

JAPAN SMALLER CAPITALIZATION FUND, INC.

October 24, 2017

To Our Shareholders:

We present the Semi-Annual Report of Japan Smaller Capitalization Fund, Inc. (the “Fund”) for the six months ended August 31, 2017.

The net asset value per share (“NAV”) of the Fund increased by 15.0% and the closing market price of the Fund (on the New York Stock Exchange) increased by 16.4% for the six months ended August 31, 2017. The closing market price of the Fund on August 31, 2017 was \$12.34, representing a discount of 11.2% to the NAV of \$13.90. The net assets of the Fund totaled \$393,878,498 on August 31, 2017.

The Russell/Nomura Small Cap™ Index, the Fund’s benchmark (“Benchmark”), increased by 12.7% in United States (“U.S.”) dollar terms for the six months ended August 31, 2017. During the six months ended August 31, 2017, the Fund outperformed the Benchmark by 2.3% on a NAV basis. The Tokyo Price Index (the “TOPIX”), a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange (the “TSE”), increased by 7.3% and the Nikkei Stock Average Index (“Nikkei”), a price-weighted index of the 225 leading stocks on the TSE, increased by 4.6% in U.S. dollar terms during the six months ended August 31, 2017. The Japanese yen (“Yen”) appreciated by 1.8% against the U.S. dollar during the six months ended August 31, 2017.

For the quarter ended August 31, 2017, the Benchmark increased by 7.2%, the TOPIX increased by 3.8%, and the Nikkei increased by 0.6% in U.S. dollar terms. The NAV of the Fund increased by 8.5% and outperformed the Benchmark by 1.3%. The Fund’s share price increased by 7.8% during the quarter. The Yen appreciated by 0.6% against the U.S. dollar during the quarter.

Investment Strategy

The Fund invests in undervalued stocks that offer fundamental strength and potential for improvement. The Fund performs extensive fundamental research to identify stocks that can create shareholder value. The Fund focuses on companies that are leaders in certain niche markets, companies with large or expanding market shares, stocks with superior shareholder distribution policies, and stocks that offer good growth prospects. In the Japanese small cap equity market, valuation anomalies do exist and can be exploited through active management. There are a number of factors that the Fund considers when selling an investment, including a stock which appears fully valued, unexpected deterioration in earnings or a substantial loss that impairs the company’s net assets, and a stock’s diminishing potential given declining competitiveness due to a change of business environment or failure of business strategy.

Performance

In terms of the sector allocation strategy, an underweight position in the Banks sector and an overweight position in the Wholesale Trade sector produced positive contributions. Sector returns were eroded by overweight positions in the Transportation and Warehousing and Iron and Steel sectors.

Relative performance was positively impacted by Toenec Corporation in the Construction sector, Seiren Co., Ltd. in the Textiles and Apparel sector, Espec Corp. in the Electric Appliances sector, and Start Today Co., Ltd. in the Retail Trade sector.

Conversely, relative performance was negatively impacted by ABC-Mart, Inc. in the Retail Trade sector and Tracom Co., Ltd. and Japan Transcity Corporation in the Transportation and Warehousing sector.

Market Review

The Benchmark increased by 10.7% and outperformed the TOPIX index, which increased by 5.4% in local currency terms, for the six months ended August 31, 2017. The Japanese equity market posted a steep downturn at the beginning of the review period given concerns over geopolitical risks. The Japanese equity market later rallied due to the sustained positive outlook for corporate earnings for the fiscal year ending March 2018.

The Japanese equity market fell at the start of the review period as it faced risk factors such as concerns about the ability of the Trump administration to pass key legislation in the U.S. and the geopolitical risks such as North Korea's missile launch and increased U.S. military involvement in the Syria conflict.

In mid-April 2017, the Japanese equity market rebounded after economic dialogue between the U.S. and Japan resulted in no indications of negative changes to the bi-lateral trade policy even though the U.S. administration displayed strong willingness to reform the tax system. From the end of April to the beginning of May 2017, the Japanese equity market posted a strong rally as Emanuel Macron, a candidate that supports the European Union ("EU"), took the lead in the French presidential elections. Risk aversion subsided and the Yen depreciated against the U.S. dollar, while expectations grew for continued improvement in corporate profits.

Earnings results for the fiscal year ended March 2017 and expectations for the fiscal year ending March 2018 from Japanese companies were announced mid-May 2017. The sustained positive outlook for corporate earnings for the fiscal year

ending March 2018 helped the Japanese equity market extend its gains from May to July 2017. Overall results were encouraging as companies maintained relatively high profit margins despite volatility in both global demand conditions and exchange rates. Earnings prospects from many companies were within the expected range based on conservative assumptions.

In August 2017, strong quarterly earnings results from Japanese companies were supportive for the equity market, while geopolitical uncertainties appeared to be causing some deterioration in broad market sentiment. The TOPIX index declined slightly due to selling pressure amid a more risk-averse environment as North Korea suggested launching a missile towards Guam. However, the Benchmark appreciated as small cap stocks outperformed relative to the large cap market given the relatively stable business performance of smaller domestically oriented companies.

Outlook and Future Strategy

Although geopolitical risks surrounding North Korea's recent actions remain an overhanging concern, the Fund expects the Japanese economy to continue its moderate expansion with support from external demand, government spending, and steady personal consumption. Given limited visibility regarding the timing of any possible fiscal stimulus measures from the U.S. government or a slowdown in the Chinese economy, Japan's economic growth momentum is expected to peak gradually towards the latter half of 2017. For the time being, economic recoveries in the EU and emerging countries should continue to support Japanese corporate earnings. As such, the Fund expects the resilient corporate earnings prospects along with the Bank of Japan's monetary easing measures to provide some support for the Japanese equity market.

Results announced by Japanese companies for the first quarter of 2017 solidly beat consensus

estimates. Consequently and along with a favorable Yen to Euro exchange rate, Nomura Securities upgraded the continuing profit growth estimates for Small Cap stocks from 7.7% to 9.0% for 2017. Moreover, not only cyclical sectors but also some domestic-oriented sectors also announced superior earnings growth rates that exceeded market expectations. This might indicate that earnings drivers for Japanese firms have diverged further, beyond just the effect of currency movements. Despite concerns about a peak in momentum toward the latter half of the year and stronger earnings prospects shown from the first quarter of 2017 results, the current Japanese small cap equity market price to earnings ratio is around 17 for 2017, which the Fund believes is reasonable.

Investors will continue to monitor potential shifts in monetary policy by the major central banks. From the latter half of 2017 to 2018, the Fund expects the normalization of quantitative monetary easing to progress further in the U.S. and Europe. As the inflation rate remains low, it is difficult to expect the U.S. authorities to accelerate their monetary tightening process or for the

Eurozone to implement an early rate hike. Nonetheless, it is the Fund's view that the Federal Reserve Bank will continue to raise its Federal Funds rate as long as economic indicators such as the unemployment rate and the Purchasing Managers Index remain buoyant. Meanwhile, the current monetary easing measures will be maintained for the time being in Japan. Towards next year, potential expansion of interest rate gaps between Japan and other developed countries and a weaker Yen could be supportive, considering the positive impact on Japanese corporate earnings in general.

The Fund appreciates your continuing support.

Sincerely,



Yutaka Itabashi
President

DISCLOSURES

Sources: Nomura Asset Management U.S.A. Inc., Nomura Asset Management Co., Ltd., and Bloomberg L.P. Past performance is not indicative of future results. There is a risk of loss.

The NAV price is adjusted for reinvestment of income dividends, ordinary income distributions, and long-term capital gain distributions. The New York Stock Exchange's closing market price is adjusted for reinvestment of income dividends, ordinary income distributions, and long-term capital gain distributions. The Fund's performance does not reflect sales commissions.

This material contains the current opinions of the Fund's manager, which are subject to change without notice. This material should not be considered investment advice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long term.

