November 2012

LOOKING BEYOND TRADITIONAL BENCHMARKS TO ADD VALUE IN EMERGING MARKETS

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Introduction

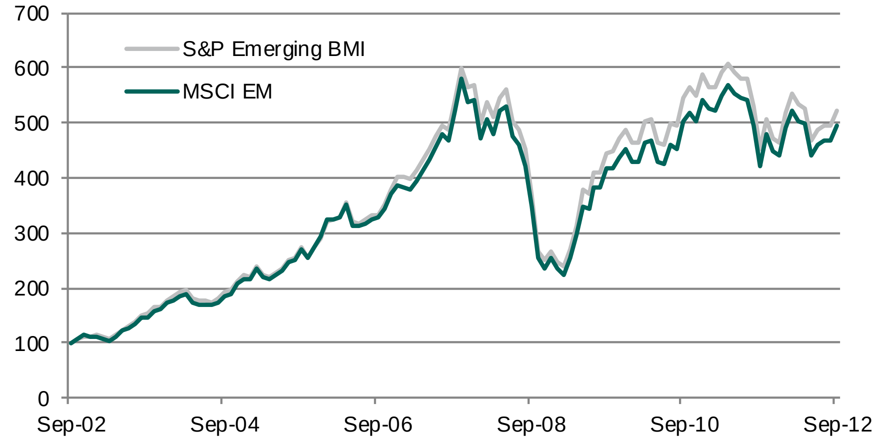
As emerging markets have grown in size and importance, emerging market equities have become a core part of many portfolio allocations. In addition, the increased diversity and liquidity of emerging equity markets have also made strategies commonly used to manage developed market portfolios (such as tactical allocations across regions and size segments) much more accessible to emerging market investors.

Despite these trends, the use of more complex asset allocation strategies within emerging market equities remains extremely limited as the vast majority of investors continue to gain exposure to this asset class either via index-linked products that track traditional benchmarks or through active managers with mandates closely tied to those benchmarks. While accessing emerging markets through a single holding linked to a conventional benchmark is an effective, low-cost way to obtain unbiased exposure to this asset class, evidence indicates that utilizing a more discerning approach to manage emerging markets portfolios may potentially add value in the same ways it can in the U.S. and other developed markets.

All Emerging Market Benchmarks are Not Created Equal

While most emerging market benchmarks tend to be highly correlated, there are methodological differences that can result in substantive performance differentials over time. Therefore, it is very important to understand how emerging market benchmarks are constructed. For example, in the trailing 10-year period ending September 30, 2012, the S&P Emerging BMI gained 423% on a cumulative total return basis, while the MSCI Emerging Markets Index gained a comparatively small 396%, for the same time period. Analysis shows that the difference in performance was driven by two main factors. First, the MSCI Emerging Markets Index has an approximate weight of 15% to South Korea, while South Korea has been ineligible for the S&P Emerging BMI since 2001 when it was reclassified as a developed market. Over this time period, South Korea has underperformed all emerging markets except Taiwan and Hungary. Secondly, the S&P Emerging BMI Index has significantly broader coverage including large-, mid- and small-caps, while MSCI Emerging Markets includes only large- and mid-cap stocks. Over this period, the S&P Emerging SmallCap outperformed the S&P Emerging LargeMidCap by more than 122%.

Exhibit 1: S&P Emerging BMI Has Outperformed MSCI EM Over Time



Source: S&P Dow Jones Indices, MSCI. Data from September 30, 2002 through September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

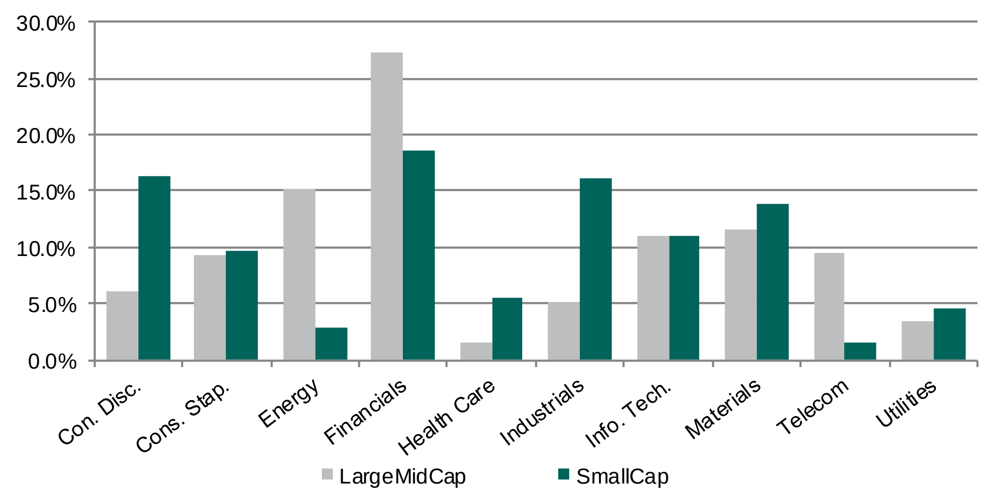
While most emerging market benchmarks tend to be highly correlated, there are methodological differences that can result in substantive performance differentials over time.

