

# Why Index Construction Matters in Colombian Equity Benchmarks

## Contributor

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## INTRODUCTION

Introduced on Oct. 24, 2013, the [S&P Colombia Select Index](#) is one of the leading benchmarks measuring the Colombian equity market. Designed to track the largest and most liquid Colombian stocks, this index was authorized by the Colombian Ministry of Finance and Public Credit (Ministerio de Hacienda y Crédito Público [MHCP]) in 2015 to sit alongside the MSCI COLCAP Index<sup>1</sup> as the only two domestic equity components of the Índice Agregado de Renta Variable Local (IARVL).<sup>2</sup> The IARVL is a composite index calculated by the MHCP to track the performance of the Colombian equity market and serve as a benchmark for private and public institutional portfolios, including those of pension funds.

While the S&P Colombia Select Index and MSCI COLCAP Index share the objective of measuring the performance of the local equities market, the S&P Colombia Select Index's inclusion of single-company and sector caps results in a more diversified measure of the Colombian equities market. Despite the larger number of securities in the MSCI COLCAP Index, it is a more concentrated index at the company and sector level, compared with the S&P Colombia Select Index. These variations in exposure have also led to meaningful differences in risk/return profiles historically, with the S&P Colombia Select Index outperforming the MSCI COLCAP Index over the mid and long term.

## METHODOLOGY OVERVIEW

The S&P Colombia Select Index methodology is composed of four sections: the underlying universe, eligibility criteria, index construction, and index maintenance.

<sup>1</sup> The MSCI COLCAP Index, launched on May 28, 2021, was developed in alliance with the Colombia Stock Exchange (Bolsa de Valores de Colombia [BVC]) and succeeds the previous COLCAP Index, which was originally created in 2008 and was active until May 27, 2021, when MSCI became the official index administrator.

<sup>2</sup> In May 2015, the S&P Colombia Select Index was approved by the Financial Superintendence of Colombia (SuperIntendencia Financiera de Colombia [SFC]) as one of the local equity indices used to calculate the IARVL.

## A Closer Look at the Universe

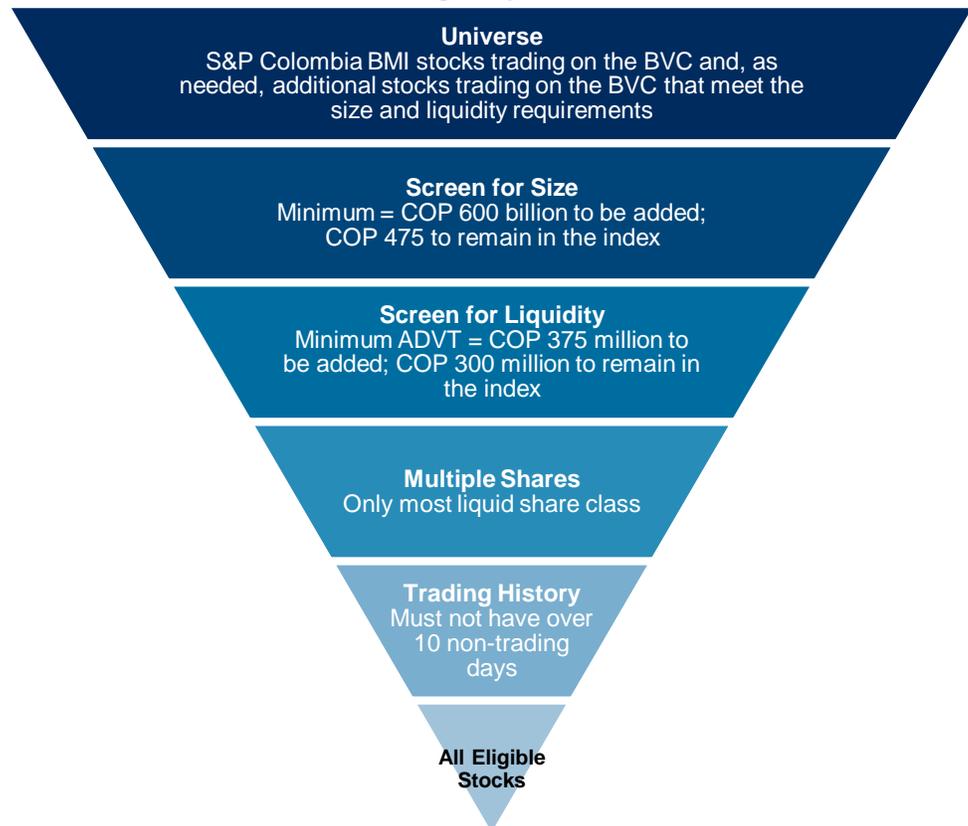
The S&P Colombia Select Index methodology starts with a universe composed of the [S&P Colombia BMI](#), a sub-index of the S&P Global BMI,<sup>3</sup> which has eligibility requirements that must be met by all emerging market companies. Additionally, the universe can be expanded to include Colombian companies trading on the Colombia Stock Exchange (Bolsa de Valores de Colombia [BVC]) that meet the eligibility criteria of the S&P Colombia Select Index, so that it contains at least 14 stocks.

