

PM's Monthly Insight

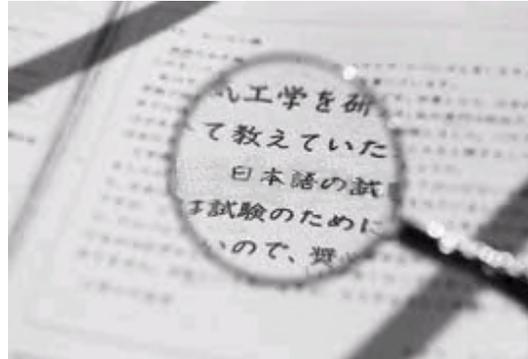
FUNDAMENTAL ACTIVE GROUP

MARKET OUTLOOK AND INVESTMENT STRATEGY

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Market Outlook

We expect the Tokyo market to grow in the second half of April. As the yen has appreciated to around JPY105 level, we anticipate weak development in early April as investors will be watching the fiscal year 2017 results as well as guidance for FY2018. The yen appreciation was higher than the company's forecast for Q1 2018 (January-to-March) because the initial forecast had been conservative, therefore it is likely to end above the forecast.

On the other hand, with regard to forecasts for FY2018, investors' concern is increasing. Particularly concerning companies that tend to announce company forecasts conservatively, such as automobiles, concern for announcements of declining profit will be announced on the basis of current profit on the premise of 100 yen per dollar, is increasing.

Major automobile companies had increased their net profit by +10% to +30% mainly due to the withdrawal of the deferred tax liability of the financial subsidiaries following the US tax system reform in FY2017. Consequently, there is likely to be a significant decline in net profits for FY2018. If we assume JPY105 as a prerequisite, the percentage increase for operating profit and ordinary profit will be about +5% for all Japanese companies. However, because the expected PER of the TSE first listed companies is 13x, which is very cheap, we anticipate that the TOPIX index will rise as concern for earnings will be digested into the stock price before earnings announcements. The bottoming out of stock prices just before the announcement of the earnings is typical when there is concern for earnings.

Regarding monetary policy, we forecast that the Bank of Japan (BoJ) will maintain the current policy for the time being. Since the rate of increase in the CPI (consumer price index) has not reached the target, the target range of interest rates will not be raised.

Regarding politics, Mr Abe is not likely to resign because of the Moritomo scandal. Regarding discounts on land, garbage at the site is actually buried underground and it is not worthy unlike being reported. It is rather expensive compared to the neighbouring land purchased by Toyonaka city. However, because the Ministry of Finance's violation of the law concerning rewriting of related documents, there is a possibility that the Minister of Finance Aso may be held responsible, but unlike the Prime Minister, the impact of Mr Aso's withdrawal on the stock market should be relatively small.

In regards to the trade war, it seems that the US is requesting for bilateral Free Trade Agreement (FTA) negotiations with Japan. Even if Japan responds to negotiations, it will take

time, so it is unlikely to be bad news for the market. Current share prices seem to suggest that these negative factors are discounted, and we expect the market to rise in the second half of April.

Investment Strategy

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

Concerning stock picks, we plan to incorporate stocks that can expect profit increases for FY2018. We are overweighting the construction & materials sector, but underweighting major construction companies. We overweight companies such as telecommunications and electric construction companies, semiconductor materials, and automobile exhaust gas control parts producers. We also continue to overweight machine sectors on the back of a strong order back log. We underweight defensive sectors such as foods, pharmaceuticals and retail trade sectors. However, we will reduce our underweight in individual stocks which are expected to post strong earnings growth among the food and retail trade sectors.

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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.

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