

Market Review

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The structure of global equity markets at Russell Index Reconstitution June 2011

On June 24, 2011, the annual reconstitution of the Russell Indexes took effect. In this commentary we take the opportunity to once again examine the structure and characteristics of global equity markets at Russell Reconstitution.¹ For the past two years in this, our second-quarter commentary, we have shone a spotlight on the BRIC countries – Brazil, Russia, India and China – as well as on global and regional markets in order to highlight how the Russell Global Indexes, which are constituted on a global-relative rather than country-first basis, illuminate the structure of the world equity markets in terms of emerging vs. developed countries; regions; sectors and styles.² At their annual conference in April of this year, the BRIC countries invited South Africa to be the fifth member of this special grouping of emerging-markets countries; accordingly, this year, we add South Africa to the mix. BRIC has become BRICS.

The continuing recovery of global equity markets

During the 12 months July 1, 2010 to June 30, 2011 – Recon Year 2011³ – world equity markets continued to recover from the massive declines in valuations that occurred during the global recession. The International Monetary Fund dates the recession as

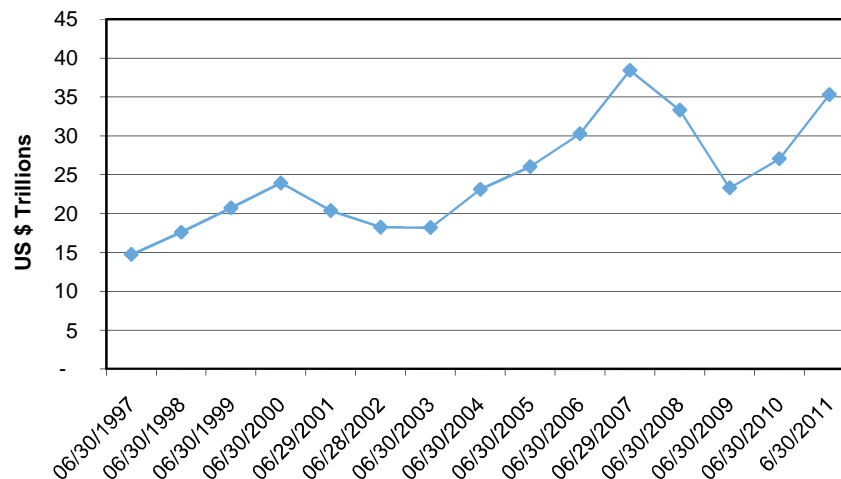
¹ The author thanks Oanh Hoang for her invaluable contribution to this research. I also thank my reviewers, Kyla Roberts, Rob Balkema and Mark Thurston.

² For prior analysis on Russell Index methodology and BRIC countries, see M. Fjelstad, “The structure of global equity markets at Russell index reconstitution June 2010,” Russell Research, July 2010; M. Fjelstad, “BRIC Countries after Russell Index 2009 Reconstitution: a Snapshot in Time,” Russell Research, July 2009; and K. Haughton, X. Yan, G. Cano and P. Velvadapu, “It’s all a matter of perspective,” Russell Indexes, March 2008.

³ For purposes of this paper, we employ the term “Recon” to designate the last day of June in each year when Russell Reconstitution impacts the month-end reporting of index returns, weights and characteristics. For example, Recon 2010 refers to the last business day of June 2010; similarly, Recon 2011 refers to the last business day of June 2011. We further define the 12-month period from one Reconstitution to the next as a “Recon Year”; e.g., for Recon Year 2011, returns are calculated for the 12-month period beginning July 1, 2010 and ending June 30, 2011. See the Appendix for a full mapping of terminology to exact dates.

beginning in December 2007 and ending in August of 2009, so as of Recon 2011 the global economy has been in a recovery for close to two years. Figure 1 shows that from Recon 2010 to Recon 2011, global equity markets as measured by the Russell Global Index⁴ (RGI) increased 30% in value, reaching a total valuation level of \$35.3 trillion. The chart depicts a market-value level that is not far below the level of June 2007, before the recession began, suggesting a robust global equity market recovery.

Figure 1⁵ / Market cap after reconstitution – Russell Global Index



Source: Russell Indexes. Market cap is float-adjusted.

The spectre of a double dip recession still haunts the investment world, however. At the time of this writing, investment professionals continue to voice many fears, including but not limited to the possibilities of: a US debt default; sovereign debt default(s) on the part of one or more European countries; the collapse of the European Monetary Union; slowing growth and/or runaway inflation in emerging markets; and reduced supply of energy due to ongoing political unrest in Middle Eastern and Northern African countries at a time of increasing demand. These concerns continue to contribute to market volatility.

In Figure 2 we see the impact a strong market has had on the capital structure of the Russell Global Index (RGI): the market cap⁶ of the largest company and the smallest company are up significantly over the period. Exxon Mobil – the largest company in the RGI as of Recon 2010 and Recon 2011 – has experienced a gain of 45% in market value over the last 12 months. The boundary line between small and large cap stocks (defined globally at 85% of total market cap⁷) is US\$1.62 billion, 25% higher than in June 2010.

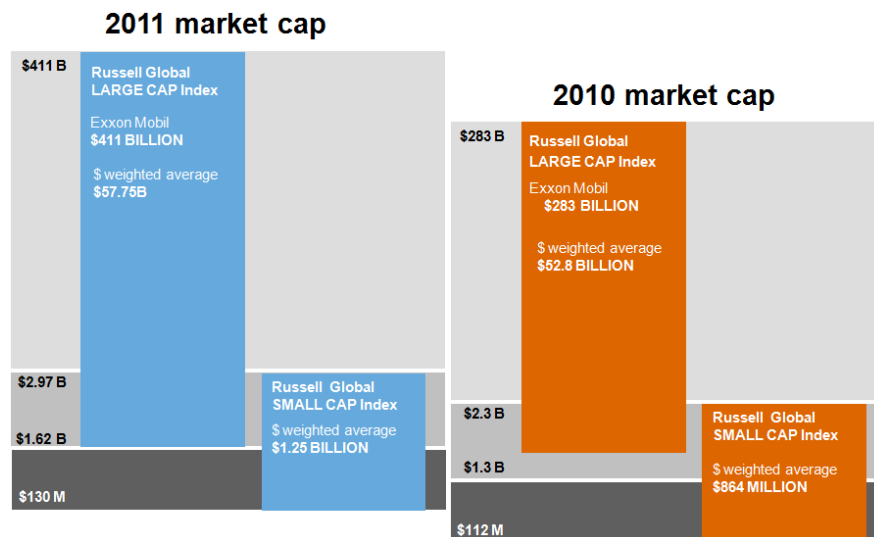
⁴ Throughout this paper we use Russell Indexes to measure the performance and characteristics of global equity markets, regions, countries, sectors and styles.

