



Outlook for Japanese Stock Market & Economy

Hisashi Shiraki, CMA
Chief Global Strategist

Xinyan Zhao
Associate

Miwa Asahi
Manager

Kenji Maehara
Associate

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Sumitomo Mitsui DS Asset Management



Outlook for Japanese Stock Market

Market Outlook

- **Japanese Stock Market Hits Record High**

Growing optimism about the economic policy of new Prime Minister Takaichi has continuously driven the Japanese stock market to record highs. Subsequently, fiscal stimulus 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 45,000 to 50,300 for December 2025 and from 45,200 to 50,400 for March 2026 respectively, reflecting our renewed earnings estimates and valuations based on the strong nominal GDP growth, mild inflation, and the economic measures implemented by the new PM Takaichi and her administration.

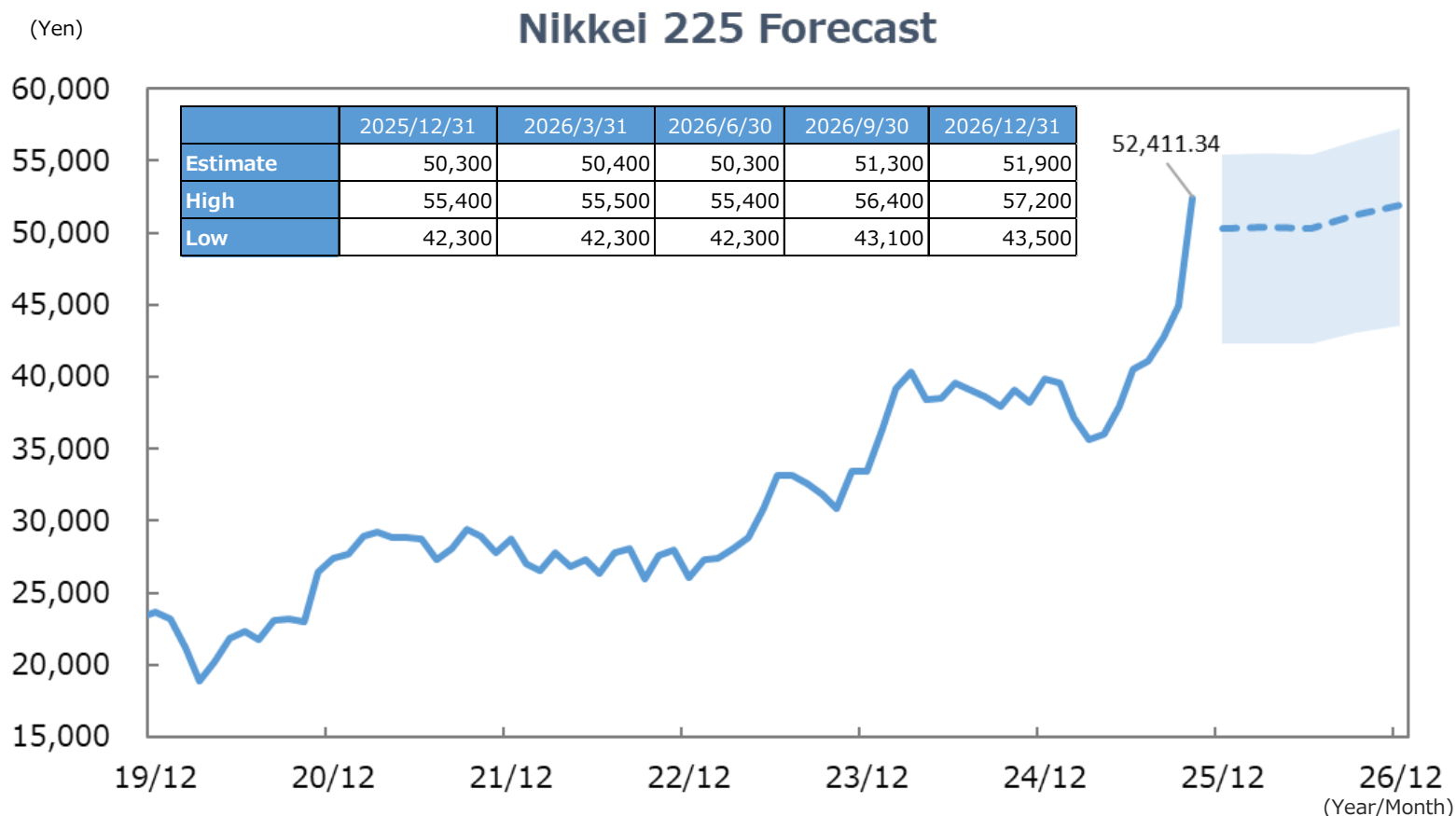
- **Rising Interest Rates May Weigh on Share Price Valuations**

The Bank of Japan's (BOJ) 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 as they have raised the volume of share buybacks due to improving corporate governance.

We Expect a Bullish Market Perspective Going Forward

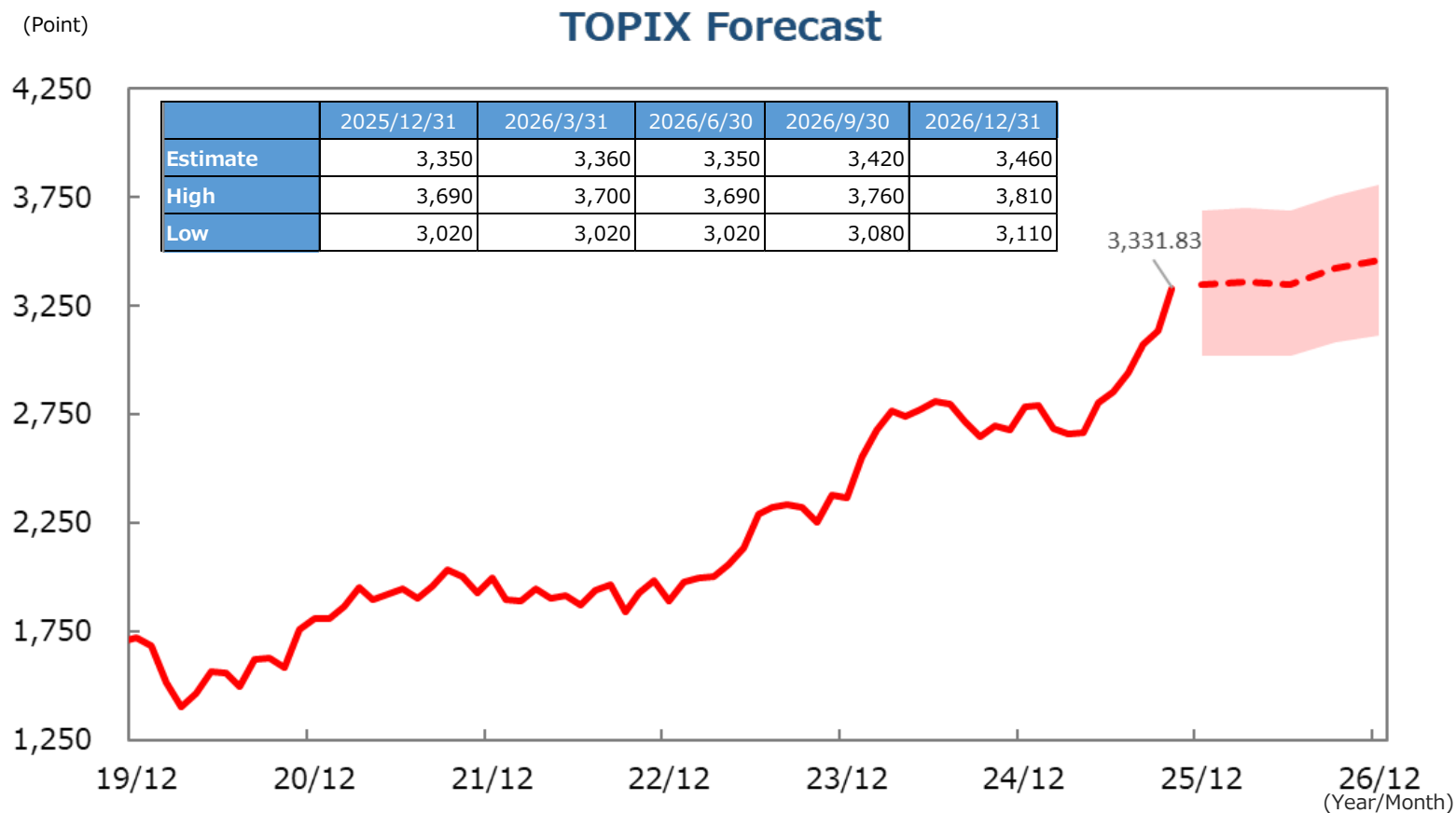


Data is from December 2019 to December 2026. Data after October 2025 is our forecast.

Note: The forecasts are as of October 31st 2025.

(Source) Bloomberg, SMDAM

We Expect a Bullish Market Perspective Going Forward

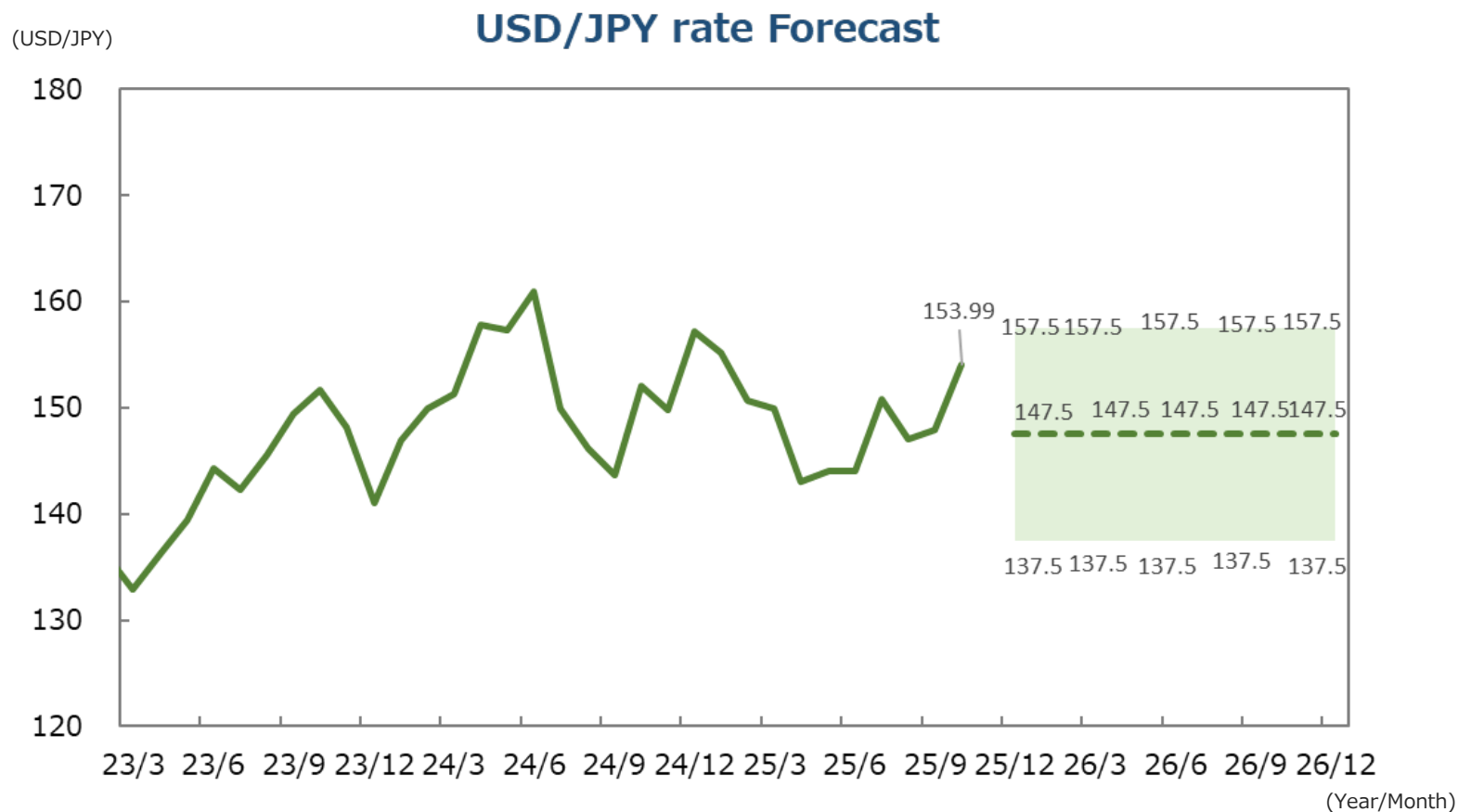


Data is from December 2019 to December 2026. Data after October 2025 is our forecast.

Note: The forecasts are as of October 31st 2025.

(Source) Bloomberg, SMDAM

Divergence of Monetary Policy Expected to Weigh on the US Dollar



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

Note: The forecasts are as of October 31st 2025.

(Source) Bloomberg, SMDAM

Upside / Downside Risk Scenarios

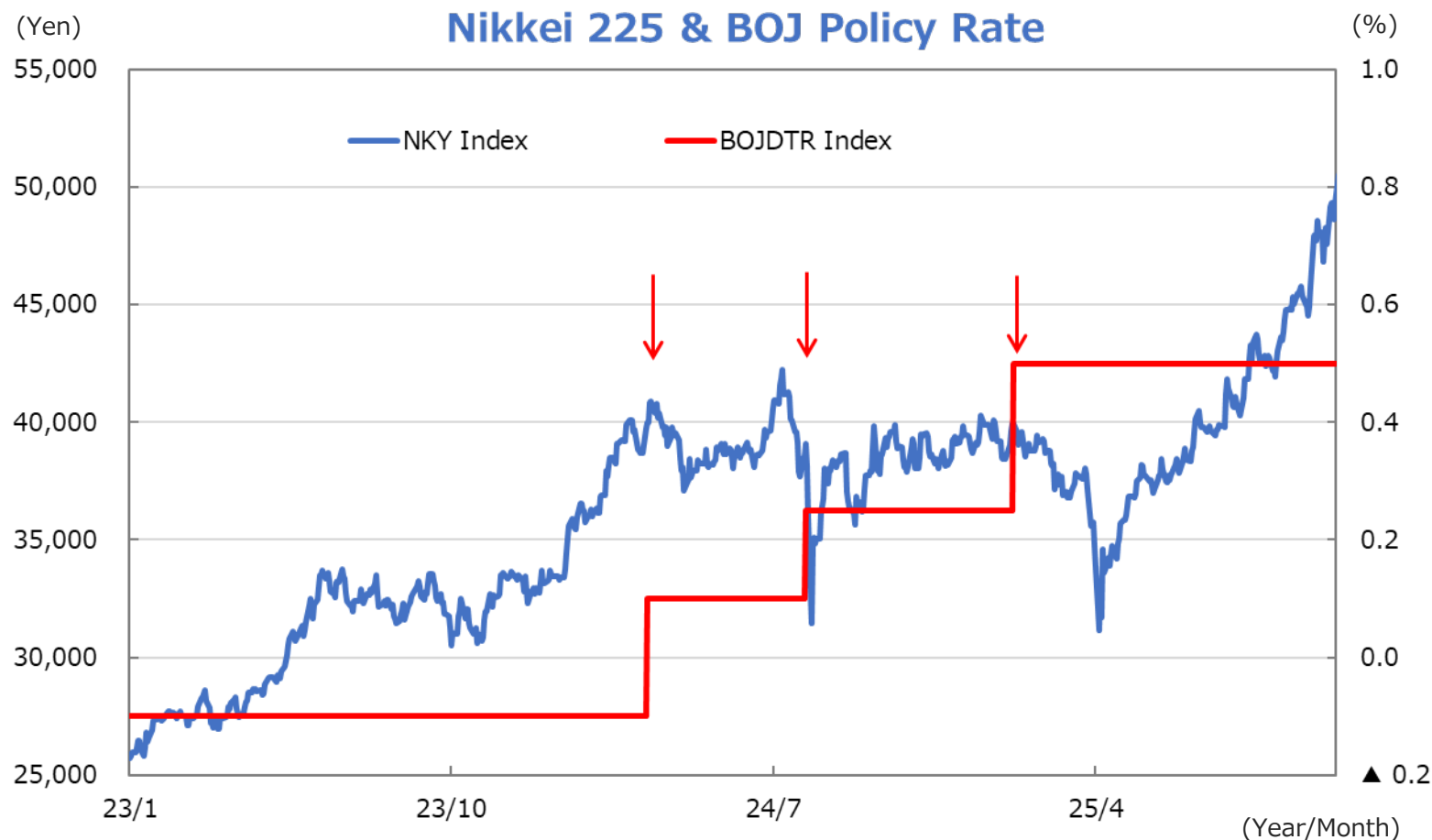
■ Upside Risks

- **Robust foreign inflows** into the Japanese stock market due to further improvements in corporate governance
- **Acceleration of the rally in Big Tech stocks** boosted by the social implementation and monetization of artificial intelligence (AI)
- **Growing optimism** about the new Prime Minister and her economic policy

