



Japan's ROE revolution
Could the best be yet to come?

Japan Outlook - June 2026

For Professional Investors Only

1. Introduction

The Tokyo Stock Exchange's (TSE) well-known reform agenda is no longer an abstract or hypothetical concern. It has already driven meaningful changes in the return on equity (ROE) in the Japanese market; we believe this trend will continue and even accelerate. This white paper summarises our view of recent developments here, as well as providing our forward-looking view on how this theme will continue to play out.

2. Executive summary

- **Whisper it quietly: TSE reform is working, and there is still ample opportunity**

Since the TSE's 2023 request for listed companies to exhibit "cost of capital conscious management", the share of Prime Market companies trading below 1x PBR has dropped meaningfully. Following these early successes, the focus is now shifting from celebrating companies simply re-rating to book value and towards more profound and long-lasting transformations taking place as these self-same companies move on from fixing their houses to more ambitious and expansionary capital allocation policies.

- **The rising ROE story in particular has only just begun**

At circa 9.7%, the TOPIX 500's ROE remains roughly half that of the S&P 500. This illustrates just how far the rising ROE potential of the Japanese market may have yet to run to bring it up to or close to parity with the other developed markets. The comparative data shown below strongly implies Japan can and should expect ROE to continue to rise substantially from current levels.

- **The next easy-win? Japanese balance sheets are still cash-heavy**

Despite the progress made to date, cash and deposits still make up ~14–15% of Japanese non-financial corporate balance sheets. The US figure is closer to 2-3%. This excess cash is a tremendously powerful latent source of shareholder returns, M&A, and CAPEX. Japan's capital-efficiency story still has a multi-year runway ahead of it.

- **The momentum story building towards critical mass**

Shareholder total returns are accelerating sharply. Both dividends and buybacks for TOPIX 500 companies hit record highs in FY2024–FY2025, with the total shareholder return ratio approaching ~70%. Seen against the backdrop of a historical return of around 30–50%, this represents a dramatic shift in gears for a reenergised corporate Japan.

- **This all adds up to an ideal landscape for active management**

As shown on page 8 where we plot Forward ROE against Actual PBR, we can find a dense cluster of companies bunched around 7–10% forward ROE with PBR near 1. This implies this cohort of companies are priced as if they will only just earn their ~8% cost of capital. Companies in this cluster that can credibly lift ROE above cost of capital via margin improvements, capital returns, or smarter cash deployment therefore offer the most asymmetric re-rating potential in the Japanese market today.

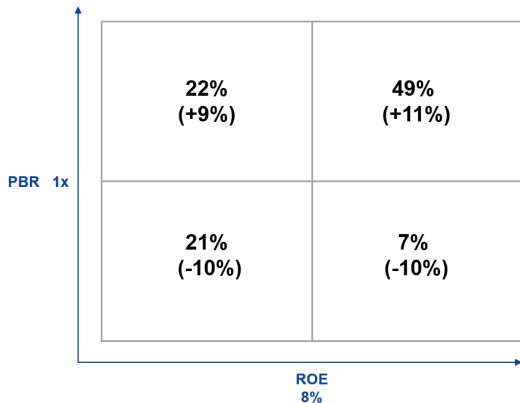


3. Corporate Japan under the microscope

How have Japanese corporates responded to these reforms?

As seen below, many of the 'main offenders' in terms of low PBR or ROE have significantly raised their game over the past 4 years.

Figure 1: Breakdown by PBR-ROE



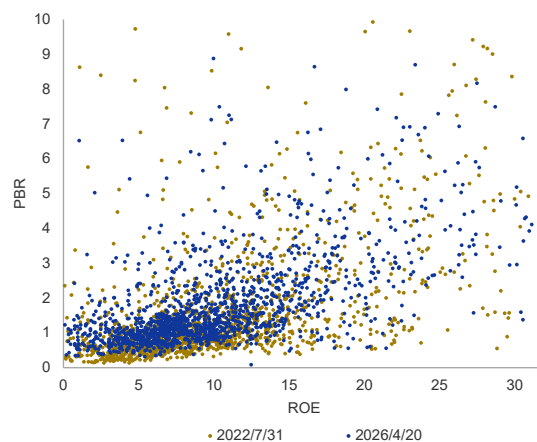
Source: Bloomberg as of April 2026

The worst performing low-ROE/low-PBR cohort of companies has seen its membership fall by 10%, and the also underperforming but not quite as egregiously cohort of low-PBR/high-ROE companies has also seen its numbers fall by around 10%. Meanwhile, the high-PBR quadrants have both grown as shown below in Figure 1.

