



Outlook for Japanese Stock Market & Economy

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Sumitomo Mitsui DS Asset Management



Outlook for Japanese Stock Market

Market Outlook

- **Japanese Stock Market Hits Record High Again**

The growing optimism fueled by the US Federal Reserve rate cut has pushed the Japanese stock market to a record high. Subsequently, fiscal expansion by the US and the EU is 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 44,200 to 45,000 for December 2025 and from 44,500 to 45,200 for March 2026, reflecting our renewed earnings estimates and valuations, supported by strong nominal GDP growth, mild inflation, and an accommodative fiscal policy.

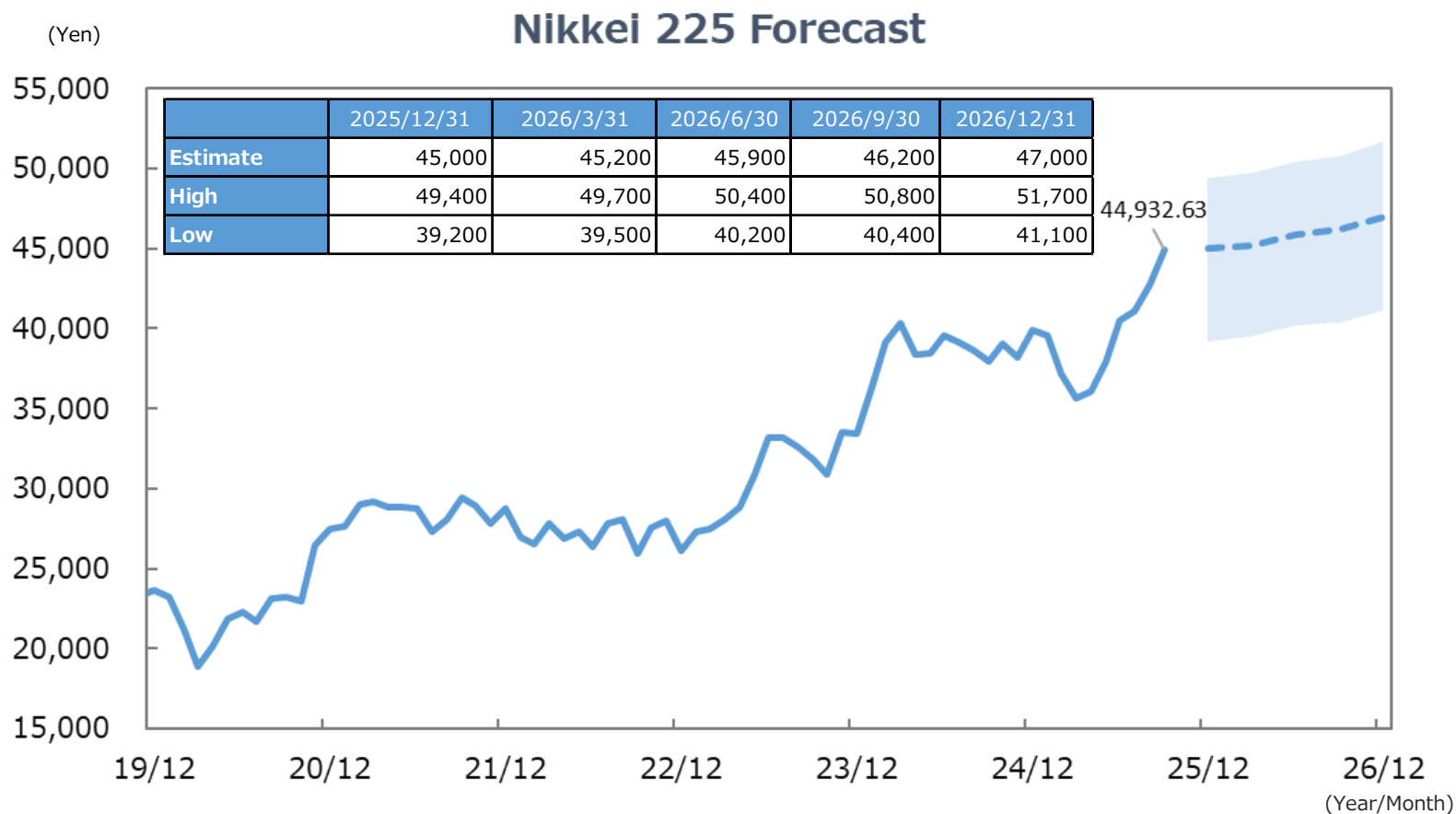
- **Rising Interest Rates May Weigh on Share Price Valuations**

Political uncertainty and the BOJ's monetary tightening could weigh on share price valuations going forward.

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

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

We Expect Encouraging Market Perspective Going Forward

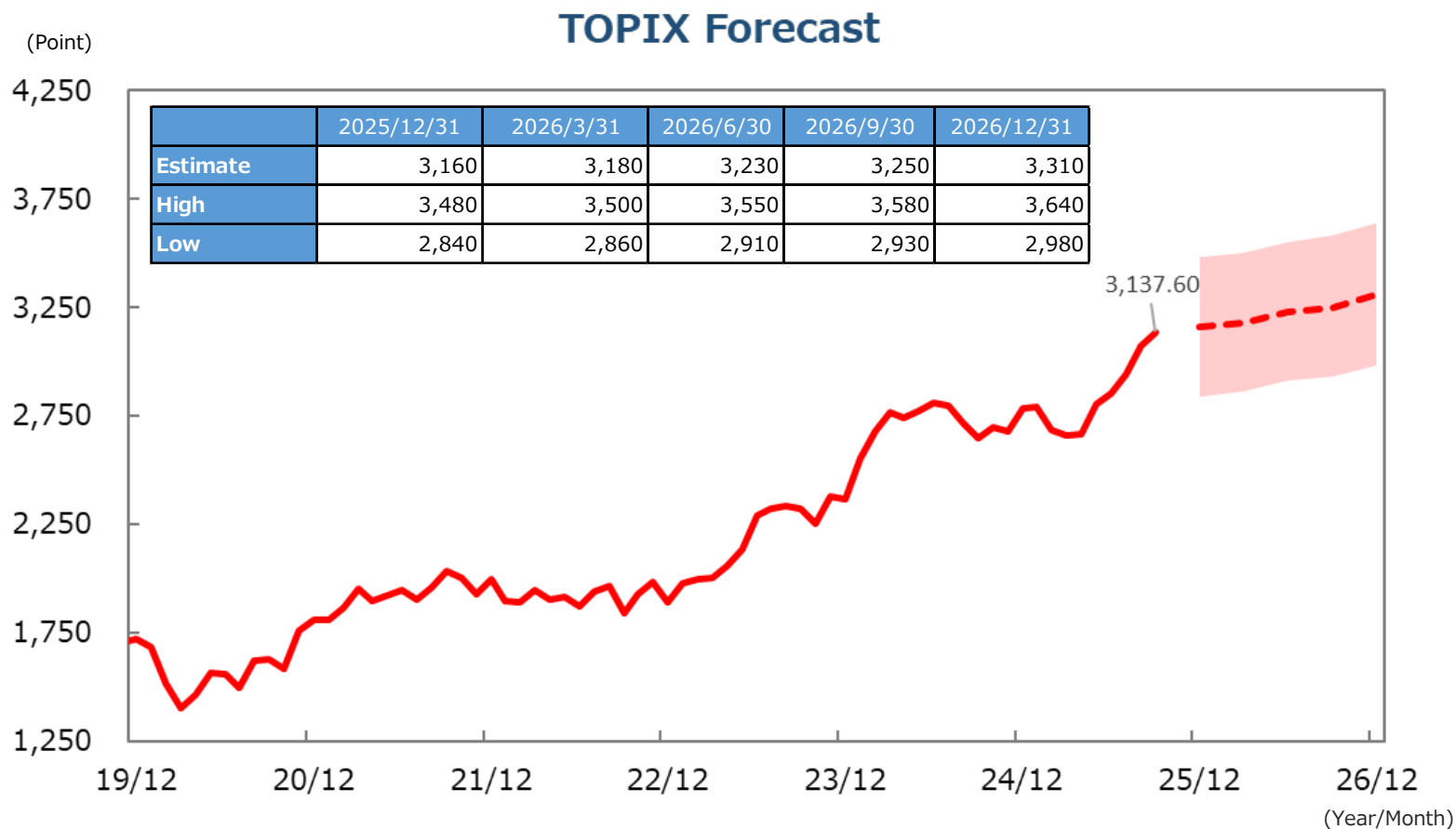


Data is from December 2019 to December 2026. Data after September 2025 is our forecast.

Note: The forecasts are as of September 19th, 2025.

(Source) Bloomberg, SMDAM

We Expect Encouraging Market Perspective Going Forward

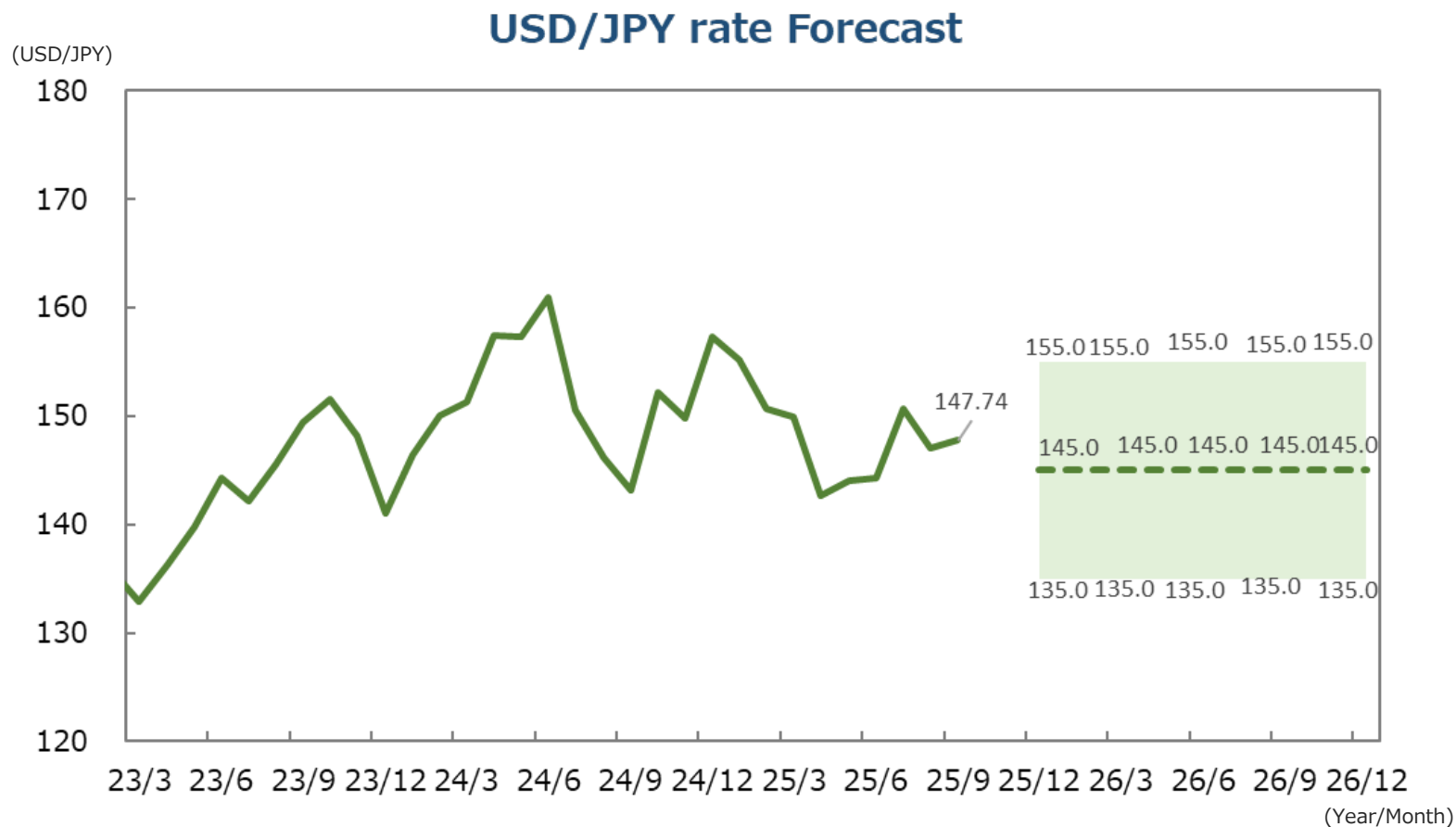


Data is from December 2019 to December 2026. Data after September 2025 is our forecast.

Note: The forecasts are as of September 19th, 2025.

(Source) Bloomberg, SMDAM

Divergence of Monetary Policy to Weigh on the Dollar Ahead



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

Note: The forecasts are as of September 19th, 2025.

(Source) Bloomberg, SMDAM

Upside / Downside Risk Scenarios

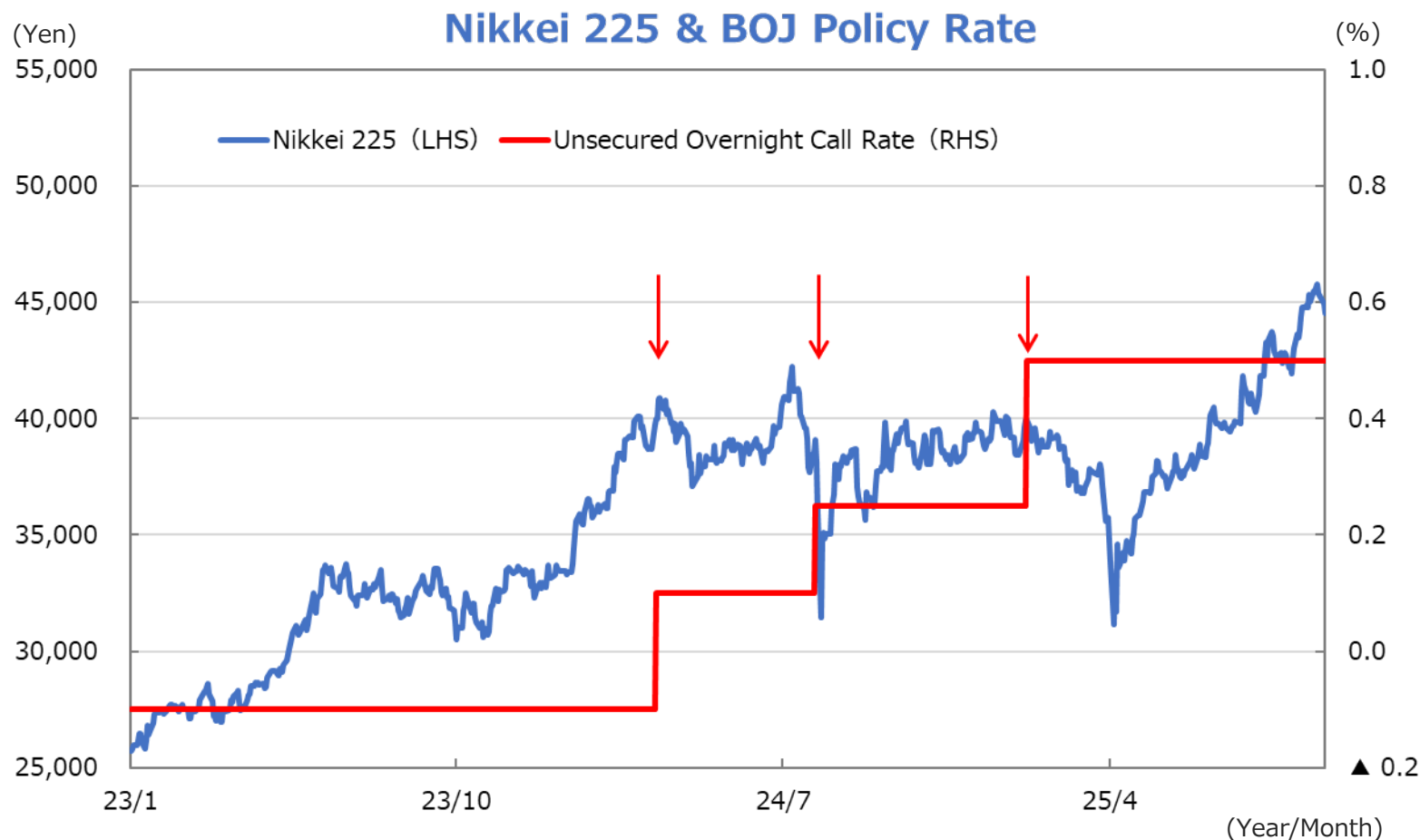
■ Upside Risks

- **Robust foreign inflows** into the Japanese stock market have been 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

