

Fundamental Active Group PM's Monthly Insights

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Market Outlook

In October to December, the Japanese stock market is expected to rise toward the end of the year on the back of strong corporate earnings. A wait-and-see attitude had persisted over developments in monetary policies of major central banks and political events. However, with these uncertainties now resolved, we expect Japanese stock prices to move in line with individual companies' fundamentals from October onward.

Three factors that may provide a tailwind for the market:

- **The Snap Election for the House of Representatives on October 27:** Looking back the history, the Japanese stock prices have tended to rise for 2-3 months following the dissolution of the House of Representatives. We expect the election to boost the government's approval rating and raise expectations for the new cabinet's economic measures.
- **Anticipating Stable Foreign Exchange Rates:** Expectations for a soft landing of the U.S. economy and the Bank of Japan (BOJ)'s monetary policy bring hope for a stable foreign exchange market. Given the outlook for Japanese inflation, a sharp rise in domestic interest rates seems unlikely. The new leader of the ruling Liberal Democratic Party (LDP), Mr Shigeru Ishiba, has remarked, "Continuing the basic policy of monetary easing while gradually transitioning toward environment with higher interest rates is the right approach." His stance largely aligns with the BOJ's current policy of gradual monetary normalisation.
- **Expectations for Interim Earnings Results:** Upward revisions are expected as companies' earnings forecasts tend to be conservative. In addition, companies are becoming more conscious of their share prices and are expected to strengthen their shareholder returns.

Ishiba Administration's economic policy:

The economic policies of the Ishiba administration are expected to follow the path set by the Kishida administration, with a focus on economic considerations. Therefore, we do not expect any significant changes. Ishiba stated that the priority of his economic and fiscal policies is to overcome deflation in order to achieve "a growth-oriented economy driven by wage increases and investments." He also emphasises accelerating the shift of household financial assets from savings to investment, which is also in line with the policy stance of the previous administration.

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

Ishiba has softened his stance on "zero nuclear power plants" and now plans to utilise nuclear power, with safety as the top priority. Katsunobu Kato, former Chief Cabinet Secretary, was appointed as Finance Minister. Kato, who was one of the candidates in the LDP presidential election, advocated for a bold supplementary budget during the election and supported a policy of corporate wage increases. As such, he is seen as having an understanding of the new administration's economic measures. We think the likelihood of a negative shift in economic policies is lower than imagined.

Corporate earnings:

The earnings forecast revision index remains in positive territory even after the earnings announcements. As the average corporates assumption of USD/JPY exchange rate is around 145s, there is a high probability of many upward revisions in interim earnings results starting from late October, which could be a positive factor for Japanese stocks.

Additionally, the total amount of share buybacks executed in the first half of FY2024 (April to September) reached JPY 8 trillion, up 102% YOY. This high level of share buybacks is supported by strong corporate performance, abundant cash and deposits, perceptions that stock prices are undervalued, and progress in corporate governance reforms.

For FY2024 as a whole, the total amount of share buybacks is anticipated to reach approximately JPY 16 trillion. The ratio of buybacks to net profit after tax is estimated at 25.7%, and the total payout ratio, including dividends, is expected to exceed 60%. These factors, along with the increase in EPS and ROE, are likely to contribute to pushing up the Japanese stock market.

Investment Strategy

For the Fundamental Active strategy:

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

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

In the GICS sector, we will maintain our overweight in consumer discretionary, energy, and communication services. Our strategy of focusing on bottom-up stock selection over sector allocation remains unchanged.

We will focus on stocks that are expected to make upward revisions in their interim earnings forecasts and those that we have a high conviction of earnings improvement beyond FY2025. We also intend to increase our weighting in stocks that are expected to enhance shareholder returns.

In addition, we will consider buying quality stocks whose share prices have declined due to deteriorating supply and demand conditions. As the risks of overseas recessions and the likelihood of accelerated yen appreciation receded, we will also consider purchasing undervalued cyclical stocks driven by external demand.

Conversely, we will maintain our underweight in industrials and health care, which show relatively weak earnings growth. Although our baseline scenario assumes that the geopolitical risks in the Middle East will not prolong, we remain vigilant about these risks.

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

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