

## SIZING UP TWO POPULAR CHINESE EQUITY INDICES

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*The S&P China BMI and FTSE China 25 employ vastly different methodologies, resulting in highly differentiated index portfolios and divergent long-term performance characteristics*

The S&P China BMI (Broad Market Index) and FTSE China 25 are two of the most widely used Chinese equity indices. However, they employ vastly different methodologies, resulting in highly differentiated index portfolios and divergent long-term performance characteristics. Over the last several years, the sector and size diversification of the S&P China BMI has resulted in relative outperformance on both an absolute and risk-adjusted basis, when compared to the FTSE China 25.

The FTSE China 25 measures the performance of 25 of the largest, most liquid Chinese stocks listed on the Hong Kong Stock Exchange. This methodology results in the following characteristics<sup>1</sup>:

- An easily traded index basket with highly liquid constituents
- Limited market coverage (approximately 50%)
- Biased sector exposures that overly weight export-oriented sectors
- The exclusion of many Chinese stocks available to global investors due to limiting the universe to Hong Kong listings
- Less attractive long-term historical performance relative to the S&P China BMI, driven by large-cap bias and concentration in underperforming sectors

The S&P China BMI measures the investable universe of Chinese stocks available to global investors. This methodology results in the following characteristics<sup>1</sup>:

- A high level of market coverage (approximately 98%)
- Sector exposures representative of the Chinese equity market with significant exposure to sectors with high sensitivity to the local economy
- Inclusive eligibility criteria to ensure there are no exclusions based on listing venue
- The inclusion of smaller companies, which have historically generated higher growth
- Strong long-term performance track record driven by broad sector and size range coverage

### Methodology Overview

The S&P China BMI is a sub-index of the S&P Global BMI. It includes all Chinese stocks that are accessible to global investors (i.e. the index excludes A-Shares) which have at least USD 100 million in float-adjusted market capitalization and USD 50 million in annual value traded. The index is weighted by float-adjusted market capitalization, undergoes a full review annually and is reviewed for share changes and new IPOs quarterly. Buffers on size and liquidity thresholds are employed at each annual review to reduce turnover.

The FTSE China 25 comprises the largest 25 Chinese-domiciled companies listed on the Hong Kong Stock Exchange, as measured by total market capitalization. Constituents are weighted by float-adjusted market capitalization, and the index undergoes a full review on a quarterly basis. At each quarterly review, single stocks are capped at 10%, and the sum of all stocks weighing greater than 5% is capped at 40% in order to reduce single-stock concentration. Buffers are also employed at each quarterly review to reduce turnover.

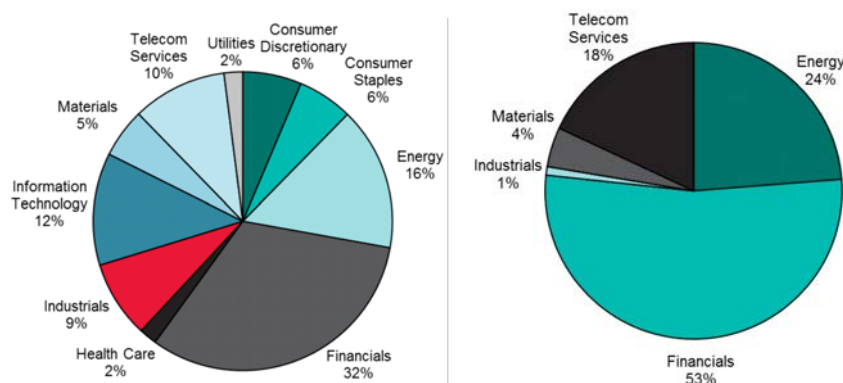
<sup>1</sup> Information relating to the FTSE China 25 can be found on the FTSE website, [www.ftse.com](http://www.ftse.com).

<sup>1</sup> Information relating to the S&P China BMI can be found on the S&P Indices website, [www.indices.standardandpoors.com](http://www.indices.standardandpoors.com).

### Sector Representation

As illustrated in Exhibit 1, the FTSE China 25 includes stocks from just five of the ten GICS sectors and is highly concentrated in financials (53%) and energy (24%). On the other hand, the S&P China BMI is broadly reflective of the Chinese equity market including stocks from all ten sectors.

