

Japanese Equity Market Outlook

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< Market review from July to August >

The equity market was sluggish in July. The TOPIX tumbled 4.39%, and the Nikkei Average dropped 3.46%. The index weakened at the start of the month following the decline in the U.S. Manufacturing ISM index, but then the market rose marginally when more financial easing was announced by the U.K., the Euro-area, and China. However, stock prices plunged again after the release of worse than expected employment data in the U.S. The fall in the market was also as a result of the BOJ not providing additional financial easing, and the fact that the financial status of Spanish local governments was deteriorating. Around the 25th and 26th of the month, the market finally rallied on the news that the ESM could get a banking license, and the comment from Mr. Draghi, President of the European Central Bank, saying that the ECB is ready to do whatever it takes to preserve the Euro.

At the beginning of August, the market is maintaining its upward trend as a result of positive US employment data and a slight depreciation in the Yen. Compared to the end of July, the TOPIX has gained 1.50%, and the Nikkei 225 has advanced 2.64%. (as of August 15th)

< Weak corporate earnings >

August sees the start of companies reporting earnings for the first quarter of 2012 (April to June). According to our calculations, the total of Tokyo Stock Exchange 1st section will see a 5.5% increase in revenue, a 9.4% decrease in current profit, and a 13.7% decrease in net profit. Our forecasts for the financial year 2012 (April 2012 to March 2013, based on each company's forecast) are for a 3.8% increase in revenue, a 12.0% increase in current profit, and a 46.9% increase in net profit. However, if we compare this 2012 forecast to our forecasts from the end of May, the figures have been adjusted downward by 1.4%, 2.1%, and 4.8% respectively. Moreover, the first quarter figures account for only 23.5% in revenues, 21.8% in current profits, and 19.2% in net profits out of the fully year 2012 total. Although normally the first quarter does not contribute much to the financial year, the current first quarter estimates seem to be in very low level. Thus, there is a high chance of an additional downward adjustment to the 2012 earnings forecast.

Although expectations are for weaker earnings, there was not a big negative impact on the stock market. It may be that the current stock prices already are in weak level, and the market may be undervalued.

< Outlook >

We expect the stock market will rise over the next year, although it may be a gradual recovery. There are two reasons for this. First, the global economy is expected to recover gradually from the current slowdown, and second, Japanese stocks seem to have little further downside in valuation terms based on price to book value.

In the U.S., the housing market seems to be bottoming out, and also employment is improving slightly. We expect this trend of further economic recovery to continue through to the end of the year. Of course, this recovery trend could be derailed by the result of the Presidential and Congressional elections this year. However, if the economy weakens, we would expect to see more financial easing. Other countries should also see some improvement in their economies as a result of financial easing policies.

With regard to Japanese stocks, a price to book ratio of 0.9 times is still regarded as a sign that they are too cheap. Compared to overseas markets, Japanese stocks seem to have little further downside unless there is a further external shock to the market. On the political side, the LDP (Liberal Democratic Party), opposition party, has cooperated with the government in passing a bill for increasing the consumption tax rate. However, in exchange, the possibility that the Lower House may be dissolved leading to an election seems to be high at this moment. If there is an election, the LDP is expected to win it to form a new government. Mr. Hashimoto, the current Mayor of Osaka city and a new emerging political power, is expected to secure considerable seats in the House. The stock market would be expected to react positively to the formation of a new government due to the general feeling of disappointment with regard to the current government.

The main risk at this moment is whether there will be an economic recovery in Europe and China. In Europe, the risk is that fiscal austerity and the financial crisis derail the recovery. Whereas in China, the risk is that the government does not repeat the economic stimulus which we saw after the shock of the Lehman Brothers bankruptcy. It may take some time until we can see a clear economic recovery in China although we may not see a further economic downturn. If these two economic areas experience a prolonged economic downturn, the global economy will also be negatively affected with the result that stock prices will stay within the current range.

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