



PM'S PERSPECTIVES VALUE + ALPHA GROUP

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Author: Takuya KAMIISHI
Portfolio Manager, Value + Alpha

Three key aspects of ESG investment: Achieving returns, dealing with social issues in Japan, while ensuring objectivity

The job-hunting season for Japanese students graduating next spring is in full swing. During my job search as a university student 10 years ago, I wrote down in my applications that my motivation for applying for the job was “to contribute to the further prosperity of Japan” for virtually every company that I applied for. This was because the professors at my University often expressed their concerns over the future of this country. During my job search, I attended seminars of more than 150 companies, but I was still unclear as to which company would give me the opportunity to contribute to the future of Japanese society. In the end, I decided to take a job with an asset management company which had competitive advantages in Japanese equity businesses where the information concerning the future of this country accumulates the most.

In my line of work, I get numerous opportunities to hear the stories of experts from various sectors and corporate executives. I have come to realise that demographics would be the most significant problem for Japan. However, since it is difficult for management companies to handle social problems as part of our businesses, the most I could do was to host study sessions and seminars on certain topics as external activities. Subsequently, a significant wave of ethical, social and governance (ESG) focussed investments across the asset management industry finally gave us the chance to work on social problems through our business. During the last few months, our company has been working toward the launch of a new ESG fund with the support of many people, and this gave me the opportunity to work on social issues and think about how ESG investment should play a role in our society.

I believe that there are three key aspects to ESG investment: “achieving returns”, “dealing with social issues in Japan”, while “ensuring objectivity”.

Environmental funds became popular in the market around 2007. I believe that one of the reasons for the boom to end was that being environmentally focussed was perceived to be just a “theme”, and it was not quite clear how these funds were aiming to generate returns. Therefore, in order to avoid our ESG fund from becoming just another short lived thematic fund, we made sure that its returns are generated by the following strategies; 1) to achieve organic growth which would contribute to solving ESG issues, 2) to find attractively valued stocks through our bottom-up research and valuation methods, 3) to enhance enterprise value through engagement strategies.

When we talk about ESG investment, we often refer to international credit rating agencies and/or SDGs (Sustainable Development Goals). However, if we evaluate ESG by only credit ratings and SDGs, it would leave out the social issues which Japan is facing right now. For example, with regard to the problem of an aging population, SDGs only refer to nutrition standards, transport systems, and greening & public space. However, Japan is facing mounting concerns over its aging population such as increasing burden on social benefits and fiscal spending, loosening ties within the society, poor conditions in aged care services, a growing number of elderly people living below the minimum income level, silver demographic, and so on. Therefore, it would not be sufficient if we only adopt the approach of SDGs since key social issues would differ by countries such as the case of Hong Kong where housing is the largest societal problem due to its

land scarcity. This would also apply to the subject of corporate governance. For example, the backdrop for defining ESG issues differs significantly between the US and Japan. In the US, for example, excessively high salaries paid to top executives particularly in large companies has been a problem whereas one of the biggest challenges for Japanese companies has been how they facilitate a shift by management that would reflect the views of shareholders. Therefore, what is crucial for us is how we define ESG themes that are unique to Japanese society, which in turn leads to the key features of the fund.

Another important aspect of ESG investment is to ensure objectivity in its strategies. If the fund manager happens to hold extreme views on certain social issues, that could influence his investment decisions on ESG in a way which is not supported by the investors. Therefore, when we define issues for ESG, it is crucial for us to maintain objectivity in that process without allowing the personal opinions of fund managers to cloud their judgment on social and political issues. In our new ESG fund, which we are currently planning to launch, we are trying to ensure objectivity in our decisions by referring to the data on book sales to capture trends in our society.

During the current results season, companies such as **Nihon Unisys** and **Yokogawa Electronic** presented excellent interim business plans that effectively incorporate ESG considerations into their corporate philosophies and business strategies. We believe that more companies will follow in their footsteps by adopting more ESG-conscious policies on business strategies and investments. Under these circumstances, if you ever become interested in an ESG fund, I would encourage you think about the following three questions – “What are the factors that generate returns?”, “How are the social issues in Japan incorporated in ESG?”, and “How the strategic objectivity is maintained?”.

Takuya KAMIISHI, CMA, Portfolio Manager, Value + Alpha Group, Equity Management Department

Mr Kamiishi joined Daiwa SB Investments in 2009 and covered US & European equities as a strategist from 2010 to 2013. He moved to Hong Kong in 2013 as an analyst for the auto & industrials sector in Asia Pacific ex-Japan equity. In 2015, he returned to Japan and covered the IT & services sector as a Japan equity analyst. In 2016, he became a portfolio manager in the Value + Alpha group.

Mr Kamiishi obtained a BA degree in Economics from Keio University in Japan.

Contact Details

Yuhki Sophia KING

Head of Business Development
& Client Relations

Phone: +44 (0) 20 7597 7035

Email: yuhki.king@daiwasbi.co.uk

Luke BURDESS

Business Development Manager

Phone: +44 (0) 20 7597 7024

Email: luke.burdess@daiwasbi.co.uk

Daiwa SB Investments (UK) Ltd.
5 King William Street
London EC4N 7DA, United Kingdom

www.daiwasbi.co.uk

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