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Index Education

The S&P Global BMI: Providing Consistent Insights into Global Equity Markets since 1989

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Over the past few decades, best practices for global equity benchmark construction have converged on a few key principles. First, a properly constructed global index series must fully capture the investable equity opportunity set. In order to do so, it should include large-, mid-, and small-cap companies, incorporate minimum size and liquidity requirements, and be float adjusted so that it only includes shares available for purchase. Second, it should utilize a modular, building block approach that allows the global opportunity set to be decomposed into subsets without gaps or overlaps. Last but not least, it should apply a consistent methodology across markets and have continuity in its approach over time. These principles are critical to ensuring a fair and robust benchmark that can be utilized by market participants to support key aspects of the investment process such as performance measurement, asset allocation, and index replication.

Established in 1989, the S&P Global BMI (Broad Market Index) Series pioneered these core benchmarking principles. Ahead of its time in many respects, the S&P Global BMI lays claim to a number of important firsts in the global indexing industry; the most important of these being that it was the first to incorporate float adjustment and to include large-, mid-, and small-cap companies in a single modular global benchmark. As a result, the S&P Global BMI is used by some of the world's largest and most sophisticated asset managers and asset owners, who value it as a comprehensive and trusted data set.

In this paper, we will cover the following major points.

- With more than 30 years of seamless history, the S&P Global BMI provides a consistent universe for historical market analysis and back-testing investment strategies.
- Over the years, other major global equity indices have converged to follow the S&P Global BMI framework—in particular its float adjustment and modular inclusion of large-, mid-, and small-cap securities in a single index series.
- The S&P Global BMI's deep small-cap segment provides the most comprehensive measure of global small-cap securities.

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- Differing country classifications for South Korea among major index providers may lead to meaningfully different representations of the emerging market opportunity set.
- Other competitors' indices, such as MSCI EAFE, may inadvertently create a gap in coverage by excluding Canadian securities. An alternative, such as the S&P Developed ex-U.S. BMI, eliminates that gap.

COMPREHENSIVE COVERAGE

The S&P Global BMI enables market participants to gain precise measures of markets.

The S&P Global BMI spans 50 developed and emerging markets and over 11,000 companies, and it includes over 99% of available market cap for each country. The index blueprint allows for the creation of hundreds of thousands of indices, sliced and diced from the global headline index in a flexible, customizable, and modular approach. This enables market participants to gain precise measures of markets across countries and regions, sizes, sectors, and investment styles (growth and value).

Exhibit 1: The S&P Global BMI – Modular Design and Comprehensive Focus

CRITERIA	COUNTRY/REGION	SIZE	SECTOR/ INDUSTRY	STYLE	CURRENCY
S&P Global BMI Criteria	• 50 Countries: -25 Developed -25 Emerging • Full Array of Regions: -Developed ex-U.S. -Developed Asia -Emerging, etc.	• LargeCap • MidCap • SmallCap • BMI (L+M+S) • Combinations: -LargeMidCap -MidSmallCap	• 11 GICS® Sectors • 24 GICS Industry Groups	• Growth • Value	• USD • GBP • EUR • AUD • CAD • JPY • LCL
Sector Index	S&P Global BMI Communication Services (Sector) (USD)				
Region Index	S&P Developed ex-U.S. LargeMidCap Growth (USD)				
Country Index	S&P Brazil BMI Materials (Sector) (EUR)				
Approximately 200,000 standard index combinations					

Source: S&P Dow Jones Indices LLC. Data as of May 31, 2020. Table is provided for illustrative purposes.

CONTINUOUS AND CONSISTENT FLOAT-ADJUSTED HISTORY

Float adjustment is necessary to accurately reflect shares that are available to global investors.

Float adjustment—now the industry standard for equity benchmarks—is necessary to accurately reflect shares that are available to global investors. This is particularly important in many international equity markets where government and other strategic holdings tend to represent a significant portion of total equity market capitalization.

