FPA Financial

Investment Committee Policy Summary

September 2022

Japan
Economy / Stock Market Outlook

Q2 GDP grew by 3.5% qoq saar

- Japan's GDP grew by 3.5% qoq seasonally adjusted annualised rate (saar) in Q2 2022 to ¥542.1 trillion, above its pre-pandemic level and an upward revision from the preliminary 2.2% expansion estimate. The increase was underpinned by increases in private consumption and business spending. In Q1 2022, real GDP increased by 0.1%.

- According to the Bank of Japan (BOJ), the impact of COVID-19 and supply-side constraints on the economy are expected to wane going into the middle of FY2022/23. However, the economy continues to remain under pressure from the rise in commodity prices due to factors such as the situation in Ukraine.

- Most financial institutions have revised their 2022 GDP projections downwards, citing economic slowdown in Japan's key trading partners such as the US, Europe, and China. However, rising capital expenditure, expected fiscal stimulus in October, and accommodative monetary policy could underpin Japanese economic growth.

- For 2022, the Japanese economy is expected to expand by between 1.00% and 2.00% while growth in 2023 is expected range between 0.80% and 2.10%, as shown in **Exhibit 1**.

GDP Forecast By Various Institutions

Exhibit 1: Japan GDP Forecast for 2022 and 2023

	2022F	2023F
IMF (Jul-22)	1.70%	1.70%
OECD (Jun-22)	1.70%	1.80%
BOS Aug-22	1.00%	0.90%
DWS Aug-22	1.50%	0.90%
Citi Aug-22	1.30%	1.40%
Wells Fargo Aug-22	1.40%	1.60%
SMBC Aug-22	2.00%	2.10%
BOJ Jul-22*	2.40%	2.00%
SMDAM Aug-22*	1.50%	0.70%

** For fiscal year ending March*

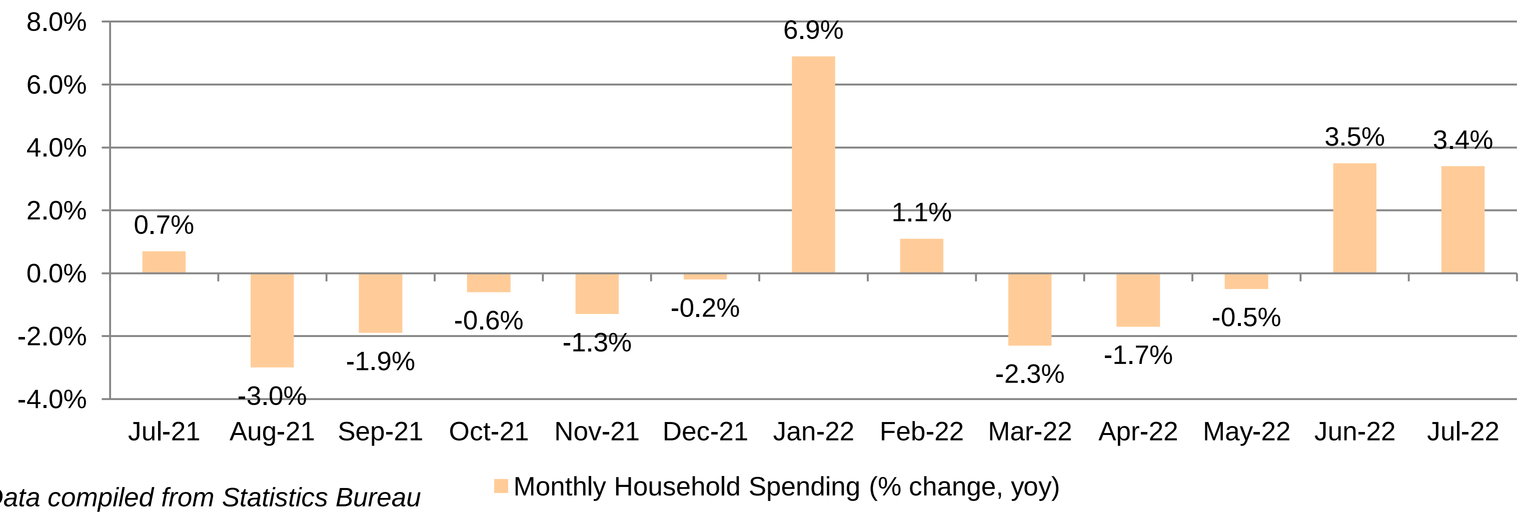
Source: Respective financial institutions

Household Spending Rose By 3.4% yoy in July

- According to the Statistics Bureau of Japan (SBJ), household spending in Japan rose by 3.4% yoy in July, following a 3.5% yoy gain in June, as shown in **Exhibit 2**. Spending decreased by 1.4% from June as a resurgence in COVID-19 cases and inflation caused by the weak yen created headwinds to private spending.

