



Outlook for Japanese Stock Market & Economy

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-September 2025-



Sumitomo Mitsui DS Asset Management



Outlook for Japanese Stock Market

Market Outlook

- **Japanese Stock Market Rebounded Sharply Following the Agreement on Trump Tariffs. We Expect the Japanese Market to Resume its Long-Term Upward Trend.**

Japan's economic downturn is expected to bottom out thanks to the unexpected agreement reached in the Japan-US trade talks in Q3 of 2025. Thereafter, fiscal expansion by the US and the EU are expected to bolster the Japanese economy and corporate earnings going forward.

- **We Have Raised our Price Targets for the Nikkei 225**

We have raised our target price for the Nikkei 225 from 41,900 to 44,200 in December 2025 and from 42,300 to 44,500 in March 2026, based on the changes in our estimates of EPS and valuations due to strong nominal GDP growth, mild inflation, an accommodative fiscal policy, and improving corporate governance.

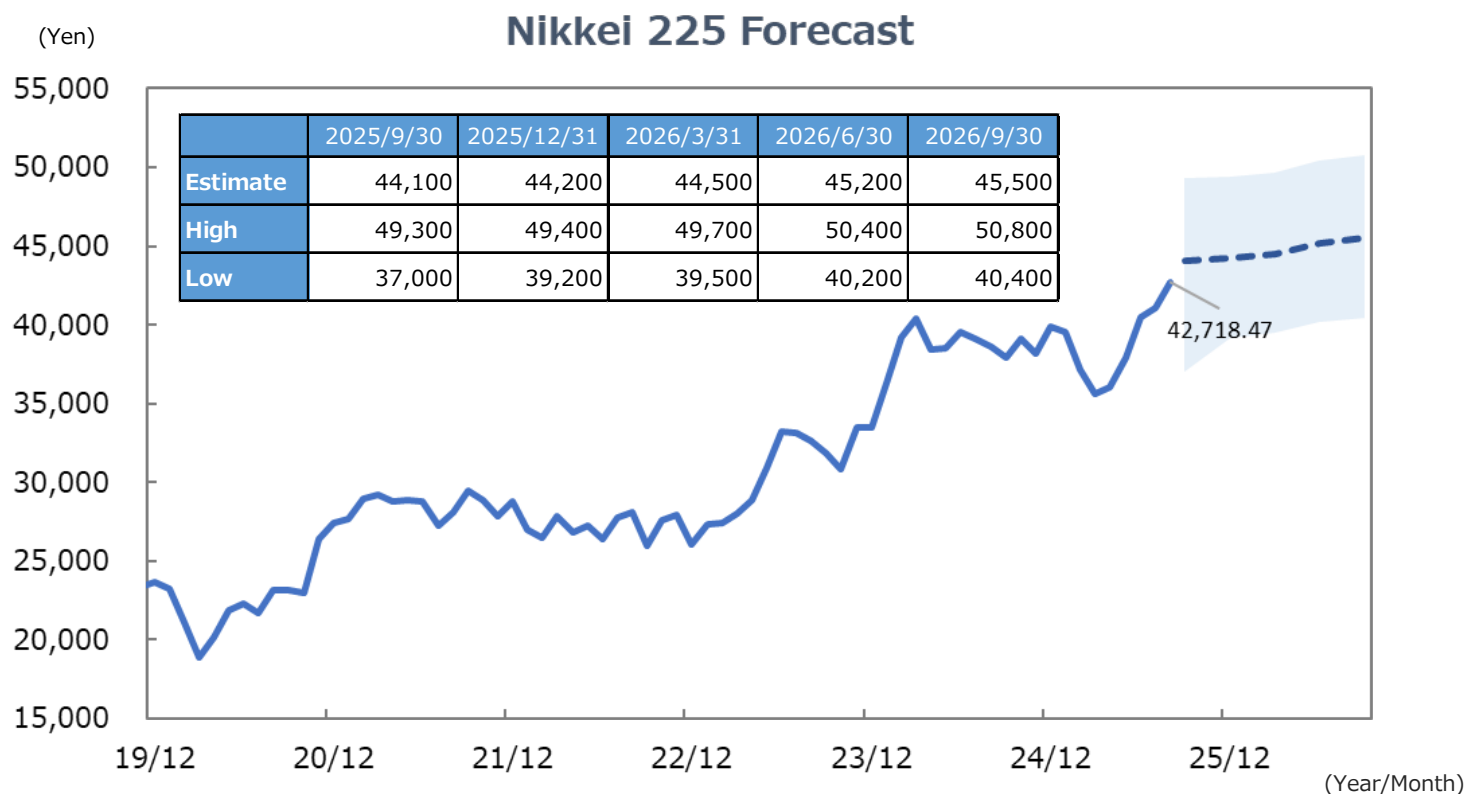
- **Rising Interest Rates May Weigh on Share Price Valuations**

Political uncertainty and monetary tightening could lift interest rates and weigh on share price valuations going forward.

- **Improving Corporate Governance Improve Stock Market Dynamics**

The corporate sector has become a major buyer in the Tokyo Stock Exchange due to the rising volume of buybacks and improving corporate governance.

Japanese Equity to Resume Bullish Trend in Mid-to-Long Term

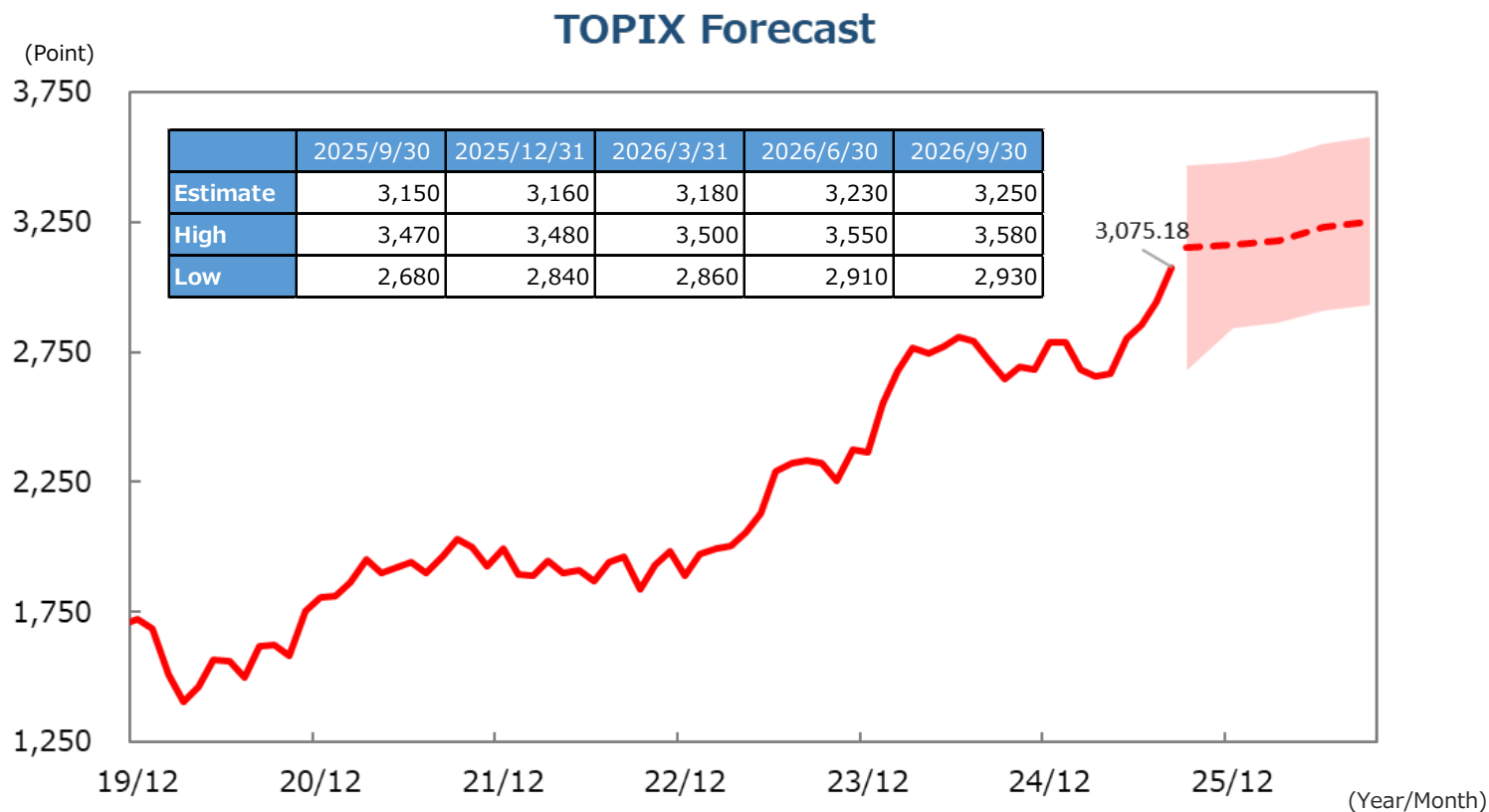


Data is from December 2019 to September 2026. Data after August 2025 is our forecast.

Note: The forecasts are as of August 20th, 2025.

(Source) Bloomberg, SMDAM

Japanese Equity to Resume Bullish Trend in Mid-to-Long Term

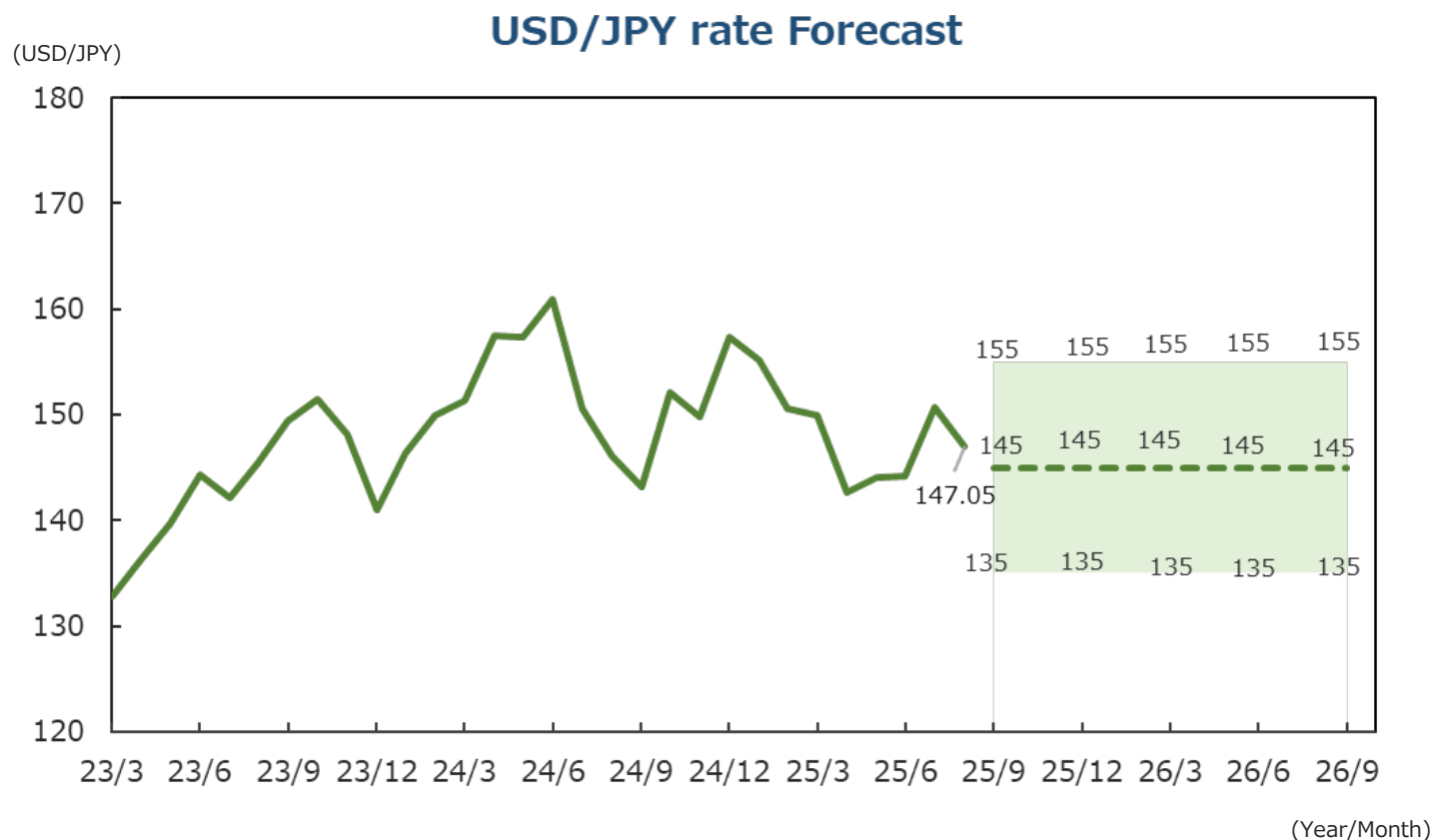


Data is from December 2019 to September 2026. Data after August 2025 is our forecast.

Note: The forecasts are as of August 20th, 2025.

(Source) Bloomberg, SMDAM

Divergence of Monetary Policy to Weigh on the Dollar Ahead



Data is from March 2023 to September 2026. Data after August 2025 is our forecast.

Note: The forecasts are as of August 20th, 2025.

(Source) Bloomberg, SMDAM

Upside / Downside Risk Scenarios

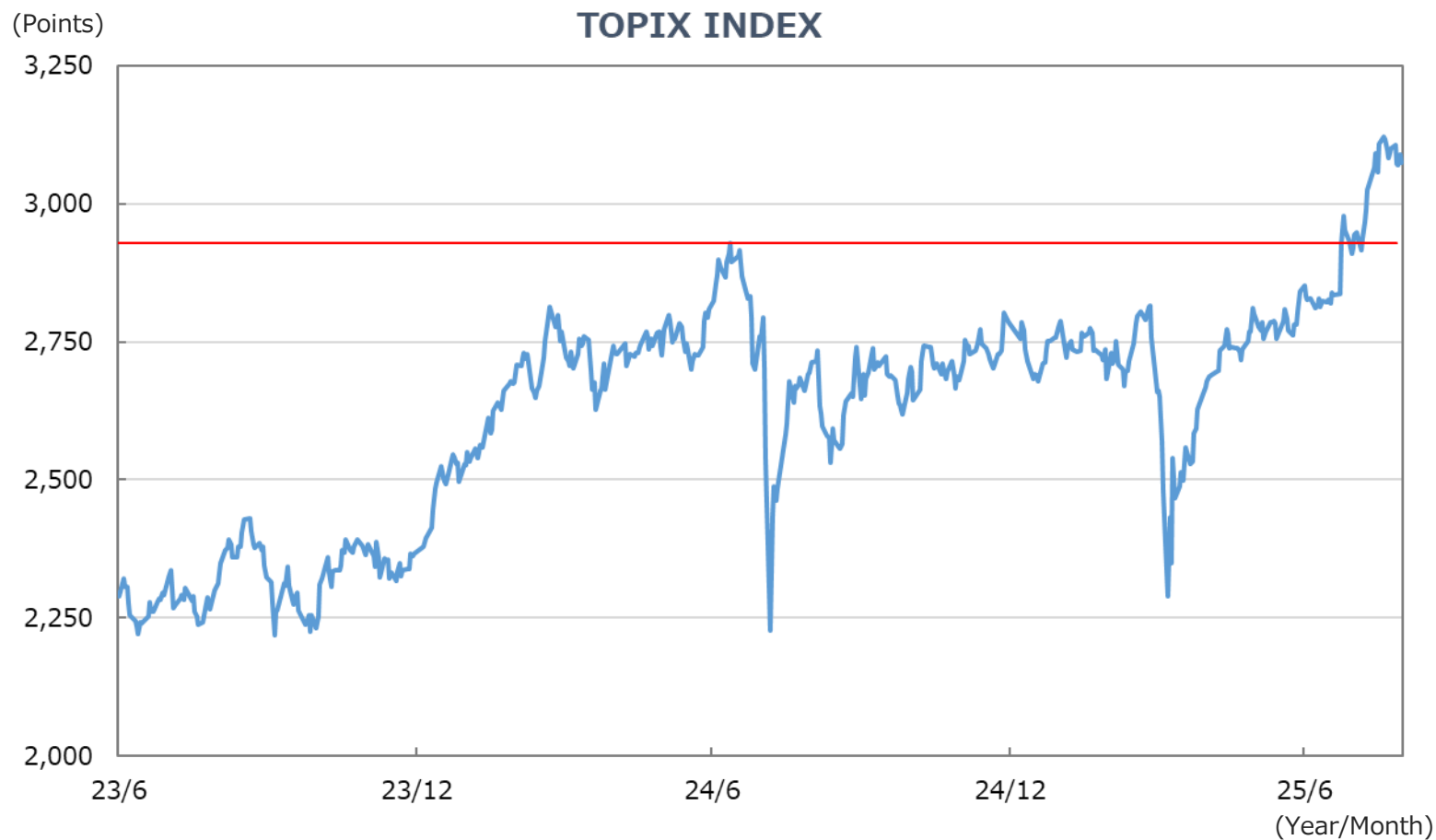
■ Upside Risks

- Robust foreign inflows into the Japanese stock market fueled by further improvements in corporate governance
- Resurgence of Big Tech stocks boosted by the social implementation and monetization of artificial intelligence (AI)
- Growing optimism fueled by fiscal expansion

