SOMPO ASSET MANAGEMENT

A Theme Park for Security, Health & Wellbeing

Director of Kanto Local Finance Bureau (Financial instruments firm) No. 351
a member of the Japan Investment Advisors Association, and the Investment Trusts Association, Japan

Economy & Financial Market Outlook: Japan

Economy

We expect eased covid restrictions and continued loose monetary policy to provide support to the Japanese economy. However, we note concern over corporate earnings falling on higher raw material prices and household spending slowing due to inflation.

Japan's core CPI (excluding perishables) was up 2.1% YoY in April (March: 0.8%). Core CPI is likely to grow approximately 2.0% as prices are pushed up by increased energy costs and the impact from the spring 2021 drop in mobile phone fees fades.

Prime Minister Fumio Kishida's 2022 Policies for Economic and Fiscal Management and Reform have received cabinet approval. As part of an effort to establish Kishida's *new capitalism,* the policies aim to double asset-based income and promote a shift away from saving and toward investment. The market feared the prime minister could look to raise the tax on capital gains and dividends, something he had mentioned before, but the plan included no such language.

Bond Market

◆ Review

JGB yields (and prices) were flat MoM in May as although a mid-month announcement showed that Core CPI for the month was up by over 2%, expectations were unchanged for the BoJ to adjust monetary policy and US rate growth halted on increased expectations for slowed inflation.

◆ Outlook

We expect JGB yields to face upward pressure as inflation sparks a reversion to normal monetary policy around the world. However, we think yield growth for JGBs with maturities of 10 years and below will be limited as we doubt the BoJ will raise the policy rate in the near term.

Stock Market

◆ Review

The Japanese equity market rose slightly in May. The market fell at the beginning of the month on fears the FRB would accelerate monetary tightening in the US but then rebounded in the second half of the month on news of economic stimulus and the end to lockdowns in China.

◆ Outlook

We expect the Japanese equity market to remain firm. We believe corporate earnings will be strong because of support from the pickup in domestic economic activity and the recovery to Chinese business activity, which fell on strict lockdown measures, despite the rising price of raw materials like energy and grain having a negative impact. We believe there will unlikely be a big crash in the Japanese equity market because it is already at an undervalued level and companies are buying back shares at a level never seen before.

Economy & Financial Market Outlook: US

Economy

We expect the resilience of the US economy to be tested as we are now in late-stage economic recovery and the FRB is moving to tighten monetary policy to counter inflation.

Core PCE inflation (excluding perishables and energy), was up 4.9% YoY in April (up 5.2% in March). The unemployment rate was 3.6% in May (April: 3.6%).

With the FRB rushing to normalise monetary policy by lifting the policy rate and shrinking its balance sheet, our eyes are on whether the central bank will be able to guide the economy to a soft landing, stemming inflation without causing a recession.

Bond Market

◆ Review

10-year US yields fell (prices rose) slightly in May as despite the FRB raising rates 0.5%, expectations for a slowdown in inflation increased and concerns over the impact monetary tightening will have on the economy grew.

◆ Outlook

We expect US yields to rise but growth to come under pressure. We believe there will be continued upward pressure on yields, with the policy rate being hiked further as the FRB pushes ahead with monetary policy normalization. However, growth will likely come under pressure because of the Russian invasion of Ukraine and monetary tightening in the US increasing global economic uncertainty. This should lead to a drop in forecasts for excessive rate hikes.

Stock Market

◆ Review

The US equity market was flat MoM in May. The market fell at the beginning of the month because of monetary tightening by the FRB but then rebounded as CPI slowed MoM.

◆ Outlook

We believe the US market will exhibit volatility going forward.

The future of the global economy is becoming more uncertain because of concerns over the Russian invasion of Ukraine and increased energy prices as well as monetary tightening by the FRB. We expect the equity market to continue to struggle as the government may not be able to implement measures to fight an economic slowdown while prioritising counters to inflation.

Currency Market

◆ Review

USD depreciated versus JPY in May. USD appreciated at the beginning of the month because of the increase in US long-term rates but this came to a halt in the middle of the month as the market looked to avoid risk because of concerns US monetary tightening would lead to an economic slowdown. This led to JPY appreciation versus USD.

◆ Outlook

We expect JPY to be susceptible to depreciation versus USD over the near term. We expect the differing stances on monetary policy between the two countries (with the US normalising monetary policy and Japan carrying on with loose monetary policy) to boost the strength of USD. Increased energy prices on the back of Russian sanctions should then put downward pressure on JPY.

