



Index Insights | Sustainable Investment – Equity

Growing focus on ESG in Japan

Disclosure, outperformance and roll costs

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Written in collaboration
with SGX

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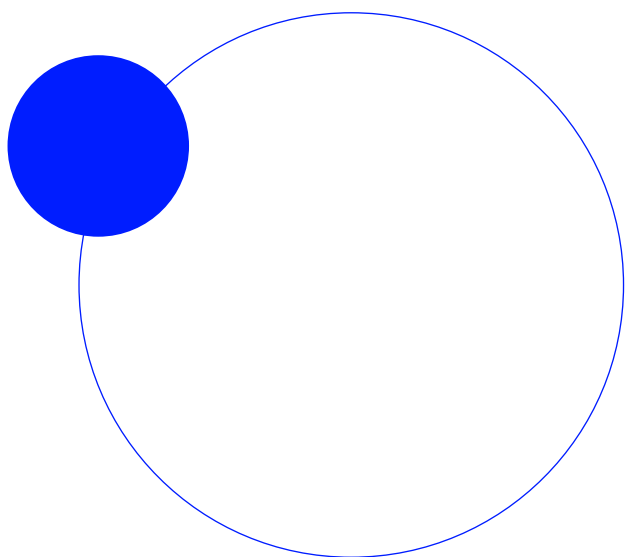
Quarterly analysis

With the advancement of the Japanese sustainable market, there have been calls for more disclosure and consistency in ESG scores. FSA is calling for a voluntary code on a 'comply or explain' basis.

This Japanese ESG indices and passive investment report, written in collaboration with SGX, reviews the development of Japan's sustainability standards, the ESG performance of Japanese listed companies compared to the broad-market index, and the growth of index-linked SGX FTSE Blossom Japan Index Futures.

Key highlights from this quarter's analysis:

- Q4 2022 was another strong quarter for FTSE Russell's Japan ESG flagship index series.
- The outperformance of the blossom index series over the traditional market cap index is attributed to the stock selection effect.
- SGX FTSE Blossom Japan Index Futures continues to be the leading listed derivatives solution on the FTSE Blossom Japan Index.



More disclosure for ESG investment in Japan required

In Japan, ministry-led movements to set definitions and guidelines for ESG investment are gaining momentum. First, Japanese Financial Services Agency (FSA) published 'The Code of Conduct for ESG Evaluation and Data Providers'¹ (the Code) in December 2022 in response to opinions that methodologies and process aren't transparent, and that it is difficult to understand that companies' ESG scores are different by each ESG evaluation provider.

The Code, which included six Principles² with their guidelines and concepts, is designed to be a voluntary code on a 'comply or explain' basis to encourage improvement by each data provider. FSA calls for organizations to express their support for the Code via public announcement, and the organizations supporting the Code will either comply with the principles and guidelines of the Code, and or explain the reasons why they do not comply with a particular principle or guideline.

FTSE Russell, which provides the FTSE ESG Scores integrated in various sustainable indices such as the FTSE Blossom Japan Index series, had been involved in the process and public consultation and announced its endorsement to comply with the Code in February 2023.

The FSA also announced 'Proposed Partial Amendments to the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc., regarding ESG Investment Trusts'³ in December 2022 (currently in draft at February 28, 2023). There are a number of investment products that incorporate ESG factors in their names and investment strategies, which had increased both in Japan and overseas. At the same time, concerns over 'greenwashing' actual investments might not be commensurate with such ESG claims and are attracting attention globally.

Given this background regarding publicly offered investment trusts in Japan that position ESG as a key factor in the selection of investment assets (hereinafter referred as *ESG investment trust*), FSA proposed it is necessary to:

- consider ESG as a key factor in the selection of investment assets
- describe the selection process in the 'Objective and Characteristics of the Fund' section of the delivery prospectus

For example, managers need to disclose the target and real percentage of ESG assets in the portfolio, as well as selected ESG theme details and the investment process with its integration and methodology.

