

JAPAN SMALLER CAPITALIZATION FUND INC

Form N-30D

November 05, 2002

JAPAN
Smaller Capitalization
Fund, Inc.

SEMI-ANNUAL REPORT

AUGUST 31, 2002

October 25, 2002

JAPAN SMALLER CAPITALIZATION FUND, INC.

To Our Shareholders:

We present the Semi-Annual Report of the Japan Smaller Capitalization Fund, Inc. (the "Fund") for the six months ended August 31, 2002. The Net Asset Value per share ("NAV") of the Fund increased by 21.8% during the six months. The closing market price of the Fund on August 31, 2002, on the New York Stock Exchange was \$7.29 representing a premium of 2.1% to the NAV of \$7.14. The net assets of the Fund amounted to \$113,114,771 on August 31, 2002.

The TOPIX, consisting of all companies listed on the Tokyo Stock Exchange (the "TSE") First Section, increased by 4.8% and the Nikkei Average Index (a price-weighted index of 225 leading stocks on the TSE) increased by 2.5%, in United States ("U.S.") dollar terms, during the six months ended August 31, 2002. The Nikkei OTC Average Index (the "OTC Index"), a price-weighted index of the quotations of the OTC registered stocks, and the Index of the Japan Securities Dealers Association Quotation System (the "JASDAQ Index"), a capitalization-weighted index of all OTC stocks, increased by 16.0% and 11.4%, respectively, in U.S. dollar terms, during the same period. The Japanese yen (the "Yen") appreciated by 11.4% against the U.S. dollar during the six months.

The Fund outperformed the OTC Index and the JASDAQ Index by 5.9 percentage points and 10.4 percentage points, respectively, during the six months ended August 31, 2002. The overweight position and effective stock selection in the Consumption sector outweighed some negative results from the overweight position in the Electronics sector.

The NAV of the Fund decreased by 6.7%; for the quarter ended August 31, 2002. During the same period, the TOPIX, the Nikkei Average Index, the OTC Index and the JASDAQ Index declined by 12.1%, 14.5%, 5.0% and 7.5% respectively, in U.S. dollar terms. The Yen appreciated by 4.3% during the same period. The Fund underperformed the OTC Index by 1.7 percent-

age points and outperformed the JASDAQ Index by 0.8 percentage points. While the overweight position and stock selection in the Consumption sector worked positively, the overweight position in the Electronics sector and stock selection results in the Information/System sector had negative effects on the relative performance.

The Portfolio

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The Fund's equity exposure decreased from 99.3% at February 28, 2002 to 99.0% at August 31, 2002. The Fund was diversified into 91 issues, of which 63 issues were OTC stocks, 19 were other smaller capitalization stocks and 9 were TSE First Section stocks, comprising 64.7%, 23.6% and 10.7% respectively, of net assets on August 31, 2002.

Japanese Economy and Stock Market Outlook

The OTC Index achieved a modest gain of 2.8% in local currency terms for the six months ended August 31, 2002.

In mid-February 2002, the Japanese OTC stock market entered a strong recovery phase in tandem with an explosive rebound in the TOPIX, which was triggered by the tightening of short selling regulations in Japan and was later helped by an unexpectedly strong recovery in U.S. economic growth. External factors raised hopes of a turnaround in Japan's industrial production cycle and better prospects for Japanese exporters. Signs that worldwide semiconductor and personal computer sales were starting to bottom out also provided some support.

The Japanese OTC stock market maintained its upward momentum until early June, driven mainly by expectations of a cyclical turnaround in the economy, based on improvements in industrial production and lower inventory levels. Corporate financial results were released from mid-April through late May. Although the historical results were poor, projections for fiscal year 2002 indicated a strong rebound in earnings among certain sectors. The OTC Index recorded an eleven-month high in early June, reflecting these improvements in fundamentals.

However, positive momentum later gave way to deteriorating investor sentiment caused by the weakness of the U.S. stock market, owing to concerns about the sustainability of the U.S. economic recovery and the dollar's depreciation against the Yen to the 120 Yen to one U.S. dollar level. Although the domestic economic factors indicated a cyclical turnaround, investors began to focus on the unfavorable currency trend and the likely impact that a U.S. economic slowdown would have on the nascent export-driven recovery in Japan.

