

Fundamental Active Group PM's Monthly Insights

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Market Outlook

We expect the TOPIX index to rise +13% to 1,950 on the assumption that the P/E ratio will bounce back to the midpoint of range (around 15 times) from 2000 onward and earnings per share (EPS) will grow at the pace of 6%.

We expect stock price rallies due to these three reasons below:

- 1) The government expanded its fiscal expenditures.
- 2) The Bank of Japan (BOJ) maintains monetary easing policies.
- 3) Corporate earnings will turn up with economic recovery.

Corporate earnings declined in 2019 amid a downturn in the domestic economy on the back of the consumption tax hike as well as the US-China trade dispute. However, the Japanese economy is likely to bounce back in 2020 after a large-scale supplementary budget was compiled not only for restoration work following natural disasters but also as measures for economic stimulus. We see some progress in US-China trade talks, while orders for electronic parts and semiconductor manufacturing equipment are picking up amid intense competition for the commercialisation of 5G mobile devices. Corporate earnings are most likely to increase if we can see the stability in the FX markets. Stronger shareholder returns including an increase in share buybacks should also boost EPS.

With regard to monetary policies, we expect accommodative policies to remain for a while without additional easing measures as the BOJ still firmly upholds its inflation target at 2%. We do not expect the BOJ to cut interest rates further as wider negative ranges tend to provoke the yen appreciation.

Prime Minister Shinzo Abe's issue with succession will come up for discussion in the 2H of 2020 before his term as leader of the Liberal Democratic Party (LDP) expires in autumn 2021. A media survey cited Ishiba, Kishida and Kono as candidates for the next prime minister. Ishiba's support rating is low among Diet members but high among LDP members. His contender, Kishida is well-known for his fiscal austerity attitude, but he may have to commit himself to aggressive fiscal policies including economic stimulus measures to gain support from LDP members and beat Ishiba in the election.

The Japanese stock market is likely to enter a correction phase on an interim basis in the first half of January due to growing tensions in the Middle East and buying pressure on the yen. Rising oil prices normally lead to the yen's weakness however the yen's value is rising this time. We believe worse-than-expected US economic indicators and the lower US Treasury 10-year yield have pushed the yen higher. If the yen's value remains high, investors will be disappointed at earnings results and sell their stocks. We expect Japanese stock prices to be volatile as they are affected by external factors until late January when the earnings announcement season for the October-December quarter gets underway. However, the market will overcome a correction phase in the short term given the existence of a string of favourable conditions for stock prices such as easing monetary policies and expansionary fiscal policies.

We can expect earnings recovery from the January-March quarter onward as the impact of the tax hike diminishes and the effects of the supplementary budget spread into the economy. Earnings will recover in 2020 if foreign exchange markets stabilise. Even poorly performing companies will run out of negative news, bringing stock price rebounds when the next earning season kicks off

Investment Strategy

Overweight sectors (Largest shown first):	Underweight sectors (Largest first):
Information technology	Industrials
Materials	Health care
Financials	Real estate

Sectors shown are TOPIX 17 industries

We overweight construction & materials as well as electronic component makers and semiconductor manufacturing equipment (SME) makers on expectations for an increase in 5G-related investments and mobile terminal production. On the other hand, we underweight foods and services.

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Mr Kamohara is the Lead Portfolio Manager of the Fundamental Active product. He started his career with Daiwa Securities in 1987 and transferred to Daiwa Institute of Research the following year to become a Japanese equity analyst. He was seconded to their Frankfurt office (between November 1992 and February 1995) and Hong Kong office (between February 1995 and March 1997) as an analyst for European and Asia equities respectively. He transferred to Daiwa International Capital Management, the former entity of Daiwa SB Investments, in 1998 to become a fund manager of international equities.

He became a Japanese equity portfolio manager in October 2000 and has managed the Fundamental Active product since its inception in October 2003.

Mr Kamohara graduated from Kyoto University with a BA degree in Educational Administration (1987).

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Mr Taniuchi supports Mr Kamohara in managing the Fundamental Active product. He started his career with Yamaichi Securities in 1996. He moved to Nikko Asset Management the following year as a trader of equities, convertible bonds and FX. He became a senior portfolio manager of Japanese equity specialising in Growth stocks. He joined Daiwa SB Investments in June 2008 to support Mr Kamohara in managing the Fundamental Active product.

Mr Taniuchi graduated from Tokyo University of Science with BS/Engineering in Industrial Administration (1996).

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