Daiwa SB Investments

PM'S MONTHLY INSIGHT
FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

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Japanese stocks are likely to start climbing in the second half of May. Falling stock prices suggest that the market has already priced in forecasts of earnings decline for FY2019 as the FY2018 earnings announcement is running its course. We expect the stock prices to rise in the last half of the month as economic stimulus measures by the government are incorporated. The GDP growth rate for the January-March quarter released on 20 May is likely to turn negative, which should provoke debates over economic stimulus measures with the Upper House election and the consumption tax hike planned in July and October respectively. Weak economic indicators could trigger a reconsideration of the consumption tax hike, including its re-postponement as the tax hike could become a burden for the LDP heading into the Upper House elections. On the other hand, the Bank of Japan (BoJ) has clearly articulated its forward guidance and confirmed that it would maintain its accommodative monetary policy at the end of April. So stock prices are ready to rebound on both fiscal and monetary fronts. In particular, the increased likelihood of the postponement (of the consumption tax hike) will boost the stock market.

With regards to corporate performances, their deterioration in FY2019 will not go beyond our expectations. They may even surpass companies' estimates. According to financial results for FY2018 (ending in either February or March) gathered by **Mizuho Securities** from 18% of companies in terms of the number of companies and 30% in terms of the market capitalisation, recurring profits declined by 2% and net profits declined by 3%. Looking at the 4Q (January-March) results, recurring profits increased by 7% and net profits increased by 14% YoY with electric power companies and general trading companies as the largest contributors. The former generated striking earnings improvement as a result of electric rate hikes, while the latter benefited from a decrease in impairment losses.

The aggregate data of companies' guidance released so far suggest that both recurring profits and net profits will decline by 1% in FY2019 respectively. These figures are conservative compared with consensus forecasts by sell-side analysts which are an increase of 6% in recurring profits and an increase of 8% in net profits. As some companies set an assumed foreign exchange rate at JPY100 or JPY105 per USD in issuing forecasts, actual profits will likely top their conservative guidance. Although the rest of the companies are also likely to announce weak guidance, stocks will remain undervalued, trading at around 13 times of forward P/E. In case fiscal measures are implemented by the government to stimulate the economy, stocks have plenty of upward mobility.

Investment Strategy

Overweight Sectors	Underweight Sectors
Commercial Trade	Transport & Logistics
Financials (Ex Banks)	IT & Services, Others
Automobiles & Transportation	Machinery

We take overweight positions in names with solid earnings and strong shareholder returns including share buybacks expected such as non-life insurance, general trading, energy resources and construction & materials. We also overweight the automobiles sector given a huge upside potential when the US and Japan make progress in trade negotiations. We think the sector is undervalued despite expanding sales at home and abroad. On the other hand, we underweight the transportation sector due to a prospect for fierce competition in delivery charges, while holding railway stocks with stable performances. We also underweight the machinery sector due to its high valuation as well as the IT & services sector by shying away from **NTT DoCoMo** and **KDDI**, both of which are likely to suffer earnings decline following a cut in telecom rates.

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

Masashi KAMOHARA, CMA – Senior Portfolio Manager and Group Leader, Fundamental Active Group, Equity Management Department

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).

Note: Daiwa SB Investments Ltd. (DSBI) merged with Sumitomo Mitsui Asset Management Company, Limited (SMAM) on 1 April 2019.

Hideyuki TANIUCHI, CFA/CMA – Senior Portfolio Manager

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.

Mr Taniuchi graduated from Tokyo University of Science with BS/Engineering in Industrial Administration (1996).

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On 1 April 2019, Sumitomo Mitsui Asset Management and Daiwa SB Investments merged to form **Sumitomo Mitsui DS Asset Management.**