■ Downside Risks

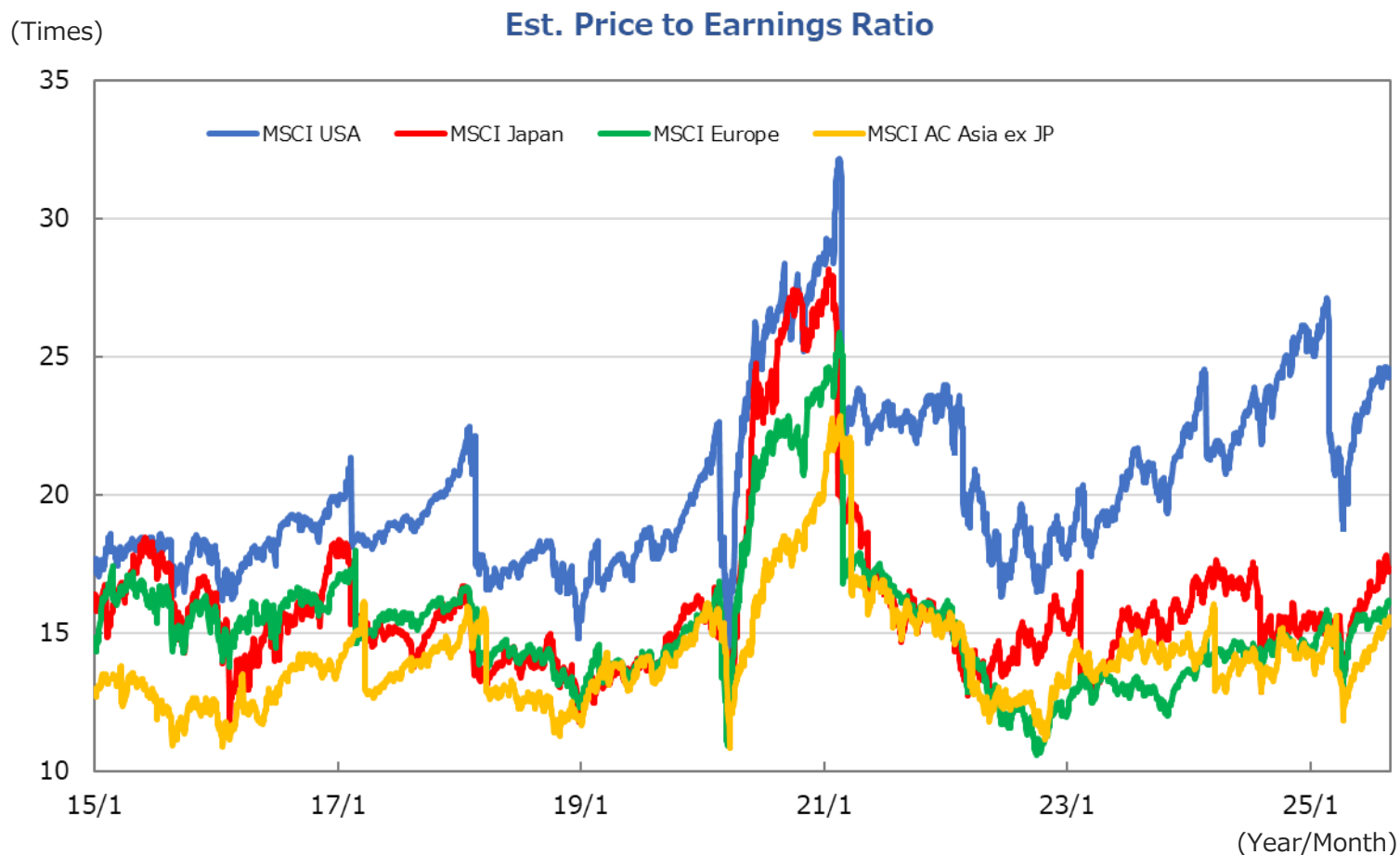
- Renewed deterioration in the US-China trade talks
- Excessive monetary easing by the US Federal Reserve and Yen's appreciation
- Spike of Japanese government bond (JGB) yields owing to the concern over fiscal deficit and increased defense spending
- Foreign investors sell-off due to the turmoil in domestic politics
- Negative impact of excessive accumulation of inventories due to Trump tariffs

TOPIX Breaking Record High After Year of Range-Bound Trading



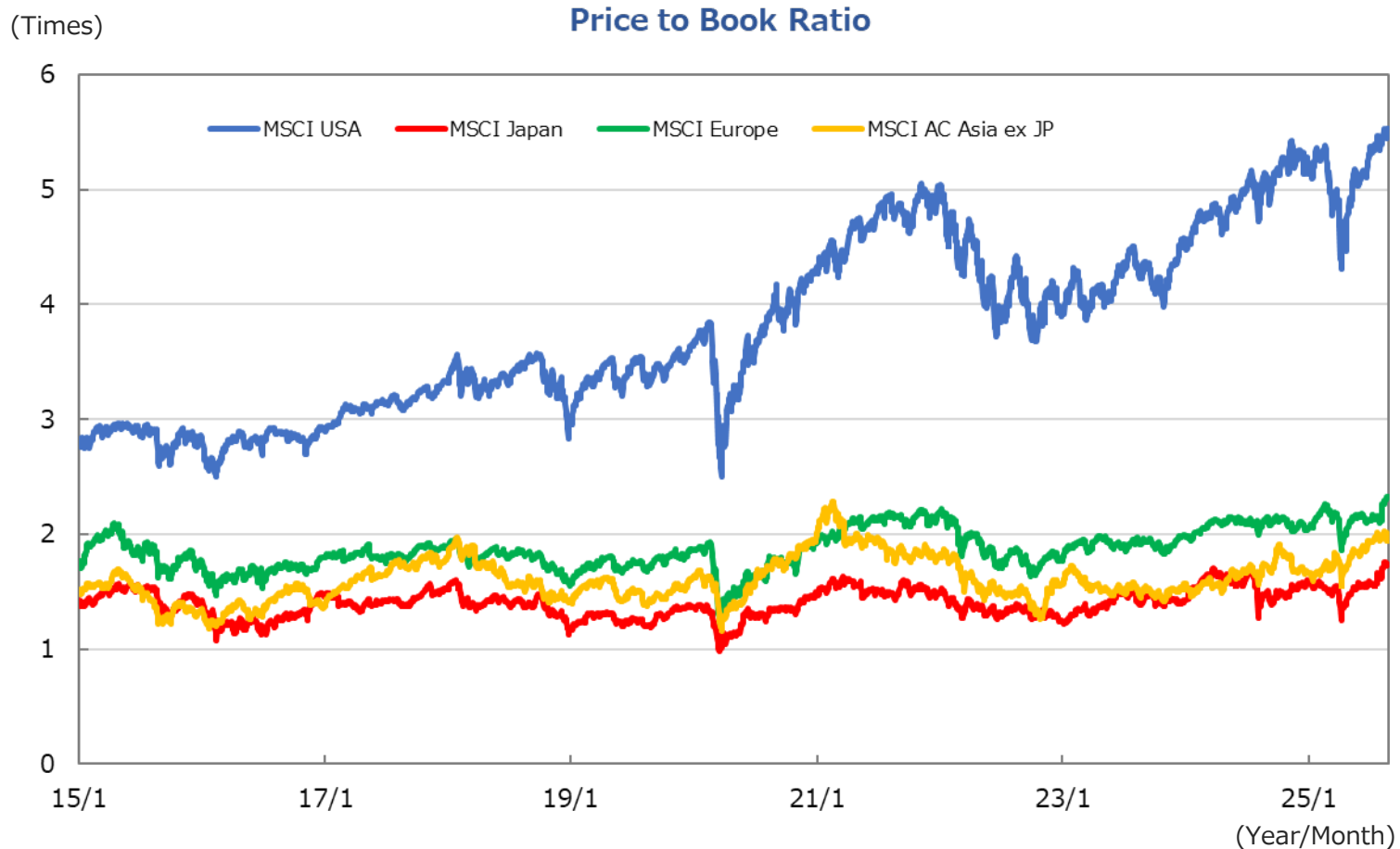
Data is from 30th June 2023 to 29th August 2025.
(Source) SMDAM, Bloomberg

Recent Rally Pushes P/E Ratio Above Long-Term Average



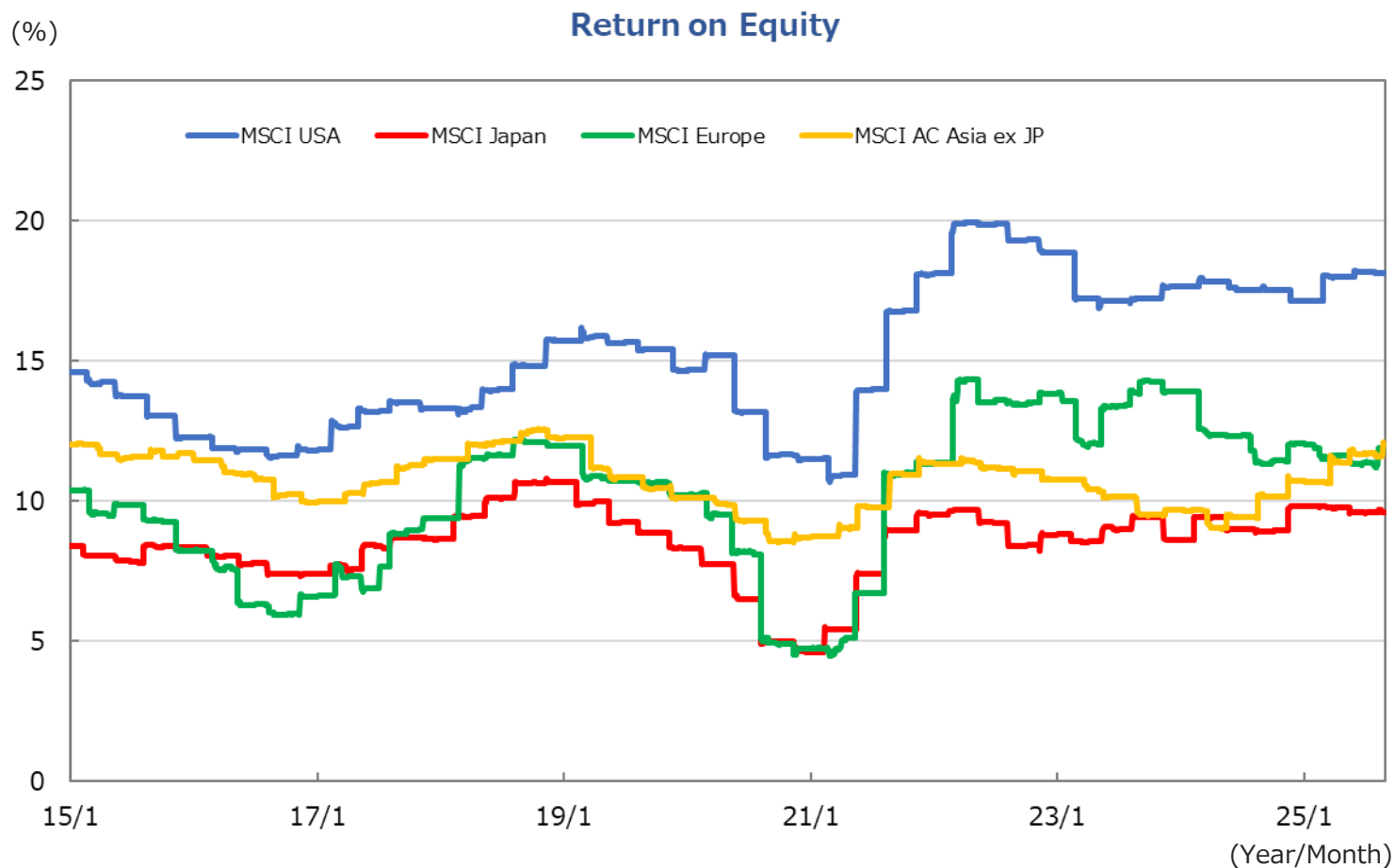
Data is from January 2015 to August 2025.
(Source) SMDAM, Bloomberg

