BIG IN JAPAN

The 2020 Olympic Games were, as expected, a marvelous spectacle. New heroes emerged as the world witnessed the feats that the human body could achieve. What was not expected when the games were awarded to Tokyo back in 2013, was that they would be staged a year later than planned due to Covid. It is interesting that the delayed Olympics were held in Japan, a quite traditional country that is often seen as being behind schedule when it comes to modernization. Nowhere is this more evident than in the country's corporate practices, which have been deemed to be far behind the more shareholder-friendly standards applied in the West.

But this is changing. The government is pushing Japanese companies to improve their reporting, consider climate risk and embrace the digital world. Such a move will be welcomed by international investors, many of whom have been left frustrated at trying to persuade Japanese companies to invest the vast sums of capital they hold to become more competitive. The current mergers and acquisitions boom in the country shows that this message is finally hitting home.

This change is needed. Although home to global giants such as Sony, Toyota and Honda, Japan has endured three decades of stagnation and has an increasingly aging population. It has also lost its position to China as the world's second largest economy and so Japanese companies need to improve their competitiveness on the world stage.

We spoke to Asset Management One to find out how the country is shredding its traditional image to become more investor friendly.

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RE-VISITING JAPAN AS A LAND OF GOLD

750 years ago, in 1271, a young Venetian merchant set sail for Asia, travelling extensively across the continent. He later went on to write the renowned book, The Travels of Marco Polo, in which he described Zipangu as the land of gold.

In this well-known tale, Zipangu is believed to be the origin of Japan. In the Japanese language, the country is called "Nihon" or "Nippon", which literally means "the land of the rising sun".

So, is Japan a land of gold or the land of the rising sun? Will the sun rise and shine again as it did in the 1970s and 80s? Most investors seem to disagree. They have been attracted to the US markets where many technology-driven companies list their shares. They are also looking to China, which has overtaken Japan as the world's second largest economy after the US.

Current day Japan is a low growth, if any, mature economy with a rapidly ageing and decreasing population. An old school industrialised nation with boring conglomerates that engage in cyclical businesses, lacking cutting-edge innovation and thought-provoking initiatives. The nation is heavily indebted and financed by 0% coupons and its central bank. The government seems to lack a clear strategy and is often criticized for being slow to react.

Not to be cynical here, but this is a stereotypical image that global investors associate with Japan these days. Unfortunately, there is a degree of undeniable truth in this view.

However, Japan is going through transformations which are often missed, even by observant investors. Although less conspicuous compared to its rival China, Japan tends to move in one direction with strong commitment once the course is clearly set. Therefore, identifying such changes and investing in relevant opportunity sets early could yield attractive investment returns.

Transformation underway

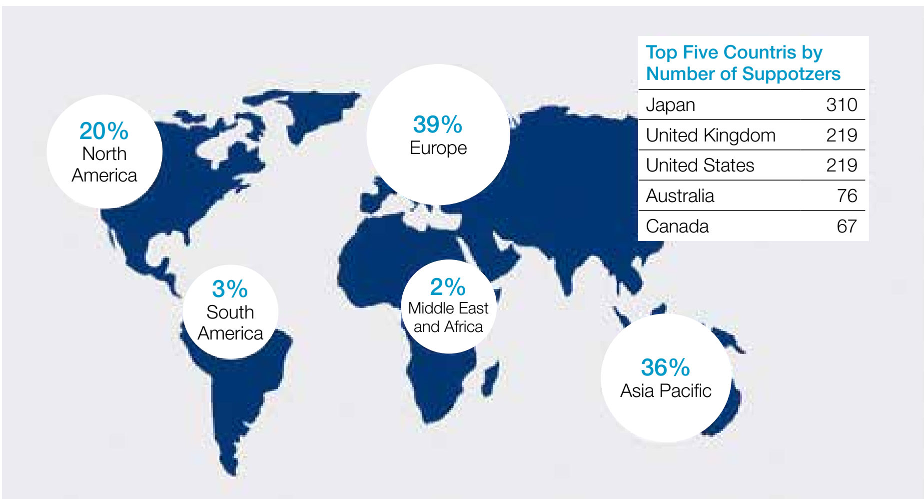
There are several areas of transformation that Japanese companies and society are currently going through. These are corporate governance, activism, mergers and acquisitions, enhanced disclosure, climate change and digital transformation.

