Director of Kanto Local Finance Bureau (Financial instruments firm) No. 351
a member of the Japan Investment Advisors Association, and the Investment Trusts Association, Japan

Economy & Financial Market Outlook: Japan

Economy

Expecting Moderate Economic Recovery

We expect the Japanese economy will be supported by government economic measures and corporate capital expenditures. However, we believe the pace of economic growth will be slow due to concerns that persistent inflation will put downward pressure on consumption.

Japan's core CPI (excluding perishables) was up 1.4% YoY in May (April: 1.4%). We believe core CPI growth will remain around 2.0%. While government support measures will cause short-term price fluctuations, there will be a greater impact from JPY depreciation and resource prices.

We expect the BoJ will continue to scale back easy monetary policy given it has greater concerns about inflation. However, further rate hikes will likely proceed slowly because the BoJ will take a more cautious approach than before to monetary policy changes amid heightened concerns over the impact of rate hikes on the domestic economy.

Bond Market

Upward Yield Trend on Gradual Rate Hikes

◆ Review

10-year JGB yields (and prices) were flat in June. Despite a decline in crude oil prices pushing down expected inflation, yield remained flat MoM due to growing views that the government fiscal expansion would lead to increased bond issuance.

◆ Outlook

We believe interest rates will move upward. Real interest rates are likely to increase due to tight money supply on the back of growth in bank lending and the government's stance to expand fiscal spending. Japanese interest rates will be subject to upward pressure as the BoJ will move away from easy monetary policy given its greater concerns about inflation.

Stock Market

Expecting to Remain Firm

◆ Review

The Japanese equity market rose in June. The market was supported by increasing hopes for an end to the war between the US and Iran.

◆ Outlook

We expect the market to remain firm. Valuation (forward P/E), which reflects overall market expectations, is currently at a high level compared to historical averages, primarily driven by some AI and semiconductor names amid diminishing uncertainty in the Middle East. Although the market has already priced in expectations for AI and semiconductor names to a large extent, these expectations are likely to be sustained as there are no immediate signs of a decline in semiconductor demand and AI-related investments. We expect the market to remain robust, driven by improvements in earnings forecasts for FY26. Crude oil prices have now stabilized, and the situation has eased more than previously, despite likely cost increases stemming from the Middle East. We should remain vigilant about a potential market correction, given that share prices have risen rapidly so far. That said, we don't expect a large market correction as there is strong equity demand from a high level of share buybacks and the BoJ has relatively accommodative monetary policy compared to the US and Europe.

Economy & Financial Market Outlook: US

Economy

Expecting Short-term Strength

The US economy looks to remain resilient given its relatively limited exposure to the situation in the Middle East. We believe it will continue to show strength as tax cuts and capex demand, mainly from communication sector, will support the economy amid inflationary pressures stemming from high crude oil prices.

Core PCE inflation (excluding food and energy) was up 3.4% YoY in May (up 3.3% in April). The unemployment rate was 4.2% in June (May: 4.3%), indicating a firm labor market.
Amid the rising inflationary pressure, stemming from persistently high energy prices, the market expectations for rate cuts receded. Investors have been cautiously monitoring monetary policy. The Fed will continue to take a cautious approach for policy management to achieve maximum employment and price stability. We believe the Fed will make policy rate decisions while monitoring the pace of the slowdown in the job market and inflation.

Bond Market

Rising Interest Rates to Gradually Ease

◆ Review

10-year US yields fell (prices rose) in June. Yields rose early in the month due to high crude oil prices amid uncertainty over peace negotiations between the US and Iran, along with strong US jobs data. However, in the middle of the month, yields began to decline as crude oil prices fell following the signing of a memorandum of understanding to end the war between the two countries. Towards the end of the month, yields further decreased due to continuous decline in oil prices.

◆ Outlook

We expect rising rates to gradually ease. Given that inflation has been trending upward, caused by the Middle East situation, persistent expectations for Fed rate hikes this year are likely to keep rates high. Meanwhile, crude oil prices have dropped following the agreement in principle on US-Iran peace talks. We believe the Fed's stance to curb inflation will bring inflation under control. Thus, we foresee rate increases will gradually moderate.

Stock Market

Expecting Volatility from AI Investment Rotation

◆ Review

The US equity market rose in June. Despite progress in the Middle East peace talks, the market remained volatile, fueled by fears over the sustainability of AI investments and persistent inflation. Throughout the month, there was a clear shift in investors' stock selection from hyperscalers to semiconductor and defensive sectors, as seen in the weak performance of the Magnificent Seven.

