Japan Equity Market Outlook

Sumitomo Mitsui DS Asset Management

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Summary

Japan Equity Outlook

In August, TOPIX rose 3.8%, its fifth consecutive gain, and reached record highs, while the Nikkei 225 gained 3.0%, its first rise in two months. April–June Japanese and US earnings supported equities, while Fed and BOJ tightening expectations and higher long-term yields capped gains.

Prolonged Middle East conflict is keeping energy prices elevated and making central banks more hawkish. However, largely supply-driven inflation makes aggressive 2022–23-style tightening unlikely. AI demand and fiscal expansion should sustain the global recovery and earnings growth, although tighter policy may curb demand. We retain a positive view on Japanese equities, but rates matter.

Economic and Monetary Policy

Global and domestic recovery remains our base case, supported by AI demand and fiscal expansion, despite Hormuz's prolonged effective closure. Amid inflation concerns, we expect BOJ hikes in September, January and June following June's move, and one Fed hike this year. Warsh's hawkish remarks make September action likelier. Intervention and warnings corrected yen weakness, but high US rates and structural yen-selling flows should sustain dollar strength.

Key Drivers for Japan's Stock Market

Japanese equities remain supported by the end of deflation, governance reform, and improving capital efficiency. The Takaichi administration's growth investment and economic-security policies may provide additional tailwinds.

Risks and Events

Downside risks include sharply higher US real or Japanese long-term yields, weaker AI earnings, oil-driven deterioration in Japan's terms of trade, Japan-China tensions, and rapid yen appreciation. Upside potential comes from faster AI monetization, concrete Takaichi growth measures, and stronger recognition of governance reforms.

Outlook for the Japanese Economy

SMDAM Forecasts: Japanese Economy

Forecasts as of 18 Aug 2026		FY22 (A)	FY23 (A)	FY24 (A)	FY25 (A)	FY26 (E)	FY27 (E)
Real GDP	(yoy, %)	1.5	0.1	0.7	0.9	1.0	1.0
Private Consumption	(yoy, %)	2.5	▲ 1.0	0.1	1.3	0.7	1.4
Private Resid. Investment	(yoy, %)	0.7	2.0	▲ 0.4	▲ 2.6	0.5	▲ 0.2
Private Capex	(yoy, %)	4.2	0.8	1.8	2.3	▲ 0.7	2.0
Public Investment	(yoy, %)	▲ 4.5	▲ 0.1	0.1	▲ 0.3	0.7	0.6
Net Exports (contribution)	(%point)	▲ 0.6	1.2	▲ 0.3	▲ 0.1	0.4	▲ 0.2
Exports	(yoy, %)	4.7	3.1	2.7	2.0	2.4	2.1
Imports	(yoy, %)	7.3	▲ 2.2	4.0	2.6	0.0	3.3
Nominal GDP growth	(yoy, %)	2.7	4.9	4.0	4.2	3.7	3.0
GDP deflator	(yoy, %)	1.2	4.8	3.2	3.3	2.7	2.0
Industrial production	(yoy, %)	▲ 0.3	▲ 1.9	▲ 1.5	▲ 0.1	2.7	1.4
CPI (less fresh food & institutional factors)	(yoy, %)	4.0	2.8	2.7	2.7	3.1	2.1
Unemployment Rate	(%)	2.6	2.6	2.5	2.6	2.5	2.4
Policy Rate	(End of Period, %)	▲ 0.1	0-0.1	0.50	0.75	1.50	1.75

Note: Forecasts by SMDAM.
Source: SMDAM

Economic and Asset Price Outlook for Key Regions

SMDAM Forecasts: Major Economies, Rates and FX

Forecasts as of 20 Aug 2026		2025 Q4	2026 Q1	Q2	Q3	Q4	2027 Q1	Q2	Q3
GDP Growth Rate									
United States	(saar, %)	0.5	2.1	1.5	3.3	2.0	1.9	1.9	1.9
Japan	(saar, %)	1.0	1.9	1.1	0.7	0.7	0.6	1.8	0.7
Euro Area	(saar, %)	0.8	0.0	1.8	0.8	1.2	1.5	1.6	1.6
China	(yoy,%)	4.5	5.0	4.3	4.4	4.6	4.5	4.6	4.5
Inflation									
United States	(core PCED, yoy, %)	2.8	3.1	3.3	3.3	3.3	2.9	2.7	2.7
Japan	(core CPI, yoy, %)	2.8	1.7	1.5	1.8	2.6	3.2	1.5	1.4
Euro Area	(yoy, %)	2.1	2.0	3.0	3.1	3.2	2.9	2.2	2.2
China	(yoy, %)	0.6	0.9	1.2	0.7	1.0	0.3	0.2	0.2
Policy Rates									
United States	(End of Period, %)	3.5-3.75	3.5-3.75	3.5-3.75	3.5-3.75	3.75-4.0	3.75-4.0	3.75-4.0	3.75-4.0
Japan	(End of Period, %)	0.75	0.75	1.00	1.25	1.25	1.50	1.75	1.75
Euro Area	(End of Period, %)	2.00	2.00	2.25	2.50	2.50	2.50	2.50	2.50
China	(End of Period, %)	1.40	1.40	1.40	1.40	1.40	1.40	1.30	1.30
Long-term Rates									
US 10Y	(End of Period, %)	4.17	4.32	4.47	4.70	4.80	4.70	4.60	4.60
Japan 10Y	(End of Period, %)	2.06	2.35	2.67	2.90	3.00	3.10	3.10	3.10
Germany 10Y	(End of Period, %)	2.86	3.00	2.86	3.20	3.30	3.20	3.10	3.10
FX									
USD/JPY	(End of Period)	156.7	158.7	162.5	162.0	164.0	164.0	164.0	164.0
EUR/JPY	(End of Period)	184.1	183.4	185.8	184.7	185.3	185.3	185.3	185.3
Stock Prices									
TOPIX	(End of Period)	3,409	3,498	3,995	4,200	4,300	4,350	4,350	4,350
Nikkei 225	(End of Period)	50,339	51,064	70,062	69,300	71,000	71,800	71,800	71,800

		2024 (yoy,%)	2025 (yoy,%)	2026 (yoy,%)	2027 (yoy,%)
GDP Growth Rate					
United States	(saar, %)	2.8	2.1	2.2	2.1
Japan	(saar, %)	0.7	1.2	1.0	0.9
Euro Area	(saar, %)	1.0	1.3	0.8	1.4
China	(yoy,%)	5.0	5.0	4.6	4.5
Inflation					
United States	(core PCED, yoy, %)	2.9	2.8	3.3	2.7
Japan	(core CPI, yoy, %)	2.7	3.1	1.9	1.7
Euro Area	(yoy, %)	2.4	2.1	2.8	2.3
China	(yoy, %)	0.2	0.0	0.9	0.2

Note: Japan is FY-based.

Note: Forecasts by SMDAM.

Source: SMDAM

This Month’s Topic (1): Japan’s Policy Dynamics

August polls showed mixed moves in support for the Takaichi Cabinet, but the rapid decline seen in July eased. Approval fell five points to 53% in NHK’s poll and one point to 56% in Yomiuri’s, but rose one point to 63% in Sankei’s and four points to 62% in Nikkei’s, returning to the 60% range after two months.

Reports suggest Kihara, Katayama, Motegi, Aso and Suzuki may remain in their posts after the Cabinet reshuffle and LDP executive appointments expected in mid-to-late September. **Rather than a major overhaul to lift approval, Takaichi will likely prioritize party unity** and continuity in diplomacy, fiscal and monetary policy, and security. This may temper her policy imprint but support stable policymaking.

FY2027 general-account budget requests reached a record ¥143.1 trillion, but were only ¥2.5 trillion above the combined FY2026 initial and FY2025 supplementary budgets. Takaichi aims to limit new bond issuance to around ¥40 trillion, still far above the FY2026 initial plan of ¥29.6 trillion. **Requests under the “Strong and Prosperous Japan” investment framework exceeded ¥12 trillion**. The government may forgo a second FY2026 supplementary budget, consistent with consolidating necessary spending in the initial budget, although Middle East tensions could require further measures.

The BOJ’s July summary of opinions highlighted upside inflation risks and calls for faster hikes. Hawkish board member Takata cited consecutive hikes and a 50bp move, while Bessent pressed the BOJ to tighten. **Markets priced in earlier hikes and a higher terminal rate**. Tightening expectations and fiscal concerns briefly pushed the 10-year JGB yield above 3% in early September. Yields then eased and the yen strengthened after Bessent criticized Takaichi’s reflationary policy mix and reports suggested no second supplementary budget, fueling policy-normalization expectations.

Higher yields are changing the JGB investor base. Household interest in retail JGBs is rising, and the government is considering NISA eligibility. Greater household ownership could support stable absorption, though deposit outflows may reduce banks’ buying capacity. Speculation that GPIF may raise its domestic-bond allocation remains unconfirmed.

Coming policy focuses include the Cabinet reshuffle and LDP executive appointments, autumn Diet session, food-tax-cut design, BOJ tightening pace, and year-end FY2027 budget and tax-reform decisions.

Markets will also watch October’s TOPIX rebalancing, which screens all three market segments by turnover and free-float market capitalization. Qualifying stocks are expected to fall from about 1,650 to around 1,000. Nonqualifying constituents will not be removed immediately; their weights will be reduced gradually, with reassessment in 2027.

Middle East tensions are worsening Japan’s terms of trade and restraining nominal growth, (G), while inflation concerns lift long-term rates, (R), bringing the two closer. If (R) persistently exceeds (G), corporate funding and government interest costs could outpace nominal-income growth, heightening fiscal-sustainability and equity-valuation concerns. A 10-year yield above 3% does not itself mean (R) exceeds (G), since the relevant fiscal measure is the government’s average funding cost. Questions over whether yields are economically appropriate could lead the BOJ to reconsider bond purchases.

This Month's Topic (2): Rising Expectations of a September Fed Rate Hike

Fed Chair Warsh struck a hawkish tone at Jackson Hole. He called short-term rates the Fed's primary policy tool and argued that resilient economic activity and markets meant financial conditions were not clearly restrictive. With the labor market consistent with full employment, he said price stability should take priority. PCE inflation stood at 3.7% year on year and 4.1% annualized over six months. Prices had risen by more than 3% for 54% of items over 12 months and 49% on a six-month annualized basis, indicating broad inflationary pressure. Acknowledging the Fed's responsibility for 65 months of high inflation, Warsh said there was still "work to do" unless underlying inflation moved clearly and sufficiently quickly toward 2%.

Although he did not explicitly signal a September hike, he kept it on the table. Having delivered a hawkish message despite mounting political pressure ahead of the midterm elections, Warsh may not hesitate to act. President Trump warned against a hike on September 4, placing the policy decision and Fed independence in focus.

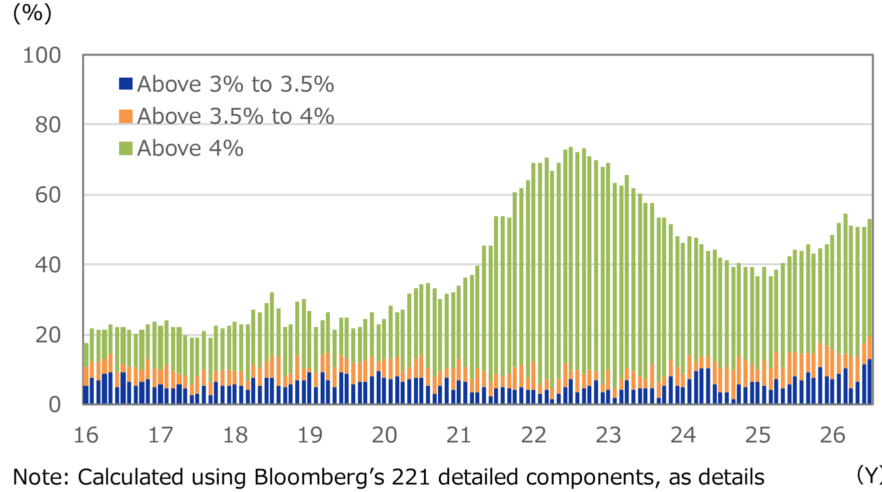
Markets have not fully priced in a September hike. If the Fed acts, short-term yields would likely rise, initially flattening the yield curve, strengthening the dollar and pressuring equities. A "Warsh put" appears unlikely initially, while political confrontation and concerns about further hikes could increase volatility.

However, risk aversion need not persist. If the Fed pauses after one or two hikes while stabilizing inflation expectations without derailing growth, rate pressure should ease and equities could return to fundamentals. Demonstrating independence and prioritizing price stability could also bolster Fed credibility, containing inflation expectations, term premiums and long-term yields. This scenario would require revision if persistent inflation necessitated more than two hikes.

Conversely, a hold interpreted as dovish would likely lower short-term yields, weaken the dollar and lift equities initially. If viewed as politically motivated rather than justified by easing inflation, however, inflation expectations and term premiums could rise, steepening the curve and weighing on equity valuations.

Fed decisions also affect global financial conditions through US yields, the dollar and dollar-funding costs, with significant implications for emerging markets and dollar borrowers. A hold that undermines Fed credibility could weaken the dollar over time, although near-term moves would also depend on interest-rate differentials and risk sentiment.

Share of PCE Price Index Components with YoY Inflation Above 3%



Note: Calculated using Bloomberg's 221 detailed components, as details of the Fed's 199 components are unavailable.
Note: Latest data are for July 2026.
Source: SMDAM and Bloomberg

This Month's Topic (3): Exploring the Macroeconomic Drivers of Strong US and Japanese Earnings #1

- Despite higher energy and transport costs as Middle East tensions intensified and persisted, second-quarter 2026 net income rose 69.2% year on year at S&P 500 companies and 70.8% at TOPIX 500 companies. We examine the macroeconomic backdrop to these results.

- Our hypothesis is that pricing power in both countries supported earnings. The GDP deflator measures economy-wide prices and helps assess whether companies can pass rising costs through.

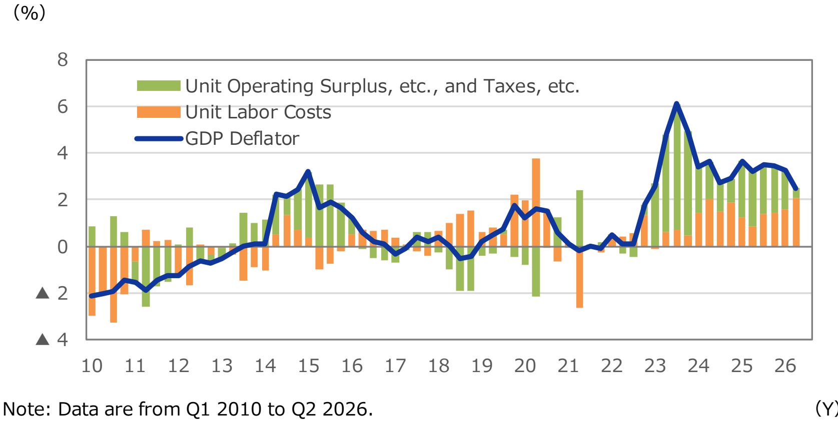
- From an income and distribution perspective, the GDP deflator can be decomposed into unit labor costs and unit operating surplus, taxes and related items. If prices rise faster than labor costs, operating surplus tends to increase.

- Historically, unit operating surplus, taxes and related items have contributed substantially to GDP-deflator inflation in both economies. This suggests firms raised prices while securing profits, rather than merely passing through labor costs. However, the composition diverged in April–June 2026.

- In the US, GDP-deflator inflation accelerated from 3.3% to 4.3%. The labor-cost contribution remained subdued, while operating surplus, taxes and related items expanded sharply. Price increases and productivity gains likely preserved profits, with pricing power, scale and productivity supporting earnings.

- In Japan, GDP-deflator inflation slowed from 3.2% to 2.6%. The contribution from operating surplus, taxes and related items remained positive but narrowed quarter on quarter.

Decomposition of Japan's GDP Deflator (YoY)

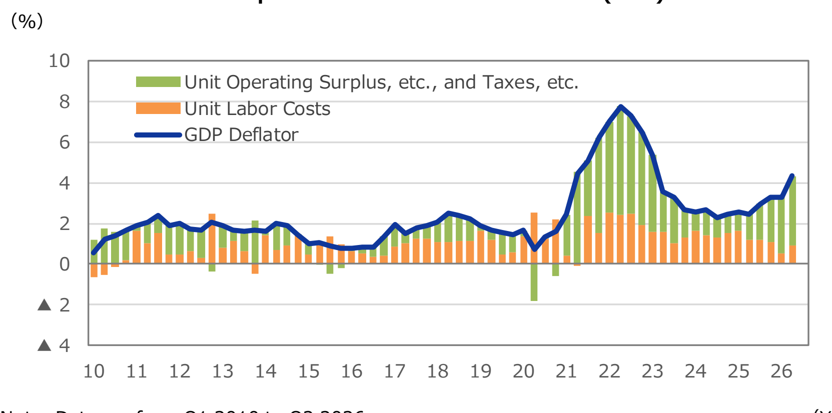


Note: Data are from Q1 2010 to Q2 2026.

Note: Unit labor costs (ULCs) equal nominal employee compensation divided by real GDP. Unit operating surplus, etc., and taxes, etc. are the GDP-deflator residual after deducting the ULC contribution.

Source: SMDAM and the Cabinet Office

Decomposition of the US GDP Deflator (YoY)



Note: Data are from Q1 2010 to Q2 2026.

Note: Unit labor costs (ULCs) equal nominal employee compensation divided by real GDP. Unit operating surplus, etc., and taxes, etc. are the GDP-deflator residual after deducting the ULC contribution.

Source: SMDAM and the US Bureau of Economic Analysis

This Month's Topic (3): Exploring the Macroeconomic Drivers of Strong US and Japanese Earnings #2

- Japan's slowdown reflected export-deflator inflation of 13.3% and higher import-deflator inflation of 15.0%. Because imports are deducted from GDP, higher import prices depress the GDP deflator. Middle East-driven oil and transport costs worsened Japan's terms of trade, partly offsetting price increases and reducing the operating-surplus contribution.

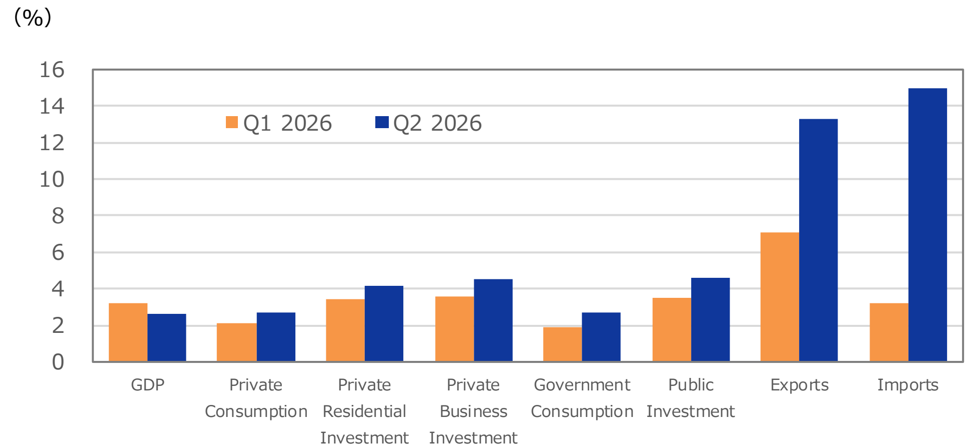
- Yet Japanese firms retained pricing power. Private-consumption deflator inflation accelerated from 2.1% to 2.7%, business-investment inflation from 3.6% to 4.5%, and export inflation from 7.1% to 13.3%. Export prices rose in yen and contract-currency terms, suggesting exporters raised overseas prices and protected profits.

- Profits were more resilient at energy-efficient, low-energy businesses and exporters of high-value-added products. Import-dependent firms with limited domestic pricing power faced greater pressure, likely widening performance gaps.

- The TOPIX 500 earnings surge cannot be explained by price increases alone. AI and semiconductor demand, yen translation effects, and income from overseas subsidiaries and local production also contributed, reflecting returns from foreign direct investment and exposure to US growth.

