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 Slow Economic Recovery

We expect the Japanese economy will be supported by growth in personal consumption spurred on by real wage rises and increased capital investments to tackle labour shortages. However, we believe economic recovery will only be gentle given uncertainty over US trade policy and concerns over economic downturns in Europe and China.

Japan's core CPI (excluding perishables) was up 2.7% YoY in November (October: 2.3%). We believe core CPI growth will remain around 2.5% for this fiscal year because of cuts to subsidies aimed at curbing electricity and gas bills and the increase in energy prices caused by JPY depreciation.

We expect the BoJ to continue to scale back easy monetary policy. However, further rate hikes will likely come in slow given that central banks in the US and Europe have already shifted to easing cycles and that the BoJ will be cautiously keeping watch of the impact ending easy monetary policy will have on the Japanese economy.

Bond Market

Expecting Rate Growth

◆ Review

10-year JGB yields rose (prices fell) in December. Yields rose as although the BoJ kept rates unchanged during its December Monetary Policy Meeting, JPY depreciation caused by shrinking expectations for the Fed to lower rates has increased expectations for the BoJ to raise rates in the medium term.

◆ Outlook

We believe interest rates will increase slightly. Japanese interest rates will be subject to upward pressure as the BoJ will move away from easy monetary policy, raising rates. However, growth will likely be moderate because rate hikes may be slow given recent fiscal constraints.

Stock Market

Near-term Upside Resistance

◆ Review

The Japanese equity market was up in December. Market growth was driven by JPY depreciation vs USD caused by the interest rate differential expanding between the two countries and expectations surrounding the merger of two big automakers.

◆ Outlook

We expect the market will face upside resistance over the near term.

Japanese corporate earnings will likely grow on the back of positive factors like recovering domestic real wages, the cyclical recovery to manufacturing, and capital efficiency improvement measures implemented by companies following pressure from the Tokyo Stock Exchange (TSE).

Share prices do not look overvalued given current general valuation metrics such as forward P/E. However, downside pressure will likely grow because of concerns of heightened tariffs from the US and JPY appreciation on the back of differing directions of monetary policy between Japan and the US. That said, it is difficult to envision a large correction to the Japanese market given strong equity demand from large-scale share buybacks and the BoJ's relatively accommodative monetary policy compared to Europe and the US.

Economy & Financial Market Outlook: US

Economy

Expecting Robust Economy in Near Term

We expect the US economy to remain strong over the near term because while the Fed will likely maintain tight monetary policy, consumption will remain strong given the stable labour market and strong wages.

Core PCE inflation (excluding perishables and energy), was up 2.8% YoY in November (up 2.8% in October). The unemployment rate was 4.1% in December (November: 4.2%).

While the Fed decided to cut rates by 25 basis points at its December FOMC meeting, further cuts will likely come at a slower pace given market recognition that rates are now at a neutral level. We will be keeping watch of the inflation rate and monetary policy. The Fed made it's rate cut decision on the assumption that inflation would continue to slow but President-elect Donald Trump's policies may again lead to increased inflation.

Bond Market

Rates Up in Near-term then Down

◆ Review

10-year US yields rose (prices fell) in December. Yields rose significantly as rate cut pace expectations adjusted downward after the FOMC raised its dot plot forecast during the month, signaling a lesser degree of cuts in 2025.

◆ Outlook

We expect rates will likely remain high over the near term and then shift downward. The Fed will likely be very careful in considering further rate cuts given that the US economy remains strong and inflation has stopped slowing. It will also be keeping a close eye on the effects of Trump's policies. As such, rates will likely remain high over the near term given continued uncertainty surrounding further rate cuts. Over the longer term we expect rates to fall as the market will price in fed cuts. The market will do this because of the expected slowdown in the labour market and core CPI falling to below 3.0% given the tightening we have seen so far.

Stock Market

Expect Upside Resistance on High Rates

◆ Review

The US equity market fell in December as investors were pessimistic on rate rises caused by expectations for slower cuts from the Fed.

◆ Outlook

We expect the US equity market to face upside resistance due to concerns rates will remain high. Expectations of a soft landing for the economy remain high and corporate earnings forecasts are strong. However we expect the market to face resistance as valuations will be weighed down by the slowdown in generative AI that has been driving recent market growth and there remains the possibility that inflation concerns stemming from Trump's policies will mean rates remain high.

Currency Market

Constant Near Term then USD down vs. JPY

◆ Review

USD appreciated versus JPY in December as the BoJ decided to leave rates unchanged at its December Monetary Policy Meeting and US rate cut expectations fell on the FOMC lifting its dot plot forecast despite lowering rates 25 basis points. Downward pressure on JPY also came from lower expectations for the BoJ to raise rates following comments from its December Monetary Policy Meeting that there remain uncertainties over Japanese real wages and the US economy.

◆ Outlook

We expect USD to remain unchanged versus JPY over the near term then to depreciate gently.

We expect little change over the near term as both the Fed and BoJ will be reluctant to make any moves without carefully assessing the impacts of Trump's incoming policies. The following USD depreciation versus JPY we expect will come from the Fed then looking to slowly cut rates, the BoJ lifting rates, and weakening downward pressure on JPY from real demand as we see improvements to Japan's trade deficits.