⁵ Market cap values in all charts and tables are float-adjusted, unless otherwise noted.

⁶ Market cap in Figure 2 is total market cap; for this figure, market cap is not float-adjusted.

⁷ See Russell Global Indexes Construction and Methodology, April 2011: http://www.russell.com/indexes/documents/Global_Indexes_Methodology.pdf

Figure 2 / Comparison of market capitalization structure of the Russell Global Index



Source: Russell Indexes.

Data as of May 29, 2010 and May 31, 2011 – total market cap.

Our snapshot of global equity markets as of the Recon year ending June 2011 reveals the following:

- For the third year in a row, emerging markets gained in importance within the Russell Global Index at the expense of developed markets, continuing a long-term trend.
- Reversing an effect we observed for the last two years, Europe gained ground in the Russell Global Index at the expense of the Asia-Pacific region. North America and Emerging EMEA posted modest gains.
- Global sector structure remained stable, and returns during the year generally exhibited characteristics of a positive economic climate. The four sectors that outperformed the global index – Consumer Discretionary, Energy, Materials & Processing and Producer Durables – are traditionally viewed as cyclical. Three of the five sectors that underperformed – Consumer Staples, Health Care, and Utilities – are viewed as defensive. The exceptions to the expectations of sector performance during a solidly positive economic phase are the underperforming Financial and Technology sectors, normally viewed as cyclical. Certainly, investor unease about the state of the global banking sector – the recession’s epicenter – explains the continued underperformance of financials.
- In terms of style, small cap outperformed large cap, but to a lesser extent than last year, and growth beat value even more than last year; both are consistent with a view that the global economy is in a positive state.
- Notable shifts toward growth occurred in the global Consumer Staples, Utilities and Energy sectors. Utilities remains a value sector despite this shift. Financial Services became even more value-oriented and has become the sector with the greatest value bias. Technology also moved toward value, but still is predominantly tilted toward growth.

BRIC, BRICS, or....

The BRIC countries have often been cited as an example of life imitating art. In 2001, Jim O'Neill of Goldman-Sachs created the acronym "BRIC" for the four largest emerging-markets countries.⁸ Since that time, these four countries have increasingly promoted a special relationship among themselves; beginning in 2009, they have held annual BRIC summits every April.

In the investment world, there has been much speculation (and many suggestions) over the last ten years about BRIC membership. Does Russia really belong? Which country(ies), if any, should be added to the group? In 2011, the four BRIC member countries moved on their own to augment their membership: they invited South Africa to join the group and to participate in the April 2011 BRIC conference. Thus BRIC has become BRICS. Although investment pundits' opinions about the addition of South Africa are mixed, we will follow the BRIC decision to select South Africa as the fifth member. In this paper we focus on the BRIC/S to highlight important changes in the structure of global equity markets; adding South Africa increases the scope of our analysis.

Our spotlight on the BRICS countries reveals that:

- At Recon 2010 and Recon 2011, BRICS countries, with the exception of India, now carry a greater weight in the RGI. This year, China had the greatest increase in index weight and now accounts for 2.7% of the Russell Global Index. Russia's gain (second in size to China's this year) and India's weight reduction mean that those two countries are now equal in their weights – 1.14% – in the RGI. Brazil and South Africa both saw slight improvements in their weights in the RGI. China is still the largest BRICS country in the RGI; Brazil remains second in size, followed by Russia and India. South Africa debuts as the smallest of the BRICS, accounting for 1% of global equity markets as represented by the RGI.
- India, China and Brazil underperformed the Russell Global Index over Recon Year 2011, while Russia and South Africa outperformed. Russia was the best-performing BRICS country during this period, and India the worst-performing: India posted a 12-month return for the year ending June 2011 that was 26 percentage points (pp) below the return to the RGI.
- China experienced a 5.7 pp increase in weight in the Technology sector at Recon 2011, by far the biggest shift in sector weights among the BRICS. South Africa and Brazil posted large reductions in Materials & Processing; Russia's exposure to Energy increased (Russia's dependence on this sector is significant), as did India's exposure to Financial Services.
- In terms of cap structure, Russia, an equity market dominated by large cap companies, shifted further toward large cap stocks. India, the BRICS country with the greatest small cap exposure, had a small change in the direction of large cap but still remains heavily weighted toward smaller companies as compared to the global average and the other BRICS. South Africa also exhibits a small cap bias relative to the global average, as does, to a lesser extent, China. China marks a small shift toward small cap as of Recon 2011. Brazil continues to be biased toward larger companies.

⁸ See Jim O'Neill, "Building Better Global Economic BRICS," Goldman Sachs Global Economics Paper No. 66, November 2001.

Emerging markets in the global economy

At Recon 2009 and Recon 2010 we noted an increase in the weight of emerging markets in the Russell Global Index⁹ – a reflection of, first, the fact that the global economic crisis had a greater impact on the developed world; and second, that the emerging world continued to do well during the early stages of the recovery. As of Recon 2011 we note that this trend has continued: emerging markets gained 0.4 pp in index weight, at developed markets' expense. Key measures of the positions of developed and emerging markets within the Russell Global Index are shown in Table 1.

