

JAPAN EQUITY MONTHLY

July 2018

Japanese equities mixed in June

The Japanese equity market was mixed in June, with the TOPIX (w/dividends) falling 0.76% on-month and the Nikkei 225 (w/dividends) climbing 0.65%. Stocks rose in the first half of the month as the yen depreciated against the US dollar on stronger-than-expected US economic data and growing expectations for additional interest rate hikes. In addition, stocks benefitted from easing geopolitical concerns after the summit between the leaders of the US and North Korea concluded without issue. However, the market subsequently declined in the second half of the month on concerns over intensifying trade tensions between the US and China and worries that a trade war could spread to other countries after the US announced its intention to impose higher tariffs on cars imported from the European Union.

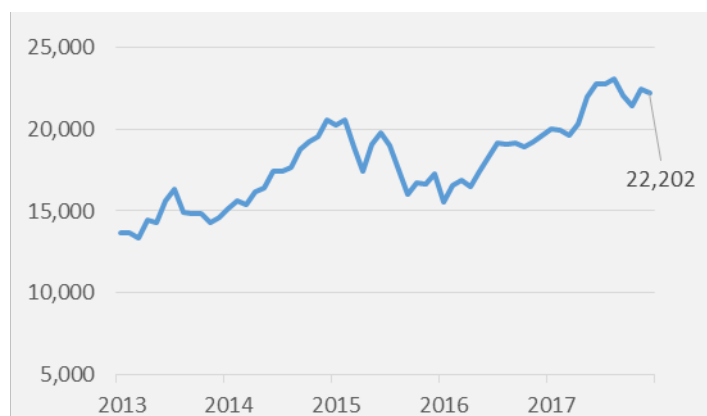
Of the 33 TSE sectors, nine including Oil & Coal Products, Fishery, Agriculture & Forestry and Pharmaceuticals posted gains during the month, while 24 including Other Products, Air Transportation and Metal Products declined.

Exhibit 1:

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	22,201.82	-1.2%	0.6%	-2.3%
JGB Yield	0.040	-0.015	-0.013	+0.001
JPY/USD	108.93	-0.3%	1.7%	-3.1%
JPY/EUR	127.22	-3.7%	-2.8%	-4.3%
MSCI World	2,092.92	0.3%	-1.2%	0.7%

Source: Bloomberg, as of 29 June 2018

Exhibit 2:



Source: Bloomberg, as of 29 June 2018

Room for upside in Japan

Foreigners turned net sellers of Japanese equities in May on rising U.S. yields and escalating trade tension between the U.S. and China. We see this selling as cyclical and not a trend.

Despite recent news flows, we are upbeat about Japanese corporate earnings and see high single-digit growth for TOPIX companies in the next 12 months. We forecast the Nikkei will rise approximately 10% in the same period, as earnings reported to the interim result season (Oct.-Nov.) are expected to be positive. Strong exports will lead this direction in our view. Volatility is high on fluctuations in the flow of information and money ahead of the U.S. election season. We expect this to continue, with buybacks later.

Remain optimistic on corporate earnings

The “Abenomics” rally that began in 2013 is likely to continue. Investors in Japan have been cautiously optimistic. But if increasing trade volume can lead to inflation in the near future, they will become more confident to invest more in an expanding economic environment for the first time in two decades. Stronger inflation is likely by the fiscal year-end in March 2019. This should be led by an increase in exports, to expand inventory and production for corporate Japan and raise wages and capex.

Higher rates in the US are related to supportive environment for exports from Japan. Protectionism is a risk for global investors in terms of sentiment, but so far we do not expect a heavy impact on corporate earnings for this year.

