STOXX

FALL 2012

PULSE



THE POWER OF
MINIMUM VARIANCE

DEMAND FOR STRATEGY
INDICES SEEN
RISING IN CHINA

VIEWS ON ESG
INVESTING

EUROPE EQUITIES
VALUATIONS ATTRACTIVE

WELCOME
TO THE FIRST EDITION OF STOXX PULSE

MEET STOXX AT A CONFERENCE

» Oct 24–25, 2012
ETF & INDEXI NG EUROPE INVESTMENTS IN LONDON
Konrad Sippel, Head of Product Development at STOXX, speaks on "Optimising ETF investments by using innovative index underlyings" on Oct. 24.

» Nov 15, 2012
ENHANCED INVESTMENT ANALYSIS CONFERENCE IN LONDON
Konrad Sippel, Head of Product Development at STOXX, moderates a panel on "Investor expectations on Sustainability: What do investors look for? How to make your ESG performance transparent. The value of transparent Sustainability Indices."

» Dec 2–5, 2012
SUPER BOWL OF INDEXING IN PHOENIX, USA
Rod Jones, Head of Sales North America at STOXX, participates in a panel discussion on "Restoring Diversification with Managed Futures" on Dec 4.

» Dec 5–6, 2012
SOUTH-EAST ASIA INSTITUTIONAL INVESTMENT FORUM IN SINGAPORE
Meet STOXX at our booth at the event.



Hartmut Graf – CEO, STOXX Limited

DEAR READERS,

Welcome to the first edition of STOXX Pulse, a quarterly newsletter we have started to illuminate investment concepts and provide news and views to our clients. There is a very important part of passive investing, which we aim to highlight here: the underlying indices. We solely make indices which are objective and based on strict rules. But the ideas that give them birth and the impact they have on the investment community need a voice and a forum.

In this issue, we talk about minimum variance and its possible benefit of lower risk and higher reward. We present you views from academia to industry on ESG investing, and we interview one of the leading asset managers in China, a country where the indexing and ETF businesses are growing rapidly.

At STOXX Ltd., we have grown index-wise and people-wise in 2012. We launched the STOXX+ Minimum Variance index family and the EURO iSTOXX 50 Equal Risk Index. We expanded our ESG and Emerging Market index families.

To manage our growing product offerings, we hired Anthony Da Costa as chief operating officer and Mark Rodino as global head of sales this summer. Their more than 35 years of experience in the index and derivatives industries will be a great advantage for us.

I hope you enjoy this first edition. For comments and/or suggestions, please contact the editor Rajiv Sekhri at rajiv.sekhri@stoxx.com.

Regards,



Hartmut Graf
CEO, STOXX Limited

LOW RISK, HIGH REWARD ARE YOU KIDDING ME?

MINIMUM VARIANCE PORTFOLIOS TAKE CENTRE STAGE DURING TURBULENT ECONOMIC TIMES

Minimizing risk to maximize return is a strategy as old as humanity itself. But the mantra in the financial world has mostly been that the more risk one takes, the higher will be one's expected reward, or potential loss. So it might sound a tad counter-intuitive if someone were to tell you that risk and reward are not really trade-offs but two sides of the same coin. You can keep your risk low and your reward high through a minimum variance strategy whose primary goal is to keep volatility at a minimum in your portfolio.

Global equity markets have seemed like a minefield since 2007, with investors not knowing what might happen with the next step they take. The STOXX Global 150 has lost nearly 17 percent from August 2007 to August 2012, the STOXX BRIC 100 has eked out a gain of merely 2 percent, and the STOXX All Europe 100 has lost about 31 percent. These turbulent times – with investors still wanting to win but at the same time vigilantly trying to minimize risk – have rekindled interest in minimum variance, a strategy developed nearly 60 years ago by Harry Markowitz, whose Modern Portfolio Theory won him the Nobel Prize in 1990.