Table 1 / Key Statistics for developed and emerging equity markets – Recon 2010 and Recon 2011

	2011		2010		Change From 2010	
	% of Global		% of Global		Difference	% Change
Developed						
# of securities	7125	70.37%	7471	71.88%	-346	-1.51%
# of countries	26	54.17%	26	54.17%	0	0.00%
Market cap (US\$ B)	30118.94	85.33%	23184.23	85.75%	6934.71	29.91%
Change in index weight						-0.42%
Emerging						
# of securities	3000	29.63%	2922	28.12%	78	1.51%
# of countries	22	45.83%	22	45.83%	0	0.00%
Market cap (US\$ B)	5178.35	14.67%	3851.98	14.25%	1326.36	34.43%
Change in index weight						0.42%

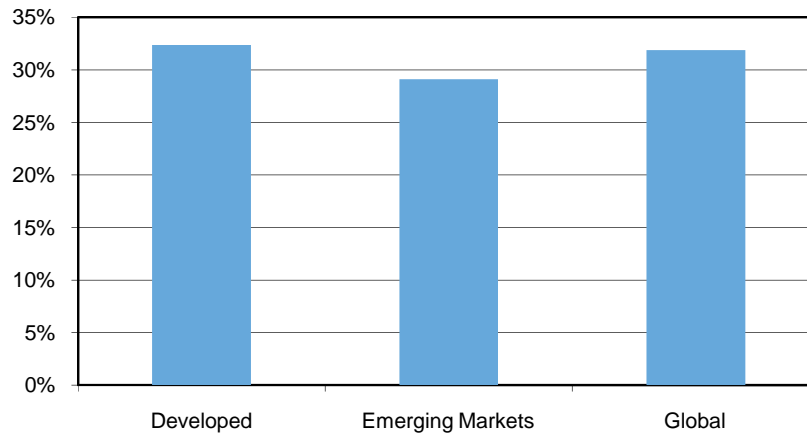
Source: Russell Indexes. Market cap is float-adjusted.

At Recon 2011, the RGI has an increased proportion of constituents from emerging world markets. Developed markets lost in aggregate 346 companies, and emerging gained 78. In terms of market weight, emerging markets presently constitute 14.7% of global equity market cap.

This increased weight of emerging markets in the Russell Global Index was achieved despite lower equity returns to emerging countries vs. developed countries during the 12 months of Recon Year 2011. In Figure 3 we see that developed markets returned 32.3% over Recon Year 2011, while emerging markets returned 29%. Investors have pulled back slightly in emerging markets due to uncertainty about whether emerging countries can manage stable growth: can and will these countries control inflationary pressures; will those controls, if enacted, hurt prospects for continued growth?

⁹ In September 2010, Russell Indexes redefined the constituency of the Russell Global Index by removing frontier markets. At that time, all historical performance and characteristics of the RGI were recalculated on the basis of the redefined Index membership. All tables and figures in this paper reflect these changes for statistics at Recon 2010, Recon 2011 and for returns over Recon Year 2011.

Figure 3 / Recon Year 2010–2011 total returns, Russell Developed, Russell Emerging Markets, and the Russell Global Index



Source: Russell Indexes. Market cap is float-adjusted.

Index returns shown here and in subsequent charts and tables represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

It is interesting to observe that emerging markets countries in general, and the BRICS in particular, now enjoy increased influence and greater clout in the global economy. This was made clear by their influence during the election of the new president of the International Monetary Fund (IMF), a position that to date has always been held by a European. Europe continued its leadership hold on the IMF with the election of Christine Lagarde of France as president in late June. Many press articles had suggested, however, that it was time for an IMF president from an emerging market country rather than from developed Europe. Lagarde sought BRICS support, as did other candidates for the position; Lagarde's pledge to increase emerging markets' voting power in the IMF is often cited a key factor in her election to the post.

But not all BRICS countries' weights increased between Recon 2010 and Recon 2011. In contrast to last year, when India posted the largest increase in weight in the RGI, at Recon 2011 India's weight is down 0.3 pp, as we see in Table 2. Russia gained ground and at Recon stood equal to India in terms of weight in the RGI. China edged out Russia in positive index weight change (with its gain of 0.19 pp to Russia's 0.18 pp). Brazil and South Africa experienced marginal increases in index weight from Recon 2010 to Recon 2011.

Table 2 / BRICS countries in the Russell Global Index – 2010 and 2010 at Recon

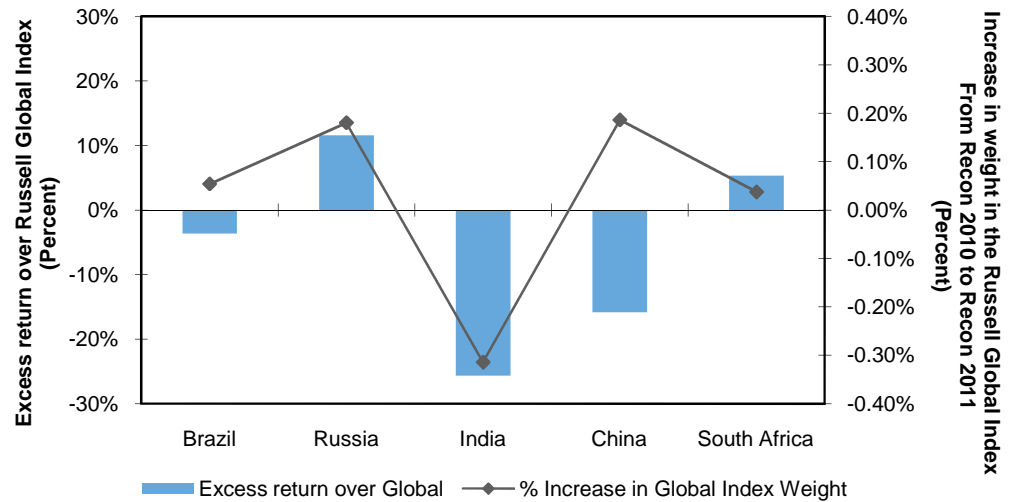
	2011		2010		Change from 2010	
	% of Global		% of Global		Difference	% Change
Brazil						
# of securities	194	1.92%	198	1.91%	-4	-2.02%
Market cap (US\$ B)	733	2.08%	547	2.02%	186	34.04%
Change in index weight					0.05%	2.67%
Russia						
# of securities	103	1.02%	120	1.15%	-17	-14.17%
Market cap (US\$ B)	404	1.14%	260	0.96%	143	55.00%
Change in index weight					0.18%	18.73%
India						
# of securities	456	4.50%	480	4.62%	-24	-5.00%
Market cap (US\$ B)	402	1.14%	393	1.45%	9	2.33%
Change in index weight					-0.31%	-21.62%
China						
# of securities	580	5.73%	417	4.01%	163	39.09%
Market cap (US\$ B)	941	2.67%	671	2.48%	271	40.36%
Change in index weight					0.19%	7.51%
South Africa						
# of securities	118	1.17%	123	1.18%	-5	-4.07%
Market cap (US\$ B)	357	1.01%	263	0.97%	94	35.60%
Change in index weight					0.04%	3.87%

Source: Russell Indexes. Market cap is float-adjusted.

