

## **PM'S MONTHLY PERSPECTIVES VALUE + ALPHA GROUP**

### **Market Outlook & Investment Strategy**

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In August, the MSCI Japan index declined on the back of the recent sell-off in the Turkish lira, the strengthening of the Japanese yen against the US dollar, and worse-than-expected economic data from China. In the first half of the month, the MSCI Japan pulled back amid a sharp decline of the Turkish lira, an announcement by the Trump administration that the US would double the rate of tariffs on imports from Turkey, as well as media reports that the European Central Bank (ECB) has become concerned about exposure to Turkish debt by European banks.

The MSCI Japan was also weighed down by worse-than-expected economic data (retail sales, industrial production, etc.) from China and the strengthening of the Japanese yen. However, the MSCI Japan regained its strength somewhat in the second half of the month with help from dovish comments from Jerome Powell, the Chairman of the US Fed, that “we have not seen any clear sign of an acceleration of inflation above our target” and also by the announcement that the US and Mexico have reached an agreement in the renegotiation of the North American Free Trade Agreement (NAFTA). In the month of August, the TOPIX (total return) index decreased by -1.0% in Japanese yen terms, and US dollar denominated MSCI Japan (net total return) index advanced by +0.2%.

We expect that the following topics will be the key factors for the Japanese equity market going forward.

**Election: Prime Minister Abe leads in September Liberal Democratic Party (LDP) election; win by either candidate is expected to have a limited effect on stock market.**

A leadership election for the LDP was announced on 7 September 2018 and the vote will take place on 20 September 2018. Prime Minister Abe and former General Secretary Ishiba have announced their candidacy. In the LDP leadership election, the winning candidate is determined by a majority vote out of a total of the 405 ballots of members of the National Diet affiliated with the LDP plus the 405 regional ballots allotted to party members/supporters. The table below summarises the principal positions of Prime Minister Abe and former General-Secretary Ishiba; however, the campaign promises of both candidates are essentially identical. Either candidate's monetary policy will be to continue monetary easing to completely prevent deflation. They also both intend to raise the consumption tax from 8% to 10% in October 2019 in accordance with the LDP's commitment. Regarding the revision of Article 9 of the Constitution, they promise to legalise the potential of the Japan Self-Defense Force to fight a war. If pushed to identify a difference, one might note former General Secretary Ishiba's fervent commitment to income distribution towards rural areas; however, apart from that, the substance of each candidate's positions is similar. Regardless of which candidate wins, the forecast is for Japan's economic policy to remain the same and for the impact on the stock market to be limited.

**Main Positions for the LDP Leadership Election**

Subject	Prime Minister ABE	Former General Secretary ISHIBA
Monetary Policy	Continue monetary easing. Completely overcome deflation	Continue monetary easing. Continue macroeconomic policies to avoid relapse into deflation
Consumption Tax	Raise from 8% to 10%.	Raise from 8% to 10%.
Constitutional Revision	Maintain Article 9 Paragraphs 1, 2. Make SDF (Self-Defence Force) explicit.	Remove Article 9 Paragraph 2.

Source: Compiled by Daiwa SB Investments (Tokyo) from various materials, data as at 10 September 2018.

\*Article 9 Paragraph 1: Renunciation of war or use of military force for resolution of conflicts. / Article 9 Paragraph 2: Non-maintenance of military forces including land, sea, or air force; repudiation of right to belligerency.

A poll conducted on the 7th and 8th of September by Kyodo News found that 61.0% of the party members/supporters who will influence the regional vote responded that they will vote for Prime Minister Abe, while 28.6% will vote for former General Secretary Shigeru Ishiba. In terms of the structure in which leadership elections are settled, Prime Minister Abe is in a position to obtain over 270 votes, about 2 out of every 3, of the 405 regional ballots cast by party members/supporters. According to the 8 September 2018 article by the Nihon Keizai Shimbun, Prime Minister Abe is forecast to take about 340 votes of the 405 allotted to members of the National Diet, and his chances of winning appear high.

