

Global Outlook 2025

January 2025

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Forecast Summary

Economic Forecast Summary for 2025

Calendar Year		2023 (Actual)	2024 (AMO Estimate)	2025 (AMO Forecast)
US	Real GDP (YoY%)	2.9	2.8	2.3
	Core CPI (YoY%)	4.8	3.4	2.7
Eurozone	Real GDP (YoY%)	0.5	0.8	0.6
	HICP (YoY%)	5.4	2.4	2.1
China	Real GDP (YoY%)	5.2	4.9	4.5
	CPI (YoY%)	0.2	0.6	0.7
Japan	Real GDP (YoY%)	1.7	-0.2	1.7
	Core CPI (YoY%)	3.1	2.6	2.2

Stock Market Forecast Summary for 2025

Calendar Year		2023 (Actual)	2024 (AMO Estimate)	2025 (AMO Forecast)
US	S&P500	4770	5950	6150
	YoY%	24.2	24.7	3.4
Eurozone	DAX	16752	20000	20800
	YoY%	20.3	19.4	4.0
China	Shanghai Composite	2975	3300	3500
	YoY%	-3.7	10.9	6.1
Japan	TOPIX	2366	2800	3000
	YoY%	25.1	18.3	7.1

Bond Market Forecast Summary for 2025

Calendar Year		2023 (Actual)	2024 (AMO Estimate)	2025 (AMO Forecast)
UST 10-Year Yield (%)		3.88	4.50	4.30
Germany 10-Year Yield (%)		2.02	2.10	2.00
Japanese Government Bond (JGB) 10-Year Yield (%)		0.61	1.00	1.20

Source: Bloomberg, Factset, Asset Management One Co., Ltd.

Note: 1. The data doesn't suggest or guarantee any future economic situations, market outlook, other trends related to investment environments, etc. Past performance is not a reliable indicator of future results.

2. For Japan core CPI, all items excluding fresh food
US core CPI, all items excluding food and energy

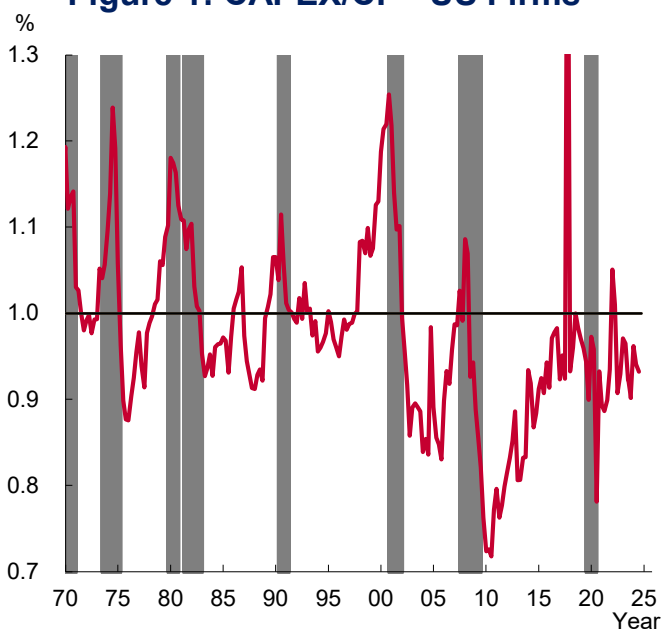


Naoki Murakami
Senior Economist

Economic Outlook

The US economy continues to exhibit stable growth, and we anticipate that the fiscal policies of the incoming Trump administration, including both tariff increases and tax cuts, will be implemented by 2025, providing a modest boost to the US economy overall. The ratio of capital investment to cash flow among US companies remains low, indicating potential for expansion in capital investment (Figure 1). We expect this to lead to increased capital expenditure from companies that have previously held back on investment activities. Additionally, deregulation under the incoming Trump administration may encourage innovative capital investments by businesses.

Figure 1: CAPEX/CF - US Firms



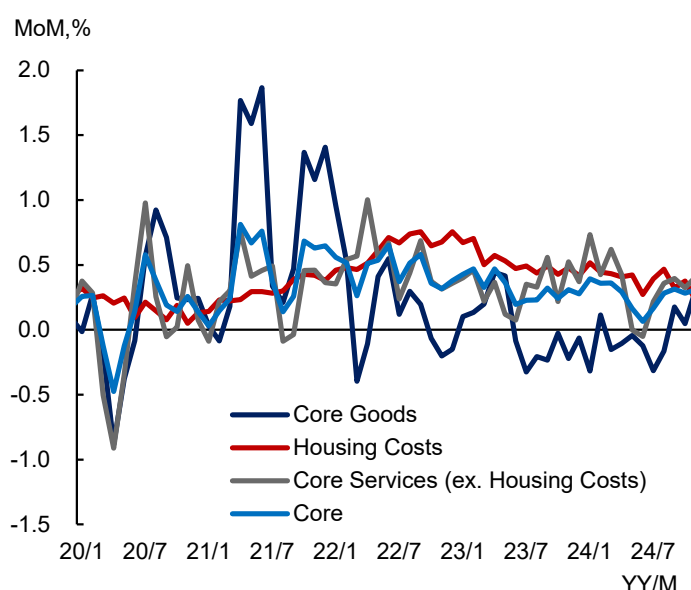
Sources: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: 1. Quarterly data from 1Q 1970 to 3Q 2024
2. Shadow areas represent recessionary periods

In the labour market, although job growth has continued to slow, the significant deterioration in the unemployment rate that many feared has not materialized. The labour market continues to show a slowdown in the growth of employment numbers, while the significant deterioration of the unemployment rate did not happen.

Considering that the decrease in job openings suggests a potential bottoming out, it is expected that the softening of the labour market will continue into 2025, but the likelihood of extreme adjustments in the labour market is likely limited.

