Daiwa SB Investments

PM'S MONTHLY INSIGHT
FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

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We are bullish on Japanese stocks. Our view is that Japanese stocks will continue to trend upwards. We forecast that by the end of the year, Japanese stocks will rise by around 10%, with the Nikkei Average reaching 26,000, and the TOPIX Index to hit 2,000.

The factors seen driving this upward trend are as follows.
(1) Corporate performance is improving, and valuations are at low levels
(2) Demand from programs aimed at post-natural disaster reconstruction, and expansive fiscal policy ahead of the Upper House elections in 2019
(3) Continuation of the Bank of Japan's accommodative monetary policy

Performance in Q1 (April to June 2018) was positive, with companies listed on the 1st section of the Tokyo Stock Exchange posting an 8% increase in operating profit, and an 11% increase in net profit. Performance in Q2 (July to September 2018) is also expected to be good. Consequently, when interim results announcements begin at the end of October, it is likely that full-year forecasts will be revised upward. In terms of the exchange rate, the yen has been weaker-than-expected, and we expect results for export companies to overshoot forecasts. Japanese companies are becoming more active in their approach to shareholder returns, and we predict that more companies will announce dividend hikes and share buybacks when they disclose interim results.

Because growth in corporate earnings had been low in comparison to the US, Japanese stocks had been trading in a range. Since the Q1 announcements, Japanese earnings forecasts have been revised upwards, and valuations are at historically low levels. The automotive industry being able to avoid the additional tariffs that had previously been a source of concern is also a positive factor for the market as a whole.

Prime Minister Shinzo Abe has been re-elected as the leader of the Liberal Democratic Party. The next issue is winning the Upper House elections in the summer of next year. The driver of Prime Minister Abe's approval rating is economic growth. Recently, due to the impact of natural disasters, the economy has temporarily slowed, which makes it highly likely that an expansive fiscal policy will be adopted. Because his approval rating was low in the regions during the elections for the presidency of the LDP (Liberal Democratic Party), we believe that public spending will be used to stimulate the economy, with such programs including reconstruction work related to the natural disasters. The number of people employed is rising, as are salaries, resulting in increases in gross income for the Japanese people. Labour shortages are pushing companies to invest in labour-saving measures, and capital expenditures are accordingly trending upwards. As a result of the stimulus measures, we expect Japanese GDP to get back on the growth track.

Bank of Japan Governor Haruhiko Kuroda has repeatedly indicated that monetary easing policies will remain in force until the rate of growth in the CPI (Consumer Price Index) is stable at 2%. Therefore, we can expect the accommodative monetary policy stance to continue.

Investment Strategy

Overweight Sectors (largest shown first):	Underweight Sectors (largest shown first):
Commercial & Wholesale Trade	Foods
Electric Appliances & Precision Instruments	Retail Trade
Pharmaceutical	Electric Power & Gas
Construction & Materials	Transportation & Logistics

We will overweight stocks and sectors where we expect positive earnings momentum. We are overweight commercial & wholesale trade, pharmaceutical, and construction & materials sectors, and underweight foods and retail trade sectors. Trading companies are seeing the benefits of higher energy prices in such areas as oil, coal and gas. in the pharmaceutical sector we have taken positions centred around companies that are seeing earnings growth as a result of the contribution from new drugs. In the construction sector, we have invested in medium-sized general contractors, plant companies and companies involved in information and technology engineering. In the foods and retail trade sectors, companies are seeing falling profit margins as a result of being unable to fully pass on to customers the increases in their personnel and transportation costs, hence our underweight stance. In addition, with the automotive industry having avoided additional tariffs in the US market, we have raised our weighting in the auto sector to an almost neutral level. We are currently considering whether to overweight the sector, including automotive parts, after interim earnings.

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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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