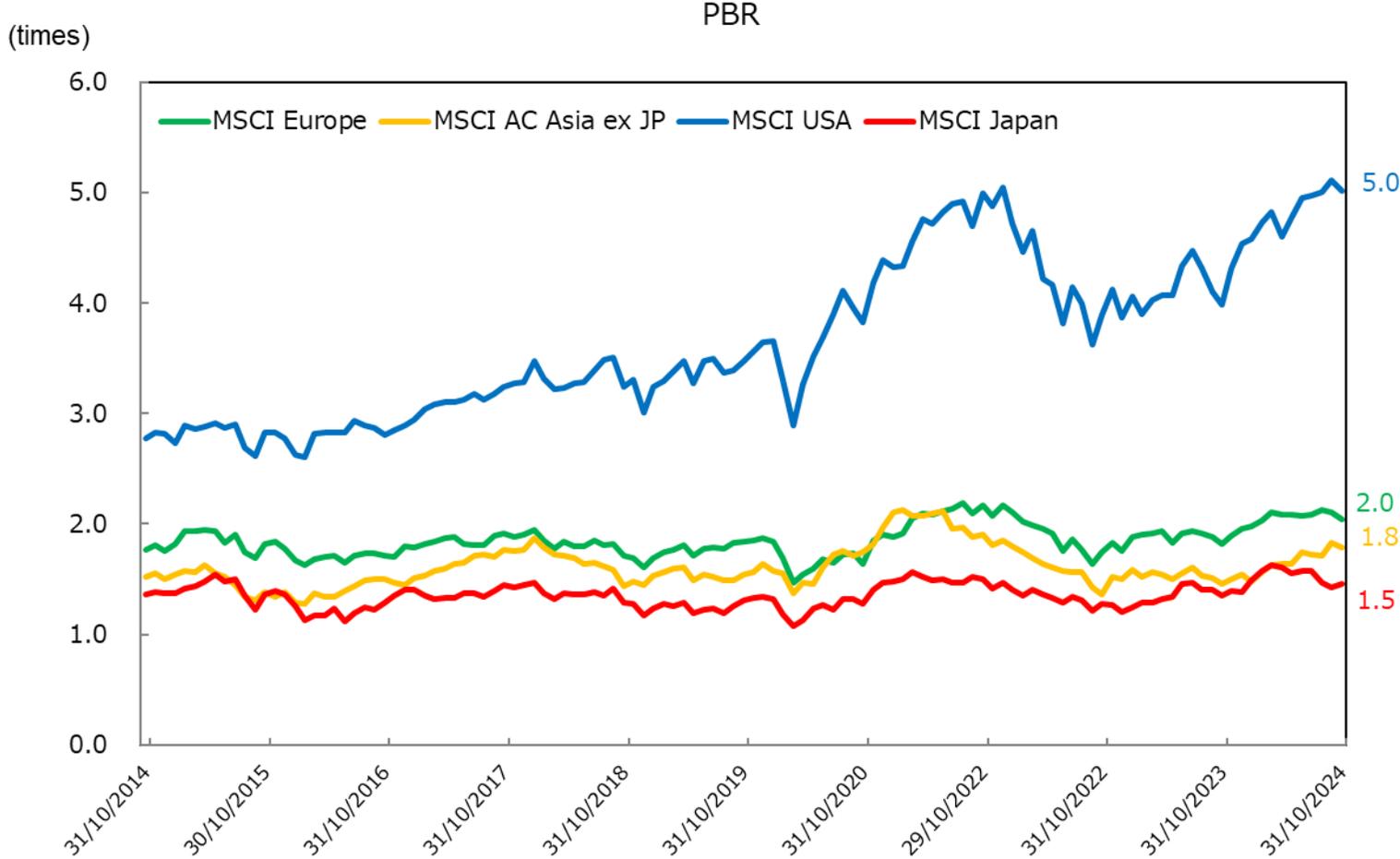
Data is from October 31st 2014 to October 31st 2024
(Source) MSCI

(DD/MM/YYYY)

Earnings growth maintains momentum



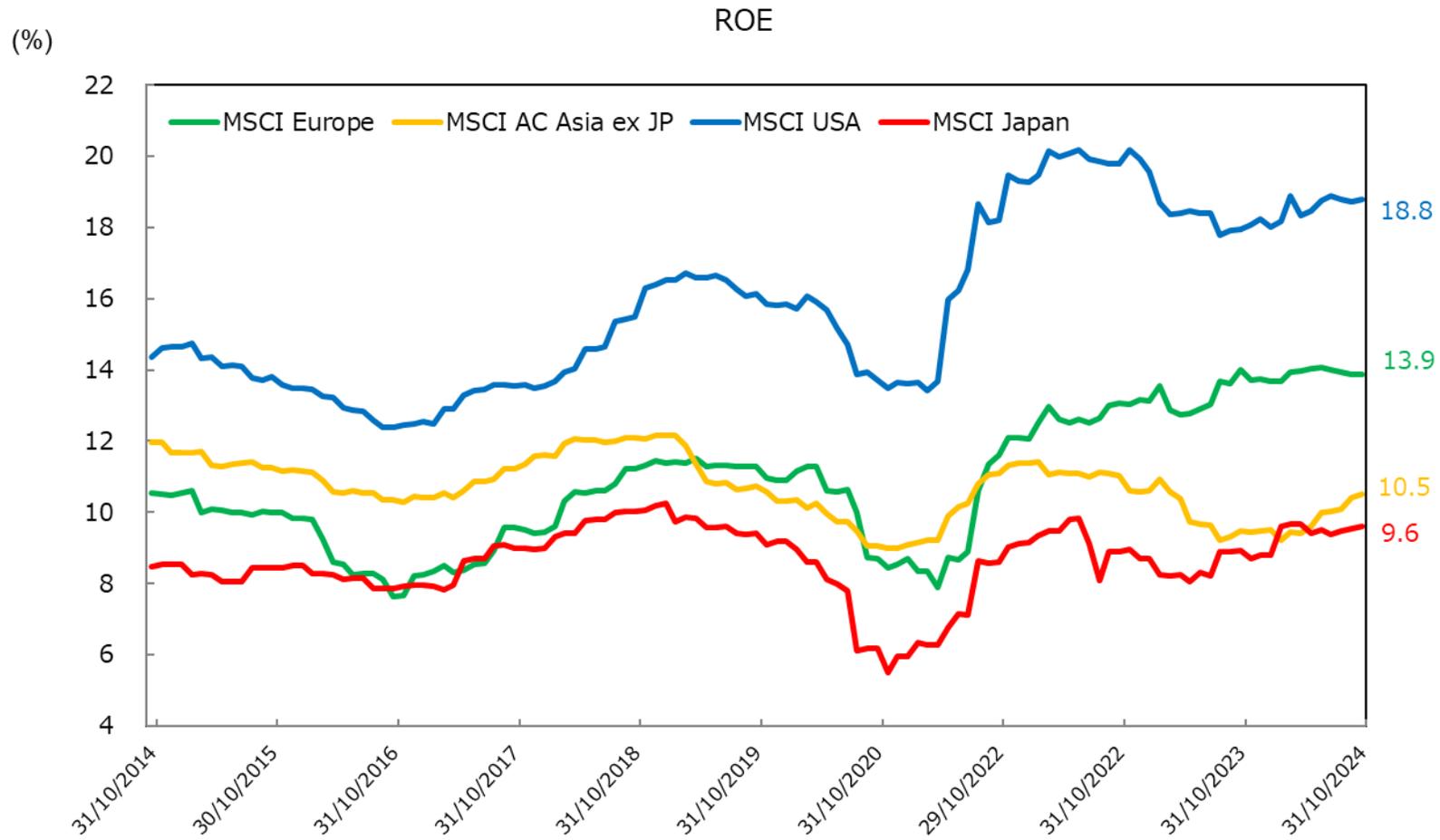
Japan's P/B ratio lags behind global peers



Data is from October 31st 2014 to October 31st 2024
 (Source) MSCI

(DD/MM/YYYY)

Earnings growth supports upward trend of Japan's ROE

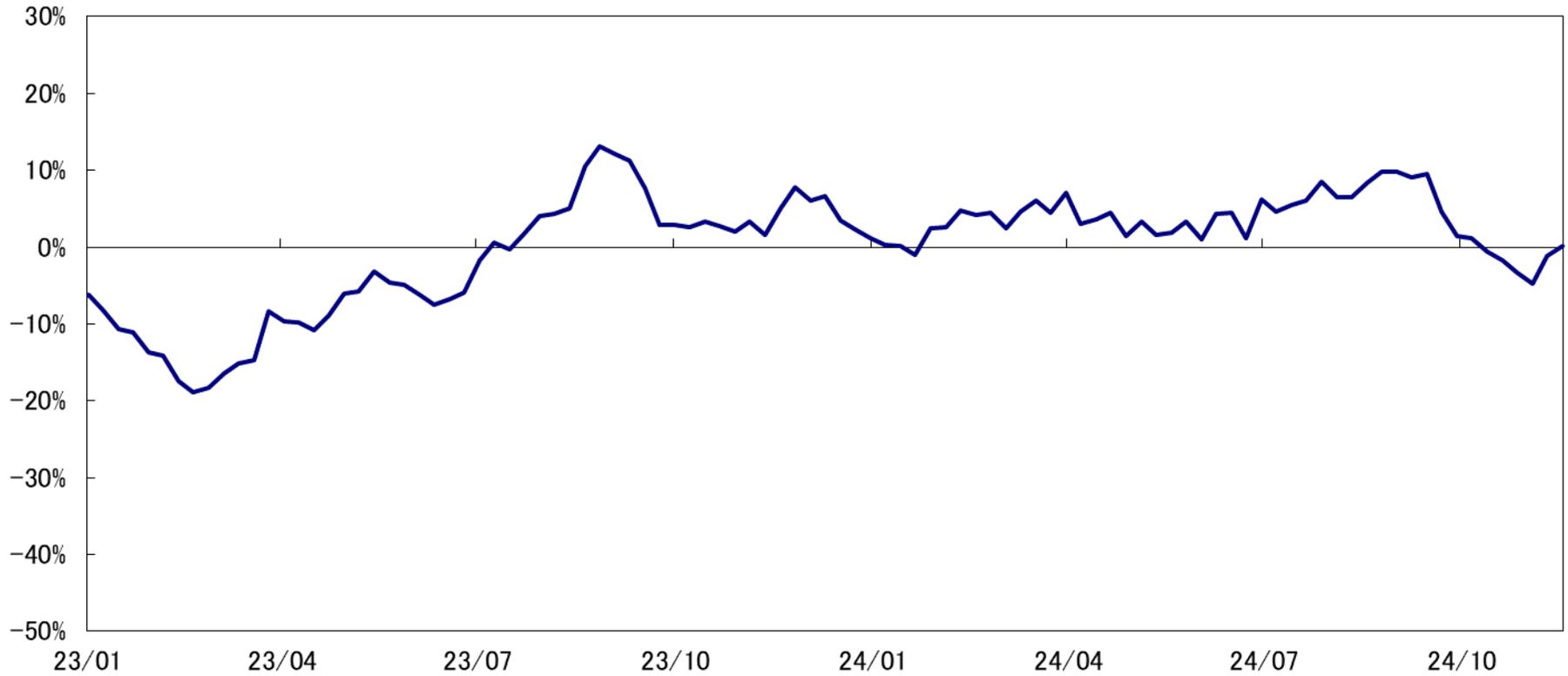


Data is from October 31st 2014 to October 31st 2024
(Source) MSCI

(DD/MM/YYYY)

