# Past the AI Trade: Japan's broadening earnings and compounding reforms

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## Key Takeaways

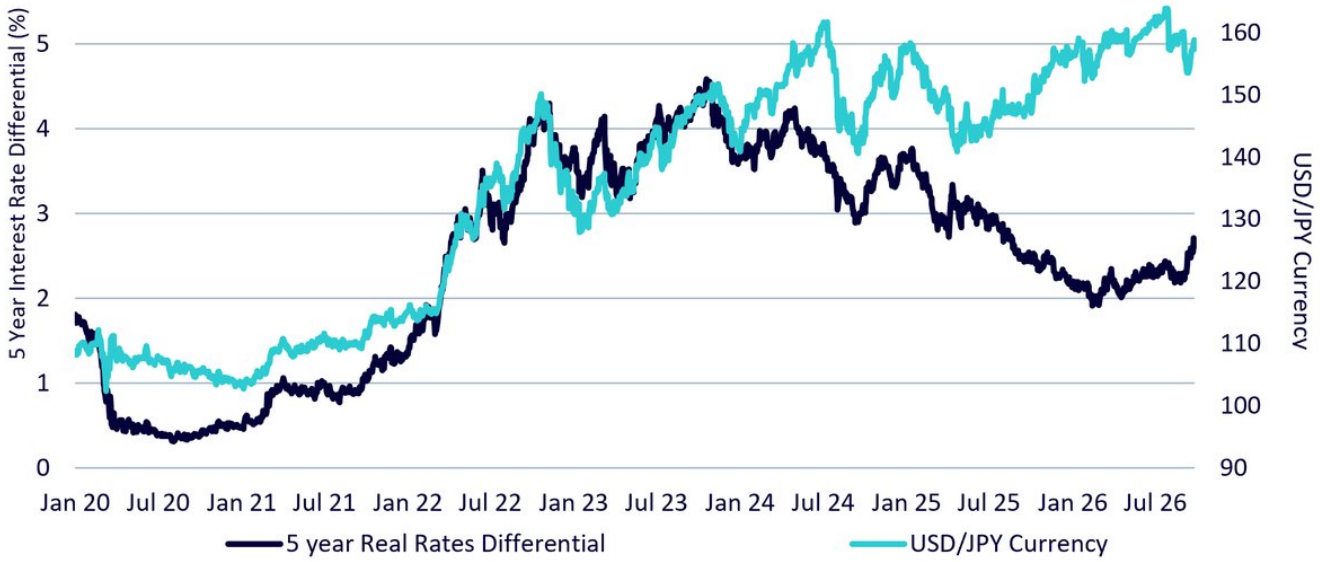
- Despite the Bank of Japan (BOJ) hike to 1.25%, the yen failed to strengthen because a hawkish Federal Reserve now dominates USD/JPY trajectory.
- The classic US–Japan rate-differential/USD-JPY link has broken down since 2024. Risk appetite, US Treasury yields and Japan's funding-currency role matter more, so yen weakness can persist through BOJ hikes.
- A soft yen maintains the competitive advantage for Japanese exporters.
- Governance reform keeps compounding and capital-allocation quality, not payout size alone, drives the multi-year re-rating.
- Earnings growth leadership is broad-based: electronics riding AI and industrial-infrastructure demand, and banks benefiting from wider spreads and stronger lending.

The Bank of Japan (BOJ) and the Federal Reserve (Fed) both raised policy rates by 25bps, taking Japan's policy rate to 1.25%, its highest level in roughly three decades, and the Fed funds rate to 4%. Both moves were well flagged and priced by markets ahead of time. What stands out to us is not the size of the hike but the tone: the BOJ's September statement leaned hawkish on diagnosis, flagging that underlying inflation could push through 2% as firms grow more willing to raise wages and prices, even as two board dissents underlined how contested the pace of normalisation still is. Yet the yen has not strengthened in response. If anything, the Fed's own message hardened further. September's projections lifted the median 2027 fed funds estimate to 4.1% from 3.6% in June, and that 'higher for longer' signal out of Washington has done more to keep the currency pair elevated than anything coming out of Tokyo.

