SOMPO ASSET MANAGEMENT

A Theme Park for Security, Health & Wellbeing

Economy & Financial Market Outlook

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a member of the Japan Investment Advisors Association, and the Investment Trusts Association, Japan

Economy & Financial Market Outlook: Japan

Economy

Expecting Slower Growth

We expect the Japanese economy will continue to be supported by loose monetary policy and inbound tourism demand. However, we believe economic recovery will only be gentle because of weak consumption, caused by current negative real wage growth, and lower expectations for foreign demand growth, caused by the slowdown in overseas economies.

Japan's core CPI (excluding perishables) was up 2.0% YoY in January (December: 2.3%). However, we believe core CPI growth will remain around 2.5% over the near term despite YoY declines in prices of imported goods because of the end of government subsidies lowering electricity and gas prices.

The BoJ showed growing confidence that there will be sustainable wage and price growth. Hence, we believe the central bank could exit negative rates as early as April if it sees sustainable wage growth on the back of rises at the spring wage negotiations. However, further rate hikes will likely be small given that central banks in the US and Europe are pivoting towards rate cuts and the BoJ being cautious, carefully watching the adverse impacts the end of easy monetary policy have.

Bond Market

Expecting Rates to Rise Moderately

◆ Review

10-year JGB yields fell (prices rose) moderately in February.

Yields for short- and medium-term bonds rose on abated expectations for rate cuts by overseas central banks. However, yields for super-long-term bonds fell as BoJ officials signaled that monetary easing would continue even after the lifting of negative rates.

◆ Outlook

We believe interest rates will remain flat. While normalisation of monetary policy by the BoJ will put upward pressure on rates, growth will likely be moderate because rate hikes will likely be slow given sentiment that the domestic economy has peaked and recent fiscal conditions.

Stock Market

Expecting Upside Resistance

◆ Review

The Japanese equity market was up in February. Domestic share prices rose significantly on the back of strong earnings results in and out of the country and continued net inflows from foreign investors, with stock-picking focused on large-cap names in particular.

◆ Outlook

We believe the Japanese market will gradually see greater upside resistance. Corporate profits next fiscal year will likely keep increasing on the back of inventories bottoming out and domestic real wages recovering. However, profit growth momentum will highly likely slow on domestic economic normalisation, a waning tailwind from the yen's depreciation, and tight monetary policy in Europe and the US.

It is difficult to envision a large correction to the Japanese market given that valuations are not at expensive levels (despite growing quickly on the back of foreign inflows and expectations already being baked in) and there is a lot of demand for stocks driven by expectations for improved capital efficiency, and large-scale share buybacks (following Tokyo Stock Exchange (TSE) pressure).

Economy & Financial Market Outlook: US

Economy

Expecting Economic Slowdown

The US economy is running strong despite tight monetary policy. However, we expect it to slow as the consequences of monetary tightening become more apparent.

Core PCE inflation (excluding perishables and energy), was up 2.8% YoY in January (up 2.9% in December). The unemployment rate was 3.9% in February (January: 3.7%).

Fed Chairman Jerome Powell expressed the Fed's cautious stance on cutting rates too early by signaling that the central bank awaits more data to determine when to start trimming rates. He stated at the February semiannual monetary policy report to Congress that the central bank will initiate rate cuts in 2024. The market anticipates the initiation of rate cuts around mid-year. We will be watching for when the Fed will start rate cuts and how fast they will be amid a both a robust economy and disinflation.

Bond Market

Rates Flat in Near Term, Then Down

◆ Review

10-year US yields were up (prices down) in February. Interest rates rose as the Fed will likely start policy rate cuts significantly later than the market expected given a higher-than-expected US Consumer Price Index (CPI) and more cautious comments from Fed official regarding early rate cuts.

◆ Outlook

We expect yields to remain flat over the near term and to then shift to a downward trend. We believe that rates will stabilise given that inflation, which has peaked, remains high. However, after stablising, rates will likely turn downward again as the market will price in easing. The market will do this because of the expected slowdown in core CPI to around 3.0% given the tightening we have seen so far.

Stock Market

Expecting Upside Resistance

◆ Review

The US equity market rose in February. US share prices rose at the beginning of the month following a robust January US jobs report and strong earnings results from big tech companies. The market then temporarily sagged as long-term interest rates rose on higher-than-expected January US CPI. However, the market, particularly semiconductor and big tech stocks, climbed on the back of heightened expectations for generative artificial intelligence (AI) following the earnings release for Nvidia, a big US semiconductor company.

◆ Outlook

We expect the US equity market to face upside resistance over the short term despite persistently strong expectations for generative AI, as Powell said at a recent interview that a March rate cut is unlikely and as the market is concerned that lenders, particularly US regional banks, will become further reluctant to lend for commercial real estate.

Currency Market

USD to Fall Slowly vs. JPY

◆ Review

USD appreciated versus JPY in February on a stronger-than-expected job report and CPI, elevated US rates (given Fed officials curbing expectations for early rate cuts), and cautious remarks from BoJ deputy governor Shinichi Uchida about rate hikes after the lifting of negative interest rate policy.

◆ Outlook

We expect USD to slowly depreciate versus JPY. We believe there will be downward pressure on USD versus JPY as the Fed is preparing to begin cutting rates while the BoJ is preparing to normalise monetary policy. However, this depreciation will likely be gentle given the unlikeliness of early rate cuts (US inflation remains high and sticky given the strong labour market) and the likelihood of a cautious approach to normalisation from the BoJ (given risk of downturn in global economy).

