



Outlook for the Japanese Economy and Stock Market

June 2021

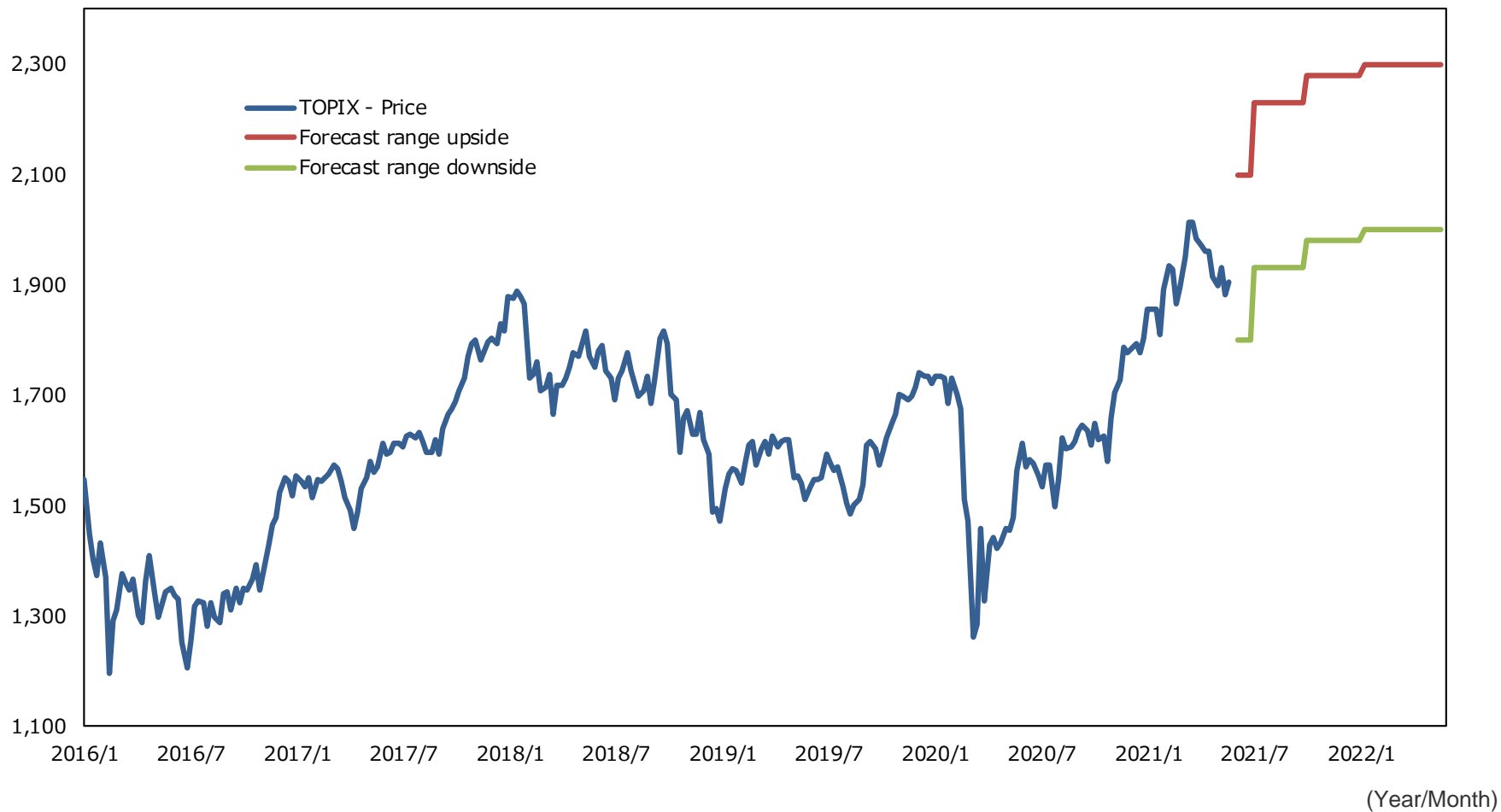
Outlook for the Japanese Stock Market

Market Outlook

- We believe recent market corrections offer attractive investment opportunities for long term investors.
- Our TOPIX target for the end of FY2021 is 2,150, with estimated EPS 125 x PER 17.
- Disappointing earnings guidance for the current fiscal year and growing concerns about changes to US monetary policy are weighing on the market in the short run.
- The Japan equity market will resume its bullish trend after confirming sound fundamentals and reviving domestic demand thanks to the progress of vaccinations.
- We don't see multiple expansion from the current level owing to the normalization of the global economy coinciding with the hike of long term interest rates.

TOPIX index and forecast

(Points)



Note: TOPIX data is from January 1 2016 to May 21 2021.
Source: TOPIX: Tokyo Stock Exchange, forecast by SMDAM

Upside/downside risks

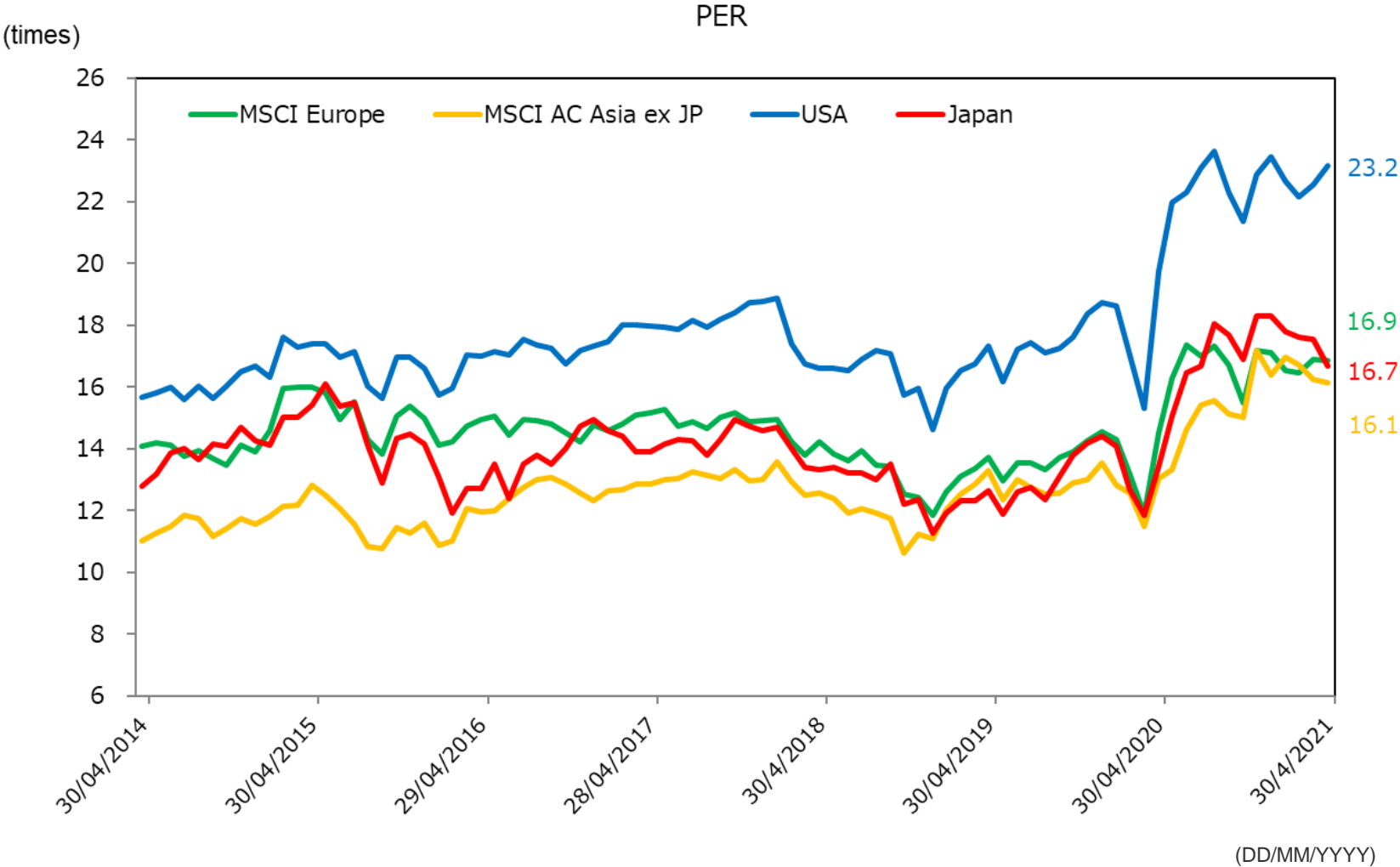
Upside risks

- Rapid progress of COVID-19 vaccinations and early return to normal
- Decisive action by the government to tackle COVID-19
- Easing of diplomatic tensions between the US and China
- Further weakening of the Japanese Yen

Downside risks

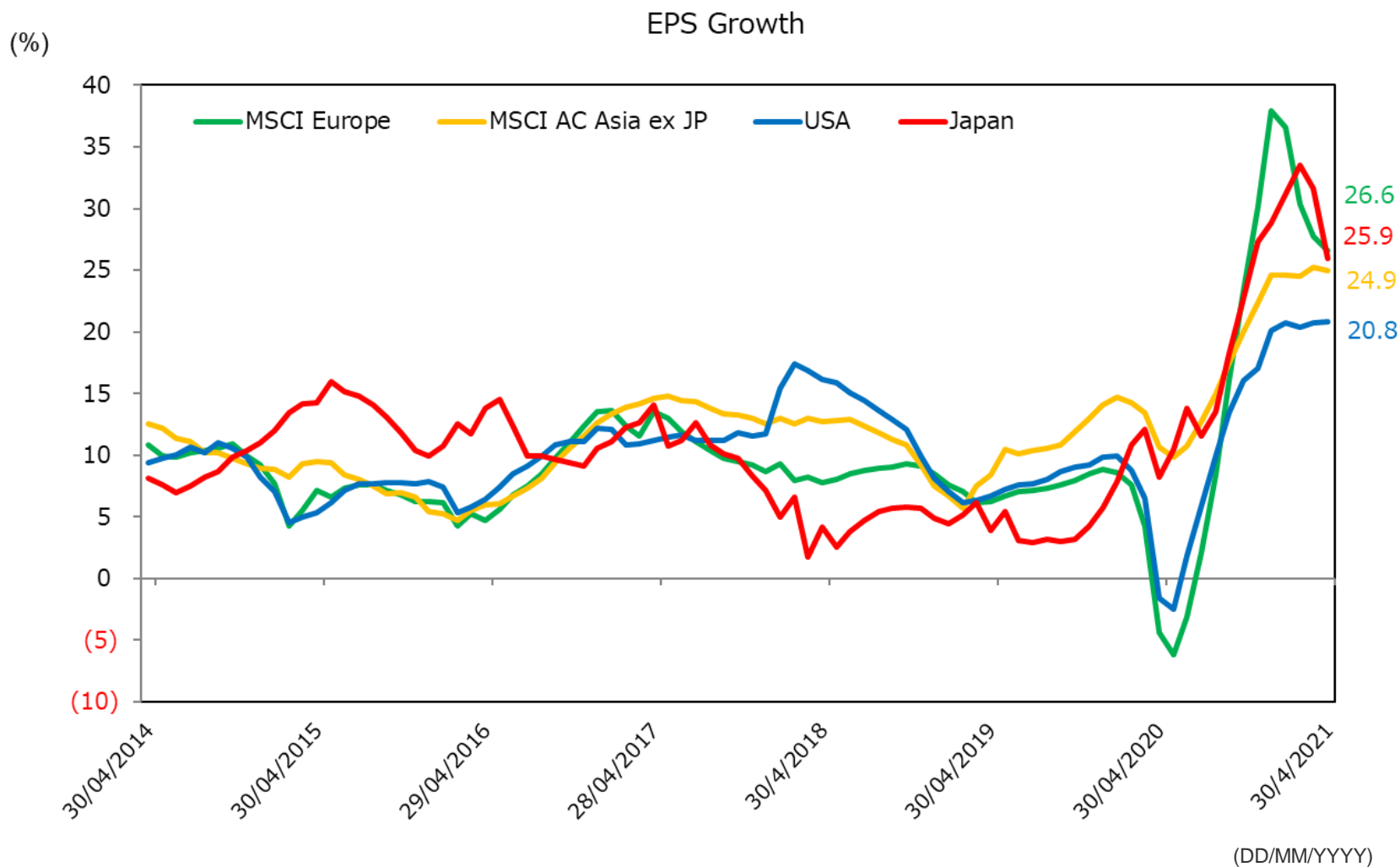
- Concerns about inflation
- Sudden hike of interest rates
- Slow progress of vaccinations and delay of economic recovery
- Concerns over the sustainability and the effectiveness of the current policy mix, fiscal and monetary
- Worsening diplomatic relations between Japan and China

