Sumitomo Mitsui DS Asset Management

Familiar melody – new rhythm: Japan’s corporate reform agenda building to a crescendo

SMDAM’s discussions with the TSE - September 2026

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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.

Japan’s place in a (re)evolving global capital market

In global markets, Japan’s traditional role as a diversifier and quasi-safe haven is now being complemented by a newer view that corporate reform could drive earnings growth alongside a potential re-rating.

A key engine of this is the cultural paradigm shift underway in the boardrooms of corporate Japan. With the generation of CEOs who stewarded their companies through the barren decades of the 1990s and 2000s now retiring, a new crop of younger managers more geared towards innovation, risk-taking and growth are taking over. We have previously discussed this trend, and it is part of why we believe there is still so much fuel to add to the fire that has been ignited under the Japanese market.

While allocators appeared in early 2026 to be actively moving capital out of the US and into other markets, as they had the previous year, the picture is less clear today. As such, the so-called Great Rotation may still be turning, potentially pointing back towards sustained inflows into US markets. In fact, the phrase ‘Great Rotation’ is beginning to resemble how the concept of ‘revolution’ was originally understood.

20th-century political theorist Hannah Arendt observed that the original meaning of ‘revolution’ contrasted sharply with its modern usage. It originally referred to something – commonly a celestial body – completing a 360-degree cycle and returning to its starting point.

Applied to societies, a revolution therefore meant a change from one situation to its opposite, and then back again. Only with the French Revolution did the term come to describe a change (from Monarchy to Republic, in that case) without a return to the original position.

Today, Japan’s investment case is evolving from a story of governance reform to one of expected earnings growth. With the low-hanging fruit of corporate governance improvements already harvested, the stage is now set for growth to build on those foundations.

1. Where is Japan today?

Our view is that improving corporate behaviour, greater market discipline and structural reforms are creating opportunities, while persistent yen weakness remains the principal headwind.

You may have heard this already, but please take another look! The Japanese market is currently experiencing something completely unprecedented. As the graphic below summarises, the market has achieved record highs across a range of indicators. Crucially, we wish to draw attention to the particular peaks seen in corporate M&A activity and shareholder proposals from institutional investors. Taken in tandem, we believe this suggests the gains from the reform agenda are only just starting to shine through, and investors can be confident a multi-year runway lies ahead for corporate Japan to continue to accelerate.

Market snapshot

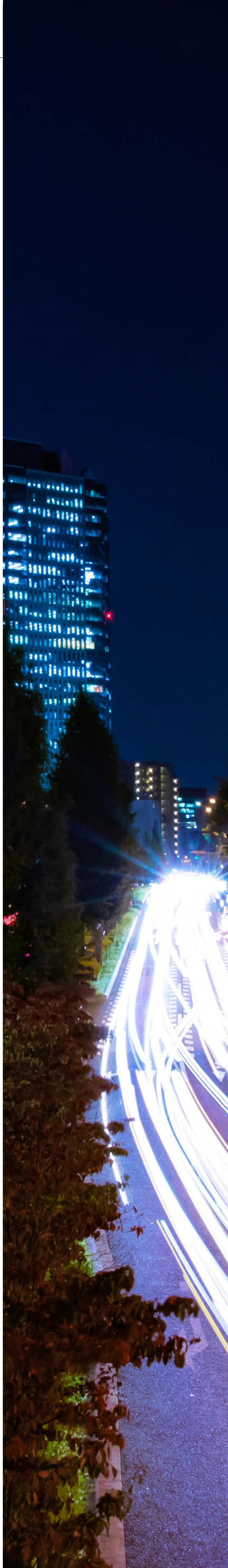
Record High TOPIX Index **4,095.05** point Closing price on June 22, 2026	Record High Cross-shareholding sales **9.2** trillion JPY Companies that FY end in March 2025	Record High Shareholder returns **44** trillion JPY FY 2025
Record High Shareholder proposals (Institutional Investors) **150** As of June 2026	Record High M&A cases **5,115** M&A in 2025	Companies disclosing capital efficiency improvement plan **94%** in Prime Market As of Apr. 2026
Record High Companies adopting stock compensation **2,415** Companies As of Aug 2025	Retail investment through new NISA accounts **30** trillion JPY As of the end of January, 2026	Companies with at least 1/3 independent directors **99%** in Prime Market As of July 12, 2025

