



Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management

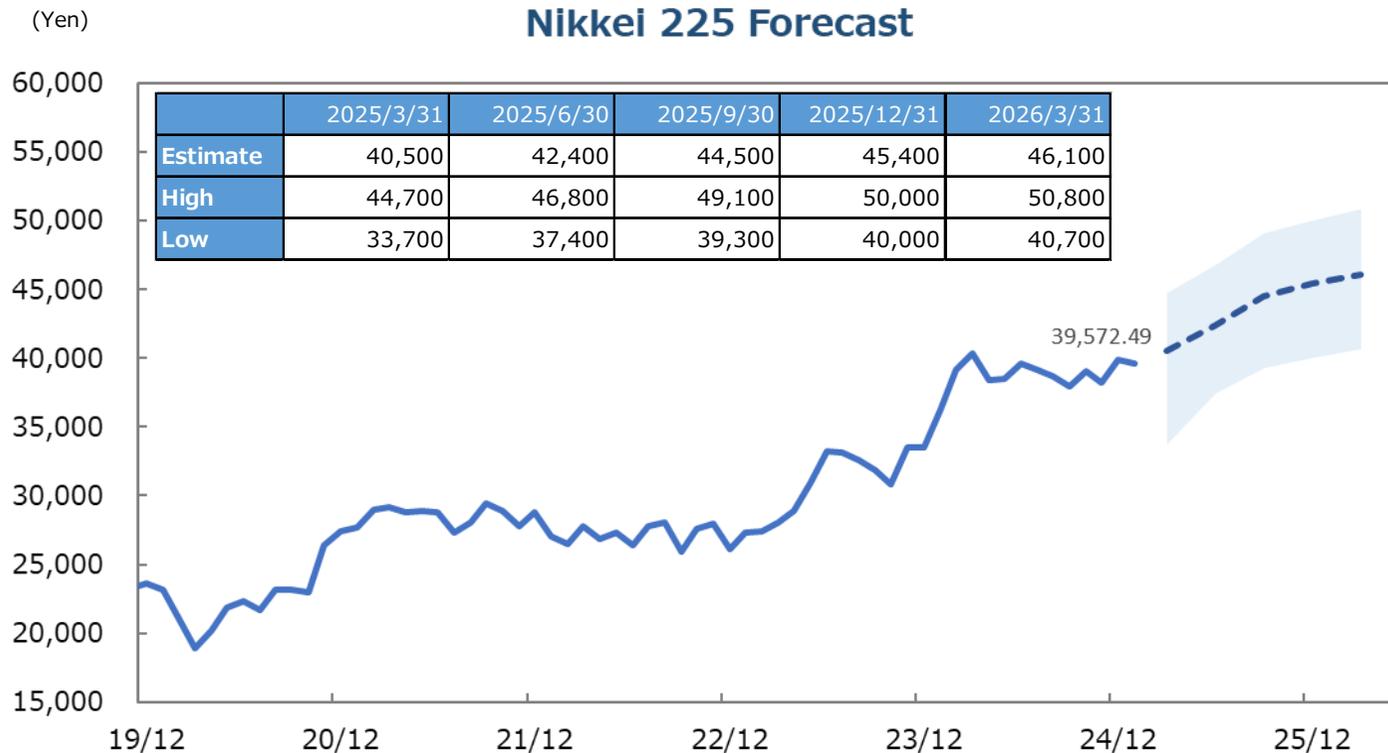


Outlook for Japanese Stock Market

Market Outlook

- We are bullish on the Japanese stock market in the mid-to-long term driven by steady growth of corporate earnings, the virtuous cycle of “wage increase and mild inflation”, and improvements in corporate governance.
- We expect the recent range trading will break upward once the future path of the US monetary policy and the cycle of the global economy becomes clearer.
- We expect the Nikkei 225 will reach 45,400, 15% upside potential, by the end of 2025.
- Foreign investors seem to be gradually returning to the Japanese stock market despite the Bank of Japan’s monetary tightening and the political uncertainty. The normalization of the economy and rising interest rate boosting confidence in the domestic value stocks, such as banks and other financial names.

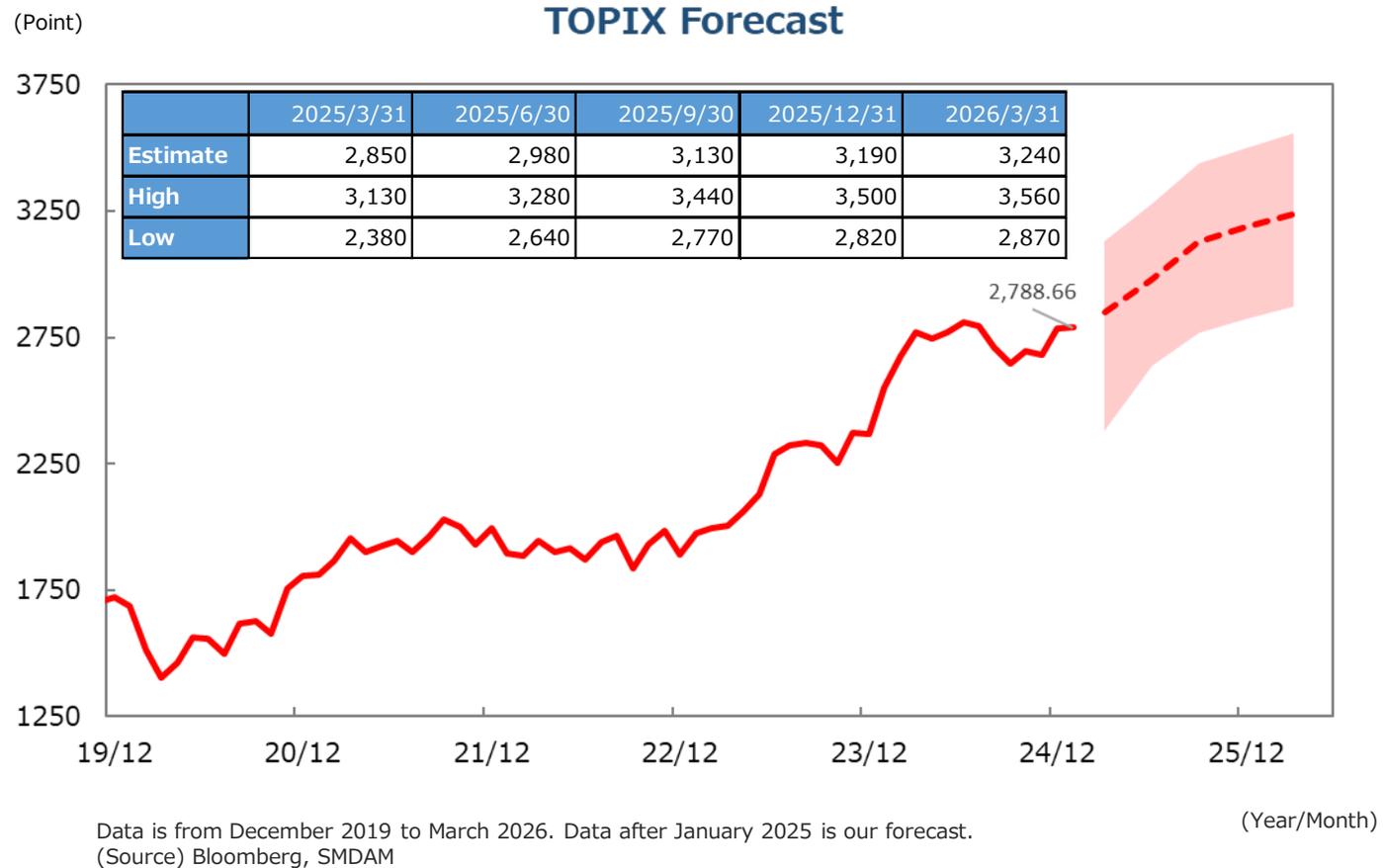
We see bullish perspective of Japanese equity



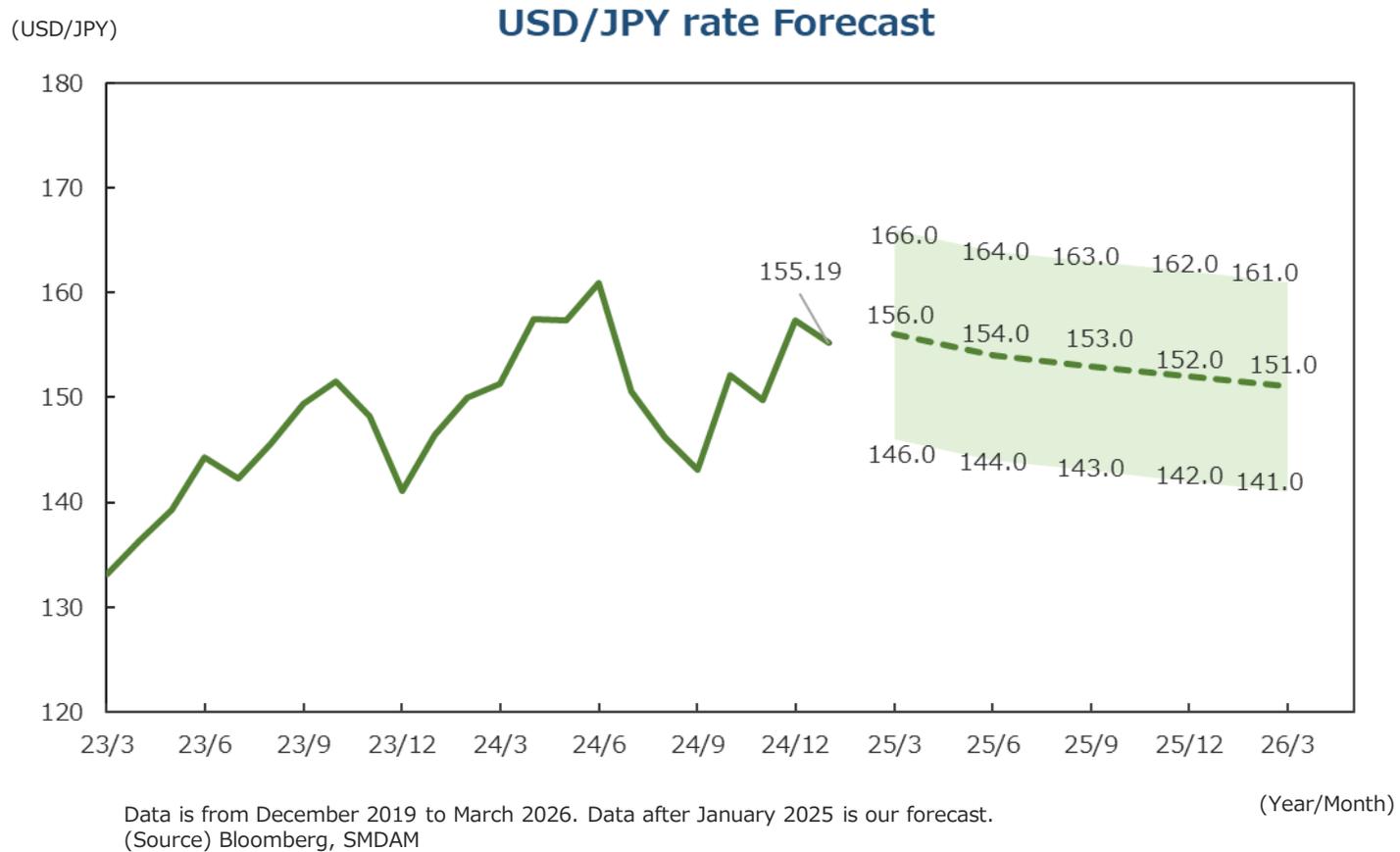
Data is from December 2019 to March 2026. Data after January 2025 is our forecast.
 (Source) Bloomberg, SMDAM

(Year/Month)

