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This month's focus: **“Environmental, Social and Governance (ESG) Issues in Investing”**

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Environmental, social, and governance (ESG) investment is expanding worldwide, mainly by institutional investors that have signed ‘Principles for Responsible Investment’ (PRI). At the core of this expansion are asset owners, whose investment beliefs, policies, and activities have a strong impact on market participants.

Market factors and changing perceptions, including the increasing recognition of factors related to ESG investment, including the benefits of ESG in the investment decision-making process, continue to progress in Japan. The enactment of the stewardship code (norm) has also helped to expand ESG investment. This paper discusses trends and future developments of international ESG investment.

Corporate Social Responsibility and Firm Value *Toru Kawamura / Kyoko Nagata* 15

There has been much debate on whether or not corporate social responsibility (CSR) enhances firm value. This study revisits this question by focusing on agency conflicts between managers and shareholders. The results show that corporate social performance (CSP) is positively associated with the value of firms in which agency problems are less severe, whereas CSP is negatively related with firm value when managers are more likely to be entrenched and invest in CSR for their own reputation at the expense of shareholders. Overall, our findings suggest that CSR has a value-enhancing effect under certain circumstances where managers are disciplined not to waste shareholders’ resources.

ESG and Crash Risk for Japanese firms*Lu Jie, CMA / Kan Nakajima, CMA* 26

This paper investigates the relationship between environmental, social, and governance (ESG) factors and the crash risk of Japanese firms, following Kim *et al.* [2014], who found that the effect of corporate social performance (CSR) mitigated firms’ future stock price crash risk by substituting for a firm’s weak governance mechanism. We find from our regression analysis that firms with low ESG scores have a higher crash risk. Moreover, the crash risk of these firms is negatively associated with the level of foreign ownership. While low ESG scores are closely related with the non-disclosure

of bad news, these results suggest that the market discipline effect of foreign investors may result in reduced non-disclosure of bad news on the part of managers in firms less engaged in ESG issues.

ESG Factors and Return on Stock Investments	<i>Masaharu Ito, CMA</i>	39
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This research paper presents our analysis of the relationship between environmental, social, and governance (ESG) factors and return on stock investments, focusing specifically on independent directors and women’s empowerment (women in management and director positions). Our findings reveal that portfolios which include corporations actively appointing independent directors in their composition tend to gain high returns. Meanwhile, in a breakdown of investment returns by industry and company, we found that returns were higher for the company factor (where the company factor was the question of whether a company actively appoints independent directors). As for women’s empowerment, here also, portfolios which include corporations promoting women’s empowerment in their composition were found to gain higher returns.

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In this paper, we focus on three structural factors that drive currency markets, namely carry trade, trend, and value. We compare two models for predictive accuracy of a covariance matrix of these factors and perform a comparative analysis on returns based on different methods of portfolio construction. As a result, we find that the predictive accuracy of the covariance matrix is improved by cDCC-GARCH compared to the rolling approach. Our analysis also reveals that using cDCC-GARCH, an equal risk contribution strategy shows higher risk-return efficiency and lower drawdown than other strategies, which indicates its relative stability as an investment strategy in currency markets.

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