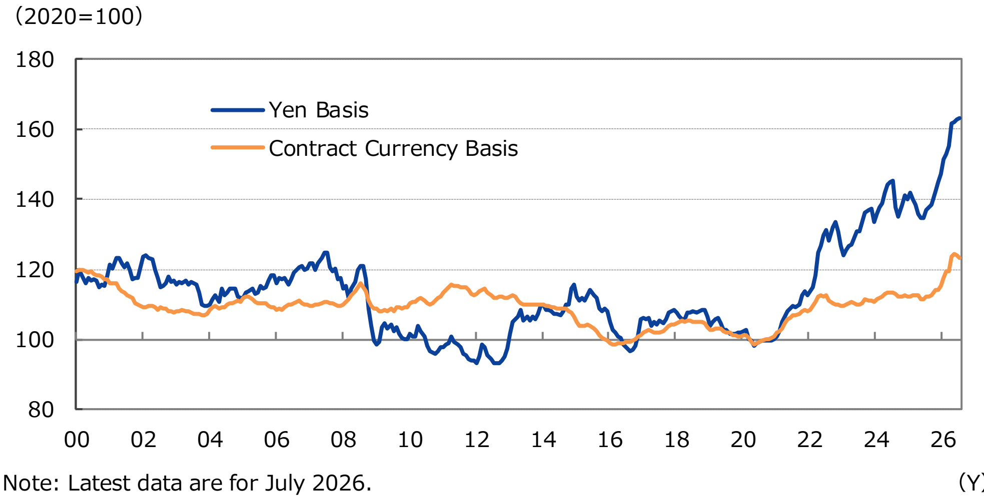
- Near term, prolonged conflict may raise import costs and long-term yields, pressuring margins and P/E ratios differently across companies. Still, earnings growth despite deteriorating terms of trade demonstrates resilience. Easing import inflation and labor-saving investment that absorbs wage increases and improves margins could support Japanese equities over the medium term.

Japan's GDP Deflator and Deflators by Demand Component (YoY)



Source: SMDAM and the Cabinet Office

Japan Export Price Index



Note: Latest data are for July 2026.

Source: SMDAM and the BoJ

Trends in Major Asset Prices

TOPIX (Daily)

Note: Latest data are for 4 Sep 2026 (Y/M)

Source: SMDAM and Bloomberg

S&P500 (Daily)

Note: Latest data are for 4 Sep 2026 (Y/M)

Source: SMDAM and Bloomberg

Japan 10-Year Government Bond Yield (Daily)

Note: Latest data are for 4 Sep 2026 (Y/M)

Source: SMDAM and Bloomberg

USD/JPY (Daily)

Note: Latest data are for 4 Sep 2026 (Y/M)

Source: SMDAM and Bloomberg

Trends in Value/Growth and Foreign/Domestic Demand for Japanese Stocks

Japanese Stocks: Value/Growth (Daily)

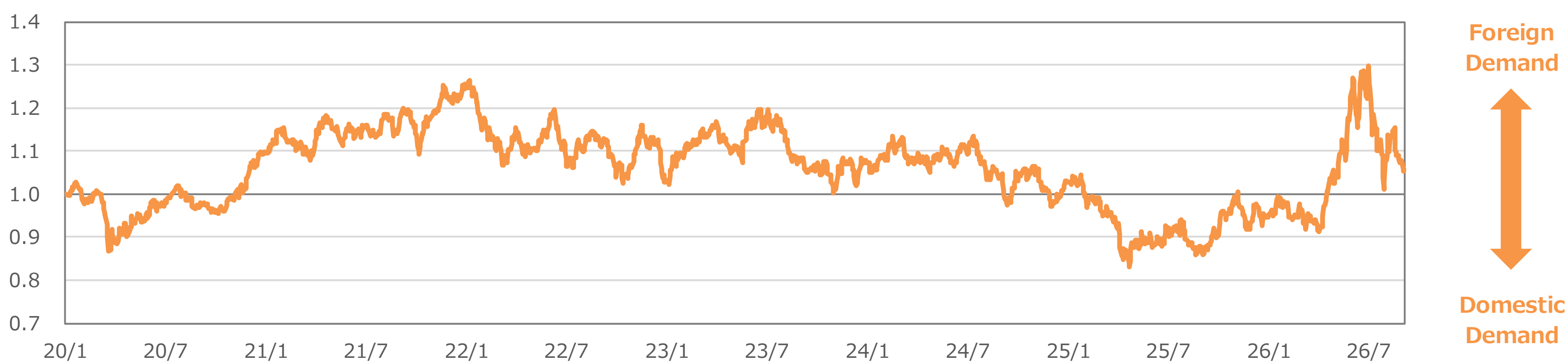
(30 Dec. 2019=1)

Note: Latest data are for 4 Sep 2026. Value/Growth represents Russell Nomura Total Market Value Index vs Growth with Dividend. (Y/M)

Source: SMDAM and Bloomberg

Japanese Stocks: Foreign Demand/Domestic Demand (Daily)

(30 Dec. 2019=1)



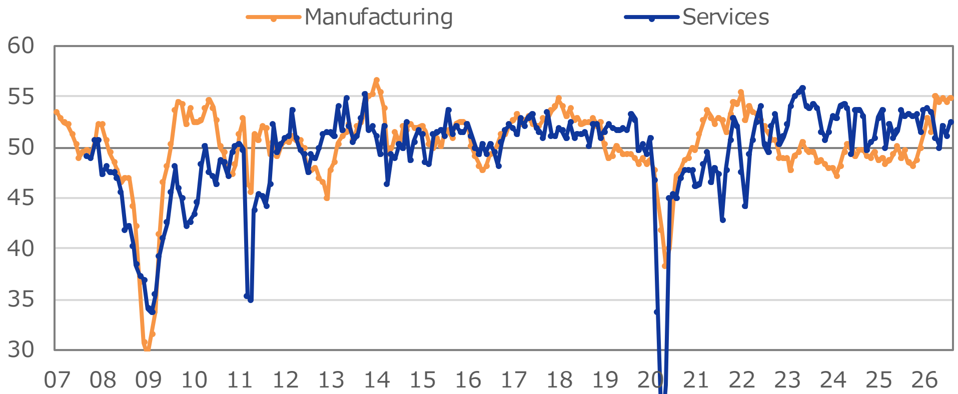
Note: Latest data are for 4 Sep 2026. Foreign/Domestic Demand represents Nikkei Global Exposure 50 vs Domestic. (Y/M)

Source: SMDAM and Bloomberg

Japanese Economic Indicators (1)

PMI

(sa, >50=improvement since previous month)



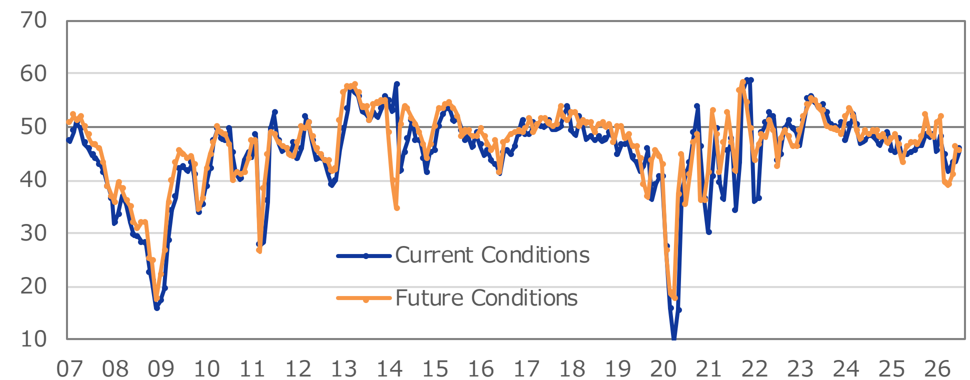
(Y)

Note: Latest data are for Aug 2026

Source: SMDAM and S&P Global

Economy Watchers Survey

(sa, DI)



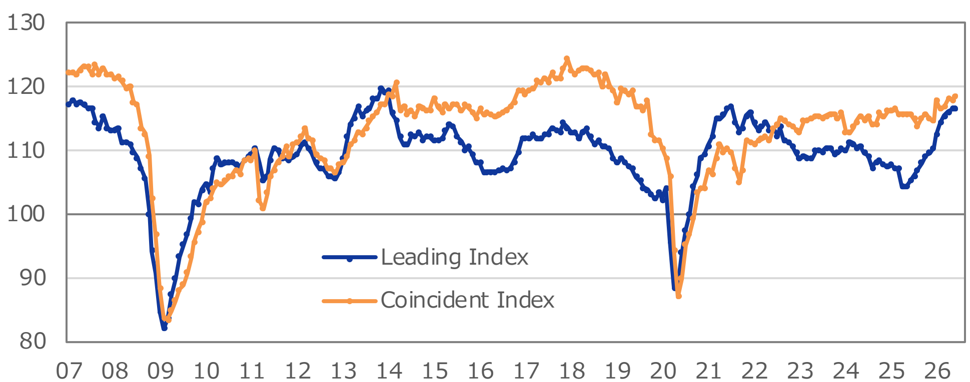
(Y)

Note: Latest data are for Jul 2026

Source: SMDAM and Cabinet Office

Index of Business Conditions

(sa, 2020=100)



(Y)

Note: Latest data are for Jun 2026

Source: SMDAM and Cabinet Office

Machine Tools (Orders YoY - Order Backlogs YoY)

(%)

(Y)

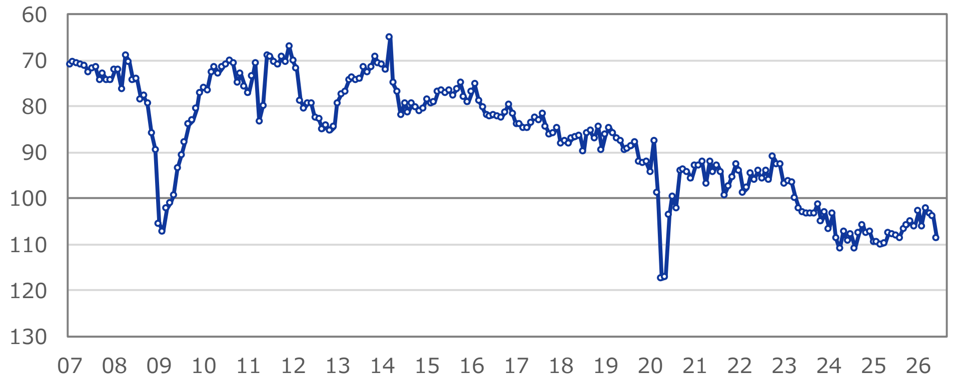
Note: Latest data are for Jul 2026

Source: SMDAM and Japan Machine Tool Builders’ Association

Japanese Economic Indicators (2)

Index of Producer's Inventory Ratio of Final Demand Goods

(sa, 2020=100, Inverted)

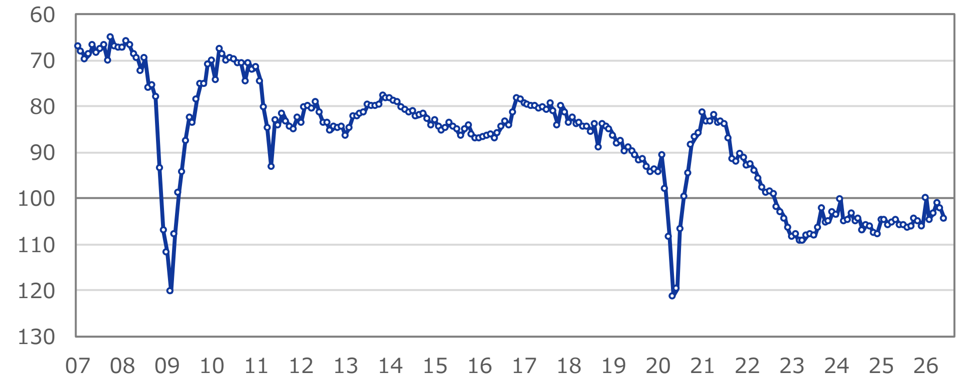


Note: Latest data are for Jun 2026

Source: SMDAM and Cabinet Office

Index of Producer's Inventory Ratio of Producer Goods

(sa, 2020=100, Inverted)

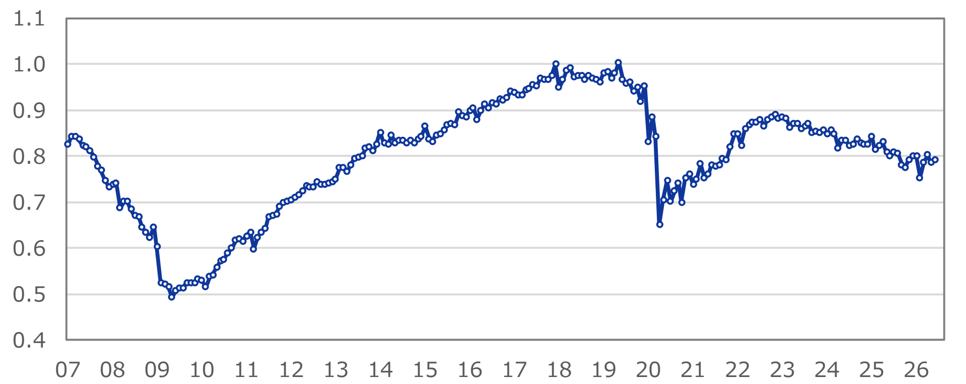


Note: Latest data are for Jun 2026

Source: SMDAM and Cabinet Office

New Job Offers (Excluding New School Graduates)

(sa, million persons)

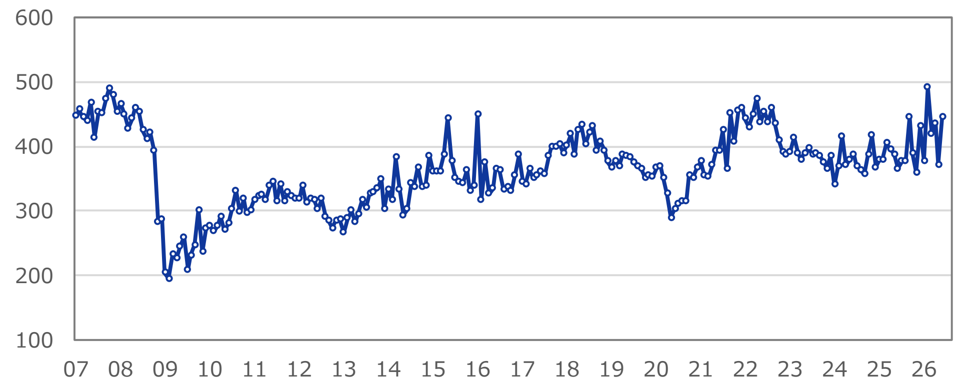


Note: Latest data are for Jun 2026

Source: SMDAM and Cabinet Office

Machinery Orders at Constant Prices (Manufacturing)

(sa, billion JPY)



Note: Latest data are for Jun 2026

Source: SMDAM and Cabinet Office

Japanese Economic Indicators (3)

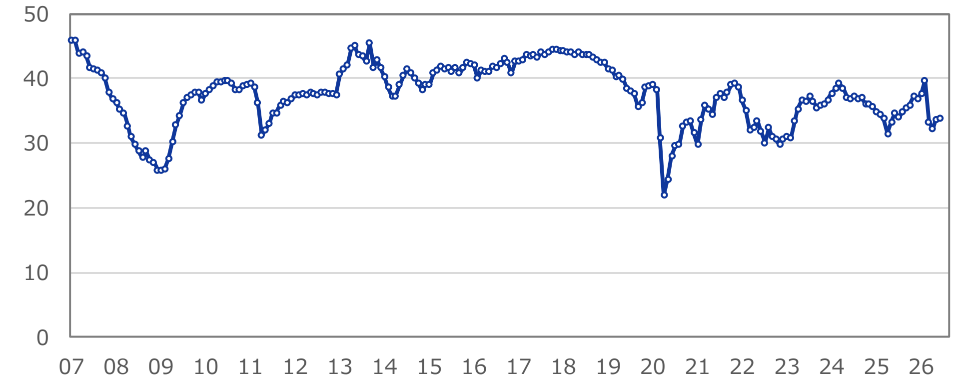
Total Floor Area of New Housing Construction Started

(million ㎡)

Note: Latest data are for Jun 2026 (Y)

Source: SMDAM and Cabinet Office

Consumer Confidence Index

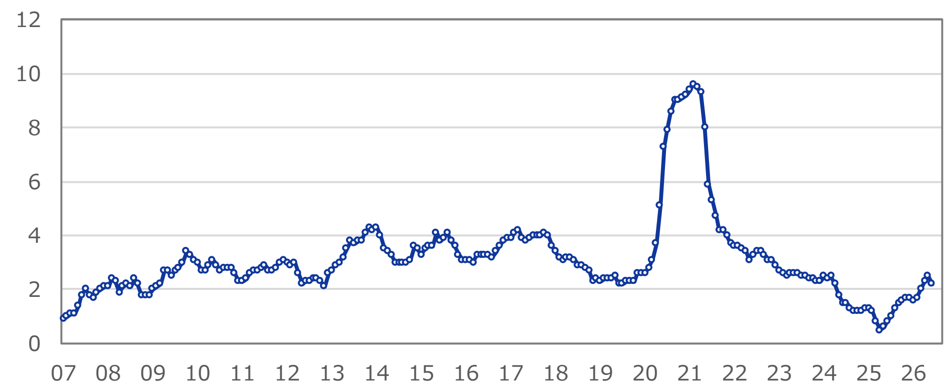


Note: Latest data are for Jun 2026 (Y)

Source: SMDAM and Cabinet Office

M2(YoY)

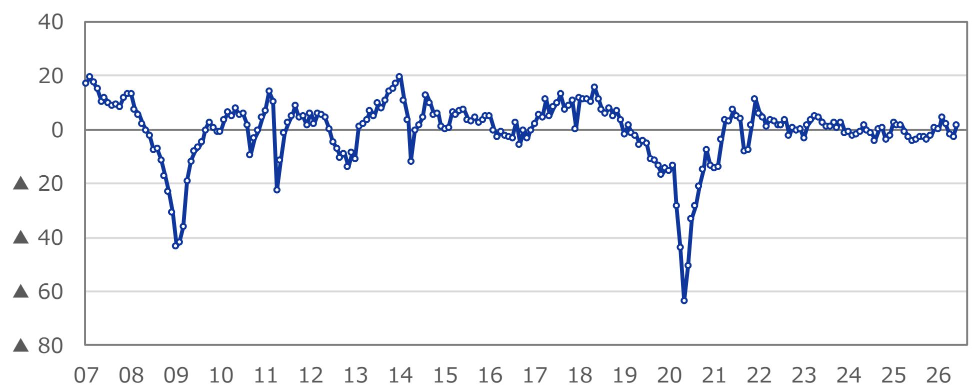
(%)



Note: Latest data are for Jun 2026 (Y)

Source: SMDAM and Cabinet Office

Sales Forecast DI of Small Businesses

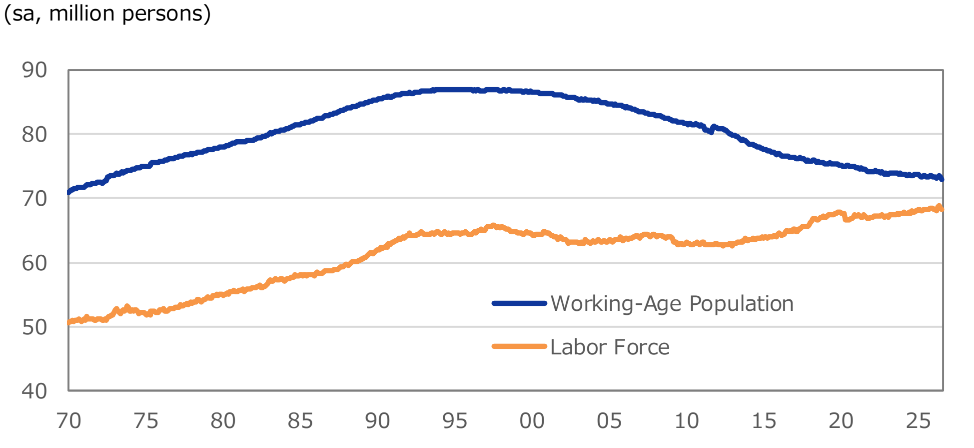


Note: Latest data are for Jun 2026 (Y)

Source: SMDAM and Cabinet Office

Japanese Economic Indicators (4)

