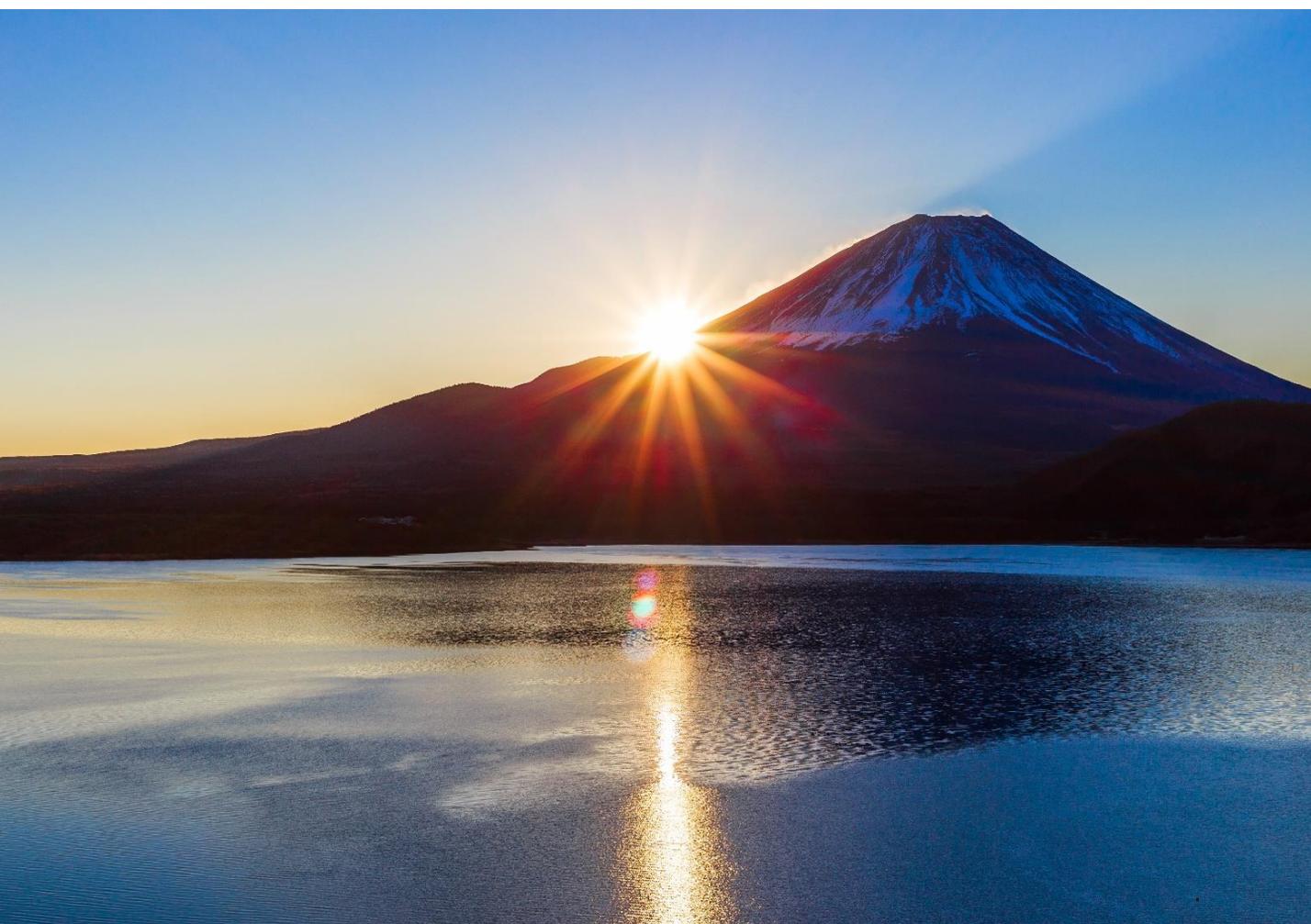


Asset Management One Co., Ltd.

