



SEAFARER®

A Tale of Two Indices:
Positive vs. Normative Indexation in the Emerging Markets

April 2020

A Tale of Two Indices – Overview



Available at www.seafarerfunds.com/a-tale-of-two-indices

Steph Gan examines questions that are fundamental to the emerging market asset class: How are emerging market indices designed, and what are their objectives? In what manners do the benchmarks excel, and what are their limitations?



A Tale of Two Indices – Part I How to Design an Index for the Emerging Markets

April 2020 – Emerging market index providers' pursuit of scalability and replicability has taken precedence over fidelity to the fundamentals of the underlying markets.

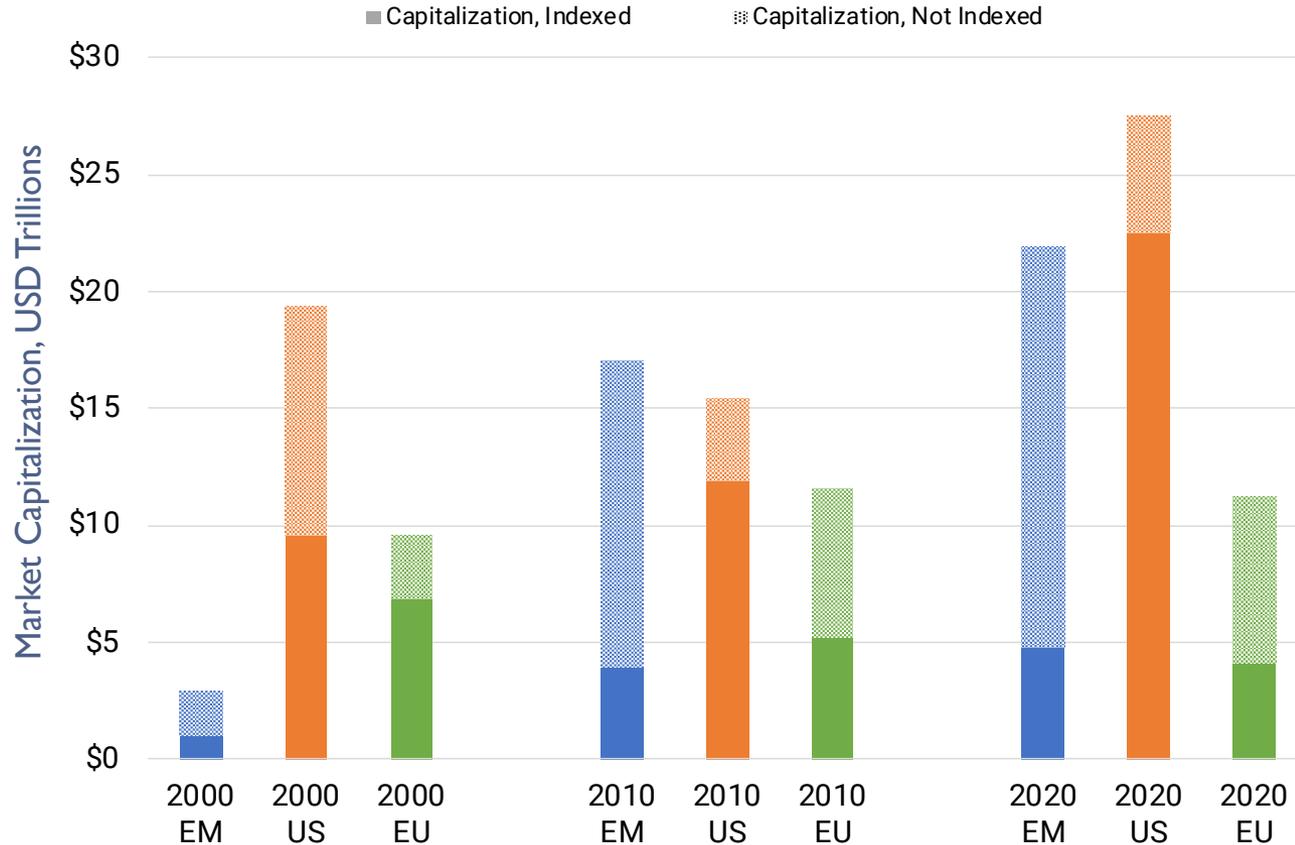


A Tale of Two Indices – Part II A Practical Comparison of Indexing Methods

April 2020 – An empirical comparison between one major emerging markets index and the underlying equity universe shows clear differences in the representations of capitalization, countries, and industries.

