

Australian Benchmarks: The Competition Heats Up

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What began over a decade ago as a move to replace Australia's primary domestic equity index with a series of indices better aligned with investor benchmarking needs, has evolved into a competition among index providers trying to gain a foothold in the Australian market. Back in 2000, the ASX and Standard & Poor's® (S&P) jointly launched the S&P/ASX suite of indices to meet performance and benchmarking requirements that were not satisfied by Australia's primary domestic index, the "All Ordinaries Index" or "All Ords." At the same time, the All Ords shifted from roughly 250 to 500 stocks of the largest companies by market capitalization, and ultimately became a non-investable indicator of broad market movements.

Since their introduction, the S&P/ASX indices have essentially dominated the Australian market, dramatically reducing the importance of the All Ords. Moreover, while other index providers have attempted to gain traction in the Australian market, they have yet to unseat their S&P/ASX index rivals. Some have certainly tried. In 2010, MSCI launched an index to compete directly with the S&P/ASX 200. FTSE also launched joint venture indices with the Association of Superannuation Funds of Australia focused on after-tax management.

Despite the fact that alternative index providers have not made significant inroads in the Australian market to date, if recent introductions are any indication, the competition will continue to heat up. Particularly as new investment mandates and areas of focus arise—ETFs and after-tax performance as examples—alternative index providers such as MSCI and FTSE will find more opportunities to differentiate and develop their market presence in Australia.

THE S&P/ASX INDICES: MARKET DOMINANCE

Today, the S&P/ASX indices (S&P/ASX 200 and sub-indices such as the S&P/ASX LPT 200,¹ S&P/ASX 50 and S&P/ASX 100) are the most widely followed in the Australian market, with the S&P/ASX 200 considered the index of choice for domestic investors. Additional indices include the S&P/ASX 300 and the Small Ordinaries. More recently, an "All Australian" line of indices has been added to the S&P/ASX suite after a change in methodology allowed cross-listed foreign stocks to enter the existing indices.

S&P/ASX 200

The S&P/ASX 200, which is equivalent to the S&P 500 Index in the US, is a market-cap-weighted index which represents approximately 83% of the market capitalization of the Australian equity market. Comprised of 200 of the largest and most liquid companies listed on the ASX, the Index is float-adjusted and reviewed quarterly. Both the construction of this index and its sub-indices reflect significant tactical themes for investors in the Australian market—most notably Financial and Resource stocks. In addition, the SPI futures contract—the dominant futures contract for the Australian market—is benchmarked against the S&P/ASX 200.

THIS ARTICLE IS FEATURED IN SSGA'S BETA BOOK.

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- With \$895 Billion in AUM,² SSgA is one of the world's largest index managers, delivering cost-effective strategies to institutional investors worldwide.
- SSgA's Global Equity Beta Solutions team is comprised of 60 dedicated investment professionals in 7 investment centers around the globe providing local expertise and experience.²
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- SSgA's indexing strategies currently span 75 countries and over 400 benchmarkweighting schemes.²

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Given the strong role played by banks in the Australian market, the Financials sector (ex-REITs) accounts for more than 30% of the S&P/ASX 200 Index, with the four major Australian banks representing over 70% of this sector.

With respect to resources, historically, the Australian market—and economy—have had a high exposure to natural resources. Accordingly, the original All Ords Index was divided into Industrials and Resources, and the S&P has continued to publish Industrials and Resources versions of the S&P/ASX 200. While resources remain a major driver of the market, classification of institutional portfolios into industrials versus resources has gradually declined over the last couple of decades. The S&P/ASX 200 Industrials Index includes companies whose primary business is to manufacture and distribute capital goods or provide commercial services and supplies. The S&P/ASX 200 Resources Index consists of stocks from the S&P/ASX 200 that are included in either the Energy Sector or Metals & Mining Industry.

S&P/ASX 50

Representing the large cap universe for Australia, the S&P/ASX 50 consists of the largest 50 stocks (determined by float-adjusted market capitalization) from the S&P/ASX 200 universe. Covering roughly 69% of the total market capitalization of the Australian equity market, the S&P/ASX 50 focuses on the most investable and liquid stocks. This Index has the same concentration of Resources and Financials as in the S&P/ASX 200, with Financials (ex-REITs) accounting for approximately 36.50%. Within Financials, the four major banks—Australia and New Zealand Banking Group (ANZ), Commonwealth Bank of Australia (CBA), National Australia Bank Ltd (NAB) and Westpac Banking Corp. account for close to 28.50%, which is over 78% of the sector for the index. Resources make up 34% of the S&P/ASX 50, with BHP and RIO dominating the sector at 56%, that is 19% of the total index.

