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Japan Quantitative Strategy | Japan

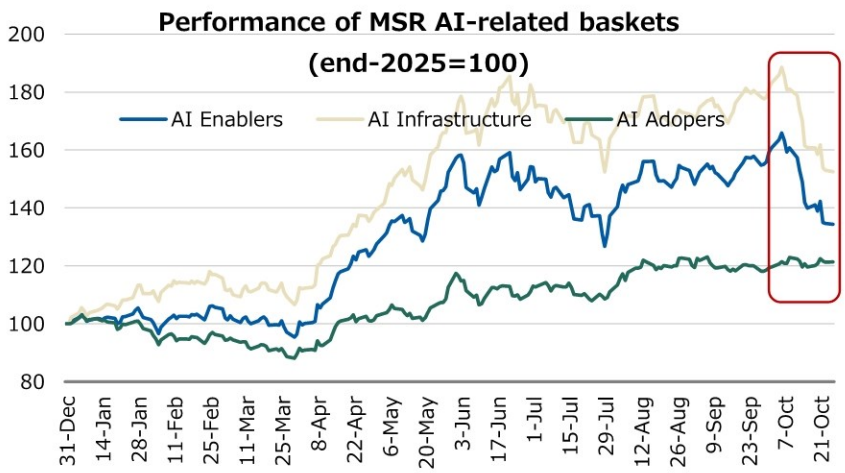
From AI Upstream to Downstream

We would use any rebounds in semiconductor and data-center stocks to reduce exposure, while focusing on resilient AI adopters. At the same time, we would increase allocations to low-volatility and financially sound value stocks, and seek opportunities among companies adopting and deploying AI.

Key Takeaways

- Semiconductor and data center-related stocks corrected sharply in the third and fourth weeks of October.
- We believe these segments may still face further downside risk over the medium term.
- In contrast, AI adopters have been relatively resilient, suggesting an increasing divergence within the AI theme.
- We screen for Japanese stocks showing high return sensitivity to the AI Adopters basket.

Exhibit 1: Performance of Global AI-Related Baskets: AI Adopters Remain Resilient Despite the Recent Correction



Source: Bloomberg, Morgan Stanley Research.
Note: AI Enablers: MSRSTAIE Index; AI Infrastructure: MSRSTAII Index; AI Adopters: MSRSTAIA Index.

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From AI Upstream to Downstream

From the third to the fourth week of October, growing concerns over financing and credit risks surrounding AI infrastructure investment triggered a sharp sell-off in semiconductor and data center-related stocks. In contrast, as discussed below, shares of companies that leverage AI have remained relatively resilient, suggesting that performance is beginning to diverge within the broader AI theme.

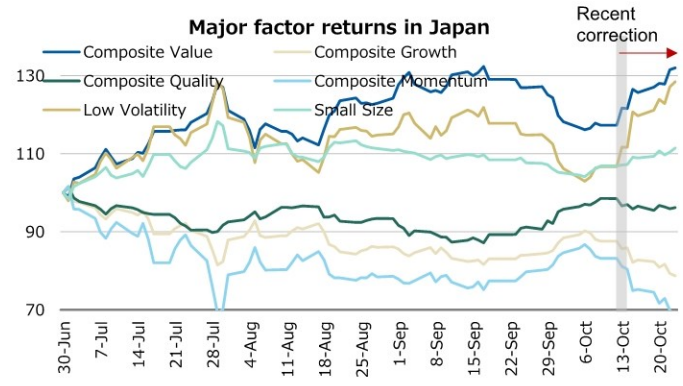
In our report, Navigating the More Challenging Later Stage of the AI Rally (9 Oct 2026), we argued that, given rising interest rates and elevated valuations, this is not a time to be complacent about the sustainability of the AI rally. We also recommended tactically adding exposure to low-volatility stocks while maintaining allocations to financially sound value stocks, in preparation for a potential reversal of the AI-driven, highly concentrated market.

The speed and magnitude of the recent correction exceeded our expectations. Nevertheless, the direction of the market rotation, with low-volatility and value factors outperforming, is consistent with the view we expressed in our previous report (Exhibit 2). This trend has also been evident in both Japan and the US.