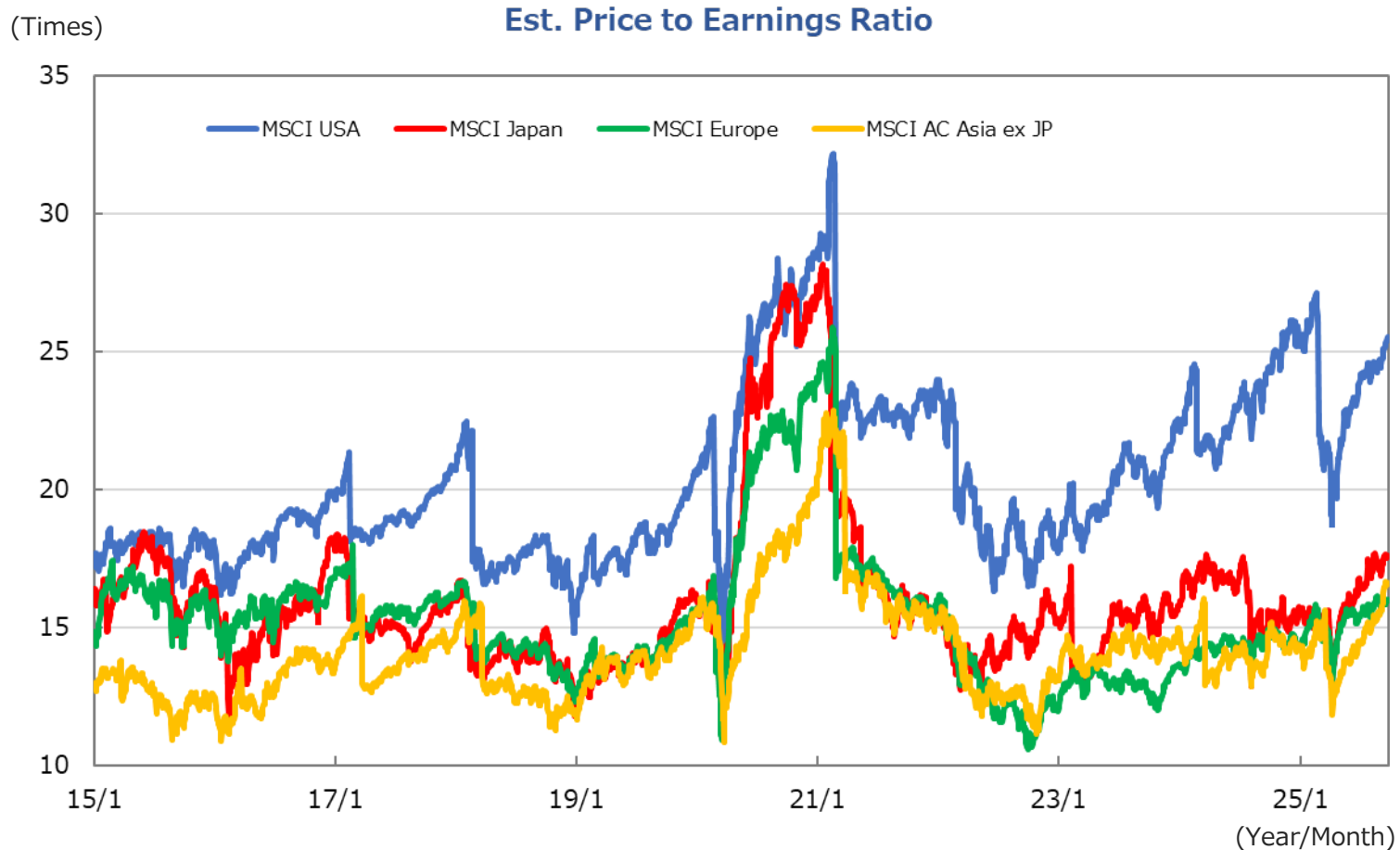
- **Renewed deterioration** in the US-China trade relations
- **Excessive monetary easing** by the US Federal Reserve and Yen's appreciation
- **Spike of Japanese Government Bond (JGB) yields** due to the concerns over the expansion of defense spending and a widening fiscal deficit
- **Negative impact** of excessive accumulation of inventories due to Trump tariffs
- **A sudden shift in market sentiment** resulting from the start of ETF sell-offs by the Bank of Japan (BOJ)

Recent Three Rate Hikes Had All Hit Stock Market Valuation



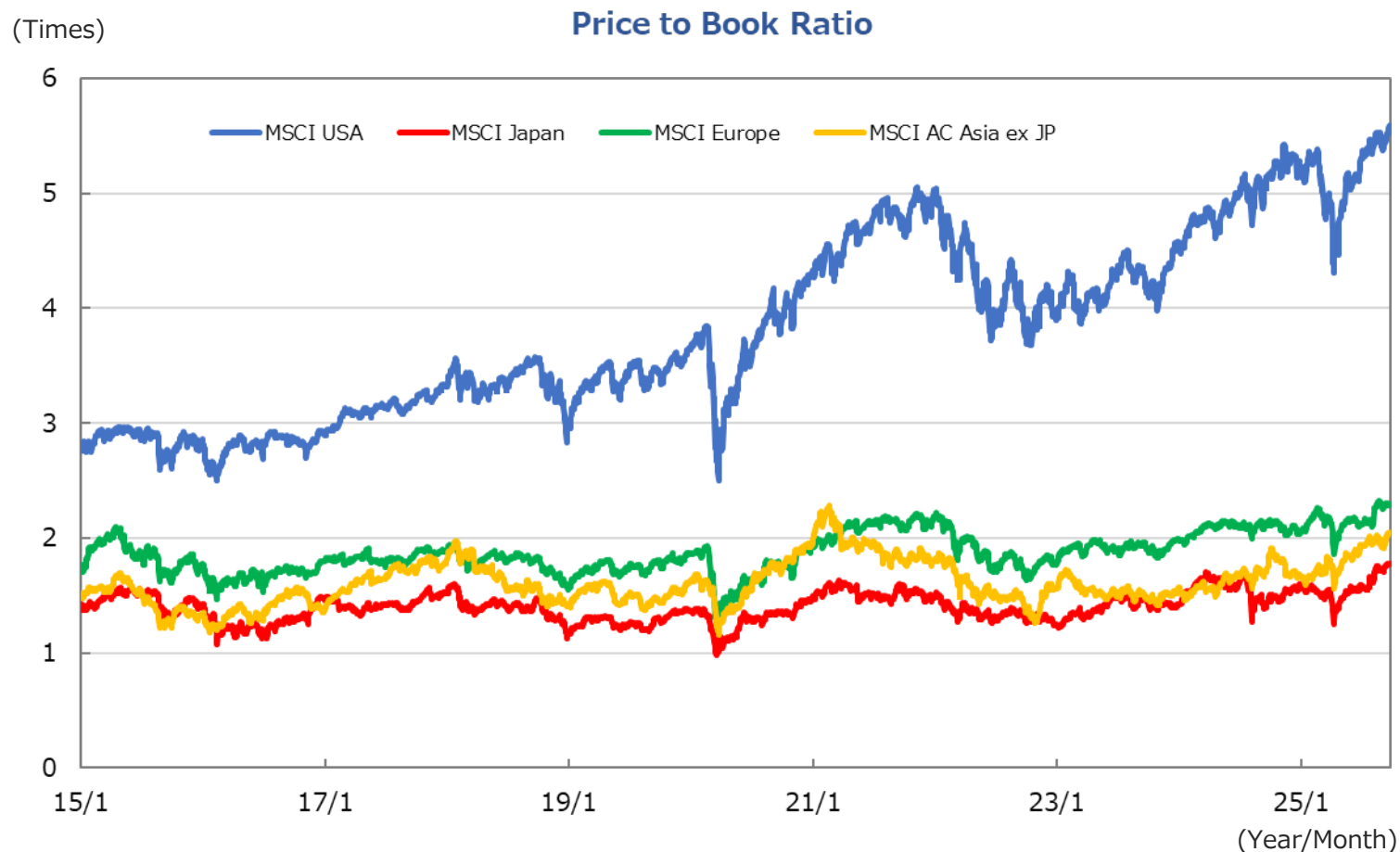
Data is from 4th January 2023 to 30th September 2025.
(Source) SMDAM, Bloomberg

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



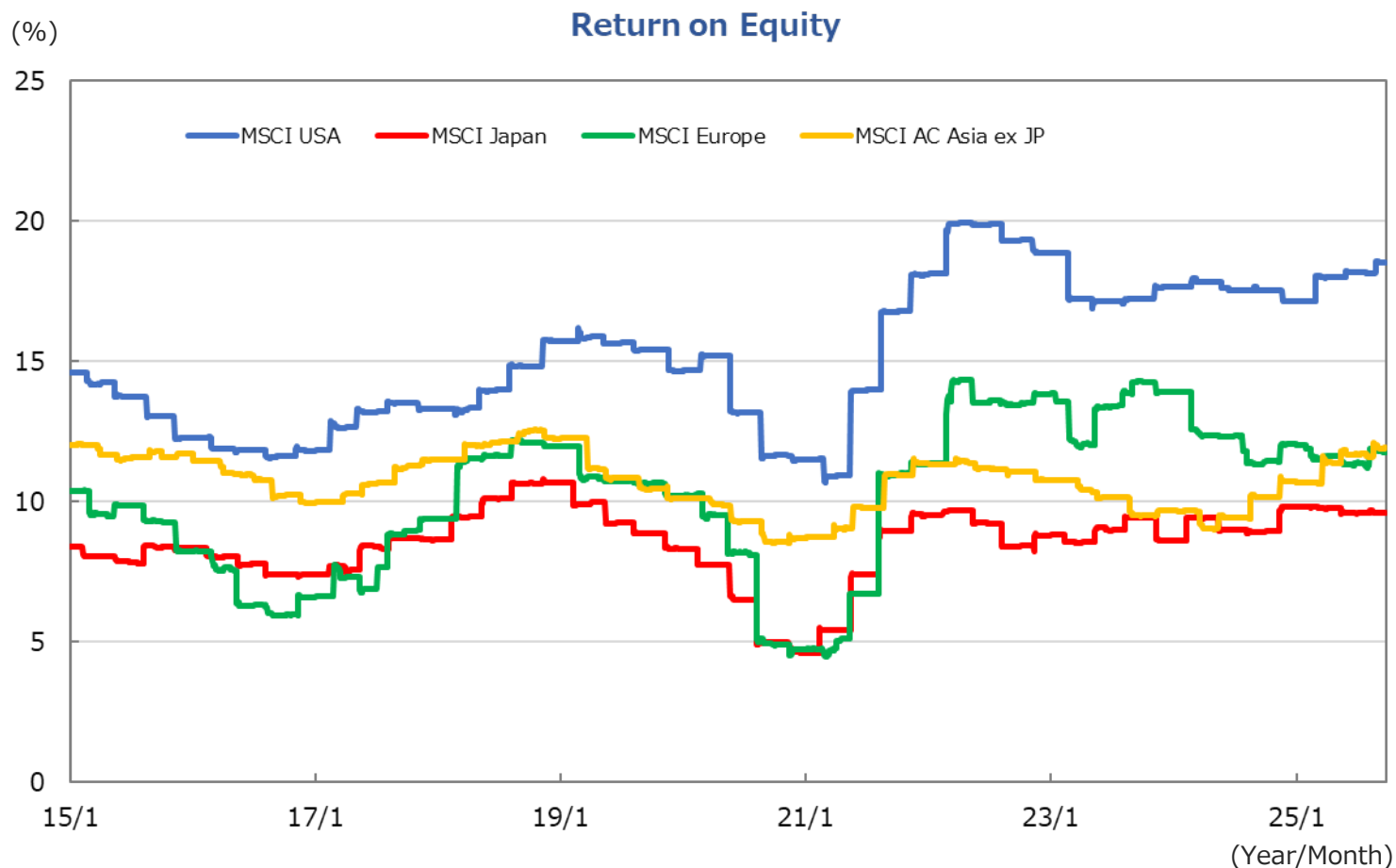
Data is from January 2015 to September 2025.
(Source) SMDAM, Bloomberg

