SOMPO ASSET MANAGEMENT

A Theme Park for Security, Health & Wellbeing

Economy & Financial Market Outlook

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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 given that pressure on exporter profits from the increase in US tariffs will drag on the domestic economy.

Japan's core CPI (excluding perishables) was up 2.7% YoY in August (July: 3.1%). We believe core CPI growth will be around 3.0% because while government subsidies for utility bills will create downward pressure on inflation in the short term, 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 concerns could easily pick up in regards to the impact US tariffs will have on the domestic economy 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 rose (prices fell) in September because of increased expectations for economic measures by an incoming administration following Prime Minister Shigeru Ishiba's resignation announcement and given the increased likelihood the BoJ will hike rates within the year, stemming from how ready some officials looked at the September monetary policy meeting. Yields on ultra-long maturities declined slightly on receded fears over supply after the Ministry of Finance decided to reduce future issuance.

◆ 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. But at the same time we expect rates will lack a clear sense of direction because inflation looks to be sustainable and rate hikes may be slow given BoJ officials will be cautiously looking to determine the impact of uncertainties surrounding US trade policy and their impact on Japanese companies.

Stock Market

Gradual Upside Resistance

◆ Review

The Japanese equity market rose in September because of expectations for Fed rate cuts and expansionary fiscal policy by the new Japanese government administration.

◆ Outlook

We expect the market will gradually face more upside resistance.

We believe there is need for caution over the near term as equity valuations (forward P/E, etc.) have been pulled upwards by a select number of stocks and are no longer undervalued because of US rate cuts and expectations for new policies from the incoming government administration in Japan. We can see slight signs of valuation froth. However, we also believe Japanese corporate earnings forecasts will now improve given the increased likelihood they will not fall as much as initially expected following the easing of tariffs from the US.

We do not expect any large drop in the Japanese 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. We expect that the negative impact of tariffs will have faded out by 2H in the coming fiscal year. An increase in corporate earnings will then start to look more likely but we believe it will still take some time before this growth can get underway in a serious way.

Economy & Financial Market Outlook: US

Economy

Expecting Instability

We expect instability in the US economy. The labour market has been slowing despite resilience in the US economy and concerns remain over the impact tariffs will have on inflation.

Core PCE inflation (excluding perishables and energy), was up 2.9% YoY in August (up 2.9% in July). The unemployment rate was 4.3% in August (July: 4.2%).

The Fed decided at its September FOMC (Federal Open market Committee) to lower interest rates by 25bps in an attempt to arrest any further weakening of the domestic jobs market. Fed Chair Jerome Powell also signaled further rate cuts at the following press conference. With inflation forecasts for 2026 now being raised we will be keeping watch of the pace of coming rate cuts.

Bond Market

Rates Unstable in Near Term, Then Down

◆ Review

10-year US yields fell (prices rose) in September. Yields fell at the beginning of the month as August jobs data showed a slowdown in the labour market. Despite the decision to lower interest rates by the Fed at its September FOMC, the drop in yields then halted as Powell mentioning that the cut was a “risk management cut” eased expectations for further big cuts.

◆ Outlook

We expect rates will be unstable over the short term and then turn downwards. Following its decision in September to cuts rates in light of increased concerns of deterioration to the labour market, the Fed is expected to continue with further cuts while keeping an eye on how tariffs are impacting inflation and the economy. As such, the pace of rate hikes will remain uncertain. As such, we expect rates to remain 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

Continued Back and Forth at High Levels

◆ Review

The US equity market rose in September. Growth was driven by maintained expectations for two more rate cuts by the Fed before year-end and growth in a select few large-cap AI-related names, driven by sudden increased order backlogs from hyperscalers (cloud service providers).

◆ Outlook

We expect the US equity market to be tugged back and forth at current high levels. Investors remain concerned over current high prices, with valuations growing to even greater overheated levels, especially for AI-related large-cap tech stocks. However, we expect the market will be able to remain at high levels because of expectations for the Fed to cut rates again and support from continued strong earnings, which are starting to be seen in upwards revisions to earnings at non-tech companies.

Currency Market

Gentle USD Depreciation vs. JPY

◆ Review

USD appreciated versus JPY in September. Investors sold JPY in the first half of the month on heightened concerns of political instability following LDP Secretary General Hiroshi Moriyama announcing his intention to resign. We saw a brief break in JPY depreciation when USD started to weaken on heightened expectations for rate cuts in the US but the second half of the month also ultimately saw JPY depreciated versus USD as Fed officials showed caution over further rate cuts and concerns rose over the prospect of fiscal expansion in Japan.

◆ Outlook

We expect USD to depreciate versus JPY at a gentle pace. We foresee USD depreciation versus JPY as the Fed has hinted at further rate cuts given concerns over the slowdown in the US labour market and the BoJ is expected to retract its easy 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 and investors are conscious of the possibility of fiscal expansion and delayed BoJ rate hikes under a government administration headed by Sanae Takaichi.