- In a Reuters report, hotel expenses grew by 55% yoy in July, while transport fees rose by 48% yoy. The expansion in leisure items boosted spending growth compared to July 2021 when restrictions on face-to-face services kept consumers at home. Separate government data showed that inflation-adjusted real wages fell by 1.3% yoy in July as the jump in consumer prices from the yen reaching fresh 24-year lows outpaced the gain in nominal wages. Taken together, rising inflation in Japan has added pressure to private consumption, though there remains room for recovery following Japan's recent economic recovery to its pre-pandemic level.

<u>Exhibit 2: Japan Monthly Household Expenditure (% change, yoy)</u>



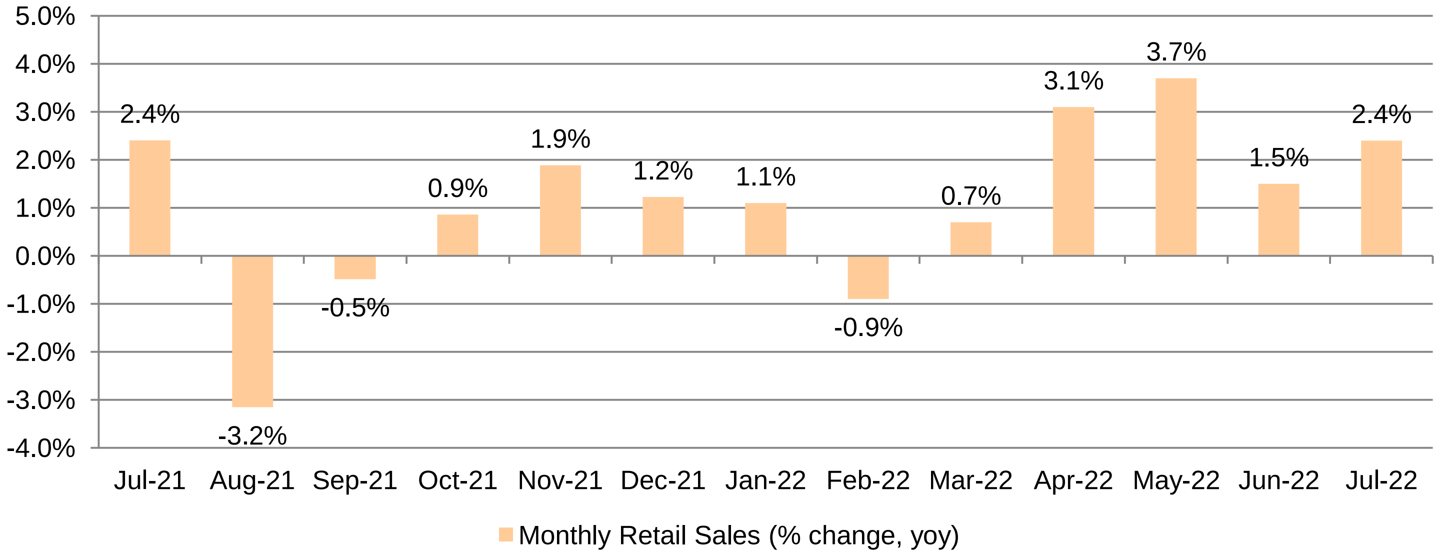
Source: Data compiled from Statistics Bureau

Retail Sales Increased by 2.4% yoy in July

- According to the Ministry of Economy, Trade, and Industry (METI), Japan's retail sales rose by 2.4% yoy in July as shown in **Exhibit 3** from a 1.5% increase in June. The increase can be attributed to stronger sales of medicine & toiletries as well as general merchandise, and is the fifth straight month of increases.

- The recovery of the Japanese economy to its pre-pandemic levels saw spending on medicine & toiletries increase by 8.4% compared to the year before, and spending on general merchandise increase by 4.5% yoy. However, consumers also spent 7.9% more on fuel compared to a year ago, and sales of machinery & equipment as well as motor vehicles fell by 5.5% and 2.3% respectively as supply-side constraints persist.