ESG investment provided in Japan is expected to further increase the need and demand for passive investment using quantitative ESG scores based on transparent methodologies on these requirements.

¹ Please see [The Code of Conduct for ESG Evaluation and Data Providers](#)

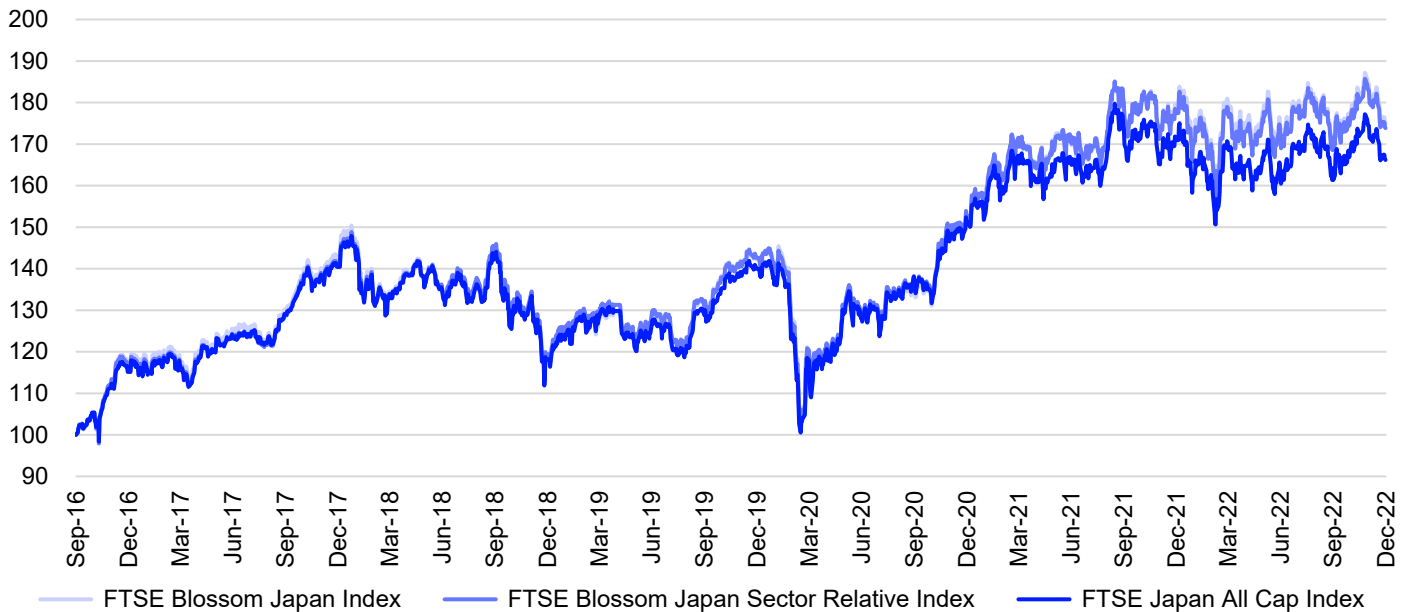
² Securing Quality, Human Resources Development, Ensuring Independence and Managing Conflicts of Interest, Ensuring Transparency, Confidentiality, Communication with Companies.

³ Please see [Draft of Revised Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.](#)

FTSE Blossom Japan Index Series continues to outperform traditional market indices

The fourth quarter of 2022 was another strong period for FTSE Russell's Japan ESG flagship index series.

Exhibit 1. Performance (total return, JPY)



Source: FTSE Russell. Data based on Total Return in JPY, as of December 30, 2022. Past performance is no guarantee of future results. Please see end for important legal disclosures.

Both the FTSE Blossom Japan Index and FTSE Blossom Japan Sector Relative Index outperformed the traditional FTSE Japan All Cap Index by 87bp and 36bp respectively (Exhibit 2).