■ Downside Risks

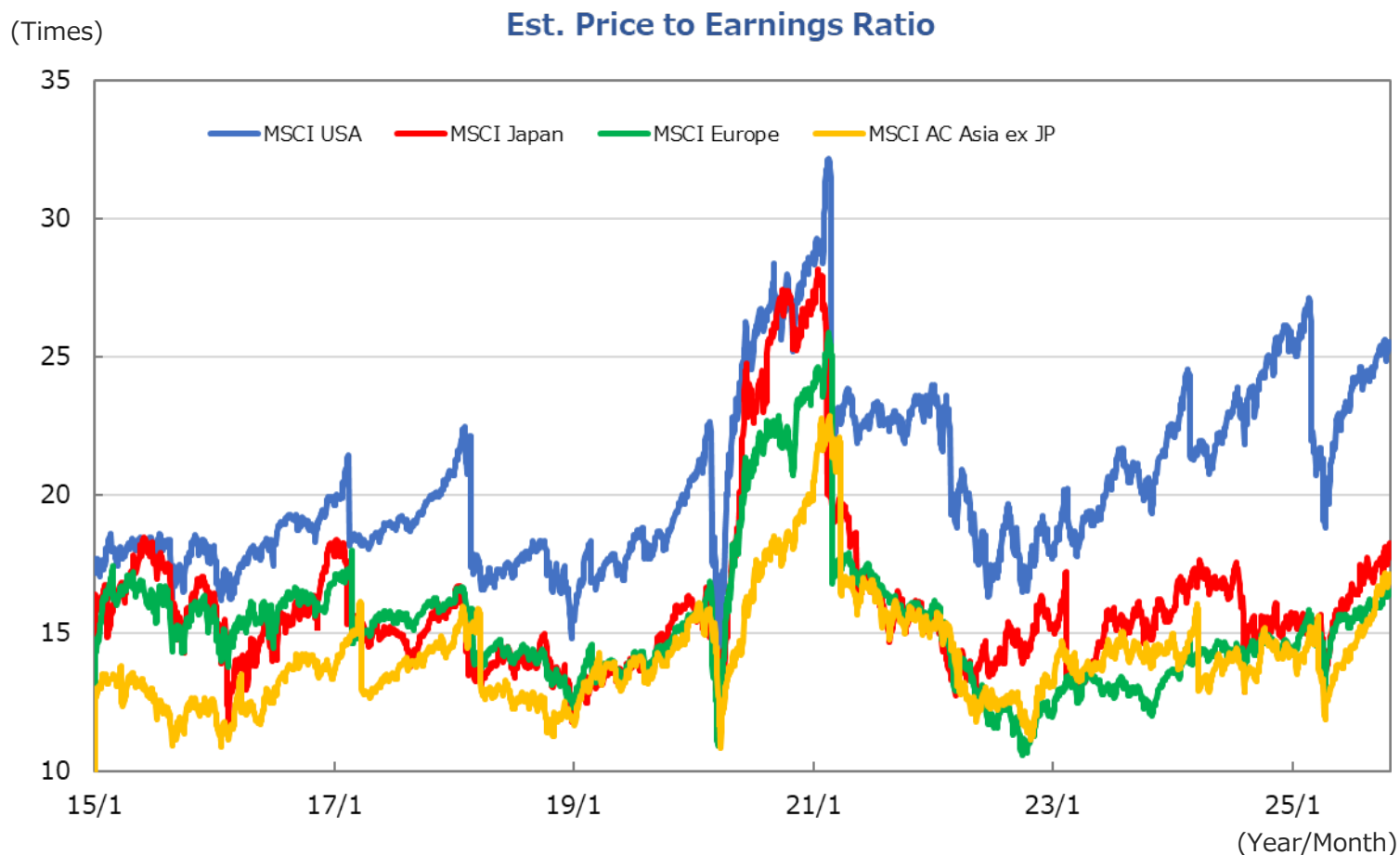
- **Renewed deterioration** in US-China trade relations
- **Excessive monetary easing** by the US Federal Reserve and Yen's appreciation
- Rising fears about the **US private credit market** triggering turmoil in financial markets
- **Spike in Japanese Government Bond (JGB) yields** due to the concerns over the expansion of defense spending and a widening fiscal deficit
- **Negative impact** of excessive inventory accumulation due to Trump tariffs

Recent Three Rate Hikes Drag Down Share Price Valuation



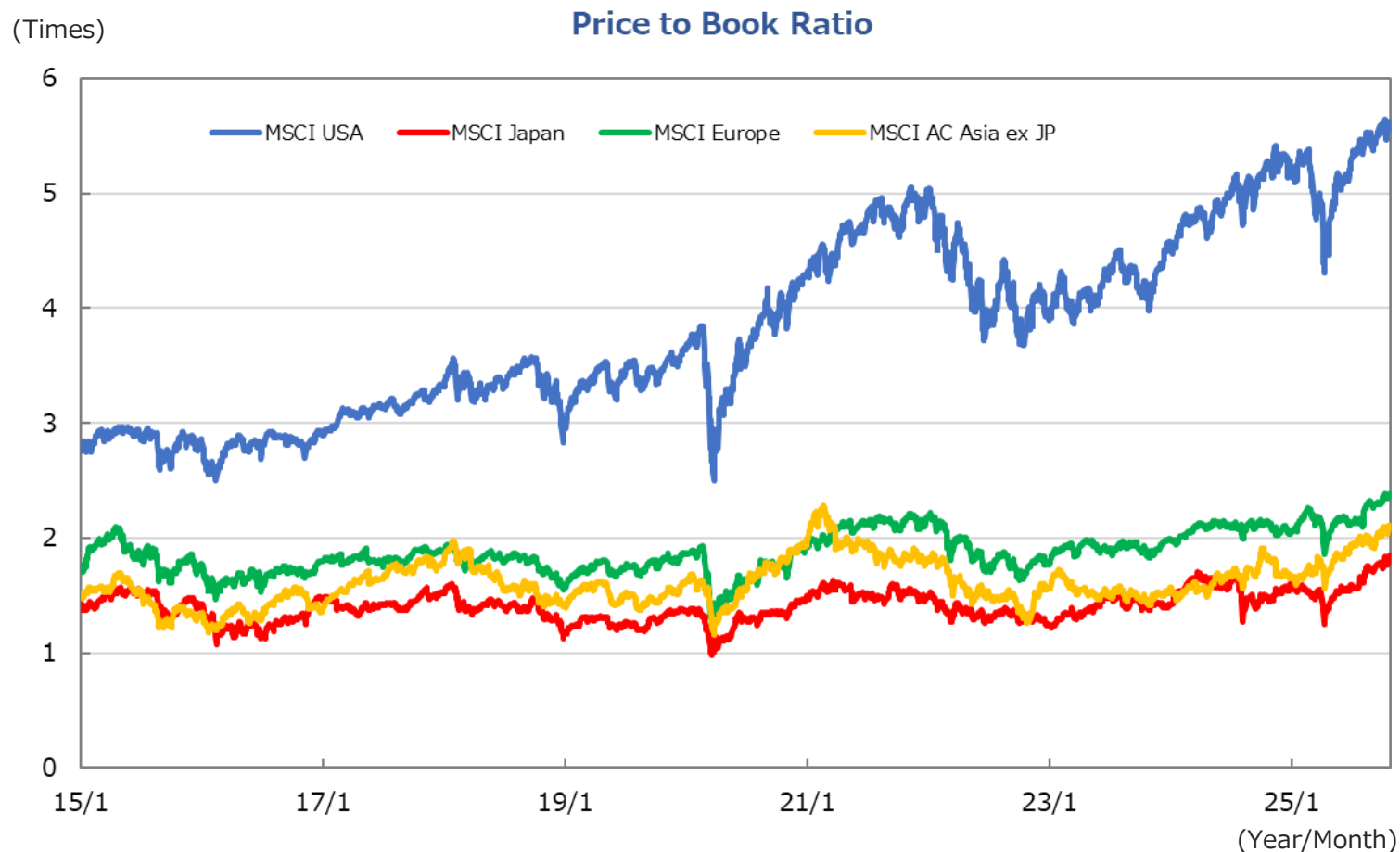
Data is from 4th January 2023 to 31st October 2025.
(Source) SMDAM, Bloomberg

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



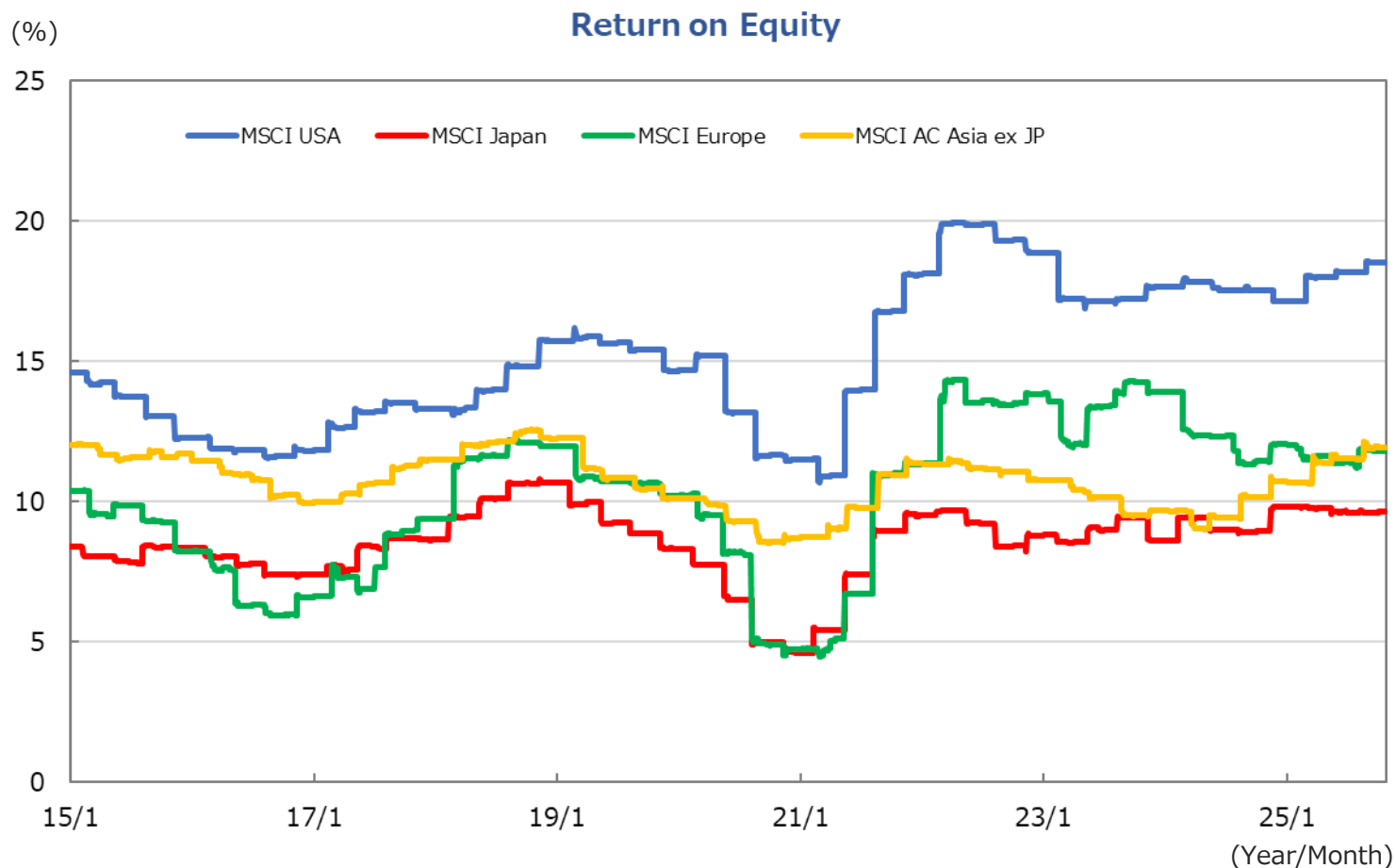
Data is from January 2015 to October 2025.
(Source) SMDAM, Bloomberg