*The S&P Colombia Select Index is one of the leading benchmarks measuring the Colombian equity market.*

## Eligibility Criteria for the S&P Colombia Select Index

Stocks are then screened using a series of eligibility criteria, including size (float-adjusted market capitalization [FMC]) and liquidity (average daily value traded [ADVT]). These measures are considered in Colombia pesos (COP) to eliminate any currency fluctuation that may impact the local value of the listed stocks. Exhibit 1 further details the eligibility criteria for inclusion and continuous membership.

### Exhibit 1: S&P Colombia Select Eligibility Criteria



*In 2015, the S&P Colombia Select Index joined the MSCI COLCAP Index as one of only two domestic equity components of the IARVL.*

Source: S&P Dow Jones Indices LLC. Chart is provided for illustrative purposes.

<sup>3</sup> Please refer to the [S&P Global BMI, S&P/IFCI Methodology](#) for details on the eligibility requirements.

## Constructing the S&P Colombia Select Index

*The S&P Colombia Select Index methodology starts with the S&P Colombia BMI as the universe.*

The construction of the S&P Colombia Select Index consists of selecting the stocks that meet the eligibility criteria and then weighting them.

Companies with multiple share classes are typically represented by their most liquid eligible share class.

The index requires a minimum of 14 stocks at rebalancing. If needed, the universe is expanded to all BVC-listed stocks. The selection of additional stocks would be limited to the next-most-liquid non-component stocks until the minimum count of 14 stocks is reached.

The next step is the weighting of the constituents. All stocks in the index are weighted by their FMC, subject to the following criteria:

1. The weight of any company cannot exceed 15% of the index;
2. The weight of any one GICS® sector cannot exceed 40% of the index; and,
3. The minimum initial portfolio size that can be turned over in a single day (based on 12-month ADVT) cannot be lower than COP 60 billion.<sup>4</sup>

*Stocks are then screened using a series of eligibility criteria, including size and liquidity.*

The weighting mechanism is designed to improve stock diversification and liquidity and to reduce concentration among stocks and economic sectors.

The maintenance and governance of the S&P Colombia Select Index are overseen by S&P DJI's Index Production and Index Committee teams, respectively, on an ongoing basis in an effort to ensure that the index meets its objective, a process that may include changes to the methodology. It is standard practice to consider all methodology documents as "live" documents that may adapt as market conditions evolve. For example, since its launch on Oct. 31, 2013, the S&P Colombia Select Index has undergone changes, mostly to address the decrease in local market liquidity. This has involved expanding the universe, providing a minimum count of stocks, and changing the currency rate of the eligibility criteria to local currency. This eliminated currency exchange rate fluctuations that led to the U.S. dollar impacting index composition.

*After the selection process, all stocks that meet the eligibility criteria are weighted by their FMC.*

<sup>4</sup> If necessary, based on market conditions, the portfolio size used to calculate basket liquidity weight may be adjusted at the discretion of the S&P DJI Index Committee to achieve each of the weighting criteria.

## METHODOLOGY COMPARISON

While the S&P Colombia Select Index and the MSCI COLCAP Index have the shared objective of measuring the local Colombian equities market, their approaches differ. One of the differences is the number of components within each index. The S&P Colombia Select Index requires a minimum of 14 stocks at rebalancing. The MSCI COLCAP Index requires 25 stocks and 20 companies. In Colombia, the current market conditions of low liquidity and limited listed stocks<sup>5</sup> are rather high thresholds to meet, forcing the MSCI COLCAP Index to include potentially illiquid stocks.

