Daiwa SB Investments

PM'S MONTHLY INSIGHT
FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

August 2018

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We expect the Japanese equity market will gradually gain ground during August. The primary reasons for this include: 1) the April-June quarterly results will likely show that corporate fundamentals remain solid, 2) the continuation of accommodative monetary policy by the Bank of Japan (BoJ) was reaffirmed at its July-end policy meeting, 3) a stable political environment is expected to continue as now the chances of Abe winning the Liberal Democratic Party (LDP) president election in September is higher.

The first quarter (April-June) earnings season has crossed the halfway mark. Many companies will likely beat their earnings estimates as they are generally reporting high achievement ratios versus their conservative targets. Only a handful of companies are expected to revise up their full-year estimates at this point, as it has been only three months since the start of FY2018, however, share prices of companies that marked a solid start to the year have rallied on positive results in general. According to the data provided by **Mizuho Securities**, 61% of companies listed on the First Section of the Tokyo Stock Exchange have reported their first quarter results as of 3 August, achieving 5% YoY growth in operating income and 7% YoY growth in net profit. If we compare these results with the consensus estimates for the first quarter available at the end of May, the actual results have exceeded the expectation by 8% on operating income and 15% on net profit thus far, indicating that companies are achieving strong growth for both revenue and profit.

With regard to monetary policies, the BoJ did not alter its accommodative monetary policy except for the changes to ETF purchases as stated in its policy statement. However, it announced that there will be some changes to its yield curve control policy which include: 1) it may tolerate a rise in the 10-year JGB yield to as high as 0.2%, and 2) to reduce the size of the Policy-Rate Balance in current accounts held by financial institutions at the BoJ to which a negative interest rate of -0.1% is applied. We anticipate that these new policies may facilitate quantitative easing as they might encourage financial institutions to participate in auctions to purchase JGB by allowing the 10-year JGB yield to rise to 0.2%.

The LDP's leadership election is coming up in September. The member who will be elected as the leader of LDP will ultimately become prime minister. The majority of LDP Diet members are supporting Abe for his third term. Former Defense Minister Shigeru Ishiba, the top contender to Abe, is trying to gain support from LDP members by criticising Abe's economic policies, claiming that his cabinet has failed to achieve economic recovery in regional areas of the country. However, we think that it will be quite difficult for Ishiba to win enough support from LDP members as he failed to receive credit for his role as the regional revitalisation minister, and we maintain our view that Abe is poised to win another term in September.

While concerns over trade war remain intact with the US decision to impose tariffs on automobile imports, however, we think that concerns on domestic issues have mostly been resolved. We see significant upside in Japanese equities as the current forward P/E ratio of the TOPIX is hovering around at 13x, which is close to the level right after the Great East Japan Earthquake in 2011.

Investment Strategy

Overweight Sectors (largest shown first):	Underweight Sectors (largest shown first):
Construction & Materials	Automobiles & Transportation
Electric Appliances & Precision Instruments	Foods
Raw Materials & Chemicals	Retail Trade
Commercial & Wholesale Trade	Transportation & Logistics

With regard to our sector selection, we continue to overweight construction & materials, electric appliances & precision instruments, raw materials & chemicals and wholesale trade, while we underweight automobiles & transportation, foods, retail trade and transportation & logistics sectors. We have trimmed our underweight positions in banks by increasing our exposure to the sector as their share prices have declined in relative terms on historical basis. We have increased our holdings in undervalued stocks with a low P/B ratio and possibility of share buybacks. On the other hand, in the chemicals and IT & services sectors, we reduced our position in high-valuation stocks. We continue to increase the weight of companies with strong earnings performance with a low P/B ratio.

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

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Disclosures