SuMi TRUST
SUMITOMO MITSUI TRUST GROUP

SuMi TRUST Monthly Commentary

August 2019

1. **Earnings Forecast for FY 2019 and FY2020**
2. **Impact of US-China trade frictions on Japanese companies**

1. SuMi TRUST has updated its operating profit forecast for the Nikkei 225 (see Figure 1) for the current fiscal year ending March 2020 (FY2019) and the next fiscal year ending March 2021 (FY2020).

・FY 2019: We forecast lower earnings from falling demand in the material sectors (Iron & Steel, Non-ferrous Metals) and Auto & Transport Equipment, a slowdown in the external demand-related and technology sectors including Electric Appliances, and slightly lower earnings in the Energy Resources. Conversely, we see the domestic demand-related sectors such as Retail and Services holding up despite a slight slowdown. However, the domestic demand-related sectors overall will be dragged down by companies impacted by their overseas investments.

・FY 2020: With a gradual recovery in demand, we see higher earnings in the external demand-related sectors including the material sectors (Iron & Steel, Non-ferrous Metals), Energy Resources and Auto & Transport Equipment. We also see increased earnings amongst domestic demand-related companies that include Retail, which is cutting its costs, higher consumption of Services due to longer leisure time, and improving earnings in the Pharmaceuticals which is seeing the effects of acquisitions.

Figure 1. Operating Profit Forecast for FY2019 and FY2020

			No. of Co's	SuMi TRUST			Consensus
				FY2019	FY2020		FY2020
				Projection as of June 2019	Projection as of March 2019	Projection as of June 2019	Projection as of June 2019
Total			185	-3.0%	7.7%	10.2%	8.7%
	Manufacturing		132	-1.9%	9.1%	12.3%	10.1%
	Non-manufacturing		53	-5.0%	4.8%	6.3%	6.3%
	Sector	**Chemicals & Textile**	22	4.4%	5.2%	6.0%	4.4%
		Iron & Steel	4	-31.0%	19.0%	29.9%	12.2%
		Non-ferrous Metals	11	-4.6%	10.8%	11.2%	5.3%
		Energy Resources	3	-2.7%	17.5%	19.6%	13.4%
		Auto & Transport Equipment	14	2.0%	7.5%	5.1%	6.1%
		Machinery	14	-1.1%	0.4%	6.4%	8.3%
		Electrical Appliances	31	-2.8%	9.6%	11.1%	7.4%
		Glass & Ceramic Products	8	1.3%	7.2%	8.2%	13.3%
		Food	13	0.9%	6.2%	6.2%	8.8%
		Pharmaceuticals	7	-27.4%	26.6%	105.1%	83.0%
		Pulp & Paper	2	14.2%	5.3%	10.5%	12.1%
		Other manufacturing	3	5.0%	4.2%	9.0%	3.1%
		Retail	8	5.7%	9.9%	10.3%	6.2%
		Transportation & Logistics	15	2.3%	6.9%	8.6%	3.2%
		Construction & Real Estate	15	13.5%	1.8%	3.6%	3.2%
		Information & Communication	7	-18.1%	1.7%	6.0%	9.4%
		Services	8	4.5%	17.8%	2.8%	2.9%
Other Nikkei 225 co's (not included in the above; figures based on net income)							
	Sub-total:		32	16.4%	0.9%	-0.4%	1.0%
		Electric Power & Gas	5	23.1%	1.2%	-12.4%	-9.6%
		Wholesale Trade	7	6.3%	0.5%	0.0%	4.5%
		Financials	20	22.3%	1.0%	1.4%	0.7%
FX assumptions		JPY/ USD		110	110	110	
		JPY/ EUR		120	125	120	
Total							
	Domestic/external demand sectors		185	-3.0%	7.7%	10.2%	8.7%
		External sectors	99	-0.9%	8.1%	8.8%	7.1%
		Domestic sectors	86	-5.5%	7.2%	11.8%	10.6%

Notes:
1. FY 2019 is from April 2019 to March 2020 and FY 2020 is from April 2020 to March 2021.
2. Consensus numbers are taken from the Japan Company Handbook published by Toyo Keizai Inc.
3. Where the consolidated parent co. and subsidary are both included in the Nikkei 225, we excluded the subsidary to avoid double accounting.
4. Each percentage is shown as compared with the corresponding period of a year earlier

Comments on the earnings forecast of major sectors for FY2019 and FY2020 are shown in Figure 2.