Before making its permanent home at S&P Dow Jones Indices in 2004, the index suite now known as the S&P Global BMI Series was launched 15 years earlier by Salomon Brothers. At launch, the index was the first-ever float-adjusted global benchmark, and it was the first to include large-, mid-, *Throughout its 30-year history the S&P Global BMI's methodology has remained largely unchanged.*

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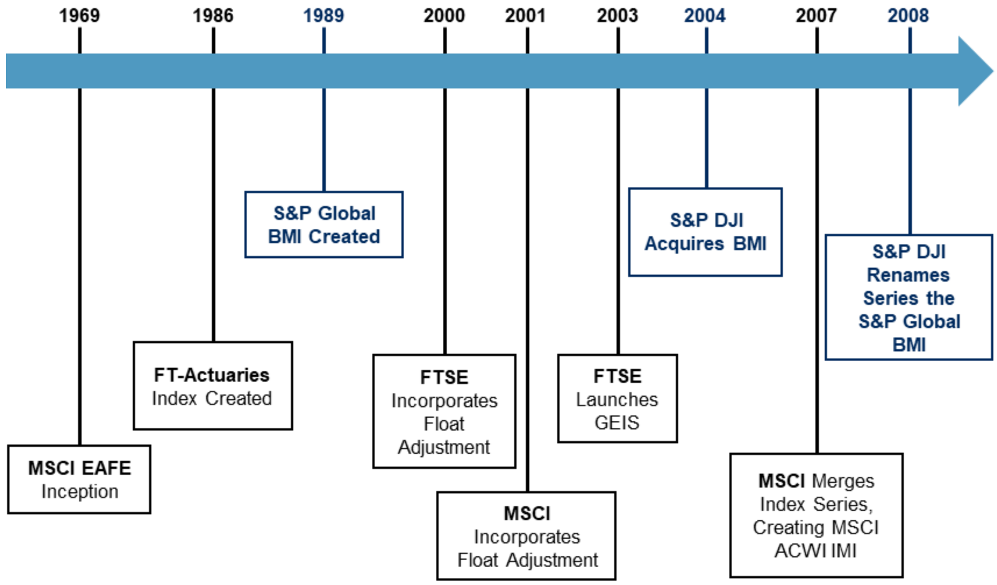
and small-cap companies in a single index series. Throughout its 30-year history, its methodology has remained largely unchanged, leading to a unique data advantage compared with alternative benchmarks. FTSE and MSCI, for example, did not begin to incorporate float adjustment until 2000 and 2001,[1] respectively. Likewise, FTSE and MSCI first introduced modular "all-cap" index series in 2003 and 2007, respectively.[2]

Exhibit 2: The S&P Global BMI – Benchmark Indices History



Source: S&P Dow Jones Indices LLC, MSCI, FTSE Russell. Data as of May 31, 2020. The S&P Global BMI was originally named the Salomon Brothers World Equity Index. Chart is provided for illustrative purposes.

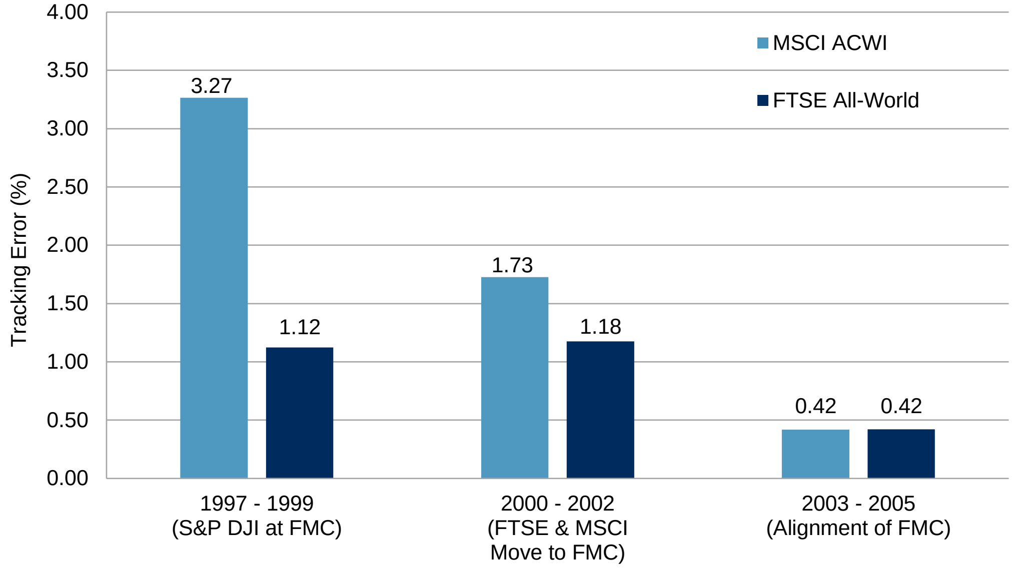
We highlight the impact of lack of stable application of float adjustment throughout history in Exhibit 3. Using the S&P Global LargeMidCap returns against those of alternative benchmarks, we compare the annualized tracking error in three consecutive three-year periods: 1) when S&P DJI was the only provider incorporating float adjustment; 2) during the MSCI and FTSE transition to float adjustment; and 3) after alignment. It is notable that the tracking error between the S&P Global LargeMidCap and the alternative indices was greatly reduced after 2001 when MSCI and FTSE completed the transition to float adjustment.