Economy & Financial Market Outlook: Europe

Economy

We are concerned of the impact economic sanctions on Russia and further inflation via heightened energy prices will have on the European economy.

The region's core CPI (excluding volatile perishables and energy) recorded positive growth of 3.8% (YoY) in May (April: 3.5%).

Market participants will be expecting the ECB to both tackle inflation and boost economic growth as the spectre of stagflation, i.e. simultaneous economic slowdown and inflation (via increased energy prices), comes into focus. The ECB has announced it will be raising rates as well as putting an end to quantitative easing in July. We will continue to keep watch for developments in monetary tightening, for example details on the scale and pace of rate hikes.

Bond Market

◆ Review

German 10-year yields rose (prices fell) in May as expectations grew for an early rate hike on the back of hints from ECB officials that one could occur in July and higher-than-expected CPI in the eurozone.

◆ Outlook

We expect the German bond market to remain unstable but yields to continue on a general uptrend. We believe strong expectations for the normalisation of monetary policy in light of rising inflation will mean upward pressure remains on German yields. However, we believe yields will remain unstable over the near term as they come under downward pressure from concerns of economic decline stemming from continued uncertainty caused by the Russian invasion of Ukraine.

Stock Market

◆ Review

The European equity market fell in May because of ECB officials signaling for quick rate hikes amidst increasing inflation in the eurozone and monetary tightening from the FRB.

◆ Outlook

We expect the European equity market to be sensitive going forward. Uncertainty is growing over the global economy on the back of tightening monetary policy across the world. We expect the equity market to continue to struggle as governments may not be able to implement measures to oppose economic slowdown while prioritising counters to inflation.

Currency Market

◆ Review

EUR appreciated versus JPY in May. EUR depreciated at points during the month when risk avoidance picked up but ultimately appreciated on heightened expectations for rate hikes in Europe following ECB officials signaling an aggressive stance on the normalisation of monetary policy.

◆ Outlook

We believe EUR has limited room for further growth over the short term. While heightened expectations for normalisation of monetary policy in the eurozone will put upward pressure on EUR, any further upside will be limited over the near term as the Russian invasion of Ukraine will act as a strong weight on the eurozone economy.

Economy & Financial Market Outlook: Emerging Market

Economy

We expect production to pick up again in China as the government has begun removing restrictions following the drop in new covid cases in Shanghai. We believe the Chinese economy will steadily firm up as the Chinese government, facing growing alarm over a potential drop in the economy, has announced robust economic stimulus in the form of eased restrictions on housing purchases and reduced taxes on vehicle purchases.

We fear increases to energy and food prices in emerging markets on further deterioration to the situation in Ukraine. Many countries have already hiked rates to combat inflation and to protect their currencies. We expect this tightening of monetary policy to dampen economic growth.

Bond Market

◆ Review

Yields on emerging market bond indexes as a whole were flat MoM in May. Yields rose in countries like Columbia and Romania, where central banks hiked rates, and fell in countries like Mexico and Malaysia.

◆ Outlook

We expect emerging country yields to be on a general uptrend because US yields will likely face upward pressure and there are fears increasing energy and food prices will accelerate inflation.

Stock Market

◆ Review

Emerging market equities fell in May on the re-ignition of fears Chinese ADRs could be delisted from the US exchanges and concerns of an acceleration to monetary tightening given increasing inflation in the US.

◆ Outlook

We expect movements in emerging market equities to be touchy going forward.

We believe emerging market equities will continue to struggle despite expectations for China to offer support to its economy through monetary and fiscal measures as there is increased uncertainty over the global economy stemming from the Russian invasion of Ukraine, the spike in energy prices, and monetary tightening by the FRB.

Currency Market

◆ Review

Emerging market currencies appreciated versus USD but were flat versus JPY in May. Appreciation was seen in currencies like the Brazilian real, Mexican peso, and Chilean peso as the central banks of these countries hiked rates. Depreciation was seen in the Turkish lira and Hungarian forint because of deterioration to the situation in Ukraine.

◆ Outlook

We expect emerging market currencies to be unstable given heightened geopolitical risks and the continued spread of covid. They may easily be nudged to the downside as the normalization of US monetary policy puts increased upward pressure on USD.

Risks and Expenses relating to Discretionary Investment Contracts

● Risks relating to Discretionary Investment Contracts

Under discretionary investment contracts, marketable securities such as global/domestic equities and fixed incomes are mainly invested. Market values of these assets are subject to change due to fluctuations in market price of assets, foreign exchange rates, and so on. Such investment may incur losses in the initial fiduciary assets, or may damage beyond the initial invested principal amounts.
The contents and characteristics of risks vary according to asset type, investment restrictions, traded markets, investee countries, and so on. Thus, before entering into a contract, prospective clients are requested to first confirm all relevant items of the "Documents prior to conclusion of contract."