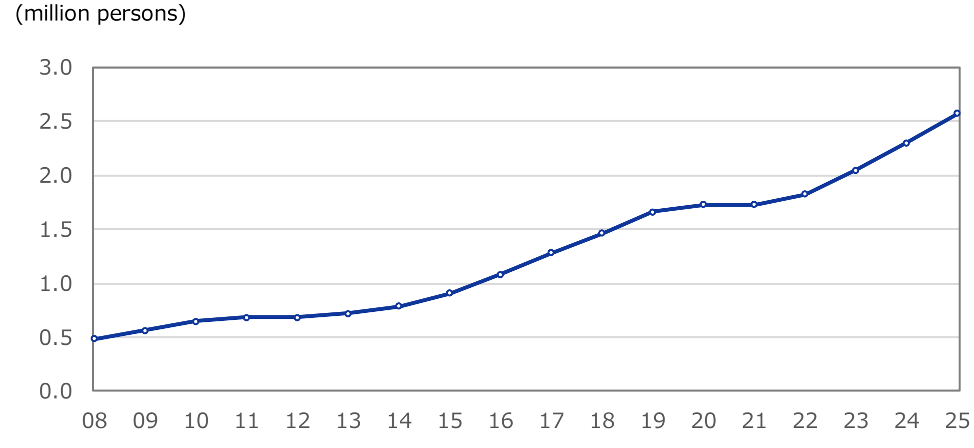
Working-Age Population and Labor Force



Note: Latest data are for Jul 2026

Source: SMDAM and MIC

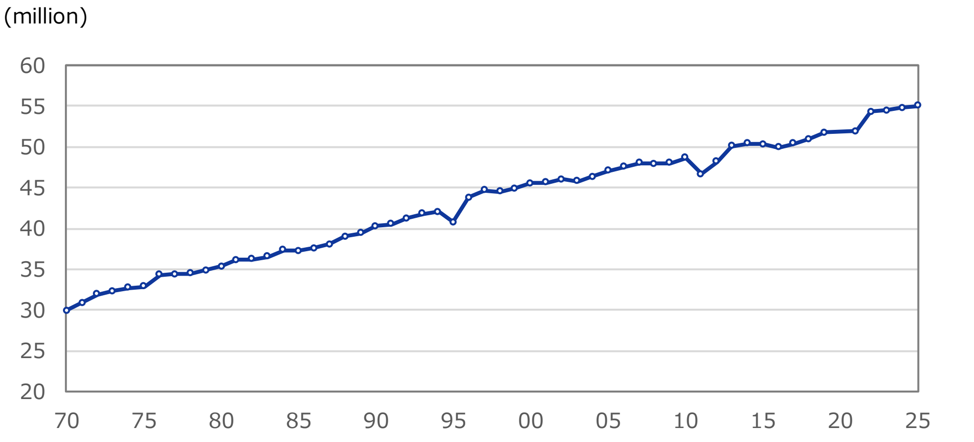
Number of Foreign Workers



Note: Latest data are for 2025

Source: SMDAM and MHLW

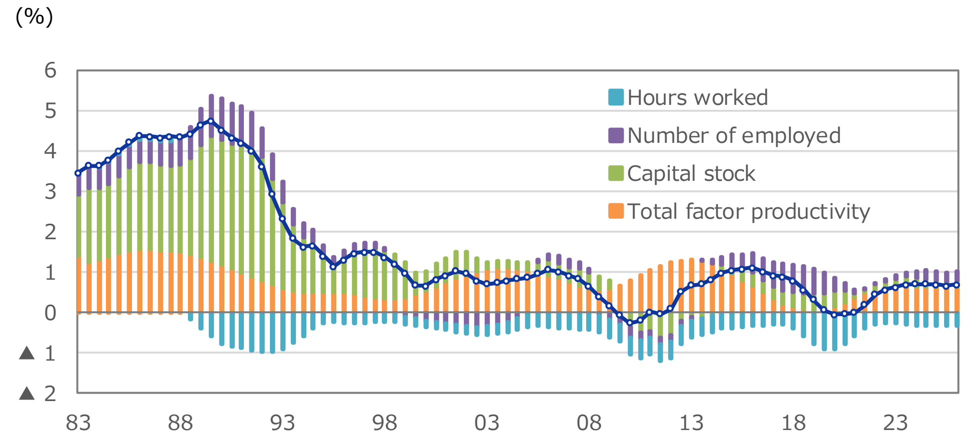
Number of Households



Note: Latest data are for 2025

Source: SMDAM and Cabinet Office

Potential Growth Rate

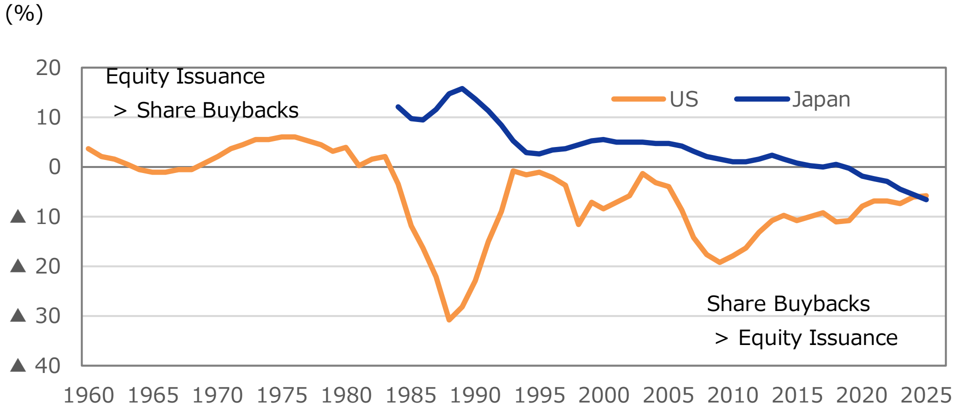


Note: Latest data are for 1Q 2026

Source: SMDAM and BoJ

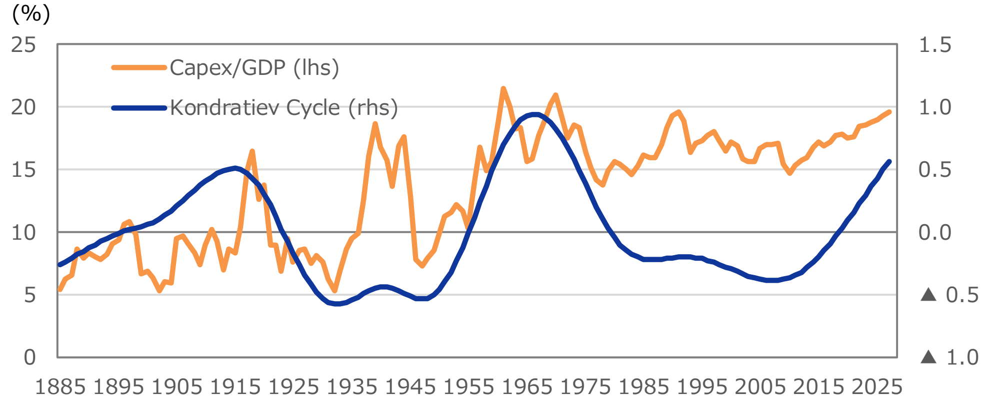
Japanese Economic Indicators (5)

Net Equity Issuance in Japan and the US



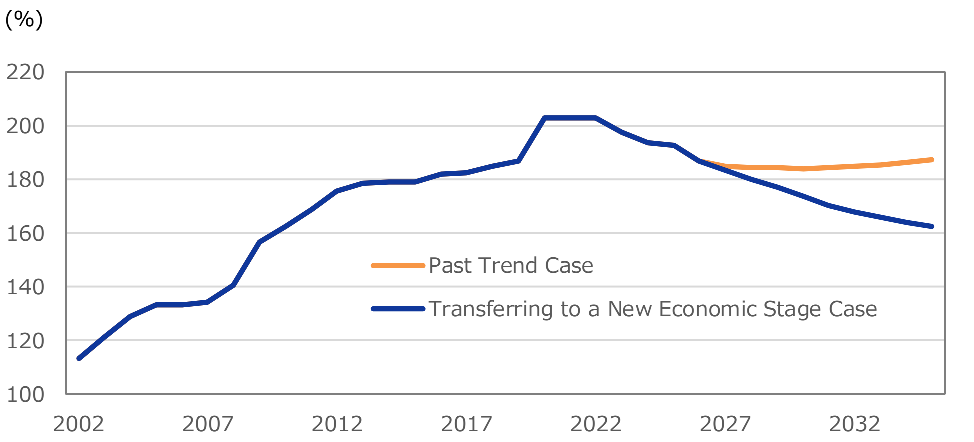
Note: Latest data are for 2025.
Note: Net Equity Issuance / Market Cap (5Y MA)
Source: SMDAM, BoJ and FRB

Japan Capex/GDP Ratio (Long-Term Trend) and Kondratiev Cycle



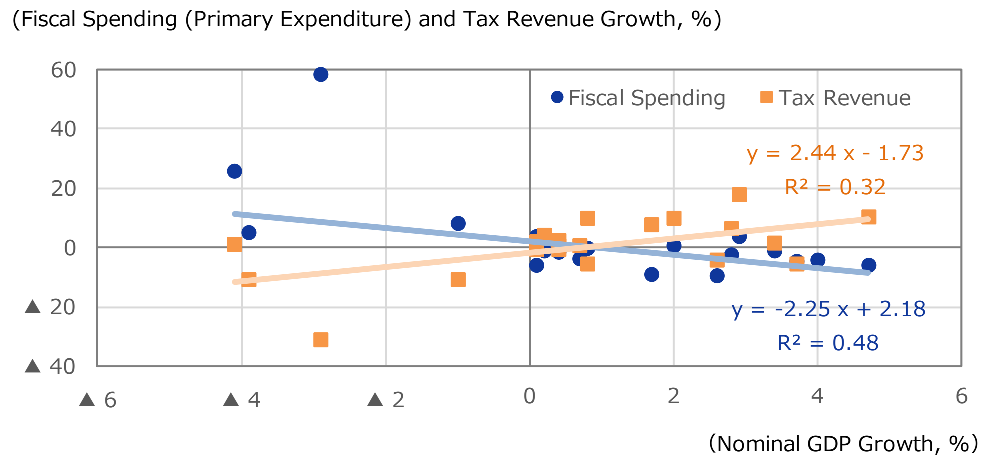
Note: Latest data are for 2027 (including some forecasts)
Note: Kondratiev Cycle is statistically derived as a 40 to 70 year cycle from the Capex/GDP ratio.
Source: SMDAM and Cabinet Office

Debt-to-GDP Projection (Medium to Long Term) by Cabinet Office



Note: Latest data are for 2035 (including some forecasts)
Note: New Economic Stage assumes 3% nominal growth. Source: SMDAM and Cabinet Office

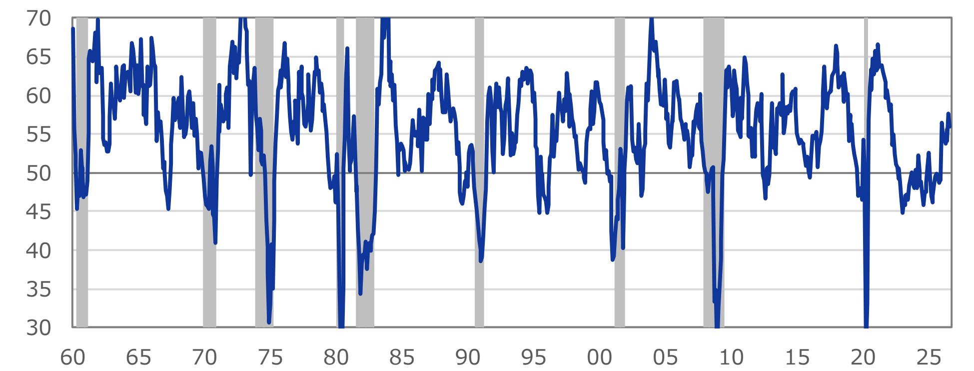
Fiscal Spending, Tax Revenue, and Nominal GDP Growth



Note: The Data covers FY2003 to 24, and the regression line is calculated excluding outliers.
Source: SMDAM and Cabinet Office

US Economic Indicators

ISM Manufacturing PMI (Average of Production and New Orders)

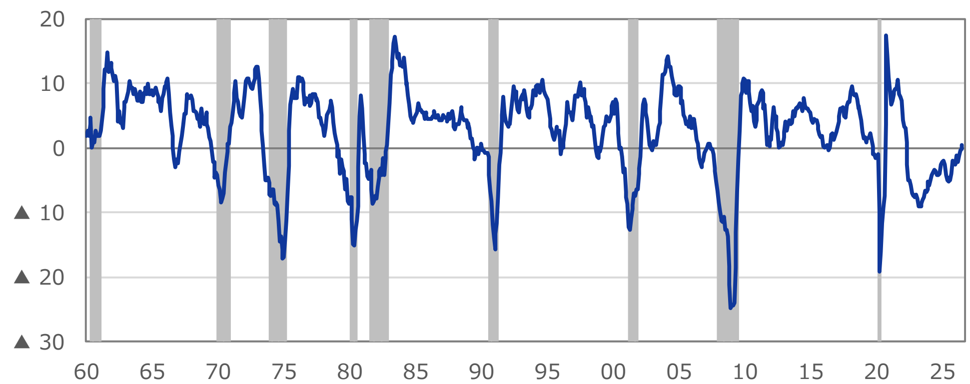


Note: Latest data are for Aug 2026. The shaded areas represent periods of recession. (Y)

Source: SMDAM and ISM

Conference Board Leading Economic Index

(6-Month Annual Change)

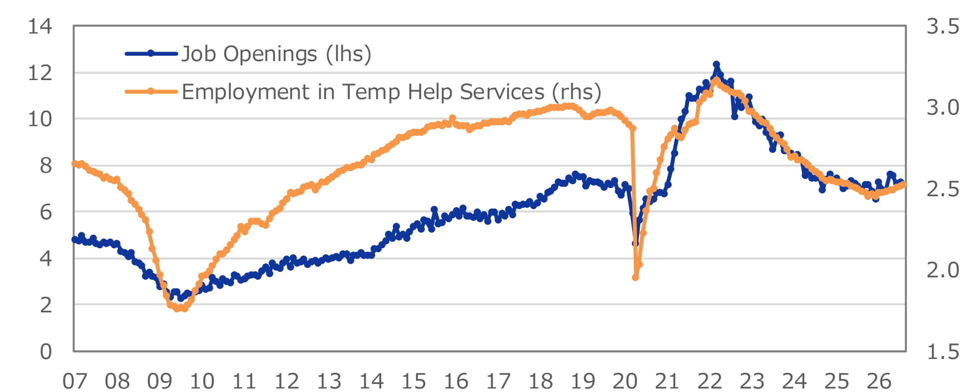


Note: Latest data are for Jul 2026. The shaded areas represent periods of recession. (Y)

Source: SMDAM and Conference Board

Job Openings and Employment in Temporary Help Services

(sa, million persons) (sa, million persons)

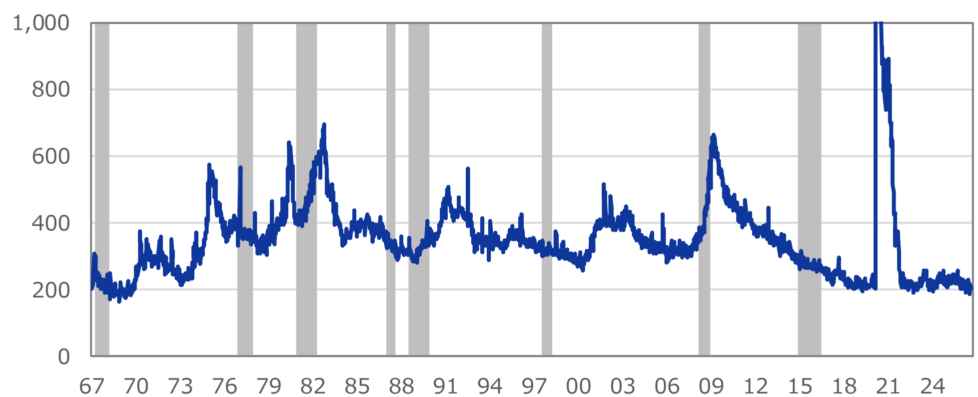


Note: Latest data are for Aug 2026 (Y)

Source: SMDAM and Bureau of Labor Statistics

Initial Jobless Claims

(sa, thousand persons)



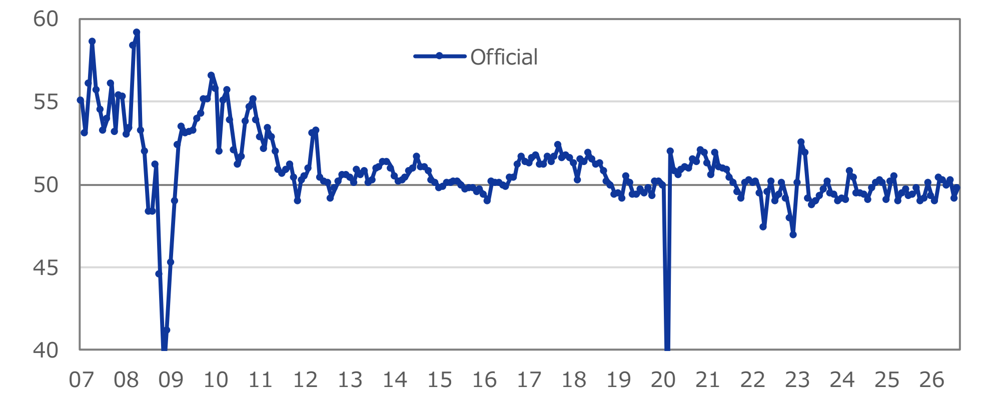
Note: Latest data are for 28 Aug 2026. The shaded areas represent periods of recession (Y)

Source: SMDAM and Department of Labor

Overseas Economic Indicators

China Manufacturing PMI

(sa, >50=improvement since previous month)

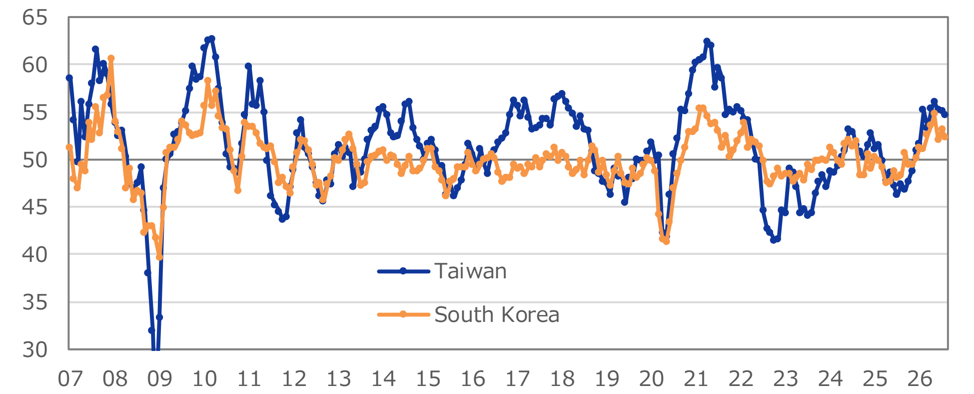


Note: Latest data are for Aug 2026

Source: SMDAM and China Federation of Logistics & Purchasing

Manufacturing PMI (Taiwan, South Korea)

(sa, >50=improvement since previous month)

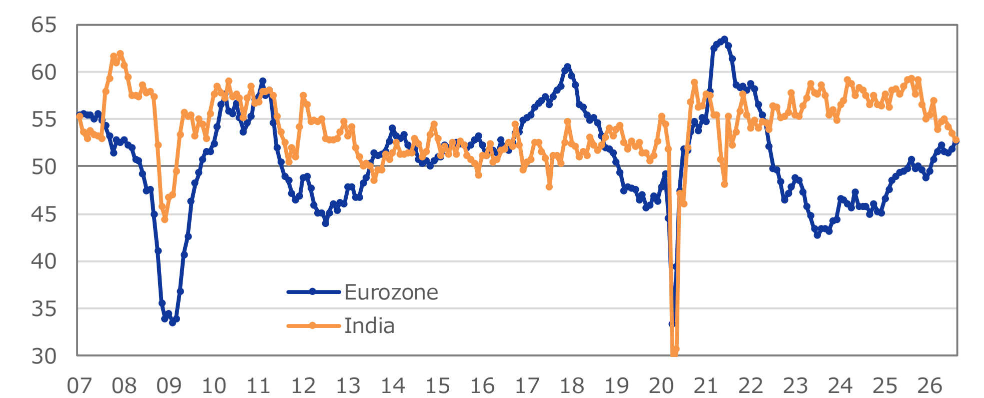


Note: Latest data are for Aug 2026

Source: SMDAM and S&P Global

Manufacturing PMI (Eurozone, India)

(sa, >50=improvement since previous month)

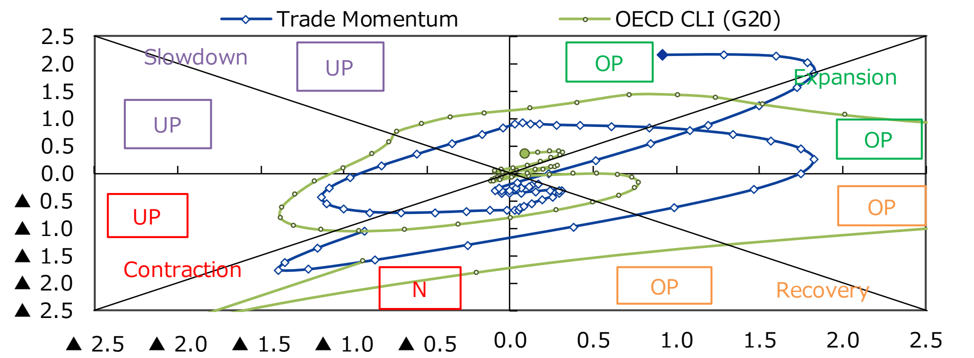


Note: Latest data are for Aug 2026

Source: SMDAM and S&P Global

Trade Momentum & OECD Composite Leading Indicator (CLI) Phases

Trade Momentum (Z-score) / OECD CLI Level (Index - 100)



