CIO's View on the Recent Turmoil in the Japanese Equity Market

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Japanese stock markets saw a significant decline on March 31, with the Nikkei average falling by 4.1% and the TOPIX by 3.6%.

On March 26, US President Donald Trump signed an executive order that imposes a 25% tariff on imported automobiles, followed by an announcement regarding reciprocal tariffs that are scheduled to take effect on April 2. This deluge of tariff related news from the White House is thought to reflect the "deal-making" tactical approach that President Trump favours. Because these tariff announcements were seemingly used as a form of negotiating leverage to extract concessions from trading partners, the tariff figures are punitively high at first - but there is also precedent for them being adjusted down as negotiations progress. However, the current situation seems to be evolving beyond a mere bargaining tactic, whereby the Trump administration is attempting to compensate for non-tariff barriers of its trading partners, and is now raising fears of a global economic slowdown.

Moreover, the equity market sell-off in Japan on March 31 is largely attributed to the decline in US markets at the end of last week. The February 2025 US personal consumption expenditures (PCE) core deflator released on March 28 exceeded market expectations, and indicated persistent inflation. Combined with the aforementioned uneasiness regarding tariffs, concerns of stagflation – such as rising prices amid slowing US economic growth – have also intensified.

Japanese stock markets also experienced a significant downturn in August last year. However, this recent decline is primarily a result of US trade policy, so the characteristics are somewhat different. US equities have also fallen by nearly 10% from the highs in February when the market first reacted to the tariff concerns. However, some may argue that this decline still falls short of being a sufficient market correction when considering the substantial rise in the market in 2023-2024. The ongoing trends regarding tariff imposition, inflation dynamics, and economic slowdown concerns are likely to persist as critical issues, so economic fundamentals could remain uncertain for the time being.

That said, because of the recent equity market decline, the tariff related negative factors have already been priced in to some extent, and even after the reciprocal tariffs are unveiled on April 2, the ongoing short-term impact on the market may be minimal. Moreover, stock valuations in Japan are reasonable and lie firmly within their 10-year range with a market price-to-earnings ratio (PER) of 14 and a price-to-book ratio (PBR) of 1.3. Neither metric shows any sign of being overvalued. Should a hard landing occur in the US, with negative shock waves running through the global economy, there is a risk that Japanese equity market valuations could contract temporarily. From mid-year onwards, the impact of tariffs and economic uncertainty is expected to subside, and this should allow share prices to recover as valuations again start to reflect corporate performance rather than policy noise.

Although there are other risk factors, such those relating to currency and new fiscal year earnings forecasts, we currently anticipate higher single-digit growth in corporate earnings for fiscal year 2025 (ending March 2026). In order to successfully achieve solid investment performance against the backdrop of economic uncertainty, we will continue to employ careful analysis of economic and corporate fundamentals, while also focusing on aspects such as advancements in corporate reform.

Important Disclosures