

Global Markets Exploration

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A tailored view of Asian markets through Russell Custom Indexes

Amidst the constantly evolving global investment landscape, investors continually seek investment solutions that meet their specific needs. Custom indexes represent an opportunity for investors to achieve individualized exposures corresponding to their investment objectives; the accuracy and flexibility of such indexes enable their adaptation to investors' distinct strategies. Applications of custom indexes include their use as comprehensive equity market performance benchmarks, which can serve as equity market proxies for asset allocation analysis.

Additionally, custom indexes can be designed not only to capture specific exposures, but also to form the foundation for complex investment vehicles. For example, due to their effectiveness in measuring the performance of a new opportunity set or investment mandate, Russell custom indexes are well suited as a basis for ETFs and other structured products.

Russell custom indexes are based on Russell's series of U.S. and global indexes and can be built on a wide variety of factors and criteria.

Russell Custom Indexes

- Pure style indexes (growth/value)
- Client-defined screens (quality/social responsibility/liquidity)
- Blended indexes
- Custom regions
- Custom sectors

Custom index criteria

- Geography
- Sector or industry classification
- Alternative weighting
- Hedging
- Tax rates

In this report we showcase examples¹ of Russell custom indexes in Asia ex-Japan markets² to demonstrate the targeted exposures that custom indexes can provide. In particular, we consider custom indexes constructed by custom sector, custom region and alternative weighting methods.

¹ The custom indexes featured in this analysis are based on the author's own concept and are not currently Russell Indexes products. No specific user has been granted a limited license to these indexes.

² "Asia ex-Japan markets" herein refers to the stock markets of China, Korea, Taiwan, India, Hong Kong, Singapore, Malaysia, Indonesia, Thailand and the Philippines, which together comprise the Russell Asia ex-Japan Index (as of August 31, 2011).

Overview

- This report highlights examples of hypothetical Russell custom indexes that could be constructed by customizing the Russell Asia ex-Japan Index:
 - The Asia ex-Japan Consumption Sector Custom Index
 - The ASEAN-5 Custom Index and the ASEAN-5 Country Equal Weight Custom Index
 - The Asia ex-Japan Large Cap Equal Weight Custom Index
- The above hypothetical custom indexes serve different purposes and are therefore appropriate for a variety of investors with diverse strategies.
- A performance simulation³ of the past 10 years shows that each of the above hypothetical custom indexes would have outperformed the Russell Asia ex-Japan Index over that time period.

Custom sectors: the Asia ex-Japan Consumption Sector Custom Index

The consumption sector would show attractive performance in Asia ex-Japan markets

In Asia ex-Japan markets, consumer spending is popularly expected to continue to expand, supported by a growing middle class and boosted by government policies designed to reduce savings rates and rebalance economies toward consumption. In light of anticipated continued growth in Asia ex-Japan consumer spending, one possible focus of investor interest is the Asia ex-Japan consumption sector, the performance⁴ of which can be approximated by a custom sector index.⁵