We see bullish perspective of Japanese equity



Narrowing interest rate gap to weigh on USD/JPY rate ahead



Upside / Downside risk scenarios

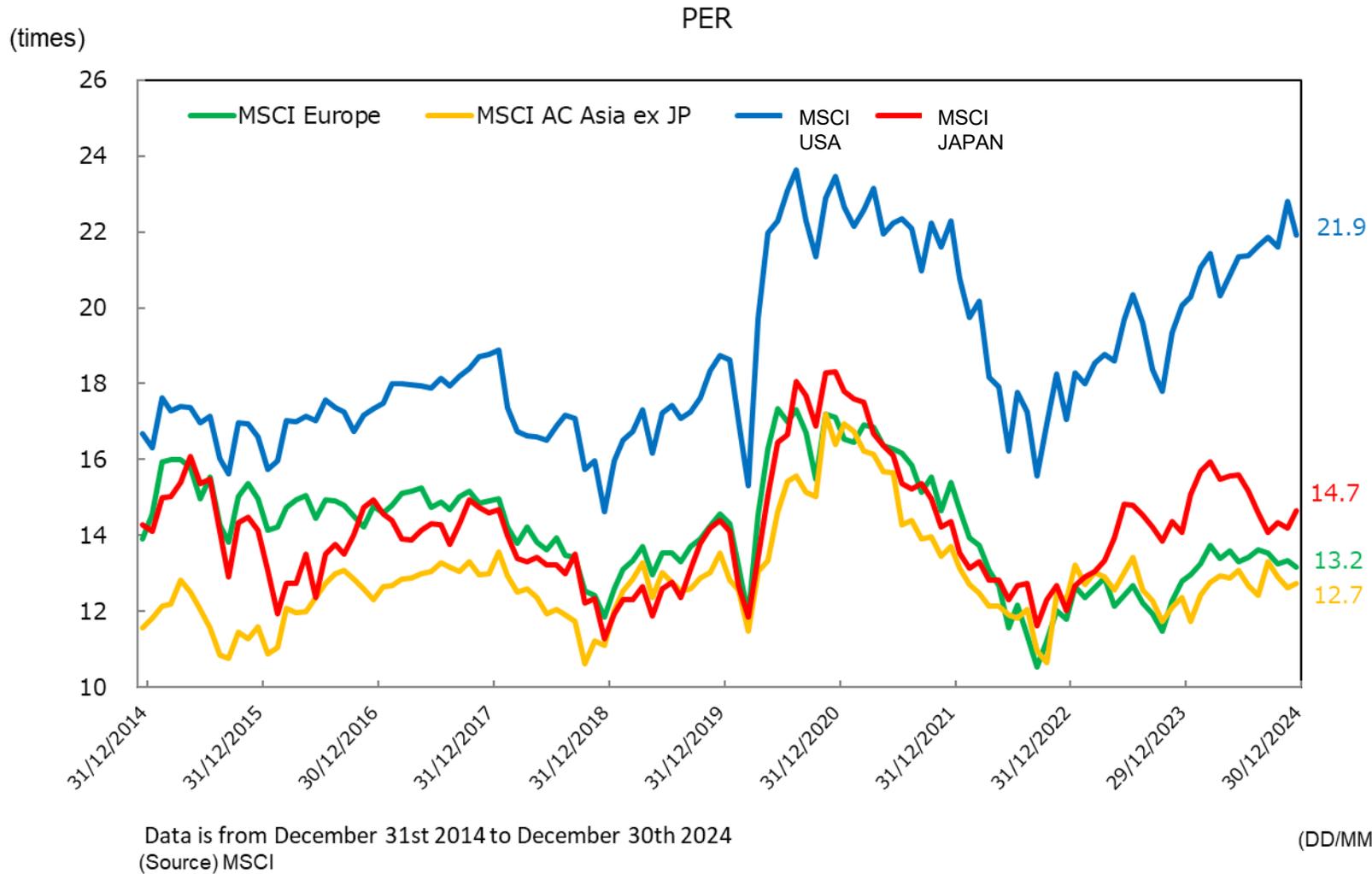
■ Upside Risks

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

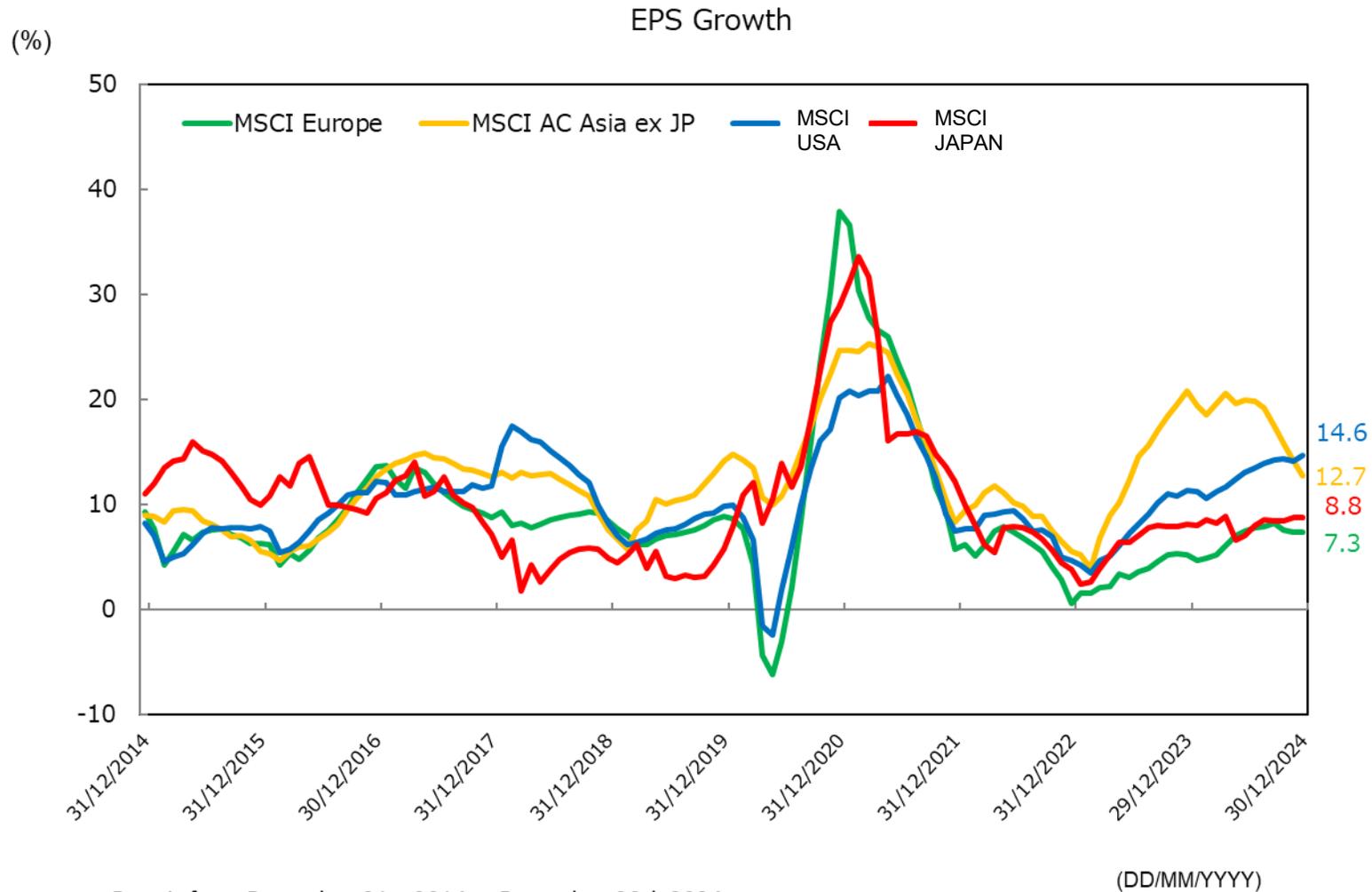
■ Downside Risks

- Slow down in wage increases
- Excessive and rapid appreciation of the JPY
- Stagnation in the business cycle of the manufacturing sector

P/E ratio is at the 10 year average in Japan

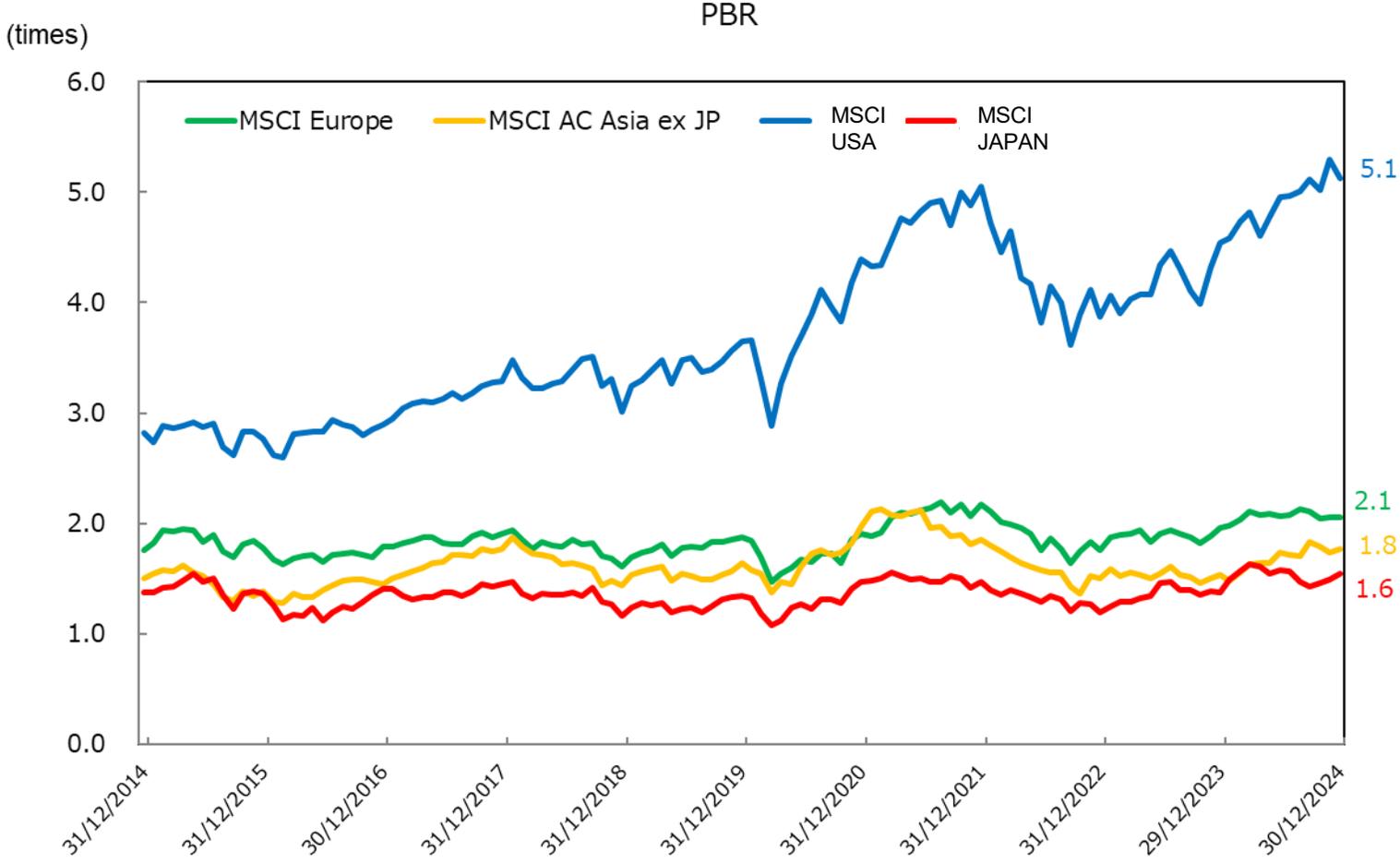


Earnings growth keeps steady momentum



Data is from December 31st 2014 to December 30th 2024
(Source) MSCI

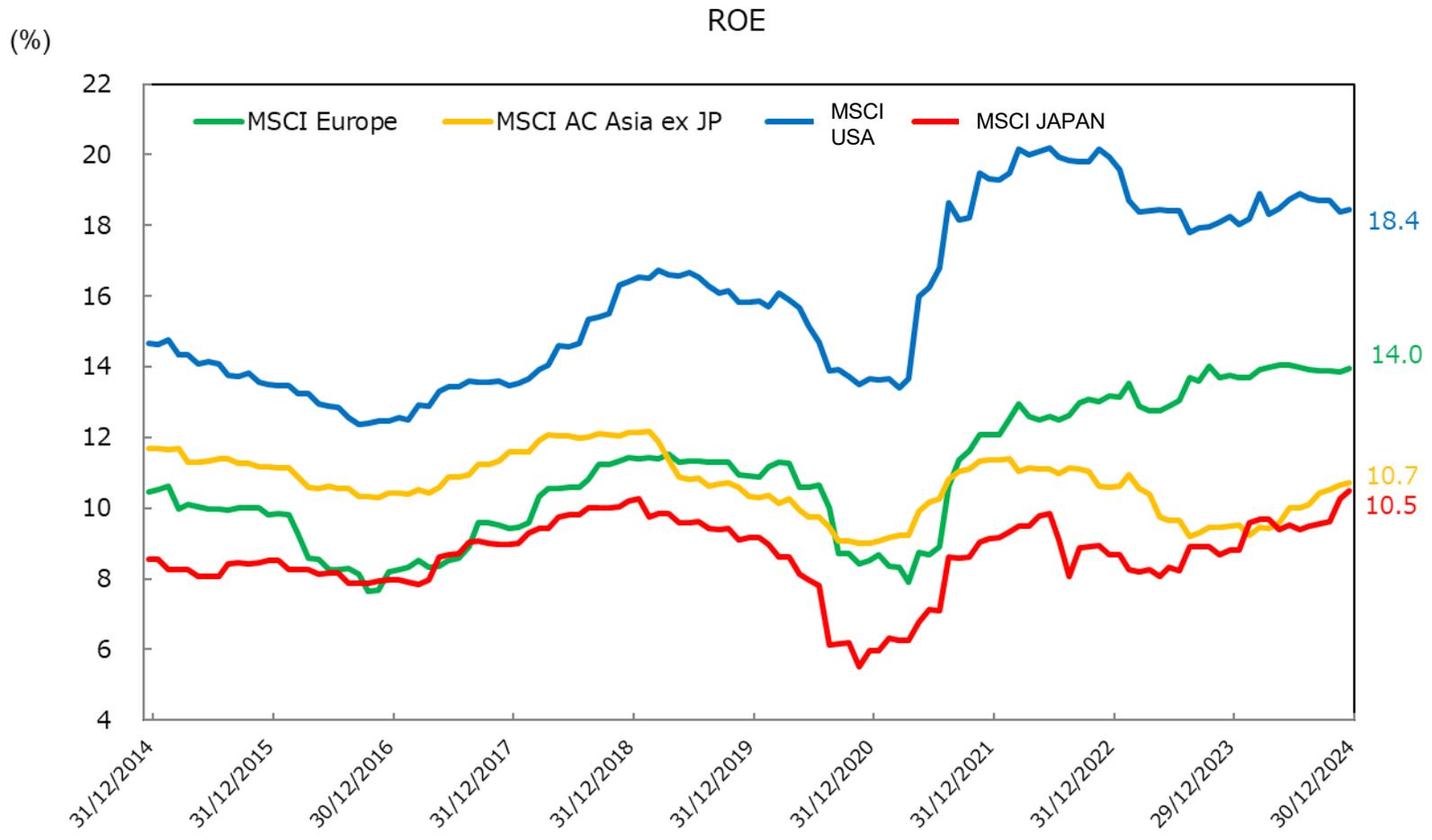
Japan's Price to Book rising but still lagging behind global peers



Data is from December 31st 2014 to December 30th 2024
 (Source) MSCI

(DD/MM/YYYY)

Earnings growth boosts Japan's ROE

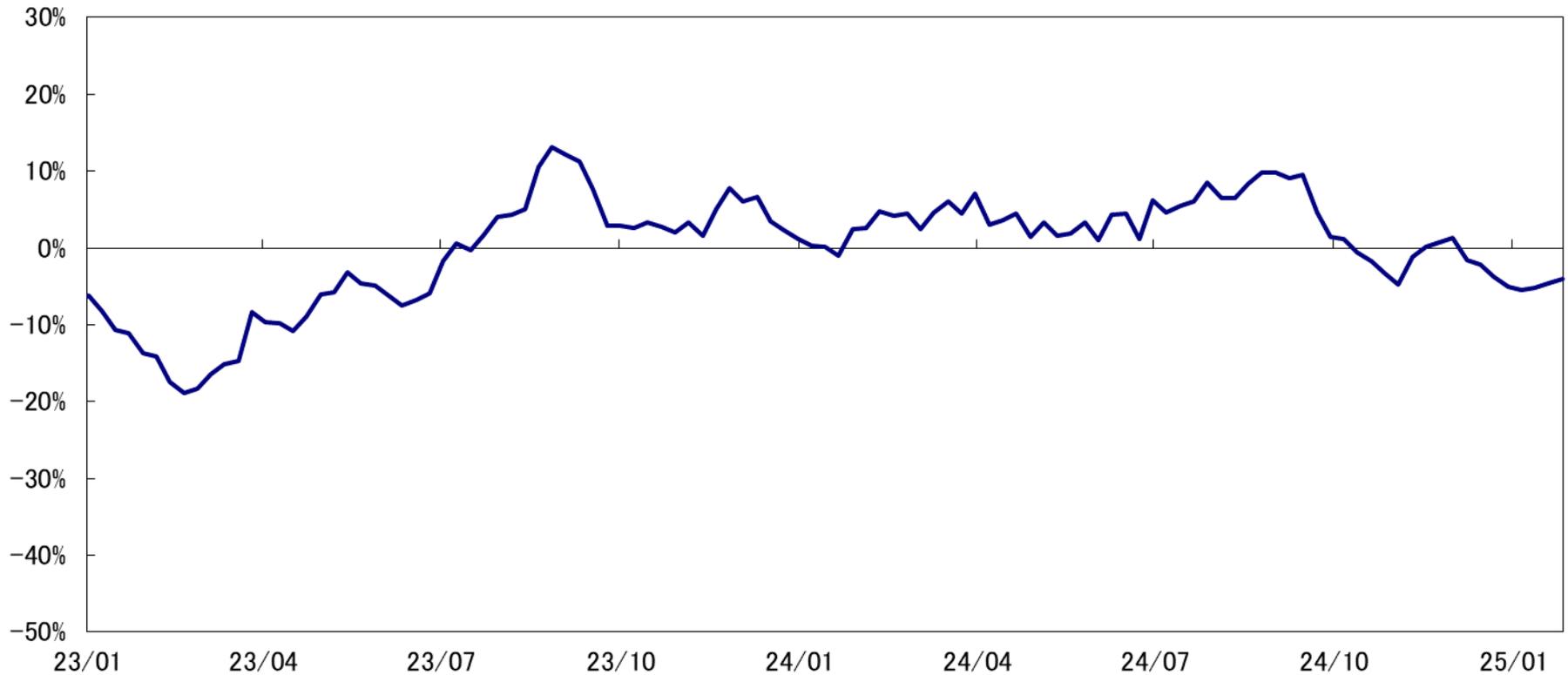


Data is from December 31st 2014 to December 30th 2024
 (Source) MSCI

(DD/MM/YYYY)