This is not a new phenomenon. As the chart below shows, the well-worn relationship between the US-Japan interest rate differential and USD/JPY has become far less reliable since 2024. The real rate differential has narrowed from a peak of roughly 4.5% to about 2.2% today[1], which on a textbook carry-trade model should have pulled the yen stronger. Instead, USD/JPY has pushed to fresh highs above 158[2]. In our view, this reflects a shift in what is actually driving the pair: risk appetite and US Treasury yields now matter more than the bilateral rate gap, and Japan's role as a cheap funding currency keeps it

attractive to carry positions even as the BOJ normalises. That, in turn, means yen weakness can persist even while the BOJ hikes, a dynamic we don't think markets should assume will self-correct quickly.

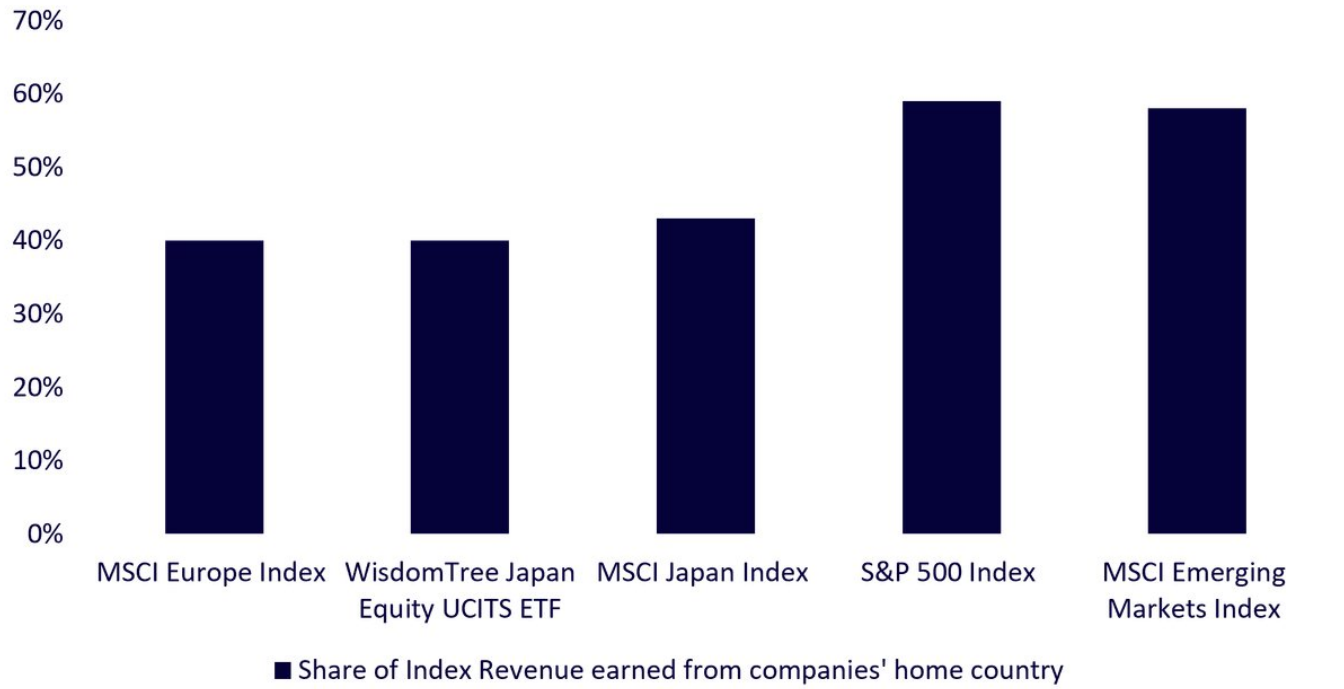
**Figure 1: Dollar/yen diverges from relative rates**




Source: Bloomberg Finance L.P., WisdomTree as of 25 September 2026. **Historical performance is not an indication of future results and any investments may go down in value.**

Companies in the WisdomTree Japan Equity UCITS ETF (**Ticker: DXJZ**) derive only 40% of underlying revenue from Japan itself, notably lower than the MSCI Emerging Markets' 58% or the S&P 500's 59%. In other words, the portfolio's foreign-revenue exposure is a direct beneficiary of continued yen softness, which is one reason we see the exporter-heavy segment of the market as reasonably well positioned.