P/B Ratio Reaches its Highest Level since 2015



Data is from January 2015 to August 2025.
(Source) SMDAM, Bloomberg

Japan's ROE is Hovering Just Below 10%

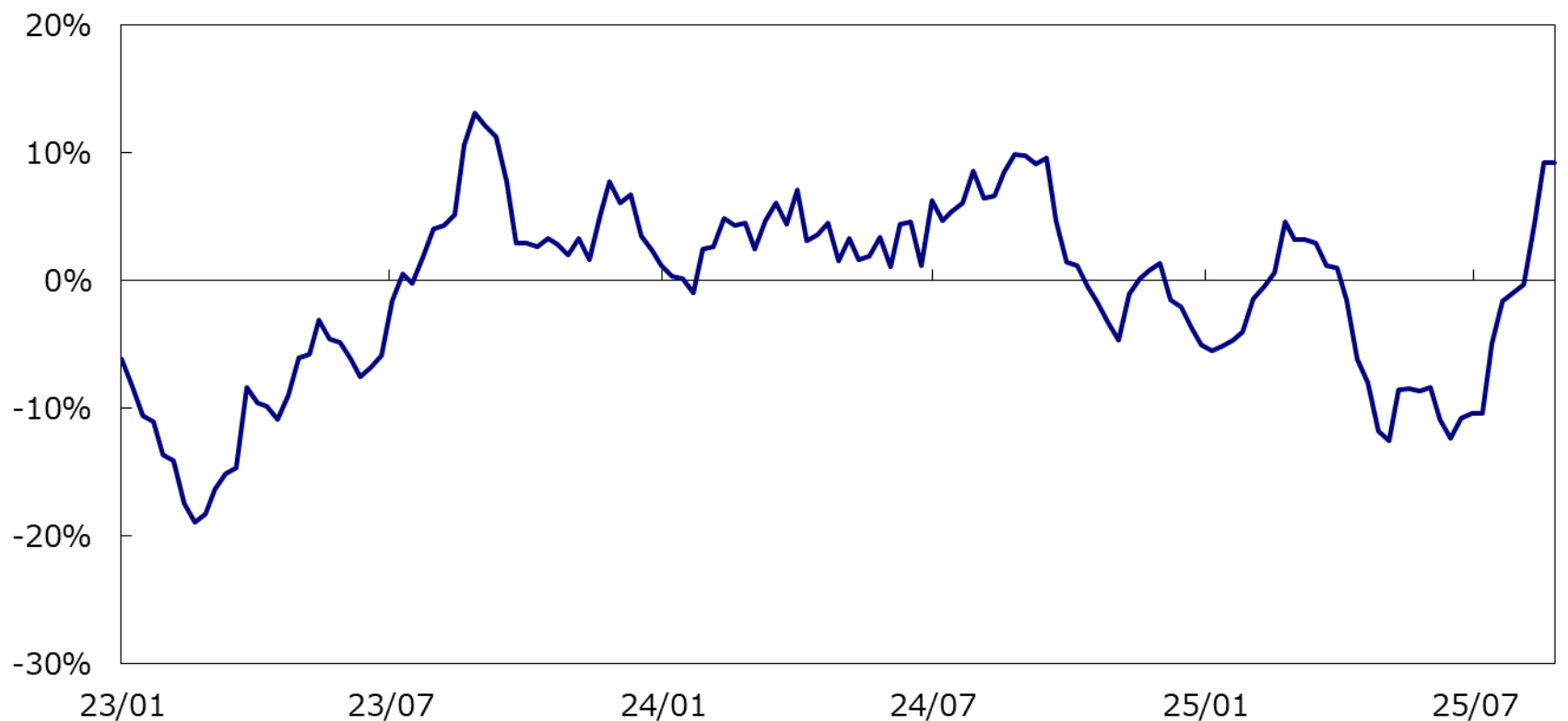


Data is from January 2015 to August 2025.
(Source) SMDAM, Bloomberg



Growing Optimism After Agreement in Trade Talks with US

TOPIX EPS Revision Index

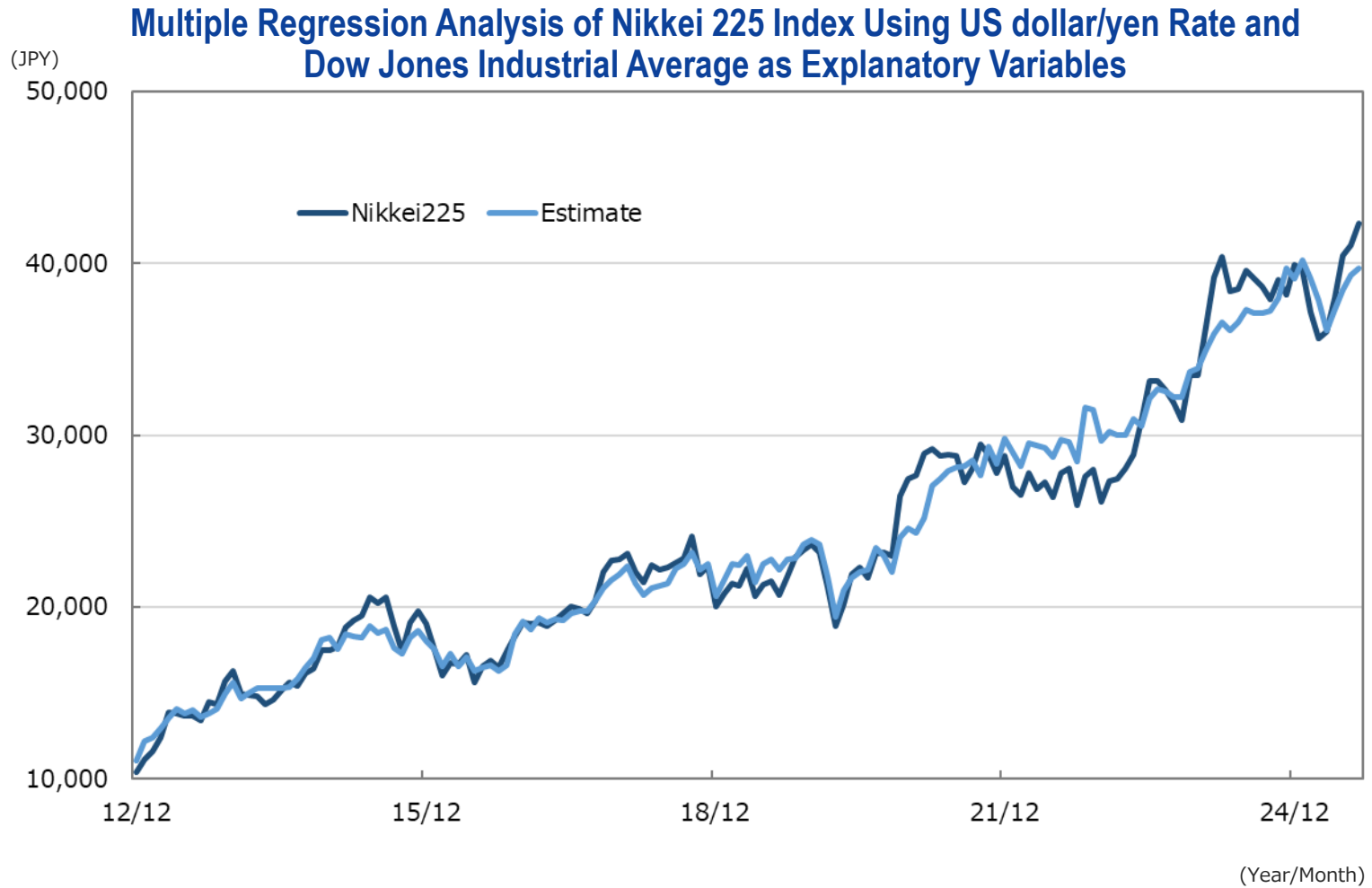


Data is from January 5th 2023 to 28th August 2025
(Source) Datastream, IBES

(YY/MM)

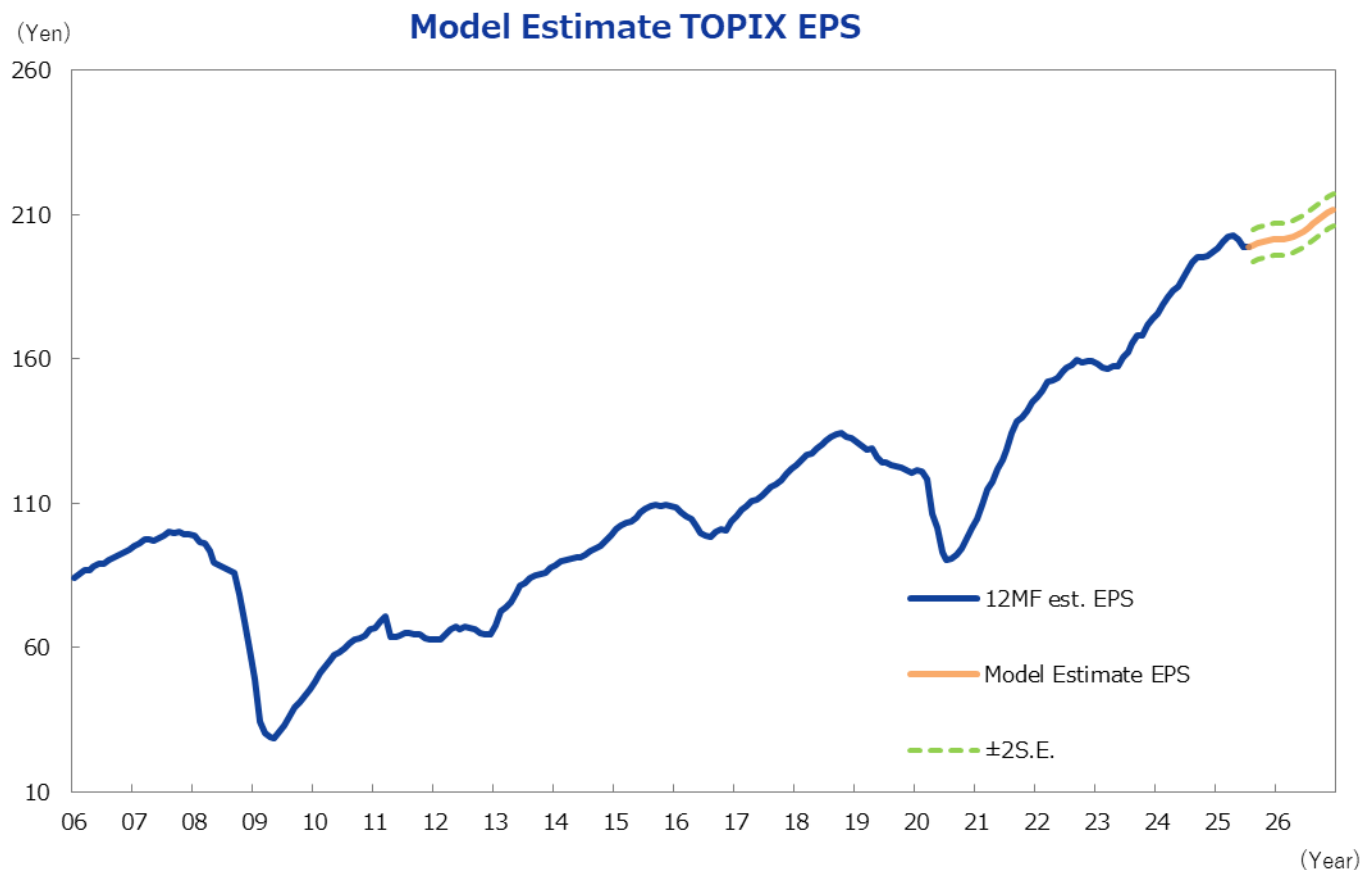


Japanese Stock Boosted by US Stocks and Dollar/Yen Rate



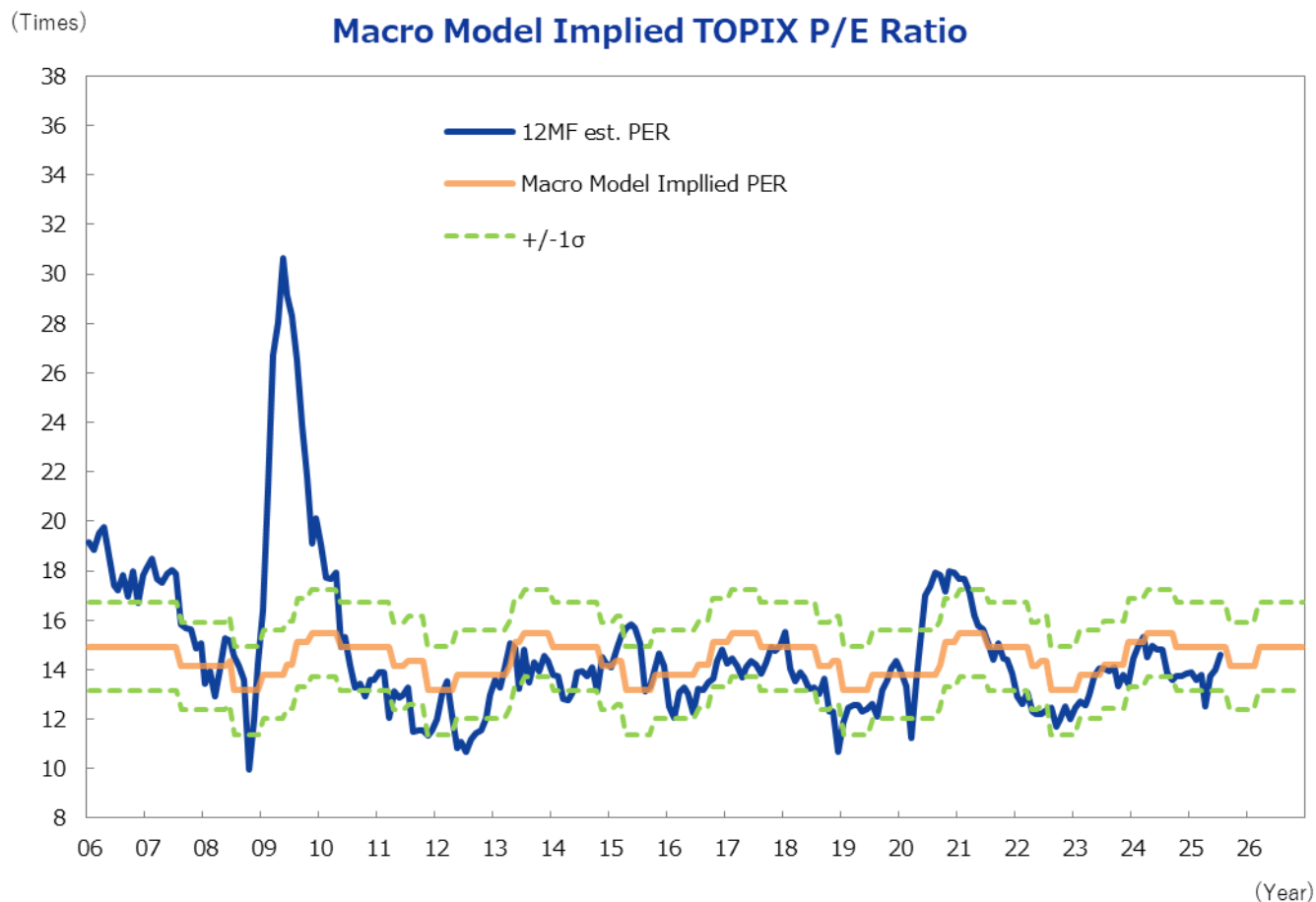
Data is from December 2012 to August 2025.
(Source) SMDAM, Bloomberg

Quant Model Suggests EPS Growth to Slow Down Temporarily



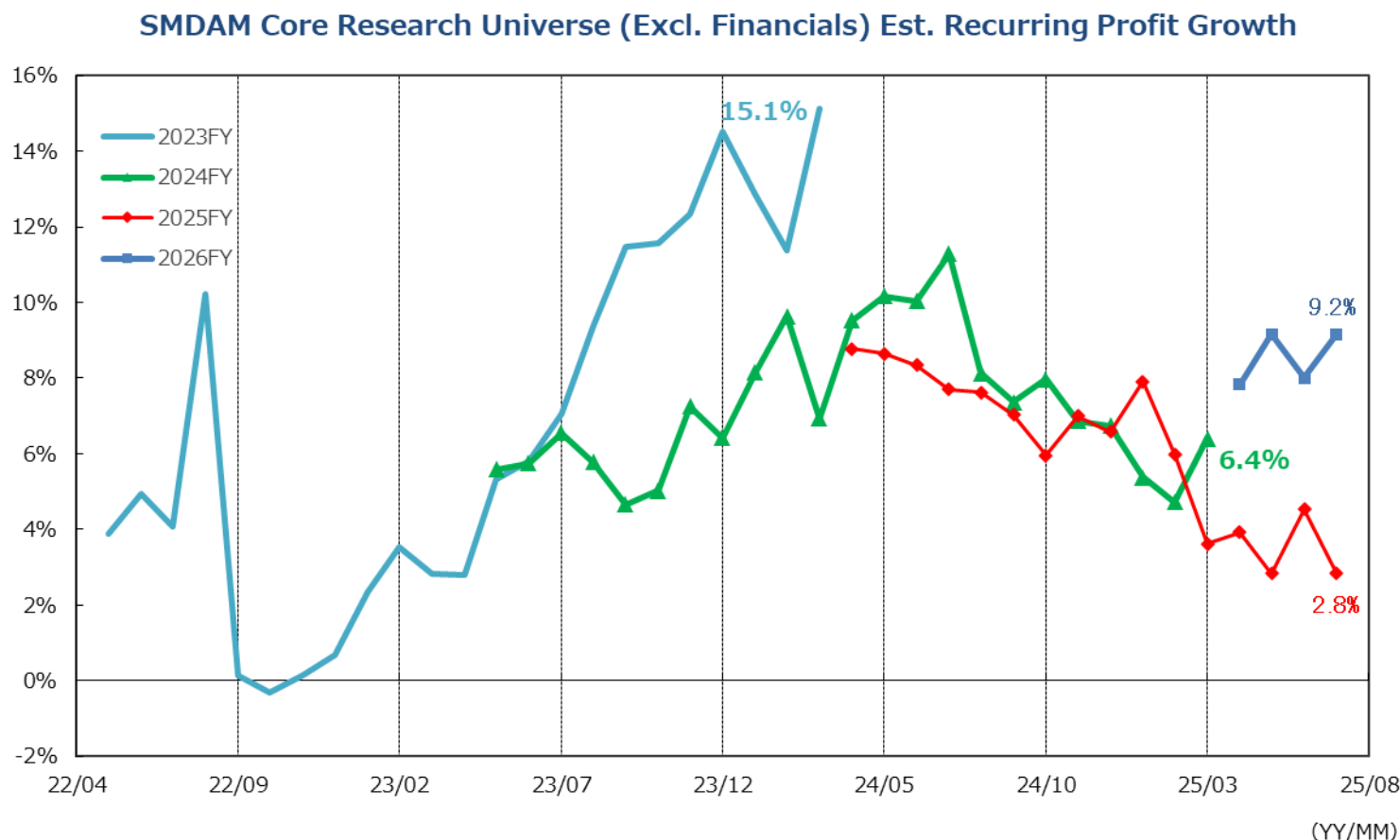
Note: Consensus data is from January 2006 to July 2025. Model estimate Data is from August 2025 to December 2026.
Source: SMDAM

P/E Ratio Moves Toward Model Implied Fair Level



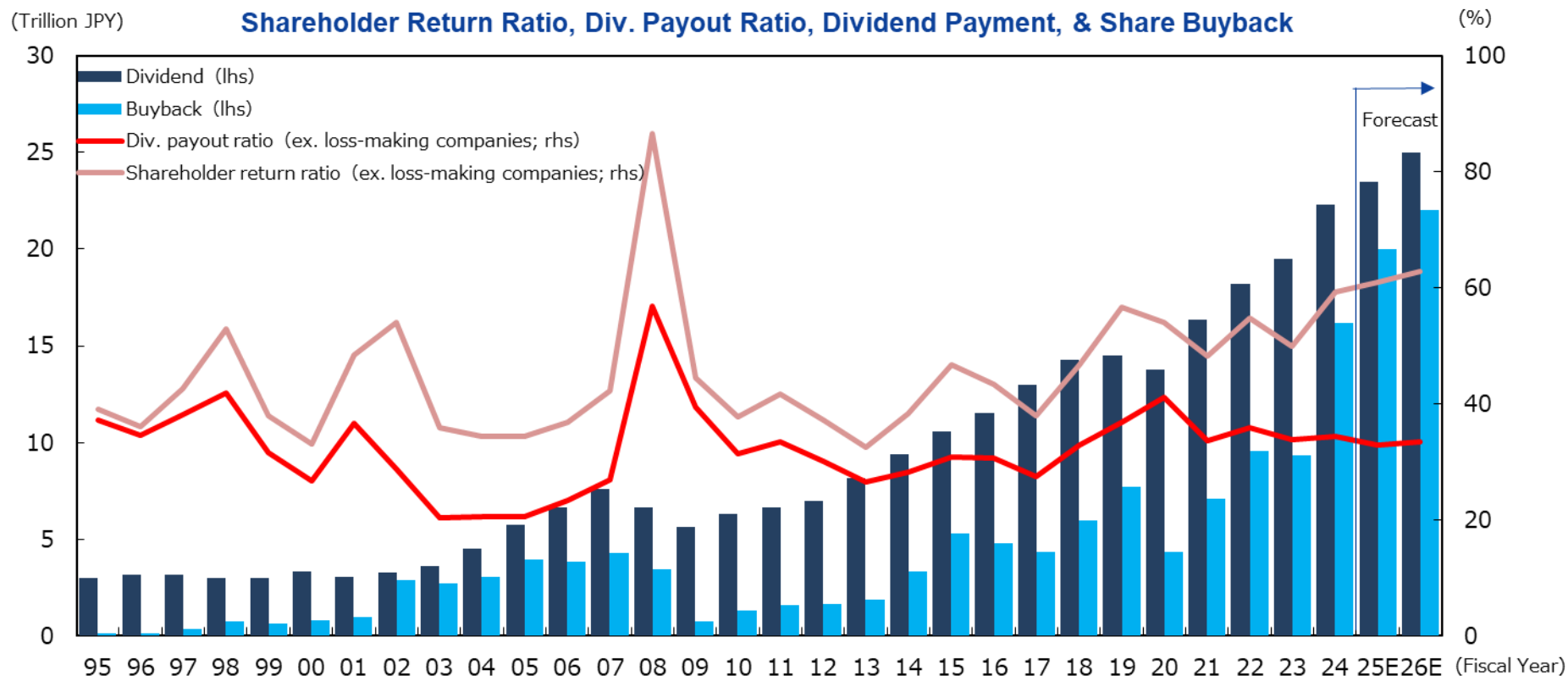
Note: Consensus data is from January 2006 to July 2025. Model estimate Data is from August 2025 to December 2026.
Source: SMDAM