Figure 2. Comments on Earnings Forecast for FY2019/FY2020 of the Major Sectors

Sector	Year	Comments
Chemicals & Textile	FY2019	Profits are expected to increase due to stable growth of toiletries businesses, an increase in the volume of specialty chemicals, and the effects of structural reforms at specified companies.
	FY2020	Profits are expected to increase due to stable growth in toiletries, recovery in demand related to electronics, and an increase in the volume of specialty chemicals.
Iron & Steel	FY2019	Profits are expected to decline due to declining margins due to rising prices of material cost, iron ore.
	FY2020	Profits are expected to increase due to cost reduction, stability of material cost, and recovery of crude steel production.
Non-ferrous Metals	FY2019	Profits are expected to decline due to the deterioration of the electronics-related business and the sluggish non-ferrous metal prices.
	FY2020	Profit is expected to increase due to the recovery of the electronics-related business.
Energy Resources	FY2019	Profits are expected to decline due to declining petrochemical margins and falling prices of resources such as copper and coal.
	FY2020	Profits are expected to increase due to business expansion arising from resource development project and synergies effect on integration.
Auto and Transportation Equipment	FY2019	Despite a slight decline in auto sales, the impact of exchanges rates and an increase in raw material prices and expenses, profits are expected to increase owing to a decline in quality costs and temporary factors.
	FY2020	Although vehicle sales are flat, profits are expected to increase as the impact of raw material prices is expected to peak out.
Machinery	FY2019	Profits are expected to decline in businesses associated with strong economic cycles such as machine tools and bearings.
	FY2020	Demand in capital investment such as machine tool orders will bottom out in FY19 based on the past average cycle, and profit will increase in FY2020.
Electrical Appliances	FY2019	Profits are expected to decline due to temporary factors such as structural reform.
	FY2020	Profits are expected to increase due to expansion of vehicle related equipment.
Glass & Ceramic Products	FY2019	Profits are expected to increase due to increase in cement prices and stabilization of raw fuel prices.
	FY2020	Profits are expected to increase due to operational improvement among glass companies and the stabilization of raw material prices.
Food	FY2019	The sluggish top-line growth, rising costs of raw material prices and labor cost, as well as temporary factors in some names, will weigh on earnings outlook.
	FY2020	Profits are expected to increase partly due to a rebound of temporary factors. However, the profit growth would be a single digit only as a severe cost increase will be a drug in the sector as a whole.
Pharmaceuticals	FY2019	New drugs are driving a growth, but profits are expected to decrease due to a revision of medical fee following the consumption tax hike and large acquisition costs.
	FY2020	Although a drug price revision is expected in April, profits are expected to increase due to a drop in large-scale acquisition costs and a growth driven by new drugs.

Sector	Year	Comments
Retail	FY2019	As private spending is expected to be weaker after the consumption tax hike, retailers will change their price policies and strengthen sales promotion especially in the second half.
	FY2020	Profits continue to increase while absorbing an increase in personnel and logistic costs due to changes in cost structure resulting from structural reforms.
Construction & Real Estate	FY2019	Profits are expected to increase due to improvement in the profit margin among construction companies as well as an increase in rent and sales gains of real estate.
	FY2020	Profits are expected to increase due to an increase in rent and sales gains of real estate.
Information & Communication	FY2019	Profits are expected to decrease due to intensifying competition amid new entry and the introduction of a new fee system by some mobile carriers.
	FY2020	Although the impact from new fee plans and new entry will continue, profits are expected to recover slightly due to the cost efficiency of each company and gains from non-communications monetization.
Wholesale Trade	FY2019	Profits are expected to increase due to a rebound from temporary losses in the previous fiscal year, the same level of resource prices and growth in non-resource businesses.
	FY2020	The non-resource businesses continue to grow, but the growth will remain flat due to a decline in resource prices.
Financials	FY2019	Profits are expected to increase due to structural reforms and the removal of losses by special factors in the previous year.
	FY2020	Profits are expected to increase due to progress of structural reform.

• Changes since the end of March: With the global economy showing signs of a slowdown, we have revised downwards our earnings forecast for external demand-related companies. In addition, our forecast reflects the impact of large scale overseas acquisitions by domestic demand-related companies.

2. SuMi TRUST has also updated the view on impact of US-China trade frictions on Japanese companies

Intensifying trade frictions have resulted in an increased the number of bankruptcies, higher unemployment and sluggish consumption in China. It has also impacted some Japanese companies there as well. Additional risks include falling investments into China, changes in the supply chain, and additional tariffs by the US. On the other hand, this increases business opportunities and should improve Sino-Japanese relations. Furthermore, we can expect monetary relaxation measures and stimulus policies to underpin the economy, and thus do not see much more downside for Japanese companies.

For Japanese companies, the slowdown in external demand and sluggishness in personal consumption from higher consumption taxes will become a burden. But economic stimulus measures to counter higher taxes, and rising wages stemming from the tight labour market, should keep the Japanese economy on a path of gradual expansion. Whilst we expect lower earnings for FY 2019, FY 2020 should see higher earnings.

Disclaimer – UK

This marketing communication is issued by Sumitomo Mitsui Trust International Limited (“SMTI”). SMTI is authorised and regulated by the United Kingdom’s Financial Conduct Authority (the “FCA”), whose address is 12 Endeavour Square, London, E20 1JN, United Kingdom.
This marketing communication has been made available to you only because SMTI has classified you as a professional client in accordance with the FCA’s rules. If you have received this marketing communication from a source other than SMTI, you should contact SMTI before using it or relying on it. You must not send this marketing communication to any other person without first having received written approval from SMTI.
The information contained in this marketing communication (the “Material”) is being made available for information purposes only and is designed to provide information on the investment services which SMTI may offer to clients.
Nothing in the Material amounts to or should be construed as an actual offer by SMTI to provide any investment services to any person. If SMTI agrees to provide any investment services to any person, those services will be the subject of a separate written agreement between SMTI and that person. Furthermore,
the Material has not been prepared with any consideration of the individual circumstances of any person to whom it is communicated.
Accordingly, it is not intended to, and does not, constitute a personnel recommendation in relation to the purchase or sale of, or exercise of any rights in relation to, any financial instruments or advice in relation to any investment policy or strategy to be followed. The Material also does not contain the results of any investment research carried out by SMTI and is not intended to amount to a financial promotion of any particular financial instrument which may be referred to in it.
While SMTI uses all reasonable endeavours to ensure the Material is accurate, it has not been prepared with a view to any person relying on it. Accordingly, SMTI accepts no responsibility for any loss caused to any recipient of this document as a result of any error, inaccuracy or incompleteness in the Material, nor for any error in the transmission or receipt of this communication.

Any enquiries regarding the products should be made to:
Hirofumi Hayashi
Head of Investment Management Department
Sumitomo Mitsui Trust International Limited
155 Bishopsgate, London EC2M 3XU, United Kingdom
Direct: +44 (0)20 7562 8405
Email: imd@smtil.com
Sumitomo Mitsui Trust International Limited is authorised and regulated by the Financial Conduct Authority