Market Outlook 2021

December 2020



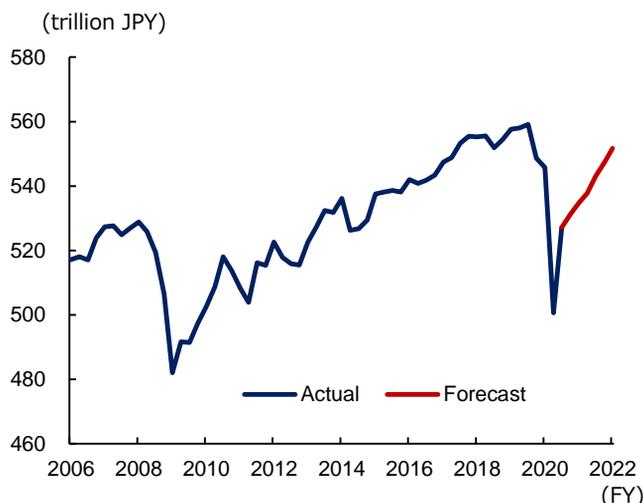
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Japan Economic Outlook

Japanese Economy

The Japanese economy bottomed out in the April-June quarter 2020 along with the global economy. Asset Management One expects a moderate pace of economic recovery in Japan for the foreseeable future, as the risk of a similar resurgence in the number of COVID-19 infections witnessed in Europe and the United States remains at the end of 2020. Given that rollout of vaccines has just begun in December 2020, Asset Management One expects vaccines to become available for the wider population in second half of 2021, this is likely to restrain the economic recovery and GDP to below pre-crisis levels at the end of 2021. Exports, which boosted GDP growth until last summer, are likely to slow to a more moderate pace of growth. It is reassuring, however, to note that bankruptcies and loss of jobs are well contained by policy measures, limiting the risk of a sharp fall in capital expenditure and consumption.

Japan Real GDP



In December 2020, the Japanese government has added an economic package worth over 73 trillion yen (\$708 billion) to fund additional and existing fiscal support, providing a sense of reassurance of policy continuity.

Forecast Summary

Calendar Year	2018 (Actual)	2019 (Actual)	2020 (Estimate)	2021 (Forecast)
Real GDP (YoY%)	0.6	0.3	-5.3	2.8
Core CPI (YoY%)	0.8	0.7	-0.2	-0.4
JGB 10-Year Yield (%)	0.00	-0.01	0.00	0.00
USD/JPY (¥)	109.7	108.7	105.0	108.0
TOPIX EPS	120.3	107.8	75.0	105.0
YoY%	2.0	-10.4	-30.4	40.0
TOPIX	1494	1721	1800	1900
YoY%	-17.8	15.2	4.6	5.6

Source: Bloomberg, FactSet, Asset Management One

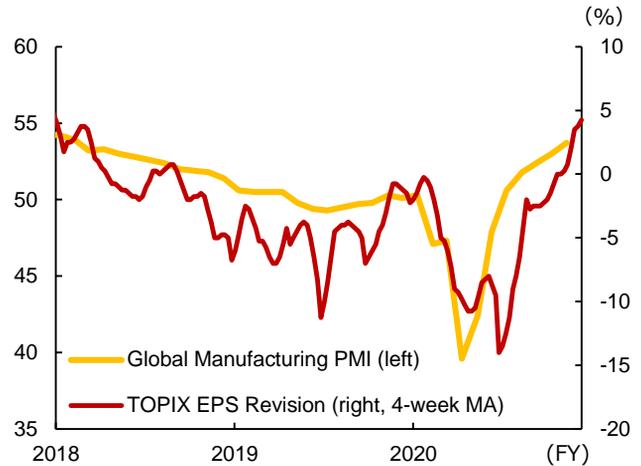
Japan Market Outlook

Equity market

In 2020, Japanese equities rose sharply with price-to-earnings multiple expansion despite the resurgence of COVID-19 since the autumn. Asset Management One has a constructive view on the market with improved earnings prospects in 2021. There are four factors that support our view. Firstly, monetary and fiscal policies are expected to remain accommodative and expansionary worldwide, including in Japan. Secondly, investors perceive Japanese stocks to be the most cyclical among global stock markets and are likely to buy as the economy normalizes and trade volume recovers. Thirdly, vaccines are expected to become widely available in Japan in the second half of 2021, further improving the prospects of Japanese corporate earnings. Fourthly, the Suga administration is likely to focus on policy implementations to support the economy for the time being, which is also positive for the stock market.

In terms of corporate earnings, market expectations for EPS are already being revised upwards as global manufacturing PMI improves. For CY2021, earnings are expected to increase by around 40% in terms of the TOPIX EPS, and depending on the resumption of economic activity, there may be room for further upside. The Tokyo Olympic and Paralympic Games, if they are held as currently planned, would give a significant boost to the tourism industry inviting visitors from overseas. Global recovery of economic activity may fuel at some point speculation of a rise in U.S. long-term interest rates, which may be detrimental to emerging market stock markets.