Japan's P/B Ratio Reached its Highest Level Since 2007



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

ROE Remains Unchanged due to Excess Capital Build-Up

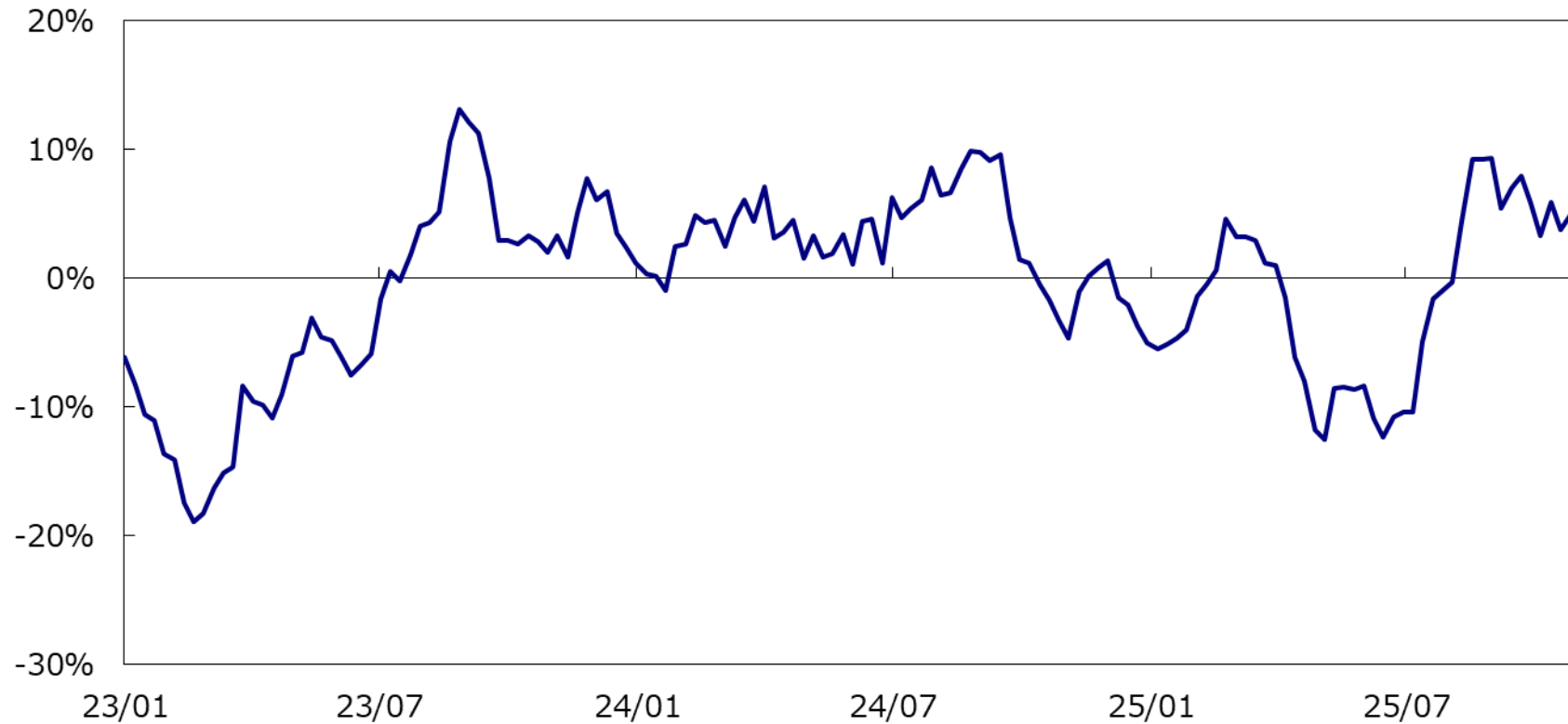


Data is from January 2015 to October 2025.
(Source) SMDAM, Bloomberg



Analysts' Revision Keeps Positive Momentum

TOPIX EPS Revision Index

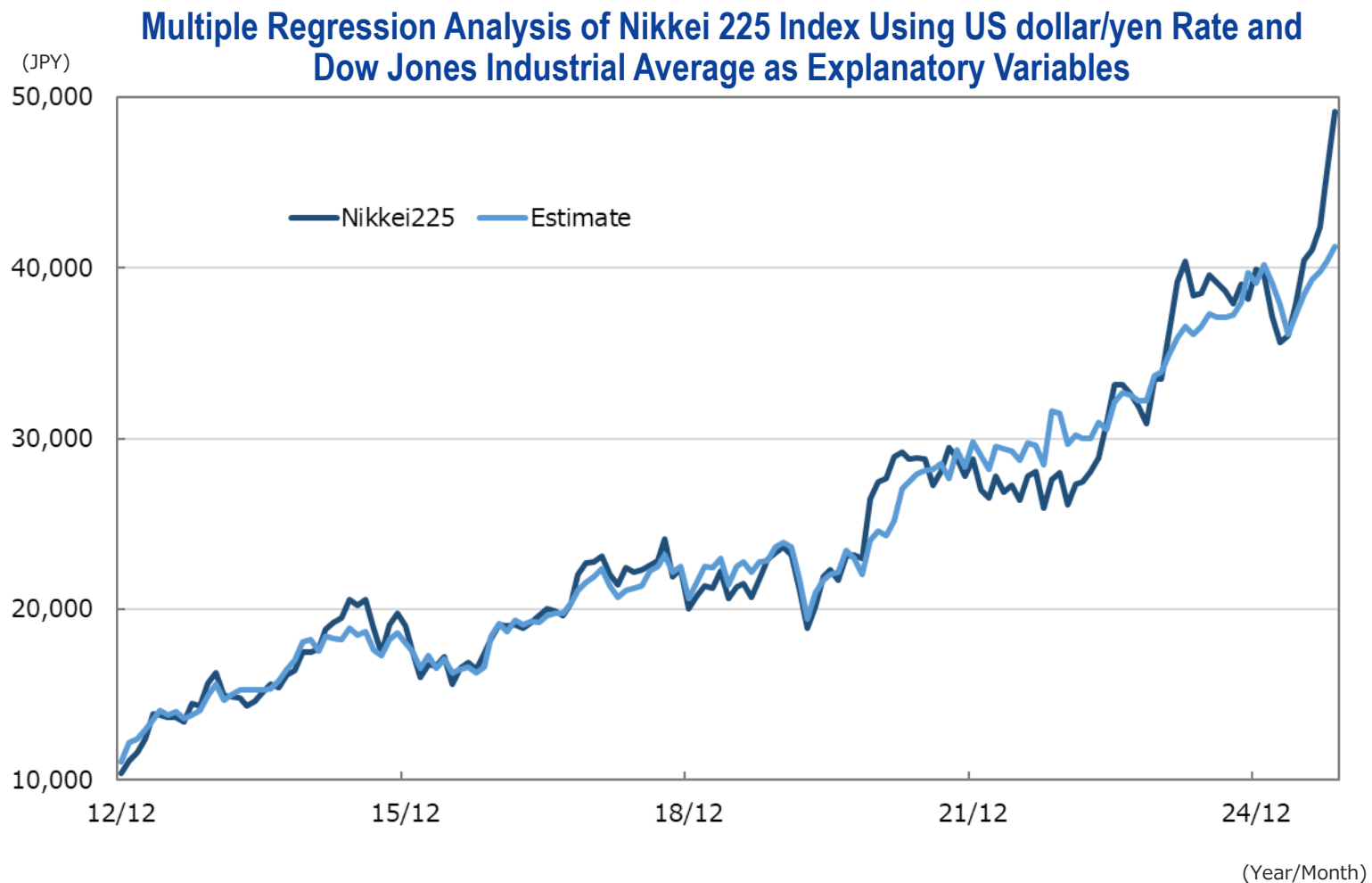


Data is from January 5th 2023 to 30th October 2025
(Source) Datastream, IBES

(YY/MM)



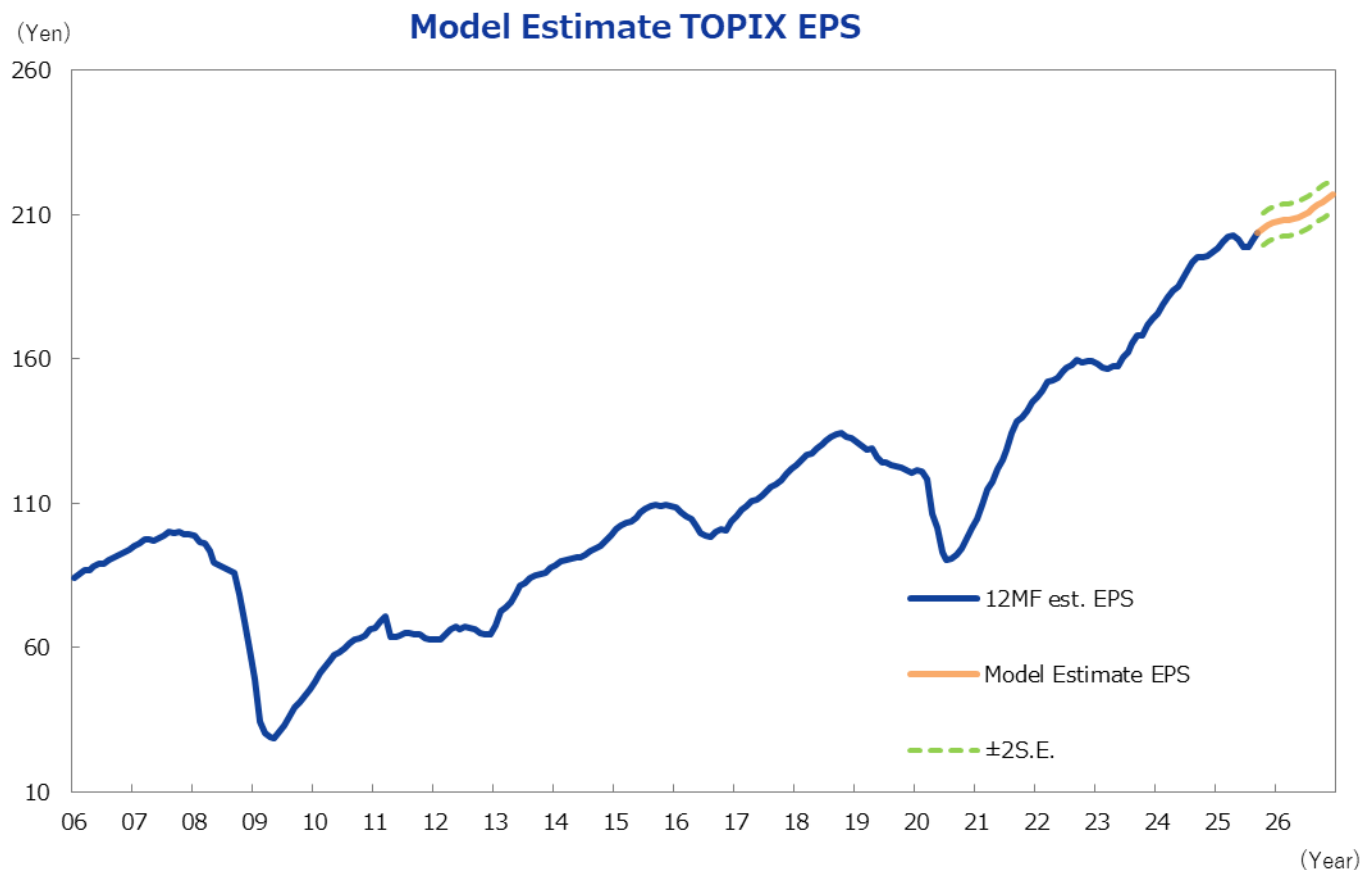
Regression Analysis Indicates Overdone in Recent Rally



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

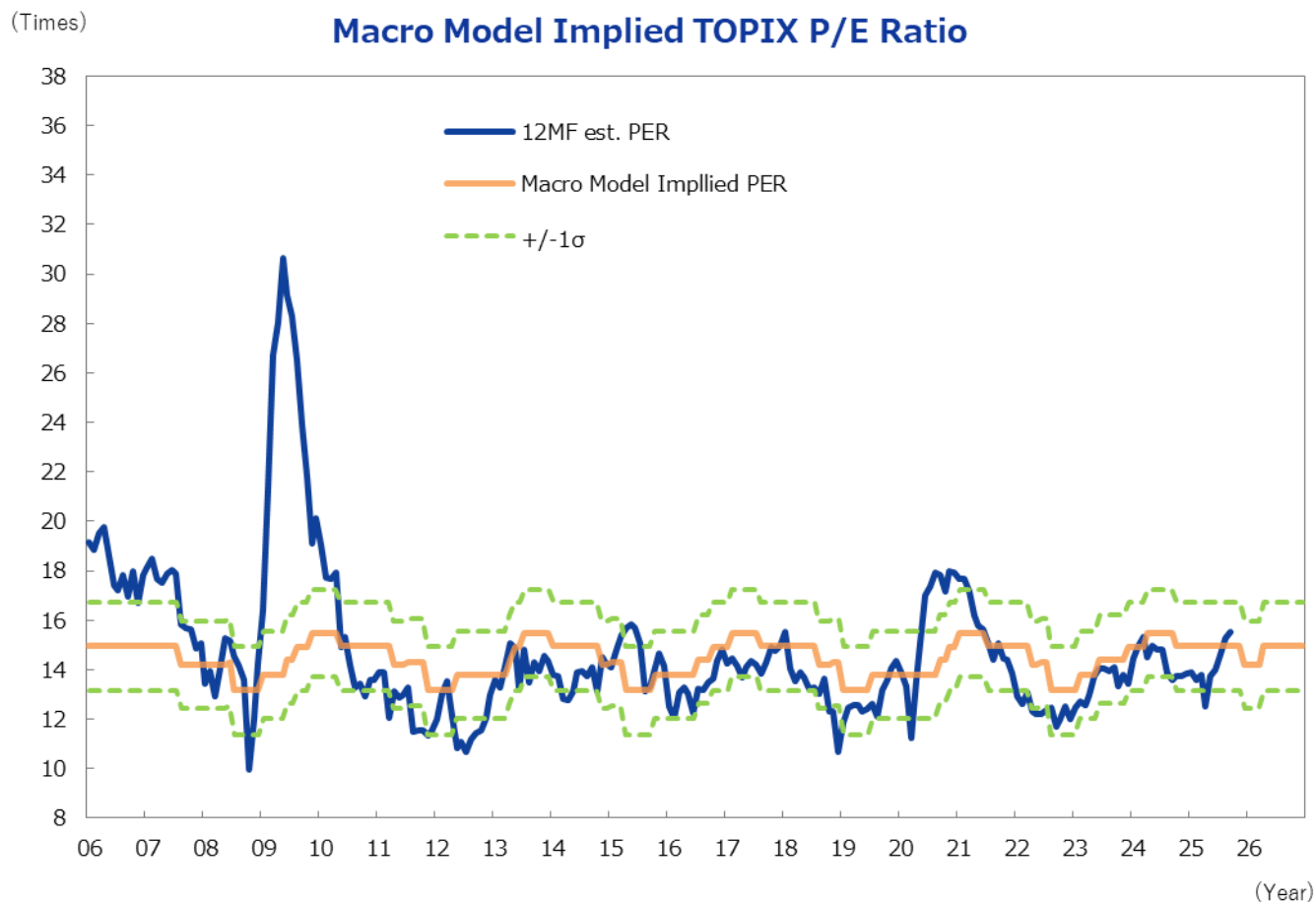


Quant Model Suggests EPS to Accelerate Going Forward



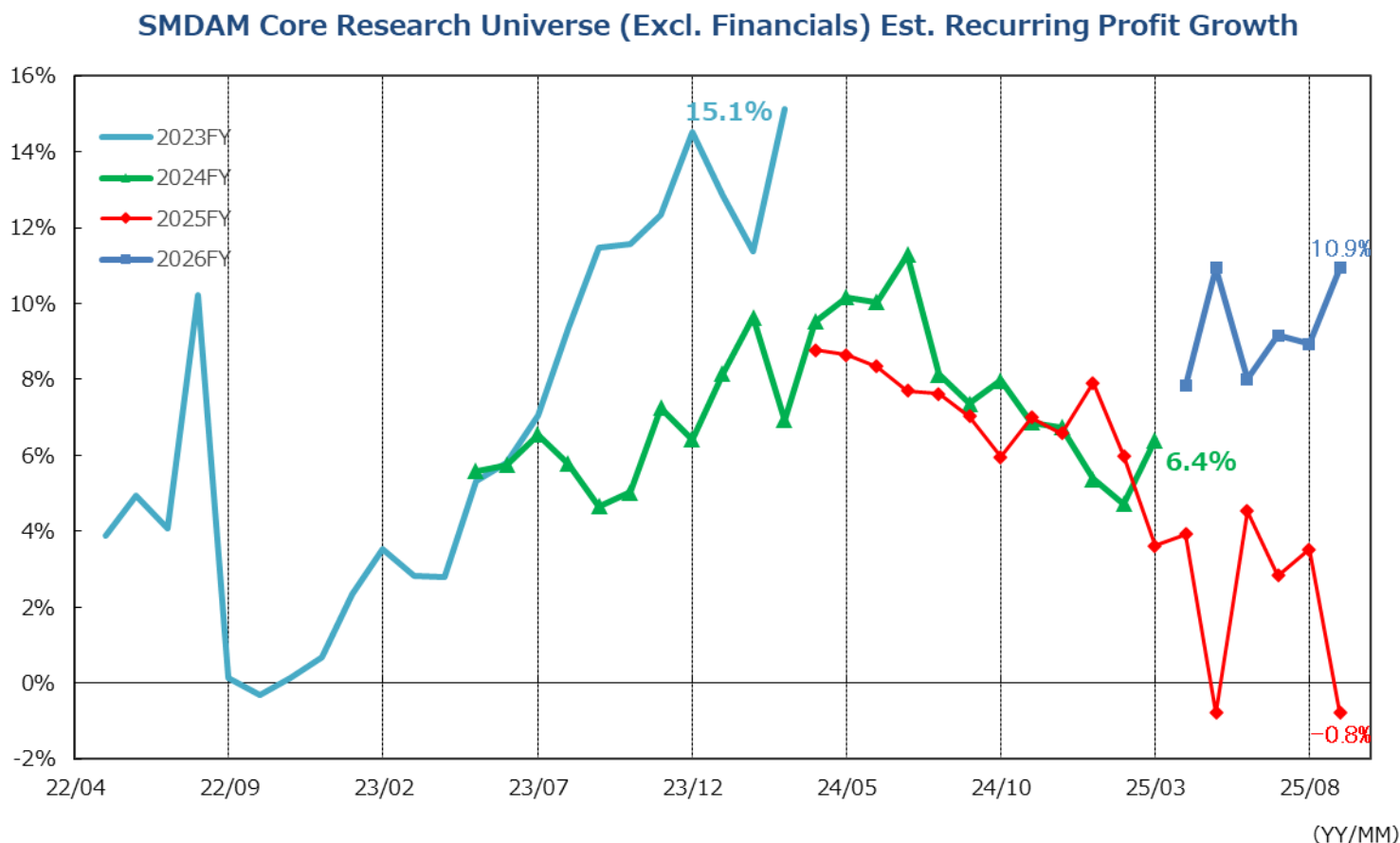
Note: Consensus data is from January 2006 to September 2025. Model estimate Data is from October 2025 to December 2026.
Source: SMDAM