Services offset the weakness of manufacturers' revision

TOPIX Revision Index

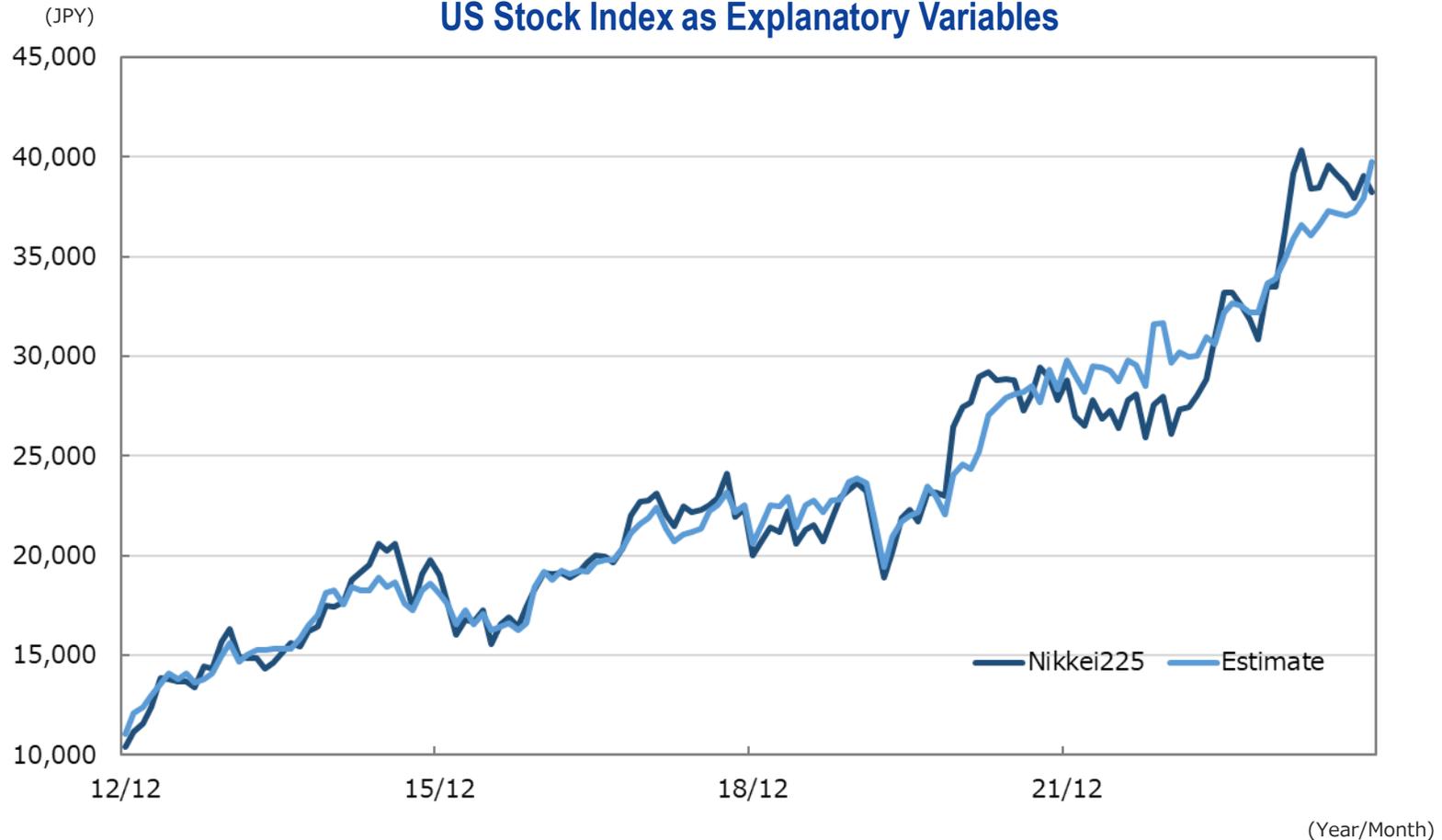


Data is from January 5th 2023 to November 21st 2024
(Source) Datastream, IBES

(YY/MM)

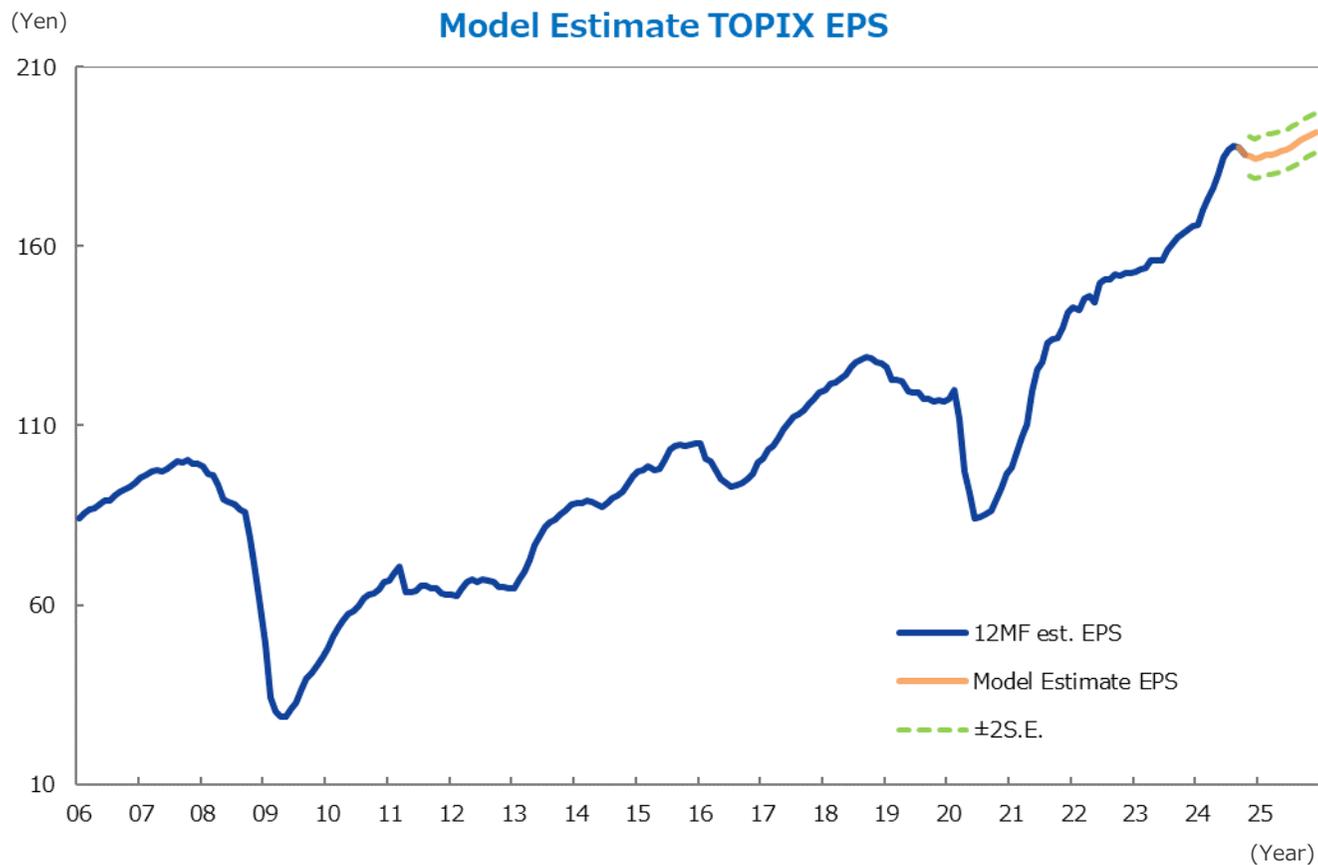
Weakening Yen and rally of US equity boost Nikkei 225

Multiple Regression Analysis of Nikkei 225 Index Using Exchange Rate and US Stock Index as Explanatory Variables



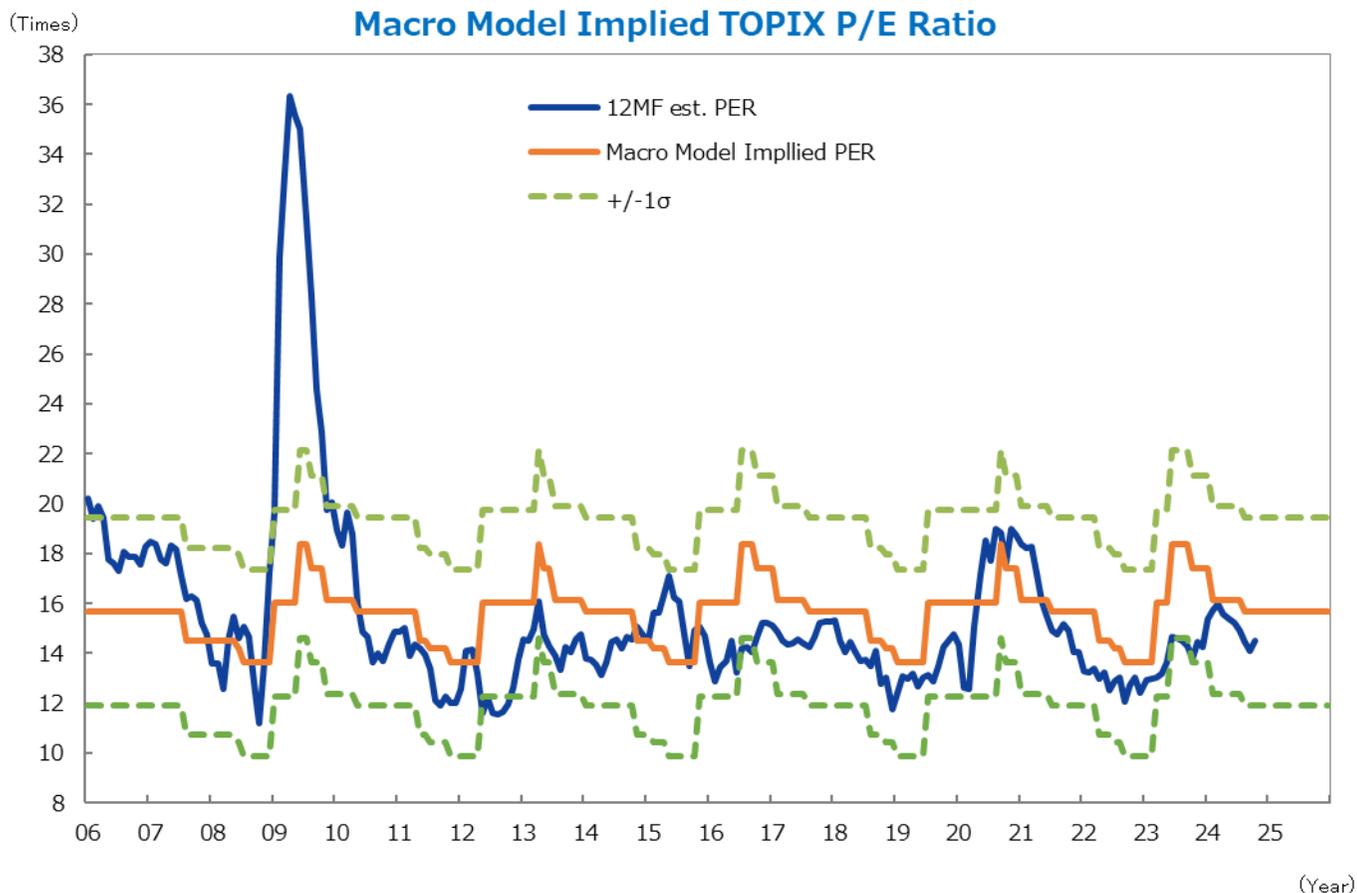
Data is from December 2012 to November 2024.
(Source) SMDAM, Bloomberg