S&P/ASX 100

The S&P/ASX 100 Index contains the largest 100 eligible stocks, ranked by free float-adjusted market capitalization, from the S&P/ASX 200 universe. These 100 stocks represent approximately 78% of the Australian equity market. Because the last 50 stocks of this Index form the S&P/ASX MidCap 50, the S&P/ASX Index can be considered the large- and mid-cap index of choice.

S&P/ASX 200 A-REITS

This Index was developed to track the performance of Australian REITs in the S&P/ASX 200. The number of stocks in the Index is not fixed, and has been steadily decreasing. Currently, the Index is highly concentrated, with three stocks accounting for approximately 51% of the Index. In July 2002, the GICS classification was adopted for use in relation to the S&P/ASX indices. In addition to the 10 standard GICS Sectors, two sector indices were introduced in the Australian market, reflecting the importance of property trusts as a distinct sector. Specifically, the Financials sector was broken into Property Trusts and Financials (excluding Property Trusts). More recently, in order to

conform to global standards, “property trust” has been replaced with “REIT” in index descriptions, so the Index has been renamed S&P/ASX 200 A-REITS. Thus, any stock in the S&P/ASX 200 that is classified as a REIT will be a constituent of the S&P/ASX 200 A-REIT Index.

S&P/ASX 300

With a somewhat checkered past, the S&P/ASX 300 Index reflects the debate back in 2000 over whether the new standard index should have more or fewer stocks than the original All Ords Index. When introduced in 2000, this Index contained 300 stocks, but over time, stock eligibility became increasingly difficult based on liquidity and size criteria. Beginning in August 2001, when a stock was dropped from the Index due to a takeover it was not replaced and, in December 2001, the Index did not return to 300 constituents at the quarterly rebalance. At one point the Index fell to a low of 253 stocks. Then, in 2004, S&P began to use quarterly rebalances to bring the Index back to 300 stocks. To make this possible, relative liquidity requirements were adjusted down from 50% to 30%. However, with the 3 reduction in liquidity requirements, there has been an increase in the ‘index effect’ around additions to the S&P/ASX 300 Index. Index effect refers to the phenomenon where stocks being added to the Index tend to have their price pushed up while stocks being deleted generally suffer price declines as a result.

Today, there is still some debate over the value of the additional 100 stocks. Most institutional investors in Australia choose the 200, considering the cost of the additional 100 constituents excessive. Currently the Index covers approximately 85% of the Australian equity market capitalization, an additional 2% over the S&P/ASX 200.

S&P/ASX Small Ordinaries

As the small capitalization index of the series, this Index is constructed from the S&P/ASX 300 constituents, excluding the stocks that are included in the S&P/ASX 100. The S&P/ASX Small Ordinaries Index covers less than 10% of the market capitalization of Australian equities listed on the ASX.

S&P All Australian Series

In June 2007, the All Australian series of indices was launched following a change in the eligibility criteria for stocks in the S&P/ASX indices. Under the new S&P methodology, foreign domiciled stocks, dually listed on the ASX, could be included in the S&P/ASX 200 and other domestic indices. In response to market demand, S&P introduced the All Australian indices for investors who wanted to maintain a truly domestic portfolio. The All Australian indices are the S&P/ASX All Australian 200 and the S&P/ASX All Australian 50. The All Australian 50 has replaced the S&P/ASX 50 as the Australian component of the S&P Global 1200 to avoid the double counting of cross-listed stocks, which is one of the primary criticisms of the change in methodology for the mainstream indices. In June 2011, eight stocks in the S&P/ASX 200 Index were considered foreign—News Corporation, Resmed, Fletcher Building, Henderson Group, Telecom Corp of NZ, Singapore Telecommunication, Alacer Gold and Oceana Gold Corp. At the time, the combined weight of these foreign