Core Consumer Price Index (core CPI, which excludes fresh food and energy), which was around +4% year-on-year at the end of 2023, decelerated to +3.2% year-on-year by the summer of 2024, primarily due to a decline in core service prices excluding housing costs amidst a tightening financial environment. However, disinflation subsequently stalled as core service prices began to accelerate. There are visible signs of a decline in housing costs, which have remained elevated for an extended period, and we expect inflation to continue to slow, albeit gradually, in 2025, particularly concerning housing costs. Conversely, the tariff increases implemented by the incoming Trump administration may exert upward pressure on inflation, particularly for goods (Figure 2).

Figure 2 : Core CPI (by items)



Sources: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Monthly data from January 2020 to November 2024

Monetary and Fiscal Policy Outlook

At its December Federal Open Market Committee (FOMC) meeting, the Federal Reserve Board (FRB) revised its forecast for interest rate cuts in 2025, lowering it from four to two. During his post-meeting press conference, Federal Reserve (Fed) Chairman Jerome Powell emphasized the appropriateness of moderating the pace of rate cuts amid heightened uncertainty regarding policy and inflation. Should the incoming Trump administration's tariff increases and fiscal policies significantly hinder disinflationary progress, the number of rate cuts this year may be further reduced from the two currently projected.

Risk Scenarios

We believe the most significant risk lies in a scenario where inflation re-accelerates as a result of the policies implemented by the incoming Trump administration, thus hindering the Federal Reserve's ability to cut interest rates. Should all of Trump's proposed tariff increases be enacted, core inflation could temporarily exceed 3% once more. Additionally, stricter immigration controls may intensify wage inflation in specific sectors by limiting the labour supply. The direct effects of Trump's policies on the economy are also undeniable; retaliatory tariffs from other countries could place downward pressure on the US economy through reduced exports.

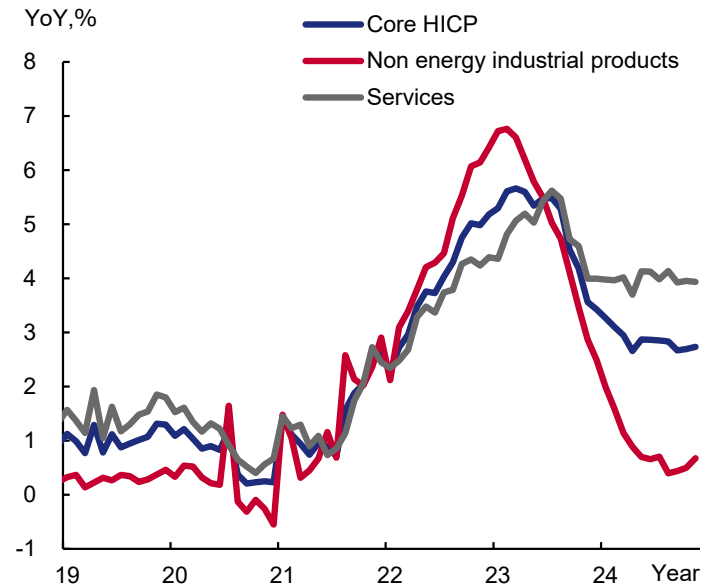


Economic Outlook

Growth in the Eurozone economy is expected to remain stagnant in 2025. There are expectations that consumer spending will pick up further this year, as unemployment remains at historically low levels and households' real incomes improve due to rising wages and slowing inflation. However, the savings rate of Eurozone households remains high against the backdrop of some soft consumer sentiment and other factors, and the improvement in consumer spending is likely to remain limited. The weakness of the German economy is also expected to continue to weigh on the Eurozone economy this year. Factors such as stagnant domestic demand, including consumption and residential investment against a backdrop of high real interest rates, and rising energy costs associated with reduced energy dependence on Russia are expected to continue to act as downward pressures on the German economy. However, given the European Central Bank (ECB)'s aggressive interest rate cuts, it is unlikely that the Eurozone economy will go into recession.

Regarding prices, the core Harmonised Index of Consumer Prices (core HICP, all items excluding energy, food, alcohol and tobacco) that the ECB focuses on, continues to grow in the 2% YoY range while the growth of goods (non-energy industrial products) prices has slowed considerably, although service prices have been reluctant to fall (Figure 1). Such subdued inflation is expected to continue over this year and beyond.

Figure 1: Core HICP and Components



Sources: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Monthly data from January 2019 to November 2024

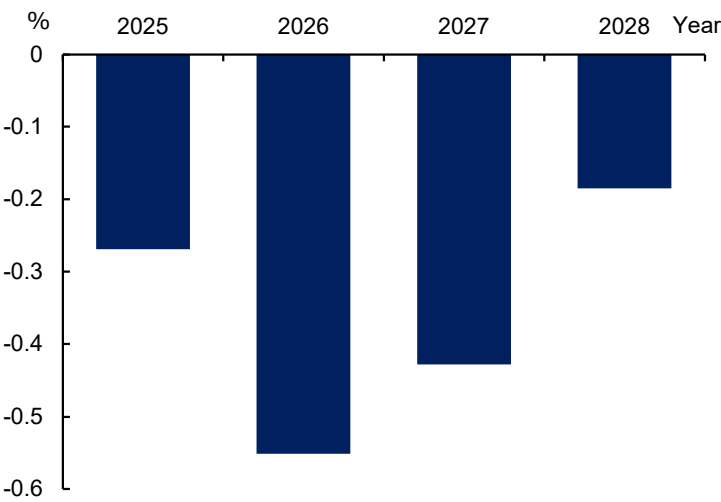
Monetary and Fiscal Policy Outlook

At the December 2024 ECB Council meeting, the ECB revised its previous monetary policy stance. Specifically, (1) the tightening bias in monetary policy was eliminated against a backdrop of disinflation and downside risks to economic growth, and (2) with regard to the time horizon of policy, there is no longer a need to necessarily rush to achieve the inflation target. Under these circumstances, we expect the ECB to decide on a series of rate cuts through March 2025, after which the ECB will cut rates toward the neutral rate, while keeping an eye on the FRB's monetary policy.