Estimated EPS to accelerate in the near future



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

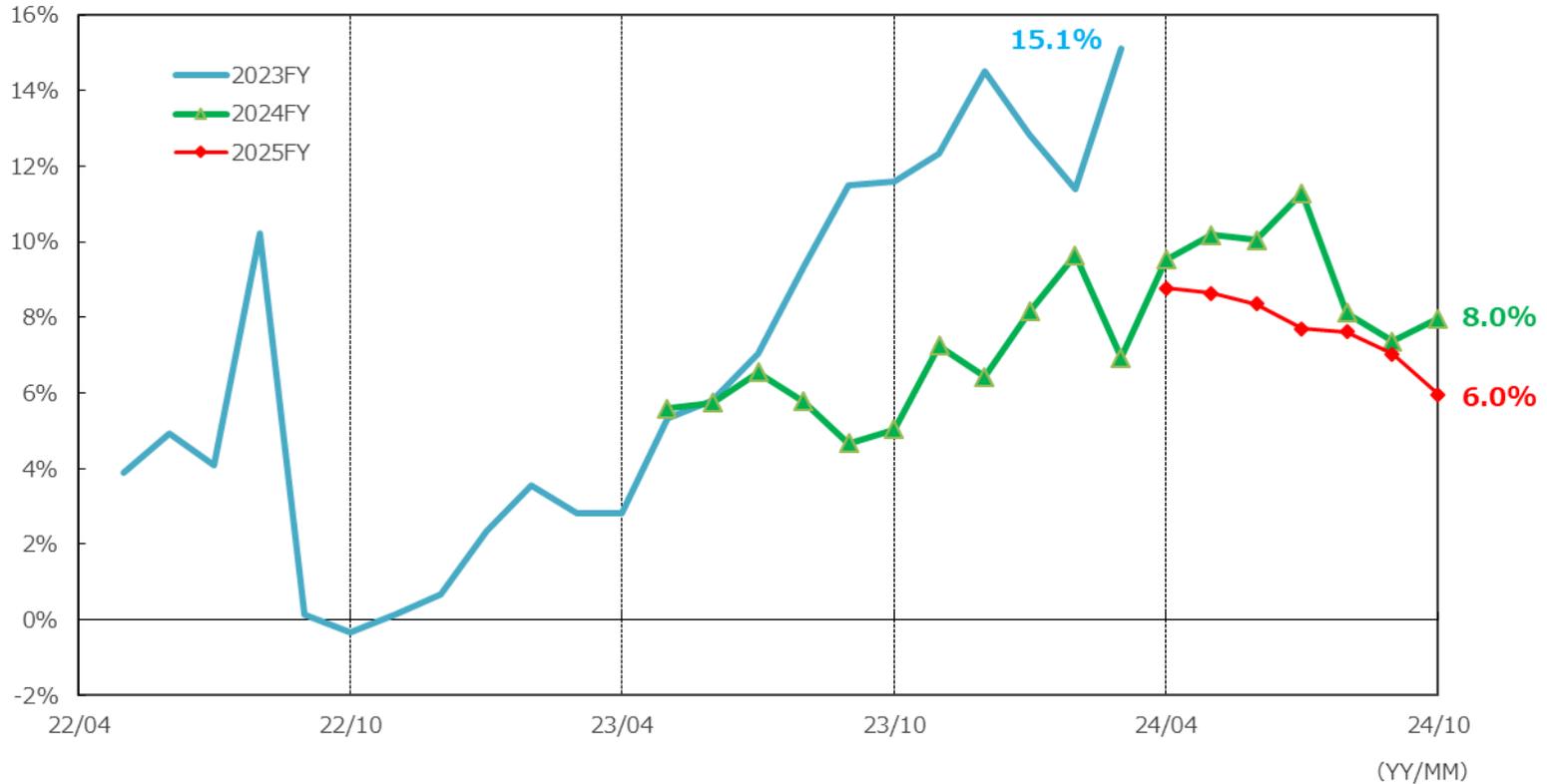
TOPIX is currently traded with attractive P/E ratio



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

SMDAM in-house analysts forecast slowing earnings momentum

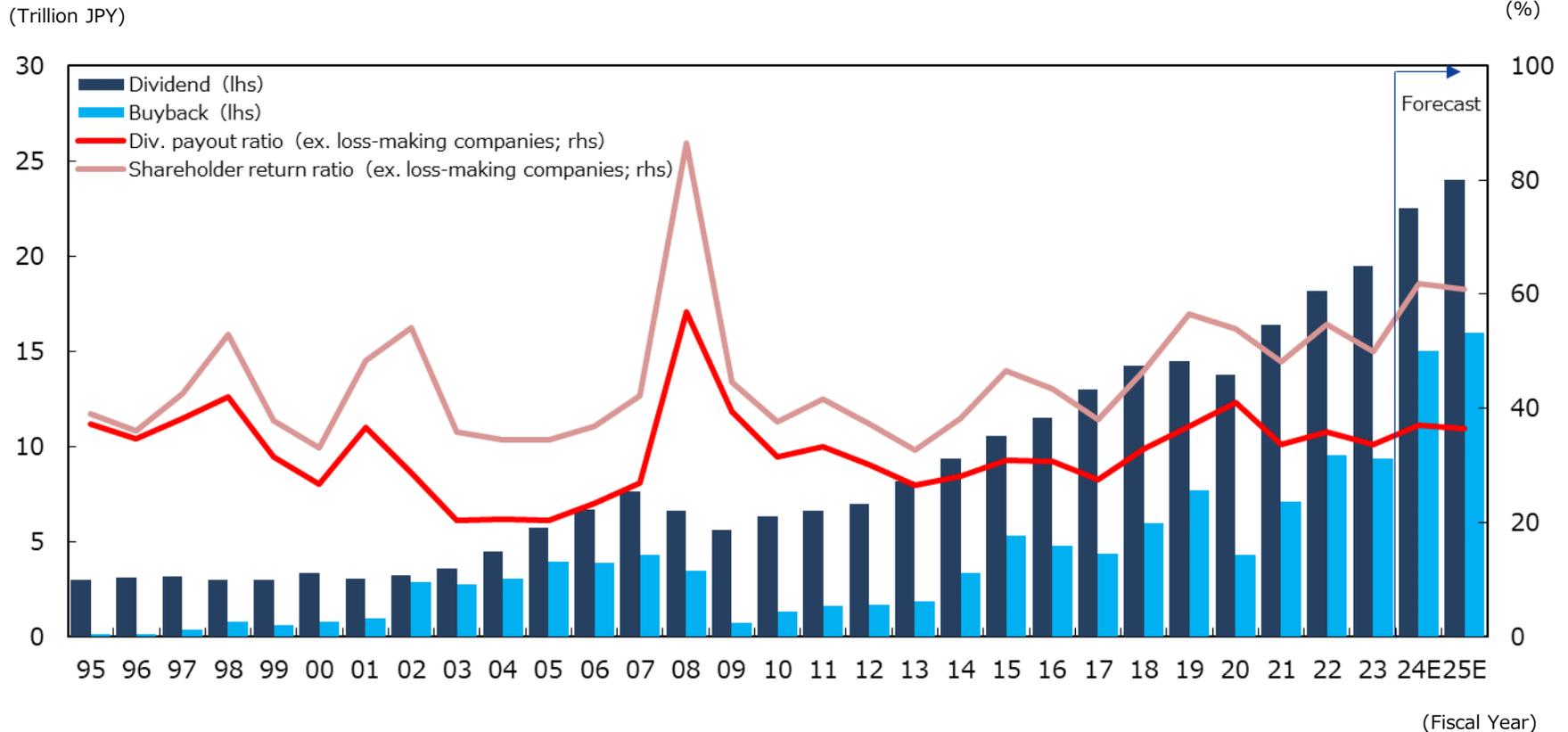
SMDAM Core Research Universe (Excl. Financials) Est. Recurring Profit Growth



Note: Data is as of 12th November 2024, SMDAM Core Universe (Excl. Financials) consists of 398 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Streak of record-breaking dividends and share buybacks

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to FY2025. FY2024 and FY2025 are forecasts by Daiwa Securities.
 Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Seesaw of value and growth in the short term

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	1.08	-2.11	14.38	14.25	37.63	31.86	61.01
Total Value	2.29	-2.35	19.37	17.43	53.40	61.44	76.74
Top Cap Value	3.84	-3.06	26.93	21.30	64.62	75.15	108.80
Large Cap Value	2.28	-2.83	20.62	17.73	55.51	64.55	82.33
Mid Cap Value	0.78	-2.55	14.84	14.33	45.67	53.03	52.63
Small Cap Value	2.26	-0.06	13.77	16.04	44.04	48.21	53.23
Micro Cap Value	1.79	-0.06	11.43	13.96	40.58	44.35	47.69
Total Growth	-0.02	-1.87	10.07	11.43	23.91	8.22	45.09
Top Cap Growth	-0.20	-2.74	13.08	15.12	30.19	12.29	57.67
Large Cap Growth	-0.20	-2.23	10.86	12.01	25.94	9.77	49.54
Mid Cap Growth	-0.18	-1.18	6.76	6.38	18.34	5.14	36.17
Small Cap Growth	1.61	1.44	3.35	6.39	8.25	-3.93	12.19
Micro Cap Growth	-0.45	-3.23	-0.97	2.54	2.69	-12.52	7.87
Top Cap Total	1.35	-2.88	18.18	17.48	44.10	36.34	77.65
Large Cap Total	0.93	-2.51	15.17	14.58	39.09	32.83	65.26
Mid Cap Total	0.36	-1.95	11.12	10.67	32.15	28.04	48.87
Small Cap Total	2.01	0.49	9.61	12.21	29.09	26.02	36.99
Micro Cap Total	1.07	-1.10	7.11	10.01	26.88	23.08	34.56

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



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** In the third quarter of 2024, real GDP grew for the second consecutive quarter. Increasing consumer spending backed by wage increases and flat-rate tax cuts has supported the economy despite the negative impact from the major typhoon and huge earthquake. We think the decline in CAPEX caused by the weakness in capital goods and aggregate supply will be temporary thanks to the strength in production plans of capital goods. Regarding the external demand, goods export has increased and covered the declining of service export.
- **Inflation is easing.** Nationwide core CPI rose by +2.3% YOY in October, down from +2.4% in September, while Tokyo Metropolitan Area core CPI rose by +1.8% YOY in October, down from +2.0% in September. Nationwide CPI has been slowing due to the decrease in electricity and gas prices thanks to subsidies by the government. Regarding Tokyo Metropolitan Area CPI, while the receding impact of utility bill cuts weighed on inflation, price increases in foods put upward pressure on CPI.

[Outlook]