Minimum variance strategies have been around for about two decades but only in recent years – after the financial crisis struck – have investors paid attention to them.

"Numerous scientific studies have confirmed that minimum variance portfolios perform better," said Grigory Vilkov, assistant professor of finance at Frankfurt-based Goethe University's Faculty of Economics and Business Administration.

Vilkov, who researches minimum variance and other portfolio optimization methods as well as equity options, told STOXX Pulse in an interview: "Definitely investors are now more careful about potential risks than they were before 1987, than they were even 10 years ago. Minimum variance indices may be quite a helpful tool for such investors."



GRIGORY VILKOV
Goethe University, Faculty of Economics and Business Administration, Frankfurt

A minimum variance portfolio's basic premise is to improve the long-term, risk-return profile by optimizing the weights of its components with regard to overall risk. While mean-variance portfolios, the first byproduct of Markowitz's Modern Portfolio Theory, are built on mean and variance-covariance, minimum variance portfolios are calculated using a variance-covariance matrix only.

For example, the STOXX+ Minimum Variance index family is created by calculating the exposure of each constituent in a benchmark index to seven style factors, including value, growth, leverage, momentum, to create a variance-covariance matrix. So instead of creating a matrix that measures 600 stocks against 600, which creates a large number of variables, using a factor-model approach offers more robust data.

"There has been a good marketing move from index companies to provide risk-based indices in recent years," Vilkov said. "The technology used to create minimum variance indices and to implement required portfolio rebalancing has improved tremendously in the past five to 10 years."

Another feature of minimum variance indices is their natural tendency to favor defensive sectors, such as consumer goods and utilities and their built-in adeptness to recognize risk before it strikes. For example, the STOXX+ Minimum Variance indices recognized the increased risk in financials even before the crisis happened, reducing the exposure accordingly to the sector.

"The documented out-of-sample performance of minimum variance portfolios still has to be explained theoretically," Vilkov said, adding that while most financial theories are "strictly" theoretically supported, the fact that minimum variance is not does not take away from its robustness.

Until now, minimum variance has been applied mostly to shares. But Vilkov said he thinks the future will bring cross-asset minimum variance, extending to bonds and commodities. In addition, he sees the application of option-implied methods to minimum variance portfolios to get an element of the future and not just past prices into the equation.

"You can, for example, take the market perception of the 30-day future development of stock prices and insert some implied moments of return into your calculation," Vilkov said. "I am talking about using forward looking information which is implied in the current prices of options to improve your portfolio."

While it may seem that minimum variance has no disadvantages, Vilkov said that is not the case. While a variance-covariance matrix can be better estimated than mean returns, the matrix can contain estimation errors.

The "typically high turnover due to rebalancing" is another disadvantage, Vilkov said, adding that a mean-variance portfolio may still not be easy for an individual investor to trade, especially if a broad investment universe is considered. «

	STOXX Global 1800	STOXX+ Min. Var.	STOXX+ Min. Var. Unc.
Annualized returns	-1.03%	8.34%	8.67%
Volatility	17.84%	10.79%	8.68%
Sharpe ratio	-0.06	0.77	1.00
Maximum Drawdown	58.7%	42.3%	31.2%

Tabel data from from 31.12.1999 to 02.05.2012.



Graph data from Dec. 31, 1999 to Sept 14, 2012



DEMAND FOR STRATEGY INDICES, ETFs SEEN RISING IN CHINA

STOXX Ltd. interviewed Shang Zhimin, chief investment officer of Hua An Asset Management Co, one of the biggest asset managers in China. Founded in 1998, Hua An has more than 90 billion yuan ($14.2 billion) of assets under management. We asked him a few questions about China's growth and the future of the asset management industry in the country.