In July and August, the weakness in the U.S. stock markets, the result of growing investor skepticism following a series of accounting fraud allegations against major American companies, further aggravated sentiment in the Japanese stock market. Cautious business projections issued by some of the leading technology companies, reflecting the recent slow down in the global technology markets also undermined investor sentiment. In fact, leading U.S. and Asian semiconductor manufacturers have announced reductions in capital expenditures, which has pulled the prices of Japanese semiconductor production equipment stocks down further.

Although Prime Minister Koizumi's reform plans have been proceeding gradually, with modest progress in postal service privatization and road corporation reforms, the market remained indifferent given their lack of any immediate impact on the economy. The Japanese OTC stock market entered another downturn in June that has continued through the end of August and has erased most of the gains made earlier in the year.

Outlook and Future Strategy

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Latest Gross Domestic Product ("GDP") figures, showing a 1.9% annualized quarter-on-quarter growth rate, confirmed that a cyclical recovery was underway in the second quarter, led mostly by net exports. As exports made the dominant contribution to GDP, the lackluster U.S. economic outlook has cast a shadow over the domestic economy as well. Exacerbating this deteriorating outlook for the economy, industrial production for July recorded a second consecutive decline on a month-on-month basis, while inventory levels increased slightly. Hence, recent evidence indicates that the Japanese economy seems to be stalling. However, the Fund never expected the path to recovery to be straightforward, since the completion of inventory adjustment has been the leading force. Although we have not discarded our moderate recovery expectations, the macro-economic environment is likely to weigh on the stock market in the absence of any support from the Japanese government.

The basic fundamentals surrounding the Japanese OTC stock market have not changed drastically, but the psychological framework has deteriorated substantially. Accounting scandals in the U.S. have given way to concerns about earnings expectations, and corporate scandals involving a number of leading Japanese industry sectors have undermined confidence in corporate management in general. To complicate matters further, changes in the tax schedule in Japan for capital gains for individual investors are so complex that the authorities are failing to attract more retail investors to the stock market. Furthermore, the question of whether the U.S. will initiate a war against Iraq continues to weigh heavily on the world financial markets.

Consequently, we do not expect any immediately supportive developments for the stock market, although valuation levels have become even more attractive, as the prospective price earnings ratio of the Japanese OTC stock market has shrunk to around 17 times and the price book ratio has fallen to less than 1.3 times. We still believe the Japanese stock market offers some upside potential from the current depressed level once confidence in the earnings recovery is restored. Therefore, taking too pessimistic a view on the stock market from the current level is just as risky as being too optimistic. For the stock market to rise beyond a mere temporary rebound from the current depressed level, the economy needs to escape the current deflationary environment.

The continuing severe correction in the stock market might offer further opportunities for re-balancing the Funds at the individual stock level. The market correction is now creating opportunities for bottom fishing, so we will continue in our efforts to identify stocks that are over-sold compared with their fundamentals.

Effective October 1, 2002, the Nikkei OTC Index has been re-named the Nikkei JASDAQ Stock Price Average. Future shareholders reports will use that name. This change has no impact on the management of the Fund.

We appreciate your continuing support of your Fund.

Sincerely,

Kazuhiko Hama
President

SHAREHOLDERS ACCOUNT INFORMATION

Shareholders whose accounts are held in their own name may contact the

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Fund's transfer agent, Equiserve Trust Company, N.A. at (800) 426-5523 for information concerning their accounts.

INTERNET WEBSITE

NAM-U.S.A. has established an Internet website which highlights its history, investment philosophy and process and products, which includes the Fund. The Internet web address is www.nomura-asset.com. We invite you to view the Internet website.

JAPAN SMALLER CAPITALIZATION FUND, INC.

