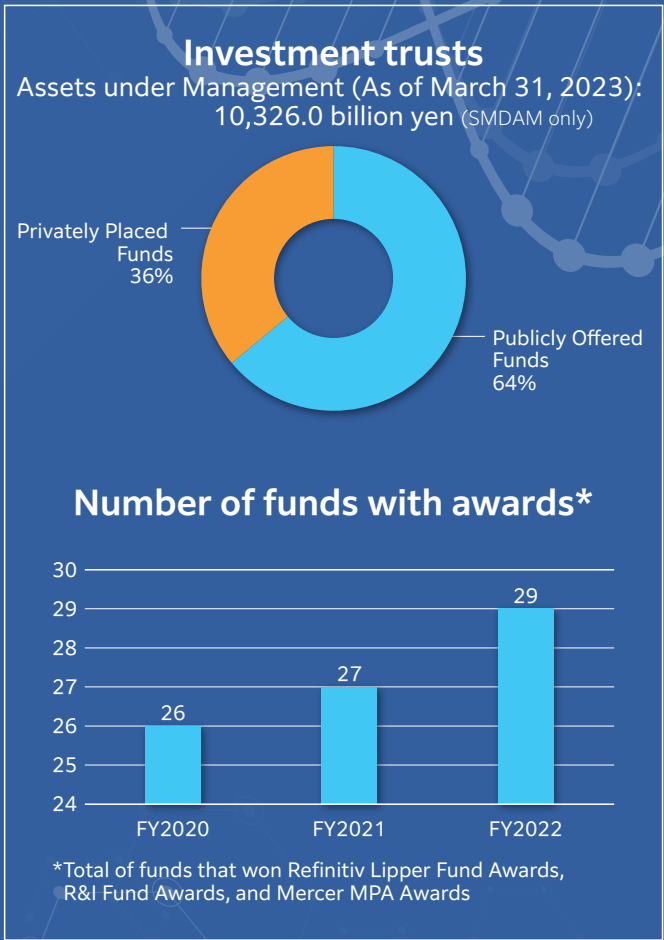
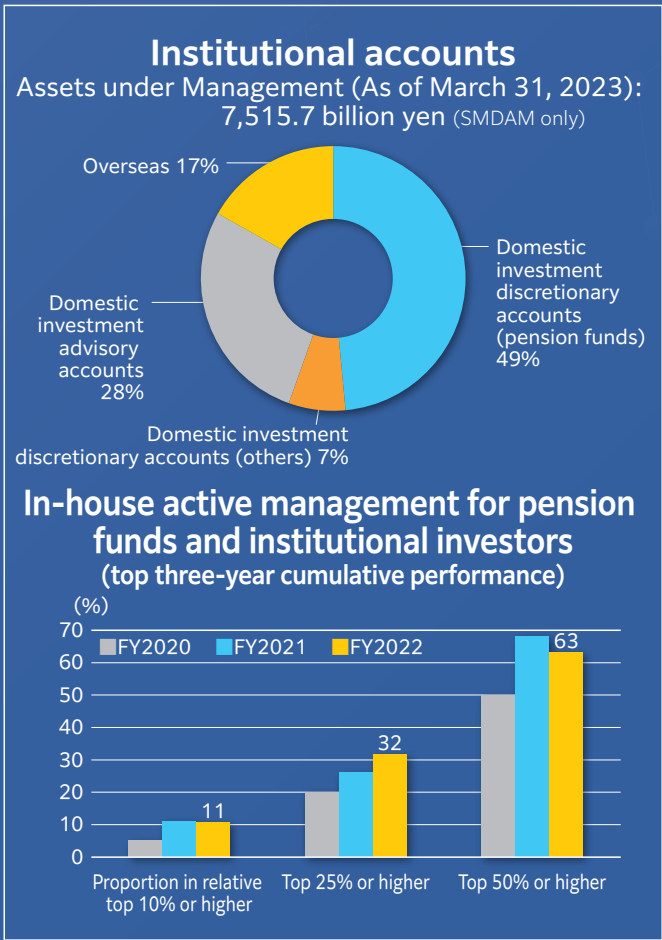


# Progress in Sustainable Investment Management

We are working to enhance our investment management capability, in order to offer good-quality excess returns to our customers on a long-term basis through investment management.

## Contents

SMDAM ESG Evaluation and Utilization	36
Message from the Head of Investment Management Division	37
Aiming to Provide Sustainable Added Value	39
JP Equity Value +a Group Initiatives	40
ESG Evaluations for SMEs	41
2030 Vision for the Investment Development Group	42
ESG Integration in Japanese Fixed Income	43
ESG Integration in Global Fixed Income	44
ESG Dialogue in the Engagement Investment Group	45
Sustainable Product Development in the Alternative Investment Department	46
Day in the Life of a Fund Manager	47
Statement on Principal Adverse Impacts of Investment Decisions on Sustainability Factors	49
Disclosure Based on TCFD recommendations	51
Important Precautions	53



## Our ESG Evaluation and Utilization Methods

We have multiple ESG scoring systems matched to the investment requirements of each product, in order to enhance our ESG integration. In terms of our perspective for ESG score classifications, our assessments correspond to the characteristics of domestic/overseas, corporation size, and asset class. In this section, we provide some case studies related to our utilization of ESG scores, based on specific examples.

### Overview of ESG Evaluations

There is a tradeoff between detailed evaluations and broad coverage of companies. In order to complement this tradeoff, we have developed multiple ESG scoring systems suited to different applications. One of our strengths is our substantial research system, which we have developed through our experience in active investment. We prioritize detailed ESG scores particularly from an investment perspective.

Comprehensive scores are our representative ESG scores (for companies covered by our research analysts in Japan). A notable characteristic of these scores is that they are detailed evaluations based on two axes, “analyst evaluations,” which incorporate factors such as forecast contributions to earnings from ESG-related products and services by analysts in our Investment Department, and “basic evaluations,” in which analysts from the Responsible Investment Section evaluate the level of corporate ESG promotion systems and information disclosure. Additionally, we have also developed in-house ESG evaluations (Core), based on our strength in investing in SMEs, and we began using these evaluations in FY2021.

### Features and Specific Examples of ESG Evaluations

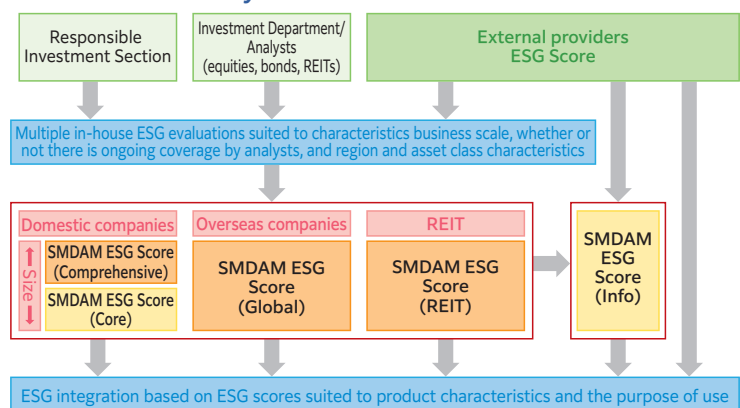
Our evaluations are based on two axes, enabling multifaceted evaluations from combinations of these factors, including evaluations for each of “analyst evaluations” and “basic evaluations,” as well as evaluations based on the total of these evaluations, and comparisons of “analyst evaluations” and “basic evaluations.”

As an example of how we utilize these scores when focusing on the difference between “analyst evaluations” and “basic evaluations,” if the “analyst evaluation” is greater than the “basic evaluation,” we may find that there is room for improvement in the future. “Basic evaluations” are evaluations of current circumstances based on disclosed materials, whereas “analyst evaluations” incorporate future forecasts. As a result, in cases such as those described above, we can predict a future increase in the “basic evaluation.” We support the materialization of an enhancement in corporate value at such companies through an increase in their market recognition, by encouraging active engagement related to information disclosure.

### Our Views and Future Initiatives

We have seen a rapid spread in ESG, and there has been notable progress in corporate initiatives over the past few years. A few years ago, appointing multiple outside directors was a challenge, but now it has more or less become standard for companies to have at least one-third outside directors, and it is anticipated that they will form a majority in the future. Additionally, from the perspective of diversity, we are also seeing progress on the appointment of female directors. Based on these circumstances, it is important that we regularly review our ESG scoring items and levels, in order to ensure our ESG scores remain up to date. In addition, I feel that an issue related to the tradeoff between detailed evaluations and broad coverage of companies, as mentioned at the start of this section, is the creation of a system that can combine both depth and breadth. There has been a notable increase and accumulation of ESG data that can be utilized, thanks to progress on the disclosure of information related to ESG by companies and an expansion in ESG data providers. We aim to balance depth and breadth by effectively utilizing this information.

#### SMDAM ESG Score System



**Hideki Kawanabe**  
General Manager, Responsible Investment Section

## Message from the Head of Investment Management Division

その一歩で、  
未来は変えられる。 **Be Active.**

In FY2023, SMDAM launched “Challenge and Change for 2030,” our new medium-term management plan. Based on our medium-term vision, we are pursuing sustainability in the Investment Management Division, while also working to strengthen our systems from a medium- to long-term perspective and effectively utilize human resources, and thereby enhance our investment management capabilities.

### Sustainability from the Perspective of Head of the Investment Management Division (Three layers of sustainability)

#### 1 Sustainability in the investment management process

The most important requirement for the Investment Management Division in an investment company is the creation of systems that can maintain good quality investment products over a very long timeframe, in other words, the execution of measures to guarantee the sustainability of existing investment processes. Additionally, many good-quality products require sustainability over a period in excess of decades, usually beyond the length of a single person’s career. For this reason, I think that securing capable human resources and passing on investment management knowledge are major issues.

#### Challenge and Change to solve issues

- ◆ Ensure detailed descriptions of investment processes and ongoing improvement, as well as the accumulation of those records, for all investment processes
- ◆ Build succession plans for investment professionals. At the same time, also appropriately allocate human resources
- ◆ Appropriate management of investment limits
  - Sustainability refers to important measures to ensure we can continue providing investment excess returns over the long term
- ◆ Spread awareness and share knowledge of existing investment processes
  - Hold fund manager seminars where each fund manager explains their own investment philosophy and processes to young employees

#### 2 Investment Management Division sustainability

A sustainable Investment Management Division is a result of ensuring that each individual investment process is sustainable.