Risk Scenarios

The biggest risk in 2025 is seen as a tariff increase by the incoming US Trump administration. President-elect Trump has indicated that he may raise tariffs on imports from the Eurozone, which, if implemented, would be expected to depress economic growth in the region (Figure 2). In addition, Trump is expected to press European members of the North Atlantic Treaty Organization (NATO) to raise defense spending. There are also concerns that prolonged instability in the governments of Germany, France, and other countries may cause companies to hold back on capital investment.

Figure 2: Impact on Eurozone GDP of Increased Uncertainty in Tariffs and Trade Policy



Sources: International Monetary Fund (IMF),
Asset Management One Co., Ltd.

Note: 1. Annual data from 2025 to 2028

2. Estimates based on the following assumptions:

- I. Starting in mid-2025, the U.S., Eurozone, and China will impose a 10% tariff on trade flows between the three regions
- II. 10% tariff on trade flows between the U.S. and the rest of the world (in both directions)
- III. Uncertainty in trade policy will reduce investment



Yuko Iizuka
Economist

Economic Outlook

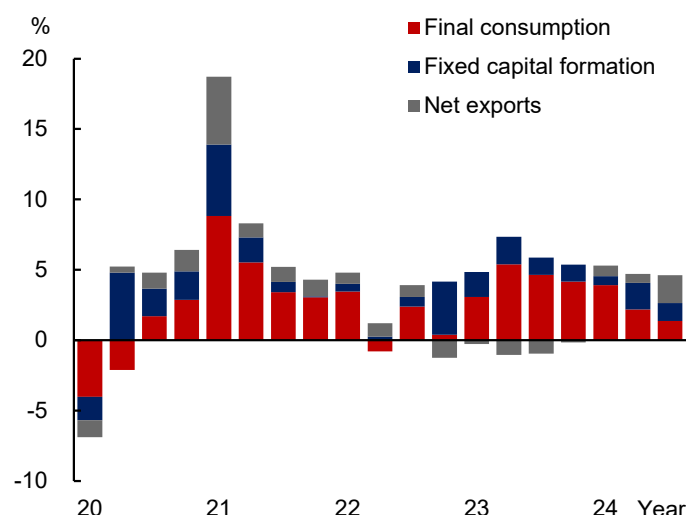
In 2024, China's economy was supported by robust external demand and increased infrastructure investment. On the other hand, personal consumption was suppressed due to the reverse asset effect of real estate caused by the continuing slump in the real estate market and the slow improvement in the employment environment, especially among young people. Signs of a bottoming out in real estate prices and consumer spending were confirmed from October onward, as policy makers provided support for the replacement of consumer goods and equipment, lowered mortgage rates, and eased restrictions on home purchases but it is assessed as inadequate for economic recovery.

Beginning in September 2024, the authorities have announced a policy of monetary easing, stock price support, and real estate measures clearly aimed at boosting the economy, and Chinese stock markets had rallied sharply in response. The market was then weighed down at times by disappointment among market participants amidst the lack of concrete details of the stimulus package.

For 2025, there is a strong sense of uncertainty about the impact of the incoming Trump administration's tougher tariffs on China, and foreign demand is not expected to contribute to the GDP growth rate as it did in 2024. Since 2025 is the last year of the 14th Five-Year Plan, the authorities are expected to strengthen policy support for the expansion of domestic demand, including consumption and investment, in order to achieve the GDP growth target of around 5%.

A program to support debt restructuring by raising the ceiling on local government bond issuance has already been announced at the November meeting of the Standing Committee of the National People's Congress, and it is expected that local infrastructure investment will make progress (Figure 1).

Figure 1: Contribution to GDP Growth by Each Item



Sources: China Economic Information Center (CEIC),
Asset Management One Co., Ltd.
Note: Quarterly data from 1Q 2020 to 3Q 2024

Monetary and Fiscal Policy Outlook

The Central Economic Work Conference, which discusses economic policy for 2025, has set the policy mix of “more aggressive fiscal policy” and “moderately accommodative monetary policy” as “the top priority is to stimulate domestic demand by boosting consumption and improving investment efficiency”.

Although the government has indicated that it intends to raise the budget deficit target for 2025, no specific figures have been announced, and it is expected that more concrete details will be revealed in the future. As for monetary policy, there is a strong possibility that interest rates will be cut again in the first half of 2025, as the government has shown a willingness to tolerate a weaker yuan in preparation for a decline in exports due to tighter tariffs.

The Chinese authorities are expected to announce the details of the stimulus package at the National People's Congress scheduled to be held in March 2025, while keeping a close eye on the policies of the incoming Trump administration.

Risk Scenarios

The first risk to the Chinese economy in 2025 is the prospect of tougher tariffs on China by the incoming US Trump administration. China's exports to the US as a percentage of its total exports has been declining since the first Trump administration, and if US tariffs on China are increased by about 10%, the impact on the Chinese economy through exports is expected to be limited. However, there has been a recent rush of exports from China in preparation for tougher tariffs from the US, and it is highly likely that a significant decline in exports will materialize as a reaction immediately after the tariffs are actually implemented. In addition, if the relocation of production bases from China to Southeast Asia and India accelerates in order to avoid the effects of US-China trade friction, there is a risk of accelerated withdrawal of investment funds from China by foreign companies and a contraction of China's domestic manufacturing industry (Table1).

Table 1: China's Top 10 Export Destinations

Export Destinations	Export value (100mil USD)		Share (%)		
	2016	2023	2016	2023	Change
U.S.	3891	5060	18.2	14.8	↓
Hong Kong	2940	2787	13.8	8.1	↓
Japan	1296	1581	6.1	4.6	↓
Korea	958	1510	4.5	4.4	↓
Vietnam	620	1419	2.9	4.1	↑
India	594	1186	2.8	3.5	↑
Russia	377	1114	1.8	3.3	↑
Germany	660	1011	3.1	3.0	↓
Netherlands	581	1007	2.7	2.9	↑
Malaysia	394	900	1.8	2.6	↑

Source: CEIC, Asset Management One Co., Ltd.