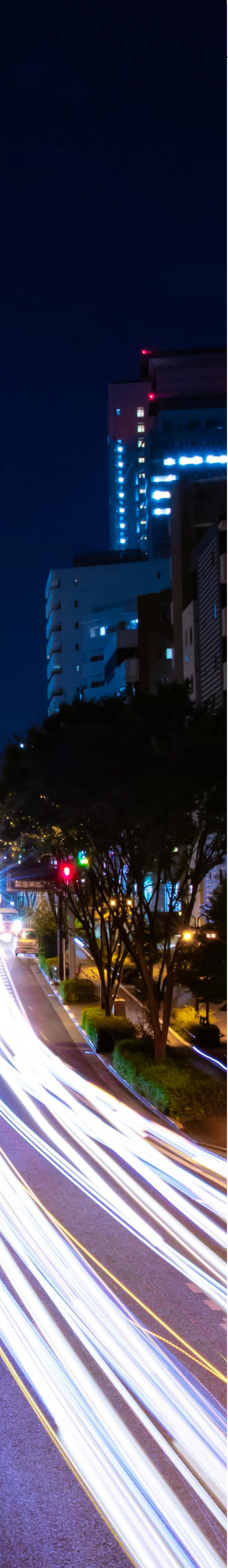
Source: MARR Online (Refco) and Nikkei, Inc.

The Tokyo Stock Exchange's (TSE) central message is that Japan's corporate governance transformation remains firmly on track today, with gains already delivered but so much more yet to come. Japanese companies today are all but unrecognisable from their predecessors of 10 years ago in terms of being more focused on shareholders, capital efficiency, and market valuations. With ongoing support from regulators, government agencies, and investors, the best may be yet to come.

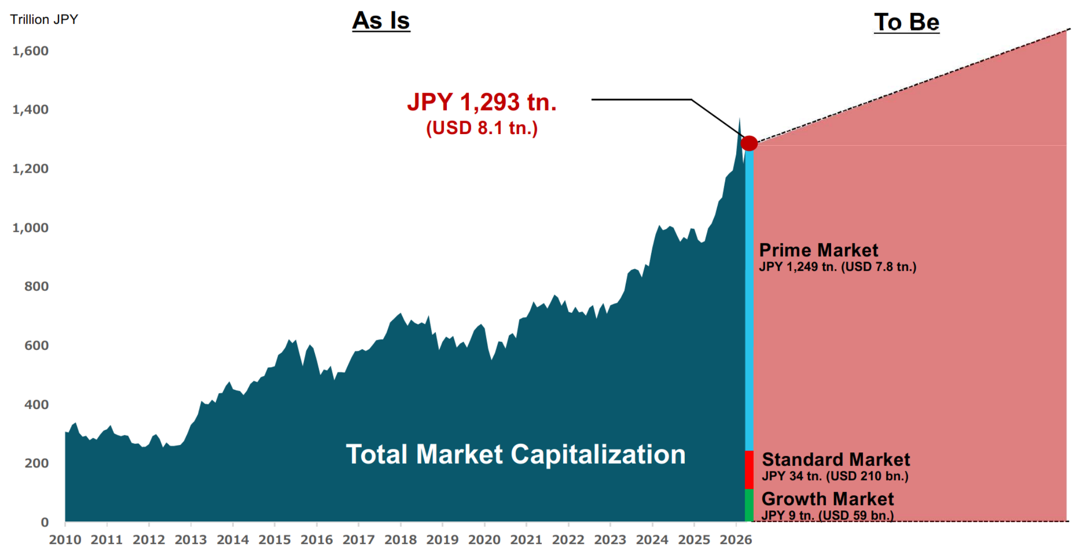
The TSE have described Japan as only being in the "second innings". Perhaps a more appropriate analogy for non-US investors today would be that we're somewhere approaching the half-time whistle. Huge progress has been made, but the groundwork laid over the past decade still has much more to yield up.

One concrete metric by which this process can be tracked is the steady expansion of listed market cap over recent years. The chart on the next page gives an overview of where this sits currently – as well as where we hope to get to eventually.





