

## Japanese Equity Market Outlook

March 18, 2013

Daiwa Asset Management Co. Ltd.

### <Market review from February to March 2013 >

In February 2013, equity markets rose, with the TOPIX and the Nikkei Stock Average up 3.77% and 3.78%, respectively. Equity prices started with a rise, due to the heightened expectations for an earlier bold monetary easing by the Bank of Japan (BOJ) after the announcement by BOJ Governor Shirakawa of resigning before his term as well as the resultant weaker yen. Equity prices dropped temporarily, however, following a pause in the weaker yen, which was caused by the expectation that criticism of the weaker yen would be heightened from other countries at the G20 meetings. Equity prices subsequently rose again, partly because: there was no notable criticism of the weak yen; the possibility of Japan's participation in the Trans-Pacific Strategic Economic Partnership Agreement (TPP) was heightened following the Japan-U.S. summit meeting; and Mr. Haruhiko Kuroda and Mr. Kikuo Iwata—who had been strongly criticizing the current BOJ policy—were reported to have become the leading candidate for BOJ Governor and Deputy Governor, respectively. Towards the end of the month, equity prices dropped at one point reflecting the result of the election in Italy, but it turned out to be temporary.

After entering into March, the speed of the rise in equity prices accelerated. The rise was due to the factors that, in addition to the expectations for domestic policy, the Dow Jones Industrial Average recorded a new high following the successive announcements of good economic indicators in the U.S., as well as the strong dollar and weak yen progressed further. From the end of February, the TOPIX rose 7.99%, and the Nikkei Stock Average 8.66% (as of March 15).

### <Recovery of corporate earnings >

Since November 2012, Japanese equities have been rising rapidly, which is due to the strong influence of expectations for policy response after the change of government. Nonetheless, the rise in equity prices is not solely dependent on psychological factors. The recovery trend of corporate earnings, which is the most important economic fundamental, has been conspicuous. As for the total of 1,316 companies—with the full year ending in March—in the 1st Section of Tokyo Stock Exchange, quarterly earnings in FY2012 (April 2012 – March 2013) showed that net income dropped 13.4% and 21.2% year on year in April – June and July – September, respectively, and then rose 247.0% in October – December. We can see the recovery of earnings as ordinary income without temporary loss/profit decreased 9.2% and 2.5% in April – June and July – September, respectively and then increased 31.5% in October – December. Moreover, as for developments of TOPIX/EPS for each fiscal year, the EPS in FY2014 is expected to surpass the past peak in FY2007. Please note that room seems to remain for further rise as the current weak yen is not likely to have been fully reflected in the forecasts of FY2013 and FY2014.

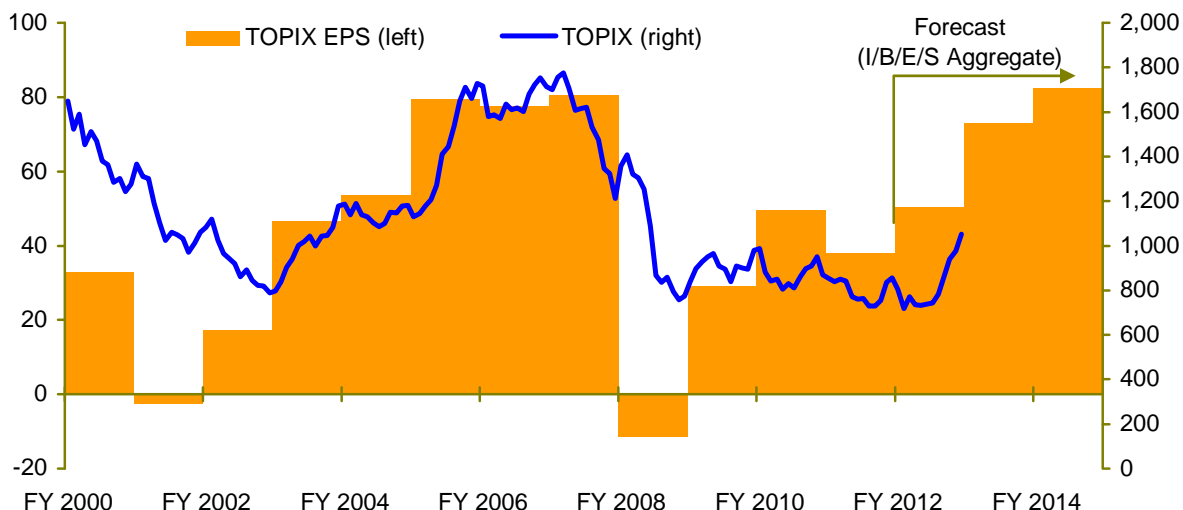
## < Outlook >

Looking ahead one year or so, we expect equity markets to rise towards July – August, followed by a temporary adjustment phase from September to the end of the year.

Since the sense of overheating is becoming pronounced, technical adjustments of 5 – 8% for TOPIX may happen anytime. The trend of rising equity prices, however, is likely to continue, owing to the expectations for policy responses and the realization of their effects. The supplementary budget passed on February 26 is expected to be fully implemented from now on, which in turn would push up the current economic activities considerably. Moreover, the new BOJ governing team to start on March 20 is likely to take policy measures in order to forestall negative responses in the market. Furthermore, a growth strategy is scheduled to be decided in June. In preparation for the upper house election in July, the government and the ruling parties are likely to take various policy measures without interruption.

We expect adjustments from September to the end of the year, with a rise in interest rates in the U.S. possibly triggering it. Although the U.S. economy slowed down from spring to summer in the past three years, many are in the view that it will not slow down this year. Without the slowdown from spring to summer, cutback and suspension of quantitative easing and the end of the zero-interest rate policy are more likely to be brought forward considerably than is currently thought. As a result, the U.S. interest rates could potentially increase substantially, while U.S. equity prices dropping. In that case, Japanese equities are also likely to be affected. In addition, there appear to be some factors to push down equity prices toward the end of the year, such as the returning of reduced tax rates of 10% on capital gain and dividends to the original 20%; and concerns about a temporary economic slowdown expected after the rise in the consumption tax rate (from 5% to 8%) to be implemented in April 2014. In 2014, however, these negative factors are to exhaust their impacts, and therefore, equity prices are expected to be back on an increasing trend.

## TOPIX EPS



FY 2000 ~ FY 2014 (TOPIX:Mar 2013)

\*FY yyyy : from Apr yyyy to Mar yyyy+1

Source: Thomson Reuters/DATASTREAM

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