**Figure 2: Share of International revenue derived from global exporters**

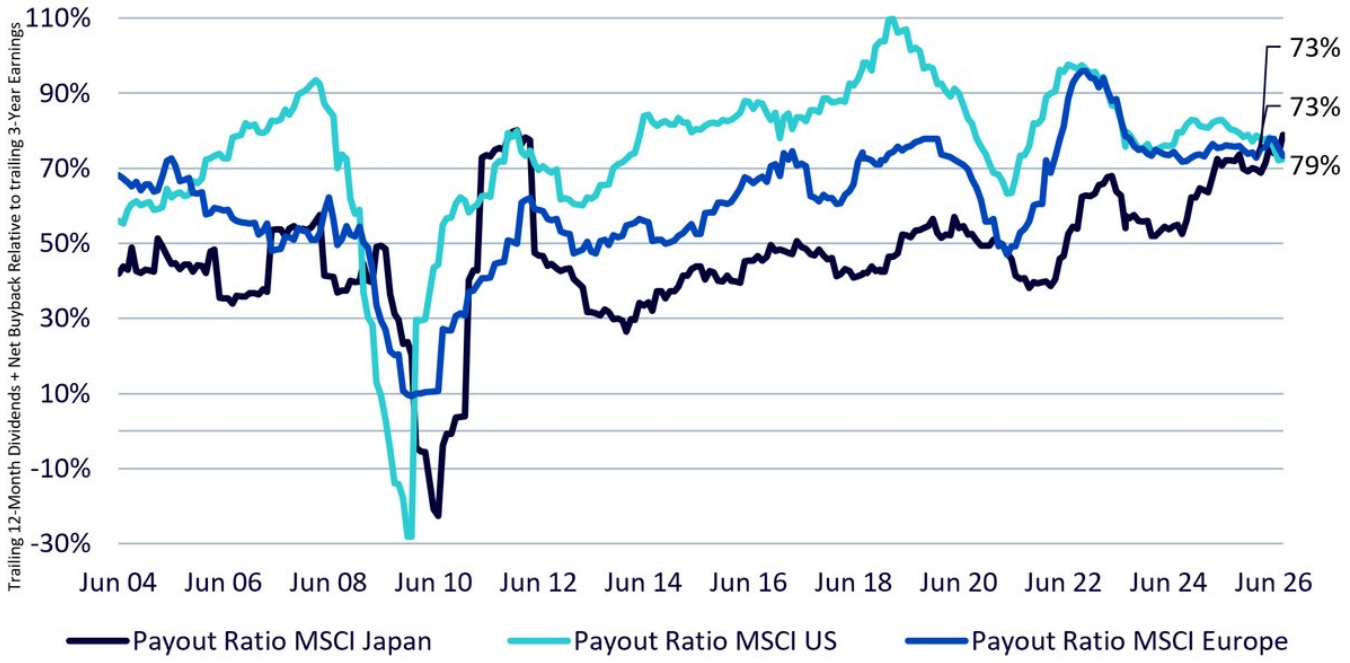



Source: FactSet, MSCI, WisdomTree as of 31 August 2026. **Historical performance is not an indication of future results and any investments may go down in value.**

## Corporate governance: a reform story still compounding

Currency is only part of the story, however. The multi-year corporate governance reform programme initiated by the Tokyo Stock Exchange continues to compound, and in our view remains underappreciated. Japan's shareholder payout ratio (including dividends and buybacks) has risen from 33% in 2013 to roughly 79%[3], outpacing the US (73%) and Europe (73%).

