Marketing Communication
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Value + Alpha Group

PM's Monthly Perspectives

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MARKET DEVELOPMENTS

The MSCI Japan index declined due to a stronger yen against the US dollar and a fall in semiconductor-related stocks. However, global stocks advanced in response to dovish remarks by the Federal Reserve Chair Jerome Powell in his post-Federal Open Market Committee press conference and a fall in US bond yields on the back of easing concerns about US inflation. Japanese stocks were pushed down by a stronger yen against the US dollar on the back of weaker-than-expected US CPI data, possible currency interventions by the Japanese government and the Bank of Japan (BOJ), and some unconfirmed speculative media reports that the BOJ would raise interest rates. Additionally, sales guidance from **ASML Holding** and **Renesas Electronics** that fell short of analysts' estimates as well as media reports that the US was considering tougher rules to restrict exports of semiconductor equipment to China, caused semiconductor-related stocks to fall, which also weighed on Japanese stocks as "momentum stocks," which had been the driving force behind Japan's rising stock market, dropped in tandem with the semiconductor-related stocks. Incidentally, the BOJ's decision, made during the afternoon session of the market on 31 July, to raise its policy rate to 0.25% and trim down government bond purchases, came as somewhat of a surprise to market participants. Market reactions to the decisions were: the US dollar-yen rates and bond yields displayed a neutral stance, while Japanese stocks, particularly bank stocks, saw a rise during the rest of the afternoon session, which ended at 3:00pm. (The yen started to see a sharp appreciation against the US dollar from around 4:00pm on 31 July, which brought Japanese stocks down significantly on 1 August.)

<u>Monetary policy: The July rate hike was earlier than analysts' consensus estimates; the BOJ may have wanted to combat a weak yen early</u>

The Bank of Japan (BOJ) decided at its July monetary policy meeting (MPM) to make an additional rate hike and reduce long-term government bond (JGB) purchases. Its policy rate rose to 0.25% from 0% to 0.1%. According to QUICK Corp's monthly market survey on bonds conducted during 23-25 July, ahead of the MPM, the majority of respondents predicted that the BOJ would not raise its policy rate at the MPM, with 74% of them saying that the BOJ would leave its policy rate unchanged. As for the monthly outright purchases of Japanese government bonds (currently around JPY6 trillion), the BOJ will reduce the amount by around JPY400 billion per quarter, in principle, bringing the purchase amount to around JPY3 trillion per month in the January-March quarter of 2026. This is in line with surveys by private companies and media reports in the run-up to the MPM.

In its statement, the BOJ said that Japan's economic activity and prices have been developing generally in line with its outlook, and that upside risks to inflation rates from a rise in import prices require attention. Under such circumstances, the BOJ said it judged it appropriate to adjust the degree of monetary accommodation from the perspective of achieving the price stability target of 2% in a sustainable and stable manner. The BOJ provided an official explanation as such, but we think that there is no denying that the decision to raise interest rates this time was somewhat abrupt, and in addition to the view like ours that it was in response to the yen's depreciation, there is also a view that pressure from the political side influenced the BOJ's decision more than expected. The BOJ kept its new core CPI (excluding fresh food and energy) outlook from the previous outlook throughout the forecast horizon of FY2024-FY2026, but about risk factors, it added in the Outlook Report that "with firms' behaviour shifting more toward raising wages and prices recently, exchange developments are, compared to the past, more likely to affect prices", suggesting that the BOJ is cautious about exchange rate movements. About the GDP risk balance, the report said that risks to economic activity are skewed to the upside for FY2025. (In the previous outlook, upside and downside risks are generally balanced from FY2024) About the CPI risk balance, the report said that risks to prices are skewed to the upside for FY2024 and FY2025. (In the previous outlook, the risks are skewed to the upside for FY2024, but are generally balanced afterwards.) Given BOJ Governor Kazuo Ueda saying at the post-MPM press conference, "the current real interest rate is extremely low", the market will focus on the pace and level of future rate hikes. We expect the next rate hike to be in December 2024.

Major changes in BOJ's monetary policy framework

	Item	Previous Policy	Newest Changes
1	Uncollateralized overnight call rate	Encourage it to remain at around 0 to 0.1%	0.25%
2	Current account deposits at BOJ	0.1%, excluding required reserve balances	0.25%, excluding required reserve balances
3	JGB purchases	Continue to buy long-term JGBs with broadly the *same amount* as before. (Around JPY6 trillion plus or minus roughly JPY1.5 trillion) Conducting fixed-rate purchase operations and the Funds-Supplying Operations against Pooled Collateral.	Decided on a plan to reduce the amount of its monthly outright purchases of long-term JGBs by about JPY400 billion per quarter so that it will be about JPY3 trillion per month in January-March 2026. Conduct an interim assessment of the plan for the reduction of its purchase amount of JGBs in June 2025. In principle, the BOJ intends to maintain the plan for the reduction after the assessment, while it may modify the plan as appropriate, if deemed necessary after reviewing the developments in and functioning of the JGB markets. The BOJ will also discuss a guideline for its JGB purchases from April 2026 and announce the results. Amend the plan for the reduction at the MPMs, if deemed necessary.
4	Forward guidance	Conduct monetary policy as appropriate in response to developments in economic activity and prices as well as financial conditions. Anticipates that accommodative financial conditions will be maintained for the time being.	If the outlook for economic activity and prices presented in the July Outlook Report will be realized, the BOJ will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation. Conduct monetary policy as appropriate in response to developments in economic activity and prices as well as financial conditions.