I believe that, in order to achieve this objective, the development of new investment processes and investment strategies is a key issue. Our current main investment processes must have been new in the past, and were created as the result of some new initiative, research, or perspective.

Unfortunately, it has been observed as a rule of thumb that, over time, some investment strategies lose their meaning for some reason or other. The Investment Management Division will eventually decline if we just maintain our existing investment processes.

#### Challenge and Change to solve issues

- ◆ Explore hypotheses and incorporate hypotheses to create new investment strategies
  - Hypotheses created by fund managers and analysts
  - Hypotheses created from investment development research
  - Absorb external knowledge and add our own inventive measures
- ◆ Brush up our existing investment engine
  - Revise it to suit new customer segments and distribution channels
  - Take on the challenge of active ETFs
  - Develop solution-type investment processes suited to specific risk-return profiles required each time

## Wataru Ogihara

Deputy President Executive Officer, Head of Investment Management Division

### 3 Investment company sustainability

A sustainable investment company is a result of ensuring that the Investment Management Division and each individual investment process are sustainable. As a company, we face various issues, many of which are due to our internal culture and accumulation of existing practices, and it is likely that there are also many issues that we are not even aware of internally. This means we may not notice that we face the risk of a decline in efficiency or stagnation.

#### Challenge and Change to solve issues

- ◆ Conduct engagement with senior management of SMDAM by the Responsible Investment Section
  - Utilize knowledge obtained in engagement with listed companies
  - Expect to contribute to our own sustainability by evaluating SMDAM as an operating company

### Viewpoint of the Investment Management Division in the Medium-term Management Plan

**Be Active.**

**We will strengthen our active investment processes, an area where we are already competitive, while also fostering a corporate culture of actively taking on the challenge of new investment domains. In this way, we will build an investment organization is solid and sustainable on a long-term basis.**

In our three-year medium-term management plan, which began in April 2023, we have positioned the “further enhancement of investment performance and expansion of new investment domains” as our first pillar, and we are focusing on further improving the quality of our investment products and enhancing our line-up of good-quality products.

#### Further enhance investment performance and expand new investment domains

- Acquire and maintain performance in the top tenth percentile in areas where we compete, and establish a brand as an asset management company of the highest quality
- Expand investment domains for in-house investment, including global, multi-asset, and alternative assets, while also identifying and offering top-class investment products on a global basis in outsourced investment
- Practice stewardship and ESG activities to balance the acquisition of investment returns and a sustainable society

### 1 Offer top-quality investment products

We aim to offer investment results that exceed the expectations of customers in each domain, and have set forth the target of “acquiring and maintaining performance in the top tenth percentile.”

#### [Main initiatives]

- ◆ Focus on maintaining and improving quality in all investment products and achieve relative superiority within the same domain
- ◆ Enhance our investment process and secure further investment performance through strengthening our global research, developing various types of engines that actively utilize advanced technologies such as AI, and other methods
- ◆ Appropriately manage investment limit amounts to ensure the quality of active investment

### 2 Expansion of investment domains

In each asset class – global, multi-asset, and low liquidity alternative assets – we will focus on expanding the domains where we offer in-house investment, while also working with external partners to identify and offer investment products that are both top-class and scarce.

#### [Main initiatives related to global assets]

- ◆ In global equities, strengthen our capabilities for identifying promising themes and investee companies by restructuring and building systems for equity research in a cross-regional manner
- ◆ In global fixed income, strengthen our systems for investment and research of global credit fixed income, including high yield bonds, in order to enhance our credit risk management capabilities

#### [Main multi-asset initiatives]

- ◆ Provide high-quality products and expand advisory services to educational corporations, individual investors, etc.
  - ▶ Begin offering the “Hirogin Fund Wrap Service ‘MY GOALS’” through The Hiroshima Bank, Ltd.
- ◆ Establish a global macro strategy investment team and create products that aim to generate high absolute returns

#### [Main initiatives in low liquidity alternative assets]

- ◆ In addition to our ability to offer a diverse range of products, strengthen our gatekeeper operation systems by enhancing fund analysis systems and increasing the number of personnel, while also expanding classes of potential customers by further enhancing the products that we handle, enhancing our products for individual investors, etc.
- ◆ Collaborate with shareholder companies and affiliated companies internally and externally to focus on expanding our range of in-house investment products into new domains such as environment-related, overseas infrastructure, and equity crossover investment
  - ▶ Offer in-house infrastructure debt investment products through collaboration with the SMBC Group
  - ▶ Begin considering an investment fund that specializes in the hydrogen field, together with the Japan Hydrogen Association

[https://www.smd-am.co.jp/news/news/2023/news\\_20230324/](https://www.smd-am.co.jp/news/news/2023/news_20230324/)



### 3 Continuously practice stewardship and ESG activities to balance the acquisition of investment returns and a sustainable society

- ◆ For our ESG evaluation methods, we will redevelop our structure to facilitate evaluations across asset classes, market capitalizations, and regions, thereby enhancing the effectiveness of our evaluations in investment decisions
- ◆ For engagement, we will prepare a collection of best practices based on materiality. At the same time, we will ensure thorough management of phases of dialogue with companies, thereby supporting ESG initiatives and promoting the enhancement of corporate value



## Aiming to Provide Sustainable Added Value ~ Product management ~

その一歩で、  
未来は変えられる。 **Be Active.**

In order to accelerate our planning and promotion of business strategy related to investment products, we established the new Product Management Department in April 2023. Ayaka Ishida of the Investment Solution & Marketing Department spoke with Yoshiharu Takeda, General Manager, who manages the Product Management Department, about the background to the establishment of his department and its future initiatives.

### Background and Objectives of the Establishment of the Product Management Department

**Ishida** Please tell us about the background to the establishment of the Product Management Department.

**Takeda** Our Mission & Vision is to contribute to improving the Quality of Life (QOL) of our stakeholders, and we aim to forecast changes in the environment surrounding our customers from a long-term perspective, and continuously provide added value. This department was established to enhance our planning and execution capabilities in relation to these kinds of long-term business and product strategies.

**Ishida** I think the establishment of the Product Management Department has the potential to change the business model of SMDAM. Are there any signs of change in this regard?

**Takeda** Opportunities have increased for long-term discussion of strategy between employees. One role of our department to envision the future and create new things. We are also discussing new business models while forecasting the impact of social, economic, political, and legal changes, as well as technical innovation, on financial markets and our customers.

### Product Management/Project Management/Solution Services

**Ishida** What are the characteristics of product management at SMDAM?

**Takeda** Our target is to continuously offer added value by adopting a comprehensive view of our product portfolio and rearranging it to create a portfolio for the future. Based on this target, we will establish company-wide projects and take on the challenge of developing highly novel in-house investment products. Additionally, we will also participate in product governance to verify the status of individual products.

**Ishida** What kind of initiatives are you implementing in order to develop products from a customer's perspective?

**Takeda** The definition of good performance differs depending on customers' approaches and investment objectives. Accordingly, we clarify our expected customer and results from products when setting investment targets, and emphasize the sharing of this information with the persons responsible for investment. Additionally, we are also focusing on solution services to offer investment services suited to the issues and needs of our individual customers.

### Brand Management ~ Collaboration with the Investment Department ~

**Ishida** How do you come up with strengths for SMDAM's products?

**Takeda** As forms of communication with customers change in line with social and technological changes, we have established the "Be Active" service brand, and are directly communicating the value that SMDAM can offer. To ensure that customers experience our unique value at the product level, we are brushing up the content that we share and the ways that we share it.

**Ishida** Is there anything that you hope for from the Investment Department?

**Takeda** At SMDAM, we have in-house investment products with a great track record. To ensure that our customers trust us and feel attached to SMDAM, we must repeatedly think about and enhance the value of our products. We intend to work together with the Investment Department to explain our focus and sincerity concerning our investment philosophy and investment methods in a way that is easy to understand.

### New Issues and Future Direction

**Ishida** Please tell us about current issues and your future ambitions and direction.

**Takeda** One issue that we face is putting the necessary pieces together to be the "best asset management company contributing to Quality of Life," which is what SMDAM is aiming for. Another role of our department is the creation of new things by connecting things together. We will put the pieces together by connecting things within SMDAM, sometimes with things from outside the Company, and thereby contribute to improving our stakeholders' QOL.

**Ishida** I understood the role of the Product Management Department well. Thank you for your time today.



**Yoshiharu Takeda**

General Manager of the Product Management Department  
Motto: "Karma"

**Ayaka Ishida**

Marketing Promotion Team,  
Investment Solution & Marketing Department  
Motto: "Thank those who help you"

## JP Equity Value +a Group Initiatives ~ Aiming to create new value ~

### Enhancing the Efficiency and Sophistication of In-House AI

The Value +a Group in the Investment Department is applying an original AI engine developed in-house by that department's Investment Development Group to the management of Japanese equity funds (for details, please refer to last year's Sustainability Report).

As an initiative launched in 2022, we first created a system to obtain AI scores (scores from an AI evaluating the text of financial results summaries) as an output. This system features a simple user interface and enables users to easily check historical AI scores for individual stocks and generate charts. We have made improvements as needed, such as fine-tuning methods of obtaining data and displaying moving average charts, as part of our efforts to

enhance the efficiency and sophistication of our AI engine and system. Additionally, we have accumulated a number of successful examples of stock selection utilizing AI scores, so we verified its effectiveness in both quantitative and qualitative terms. We have collaborated internally to prepare documents based on the results of this analysis, and are making proposals to investors in funds that utilize AI scores.

For our next development, we have begun planning a system for analyzing and scoring textual data other than summaries of financial reports. We will continue combining the knowledge of fund managers with AI and promoting the development of highly effective and efficient investment systems.

