

Equities

8 June 2011 | 32 pages

Japan Equity Strategy

Corporate earnings outlook for FY3/12 and FY3/13

■ Equities

- **Earnings momentum to recover rapidly after a slowdown** — We divided corporate results into four categories: companies with rising revenues and earnings, those with rising revenues but falling earnings, those with falling revenues but rising earnings, and those with falling revenues and falling earnings. In January–March 2011, the number of companies with rising revenues and earnings fell and those with falling revenues and earnings rose, a pattern we expect to continue in FY3/12 H1 and seemingly marking the end of the earnings recovery cycle. However, in FY3/12 H2, we expect the number of companies reporting rising revenues and earnings to rise rapidly and earnings momentum to quickly recover.
- **81% of firms announced FY3/12 earnings forecasts** — As of June 2, 81% of TSE1 listed companies had announced FY3/12 earnings forecasts. Industries where the percentages of announcements were low included many automotive-related, such as transport equipment, steel, rubber, and metal products. A marked lack of visibility due to supply-chain disruptions is set to have an impact.
- **Forecast earnings trajectory heading down on disaster** — The forecast trajectory for sales, RP, and NP has shifted downward compared to before the March 11 disaster. Corporates are forecasting that FY3/12 RP will reach the pre-disaster forecast level for FY3/11 but do not expect NP to reach the pre-disaster forecast level for FY3/12. We think this is because they plan to book extraordinary losses related to the March 11 disaster.
- **Top-down estimates** — Estimating TOPIX EPS from the top down, we model 51 points for FY3/12 (up 0.2% YoY) and 70 points (up 37.8%) for FY3/13. This suggests that corporate earnings will be largely flat in FY3/12 and normalize in FY3/13. In our risk-scenario analyses for industrial production and the euro/yen rate, we do not see the need to change our basic stance outlined above.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Outlook for FY3/11–3/12 corporate earnings

Impact of east Japan earthquake on corporate earnings

Rapid recovery after temporary dip in momentum

Corporate earnings momentum slowed due to the east Japan earthquake. Figure 1 divides corporate earnings since FY3/05 Q1 into four categories—revenue and earnings growth, revenue growth but earnings decline, revenue decline but earnings growth, and revenue and earnings decline—and shows the percentage of companies in each category. We use RP for earnings growth/decline, and the universe is TSE1 companies with March fiscal year-ends.

There is a clear four-stage pattern among the four groups in a normal earnings cycle. Early in an earnings recovery, demand is declining but companies cut costs to achieve profit growth, so revenues decline but earnings grow. In stage two, demand starts to recover, so the percentage of companies with both revenue and earnings growth increases. Thirdly, costs begin to grow due to expansion in capex and employment, so revenues grow but earnings decline at an increasing percentage of companies. And finally, demand turns down, so more companies suffer decline in both revenues and earnings.

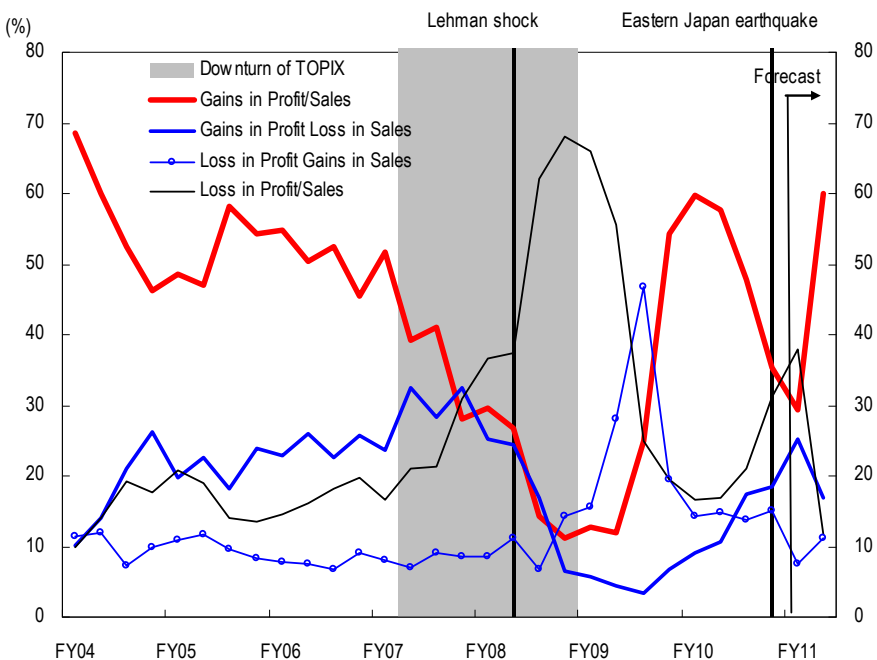
Decrease in percentage of both revenue and earnings growth, increase in both revenue and earnings decline in FY3/11 Q4, FY3/12 H1

In FY3/11 Q4, the percentage of companies enjoying growth in both revenue and earnings declined markedly, while that of companies reporting decline in both revenue and earnings expanded. Among companies that had disclosed FY3/12 guidance as of June 2, the percentage expecting growth in both revenue and earnings will decline further, and that expecting decline in both revenue and earnings will expand further, in H1. This is typical of the latter part of the earnings cycle, and results from a loss of earnings momentum due to the earthquake.

But marked expansion in revenue, earnings growth category in FY3/12 H2

However, we expect a turnaround in FY3/12 H2, projecting rapid expansion in the category of companies experiencing growth in both revenues and earnings, and a sharp contraction in that for decline in both revenue and earnings. We therefore envisage a rapid recovery in earnings momentum.

Figure 1. Share of companies experiencing revenue, profit growth/decline



Notes: 1) H1 and H2 figures for FY3/12. 2) Universe of TSE1 companies with March fiscal year-ends. 3) Includes retailers with February fiscal year-ends for FY3/12 only.

Source: Astra Manager, Citi Investment Research and Analysis

FY3/12 guidance disclosed by 81% of companies

81% of companies release FY3/12 projections

As of June 2, 1,393 TSE1 companies with March fiscal year-ends (including retailers with February year-ends) had reported FY3/11 results. Of these, 1,129, or 81%, disclosed FY3/12 guidance.

Fewer companies in auto-related sectors disclose guidance

Figure 2 shows the ranking of the TSE 33 industry classifications according to the percentage of companies disclosing FY3/12 guidance. Along with securities and commodity futures, transport equipment, steel, rubber products and metal products fill out the bottom five places. Disruptions to supply chains have hurt visibility for auto production, so, other than securities, the lowest ranked sectors are all closely rated to autos.

Figure 2. Ranking by percentage of companies disclosing FY3/12 guidance

	Share of companies released FY11 Earning Forecasts (%)	(%)
1	Sec.&Com.Fut	4.8
2	Trans.Equip.	16.7
3	Iron & Steel	52.9
4	Rubber Prod.	55.6
5	Metal Prod.	63.0
6	Air Trans.	66.7
7	Oth.Fin.Bus.	73.7
8	Gl.&Cer.Prod	73.9
9	Fish/Ag.&For	75.0
10	Elec.Pwr&Gas	75.0
11	Other Prod.	77.1
12	Nonfer.Mtls	78.3
13	Elec. App.	78.6
14	Machinery	81.0
15	TSE1	81.0
16	TSE1 (exFinancials)	81.8
17	Chemicals	82.9
18	Oil&Coal P.	83.3
19	Services	84.5
20	Insurance	85.7
21	Foods	86.7
22	Prec. Inst.	87.0
23	Land Trans.	88.2
24	Text&Apparel	88.5
25	Whsng&H.Tr.S	88.9
26	Pulp&Paper	90.0
27	Banks	90.4
28	Whsle Trade	90.5
29	Retail Trade	93.1
30	Construction	93.3
31	Pharm.	93.5
32	Inf.&Com.	95.9
33	Marine Trans	100.0
34	Mining	100.0
35	Real Estate	100.0

Source: Astra Manager, Citi Investment Research and Analysis

Figure 3. Ranking by FY3/11 extraordinary charges/RP

	FY10 Extraordinary losses / RP ratio ranking	
1	Oth.Fin.Bus.	289.8%
2	Elec.Pwr&Gas	101.9%
3	Pulp&Paper	94.2%
4	Fish/Ag.&For	63.4%
5	Insurance	63.1%
6	Sec.&Com.Fut	60.9%
7	Air Trans.	56.2%
8	Oil&Coal P.	49.4%
9	Land Trans.	46.6%
10	Metal Prod.	40.1%
11	Construction	30.8%
12	Text&Apparel	29.6%
13	Real Estate	29.4%
14	Marine Trans	28.5%
15	Retail Trade	27.9%
16	Iron & Steel	27.8%
17	Gl.&Cer.Prod	26.9%
18	Foods	25.8%
19	Whsng&H.Tr.S	24.0%
20	Nonfer.Mtls	23.8%
21	Services	23.7%
22	Prec. Inst.	22.1%
23	TSE1 (exFinancials)	22.1%
24	Other Prod.	21.9%
25	TSE1	21.6%
26	Rubber Prod.	18.3%
27	Chemicals	17.0%
28	Elec. App.	15.8%
29	Machinery	14.8%
30	Trans.Equip.	8.8%
31	Pharm.	8.4%
32	Inf.&Com.	7.7%
33	Banks	7.7%
34	Whsle Trade	7.2%
35	Mining	1.5%

Source: Astra Manager, Citi Investment Research and Analysis

Downward shift in earnings trajectory due to earthquake

In FY3/11, sales grew 6.4% YoY, RP 46.9% and NP 54.8% (please see Figure 21 for data by sector). As of March 10, the day before the earthquake, Toyo Keizai projections were for growth of 7.0% YoY in sales, 51.4% in RP and 88.2% in NP (please see Figure 22 for data by sector). So the earthquake has caused a downward shift in the trajectory of earnings, but the decline was particularly marked for NP. We think this is because of FY3/11 extraordinary charges resulting from the earthquake.

Extraordinary charges/RP particularly large for electric power & gas sector

Figure 3 ranks the TSE 33 industry classifications by extraordinary charges/RP. The earthquake appears to have had a particularly large impact on electric power & gas; fishery, agriculture & forestry; insurance; and pulp & paper.

Combined, companies for which FY3/12 guidance is available expect growth of 4.5% YoY in sales, 6.0% in RP and 11.6% in NP. This compares with Toyo Keizai projections as of March 10 for growth of 3.9% YoY in sales, 11.4% in RP and 14.4% in NP. While there is little change in the sales growth projection, the earthquake has caused a marked decline in expected rates of growth for RP and NP. This is probably because of expenses related to the repair of quake damage.