Economy & Financial Market Outlook: Europe

Economy

Expecting Continued Slow Growth

We expect European economic growth to continue to be slow as although the ECB has cut its policy rate, reflecting stagnation in the regional economy, it is still at what would be considered a tight policy level.

The region's core CPI (excluding volatile perishables and energy) recorded positive growth of 2.7% (YoY) in December (November: 2.7%).

The ECB cut its policy rate by 25 basis points at its third straight meeting in December. The region's economy continued to stagnate so we believe the central bank will be on the lookout for when to cut rates again.

Bond Market

Rates Flat in Near Term, Then Down

◆ Review

German 10-year yields rose (prices fell) in December. Yields rose despite ECB president Christine Lagarde hinting at continued rate cuts at the central bank's December meeting as US bond yields rose and European economic sentiment stopped declining.

◆ Outlook

We expect interest rates to be flat over the near term and then fall. Little change near term will be driven by high US rates caused by uncertainty over Fed rate cuts. However, in the longer term we believe rates will fall gently as the ECB has hinted at continued cuts and is largely expected to go ahead with them incrementally given slowing inflation and concerns over a deteriorating economy.

Stock Market

Expecting Upside Resistance

◆ Review

The European equity market fell in December as investors were pessimistic on interest rates increases across multiple countries caused by faltering expectations for rate cuts in the US.

◆ Outlook

We expect the market to face upside resistance.

Investors have priced in negatives such as worsened economic sentiment and lackluster corporate earnings in the region. While valuations are not expensive, we expect upside resistance to come from it still being too soon to expect aggressive easing and upward pressure on interest rates.

Currency Market

EUR to Fall Moderately vs JPY

◆ Review

EUR appreciated versus JPY in December. EUR fell at the beginning of the month on the back of political troubles in France and expectations for the ECB to cut rates. Throughout the rest of the month EUR appreciated versus JPY as political concerns in France receded and expectations for a BoJ rate cut fell.

◆ Outlook

We expect EUR to depreciate gently versus JPY as while BoJ is working towards monetary policy normalisation, albeit at a cautious pace, the ECB is expected to conduct further progressive cuts on slowing inflation and concerns over a deteriorating economy.

Economy & Financial Market Outlook: Emerging Market

Economy

EM Slowing But Stronger than Developed

The real economy in China continues to show a mix of positives and negatives. Home and land-use rights sales have bottomed out and thanks to the announcement of further monetary easing in September we are starting to see signs of improvements to cash flow at real estate companies. However, retail sales and investment in fixed assets remain low. On the policy front, the Chinese government is mulling the issuance of 3 trillion yuan in special government bonds and announced at the beginning of the year a plan for new subsidies for digital device (smartphone, tablets, etc) replacement purchases. While both of these measures lack the luster to bring the economy completely out of the doldrums, it shows the government is more willing than in the past to implement economic stimulus.

While Trump's protectionist tariffs and USD appreciation will have a negative impact on emerging economies, we believe they will still perform better than developed economies given that domestic demand is strong and inflationary pressure is easing.

Bond Market

Yields to Fall Gradually

◆ Review

Emerging market yields rose overall in December. Yields rose in Brazil, where growth in the expected inflation rate and currency depreciation pushed the central bank to hike rates 100bps, and Columbia, where the central bank only cut rates by 25bps, contrary to market expectations of a 50bps cut.

◆ Outlook

We expect emerging country yields to slowly decrease. We think it will be very difficult for emerging economies to cut rates significantly given that they will try to protect their currencies against depreciation. All the while, expectations for rate cuts in the US are declining given its strong economy. However, we do expect emerging yields to fall slowly while the US makes gradual cuts as emerging nations are seeing reduced inflationary pressure.

Stock Market

Expecting Weakness

◆ Review

Emerging market equities rose (local currency basis) in December.

Emerging market equities rose in early in the month on the back of better-than-expected economic indicators like Chinese manufacturing PMI and the Chinese government emphasizing the need for economic stimulus at its politburo meeting. The market fell in the middle of the month as the market was negative on no announcement of economic stimulus at China's Central Economic Work Conference and worries of outflows of capital from Asia on emerging assumptions that US rate cuts will be slow. The market then rose during the end of the month, finishing the month up, on growth in US semiconductor stocks and news that the Chinese government is considering the issue of three trillion yuan of special bonds.

◆ Outlook

We expect emerging market equities to face upside resistance. We believe investors will continue avoiding risk given deep concerns over further US-China frictions in trade and advanced technologies. We also note concerns that capital may flow out from Asia given the growing popularity of the opinions that US rate cuts will be slower than previously expected.

Currency Market

Appreciation but Upside Resistance

◆ Review

Emerging market currencies appreciated versus JPY in December as JPY was sold off on reduced expectations for an early rate hike by the BoJ. At the same time, emerging market currencies depreciated versus USD as the greenback rose on reduced expectations for rate cuts by the Fed. Versus JPY, the Mexican peso appreciated on the retreat of excessive alarm over Trump's trade policies. The Chinese yuan appreciated as Chinese authorities moved to prevent its depreciation.

◆ Outlook

We expect emerging market currencies as a whole to face upside resistance over the near term given USD strength coming from the strength of the US economy and concerns over Trump's trade policies.

Over the longer term we expect emerging market currencies to appreciate as the US slowly cuts rates. Individual currency 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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