**Figure 3: Japanese payouts catchup with US & Europe**




Source: FactSet, MSCI as of 31 August 2026. **Historical performance is not an indication of future results and any investments may go down in value.**

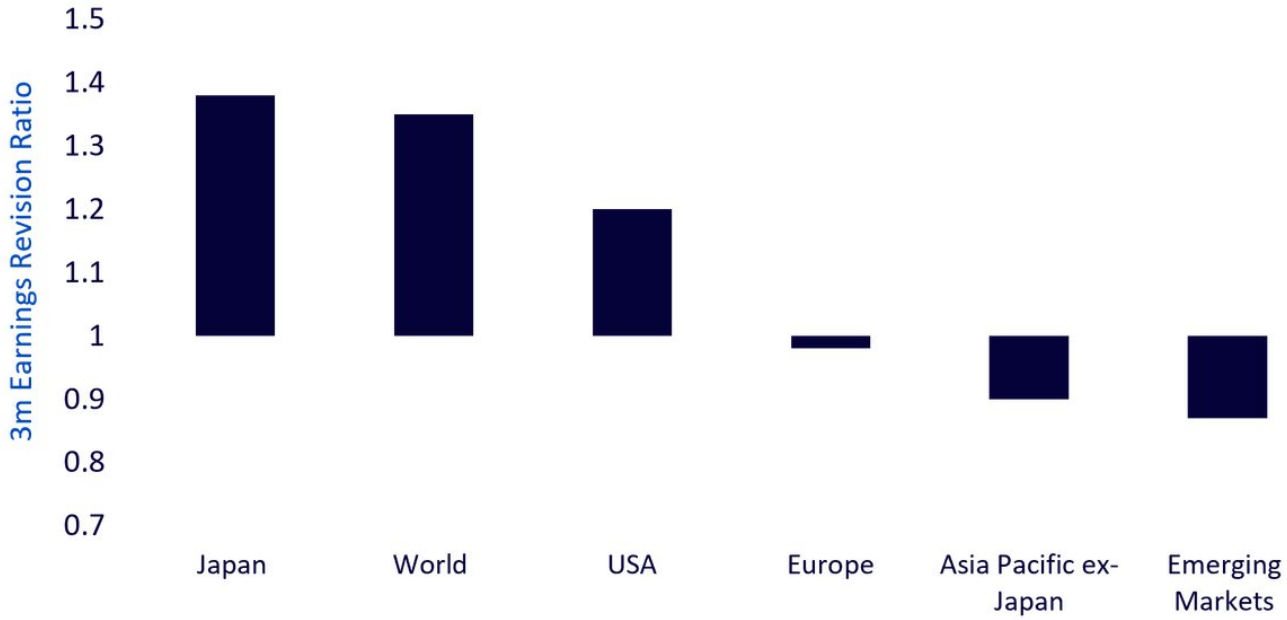
Total shareholder returns reached a record ¥43.5 trillion in fiscal 2025, up 13%yoy, alongside record levels of cross-shareholding sales, shareholder proposals and stock-based compensation adoption. The Financial Services Agency is expected to revise the Corporate Governance Code around mid-2026 with an explicit focus on the productive use of idle cash. We continue to think it is capital-allocation quality, rather than payout size alone, that separates the long-run winners from the rest – which argues for a multi-year re-rating rather than a one-off catch-up trade.

## Earnings: broadening beyond the AI narrative

This has become evident in the earnings outlook. Earnings are broadening. Japan's earnings revision ratio hit an all-time high in August, moving from 1.38 to 2.27, comfortably outpacing the broader global revision ratio's rise from 0.99 to 1.35.

