

PM's Monthly Perspectives

Author



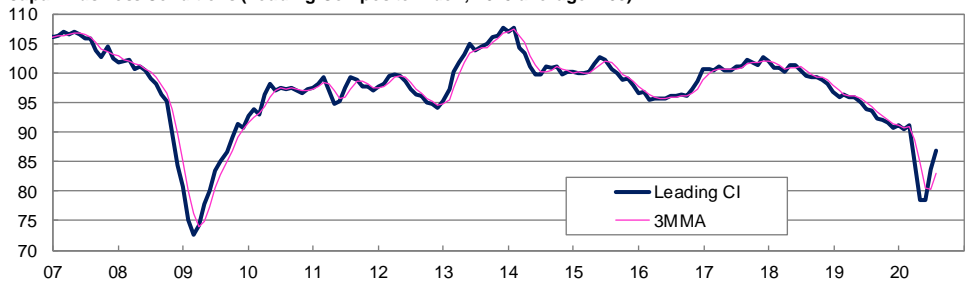
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In August, the MSCI Japan increased due to easing of concerns over the new coronavirus, positive US economic indicators and a shift in the Fed's monetary policy framework. We also saw a progress in vaccine development. The number of new coronavirus cases kept rising until July but shifted to a downturn in August. Investors welcomed better-than-expected economic indicators in the US such as ISM manufacturing/non-manufacturing indices. In addition, investors' risk tolerance was lifted when the Fed adopted a new strategy for monetary policy that will be tolerant of inflation over 2%, while putting more emphasis on employment than before. On the other hand, the resignation of Shinzo Abe, Japan's longest-serving prime minister, due to ill health weighed on domestic stock markets in late August. The news that all the shareholding ratios of Warren Buffet in five major Japanese general trading companies exceeded 5%, drew attention among market participants at the end of the month.

Economy: Japan's leading indicators show continuing improvements

Japan's flash leading index, the composite index of eleven leading indicators (CI) for July rose to 86.9 from 84.4 for the previous month. This means the domestic economy is on the road to recovery after bottoming out in April/May.

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



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

Nine leading indicators are incorporated in the flash CI and 6 of 9 improved in July. In particular, the index of inventory rates of final demand goods and the sales forecast diffusion index of small businesses contributed a lot to the upturn. This means a decrease in inventories and an improvement in small company's sales forecast led to a bullish view of the economic outlook. If these inventories continue to decline, industry production should also turn up down the road.

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



Source: Bloomberg, data correct as of 7 September 2020,

Note: The more the index declines, the better the economic outlook becomes.

Sales Forecast DI of Small Businesses (SA)



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

Another important leading indicator, the Economy Watchers Survey (average of current and future) also rose from 38.6 in July to 43.2 in August, after it slightly declined in July on fears about the coronavirus pandemic and the long rainy season. According to its comments, a recovery in auto production and fiscal expenditures including the 'Go To' Travel campaign (subsidies for domestic tourism) seem to have contributed to the economic recovery.

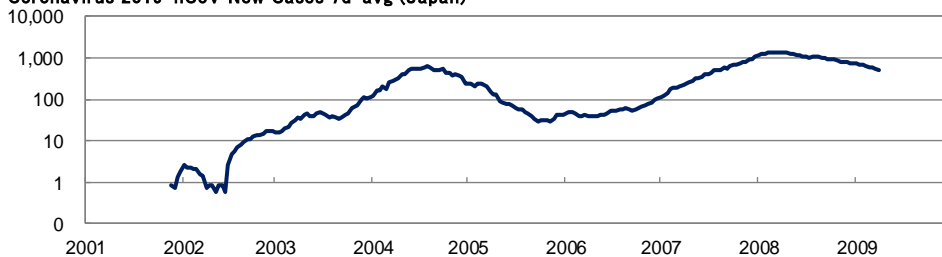
Japan Economy Watchers Survey (Average of Current and Future)



Source: Bloomberg, data correct as of 8 September 2020.

The number of new coronavirus cases started to decline in early August, which is likely to drive up the economic outlook.

Coronavirus 2019-nCoV New Cases 7d-avg (Japan)



Policy: Business-friendly environments should continue despite resignation of Prime Minister Abe

Shinzo Abe expressed his intention to step down on 28 August, saying that he could not risk making errors of political judgment in a weakened physical condition due to a relapse of ulcerative colitis in early August. The cabinet will resign en masse as soon as the ruling Liberal Democratic party (LDP) chooses his successor.

We believe that Mr. Abe's resignation will have only a limited impact on economic fundamentals because of three reasons below. 1) Whoever succeeds his position is likely to adopt similar business-friendly policies given the characteristics of the LDP. 2) The Bank of Japan (BoJ) governor, Haruhiko Kuroda is likely to maintain measures to prop up stock prices such as accommodative monetary policies and ETF purchases until his term expires in April 2023. 3) Given an economic downturn due

to the coronavirus pandemic, it is difficult for any successor to change Mr. Abe's course and scrap economic stimulus packages through fiscal expenditures. Expansive fiscal policies should continue for a while no matter who assumes the post of next Prime Minister.

The LDP presidential election to decide the next Prime Minister will be held in the middle of September. With regard to ensuing political events, we have significant interest in when the election of the House of Representatives will be held. While the current term of House of Representatives members ends in October 2021, its election is often held ahead of the termination of its term in the form of snap general elections. The approval rating tends to increase right after the cabinet's inauguration: a so-called honeymoon period. So, the new Prime Minister is likely to step into a snap general election early in their term, namely the October-December quarter this year. When the election date is made clear, major concerns among market participants will move to policy content and the election result.

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.

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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:

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