Because capitalization-based indices are inherently backward-looking, countries and industries that represent the next leg of the developing world's "emergence" are likely to be under-represented in the leading EM index.

Equity Market Capitalization Tracked by MSCI Indices
As of 12/31/00; 12/31/10; 3/31/20



Reference indices are MSCI Emerging Markets, MSCI US, and MSCI Europe. Total EM and EU equity market capitalizations are calculated as the sum of capitalizations for companies trading above \$100 million. EM equity market capitalization is calculated as the sum of capitalizations for 26 countries included in the MSCI EM Index: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. US equity market capitalization is from the Bloomberg United States Exchange Market Capitalization USD Index. EU equity market capitalization is calculated as the sum of capitalizations for 15 developed European countries included in the MSCI EU Index: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK.

Sources: Bloomberg, FactSet, Seafarer.

What Belongs In a Passive Index?



Comparison of Two Leading Emerging Market Indices

	MSCI EM Index	FTSE EM All Cap China A Inclusion Index
Market Capitalization	Mid- and large-cap	Small-, mid-, and large-cap
Countries Represented	26	24
Inclusion		
South Korea	Yes	No; Developed Market classification
Kuwait	No; Frontier Market classification	Yes
Poland	Yes	No; Developed Market classification
Chinese A-Shares	Yes; Partial Weight	Yes; Partial Weight
Number of Constituents	1,404	4,043
Cumulative Weight of Top 10 Constituents	24.5%	22.0%
Market Cap Statistics (USD million), free-float weighted		
Average	4,430	1,524
Largest	358,941	369,054
Smallest	104	10
Median	1,687	246
Market Cap Statistics (USD million), not weighted		
Average	14,310	5,058
Largest	1,879,348	1,879,348
Smallest	174	20
Median	6,087	1,422

As of 12/31/2019.

Sources: MSCI, Factset, FTSE Russell, Bloomberg.

Comparison of MSCI EM Index and Seafarer’s “Positive” EM Benchmark

	MSCI EM Index	Positive EM Benchmark
Number of Constituents	1,404	10,800
Countries Represented	26	26
Index Market Cap (USD million)	6,220,193	27,788,490
Index Market Cap as % of Positive EM	22.4%	100.0%
Cumulative Weight of Top 10 Constituents	24.5%	17.1%
Market Cap Statistics (USD million), not weighted		
Weighted Average	115,674	185,639
Median	6,087	524
Lowest	174	100
Highest	1,879,348	1,879,348

Seafarer defines an objective “positive” benchmark as comprising companies with an equity market capitalization of at least USD 100 million in 26 EM countries, as defined by MSCI. Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