Are Emerging Market Small-Caps Overlooked?

The exclusion of small-caps from the MSCI Emerging Markets Index raises an important issue. Since many investors access emerging markets via an index-linked product tracking this index or through active managers whose mandates are closely tied to this benchmark, many investors, perhaps inadvertently, may not have exposure to emerging market small-caps. Importantly, emerging market small-caps have investment characteristics distinct from their large- and mid-cap counterparts (apart from their smaller size).

As illustrated in Exhibit 2, large- and mid-cap stocks are concentrated in financials and export-oriented sectors, such as energy and materials, which tend to be largely driven by global market forces. On the other hand, emerging market small-caps have higher weightings in consumer discretionary, consumer staples, health care and utilities, which are more closely associated with domestic economic activity.

Exhibit 2: Comparative Sector Weights for S&P Emerging SmallCap and S&P Emerging LargeMidCap

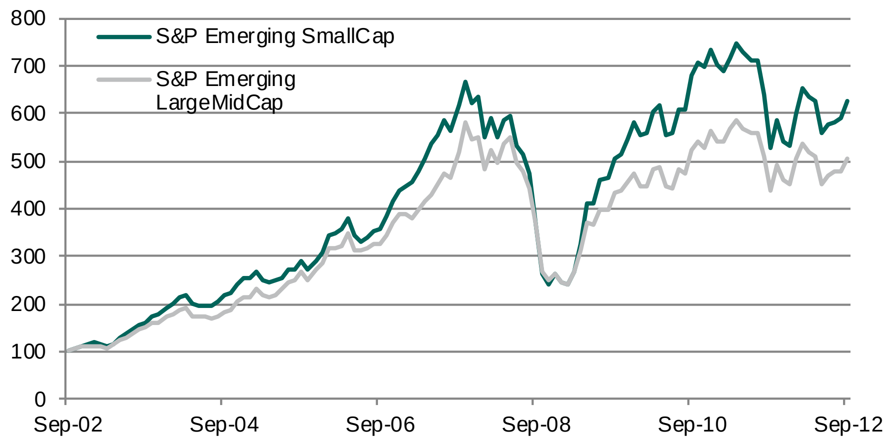


Source: S&P Dow Jones Indices. Data as of September 30, 2012. Charts are provided for illustrative purposes.

Emerging market small-caps have performed well over the long-term, and while highly correlated to them, have exhibited significant performance differentiation from large- and mid-caps. Over the past 10 years, the S&P Emerging SmallCap Index has returned an annualized 20.2%, outpacing the 17.6% CAGR (Compound Annual Growth Rate) of the S&P Emerging LargeMidCap Index at a modestly higher level of volatility (10-year annualized standard deviation of 26% vs. 24%). Performance since the end of the financial crisis has been particularly distinct. In fact, since the beginning of March 2009, the S&P Emerging SmallCap Index has gained a cumulative return of 162%, far outpacing the 112% cumulative total return for the S&P Emerging LargeMidCap Index. This has been at least partially reflective of the sector differences across the size ranges, as consumer staples and discretionary have been sector leaders, while energy has lagged during the recovery.

Since many investors access emerging markets via an index-linked product tracking the MSCI Emerging Markets Index or through active managers whose mandates are closely tied to this benchmark, many investors, perhaps inadvertently, may not have exposure to emerging market small-caps.

Exhibit 3: Outperformance of Emerging Market Small-Caps



Source: S&P Dow Jones Indices. Data from September 30, 2002 through September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

Although performance differentials between size ranges are, to some extent, driven by differences in sector and geographic allocations, there is compelling evidence of a small-cap premium in emerging markets. Over the past 10 years, small-caps have outperformed large- and mid-caps across all major regions and across seven of ten sectors as depicted in Exhibits 4 and 5.