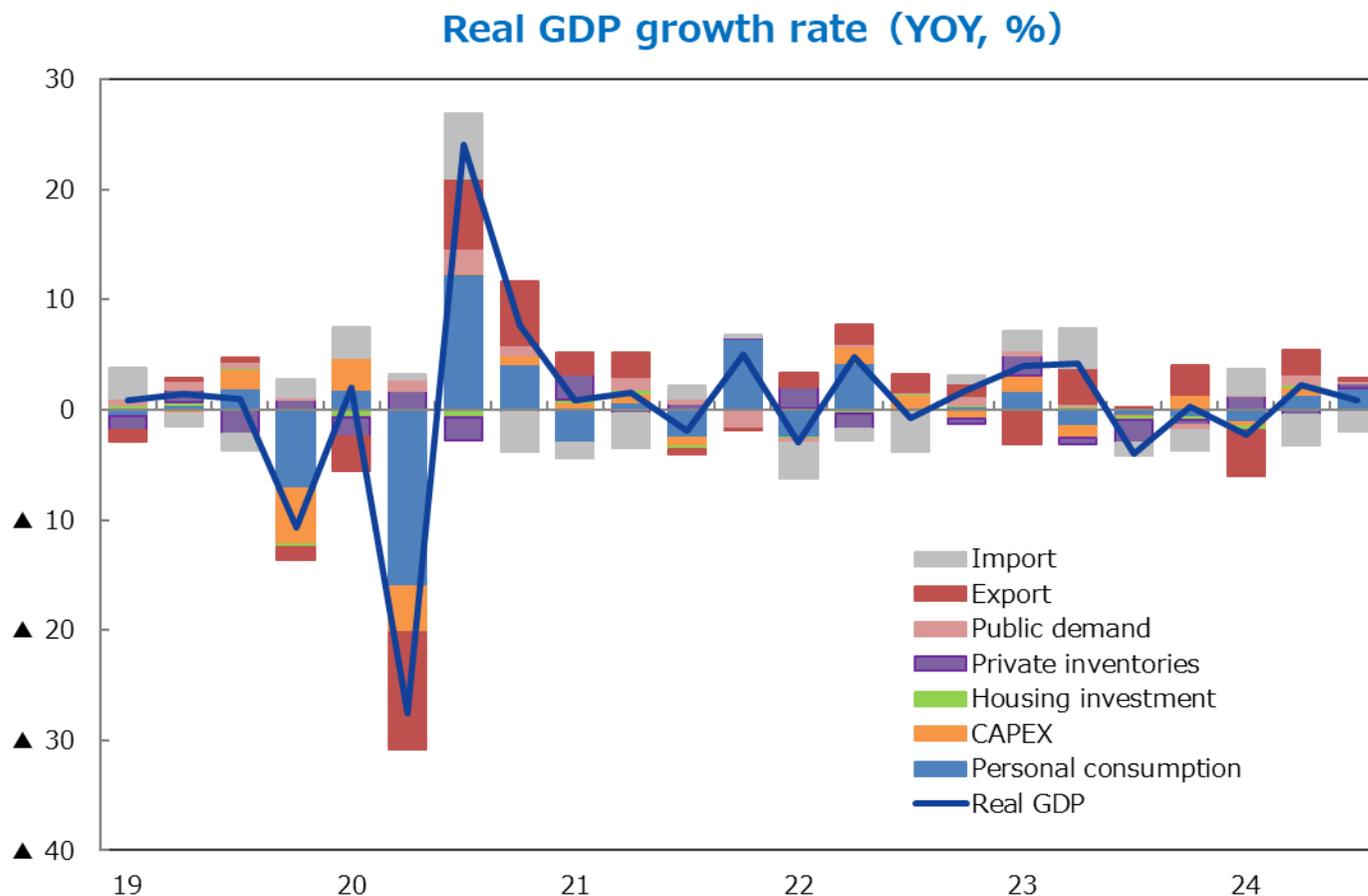
- ① **While we have lowered our real GDP growth forecast for FY 2024 from +0.4% to +0.3%, we have raised our estimate for FY 2025 from +1.0% to +1.2%. We also expect the Japanese economy to grow by +0.8% in FY 2026 in real terms.** The downward revision for FY 2024 is mainly due to the decline of real GDP growth in Q3 2024. The upward revision for FY 2025 is mainly due to the tax reduction as a result of the review of the basic income deduction, upward revision of the U.S. economic outlook, and increased base effects. We have composed the scenario with the assumption that the ruling party would accept half the amount of the revised basic income deduction that the Democratic Party for the People requests. We expect the Japanese economy to return to a moderate growth path on the back of wage increases, from CAPEX motivation, such as labor saving, digitalization, greening, urban development, and construction of semiconductor factories, and the resilience of overseas economies.
- ② **We have raised our core CPI forecast for FY 2024 from +2.5% to +2.6%, and that for FY 2025 from +1.8% to +2.1%. We expect core CPI to remain stable at +2.0% in FY 2026.** The upward revision for FY 2024 and 2025 reflects the unexpected hike of the Tokyo Metropolitan Area core CPI, change in currency outlook, and revision of expected subsidies for electricity and gas prices. We have shortened the assumed subsidized period for FY 2025 from 9 months (January to September) to 3 months (January to March). The rise in service prices accompanied by wage hikes would support the inflation rate, despite the likelihood of cost-push pressure stemming from import prices dissipating. We forecast core CPI to maintain its momentum around +2.0% YOY, diminishing gradually with some fluctuations.
- ③ **We expect the government to adopt accommodative fiscal policies.** Prime Minister Ishiba has confirmed that he will follow his predecessor's policies and focus on combatting deflation over the next three years. We have lowered our estimate of fiscal stimulus from 25 trillion yen to 20 trillion yen in total for national and local budgets. Regarding supplementary budget for FY 2024, we estimate the size to be similar to FY2023, although Prime Minister Ishiba had initially indicated an increase.
- ④ **We have maintained our forecast for the Bank of Japan's monetary policy.** We expect the BOJ to raise its policy rate to 0.50% in January 2025, 0.75% in July 2025, 1.00% in January 2026, and 1.25% in January 2027 respectively. The BoJ is expected to proceed with the next rate hike after conducting comprehensive research on the domestic economy, inflation, and overseas economies, particularly the United States in the "Outlook Report" in January 2025, with careful coordination with the government. There is a risk of an unexpectedly early rate hike in cases of excessive currency depreciation. From thereon, gradual rate hikes are expected once every six months, towards 1.0% which is the lower end of the neutral interest rate range (1% to 2.5%). Beyond that, the pace of rate hikes is expected to slow down, with intervals of about one year.

Forecast for the Japanese economy

Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24 Est	FY25 Est	FY26 Est
Real GDP	3.1%	1.6%	0.8%	0.3%	1.2%	0.8%
Private final consumption expenditure	1.8%	2.7%	-0.6%	0.8%	1.4%	0.8%
Private housing investment	0.3%	-3.3%	0.3%	-1.8%	-0.9%	-1.3%
Private-sector capital investment	3.2%	4.1%	0.3%	2.3%	1.8%	1.6%
Private inventory investment	0.5%	0.1%	-0.2%	0.0%	0.0%	0.0%
Public fixed capital formation	-6.5%	-6.1%	0.6%	0.9%	0.1%	0.7%
Net export contribution	0.8%	-0.5%	1.4%	-0.6%	0.0%	0.1%
Exports of goods and services	12.5%	4.9%	2.8%	1.5%	3.4%	3.3%
Imports of goods and services	7.4%	7.3%	-3.2%	4.5%	3.4%	2.9%
Nominal GDP	3.0%	2.5%	4.9%	3.0%	3.0%	2.4%
GDP deflator	-0.1%	0.9%	4.1%	2.7%	1.9%	1.6%
Industrial Production Index	5.6%	-0.3%	-1.9%	0.7%	2.6%	1.5%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.6%	2.1%	1.9%
Domestic corporate goods price index	7.1%	9.6%	2.4%	2.5%	1.0%	1.4%
Employee compensation	2.1%	2.4%	1.8%	3.7%	3.5%	3.4%
Unemployment rate	2.8%	2.6%	2.6%	2.5%	2.3%	2.2%
Monetary Policy interest rate (Short term)	-0.10%	-0.10%	0-0.1%	0.50%	1.00%	1.25%

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

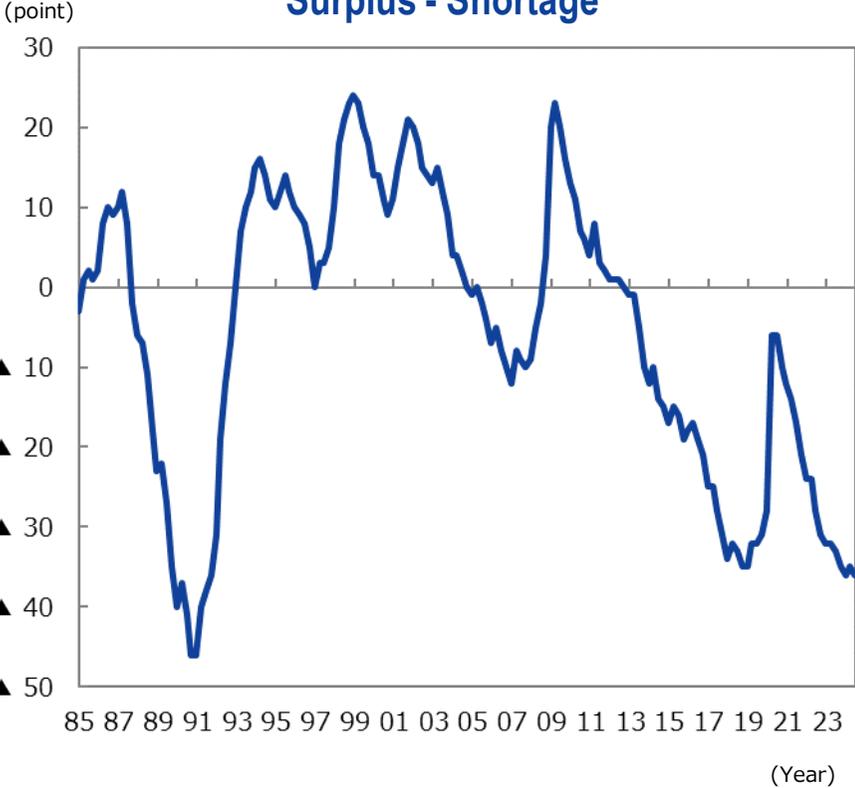
Japanese economy returns to a growth trend



Note: Data is from Q1 2019 to Q3 2024.
Source: Cabinet office, SMDAM

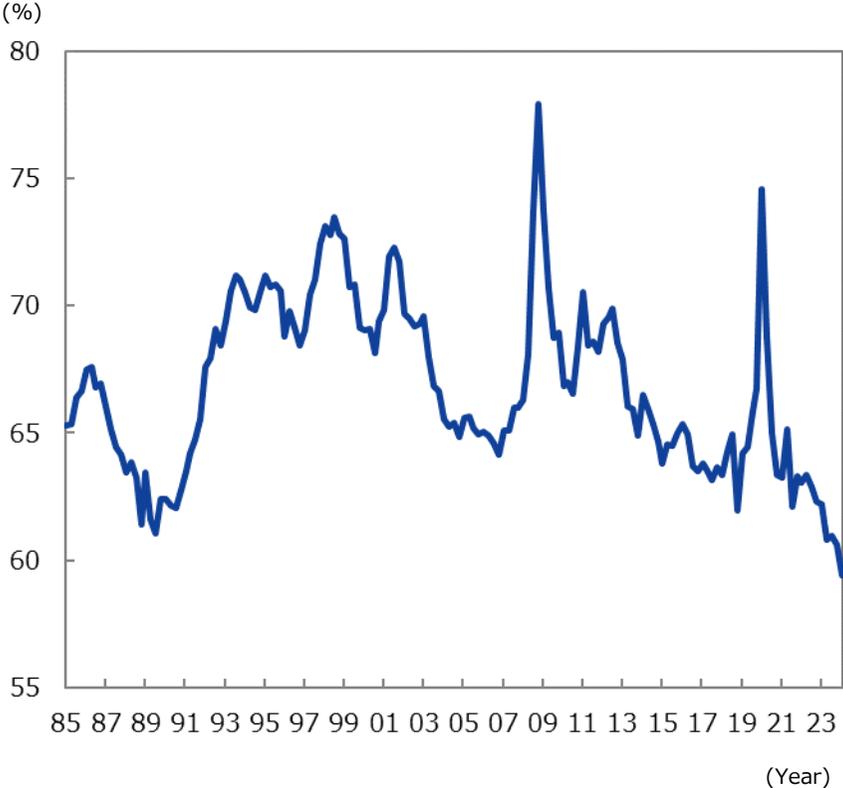
Conundrum of Japanese labor market

Employment Sufficiency Index "Surplus - Shortage"



Note: Data is from April 1985 to September 2024.
Source: The bank of Japan, SMDAM

