MSCI 25/50 Indices | February 2010

Introduction

MSCI Barra recently launched the MSCI 25/50 Index Methodology, which can be applied across countries and sectors to create investable MSCI 25/50 Indices. These indices are designed to serve as benchmarks for Regulated Investment Company (RIC)-compliant funds in the US. Two key requirements at the end of each quarter of a tax year for RIC-compliant funds are: 1) no more than 25% of the value of the fund's assets may be invested in a single issuer, and 2) the sum of the weights of all issuers representing more than 5% of the fund should not exceed 50% of the fund's total assets.

These long-only indices are constructed through portfolio optimization to meet issuer-level constraints and are designed to achieve, with low turnover, a low tracking error with the respective MSCI index. They are rebalanced on a quarterly basis to coincide with the reporting requirements of RIC-compliant funds and to ensure a timely and ongoing reflection of the 25/50 issuer level constraints.

In this document, we present the salient features of the MSCI 25/50 Index Methodology and highlight the characteristics of the recently launched MSCI US 25/50 Investable Market Sector Indices.

1. Index Methodology Highlights

The design of the MSCI 25/50 Indices is driven by two key principles: a timely and ongoing reflection of the 25/50 concentration constraint, and a minimization of tracking error with the respective MSCI parent index while maintaining low turnover.

The index construction process employs portfolio optimization using the Barra Open Optimizer. The optimization process seeks to minimize turnover and tracking error with the parent index, while meeting the issuer-level 25/50 constraint. The tracking error of the MSCI 25/50 Index versus the MSCI parent index is measured as the distance between the constituent weights of the MSCI 25/50 Index and the MSCI parent index. Turnover is minimized by applying a transaction cost penalty of 50 basis points. The minimum weight of any MSCI 25/50 Index constituent is equal to the weight of the smallest constituent in the respective MSCI parent index.

In addition, to ensure a timely and ongoing reflection of the 25/50 constraint, the MSCI 25/50 Indices are rebalanced periodically each quarter at the end of February, May, August, and November, coinciding with the Quarterly and Semi-Annual Index Reviews of their parent indices. There is no index rebalancing due to non-compliance between the Quarterly Index Reviews.

Furthermore, buffers of 10% of the value of each constraint are used to reduce the risk of non-compliance due to short-term market movements between quarterly reviews. As a result, at initial construction or subsequent rebalancing dates, the weight of any single issuer cannot exceed 22.5% of the index weight, and all issuers with a weight above 4.5% cannot exceed 45% of the index weight.

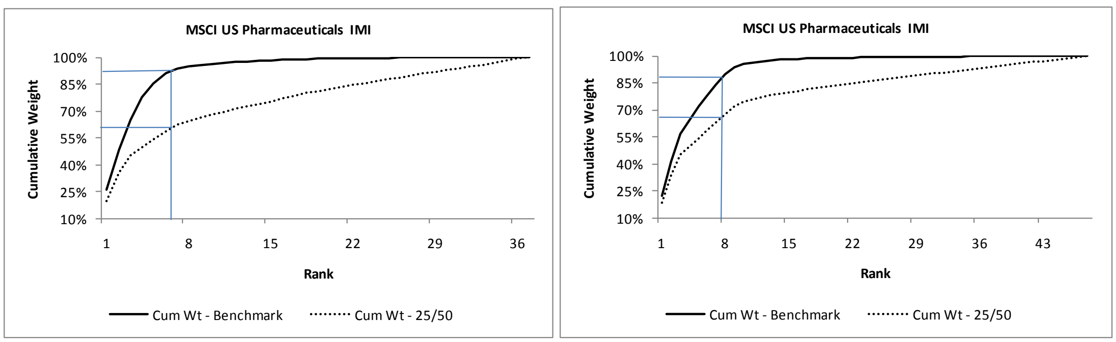
Lastly, the index is maintained to reflect changes due to corporate events, such as the addition of a newly eligible security in the MSCI parent index. An early inclusion of a large IPO, or a security migrating to the MSCI parent index from another size segment, would result in the inclusion of that security in the MSCI 25/50 Index and trigger a full rebalancing. However, a security added to the MSCI parent index following a corporate event (e.g., spin off, merger) affecting an existing constituent is added to the MSCI 25/50 Index without triggering a rebalancing. The deletion of a constituent from the MSCI parent index following a corporate event triggers its deletion from the MSCI 25/50 Index without rebalancing.

2. Illustrative MSCI 25/50 Indices

In this section, we highlight the key facets of the MSCI 25/50 Index Methodology by analyzing the characteristics of the simulated MSCI 25/50 Indices derived from the MSCI US Pharmaceuticals Investable Market Index (IMI) and the MSCI US Telecommunication Services Investable Market Index (IMI).

As seen in Exhibit 1 below, the MSCI US Pharmaceuticals IMI shows a high degree of concentration, with the top six securities having weights greater than 4.5% each and contributing to a cumulative weight of 91% as of December 2009. The corresponding MSCI 25/50 Index caps the individual weights of these top six securities at a maximum of 22.5% and their cumulative weight at 59%.