Note: 1. Annual data of 2016 and 2023

2. "Change" indicates increase or decrease in share (%) in 2023 compared to 2016.

Other risks include the risk of market disappointment leading to a decline in the Chinese stock market if the size of the fiscal stimulus package that is expected to be announced is smaller than expected and deemed insufficient to stimulate the economy. In addition, if consumer confidence does not recover due to a weak social security system and a difficult employment environment, the recovery of the Chinese economy is likely to be delayed.



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Economic Outlook

The economy is expected to continue recovering in 2025, driven by domestic demand such as consumer spending and capital investment. This recovery is supported by the prospect of real wages turning positive and a strong appetite for efficiency and labour-saving investments against a backdrop of labour shortages. The driving forces of the Japanese economy include (i) Personal Consumption: This will be supported by higher wages and increased incomes from tax cuts, (ii) Domestic Capital Investment: This reflects investments in digital transformation, efficiency, and labour-saving initiatives in response to labour shortages, as well as continued on-shoring due to a weak yen and geopolitical risks, and (iii) Inbound Consumption: Increased spending by foreign tourists is also expected to contribute. On the other hand, risk factors include (i) Stagnant consumption due to persistently high prices, (ii) Downturn in overseas economies such as those of the US and China, and (iii) Higher import tariffs resulting from the Trump administration's policies.

The Bank of Japan (BoJ) raised its policy rate (the unsecured call rate) from around 0-0.1% to around 0.25% at the Monetary Policy Meeting in July 2024. With regard to JGB purchases, it was decided to reduce the purchase amount from the monthly figure of around 6 trillion yen to around 3 trillion yen per month in the January-March quarter in 2026 (a reduction of around 400 billion yen each quarter).

Given that immediately after the July rate hike, the USD/JPY rate strengthened rapidly and Japanese stocks plummeted, the BoJ clarified its stance not to raise interest rates while the market is unstable. At the same time, however, the BoJ essentially maintains its stance of continuing to raise policy rates if the economy and prices are on track. The next rate hike is expected to take place by January 2025, with an equal chance of occurring in either December 2024 or January 2025.

Forecast Summary

Calendar Year	Actual 2022	Actual 2023	AMO's Estimate 2024	AMO's Forecast 2025
Real GDP (YoY, %)	1.2	1.7	-0.2	1.7
Core CPI (YoY, %)	2.3	3.1	2.6	2.2
BOJ Policy Rate(%)	-0.10	-0.10	0.25	1.00
JGB 10-Year Yield (%)	0.42	0.61	1.00	1.20
USD/JPY	131	141	150	143
TOPIX EPS	145	171	185	200
YoY, %	7.0	18.0	8.2	8.1
TOPIX	1892	2366	2800	3000
YoY, %	-5.1	25.1	18.3	7.1

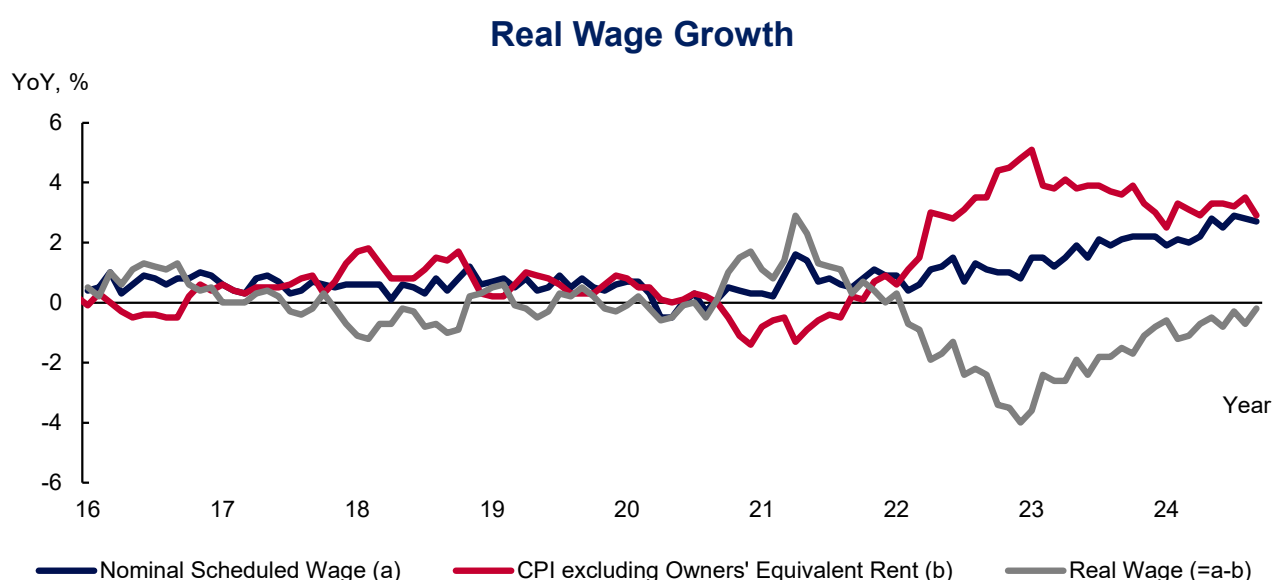
Source: Bloomberg, Factset, Asset Management One Co., Ltd.

Note: 1. The data doesn't suggest or guarantee any future economic situations, market outlook, other trends related to investment environments, etc. Past performance is not a reliable indicator of future results.

We anticipate that the BoJ will raise the policy rate to 1%, which is considered the neutral rate, by the end of 2025. If the Trump administration's policies lead the Federal Reserve (Fed) to pause rate cuts in 2025, the BoJ will find it relatively easier to proceed with rate hikes. The significant market fluctuations in August 2024 were likely due to the BoJ's decision to hike rates at a time when expectations for Fed rate cuts had significantly strengthened.