Comparisons between changes in the Fund's net asset value or market price per share and changes in the Fund's benchmark should be considered in light of the Fund's investment policy and objective, the characteristics and quality of the Fund's investments, the size of the Fund, and variations in the Yen/U.S. Dollar exchange rate. This report is for informational purposes only. Investment products offered are not FDIC insured, may lose value, and are not bank guaranteed.

Indices are unmanaged. An index cannot be directly invested into.

Certain information discussed in this report may constitute forward-looking statements within the meaning of the U.S. federal securities laws. The Fund believes that the expectations reflected in such forward-looking statements are based on reasonable assumptions and can give no assurance that the Fund's expectations will be achieved. Forward-looking information is subject to certain risks, trends and uncertainties that could cause actual results to differ materially from those projected.

The Russell/Nomura Small Cap™ Index represents approximately 15% of the total market capitalization of the Russell/Nomura Total Market™ Index. It measures the performance of the smallest Japanese equity securities in the Russell/Nomura Total Market™ Index. As of August 31, 2017, there are 1,138 securities in the Russell/Nomura Small Cap™ Index.

SHAREHOLDERS ACCOUNT INFORMATION

Shareholders whose accounts are held in their own name may contact the Fund's registrar, Computershare Trust Company, N.A., at (800) 426-5523 for information concerning their accounts.

PROXY VOTING

A description of the policies and procedures that the Fund uses to vote proxies relating to portfolio securities is available (1) without charge, upon request, by calling toll-free 1-800-833-0018; and (2) on the website of the Securities and Exchange Commission ("SEC") at <http://www.sec.gov>. Information about how the Fund voted proxies relating to securities held in the Fund's portfolio during the most recent 12-month period ended June 30 is available (1) without charge, upon request, by calling toll-free 1-800-833-0018; and (2) on the SEC's website at <http://www.sec.gov>.

Additional information about the Fund's Board of Directors is available (1) without charge, upon request, by calling toll-free 1-800-833-0018; and (2) on the website of the SEC at <http://www.sec.gov> in the Fund's most recent proxy statement filing.

AVAILABILITY OF QUARTERLY SCHEDULE OF INVESTMENTS

The Fund files a schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Fund's Forms N-Q are available on the SEC's web site at <http://www.sec.gov>. The Fund's Forms N-Q may also be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

FUND CERTIFICATION

In December 2016, the Fund filed its Principal Executive Officer Certification with the New York Stock Exchange pursuant to Section 303A.12(a) of the New York Stock Exchange Corporate Governance Listing Standards.

The Fund's Principal Executive Officer and Principal Financial Officer Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 were filed with the Fund's Form N-CSR and are available on the SEC's web site at <http://www.sec.gov>.

SHARE REPURCHASES

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940 that from time to time the Fund may repurchase shares of its common stock in the open market.

INTERNET WEBSITE

Nomura Asset Management U.S.A. Inc. has established an Internet website which highlights its history, investment philosophy and process and products, which includes the Fund.

The Internet web address is <http://funds.nomura-asset.com>.

JAPAN SMALLER CAPITALIZATION FUND, INC.
FUND HIGHLIGHTS—AUGUST 31, 2017 (Unaudited)

KEY STATISTICS

| | |
|---|---------------|
| Net Assets | \$393,878,498 |
| Net Asset Value per Share | \$13.90 |
| Market Price | \$12.34 |
| Percentage Change in Net Asset Value per Share* | 15.0% |
| Percentage Change Market Price* | 16.4% |

MARKET INDICES

| Percentage change in market indices:* | <u>YEN</u> | <u>U.S.\$</u> |
|---|------------|---------------|
| Russell/Nomura Small Cap™ Index | 10.7% | 12.7% |
| Tokyo Price Index | 5.4% | 7.3% |
| Nikkei Stock Average Index | 2.8% | 4.6% |

*From March 1, 2017 through August 31, 2017.

INDUSTRY DIVERSIFICATION

| | <u>% of Net Assets</u> | | <u>% of Net Assets</u> |
|--|----------------------------|------------------------------------|----------------------------|
| Retail Trade | 16.3 | Real Estate | 4.3 |
| Wholesale Trade | 13.8 | Electric Appliances | 4.2 |
| Chemicals | 10.6 | Other Products | 4.1 |
| Machinery | 7.5 | Textiles and Apparel | 2.5 |
| Transportation and Warehousing | 5.3 | Banks | 1.8 |
| Services | 5.2 | Utilities | 1.4 |
| Metal Products | 5.1 | Financing Business | 1.2 |
| Iron and Steel | 4.9 | Transportation Equipment | 1.1 |
| Information and Communication | 4.7 | Precision Instruments | 0.7 |
| Construction | 4.5 | Food | 0.6 |

TEN LARGEST EQUITY HOLDINGS BY FAIR VALUE

| <u>Security</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---------------------------------------|-----------------------|----------------------------|
| Ryoden Corporation | \$ 10,958,294 | 2.8 |
| SIIX Corporation | 10,392,626 | 2.6 |
| Amiyaki Tei Co., Ltd. | 10,237,118 | 2.6 |
| Trancom Co., Ltd. | 10,175,140 | 2.6 |
| Osaka Steel Co., Ltd. | 9,904,542 | 2.5 |
| Toenec Corporation | 9,825,542 | 2.5 |
| Oiles Corporation | 9,585,091 | 2.4 |
| Hisaka Works, Ltd. | 8,983,236 | 2.3 |
| H.I.S. Co., Ltd. | 8,693,835 | 2.2 |
| Keihanshin Building Co., Ltd. | 8,409,718 | 2.1 |