Global comparison of key valuations: PER



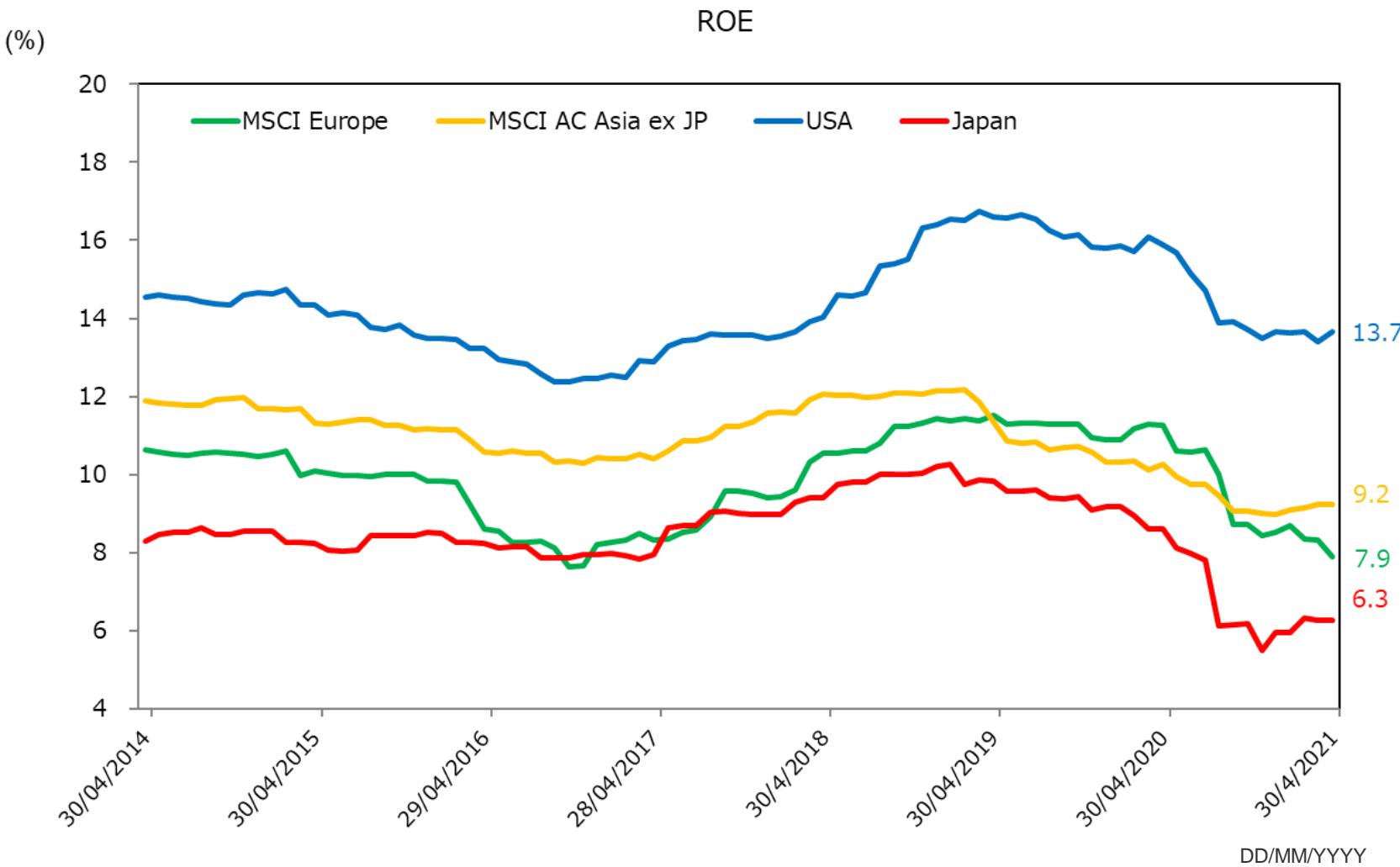
Note: Data is from 30 April 2014 to 30 April 2021
 Source: MSCI

Global comparison of key valuations: EPS growth



Note: Data is from 30 April 2014 to 30 April 2021
Source: MSCI

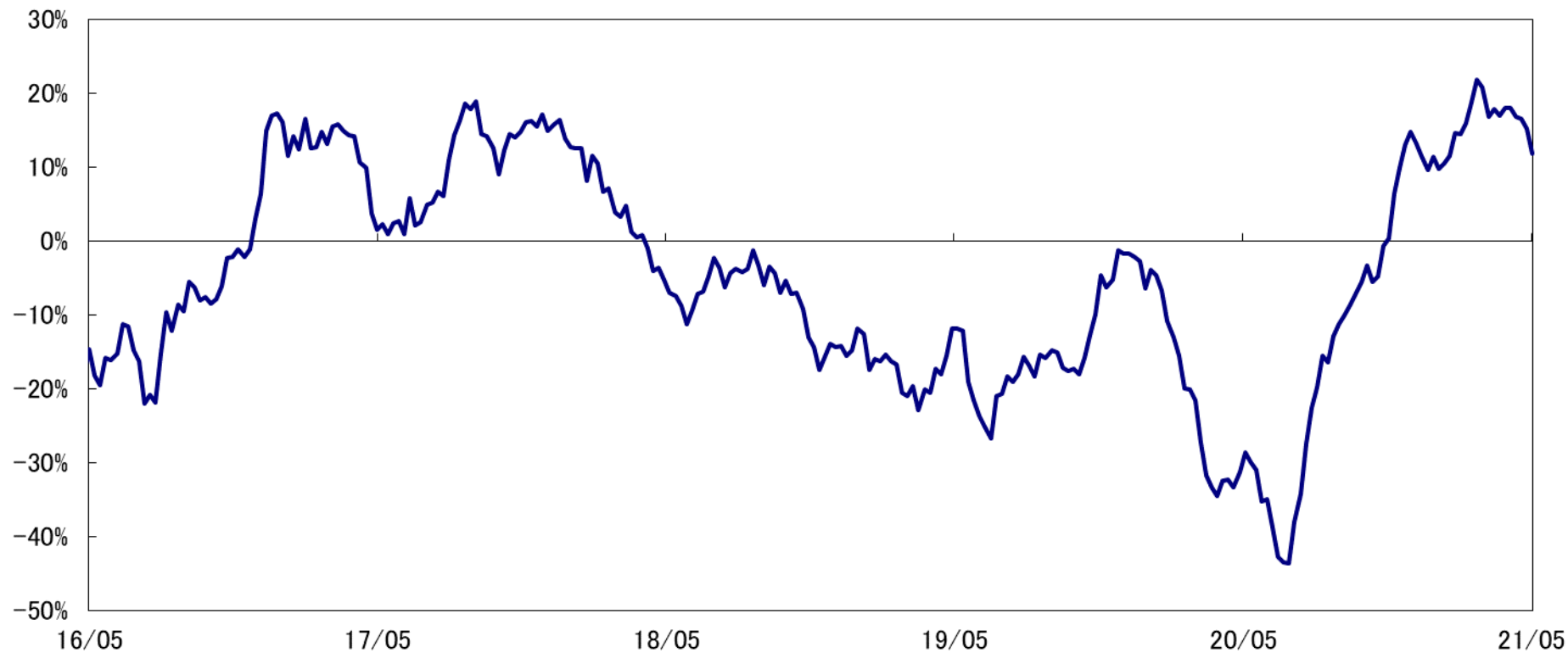
Global comparison of key valuations: ROE