FUND HIGHLIGHTS-AUGUST 31, 2002

(Unaudited)

KEY STATISTICS

Net Assets	\$113,114,771
Net Asset Value per Share	\$7.14
Closing NYSE Market Price	\$7.29
Percentage Change in Net Asset Value per Share*+	21.8%
Percentage Change in NYSE Market Price*+.....	31.8%

MARKET INDICES

Percentage change in market indices:*

	YEN	U.S.
	---	----
TOPIX	(7.1%)	4.8
Nikkei Average	(9.1%)	2.5%
JASDAO	(1.2%)	11.4%
Nikkei OTC Average	2.8%	16.0%

*From March 1, 2002 through August 31, 2002.

+Reflects the percentage change in share price

ASSET ALLOCATION

Japanese Equities	
OTC Stocks	64.7%
Other Smaller Capitalization Stocks	23.6
TSE First Section Stocks	10.7
Cash and Cash Equivalents	1.0

Total Investments	100.0
Liabilities in Excess of Other Assets, Net	0.0

Net Assets	100.0%
	=====

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INDUSTRY DIVERSIFICATION	% of Net Assets		% of Net Assets
-----	-----		-----
Retail	20.6	Electric	3.6
Chemicals and Pharmaceuticals	12.5	Banks and Finance	3.4
Electronics	9.4	Restaurants	3.4
Information and Software	9.1	Machinery and Machine Tools	2.8
Miscellaneous Manufacturing.....	8.6	Automotive Equipment and Parts	2.2
Services	8.3	Real Estate and Warehouse	2.1
Food Manufacturing	6.4	Textiles and Apparel	1.3
Wholesale	4.7	Telecommunications	0.6

TEN LARGEST EQUITY HOLDINGS BY MARKET VALUE

Security	Market Value	% of Net Assets
-----	-----	-----
Chiyoda Co., Ltd.	\$4,410,064	3.9
T & K Toka Co., Ltd.	3,621,437	3.2
Cawachi Limited.....	3,402,518	3.0
Yahoo Japan Corp.	3,182,756	2.8
Plenus Co., Ltd.	3,085,252	2.7
Toys R Us-Japan, Ltd.....	2,791,100	2.5
UMC Japan	2,767,145	2.5
Sanyo Electric Credit Co., Ltd.	2,732,455	2.4
Kuroda Electric Co., Ltd.	2,730,392	2.4
Tow Co., Ltd.	2,492,401	2.2

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS

August 31, 2002

(Unaudited)

EQUITY SECURITIES	Shares	Cost	Market Value	A
-----	-----	-----	-----	-----

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Automotive Equipment and Parts			
Exedy Corporation	172,400	\$1,702,398	\$1,101,769
Automobile clutches			
Nippon Cable Systems Inc.	115,000	1,054,173	1,031,238
Control cables			
SPK Corporation	45,600	590,497	378,192
Replacement parts		-----	-----
Total Automotive Equipment and Parts		3,347,068	2,511,199
		-----	-----
Banks and Finance			
Aiful Corporation	17,050	1,440,881	1,119,774
Consumer loans			
Sanyo Electric Credit Co., Ltd.	106,400	3,582,788	2,732,455
Finance		-----	-----
Total Banks and Finance		5,023,669	3,852,229
		-----	-----
Chemicals and Pharmaceuticals			
Arisawa Manufacturing Co., Ltd.	71,700	1,212,386	1,388,540
Glassfibers and insulating resins			
C. Uyemura & Co., Ltd.	133,000	2,625,313	2,407,696
Chemicals			
FP Corporation	22,500	956,479	545,615
Polystyrene and other synthetic resin foodware			
Konishi Co., Ltd.	127,800	1,423,557	1,162,161
Adhesives and construction sealants			
Mandom Corporation	78,000	1,090,432	1,503,979
Cosmetic products			
Matsumoto Yushi-Seiyaku Co., Ltd.	86,000	1,607,793	1,129,626
Analgesic anti-inflammatory agents			
Milbon Co., Ltd.	50,100	1,668,844	1,645,182
Hair-care products for beauty salons			
Shizuokagas Co., Ltd.	238,000	709,479	749,480
Natural gas supplier			
T & K Toka Co., Ltd.	126,500	3,521,332	3,621,437
Ink for printing		-----	-----
Total Chemicals and Pharmaceuticals		14,815,615	14,153,716
		-----	-----
Electric			
Citizen Electronics Co., Ltd	21,700	1,267,964	1,609,708
Electric parts			