Our perpetual goal

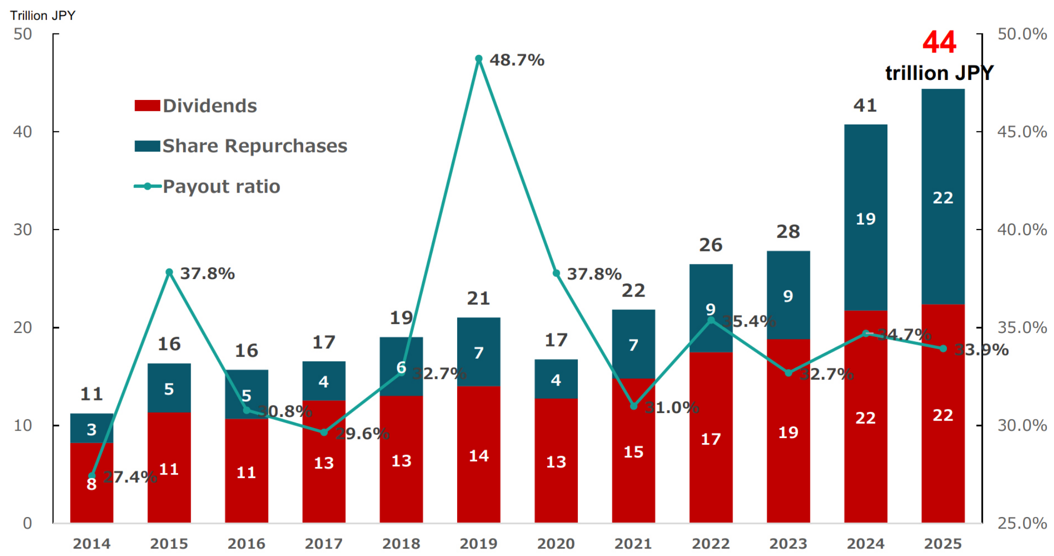


Source: Tokyo Stock Exchange, 1 USD = 160 JPY as of the end of April 2026

2. More efficient market means better shareholder returns

The governance improvements matter first and foremost because they have changed corporate behaviour, thus enhancing shareholder total returns. As the chart below shows, buybacks have risen sevenfold over the past decade, while dividends have almost tripled.

Shareholder returns

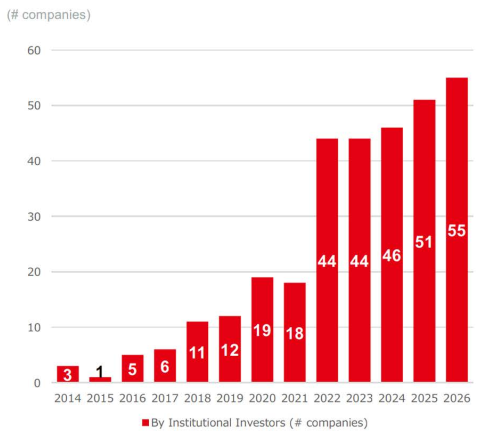


Source: JPX, Ichiyoshi Securities, SBI Okasan Securities, Bloomberg based on data from Okasan Securities, as at the end of December 2025.

Japan is seeing record levels of shareholder activism, rising takeover activity, increasing M&A, and growing private-equity involvement. At the same time, longstanding barriers such as cross-shareholdings and takeover defences are steadily being dismantled, creating a healthier market for corporate control and value creation.

The real step-up in activity here came in FY2022, and as the chart below highlights, this elevated level has since become the new normal for Japan.