Exhibit 3: Japan Monthly Retail Sales (% change yoy)



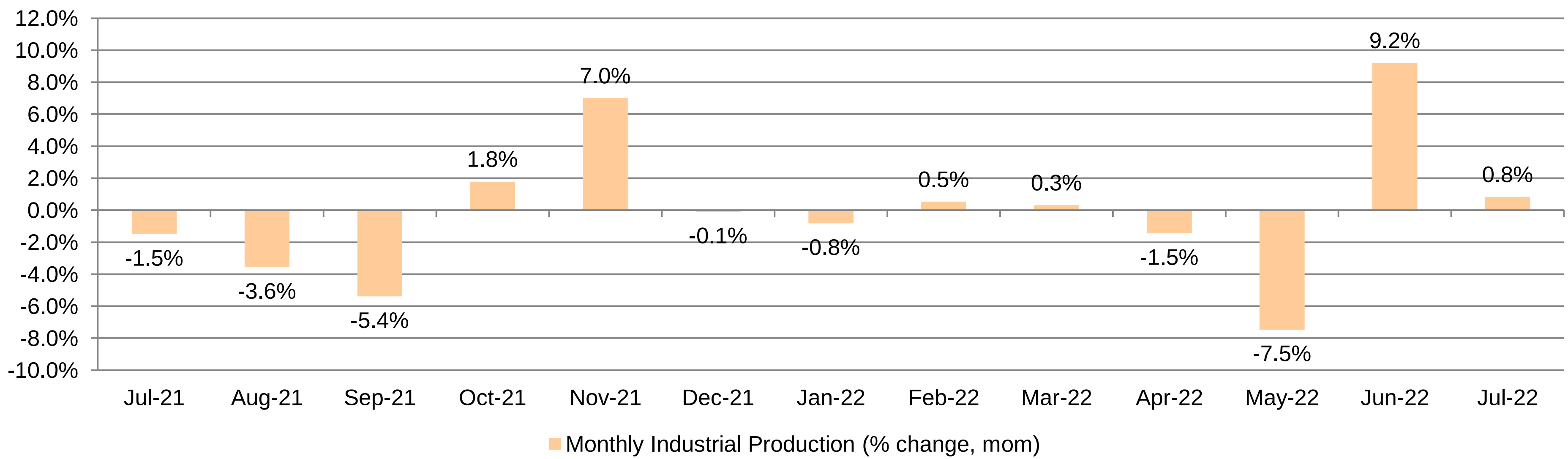
Source: Data compiled from Ministry of Economy, Trade, and Industry

Industrial Production Rose by 1.4% mom in July

- According to the Ministry of Economy, Trade, and Industry (METI), Japan's industrial production rose by a seasonally adjusted 1.4% month-on-month in July as shown in **Exhibit 4**. The increase is largely due to the higher production of vehicles and general-purpose machinery.

- The increase was a slowdown from the 9.2% mom increase in June. The slowdown was largely attributed to drag caused by supply disruptions and a high-tech chip shortage. However, Manufacturers surveyed by METI expect output to gain 5.5% in August, followed by a 0.8% increase in September.

Exhibit 4: Japan Monthly Industrial Production (% change mom)



Source: Data compiled from Ministry of Economy, Trade, and Industry

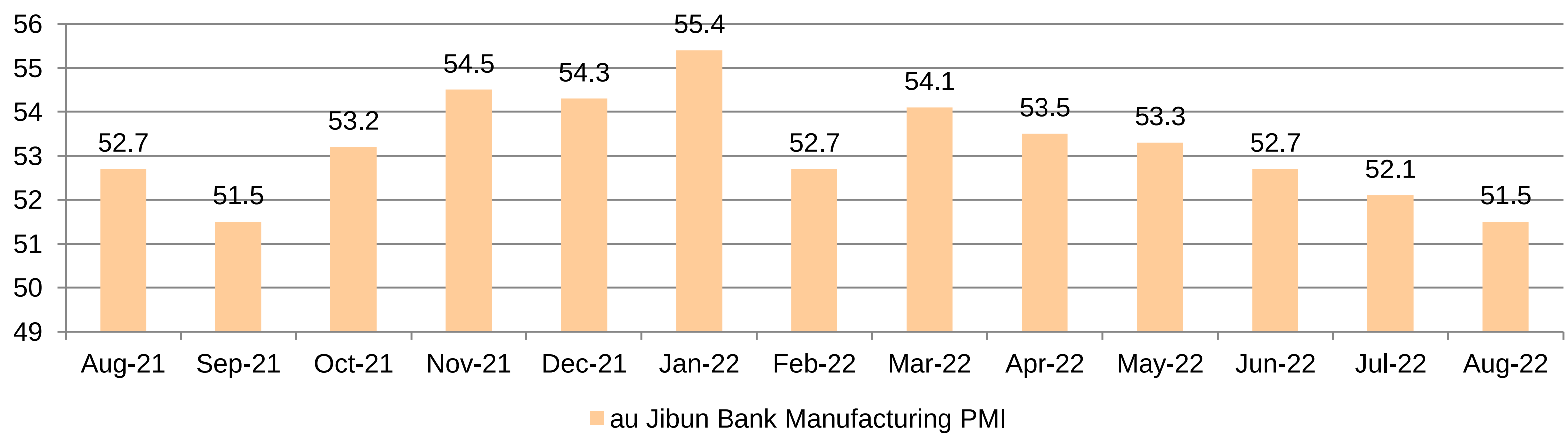
Manufacturing Activity Expanded in August