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

August 31, 2002

(Unaudited)

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	Shares -----	Cost -----
Eneserve Corporation	28,000	\$ 688,269
Electric generation system for supermarkets		
Mirai Industry Co., Ltd.	201,000	2,316,532
Plastic molded electric materials		-----
Total Electric		4,272,765

Electronics		
Chiyoda Integre Co., Ltd.	81,500	977,660
Electronic components		
Cosel Co., Ltd.	59,000	1,698,071
Electrical machinery		
Digital Electronics Corp.	55,000	1,221,737
Electronic components		
Fuji Electric Industry Co., Ltd.	93,000	993,449
Electronic parts		
Fukuda Denshi Co.	39,000	961,762
Medical electronic equipment		
Kuroda Electric Co., Ltd.	119,000	1,756,571
Material and components		
Miyota Co., Ltd.	44,000	706,365
Watches, quartz oscillators and electronic image equipment		
Nagano Keiki Co., Ltd.	53,890	988,924
Measuring instruments		
Roland Corporation	3,400	88,779
Electronic keyboard for musical instruments		
UMC Japan+	1,580	3,421,715
Semiconductor memory chips		-----
Total Electronics		12,815,033

Food Manufacturing		
Ariake Japan Co., Ltd.	32,300	739,366
Natural seasonings		
Iwatsuka Confectionery Co., Ltd.	39,100	384,367
Rice crackers		
Kaklyasu Honten Co., Ltd.	62,000	674,732
Processed meat products, fresh meats, and side dishes		
Origin Toshu Co., Ltd.	39,600	587,625
Delicatessen items and lunch boxes		
Ozeki Co., Ltd.	12,000	1,132,929
Supermarket chain		
Plenus Co., Ltd.	78,800	2,275,644
Japanese lunch-boxes		

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

AUGUST 31, 2002

(Unaudited)

	Shares	Cost
	-----	-----
Raise Co., Ltd.	114,000	\$1,606,660
Supermarket chain		
Total Food Manufacturing		7,401,323

Information and Software		
Argo Graphics Inc.	36,000	896,182
Computer aided design software		
CAC Corp.	147,000	2,325,072
Information technology services		
Celartem Technology Inc.+	93	368,928
Software development		
Fuji Soft ABC Inc.	13,300	836,138
Computer systems development		
Fujitsu Broad Solution & Consulting Inc.	44,500	1,794,921
Business application software		
Konami Computer Entertainment Tokyo, Inc.	133,760	1,556,516
Video games software		
Trend Micro Inc.	19,500	1,488,481
Computer software, anti-virus server		
Works Applications Co., Ltd.+	114	1,348,540
Software development		
Yahoo Japan Corp.+	126	11,237,066
Internet services		
Total Information and Software		21,851,844

Machinery and Machine Tools		
Disco Corp.	15,500	1,151,460
Dicing saws for semiconductors		
Suruga Seiki Co., Ltd.	20,000	540,974
Industrial mechanical equipment		
THK Co., Ltd.	78,700	3,419,652
Linear motion systems for industrial machines		
Yushin Precision Equipment Co., Ltd.	44,800	2,096,872
Injection molding related machinery		
Total Machinery and Machine Tools		7,208,958

Miscellaneous Manufacturing		
Central Glass Co., Ltd.	336,000	1,759,202
Glass products		
Eidai Kako Co., Ltd.	144,000	1,085,863
Synthetic resin processed products		

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

August 31, 2002

(Unaudited)

	Shares -----	Cost -----
Fuji Seal, Inc.	19,700	\$542,645
Packing materials		
Fujimi Inc.	64,700	1,951,159
Polishing materials for silicone wafers		
Hoden Seimitsu Kako Kenkyusho Co., Ltd.	62,000	1,015,688
Aluminum extruding molds		
Mani, Inc.	7,000	126,984
Medical goods and equipment		
Nichiha Corporation.....	194,600	1,739,791
Ceramic exterior walls and fiberboards		
Nippon Kodoshi Corp.	180,000	2,785,484
Paper for electric insulation		
Suruga Co., Ltd.	67,800	1,009,472
Daily necessities, novelties and promotional items		
Tomy Co., Ltd.	24,100	511,456
Toys		-----
Total Miscellaneous Manufacturing.....		12,527,744