Shareholder proposal trends



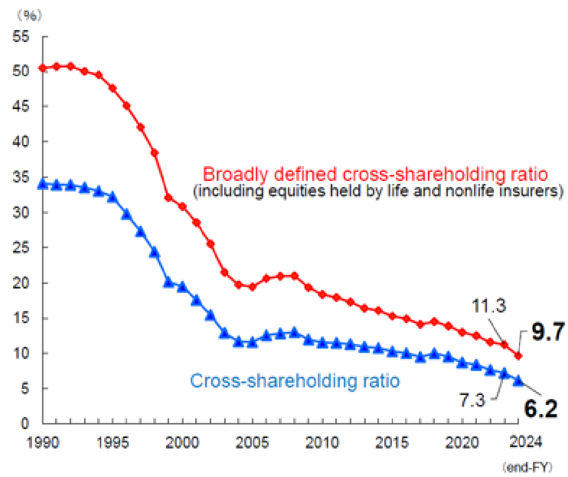
Institutional investor proposal themes

Proposal Theme	June 2023	June 2024	June 2025	June 2026
Finance-related ✓ dividend increase ✓ share repurchase, etc.	40	53	41	36
Governance-related ✓ appointment/dismissal of directors ✓ changes to articles of incorporation, etc.	54	49	71	101
Disclosure ✓ cost of capital ✓ officer compensation, etc.	21	25	22	10
Management strategy	1	2	0	3
Total	116	129	134	150

Source: Sumitomo Mitsui Trust Bank compiled by JPX as of end of June 2026.

Encouragingly, both the absolute increase and classification of the proposals submitted imply strong governance is now high on investors' list of priorities.

'Cross-shareholdings are declining



Source: Nomura Institute of Capital Markets Research

Lastly, this trend has been reinforced by the dramatic unwinding of cross-shareholdings. Although much of the heavy lifting on this front was completed in the 1990s, the steady downward trend from 2010 onwards has consolidated and built on this early progress.

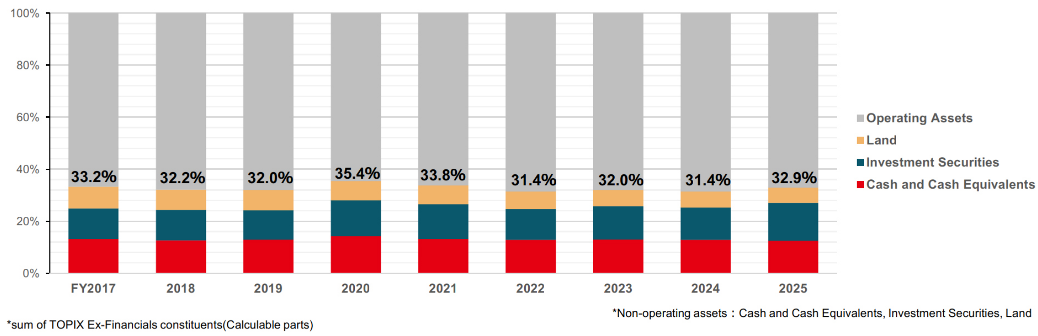
Corporate Japan today exhibits much cleaner and clearer lines of separation between rival entities than was the case in the past and investors are taking note of this.

3. Shift from 'value preservation' to 'growth creation'

The TSE is increasingly encouraging a focus on growth rather than simply improving governance alone. Japan has tremendous pent-up potential in this regard. Strategic sectors such as AI, quantum computing, pharmaceuticals, aerospace, and other high-growth industries of the future are being prioritized.

Regardless of industry sector, however, the sheer scale of monetary ammunition that Japanese corporates could in theory bring to bear on generating growth is significant. As the chart below shows, the ratio of operating to non-operating assets remains far above what leaner Western companies would run. The firepower available for investment into M&A, R&D, human capital, Capex and buybacks/dividends remains formidable.

