Marketing Communication
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Value + Alpha Group

PM's Monthly Perspectives

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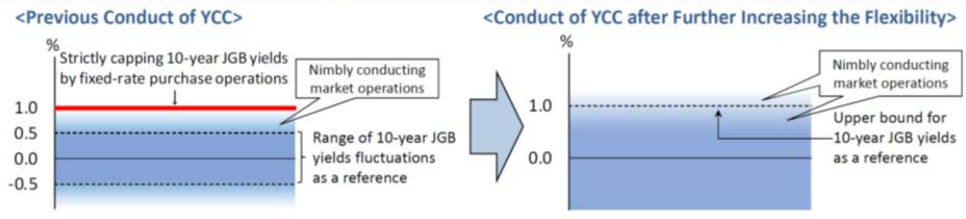
The MSCI Japan index declined due to a rise in US 10-year Treasury yields and escalating tensions in the Middle East. Following the Fed Chairman Jerome Powell's speech, saying, "Does it feel like policy is too tight right now? I would have to say no," and low demand for US 5-year and 30-year Treasuries at auctions. US Treasury yields rose, and US stocks fell at various points, and then Japanese stocks fell in tandem. In addition, the stock market initially reacted calmly to the Israeli-Palestinian war, but reacted negatively when the bombing of a hospital in the Gaza Strip prompted Iran's foreign minister to call on Islamic countries to embargo crude oil exports to Israel, which could lead to a spike in crude oil prices. In addition, there was a flurry of news about monetary tightening, including hawkish views that dominated at the beginning of the month, reports that the Bank of Japan (BoJ) would revise its inflation expectations upward in mid-month, and the monetary policy change by the BoJ at the end of the month to make the 1.0% upper limit on long-term rates more flexible, but the impact on Japanese stocks was limited, perhaps because this level of policy revision had already been priced in.

Monetary policy: BoJ increased flexibility on upper limit of long-term rates, Japanese stock market reacted calmly.

On 31 October, the BoJ announced a revision to its monetary policy. Our initial impression was that Japanese stocks would fall slightly due to this revision, but perhaps the market had already priced in this level of correction, and the impact on Japanese stocks was limited. We think the performance of Japanese stocks throughout October was not significantly different from that of global stocks. We will discuss below the changes in monetary policy, our expectations for monetary policies going forward, and a summary of BoJ Governor Kazuo Ueda's press conference:

Further Increasing the Flexibility in the Conduct of Yield Curve Control (YCC)

- The Bank will patiently continue with monetary easing under Yield Curve Control (the short-term policy interest rate: -0.1%, the long-term interest rate: around 0%), aiming to support Japan's economic activity and thereby facilitate a favorable environment for wage increases.
  - Toward the end of the projection period, the Bank expects that underlying CPI inflation will increase gradually toward achieving the price stability target of 2 percent, while this increase needs to be accompanied by an intensified virtuous cycle between wages and prices.
- With extremely high uncertainties surrounding economies and financial markets at home and abroad, the Bank judges that it is appropriate to increase the flexibility in the conduct of yield curve control, so that long-term interest rates will be formed smoothly in financial markets in response to future developments.



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y/y % chg.

	Fiscal 2023	Forecasts made in July	Fiscal 2024	Forecasts made in July	Fiscal 2025	Forecasts made in July
CPI (all items less fresh food)	+2.8	+2.5	+2.8	+1.9	+1.7	+1.6
(Reference) CPI (all items less fresh food and energy)	+3.8	+3.2	+1.9	+1.7	+1.9	+1.8

Note: Figures indicate the medians of the Policy Board members' forecasts (point estimates).

Source: Bank of Japan, taken by SMDAM (Tokyo) November 2023.

First of all, the BoJ's most significant policy change this time is in long-term rates. In the past, the BoJ set the yields on 10-year JGBs at around 0% with fluctuations around ±0.5%, and did 1.0% as the strict upper limit ("Strictly capping 10-year JGP yields by fixed-rate purchase operations"). However, in the new monetary policy, although the focus remains on around 0%, the fluctuation range of ±0.5% is abolished, and the upper bound of 1.0% is set as a reference rather than a strict cap ("Upper bound for 10-year JGB yields as a reference", "Nimbly conducting market operations"). The upper end of the reference was not specified, but we estimate at this point that it is around 1.25%.

Looking ahead, we continue to expect the BoJ to lift its yield curve control (YCC) and negative interest rates in April 2024. Our economists predict that the BoJ will end the unprecedented monetary easing after confirming favorable wage increases, which could be shown in the results of the Japanese Trade Union Confederation (Rengo)'s spring labor offensive to be released in the middle of March 2024, and putting it in the April Outlook Report, saying that the probability of achieving the price stability target has increased.

SMDAM Summary of Governor Ueda's press conference :
(extracts our fund managers focused on)

Q: Why the readjustment of YCC?