[1] https://www.msci.com/eqb/pressreleases/archive/20001210_pr01.pdf

[2] MSCI merged its small-cap series with the MSCI Standard (i.e., LargeMidCap) Indices in two phases in November 2007 and May 2008, creating the MSCI Investable Market Indices. Prior to this, the MSCI SmallCap Index was maintained separately and had overlap with the MSCI Standard Indices. FTSE's Global All Cap Index series was introduced in 2003.

Before the year 2000, the S&P Global BMI was the only index among its peers to use float adjustment.

Exhibit 3: Global Indices Comparison – Significant Tracking Error Prior to Alignment of Float-Adjustment Treatment



Source: S&P Dow Jones Indices LLC, MSCI, FTSE. Data as of March 31, 2020. Chart is provided for illustrative purposes.

The convergence of best practices by index providers has led to similar risk/return profiles of the indices in recent years.

The convergence of best practices by index providers has led to similar risk/return profiles of the indices in recent years (see Exhibit 4). However, this convergence over time means that for back-tested strategies and historical research, users need to be mindful of the differences that once existed. Having a continuous and consistent history means the S&P Global BMI Series eliminates an important source of bias compared with other indices that underwent important methodology changes.

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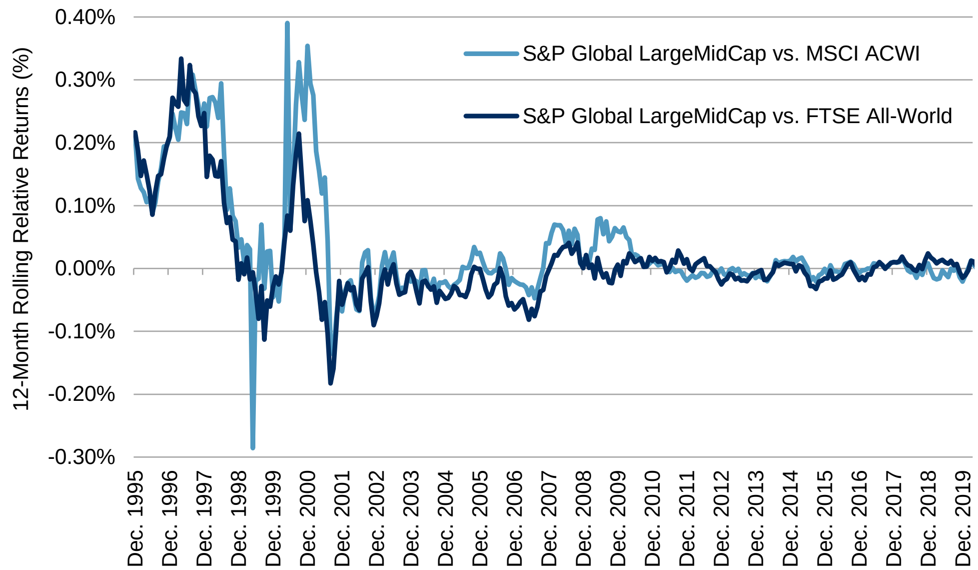
Exhibit 4: Decrease in Relative Performance Differences over Time



Source: S&P Dow Jones Indices LLC, MSCI, FTSE. Data as of May 29, 2020. Index performance based on total return in USD. Chart is provided for illustrative purposes.

Specific country and regional indices may exhibit more substantial comparable differences, as strategic holders concentrated in some countries would increase this effect.

THE FIRST TO PROVIDE EXPOSURE TO GLOBAL SMALL CAPS

The S&P Developed SmallCap was the first global index covering the small-cap size range.

Introduced in 1989, the S&P Developed SmallCap was the first global index covering the small-cap size range.[3] At the time, international equity investing almost exclusively focused on large- and mid-cap companies, as defined by MSCI's "Standard" index series. However, this new index offering paved the way for growing adoption of international small caps as a unique market segment. Many institutional investors now use "all-cap" indices as policy benchmarks for international equity asset classes as well.