- According to S&P Global Market Intelligence, the index of manufacturing activity worsened to 51.5 in August 2022, from 52.1 in July 2022, as shown in **Exhibit 5**. The reading was the joint-weakest since February 2021.

- While still above the 50-level separating growth from contraction, the slowdown was partially due to a decrease in new orders as sales fell for the second month in a row, and at the sharpest rate since October 2020. Firms commented that orders were dampened by a surge in COVID-19 cases, as well as weaker economic conditions both domestically and abroad.

- According to Usamah Bhatti, economist at S&P Global Market Intelligence, the dip in manufacturing is likely to continue in the near term as the absence of new orders amid dampening client confidence lifted capacity pressure on manufacturers, giving pressure on supply chains, and inflationary pressures in the sector, a chance to ease.

Exhibit 5: au Jibun Bank Manufacturing PMI



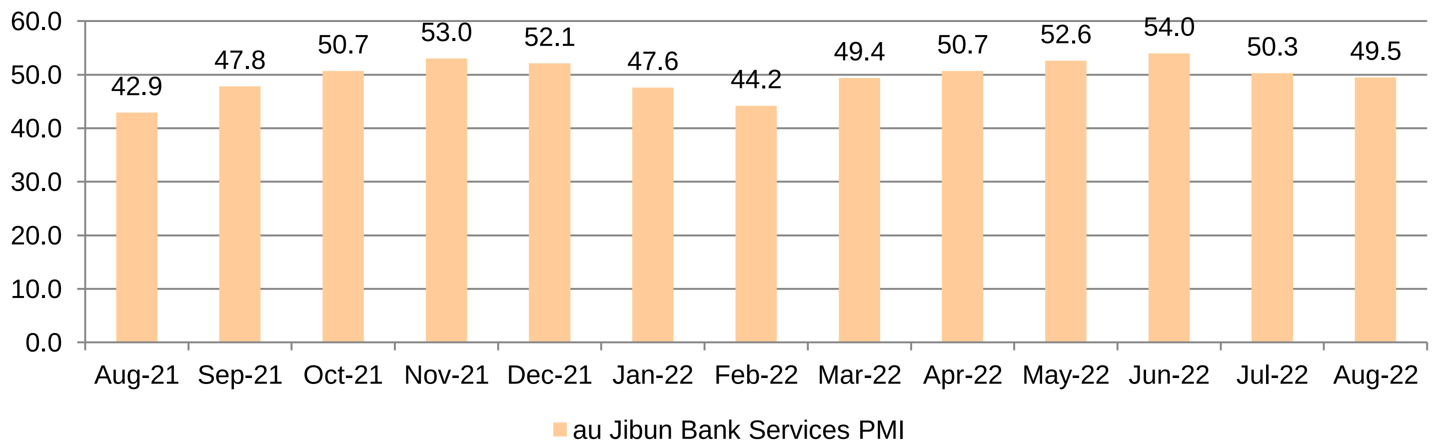
Source: Data compiled from S&P Global Market Intelligence

Services Activity Contracted in August

- According to S&P Global Market Intelligence, services activity contracted to 49.5 in August 2022 from 50.3 in July, as shown in **Exhibit 6**. The reading was the first contraction in service sector activity since March, falling below the 50 level separating growth from contraction.

- The contraction is largely attributed to the surge in COVID-19 cases that dampened demand and activity within the sector, with total new business stagnating in August following continuous increases in the previous three months. Although firms anticipate activity to increase over the next 12 months, the level of positive sentiment dipped to a three-month low in August.

