

Higher oil, higher rates, higher markets? Japanese equities set against rising rates and crude prices

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Marketing communication for professional investors only

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.

Executive summary:

- The Nikkei 225 has remained soft amid rising crude oil prices and long-term interest rates.
- This masks a high degree of style, size and sector rotation taking place underneath the surface, however.
- By sector, resource- and energy-related and financial sectors have performed well; by style, value has outperformed; and by size, small caps have performed well.
- As long as upward pressure on crude oil prices and long-term interest rates persists, we expect investor attention to remain focused on the value factor, small-cap relative to large, domestic-demand as opposed to exporters, and high-dividend payers over future growth prospects.

Looking beyond the index – winners and losers in a high dispersion environment

After reaching a record high of ¥72,366.34 on June 25 (based on closing prices; the same applies hereinafter), the Nikkei Stock Average has tended to weaken and remain range-bound. During this period from June through to mid-September, WTI crude oil futures rose 47.1%, while Brent crude oil futures rose 44.5%, highlighting the sharp increase in crude oil prices globally. As a major oil and energy importing economy, Japan has undoubtedly been negatively affected by this shift. Amid inflation concerns and other factors, Japan's 10-year government bond yield rose 40.8 basis points (bp; 1 bp = 0.01%) and has now exceeded the symbolic 3% level.

Such increases in crude oil prices and long-term interest rates are presumed to have contributed to the Nikkei 225's weak performance after it reached a record high. In this report, therefore, we examine the performance of sectoral, style, and other indices besides the Nikkei 225 from June 25 through September 15, in order to explore how Japanese equities as a whole performed amid rising crude oil prices and long-term interest rates. The story is noticeably more complicated than might appear simply by looking at the headline index performance; we see this as encouraging for investors willing to commit to stock selection as an approach to find alpha from markets that may trade sideways for some time.

Has the ”HALO” trade reached Japan?

The so-called “Heavy Assets, Low Obsolesce” trade became well-known in early 2026 as a means to navigate AI-related uncertainty. The basic idea is that we are rapidly rotating out of a world in which low margin call software and technology companies represented the best investment propositions and into one where previously unloved heavy asset plays (resource, energy, even defense) are now back in demand due to their essential role in making the AI revolution happen.

It might at first seem as though Japan is not likely to feature prominently in this trade given the composition of the Japanese market. However, a type of HALO rotation has indeed been occurring in Japan recently.

First, looking at the 33 Tokyo Stock Exchange sector indices, strong performance can be observed in resource- and energy-related sectors, which tend to benefit from higher crude oil prices, as well as in financial sectors such as banks, which tend to benefit from rising long-term interest rates. In contrast, electrical machinery and nonferrous metals, including artificial intelligence (AI)- and semiconductor-related stocks; glass and ceramics products and chemicals, which tend to face headwinds from higher crude oil prices; and construction and real estate, which tend to face headwinds from rising long-term interest rates, have posted weak performance. These trends are summarized in Figure 1.

Figure 1: Japanese equity performance amid rising oil prices and long-term

Industry Indices					
Marine Transportation	36.2	Information & Communication	9.0	Chemicals	-8.4
Services	28.4	Land Transportation	8.7	Metal Products	-9.3
Oil & Coal Products	21.0	Pharmaceuticals	6.0	Machinery	-10.2
Mining	20.4	Warehousing & Harbor Transportation	5.5	Electric Appliances	-14.8
Securities & Commodity Futures	17.0	Rubber Products	4.0	Nonferrous Metals	-24.5
Insurance	15.3	Textiles & Apparels	3.3	Glass & Ceramics Products	-24.9
Wholesale Trade	15.3	Other Financing Business	2.9		
Electric Power & Gas	14.3	Air Transportation	2.8		
Iron & Steel	14.1	Foods	2.7		
Banks	12.9	Fishery, Agriculture & Forestry	-0.1		
Other Products	11.4	Retail Trade	-2.4		
Pulp & Paper	9.6	Real Estate	-2.8		
Transportation Equipment	9.5	Construction	-5.4		
		Precision Instruments	-8.0		