Consumer prices (excluding fresh food, core) are expected to maintain growth of around 2%. Goods prices will fluctuate depending on international commodity markets, exchange rates, and the government's energy subsidy policies, but the underlying trend of prices, which has been steady around 0%, is expected to reach an increase rate in the high 1% range as the rise in service prices expands due to wage increases.

Japanese Trade Union Confederation (RENGO) has demanded wage increases of more than 5% in the upcoming spring labour negotiations of 2025, and has indicated a policy of demanding wage increases of more than 6%, particularly for labour unions in small and medium-sized enterprises (SMEs). We expect that the trend of wage increases and consumer price rises will continue in 2025 as well.



Source: Japan Ministry of Health, labour and Welfare, Asset Management One Co., Ltd.
Note: Monthly data from January 2016 to September 2024

Will wage increases, which hold the key to maintaining a 2% consumer price increase, continue beyond 2026 ?

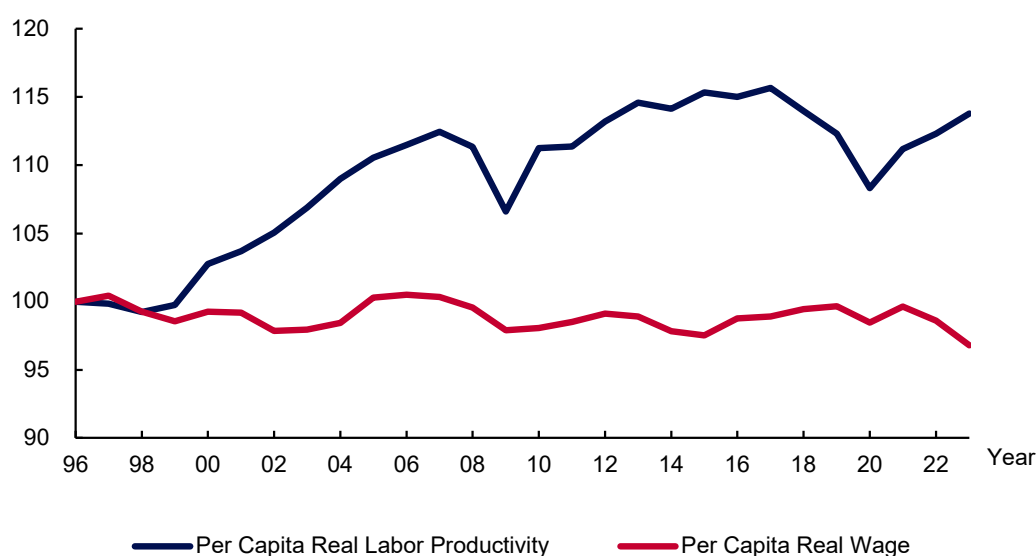
In the medium to long term, it will be crucial whether wage increases are accompanied by productivity growth rather than relying on cost-push pressures due to supply constraints (manpower shortages). Otherwise, it will squeeze corporate profits.

Looking at the economy as a whole, wages in Japan have been restrained compared to labour productivity growth. However, the situation varies significantly depending on the industry and company size. When examining the labour share by company size, it is considerably higher in SMEs compared to large companies, suggesting that rising labour costs have a greater impact on profits. If SMEs operate in a B2B context, it may be possible to pass on costs to large companies. On the other hand, in B2C contexts such as the food and beverage and personal services industries, such cost pass-through may be more challenging.

Generally, the relationship between wage growth rates and labour productivity is influenced by regulations and employment practices in the labour market. In Japan, workers have historically accepted lower wage increases in exchange for higher job security (often referred as “lifetime employment”). In contrast, in countries like the US, where job security is lower, wage increases have more closely reflected productivity growth.

In Japan, manpower shortages are becoming more severe due to demographic trends, and this situation is unlikely to be resolved in the short term. While job-based employment is already becoming more prevalent, we expect that wage increases reflecting labour productivity growth will become more established as societal norms evolve.

Real Labour Productivity and Real Wage



Source: Japan Ministry of Health, labour and Welfare,
Japan Cabinet Office, Asset Management One Co., Ltd.
Note: 1. Annual data from CY1996 to CY2023
2. CY1996=100

Monetary and Fiscal Policy Outlook

Monetary Policy

The BoJ is expected to continue raising interest rates as a basic policy amid prospects for a virtuous cycle of income and growth. The next rate hike is anticipated by January 2025, with the unsecured call rate likely to be raised to 0.50%. By the end of 2025, the BoJ is expected to raise the policy rate to 1.0%, which is considered the lower limit of the neutral rate.

Admittedly, there is a significant hurdle in raising the interest rate above 0.50%, which has been recognized as an "insurmountable barrier" since the Bank of Japan Law came into force in 1998, granting the BoJ autonomy over its monetary policy. On the political side, the Democratic Party For the People (DPFP) and other parties that emphasize income redistribution policies, may pressure to delay the rate hike due to concerns about the impact on mortgage rates and other factors.

Additionally, if the Fed does not signal a pause and proceeds to cut interest rates, financial markets may adjust excessively, as they did in August 2024, due to the differing directions of monetary policy between the US and Japan.

The BoJ will need to provide a more detailed explanation of the neutral interest rate level and the impact of a rate hike on the macroeconomy and other factors than it currently does. Under Governor Ueda, decisions to lift negative interest rates or raise interest rates are often communicated through newspaper reports in the late evening immediately before a meeting. This approach tends to surprise the market. While this can be a positive surprise in the case of monetary easing, in the current situation, the BoJ is expected to change its stance to allow the market to factor in the decision more in advance through newsletters like the Fed, rather than immediately before the meeting, in order to avoid excessive market volatility.

Fiscal Policy

Following the results of the lower house election, the ruling party has become a minority government and has been forced to incorporate the policies of the opposition parties, especially the DPFP. The supplementary budget for Fiscal Year (FY) 2024 (ending March 2025) is expected to be around 13 trillion yen in terms of expenditure. The contents include (i) benefits for low-income earners, (ii) extension of gasoline, electricity, and gas subsidies, (iii) subsidies for the semiconductor industry (i.e., Rapidus Corporation), and (iv) local subsidies, all of which are extensions of previous policies and are expected to have a limited additional buoyancy effect on the economy.