Exhibit 2. Performance attribution analysis for FTSE Blossom Japan Index Series

FTSE Blossom Japan Index

	Quarterly change (2022/10-12)				2015/12–2022/12				2015/12–2022/9			
	Industry allocation	Stock selection	Interaction	Total contribution	Industry allocation	Stock selection	Interaction	Total contribution	Industry allocation	Stock selection	Interaction	Total contribution
Technology	-2.6	-18.8	0.8	-20.7	-11.2	21.6	0.5	10.9	-8.6	40.4	-0.3	31.6
Telecommunications	-0.6	-0.1	-0.2	-0.9	-19.4	21.9	-5.1	-2.6	-18.7	22.0	-5.0	-1.7
Health care	-2.0	24.6	0.4	22.9	-13.4	45.4	-0.5	31.4	-11.4	20.8	-0.9	8.5
Financials	0.1	29.1	0.5	29.7	-4.4	142.1	19.9	157.7	-4.4	113.1	19.4	128.0
Real estate	-2.6	-38.1	-2.1	-42.9	-25.8	-93.7	-43.1	-162.7	-23.2	-55.5	-41.0	-119.8
Consumer discretionary	0.1	27.0	0.0	27.1	7.9	276.6	9.1	293.7	7.9	249.6	9.1	266.5
Consumer staples	-0.4	-6.8	-0.1	-7.3	18.4	37.2	-6.4	49.2	18.7	44.0	-6.3	56.5
Industrials	0.4	63.2	-1.3	62.2	28.2	52.9	-40.8	40.3	27.8	-10.3	-39.4	-21.9
Basic materials	-0.7	15.8	-0.4	14.6	-7.0	153.7	-3.3	143.3	-6.3	138.0	-3.0	128.7
Energy	0.1	0.5	0.0	0.6	2.7	9.2	1.0	13.0	2.6	8.7	1.0	12.3
Utilities	-0.6	2.1	-0.2	1.2	-14.8	83.1	-2.8	65.5	-14.2	81.0	-2.5	64.2
Total Return (Local)	-9.0	98.3	-2.6	86.7	-38.8	750.1	-71.6	639.7	-29.9	651.8	-68.9	553.0

FTSE Blossom Japan Sector Relative Index

	Quarterly change (2022/10-12)				2015/12–2022/12				2015/12–2022/9			
	Industry allocation	Stock selection	Interaction	Total contribution	Industry allocation	Stock selection	Interaction	Total contribution	Industry allocation	Stock selection	Interaction	Total contribution
Technology	-0.4	-18.4	0.0	-18.8	4.1	-23.5	-1.3	-20.7	4.5	-5.1	-1.3	-1.9
Telecommunications	-0.5	-3.2	0.0	-3.6	-14.1	-71.5	0.9	-84.7	-13.6	-68.3	0.9	-81.0
Health care	-0.5	5.9	0.2	5.6	-3.3	72.2	5.2	74.2	-2.8	66.3	5.1	68.5
Financials	0.4	18.8	0.0	19.2	-3.0	92.4	-1.5	87.9	-3.4	73.6	-1.5	68.7
Real estate	-1.6	-28.9	-0.8	-31.3	0.7	-49.0	-5.8	-54.0	2.4	-20.1	-4.9	-22.7
Consumer discretionary	-0.3	27.6	0.0	27.4	2.3	180.2	-0.1	182.4	2.5	152.6	-0.1	155.0
Consumer staples	-0.5	-0.2	-0.1	-0.8	3.1	47.4	-2.3	48.2	3.6	47.7	-2.2	49.0
Industrials	-1.0	31.4	-0.5	29.9	-7.2	232.4	2.6	227.7	-6.2	201.0	3.0	197.9
Basic materials	0.2	5.8	0.0	5.9	2.9	22.3	-0.4	24.7	2.7	16.5	-0.4	18.8
Energy	0.1	0.0	0.0	0.1	4.5	-4.8	-1.1	-1.3	4.4	-4.8	-1.0	-1.4
Utilities	0.4	2.1	-0.1	2.4	4.3	1.0	-0.3	5.0	3.9	-1.1	-0.2	2.6
Total Return (Local)	-3.7	41.0	-1.3	35.9	-5.8	499.3	-4.1	489.5	-2.0	458.4	-2.8	453.5

Source: FTSE Russell. Data as of December 30, 2022.