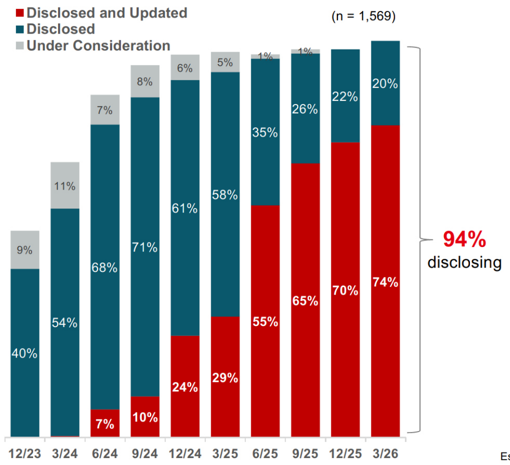
Non-Operating Assets



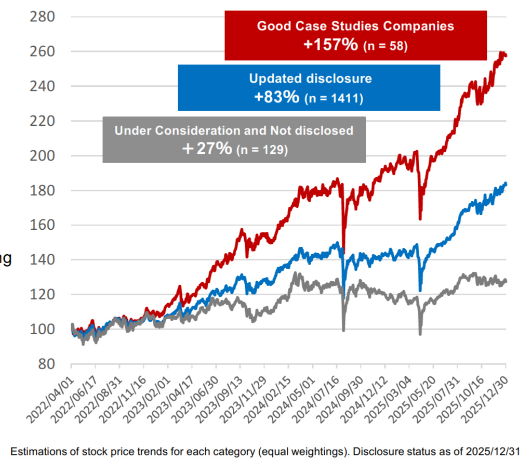
Source: Bloomberg, as of December 2025

The TSE believes it is succeeding in gradually shifting Japanese management teams away from a conservative capital-preservation mindset toward investing for future growth. Part of this reflects the increased expectations for disclosure, the impact of which on performance can be seen from the chart below. The clear and obvious linkage between better disclosure and better performance has not been missed by Japanese corporates.

Prime Market Rate of Disclosure



Post-Disclosure Impact: Prime



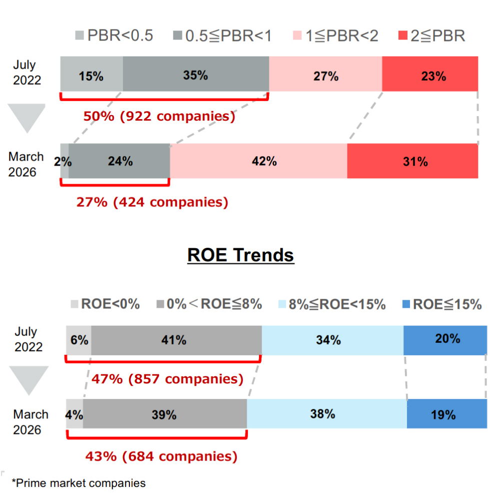
Source: Tokyo Stock Exchange - (Left chart: as of March 2026; Right chart: December 2025)

4. Reforming the IPO and growth ecosystem

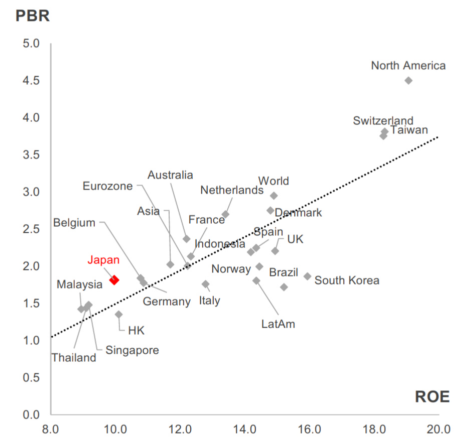
The TSE sees Japan's startup and IPO ecosystem as underdeveloped relative to the US in particular. Historically, many companies viewed an IPO as a badge of prestige rather than the beginning of a growth journey. The TSE's new Growth Market reforms aim to encourage only larger, more scalable businesses to come public, with better post-listing performance, greater institutional participation, and stronger accountability through market-cap and growth targets as outcomes.

The ultimate goal of this would be to fix Japan's previously woeful performance as measured via metrics like PBR and ROE, although importantly as the charts on the following pages show, progress to date on this front has been substantial.

PBR Trends



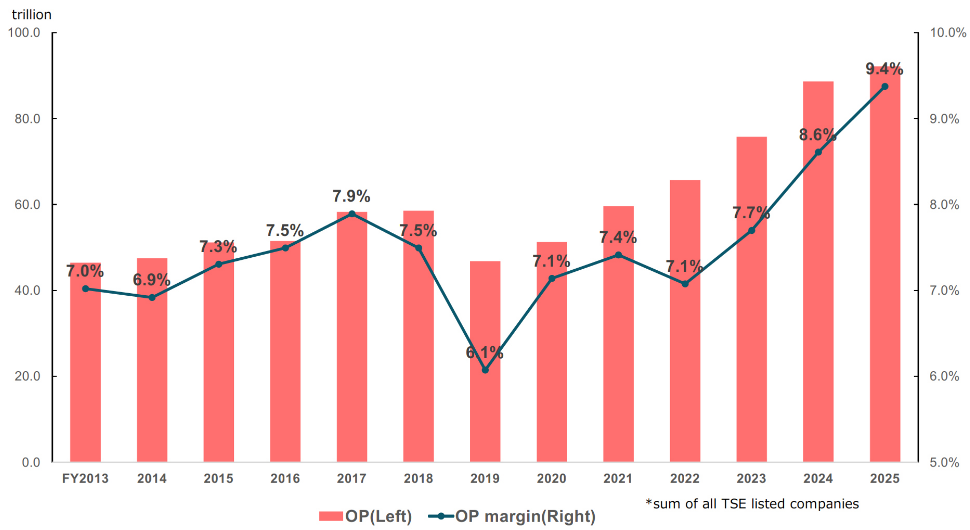
International comparison (ROE vs PBR)



