



PM'S MONTHLY INSIGHT FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

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We expect Japanese equities to test a level of support in August. The influence of the US market is likely to wane while the individual factors such as performances will determine the movements of stock prices.

The April-to-June quarter earnings announcement season got under way in late July. According to data by **Mizuho Securities**, which aggregated the earnings results of companies which have made the announcement by the end of July (roughly 50% of the total), their operating income and net income decreased by -7% and -14% respectively. Poor earnings results by export-oriented companies in sectors such as electric appliances, machinery, automobiles and chemicals stand out on the back of the economic slowdown in export destinations, including China. Based on the above already announced FY2019 1H (April-to-September) earnings guidance, we expect that operating income and net income would decrease by -15% and -13% respectively in the July-to-September quarter. On the other hand, earnings recoveries are expected in the FY2019 2H, given the companies' FY2019 full year forecast of a -3% and -2% decline in operating income and net income respectively.

It seems that the poor earnings of export-oriented companies were within the assumptions made by most market participants, as we saw some names even rally despite sharp declines in their April-to-June quarter earnings. We believe this was because investors might focus more on the companies' smooth progress toward annual targets. Unlike the previous earnings season in May when stock prices dropped immediately after announcement despite strong earnings, many names with strong earnings enjoyed rallies in the past quarter. Corporate earnings and their order situations are being reflected in stock prices, which is a favourable environment for market participants.

The cool weather due to the prolonged rainy season is weighing down consumer spending. The last-minute jump in demand ahead of the consumption tax hike is running its course. Despite these negative factors, the room for stock price declines is limited as their valuations are already low in terms of historical averages even on the assumption that the corporate net income decreases by -20%. The administration is unlikely to discuss economic measures in August. So we believe the market will try to find the bottom with no fresh incentives after the earnings season.

Investment Strategy

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

We will continue to underweight the export sectors such as machinery, automobiles and electric appliances due to yen appreciation following the escalation of US-China trade disputes, while taking overweight positions in defensive sectors such as pharmaceutical and retail trade. Typically, we are planning to reduce the weights of financials and banking sectors under such circumstances, but this time we will maintain the existing weights by accumulating **Nomura** (8604) and **Mitsubishi UFJ Financial Group** (8306) due to the following reasons:

- Non-life insurance companies achieved major earnings growth as the loss on natural disasters decreased.
- Profit in the Fixed Income Clearing Corporation (FICC) unit surged at Nomura Holdings.
- Mitsubishi UFJ Financial Group is likely to make large amounts of profits in foreign bond investments.

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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