Global PMI and TOPIX EPS Revision*



Data: January 1, 2018 - December 9, 2020

Source: Refinitiv

*The number of upward revisions minus the number of downward revisions divided by the total number of stocks. Positive value indicates improving earnings momentum.

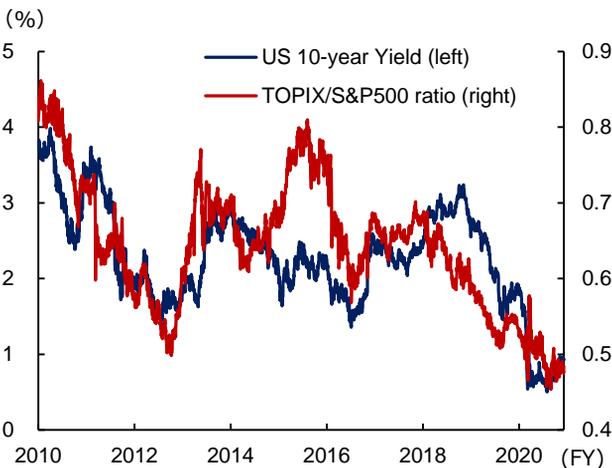
The fact that Japanese stocks have historically been positively correlated with U.S. long-term interest rates is reassuring. The Japanese stock market has tracked its peers in the United States in 2020, providing room for further upside in 2021. Based on our main scenario assumption of 40% rise in EPS amid ongoing accommodative monetary policy and economic recovery, Asset Management One expects the TOPIX index to reach 1,900 points and the Nikkei 225 Stock Average to reach 28,000 yen. Given the flush of liquidity pumped into the global financial markets central banks, the stock market may extend its gains towards 2,000 points in terms of TOPIX and 30,000 yen in terms of Nikkei.

Japan Market Outlook

Bond market

The Bank of Japan is most likely to maintain its current policy stance in 2021, with long-term interest rates, 10-year JGB yield, to remain within the target range. This trend will be further reinforced as investors become more convinced of the continuity of the Liberal Democratic Party led government post the general election of the House of Representatives, likely in Autumn of 2021. Despite ongoing concerns of a rise in overseas interest rates in the United States and other countries, the Bank of Japan's yield curve control (YCC) will keep domestic interest rates up to the 10-year zone under control. On a separate note, in the United States, where the labour market is expected to take time to recover, the Federal Reserve Board may introduce a policy similar to the BOJ's YCC to curb the rise in long-term interest rates.

10-Year UST Yield and TOPIX/S&P500 ratio

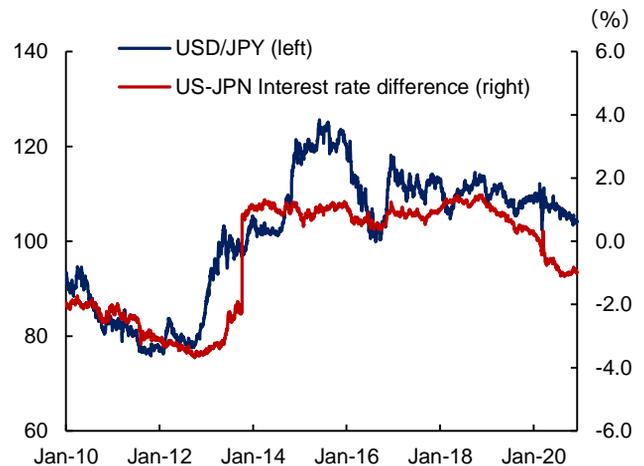


Data: January 4, 2010 - December 9, 2020
Source: Bloomberg

Foreign Exchange

In the foreign exchange market, movements to build up positions involving the Japanese yen are also likely to remain restrained, given the expectation that accommodative monetary policies will continue around the world. In this context, the Japanese yen is expected to trade weaker against the backdrop of the U.S.-led global economic recovery and domestic investors' continuous yen selling and purchase of foreign currency denominated assets in search of yield. The correlation between the USD/JPY exchange rate and Japanese equities has been declining, and the risk of a sharp correction in stock prices due to a stronger yen looks low for a while.

USD/JPY Currency and US-JPN Interest rate difference



Data: January 4, 2010 - December 9, 2020
Source: Bloomberg

Japan Market Outlook

Key themes for the Japanese stock market in 2021

Asset Management One has identified five key investment themes that are likely to dominate the Japanese stock market in 2021. The five investment themes include; (i) businesses responding to changes in social and economic structures in the wake of the COVID-19 pandemic; (ii) a recovery in visitors from overseas following the worldwide availability of vaccines; (iii) accelerated moves towards a decarbonised society and further expansion of ESG investment; (iv) digitalisation and digital transformation (DX); and (v) business and corporate consolidations.