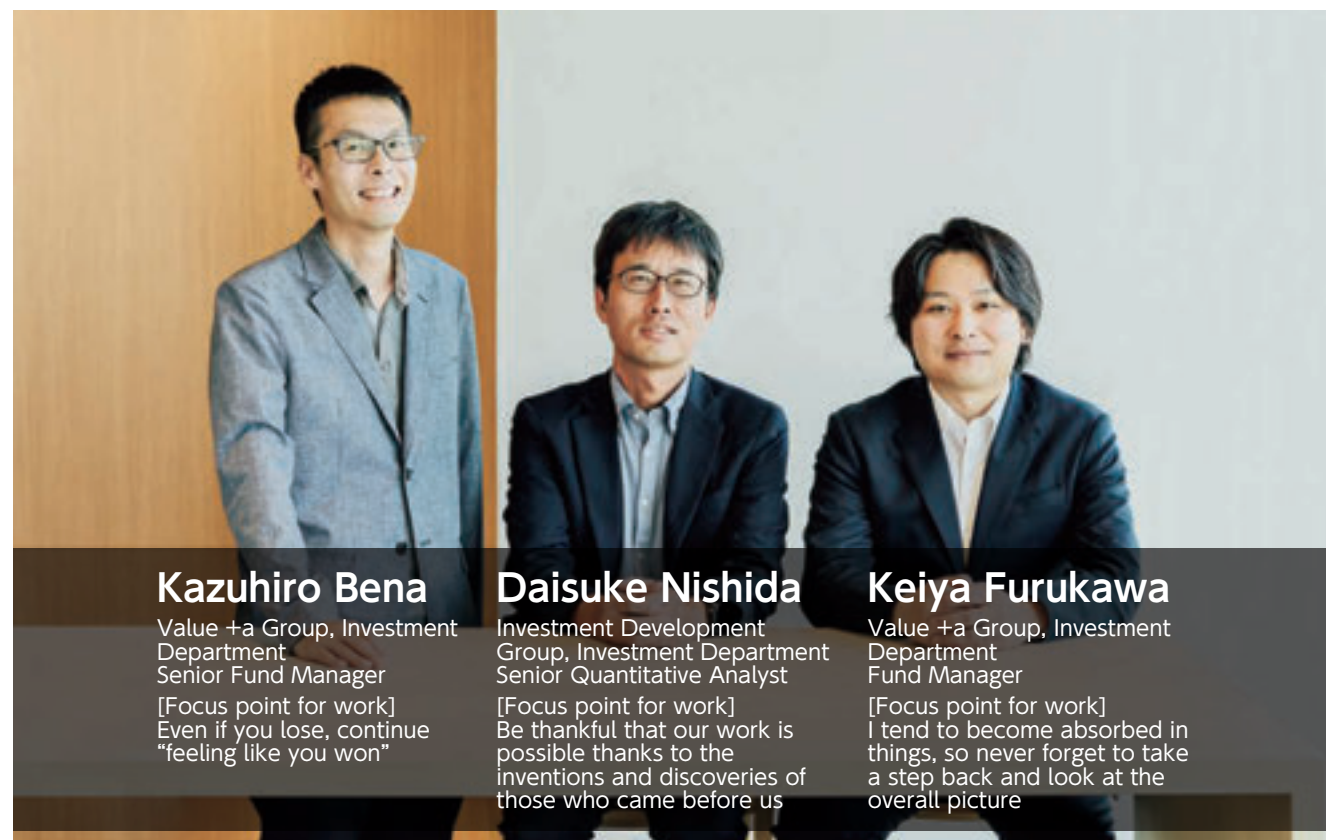
### Enhancing Corporate "Ability to Create Social Value" ~ Impact Investment ~

At the end of March 2023, we issued our first impact report. In addition to explaining our Japan impact investment strategies in a way that is easy to understand, we also focused on the ability to apply impact scores and engagement retroactively, which could be described as key to this process. When listing impact scores, we compare them with the market. We showed the excellent ability of our portfolio to create impact. Additionally, we also provided information on what issues we raised in dialogue as part of engagement activities, and the verification of the results of those activities. We even took care with small details, such as the cover design and illustrations, to communicate information more effectively, so please read it.

The most important thing for impact reports will be that we keep issuing them. This fiscal year, we intend to follow up on changes in companies' creation of impact over the past year, which we introduced in the first issue, from both a negative and a positive perspective. Additionally, we are considering enhancing the content of these reports through, for example, introducing many examples of engagement activities over the past year that are of significant interest for our customers and providing articles about our visits to plants and research laboratories. Please watch out for future developments.

Please view the reports on the SMDAM website.

[https://www.smd-am.co.jp/corporate/responsible\\_investment/esg/integration/table/pdf/2022-2023\\_impact\\_report.pdf](https://www.smd-am.co.jp/corporate/responsible_investment/esg/integration/table/pdf/2022-2023_impact_report.pdf)  
\*Japanese only



**Kazuhiro Bena**

Value +a Group, Investment Department  
Senior Fund Manager

[Focus point for work]  
Even if you lose, continue  
"feeling like you won"

**Daisuke Nishida**

Investment Development Group, Investment Department  
Senior Quantitative Analyst

[Focus point for work]  
Be thankful that our work is possible thanks to the inventions and discoveries of those who came before us

**Keiya Furukawa**

Value +a Group, Investment Department  
Fund Manager

[Focus point for work]  
I tend to become absorbed in things, so never forget to take a step back and look at the overall picture



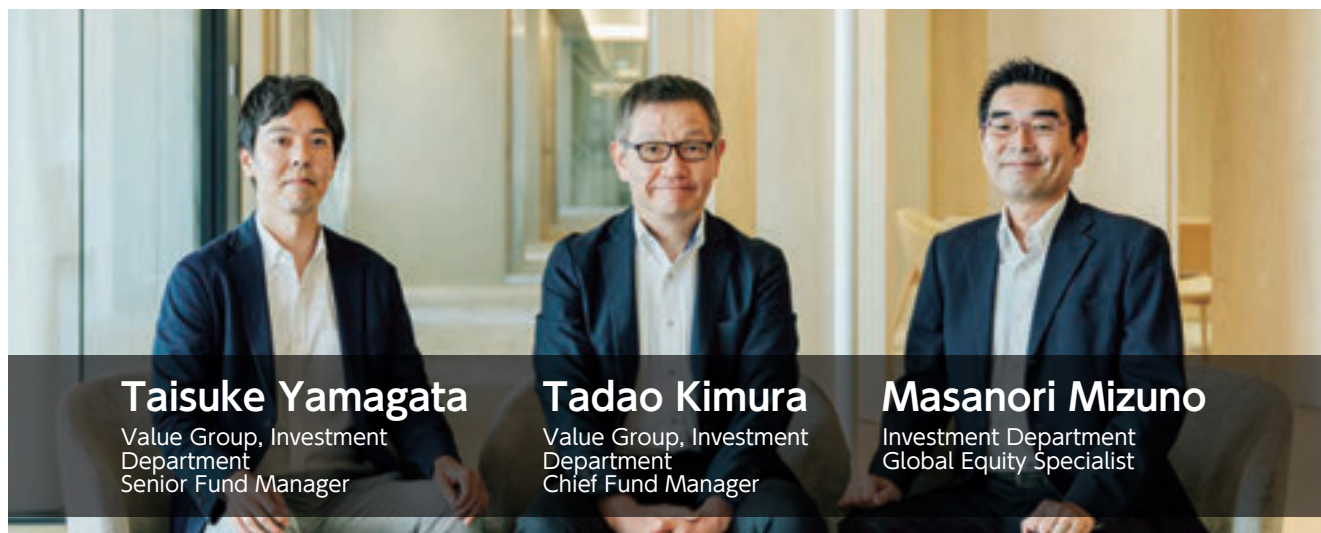
**Ayako Watanabe**

Investment Department  
Value +a Group  
Senior Fund Manager

[Motto]  
Effort, spirit, reward.  
Dawn always comes.

## ESG Evaluations for SMEs

~ Universal “standards” shared around the world are continuing to evolve ~



**Taisuke Yamagata**

Value Group, Investment  
Department  
Senior Fund Manager

**Tadao Kimura**

Value Group, Investment  
Department  
Chief Fund Manager

**Masanori Mizuno**

Investment Department  
Global Equity Specialist

### “The Tide Has Changed” – Experiencing It Through Our Own Evaluations

Over the past year, there has been a clear change in listed companies in Japan, including small and medium-sized growth companies. This is mainly due to the fact that the Tokyo Stock Exchange has shared a clear measure that companies should “work toward management that is conscious of the cost of capital and the share price,” as well as the fact that the disclosure of sustainability information is now required in annual securities reports, etc.

When we began ESG evaluations, they seemed to be polarized, but recently, we feel the scores have been converging. Overall, evaluations appear to be rising, and we are likely seeing a similar trend to the current improvement in the situation related to companies with a P/B ratio of less than one.

### Wanting to Praise Corporate Efforts to Go One Step Further

This is a good trend, but if we are not careful about how we phrase things, we may end up in a situation where companies are “doing the bare minimum and not making

progress.”

Of course, because fund managers themselves are performing ESG evaluations, they are sometimes aware of the efforts of individual companies, and in an increasing number of cases, we sense through our engagement that companies want to grow together with us.

**Kimura** “Going forward, we want to praise companies that aim for a higher level”

We express this hope in dialogue with companies, but we believe that future efforts will be important. It is a similar situation to the situation with P/B ratios, where it is not enough just for companies to regain a ratio of one.

### Want to Actively Increase the Impact on Investment Decisions

We select stocks based on our proprietary corporate valuation models, and also reflect ESG scores in a quantitative manner. Although this information has long been included in comprehensive risk analysis, we have “visualized” risk by clearly taking it into consideration in

We have developed in-house ESG scores (Core), which are granted by fund managers themselves, in partnership with the Responsible Investment Section, mainly for SMEs. These scores are reflected quantitatively in our corporate valuation models, which we depend on for stock selection.

For information about previous developments in this regard, please refer to page 32 of the “Sustainability Report 2022-2023.”

our ESG evaluations.

We are still in the trial-and-error stage, but we would like to actively increase the impact of differences in ESG evaluations on corporate valuations. Initially, we began with fairly low sensitivity to these evaluations, partly because we did not have a solid sense of them, but we have continued our efforts to enhance the accuracy of our evaluations. Companies have also taken the initiative in specializing in specific fields, etc., and through dialogue we have felt that the number of companies that are actively focusing on ESG activities is increasing.

**Yamagata** “I think now is when we will highlight our engagement activities. Responding to ESG will contribute to enhancing corporate value, and I intend to actively encourage companies, to ensure this serves as a source of further motivation.”

Praising “companies that aim for a higher level” reflects our strong desire to take an active investment stance toward such companies.

### Advancing our ESG scores (Core)

- Reflect negative impact in ESG scores (Core)
- Partly revise our evaluation standards for ESG scores (Core), in line with the spread of information disclosure based on the TCFD recommendations

## 2030 Vision for the Investment Development Group

~ Judgments that only a human can make, at a level beyond human capabilities ~

### A Society Where the Utilization of AI is a Common Practice

How to utilize ChatGPT and other AIs has been the subject of debate in many situations. Generative AIs give us the answers that we need when we give them instructions. Accordingly, it seems companies in all industries, even within Japan, are considering the introduction and utilization of AI.

