Japan Investment Commentary and Market Outlook

Recession Fears Spook Global Financial Markets

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•*The Japanese stock market fell along with global markets but displayed relative resilience on a local currency basis as weakness in the yen provided support. TOPIX 12 month forward PER sank below 12x.*

•*We remain cautiously optimistic, in principle, on Japanese shares against the backdrop of resilient earnings and attractive valuation levels. Easing of border controls and introduction of a domestic travel promotion campaign in Japan, and easing of travel restrictions in China are positive catalysts in the near-term.*

Market Movement	As at 30/06/2022
TOPIX Index	1,870,82 yen -41.85 (-2.19%)
Nikkei 255 Stock Average	26,393.04 yen -886.76 (-3.25%)
Exchange rate	1 USD = 136.32 JPY

Market Review

The Japanese stock market sank again in June.

The Japanese stock market was relatively resilient on a local currency basis compared to U.S. markets as central banks around the world took a hawkish shift to combat inflation and spooked investors with recession fears. The Fed raised the fed fund target rate by 75bps in response to rising inflation signalled by a 8.6% year-on-year increase in the May U.S. consumer price index, the highest increase since 1981, and a preliminary reading of the University of Michigan survey of consumers on inflation expectations. The European Central Bank indicated its intention to hike rates at its next meeting in July, followed by the Swiss Central Bank, unexpectedly, and the Bank of England in their battle against inflation. U.S. treasury yields rose sharply after the CPI data and stock markets fell in response. The Bank of Japan remained an outlier, sticking to its ultra-accommodative monetary policy and left rates on hold. The yen weakened in response and overseas hedge funds shorted JGBs in a bet to test the BOJ's yield curve control policy. The yen fell to a 24 year low against the U.S. dollar. Growing recession concerns weighed on commodity markets, semiconductors and related stocks. The Japanese stock market didn't escape the market downturn but was relatively resilient on a local currency basis due to weakness in the yen.

Among the TSE 33 industrial sectors, 15 sectors rose led by Electric Power & Gas, Fishery, Agriculture & Forestry, Textile & Apparel, Food, and Construction while 18 sectors fell led by Marine Transportation, Mining, Iron & Steel, Electric Appliances, and Precision Instruments.

TOPIX 12 month forward PER fell below 12x.

In terms of style, value outperformed growth, and, in terms of size, small-caps outperformed large-cap stocks during the month.

Quarter-to-date performance

Quarter-to-date, the TOPIX index has fallen 3.88% and the Nikkei 225 Stock Average index has fallen 5.13%. The Japanese yen has fallen 12.0% against the U.S. dollar.

Among the TSE 33 industrial sectors, 13 sectors rose led by Electric Power & Gas, Oil & Coal Products, Textile & Apparel, Fishery, Agriculture & Forestry, and Warehouse & Harbour Transportation while 20 sectors fell led by Services, Nonferrous Metals, Electric Appliances, Marine Transportation, and Wholesale Trade.

Year-to-date performance

Year-to-date, the TOPIX index has fallen 6.10% and the Nikkei 225 Stock Average index has fallen 8.33%. The Japanese yen has fallen 18.5% against the U.S. dollar.

Among the TSE 33 industrial sectors, 20 sectors rose led by Mining, Electric Power & Gas, Oil & Coal Products, Insurance, and Fishery, Agriculture & Forestry while 13 sectors fell led by Services, Electric Appliances, Precision Instruments, Metal Products, and Chemicals.

Monetary Policy

The Bank of Japan (BOJ) remains committed to an accommodative monetary policy and kept rates on hold at its monetary policy meeting on 17th June. In a speech delivered on 7th June, the BOJ governor Haruhiko Kuroda made a remark that households are increasingly accepting rising prices which he was later forced to retract in response to widespread criticism from the public. Governor Kuroda met with Prime Minister Kishida on 20th June and finally conceded stating a weak yen hurts the economy.

Japanese Economy

May industrial production and the BOJ Tankan Survey of Corporations suggests weakness in manufacturing - particularly in the automotive industry - partly due to lockdowns in China which lasted until recently, although the latter also suggests companies are becoming aggressive on hiring and capital expenditure.

Politics

Prime Minister Fumio Kishida's cabinet approval rating fell 6 percentage points to 60% from 66% in May according to a survey between 17th and 19th June jointly conducted by the Nikkei Newspaper and TV Tokyo. Rising prices due to soaring resource prices and a weak yen are reportedly casting a shadow over the administration's approval rating.

House of Councillors Election

On 10th July, Japan will vote on half of the 248 seats in the upper house. Out of 545 candidates running for the seats, 181 candidates are female, the highest number in history. The ruling coalition parties Liberal Democratic Party and Komeito are expected to win the election with majority. What is more important about the election is not the election itself but the fact that after this election there will be no national level election for as long as three years, giving Prime Minister Fumio Kishida time to concentrate on policy implementations. After the election, Kishida is expected to appoint close allies to his new cabinet and embark on his true agenda more aggressively.

Covid response

Novel coronavirus expert meeting at the Ministry of Health, Labour and Welfare, met on 30th June and warned against the recent uptick in new infections nationwide and in particular an acceleration observed in the Tokyo metropolitan area. This may deter an early introduction of discounted travel promotion campaign to prop up the economy and ailing travel industry.

Market Outlook

We remain cautiously optimistic, in principle, on the stock market due to resilient corporate earnings outlook and undemanding stock valuations, supported by the recovery of the global economy. Market turbulence due to accelerated tapering and rising interest rates in the U.S. and in Europe, inflationary pressure arising from supply-chain bottlenecks, high resource prices, and labour shortage remain risks to our main scenario. Ongoing conflict between Russia and Ukraine poses a grave threat to world peace and risks to the global economy with prolonged implications such as high resource prices and high transportation costs. We note that these factors will be detrimental to the global economy and corporate earnings.

In addition, Covid continues to pose threats to the global growth. Emergence of new strains and further spread of the virus may result in reinstatement of strict lockdowns worldwide and dent global economic recovery. This would pose major risks to our main scenario.

In the near term, further easing of Covid-related social restrictions, reopening of borders to overseas tourist and domestic travel promotion campaigns in Japan and easing of lockdowns and travel restrictions in China are positive catalysts that will boost the economy and support stock markets.

Upcoming Major Events

- FOMC minutes on 6th July and next meeting on 27th July
- The House of Councillors election on 10th July
- BOJ monetary policy meeting on 19th to 20th July, minutes on 26th
- National Congress of the Chinese Communist Party in Autumn
- US Midterm election on 8th November
- BOJ Governor Kuroda’s term ends on 8th April 2023

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