In-House Analysts See Positive Outlook After Temporary Pause



Note: Data is as of 12nd August 2025, SMDAM Core Universe (Excl. Financials) consists of 391 Japanese companies covered by SMDAM in-house analysts.
Source: SMDAM

Record-Breaking Dividends and Share Buybacks Continue



Note: Data is from FY1995 to FY2026. FY2025, FY2026 are forecasts by Daiwa Securities.
Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

Investors' Appetite for Domestic Value Names Return

Performance Comparison of Russell/Nomura Style Indices

| Index | Returns(%) | | | | | | |
|------------------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 3 Month | 6 Month | YTD | 1 Year | 2 year | 3 Year | 5 Year |
| RN Japan Equity | 9.55 | 14.87 | 10.69 | 14.50 | 34.19 | 59.09 | 92.72 |
| Total Value | 13.94 | 17.16 | 14.29 | 20.69 | 43.95 | 81.78 | 140.48 |
| Top Cap Value | 15.28 | 20.30 | 14.13 | 24.10 | 51.87 | 98.58 | 175.51 |
| Large Cap Value | 13.62 | 16.55 | 13.60 | 19.90 | 43.94 | 82.90 | 146.41 |
| Mid Cap Value | 11.74 | 12.45 | 12.99 | 15.67 | 35.76 | 66.07 | 115.99 |
| Small Cap Value | 15.22 | 19.64 | 17.13 | 23.81 | 43.33 | 75.99 | 114.30 |
| Micro Cap Value | 15.87 | 21.30 | 19.39 | 25.29 | 44.82 | 75.53 | 111.04 |
| Total Growth | 4.99 | 12.38 | 6.89 | 8.46 | 24.94 | 39.43 | 53.68 |
| Top Cap Growth | 2.90 | 10.33 | 3.25 | 5.10 | 26.90 | 41.68 | 60.86 |
| Large Cap Growth | 4.46 | 11.79 | 6.39 | 7.82 | 25.68 | 41.17 | 56.35 |
| Mid Cap Growth | 8.02 | 15.11 | 13.86 | 14.32 | 24.82 | 41.76 | 50.84 |
| Small Cap Growth | 9.39 | 17.21 | 11.00 | 13.96 | 18.50 | 25.57 | 32.01 |
| Micro Cap Growth | 8.47 | 14.89 | 9.33 | 8.05 | 10.83 | 15.51 | 22.30 |
| Top Cap Total | 8.07 | 14.56 | 7.83 | 12.64 | 36.89 | 63.92 | 103.55 |
| Large Cap Total | 8.90 | 14.16 | 9.91 | 13.49 | 34.16 | 59.68 | 94.72 |
| Mid Cap Total | 10.23 | 13.53 | 13.36 | 15.04 | 30.61 | 54.03 | 83.29 |
| Small Cap Total | 13.21 | 18.82 | 15.00 | 20.25 | 33.69 | 54.93 | 79.38 |
| Micro Cap Total | 13.57 | 19.32 | 16.22 | 19.64 | 33.06 | 53.35 | 77.82 |

Note : As of 29th August 2025
(Source) Bloomberg

...Excess RN Japan Equity's performance





Outlook for Japanese Economy

Current Status & Outlook of the Japanese Economy

■ Current Status

- **The economy remains resilient.** The impact of additional U.S. tariffs have been limited so far, with no significant changes in exports. As for domestic demand, CAPEX continues to be solid and consumer spending remains stable despite higher prices.
- **Nationwide core CPI continues to exceed the Bank of Japan's (BOJ) "price stability target" of 2% YOY.** Cost-push pressures stemming from rising import prices and surging rice prices are the main drivers of inflation, with food prices showing notable increases. However, core CPI slowed to +3.3% YOY in June from +3.7% in May, indicating signs of peaking.

■ Outlook

- ① **We have raised our real GDP growth estimate from +0.3% to +0.6% for FY 2025, and from +0.6% to +0.7% for FY 2026.** The upward revision is mainly due to the Japan-US tariff negotiation agreements, the abolition of the provisional gasoline tax (expected to start in November 2025), and the reflection of the latest actual figures. Though we expect slower growth in the second half of 2025 as the negative impacts of US tariffs become apparent, the economy will avoid a severe downturn. We continue to believe that the economy remains resilient, supported by steady CAPEX driven by persistent labor shortages and a recovery in consumer spending thanks to a gradual decline in inflation. From FY 2026 onward, we expect the recovery of overseas economies to contribute to a rebound in the Japanese economy.
- ② **While we have maintained our core CPI forecast for FY 2025 at +2.6%, we have lowered our forecast for FY 2026 from +1.6% to +1.4%.** The downward revision for FY 2026 is mainly due to the expected abolition of the provisional gasoline tax in November 2025. Looking ahead, we anticipate a slowdown in core CPI along with easing cost-push pressures from import prices and the stabilization of rice prices. On the other hand, we expect rising service prices, driven by wage increases, to bolster the inflation rate. Excluding special factors, such as government support for education and the abolition of the provisional gasoline tax, we forecast core CPI to maintain a momentum of around +2.0% YOY.
- ③ **We expect the government to adopt accommodative fiscal policies.** The ruling party plans to announce economic measures in the autumn, in response to US tariffs and rising prices. Having lost their parliamentary majority, the ruling party are expected to be forced into compromise with opposition parties. Opposition parties are expected to demand for tax cuts in return for their cooperation. Due to PM Ishiba's preference for tighter fiscal policies, market participants are likely to become increasingly aware of the risk of fiscal expansion following the announcement of his resignation on September 7th. Among the candidates to succeed him as the ruling Liberal Democratic Party's president, Ms. Sanae Takaichi and Mr. Shinjiro Koizumi are seen as leading contenders. If Takaichi—who advocates expansionary fiscal policy and is reluctant about monetary tightening by the Bank of Japan—were to become the next prime minister, it would likely strengthen the trend toward economy-conscious policy measures.
- ④ **We anticipate the BOJ to raise its policy rate from 0.50% to 0.75% in January 2026, and from 0.75% to 1.00% in July 2026.** Regarding the next rate hike, Governor Ueda is expected to carefully consider the impact of tariffs. We expect the economy to stall in the latter half of CY 2025 and believe the next rate hike is more likely to happen in January 2026. The momentum for wage increases, which will become clearer in January 2026, is also likely to support the case for tightening. Following this, we anticipate a policy rate hike to 1.00% in July 2026, with the terminal rate of 1.25% expected in July 2027 although which is beyond our forecast period. Potential reasons for an earlier rate hike in 2025 include limited tariff impacts, unexpectedly strong economy and price data, the BOJ prioritizing actual price increases over underlying inflation rates, excessive depreciation in the Yen, a rise in inflation expectations, and US demand for rate hikes. Conversely, reasons for an even greater delay in rate hikes include greater-than-expected negative impacts from US tariffs on the economy and inflation, lower-than-expected wage increases next fiscal year, and the possibility that Ms. Takaichi succeeds PM Ishiba and opposes rate hikes.

Note: The forecasts are as of August 18th, 2025.

Forecast for the Japanese Economy

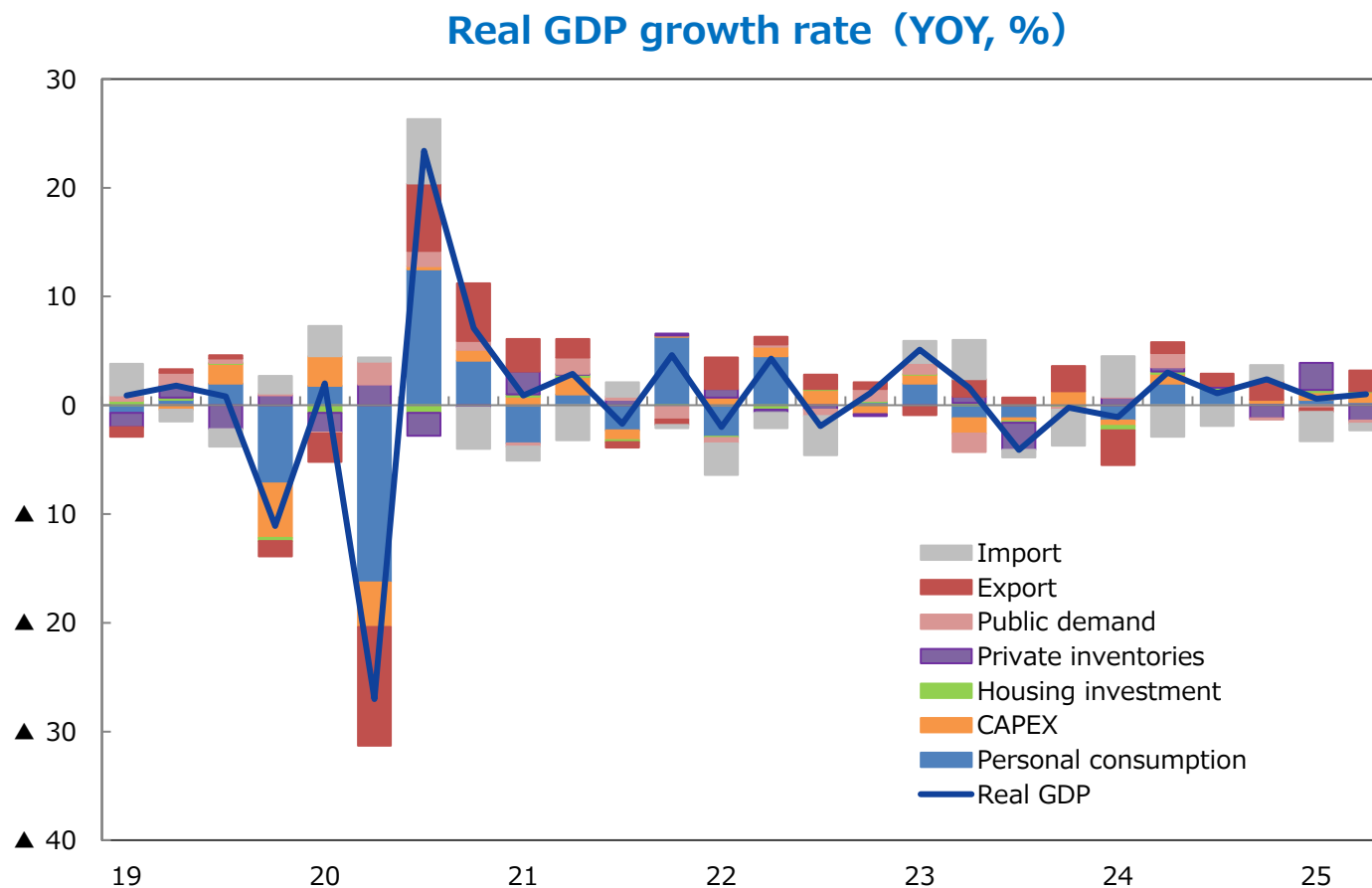
| Forecast of annual Real GDP growth and its breakdown | | | | | | |
|--|--------|--------|--------|-------|----------|----------|
| Fiscal Year | FY21 | FY22 | FY23 | FY24 | FY25 Est | FY26 Est |
| Real GDP | 3.1% | 1.3% | 0.5% | 0.8% | 0.6% | 0.7% |
| Private final consumption expenditure | 1.8% | 2.6% | -0.4% | 0.8% | 0.9% | 0.9% |
| Private housing investment | 0.4% | -2.7% | 0.7% | -0.4% | 0.2% | -1.6% |
| Private-sector capital investment | 3.6% | 3.2% | -0.8% | 2.0% | 2.1% | 1.2% |
| Private inventory investment | 0.5% | 0.0% | -0.3% | 0.1% | 0.0% | 0.0% |
| Public fixed capital formation | -6.4% | -5.5% | -0.4% | 0.8% | -0.3% | 0.8% |
| Net export contribution | 0.8% | -0.6% | 1.3% | -0.4% | -0.2% | -0.1% |
| Exports of goods and services | 12.5% | 5.0% | 3.1% | 1.7% | 1.8% | 1.1% |
| Imports of goods and services | 7.3% | 7.4% | -2.7% | 3.4% | 2.7% | 1.8% |
| Nominal GDP | 3.0% | 2.2% | 4.7% | 3.7% | 3.2% | 2.5% |
| GDP deflator | -0.1% | 0.9% | 4.2% | 2.9% | 2.5% | 1.7% |
| Industrial Production Index | 5.6% | -0.3% | -1.9% | -1.4% | 0.6% | 1.1% |
| Consumer Price Index (Core) | 0.1% | 3.0% | 2.8% | 2.7% | 2.6% | 1.4% |
| Consumer Price Index (BOJ Core) | 0.1% | 3.0% | 2.8% | 2.7% | 2.9% | 1.9% |
| Domestic corporate goods price index | 7.1% | 9.6% | 2.4% | 3.2% | 2.2% | 1.3% |
| Employee compensation | 2.1% | 2.5% | 1.9% | 4.6% | 3.4% | 3.2% |
| Unemployment rate | 2.8% | 2.6% | 2.6% | 2.5% | 2.5% | 2.5% |
| Monetary Policy interest rate (Short term) | -0.10% | -0.10% | 0-0.1% | 0.50% | 0.75% | 1.00% |

Note: Rate of increase over the previous year. Net exports are based on the degree of contribution. The consumer price index (Core) excludes the effects of free education and abolishing the provisional gasoline tax.

Note: The forecasts are as of August 18th, 2025.

