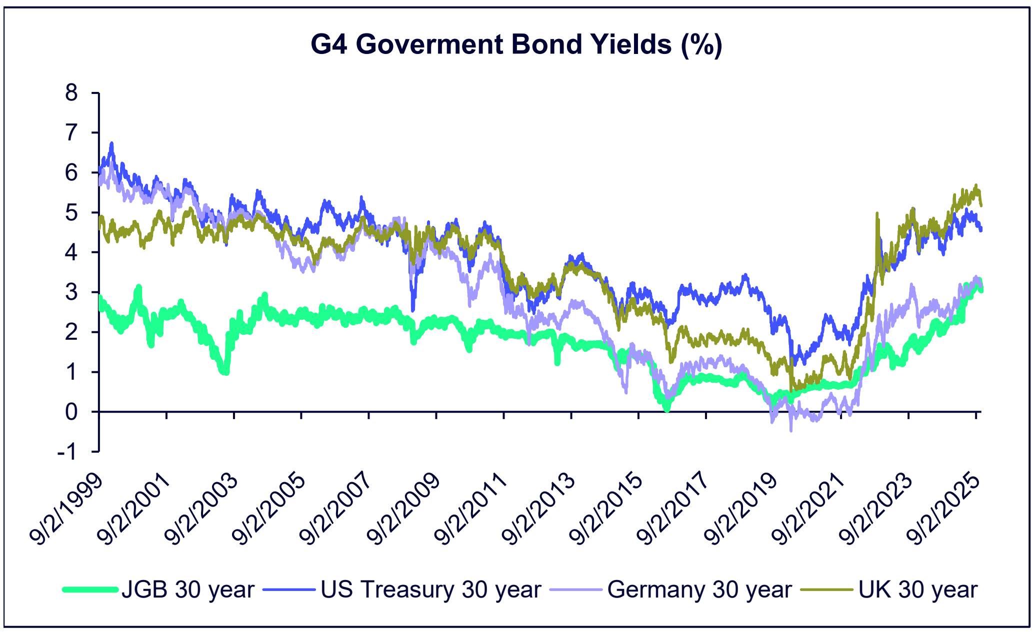
STATE STREET INVESTMENT MANAGEMENT

COMMENTARY
October 30, 2025

Mind on the Market

Chart of the Week

JGB 30 year yield at highest level since 1999 initial issuance



Source: Bloomberg, State Street Investment Management. Data as of October 30, 2025.

As global bond markets recalibrate in response to shifting monetary policies and inflation dynamics, Japanese Government Bonds (JGBs) have emerged as a compelling opportunity for both domestic and international investors. Once viewed as a low-yield, defensive asset class, JGBs are now offering competitive returns, particularly in the long end of the curve (chart above), while maintaining structural resilience that sets them apart from their G4 peers.

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Weekly Highlights

30-year JGB Yield YTD High	US HY Ba/B OAS	Est. 3m30y and 5y30y spreads
3.3%	209 bps	200 bps

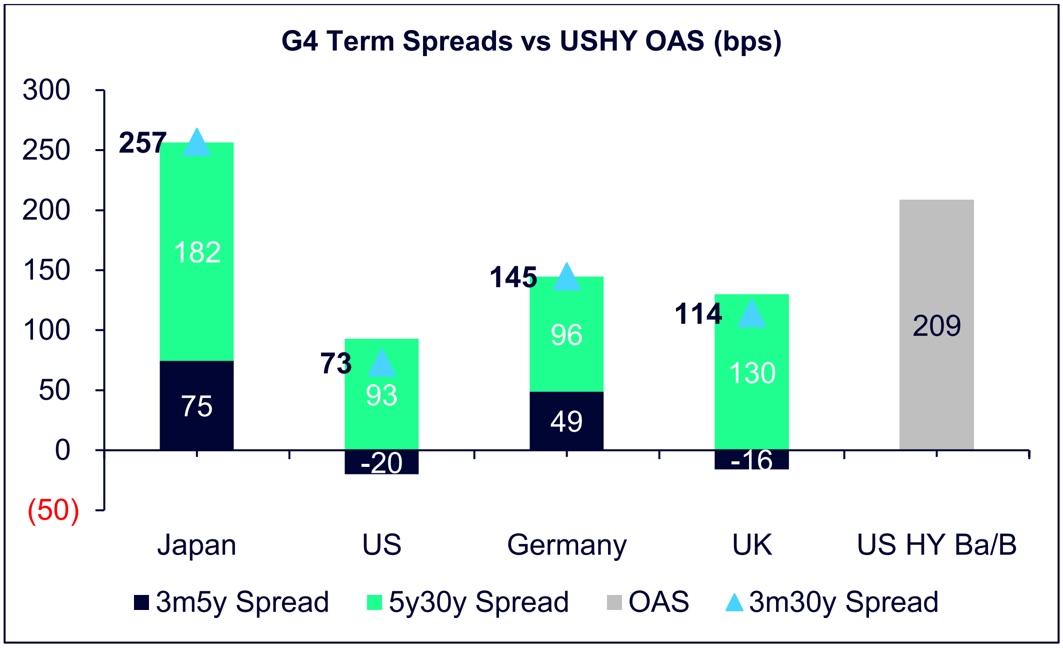
Source: Bloomberg, State Street Investment Management. As of October 30, 2025.