We expect FY3/12 sales, RP to reach pre-quake level of FY3/11

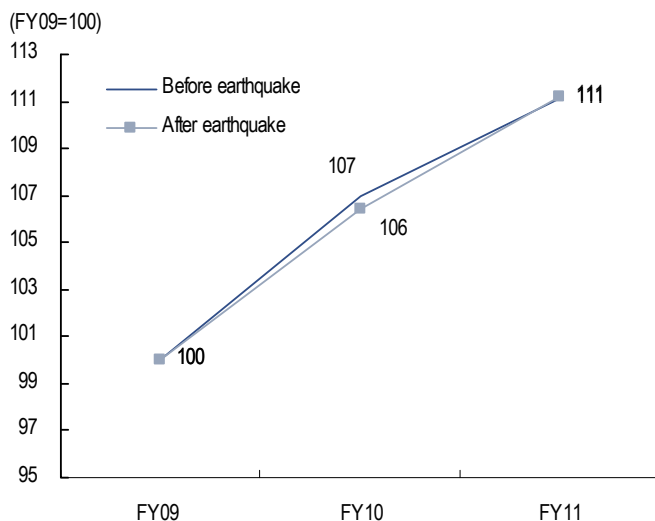
Figures 4–6 plot sales, RP and NP, indexed at 100 in FY3/10. It shows a downward shift in the trajectory of RP and NP. However, we project a recovery in FY3/12 sales to the pre-quake forecasts for FY3/11. And while we also expect FY3/12 RP to recover to marginally above the pre-quake projection for FY3/11, we expect NP to fall significantly below this level.

We would also like to note here, however, that the data lacks strict continuity, as growth rates for FY3/11 are based on the results of all companies with March fiscal year-ends, while those for FY3/12 are based on figures for companies that have disclosed FY3/12 guidance. Once more companies in sectors with low disclosure rates, such as autos, do release their guidance, the trajectory of FY3/12 sales could shift further downwards.

Companies projecting revenue, earnings growth in FY3/12 H1

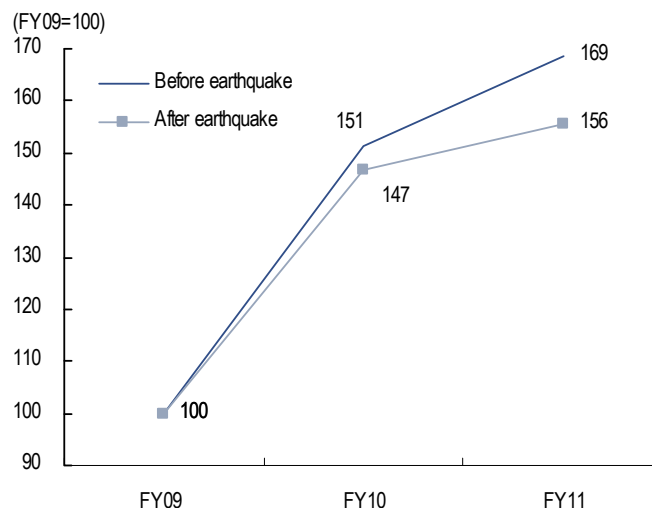
As we discuss above, the number of companies projecting growth in both revenues and earnings in FY3/12 H1 has declined because of the earthquake (Figures 1, 7). In this environment, companies that report growth in both revenue and earnings, and that are attractively valued, are likely to be highly rated by the market. Figure 8 lists companies with guidance for growth in both revenue and earnings in FY3/12 H1.

Figure 4. Trajectory of sales projections



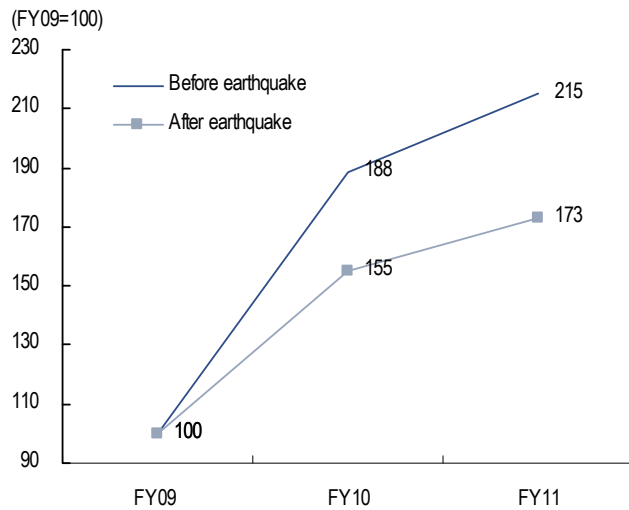
Source: Astra Manager, Citi Investment Research and Analysis

Figure 5. Trajectory of RP projections



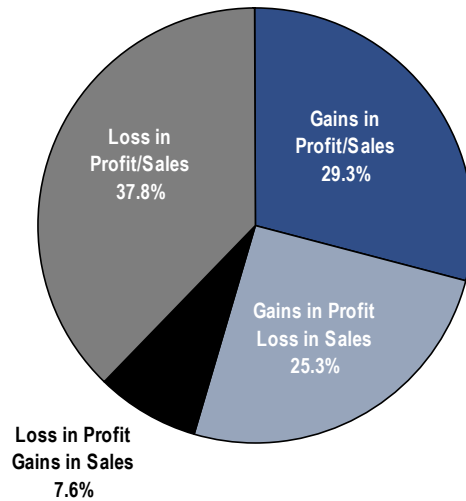
Source: Astra Manager, Citi Investment Research and Analysis

Figure 6. Trajectory of NP projections



Source: Astra Manager, Citi Investment Research and Analysis

Figure 7. Percentage of companies targeting revenue growth/decline, earnings growth/decline in FY3/12 H1



Source: Astra Manager, Citi Investment Research and Analysis

Figure 8. Companies targeting both revenue, earnings growth in FY3/12 H1

Code	Company	Share price	MCAP	Company forecast FY3/12 1H (YoY, %)			Company forecast FY3/12 (YoY, %)			Deviation from PBR 5 yr ave (%)
		(¥)	(¥bn)	Sales	RP	NP	Sales	RP	NP	
1963	JGC	2,169	562	50.8	122.0	107.3	23.0	7.3	64.9	9.2
6141	MORI SEIKI	1,059	125	48.1	-	-	20.4	1136.7	435.6	-12.0
6103	OKUMA	727	123	43.0	-	-	23.8	350.8	636.5	-5.7
7735	DAINIPPON SCREEN MFG.	679	172	25.0	9.4	14.8	9.8	-5.8	-10.5	61.1
6301	KOMATSU	2,432	2,429	23.9	40.8	56.8	16.6	36.5	32.7	6.5
4042	TOSOH	324	195	21.1	152.8	269.3	16.9	47.5	129.7	-5.9
5019	IDEMITSU KOSAN	8,990	360	19.2	20.6	30.3	16.7	-12.5	-6.1	NA
6302	SUMITOMO HEAVY IND.	562	345	16.7	11.4	13.6	15.0	14.1	7.4	-21.7
7947	FP	4,750	105	16.7	1.0	-0.6	13.7	10.7	8.1	7.9
2413	M3	566,000	148	16.7	22.8	25.5	17.8	18.0	19.0	13.5
6268	NABTESCO	1,835	233	16.1	4.7	15.0	15.8	10.4	12.0	33.3
1605	INPEX	588,000	2,150	14.8	20.8	18.5	7.7	8.1	1.0	NA
2371	KAKAKU.COM	511,000	148	14.4	1.6	2.5	19.0	20.8	22.3	17.2
5444	YAMATO KOGYO	2,641	185	13.5	52.1	29.7	18.8	37.0	21.1	-22.6
6954	FANUC	12,490	2,991	13.4	18.8	21.6	65.7	218.5	211.6	25.5
6113	AMADA	596	236	12.9	493.5	1158.7	16.5	107.2	194.6	-26.4
4555	SAWAI PHARMACEUTICAL	8,060	127	12.8	20.0	16.8	13.5	13.4	15.6	37.9
6481	THK	2,002	268	11.8	43.9	47.2	12.8	35.9	39.7	4.6
8113	UNICHARM	3,290	681	10.9	3.2	-31.0	11.7	7.6	4.3	17.0
8282	K'S HOLDINGS	3,070	187	10.3	21.1	36.2	3.8	1.3	23.9	19.9
1802	OBAYASHI	343	247	10.2	48.5	160.9	13.1	53.1	29.7	-19.2
4183	mitsui chemicals	267	273	10.0	16.4	-65.0	11.4	10.7	-15.5	-29.2
1662	JAPAN PETROLEUM EXPLORATION	3,880	222	9.6	49.4	187.9	11.9	-8.7	15.2	-29.5
7731	NIKON	1,900	762	9.3	46.0	50.4	5.9	25.4	53.8	-14.6
4061	DENKI KAGAKU KOGYO	418	211	9.2	7.6	-2.9	15.7	34.5	25.4	2.6
6273	SMC	13,040	937	8.7	18.3	23.6	7.7	11.0	29.8	2.5
6869	SYSMEX	2,894	298	8.2	11.6	10.9	10.7	15.1	13.9	18.9
4043	TOKUYAMA	393	137	8.1	42.2	53.9	7.0	3.8	2.4	-57.5
9989	SUNDRUG	2,406	162	7.8	9.3	22.5	8.1	10.0	13.3	-13.1
1803	SHIMIZU	337	266	7.3	27.6	154.8	2.0	16.9	1.4	-24.5

Notes: 1) As of May 31, 2011. 2) Company guidance. 3) Universe of TSE1 companies with market cap of at least ¥100bn that have disclosed FY3/12 H1 guidance and have March fiscal year-end.

Source: Astra Manager, Citi Investment Research and Analysis

Top down projections for FY3/12–3/13

We project TOPIX EPS of 51 in FY3/12, 70 in FY3/13

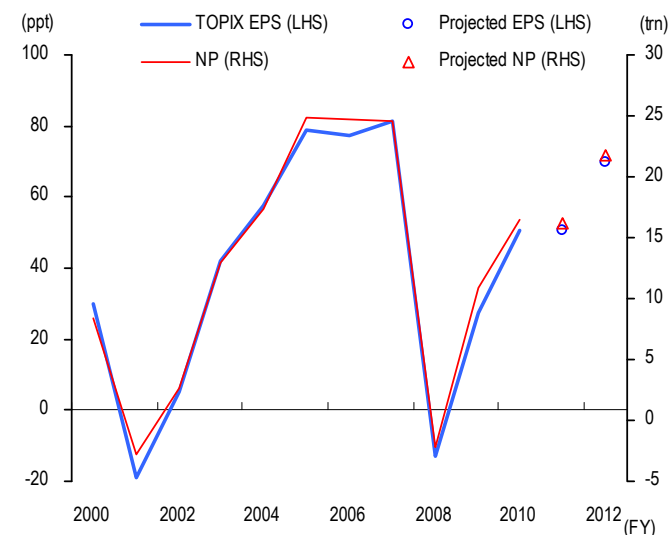
Our projections for year-on-year growth in industrial production, the yen/dollar and yen/euro rates, and the WTI price are shown in Figure 9. Based on these assumptions, we project TOPIX EPS of 51 points, up 0.2% YoY in FY3/12, and 70 points, up 37.8%, in FY3/13 (Figure 10, base-case scenario). Our methodology is outlined in the next section. Our top-down projections suggest that corporate earnings will be largely flat in FY3/12, and normalize in FY3/13.

