

JAPAN EQUITY MONTHLY

Japanese equities declined in October

The Japanese equity market dropped in October, with the TOPIX (w/dividends) falling 9.41% and the Nikkei 225 (w/dividends) declining 9.04% on-month. For the first half of the month, stocks moved upward as concerns over trade friction eased after the US, Mexico, and Canada reached a deal on the renegotiation of the North American Free Trade Agreement (NAFTA). However, Japanese equities subsequently fell after stocks in the US and around the world dropped sharply on concerns over a rapid increase in US long-term interest rates. The downward trend continued in the latter half of the month, as disappointing economic indicators in China spurred concerns over a slowdown in the country's economy. Stocks were further pressured by fears that relations between the West and Saudi Arabia would grow strained, following the suspicious death of a Saudi journalist, as well as on heightened concerns that Italy may abandon the euro due to fiscal problems.

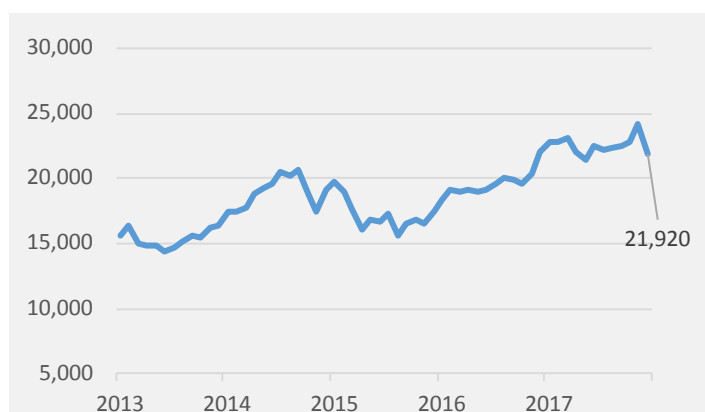
All 33 TSE sectors dropped during the month, with Marine Transportation, Glass & Ceramic Products, and Chemicals posting the steepest declines.

Exhibit 1: Major Indices (Last Month and Historic Changes)

Index	Mth-end	1-mth	3-mth	6-mth
Nikkei 225	21,920.46	-9.1%	-2.8%	-2.4%
JGB Yield	0.127	-0.003	+0.065	+0.072
JPY/USD	113.13	-0.5%	1.4%	3.5%
JPY/EUR	128.27	-2.8%	-2.0%	-3.0%
MSCI World	2,021.98	-7.4%	-6.1%	-3.1%

Source: Bloomberg, as at 31 October 2018

Exhibit 2: Nikkei 225



Source: Bloomberg, as at 31 October 2018

Fundamental Perspective

From a fundamental perspective, the Nikkei's drop to the lowest level in seven months was quite different to the fall in tech-related equities in the US. The selloff in FANG stocks was due to strengthening privacy regulations and data leaks, along with a healthy dose of profit taking. While Japanese carmakers, factory-automation providers and machinery manufacturers are exposed to the US-China tariff fight in different ways, the trade tension should not be a macro issue for Japan as long as global consumption remains steady.

Trade tensions will continue for the next five to 10 years, as we have seen over the recent two decades between the US and China. The market has priced in this sort of cyclical. We are in a late economic cycle, with no reason to think a big fall is coming. A slowdown in corporate earnings is likely, but that does not mean negative growth.

Outlook Firm

Our outlook for the Nikkei 225 remains at 24,000 by March and 25,000 by September, from around 22,000 at present, with stable FX and bond yields from both the US and Japan. In a late economic cycle, markets tend to fluctuate according to sentiment. Though we see no signs of overheated capex yet, fear of this leads higher interest rates.

The BoJ decided to keep its monetary policy unchanged, while it slightly lowered its CPI outlooks for FY2018-2020. The central bank will be keeping its current policy for longer, but won't be expanding unless there is an external shock event.