Another difference between the two methodologies is the weighting criteria. The S&P Colombia Select Index aims to limit single-stock risk by imposing a stock cap of 15%. The MSCI COLCAP Index has a stock cap of 25%. Furthermore, the S&P Colombia Select Index aims to limit the sector concentration to 40%. The MSCI COLCAP Index has no sector capping.

<b>Exhibit 2: Methodology Comparison</b>		
<b>CATEGORY</b>	<b>S&amp;P COLOMBIA SELECT INDEX</b>	<b>MSCI COLCAP INDEX<sup>6</sup></b>
Objective	The index is designed to measure the performance of a minimum of 14 stocks domiciled in Colombia, representing the largest and most liquid stocks.	The MSCI COLCAP Index is designed to represent the performance of the local Colombian equity market and includes a minimum of 25 securities and 20 issuers selected based on free float-adjusted market capitalization, liquidity, and international investability criteria.
Universe	S&P Colombia BMI stocks trading on BVC as domestic stocks. As needed, additional Colombian stocks trading on BVC meeting size and liquidity requirements may also be part of the universe.	The universe is designed to cover the Colombian equity market through local listing in the BVC. Foreign shares trading through the Colombian Global Market Segment are not eligible.
<b>ELIGIBILITY CRITERIA</b>		
Float-Adjusted Market Cap (FMC)	Stocks must have an FMC of at least COP 600 billion to be included; COP 475 billion to remain in the index.	Stocks have a MSCI Colombia Investable Market Index (IMI) cut-off of 12.5% for new securities and 6.25% for existing constituents.
Liquidity	Stocks must have 3-month, 6-month, and 12-month ADVTs of at least COP 375 million to be included; COP 300 million to remain in the index.	New securities must have 3- and 12-month annual traded value ratios (ATVR) of at least 2.5% and 1% for existing constituents.
Trading Days	Stocks must not have more than 10 cumulative non-trading days during the past three months.	At least 20% of the three-month frequency of trading for new securities and 10% of existing securities
Multiple Share Classes	Only the most liquid share class is represented.	Multiple securities from the same issuer are allowed and are assessed separately.
<b>CONSTRUCTION</b>		
Selection	All stocks that meet the eligibility criteria form the index, subject to a minimum count of 14 companies.	The MSCI COLCAP Index targets a minimum of 25 securities and 20 issuers. All securities of the MSCI Colombia IMI are included. If not achieved, then additional stocks are pulled from the investable and then eligible equity universe.
Weighting	Constituents are FMC weighted, subject to a 15% single-stock cap, 40% single-sector cap, and minimum initial portfolio of COP 60 billion that can be turned over in a single day.	Constituents are weighted according to their free float available in the market subject to a company cap of 25%.
<b>MAINTENANCE</b>		
Rebalancing	Semiannually in March and September	Quarterly, to coincide with MSCI's regular index reviews. (November full review, February, May, and August for maintenance)

Source: S&P Dow Jones LLC. Data as of Sept. 30, 2021. Table is provided for illustrative purposes.

<sup>5</sup> Source: MILA News, BVC. As of Aug. 31, 2021, the YTD traded volume is USD 4.6 billion. The number of listed stocks on the BVC is 46 as of Aug. 31, 2021.

<sup>6</sup> Source: MSCI Methodology can be found at: <https://www.msci.com/msci-colcap>

## Constituent Comparison

Exhibit 3 compares the composition and weights of each of these indices as of Sept. 30, 2021. While Bancolombia has a total weight of 15.3% in the S&P Colombia Select Index, the company has a total weight of nearly 25% in the MSCI COLCAP Index when share classes are combined. Having a quarter of the MSCI COLCAP Index represented by a single company can expose it to high single stock risk.

*The S&P Colombia Select Index requires a minimum of 14 stocks at rebalancing.*

*The MSCI COLCAP Index requires 25 stocks and 20 companies.*

*Furthermore, the S&P Colombia Select Index has a single-stock cap of 15%, while the MSCI COLCAP Index has a 25% stock cap.*