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|------------------|-------------------|------------------------|
| JAPANESE EQUITY SECURITIES | | | | |
| Banks | | | | |
| The Akita Bank, Ltd. | 1,214,000 | \$ 3,406,699 | \$ 3,684,303 | 0.9 |
| General banking services | | | | |
| The Taiko Bank, Ltd. | 902,000 | 1,796,440 | 1,917,841 | 0.5 |
| General banking services | | | | |
| The Yamanashi Chuo Bank, Ltd. | 425,000 | <u>1,874,444</u> | <u>1,664,395</u> | <u>0.4</u> |
| General banking services | | | | |
| <i>Total Banks</i> | | <u>7,077,583</u> | <u>7,266,539</u> | <u>1.8</u> |
| Chemicals | | | | |
| Adeka Corporation | 301,700 | 4,411,751 | 5,129,077 | 1.3 |
| Manufactures chemical and food products | | | | |
| C. Uyemura & Co., Ltd. | 64,200 | 2,927,394 | 3,896,743 | 1.0 |
| Plating chemicals | | | | |
| C.I. Takiron Corporation | 554,000 | 2,460,683 | 3,256,899 | 0.8 |
| Manufactures resin and composite products | | | | |
| Fujikura Kasei Co., Ltd. | 892,700 | 4,424,053 | 5,158,850 | 1.3 |
| Specialty coating materials and fine chemicals | | | | |
| Koatsu Gas Kogyo Co., Ltd. | 586,500 | 3,516,650 | 4,407,210 | 1.1 |
| High-pressured gases and chemicals | | | | |
| Sakai Chemical Industry Co., Ltd. | 192,000 | 640,969 | 924,629 | 0.2 |
| Manufactures components for cosmetics and pharmaceuticals | | | | |
| Sekisui Jushi Corporation | 232,200 | 3,428,094 | 4,251,356 | 1.1 |
| Manufactures plastics and other resin materials | | | | |
| Shikoku Chemicals Corporation | 90,000 | 819,968 | 1,211,939 | 0.3 |
| Manufactures chemical products | | | | |
| Soken Chemical & Engineering Co., Ltd. | 107,700 | 1,131,677 | 1,781,055 | 0.5 |
| Manufactures chemical products | | | | |
| Tenma Corporation | 284,300 | 4,167,779 | 5,512,664 | 1.4 |
| Manufactures synthetic resin products | | | | |
| Teraoka Seisakusho Co., Ltd. | 344,400 | 1,379,373 | 1,420,722 | 0.4 |
| Manufactures various adhesive tapes | | | | |
| T&K Toka Co., Ltd. | 173,900 | 1,661,174 | 2,014,652 | 0.5 |
| Manufactures specialized inks for printing applications | | | | |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|-------------------|-------------------|------------------------|
| Yushiro Chemical Industry Co., Ltd. | 180,000 | \$ 2,175,015 | \$ 2,708,464 | 0.7 |
| Manufactures metalworking fluids | | | | |
| <i>Total Chemicals</i> | | <u>33,144,580</u> | <u>41,674,260</u> | <u>10.6</u> |
| Construction | | | | |
| C-Cube Corporation | 7,600 | 35,334 | 37,843 | 0.0 |
| Communications construction business | | | | |
| Daiichi Kensetsu Corporation | 26,400 | 284,205 | 333,913 | 0.1 |
| Construction and real estate businesses | | | | |
| Mirai Industry Co., Ltd. | 37,000 | 517,744 | 571,532 | 0.2 |
| Manufactures electrical installation materials | | | | |
| NDS Co., Ltd. | 5,100 | 154,519 | 158,021 | 0.0 |
| Construction of communication infrastructure | | | | |
| Sysken Corporation | 12,000 | 39,067 | 39,144 | 0.0 |
| Electric communication facility construction business | | | | |
| Taihei Dengyo Kaisha, Ltd. | 66,000 | 672,132 | 882,159 | 0.2 |
| Construction of thermal and nuclear plant facilities | | | | |
| Toenec Corporation | 1,602,000 | 8,796,994 | 9,825,542 | 2.5 |
| Construction of comprehensive building facilities | | | | |
| Totetsu Kogyo Co., Ltd. | 128,000 | 3,828,407 | 4,181,182 | 1.1 |
| Operates construction-related businesses | | | | |
| Yondenko Corporation | 306,000 | <u>1,122,765</u> | <u>1,668,257</u> | <u>0.4</u> |
| Construction of electrical distribution systems | | | | |
| <i>Total Construction</i> | | <u>15,451,167</u> | <u>17,697,593</u> | <u>4.5</u> |
| Electric Appliances | | | | |
| Espec Corp | 225,400 | 2,554,273 | 4,280,460 | 1.1 |
| Manufactures environmental testing products | | | | |
| Kitagawa Industries Co., Ltd. | 400,400 | 4,199,695 | 4,565,917 | 1.2 |
| Manufactures various industrial and consumer products | | | | |
| Koito Manufacturing Co., Ltd. | 62,200 | 2,046,910 | 3,871,428 | 1.0 |
| Manufactures lighting equipment | | | | |
| Mabuchi Motor Co., Ltd. | 7,900 | 407,144 | 372,550 | 0.1 |
| Manufactures small motors | | | | |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|-------------------|-------------------|------------------------|
| Maxwell Holdings, Ltd. | 100,500 | \$ 1,713,474 | \$ 2,398,923 | 0.5 |
| Manufactures media devices, batteries and electrical appliances | | | | |
| Nihon Kohden Corporation | 45,500 | <u>1,016,416</u> | <u>1,054,246</u> | <u>0.3</u> |
| Manufactures medical electronic equipment | | | | |
| <i>Total Electric Appliances</i> | | <u>11,937,912</u> | <u>16,543,524</u> | <u>4.2</u> |
| Financing Business | | | | |
| Hitachi Capital Corporation | 114,400 | 2,556,953 | 2,654,832 | 0.7 |
| General financial services | | | | |
| Ricoh Leasing Company, Ltd. | 52,700 | <u>1,547,937</u> | <u>1,838,790</u> | <u>0.5</u> |
| Leasing and financial services | | | | |
| <i>Total Financing Business</i> | | <u>4,104,890</u> | <u>4,493,622</u> | <u>1.2</u> |
| Food | | | | |
| Japan Meat Co., Ltd. | 37,700 | 616,261 | 597,418 | 0.1 |
| Supermarket business and operation of eating-out stores | | | | |
| Kameda Seika Co., Ltd. | 40,800 | <u>1,989,423</u> | <u>1,857,326</u> | <u>0.5</u> |
| Manufactures confectioneries | | | | |
| <i>Total Food</i> | | <u>2,605,684</u> | <u>2,454,744</u> | <u>0.6</u> |
| Information and Communication | | | | |
| NS Solutions Corporation | 93,200 | 2,002,498 | 1,999,411 | 0.5 |
| System consulting services and software development | | | | |
| OBIC Co., Ltd. | 76,500 | 3,403,703 | 4,789,287 | 1.2 |
| Computer system integration | | | | |
| Okinawa Cellular Telephone Company | 208,400 | 5,726,298 | 7,385,035 | 1.9 |
| Telecommunications | | | | |
| Otsuka Corporation | 63,900 | 2,899,802 | 4,226,905 | 1.1 |
| Computer information system developer | | | | |
| Software Service Inc. | 4,600 | <u>170,597</u> | <u>219,436</u> | <u>0.0</u> |
| Provides medical information systems | | | | |
| <i>Total Information and Communication</i> | | <u>14,202,898</u> | <u>18,620,074</u> | <u>4.7</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|-------------------|-------------------|------------------------|
| Iron and Steel | | | | |
| Chubu Steel Plate Co., Ltd. | 233,500 | \$ 1,068,629 | \$ 1,620,953 | 0.4 |
| Manufactures steel-related products | | | | |
| Mory Industries Inc. | 89,600 | 1,336,350 | 2,071,168 | 0.5 |
| Manufactures steel tubing products | | | | |
| Nichia Steel Works, Ltd. | 2,115,600 | 6,306,399 | 5,805,381 | 1.5 |
| Manufactures steel-related products | | | | |
| Osaka Steel Co., Ltd. | 440,600 | <u>8,035,886</u> | <u>9,904,542</u> | <u>2.5</u> |
| Manufactures steel-related products | | | | |
| <i>Total Iron and Steel</i> | | <u>16,747,264</u> | <u>19,402,044</u> | <u>4.9</u> |
| Machinery | | | | |
| Hisaka Works, Ltd. | 1,014,000 | 9,006,576 | 8,983,236 | 2.3 |
| Manufactures heat exchangers and other machinery | | | | |
| Miura Co. Ltd. | 139,100 | 2,002,211 | 3,134,505 | 0.8 |
| Manufactures boilers and related products | | | | |
| Nippon Pillar Packing Co., Ltd. | 132,400 | 1,219,622 | 1,946,510 | 0.5 |
| Manufactures mechanical seals | | | | |
| Nissei ASB Machine Co., Ltd. | 4,700 | 81,920 | 188,760 | 0.0 |
| Manufactures stretch blow molding machines | | | | |
| Nissei Corporation | 28,200 | 251,449 | 259,054 | 0.1 |
| Manufactures reducers and gears | | | | |
| Nitto Kohki Co. Ltd. | 144,400 | 2,921,944 | 3,516,351 | 0.9 |
| Manufactures machine tools and motor pumps | | | | |
| Oiles Corporation | 527,180 | 9,175,104 | 9,585,091 | 2.4 |
| Manufactures bearing equipment | | | | |
| Sato Holdings Corporation | 36,800 | 814,734 | 878,077 | 0.2 |
| Manufactures electronic printers and other products | | | | |
| Shibuya Corporation | 14,200 | 181,166 | 468,366 | 0.1 |
| Packing plant business | | | | |
| Yamashin-Filter Corporation | 18,300 | <u>118,175</u> | <u>648,494</u> | <u>0.2</u> |
| Manufactures filters | | | | |
| <i>Total Machinery</i> | | <u>25,772,901</u> | <u>29,608,444</u> | <u>7.5</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|-------------------|-------------------|------------------------|
| Metal Products | | | | |
| Dainichi Co., Ltd. | 314,500 | \$ 2,322,740 | \$ 2,320,422 | 0.6 |
| Manufactures oil heating equipment | | | | |
| Neturen Co., Ltd. | 595,300 | 4,246,113 | 5,803,979 | 1.5 |
| Manufactures steel bars and induction heating equipment | | | | |
| NHK Spring Co., Ltd. | 311,900 | 3,045,743 | 3,114,607 | 0.8 |
| Manufactures automobile-related products | | | | |
| Piolax, Inc. | 167,000 | 2,476,965 | 4,452,119 | 1.1 |
| Manufactures automobile-related products | | | | |
| Rinnai Corporation | 47,900 | 4,037,334 | 4,156,513 | 1.1 |
| Manufactures heating appliances and components | | | | |
| Shinpo Co., Ltd. | 2,000 | <u>13,821</u> | <u>14,956</u> | <u>0.0</u> |