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As introduced in our previous report: [Ecosystem Growth: Japanese ESG indices and passive investing blossom](#), the outperformance of the FTSE Blossom Japan Index series over the traditional market capitalization index since inception has been mostly attributable to stock-selection effect. This has also remained the case for both indices in the fourth quarter of 2022, as the stock-selection effect contributed 98bp for the FTSE Blossom and 41bp for the FTSE Blossom Japan Sector Relative.

Exhibit 3 breaks down the style factor attributions for the FTSE Blossom Japan and Blossom Japan Sector Relative indices. As the analysis shows, there was substantial contribution from the Size factor for both indices in the fourth quarter of 2022. This is often the case when the global stock market rallies significantly during short periods of time on the back of macro policy expectations, such as the slowdown of the pace of Fed rate hikes. The Residual factor, which includes non-traditional factors such as ESG, showed slight reduction during the quarter. In contrast to the short-term factor analysis, the longer-term results show that Residual factor remains to be the dominant factor behind the performance of FTSE Blossom Japan Index Series.

Exhibit 3. Style Factor Attribution

FTSE Blossom Japan Index

Period	Industry	Value	Quality	Volatility	Size	Momentum	Residual	Total excess in JPY
31/05/2015 to 30/09/2022	-100.8	102.6	-84.2	-241.6	369.2	120.4	382.6	548.1
31/05/2015 to 30/12/2022	-106.0	133.8	-67.5	-271.8	461.9	132.6	351.8	634.9
Quarterly change	-5.1	31.2	16.7	-30.1	92.7	12.2	-30.8	86.7

FTSE Blossom Japan Sector Relative Index

Period	Industry	Value	Quality	Volatility	Size	Momentum	Residual	Total excess in JPY
31/05/2015 to 30/09/2022	1.1	58.9	-122.2	-122.4	3.4	177.1	430.4	426.4
31/05/2015 to 30/12/2022	0.4	83.5	-115.9	-123.6	33.9	183.9	399.4	461.6
Quarterly change	-0.7	24.6	6.3	-1.2	30.5	6.7	-31.0	35.2

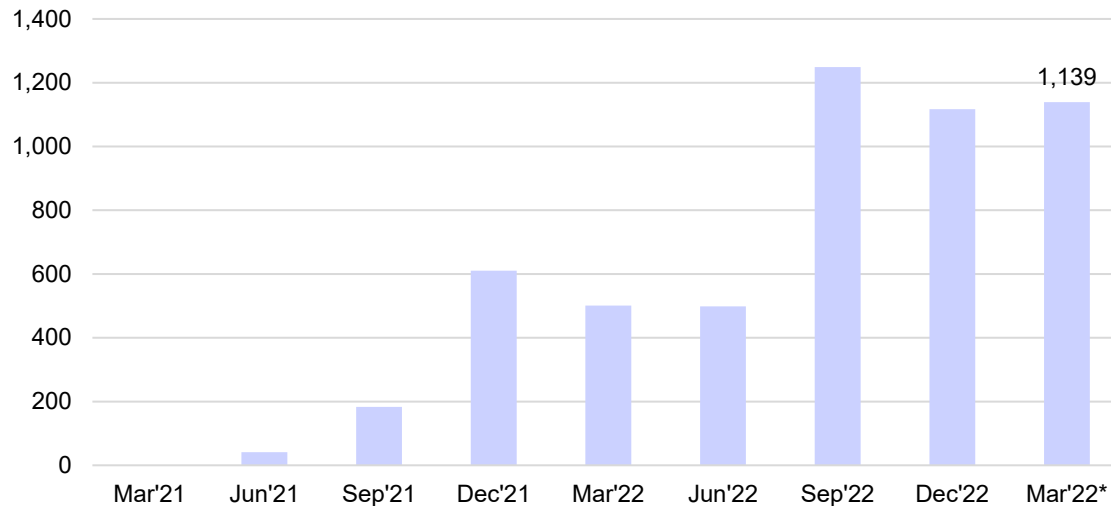
Source: FTSE Russell. Data based on December 30, 2022.