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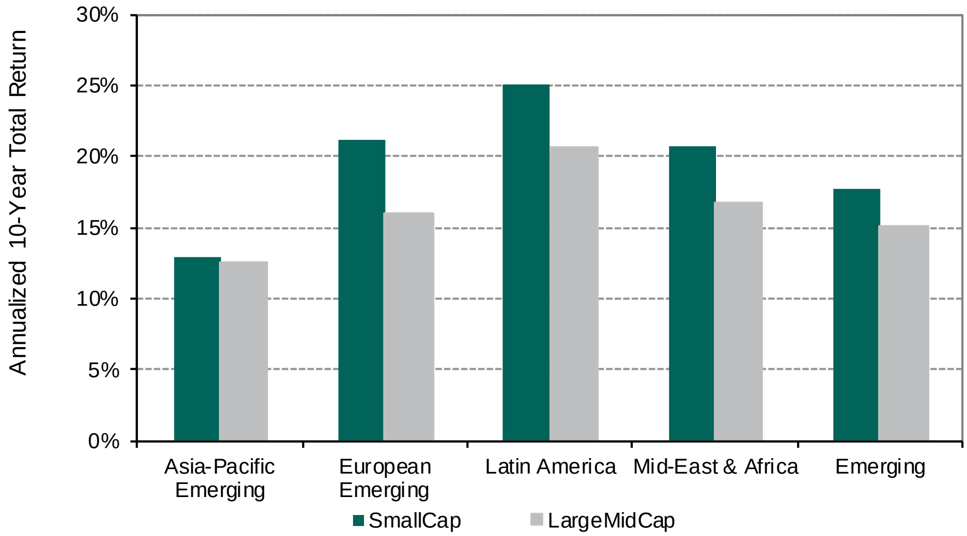
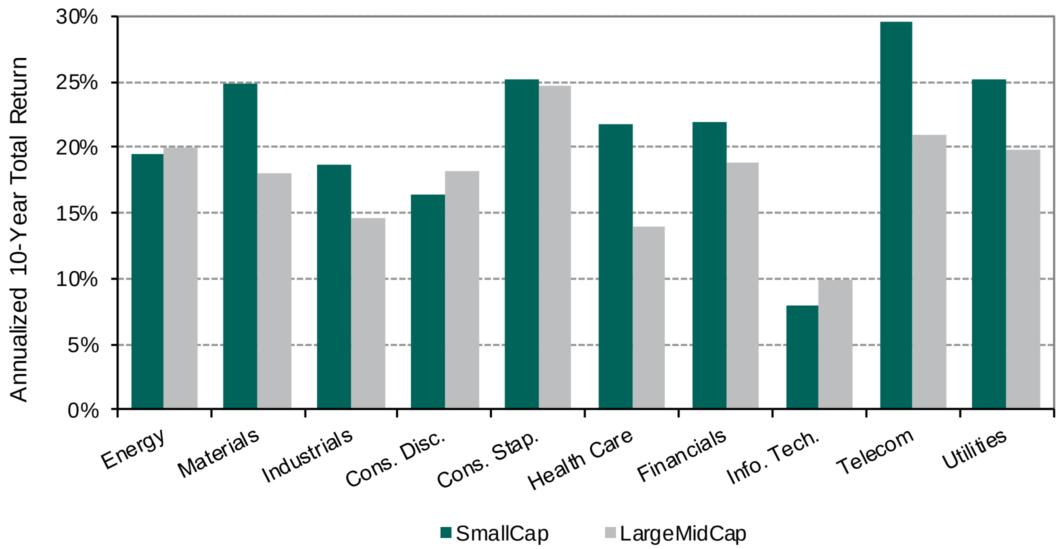
Exhibit 4: Small-Cap Outperformance Across Emerging Market Regions



Source: S&P Dow Jones Indices. Data as of September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

Exhibit 5: Small-Cap Outperformance Across Emerging Market Sectors



Source: S&P Dow Jones Indices. Data as of September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

Emerging Markets Are Not Homogenous

Although emerging markets tend to be viewed as a single asset class, there are enormous differences across countries and regions. Emerging markets vary greatly in their level of economic development, their level of political risk, the types of companies that drive their economies and many other important factors.

One way of taking a more tactical approach to emerging market investing is to view emerging markets by regional groupings. As illustrated in Exhibit 6, sector weights vary widely across emerging market regions. For example, the Asia-Pacific region has significant exposure to information technology, a sector that has virtually no representation in other emerging market regions. On the other hand, Latin America and

Emerging Europe have much higher weightings to energy and materials as these regions are home to natural resource rich countries such as Russia and Brazil.