Exhibit 1: Sector Weight Comparison – S&P China BMI and FTSE China 25



Source: S&P Indices; Bloomberg. Data as of December 31, 2011. Charts are provided for illustrative purposes. FTSE does not use GICS. However, the FTSE China 25 constituents have been mapped to GICS in order to facilitate a direct comparison of sector weightings.

*The S&P China BMI is broadly reflective of the Chinese equity market including stocks from all ten sectors.*

Furthermore, the S&P China BMI has meaningful representation in the consumer-related and information technology sectors, which have significant exposure to the local Chinese economy. However, the FTSE China 25 is highly concentrated in large financial institutions and energy companies, which tend to be driven by global market factors.

### Market Coverage

The S&P China BMI captures approximately 98% of the Chinese equity market capitalization available to global investors. Using the S&P China BMI as a proxy for the market, Exhibit 2 illustrates that the FTSE China 25 represents roughly half of the market. As a reference point, most popular tradable indices -- such as the S&P 500® and the S&P/TSX 60 -- aim to capture approximately 70% of the investable market. Furthermore, recognizing that tradable indices with fixed stock counts can often develop sector biases, these indices also take into consideration sector diversification when selecting constituents. Because the FTSE China 25 has a low fixed stock count relative to the size of the market and does not consider sector diversification, the resulting index portfolio has limited market coverage and substantial sector biases.

Exhibit 2: Market Coverage Comparison					
Sector	Float Market Cap (\$ Billion)		% of S&P China BMI	Number of Stocks	
	FTSE China 25	S&P China BMI		FTSE China 25	S&P China BMI
Consumer Discretionary	0.0	43.3	0.0%	0	77
Consumer Staples	0.0	40.7	0.0%	0	50
Energy	95.1	105.8	89.9%	6	22
Financials	179.2	219.0	81.8%	12	64
Health Care	0.0	13.1	0.0%	0	29
Industrials	1.6	57.0	2.7%	1	95
Information Technology	0.0	82.8	0.0%	0	58
Materials	7.8	36.4	21.5%	3	62
Telecom Services	68.8	69.8	98.5%	3	5
Utilities	0.0	13.8	0.0%	0	16
<b>Total</b>	<b>352.4</b>	<b>681.6</b>	<b>51.7%</b>	<b>25</b>	<b>478</b>

Source: S&P Indices; Bloomberg. Data as of December 31, 2011. Tables are provided for illustrative purposes.

### Eligibility Criteria

All shares meeting the S&P Global BMI minimum size and liquidity requirements that are accessible to foreign investors and issued by Chinese-domiciled companies are eligible for inclusion in the S&P China BMI, regardless of listing venue. The result is a broad universe of securities including H-Shares, B-Shares, Red Chips and stocks listed on non-Asian trading venues such as those in the U.S. The FTSE China 25, on the other hand, requires stocks to be listed on the Hong Kong Stock Exchange, limiting its universe to H-Shares and Red Chips. Most notably, this methodological difference results in the FTSE China 25 excluding some large Chinese information technology companies that are listed on the NASDAQ. For example, Baidu is the fourth largest constituent of the S&P China BMI, yet is not a member of the FTSE China 25.

Exhibit 3: Top Ten Stocks in S&P China BMI		
Name	Sector	Index Weight
China Mobile Ltd.	Telecom.	7.4%
China Construction Bank Corp	Financials	7.4%
Industrial & Commercial Bank of China	Financials	5.3%
Baidu.com ADR	Info. Tech.	4.7%
CNOOC Ltd.	Energy	4.1%
PetroChina Co Ltd H Shares	Energy	3.9%
Bank of China Ltd H Shares	Financials	3.3%
Tencent Holdings Ltd.	Info. Tech.	3.0%
China Life Insurance Co Ltd	Financials	2.7%
China Petroleum & Chemical Corp	Energy	2.6%
<b>Total</b>		<b>44.3%</b>

Source: S&P Indices; Bloomberg. Data as of December 31, 2011. Tables are provided for illustrative purposes.

