

JAPAN EQUITY MONTHLY

Japanese equities fell in December

The Japanese equity market fell in December, with the TOPIX (w/dividends) dropping 10.21% on-month and the Nikkei 225 (w/dividends) declining 10.28%. Japanese equities dropped in the early part of the month as US government officials indicated their intention to impose additional tariffs on Chinese products if an agreement is not reached in trade discussions by the 90-day deadline set at the US-China summit, heightening concerns. Mid-month, the market rallied briefly on expectations that tensions would ease after China announced plans to lower tariffs on US automobiles. However, equities fell once again after the stock price of a newly listed major mobile carrier fell below its IPO price, causing significant loss of investment capital that weighed heavily on sentiment.

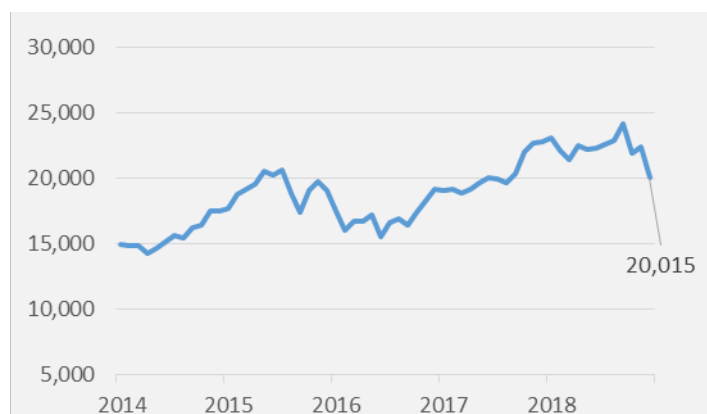
The sell-off accelerated further on concerns over an economic slowdown after the US Federal Reserve Board's decision to raise interest rates. All 33 of the Tokyo Stock Exchange sectors dropped, with Mining, Pharmaceutical, and Securities & Commodity Futures posting the steepest declines.

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

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	20,014.77	-10.5%	-17.0%	-10.3%
JGB Yield	0.003	-0.089	-0.127	-0.033
JPY/USD	110.04	-3.1%	-3.2%	-0.7%
JPY/EUR	126.02	-1.9%	-4.5%	-2.6%
MSCI World	1,883.90	-7.7%	-13.7%	-9.8%

Source: Bloomberg, as at 31 December 2018

Exhibit 2: Nikkei 225



Source: Bloomberg, as at 31 December 2018

A new Plaza Accord?

The Wall Street Journal reported in December on similarities between the US-China trade war and the US-Japan dispute in the 1980s, including the 1985 Plaza Accord that let Japan's currency rise against the dollar.

"Under similar pressure three decades ago, Tokyo made a fateful choice: major concessions to the U.S., including in the 1985 Plaza Accord that let Japan's currency rise against the dollar. What happened next offers important lessons for the U.S. about how trade conflicts can end in unanticipated ways," the Journal wrote.

We feel that these similarities are somewhat overblown, given that Huawei is China's only true global brand, and in reality, the country is in a much weaker position than Japan was in the 1980s. We don't expect an end to the tensions any time soon, as China has to protect the status quo until it can produce more value-added items.

Concerns Rise

It is clear that investors' concern is rising with worldwide stock prices plummeting in December. But the reasons are unclear. As world economic growth is expected to slow, the concern of a recession is strengthening. However, economic indicators have not deteriorated so much. Looking at interest rates in the US and the dollar-yen, the fundamentals are rather better compared to the beginning of last year.

We expect the stock market to bounce back sooner or later. However, it seems that it will take three to six months for sufficient information on items such as GDP and corporate earnings to come out. At the moment, I see the period when the Nikkei average returns to around 22,000 yen, the center of the range during 2018, in the May financial results period.

BOJ Year Ahead

The BOJ currently has two sources of difficulty. Monetary easing is not good enough for Japan and inflation may be more supported by expansion. While Japanese exports are expanding in volume, more capex and hiring is needed. An inflationary environment is coming, but when is the big question. In Japan, the CPI is more important than employment and wages. Most likely, Kuroda and the BOJ, under this level of uncertainty, won't do anything this year.