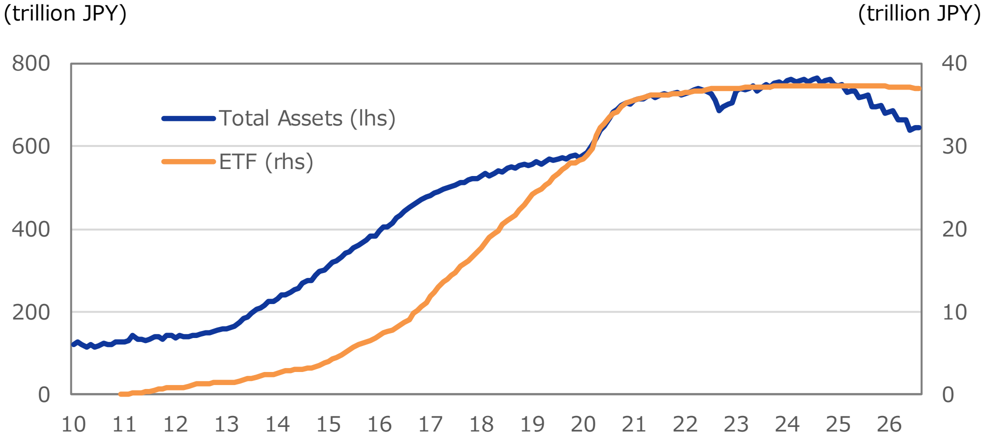
Note: Latest data are for Jul 2026

Note: Trade momentum shows cycles from indicators; OP/N/UP = past Japan stock performance

Source: SMDAM, OECD, S&P Global, LSEG and Bloomberg

BOJ Monetary Policy (1)

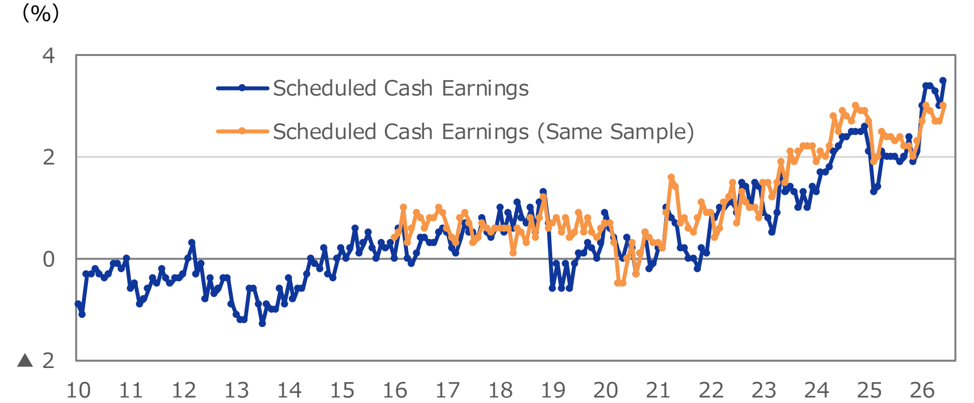
The Bank of Japan's Balance Sheet



Note: Latest data are for Aug 2026

Source: SMDAM and BoJ

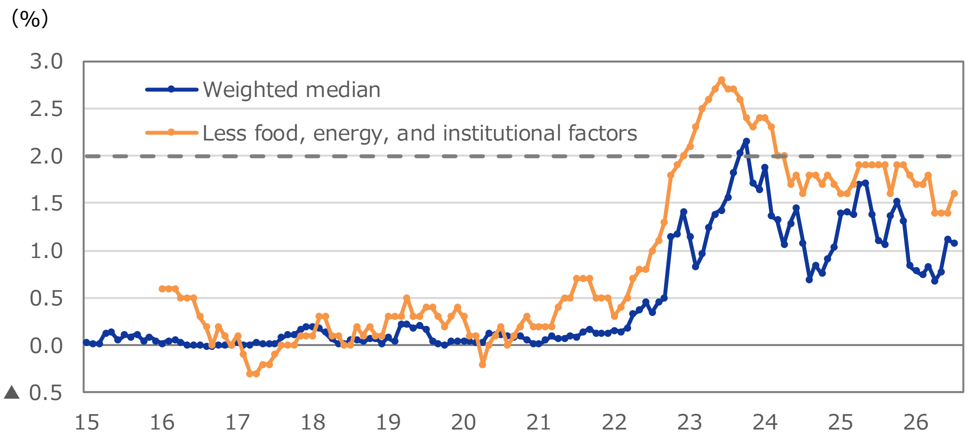
Nominal Wages (Scheduled Cash Earnings, YoY)



Note: Wage surveys change samples yearly. "Same Sample" uses only the same samples as the previous year to avoid gaps caused by such changes.

Note: Latest data are for Jun 2026 Source: SMDAM and MHLW

Indicators for Core CPI (YoY)



Note: Latest data are for Jul 2026

Source: SMDAM and BoJ

10-year Breakeven Inflation Rate

Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

Note: "Scheduled Cash Earnings" are based on different data samples for each survey conducted by MHLW. "Scheduled Cash Earnings (Same Sample)" refers to data based on the same surveyed companies. This data is published to provide a more accurate understanding of wage trends and started to be published by MHLW from 2016.

BOJ Monetary Policy (2)

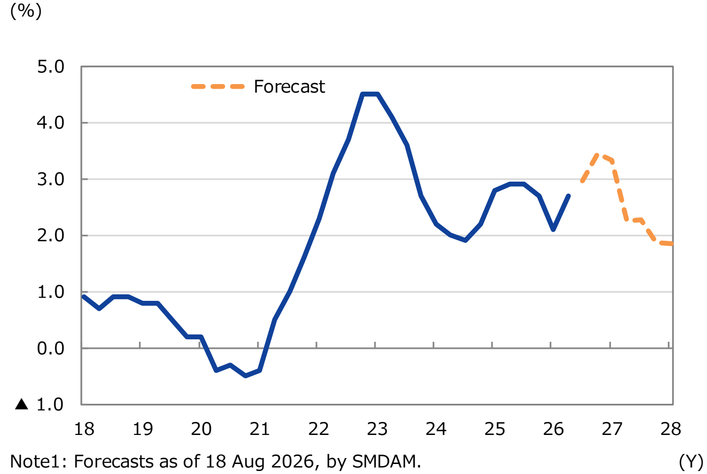
BOJ Monetary Policy Developments (Quarter-End and Latest)

	Mar 2026	Jun 2026	Jul 2026
O/N call rate	around 0.75%	Around 1.0% (rate hike)	Around 1.0%
Rate on Deposit Facility	0.75%	1.0%	1.0%
Objection to the monetary policy guideline	Committee member Takata opposed the policy of maintaining the current level and proposed an increase to around 1.00%.	Committee member Asada dissented, arguing that the Bank should maintain the guideline for money market operations.	Committee member Takata opposed the policy of maintaining the current level and proposed an increase to around 1.25%.
Conduct of Monetary Policy	Given that real interest rates are at significantly low levels, if the outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation.	Given that underlying CPI inflation has been approaching 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while closely monitoring the impact of the future course of the situation in the Middle East on Japan's economic activity and prices and examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook.	Given that underlying CPI inflation has been approaching 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook, including the impact of the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates.
JGB purchases	No Change	The Bank will reduce the planned amount of its monthly purchases of JGBs by, in principle, about 200 billion yen each calendar quarter until January-March 2027. From April 2027, the amount of its monthly purchases of JGBs will be about 2 trillion yen.	No Change
ETF Purchases	No Change	No Change	No Change

Note: Data as of 4 Sep 2026

Source: SMDAM and BOJ

CPI (less fresh food & institutional factors, YoY)

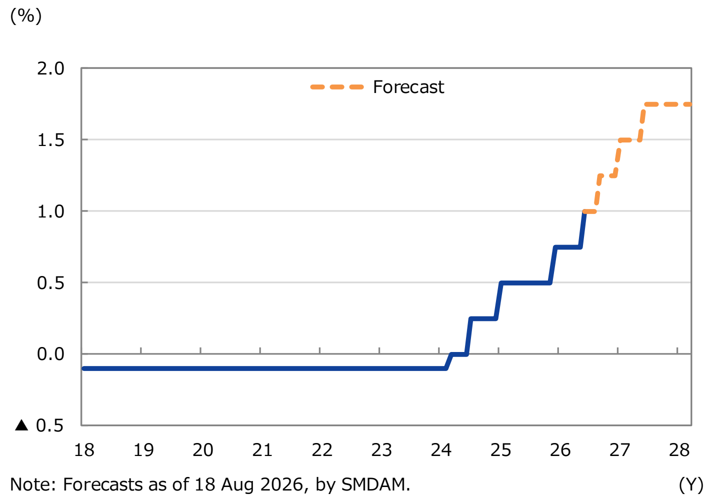


Note1: Forecasts as of 18 Aug 2026, by SMDAM.

Note2: Consumption tax-adjusted.

Source: SMDAM and BOJ

Policy interest rate

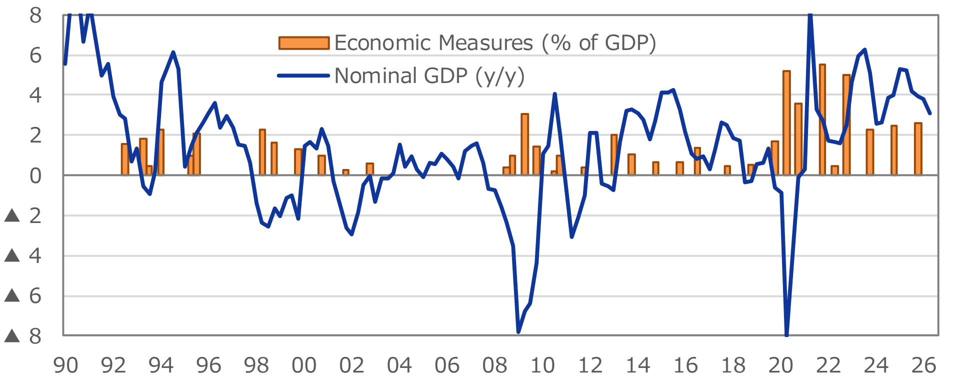


Note: Forecasts as of 18 Aug 2026, by SMDAM.

Source: SMDAM and BOJ

Japan’s Fiscal policy

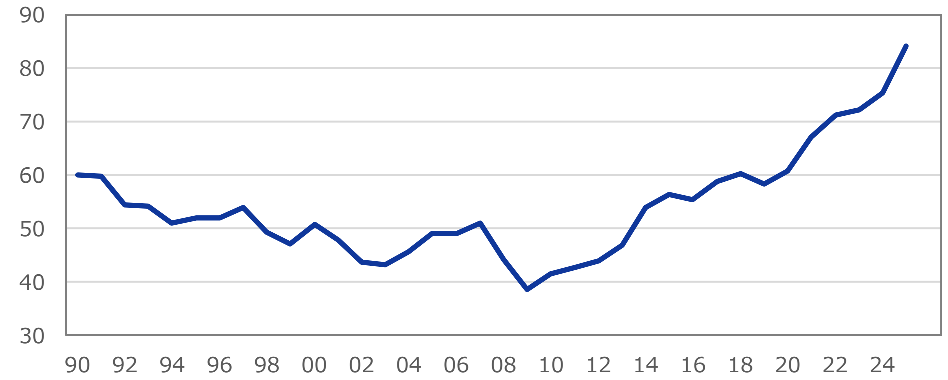
Government Economic Measures and Nominal GDP Growth Rate



Note: Latest data are for 2Q 2026. Economic measures are budget-backed amounts.

Source: SMDAM and Cabinet Office

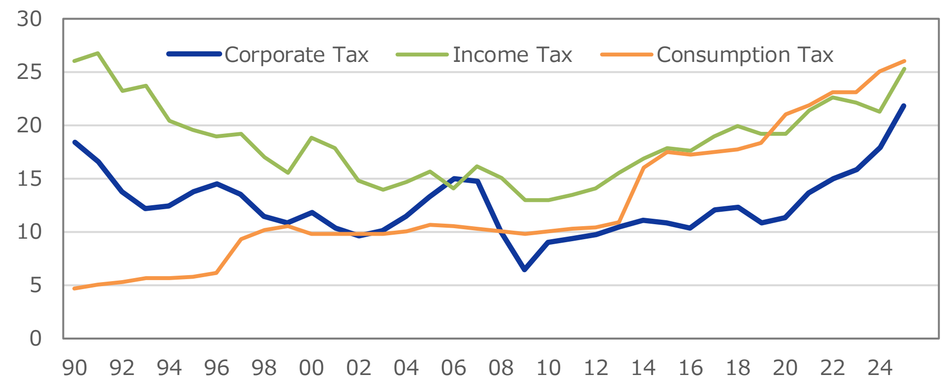
Japan's Tax Revenue



Note: Latest data are for FY2025

Source: SMDAM and MoF

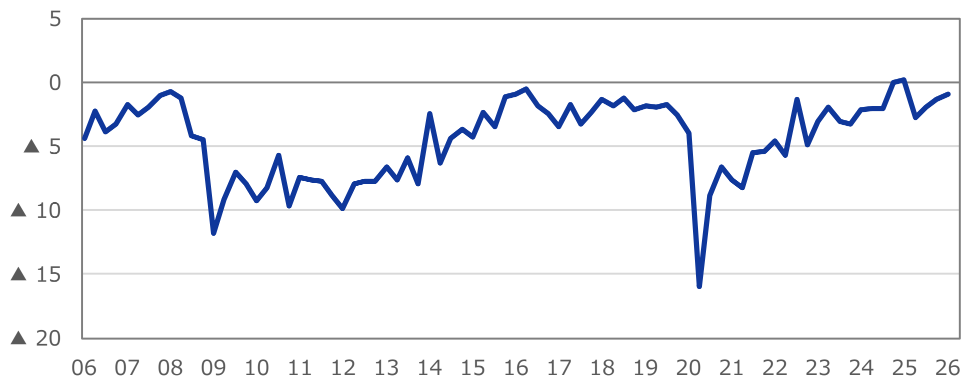
Breakdown of Tax Revenue



Note: Latest data are for FY2025

Source: SMDAM and MoF

Japan's Fiscal Balance (as a Percentage of GDP)



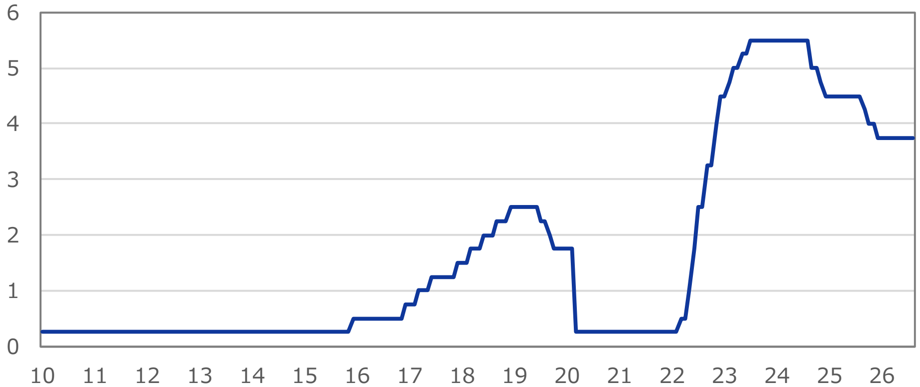
Note: Latest data are for 1Q 2026

Source: SMDAM and BoJ

Overseas Monetary Policy

Federal Funds Target Rate (Upper Bound)

(%)

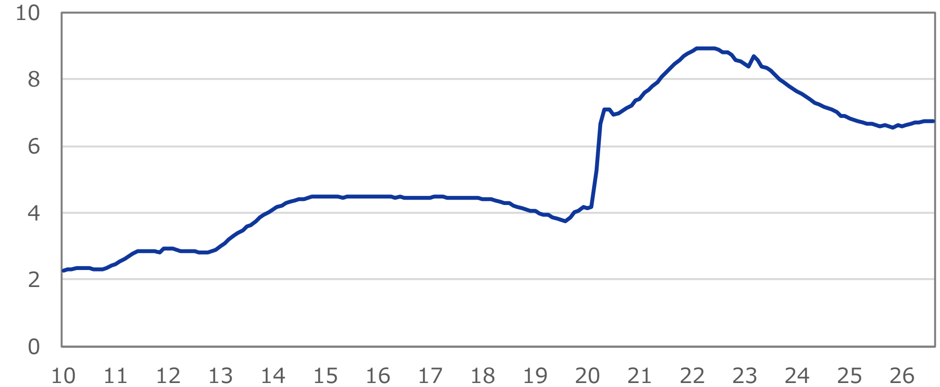


Note: Latest data are for Aug 2026

Source: SMDAM and FRB

Federal Reserve Total Assets

(trillion USD)

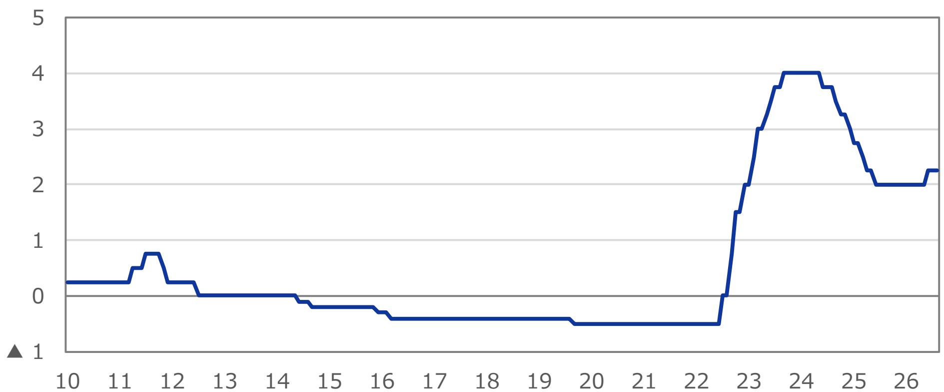


Note: Latest data are for Aug 2026

Source: SMDAM and FRB

ECB Deposit Facility Announcement Rate

(%)

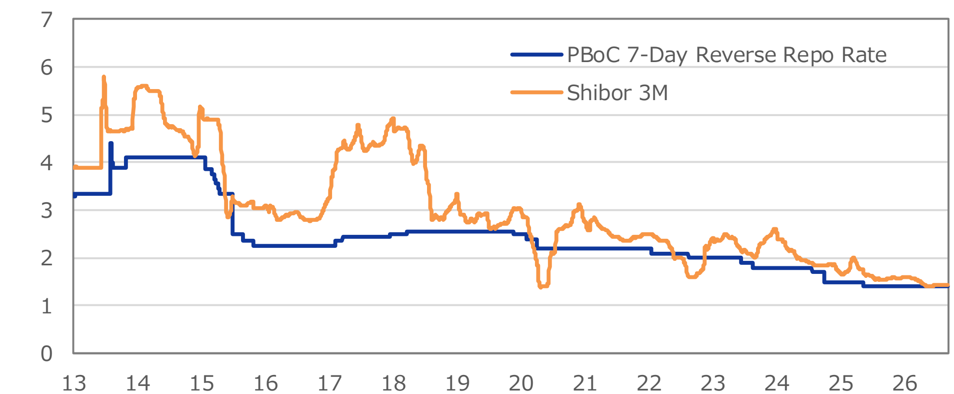


Note: Latest data are for Aug 2026

Source: SMDAM and ECB

China's Short-Term Interest Rates

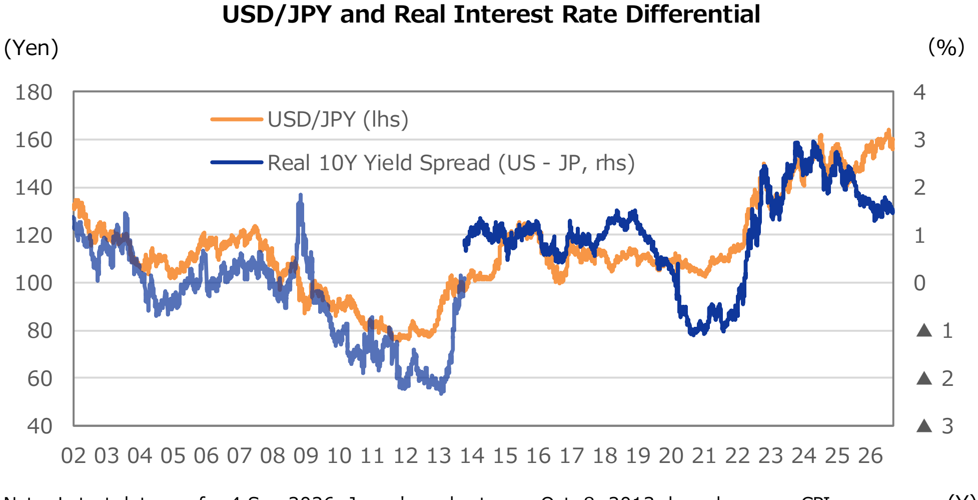
(%)