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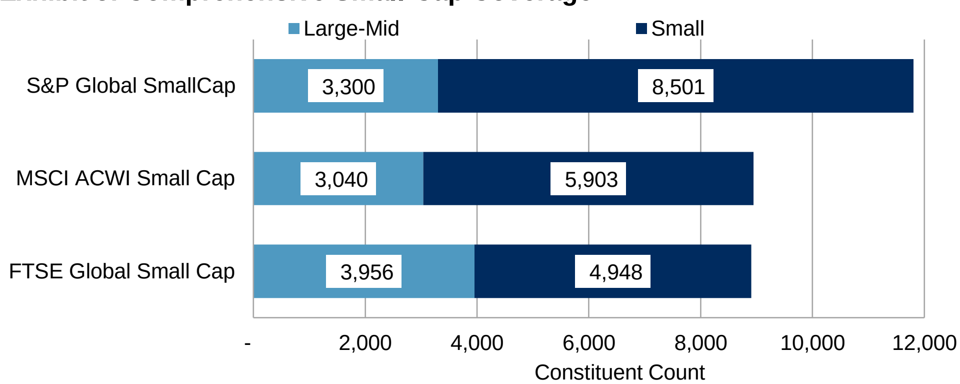
Today, the small-cap portion of the S&P Global BMI is defined as the bottom 15% of float market cap in each country. In addition to its extensive history, the S&P Global SmallCap offers significant depth into the market capitalization spectrum, as it reaches further into relatively smaller constituents. As shown in Exhibit 5, the S&P Global BMI includes more than 8,500 companies in its small-cap segment, while the MSCI and FTSE benchmarks include about 6,000 and 5,000, respectively.

Exhibit 5: Comprehensive Small-Cap Coverage



Source: S&P Dow Jones Indices LLC, MSCI, FTSE. Data as of May 29, 2020. Chart is provided for illustrative purposes.

The S&P Global BMI includes more than 8,500 companies in its small-cap segment.

COUNTRY CLASSIFICATIONS AND INCLUSION OF SOUTH KOREA

While many aspects of index construction have converged across providers, some notable differences remain, particularly in the area of country classification. Developed and emerging country assignment differences lead to notable inclusion or exclusion of these countries across market segments. One of the most meaningful country classification differences is South Korea, which S&P DJI has classified as a developed

[3] The index was previously called the Salomon Smith Barney World Extended Market Index.

market since 2001. MSCI continues to classify the country as an emerging market, while FTSE promoted its standing to developed status in 2009.

S&P DJI has classified South Korea as a developed market since 2001.

S&P DJI conducts a complete review annually of all countries included in its global equity benchmarks. Similar to other index providers, this process involves an evaluation of markets by various economic and market accessibility criteria. S&P DJI has classified South Korea as a developed market since 2001 because of its high level of economic development, considerable size and liquidity, and absence of significant foreign investment restrictions, among other reasons. Over the years, S&P DJI confirmed this classification through its annual country classification consultation process, which involves feedback from a wide range of market participants, including asset managers and asset owners.[4]

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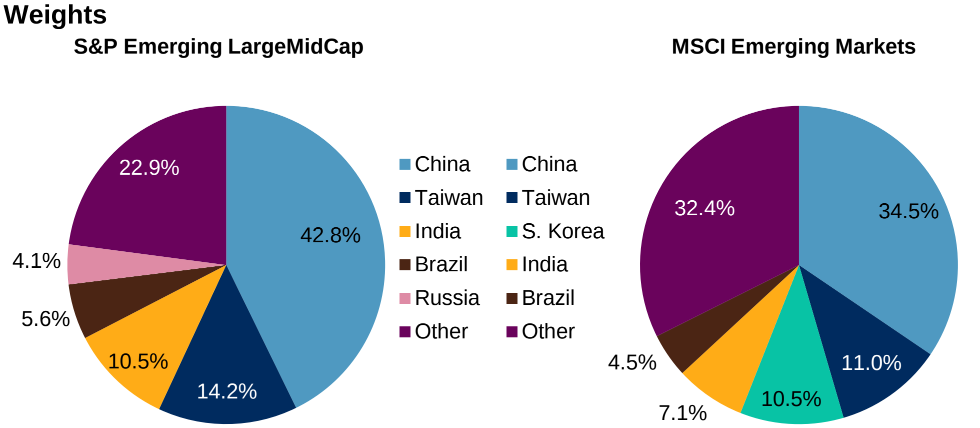
While only forming 1.7% of the S&P Developed BMI,[5]—and therefore excluded from the S&P Emerging BMI—South Korea represents an outsized weight of 10.5% in the MSCI Emerging Markets,[6] potentially crowding out less-developed markets from the benchmark. Country exposure is a key driver of risk and return in global equities, and the degree of weight differences are shown in Exhibit 6.