Figure 9. Assumptions for top-down projections

	FY2011	FY2012
IIP YoY	1.0	6.4
USD/JPY	82.1	85.3
EUR/JPY	113.6	124.8
Crude oil price	100.7	99.8

Source: Astra Manager, Bloomberg, Citi Investment Research and Analysis

Figure 10. TOPIX EPS vs. net profits

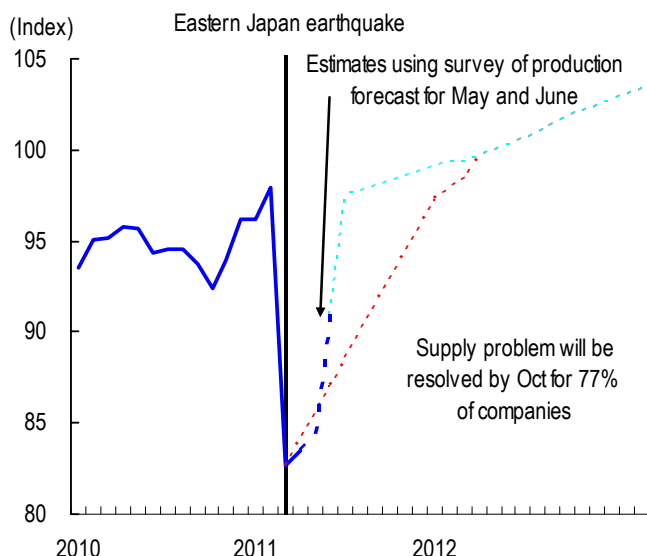


Source: Astra Manager, Citi Investment Research and Analysis

Supply chains recovering rapidly

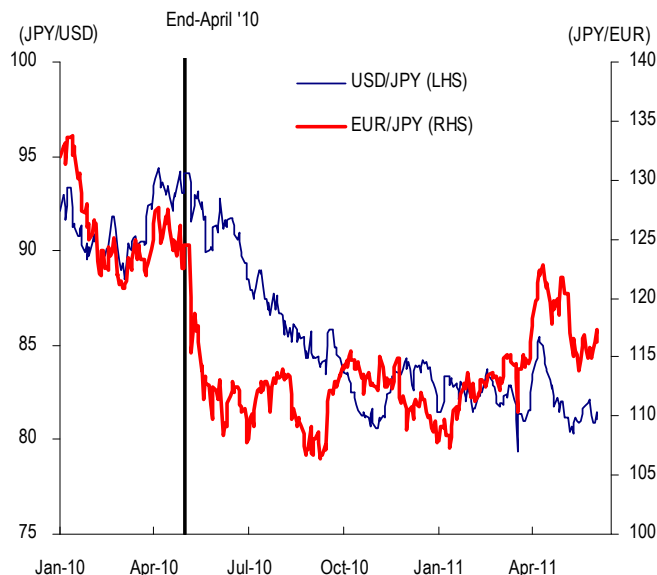
One risk to this scenario is a more rapid than expected recovery in supply chains that drives outperformance by industrial production. Japanese supply chains are apparently now recovering quickly. Some 77% of companies will overcome component procurement shortages by October, according to an April 8–15 survey by METI. However, the industrial production index is projected to rise 8.0 points MoM in May and 7.7 points in June, according to the May 31 release. This would put the June level back around the 93 of February (Figure 11).

Figure 11. Industrial production



Source: METI, Citi Investment Research and Analysis

Figure 12. Forex rates



Source: Citi Investment Research and Analysis

One downside risk is forex rates. Figure 12 plots the dollar-yen and euro-yen rates since 2010. The yen appreciated against the euro after Greece's sovereign debt problems became evident in April 2010, from around ¥125/€ at end-April 2010, to about ¥106/€ by September 2010.

Risk of yen appreciation against euro depending upon developments in Greek problem

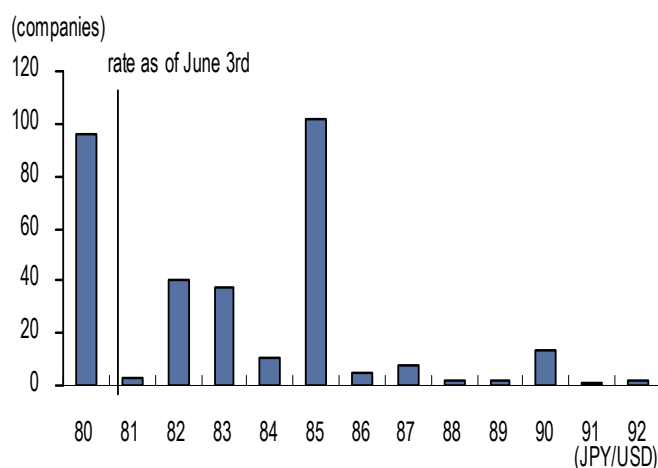
The euro has appreciated since March 2011, after rate rises by the ECB, climbing back to more than ¥120/€ as of March 2011. However, the euro has now sunk again to a little over ¥110/€, as markets again worry about the Greek sovereign debt problem. With no clear solution to the problem yet evident, the yen could appreciate further against the euro.

The dollar stood at ¥94/\$ as of end-April 2010, but subsequent concern regarding a second bottom for the US economy and the FRB's QE2 saw it sink to almost ¥80/\$ now. Our forecast for end-March 2010 is ¥84/\$, and we see little risk of the dollar depreciating by more than ¥10 as it did last year.

Caution regarding companies assuming ¥85/\$, ¥115/€

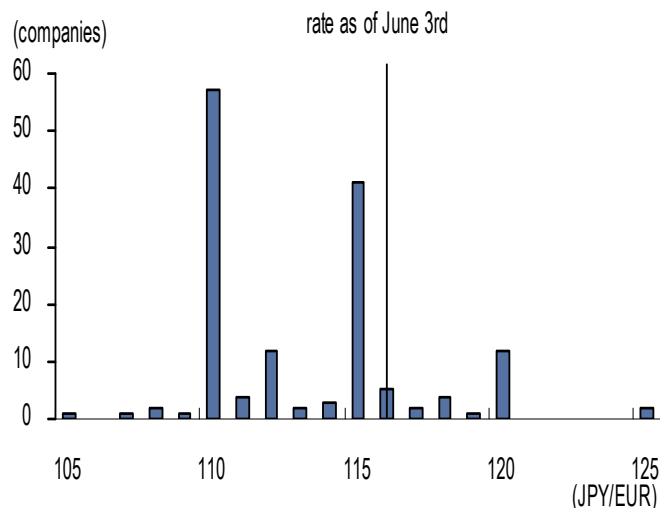
Figure 13 and 14 show the distribution of companies' forex assumptions. Most cluster around ¥110/€ and ¥115/€; and ¥80/\$ and ¥85/\$, but we see some risk of downward revisions to guidance due to forex fluctuation for companies that assume ¥115/€ and ¥85/\$.

Figure 13. Distribution of companies' ¥/\$ assumptions



Source: Astra Manager, Citi Investment Research and Analysis

Figure 14. Distribution of companies' ¥/€ assumptions



Source: Astra Manager, Citi Investment Research and Analysis

Figure 15 shows our TOPIX EPS projection for a risk scenario under which industrial production outperforms our base-case assumption, and the yen appreciates against the euro. This scenario assumes a 3 point YoY rise in the FY3/12 industrial production index and ¥105/€.

Figure 15. TOPIX EPS projection for FY3/12 under risk scenario

		FY10 EUR/JPY rate			
		113.6		105.0	
IIP YoY	+1%	51	0.2%	50	-1.7%
	+3%	53	4.7%	52	2.8%

Note: Bold font and shading denote base-case.

Source: Citi Investment Research and Analysis

The projections under the risk case in Figure 15 shows that, even if industrial production and the yen/euro rate diverge somewhat from our base-case scenario, there is no change to our fundamental outlook for earnings to be flat in FY3/12 and normalize in FY3/13.

However, there are downside risks other than forex rates. One concern is that the debate regarding a consumption-tax hike is gaining momentum within the government, but we will discuss this further on another occasion.

Methodology for top-down projections

Our FY3/12 TOPIX EPS projection is based on the following methodology.

1. We estimate sales growth based on industrial production and the nominal effective exchange rate.
2. We estimate the recurring margin based on the past level of sales and the WTI price, and RP by combining this figure with sales.

3. We estimate NP based on the NP/RP ratio.
4. We then derive our TOPIX EPS projection from the past relationship between EPS and NP.

Relationships between sales, industrial production, forex rate

Industrial production and nominal effective forex rate largely explain change in sales

Figure 16 plots total sales for TSE1 companies against year-on-year change in industrial production. It shows a close correlation between the two variables. A regression analysis of year-on-year change in sales against year-on-year change in industrial production and the nominal effective exchange rate yields the following results.

YoY change in sales = $1.9 + 0.82$ YoY change in industrial production $- 0.31$ YoY change in nominal effective exchange rate.

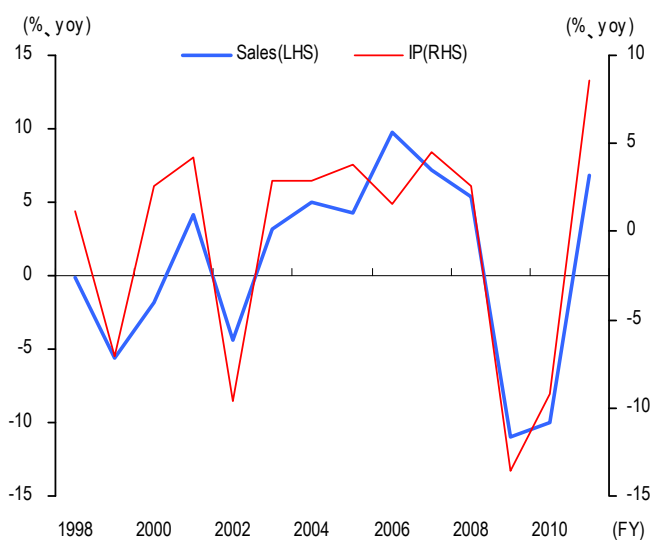
This is line with the intuitive expectation that sales will grow if industrial production expands and the yen weakens. The coefficient of determination is more than 90%, so change in industrial production and the forex rate explains most of change in sales.