The centre of gravity of the orange cloud of data points was notably lower than the current dark blue cluster, and the data in the table in Figure 1 that follows shows this numerically. Over the short years since the clarion call to improve these metrics was sent out by the TSE, the Japanese market has been fundamentally transformed into one much more favourable towards return-seeking investors. As we argue above and as the data below suggests, the best may well be yet to come, however.



Figure 2: PBR-ROE Distribution of Prime Market



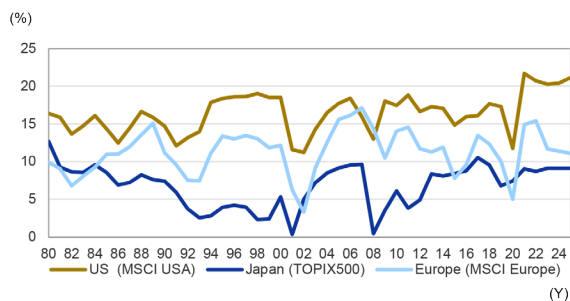
Source: Bloomberg as of April 2026

Japan's ROE: rapidly converging with other developed markets

As the ROE and Net Profit margins charts below show, while there has been a relative hierarchy of the US leading Europe and Europe leading Japan over time, the upward trend in Japan's relative performance is becoming more pronounced.

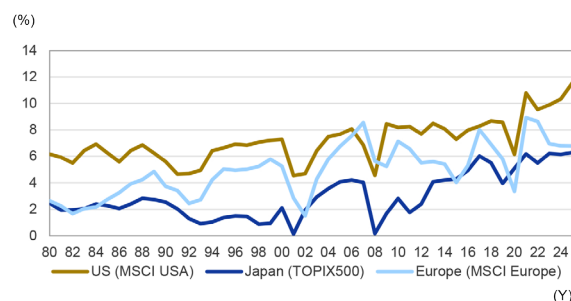
The DuPont decomposition shows this gap is driven not by leverage but mainly by lower net margins (-5.2%) and lower gross margins (-4.3%). This means the biggest re-rating catalyst for Japanese equities is likely to be margin expansion and business-portfolio reshaping, not just buybacks. Europe, whose industrial base and growth profile are more similar to Japan, has an ROE of around 12%.

Figure 3: Long-term trends of ROE in Japan, the US, and Europe



Note: Data as of December 2025. Excl. Financials (Japan: also Trading Cos)
Source: SMDAM and Daiwa Securities

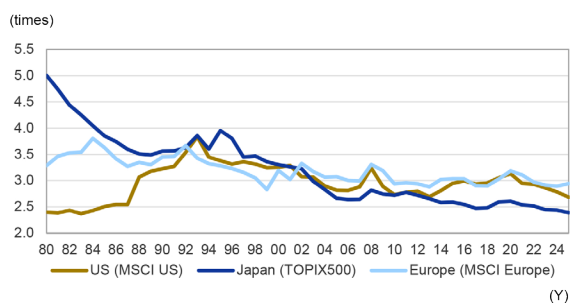
Figure 4: Long-term trends of net profit margins in Japan, US, and Europe



Note: Data as of December 2025. Excl. Financials (Japan: also Trading Cos)
Source: SMDAM and Daiwa Securities

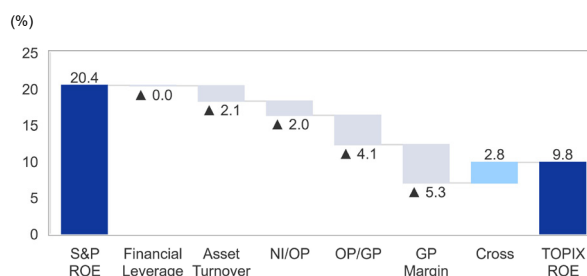
We believe investors may not have fully priced this into their view of Japan and how the market could continue to improve as the TSE agenda advances further. This trend is given support by the highly favourable profile corporate Japan displays in terms of declining leverage relative to their US and European competitors. As the chart below on the right makes clear, the potential upside in terms of how far ROE could rise in Japan is significant, with the TOPIX 500's ROE still less than half that of the S&P 500.

