

Japan Insights | Market Strategy by Nozomi Moriya

TOPIX Reform - A Driver of Corporate Transformation

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TOPIX is changing. In the first phase of its review, from October 2022 through January 2025, the index reduced the weighting of less liquid stocks, cutting its constituent count from around 2,200 to roughly 1,700. The second phase begins on October 30, 2026. Under the new criteria, stocks will be selected based on factors such as market capitalization and liquidity, regardless of their market segment. The revised index will have fewer than 1,000 constituents. The transition is scheduled to be completed by the end of July 2028, after which constituents will continue to be reviewed regularly.

TOPIX is shifting from an index focused on “representing the market” to one designed to function as an investable benchmark. The question will no longer be simply whether a company is listed, but whether it can earn a place in the market and attract capital on an ongoing basis.

Three and a half years have passed since the Tokyo Stock Exchange called on companies to manage with a clear focus on their cost of capital and share price. During that time, many companies have disclosed their policies and taken steps such as raising dividends, buying back shares and unwinding cross-shareholdings. Some overseas investors have suggested that the initial wave of reform has run its course. But disclosure and shareholder returns are not the end point. Companies must revisit their capital structures and business portfolios, then channel capital into growth. This is where the real work of corporate transformation begins.

Market discipline is driving corporate change

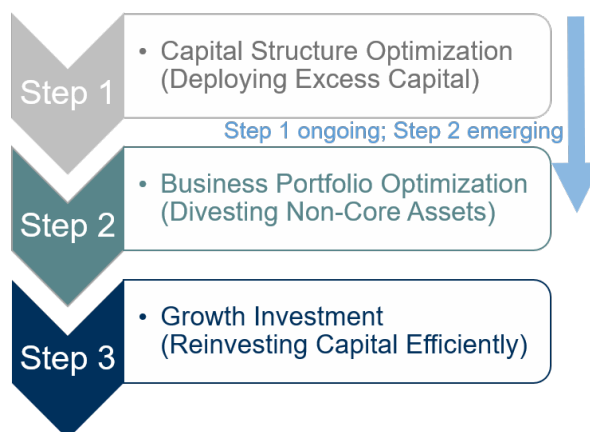
The forces behind this transformation extend beyond the TSE’s market reforms. Shareholder bases are changing, and investor engagement is intensifying. As strategic shareholdings are reduced and cross-shareholdings unwound, companies can no longer rely as readily on stable shareholders.

The business environment itself is also changing, as inflation returns and interest rates become a lasting feature of the landscape. In an era of deflation and near-zero rates, holding substantial cash reserves and maintaining a range of businesses and assets could be rational. But what made sense then may no longer be optimal today. Price signals and market discipline are once again beginning to shape corporate decision-making.

From shareholder returns to business reshaping—and then growth investment

Capital allocation is not a binary choice between shareholder returns and growth investment. Nor are the two inherently at odds. The real questions are what capital structure a company should adopt, which businesses it should fund, and how it can generate growth from those investments.

Figure 1. Three phases of corporate transformation: from shareholder returns to portfolio reshaping, then investment



Source: Nomura Asset Management

The first priority is to build on the capital policies already under way—including dividend increases and share buybacks—and use them to optimize the capital structure. Is the company holding excessive cash? Is its capital structure, including debt, appropriate? Is there scope to make better use of leverage? Reviewing these questions continuously and acting on the answers is the first step.

Once a company focuses on its capital structure, it must also examine its business portfolio. The appropriate capital structure depends on the mix of businesses. Companies need to assess the role of each business and be prepared to scale back or exit low-return operations when necessary. The question is not simply what to protect, but what to retain—and what to let go.

Growth investment comes next. Companies with low capital efficiency are unlikely to win investors' confidence by talking about growth investment alone. They first need to rebuild their capital structures and business portfolios and set out a clear capital-allocation strategy. When that strategy is convincing, investors can have confidence in the company's investment decisions and commit capital. And the opportunities for growth investment are expanding—from M&A that could drive industry consolidation, to fields linked to advanced technologies such as AI, as well as investment related to economic security and public-private collaboration.

Companies are expected to increase their value sustainably through strategic, agile capital allocation.

Assessing the upside for ROE and PBR

The ROE of Japanese companies has risen to around 10% overall. By comparison, companies in Europe and the United States are at roughly 15%. Differences in industry structure and the cost of capital mean that Japanese companies should not simply aim to match their Western counterparts. Even so, they still have room to lift ROE through greater use of leverage and improved margins.

