Marketing Communication
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Fundamental Active Group

PM's Monthly Insights

Authors

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

Market Outlook

We anticipate that the Japanese equity markets will remain stable and exhibit a gradual rise in September. The month will feature macroeconomic data releases, key monetary policy decisions, and political events of high interest to investors. In the US, job data will be released on the 6th, followed by the CPI on the 11th. Additionally, the FOMC meeting is scheduled for the 17th-18th, with consensus indicating that the US will enter a rate-cutting cycle. On the political front, the first presidential candidate debate since Vice President Kamala Harris was nominated as the Democratic presidential candidate will be held on the 10th.

In Japan, the ruling Liberal Democratic Party's presidential election will take place on the 27th. Trading value on the Tokyo Stock Exchange has been declining, reflecting investors' wait-and-see attitude ahead of these significant events. However, we believe robust corporate earnings will drive a market rise toward the end of the year.

Fundamentals are exhibiting improvement on both micro and macro fronts. For the April-June period, 66% of Japanese companies reported positive results exceeding market consensus. While a weaker yen had a positive impact, especially for companies driven by foreign demand, the earnings growth rate of domestic demand-driven companies outperformed those of foreign-demand companies, indicating strong performance on the whole.

The earnings forecasts revision index remains in positive territory even after the earnings announcements. The average assumption of the USD/JPY exchange rate is around the 145s. Therefore, we expect many upward revisions in interim earnings reports starting from late October, which could serve as a catalyst for Japanese equities.

On the macro front, Japan's inflation-adjusted real wages turned to positive for the first time in 27 months in June, and GDP for the April-June period showed positive growth, driven by consumer spending and capital expenditures. The emerging signs of recovery in domestic demand can also be seen as a positive factor for Japanese equities.

Since April 2024, Japanese companies have announced share buyback programs totalling approximately JPY 10 trillion, doubling the amount from the same period last year. This amount is equivalent to the total buybacks in FY 2023, which was a record high for a single fiscal year. Many companies announced the buybacks agilely in response to the recent crash in stock prices, demonstrating their commitment to the stock market. These high levels of share buybacks are expected to support the lower bound of the Japanese stock market.

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

Strong US retail sales data and other factors suggest that the US economy is likely to achieve a soft landing, with a slower pace of Fed rate cuts than market expectations. If oil prices don't spike, domestic inflation in Japan is expected to be around 2% in 2025, suggesting that the Bank of Japan's rate hikes are also likely to be moderate. For the time being, the exchange rate is expected to stay around current levels and will not be a major disruptive factor.

On the Japanese political front, the Cabinet's approval rating is expected to shift higher than at present regardless of who becomes the next Prime Minister. This would likely lead to a dissolution of the House of Representatives and a snap election within the year. Subsequently, the Cabinet is expected to compile economic measures, with specific policies being reflected in the FY2024 supplementary budget or in the FY2025 tax reform outline, potentially having a mildly positive impact on the economy. To raise approval ratings, improving the domestic economy is essential, and current policies are expected to be maintained. As such, it is likely to be a minimal impact on the stock market and the Fundamental Active strategy.

Investment Strategy

For the Fundamental Active strategy:

In the GICS sectors, we will remain overweight in energy, consumer discretionary, and communication services.

We continue to focus on bottom-up stock selection over sector allocation. We will increase our weighting in names that are expected to see significant earnings growth, including pharmaceuticals with strong new drug sales and information services companies with increasing orders.

Conversely, we will keep our underweight in industrials and utilities, which show relatively weak earnings growth. We will liquidate domestic service-related stocks that have seen a decline in customer numbers due to price hikes. Additionally, we will reduce our weighting in SPE (Semiconductor Production Equipment), considering potential tighter semiconductor regulations and concerns about peaking capital spending by major overseas manufacturers.

Overweight sectors (largest shown first):	**Underweight sectors** (largest shown first):
Energy	Industrials
Consumer Discretionary	Utilities
Communication Services	Healthcare

Source: SMDAM
Sectors shown are Global Industry Classification Standard (GICS) 11 sectors.

Risk Warning: 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.

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Hideyuki TANIUCHI, CFA/CMA
Senior Portfolio Manager and Group Leader, Fundamental Active Group, Equity Management Department
Mr Taniuchi 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).

Contact Details

Business Development and Client Relations
For investors outside the EEA:
Richard HAXE: +44 (0)20 7507 6431
Alex BARRY: +44 (0)20 7507 6419
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

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