

# PM'S MONTHLY PERSPECTIVES VALUE + ALPHA GROUP

## Market Outlook & Investment Strategy

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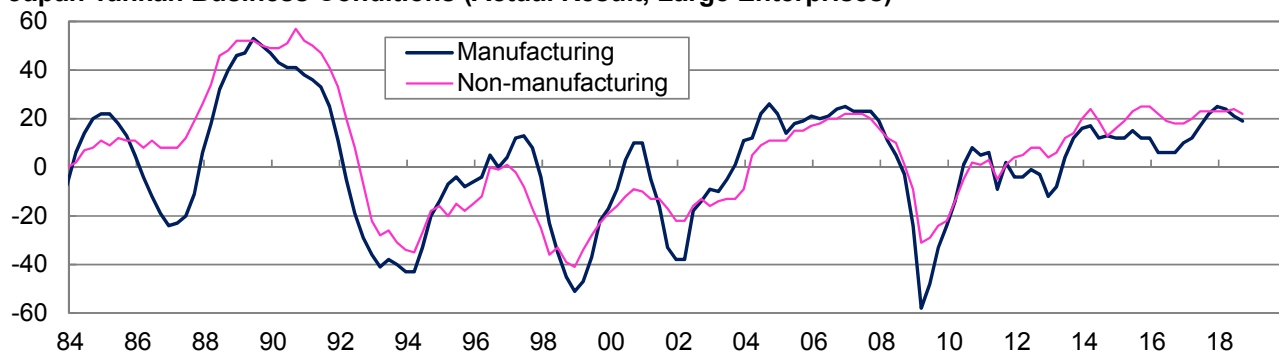
In September, the MSCI Japan index jumped on the back of yen depreciation against the US dollar, affordable valuations and expectations for stability for the Chinese economy. At the beginning of the month, the MSCI Japan pulled back due to concerns over trade wars and emerging currencies including Turkish lira. However, in the middle to late of the month, the MSCI Japan advanced thanks to easing concerns over those currencies driven by a sharp rate rise by the Turkish central bank as well as expectations for stability on the Chinese economy driven by more-than-expected aggregate financing and a positive statement on fiscal actions. Affordable valuations were also a positive factor for the Japanese equity market. In the month of September, the TOPIX (total return) index increased by +5.5% in the yen terms, and US dollar denominated MSCI Japan (net total return) index advanced by +3.0%.

We expect that the following factors will bolster the Japanese equity market down the road:

### Economy: Tankan suggests a solid domestic economy and upward revisions of earnings guidance.

Latest Tankan survey results, one of the most important economic indicators for the Japanese economy, were released on 1 October. The diffusion index (DI) for business conditions at large manufacturers worsened by -2 points (June: 21 to September: 19), the DI for large non-manufacturers declined by -2 points (June: 24 to September: 22).

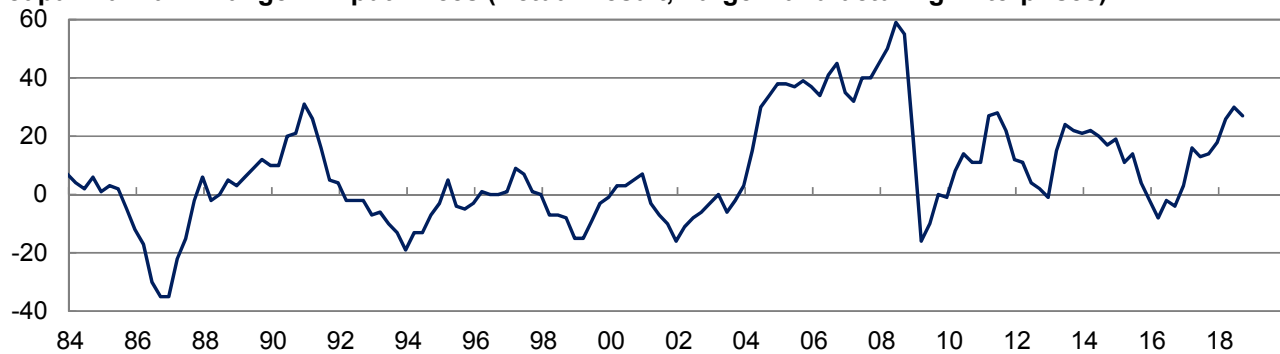
### Japan Tankan Business Conditions (Actual Result, Large Enterprises)