Recent Rally Brought P/E Ratio to Slightly Over-Valued Level



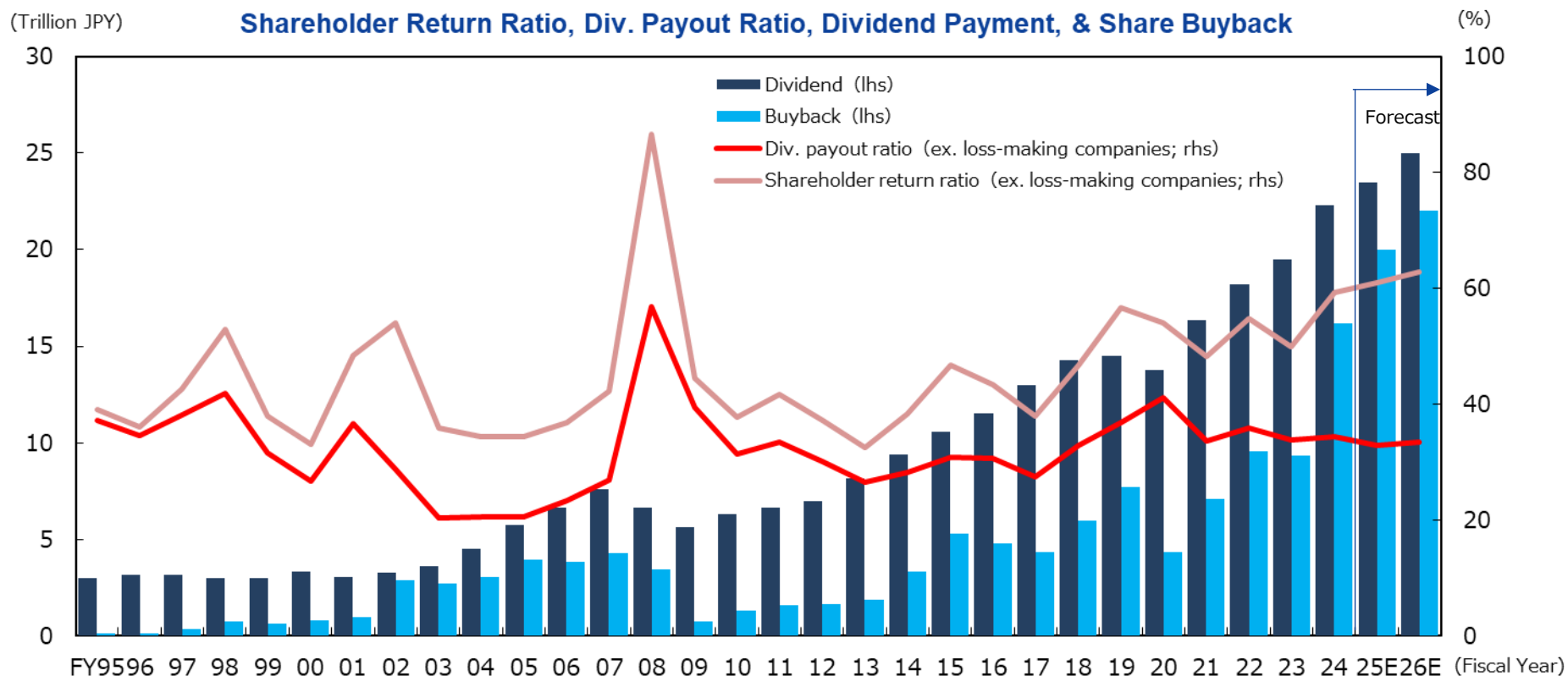
Note: Consensus data is from January 2006 to September 2025. Model estimate Data is from October 2025 to December 2026.
Source: SMDAM

Our Analysts See Bright Prospects After a Tough Year



Note: Data is as of 14th October 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



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

Large Cap Value Dominate the Tokyo Stock 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	9.48	26.35	17.36	23.94	46.55	73.84	101.76
Total Value	11.61	28.37	19.98	28.82	52.00	95.98	153.46
Top Cap Value	13.45	35.22	21.88	34.07	61.66	116.20	199.04
Large Cap Value	11.80	29.22	19.59	28.40	52.20	98.09	162.48
Mid Cap Value	9.86	22.64	16.95	22.43	42.61	78.94	124.44
Small Cap Value	10.83	25.01	21.55	30.35	50.59	86.18	115.74
Micro Cap Value	10.54	25.86	23.42	32.41	51.97	85.00	110.36
Total Growth	7.22	24.18	14.60	19.18	41.54	54.65	60.48
Top Cap Growth	7.56	25.82	12.98	18.65	45.44	61.56	73.70
Large Cap Growth	7.75	25.15	15.06	19.60	43.12	58.26	65.29
Mid Cap Growth	8.15	23.65	19.94	22.14	39.80	53.35	53.18
Small Cap Growth	2.86	16.36	10.71	15.61	28.42	27.45	24.48
Micro Cap Growth	4.45	14.71	9.64	11.89	20.31	18.21	13.53
Top Cap Total	10.07	29.78	16.72	24.84	51.63	83.02	120.30
Large Cap Total	9.73	27.15	17.27	23.73	47.23	75.94	106.11
Mid Cap Total	9.15	23.06	18.16	22.18	41.17	66.11	87.22
Small Cap Total	8.11	22.07	17.79	25.09	42.23	61.68	76.34
Micro Cap Total	8.69	22.39	19.07	25.72	41.11	60.22	72.91

Note : As of 31st October 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**, but sentiment among businesses and households remains intact, and CAPEX remains robust. While the impact of U.S. tariffs has been limited so far, exports – particularly to the US – are declining, and companies appear somewhat cautious about increasing production.
- **Nationwide core CPI continues to exceed the BOJ's "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 current inflation, with food prices showing notable increases. However, core CPI slowed to +2.7% YOY in August from +3.1% in July, marking the third consecutive month of deceleration and indicating signs of peaking.

■ Outlook

- ① **We have raised our real GDP growth estimate from +0.8% to +0.9% for FY 2025, and from +0.7% to +0.9% for FY 2026.** This upward revision reflects the economic measures set to be implemented by the new PM Takaichi's administration, with total national and local government spending expected to reach 22.5 trillion yen (within the range of 20-25 trillion yen), up from the previous estimate of 15 trillion yen. Looking ahead, while U.S. tariffs are expected to weigh on the economy and slow growth in 2025, we anticipate that the economy will avoid a severe downturn. Steady CAPEX, driven by labor shortages, and a recovery in consumer spending, due to declining inflation, should support the economy. From 2026 onwards, we also expect the recovery of overseas economies and economic measures to contribute to the recovery of the Japanese economy.
- ② **While we have raised our core CPI forecast from +2.6% to +2.7% for FY 2025, we have lowered our forecast from +1.4% to +1.3% for FY 2026.** Looking ahead, we anticipate that cost-push pressures from import prices will ease, rice prices to stabilize, and the abolition of the provisional gasoline tax to bring energy prices lower. Amid these factors, it is highly probable that core CPI will decelerate going forward. However, rising service prices driven by wage increases are expected to support the upward trend of inflation ahead. Excluding special factors such as levy for education and the provisional gasoline tax, we forecast core CPI to maintain its momentum of around +2.0% YOY.
- ③ **We expect the government to implement expansionary fiscal policies.** PM Takaichi, a proponent of proactive fiscal measures, is set to enhance economic security, including food, energy, natural resource, healthcare, defense, cybersecurity, and infrastructure resilience. Additionally, she has shown enthusiasm for raising the minimum taxable income and introducing refundable tax credits. Even so, the risk of excessive spending and fiscal deterioration seems to be marginal as PM Takaichi has demonstrated a certain degree of consideration for fiscal soundness. Furthermore, Vice President Aso, known to prioritize fiscal discipline, has significant influence over the new cabinet and the ruling LDP due to his faction's critical role in Takaichi's election win.
- ④ **We have maintained our forecast for 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 has outlined the following key areas to monitor going forward: (1) developments in the global economy, especially in the U.S., (2) the impact of the Trump tariffs on corporate earnings and wage/price-setting behaviors, and (3) the outlook for prices, including food prices. We expect the BOJ to only implement measures in January 2026, as it will take some time to evaluate the current situations of (1) and (2) mentioned above. We anticipate an interval of about six months, with a rate increase to 1.00% in July 2026, which is considered the lower end of the neutral rate range. The terminal rate is projected to be 1.25%, expected in July 2027, although this lies beyond our forecast period. Risks that could bring forward the next rate hike include significant yen depreciation, stronger-than-expected economic and price data, a sharp rise in expected inflation, and U.S. pressure for rate hikes. Conversely, risks that could delay the next rate hike include weaker-than-expected economic and price data, lower-than-expected wage increases next fiscal year, and potential opposition to rate hikes from the Takaichi administration.

Note: The forecasts are as of October 21st, 2025.

Forecast for the Japanese Economy

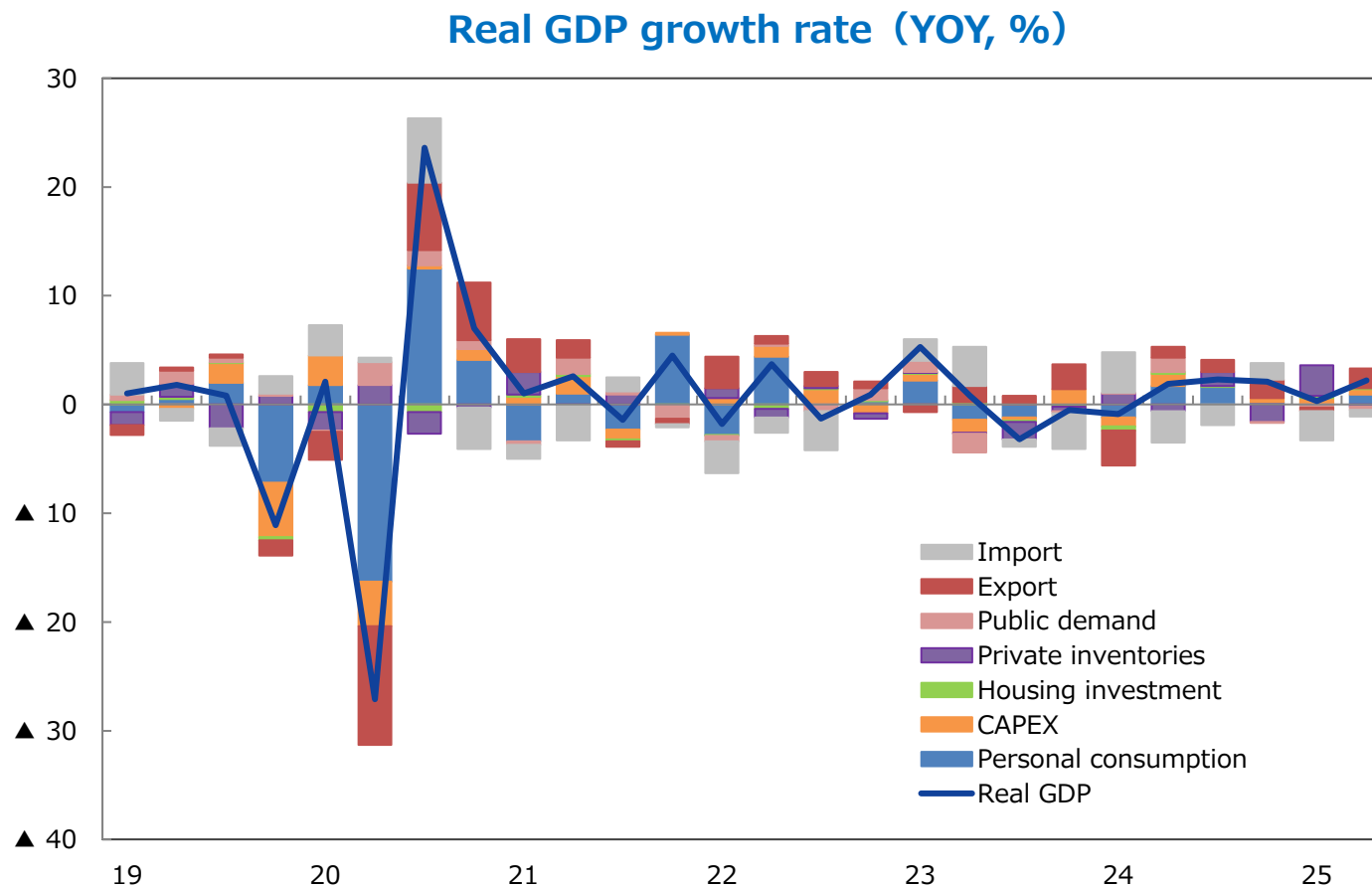
Forecast of annual Real GDP growth and its breakdown						
Fiscal Year	FY21	FY22	FY23	FY24	FY25 Est	FY26 Est
Real GDP	3.1%	1.3%	0.5%	0.7%	0.9%	0.9%
Private final consumption expenditure	1.8%	2.6%	-0.4%	0.7%	1.0%	1.2%
Private housing investment	0.4%	-2.7%	0.7%	-0.4%	-2.1%	0.2%
Private-sector capital investment	3.6%	3.2%	-0.8%	2.1%	1.4%	1.9%
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%	1.3%
Net export contribution	0.8%	-0.6%	1.4%	-0.4%	0.0%	-0.2%
Exports of goods and services	12.5%	5.0%	3.1%	1.7%	2.0%	1.1%
Imports of goods and services	7.3%	7.4%	-2.7%	3.4%	1.8%	2.1%
Nominal GDP	3.0%	2.2%	4.7%	3.7%	3.5%	2.7%
GDP deflator	-0.1%	0.9%	4.2%	2.9%	2.6%	1.8%
Industrial Production Index	5.6%	-0.3%	-1.9%	-1.4%	0.2%	1.4%
Consumer Price Index (Core)	0.1%	3.0%	2.8%	2.7%	2.7%	1.3%
Consumer Price Index (BOJ Core)	0.1%	3.0%	2.8%	2.7%	3.0%	1.8%
Domestic corporate goods price index	7.1%	9.6%	2.4%	3.4%	2.2%	1.2%
Employee compensation	2.1%	2.5%	1.9%	4.6%	3.5%	3.3%
Unemployment rate	2.8%	2.6%	2.6%	2.5%	2.5%	2.4%
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 January 2026.)

Note: The forecasts are as of October 21st, 2025.

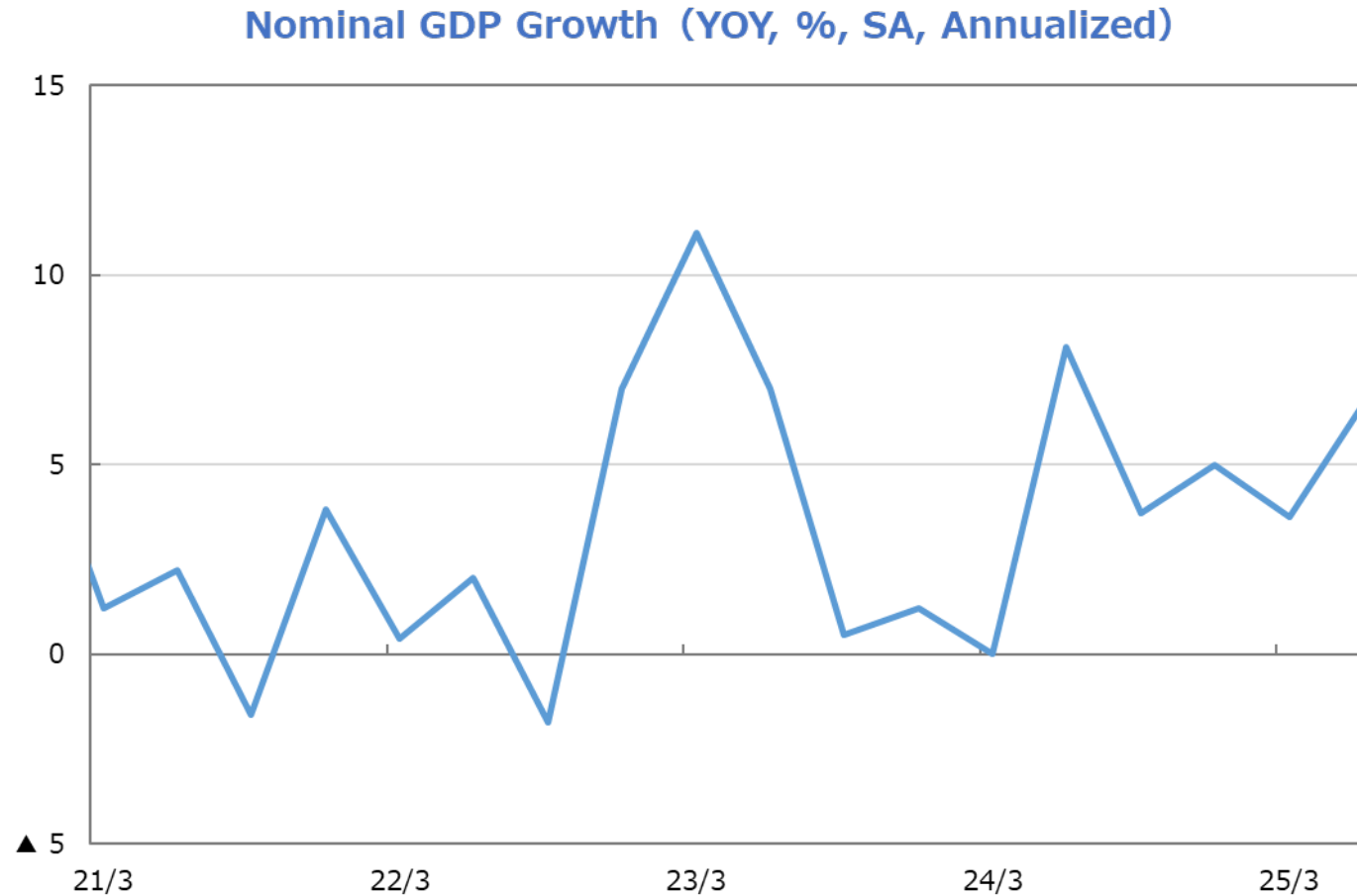
Source: Sumitomo Mitsui DS Asset Management based on data from the Cabinet Office, the Ministry of Internal Affairs and Communications, and the Ministry of Economy, Trade and Industry