Note: Data is from 30 April 2014 to 30 April 2021
Source: MSCI

Revision of earnings forecasts

TOPIX Revision Index

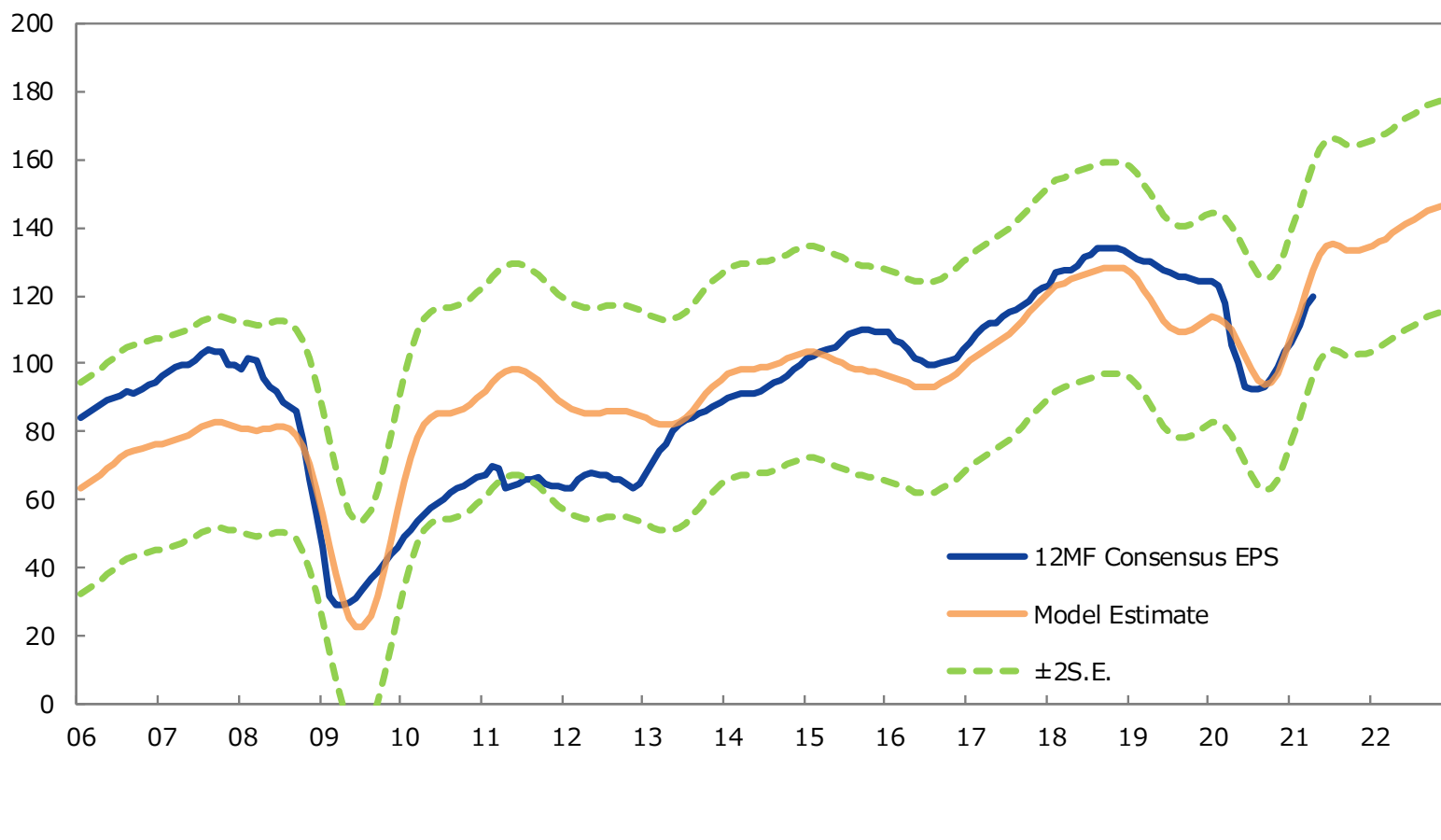


Year/Month

Note: Data is from 10 May 2016 to 11 May 2021
Source: Datastream, IBES

Top down approach, model implied fair value

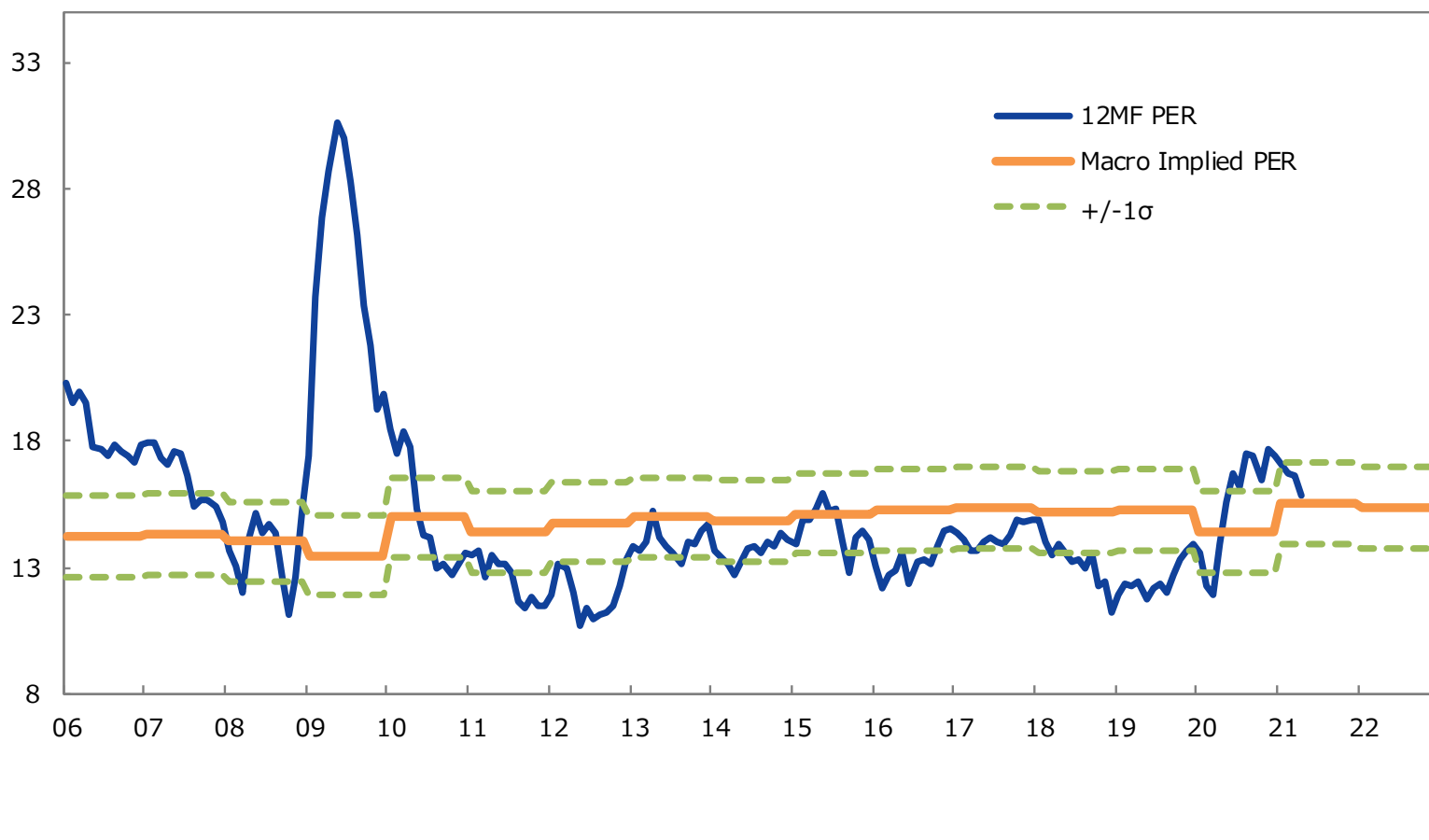
Model Estimate of TOPIX EPS



Note: Consensus data is from January 2006 to April 2021. Model data is from January 2006 to December 2022.
Source: SMDAM

Top down approach, model implied fair value

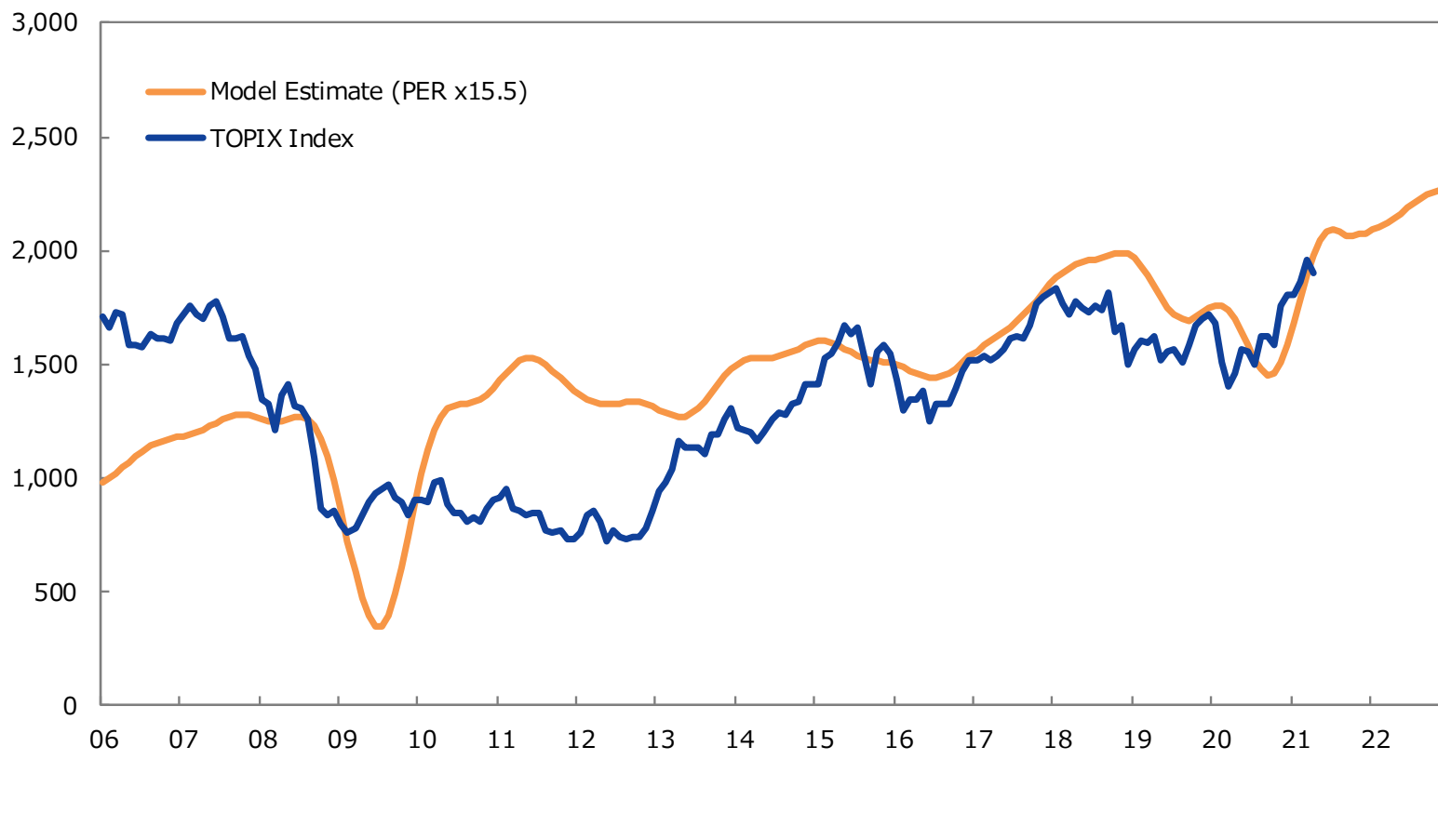
Macro Implied TOPIX PER



Note: 12MF PER data is from January 2006 to April 2021. Model data is from January 2006 to December 2022.
Source: SMDAM

