

## Japan Strategy Views

## Thoughts on TOPIX P/E range after recent rally

After a lackluster performance up to the third week of June, Japanese stocks have been making strong gains since the last week of June. This sharp rise in share prices was a bit of surprise to us, as the rise occurred earlier than we expected given we believed that an improvement in the macro environment would be necessary for Japanese stocks to break out of their recent range and see a sustained rise. We think initial price moves were mainly led by positioning and technical factors, but probably medium-term general positive views on Japanese stocks are also an underlying factor. It also appears that the market front-loaded some of the positive catalysts ahead.

We revise our TOPIX earnings forecasts. Our new forecasts call for EPS growth of +10%/+9%/+7% in FY2024-FY2026, and the cumulative 29% growth over the next three years should underpin the Japan market's move higher.

The TOPIX has now reached the upper end of our assumed P/E range of 15.0-15.5X. Given the backdrop of the recent rally, described above, further upside may be limited in the near-term until there is more evidence of a shift in fundamentals that we expect in 2H. While we do not expect a major correction, we note uncertainties around political events in Japan and the US, as well as weak upcoming seasonality, which warrant caution.

In our view, additional positive developments that could drive further upward shift of the P/E range include a stronger virtuous cycle between wages and prices with an upgrade in the domestic economic outlook, a reversal of the weak yen trend, progress in corporate governance, and further participation by individual investors.

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## 1. TOPIX/Nikkei break out

TOPIX closed at 2,772 at the end of May and 2,810 at the end of June, roughly in line with our 3-month forward TOPIX target of 2,800 as of our [March 1](#) and [April 1](#) reports. [Japanese stock performance was lackluster until the third week of June](#), but sharp gains since the last week of June have been attracting attention. On July 4, TOPIX reached a new all-time high, surpassing the previous record set 34 years ago.

[We thought](#) that a recovery in domestic demand and an improvement in the macro environment would be necessary for Japanese stocks to break out of their range and see a sustained rise. We also highlighted that 1Q earnings could be a catalyst. The recent earlier-than-expected sudden rise in share prices therefore came as a bit of a surprise to us.

We think initial price moves were mainly led by positioning and technical factors without any notable changes in fundamentals, but probably medium-term general positive views on Japanese stocks are also an underlying factor. It also appears that the market front-loaded some of the positive catalysts ahead, such as an expected solid 1Q earnings and a recovery in real wages/domestic consumption in the summer.

**Exhibit 1: The Nikkei 225 and TOPIX have broken out of their recent ranges**



Source: Bloomberg

**Exhibit 2: Following the Nikkei's move beyond its bubble-era high in February, TOPIX has now also exceeded its bubble-era high**



Source: Bloomberg

## 2. Raising our TOPIX EPS forecasts

We revise our TOPIX earnings forecasts to reflect the stronger-than-expected [4Q3/24 results](#), changes to our forex assumptions (USD/JPY to ¥155/¥150 from ¥150/¥145 for FY2024/25), and our economists' latest macro assumptions. Our new forecasts call for EPS growth of +10%/+9%/+7% in FY2024-FY2026, cumulative 29% growth over the next three years, following the 18% growth seen in FY2023. In addition to the weaker yen on the currency markets, we think the inflationary environment in Japan will boost earnings.

The TOPIX earnings revision index had been on a downward trend in April-May due to cautious guidance issued at the beginning of the fiscal year, but started to rebound and rise in June, as consensus earnings forecasts are moving upward.

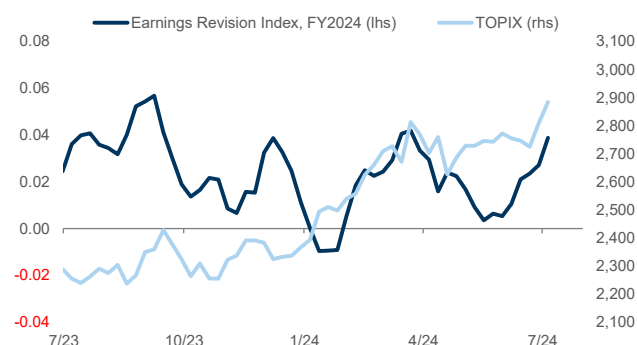
**Exhibit 3: TOPIX earnings forecast: We estimate 29% EPS growth over the next three years, following 18% growth in FY2023**

