Japanese Equity Market Outlook

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<Market review from March to April>

The Japanese equity market advanced in March. The TOPIX was up 2.20%, and the Nikkei 225 average up 3.71%. The market began with a slight fall, due to observations that Greece's private debt reduction may not succeed and also the impact of China's target growth rate being cut. However, Greece's private debt reduction issues did progress as planned and a depreciation of the yen's exchange rate boosted the stock market to rise. In response to the subsequent lower-than-expected U.S. and European economic indicators, the market declined temporarily, though a further fall was mitigated by Mr. Bernanke, the Chairman of the FRB, who hinted that monetary easing policy will continue.

In April, concerns of Spain made European financial markets become precarious, and releases of lower-than-expected U.S. economic indicators resulted in a market fall. As a reaction to the steep market rise through March, the pace of decline also accelerated. As of April 16, the TOPIX was down 5.91%, and the Nikkei 225 average down 6.08% from their levels at the end of March.

< A possibility that the Bank of Japan note rule could be virtually broken>

To moderate and protect fiscal conditions in Japan, the Bank of Japan is prohibited by law to acquire Japanese government bonds directly from the government. To maintain this in a smooth manner, the Bank of Japan formulated its own internal rules, which are not mandated legal provisions. According to these internal rules the balance amount of purchases of long-term government bond holdings by the BOJ from the market shall not exceed the amount of Bank of Japan notes issuance. In general this rule has been referred to as "the Bank of Japan note rule".There is a high possibility that this rule could be disregarded by the second half of this year. By March 31, the Bank of Japan (including the holdings of its asset purchase program) owned 70.7 trillion yen in long-term government bonds. Issuance of Bank of Japan notes outstanding was 80.8 trillion yen. It is clear that BOJ long-term government bond holding amounts were below its bank notes issuance. However, in the framework of current monetary policy, the purchase of long-term government bonds of more than 3 trillion yen every month is expected. Even after considering the redemption amounts of long-term government bonds, as well as an increase in the amount of Bank of Japan note issuance, by the second half of this year it appears there is a high possibility that the amount of long-term government bonds held by the Bank of Japan could exceed its note issuance. Furthermore, long-term government bonds held by the BOJ under its asset purchase program (6.3 trillion yen as of March 31) in this manner is not considered normal, and has been mentioned to be excluded from the Bank of Japan note rule. However, it is hard to point out the difference and its economic impact, when the BOJ buys government bonds and also follows its asset purchase program. When funds for its asset purchase program, including the amount of long-term government bonds held by the BOJ, exceeds its note issuance (in reality) it would be considered, at least by market participants, that the Bank of Japan note rule has been broken. It can also be considered that the BOJ genuinely embarked on reflationary policy modifications.

<Outlook>

For the next year, it is expected that the equity market will be range-bound in the April-June, July-September periods; is expected to advance in the October-December period; and thereafter will return to being range-bound in the 2013 January-March period.

A month ago we expected the market to approach a peak in the short-term. In reality, stock prices peaked near the end of March. Subsequent adjustments were faster and larger in size than expected. Issues such as a recurrence of European debt problems and a slowdown in the pace of improvement of the U.S economy were expected to occur after the month of May, but instead occurred earlier than expected. Despite the correction having happened earlier than expected, the possible risk of a correction after May could be low. The equity market had positive material that helped it to advance in the month of March, with subsequent unfavorable news leading to a correction. As both positive and negative news has already been discounted, for a while the market may lack a sense of direction and continue to be range-bound.

We expect the market to advance from October to December. Seasonal improvement in U.S economic indicators, an upward revision of corporate performance, and clarity of U.S presidential and parliamentary elections are the factors that would foster a rise in stock prices. We do not anticipate a sustained upward trend from January to March 2013. The reason for this is the austerity measures of the United States starting in 2013, which are expected to strongly and adversely affect the economy.

Upside risks to the outlook above are the BOJ overcoming deflation and aggressive monetary easing exceeding market expectations. Both the upside and downside can be impacted by domestic politics. In some situations there is a possibility of a dissolution of the House of Representatives and a subsequent possibility of conducting a general election before the end of the year. As a result, there is the possibility of the birth of a stable administration within the framework of a new coalition, or on the contrary the risk of greater instability and chaos unfolding than the currently existing political situation holds.