◆ Outlook

We expect the market to be volatile. Currently, we observe a bifurcated market that favors AI beneficiaries, such as semiconductor companies, backed by strong earnings. AI developers (hyperscalers) are sold off due to concerns over their immense capital expenditures. There is a possibility that stock selection between AI beneficiaries and AI developers could reverse, triggered by concerns about a potential peaking of AI capital expenditures. If such a reversal happens, we expect to see temporary volatility, especially impacting AI-related stocks, given the mounting market uncertainty.

Currency Market

Expecting Moderately Strong USD vs. JPY

◆ Review

USD appreciated versus JPY in June. The robust US jobs data and the hawkish stance from the June FOMC supported the USD. Despite the BoJ's rate hike in June, JPY was sold against USD due to fears about the BoJ falling behind the curve. Across the month, USD appreciated versus JPY.

◆ Outlook

We expect gentle USD appreciation versus JPY. There will be upward pressure on USD given the strong US economy and as current inflation is likely to sustain expectations for the Fed's rate hikes. In Japan, the growing trade deficit and the expectations of the expansionary fiscal policy under the Takaichi administration will act as downward pressure on JPY. That said, a decline in oil prices will gradually calm US inflation. We expect gentle USD appreciation versus JPY given the Fed's aggressive rate hikes are unlikely and currency interventions by the Japanese authorities are probable if JPY weakens significantly.

Economy & Financial Market Outlook: Europe

Economy

Expecting Weakness

We expect a slowdown in European economic growth in the near-term. While expansionary fiscal policy will provide some support, persistently high energy prices are likely to weigh on households and corporate activity.

The region's core CPI (excluding volatile food and energy) decelerated to 2.4% (YoY) in June (May: 2.6%). Inflation still exceeds the ECB's target even though the impact from high energy prices is limited at this stage. Against this backdrop, the market has been less concerned about additional rate hikes. Meanwhile, the Middle East situation remains highly uncertain, and inflationary pressures could intensify again depending on future energy prices. For the time being, the focus will be on the impact of the Middle East situation and any resulting rise in energy prices on households and business activities.

Bond Market

Rising Rates to Gradually Moderate

◆ Review

German 10-year yields fell (prices rose) in June. Yields initially rose early in the month, driven by persistently high energy prices, stemming from uncertainty surrounding the peace negotiations between the US and Iran. In the middle of the month, yields started to decline due to a fall in energy prices following the signing of a memorandum of understanding to end the war between the two countries. The decline in yields continued, fueled by falling energy prices until the end of the month.

◆ Outlook

We expect interest rate increases to gradually moderate. Although inflationary concerns stemming from the Middle East situation, coupled with persistent expectations for further ECB rate hikes suggest that interest rates will likely remain high. Meanwhile, crude prices have fallen following a framework agreement in peace talks between the US and Iran. The ECB rate hikes are likely to put downward pressure on the European economy, which will gradually curb inflation. Therefore, we believe interest rate rises will gradually ease.

Stock Market

Expecting Resilience amid Investment Shift

◆ Review

The European equity market rose in June. The market was driven by eased inflation concerns and diminished expectations for higher interest rates, stemming from declines in crude oil prices following the signing of a memorandum of understanding to end the war between the US and Iran. Continued stock picking of AI-related stocks in the region also supported the market.

◆ Outlook

We foresee a firm market, driven by a shift in stock picking. Investor stock preference will shift away from AI-related to non-AI-related stocks which benefit from cost reductions, triggered by declining energy prices and receding concerns over the economy. While a correction in AI-related stocks which have driven the market may limit upside potential, broader non-AI stocks will support the market, thereby keeping the overall market firm.

Currency Market

Expecting Lack of Clear Direction

◆ Review

EUR depreciated moderately versus JPY in June. The market lacked a clear sense of direction throughout the month. JPY's appreciation was primarily driven by the BoJ's rate hike at the monetary policy meeting in mid-June. Meanwhile, a decline in German yields towards the end of the month weighed on EUR, leading to moderate depreciation.

◆ Outlook

We expect the ECB's rate hikes will put downward pressure on the European economy, which will lead to EUR depreciation versus JPY. Meanwhile, in Japan, the growing trade deficit and expectations for fiscal expansion under the Takaichi administration are likely to exert downward pressure on JPY. However, we foresee that the market will lack a clear direction given the likelihood of currency interventions by the Japanese authorities if JPY weakens further.