**Exhibit 3: Index Composition**

TICKER	COMPANY	WEIGHT (%)	
		S&P COLOMBIA SELECT INDEX	MSCI COLCAP INDEX
<b>PFBCOLOM</b>	<b>Bancolombia S.A. Pref</b>	<b>15.3</b>	<b>15.9</b>
ECOPETROL	Ecopetrol S.A.	15.4	14.4
ISA	Interconexion Electrica S.A. E.S.P.	14.5	10.7
<b>BCOLOMBIA</b>	<b>Bancolombia S.A.</b>	<b>-</b>	<b>9.0</b>
GEB	Grupo Energia Bogota S.A. E.S.P.	9.0	8.3
GRUPOSURA	Grupo Inversiones Suramericana	9.1	5.4
NUTRESA	Grupo Nutresa S.A.	6.9	4.8
PFAVAL	Grupo Aval Acciones Y Valores S.A.	5.9	4.7
PFDAVVNDA	Banco Davivienda S.A.	4.4	3.7
GRUPOARGOS	Grupo Argos S.A.	5.6	3.5
CEMARGOS	Cementos Argos S.A.	5.3	2.9
CORFICOLCF	Corporacion Financiera Colombiana S.A.	3.6	2.8
PFGRUPSURA	Grupo Inversiones Suramericana	-	2.2
CELSIA	Celsia S.A.	1.9	2.2
PFGRUPOARG	Grupo Argos S.A.	-	1.9
CNEC	Canacol Energy Ltd	-	1.6
BOGOTA	Banco De Bogota S.A.	2.1	1.5
GRUBOLIVAR	Grupo Bolivar S.A.	-	1.2
PROMIGAS	Promigas S.A. E.S.P.	0.9	1.0
PFCEMARGOS	Cementos Argos S.A.	-	0.9
MINEROS	Mineros S.A.	-	0.4
PFCORFICOL	Corporacion Financiera Colombiana S.A.	-	0.4
BVC	Bolsa De Valores De Colombia S.A.	-	0.3
TERPEL	Organizacion Terpel S.A.	-	0.3
ETB	Empresa De Telecomunicaciones De Bogota S.A. E.S.P.	-	0.1

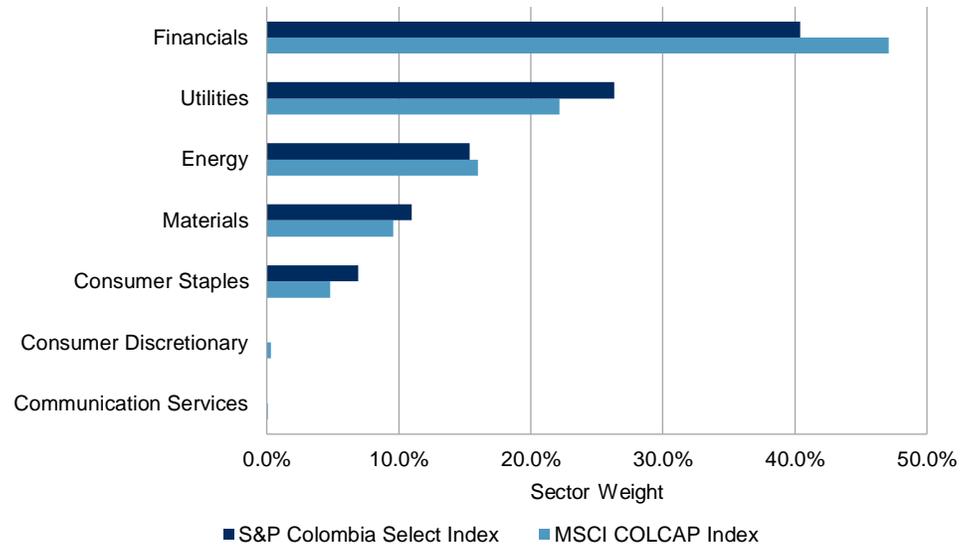
Source: S&P Dow Jones Indices LLC, [BVC](#). Data as of Sept. 30, 2021. Table is provided for illustrative purposes.

### Sector Comparison

The S&P Colombia Select Index has less sector concentration compared with the MSCI COLCAP Index due to its 40% GICS sector cap requirement. Exhibit 4 shows a lower exposure to Financials (40.4%) than the MSCI COLCAP Index, which has a weight of 47.1%, making the S&P Colombia Select Index less concentrated and more diversified across all sectors representing the local market.

*The S&P Colombia Select Index has less sector concentration compared with the MSCI COLCAP Index due to its 40% GICS sector cap requirement.*

**Exhibit 4: Sector Comparison**



Source: S&P Dow Jones Indices LLC, [BVC](#). Data as of Sept. 30, 2021. Chart is provided for illustrative purposes.

