

Fundamental Active Group PM's Monthly Insights

Authors



Hideyuki TANIUCHI, CMA/CFA
Senior Portfolio Manager and
Group Leader



Masashi KAMOHARA, CMA
Senior Portfolio Manager

Market Outlook

We expect Japanese stock markets to fluctuate in a high price range from July to September. The following factors, which bolstered Japan's stocks through June, will continue to underpin the market: (1) negative real interest rates due to an easing monetary environment remaining, (2) a recovery in Japan's domestic demand with economic reopening; (3) the recent yen depreciation, which may continue given the interest rate gap between Japan and the U.S.

On the other hand, the markets have the potential to decline in the short term due to the following factors: (1) concerns over an economic slowdown as a result of monetary tightening in the U.S. and Europe, (2) increasing profit taking by foreign investors who will start their summer vacation, (3) speculation over foreign exchange intervention to correct the excessive depreciation of the JPY. However, we see the decline caused by supply and demand factors will be only temporary, and Japanese stocks will advance again as long as the fundamentals of the Japanese economy and businesses continue to be strong.

According to the Bank of Japan's (BOJ) short-term outlook survey released on 3 July 2023, the diffusion index (DI) of business conditions rose for both manufacturing and non-manufacturing industries. Manufacturers' profit margins are improving due to both the decline in resource prices and their pass-through into prices, which is taking place with a time lag. In addition, business conditions are being supported by a recovery in vehicle production as supply chains normalise. In the non-manufacturing sector, the DI rose mainly in the hotel and restaurant sector, thanks to the progress of economic reopening and a recovery in inbound tourism. Moreover, capital expenditure plans for FY2023 were revised upward, backed by growing investment in digitalisation and environment, as well as demand for increasing productivity to address labour shortages. We anticipate corporate earnings to hit a fresh all-time high between FY2023 and FY2024 with the following factors: (1) recovery in service consumption, (2) increasing vehicle production thanks to the progressing resolution of the recent semiconductor shortage, (3) Japanese companies' improving profit margins due to their increasing prices and falling raw material costs, and (4) JPY depreciation because of a monetary easing policy maintained by the Bank of Japan.

The valuation of Japanese stocks recovered to a price earnings ratio of around 14-15 times, the average in the past 10 years, following recent surges in their prices. This average PER reflects an aspect of the Japanese economy, which suffered from deflation. The base inflation rate is likely to remain at 2-3% with increasing service prices because wages started continuously rising on the back of structural labour shortages in Japan. This is assumed to lead to higher nominal GDP growth and higher Japanese domestic sales growth for companies.

Note:

Above names are for example purposes and SMDAM is not recommending or advising these stocks.

Market Outlook ^{Cont.}

In addition, the companies obviously have taken actions to improve their earning capability by permeating capital cost-conscious management and enhancing their shareholder returns by purchasing their own shares and increasing dividends. These structural changes have backed the recent rally in Japan stocks, and effects from rising stock prices may be bigger than those from the nation's economic cycle. Therefore, we believe there still remains a sufficient room for the valuation of the stocks to grow.

Investment Strategy

Overweight sectors (largest shown first):	Underweight sectors (largest shown first):
Consumer Discretionary	Industrials
Information Technology	Consumer Staples
Communication Services	Health Care

Sectors shown are GICS 11 sectors.

GICS sector wise, we will continue to overweight consumer discretionary, information technology, and communication services. We will invest mainly in stocks which (1) are expected to improve their profitability by passing on price hikes and benefitting from the effects of a weaker JPY, (2) will realise a decrease in raw material and procurement costs, or (3) are expected to increase share buy-backs and dividends more than anticipated. We will examine and possibly increase the weight on stocks whose prices are laggards although earnings growth is anticipated. In addition, we will focus on stocks with a low price-to-book ratio, whose business restructuring and capital policy improvement are expected.

On the other hand, we will continue underweight in industrials and consumer staples sectors from the view point of earnings growth rate and valuation. Then, we will increase the weight on large blue chips whose valuation is no longer undervalued because they soared.

Risk Warning: Some statements contained in this material concerning goals, strategies, outlook or other non-historical matters may be forward-looking statements and are based on current indicators and expectations. These forward-looking statements speak only as of the date on which they are made, and the Company undertakes no obligation to update or revise any forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. The Company and/or its affiliates may or may not have a position in any financial instrument mentioned and may or may not be actively trading in any such securities.

The organisations and/or financial instruments mentioned are for reference purposes only. The content of this material should not be construed as a recommendation for their purchase or sale. Any charts and graphs provided are for illustrative purposes only.

Hideyuki TANIUCHI, CFA/CMA

Senior Portfolio Manager and Group Leader, Fundamental Active Group, Equity Management Department

Mr Taniuchi manages the Fundamental Active product with Mr Kamohara.

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 manage the Fundamental Active product and became the Group Leader in 2021.

Mr Taniuchi graduated from Tokyo University of Science with BS/Engineering in Industrial Administration (1996).

Masashi KAMOHARA, CMA

Senior Portfolio Manager

Mr Kamohara is a Portfolio Manager for 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).

Disclosures

Issued by Sumitomo Mitsui DS Asset Management (UK) Limited. Registered in England and Wales

Registered office 100 Liverpool Street, London, EC2M 2AT; registered number 1660184. Authorised and regulated by the Financial Conduct Authority.

This is a marketing communication.

Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.

The data contained in this document is for information purposes only. It is correct to the best of our knowledge at the date of issue and may be subject to change. The client legal agreement will take precedence over this document. This document is not legally binding and no party shall have any right of action against Sumitomo Mitsui DS Asset Management (UK) Limited, in relation to the accuracy or completeness of the information contained in it or any other written or oral information made available in connection with it. Nothing in this document or any related presentation shall be deemed to constitute investment advice, nor shall we be deemed to be an investment advisor unless formally appointed as such, or as discretionary investment manager, by way of written agreement.

The information contained in this presentation is to be used by the professional client that this document is issued to only.

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

This document may not be copied, redistributed or reproduced in whole or in part without prior written approval from Sumitomo Mitsui DS Asset Management (UK) Limited.

Contact Details

Business Development and Client Relations

For investors outside the EEA:

Chloé CHOQUIN: +44 (0)20 7507 6424

Email: uksales@smd-am.co.jp

Sumitomo Mitsui DS Asset Management (UK) Limited
100 Liverpool Street, London EC2M 2AT
United Kingdom
www.smd-am.co.uk