Top down approach, model implied fair value

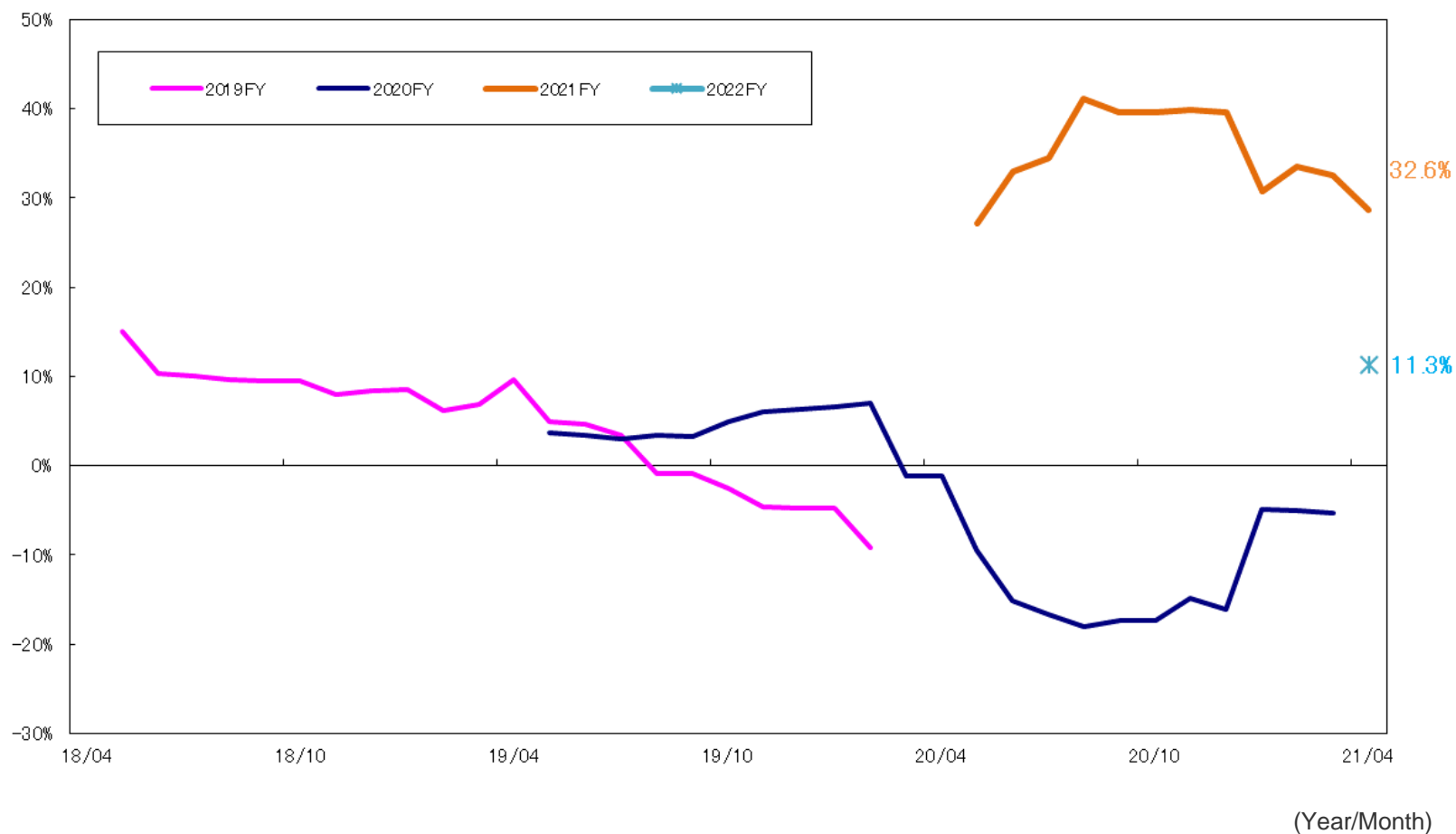
Model Estimate of TOPIX Fair Value



Note: TOPIX data is from January 2006 to April 2021. Model data is from January 2006 to December 2022.
Source: SMDAM

Bottom up estimate, corporate earnings

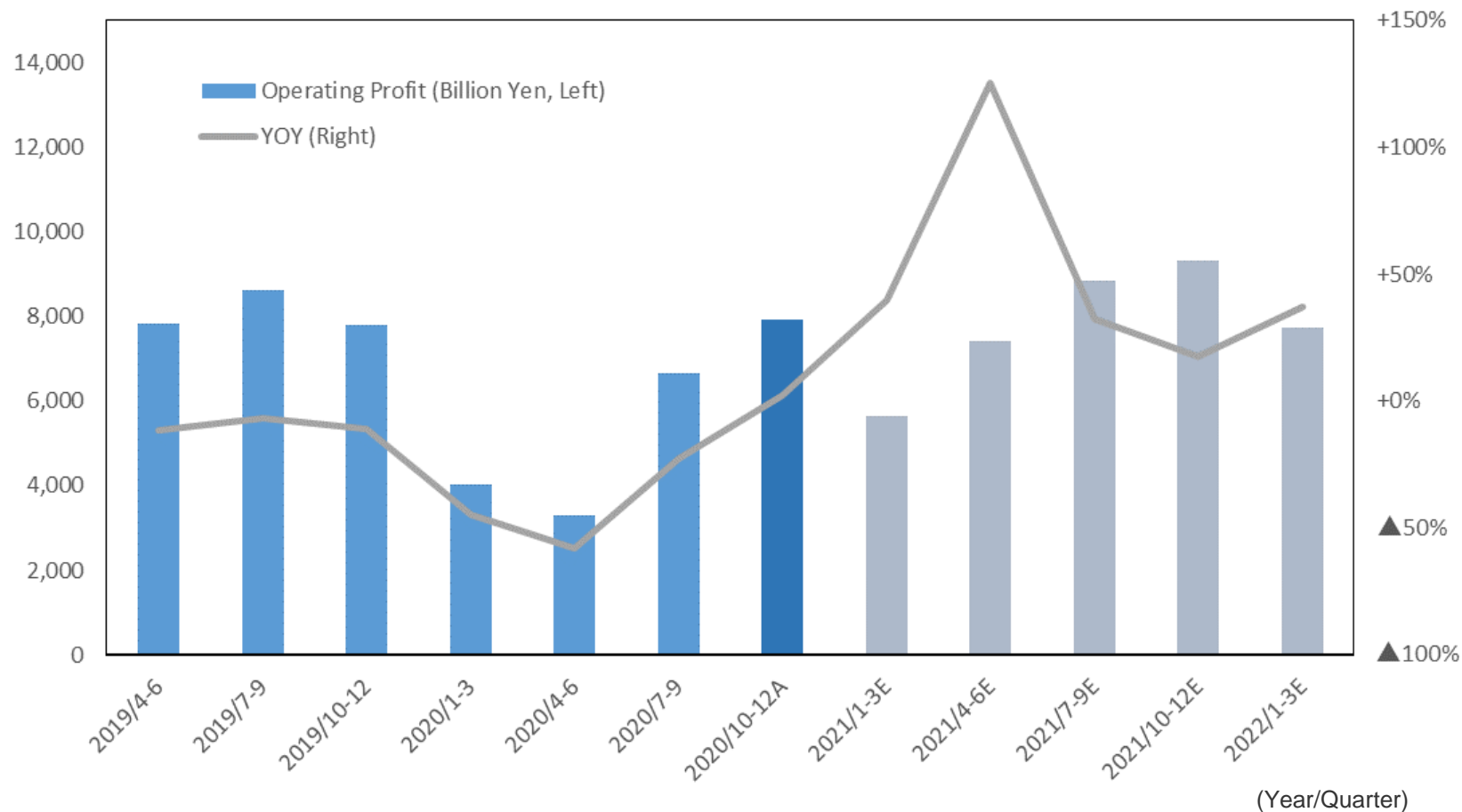
SMDAM Core Research Universe (Ex-Financial) Est. of Recurring Profit Growth



Note: SMDAM Core Universe consists of 488 major Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Bottom up estimate, corporate earnings

Operating Profit (All Industries ex-financials and Softbank Group)



Source: SMDAM

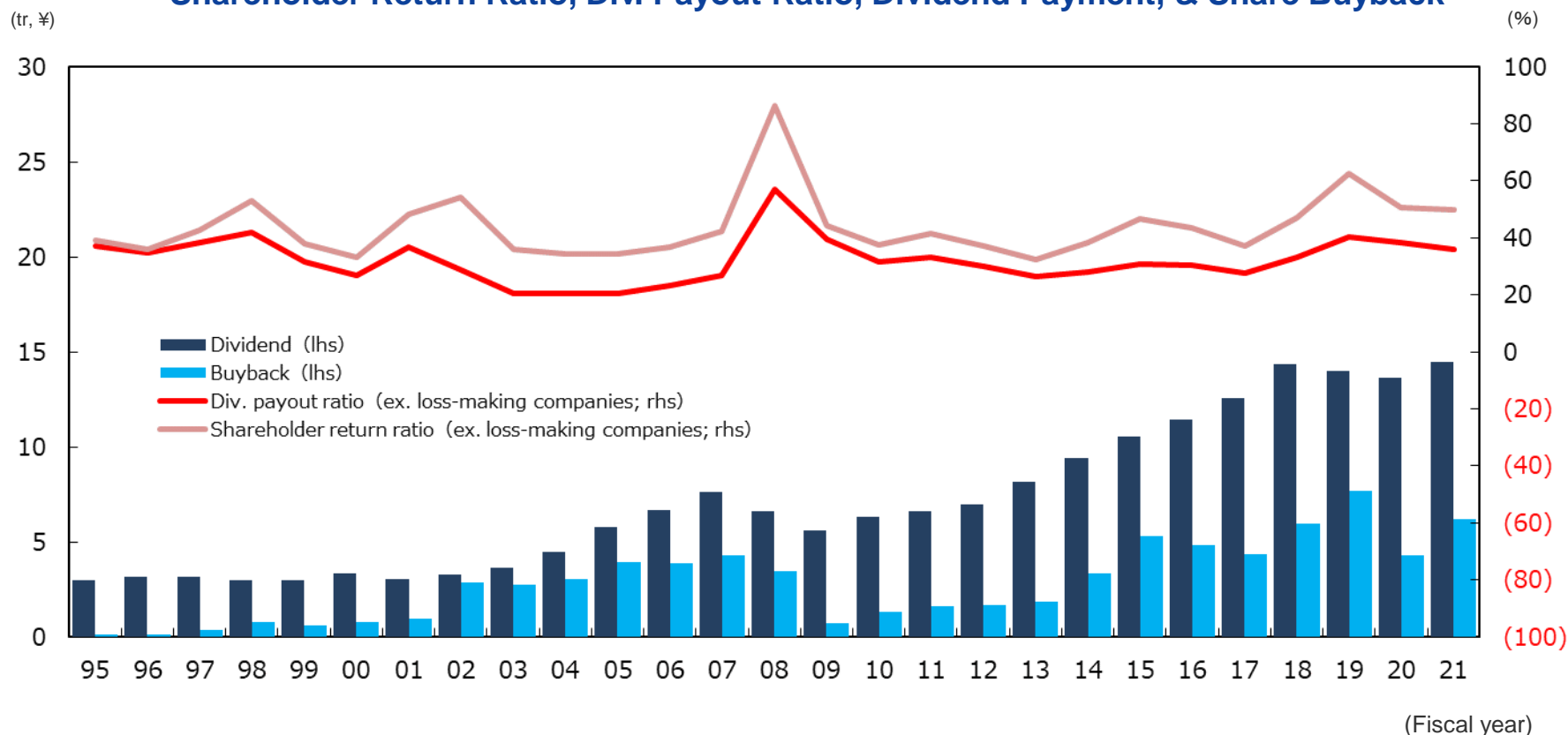
Japanese Corporate Governance and Stewardship Code

- The Stewardship Code (SC) was set in February 2014. Investors are taking more pro-active approach in talking to companies and exercising proxy voting rights. The Financial Services Agency discloses the name of institutional investors, which publicly accepted SC.
- After the inception of the Corporate Governance Code (CGC) in June 2015, pressure has been increasing on companies to improve their governance, efficiency and shareholder returns.
- These two codes have been progressively reviewed and enhanced - making visible impact on corporate behaviour and investors' attitudes as shareholders.
- In the recent amendment of the CGC, companies are required to explain the rationale of “cross-holdings” or “strategic holdings” of other companies' shares, which implicitly provide protection against takeovers and hostile shareholder actions, and is often negative for achieving shareholder value.
- The SC was reinforced in March 2020, requiring investors to evaluate ESG factors.