FY3/26 results in Japan were a clean record, with sales, operating profit and net profit beats running at 64%, 60% and 65% respectively, and aggregate TOPIX earnings growing 27% year-on-year[4]. Initial FY3/27 guidance is characteristically conservative, around 9% operating profit growth[5], built on a cautious ¥150/US$ assumption, but growth leadership is broad-based: electronics riding AI and industrial-infra-structure demand, machinery capturing factory-automation and physical-AI orders, and banks benefiting from wider spreads and stronger lending. Earnings revisions confirm the picture:

**Figure 4: Global earnings revision ratio**




Source: MSCI, IBES, FactSet, WisdomTree as of 31 August 2026. **Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.**

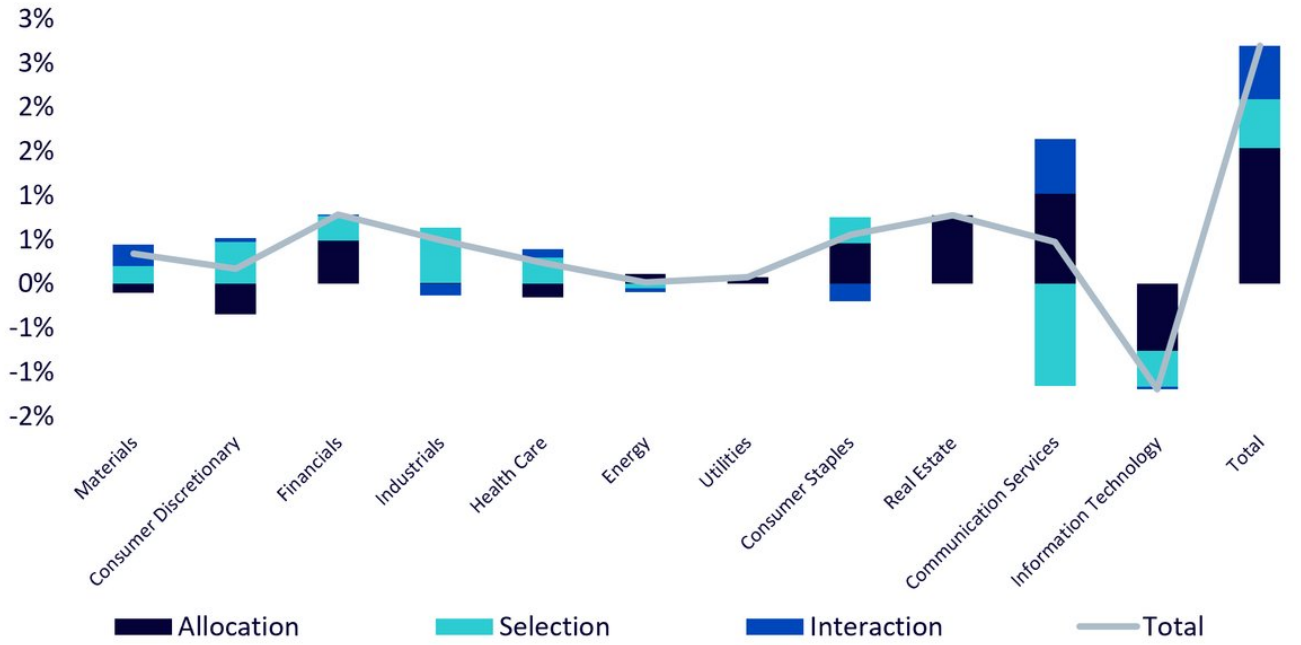
## Capturing the opportunity with WisdomTree

For euro-based investors, the WisdomTree Japan Equity UCITS ETF (**Ticker: DXJZ**) provides exposure to this improving earnings outlook, ongoing corporate governance reforms and the weaker yen. The exchange-traded fund (ETF) tracks the WisdomTree Japan Dividend UCITS Index (**Ticker: WTIDJUHT**), a fundamentally weighted index that selects Japanese companies deriving at least 20% of revenue from overseas markets, with a strong emphasis on dividend paying exporters and industrial cyclicals.

WisdomTree Japan Equity UCITS ETF has meaningful allocations to materials, financials and industrials, as well as sectors poised to benefit from Takaichi's fiscal growth plan and a steeper Japanese yield curve. Over the prior year, the WisdomTree Japan Dividend UCITS Index outperformed the MSCI Japan Index by 2.69% benefitting from its allocation to financials, industrials, and consumer staples.