Abe Meets Xi

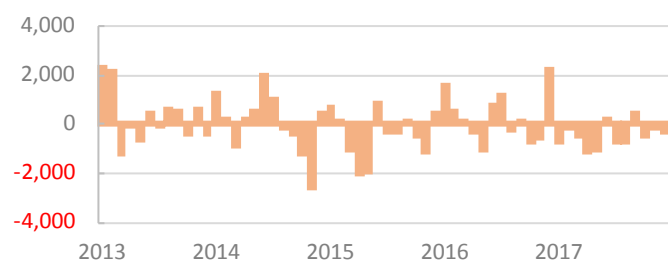
Although Abe's meeting with Xi came with a series of agreements on cooperating on infrastructure projects overseas, it will take quite some time before any of this will have an impact at a macro level.

Abe has again proven himself to be a skilled foreign statesman, and new cooperation with China could be useful if Trump's trade war turns its attention to Japan.

Exhibit 3: Major Market Indices



Japan Equity Net Purchase from Overseas (JPY bil.)



Source: Bloomberg, as at 31 October 2018

Exhibit 4: Major Index Performance, Indicators, and Valuation

Index	1-mth	3-mth	6-mth	1-yr	5-yr
Nikkei 225	-9.1%	-2.8%	-2.4%	-0.4%	40%
JGB Yield (%pt)	-0.003	+0.065	+0.072	+0.127	-0.478
JPY/USD	-0.5%	1.4%	3.5%	-0.2%	10%
JPY/EUR	-2.8%	-2.0%	-3.0%	-2.7%	-8%
MSCI World	-7.4%	-6.1%	-3.1%	-0.7%	24%
TOPIX	-9.4%	-6.1%	-7.4%	-6.8%	31%
TPX-100 (Large)	-8.6%	-4.5%	-5.2%	-5.2%	25%
TPX-400 (Mid)	-10.4%	-7.9%	-10.0%	-8.9%	37%
TPX-Small	-10.6%	-9.4%	-11.0%	-9.0%	49%

Sector (TPX-17)	1-mth	3-mth	6-mth	1-yr	5-yr
Elc Appl&Prec	-10.5%	-9.1%	-10.2%	-11.3%	49%
IT & Service	-12.3%	-5.4%	-3.8%	-4.2%	55%
Auto&Trns Eqp	-9.0%	-8.2%	-10.8%	-11.7%	2%
RawMatl & Chm	-14.0%	-10.5%	-9.6%	-8.7%	71%
Banks	-5.0%	-3.7%	-7.7%	-10.6%	-6%
Machinery	-12.5%	-8.3%	-13.3%	-15.6%	24%
Transprt&Logi	-7.5%	-4.7%	-4.1%	-1.9%	38%
Const & Matl	-9.5%	-14.7%	-16.8%	-19.2%	35%
Fincl ex Bank	-5.2%	0.8%	-3.5%	-1.1%	12%
Foods	-5.3%	-6.5%	-8.3%	-10.0%	47%
Retail Trade	-5.7%	-0.3%	-3.9%	7.0%	60%
Pharmceutical	-10.1%	-0.4%	5.3%	7.7%	62%
Commr & WhTrd	-7.1%	-0.5%	-3.3%	6.2%	50%
Real Estate	-6.6%	-7.2%	-12.2%	-6.1%	-23%
Steel&Nonfer	-12.6%	-9.5%	-14.5%	-21.7%	-13%
Elc Pwr & Gas	-3.1%	0.6%	0.8%	5.8%	11%
Engry Resourc	-10.4%	-0.3%	5.5%	26.8%	41%

Valuation	Mth-end	3-mth	6-mth	1-yr	5-yr
TOPIX					
Div. Yield (e)	2.3%	2.2%	2.1%	1.9%	1.7%
Price/Earn (e)	12.9	13.7	14.1	15.7	15.5
Price/Book	1.2	1.3	1.3	1.4	1.3
MSCI World					
Div. Yield (e)	2.6%	2.4%	2.5%	2.4%	2.5%
Price/Earn (e)	15.3	16.3	15.9	18.1	15.9
Price/Book	2.2	2.3	2.2	2.4	2.0

Market Indicator	Mth-end	3-mth	6-mth	1-yr	5-yr
Daily Turnover	63	54	53	54	48
Market Cap.	620	653	657	671	445
Net Purchase Overseas	-257	-895	-1,889	-5,089	-2,161

Source: Bloomberg, as at 31 October 2018

(e) stands for consensus estimates by Bloomberg.

Turnover and market cap in JPY tril.

Net Purchase (JPY bil.) from Overseas is cumulative monthly.

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