Russia's increased weight is even more notable in light of the fact that it had a net loss of 17 companies from 2010 to 2011. In fact, four of the five BRICS saw a decreased constituent count in the RGI at Recon 2011 as compared to Recon 2010. India, which experienced a reduction in index weight, is down 24 companies. South Africa lost 5, and Brazil lost 4. China is the exception, seeing an increase of 163 companies at Recon 2011. Looking at absolute differences in market cap between Recon 2010 and Recon 2011, China leads by this measure this year as well (+\$271B); Brazil follows (+\$186B); Russia is third (+\$143B); South Africa is also up (+\$94B); and India is last, (+\$9B).

When we compare the changes in index weights of the BRICS countries at Recon 2010 and Recon 2011 with the 12-month excess returns to the country indexes (excess over the RGI return) in Figure 4, below, we see a mixed pattern. For Russia, India and South Africa, the changes in index weights align with performance: Russia and South Africa both had positive excess returns over the Recon Year 2011 and their weights have increased; the Russell India Index measures a negative excess return of -26%, and India has a lower weight in the RGI as of Recon 2011. With Brazil and China, however, we note that their weights increased in the Global Index at Recon 2011 even though both underperformed the RGI over the Recon year.

Figure 4 / Comparison of Recon 2011 year returns in excess of the Russell Global Index (July 2010–June 2011), and changes in index weights at Recon 2010 and Recon 2011 – BRICS countries



Source: Russell Indexes. Market cap is float-adjusted.

India's underperformance over Recon Year 2011 and reduced weight at Recon 2011 is striking. This poor performance may reflect investor uncertainty regarding India, including questions about whether the country can make much-needed improvements in physical infrastructure, tackle corruption issues, control inflation and alleviate barriers to doing business in a decentralized country with multiple diverse regions, languages, jurisdictions and small local markets. The World Bank rates India 134th out of 183 countries in Ease of Doing Business.¹⁰

¹⁰ *Economic Times*, June 17, 2011.

The impact of regions

In our two previous second-quarter commentaries we noted the reduction of Europe's weight in the RGI as of Recon 2009 and Recon 2010. This year we see, from Table 3, a reversal of this trend: Europe's weight in the RGI as of Recon 2011 is now close to 27%, up 1.1 pp from Recon 2010.

The robustness of the German economy, the evident and consistent commitment of major members to preserve the European Monetary Union, and indications on the part of China of support for the Euro and European sovereign debt may have contributed to the improved position of Europe within global equity markets, despite continuing alarm over European sovereign debt levels and doubts about the viability of the Euro.

We see that the increase in Europe came primarily at the expense of the Asia-Pacific region, which now carries a weight that is 1.19 pp less than at Recon 2010. Uncertainty about Japan in the aftermath of the environmental and nuclear disasters that occurred in March, as well as the concerns about India noted above, contributed to a reduction in the weight of the Asia-Pacific region.

Emerging EMEA had the second-largest gain in index weight (+0.19 pp); North America was third, with an increased weight of 0.12 pp; this gain came in Canada, as the U.S. is slightly down in index weights from Recon 2010 to Recon 2011. Latin America essentially carries the same weight in 2011 as at Recon 2010.

Table 3 / Key statistics on major world regions in the Russell Global Index – Recon 2010 and Recon 2011

	2011		2010		Change from 2010	
	% of Global		% of Global		Difference	% Change
North America						
# of securities	3487	34.44%	3468	33.37%	19	1.07%
# of countries	2	4.17%	2	4.17%	0	0.00%
Market cap (US\$ B)	16714.30	47.35%	12769.76	47.23%	3944.54	30.89%
Change in index weight						0.12%
Europe						
# of securities	2059	20.34%	2131	20.50%	-72	-0.17%
# of countries	23	47.92%	23	47.92%	0	0.00%
Market cap (US\$ B)	9492.36	26.89%	6970.43	25.78%	2521.93	36.18%
Change in index weight						1.11%
Latin America						
# of securities	350	3.46%	358	3.44%	-8	0.01%
# of Countries	5	10.42%	5	10.42%	0	0.00%
Market cap (US\$ B)	1098.68	3.11%	832.30	3.08%	266.38	32.01%
Change in index weight						0.03%
Asia Pacific						
# of securities	3941	38.92%	4107	39.52%	-166	-0.59%
# of countries	13	27.08%	13	27.08%	0	0.00%
Market cap (US\$ B)	7467.94	21.16%	6043.00	22.35%	1424.95	23.58%
Change in index weight						-1.19%
Emerging EMEA						
# of securities	485	4.79%	544	5.23%	-59	-0.44%
# of countries	9	18.75%	9	18.75%	0	0.00%
Market cap (US\$ B)	1014.30	2.87%	725.12	2.68%	289.18	39.88%
Change in index weight						0.19%

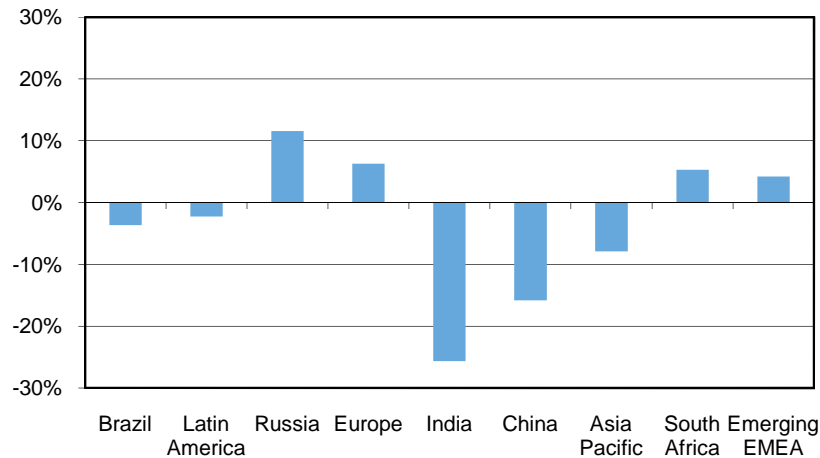
Source: Russell Indexes. Market cap is float-adjusted.

