



A Medium- to Long-Term Market Driven by Structural Changes

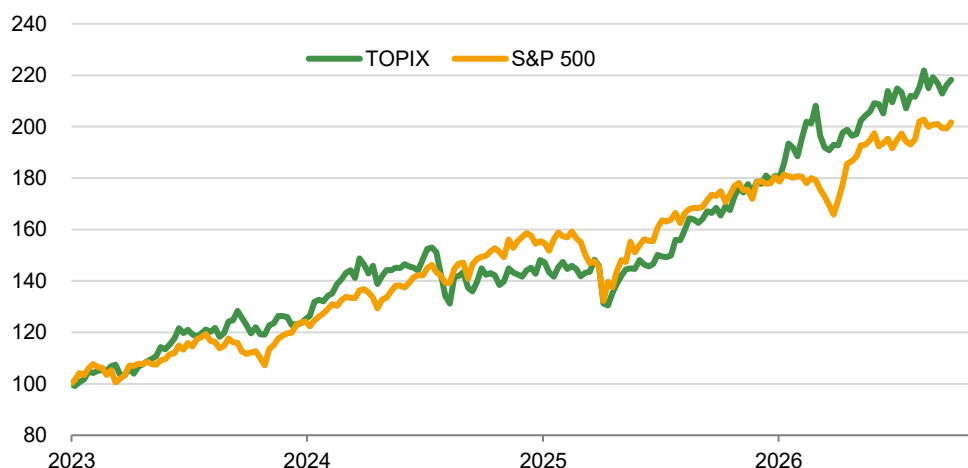
Headwinds Turn into Tailwinds, and Japanese Stocks Return to an Uptrend

Japanese Stocks Outperform US Stocks in Terms of Performance

Japanese stocks continue to deliver strong returns. Over the approximately 3 years and 9 months since the start of 2023, the TOPIX has risen 118%, outperforming the S&P 500's 102% gain by 16 percentage points. The Nikkei 225, which benefits more significantly from AI-driven tailwinds due to differences in constituent stocks and weightings, has risen 154%, further outperforming the TOPIX (all figures as of September 25).

Since the start of September, headwinds for the stock market—including high interest rates, seasonal factors, and uncertainty surrounding the US midterm elections—have intensified somewhat, causing Japanese stocks to face resistance on the upside. However, the global and Japanese economies, as well as corporate earnings, remain robust, and the outlook for the future is favorable. From the end of this year through next year, we believe the Japanese stock market will return to an upward trend, as some of these headwinds are expected to turn into tailwinds. Crucially, the structural changes in macroeconomic, microeconomic, and supply-demand dynamics—which have been the source of strong returns for Japanese stocks in recent years—along with the tailwinds from AI and government policies, remain unchanged. We believe these factors will continue to drive the Japanese stock market upward for several years to come.

Japanese Stocks Outperform US Stocks in Terms of Performance



※Indexed with early 2023 set at 100; most recent figure as of September 25, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

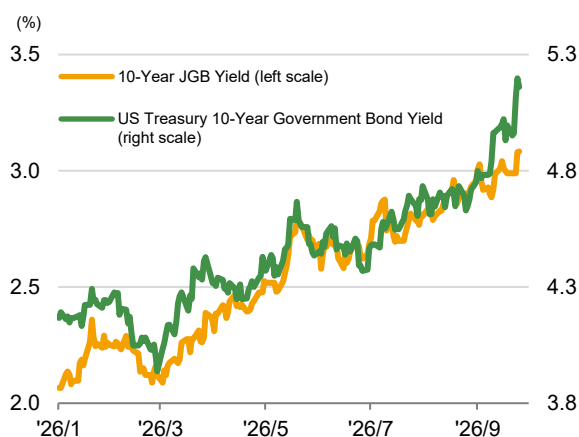
Macro Headwinds and Corporate Earnings Support

