

# GLOBAL INDEX MANAGEMENT INDEX BULLETIN UPDATE

## SECOND QUARTER 2010

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*In this bulletin, we look at how Israel's migration likely will impact both developed and emerging market indexes, examine the impact of the inclusion of Berkshire Hathaway in multiple indexes and provide a performance summary of major market indexes.*

### MSCI ISRAEL TO MIGRATE TO DEVELOPED MARKETS

On June 15, 2009 MSCI announced the results of their first annual Market Classification Review, which was the culmination of over two years of market classification consultations. Northern Trust was among the institutions that MSCI engaged to help shape the discussion and provide feedback. As a result of the review, MSCI advised that Israel would be reclassified as a developed market coinciding with the May 2010 Semi-Annual Index Review.

**Figure 1.**



As often happens with countries being promoted from emerging to developed market status, the country's relative weight decreases. In this case, the weight of Israel will shift from almost 3% of the MSCI Emerging Markets Index to 0.41% of the MSCI World Index and 0.88% of the MSCI EAFE Index. Figure 2 shows the estimates for the MSCI Israel Small Cap Index.

**Figure 2. Index Weightings**

Index	EAFE*	World*	EM
MSCI Israel	0.88%	0.41%	2.90%
MSCI Israel Small Cap	1.04%	0.41%	2.93%

Source: MSCI, \*Projected weights as of April 5, 2010

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As global assets under management benchmarked to the Developed Market index are greater, on a relative basis, than that of the Emerging Market index, we expect the overall impact of Israel's migration to produce a net inflow for the Israeli stocks being included in MSCI Developed Market Standard Indexes.

To demonstrate how Israel's reclassification likely will impact individual stocks, we highlight two companies: Teva Pharmaceutical (TEVA IT) and Check Point Software (CHKP US). Teva Pharmaceuticals represents 59.4% of MSCI Israel and will have a 0.56% weight in EAFE vs. 1.72% current weight in emerging markets. At the May 2010 Semi-Annual Review, emerging markets funds will be selling Teva, while developed markets funds will be buying the stock. As mentioned above, funds benchmarked to developed indexes are far greater than those benchmarked to emerging indexes.

Check Point Software is the third largest stock in the MSCI Israel Index with a weight of 6.05%. Although the company is domiciled in Israel, it is only currently listed in the U.S on the Nasdaq exchange. As an emerging market company, Check Point Software would be included in the MSCI Israel Index; however the rules of the developed market indexes are slightly different.

In order to be eligible for inclusion in the Index, it is required that a company be listed in its country of domicile. Currently, MSCI is not adding the stock to the developed market series. As a result, emerging markets fund managers will be selling the stock, but in this case there will be no offsetting demand for purchase. We expect both Teva and Check Point to experience elevated trading volume and volatility as the implementation date nears.

Figures 3 and 4 detail the sector composition of MSCI Israel and the various index weights of the largest stocks in Israel, respectively.

**Figure 3. MSCI Israel Sector Weights**

Sector	MSCI Israel	MSCI Israel Small Cap
Health Care	59.40%	4.91%
Financials	12.40	37.69
Materials	9.70	3.68
Information Technology	8.08	23.31
Telecommunication Services	6.95	1.93
Industrials	3.46	9.23
Energy	0.00	8.65
Consumer Discretionary	0.00	6.28
Consumer Staples	0.00	5.32

*Source: MSCI, data as of April 5, 2010*

**Figure 4. MSCI Israel Largest Security Weights**

<b>Company</b>	<b>EAFE*</b>	<b>World*</b>	<b>EM</b>	<b>Israel</b>
Teva Pharmaceutical	0.56%	0.26%	1.72%	59.40%
Israel Chemical	0.07	0.03	0.20	6.94
Check Point Software	N/A	N/A	0.18	6.05
Bank Leumi Le-Israel	0.05	0.02	0.16	5.60
Bank Hapoalim	0.04	0.02	0.13	4.48
Bezeq Israel Telecom	0.03	0.01	0.10	3.44

*Source: MSCI, \*Projected weights as of April 5, 2010*

#### **THE IMPACT OF THE INCLUSION OF BERKSHIRE HATHAWAY**

Prior to this year, Berkshire Hathaway (BRK) was one of the largest by market cap American companies excluded from the U.S. large cap benchmarks. The reason for exclusion in both the S&P and Russell benchmarks was the low liquidity levels and overall difficulty trading a stock with a price over \$100,000 per share. Berkshire Hathaway B shares, while priced lower, were also deemed not investible.