Europe now carries a heavier weight in the RGI, despite having lost a number of companies (net -72). The greatest loss in constituent count was in Asia-Pacific (net -166). EMEA also lost companies in the RGI (net -59); Latin America is slightly down (net -8), while North America had a marginal gain (net +19).

The fortunes of the BRICS countries afford an interesting comparison to their regions. All five BRICS countries, with the exception of China, line up with their respective regions in terms of the direction of changes in RGI weights. Russia and Europe experienced gains in index weights; South Africa and the EMEA region also recorded a positive net change, as did Brazil and Latin America. India's loss in index weight corresponds to the reduction in the weight of the Asia-Pacific region. The pattern is broken by China, whose increased position in the RGI is in contrast to its region's weight reduction.

When we examine 12-month performance in excess of the Russell Global Index from July 2010 through June 2011 (Figure 5), we see that all countries line up with their regions in direction. Russia and Europe outperformed the RGI to the greatest extent; South Africa and EMEA were second. China, India and Asia-Pacific underperformed the global index; the two Asia-Pacific BRICS had lower returns than their regions, India notably so. Brazil and Latin America also underperformed the global index, although not to the extent China/India/Asia-Pacific experienced. Despite the underperformance of Brazil and China relative to the global markets, both countries now carry greater weights in the RGI.

Figure 5 / Twelve-month excess returns over Russell Global Index – regions and BRIC countries, Russell Reconstitution 2011

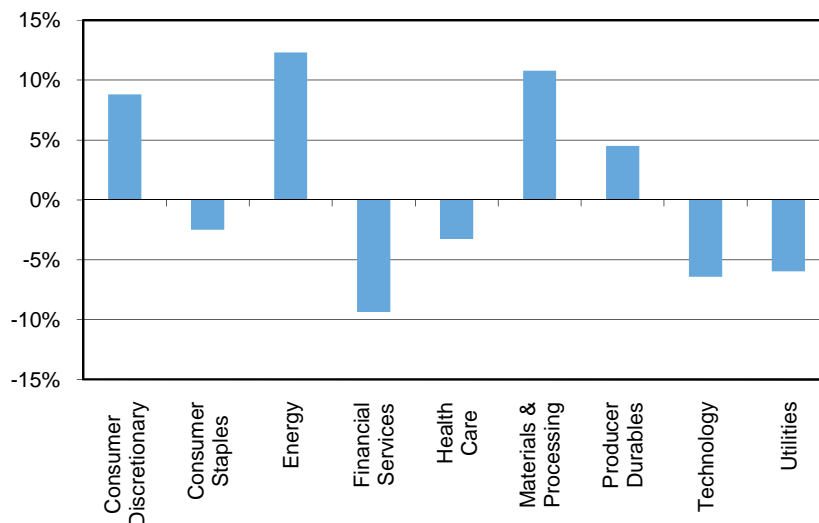


Source: Russell Indexes. Market cap is float-adjusted.

What about sectors?

In the period June 2010 to May 2011, global sectors diverged remarkably in terms of returns. Global sector returns in excess of the RGI over Recon Year 2011 are displayed in Figure 6. Uncertainty about whether the recovery would continue may be reflected by the mix of performances between defensive and cyclical sectors. Three traditionally defensive sectors – Utilities, Health Care and Consumer Staples – underperformed, in line with expectations of what normally occurs in a positive economy when cyclicals dominate. Also consistent with a growth phase, four cyclical sectors outperformed the global market: Energy, Materials & Processing, Consumer Discretionary and Producer Durables. However, Financial Services, also traditionally seen as a cyclical sector, turned in the worst performance of any sector relative to the RGI over the Recon Year. Technology, also normally classified as cyclical, underperformed as well, but not to the same extent as Financial Services. The identities of the best- and worst-performing sectors reflect first, for Energy, growing demand and uncertain supply; and second, for Financials, unalleviated concerns about the health of banks and financial institutions.

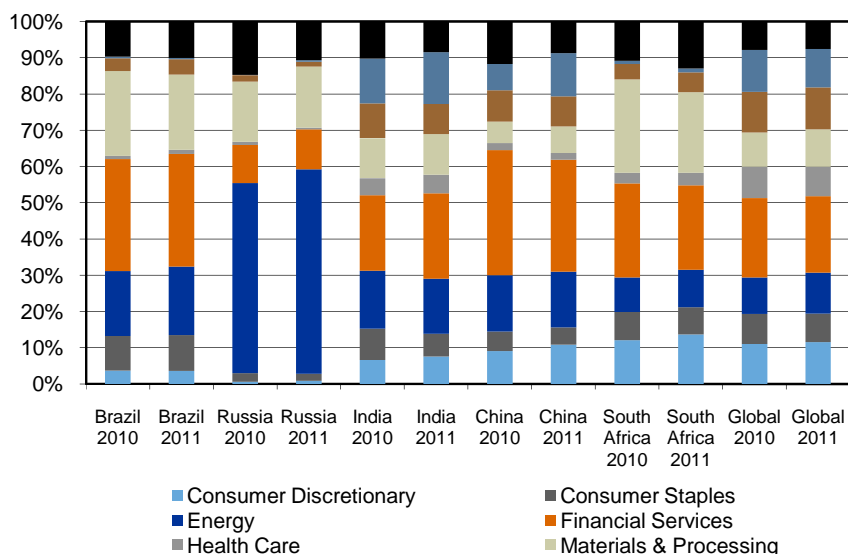
Figure 6 / Global sector returns in excess of the Russell Global Index – Recon Year 2011



Source: Russell Indexes. Market cap is float-adjusted.

