



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 domestic demand factors like increased capital investments to tackle labour shortages. However, we believe the pace of economic growth will be slow as there are concerns the result of trade negotiations with the US will put downward pressure on the economy.

Japan's core CPI (excluding perishables) was up 3.7% YoY in May (April: 3.5%). We believe core CPI growth be around 3.5% because while high school tuitions being made free will create downward pressure on inflation, the increase in import prices caused by JPY depreciation and growth in service costs caused by higher personnel costs will create upward pressure.

We expect the BoJ to continue to scale back easy monetary policy. However, further rate hikes will likely continue to come in slow as there is high uncertainty surrounding how the domestic economy will be impacted by trade negotiations and the BoJ will take a cautious approach to monetary policy changes while it looks to confirm if wages are rising and if price increases are sustainable.

Bond Market

Expecting Flat Yields

◆ Review

10-year JGB yields fell (prices rose) in June. Downward pressure on yields came from the BoJ chairman showing at a monetary policy meeting that he is taking a cautious approach to rate hikes because of uncertainty surrounding trade talks with the US. Ultra-long yields extended their decline after the Ministry of Finance, against market expectations, decided to significantly reduce ultra-long bond issuances.

◆ Outlook

We believe interest rates will stay flat. We believe Japanese interest rates will be subject to upward pressure as the BoJ will move away from easy monetary policy. Meanwhile we expect rates will lack a clear sense of direction because rate hikes may be slow given BoJ officials will be looking to determine the impact of US trade policy.

Stock Market

Upside Resistance to Continue

◆ Review

The Japanese equity market rose in June as Middle Eastern geopolitical risks eased and there were increased expectations for rate cuts in the US.

◆ Outlook

We expect the market will continue to face upside resistance.

The likelihood of Japanese corporate earnings slowing is increasing as additional tariffs from the US will likely have a negative impact. However, we still see positives in a recovery to domestic real wages and capital efficiency improvement measures implemented by companies following pressure from the Tokyo Stock Exchange (TSE).

Valuations, such as forward PER, are already above undervalued levels, led by a few individual stocks against a backdrop where we do not see much change to uncertainty around tariffs. We will need to stay alert over the near term as expectations are rising for the Fed to cut rates earlier than previously expected to combat the slowing US economy. However, we do not expect any large drop in the market as prices will be supported by strong demand for Japanese equity on the back of high levels of share buybacks and accommodative monetary policy in comparison to the US and Europe.

Economy & Financial Market Outlook: US

Economy

Expecting Instability

We expect instability in the US economy. While recent data is strong, there are concerns over how economic uncertainty, primarily due to Trump tariffs, will impact inflation and consumption.

Core PCE inflation (excluding perishables and energy), was up 2.7% YoY in May (up 2.6% in April). The unemployment rate was 4.1% in June (May: 4.2%).

The Fed decided to leave the policy rate unchanged at the fourth FOMC meeting in a row in June as despite a drop in uncertainty surrounding inflation and employment caused by changes to tariff policy, uncertainty remains high. Despite downward revisions to real GDP growth forecasts and upward revisions to inflation, the Fed still expects two rate cuts in 2025. Fed chairman Jerome Powell stated at a press conference the Fed would not rush into rate cuts. The market will be keeping watch of inflation and employment figures to try to gauge changes in monetary policy.

Bond Market

Rates Unstable in Near Term, Then Down

◆ Review

10-year US yields fell (prices rose) in June as May CPI figures came in below consensus and investor expectations for rate cuts grew following statements from vice chair for supervision Michelle Bowman indicating the possibility of a July rate cut.

◆ Outlook

We expect rates will be unstable over the short term and then turn downwards. We are seeing increased wariness amongst investors concerning the economic slowdown and accelerated inflation against a backdrop of continued uncertainty around tariff policy. The Fed is likely to be cautious in deciding when to restart rate cuts as it will also be carefully watching the impact tariffs will have on the economy and prices. As such, we believe poor visibility will likely continue to surround the speed of rate cuts and rates will be unstable over the short term. Following this we believe rates will fall and have factored in rate cuts as we expect previous tightening to lead to a slow deceleration in the labour market and CPI to fall below 3.0%.

Stock Market

Upside Resistance on Uncertainties

◆ Review

The US equity market rose in June as investors turned to a risk-on mood following progress in US-China trade negotiations and reduced geopolitical risk.

◆ Outlook

We expect the US equity market to face upside resistance.

The main US share indexes recovered to pre-tariff announcement levels and recorded record highs in June on the back of progress in trade talks between the US and various countries as well as AI expectations. While there remains potential for further upside on the greater retreat of uncertainty surrounding tariff policy, we foresee upside resistance as valuations are already at a high level and there is uncertainty over high interest rates and the economy.

Currency Market

Gentle USD Depreciation vs. JPY

◆ Review

USD appreciated versus JPY in June. USD appreciated versus JPY at the beginning of the month as it was bought on the back of May non-farm payroll data coming in stronger than expected. USD then appreciated further versus JPY as USD-buying increased on deterioration to the situation in the Middle East and JPY was sold off as the BoJ took a conservative stance on rate hikes given uncertainty in trade negotiations with the US.

◆ Outlook

We expect USD to depreciate versus JPY at a gentle pace.

