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 given the pressure on exporter profits from the increase in US tariffs dragging on the domestic economy.

Japan's core CPI (excluding perishables) was up 3.0% YoY in November (October: 3.0%). We believe core CPI growth will remain around 3.0% because while government support measures will cause fluctuations in prices in the short term, price increases caused by JPY depreciation will be offset by decreases in resource prices. Meanwhile, service cost growth will likely stay flat.

We expect the BoJ will continue to scale back easy monetary policy. However, further rate hikes will likely proceed slowly as investor views of the global economy could easily grow more conservative 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 December. Yields were pushed up as the BoJ hiked the policy rate from 50bps to 75bps at its December Monetary Policy Meeting and concerns mounted about the potential for increased inflation as JPY continued to depreciate after the meeting.

◆ 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 rate hikes may be slow given BoJ officials will be cautiously looking to determine if wages and inflation are sustainable and the impact of previous rate hikes.

Stock Market

Expecting Back-and-forth

◆ Review

The Japanese equity market rose in December. Prices were pushed up by the rate cut in the US and a dovish rate hike by the BoJ.

◆ Outlook

We expect the market will rock back and forth for a while.

Japanese corporate earnings forecasts have been rising since Japan and the US concluded their trade agreement. And it is looking like we'll see further improvements in the coming fiscal year. However, we believe there is need for caution over the near term as equity valuations (forward P/E, etc.) have been on a one-way path upwards on the back of these strong earnings and other catalysts like additional rate cuts in the US and expectations for further AI investment.

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.

Economy & Financial Market Outlook: US

Economy

Expecting Short-term Strength

We expect strength in the US economy to continue over the short term. While the US economy looks to have leveled out for the time being, we believe it will continue to show strength on effects of adjustments to monetary policy and fiscal spending.

Core PCE inflation (excluding perishables and energy), was up 2.8% YoY in September (up 2.9% in August). The unemployment rate was 4.4% in December (November: 4.5%).

Amidst growing disappointment with the economic policy of the current US administration, President Donald Trump has launched a number of his own stimulus measures, including a ban on large institutional investors buying single-family homes and the imposition of a limit on credit card rates. We will be watching what economic policies the mid-terms produce as well as their effects.

Bond Market

Rates To Fall

◆ Review

10-year US yields rose (prices fell) in December. Yields rose at the beginning of the month as treasuries were sold on concerns over a supply glut in the overall US bond market created by corporate bond issuances. Short-term bonds then saw yields drop as at its December FOMC the Fed cut rates again and decided on a program of short-dated bond purchases. However, long-dated bond yields remained level as they were impacted by the increase in rates in Japan and Europe.

◆ Outlook

We expect rates to fall.

The Fed cut rates for the third consecutive time (starting in September) at its December FOMC in light of increased concerns of deterioration to the labour market. The central bank is expected to continue with further cuts while keeping an eye on how tariffs are impacting inflation and the economy. We believe rates will fall and have factored in rate cuts as CPI has already fallen below 3.0% and we expect previous tightening to lead to a slow deceleration in the labour market.

Stock Market

Expecting Resilience on Non-AI Strength

◆ Review

The US equity market finished December largely unchanged MoM. Amidst the up and down in expectations for AI investment, the market was supported by the Fed's decision to further cut rates at its December FOMC and upward revisions to US GDP growth forecasts for 2026.

◆ Outlook

We expect the US equity market to show resilience despite a break in enthusiasm for AI stocks as the market will be supported by stock-picking in non-AI areas. We are seeing a break in AI-focused stock-picking given continued concerns over the profitability and financing for AI data centre investing. We believe stock-picking will now shift to non-AI stocks, driven by expectations for further rate cuts by the Fed and the underlying strength of the domestic real economy. As such, we expect the overall market to remain resilient as non-AI stocks will provide support while we witness a drop in the AI stocks that have been rising.

Currency Market

Gentle USD Depreciation vs. JPY

◆ Review

USD was largely unchanged MoM versus JPY in December. USD depreciated versus JPY at the beginning of the month as BoJ Chairman Kazuo Ueda hinted at rate hikes at the BoJ's December Monetary Policy Meeting. Despite actually raising rates, JPY was sold as the market interpreted the raise as a dovish move. JPY was then bought back through the end of the month on comments from senior government officials in Japan on measures to stem JPY weakness.