	FY2023	FY2024		FY2025		FY2026
	Actual	Consensus	GS Est.	Consensus	GS Est.	GS Est.
YoY, %						
Sales	5.4	3.0	4.0	3.2	2.2	2.8
Recurring Profit	15.0	8.1	9.9	9.3	8.1	6.6
EPS	17.8	8.4	10.1	10.2	9.3	7.4
EPS (¥)		184.4	187.3	203.1	204.6	219.7

Our FY2024-FY2026 USD/JPY assumptions are ¥155/¥150/¥150

Source: Goldman Sachs Global Investment Research

**Exhibit 4: Japanese companies' earnings forecasts have been revised upward recently**



Source: I/B/E/S, FactSet, Data compiled by Goldman Sachs Global Investment Research

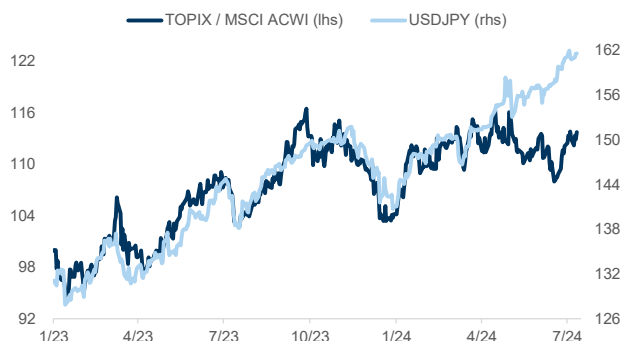
### 3. Correlation between JPY weakness and Japanese stocks is back

One of the notable developments in the Japanese stock market in 2Q was the breakdown of the correlation between forex and Japanese stocks, with the weaker yen no longer providing a tailwind for Japanese equities. However, we note with interest that the correlation between the weaker yen and higher Japanese share prices seems to have returned from late June. Nevertheless, we are skeptical about whether it will continue. If the yen weakens further from the current level, we think the side effects could become more pronounced and yen weakness may not be seen as a positive.

Our sensitivity analysis shows that a ¥10 depreciation of the yen would increase profits by 3.5%, but we think the benefits of further yen depreciation from this level are likely to be smaller than our sensitivity analysis suggests, due to the increasing negative impact on real disposable income and domestic consumption. On the side note, if the virtuous cycle between wages and prices strengthens and the pace of yen depreciation is moderate, then the emergence of side effects could be delayed.

The weaker yen trend could stop or reverse due to weaker US growth/inflation data and rising expectations for US rate cuts. If the trend were to shift to moderate yen appreciation, we believe it would create a more favorable environment for long-term investors who do not hedge their currency exposure to invest in Japanese equities. The recent buying of Japanese stocks may also reflect in part the somewhat weaker US economic data.

**Exhibit 5: The correlation between the weaker yen and higher share prices, which had broken down in 2Q, returned from late June**



Source: MSCI, Bloomberg

**Exhibit 6: Our sensitivity analysis shows that a 10-yen depreciation/appreciation of the yen would increase/decrease profits by 3.5%, but the benefits of yen depreciation are likely to be smaller due to the increasing side effects**

* GS assumption							
USDJPY	130	140	145	150	155 *	160	165
FY24 EPS growth	0.5%	4.3%	6.2%	8.2%	10.1%	12.0%	14.0%
FY24 EPS (¥)	171	177	181	184	187	191	194

Source: Goldman Sachs Global Investment Research

## 4. Positive micro developments

While the sharp rise in Japanese stocks since late June has been attracting attention, we would also highlight the positive micro developments that were seen during the preceding period of weakness.

- Share buyback announcements remained brisk after increasing sharply in April-May, with Recruit announcing a ¥600 bn buyback program this month, bringing the overall total for the year to over ¥10 tn, which already exceeds last year's level.
- AGMs have become more *live*, with the percentage of votes supporting CEO/director nominations fluctuating significantly depending on how management's performance is viewed. Since the unwinding of cross-shareholdings will reduce the number of stable shareholders, we think shareholder meetings could become even more lively going forward. We plan to look at AGMs in more detail in a future report.
- TOPIX review (new rules for TOPIX constituents): The Tokyo Stock Exchange has announced new rules related to the forthcoming TOPIX review. The number of constituent companies is expected to decline to about 1,200, increasing pressure on companies to achieve profit growth and valuation expansion.

