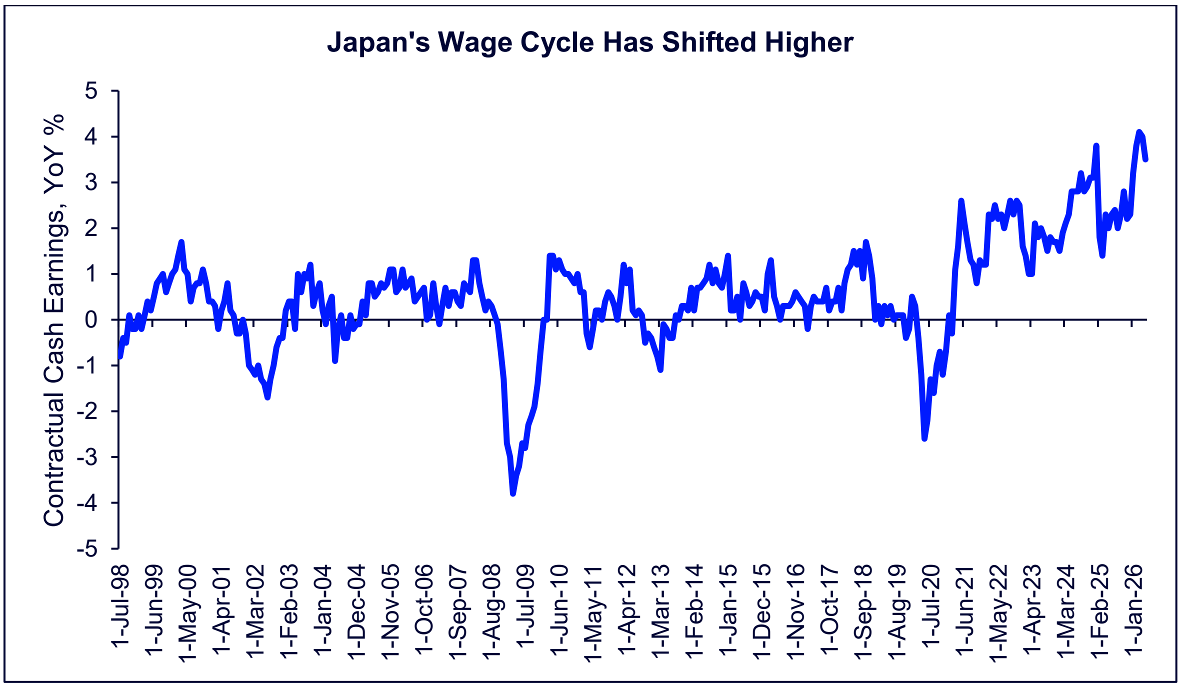
COMMENTARY
August 13, 2026

Mind on the Market

Chart of the Week



Source: FactSet, State Street Investment Management. Contractual Cash Earnings in Establishments with 30 or More Employees, YoY % Change – Japan as of May 2026.

For the first time in decades, Japan offers a compelling story across equities, bonds and currency. Structural inflation, rising wages, stronger investment returns and BOJ normalization are transforming Japan from a capital exporter into an investable market. While Korea and Taiwan may remain the higher-beta AI trades, Japan increasingly stands out as a diversified expression of the next phase of AI. As Japan moves from deflation to reflation, investors are increasingly viewing Japan as a package, rather than a single trade. The bigger story is not AI alone, but Japan's re-emergence as an investable market and *North Asia's* cleaner, more complete multi-asset opportunity.

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Weekly Highlights

ASW USD Hedged 30 Year JGB	Japan Net Foreign Equity Buying	Japan's June headline CPI (YoY)
6.76%	$78B	1.7%
Source: Bloomberg, as of August 7, 2026. Yield (%) in local currency terms.	Source: Bloomberg, as of August 7, 2026.	Source: Statistics Bureau of Japan, as of June 30, 2026.