Economy & Financial Market Outlook: Europe

Economy

Expect Moderate Recovery

Concerns over economic downturn in Europe retreated following the trade negation agreement with the US. We expect a moderate economic recovery on the back of eased inflation and support from fiscal policy.

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

French Prime Minister Sébastien Lecornu quit after just 26 days in charge following problems negotiating a workable 2026 budget and criticism of his ministerial lineup. His quick departure followed the resignation of previous Prime Minister François Bayrou. With quick prime ministerial switches occurring due to the ruling party's minority position, the government has not been able to tackle the country's worsening fiscal condition. We expect uncertainty to remain.

Bond Market

Rates to Remain High

◆ Review

German 10-year yields were mostly unchanged in September. German yields fell at the beginning of the month, dragged down by the fall in US yields. However, we then saw upward pressure on yields following a drop in expectations for additional rate cuts caused by a September ECB press conference where ECB President Christine Lagarde commented that "we continue to be in a good place."

◆ Outlook

We expect interest rates will likely remain high as concern will remain over Europe relaxing fiscal rules to expand defense spending and expectations abound 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

Upside Resistance

◆ Review

The European equity market rose in September. Growth was driven by rate cuts in the US, reports of EU tariff increases on Chinese steel, and stock-picking of defense-related names on expectations for increased defense spending.

◆ Outlook

We expect upside resistance. Despite the EU coming to an agreement with the US regarding tariffs, the potential negative impacts of these tariffs have not been adequately priced into earnings forecasts and this could result in downward earnings revisions as the impacts become more clear. There also remain concerns of geopolitical risks, such as the situation in Ukraine, as well as of the fiscal situation in France. As such, despite expectations for expanded fiscal spending in the region, we foresee upside resistance.

Currency Market

EUR to Maintain Level vs JPY

◆ Review

EUR appreciated versus JPY in September. Investors sold JPY on heightened concerns of political instability following LDP Secretary General Hiroshi Moriyama announcing his intention to resign. EUR was bought on the back of comments from Lagarde describing current rates as "in a good place" and receded expectations for additional rate cuts in Europe.

◆ 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 from 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

Watch Tariff Impact

While China did come to an agreement with the US on the sale of video streaming app TikTok, tariffs still present a big problem in the two countries coming to an agreement on trade. While a lot of attention is being paid to a few areas, like China attempting to become self sufficient in AI chips (domestic production) and its pharmaceutical companies expanding overseas, real economic indicators like consumption and investment continue to show weakness because of insufficient domestic demand. The Chinese Communist Party is expected to announce its 15th Five Year Plan at its fourth plenary session for its 20th Central Committee, expected to be held in the second half of October. Attention will be on whether the plan has any countermeasures for structural problems the country faces. Such problems include insufficient demand caused by the drop in the housing market, an ageing society, and ensuring sustainable growth of advanced industries.

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 rose (price fell) in September overall. Yields fell in Mexico, where the central bank cut rates by 25bps and indicated further rate cuts, but rose in Turkiye, there remains political instability with a growing crackdown on the main opposition party.

◆ 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 over the short term on concerns over high tariffs in the US.

Stock Market

Expecting Markets to Further Diverge

◆ Review

Emerging market equities (local currency basis) rose in September. Share prices rose in the beginning of the month on expectations for capital flows into risk assets like equities, spurred by an outlook of coming rate cuts in the US, as well as strong order values at Taiwanese semiconductor companies. The markets rose further in the middle of the month as stock-picking focused on AI-related stocks following the announcement from US hyperscalers (cloud service providers) of a big increase in orders backlogs and announcements from Chinese internet majors that they are training their own AI models using self-developed semiconductors. We then saw further growth at the end of the month as investors were positive on a large and famous US investment fund increasing its position in a Chinese internet stock.

◆ Outlook

We expect movement in emerging market equities to be mixed depending on country and sector. With recent share price growth raising alarm in the high pricing of AI-related stocks, we believe further investment in the space will be selective based on confidence in a project's prospects of actually producing revenue and the progress it has made so far. That said, we expect to see improved demand for emerging market equities overall as capital flows should increase on the back of USD depreciation (versus emerging market currencies), caused by expectations for rate cuts at the Fed.

Currency Market

Upside Resistance Over Short Term, Then Up

◆ Review

Emerging market currencies appreciated versus JPY in September. USD depreciation, caused by expectations of rate cuts, boosted emerging currencies while JPY weakened on concerns of fiscal expansion. The South African rand appreciated as the market was positive on increasing prices of commodities like iron ore and gold. The Brazilian real and Mexican peso appreciated because of high interest rates and a market looking to risk assets.

◆ Outlook

We expect emerging market currencies as a whole to face upside resistance given concerns over the impact of high US tariffs. 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.

[Important Notice]

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● 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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