Uncertainty over global politics weighs on earnings forecasts

TOPIX EPS Revision Index

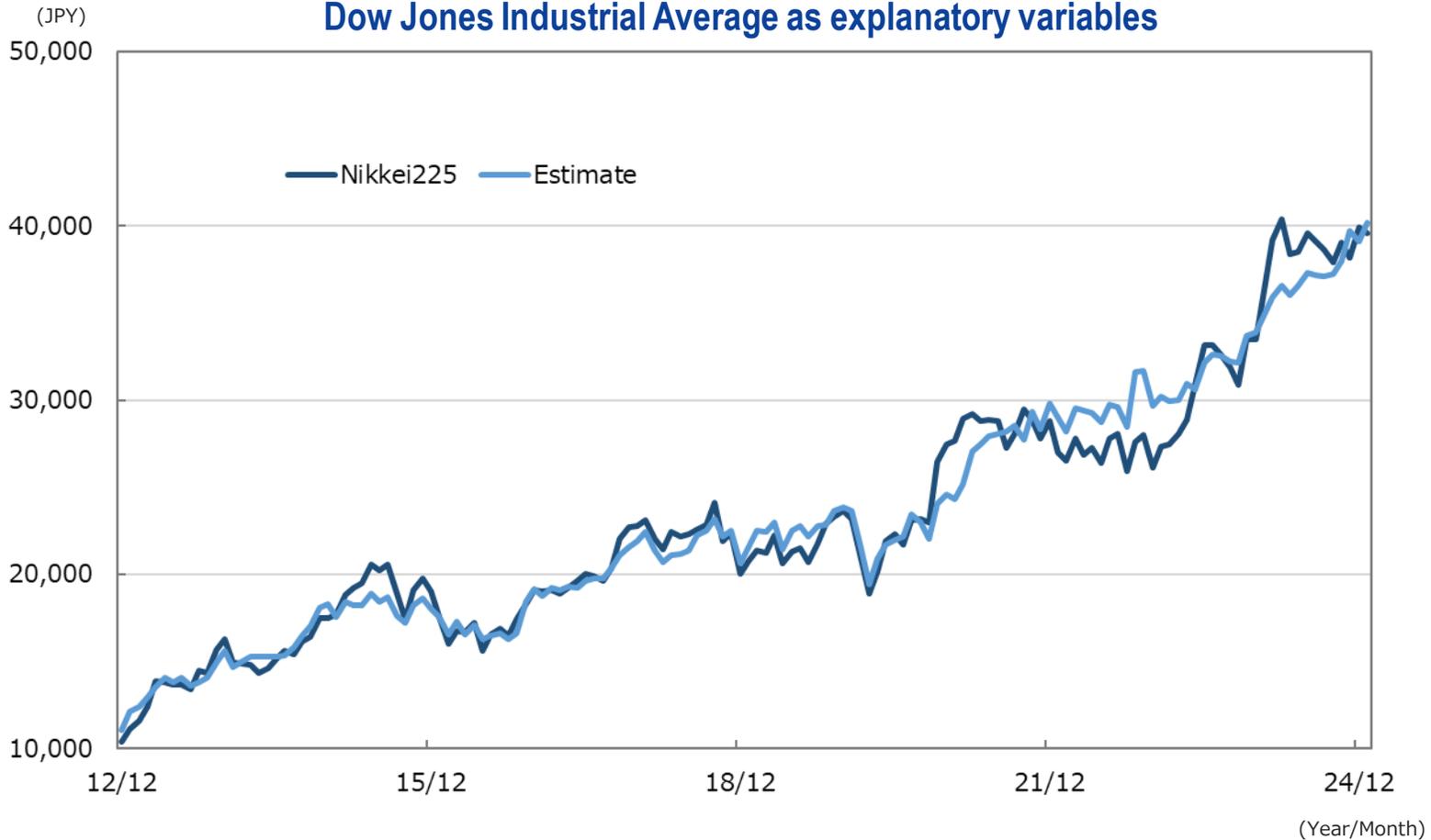


Data is from January 5th 2023 to January 31st 2025
(Source) Datastream, IBES

(YY/MM)

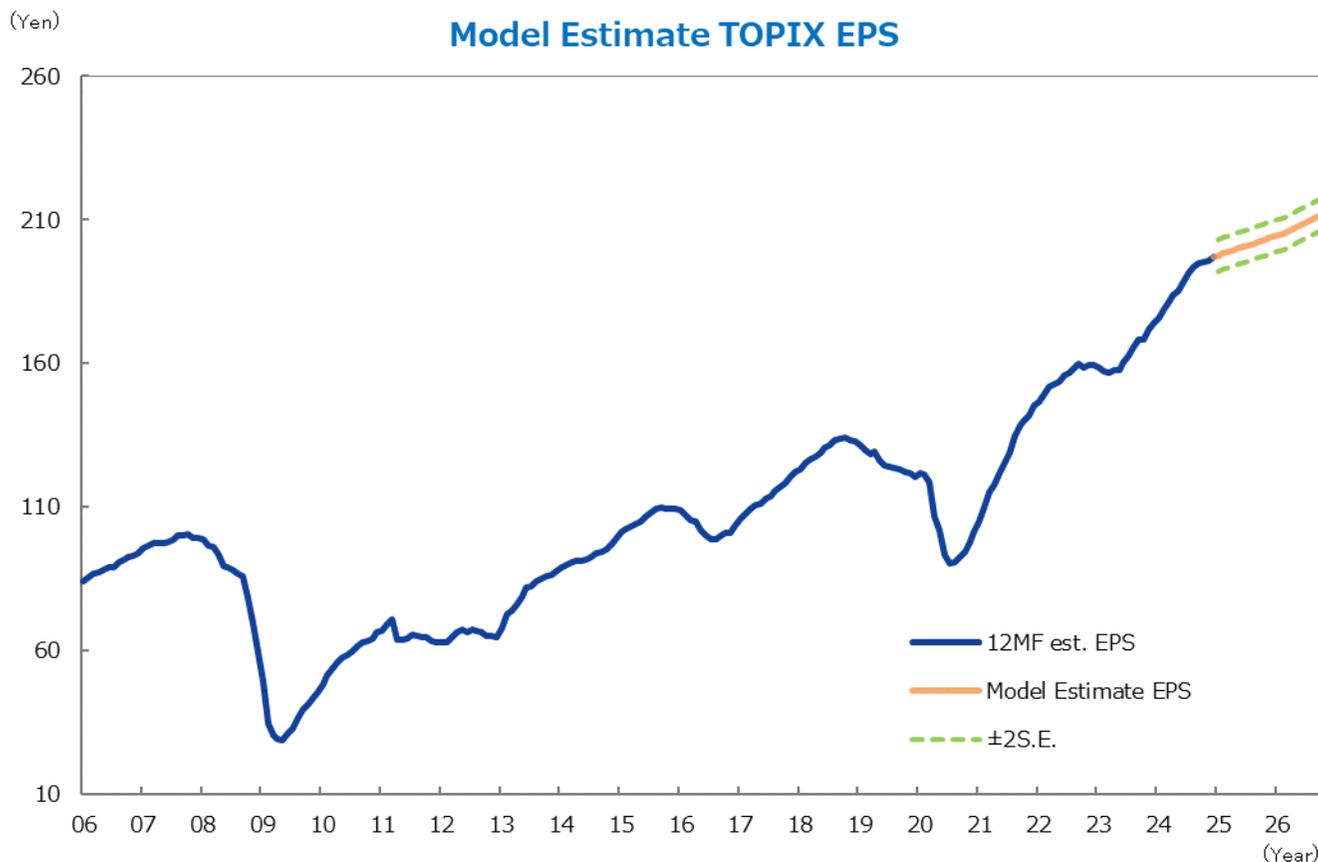
Weakening Yen and rally of US equity lift Nikkei 225

Multiple regression analysis of Nikkei 225 Index using US dollar / yen rate and Dow Jones Industrial Average as explanatory variables



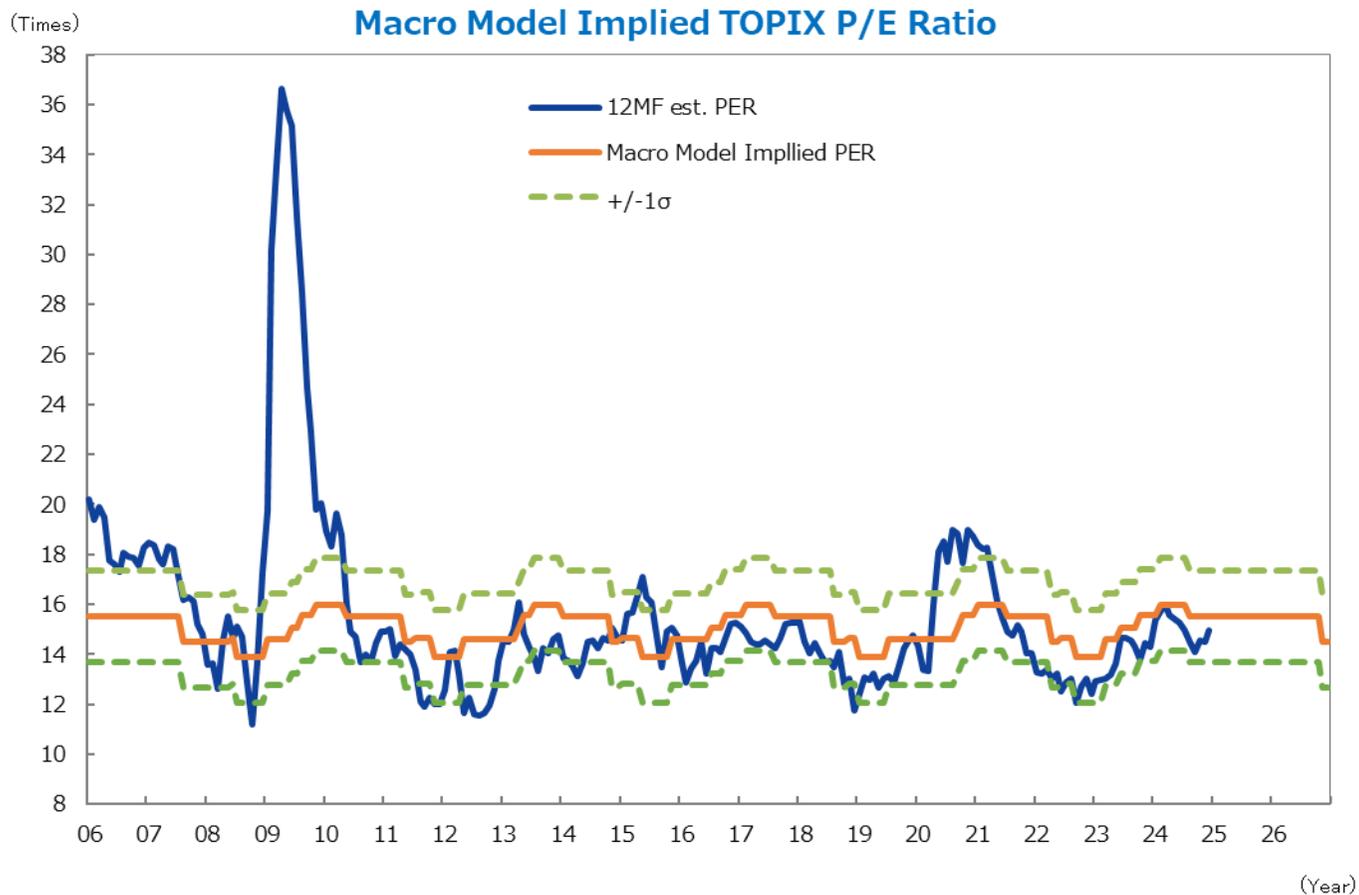
Data is from December 2012 to January 2025.
(Source) SMDAM, Bloomberg

Quant model suggests EPS keeps upward trend going forward



Note: Consensus data is from January 2006 to December 2024. Model estimate Data is from January 2025 to December 2026.
Source: SMDAM

