



**PM'S MONTHLY INSIGHT
FUNDAMENTAL ACTIVE GROUP**

Market Outlook and Investment Strategy

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Japanese equities are likely to rise in June toward the end of the month based on the three reasons below. 1) The government has a better chance of utilising economic stimuli including the postponement of the consumption tax hike ahead of the Upper House elections in July. 2) Technical indicators suggest that the stock market will most likely rebound after seeing a double drop, as stock prices have already fallen to previous lows last seen in December. 3) Corporate performance will decline marginally, leaving valuations low. If the government changes the current fiscal austerity, stock prices are likely to rebound, while the Bank of Japan (BoJ) maintains accommodative monetary policies.

Japanese equities fell after the US not only raised tariff rates on Chinese imports but also announced plans to impose levies on all Mexican imports in response to illegal migration. Even companies without factories in Mexico were not spared and suffered stock price declines. This indicates that the stock market has already priced in concerns over the worldwide reduction in trade.

The government appears to be sticking to their plan to implement the consumption tax hike without any additional economic measures, though the economy is decelerating and trade frictions are escalating.

The drop in Japanese equities is pressing the government for further economic measures. We expect the stock market to remain soft until additional economic measures or further discussions on the postponement of the tax hike are launched. If the Nikkei 225 falls below JPY20,000, it will be considered a double dip after the first dip in December, which tends to bring a rebound in the future. Technical indicators are also suggesting a turning point.

Policymakers are likely to start discussing possible implementation of economic measures including the postponement of the consumption tax hike to win the election within the month, following opinion polls that showed rising disapproval of the tax hike. Legislators close to Prime Minister Abe are said to have issued a statement to demand the postponement of the tax hike.

If the ruling coalition of the Liberal Democratic Party (LDP) and Komeito get a majority vote and win the Upper House Elections, they may be able to implement the tax hike. However, Abe will see a significant decrease in popularity. We anticipate Abe to hold double elections of both houses of parliament with the postponement of the tax hike as a manifesto to maintain the required number of delegates for his main objective, constitutional reform.

The G20 Finance Ministers and Central Bank Governors Meeting are held on the 8th and 9th of this month in Fukuoka, followed by the G20 Leaders' Summit in Osaka at the end of the month. Participants are likely to put forward ideas on how to sustain the world economy including monetary easing measures at the former meeting. The latter will likely indicate a stance toward dispute settlement, with both US and Chinese presidents expecting to attend. Any sign could lead to a recovery in stock markets.

Corporate performance was mostly in line with expectations. Companies' guidance for FY2019 were mostly flat. Sell-side analysts may downgrade their forecasts, but the current level of the forward P/E ratio (13x) is still low on a historical basis.

According to data aggregated by Mizuho Securities, companies listed on the first section of the Tokyo Stock Exchange (TSE) posted a 2% increase in operating profits, flat recurring profits and a 7% decline in net profits for FY2018. Net profits declined in reaction to a significant decrease in apparent tax rates in the previous year when auto makers and financial institutions withdrew deferred tax liabilities following tax reforms in the US.

Companies' guidance for FY2019 was 1% increase in operating profits, flat recurring profits and a 3% increase in net profits. Although operating profits, recurring profits and net profits are likely to decrease by 9%, 12% and 13% respectively in 1H of the financial year due to strong results in the same period a year earlier, earnings are likely to turn up in the 2H due to a couple of reasons below.

Firstly, unrealised loss of equity holdings will decrease at **Toyota** and **SoftBank**. Secondly, companies in the securities and marine transportation sectors are expecting earnings recoveries after booking impairment losses in the previous year. And lastly, electric utilities are likely to pass the increase in fuel costs on to the consumers.

With the sell-side consensus before the earnings announcement at a 7% increase in recurring profits, analysts started to downgrade their forecasts to narrow the gap between their own forecasts and companies' guidance. On the other hand, many companies are likely to raise their guidance for the 1H at the earnings season of the April-June quarter, given their conservative figures.

The noteworthy issue from the latest earnings announcement was an increase in share buybacks. While the amount of share repurchases hit a new high since 2010 in FY2018, the number of share buyback programs for FY2019 released by companies far outpaces that of FY2018. We can say that corporate governance is improving in respect of shareholder returns.

Investment Strategy

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

We will continue to overweight companies which we can expect earnings improvement and enhancement of shareholder returns, while taking underweight positions in information & communication, machinery, and transportation & logistics. We will reduce our weight in trading and retail trade by selling companies that have performed well to lock in profits. Whilst simultaneously increasing our weight in transportation and IT & services close to the neutral position by incorporating names that had experienced corrections despite promising earnings improvement. With the escalation of trade disputes between the US and other countries, we plan to lock in profits in the first half of June, while raising the weighting of defensive stocks such as railways and electric power. We will adjust the portfolio again in line with economic measures toward the end of the month.

*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).

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

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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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