

Japan Investment Commentary and Market Outlook

July 2025



By Kazuhiko Hosaka
Senior Product Specialist
Asset Management One Co., Ltd.
Tokyo

Market Movement	As at 31/07/2025
TOPIX Index	2,943.07 (+3.2%)
Nikkei 255 Stock Average	41,069.82 (+1.4%)
Exchange rate	1USD = JPY150.75

Note: Rates of increases and decreases are reflected in the performance of stock indices.

Japanese equities rose in July, supported by a Japan-U.S. tariff agreement that reduced automobile tariffs to 15%. Although political uncertainty and fiscal concerns followed the Upper House election, where the ruling coalition lost its majority, the TOPIX reached a record high on July 24, reflecting investor optimism about structural reforms and trade developments.

Following the Federal Open Market Committee (FOMC) and Bank of Japan (BOJ) meetings at the end of July, the yen depreciated, reaching the 150 range against the dollar. However, the release of weak U.S. payroll data on August 1 sparked concerns about a potential economic slowdown, leading to a partial retreat in dollar strength and creating headwinds for Japanese equities. Despite these external pressures, Japanese stocks demonstrated notable resilience, underpinned by increasing investor confidence in Japan's structural corporate reforms and signs that the country may be emerging from its prolonged deflationary era.

Valuations have risen ahead of earnings, with Price-to-Earnings (P/E) multiples expanding faster than Earnings per Share (EPS). While this may temporarily slow market momentum, historical patterns suggest a second rally could follow once EPS recovers. Looking ahead, applying a 15x P/E to FY2026 consensus EPS implies a realistic TOPIX target of 3,200.

Risks include Japan's political uncertainty, the \$550 billion Japan-U.S. framework, and U.S. stagflation concerns, though expectations for fiscal stimulus and reform may help offset these headwinds.

Market Review

In July, the Japanese equity market gained, with the Nikkei 225 rising 1.4% to 41,069.82 yen and the TOPIX advancing 3.2% to 2,943.07 points. Early in July, uncertainty grew as the U.S. administration hinted at raising tariffs on Japanese imports, leading to a weak market. However, mid-month saw increased buying interest in Japanese semiconductor stocks, following gains in U.S. semiconductor and high-tech stocks. Concerns over fiscal policy, rising interest rates, and yen depreciation ahead of the Upper House election on the 20th weighed on indices. Toward the end of the month, the election resulted in a minority ruling party and a transition in administration, raising concerns of fiscal expansion risks. Additionally, on July 23, a Japan-U.S. agreement reduced tariffs, including those on automobiles, to 15%, boosting Japanese stocks. The TOPIX reached a record high on July 24.

Japan-U.S. Agreement on Reciprocal Tariffs

On July 22, the U.S. government announced a major tariff agreement with Japan, setting reciprocal tariffs, including automobile tariffs, at 15%. This reduction is expected to enhance the performance of automakers and their supply chains and may influence wage increases during next year's spring labour negotiations, a priority for the government, the Bank of Japan (BOJ), and corporate executives. Economists estimate that the 15% tariff on exports to the U.S. will reduce Japan's GDP growth rate by about 0.5%, but a recession is expected to be avoided.

Political Situation After Upper House Election

Japan's ruling coalition lost its majority in the Upper House election on July 20, with the Liberal Democratic Party (LDP) and Komeito losing seats amid prolonged inflation, while opposition parties like the Democratic Party For the People (DPFP) and Sanseito gained. Prime Minister Ishiba announced on July 21 that he would remain in office due to ongoing U.S. trade talks. Opposition parties ruled out a coalition, increasing political uncertainty. Despite initial market reactions, higher interest rates and a weaker yen, share prices remained stable, supported by corporate reforms and fund flows. The Japan-U.S. agreement and Ishiba's decision to stay helped reverse some market trends. Political developments, including

potential leadership changes and policy shifts, warrant close monitoring.

