



PM's MONTHLY INSIGHT FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

March 2019

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Japanese stocks are expected to be more or less flat in March. Stock prices will be affected by the outlook for corporate earnings and the Japan and US trade talks. While overall company forecasts are likely to be revised downward slightly, we believe there is little room for stock prices to decline given the already low valuations and strong shareholder returns. We anticipate a rally mainly in auto stocks, if trade talks between Japan and the US make progress.

According to Mizuho Securities, the operating income of Japanese companies (TSE 1st section) declined by 5% in the October - December quarter, the first decline in the past 10 quarters. While the net income fell by 27% as it was inflated by a withdrawal of deferred tax liabilities in the previous year, following a taxation system reform and an apparent drop in tax rates in the US. The latest company guidance for FY2018 is as follows; the operating income will remain mostly flat and the net income will decline by 5%. Company guidance was lowered by only 2 points for operating profit and by only 3 points for net income from its initial forecasts, as they were conservative from the beginning.

Downward revision of the oil and non-ferrous metals sectors due to price declines in crude oil and non-ferrous materials as well as Toyota due to devaluation losses on its stock holdings, dragged down the overall forecasts. Forecasts for the electrical appliances and machinery sectors which are likely to be hit by the economic deceleration in China are almost flat. Among the electrical appliances and machinery sectors, although we were concerned about profit declines, downward revisions were counterbalanced by upward revisions of medical device manufacturers. Furthermore, the downward revisions were modest as their initial forecasts had been conservative.

Looking ahead, changes in forecasts for FY2018 and FY2019 by sell-side analysts will sway the stock market. The Japanese economy is left unclear until trade negotiations with the US get under way. Hence, their forecasts tend to be bearish. That being said, the market has already priced in the deterioration in earnings. The valuation is already low, so stock price falls should be limited even after further downward revisions. Conversely, we think there is plenty of upside potential for upward revised stocks. Increasing dividends and share buybacks will also support stock prices.

We are optimistic about the Japan and US trade negotiations. Japan intends to accept tariff reductions on agricultural crops. Currently, tariffs on agricultural crops imposed on the US are higher than those imposed on TPP members and EU countries, which is a disadvantage. The US might lose its share in Japan unless it concludes a treaty in a rush. On the other hand, auto makers are looking to expand production in the US, so we think it is easier for the Trump administration rather than China and Europe to reach an agreement with Japan. If the negotiations develop as expected, stock prices, mainly those in the auto sector whose valuations are low in terms of historical average are likely to rise.

Investment Strategy

Overweight Sectors	Underweight Sectors
Financials (Ex Banks)	Electric Appliances & Precision Instruments
Commercial & Wholesale Trade	Machinery
Construction & Materials	Transport & Logistics

We increased our weight in commercial trade and the non-life insurance companies which are likely to increase dividends as well as share buybacks, thus further overweighting these sectors. We recently invested in pulp and paper companies which are expected to improve earnings rapidly, to overweight the sector. Conversely, we reduced our weights in companies in the machinery and semiconductor sectors where stock prices have climbed.

*Sectors shown above are TOPIX 17 industries (ex. Performance Attribution Analysis).

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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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Mr Taniuchi supports Mr Kamohara in managing the Fundamental Active product. He started his career with Yamaichi Securities in 1996. He moved to Nikko Asset Management the following year as a trader of equities, convertible bonds and FX. He became a senior portfolio manager of Japanese equity specialising in Growth stocks. He joined Daiwa SB Investments in June 2008 to support Mr Kamohara in managing the Fundamental Active product.

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