

PM's Monthly Insight

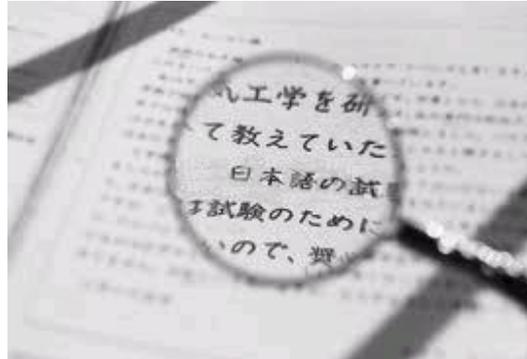
FUNDAMENTAL ACTIVE GROUP

MARKET OUTLOOK AND INVESTMENT STRATEGY

February 2018

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Market Outlook

We expect the Japanese equity market to experience a correction in February. We expect the market to continue to search for a support level as more Q3 2017 (October-to-December) earnings results are released. Japanese equities have been performing well since the middle of November; their prices are factoring in strong earnings in Japan and abroad and strong Q3 2017 earnings results. We believe that these strong earnings results from Q3 2017 have already been completely factored into the stock market. Until earnings from Q4 2018 (January-to-March) and FY2018 start to be factored into stock prices, the equity market will likely slump. Earnings announcements for Q3 2017 have continued to meet our high expectations. 56% of TSE 1st Section companies had announced their earnings by 5 February 2018, according to **Mizuho Securities**. 9-month earnings have met our expectations and are strong; +15% operating profit growth and +29% net profit growth. However, as many companies have not adjusted their earnings guidance for this fiscal year, estimates are stuck at +13% growth for operating profits and +22% growth for net profit. The earnings growth rate for Q3 2017 will likely rise going into February as we expect more favourable earnings results to come to light.

However, full-year guidance remains conservative and will likely disappoint market participants. As we think it will take some time before the positive opinions of sell side analysts to make their way through to the minds of investors, we believe that the market will experience a correction in February.

We expect the Bank of Japan (BoJ) to continue with its current accommodative monetary policy program. Market participants speculated that the BoJ was looking for an exit strategy as it trimmed Japanese Government bond (JGB) purchases in January. JGBs currently held by the BoJ have a lower redemption value compared with one year ago. Thus, in an effort to maintain its JGB amount outstanding, we believe that the BoJ reduced its bond purchases. However, the BoJ then mentioned there would be no change to monetary policy, and followed by raising bond purchases aiming to cool down the market. For the time being, there should be no change to the 10-year JGB target interest rate of 0% or other monetary policy.

There is no change to our opinion that share prices will rise throughout the year on the back of strong earnings.

Investment Strategy

Overweight Sectors:	Underweight Sectors:
Construction & Materials	Foods
Machinery	Pharmaceutical
Financials (ex-Banks)	Retail Trade
Commercial & Wholesale Trade	Transportation & Logistics

We will overweight the construction & materials, financials, machinery and commercial & wholesale trade sectors, while underweighting the foods, retail, pharmaceutical, and transportation & logistics sectors. Within the construction & materials sector, we will overweight the metals and ceramics subsectors. We will be cutting our position in major construction companies because of ongoing investigations into anti-trust law violations as well as the fact that strong earnings have already been priced into their share prices. In the financials (ex-banks) sector, we will overweight the securities and insurance subsectors. We will overweight the commercial & wholesale trade sector because commodity prices are rising, and the machinery sector because orders are solid. Conversely, we will underweight defensive sectors such as food, retails and pharmaceutical.

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Daiwa SB Investments

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Mr Kamohara is the Lead Portfolio Manager of the Fundamental Active product. He started his career with Daiwa Securities in 1987 and transferred to Daiwa Institute of Research the following year to become a Japanese equity analyst. He was seconded to their Frankfurt office (between November 1992 and February 1995) and Hong Kong office (between February 1995 and March 1997) as an analyst for European and Asia equities respectively. He transferred to Daiwa International Capital Management, the former entity of Daiwa SB Investments, in 1998 to become a fund manager of international equities.

He became a Japanese equity portfolio manager in October 2000 and has managed the Fundamental Active product since its inception in October 2003. Mr Kamohara is lead manager on 11 accounts with USD6.2 billion under management.

Mr Kamohara graduated from Kyoto University with a BA degree in Educational Administration (1987).

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