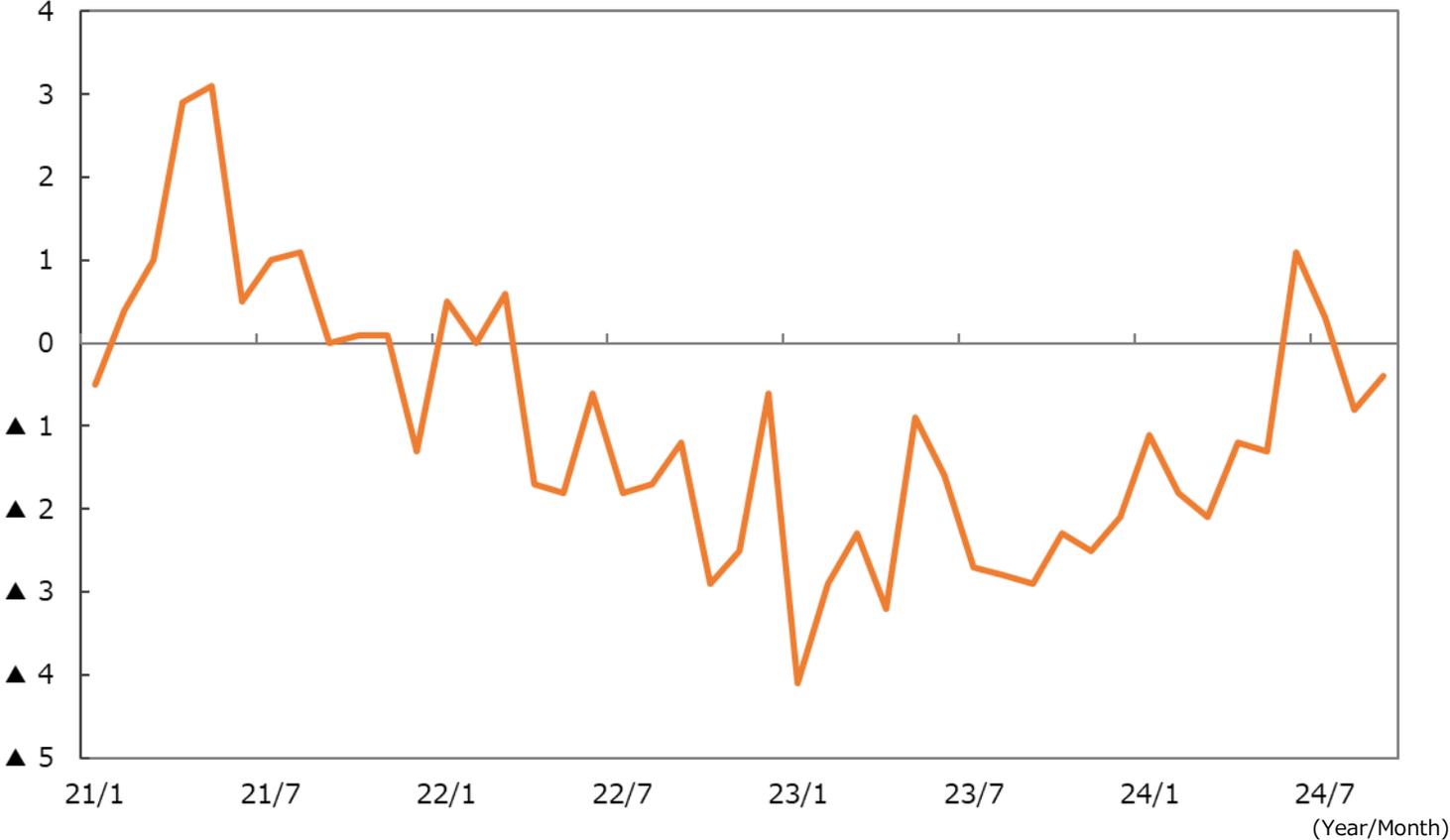
Labor Share of Added Value



Note: Data is from April 1985 to April 2024.
Source: Ministry of finance, SMDAM

Real wage growth sank into negative numbers again

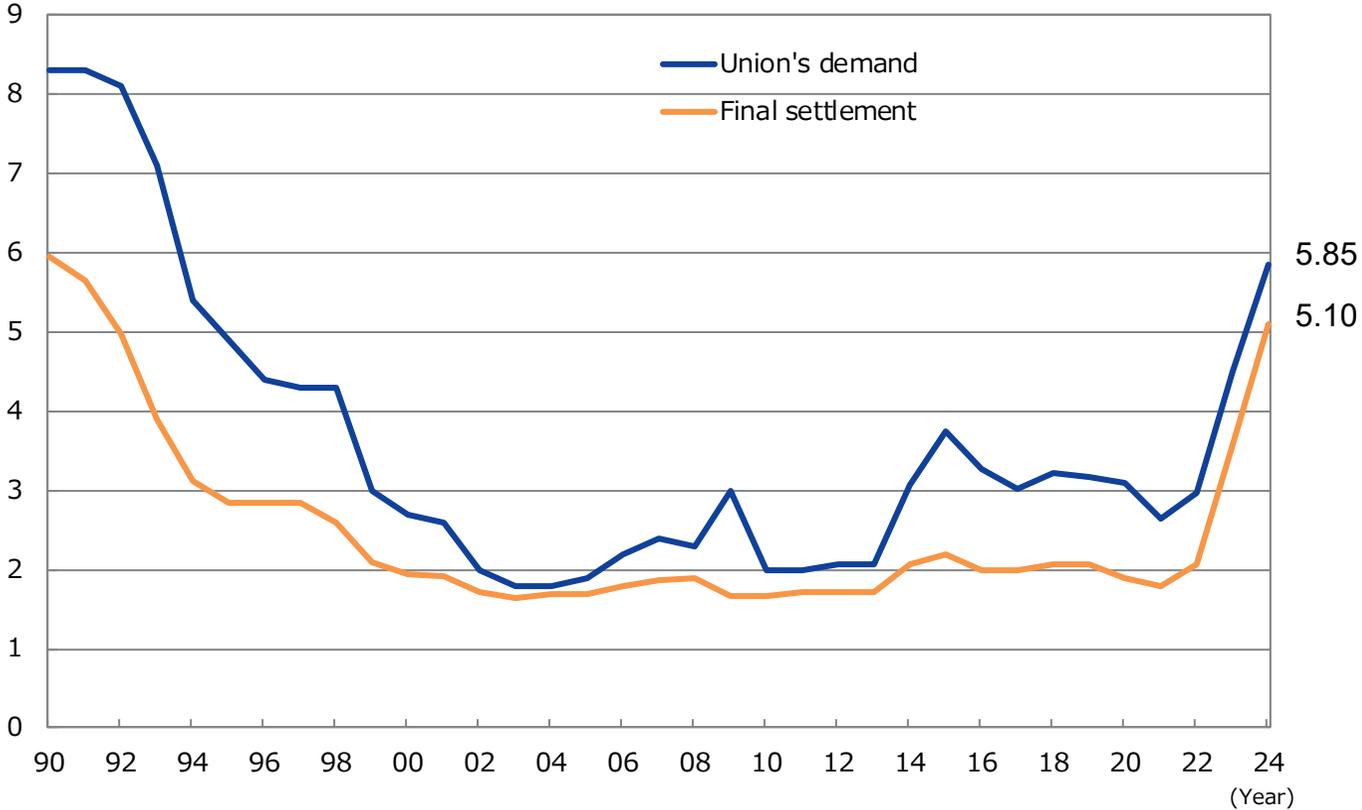
Real Cash Earnings (YOY, %)



Note: Data is from January 2021 to September 2024.
Source: Japanese Trade Union Confederation, SMDAM

Highest wage increase in 33 years

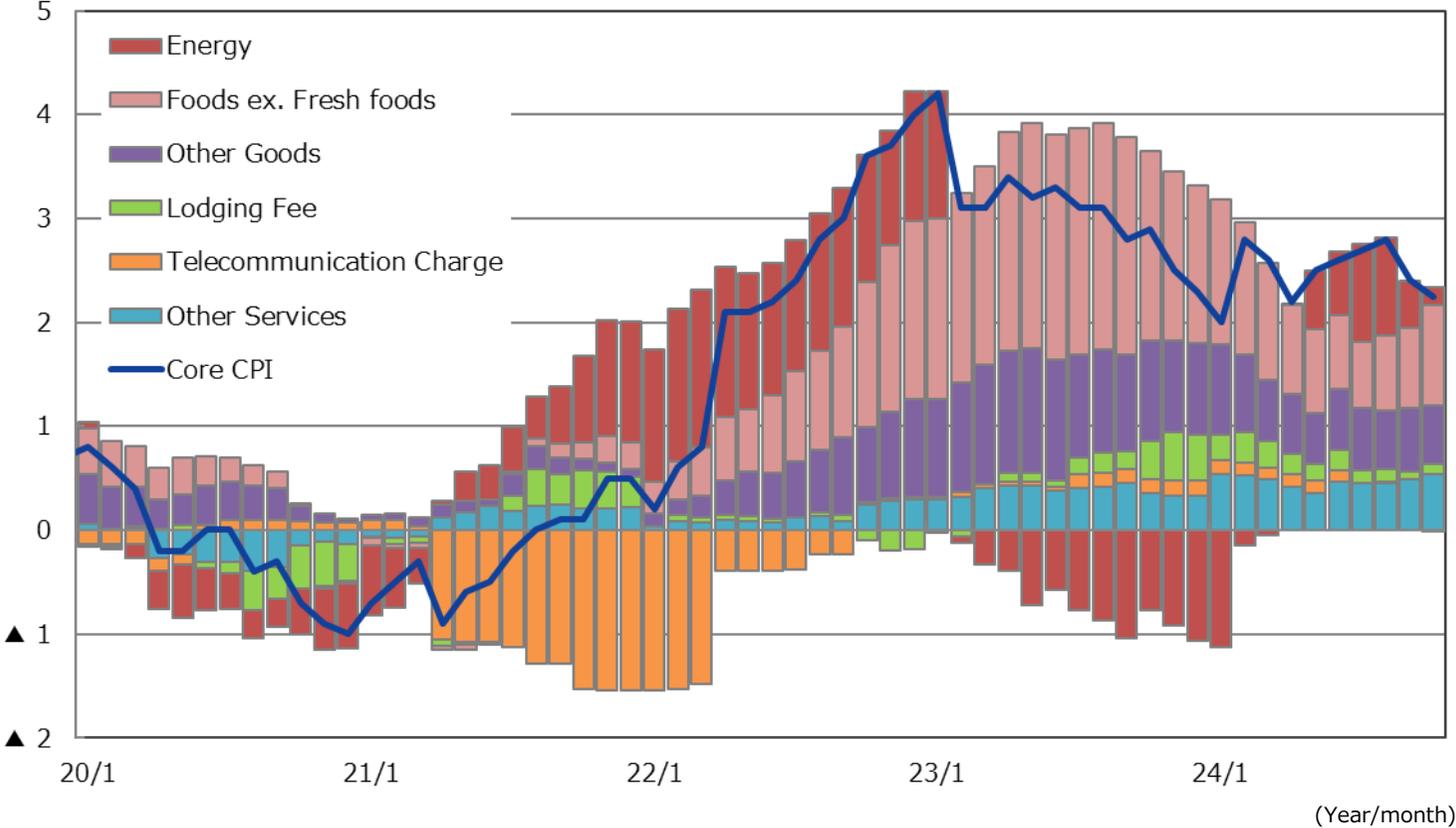
Wage increase (YOY, %)



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

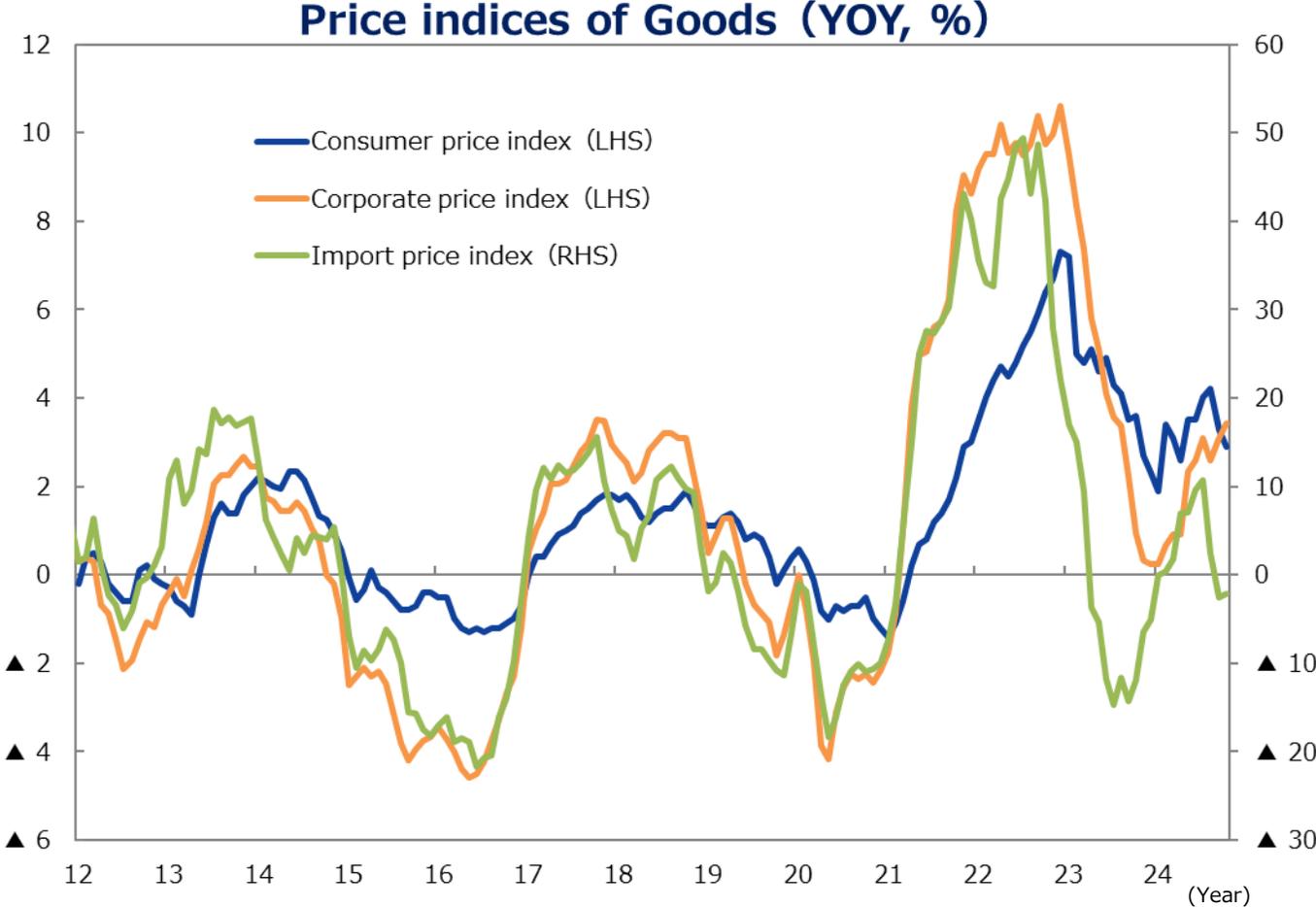
Subsidies for utility bills push down CPI

