July 2020

Value + Alpha Group

PM's Monthly Perspectives

Author

Takuya KAMIISHI, CMA
Portfolio Manager

In July, the MSCI Japan decreased due to a spike in coronavirus cases, the JPY appreciation against the USD and the long rainy season with heavy rainfalls. A steady increase in new cases throughout the month fuelled concerns over a resurgence of Covid-19 despite almost no increases in death tolls. The yen appreciation against the dollar due to downward pressures on yields on US bonds also dragged down domestic stock prices. In addition, the prolonged rainy season raised concerns over the near-term consumption. In Tokyo, too, there was only one day during the month that saw no rain at all, with sunshine hours about 70% fewer than normal years. On the other hand, a series of news reports on potential Covid-19 vaccines as well as arguments for upswings in stock prices by the Chinese government-backed media, **Securities Times** shored up domestic stock prices. There were no surprise movements in either domestic economic indicators, corporate earnings or monetary policies.

Earnings: The earnings season for the April-June quarter kicked in.
The earnings season for the April-June quarter got under way. As of 27 April, 18 out of 176 major listed companies (excluding financial firms) announced their earnings results. According to Daiwa Securities, recurring profits decreased by -36% YoY. It seems stock markets responded obediently to the results by welcoming strong earnings of companies that benefited from the coronavirus pandemic. Some companies could reduce more-than-expected costs after travel and entertainment expenses declined sharply, and they are enjoying their stock price rallies. I will show you some typical cases below.

Positives
ZOZO: The fashion ecommerce company beat the consensus estimates of sales and earnings per share (EPS). The company's gross merchandise value (GMV) grew by approximately +20% thanks to a shift to online shopping among consumers amid a decline in demand for clothing due to the coronavirus outbreak.
Ajinomoto: The food maker beat the consensus estimate of EPS while its sales were in line with the consensus estimate. Its gross profit margin improved as it could reduce a discount range thanks to growing demand for its products such as seasonings and frozen foods following the coronavirus outbreak. Its restraint on marketing activity also led to a reduction of selling, general and administrative expenses.

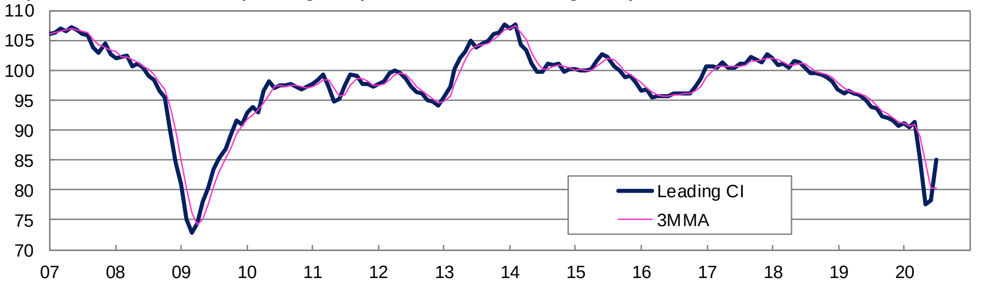
Negatives
Nissan Motor: The auto maker missed the consensus estimate of sales and EPS. The company is expecting difficulties for the current fiscal year given a drop in its factory utilisation ratios. Free cash flow of the automotive unit is unlikely to turn positive within the FY2020. Its financial unit is also facing difficulties such as interest rate increases following a series of ratings cuts by credit rating agencies and a decline in used car prices.
Canon: The precision instrument maker missed the consensus estimate of sales and EPS. Usage of photocopy machines in offices decreased and demand for cameras decelerated as well after the coronavirus outbreak. The company announced a dividend cut for the first time in 33 years due to its poor earnings, which also disappointed investors.

A lot of companies said that their earnings should turn up from now on after bottoming-out in the April-June quarter, which is in line with our view. Their earnings results for the latest quarter as well as their guidance have also been in line with our expectations. So, we keep our view unchanged. We believe that earnings recoveries will boost stock prices.

Economy: Leading indicators are turning up.

Japan's flash leading index, the composite index of eleven leading indicators (CI) for June rose to 85.0 from 78.3 for the previous month. The index climbed for two straight months, which shows the domestic economy bottomed-out back in April.

Japan Business Conditions (Leading Composite Index, 2015 average=100)



Source: Bloomberg, data correct as of 7 August 2020.

Nine leading indicators are incorporated in the flash CI and all of them improved in June. In particular, the consumer confidence index, the index of inventory rates of final demand goods and the M2 contributed a lot to the upturn. This means an improvement in consumer sentiment, a decrease in inventories and loose monetary policies led to a bullish view of the economic outlook. The index of inventory rates of final demand goods was rising until May. If these inventories continue to decline, industry production should also turn up down the road.

Japan Consumer Confidence Index (SA)

Source: Bloomberg, data correct as of 7 August 2020.

Index of Producer's Inventory Ratio of Finished Goods (Final Demand Goods, 2015 average = 100, SA, Inverted)

Source: Bloomberg, data correct as of 7 August 2020.
Note: The more the index declines, the better the economic outlook becomes.

Investment Strategy

We expect that the Japanese equity market will advance with the economic recovery and ongoing accommodative monetary policies. Over the long term, more open policies to overseas funds including the improvement in corporate governance as well as policies to boost the immigration intake are also likely to support the market. We identify external factors, such as the outbreak of financial crises and another global recession, as major risks because they might bring about a sharp yen appreciation. Taking these into consideration, we will overweight consumer discretionary sector and stocks with low price/book (P/B) ratios.

Takuya KAMIISHI, CMA
Portfolio Manager, Value + Alpha Group

Mr KAMIISHI joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr KAMIISHI obtained a BA degree in Economics from Keio University (2009) in Japan.

Note:
Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

Disclaimers

Issued by Sumitomo Mitsui DS Asset Management (UK) Limited. Registered in England and Wales

Registered office 5 King William Street, London, EC4N 7JA; registered number 1660184. Authorised and regulated by the Financial Conduct Authority.

Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.

The data contained in this document is for information purposes only. It is correct to the best of our knowledge at the date of issue and may be subject to change. The client legal agreement will take precedence over this document. This document is not legally binding and no party shall have any right of action against Sumitomo Mitsui DS Asset Management (UK) Limited, in relation to the accuracy or completeness of the information contained in it or any other written or oral information made available in connection with it. Nothing in this document or any related presentation shall be deemed to constitute investment advice, nor shall we be deemed to be an investment advisor unless formally appointed as such, or as discretionary investment manager, by way of written agreement.
The information contained in this presentation is to be used by the professional client that this document is issued to only.

Contact Details

Business Development and Client Relations	
Takahiro UENO	+44 (0)20 7507 6431
Jennifer SANDS	+44 (0)20 7507 6424
Email: uksales@smd-am.co.jp	

Sumitomo Mitsui DS Asset Management (UK) Limited
5 King William Street, London, EC4N 7DA
United Kingdom
www.smd-am.co.uk