STOXX公司近期采访了华安基金首席投资官尚志民先生。成立于1998年的华安基金是中国最大的基金管理公司之一，目前管理资产超过了900亿人民币（约142亿美元）。我们的提问包括了中国经济增长前景以及中国资产管理行业未来的发展等方面。



THE IMF RECENTLY LOWERED ITS 2012 GROWTH FORECAST FOR CHINA TO 8 PERCENT FROM 8.2 PERCENT. WHERE DO YOU SEE THE CHINESE ECONOMY HEADED DURING THE NEXT FEW YEARS?

For 2012, we expect China's GDP to grow 7.8%, lower than the IMF's forecast. But growth is expected to increase slightly in coming years. We think China has performed well in the aftermath of the global downturn. China has adopted reasonable macroeconomic policies while absorbing external shocks and dealing with adjustment for growth cycles. At the same time, the government has paid more attention to efforts on reform and growth. We do think the euro zone will slip into recession, and U.S. growth will remain sluggish, but we are relatively optimistic about the longer-term outlook for China.

国际货币基金组织将中国2012年的经济增长率预期从8.2%下调至8%。你认为未来几年中国经济将朝哪个方向发展？你是否认为中国在应对全球经济进一步恶化问题上占据了更有利的地位？

我们预期今年中国GDP增长为7.8%，低于IMF的预期。未来几年增速会逐渐小步提高。

我们认为中国面对全球经济下滑的表现良好，在吸收外部冲击、应对国内周期调整的同时，宏观政策基本合理，且政府突出了对改革和增长方式转变方面的努力。虽然我们认为欧元区会陷入衰退、美国经济增速会在很低的水平，但中国经济中长期前景仍然相对乐观。

WHAT IMPACT HAS THE GLOBAL ECONOMIC CRISIS HAD ON THE CHINESE ECONOMY? GOING FORWARD, DO YOU THINK INVESTORS, WHO ARE WORRIED ABOUT PROSPECTS IN EUROPE AND NORTH AMERICA, WILL LOOK AT CHINA AS A PLACE TO INVEST THEIR MONEY?

Global economic turmoil has hit China's economy in three areas: export slowdown, capital inflow decline and restrained confidence among entrepreneurs and consumers. Going forward, we still believe China will continue to attract more foreign investment due to its promising prospects and improving policy settings. Meanwhile, domestic investors will also invest more in overseas industry and financial markets to increase the competitiveness of their technologies and products and to diversity their financial portfolios.

你认为全球经济危机已经给中国经济带来了什么样的影响？展望未来，你认为那些对欧洲和北美前景比较担心的投资者是否会考虑将中国作为投资目的地？

全球经济的动荡主要通过三个渠道影响中国经济。其一是出口的下降，其二是资本流入下降，其三是抑制了中国企业和居民的信心。未来我们相信中国仍然会作为具有良好增长前景、制度环境不断优化的经济体，而吸引国际投资者来华投资。同时，中国的投资者也会加大对外实业和金融投资力度，以提升自己的技术和产品实力，并实现金融资产组合的多样化.



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IN THE LAST TWO YEARS, FIXED-INCOME PRODUCTS AND RELATED FUNDS HAVE GROWN FAST; SO HAVE EQUITY INDEX FUNDS. HOWEVER, THE DEVELOPMENT OF ACTIVE EQUITY FUNDS HAS BEEN RELATIVELY SLOW. WE SEE A HUGE POTENTIAL FOR ALL THESE INVESTMENT PRODUCTS.

SHANG ZHIMIN
Chief Investment Officer,
Hua An Management Co

WHAT KIND OF INVESTMENT PRODUCTS (ETFs, SHARES, BONDS, ETC.) ARE GAINING GROUND IN CHINA AND WHERE DO YOU SEE THIS TREND HEADING? DO YOU THINK CHINESE ASSET MANAGERS ARE EXPANDING INTO THE INDEX INVESTING SPACE?