| Manufactures smokeless roasters | | | | |
| <i>Total Metal Products</i> | | <u>16,142,716</u> | <u>19,862,596</u> | <u>5.1</u> |
| Other Products | | | | |
| Fuji Seal International, Inc. | 75,200 | 1,223,176 | 2,275,371 | 0.6 |
| Packaging-related materials and machinery | | | | |
| Komatsu Wall Industry Co., Ltd. | 18,800 | 323,677 | 345,064 | 0.1 |
| Manufactures various partitions | | | | |
| Nishikawa Rubber Co., Ltd. | 349,500 | 5,716,507 | 6,907,115 | 1.8 |
| Manufactures rubber automobile parts | | | | |
| Pigeon Corporation | 60,200 | 1,544,150 | 2,327,482 | 0.6 |
| Manufactures baby care products | | | | |
| The Pack Corporation | 120,300 | <u>2,547,886</u> | <u>4,104,552</u> | <u>1.0</u> |
| Manufactures paper and chemical products | | | | |
| <i>Total Other Products</i> | | <u>11,355,396</u> | <u>15,959,584</u> | <u>4.1</u> |
| Precision Instruments | | | | |
| Nakanishi Inc. | 60,100 | <u>2,057,244</u> | <u>2,593,930</u> | <u>0.7</u> |
| Manufactures dental instruments | | | | |
| <i>Total Precision Instruments</i> | | <u>2,057,244</u> | <u>2,593,930</u> | <u>0.7</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|---|---------------|-------------------|-------------------|------------------------|
| Real Estate | | | | |
| Daibiru Corporation | 385,400 | \$ 3,442,325 | \$ 4,041,175 | 1.0 |
| Real estate leasing and building management | | | | |
| Keihanshin Building Co., Ltd. | 1,331,700 | 7,539,593 | 8,409,718 | 2.1 |
| Real estate leasing and building management | | | | |
| Sanyo Housing Nagoya Co., Ltd. | 259,700 | 2,535,354 | 2,600,422 | 0.7 |
| Designs and constructs housing | | | | |
| Starts Corporation Inc. | 73,600 | <u>1,423,827</u> | <u>1,834,399</u> | <u>0.5</u> |
| Construction, leasing and management of real estate | | | | |
| <i>Total Real Estate</i> | | <u>14,941,099</u> | <u>16,885,714</u> | <u>4.3</u> |
| Retail Trade | | | | |
| ABC-Mart, Inc. | 96,800 | 5,077,901 | 4,969,514 | 1.3 |
| Retail sales of shoes | | | | |
| AIN Holdings Inc. | 3,100 | 111,971 | 227,877 | 0.1 |
| Operates pharmacies and drug store chains | | | | |
| Amiyaki Tei Co., Ltd. | 235,700 | 8,343,692 | 10,237,118 | 2.6 |
| Operates barbecue restaurant chains | | | | |
| Belc Co., Ltd. | 26,600 | 1,094,929 | 1,285,830 | 0.3 |
| Operates retail food store chains | | | | |
| Cosmos Pharmaceutical Corporation | 14,100 | 2,848,212 | 3,193,976 | 0.8 |
| Operates drug stores | | | | |
| Create SD Holdings Co., Ltd. | 168,800 | 3,246,624 | 4,380,472 | 1.1 |
| Operates pharmacies and drug store chains | | | | |
| Daikokutenbussan Co., Ltd. | 157,000 | 6,308,436 | 7,603,562 | 1.9 |
| Operates supermarkets | | | | |
| Don Quijote Holdings Co., Ltd. | 60,000 | 2,202,840 | 2,276,135 | 0.6 |
| Operates discount stores | | | | |
| Heiwado Co., Ltd. | 3,200 | 69,397 | 74,639 | 0.0 |
| Operates supermarkets | | | | |
| Hiday Hidaka Corp | 144,111 | 2,574,467 | 4,150,942 | 1.0 |
| Operates restaurant chains | | | | |
| JINS Inc. | 48,500 | 1,734,860 | 2,842,442 | 0.7 |
| Retail sales of eyewear and fashion accessories | | | | |
| Kura Corporation | 49,000 | 2,104,316 | 2,689,201 | 0.7 |
| Operates a sushi restaurant chain | | | | |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|--|---------------|-------------------|-------------------|------------------------|
| NAFCO Co., Ltd. | 44,000 | \$ 696,363 | \$ 702,049 | 0.2 |
| Operates chain of home and furniture retail outlets | | | | |
| Saint Marc Holdings Co., Ltd. | 71,500 | 1,881,587 | 2,137,431 | 0.5 |
| Operates restaurant chains | | | | |
| San-A Co., Ltd. | 96,700 | 4,383,722 | 4,248,280 | 1.1 |
| Retail sales of home goods | | | | |
| Seria Co. Ltd. | 64,100 | 1,241,619 | 3,506,265 | 0.9 |
| Discount retail sales | | | | |
| Start Today Co., Ltd. | 136,300 | 1,271,694 | 4,235,573 | 1.1 |
| Operates retail E-commerce websites | | | | |
| Sundrug Co., Ltd. | 24,500 | 877,295 | 1,014,016 | 0.3 |
| Operates pharmacies and drug store chains | | | | |
| Yaoko Co., Ltd. | 74,900 | 3,045,546 | 3,566,181 | 0.9 |
| Operates and manages groceries and supermarkets | | | | |
| Yossix Co., Ltd. | 46,600 | <u>685,753</u> | <u>877,759</u> | <u>0.2</u> |
| Operates restaurant chains | | | | |
| <i>Total Retail Trade</i> | | <u>49,801,224</u> | <u>64,219,262</u> | <u>16.3</u> |
| | | | | |
| Services | | | | |
| EPS Holdings, Inc. | 71,500 | 891,127 | 1,400,050 | 0.4 |
| Performs contract medical research services | | | | |
| H.I.S. Co., Ltd. | 260,000 | 6,842,396 | 8,693,835 | 2.2 |
| Travel business | | | | |
| Nihon M&A Center Inc. | 45,900 | 900,249 | 2,122,857 | 0.5 |
| Provides merger and acquisition brokerage services | | | | |
| Nippon Air Conditioning Services Co., Ltd. | 265,300 | 1,462,199 | 1,663,323 | 0.4 |
| Provides maintenance and management of building facilities | | | | |
| Relia, Inc. | 206,200 | 1,964,851 | 2,298,918 | 0.6 |
| Provides telemarketing services | | | | |
| Septeni Holdings Co., Ltd. | 559,500 | 1,371,310 | 1,469,224 | 0.4 |
| Internet advertising and media content business | | | | |
| Step Co., Ltd. | 135,800 | 1,228,003 | 1,815,109 | 0.5 |
| Operates preparatory schools | | | | |
| Tear Corporation | 122,300 | <u>852,571</u> | <u>955,686</u> | <u>0.2</u> |
| Funeral business | | | | |
| <i>Total Services</i> | | <u>15,512,706</u> | <u>20,419,002</u> | <u>5.2</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|--|---------------|-------------------|-------------------|------------------------|
| Textiles and Apparel | | | | |
| Hogy Medical Co., Ltd. | 26,800 | \$ 1,445,021 | \$ 1,889,673 | 0.5 |
| Manufactures medical products | | | | |
| Seiren Co., Ltd. | 451,400 | <u>5,204,611</u> | <u>8,006,295</u> | <u>2.0</u> |
| Manufactures synthetic fibers and textile products | | | | |
| <i>Total Textiles and Apparel</i> | | <u>6,649,632</u> | <u>9,895,968</u> | <u>2.5</u> |
| Transportation and Warehousing | | | | |
| Alps Logistics Co., Ltd. | 401,100 | 2,171,555 | 3,032,258 | 0.8 |
| General logistics services | | | | |
| Japan Transcity Corporation | 912,000 | 3,207,225 | 3,339,567 | 0.8 |
| General logistics services | | | | |
| Meiko Trans Co., Ltd. | 405,000 | 4,110,859 | 4,415,974 | 1.1 |
| Marine logistics services | | | | |
| Trancom Co., Ltd. | 202,500 | <u>9,138,386</u> | <u>10,175,140</u> | <u>2.6</u> |
| General logistics services | | | | |
| <i>Total Transportation and Warehousing</i> | | <u>18,628,025</u> | <u>20,962,939</u> | <u>5.3</u> |
| Transportation Equipment | | | | |
| Hi-Lex Corporation | 131,700 | 3,263,482 | 3,473,946 | 0.9 |
| Manufactures control cables | | | | |
| Nissin Kogyo Co., Ltd. | 50,100 | <u>755,312</u> | <u>866,297</u> | <u>0.2</u> |
| Manufactures automobile brake systems | | | | |
| <i>Total Transportation Equipment</i> | | <u>4,018,794</u> | <u>4,340,243</u> | <u>1.1</u> |
| Utilities | | | | |
| Keiyo Gas Co., Ltd. | 482,000 | 2,408,147 | 2,321,203 | 0.6 |
| Produces gas and energy products | | | | |
| The Okinawa Electric Power Company, Incorporated | 146,382 | <u>2,262,863</u> | <u>3,264,017</u> | <u>0.8</u> |
| Produces thermal energy products | | | | |
| <i>Total Utilities</i> | | <u>4,671,010</u> | <u>5,585,220</u> | <u>1.4</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | <u>Shares</u> | <u>Cost</u> | <u>Fair Value</u> | <u>% of Net Assets</u> |
|--|---------------|----------------------|----------------------|------------------------|
| Wholesale Trade | | | | |
| Kanaden Corporation | 319,800 | \$ 2,469,388 | \$ 3,321,352 | 0.8 |
| Factory automation business | | | | |
| Kohsoku Corporation | 330,600 | 2,953,657 | 3,544,664 | 0.9 |
| Food and industrial packaging materials | | | | |
| Matsuda Sangyo Co., Ltd. | 556,400 | 6,929,662 | 8,260,939 | 2.1 |
| Precious metals, electronic materials, and food | | | | |
| Paltac Corporation | 41,600 | 611,117 | 1,646,159 | 0.4 |
| Cosmetics and daily necessities | | | | |
| Ryoden Corporation | 1,517,000 | 10,396,581 | 10,958,294 | 2.8 |
| Purchases electronic and electrical devices | | | | |
| Senshu Electric Co., Ltd. | 240,300 | 3,570,099 | 5,000,109 | 1.3 |
| Electrical wires and cables | | | | |
| Shinko Shoji Co., Ltd. | 147,400 | 1,643,448 | 2,529,995 | 0.6 |
| Electronic components and devices | | | | |
| SIIX Corporation | 251,100 | 5,226,026 | 10,392,626 | 2.6 |
| Parts procurement, logistics, and manufacturing of electronics | | | | |
| Sugimoto & Co., Ltd. | 281,500 | 2,903,649 | 4,266,430 | 1.1 |
| Machine tools and measuring instruments | | | | |
| Techno Associe Co., Ltd. | 393,500 | <u>3,718,874</u> | <u>4,598,074</u> | <u>1.2</u> |
| Screws and nonferrous metal products | | | | |
| <i>Total Wholesale Trade</i> | | <u>40,422,501</u> | <u>54,518,642</u> | <u>13.8</u> |
| TOTAL JAPANESE EQUITY SECURITIES | | <u>\$315,245,226</u> | <u>\$393,003,944</u> | <u>99.8</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS – (Continued)