Economy & Financial Market Outlook: Emerging Market

Economy

China: Sluggish Domestic Demand
EM: Watch Geopolitical Risks & US Tariffs

In China, key economic indicators for May continued to fall short of market expectations. Among those, retail sales dropped by 0.6% YoY, marking negative growth for the first time since December 2022. Given temporary factors such as diminished effect of car purchase subsidies, and despite sales from service sector continuing to grow 4-5% YoY, domestic demand is expected to weaken further. Producer Price Index (PPI) for May grew 3.9% YoY, indicating a further increase from the previous month (up 2.8%), driven by soaring petroleum product prices. This cost-push inflation is projected to worsen corporate earnings, curb capital expenditure, and deteriorate the economy.

We believe that the strong USD, driven by heightened expectations for US rate hikes, and Trump's tariffs will negatively impact emerging economies, despite their overall firm domestic demand.

Bond Market

Volatile amid Uncertainty in the Middle East

◆ Review

Emerging market yields fell in June due to a recovery in market risk appetite following progress in peace talks between the US and Iran and a decline in energy prices. Yields fell in Turkey, an energy importer, and in Hungary, which resumed rate cuts on the back of eased geopolitical tensions.

◆ Outlook

We expect emerging market yields to be volatile for the time being. We anticipate capital outflows from emerging market bonds in periods of heightened risk aversion, triggered by fears over sustainability of AI investments. A stronger USD caused by expectations for US rate hikes could lead to higher inflation expectations in emerging economies, due to depreciation in their local currencies.

Stock Market

Expecting Shift to Non-AI Stocks

◆ Review

Emerging market equities (local currency basis) fell slightly in June. Early in the month, technology stocks in South Korea and Taiwan declined due to a lack of material progress in peace talks between the US and Iran, and increased expectations for US rate hikes. In the middle of the month, we saw buying of technology stocks which had experienced correction as the agreement to end the war was reached between the US and Iran, rapidly reducing investors' risk aversion. Towards the end of the month, China's domestic demand stocks showed weak performance amid the persistent concerns about China's economic slowdown.

◆ Outlook

We expect an investment shift from AI beneficiaries to other stocks. Stock picking has been concentrated on AI beneficiaries such as semiconductor names, which have shown strong earnings. However, AI beneficiaries' performance may be volatile amid worries over peaking AI capital expenditures. Non-AI names are becoming more attractively priced following the recent price corrections. We expect buying interest in domestic demand-related stocks that have been struggling with cost inflation, which is now easing due to a drop in oil prices.

Currency Market

Upside Resistance, Mixed by Fundamentals

◆ Review

Emerging market currencies depreciated versus JPY in June due to a stronger USD, driven by heightened expectations for US rate hikes. The Hungarian forint depreciated as its central bank decided on a 0.25% rate cut amid eased geopolitical tensions and hinted at further cuts. The Brazilian real also depreciated following a 0.25% rate cut and negative sentiment from falling oil prices.

◆ Outlook

We expect emerging market currencies as a whole to face upside resistance given increased expectations for US rate hikes. 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.

Other Important Notices

This document has been compiled by Sompo Asset Management Co., Ltd for the purpose of information provision.

This document has been created based on information that Sompo Asset Management Co., Ltd believes to be reliable, although the firm does not guarantee the accuracy or completeness of such information. The contents, opinions, and forecasts expressed in this report may at any time be changed or withdrawn without prior notice.

Performance data used in this report reflects past performance and is not a guarantee or indicator of future results.

This document does not constitute a legal disclosure document.

Disclaimer (GIPS)
“SOMPO ASSET MANAGEMENT CO., LTD. claims compliance with the Global Investment Performance Standards(GIPS®). SOMPO ASSET MANAGEMENT CO., LTD. has been independently verified for the periods 1 April 2012 through 31 March 2025. We have defined its investment advisory business and investment trust business as the "Firm" and claimed compliance with the GIPS®. A complete list of composite descriptions and policy of portfolio evaluation, performance calculation, and compliant presentation development are available upon request.”

Contact information: SOMPO ASSET MANAGEMENT CO., LTD
Investment Advisory Marketing Department
03-5290-3422

Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. Verification does not ensure the accuracy of an specific composite presentation.