Japan's GDP Continues Steady Growth Despite Trump Tariffs



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

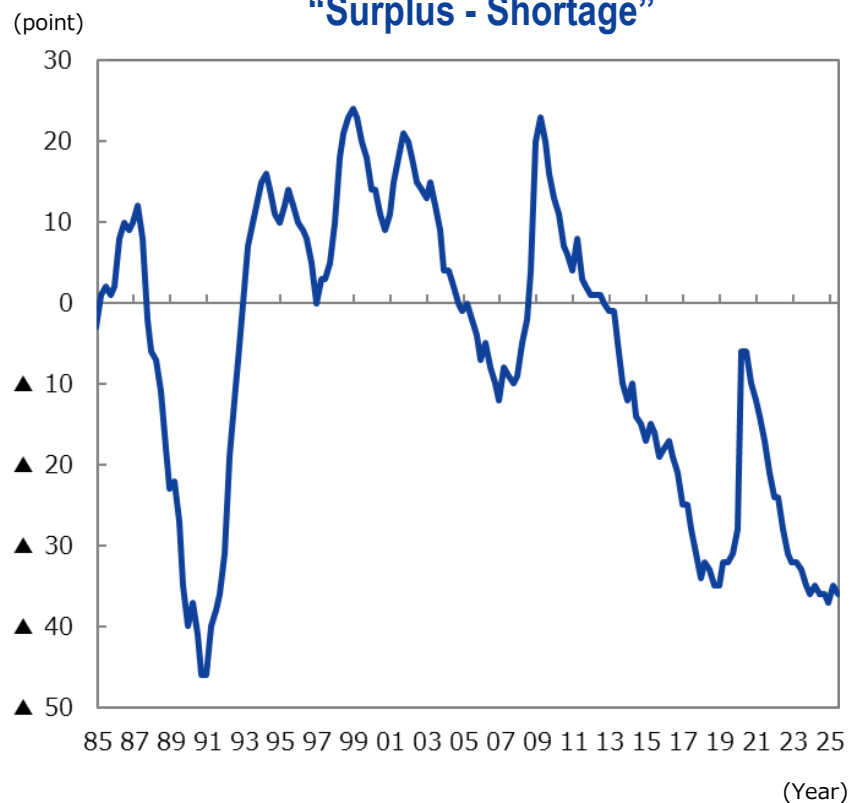
Japan's Nominal GDP Keeps Strong Momentum



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

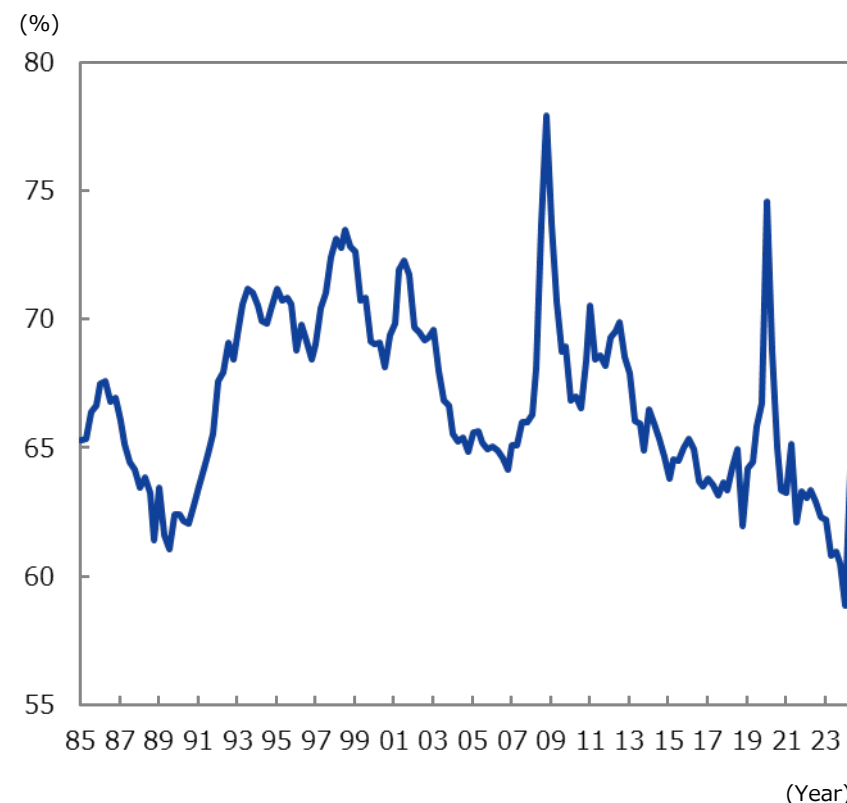
Conundrum? “Severe Labor Shortage” with “Low Labor Share”

Employment Sufficiency Index
“Surplus - Shortage”



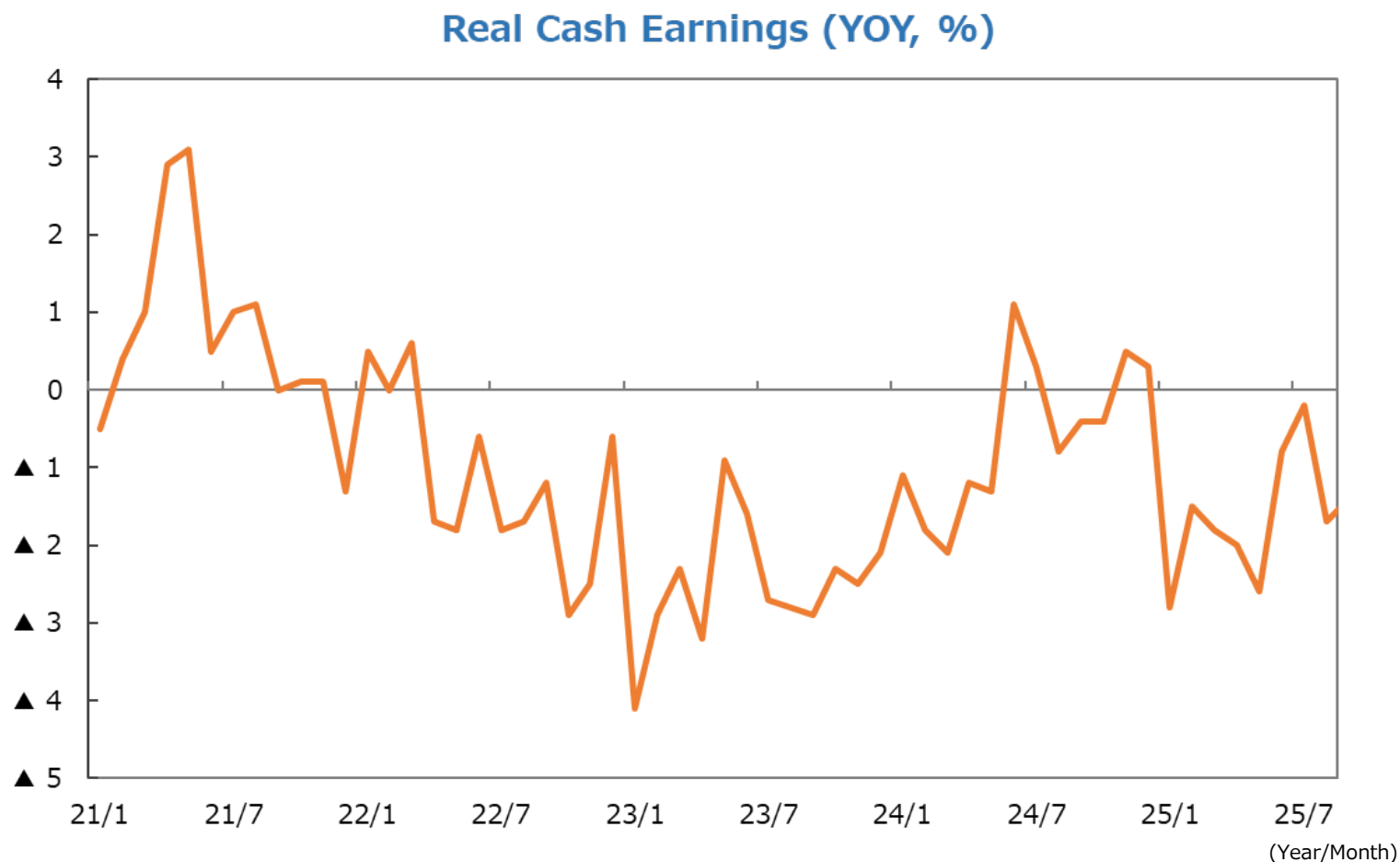
Note: Data is from April 1985 to September 2025.
Source: The bank of Japan, SMDAM

Labor Share of Added Value



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

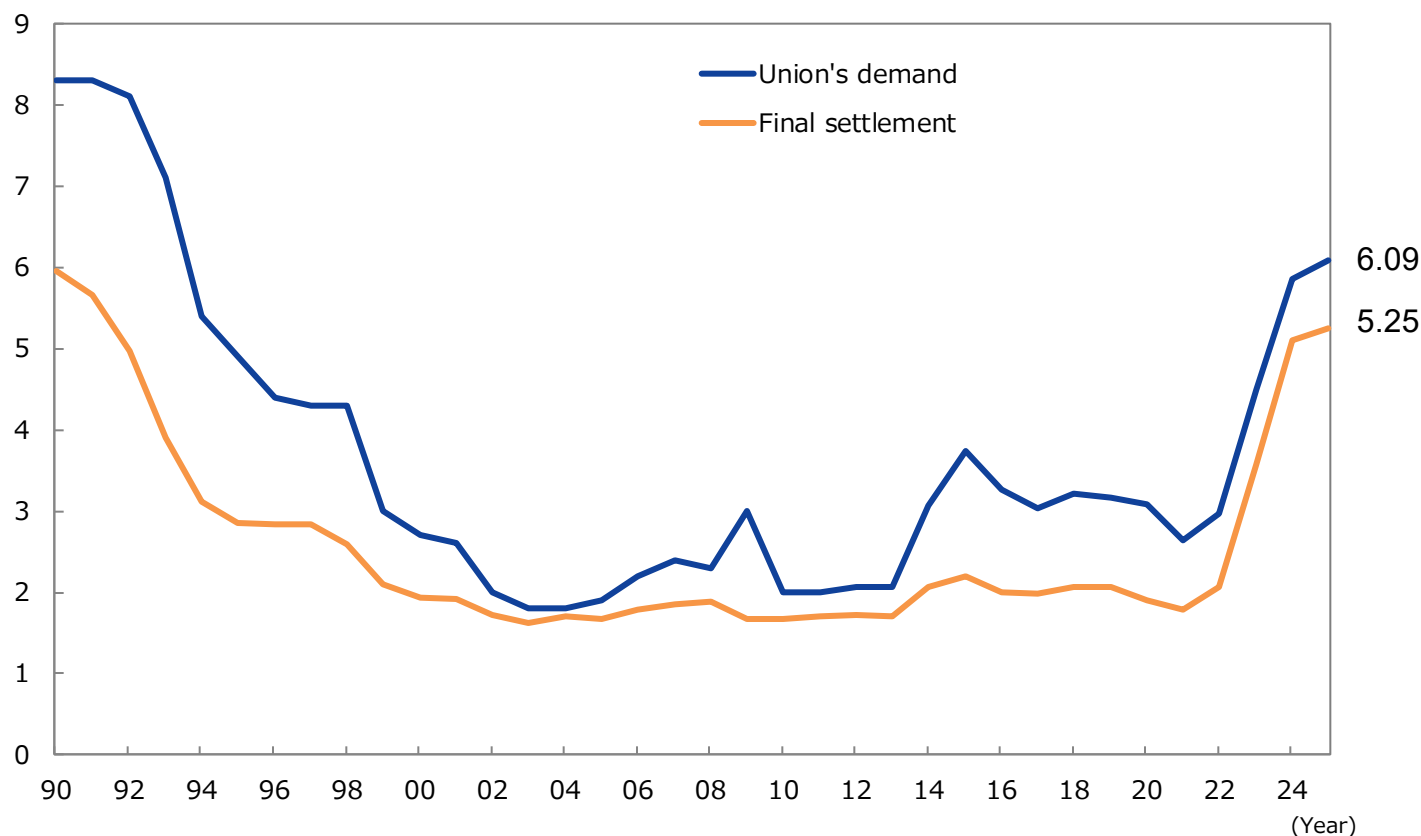
Inflation Continues to Erode Consumers' Purchasing Power



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

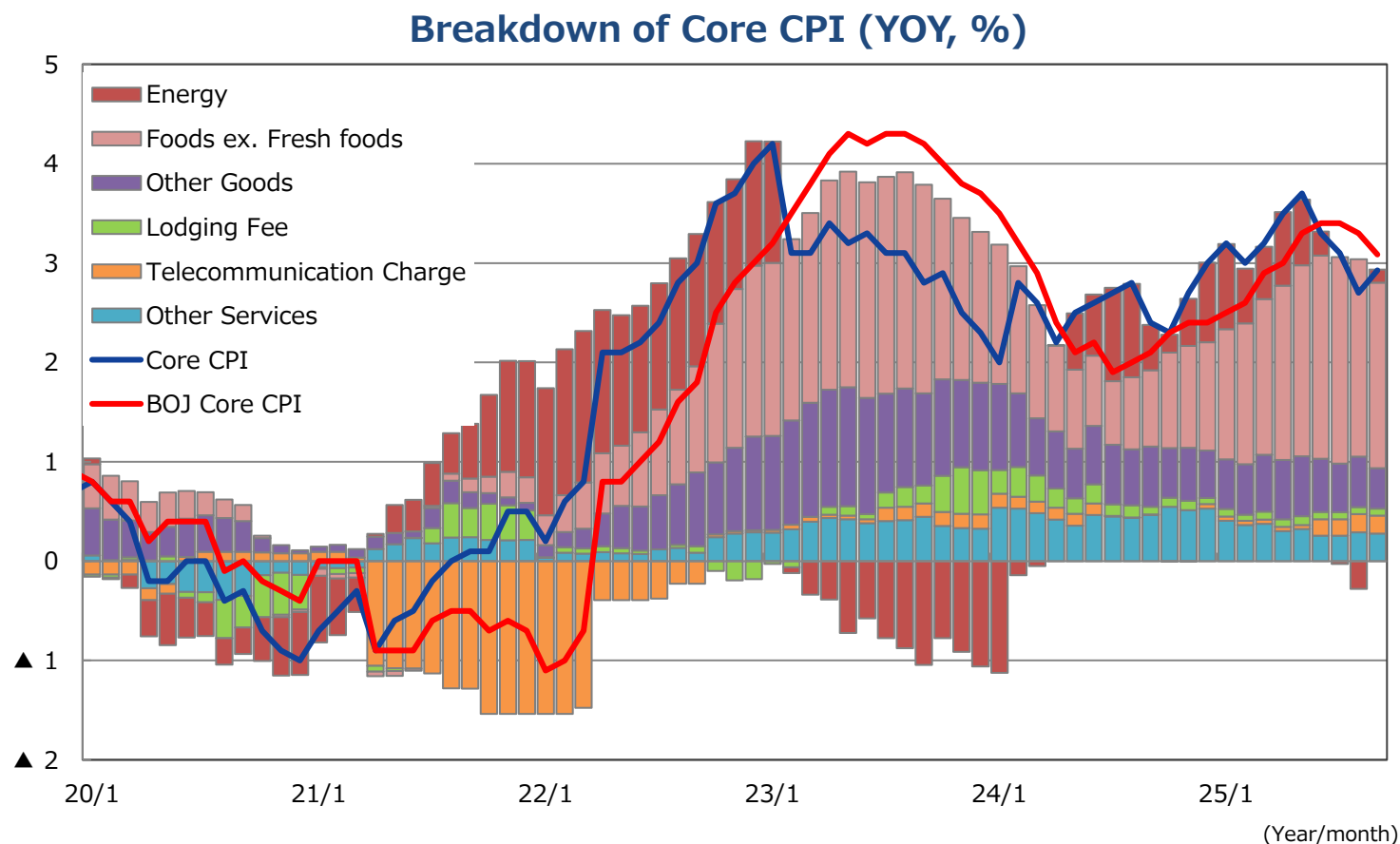
Highest Wage Increase in Japan Since the Early 90s