With regard to (i) businesses responding to changes in social and economic structures in the wake of the COVID-19 pandemic, the prolonged COVID-19 pandemic has prompted an increasing number of companies in Japan to drastically review and change their working patterns and workplaces. Services and businesses that can cope with the post-COVID-19 environment are expected to grow. As for (ii) a recovery of visitors from overseas following the worldwide availability of vaccines, there is a possibility of a sharp recovery in inbound tourism due to pent-up demand triggered by hosting of the Tokyo Olympic and Paralympic games. With regard to (iii) accelerated moves towards a decarbonised society and further expansion of ESG investment, the Paris Agreement came into effect in 2020, but the Japanese government's responses have been slow and tracked its peer signatories. This is attributable to fluctuating energy policy following the Great East Japan Earthquake and the nuclear power plant disaster, as well as the government's considerations for the automobile and other manufacturing industries.

The Suga administration has finally announced a clear policy towards decarbonisation, and it is highly likely the pace towards a green society will pick up very quickly. As for (iv) digitalisation and digital transformation (DX), both the public and private sectors are likely to move forward with efficient digitalization, including building harmonized system infrastructure across governmental departments, thanks partly to DX investment promotion tax credits. In the case of (v) business and corporate consolidations, tax reform is underway to reduce the risks associated with the restructuring of small and medium-sized companies, which could lead to positive business and corporate consolidations.

Key themes in 2021

1	Business responses to changes in the post pandemic era
2	Vaccine availability and visitors from overseas
3	Decarbonisation and ESG investment
4	Digitalisation
5	Consolidations

Japan Market Outlook

Risk factors and notable events in 2021

The COVID-19 pandemic remains the biggest risk factor for the world in 2021. Widespread availability of vaccines on a global scale will determine the move towards normalization of economic activity and how the global economy will perform. At present, vaccination of the population is expected to proceed mainly in developed countries towards the second half of 2021, but it is unclear whether it will proceed smoothly in emerging countries and whether the global economic recovery will proceed smoothly. In Japan, the general election of the House of Representatives is expected by the autumn of 2021. As things stand, it is highly likely that the current ruling party will win and the Suga administration will continue.

Other risk factors include the possibility of a change in the course of monetary policy overseas in the second half of the year, a rise in interest rates, U.S. credit market, and geopolitical risks.

A market-driven rise in the U.S. interest rate is possible but it is very unlikely the Federal Reserve Board (FRB) will change the course of its accommodative monetary policy in 2021. Asset Management One believes the FRB will swiftly react to any market-driven rises in interest rates and maintain its new policy stance of emphasis on broader employment, including minorities and low-income earners, with the average inflation target.

In the event of a rise in interest rates, the 10-year US Treasury yield of 1.5% and the 30-year US Treasury yield of around 2.5% are likely to be the levels to watch out for. Any moves above these levels, the P/E ratio is likely to adjust sharply, leading to a sell-off in U.S. growth stocks. This would also hinder the recovery of the housing market.

U.S. credit and other fixed income assets, the asset classes which have been attracting massive inflows of funds, are sources of deep-rooted concerns about a bubble, but are unlikely to collapse unless the FRB changes its stance. In terms of geopolitics, the only thing that is likely to affect Japan is the extent to which U.S. policy towards East Asia, China and North Korea in particular, and the Middle East will change under the new president. It is difficult to judge at this moment without any supporting evidence to indicate the direction of the foreign policy prospects of the Biden administration. As for North Korea, which Donald Trump managed the risk of relatively well, there is a risk that it will become more provocative again.