Breakdown of CPI (YOY, %)



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

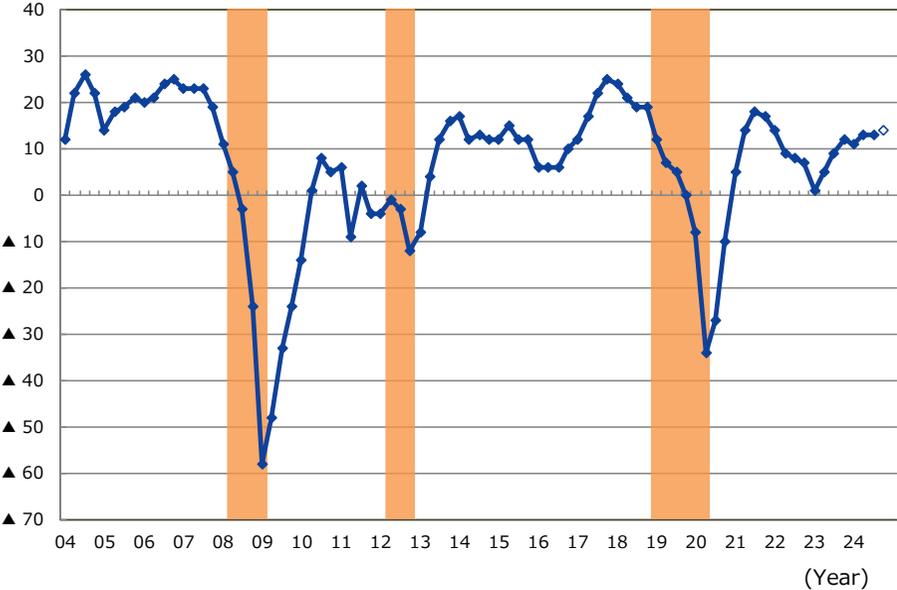
Importers enjoy widening profit margin



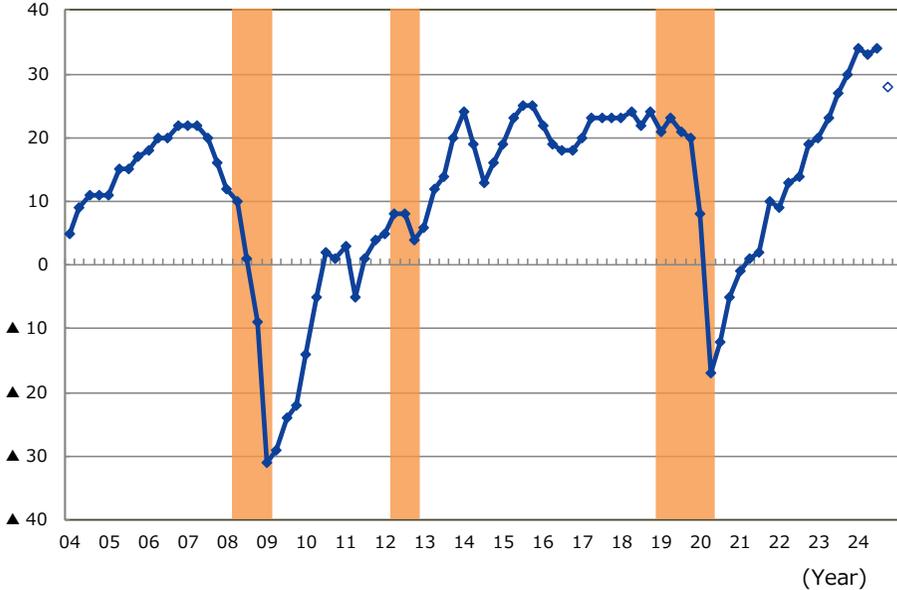
Note: Data is from January 2012 to October 2024.
Source: MIAC, Bloomberg, SMDAM

Improvement in business sentiment appears to have stalled

BOJ business condition DI Large manufacturers (%)

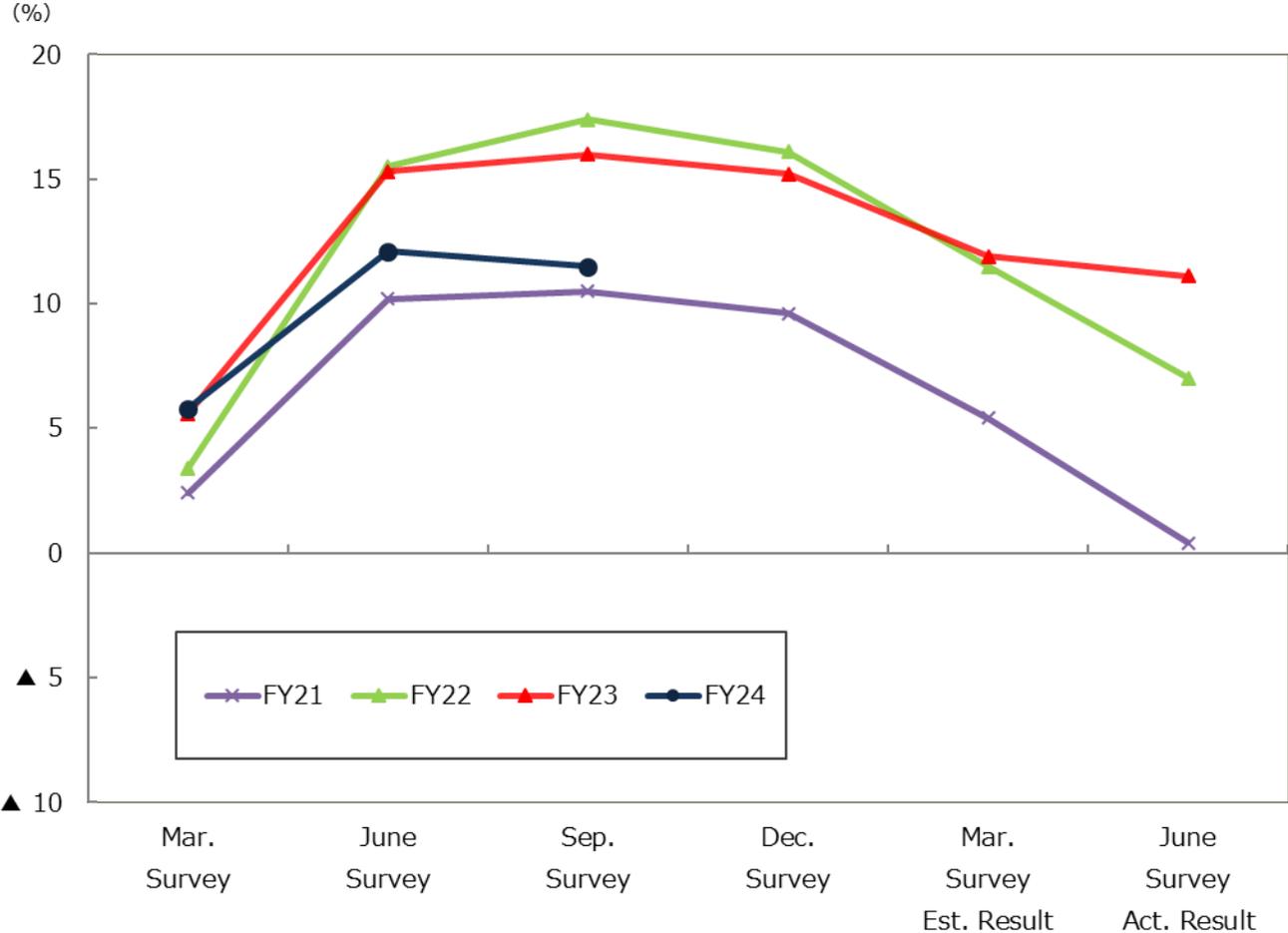


BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q3 2024. The orange shadow represents periods of economic recession.
 Source: The Bank of Japan, SMDAM

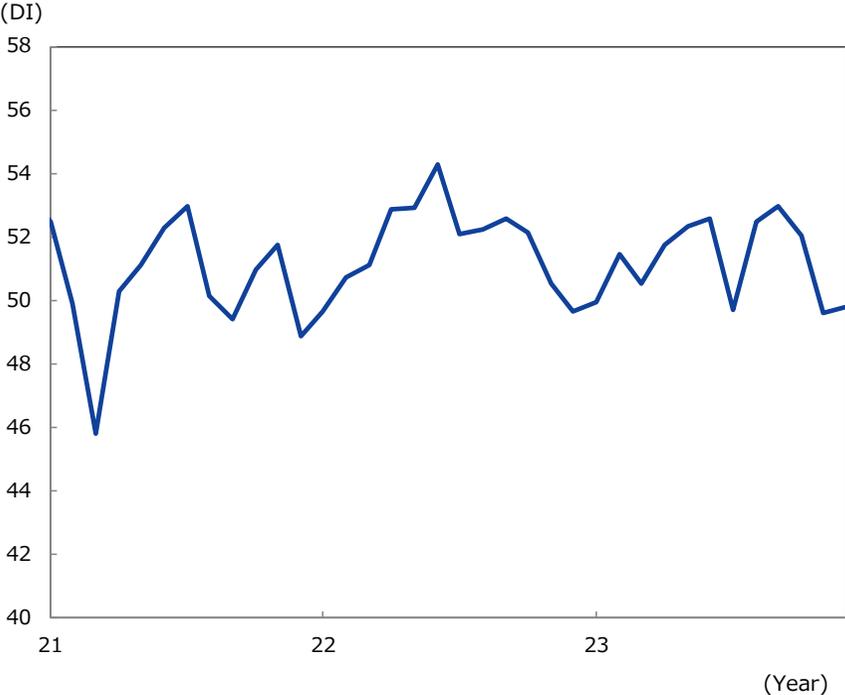
Uncertainty over the global economy gradually weighing on CAPEX



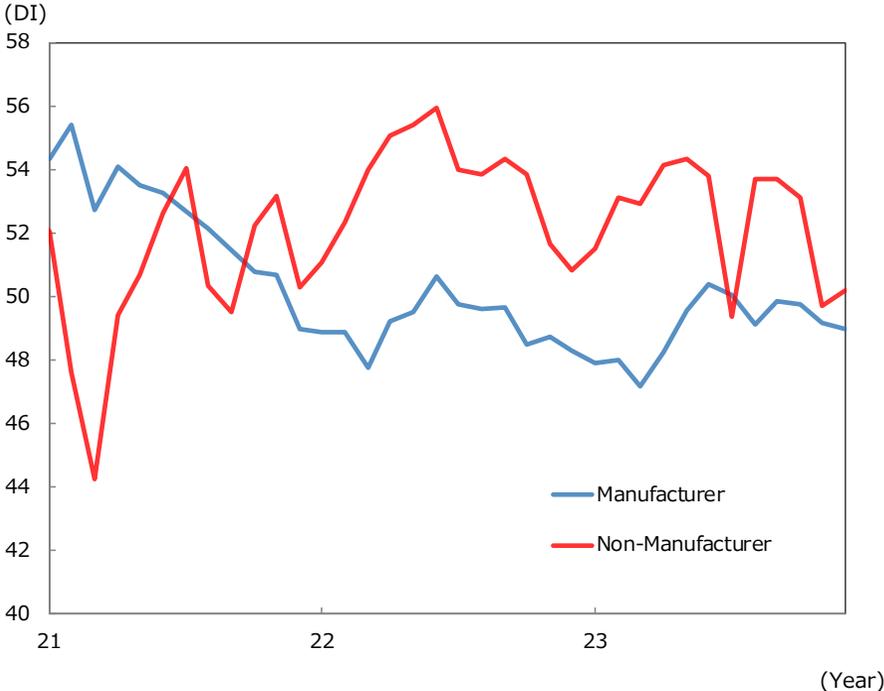
Note: Data is from Q1 FY2021 to Q3 FY2024.
 Source: The Bank of Japan, SMDAM

