

GLOBAL INDEX MANAGEMENT INDEX BULLETIN UPDATE

SECOND QUARTER 2010 SUMMARY

In this bulletin, we look at

- *The recent Russell reconstitution*
- *The MSCI semi-annual rebalance*
- *Recent downgrades of various European countries and performance impact on global indexes*

RUSSELL RECONSTITUTION 2010

The annual Russell rebalance, which took place on June 25, 2010, was notable for both the changes in methodology and the trading activity which occurred on the day of the rebalance. Over the last few years, Russell has implemented banding rules that reduced turnover; however, this year's methodology changes have expanded the investable universe of the Russell Indexes, leading to the addition of several large companies, which increased turnover from previous years.

There were three significant rule changes this year:

1. Russell lifted the exclusion of Berkshire Hathaway (BRK/B) in the Index, which was previously excluded due to corporate structure and lack of liquidity. Russell's float adjustments can now account for Berkshire's holdings in other companies, so the corporate structure barrier was lifted. Berkshire Hathaway's 50-for-1 stock split increased trading volume, making the shares more investable.
2. The primary share class rule also was changed. The new rule states that the most liquid share class will be included in the Index. Liquidity is measured by the two-year average trading volume. This rule change led to the inclusion of Discovery A and the removal of Discovery C in the Russell 1000 Index. While the actual company remained in the Index, the change of share class caused index managers to buy one share class and sell the other.
3. In 2007 Russell introduced the Benefit-Driven Incorporation (BDI) methodology, and this year they modified the country classification rules. The objective of these modifications is to better identify a company's actual country of representation.
 - Home Country Indicators (HCIs) include country of incorporation, headquarters and primary exchange. When these three indicators are the same, the company is assigned to that country.
 - If the HCIs are not the same, a company's country of incorporation will be determined by the primary location of assets and then primary location of revenues.
 - If data for primary location of assets or revenues is not available, the location of the headquarters is used; when the company's headquarters are in a BDI, like the Cayman Islands, the primary exchange is used.

All of these changes to the country classification rules resulted in several large companies such as Tyco, Covidien and Accenture being added to the Russell 1000.

July 2010

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Russell Index Turnover Summary

The additions of these companies including the addition of Berkshire Hathaway, led to a significant increase in turnover for the Russell 1000 as compared to previous years. The change in country classification methodology eliminated Chinese companies in the Russell 2000, but it was not a significant change for the small cap universe and turnover in the Russell 2000 was slightly lower than 2009.

Index	2010 Turnover	2009 Turnover	2008 Turnover
Russell 3000	7.4%	3.3%	3.7%
Russell 1000	7.8%	3.9%	4.5%
Russell 1000 Growth	46.2%	36.3%	31.1%
Russell 1000 Value	46.1%	39.8%	32.4%
Russell 2000	19.0%	24.8%	31.9%
Russell 2000 Growth	55.5%	58.8%	70.5%
Russell 2000 Value	47.9%	54.0%	55.0%
Russell SC Completeness	21.2%	7.8%	11.8%

Source: Russell Index

Russell Basket Performance Data

The performance of the various components of the trade on June 25 was modest compared to previous years. The overall trade went “right way” meaning that additions to the index (buys) outperformed the deletions (sells) for both the Russell 1000 and the Russell 2000. The difference between the performances of these two groups was not as dramatic as it was in 2009.

We typically expect non-index managers, such as hedge funds and proprietary trading desks, to attempt to anticipate index manager trading activity and participate in the trade; the relatively flat performance on the various buckets on the effective data leads us to believe that many of these non-index managers kept away from trading this index event.

	No. of Stocks	2010 Return	2009 Return	2008 Return
R1 Additions	24	2.43%	-3.27%	2.54%
R1 Deletions	4	0.44%	-7.81%	-3.85%
R2 Additions	237	1.82%	8.80%	-0.44%
R2 Deletions	201	-0.49%	-13.20%	-2.02%
R1 -> R2	18	1.30%	7.86%	-2.22%
R2 -> R1	26	0.21%	-5.24%	3.37%

Source: Russell Index

MSCI SEMI-ANNUAL REVIEW – MAY 2010

The objective of the MSCI semi-annual index reviews is to reflect changes in market structure due to performance, IPOs, de-listings and corporate events. Based on the new market size-segment cut-offs, current constituents were re-weighted and newly eligible companies were identified, resulting in additions, deletions, float and share changes to the indexes effective on the close of Wednesday, May 26, 2010. Most notably for the May review was the reclassification of Israel from emerging to developed market status.