Real Estate and Warehouse		
Nippon Kanzai Co., Ltd.	96,580	1,303,227
Comprehensive building maintenance		
Recrm Research Co., Ltd.+	945	1,172,070
Building management		-----
Total Real Estate and Warehouse.....		2,475,297

Restaurants		
Saint Marc Co., Ltd.	34,700	961,983
Restaurants and bakery shop chain		
Saizeriya Co., Ltd.	78,260	1,995,846
Italian restaurant chain		
Watami Food Service Co., Ltd.	147,350	2,379,921
Restaurant chain		-----
Total Restaurants.....		5,337,750

Retail		
Cwachi Limited.....	44,900	2,491,417
Drug store chain		
Chiyoda Co., Ltd.	468,900	3,159,376

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Specialty store chain		
Himaraya Co., Ltd.	200	2,504
Sporting goods		

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

August 31, 2002

(Unaudited)

	Shares	Cost
	-----	----
Kyoto Kimono Yuzen Co., Ltd.	577	\$2,014,182
Japanese traditional kimonos		
Nissen Co., Ltd.	54,300	438,483
Mail-order business		
Nitori Co., Ltd.	28,200	1,069,315
Home furnishings		
Otsuka Kagu, Ltd.	46,800	3,224,588
Furniture		
Prime Network Inc.	440	1,037,807
TV shopping business		
Toys R Us-Japan, Ltd.	143,500	3,983,570
Toy chain stores		
Uoriki Co., Ltd.	113,600	1,914,960
Fresh fish and sushi stores		
USS Co., Ltd.	50,000	1,147,997
Automobile auction		
Yamada Denki Co., Ltd.	27,100	2,053,113
Consumer electronics		
Total Retail.....		22,537,312

Services		
Arrk Corporation.....	11,000	376,840
Product testing		
Bellsystem 24, Inc.	3,100	1,015,540
Telemarketing		
Future System Consulting Corporation.....	192	1,081,561
Information system and consulting services		
Nichii Gakkan Company.....	29,600	1,434,734
Hospital administration services		
Sodexho Japan Co., Ltd.	157,000	3,331,323
Nursing home caterer		
Toei Animation Co., Ltd.	12,000	634,388

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Animated cartoon movies production		
Tow Co., Ltd.	214,500	1,653,845
Entertainment		
Weathernews Inc.	147,300	1,816,185
Custom weather forecasting services		-----
Total Services.....		11,344,416

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

August 31, 2002

(Unaudited)

	Shares	Cost
	-----	-----
Telecommunications		
Nippon Antenna Co., Ltd.	57,000	\$ 945,374
Communication related equipment		
Yozan Inc.+.....	279	1,138,532

Mobile telecommunication equipment		
Total Telecommunications.....		2,083,906

Textiles and Apparel		
United Arrows Limited.....	53,800	972,762

Casual clothes		
Wholesale		
ArcLand Sakamoto Co., Ltd.	125,400	1,502,668
Home appliances		
C Two-Network Co., Ltd.	22,000	844,123
Processed foods		
Hakudo Co., Ltd.	115,000	555,909
Metal products		
Hakuto Co., Ltd.	181,300	2,815,163
Electric parts		
Shinwa Co., Ltd.	11	105
Industrial machinery		
Toba, Inc.	67,000	1,015,393
Trading company for control systems		-----
Total Wholesale.....		6,733,361

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TOTAL INVESTMENTS IN EQUITY SECURITIES..... 140,748,823

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS-Continued

August 31, 2002

(Unaudited)