Exhibit 6: au Jibun Bank Services PMI



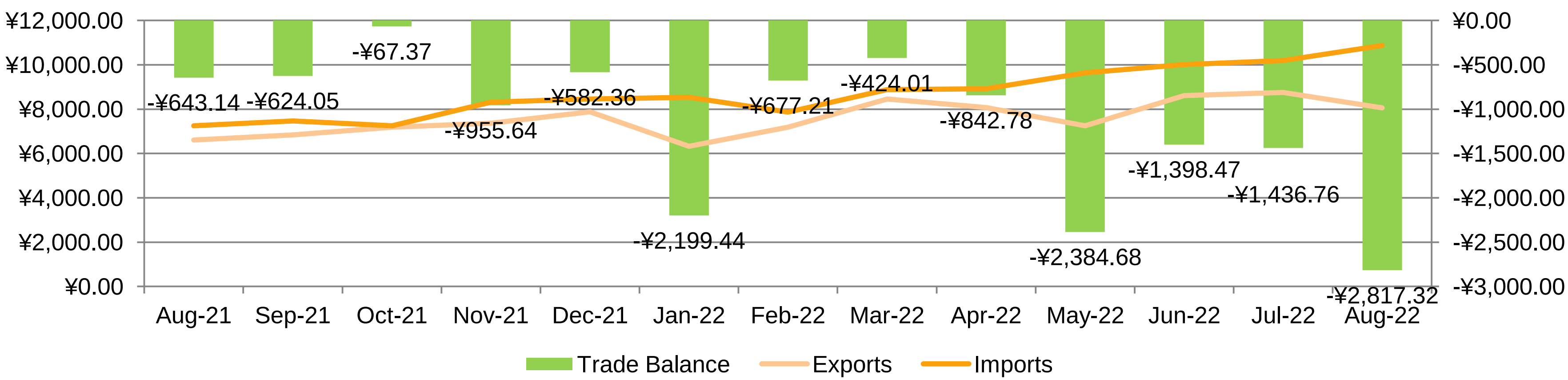
Source: Data compiled from S&P Global Market Intelligence

Trade Deficit Widened in August

- According to latest data from the Ministry of Finance, Japan's total exports rose by 22.1% yoy to ¥8,061.9 billion in August. However, imports rose by 50.1% yoy to ¥10,879.2 billion. The resulting trade deficit of ¥2,817.3 billion is the largest single-month shortfall on record and marked the 13th straight month of year-on-year shortfalls, as shown in **Exhibit 7**.

- The increases in both exports and well as imports is due primarily to the weakening of the yen and surging energy costs. Mineral fuel exports increased by 171.5%, and audio & visual apparatus increased by 115.8%, a reflection of the advantageous export conditions created by the weakened currency. On the other hand, the depreciated yen has also drastically increased the price of imports. Coal imports increased by 241.0%, while soy bean imports rose by 105.5%.

Exhibit 7: Japan Monthly Trade Balance, Exports, and Imports (in ¥ billion)



Source: Data compiled from Ministry of Finance

F • P • A

"Regenerating Opportunities"

Japan Economy: Summary of our views

- Recent economic indicators regarding Japan are mixed. The Japanese economy did better than expected and expanded by 3.5% qoq saar in the second quarter in 2022 to ¥542.1tn, above its pre-pandemic level. The growth can be attributed to increases in private consumption and business spending. However, most financial institutions revised their full year forecast downwards and projected annual growth of between 1.00% and 2.00% in 2022, and between 0.80% and 2.10% in 2023.

- Household spending, a key engine of economic growth, slowed down to an increase of 3.4% yoy in July from a 3.5% yoy increase in June. The increase highlights that the Japanese economy continues to have room for growth following its economic recovery back to its pre-pandemic level. However, from June to July, spending decreased by 1.4%, attributed to a resurgence in COVID-19 cases and rising inflation caused by the weak yen. Retail sales increased 2.4% in July, as Japan's economy recovers past its pre-pandemic level.

- Industrial production rose by 1.4% mom in July, a slowdown from the 9.2% mom increase in June, as supply disruptions and chip shortages dragged on output.

- The au Jibun Bank Manufacturing PMI slowed in August to 51.5 from 52.1 in July as sales and new orders fell for the second month in a row. Meanwhile, the au Jibun Bank Services PMI contracted to 49.5 in August from 50.3 in July as a surge in COVID-19 cases dampened activity and positive business sentiment dipped to a three-month low.

- Meanwhile, Japan's trade balance had its largest shortfall on record in August at ¥2,817.3 billion and its 13th consecutive month of year-on-year declines. As a direct result of the weak yen, both exports and imports increased by 22.1% and 50.1% yoy respectively.

- Overall, domestic consumption might continue to weaken as prices continue to rise. Furthermore, trade balance continues to decline as yen weakness persists. However, while manufacturing & services activity has slowed, they are largely due to supply-side constraints and a surge in COVID-19 cases respectively, both of which might prove to be temporary. Furthermore, Japan's economic recovery continues to be underpinned by accommodative monetary policy, with a possibility of additional fiscal stimulus in October. Considering the above, we are neutral on the Japanese economy outlook.