*The universe of the S&P China BMI is broad and includes H-Shares, B-Shares, Red Chips and stocks listed on non-Asian trading venues such as those in the U.S*

*Both sector and size diversification have contributed significantly to the relative outperformance of the S&P China BMI over the past five years.*

**Exhibit 3 (cont.): Top Ten Stocks in FTSE China 25**

Name	Sector	Index Weight
China Mobile Ltd.	Telecom.	7.4%
China Construction Bank Corp	Financials	7.4%
Industrial & Commercial Bank of China	Financials	5.3%
Baidu.com ADR	Info. Tech.	4.7%
CNOOC Ltd.	Energy	4.1%
PetroChina Co Ltd H Shares	Energy	3.9%
Bank of China Ltd H Shares	Financials	3.3%
Tencent Holdings Ltd.	Info. Tech.	3.0%
China Life Insurance Co Ltd	Financials	2.7%
China Petroleum & Chemical Corp	Energy	2.6%
<b>Total</b>		<b>44.3%</b>

Source: S&P Indices; Bloomberg. Data as of December 31, 2011. Tables are provided for illustrative purposes.

### Performance Comparison

As shown in Exhibit 4, broad coverage has enhanced the long-term performance of the S&P China BMI relative to the FTSE China 25 on both an absolute and risk-adjusted basis. In fact, both sector and size diversification have contributed significantly to the relative outperformance of the S&P China BMI over the past five years.

**Exhibit 4: Performance Comparison**

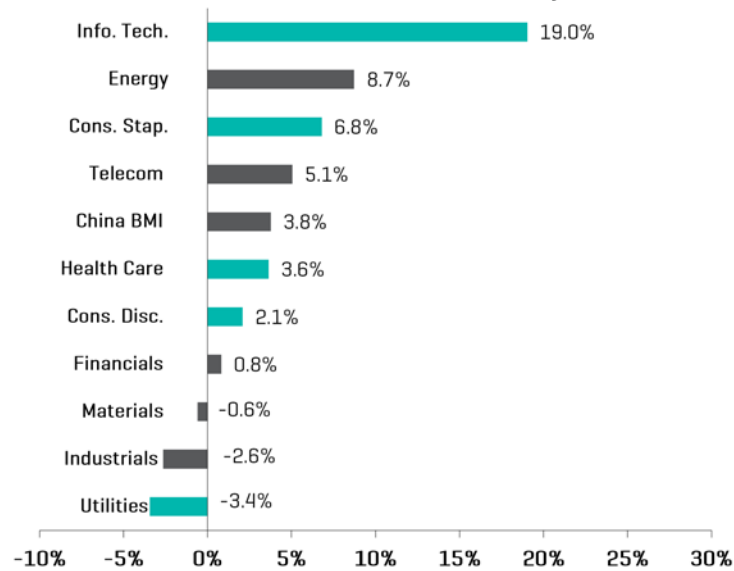
	S&P China BMI	FTSE China 25
<b>Annualized Returns</b>		
1-Year	-19.92%	-17.03%
3-Year	14.05%	9.70%
5-Year	3.77%	0.84%
<b>Risk (% pa)</b>		
3-Year Std Dev	26.93%	25.95%
5-Year Std Dev	33.74%	33.69%
<b>Sharpe Ratio</b>		
3-Year	0.1780	0.1383
5-Year	0.0701	0.0454

Source: S&P Indices; Bloomberg. Data as of December 31, 2011. Tables are provided for illustrative purposes. Past performance is not a guarantee of future results.

### Sector Diversification as a Driver of Growth

As illustrated in Exhibit 5, several sectors that have no representation in the FTSE China 25 have seen very strong performance over the past five years. For example, the information technology sector of the S&P China BMI has returned an annualized 19% per year and consumer staples has gained nearly 7% per year. Exposure to these sectors has positively impacted the performance of the S&P China BMI relative to the FTSE China 25.