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Rolling into the next quarter

SGX FTSE Blossom Japan Index Futures continues to be the leading listed derivatives solution on the FTSE Blossom Japan Index. As illustrated in Exhibit 4, Open Interest (OI) remains steady at more than \$68M (1,139 lots), making it the only Japan-focused ESG futures with meaningful OI notional⁴.

Exhibit 4. Quarter-end Open Interest (Lots)



Source: SGX. Data as of March 10, 2023.

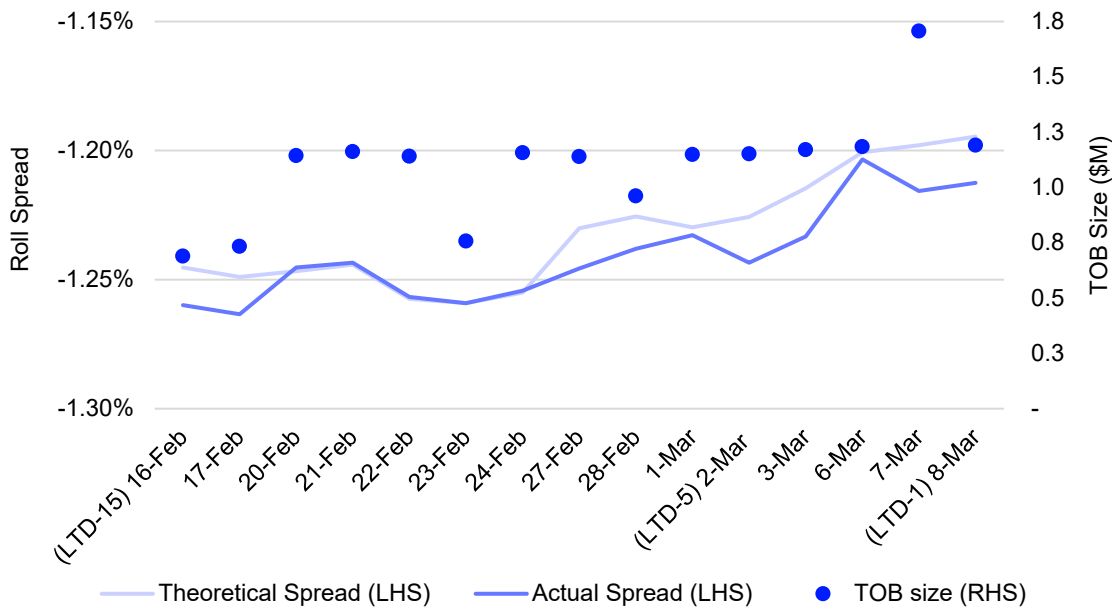
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Roll liquidity is important to investors trading futures. In the recent March–June 2023 roll, there was a single roll of US\$ 22M (365 lots) on block, an indication of the liquidity available to facilitate sizeable trades on the SGX FTSE Blossom Japan Index Futures.

For those choosing to roll on screen, liquidity on the calendar spreads is often available 15 days before last trading date (LTD-15). Spreads are as tight as 0.1 index points (~6 bps) and the top of book size is consistently above US\$ 1M from LTD-5 onward. More significantly, roll costs on screen are competitive. As can be seen in Exhibit 5, actual roll spreads are often at or even cheaper (for long futures position) than the theoretical roll spreads. With several market makers participating in the roll market, the orderbook is deep and resilient, thereby allowing users of SGX futures to rely on it for price discovery or to efficiently execute their rolls.

⁴ FIA Jan 2023 data.

Exhibit 5. March–June 2023 Roll Costs



Source: SGX. Roll spreads are calculated as a percentage of the day's average March – June 2023 spreads to volume-weighted average index level. A more negative (positive) actual spread compared to the theoretical spread means rolling a long futures position at a discount (premium) to fair value.

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