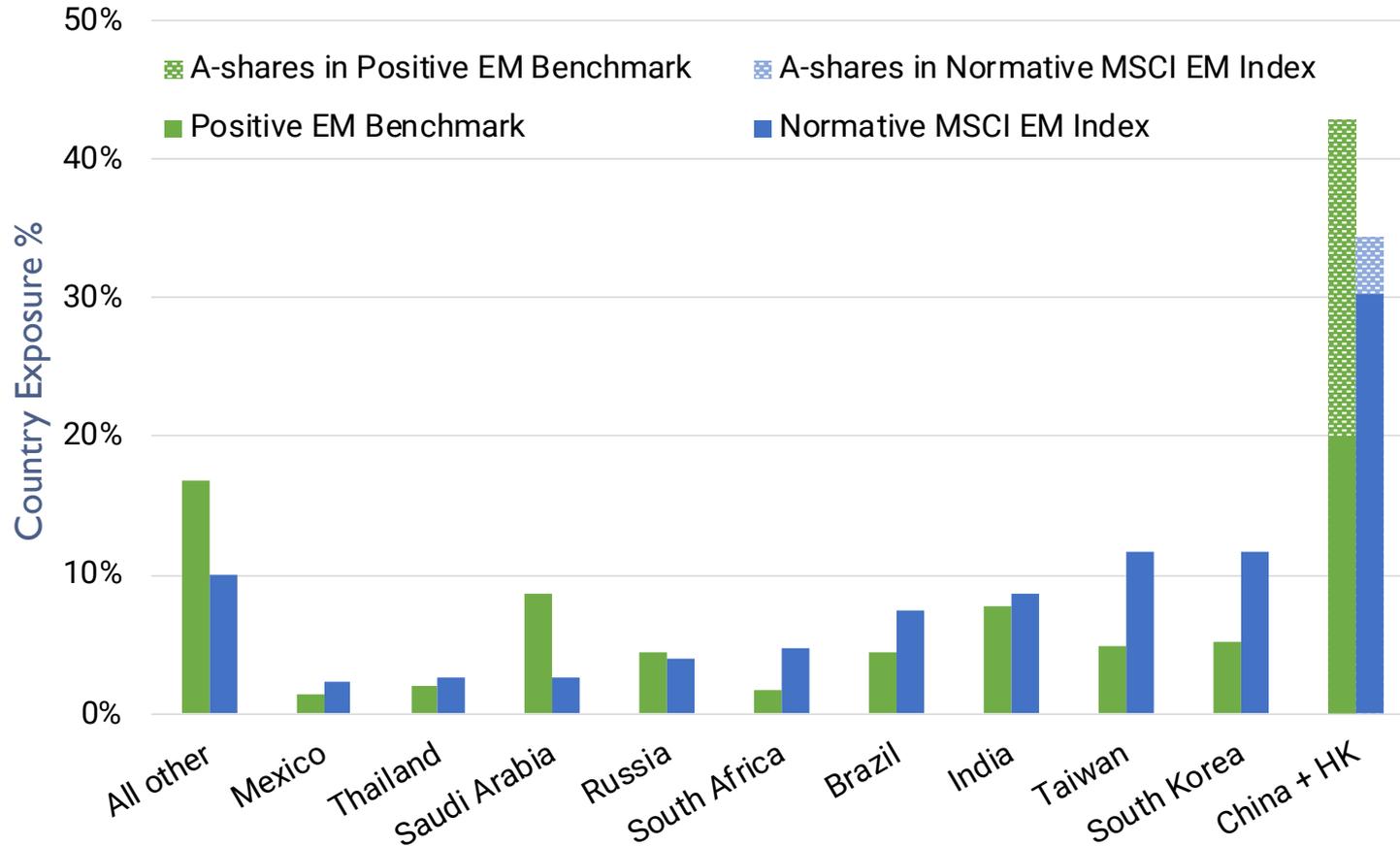
As of 12/31/2019.

Sources: Bloomberg, MSCI, Seafarer.

MSCI EM Index Country Exposure



Country Exposure Comparison –
Normative MSCI EM Index and Positive EM Benchmark