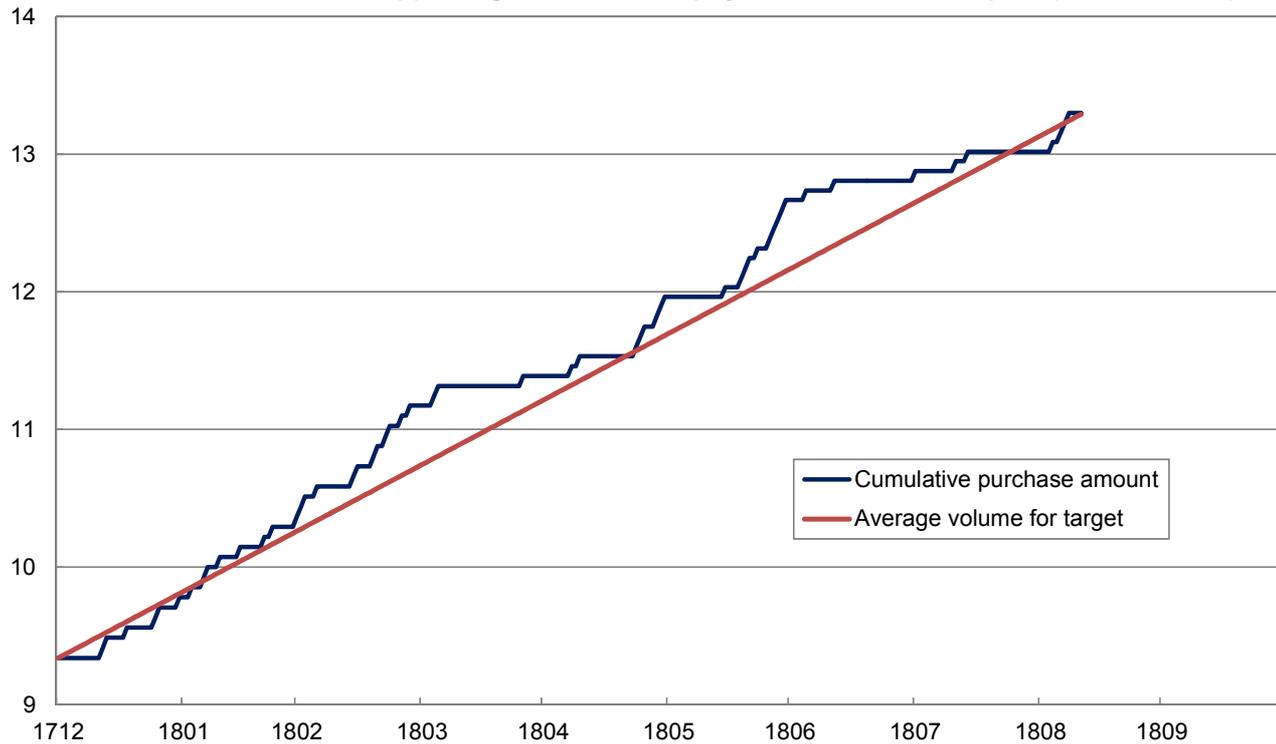
**Monetary Policy: Reports have been made that the Bank of Japan (BoJ) is stealth tapering its purchase of stock ETFs; however, it is our view that the BoJ’s ETF purchasing policy remains unchanged.**

Reports were on the rise that the BoJ was stealth tapering purchases of stock ETFs during August. The Nihon Keizai Shimbun reported on 19 August 2018, “The Bank of Japan is reducing its present pace of purchases in ETFs. This measure appears to have taken into account the revision of the adjustment policy in which the annual purchase amount of JPY6 trillion, set at the Monetary Policy Meeting held at the end of July, would be allowed to fluctuate. They are not buying when prices are at the level that they were traded in August.” It is possible that Japanese stocks fell despite the rise in US stocks in August due to the effects of reports like this.

The chart , on the next page, depicts the stock ETF purchasing pace of the BoJ, with the red line showing the BoJ’s ETF purchasing pace policy objective and the blue line showing the actual amount of ETF purchasing by the BoJ. As you can see from the blue line, while the BoJ’s ETF purchasing pace was higher in May and June, it slowed in July and August. Additionally, a correlation was present between ETF purchasing by the BoJ and average volatility of the Nikkei in the morning session in the past. In June, the BoJ often made ETF purchases in afternoon trading when the Nikkei average declined -0.3% or greater in the morning session; yet on July 20th, 23rd, and 30th and on August 2nd and 15th, when morning trading saw drops of -0.4% or greater, the BoJ did not make purchases. Thus, the view has spread that the BoJ’s method of purchasing ETFs has changed.



**BOJ ETF Purchases ex ETF supporting investment in physical and human capital (JPY, Trillions)**



Source: Compiled by Daiwa SBI from Bloomberg data as at 10 September 2018. Cumulative purchase amount is the total since April 2016.

However, we are of the opinion that there is no change in the BoJ’s policy on stock ETF purchases. Our reasoning is that compared to the BoJ policy objective, ETF purchasing pace shown by the red line and the actual purchase volume shown by the blue line was too high until June of 2018, and our interpretation posits that an adjustment of this pace was implemented in July and August 2018. There was a similar adjustment to the pace in April 2018. Furthermore, after the blue line dipped below the red line in August 2018, the purchasing pace of ETFs returned to its previous state. It will be necessary to monitor whether the BoJ is stealth tapering its purchases of stock ETFs; at the present however, we maintain our view that it will continue purchasing ETFs at a similar pace as before.

**Investment Strategy**

We expect the Japanese equity market to resume its rally amid the continuation of steady growth in the global economy, accommodative monetary policy by the Bank of Japan as well as undemanding valuations in the market. Over the long term, continuous efforts toward corporate structural reforms will be important. Major risks would include a sharp spike in the yen caused by external factors including the escalation of trade friction and the potential property bubble burst in China. Taking these points into consideration, we maintain our overweight positions in the late cyclical sectors, such as the materials and commercial & wholesale trade.

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The author's biography has been provided below:

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Mr KAMIISHI joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr KAMIISHI obtained a BA degree in Economics from Keio University (2009) in Japan.

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