

## Japanese Equity Market Outlook

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Daiwa Asset Management Co. Ltd.

### <Market review in October and the first half of November>

The Japanese equity market closed higher in the month of October with the TOPIX up 0.38%, and the Nikkei index up 3.31%. In response to concerns of sovereign debt problems in Europe, stock prices began to fall at the beginning of the month, but, with the good US economic indicators and expectations on European banks' recapitalization, the market turned its course upward immediately. Thereafter, stock prices reacted nervously due to issues related to sovereign debt crisis in Europe and remained almost flat. However, due to increased damages by large-scale floods in Thailand, a key production base for Japanese manufacturers, such companies' stocks were sold. However, near the end of October, due to the agreement of the comprehensive strategy for debt problems was made among EU member countries, stock prices advanced.

Once the calendar proceeded to November, the stock market declined again. Though the European sovereign debt crisis appeared to settle down, it intensified investors' risk averse stances again ascribed to political instability in Greece and Italy. Later, the change of political regimes in Greece and Italy slightly lessened the prevailing concerns. As of November 15, the TOPIX was down 4.34%, and the Nikkei index has fallen 4.97% from their levels at the end of October.

### <Olympus Scandal>

Olympus, a Japanese leading manufacturer of Optical fiber scopes with the largest market share in the world, has revealed that its financial losses had been concealed over the years by its top management. Olympus had activated its investments to various financial products during the 1980s, Japanese bubble economy era. The company was reported that it gradually inflated losses toward the end of bubble economy in Japan, and concealed them by the falsification of its financial records with means of transfers of book losses to offshore entities, so called "Tobashi" technique. This scandal has also caused concerns that other similar cases might come to light at other Japanese companies in due course. However, Olympus seems to be quite an unusual case in this regard.

It was not limited to Olympus alone during bubble era, but many Japanese companies activated its investment in financial products and assets. And with the end of bubble economy in the 1990s, many Japanese companies had to saddle with heavy losses. During this period, current value accounting methods were not yet introduced in Japan. Therefore, losses did not surface immediately, and became apparent in due course of time later in many cases. Although most of companies dared to reveal their losses then and had rectified their balance sheets soundly, some companies were forced into bankruptcy.

In other words, companies with good results in their core businesses should have overcome writes off of such losses with proper accounting procedures by now, while others with poor performance in their main businesses would be already bankrupt or close to bankruptcy. In addition, it would be usually unlikely that such management which conceals losses and postpones proper processes to rectify their balance sheet would achieve successful results in their core businesses. Accordingly, a case like Olympus appears to be exceptional.

## <Outlook>

When we foresee the Japanese equity market for the next year, it would still remain in a certain range yet as a result of mixed factors with positive and negative impacts. Positive factors could be rising public and private spending for the recovery from the great disaster and the attractive valuation levels of equities indicated by PBR levels below 1x. On the other hand, key negative factors could be the stagnating US and European economies, and the prolonged European sovereign debt crisis. We believe that the current level of the Japanese market is close to the bottom end of our expected trading range.

For a short-term view, a technical rebound is likely to happen soon. Disappointingly, the latest Japanese equity market is slower to rebound than other overseas markets, but it will mainly be ascribable to such negative news of Olympus scandal and poorer earnings results of companies in July to September period than the market expectations. However, once the Eurozone situation will settle down, the under-valued Japanese equity market will likely attract investors' interests. The third supplementary budget, which is expected to be finalized within November, might be a good catalyst for the rebound of the market. In addition, the Bank of Japan is recently indicating its increasing concern about stagnating risk of Japanese economy. There might be an additional monetary easing, depending on the trend of the yen currency market.

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