Given the substantial correction over a short period, a near-term rebound in AI capex-related stocks, including semiconductor and data center names, would not be surprising. However, we believe there is still room for further correction over the medium term. We therefore recommend stepping up the reduction of exposure to these stocks from here. At the same time, we would continue to increase allocations to low-volatility stocks and financially sound value stocks.

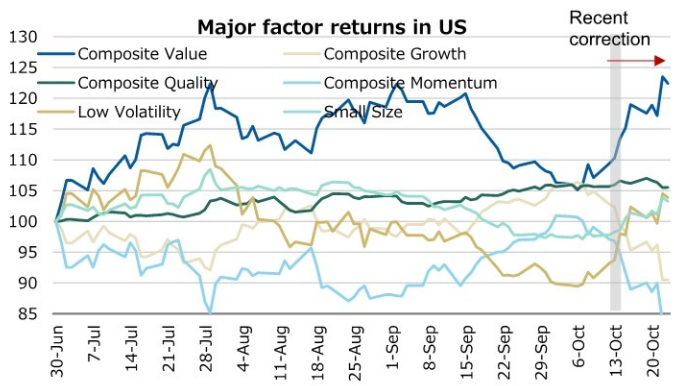
Alongside these tactical factor allocations, we view AI adoption as a structural growth opportunity over the medium to long term. AI adoption offers a thematic stock-selection lens distinct from conventional style factors, which we see as complementary to these factor allocations.

Exhibit 2: Japan Equity Factor Returns: Low Volatility and Value Have Risen Sharply



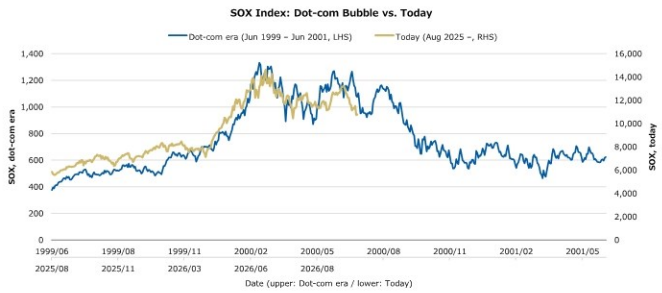
Source: FactSet, Morgan Stanley Research. MSCI universe.

Exhibit 3: US Equity Factor Returns: As in Japan, Low Volatility and Value Have Risen Sharply



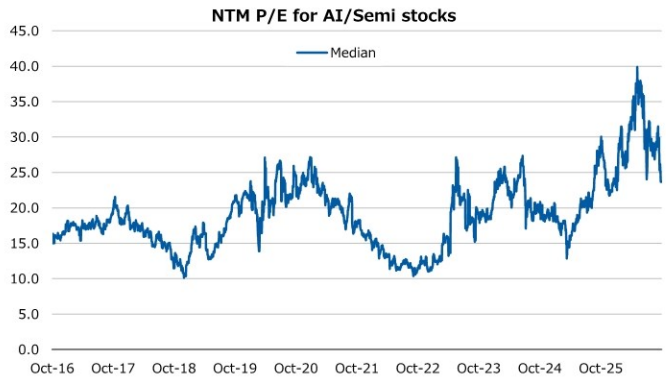
Source: FactSet, Morgan Stanley Research. MSCI universe.

Exhibit 4: SOX Index: Comparison Between the Dot-Com Bubble and Today Shows Similar Price Patterns



Source: Bloomberg, Morgan Stanley Research.

Exhibit 5: Median 12-Month Forward P/E for AI- and Semiconductor-Related Stocks: Despite the Correction, Valuations Remain High by Historical Standards

