

Fundamental Active Group PM's Monthly Insights

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Market Outlook

We expect Japanese stock markets to rise in the October-December quarter towards the year-end. The stock prices significantly rose, mainly in stocks with low price-to-book (P/B) ratio, in mid-September amid growing expectations for the early normalisation of the Bank of Japan's (BOJ) monetary policy. In the near term, profit-taking may accelerate, especially by Japanese pension funds and macro hedge funds. The valuation of global stocks is expected to fall with U.S. real interest rates sharply rising. A strong USD is favourable for Japan, but the concerns about a foreign macroeconomic slowdown triggered by the current rising interest rates will carry a risk that may negatively impact Japan's overseas earnings. The TOPIX reached a price earnings ratio (PER) of around 14 times, the average in the past 10 years. The stock market seems to have priced in, to some extent, (1) Japan's economic recovery from COVID-19 which lagged behind the U.S. and Europe and (2) the expectations for rising profit margin thanks to the permeation of price increases and a pause on raw material and energy price rises.

However, there is no change in our basically bullish view on Japanese stocks given the following factors: (1) Japan's economy has entered a virtuous cycle thanks to rising prices and wages; (2) corporate governance reform has progressed in Japan as more companies are working on the improvement of their capital efficiency; and (3) the supply-demand balance in the stock market continues to improve mainly among corporate and individual investors. From now on, we will pay attention to whether the following make steady progress in Japan; (1) sustainable price and wage increases, (2) the expansion of capital investment led by domestic demand, (3) labour productivity improvement, and (4) a rise in Japan's potential growth rate.

The BOJ's Tankan survey, released on October 2, generally suggested a recovery in the Japanese economy. It shows the recovery is led mainly by domestic demand thanks to continued strong non-manufacturing industries despite a sluggish business outlook for a part of manufacturing industries due to slowing external demand. It is right to say that companies have a strong appetite for digital investments as we can see the upward revisions of software investment plans for FY2023. In addition, companies continue to raise wages in response to labour shortages although the employment environment has not changed drastically. During the earnings announcement season for the July-September quarter, which will get into full swing from late-October, we expect upward revisions of earnings guidance will become more noticeable given the strong progress made in the April-June quarter. Adding to that, the moves toward implementing share buybacks and disclosing measures to improve enterprise value will become prominent. In general, the stock prices of companies that announced share buybacks since July have performed steadily, and this trend is likely to continue for a certain period of time.

Note:

Above stock names are for example purposes and SMDAM is not recommending or giving advice about these stocks.

Market Outlook cont.

As the new Nippon (Japan) Individual Savings Account (NISA), a tax exemption program for individual investors in Japan, starts in 2024, increasing attentions are paid toward the trends of individual investors. Of approximately 2,000 trillion of Japan's household financial assets, more than 50% is held as cash and deposits, and the holding ratio of stocks and investment trusts is lower than that in the U.S. and Europe. The new NISA program will raise the investment limit and make the investment period permanent, and will be an essential system for individuals to manage their assets. We believe a continuous inflow of individual money will support the stock market.

Investment Strategy

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

Sectors shown are GICS 11 sectors.

GICS sector wise, we will continue to overweight the consumer discretionary, information technology and communication services sectors. We will invest mainly in stocks which (1) are expected to improve their profitability by passing on price hikes and benefitting from effects of a weaker JPY, (2) will realise a decrease in raw material costs and logistics costs, or (3) are expected to buy back shares or increase dividends more than anticipated. And we will increase the weight on stocks that not only have a low P/B ratio but can also increase the return-on-equity (ROE) while growing their profits and increase shareholder returns. After the earning announcement season for the third quarter, the focus of attention will shift to earnings guidance for fiscal 2024. We will focus on stocks that will continue their profit growth trend in the next financial year.

On the other hand, we will continue to underweight the industrials and health care sectors from the viewpoints of earnings growth rate and valuation. In addition, we will decrease the weight on stocks that became overvalued as their prices rose in the July-September quarter.

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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).

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