

JAPAN EQUITY MONTHLY

March 2018

Japanese equities declined in February

The Japanese equity market fell in February, with the TOPIX (w/dividends) dropping 3.70% on-month and the Nikkei 225 (w/dividends) tumbling 4.41%. While certain stocks posted gains early in the month on positive earnings results, the market underwent a broad-based decline through to mid-month after US stocks fell on fears that strong US economic indicators could spur a sharp rise in long-term interest rates. In the latter half of the month, stocks were subsequently weighed down by concern that the yen's appreciation against the US dollar would negatively impact exporters' earnings. However, equities began recovering modestly at the end of the month on heightened expectations that the Bank of Japan (BOJ) would maintain its monetary easing policy after the current BOJ governor was nominated for reappointment. Stocks also benefitted from a rebound in US equities after US long-term interest rates steadied.

Of the 33 TSE sectors, two sectors—Precision Instruments and Pharmaceuticals—posted gains during the month, while 31 sectors including Marine Transportation, Rubber Products and Mining saw declines.

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

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	22,068.24	-4.5%	-2.9%	12.3%
JGB Yield	0.053	-0.032	+0.014	+0.044
JPY/USD	107.10	-1.6%	-4.7%	-3.1%
JPY/EUR	130.89	-3.3%	-1.6%	-0.2%
MSCI World	2,117.99	-4.3%	2.0%	8.1%

Source: Bloomberg, as at 28 February 2018

Exhibit 2: Nikkei 225



Source: Bloomberg, as at 28 February 2018

We expect healthy equity returns amid higher volatility

Japanese stocks were not spared the global selloff in early February, with the Nikkei 225 falling by over 1000 points in a day. This was caused by a larger than expected wage increase in the US in January: hourly earnings grew by 2.9% year-on-year, the biggest rise in over eight years. This sparked expectations of higher inflation and, in turn, higher interest rates. In our view, though, this is all part of the normalisation process. Wage hikes of over 3% were common before the financial crisis, and higher wages are ultimately good for consumption and GDP growth. While we would not be surprised to see volatility persist as market conditions normalise, we continue to expect healthy returns for risky assets such as equities.

Kuroda's reappointment means more continuity

Haruhiko Kuroda's reappointment for a second five-year term as Bank of Japan (BOJ) Governor was not a surprise. As expected, he reiterated a commitment to monetary stimulus. While the BOJ has not declared any policy change, Kuroda mentioned that there should be no surprises during the central bank's normalisation process, unlike when he sprang his 'bazooka' monetary stimulus on Japan in 2013. We believe that his reappointment means greater forecastability for the markets, as any eventual exit from stimulus is likely to be well-telegraphed. We do not expect any change in BOJ monetary policy in the near term, but we think that Kuroda is the best person to eventually steer the central bank towards policy normalisation.

Volume expansion should support corporate earnings despite JPY strength

Our forecast for double digit earnings growth in FY2017 remains unchanged, despite the recent yen strength. As the JPY only strengthened in the past couple of months, we do not see it being a big hit to exporters' earnings for FY2017. However, earnings guidance for FY2018 is likely to be conservative if JPY strength persists.

That said, we think volume expansion rather than forex will be the key source of corporate earnings growth in FY2018. As volumes have expanded, we have seen the correlation between corporate earnings and JPY weakness decrease. We expect robust demand, especially from the US and China, to underpin growth in corporate profits in 2018.

Exhibit 3: Major Market Indices

TOPIX



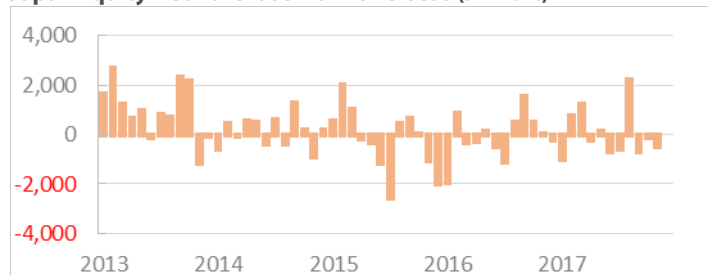
JGB Yield



JPY/USD



Japan Equity Net Purchase from Overseas (JPY bil.)



Source: Bloomberg, as at 28 February 2018

Exhibit 4: Major Index Performance, Indicators, and Valuation

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	-4.5%	-2.9%	12.3%	15.4%	78%
JGB Yield (%pt)	-0.032	+0.014	+0.044	+0.053	-0.498
JPY/USD	-1.6%	-4.7%	-3.1%	-4.7%	14%
JPY/EUR	-3.3%	-1.6%	-0.2%	10.0%	8%
MSCI World	-4.3%	2.0%	8.1%	15.2%	48%
TOPIX	-3.7%	-1.3%	9.3%	15.2%	71%
TPX-100 (Large)	-3.5%	-1.2%	9.5%	13.7%	62%
TPX-400 (Mid)	-4.3%	-2.3%	8.6%	15.3%	82%
TPX-Small	-3.2%	0.6%	10.6%	23.4%	94%

Sector (TPX-17)	1-mth	3-mth	6-mth	1-yr	5-yr
Elc Appl&Prec	-3.1%	-0.6%	14.3%	29.5%	119%
IT & Service	-2.0%	-3.8%	5.8%	18.2%	114%
Auto&Trns Eqp	-3.3%	1.0%	12.6%	11.4%	48%
RawMatl & Chm	-2.3%	-1.1%	9.5%	23.3%	121%
Banks	-5.4%	-1.5%	8.9%	0.3%	17%
Machinery	-6.7%	1.6%	16.8%	24.1%	90%
Transprt&Logi	-6.2%	-4.6%	2.8%	5.7%	44%
Const & Matl	-6.0%	-6.3%	5.5%	18.5%	111%
Fincl ex Bank	-6.0%	-2.2%	9.9%	2.7%	53%
Foods	-6.9%	-7.6%	-1.6%	6.5%	71%
Retail Trade	-1.1%	-0.6%	9.8%	15.9%	76%
Pharmceutical	1.4%	4.7%	11.3%	13.6%	65%
Commr & WhTrd	-1.4%	5.6%	15.5%	21.1%	69%
Real Estate	-7.8%	0.1%	9.3%	6.0%	1%
Steel&Nonfer	-7.0%	-3.9%	2.2%	5.8%	41%
Elc Pwr & Gas	-1.3%	-5.4%	-7.7%	-1.5%	18%
Enrgy Resourc	-7.7%	4.1%	26.8%	22.2%	30%

Valuation	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.0%	1.9%	2.1%	2.0%	1.9%
Price/Earn (e)	14.5	15.7	14.5	15.8	20.1
Price/Book	1.4	1.4	1.3	1.3	1.2
MSCI World					
Div. Yield (e)	2.5%	2.4%	2.5%	2.5%	2.7%
Price/Earn (e)	16.2	18.1	17.3	17.3	14.2
Price/Book	2.3	2.4	2.2	2.2	1.8

Market Indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
Daily Turnover	61	56	56	52	48
Market Cap.	665	680	627	568	363
Net Purchase Overseas	NA	-586	394	500	10,216

Source: Bloomberg, as at 28 February 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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