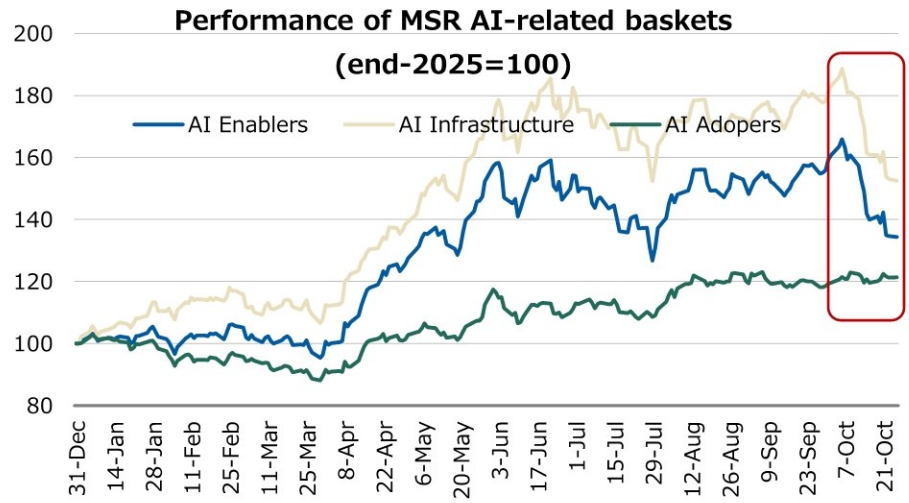


Source: Bloomberg, Morgan Stanley Research.
Note: The universe comprises 18 stocks: 285A Kioxia, 3436 SUMCO, 4062 Ibiden, 4063 Shin-Etsu Chemical, 5801 Furukawa Electric, 5802 Sumitomo Electric Industries, 5803 Fujikura, 6146 DISCO, 6526 Socionext, 6723 Renesas Electronics, 6762 TDK, 6857 Advantest, 6861 Keyence, 6920 Lasertec, 6981 Murata Manufacturing, 7735 SCREEN Holdings, 8035 Tokyo Electron, and 9984 SoftBank Group.

Semiconductor and data center-related stocks that support AI capex have undergone a significant correction, while companies that integrate AI into their own services and operations have remained relatively resilient. We believe it is increasingly important to distinguish between the AI capex side and the AI adoption side, rather than treating all AI-related stocks as a single group.

Among the global AI-related baskets provided by Morgan Stanley Research, AI Enablers (Bloomberg ticker: MSRSTAIE Index) and AI Infrastructure (MSRSTAII Index), both of which have greater exposure to the former category, have fallen sharply (Exhibit 6). In contrast, AI Adopters (MSRSTAIA Index), which has greater exposure to the latter category, had previously moved broadly in tandem with AI Enablers and AI Infrastructure but has remained relatively resilient during the recent correction. In other words, the market's focus appears to be shifting from the upstream part of the AI supply chain, namely capex and infrastructure, toward the downstream side, namely AI adoption and utilization.

Exhibit 6: Performance of Global AI-Related Baskets: AI Adopters Remain Resilient Despite the Recent Correction



Source: Bloomberg, Morgan Stanley Research.
Note: AI Enablers: MSRSTAIE Index; AI Infrastructure: MSRSTAII Index; AI Adopters: MSRSTAIA Index.

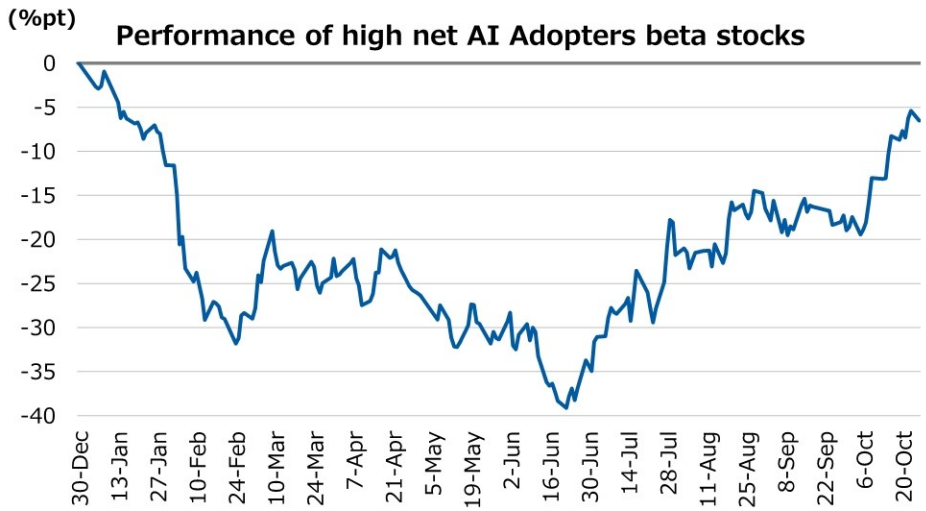
So, which Japanese stocks should investors focus on as AI Adopters? Here, we screened stocks based on the degree to which their returns have moved in tandem with the AI Adopters basket (see Exhibit 8 for the list).