Japan's Macroeconomic Environment - Soft Data Holding Up

The BOJ's June Tankan survey showed that the overall business conditions diffusion index (DI) remained resilient despite U.S. tariffs. Although the DI for large automobile manufacturers deteriorated, it remained positive, suggesting that the negative impact of tariffs has not yet materialised. Non-manufacturing sectors are cautious, but both large and small enterprises report strong sentiment. The Economy Watchers Survey also showed improved sentiment for the second consecutive month. While concerns remain over rising prices and U.S. trade policy, expectations for increased income from bonuses and wage hikes appear to support optimism.

Regarding the new tariff agreement, the direct downward pressure on Japan's GDP growth rate is estimated at around 0.5%, but this impact is less severe than without tariff reductions. Economic uncertainty has eased, and domestic demand, supported by strong wage hikes and labour-saving investments is expected to underpin personal consumption and capital investment, keeping the Japanese economy stable.

BOJ Holds Its Monetary Policy, Inflation Forecast Raised

Japan's core CPI rose 3.3% in June, slowing due to easing energy prices, while food prices climbed. At its July 30-31 meeting, the BOJ maintained its policy rate at 0.5% and raised its FY2025 inflation forecast to the upper 2% range. The risk balance shifted from "downside" to "balanced." The BOJ welcomed the Japan-U.S. trade deal but remains cautious about global policy risks. It will assess the impact of tariffs and wage trends by year-end, with a rate hike expected in early 2026.

Market Outlook

Following the FOMC and BOJ meetings on July 30-31, the yen weakened further, reaching the 150 range against the dollar by month-end. However, the U.S. employment report released on August 1 showed a sharp decline in payrolls, raising concerns about a slowdown in the U.S. economy and prompting a partial reversal in dollar strength posing a headwind for Japanese equities. Despite this, Japanese equities have remained resilient, driven by growing confidence in Japan's structural corporate reforms and the end of its 30-year deflationary period. As of July 25, foreign investors recorded net buying for 17 consecutive weeks, seemingly in response to these structural shifts. While the move away from U.S. exceptionalism remains speculative, it may mark the beginning of a gradual transition toward more diversified global equity portfolios. Despite historically large yen-buying positions, the yen has remained around 140 per dollar, suggesting that fears of further appreciation may be overstated.

Earnings Estimates and Valuation

Japanese equities have seen a surge in P/E multiples, ahead of meaningful improvement in EPS. This front-loaded valuation expansion may lead to a temporary slowdown in market momentum. However, historical patterns suggest that once EPS begins to recover, a second leg of the rally could follow. Currently, 12-month forward EPS appears to have bottomed, and forecasts likely reflect the bulk of the tariff-related downside. While domestic political uncertainty continues to weigh on sentiment, expectations for fiscal stimulus and constructive political change are emerging as influential drivers of market direction.

Looking ahead, we will closely monitor the pace of the U.S. economic slowdown and the Fed's policy stance. Should Japanese equities experience a significant pullback due to external factors, we would view it as a buying opportunity, given the structural tailwinds supporting market resilience.

The TOPIX EPS forecast (I/B/E/S consensus, YoY) has been continuously revised downward for FY2025 (ending March 2026) due to U.S. tariff impacts and weaker demand from China. Currently, the forecast stands at +1.2% YoY, with a 1.3 percentage point downward revision over the past month. In contrast, for FY2026 (ending March 2027), the market expects a normalization in corporate earnings, projecting a +12.7% YoY increase.

As for valuation, the forward 12-month P/E ratio for TOPIX stood at 14.7x as of the end of July, slightly above the 10-year median. The pace of P/E expansion has outpaced EPS growth, suggesting a potential pause in momentum. However, as seen in prior cycles, such phases often precede renewed rallies once EPS begins to recover. The 12-month forward EPS, which blends current and next fiscal year forecasts, appears to be bottoming out. Notably, as time progresses, the weight of the higher-growth FY2027 forecast will increase in this blended figure, potentially supporting further upside.

Potential Upside Over the Next 6-9 Months and Risk Factors

From a valuation standpoint, as the market increasingly focuses on next year's earnings toward year-end, applying a 15x P/E multiple to the FY2026 consensus EPS (214.58) suggests a realistic TOPIX target of 3,200 equivalent to Nikkei 44,000. In addition to sustained foreign investor inflows, strong share buybacks are contributing to a favourable supply-demand dynamic.