Source: BOJ, complied by SMDAM on 1 August 2024

Earnings: Results for April-June quarter were solid

The earnings announcement season for the April-June quarter has started. As of 7 August, approximately 62% 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 operating profit increased +7% year-on-year. Looking at actual operating profit of the TOPIX 500 companies for the April-June quarter of 2024, 44% of them announced higher operating profit than analysts' consensus estimates by 10% or more, and 19% announced the profit falling short of the consensus by 10% or more.

With many companies announcing financial results that exceeded analysts' consensus estimates, our overall impression of the quarterly earnings is positive. Trends of the results are: 1) many companies reported increased sales volumes related to data centres and semiconductors; 2) Chinese capital investment is showing signs of recovery; 3) many chemical companies reported strong results due to increased sales volumes and market improvements; and; 4) many companies announced a share buyback plan in response to the decline in the Japanese stock market.

- While price developments have been in line with the BOJ's outlook, there is a possibility that prices will deviate upward from the baseline scenario if another pass-through of recent cost increases to consumer prices happens. It is therefore necessary for the BOJ to consider whether further adjustments to monetary accommodation are needed from the perspective of risk management.
- Although price developments have been on track to achieve the price stability target of 2 percent in the second half of FY2025, upside risks to prices have become more noticeable. It is necessary for the BOJ to continue to closely monitor relevant data in preparation for the next MPM - considering that the upside risks to prices have affected consumer sentiment - and if deemed appropriate, it should raise the policy interest rate before it is too late, in response to an increase in the likelihood of achieving the target.
- The depreciation of the yen increases the possibility of an upward revision to the outlook for the inflation rate. From the standpoint of the risk-management approach, the appropriate, risk-neutral level of the policy interest rate should rise in reflection of the increased upside risks to prices.
- Developments in foreign exchange rates have a wide-ranging impact on economic activity, and if exchange rates continue to deviate from fundamentals, this will also affect the sound development of the national economy. On the other hand, since monetary policy impacts not only exchange rates but also wide aspects of people's daily lives and economic activity, it must be conducted based on the overall picture of developments in economic activity and prices.
- Monetary policy is conducted based on an assessment of the trend in prices and underlying wage developments. It is not determined by short-term developments in foreign exchange rates.

- The BOJ should reduce its purchase amount of Japanese government bonds to ensure that long-term interest rates will be formed more freely in financial markets. In doing so, it is appropriate for the BOJ to make a sizeable reduction in the purchase amount in a predictable manner, while securing flexibility to ensure stability in the JGB market.

Opinions from Government Representatives

- The government will make further progress toward achieving both economic revitalisation and fiscal consolidation.

Source: BOJ, complied by SMDAM on 1 July 2024

Below are some examples of positive and negative cases:

Positives

Asahi Kasei Corp: the chemical company beat analysts' consensus estimates for actual sales and operating income. Its chemicals segment posted strong results due to volume growth, market improvements and cost reductions. The medical devices segment is on the recovery trend due to improving inventory adjustments. The homes segment offset a challenging sales environment for single-family houses with strong condominium sales and value-added growth in order-built homes and rental management.

Misumi Group Inc: the parts developer for factory automation beat analysts' consensus estimates for actual sales and operating income. On a currency and working-day adjusted basis, its year-on-year sales improved each month, with a growth of +2% for April, +5% for May and +11% for June. The company attributes the improvement to the robust performance of its data centre business in China and the solid sales in China resulting from its distinctive strategies. The company achieved a record gross income ratio, attributing this to the weak yen, an improved product mix, and a recovery in capacity utilization, etc.

Negatives

Nissan Motor: the car manufacturer missed analysts' consensus estimates for actual sales and operating income. The company's first-quarter (April-June) 2024 earnings declined more significantly than its sales unit change, which remained flat year-over-year. This was due to a combination of factors, including increased sales incentives, currency effects such as a weaker Argentine peso, and higher HR costs. Its sales finance segment also reported a decline in profit due to a fall in used car prices in the US and an increase in the credit loss ratio.

Seven & i Holdings Co. Ltd.: the retail group missed analysts' consensus estimates for actual sales and operating income. In Japan, the company has many regional convenience stores, which negatively affected its comparable store sales compared to competitors due to the population shift from rural to urban areas following the end of the pandemic phase of COVID-19. In the US, comparable-store sales at convenience stores were weak due to continued inflation, and despite the company's strategy of not passing on the increase in raw material prices to customers, this did not result in sales growth.

Investment Strategy

We expect that the Japanese equity market to advance due to a change in the management policy by Japanese companies, driven by the Tokyo Stock Exchange's call for enhancements in the P/B ratio. Over the long term, policies that are more open to foreign capital, including an 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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CMA: Member of The Securities Analyst Association of Japan.

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