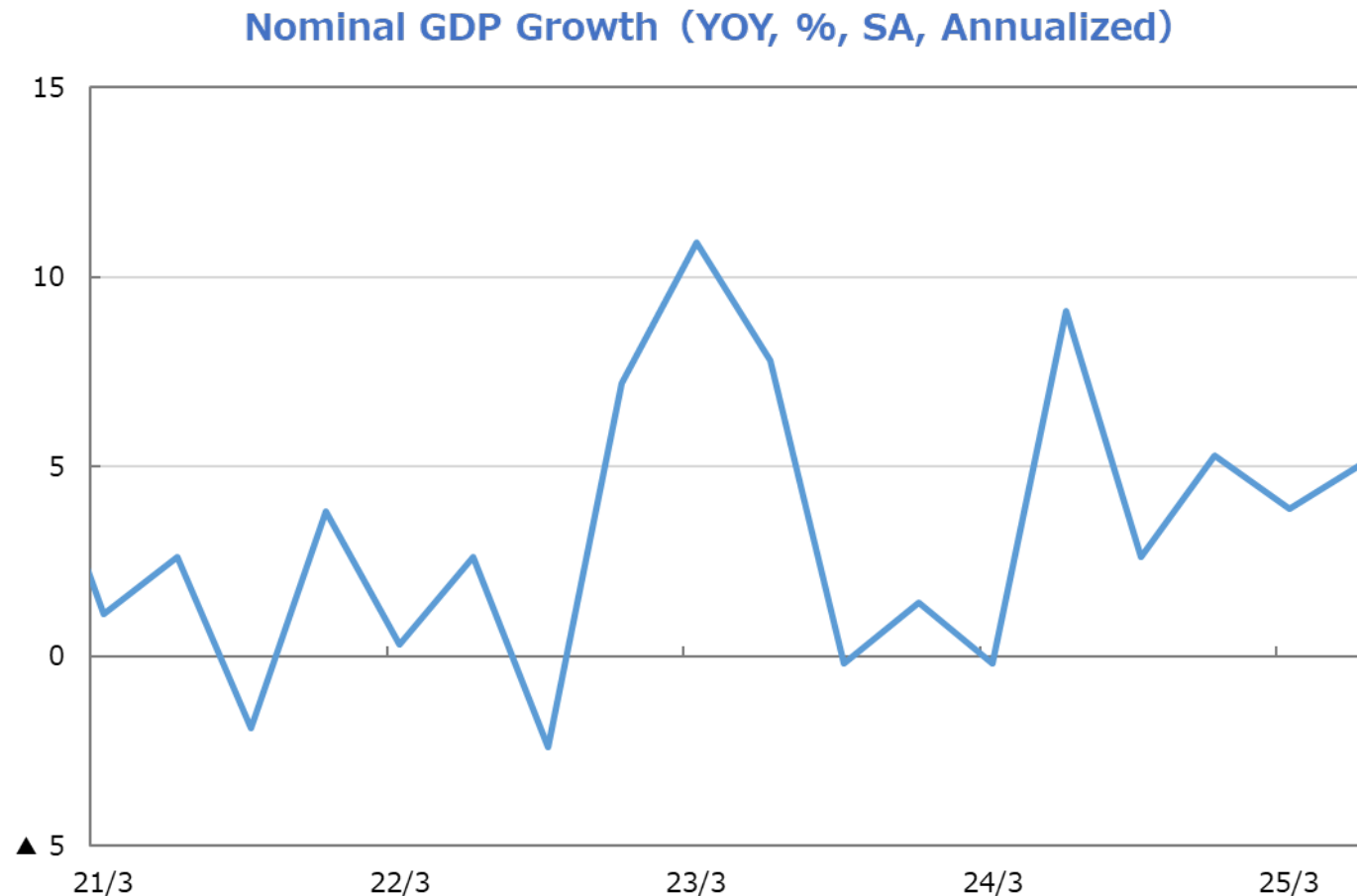
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Japan's GDP Continues Steady Growth Despite Trump Tariffs



Note: Data is from Q1 2019 to Q2 2025.
Source: Cabinet office, SMDAM

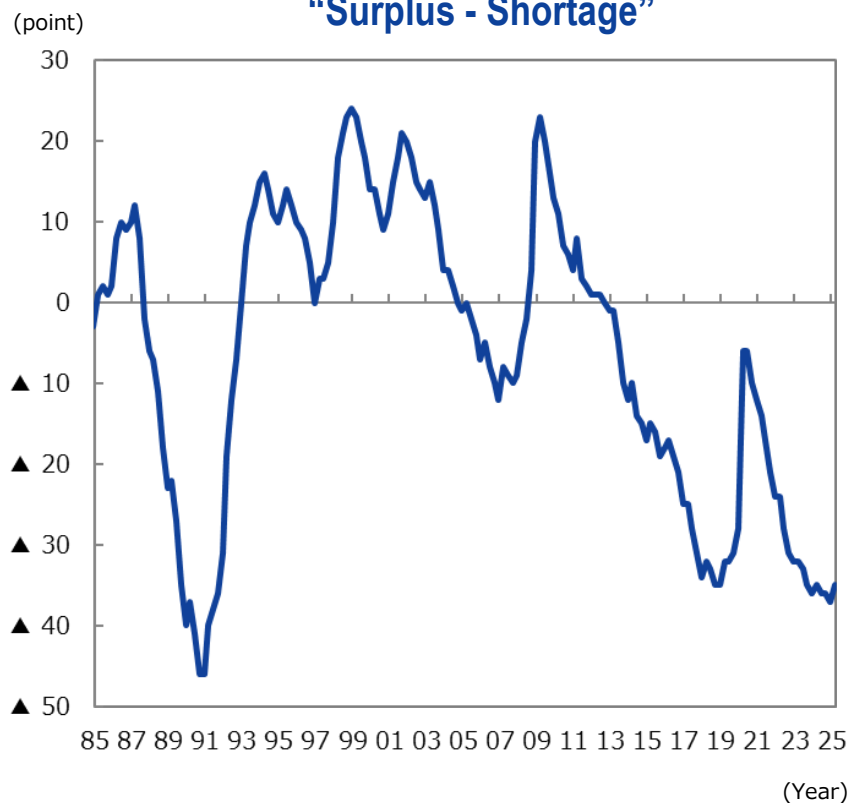
Japan's Nominal GDP Keeps Strong Momentum



Note: Data is from Q1 2021 to Q2 2025.
Source: Cabinet office, SMDAM

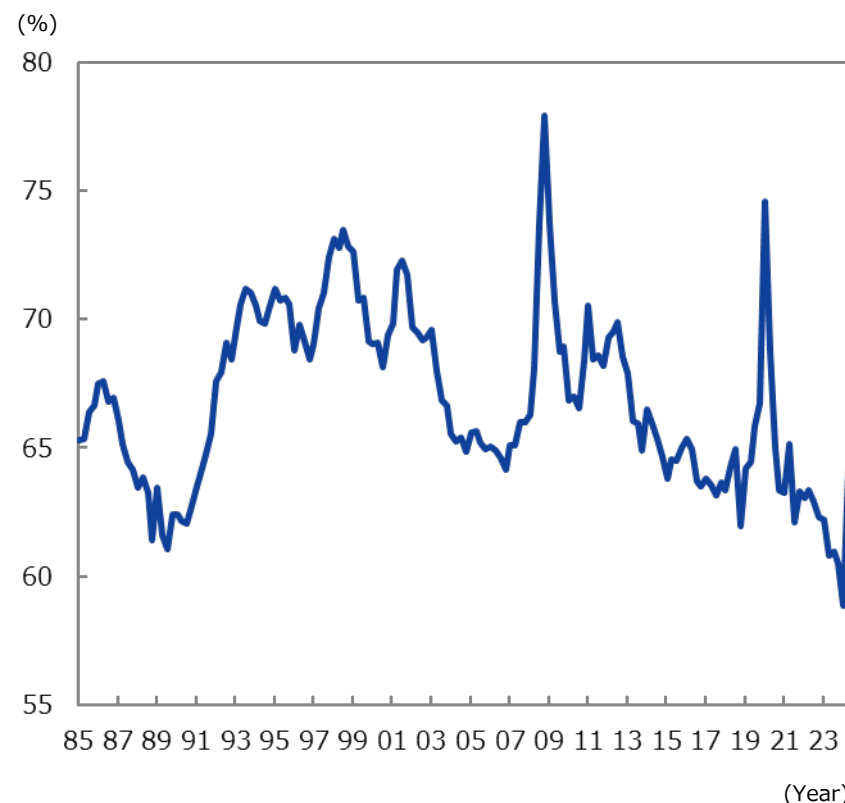
Sustainable? “Severe Labor Shortage” with “Low Labor Share”

Employment Sufficiency Index
“Surplus - Shortage”



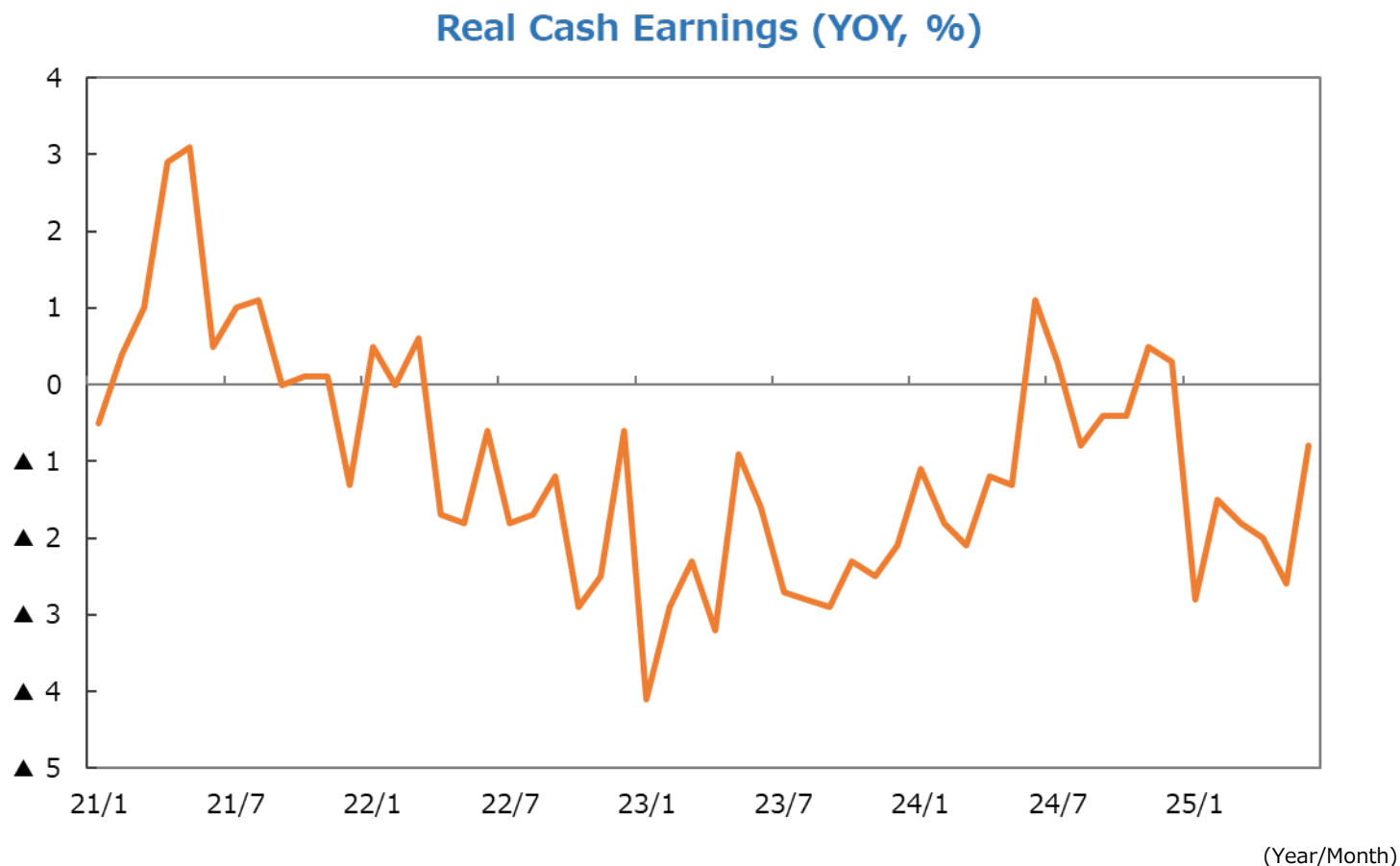
Note: Data is from April 1985 to June 2025.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



Note: Data is from April 1985 to January 2025.
Source: Ministry of finance, SMDAM

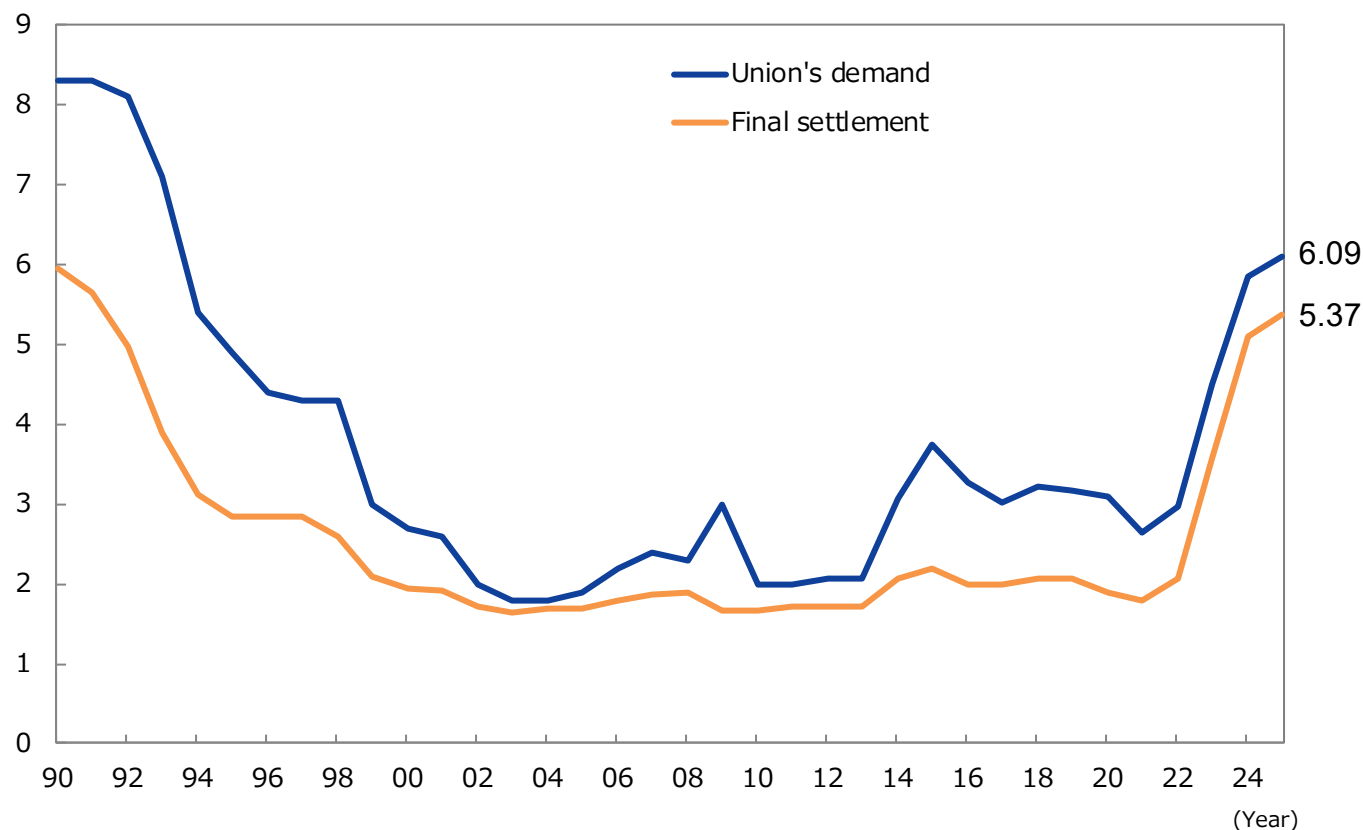
Inflation Eroding Consumers' Purchasing Power



Note: Data is from January 2021 to June 2025.
Source: Japanese Trade Union Confederation, SMDAM

Highest Wage Increase in Japan Since Early 90s

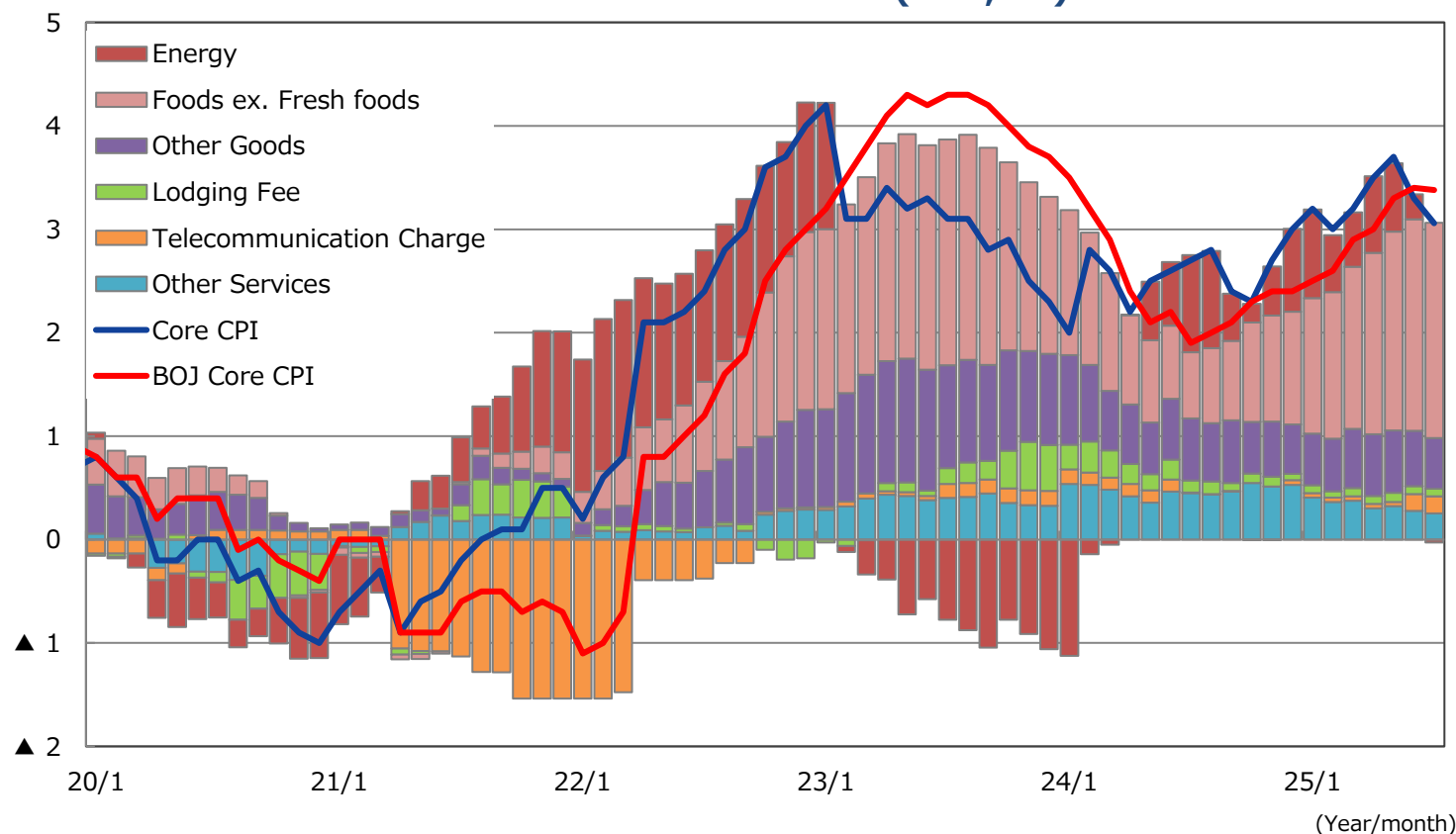
Wage increase (YOY, %)