A regression analysis of year-on-year change in the nominal effective exchange rate against year-on-year change in the dollar-yen rate and the euro-yen rate yields the following results.

YoY change in nominal effective exchange rate = -0.67 YoY change in dollar-yen rate $- 0.28$ YoY change in euro-yen rate.

Again, the coefficient of determination in excess of 90% shows that change in the dollar-yen rate and euro-yen rate explain the bulk of change in the nominal effective exchange rate. This is probably because many other currencies are pegged to the US dollar or closely linked to it.

Figure 16. Sales vs. industrial production



Note: Total sales for TSE1 companies.

Source: METI, Astra Manager, Citi Investment Research and Analysis

Figure 17. Recurring margin vs. sales



Note: Total sales, recurring margin for TSE1 companies.

Source: Astra Manager, Citi Investment Research and Analysis

**Recurring margin tends to expand as
sales grow thanks to economies of scale**

Relationships between recurring margin, sales, crude-oil price

Figure 17 shows TSE1 companies' sales and recurring margin since FY3/01. The recurring margin has ranged between 2% and 7%. When sales grow during an economic expansion, economies of scale mean that recurring margins tend to expand in line with the sales growth. However, towards the end of a period of economic expansion, growth in fixed costs, due to increase in capex and employment, cause recurring margins to start to contract. Further, once the economy begins to contract, sales decline but fixed costs remain high, so recurring margins narrow much more quickly. Another cause of contraction in recurring margins is increase in input costs due to rising crude oil prices.

We base our projections for FY3/12 and FY3/13 recurring margins on a regression analysis of recurring margins against sales and the WTI price. As we see FY3/11–3/12 as a period of economic recovery, we use data from the time of the recovery before in the financial crisis, from FY3/04 through FY3/08. Our analysis yields recurring margin forecasts of 5.3% for FY3/12 and 6.1% for FY3/13.

Recurring margin = 0.012 sales (¥trn) – 0.024 WTI price (\$/bbl)

NP/RP ratio

Figure 18 plots the NP/RP ratio for TSE1 companies since FY3/98. During the economic recovery since FY3/04, this has ranged between 45% and 60%. As we expect continuing extraordinary charges resulting from the earthquake in FY3/12, we estimate the NP/RP at 48% in FY3/12. For FY3/13, we use the 52% average for FY3/04–FY3/08.

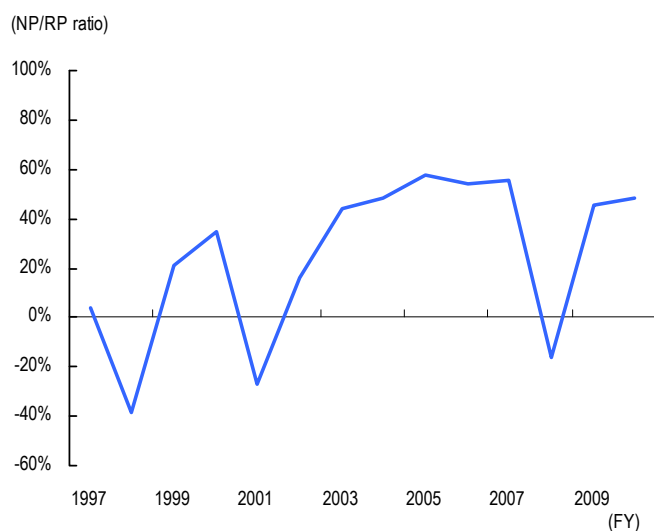
Relationship between EPS and NP

Figure 19 shows TOPIX EPS against total NP for TSE1 companies. The correlation is very close, and a regression analysis yields a coefficient of correlation of more than 90%.

EPS (points) = –5.38 + 3.46 NP (¥trn)

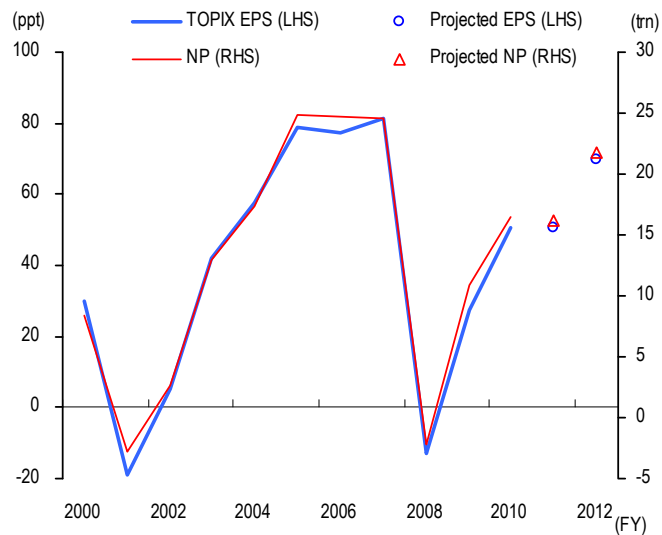
Based on the assumptions in Figure 9, and using the parameters estimated above, we project growth of 1.9% YoY in FY3/12 and 9.2% in FY3/13 for sales; –1.8% and 24.2% for RP; and –1.8% and 34.3% for NP (Figure 20). Based on our net profit projection, we forecast TOPIX EPS of 51 points, up 0.2% YoY, for FY3/12, and 70 points, up 37.8%, for FY3/13.

Figure 18. NP/RP ratio



Source: Astra Manager, Citi Investment Research and Analysis

Figure 19. TOPIX EPS vs. net profits



Source: Astra Manager, Citi Investment Research and Analysis

Figure 20. Sales, RP, NP forecasts (base case)

	Sales	RP	(% YoY) NP
FY10 (A)	7.1	43.1	50.7
FY11(E)	1.9	-1.8	-1.8
FY12(E)	9.2	24.2	34.2

Source: Citi Investment Research and Analysis

Figure 21. TSE1 FY3/11 earnings and FY3/12 guidance

	FY3/11 Actuals (YoY, %)							FY3/12 Company Estimates (YoY, %)						
	# reported	Sales	OP	RP	Extraordinary profits	Extraordinary losses	NP	# reported	RP estimates	% of reported RP estimates	Sales	OP	RP	NP
TSE1	1,393	6.4	37.6	46.9	3.0	50.1	54.8	1,129	81.0		4.5	1.2	6.0	11.6
TSE1 (exFinancials)	1,263	6.5	46.4	52.5	7.1	55.4	62.8	1,033	81.8		5.1	-0.5	0.1	8.2
Gl.&Cer.Prod	23	4.2	84.8	98.2	45.0	-25.9	542.7	17	73.9		2.9	5.6	13.2	39.9
Rubber Prod.	9	11.4	51.9	42.0	-48.9	81.9	49.2	5	55.6		6.6	-21.9	-17.4	29.5
Services	58	4.3	20.9	21.1	-10.5	81.0	4.0	49	84.5		2.1	-4.0	-5.6	15.0
Oth.Fin.Bus.	19	-5.7	NM	998.1	52.3	131.6	NM	14	73.7		-4.6	NM	NM	NM
Other Prod.	35	-5.1	-24.5	-36.0	-24.5	-15.2	-38.1	27	77.1		4.4	4.7	29.8	41.0
Pulp&Paper	10	1.5	-13.6	-9.9	-60.8	140.7	NM	9	90.0		3.6	-3.4	-3.1	112.6
Pharm.	31	0.9	-2.1	-1.6	27.4	94.0	-4.8	29	93.5		1.3	-0.9	-1.3	0.2
Whsle Trade	116	12.4	63.8	53.3	-30.7	21.5	58.3	105	90.5		7.2	14.1	9.4	12.2
Chemicals	105	10.6	75.3	78.2	-18.3	56.5	86.0	87	82.9		7.3	-1.1	0.3	12.3
Marine Trans	9	14.8	NM	NM	-37.0	-17.0	NM	9	100.0		4.8	-57.2	-59.1	-56.8
Machinery	105	10.8	129.5	133.7	37.6	21.6	320.9	85	81.0		6.5	11.4	11.0	10.0
Metal Prod.	27	9.1	42.5	40.8	449.6	52.0	97.2	17	63.0		1.0	14.1	8.9	48.7
Banks	83	-0.9	4.4	38.2	-11.0	-12.8	57.7	75	90.4		-2.0	NM	18.3	2.2
Air Trans.	3	10.0	NM	NM	422.9	76.0	NM	2	66.7		6.7	26.8	38.5	NM
Construction	89	-5.9	27.3	20.5	24.4	2.5	68.4	83	93.3		5.2	2.7	3.6	12.5
Mining	6	12.4	12.5	10.5	147.0	122.5	7.1	6	100.0		8.2	6.4	7.0	-0.1
Retail Trade	116	1.9	23.0	22.4	23.8	-13.4	89.4	108	93.1		3.6	6.2	3.9	53.3
Sec.&Com.Fut	21	-5.2	-80.6	-76.0	-73.1	22.1	NM	1	4.8		38.6	NM	NM	NM
Inf.&Com.	73	2.8	10.7	9.9	5.4	4.6	15.1	70	95.9		1.7	1.8	3.2	5.5
Foods	45	1.6	5.0	7.4	-25.8	81.7	-5.6	39	86.7		3.3	-3.3	-4.3	17.9
Fish/Ag.&For	4	1.8	29.4	26.7	7.8	317.4	-23.6	3	75.0		6.2	24.9	31.7	429.2
Prec. Inst.	23	7.5	44.9	45.5	-61.3	10.6	39.5	20	87.0		3.9	9.1	13.7	44.6
Oil&Coal P.	6	8.5	174.7	154.7	271.0	207.1	642.0	5	83.3		12.3	-10.3	-11.0	-4.8
Text&Apparel	26	8.8	124.7	264.4	-12.8	-24.4	NM	23	88.5		6.5	4.1	4.4	21.1
Whsng&H.Tr.S	18	14.8	30.1	31.8	70.8	164.6	23.5	16	88.9		17.1	12.3	8.5	25.0
Iron & Steel	34	15.9	341.8	1315.4	-44.7	152.1	NM	18	52.9		11.4	61.6	55.4	875.5
Elec.Pwr&Gas	16	5.8	16.3	19.9	300.0	31840.8	NM	12	75.0		6.0	-30.7	-33.0	-25.7
Elec. App.	131	5.8	117.1	206.5	-19.3	21.4	6580.1	103	78.6		5.6	9.3	12.7	14.7
Nonfer.Mtls	23	13.6	89.4	104.4	22.0	-3.8	677.3	18	78.3		1.0	-7.0	-5.4	-1.4
Real Estate	28	-1.1	15.5	21.1	-10.2	-34.2	112.8	28	100.0		-1.8	-1.9	-6.5	26.8
Insurance	7	18.9	NM	-34.5	623.2	22.0	-49.4	6	85.7		1.0	NM	68.7	93.7
Trans.Equip.	60	6.9	95.0	100.0	57.4	-11.0	172.2	10	16.7		3.1	-17.5	-19.3	-11.1
Land Trans.	34	0.1	7.7	16.0	-16.1	35.8	8.4	30	88.2		-1.7	-26.1	-31.5	-28.6

Notes: 1) TSE1 companies with March fiscal year-ends. 2) Includes retailers with February fiscal year-ends. 3) Guidance as of June 2.

