

# Challenges and Impacts of Benchmark Indices in Emerging Markets

INVESTMENT FUNDS CONFERENCE  
CARTAGENA, COLOMBIA

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June 5th, 2014

## AGENDA

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01 **TRENDS IN INDEX INVESTING**

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02 **GROWTH OF EMERGING, LATAM AND MILA MARKETS**

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03 **DIFFERENT TRAJECTORIES OF GROWTH FOR LATAM COUNTRIES**

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04 **ANOMALIES WITH BROAD BENCHMARKS**

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05 **ALTERNATIVES TO BROAD BENCHMARKS**

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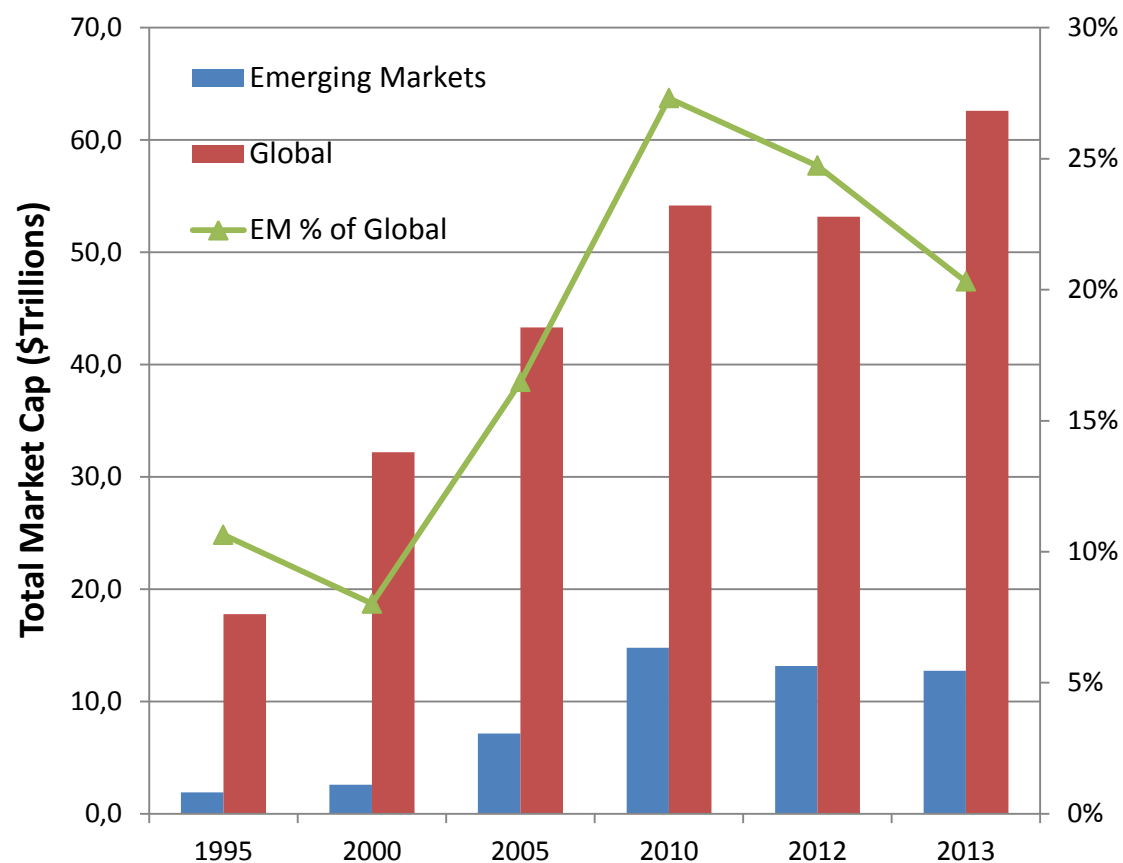
## INVESTING VIA INDICES

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- Index investing has grown exponentially in the last decade.
- Traditionally emerging markets were considered the bastion of active managers but in recent years with allocations to emerging markets becoming the norm, passive investing has seen a rise in this space too.
- Emerging markets investments via indices has grown rapidly too – according to a SSgA ETF report\* as of the end of 2013, \$255 billion was in emerging market ETFs alone with close to 800 ETFs focused on emerging markets.
- This does not include all the indexed emerging market assets but does provide an idea of the kind of fund flows that are driven by index changes to emerging markets.
- Traditionally investors have looked at broad benchmarks for emerging markets investing, recently more specialized indices have become the norm which provide a more focused investment story.

Source : \*SPDR University, 2014 ETF and Investments Outlook

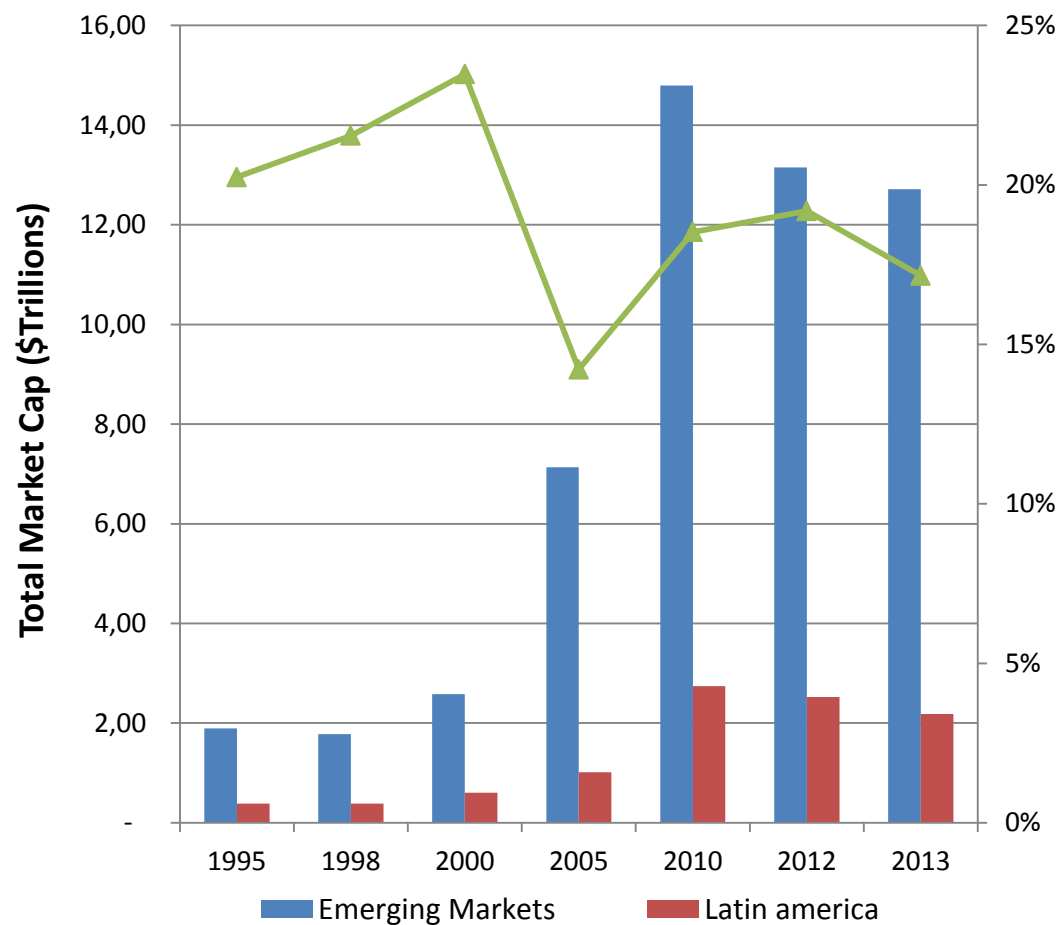
# GROWTH & DEVELOPMENT OF EMERGING MARKETS



- Emerging markets have grown more than 10 times their size since 1995.
- There has been pull back since 2009 but will remain strong for years to come.
- The broad picture does not give the full story.

Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

## GROWTH & DEVELOPMENT OF LATIN AMERICAN MARKETS



- Latin American markets have been rather volatile in the last 20 years
- The % share of LATAM in Emerging markets peaked at 24% in 2000 and has hovered around 17% since then.
- This does not show the full picture, since the market mix in this period has changed.

Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

# WEIGHTS IN EMERGING MARKETS BENCHMARKS

Data as of December 1995		
Country	Float Market Capitalization	Country Weight in S&P Emerging BMI
Argentina	13,125,176,078	3.00%
Brazil	55,670,806,553	12.74%
Chile	27,915,854,826	6.39%
China	2,880,517,428	0.66%
Colombia	4,556,854,880	1.04%
Czech Republic	2,697,985,963	0.62%
India	11,596,938,170	2.65%
Indonesia	15,810,223,251	3.62%
Israel	6,079,015,006	1.39%
Malaysia	90,495,311,758	20.71%
Mexico	35,292,286,426	8.08%
Pakistan	1,704,214,593	0.39%
Peru	3,508,614,715	0.80%
Philippines	12,542,508,703	2.87%
Poland	912,830,169	0.21%
South Africa	98,830,275,815	22.62%
Taiwan	16,815,057,425	3.85%
Thailand	30,602,402,946	7.00%
Turkey	3,969,526,680	0.91%
Venezuela	1,942,367,609	0.44%
Grand Total	436,948,768,994	100.00%

Data as of December 2013		
Country	Float Market Capitalization	Country Weight in S&P Emerging BMI
Brazil	469,525,774,269	11.57%
Chile	84,081,261,411	2.07%
China	989,331,151,380	24.37%
Colombia	59,534,014,410	1.47%
Czech Republic	10,422,375,104	0.26%
Egypt	12,902,758,465	0.32%
Hungary	10,923,839,638	0.27%
India	339,648,375,108	8.37%
Indonesia	104,995,911,508	2.59%
Malaysia	164,649,428,550	4.06%
Mexico	240,780,448,506	5.93%
Morocco	10,283,206,966	0.25%
Peru	26,842,126,638	0.66%
Philippines	65,233,009,446	1.61%
Poland	79,544,020,050	1.96%
Russia	288,286,038,028	7.10%
South Africa	329,022,081,604	8.11%
Taiwan	583,062,786,612	14.37%
Thailand	118,186,394,146	2.91%
Turkey	71,565,570,900	1.76%
Grand Total	4,058,820,572,738	100.00%

Source: S&P Dow Jones Indices. The S&P Emerging BMI was launched on Dec 31, 1997. Data shown prior to this date reflects back-tested , hypothetical data.

## WEIGHTS IN THE LATAM REGION

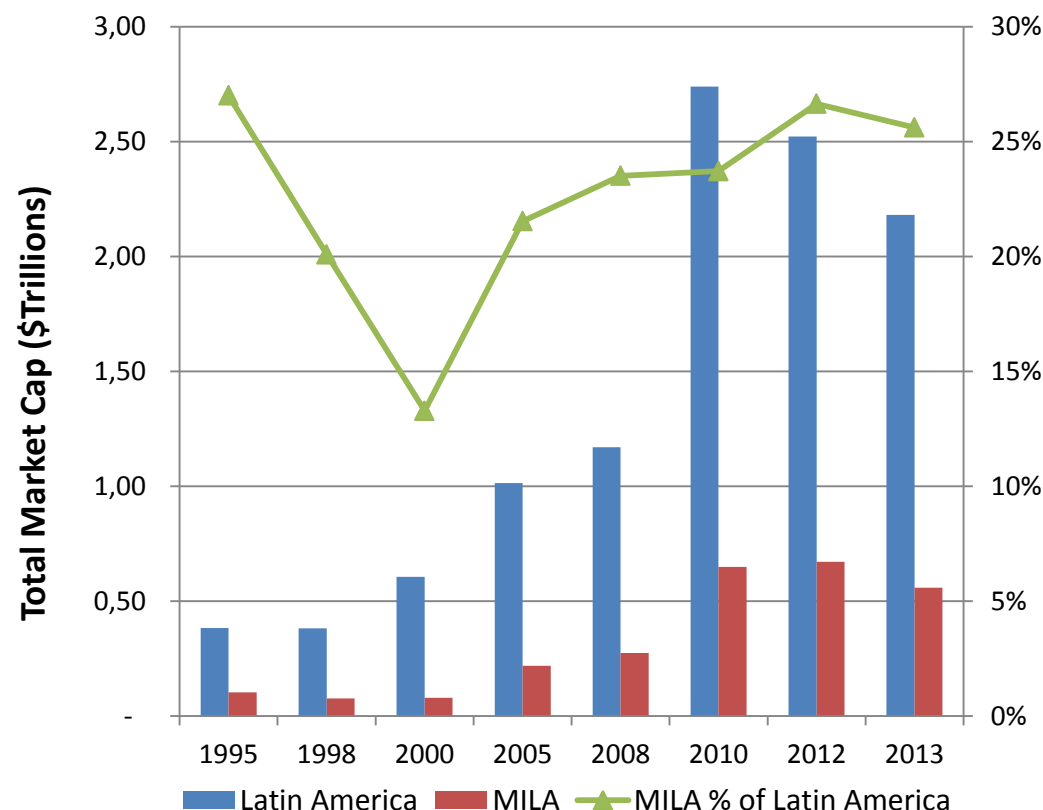
Data as of December 1995		
Country	Float Market Capitalization	Country Weight in S&P LATAM BMI
Argentina	13,125,176,078	9.48%
Brazil	55,670,806,553	40.19%
Chile	27,915,854,826	20.16%
Colombia	4,556,854,880	3.29%
Mexico	35,292,286,426	25.48%
Venezuela	1,942,367,609	1.40%
Grand Total	138,503,346,372	100.00%

Data as of Dec 2013		
Country	Float Market Capitalization	Country Weight in S&P LATAM BMI
Argentina	-	-
Brazil	469,525,774,269	53.31%
Chile	84,081,261,411	9.55%
Colombia	59,534,014,410	6.76%
Mexico	240,780,448,506	27.34%
Peru	26,842,126,638	3.05%
Venezuela	-	-
Grand Total	880,763,625,234	100.00%

- Colombia's weight in the LATAM region has doubled in this period.
- During the same period LATAM's weight in the S&P Emerging BMI dropped to 22% from 32%, a 33% drop.

Source: S&P Dow Jones Indices. The S&P Emerging BMI was launched on Dec 31, 1997. Data shown prior to this date reflects back-tested , hypothetical data.