FIGURE 1: INDEX FEATURES

INDEX	FLOAT ADJUSTED	MARKET CAP WEIGHTED	APPROXIMATE MARKET COVERAGE (%)	FOREIGN SECURITIES ALLOWABLE	LIQUIDITY SCREEN*	REBALANCE
S&P/ASX 200	Yes	Yes	83	Yes	Relative Liquidity of 50%	Quarterly
S&P/ASX 50	Yes	Yes	69	Yes	Relative Liquidity of 50%	Quarterly
S&P/ASX 100	Yes	Yes	78	Yes	Relative Liquidity of 50%	Quarterly
S&P/ASX 300	Yes	Yes	85	Yes	Relative Liquidity of 30% (no relation to size, unlike other indexes where size criteria need to be met)	Semiannual
S&P/ASX SMALL ORDINARIES	Yes	Yes	7	Yes	As per 300	Quarterly
S&P/ASX ALL AUSTRALIAN 200	Yes	Yes	82	No	Relative Liquidity of 50%	Quarterly
S&P/ASX ALL AUSTRALIAN 50	Yes	Yes	68	No	Relative Liquidity of 50%	Quarterly
MSCI AUSTRALIA 200	Yes	Yes	84	No	Adequate Liquidity measured by 12 and 3 month Annual Traded Volume Ratio and 3 month frequency of trading	Quarterly

Source: MSCI, S&P

* Relative Liquidity = Stock Median Liquidity divided by Market Liquidity. Stock Median Liquidity is median daily value traded for each stock divided by average float/index weight-adjusted market capitalisation for previous six months. Market Liquidity is determined using the market capitalisation weighted average of the stock median liquidities of the 500 constituents in the All Ordinaries index.

stocks was approximately 1.4% of the index (News Corporation was the largest in weight by far, accounting for in excess of 0.7%). The methodology of the All Australian series mirrors that of the other S&P/ASX indices, apart from the definition of eligible securities.

Interest in the All Australian suite of indices has been lukewarm, perhaps based on 1) the fact that the SPI futures contract is benchmarked against the S&P/ASX 200, solidifying the popularity of this Index and 2) minimal investor concern over current exposure to non-domestic stocks in the S&P/ASX 200.

MSCI AUSTRALIA INDEX SERIES

While the S&P/ASX 200 Index is favored by most domestic investors, the MSCI Australia Index is the index of choice for offshore investors reflecting the strong global position of MSCI in multi-country indices. Though at present, global index provider MSCI has gained little foothold in the Australian market, changes in that market—particularly the growth of the ETFs—have opened the door. Alternative index providers, such as MSCI, are taking advantage of that opportunity as evidenced in the introduction of the following indices:

MSCI Australia 200 Index

Launched in September 2010, the MSCI Australia 200 Index competes directly with the S&P/ASX 200. In fact, this Index was the basis for a new ETF launched on the ASX to compete with the SPDR 200. Designed to track the performance of the 200 largest securities in the Australian equity market, the MSCI Australia 200 Index covers approximately 84% of the market. It is market cap-weighted, free float-adjusted and, unlike the S&P/ASX 200, excludes foreign companies listed on the ASX.

FIGURE 2: TRACKING ERROR COMPARISONS OF S&P/ASX 200, S&P/ASX ALL AUSTRALIAN 200 AND MSCI AUSTRALIA 200 AS OF APRIL 30, 2011

	MSCI AUSTRALIA 200 (%)	S&P/ASX 200 (%)	S&P/ASX ALL AUSTRALIAN 200 (%)
MSCI AUSTRALIA 200	0.00	0.28	0.26
S&P/ASX 200	0.28	0.00	0.20
S&P/ASX ALL AUSTRALIAN 200	0.26	0.20	0.00

Source: Axioma, MSCI, S&P.

Past performance is not a guarantee of future results.

Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

News Corporation is a noticeable mis-weight when comparing both the MSCI 200 Index and the All Australian 200 to the S&P/ASX 200, as this stock changed domicile from Australia to the United States. A small holding of cross-listed News Corp securities remains on the Australian exchange as “Chess Depository Receipts” or “CDIs.” These are eligible constituents in the S&P/ASX 200, which allows foreign stocks listed in Australia.

MSCI Australian Select High Dividend Yield Index

This custom market-capitalization-weighted Index, based on the MSCI Global Investable Market Index, includes only securities with a dividend yield greater or equal to the dividend yield of the parent index (MSCI Australia IMI Index) ex-REITs. The Index includes dividend persistence and sustainability screens and has been used to expand the SPDR® range of products on the ASX with the launch of the SPDR MSCI Australia Select High Dividend Yield ETF.

