



PM'S MONTHLY INSIGHT FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

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We forecast that during November the Japanese market will form a baseline, and then move upwards. In October, all sectors turned negative. Foreign investors were major net sellers. Due to the impact of changes in country allocation and asset allocation, many stocks were sold off irrespective of valuations. We see that an increasing number of large caps are trading on PERs of 10x or lower, and have dividend yields of more than 4%, despite expected record earnings growth. We expect changes in allocation to run their course in early November, and Japanese stocks to rally when valuations start to reassert themselves.

In October there was a global sell-off in stocks, which we ascribe to the following factors:

- (1) A rise in US long-term interest rates
- (2) Trade disputes between the US and China caused by protectionist trade policies in the US, and concerns about Chinese growth slowing as a result
- (3) An increase in oil prices
- (4) Concerns over depreciation in currencies, and decelerating economic growth, in developing countries
- (5) Political instability in Europe

Finally, as a factor unique to Japan, a rise in consumption tax was announced at precisely the same time the external environment was deteriorating.

However, uncertainties that have depressed share prices are being resolved little by little. For example, the rise in long-term interest rates in the US can be explained by favourable business conditions, and the real economy is strong. The rates hike impact has already been factored into share prices via the decline in growth stocks. In addition, the US interest rate increase is slowing down. We cannot expect any progress in the trade dispute between the US and China until after the mid-term elections, but stimulative measures, such as the reductions in income tax announced by China, are positive factors that should mitigate uncertainty. Developing country currencies such as the Turkish lira and the Brazilian real have regained some of their composure, and the oil price has also fallen from its recent peak. In Japan, a lively debate is unfolding in relation to stimulative measures ahead of the implementation of the consumption tax hike in a year's time. If these measures are deployed, we should see a further strengthening of the recovery in consumption (on the back of steady increases in wages), and of reconstruction demand (resulting from natural disasters such as typhoons and earthquakes), providing downside support for the Japanese economy.

Japanese companies have begun to announce results for the July-September quarter. It is noticeable that performance has deteriorated at some companies in the construction space, which has been hit by typhoons and other natural disasters, as well as in areas affected by trade disputes, including basic materials, such as chemicals and steel, factory automation and semi-conductor production equipment. Nevertheless, there are also many companies in sectors such as trading, electronic components, machinery and automobiles which have revised their forecasts upwards, and overall it seems that the trend of earnings improvement is being maintained. Increasingly, share prices are rallying after results

have been announced. It is noticeable that share prices are reacting positively to companies strengthening returns to shareholders through measures such as dividend hikes and share buybacks.

On October 31, the Bank of Japan confirmed that it would maintain its accommodative monetary policies. Overseas risks are also gradually falling. We therefore expect Japanese shares to rise, led by stocks with favourable earnings momentum.

Investment Strategy

Overweight Sectors	Underweight Sectors
Financials	Foods
Commercial & Wholesale Trade	Electric Appliances & Precision Instruments
Banks	Transportation & Logistics
Automobiles	Retail Trade
Pharmaceutical	

We are overweight in financials, commercial & wholesale trade, banks, automobiles and pharmaceutical sectors, and underweight in foods, electric appliances & precision instruments, transportation & logistics and retail trade sectors. We invest in names with strong revenue growth and those which expect an earnings improvement in the second half of the fiscal year. We are overweight the automobile sector because car makers are revising up their forecasts in succession as we have expected. Although the range of revisions remains modest due to ongoing trade frictions with the US and a deceleration of unit sales in China, we can expect an upward revision from the forecast. In the financial sector, we will raise our weight in securities and insurers on the back of a recovery in stock trading volumes on the Tokyo Stock Exchange and a rise of the yield on long-term Japanese government bonds (JGB). We remain underweight in the food, retail trade and transportation sectors due to their low earnings against the backdrop of rising transportation and labour costs.

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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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