Indexing Global Markets

With an established name for index construction in the U.S., Russell went into similar products but on a global scale. The launch of the Russell Global Indexes comes as a natural extension of the domestic indexes and, more importantly, it is consistent with the U.S. methodology. Designed to represent what is available and investible globally, the index series comes as quite a handy tool for money managers, passive funds, fund sponsors, consultants, researchers, and academia.

What was the rationale behind the creation of the Russell Global Indexes? How do they differ from other similar products?

With more than 70 years of experience in this business, we certainly have a reputation for index construction and thought leadership in the field. We have been pioneers in terms of open, transparent, and representative index design methodology.

In January 2007, we launched an index to emulate the global investable equity market and, at the same time, to remain consistent with our U.S. methodology and indexes. The Russell Global Index is a comprehensive benchmark tool that represents what is available and investible globally. Now the manager has two consistent tools, which tinker together perfectly.

The reason behind creating a global index was the demand from our clients for a more robust, comprehensive, transparent, and consistent family of indexes. Our clients, who are using our U.S. indexes, wanted their natural global extension. We were getting a tremendous amount of feedback and we always pay attention to that. Our users include money managers, passive funds, fund sponsors, consultants, researchers, and academia.

What is the definition of 'global' in the case of the Russell Global Indexes?

In the index creation process, we cast our net broadly. We look for all the exchange-traded equities, or at about 50,000 to 60,000 securities. Once we pull that data, we analyze it and we whittle down that universe based on rules that are listed on our website: www.russell.com.

One of the requirements is market cap of at least $1 million. Then we examine the liquidity. Although our indexes are constructed with a global footprint, the individual country is still important. You have to be able to invest, get in and out, and repatriate your dollars on a timely basis in that country. Based on market evaluation, we determine whether the specific market is developed or emerging, and we assign country scores. A country has to reach a certain score to be included in the index.

Then we do individual float research on the securities, and we consider the government restrictions, the foreign ownership limits, etc. In the end, we include over 10,000 securities. Overall, our global family of indexes represents market-cap weighted segments of the markets worldwide without gaps or overlaps.

Would you explain the construction of the indexes in terms of the number of countries and stocks, as well as the reconstitution process?

We reconstitute our global indexes annually, every June, just as the U.S. indexes. We begin the process early each year. In February, we start announcing to our clients any proposed changes, considerations, or amendments to the methodology. On May 31, we establish the preliminary new membership and we publish it. We track that membership for the next few weeks before it becomes final in late June.

Currently, we have about 10,700 securities spread across 70 countries. These include the usual 26 developed countries and 44 countries in emerging markets, including recent additions like Vietnam, Tunisia, and Kazakhstan.

SUSIE CASWELL is a senior product manager for Russell Investments' family of global indexes which measure markets in more than 30 regions, 70 countries and includes approximately 10,000 securities.

Caswell has responsibility for Russell's global index methodology, product development and management, including product enhancements, methodological changes, and client communications. She also serves as a product expert supporting client service, operations and marketing. Caswell, who brought more than 25 years of broad experience to her current role, joined Russell in 2006 and participated in the creation of the Russell Global Indexes.

"The index is constructed global-relative and large cap is large cap around the world. It does not matter if you are in the U.K., the U.S., or Slovenia; it behaves similarly. We use the same definition and the same methodology with a global perspective."

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Performance

Russell Global Indexes - Historical Turnover (shown in US dollars)