Equities – AI Trade is Moving Toward the Physical Economy

The first phase of AI was about building the brains: semiconductors and memory, driving outsized gains in Korea and Taiwan through a narrow group of market leaders. The next phase is about bringing AI into the physical economy through robotics, automation, precision manufacturing and industrial infrastructure.

That should play directly to Japan's strengths. As a critical link in the global supply chain and the emerging US-led "Pax Silicon" ecosystem, Japan is increasingly becoming the backbone of physical AI deployment. Japanese companies occupy key positions across semiconductor equipment, factory automation, robotics, machine tools, sensors and industrial infrastructure, allowing them to benefit regardless of where AI demand ultimately emerges.

Demographics provide an additional tailwind. Aging populations and labor shortages across the developed world are making automation an economic necessity, reinforcing Japan's role as AI broadens beyond a narrow group of hyperscalers and semiconductor winners into real-world deployment.

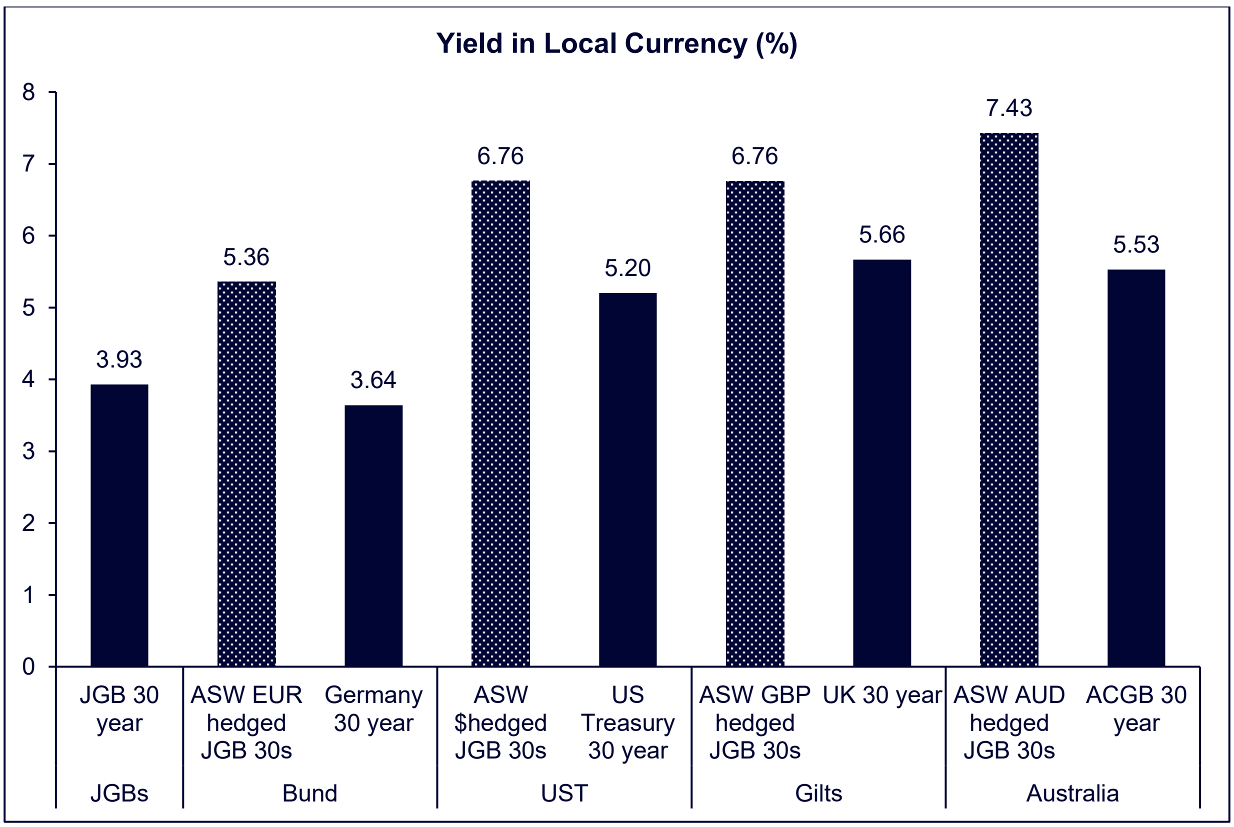
Bonds – More Than a Pension Repatriation Story