As of 12/31/2019.
Sources: Bloomberg, MSCI, Seafarer.

MSCI China A-Shares Inclusion Journey



China's Market Liberalization Efforts

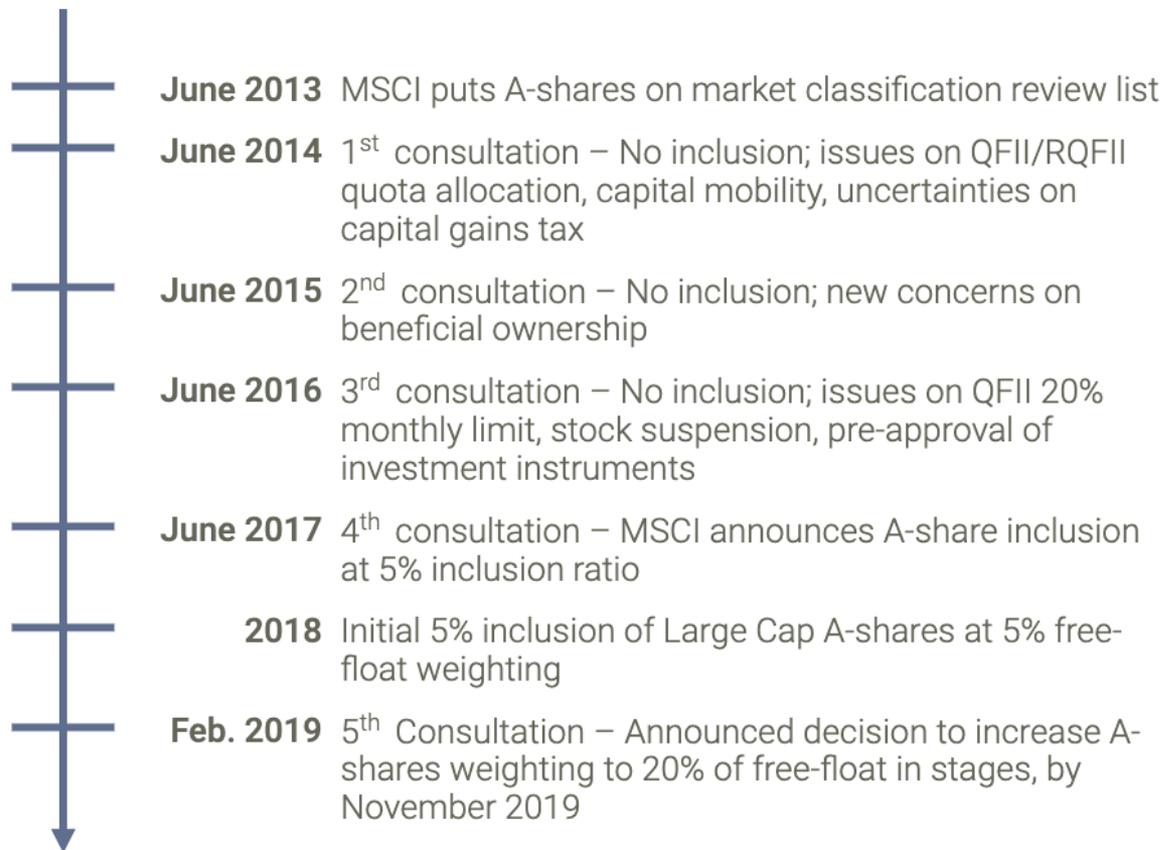
2002-2012 QFII and RQFII schemes launched