Japan's P/B Ratio Reached to the Highest Since 2007



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

ROE Remains Unchanged due to Build up of Excess Capital

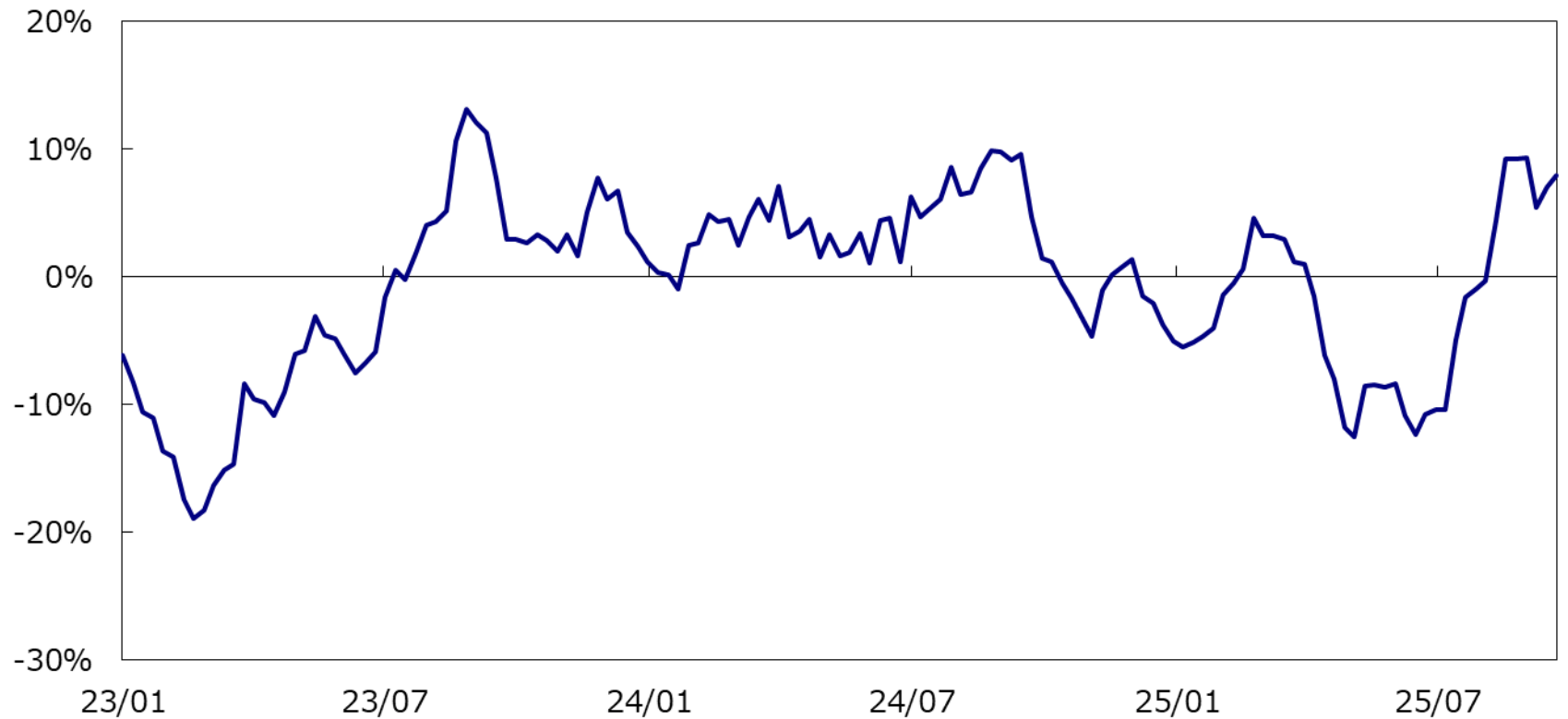


Data is from January 2015 to September 2025.
(Source) SMDAM, Bloomberg



Analysts Getting Optimistic about Earnings Perspective

TOPIX EPS Revision Index

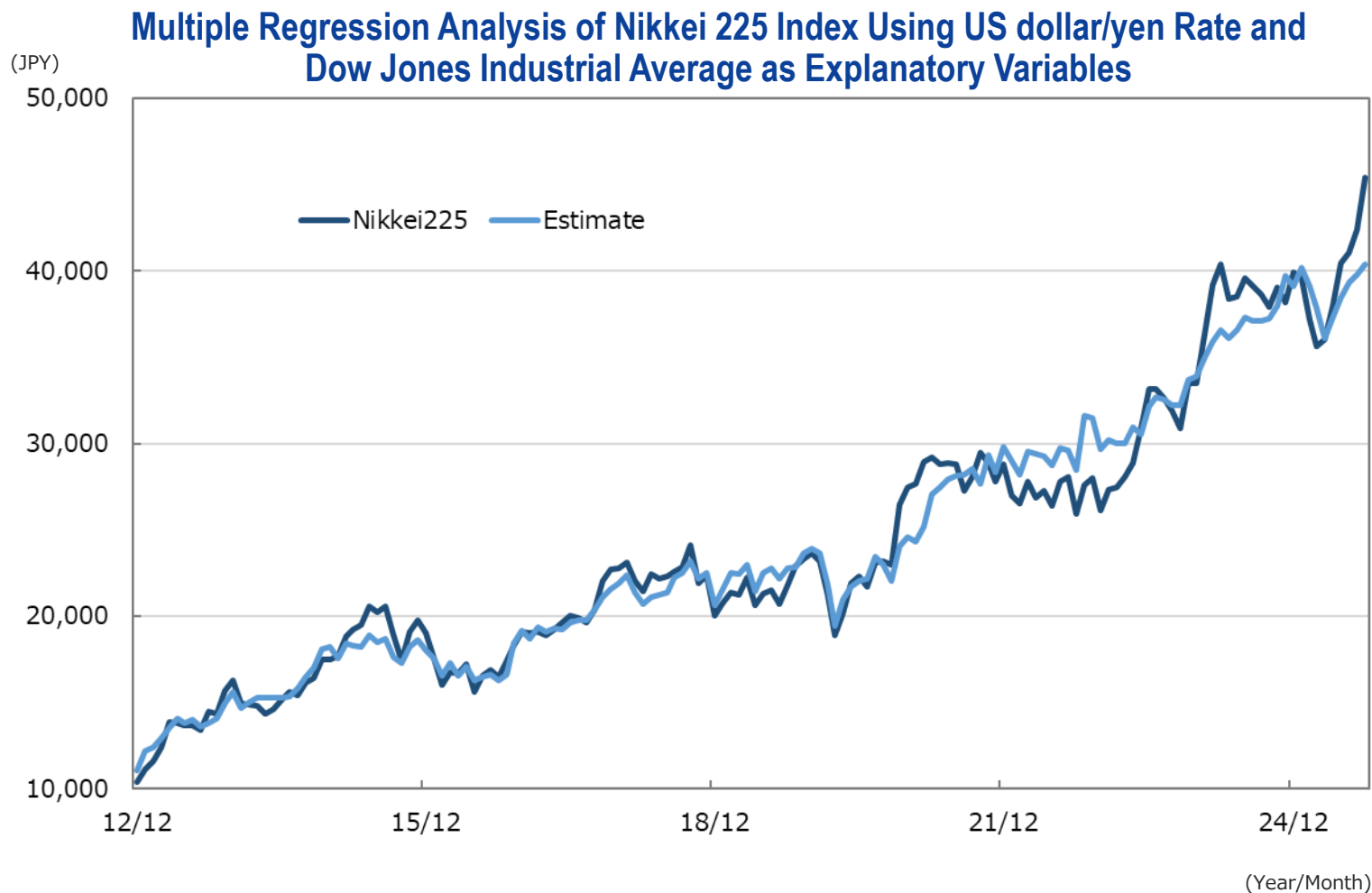


Data is from January 5th 2023 to 25th September 2025
(Source) Datastream, IBES

(YY/MM)

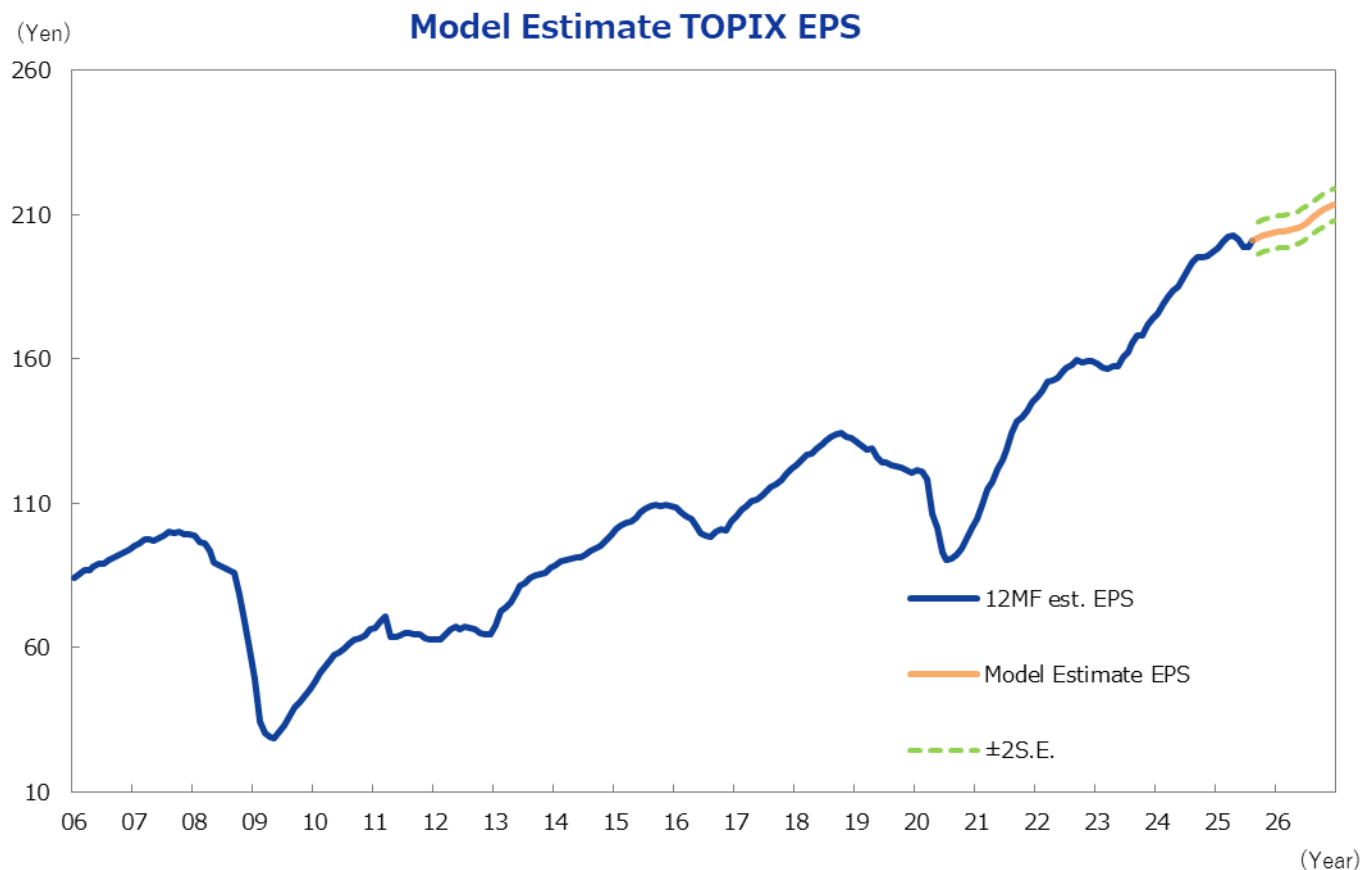


Regression Analysis Indicates Overdone in Recent Rally



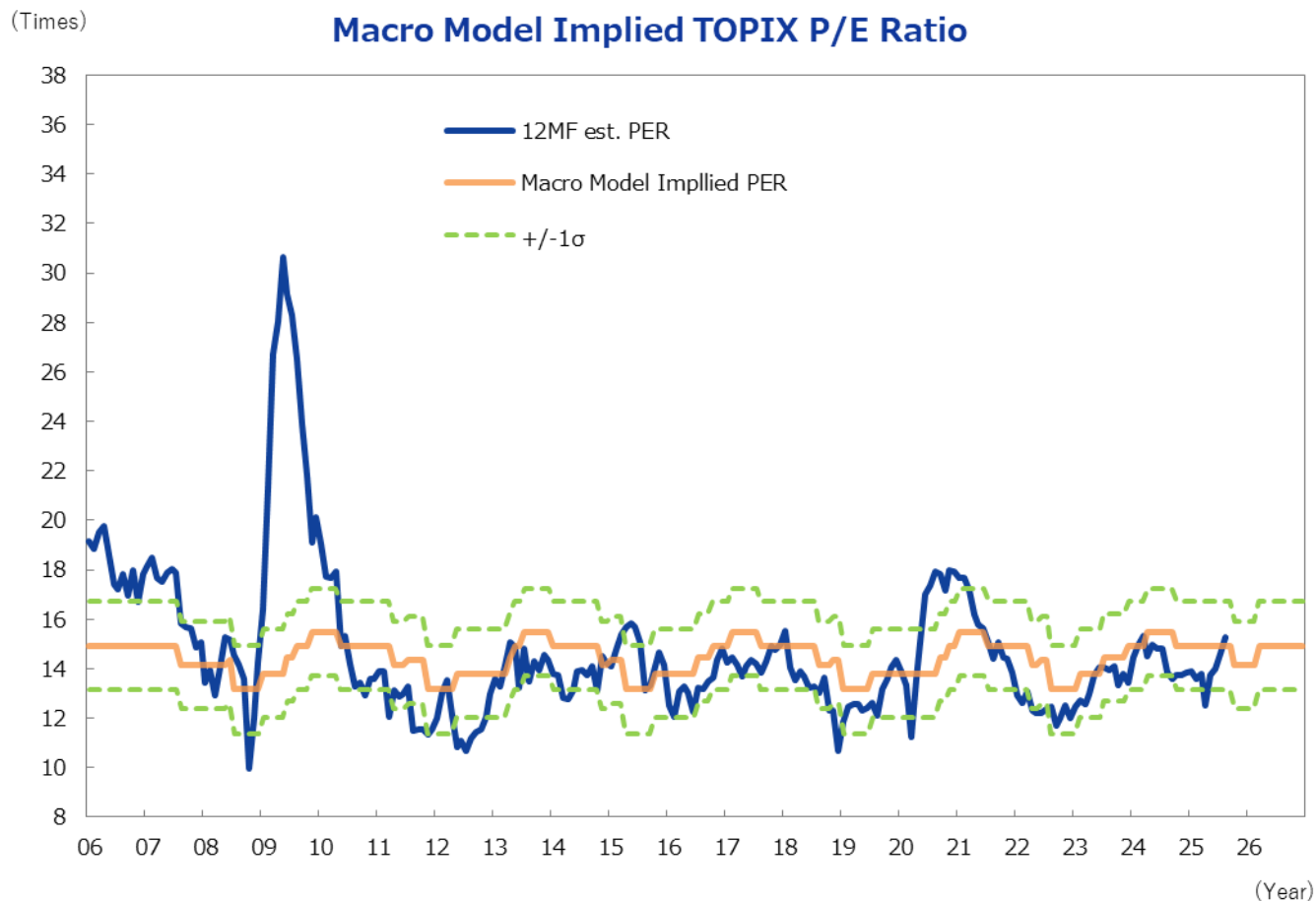
Data is from December 2012 to September 2025.
(Source) SMDAM, Bloomberg

Quant Model Suggests EPS Growth to Slow Down Temporarily



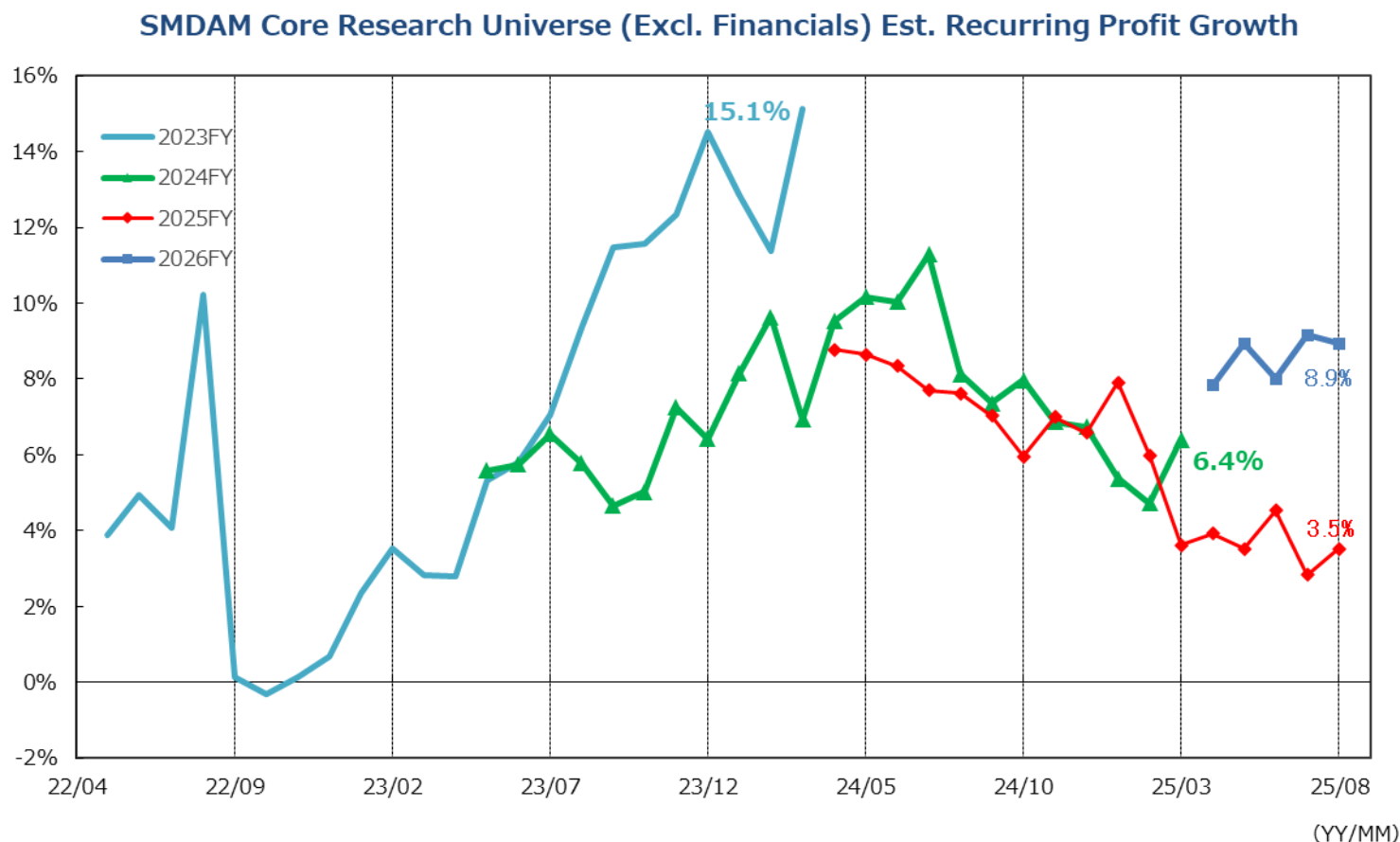
Note: Consensus data is from January 2006 to August 2025. Model estimate Data is from September 2025 to December 2026.
Source: SMDAM