Source: Bloomberg, as at 1 October 2018

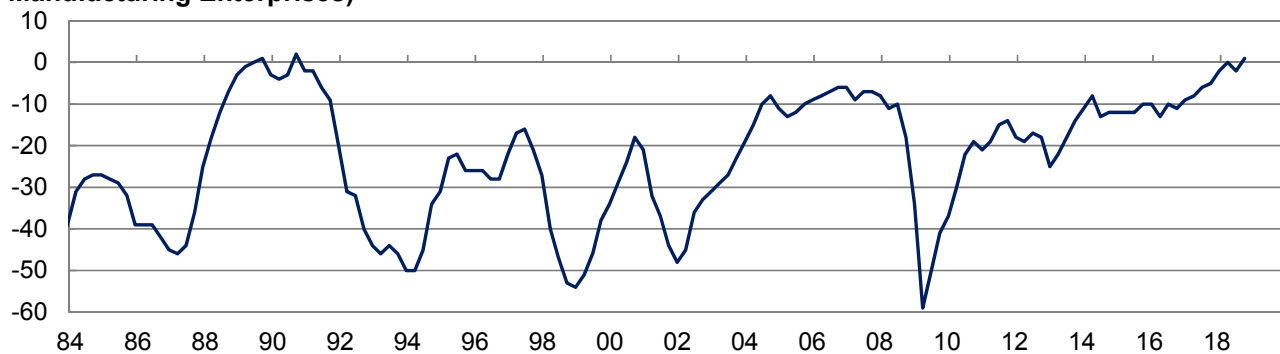
These declines in sentiment could be primarily due to impacts of natural disasters such as typhoons and earthquakes which occurred in succession during the latest quarter, because various indicators other than DI improved. For example, input prices at large manufacturers improved by -3 points (30 June to 27 September) and domestic supply & demand conditions for products and services at large manufacturers also improved by 3 points (2 June to 1 September). This means upward pressure on prices of raw materials has eased while the supply-demand balance for products has slightly improved in these three months.

**Japan Tankan Change in Input Prices (Actual Result, Large Manufacturing Enterprises)**



Source: Bloomberg, as at 1 October 2018

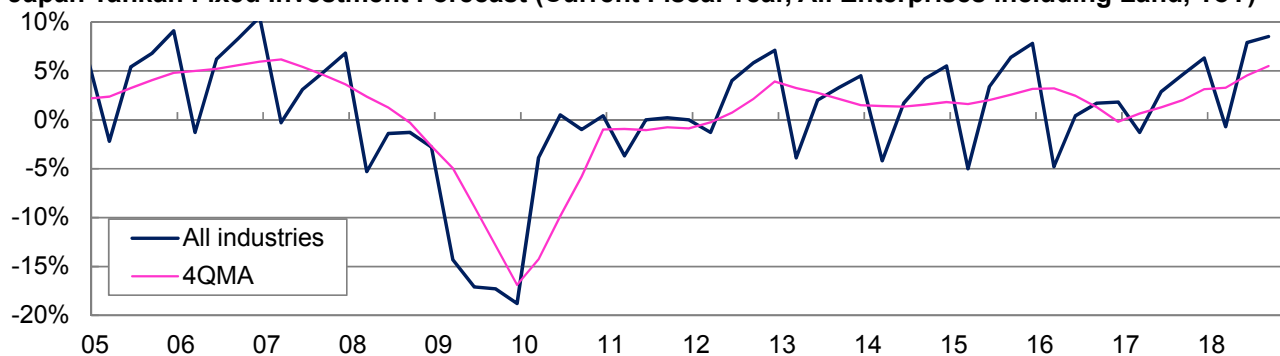
**Japan Tankan Domestic Supply and Demand Conditions for Products and Services (Actual Result, Large Manufacturing Enterprises)**



Source: Bloomberg, as at 1 October 2018

The projection for fixed investment including land purchase for FY2018 was revised up to +8.5% YoY from +7.9% YoY in June. An appetite for capital investments by companies has been strong as ever.