The notoriously poor corporate governance of Japanese companies is a story of the past. This can be attributed to government initiatives to improve corporate management's mind-set towards profitability and shareholders through the introduction and regular revisions of Japan's corporate governance and stewardship code. Although somewhat conservative, many companies nowadays provide a clear strategy and profitability objectives in their guidance. Moreover, they have also conducted record levels of share buybacks during the past few years. Return-on-equity is expected to bounce back to achieve the 8% target prescribed in the Ito Report published in 2014. Companies are buying back more than ¥4trn ($40bn) worth of shares every year and, together with dividends, total shareholder return has climbed above 50% in the past few years.

Activism, which society had previously been critical of, is gradually gaining traction in Japan. The discord between Sony and Third Point, run by US billionaire Daniel Loeb, is an apt example. In 2020, 24 listed companies received activists' proposals, a substantial increase from just two companies in 2015, according to IR Japan. Corporate Japan's move to improve profitability is also evident in the growing number of mergers and acquisitions initiated by Japanese companies. More than 3,500 transactions have been completed per annum in the past three years.

Corporate disclosure in English is an area that is a work in progress, and adaptation has been particularly slow with only 30% of listed companies notifying investors of their annual general meeting in 2020, according to the Tokyo Stock Exchange. However, this was an increase of 7% in 12 months, with large-cap companies leading the way. A surprising fact is that, in terms of Task Force on Climate-related

Geographic distribution of TCFD supporters



Source: Task Force on Climate-related Financial Disclosures 2020 Status Report

Financial Disclosures (TCFD), Japan has a top ranking in terms of its number of supporters. It ranks number two in the level of companies taking action on science-based tests and is third in terms of the number of RE100 members. With the revised corporate governance code implemented this year, which encourages companies to provide TCFD or an equivalent level of disclosure on climate change actions, and with Sustainable Finance Disclosure Regulation and taxonomy coming into effect in Europe, one would expect that Japanese companies are preparing to improve their disclosures in these areas.

In addition, reforming the TOPIX is underway, with an aim to enhance the attractiveness of the index along with the re-classification of listing markets. The proposed change is prompting 664 companies, a quarter of its 2,190 constituents, to increase their free float by January 2025 or face exclusion from the index.

Digitalisation is another area that has taken off in Japan in the wake of the pandemic. With the government finally promoting change and, in many respects, forcing companies to adopt to a new reality, this transformation has accelerated significantly during the past 18 months. Companies such as M3, GMO GlobalSign and NRI are leading the digital transformation of Japan.

Our approach

The Japan Growth Equity Strategy, managed by Japanese equity market veteran with over 27 years investment experience, Seiichiro Iwamoto (an employee of Asset Management One), is unique in its approach. The team use a proprietary "Growth Categories Framework" to map all the growth opportunities throughout society and classify them into a matrix. They then populate each category with relevant companies identified through bottom-up research. This holistic approach provides Iwamoto a breadth of investment opportunities without focusing on particular sectors or themes. This approach is available through Asset Management One International's Luxembourg domiciled UCITS fund, AMO Japan Growth Equity Portfolio.

Playing the China story through Japan

Given the recent tensions between China and the US, the amplified protectionism around the world and Beijing's crackdown on Chinese tech giants, property, education and gaming industries, coupled with its growing influence over Hong Kong, is it safe to invest in Chinese stocks? With growing regulatory scrutiny and political risks, the attractiveness of investing directly in Chinese companies is eroding quickly, and no longer compensates investors for the associated risks.

A compelling proposition is to play China through Japan. Despite Beijing's push for the "buy made in China" campaign, expertise in the production of certain materials, such as components and machinery relevant for the development of the Chinese manufacturing sector, remains in Japan, therefore offering attractive exposure to growth stories in China.

Re-visit Japan to uncover gold

Japan may not be positioned at the top of a global investor's list of attractive opportunities, however nor should it be at the bottom. Japan is experiencing numerous transformations and has lower risks as a developed market when compared to emerging markets. Many investors have become sceptical about Japan and have been reducing their exposure to the country over the past few years. This move has made it deeply undervalued and left it with many untouched opportunities.

It has become a neglected land of gold, where many hidden gems are waiting to be discovered.

Asset Management One International, a leading asset manager headquartered in Japan, with deep roots in the development of industrial Japan, can assist you in constructing your portfolio's exposure in Japan.

SUSTAINABILITY: A JAPANESE BLUEPRINT

Japan is no stranger to economic transformation plans. The world's third largest economy has lived with stagflation for three decades and various prime ministers have been tasked with fixing the problem.