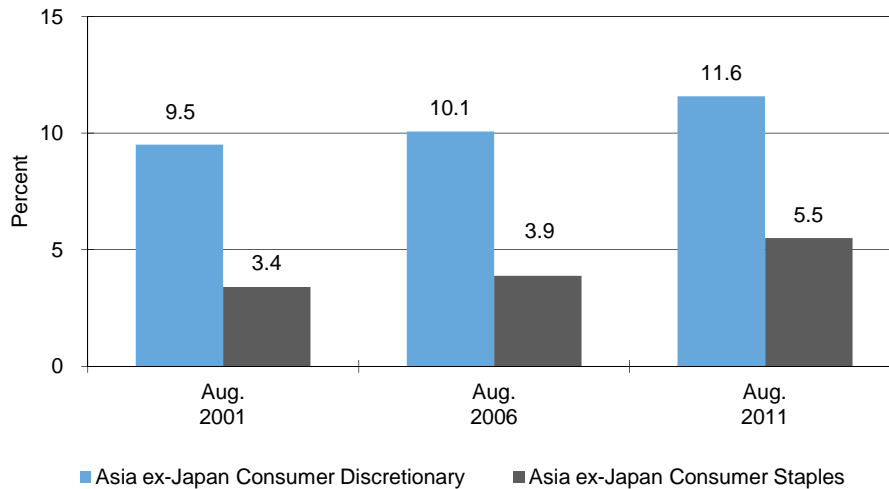
Russell Global Sectors, Russell Indexes' sector classification system, identifies two consumption-related sectors: Consumer Discretionary and Consumer Staples. Consistent with investor perceptions of strong growth in Asia ex-Japan consumption-related sectors, Figure 1 illustrates that the Consumer Discretionary and Consumer Staples share of total Asia ex-Japan's market cap has climbed swiftly over the past 10 years, topping 17% in 2011. The two consumption-related sectors' growth has been rapid, even relative to the fast-growing Asia ex-Japan markets during the same period, as shown in Figure 1.

³ The Asia ex-Japan Consumption Sector Custom Index, ASEAN-5 Custom Index and ASEAN-5 Country Equal Weight Custom Index were calculated using Russell Global Index monthly returns to calculate the hypothetical monthly market values of the custom sub-indexes. Then the particular weighting scheme was applied and the returns were calculated for each custom index. For the Asia ex-Japan Large Cap Equal Weight Custom Index, the existing Russell equal weight methodology (including the liquidity screen, capacity screen, and process of equal weighting) was used to construct the custom index. All custom indexes in this analysis are based on Russell Global Index data and Russell construction standards. The Russell Global Indexes Construction and Methodology, which contains the construction and methodology for the Russell Equal Weight Indexes, is available at Russell.com/indexes.

⁴ All returns for custom indexes quoted in this analysis are simulated.

⁵ See "Russell Asia Market Commentary: Your analysis of recent economic events and market movements," by Andrew Pease and Yuliya Brayshaw, *Russell Research*, September 2011.

Figure 1 / Consumption sectors' market cap share of total Asia ex-Japan market cap, as of August 31, 2011



Source: Russell Indexes

Having noted the recent growth seen in Asia ex-Japan consumption-related sectors, we analyze the construction of a custom index intended to deliver exposure to these sectors. An Asia ex-Japan consumption-sector custom index could be created by integrating a number of existing consumption-related sector indexes. We suggest an Asia ex-Japan custom index – which we will call the Asia ex-Japan Consumption Sector Custom Index (CSCI) – constructed by integrating the float-adjusted market cap–weighted performance of the Asia ex-Japan Consumer Discretionary and Consumer Staples sectors.

In Table 1 we compare the CSCI to the sector and country structures of the Russell Asia ex-Japan Index (RAJI).⁶ The sector structure side of Table 1 confirms that the custom index would indeed be composed only of the two consumption sectors, which would differentiate the CSCI from the nine-sector RAJI.

As shown on the country structure side of Table 1, the CSCI and the RAJI would encompass the same countries. However, there are some marked differences between the simulated country structures of the CSCI and the RAJI. The CSCI would be overweight to Korea and underweight to Taiwan relative to the RAJI.

⁶ The Russell Asia ex-Japan Index represents the Asia ex-Japan market as a whole.