Style Indices	
TOPIX Value	3.3
TOPIX Growth	-2.5
Size Indices	
TOPIX Small	3.3
TOPIX 100	1.7
TOPIX Mid 400	-3.5
Domestic / External Demand Indices	
Nikkei Domestic Demand Stocks 50 Index	6.9
Nikkei External Demand Stocks 50 Index	-14.0
Theme Indices	
Nikkei 225 High Dividend Yield Stock 50 Index	11.6
Nikkei Consecutive Dividend Increase Stock Index	5.9
Nikkei Progressive High Dividend Stock Index	5.0
Nikkei Semiconductor Stock Index	-35.3
Market Indices	
TSE Growth Market Index	12.0
TSE Standard Market Index	4.2
TSE Prime Market Index	0.5
TOPIX and Nikkei 225	
TOPIX	0.5
Nikkei Stock Average	-12.3

Note: Data covers the period from Q2 1985 to Q2 2026. Seasonally adjusted. Large firms refer to corporations with capital of 1 billion yen or more. Medium-sized and small firms refer to corporations with capital of 10 million yen or more but less than 1 billion yen.

Source: Compiled by Sumitomo Mitsui DS Asset Management based on Ministry of Finance data.

Next, looking at style indices, growth stocks (TOPIX Growth) fell 2.5%, while value stocks (TOPIX Value) rose 3.3%, showing relatively strong performance. Among size-based indices, small-cap stocks (TOPIX Small) rose 3.3%, large-cap stocks (TOPIX 100) rose 1.7%, and mid-cap stocks (TOPIX Mid400) fell 3.5%. This suggests that, amid rising crude oil prices and long-term interest rates, funds flowed into value and small-cap stocks.





Will small still be beautiful?

Looking ahead we expect value and small-cap stocks to continue to be best placed in this environment.

In terms of domestic- versus external-demand exposure, domestic-demand stocks (the Nikkei 225 Domestic Demand Stock 50 Index) rose 6.9%, in sharp contrast with external-demand stocks (the Nikkei 225 External Demand Stock 50 Index), which fell 14.0%. By theme, high-dividend stocks performed well, while semiconductor stocks posted particularly large declines. By market segment, the TSE Growth Market Index, which includes many domestic-demand stocks, rose 12.0%; the TSE Standard Market Index rose 4.2%; and the TSE Prime Market Index rose 0.5%. The Tokyo Stock Price Index (TOPIX) also rose 0.5%.

Thus, amid rising crude oil prices and long-term interest rates, “value stocks,” “small-cap stocks,” “domestic-demand stocks,” and “high-dividend stocks” appear to have been favored from June 25 through September 15. It can be concluded that investment funds did not flow out of the Japanese equity market as a whole, at least. While these categories may not necessarily continue to deliver relatively strong performance going forward, they are likely to attract attention as long as upward pressure on crude oil prices and long-term interest rates remains.

Drawing it all together

Rising oil prices and higher long-term interest rates have weighed on the Nikkei 225 even as Japan’s broader equity market remained relatively resilient. WTI and Brent crude prices surged more than 44%, while Japanese 10-year bond yields rose above 3%. These changes are serious and structural in nature, and have created the conditions for a widespread style and sector rotation in the Japanese market.

Market leadership shifted toward sectors and styles that benefit from this environment. Resource, energy and financial stocks outperformed, while AI, semiconductor, construction and real estate-related sectors lagged. Value stocks outperformed growth stocks, and small-cap stocks delivered stronger returns than large- or mid-cap peers.

Domestic-demand and high-dividend stocks proved particularly resilient. As such we believe that value, small-cap, domestic-demand and high-dividend stocks are likely to remain areas of interest as long as oil prices and bond yields continue to face upward pressure.

The current Financial Position DI stands at a high level of 11 percentage points, indicating ample financial leeway. Considering the recent correlation with the spread between ROA and the average interest rate paid, even if future rate hikes compress the spread to around 2 percentage points, the DI is very likely to remain in positive territory. While variations across individual firms warrant caution, a scenario in which corporate financing conditions deteriorate rapidly across the corporate sector as a whole appears unlikely.

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