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 growth in personal consumption spurred on by real wage rises and increased capital investments to tackle labour shortages. However, we believe economic recovery will only be gentle given uncertainty over US trade policy and concerns over economic downturns overseas.

Japan’s core CPI (excluding perishables) was up 3.2% YoY in January (December: 3.0%). We believe core CPI growth will remain around 2.5-3.0% because policies aimed at curbing rapid changes in electricity and gas bills will put downward pressure on prices while the increase in import prices caused by JPY depreciation will create upward pressure.

We expect the BoJ to continue to scale back easy monetary policy. However, further rate hikes will likely come in slow given that central banks in the US and Europe have already shifted to easing cycles and that the BoJ will be cautiously keeping watch of the impact ending easy monetary policy will have on the Japanese economy.

Bond Market

Expecting Slight Rate Growth

◆ Review

10-year JGB yields rose (prices fell) in February. Yields rose as expected inflation rose on the BoJ signaling it will raise rates further and inflation rose as price increases took root.

◆ Outlook

We believe interest rates will increase slightly. Japanese interest rates will be subject to upward pressure as the BoJ will move away from easy monetary policy. However, growth will likely be moderate because rate hikes may be slow given BoJ officials will be looking to determine the impact of US trade policy.

Stock Market

Near-term Upside Resistance

◆ Review

The Japanese equity market fell in February. The fall was the result of concerns over Trump tariffs and economic decline as well as JPY appreciation caused by the shrinking interest rate differential between the US and Japan.

◆ Outlook

We expect the market will face upside resistance over the near term.

Japanese corporate earnings will likely grow on the back of positive factors like recovering domestic real wages, the cyclical recovery to manufacturing, and capital efficiency improvement measures implemented by companies following pressure from the Tokyo Stock Exchange (TSE).

Valuations, such as forward PER, have fallen on concerns over strengthened tariffs from the US and JPY appreciation caused by the different directions of US and Japanese monetary policy. We expect share price volatility to grow until the market has a clearer view on tariff policy. As such, it will take some time before valuations recover. That said, it is difficult to envision a large correction to the Japanese market given strong equity demand from large-scale share buybacks and the BoJ’s relatively accommodative monetary policy compared to Europe and the US.

Economy & Financial Market Outlook: US

Economy

Expecting Instability

We expect instability in the US economy. While employment data is strong, investors are aware of the impact deteriorating sentiment and changes to asset prices will have on actual consumption amidst increasing uncertainty around policy such as tariffs.

Core PCE inflation (excluding perishables and energy), was up 2.6% YoY in January (up 2.9% in December). The unemployment rate was 4.1% in February (January: 4.0%).

After the January FOMC meeting, Fed chair Jerome Powell stated that he believes there is no need to rush monetary policy changes while there is so much uncertainty around the impact those policy changes will have. The US economy could now face a sharp shift on the back of trade policy changes and uncertainty around monetary policy is growing as what those policies will be and the impact they will have remains uncertain.

Bond Market

Rates to Stay Put in Near Term, Then Down

◆ Review

10-year US yields fell (prices rose) in February. Yields fell because retreating concerns over deteriorating demand for treasuries and uncertainty over the economic impact Trump tariffs will have.

◆ Outlook

We expect rates will likely move sideways over the near term and then shift downward. The Fed will likely be very careful in considering further rate cuts, keeping a careful eye on the impact Trump tariffs will have on the economy and inflation amidst concerns tariffs will slow the economy. This readily causes continued uncertainty surrounding further rate cuts and will likely lead to rates moving sideways over the near term. Over the longer term we expect rates to fall as the market will price in fed cuts. The market will do this because of the expected slowdown in the labour market and core CPI falling to below 3.0% given the tightening we have seen so far.

Stock Market

Sensitive Given Trump Policy Uncertainty

◆ Review

The US equity market fell in February given uncertainty over US tariff policy and the shift to a risk-off mood on the back of concerns over the US economy.

◆ Outlook

We expect the US equity market to experience upside resistance. We are seeing a break in the growth of generative AI names, which were previously driving market growth, since the release of a lower-cost AI model in China.

We believe that uncertainty over the effects of Trump policies, foremost tariff policy, will lead to sensitive market movements in the near term.

Currency Market

Gentle USD Depreciation vs. JPY

◆ Review

USD depreciated versus JPY in February as the interest rate differential between the US and Japan shrunk. Japanese rates rose on the back of posturing for further rate hikes at the BoJ and US long-term rates fell on domestic economic uncertainty.

◆ Outlook

We expect USD to depreciate versus JPY at a gentle pace. Depreciation will result from the Fed looking to cut rates again on the back of concerns over an economic slowdown in the US and the BoJ continuing to move away from accommodative monetary policy. However, USD depreciation 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

Chance of Move Away From Slow Growth

Europe may soon escape its stagnant economic growth as investors are starting to believe there will be an end to rate cuts given the slow economy and because of expectations around a shift in fiscal policy in Germany.