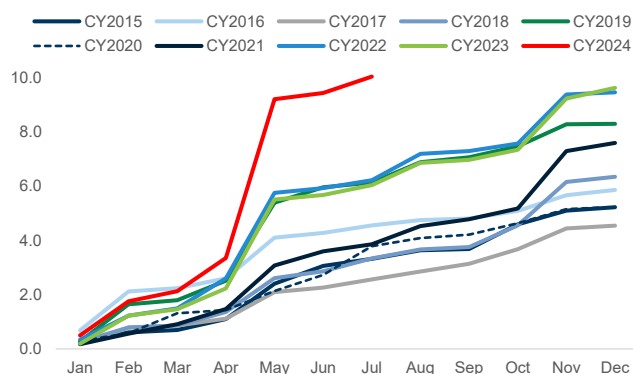
**Exhibit 7: AGM approval ratings**

6M ADTV &gt; \$20mn

Ticker	Name	Latest FY	Previous Rating	Latest Rating	Latest vs prev.
7751	CANON INC	12/2023	50.6%	90.9%	+40.3%
9503	KANSAI ELEC POWER	03/2024	66.2%	97.9%	+31.7%
5021	COSMO ENERGY HLDGS	03/2024	67.1%	96.3%	+29.3%
9508	KYUSHU ELEC POWER	03/2024	68.6%	96.8%	+28.2%
8316	SUMITOMO MITSUI FG	03/2024	67.3%	94.6%	+27.3%
7003	mitsui E&S CO LTD	03/2024	70.4%	95.9%	+25.5%
6417	SANKYO CO LTD	03/2024	71.3%	96.4%	+25.1%
9434	SOFTBANK CORP	03/2024	76.2%	99.2%	+23.0%
3382	SEVEN & I HOLDINGS	02/2024	76.4%	95.6%	+19.2%
9506	TOHOKU ELEC POWER.	03/2024	78.8%	97.4%	+18.6%
5803	FUJIKURA	03/2024	72.0%	90.2%	+18.2%
4324	DENTSU GROUP INC	12/2023	65.6%	81.3%	+15.7%
9766	KONAMI GROUP CORP	03/2024	82.2%	97.7%	+15.5%
9201	JAPAN AIRLINES CO	03/2024	82.6%	97.2%	+14.7%
7202	ISUZU MOTORS	03/2024	82.2%	96.0%	+13.8%
7911	TOPPAN HOLDINGS IN	03/2024	69.2%	82.2%	+12.9%
4661	ORIENTAL LAND CO	03/2024	82.7%	95.1%	+12.4%
7951	YAMAHA CORP	03/2024	87.7%	98.7%	+11.0%
6323	RORZE CORP	02/2024	80.1%	89.8%	+9.7%
9502	CHUBU ELEC POWER	03/2024	71.5%	80.4%	+8.9%
3659	NEXON CO LTD	12/2023	78.7%	87.5%	+8.8%
6367	DAIKIN INDUSTRIES	03/2024	88.4%	96.8%	+8.4%
7974	NINTENDO CO LTD	03/2024	83.8%	92.0%	+8.2%
4107	ISE CHEMICALS CORP	12/2023	89.5%	97.6%	+8.1%
1801	TAISEI CORP	03/2024	66.0%	73.7%	+7.8%
3132	MACNICA HLDGS INC	03/2024	91.6%	99.3%	+7.7%
2801	KIKKOMAN CORP	03/2024	79.4%	86.7%	+7.3%
3563	FOOD & LIFE COMPAN	09/2023	86.7%	92.8%	+6.1%
8795	T&D HOLDINGS INC	03/2024	77.2%	82.5%	+5.3%
8697	JAPAN EXCHANGE GP	03/2024	88.9%	94.1%	+5.2%