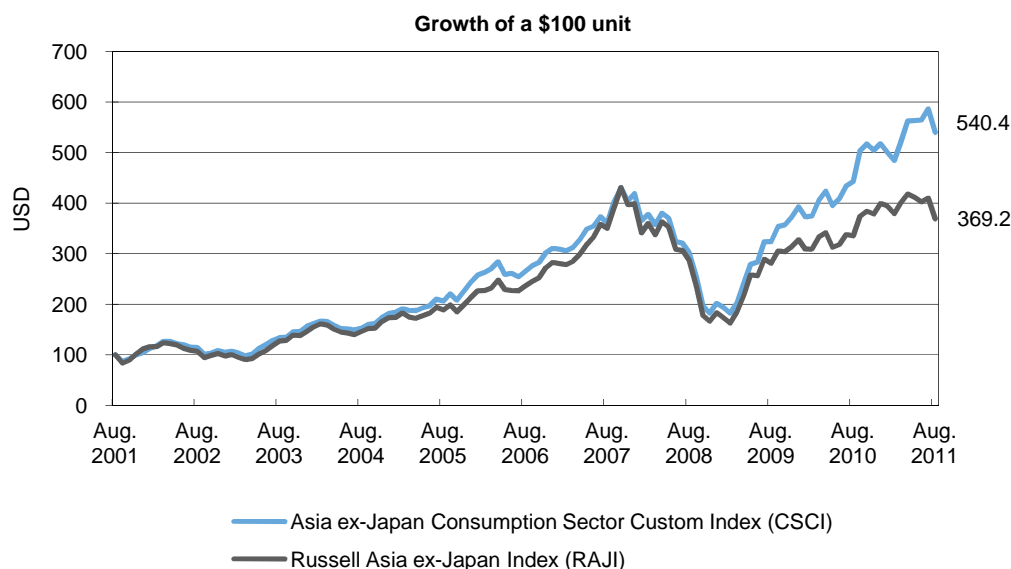
Table 1 / Simulated sector and country structure of the Asia ex-Japan Consumption Sector Custom Index, as of August 31, 2011

Sector	Sector Structure		Country Structure		
	Asia ex-Japan Consumption Sector Custom Index (%)	Russell Asia ex-Japan Index (%)	Country	Asia ex-Japan Consumption Sector Custom Index (%)	Russell Asia ex-Japan Index (%)
Financial Services		28.9	Korea	26.5	18.4
Technology		16.4	China	23.8	25.3
Consumer Discretionary	67.8	11.6	India	9.1	10.4
Materials & Processing		10.3	Singapore	8.3	7.5
Producer Durables		9.4	Hong Kong	7.6	9.7
Utilities		8.4	Malaysia	7.3	4.5
Energy		8.1	Taiwan	7.2	16.4
Consumer Staples	32.2	5.5	Indonesia	6.1	3.8
Health Care		1.4	Thailand	3.1	2.8
			Philippines	0.9	1.2

Source: Russell Indexes

Figure 2 compares the CSCI's simulated performance over the last 10 years to the RAJI's performance between August 31, 2001, and August 31, 2011. We find that an initial investment of US\$100 in the constituent securities within the RAJI would have grown to US\$369.20 by 2011. However, a simulated investment of US\$100 in the constituent securities within the hypothetical consumption-related sector-only CSCI would have grown to US\$540.40. The CSCI would have outperformed the RAJI on a simulated cumulative basis in every month except November 2001 and significantly outperformed the RAJI since August 2009, producing high hypothetical historical returns.

Figure 2 / Simulated performance of the Asia ex-Japan Consumption Sector Custom Index, as of August 31, 2011



Source: Russell Indexes

Table 2 compares the past one-, three-, five- and 10-year simulated average annual returns and simulated standard deviations of the CSCI with those of the RAJI. In each of these periods, we find that the CSCI would have outperformed the RAJI, the index that represents the Asia ex-Japan markets overall, with comparable or lower volatility.

Despite containing fewer sectors, the CSCI's standard deviation level would be similar to that of the RAJI; it would have lower simulated standard deviations over the last three, five and 10 years and only slightly higher simulated standard deviation over the last year. We find that the CSCI would have presented historically higher simulated performance, as measured by investment return, while maintaining comparable or better volatility ratios than the RAJI. We find that the custom sector index approach would be particularly effective at capturing high simulated returns due to simulated sector-related outperformance.