In the tax reform for FY 2025 (ending March 2026), the DPFP has proposed raising the threshold of the "1.03 million yen barrier" to "1.78 million yen." If fully realized, this change could result in a tax revenue decrease of approximately 7.6 trillion yen, which is expected to correspond with an increase in personal income, according to government estimates. The DPFP supports this increase based on the fact that the nationwide weighted average minimum wage has risen from 611 yen in 1995 to 1,055 yen in 2024, representing a 1.73-fold increase. During the same period, the consumer price inflation rate has increased the 1.03 million yen tax threshold to approximately 1.13 million yen when applying a 1.1-fold increase. The anticipated 7.6 trillion yen reduction in tax revenue is roughly equivalent to a 3% decrease in consumption tax, indicating a significant fiscal impact. We expect the actual effects to fall somewhere between these estimates. The implementation of the tax reform is scheduled for April 2025, but it is expected to be applied retroactively from January. Assuming a marginal propensity to consume (MPC) of 30%, we project that personal consumption could increase by approximately 0.3 percentage points, while real GDP may rise by about 0.2 percentage points.

Key Points Regarding Future Policy Trends

Based on statements and political stances prior to the Japanese presidential election, it has been pointed out that Prime Minister Ishiba may promote policies such as increased fiscal spending for regional revitalization, corporate tax hikes, and strengthened taxation on financial income. However, due to his weak foundation within the Liberal Democratic Party (LDP) and the loss of a majority for the ruling coalition in the House of Representatives elections in October, the scope for Ishiba to assert his uniqueness has significantly diminished. Furthermore, in the domestic stock market and asset management industry, there has been a suggestion of continuity in policies favorable to the market, such as those promoted by the former Prime Minister Kishida's administration under the concept of becoming an "asset management nation." As a result, concerns about Ishiba's unique policies have somewhat eased. In the context of a minority ruling party government, there is an increasing necessity to incorporate policy proposals from the DPFP, such as raising the income threshold of 1.03 million yen (expanding the basic income tax deduction) and gasoline tax reductions, leading to a greater emphasis on income redistribution policies.

Despite relatively strong economic conditions, low unemployment rates, and a generally rising stock market, the low approval ratings for the government have become a common issue among developed countries.

The rising prices have made life difficult, leaving many without discretionary funds to invest in risk assets, preventing them from benefiting from the stock market gains. This voting behavior among those affected is believed to have influenced the election results in the US and Europe in 2024. The same trend was observed in Japan, where the policy stance of the DPFP to "increase take-home pay" has gained support among the public.

Due to Ishiba's weak support within the party, there were calls in the market for Takaichi, who advocates for the continuation of Abenomics, to compete against Ishiba in a runoff in the LDP presidential election. However, it is believed that policies lacking consideration for income redistribution will not gain public support in the current situation. Therefore, it is not expected that there will be a strengthening of anti-Ishiba forces within the party or a split within the LDP.

Note: The term "1.03 million yen barrier" refers to a concept in Japan in the context of taxes. This barrier indicates that if an annual income exceeds 1.03 million yen, the individual will lose certain tax benefits, such as the spouse deduction or dependent exemption. Specifically, if a spouse earns 1.03 million yen or less, they can take advantage of the spouse deduction, resulting in reduced tax liabilities. However, if their income exceeds 1.03 million yen, these deductions will no longer apply, leading to an increased tax burden. As a result, many part-time workers, such as housewives or spouses, typically adjust their working hours to avoid exceeding the 1.03 million yen threshold. Due to this system, many people are mindful of the "1.03 million yen barrier" when considering their income while working.

In the tax reform for FY 2025, it is highly likely that the DPFP's proposal to raise the annual income threshold of the "1.03 million yen barrier" will be included. A gasoline tax reduction is also expected to be considered. While fiscal policy may become expansionary and boost domestic economic conditions, the issue of how to secure funding becomes critical if it results in permanent tax cuts. Raising the threshold is anticipated to encourage labour supply, and if labour supply increases, there is a possibility that consumption tax revenue will rise through increased income. However, it has been pointed out that Japan's labour participation rates for women and the elderly, which were once considered low on an international scale, have already risen significantly, suggesting that the effect may be limited.

Additionally, it is necessary to consider the thresholds of 1.06 million yen and 1.3 million yen, which could lead to a reverse phenomenon where social insurance burdens arise, resulting in decreased take-home pay.

Since social insurance premiums are shared by companies, any increase in these premiums is expected to particularly heighten the cost burden for SMEs. On the other hand, this will also affect the amount of pension that workers will receive in the future. The traditional system, which assumes a household structure where the husband works and the wife is a full-time homemaker (and does not divorce), is increasingly seen as outdated. There is a growing consensus that everyone should bear the burden of social insurance premiums.

Note: The thresholds of 1.06 million yen and 1.3 million yen pertain to social insurance premiums. If part-time workers and others earn more than 1.06 million yen or 1.3 million yen annually, they will be removed from their spouse's dependency, resulting in the burden of social insurance premiums and a reduction in their take-home pay. The 1.06 million yen threshold applies to those working in companies with 51 or more employees. When an annual income exceeds 1.06 million yen and weekly working hours exceed 20 hours, the worker is removed from their spouse's dependency and must pay employees' pension and health insurance premiums. The 1.3 million yen threshold applies to those working in companies with 50 or fewer employees. If the annual income exceeds 1.3 million yen, the worker is removed from their spouse's dependency and must pay national pension and national health insurance premiums.

