

Fundamental Active Group PM's Monthly Insights

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Market Outlook

We expect the Japanese stock market will advance smoothly in August. Earnings of domestic companies, especially those of manufacturers, rebounded strongly in the April-June quarter as we expected, boosting stock prices of those whose earnings exceeded market estimates. We hope the government will announce additional economic packages when the Olympic Games are over, leading to stock price rallies.

According to **Mizuho Securities**, 39% of companies listed on the first section of the Tokyo Stock Exchange (TSE) with a fiscal year ending at the end of February or March announced earnings for the April-June quarter as of 30 July. They achieved sharp year-on-year (YoY) earnings recoveries due to so-called base effects. Operating income tripled and net income almost quintupled from the previous year when earnings plunged due to the coronavirus pandemic. In particular, earnings improvements of manufacturers were outstanding. A series of manufacturers swung back to profitability. On the other hand, construction companies and electric power/gas suppliers suffered earnings declines. Construction companies that were hit by repeated declarations of the state of emergency have been hesitant in commencing new projects until the end of the Olympic Games due to concerns over traffic restrictions, while utility companies are struggling to pass on higher fuel costs to customers. However, earnings of these two sectors should turn up from the October-December quarter. Earnings recoveries of domestic companies will become more obvious in August when companies that can benefit from the JPY depreciation such as auto/ electric appliance/ machinery makers will release their earnings results.

Despite the spread of the new variant coronavirus strain, death tolls are not increasing that much. Stock prices adjusted in late July following the fresh declaration of the state of emergency. But we expect the number of new cases will peak out soon given the vaccination programs started to cover young people under 40.

We expect an increasing number of companies will announce strong earnings. Given another economic package from the government when the Olympic Games are over, domestic stock prices should advance smoothly in August.

Investment Strategy

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

Sectors shown are GICS 11 sectors.

We will take an overweight position in the materials sector with a focus on stocks that are likely to enjoy high earnings growths by price hikes. We will also remain overweight in the IT sector by maintaining the overweight range of the software service subsector whose order intake is turning up at a high level. On the other hand, we reduced the overweight range of semiconductor manufacturing equipment (SME) stocks. We will also maintain an overweight position in the consumer discretionary sector by taking an overweight position in auto-related stocks while taking an underweight position in apparel stocks. We will take underweight positions in the industrials sector by taking underweight positions in domestic-demand stocks such as construction/transportation ones. We will also remain underweight in the consumer staples sector as we recoil from its high valuation.

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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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Risk warning: On 1 January 2021 the UK left the EU transitional arrangements and no longer benefits from passporting rights into EEA countries.

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