Macroeconomic headwinds are intensifying at present. In Japan, long-term interest rates have reached 3% for the first time in 30 years, while in the US and Europe, long-term interest rates and ultra-long-term rates (with maturities exceeding 10 years) continue to rise. The challenge lies in the fact that this global upward pressure on interest rates stems not from a single cause, but from a synergy of various factors. With inflation remaining stubbornly high due to the prolonged turmoil in the Middle East, major central banks have been moving to raise rates or accelerate the pace of rate hikes, and market expectations have shifted toward a more hawkish stance. The BOJ decided to raise interest rates at this month's Monetary Policy Meeting; since the previous rate hike occurred at the June meeting, the pace of rate hikes—which had been roughly once every six months—has accelerated to about once every three months. The Federal Reserve (Fed) and the ECB (European Central Bank) also decided to raise rates at their September meetings. Markets are anticipating the possibility of further rate hikes by both central banks. Furthermore, pressure for fiscal expansion is mounting in Japan, the US, and Europe, fueling widespread concerns about deteriorating fiscal conditions. In addition, US hyperscalers and others are issuing massive amounts of corporate bonds to fund AI-related investments; as competition with government bonds for capital intensifies, the supply-demand balance for government bonds is deteriorating.

Furthermore, crude oil prices remain elevated due to concerns over the situation in the Middle East. While the price hike in crude oil exerts downward pressure on corporate earnings through higher costs, its impact on interest rates is also significant. In a situation where upward pressure on interest rates is already strong, high crude oil prices—which lead to inflation pressure and rising interest rates—are particularly prone to being viewed negatively.

On the other hand, strong corporate earnings are supporting the Japanese stock market. The April–June financial results for companies with fiscal years ending in March—announced from late July through mid-August—were exceptionally strong. Net income significantly exceeded analysts' prior forecasts of approximately a 20% year-on-year increase, posting a substantial 61% year-on-year rise. The strength of the AI sector remained notable, but this positive trend also spread to other industries. In response to the strong financial results, analysts have continued to make upward revisions to their full-year estimates, and the projected EPS growth rate for the TOPIX for fiscal year 2026 has risen to over 20% year-on-year. The earnings season also saw numerous announcements of share buybacks; as of the end of August, the total share buyback limit launched since the beginning of the year exceeded 20 trillion Yen, marking a further acceleration from last year. Amid intensifying headwinds, strong corporate earnings and share buybacks are providing support, and the market is expected to continue trading within a high-volatility range for the time being.

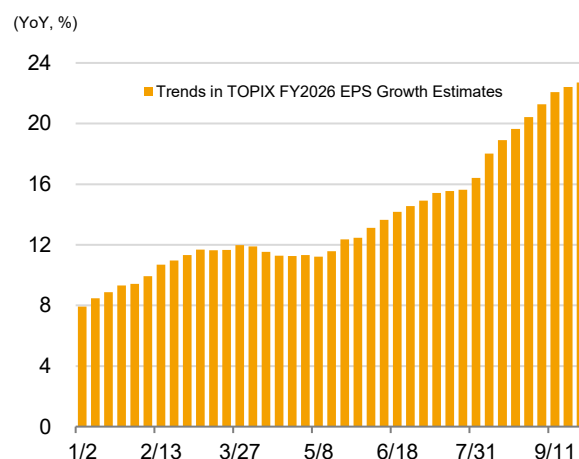
Interest rates are rising globally



※Most recent figures as of September 25, 2026

Source: Bloomberg; Compiled by Daiwa Asset Management

Earnings estimates for FY2026 continue to experience upward revisions



※Consensus estimates; most recent figures as of September 25, 2026

Source: FactSet; Compiled by Daiwa Asset Management

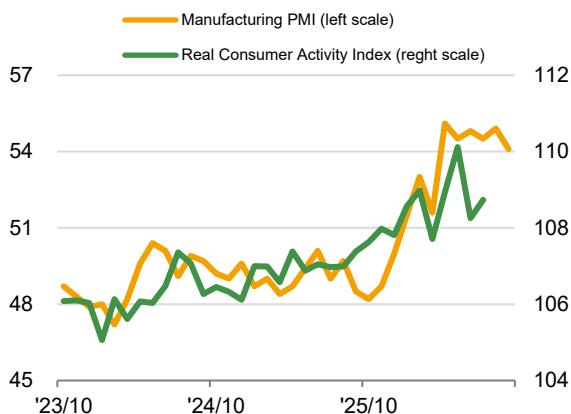
Headwinds Turning into Tailwinds Toward Year-End and into Next Year