Table 2 / Simulated average return and standard deviation of Asia ex-Japan Consumption (annualized; % in USD), as of August 31, 2011

	Average Return		Standard Deviation	
	Asia ex-Japan Consumption Sector Custom Index	Russell Asia ex-Japan Index	Asia ex-Japan Consumption Sector Custom Index	Russell Asia ex-Japan Index
Past 1 year	22.0	10.1	20.6	19.3
Past 3 years	21.4	8.8	29.6	30.9
Past 5 years	15.3	9.4	26.4	28.0
Past 10 years	18.4	14.0	22.4	24.2

Source: Russell Indexes

Custom regions: the ASEAN-5 Custom Indexes

The ASEAN-5 Custom Index (ASEAN-5) and the ASEAN-5 Country Equal Weight Custom Index (ACEW) would have both outperformed the benchmark RAJI over the past 10 years

ASEAN (the Association of Southeast Asian Nations), a geopolitical and economic organization of 10 Southeast Asian countries, and its member countries represent an example of investor focus on a specific region not always separated out by traditional regional indexes. Investor opportunity exists in the ASEAN region in general: in 2010, the ASEAN members' combined nominal GDP had grown to US\$1.9 trillion.⁷ With such a high combined nominal GDP, if ASEAN were a single entity, it would rank as the ninth-largest economy in the world.⁸ In light of the fact that ASEAN's five founding members – Indonesia, Malaysia, the Philippines, Singapore and Thailand – currently account for more than 90 percent of the combined nominal GDP of all current ASEAN members, there is clearly opportunity for a custom index focusing on the five founding, or core, ASEAN members.⁹

We examine both a cap-weighted core ASEAN custom index, which we will call the ASEAN-5 Custom Index (ASEAN-5), and an equal weight ASEAN core index, which we will call the ASEAN-5 Country Equal Weight Custom Index (ACEW). The ACEW would be equal-weighted at the country level. The parent index for these ASEAN custom indexes would be the Russell Asia ex-Japan Index, which is appropriate due to the latter's broad coverage of the five core ASEAN countries.

⁷ Source: IMF – World Economic Outlook Database, April 2011.

⁸ Source: IMF – World Economic Outlook Database, April 2011.

⁹ Source: IMF – World Economic Outlook Database, April 2011.

Table 3 shows the simulated country structure of the ASEAN-5 and the ACEW compared to the RAJI. We find that the ASEAN-5 would have the highest country concentration of the three indexes: the ASEAN-5 would be overweight to Singapore and Malaysia compared to both the ACEW and the RAJI. The ASEAN-5's weight to Indonesia would vastly exceed the RAJI's weight to Indonesia, but it would be comparable to the ACEW's weight to Indonesia. The ASEAN-5 would overweight its top two constituents – Singapore and Malaysia – relative to the ACEW's and RAJI's top two constituents. In fact, the ASEAN-5's most heavily-weighted constituent, Singapore, would be more than 10 percentage points (pp) overweight relative to the top-weighted constituent in either the RAJI or the ACEW.

The ACEW would rebalance quarterly, and it would maintain its country equal-weighting between rebalances through a buy-and-hold stance. Despite these provisions for maintaining the ACEW's country-level equal weighting, after any rebalance, stock market fluctuations would begin to cause the individual countries' weightings to shift. Therefore, there might be slight deviations from true country-level equal weighting between quarterly rebalances. This phenomenon is made visible in Table 3: we see that just before the hypothetical September rebalancing, most of the ACEW's country weights would have drifted away from 20% by approximately one pp.¹⁰ This drift is small, but it explains why the ACEW, which would be equal-weighted on a country level, might not have a perfectly equal-weighted country structure.

