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March 14, 2011

Tohoku Pacific Earthquake and market outlook for Japan

The staff of Tokio Marine Asset Management Co., Ltd. expresses our condolences to the victims of the Tohoku Pacific Earthquake.

It is inevitable that this earthquake will temporarily depress the Japanese economy. In particular, Tokyo Electric has to ration electricity in order to restore power to the areas most affected by the disaster, and this has caused concern about infrastructure impairment across a large area, including Tokyo. These rolling blackouts are the first to occur since the chaotic period immediately following World War II, and the resulting economic upheaval looks to be more than was originally anticipated. On the other hand, a supply-demand gap already exists in the overall Japanese economy due to a lack of demand in this deflationary environment, and general sentiment is that because Japanese companies already have extra operating capacity, the long-term effect on the economy will not be particularly crippling.

We do expect some disruption to the financial and securities markets. With increasing uncertainty about the direction of the Japanese economy, it is likely that domestic investors will become risk averse and move into low-risk assets. Also, given that the damage seems worse than originally reported, it is likely that foreign investors will sell their Japanese equities, putting downward pressure on the market. In the six months after the Great Hanshin-Awaji (Kobe) Earthquake in January 1995 the market dropped by over 20%, and based on this it is possible that TOPIX will drop below 800 points. However, current company earnings and valuations are very different from what they were in January 1995. At that time P/E ratios were well over 50x, whereas currently they seem undervalued at approximately 14x. With regards to currency movement, there are some concerns about yen appreciation as a result of repatriation by Japanese companies, but the Bank of Japan has indicated that it will implement additional monetary easing measures, and we see the risk of significant yen appreciation as limited. Accordingly,

while the market may sink to low levels, we currently think that this will most likely not escalate into a critical long-term situation.

On the policy side, the government seems to be cooperating well across party lines to respond to this crisis, and the Bank of Japan has committed to providing a supply of funds to the short-term money market. While it will take some time, as post-disaster reconstruction progresses, we think the financial and securities markets will also stabilise.

We will continue to closely monitor the market situation going forward.

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