	Index Market Value 06/30/2008	Index Market Value Average (2002-2008)	Additions * 06/30/08	Additions * Average	Deletions * 06/30/08	Deletions * Average
Global	$33,554,971.9	$27,205,552.1	4.03%	5.02%	3.78%	3.12%
Global Large Cap	$30,132,516.6	$24,215,302.0	4.38%	5.08%	3.42%	2.95%
Global Small Cap	$ 3,422,455.4	$ 2,990,250.1	14.89%	16.42%	20.55%	16.29%
Global ex-US	$19,591,709.9	$14,251,694.5	5.57%	7.04%	5.16%	4.57%
Global ex-US Large Cap	$17,217,681.4	$12,383,219.5	5.77%	7.23%	4.55%	4.28%
Global ex-US Small Cap	$ 2,374,028.6	$ 1,868,475.0	16.59%	18.21%	22.04%	18.95%
Global ex-NA	$18,073,872.0	$13,128,006.4	5.59%	6.95%	5.03%	4.65%
Global ex-NA Large Cap	$15,916,438.2	$11,444,541.8	5.80%	7.17%	4.50%	4.36%
Global ex-NA Small Cap	$ 2,157,433.8	$ 1,683,464.6	16.53%	17.54%	21.40%	18.79%
Developed	$29,358,354.7	$25,002,896.5	2.72%	4.21%	3.02%	2.63%
Developed Large Cap	$26,707,464.4	$22,544,611.8	3.18%	4.28%	2.86%	2.56%
Developed Small Cap	$ 2,650,890.4	$ 2,458,284.7	11.57%	14.44%	17.49%	14.12%
Developed ex-US	$15,395,092.7	$12,049,038.9	3.48%	5.70%	4.07%	3.83%
Developed ex-US Large Cap	$13,792,629.2	$10,712,529.3	3.78%	5.87%	3.73%	3.68%
Developed ex-US Small Cap	$ 1,602,463.6	$ 1,336,509.7	11.85%	15.17%	17.65%	15.87%
Emerging Markets	$ 4,196,617.2	$ 2,202,655.6	13.71%	15.32%	9.48%	8.96%
Emerging Markets Large Cap	$ 3,425,052.2	$ 1,670,690.2	14.31%	17.50%	8.14%	8.77%
Emerging Markets Small Cap	$ 771,565.0	$ 531,965.4	26.96%	25.93%	31.69%	26.69%

*AT RECONSTITUTION; SOURCE RUSSELL INVESTMENTS; FLOAT ADJUSTED

Are all the 10,000 securities in one index, or are they spread in different indices?

The Global Index itself is a modular index. On a daily basis, we calculate about 48,000 indexes. The 70 countries and 10,000+ securities can be sliced and diced by market cap, sector, industry, and country, by developed or emerging. For example, we have the Russell Developed Large Cap Index and the Russell Asia-Pacific Mid Cap Index. These are all subcomponents of the Global Index.

You can go down to the most granular level or you can total all the securities for a region, industry, country, or even globally. However, it is important to note that any component will still roll and total up to the global. That is very important to the managers, the consultants, the quantitative style fund managers, because many times they get granular and do detailed research. Nothing is more frustrating than pulling out a component and realizing that it does not total.

Which currency do you use for measuring the market capitalization? Also, how do you calculate the end of the day value, given the different time zones you work in?

We calculate our indexes as the world turns and the exchanges close, beginning with New Zealand. Therefore, we deliver index returns daily by region and, at the end of the day, consolidate a global index. As the Asia-Pacific markets close, we calculate those individual markets. Then, as Europe closes, we calculate those values. Then it is the Americas. The market index of Peru is the last that is calculated.

So, we receive the data from the individual exchanges as they close. After that, I publish a consolidated global file. Anyone tracking the indexes can collect them regionally or can wait for the global file at the end of my day. The index is calculated based on a Western work week, Monday through Friday. We calculate it on holidays, with the only exception being New Year's Day.

Regarding the currency, we collect the data on securities in the local currency. Every security is assigned a primary exchange, and that's the currency we use. The country indexes are calculated at local country value, but we also calculate the global index in seven other world currencies: USD, GBP, Australian dollar, Canadian dollar, Yen, Swiss Franc, and Euro.

When we calculate the daily performance, we start at the security level to establish its market value and performance. As we roll to the country level, we convert that value to the country level currency. Once you roll up to the regional and the global level, the notion of currency becomes a matter of how do you want to see the global market value, whether you need it in USD or Euro. So we provide clients with multiple currency values on a daily basis.

Since you have a market-cap weighted index, how do you handle bubble situations, such as the one in 1998 across the emerging markets, for example?

We construct our index based on the opportunity set for the manager and the fund sponsor. They take the decisions based on their mandate and what they are looking for.