The P/E Ratio is Going Above the Model-Implied Fair Level



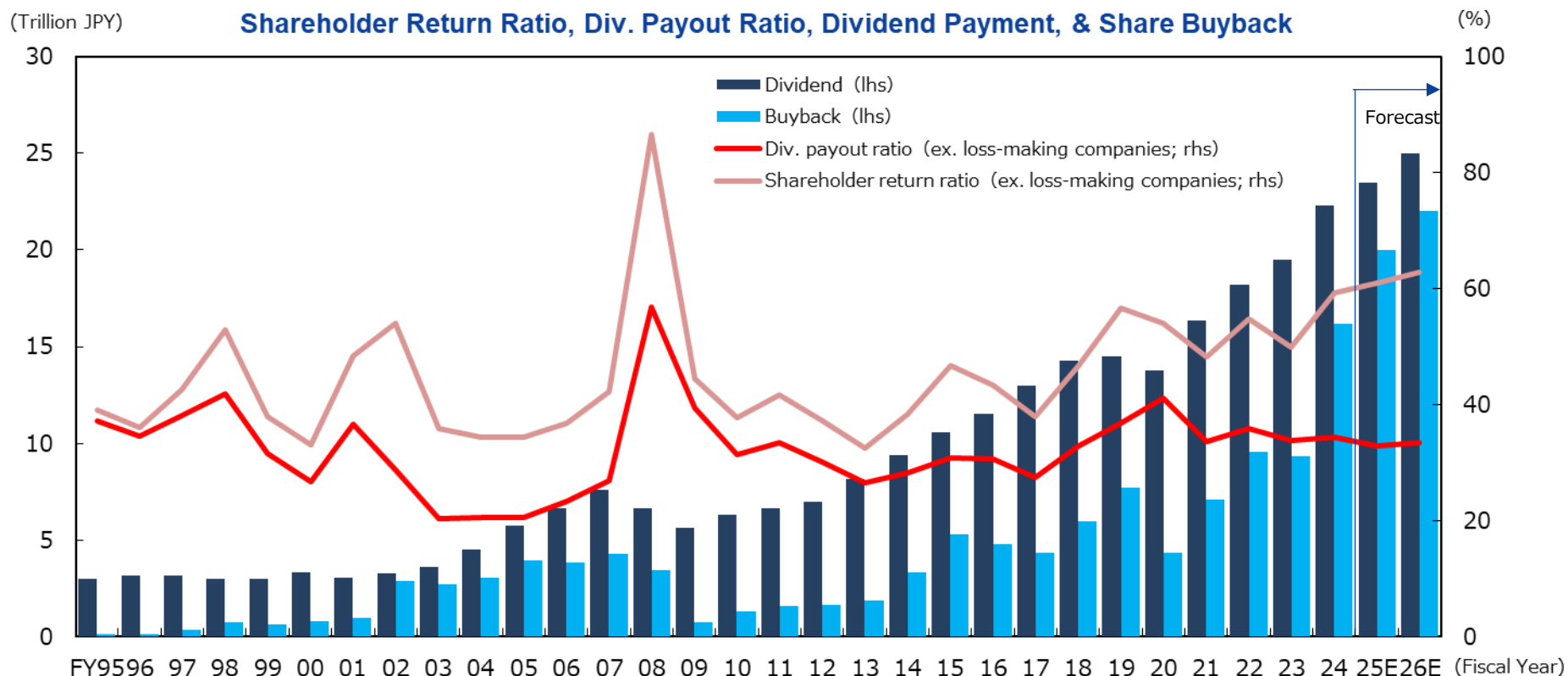
Note: Consensus data is from January 2006 to August 2025. Model estimate Data is from September 2025 to December 2026.
Source: SMDAM

Our Analysts See Positive Earnings Outlook Next Fiscal Year



Note: Data is as of 12th September 2025, SMDAM Core Universe (Excl. Financials) consists of 373 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

Value, Domestic, and Small Caps Dominate the Market

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	10.11	14.37	13.14	19.00	36.26	72.29	94.75
Total Value	15.92	15.87	17.09	26.01	42.49	97.13	150.36
Top Cap Value	19.16	19.43	18.24	32.63	50.84	118.95	196.45
Large Cap Value	16.16	15.50	16.53	25.85	42.20	99.97	159.83
Mid Cap Value	12.77	11.11	14.56	19.05	33.37	79.78	121.14
Small Cap Value	14.94	17.39	19.36	26.24	43.27	84.51	111.02
Micro Cap Value	14.66	19.03	21.78	28.47	44.95	85.84	105.60
Total Growth	4.19	12.71	8.98	12.21	30.39	50.75	51.50
Top Cap Growth	3.63	11.68	5.86	11.40	32.51	55.83	61.85
Large Cap Growth	4.20	12.62	8.80	12.16	31.40	53.62	55.22
Mid Cap Growth	5.46	14.72	15.78	14.63	30.68	51.19	46.53
Small Cap Growth	4.07	13.34	10.46	12.42	21.82	28.89	22.85
Micro Cap Growth	6.53	12.97	10.33	8.83	15.07	21.88	14.10
Top Cap Total	10.05	15.03	11.07	19.84	39.57	80.46	110.94
Large Cap Total	9.92	14.07	12.58	18.56	36.36	74.17	98.38
Mid Cap Total	9.71	12.56	15.07	17.01	32.09	65.59	81.75
Small Cap Total	11.13	16.03	16.27	21.22	35.11	61.29	72.86
Micro Cap Total	12.13	17.17	18.17	22.00	34.69	62.17	70.52

Note : As of 30th September 2025
(Source) Bloomberg

...Excess RN Japan Equity's performance





Outlook for Japanese Economy

Current Status & Outlook of the Japanese Economy

■ Current Status

- **The economy is in a soft patch.** Exports are sluggish, particularly to the United States, and companies remain somewhat cautious about production. While the impact of US tariffs has been limited so far, it may gradually become more apparent.
- **Nationwide core CPI continues to exceed the Bank of Japan's (BOJ) "price stability target" of 2% year-on-year (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 +3.1% YOY in July from +3.3% in June, marking the second consecutive month of deceleration and indicating signs of peaking.

■ Outlook

- ① **While we have raised our real GDP growth estimate from +0.6% to +0.8% for FY 2025, we have maintained our forecast at +0.7% for FY 2026.** The upward revision for FY 2025 is mainly due to the reflection of Q2 GDP figures. While we expect slower growth in the latter half of 2025 due to the negative impacts from US tariffs, the economy is likely to avoid a severe downturn. We 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 at +2.6% for FY 2025, we have lowered our forecast from +1.6% to +1.4% for FY 2026.** Looking ahead, we anticipate that cost-push pressures from import prices will ease, and rice prices will also stabilize. We also expect the abolition of the provisional gasoline tax. Amid these factors, core CPI is likely to decelerate. However, rising service prices driven by wage increases are expected to support 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.** Following the announcement of PM Ishiba's resignation, the Liberal Democratic Party (LDP) presidential election has been scheduled. Candidates are expected to include Mr. Koizumi, Ms. Takaichi, Mr. Hayashi, Mr. Kobayashi, and Mr. Motegi. Regardless of who becomes the next president, we anticipate the implementation of economic measures in response to US tariffs and rising prices. However, if Ms. Takaichi becomes the next Prime Minister, the risk of fiscal deterioration is likely to increase.
- 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.** Governor Ueda is expected to carefully consider the impact of US tariffs before making a decision of next rate hike. Given the expected economic slowdown in the latter half of CY2025, the next rate hike is more likely to occur in January 2026 rather than this year. The pace for wage increases, which will become clearer in January 2026, is also key to the BOJ's decision on the next tightening. Following this, we anticipate a policy rate will be raised to the terminal rate of 1.25% in July 2027, although this lies beyond our forecast period. The BOJ might bring forward the next rate hike in 2025 if the impact of Trump's tariffs on economic and price data proves limited, if the BOJ places greater emphasis on actual inflation rather than underlying inflation, if the yen depreciates significantly, if inflation expectations rise above forecasts, and if the U.S. pressures Japan to raise rates. Conversely, the BOJ might postpone the next rate hike in the event of greater-than-expected negative impacts from US tariffs on the economy and inflation, lower-than-expected wage increases next fiscal year, and Ms. Takaichi's victory in the LDP presidential election.

Note: The forecasts are as of September 17th, 2025.

Forecast for the Japanese Economy

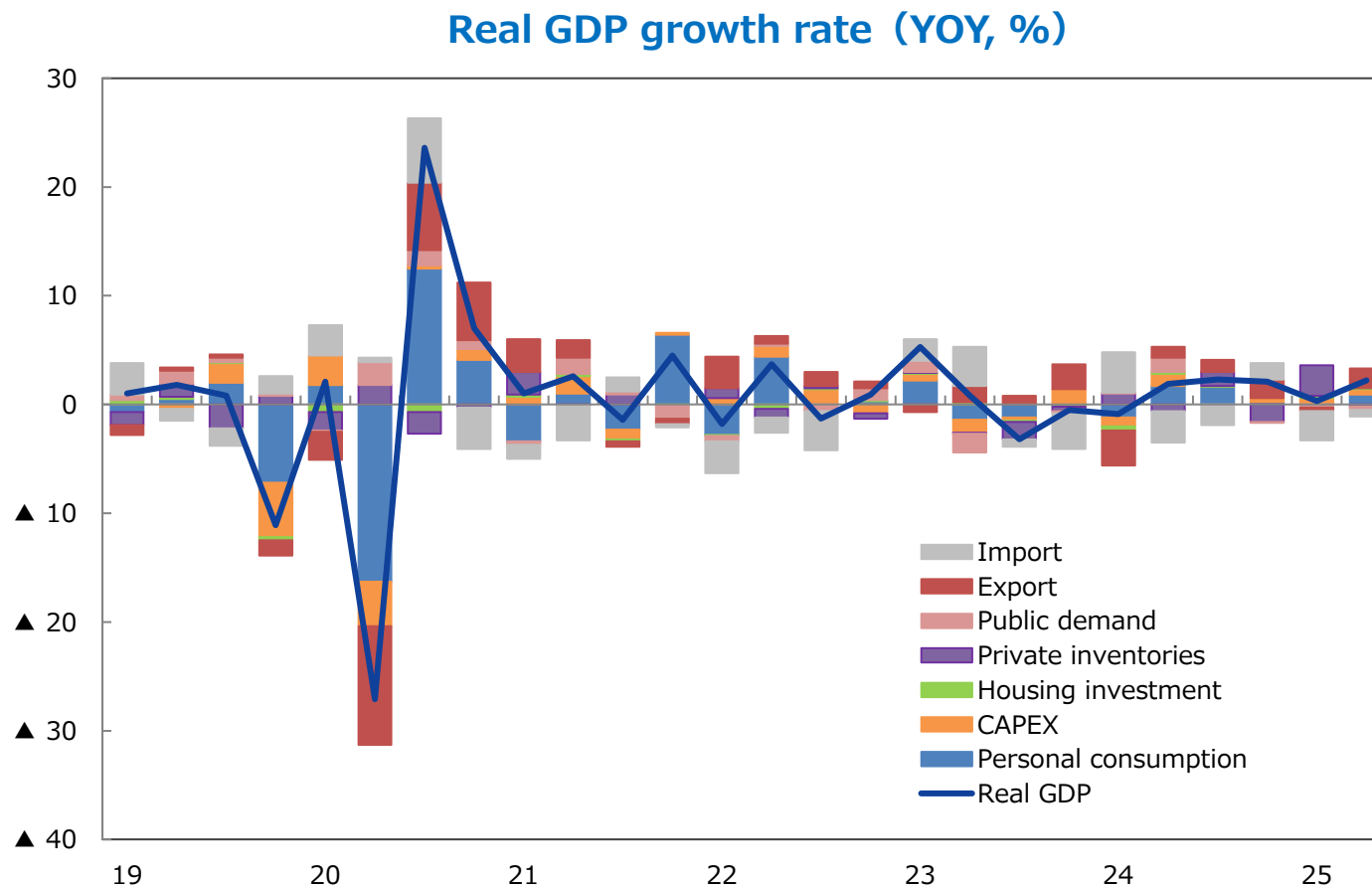
Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24	FY25 Est	FY26 Est
Real GDP	3.1%	1.3%	0.5%	0.7%	0.8%	0.7%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.7%	1.0%	0.9%
Private housing investment	0.4%	-2.7%	0.7%	-0.4%	-1.1%	-0.6%
Private-sector capital investment	3.6%	3.2%	-0.8%	2.1%	1.3%	1.3%
Private inventory investment	0.5%	0.0%	-0.3%	0.1%	0.2%	0.0%
Public fixed capital formation	-6.4%	-5.5%	-0.4%	0.8%	-0.2%	0.8%
Net export contribution	0.8%	-0.6%	1.4%	-0.4%	-0.2%	-0.1%
Exports of goods and services	12.5%	5.0%	3.1%	1.7%	1.5%	1.1%
Imports of goods and services	7.3%	7.4%	-2.7%	3.4%	2.4%	1.7%
Nominal GDP	3.0%	2.2%	4.7%	3.7%	3.4%	2.4%
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%	-0.1%	1.3%
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%	3.4%	2.1%	1.3%
Employee compensation	2.1%	2.5%	1.9%	4.6%	3.5%	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. (We anticipate being abolished in November 2025.)

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

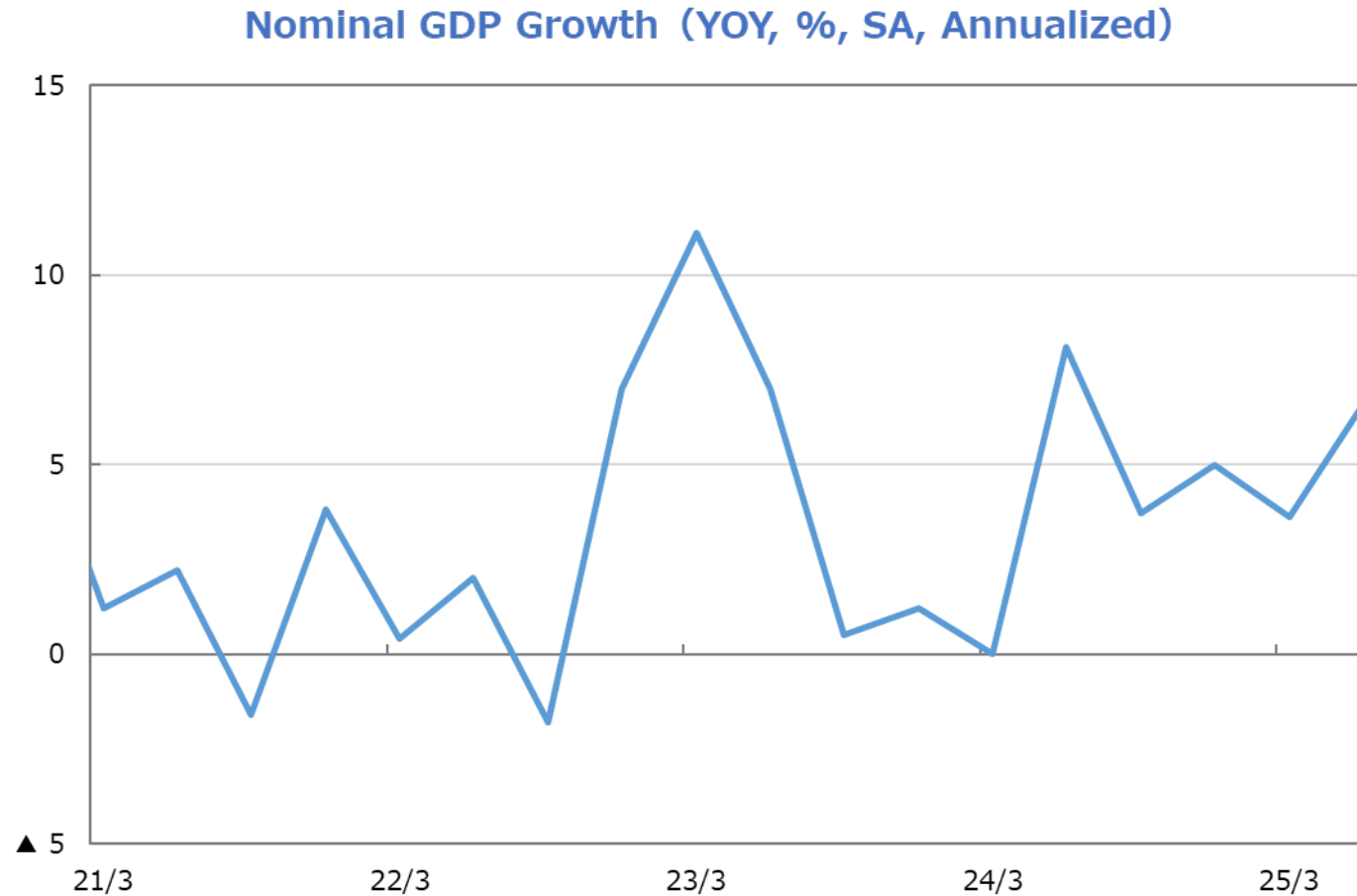
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Japan's GDP Continues Steady Growth Despite Trump Tariffs