Yield Curve Steepening: Japan’s New Normal

The Japanese Government Bond (JGB) yield curve has steepened notably in 2025, following the Bank of Japan’s (BoJ) exit from Yield Curve Control (YCC) in March 2024 and emerging supply-demand imbalances. As of October 2025, the 30-year JGB yield has climbed to 3.3%, while the 10-year yield has reached 1.7%—a 17-year high. This steepening reflects a combination of *improving fundamentals*, including stronger potential growth and inflation expectations, as well as a repricing of the fiscal term premium. *Technical factors* also play a role, with reduced bond purchases from both the BoJ and Japanese life insurers contributing to the shift.

Currently, Japan’s 3-month–30-year and 5-year–30-year spreads hover around 200 basis points—by far the steepest among G4 economies, where comparable spreads are roughly half that level. In fact, Japan’s curve is wider even when compared to Ba/B-rated high-yield option-adjusted spreads (OAS), offering a compelling cross-asset valuation contrast.

JGB steepest among peers on term spreads



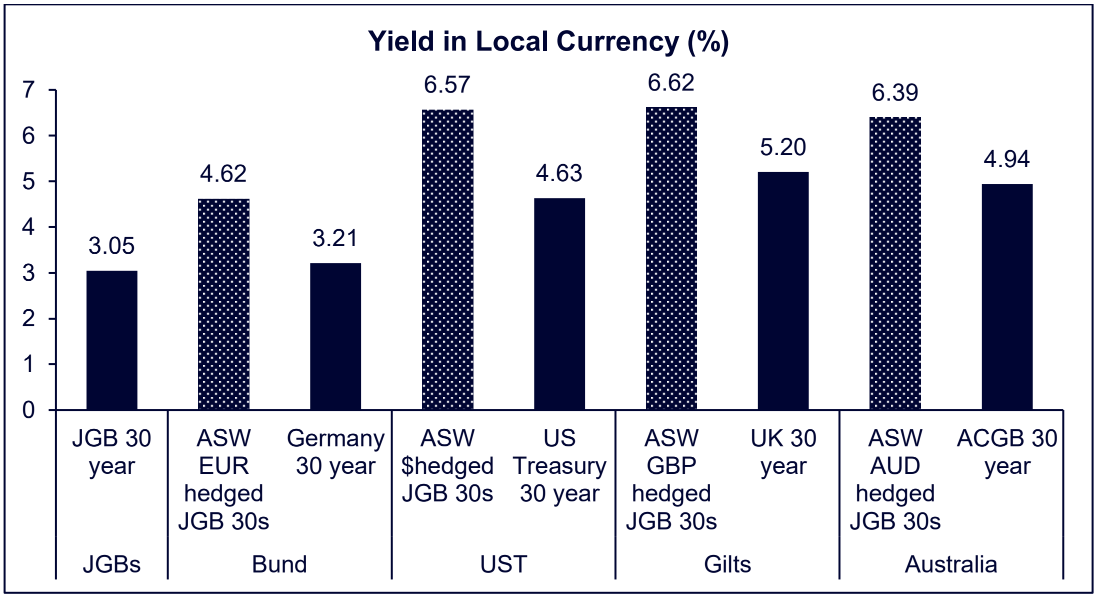
Source: Bloomberg, State Street Investment Management. Data as of October 30, 2025.