Note: Data is from FY 1990 to FY 2025.
Source: Japanese Trade Union Confederation, SMDAM

Rising Food Prices Push CPI Higher

Breakdown of Core CPI (YOY, %)

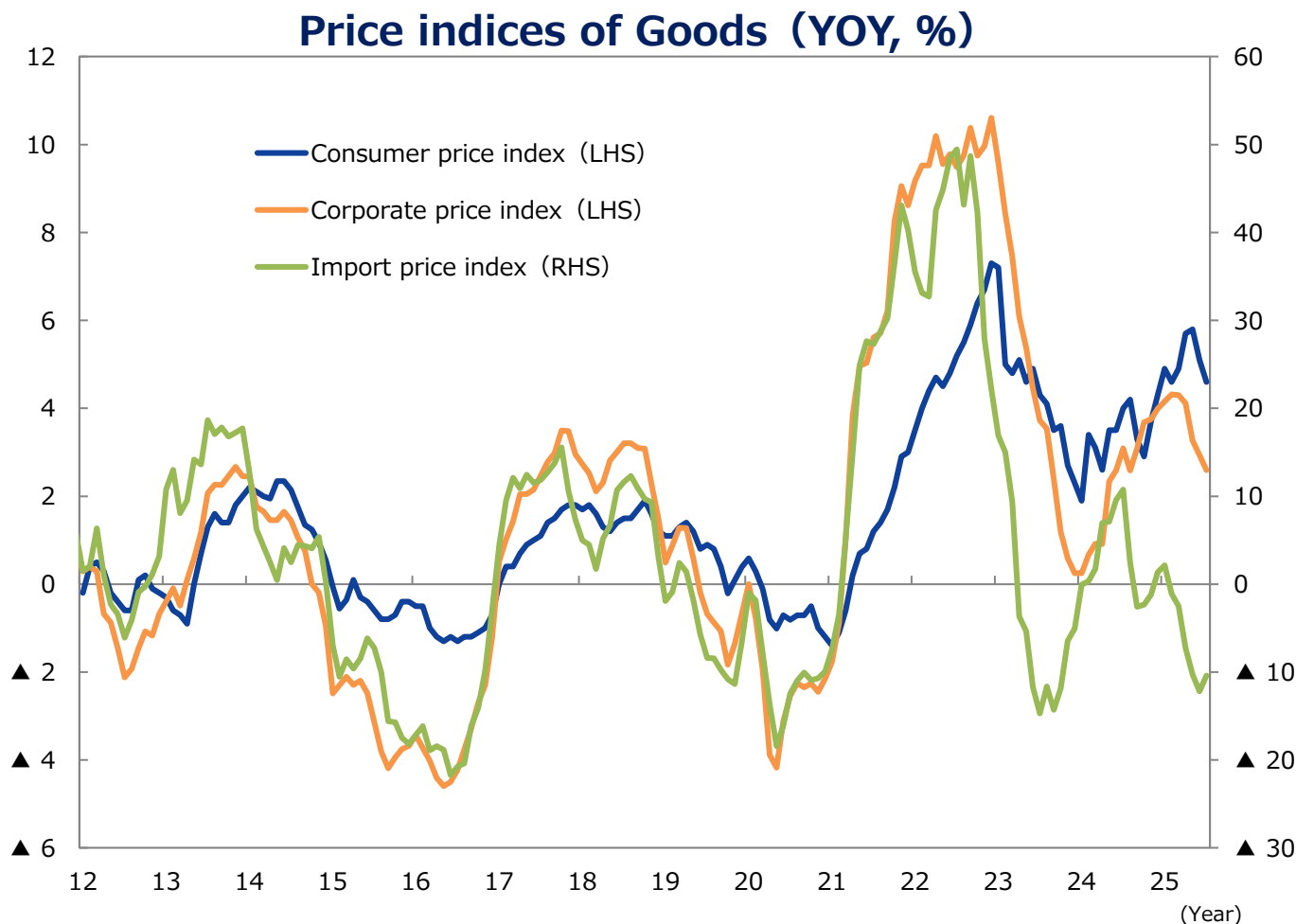


Note: Data is from January 2020 to July 2025.

Note: The Core CPI excludes the fresh foods. Special factors, such as the effects of free education and abolishing the provisional gasoline tax, are considered.

Source: MIAC, SMDAM

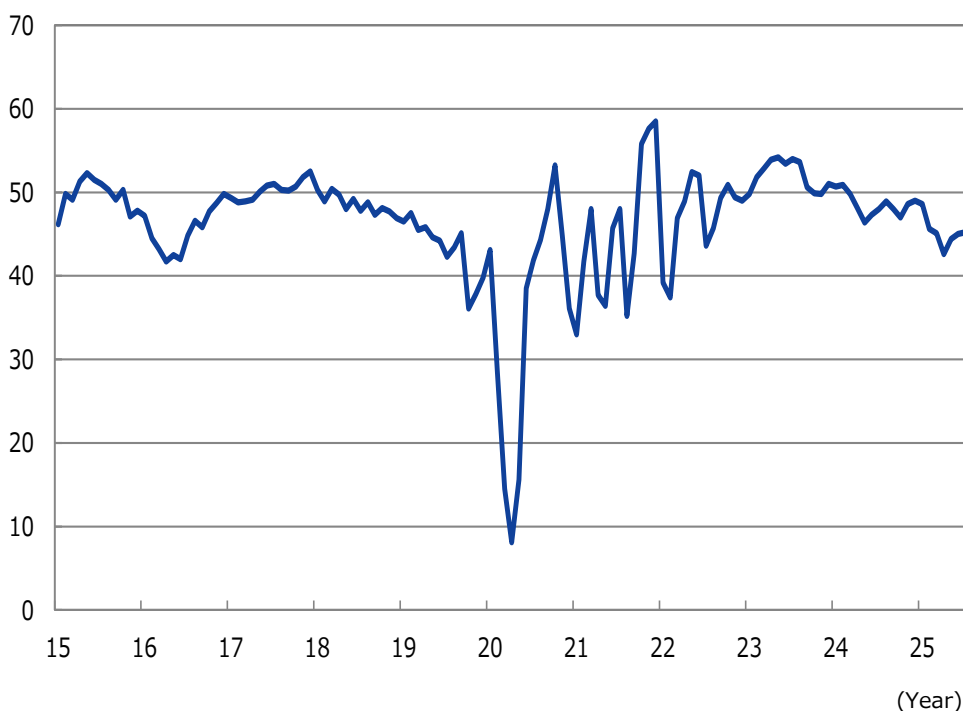
Rising CPI and Falling Import Prices Boost Profit Margin of Importers



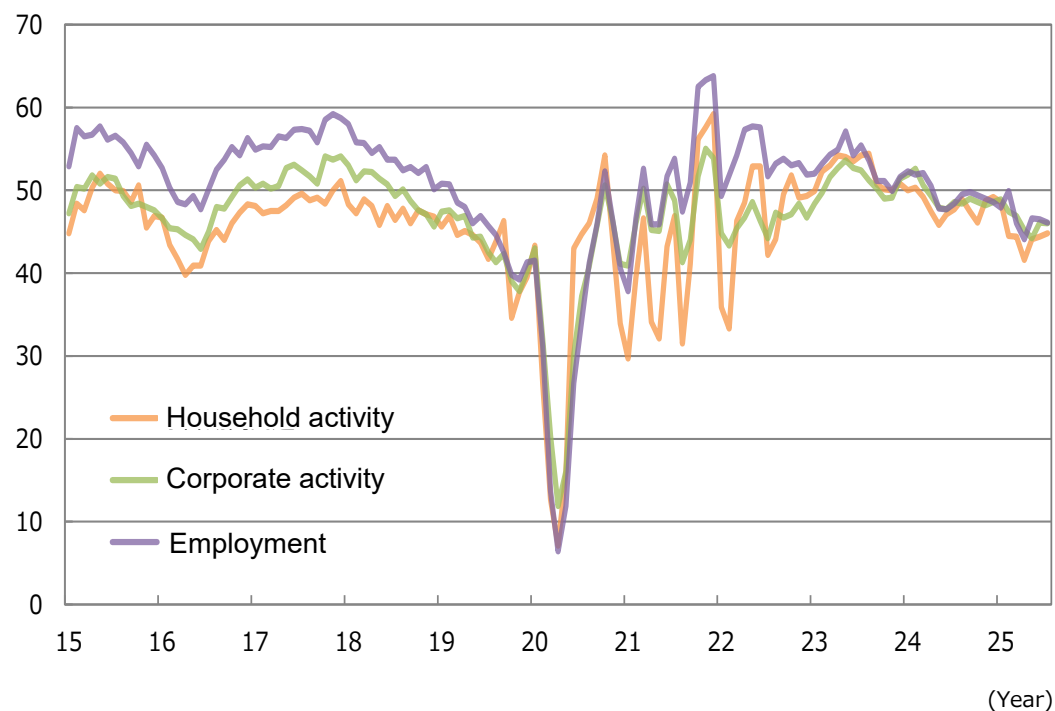
Note: Data is from January 2012 to July 2025.
Source: MIAC, Bloomberg, SMDAM

Growing Unease with Slowing Economy and Higher Inflation

DI for Current Economic Conditions



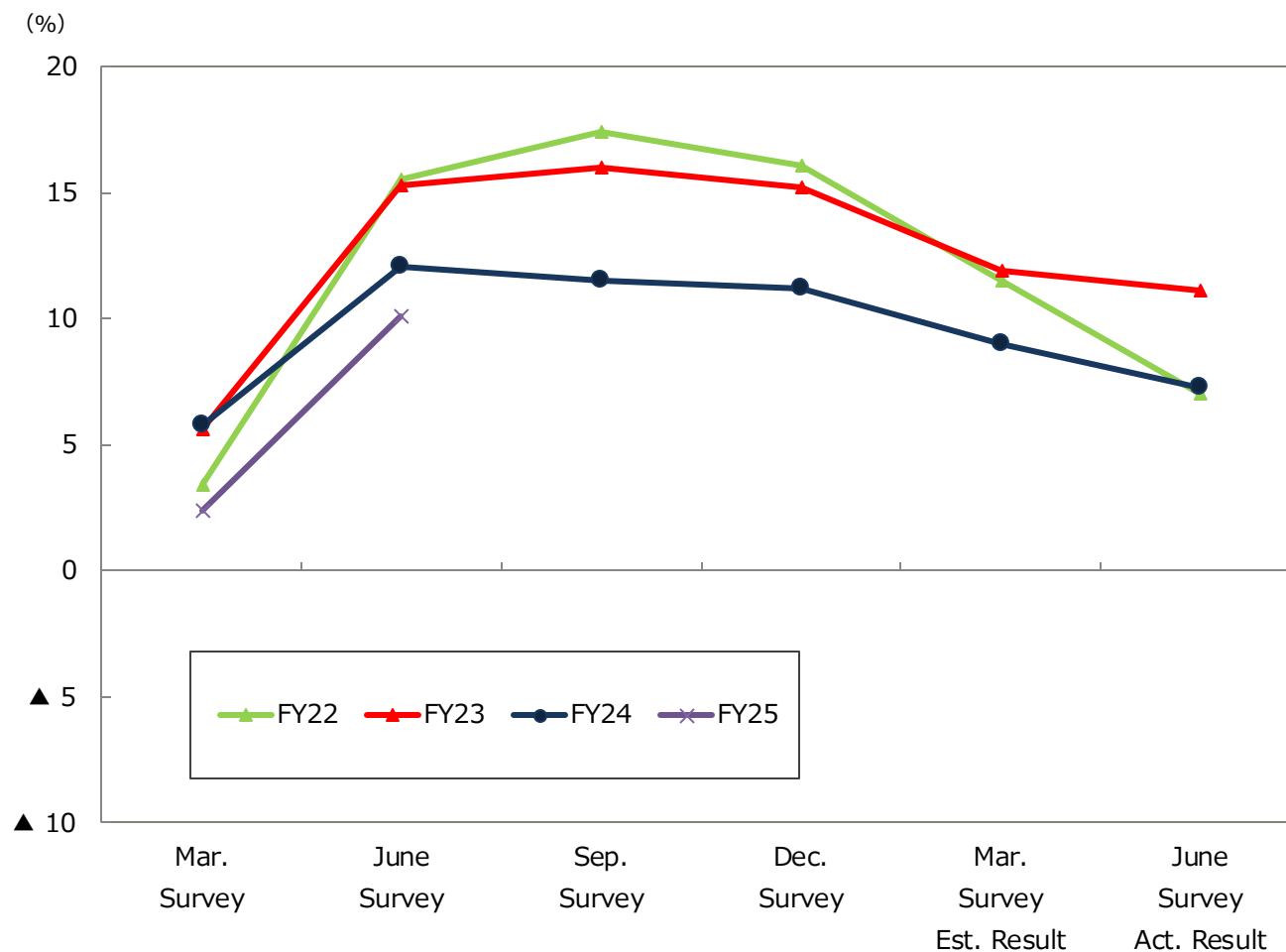
Breakdown of DI for Current Economic Conditions



Note: Data is from January 2015 to July 2025.
Source: Economy Watchers Survey, Cabinet Office

Receding Uncertainty Over the Economy Lifts CAPEX Appetite

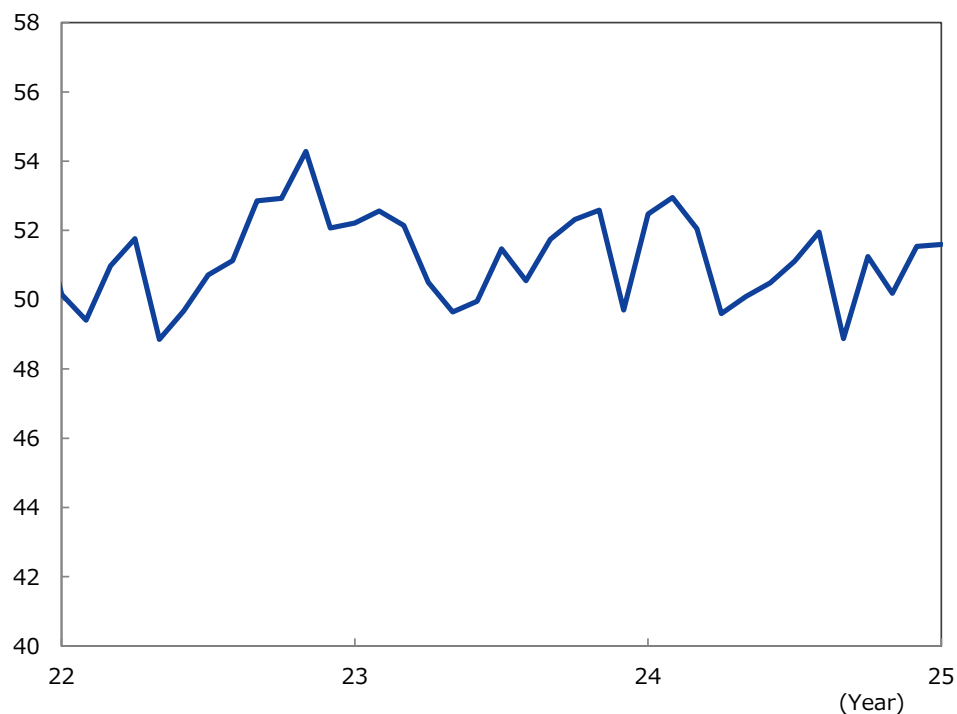
Plan of CAPEX (Inc. Software, Ex. Land and R&D, YOY)