MSCI Developed World Summary

Based on the review, 39 companies were added to the World Index, while 27 were deleted. One-way turnover was 1.1%. Of the 39 additions, 16 were Israeli companies (a result of the migration from emerging to developed market status). While all Israeli additions totaled 0.40% of the new index, Teva Pharmaceuticals was the largest company added with a weight of 0.25% in the MSCI World Index. After Teva, the next three largest additions to MSCI World Index were North American companies. CIT Group, following its emergence from bankruptcy, became eligible to be included in the Index with a weight of 0.03%, and both Red Back Mining and F5 Networks were migrations from the Small-Cap Index to the Large/Mid-Cap Index with similar index weights. On a net basis, the number of constituents in the MSCI World Index increased by 12 names to 1,659, with a new market capitalization of \$22.9 trillion USD, a 0.8% increase.

The most notable change in MSCI EAFE was the addition of Israel. There were 28 additions during the semi-annual rebalance of which 16 were Israeli companies that were reclassified as developed markets.

The MSCI World Small Cap Index saw 311 security additions and 106 deletions, resulting in one-way index turnover of 5.0% and a 2.1% increase in market capitalization. Of the 311 additions, 66 were the result of Israel's reclassification to developed markets. On a net basis, the number of constituents in the MSCI World Small Cap Index increased by 205 names to 4,558 securities with a new market capitalization of \$3.5 trillion USD.

MSCI Emerging Market Summary

In the Emerging Markets Index, 19 securities were added and 34 deleted, resulting in one-way index turnover of 4.1% and a 1.8% decrease in market capitalization. Of the 19 additions, 13 were Asian companies. The largest addition was Indonesia's Gudang Garam at 0.05%, which had previously failed the short-term liquidity requirements. Three other Asian companies, China's Lee & Man Paper Manufacturing, India's Rural Electrification Company and Korea's Seoul Semiconductor Company were each added with a weight of 0.04%. From a country perspective, China experienced the largest weight change from 17.4% to 18.3%. The most notable deletion was Teva Pharmaceuticals, due to Israel graduating from emerging to developed market status. As a result of the review, the number of constituents in the emerging markets index decreased by 15 names to 755 securities, with a new market capitalization of \$3.3 trillion USD.

There were 249 security additions and 131 deletions from the Emerging Markets Small Cap Index, resulting in one-way index turnover of 13.1%. Of the 249 additions, 214 were in the emerging markets of Asia. However, the largest individual additions to Emerging Market Small Cap Index were from Latin America. Cetip On and Sul America Units, both Brazilian companies, were newly eligible with index weights of 0.22% and 0.21%, respectively. Sixty-four Israeli securities, formerly 2.9% of the Index, were deleted as a result of the review. On a net basis, the number of constituents in the MSCI Emerging Markets Index increased by 118 names to 1,899 securities with a new market capitalization of \$488 billion USD, representing a 4.1% increase.

PORTUGAL, IRELAND, ITALY, GREECE AND SPAIN – WHAT HAPPENED IN 2010?

Concerns over the sovereign debt of several European countries dominated financial news during the first half of 2010. Greece, Portugal, Ireland, Italy and Spain were in the spotlight as fears of potential default spread through Europe. Moody's downgraded Greek debt in June to junk status while a few other countries remained on watch. As attention was turned to the sovereign debt of these countries the acronym "PIIGS" was introduced as a shorthand reference to these countries.

In this section we will review how these countries have performed thus far in 2010 and the impact they have on the main international benchmarks.

Performance of PIIGS

For each of the indexes, Greece, Italy, Portugal and Spain were the four bottom performers for the first half of 2010. Greek stocks posted the lowest performance during this period, losing nearly half of their value.

Table 1: 2010 Country and Regional Performance as of June 30, 2010

	Q2 (%)	YTD (%)
Greece	-40.50	-48.33
Ireland	-19.82	-20.24
Italy	-21.58	-27.30
Portugal	-17.47	-25.93
Spain	-20.79	-32.90
MSCI EAFE	-13.97	-13.23
MSCI World	-12.67	-9.84
MSCI ACWI	-12.12	-9.37
MSCI ACWI ex US	-12.45	-11.06

Source: MSCI Barra, Factset

It is worth noting that the strong performance of the U.S. dollar relative to the Euro exacerbated the decline of the PIIGS countries in USD terms. The Euro moved from \$1.4338 on December 31, 2009 to \$1.2236 on June 30, 2010, a 14.7% drop. As a result, performance in local terms was somewhat higher than in USD terms.

Table 2: Country Performance in Euros as of June 30, 2010

	YTD Returns in local terms (%)
Greece	-39.48
Ireland	-6.57
Italy	-14.84
Portugal	-13.24
Spain	-21.40

Source: MSCI Barra, Factset

Weight of PIIGS in Global Indexes

The table below shows their respective weight in different indexes at two points in time, 2009 year end and June 30, 2010. As one might suspect, given the economic difficulties, in most cases weights of these countries decreased substantially.