Note: Latest data are for 4 Sep 2026

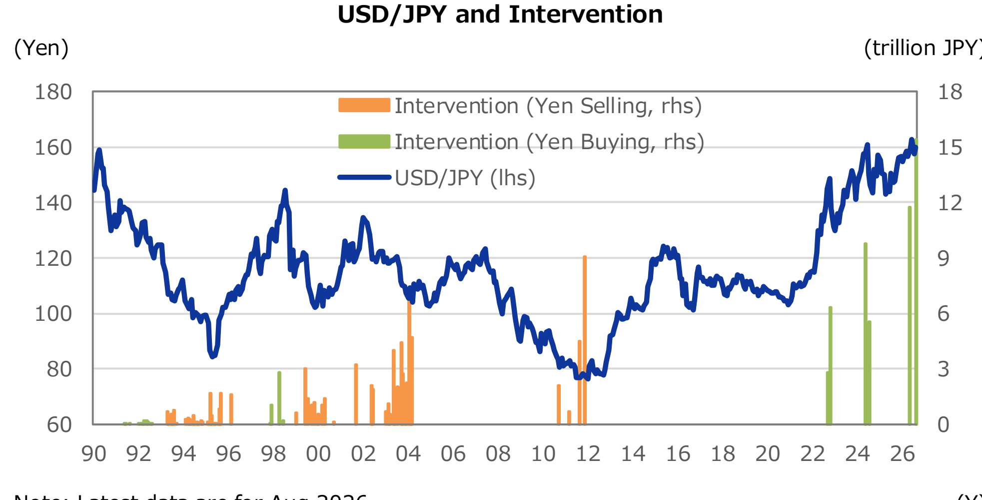
Source: SMDAM, PBoC and Bloomberg

USD/JPY



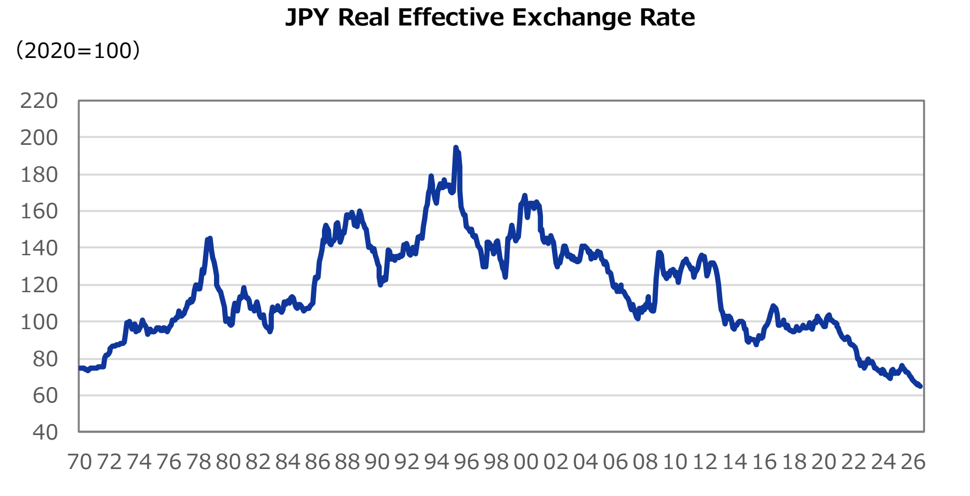
Note: Latest data are for 4 Sep 2026. Japan's real rate pre-Oct. 8, 2013, based on core CPI.

Source: SMDAM and Bloomberg



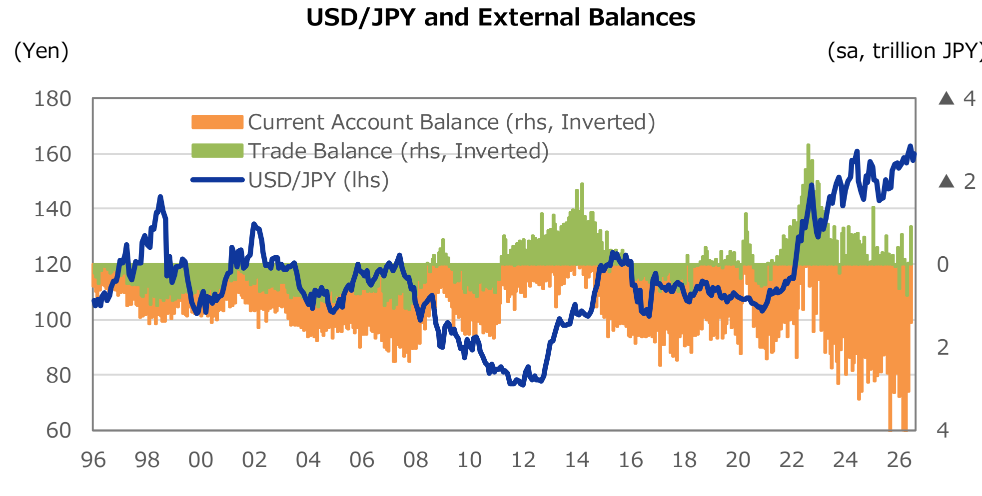
Note: Latest data are for Aug 2026

Source: SMDAM, MoF and Bloomberg



Note: Latest data are for Jul 2026

Source: SMDAM and BoJ



Note: Latest data are for Aug 2026

Source: SMDAM, MoF and Bloomberg

Earnings Forecast:

Bottom-Up Corporate Earnings Forecast for Japan

Forecasts as of 15 Jun 2026	FY24 billion JPY (A)	FY25 billion JPY (A)	FY26 billion JPY (E)	FY27 billion JPY (E)	FY25 YoY, % (A)	FY26 YoY, % (E)	FY27 YoY, % (E)
Revenue							
Total (Ex-Financials)	688,760	707,743	764,815	796,418	+2.8	+8.1	+4.1
Manufacturing	405,212	414,512	452,488	471,783	+2.3	+9.2	+4.3
Non-Manufacturing	283,549	293,231	312,327	324,635	+3.4	+6.5	+3.9
Total (Ex-Financials, Ex-SoftBank G)	681,517	699,944	756,280	787,333	+2.7	+8.0	+4.1
Operating Profit							
Total (Ex-Financials)	60,181	63,364	77,383	83,354	+5.3	+22.1	+7.7
Manufacturing	33,638	33,323	47,838	54,938	▲ 0.9	+43.6	+14.8
Non-Manufacturing	26,543	30,041	29,545	28,416	+13.2	▲ 1.6	▲ 3.8
Total (Ex-Financials, Ex-SoftBank G)	55,750	56,083	73,148	82,590	**+0.6**	**+30.4**	**+12.9**
Ordinary Profit							
Total (Ex-Financials)	62,528	66,984	81,070	86,528	+7.1	+21.0	+6.7
Manufacturing	35,920	35,650	49,534	56,459	▲ 0.8	+38.9	+14.0
Non-Manufacturing	26,608	31,334	31,536	30,069	+17.8	+0.6	▲ 4.6
Total (Ex-Financials, Ex-SoftBank G)	60,823	60,850	76,835	85,764	**+0.0**	**+26.3**	**+11.6**
Profit After Taxes							
Total (Incl. Financials)	52,161	56,259	68,135	71,826	+7.9	+21.1	+5.4
Total (Ex-Financials)	42,718	44,485	57,212	59,631	+4.1	+28.6	+4.2
Manufacturing	24,106	22,488	34,758	39,550	▲ 6.7	+54.6	+13.8
Non-Manufacturing	18,612	21,997	22,455	20,081	+18.2	+2.1	▲ 10.6
Total (Ex-Financials, Ex-SoftBank G)	41,565	39,482	53,962	59,920	▲ 5.0	+36.7	+11.0

Note1: Forecasts by SMDAM.

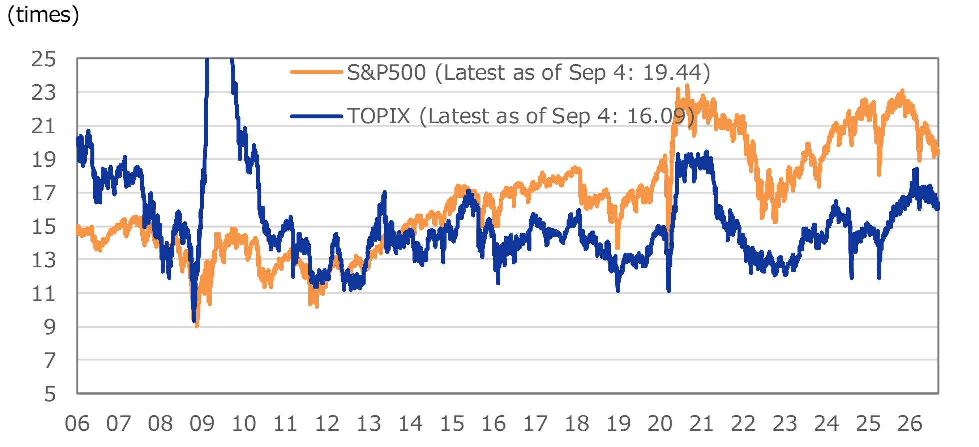
Note2: FX assumptions are USD/JPY at 159 and EUR/JPY at 186. A 1 JPY depreciation vs. USD increases ordinary profit by approximately 0.5%.

Note3: Coverage includes 402 Total (Incl. Financials), 376 Total (Ex-Financials), 226 Manufacturing, and 150 Non-Manufacturing stocks.

Note4: Aggregated earnings figures are based on in-house corporate forecasts and provided for reference only. Accuracy is not fully guaranteed.

Valuation (1)

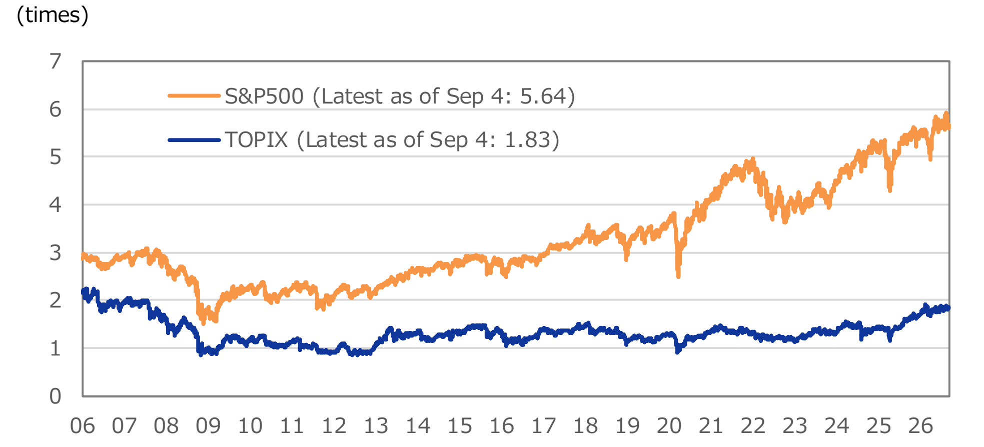
S&P 500 and TOPIX 12-Month Forward P/E Ratio



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

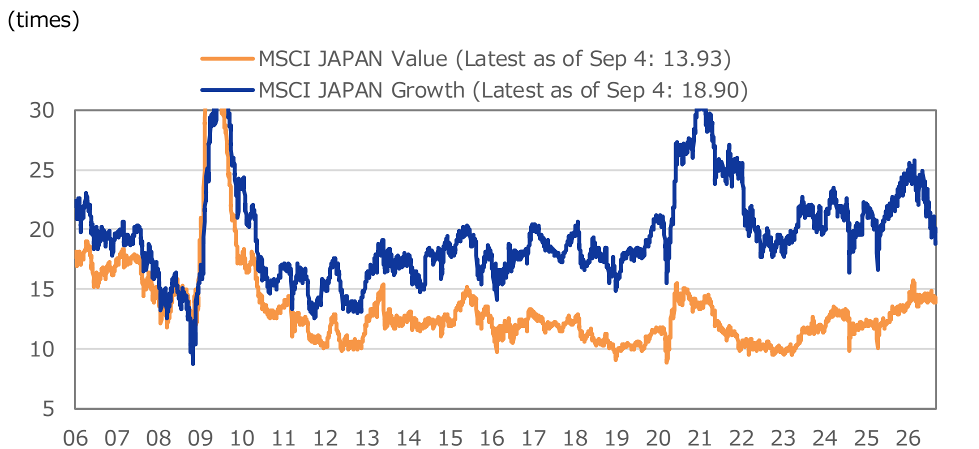
S&P 500 and TOPIX Historical P/B Ratio



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

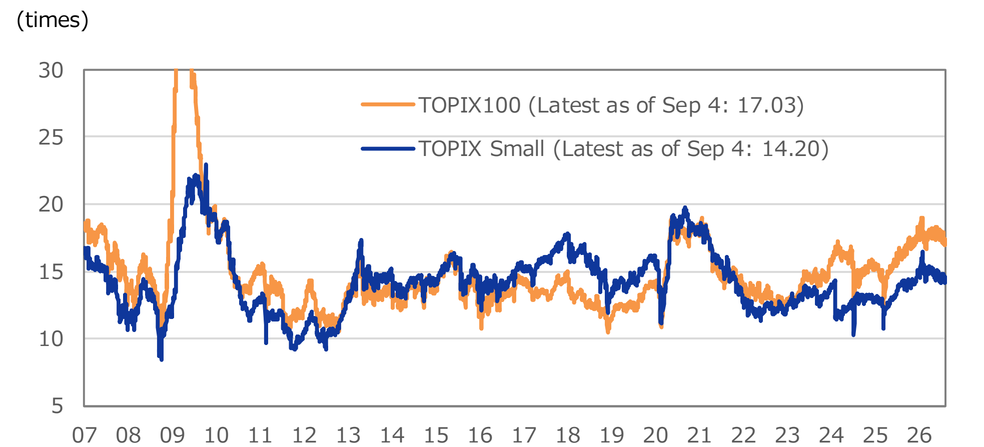
MSCI Japan 12-Month Forward P/E Ratio



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

TOPIX 100 and TOPIX Small 12M Forward P/E Ratio

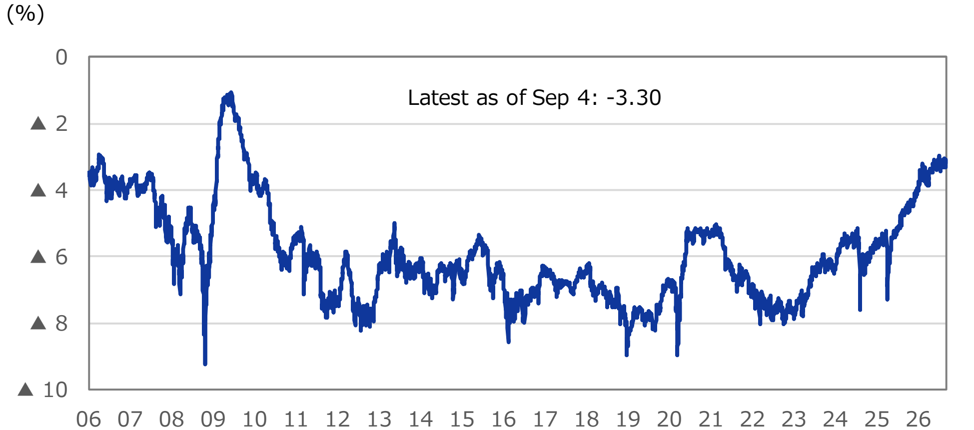


Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

Valuation (2)

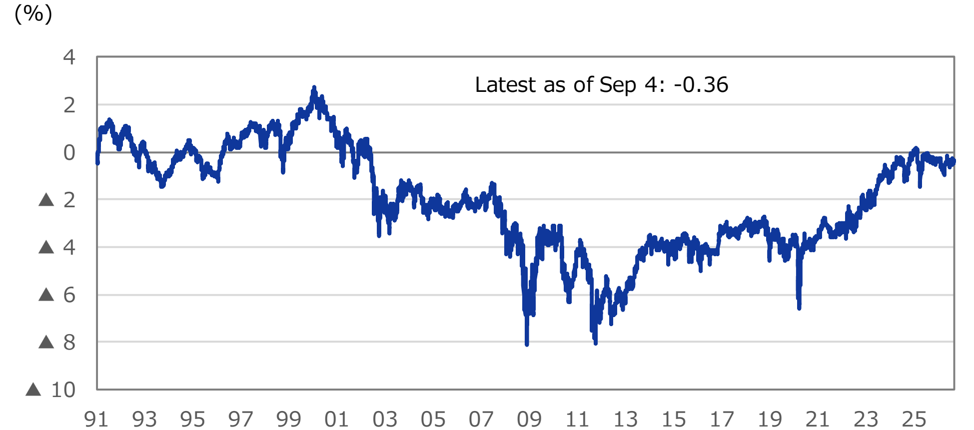
TOPIX Yield Spread (10Y JGB - Earnings Yield)



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

S&P 500 Yield Spread (10Y UST - Earnings Yield)



Note: Latest data are for 4 Sep 2026

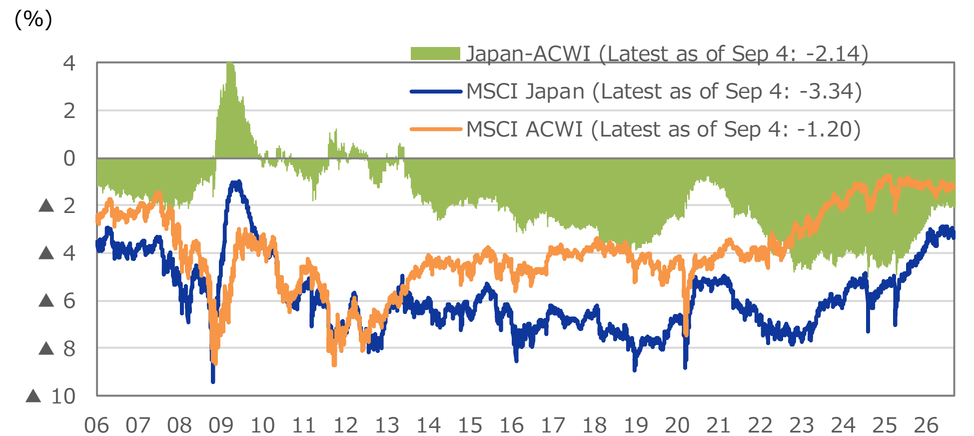
Source: SMDAM and Bloomberg

STOXX Europe 600 Yield Spread (10Y Bund - Earnings Yield)

Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

MSCI Japan and ACWI Yield Spread (10Y Bond Yield - Earnings Yield)



Note: Latest data are for 4 Sep 2026. For 10Y bond yield, Japan uses JGB, ACWI uses UST.

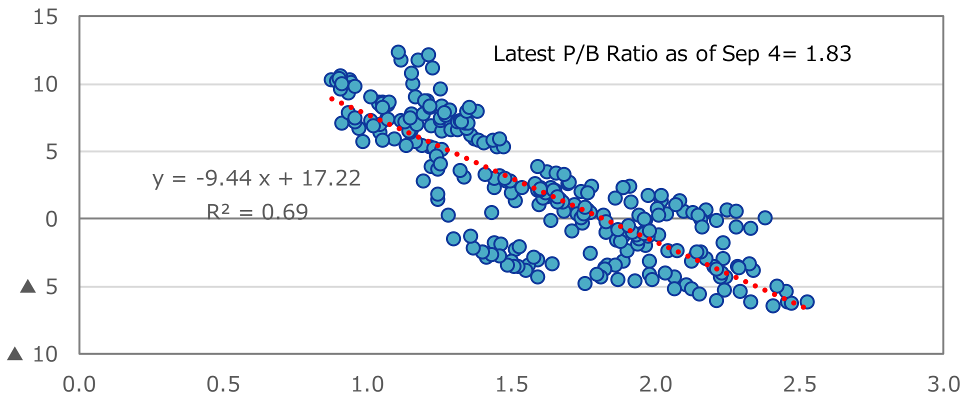
Source: SMDAM and Bloomberg

The above figures represent past performance and future forecasts, and do not guarantee the future market environment, etc.