Exhibit 3: Major Market Indices

TOPIX



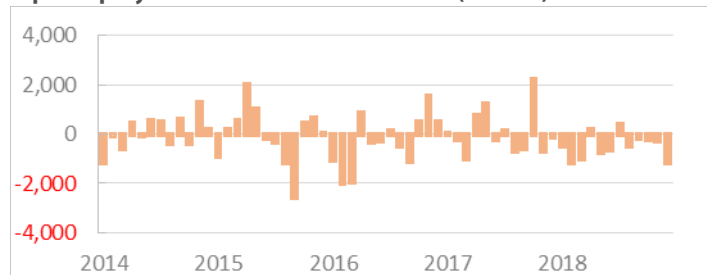
JGB Yield



JPY/USD



Japan Equity Net Purchase from Overseas (JPY bil.)



Source: Bloomberg, as at 31 December 2018

Exhibit 4: Major Index Performance, Indicators, and Valuation

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	-10.5%	-17.0%	-10.3%	-12.1%	34%
JGB Yield (%pt)	-0.089	-0.127	-0.033	+0.003	-0.619
JPY/USD	-3.1%	-3.2%	-0.7%	-2.4%	8%
JPY/EUR	-1.9%	-4.5%	-2.6%	-6.8%	-8%
MSCI World	-7.7%	-13.7%	-9.8%	-10.4%	18%
TOPIX	-10.4%	-17.8%	-13.7%	-17.8%	22%
TPX-100 (Large)	-9.9%	-17.6%	-12.1%	-16.4%	18%
TPX-400 (Mid)	-10.3%	-17.2%	-14.5%	-18.8%	29%
TPX-Small	-13.2%	-20.3%	-19.2%	-22.3%	32%

Sector (TPX-17)	1-mth	3-mth	6-mth	1-yr	5-yr
Elc Appl&Prec	-12.0%	-20.7%	-18.7%	-22.7%	33%
IT & Service	-11.2%	-21.1%	-13.3%	-13.1%	42%
Auto&Trns Eqp	-7.7%	-15.5%	-12.9%	-20.6%	-1%
RawMatl & Chm	-8.8%	-18.5%	-13.7%	-16.6%	67%
Banks	-13.0%	-20.3%	-14.9%	-28.0%	-19%
Machinery	-14.7%	-23.3%	-18.5%	-29.4%	9%
Transprt&Logi	-4.2%	-7.3%	-4.4%	-4.4%	45%
Const & Matl	-8.5%	-15.1%	-18.4%	-26.3%	27%
Fincl ex Bank	-12.4%	-19.0%	-12.9%	-17.9%	5%
Foods	-7.3%	-9.3%	-13.0%	-15.7%	46%
Retail Trade	-10.8%	-13.3%	-11.3%	-8.1%	48%
Pharmaceutical	-15.9%	-21.2%	-10.0%	-6.9%	42%
Commr & WhTrd	-7.9%	-15.5%	-9.3%	-11.8%	39%
Real Estate	-8.4%	-11.1%	-12.2%	-10.6%	-21%
Steel&Nonfer	-10.6%	-22.5%	-17.6%	-33.4%	-21%
Elc Pwr & Gas	-4.3%	-3.7%	0.1%	11.1%	17%
Engry Resourc	-15.8%	-33.9%	-20.0%	-24.4%	8%

Valuation	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.6%	2.1%	2.2%	1.9%	1.8%
Price/Earn (e)	11.9	14.1	13.6	15.8	14.7
Price/Book	1.1	1.3	1.3	1.4	1.3
MSCI World					
Div. Yield (e)	2.8%	2.4%	2.5%	2.4%	2.7%
Price/Earn (e)	14.3	16.5	15.9	17.1	14.7
Price/Book	2.1	2.4	2.3	2.4	1.9

Market Indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
Daily Turnover	49	55	52	53	49
Market Cap.	562	620	659	690	436
Net Purchase Overseas	-1,146	-1,702	-1,929	-5,745	-8,079

Source: Bloomberg, as at 31 December 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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