Source: Astra Manager, Citi Investment Research and Analysis

Figure 22. Corporate earnings forecasts for FY3/11– 3/12 as of March 10

	# reported	FY3/11 Estimated Change (%)				FY3/12 Estimated Change (%)			
		Sales	OP	RP	NP	Sales	OP	RP	NP
TSE1	1,393	7.0	89.9	51.4	88.2	3.9	7.5	11.4	14.4
TSE1 (exFinancials)	1,263	7.0	46.8	52.4	96.3	4.3	16.6	13.0	16.5
Gl.&Cer.Prod	23	4.9	93.5	106.6	581.0	-1.4	8.9	11.3	16.8
Rubber Prod.	9	12.7	55.3	42.6	71.0	659.2	314.1	487.2	379.4
Services	58	5.5	25.4	22.3	12.8	-0.6	41.5	39.7	64.9
Oth.Fin.Bus.	19	-8.6	NM	4160.8	NM	43.1	1348.7	113.1	NM
Other Prod.	35	-2.4	-16.5	-31.3	-22.6	13.2	29.7	52.2	63.3
Pulp&Paper	10	2.1	-11.3	-8.7	-11.2	-3.5	1.3	1.4	13.4
Pharm.	31	0.7	-5.3	-5.3	-6.6	-9.2	-4.6	-4.7	-4.6
Whsle Trade	116	13.0	66.4	58.0	63.4	-10.5	62.8	42.6	27.0
Chemicals	105	11.3	77.8	79.9	99.5	-0.2	2.3	3.7	8.9
Marine Trans	9	14.7	NM	NM	NM	8.1	7.7	17.3	23.3
Machinery	105	10.8	129.9	127.5	290.9	-3.9	7.8	14.3	20.2
Metal Prod.	27	9.6	53.2	48.8	204.8	2.1	18.5	18.0	20.3
Banks	83	2.9	-17.4	56.9	73.0	4.9	2.2	-0.1	-6.3
Air Trans.	3	12.1	NM	NM	NM	13.3	57.9	89.3	95.3
Construction	89	-3.9	29.7	21.4	77.0	3.0	10.9	13.6	12.8
Mining	6	7.0	3.1	3.5	0.1	9.1	9.9	10.1	5.0
Retail Trade	116	2.3	18.8	17.0	102.5	35.9	8.1	12.4	8.9
Sec.&Com.Fut	21	-3.9	-86.0	-51.6	-69.1	200.6	7589.9	219.0	216.9
Inf.&Com.	73	2.3	8.0	7.4	13.9	25.3	-10.6	-4.3	3.6
Foods	45	0.5	1.2	2.3	-3.6	14.1	3.7	6.2	9.8
Fish/Ag.&For	4	3.6	32.7	15.2	60.8	-55.0	-68.8	-66.9	-65.8
Prec. Inst.	23	8.4	48.6	50.1	64.2	52.2	35.5	47.4	49.1
Oil&Coal P.	6	6.9	103.0	94.1	647.7	-74.2	-73.9	-78.2	-88.0
Text&Apparel	26	8.8	121.6	256.2	NM	60.3	49.6	53.8	63.6
Whsng&H.Tr.S	18	14.7	30.2	29.8	32.2	24.6	26.4	21.8	30.6
Iron & Steel	34	16.2	332.3	1287.9	NM	10.3	34.2	44.5	46.7
Elec.Pwr&Gas	16	5.4	9.3	10.4	-11.8	0.1	0.1	-0.1	20.4
Elec. App.	131	7.2	125.7	224.4	9178.2	7.5	17.7	22.8	33.2
Nonfer.MtIs	23	12.9	85.1	98.2	730.9	4.5	16.3	17.0	22.2
Real Estate	28	-1.3	16.9	19.0	133.7	30.5	257.8	9.7	12.2
Insurance	7	17.5	NM	11.9	4.7	-50.4	-50.4	-58.7	-66.2
Trans.Equip.	60	7.8	109.4	111.5	204.7	-0.5	6.9	4.3	10.9
Land Trans.	34	1.1	12.0	20.8	25.0	-1.2	2.5	3.6	9.9

Note: Toyo Keizai forecasts. 2) TSE1 companies with March fiscal year-ends. 3) Includes retailers with February fiscal year-ends.

Source: Astra Manager, Citi Investment Research and Analysis

Market Outlook

Investment opinion: Overweight

Stock markets around the world continue to move slowly upward against the backdrop of a global economic recovery. Our end-2011 MSCI AC World Index target is 380, and we therefore anticipate an increase of about 10% from the current level of around 340.

We continue to be cautious about Japanese equities short term but optimistic about the medium term. We think low valuations for Japanese equities will correct over time, but there are short-term risks, namely concerns of a slowdown in the global economy, that the process of bringing the Fukushima nuclear problems to a close is not going as planned and growing uncertainty about the cost to financial institutions due to nuclear accident compensation. However, even if shares do decline, we think low valuations will provide support and TOPIX will bottom at about 790 in April-June, so downside appears limited.

Upside risk factors could include parts and power shortages, or greater-than-anticipated growth in the US and developing economies.

Downside risks include any worsening of problems at nuclear power plants, further impeding economic activity, and the financial crisis in Europe. We see the risk of the crisis spreading to Spain.

Figure 23. Global Economic Outlook

GDP	2010	2011E	2012E
Japan	4.0	-0.6	3.2
US	2.9	2.7	3.1
UK	1.3	1.8	2.6
Eurozone	1.6	2.1	1.6
Asia	9.1	7.7	7.7
Global	4.1	3.5	3.9

CPI	2010	2011E	2012E
Japan	-0.7	0.5	0.5
US	1.6	2.9	1.7
UK	3.3	4.6	3.4
Eurozone	1.6	2.7	2.2
Asia	4.3	5.5	4.5
Global	2.7	3.9	3.3

Interest Rates	Current	4Q11	2Q12
Japan	0.10	0.10	0.10
US	0.25	0.25	0.75
UK	0.55	1.00	1.50
Euro area	1.25	1.75	2.25

10yr Yield	Current	4Q11	2Q12
Japan	1.10	1.40	1.80
US	3.03	3.60	3.85
UK	3.25	4.10	4.35
Euro area (Bunds)	3.00	3.65	3.80

FX Rates	Current	4Q11	2Q12
¥/\$	81	83	85
\$/€	1.46	1.42	1.49
\$/£	1.64	1.65	1.73
\$/RMB	6.48	6.35	6.20

Note: Citi estimates.

Source: Citi Investment Research and Analysis.

Figure 24. Citigroup global strategy team's regional views

Overweight	Neutral	Underweight
Emerging Markets	US	Europe ex-UK
Japan	UK	Developed Asia

Source: Citi Investment Research and Analysis.

Figure 25. TOPIX and Nikkei 225 forecasts

	TOPIX	Nikkei 225
End of 2011	920	10,300
Mar of 2012	950	10,700

Source: Citi Investment Research and Analysis.

Figure 26. TOPIX EPS forecasts

	Citi	yoy %	Bloomberg	yoy %
FY2010	50		50	
FY2011	51	0.2	54	7.7
FY2012	70	37.9	68	25.0

Source: Bloomberg, Citi Investment Research and Analysis.

Themes to watch

Stocks related to non-nuclear energy, energy saving: Inpex, JX Holdings, Mitsui & Co, Itochu, Tokyo Gas

Everyday consumption: Point, JT, Seven & i

Emerging economies: Komatsu, Fanuc, Suzuki

Smartphones and tablet PCs: Shinko Electric, KDDI

Note: Companies taken from our model portfolio.

Sector recommendations

We see non-nuclear energy as a long-term theme and therefore overweight sectors related to energy. We underweight utilities and financials, given poor visibility regarding the nuclear crisis and compensation.

Figure 27. Sector recommendations

Overweight	Neutral	Underweight
Consumer staples	Material	Financials
Energy	Health Care	Utilities
	Industrials	
	Information technology	
	Consumer discretionary	
	Telecommunications	

Source: Citi Investment Research and Analysis.

Five top picks

Figure 28. Five top picks

	Reasons to Buy
1605 INPEX	A final investment decision on the major Ichthys project in Australia is pending and the company may be able to reach basic agreements on LNG purchasing contract by mid-year. We think the ratio of share price to reserves looks low
2685 Point	The company has the highest level of asset efficiency among listed retailers that operate their own stores, with a FY2/10 ROA of 17.1%. The shares look significantly undervalued
3382 Seven & i	Mainstay convenience store earnings are bottoming out. The shares look significantly undervalued
6967 Shinko Electric	The construction of a new fab at the Takaoka plant increases the company's chances of embarking on a new growth phase
8001 Itochu	Expectations of substantial earnings growth this year. Shares continue to look undervalued

Source: Citi Investment Research and Analysis.