Markets are focused on potential pension demand for JGBs, but the bigger story is the return of yield and the end of Japan's zero-rate era. With banks holding roughly ¥400 trillion of excess cash and the BOJ gradually normalizing policy, domestic demand for JGBs is strengthening as global investors revisit an asset class largely ignored for decades.

The conversation is shifting from "*Why own JGBs*?" to "*How much JGB exposure should investors have*?"

Near term, we remain neutral as investors continue searching for fair value after years of BOJ market distortion. Longer term, however, yields above 3% on 10-year JGBs and 4% on 30-year bonds are becoming increasingly difficult for domestic investors to ignore. For foreign investors, hedged yields also remain attractive, providing another structural source of demand (Figure 2).

Figure 2: FX hedging premium adds 100-200bps to hedged JGB yields



Source: Bloomberg, State Street IM. As of August 7, 2026. Hedge costs are calculated using cross-JPY FX forwards on a 3-month rolling basis. Past performance does not guarantee future results.

Currencies – From Funding Currency to Investable Currency

Both the yen and Korean won have traded near multi-decade lows in recent years, but the underlying flow dynamics are beginning to diverge. Korea's currency weakness has persisted despite record chip exports and strong AI-driven earnings, as foreign investors have increasingly taken profits following a semiconductor-led rally (Figure 3).

Japan's story is different.

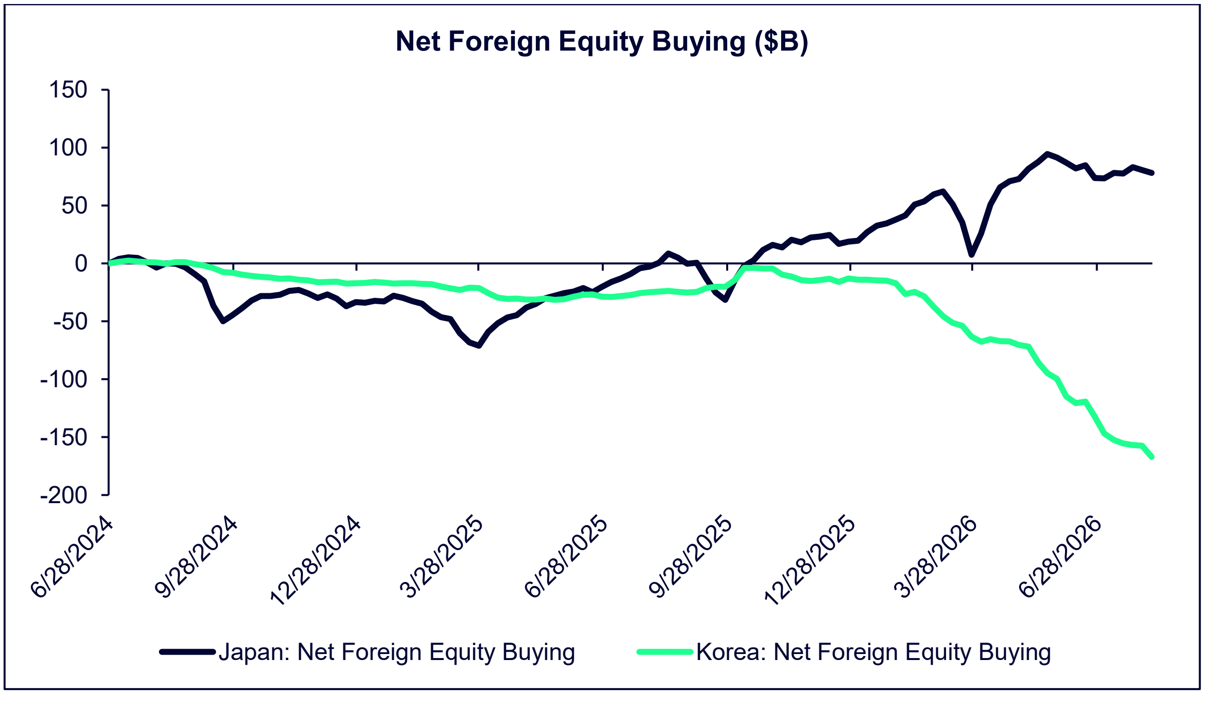
Recent US-Japan intervention and a potentially faster BOJ normalization path should place a soft floor under the yen. For years, the currency was weighed down by ultra-low yields, negative real rates and persistent capital outflows. Those forces will not disappear overnight, but the backdrop is changing.