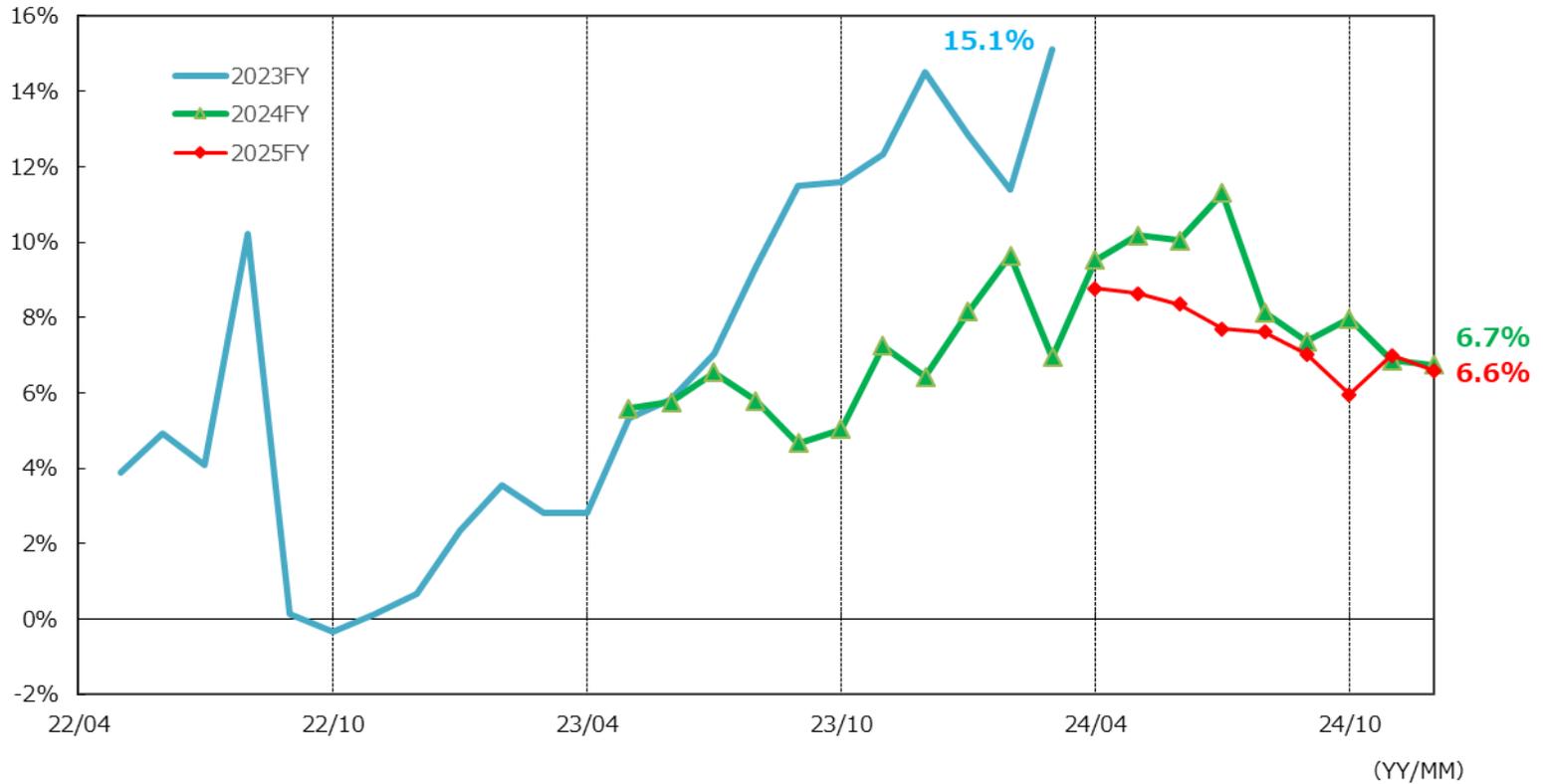
TOPIX is currently traded with attractive P/E ratio



Note: Consensus data is from January 2006 to December 2024. Model estimate Data is from December 2006 to December 2026.
Source: SMDAM

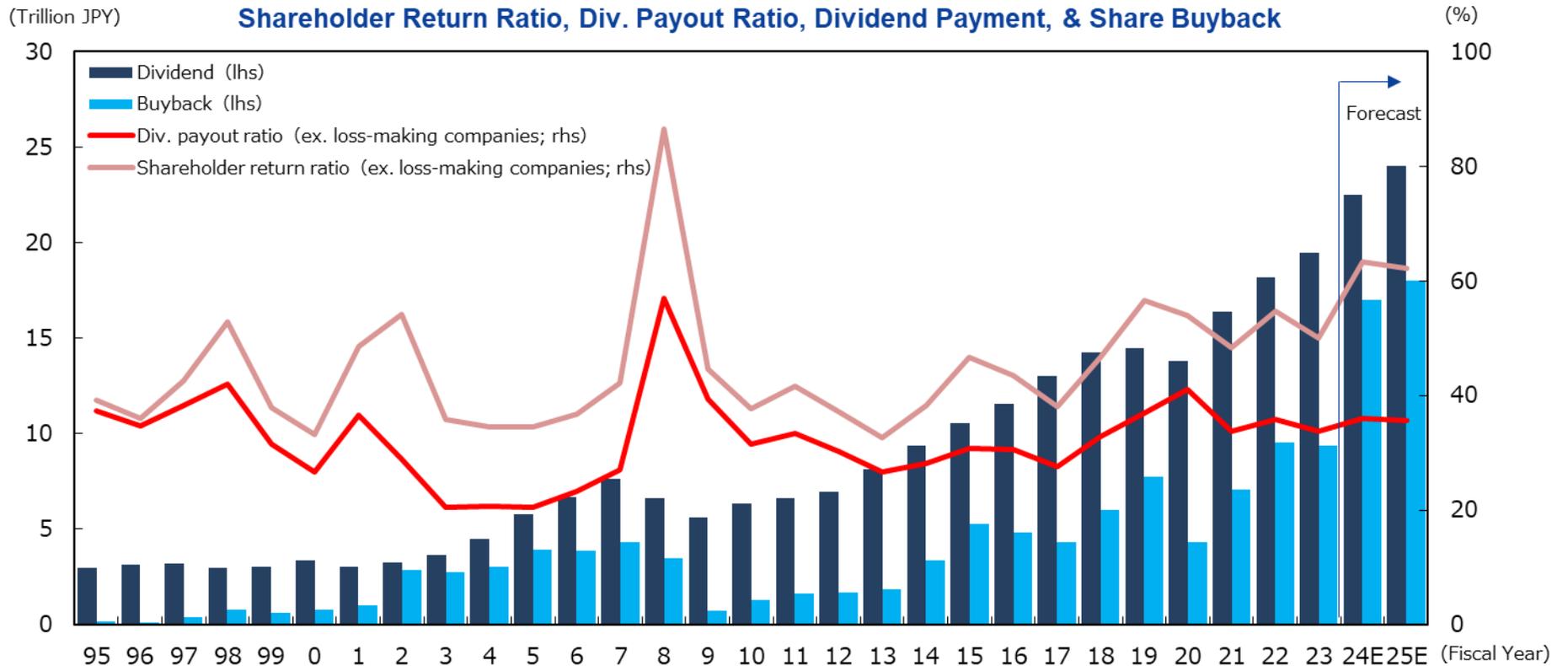
SMDAM analysts see a cruising speed of earnings growth ahead

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



Note: Data is as of 21st January 2025, 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



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	3.36	-2.93	-1.53	8.09	42.81	42.76	58.27
Total Value	4.60	-3.54	-1.96	12.00	54.93	63.53	74.89
Top Cap Value	7.38	-3.89	-1.79	18.40	65.64	77.05	106.76
Large Cap Value	4.60	-4.39	-1.99	12.18	56.38	65.25	79.88
Mid Cap Value	1.77	-4.99	-2.23	6.26	46.62	52.62	50.34
Small Cap Value	4.44	0.57	-1.84	11.03	48.23	55.60	53.66
Micro Cap Value	4.13	-0.21	-2.13	8.51	42.55	51.48	46.62
Total Growth	2.26	-2.30	-1.06	4.72	31.90	24.90	41.71
Top Cap Growth	4.04	-2.88	-0.53	6.64	38.74	28.60	52.97
Large Cap Growth	2.48	-2.46	-0.88	5.18	34.37	26.35	46.14
Mid Cap Growth	-0.72	-1.81	-1.71	2.18	26.17	21.81	33.91
Small Cap Growth	0.48	-0.59	-2.55	0.90	13.14	13.72	9.12
Micro Cap Growth	-2.67	-5.14	-3.46	-5.82	3.33	6.03	1.23
Top Cap Total	5.31	-3.31	-1.06	10.97	49.82	47.99	74.11
Large Cap Total	3.42	-3.39	-1.42	8.25	44.36	43.50	62.21
Mid Cap Total	0.62	-3.64	-2.02	4.36	36.70	37.24	46.33
Small Cap Total	2.97	0.17	-2.09	7.07	33.81	38.11	35.84
Micro Cap Total	1.92	-1.80	-2.54	3.58	28.47	34.88	31.15

Note : As of 22nd January 2025
(Source) Bloomberg



Outlook for Japanese Economy

Current status & Outlook of Japanese economy

[Current Status]

- **The economy is recovering.** While external demand is slightly sluggish due to the current decrease in export, domestic demand is solid, thanks to steady CAPEX, in areas such as software, capital goods and total supply. Wage increase is supporting consumer spending despite higher inflation. So far, the growing uncertainty over the US economic policies has limited impact on business sentiment.
- **Inflation is on an upward trend.** Nationwide core CPI rose by +2.7% YOY in November, up from +2.3% in October, and the Tokyo Metropolitan Area core CPI rose by +2.4% YOY in December, up from +2.2% in November. The rise in both Nationwide and the Tokyo Metropolitan Area core CPI was mainly driven by energy prices, following the reduction of government emergency measures implemented to cope with the extreme heat. Additionally, rising service prices and cost-push pressure from the depreciation of the JPY also contributed to the upward trend.

[Outlook]

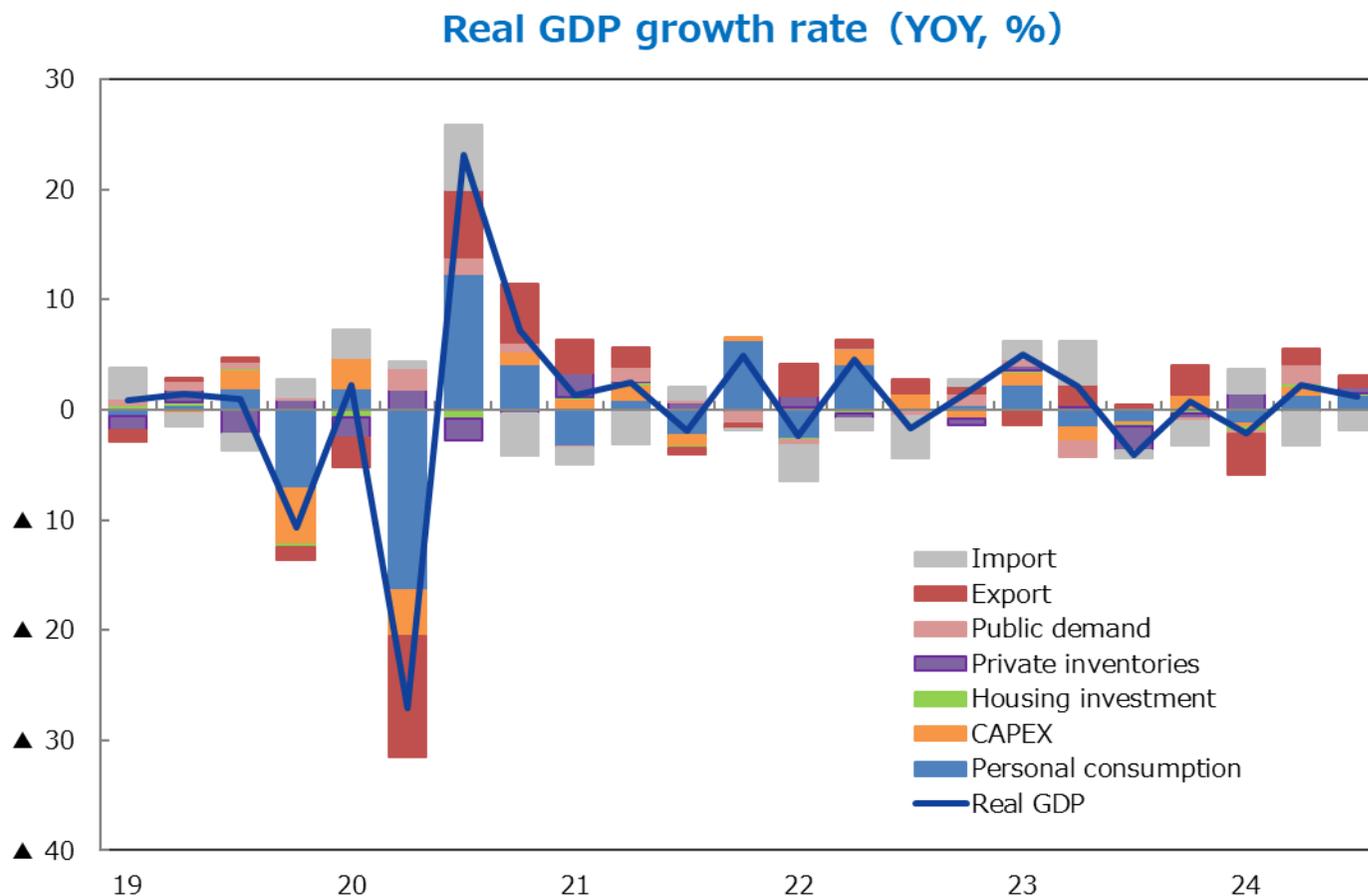
- ① **While we have maintained our real GDP growth forecast for FY 2024 at +0.5% and that for FY 2026 at +0.9%, we have lowered our estimate for FY 2025 from +1.2% to 1.0%.** The downward revision for FY 2025 reflects a reduction in our assumed scale of tax cuts from 3.8 trillion yen to 0.7 trillion yen, as expected by the ruling party. This revision considers the possibility of power dilution of the Democratic Party for the People as the Japan Innovation Party approaches the ruling party. We expect the Japanese economy to return to a moderate growth trajectory, supported by wage increases, steady appetite for CAPEX (such as labor saving, digitalization, greening, urban development, and construction of semiconductor factories), economic measures, and the resilience of overseas economies.
- ② **While we have maintained core CPI forecast for FY 2024 at +2.6%, we have raised our estimate for FY 2025 from +2.1% to +2.2% and that for FY2026 from +1.5% to +1.9%.** The upward revision for FY 2026 is mainly due to the cancellation of assumption regarding the elimination of the provisional gasoline tax. We expect cost-push pressure from import prices to ease, while inflation will be stable due to the rising service prices driven by wage hikes. We forecast core CPI to decelerate a bit, still maintain a momentum of around +2.0% YOY.
- ③ **We expect the government to adopt accommodative fiscal policies.** Prime Minister Ishiba has confirmed that he will continue his predecessor's policies and focus on combating deflation over the next three years. In November, the Cabinet approved a comprehensive economic measure aimed at "ensuring people's safety and security and sustainable growth." Regarding tax cuts, an agreement has been reached between the ruling party and the opposition Democratic Party for the People to raise the minimum taxable income from the current 1.03 million yen, starting in 2025. The Japan Innovation Party emphasizes on education fee support, including tuition support for high school students, and free school lunches.
- ④ **We have maintained our forecast for the Bank of Japan's monetary policy.** We expect the BOJ to raise its policy rate to 0.75% in July 2025, 1.00% in January 2026, and 1.25% in January 2027. We anticipate the BOJ to raise interest rate gradually towards the lower bound of a neutral economic interest rate level (between 1% to 2.5%) at a pace of once every six months until the rate reaches 1%. Beyond that point, the pace of rate hikes will slow down to once a year. There is a risk of a delay in the rate hike if the US raises tariffs. If the Japanese economy is negatively impacted by the higher US tariffs without a corresponding depreciation of the yen, it is possible that the BOJ will delay the rate hikes and maintain its current policy for an extended period.