Corporate earnings are not only strong at present but also show a favorable medium-term outlook. Although uncertainty has increased due to the deterioration of the situation in the Middle East and rising crude oil prices since the end of February, both the global and Japanese economies have remained resilient, and it is considered unlikely that economic growth will be significantly dampened going forward. Domestically, as efforts to source alternatives to crude oil and related products are progressing, the adverse effects of supply constraints have not yet become significantly apparent. TOPIX EPS, which rose 9% year-on-year in fiscal 2025 despite the impact of Trump tariffs and other factors, is projected to see a substantial increase of over 20% in fiscal 2026—partly due to a rebound from those tariffs—with earnings expected to grow by approximately 10% in fiscal 2027–28 as well. While cyclical tailwinds are contributing to the current strength in earnings, it is also important to note—as discussed below—that structural changes such as inflation and corporate governance reforms are enhancing corporate growth potential. This implies that the cruising speed of earnings growth has accelerated compared to the past 20–30 years, which can be seen as a driver of sustained gains in the Japanese stock market.

Currently, investors are reluctant to take on significant risk due to seasonal factors—such as the tendency for US stocks to decline in September (particularly in the second half of the month)—and uncertainty surrounding the US midterm elections in early November. However, this situation is expected to reverse heading into year-end and next year. While September typically brings headwinds due to seasonal factors, Japanese stocks tend to rise strongly toward the end of the year, turning these headwinds into tailwinds. From late October through mid-November, companies will announce their interim financial results. With strong financial results expected, the solid performance of Japanese companies is likely to once again draw investors' attention and serve as a factor driving stock prices higher.

Furthermore, while it is difficult to predict the outcome of the US midterm elections, regardless of the result, once the event has passed, investors will be able to adjust their positions accordingly. This will make investors more willing to take on risk, making it easier for the stock market to rise. Furthermore, stock prices tend to perform strongly during the third year of a US president's term. This is attributed to the fact that, as the term enters its second half and with the next presidential election in mind, policies that are positive for the economy and stock prices are more likely to be introduced. Consequently, the period from after the midterm elections through next year—which marks the third year of the term—can be seen as a time when investors are likely to adopt a more positive outlook toward the stock market.

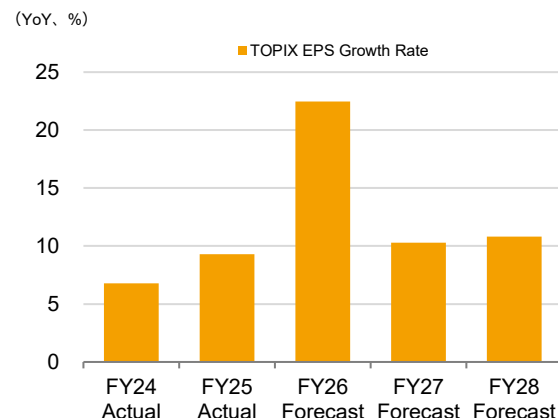
Domestic Economy Remains Resilient Despite Deteriorating Middle East Tensions



※The most recent figure for the Real Consumption Activity Index was in July 2026, and the most recent Manufacturing PMI figure is from September 2026

Source: BOJ, S&P Global; Compiled by Daiwa Asset Management

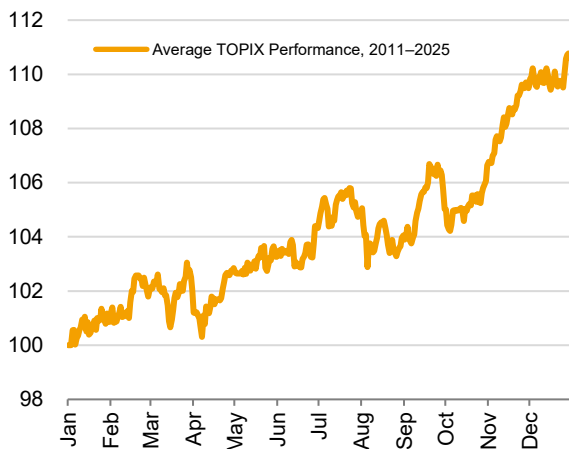
Japanese Companies' Growth Potential Is Increasing



※Consensus estimates; as of September 25, 2026

Source: FactSet data; Compiled by Daiwa Asset Management

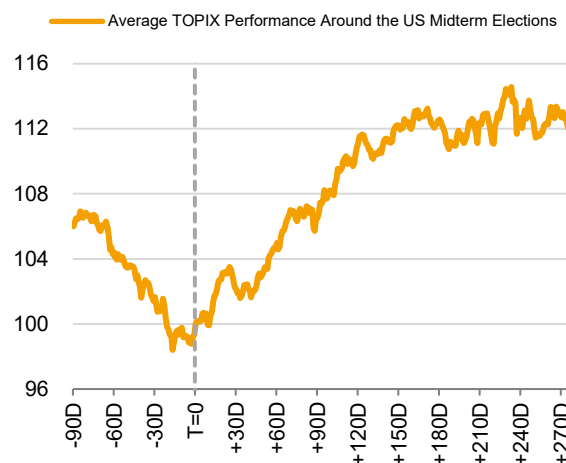
Seasonal Tailwinds for Japanese Equities Toward Year-End