FIGURE 3: TOP 10 UNDERWEIGHTS AND OVERWEIGHTS BY SECURITY

AS OF APRIL 30, 2011

MSCI VS S&P/ASX 200 Underweights (%)		MSCI vs S&P/ASX ALL AUSTRALIAN 200 Underweights (%)		S&P/ASX 200 VS S&P/ASX ALL AUSTRALIAN 200 Underweights (%)	
NEWS CORPORATION	-0.70	OIL SEARCH LTD	-0.67	BHP BILLITON LTD	-0.16
OIL SEARCH LTD	-0.66	BHP BILLITON LTD	-0.37	CMNWLT BK OF AUST	-0.10
EQUINOX MINERALS	-0.22	TELSTRA CORP LTD	-0.10	WESTPAC BKG CORP	-0.08
BHP BILLITON LTD	-0.21	AURORA OIL & GAS LTD	-0.09	NATL AUSTRALIA BK	-0.07
RESMED INC	-0.18	CARSAL.COM LTD	-0.06	AUST & NZ BANK GRP	-0.07
FLETCHER BUILDING	-0.16	BATHURST RESOURCES	-0.06	BATHURST RESOURCES	-0.06
HENDERSON GROUP PL	-0.11	TRANSURBAN GROUP	-0.05	BEADELL RESOURCES	-0.05
AURORA OIL & GAS LTD	-0.09	BEADELL RESOURCES	-0.05	RIO TINTO LIMITED	-0.05
TELECOM CORP OF NZ	-0.08	DISCOVERY METALS	-0.05	WESFARMERS LTD	-0.05
CARSAL.COM LTD	-0.06	ARDENT LEISURE GP	-0.04	INTEGRA MINING LTD	-0.04
Overweights (%)		Overweights (%)		Overweights (%)	
CAMPBELL BROTHERS	0.26	CAMPBELL BROTHERS	0.26	NEWS CORPORATION	0.70
WOODSIDE PETROLEUM	0.20	WOODSIDE PETROLEUM	0.17	EQUINOX MINERALS	0.22
CMNWLT BK OF AUST	0.17	SAI GLOBAL LTD	0.09	RESMED INC	0.18
WESTPAC BKG CORP	0.15	WESTFIELD GROUP	0.09	FLETCHER BUILDING	0.16
WESTFIELD GROUP	0.11	CMNWLT BK OF AUST	0.07	HENDERSON GROUP PL	0.11
RIO TINTO LTD	0.10	WESTPAC BKG CORP	0.07	TELECOM CORP OF NZ	0.08
WESFARMERS LTD	0.10	MAP GROUP	0.06	SINGAPORE TELECOMM	0.06
AUST & NZ BANK GRP	0.09	ASTON RESOURCES	0.06	ALACER GOLD CORP	0.06
SAI GLOBAL LTD	0.09	PHARMAXIS	0.06	OCEANAGOLD CORP	0.03
NEWCREST MINING	0.09	WESFARMERS LTD	0.06	ELDORADO CORP	0.03

Source: MSCI, S&P.

FIGURE 4: MIS-WEIGHT BY SECTOR

AS OF APRIL 30, 2011

MSCI VS S&P/ASX 200 (%)		MSCI VS S&P/ASX ALL AUSTRALIAN 200 (%)		S&P/ASX 200 VS S&P/ASX ALL AUSTRALIAN 200 (%)	
ENERGY	-0.68	ENERGY	-0.83	FINANCIALS-S	-0.33
CONSUMER DISCRETIONARY	-0.42	MATERIALS	-0.39	CONSUMER STAPLES-S	-0.17
MATERIALS	-0.30	TELECOMMUNICATION SERVICES	-0.10	ENERGY-S	-0.15
TELECOMMUNICATION SERVICES	-0.20	INFORMATION TECHNOLOGY	-0.04	INDUSTRIALS-S	-0.10
HEALTH CARE	-0.05	UTILITIES	0.03	MATERIALS-S	-0.09
INFORMATION TECHNOLOGY	-0.03	HEALTH CARE	0.07	INFORMATION TECHNOLOGY-S	-0.01
UTILITIES	0.04	CONSUMER STAPLES	0.13	UTILITIES-S	-0.01
CONSUMER STAPLES	0.30	CONSUMER DISCRETIONARY	0.21	TELECOMMUNICATION SERVICES-S	0.10
INDUSTRIALS	0.54	INDUSTRIALS	0.44	HEALTH CARE-S	0.12
FINANCIALS	0.81	FINANCIALS	0.47	CONSUMER DISCRETIONARY-S	0.63

Source: MSCI, S&P.