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	3.0%	1.4%	0.7%	0.5%	1.0%	0.9%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.6%	1.1%	0.8%
Private housing investment	0.3%	-2.6%	0.8%	-1.6%	-0.9%	-1.1%
Private-sector capital investment	3.2%	3.6%	-0.1%	2.5%	1.8%	1.6%
Private inventory investment	0.5%	0.0%	-0.3%	0.1%	0.0%	0.0%
Public fixed capital formation	-6.4%	-5.5%	-0.3%	0.9%	0.0%	0.7%
Net export contribution	0.8%	-0.5%	1.4%	-0.6%	0.1%	0.1%
Exports of goods and services	12.5%	4.9%	2.8%	0.7%	3.2%	3.5%
Imports of goods and services	7.3%	7.3%	-3.3%	3.8%	2.8%	3.0%
Nominal GDP	2.9%	2.3%	4.9%	3.0%	2.9%	2.5%
GDP deflator	-0.1%	0.9%	4.2%	2.6%	1.9%	1.7%
Industrial Production Index	5.6%	-0.3%	-1.9%	-0.4%	2.2%	1.5%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.6%	2.2%	1.9%
Consumer Price Index (BOJ Core)	-0.8%	2.2%	3.9%	2.2%	2.1%	2.0%
Domestic corporate goods price index	7.1%	9.6%	2.4%	2.9%	1.3%	1.1%
Employee compensation	2.1%	2.5%	1.9%	4.0%	3.5%	3.4%
Unemployment rate	2.8%	2.6%	2.6%	2.5%	2.4%	2.3%
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

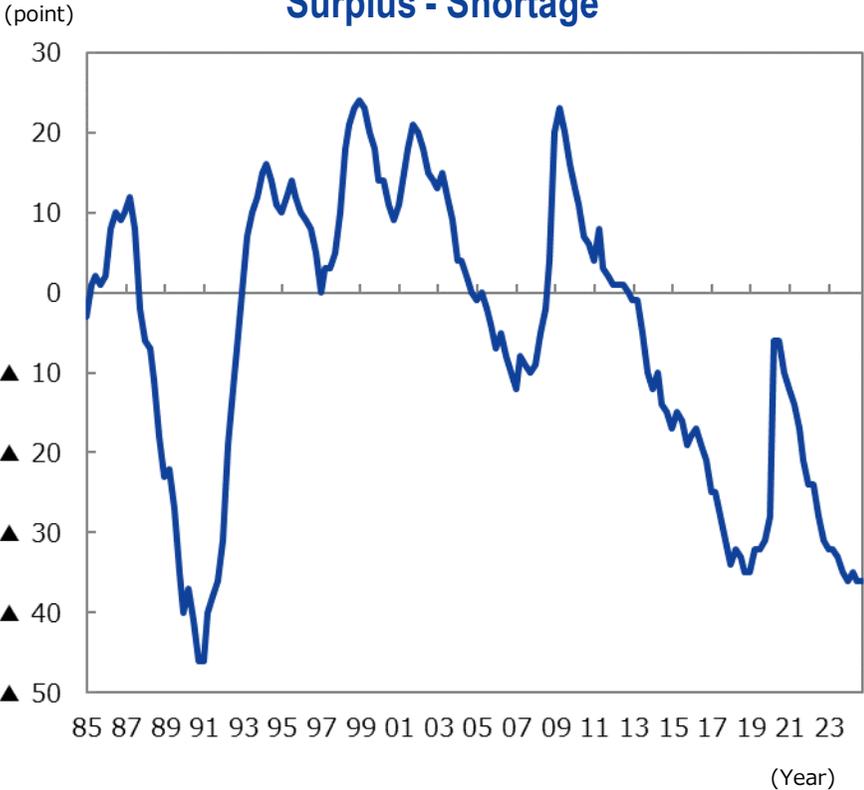
Japanese economy returns to a growth trend



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

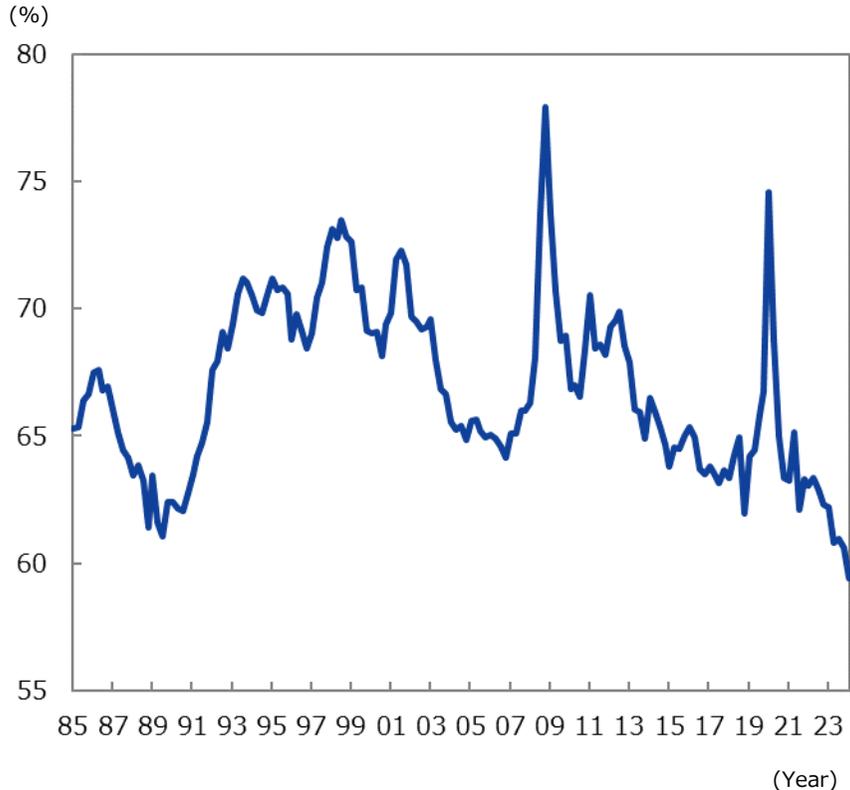
Conundrum of Japanese labor market

**Employment Sufficiency Index
"Surplus - Shortage"**



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

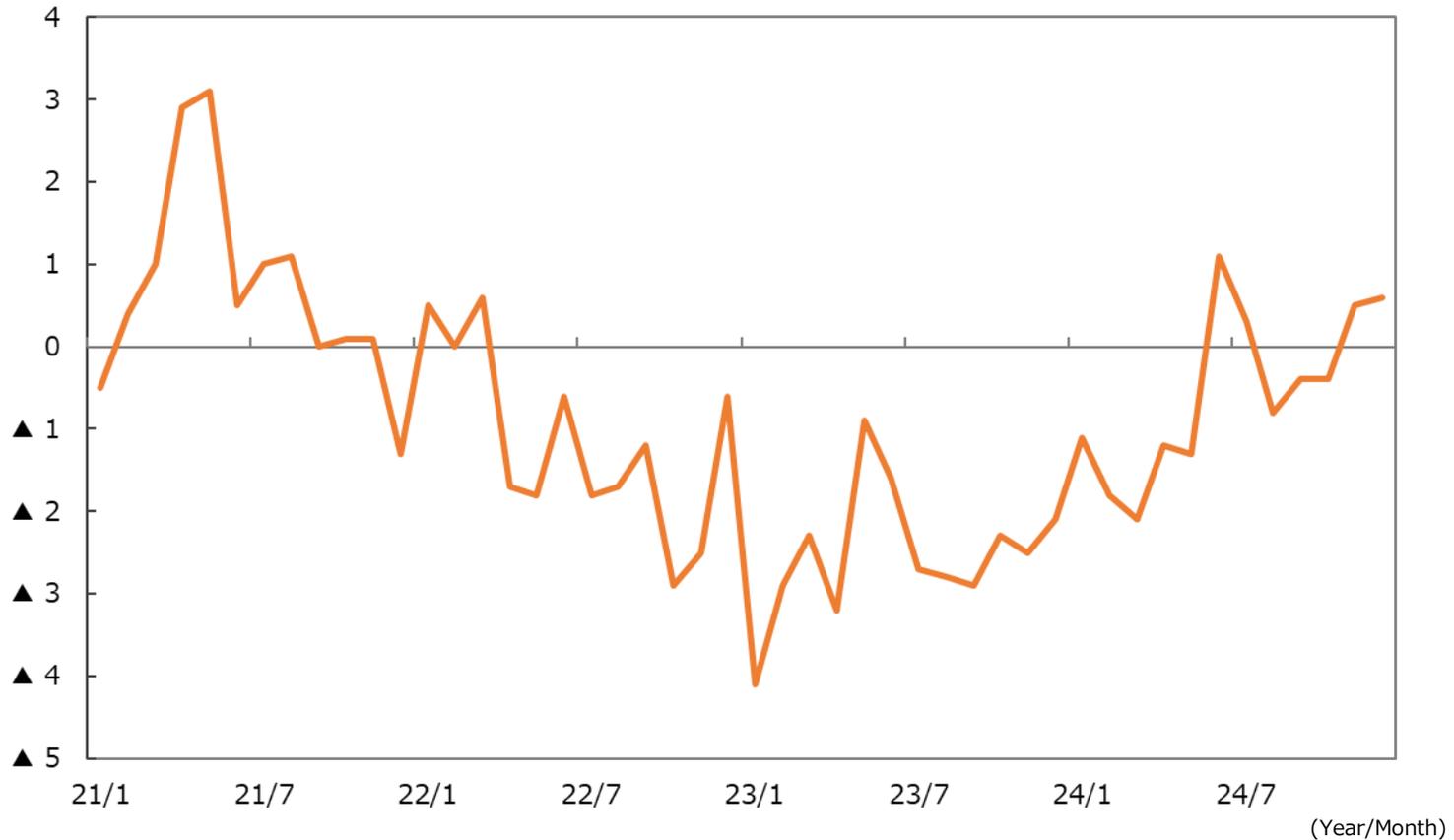
Labor Share of Added Value



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

Wage increase start beating inflation

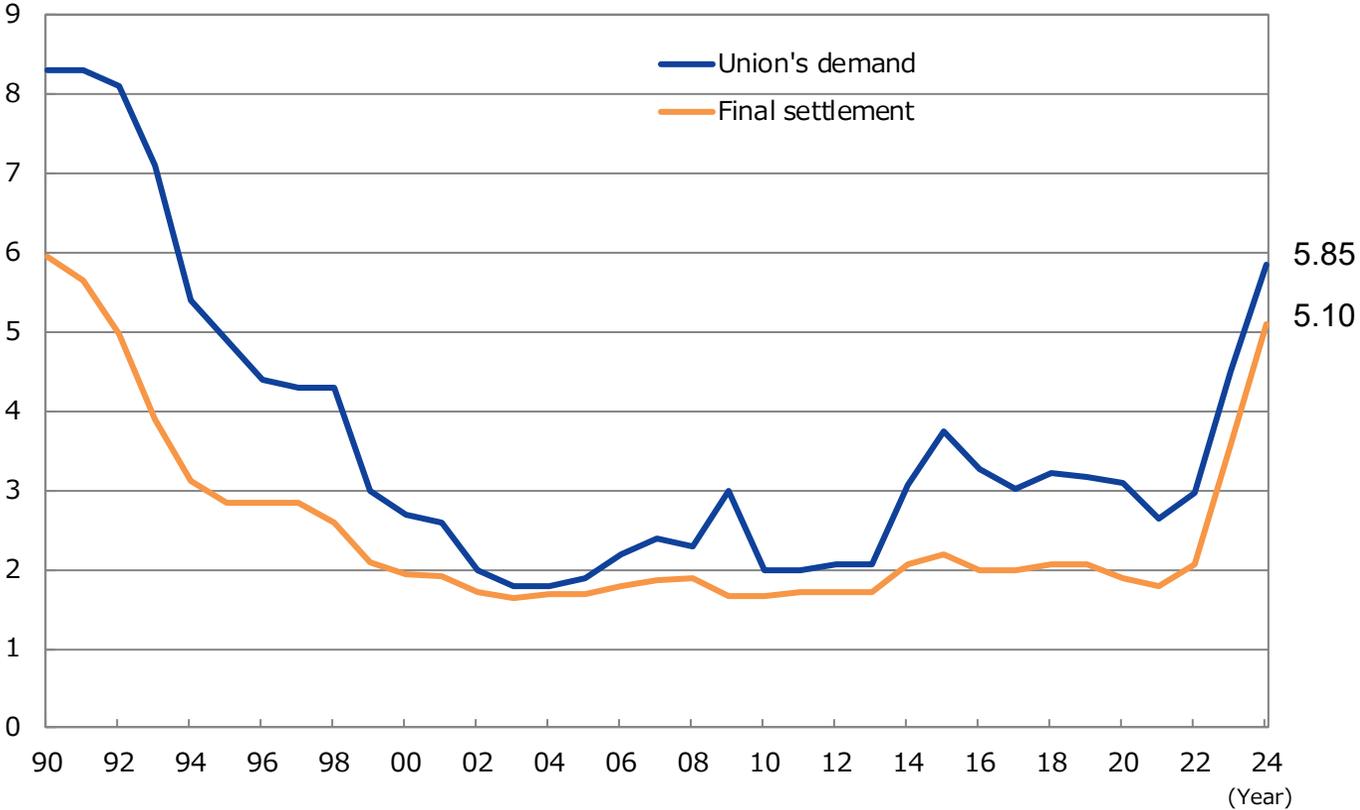
Real Cash Earnings (YOY, %)



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

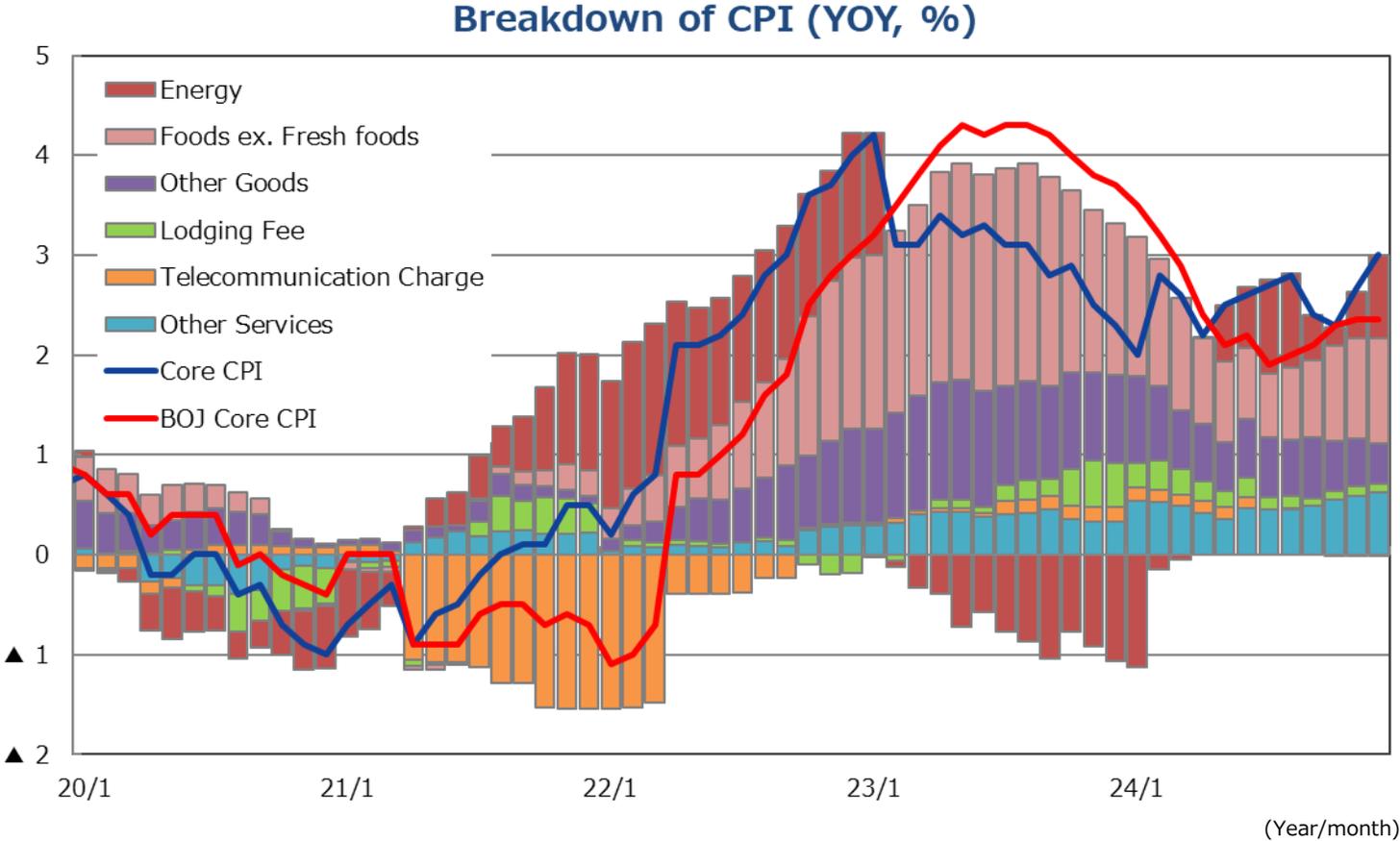
Highest wage increase in 33 years

Wage increase (YOY, %)