In the last two years, fixed-income products and related funds have grown fast; so have equity index funds. However, the development of active equity funds has been relatively slow. We see a huge potential for all these investment products. Fixed-income products benefit from interest-rate liberalization, the corporate bond markets expanding and the introduction of new financial instruments, such as Treasury bond futures. Equity index funds benefit from their high liquidity, low fee and the fact that the structure of the product is distinct. Hence they are popular with institutional investors. As to active equity funds, we believe they will attract more institutional and individual investors as long as the domestic equity market system reform takes place step by step and the macroeconomy bottoms out.



As one of the fastest growing financial instruments in recent years, ETFs have been a mainstream product of passive index instruments. Domestic asset managers have noticed that ETFs have huge advantages on asset allocation, trend-following trade and arbitrage trade, and they could implement many trade strategies when combing ETFs with index futures or other derivatives.

你认为哪些投资产品（比如ETF、股票、债券等）正在中国日益普及，同时这一趋势未来将朝哪个方向发展？你是否认为中国的资产管理公司正在扩大其在指数投资方面的业务？

最近两年，中国的固定收益类产品和基金得到了较大的发展，股票指数基金也发展较快，但主动性股票基金发展较慢。未来，我们认为三者都有较大的发展潜力。固定收益类产品受益于中国利率市场化、公司债发行不断扩大、国债期货等新金融工具的引入；股票指数型基金受益于其流动性、低费率，以及最终投资标的清晰的特点，会受到机构投资者的青睐，而主动型股票基金则将随着中国股市的制度调整逐渐到位、宏观经济增速的见底回升，而吸引机构和个人投资者。

ETF产品是近年发展最快的产品之一，已成为被动指数产品的主流品种。国内资产管理者已经意识到ETF产品在资产配置、趋势交易、套利交易中的巨大优势，并与股指期货等衍生品组合产生多种交易策略。

HAVE CHINESE INVESTORS TRADITIONALLY BOUGHT ETF PRODUCTS LINKED TO INDICES? IS THAT TREND CHANGING?

Domestic investors tend to use ETFs to track the performance of indices, especially CSI 300, SSE 180, SZSE 100 or other key indices because of the size and liquidity advantage of ETFs.

This trend is expected to continue for a long time. As it grows, domestic investors will require higher trading volumes in the ETF sector, lower tracking error and better ways to select ETFs. They will also demand more sector diversity and industry representation in the ETF sector.

中国投资者是否有购买与指数相关ETF产品的习惯？这种趋势是否正在发生变化？如果有变化，变化的原因是什么，正在朝哪个方向发展？

目前由于ETF产品的规模、流动性优势，国内投资者倾向于利用ETF跟踪指数，尤其是国内的主流指数如沪深300、上证180、深100指数

这一趋势预计将维持较长时间，并伴随着国内投资者对ETF的流动性、跟踪误差等要求在提高，国内ETF产品的发展除了以上两点外，在板块的差异性、代表性上将提出新的要求，如未来行业ETF将有显著的需求。