Specifically, we (1) calculated the beta of each TOPIX 1000 constituent to the AI Adopters basket, controlling for TOPIX returns; (2) similarly calculated the beta to the AI Enablers basket; and (3) subtracted the beta to the AI Enablers basket from the beta to the AI Adopters basket. We refer to this difference as the "net AI Adopters beta" and selected the top 50 stocks based on this measure.

We used weekly stock return data. This is because many of the basket constituents are US stocks, meaning that daily data could be affected by time-zone differences, while monthly data would provide too few observations. The sample period runs from January 2025 through the end of September 2026.

Exhibit 7 shows the share price performance of these stocks. Their performance was weak in the first half of the year, partly amid concerns over the so-called "death of SaaS," but has improved in the second half and more recently. While short covering may have contributed to the rebound, we believe this trend, together with the resilience of global AI Adopters, is worth watching as a potential sign of a rotation toward companies that leverage AI. The AI rally to date has been led primarily by semiconductor and data center-related stocks. However, at a time when many market participants are increasingly concerned about the outlook for these stocks, we see a meaningful likelihood that AI adopters could emerge as the next global theme within the broader AI trade.

Exhibit 7: Retrospective Performance of Stocks with High Net AI Adopters Beta (vs. TOPIX)



Source: Bloomberg, QUICK Workstation, Morgan Stanley Research.
Note: The universe is fixed at the 50 stocks selected based on weekly data from January 2025 through the end of September 2026. Performance assumes an equal-weighted portfolio formed at the end of 2025. It does not represent the performance of a strategy that could have been implemented using only information available at each point in time.

From a global perspective, our thematic research analyst Stephen Byrd recommends a barbell strategy combining companies addressing infrastructure bottlenecks such as power supply and selected semiconductor and infrastructure names with early software enablers and AI adopters (Mapping AI's Rate of Change: From Buildout to Broadening, 24 Sep 2026). Importantly, the enabler category also includes infrastructure and security software providers and is not limited to semiconductor and data-center companies. In this report, we explore investment opportunities among Japanese companies adopting and leveraging AI, while advocating reduced concentration in AI capex-related stocks.