● Fees relating to discretionary investment contracts

[Clients bear the following expenses.]

■ Fees applicable directly and/or indirectly during the period of a discretionary investment contract

An investment management fee will be applicable. The fee tables to be applied vary depending on the assets, the amount of contract, the contract details, and so on. Thus, the fee schedule and/or maximum fee amounts cannot be provided in advance. Prospective clients are therefore requested to confirm the relevant items by reading carefully the "Documents prior to conclusion of contract" .

■ Other costs and expenses

There may be variable additional costs incurred. As the amount and/or the maximum amount of those "other costs and expenses" vary depending on investment circumstances, those cannot be specified beforehand.

*The total costs relating to discretionary investment contracts cannot also be specified beforehand as they vary according to contract periods

<Notes> The above risks and costs pertain to discretionary investment contracts in general. As the risks and costs entailed by discretionary investment contracts may vary by each contract, prospective clients are requested to read carefully all relevant items of the "Documents prior to conclusion of contract" in advance.

Risks and Expenses regarding Investment Trusts (Mutual Funds)

● Risks relating to Investment Trusts (Mutual Funds)

Investment Trusts mainly invest in marketable securities such as domestic and global equities and fixed incomes and those are subject to price fluctuations of markets, Thus, the unit prices of such funds may also fluctuate depending on changes in market price of such assets, and changes in foreign exchange rates in case of assets denominated in foreign currencies.
Fund prices are therefore exposed to the risk of fluctuations in price of marketable securities and/or foreign exchange rates, and so on. Accordingly, principal amounts invested by clients are not guaranteed.

As each investment trusts fund has its own target asset class, investment restrictions, traded markets and investee countries, and so on, the degree and characteristics of the risks entailed by each mutual fund vary. Prospective clients are therefore requested to read carefully the prospectus and the "Documents prior to conclusion of contract" of the relevant mutual funds.

● Fees and expenses relating to Mutual Funds

[Clients bear the following expenses.]

■ Fees and expenses to be paid directly at the time of subscription (subscription fee): Maximum 3.85% (3.5% excluding tax)

■ Fees and expenses to be paid directly at the time of redemption or selling (redemption fee): Maximum 0.5%

■ Expenses to be paid indirectly during the holding period (management fees) : Maximum 2.09% (1.9% excluding tax)

■ Other expenses: Additionally, the expenses according to the holding period of Investment Trusts are paid by clients. As the "Other expenses" items fluctuate according to the investment circumstance, the schedule and/or upper limit relating those expenses cannot be provided in advance. Prospective clients are therefore requested to confirm the relevant items by reading carefully the prospectus and the "Documents prior to conclusion of contract" of the relevant mutual fund.

As the total costs vary according to the holding period of each investor, it cannot be specified beforehand.

<NOTES> The above risks and costs pertain to investment trusts in general. The fee rates listed above are the highest among all investment trusts managed by SOMPO ASSET MANAGEMENT CO., LTD. As the risks and costs entailed by an investment trust may vary by each investment trust, prospective clients are requested to read carefully all relevant items of prospectus and the "Documents prior to conclusion of contract" in advance.

Other Important Notices

This document has been compiled by Sompo Asset Management Co., Ltd for the purpose of information provision.

This document has been created based on information that Sompo Asset Management Co., Ltd believes to be reliable, although the firm does not guarantee the accuracy or completeness of such information. The contents, opinions, and forecasts expressed in this report may at any time be changed or withdrawn without prior notice.

Performance data used in this report reflects past performance and is not a guarantee or indicator of future results.

This document does not constitute a legal disclosure document.

Disclaimer (GIPS)
“SOMPO ASSET MANAGEMENT CO., LTD. claims compliance with the Global Investment Performance Standards(GIPS®). SOMPO ASSET MANAGEMENT CO., LTD. has been independently verified for the periods 1 April 2012 through 31 March 2021. We have defined its investment advisory business and investment trust business as the "Firm" and claimed compliance with the GIPS®. A complete list of composite descriptions and policy of portfolio evaluation, performance calculation, and compliant presentation development are available upon request.”

Contact information: SOMPO ASSET MANAGEMENT CO., LTD
Investment Advisory Marketing Department
03-5290-3422

Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. Verification does not ensure the accuracy of an specific composite presentation.