So how can we use the generative AIs for investment? We cannot currently entrust final investment decisions to an AI, but they can provide materials that help us make decisions.

For example, when we asked ChatGPT (GPT-4), “Who is the Prime Minister of Japan?,” the response was that the Prime Minister as of September 2021 was Yoshihide Suga. If we just ask it in a normal way, it will not tell us the name of the current Prime Minister. Sometimes, depending on how we ask it, it will not give the name of the current Prime Minister. This is because, in general, the knowledge (learning) of ChatGPT stops at the point in the past where it was trained in advance. In asset management, we work not just with universal matters and historical facts, but also with information that is changing every moment.

In fact, however, there is already a way to make ChatGPT refer to the latest information. If we make a system that matches the way we use this tool, it will be very powerful.

### Investment Development Group Initiatives

AI technology can be used in various processes, from information gathering to investment decisions. It is important that we consider where we can utilize AI technology in actual investment operations, and also how we can achieve this at low cost.

In the Investment Development Group, we are always considering ways to use this technology that match frontline operations, while listening to the wishes of people responsible for those operations. For example, we have created a system that creates a list of information from various sources that fund managers, etc., want to review for potential investment candidates, then quickly proposes a list of companies to visit for corporate analysis based on accumulated expertise and the latest information. If we use generative AI for such systems, it will increase the accuracy of proposals. Other systems that we offer include one that shares alerts for negative media reports in local languages from around the world, and one



**Takehide Hirose**

Investment Development Group,  
Investment Department  
Group Head

[Motto] Virtue attracts

In recent years, AI has been developing at a pace where it will outstrip the ability of humans to make judgments. In the future, we may enter an age when AI proposes its own investment decisions. In the Investment Development Group, we have been utilizing such AIs to provide support to enable fund managers to concentrate on their own value creation.

that finds stocks related to attractive investment themes. In this way, we are considering ways to advance our operations by utilizing AI technology, while listening to the needs of colleagues in actual operational settings.

In joint research with a university, we are also studying how generative AIs respond to issues in actual operations. Internally, there are a very large number of parameters and structural choices, and we do not know what factors to combine in what ways to make these systems effective. In order to use AI in actual operations, we must decide on AI models that match our reasons for using them through significant trial and error. We are constantly exploring studies and research directions to achieve that aim.

### Future Vision for Asset Management Operations

I believe that systems where generative AIs that reference investment expertise accumulated in actual investment operations interpret new information and teach the necessary information to investors are already at a technically feasible level.

In the future, it appears likely that each fund manager will

be able to enjoy the benefits of some form of AI support on a daily basis. It will still require time, however, until AI makes final investment decisions. AIs must be able to process and understand “new information,” have “specialist financial knowledge (including unique investment expertise),” and be able to understand “signs for the future that link information and actual society.”

We intend to work every day to enable us to utilize the latest technologies in actual operations, in order to incorporate technological progress that enhances operational efficiency, and furthermore, to “make judgments that only a human can make, at a level beyond human capabilities.”



## ESG Integration in Japanese Fixed Income

In our fixed income investment, we are focusing on ESG integration, mainly to reduce long-term refinancing risk and enhance the robustness of performance. At SMDAM, we are utilizing a machine learning model that uses ESG scores in the selection of corporate bonds, while also working to enhance the effectiveness of engagement. In the future, we will strengthen our analysis and monitoring of ESG bonds.

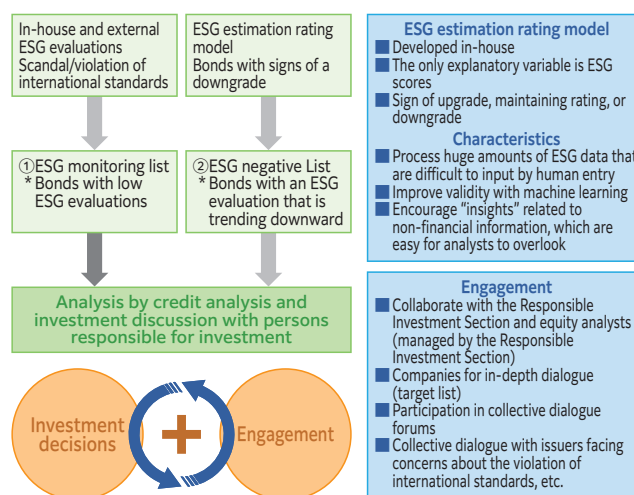
### Security Selection Process Utilizing ESG Estimation Rating Model

One notable characteristic of our domestic credit investment management is the fact that we incorporate quantitative judgements based on an ESG estimation rating model developed in-house in our process for assessing the creditworthiness of individual bonds. In terms of our credit strategy, we believe that detailed monitoring at the individual bond level affects our performance because the prices of bonds for which events have occurred fluctuate in a discontinuous manner. In addition to industry relative valuations, specific factors, and our unique indicators for assessing credit, such as the R rating, which shows the level of tail risk, we also use this model to monitor credit risk by creating regular lists of issuers with signs of a downgrade, and issuers with a low third-party or in-house ESG evaluation.

We position these lists as encouraging “insights” related to non-financial information for credit analysts, who focus on financial information. They only provide materials for use in bond analysis and investment information, and decisions on whether or not the possibility of a downgrade or default will increase are left up to the analyst or person responsible for investment.

In meetings, we use the ESG analysis of responsible analysts as a starting point for determining an investment policy, adjusted for investment professionals’ own analysis and interpretation.

There have been an increasing number of cases when, even though an analyst has judged that the direct financial impact will be limited, persons responsible for investment have contributed to performance by quickly selling bonds based on their prioritization of the wrongfulness of ESG events and the impact on spreads.



### Engagement that is Also Effective for Credit Investment

We regularly verify the validity of our ESG estimation rating model, and endeavor to maintain its accuracy. We believe, however, that engagement is an effective method to maintain and improve the creditworthiness of more long-term investee companies.

The Responsible Investment Section summarizes the status of our engagement activities, and shares this information at “Stewardship/ESG meetings,” cross-departmental meetings with members including the Responsible Investment Section, Investment Department, and responsible officers. In addition to specific examples of dialogue by credit analysts, in FY2022, we began an initiative to encourage improvement in corporate actions by identifying investee companies with significant room for improvement on ESG issues in our domestic credit universe, and conducting in-depth dialogue on specific topics with these companies. We are gradually strengthening dialogue and collective



engagement in partnership with related departments within our company.

### ESG Bond Analysis and Monitoring as Essential Tools for Mitigating Refinance Risk At Maturity

In order to maintain and improve fund returns over the long term, we believe it is vital that we focus more earnestly on ESG bond analysis and monitoring, in addition to improving corporate value through fixed income engagement.

At present, there is no clear academic consensus on the superiority of ESG bonds in terms of performance, and we can say that prioritizing the ratio of investment returns to creditworthiness is a reasonable investment action. We cannot lose sight, however, of the fact that over the past year, there has been an acceleration in the trend among major institutional investors and banks around the world to reflect international standards and decarbonization initiatives in financing policies and criteria for the exercise of voting rights. At present, we have confirmed that there are already some industries where it is not easy for companies to issue ESG bonds, and the risk that long-term refinancing will be difficult if ESG bonds cannot be issued is becoming increasingly likely.

In order to avoid a loss of value in bonds held over the long term, we are developing systems to strengthen our ESG bond analysis and monitoring, in partnership with the Responsible Investment Section. Through such means, we intend to help enhance the robustness of the performance of our investment funds.

## ESG Integration in Global Fixed Income

Noriko Miyoshi  
Chief Investment Officer



### SMDAM ESG Scores (Global) to Reflect Negative Impact, Etc.

One notable characteristic of our overseas credit investment management is that we utilize in-house ESG evaluations. Our ESG scores (Global) are a framework for overseas companies managed by the Responsible Investment Section, in which we perform evaluations based on two axes, “basic evaluations,” which cover a wide range of non-financial information, and “analyst evaluations,” which focus on the factors that we consider important. “Qualitative assessments by analysts,” which are performed by staff working with foreign equities and overseas credit analysts, are our most important source of added value.

Additionally, we take steps to reduce bias and enhance objectivity by incorporating information from multiple external ESG rating institutions, etc., while also reflecting signals, reputational risk, etc., from alternative data, etc. We believe this acts as an input for fund managers, enabling them to quantitatively ascertain the level of ESG risk and changes in ESG risk, in a way that is comparable between industries and countries/regions, meaning it can easily contribute to investment actions.

### Disciplined Investment Process Utilizing ESG Assessments

In addition to ESG scores (Global), we also monitor representative external ESG evaluations, and submit reports concerning any issuers facing ESG issues to the Investment Policy Committee.

#### Examples of issuers that require reports to the “Investment Policy Committee”

- ① Issuers with low SMDAM ESG scores (Global)
- ② Issuers with low representative external ESG evaluations
- ③ Issuers for whom external institutions assess that there is a possibility of a violation of international standards
- ④ Issuers for whom external institutions assess that a material scandal has occurred
- ⑤ Candidates for exclusion from the scope of investment

Credit analysts consider the impact on the creditworthiness of the issuer in detail, and review indicators for assessing creditworthiness, such as internal ratings. Under this system, persons responsible for investment discuss whether or not to invest in the issuer with credit analysts, and reflect the results in their investment decisions.

### Prioritization of Direct Interviews and On-Site Research

Based on my experience of watching global credit markets over many years, I believe that dialogue is meaningful because it enables us to directly confirm issuers’ commitment to their ESG strategy. In order to confirm issuers’ commitment in this way, I myself, as Chief Investment Officer (CIO) have conducted on-site research with credit analysts, not just at issuers’ headquarters, but also at actual clean energy power plants, and I emphasize the implications from such research.