Model portfolio

Figure 29. Model portfolio

Code	Company	Market weight	Citi weight	Rating	RP YoY (%)		PER (x)		ROE (%)	MCAP(¥bn)	Pct to chg vs. TOPIX (%)	
		Share prices (¥)			FY3/12E	FY3/13E	FY3/12E	FY3/13E	FY3/12E	7-Jun-11	3m	1m
Consumer staples		Overweight	5.9%	8%								
2914	Japan Tobacco	309,500	4%	1M	6.3	16.4	16.3	13.1	10.8%	2,933	8.6	-0.1
3382	Seven & i Holdings	2,132	4%	1M	7.6	12.3	20.8	13.5	5.3%	1,904	8.6	11.4
Materials		Neutral	8.3%	8%								
4114	Nippon Shokubai	235	4%	1M	11.5	10.1	8.9	8.1	11.4%	202	20.3	5.3
5711	Mitsubishi Materials		4%	1M	NM	54.5	25.6	6.8	3.5%	307	-9.3	-9.7
Health Care		Neutral	6.2%	6%								
4502	Takeda Pharmaceutical	3,780	6%	1M	-0.2	-27.8	12.7	17.5	10.1%	2,976	8.2	2.3
Industrials		Neutral	21.1%	22%								
6301	Komatsu	2,363	5%	1M	45.4	13.8	10.9	9.5	20.4%	2,230	5.5	-11.8
6367	Daikin Industries	2,737	4%	1M	11.1	35.7	16.4	11.9	9.6%	792	18.8	11.2
6954	Fanuc	12,200	5%	1M	19.5	8.9	15.7	14.5	15.9%	2,357	10.7	-1.7
8001	Itochu	807	3%	1M	48.4	8.7	7.1	6.3	15.7%	1,269	10.6	-1.8
8031	Mitsui & Co.	1,325	5%	1M	153.9	6.3	7.3	6.5	14.5%	2,418	3.2	-0.5
IT		Neutral	13.1%	12%								
6967	Shinko Electric Industries	793	3%	1H	-15.1	248.8	50.7	13.0	1.6%	107	-5.6	3.5
7741	Hoya	1,713	3%	1M	24.9	13.9	10.3	9.5	18.0%	727	3.1	3.8
7751	Canon	3,745	6%	1M	-3.3	52.6	18.0	11.8	9.4%	4,601	13.3	4.3
Consumer Discretionary		Neutral	19.6%	19%								
2685	Point	3,350	3%	1M	0.7	19.5	9.6	7.8	21.0%	79	-0.2	-2.0
6902	Denso	2,818	5%	1M	52.0	18.5	14.7	13.3	8.0%	2,266	9.1	12.0
6952	Casio Computer	561	3%	2M	44.4	33.1	17.4	13.3	6.2%	150	-9.2	-8.1
7269	Suzuki Motor	1,727	4%	1M	6.1	8.5	17.9	16.5	5.9%	963	4.7	-1.6
7453	Ryohin Keikaku	3,655	4%	1M	7.3	16.9	11.9	9.7	10.4%	100	8.7	4.6
Financials		Underweight	17.5%	14%								
8306	Mitsubishi UFJ Financial Group	360	5%	1H	2.4	3.2	8.6	8.3	5.3%	5,133	-6.4	-2.9
8591	ORIX	7,640	4%	1H	30.5	10.9	12.0	10.9	5.5%	809	-4.2	3.0
8750	Dai-ichi Life	112,600	5%	1H	132.7	0.3	16.2	16.6	7.2%	1,085	-12.7	-9.3
Telecommunication Services		Neutral	3.9%	4%								
9433	KDDI	566,000	4%	2M	-2.4	-0.8	11.0	10.8	11.0%	2,416	23.1	9.7
Utilities		Underweight	2.6%	1%								
9531	Tokyo Gas	349	1%	1L	-44.9	92.5	22.7	11.6	4.7%	940	12.3	2.8
Energy		Overweight	1.6%	6%								
1605	Inpex	571,000	3%	1H	13.8	4.8	13.6	13.7	7.5%	2,103	12.8	7.5
5020	JX Holdings	524	3%	1H	3.9	-9.1	6.2	6.9	12.4%	1,318	2.0	2.5

Note: The index composition indicates the sector weight as a proportion of the S&P Japan Equity Index. NM: Not meaningful.
Source: S&P Global Equity Indices, Citi Investment Research and Analysis.

Macro takeaways

We provide brief summaries compiled by Bruce Rolph in *The Globaliser* and *The Weekly Globaliser*. For more details, please refer to individual reports.

Regional Strategy

Global
Robert Buckland
1-June -2011

Global Equity Strategist

'Here we go again – another conundrum', sighs *Global Equity Strategist Robert Buckland*, 'like last August, benchmark government bond yields have fallen sharply around the world, suggesting a sharp economic slowdown is imminent... but benchmark global equity indices have moved little... bears call this complacency; the bulls, resilience... over the past 11 years, equities have been proven 'right' 7 times vs bonds 2 times... and this time, we expect equities to win again... in the Grind Higher, share prices tend to follow EPS, not volatile macro measures... if US treasury yields are likely to move higher for the rest of the year, then global equity investors should overweight Japan vs the US and favour cyclical vs defensives'.

Global Emerging
Geoffrey Dennis
30-May-2011

Global Emerging Markets Strategy — Still Bullish

We remain very constructive on emerging market (EM) equities for the rest of 2011. Our year-end target for MSCI GEMs is 1,500, an upside of over 30% from current levels. One of the strongest supports for higher EM equity markets is the historically low cost of capital in the EM's, which, as defined by EMBI+, has fallen sharply in recent years as fundamentals have improved. And, based on our new discount rate measure for EM markets – the MSCI-weighted EM Debt Yield – shows EM equities to be even more attractively valued relative to bonds than this conventional measure of the region's average debt yield would indicate. So stay the course. Brazil, China, Korea, Russia are our top picks.

Europe
Jonathan Stubbs & Adrian Cattley
27-May-2011

European Equity Strategy — Tactical Shift: Banks To Overweight

Over the past 3-months, Banks have been the worst performing sector in Europe. This reflects heightened sovereign fears and ongoing concerns over capital shortages across the sector. But, a lot of bad news now appears to be priced into a sector which has already undergone significant capital repair in the past 2 years. And now at 2010 absolute lows, we believe, the probability of a material sell-off from current levels is low. Thus, we up Banks to Overweight, but maintain a quality bias. Favouring banks with stronger capital positions, better funding and higher RoE opportunities. Our analysts' top picks are Standard Chartered PLC (STAN.L; £15.78; 1M), Credit Suisse (CSGN.VX; SFr35.19; 1M), BNP Paribas SA (BNPP.PA; €52.64; 1M), DNB NOR ASA (DNBNOR.OL; Nkr79.80; 1M) and HSBC Holdings PLC (HSBA.L; £6.23; 1M).

Asia Pacific
Markus Rosgen
30-May-2011

The Case For Asian Equities

Markets have a history of declining when investors are drunk on risk. This is not the case at present. Investor positioning does not indicate a high degree of bullishness. And when it comes to worries, investors have plenty of them. Inflation is just one of those fears. Growth slowing and margin pressure are others. Overdone: GDP growth deceleration does not stop earnings from growing, nor does it stop the market from moving higher. Add that the US\$ now looks overbought near-term, and the omens for Asian markets don't look nearly as bad as the current mindset of investors would suggest.

CEEMEA
Andrew Howell
26-May-2011

CEEMEA Strategy — Attack Of The ETFs

More than 25% of all institutional assets in both emerging markets (EM) and Central Eastern Europe Middle East & Africa (CEEMEA) are now managed by passive funds, from less than 10% a few years ago. This marks a major shift in the way

money is managed in EM. More passive money also should lead to a variety of changes in CEEMEA: higher stock correlations; higher volatility during index inflows/outflows; a valuation premium for index stocks; and general decline in market efficiency. Still, to pronounce the death of active fund management seems premature. If anything, the further rise of ETFs is likely to make it easier for active funds to outperform – helping to justify their higher fees!

Economists

Economics
Willem Buiter
25-May-2011

Global Economic Outlook & Strategy

We continue to expect strong global growth this year and next, with global GDP rising 3½-4% each year, well above the long-run average of just below 3% YoY. We expect that US GDP growth will rebound to about 3% QoQ in Q2, buoyed by solid job growth, strong business investment and less drag from energy costs. The slowdown in China is likely to prove mild. But growth remains uneven and many economies will not be growing particularly strongly this year and 2012. Moreover, the EMU sovereign credit crisis is unlikely to fade quickly, with the chance of debt restructuring high in Greece, Ireland and Portugal.

Economics
Robert DiClemente
27-May-2011

US Recovery's Detour

The Japan earthquake and its aftermath are taking a toll on near-term US economic growth. Supply chain disruptions may trim as much as a full percentage point off Q2 growth to ~2¼% with further residual impact on Q3. But barring new shocks, we believe the expansion should recapture momentum in the second half. Roughly 23% of manufacturers and 15% of non-manufacturing firms are reporting Japan-related delays, but these firms have raised their 2011 forecasts for revenues, capex and hiring. In addition, forward-looking indicators with longer horizons are signaling that moderate expansion is not threatened.

The Point for Japan – Top Calls

[Minivehicle Maker Investment Angle — Laggard Suzuki poised for rerating; Daihatsu fairly valued](#)

Japan | Auto Manufacturers

We revise up our forecasts in response to the acceleration of production normalization. For Daihatsu, we raise our target price to ¥1,360 from ¥830 and upgrade to Hold from Sell. The stock has outperformed markedly since the end-April results announcement but we think the positives are priced in. For Suzuki, we raise our target price to ¥2,430 from ¥1,950 and upgrade to Buy from Hold. The shares have lagged following recent downbeat company comments on production, but we think Suzuki is fully capable of restoring its domestic operating rate in step with Daihatsu. We think Q1 results announcements will be the catalyst for Suzuki share price upside and we see merit in a pair trade.

[USS \(4732\) — Downgrading to Hold on slump in vehicles put up for auction](#)

Japan | Auto Manufacturers | Hold/Medium Risk

We revise down our forecasts as we expect the plunge in the number of vehicles exhibited for auction to continue over the near term, denting earnings. We accordingly lower our target price to ¥6,600 from ¥7,180 and downgrade to Hold from Buy. That said, we think USS's dominant market share and auction expertise will enable it to recover faster than rivals when conditions improve.

[Casio Computer \(6952\) — Downgrading to Hold as cost cuts fall short of our forecast](#)

Japan | Consumer Electronics | Hold/Medium Risk

We downgrade to Hold from Buy and lower our target price to ¥640 from ¥830. There is no change to our outlook for high margins and RoIC in core businesses (wrist watches, etc.) However, cost cuts in the digital camera business, which Casio has decided to downsize, are not advancing as fast as we expected and we think digital cameras could be a drag on earnings. Also, visibility for the new network business, for which Casio has declined to disclose the business model, is poor and we now think share price upside is limited.

[Social game sector investment approach — Focus on new market development via DeNA's in-house titles](#)

Japan | Internet

We think expansion of social game platforms for smartphones will determine share price trends in the medium term. For this expansion to happen, firms will need to develop hit new-genre app titles. In our view, Ninja Royale, an in-house title recently released by DeNA, appears to have that potential. As such, we think the shares look significantly undervalued, so we retain our Buy rating.

[Oil sector — Recommending low-PER, high-RoE JX Holdings and Idemitsu](#)

Japan | Oil Companies - Majors

Sector share prices have been weak recently, pricing in excessive concerns over temporary or insignificant factors. We remain convinced of a low-PER driven market in 2011 and recommend JX Holdings (top pick) and Idemitsu Kosan (newly

upgraded to Buy), where we see good prospects for upward revisions. We also upgrade Cosmo Oil to Hold: the overhang of DTA reversal concerns has lifted and other positives have emerged, but we see risk of a plan shortfall. We maintain our Buy on AOC, our Hold on TonenGeneral, and our Hold on Showa Shell.