	Principal Amount -----	Cost ----	Market Value -----
INVESTMENTS IN SHORT-TERM SECURITIES			
Wachovia Grand Cayman interest bearing call account 1.81% due 9/3/02.....	\$1,100,000	\$ 1,100,000	\$1,100,000
		-----	-----
TOTAL INVESTMENTS IN SHORT-TERM SECURITIES.....		1,100,000	1,100,000
		-----	-----
INVESTMENTS IN FOREIGN CURRENCY			
Hong Kong Shanghai Bank-Tokyo Non-interest bearing account.....	JPY 888,675	7,511	7,483
		-----	-----
TOTAL INVESTMENTS IN FOREIGN CURRENCY.....		7,511	7,483
		-----	-----
TOTAL INVESTMENTS.....		141,856,334	113,142,990
		-----	-----
LIABILITIES IN EXCESS OF OTHER ASSETS, NET.....		(30,247)	(28,219)
		-----	-----
NET ASSETS.....		\$141,826,087	\$113,114,771
		=====	=====

+Non-income producing security.

Portfolio securities and foreign currency holdings were translated
at the following exchange rate as of August 31, 2002.

Japanese Yen JPY (Yen)118.76 = \$1.00

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See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF ASSETS AND LIABILITIES

August 31, 2002

(Unaudited)

ASSETS:

Investments in securities, at market value (cost-\$140,748,822).....
Investments in short-term securities, at market value (cost-\$1,100,000).....
Investments in foreign currency, at market value (cost-\$7,511).....
Cash.....
Receivable for dividends and interest, net of withholding taxes.....
Prepaid expenses.....

Total Assets.....

LIABILITIES:

Accrued management fee.....
Other accrued expenses.....

Total Liabilities.....

NET ASSETS:

Capital stock (par value of 15,846,384 shares of capital stock outstanding, authorized
100,000,000, par value \$0.10 each).....
Paid-in capital.....
Accumulated net realized loss on investments and foreign currency transactions.....
Unrealized net depreciation on investments and foreign exchange.....
Accumulated net investment loss.....

Net Assets.....

Net asset value per share.....

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See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF OPERATIONS

FOR THE SIX MONTHS ENDED AUGUST 31, 2002

(Unaudited)

INCOME:	
Dividend income (less \$94,745 withholding taxes).....	\$536,886
Interest income.....	7,835

Total Income.....	
EXPENSES:	
Management fee.....	582,215
Custodian fees.....	92,000
Legal fees.....	37,720
Registration fees.....	33,545
Auditing and tax reporting fees.....	25,944
Shareholder reports.....	22,632
Directors' fees and expenses.....	20,240
Annual meeting expenses.....	11,592
Transfer agency fees.....	10,120
Miscellaneous.....	4,968
Insurance.....	1,104

Total Expenses.....	
INVESTMENT LOSS-NET.....	
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND FOREIGN CURRENCY:	
Realized gain/loss on investments and foreign currency transactions:	
Net realized loss on investments.....	(
Net realized gain on foreign exchange.....	
Net realized loss on investments and foreign exchange.....	(
Change in net unrealized depreciation on translation of foreign currency and other assets and liabilities denominated in foreign currency....	1
Change in net unrealized depreciation on investments.....	
Net realized and unrealized gain on investments and foreign exchange..	2
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS.....	\$2
	==

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	For the Six Months Ended August 31, 2002 (Unaudited) -----
FROM INVESTMENT ACTIVITIES:	
Net investment loss.....	\$(297,359)
Net realized loss on investments.....	(2,583,541)
Net realized gain/(loss) on foreign exchange.....	47,817
Change in net unrealized appreciation/(depreciation) on investments and foreign exchange.....	23,132,385

Increase/(decrease) in net assets derived from investment activities and net increase/(decrease) in net assets.....	20,299,302

FROM DISTRIBUTIONS TO SHAREHOLDERS:	
Long Term Capital Gains (\$0.00 and \$0.08 per share, respectively).....	0