This positions Japan as a standout in terms of curve steepness, offering attractive duration plays for investors seeking long-term yield pickup.

Hedged Yield Advantage: USD, EUR, GBP, AUD Perspectives

For foreign investors, the appeal of JGBs is amplified when returns are hedged back into their home currencies. This enhanced appeal, often 140~200bps above local sovereign alternatives, stems from favorable FX forward dynamics—driven by interest rate differentials between Japan and its peers—and favorable cross-currency basis swaps.

Hedged JGB yields (dotted columns) offer pick-up from FX hedging premiums



Source: Bloomberg, State Street Investment Management. Data as of October 30, 2025. Hedge costs are calculated using cross-JPY FX forwards on a 3-month rolling basis. Past performance does not guarantee future results.

These hedged returns make JGBs particularly attractive for pension funds, insurers, and long-term allocators seeking yield enhancement without taking on excessive credit or currency risk.

Structural Strengths: Why JGBs Are Different

Japan's resilient fundamentals and stable sovereign debt profile stand out among developed markets, even amid recent political turbulence:

- Over 90% of JGBs are held domestically, primarily by banks, pension funds, and the BOJ itself. This reduces exposure to foreign capital flight and cushions against market shocks.
- Japan remains the world's largest net creditor, with over $3.7 trillion in external assets, providing a strong buffer against external financing risks.
- The household financial asset base is nearly double the national debt, reinforcing the country's ability to self-finance and maintain investor confidence.

These factors insulate Japan from the kind of bond market volatility seen in countries like the UK during the "Truss moment," where fiscal shocks triggered rapid sell-offs.

Investor Positioning: Long-Term Opportunity vs Risks

The steep JGB curve offers multiple entry points:

- Long-duration strategies can lock in elevated yields at the 30-year point, with elevated 5s30s spreads.
- Curve flattening trades may emerge in 2026 as the BOJ approaches its terminal rate and the Ministry of Finance adjusts issuance to address supply-demand imbalances.
- Foreign investors increasingly drawn to JGBs for their hedged yield premiums.

While the outlook is constructive, investors should monitor:

- **Fiscal policy shifts,** especially given the LDP's lack of majority in both chambers of the Diet, which could introduce volatility. Specifically, Takaichi has floated a 13.9 (T) yen stimulus package aimed at inflation relief through income tax exemptions and tax credits. However, the fragmentation in government could dilute these promises and dampen exuberance. Although fiscal measures could be stimulative for selective equity sectors Takaichi's policies fuel Japan's market rally | State Street, it also places further downward pressure on the Yen in the near term. Investors may consider FX hedging strategies to mitigate currency risk.
- **Global policy rate direction,** notably the Fed, which could impact FX hedging costs and Hedged JGBs' relative appeal. The US Federal Reserve cut interest rates this week to 3.75~4.00% and the market is pricing in an additional 25 bps cut in December. SSIM projects an additional 50–75 bps in cuts through 2026, contingent on inflation moderation, labor market softness, and sub-trend growth. This trajectory is likely to reduce FX hedging costs, which would make Hedged JGBs relatively less attractive given lower hedge premium. This is however offset by duration gains from underlying domestic yields. A dovish Fed in general offers a cautiously supportive backdrop for fixed income as a whole including JGBs, though the outlook remains clouded by macro uncertainties

Conclusion: A New Era for JGBs

JGBs have evolved from traditional low yielding safe havens into strategic assets offering competitive yields, structural resilience, and attractive hedged returns. In an environment of elevated global rates and shifting capital flows, JGBs stand out as high-quality, long-duration instruments with global relevance.

Their higher absolute and hedged yields provide meaningful diversification benefits, and the opportunity cost of excluding JGBs from global portfolios is rising. Looking forward, 2026 and beyond presents a compelling setup: potential curve flattening and outright long opportunities in the belly of the curve, as Japanese banks begin deploying their 400 trillion yen in cash reserves amid the BOJ nearing its terminal rate especially if policy rate rises above the physiologically important 1~%.

About State Street Investment Management

Important Risk Information

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Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Currency Risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Generally, among asset classes, stocks are more volatile than bonds or short-term instruments. Government bonds and corporate bonds generally have more moderate short-term price

fluctuations than stocks, but provide lower potential long-term returns. U.S. Treasury Bills maintain a stable value if held to maturity, but returns are generally only slightly above the inflation rate.

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