Exhibit 8: Stocks with High Net AI Adopters Beta

Code	Name	TSE 17 sectors	Share price (JPY, 10/23)	Mkt Cap (JPY mn, 10/23)	Forward P/E (X)	P/B (X)
2121	MIXI	IT&Serv&Oth	3,940	270,012	10.3	1.37
2326	DIGITAL ARTS	IT&Serv&Oth	6,040	85,363	21.3	4.41
2327	NS SOLUTIONS	IT&Serv&Oth	4,201	768,791	23.1	2.78
2492	INFOMART	IT&Serv&Oth	789	211,064	67.9	7.00
3498	KASUMIGASEKI CAPITAL	Real Estate	7,090	174,548	7.3	2.01
3635	KOEI TECMO HOLDINGS	IT&Serv&Oth	1,658	557,249	15.0	1.98
3659	NEXON	IT&Serv&Oth	2,773	2,166,576	18.8	2.01
3660	ISTYLE	IT&Serv&Oth	466	47,840	31.5	1.95
3673	BROADLEAF	IT&Serv&Oth	487	95,351	27.6	3.51
3697	SHIFT	IT&Serv&Oth	1,156	309,231	26.9	7.11
3762	TECHMATRIX	IT&Serv&Oth	3,485	155,147	25.8	5.28
3769	GMO PAYMENT GATEWAY	IT&Serv&Oth	8,725	667,965	27.3	5.30
3778	SAKURA INTERNET	IT&Serv&Oth	2,845	119,179	76.0	3.70
3844	COMTURE	IT&Serv&Oth	1,320	42,559	18.7	2.18
3923	RAKUS	IT&Serv&Oth	1,113	394,260	14.9	10.27
3993	PKSHA TECHNOLOGY	IT&Serv&Oth	3,700	118,208	33.4	3.17
3994	MONEY FORWARD	IT&Serv&Oth	6,747	375,826	-	9.04
4071	PLUS ALPHA CONSULTING	IT&Serv&Oth	2,324	98,559	18.8	5.66
4180	APPIER GROUP	IT&Serv&Oth	1,421	146,081	35.2	3.63
4194	VISIONAL	IT&Serv&Oth	9,582	388,089	20.9	4.51
4307	NOMURA RESEARCH INSTITUTE	IT&Serv&Oth	6,174	3,464,833	28.3	9.25
4373	SIMPLEX HOLDINGS	IT&Serv&Oth	1,260	299,764	22.6	5.69
4385	MERCARI	IT&Serv&Oth	3,704	612,563	16.9	4.41
4432	WINGARC1ST	IT&Serv&Oth	3,810	133,764	17.9	2.69
4443	SANSAN	IT&Serv&Oth	2,118	268,787	28.6	13.28
4676	FUJI MEDIA HOLDINGS	IT&Serv&Oth	4,196	709,640	22.9	1.11
4680	ROUND ONE	IT&Serv&Oth	1,318	381,115	18.0	4.04
4704	TREND MICRO	IT&Serv&Oth	7,260	1,022,946	30.7	8.15
4716	ORACLE JAPAN	IT&Serv&Oth	10,000	1,283,141	19.0	11.35
4722	FUTURE	IT&Serv&Oth	2,428	231,456	18.3	3.24
4733	OBIC BUSINESS CONSULTANTS	IT&Serv&Oth	9,420	710,306	36.5	4.20
4751	CYBERAGENT	IT&Serv&Oth	1,294	656,231	15.4	3.20
4776	CYBOZU	IT&Serv&Oth	3,235	170,671	19.2	8.32
4819	DIGITAL GARAGE	IT&Serv&Oth	2,410	115,687	37.1	1.53
5032	ANYCOLOR	IT&Serv&Oth	3,200	195,509	13.9	6.60
6036	KEEPER TECHNICAL LABORATORY	IT&Serv&Oth	3,930	111,144	17.3	4.27
6088	SIGMAXYZ HOLDINGS	IT&Serv&Oth	631	54,252	11.3	3.93
6098	RECRUIT HOLDINGS	IT&Serv&Oth	19,060	28,065,929	34.9	14.85
6460	SEGA SAMMY HOLDINGS	Machinery	3,359	717,299	19.2	1.92
6532	BAYCURRENT	IT&Serv&Oth	11,500	1,727,613	35.1	16.52
6701	NEC	Elec&Prec	5,390	7,353,304	25.1	3.20
7383	NET PROTECTIONS HOLDINGS	Fin(ExBank)	364	36,302	16.6	1.68
7974	NINTENDO	IT&Serv&Oth	8,539	10,991,913	26.6	3.37
9449	GMO INTERNET GROUP	IT&Serv&Oth	3,769	404,599	15.2	2.25
9552	QUANTS RESEARCH INSTITUTE HOLD	IT&Serv&Oth	1,082	54,852	16.1	14.62
9682	DTS	IT&Serv&Oth	1,229	195,594	16.3	3.18
9697	CAPCOM	IT&Serv&Oth	4,300	2,291,948	30.5	6.28
9722	FUJITA KANKO	IT&Serv&Oth	3,050	186,163	14.6	4.25
9759	NSD	IT&Serv&Oth	3,255	270,165	18.4	3.58
9889	JBCC HOLDINGS	IT&Serv&Oth	2,343	166,576	23.4	5.74

Source: Bloomberg, Morgan Stanley Research.
Note: (1) For TOPIX 1000 constituents, we calculated each stock's beta to the AI Adopters basket, controlling for TOPIX returns; (2) similarly, we calculated each stock's beta to the AI Enablers basket; and (3) we subtracted the beta to the AI Enablers basket from the beta to the AI Adopters basket and selected the top 50 stocks based on this measure.

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Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1599	43%	455	48%	28%	783	44%
Equal-weight/Hold	1563	42%	394	42%	25%	763	43%
Not-Rated/Hold	2	0%	1	0%	50%	1	0%
Underweight/Sell	570	15%	96	10%	17%	227	13%
Total	3,734		946			1774	

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