Business sentiment is flat and mixed

Composite PMI



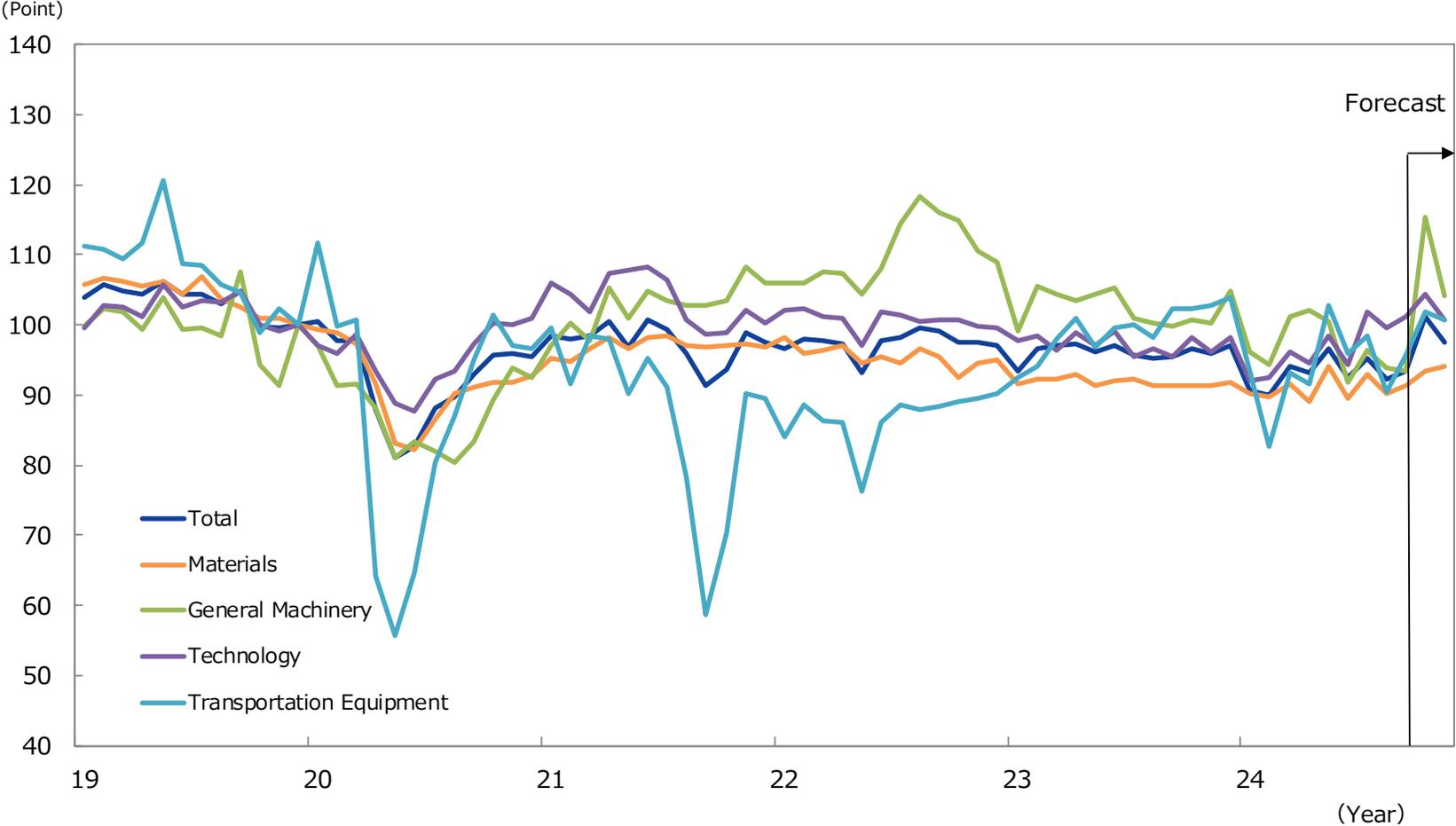
PMI, Manufacturer & Non-Manufacturer



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

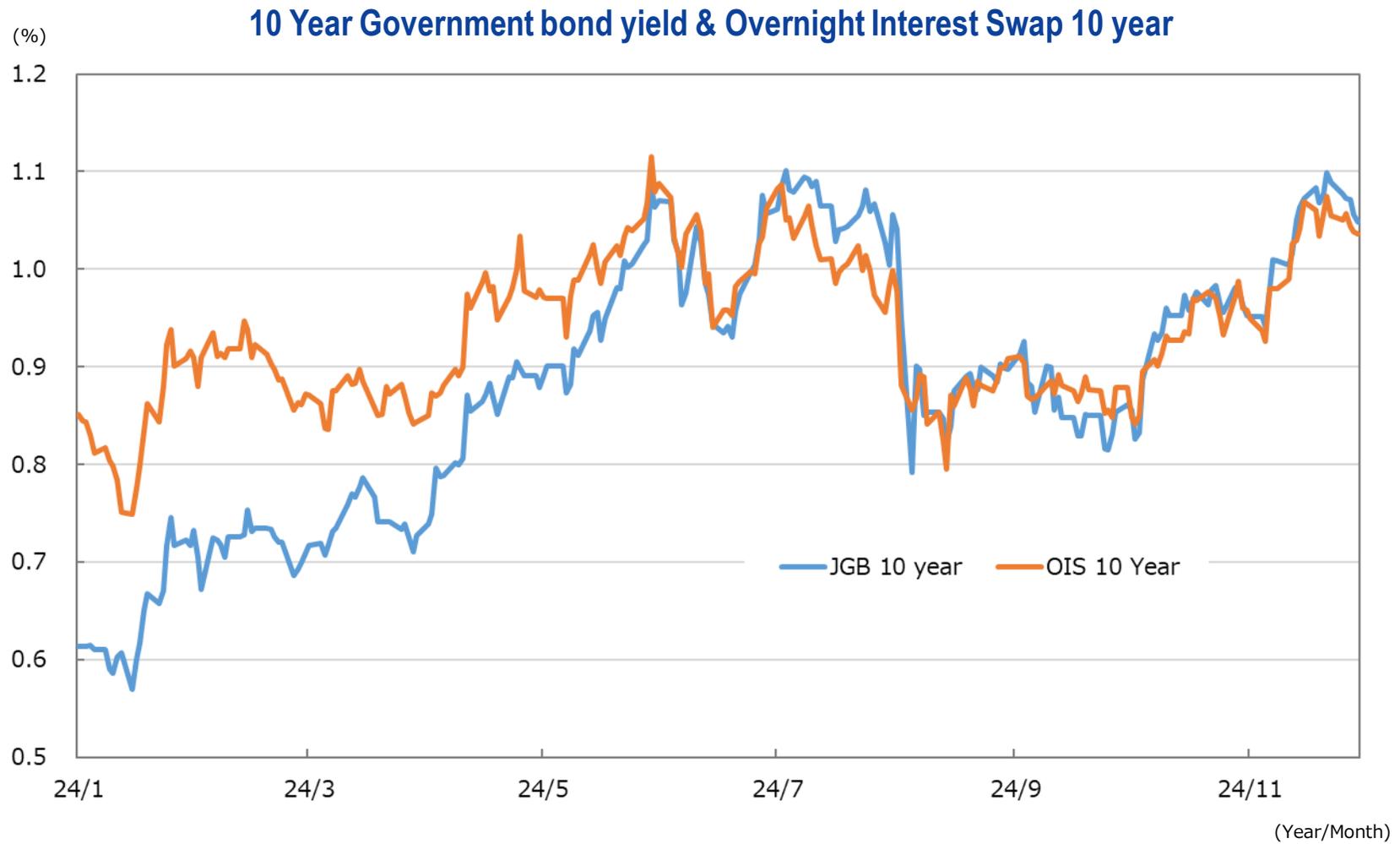
Industrial production will temporarily rebound ahead

Industrial Production (Dec. 2019=100)



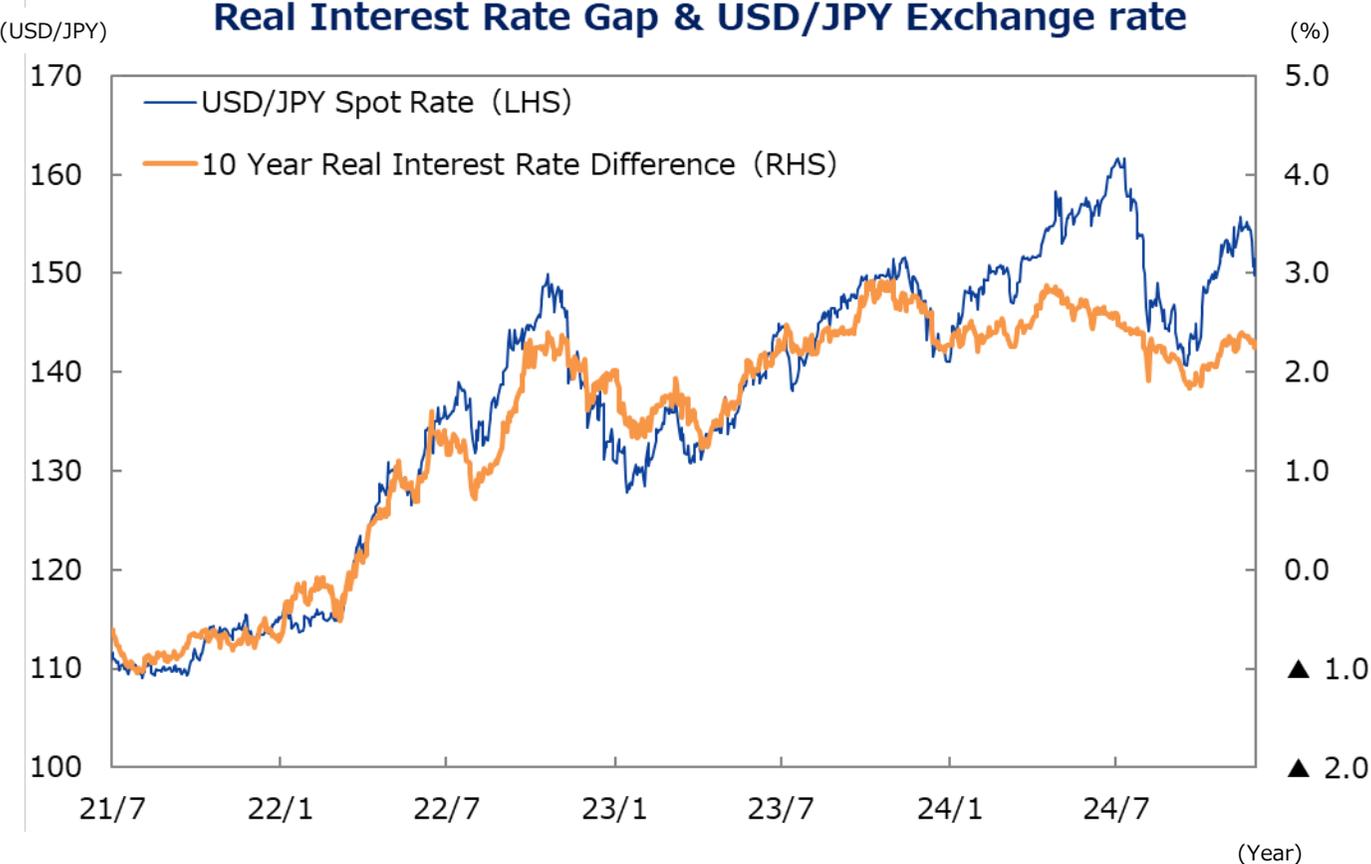
Note: Data is from January 2019 to November 2024. Data after September 2024 is forecasts.
Source: METI, SMDAM

