

JAPAN EQUITY MONTHLY

June 2018

Japanese equities declined in May

The Japanese equity market declined in May, with the TOPIX (w/dividends) dropping 1.67% on-month and the Nikkei 225 (w/dividends) falling 1.18%. From the start of the month until mid-May, stocks were weighed down by growing tensions in the Middle East after the US withdrew from a nuclear agreement with Iran. Nevertheless, the market moved upwards as concerns over North Korea eased following the announcement of a summit in Singapore between the leaders of the US and North Korea and as depreciation in the yen stoked expectations of stronger earnings for exporters. However, stocks declined later in the month on renewed concerns over trade protectionism after the US announced that it would consider additional tariffs on car imports, while political turmoil in Italy sent the yen higher against the US dollar.

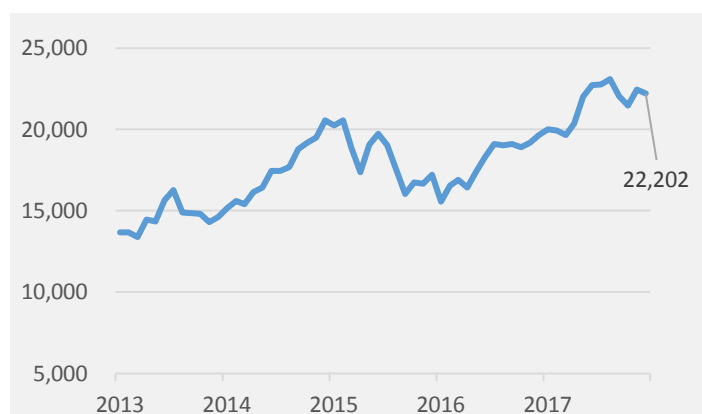
Of the 33 TSE sectors, nine including Services, Chemicals and Glass & Ceramics Products posted gains during the month, while 24 including Mining, Marine Transportation, and Nonferrous Metals declined.

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

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 at 31 May 2018

Exhibit 2: Nikkei 225



Source: Bloomberg, as at 31 May 2018

We expect Japan's growth recovery to continue

Following eight consecutive quarters of growth, Japan's GDP contracted by 0.6% year-on-year in the quarter ending March 2018. We see this as more of a blip rather than a declining trend.

It has been ten years since the Lehman collapse sent shockwaves across the financial markets worldwide, and we believe that the global economy is now in a cycle of recovery. In the US, there has been a consistent jobs recovery since 2014, and wages have been picking up since 2015. Momentum is also gathering pace in retail sales and imports. This underpins our belief that Japan's export-led growth will continue in the medium term, even if the pace of growth moderates.

Remain constructive on corporate earnings

Japan corporates had another year of double-digit earnings growth in FY2017. Unsurprisingly, their forecasts for FY2018 are much more conservative: companies expect pre-tax profits to grow by only 2% for the fiscal year ending March 2019, largely owing to uncertainty over volatile foreign exchange rates.

We are considerably more optimistic. Since the second half of FY2017, we have observed a decreasing correlation between corporate earnings and JPY weakness, as robust demand has supported growth in export volumes. We expect upward revisions to earnings growth forecasts to come through in the second half of FY18, and ultimately see earnings growth reaching high single digits for the current fiscal year.

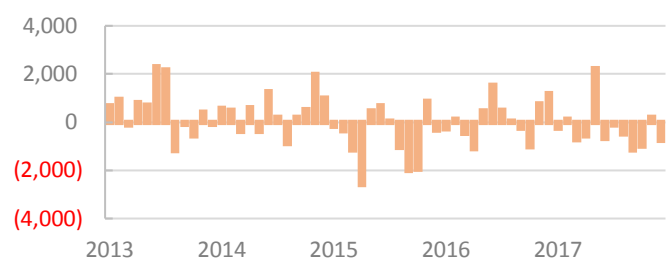
US auto tariff threats not a near-term concern

Donald Trump's recent threats to raise tariffs on auto imports to the US have weighed on sentiment, given that a considerable proportion of Japan's car exports are to the US. In our view, Trump is likely aiming for increased employment in the US, and is using the tariff threats as a starting point for further discussions targeted at getting Japanese and German automakers to open more factories and hire more workers in the US. We continue to monitor the situation, but our near-term earnings estimates remain unchanged. We also do not expect a significant impact on GDP growth in the next couple of years. If the tariffs do end up being implemented, this could have negative implications for Japanese automakers in the long term; however, demand growth should go some way towards mitigating any potential losses.

Exhibit 3: Major Market Indices



Japan Equity Net Purchase from Overseas (JPY bil.)



Source: Bloomberg, as at 31 May 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%
Engry 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 at 31 May 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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