Japan Equities

- Over the period from 01.07.22 to 16.09.22, the NIKKEI 225 index rose by 6.29% to 27,567.7and the TOPIX rose by 5.07% to 1938.6. Despite slowing global demand and overseas recession fears, strong corporate earnings and the loosening of travel restrictions boosted sentiments overall.

- Latest data provided by MSCI as at 31.08.22 show that MSCI Japan index was trading on a forward PE of 12.72x, lower than the long-term average of 28.63x and JP-Morgan's 15-year average PE multiple of 15.40x as at 31.12.20. At the same time, MSCI Japan index's PB multiple of 1.31x is also lower than its historical average of 1.70x but higher than JP-Morgan's 15-year average PB multiple of 1.30x for Japan as at 31.12.20.

- While financial institutions are generally positive on the direction of the stock markets, Nikkei 225 targets are 26,000 in 2022 and 28,400 for FY2022/23. Given those targets, the implied returns for FY2022 would be between -5.7% and 3.0%% for 2022 and FY2022/23 respectively.

- We note that financial institutions such as SMDAM, Morgan Stanley, UBS, Bank of Singapore, Nikko AM, Fidelity, and Schroders are positive on Japanese equities, while Blackrock, HSBC, and Bank of Singapore are neutral on Japanese equities.

Japan Equities

SMDAM, Morgan Stanley, UBS, Nikko AM, Fidelity, and Schroders are positive on Japanese equities

- **SMDAM**
  - SMDAM maintained their TOPIX target for March 2023 at 1,960, but revised up their Nikkei target for March 2023 to 28,400. They expect range trading in the Japanese stock market to continue in the near future. While the downside of the market is supported by the stable Japanese economy and accommodative monetary policy, the upsides are also limited owing to prolonged global economic concerns.
  - However, SMDAM believes a bullish trend will resume once the market confirms the level and timing of the peak of monetary tightening in the US.
- **Morgan Stanley**
  - Morgan Stanley believes that Japanese stocks are better able to withstand the pressures facing peers overseas amid growing recession risks, due to improving capital discipline and the weak yen. The divergence in monetary policy between Japan and other developed economies would keep the yen weak and benefit exporters. Furthermore, the loosening of pandemic restrictions is expected to underpin domestic recovery.
  - Morgan Stanley believes that Japan's more cautious loosening of pandemic restrictions and employment-focused stimulus programs have resulted in the economy benefiting from incremental reopening tailwinds.
- **UBS**
  - UBS noted the relaxation of travel restrictions for foreign visitors in Japan, and believes that with still-solid pent-up demand and a boost from international visitors over 2023, Japan's economic reopening should drive earnings in FY2022/23.
  - UBS sees investment opportunities in the airline, railway, and hotel sub-sectors as well as select retail and cosmetic companies.

Japan Equities

- **Nikko AM**
  - Nikko AM noted that Japanese equities are basically flat year-to-date, compared to most markets which have fallen over the year. Nikko AM believes that Japan's commitment to maintaining loose monetary policy in spite of global monetary tightening has supported growth and created a relative safe haven for investors.
  - Nikko AM believes that the yen's continued depreciation is driven by changes in relative policy and real yields. Nikko AM believes that peak hawkishness has already been priced into the US Federal Reserve's plans, and that the worst pressures on the yen are over while the upside in earnings as a result of the weak yen are compelling. The result would be tailwinds for exports and economy as COVID-19 cases decline and inflation becomes less of a concern with still-easy policy to support domestic growth.
  - Nikko AM believes the weak yen is a tailwind for positive earnings. Furthermore, China has surpassed the US to become Japan's most important trading partner- while weak Chinese demand acts as a near-term headwind, the weakness is priced in while Chinese authorities continue to ease policy to stimulate growth. Nikko AM is of the opinion that Japanese equities could be a strong beneficiary from improving Chinese demand as well as the weak yen.

- **Fidelity**
  - Fidelity noted that Japanese equities registered modest gains in August due to solid earnings and expectations that global inflation has peaked. However, the US Federal Reserve's comments to continue raising interest rates caused the yen weaken further amid the widening monetary policy gap between Japan and the US.
  - Fidelity also noted that 2Q 2022 corporate results showed positive earnings trends, driven by the reopening of the economy. Non-manufacturing sectors showed strong profits despite rising commodity prices, with many sectors registering profit growth back to above pre-pandemic levels. Manufacturing also showed modest growth and strong margins despite a decline in sales and industrial production. The sharp depreciation of the yen has resulted in a broad recovery of the manufacturing sector
  - Fidelity also notes that PM Kishida's announcement of the relaxation of border controls in early September has driven advances in reopening plays such as airlines.