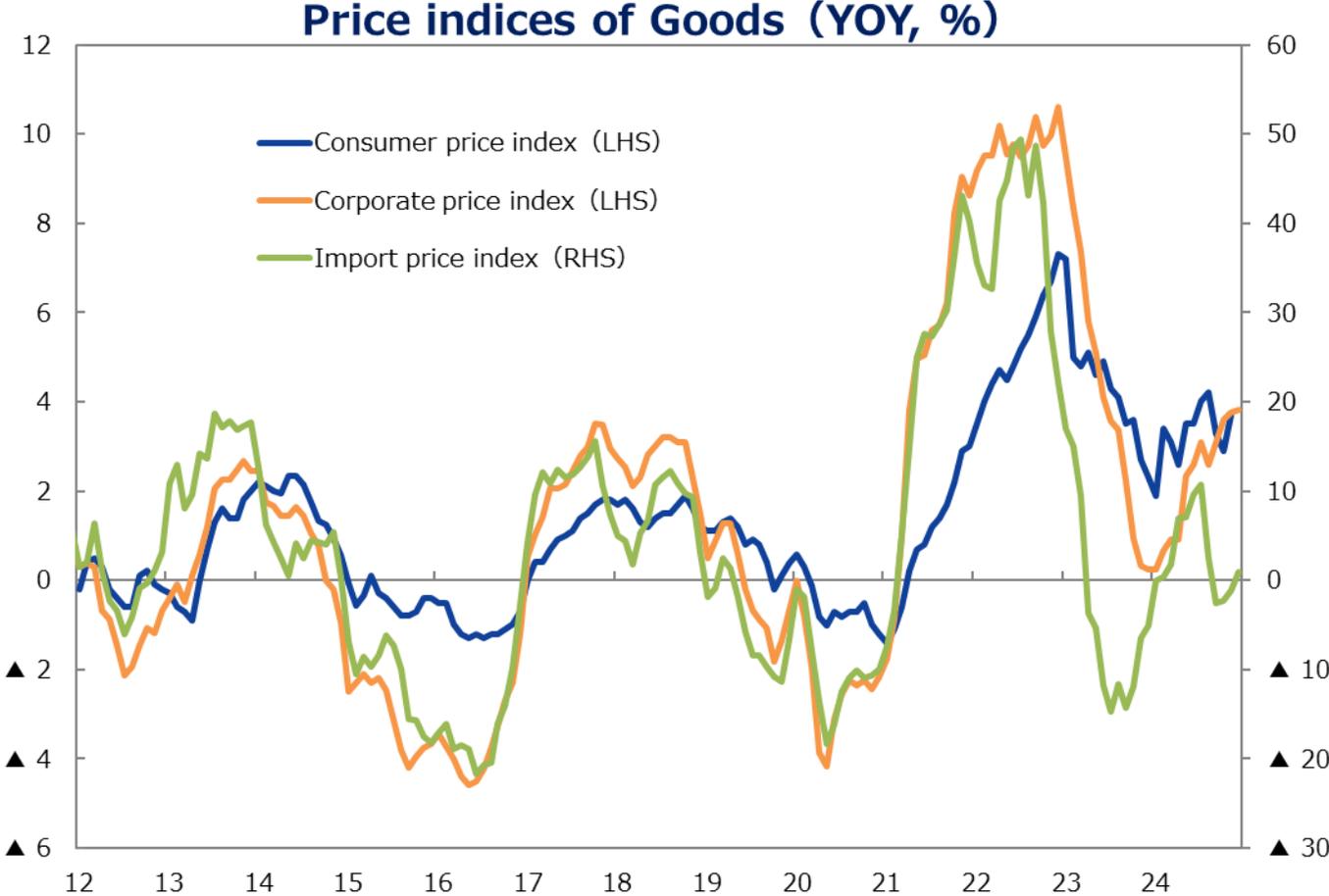
Note: Data is from FY 1990 to FY 2024.
Source: Japanese Trade Union Confederation, SMDAM

Energy and foods boost inflation



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

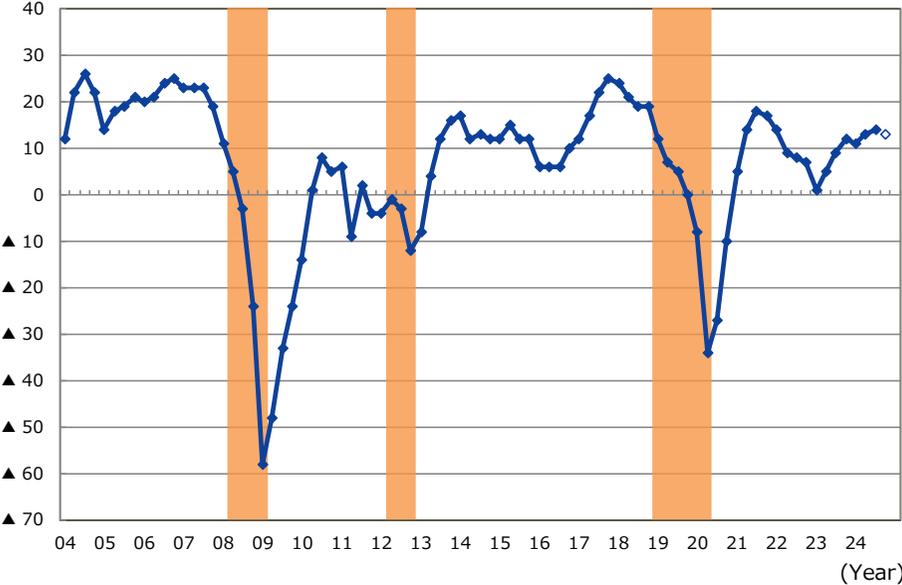
Corporate price rising despite weaker import prices



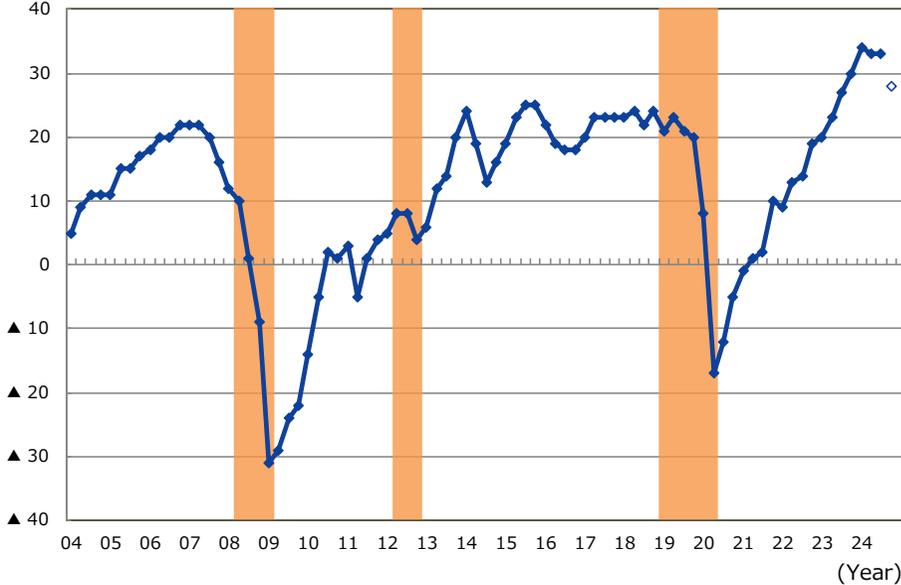
Note: Data is from January 2012 to December 2024.
Source: MIAC, Bloomberg, SMDAM

Improvement in business sentiment appears to have stalled

BOJ business condition DI Large manufacturers (%)



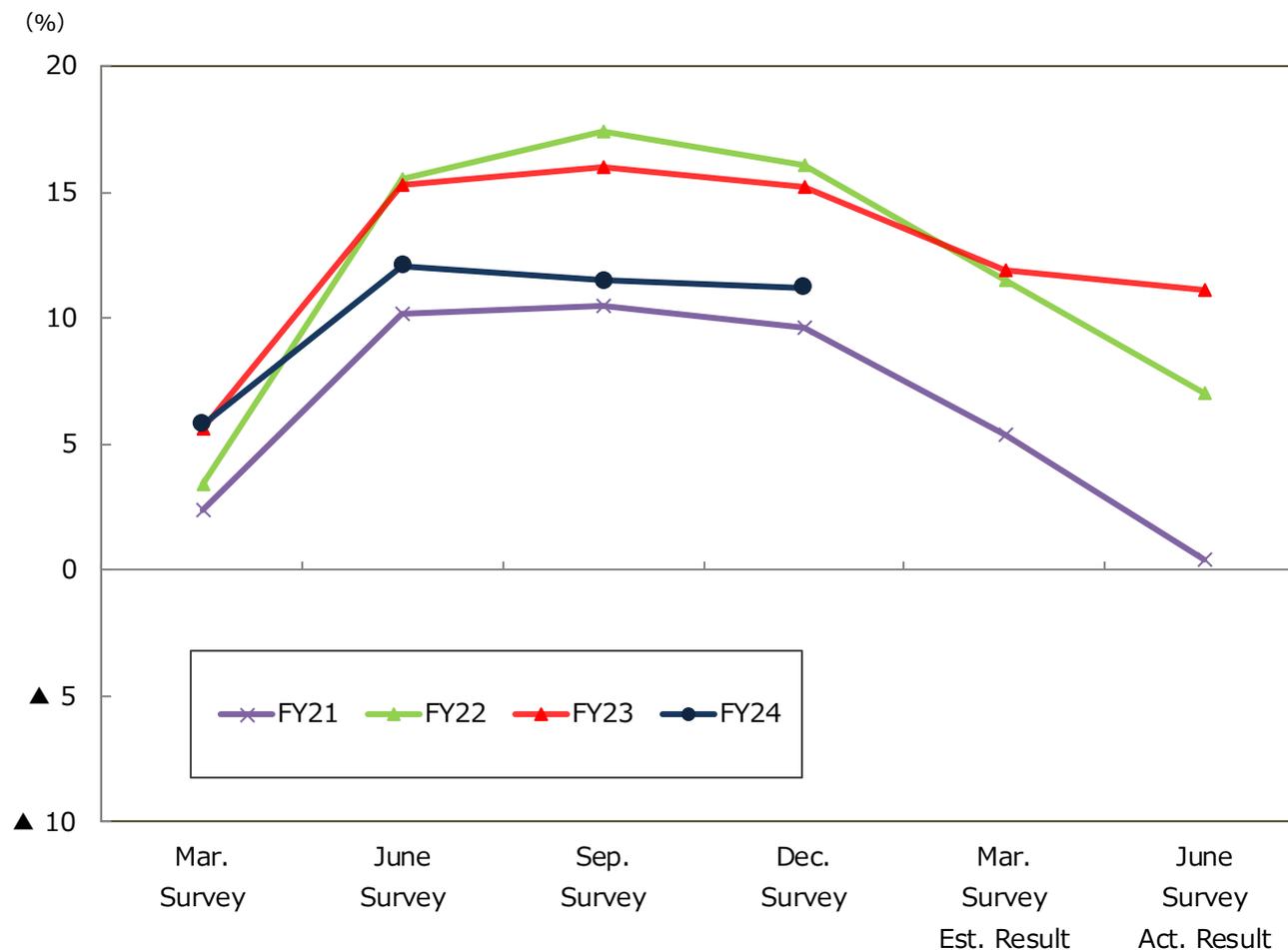
BOJ business condition DI Large non-manufacturers (%)



Note: Data is from Q1 2004 to Q4 2024. The orange shadow represents periods of economic recession.
 Source: The Bank of Japan, SMDAM

Appetite for CAPEX keeps momentum so far

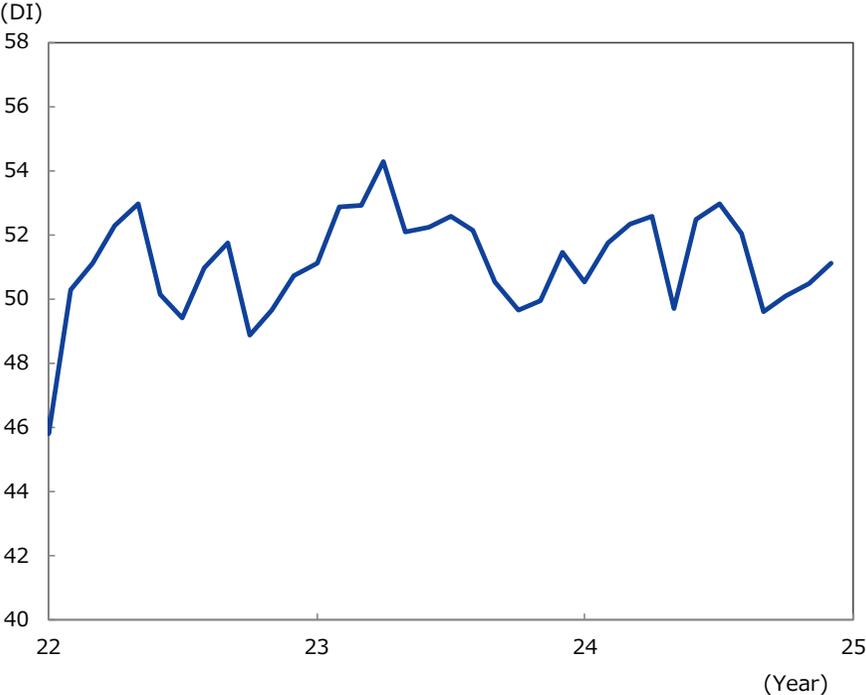
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