Wage increase (YOY, %)



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

Food Prices Lift Inflation Higher

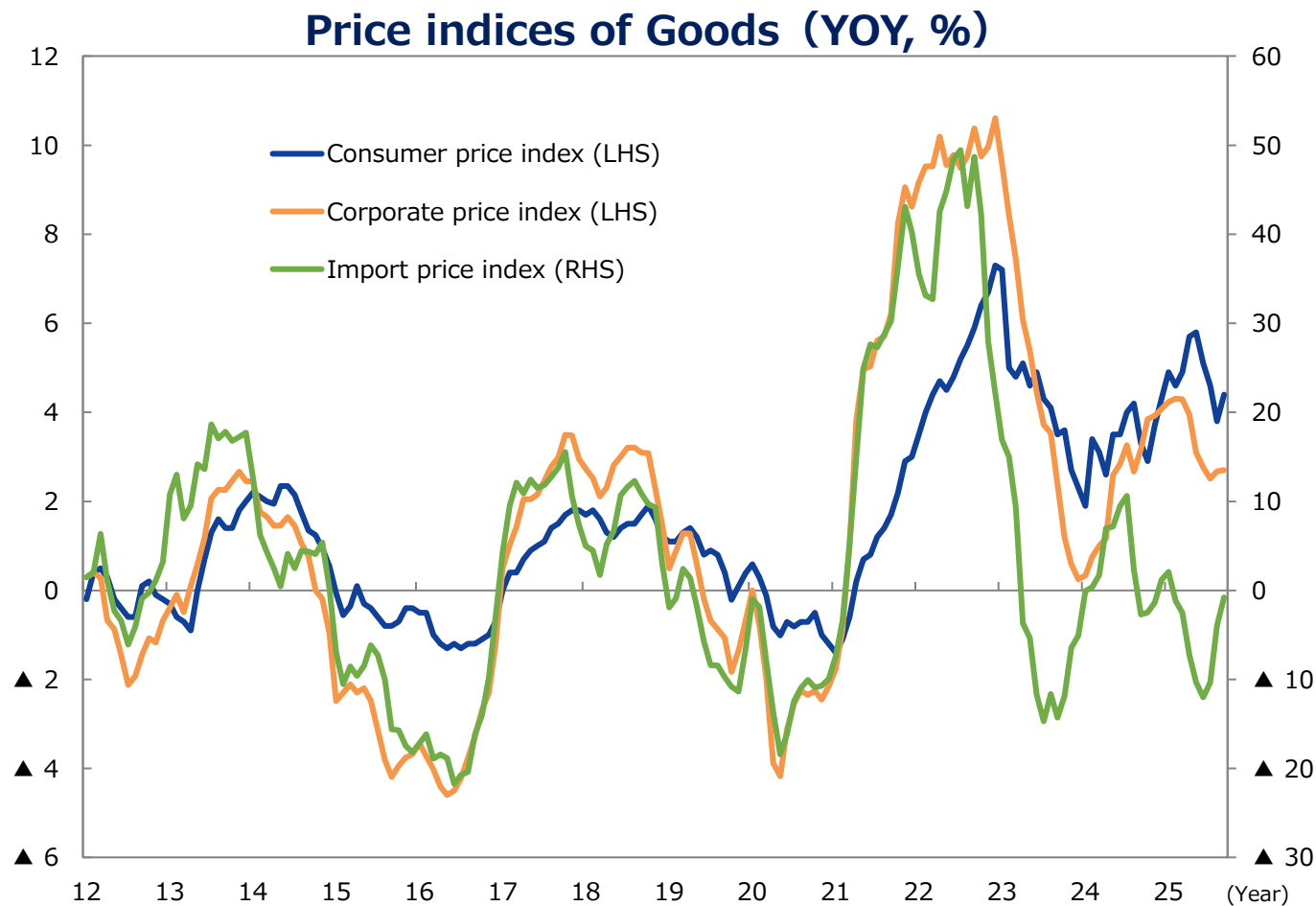


Note: Data is from January 2020 to September 2025.

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

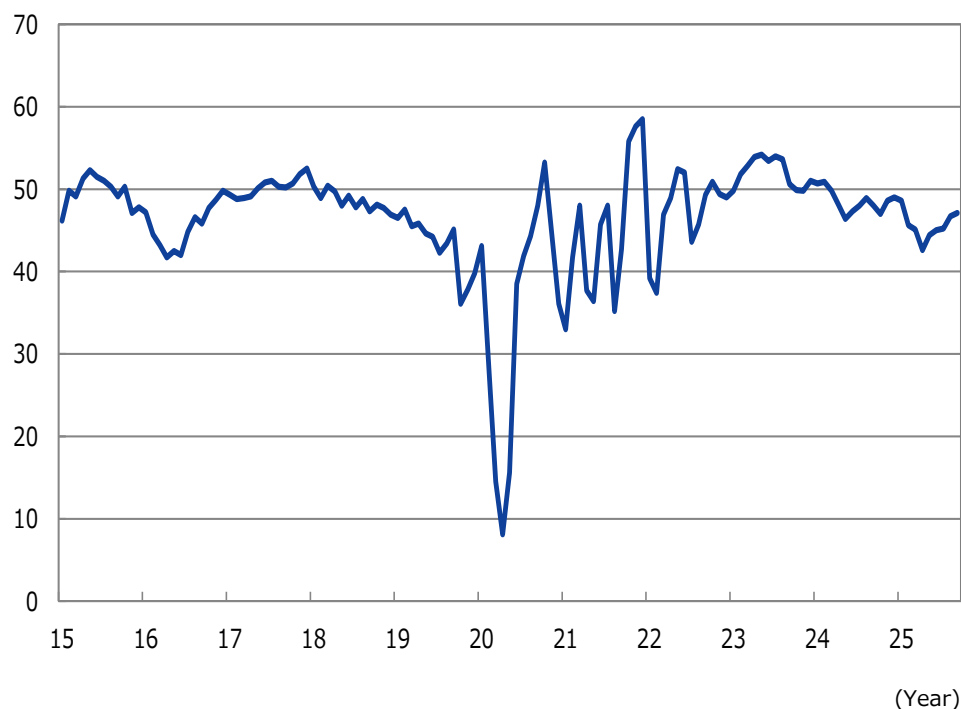
Divergence of Rising CPI and Falling Import Prices



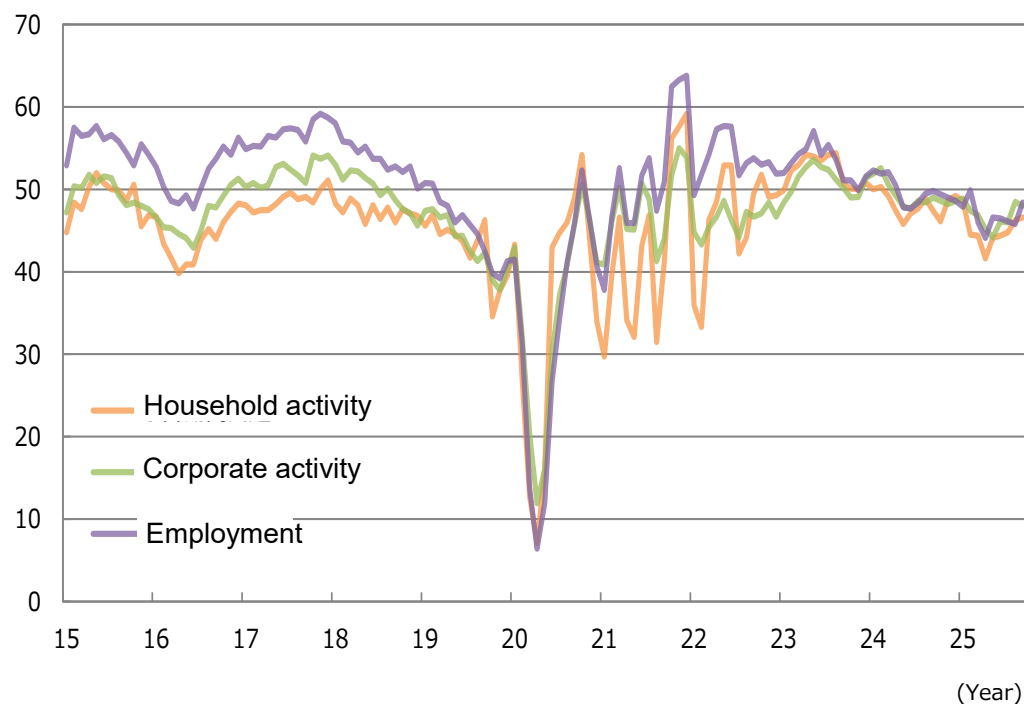
Note: Data is from January 2012 to September 2025.
Source: MIAC, Bloomberg, SMDAM

Growing Unease with Slowing Economy and Higher Inflation

DI for Current Economic Conditions

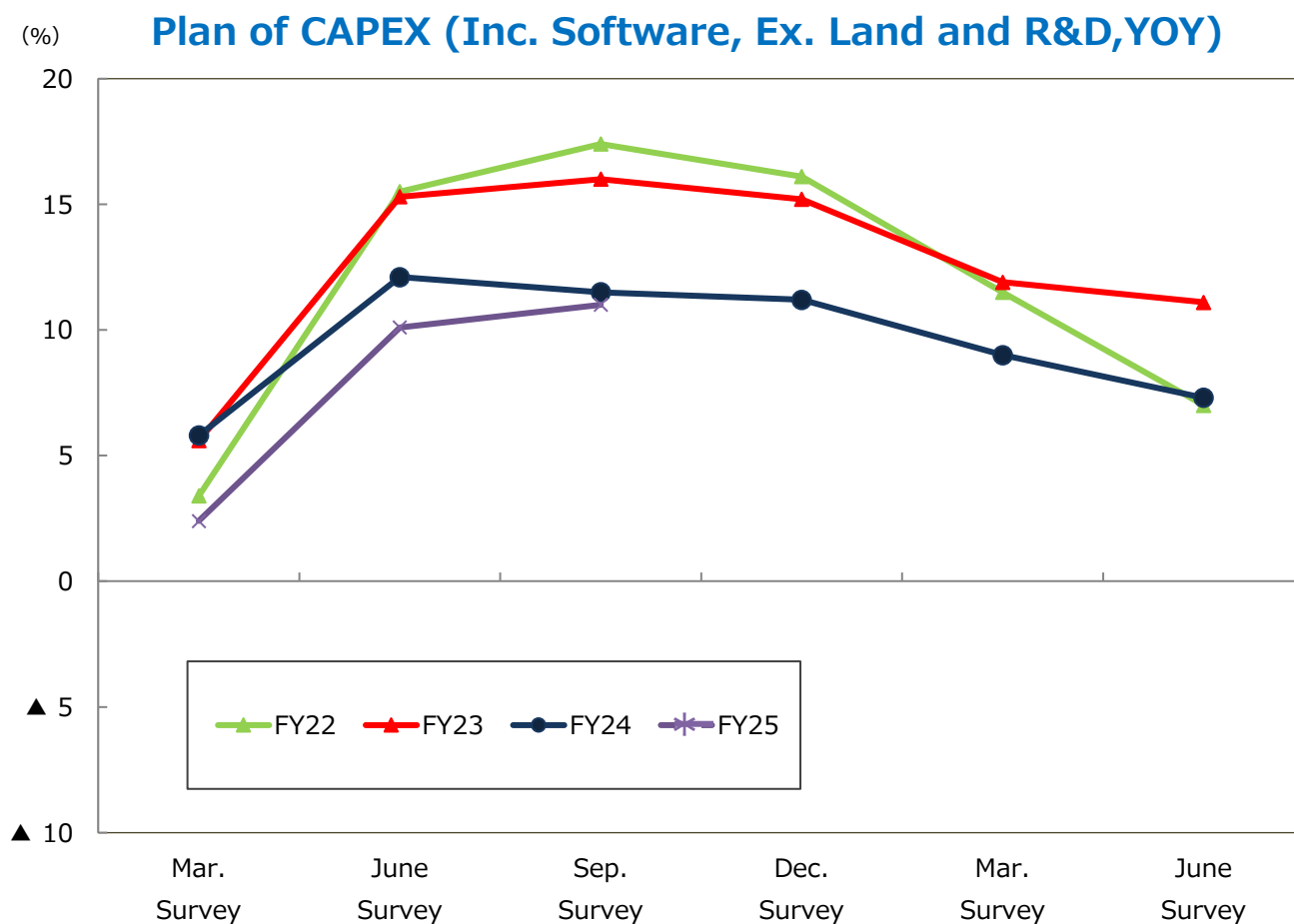


Breakdown of DI for Current Economic Conditions



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

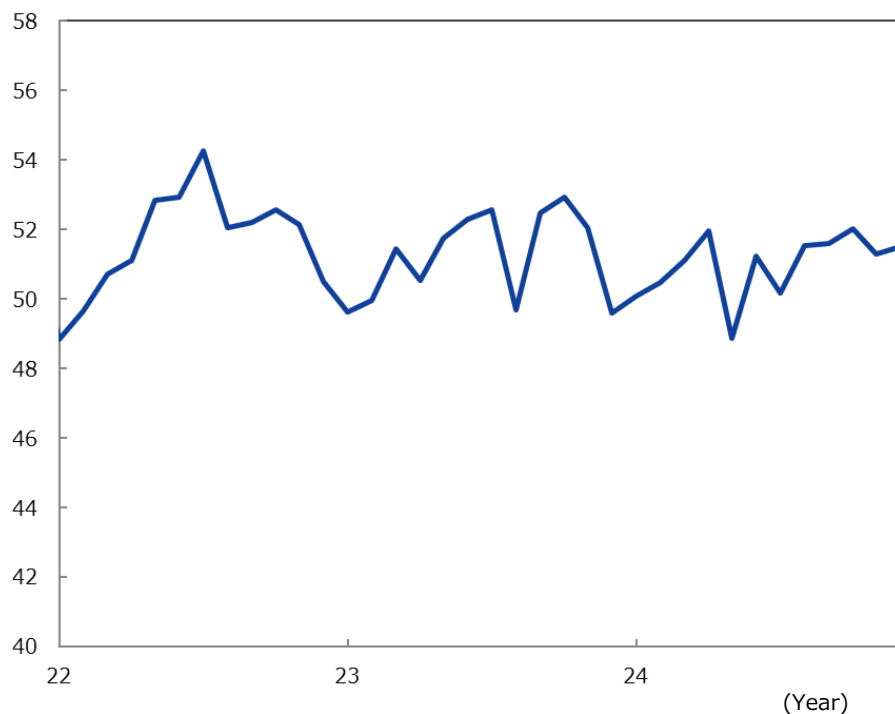
Receding Uncertainty Over the Economy Lifts CAPEX Appetite



