

Reviewing the 2020 Market Classification Review

Featuring: **Sebastien Lieblich**, Managing Director, MSCI Research

Adam Bass:

This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass and today is June 25th, 2020. This week index provider's classification of a country's equity markets can have a major impact, not only for that country, but for investors around the world. MSCI released the results of its annual review earlier this week.

Adam Bass:

Today, we'll hear the reasons behind the results. For those, we turn to Sebastian Lieblich, Global Head of Index Solutions and Chairman of the MSCI Equity Index Committee. Thanks for joining us, Sebastian.

Sebastien Lieblich:

Thank you for having me.

Adam Bass:

Today we're speaking to you from your home in Paris, but before the pandemic, you spent a lot of your time traveling. How's the adjustment been?

Sebastien Lieblich:

It's true that over, let's say the past five years, I got familiar with not being very long in the same spot as you mentioned, traveling quite extensively, which basically has killed my familiarity with routine. But with the COVID impact and being grounded at home, I had to familiarize myself again with just having a routine day, getting up at the same time, doing the same things at the same time, sitting at my desk and basically not being in between two planes. Yeah, well it was quite the changer for me.

Adam Bass:

For those who may not be familiar, can you quickly describe what the Annual Market Classification Review is? How does it work? What exactly are you evaluating?

Sebastien Lieblich:

Sure. So what we are evaluating is whether a country index is classified in its correct investment universe. Investment universe, being defined as developed, emerging or frontier market. Every year, we assess all the country indexes that we have, the economic development of the equity of the country of the equity market, the breadth and the depth of the equity market in terms of investible securities and the market accessibility. We assess that and every year we make proposals for potential reclassification. Then once we communicate this proposal in June of every year, we embark on a year long consultation process and we announce the decision related to this consultation June of the following year. Now basically what we've announced on June 23rd was the result of this year cycle, which started in June of 2019.

Adam Bass:

For this year, one big area of focus was Argentina, which remains in the Emerging Market Index. What was behind that?

Sebastien Lieblich:

Indeed, so we've taken the decision to keep Argentina in our Emerging Market Index, even though the Argentinian authorities have imposed over the course of 2019 a number of market accessibility constraints in the form of capital and effects controls that basically rendered the access to the domestic equity market for international investors quasi impossible. But, the reason why we kept the Argentina Index within our Emerging Market Index is simply due to the fact that the constituents of the index are actually all foreign listed and specifically listed in the US. These impediment to invest locally don't impact the replicability of the index. However, we extended the consultation period, and we are closely monitoring what's happening with respect to the current capital controls or accessibility constraints and whether further constraints might be implemented. If that were the case, we might act relatively swiftly and actually remove the MSCI Argentina Index from our EM Index.

Adam Bass:

When you say act swiftly, does that mean before next year's review?

Sebastien Lieblich:

Absolutely. I mean, before next year's review and as we've stated in, in the press release, we will do that as soon as practicable after the announcement of our decision,

Adam Bass:

These types of unknowns, this situation, it's not a new one for Argentina, right?

Sebastien Lieblich:

No, that's, that's absolutely right. As a reminder, back in 2009, we already had the Argentina Index in the Emerging Market Index. At that point in time, it got already reclassified from emerging market into frontier market because they had imposed capital controls. We kept it in frontier markets for about 10 years. Then last year, after a series of very significant improvement in terms of accessibility, and again, a year long consultation, we implemented an upgrade of the Argentina Index to the Emerging Market Index, but only few months after the upgrade, the Argentinian authorities yet again, introduced capital controls, which spurred this consultation.

Adam Bass:

This year's review also aimed a spotlight on Turkey. What's the issue there? Is there a reclassification proposal?

Sebastien Lieblich:

There is no reclassification proposal on the MSCI Turkey Index. However, we've seen over the past month and almost to some extent over the past year, we have seen increased deterioration in the accessibility to the Turkish equity market. There have been some issues around foreign exchange and more recently they banned short selling and stock lending, which basically makes the access to them for emerging market investors to the equity market, more difficult.

Sebastien Lieblich:

We're not yet at the stage where we feel that a proposal is required, but we will be tightly monitoring the developments over the coming months and potentially years, and make sure that if any further accessibility constraints are introduced by the Turkish authorities, we would reflect that and potentially start a consultation on a potential reclassification of the MSCI Turkey Index, either to frontier market or to standalone.

Adam Bass:

Iceland, on the other hand, got a bump up from standalone to frontier market. What drove that decision?

Sebastien Lieblich:

That's correct. Iceland had, I'd say a setback in terms of its evolution in its equity market, which dates back to the great financial crisis back in 2008, where a lot of measures were put in place by the authorities in Iceland to preserve the economy, preserve the market, which basically put the equity market on the sideline. They managed to turn it around and slightly more than let's say, 10 years, they removed all the constraints. They developed again their market. Companies have started to grow again in size and liquidity to a point where investors have actually highlighted to us that Iceland becomes a interesting investment avenue for frontier market investors. We should consider potentially including them in the Frontier Market Index, which in addition to our own analysis for the year ago, the opening of a consultation for formerly adding the MSCI Iceland Index to our Frontier Market Index.

Adam Bass:

Iceland's equity market is pretty small. Were you surprised by the high level of interest from investors?

Sebastien Lieblich:

Yeah. Yeah. No, absolutely it is. It is quite surprising, but I think that as small as a country might seem to be for frontier market investors, nevertheless, it adds diversity to the index and they're happy with that. Being able to add a different type of stocks in terms of geographical diversification has been seen as a very big positive, and for frontier market investors, this equity market was already, I mean to a very large extent accessible, and that's why they requested it.

Adam Bass:

When we were talking Turkey and Argentina, for that matter, the big issue seemed to be accessibility, clearly a major factor at play. It also seemed to be what drove the annual reviews comments about countries like Lebanon, Bangladesh, and Nigeria. These markets have recently shown a lack of accessibility for investors. Was that a concern?

Sebastien Lieblich:

What we've seen in these three markets that you mentioned Lebanon, Bangladesh and Nigeria, is that we see some deterioration, which is quite significant in the accessibility. These accessibility constraints are okay in a frontier market context, as long as they remain temporary. For time being, these constraints are perceived as temporary so we monitor that. But if they were to be prolonged in time, then we might, or we're not excluding the possibility of opening up again a consultation asking frontier market investors, "Are these markets still fit for purpose to be included in a composite index, such as the frontier market index?"

Adam Bass:

Consultations are a global process and COVID-19 has been affecting at least some parts of the world for the last six months, about half of that process. How did that change the way you conducted consultations?

Sebastien Lieblich:

There are two dimensions to it. One is the logistics, right? Usually the way we conduct these kinds of consultations is that my team and myself, we're traveling, we're visiting clients face-to-face to have these discussions. Obviously being grounded and our clients being grounded, we had to conduct the consultation meetings over at best video calls, but more often phone calls. We needed to adapt to this because you cannot read the body language. You don't have this personal contact. It was logistically speaking, slightly different. Then also now from an organizational point of view, it was also more difficult specifically over the months off March, April and May to actually get in touch with the clients because they had other problems to deal with.

Adam Bass:

All that is completely understandable. But what about the outcomes? Did COVID have any effect there?

Sebastien Lieblich:

The answer is clearly no. Overall, COVID did not have any impact on our assessment of accessibility and classification of market as part of this year's review.

Adam Bass:

That's all for this week. Thanks to Sebastian and to all of you for joining us. If you have a moment, we hope you'll subscribe to the podcast so you can stay up to date on our latest episodes and insights.

Adam Bass:

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