Valuation

Figure 30. Japan Sector Weightings & Relative Returns

	2011/6/3	MCAP \$mn	Weight %	Relative return (%)			
				1m	3m	12m	Ytd
Energy		39,916	1.8	-2.8	6.7	17.4	14.2
Materials		169,893	7.6	-3.1	0.3	-0.5	1.2
Chemicals		104,951	4.7	-1.5	5.1	10.9	9.2
Metals & Mining		57,015	2.6	-6.0	-6.4	-13.1	-9.2
Industrials		462,754	20.8	-0.9	4.1	8.0	4.3
Capital Goods		350,661	15.7	-1.6	6.5	16.3	7.6
Building Products		30,856	1.4	1.3	6.3	6.1	10.6
Construction & Engineering		18,396	0.8	7.0	22.8	22.8	15.4
Electrical Equipment		50,908	2.3	3.7	7.9	11.2	7.1
Machinery		141,761	6.4	-3.8	7.8	23.1	9.9
Trading Companies & Distributors		108,738	4.9	-2.6	2.7	15.2	3.9
Commercial & Professional Services		20,161	0.9	-3.3	-0.1	-8.3	-2.6
Transportation		91,933	4.1	2.2	-3.4	-12.7	-5.4
Air Freight & Logistics		5,988	0.3	3.0	6.9	5.0	15.9
Marine		13,919	0.6	-2.0	-9.0	-20.4	-14.3
Road & Rail		66,132	3.0	2.8	-3.6	-13.0	-5.1
Consumer Discretionary		440,767	19.8	2.5	2.0	5.3	4.1
Automobiles & Components		285,124	12.8	2.5	2.8	11.0	7.8
Auto Components		56,629	2.5	3.8	8.0	13.5	9.6
Automobiles		228,495	10.3	2.2	1.5	10.4	7.3
Consumer Durables & Apparel		98,955	4.4	0.8	-1.9	-6.0	-5.4
Household Durables		73,852	3.3	-1.6	-5.3	-12.8	-10.6
Leisure Equipment & Products		22,881	1.0	9.6	9.2	21.1	14.2
Consumer Services		8,673	0.4	3.1	1.0	-1.8	0.2
Media		9,732	0.4	6.1	0.4	0.2	0.9
Retailing		38,283	1.7	5.9	7.6	1.3	6.5
Internet & Catalog Retail		7,293	0.3	11.3	14.9	28.7	23.7
Multiline Retail		8,470	0.4	-2.6	-11.3	-20.6	-16.3
Specialty Retail		22,520	1.0	7.0	14.0	3.4	11.7
Consumer Staples		119,365	5.4	5.1	10.2	7.8	7.4
Food & Staples Retailing		32,072	1.4	6.6	8.4	9.5	5.8
Food Beverage & Tobacco		62,617	2.8	3.5	11.4	8.5	11.1
Beverages		20,122	0.9	4.3	13.6	3.2	8.7
Food Products		25,144	1.1	5.4	12.8	8.4	11.3
Tobacco		17,351	0.8	0.0	6.8	16.2	14.2
Household & Personal Products		24,676	1.1	7.4	9.4	3.8	0.8
Health Care		139,425	6.3	4.7	11.2	6.6	6.3
Health Care Equipment & Services		24,971	1.1	6.6	14.9	0.3	4.1
Pharmaceuticals Biotechnology & Life Sciences		114,453	5.1	4.3	10.4	8.1	6.8
Financials		376,664	16.9	-1.2	-6.3	-7.8	-6.0
Banks		193,231	8.7	-2.2	-7.9	-12.1	-8.1
Diversified Financials		42,542	1.9	-1.1	-9.4	-13.4	-10.3
Insurance		64,062	2.9	-1.4	-5.6	-9.3	-3.1
Real Estate		76,830	3.4	1.6	-0.2	11.6	0.0
Real Estate Investment Trusts		16,481	0.7	3.0	11.6	18.6	2.5
Real Estate Management & Development		60,350	2.7	1.2	-3.0	9.9	-0.7
Information Technology		299,814	13.5	0.7	2.2	-3.7	-2.2
Software & Services		48,821	2.2	0.2	-0.7	-16.5	-6.5
Internet Software & Services		10,686	0.5	3.7	13.3	6.3	13.9
IT Services		7,860	0.4	-1.6	-0.1	-17.2	-2.6
Software		30,275	1.4	-0.6	-4.2	-20.6	-11.7
Technology Hardware & Equipment		228,713	10.3	1.2	3.2	1.0	-1.4
Semiconductors & Semiconductor Equipment		22,279	1.0	-2.4	-1.7	-17.2	-0.9
Telecommunication Services		103,940	4.7	3.5	10.4	28.0	19.5
Utilities		75,043	3.4	-15.0	-38.5	-45.1	-38.8
Electric Utilities		52,521	2.4	-20.3	-48.0	-53.1	-47.7
Gas Utilities		19,774	0.9	1.4	8.5	-7.1	3.6
MSCI Japan		2,227,581	100.0				

Source: MSCI, Citi Investment Research and Analysis.

Figure 31. Japan Relative Ratings

	2011/6/3	PE Relative				Yield Relative			
		2009	2010	2011E	2012E	2009	2010	2011E	2012E
Energy		87.0	68.3	49.7	75.3	115.0	146.5	201.2	132.7
Materials		197.9	105.6	90.9	90.8	50.5	94.7	110.0	110.1
	Chemicals	229.9	94.6	88.1	93.2	43.5	105.7	113.5	107.3
	Metals & Mining	236.9	120.1	89.2	83.9	42.2	83.2	112.1	119.1
Industrials		61.5	81.2	78.6	84.4	162.7	123.2	127.3	118.5
	Capital Goods	62.6	77.6	71.8	77.6	159.7	128.9	139.4	128.9
	Building Products	NM	113.7	94.0	93.9	NM	88.0	106.3	106.5
	Construction & Engineering	308.1	122.6	106.5	117.3	32.5	81.6	93.9	85.2
	Electrical Equipment	120.5	99.1	100.7	103.8	83.0	100.9	99.3	96.4
	Machinery	115.8	121.1	109.3	114.4	86.4	82.5	91.5	87.4
	Trading Companies & Distributors	26.9	45.0	42.1	47.2	371.8	222.0	237.6	211.9
	Commercial & Professional Services	71.5	102.9	113.1	126.6	139.9	97.2	88.5	79.0
	Transportation	55.9	93.2	111.4	115.1	178.9	107.3	89.8	86.9
	Air Freight & Logistics	43.8	91.8	129.2	130.5	228.2	108.9	77.4	76.6
	Marine	NM	64.8	76.2	77.3	NM	154.4	131.3	129.3
	Road & Rail	42.8	99.0	119.1	124.4	233.6	101.0	83.9	80.4
Consumer Discretionary		NM	135.0	130.4	104.2	NM	74.1	76.7	96.0
	Automobiles & Components	1354.2	100.6	119.8	95.3	7.4	99.4	83.5	104.9
	Auto Components	282.5	86.2	105.5	94.8	35.4	115.9	94.8	105.5
	Automobiles	22619.1	104.9	124.0	95.4	0.4	95.3	80.6	104.8
	Consumer Durables & Apparel	NM	NM	188.1	125.8	NM	NM	53.2	79.5
	Household Durables	NM	NM	242.9	128.0	NM	NM	41.2	78.1
	Leisure Equipment & Products	496.0	132.0	112.5	118.8	20.2	75.8	88.9	84.2
	Consumer Services	52.7	120.6	135.7	134.8	189.7	82.9	73.7	74.2
	Media	76.3	121.3	137.5	144.2	131.0	82.4	72.7	69.3
	Retailing	66.8	113.0	113.1	119.5	149.8	88.5	88.4	83.7
	Internet & Catalog Retail	48.9	168.0	169.3	174.9	204.7	59.5	59.1	57.2
	Multiline Retail	NM	NM	165.5	130.1	NM	NM	60.4	76.8
	Specialty Retail	39.4	71.6	92.2	105.4	253.5	139.7	108.4	94.9
Consumer Staples		60.3	114.5	125.5	130.6	165.8	87.4	79.7	76.6
	Food & Staples Retailing	77.0	92.6	126.1	122.3	129.8	108.0	79.3	81.8
	Food Beverage & Tobacco	55.6	121.7	118.2	125.1	179.8	82.2	84.6	79.9
	Beverages	51.8	153.0	111.1	114.2	193.2	65.4	90.0	87.6
	Food Products	60.7	108.4	121.8	133.9	164.9	92.2	82.1	74.7
	Tobacco	54.5	114.7	121.8	127.2	183.4	87.2	82.1	78.6
	Household & Personal Products	56.0	135.9	147.9	163.4	178.5	73.6	67.6	61.2
Health Care		40.4	85.9	107.1	130.4	247.8	116.4	93.3	76.7
	Health Care Equipment & Services	63.6	131.4	155.0	152.6	157.2	76.1	64.5	65.5
	Pharmaceuticals Biotechnology & Life Sciences	37.3	79.8	100.4	126.4	268.0	125.2	99.6	79.1
Financials		97.3	67.9	80.7	92.9	102.8	147.2	123.9	107.7
	Banks	70.6	46.6	58.2	73.0	141.6	214.4	171.8	137.1
	Diversified Financials	NM	154.9	139.1	114.4	NM	64.6	71.9	87.4
	Insurance	57.9	152.8	138.5	135.4	172.8	65.4	72.2	73.9
	Real Estate	65.1	129.6	137.2	152.3	153.5	77.1	72.9	65.7
	Real Estate Investment Trusts								
	Real Estate Management & Development	65.1	129.6	137.1	151.8	153.5	77.1	72.9	65.9
Information Technology		NM	109.1	106.3	109.0	NM	91.7	94.1	91.8
	Software & Services	31.9	108.8	133.2	138.9	313.7	91.9	75.1	72.0
	Internet Software & Services	62.4	94.6	107.3	120.4	160.2	105.7	93.2	83.0
	IT Services	39.8	89.4	103.8	115.9	251.3	111.8	96.4	86.3
	Software	26.5	121.6	160.0	156.3	377.0	82.2	62.5	64.0
	Technology Hardware & Equipment	NM	102.2	101.0	103.9	NM	97.8	99.0	96.3
	Semiconductors & Semiconductor Equipment	NM	356.0	118.5	114.1	NM	28.1	84.4	87.6
Telecommunication Services		36.4	70.3	79.3	90.4	274.9	142.3	126.1	110.6
Utilities		34.1	NM	NM	319.2	292.9	NM	NM	31.3
	Electric Utilities	32.6	NM	NM	2620.3	306.9	NM	NM	3.8
	Gas Utilities	40.9	66.0	103.1	111.4	244.3	151.5	97.0	89.8
MSCI Japan		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MSCI, Citi Investment Research and Analysis.