Table 3 / Constituent countries and their simulated weights in the ASEAN-5 Custom Index and the ASEAN-5 Country Equal Weight Custom Index, as of August 31, 2011

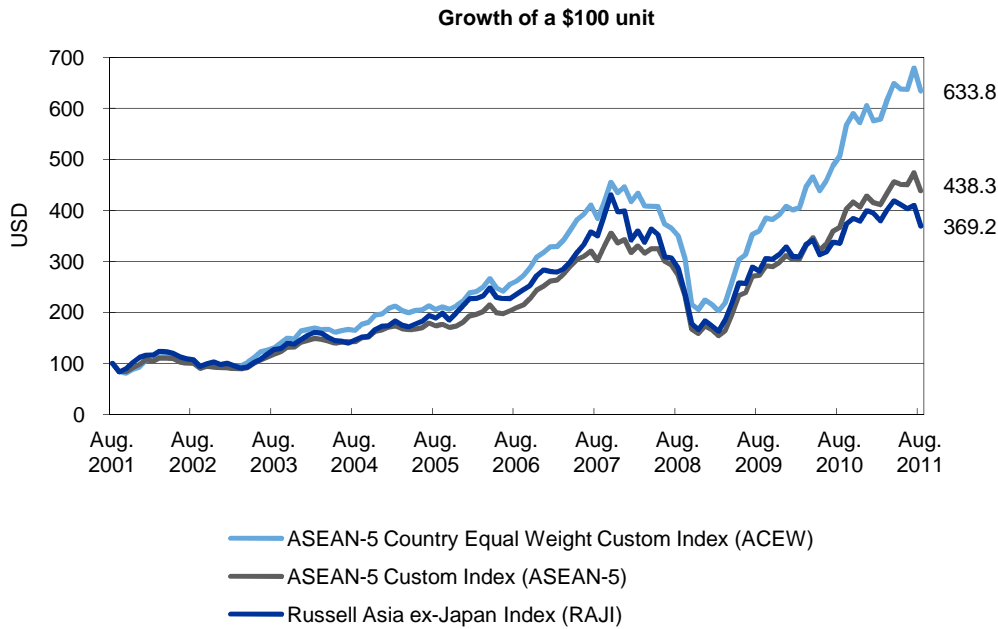
Constituent Countries	ASEAN-5 Custom Index (%)	ASEAN-5 Country Equal Weight Custom Index (%)	Russell Asia ex-Japan Index (%)
China			25.3
Korea			18.4
Taiwan			16.4
India			10.4
Hong Kong			9.7
Singapore	37.9	18.9	7.5
Malaysia	22.6	18.8	4.5
Indonesia	19.2	20.1	3.8
Thailand	14.0	21.3	2.8
Philippines	6.2	20.9	1.2

Source: Russell Indexes

¹⁰ Russell Equal Weight Indexes are rebalanced in June, September, December and March. As of this writing, Russell Equal Weight Indexes were last rebalanced on June 24, 2011.

Figure 3 compares the ASEAN-5's and the ACEW's simulated performance to the RAJI's over the past 10 years. An initial unit of US\$100 would have grown to US\$369.20 between August 31, 2001, and August 31, 2011 in the RAJI. On the other hand, an initial unit of US\$100 would have grown to US\$438.30 by August 31, 2011 in the ASEAN-5 or to US\$633.80 in the ACEW. We conclude that the overall simulated performance of the core five ASEAN member countries would have exceeded that of the entire Asia ex-Japan region for the period between August 31, 2001, and August 31, 2011, despite the fact that the ASEAN-5 would have underperformed the RAJI on a cumulative basis in some periods. Furthermore, we conclude that the ACEW would have historically outperformed both the ASEAN-5 and the RAJI.

Figure 3 / Simulated performance of the ASEAN-5 Country Equal Weight Custom Index and the ASEAN-5 Custom Index, as of August 31, 2011



Source: Russell Indexes

Table 4 compares the ASEAN-5's and the ACEW's one-, three-, five- and 10-year simulated annual returns and simulated standard deviations with those of the RAJI. In each of these periods, the ASEAN-5 would have outperformed the RAJI in terms of annual returns, but both indexes trailed the ACEW's simulated performance.