Japan Equities

- **Schroders**
  - Schroders noted that Japanese equities rose in August due to strong corporate earnings and an anticipated peak to US inflation. Meanwhile, the yen continued its depreciation against the US dollar. Although profit momentum slowed from Q1 2022, overall corporate results were ahead of expectations and profit margins have shown resilience in spite of increasing cost pressures.
  - With many companies having made conservative forecasts for FY2022/23, Schroders believes there is scope for upward revisions around the Q3 2022 results announcements.

Blackrock, HSBC, and Bank of Singapore are neutral on equities

- **Blackrock**
  - Blackrock cites the accommodative monetary policy in Japan and increasing dividend payouts as underpinning Japanese equities. However, slowing global growth is a risk that creates headwinds for Japanese stocks.

- **HSBC**
  - HSBC notes that while Japanese government policy remains supportive of corporate earnings, the economy is vulnerable to the rising energy prices globally. Furthermore, they note that profit margins in Japanese companies are getting squeezed by increasing import prices caused by the weak yen, and weak domestic consumptions trends.

- **Bank of Singapore**
  - Bank of Singapore (BOS) noted that the April-June reporting season saw select companies benefiting from re-opening and Yen depreciation tailwinds reporting solid earnings despite higher raw material costs and supply limitations
  - BOS also noted that the proportion of firms announcing buybacks in the latest results release was lower, reflecting caution and macro-economic uncertainties.

Japan Equities

- We have summarized the Nikkei 225 targets from various financial institutions as shown in **Exhibit 8**.

Exhibit 8: 2022 Nikkei 225 Index Target

Financial Institutions	Nikkei 225 Target	
	2022	Expected Returns*
Current Nikkei 225 as at 16.09.22	27,568	
SMDAM**	28,400	3.0%
Nomura	26,000	-5.7%

*Based on closing price as at 16.09.22

**For fiscal year ended March

Source: respective financial institutions, Reuters

Japan Equities

There are also potential catalysts that could underpin the Japanese stock market

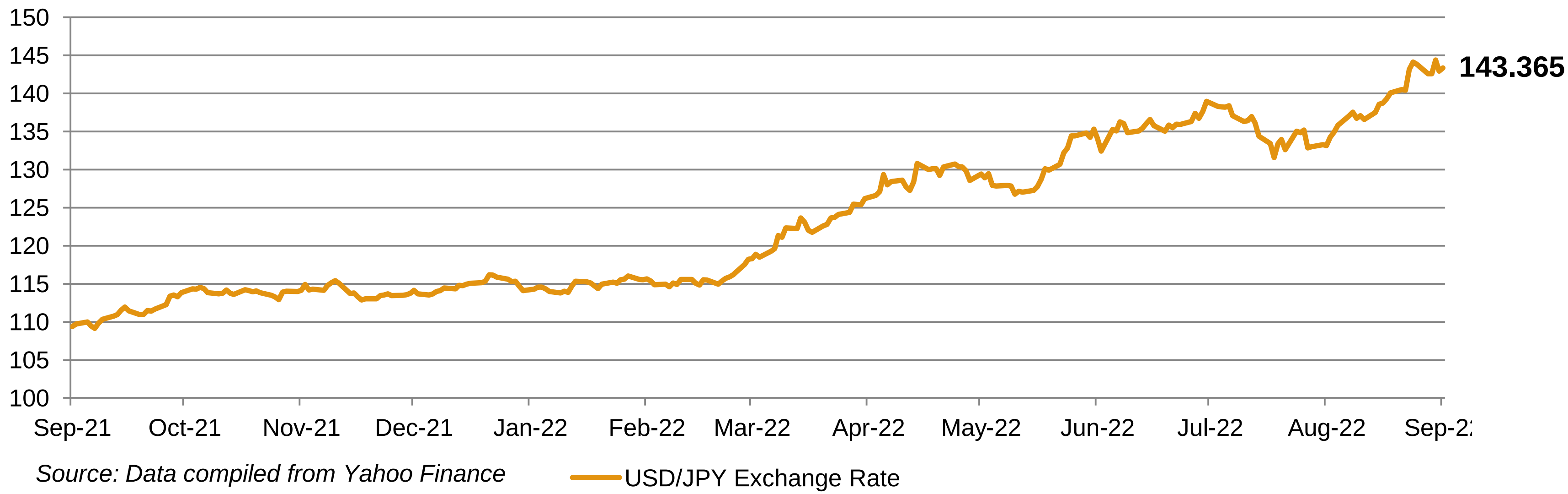
- Global Investors in equity funds are reducing exposure to Chinese holdings
  - Increasing tensions between the US and China over Taiwan have led to global investors rotating their portfolios away from China as they reassess risks due to the China's rapidly changing environment.
  - Considering the above, Japanese equities may benefit from the portfolio reallocation, potentially experiencing a boost in capital and investment. Japan's recovering economy and accommodative monetary policy might make it a relative safe haven for investors, possibly underpinning sentiments and investment in Japanese equities.