Number of investors that publicly announced acceptance of the Stewardship Code	
Trust banks	6
Investment managers	199
Insurance companies	24
Pension funds	63
Others	12
Total	304

Shareholder returns, buybacks and dividends

Shareholder Return Ratio, Div. Payout Ratio, Dividend Payment, & Share Buyback



Note: Data is from FY1995 to 2021. 2020 and 2021 are forecasts of Toyo-Keizai in dividend and of Daiwa Securities in share buybacks.
 Source: Toyo Keizai, Quick, and INDB compiled by Daiwa Securities

Winners and losers

Performance Comparison of Russell/Nomura Style Indices

Index	Returns(%)						
	3 Month	6 Month	YTD	1 Year	2 year	3 Year	5 Year
RN Japan Equity	-2.10	9.91	4.99	27.23	22.75	5.40	42.40
Total Value	3.59	16.56	13.31	30.36	13.26	-6.53	30.77
Top Cap Value	4.62	19.56	15.74	35.27	19.92	1.47	37.99
Large Cap Value	3.88	17.59	14.43	32.10	13.65	-4.83	31.38
Mid Cap Value	2.98	15.25	12.86	27.90	4.77	-13.72	21.89
Small Cap Value	2.22	11.92	8.28	22.68	11.45	-14.05	27.30
Micro Cap Value	0.84	8.94	5.26	17.59	9.73	-15.31	30.10
Total Growth	-8.04	3.07	-3.37	23.96	30.18	16.41	54.49
Top Cap Growth	-9.40	5.22	-3.10	27.13	34.24	23.57	63.09
Large Cap Growth	-8.50	3.23	-3.56	24.81	32.28	18.97	56.17
Mid Cap Growth	-6.94	0.06	-4.33	21.07	29.08	12.00	46.54
Small Cap Growth	-3.13	1.47	-1.34	16.72	14.08	-1.79	40.10
Micro Cap Growth	-4.04	4.23	0.28	20.67	18.16	1.77	47.93
Top Cap Total	-3.10	11.71	5.20	31.14	27.61	12.78	50.61
Large Cap Total	-2.50	10.18	4.96	29.10	24.33	7.99	44.74
Mid Cap Total	-1.62	8.06	4.62	26.23	19.64	1.22	36.81
Small Cap Total	0.53	7.88	5.16	20.47	14.09	-8.43	32.65
Micro Cap Total	-0.62	7.54	3.77	19.21	13.13	-8.87	37.60

Note: As of 19 May 2021.
Source: Bloomberg

Outlook for the Japanese Economy

Current status and outlook for the Japanese economy

- The forecast for real GDP is +3.9% (previously +4.2%) in FY 2021, and +2.3% (+2.1%) in FY 2022. Growth forecast for FY 2021 was revised downward in response to the third declaration of a state of emergency. On the other hand, FY 2022 was revised upward, taking into account the reaction to the downward trends in FY 2021. The declaration of a state of emergency has delayed the timing of economic recovery. Growth near 0% is expected in Q2 FY2021. On the other hand, in and after Q3 of FY2021, the economy is expected to recover due to the vaccine roll out, the recovery of external demand, and the recovery of automobile production.
- The nationwide core CPI outlook (excluding effects of the consumption tax hike and free education) is +0.2% (previously +0.3%) in FY2021, and +0.5% (+0.5%) in FY2022. The main reason for the downward revision in FY 2021 was a reduction in mobile phone charges. However, based on the results of the Tokyo metropolitan area, the deviation from previous assumptions is small and the downward revision is small. The nationwide core CPI is expected to remain near zero for the time being and then turn positive led by energy. However, the supply-demand is well balanced, and the underlying inflationary pressure is likely to be limited.
- The overall monetary policy framework is likely to be maintained for the time being. The central bank expects negative interest rates to be cut further only in emergencies, such as a sharp rise in the yen. In the "Review to implement more effective and sustainable monetary easing" the Bank of Japan has announced measures to deal with side effects, such as more flexible purchasing policies for ETFs and J-REITs and clarification of the range of fluctuations in long-term interest rates, so the overall monetary policy framework is likely to be maintained for the time being. The Bank of Japan has established a new interest rate system to promote loans and has made it clear that there is room for interest rate cuts, but further monetary easing will be taken only in emergencies, such as a sharp rise in the yen. "Financial support measures for companies" will expire in September 21, but financial conditions for accommodations, restaurants and other services remain tight. If the situation continues, the measures are likely to be extended.

Current status and outlook for the Japanese economy

- The discussions on the supplementary budget could intensify in autumn, when a snap election is expected. Prime Minister Suga has said he will not compile a supplementary budget during the current Diet session. As the possibility of early dissolution of the lower house for a general election has receded, it is highly likely that the budget will be covered by reserve funds.
- The main scenario is continuation of economy-friendly fiscal and monetary policy management. Prime Minister Suga has called for the continuation of Abenomics, and policy management is generally in line with this. Even if the administration of Prime Minister Suga ends up with a short life span, it is likely that the government will continue its economy-friendly policies until COVID-19 outbreak is under control.

Forecast of Annual Real GDP Growth							
Fiscal Year	FY16	FY17	FY18	FY19	FY20	FY21 Est	FY22 Est
Real GDP	0.8%	1.8%	0.2%	-0.5%	-4.6%	3.9%	2.3%
Private final consumption expenditure	-0.3%	1.0%	0.1%	-1.0%	-6.0%	3.4%	1.9%
Private housing investment	4.3%	-1.8%	-4.9%	2.5%	-7.1%	1.4%	2.1%
Private-sector capital investment	0.8%	2.8%	1.0%	-0.6%	-6.9%	4.0%	5.6%
Public fixed capital formation	0.5%	0.6%	0.8%	1.5%	4.0%	2.5%	1.5%
Net export contribution	0.7%	0.4%	-0.2%	-0.4%	-0.7%	1.2%	0.1%
Exports of goods and services	3.4%	6.3%	2.0%	-2.2%	-10.4%	12.8%	5.4%
Imports of goods and services	-0.5%	3.8%	3.0%	0.2%	-6.8%	5.9%	5.1%
Nominal GDP	0.8%	2.0%	0.1%	0.3%	-4.0%	3.3%	2.6%
GDP deflator	0.0%	0.2%	-0.1%	0.9%	0.7%	-0.6%	0.3%
Industrial Production Index	0.8%	2.9%	0.3%	-3.7%	-9.9%	11.7%	4.7%
Consumer Price Index (Core)	-0.2%	0.7%	0.8%	0.4%	-0.5%	0.2%	0.5%
Domestic corporate goods price index	-2.4%	2.7%	2.2%	0.1%	-1.4%	1.8%	0.0%
Employee compensation	2.4%	2.0%	3.2%	2.0%	-2.0%	0.4%	1.5%
Unemployment rate	3.0%	2.7%	2.4%	2.4%	2.9%	2.8%	2.7%
Call Rate (End value)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%

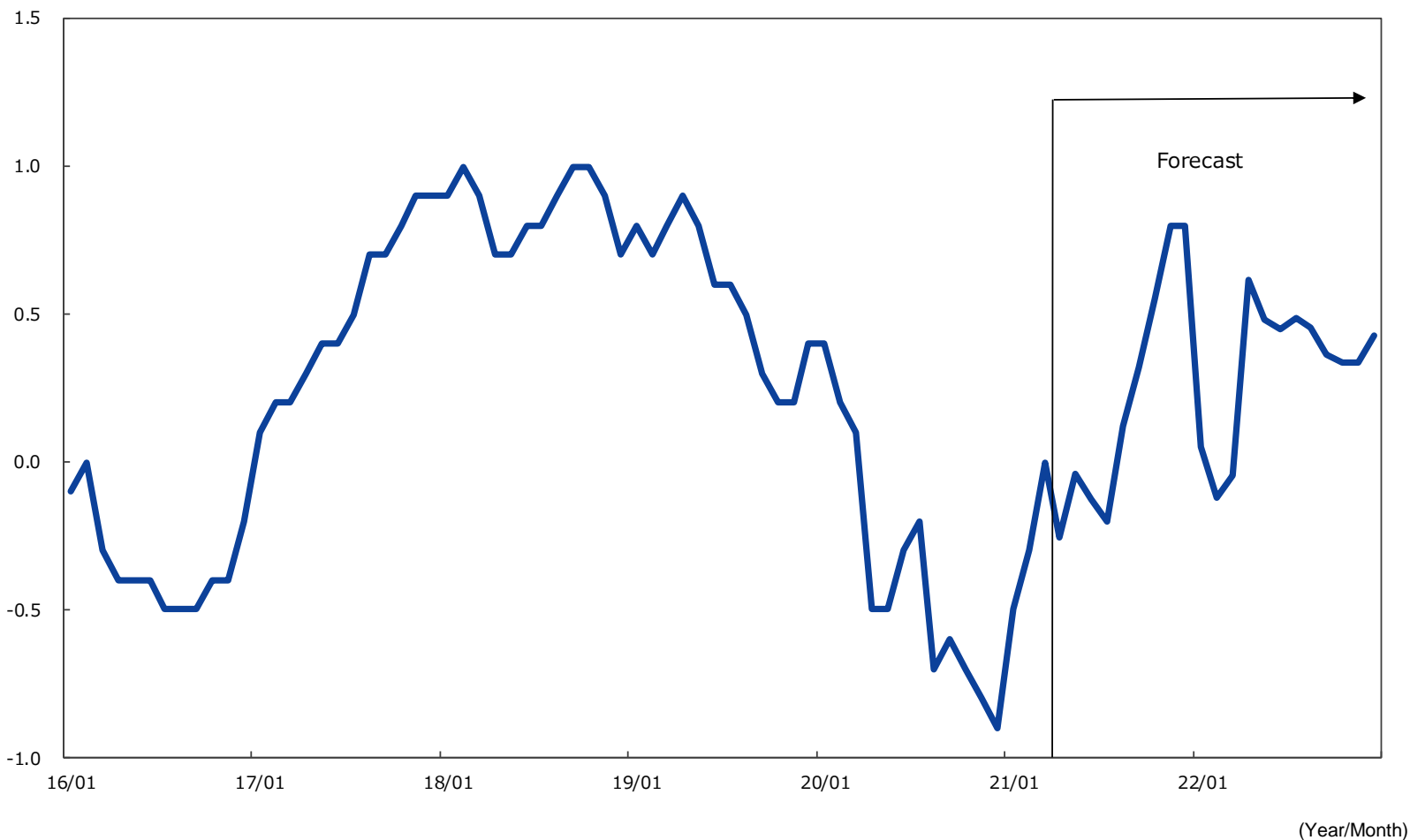
Note: Rate of increase over the previous year. Net exports are based on the degree of contribution, and the consumer price index (core) excludes the effects of the consumption tax and free education. The forecast is for SMDAM

Source: Creation of SMDAM based on data from the Cabinet Office, Ministry of Internal Affairs and Communications, and Ministry of Economy, Trade and Industry (METI)