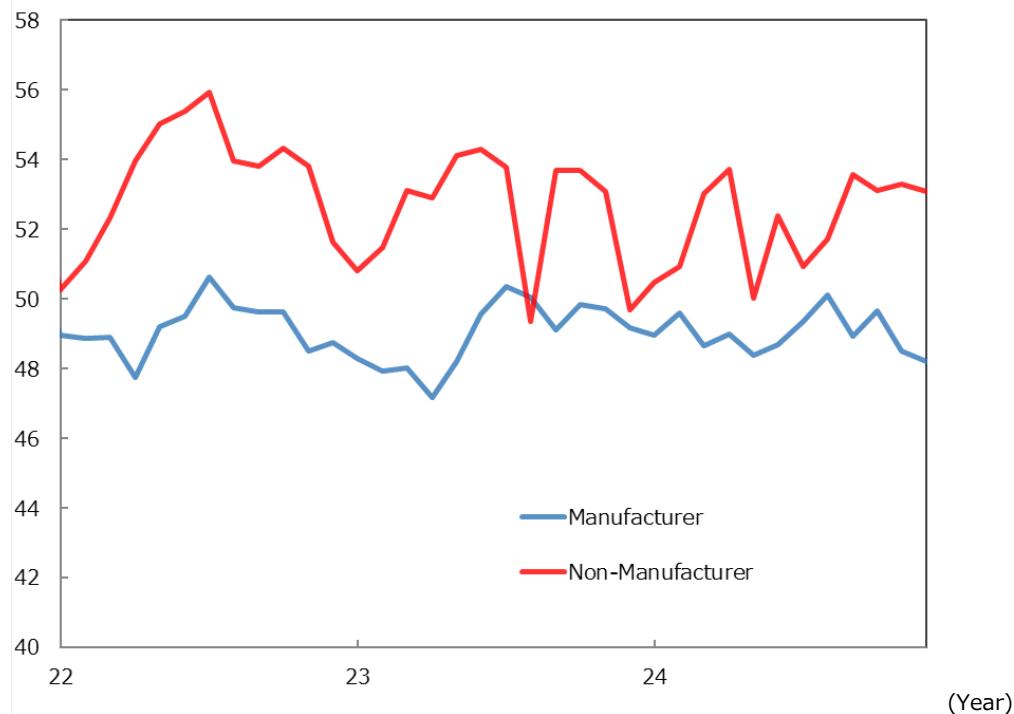
Note: Data is from Q4 FY2021 to Q2 FY2025.
Source: The Bank of Japan, SMDAM

“K-Shape” Divergence of Business Sentiment

Composite PMI(%pt)



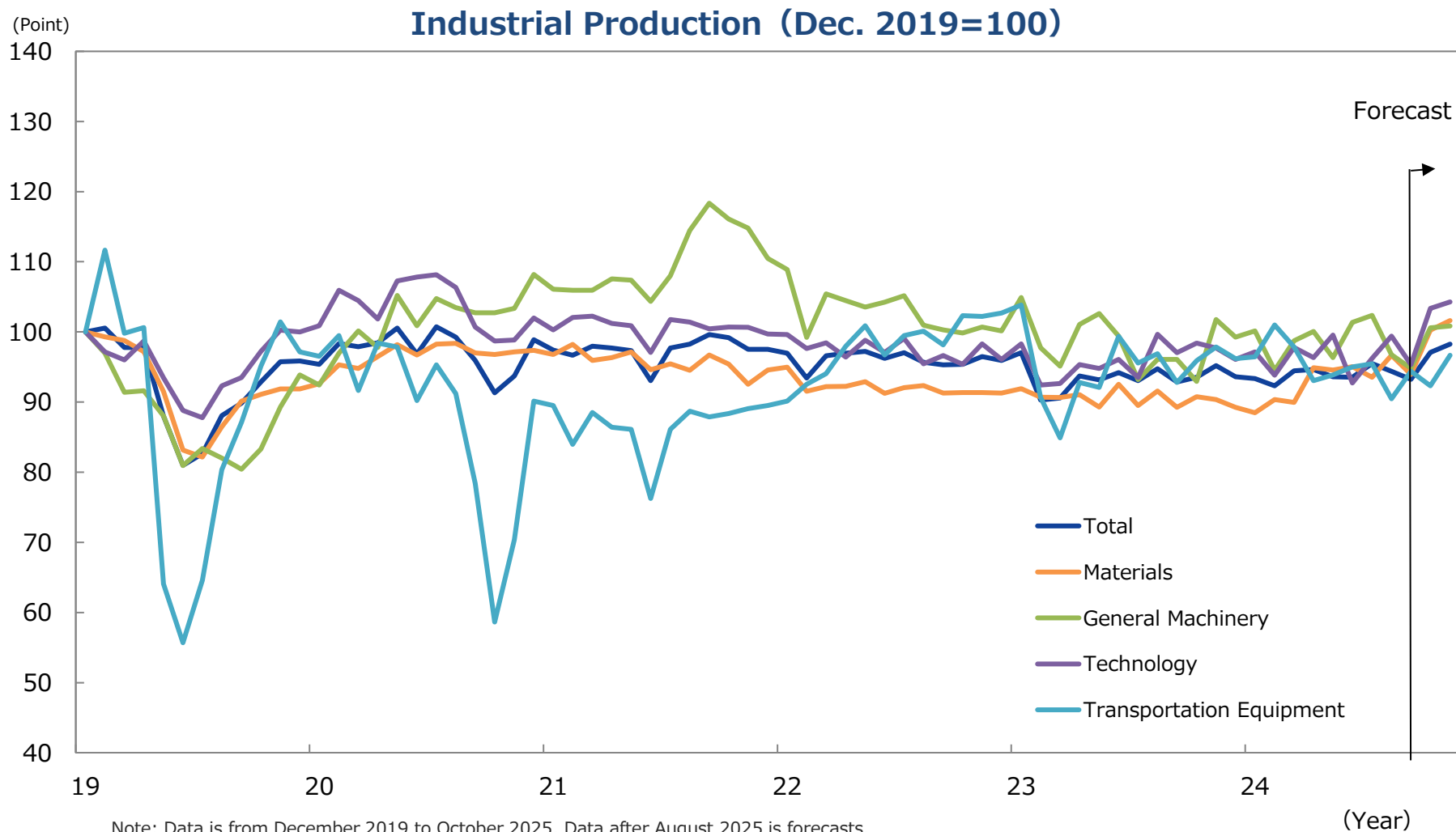
PMI, Manufacturer & Non-Manufacturer(%pt)



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



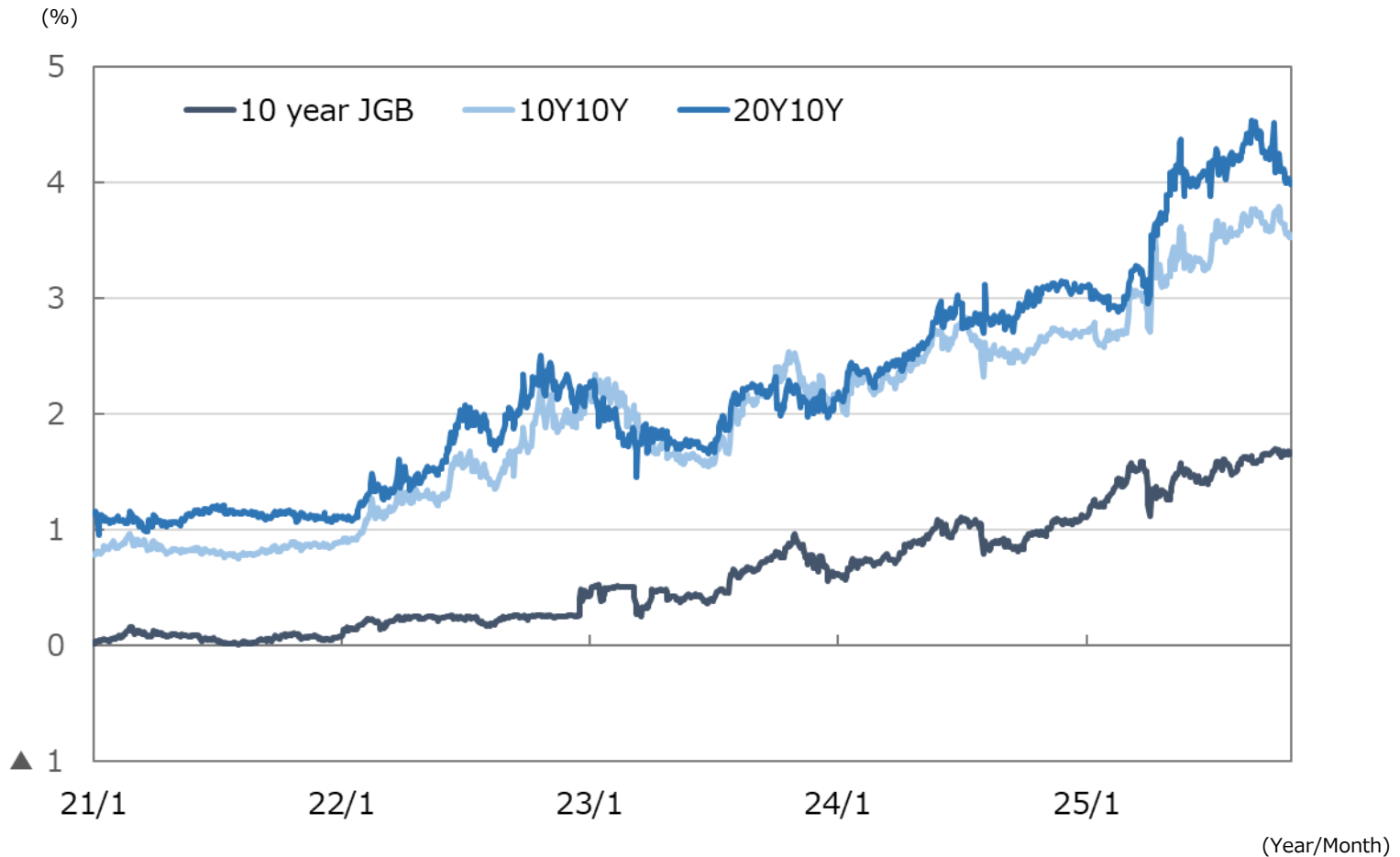
Auto Production to Recover Going Forward



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

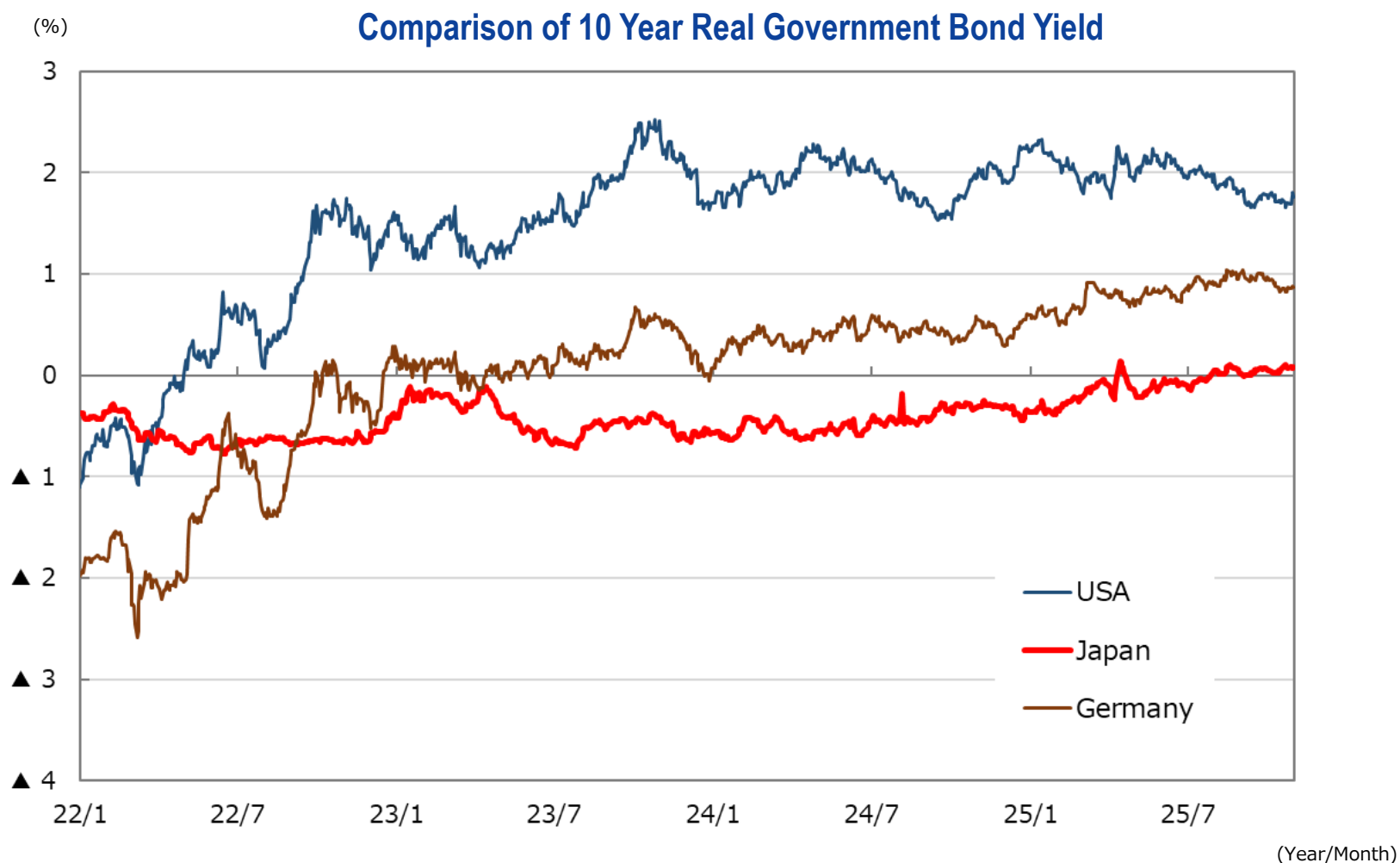
Yield Curve of Ultra-Long End Start Flattening

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



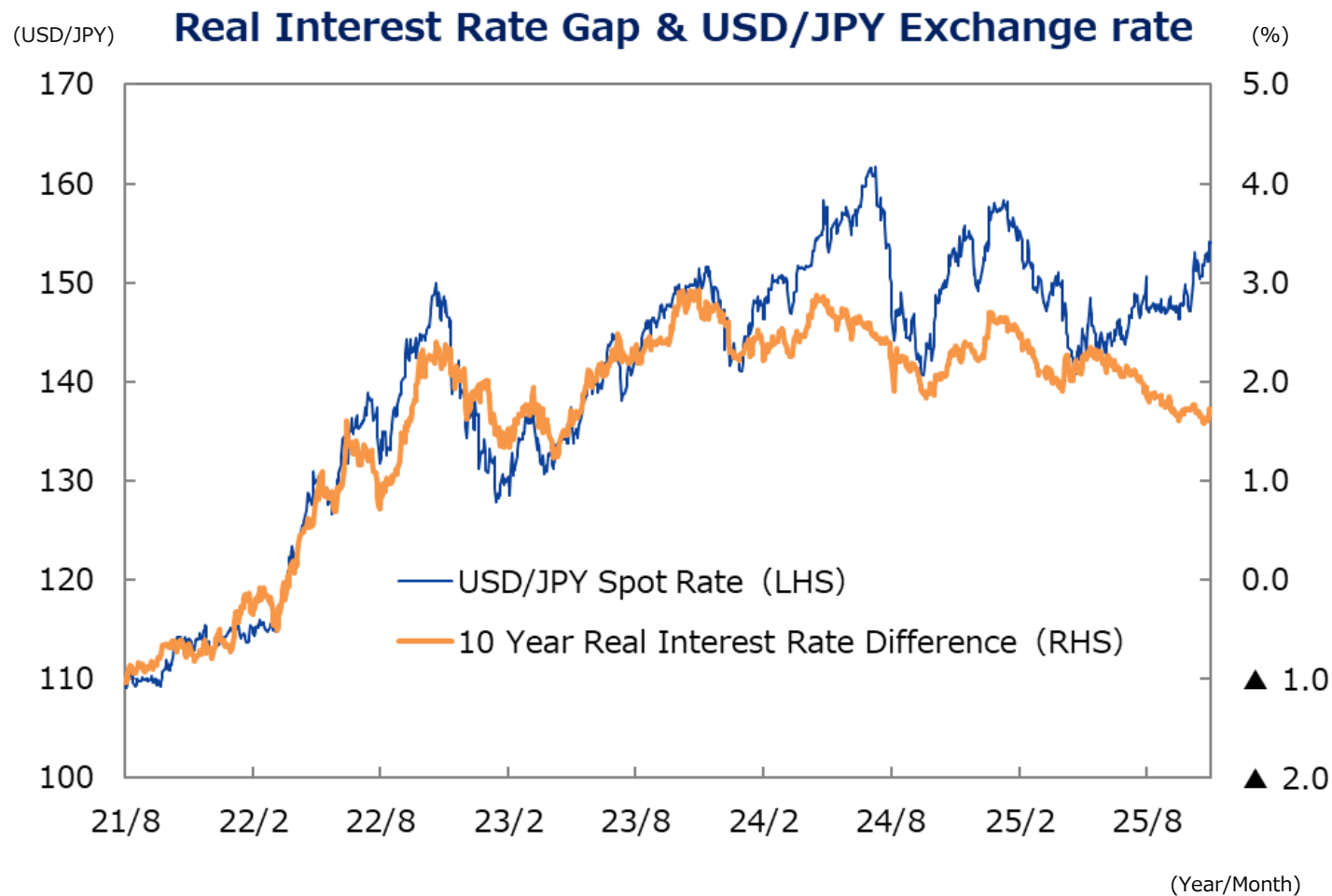
Note: Data is from 4th January 2021 to 31st October 2025.
Source: Bloomberg

