



PM'S MONTHLY INSIGHT FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

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We expect that the Japanese equity market will gain ground in September. In addition to solid corporate earnings, we expect Prime Minister Abe will win the Liberal Democratic Party (LDP) leadership election which will provide a tailwind for Japanese equities as it will ensure political stability in the country. We believe that the focus of debate will shift towards stimulative policies after the general election with the upcoming Upper House election in the summer of 2019. Concerns over trade wars continued to weigh on share prices as there appears to be no end in sight to the battle. Although solid corporate fundamentals are confirmed by the April-to-June quarterly results, the Nikkei Stock Average is still hovering below 23,000. We believe that in order for Japanese equities to advance further, it will be necessary for the government to come up with effective economic measures in order to ensure continuation of current economic growth in the eyes of investors.

TSE 1st section companies' earnings announcements for the April-to-June quarter ended recently. According to the data provided by **Mizuho Securities**, the results are as follows: the operating profit and the net profit increased +8% YoY and +11% YoY respectively. Overall, the companies got off to a good start in FY2018 with better-than-expected results as they have managed to cover rising costs of wages and raw materials by achieving top-line growth. However, the earnings guidance for FY2018 softened with a +2% YoY increase in operating profits and a -2% YoY decline in net profits. The reason that companies are expecting negative YoY growth on net profits is primarily due to the impact of US tax reform in 2017, as many companies had reversed their deferred tax liabilities which were recorded on their balance sheets as a future tax payment. On the other hand, the consensus estimates of sell side analysts are +7% growth in operating profits and +2% growth in net profits for FY2018. We also see the possibility that analysts will start to revise up their forecast in light of healthy results in the April-to-June quarter.

The LDP's leadership election is scheduled to be held on September 20. We expect Prime Minister Abe to win a landslide victory by receiving strong support from Diet and LDP members as he is acclaimed for major accomplishments. According to the results of the Monthly Labour Survey¹ in June, the Total Cash Earnings increased 3.3% YoY due to higher summer bonuses. Moreover, the results of the Financial Statements Statistics of Corporations by Industry² show that capital expenditures of all-industry increased 13% YoY in April-June quarter, indicating that companies are regaining their momentum to increase business investment. However, consumption data indicated a weakening trend. The Household Survey³ for June shows that consumption remains subdued despite income growth as people are cutting their spending to save more against the uncertain future. As mentioned above, we think that the focus of debate will shift towards stimulative policies after September with the upcoming Upper House election in the summer of 2019. Since eligible voters in rural areas tend to claim that the benefits of economic recovery have not reached local regions compared to metropolitan areas, we think that the government will make an effort to implement "rural-friendly" policies going forward such as by increasing budget for public works projects. We expect that the focus of policy debate will be on postponement of the consumption tax after the general election as part of government efforts to ensure continuation of economic growth.

Japanese equities continue to be weighed down by concerns over trade war and the recent decline of emerging market currencies. However, we believe that pro-growth policies by the Japanese government should provide a tailwind for equities. Thus, we expect the Nikkei Stock Average will eventually break 23,000 barrier.

¹ Monthly Labour Survey : The Ministry of Health, Labour and Welfare

² Financial Statements Statistics of Corporations by Industry: The Ministry of Finance

³ Household Survey: The Ministry of Internal Affairs and Communications

Investment Strategy

Overweight sectors (Largest shown first):	Underweight sectors (Largest first):
Electric Appliances & Precision Instruments	Automobiles & Transportation
Construction & Materials	Retail Trade
Commercial & Wholesale Trade	Foods
Raw Materials & Chemicals	IT & Services, Others

Our investment strategy will remain focused on earnings growth estimates. We think that Japanese companies are somewhat confused over the current weakness in the equity market despite healthy corporate fundamentals. Based on our earnings estimates, however, many companies are still left with the chance to revise up their dividend payouts and increase share buybacks as the large number of companies have already announced plans to enhance shareholder returns. We plan to invest proactively in companies that are likely to announce upward revisions in earnings and dividends, share buyback plans during the midterm earnings season, which starts in late October. The reason being that in the April-to-June quarterly results release season, Japanese companies are generally hesitant to change their guidance after only three months of the new fiscal year start.

If Prime Minister Abe is re-elected for another term in the LDP leadership election on 20 September, we believe that it will ensure political stability in the country. The government will likely to implement stimulative policies thereafter, aiming to boost public support towards the upcoming Upper House election in the summer of 2019. We believe that risks posed by the trade war are likely to recede after the US mid-term election on 6 November, and we shall expect to see a shift occur in the current market trends as share prices will start to reflect earnings and shareholder return policies.

In that case, we expect our current portfolio holdings, as well as the above mentioned target investment names will outperform the benchmark. In order to maximise excess return, we will strengthen further in bottom-up research and take an agile investment approach strategy through stock selection and sector allocation towards the end of the year.

Our Top-picks

We believe that the following names will offer attractive investment opportunities going forward:

- Suppliers and manufacturers of electric devices and components used for electric vehicles.
- Manufacturers of electric devices and components for 5G mobile phones and smart phones that are done with inventory adjustments.
- Manufacturers of products popular among tourists such as cosmetics and groceries with growth in export volumes.
- Liquefied Natural Gas (LNG) related companies experiencing a sharp increase in demand.

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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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