*Despite the larger number of securities in the MSCI COLCAP, it is a more concentrated index at the company and sector level.*

### PERFORMANCE ANALYSIS

The S&P Colombia Select Index delivered higher returns compared with the MSCI COLCAP Index over the mid- and long-term periods. These indices had comparable volatility, leading to higher risk-adjusted returns for the S&P Colombia Select Index across every period analyzed.

*The S&P Colombia Select Index delivered higher returns compared with the MSCI COLCAP Index over the mid- and long-term periods...*

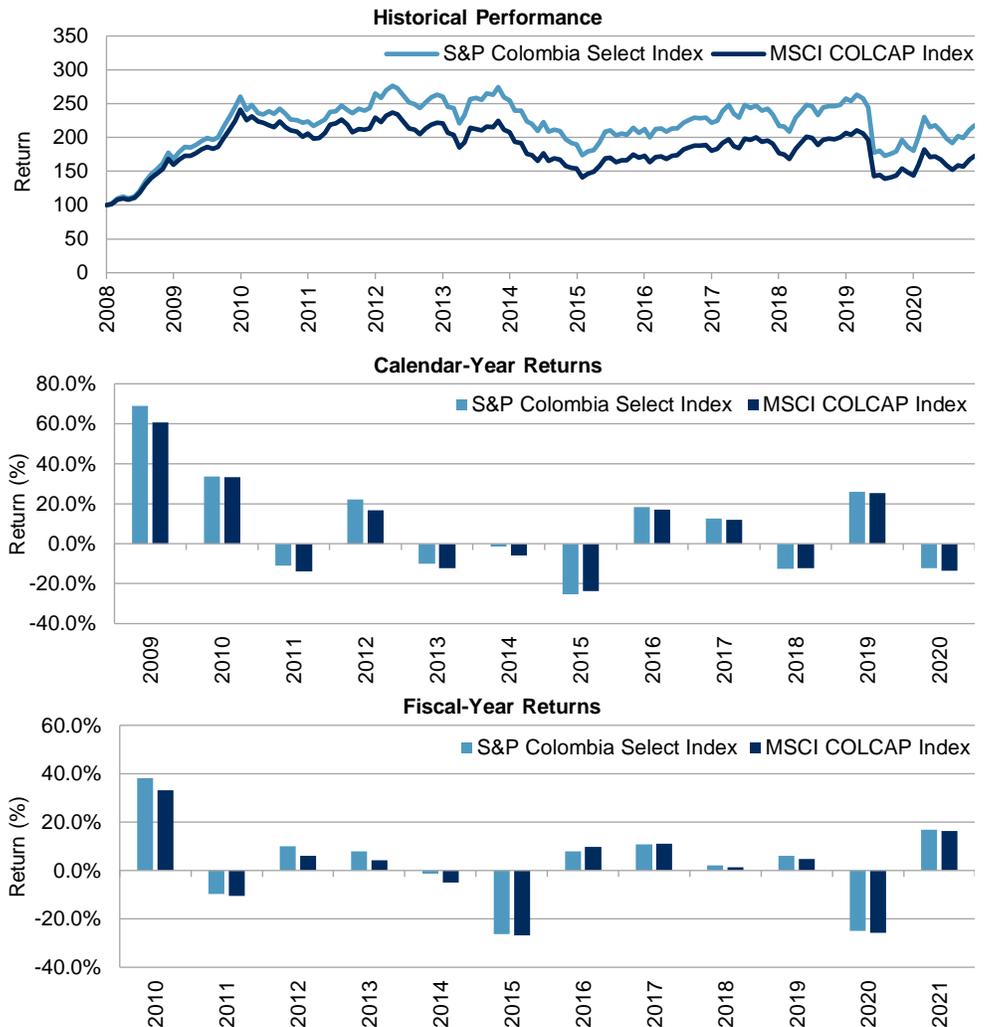
*...and they had comparable volatilities, leading to higher risk-adjusted returns for the S&P Colombia Select Index.*