※Indexed with the start of the year set to 100

Source: FactSet data; Compiled by Daiwa Asset Management

TOPIX Tends to Rise from the US Midterm Elections Through the Third Year of a Presidential Term



※Indexed with Election Day (T=0) set to 100, calculated based on US midterm elections from 1974 to 2022

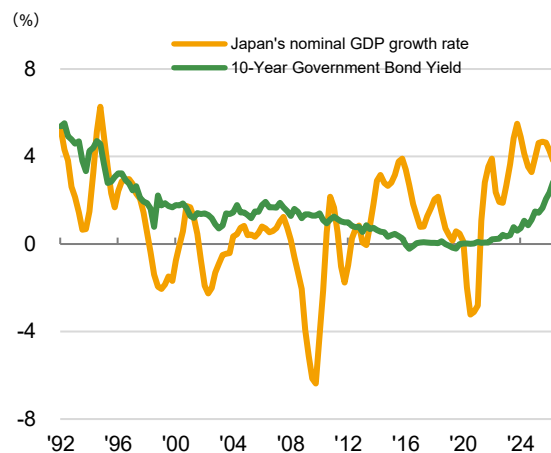
Source: Bloomberg; Compiled by Daiwa Asset Management

Higher Interest Rates Warrant Monitoring, but Current Levels Should Not Derail Equity Gains

Since interest rates are rising due to various factors, a sharp decline is unlikely, and they are likely to remain elevated. On the other hand, there are no signs that rising interest rates or rate hikes by central banks are acting as a strong brake on the economy; the impact remains limited to a mild headwind on valuations. While domestic long-term interest rates have exceeded 3%, nominal GDP growth has remained in the 3–4% range due to the shift toward inflation. With economic growth continuing to outpace long-term interest rates, current interest rate levels are not expected to hinder the stock market's upward trend.

However, if interest rate hikes accelerate further, headwinds for the stock market are expected to intensify. In particular, the stock market tends to react negatively during periods of rapid interest rate increases. Furthermore, should the situation in the Middle East deteriorate further, downward pressure on the stock market could intensify due to increased investor risk aversion, as well as rising inflation pressure and upward pressure on interest rates driven by higher crude oil prices. We believe the Japanese stock market will return to an uptrend, but depending on interest rate trends, the timing of reaching our target levels may be delayed.

Growth Continues to Outpace Interest Rates



※The most recent nominal GDP figure is for the April–June 2026 quarter, the most recent 10-year government bond yield is as of September 25, 2026

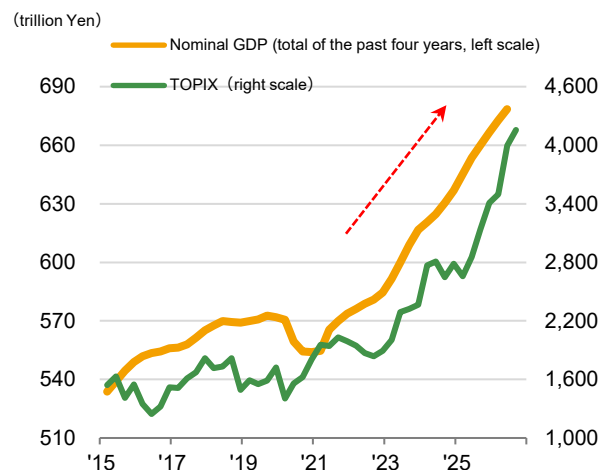
Source: Bloomberg; Compiled by Daiwa Asset Management

Structural Change 1: Shift to Inflation

Structural changes remain the medium- to long-term drivers of Japanese stocks. On the macro front, the shift to inflation in the Japanese economy is providing a tailwind for the stock market. Inflation, accompanied by high nominal wage growth, is boosting nominal GDP growth, which in turn is supporting corporate earnings through sales growth. Against the backdrop of rising interest rates, earnings in the financial sector—including banks—are also increasing.

