Japanese Equity Market Outlook

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< Market review in December and the first half of January >

The Japanese equity market recovered marginally in the month of December with the TOPIX up 0.02%, and the Nikkei Index up 0.25%. At the beginning of the month, positive news such as the agreement among Japan, European and the US Central Banks to supply sufficient US dollar liquidity to the market and the release of steady US economic indicators made the market rise. However, since the agreement in the EU summit meeting on Dec. 9th was not appreciated as an effective solution for the stability of the current financial market, the equity market turned its course downward again. On Dec. 19th, the news that North Korean leader, Kim Jong Il died pushed down the market due to increasing geo-political risks in the adjacent region. Near the end of the month, ECB's Long-Term Refinancing Operation (LTRO) which eased some concern about financial conditions of EU countries, and the improvement of the US economic indicators made the market rebound again.

In January 2012, the market is fretting over news related to European sovereign debt issues such as the downgrading of sovereign bonds or the results of their auctions. As of January 16, the TOPIX was down 0.46%, and the Nikkei 225 has fallen 0.91% from their levels at the end of December.

< Small-cap or domestic demand-related stocks will be highlighted in 2012 >

In 2011, the TOPIX index was down 18.9% annually, but it was obvious that the small-cap stocks performed better than large-cap stocks. The TOPIX Small index only lost 7.8% of its ground while the TOPIX Core 30 index declined 25.4% (See Chart 1 below). In addition, such small or start-up company indices as the TSE 2nd section stock price index, the TSE Mothers index and the JASDAC index also relatively performed well. It was because the performances of large export-oriented manufacturers' stocks and large financial institutions' stocks were poor due to negative effects from chaotic overseas financial markets, while domestic-oriented, small-cap and non-manufacturing stocks could perform better thanks to the demand for disaster recovery. Such situation is clearly indicated in the difference between the industrial production index which is easily subject to the trend of external demand and the tertiary industry activity index which mainly relies on domestic demand (Shown in Chart 2). In 2012, it is expected that performance of major manufacturers' and financial institutions' stocks would improve because effects of the disaster and floods in Thailand are no longer expected. It is important to monitor cautiously the situation of overseas financial markets and European sovereign debt issues for the time being. On the other hand, domestic-oriented, small-cap and non-manufacturing stocks are expected to stay steady, supported by moderate recovery of Japanese domestic economy after the disaster.

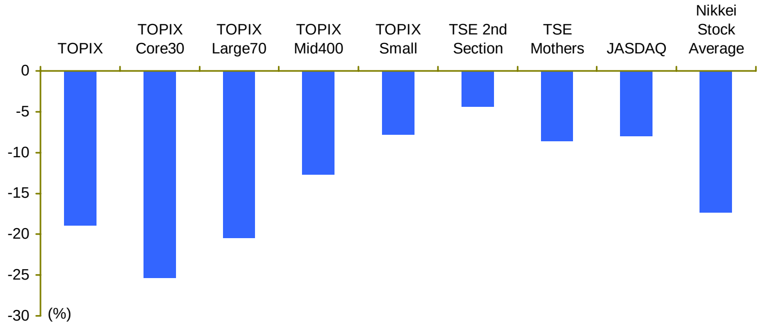
<Outlook>

In 2012, the Japanese equity market is expected to gain ground in the spring, then consolidate from summer to autumn, and later advance toward year-end.

Why do we expect some recovery in the spring? It is because investors' concern of European sovereign debt crisis is expected to retreat temporarily. S&P downgraded the ratings of 9 Euro member countries, but it merely confirmed the perception of market participants and was no surprise to the market. Although there is concern of further weakening of the Euro, it is subject to monetary policies of the ECB and need not be over-concerned. Market participants tend to focus on the weakness of the Euro and the higher yields of European sovereign bonds, but it should also be noted and positively evaluated that equity indices of major European countries (Germany, France, Italy and Spain) have all remained above their September 2011 lows, pricing in the worst for the time being. At present, European sovereign debt issues are dominating the market as major negative factors. Accordingly, if concerns of such issues are retreated temporarily, the sentiment of the market would improve dramatically, and the stock prices might unexpectedly advance.

From summer to autumn, we expect that the market would start to consolidate for a while due to uncoordinated stances of EU member countries for the solution of their sovereign debt issues. Unclear political aspects in Japan and overseas, including possible elections, would make the forecast of the trend of the market difficult. However, the market is expected to rebound toward the end of the year due to expectation to the Bank of Japan's new governor and deputy governors who might adopt a new market-friendly monetary policy.

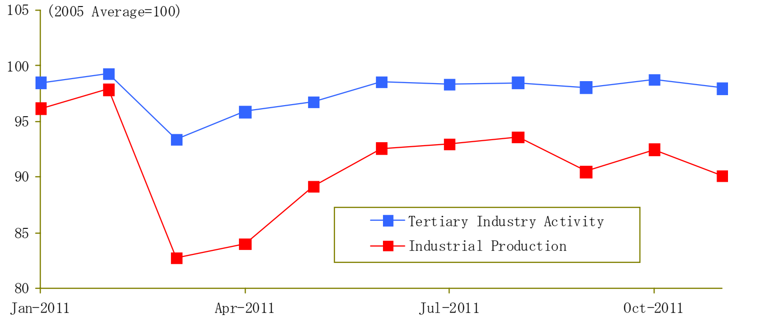
Chart 1: Performances of Japanese Equity Indexes, 2011



End of 2010～End of 2011

Source: QUICK/Astra Manager

Chart 2: Japanese Economic Activity



Jan 2011～Nov 2011

Source: Ministry of Economy, Trade and Industry