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Value + Alpha Group

PM's Monthly Perspectives

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In March, the MSCI Japan advanced due to hopes for an acceleration in the global economic recovery, a progress in the US's vaccination effort and JPY depreciation. The market welcomed a US stimulus plan worth USD1.9 trillion and the US ISM Manufacturing PMI beat the estimate. It also uplifted investor sentiment that the FDA granted **Johnson & Johnson** an authorisation to deliver its vaccine doses for use, meanwhile Joe Biden raised the target for the pace of US vaccinations. In addition, JPY depreciation against the USD propped up domestic stock prices. The Bank of Japan (BOJ) governor's comments such as "there is no need to expand the range of fluctuations in long-term interest rates" and "The bank has no intention to either raise the yield of ultra-long-term government bonds or steepen the yield curve" pushed down domestic bond yields and the value of JPY in turn. By the way, the BOJ decided to abandon its JPY6 trillion annual target for ETF (exchange traded fund) purchases during the month while retaining its operation to step in by buying ETFs worth approximately JPY 50.1 billion whenever the TOPIX index has lost -1% in the morning session, with a limited impact on the index for the whole month.

Monetary Policy: Negative view on BOJ's policy change despite no surprise in the market

The BOJ announced a policy change on 19 March. However, the bank generally maintains the current accommodative monetary policies with no surprise in the market. Main changes are described below.

The bank slightly expanded a fluctuation in 10-year bond yields from plus or minus 0.2% to 0.25%. Mr. Kuroda said that it just tried to make clear the trading band of long-term interest rates with no intention to expand it. The bank introduced the continuous limited price operations to maintain the target fluctuation.

The bank removed its JPY 6 trillion annual target for equity ETF purchases while retaining an annual cap of JPY12 trillion. In addition, it now buys ETFs tracking the TOPIX only.

The bank suggested a possibility to dig into further negative interest rates while introducing the interest scheme to promote lending which is similar to the targeted longer-term refinancing operations (TLTROs) by ECB which tries to reduce negative interest burdens on banks. More specifically speaking, an interest rate of 0.2% per annum shall be applied to the amount outstanding of borrowings under the "Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19) " while an interest rate of 0.1% per annum shall be applied to the amount excluding the case above under the same operations and an interest rate of 0 percent per annum shall be applied for Fund-Provisioning Measures to Support Strengthening the Foundations for Economic Growth and Funds-Supplying Operations to Support Financial Institutions in Disaster Areas. When negative interest rates go further, the bank shall increase deposit interest rates on banks' current account balances.

The bank changed rules on the calculation of the macro add-on balance to reduce banks' interest burdens.

We think the latest BOJ policy changes, in particular, the decision to virtually reduce equity ETF purchases will work negatively for domestic stock markets. The bank has bought ETFs worth JPY6 trillion per annum so far but now we can never know its pace of buying. It is said that the BOJ bought ETFs worth JPY270 billion in March. The pace which is equivalent to JPY3.2 trillion per annum suggests a cutback on the program. The BOJ bought ETFs worth JPY50.1 billion when the TOPIX declined -1% or more in the morning session in March and those worth JPY70.1 billion when the index declined -2% or more, but if the BOJ changes ETF purchase rules in the future, the action might be seen as a tapering or an indication of high valuations of Japanese equities.

The BOJ mentioned in the appendix that the lower the level of the TOPIX index is compared with its 100-day moving average, the higher the stock market volatility is, the bigger the stock price decline rate before the ETF purchase by the bank is and the bigger the scale of the ETF purchase is, the bigger the effect of ETF purchases becomes. Therefore, we assume the BOJ should increase ETF purchases when the stock market collapses while we cannot expect a large-scale action by the bank in normal times.