Ticker	Name	Latest FY	Previous Rating	Latest Rating	Latest vs prev.
6504	FUJI ELECTRIC CO.	03/2024	91.0%	85.1%	-5.9%
4005	SUMITOMO CHEM CO	03/2024	91.9%	85.7%	-6.2%
7276	KOITO MFG CO LTD	03/2024	88.2%	81.4%	-6.8%
8830	SUMITOMO RLTY&DEV	03/2024	87.0%	80.0%	-7.0%
4519	CHUGAI PHARM CO	12/2023	91.7%	84.7%	-7.0%
4755	RAKUTEN GROUP INC	12/2023	89.5%	82.2%	-7.3%
8227	SHIMAMURA CO	02/2024	90.4%	83.0%	-7.4%
7259	AININ CORPORATION	03/2024	98.4%	90.8%	-7.6%
6586	MAKITA CORP	03/2024	95.4%	87.5%	-7.9%
7912	DAI NIPPON PRINTNG	03/2024	82.7%	74.6%	-8.1%
9531	TOKYO GAS CO	03/2024	98.5%	90.4%	-8.1%
5332	TOTO LTD	03/2024	96.9%	88.7%	-8.2%
3407	ASAHI KASEI CORP	03/2024	97.9%	89.7%	-8.2%
8411	MIZUHO FINL GP	03/2024	86.0%	77.0%	-9.0%
2127	NIHON M&A CENTER H	03/2024	96.9%	87.5%	-9.4%
3994	MONEY FORWARD INC	11/2023	93.4%	84.0%	-9.5%
9432	NIPPON TEL&TEL CP	03/2024	94.1%	84.0%	-10.1%
8306	mitsubishi UFJ FIN	03/2024	75.9%	64.6%	-11.4%
7013	IHI CORPORATION	03/2024	90.1%	78.2%	-11.9%
3697	SHIFT INC	08/2023	97.8%	84.9%	-12.9%
8309	SUMITOMO MITSUI TR	03/2024	83.7%	70.0%	-13.6%
6315	TOWA CORP	03/2024	99.0%	83.1%	-15.9%
8766	TOKIO MARINE HLDG	03/2024	83.0%	66.9%	-16.0%
6971	KYOCERA CORP	03/2024	81.1%	64.8%	-16.3%
9984	SOFTBANK GROUP CO	03/2024	95.9%	79.2%	-16.7%
4502	TAKEDA PHARMACEUTI	03/2024	95.7%	76.2%	-19.5%
8630	SOMPO HOLDINGS INC	03/2024	83.4%	61.5%	-21.9%
3038	KOBE BUSSAN CO LTD	10/2023	90.3%	67.0%	-23.3%
6753	SHARP CORP	03/2024	88.9%	63.6%	-25.3%
8473	SBI HOLDINGS INC	03/2024	94.3%	61.1%	-33.2%

Source: Company data, Data compiled by Goldman Sachs Global Investment Research

**Exhibit 8: Announced share buybacks have already exceeded last year's record level**  
JPY tn

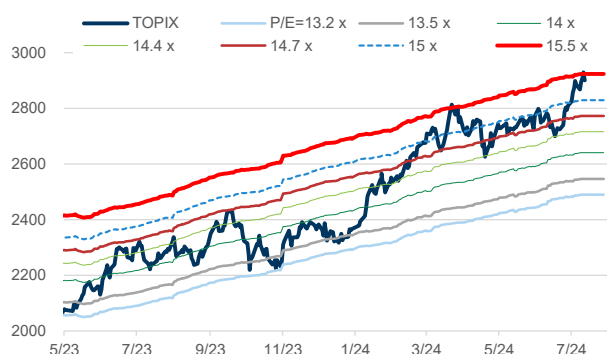
Source: QUICK, Data compiled by Goldman Sachs Global Investment Research

**5. Thoughts on TOPIX P/E range**

The TOPIX has now reached the upper end of our assumed P/E range of 15.0-15.5X. This is also the P/E level at which the index peaked in late March. Given the backdrop of the recent rally, described above, further upside may be limited in the near term until there is more evidence of a shift in fundamentals that we expect in 2H, including solid 1Q earnings and evidence of a strengthening recovery in domestic demand. While we do not expect a major correction, we note uncertainties around political events in Japan and the US, as well as weak upcoming seasonality, which warrant caution.

