Sumitomo Mitsui DS Asset Management

Markets rally on prospects of greater domestic investment, but fiscal credibility remains the key challenge

Japan Market Insights - July 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 world-wide.

Highlights:

- Markets staged a "triple rally" following Finance Minister Satsuki Katayama's comments encouraging greater domestic investment
- While a higher allocation to domestic assets by GPIF is conceivable, any portfolio changes are constrained by the fund's mandate to act solely in the interests of pension beneficiaries
- Efforts to broaden domestic investment and expand the investor base for Japanese government bonds are positive developments, particularly as the Bank of Japan reduces its bond purchases. However, sustained demand for government bonds will ultimately depend on confidence in Japan's fiscal management.

Japanese financial markets reacted strongly to comments from Finance Minister Satsuki Katayama on 10 July, after she stated that the government intends to encourage households and pension funds, including the Government Pension Investment Fund (GPIF), to increase investment in Japanese financial assets. Although no specific measures were announced, the remarks sparked a broad-based market rally, with equities rising, government bond yields falling, and the yen strengthening against the US dollar.

The market response reflected expectations that greater domestic investment could support demand for Japanese assets. Following the comments, the domestic market saw a "triple rally" as the Nikkei Stock Average rose sharply, while yields on 10-year Japanese government bonds declined and the yen appreciated.

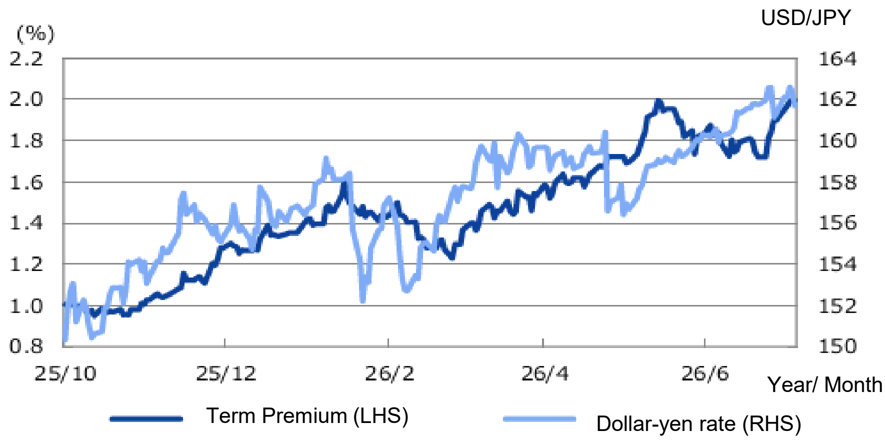
Table 1: GPIF's basic portfolio allocation

	Domestic Bonds	Foreign Bonds	Domestic Equities	Foreign Equities
Asset Allocation	25%	25%	25%	25%
Allowed deviation range (each asset)	±6%	±6%	±6%	±6%
Allowed deviation range (bonds/equities)	±9%		±9%	

Note: Asset allocation for the 5th Medium-term Objectives Period

Source: GPIF and SMDAM

Chart 2: Term premium and dollar-yen rate



Note: Data from 6 October 2025 to 10 July 2026. Liberal Democratic Party leadership election was on 4 October 2025.

Source: Bloomberg and SMDAM

What will be the role of GPIF, the world's largest pension fund?

Under its current strategic asset allocation, GPIF maintains a broadly balanced portfolio, with 25% allocated to each of domestic equities, foreign equities, domestic bonds and foreign bonds.

In theory, the fund could increase its allocation to domestic assets by reducing overseas holdings and reinvesting the proceeds in Japanese stocks and bonds. Such a shift would likely involve repatriation of capital, creating demand for the yen while simultaneously supporting domestic asset prices. The market's reaction therefore appears rational given these potential implications.

However, a meaningful change in GPIF's allocation is far from straightforward. The fund is required to manage assets exclusively for the benefit of pension beneficiaries and is prohibited from pursuing other policy objectives. In other words, portfolio adjustments cannot be made with the aim of supporting the currency or promoting broader economic policy goals. This fiduciary constraint makes the use of GPIF as a policy tool both challenging and politically sensitive.

Fiscal confidence is key to JGB demand

Minister Katayama's comments also highlighted the government's intention to expand the range of government bonds available to retail investors. This initiative comes as the Bank of Japan gradually reduces its purchases of long-term government bonds, increasing the importance of attracting alternative sources of stable demand.

Broadening the investor base to include households as well as domestic and international institutional investors will require clear communication on government bond issuance and a demonstration of commitment to fiscal consolidation.

Nevertheless, expanding participation alone is unlikely to be sufficient. Recent market concerns have centred on perceived weakening of fiscal discipline, as well as policy discussions that some investors believe could undermine the Bank of Japan's independence. These factors have contributed to rising term premiums and periods of yen weakness, underscoring the importance of maintaining confidence in the broader policy framework.

Ultimately, while measures designed to encourage greater domestic investment are likely to be welcomed by markets, the success of such initiatives will depend on more than institutional reforms. Sustained demand for Japanese government bonds will ultimately be underpinned by confidence in Japan's fiscal management. As a result, market participants will be watching closely for further details on both the government's investment initiatives and its broader fiscal strategy.

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

General disclosure:

The material is intended for professional and institutional investors only.

This material is intended for information purposes only without regard to any particular user's investment objectives or financial situation and should not be construed as an offer, solicitation, recommendation, or advice to buy or sell securities or pursue any investment strategy in any jurisdiction. Any examples used, charts, and graphs are generic, hypothetical, and for illustration purposes only. Any forecasts, figures, opinions, or investment techniques and strategies contained are for information purposes only, and are based on certain assumptions and current market conditions that are subject to change without prior notice. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. Nothing in this material constitutes accounting, legal, regulatory, tax or other advice.

No representation or warranty is made as to the accuracy, completeness, fairness or timeliness of the statements or any information contained herein. This material is not legally binding and no party shall have any right of action against Sumitomo Mitsui DS Asset Management (UK) Limited, including our affiliates, in relation to the accuracy or completeness of the information contained in it or any other written or oral information made available in connection with it. The views expressed are those of the author at the time of the writing. The material is correct to the best of our knowledge at the date of issue and subject to change without notice.

This material is issued by Sumitomo Mitsui DS Asset Management (UK) Limited. Registered in England and Wales. Registered office: 100 Liverpool Street, London, EC2M 2AT, United Kingdom; registered number 01660184. Authorised and regulated by the Financial Conduct Authority.

Risk warning: Investment involves risk, including possible loss of the principal amount invested, and the value of your investment may rise or fall. Past performance is not a reliable indicator of future performance and may not be repeated. An investment's value and the income deriving from it may fall, as well as rise, due to market fluctuations. Investors may not get back the amount originally invested.

4