Volatility, as calculated by standard deviation, would have been somewhat lower for the ASEAN-5 than for the RAJI, despite the fact that the former index would have had a smaller number of constituent countries and a smaller market cap. On the other hand, the ACEW's volatility would have been slightly higher than that of the ASEAN-5 over the past one year and 10 years and slightly lower than that of the ASEAN-5 over the past three years and five years. The ACEW's volatility would be equal to or less than the RAJI's volatility in all four periods. We find that compared to the RAJI, both of the custom ASEAN indexes would have had higher simulated performance and comparable or lower volatility. As a result, we find that country-selection customizations and country equal weight indexes can be appropriate for investors seeking to capture or control exposure to a select group of countries.

Table 4 / Simulated average return and standard deviation of the ASEAN-5 Custom Index and the ASEAN-5 Country Equal Weight Custom Index (annualized; % in USD), as of August 31, 2011

	Average Return			Standard Deviation		
	ASEAN-5 Custom Index	ASEAN-5 Country Equal Weight Custom Index	Russell Asia ex-Japan Index	ASEAN-5 Custom Index	ASEAN-5 Country Equal Weight Custom Index	Russell Asia ex-Japan Index
Past 1 year	19.6	25.1	10.1	17.0	19.3	19.3
Past 3 years	17.1	21.9	8.8	30.3	29.8	30.9
Past 5 years	15.9	19.4	9.4	25.8	25.6	28.0
Past 10 years	15.9	20.3	14.0	21.6	21.9	24.2

Source: Russell Indexes

Alternative weighting: the Asia ex-Japan Large Cap Equal Weight Custom Index

Russell's equal weight methodology would have outperformed in Asia ex-Japan markets

The Russell Equal Weight Indexes offer a practical and unique solution for managers interested in alternative weighting methods. This innovative new series improves on traditional equal weight indexes by equal-weighting by sector. Traditional equal weight indexes apply the same weight to each constituent. A sector equal-weighted index, which equally weights each sector within an index and then equally weights the securities within each sector, provides greater diversification benefits than traditional equal weighting for the reason that only equal weighting by constituents introduces sector risk.¹¹ In this section we present not a custom index equal-weighted by country, like the ACEW, but a custom index equal-weighted by sector and constituents.

Table 5 illustrates the simulated sector and country structures of the Asia ex-Japan Large Cap Equal Weight Custom Index (LCEW) as of August 31, 2011. Despite some drift caused by post-rebalance¹² share price fluctuations, sector weights would have remained within 0.8 pp of being equal-weighted. In contrast, the sector weightings for the Russell Asia ex-Japan Large Cap Index (AJLC) demonstrate the sector structure of a cap-weighted index, in which one sector may become dominant (such as Financial Services in Table 5), and other sectors' weights may be negligible (for example, Health Care in Table 5).

Table 5 also suggests the extent to which the LCEW's simulated country structure is affected by being equal-weighted by sector. Compared to the AJLC, the LCEW would be relatively overweight to India and China and relatively underweight to Korea, Taiwan and Hong Kong.

Table 5 / Simulated sector and country structure of the Asia ex-Japan Large Cap Equal Weight Custom Index, as of August 31, 2011

Sector	Sector Structure		Country	Country Structure	
	Asia ex-Japan Large Cap Equal Weight Custom Index (%)	Russell Asia ex-Japan Large Cap Index (%)		Asia ex-Japan Large Cap Equal Weight Custom Index (%)	Russell Asia ex-Japan Large Cap Index (%)
Financial Services	11.4	30.7	China	29.8	26.9
Technology	10.8	16.6	India	20.7	10.4
Consumer Discretionary	11.3	10.4	Korea	13.0	19.2
Utilities	11.2	9.6	Taiwan	9.7	14.2
Energy	11.2	9.1	Indonesia	6.0	3.6
Materials & Processing	11.1	9.1	Singapore	5.2	7.8
Producer Durables	10.9	8.4	Hong Kong	5.1	10.6
Consumer Staples	11.8	5.1	Malaysia	4.7	3.9
Health Care	10.2	0.9	Thailand	3.5	2.3
			Philippines	2.2	1.0