- Falling oil prices
  - Following the increase in US interest rates in September, there are heightened concerns of global recession, which decreased the demand for oil and other fuels, resulting in lower oil prices that have recently hit an 8-month low. Furthermore, the stronger dollar reduces the demand for oil by making it more expensive in other currencies.
  - Falling costs of oil and other fuels would directly reduce Japan's input costs for corporations while also decreasing Japan's trade deficit via lower value of imports. Reduced costs for corporations would improve corporate profit margins and earnings.

Japan Equities

- Weak yen
  - Despite the Ministry of Finance’s intervention in the currency market to prop up the yen, the yen continues to remain weak, as shown in **Exhibit 9**. The yen weakness is expected to continue boosting exports for Japanese companies. The depreciated currency would make exports by Japanese companies cheaper and more attractive to consumers overseas, improving demand for Japanese products.
  - The boost to demand for Japanese exports and revenue would also improve corporate profit margins and earnings

Exhibit 9: USD/JPY Exchange Rate



Source: Data compiled from Yahoo Finance

“Regenerating Opportunities”

Japan Equities

However, there is a downside risk that could have a negative impact on the stock market

- Inflation risk
  - Japan's core CPI recently increased by 2.8% yoy in August, the fastest since October 2014, due to increased costs of raw materials, food, and energy.
  - Rising inflation might increase pressure on companies to raise wages. An increase in wages would in turn increase costs and erode companies' profit margins.

Japan Equities: Summary of our views

- Both the major Japanese stock indices advanced, due to strong earnings results and Japan's economic reopening, despite slowing demand and weak economic growth abroad..
- Latest data provided by MSCI as at 31.08.22 show that MSCI Japan index was trading on a forward PE of 12.72x, lower than the long-term average of 28.63x and JP-Morgan's 15-year average PE multiple of 15.40x. At the same time, MSCI Japan index's PB multiple of 1.31x is also lower than its historical average of 1.70x but higher than JP-Morgan's 15-year average PB multiple of 1.30x for Japan
- Financial institutions are also generally positive on Japanese equities.
- There are also potential catalysts to the stock markets. Reduction of global investors' exposure to Chinese holdings due to geopolitical tensions might potentially see equity funds invested in China redirected to Japan. Furthermore, falling oil prices could directly reduce input costs for Japanese corporations, while also decreasing Japan's trade deficit via lower value of imports. The weak yen would also boost exports from Japanese companies. Falling oil prices and the weak yen combined would improve corporate margins and earnings.
- We believe that with monetary policy in Japan continuing to be accommodative, and with 10-year Japanese Government Bond (JGB) yields at 0.257%, equities remain the more enticing option with attractive valuations. However, inflation risk continues to pose a measure of downside risk to Japanese equities through potentially rising costs. We thus believe that stock selection will be key in this period, with opportunities existing in select sectors.
- Considering the above, we are currently positive on Japanese equities.

Our Contact Details

Please contact our wealth managers for further information at:

FPA Financial Corporation Pte Ltd
60 Paya Lebar Road,
#11-02 Paya Lebar Square
Singapore 409051
Tel: (65) 6323 1788   Fax: (65) 6323 1768
www.FPAFinancial.com

Disclaimer:

The research data, information, or opinion expressed herein may include those that are provided by third parties. They are provided by sources we believe to be reliable, but we do not guarantee their accuracy, timeliness, completeness or suitability for any particular purpose. Any research data, information, or opinion expressed does not constitute a solicitation for the purchase or sale of any investment.

The opinions or recommendations expressed herein are premised upon reasonably available data at the relevant time. Please note that markets and the value of investments may experience significant fluctuations in short periods of time, which may render the opinions or recommendations incomplete, inaccurate or inappropriate. You should take into account such fluctuations or other material events before relying on the opinion or recommendation for assessing your investment decisions. We shall not be howsoever liable for any opinions or recommendations being incomplete, inaccurate or inappropriate due in whole or in part to subsequent unforeseen events.