Topic: Digitalization

The COVID-19 pandemic set to accelerate Japan's digital revolution

Prime Minister Suga vowed at the onset of his administration to create a new Digital Agency, and push ahead with deregulation to improve the efficiency of government services. In the meantime, structural changes are accelerating as people adapt to a new way of life in the wake of the COVID-19 pandemic. Digitalization - characterized by practices such as remote working – is one of the key changes which we believe has the potential to boost Japan's potential growth rate.

i. Labour input - the potential to mitigate the negative impact of population onus

Japan is one of the first developed countries in the world to face the issue of an ageing population - the working-age population peaked in 1997 and has been in decline for many years. In spite of this, the nation has been reluctant to open up to immigrants to replace and supplement its declining workforce. To make matters worse, the COVID-19 pandemic has made it even more difficult to utilize the existing immigrant labour force. If this trend continues, the decline in the labour force could spur a further fall in Japan's potential growth rate. However, if remote working takes root, it will provide a new set of employment opportunities for workers who previously would have had no choice but to leave their jobs for a variety of reasons, such as nursing care (with Japan's declining birthrate and ageing population, many workers are taking care of their parents), childcare, or their spouse's transfer. It will also lower the bar for overseas workers to take on work for Japanese companies in their home countries. In Japan, the digital revolution could help to alleviate the negative effects of the demographic decline in working-age population.

ii. Capital input - the potential for accelerated investment in digitalisation

In December, the Bank of Japan's Tankan survey of capital investment (excluding land investment) showed a decline of 3.0% year-on-year, a downward revision of 2.1 percentage point from three months ago. However, software investment remained positive even throughout the COVID-19 pandemic, with 3.4% growth year-on-year after downward revision from the previous forecast. This represents management's strong will to invest in digitalisation, such as remote working and labour-saving technologies, in anticipation of the post-COVID-19 era.

Tankan survey of capital investment (excluding land investment)

	FY2019		FY2020 Plan		
	Actual	Mar	Jun	Sep	Dec
Capital Investment*	1.6	1.2	0.9	-0.9	-3.0
Software Investment	10.3	2.6	4.8	6.4	3.4
R&D Investment	1.5	0.9	1.3	-0.5	-2.3

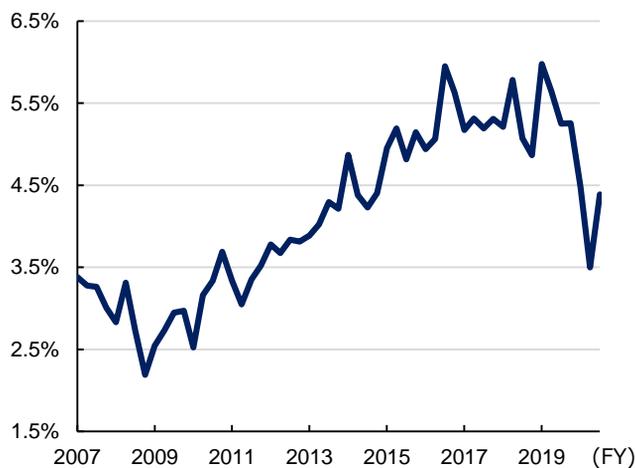
*Including Software & R&D Investment
Source: Bank of Japan

Topic: Digitalization

iii. Total factor productivity - the potential to improve profit margins by controlling costs

Initially, the introduction of remote working in Japan was not necessarily accompanied by an increase in productivity. In many industries, the time and physical costs associated with travel were reduced, but productivity may have regressed initially due to the unfamiliarity of new working arrangements. However, more than half a year after the introduction of remote working in many companies, the benefits are finally outweighing the costs. This is also reflected in corporate profits, with seasonally adjusted corporate statistics showing that margins and recurring profit margins, bottomed out in the April-June quarter and improved significantly in the July-September quarter, as shown in Figure 2. This, of course, is due to a resumption of production, which had been halted by restrictions on economic activity and supply chain disruptions, and a recovery in exports, which probably contributed to the increase in the top line. However, the improvement in margins due to cost control (particularly through lower face-to-face sales costs), achieved by adapting to new behaviours, is also likely to have boosted the bottom line. If costs remain under control and top lines return to pre-COVID-19 levels in the future, we can expect a significant improvement companies bottom lines.

Change of Ordinary Income ratio



Data: 2007 1Q - 2020 3Q
Source: Ministry of Finance

It may be hard to believe that Japanese companies, which have traditionally been slow to make decisions and conservative about adopting new technologies, have changed so quickly. However, it should be remembered that Japanese companies have strengthened their corporate structure and have subsequently achieved record profits during previous serious crisis such as the oil crisis, the strong yen recession, the global financial crisis and the Great East Japan Earthquake.