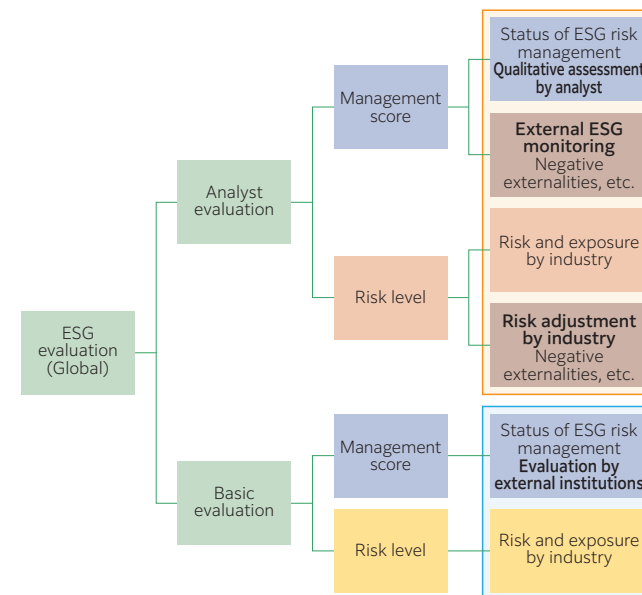
### Looking Closely at Issuers that Violate International Standards, Etc. Priority Engagement

We do not have a simple process for excluding companies where scandals occur and specific sectors from the scope of investment, but we engage in dialogue based on an engagement target list that emphasizes and prioritizes issuers about which there is debate concerning these topics, as well as negative externalities and ESG risk that is expected to be taken into consideration under SFDR. We regularly report the status of progress, etc., in this regard at “Stewardship/ESG meetings.” Working with our equities teams, who have voting rights, enhances our access to senior managers, and we also utilize collective engagement with external institutions, particularly for serious incidents such as violations of international

standards, to ensure there is no room for a conflict of interest. When there is no potential for improvement based on dialogue with an issuer, we may exclude them from the scope of investment across asset classes.

### Focusing on the Consideration of ESG Evaluations and Impact that will Continue to Contribute to Performance

In the US, we have seen a partial increase in opposition to ESG investment by institutional investors, etc., but we believe that even when selecting ESG investments, the importance of integrating ESG as a method for pursuing the “highest performance” remains unchanged. We will continue utilizing a disciplined approach and working to secure performance that meets the expectations of our customers and society.



■ “Analyst evaluation”  
SMDAM focuses on important areas  
: Different ESG issues for each industry  
: Evaluations based on corporate analysis and dialogue  
: Consideration of negative externalities, etc., based on rules

■ “Basic evaluation”  
Covers wide-ranging non-financial information  
: Quantification of financial materiality  
: Comparable across industries and countries/regions  
: Uses multiple ESG rating institutions

## ESG Dialogue in the Engagement Investment Group

~ Creating a “win-win” relationship with proposals that contribute to the sustainable growth of investee companies ~



In the Engagement Investment Group, we have continued engaging in dialogue with a focus on management issues specific to investee companies since we began investing in 2016. Amid such efforts, there has been an increase in the number of companies that are accepting and implementing our engagement proposals.

**Shunpei Yoshimura**

Fund Manager, Engagement Investment Group,  
Investment Department\*

\* At the time of writing. Currently assigned to the Value  
Group, Investment Department

Things valued in work:  
Curiosity. Investigate, look into, and try everything

### Changes in Corporate Actions Contribute to Improvements in Corporate Value

In the Engagement Investment Group (this “Group”), we perform engagement activities, mainly with companies that are highly competitive in their businesses, but are not sufficiently valued by equity markets because of some management issue or a lack of appeal to markets. We aim to secure excess returns by encouraging such companies to change their corporate actions.

In our engagement, we conduct detailed research in advance, then identify any management issues through meetings with the company. Additionally, in this Group, we make proposals that will contribute to sustainable growth and build “win-win” relationships with companies, instead of pursuing unsustainable short-term profits, advocating solely for stronger shareholder returns, or other such proposals.

Our engagement covers a wide range of themes, including business management, organizational management, and information disclosure, but ESG initiatives and their disclosure are major themes.

### “Is ESG Related to Improving Corporate Value ?”

ESG is often described as “non-financial information,” and sometimes we meet managers who think about ESG separately from business strategy. We often receive questions from such managers about the significance of focusing on ESG and its contribution to corporate value. In our view, ESG is “not yet financial information.” We consider it an extremely effective framework for formulating long-term management strategy, and we encourage change in corporate action by informing managers of its effectiveness.

Within ESG, thinking about “E (= Environment)” requires an understanding of megatrends such as decarbonization, problems surrounding waste disposal, and the

conservation of water resources. Accordingly, it contributes to exploring business opportunities and risks. “S (= Social)” also means management resources that support business management and strengthening supply chain management, while “G (= Governance)” refers to appropriate strategy and the creation of systems capable of refining and executing investment projects. Accordingly, ESG refers to medium- to long-term management strategy itself.

When discussing ESG with managers from this perspective, they express us that they want to utilize it because it seems it will be useful for managing their own management resources and formulating strategies, and we are thus promoting engagement on how to incorporate ESG into management, including organizational systems.

### Reconfiguring Information That Already Exists and Incorporating It in Strategy and Corporate Stories

In this Group, we also perform engagement aimed at enhancing the disclosure of ESG information. There are also many companies where the basic elements necessary for ESG disclosure exist in expertise and data accumulated within the company, and qualitative information that has already been disclosed. In some cases, reconfiguring this information and incorporating it in strategies and corporate stories contributes to finding solutions.

Additionally, there are also companies that have not been sufficiently evaluated by ESG rating institutions, despite disclosing ESG information. For such companies, we focus on engagement aimed at improving their evaluation by telling them points where they should improve their disclosure, etc.

Going forward, we will continue engagement to contribute to enhancing the corporate value of investee companies, etc., thus fulfilling our fiduciary responsibility by improving investment performance.

## Sustainable Product Development in the Alternative Investment Department



As efforts to achieve net-zero emissions by 2050 accelerate around the world, the range of potential investments is becoming increasingly diverse. The need for risk avoidance is also growing as climate change risk becomes increasingly pronounced. In this section we introduce some of SMDAM's initiatives related to new social needs.

From image top left

**Akihiro Sato**  
General Manager assigned to the Alternative Investment Department

**Aoi Yokota**  
Project Investment Group, Alternative Investment Department Fund Manager

**Miyu Iwakura**  
Project Investment Group, Alternative Investment Department Assistant Fund Manager

**Nobuhisa Fukumi**  
Project Investment Group, Alternative Investment Department Senior Fund Manager

From image bottom left

**Yukari Hara**  
Project Investment Group, Alternative Investment Department Fund Manager

**Haruhiko Takamoto**  
Project Investment Group, Alternative Investment Department Head

**Masahiro Tobata**  
Project Investment Group, Alternative Investment Department Senior Fund Manager

### Outline of Infrastructure Debt Funds and Recent Initiatives

Our Infrastructure Debt Funds supply funds for infrastructure projects (electric power, gas, transportation, etc.) that are essential for society and the economy, in the form of financing (debt). We offer attractive investment opportunities by linking the asset management needs of investors with the funding needs of infrastructure projects. We invest globally, meaning that we are contributing to the promotion and development of infrastructure projects in various countries around the world. We also invest in renewable energy projects such as solar and wind power, enabling us to contribute to the reduction of CO<sub>2</sub> emissions, a major issue in recent times. Recently, we have been considering a system for visualizing the positive social effects of projects that we invested in. Through such initiatives, SMDAM is pursuing new value for investors.

### Establishment of investment Funds to Popularize Hydrogen

Together with the Japan Hydrogen Association (JH2A), we are preparing to establishment an investment fund that aims to promote the popularization of hydrogen in Japan from a financing perspective. Hydrogen is attracting attention around the world as a form of energy that does not emit CO<sub>2</sub> when used, and investment funds specializing in the hydrogen field have already been established in Europe, resulting in active investment in hydrogen projects. With amendments to the Basic Hydrogen Strategy in June 2023, there has also been an acceleration in efforts to achieve a hydrogen society in Japan, which is expected to result in a further increase in the need for funding in the hydrogen field. Through the establishment of this fund, we intend to contribute to the realization of a hydrogen society in Japan and the achievement of carbon neutrality, by supplying the necessary funds for hydrogen in all stages, including its "creation," "transportation," "storage," and "usage."

### Fund for CAT bonds, the Subject of Growing Focus

Our company has been managing a CAT bond (Catastrophe Bond) fund in-house since 2014, based on investment advice received from Mitsui Sumitomo Insurance. CAT bonds are insurance-linked securities that securitize disaster risk related to natural disasters, pandemics, and other events that have a low probability of occurrence but cause enormous damage when they occur. They provide a mechanism for insurance companies, etc., to transfer their own disaster risk to investors on capital markets, instead of paying insurance premiums. For investors, CAT bonds are attractive for the following reasons.

- They can secure relatively high yield premiums
- They are not very correlated with traditional assets because the acquired risk, which is the source of returns, differs

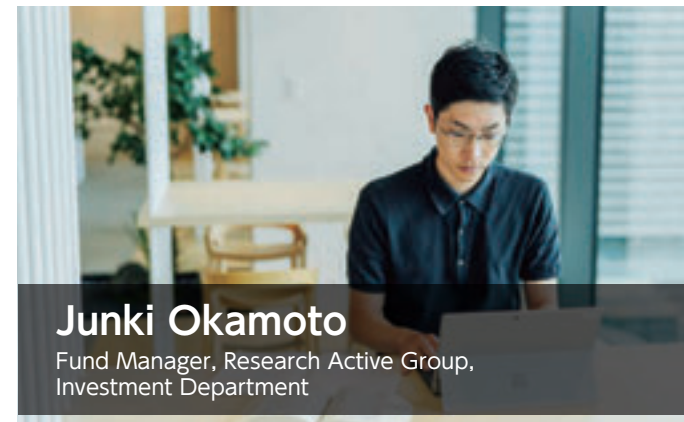
If a major disaster occurs, part (or all) of the principal of the CAT bond is allocated to the recovery of the region affected by the disaster. This means CAT bonds have an ESG aspect, in that they provide finance in the event of disaster, and have thus been attracting growing attention in recent years.

## Day in the Life of a Fund Manager

Four young fund managers told us about their “day-to-day” work and how they spend their time off work.