Policy change by BOJ and our view of its impact on equities

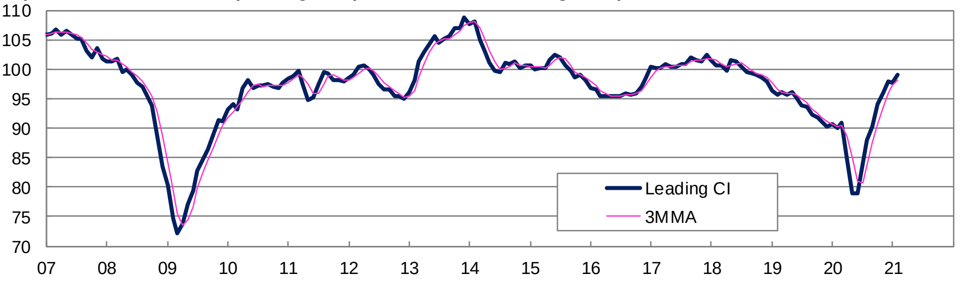
Item	Previous policy	Current policy	Impact on equities prediction
Forward guidance for interest rates	As long as it is necessary for maintaining that target (2%) in a stable manner.	No change	Neutral
Long-term interest rate	・Around 0% ・move about ±**0.2%**	・Around 0% ・move about ±**0.25%**	Neutral
Short-term policy interest rate	-0.1%	-0.1%	Neutral
ETFs purchases	・Annual pace: **6 trillion yen** ・Upper limit: 12 trillion yen ・Type: TOPIX, Nikkei 225, JPX400	・Annual pace: **No target** ・Upper limit: 12 trillion yen ・Type: TOPIX	Negative
J-REITs purchases	・Annual pace: 90 billion yen ・Upper limit: 180 billion yen	・Annual pace: No target ・Upper limit: 180 billion yen	Neutral

Source: BOJ, as of 19 March 2021.

Economy: Upturns in domestic leading indicators

Leading composite indices for February rose thanks to increased consumer confidence and rising commodity prices. They were released by the Cabinet Office on 7 April. Our economists' view that the indices for March will move up further should provide a boost to the domestic economy in the short-term.

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



Source: Bloomberg, data correct as of 7 April 2021.

On the other hand, Japan lags behind the US and Europe in vaccination programs even as the number of new coronavirus cases is increasing, which should drag down the economic outlooks.

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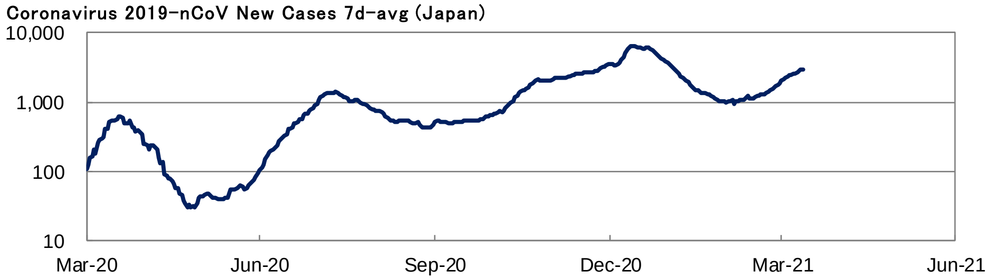
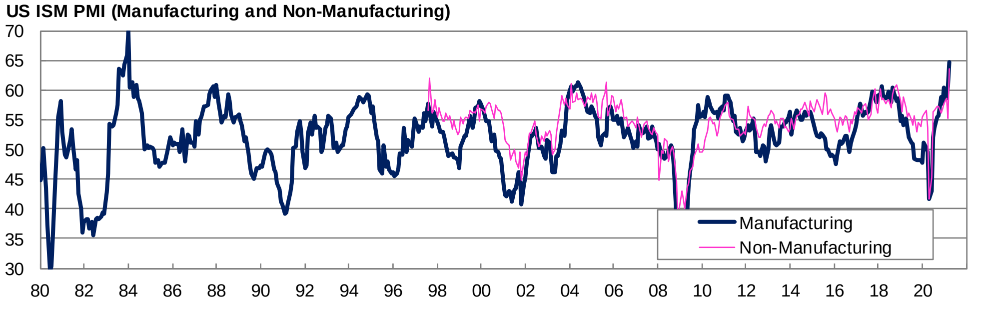


Source: Bloomberg, data correct as of 11 April 2021.

We should also keep an eye on the movement of US ISM manufacturing and non-manufacturing PMIs given the index lately hit a historical high. Global stock markets are likely to decline it they price in the index's slide.



Source: Bloomberg, data correct as of 5 April 2021.

Investment Strategy

We expect that the Japanese equity market to remain range-bound due to a tug-of-war between accommodative monetary policies and a sense of overvaluation, especially in the US equity market. 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 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 the 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:
Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

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