Exhibit 1: MSCI US Pharmaceuticals Investable Market Index — Concentration

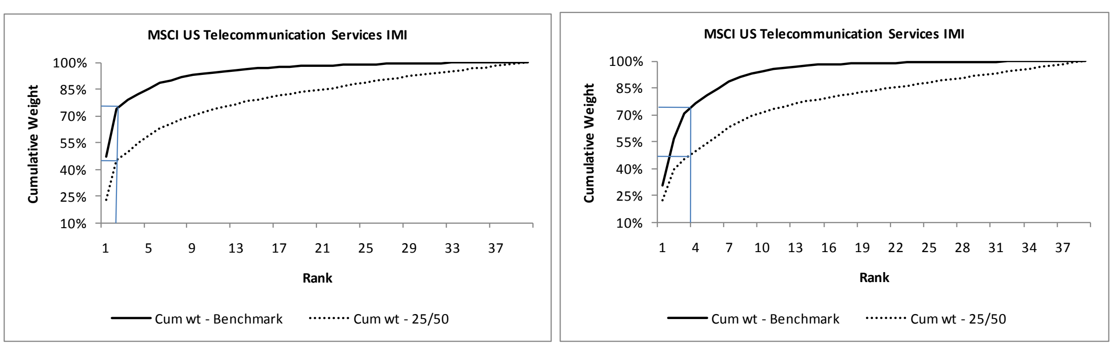


As of December 2009

As of December 2002

Similarly, as seen in Exhibit 2 below, the MSCI US Telecommunication Services IMI shows a high degree of concentration. The top two securities, namely Verizon and AT&T, have weights greater than 22.5% each and contribute to a cumulative weight of 74% as of December 2009. The corresponding MSCI 25/50 Index caps the individual weights of the top 2 securities at a maximum of 22.5%, and their cumulative weight is lowered to 45%.

Exhibit 2: MSCI US Telecommunication Services Investable Market Index — Concentration

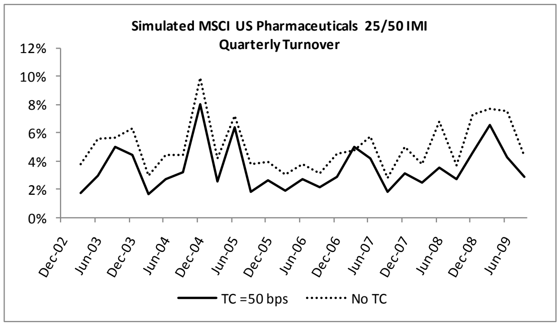


As of December 2009

As of December 2002

Another salient feature of the methodology is the use of a transaction cost (TC) penalty to manage the turnover of the index. As seen in Exhibits 3 and 4, we observe that applying a TC penalty of 50 bps reduces the average turnover by nearly 30% without a significant impact on the tracking error.

Exhibit 3: Turnover



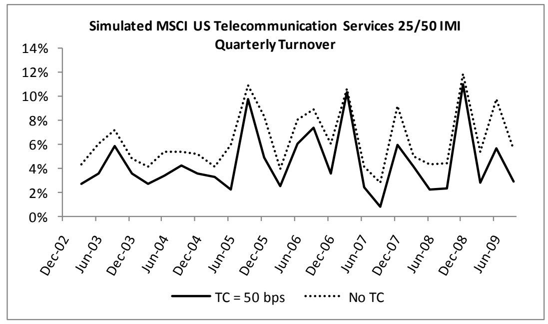


Exhibit 4: Performance Summary

MSCI US Telecommunication Services 25/50 IMI			
	Parent	TC = 50bps	No TC
Return	2.41%	5.00%	4.80%
Risk	23.96%	23.92%	24.05%
Active Risk		5.89%	6.17%
Turnover		17.75%	25.36%

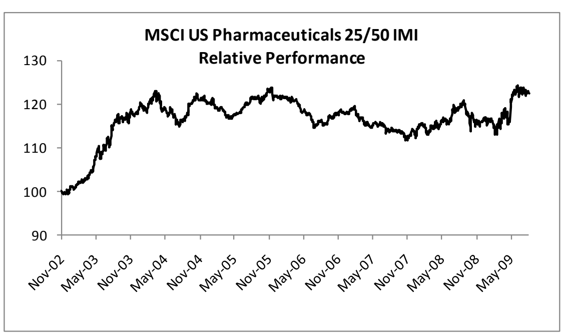
Annualized data based on simulations from Nov 2002 - Aug 2009

