Sumitomo Mitsui DS Asset Management

Japanese equities emerging from the fog of war

Japan Market Insights - May 2026

Japan Equity Research Team
SMDAM

We are one of the largest investment management companies in Japan, offering discretionary investment management, investment trusts and advisory services to a range of institutional investors, pension funds, government agencies and retail investors worldwide.

"The great uncertainty of all data in war is because all action is, to a certain extent, planned in a mere twilight – like the effect of a fog – giving things exaggerated dimensions and unnatural appearance"

Carl von Clausewitz, On War

With the current fragile ceasefire in the Gulf between the US and Iran still holding, global equity markets have been given some respite from the turmoil of the first month of intense military action. However, both the situation today and the path to any sort of return to normality in the Gulf remains far from clear. The fact that 6 weeks and counting of either zero or very low shipment levels passing through the Straits of Hormuz will soon result in physical shortages of unknown degree and duration is difficult for the equity markets to price, although we believe this has been done more successfully in the Japanese market than elsewhere.

All of this brings to mind the concept of the 'fog of war' developed by the Napoleonic general sometimes called the philosopher of war, Carl von Clausewitz. Although he seldom used the term precisely in this form, the idea of 'fog' or 'twilight' denoting the profound uncertainty that emanates out from war and clouds the ability of all participants to accurately assess the landscape and act rationally seems to capture the situation as it exists today both with regard to the status of the ceasefire and the looming supply shortages and how severe or short-term these may prove to be.

SMDAM's view

- Although the Middle East situation remains highly uncertain, the Nikkei 225 and TOPIX have been trading firmly over the past week.
- Factors behind this include still strong fundamentals across much of the Japanese market, as well as rising U.S. equities, a pause in the oil-price rally, expectations for an agreement in negotiations, and market views that the ceasefire deadline may be extended.
- If an end-to-hostilities scenario is being priced in to some extent, the key to whether Japanese equities can sustain their gains will be the upcoming Japanese and U.S. corporate earnings results and investor reaction to these.
- Whether or not it is premature at this stage to price in the peaceful conclusion of the conflict we cannot say. However, we would point out that where fundamentals have not yet deteriorated, as they haven't for most of the Japanese market, this seems to be an acceptable approach to the current uncertainty.

Reasons to be cheerful – corporate Japan's fundamentals remain strong

Going slightly deeper into why Japanese equities have remained firm despite the ongoing uncertainty and Japan's well-documented reliance on imported natural resources, we would draw attention to the following factors:

1) Major U.S. equity indices—including the Nasdaq Composite, the Philadelphia Semiconductor Index (SOX), and the S&P 500—have all been hitting fresh record highs day after day, led by gains in tech stocks. This optimism can appear to be incongruous with the events taking place in the Gulf, but the resumption of investor enthusiasm for the AI trade after a period of more muted engagement is understandable. This positive sentiment has fed through into the Japanese market where numerous AI-related stocks can be found, especially those crucial to the hardware and infrastructure layer of the new AI ecosystem.

2) Crude oil prices appear to be losing upward momentum and stabilizing, albeit at a higher level than that seen before the conflict began. This has provided some useful respite for heavy oil-importing economies like Japan, although the long-term vulnerability this conflict has highlighted remains as a structural problem in need of an eventual solution.

3) Finally, the global equity markets evidently still hope and expect that the US–Iran talks aimed at ending hostilities will ultimately result in an agreement that allows trade to flow freely again.

In particular regarding 3), given President Trump's past remarks and actions, if negotiations with Iran fail to make progress quickly, there is a high likelihood that the ceasefire deadline will be extended on an indefinite basis. This assessment appears to be widely shared by the market, and is part of why equity markets are rallying upwards so sharply despite no official settlement having been reached. Additionally, while both the U.S. and Iran are adopting a tough stance ahead of the ceasefire deadline, this may be "posturing" in public, and it is entirely possible that preparations for a second round of peace talks are progressing behind the scenes. This, too, seems to be priced in to some degree and is likely supporting expectations of a final agreement.

