Japanese Equity Market Outlook

March 19, 2012

Daiwa Asset Management Co. Ltd.

<Market review from February to March>

The Japanese equity market gained further ground in February. The TOPIX index was up 10.68%, and the Nikkei 225 Index up 10.46%. Throughout the month, the equity market steadily advanced on top of several positive developments, such as good results revealed by U.S. economic indicators such as ISM economic indicators and employment data, a setback of the European sovereign debt crisis by the LTRO program realized by the ECB and the agreement of a second aid package among EU member countries for Greece. In addition, the BOJ's announcement of a change in its monetary policy with "the price stability goal in the medium and long-term" and actual additional monetary easing at the same time, and resulting depreciation of the yen were boosters for the advance of the Japanese equity market.

In March, the market slightly lost its advancing momentum due to investors' concerns of the market's advance being too sharp and temporary concerns of disagreement on Greece's PSI (Private Sector Involvement). However, the market never lost its gaining momentum completely, and kept its favorable sentiment to continue its advance. As of March 16, the TOPIX index was up 3.68%, and the Nikkei 225 Index was up 4.18% from their levels at the end of February.

<Change of trend in USD/Yen?>

After the U.S. FOMC meeting in January, the yen appreciated to a level of 76 against the USD, but later reversed its course to depreciate, and was quoted around 84 against the USD on March 15. The following three reasons were bearish factors for the yen: (1) Investors' expectation for QE3 by the FED retreated due to consecutive releases of good U.S. economic indicators and a relatively clear trend of the U.S. economic recovery. (2) The expectation of the BOJ's holding of its monetary easing stance for the time being was boosted by the announcement of the bank's "price stability goal in the medium to long-term". (3) Investors' risk appetite gradually recovered thanks to a retreat of concerns of Europe's sovereign debt issues, which would be a negative factor for the yen since it was chosen as a safer asset in risky situations.

From a technical analysis view point, it is known that the 52 week moving average is empirically useful to see the USD/Yen trend. Its exchange rate had stayed almost consistently below its 52 week moving average from 2007, but it crossed the moving average upward and has stayed above since this February. Hence it could be viewed as its trend being changed from a technical view point.

The depreciation of the yen would boost Japanese corporate business results, and is expected to positively affect the equity market. Especially, it is expected that the depreciation of the yen would become a major positive factor for the market from February because of a backlash to the too strong yen as a heavy burden on the equity market in 2011.

<Outlook>

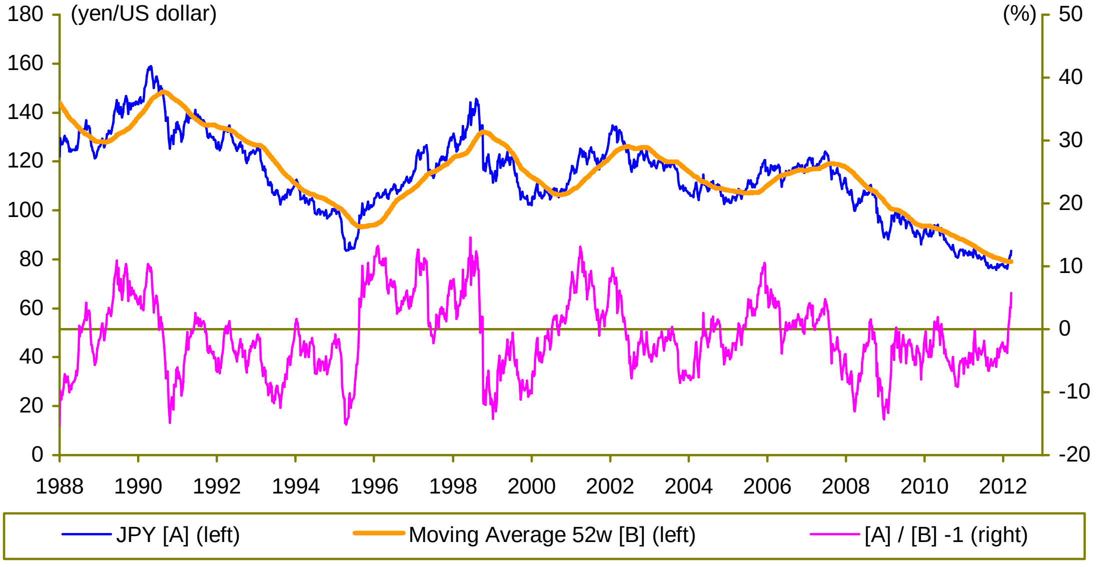
For the next year, it is expected that the market might peak in March to April, and will likely stay in a correction mode until 3Q, and then will start to gain ground again from 4Q to the beginning of 2013.

We had expected the current sharp rally from the latter half of January in commentary last month, and view the recent peak of the market approaching in a short while. The following 4 points are reasons for such a view. (1) The P/E and P/B ratios of the Japanese equity market seem no longer attractive among other international markets. (2) From a technical view point, the market seems to be in an over-bought situation after its latest sharp rally. (3) Three major encouraging factors for the market (the retreat of concerns of Europe's sovereign debt crisis, the U.S. economic recovery and the depreciation of the yen) seemed mostly priced in. (4) Any new positive factors for the market are not expected for the time being.

On the other hand, negative factors are expected to surface after May, due to (1) a reaction to the recent sharp rally; (2) a resurgence of Europe's sovereign debt concerns; (3) a slowdown of the U.S. economic recovery. However, the market is expected to recover its upward momentum from 4Q to the beginning of 2013. It seems that market participants will strongly anticipate the nomination of a new pro-monetary easing governor and vice governors of the BOJ in March-April 2013.

If the BOJ took an easing stance more aggressive than the market expected in order to make the Japanese economy stave off its deflationary situation, it may boost the market more sharply than expected. On the other hand, the downside risks of the market against the above mentioned view are the end of various economic stimuli and the execution of a large scale spending cut plan without any amendment in the U.S.

Japanese Yen and Moving Average : 52 Weeks



Jan 2, 1988～ Mar 16, 2012

Source: QUICK/Astra Manager