AUGUST 31, 2017

(Unaudited)

| | Cost | Fair Value | % of Net Assets |
|---|----------------------|----------------------|------------------------|
| FOREIGN CURRENCY | | | |
| Japanese Yen | | | |
| Interest bearing account | \$ 2,001,372 | \$ 1,992,729 | 0.5 |
| TOTAL FOREIGN CURRENCY | <u>2,001,372</u> | <u>1,992,729</u> | <u>0.5</u> |
| TOTAL INVESTMENTS AND FOREIGN CURRENCY | <u>\$317,246,598</u> | <u>\$394,996,673</u> | <u>100.3</u> |
| LIABILITIES LESS OTHER ASSETS, NET | | <u>(1,118,175)</u> | <u>(0.3)</u> |
| NET ASSETS | | <u>\$393,878,498</u> | <u>100.0</u> |

Portfolio securities and foreign currency holdings were translated at the following exchange rate as of August 31, 2017.

Japanese Yen JPY ¥ 110.055 = USD \$1.00

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF ASSETS AND LIABILITIES

AUGUST 31, 2017

(Unaudited)

ASSETS:

| | |
|---|--------------------|
| Investments in Japanese equity securities, at fair value (cost—\$315,245,226) . . . | \$393,003,944 |
| Foreign currency, at fair value (cost—\$2,001,372) | 1,992,729 |
| Receivable for investments sold | 362,880 |
| Receivable for dividends | 239,747 |
| Prepaid expenses | 54,354 |
| Cash and cash equivalents | <u>49,825</u> |
| Total Assets | <u>395,703,479</u> |

LIABILITIES:

| | |
|--|------------------|
| Payable for investments purchased | 1,384,033 |
| Accrued management fee | 274,982 |
| Accrued directors' fees and expenses | 2,479 |
| Other accrued expenses | <u>163,487</u> |
| Total Liabilities | <u>1,824,981</u> |

NET ASSETS:

| | |
|---|----------------------|
| Capital stock (28,333,893 shares of capital stock outstanding, 100,000,000 shares authorized, par value \$0.10 each) | 2,833,389 |
| Paid-in capital | 286,055,217 |
| Accumulated net realized gain on investments and foreign currency transactions . | 32,829,356 |
| Net unrealized appreciation on investments and foreign currency transactions . . | 77,758,565 |
| Accumulated net investment loss | <u>(5,598,029)</u> |
| Net Assets | <u>\$393,878,498</u> |
| Net asset value per share | <u>\$13.90</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF OPERATIONS

FOR THE SIX MONTHS ENDED AUGUST 31, 2017

(Unaudited)

INCOME:

| | | |
|--|-------------|--------------------|
| Dividend income (net of \$381,643 withholding taxes) | \$3,434,797 | |
| Interest income | <u>686</u> | |
| Total Income | | <u>\$3,435,483</u> |

EXPENSES:

| | | |
|------------------------------------|----------------|------------------|
| Management fee | 1,548,104 | |
| Custodian fee | 160,191 | |
| Legal fees | 79,041 | |
| Directors' fees and expenses | 65,227 | |
| Other expenses | <u>101,221</u> | |
| Total Expenses | | <u>1,953,784</u> |

INVESTMENT INCOME—NET

| | | |
|--|--|------------------|
| | | <u>1,481,699</u> |
|--|--|------------------|