Source: Goldman Sachs Securities, as of March 2026.

As the Japanese market begins to move away from the bottom left quadrant and towards the upper right of the chart above, investor interest in Japan will naturally expand, potentially providing the subsequent inflows to keep the momentum going. Margin expansion has also been part of this story, with the increased focus on ROE having translated into an upward trend here.

Profit and margins have been trending higher



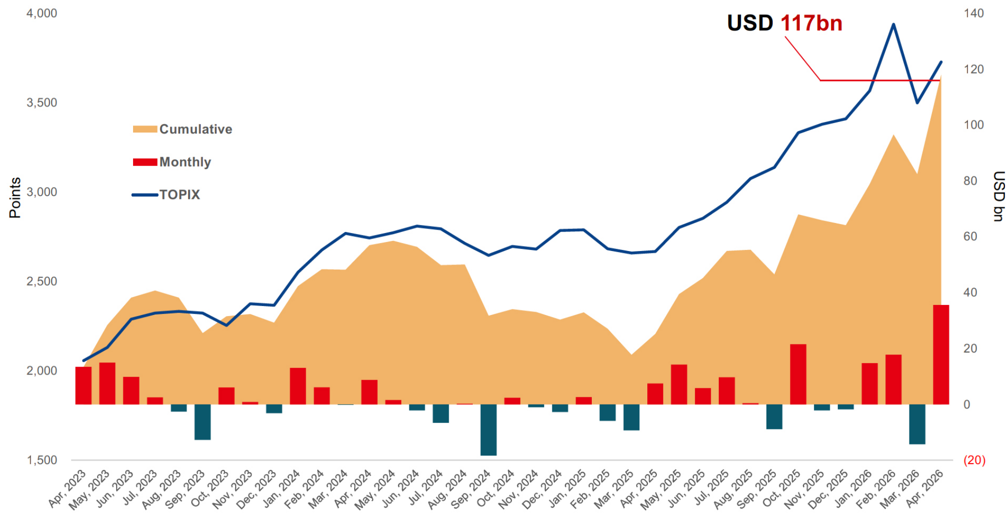
Source: Bloomberg, as of December 2025

5. Biggest challenge remains the yen

As we have discussed previously, yen depreciation remains an ongoing risk. While governance and market reforms are positive, the weak yen remains the key concern for international investors. The TSE views currency weakness as the most significant near-term issue facing investors evaluating Japan.

However, inflows since the TSE launched its capital efficiency request in March, 2023 have far exceeded expectations. As can be seen below, notwithstanding yen weakness, global investors have allocated more than $115 billion into the Japanese market in recent years. As such, yen weakness can be seen as both a near-term risk and a medium-term opportunity.

Foreign inflows



Note: USD=160 JPY

Source: Bloomberg, as of April, 2026

Bring it all together

- Japan is increasingly being viewed as a structural growth opportunity rather than simply a governance reform story.
- TSE reforms are delivering results but still have further to run. Corporate behaviour has improved materially, and we believe the reform journey is only around halfway complete.
- Shareholder returns are improving. Buybacks, dividends, activism, and M&A activity have all risen, while cross-shareholdings continue to decline.
- Japanese companies have substantial growth firepower. Strong balance sheets and excess assets provide capacity for investment, M&A, R&D and other growth initiatives.
- The weak yen remains the key risk, but foreign investor inflows have stayed strong, reflecting confidence in Japan's long-term structural transformation.

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