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

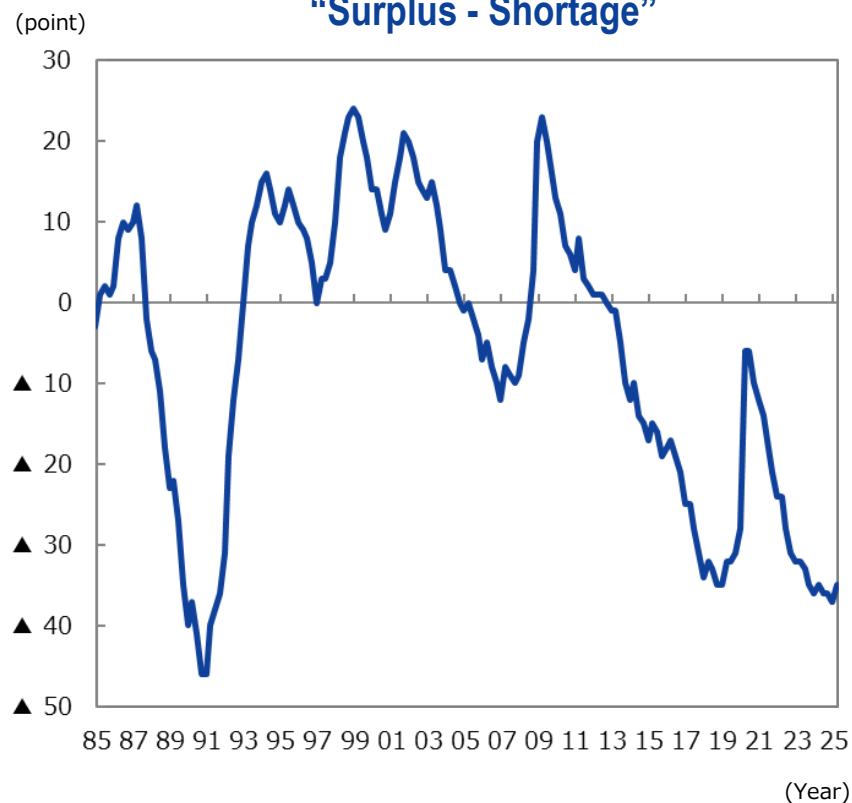
Japan's Nominal GDP Keeps Strong Momentum



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

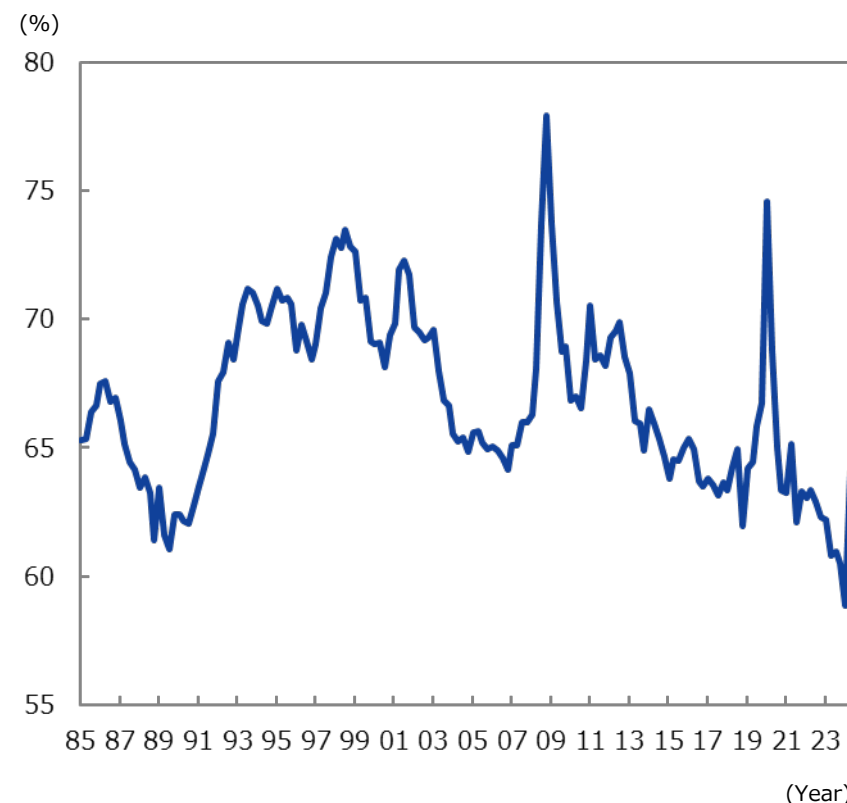
Conundrum? “Severe Labor Shortage” with “Low Labor Share”

Employment Sufficiency Index
“Surplus - Shortage”



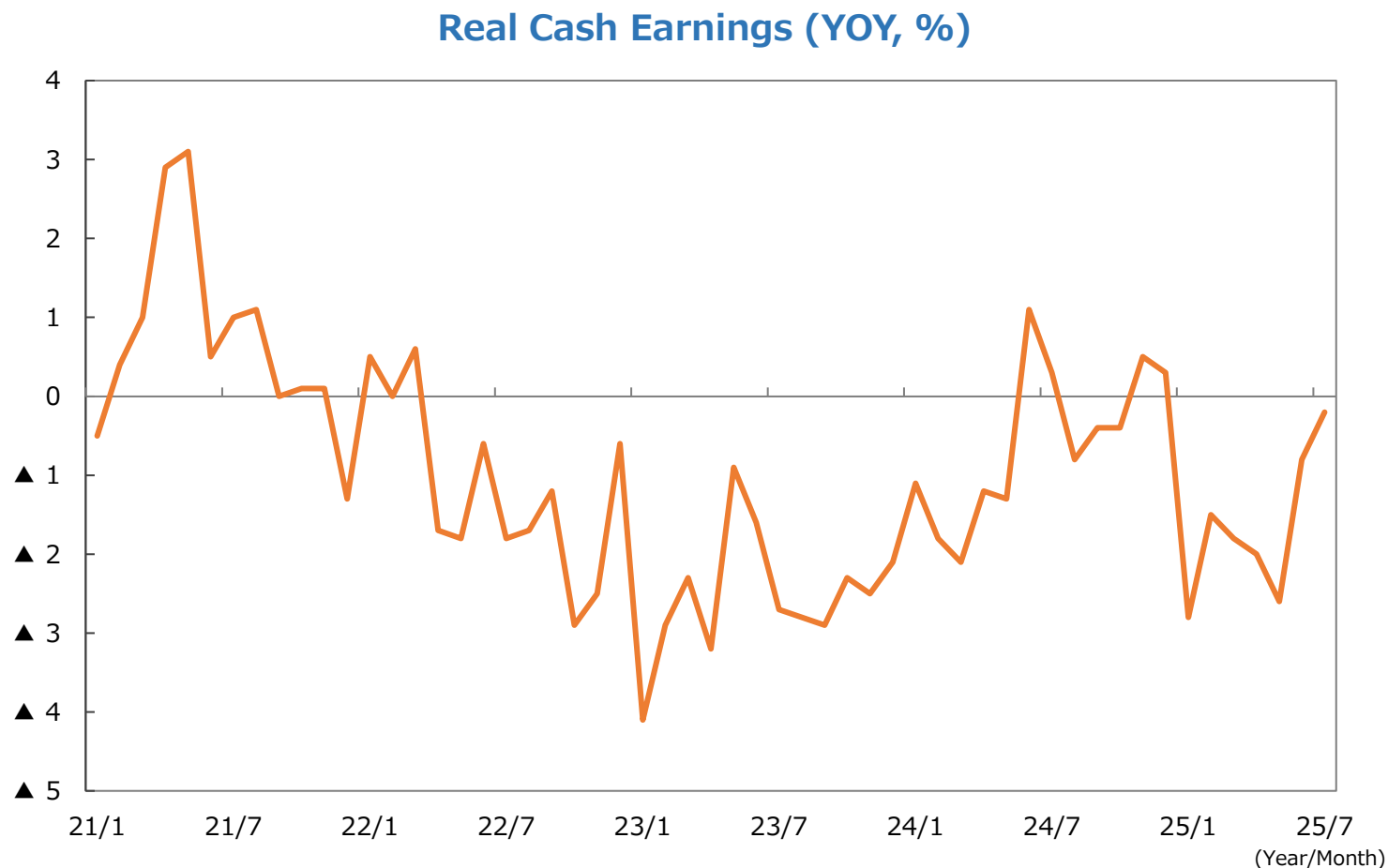
Note: Data is from April 1985 to June 2025.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



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

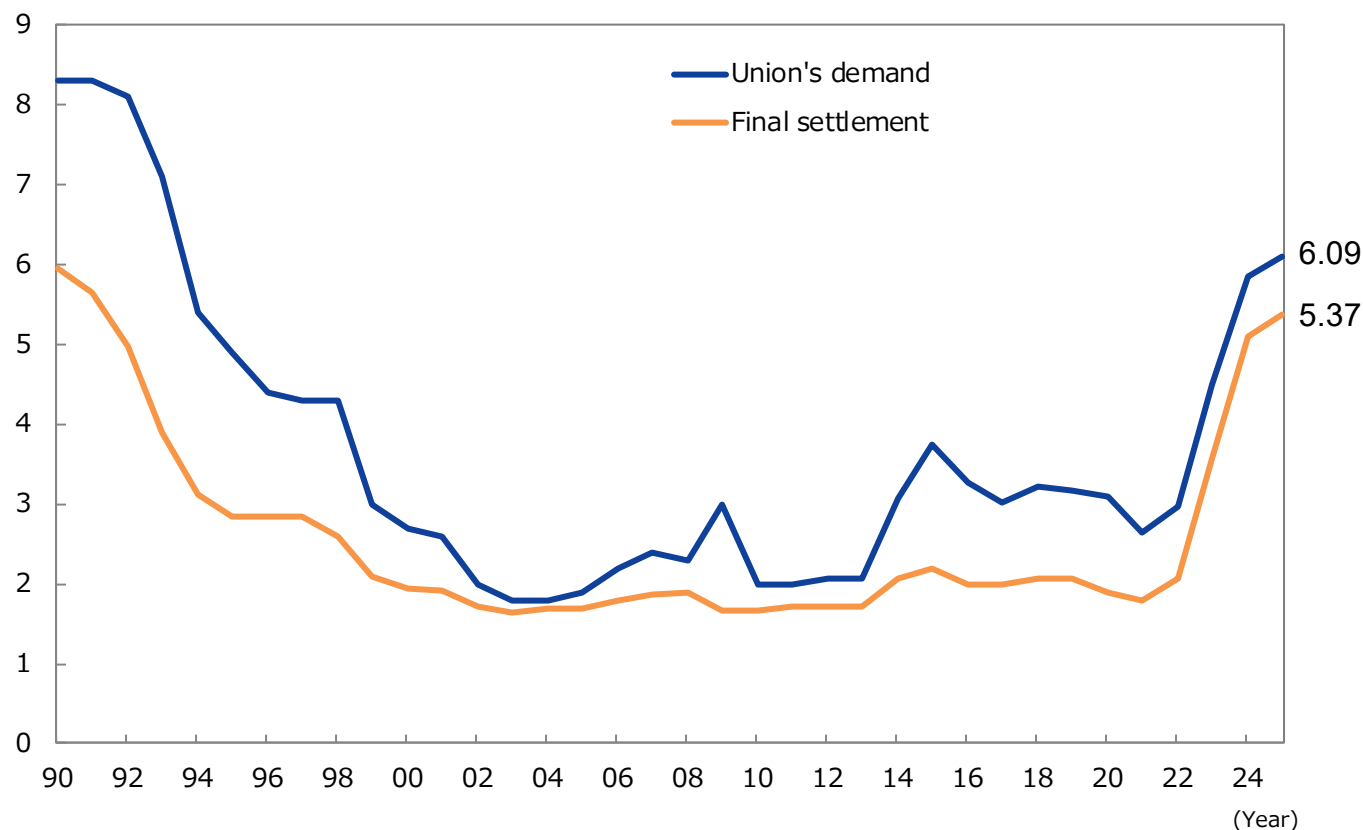
Inflation Eroding Consumers' Purchasing Power



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

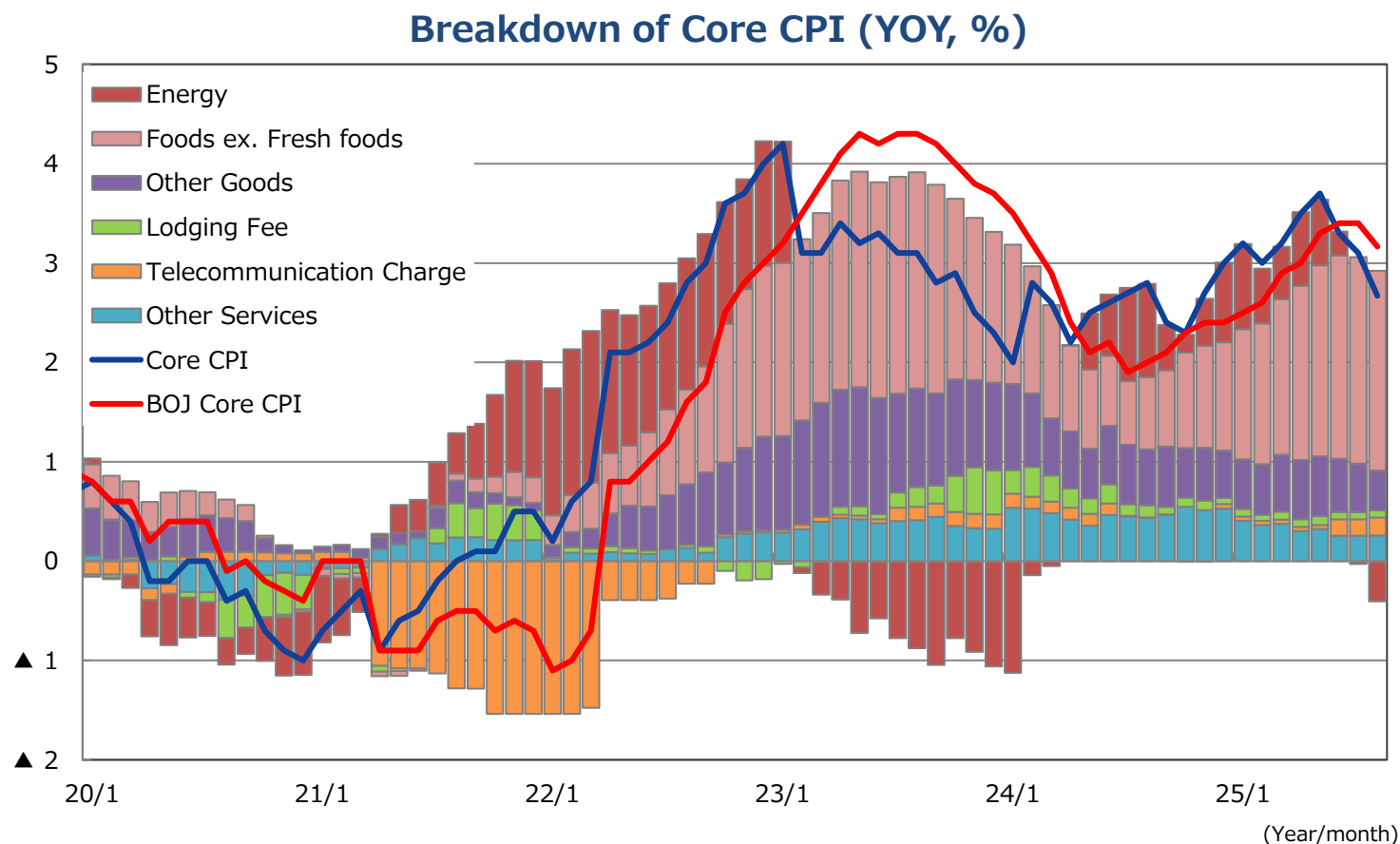
Highest Wage Increase in Japan Since Early 90s