REALIZED AND UNREALIZED GAIN ON INVESTMENTS AND FOREIGN CURRENCY:

| | | |
|---|--|---------------------|
| Realized gain on investments and foreign currency transactions: | | |
| Net realized gain on investments | | 27,116,871 |
| Net realized gain on foreign currency transactions | | <u>25,200</u> |
| Net realized gain on investments and foreign currency transactions | | 27,142,071 |
| Net change in unrealized appreciation on investments | | 13,991,604 |
| Net change in unrealized appreciation on foreign currency transactions and translation | | <u>8,750,000</u> |
| Net realized and unrealized gain on investments and foreign currency transactions and translation | | <u>49,883,675</u> |
| NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS | | <u>\$51,365,374</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENTS OF CHANGES IN NET ASSETS

| | For the Six Months Ended August 31, 2017 (Unaudited) | For the Year Ended February 28, 2017 |
|--|---|---|
| FROM OPERATIONS: | | |
| Net investment income | \$ 1,481,699 | \$ 3,250,651 |
| Net realized gain on investments | 27,116,871 | 14,027,703 |
| Net realized gain (loss) on foreign currency transactions | 25,200 | (116,869) |
| Net change in unrealized appreciation on investments | 13,991,604 | 50,344,095 |
| Net change in unrealized appreciation on foreign currency transactions and translation | <u>8,750,000</u> | <u>3,981,045</u> |
| Net increase in net assets resulting from operations | <u>51,365,374</u> | <u>71,486,625</u> |
| FROM DISTRIBUTIONS TO SHAREHOLDERS: | | |
| Ordinary income distribution | — | (9,809,194) |
| Capital gains distribution | <u>—</u> | <u>(16,714,163)</u> |
| Decrease in net assets derived from distributions to shareholders ... | <u>—</u> | <u>(26,523,357)</u> |
| NET ASSETS: | | |
| Beginning of period | <u>342,513,124</u> | <u>297,549,856</u> |
| End of period (including accumulated net investment loss of \$5,598,029 and \$7,079,728 respectively) | <u>\$393,878,498</u> | <u>\$342,513,124</u> |

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS (Unaudited)

1. Significant Accounting Policies

Japan Smaller Capitalization Fund, Inc. (the “Fund”) is registered under the Investment Company Act of 1940, as amended (the “Investment Company Act”), as a non-diversified, closed-end management investment company. The Fund was incorporated in Maryland on January 25, 1990 and investment operations commenced on March 21, 1990. The Fund’s investment objective is to seek long-term capital appreciation through investments primarily in smaller capitalization Japanese equity securities.

The accompanying financial statements have been prepared in accordance with United States (“U.S.”) generally accepted accounting principles (“GAAP”) and are stated in United States dollars. The Fund is an investment company that follows the accounting and reporting guidance in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 946 *Financial Services-Investment Companies*. The following is a summary of the significant accounting and reporting policies used in preparing the financial statements.

(a) Valuation of Securities — Investments traded in the over-the-counter market are fair valued at the last reported sales price as of the close of business on the day the securities are being valued or, if none is available, at the mean of the bid and offer price at the close of business on such day or, if none is available, the last reported sales price. Portfolio securities which are traded on stock exchanges are fair valued at the

last sales price on the principal market on which securities are traded or, lacking any sales, at the last available bid price. Securities and other assets, including futures contracts and related options, that cannot be fair valued using one of the previously mentioned methods are stated at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund.

(b) Foreign Currency Transactions — Transactions denominated in Japanese Yen (“Yen”) are recorded in the Fund’s records at the prevailing exchange rate at the time of the transaction. Asset and liability accounts that are denominated in Yen are adjusted to reflect the current exchange rate at the end of the period. Transaction gains or losses resulting from changes in the exchange rate during the reporting period or upon settlement of foreign currency transactions are included in results of operations for the current period.

The net assets of the Fund are presented at the exchange rates and fair values on August 31, 2017. The Fund does isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates on investments from the fluctuations arising from changes in the market prices of securities held at August 31, 2017. Net realized gains or losses on investments include gains or losses arising from sales of portfolio securities and sales and maturities of short-term securities. Net realized gains or losses on the foreign currency transactions arise from sales of foreign currencies, currency gains or losses realized on securities transactions between trade and settlement

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS— (Continued) (Unaudited)

date, and the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Fund's books and the U.S. dollar equivalent of the amounts actually received or paid.

(c) Security Transactions, Investment Income and Distributions to Shareholders — Security transactions are accounted for on the trade date. Dividend income and distributions are recorded on the ex-dividend dates and interest income is recorded on the accrual basis. Realized gains and losses on the sale of investments are calculated on a first in, first out basis.

Distributions from net investment income and net realized capital gains are determined in accordance with Federal income tax regulations, which may differ from U.S. GAAP. To the extent these "book/tax" differences are permanent in nature (i.e., that they result from other than timing of recognition—"temporary"), such accounts are reclassified within the capital accounts based on their Federal tax-basis treatment; temporary differences do not require reclassification. Dividends and distributions which exceed net realized capital gains for financial reporting purposes, but not for tax purposes, are reported as distributions in excess of net realized capital gains.

Pursuant to a securities lending agreement with Brown Brothers Harriman & Co., the Fund may lend securities to qualified institutions. It is the Fund's policy that, at origination, all loans shall be secured by collateral of at least 102% of the value of U.S. securities loaned and 105% of the value of foreign securities loaned. It is the

Fund's policy that collateral equivalent to at least 100% of the fair value of securities on loan must be maintained at all times (when applicable). Collateral is provided in the form of cash, which would be invested in certain money market funds. The Fund is entitled to receive all income on securities loaned, in addition to a portion of the income earned as a result of the lending transaction. Although each security loan is fully collateralized, there are certain risks. On November 21, 2008, the Fund suspended its participation in the securities lending program. The Fund may resume its participation in the future. During the fiscal year ended February 28, 2017 and the semi-annual period ended August 31, 2017, the Fund did not earn fees from lending Fund portfolio securities, pursuant to the securities lending agreement.

(d) Capital Account Reclassification — For the year ended February 28, 2017, the Fund's accumulated net investment loss was decreased by \$2,469,284 and the accumulated net realized gain on investments and foreign currency transactions was decreased by \$2,469,284. These adjustments were primarily due to the result of the reclassification of foreign currency losses and the tax treatment of passive foreign investment companies. These adjustments had no impact on net assets.

(e) Income Taxes — A provision for U.S. income taxes has not been made since it is the intention of the Fund to continue to qualify as a regulated investment company under the Internal Revenue Code and to distribute within the allowable time limit all taxable income to its shareholders.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS— (Continued) (Unaudited)

Under Japanese tax laws, a withholding tax is imposed on dividends at a rate of 15.315% and such withholding taxes are reflected as a reduction of the related revenue. The withholding tax rate of 15.315% was reduced to 10% upon the submission of Form 17 — Limitation on Benefits Article. There is no withholding tax on realized gains.

In accordance with U.S. GAAP requirements regarding accounting for uncertainties in income taxes, management has analyzed the Fund's tax positions taken or expected to be taken on federal and state income tax returns for all open tax years (the current and the prior three tax years), and has concluded that no provision for income tax is required in the Fund's financial statements. The Fund recognizes interest and penalties, if any, related to uncertain tax positions as income tax expense in the statement of operations. During the current year and for the prior three tax years, the Fund did not incur any interest or penalties.

(f) Use of Estimates in Financial Statement Preparation — The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from these estimates.

(g) Concentration of Risk — A significant portion of the Fund's net assets consists of Japanese securities which involve certain considerations and risks not typically associated with investments in the U.S. In addition to the

smaller size, and greater volatility, there is often substantially less publicly available information about Japanese issuers than there is about U.S. issuers. Future economic and political developments in Japan could adversely affect the value of securities in which the Fund is invested. Further, the Fund may be exposed to currency devaluation and other exchange rate fluctuations.