Valuation and Return

TOPIX Historical P/B Ratio and 10Y Annualized Return (From Oct. 1993)

10Y Annualized Return (%)

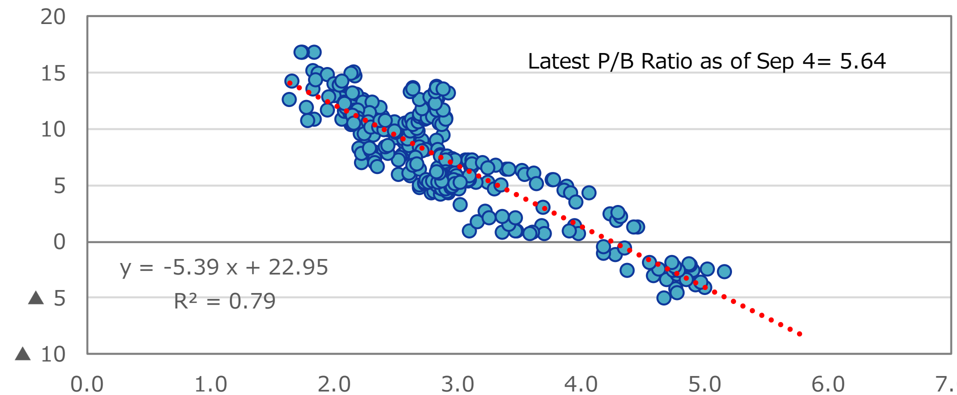


Note: Latest data are for Aug 2026 TOPIX Historical P/B Ratio (times)

Source: SMDAM and Bloomberg

S&P500 Historical P/B Ratio and 10Y Annualized Return (From May 1990)

10Y Annualized Return (%)

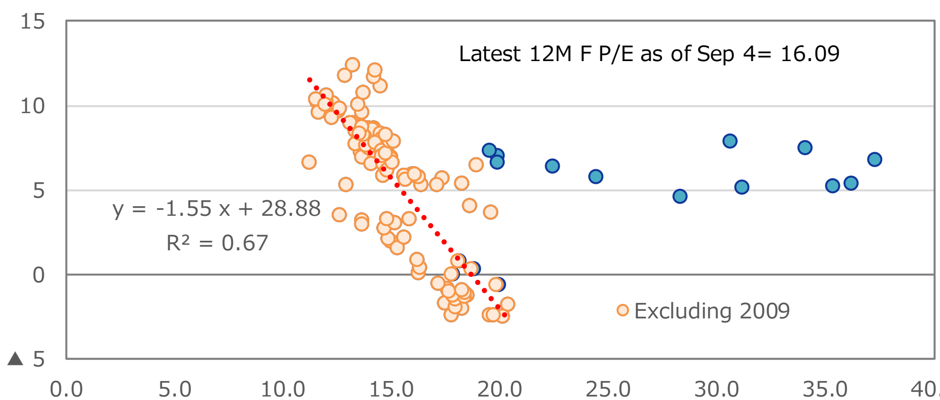


Note: Latest data are for Aug 2026 S&P500 Historical P/B Ratio (times)

Source: SMDAM and Bloomberg

TOPIX 12M Forward P/E and 10Y Annualized Return (From Jul. 2005)

10Y Annualized Return (%)

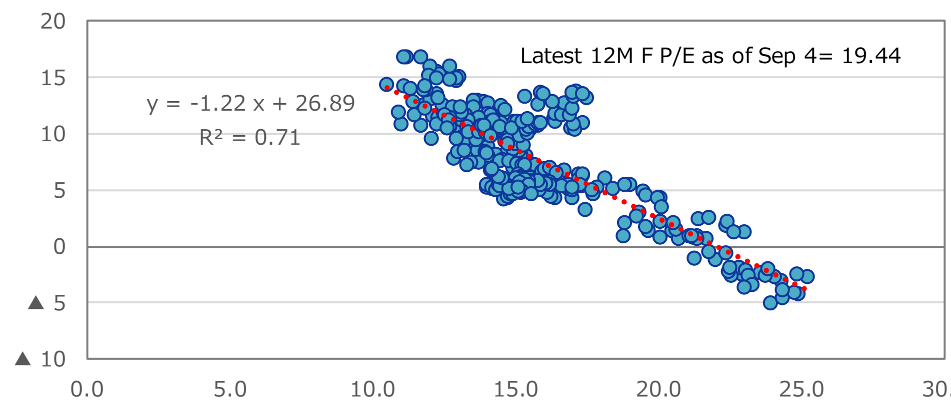


Note: Latest data are for Aug 2026. The blue dots show 2009 data. TOPIX 12M Forward P/E (times)

Source: SMDAM and Bloomberg

S&P500 12M Forward P/E and 10Y Annualized Return (From Jan. 1990)

10Y Annualized Return (%)

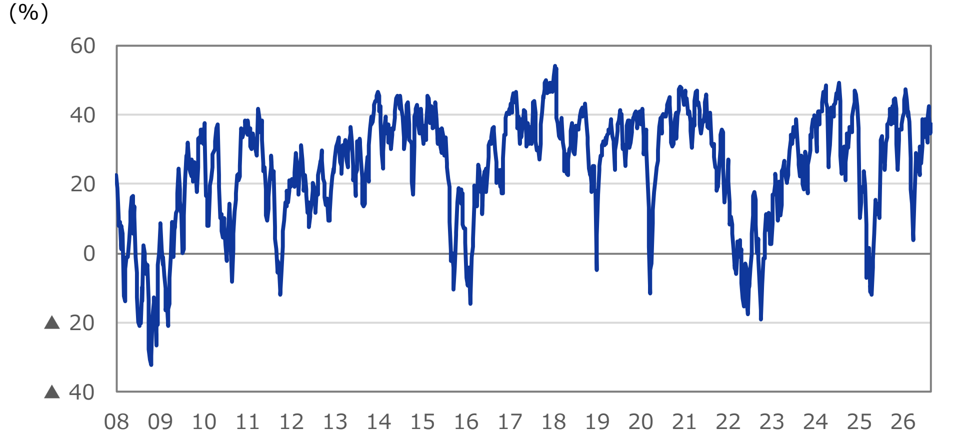


Note: Latest data are for Aug 2026 S&P500 12M Forward P/E (times)

Source: SMDAM and Bloomberg

Stock Market Sentiment and Supply-Demand

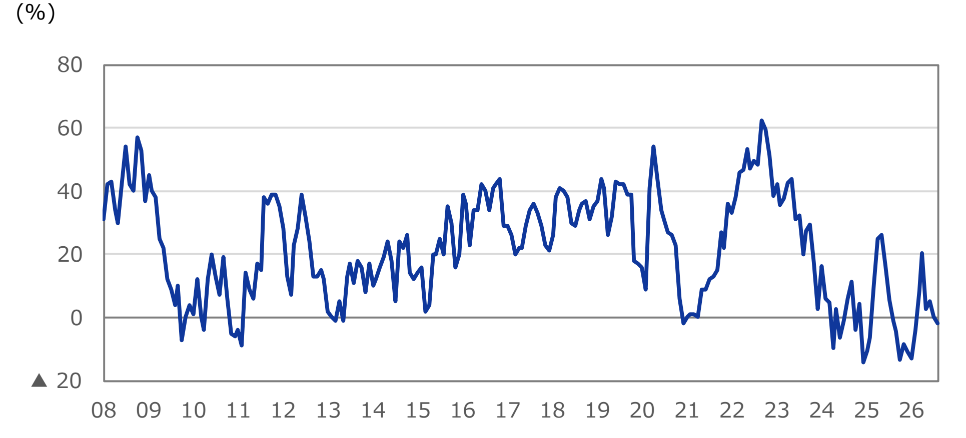
Investors Intelligence Bull-Bear Spread



Note: Latest data are for 28 Aug 2026

Source: SMDAM and LSEG

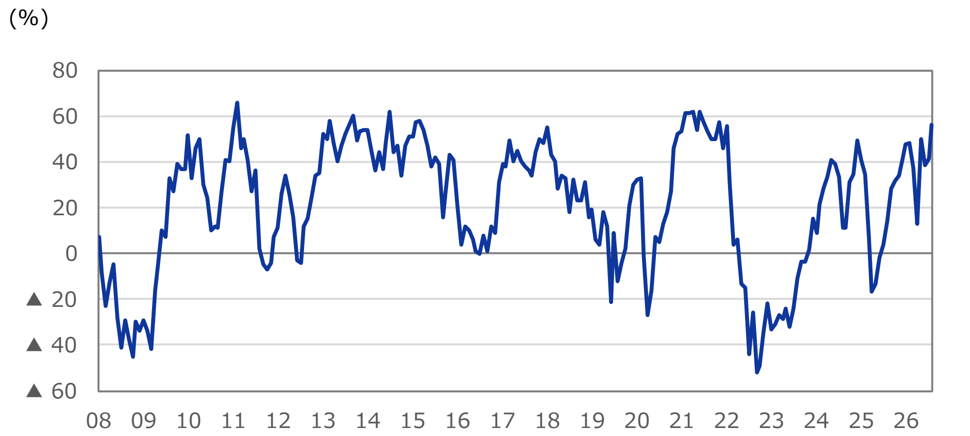
FM Survey: Cash Net Balance



Note: Latest data are for Aug 2026

Source: SMDAM and BofA

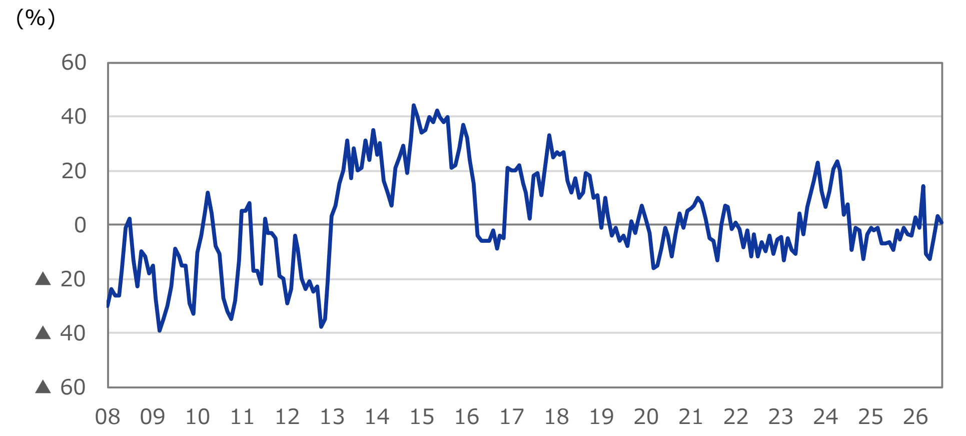
FM Survey: Equities Net Balance



Note: Latest data are for Aug 2026

Source: SMDAM and BofA

FM Survey: Japanese Equities Net Balance

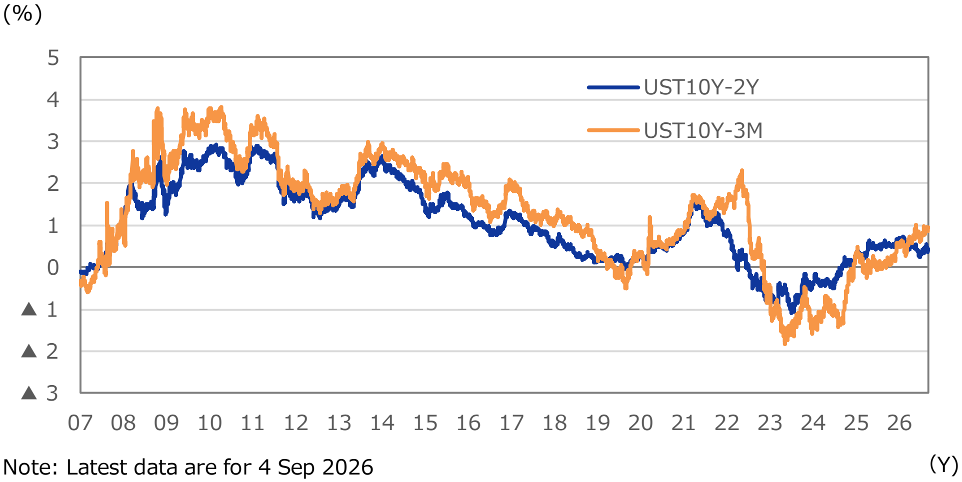


Note: Latest data are for Aug 2026

Source: SMDAM and BofA

Risk Indicators

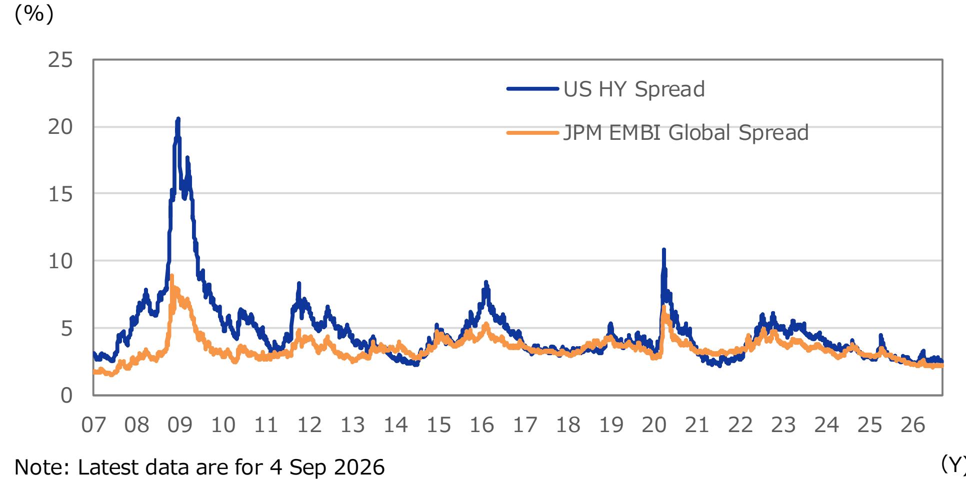
US Yield Curve Spread



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

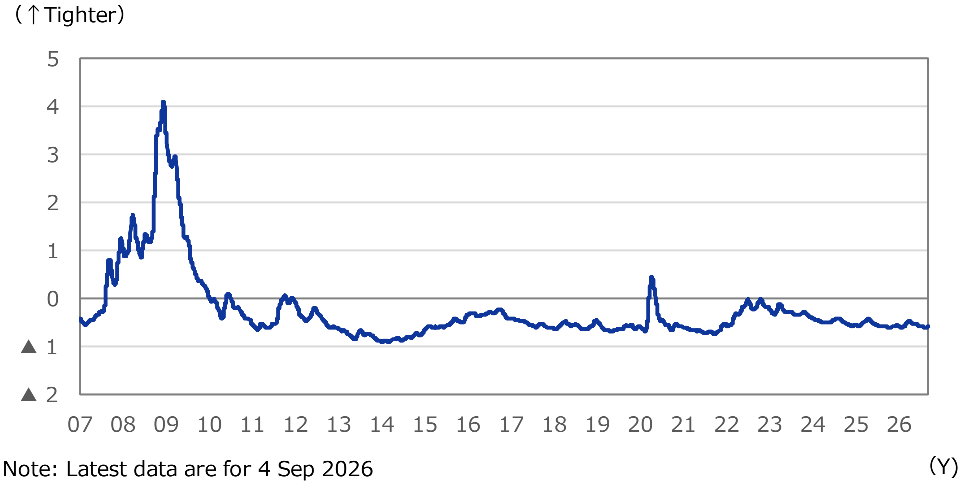
US HY Spread and EM Spread



Note: Latest data are for 4 Sep 2026

Source: SMDAM and Bloomberg

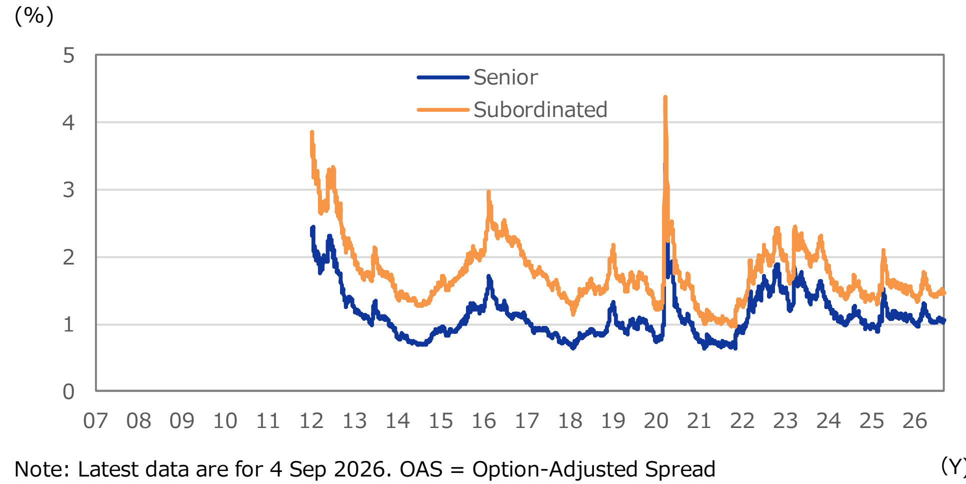
Chicago Fed Adjusted National Financial Conditions Index (ANFCI)



Note: Latest data are for 4 Sep 2026

Source: SMDAM, Chicago Fed and Bloomberg

USD IG Financials OAS

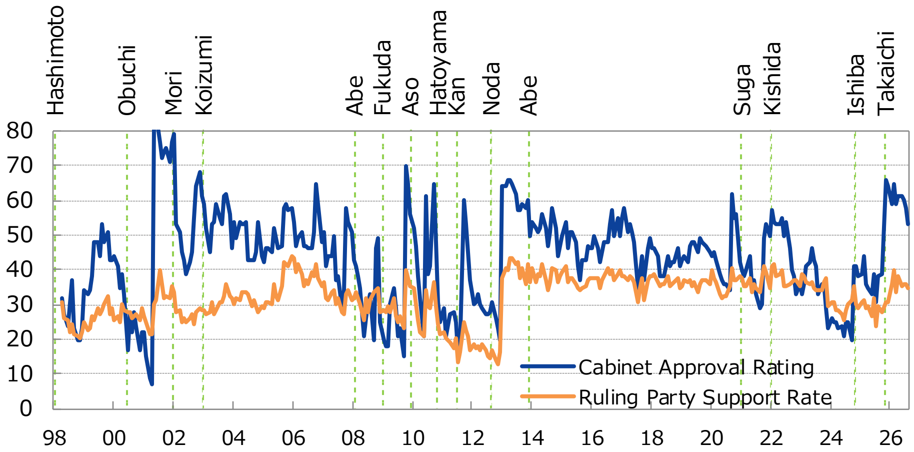


Note: Latest data are for 4 Sep 2026. OAS = Option-Adjusted Spread

Source: SMDAM and Bloomberg

Japanese Politics:

Cabinet Approval Rating and Ruling Party Support Rate (%)



Source: SMDAM and NHK
Note: Latest data are for Aug 2026

Seats in Lower and Upper Houses Note: As of 4 Sep 2026

	Lower House seats	Upper House seats
Liberal Democratic Party	316	101
Nippon Ishin / Japan Innovation Party	36	19
Ruling parties	**352**	**120**
Centrist Reform Alliance / Constitutional Democratic Party	48	39
Centrist Reform Alliance / Komeito		21
Democratic Party For the People	28	25
Party of Life	0	5
Japanese Communist Party	4	7
Sanseito	15	15
Team Mirai	11	2
Others + Vacancies	7	14
Majority	**233**	**125**
Total	**465**	**248**

Source: SMDAM, the House of Representatives and the House of Councillors

Political Calendar and Key Events

Feb 18	2nd Takaichi Cabinet launched
Feb 25	**Potential successors to BOJ's Noguchi (late Mar) and Nakagawa (late Jun) are both reflationists.**
Mar 19	Japan–U.S. summit
March?	**Growth Strategy Council drafts investment roadmap**
Jun 5	**Supplementary budget (¥3tn+) passed**
Jun 16	**BOJ meeting: rate hiked to 1%**
Jul 21	**Cabinet approved Basic Policy and Growth Strategy**
Jul 21	**Corporate Governance Code revised**
early Aug	**Cabinet decision on cutting the VAT on food**
Late Aug	FY2027 budget requests due
Autumn?	**Extraordinary Diet**
Oct 30	BOJ meeting: possible rate hike
Dec	**FY2027 budget draft and tax reform outline**
By year-end	**Three National Security Documents revised**

Source: SMDAM and various media reports

Outlook for the Takaichi Administration

Stronger political leverage	LDP holds 2/3 in Lower House; can override Upper House rejection
Political stability	No national elections until summer 2028 (Upper House)
Fiscal expansion risk	Pushing proactive fiscal policy will likely lead to a larger budget