## GROWTH & DEVELOPMENT OF MILA REGION

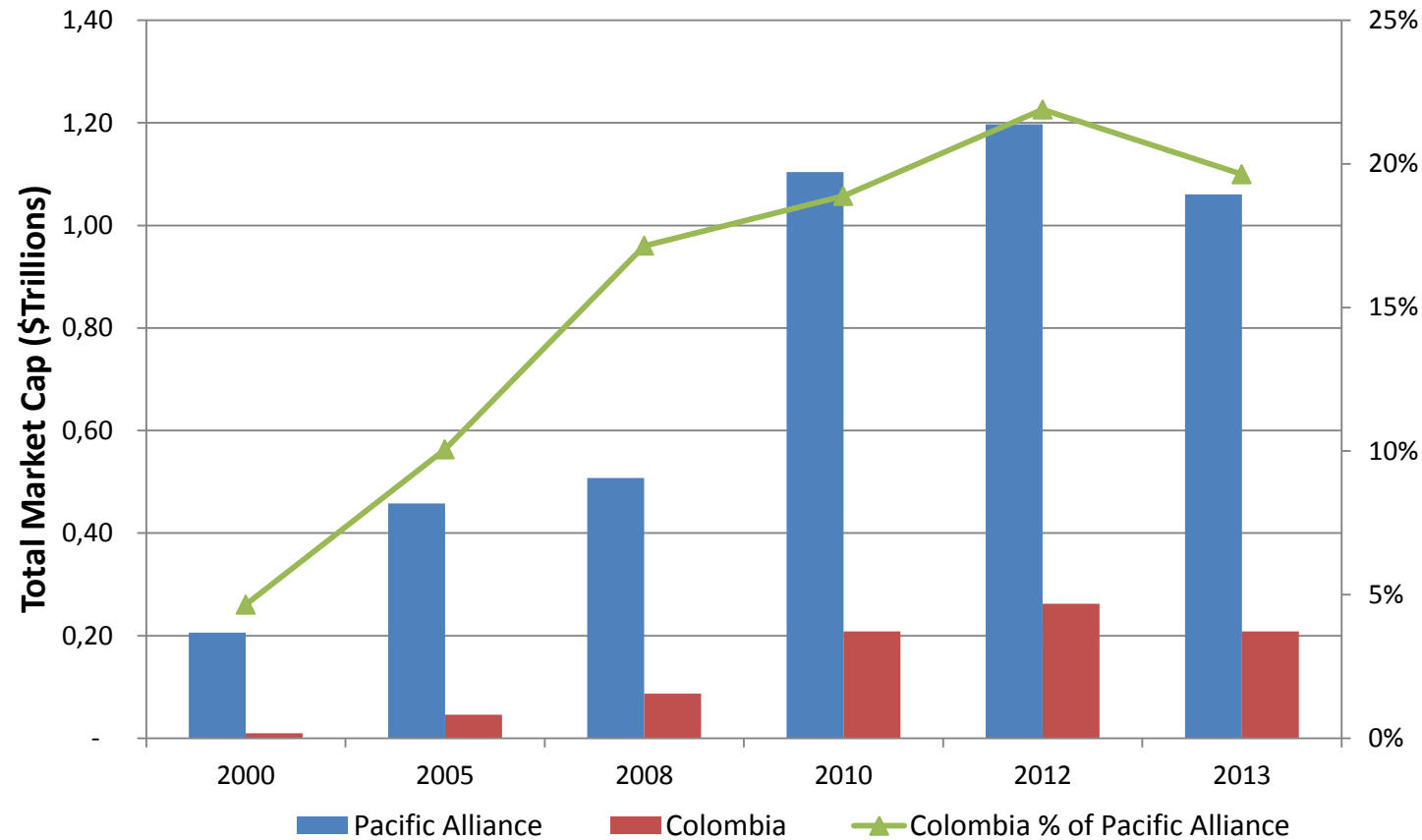


- The MILA region has grown exponentially in the last 6 years
- As of Dec 31, 2013 it was close to 25% of the LATAM total market capitalization
- However because of its small size relative to the emerging markets pie, it gets a very small representation in a global portfolio
- In addition some companies are not represented at all

Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

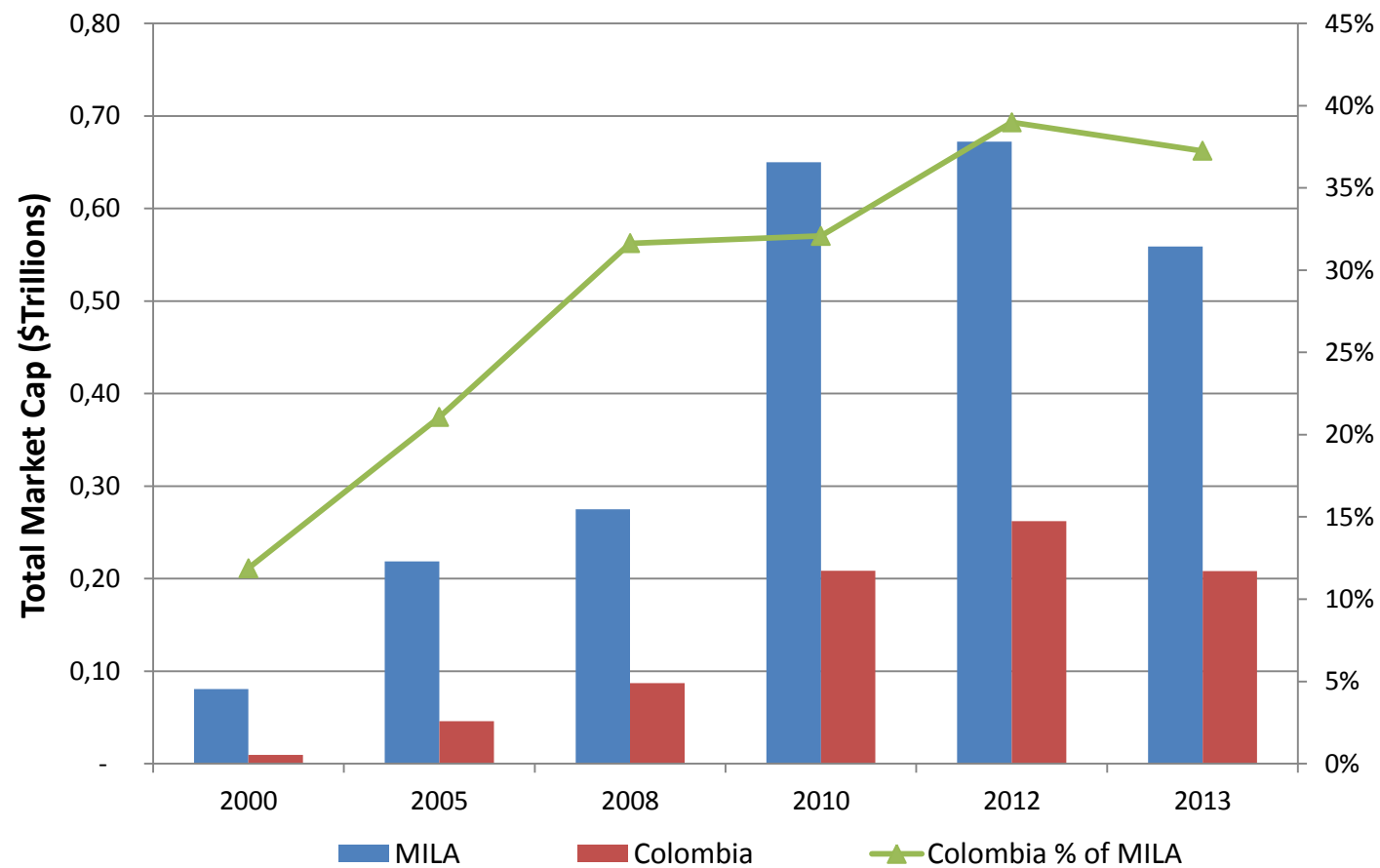


# GROWTH & DEVELOPMENT OF COLOMBIA COMPARED TO PACIFIC ALLIANCE REGION



Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

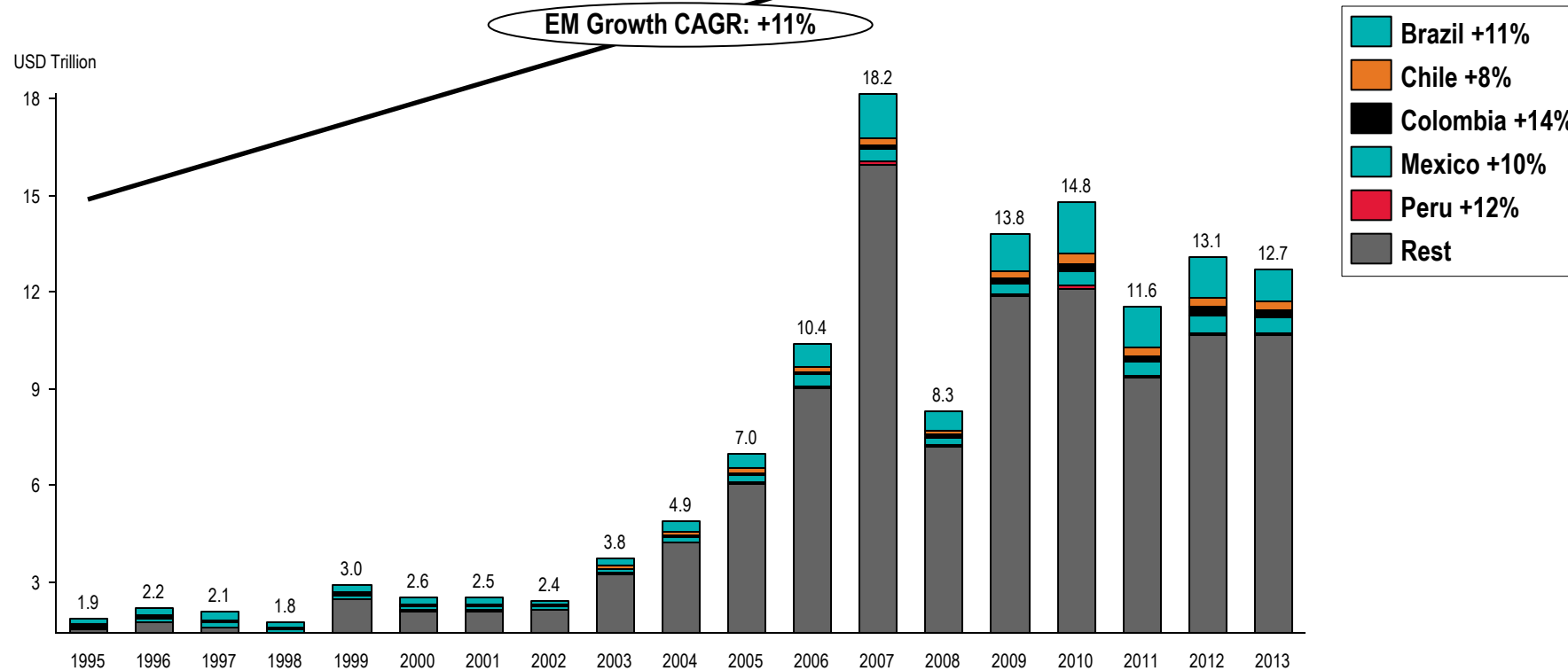
# GROWTH & DEVELOPMENT OF COLOMBIA COMPARED TO MILA REGION



Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

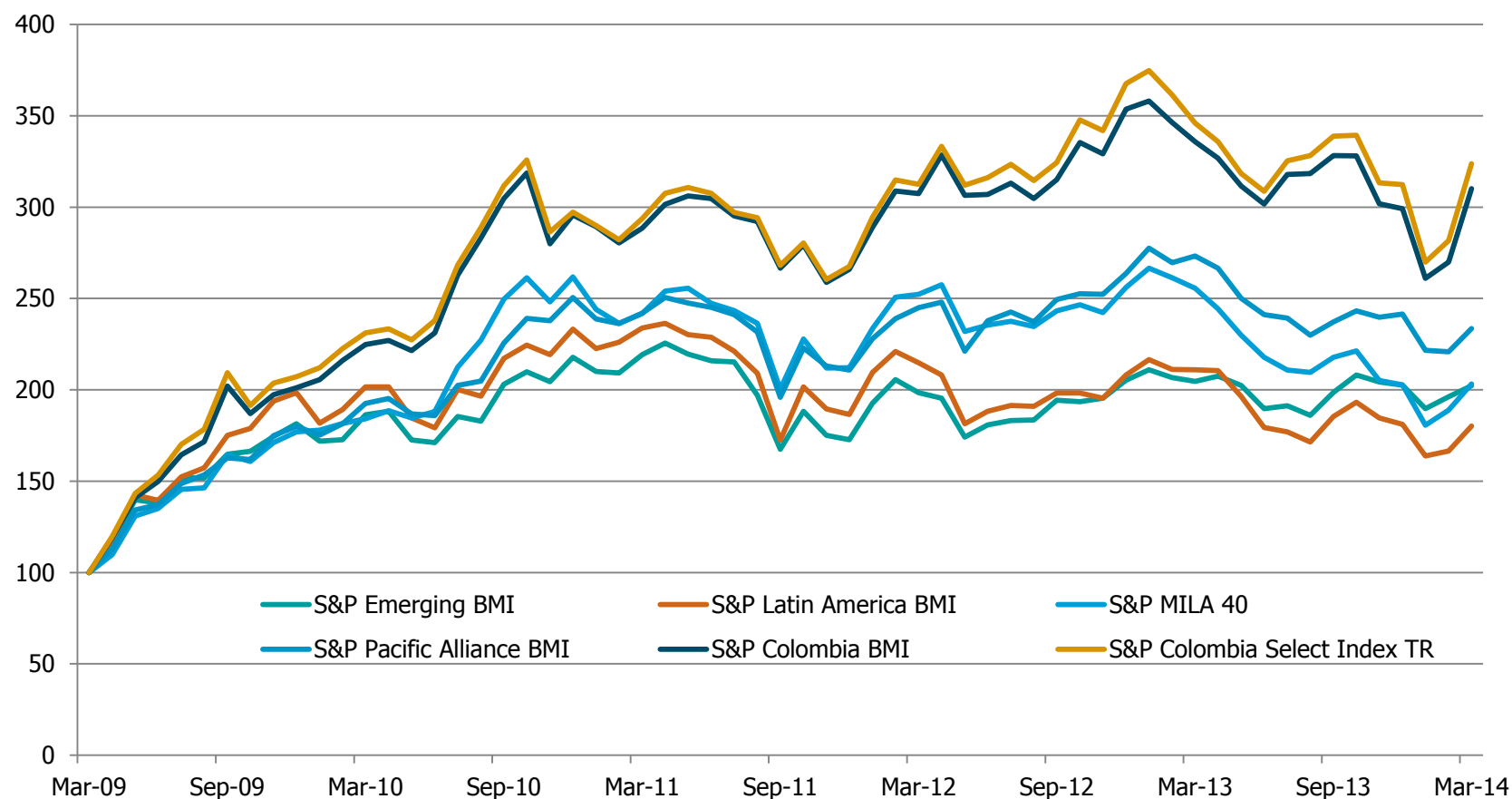
# LATIN AMERICAN MARKETS HAVE KEPT WITH THE GROWTH IN EMERGING MARKETS

## Market Capitalization of Emerging Market Countries (Trillion USD)



Source: S&P Dow Jones Indices Global Stock Markets Factbook. Data as of December 31 each year. Charts are provided for illustrative purposes.

## 5-YEAR PERFORMANCE BASED ON TOTAL RETURN



Source: S&P Dow Jones Indices. Data as of March 31, 2014. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Past Performance is no guarantee of future results.

## 5-YEAR PERFORMANCE COMPARISON

<i>Data as of March 31, 2014 (USD, TR)</i>	<b>S&amp;P Colombia Select Index</b>	<b>S&amp;P Colombia BMI</b>	<b>S&amp;P MILA 40 Index</b>	<b>S&amp;P Pacific Alliance BMI</b>	<b>S&amp;P Latin America BMI</b>	<b>S&amp;P Emerging BMI</b>
<b>Returns</b>						
1 year	-6.4%	-7.7%	-20.5%	-14.5%	-14.6%	-1.1%
3 year	3.3%	2.4%	-5.6%	-1.2%	-8.3%	-2.7%
5 year	26.5%	25.4%	15.2%	18.5%	12.5%	15.1%
7 year	NA	13.6%	7.8%	5.5%	3.8%	4.0%
10 year	NA	24.6%	16.1%	14.8%	14.9%	10.8%
<b>Risk</b>						
3 year	20.0%	19.3%	20.4%	18.9%	22.9%	19.5%
5 year	24.0%	23.4%	21.7%	20.0%	25.0%	21.8%
7 year	NA	25.9%	24.0%	23.2%	28.5%	25.9%
10 year	NA	28.9%	22.5%	21.7%	27.0%	23.7%
<b>Risk Adjusted Returns</b>						
3 year	0.17	0.13	-0.27	-0.06	-0.36	-0.14
5 year	1.10	1.09	0.70	0.92	0.50	0.69
7 year	NA	0.52	0.32	0.24	0.13	0.16
10 year	NA	0.85	0.72	0.68	0.55	0.46

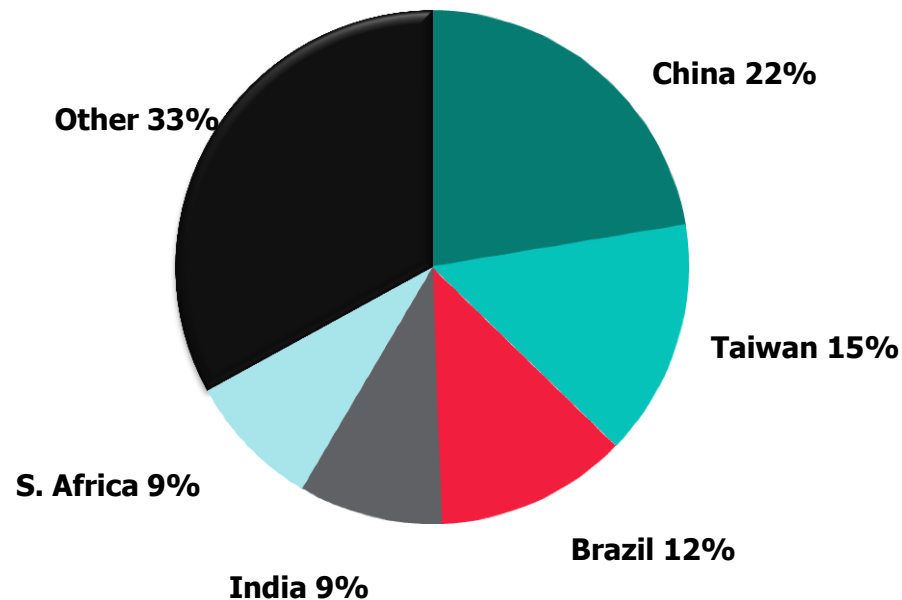
Source: S&P Dow Jones Indices. Data as of March 31, 2014. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Past Performance is no guarantee of future results.