(h) Indemnifications — Under the Fund's organizational documents, its officers and directors are indemnified against certain liabilities arising from the performance of their duties to the Fund. Additionally, in the normal course of business, the Fund enters into contracts that contain a variety of representations which provide general indemnifications. The Fund's maximum exposure under these agreements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. However, based on experience, the Fund expects the risk of loss to be remote and as such no additional accruals were recorded on the Statement of Assets and Liabilities.

2. Management Agreement and Transactions With Affiliated Persons

Nomura Asset Management U.S.A. Inc. ("NAM-USA" or the "Manager") acts as the Manager of the Fund pursuant to a management agreement. Under the management agreement, the Manager provides all office space, facilities and personnel necessary to perform its duties. Pursuant to such management agreement, the Manager has retained its

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS— (Continued) (Unaudited)

parent company, Nomura Asset Management Co., Ltd. (“NAM”), as investment adviser to the Fund.

As compensation for its services to the Fund, the Manager receives a monthly fee at the annual rate of 1.10% of the value of the Fund’s average weekly net assets not in excess of \$50 million, 1.00% of the Fund’s average weekly net assets in excess of \$50 million but not exceeding \$100 million, 0.90% of the Fund’s average weekly net assets in excess of \$100 million but not exceeding \$175 million, 0.80% of the Fund’s average weekly net assets in excess of \$175 million but not exceeding \$250 million, 0.70% of the Fund’s average weekly net assets in excess of \$250 million but not exceeding \$325 million, 0.60% of the Fund’s average weekly net assets in excess of \$325 million, but not exceeding \$425 million and 0.50% of the Fund’s average weekly net assets in excess of \$425 million. Under the management agreement, the Fund incurred fees to the Manager of \$1,548,104 for the six months ended August 31, 2017. Under the investment advisory agreement, NAM earned investment advisory fees of \$682,851 from the Manager, not the Fund, for the six months ended August 31, 2017. At August 31, 2017, the management fee payable to the Manager by the Fund was \$274,982.

Certain officers and/or directors of the Fund are officers and/or directors of the Manager. Affiliates of Nomura Holdings, Inc. (the Manager’s indirect parent) did not earn any fees in commissions on the execution of portfolio security transactions for the six months ended August 31, 2017. The Fund pays each Director not affil-

iated with the Manager an annual fee of \$17,000 plus \$2,000 per meeting attended. In addition, the Fund pays each Director not affiliated with the Manager \$1,000 per telephone meeting attended together with actual expenses related to attendance at meetings. The Chairman of the Board, presently Rodney A. Buck, is paid an additional annual fee of \$5,000. The Chairman of the Audit Committee, presently David B. Chemidlin, is paid an additional annual fee of \$2,000. Such fees and expenses for unaffiliated Directors aggregated \$65,227 for the six months ended August 31, 2017.

3. Purchases and Sales of Investments

Purchases and sales of investments, exclusive of foreign currency and investments in short-term securities, for the six months ended August 31, 2017 were \$100,790,089 and \$97,199,612, respectively.

4. Federal Income Tax

As of February 28, 2017, net unrealized depreciation on investments, exclusive of foreign currency, for federal income tax purposes was \$46,803,331, of which \$52,682,063 related to appreciated securities and \$5,878,732 related to depreciated securities. The cost of investments, exclusive of foreign currency of \$411,642, at February 28, 2017 for federal income tax purposes was \$292,737,458.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS— (Continued) (Unaudited)

At February 28, 2017, the components of accumulated earnings on a tax basis were as follows:

| | |
|--|-----------------------------|
| Unrealized appreciation on investments and foreign currency transactions | \$46,817,380 ^(a) |
| Undistributed long-term capital gains | 5,500,899 |
| Undistributed ordinary income | <u>1,306,239</u> |
| Total accumulated earnings | <u>\$53,624,518</u> |

(a) The differences between book basis and tax basis unrealized depreciation is attributable to the tax deferral of losses on wash sales and the tax treatment of passive foreign investment companies.

The Fund paid an ordinary income distribution of \$11,418,559, which represents \$0.4030 per share and a long-term capital gains distribution of \$15,104,798, which represents \$0.5331 per share to shareholders of record as of December 19, 2016. The distribution was paid on December 23, 2016.

The Fund paid an ordinary income distribution of \$8,777,840, which represents \$0.3098 per share and a long-term capital gains distribution of \$16,085,151, which represents \$0.5677 per share to shareholders of record as of December 21, 2015. The distribution was paid on December 28, 2015.

The tax character of distributions paid during the fiscal years ended February 28, 2017 and February 29, 2016 were as follows:

| | February-17 | February-16 |
|-----------------|--------------|--------------|
| Ordinary Income | \$11,418,559 | \$ 8,777,840 |
| Capital Gains | \$15,104,798 | \$16,085,151 |

5. Fair Value Measurements

In accordance with U.S. GAAP, fair value is defined as the price that the Fund would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. U.S. GAAP also establishes a framework for measuring fair value, and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Fund. Unobservable inputs reflect the Fund's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Each investment is assigned a level based upon the observability of the inputs which are significant to the overall valuation. The three-tier hierarchy of inputs is summarized below.

- Level 1—quoted prices in active markets for identical investments
- Level 2—other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3—significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS— (Continued) (Unaudited)

The following table summarizes the valuation of the Fund's investments by the above fair value hierarchy levels as of August 31, 2017.

| <u>Level</u> | <u>Investments in Securities</u> |
|--------------------------|---|
| Level 1 | |
| Equity Securities* | \$393,003,944 |
| Level 2 | -0- |
| Level 3 | -0- |
| Total | <u>\$393,003,944</u> |

* Please refer to the Schedule of Investments for break-down of the valuation by industry type.

During the six months ended August 31, 2017, there were no transfers between Level 1, Level 2 or Level 3 securities.

During the six months ended August 31, 2017, the Fund did not hold any instrument which used significant unobservable inputs (Level 3) in determining fair value.

JAPAN SMALLER CAPITALIZATION FUND, INC.

FINANCIAL HIGHLIGHTS

For a share of common stock outstanding throughout each period:

| | For the Six Months Ended August 31, 2017 (Unaudited) | For the Year Ended | | | | |
|--|---|---------------------------|---------------------|---------------------|-------------|-------------|
| | | February 28, | February 29, | February 28, | | |
| | | 2017 | 2016 | 2015 | 2014 | 2013 |
| Net asset value, beginning of period | \$12.09 | \$10.50 | \$10.98 | \$9.85 | \$8.83 | \$8.85 |
| Investment operations: | | | | | | |
| Net Investment income* | 0.05 | 0.12 | 0.06 | 0.06 | 0.05 | 0.07 |
| Net realized and unrealized gain (loss) on investments and foreign currency | 1.76 | 2.41 | 0.34 | 1.20 | 1.17 | (0.01) |
| Total from investment operations | 1.81 | 2.53 | 0.40 | 1.26 | 1.22 | (0.06) |
| Less Distributions: | | | | | | |
| Distributions from ordinary income | — | (0.35) | (0.17) | (0.12) | (0.20) | (0.08) |
| Distributions from capital gains | — | (0.59) | (0.71) | (0.01) | — | — |
| Total from distributions | — | (0.94) | (0.88) | (0.13) | (0.20) | (0.08) |
| Net asset value, end of period | \$13.90 | \$12.09 | \$10.50 | \$10.98 | \$9.85 | \$8.83 |
| Market value, end of period | \$12.34 | \$10.60 | \$8.98 | \$9.69 | \$8.84 | \$8.00 |
| Total investment return** | 16.4% | 29.4% | 0.7% | 11.2% | 13.0% | 3.4% |
| Ratio/Supplemental Data: | | | | | | |
| Net assets, end of period (000) | \$393,878 | \$342,513 | \$297,550 | \$311,094 | \$278,994 | \$250,273 |
| Ratio of expenses to average net assets | 1.08%† | 1.09% | 1.11% | 1.13% | 1.19% | 1.19% |
| Ratio of net income to average net assets | 0.82%† | 0.99% | 0.50% | 0.62% | 0.53% | 0.86% |
| Portfolio turnover rate | 27% | 20% | 24% | 41% | 101% | 37% |

* Based on average shares outstanding.