Figure 5: Long-term trends of financial leverage in Japan, US, and Europe



Note: Data as of December 2025.
Excl. Financials (Japan: also Trading Cos)
Source: SMDAM and Daiwa Securities

Figure 6: ROE comparison of Japan vs US (TOPIX 500 vs S&P 500, Ex-Financials)



Note: Data as of 31 March 2026
Source: SMDAM and Bloomberg

Fuel in the tank

The ability of Japan's companies to continue to improve their financial metrics and shareholder returns is supported by the availability of deployable cash on Japanese balance sheets.

Japanese corporates still have roughly 5x the US level of cash on balance sheets (~2–3%), and this leaves ample firepower available for better capital allocation policies to increase shareholder value across corporate Japan as the reform agenda continues to roll out.

Whilst credit will be essential to underpin the ongoing reindustrialisation effort in the US, not only did Japan never deindustrialise, or not to anything like the same extent, but Japanese companies still have ample financial firepower sat unused on their balance sheets today to allow for CAPEX as part of a measured capital allocation policy.

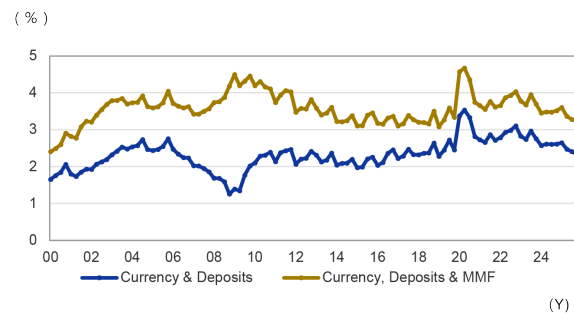
Figure 7: Cash Ratio in B/S of Japanese Non-Financial corporations



Note: Latest data are for 4Q 2025

Source: SMDAM and FRB

Figure 8: Cash ratio in B/S of US Non-Financial corporations



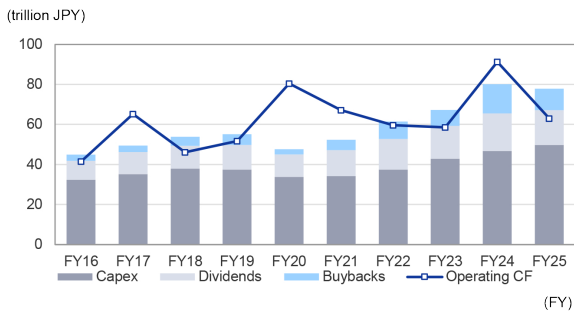
Note: Latest data are for 4Q 2025

Source: SMDAM and FRB



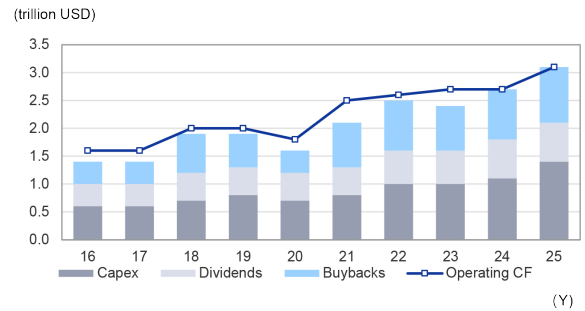
As such it is unsurprising that aggregate shareholder returns are trending upwards for the TOPIX 500, albeit with more volatility than is the case in the US market. The fact that buybacks have only recently begun to figure as a meaningful component of this return again suggests this pattern can be extrapolated forwards with a certain level of confidence.