<b>Exhibit 5: Risk/Return Comparison</b>		
<b>PERIOD</b>	<b>S&amp;P COLOMBIA SELECT INDEX</b>	<b>MSCI COLCAP INDEX</b>
<b>RETURNS (%)</b>		
3-Month	7.93	9.06
YTD	-5.49	-5.28
12-Month	16.91	16.22
<b>ANNUALIZED RETURNS (%)</b>		
3-Year	-2.40	-3.30
5-Year	1.06	0.34
10-Year	-0.18	-1.50
Since Inception (Oct. 31, 2008)	0.50	0.35
<b>RISK (STANDARD DEVIATION, %)</b>		
3-Year	23.9	23.4
5-Year	20.1	19.5
10-Year	17.5	17.4
Since inception (Oct. 31, 2008)	17.5	17.1
<b>RISK-ADJUSTED RETURN</b>		
3-Year	-0.100	-0.141
5-Year	0.053	0.018
10-Year	-0.010	-0.086
Since Inception (Oct. 31, 2008)	0.029	0.020
<b>CORRELATION (%)</b>		
Since Inception (Oct. 31, 2008)	98.95	

For additional information and more recent data on the S&P Colombia Select Index, please see the latest [month-end factsheet](#).

Source: S&P Dow Jones Indices LLC, MSCI, and [BVC](#). Data from Oct. 30, 2008, to Sept. 31, 2021. Index performance shown in COP. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

**Exhibit 6: Performance Comparison**



*The S&P Colombia Select Index's construction characteristics differentiate it from the MSCI COLCAP Index.*

For additional information and more recent data on the S&P Colombia Select Index, please see the latest [month-end factsheet](#).  
 Source: S&P Dow Jones Indices LLC, MSCI, and [BVC](#). Historical performance data from Oct. 30, 2008, to Sept. 30, 2021. Calendar-year-end return data from Dec. 31, 2008, to Dec. 31, 2020. Fiscal-year-end return data from Sept. 30, 2009, to Sept. 30, 2021. Index performance shown in COP. Past performance is no guarantee of future results. Charts are provided for illustrative purposes and reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

**CONCLUSION**

The S&P Colombia Select Index and MSCI COLCAP Index are designed to be representative measures of the investable Colombian equity market. However, the S&P Colombia Select Index's inclusion of single-stock and sector caps is designed to result in a more diversified index with less risk, represented by individual company share classes and less exposure to a single equity sector. These index construction characteristics aim to present a focused index composed of leading large and liquid Colombian stocks.

**APPENDIX**

<b>Exhibit 7: S&amp;P Colombia Select Index Methodology Changes since Jan. 1, 2015</b>			
<b>EFFECTIVE DATE</b>	<b>CHANGE</b>	<b>PREVIOUS METHODOLOGY</b>	<b>UPDATED METHODOLOGY</b>
March 16, 2018	Index Universe	The underlying index universe is all domestic stocks in the S&P Colombia BMI that trade on the BVC.	The underlying universe is all domestic stocks in the S&P Colombia BMI that trade on the BVC. If at rebalancing, the count results in less than 14 eligible stocks, the index universe is expanded so that all stocks trading on the BVC are included in the review. In such a scenario, the next most liquid, non-component stocks meeting the minimum FMC of at least COP 600 million are added until the count reaches 14.
	Minimum Component Count	-	At each semiannual rebalancing, the index must have a minimum of 14 components.
March 17, 2017	Market Capitalization Eligibility Factor	Minimum FMC of USD 200 million	Minimum FMC of COP 600 billion
	Liquidity Eligibility Factor	Minimum 3-month, 6-month, and 12-month ADVT of USD 125,000	Minimum 3-month, 6-month, and 12-month ADVT of COP 375 million
	Selection Buffers for Current Constituents	Minimum FMC to remain in the index of USD 150 million. Minimum three-month ADVT to remain in the index of USD 100,000.	Minimum FMC to remain in the index of COP 450 billion. Minimum three-month ADVT to remain in the index of COP 300 million.
	Constituent Weighting	Minimum basket liquidity of USD 50 million	Minimum basket liquidity of COP 60 billion
Sept. 15, 2017	Rebalancing Reference Date	The rebalancing reference date is the last business day of the month prior to rebalancing.	The rebalancing reference date is the third Friday of the month prior to rebalancing.

Source: S&P Dow Jones Indices LLC. Data as of Sept. 30, 2021. Table is provided for illustrative purposes.

## PERFORMANCE DISCLOSURE/BACK-TESTED DATA

The S&P Colombia Select Index was launched October 31, 2013. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at <http://www.spglobal.com/spdji>. Past performance of the Index is not an indication of future results. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results. Please refer to the methodology for the Index 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. Back-tested performance is for use with institutions only; not for use with retail investors.

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