Risk Scenarios

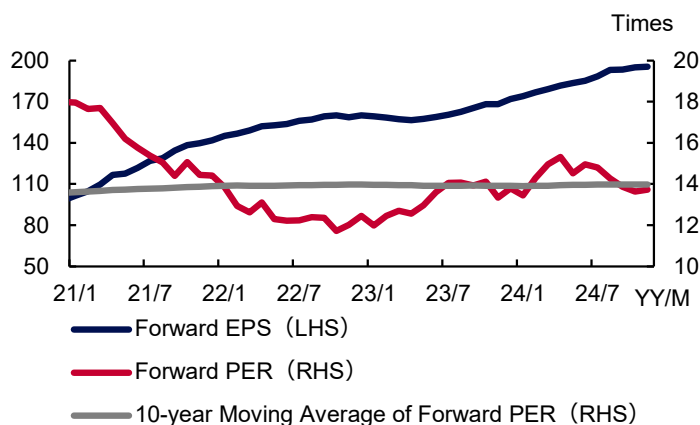
Downside risk factors, as already partially mentioned above, include the negative impact of the incoming Trump administration's policies, uncertainty surrounding monetary policy in Japan and the US, the possibility that the domestic economy will not recover even with wage increases, and instability in the domestic political situation. On the other hand, one upside risk factor is a significant recovery of the Chinese economy. However, China is in the process of its economic growth's slowing down over the medium to long term, and we see little likelihood of this happening.

Market Outlook

Notwithstanding the BoJ's tightening stance, we expect profit growth to continue against the backdrop of domestic economic recovery, leading to a sustained upward trend in Japanese stocks. We think factors to support Japanese stocks include (i) The transition from a deflationary economy to a growth economy, (ii) Progress in management reforms focused on capital costs and stock prices, (iii) The increasing strategic importance of Japan to the US. under the Trump administration from a security perspective, and (iv) Market revitalization through the government's policy of becoming a "nation of asset management."

Japanese equities rose substantially in 2024, most of the gains occurred by end of July, when the BoJ decided to raise interest rates, leading to August sharp correction. The yen strengthened temporarily after the BoJ's rate hike and the Fed started cutting rates, which increased USD/JPY volatility, while domestic corporate earnings for the July-September quarter were somewhat lackluster, especially for automobiles, due to foreign exchange losses, and volatility in Japanese equities remained higher than before the BoJ's July hike, which have led to a holding back of Japanese stock purchases, particularly from foreign investors. However, corporate earnings are projected to continue expanding in 2025, with an expected inflation rate of 2%. The BoJ is anticipated to cautiously adopt interest rate hikes, and the rise in domestic long-term interest rates is expected to be managed. As a result, a significant valuation adjustment of the TOPIX, similar to what occurred in August 2024, is not anticipated. We expect the TOPIX index to reach 3000 by the end of 2025.

TOPIX Forward EPS and PER



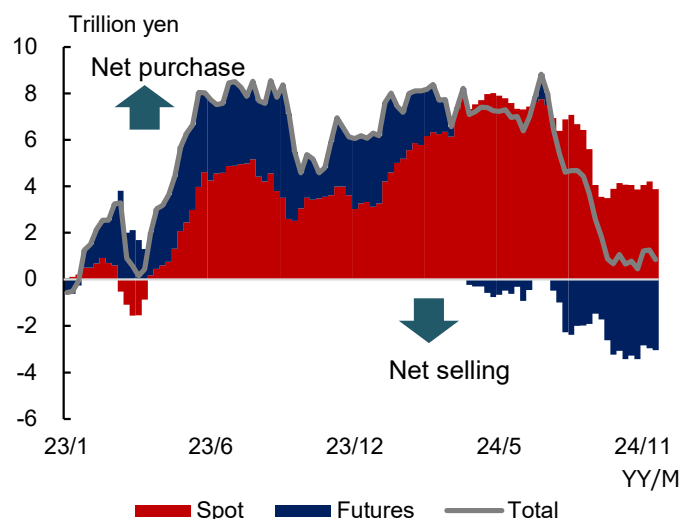
Source: LSEG Data & Analytics, Asset Management Co., Ltd.

Note: 1. Monthly data from January 2021 to November 2024

2. Forward PER indicates price to earnings ratio based on 12 month forward earnings

3. Stock price = Forward EPS × Forward PER

Japanese Equity Purchases by Foreigners



Source: Bloomberg, Asset Management One Co., Ltd.

Note: 1. Weekly data from the week of 4-6 January 2023 to the week of 6- 22 November 2024

2. The cumulative net purchase amount of Japanese equities, total of two markets, excluding Nikkei 225 micro futures

The trend of companies enhancing capital efficiency is gaining traction, particularly with a rise in share buybacks in 2024, which has sustained share prices. In 2025, we anticipate a similar increase in share buybacks. While more companies are expected to pursue privatization through management buyouts (MBOs) due to the higher costs of being listed, those wishing to remain public will continue to face the need for management reforms. This dynamic is expected to contribute to the revitalization of the market.

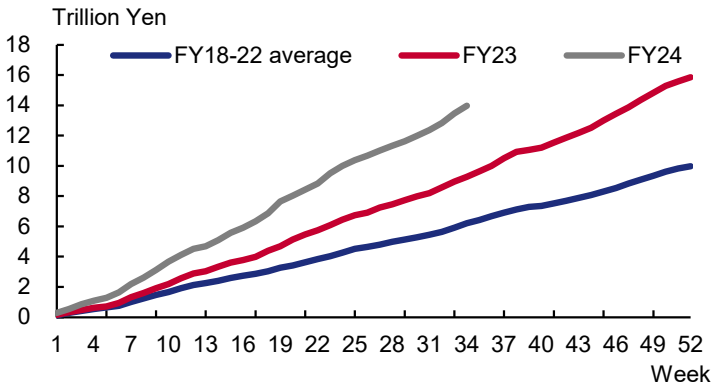
There are concerns that geopolitical risks will increase in 2025 as Trump's second administration begins. Although Trump has suggested raising import tariffs not only against China but also uniformly across the world, we think that it is used as a bargaining tool in bilateral negotiations and it is not likely that import tariffs will actually be raised on all items. Japan's share of US imports has also not been high in recent years, at less than 5%. From the perspective of China, Japan's strategic position is seen as increasing in importance, which makes Japan a relatively low-risk country. However, the impact of tariff hikes on automobiles, which are the top export item to the US and are often bypassed through Mexico and other countries, will be a concern.