Sanaenomics: Key Policy Outlook

Policy	Expected direction	Watchpoints
Responsible proactive fiscal policy	Fiscal targets loosen; drop single-year PB surplus; focus on debt/GDP	FY2027 budget draft
	Shift to main budget; **FY27 initial budget to expand sharply**	FY2027 budget draft
Growth & resilience investment	Support AI/ship/space/energy/defense; **up to ¥10tn** potentially allocated	FY2027 budget draft
Revise security documents	Broaden defense exports; **defense/GDP target could rise 2%→3% (+¥6tn)**	FY2027 budget draft
Two-year cut in food VAT	**Zero tax: ¥5T cut. 1% likely. Starts Apr 2027. Key: funding**	Autumn extraordinary Diet

Note: As of 4 Sep 2026

Governance (1): Revised CG Code highlights the importance of growth investments

Overview of the Revisions to the Corporate Governance Code

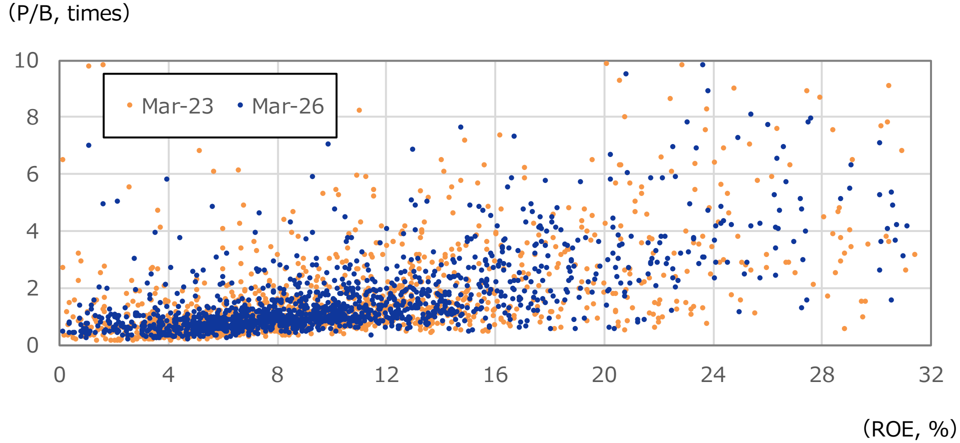
Note: Data as of 31 Jul 2026

Theme	Direction of the Proposed Revisions
Overall	To encourage companies to focus on essential initiatives for mid-to-long-term value creation (e.g., appropriate resource allocation for growth), the revisions limit "comply or explain" principles to abstract/conceptual ones. New "Interpretative Guidelines" were established with specific details and backgrounds to support effective implementation. **Aiming for the "substantiation of the Code" by returning to its original principle-based spirit**, listed companies are expected to implement practices aligned with each principle's intent based on their specific circumstances.
Promotion of Growth Investments	The revisions specify the importance of growth investment initiatives as the board's role/responsibility. Specific examples include: 1. Building a growth trajectory toward company goals. 2. **Explaining specific actions for resource allocation (e.g., capex, R&D, human/intellectual capital investments, and business portfolio reviews) to achieve growth.** 3. **Continuously verifying if resource allocation aligns with disclosed management strategies/plans for growth.** **The revisions cite verifying whether financial assets (like cash/deposits) and physical assets are effectively utilized for growth investments.** Holding such assets is not entirely denied; maintaining appropriate cash levels can be part of resource allocation if the company can explain its necessity and rationality.
Enhancement of Board Functions	Considering the increasing proportion of independent outside directors and the improving environment for their supervisory functions, the revisions emphasize the importance of their roles/responsibilities, securing quality/quantity, and ensuring independence to enhance their effectiveness. It also adds that the functions of the secretariat (e.g., corporate secretary), which plays a key role in supporting directors including the chair and outside directors, should be strengthened.
Pre-AGM Disclosure of Securities Report	The revised principles cite **submitting the Annual Securities Report before the general shareholder meeting (AGM) as a key example of securing an appropriate environment for exercising voting rights. The Interpretative Guidelines supplement that submitting the report at least 3 weeks before the AGM is most desirable, and pushing back the AGM date can be considered as an option.**

Source: SMDAM and FSA

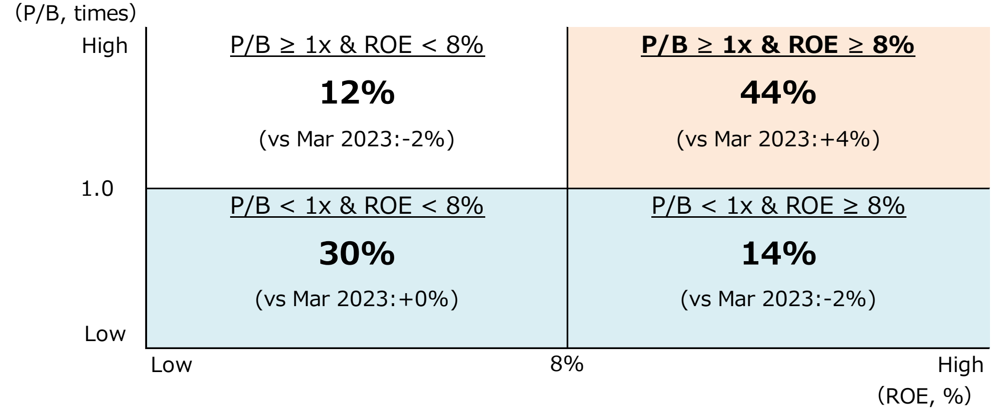
Governance (2): Corporate Response to TSE's Cost of Capital Conscious Management Request

Shifts in P/B and ROE Distribution of TSE Prime Companies Before and After the Call for Capital Cost and Stock Price-Conscious Management



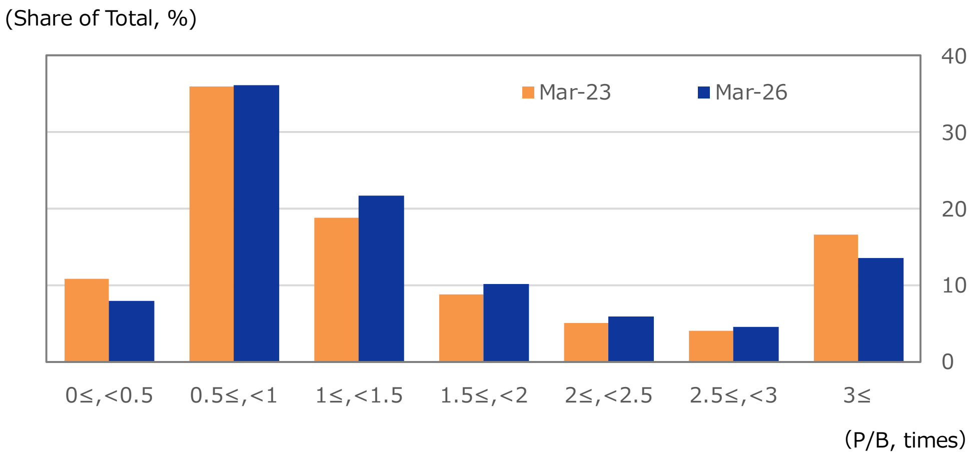
Source: SMDAM and Bloomberg

P/B & ROE Distribution in TSE Prime Companies Pre-/Post-Call for Capital Cost and Stock Price-Conscious Management (Mar 2026, Share of Total)



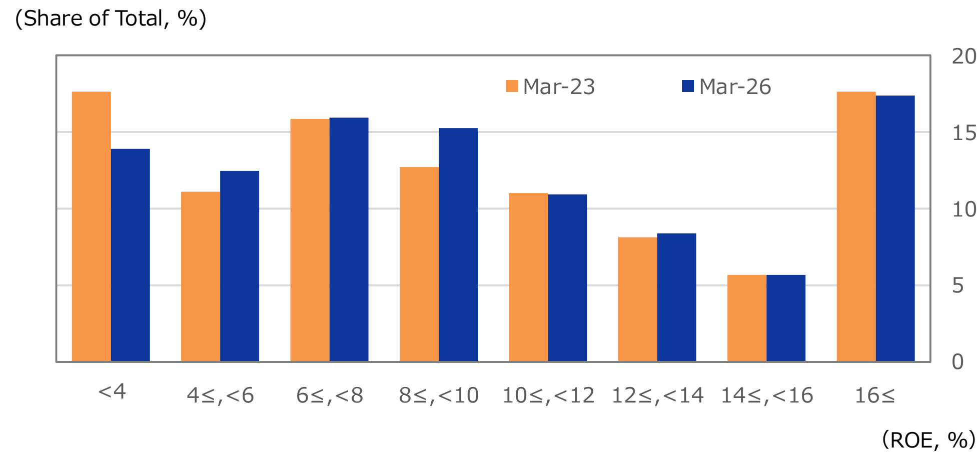
Source: SMDAM and Bloomberg

Shifts in P/B Distribution of TSE Prime Companies Before and After the Call for Capital Cost and Stock Price-Conscious Management



Source: SMDAM and Bloomberg

Shifts in ROE Distribution of TSE Prime Companies Before and After the Call for Capital Cost and Stock Price-Conscious Management

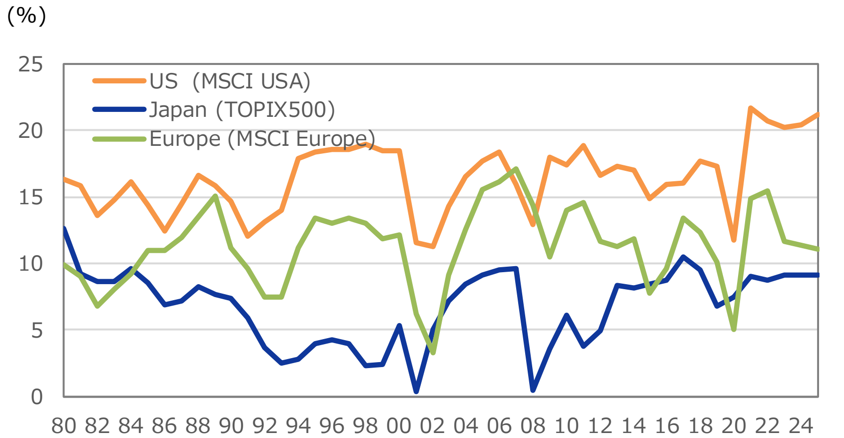


Source: SMDAM and Bloomberg

The above figures represent past performance and future forecasts, and do not guarantee the future market environment, etc.

Governance (3): ROE

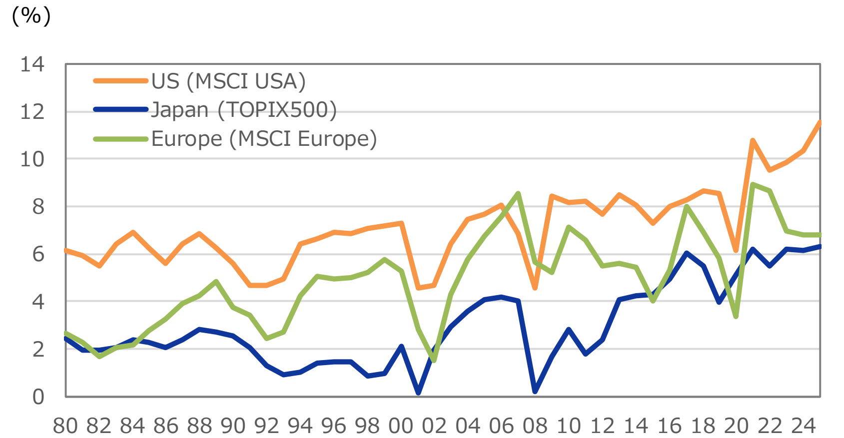
Long-term Trends of ROE in Japan, the US, and Europe



Note: Latest data are 2025. Excl. Financials (Japan: also Trading Cos)

Source: SMDAM and Daiwa Securities

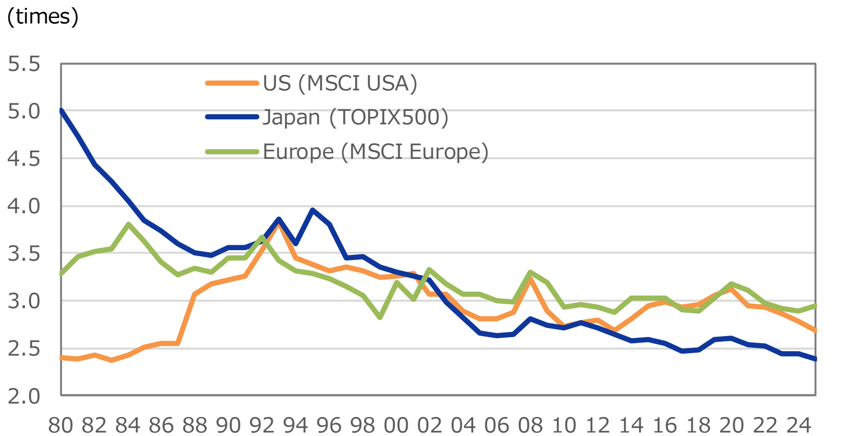
Long-term Trends of Net Profit Margins in Japan, US, and Europe



Note: Latest data are 2025. Excl. Financials (Japan: also Trading Cos)

Source: SMDAM and Daiwa Securities

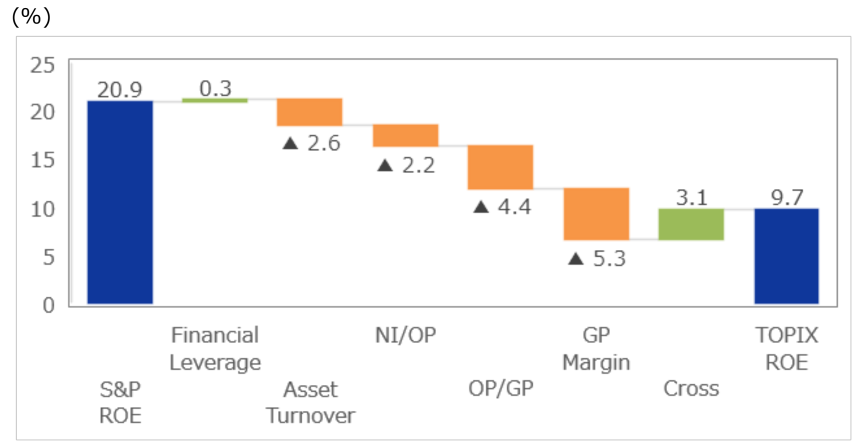
Long-term Trends of Financial Leverage in Japan, US, and Europe



Note: Latest data are 2025. Excl. Financials (Japan: also Trading Cos)

Source: SMDAM and Daiwa Securities

ROE Comparison: Japan vs US (TOPIX 500 vs S&P 500, Ex-Financials)



Note: Latest Data as of 4 Sep 2026

Source: SMDAM and Bloomberg

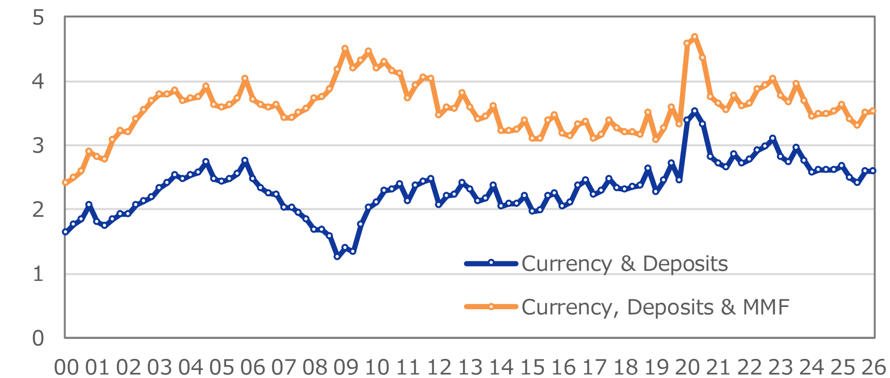
Governance (4): Effective Cash Utilization

Cash Ratio in B/S of Japanese Non-Financial Corporations

Note: Latest data are for 1Q 2026

Source: SMDAM and BoJ

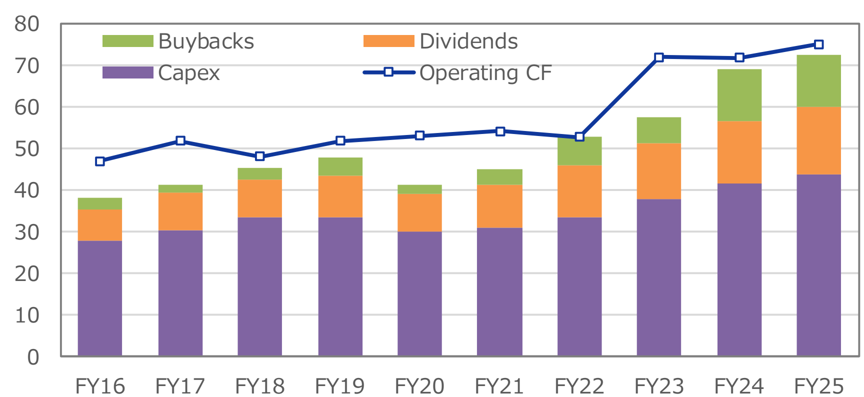
Cash Ratio in B/S of US Non-Financial Corporations



Note: Latest data are for 1Q 2026

Source: SMDAM and FRB

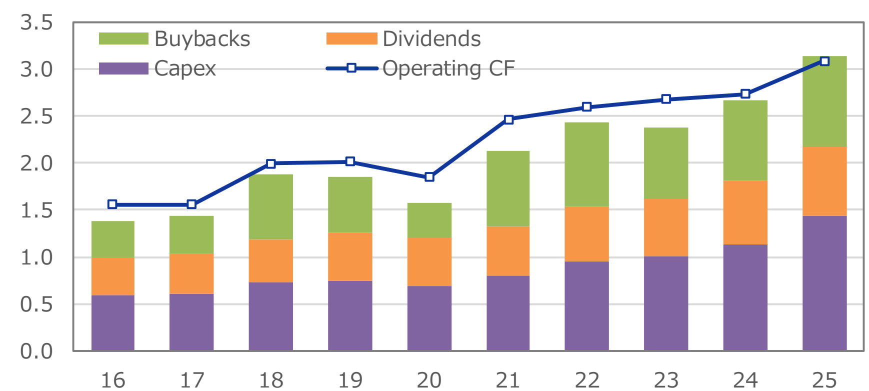
OCF, Investment, and Shareholder Returns for TOPIX 500 Companies



Note: Excludes Financials. Latest data are for FY2025.