Despite the strong differences in global sector performance over the period July 2010 to June 2011, we observe only minor changes in the sector structure of the global index, although the five BRICS countries exhibit larger shifts. The BRICS member countries have very different economies and thus very different sector exposures. Figure 7 shows the sector allocations at Recon 2010 and Recon 2011 for the BRICS countries as well as for the Russell Global Index. Sector structure for the RGI (the two columns at far right) shows slight changes from 2010 to 2011; the weights of defensive sectors are slightly down, while cyclical sectors experienced minor increases in index weights from Recon 2010 to Recon 2011.

Figure 7 / Global and BRIC country sector allocation – Russell Recon 2010 and Recon 2011



Source: Russell Indexes. Market cap is float-adjusted.

Bigger shifts occurred in sector weights in the BRICS countries, as we see in Table 4, where we have highlighted (in orange) the biggest changes. Russia's concentration in the Energy sector increased over this period. Russia's equity market is now 56% Energy; this increase was offset by a meaningful reduction in Utilities. Russia's Consumer Discretionary sector was almost nonexistent in Recon Year 2010, making its slight increase in Recon Year 2011 more notable. China's exposure to Financial Services has been reduced somewhat from 2010 to 2011, while its exposure to Technology has increased by 5.7 pp, the biggest sector shift among the BRICS over this period. South Africa and Brazil both marked a reduction in Materials & Processing, down 4.4 pp and 3.5 pp, respectively. In Brazil, the decrease was offset by slight increases in Financial Services, Consumer Staples and Technology; and in South Africa, by Utilities, Technology and Consumer Discretionary. Sector structure in India changed relatively little between Recon 2010 and Recon 2011, but India's sector structure is notable for the fact that it was the BRICS country with the largest increase in Financial Services, the global sector that underperformed most relative to the RGI. This increase was balanced by reductions in Energy and Consumer Staples. Energy is down in all BRICS, with the exception of Russia, as noted above.

Table 4 / Change in sector weights, BRICS countries – Recon 2010 to Recon 2011

	Brazil	Russia	India	China	South Africa
Consumer Discretionary	-0.70%	-0.33%	0.42%	1.19%	1.06%
Consumer Staples	0.91%	0.07%	-1.87%	-0.11%	0.11%
Energy	-0.31%	2.66%	-2.06%	-1.47%	-0.34%
Financial Services	0.99%	1.37%	3.57%	-2.80%	-1.87%
Health Care	0.73%	0.05%	0.81%	0.40%	1.03%
Materials & Processing	-3.47%	-0.56%	-0.55%	0.57%	-4.40%
Producer Durables	0.40%	-0.82%	-1.75%	-0.71%	0.89%
Technology	0.86%	1.37%	2.94%	5.68%	1.21%
Utilities	0.59%	-3.81%	-1.52%	-2.75%	2.31%

Source: Russell Indexes. Market cap is float-adjusted.

Recon Year 2011 (July 2010 to June 2011) returns to sectors within the BRICS differed markedly from Russell Global Sector returns, as reported in Table 5. The country sectors that underperformed by the greatest percentage relative to global sectors were in India and Russia. India's Energy and Producer Durables sectors turned in substantial negative excess returns, -51% and -47%, respectively; in fact, all of India's sectors, with the exception of Health Care, underperformed their global counterparts. Similarly, China's sectors also underperformed global sectors in all but one category: Technology. South Africa is at the other end of this relative performance continuum: all South African sectors but one – Materials & Processing – outperformed global sectors over this time period. Russia claims both the greatest under- and over-performance by a sector among the BRICS: Russia's Health Care sector underperformed Global Health Care with excess returns of -55%; its Consumer Staples sector outperformed its global counterpart with excess returns of 46%. Brazil turned in middle-of-the-road sector performance, outperforming in five sectors and underperforming in four sectors relative to the corresponding global sectors. Brazil's Energy sector underperformed with negative excess returns of -38%, representing Brazil's highest magnitude of either outperformance or underperformance.

Table 5 / BRICS sector returns in excess of global sectors – Recon Year 2011

	Brazil	Russia	India	China	South Africa
Consumer Discretionary	-0.3%	21.4%	-29.0%	-18.8%	17.3%
Consumer Staples	10.1%	45.7%	2.5%	-17.7%	4.7%
Energy	-37.8%	-1.9%	-51.3%	-11.7%	9.7%
Financial Services	12.4%	22.2%	-12.2%	-18.0%	9.7%
Health Care	20.3%	-54.5%	-10.4%	-34.5%	8.9%
Materials & Processing	-21.9%	22.5%	-36.6%	-5.9%	-26.0%
Producer Durables	13.0%	-20.6%	-46.8%	-30.9%	1.9%
Technology	-10.1%	6.2%	-10.4%	26.1%	9.7%
Utilities	16.7%	-1.8%	-30.5%	-20.7%	38.3%

Source: Russell Indexes. Market cap is float-adjusted.

The impact of cap size and style

During Recon Year 2010 we noted that small caps trounced large caps (small cap premium: 7.6 pp), while growth outperformed value, but to a lesser degree (value premium: -2.4 pp). During Recon Year 2011, small caps continued to outperform large caps, but not nearly to the same extent: the small cap premium over Recon Year 2011 was 2.3 pp. Growth, however, did much better than value over the last 12 months, during which the value premium was -4.1 pp. Both premia are consistent with expectations of relative cap and style performance in a positive economic climate.

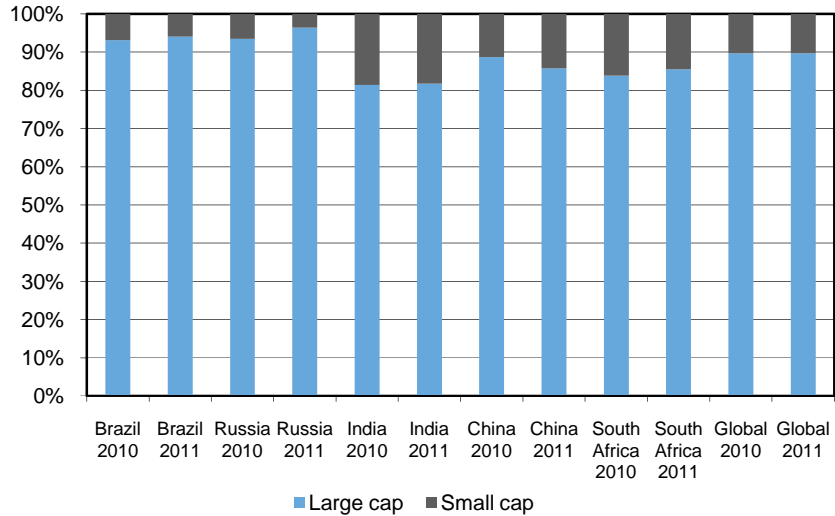
Table 6 / Twelve-month returns to global styles – July–June, 2002–2011

