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Ride the Yen rise for yield pickup

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With tariff uncertainty rising, domestic policy turning more hawkish, and the yen appreciating sharply, investors might start getting antsy about the extended bout of stability the TOPIX has enjoyed. While tariffs could indeed lead to a dip in the TOPIX in the near term, long-term investors should look upon these as potential entry opportunities. For now, investors can make use of the trend decline in the USDJPY to sell upside risk in the pair at or above 152 for yield pickup.

Amid all the tumult in both US and China equities, Japan's TOPIX index has been quite tightly rangebound since November. With the tariff threat still looming over the global economy, the JPY having appreciated 7% against the USD in the last eight weeks, and 10-year JGB yields almost doubling from end-September, investors might be turning more cautious on Japan equities.

While tariffs are indeed likely to dominate over the coming weeks and maybe months, the downside risks to the TOPIX are likely to be somewhat contained by the resilient global economic fundamentals. Investors might be better served viewing dips in the TOPIX as providing better entry levels for long-term exposure. In the near term, we believe the likely continuation of JPY appreciation provides an avenue for yield pickup strategies over the coming months.

Moderate downside risks from tariffs. Although Japan appears to stand a reasonable chance of avoiding direct tariffs, those risks cannot be ruled out given that President Trump has in the past complained about the unfairness of JPY weakness. Japan's economy and equity market could also be affected indirectly by tariffs in general: when US-China tensions escalated in 2018, the TOPIX still fell 26% peak to trough, more than other developed markets, despite the absence of direct tariffs on Japanese exports. It should be noted though that with two-fifths of US imports already incurring tariffs of over 20%, much of the final tariff impact might already be priced in.

All in all, we see dips in the TOPIX to 2600 (equates to long-term average P/E of about 13.7x) as representing a reasonably attractive entry point for long-term investors – assuming the US economy avoids a recession. In the meantime, record levels of share buybacks should continue to provide the TOPIX with downside support, even if these are now baked into expectations and thus not likely to provide much upside impetus.

But the macroeconomic environment is still resilient. At present, economic demand in the US is still robust, and improving in Japan. Inflation and wage growth are accelerating in Japan, where the latest trade union confederation wage demands of 6.09% topped 6% for the first time in 32 years. This sets the stage for positive "Shunto" wage negotiations between labor and management which might yield a healthy rise in incomes and in turn consumption. In fact, we expect real wage growth in Japan to turn positive this year. Furthermore, manufacturing appears to be on the mend in the US, and bottoming in Europe and China.

Yen appreciation offers opportunity to boost portfolio income. BoJ policy normalization now appears to be on a firm footing and could potentially accelerate this year. A strong Shunto result will likely give the BoJ the needed assurance that CPI inflation will remain above the BoJ's 2% target level, and potentially push it to hike rates earlier. Certainly, BoJ Deputy Governor Shinichi Uchida also signaled this week that policy rates are on a gradual path toward 1% by March 2026 – this is in line with our current expectations, but we think the risk of these being frontloaded has increased. We thus project the USDJPY maintaining its downward trend toward 145 by year-end and 142 by March 2026. We thus favor selling upside risk at or above 152 for yield pickup.

To bolster portfolios against rising market volatility, investors may also look outside the region. We think Easing European monetary policy and bottoming European growth should prove supportive, and suggest investors consider thematic exposure to a basket of European stocks – via our Six ways to invest in Europe theme – that are most exposed to six catalysts of robust performance.

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