# CONCENTRATION RISKS IN TRADITIONAL CAPITALIZATION WEIGHTED EMERGING MARKET BENCHMARKS

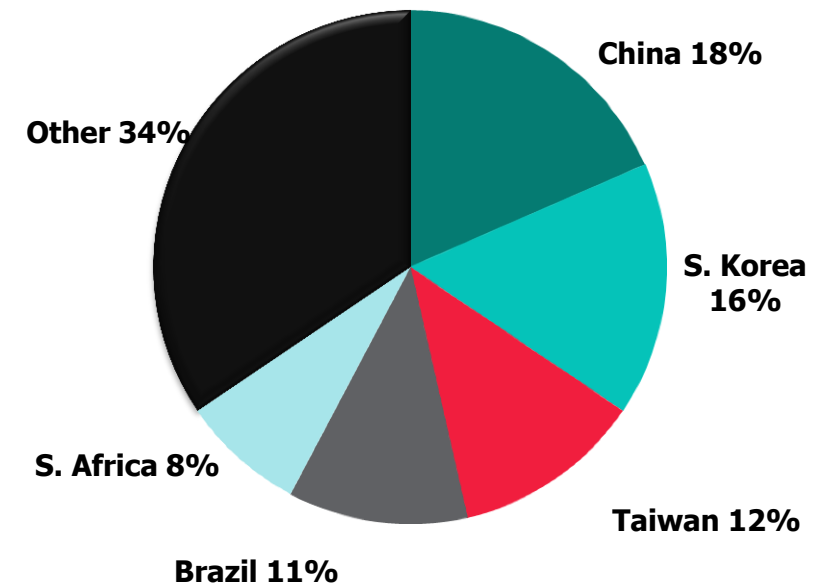
- High concentration in the largest, most advanced markets
  - S. Korea, Taiwan & the BRICs

## Country Weight Comparison

**S&P Emerging LargeMidCap**



**MSCI Emerging Markets**



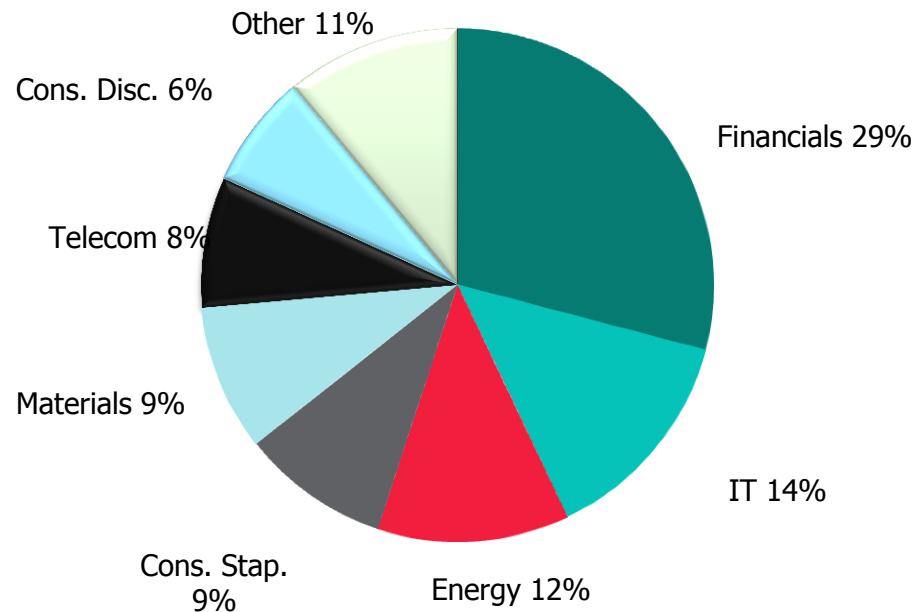
Source: S&P Dow Jones Indices; MSCI. Data as of April 30, 2014.

# CONCENTRATION RISKS IN TRADITIONAL CAPITALIZATION WEIGHTED EMERGING MARKET BENCHMARKS

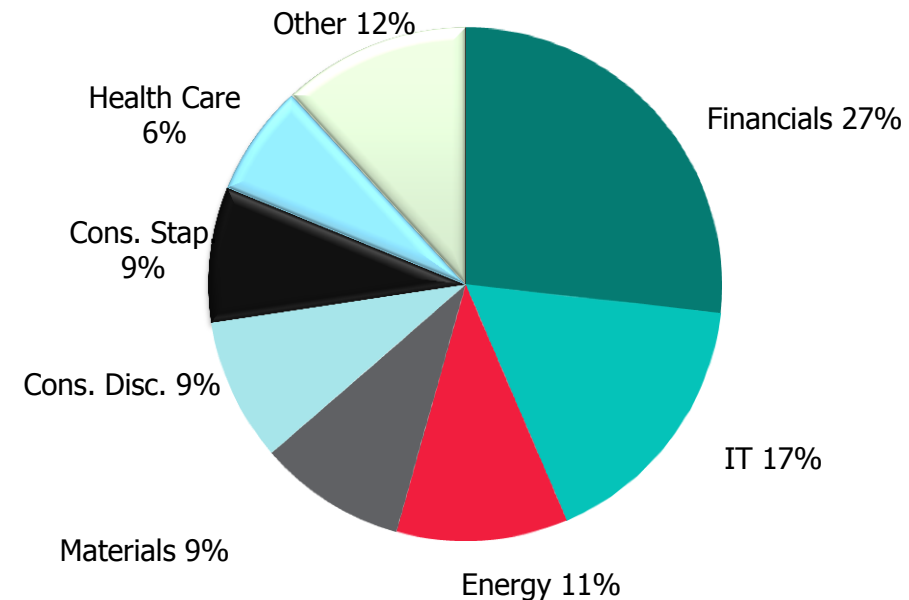
- High concentration in mature, export-oriented sectors
  - Financials, Energy & Materials represent about half of the index
- Limited exposure to domestic demand