Table 3: Country Weight Comparison (% of Index)

	MSCI EAFE		MSCI World		MSCI ACWI ex US		MSCI ACWI	
	12/31/09	6/30/10	12/31/09	6/30/10	12/31/09	6/30/10	12/31/09	6/30/10
Greece	0.51	0.28	0.24	0.13	0.36	0.19	0.21	0.11
Ireland	0.27	0.29	0.13	0.13	0.19	0.20	0.11	0.11
Italy	3.47	2.84	1.63	1.28	2.44	1.96	1.42	1.11
Portugal	0.32	0.27	0.15	0.12	0.22	0.19	0.13	0.11
Spain	4.60	3.47	2.16	1.57	3.24	2.39	1.88	1.36

Source: MSCI Barra, Factset

Among developed countries, Greece has the second smallest weight in MSCI EAFE and MSCI World after New Zealand with 0.05% of the Index.

MSCI rebalanced its indexes twice during the period, in February and in May during which securities were added and removed. Ireland, for instance held four names in the Index at the end of 2009 and five at the end of June. This explains its weight virtually not changing in spite of underperforming the major indexes.

Impact of PIIGS Performance on Global Indexes

Given the performance of these countries and their respective weights in different benchmarks, we are able to show the impact they had on the previously discussed benchmarks. Table 4 displays how much each country contributed to the total return of each index.

Table 4: 2010 Contribution to Index Performance (Though June 30, 2010 (in %))

	MSCI EAFE	MSCI World	MSCI ACWI ex US	MSCI ACWI
<i>Index return</i>	-13.23	-9.84	-9.37	-11.06
Greece	-0.22	-0.10	-0.16	-0.09
Ireland	-0.06	-0.03	-0.04	-0.02
Italy	-0.87	-0.40	-0.61	-0.35
Portugal	-0.07	-0.03	-0.05	-0.03
Spain	-1.36	-0.63	-0.97	-0.55

Source: MSCI Barra, Factset

As clearly shown in the table above, Spain and Italy had a substantial negative contribution to the overall performance of these indexes due to their higher weights.

While news coming from these countries and the potential consequences for large European banks did have a serious impact on world equity markets, performance for broad indexes was still driven by the largest countries. For instance, the United States, the largest weight in MSCI World Index with nearly 50%, contributed -3.51% to the performance of this particular index.

Second Quarter 2010 Market Summary as of June 30, 2010

	U.S. Dollar Return Total Return %		
	2Q	YTD	Trailing One-Year
U.S. EQUITIES			
S&P 500	-11.43	-6.65	14.43
S&P 400	-9.59	-1.36	24.93
S&P 600	-8.73	-0.88	23.64
Russell 1000	-11.44	-6.40	15.24
Russell 2000	-9.92	-1.95	21.49
Russell 3000	-11.32	-6.05	15.72
Russell 3000 Growth	-11.55	-7.25	13.95
Russell 3000 Value	-11.09	-4.83	17.57
Dow Jones Total Market Index	-11.12	-5.64	16.11
GLOBAL EQUITIES			
MSCI World	-12.67	-9.84	10.20
MSCI EAFE	-13.97	-13.23	5.92
MSCI Emerging Markets	-8.37	-6.17	23.15
MSCI ACWI	-12.12	-9.37	11.76
MSCI ACWI ex-U.S.	-12.45	-11.06	10.43
MSCI ACWI ex-U.S. IMI	-11.86	-8.65	11.49
MSCI Developed Market ex-U.S. Small Cap	-11.12	-6.31	15.70
MSCI Emerging Small Cap	-6.91	-2.19	35.16
S&P Frontier Market Extended 150	-11.05	-1.33	3.79
ALTERNATIVES BENCHMARKS			
FTSE EPRA/NAREIT Global Index	-1.94	-4.23	25.05
Dow Jones-UBS Commodity Index	-4.81	-9.6	2.75
U.S. FIXED INCOME			
BC Aggregate	3.49	5.33	9.50
BC Govt/Credit	3.88	5.49	9.65
BC Govt/Credit Intermediate	2.97	4.56	8.29
BC High Yield 2% Cap	-0.06	4.45	26.66
BC Tips	3.82	4.41	9.52
GLOBAL FIXED INCOME			
BC Global Aggregate	-0.04	-0.31	5.00
BC Global Emerging Market	-0.84	2.73	17.80
BC 1-3 Month T-Bills	0.038	0.054	0.123

Source: Standard & Poor's, Russell, Dow Jones, MSCI, FTSE, Barclays Capital

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