Investors should note that the Fund is exposed to equity market and currency risk, and its focus on dividend-paying Japanese exporters may result in periods of underperformance relative to the broader Japanese equity market. Capital is at risk.

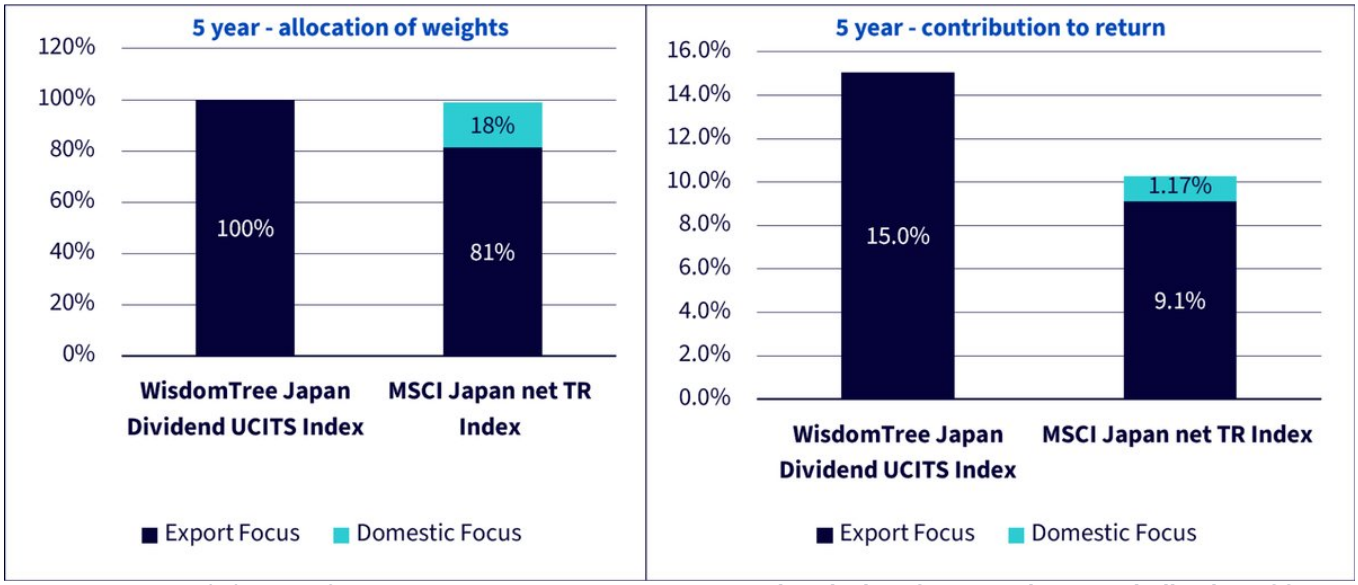
**Figure 5: Sector attribution**




Source: FactSet, WisdomTree from 29 August 2025 to 31 August 2026. **Historical performance is not an indication of future performance and any investments may go down in value.**

Over the past 5 years, the WisdomTree Japan Dividend UCITS Index outperformed the MSCI Japan Index by 5% supported by its tilt to Japanese exporters.

**Figure 6: Attribution of returns (5 years) based on geographic revenue exposure**




Source: FactSet, WisdomTree from 31 August 2021 to 31 August 2026. **Historical performance is not an indication of future performance and any investments may go down in value.**

## Conclusion

The case for Japanese equities no longer rests on a single driver. A soft yen supports exporter earnings, governance reform keeps lifting payouts and sharpening capital allocation, and the earnings recovery is broadening well beyond the AI names. These forces can compound together over several years, rather than fading as a one-off trade.

[1]Source: Bloomberg Finance L.P., as of 18 September 2026.

[2]Source: Bloomberg Finance L.P. as of 25 September 2026.

[3]Source: FactSet as of 31 August 2026.

[4]Source: CLSA as of 30 June 2026.

[5]Source: CLSA as of 30 June 2026.

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