Although it is difficult to predict in advance which regions will outperform, the high variation in performance across countries provides compelling evidence that significant alpha generation is possible by implementing a tactical asset allocation strategy based on geography within the emerging markets.

Exhibit 6: Regional Emerging Market Sector Weights

Sector	Asia Pacific	Latin America	Europe	Middle-East & Africa
Consumer Discretionary	7.9%	6.5%	2.3%	16.4%
Consumer Staples	7.4%	16.0%	5.2%	8.1%
Energy	9.7%	11.9%	38.0%	7.3%
Financials	27.1%	23.1%	23.6%	29.3%
Health Care	2.4%	1.2%	1.0%	4.2%
Industrials	7.4%	7.5%	3.3%	6.4%
Information Technology	19.3%	1.8%	1.0%	0.5%
Materials	8.4%	17.5%	11.9%	16.8%
Telecommunication Services	7.5%	8.6%	8.2%	11.0%
Utilities	2.8%	5.9%	5.5%	0.0%

Source: S&P Dow Jones Indices. Data as of September 30, 2012. Charts are provided for illustrative purposes.

These differences tend to translate into large variances in stock market performance across regions. As illustrated in Exhibit 7, performance has varied widely across emerging market regions over both the short and long term. Year-to-date through September 30, 2012, the S&P European Emerging BMI has gained nearly 17%, far outpacing the 6.3% return of the S&P Latin America BMI. Likewise, over the trailing 10-year period, the S&P Latin America BMI has gained an impressive 26% per annum, significantly outperforming the Asia-Pacific (14.8%) and European Emerging (15.6%) regions.

Exhibit 7a: Emerging Market Regional Performance Differentials

Region	YTD	3-Year	5-Year	10-Year
Asia Pacific	14.3%	5.7%	-1.1%	14.8%
Europe	16.9%	5.6%	-6.3%	15.6%
Latin America	6.3%	4.2%	1.4%	26.0%
Mid-East & Africa	13.9%	10.1%	4.7%	20.2%
Difference Between Best and Worst Performer	**10.6%**	**5.9%**	**11.0%**	**11.3%**

Exhibit 7b: Developed Market Regional Performance Differentials

Region	YTD	3-Year	5-Year	10-Year
Asia Pacific	9.1%	4.1%	-3.0%	8.3%
Europe	12.8%	3.0%	-4.9%	10.0%
North America	15.5%	12.9%	1.4%	9.1%
Difference Between Best and Worst Performer	**6.3%**	**9.9%**	**6.3%**	**1.7%**

Source: S&P Dow Jones Indices. Data as of September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

Although it is difficult to predict in advance which regions will outperform, the high variation in performance across countries provides compelling evidence that significant alpha generation is possible by implementing a tactical asset allocation strategy based on geography within the emerging markets. In fact, as illustrated in Exhibit 7, performance differentials between the best and worst performing regions have been significantly larger in most periods (particularly over the long term) in emerging markets than in developed markets.

Rethinking Core Emerging Market Holdings

Traditional market capitalization weighted emerging market benchmarks, like the MSCI Emerging Markets Index, are heavily concentrated in relatively mature economies, such as South Korea and Taiwan, which may be less likely to achieve the fast-paced growth typical of emerging economies.

Traditional market capitalization weighted emerging market benchmarks, like the MSCI Emerging Markets Index, are heavily concentrated in relatively mature economies, such as South Korea and Taiwan, which may be less likely to achieve the fast-paced growth typical of emerging economies. Likewise, they are dominated by financials and export-oriented sectors, such as energy and materials, which tend to be driven by global market forces and have relatively little exposure to consumer-oriented sectors that are more likely to benefit from domestic emerging market demand. These factors have led some to question whether investments closely tied to traditional capitalization-weighted benchmarks are the best way to gain exposure to the growth of emerging markets.

To counteract these perceived limitations, some investors have implemented more complex asset allocation strategies by overweighting less mature emerging markets and by adding exposures focused on consumer-oriented sectors to increase exposure to local economic demand. However, another option is to simply re-evaluate the core holding. The S&P Emerging Markets Core Index, introduced in October 2012, was specifically designed to reduce exposure to more advanced economies and increase sector and industry diversification while being broadly representative of emerging market equities.