	Russell Global Growth Index	Russell Global Value Index	Value Premium (Value– Growth)	Russell Global Large Cap Index	Russell Global Small Cap Index	Small Cap Premium (Small Cap– Large Cap)
2002–2003	-0.5	-0.6	-0.1	-0.8	2.4	3.3
2003–2004	23.4	29.3	6.0	24.9	39.8	14.8
2004–2005	8.0	17.3	9.3	12.2	17.4	5.3
2005–2006	17.3	20.4	3.1	18.4	23.0	4.6
2006–2007	26.1	26.4	0.3	25.9	29.1	3.1
2007–2008	-4.9	-14.2	-9.3	-8.9	-14.8	-5.9
2008–2009	-28.4	-29.3	-0.8	-29.0	-27.3	1.7
2009–2010	15.2	12.8	-2.4	13.3	20.9	7.6
2010–2011	33.9	29.8	-4.1	31.6	33.9	2.3

Source: Russell Indexes. Market cap is float-adjusted. Data calculated using MPI Stylus™.

Russell's global relative definitions of style allow us to recognize and evaluate stylistic differences across countries, rather than forcing all countries and regions to fit the same mold. The world clearly recognizes that countries differ in their sector weights; they differ in cap and style exposure as well. To illustrate, BRICS countries differ markedly in their exposures to cap size and style. In Figure 8 we see that BRICS countries are not equally exposed to large and small cap companies. We have noted in past years the bias in Russia toward large cap companies; this tilt increased at Recon 2011. Brazil is also fairly biased toward large cap, but this relative overweight did not change very much between Recon Year 2010 and Recon Year 2011. At the other extreme we see India, with its sizable exposure to small cap, a bias to be expected in a country known for its startups and small, dynamic companies. India's small cap tilt experienced minimal reduction at Recon 2011. China has a slightly larger allocation to small cap now than it had in 2010. The newest BRICS member, South Africa, has a tilt toward small cap that is similar to, though not quite as large as, India's. South Africa's exposure to small cap stocks was reduced slightly from 2010 to 2011.

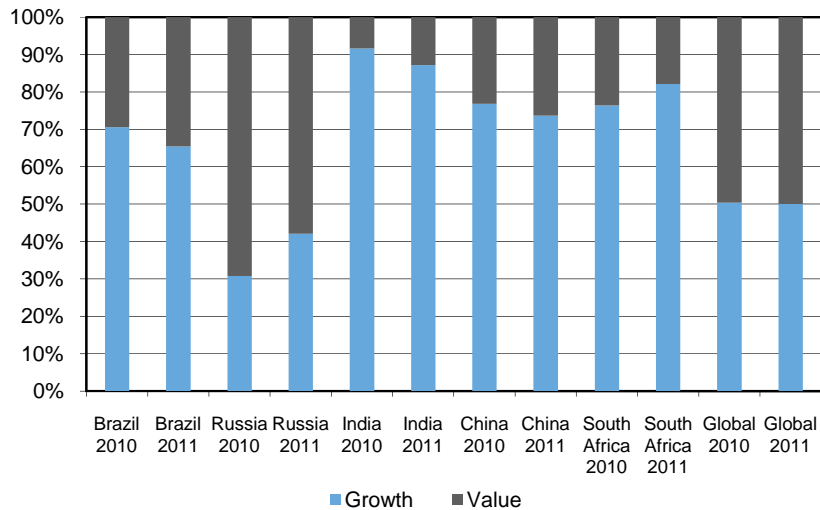
Figure 8 / Large and small cap structure – Russell Global Index and BRICS countries at Recon 2010 and Recon 2011 (based on float-adjusted market cap and weights)



Source: Russell Indexes. Market cap is float-adjusted.

Figure 9, below, shows the allocations to growth and value for the BRICS countries at Recon 2010 and Recon 2011. The largest change from 2010 in style exposure is in Russia, where the bias to value is lower than in 2010. Russia remains predominantly a value country, however, and is the only BRICS country with a value bias. The other four countries are tilted to growth, although to differing degrees. Among the BRICS, India continues to be by far the most exposed to growth, but its exposure to value is up from Recon 2010. Brazil and China moved in the same direction: both are more exposed to value than they were at Recon 2011. China and Brazil remain solidly growth countries, however. The newest member, South Africa, is also tilted toward growth, a tilt that increased at Recon 2011.

Figure 9 / Growth and value weights for BRICS countries – Russell Reconstitutions 2010 and 2011