Higher ROE can also support a higher PBR. If the current cost of equity and expected growth rate are held constant, an increase in ROE from 10% to 12% could lift PBR from approximately 1.7 times to 2 times. If ROE rises to 15%, PBR could reach around 2.5 times. This is, of course, only a mechanical estimate; actual share prices depend on many factors.

Ultimately, whether TOPIX can reach 6,000 or the Nikkei Average 100,000 will depend on whether market discipline takes hold—and whether companies can reassess their capital structures, reshape their businesses and increase corporate value through growth investment. In other words, I believe Japanese equities still have room to be revalued through companies' own decisions.

Note: This material contains personal views and does not necessarily reflect Nomura Asset Management's house view.

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Nozomi Moriya is Chief Strategist for Institutional Clients in Japan and overseas at Nomura AM. She joined the firm in September 2026 after more than two decades at UBS, where she worked as an equity analyst covering the Japanese consumer sector before becoming Japan Equity Strategist in 2023.

Drawing on her extensive experience analyzing Japanese companies and industries, she specializes in analyzing Japan's corporate reforms and connecting bottom-up corporate developments with broader macroeconomic and capital-market trends. She also actively shares her views on Japanese equities with audiences in Japan and abroad, highlighting their global appeal.

She graduated with a B.A. in Economics from the University of Tokyo in 2003.

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Customers pay the following expenses.

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[Calculation formula] Assets amount under contract x fee rate (%) x length of the contract (days) / 365

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Important Information (based on Japan Financial Instruments Exchange Act)

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Investment trusts primarily invest in securities whose prices fluctuate, such as domestic and international equities and public and corporate bonds. As the principal amount invested is not guaranteed, the price per investment unit may fluctuate due to changes in the market prices of the underlying assets, foreign exchange rates, and other factors. Consequently, the value of an investment may fall below the amount originally invested, resulting in a loss.

Investment trusts are different from bank deposits and savings. In addition, the nature and characteristics of the risks involved vary among investment trusts because the types of underlying assets, investment restrictions, trading markets, and countries in which they invest differ from one investment trust to another. Before investing, please carefully read the Investment Trust Prospectus (Prospectus for Delivery) and the Pre-Contractual Disclosure Document.

Fees and Expenses Associated with Investment Trusts October, 2026

Sales Charge at Purchase Up to 3.85% (including tax)	The fee is borne by investors when they apply to purchase an investment trust. The distributor receives this fee as compensation for expenses related to the sale of the investment trust. Please confirm the applicable fee rate and other details with the distributor of the investment trust. Depending on the investment trust, a “redemption fee” or other fee may also be charged when the investment is redeemed (including upon maturity).
Management Fee (Trust Fee) Up to 2.222% (including tax)	This fee is charged for the period during which an investor holds the investment trust. The investment trust management company receives its portion as compensation for managing the fund; the trustee receives its portion for the safekeeping and administration of the trust’s assets; and the distributor receives its portion for administrative services related to the payment of distributions and redemption proceeds, as well as for mailing investment reports. • For some funds, an additional performance-based fee may be charged depending on investment performance. • In the case of a fund of funds, except for certain funds, trust fees and other expenses for the investment trust securities in which the fund invests are charged separately.
Trust Asset Retention Amount (retention charge) Up to 0.5%	Investors bear this charge when redeeming their holdings in an investment trust or in similar circumstances. It is intended to ensure that investors themselves bear the costs incurred within the trust assets as a result of their redemptions or similar transactions.
Other Fees and Expenses	In addition to the fees and expenses described above, investors may be required to bear other costs depending on the holding period and other factors, including brokerage commissions incurred in trading portfolio securities and other assets, taxes imposed on the fund, audit fees, and various expenses associated with the safekeeping and administration of assets overseas. As these fees and expenses may vary depending on the fund’s investment performance and other factors, their rates, maximum amounts, and other details cannot be specified in advance.

The total amount of the fees and expenses described above varies depending on the period during which investors hold the fund and other factors; therefore, it cannot be stated in advance.

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The risks and expenses associated with investment trusts vary depending on the individual investment trust. Before investing, please carefully read the Investment Trust Prospectus (Prospectus for Delivery) and the Pre-Contractual Disclosure Document.

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