Higher domestic yields, BOJ normalization, stronger corporate governance, rising FDI and improved investment returns are making Japanese assets increasingly competitive. Japan's fundamentals also remain solid, supported by a current-account surplus of roughly 5% of GDP and a declining net debt-to-GDP ratio.

One underappreciated driver is hedging flows. While foreign investors have been reducing Korean equity exposure, they have largely stayed invested in Japan (Figure 3), often with high hedge ratios to capture the hedge premium. As BOJ normalization narrows rate differentials, lower hedge ratios could become an additional source of yen demand.

The yen is evolving from a funding currency into an investable currency. The next major move in the yen may ultimately be higher, not lower.

Figure 3: Japan retains foreign capital as Korea sees profit-taking



Source: Bloomberg, State Street IM. In USD as of August 7, 2026.

Risks

The most obvious risk is that the AI investment cycle proves overbuilt. A sharp slowdown in AI capex spending would pressure semiconductors, automation, robotics and industrial demand, weakening one of the key pillars of the Japan thesis.

A second risk is that Japan's reflation becomes too successful. If inflation accelerates materially above expectations, the BOJ could be forced into a much more aggressive tightening cycle. While gradual normalization should support the yen and improve capital allocation, an abrupt hiking cycle could trigger significant capital repatriation, disrupt carry trades and create volatility across global markets accustomed to decades of inexpensive Japanese funding.

The greatest risk to the “Japan Is Back” story may not be stagnation, but success that arrives too quickly.

Source: Bloomberg, FactSet, Statistics Bureau of Japan, State Street Investment Management. Data as of 8/7/2026 unless otherwise stated. The performance data quoted represents past performance. Past performance does not guarantee future results. Investing involves risk, including the risk of loss of principal.

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* This figure is presented as of June 30, 2026 and includes ETF AUM of $2,203.98 billion USD of which approximately $156.81 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Investment Management are affiliated. Please note all AUM is unaudited.

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Investments in small-sized companies may involve greater risks than in those of larger, better known companies.

Commodities investing entail significant risk as commodity prices can be extremely volatile due to wide range of factors. A few such factors include overall market movements, real or perceived inflationary trends, commodity index volatility, international, economic and political changes, change in interest and currency exchange rates.

Asset Allocation is a method of diversification which positions assets among major investment categories. Asset Allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss.

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Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates rise bond values and yields 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.

Increase in real interest rates can cause the price of inflation-protected debt securities to decrease. Interest payments on inflation-protected debt securities can be unpredictable.

There are risks associated with investing in Real Assets and the Real Assets sector, including real estate, precious metals and natural resources. Investments can be significantly affected by events relating to these industries.

Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations. Investments in emerging or developing markets may be more volatile and less liquid than investing in developed markets and may involve exposure to economic structures that are generally less diverse and mature and to political systems which have less stability than those of more developed countries.

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.

AdTrax: 5064514.164.1.GBL.RTL
Exp. Date: 8/31/2027.