Wage increase (YOY, %)



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

Falling Energy Prices Weigh on Inflation

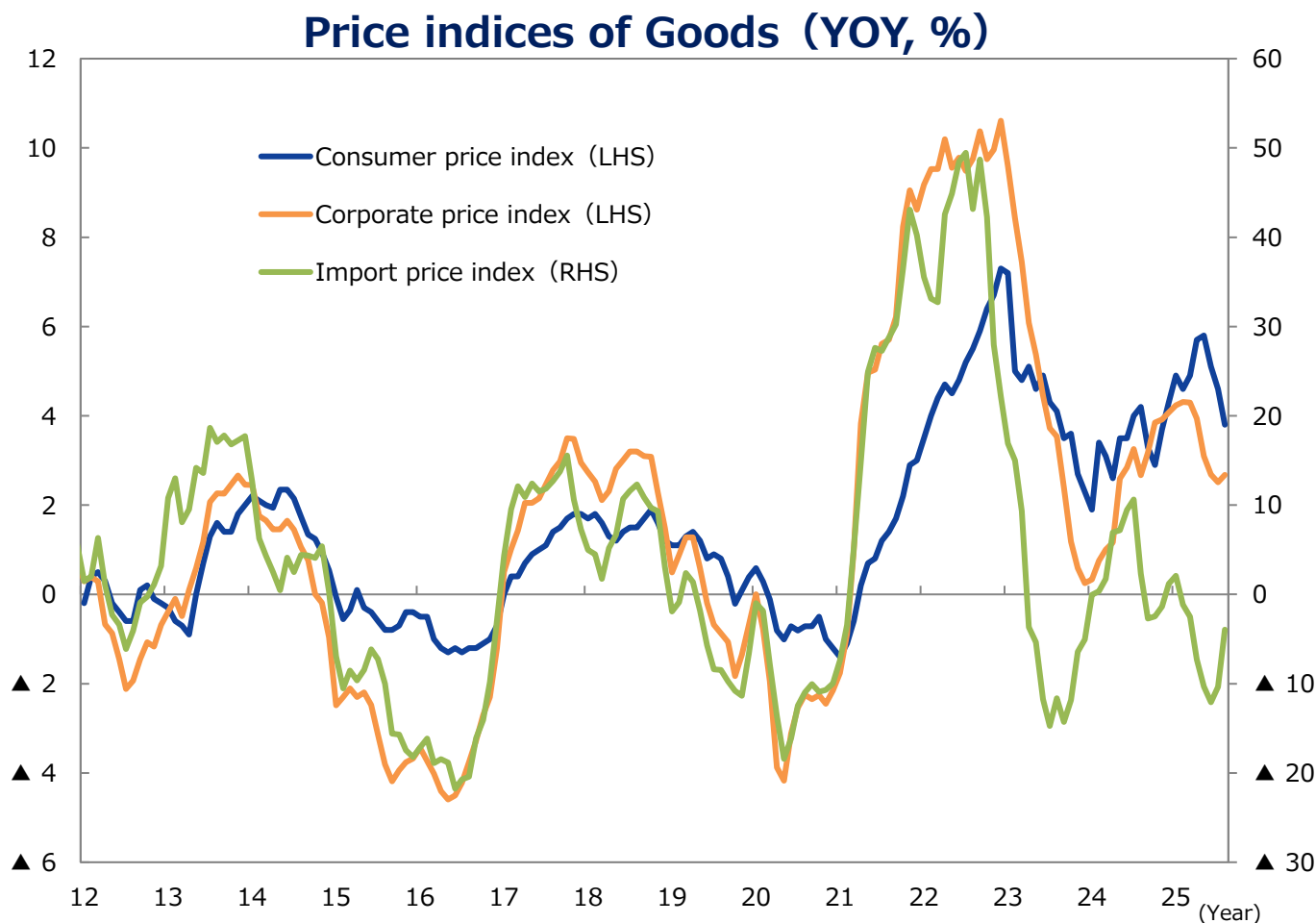


Note: Data is from January 2020 to August 2025.

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

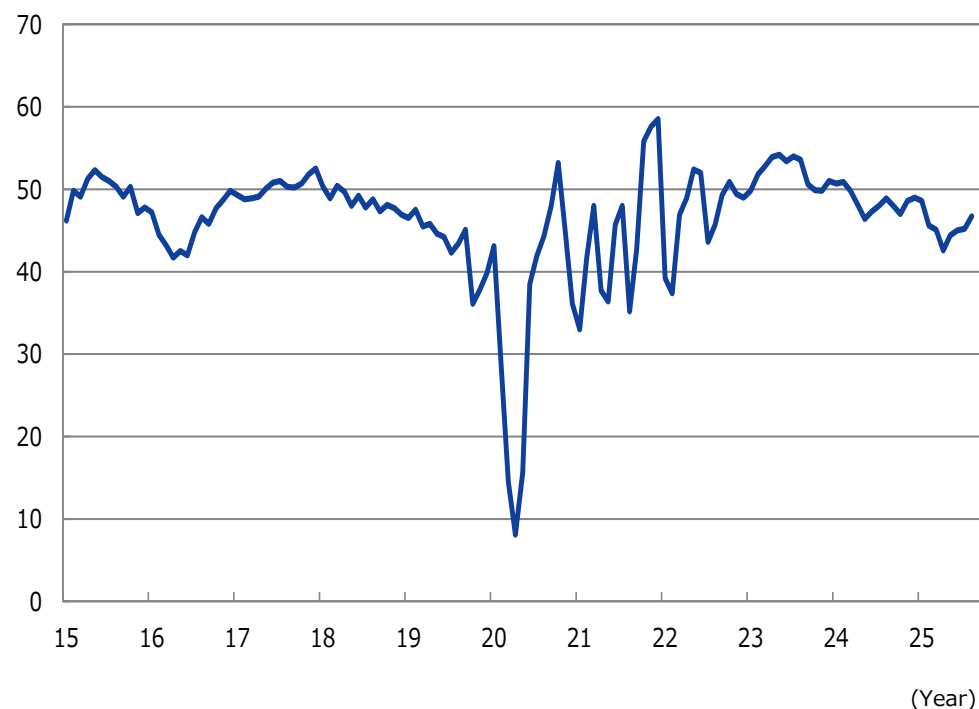
Divergence of Rising CPI and Falling Import Prices



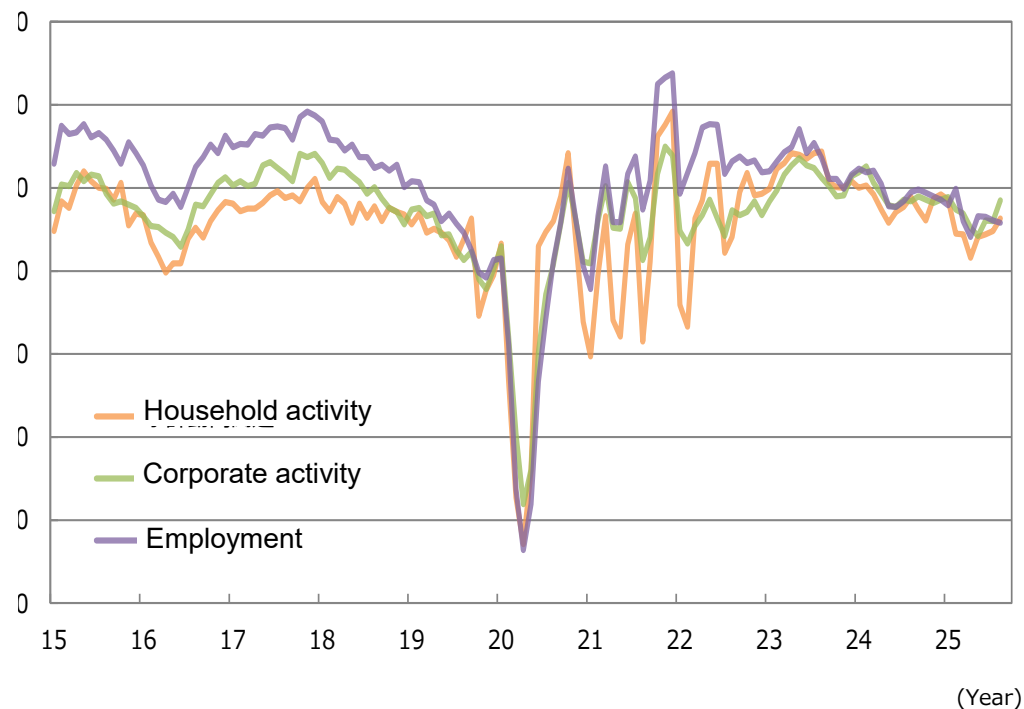
Note: Data is from January 2012 to August 2025.
Source: MIAC, Bloomberg, SMDAM

Growing Unease with Slowing Economy and Higher Inflation

DI for Current Economic Conditions

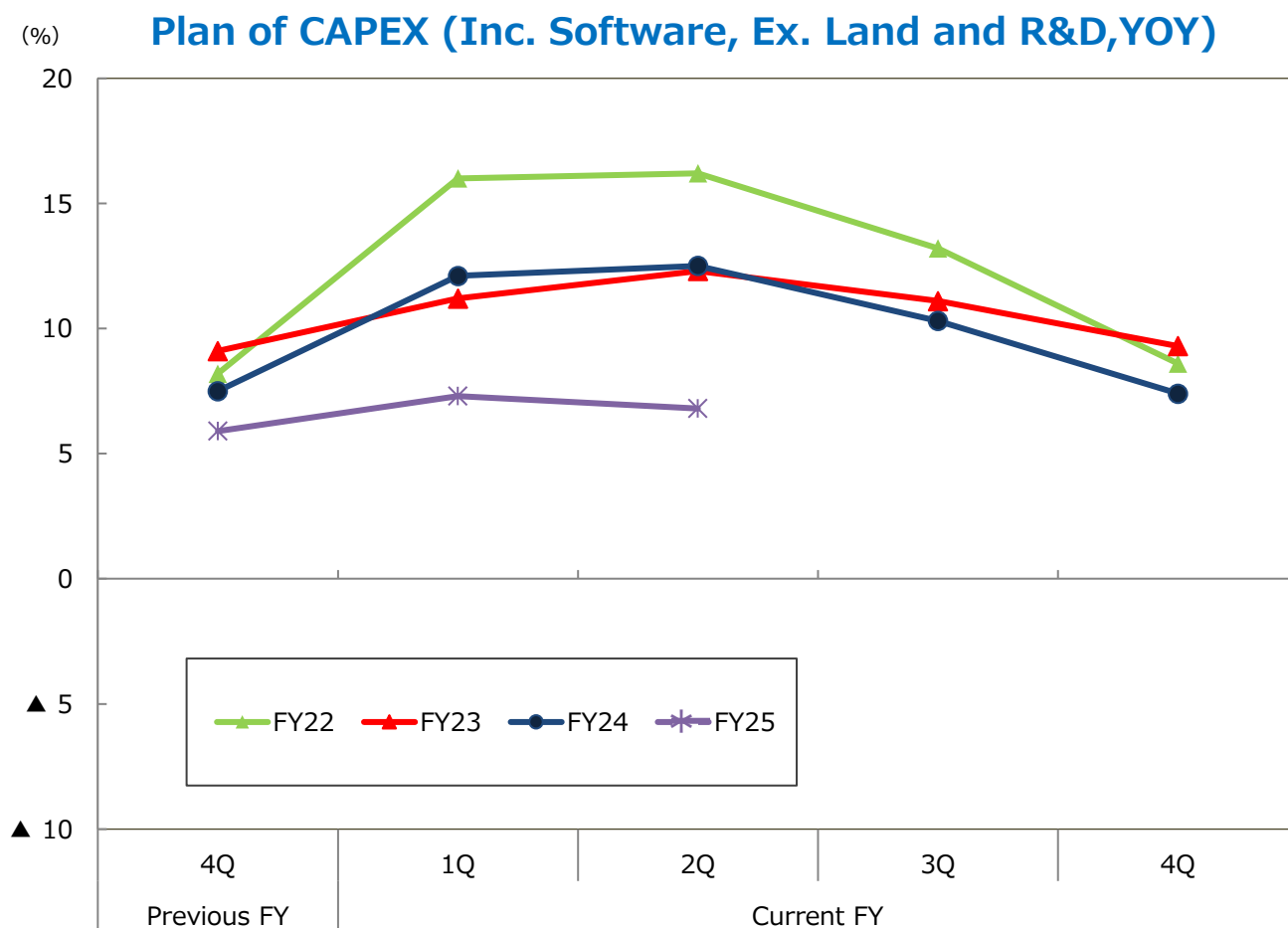


Breakdown of DI for Current Economic Conditions



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

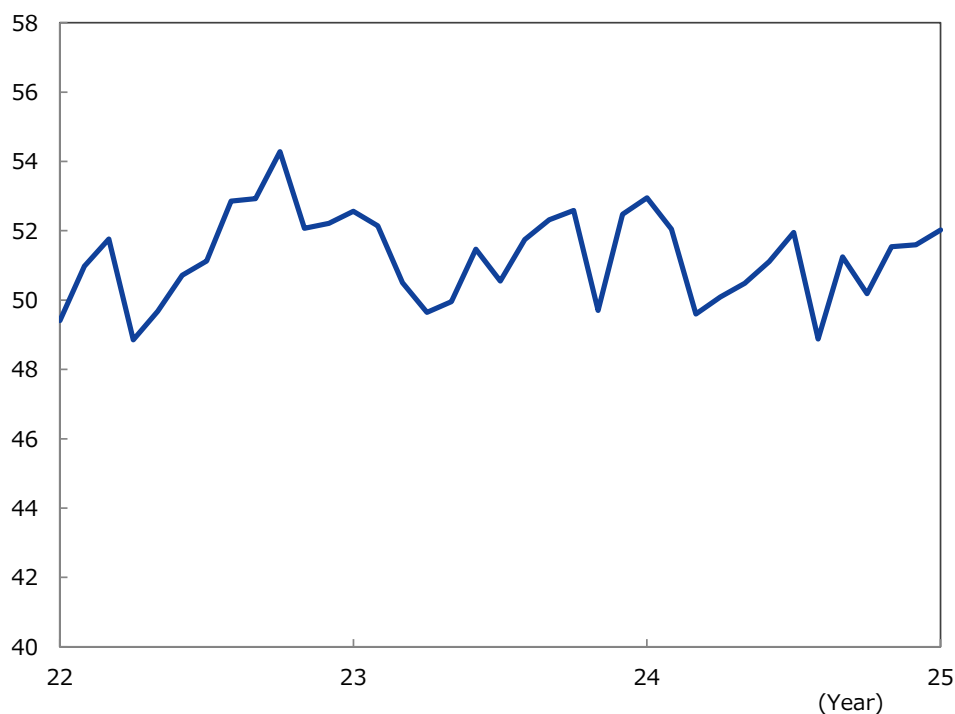
Receding Uncertainty Over the Economy Lifts CAPEX Appetite



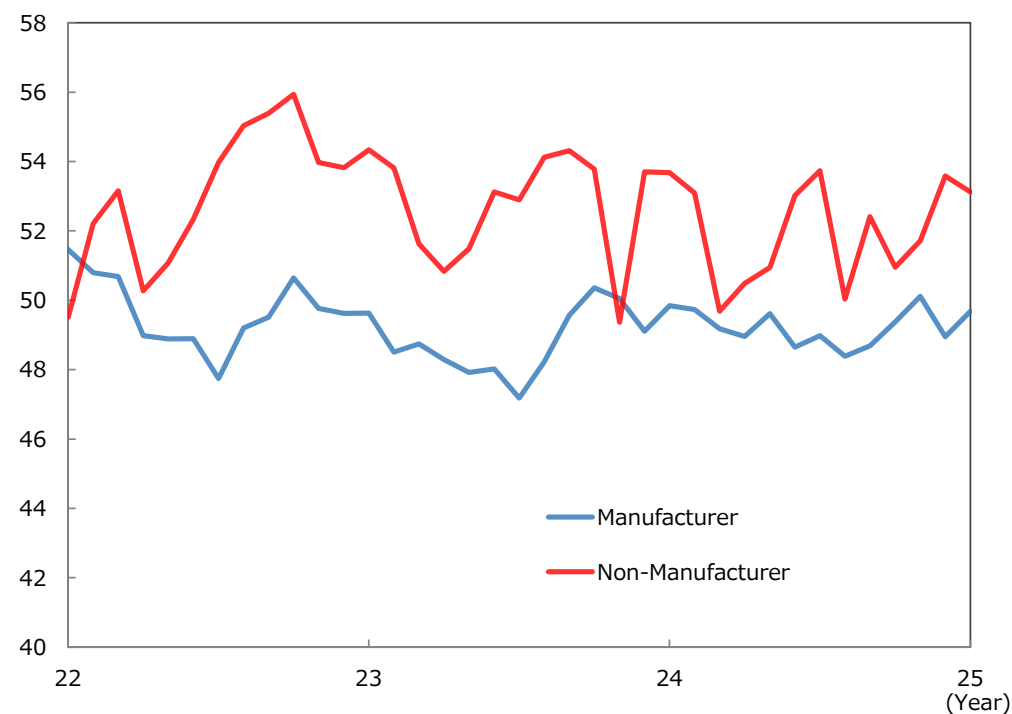
Note: Data is from Q4 FY2021 to Q2 FY2025.
Source: The Bank of Japan, SMDAM