## Sector Composition Comparison

**S&P Emerging LargeMidCap**



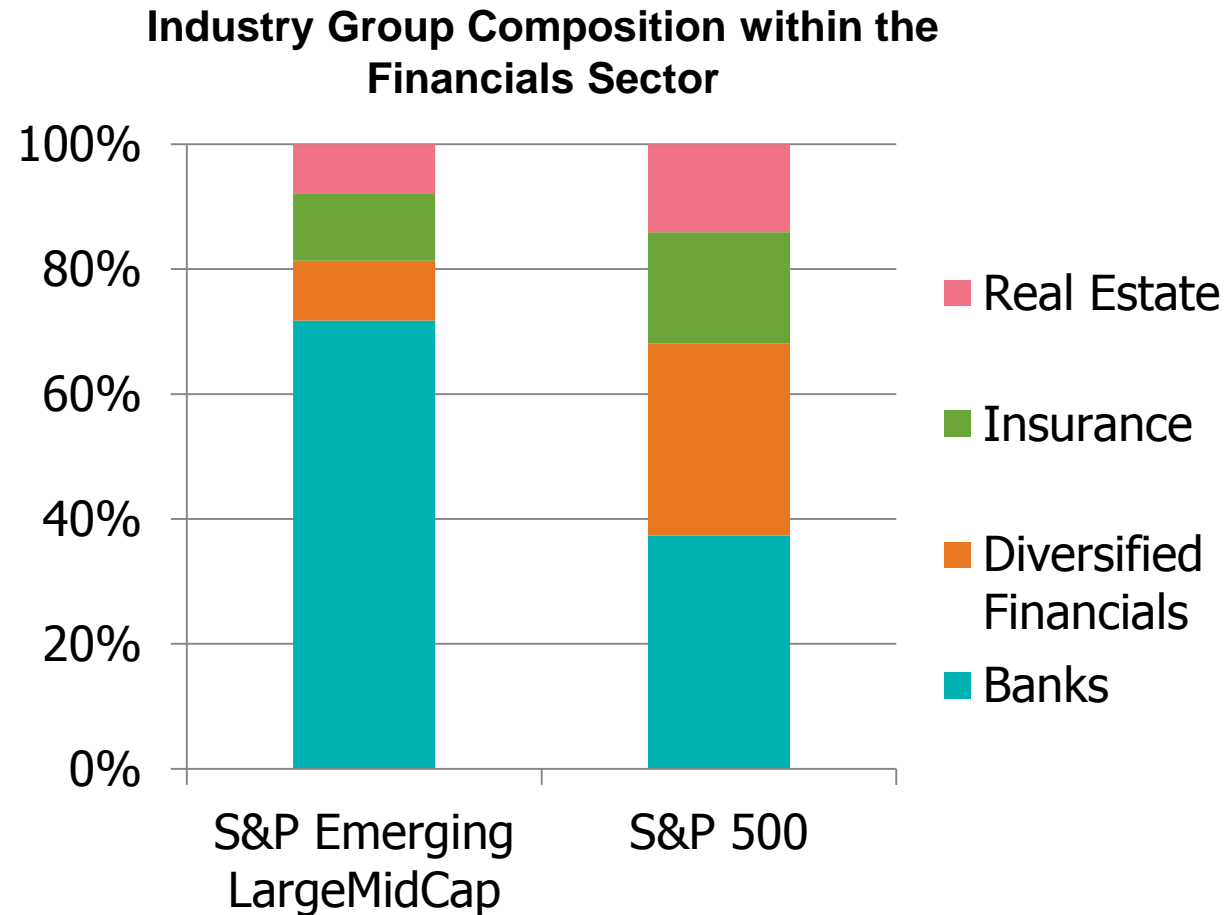
**MSCI Emerging Markets**



Source: S&P Dow Jones Indices; MSCI. Data as of April 30, 2014.

## CONCENTRATION RISKS IN TRADITIONAL CAP WEIGHTED EMERGING MARKET BENCHMARKS

- Limited diversification within sectors as well . . .



Source: S&P Dow Jones Indices. Data as of April 30, 2014.



## ALTERNATIVES TO TRADITIONAL EMERGING MARKET INDICES

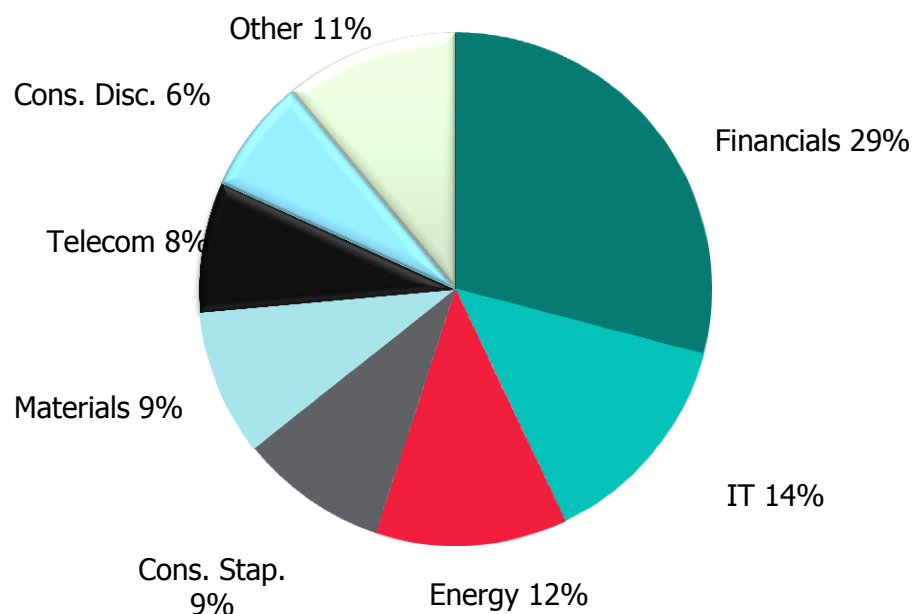
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- Because of concentration issues with broad, capitalization weighted benchmarks, investors have started to demand alternative ways to view emerging market equities
  1. Segmenting markets by geography or by sector
  2. Expanding the opportunity set to include small-caps
  3. Thematic and Strategy Indices
    - Emerging Market Consumer, Dividends, Low Volatility
  4. Defining an alternative core index

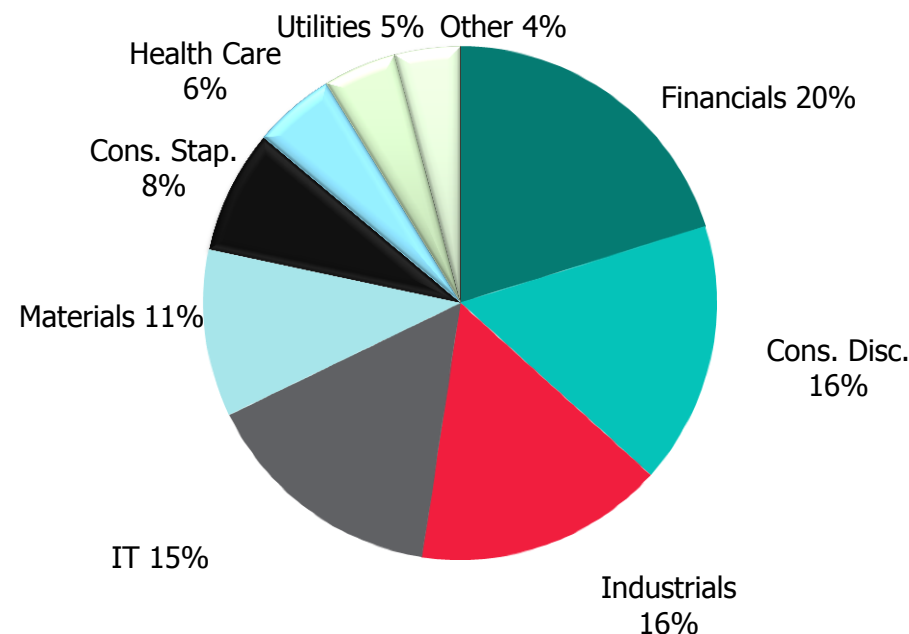
## SECTOR COMPOSITION COMPARISON OF EM SIZE INDICES

- Most widely used emerging market indices and ETFs exclude small-caps
- Emerging market small-caps have greater exposure to consumer and other domestically oriented sectors than larger EM companies