Weights are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

MSCI Australian Shares Large Cap Index

This Index is designed to reflect the performance of large-cap companies in the Australian equity market. It is free float-adjusted, aiming to capture approximately 70% of the free float market capitalization of the investable Australian equity universe.

MSCI Australian Shares Small Cap Index

This Index aims to capture the performance of small-cap companies in the domestic Australian equity market. It is free float-adjusted and represents approximately 14% of the adjusted market capitalization for the small-cap segment of the investable Australian equity universe.

Both the MSCI Australian Shares Small Cap and Large Cap indices have been introduced to the market as the basis for an ETF provider to launch new ETFs in the Australian market.

FTSE ASFA INDICES

In addition to increasing interest in and strong growth of ETFs in the Australian market, the Australian investment community has also considered after-tax management and performance to be key areas of focus. In response, FTSE partnered with the Association of Superannuation Funds of Australia (ASFA) to develop and deliver after-tax benchmarks for the Australian market in 2009. The aim was to provide the industry with tools to transition to after-tax performance measurement and reporting.

The indices that were initially developed focused primarily on tax adjustments for franking credits—an important tax component of income for domestic investors in the Australian market. The indices covered tax rates applicable to Superannuation funds, mid- or high-tax bracket personal investors and tax-exempt investors. The indices also adjusted for certain tax effects associated with participation in off-market buy-backs.

In March 2011, FTSE announced the introduction of additional after-tax benchmarks which calculate the effects of capital gains tax, both realized and unrealized, in addition to franking credits and off-market buy-backs. Capital gains or losses are first assumed to result from corporate actions or any event that causes changes to the index constituents. FTSE has also included an assumption that 20% of the portfolio is realized and reinvested every year, which results in full turnover of the index every five years and provides a second source of capital gains or losses. This level of turnover reflects the average tenure of a portfolio manager, and its inclusion ensures that the cost base of the index remains relevant and meaningful to a live portfolio. Once again, the series includes a range of tax rates to cater to most investor classes. The range of indexes in these two series include:

- FTSE ASFA Australia Large Cap 50 Index
- FTSE ASFA Australia 100 Index

- FTSE ASFA Australia Mid Cap 150 Index
- FTSE ASFA Australia 200 Index
- FTSE ASFA Australia 300 Index
- FTSE ASFA Australia Small Cap Index
- FTSE ASFA Australia All-Share Index
- FTSE ASFA Australia All-Share ex-100 Index
- FTSE ASFA Australia Sector Indices
(based on ICB sector classifications)

Superannuation Funds in this market are expecting fund managers to become increasingly “tax aware” and, as a result, the FTSE ASFA indices have attracted plenty of attention. Even if they are not the perfect solution, these indices are a step in the right direction in allowing investors to gauge the tax effectiveness of their managers. FTSE is also promoting these indices as benchmarks that are appropriate for ETF products.

CONCLUSION: INDICES TO EVOLVE THROUGH COMPETITION

Until recently, domestic investors in the Australian market have almost universally favored indices provided by S&P in partnership with the Australian Stock Exchange. Alternative index providers found it nearly impossible to make any meaningful impact in this market.

The tide may be turning, however, based on certain factors inherent in the evolution of the Australian marketplace. Developments in ETF product offerings—strong growth in the number of products and level of assets along with changing performance reporting requirements—have been the catalysts for providers such as MSCI and FTSE to introduce new indices to the Australian market. As the influx of ETF providers continues, the shortage of benchmarks allowing differentiation will become more pronounced and the demand for index alternatives more pressing.

In addition, after-tax performance reporting is on the upswing and shows no signs of diminishing. FTSE has taken full advantage as first mover on this development and has already generated significant market interest in its range of after-tax benchmarks. While after-tax benchmarks are, by their nature, complex and difficult to implement, they could still prove to be a source of competitive pressure for S&P.

Whether S&P loses its stronghold on index dominance in the Australian market remains to be seen. Any competitive pressure that spawns new index alternatives, however, could potentially benefit the Australian investment community with respect to more diverse benchmarking opportunities.

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¹ "LPT" is a Listed Property Trust, similar to a REIT in the US.

² SSgA, As of 30 June 2011.

³ Bloomberg, as of 31 December 2011.

⁴ As of 31 December 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US\$63 billion as of 31 December, 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

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