### Finding small and midcap shares with major potential

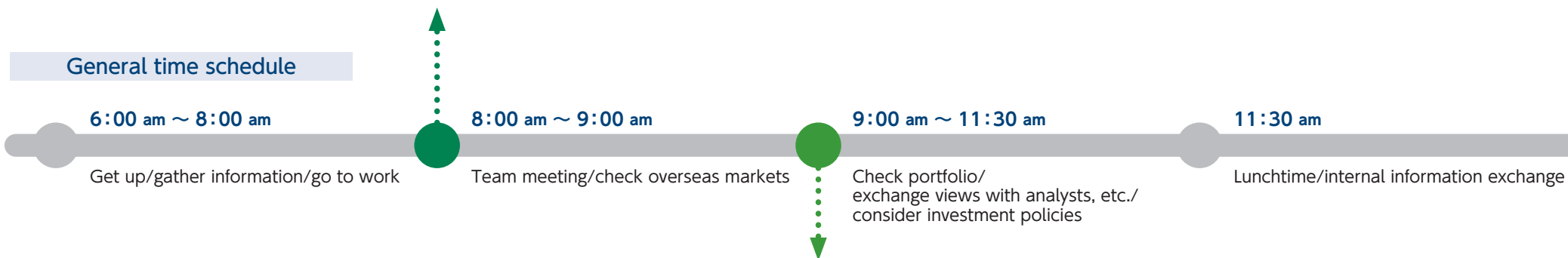
In my team, we invest in small and midcap shares that are currently undervalued but have the potential for major change. In order to find such companies, it is important to quickly notice any unexpected changes in the company or the external environment. We look for signs of change from various perspectives, such as interviews with companies, exchanging views with analysts who are very knowledgeable on industry trends, reading quarterly company handbooks, and finding insights in daily life. At present, we mainly gather information manually, but we aim to leverage IT skills to find opportunities for investment more broadly and efficiently. Additionally, we also oversee investments for overseas customers, so we place importance on initiatives related to ESG and the SDGs. I will further refine this aspect of my work by strengthening dialogue with investee companies and cooperation with the Responsible Investment Section.



**Junki Okamoto**

Fund Manager, Research Active Group,  
Investment Department

### General time schedule



**Rihoko Takanohashi**

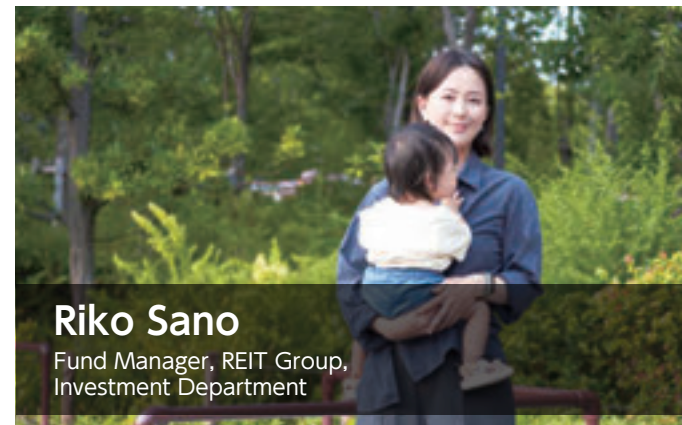
Fund Manager, Equity Quantitative Group,  
Investment Department

### As a passive fund manager

As a passive manager, I am entrusted with primary oversight over a number of funds. In the funds that I am responsible for, I engage in portfolio management, including the formulation of investment policies and cash management. In passive fund investment, I place importance on “staying humble,” and I take care in this regard. The important thing with passive funds is how to limit costs while achieving correlation with the benchmark. In addition to daily checks of funds for divergence from benchmarks, I also endeavor to ensure nothing unexpected happens, particularly by paying close attention when preparing for rebalancing. Additionally, I spend my days endeavoring and exploring how to make choices that contribute as much as possible to funds, while utilizing the characteristics of our team operation, even for a single acquisition or other corporate action. In the future, I intend to utilize the knowledge I have gained in passive fund investment to participate in product development, etc.

### Balancing investment management work and childcare

I work as a REIT fund manager and analyst. In April 2023, I returned to work full-time, and I have daughters aged three and one. I am able to balance home and work thanks to the understanding toward my home environment in the workplace and the fact that I can work flexibly. Both my husband and I were able to take one year of childcare leave, which meant that naturally we shared housework and childcare tasks. Even after returning to work, if one of our children is sick and we are unable to get a reservation for sick child daycare or a babysitter, my husband and I talk about it, and one of us works from home or takes leave. It is likely there will also be times when I need to suddenly go home early because my child is sick, so we always share work within the team to ensure tasks do not become attached to specific people, and I feel like communication between team members has naturally increased as a result. By the way, it is helpful to me that when I take my children out in the stroller, there are barrier-free spaces and diaper changing stations in commercial facilities, etc. Actual experiences such as these have reinforced my feeling that I want to support the social initiatives of REIT companies.



**Riko Sano**

Fund Manager, REIT Group, Investment Department

1:00 pm onward

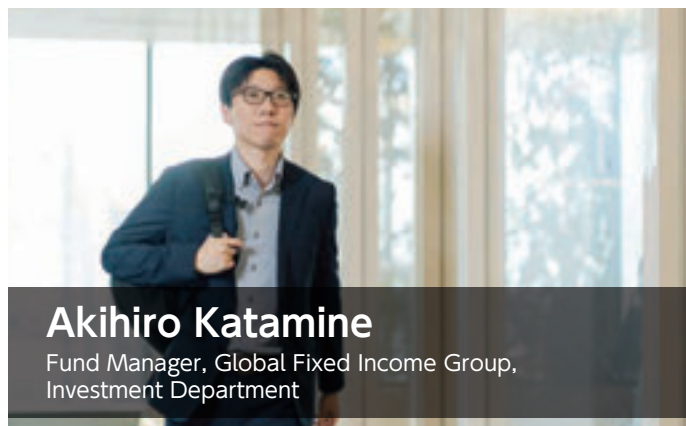
External meetings, check portfolio/consider investment policies

3:00 pm

(Use flextime) Go home/meet child at daycare/childcare

5:00 pm

Leave work/research activities at graduate school



**Akihiro Katamine**

Fund Manager, Global Fixed Income Group, Investment Department

### Balancing research at graduate school and fund manager work

Since FY2023, I have been attending graduate school after work. At present, I am mainly working on the foundations for research, and I attend classes almost every weekday evening, while also completing assignments and revising topics after I go home and at weekends. The understanding and cooperation of my team helps me balance these activities with work. While working on overnight trades, members of my group have adjusted my work and taken care to ensure I am in time for my classes. There are also almost ten people in the Company who have finished this course, and it is a very reassuring environment, including opportunities for sharing information. At graduate school, I am learning not just traditional finance theories, but also mathematical understanding and verification methods using programming, which will contribute to cutting-edge research. It is not just about developing the ability to make decisions based on a quantitative approach. Instead, by developing an understanding of the latest research by authorities in each country and new academic investment methods, etc., I aim to utilize this knowledge in my actual work.

## Statement on Principal Adverse Impacts of Investment Decisions on Sustainability Factors

We believe that it is our natural responsibility as an asset management company to consider the Principal Adverse Impacts (PAIs) of companies on the environment and society, as well as sustainability risk on investee companies from the environment and society. In order to fulfill this responsibility, we endeavor to document our approach and policies related to the consideration of PAIs, and promote knowledge-sharing within the Investment Management Division.

### Our Mission & Vision and Basic Policy on ESG Investment

In Our Mission & Vision, we clearly state that Our Mission is to “contribute to a diversified and sustainable society through our investment activities” and “aim for collective growth, based on a respectful understanding of all stakeholders.” In our “Basic Policy on ESG Investment,” we have established that we will consider the impact of investee companies on environmental and social sustainability (sustainability risk) and the PAIs of investee companies, in all investment products in our asset management operations.

### Identification of PAI and Assignment of Priority Order

We have identified six high priority indicators that are deeply related to materiality in our asset management operations and for which it is relatively possible to obtain data, from among the indicators for the voluntary disclosure of PAIs set forth in the EU Sustainable Finance Disclosure Regulation (SFDR). Together with 14 essential indicators, we monitor these 20 indicators and regularly disclose related information.

### Consideration of PAIs in Our Investment Processes

#### ① Negative screen based on international standards

We perform engagement activities with companies that have violated international standards, etc. For details, please refer to P32.

#### ② Consideration of PAI indicators

In relation to sustainability risk and PAIs at investee companies, we believe that taking into consideration both other financial and non-financial factors will contribute to securing long-term risk-adjusted returns. At present, however, many of the indicators that we monitor are only disclosed by a small number of advanced companies. While following the development of international

#### PAI indicators continuously monitored and disclosed by SMDAM

Indicator①	GHG emissions	Indicator⑧	Emissions to water	Indicator⑮	Investment in companies without carbon emission reduction initiatives
Indicator②	Carbon footprint	Indicator⑨	Hazardous waste and radioactive waste ratio	Indicator⑯	Water usage and recycling
Indicator③	GHG emissions intensity of investee companies	Indicator⑩	Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	Indicator⑰	Lack of supplier code of conduct
Indicator④	Exposure to companies active in the fossil fuel sector	Indicator⑪	Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Indicator⑱	Insufficient whistleblower protection
Indicator⑤	Share of non-renewable energy consumption	Indicator⑫	Unadjusted gender pay gap	Indicator⑲	Lack of human rights policy
Indicator⑥	Energy consumption intensity per high impact climate sector	Indicator⑬	Board gender diversity	Indicator⑳	Lack of anti-corruption and anti-bribery policies
Indicator⑦	Activities negatively affecting biodiversity sensitive areas	Indicator⑭	Exposure to controversial weapons		

disclosure rules, we request that investee companies enhance their information disclosure.

#### ③ Continuous process

We continuously analyze investee companies' sustainability risk and PAIs based on information obtained through engagement, either independently or collectively with other institutional investors, and dialogue, etc., with NGOs and other stakeholders. The results of analysis are shared internally in the form of analyst reports, ESG scores, etc., thus supporting the investment decisions of investment teams.

### Engagement and Escalation

Companies that have a PAI on the environment and society face the risk of future damage to their corporate value through punishments owing to violations of laws and regulations, a loss of trust of consumers, etc. From the perspective of avoiding such risk, we endeavor to perform engagement that encourages companies to quickly rectify issues.

If there is no prospect for improvement even after continuous dialogue, we adopt a strict stance toward actions related to social trust, such as those that do not respect a harmonious relationship with stakeholders, when exercising voting rights. Furthermore, if no improvement can be confirmed in relation to particularly significant

matters, we may consider excluding the company from the scope of investment based on our Management Rules Concerning Companies Not Suitable for Investment, etc.

### Collective Engagement and Initiative

In order to make engagement more effective and efficient, we perform collective engagement through participation in initiatives in Japan and overseas.

### Knowledge-sharing Initiatives

Following the enactment of the SFDR in the EU, there has been an increased expectation that asset management companies will contribute to the creation of a sustainable society. In response, we have been implementing internal knowledge-sharing initiatives related to PAIs, led by the Responsible Investment Section. Specifically, these initiatives include disclosure for persons responsible for investment, such as an overview of the SFDR and other laws and regulations and information on GHG emissions, water, gender, diversity, and other individual themes, the regular issuance of “PAI reports” that explain practical guidelines, etc., for our investment operations, and seminars with external specialists.