Topic: Environmental Policy

Japan moves towards a green society by 2050

Prime Minister Suga pledged to achieve the decarbonisation of Japan by 2050. While this is due to increasing international pressure to step up climate change action, it is a notable move by Suga, a results-oriented prime minister, who has made a major shift in Japan's environmental policy. Suga's government has set targets and is moving rapidly to improve the environment in order to achieve them.

i. Japan announces decarbonisation target by 2050

Japan has been conspicuously reluctant to decarbonise its economy due to concerns over impact to its manufacturing industry, particularly in the automotive sector, and its reliance on thermal power generation in the wake of the nuclear power plant disaster in 2011. The failure of Environment Minister Koizumi to take concrete steps towards decarbonisation, such as the abolition of coal-fired power generation, at COP25 in 2019 is still fresh in the minds of many in Japan. Therefore, it was a surprise move, soon after taking office in October 2020, by Prime Minister Suga to announce in his speech at the opening of an extraordinary session of the Diet that Japan aims to achieve a green society by 2050.

ii. Increasing international pressure to act on climate change and Suga's appointment in Japan

Looking around the world, major European countries have been the first to announce the abolition of coal-fired power generation. In the United States, President-elect Joe Biden, who pledged to return to the Paris Agreement on the day of his inauguration and aims to achieve net-zero emissions will take office on 20th January. In global financial markets, corporate climate change initiatives are becoming an essential element in investment, lending and trading activities, and there is a move to strengthen decarbonisation efforts, particularly among global companies. In the midst of this global trend, the appointment of Suga, a results-oriented prime minister, is a noteworthy move that has led to a major shift in Japan's environmental policy. As Chief Cabinet Secretary under the previous Abe administration, Suga has a proven track record of implementing a range of policies.

Topic: Environmental Policy

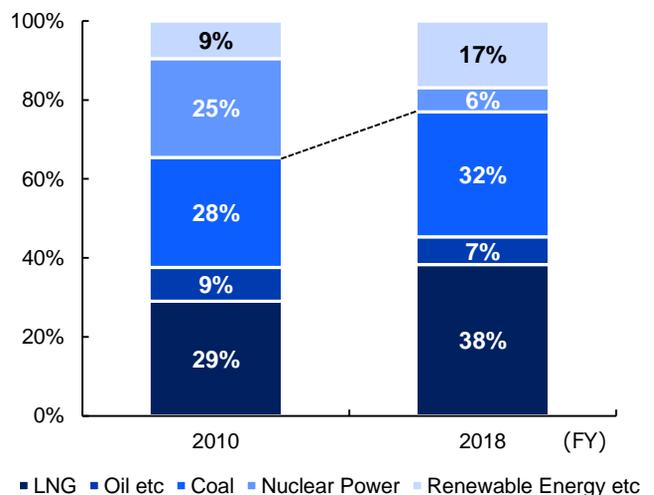
iii. The Suga administration's decarbonisation policy: setting clear targets and creating the environment to achieve them

The Suga administration has set a policy target of reducing overall greenhouse gas emissions to net-zero by 2050, and is working at a rapid pace in preparation in order to achieve this goal. With regards to power generation, which accounts for a large proportion of carbon dioxide (CO₂) emissions in Japan, the government has pledged to retire old inefficient coal-fired power plants and imposed a clear target on car manufacturers to sell all new cars as electric vehicles by the mid-2030s. Falling behind the global trend here could lead to a decline in the competitiveness of the country's key industry, the automotive industry. The government is planning to introduce an emissions trading scheme for the automotive industry to encourage companies to compete. To achieve its ambitious targets, which are comparable to the global targets, the Suga administration made "realising a green society" a key part of its growth strategy, alongside digital reforms, in the economic stimulus package drawn up shortly after its inauguration. A ¥2 trillion fund will be set up to promote green investment and support the research and development of companies engaged in technological innovation over a 10-year period.

The green investment fund will support the development of equipment that can produce hydrogen, which is regarded as a clean energy source, on a large scale at low cost, and rechargeable storage batteries, which are essential for promoting wider use of electric vehicles and renewable energy. In addition, development of technology for capturing, storing and recycling CO₂ is also very important for Japan as it is practically impossible to halt all thermal power generation plants.

Japan has a track record of developing essential technologies ahead of other countries with an ability to lead the world. However, in a number of cases, other countries have placed these technologies into practice ahead of Japan due to slow decision making in terms of practical application and social implementation. In December 2019, the world's first liquefied hydrogen carrier was introduced in Japan, and an experimental project to transport liquefied hydrogen from Australia to Japan is now underway. We feel that with Suga's commitment to implement regulatory reforms to achieve the targets, Japan has the potential to make material progress in its environmental policy under the new administration.

Proportion of Electricity Generation Capacity in Japan



Source: Agency for Natural Resources and Energy

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