

# JAPAN EQUITY MONTHLY

February 2018

## TOPIX gained on positive Q3 GDP growth

The Japanese equity market rose in January, with the TOPIX (w/dividends) climbing 1.06% on-month and the Nikkei 225 (w/dividends) rising 1.47%. The market moved upward at the start of the month on better-than-expected US economic indicators and improved confidence over the US economic outlook amid expectations for future capital spending growth driven by corporate tax cuts. Stocks then declined from mid-month, despite some brief periods of gains driven by upbeat earnings expectations as well as the Bank of Japan's (BOJ's) decision to stand pat on its monetary policy. The yen appreciated against the US dollar following comments by the US Treasury Secretary praising a weaker dollar, which spurred concerns of a negative earnings impact on Japanese exporters.

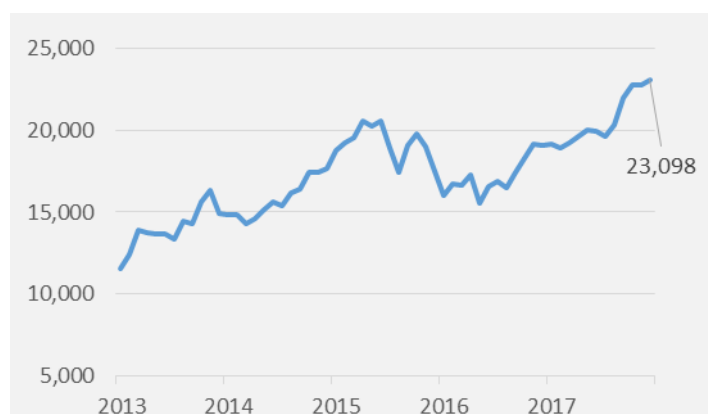
Nevertheless, stocks were able to hold onto earlier gains to end the month positive. Of the 33 TSE sectors, 19 including Real Estate, Securities & Commodity Futures, and Other Products posted gains during the month, while 14 sectors including Air Transportation, Construction, and Fishery, Agriculture & Forestry saw declines.

### Exhibit 1: Major Indices (Last Month and Historic Changes)

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	23,098.29	1.5%	4.9%	15.9%
JGB Yield	0.085	+0.037	+0.014	+0.002
JPY/USD	108.82	-3.4%	-4.0%	-1.6%
JPY/EUR	135.42	0.1%	2.7%	4.4%
MSCI World	2,213.24	5.2%	8.7%	12.9%

Source: Bloomberg, as at 31 January 2018

### Exhibit 2: Nikkei 225



Source: Bloomberg, as at 31 January 2018

## BOJ could begin tapering in 2H2018

The Bank of Japan (BOJ) has been trimming its bond purchases lately, fuelling speculation that the central bank may wind back its monetary stimulus this year. While BOJ Governor Haruhiko Kuroda has repeatedly dismissed this possibility, we believe that the BOJ could be set to start tapering as early as the second half of 2018. We expect the BOJ to begin with moderating its purchases of Japanese equities and long-term Japanese Government Bonds, in line with their aim to steepen the back end of the yield curve. As a result, the yield curve control (YCC) is likely to be eased from the current target of zero percent for 10-year JGB yields to around 0.3-0.7% in the later part of the year. Meanwhile, the short-term interest rate target should remain at -0.1%.

That said, Japan's inflation outlook will be the key deciding factor for policy normalisation. We believe that the BOJ will only formally introduce monetary policy tightening when it sees more evidence of core inflation rising towards its 2% target level. We expect inflation to pick up in the second half of 2018.