Figure 32. Japan Earnings Growth

	2011/6/3	Earning Growth (%)			Dividend Growth (%)		
		2010	2011E	2012E	2010	2011E	2012E
Energy		185.5	73.6	-18.0	-7.8	25.0	0.4
Materials		319.9	46.8	24.5	4.9	11.9	10.7
	Chemicals	444.2	35.8	17.6	11.1	10.4	5.9
	Metals & Mining	341.9	70.3	32.1	-4.1	19.9	21.8
Industrials		69.7	30.6	15.7	22.9	17.3	9.2
	Capital Goods	80.8	36.7	15.0	32.0	24.1	9.7
	Building Products	NM	52.9	24.5	24.3	2.0	2.8
	Construction & Engineering	463.1	45.6	12.9	5.7	6.2	5.7
	Electrical Equipment	172.4	24.4	20.7	38.6	11.5	8.6
	Machinery	114.1	40.1	18.8	23.8	22.1	9.9
	Trading Companies & Distributors	33.8	35.3	10.9	42.8	35.4	11.4
	Commercial & Professional Services	55.6	15.1	11.0	-1.9	2.1	2.9
	Transportation	34.3	5.8	20.3	5.2	-2.1	8.7
	Air Freight & Logistics	6.9	-10.2	23.1	0.0	1.0	4.5
	Marine	NM	7.5	22.4	18.8	-14.1	24.2
	Road & Rail	-3.1	5.0	19.0	1.7	0.8	5.4
Consumer Discretionary		NM	30.8	55.7	1.6	9.2	26.1
	Automobiles & Components	2917.0	6.1	56.3	3.8	12.5	35.5
	Auto Components	634.0	3.4	38.4	27.7	5.8	16.1
	Automobiles	48219.3	7.0	61.6	-1.2	14.4	40.3
	Consumer Durables & Apparel	NM	NM	85.9	-7.2	3.9	8.8
	Household Durables	NM	NM	135.9	-10.6	1.6	9.8
	Leisure Equipment & Products	741.9	48.4	17.8	2.8	9.6	6.1
	Consumer Services	-2.1	12.4	25.2	4.9	3.2	8.9
	Media	41.0	11.6	18.5	8.1	6.7	8.6
	Retailing	32.5	26.3	17.7	11.0	1.0	7.6
	Internet & Catalog Retail	-34.8	25.5	20.4	100.0	-4.7	7.3
	Multiline Retail	NM	NM	58.1	-14.7	5.1	3.1
	Specialty Retail	23.5	-1.8	8.8	24.7	-0.5	9.8
Consumer Staples		18.1	15.4	19.4	4.4	4.5	4.2
	Food & Staples Retailing	86.5	-7.2	28.2	3.0	1.0	2.3
	Food Beverage & Tobacco	2.4	30.2	17.4	7.9	8.7	6.4
	Beverages	-24.2	74.1	21.0	7.8	4.5	4.8
	Food Products	25.4	12.6	13.1	3.3	4.8	3.8
	Tobacco	6.5	19.2	19.0	14.9	17.9	10.7
	Household & Personal Products	-7.6	16.2	12.6	2.1	1.5	2.3
Health Care		5.3	1.4	2.1	1.3	1.3	1.8
	Health Care Equipment & Services	8.5	7.2	26.3	10.4	-3.2	4.8
	Pharmaceuticals Biotechnology & Life Sciences	4.7	0.6	-1.3	0.3	1.7	1.6
Financials		220.9	6.5	8.0	-4.9	2.7	2.4
	Banks	239.2	1.3	-0.8	-4.3	-1.5	-0.1
	Diversified Financials	NM	40.8	51.1	-26.8	9.0	10.0
	Insurance	-15.1	39.5	27.2	14.4	17.3	1.6
	Real Estate	12.6	19.5	12.0	2.9	12.9	5.3
	Real Estate Investment Trusts	-	-	-	-	-	-
	Real Estate Management & Development	12.6	19.5	12.3	2.9	6.2	5.6
Information Technology		NM	29.8	21.2	2.9	7.1	9.2
	Software & Services	-34.4	3.4	19.2	-34.1	-11.2	12.3
	Internet Software & Services	47.8	11.5	10.7	60.7	16.9	10.6
	IT Services	-0.3	9.0	11.3	1.3	0.9	2.8
	Software	-51.1	-3.9	27.3	-43.0	-17.5	15.5
	Technology Hardware & Equipment	NM	27.9	20.9	16.7	10.9	8.8
	Semiconductors & Semiconductor Equipment	NM	279.9	29.1	63.9	19.9	6.5
Telecommunication Services		16.0	12.0	9.1	4.0	6.9	5.3
Utilities		NM	NM	NM	-10.5	-16.2	-3.2
	Electric Utilities	NM	NM	NM	-13.1	-19.9	-4.5
	Gas Utilities	38.9	-19.0	15.0	5.3	1.2	1.8
MSCI Japan		124.1	26.5	24.3	3.0	6.6	8.3

Source: MSCI, Citi Investment Research and Analysis.

Figure 33. Japan Sector Ratings

	2011/6/3	PE (x)				Dividend Yield (%)			
		2009	2010	2011E	2012E	2009	2010	2011E	2012E
Energy		35.2	12.3	7.1	8.7	2.0	1.8	2.2	2.3
Materials		80.2	19.1	13.0	10.4	1.8	1.9	2.1	2.3
	Chemicals	93.1	17.1	12.6	10.7	1.8	2.0	2.2	2.3
	Metals & Mining	96.0	21.7	12.8	9.7	1.6	1.6	1.9	2.3
Industrials		24.9	14.7	11.2	9.7	1.6	1.9	2.3	2.5
	Capital Goods	25.4	14.0	10.3	8.9	1.4	1.9	2.3	2.5
	Building Products	-84.2	20.6	13.4	10.8	1.7	2.2	2.2	2.3
	Construction & Engineering	124.8	22.2	15.2	13.5	1.8	1.9	2.1	2.2
	Electrical Equipment	48.8	17.9	14.4	11.9	1.0	1.3	1.5	1.6
	Machinery	46.9	21.9	15.6	13.2	1.1	1.3	1.6	1.8
	Trading Companies & Distributors	10.9	8.1	6.0	5.4	1.9	2.7	3.7	4.1
	Commercial & Professional Services	28.9	18.6	16.2	14.6	3.0	2.9	3.0	3.1
	Transportation	22.6	16.9	15.9	13.2	1.9	2.0	1.9	2.1
	Air Freight & Logistics	17.8	16.6	18.5	15.0	1.8	1.8	1.8	1.9
	Marine	-179.8	11.7	10.9	8.9	2.2	2.6	2.2	2.7
	Road & Rail	17.3	17.9	17.0	14.3	1.9	2.0	2.0	2.1
Consumer Discretionary		-582.9	24.4	18.6	12.0	1.4	1.4	1.6	2.0
	Automobiles & Components	548.6	18.2	17.1	11.0	1.4	1.4	1.6	2.1
	Auto Components	114.4	15.6	15.1	10.9	1.2	1.5	1.6	1.8
	Automobiles	9162.7	19.0	17.7	11.0	1.4	1.4	1.6	2.2
	Consumer Durables & Apparel	-29.0	-299.1	26.9	14.5	1.6	1.5	1.6	1.7
	Household Durables	-20.4	-53.1	34.7	14.7	1.6	1.5	1.5	1.6
	Leisure Equipment & Products	200.9	23.9	16.1	13.7	1.8	1.8	2.0	2.1
	Consumer Services	21.4	21.8	19.4	15.5	1.8	1.9	2.0	2.2
	Media	30.9	21.9	19.7	16.6	1.4	1.5	1.6	1.7
	Retailing	27.0	20.4	16.2	13.7	1.2	1.3	1.3	1.4
	Internet & Catalog Retail	19.8	30.4	24.2	20.1	0.1	0.2	0.2	0.3
	Multiline Retail	-23.4	-80.4	23.7	15.0	2.1	1.8	1.9	1.9
	Specialty Retail	16.0	12.9	13.2	12.1	1.2	1.5	1.5	1.6
Consumer Staples		24.4	20.7	17.9	15.0	2.2	2.3	2.4	2.5
	Food & Staples Retailing	31.2	16.7	18.0	14.1	2.6	2.7	2.7	2.8
	Food Beverage & Tobacco	22.5	22.0	16.9	14.4	1.8	1.9	2.1	2.2
	Beverages	21.0	27.7	15.9	13.1	1.8	2.0	2.1	2.2
	Food Products	24.6	19.6	17.4	15.4	1.7	1.7	1.8	1.9
	Tobacco	22.1	20.7	17.4	14.6	1.8	2.1	2.5	2.8
	Household & Personal Products	22.7	24.6	21.1	18.8	2.6	2.6	2.7	2.7
Health Care		16.3	15.5	15.3	15.0	3.3	3.4	3.4	3.5
	Health Care Equipment & Services	25.8	23.8	22.2	17.5	1.3	1.5	1.4	1.5
	Pharmaceuticals Biotechnology & Life Sciences	15.1	14.4	14.3	14.5	3.8	3.8	3.9	3.9
Financials		39.4	12.3	11.5	10.7	2.9	2.7	2.8	2.9
	Banks	28.6	8.4	8.3	8.4	3.7	3.5	3.5	3.4
	Diversified Financials	-18.9	28.0	19.9	13.2	2.5	1.8	2.0	2.2
	Insurance	23.4	27.6	19.8	15.6	1.9	2.1	2.5	2.5
	Real Estate	26.4	23.4	19.6	17.5	1.5	1.5	1.7	1.8
	Real Estate Investment Trusts	-	-	-	-	-	-	-	-
	Real Estate Management & Development	26.4	23.4	19.6	17.5	1.5	1.5	1.6	1.7
Information Technology		-209.3	19.7	15.2	12.5	1.9	2.0	2.1	2.3
	Software & Services	12.9	19.7	19.0	16.0	3.8	2.5	2.2	2.5
	Internet Software & Services	25.3	17.1	15.3	13.8	0.6	0.9	1.1	1.2
	IT Services	16.1	16.2	14.8	13.3	2.7	2.8	2.8	2.9
	Software	10.7	22.0	22.9	18.0	5.3	3.0	2.5	2.9
	Technology Hardware & Equipment	-67.9	18.5	14.4	11.9	1.7	1.9	2.1	2.3
	Semiconductors & Semiconductor Equipment	-14.5	64.4	16.9	13.1	1.0	1.6	2.0	2.1
Telecommunication Services		14.7	12.7	11.3	10.4	2.1	2.2	2.3	2.4
Utilities		13.8	-12.5	-16.3	36.7	5.2	4.7	3.9	3.8
	Electric Utilities	13.2	-6.7	-8.4	301.3	6.3	5.5	4.4	4.2
	Gas Utilities	16.6	11.9	14.7	12.8	2.5	2.6	2.6	2.7
MSCI Japan		40.5	18.1	14.3	11.5	2.1	2.2	2.3	2.5

Source: MSCI, Citi Investment Research and Analysis.

Appendix A-1

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