

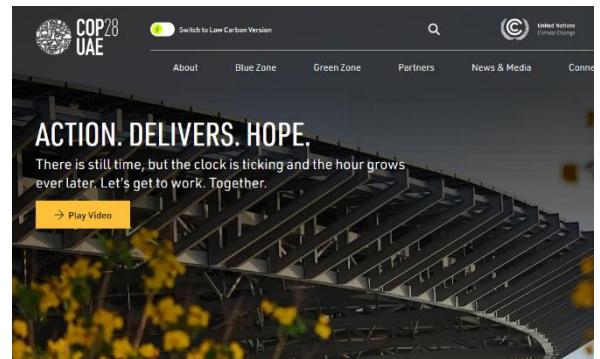
# Time for ESG Investment in Japan

## COP28 and Opportunities in Japanese Equities

### 1. Introduction

Starting in the late November the United Arab Emirates will host the COP28\* Summit, where delegates will examine key issues and specific targets for climate change.

As an oil-producing country, the UAE is the host, but the commitment to reduce reliance on fossil fuels and transition to renewable energy is not expected to waver. Discussions on the intersection of climate change and biodiversity conservation are also anticipated to garner attention.



Source: <https://www.cop28.com/en/>

\*COP28: the 28th Conference of the Parties is part of a series of annual meetings where countries to discuss under the United Nations Framework Convention on Climate Change (UNFCCC).

### 2. COP28 in Dubai

#### 1) "Global Stocktake";

The year 2023 marks the inaugural implementation of the "Global Stocktake" stipulated in the Paris Agreement, and COP28 is expected to review countries' progress towards global reductions of GHG emissions.

Based on the discussions at COP28, participating countries will be asked to update their Nationally Determined Contributions and long-term strategy in 2024. Japan will also be asked to submit targets for enhancing GHG emissions reduction.

Social implementation of innovative technologies such as renewable energy generation and the spread of new non-fossil fuels will be key to achieve the ultimate goal of net zero emissions by 2050. However, these technologies are expected to be effective mainly after 2030.

#### Exhibit 1: What is the Global Stocktake?

- **The global stocktake is a process for countries and shareholders to see where they're collectively making progress towards meeting the goals of the Paris Climate Change Agreement (– and where they're not).**

**It's like taking inventory.**

Source: UNFCCC, SMDAM

## 2) Japan's Prime Minister Kishida said;

As Prime Minister Kishida emphasizes, transition finance\*, which is in line with keeping a limit of 1.5°C temperature rise, avoiding carbon lock-ins and based on effective emissions reduction, will play an important role as a bridge to promote the decarbonization of the entire economy.

Whilst Japan's national level support and commitment towards "greening" its economy looks impressive, there have been questions about implementation and implications – especially for the private sector.

\*Transition finance: Investment, financing, insurance, and related products and services that are necessary to support an orderly, real economy transition to net zero as described by the four key financing strategies that finance or enable 1) entities and activities that develop and scale climate solutions; 2) entities that are already aligned to a 1.5 degrees C pathway; 3) entities committed to transitioning in line with 1.5 degrees C-aligned pathways; or 4) the accelerated managed phaseout of high-emitting physical assets.

*Final Report  
Financial Institution Net-zero Transition Plans  
[GFANZ]*

## Exhibit 2: 3 Prerequisites of Transition Finance

### ■ Transition Finance

- 1) In line with keeping a limit of 1.5°C temperature rise
- 2) Avoiding carbon lock-ins
- 3) Based on effective emissions reduction

Source: <https://www.mofa.go.jp/files/100506878.pdf#page=11>

## 3) Global consensus in Hiroshima;

Developments, such as the inclusion of three qualifying clauses related to the concept of 'transition finance' in the G7 Hiroshima Leaders' Communiqué, are helping to reduce skepticism among global stakeholders.

## Exhibit 3: G7 2023 Hiroshima Summit



Source: [G7 2023 HIROSHIMA SUMMIT](https://www.g7summit.org/)

Messages to support transition efforts in Asia, strategically conveyed by the Prime Minister during the two “Japan Weeks” in October 2023 were further well acknowledged globally, in our investment teams’ observation.

## Exhibit 4: Japan Weeks



The government of Japan, in cooperation with relevant parties, held “Japan Weeks” from September 25 to October 6, 2023 with intensively inviting foreign investors and asset management companies, to promote relevant policies for the realization of an international financial center and Japan's attractiveness as a financial and capital market.