Decrease in net assets derived from distributions to shareholders.....	0

Net increase (decrease) in net assets.....	20,299,302

NET ASSETS:	
Beginning of period.....	92,815,469

End of period (including accumulated net investment losses of \$367,124 and \$69,765 respectively).....	\$113,114,771
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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 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 issued to its shareholders of record as of the close of business on October 25, 1999 nontransferable Rights to subscribe for up to an aggregate of 3,804,940 shares of Common Stock of the Fund at a rate of one share of Common Stock for three Rights held ("Primary Subscription"). The Fund had the ability to increase the number of shares subscribed for in this offering by up to 25% of the Primary Subscription, or an additional 951,235 shares, to honor record date shareholder requests to purchase more shares. During November 1999, the Fund issued a total of 4,458,565 shares of Common Stock on exercise of such Rights at the subscription price of \$11.99 per share, compared to a net asset value per share of \$16.20 and a market value per share of \$12.6875. Additionally, a sales load of 3.75% was charged to each share issued. Right offering costs of approximately \$546,000 and the sales load were charged directly against the proceeds of the Rights Offering. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of Securities-Investments traded in the over-the-counter market are valued at the last reported sales price as of the 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 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. Short-term debt securities which mature in 60 days or less are valued at amortized cost if their original maturity at the date of purchase was 60 days or less, or by amortizing their value on the 61st day prior to maturity if their term to maturity at the date of purchase exceeded 60 days. Securities and other assets for which market quotations are not readily available are valued 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 are recorded in the Fund's records at the current prevailing 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 operations for the current period.

The net assets of the Fund are presented at the exchange rate and market values at the end of the period. The Fund isolates that portion of the change in unrealized appreciation (depreciation) included in the statement of operations arising as a result of changes in Yen rates at August 31, 2002 on investments and other assets and liabilities. Net realized foreign exchange gains or losses includes gains or losses arising from sales of portfolio securities, sales and maturities of short-term securities, currency gains or losses realized between the trade and settlement dates on securities

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transactions, 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 date and interest income is recorded on the accrual basis. Realized gains and losses on the sale of investments are calculated on the identified cost basis.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS (Unaudited) -Continued

Distributions from net investment income and net realized gains are determined in accordance with Federal income tax regulations, which may differ from generally accepted accounting principles. 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 gains for financial reporting purposes, but not for tax purposes, are reported as distributions in excess of net realized gains.

(d) Income Taxes - A provision for United States income taxes has not been made since it is the intention of the Fund 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.

Under Japanese tax laws, a withholding tax is imposed on dividends at a rate of 15% and on interest at a rate of 10% and such withholding taxes are reflected as a reduction of the related revenue. There is no withholding tax on realized gains.

(e) Capital Account Reclassification - For the year ended February 28, 2002, the Fund's accumulated net realized loss was decreased by \$205,936 and paid in capital was decreased by \$1,111,592, with an offsetting decrease in accumulated net investment gross of \$905,656. This adjustment was primarily the result of the reclassification of foreign currency gains and reclassification of the net operating loss.

(f) Use of Estimates in Financial Statement Preparation - The preparation of financial statements in accordance with generally accepted accounting principles 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 United States. 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.

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2. Management Agreement and Transactions With Affiliated Persons

Nomura Asset Management U.S.A. Inc. (the "Manager") acts as the manager of the Fund pursuant to a management agreement. Under the 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 parent company, Nomura Asset Management Co., Ltd. (the "Investment Adviser"), to act as investment adviser for 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, .90% of the Fund's average weekly net assets in excess of \$100 million but not in excess of \$175 million and .80% of the Fund's average weekly net assets in excess of \$175 million. For services performed under the Investment Advisory Agreement, the Investment Adviser receives a monthly fee from the Manager at the annual rate of .50% of the Fund's average weekly net assets not in excess of \$50 million, .45% of the Fund's average weekly net assets in excess of \$50

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS (Unaudited)-Continued

million but not in excess of \$100 million, .40% of the Fund's average weekly net assets in excess of \$100 million but not in excess of \$175 million and .35% of the Fund's average weekly net assets in excess of \$175 million. Under the Management Agreement, the Fund paid or accrued fees to the Manager of \$582,215 for the six months ended August 31, 2002. Under the Investment Advisory Agreement, the Manager informed the Fund that the Investment Adviser earned fees of \$262,999 for the six months ended August 31, 2002. At August 31, 2002, the fee payable to the Manager, by the Fund, was \$94,535.