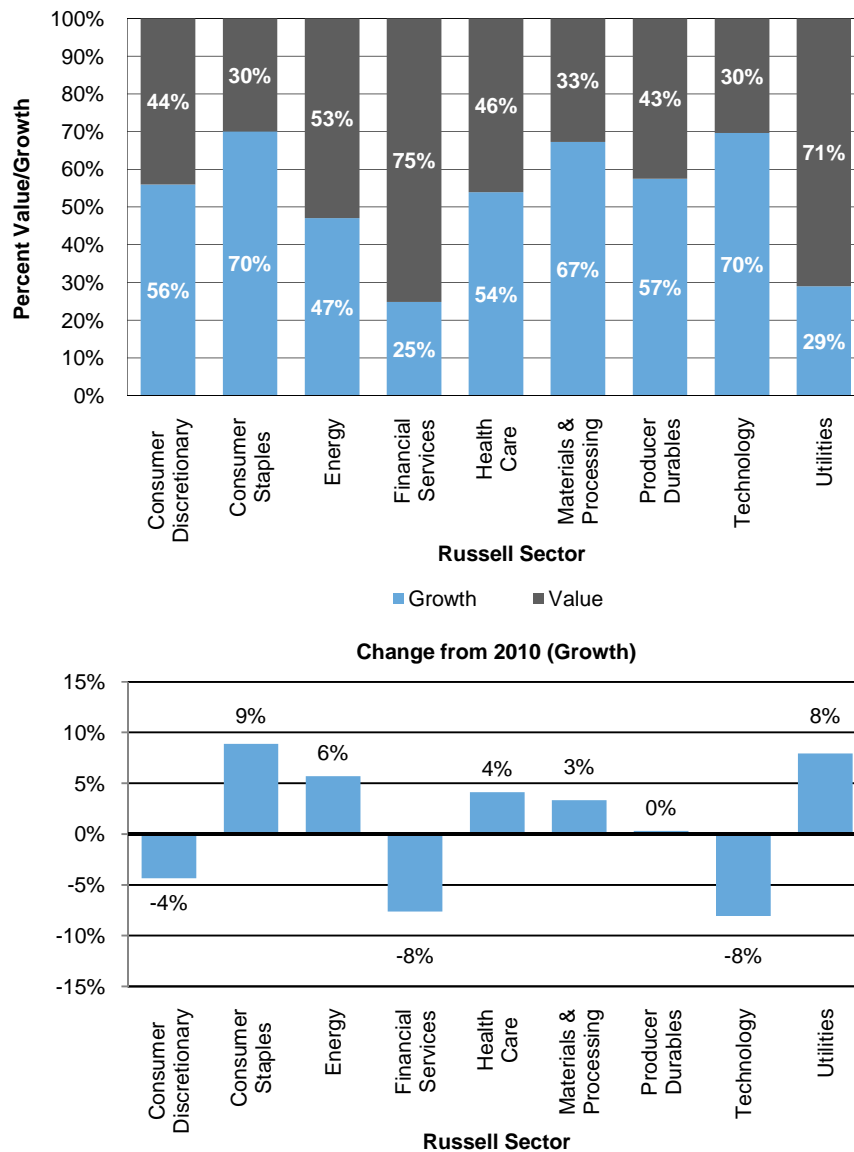


Source: Russell Indexes. Market cap is float-adjusted.

Where style and sector intersect

The most dramatic change in style bias in global sectors (see Figure 10) from Recon 2010 to Recon 2011 is in the global Consumer Staples sector. Historically a growth sector, Consumer Staples became even more so, experiencing a shift of 9 pp out of value toward growth. Other notable shifts toward growth occurred in the Utilities and Energy sectors. Global Utilities remains a value sector despite this shift, but Energy is now the most equally balanced sector in terms of style (53% value/47% growth). Financial Services became even more value-oriented and is at the time of this writing the sector with the greatest value bias, at 75%; Utilities follows, at 71%. Technology also moved toward value but remains a solid growth-oriented sector. Technology and Consumer Staples are tied as the sectors most tilted toward growth, each being 70% growth/30% value.

Figure 10 / Russell global sectors – breakdown by style – Recon 2011



Source: Russell Indexes. Market cap is float-adjusted.

Summary

Our snapshot of global equity markets and BRICS countries at Russell Index Reconstitution 2011 illuminates a number of important trends:

- Global equity market values improved significantly during Recon Year 2011; valuations are very close to what they were in June 2007, before the global recession began, suggesting a strong recovery. Global sector, cap and style returns also are in line with performance expectations for a strong economic climate.
- Emerging markets have again increased in importance and weight within global equity markets relative to developed markets; this is a trend that has been observable over a number of years.
- Europe has gained ground in the Russell Global Index at the expense of the Asia-Pacific region. Over Recon years 2009 and 2010, Europe suffered a reduction in index weight, while Asia-Pacific grew, so this is a notable change. The aftermath of the disasters in Japan and investor concerns about India's economic and business conditions contributed to the reduction in the weight of the Asia-Pacific region. Europe continues to struggle with public and private debt levels: the long hangover after the credit bubble orgy. Nevertheless, investors appear to have an improved evaluation of the region. Germany's economic boom has a beneficial impact across Europe; the monetary union has held together to date in support of its troubled members; the Euro has remained stable, due at least partly to the support of major nations, most notably, China.
- For the BRICS, the major stories at Recon 2011 are India and Russia, despite the fact that most of the media hype and investor pundits focus on China. India's weight in the RGI is down at Recon 2011; the performance of its equity market over Recon Year 2011 is dismal. While China also underperformed, as did the Asia-Pacific region, problems specific to India have contributed to India's reduced position in the RGI and poor performance. Russia, on the other hand, has been allotted a greater weight in the global index, and it outperformed the RGI by the greatest margin among BRICS countries over the Recon year. Russia's performance is driven to a great extent by the Energy sector, which was the best-performing sector for this Recon year.

In this snapshot of global equity markets, we observe a world that in many respects looks to be solidly in recovery. The credit crisis and global recession hit the developed world, especially Europe, very hard. Emerging markets weathered the storm relatively well, due at least in part to the fact that they were not fully integrated with the global economy or the developed-markets banking system. At Recon 2011 we see that Europe's position in global equity markets has improved, global equity market levels are up, and cyclical sectors have generally done well.

The signals are mixed, however. The emerging-markets growth machine may be slowing: India and China – and, to a lesser extent, Brazil – underperformed the Russell Global Index during Recon Year 2011. Globally, the Financial Services sector continues to struggle, turning in negative excess returns to the Russell Global Index of close to 10%. This is the third Recon Year in a row for which Financial Services has underperformed the RGI, and this year – 2011 – Financial Services was the worst-performing global sector. Financial institutions and banks supply credit and the flow of capital that is essential for growth; it is not clear that this vital sector has fully recovered.

Appendix: Definition of terms

Recon: The Annual Reconstitution of all Russell Indexes occurs on the last Friday of the month of June each year. The reconstitution of the Russell Indexes impacts month-end values, returns and characteristics for the indexes as of the last day of June each year. Accordingly, we employ the term “Recon” to designate the last day of each June when reconstitution is incorporated in month-end numbers, i.e. –

Recon 2010: The last business day of June 2010

Recon 2011: The last business day of June 2011

Recon Year: We define a “Recon Year” primarily for the purpose of returns calculation to designate the 12-month period from one Recon to the next, i.e. –

Recon Year 2010: The 12-month period July 1, 2009 to June 30, 2010

Recon Year 2011: The 12-month period July 1, 2010 to June 30, 2011



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