[Japan Weeks | International Financial Center Japan by FSA](#)

Source: [Prime Minister's Office of Japan](#)

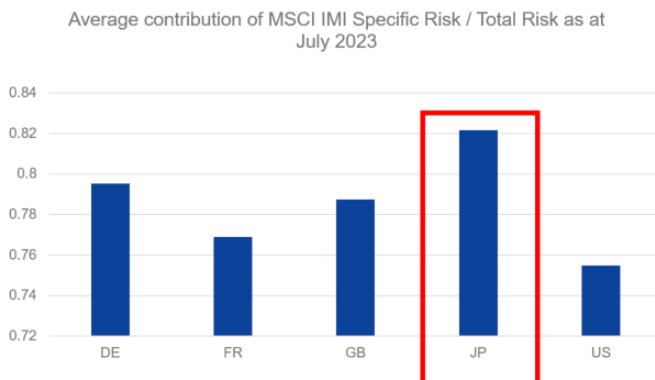
## 3. Opportunities in Japan

### 1) Exploitable inefficiencies;

In our perspective, the transition presents both risks and business opportunities for Japanese companies, while also contributing to sustainability.

Japan's equity market has a \$6 trillion market cap, over 3900 listed companies and insufficient analyst coverage. As a large, well-resourced active manager, we believe our firm is well positioned to help investors to navigate the market.

## Exhibit 5: Higher specific risk in Japan

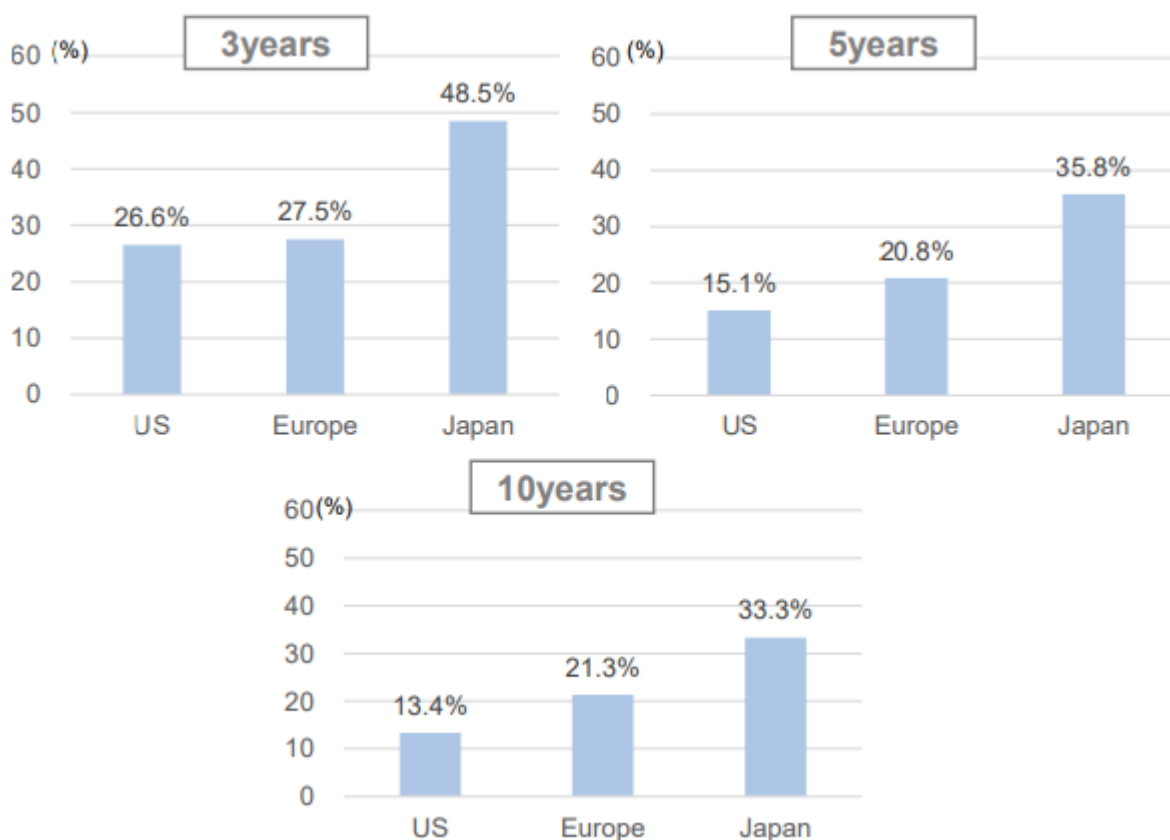


Universe: MSCI IMI  
 Countries covered: Japan, USA, UK, France, Germany  
 Duration: 2010/8/31 - 2023/7/31  
 Risk Value: Barra individual total risk and specific risk  
 Aggregation method: Simple average of each stock specific risk/total risk calculated for each country.

## 2) More active managers outperforming;

According to JFSA in its “Progress Report 2023 - For Enhancing Asset Management Business in Japan”, the share of passive investing to active investing in Japanese equities is high in the portfolio of institutional investors. However, statistics shows that the percentage of actively managed large-cap retail funds that beat their respective benchmark index is higher in Japan than in the US and the EU. This means there is more opportunity for asset management companies in Japan to increase the volume of actively managed funds in order for improving efficiency in the capital market as well as increasing their management fees.