Core CPI with our forecast

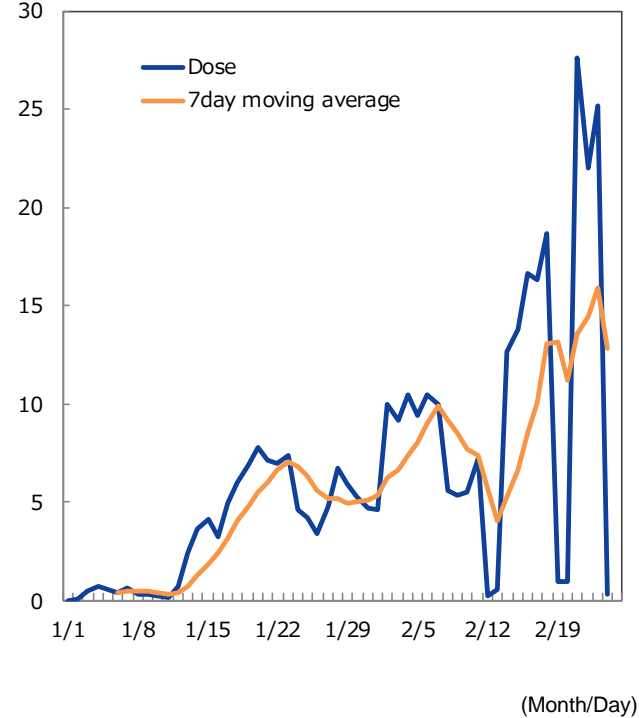
Core CPI (YOY) with Forecast



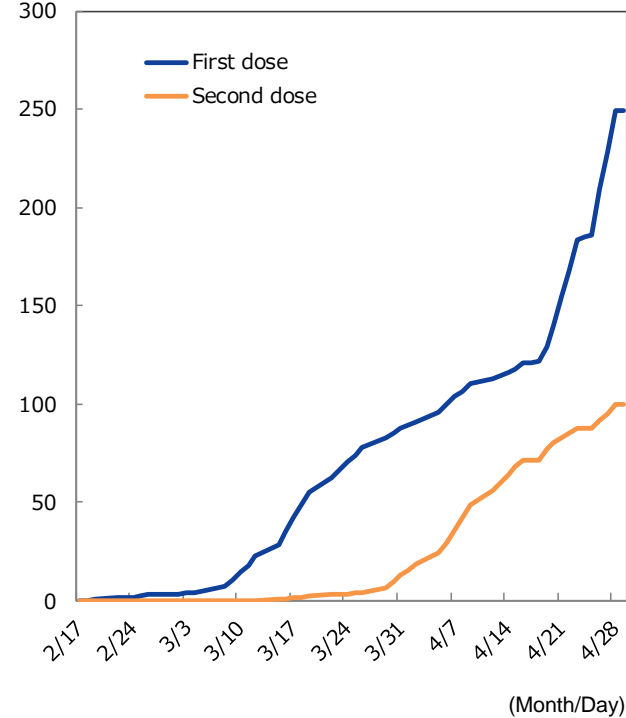
Note: Data is from January 2016 to December 2022. Actual data is until March 2021. Forecast is from April 2021 to December 2022
Simulation assumptions: WTI = USD 60.0, USD/JPY spot = 107.5 at the end of 2021 & 2022
Source: MIAC, Bloomberg, SMDAM

Progress of COVID-19 vaccinations

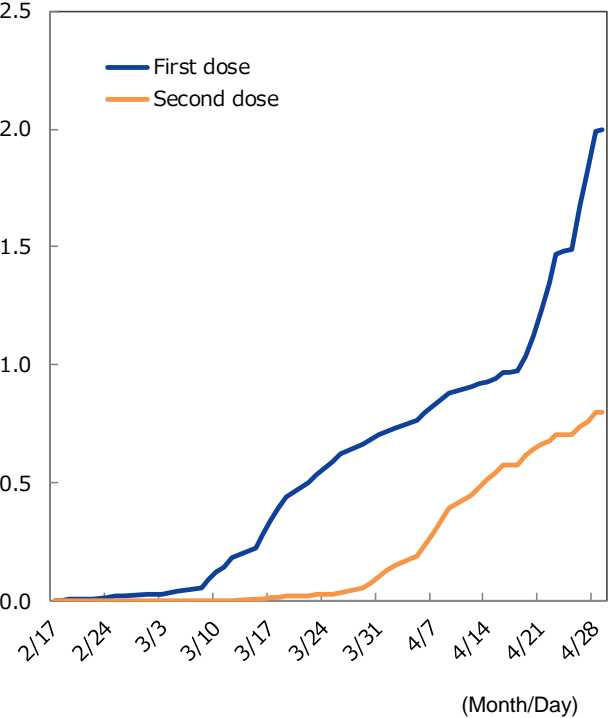
(10,000) Daily number of vaccinations



(10,000) Cumulative number of vaccinations



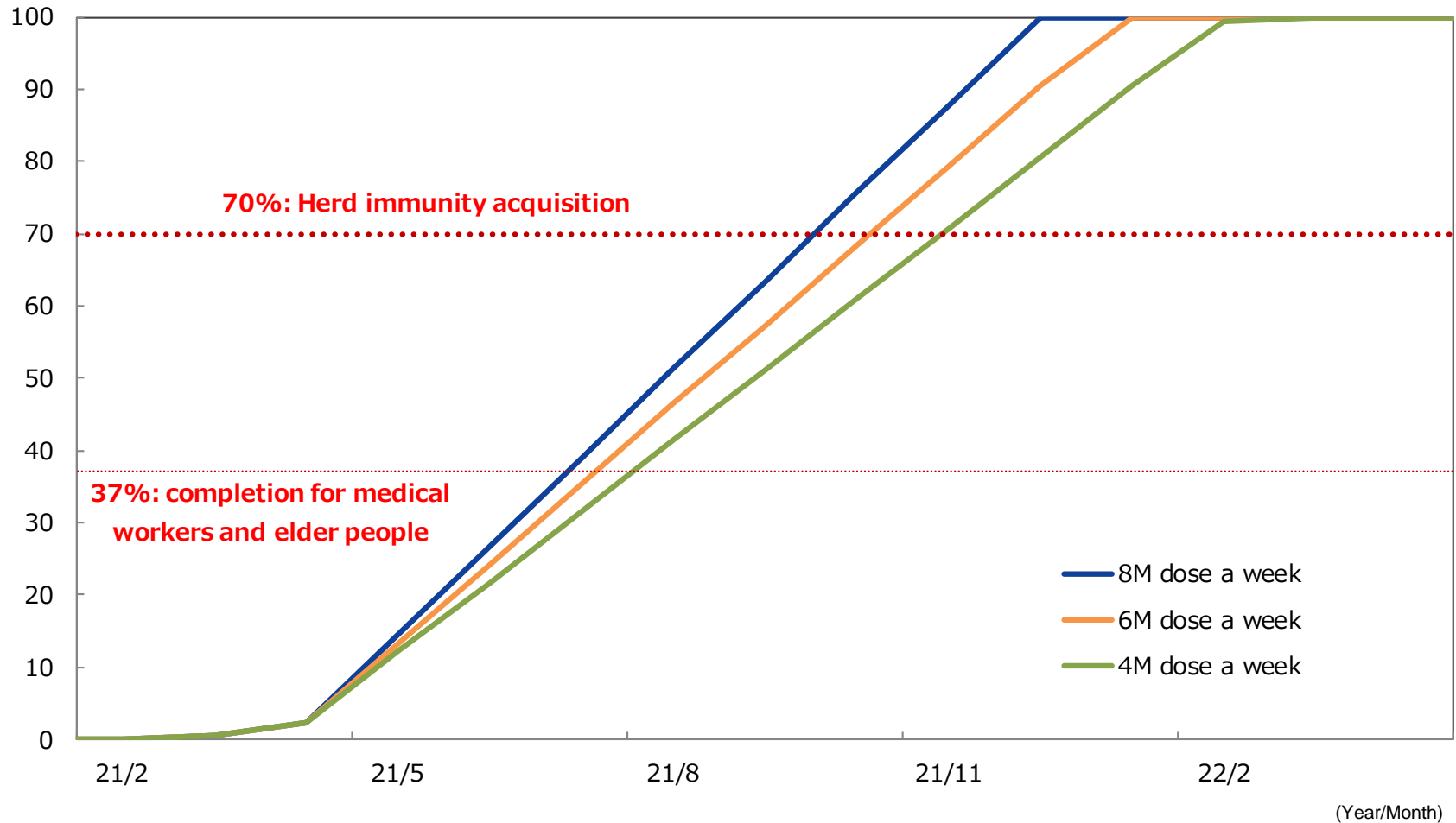
(%) Total vaccinations/population ratio



Source: Ministry of Health, Labour and Welfare (MHLW), SMDAM

Schedule for COVID-19 vaccinations

Simulation of vaccination/population ratio (16 years or older)



Source: Ministry of Health, Labour and Welfare (MHLW), SMDAM

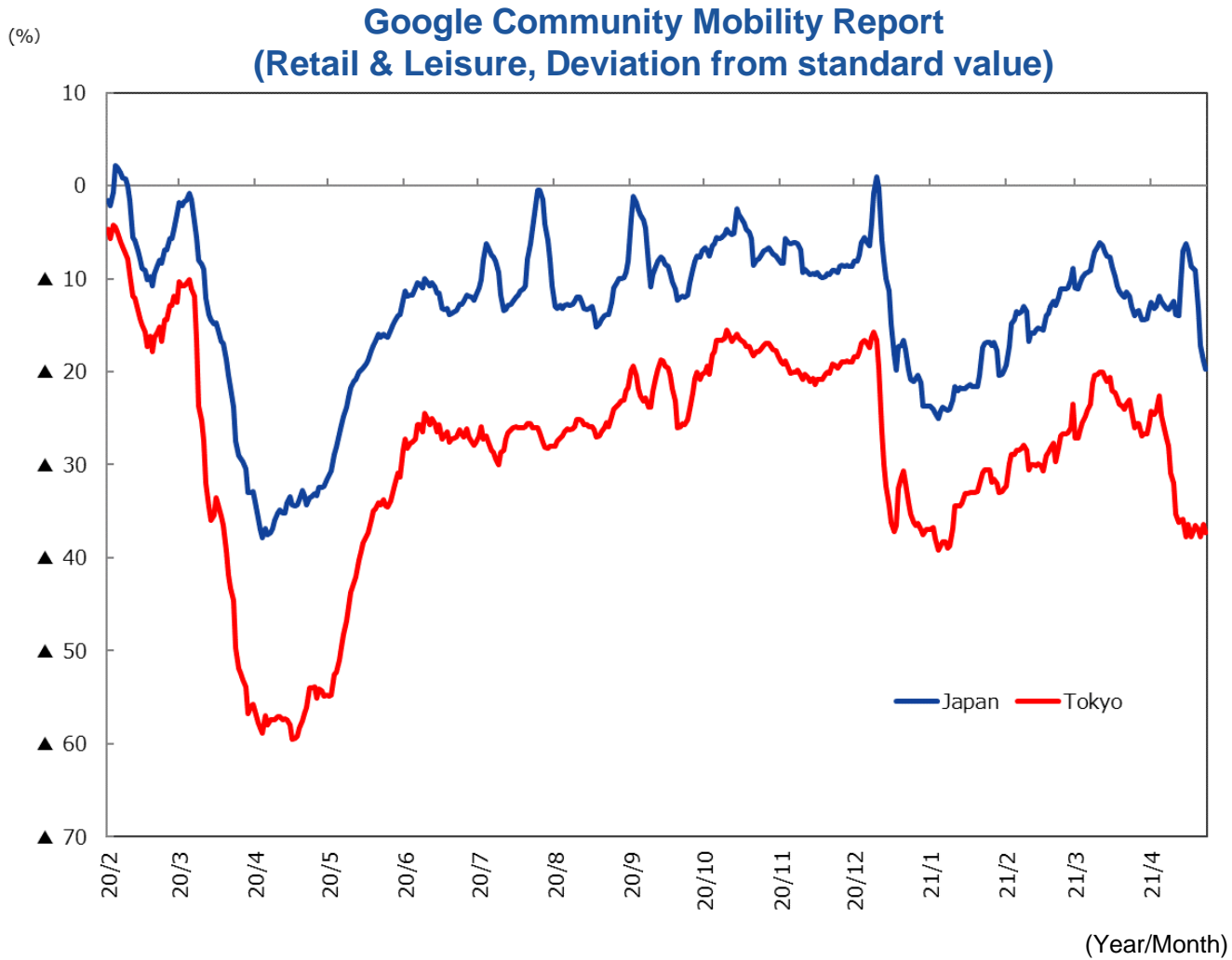
Schedule for COVID-19 vaccinations

Schedule of COVID-19 vaccinations in Japan

	Vaccination Target							Vaccine Supply				
	Health care workers with highest priority	Health care workers	Elderly persons (65 years old ~)	Elderly care facility workers	Persons with underlying diseases	General (60 ~ 64 years old)	General (16 ~ 64 years old)	Pfizer import	AstraZeneca Import and domestic production	Moderna import	Novavax domestic production	J&J Before contract
	40,000 people (0.03%)	4.7 million people (3.8%)	36 million people (28.8%)	2 million people (1.6%)	8.2 million people (6.6%)	7.5 million people (6.0%)	52 million people (41.6%)	72.2 million doses	60 million doses	25 million doses	125 million doses	
February	Vaccination has started							Approved	Apply for approval			
March		Vaccination has started							15 million doses imported	Apply for approval		
April			Vaccination has started									
May			Speed of distribution accelerated						Expected to be approved and start domestic production	Expected to be approved		
June			Distribution completed					Cumulative 50 million doses imported				
July			Target of completion of vaccination									
August												
September								Cumulative 97 million doses imported		Cumulative 25 million doses imported		
October & later											Expected to start domestic production	