**S&P Emerging LargeMidCap**

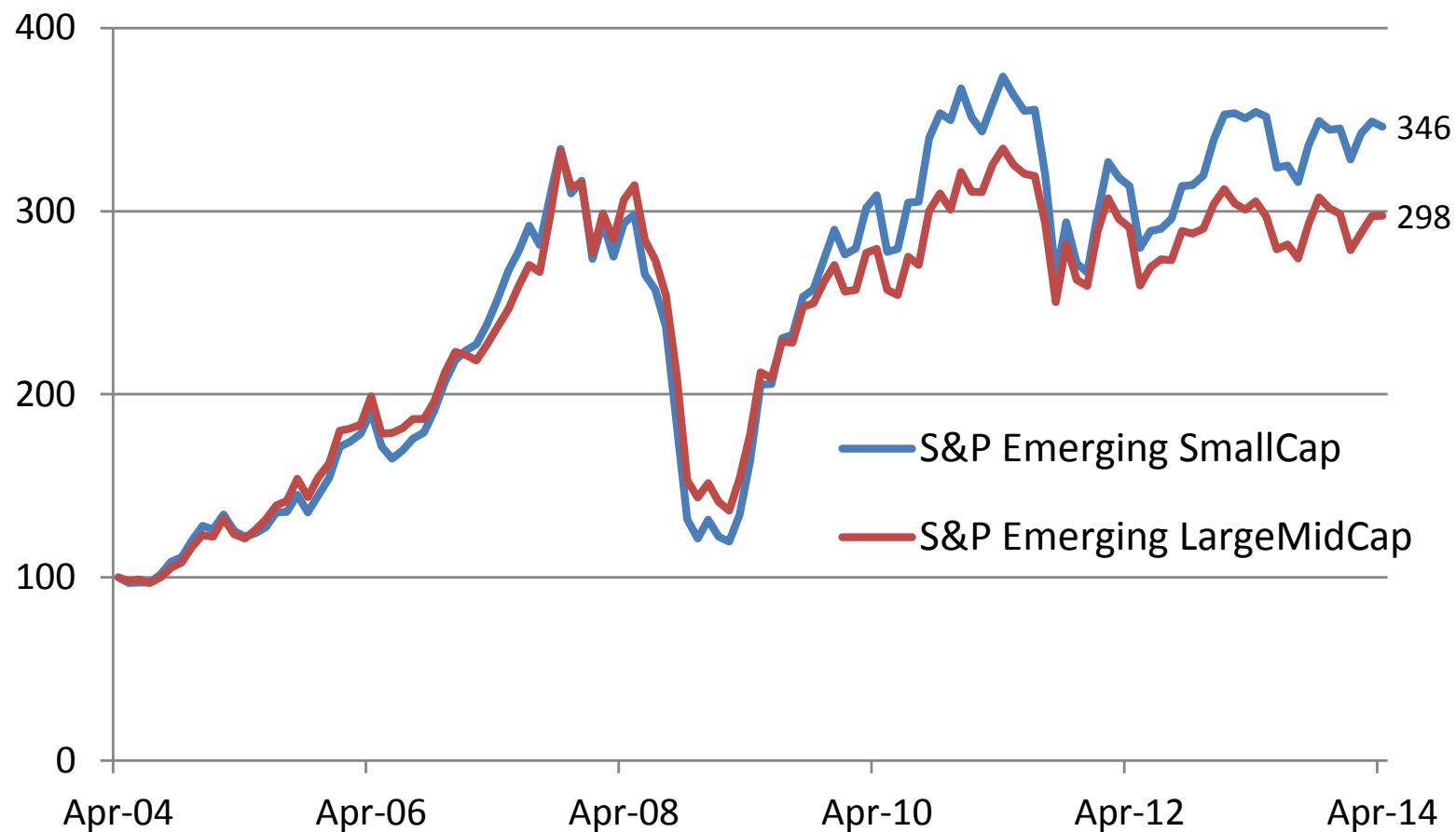


**S&P Emerging SmallCap**



Source: S&P Dow Jones Indices. Data as of April 30, 2014.

## OUTPERFORMANCE OF EMERGING MARKET SMALL-CAPS



Source: S&P Dow Jones Indices. Data from April 30, 2004 through April 30, 2014. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

## OUTPERFORMANCE OF EMERGING MARKET SMALL-CAPS

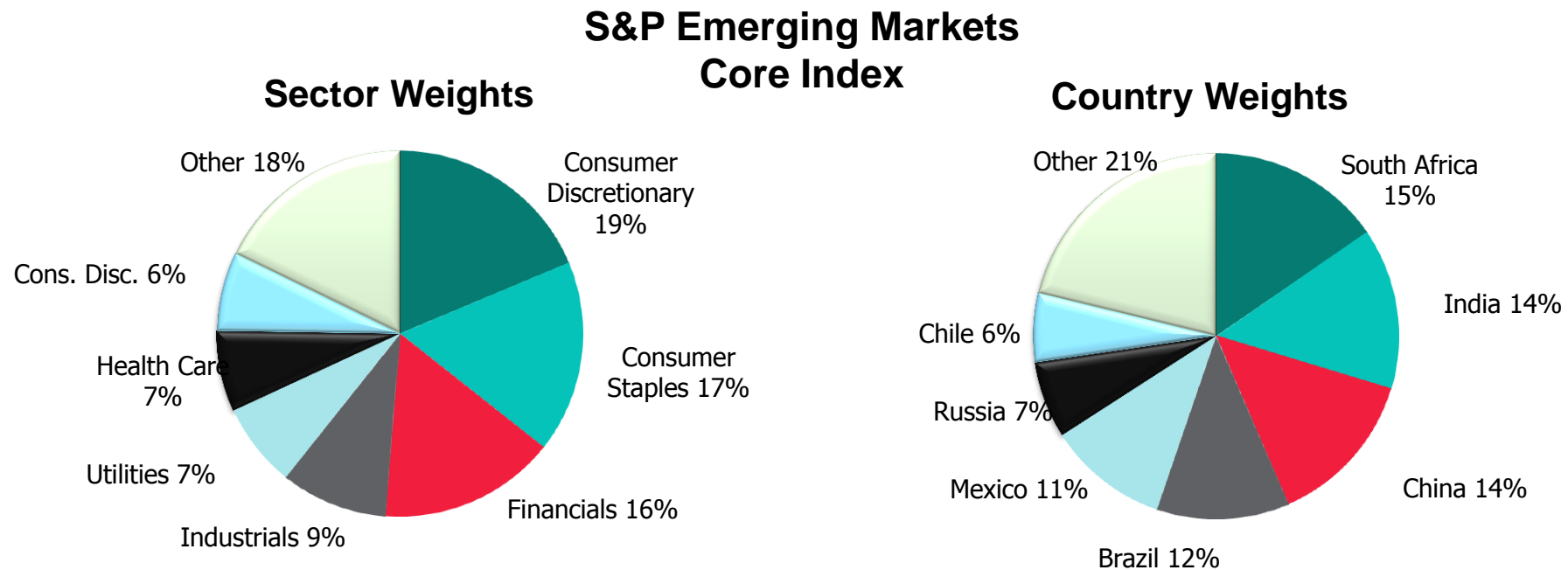
Small-Caps have beaten Large/Mid-Caps in seven of the last ten years.

Year	S&P Emerging SmallCap	S&P Emerging LargeMidCap	Variance
2013	1.7%	-1.8%	3.5%
2012	27.3%	17.3%	10.0%
2011	-27.3%	-19.4%	-8.0%
2010	26.6%	18.8%	7.8%
2009	120.6%	78.6%	42.0%
2008	-58.5%	-52.0%	-6.5%
2007	44.9%	41.3%	3.6%
2006	41.6%	37.7%	3.9%
2005	20.4%	31.7%	-11.2%
2004	34.1%	23.8%	10.3%

Source: S&P Dow Jones Indices. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

## APPROACH FOR A MORE DIVERSIFIED EMERGING MARKETS INDEX

- Limit universe to liquid companies in emerging economies
- Use industry groups as building blocks to reduce dominance of mature sectors and industries
- Equal-weight constituents
- Cap country weights at 15% to reduce country concentration

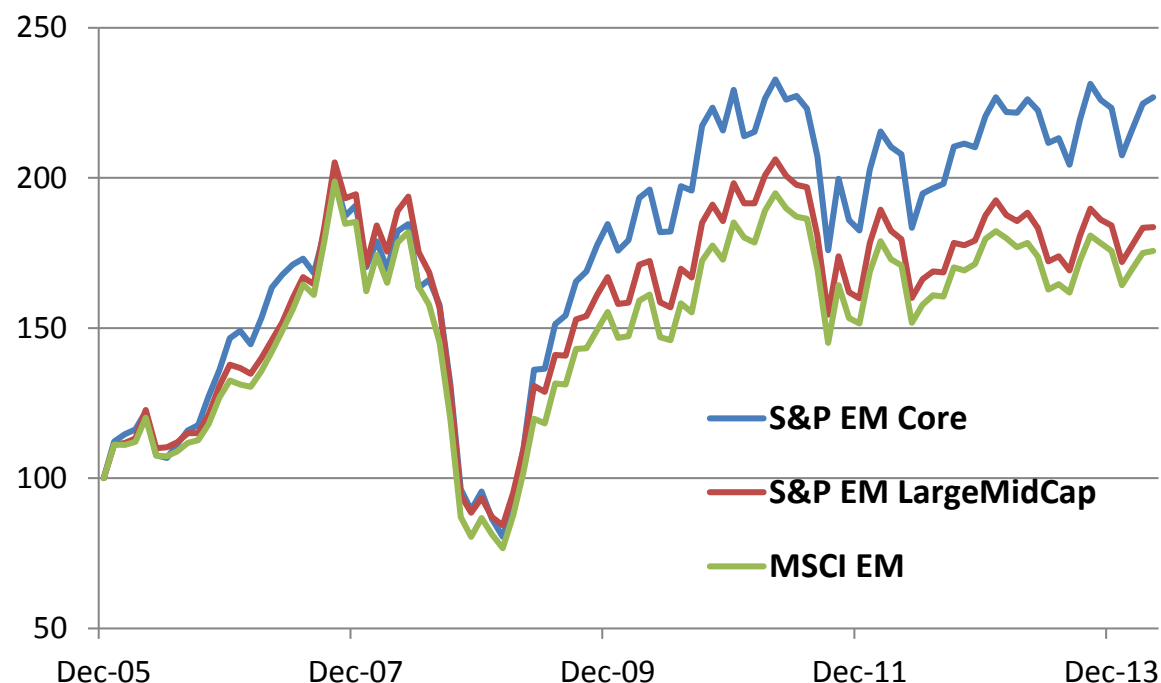


Source: S&P Dow Jones Indices. Data as of April 30, 2014. Charts are provided for illustrative purposes.