**Exhibit 6: Percentage of actively managed large-cap funds that beat their respective benchmark index in Japan, the US and the EU**



(Source) FSA, based on the data of Ibbotson Associates Japan. Benchmarks refer to TOPIX (including dividends) for Japan, S&P500 (including dividends) for the United States, and MSCI Europe (net; dollar-based) for Europe. This analysis is done using the data after deducting investment management costs as of the end of December 2022.

Source: Financial Services Agency of Japan

## 4. SMDAM's potential contribution

### 1) ESG integration, instead of “add-on”;

Particularly in the ever-evolving ESG investment space, it is key for stock pickers to substantially “integrate” diligent fundamental research and non-financial analysis to reliably capture opportunities. Instead of naïve exclusions, best-in-class, or CSR-worship, we believe technological assessment, value creation analysis, and a variety types of engagement are indispensable in consistently generating alpha.

#### Exhibit 7: SMDAM's Policies for integration of sustainability risks into its investment process



[https://www.smd-am.co.jp/english/corporate/responsible\\_investment/pdf/policies\\_for\\_integrations\\_2023.pdf](https://www.smd-am.co.jp/english/corporate/responsible_investment/pdf/policies_for_integrations_2023.pdf)

Source: SMDAM

### 2) Consideration of adverse impacts;

Outcome-oriented management at an organizational level further differentiates our firm from competitors. SMDAM is one of the very few asset managers in Japan which discloses “Entity-level PAI metrics under the SFDR”, meeting global expectations to consider negative impacts in addition to ESG risks, illustrating our firm-wide commitment.

PAI: Principal Adverse Impacts are the most significant negative impacts of investments on the environment and people. When a financial market participant considers principal adverse impacts, it means that it should seek to reduce the negative impact of the companies they invest in. [\[2023 Joint ESAs Report\]](#)

SFDR: The EU Sustainable Finance Disclosure Regulation, a set of rules on transparency in providing sustainability-related information. It requires financial market participants, such as investment managers, to disclose information about sustainability risks and principal adverse sustainability impacts (PAI).

## Exhibit 8: Selected SMDAM's Statement on Principal Adverse Impacts of investment decisions on sustainability factors

Metric	Impact [year n]	Impact [year n-1]	Explanation	Actions taken, and actions planned and targets set for the next reference period
M3. Carbon footprint	663.00	NA	In general, Carbon footprint is considered as an important factor... However, could be higher than the benchmarks or in a YoY...	... announced the 2030 interim targets ... 50% by 2030... the Investment Manager aligns its business strategies and operations, develops products...
M10. Violations of international norms	0.65	NA	... Notwithstanding this limitation... suggests the Investment Manager's disciplined investment process prevents it from investing in...	... excludes through the firm-wide norm-based screening and exclusion ... actively managed, the Investment Manager sets its target at 0%...
M13. Board gender diversity	22.41	NA	... In addition ... considers board gender diversity of its investees in light of zero female on board (3.6% of the portfolio)...	... believes diversity in a broader sense is a factor to maximize shareholders' value ... as a member of the 30% Club Japan Investor Group...
E4. Companies without carbon emission reduction initiatives	45.89	NA	... the largest portfolio constituents without such initiatives are ESG leaders of US and Japan in Software & Services, Chemicals, and Auto...	... alone does not necessarily resulted in its investment decision... while interim targets have been set... as a member of NZAMI.

[https://www.smd-am.co.jp/english/corporate/responsible\\_investment/pdf/SFDR\\_disclosure\\_statement\\_July\\_2023.pdf](https://www.smd-am.co.jp/english/corporate/responsible_investment/pdf/SFDR_disclosure_statement_July_2023.pdf)

Source: SMDAM

### 3) Aspiring to lead in the investment chain;

Japan equities have appreciated in 2023, partially triggered by increasing momentum of the monumental shift in corporate governance as earlier in the year [Tokyo Stock Exchange published a memorandum](#) demanding listed companies more conscious of the cost of capital.

Given this pressure on enterprises to allocate capital more efficiently, buy-backs may not be sufficient and we expect investors to turn their attention to focus on how companies will achieve sustainable growth.

ESG-aware investments in Japan have enjoyed G-driven tailwinds, the E-aspect should become more relevant against the backdrop of ongoing global transition efforts.

SMDAM aspires to bridge the gap by enhancing accountability in ensuring that Japan's GX (Green Transformation) policy adheres to the Science-Based Policy recommended by the Intergovernmental Panel on Climate Change (IPCC). It also strives to assess each company's initiatives, ensuring alignment with pathways conducive to achieving the Paris Agreement's objective of limiting global temperature rise to 1.5°C above pre-industrial levels

We aim to be a leading player in the development of the Investment Chain in Japanese society, and will play the role expected of an investment management company following COP28 through daily investment decisions and engagements with policy makers and investee companies.

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