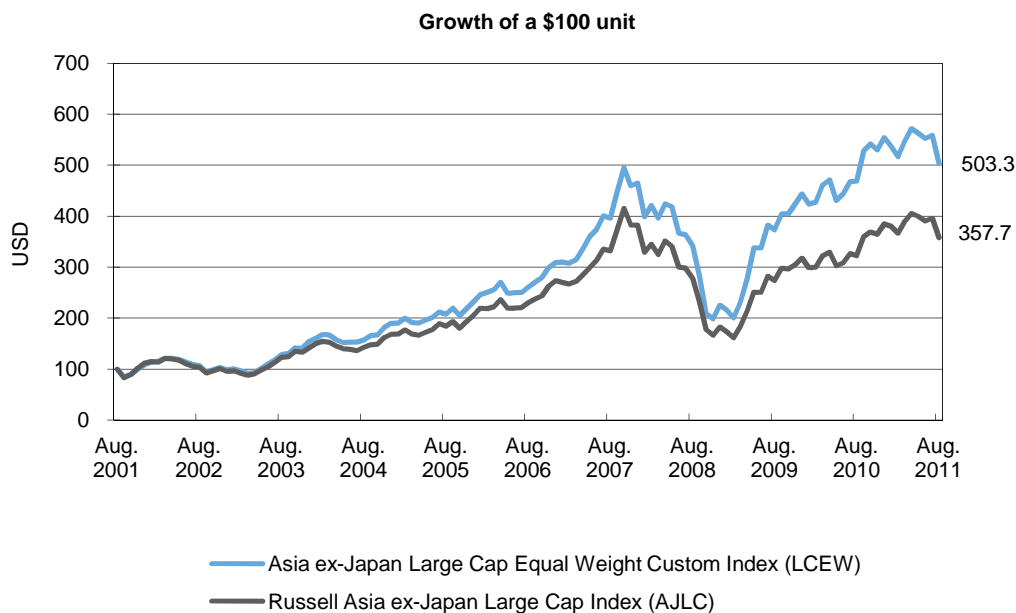
Source: Russell Indexes

¹¹ See "The Russell Equal Weight Indexes: An enhancement to equal weight methodology" by Pradeep Velvadapu, *Russell Research*, October 2010.

¹² Russell Equal Weight Indexes are rebalanced in June, September, December and March. As of this writing, Russell Equal Weight Indexes were last rebalanced on June 24, 2011.

Figure 4 highlights the simulated performance of the LCEW. Between August 31, 2001, and August 31, 2011, an initial unit of \$100 in the LCEW would have grown to US\$503.30, far exceeding the US\$357.70 that would have been achieved by the AJLC. In Figure 4 we also see that the LCEW would have outperformed the AJLC on a cumulative basis for almost all periods. We find that the simulated performance of the ACEW and LCEW – as simulated in Figure 4 and earlier in Figure 3 – would support Russell research that has found that equal weight indexes would have historically performed well in the Asia Pacific¹³ and in other regions.¹⁴

Figure 4 / Simulated performance of the Asia ex-Japan Large Cap Equal Weight Custom Index (LCEW), as of August 31, 2011



Source: Russell Indexes

¹³ See “The Russell Equal Weight Indexes: A case for Greater China” by Noriyuki Oharazawa, *Russell Research*, April 2011.

¹⁴ See “The Russell Equal Weight Indexes: An enhancement to equal weight methodology” by Pradeep Velvadapu, *Russell Research*, October 2010.