Certain Officers and/or Directors of the Fund are officers and/or directors of the Manager. The Nomura Securities International Co., Ltd. (the Manager's indirect parent) and affiliates earned \$2,571 in commissions on the execution of portfolio security transactions for the six months ended August 31, 2002. The Fund pays each Director not affiliated with the Manager an annual fee of \$5,000 plus \$500 per meeting attended, together with such Director's actual expenses related to attendance at meetings. Such fees and expenses for unaffiliated Directors aggregated \$20,240 for the six months ended August 31, 2002.

3. Purchases and Sales of Investments

Purchases and sales of investments, exclusive of investments in foreign currencies and short-term securities, for the six months ended August 31, 2002 were \$13,516,549 and \$14,174,508, respectively.

As of August 31, 2002, net unrealized depreciation on investments exclusive of investments in foreign currency and short-term securities for Federal income tax purposes was \$28,713,316 of which \$12,362,982 related to appreciated securities and \$41,076,298 related to depreciated securities. The aggregate cost of investments, exclusive of investments in foreign currencies and short-term securities of \$1,107,511 at August 31, 2002 for Federal income tax purposes was \$140,748,823. In accordance with U.S. Treasury regulations, the Fund elected to defer \$69,765 of net realized foreign currency losses and \$1,372,594 of net realized capital losses arising after October 31, 2001. Such

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losses are treated for tax purposes as arising on March 1, 2002. The Fund has a capital loss carryforward as of February 28, 2002 of approximately \$22,683,799 which expires February 28, 2010.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS—Continued

FINANCIAL HIGHLIGHTS

Selected per share data and ratios for a share of common stock outstanding throughout the period.

	For the Six Months ended August 31, 2002 (Unaudited)	For the Year End		
		February 28 2002	February 29 2001	February 29 2000
Net asset value, beginning of period.....	\$5.86	\$7.59	\$16.39	\$5.86
Rights Offering costs*.....	--	--	--	(0.16)
Net investment loss.....	(0.02)	(0.06)	(0.09)	(0.11)@
Net realized and unrealized gain (loss) on investments and foreign currency.....	1.30	(1.59)	(7.89)	11.99@
Total from investment operations.....	1.28	(1.65)	(7.98)	11.88@
Distributions to shareholders from:				
Net realized capital gains.....	--	(0.08)	(0.82)	--
Net investment income.....	--	--	--	--
Total distributions.....	0.00	(0.08)	(0.82)	0.00
Decrease in net asset value due to shares issued through Rights Offering*.....	--	--	--	(1.19)
Net asset value, end of period.....	\$7.14	\$5.86	\$7.59	\$16.39
Market value, end of period.....	\$7.29	\$5.53	\$6.89	\$11.00
Total investment return+.....	31.8%	(18.6%)	(31.1%)	76.0%
Net asset value total return++.....	21.8%	(21.7%)	(49.1%)	179.7%
Ratio to average net assets/supplemental data:				
Net assets, end of period (in 000).....	\$113,115	\$92,815	\$120,275	\$259,766
Operating expenses.....	1.51%+	1.58%	1.33%	1.33%
Net investment loss.....	(0.54%)+	(0.84%)	(0.76%)	(0.88%)
Portfolio turnover.....	12%	38%	78%	50%

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

++Based on net asset value per share, adjusted for reinvestment of income dividends and long term capital share transactions. Total return does not reflect sales commissions.

* Decrease is due to Rights Offering (see note 1).

+ Annualized.

@ Based on average shares outstanding.

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BOARD OF DIRECTORS

William G. Barker, Jr.
Kazuhiko Hama
Chor Weng Tan
Arthur R. Taylor
John F. Wallace

OFFICERS

Kazuhiko Hama, President
Keisuke Haruguchi, Vice President
Kenneth L. Munt, Vice President and Secretary
David G. Stoeffel, Vice President
Rita Chopra-Brathwaite, Treasurer

MANAGER

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DIVIDEND PAYING AGENT, TRANSFER AGENT AND REGISTRAR

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INDEPENDENT ACCOUNTANTS

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JAPAN SMALLER CAPITALIZATION FUND, INC.

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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.

The accompanying Financial Statements, including the Schedule of Investments, have not been examined by the Fund's independent accountants,

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PricewaterhouseCoopers LLP, and accordingly, they express no opinion thereon.