Economy & Financial Market Outlook: Europe

Economy

Expecting Continued Slow Growth

We expect European economic growth to continue slowing as the ECB is continuing with monetary tightening despite stagnation in the eurozone economy.

The region's core CPI (excluding volatile perishables and energy) recorded positive growth of 3.1% (YoY) in February (January: 3.3%).

ECB President Christine Lagarde warned at the European Parliament against hasty rate cuts, while the European Commission downgraded its 2024 real growth forecast for the euro area to 0.8%. The central bank will have to strike a difficult balance between aiding the slowing eurozone economy and tackling continuing high inflation.

Bond Market

Rates Flat in Near Term, Then Down

◆ Review

German 10-year yields rose (prices fell) in February. Interest rates rose due to partially abated concerns over an economic downturn on the back of the ECB keeping its stance on restrictive monetary policy and European economic sentiment indicators bottoming out. US interest rates, which have a significant impact on European rates, rose and this also acted as upward pressure.

◆ Outlook

We expect German bond yields to be flat over the near term and fall after that. Although they will be flat, we do still expect to see some fluctuations over the near term because of the ECB's focus on data. However, in the longer term we believe yields will gently fall as the central bank is likely watching when the Fed starts rate cuts given falling CPI growth.

Stock Market

Market to Be Sensitive

◆ Review

The European equity market rose in February. Share prices were down at the beginning of the month due to shrunk expectations for the Bank of England to trim rates following its decision at its February policy meeting to leave the policy rate unchanged and because of lower-than-expected German industrial production data for December 2023. The market subsequently rose as ECB officials signaled that the central bank should not push back rate cuts too far and as expectations for generative AI grew on the back of Nvidia's earnings results.

◆ Outlook

We expect the European equity market to be sensitive as although expectations surrounding generative AI are strong, Lagarde has displayed that the ECB will avoid lowering interest rates prematurely, pointing out the risk that consumer prices may climb again. China's economic downturn may also have negative impacts on earnings for European companies.

Currency Market

EUR Upside Down on Eurozone Slowdown

◆ Review

EUR appreciated versus JPY in February following cautious remarks from BoJ deputy governor Shinichi Uchida about rate hikes once negative rate policy comes to an end and ECB officials curbing expectations for early rate cuts by pointing out how acting too early could cause inflation to rise again.

◆ Outlook

We expect EUR to gently depreciate versus JPY. This is because the BoJ is preparing to normalise monetary policy while the ECB will likely cautiously follow the Fed's rate cuts.

Economy & Financial Market Outlook: Emerging Market

Economy

EM Slows But Stronger than Developed

Expectation for China's economy to bottom out is currently growing because Chinese New Year spending rebounded, as seen in the number of travelers using public transportation and total film box office takings recovering to pre-pandemic levels. However, continued declines in home prices in major cities in the country are acting as a headwind. We believe it will take some time before we see an end to subdued consumption and economic slowdown.

We believe people in China are refraining from consumption and investment because the government's priorities remain unclear as it tries to strike a balance between economic stimulus and stricter social controls.

We expect to see economic slowdown in developing countries over the near term as they feel the impact of cumulative rate hikes and slowed economies in developed countries. However, we believe economies in developing countries will be more robust than those in developed countries because more countries are turning to rate cuts as inflationary pressure eases against a backdrop of firm domestic demand.

Bond Market

Yields to Fall Gradually on Rate Cuts

◆ Review

Emerging market yields as a whole remained flat in February following an improvement in investor risk appetites, as seen by the fact that the US equity market hit a new record high in the month, even while US interest rates rose. Thai government bond yields fell, while Brazilian government bond yields rose.

◆ Outlook

We expect emerging country yields to slowly decrease given the increasing number of developing countries cutting rates on the back of weakening inflationary pressure.

Stock Market

Market Indecisive - Slowdown vs. Stimulus

◆ Review

Emerging market equities rose in February. Emerging markets rose as share prices of semiconductor-related firms in Taiwan and South Korea climbed following US large tech companies boosting their investments into generative AI and as the People's Bank of China lowered the five-year loan prime rate, one of the bank's policy rates. The markets were then temporarily sluggish on the back of a disappointing release of details for the South Korean government's *Corporate Value-Up Program*. However, overall share price movement in the month was positive.

◆ Outlook

We expect emerging market equities to face upside resistance. We believe China's economic path forward remains unclear despite a plan to announce economic policy planned at the National People's Congress. The markets could become concerned again over earnings deterioration caused by the economic slowdown at upcoming earnings announcements in China.

Currency Market

Appreciation on End to US Rate Hikes

◆ Review

Emerging market currencies depreciated versus USD but appreciated versus JPY, given JPY depreciation, in February. Many emerging market currencies depreciated against USD as the greenback strengthened on a rise in US rates. Particularly, the South African rand, on which investors were bearish given the country's withdrawals of foreign exchange reserves to reduce fiscal debt, and the Turkish lira, for which the governor of central bank resigned, significantly fell against USD.

◆ Outlook

We expect emerging market currencies as a whole to appreciate when US rate hikes come to an end but that individual movements will be determined by fundamentals.

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.

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