Country exposure is a key driver of risk and return in global equities.

Exhibit 6: Impact of South Korea Classification on Emerging Market Index Weights



Source: S&P Dow Jones Indices LLC, MSCI. Data as of May 29, 2020. Charts are provided for illustrative purposes.

LIMITATIONS OF MSCI EAFE AS A REGIONAL DEFINITION

For a U.S. investor, developed market exposure outside of the U.S. is a core building block in forming a comprehensive global portfolio. In part because of its status as the world's first international equity index, MSCI EAFE enjoys a commanding market presence for international equity benchmarks. It also serves as the underlying index for many of the largest

[4] For more information on the coverage and history of the S&P Global BMI, please see "Inside the S&P Global BMI."

[5] S&P Dow Jones Indices data as of April 30, 2020.

[6] MSCI data as of April 30, 2020.

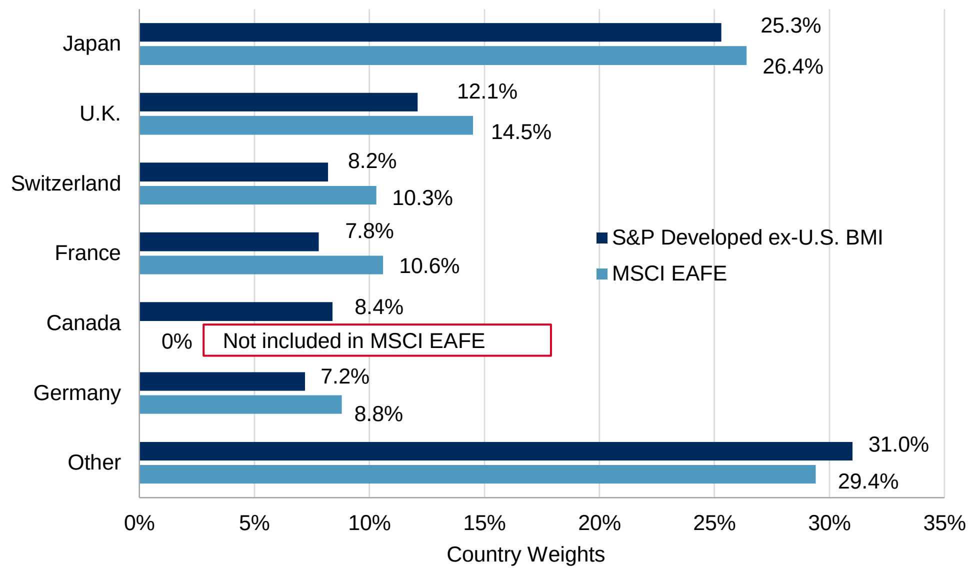
international equity ETFs and index funds. However, what many don't realize is that it excludes Canadian securities entirely, which may create an unintended gap in exposure or reflect an unfair performance benchmark for a manager focused on developed ex-U.S. equities. The S&P Developed ex-U.S. BMI eliminates this gap, covering all of the 24 developed market countries outside of the U.S.

The MSCI EAFE excludes Canadian securities entirely.

As depicted in Exhibit 7, the exclusion of Canada and South Korea—both of which are included in the S&P Developed ex-U.S. BMI and the FTSE Developed ex-US—amount to an exclusion of approximately 12.5% from the popular MSCI EAFE.

Excluding Canada may create an unintended gap in exposure or reflect an unfair performance benchmark in developed ex-U.S. equities.

Exhibit 7: Unintended Canadian Exposure Gap



Source: S&P Dow Jones Indices LLC, MSCI. Data as of May 29, 2020. Chart is provided for illustrative purposes.

CONCLUSION

The S&P Developed ex-U.S. BMI eliminates this gap, covering all of the 24 developed market countries outside of the U.S.

Since 1989, the S&P Global BMI has provided a comprehensive array of indices that offer seamless history for market analysis and for back-testing investment strategies. The emerging and developed ex-U.S. benchmarks within the S&P Global BMI Series provide clear coverage of target markets without unintended gaps or overlaps. The small-cap segment of the global index offers excellent depth in excess of widely used alternative offerings. Although its name has changed over the years, the S&P Global BMI has provided a consistent lens into global equity markets for more than 30 years.

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