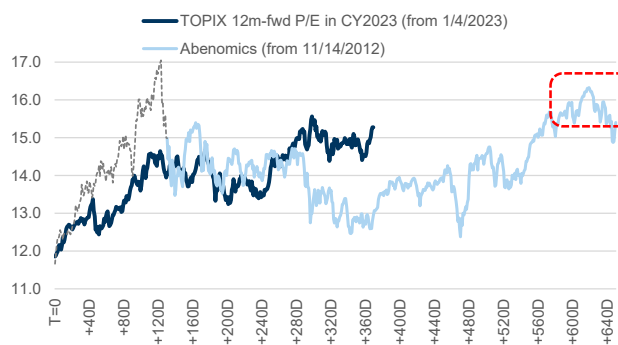
In our view, additional positive developments that could drive further upward shift of the P/E range include a stronger virtuous cycle between wages and prices with an upgrade in the domestic economic outlook, a reversal of the weak yen trend, progress in corporate governance, and further participation by individual investors. If the TOPIX were to break out of its current range, we think the Abenomics peak of 16.3X (May 2015) would be investors next focus.

**Exhibit 9: TOPIX has reached the upper end of our assumed P/E range (15.0-15.5x)**



Source: FactSet, Data compiled by Goldman Sachs Global Investment Research

**Exhibit 10: Excluding the initial overshoot, the peak P/E during Abenomics was 16.3x**



Source: FactSet, Data compiled by Goldman Sachs Global Investment Research

**Exhibit 11: 3m and 12m forward TOPIX levels based on USD/JPY and P/E levels**

3-month forward TOPIX level

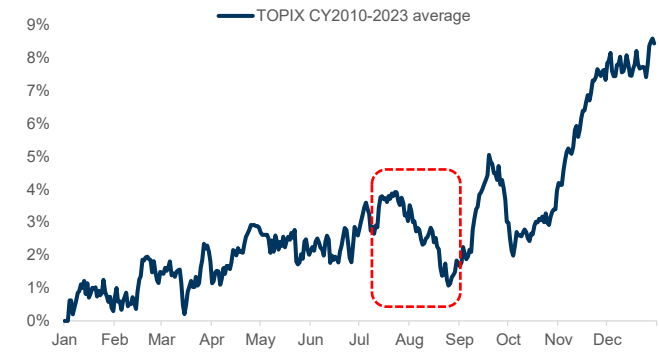
		USDJPY						
		130	140	145	150	155	160	165
Forward P/E	13.0	2,305	2,393	2,437	2,482	2,526	2,570	2,614
	13.5	2,393	2,485	2,531	2,577	2,623	2,669	2,715
	14.0	2,482	2,577	2,625	2,672	2,720	2,768	2,815
	14.5	2,571	2,669	2,719	2,768	2,817	2,867	2,916
	15.0	2,659	2,761	2,812	2,863	2,914	2,965	3,016
	15.2	2,695	2,798	2,850	2,902	2,953	3,005	3,057
	15.3	2,713	2,817	2,869	2,921	2,973	3,025	3,077
	15.5	2,748	2,853	2,906	2,959	3,012	3,064	3,117
	16.0	2,837	2,945	3,000	3,054	3,109	3,163	3,217
	16.3	2,890	3,001	3,056	3,112	3,167	3,222	3,278

12-month forward TOPIX level

		USDJPY						
		130	140	145	150	155	160	165
Forward P/E	13.0	2,472	2,567	2,614	2,662	2,709	2,757	2,804
	13.5	2,567	2,666	2,715	2,764	2,814	2,863	2,912
	14.0	2,662	2,765	2,816	2,867	2,918	2,969	3,020
	14.5	2,758	2,863	2,916	2,969	3,022	3,075	3,128
	15.0	2,853	2,962	3,017	3,071	3,126	3,181	3,236
	15.2	2,891	3,002	3,057	3,112	3,168	3,223	3,279
	15.3	2,910	3,021	3,077	3,133	3,189	3,244	3,300
	15.5	2,948	3,061	3,117	3,174	3,230	3,287	3,343
	16.0	3,043	3,159	3,218	3,276	3,335	3,393	3,451
	16.3	3,100	3,219	3,278	3,338	3,397	3,457	3,516

Source: Goldman Sachs Global Investment Research

Exhibit 12: Weak seasonality ahead



Source: Bloomberg, Data compiled by Goldman Sachs Global Investment Research

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