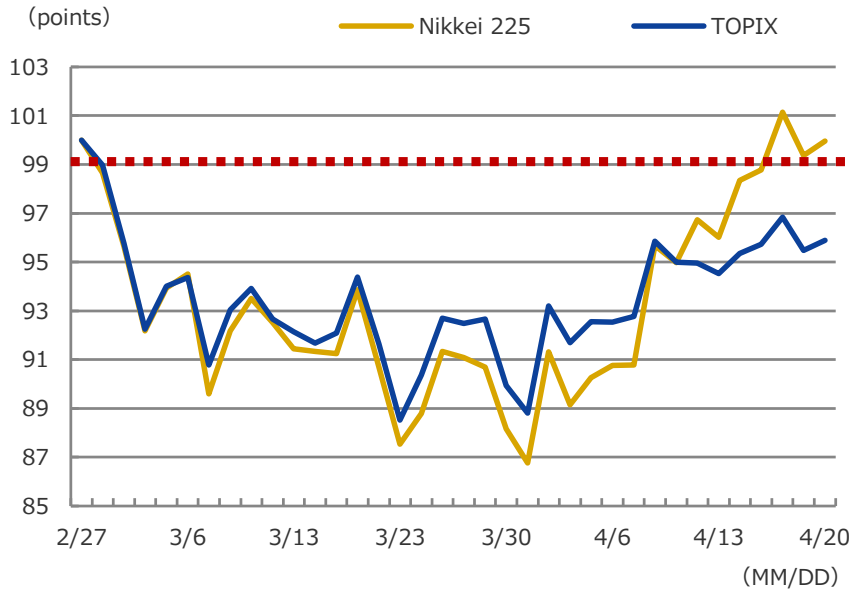
"Whereof one cannot speak, thereof one must be silent"

To quote a second philosopher, Ludwig Wittgenstein ends his famous text, Tractatus Logico-Philosophicus, with this enigmatic phrase. Put plainly, what you don't know about, you shouldn't or can't speak about. This is our approach to commenting in detail on the US-Iran negations, where the fog of war here is simply too impenetrable. Readers can see how fluid the situation is simply by comparing our views on the Japanese market from just a few weeks ago to how we frame the situation now.

However, we can comment by noting that the fundamentals of corporate Japan will likely from here forward take center stage in terms of defining the next movement of the market.

In other words, we believe there is a strong likelihood that U.S. and Japanese equities are rising early in anticipation of a scenario in which, as long as the ceasefire between the United States and Iran holds, negotiations will continue and will ultimately lead to an agreement and an end to hostilities. Assuming a return to some sort of trade arrangement at least somewhat similar to that before the war began, Japanese companies look well-positioned to ride out the turbulence. Looking again at recent price moves in the Nikkei 225 and TOPIX, the Nikkei has recovered to roughly its pre-attack level prior to the conflict commencing, while TOPIX has not yet fully recovered.

Nikkei 225 and TOPIX following the deterioration in the Middle East



The data cover the period from February 27 to April 20, 2026. Indexed with the closing value on February 27, 2026 set to 100. Source: Prepared by Sumitomo Mitsui DS Asset Management based on Bloomberg data.

The Nikkei has risen sharply in recent days, but the main contributors have been high-priced stocks such as Advantest, SoftBank Group, and Tokyo Electron, which appear to have benefited from the rally in US tech shares. If the above scenario for the Middle East is being priced in to some extent, the sustainability of the rise in Japanese equities is increasingly likely to hinge on the earnings results of Japanese companies as well as U.S. tech firms that are scheduled to be released in the coming weeks.

