

# Fundamental Active Group PM's Monthly Insights

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## Market Outlook

We expect the Japanese stock market to lose ground in July. Domestic companies are likely to suffer sharp earnings declines in a serious economic downturn following social distancing measures. Although Japanese stock markets rose in late March on the back of monetary easing by the Bank of Japan (BOJ) and expectations for an expansion in fiscal expenditures by the government and continued to advance smoothly since then, this upward trend driven by massive liquidity infusion from the BOJ is likely to end at least temporarily in late July or early August. The reason behind this projection is that an increasing number of domestic companies would probably face major declines in operating income for the April-June quarter, with more companies falling into the red on an operating basis. Sell-side analysts are expected to release sharp downgrades of earnings forecasts for FY2020 at around the incoming earnings season that starts at the end of July. These downgrades should lead to a temporary correction in the stock markets.

Many countries have eased movement restrictions and resumed economic activity. Japan's industrial production is expected to rise in June as a result of economic stimulus packages by the government while domestic operating income are expected to hit bottom in the April-June quarter. On the other hand, as net profits shrunk sharply in the January-March quarter as many companies booked huge amounts of extraordinary expenses such as impairment losses and tapped into deferred tax assets, some of them may see a net earnings recovery from the previous quarter despite declines in operating income. We expect domestic stock prices to bounce back in the wake of the earnings season on expectations for an earnings recovery in FY2021. With massive monetary easing by the BOJ and strong fiscal policies by the government, we expect the Nikkei225 to go beyond the peak in 2018 (JPY24,448) by the end of this year.

Retailers that have their fiscal year end in February, have started to announce their earnings for the March-May quarter. Supermarkets and drugstores which earn mainly from foods and toiletries have been performing well, others including clothing shops and department stores are operating in the red on an operating basis. Convenience stores also suffered a decline in sales following social distancing measures. Sales results of consumer goods are different according to categories. While sales of cosmetics, apparel and beverages dropped sharply following the coronavirus outbreak, white goods including air-conditioners and home furniture have been selling well behind the expansion of teleworking.

With regards to companies with their fiscal year end in March, such as the oil industry, some financial institutions and the **SoftBank Group** that booked large amounts of valuation losses and loss provisions in the January-March quarter should see sharp earnings recoveries in the April-June quarter thanks to price rebounds in their assets. When we look at domestic economic activities, auto-makers gradually started to increase production and other industries also resumed production after the nationwide state of emergency was lifted on 25 May. Operating income of listed companies should turn up and surge in the July-September quarter against this backdrop. Steady steepening of the yield curve in the Japanese Government Bond (JGB) market also implies an economic recovery. Therefore, even if stock prices peak out during the earnings season, the market correction period is unlikely to last long. We expect the stock market to rise again soon on expectations for earnings recovery.

## Investment Strategy

Overweight sectors (Largest shown first):	Underweight sectors (Largest first):
Information technology	Consumer Staples
Materials	Industrials
Financials	Real Estate

Sectors shown are TOPIX 17 industries

Despite advances in domestic electronic components/ semiconductor stocks following US tech stock rallies, we will reduce the overweight range of the IT sector while remaining overweight in the sector, as US sanctions on the Chinese telecoms group Huawei are likely to hit their earnings of related Japanese companies. On the other hand, we will increase the weight of financial stocks including insurers given the rising long-term interest rates in Japan. We will also increase the weight of consumer discretionary including auto stocks on the back of a recovery of auto production.

## Masashi KAMOHARA, CMA

### Senior Portfolio Manager and Group Leader, Fundamental Active Group, Equity Management Department

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).

## Hideyuki TANIUCHI, CFA/CMA

### Senior Portfolio Manager

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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