Exhibit 8: Comparative Country Weights

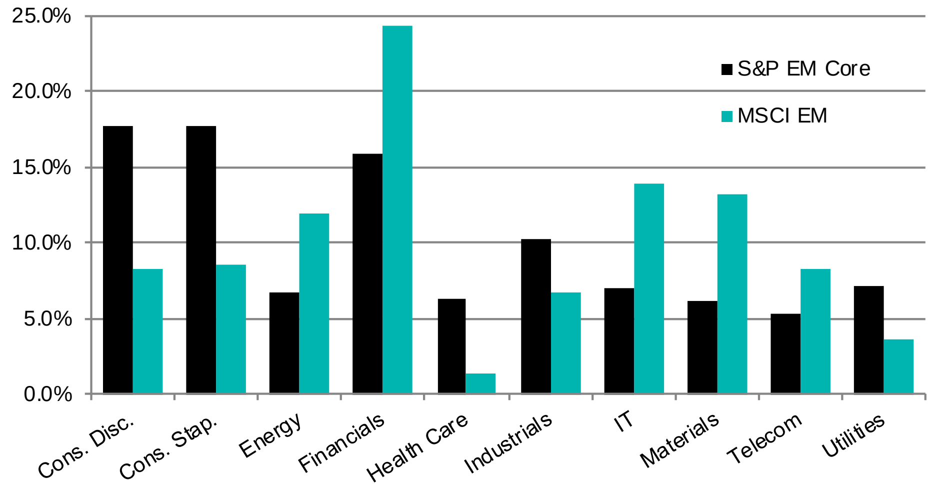
Country	S&P EM Core	MSCI EM	Difference
India	15.5%	7.0%	8.5%
China	15.2%	16.7%	-1.5%
South Africa	14.9%	7.9%	7.0%
Brazil	9.7%	12.6%	-2.9%
Russia	8.5%	6.1%	2.4%
Mexico	7.6%	5.0%	2.6%
Malaysia	7.5%	3.6%	3.9%
Chile	7.5%	1.8%	5.7%
Indonesia	3.7%	2.7%	1.0%
Turkey	2.4%	1.7%	0.7%
Others	7.3%	8.3%	-1.0%
S. Korea	0.0%	15.5%	-15.5%
Taiwan	0.0%	11.1%	-11.1%

Source: S&P Dow Jones Indices, MSCI. Data as of September 30, 2012. Charts are provided for illustrative purposes.

The S&P Emerging Markets Core Index excludes securities from South Korea and Taiwan and caps individual country weights at 15%. As illustrated in Exhibit 8, this results in eliminating or reducing exposure to larger, more advanced markets, while significantly increasing exposure to smaller, less developed markets such as South Africa, Mexico, Malaysia and Chile.

63% of the weight of the MSCI Emerging Markets Index is concentrated in financials, information technology, energy and materials – four sectors that tend to be driven by global market forces and developed market demand. On the other hand, these sectors hold a combined weight of just 37% in the S&P Emerging Markets Core Index.