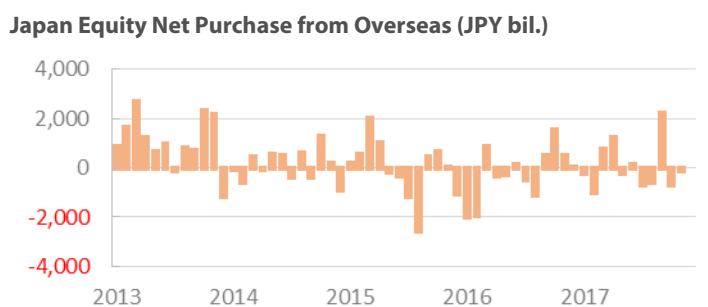
## Abe expected to adopt a 'wait and see' approach before declaring the end of deflation

Japan is enjoying its second-longest expansion since the end of World War II. However, the country has yet to emerge decisively from deflation. Coupled with the consumption tax hike which is expected to be implemented in late 2019, it may be premature for the government to declare an official end to deflation. We believe that Abe will adopt a wait-and-see approach and assess the potential economic impact of the tax hike. While inflation has been rising in 2017, the growth has been modest and we believe that the government will first need reasonable assurance that Japan will not slip back into a deflationary environment in the future.

## Strength in yen expected to be transitory

We believe that yen's strength against the USD during the month is largely transitory as it was influenced more by the market's interpretation of Kuroda's inflation expectations. We continue to see the yen weaken to 118 against the dollar. Overall, we expect growth and economic fundamentals in the US to outpace that of Japan's, and expected monetary policy divergence between the two central banks should help strengthen the USD against yen going forward.

Exhibit 3: Major Market Indices



Source: Bloomberg, as at 31 January 2018

Exhibit 4: Major Index Performance, Indicators, and Valuation

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	1.5%	4.9%	15.9%	21.3%	100%
JGB Yield (%pt)	+0.037	+0.014	+0.002	+0.085	-0.578
JPY/USD	-3.4%	-4.0%	-1.6%	-4.4%	18%
JPY/EUR	0.1%	2.7%	4.4%	11.2%	12%
MSCI World	5.2%	8.7%	12.9%	23.5%	58%
TOPIX	1.1%	4.0%	13.5%	20.7%	88%
TPX-100 (Large)	1.4%	3.7%	12.9%	18.0%	76%
TPX-400 (Mid)	0.5%	4.2%	13.5%	22.7%	105%
TPX-Small	0.9%	5.3%	16.7%	30.5%	117%

Sector (TPX-17)	1-mth	3-mth	6-mth	1-yr	5-yr
Elc Appl&Prec	3.1%	5.0%	17.3%	34.0%	136%
IT & Service	1.1%	0.3%	9.0%	20.2%	137%
Auto&Trns Eqp	1.3%	4.6%	15.7%	15.1%	57%
RawMatl & Chm	0.0%	3.9%	14.6%	28.5%	139%
Banks	-0.5%	3.6%	11.0%	6.6%	32%
Machinery	4.1%	9.0%	25.0%	33.9%	114%
Transprt&Logi	0.3%	3.2%	10.9%	12.9%	70%
Const & Matl	-2.2%	0.7%	12.1%	26.8%	128%
Fincl ex Bank	2.6%	5.7%	11.3%	11.1%	76%
Foods	-1.5%	0.8%	6.3%	17.4%	94%
Retail Trade	-1.1%	5.9%	12.9%	17.9%	106%
Pharmceutical	1.5%	2.9%	10.2%	16.4%	73%
Commr & WhTrd	0.2%	9.8%	20.6%	26.6%	75%
Real Estate	8.4%	8.2%	13.7%	14.5%	26%
Steel&Nonfer	-1.4%	2.9%	10.9%	17.3%	45%
Elc Pwr & Gas	-0.6%	-6.0%	-6.0%	0.6%	34%
Enrgy Resourc	-1.3%	22.1%	42.4%	33.8%	38%

Valuation	Mth-end	3-mth	6-mth	1-yr	5-yr
<b>TOPIX</b>					
Div. Yield (e)	1.9%	1.9%	2.1%	2.0%	1.9%
Price/Earn (e)	15.8	15.7	14.4	15.7	18.9
Price/Book	1.4	1.4	1.3	1.3	1.1
<b>MSCI World</b>					
Div. Yield (e)	2.4%	2.4%	2.5%	2.5%	2.8%
Price/Earn (e)	17.1	17.9	17.5	17.1	13.8
Price/Book	2.4	2.3	2.3	2.2	1.8

Market Indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
Daily Turnover	55	57	53	50	48
Market Cap.	691	671	606	577	342
Net Purchase Overseas	NA	-789	147	721	11,548

Source: Bloomberg, as at 31 January 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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