

Japanese Equity Market Outlook

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Daiwa Asset Management Co. Ltd.

<Market review from June to July 2013 >

In June 2013, equity markets declined, with TOPIX and the Nikkei Stock Average down by 0.17% and 0.71%, respectively. During the first half of the month, equity prices dropped, due to the strengthened risk aversion by investors with the heightened expectations for the reduction of quantitative monetary easing in the United States. Moreover, it was also a negative factor that the Third Round of Policies under the Growth Strategy announced by Prime Minister Abe was within the scope of previous media reporting. In the latter half of the month, equity prices rose in favorable response to the weaker yen in the foreign exchange markets and the announcements of favorable economic indicators. While there was a phase of concerns about a rapid rise of short-term interest rates and heightened uncertainty about the stability of the financial systems in China, markets gradually regained calm as the People's Bank of China began to take measures to stabilize markets.

After entering into July, equity prices have been continuing the trend of rebounding. Equity prices have been pushed up by the steady economic indicators in Japan and the United States such as the Bank of Japan (BOJ)'s *Tankan* survey as well as the *ISM Manufacturing* Report on Business and employment statistics in the United States. From the end of June, TOPIX increased 6.01% while the Nikkei Stock Average 6.06% (as of July 12).

<Upper House elections on July 21 >

The upper house elections will be implemented on July 21. The term for the upper house is six years, and unlike the lower house, there is no dissolution. Elections are held every three years to elect half the members. In this upper house elections, as with the lower house elections in last December, the Liberal Democratic Party is forecast to increase its seats drastically, with the expected majority of the ruling parties—in coalition with the New Komeito—in the upper house.

In Japan, after the 2007 upper house elections, the ruling parties have often held less than half of the total seats at the upper house. As a result, draft laws that are important for the economy and the society have not been enacted in many cases, which in turn has been a factor for economic stagnation. After the upper house elections, we can expect policies to be implemented expeditiously. There is a concern in some parts that the main focus of Prime Minister Abe might shift from the economy to constitutional amendment after the upper house elections. Nonetheless, Prime Minister Abe is likely to continue giving the economy the top priority in his handling of the government, as the coalition partner New Komeito is cautious about constitutional amendment, while the Japan Restoration Party—which is an opposition party but is in favor of constitutional amendment—is not forecast to gain many seats.

< Outlook >

Looking ahead for the coming one year or so, we expect equity prices to rise followed by adjustments in 2013, and to steadily rise after entering into 2014.

The rise since the second half of June is expected to continue until September to October with the possibility of surpassing the highest price recorded in May. This is because, in addition to the steady recovery of the economy, expectations for policy measures are likely to be heightened again. Over September and October, the following policy developments are expected. First, we anticipate the formulation of a supplementary budget along with the final decision to raise the consumption tax rate, implementation of the second round of quantitative and qualitative monetary easing by the BOJ, and formulation of a second growth strategy. Moreover, Tokyo is very likely to be designated as a National *Strategic Special Zone* announced in the first Growth Strategy. Tokyo is thought to be less resistant to deregulation than local areas, and therefore, high-impact measures are expected to be adopted. There is a possibility of casinos being allowed in special deregulation zones, as a draft law to lift the ban on casinos could be submitted by Diet members. The host for the 2020 Olympic Games will be decided on September 7, and if Tokyo were selected, it would be a boon to these moves.

Nevertheless, towards the end of the year, equity prices are expected to go through temporal adjustments owing to the start of the reduction of the U.S. quantitative easing and the impact of changes in securities taxation. To a considerable degree, markets appear to have taken into account of the start of the reduction of the U.S. quantitative easing before the year-end. However, the confidence leading to a rise in U.S. stock prices with long-term interest rates increasing at the same time, the situation of the U.S. markets will resemble that of 1987, when we had the Black Monday, rather than the ones in 2004 or 1994 which have recently been cited for comparison. We need to be cautious. The change of securities taxation means that taxation of capital gain and dividend will return from the reduced 10% to the original 20% in 2014. It is expected that individual investors will rush to sell before the rise of the tax rate.

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