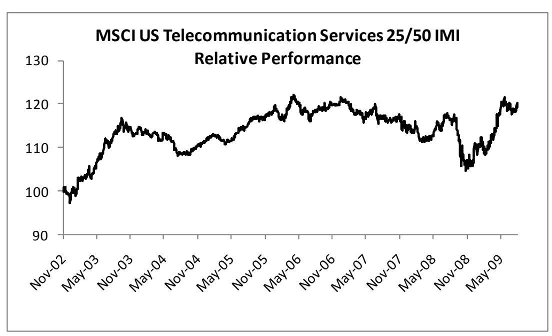
MSCI US Pharmaceuticals 25/50 IMI			
	Parent	TC = 50 bps	No TC
Return	-0.21%	2.71%	2.50%
Risk	18.45%	18.32%	18.44%
Active Risk		4.79%	4.87%
Turnover		13.96%	20.19%

Annualized data based on simulations from Nov 2002 - Aug 2009

From the relative performance of the simulated MSCI 25/50 Indices, as seen in Exhibit 5, the MSCI 25/50 Indices underweight the large caps on average and outperform in periods of small-cap outperformance, as seen during early 2003 and early 2009. Conversely, the simulated MSCI US Telecommunication Services 25/50 IMI underperforms in Q4 2008, which witnessed a flight to quality and large-cap outperformance.

Exhibit 5: Relative Performance of simulated MSCI 25/50 Indices





3. MSCI US 25/50 Investable Market Sector Indices

Finally, we examine the characteristics of the MSCI US 25/50 Investable Market Sector Indices. As seen in Exhibit 6, sectors such as Energy, Telecommunication Services, Information Technology, and Consumer Staples are non-compliant with the 25/50 constraints as of November 2009, with Telecommunication Services and Energy being the most concentrated sectors.

Exhibit 6: Characteristics of Simulated MSCI US 25/50 Investable Market Sector Indices

Sector	Number of Issuers	Number of Issuers > 22.5%	Sum of Weights of Issuers > 22.5%	Number of Issuers > 4.5%	Sum of Weights of Issuers > 4.5%
Financials	486	0		4	27.8%
Information Technology	416	0		7	48.5%
Consumer Discretionary	373	0		1	5.8%
Industrials	371	0		2	17.6%
Healthcare	308	0		4	33.9%
Energy	161	1	26.4%	5	53.9%
Materials	123	0		6	40.8%
Consumer Staples	115	0		5	51.5%
Utilities	89	0		5	27%
Telecommunications	39	2	73.4%	3	78.3%

Based on analysis from November 2009

Exhibit 7 depicts the historical risk/return characteristics for the MSCI US Investable Market Sector Indices and their corresponding MSCI US 25/50 Indices. Sectors such as Materials, Consumer Discretionary, Healthcare, Financials, and Utilities are compliant with the 25/50 constraints throughout the analysis period. Sectors such as Telecommunication Services, Energy, and Consumer Staples are non-compliant. Finally, it is noteworthy that the simulated MSCI US Telecommunication Services 25/50 IMI has the highest turnover across all ten sectors, given its concentrated portfolio, as seen in exhibit 6.

Exhibit 7: Risk / Return and Turnover of Simulated MSCI US 25/50 Investable Market Sector Indices

	US IMI			US IMI 25/50			
	Return	Risk	Average One-way Turnover	Return	Risk	Tracking Error	Average One-way Turnover
Energy	13.8%	30.9%	2.7%	15.9%	31.9%	2.4%	6.6%
Materials	7.9%	28.0%	2.9%	7.9%	28.0%	0.1%	2.9%
Industrials	4.4%	23.3%	2.7%	4.7%	23.4%	0.3%	4.1%
Consumer Discretionary	2.0%	24.2%	4.5%	2.0%	24.2%	0.1%	4.5%
Consumer Staples	6.2%	14.9%	5.3%	6.9%	15.0%	1.1%	8.3%
Health Care	3.6%	17.5%	2.6%	3.6%	17.5%	0.0%	2.6%
Financials	-1.7%	35.8%	2.8%	-1.7%	35.8%	0.0%	2.8%
Information Technology	4.4%	24.7%	4.4%	4.5%	24.8%	0.2%	4.6%
Telecommunications	2.4%	24.0%	2.7%	5.0%	23.9%	5.9%	17.8%
Utilities	10.1%	19.9%	2.1%	10.1%	19.9%	0.0%	2.1%

Annualized statistics based on simulated history from November 2002-August 2009

4. Conclusion

We presented the key aspects of the MSCI 25/50 Index Methodology and illustrated the characteristics of the MSCI US 25/50 Investable Market Sector Indices. The constrained optimization approach of the methodology strikes a good balance by ensuring a timely and ongoing reflection of the 25/50 constraints while minimizing tracking error and turnover. Thus, these indices could serve as pertinent benchmarks either for passive replication or for active managers who need to comply with the 25/50 constraints.

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The company’s flagship products are the MSCI International Equity Indices, which include over 120,000 indices calculated daily across more than 70 countries, and the Barra risk models and portfolio analytics, which cover 59 equity and 48 fixed income markets. MSCI Barra is headquartered in New York, with research and commercial offices around the world.