A: We have judged it is appropriate to increase the flexibility of the YCC so that interest rates could be formed smoothly in financial markets in response to future developments. Strictly controlling the upper limit through continuous fixed-rate purchase operations has a powerful effect, but it can also have significant side effects. Rather than after the side effects occurred, we decided that we wanted to move quickly a little earlier, so we made it more flexible. The aim includes restoration of market functioning to some extent.

Q: Are the recent rises in long-term rates within expectations?

A: We did not think the rates would rise to close to 1% in July. The fact that the rises in US rates exceeded our expectations is the largest factor behind the rises in JGB yields.

Q: Has the price stability target come closer?

A: There are high uncertainties, and thus, we have not come to the point where we can see, with a high degree of probability, the achievement of the price stability target in a sustainable and stable manner. Inflation expectations have risen moderately, and it is true that the probability that the forecast will be realised is slightly increasing. We would like to closely monitor whether a virtuous cycle between wages and prices will intensify.

Q: What makes the achievement of the price stability target?

A: It is when price increases continue to be followed by wage increases, and wage increases push up prices, especially service prices, etc., which needs to be hovering around 2%. Next year's spring negotiations between management and labor should be an important event.

Q: Was foreign exchange considered for the YCC adjustment?

A: It is desirable that exchange rates move in a stable manner in line with fundamentals. We would like to monitor the foreign exchange markets in close cooperation with the Japanese government. If the exchange rates have a significant impact on our inflation expectations, it could lead to a change in monetary policy. The increase in the YCC flexibility is, in a way, intended to protect financial markets from possible future increases in volatility and side effects associated with such increases. The volatility includes the one in the foreign exchange markets.

Source: Bank of Japan, compiled by SMDAM (Tokyo)

Earnings: Japanese companies reported steady earnings results for July-September period

The earnings announcement season for the July-September quarter got under way. As of 8 November, approximately 63% of major listed companies (excluding financials and listed subsidiaries of a listed company) on the Prime Section of the Tokyo Stock Exchange (TSE) announced their earnings results. According to Daiwa Securities, the aggregate sales and operating income increased 2% and 30%, respectively. Looking at actual operating income of the TOPIX 500 companies for the July-September quarter of 2023, 41% of them announced higher operating income than analysts' consensus estimates by 10% or more, and 25% announced income falling short of the consensus by 10% or more.

As a fund manager, I have an impression that the results for the July-September period were somewhat positive. What I paid attention to the most for these results was whether inventories were decreasing and whether there were any comments made at the results briefing regarding the end of inventory adjustments and bottoming out of capacity utilisation rate in the future. Many materials companies and some electronics component companies made comments on the end of inventory adjustments, which gave an impression to me that intermediate goods related companies whose goods are used in manufacturing the final products, are beginning to bottom out. In addition, while there are many positive results in automobile industry due to weak yen and recovery in automobile production, cyclical stocks, such as IT and FA related stocks, that are seen as growth stocks as a theme at first glance, saw a sharp decline in profits. And China economy is still at the bottom. These are current impressions. Below are the main financial results:

Positives

Murata Manufacturing: The electronic components maker's sales fell short of consensus estimates, but its operating profit beat market consensus. Profitability improved as a result of reducing sales of low-margin products intentionally and increasing sales of high-margin products, such as high-frequency filters and MetroCirc, a multilayer resin substrate. Also, at the beginning of the fiscal year, Murata said that it would reduce inventory by 40 billion yen, but in 2Q 2023, Murata actually reduced it by 35.5 billion yen and in 2H 2023, Murata established a system that enables it to produce in line with its sales size. Additionally, monthly orders improved month on month starting from June and continued to do so in July, August and September.

Toyota Motor: This auto OEM beat consensus estimates of sales and profits. The increase in profits can be attributed not only to the recovery in automobile production following the end of the semiconductor shortage but also to price increases and reductions in incentives. As for the future of North America market, solid final demand and foreseeable continuation in inventory recovery phase were confirmed, as 1) inventory started to improve in September to some extent which has been experiencing a shortage up until August and 2) a demand is strong.

Negatives

Omron: A manufacturer of factory automation and healthcare equipment posted sales and profits below market consensus. Fixed costs became a burden due to the increase in personnel costs and selling general and administrative (SG&A) expenses in the previous quarter, and results worsened further in this quarter due to production adjustments and inventory adjustments as well as a decline in its high margin solution business in China. Due to weak demand in China and continued inventory adjustments at its distributors, inventory adjustments in the control equipment business are expected to continue until Q3 2024.

Astellas Pharma: Astellas This pharma's operating profit was below market consensus. SG&A expenses, research & development expenses, and amortisation of intangible assets were all higher than expected, and sales of new drug Veozah were lower than expected. Additionally, the company revised its full year operating profit forecast downward reflecting weak yen and acquisition-related costs.

Investment Strategy

We expect that the Japanese equity market will advance in the short term due to a change in the management policy of Japanese companies with a P/B ratio below 1x driven by TSE policy. Over the long term, policies that are more open to foreign capital, including 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 crisis and global recession, as major risks. Taking these into consideration, we will overweight low-P/B companies with large net-cash positions or a lot of unrealised gains on land.

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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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