Major stocks contributing to the rise in the Nikkei 225

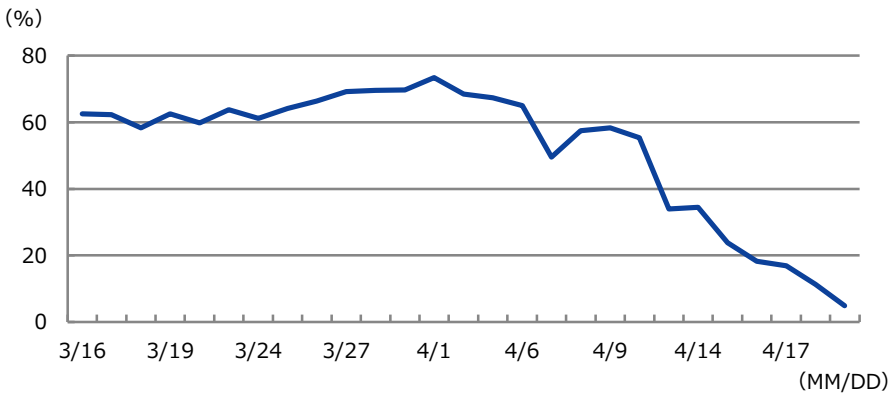
Rank	Stock / Contribution	Rank	Stock / Contribution
1	Advantest / ¥1,182.66	6	Fujikura / ¥233.11
2	SoftBank Group / ¥972.68	7	Kioxia Holdings / ¥169.89
3	Fast Retailing / ¥769.13	8	FANUC / ¥167.44
4	Tokyo Electron / ¥584.29	9	Daikin Industries / ¥84.64
5	TDK / ¥234.07	10	Murata Manufacturing / ¥76.59

The top 10 contributors to the Nikkei Stock Average's rise during the period from April 7, 2026, the day before the reported two-week ceasefire agreement between the United States and Iran, to April 20. During this period, the Nikkei rose by 5,395.33 yen. Source: Prepared by Sumitomo Mitsui DS Asset Management based on Bloomberg data.

Rates expected to remain unchanged

Lastly, the fact that global events have changed expectations for further monetary normalization in Japan is also relevant. The market-implied probability of a rate hike has declined, and the Bank of Japan (BoJ) is expected to leave rates unchanged this time; attention will be on the Outlook Report and Governor Ueda's remarks.

The probability of a BOJ rate hike in April as priced in by the market



Data covers the period from March 16 to April 21, 2026. The figures show the probability of a 25-basis-point (bp; 1 bp = 0.01%) rate hike at the April meeting in the uncollateralized overnight call rate as implied by overnight index swaps (OIS). Source: Prepared by Sumitomo Mitsui DS Asset Management based on Bloomberg data.

The BoJ will hold its Monetary Policy Meeting on April 27–28. The market-implied probability of a rate hike at this meeting briefly rose to around 70% in early April, but expectations have since retreated sharply, as the BOJ has not communicated anything suggesting an imminent hike. Accordingly, we have revised our forecast for the next rate hike to June, and raised our terminal rate assumption from 1.75% to 2.00%. Broadly speaking, this is supportive for the equity market and the stability of the monetary environment is a further factor aiding the market rebound.

Note: Although individual stocks are mentioned, this does not constitute a recommendation of those securities.

Contact Details

Sumitomo Mitsui DS Asset Management (UK) Ltd.
100 Liverpool St., London EC2M 2AT, United Kingdom

www.smd-am.co.uk - uksales@smd-am.co.jp

Richard HAXE
Managing Director, Head of Business Development
+44 20 7507 6431
richard_haxe@smd-am.co.jp

Alex BARRY
Executive Director, Head of Sales, UK and Ireland
+44 20 7507 6419
alex_barry@smd-am.co.jp

Chloé CHOQUIN
Director, Business Development
+44 20 7507 6424
chloe_choquin@smd-am.co.jp

Thomas CARTWRIGHT
Director, Business Development
+44 20 7507 6440
thomas_cartwright@smd-am.co.jp

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