## Monitoring and disclosure/reporting

We have selected seven indicators from among target indicators for corporate monitoring of PAIs related to our portfolio. We have also listed one indicator that covers countries/regions.

Indicator subject	Essential/voluntary	Theme	PAI	Indicator definition	Indicator	Major negative impact	Response measures
Company	Essential item	Climate and other environment-related indicators	GHG emissions	GHG emissions attributable to investment measures based on the percentage held	26.8 million tons	No	Conduct research together with the Responsible Investment Section, while investment teams perform engagement with a focus on climate change, either individually or collectively. Engage in dialogue requesting high-quality disclosure, such as the acquisition of CDP scores or SBT certification. (Note)The indicator on the left refers to Scope 1-3 emissions, calculated based on Sustainalytics data. Disclosure based on the TCFD recommendations differs from the original data.
			Carbon footprint	GHG emissions per million euros of investment	663.00 tons/million euros	No	
		Social and employees, respects for human rights, anti-corruption, and anti-bribery matters	Non-compliance with international standards* *Principles of the UN Global Compact and the OECD Guidelines	Proportion of portfolio of investee companies that violated international standards	0.65%	No	Respond by excluding from the scope of investment based on screening for international standards at the company-wide level. Utilize Sustainalytics international standards engagement to engage in dialogue. For active investment, we have set a target of 0%.
			Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Proportion of portfolio of investee companies that do not monitor international standards	58.96%	No	It is said that many Japanese companies have insufficient monitoring, but many are companies with high external ESG evaluations. Through engagement, either independently or collectively, we promote the disclosure of information related to compliance with international standards by investee companies.
			Board gender diversity	Average of "number of female directors ÷ total number of directors" weighted by market capitalization, for investee companies	22.41%	No	We submit votes opposing proposals for the election of directors for companies listed on the TSE Prime Market with no female directors. Furthermore, because we a member of the "30% Club", we encourage companies to increase the proportion of female directors.
			Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	Proportion of portfolio of companies manufacturing and buying/selling inhumane weapons	0.00%	No	We designate companies that engage in the manufacture, purchase, or sale of inhumane weapons, as defined by treaties ratified by Japan, as companies not suitable for investment, etc., and we prohibit the holding of these companies, in principle.
	Voluntary item	Climate and other environment-related indicators	Investments in companies without carbon emission reduction initiatives	Proportion of portfolio of companies with transactions with companies with no relation to initiatives aimed at achieving the Paris Agreement	45.89%	No	The issuers with a lack of measures are all major Japanese companies with high external ESG evaluations. We believe that these companies should execute sufficient measures to eliminate any concerns of major negative impact.
Country/region	Essential item	Social and employees, respects for human rights, and anti-corruption	Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	Investee countries that violate international treaties and agreements	0.00%	No	In active investment, we impose limits on investment in sovereigns, etc., that violate social standards. We added Russian and Belarusian government bonds, in relation to the invasion of Ukraine.



## Disclosure Based on TCFD recommendations

### Indicators and Targets

SMDAM has established interim targets for 2030 based on our commitment to NZAMI ("Setting an Interim Targets for 2030 Based on Commitment to the Net Zero Asset Managers Initiative" [https://www.smd-am.co.jp/english/pressrelease/2023/NewsRelease\\_20230227\\_E.pdf](https://www.smd-am.co.jp/english/pressrelease/2023/NewsRelease_20230227_E.pdf)).

In addition to monitoring the status of progress related to interim targets that have been set, we are also endeavoring to expand coverage of our AUM.



#### [NZAMI Targets]

Item	Explanation	Notes
Scope	GHG emissions from the SMDAM portfolio	
Indicator	Carbon footprint	Indicators such as weighted average carbon intensity are also monitored as reference indicators.
Target	Net zero emissions by 2050 Reduce by half compared with end-March 2021 by 2030	Reference date: March 31, 2021; 96tCO <sub>2</sub> e/million USD Measurement date: March 31, 2023; 74tCO <sub>2</sub> e/million USD
Scope	Scopes 1 and 2	We also monitor indicators including Scope 3 emissions at investees. We plan to consider setting targets for Scope 1-3 emissions at investees, based on the progress of data disclosure at investees.
Coverage	Equivalent to 54% of SMDAM AUM (end-March 2022)	If the scope of assets for which GHG emissions can be calculated under international standards grows, SMDAM will appropriately expand the scope of applicable AUM.

#### [Information about TCFD disclosure]

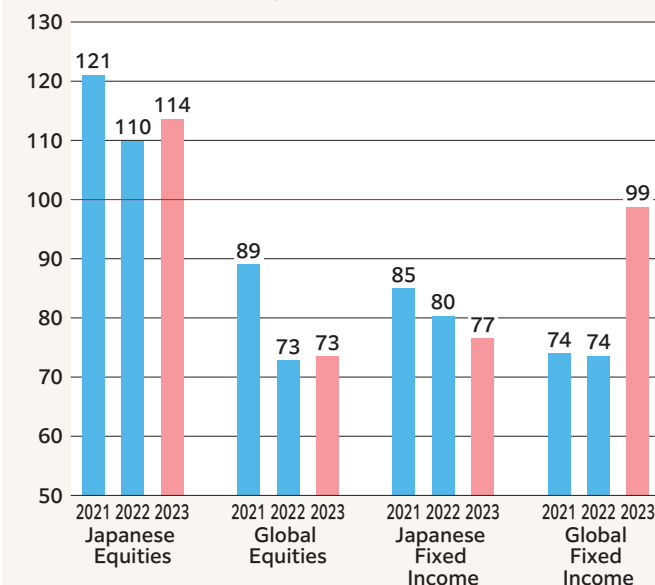
Item	Explanation	Notes
SMDAM portfolio	Japanese equities, global equities, Japanese fixed income, and global fixed income, managed in-house by SMDAM or externally-consigned	From 2023, AUM externally consigned to funds of funds (FOFs) have been added to the scope of applicable assets.
GHGs	Greenhouse gases	Carbon dioxide, methane, dinitrogen monoxide, specified fluorine compounds
Portfolio GHG emissions	Total GHG emissions linked to portfolio	$\Sigma$ [GHG emissions of issuers × (Value of issuer holdings) ÷ {(Issuer market cap) + (Total issuer interest-bearing debt)}]
Carbon footprint	GHG emissions per million USD portfolio value under the TCFD recommendations	Portfolio GHG emissions ÷ Portfolio value Carbon footprint for Japanese and global fixed income excludes government bonds, local government bonds, and government institution-related bonds.
Weighted average carbon intensity	Weighted average by holding weight of carbon intensity of each investee company	$\Sigma$ [(Issuer GHG emissions) ÷ (Issuer net sales)] × [(Value of issuer holdings) ÷ (Portfolio value)]
Carbon intensity	GHG emissions per million USD of net sales of investee companies	Portfolio GHG emissions ÷ $\Sigma$ [(Issuer net sales) × (Value of issuer holdings) ÷ {(Issuer market cap) + (Total issuer interest-bearing debt)}]
Benchmark	TOPIX for Japanese equities, MSCI Kokusai for global equities, Nomura-BPI for Japanese fixed income, and Bloomberg Global Aggregate Ex-Japan for global fixed income	
Scope	Scopes 1-3	

### SMDAM Portfolio Status

#### GHG emissions from the SMDAM portfolio (Figures 1 and 2)

A comparative analysis of our carbon footprint (Scopes 1-3) against benchmarks for each asset class shows that while results for Japanese equities exceeded benchmarks, results for global equities and Japanese fixed income fell below them. This was impacted by the fact that value equities make up a relatively large portion of our Japanese equities portfolio, and we are overweight in capital goods and materials sectors, which emit large amounts of GHGs. The large increase in the carbon footprint of our global fixed income was due to an increase in our investment exposure to India and other emerging markets, in line with the expansion of the scope of calculation to include externally consigned FOFs.

**Figure 1** SMDAM portfolio by asset class  
Carbon footprint (as of March of each year)



The benchmark for each year is set at 100  
(Source) Prepared by Sumitomo Mitsui DS Asset Management based on MSCI data  
Please refer to Disclaimer on page 54.

**2 Analysis of Transition Risks and Physical Risks in Portfolio (Figure 3)**

Using the “CVaR” analysis tool supplied by MSCI, we performed an analysis of the transition and physical risks in our portfolio.

The purpose of this analysis of multiple scenarios is to quantitatively ascertain the potential loss of value in our portfolio from climate change stress. More so than extracting accurate forecast figures, it is designed to enable us to draw up a future image of a scenario in which we subject our portfolio to stress without taking sufficient action.

The changes from the results of last year’s analysis are as follows. We believe that changes to MSCI’s evaluation models had a significant impact.

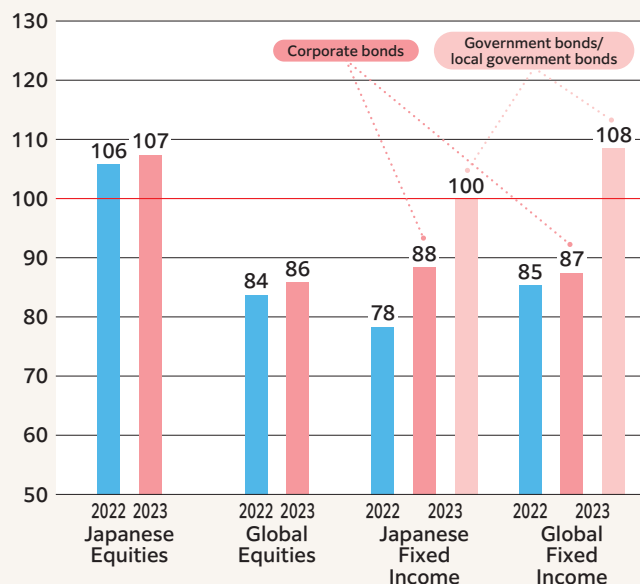
The risk of loss in the value of our portfolio increased compared with the previous year under the strictest scenario, where the rise in temperatures by 2100 is limited to 1.5°C.

Transition risks	Technological opportunities	The result of easing under the 1.5°C was reduced to +2.6% (+9.3% in the previous year).
	Policy risks	The risk of value loss related to Scope 3 emissions (supply chain emissions) under the 1.5°C scenario grew to -7.6% (-4.0% in the previous year).
Physical risks		The risk of value loss related to excessive heat under the 1.5°C scenario grew to -9.1% (-5.7% in the previous year).