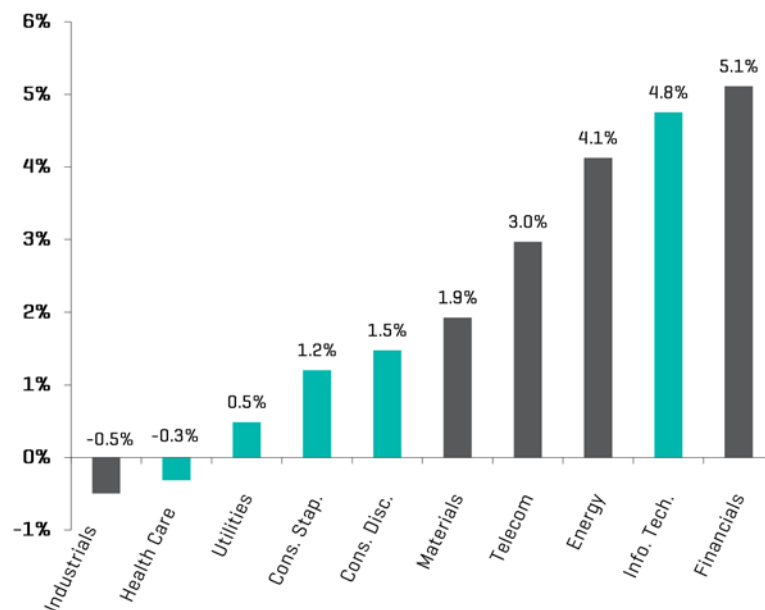
**Exhibit 5: Five-Year Annualized Total Return by Sector**



Source: S&P Indices. Data as of December 31, 2011. Graphs are provided for illustrative purposes. Past performance is not a guarantee of future results. The teal bars represent sectors not included in the FTSE China 25. The gray bars represent sectors included in both the S&P China BMI and FTSE China 25.

Exhibit 6 illustrates the contribution of each sector to the five-year cumulative return of the S&P China BMI. As the most heavily weighted sector, financials had the most significant impact on performance. However, information technology, consumer discretionary and consumer staples also made significant positive contributions to overall performance.

**Exhibit 6: Sector Contribution to Five-Year Total Return**



Source: S&P Indices. Data as of December 31, 2011. Graphs are provided for illustrative purposes. Past performance is not a guarantee of future results. The teal columns represent sectors not included in the FTSE China 25. The gray columns represent sectors included in both the S&P China BMI and FTSE China 25.

### Size Diversification as a Driver of Growth

While the FTSE China 25 comprises only the largest Chinese stocks, the S&P China BMI includes nearly 500 securities covering the full range of large-, mid- and small-cap size segments. Despite poor recent performance, Chinese small-caps have outperformed large- and mid-caps over the longer term, contributing positively to the performance of the S&P China BMI relative to the FTSE China 25 over the past five years.

*Despite poor recent performance, Chinese small-caps have outperformed large- and mid-caps over the longer term.*

**Exhibit 7: Size Range Performance Comparison**

	S&P China LargeMidCap	S&P China SmallCap
<b>Annualized Returns</b>		
1-Year	-17.06%	-33.12%
3-Year	13.09%	19.07%
5-Year	3.57%	6.19%
<b>Risk (% pa)</b>		
3-Year Std Dev	25.90%	33.51%
5-Year Std Dev	33.67%	37.12%
<b>Sharpe Ratio</b>		
3-Year	0.1727	0.1966
5-Year	0.0682	0.0907

Source: S&P Indices. Data as of December 31, 2011. Tables are provided for illustrative purposes. Past performance is not a guarantee of future results.

### Conclusion

The S&P China BMI is designed to be a comprehensive, yet investable benchmark for the Chinese equity market. It includes large-, mid- and small-cap stocks, and its sector composition is reflective of the broad Chinese equity market.

On the other hand, the FTSE China 25 comprises 25 of the largest and most liquid Chinese equities listed on the Hong Kong stock exchange. The result is a large-cap portfolio that is highly liquid and tradable but narrowly focused and highly concentrated in certain sectors.

Over the last several years, the sector and size diversification of the S&P China BMI has resulted in relative outperformance on both an absolute and risk-adjusted basis, when compared to the FTSE China 25.

### ETF Linked to the S&P China BMI

ETF	Ticker
SPDR S&P China ETF	GXC

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