Note: Parentheses of the vaccinated subjects show the ratio of population.
Source: Creation of Sumitomo Mitsui DS Asset Management based on various material

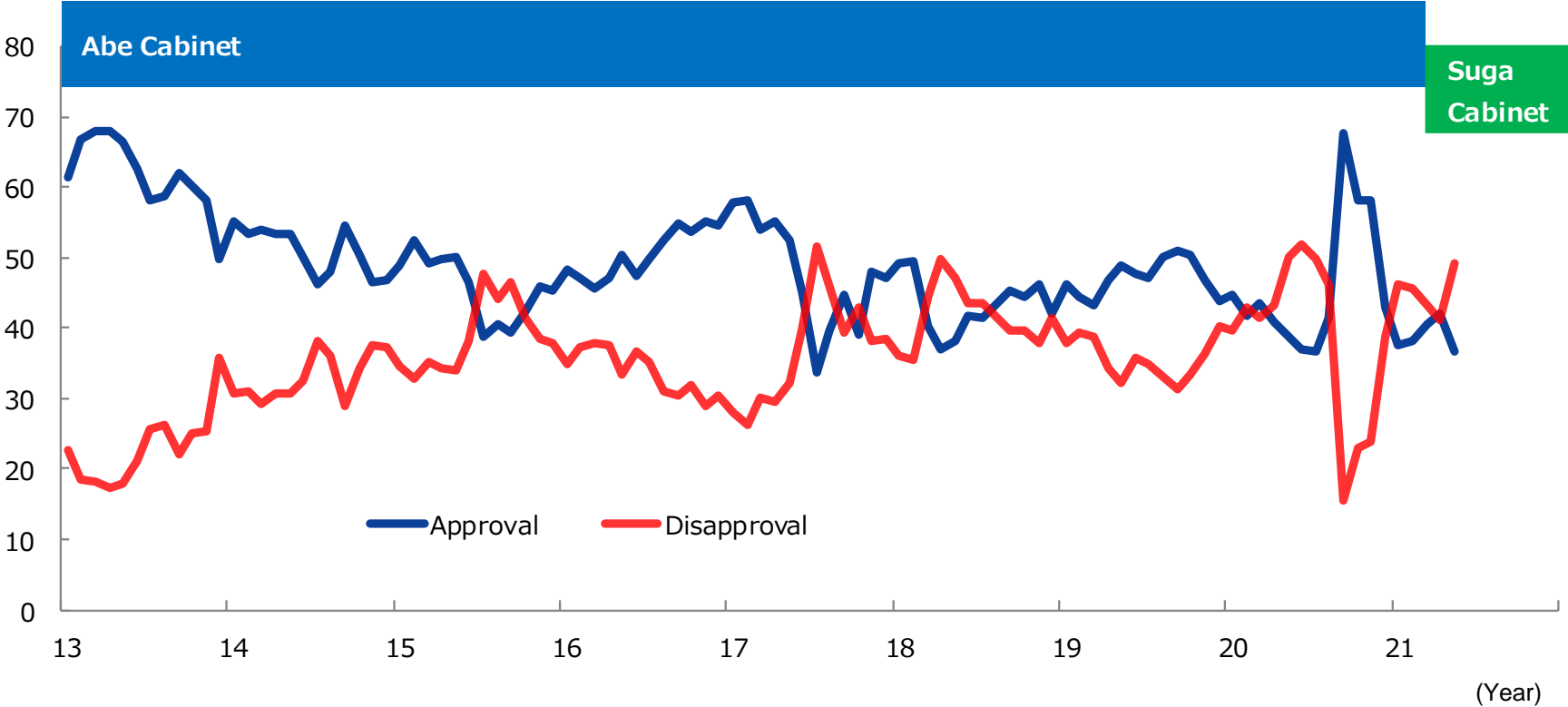
Mobility data



Source: Google, SMDAM

Government approval rate

Approval Rate of Cabinet



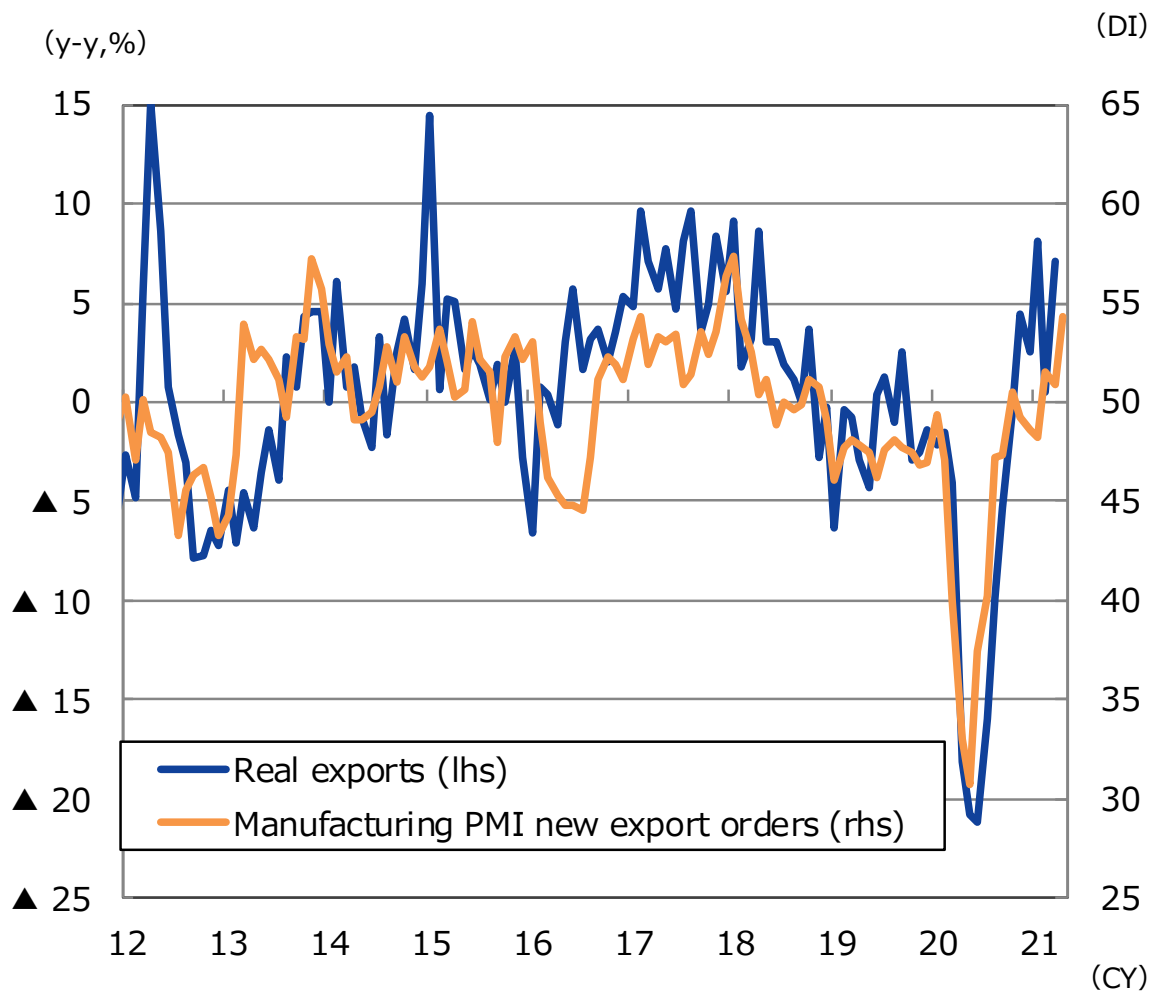
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Political schedule and forecast for snap election

Date	Schedule of Political Events	Possibility of Snap Election
June 11-13th June 16th	G7 Summit in UK End of the ordinary Diet session	15% : Before Olympic Games
July 4th July 23rd	Tokyo Metropolitan Assembly Election <u>Tokyo Olympics (Until August 8)</u>	
August 25th	<u>Tokyo Paralympics (Until September 5)</u>	10% : During Olympic / Paralympic Games
September 1st	Launch of Digital Agency	
September 30th	<u>Expiration of Ruling LDP President's Term</u>	50% : Before the election of President of LDP
October 21st	<u>End of the term of the House of Representatives</u>	25% : After the election of President of LDP

Exports and manufacturing activities

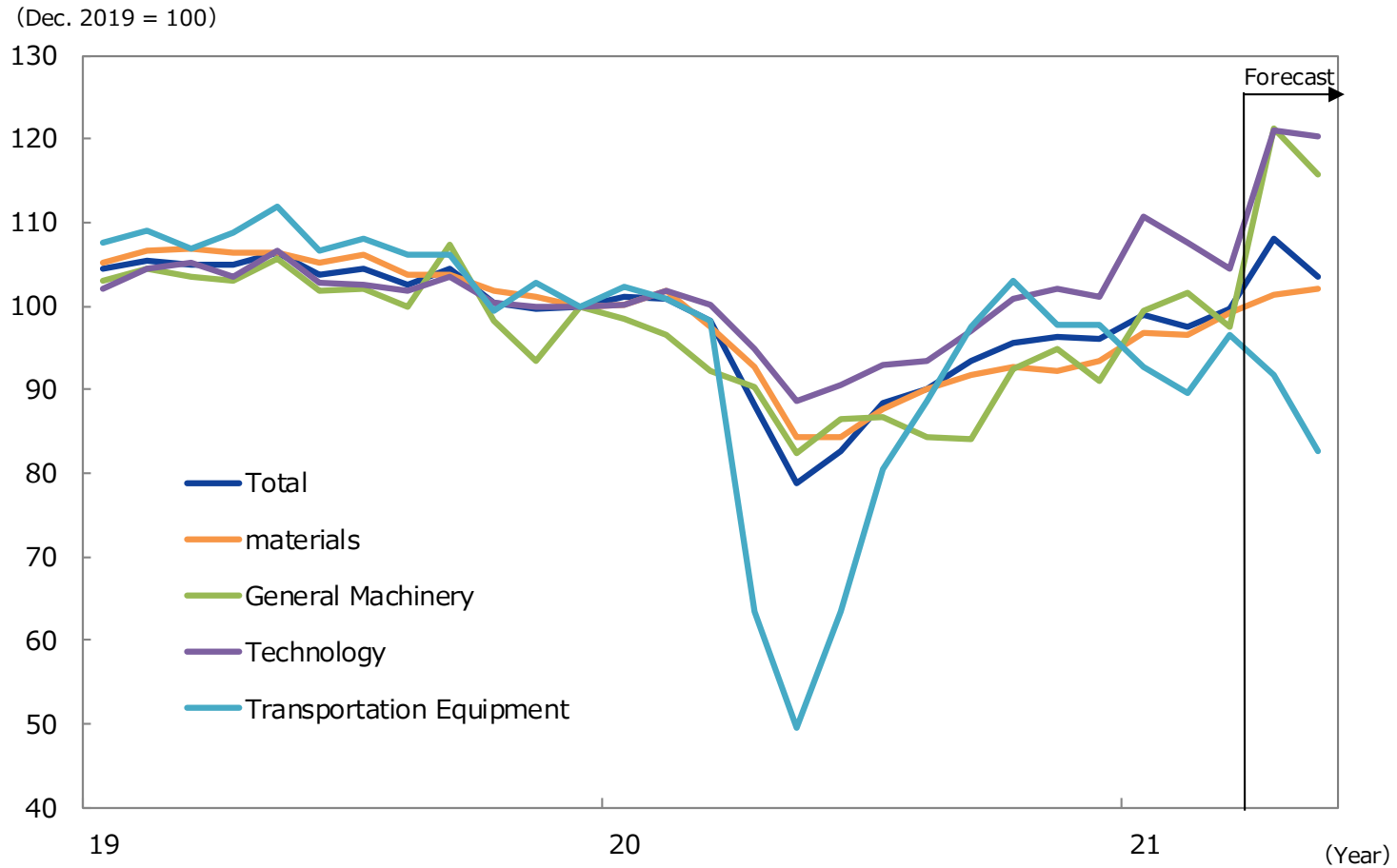
Real exports and manufacturing PMI new export orders



Source: Compiled by SMDAM based on data provided by the Bank of Japan, the Cabinet Office and Markit.