2014 Shanghai Connect launched

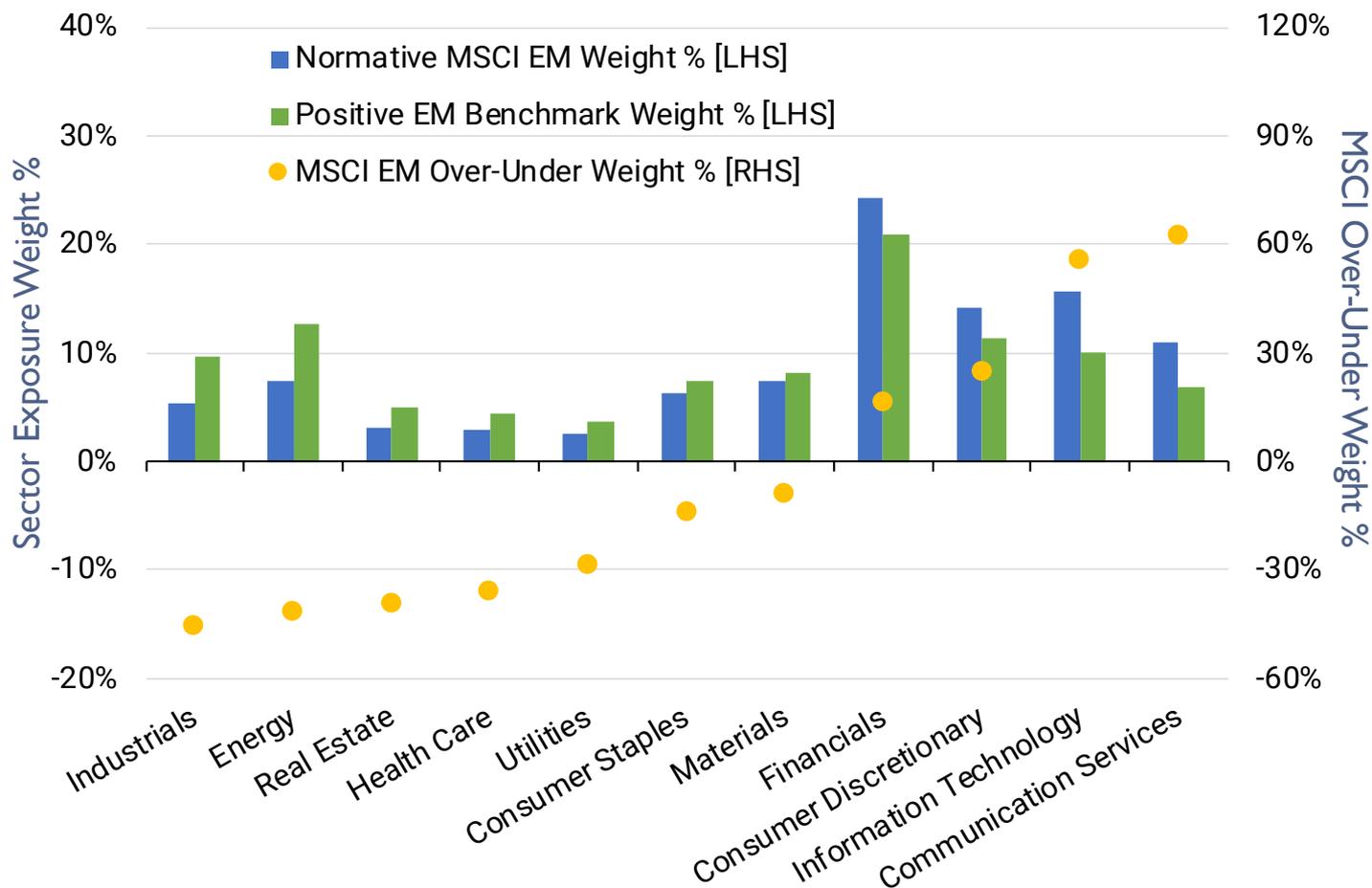
2016 Shenzhen Connect launched

2018 Stock Connect total daily quotas quadrupled

MSCI China A-Shares Inclusion Efforts



Industry Exposure Comparison –
Normative MSCI EM Index & Positive EM Benchmark

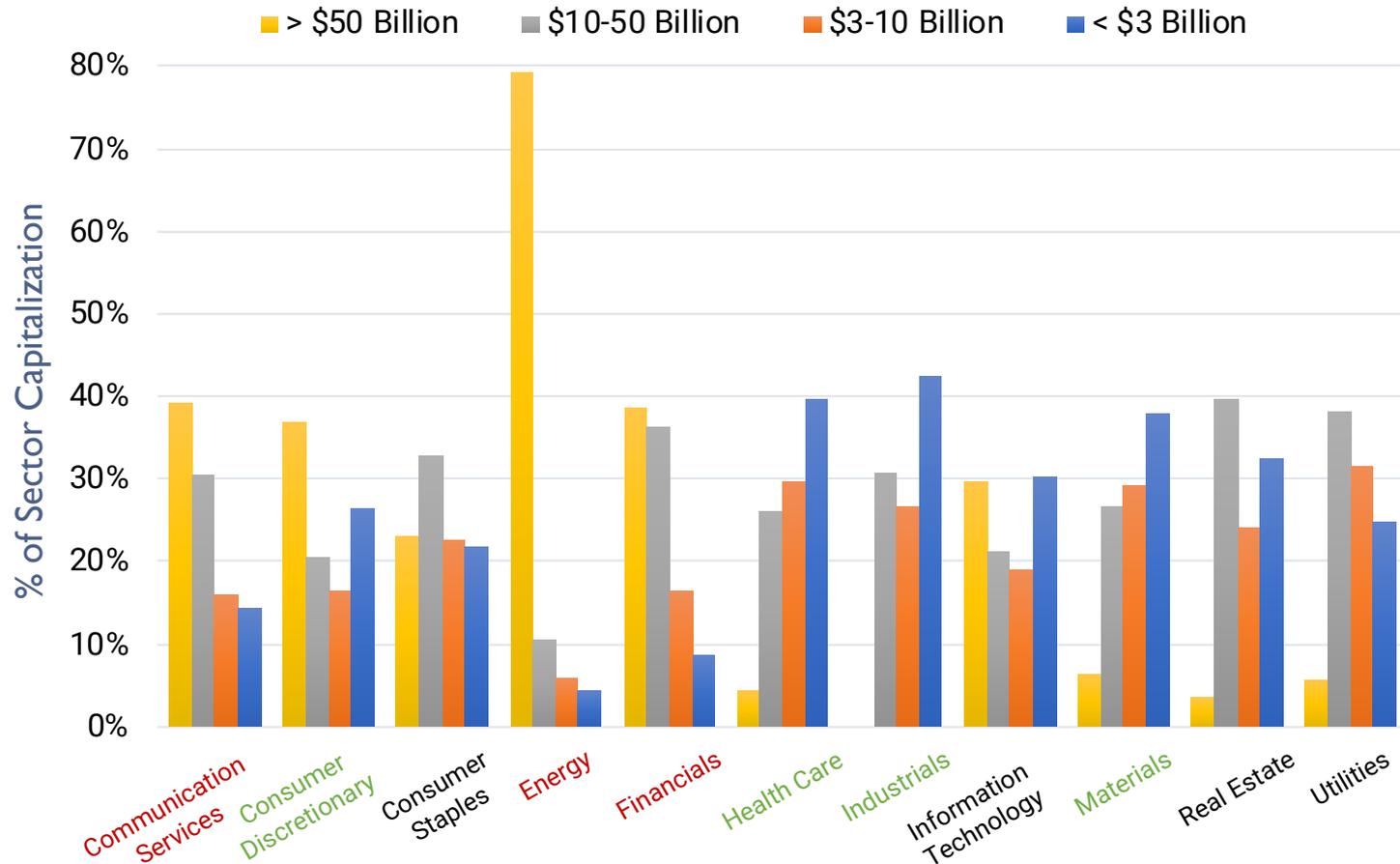


As of 12/31/2019.
Sources: Bloomberg, MSCI, Seafarer.

Capitalization Focus Can Determine Sector Exposure



Industry Weighting by Company Capitalization Size
Positive EM Benchmark



Note: Small-cap stocks are markedly under-represented in certain sectors (indicated with red labels: Energy, Communication Services, and Financials), but enjoy strong representation in other sectors (with green labels: Consumer Discretionary, Health Care, Industrials, and Materials).

As of 12/31/2019.

Sources: Bloomberg, MSCI, Seafarer.

Past performance does not guarantee future results.

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The MSCI Emerging Markets Index is a free float-adjusted market capitalization index designed to measure equity market performance of emerging markets. Index code: MXEF. The MSCI U.S. Index is a free-float weighted index designed to measure the performance of the large- and mid-cap segments of the U.S. market. Index code: MXUS. The MSCI Europe Index captures large- and mid-cap representation across the European developed markets equity universe. Index code: MXEU. The Bloomberg United States Exchange Market Capitalization USD Index is a total capitalization index representing actively traded, primary securities on U.S. exchanges. Index code: WCAUUS. The FTSE Emerging Markets All Cap China A Inclusion Index is a market capitalization weighted index representing the performance of large-, mid- and small-capitalization stocks in emerging markets. Index code: FQEACR. It is not possible to invest directly in an index.

Market Capitalization is the value of a corporation as determined by the market price of its issued and outstanding common stock. It is calculated by multiplying the number of outstanding shares by the current market price of a share. **Chinese A-Shares** are a class of securitized common stock in Chinese companies, traded exclusively on Chinese stock exchanges (i.e., Shanghai and Shenzhen), and denominated