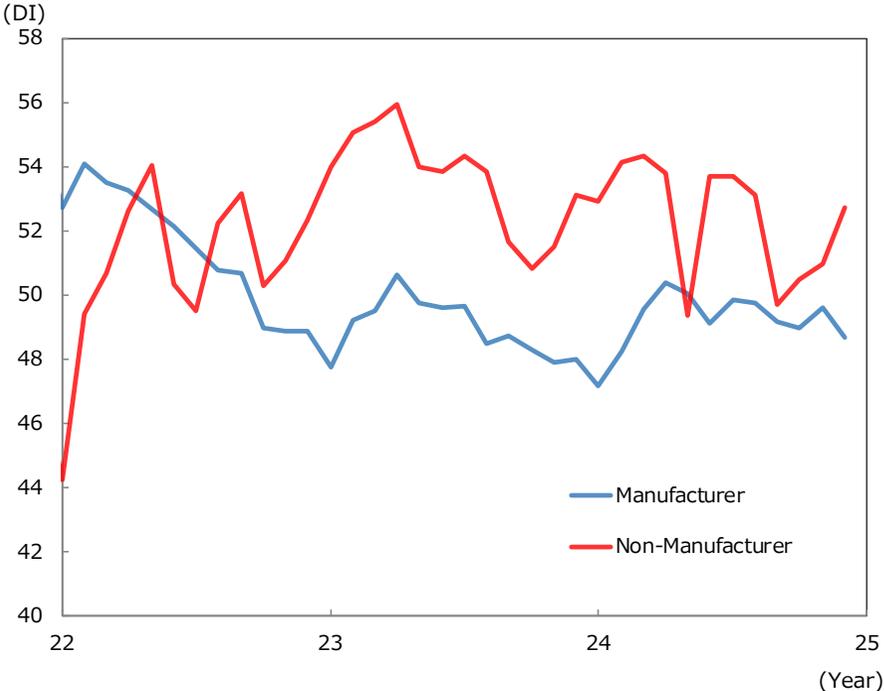
Note: Data is from Q1 FY2021 to Q4 FY2024.
Source: The Bank of Japan, SMDAM

Business sentiment diverges between manufacturers & services

Composite PMI



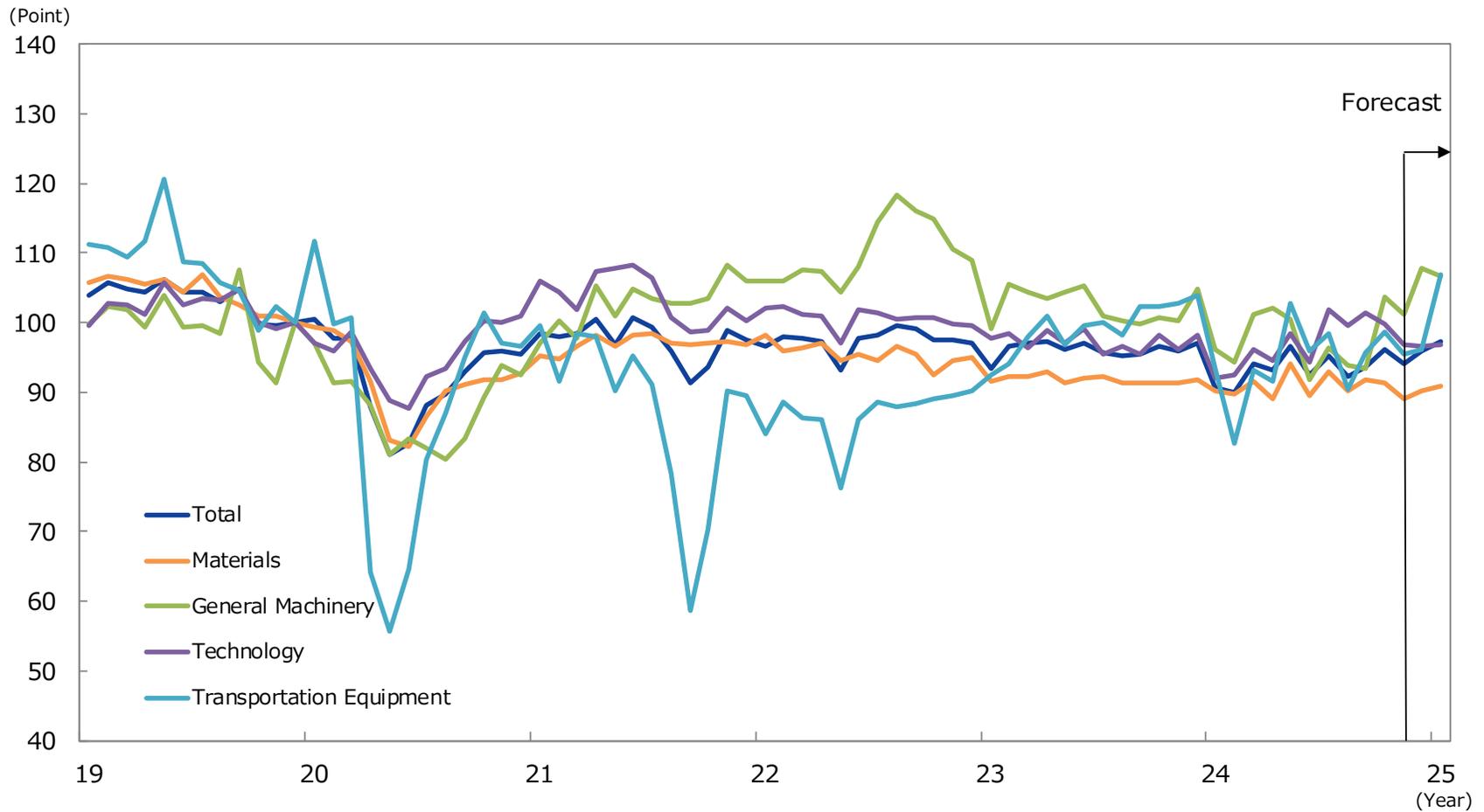
PMI, Manufacturer & Non-Manufacturer



Note: Data is from February 2022 to January 2025.
Source: Bloomberg, SMDAM

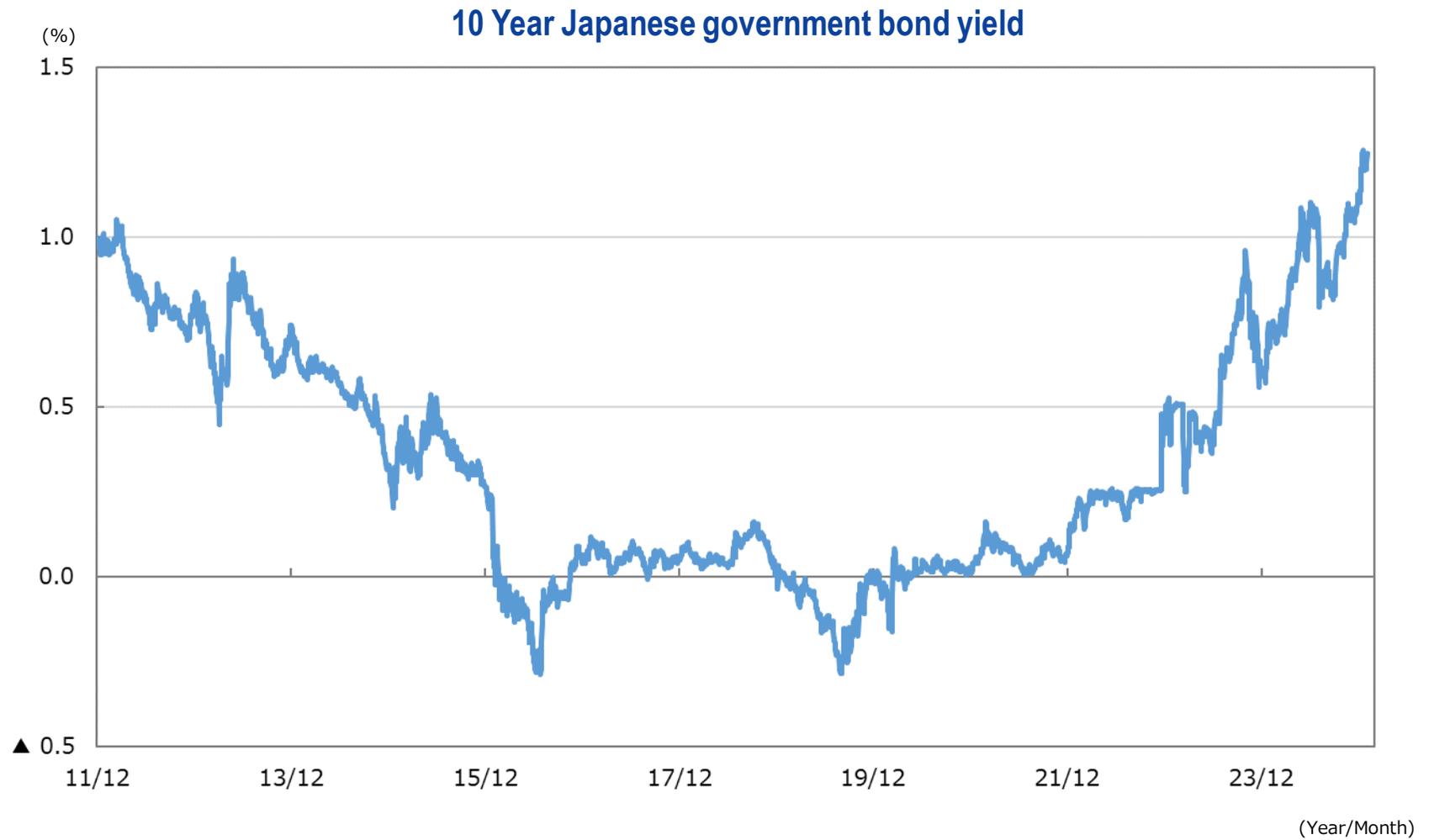
Autos to boost Industrial production in the near future

Industrial Production (Dec. 2019=100)



Note: Data is from January 2019 to January 2025. Data after November 2024 is forecasts.
Source: METI, SMDAM

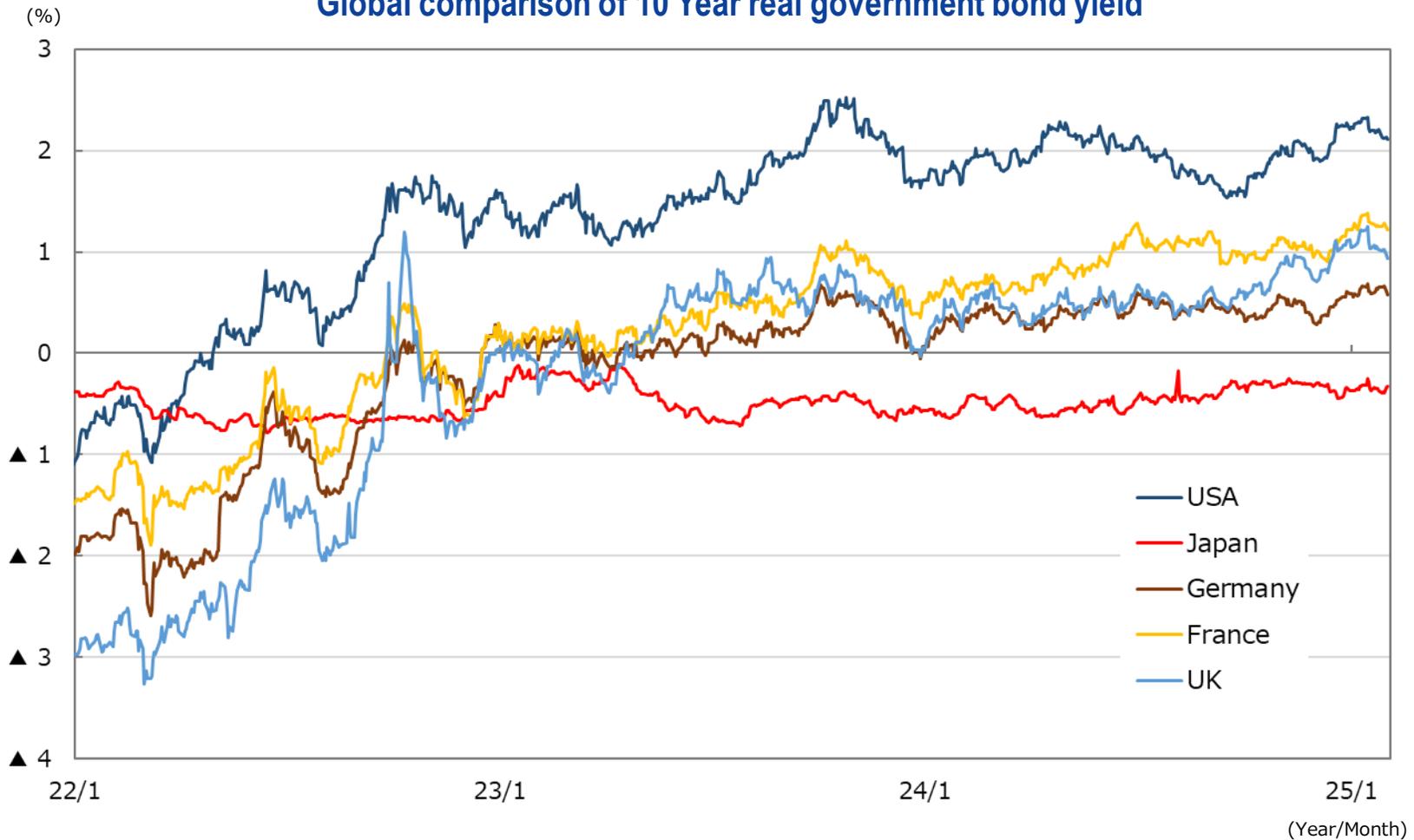
Growing expectation for further monetary tightening