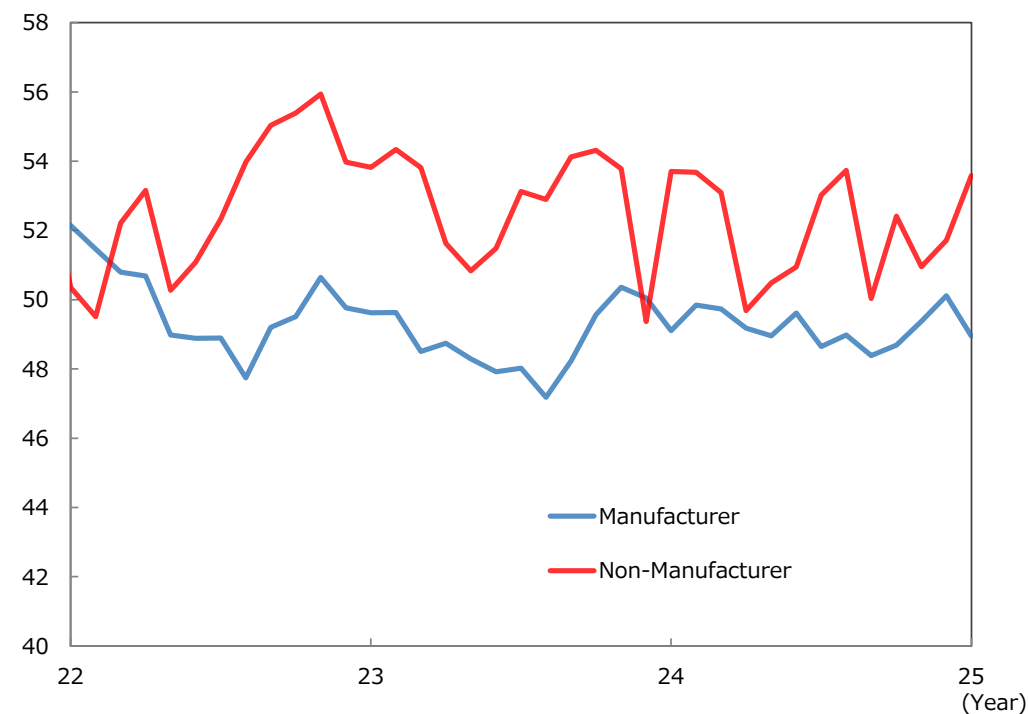
Note: Data is from Q1 FY2022 to Q2 FY2025.
Source: The Bank of Japan, SMDAM

Business Sentiment of Non-manufacturers Bottoming

Composite PMI(%pt)

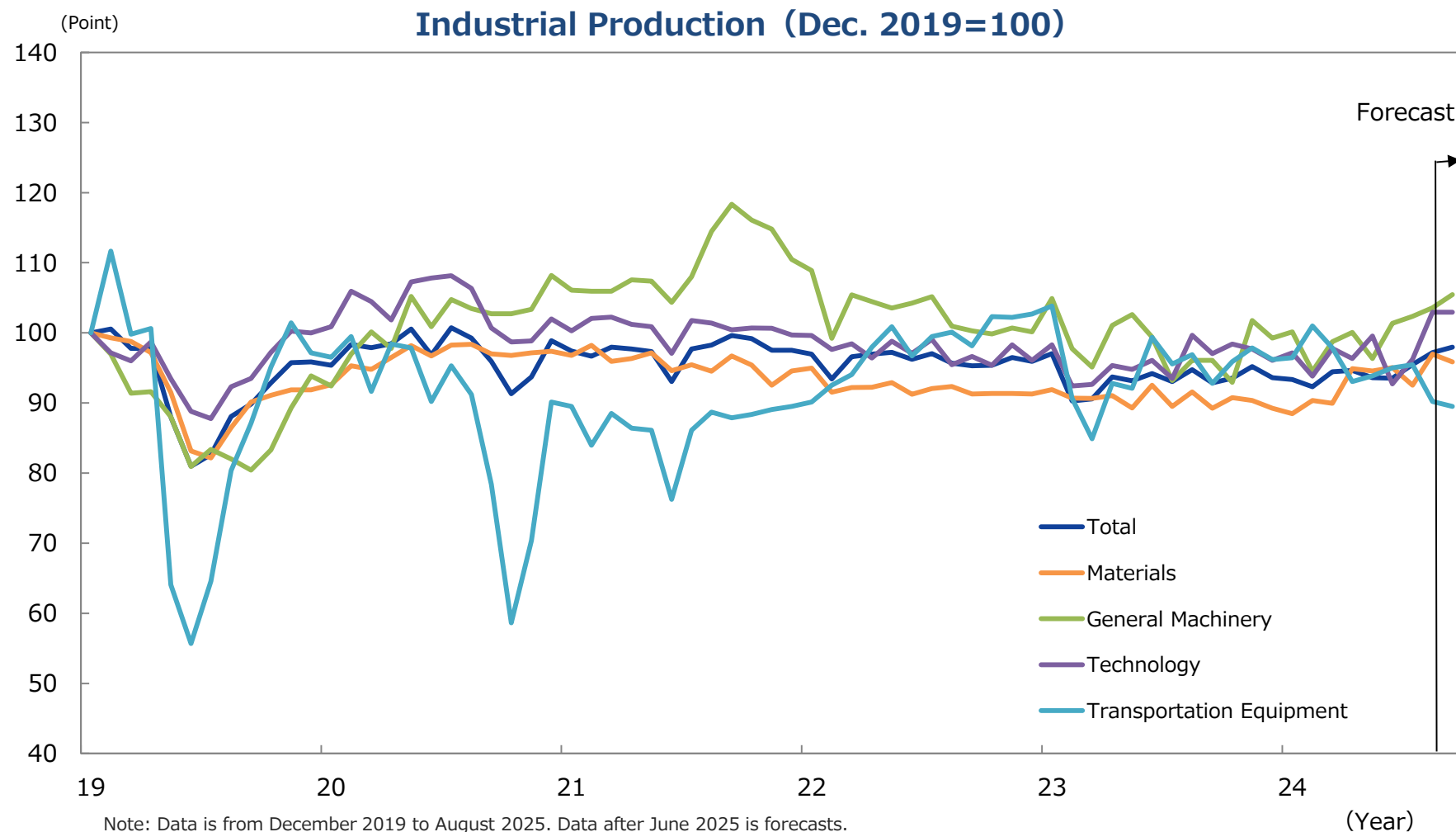


PMI, Manufacturer & Non-Manufacturer(%pt)



Note: Data is from July 2022 to July 2025.
Source: Bloomberg, SMDAM

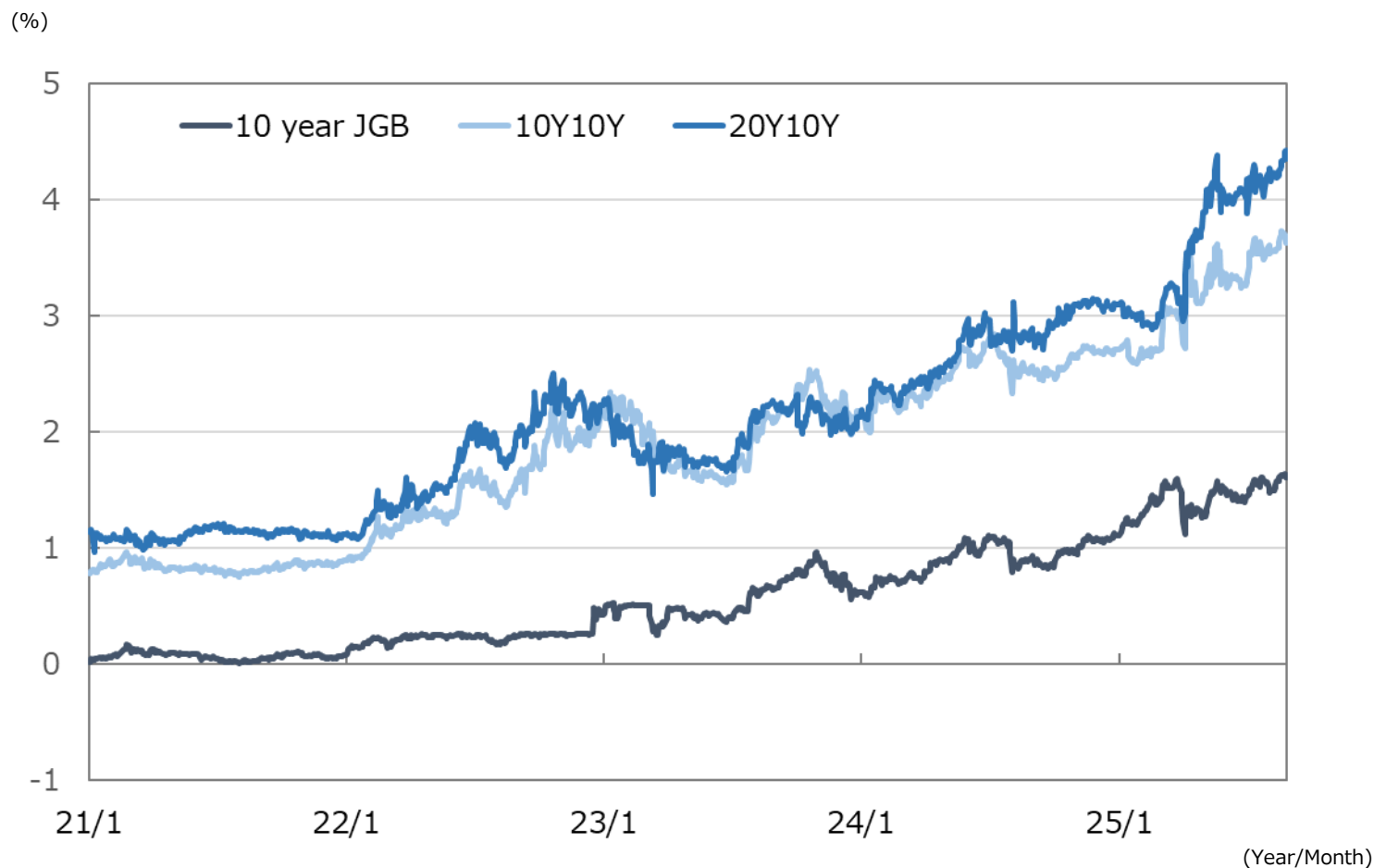
Sluggish Autos Weigh on Industrial Production



Note: Data is from December 2019 to August 2025. Data after June 2025 is forecasts.
Source: METI, SMDAM

Fiscal Concerns Steepens Yield Curve of Ultra-Long End

10 year Japanese Bond Yield, 10Y10Y, and 20Y10Y

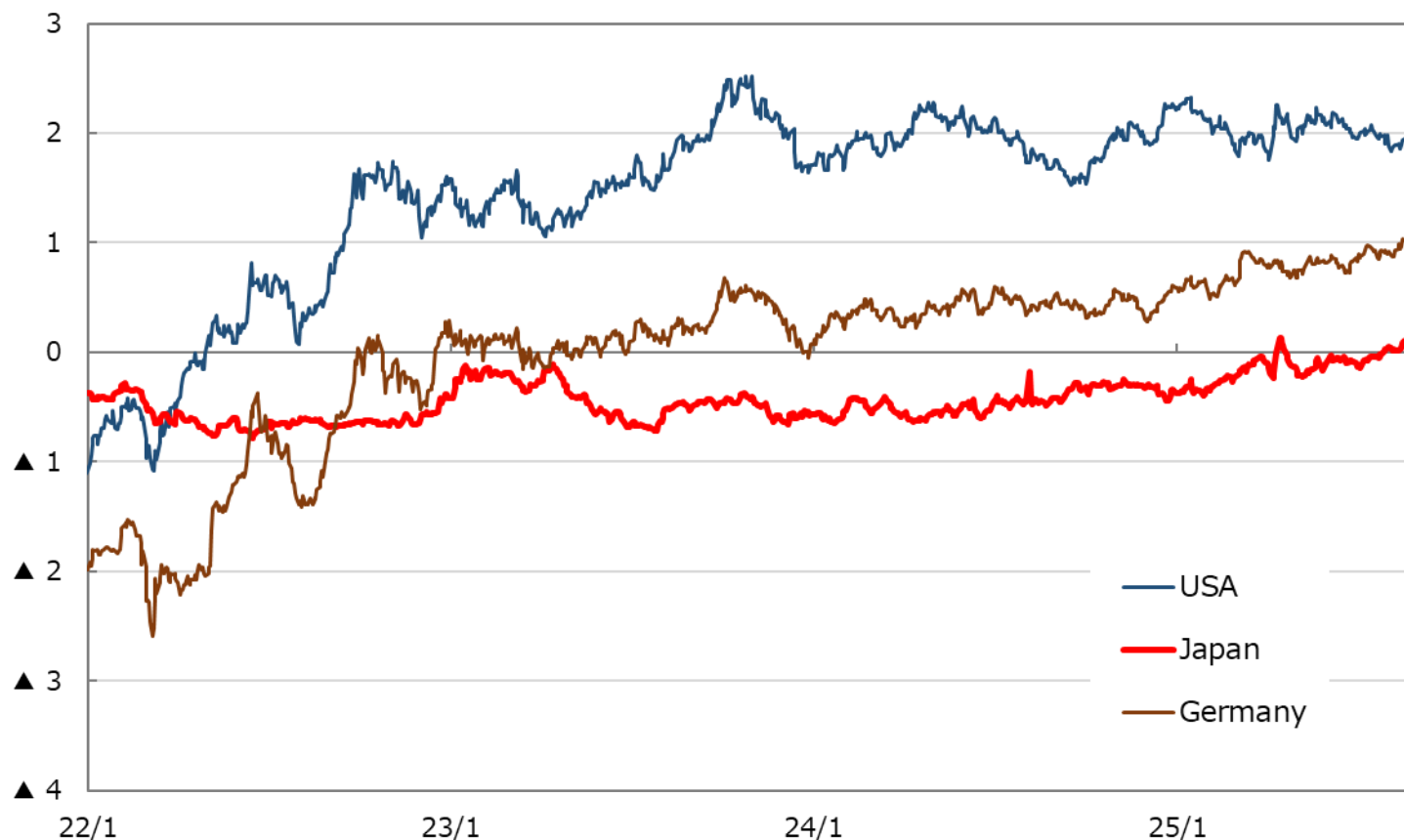


Note: Data is from 4th January 2021 to 29th August 2025.
Source: Bloomberg

10-Year Real JGB Yield Becomes Slightly Positive

(%)

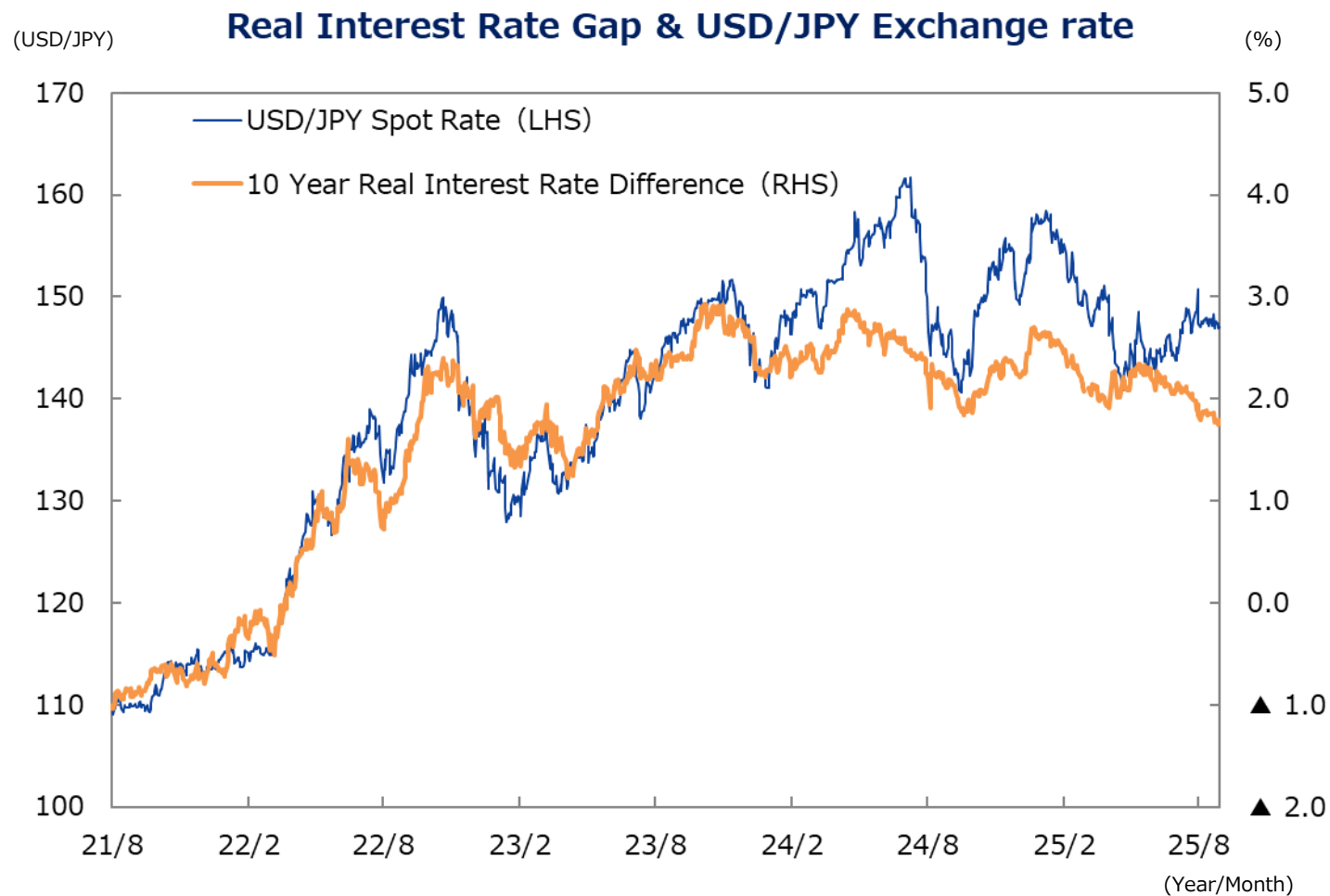
Comparison of 10 Year Real Government Bond Yield