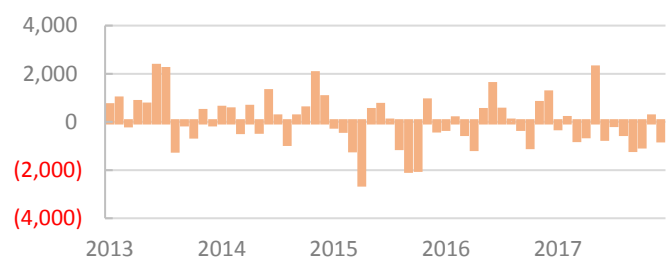
US-China trade tension may benefit Japan

Japan will likely benefit from the reduction in Chinese purchases of US goods and services (including tourism by Chinese) resulting from tariff hikes and general anti-US sentiment, but investors in Japan will likely still not be positive about the general global trend towards protectionism because Japan is quite reliant, especially in terms of corporate profits, on international trade. Worries abound as well about the next US target of automobiles. While Japan produces about half of its US sales in the US, it is exposed for the other half. Thus, sentiment for Japanese equities will likely be volatile over the summer, but fears contained by corporate profits continuing to rise in the meantime and the very solid Japanese political foundation as Abe extends his unprecedented leadership tenure.

Exhibit 3: Major Market Indices



Japan Equity Net Purchase from Overseas (JPY bil.)



Source: Bloomberg, as of 29 June 2018

Exhibit 4: Major Index Performance, Indicators, and Valuation

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	-1.2%	0.6%	-2.3%	13.0%	62%
JGB Yield (%pt)	-0.015	-0.013	+0.001	+0.040	-0.813
JPY/USD	-0.3%	1.7%	-3.1%	-1.7%	10%
JPY/EUR	-3.7%	-2.8%	-4.3%	2.4%	-1%
MSCI World	0.3%	-1.2%	0.7%	9.5%	46%
TOPIX	-1.7%	-1.2%	-2.5%	11.4%	54%
TPX-100 (Large)	-1.9%	-1.9%	-3.1%	10.1%	44%
TPX-400 (Mid)	-1.6%	-0.1%	-2.4%	11.6%	66%
TPX-Small	-0.5%	-0.3%	0.3%	18.3%	88%

Sector (TPX-17)	1-mth	3-mth	6-mth	1-yr	5-yr
Elc Appl&Prec	-1.5%	-4.3%	-4.8%	15.9%	87%
IT & Service	0.3%	1.6%	-2.2%	10.0%	88%
Auto&Trns Eqp	-4.9%	-6.9%	-6.0%	8.4%	18%
RawMatl & Chm	1.9%	1.5%	0.3%	20.0%	108%
Banks	-5.7%	-6.9%	-8.2%	1.4%	2%
Machinery	-2.9%	-7.2%	-5.7%	14.4%	62%
Transprt&Logi	1.1%	6.7%	1.9%	11.3%	51%
Const & Matl	-3.3%	-0.7%	-6.9%	10.1%	82%
Fincl ex Bank	-3.1%	0.0%	-2.2%	6.6%	31%
Foods	-0.3%	4.4%	-3.5%	0.2%	66%
Retail Trade	-0.2%	6.0%	5.4%	16.3%	75%
Pharmceutical	0.5%	-1.6%	3.1%	11.3%	67%
Commr & WhTrd	-1.8%	-0.3%	5.3%	26.0%	70%
Real Estate	-3.4%	3.4%	3.6%	7.7%	-1%
Steel&Nonfer	-5.7%	-9.7%	-13.3%	4.6%	16%
Elc Pwr & Gas	0.1%	13.2%	7.0%	1.9%	4%
Enrgy Resourc	-7.1%	-1.0%	3.1%	34.1%	40%

Valuation	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.2%	2.0%	1.9%	2.1%	1.9%
Price/Earn (e)	13.7	14.5	15.7	14.4	14.2
Price/Book	1.3	1.4	1.4	1.3	1.2
MSCI World					
Div. Yield (e)	2.5%	2.5%	2.4%	2.5%	2.7%
Price/Earn (e)	15.9	16.2	18.1	17.3	13.9
Price/Book	2.3	2.3	2.4	2.2	1.8

Market Indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
Daily Turnover	54	53	54	53	48
Market Cap.	658	647	680	604	398
Net Purchase Overseas	-741	-1,532	-3,260	-3,114	1,982

Source: Bloomberg, as of 29 June 2018

(e) stands for consensus estimates by Bloomberg. Turnover and market cap in JPY tril.

Net Purchase (JPY bil.) from Overseas is cumulative monthly.

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