In January 2010, Berkshire Hathaway B executed a 50 for 1 split, bringing the price level from approximately \$4,000 to approximately \$80. On February 12, 2010, the company acquired Burlington Northern Santa Fe for a combination of cash and stock. Based on the merger and the stock split, S&P announced Berkshire Hathaway B would replace Burlington Northern Santa Fe in the S&P 500 Index.

The inclusion of Berkshire Hathaway B in the S&P 500 had a large impact not only on the stock price, but on index portfolios tracking the benchmark. Berkshire Hathaway B would be 1.2% of the Index — one of the top 20 stocks in the index — leading to an expected demand of 185 million shares from index managers, 21 times the average trading volume. Many index funds had to sell shares of other companies to buy Berkshire Hathaway B. On February 12 effective date, Berkshire Hathaway B was up 0.27% while the S&P500 was down 0.27%. While there are other factors that would have affected the S&P 500, the additional selling pressure certainly played a part in the drop of the Index.

One overlooked impact of the Berkshire Hathaway B addition is the subsequent deletion from the Dow Jones U.S. Total Market Completion Index, which is made up of every investible company in the U.S., excluding the S&P 500. Berkshire Hathaway B was the largest company in the Index with a weight of 5.86% as of February 11. The second largest company had an Index weight of 0.42%. Index managers sold Berkshire Hathaway B at the close of trading February 12 and invested the proceeds in the rest of the Index. On the effective date, while the S&P 500 was down 0.27%, the Dow Jones U.S. Completion Index was up 0.71%. The actual index effect is difficult to gauge, but it is clear that the excess demand had an impact on the performance of the Dow Jones U.S. Completion Index.

As a result of these changes, Russell has removed the rule excluding Berkshire Hathaway from the Russell indexes. This should clear the way for the company to be added to the Russell 1000 Index at the annual rebalance in June. The current estimates for share demand are 65 million shares, approximately 6.5 times average daily volume.

## First Quarter 2010 Market Summary as of March 31, 2010

	U.S. Dollar Return Total Return %		
	QTD	YTD	Trailing One-Year
	<b>U.S. EQUITIES</b>		
S&P 500	5.39	5.39	49.77
S&P 400	9.09	9.09	64.07
S&P 600	8.61	8.61	64.00
Russell 1000	5.70	5.70	51.60
Russell 2000	8.85	8.85	62.76
Russell 3000	5.94	5.94	52.44
Russell 3000 Growth	4.87	4.87	50.50
Russell 3000 Value	7.05	7.05	54.46
Dow Jones Total Market Index	6.16	6.16	52.62
<b>GLOBAL EQUITIES</b>			
MSCI World	3.24	3.24	52.37
MSCI EAFE	0.87	0.87	54.44
MSCI Emerging Markets	2.40	2.40	81.08
MSCI ACWI	3.13	3.13	55.48
MSCI ACWI ex-U.S.	1.58	1.58	60.93
MSCI ACWI ex-U.S. IMI	2.01	2.01	63.29
MSCI Developed Market ex-U.S. Small Cap	5.41	5.41	74.55
MSCI Emerging Small Cap	5.07	5.07	118.10
S&P Frontier Market Extended 150	10.72	10.72	59.11
<b>ALTERNATIVES BENCHMARKS</b>			
FTSE EPRA/NAREIT Global Index	3.37	3.37	83.82
Dow Jones-UBS Commodity Index	-5.03	-5.03	20.53
<b>U.S. FIXED INCOME</b>			
BC Aggregate	1.78	1.78	7.69
BC Govt/Credit	1.55	1.55	7.51
BC Govt/Credit Intermediate	1.54	1.54	6.92
BC High Yield 2% Cap	4.51	4.51	55.64
BC Tips	0.56	0.56	6.18
<b>GLOBAL FIXED INCOME</b>			
BC Global Aggregate	-0.27	-0.27	10.23
BC Global Emerging Market	3.61	3.61	34.94
BC 1-3 Month T-Bills	0.015	0.015	0.127

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

## NORTH TRUST GLOBAL INVESTMENTS - GLOBAL INDEX MANAGEMENT

All of us at Northern Trust Global Investments look forward to working with you to effectively manage the index rebalances and benchmark changes indicated above. We also welcome discussions on general benchmark information and would be delighted to share the details of our research on each index series.

If you have any questions or are interested in discussing related index trading strategies, please contact the Global Index Management team ([global\\_quant\\_strategy@ntrs.com](mailto:global_quant_strategy@ntrs.com)).

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