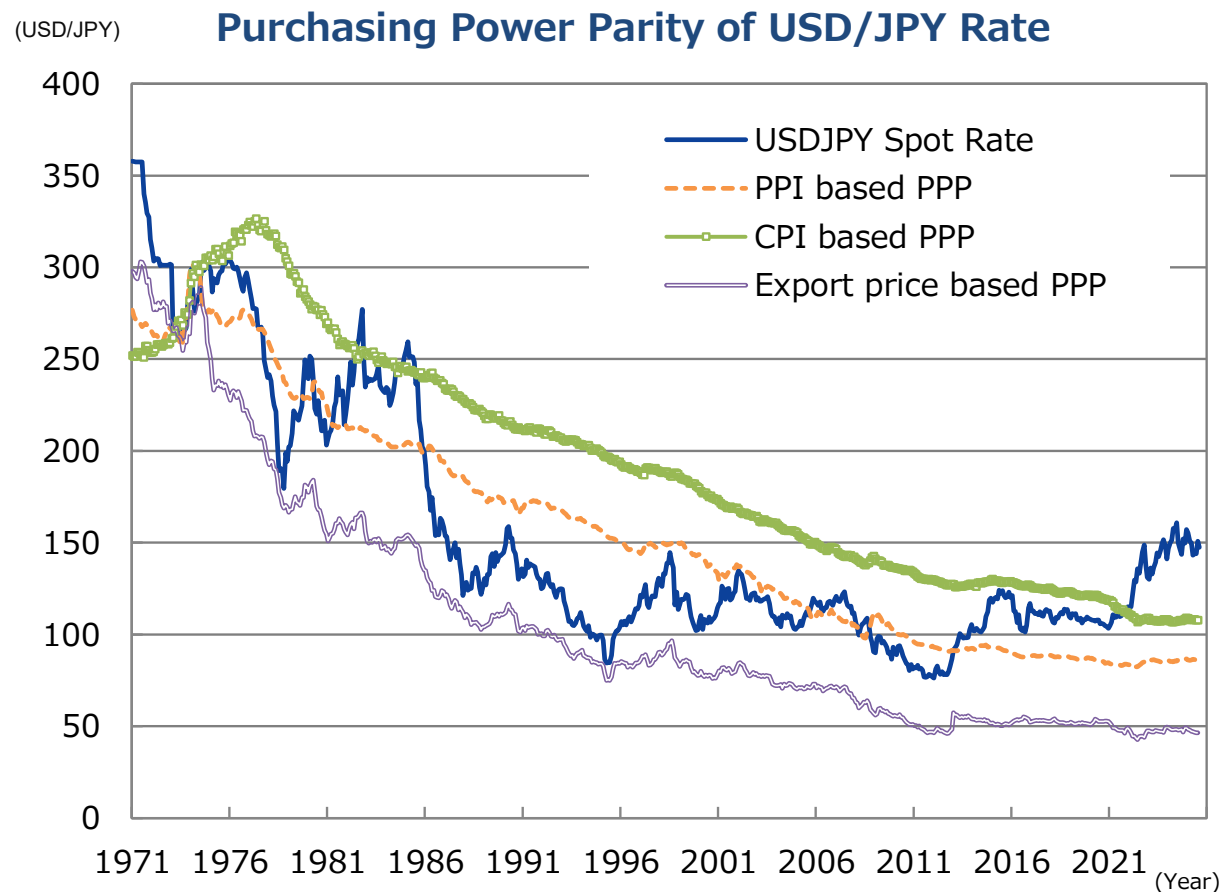
(Year/Month)

Note: Data is from 1st January 2022 to 29th August 2025.
Source: Bloomberg

Dollar/Yen Remains Steady Despite Narrowing Interest Rate Gap



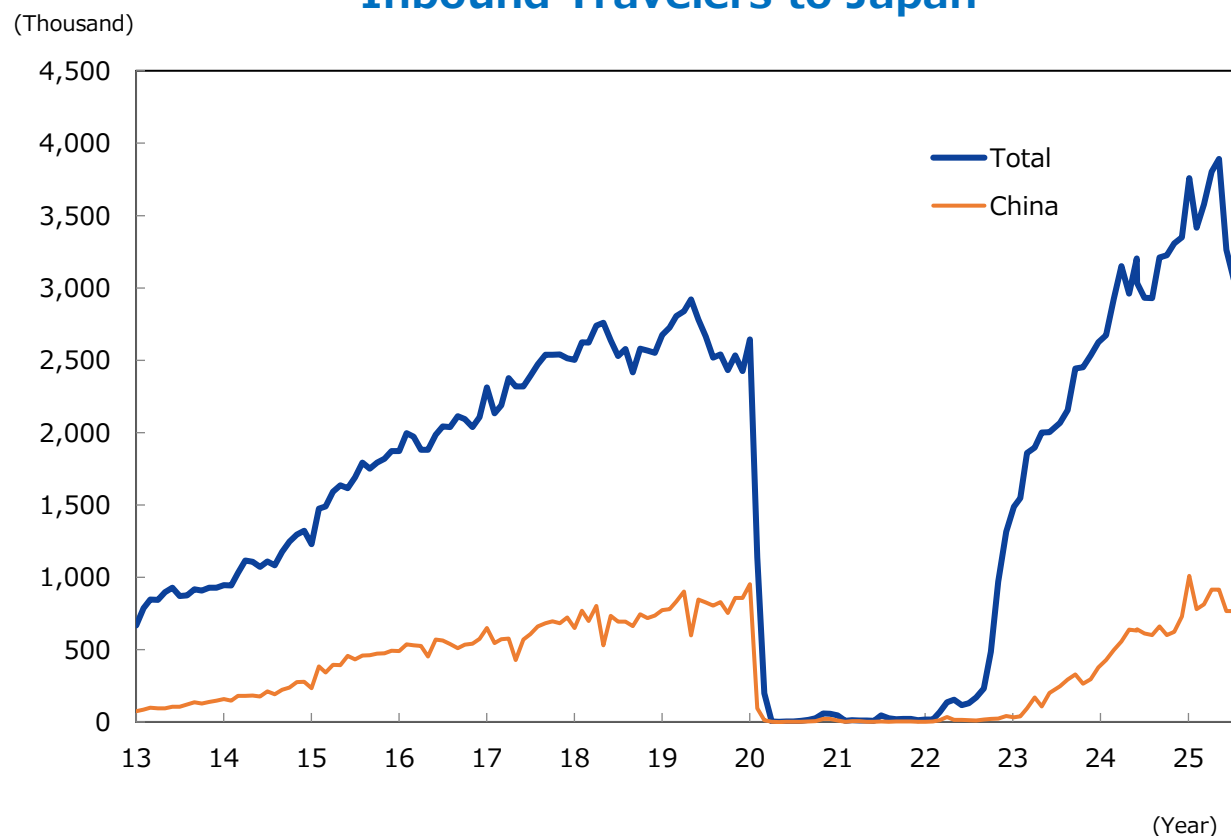
Purchasing Power Parity Indicates Overvaluation of US Dollar



Note: Data is from January 1971 to August 2025.
Source: DOL, Bank of Japan, SMDAM

“Earthquake Rumor” Stumbles Inbound Travel from Asia in July

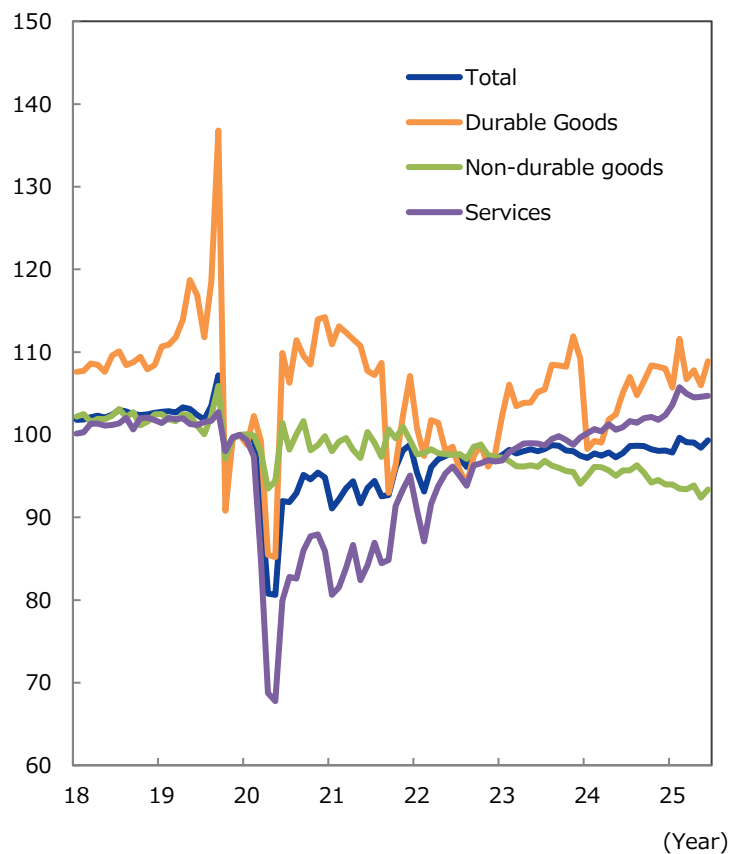
Inbound Travelers to Japan



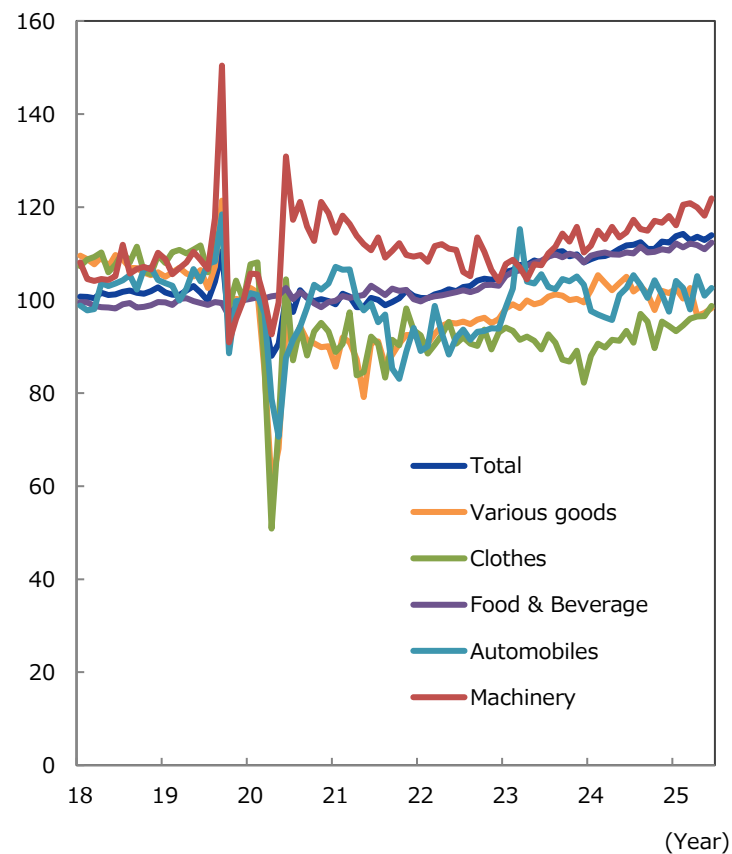
Note: Data is from January 2013 to July 2025. Data is non-seasonally adjusted.
Source: Japan National Tourism Organization, SMDAM

Consumer Activities are Mixed due to Weak Real Income

Consumer Activity Index (Dec. 2019 = 100)



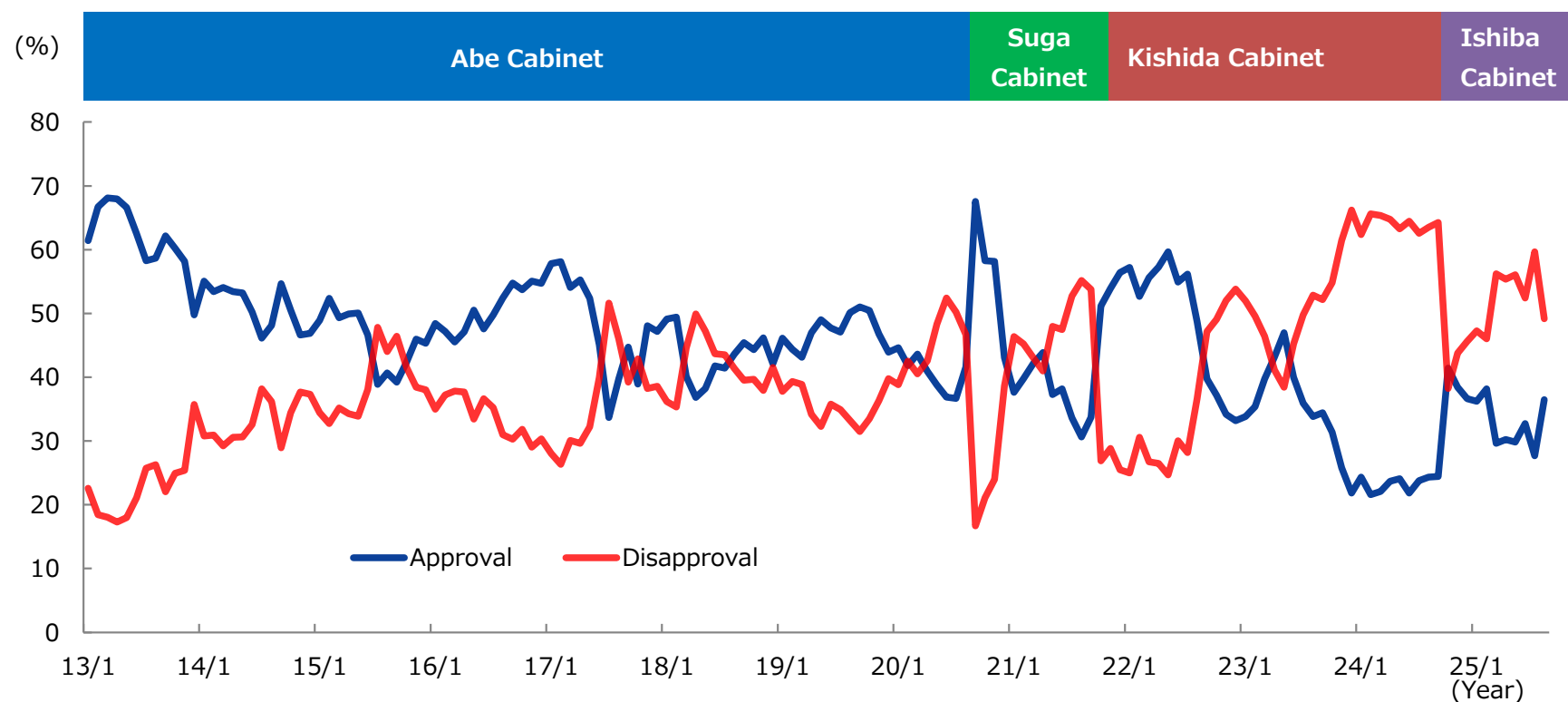
Retail Sales (Dec. 2019 = 100)



Note: Data is from January 2018 to June 2025.
Source; Bank of Japan, METI, and SMDAM

PM Ishiba's Approval Ratings Rebound After Election Defeat

Cabinet approval rate



Note: Data is from January 2013 to August 2025.
Source: NHK, Asahi, Kyodo, Nikkei, Yomiuri, Sankei, Mainichi, Jiji, and SMDAM

Schedule of Major Events

| Year | Month | Date | Event |
|------|-----------|------------|--|
| 2025 | August | 15 | Release of 2025 Q2 GDP |
| | September | 8 18-19 | Revision of 2025 Q2 GDP Monetary Policy Meeting |
| | October | 29-30 | Monetary Policy Meeting |
| | November | 17 | Release of 2025 Q3 GDP Cabinet approval of economic measures |
| | December | 8 18-19 | Revision of 2025 Q3 GDP Monetary Policy Meeting Cabinet approval of the initial budget for FY 2026 and the outline for tax reform |
| 2026 | January | | Ordinary Diet Session Monetary Policy Meeting |
| | February | | Release of 2025 Q4 GDP |
| | March | 31 | Revision of 2025 Q4 GDP Release of the results of spring negotiations of Trade Union Confederation Monetary Policy Meeting Enactment of the FY 2026 budget and tax-related bills Expiration of the term of the Bank of Japan's Noguchi Policy Board member |
| | April | | Monetary Policy Meeting |
| | May | | Release of 2026 Q1 GDP |
| | June | 29 | Revision of 2026 Q1 GDP Cabinet's decisions on "Big-boned policy" Monetary Policy Meeting G7 Summit End of the ordinary Diet session Expiration of the term of the Bank of Japan's Nakamura Policy Board member |

(Source) Compiled by Sumitomo Mitsui DS Asset Management Co., Ltd.

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