We aim to represent the market. If a particular sector or country is up or down, we have a passing interest, but that is not how we construct the index. We would not include a country that is volatile and all over the place. We use ratings and various criteria to determine if a country is eligible for the index. We closely monitor and watch those countries, especially in the emerging market space, even if they seem to be relatively stable.

We look at the market globally and screen for the viable opportunities for investment. We do not aim to capture a certain percentage of coverage in any country; we do not try to go to 85% in Slovenia or 85% in Turkey. Rather, we look for the securities in those countries that pass the criteria to get into the index. In any emerging markets, we may have 30, 20, or 5 securities. If there is only one security in that country, so be it. But it is up to the manager to decide whether to go into that market and that security.

Does your definition of small or large cap differ for the different markets? How do you resolve the issue that a small-cap company in the U.S. could be a mega-cap company in another?

Russell Indexes are constructed global-relative, so large cap is large cap around the world. It does not matter if you are in the U.K., the U.S., or Slovenia. Small cap around the world behaves similarly. We take the division line between large cap and small cap and snap it global relative. We use the same definition and the same methodology around the world. We don't use country-relative definitions; we look at it from a global perspective. We snap a line, and that line is global.

What is the rationale behind that approach? The large-cap global index could be dominated by the top seven or eight markets around the world.

There are companies like Samsung in South Korea, for example, which are mega-cap companies by any definition. Since we are looking at global behavior, it is relatively easy to find small companies in a single country, like Russia, that are many times larger than the companies in other countries, for example, in New Zealand.

The rationale behind our approach is that we look for consistency, and any of our researchers would tell you that large cap behaves like large cap around the world. It does not matter what country it is in. We believe a large cap in Slovenia should be classified the same as a large cap in the U.K., Germany, or the U.S. We think that most investors believe that companies with divergence in market capitalization shouldn't be classified the same.

How many are the large-cap companies on a global scale? And what is your cutoff line in terms of capitalization sizes?

We take all 10,700+ securities and we rank them from top-to-bottom by their market cap. Next, we draw the line at 90% of that universe and that becomes the break between the large cap and the mid cap. The mid-cap cutoff is at 60%, which means that we go down to the 60% level to determine what the mid cap is. For the small caps, the cutoff is at about $1.89 billion right now. We do employ banding of 5% around our absolute cut, and that helps to control turnover within our index.

We have between 3,500 and 4,000 large-cap companies in the index. The 90% cutoff right now is a little better than $3.0 billion. The U.S. component of the global large-cap index is the Russell 1000 Index, so we include about 1,000 large-cap companies from the U.S.

What is the turnover within the index?

We reconstitute our indexes with the goal to have accurate and timely reflection of the current market. When we reconstitute the index, there are securities coming in and out of the indexes. Depending on what is going on in the economy, a security can lose a large percentage of its market value and be no longer eligible for our index, for example.

Next, we may include new companies or companies that were previously not eligible for some reason, such as liquidity or foreign ownership limits. The turnover refers to this one-time event each year, the annual reconstitution. This year, for example, we saw about 1,200 additions and 963 securities drop out of the global index. This resulted in a turnover rate of 4% in terms of new adds and almost 4% deletes.

A security can also move in or out of our index following corporate action, an IPO, a spinoff, or an acquisition. We bring IPOs into our index each quarter. Prior to the end of each quarter, we announce IPO additions according to a set schedule so managers are informed in advance and can trade and get into those positions. On a global basis, we saw 60 to 80 IPO adds each quarter the past few years.

Russell Global Indexes

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RUSSELL GLOBAL INDEXES - LARGEST & SMALLEST SECURITIES AS OF RECONSTITUTION (BASED ON TOTAL MARKET CAP)

	Reconstitution 2008	
Index	Largest	Smallest
Global Mega Cap*	$469.0	$15.1
Global Mid Cap*	$19.6	$1.9
Global Large Cap*	$469.0	$1.9
Global Small Cap*	$3.1	$25.7

PRODUCT MANAGER

Susie Caswell	2006

** billions*
Data through: 08/31/2008; Source: Company Documents

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