** Based on market value per share, adjusted for reinvestment of income dividends, ordinary income distributions, long-term capital gain distributions, and capital share transactions. Total return does not reflect sales commissions.

† Annualized

JAPAN SMALLER CAPITALIZATION FUND, INC.

Board Review of the Management and Investment Advisory Agreements

The Board of Directors of the Fund (the “Board”) consists of five directors, four of whom are independent or non-interested directors (the “Independent Directors”). The Board considers matters relating to the Fund’s management and investment advisory agreements throughout the year. On an annual basis, the Board specifically considers whether to approve the continuance of these agreements for an additional one-year period. The specific agreements (the “Agreements”) consist of the Fund’s management agreement with Nomura Asset Management U.S.A. Inc. (the “Manager”) and the investment advisory agreement between the Manager and its parent, Nomura Asset Management Co., Ltd. (the “Investment Adviser”).

The Board, including the Independent Directors, most recently approved the continuance of the Agreements at a meeting held on August 24, 2017. In connection with their deliberations at that meeting and at a separate meeting of the Independent Directors held on August 11, 2017, the Independent Directors received materials that included, among other items, information provided by the Manager regarding (i) the investment performance of the Fund, performance of other investment companies and performance of the Fund’s benchmark, (ii) expenses of the Fund and the management fee paid by the Fund to the Manager and the advisory fee paid by the Manager to the Investment Adviser, (iii) advisory fees charged by the Manager and the Investment Adviser to comparable accounts and (iv) the profitability of the Agreements to the Manager and the Investment Adviser. Included in the materials was a report prepared by Broadridge Board Reporting and Compliance (“Broadridge”) for use by the Independent Directors in their consideration of the continuance of the Agreements (the “Broadridge Report”). Broadridge is an independent firm retained by many investment companies to provide data with respect to investment company performance and expenses. The Broadridge Report contained information regarding the Fund and other closed-end funds not affiliated with the Manager that compared, among other items, the respective funds’ management fees and operating expenses.

The Independent Directors sought and received additional information from the Investment Adviser, including information concerning management personnel, expense allocation methodologies, the impact of the liquidation of Korea Equity Fund, Inc., another closed-end fund managed by the Manager and the Investment Adviser, on the Fund (including the level of support and services that the Fund will receive from the Manager and the Investment Adviser), and the Investment Adviser’s business continuity plan and cybersecurity efforts. The Independent Directors were advised by, and received materials (including a detailed memorandum reviewing the applicable legal standards and factors taken into account by the Supreme Court and other relevant court decisions) from their independent counsel in considering these matters and the continuance of the Agreements.

In considering the continuance of the Agreements at the meeting held on August 24, 2017, the Board, including the Independent Directors, did not identify any single factor as determinative. Matters considered by the Directors in connection with their review of the Agreements included the following:

The nature, extent and quality of the services provided to the Fund under the Agreements. The Board considered the nature, extent and quality of the services provided to the Fund by the Manager and the Investment Adviser and the resources dedicated by the Manager and the Investment Adviser. These services included both investment advisory services and related services such as the compliance oversight provided by the Manager. Based on its review of all of the services provided by the Manager and the Investment Adviser, the Board, including the Independent Directors, concluded that the nature, extent and quality of these services supported the continuance of the Agreements.

Investment performance. The Board considered performance information provided by Broadridge and the Manager regarding the Fund’s investment performance over a number of time periods, including the one-year, three-year and five-year periods recently ended. In response to requests by the Independent Directors, the Manager provided information about the performance of the Fund compared to the Fund’s benchmark index, data on the Fund’s ex-

JAPAN SMALLER CAPITALIZATION FUND, INC.

Board Review of the Management and Investment Advisory Agreements (continued)

pense ratio and components thereof, and comparative fee, expense ratio and performance information for other funds investing primarily in Japanese securities. The Broadridge Report also provided supplemental information relating to performance, expense ratios, and fees of U.S. investment companies investing in equity securities of Asian and other non-U.S. issuers.

In connection with their review of investment performance, the Independent Directors noted that, following a series of discussions with management in 2012 and 2013 that focused on the Fund's performance, the Investment Adviser had installed a new management team as of July 1, 2013. The Independent Directors recognized that, as contemplated at the time of the transition, the new portfolio managers had invested in a more diversified portfolio than the Fund had maintained in the past with an increased focus on value characteristics evidenced by financial measurements. The Independent Directors also noted the Fund's comparative performance since the transition and the Fund's performance for the one-year and three-year periods ended June 30, 2017 amongst six funds (including the Fund) identified by the Manager as having similar investment objectives. The Board noted that Broadridge Report ranked the Fund in the top quintile of its performance universe, which is a number of closed-end funds investing in equity securities of non-U.S. issuers, for the one, three and five-year periods. Based on their review, the Independent Directors concluded that the Fund's performance supported the continuance of the Agreements.

The costs of the services to be provided and the profits to be realized by the Manager and its affiliates from their advisory relationships with the Fund. The Board considered the fee payable under the Fund's management agreement in connection with other information provided for the Directors' consideration. The Board noted that according to the Broadridge Report, the Fund's contractual management fees, which are just above the median for the comparable funds identified by Broadridge, drop below the median at larger asset sizes due to the Fund's breakpoints and that the Fund's non-management expenses were below the median for the comparable funds identified by Broadridge. The Board also considered information provided by the Manager regarding fees charged by the Manager and its affiliates to institutional accounts and other investment companies having investment objectives similar to the Fund's investment objective, including Japanese retail unit trusts. The Board recognized that the nature of the services provided by the Manager and the Investment Adviser to other investment vehicles and separate accounts differed from the range of services provided to the Fund.

The Manager also provided the Board with information prepared by the Manager and the Investment Adviser indicating the profitability of the Agreements to these respective advisers. This presentation included information regarding methodologies used to allocate expenses in considering the profitability of the Agreements to the Manager and the Investment Adviser. The Independent Directors reviewed this information with the Manager to understand expense allocation methodology utilized by the Investment Adviser.

After reviewing the information described above, the Independent Directors concluded that the management fee proposed to be charged to the Fund was reasonable and the profitability of the Agreements to the Manager and the Investment Adviser supported the continuance of the Agreements.

Economies of scale. The Board also considered whether the Manager and the Investment Adviser realize economies of scale as the Fund grows larger and the extent to which any economies of scale are shared with the Fund and its shareholders. The Board noted that the management agreement contains six separate breakpoints in the management fee for net assets above \$50 million, with the last breakpoint applicable to net assets in excess of \$425 million.

Based on an evaluation of all factors deemed relevant, including the factors described above and taking into account information received throughout the preceding year, the Board, including each of the Independent Directors, concluded that each of the Agreements should be continued through August 31, 2018.

BOARD OF DIRECTORS

Rodney A. Buck
David B. Chemidlin
Yutaka Itabashi
E. Han Kim
Marcia L. MacHarg

OFFICERS

Yutaka Itabashi, *President*
Takeshi Toyoshima, *Vice President*
Maria R. Premole, *Vice President*
Neil A. Daniele, *Secretary and Chief Compliance Officer*
Amy J. Robles, *Treasurer*
Kelly S. Lee, *Assistant Treasurer*

MANAGER

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INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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This Report, including the Financial Statements, is transmitted to the Shareholders of Japan Smaller Capitalization Fund, Inc. for their information. This is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in the Report.



JAPAN

Smaller Capitalization Fund, Inc.

SEMI-ANNUAL REPORT

AUGUST 31, 2017