Social norms among consumers and businesses are also changing. Companies are becoming more aggressive in their pricing strategies, and consumers are increasingly accepting price hikes. On the other hand, as inflation rates have outpaced wage growth in recent years, a trend toward frugality has been spreading. However, real wage growth has turned positive since the start of this year; if consumers become more accepting of corporate price hikes than ever before, companies will regain the pricing power lost during the deflationary period, and the shift to inflation will enter a new phase.

Inflation Continues to Act as a Tailwind for the StockMarket

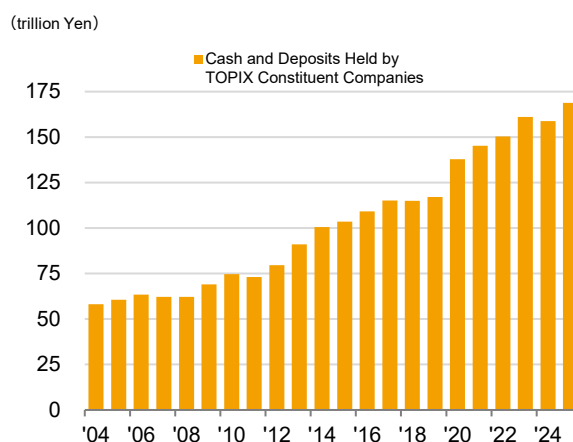


※The most recent figure for nominal GDP is for the April–June 2026 quarter; the TOPIX figure is as of the end of August 2026
Source: Bloomberg; Compiled by Daiwa Asset Management

Structural Change #2: Corporate Governance Reform

Progress in corporate governance reforms in the Japanese equity market has attracted significant attention both in Japan and abroad, leading investors to reassess Japanese companies that were previously viewed as deserving their low valuations. Although three years have passed since the Tokyo Stock Exchange issued its request, governance reform is still in the process of evolving. This year, the Corporate Governance Code was revised for the first time in five years. Of particular note was the provision stating that companies “should continuously assess” whether they are “effectively utilizing management resources—such as financial assets (cash and deposits) and tangible assets—for growth investments and other purposes.” While it has been pointed out that holding excessive cash and deposits is one factor contributing to Japanese companies’ low return on equity (ROE), this revision is likely to prompt them to utilize financial and tangible assets more proactively. Furthermore, the TOPIX’s ROE—which has been stagnant in recent years—is expected to begin rising, and the trend toward the revaluation of Japanese companies is likely to gain even more momentum.

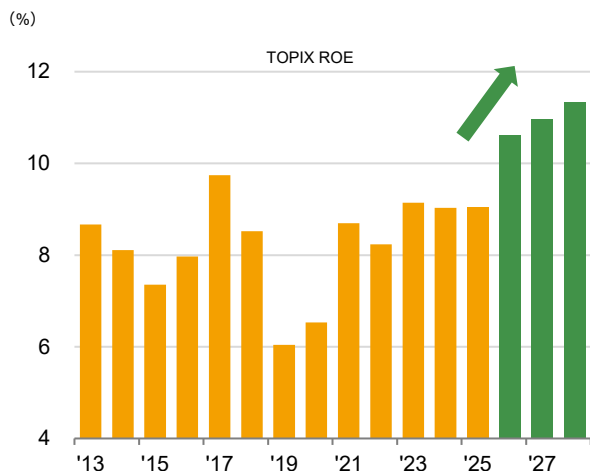
Revisions to the Corporate Governance Code Should Encourage More Effective Use of Cash



※Excludes cash, cash equivalents, and financial assets; most recent figure is for fiscal year 2025

Source: FactSet; Compiled by Daiwa Asset Management

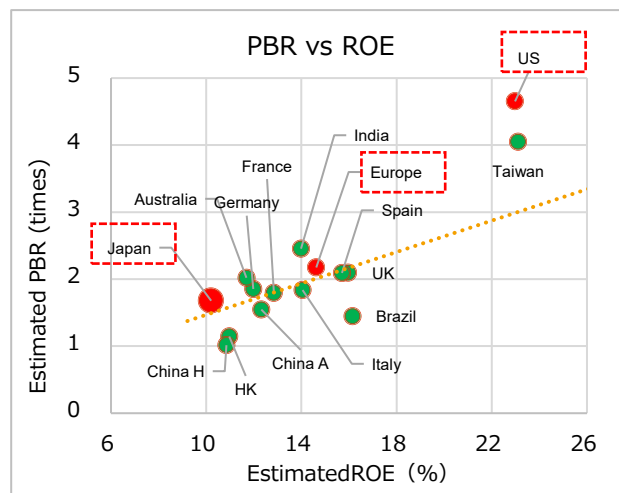
Japanese Companies Entering a Phase of ROE Expansion