USD depreciation versus JPY will result from the Fed looking to cut rates again on the back of concerns over economic slowdown in the US and the BoJ continuing to move away from accommodative monetary policy. However, USD depreciation versus JPY will likely be gentle given that both the Fed and the BoJ will be cautious in their management of monetary policy while they observe the impacts of Trump's trade policy.

Economy & Financial Market Outlook: Europe

Economy

Expect Instability

The European economy will likely move in an unstable fashion as while we expect support from fiscal policy across multiple countries following recent stagnation, we are also concerned of the impact of trade frictions with the US.

The region's core CPI (excluding volatile perishables and energy) recorded positive growth of 2.3% (YoY) in June (May: 2.3%).

Additional tariffs on EU goods announced by Trump are due to come into effect in early July. With no visible progress in EU-US trade talks, investors are keeping watch of the final level tariffs will end up at as well as when and the extent of impact will be.

Bond Market

Rates to Remain High

◆ Review

German 10-year yields rose (prices fell) in June. Rates were subject to upward pressure as ECB president Christine Lagarde suggested the central bank would be pausing rate cuts and because of the increase in crude oil prices linked to tensions in the Middle East. German yields in particular were subject to upward pressure because of heightened concerns of bond issuances by the German government as part of a debt raising plan.

◆ Outlook

We expect interest rates will likely remain high as concern will remain over Europe relaxing fiscal rules to expand defense spending and there are expectations for other fiscal spending to support the economy. This is amidst a backdrop of the ECB suggesting it is done with rate cuts despite economic uncertainty and disinflationary pressure in the region.

Stock Market

Sensitivity on Uncertainty Over Tariffs

◆ Review

The European equity market fell in June. We saw profit-taking in Germany after the country's stock market hit record highs over multiple days and increased uncertainty surrounding tariffs as the deadline for the tariff pause of 9 July approached.

◆ Outlook

We expect the market to be volatile as while share prices will continue to be supported by an expansion of fiscal spending in the region and lingering expectations for monetary easing by the ECB, investors will likely be watching for how tariffs will change following 9 July.

Currency Market

EUR to Maintain Level vs JPY

◆ Review

EUR appreciated versus JPY in June. EUR was bought following indications from Lagarde at the June monetary policy meeting that the ECB will be pausing rate cuts. JPY was sold off as the BoJ showed a cautious stance towards rate hikes amidst uncertainty surrounding US trade talks.

◆ Outlook

We expect there to be upward pressure on JPY as the BoJ continues to move away from accommodative monetary policy. However, we also expect to see upward pressure on EUR as there is expected to be economic support on the back of an expansion in fiscal spending and interest rates will likely stay high. As such, we believe there will be little change between EUR and JPY.

Economy & Financial Market Outlook: Emerging Market

Economy

Concern of China Foreign Demand Dip

Trade negotiation efforts between the US and China are still thought to be strained, with no clear progress seen on tariff rates to be implemented, despite China agreeing to reopen rare earth exports to the US in mid-June. Chinese manufacturing PMI continues to indicate a contracting economy, on the back of uncertainty over Trump tariffs, and manufacturing capex continues to slow. There have been media reports that, against the backdrop of economic downturn risk, the Chinese government is considering additional stimulus for the real estate and consumer sectors, through which the government is likely looking to prop up the economy by boosting domestic demand.

While emerging economies are seeing inflationary pressure ease against a backdrop of overall firm domestic demand, Trump's tariffs will have a negative impact on their economies. We will be watching for the next movements of the US government.

Bond Market

Yields to Fall Gradually

◆ Review

Emerging market yields fell (price rose) slightly in June overall. Yields fell in Türkiye, where the central bank moved away from its position on monetary tightening as inflation has fallen, and Mexico, where the central bank lowered rates by 50bps at its fourth consecutive monetary policy meeting.

◆ Outlook

We expect emerging country yields to slowly decrease while the US makes gradual cuts to rates given that emerging nations are seeing reduced inflationary pressure. However, yields are likely to be volatile on concerns over Trump trade policy for the time being.

Stock Market

Expecting Turbulence

◆ Review

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

Emerging market share prices rose in the beginning of the month on optimism over US-China trade talks and heightened expectations for economic stimulus in South Korea on the victory of Lee Jae-myung of the ruling Democratic Party in the Presidential election. Markets rose briefly in the middle of the month as the market was positive on expected corporate governance improvements following the announcement of revisions to the Commercial Act in South Korea. However, they then fell on concerns over geopolitical risk stemming from the Israel-Iran conflict. Emerging markets then continued to rise at the end of the month on agreement for ceasefire between Israel and Iran.

◆ Outlook

We expect turbulence in emerging market equities going forward. The market will likely be influenced by news releases concerning post-9 July while there remains uncertainty over trade negotiations with the US. The impact of tariffs on the economies of emerging markets is becoming more evident and we believe concerns over deteriorating earnings will likely cap share prices.

Currency Market

Upside Resistance Over Short Term, Then Up

◆ Review

Emerging market currencies appreciated versus JPY in June as USD weakness continued and the market turned in favour of risk on a retreat in concerns over the Middle East. The Brazilian real appreciated as the central bank raised the policy rate 25bps and signaled it would keep interest rates high over the long term. The Hungarian forint appreciated as the central bank signaled it would continue with tight monetary policy to combat increasing inflation.

◆ Outlook

We expect emerging market currencies as a whole to face upside resistance given concerns over Trump's trade policy. 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.

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● Risks relating to Investment Trusts (Mutual Funds)

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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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