Letter from Japan: Stock market projections in a post-election landscape

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Industry Experience: 27+ years

Time in SMDAM: 16+ years

He moved to Nikko Asset Management the following year as a trader to handle transactions in equities, convertible bonds and foreign exchange. In 1999, he started his career as a fund manager being heavily involved in and emphasizing bottom-up research for Japanese equities specializing in growth stocks.

He joined Daiwa SB Investments (one of the SMDAM's former entities) in June 2008 to manage the Fundamental Active Strategy, ect. and was promoted to the Unit Leader in 2020.
Taniuchi is not only a Certified Member Analyst of the Security Analysts Association of Japan, but also obtained the right to use the CFA designation in 2005.

SMDAM as at 1 July 2024

Market Outlook

We expect a volatile month fo Japanese equity, but the market will deliver a positive return.

On the political front, the U.S. presidential election is slated for the 5th, and the Japanese prime ministers' nomination election will take place on November 11th. The Federal Open Market Committee (FOMC) will also hold its meeting on 6th-7th. While Trump appears to have a slight lead in key swing states, it is difficult to forecast the overall outcome, including the election results for the House of Representatives and the Senate. However, we anticipate investors to enter a more risk-taking phase in the second half of the month, after the wait-and-see mood in the first half regarding central banks' monetary policies and political developments in key countries. As uncertainty factors recede, we expect share prices to align more closely with company fundamentals.

The ruling Liberal Democratic Party (LDP)-Komeito coalition fell short of a majority in the lower House election on October 27, securing only 215 seats, leaving domestic political stability somewhat uncertain. The possibility remains that stock market volatility could increase over the political situation. Nonetheless, we maintain a positive outlook for the Japanese economy, which appears to be entering a virtuous cycle of rising wages and prices. Our medium-term bullish view of the Japanese stock market remains unchanged.

We are focused on three major themes:

1. The potential for partial policy coordination or cooperation with opposition parties within the framework of the ruling LDP-Komeito coalition. While some policies may require concessions to the opposition, the general direction of the coalition is expected to persist, alleviating excessive concerns about political instability.

2. The expectation of supporting domestic economy by formulating economic measures with next summer's upper house election in sight. Opposition parties, with whom the ruling coalition is likely to seek cooperation, have proposed easing the burden on the public in areas such as taxation, social security, education, and childcare. Increased fiscal spending is expected to further support the domestic economy.

3. Expectations for sustained growth in corporate earnings (EPS). Our bottom-up forecast suggests that corporate earnings will continue to improve through FY2025. Should earnings results demonstrate resilience and upside potential of corporate performance and continued share buybacks, this could raise expectations for a rise in Japanese equities.

Investment Strategy

For the Fundamental Active strategy:

Overweight sectors (largest shown first):	**Underweight sectors** (largest shown first):
Consumer Discretionary	Industrials
Energy	Consumer Staples
Communication Services	Health Care

In the GICS sector, we will maintain our overweight positions in consumer discretionary, energy, and communication services.

Our portfolio will focus on a bottom-up approach, maintaining core stocks that demonstrate sustainable earning growth driven by individual company factors. We favour stocks with upward revisions to their company plans in the interim results and those with robust prospects for performance improvements beyond FY2025. Additionally, we plan to increase the weighting of stocks that are anticipated to enhance shareholder returns.

As the risk of overseas recession and the scenario of accelerated yen appreciation have subsided, we will also consider purchasing undervalued cyclical stocks driven by external demands. Among domestic demand-driven stocks, we will target those with potential for new store openings, benefits from inbound tourism, and the positive impacts of price increases. Within the financials sector, we will favour banks and insurance companies that continue to exhibit performance improvements and high levels of shareholder returns.

Conversely, we will maintain our underweight in industrials and consumer staples, where earnings growth rate is relatively weak.

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