※FY26–28 figures are consensus estimates, as of September 25, 2026

Source: FactSet; Compiled by Daiwa Asset Management

Japanese Equities Poised for Further Re-Rating



※Estimated ROE and PBR are based on the consensus forecast for the next fiscal year, as of September 25, 2026

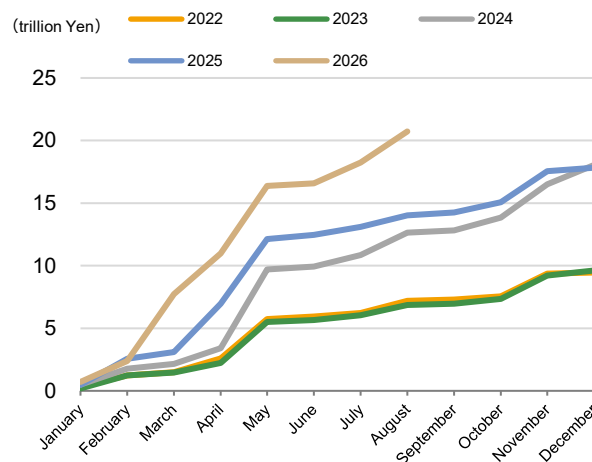
Source: Bloomberg; Compiled by Daiwa Asset Management

Structural Change ③: Domestic Investors Gaining Prominence

Structural changes in supply and demand also serve as a medium- to long-term tailwind for Japanese stocks. Foreign investors have traditionally wielded strong influence in the Japanese stock market, and past bull markets have been driven by financial inflows from these investors. However, since 2021, corporate entities have become the largest buyers of Japanese stocks. This trend is driven by a surge in share buybacks accompanying progress in corporate governance reforms; given Japanese companies' abundant cash and deposits, as well as the aforementioned revisions to the Corporate Governance Code, the increase in share buybacks is expected to continue.

In response to the inflationary environment, households are beginning to adopt a more positive stance toward the stock market. According to the Flow of Funds Statistics for the July–September 2025 quarter, the ratio of cash and deposits to total financial assets held by households fell below 50% for the first time in 18 years and has continued to decline since then. Meanwhile, the share of risk assets, such as stocks and equity investment trusts, is on the rise. While an increase in the market value of stocks due to rising share prices is one factor, financial inflows—primarily into investment trusts—are also continuing. Amid the transition from deflation to inflation, the shift from savings to investment is still in its early stages, and financial inflows into the stock market are likely to continue over the medium to long term.

Japanese Companies' Share Buyback Limits See Significant YoY Increase



※Cumulative announced amount year-to-date, as of the end of August 2026

Source: Quick; Compiled by Daiwa Asset Management

The Government's Growth Strategy

Policy measures aimed at the medium- to long-term growth of the Japanese economy are now in full swing. In July, the government approved the "Japan Growth Strategy" by Cabinet decision. The public-private investment roadmap, covering 17 strategic areas, projects cumulative public and private investment of over 370 trillion Yen by fiscal year 2040. In addition to the effects of this investment, if the benefits of R&D investment and more efficient allocation of production resources are fully realized, the government estimates that the potential growth rate—which represents the economy's supply capacity—will rise to 1.8% between 2036 and 2040.

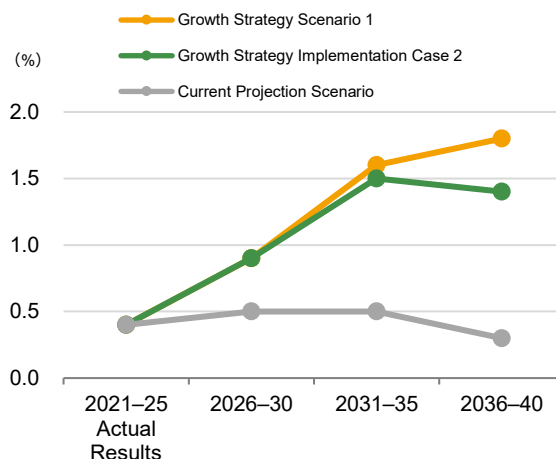
For corporate earnings, which are heavily influenced by economic trends, an increase in the economy's overall potential growth rate means greater scope for profit expansion over the medium to long term. Furthermore, capital from around the world flows into the stock market in search of growth opportunities. The current administration's commitment to growth and its ambitious growth strategy are crucial for attracting foreign capital and are expected to lead to an improved valuation of Japanese stocks.