## OUTPERFORMANCE OF S&P EMERGING MARKETS CORE INDEX

- Outperformance of S&P EM Core post financial crisis compared to traditional capitalization weighted benchmarks has been driven by:
  1. Greater exposure to less advanced markets
  2. More diversified sector & industry exposure

**Comparative Performance (Dec 2005 – Apr 2014)**

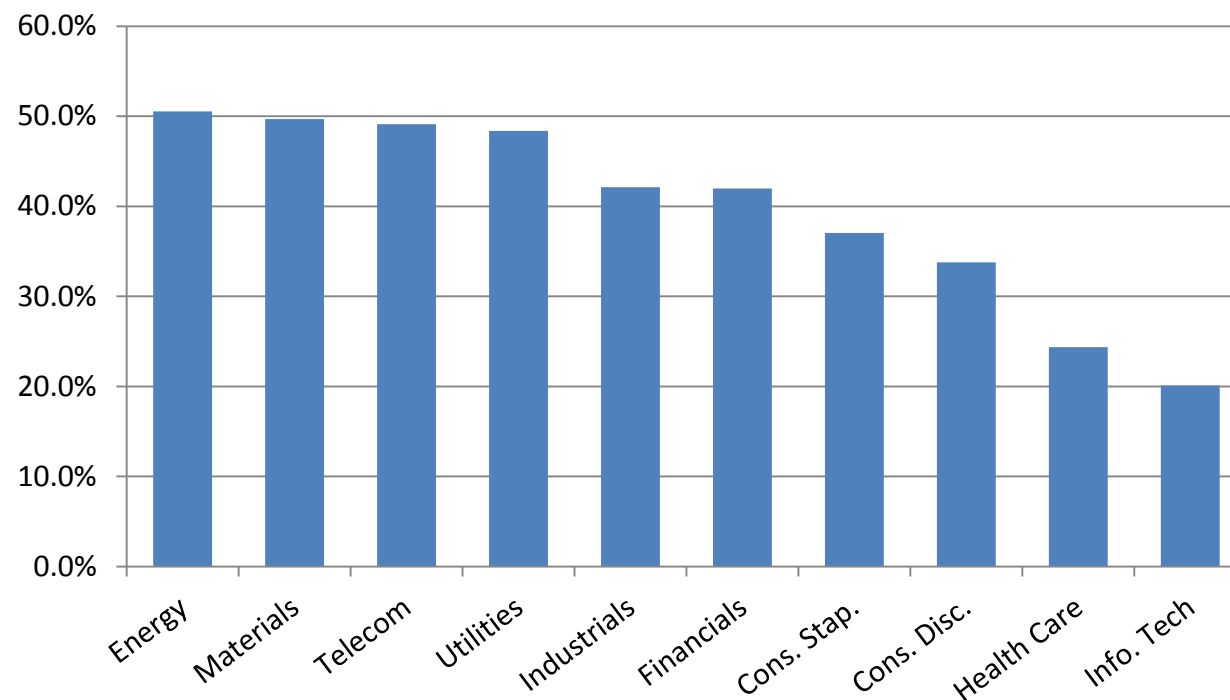


Source: S&P Dow Jones Indices; MSCI. Data as of April 30, 2014. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Past Performance is no guarantee of future results.

## EMERGING MARKET SECTOR PERFORMANCE TRENDS

- Export-oriented sectors led the way in the boom leading up to the 2008 financial crisis.

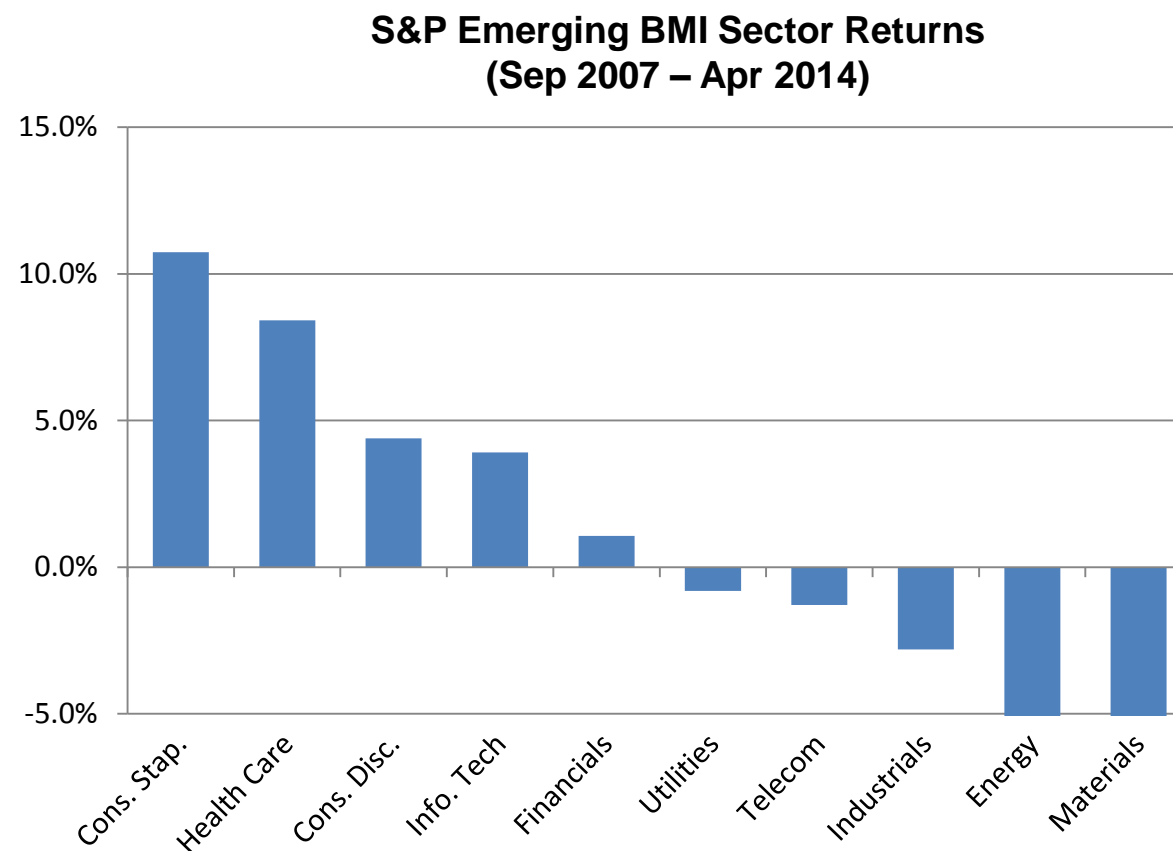
**S&P Emerging BMI Sector Returns  
(Sep 2002 – Sep 2007)**



Source: S&P Dow Jones Indices. Annualized returns are calculated based on gross total return index levels in USD. Charts are provided for illustrative purposes.

## EMERGING MARKET SECTOR PERFORMANCE TRENDS

- Domestic demand sectors have led the way since the 2007 peak while export-oriented sectors have severely lagged



Source: S&P Dow Jones Indices. Annualized returns are calculated based on gross total return index levels in USD. Charts are provided for illustrative purposes.



## PERFORMANCE DISCLOSURE

The S&P MILA 40 was launched on August 29, 2011. The S&P Colombia Select Index was launched on November 24, 2013. All information presented prior to the launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com). It is not possible to invest directly in an index.

The S&P Colombia Select Index was launched on November 24, 2013. All information presented prior to the launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com). It is not possible to invest directly in an index.

The S&P Pacific Alliance BMI Index was launched on April 30, 2014. All information presented prior to the launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com). It is not possible to invest directly in an index.

The S&P Emerging Markets Core Index was launched on Oct 8, 2012. All information presented prior to the launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com). It is not possible to invest directly in an index.

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Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at [www.spdji.com](http://www.spdji.com) for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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