The region's core CPI (excluding volatile perishables and energy) recorded positive growth of 2.6% (YoY) in February (January: 2.7%).

The ECB cut its policy rate by 25 basis points for the fifth time in a row at its February meeting. However, it then went on to signal a move away from rate cuts as the current rate is close to the neutral rate. The region's economy continues to stagnate and the outlook is growing more opaque because of uncertainty surrounding Trump trade policy and the situation in Ukraine.

Bond Market

Rates to Remain High

◆ Review

German 10-year yields fell (prices rose) slightly in February. Downward pressure on yields came from a break to the increase in energy prices (natural gas, etc.) and the fall in US rates. However, the decline was slight because of concerns over a German fiscal expansion.

◆ Outlook

We expect interest rates will likely remain high as concern will likely remain over Europe relaxing fiscal rules to expand defense spending, monetary policy is becoming less tight and the ECB has signaled a halt to rate cuts.

Stock Market

Further Strength on Easing Expectations

◆ Review

The European equity market rose in February on the back of earnings outpacing expectations, hopes of a ceasefire between Russia and Ukraine, and expectations for the ECB to cut rates.

◆ Outlook

We expect the market to remain strong. While concerns remain over global economic deterioration on the back of Trump's tariff policy as well as geopolitical risks, we expect the European market to remain strong as valuation multiples are now adjusting upward because of monetary easing after having trailed behind US equities.

Currency Market

EUR to Maintain Level vs JPY

◆ Review

EUR depreciated versus JPY in February.

Expectations of a bottom-out in Eurozone economic sentiment and ceasefire negotiations for the war in Ukraine provided upward pressure for EUR. However, this was outshone by JPY upward pressure caused by the BoJ maintaining that it would continue to lift rates.

◆ Outlook

We expect the BoJ to continue moving away from accommodative monetary policy and believe this will provide upward pressure for JPY. However, we also believe that fiscal expansion in Europe will boost the economy, keep interest rates high, and support EUR. As such, we think EUR will remain largely unchanged versus JPY.

Economy & Financial Market Outlook: Emerging Market

Economy

EM Slowing But Stronger than Developed

The Chinese government has set its GDP growth target for 2025 at around 5%, the same as in 2024. With US-China trade frictions heating up, there is a risk the country could undershoot this target. That is why we believe the Chinese government will announce further economic stimulus measures focusing on increased fiscal spending. Fixed asset (real estate) investment remains sluggish but we are seeing signs of recovery in some areas. For example, total social financing and amount spent on smartphones are growing at a strong pace on the back of economic stimulus measures, including monetary easing and subsidies.

While Trump's protectionist tariffs will have a negative impact on emerging economies, we believe they will still perform better than developed economies given that domestic demand is strong and inflationary pressure is easing.

Bond Market

Yields to Fall Gradually

◆ Review

Emerging market yields were roughly flat in overall in February, with some countries seeing higher yields and some seeing lower. For example, yields rose in Turkey, where CPI figures overshot expectations, but fell in Mexico, where Trump extended tariffs.

◆ Outlook

We expect emerging country yields to slowly decrease. We think it will be very difficult for emerging economies to cut rates significantly given that they will try to protect their currencies against depreciation. All the while, expectations for rate cuts in the US are declining given its strong economy. However, we do expect emerging yields to fall slowly while the US makes gradual cuts as emerging nations are seeing reduced inflationary pressure.

Stock Market

Expecting Strength

◆ Review

Emerging market equities rose (local currency basis) in February. The stock market, led by semiconductor names, fell at the beginning of the month following the late-January announcement of a low-cost generative AI model out of China and the subsequent concerns of a drop in demand for AI chips. Share prices then rose consistently through the middle of the month as we saw cyclical stock picking in Chinese AI names and the concerns abated over a strengthening of regulations on Chinese internet companies following the Chinese government's symposium with industry leaders. The market then rebounded down through the end of the month as US semiconductor names fell and reports came out that the Trump administration was considering tightening semiconductor regulations pertaining to China. However, overall the market was up for the month.

◆ Outlook

We expect emerging market equities to be strong going forward. We expect volatility over the short term, dictated by daily news flow, as the back and forth between the US and China regarding trade and advanced technologies will likely be in a loop of perceived progress and regression. Currently stock-picking is concentrated in a few AI stocks but we expect this to expand to names that can benefit from productivity gains through the use of AI. This should act as support for the market.

Currency Market

Upside Resistance Over Short Term, Then Up

◆ Review

Emerging market currencies depreciated versus JPY in February as JPY was bought on heightened expectations for a BoJ rate hike. EM currencies rose versus USD because of the drop in US rates. The Turkish lira depreciated as expectations heightened for continued rate cuts by the central bank. The Brazilian real depreciated as a reaction to its increase last month and to Trump tariff policy.

◆ Outlook

We expect emerging market currencies as a whole to face upside resistance over the near term given USD strength coming from the strength of the US economy and concerns over Trump's trade policies.

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.

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.

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