SuMi TRUST Monthly Commentary

November 2019

Outlook for the Japanese Markets in 2020

1. Japanese Economy

Real GDP growth for the July-September 2019 quarter was +0.2% QoQ annualized, the fourth consecutive quarterly growth. The prime driver was domestic demand. With last minute demand seen before the consumption tax hike, private sector consumption, housing investment and capital investment (propelled by rationalisation and labor-saving measures) were the key drivers. Conversely, external demand suffered from a global economic slowdown due in large part to Sino-US trade frictions. As for the October-December quarter, we may see negative growth as result of slowing personal consumption after the consumption tax hike, and damage from the typhoons. However, this may well be offset and muted by the government's counter tax hike measures (i.e. an exemption for foods which remains at 8%, reward points and free pre-school education) and the successful Rugby World Cup Japan.

As for FY 2020, easing tensions between the US and China should bring recovery to external demand whilst domestic demand should be supported by personal consumption, capital expenditures and public investments. Hence, we see moderate growth of +0.4% for FY 2020. In addition, we see tailwinds from Prime Minister Abe's economic policies ahead of the Tokyo Olympics and Paralympics in 2020 that include natural disaster relief measures and counter measures against the consumption tax hike. We believe the Tokyo Olympics and Paralympics will have a bigger economic impact than the Rugby World Cup Japan, which has boosted both inbound and domestic tourist consumption, estimated around 440 billion yen. The risks will continue to be external factors including a global economic slowdown and Brexit.

2. Japanese Monetary Policy

The Bank of Japan's accommodative policies are expected to continue for some time. In its October meeting, the BOJ left policy unchanged and adopted a new forward guidance. Whereas the previous guidance read, "As for policy rates, the BOJ intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, at least through around spring 2020", the latest forward guidance made no mention of dates, in effect leaving it open ended and signaling continued easing for a prolonged period. Moreover, the BOJ has not ruled out deeper cuts in the already negative interest rates. However, given the impact on the banks and other repercussions, the hurdles are high. Unless the yen goes below 100 yen* against the USD, we believe the BOJ will maintain the current policy.
* 100 yen is 1) considered the breakeven point by manufacturers according to data compiled by the Cabinet Office, and 2) the last high recorded in the summer of 2016.

3. Foreign Exchange Market

The BOJ has maintained current policy and the Fed has ended its round of preventive rate cuts. Any rate hike by either central bank would require higher inflation which seems unlikely at this moment. We consider that a preventive rate cut by the Fed has improved market sentiment and has tilted the market to a risk-on mode. With the coming US Presidential Election, we believe that any rise in the USD would be muted. We see USD-JPY trading in a range (JPY 105-115) for the time being.

4. Japanese Equity Market

2020 should see continued easing by the central banks of the US, Japan and Europe, and a positive turnaround in Japanese corporate earnings. Our forecast for FY 2019 (ending March 2020) earnings is -7.9% (as of October 2019). However, FY 2020 should see demand recovery particularly in external demand sectors such as materials, energy and transportation equipment, and stable growth in the retail and telecommunications sectors. In addition, we see positive effects from acquisitions in the pharmaceutical sector as well as from the Tokyo Olympics and Paralympics, which should bode particularly well for domestic demand-led companies. For FY 2020, we forecast +10.7% earnings growth (as of October 2019). Moreover, the Japanese equity market remains cheap on a PE basis, and we expect to see continued share buybacks after record purchases in FY 2019. Should the Sino-US trade talks proceed and concerns of a higher yen recede, investor sentiment should improve, and the market may see a re-rating. In such a scenario, we could see the Nikkei 225 average reach 27,000 (up 15% from late November). As the impact of the higher consumption tax rate which took effect in October 2019 fades, the 2020 economy should see improvement in consumer sentiment as we head towards the Tokyo Olympics and Paralympics in July. Inbound tourism will also be an added boost to the economy and the government will announce fiscal measures after the games as a precaution.

Since the 1984 Los Angeles Olympics, every host nation has seen higher share prices (specifically stock indices) at the end of the following year preceding the games. Some investors believe that economies tend to slow down after hosting the Olympics on weaker investments. However, stock markets tend to rise conversely because such factors are already priced in and governments announce countermeasures as well. Japan should be no exception. In the external demand sector, we have been focusing on the steady progress in inventory adjustment in the manufacturing industry, especially the electrical equipment and machinery sectors. The Sino-US battle for high tech supremacy still continues at this moment. Once trade talks proceed and increased tariffs are reviewed, the global trade environment will be improved. This should lead to a recovery in capital expenditure demand and a cyclical recovery in a wide range of stocks. In other areas, the Taiwanese general election will take place in January 2020. And at the end of January, the UK will face the EU Brexit deadline. Korea will hold its general election in April, and in November, the US Presidential Election will take place. With much uncertainty in the international political arena, the market may be capped. In the US, there is much excitement over which democratic challenger will be nominated. Other factors such as Sino-US trade, global interest rates and Middle Eastern affairs all have the potential to move markets. 2020 is a year in which international affairs may take a more central stage than 2019.

5. Stocks of the month

We focus on companies which can solve social problems through innovation. For example, the aging society and health consciousness have laid emphasis on the critical role of companies making new drug discoveries and medical equipment. And with the declining working age population, resulting labor shortage and rising labor costs, the world needs companies with automation and conservation technology. In short, the world needs companies that can help improve social convenience using technology. Thus, we see much promise in investment themes such as “Healthcare”, “Automation” and “Technology”.

In “Healthcare”, we focus on Asahi Intecc (7747) which develops, manufactures and sells catheters (medical capillaries) and related products such as guiding catheters. Asahi Intecc has developed breakthrough technology in cardiovascular treatment, has its own integration production and develops its own materials. It has also expanded successfully in the overseas markets. We also focus on Daiichi Sankyo (6383) for its successful development of new anti-cancer treatment drugs.

In “Automation”, we focus on Daifuku (6383) known for its logistics automation equipment which enables optimization of product sorting and transport at logistics facilities. The company has improved delivery efficiency for the e-commerce business.

In “Technology”, we like companies with their own unique business models and goods/services, which distinguish them from their competitors, and cater to client needs. Specifically, we focus on M3 (2413) which provides efficient information with professionals in a medical industry via the internet. We also focus on GMO Payment Gateway (3769) which is the largest provider of an e-commerce settlement platform for consumers. It has expanded in the move towards a cashless society.

All enquiries regarding this report should be made to:

Global Business Development Department
Sumitomo Mitsui Trust Asset Management Co., Ltd. Tokyo-to 105-0011 Japan

Tel: +81-3-6453-3770
e-mail: global_sales@smtam.jp

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Any enquiries regarding the products should be made to:
Hirofumi Hayashi
Head of Investment Management Department
Sumitomo Mitsui Trust International Limited
155 Bishopsgate, London EC2M 3XU, United Kingdom
Direct: +44 (0)20 7562 8405
Email: imd@smtil.com
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