in renminbi, China's currency. Historically, A-shares were inaccessible to foreign investors, but more recently China has allowed foreign investors to purchase A-shares through the Qualified Foreign Institutional Investor (QFII) program and the Stock Connect programs. **Qualified Foreign Institutional Investor (QFII)** is a program that permits certain licensed global institutional investors to participate in China's renminbi-based mainland capital markets, subject to a quota. **Renminbi Qualified Foreign Institutional Investor (RQFII)** is a modified version of QFII; RQFII participants can invest in the same range of investment products as QFIIs and are subject to the same restrictions, but RQFII uses renminbi to purchase securities, while a QFII participant uses their domestic currency. **Shanghai-Hong Kong Stock Connect** is a trading link launched in 2014 that allows offshore, non-domestic-Chinese investors and entities to invest in Chinese A-shares listed on the Shanghai Exchange. Investment via the Stock Connect occurs through a special mechanism that was designed and implemented by the Hong Kong Stock Exchange. The Stock Connect also allows Mainland China investors to purchase certain Hong Kong-listed stocks via accounts with the Shanghai Exchange. **Shenzhen-Hong Kong Stock Connect** is a trading link launched in 2016 that allows offshore, non-domestic-Chinese investors and entities to invest in Chinese A-shares listed on the Shenzhen Exchange. Investment via the Stock Connect occurs through a special mechanism that was designed and implemented by the Hong Kong Stock Exchange. The Stock Connect also allows Mainland China investors to purchase certain Hong Kong-listed stocks via accounts with the Shenzhen Exchange. **Stock Connect** consists of trading links that allow offshore, non-domestic-Chinese investors and entities to invest in Chinese A-shares listed on the Shanghai and Shenzhen Exchanges. Investment via the Stock Connect occurs through a special mechanism that was designed and implemented by the Hong Kong Stock Exchange. The Stock Connect also allows Mainland China investors to purchase certain Hong Kong-listed stocks via accounts with the Shanghai and Shenzhen Exchanges.



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