Business Sentiment of Non-manufacturers Bottoming

Composite PMI(%pt)

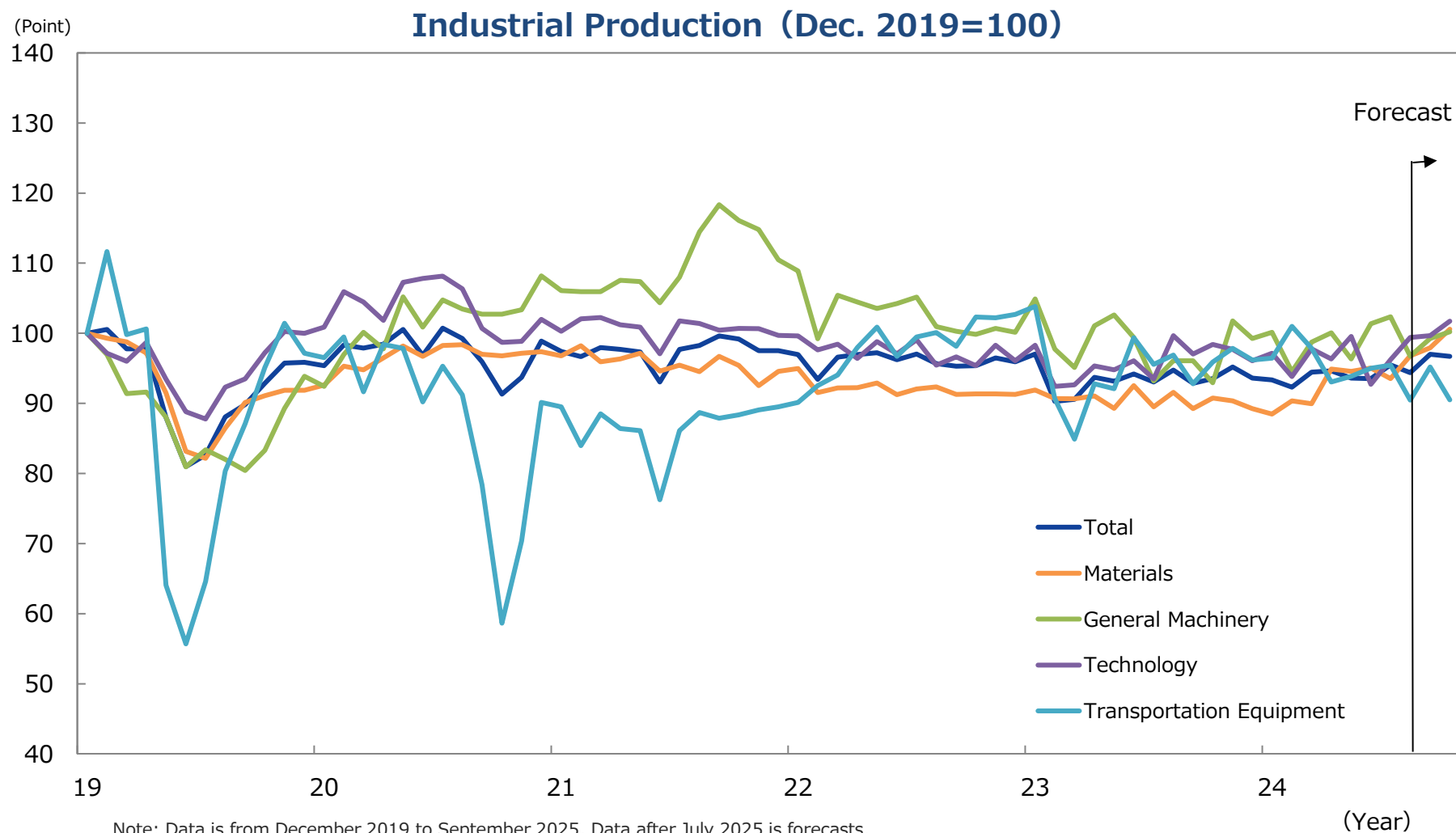


PMI, Manufacturer & Non-Manufacturer(%pt)



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

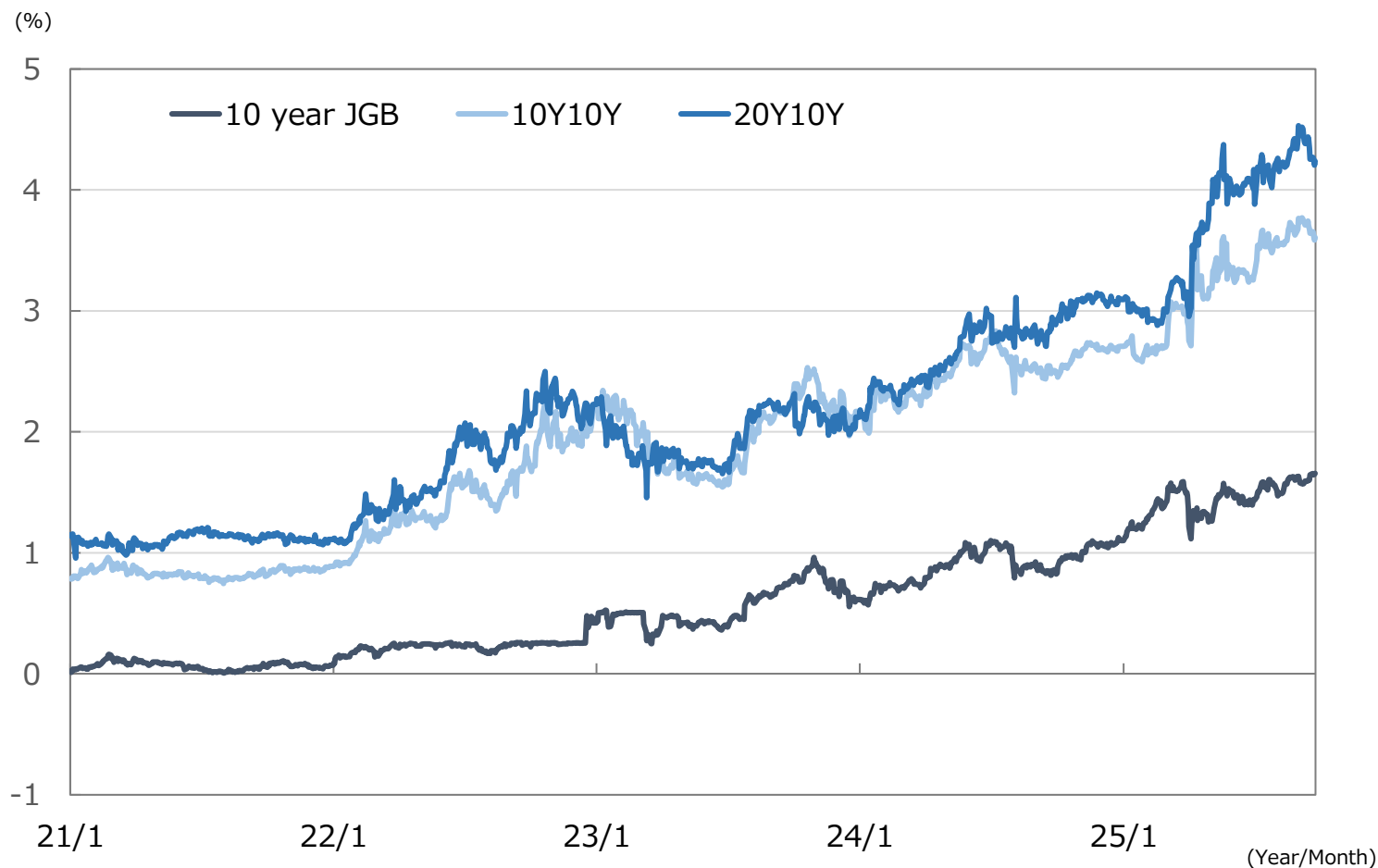
Sluggish Autos Weigh on Industrial Production



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

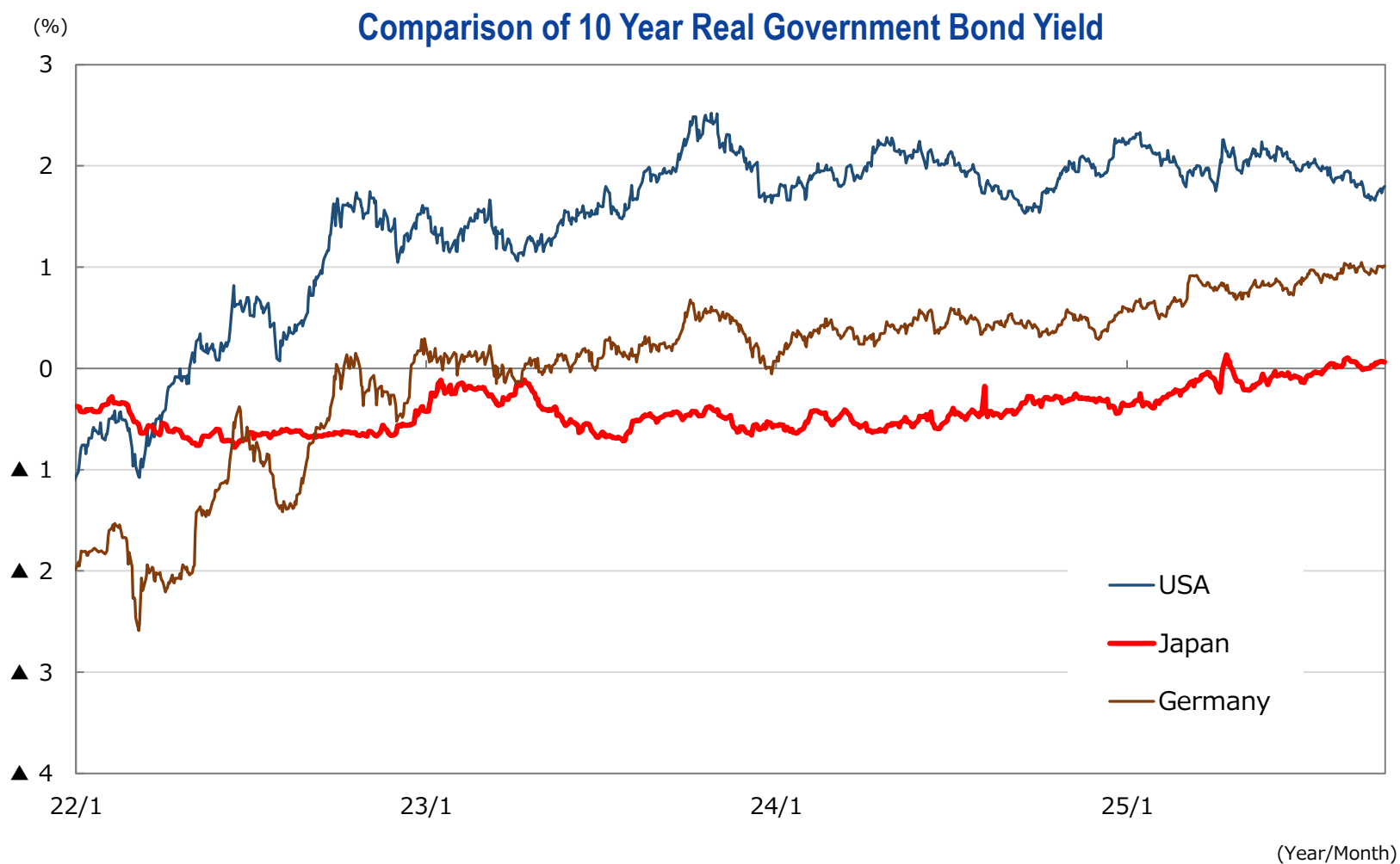
Yield Curve of Ultra-Long End Start Flattening

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



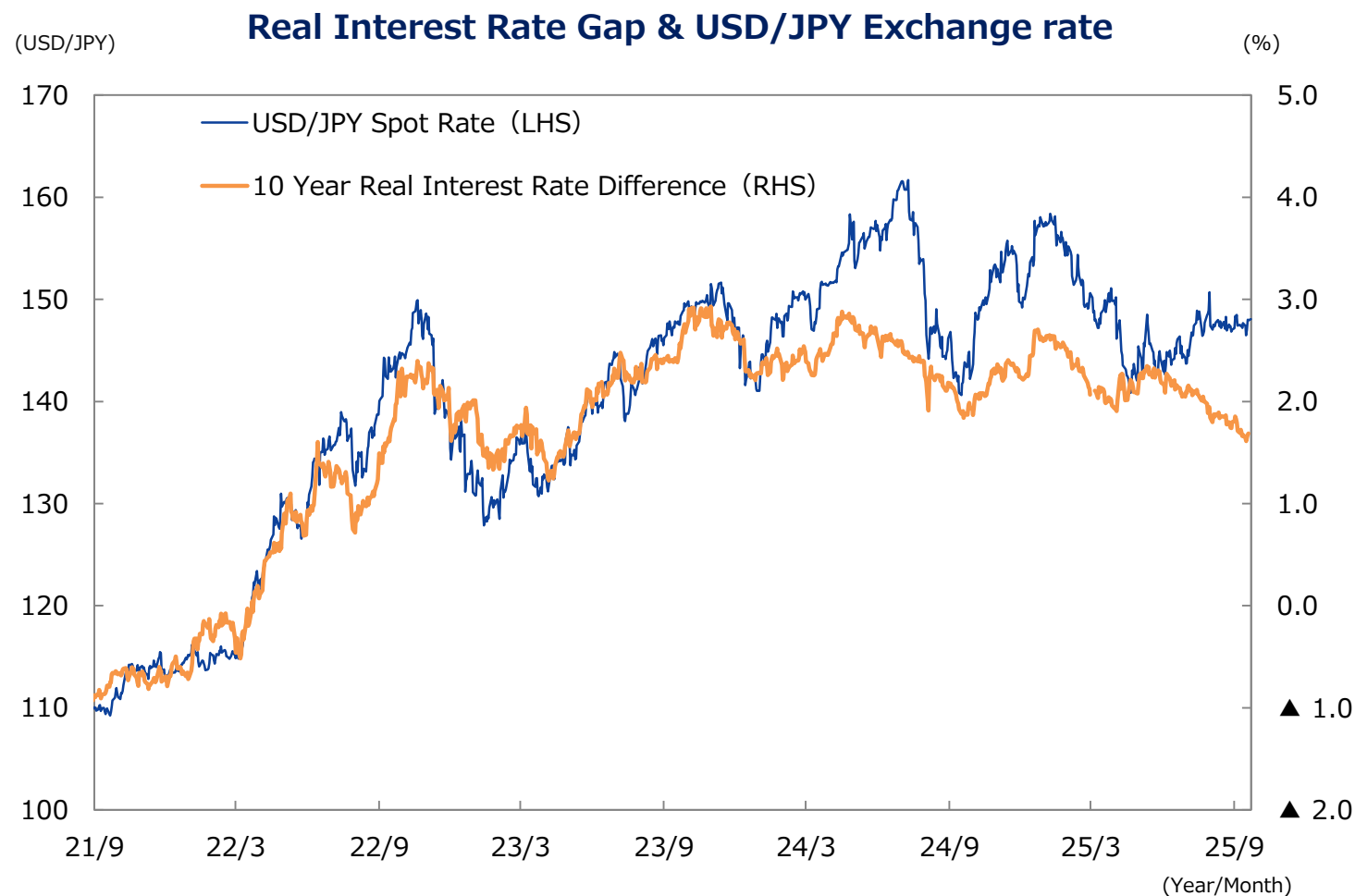
Note: Data is from 4th January 2021 to 26th September 2025.
Source: Bloomberg