Now the government is working towards two major economic outcomes after setting a target to be carbon neutral within 30 years. Switching from a dependency on fossil fuels to renewable sources is not going to be easy.

Japan's Asset Management One is playing its part by vowing to make its portfolios carbon neutral by 2050. Working with policymakers and corporate boardrooms as well as collaborating with other professional investors around the world are part of its strategy.

In the following pages the asset manager discusses its plans and the core issues it is tackling to make the world more sustainable.

In November, Akira Sugano, CEO of Asset Management One (AMO), travelled to Glasgow to participate in the United Nations Climate Change Conference (COP26) as well as the World Climate Summit. The message he brought with him was one of leadership, active engagement and collaboration – all components of Japan's transformation to sustainability.

ESG and sustainability have become prevalent buzzwords, not only in Japan but globally, proliferating media headlines as well as daily conversations. Due to its heavy dependence on fossil fuels, many critics were sceptical of Japan's commitment to achieving meaningful levels of decarbonisation. These critics, as well as the world, took notice in October 2020 when former Prime Minister Suga pledged that Japan would achieve carbon neutrality by 2050. The commitment was followed by an interim government plan to achieve a 43% reduction in greenhouse gas (GHG) emissions by 2030 (in comparison to 2013), coupled with an ambitious revision to the government's energy source plan, decreasing fossil fuel dependency and replacing it with renewable energy.

A few months later, in December 2020, the Net Zero Asset Managers initiative (NZAM) was established. The initiative is composed of global asset managers aiming to achieve net zero GHG emissions. As one of the 30 initial signatories and the only Japanese firm amongst the founding members AMO set a precedent. Just shy of its one-year anniversary, NZAM's membership increased to 220 members by November, representing approximately $57trn (£42.7trn) in assets under management (AUM). NZAM's signatories have committed to supporting the goal of net zero GHG emissions by 2050, which aligns with global efforts to limit warming to 1.5°C. These global asset managers have also committed to setting an interim target for the proportion of their assets to be managed in line with the attainment of net zero emissions by 2050 or sooner, by working with asset owners and clients on decarbonisation goals. AMO has set an ambitious target of ¥30trn (£200trn) worth of AUM (53% of their AUM, as of March 2021) as its 2030 interim goal, on the path to achieving GHG emissions by 2050 or earlier.

Perpetuating this call to action amongst the asset management industry, in early 2021 Mr Sugano spearheaded an project, redefining AMO's raison d'etre and corporate purpose: "Creating a sustainable future through the power of investment." This aptly captures the firm's aspiration and reflects its commitment to net zero. As an asset manager, AMO is committed to working with all constituents in the investment chain to accelerate the transition towards net zero in three areas:

1. We will strive to increase the amount of assets managed that align with the net zero initiative. This includes offering active strategies which invest in companies possessing the ability to increase their enterprise value whilst working toward the net zero goals. From quantitative and qualitative perspectives, we will assess investee companies and direct capital to support those demonstrating an active commitment and make solid progress in achieving net zero. For passive strategies, we are planning to launch passive products with a focus on engagement to encourage a wider range of companies to act and make the transition towards net zero. This approach will enable AMO to raise awareness and drive action across the entire market, including companies that have not yet taken the necessary steps, as well as those already working towards net zero goals.

2. Through engagement, the firm is a proactive proponent of encouraging companies to transform their business models towards increased sustainability and decarbonisation. Rather than simply divesting from the companies that are not yet fully aligned with the net-zero scenario, our priority is to engage with them. Our goal is to gain a holistic understanding of the company which allows us to have a constructive dialogue to bring about improvement and positive changes. Where there is no evident progress despite this engagement, we will consider opposing the election of directors at the respective companies.

3. We will continue working with policy makers and other organisations to strengthen ongoing efforts towards achieving net zero goals by 2050. This is exemplified by AMO's participation in climate change and environment-related study groups and initiatives established by the Ministry of Economy, Trade and Industry and the Ministry of the Environment.

AMO is one of the few Japanese asset managers to join Climate Action 100+ (CA100+), an engagement initiative launched in 2017 to ensure the world's largest corporate GHG emitters take remedial actions. Together with a US public pension fund, AMO has been co-leading the engagement with a major Japanese automotive company, as part of the joint efforts to achieve the CA100+ goals. In this instance, the foreign asset owner offers a more global perspective, while AMO offers a local context on ESG. Such collaboration has enabled AMO to build stronger ESG engagement with the company for positive impact and solutions.