Note: Data is from 31st December 2011 to 31st January 2025.
Source: Bloomberg

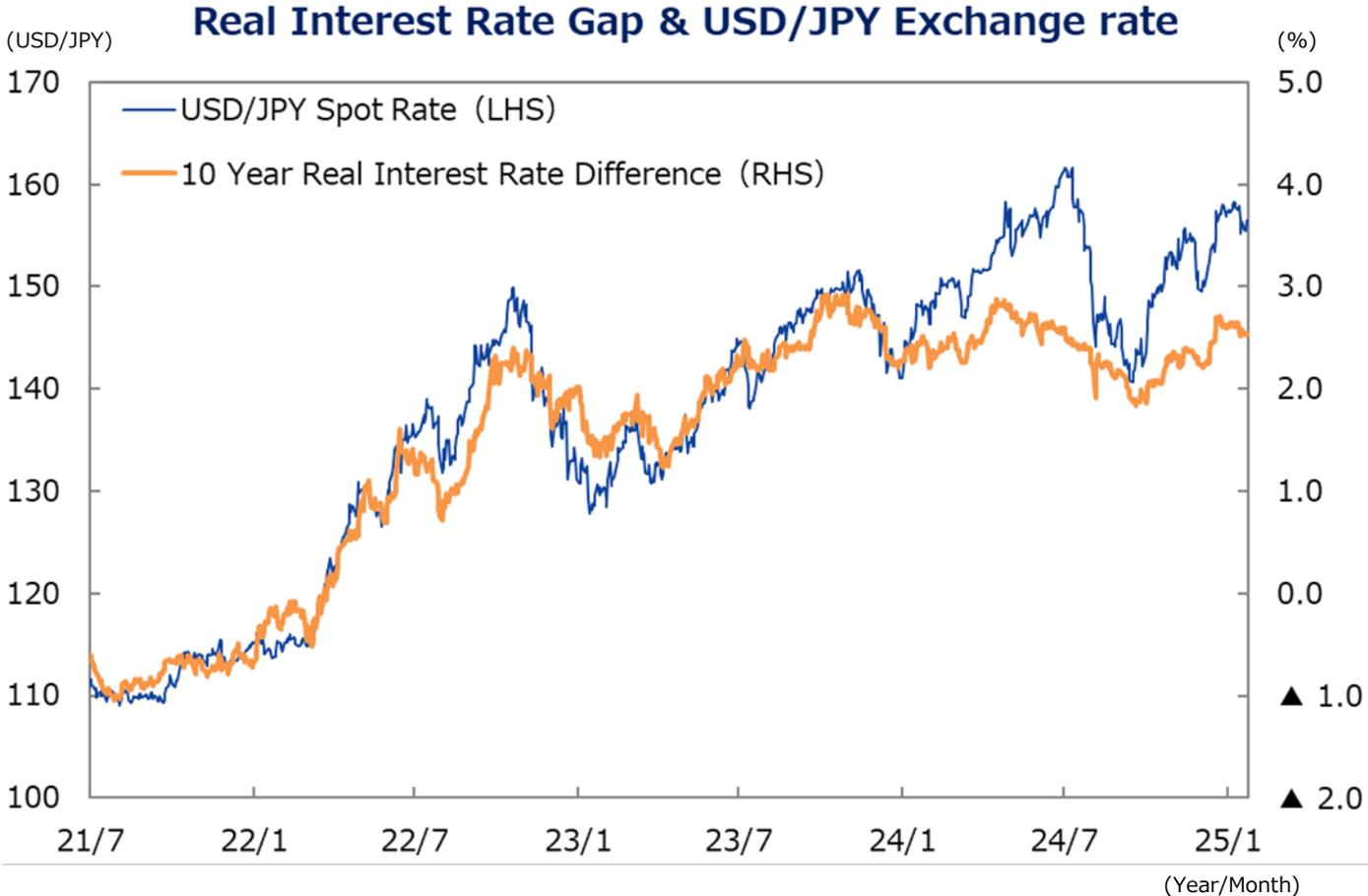
Why is Japan interest rate going to be raised further?

Global comparison of 10 Year real government bond yield



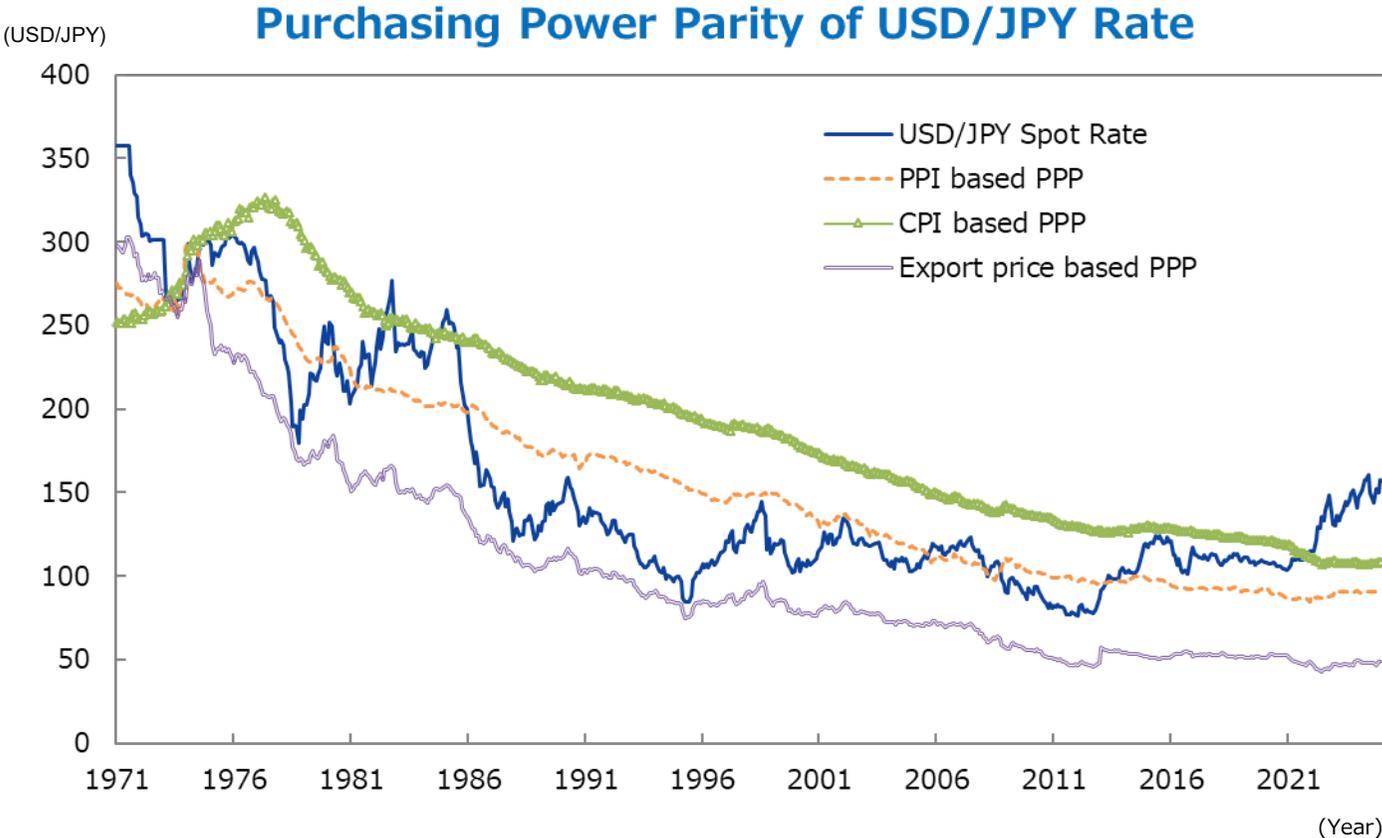
Note: Data is from 1st January 2011 to 31st January 2025.
Source: Bloomberg

Divergence between FOREX and interest rate gap again



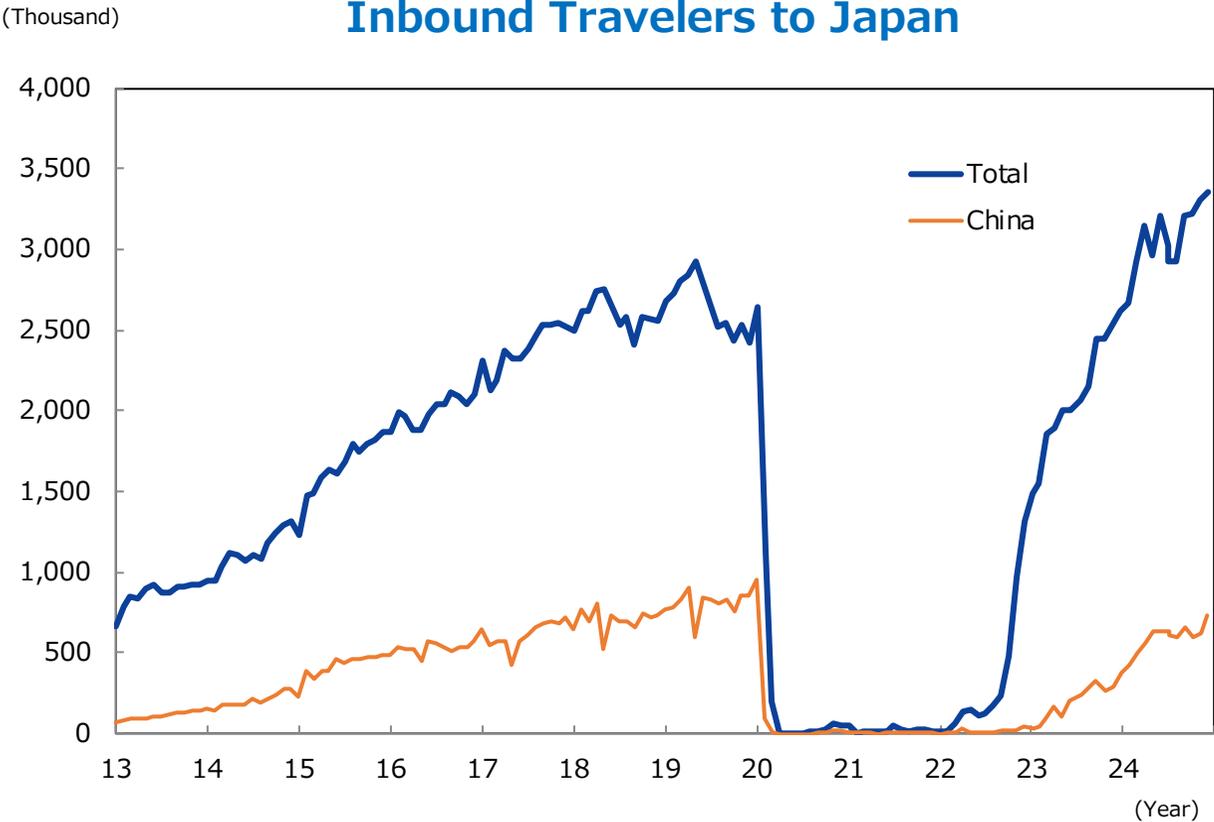
Note: Real interest rates are 10 year government bond yields. Data is from 1st July 2021 to 31st January 2025.
Source: Bloomberg, SMDAM

USD/JPY rate stays far above purchasing power parity



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

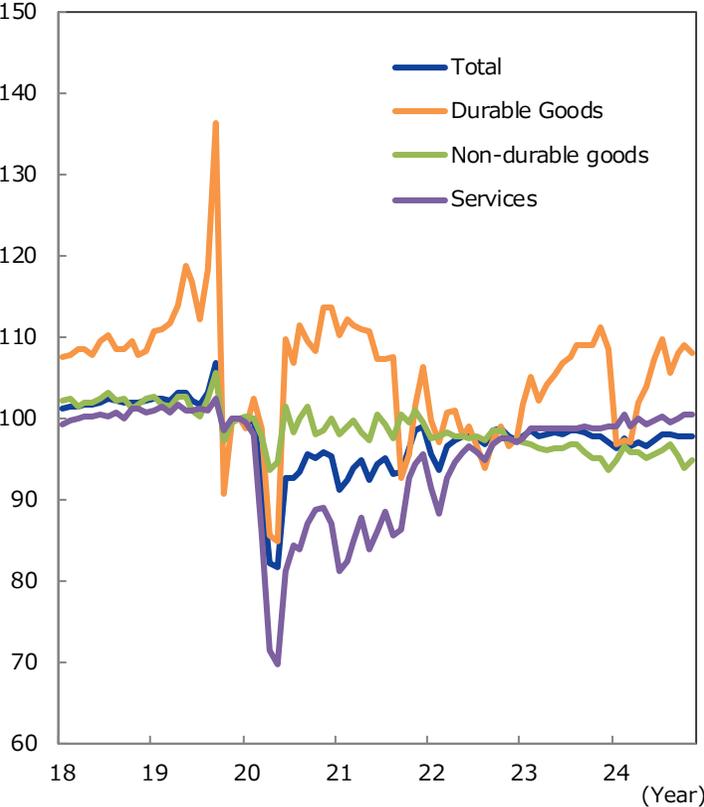
Inbound travel keeps strong momentum



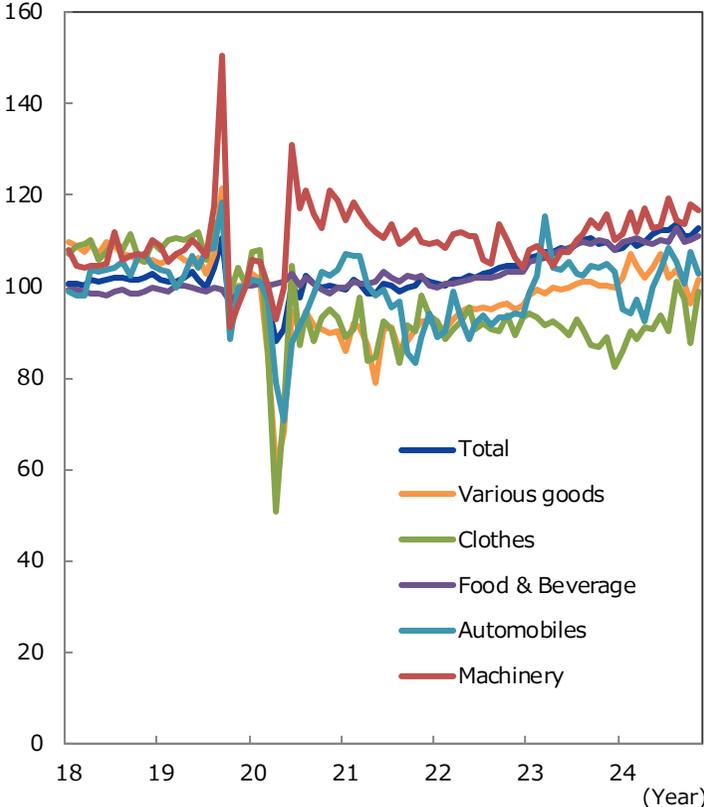
Note: Data is from January 2013 to December 2024. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumers are mixed with solid appetite for durables

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



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

PM Ishiba failed to boost popularity of the ruling party

Cabinet approval rate



Note: Data is from January 2013 to January 2025.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of major events

Year	Month	Date	Event
2025	February	17	Japan-U.S. Summit Meeting Release of 2024 Q4 GDP
		March	11
	14		Release of the results of spring negotiations of Trade Union Confederation
	18-19		Monetary Policy Meeting
	25		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	9	Revision of 2025 Q1 GDP
		16-17	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	22	Final results of spring negotiations of Trade Union Confederation
		28	Election of the Tokyo Metropolitan Assembly Member
Election of the House of Councillors			
August		Release of 2025 Q2 GDP	
September	18-19	Revision of 2025 Q2 GDP Monetary Policy Meeting	
	29-30	Monetary Policy Meeting	
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 2026 and the outline for tax reform	

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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