Naturally, downside risks remain. Japan's \$550 billion framework agreement with the U.S., along with persistent stagflation concerns in the U.S., could act as headwinds, limiting the potential for a sharp re-rating in valuations. Additionally, the uncertain outlook for Japan's political landscape continues to be a concern. However, expectations for fiscal expansion may help offset these risks.

Contact Information

Asset Management One International Ltd.

30 Old Bailey
London
EC4M 7AU
UK

Telephone

+44 (0)207 090 6800

Email

business.development@am-one-int.co.uk

Website

www.am-one-int.co.uk

LinkedIn

www.linkedin.com/company/asset-management-one-international-ltd

Report prepared by

Kazuhiko Hosaka

Senior Product Specialist

Asset Management One Co., Ltd.

Tekko Building, 8-2
Marunouchi 1-chome
Chiyoda-ku
Tokyo 100-0005
Japan

Net Zero Asset Managers Initiative

Asset Management One is one of the 30 founding members of the Net Zero Asset Managers Initiative.

Signatory of:



Disclaimers

Asset Management One International Ltd. ("AMOI") is authorised and regulated by the Financial Conduct Authority ("FCA") in the UK. AMOI is the UK subsidiary of Asset Management One Co., Ltd. in Japan ("AMO Tokyo").

AMO Tokyo is regulated by the Financial Services Agency in Japan and conducts its discretionary investment advisory business as a registered and licensed investment advisor under the Financial Instruments and Exchange Act of Japan.

This material was prepared by AMO Tokyo for informational purposes only, and is neither an offer to buy or sell, nor a solicitation of an offer to buy or sell any security, instrument, or investment, nor a solicitation or an offer of any service (the "Transaction") and does not guarantee any realisation of the Transaction.

This material is only for and is directly only at persons who are qualified as Professional Clients or Eligible Counterparties under the rules of the FCA or equivalent client categories in certain jurisdictions, including institutional investors and financial intermediaries. Any persons falling into other client categories, including Retail Clients and persons who are restricted in accordance with US, Japanese or other applicable securities laws, should not rely or act upon it. If you have any doubt about any of the information in this material, please consult your financial advisor.

The information and opinions expressed in this material are based on views of the investment team at AMO Tokyo, publicly available information, and information that AMOI has legally obtained and believes to be reliable, accurate, and complete. However, AMOI does not guarantee the reliability, accuracy or completeness of the information and opinions expressed in this material.

Furthermore, the information and opinions contained in this material is only current as of the date this material was prepared and are subject to change without notice, and they may be affected by changes in the initial premises due to factors including, but not limited to, shifts in the market environment, and/or amendments in accounting, taxation and other applicable laws, rules and regulations. Any hypothetical illustrations, forecasts and estimates contained in this material are forward-looking statements and are based upon various assumptions. Changes to assumptions may have a material impact on forward-looking statements. The assumptions presented herein are strictly hypothetical, and this material does not suggest or specify all possible risks relating to the Transaction.

AMOI assumes no duty to update any statement in this material.

The value of an investment portfolio and the income from it may fall as well as rise, and investors may not get back the amount originally invested. Past performance is not a reliable indicator of future performance.

The decision to use the information and opinions expressed in this material and/or whether to enter into the Transaction should be made based on the sole judgment of each individual receiver of this material. It is recommended that each individual receiver of this material should consult with their legal, investment, accounting, tax and other professional advisers in order to make an independent determination of the suitability, risks and consequences of the Transaction before such decision is made. Nothing in this material shall constitute an obligation on either the recipient of the material or AMOI to enter into the Transaction.

The intellectual property and all other rights pertaining to the data published in this documentation including benchmark indices shall remain the property of the publisher and licensor.

Regardless of the purpose, any reproduction or circulation, in part or in whole, and/or use of this report in any shape or form without the prior written consent of AMOI is strictly prohibited. All liability under any applicable laws howsoever arising in connection with the use of this material by the recipient is hereby excluded to the fullest extent permissible by law.