



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

Market Outlook and Investment Strategy

July 2019

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We expect Japanese equities to climb through to the end of July, but to retreat after the April-June quarter earnings season, toward the end of September. We envisage the equity market to rise after the consumption tax hike in October, helped by the enhancement of stimulus measures. The TOPIX Index and the Nikkei 225 will likely end the year at around 1,700 and 23,000 respectively. Taking the looming consumption tax hike into account, we have revised our previous forecasts downwards.

We believe the markets have staved off the worst-case scenario, as the US and China decided to resume trade negotiations at the G20 meeting in Osaka. In addition, there seems to be little room for stock prices to fall further after the tax hike, given the decline in the first half of June when the market priced in the negative impact of trade frictions to the maximum.

The Upper House election is set to be held on 21 July. According to opinion polls, the ratio of voters who are against the consumption tax hike is rising, suggesting the ruling Liberal Democratic Party (LDP) cannot retain the existing seats.

The April-June quarter earnings season will start in late July, but an increasing number of companies, particularly exporters, are likely to report earnings decline as the ill effects of trade disputes come to the fore. The consensus forecast on the sell side for the FY2019 is a net earnings growth by around 5%, but most analysts estimate Japanese corporates' earnings will recover in the 2H FY2019 (October-March).

If the April-June quarter results fall below market consensus, hopes for recoveries in the 2H are likely to fade, leading to downgrades of full-year forecasts. On the other hand, if corporate earnings deteriorate, companies are unlikely to raise wages, which forces the government to strengthen stimulus measures. We believe the LDP will beef up economic stimulus measures to gain ground after the Upper House election.

Japanese stock prices firmed up in late June thanks to external factors such as the prospect of interest rate cuts in the US and the easing of tensions between the US and China. However, we expect stock prices to retreat by pricing in poor earnings during the next earnings season from the end of July to early August. They are likely to rebound at the beginning of October when the consumption tax hike is implemented as investors would run out of negative news by then.

Investment Strategy

Overweight Sectors	Underweight Sectors
Financials (ex Banks)	Machinery
Retail Trade	Banks
Raw Materials & Chemicals	Transportation & Logistics

We overweight retail trade and pharmaceutical which are insulated from the consumption tax hike as well as non-life insurance which expects a reduction in natural disaster risk while underweighting machinery and electric appliances due to deteriorated trade environment. We will maintain an underweight position in Banks but narrow its underweight range, following far sharper declines in its valuation compared with other sectors.

Notes:

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

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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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