Figure 9: OCF, investment, and shareholder returns for TOPIX 500 companies



Note: Latest data are for 2025
Source: SMDAM and Bloomberg

Figure 10: OCF, investment, and shareholder returns for S&P 500 companies



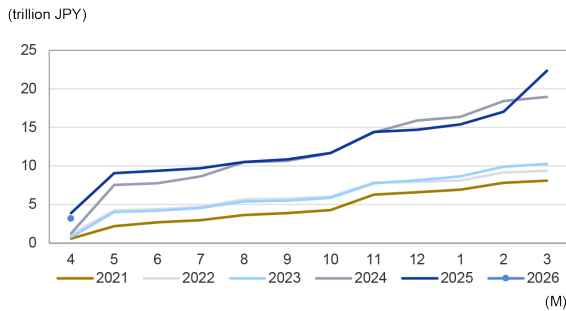
Note: Latest data are for 2025
Source: SMDAM and Bloomberg



Buybacks are back for good

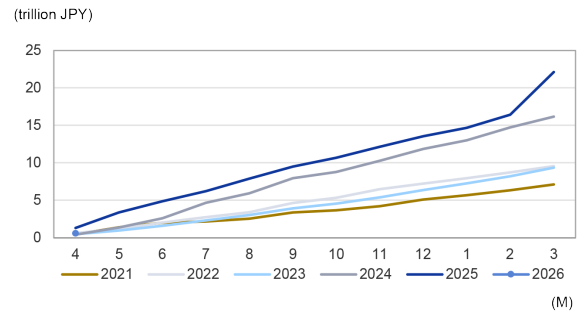
As referenced above, it is possible that share buybacks will take up the strain as a key driver of shareholder returns in the quarters ahead. As the charts below show, Japanese corporates are year-on-year increasing their activity in this space and it is by now an expected part of how management interacts with their shareholder base.

Figure 10: Share buyback programs by Japanese companies (FY Cumulative)



Note: Latest data are for March 2026
Source: SMDAM and INDB

Figure 11: Share buyback activity by Japanese companies (FY Cumulative)

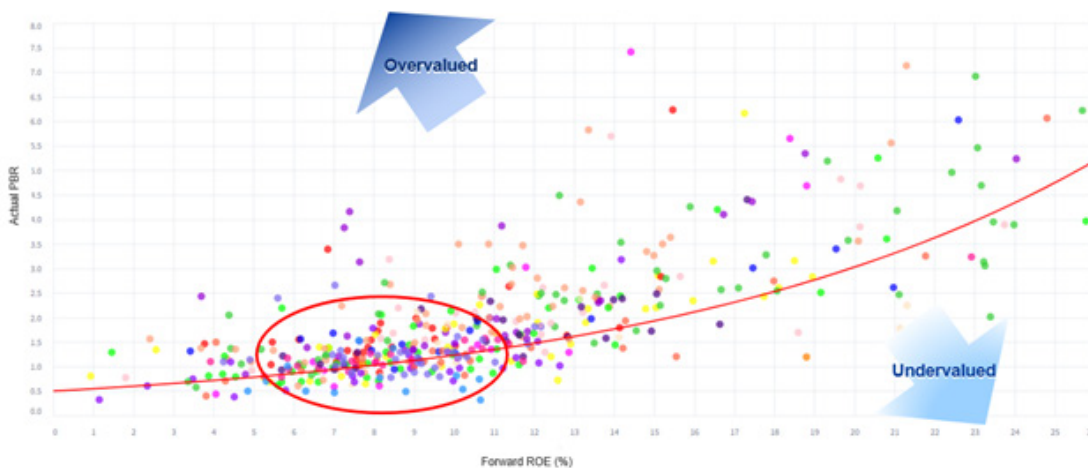


Note: Latest data are for March 2026
Source: SMDAM and INDB

Cumulative buyback announcements through March 2026 are running well above every prior year at circa ¥22 trillion, and this confirms that capital-return discipline is becoming embedded in the system rather than being seen as a ‘one-off’ not to be repeated.

Where might the best opportunities be found?

Drawing this all together, Japan will likely remain an ideal hunting ground for active managers. In particular, the narrative outlined above suggests some key locations for analysis to focus on. Below can be seen a visualisation of the Japanese market by PBR and ROE with a particular cluster of companies highlighted.



Source: Bloomberg, SMDAM as at 20 April 2026

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