10-Year Real JGB Yield Becomes Slightly Positive



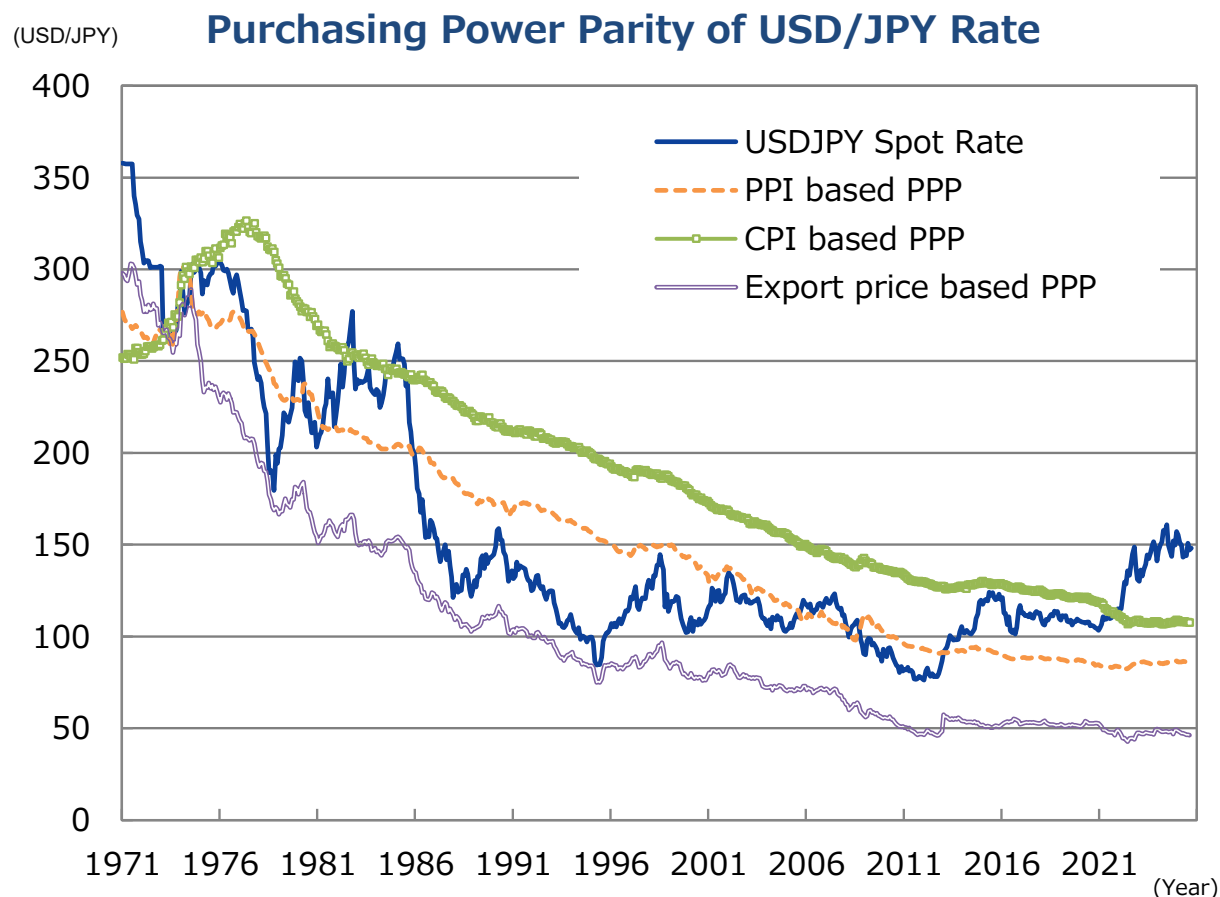
Note: Data is from 1st January 2022 to 26th September 2025.
Source: Bloomberg

Dollar/Yen Remains Steady Despite Narrowing Interest Rate Gap



Note: Data is from 1st September 2021 to 22nd September 2025.
Source: Bloomberg

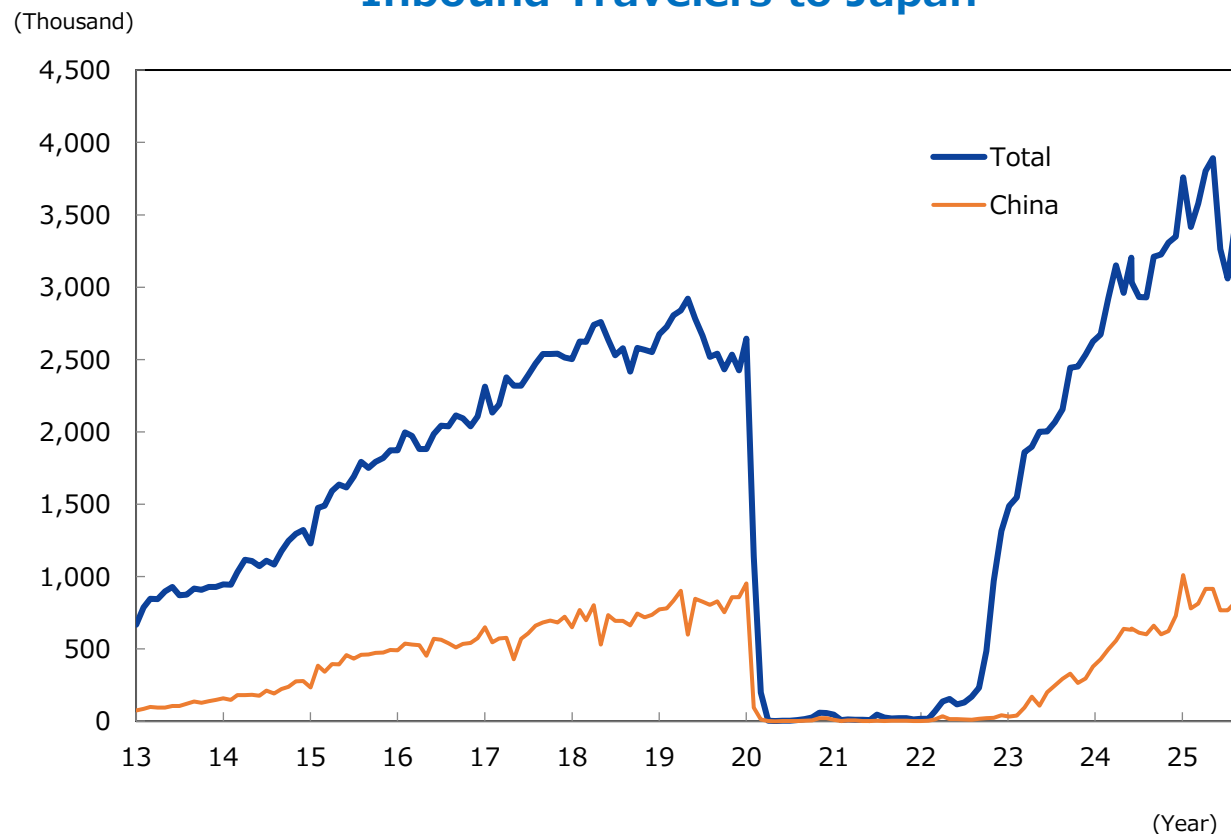
Purchasing Power Parity Indicates Overvaluation of US Dollar



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

Inbound Travel resumed its upward trend in August

Inbound Travelers to Japan

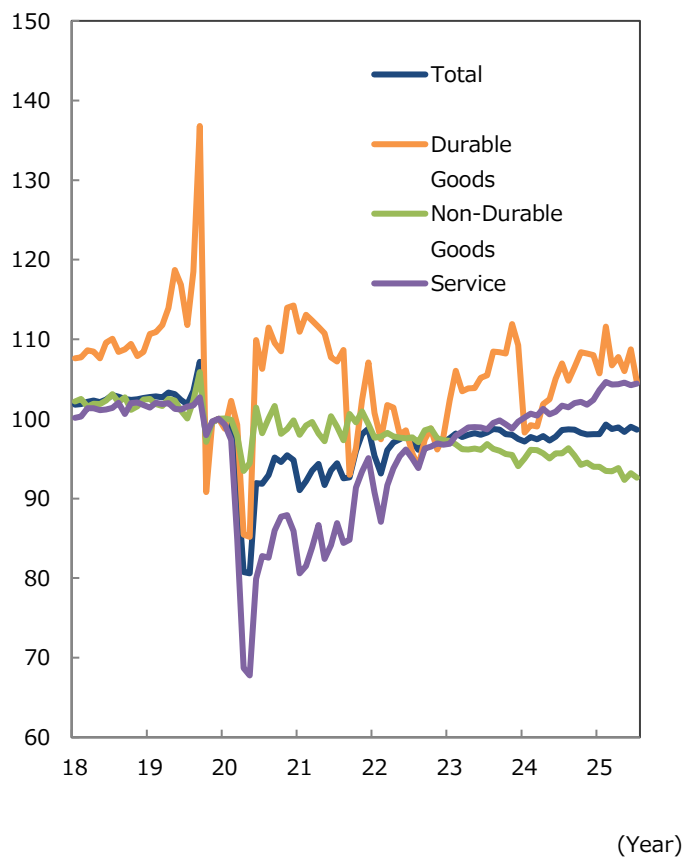


Note: Data is from January 2013 to August 2025. Data is non-seasonally adjusted.

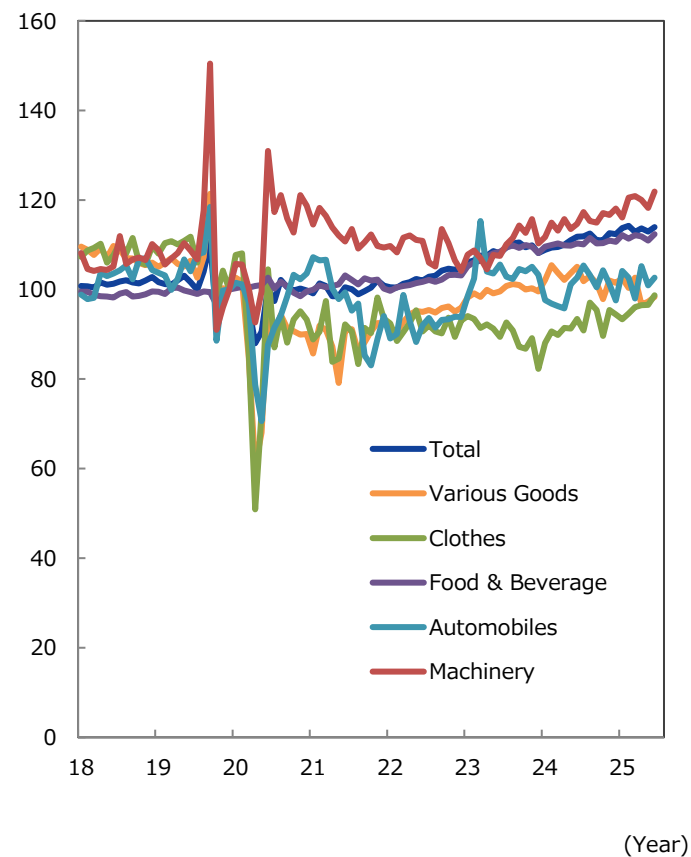
Source: Japan National Tourism Organization, SMDAM

Consumer Activities are Mixed due to Weak Real Income

Consumer Activity Index (Dec. 2019 = 100)



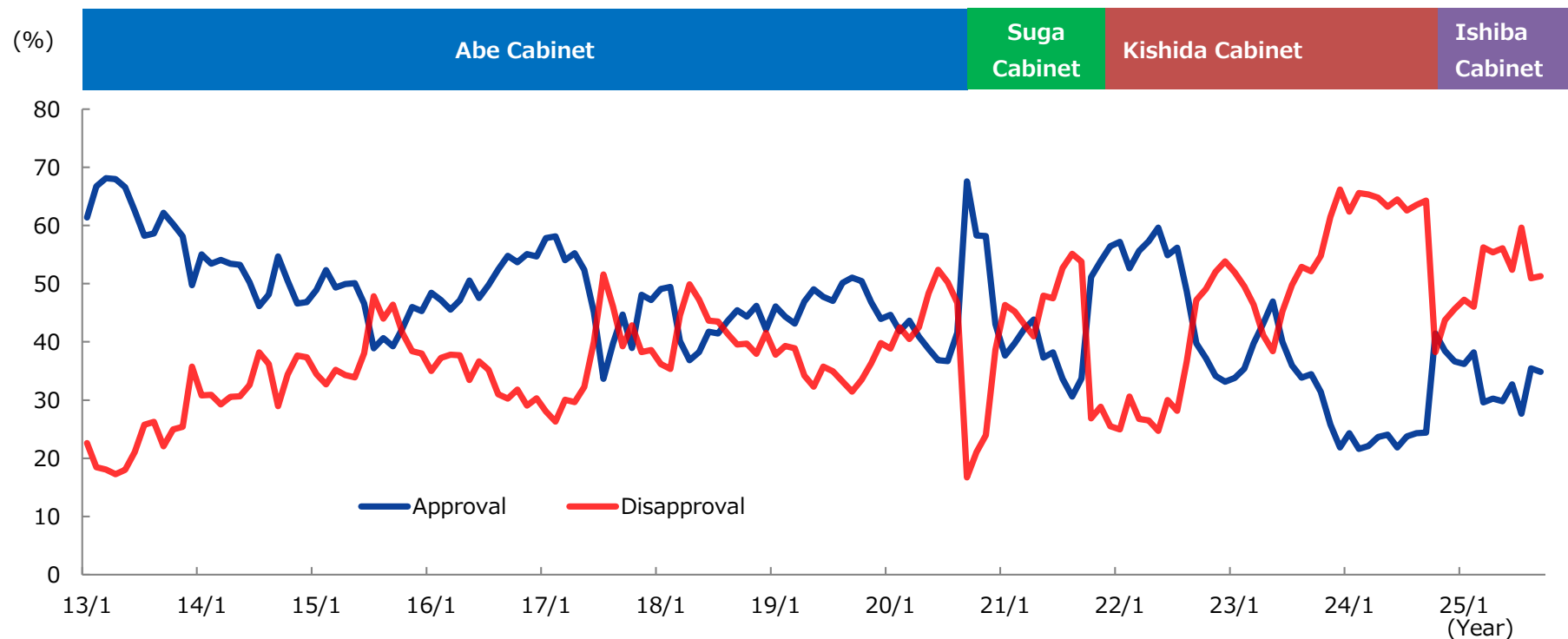
Retail Sales (Dec. 2019 = 100)



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

Ruling LDP struggling Even After the Step Down of PM Ishiba

Cabinet approval rate



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

Schedule of Major Events

Year	Month	Date	Event
2025	Septemebr	8	Revision of 2025 Q2 GDP
		18-19	Monetary Policy Meeting
		22	Official announcement of the LDP presidential election
	October	4	Voting and ballot counting for the LDP leadership election
		29-30	Extraordinary Diet session (FY2025 supplementary budget) Monetary Policy Meeting
	November	17	Release of 2025 Q3 GDP
	December	8	Revision of 2025 Q3 GDP
		18-19	Monetary Policy Meeting Cabinet approval of the initial budget for FY 2026 and the outline for tax reform
2026	January	22-23	Ordinary Diet Session Monetary Policy Meeting
			Release of 2025 Q4 GDP
	March	18-19	Revision of 2025 Q4 GDP Release of the results of spring negotiations of Trade Union Confederation Monetary Policy Meeting
		31	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	27-28	Monetary Policy Meeting
	May		Release of 2026 Q1 GDP
	June	15-16	Revision of 2026 Q1 GDP Cabinet's decisions on "Big-boned policy" Monetary Policy Meeting(Interim Assessment of the Government Bond Purchase Reduction Plan) End of the ordinary Diet session
		29	G7 Summit 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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