**3 Analysis of Conformance of Portfolio with Paris Agreement (Figure 4)**

For the implied temperature rise index, we indicate conformant climate change target estimates in “C” units based largely on the GHG emission targets that our investee companies have committed to. We have arrived at the result that 64% (49% in the previous year) of our portfolio will be conformant with the 2°C scenario under the Paris Agreement in the future. On the other hand, investee companies that will not be conformant with the Paris Agreement at all under existing plans (the area indicated by the red line graph) constitute just 10% of our portfolio (16% in the previous year). We encourage investee companies to acquire SBT 1.5°C target certification, and this analysis indicates the success of these activities.

**Figure 2** SMDAM portfolio by asset class  
Weighted average carbon intensity (as of March of each year)



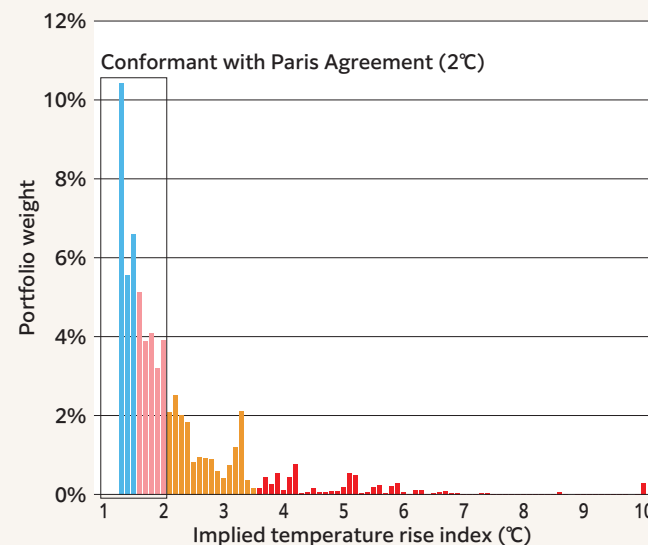
The benchmark for each year is set at 100  
(Source) Prepared by Sumitomo Mitsui DS Asset Management based on MSCI data  
Please refer to Disclaimer on page 54.

**Figure 3** Potential loss of value of portfolio by temperature rise scenario (as of March 2023) (%)

Asset class	Scenario	Companywide portfolio		
		1.5°C	2.0°C	3.0°C
Transition risks		-11.3	-7.8	-2.4
Policy risks	Scope 1	-5.4	-4.8	-2.2
	Scope 2	-0.8	-0.4	-0.2
	Scope 3	-7.6	-3.8	-0.5
Technological opportunities		2.6	1.3	0.5
Physical risks (by cause)		-17.9	-17.9	-22.1
Excessive heat		-9.1	-9.1	-11.1
Coastal flooding		-7.1	-7.1	-8.8
Typhoons		-1.8	-1.8	-4.2
Heavy rain		-1.0	-1.0	-1.5
Flooding		-0.6	-0.6	-0.8
Rivers overflowing		-0.2	-0.2	-1.1

(Source) Prepared by Sumitomo Mitsui DS Asset Management based on MSCI data  
Please refer to Disclaimer on page 54.

**Figure 4** Distribution of implied temperature rise index (°C) (as of March 2023)



(Source) Prepared by Sumitomo Mitsui DS Asset Management based on MSCI data  
Please refer to Disclaimer on page 54.

## Important Precautions

### Precautions Related to Investment Advisory Contracts and Discretionary Investment Management Contracts (Risks and Expenses)

#### Risks related to investment advisory contracts and discretionary investment management contracts

Financial products and financial derivatives products that are invested in under discretionary investment management contracts or for which investment is advised under investment advisory contracts may incur losses due to fluctuations in interest rates, currency values, market prices on financial instruments markets, or other financial indicators.

The variable factors include the risk of price fluctuations in marketable securities and other instruments, the credit risk of issuers and other bodies, the risk of fluctuations in interest rates and financial markets, and liquidity risk, specifically, the inability to execute transactions under conditions of sufficient liquidity. (Foreign denominated assets are also subject to foreign exchange risk.)

The client's investment principal, therefore, is not guaranteed, and a loss of principal may be incurred if the value of financial instruments or other assets declines.

When margin transactions or futures/options transactions (hereunder "derivatives transactions") are used in connection with investment of assets under management, the derivatives transactions amount may exceed the amount of the customer margin or other guarantee money (hereunder "customer margin, etc."), and losses exceeding the customer margin, etc. may be incurred as a result of fluctuations in interest rates, currency values, market prices on financial instruments markets, or other financial indicators.

Customer margin, etc. amounts and calculation methods vary depending on the transaction's circumstances and counterparty, so it is not possible to indicate the ratio of the derivative transactions amount to the customer margin, etc. amount.

#### Fees and commissions on investment advisory contracts and discretionary investment management contracts

##### Investment management fee

A fixed management fee is charged for investment advisory contracts and discretionary investment management contracts. It is calculated by multiplying the contract asset amount (the base amount used to calculate investment advisory fees) by a rate\* set in advance.

\* This rate varies depending on the provisions of the contract with the client, investment conditions, and other factors, so it cannot be stated in advance. The details of contract asset amounts and calculation methods are determined separately in consultation with the client. Depending on the contract's provisions, an incentive fee may also be charged in addition to the aforementioned management fee.

##### Other fees and commissions

The following fees and commissions are charged in addition to the aforementioned investment advisory fees.

- (1) Trading commissions for financial products charged on assets under management
- (2) Reserves for trust assets and the trust fees and trust administrative expenses\* deducted from trust assets when investments are made in investment trusts in accordance with discretionary investment management contracts.
- (3) Management fees and incentive fees to foreign investment managers, management and custodial fees to investment trust management and custodial companies, trustee fees, audit fees, and other investment trust management expenses deducted from trust assets when investments are made in foreign domiciled investment trusts in accordance with discretionary investment management contracts.

\* In the case discretionary accounts invest in investment trusts various expenses include the audit expenses of investment trusts.

As the actual amount of these commissions, etc. are determined based on the specifics of transactions, etc., and are recognized as expenses whenever incurred or billed, or fluctuates depending on the status of investments, etc., the maximum amount and calculation method of these commissions, etc. cannot be stated herein.

The upper limit and calculation method, etc. for the total amount of the aforementioned investment advisory fees and other fees and commissions charged to the client cannot be indicated herein for the reasons stated above.

Note: The above risks, fees, etc. differ depending on the specifics of contracts and the status of investments, etc. Therefore, before entering into a contract, please confirm written documents prior to concluding the contract.

As of September 30, 2023

#### For institutional account clients

- These materials have been prepared for the purpose of introducing information on some of the products that we are capable of providing. They do not constitute a disclosure document in accordance with the Financial Instruments and Exchange Act of Japan.
- The risks and returns described herein are calculated based on historical data, our current outlook for the economy, and other factors, and do not constitute a guarantee of future risks or returns.
- Data on rates of returns not from actual funds, including that from simulations described herein, does not include compensation, transaction fees, rebalancing costs, etc. incurred in actual fund management.
- The investment products and methods described herein do not guarantee future investment performance or principal, and it is possible that investments will incur losses. All investment outcomes, including losses, are attributed to the client.
- Market projections and other forward-looking statements described herein are opinions as of the time these materials were prepared and do not constitute a guarantee of future trends or results. They may not be reflected in current investment policies and may change in the future without notice.
- Third-party evaluations described herein are based on analyses of past performance over a certain period of time and do not constitute a guarantee of future investment results, etc.
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- Reference may be made to individual stocks herein. However, this is for illustration purposes and may not necessarily indicate that those stocks will be invested in. Additionally, this does not constitute a recommendation of these stocks.

## Precautions Related to Investment Trusts (Risks and Expenses)

### Risks related to investment trusts

The prices of investment trusts fluctuate because they are affected by the price movements of the securities included in them (foreign currency denominated assets are also subject to exchange rate fluctuations). Losses may be incurred when prices decline, and this may result in a loss of principal.

All gains and losses generated by a fund from its investments are attributed to the beneficiary. Unlike bank deposits, investment trusts do not guarantee principal and also do not guarantee any particular investment performance.

### Expenses related to investment trusts

Customers need to pay the following expenses related to investment.

#### ■ Expenses charged directly

Transaction fee: **Up to 3.85% (tax included)** Redemption (cancellation) fee: **Up to 1.10% (tax included)** Redemption fee reserved as part of trust assets: **Up to 0.50%**

#### ■ Expenses incurred indirectly during the holding period of the investment trust

Trust fees: **Up to 2.255% annually (including tax)**

#### ■ Other expenses

The following fees and commissions are also paid out of trust assets: audit fees; brokerage commissions and other charges on traded securities; expenses for derivative transactions (including consumption and other taxes); and charges for the custody of assets overseas, etc. Some investment trusts also set incentive fees, and these fees are paid out of trust assets. If a fund invests in other funds, asset management fees and other expenses from those funds are incurred indirectly. Because these charges depend on the specifics of the transaction and other factors and because they change depending on investment conditions, upper limits and calculation methods cannot be specifically stated in advance.

\* The total amount of the abovementioned fees and commissions borne by clients, and their upper limits and calculation methods, cannot be stated specifically in advance because they vary depending on the client's holding period and other factors.

Caution : The above risks and expenses pertain to investment trusts in general. The rates listed are the highest applicable for their respective fees among the investment trusts we manage. Furthermore, as the risks and charges entailed by an investment trust vary from one trust to another, before making an investment the client is requested to read carefully all relevant items within the investment trust summary prospectus and the other documents provided prior to signing a contract.

Investment Trusts are unlike deposit/saving or insurance contract, not protected by Deposit Insurance/Saving Insurance/Policyholders Protection Corporation. In addition, when purchased through registered financial institutions, they are not covered by the Investor Protection Fund.

Please note that investment trusts cannot be redeemed or canceled during the closed period or on public holidays in Japan or overseas.

As of September 30, 2023

### For investment trust distributors and individual investors

- This document has been prepared by Sumitomo Mitsui DS Asset Management for the purpose of providing information.
- It is not intended to recommend or solicit the purchase or sale of any particular investment trust, life insurance policy, stock, bond, or other investment product.
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Report current as of November 17, 2023

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その一歩で、未来は変えられる。

 Sumitomo Mitsui DS Asset Management

Registration number: The Director of Kanto Local Finance Bureau (KINSHO) No. 399

Membership: The Investment Trusts Association, Japan /

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