Source: SMDAM and Bloomberg

OCF, Investment, and Shareholder Returns for S&P 500 Companies

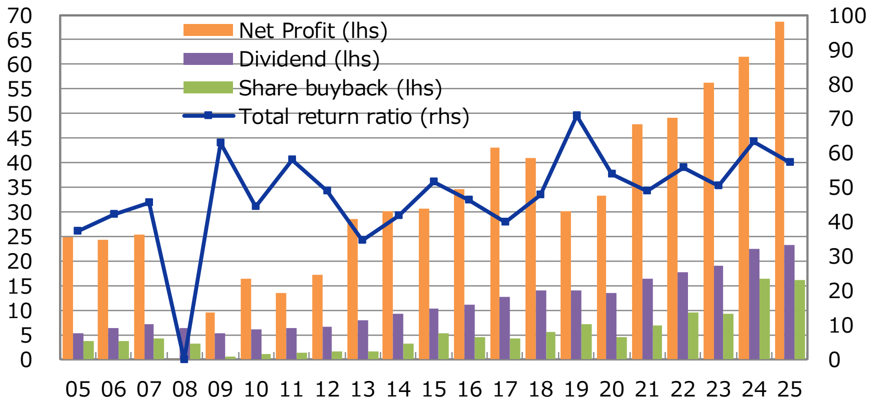


Note: Latest data are for 2025

Source: SMDAM and Bloomberg

Governance (5): Shareholder Returns

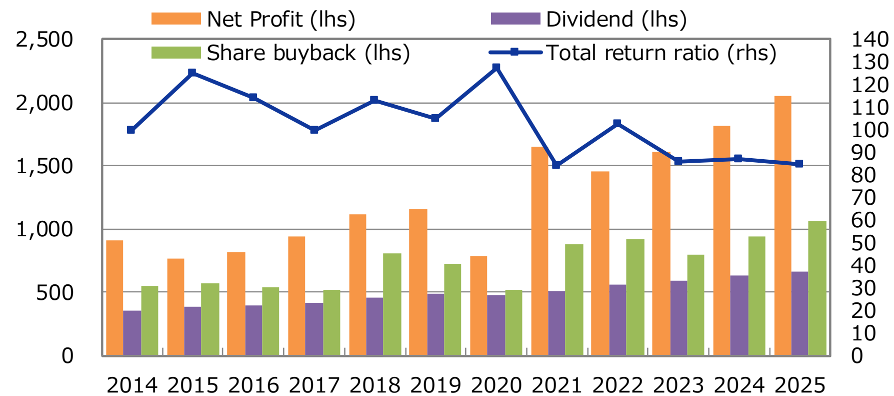
Total Shareholder Return Ratio (TOPIX)



Note: Latest data are for FY2025

Source: SMDAM, Tokai Tokyo Securities, and Bloomberg

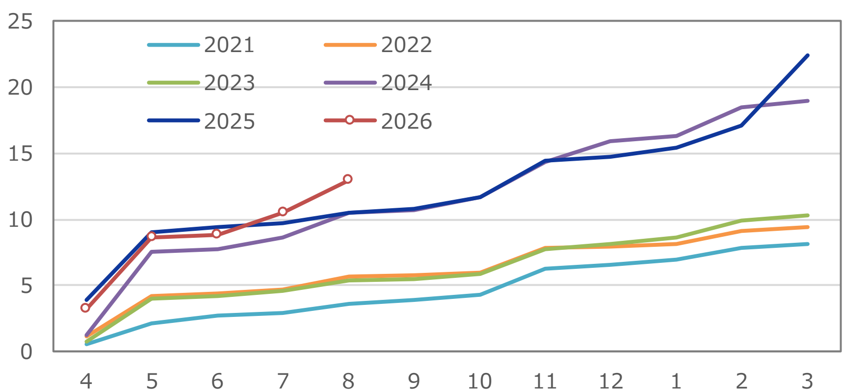
Total Shareholder Return Ratio (S&P500)



Note: Latest data are for 2025

Source: SMDAM, Tokai Tokyo Securities, and Bloomberg

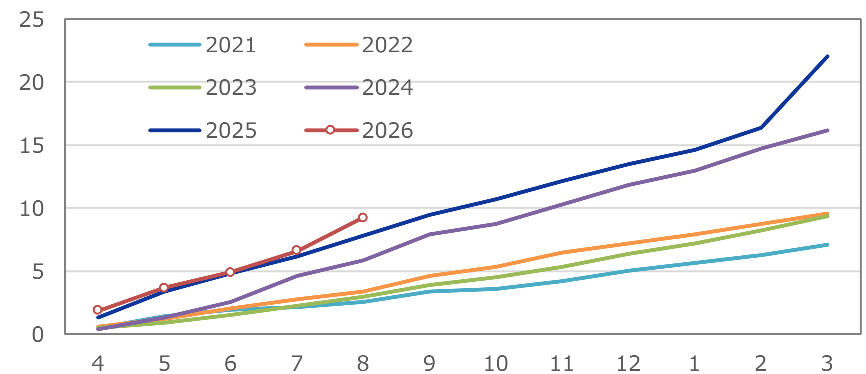
Share Buyback Programs by Japanese Companies (FY Cumulative)



Note: Latest data are for Aug 2026

Source: SMDAM and INDB

Share Buyback Activity by Japanese Companies (FY Cumulative)



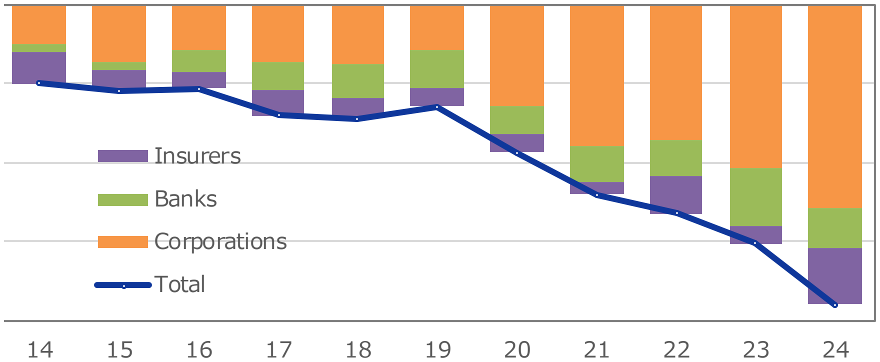
Note: Latest data are for Aug 2026

Source: SMDAM and INDB

Governance (6): Ownership Structure & Shareholder Meetings

Cross shareholding unwinding

(trillion JPY)

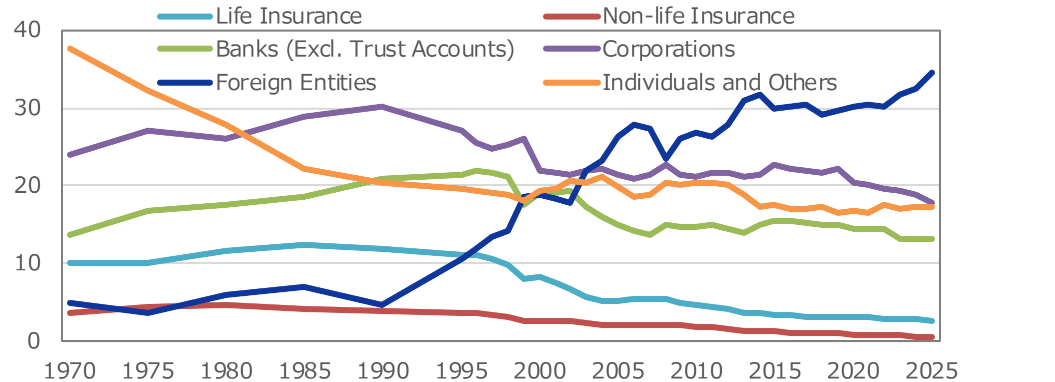


Note: Latest data are for FY2024

Source: SMDAM and Tokai Tokyo Securities

Distribution of Equity Ownership by Shareholder Type

(%)

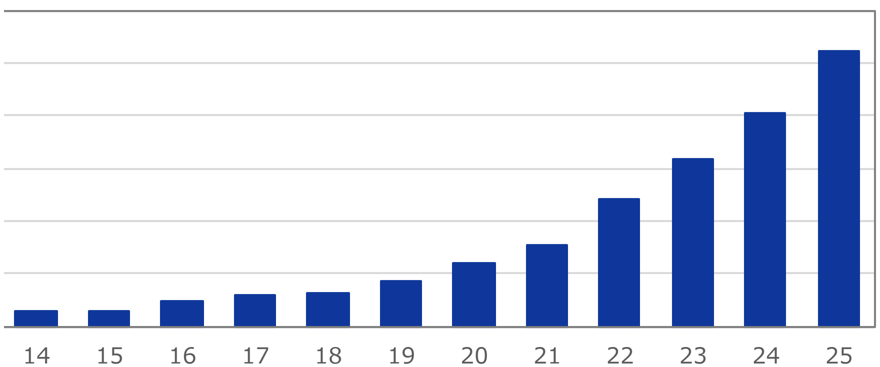


Note: Latest data are for FY2025

Source: SMDAM and JPX

Percentage of Companies with a Majority of Independent Outside Directors

(%)

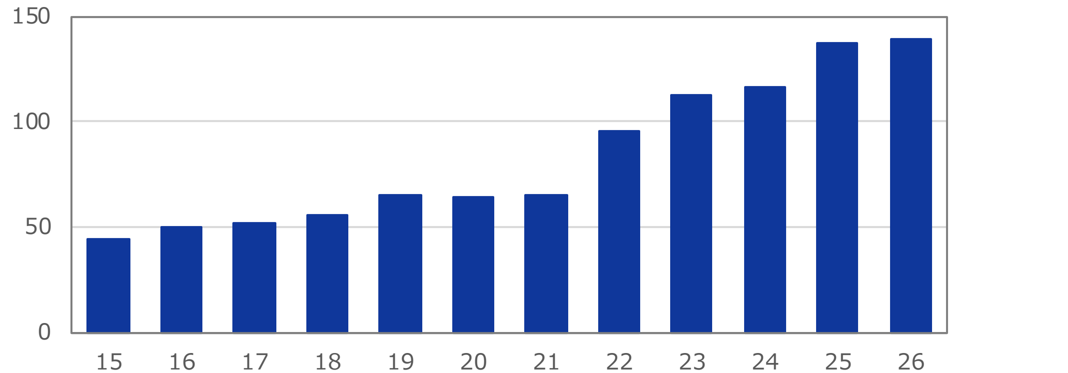


Note: Latest data are for FY2025

Source: SMDAM and JPX

Number of Shareholder Proposals

(Number of Companies)



Note: Latest data are for FY2026

Source: SMDAM and Japan Institute of Business Law

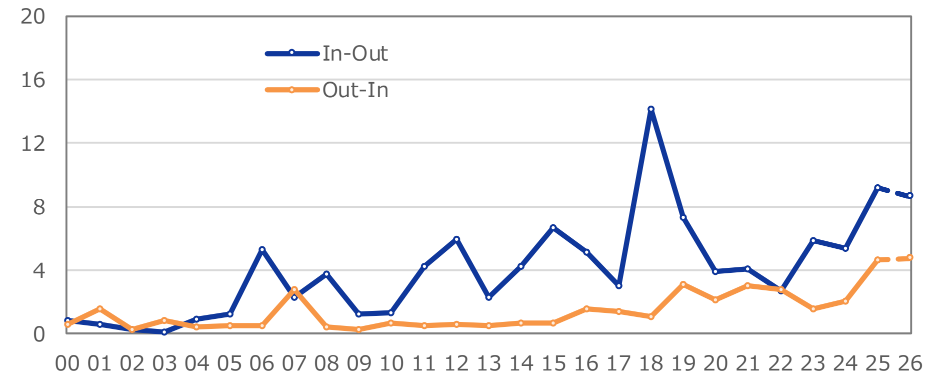
The above figures represent past performance and future forecasts, and do not guarantee the future market environment, etc.

Sumitomo Mitsui DS Asset Management

Governance (7): Rising Takeover Risk

Trends in M&A Deal Value Involving Japanese Companies

(trillion JPY)

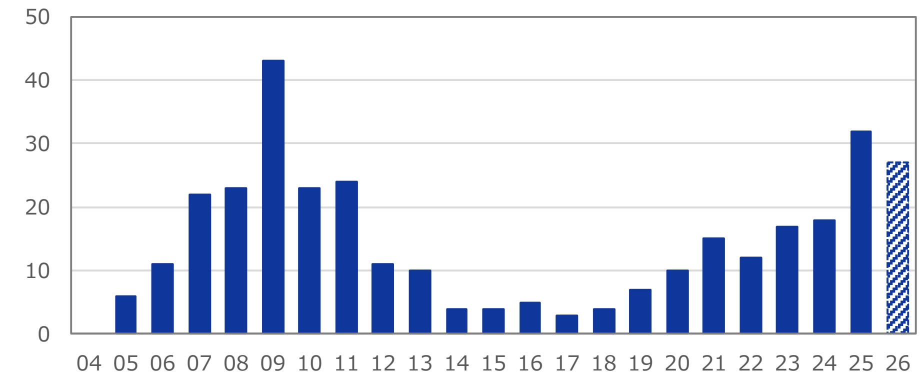


Note: Latest data are for 2026. 2026 is annualized through Aug (Y)

Source: SMDAM and Bloomberg

Trends in MBO Transactions

(Number of Cases)

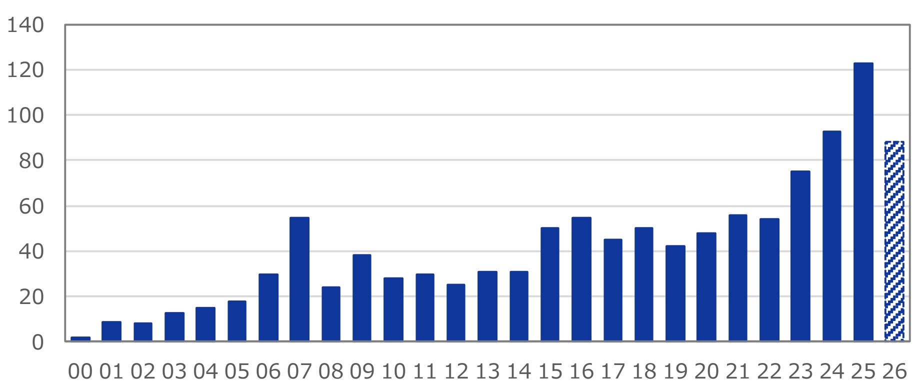


Note: Latest data are for 2026. 2026 is annualized through Aug (Y)

Source: SMDAM and Bloomberg

Trends in Number of TOBs (TSE Listed Companies)

(cases)

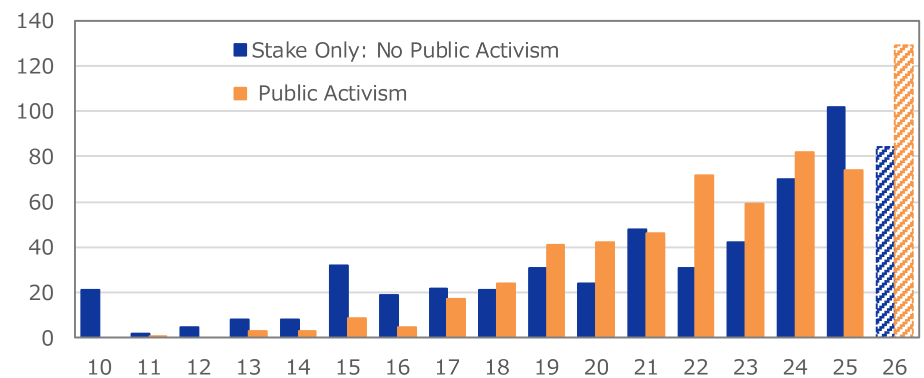


Note: Latest data are for 2026. 2026 is annualized through Aug (Y)

Source: SMDAM and Bloomberg

Activist investor activity

(Number of Cases)



Note: Latest data are for 2026. 2026 is annualized through Aug (Y)

Source: SMDAM and Bloomberg

NISA

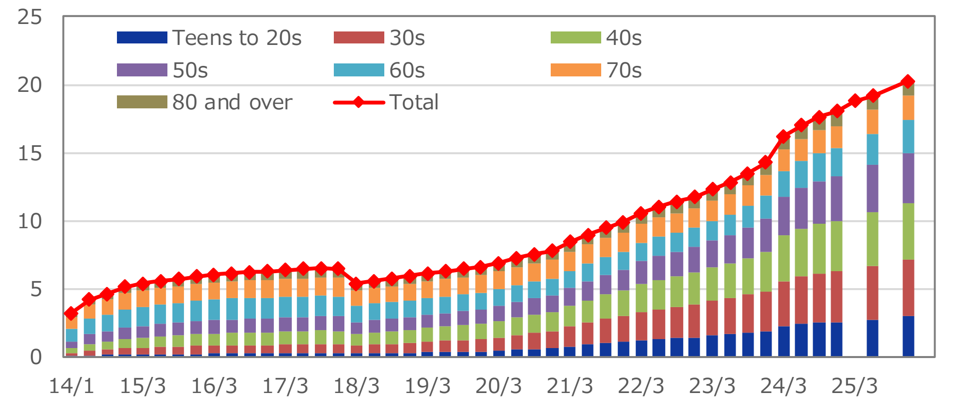
Comparison of old and new NISA (Tax free investing program like UK ISA)

	Old NISA		NEW NISA		
	Tsumitate NISA	General NISA	Tsumitate Quota	Growth Quota	Kodomo NISA
Lifetime Limit	JPY 8 mn	JPY 6 mn	JPY 18 mn (JPY 12 mn for Growth Quota)		JPY 6 mn
Annual Limit	JPY 0.4 mn	JPY 1.2 mn	JPY 1.2 mn	JPY 2.4 mn	JPY 0.6 mn
Tax Exemption Period	20 years	5 years	No Limit		No Limit
Availability for Combined Use	No		Yes		
Investment Option	FSA selected Investment trusts and ETFs	Listed stocks, ETFs, REITs and Investment trusts	FSA selected Investment trusts and ETFs	Listed stocks, ETFs, REITs and Investment trusts	FSA selected Investment trusts and ETFs
Target Age	18 and older		18 and older		0–17 years old

Source: SMDAM and FSA

Note: As of 4 Sep 2026

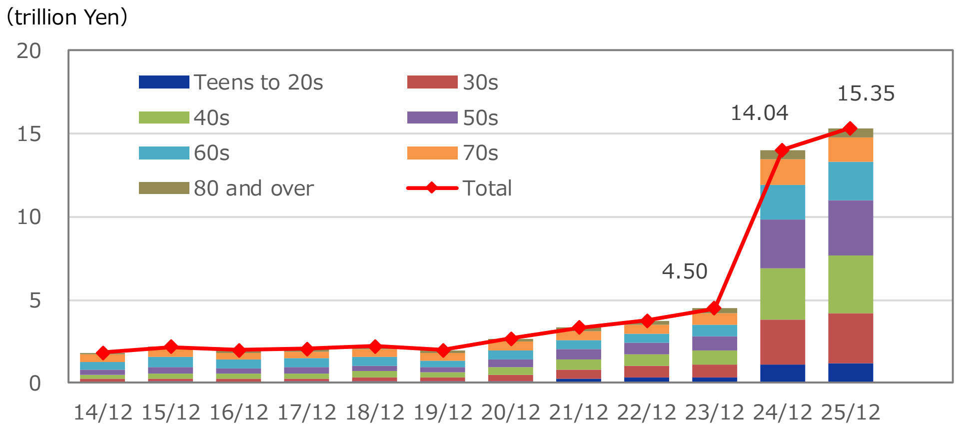
Number of NISA Accounts by Age Group



Note: Latest data are for end-Dec 2025; some age breakdowns unpublished.

Source: SMDAM and Japan Securities Dealers Association

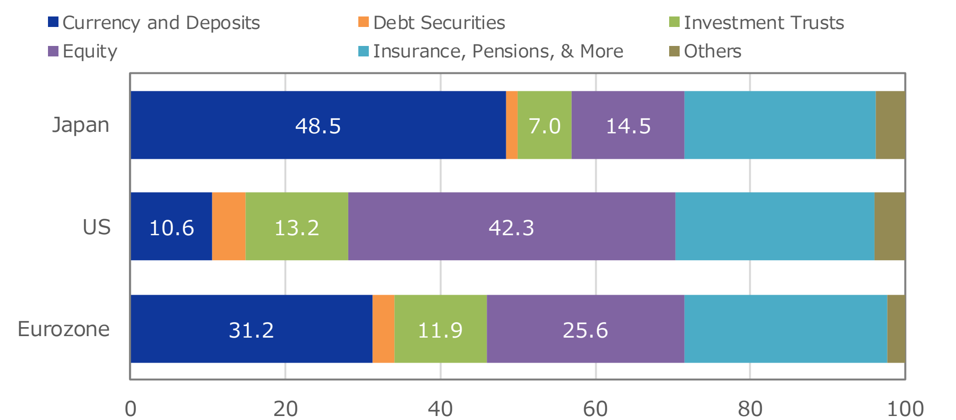
Annual Purchase Amount in NISA Accounts by Age Group



Note: Latest data are for end-Dec 2025.

Source: SMDAM and Japan Securities Dealers Association

Financial Assets held by Households (As of March 2026)



Source: SMDAM, BoJ, FRB and ECB

Event Schedule: Focus— Y2027 budget proposal and tax reform

	Date	Japan	Date	U.S.	Date	Other Regions
September 2026	Mid-to-late Sep	Cabinet reshuffle and LDP executive appointments				
October to December	**Dec** **By year-end?**	**Cabinet Approval of the 27 FY Budget Proposal and Tax Reform Outline** **Revision of the three key national security documents**	Oct? **Nov 3** **Dec?**	US Treasury Semi-annual Currency Report **U.S. midterm elections** **Final reports of five Fed task forces**		
January to March 2027	Jan Mid-Mar	Opening of the Ordinary Diet Session Key Response Day for Spring Wage Negotiations	Jan	The Opening of the U.S. Senate and House of Representatives	Jan Mar	IMF World Economic Outlook National People's Congress of China
April to June	Apr Q2? Jun? End-Jun	Unified local elections Successor nominations for BOJ Board Members Takata and Tamura (Terms expire Jul 23, 2027) Cabinet's approval of the Basic Policy Closing of the Ordinary Diet Session	Jun?	US Treasury Semi-annual Currency Report	Apr Apr Jun	IMF and World Bank Spring Meetings IMF World Economic Outlook G7 Summit
July to September	Jul 23 **Sep**	Terms of BOJ Board Members Takata & Tamura expire **LDP presidential election**	Aug	Jackson Hole Economic Symposium	Jul	IMF World Economic Outlook

Source: Compiled by SMDAM

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