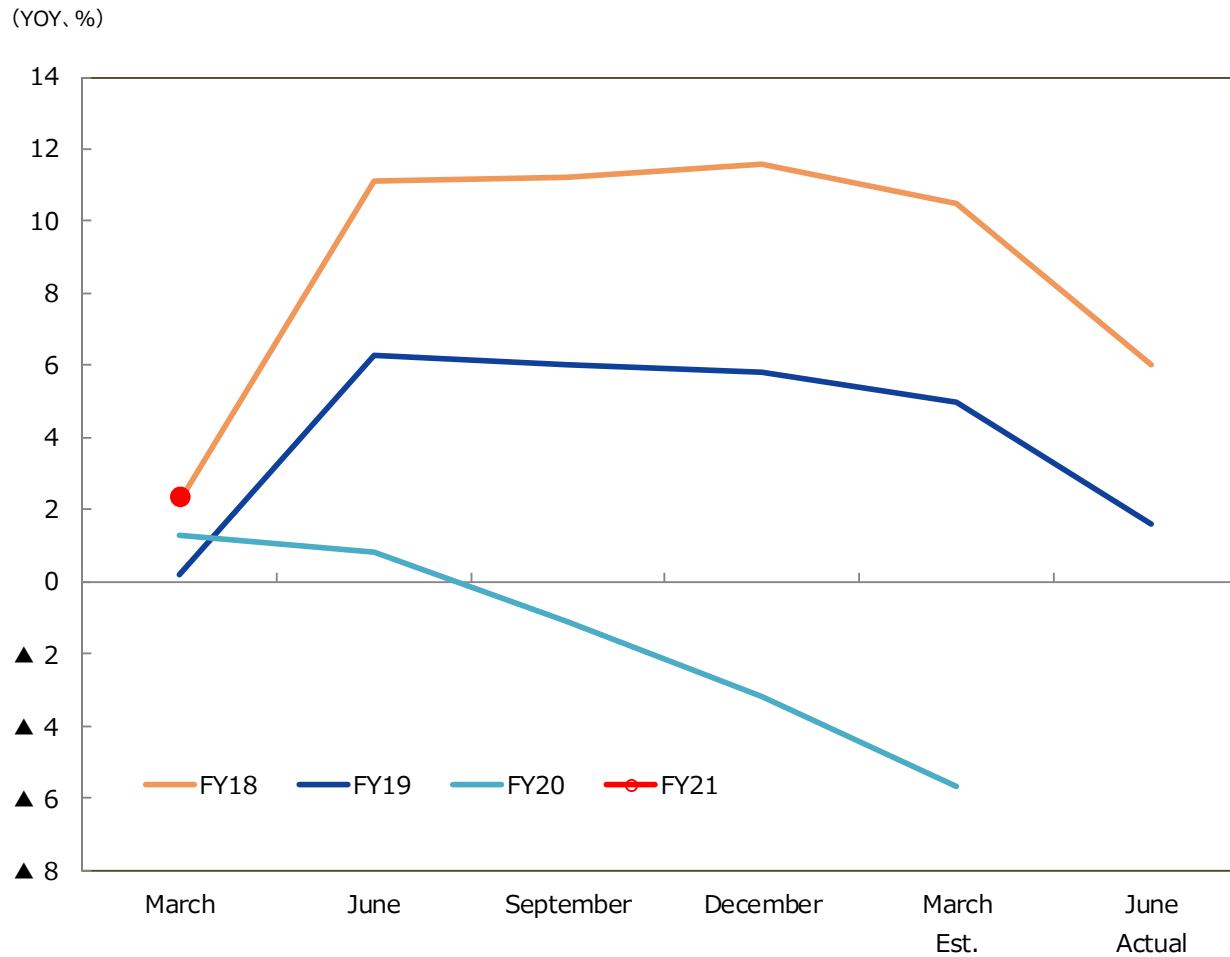
Industrial production

Industrial Production (Monthly)



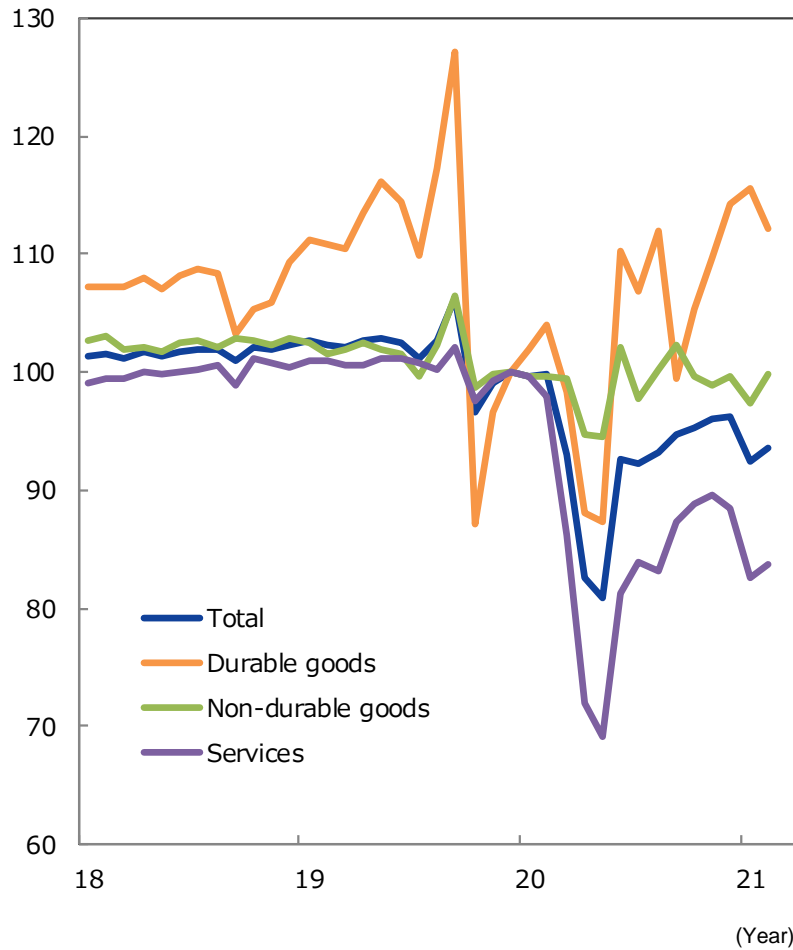
CAPEX

Plan of CAPEX (inc. software, ex. Land and R&D)

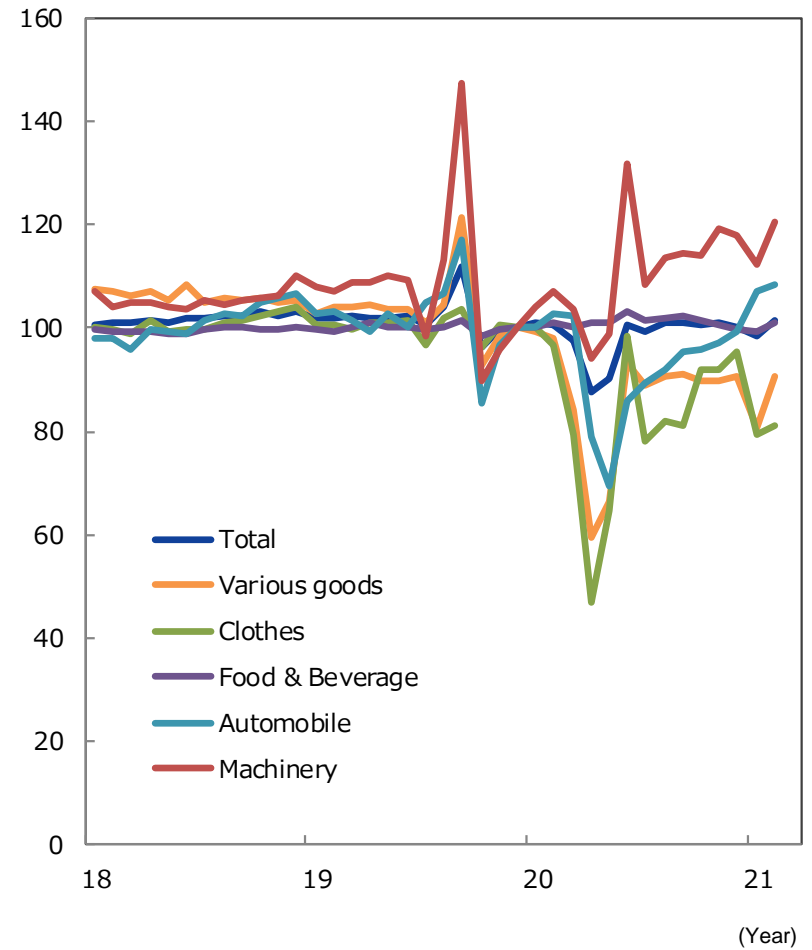


Consumer spending

Consumer Activity Index (Dec. 2019 = 100)



Retail Sales (Dec. 2019 = 100)



Source: Bank of Japan, Ministry of Economy, Trade and Industry (METI) and SMDAM

Schedule of major events

Main domestic events for the future			
2021	June	16	End of the ordinary Diet session
		17-18	Monetary Policy Meeting
		29	Term of office of the BOJ Policy Board Member Masai
		Expected	Cabinet Decision on Basic Policies and Growth Strategies
	July	15-16	Monetary Policy Meeting (perspective report)
		23	Tokyo Olympics (Until August 8)
		Expected	Tokyo Metropolitan Assembly election
	August	25	Tokyo Paralympics (Until September 5)
	Summer	Expected	Revised CPI standards
	September	1	Launch of Digital Agency
		21-22	Monetary Policy Meeting
		30	Expiration of Ruling LDP President's Term
October	21	End of the term of the House of Representatives	
	27-28	Monetary Policy Meeting (perspective report)	
December	26-17	Monetary Policy Meeting	
	Expected	Outline of Tax Reform in Fiscal 22	
	Expected	Cabinet Decision on the FY 22 Budget	

Source: Compiled by SMDAM.

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