AI-Related Stocks Will Continue to Drive the Japanese Market

Although Japan does not have any hyperscalers or leading AI model developers (such as OpenAI, Anthropic, or DeepSeek), there are many companies with strengths in AI infrastructure—including semiconductor manufacturing equipment, electronic components, electrical wiring, and data center-related sectors—and their earnings are growing significantly as they benefit from the rapid expansion of AI capital spending. Although Japanese AI-related stocks have been trading somewhat erratically recently following a sharp rally in April–June and a subsequent sharp decline, they are expected to continue driving the Japanese stock market given the high growth potential of the AI-related market.

Current fundamentals are strong; AI-related companies are projected to post high profit growth rates through fiscal years 2026 and 2027, and analysts continue to make upward revisions to their forecasts. As profit margins expand, their impact on the overall performance of the Japanese stock market is also increasing. Furthermore, of the public-private investment in the 17 strategic sectors announced by the government, over 100 trillion Yen is allocated to AI and semiconductors, providing additional tailwinds from the government's growth strategy.

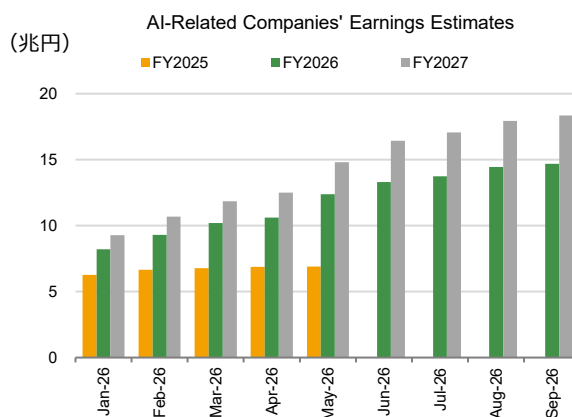
Government Projects Potential Growth Rate to Increase to the Upper 1% Range



- ※Growth Strategy Scenario 1: In addition to increased demand driven by additional fiscal spending and the effects of investments based on the Public-Private Investment Roadmap, the benefits of R&D investment and the efficient allocation of production resources are fully realized
- ※Growth Strategy Scenario 2: In addition to increased demand from additional fiscal spending, the effects of investments based on the Public-Private Investment Roadmap, among other factors, materialize
- ※Current Projection Scenario: Only the effect of increased demand from additional fiscal spending

Source: Cabinet Office; Compiled by Daiwa Asset Management

AI-Related Companies Expected to Deliver Strong Earnings Growth as Analyst Estimates Continue to Rise



※Consensus estimate; most recent figures as of September 25, 2026

Source: FactSet; Compiled by Daiwa Asset Management

Nikkei 225 to Reach 86,000 Yen by the End of 2027

We continue to maintain a medium-term bullish stance on Japanese stocks. Tailwinds for Japanese stocks persist, including the shift toward an inflationary economy, corporate governance reforms, buying of Japanese stocks by domestic investors, and the government's growth strategy. Although Japanese stocks have already risen significantly, we view the current market not as a mere business cycle but as a medium- to long-term uptrend driven by structural changes.

While there are currently headwinds such as high interest rates and uncertainty surrounding the situation in the Middle East, we do not believe these will significantly weigh on the stock market. Fundamentals remain strong, with earnings forecasts undergoing further upward revisions amid expectations of robust profit growth. We expect some of these headwinds—such as seasonal factors and uncertainty surrounding the US midterm elections—to turn into tailwinds from the end of this year through next year, and we believe the Japanese stock market will once again strengthen its upward trend. We estimate that the Nikkei 225 will reach 86,000 Yen and the TOPIX will reach 4,800 by the end of 2027.

Our Estimate Calls for the Nikkei 225 to Reach 86,000 by End-2027



※ The green dashed line represents Daiwa Asset's forecast; the most recent actual data is as of September 25, 2026

Source; Bloomberg; Compiled by Daiwa Asset Management

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