Japan's Top 10 Exports to US

CY2023	Trillion Yen	Share(%)
Total	20.3	100.0
Automobiles	5.8	28.8
Engines and Turbines	1.1	5.3
Automobile parts	1.1	5.3
Construction and Mining Machinery	0.9	4.7
Scientific Optical Equipment	0.5	2.6
Semiconductor Production Equipment	0.5	2.4
Pharmaceuticals	0.4	2.2
Heavy Electrical Machinery	0.4	2.0
Electric Measuring Instruments	0.4	1.9
Centrifugal Machinery	0.3	1.7

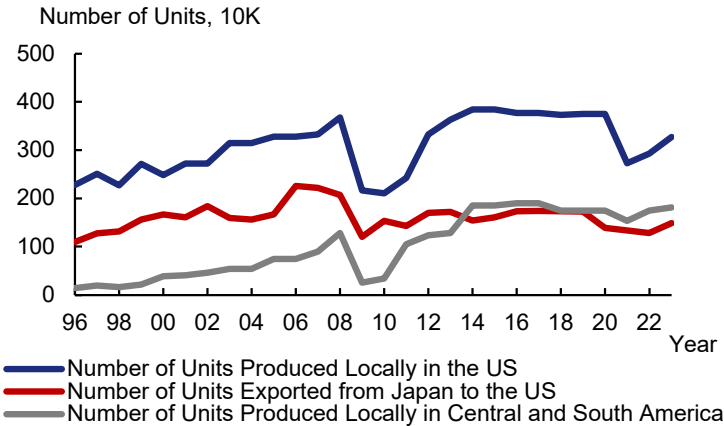
Source: Ministry of Finance Japan, Asset Management One Co., Ltd.

Japanese Equity Purchases by Corporates



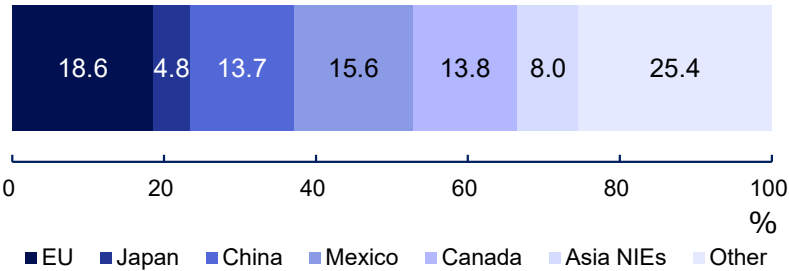
Source: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Weekly data from FY2018 and FY2024

Japanese Automobiles Units Breakdown



Source: Japan Automotive Manufacturers Association,
Asset Management One Co., Ltd.
Note: Annual data from CY1996 to CY2023

US Imports by Country



Source: US BEA, JETRO, Asset Management One Co., Ltd.
Note: CY2023

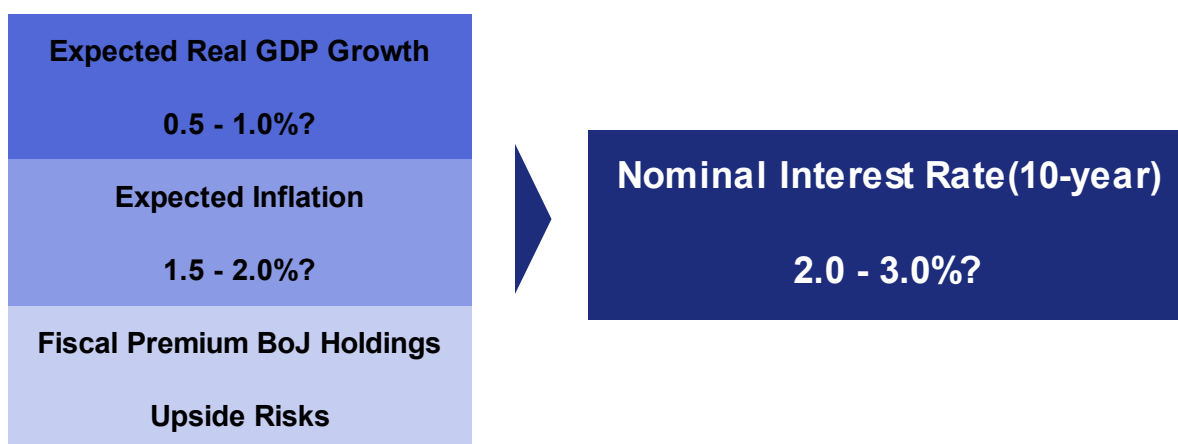
Japanese long-term interest rates

We expect Japanese long-term interest rates to trend moderately upwards following the entrenchment of inflation and the BoJ's interest rate hikes. Given that 2% inflation is entrenched in the Japanese economy in the medium to long term and Japan's potential growth rate is around 0-1%, it is theoretically possible for the long-term interest rates to rise to around 2-3%. However, the BoJ's holdings remain large and, even taking into account the impact of QT (Quantitative Tightening), the stock effect is expected to restrain the rise in long-term interest rates for the time being. We also do not expect US long-term interest rates to rise further, and developments in overseas interest rates are likely to act as a factor restraining the rise in domestic long-term interest rates. We expect real long-term interest rates to remain in negative territory and not significantly affect the domestic economy.

USD/JPY rates

The Fed is likely to suspend interest rate cuts by the end of 2025 and take a wait-and-see approach, and even if the BoJ raises interest rates, the USD/JPY rate is expected to appreciate only moderately to a level above 145 yen. There remains the possibility of a renewed expansion of carry trades by short-term foreign investors. However, if the BoJ's tightening stance is halted and the Japanese government reaches a milestone level such as 155 or 160 yen, and there are signs of a build-up of yen selling positions by short-term foreign investors, the government will not hesitate to intervene in the market.

Theoretical JGB 10-year Yield



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