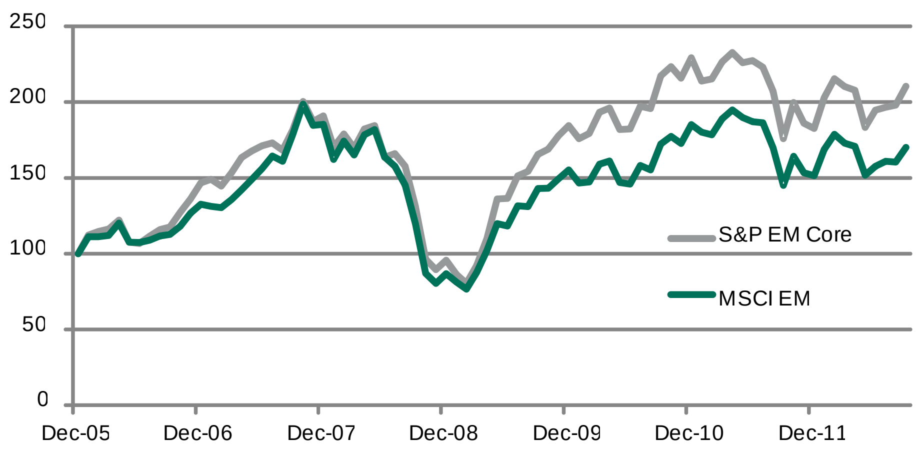
Exhibit 9: Comparative Sector Weights



Source: S&P Dow Jones Indices, MSCI. Data as of September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Stock selection for the S&P Emerging Markets Core Index is performed by selecting the largest stocks, by float-adjusted market capitalization, across all 24 GICS® industry groups. The constituents are then equally-weighted (subject to the aforementioned 15% country cap). The result is an index portfolio that is diversified by sector and industry. As shown in Exhibit 9, 63% of the weight of the MSCI Emerging Markets Index is concentrated in financials, information technology, energy and materials – four sectors that tend to be driven by global market forces and developed market demand. On the other hand, these sectors hold a combined weight of just 37% in the S&P Emerging Markets Core Index. Likewise, consumer staples and consumer discretionary comprise less than 17% of the MSCI Emerging Markets Index, but are more than 35% of the weight of the S&P Emerging Markets Core Index.

Exhibit 10: S&P Emerging Markets Core Outperforms



Source: S&P Dow Jones Indices; MSCI. Data from December 31, 2005 through September 30, 2012. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Greater exposure to less advanced economies and to more domestically oriented sectors has driven the S&P Emerging Markets Core Index to significantly outperform capitalization-weighted benchmarks in recent years (see Exhibit 10). In fact, since December 31, 2005, the index has amassed a cumulative total return of nearly 111%, outpacing the MSCI Emerging Markets Index by more than 40%, at a similar level of volatility (annualized standard deviation of 27.7% versus 27.0%).

Conclusion

The tremendous growth and development of emerging markets has expanded the opportunity set available to investors. Although index innovation and associated product development have encouraged some members of the investment community to look deeper at opportunities within the emerging markets, the vast majority of assets remain linked directly to index-based products tracking traditional benchmarks. Evidence indicates that taking a more discerning approach to emerging markets investing has the potential to add value.

Since December 31, 2005, the S&P Emerging Markets Core Index has amassed a cumulative total return of nearly 111%, outpacing the MSCI Emerging Markets Index by more than 40%, at a similar level of volatility.

Exhibit 4: Investment Products Linked to S&P 500 Volatility-Controlled Equity Indices

Underlying Index	Product Name	Ticker
S&P Emerging BMI	SPDR S&P Emerging Markets ETF	GMM
S&P Emerging Markets Core Index	EGShares Emerging Markets Core ETF	EMCR
S&P Asia Pacific Emerging BMI	SPDR S&P Emerging Asia Pacific ETF	GMF
S&P European Emerging BMI	SPDR S&P Emerging Europe ETF	GUR
S&P Latin America BMI	SPDR S&P Emerging Latin America ETF	GML
S&P Mid-East and Africa BMI	SPDR S&P Emerging Middle East & Africa ETF	GAF
S&P China BMI	SPDR S&P China ETF	GXC
S&P Russia BMI Capped	SPDR S&P Russia ETF	RBL
S&P Emerging < $2bn	SPDR S&P Emerging Markets Small Cap ETF	EWX
S&P Asia Pacific Emerging < $2bn	Small Cap Emerging Asia Pacific ETF	GMFS

S&P Dow Jones Indices does not sponsor, promote or endorse any investment product linked to any of our indices. The above is a complete list of all products that are currently linked to the indices discussed in this report.

Performance Disclosure

The inception date of the S&P Emerging Markets Core Index was October 8, 2012, at the market close. All information presented prior to the index inception date is back-tested. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at www.spdji.com/spindices.

Past performance is not an indication of future results. Prospective application of the methodology used to construct the S&P Emerging Markets Core Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the index. Please refer to the methodology paper for the index, available at www.spdji.com or www.spindices.com 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. It is not possible to invest directly in an Index.

Another limitation of back-tested hypothetical information is that generally the back-tested calculation is prepared with the benefit of hindsight. Back-tested data reflect the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities (or fixed income, or commodities) markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

The index returns shown do not represent the results of actual trading of investor assets. S&P/Dow Jones Indices LLC maintains the indices and calculates the index levels and performance shown or discussed, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause actual and back-tested performance to be lower than the performance shown. In a simple example, if an index returned 10% on a US $100,000 investment for a 12-month period (or US$ 10,000) and an actual asset-based fee of 1.5% were imposed at the end of the period on the investment plus accrued interest (or US$ 1,650), the net return would be 8.35% (or US$ 8,350) for the year. Over 3 years, an annual 1.5% fee taken at year end with an assumed 10% return per year would result in a cumulative gross return of 33.10%, a total fee of US$ 5,375, and a cumulative net return of 27.2% (or US$ 27,200).

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