◆ Outlook

We expect USD to depreciate versus JPY at a gentle pace. We foresee USD depreciation versus JPY as the Fed will conduct 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 under a government administration headed by Sanae Takaichi.

Economy & Financial Market Outlook: Europe

Economy

Expecting Moderate Recovery

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 December (November: 2.4%).

The ECB left rates unchanged for the fourth consecutive time at its December Governing Council meeting in a nod to the region's stable inflation and resilient economic activity. The central bank made no comment on how the recent rise in economic forecasts and CPI growth will impact its monetary policy decisions but maintained its data-dependent stance.

Bond Market

Rates to Remain High

◆ Review

German 10-year yields rose (prices fell) in December as forecasts for rate hikes rose on hawkish comments (monetary tightening) from top ECB officials concerning rates. Expectations for rate hikes at the BoJ also helped push up German yields.

◆ 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 given stable inflation.

Stock Market

Expecting Continued Firm Market

◆ Review

The European equity market rose in December. The financials sector pushed the overall market up as bank stocks were bought on expectations for expanded net interest margins given the steepening of the yield curve. This was despite thin trading volume through the end of the year.

◆ Outlook

We expect the European equity market to continue to firm. We expect the European market to attract capital once money starts to shift from AI to non-AI stocks given its low percentage of technology companies. We also expect corporate earnings in the region to be strong given expectations for economic recovery on the back of lowered rates and expanded fiscal spending. We can also see a clear path of capital towards European equities given their low valuations compared to other markets.

Currency Market

EUR to Remain Level vs JPY

◆ Review

EUR appreciated versus JPY in December. JPY underwent selling pressure despite BoJ Chairman Kazuo Ueda hinting at rate hikes at the BoJ's December Monetary Policy Meeting as the market interpreted his stance as a dovish move. EUR strengthened on hints from hawkish ECB officials of future rate hikes.

◆ 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 support for EUR as economic support is expected from an expansion in fiscal spending and high interest rates. As such, we believe there will be little change between EUR and JPY.

Economy & Financial Market Outlook: Emerging Market

Economy

China Remains Weak, Watch Tariff Impact

The economic slowdown in China has become clearer with retail sales data for November coming in low and undershooting market expectations and the YoY decrease in fixed asset investment becoming even more pronounced. The Chinese government has hinted that it will not interfere in the financial problems faced by large regional government-backed real estate companies, but will let market forces correct the problem. As such, we believe that mistrust of real estate companies will reduce people's desires to purchase real estate.

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.

Bond Market

Yields to Fall Gradually

◆ Review

Emerging market yields were overall largely unchanged in December. Yields fell in Turkiye as the country's central bank lowered rates by a larger-than-expected 150bps. Yields rose in Brazil, where the central bank left rates unchanged for the fourth consecutive 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 over the short term on concerns over high tariffs in the US.

Stock Market

Expecting Increased Gap in Sector Picks

◆ Review

Emerging market equities (local currency basis) rose in December. Share prices rose at the beginning of the month, with capital flowing toward AI and semiconductor stocks on expectations for further rate cuts in the US. However, the market then fell in the middle of the month as investors looked more to risk avoidance on financial issues at large Chinese real estate companies causing them to look to delay interest payments and extend the maturity of their corporate bonds. Late-month then saw a rapid rise in the semiconductor stock prices on the steep rise in memory prices caused by increased demand for data centres and South Korean semiconductor companies' efforts to develop GPUs for AI-use.

◆ Outlook

We expect to see mixed performances based on sectors. We expect semiconductor stocks to remain relatively strong as memory prices will likely remain high given difficulties in boosting memory production quickly. Outside of semiconductors, while major companies will struggle to boost earnings, those that look to expand abroad should see improvements. Share price performance will be highly company-specific. We believe the gap between sectors will widen depending on earnings.

Currency Market

Upside Resistance Over Short Term, Then Up

◆ Review

Emerging market currencies appreciated versus JPY. The emerging currency market was positive on USD depreciation caused by the Fed rate cut and decision to purchase short-maturity treasuries. The South African rand appreciated on the increase in commodity prices and the Mexican peso appreciated on carry trade movements.

◆ 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.

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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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