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Value + Alpha Group

PM's Monthly Perspectives

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In September, the MSCI Japan index increased as investors thought domestic stocks were cheaper than overseas ones. This increase pinned hopes on economic packages by the new Prime Minister (PM) as well as recognising a decrease in new coronavirus cases. Japanese stocks had been lagging behind other major markets but caught up when a media report on Japan's ruling Liberal Democratic Party (LDP) leadership vote drew attention from investors. Hopes for public spending by the new PM as well as a decrease in new coronavirus cases also provided a boost to stock prices. Japanese stocks could outperform others amid mounting concerns abroad such as fears about the increased CPI amid rising crude oil prices in Europe, worries over disappointed earnings results due to a disruption in supply chains in the US and threats of a default by **China Evergrande** in China, because investors thought that Japan is relatively immune from these concerns.

Policy: Business-friendly economic policies should continue with Kishida as the new PM

Fumio Kishida won the LDP leadership contest on 29 September. Given the LDP is the ruling party, he will become the next PM of Japan. We believe he will generally follow business-friendly economic policies of the party without making any big change on the assumption that he is not a loner type that executes policies in his own way. Kishida is expected to seek advice from various people before making decisions and implement balanced policies. That said, we think last month's rally was driven by a strength in Japanese stocks, catching up with other markets after having been a laggard rather than hopes for the new administration.

Kishida advocates expansionary fiscal policies. According to media reports, his statements up to this point include "I will formulate economic packages worth a few tens of trillion JPY within this year," "I won't raise the consumption tax rate over the next ten years," and "I will not worry about the fiscal balance until the favourable cycle of growth and distribution is realised." On the other hand, he also said that the government should not give up the fiscal reconstruction given the balanced budget is a cornerstone for credibility building. So, we believe Kishida will increase fiscal spending until his stance casts doubt on fiscal situations.

While Kishida has a slightly hawkish view on monetary policies, he proclaimed during the latest election campaign that he would maintain monetary easing policies with the inflation target unchanged at 2%. Given his answer that he should refrain from preconception when asked about a BOJ (Bank of Japan) exit strategy, he is unlikely to put pressure on the bank to shift its policy. BOJ governor Kuroda is likely to retain the current easing stance until at least the end of his term in April 2023 in view of the domestic CPI falling far below the target.

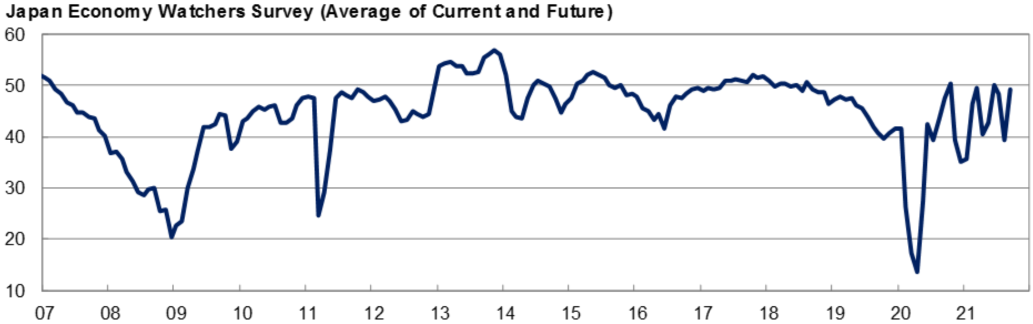
We consider the fact that Kishida's manifesto may have negative effects on stock markets, such as a hike in the financial income tax rate from 20% to 30% and an overhaul on the quarterly earnings disclosure by domestic companies as risk factors. While most companies disclose quarterly earnings results but don't make predictions about quarterly earnings unlike the US where corporate short-termism is causing controversy, we have to keep a watch on future policy trends with a focus on statements from Kishida that can have an unexpected impact on stock markets

Kishida will deliver a policy speech in early October and the Lower House election is expected to be held either on 7 or 14 in November. According to the opinion poll, the LDP-led ruling coalition should maintain a majority without any issues. As a result, we don't change our view that the domestic economy will pick up in the near term with fresh economic packages released by the administration ahead of the general election.

Economy: Domestic leading indicators rose in line with our forecast with this strength expected to continue next month

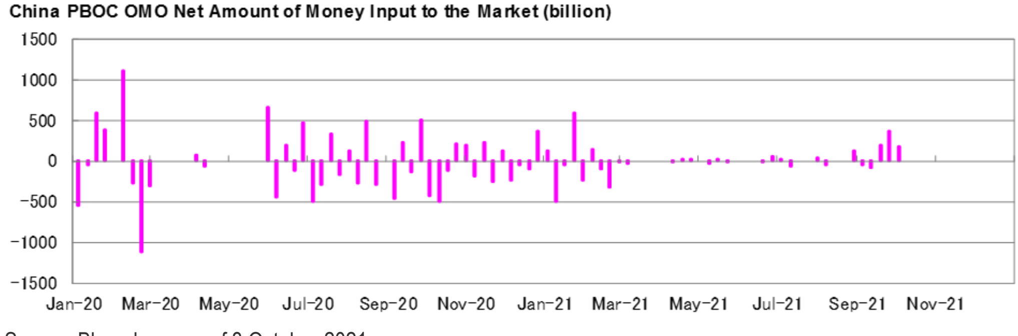
The Economic Watchers Survey (the average of current and future), one of the leading indicators on which we put the most importance, rose sharply from 39.2 in August to 49.4 in September, as we expected. This was mainly due to the abating of concerns over the coronavirus infection. We assumed the indicator should turn up in September due to a progress in vaccination programs, hopes for fresh economic packages by the new PM and a recovery in auto production. What fell short of our expectation was the lack of reference to economic packages from Kishida and a delay in recovery of auto production.

What drew our attention in the latest survey was a huge gap of 14.5 between the DI for current economic conditions (42.1) and the index for future ones (56.6). The latter has exceeded the former by a large margin of over 10 only three times excluding this month since the inception of the indicator in 2001. Given the average of current and future for the following month rose at all these three times, we think the indicator for this October will improve again by following the precedents.



Source: Bloomberg, as of 8 October 2021.

We expect economic indicators in China will improve and exceed the current level in six months given runs on wealth management products haven't spread across the country and the People's Bank of China (PBOC) has introduced monetary easing measures for three straight weeks since the middle of September, while knowing we need to keep a close watch on the trend.



Source: Bloomberg, as of 8 October 2021.

Sumitomo Mitsui DS Asset Management

Investment Strategy

We expect that the Japanese equity market will advance in the short term on the back of the economic recovery and accommodative monetary policies. P/E ratios of domestic companies are hovering at the lowest level since May 2020, as of 7 October, following stock price declines earlier this month. 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 sharp JPY 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:
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