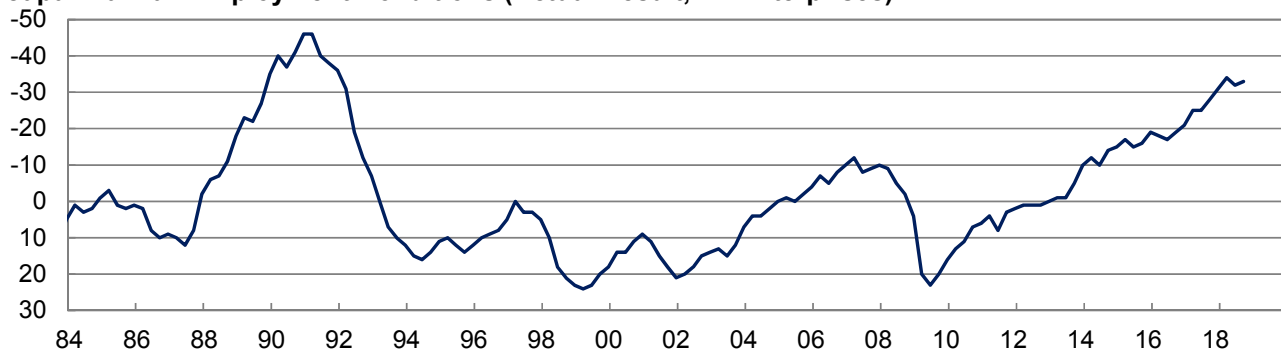
**Japan Tankan Fixed Investment Forecast (Current Fiscal Year, All Enterprises including Land, YoY)**



Source: Bloomberg, as at 1 October 2018

Employment conditions have not changed since the last survey (June: -32 to September: -33).

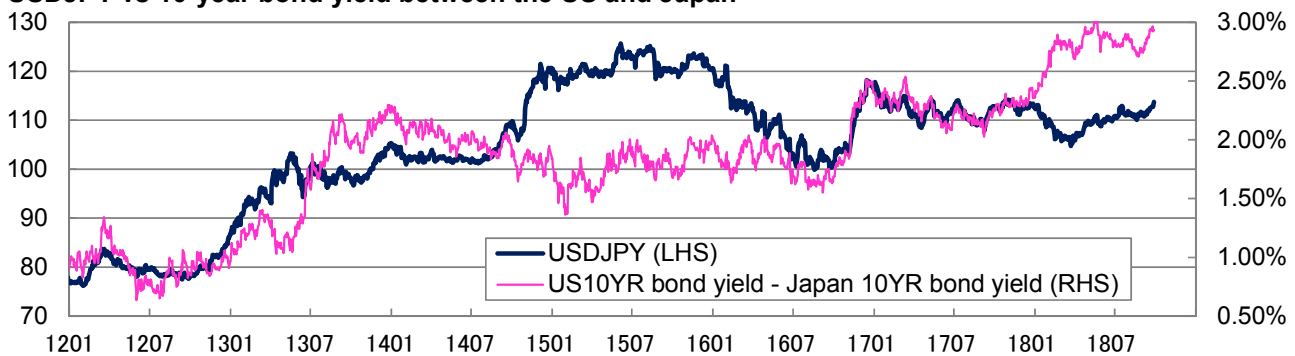
**Japan Tankan Employment Conditions (Actual Result, All Enterprises)**



Source: Bloomberg, as at 1 October 2018

In conclusion, DI tells us that overall business conditions in Japan remain better than their long-term historical averages without any signs of economic slowdown. We see strength in the Japanese economy. According to the Tankan survey, the average exchange rate prediction by large manufacturers for FY2018 is 107.40 yen per dollar. Since this is conservative compared to the actual rate (113.70) at the end of September 2018, Japanese companies are likely to revise up their earnings guidance within the next few months.

**USDJPY vs 10-year bond yield between the US and Japan**



Source: Bloomberg, as at 28 September 2018

**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 affordable valuations in the market. Over the long term, continuous efforts in corporate structural reforms are important. Major risks will include sharp spikes in the yen caused by external factors, including the escalation of trade frictions and the potential Chinese property market bubble bursting. Taking these points into consideration, we maintain our overweight positions in cyclical sectors, such as materials and industrials (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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