Table 6 shows the LCEW's past one-, three-, five- and 10-year simulated annual returns and simulated standard deviations. Despite underperforming the AJLC over the past year, the LCEW would have outperformed the AJLC over the past three-, five- and 10-year periods.

Table 6 also illustrates that the LCEW would have experienced slightly higher levels of volatility in comparison to the AJLC, with its standard deviation slightly exceeding the AJLC's in each of the periods shown in Table 6. We conclude that over the historical period in Table 6 the LCEW would have generated higher simulated returns than the AJLC, with only slightly elevated volatility.

Table 6 / Simulated average return and standard deviation of the Asia ex-Japan Large Cap Equal Weight Custom Index (annualized; % in USD), as of August 31, 2011

	Average Return		Standard Deviation	
	Asia ex-Japan Large Cap Equal Weight Custom Index	Russell Asia ex-Japan Large Cap Index	Asia ex-Japan Large Cap Equal Weight Custom Index	Russell Asia ex-Japan Large Cap Index
Past 1 year	7.4	10.8	20.1	19.0
Past 3 years	13.8	8.7	33.0	29.8
Past 5 years	14.1	9.3	29.4	27.3
Past 10 years	17.5	13.6	24.5	23.8

Source: Russell Indexes

Conclusion

In this analysis we have introduced three types of potential custom indexes: sector customizations, as represented by the Asia ex-Japan Consumption Sector Custom Index; country selection customizations, as represented by the ASEAN-5 Custom Index; and customization by two different “flavors” of alternative weighting, as represented by the ASEAN-5 Country Equal Weight Custom Index and the Asia ex-Japan Large Cap Equal Weight Custom Index. Utilizing such indexes can enable the investor to monitor or track the performance of a select exposure strategy portfolio seeking to add value from custom sector, region or country exposures.

We created the first featured index, the Asia ex-Japan Consumption Sector Custom Index, by customizing the Russell Asia ex-Japan Index sectors with a focus on consumption sectors. We have seen that this approach would have been effective at capturing high returns from sector-related outperformance, in this case capturing the recent explosion of Asian consumption. The second featured index, the ASEAN-5 Custom Index, was created by picking core ASEAN countries from among the Russell Asia ex-Japan Index's constituent countries. We have demonstrated that country selection customizations can be appropriate for investors seeking to control exposures to custom regions. Based on our simulations, both the Asia ex-Japan Consumption Sector Custom Index and the ASEAN-5 Custom Index are cap-weighted custom indexes, and both would have experienced higher historical returns than the benchmark Russell Asia ex-Japan Index over the period of analysis.

The two featured equal weight indexes – the ASEAN-5 Country Equal Weight Custom Index and the Asia ex-Japan Large Cap Equal Weight Custom Index – fall under the category of alternatively weighted, or non-cap-weighted, indexes. We have analyzed two different types of equal weight indexes: a *country* equal weight index (the ASEAN-5 Country Equal Weight Custom Index) and a *sector and constituent* equal weight index (the Asia ex-Japan Large Cap Equal Weight Custom Index). We have found that equal weight indexes can be particularly useful for implementing a select exposure strategy designed to control country (ACEW), sector (LCEW) or individual stock (LCEW) exposure. We have also found that both of the simulated equal weight indexes would have historically outperformed their respective benchmarks over the period of analysis.

Throughout this analysis, we have found that custom indexes can be used to deliver specific index solutions to a variety of different investors with diverse objectives. By providing a range of customization options, such indexes can be tailored to individual investors' needs. Russell Custom Indexes provide a wide variety of customization options and are supported by both the extensive global coverage of the Russell Global Index and Russell Indexes' long history of transparent, rules-based index construction.

About Russell Indexes

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¹⁵ See “Russell Global Indexes Construction and Methodology,” June 2011, available at www.russell.com/indexes.

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