Market has started pricing in the next rate hike by BOJ



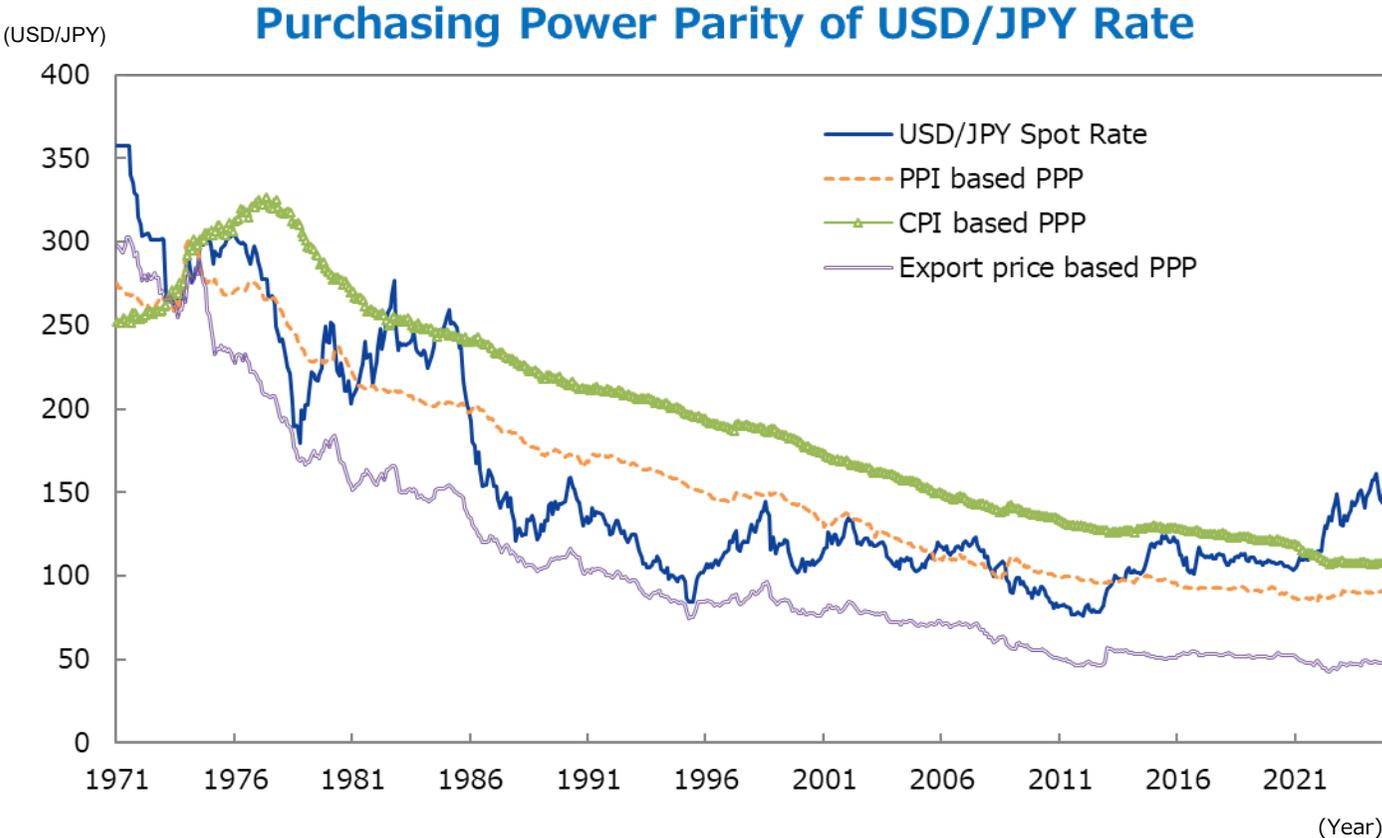
Note: Data is from 1st January 2024 to 29th November 2024.
Source: Bloomberg

Divergence between FOREX and interest rate gap again



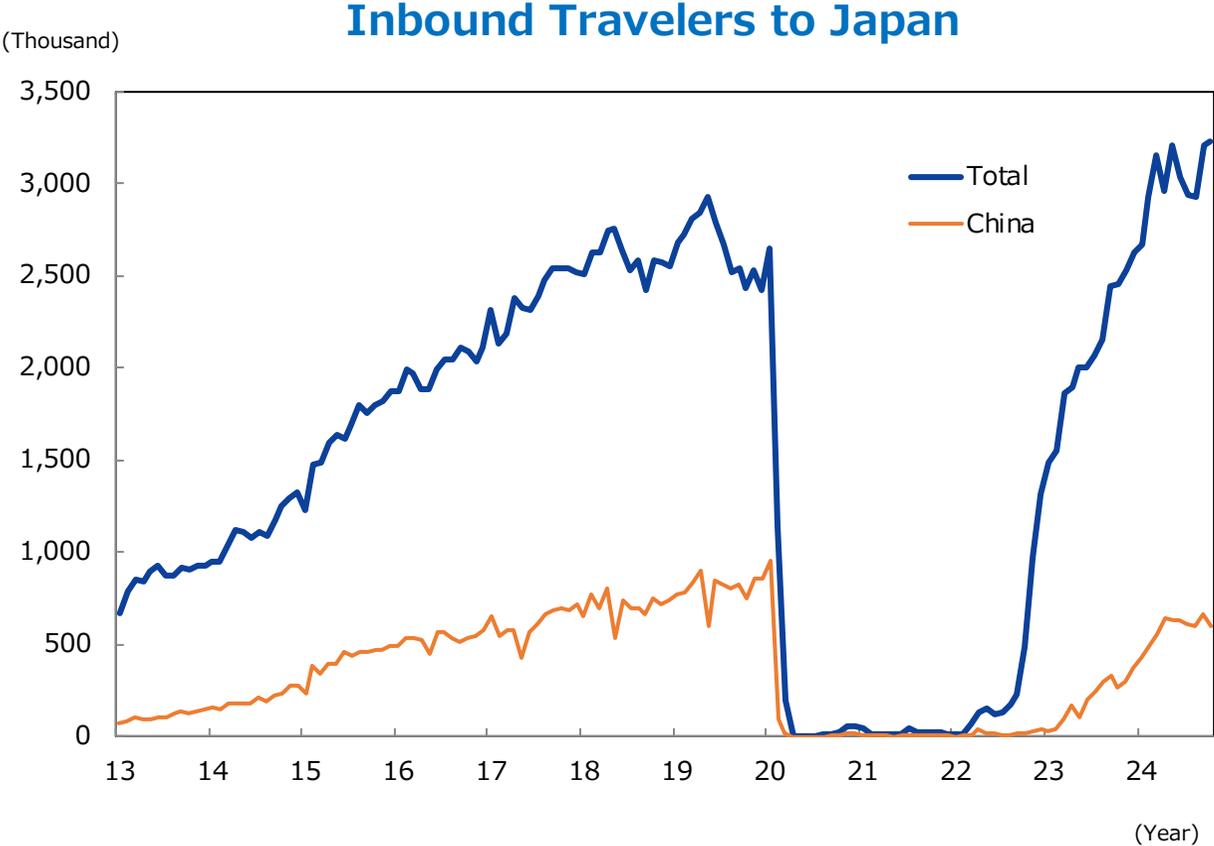
Note: Real interest rates are 10 year government bond yields. Data is from 1st July 2021 to 30th November 2024.
Source: Bloomberg, SMDAM

USD/JPY rate stays far above purchasing power parity



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

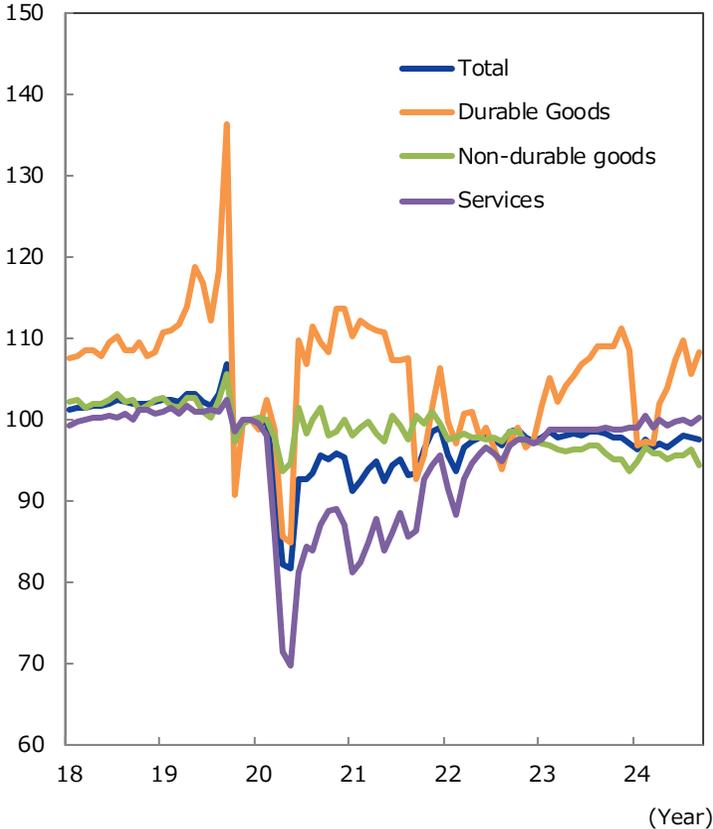
Inbound travel boom continues despite weak flow from China



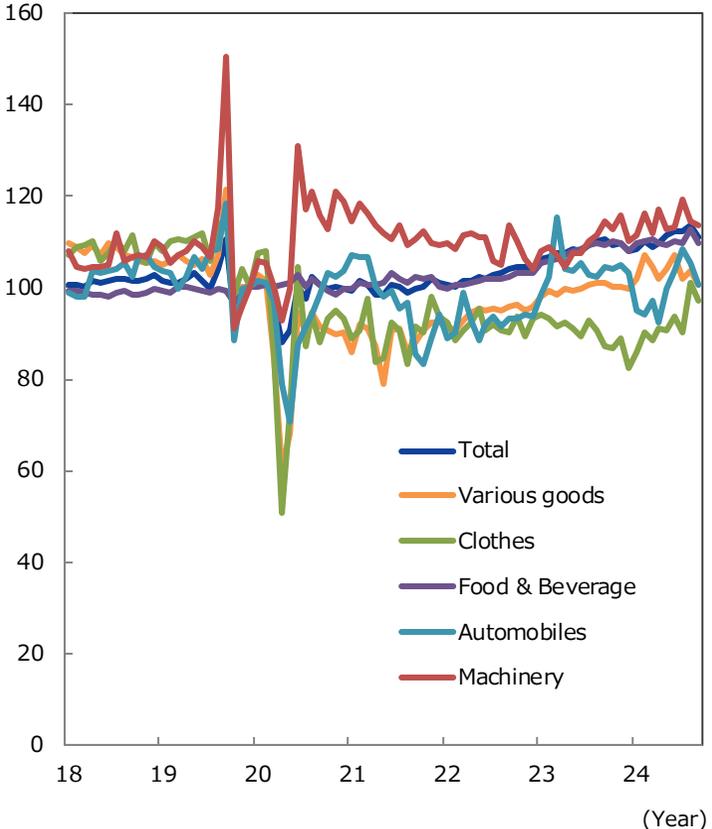
Note: Data is from January 2013 to October 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Momentum of auto sales recovery peaked

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



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

Ruling party failed to boost popularity by changing prime minister

Cabinet approval rate



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

Schedule of major events

Year	Month	Date	Event
2024	December	9	Revision of Q3 GDP
		18-19	Monetary Policy Meeting Diet resolution of FY 2024 supplementary budget Cabinet approval of the initial budget for FY 2025 and the outline for tax reform
2025	January	23-24	Ordinary Diet Session Monetary Policy Meeting
	February	17	Release of 2024 Q4 GDP
	March	11	Revision of 2024 Q4 GDP
		18-19	Monetary Policy Meeting
		25	Release of the results of spring negotiations of Trade Union Confederation Expiration of the term of the Bank of Japan's Adachi Policy Board member Enactment of the FY 2025 budget and tax-related bills
	April	13	Start of Osaka Expo
		30-5/1	Monetary Policy Meeting
	May		Release of 2025 Q1 GDP
	June	16-17	Revision of 2025 Q1 GDP Monetary Policy Meeting Cabinet's decisions on "Big-boned policy" End of the ordinary Diet session
		30	Expiration of the term of the Bank of Japan's Nakamura Policy Board member
	July	28	Final results of spring negotiations of Trade Union Confederation Election of the House of Councillors
	August		Release of 2025 Q2 GDP
	Septemebr	18-19	Revision of 2025 Q2 GDP Monetary Policy Meeting
29-30		Monetary Policy Meeting	
October	30	Expiration of the term of the House of Representatives	
November		Release of 2025 Q3 GDP	
December	18-19	Revision of 2025 Q3 GDP 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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