In its first sustainability report issued in October, AMO revealed its holistic approach in tackling sustainability issues and provided conceptual guidelines and examples of implementation. To identify issues and better understand their importance to the global environment and society AMO created a framework to analyse and plot these "barriers" based upon sustainable and financial materiality.

When identifying global environmental and social issues, the firm is guided by information sourced from businesses, NGOs and the World Economic Forum to map the materiality without being bound by existing ESG factors. The barriers are segmented into four broad categories: environmental, geopolitical, social and technological.

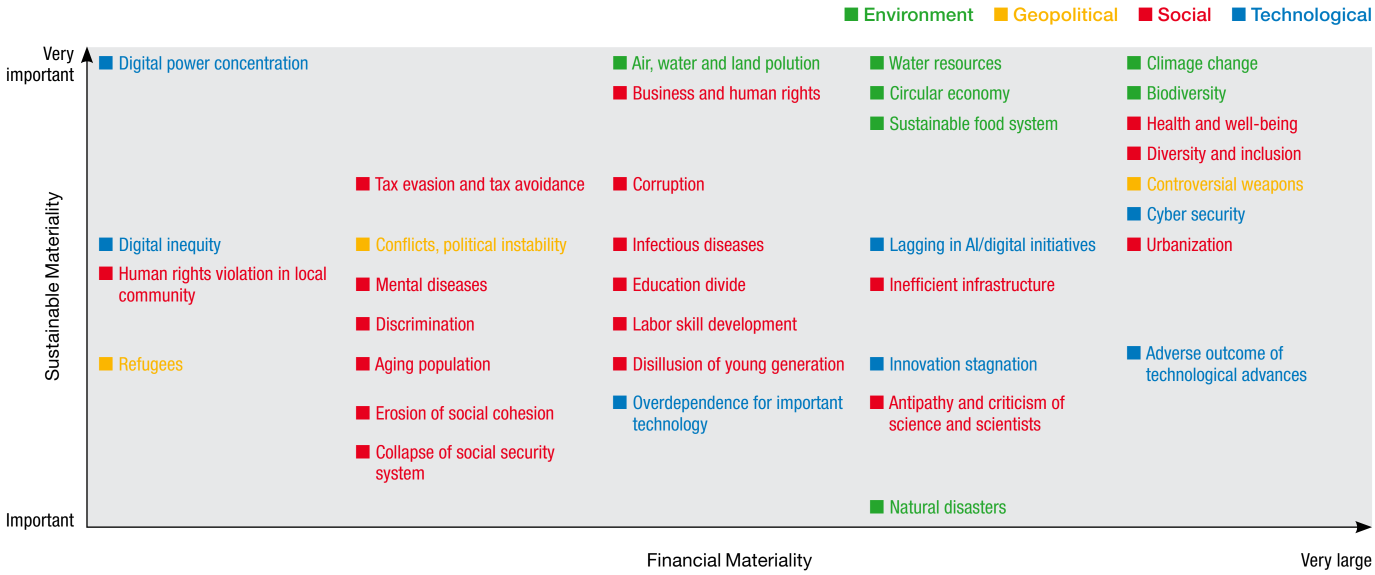
Sustainable materiality plotted on vertical axis, is an indication of the global society's level of interest in environmental and social issues. Financial materiality on the horizontal axis, focuses on economic impact and reflects important themes whilst indicating the level of economic impact from and on corporate activities. The materiality map indicated by these two axes is considered by AMO as a compass for creating a sustainable future through the power of investment.

In parallel with the materiality map, AMO has recognised nine core issues to economic and societal materiality: climate change, biodiversity, health & wellbeing, diversity & inclusion, water resources, circular economy, sustainable food system, air, water and land pollution, and business & human rights. Subsequently, we have selected three areas: 1. Climate change, 2. Biodiversity and environmental destruction, and 3. Human rights and health & wellbeing within which AMO can contribute to solving issues as an investor and are also common for the individual company and the entire supply chain. In the future, areas of focus will be the central axis for our engagement proxy voting and investment decisions, and applied to the firm's wide-ranging business activities, including product strategy and corporate sustainability.

We will engage on these issues alongside the traditional dialog focusing on strategy and governance disclosure, items which form the basis of sustainable corporate activities.

AMO is committed to leading the sustainability transformation whilst advocating for and instigating change in Japanese corporate culture and society. Climate change is an urgent global issue and a complex challenge interconnecting multiple issues across a spectrum of disciplines. It is essential for all stakeholders, including governments, companies and consumers, to work in co-operation towards resolving this ever-changing issue.

Materiality Map



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