10-Year Real JGB Yield Becomes Slightly Positive



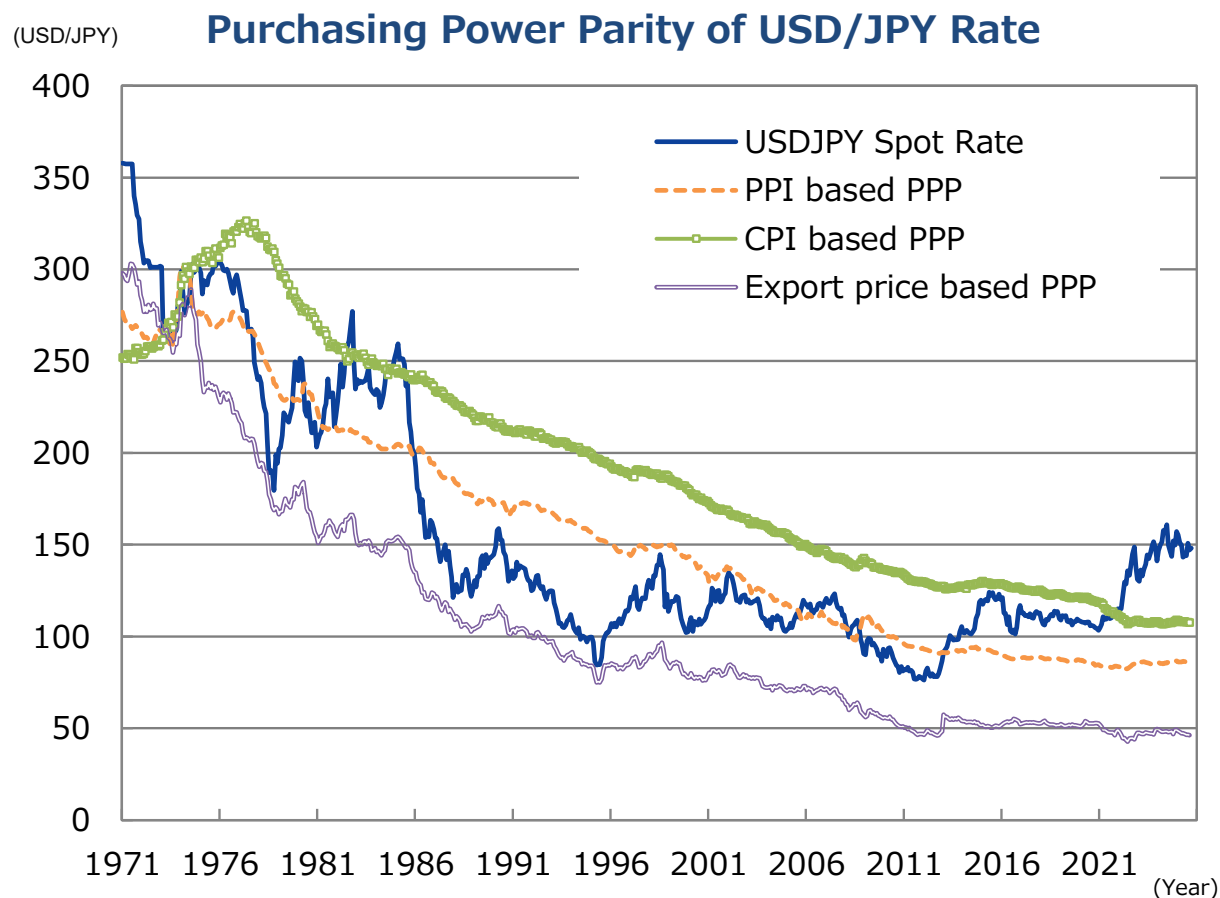
Note: Data is from 1st January 2022 to 31st October 2025.
Source: Bloomberg

Dollar/Yen Getting Higher Despite Narrowing Interest Rate Gap



Note: Data is from 1st September 2021 to 31st October 2025.
Source: Bloomberg

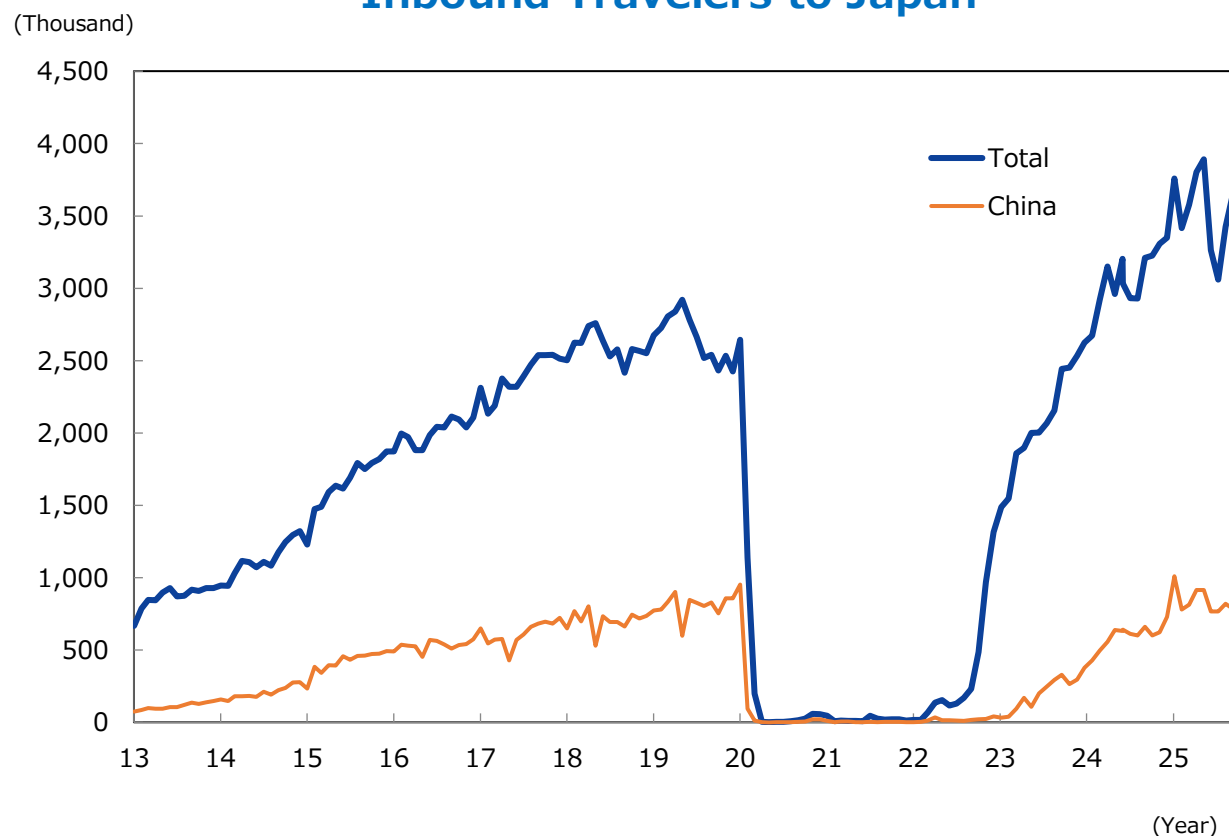
Purchasing Power Parity Indicates Overvaluation of US Dollar



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

Inbound Travel Resumed its Upward Momentum

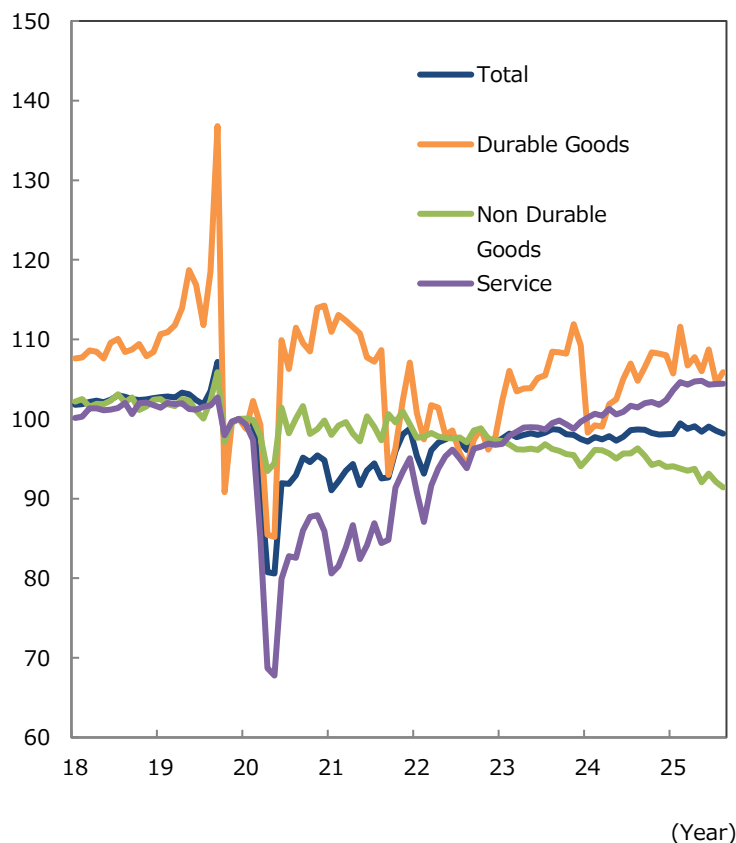
Inbound Travelers to Japan



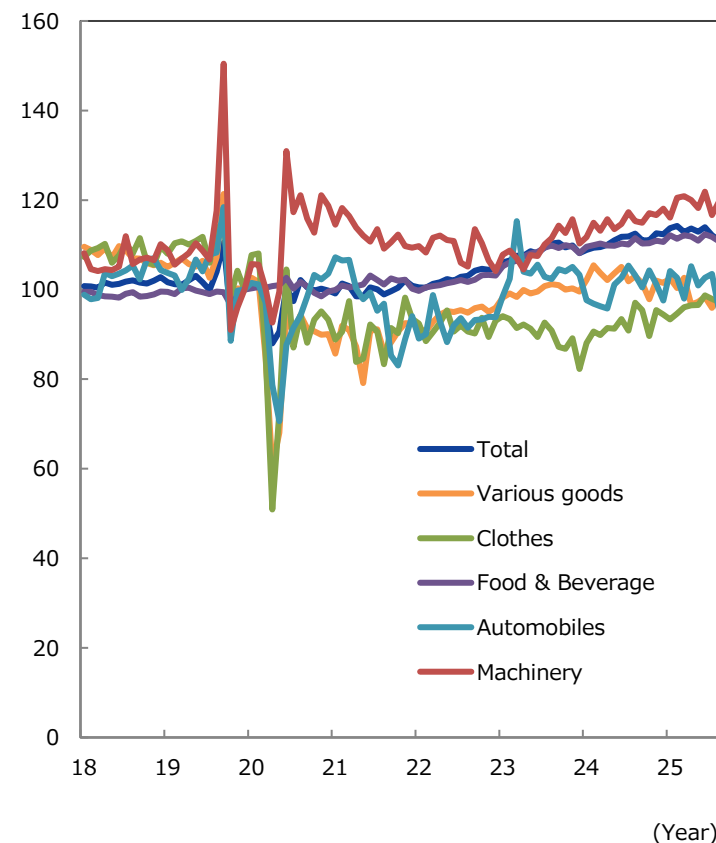
Note: Data is from January 2013 to September 2025. Data is seasonally adjusted by SMDAM.
Source: Japan National Tourism Organization, SMDAM

Consumer Activities are Mixed due to Weak Real Income

Consumer Activity Index (Dec. 2019 = 100)



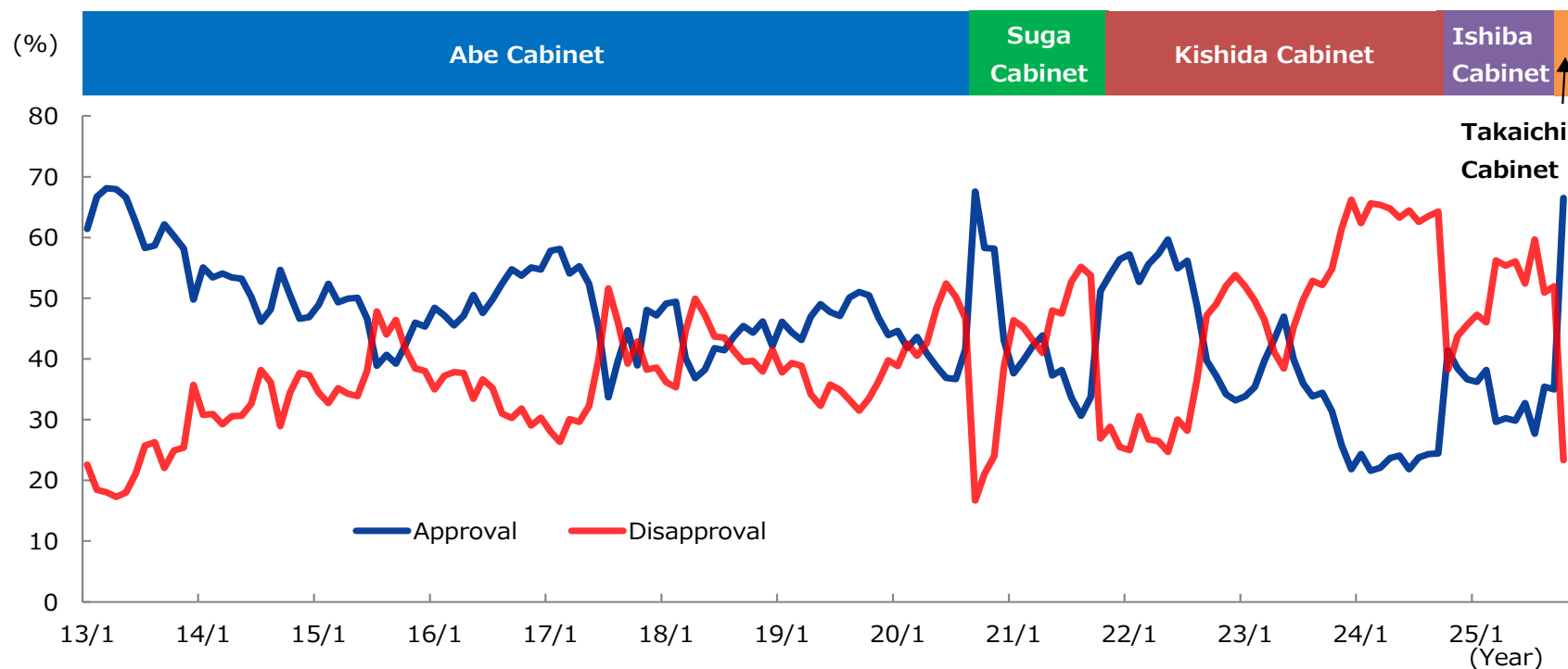
Retail Sales (Dec. 2019 = 100)



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

New PM Takaichi Secured Broad Public Approval

Cabinet approval rate



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

Schedule of Major Events

Year	Month	Date	Event
2025	October	4	Voting and ballot counting for the LDP leadership election
		21	Extraordinary Diet Session (Prime Minister Designation Election)
		29-30	President Trump's Visit to Japan Monetary Policy Meeting
	November	17	Release of 2025 Q3 GDP Cabinet Approval of Economic Measures
	December	8	Revision of 2025 Q3 GDP
		18-19	Monetary Policy Meeting Passage of the FY2025 Supplementary Budget 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
	February	16	Release of 2025 Q4 GDP
	March	10	Revision of 2025 Q4 GDP
		18-19	First Summary of Responses in Rengo's Spring Wage Negotiations Monetary Policy Meeting
		31	Passage of the FY2026 Budget Bill and Tax Reform-Related Legislation 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)
		29	End of the ordinary Diet session G7 Summit Expiration of the term of the Bank of Japan's Nakamura Policy Board member
	July	30-31	Monetary Policy Meeting
	August		Release of 2026 Q2 GDP
	September	17-18	Monetary Policy Meeting Revision of 2026 Q2 GDP

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

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