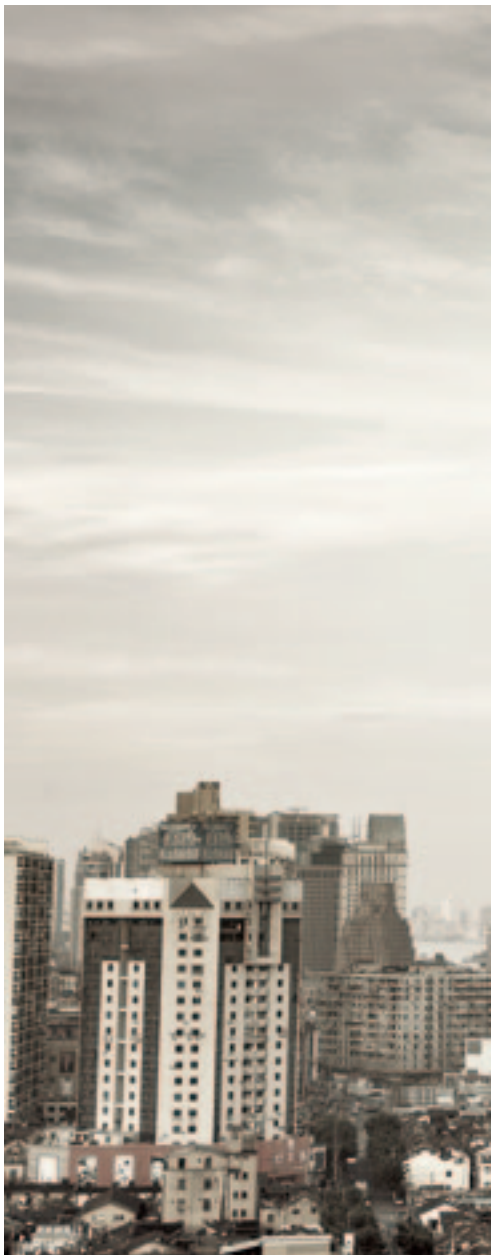
DO YOU THINK THE INDICES THAT COVER ASIA, PARTICULARLY CHINA, REFLECT THE ECONOMIC AND FINANCIAL REALITY OF THE REGION? DO YOU THINK INDEX PROVIDERS NEED TO PROVIDE OTHER TYPES OF INDICES TO ALLOW INVESTORS TO TAKE ADVANTAGE OF GROWTH OPPORTUNITIES IN THE REGION?

CSI 300 is the one index that best represents China's equity market as a whole. It covers 70% of China's market capital-

ization and includes almost all the industries in China. There have been many sub-indices reflecting different sectors and styles that are based on the CSI 300. Furthermore, there are many other indices that reflect different geographic markets, e.g. SZSE 300, SSE 180, and the SME Board Index. We think these indices can meet the demand of varied investors for different market structures and styles. Of course, there are many opportunities for strategy indices.

你认为这些追踪了亚洲市场，尤其是中国的指数，能否反映出该地区经济和金融的真实情况？你认为指数提供商是否有必要提供其他类型的指数，从而让投资者能够从该地区的发展机遇的获利？你认为哪些投资产品（比如ETF、股票、债券等）正在中国日益普及，同时这一趋势未来将朝哪个方向发展？你是否认为中国的资产管理公司正在扩大其在指数投资方面的业务？

目前最能代表中国市场的是沪深300指数，其市值占比约在70%左右，基本涵盖了所有的行业。在沪深300宽基指数的基础上，已经存在诸多反映不同行业和风格的子指数。此外，市场上也存在很多不同板块市场的代表指数，如深圳300指数，上海180指数，中小板指数等等。我们认为，这些指数已经能满足不同投资者对不同市场结构和风格的需求。当然在策略指数上，目前来看还有很多机会。



» GLOBAL ECONOMIC TURMOIL HAS HIT CHINA'S ECONOMY IN THREE AREAS: EXPORT SLOWDOWN, CAPITAL INFLOW DECLINE AND RESTRAINED CONFIDENCE AMONG ENTREPRENEURS AND CONSUMERS.

THE PERSONAL SAVINGS RATE IN CHINA IS AMONG THE HIGHEST IN THE WORLD. TRADITIONALLY, CHINESE INVESTORS HAVE BOUGHT INVESTMENTS AT THE BANK. HOW IS THAT CHANGING? DO RETAIL INVESTORS HAVE ENOUGH PRODUCTS IN WHICH THEY CAN INVEST? IS THERE A GAP THAT NEEDS TO BE FILLED?

At present, banks are center of the financial system in China as they have the natural advantage of reputation, channel and resource. Banks still play a leading role in selling funds and other investment products. And that will not change over a long period of time. For sure, ETF sales mainly depend on brokerage firms, and China is also gradually opening up the market for fund sales licenses, which are new trends. As for products, we think there are many products, but more innovative products need to be developed as they are well received by the market.

中国的居民储蓄率是全球最高的国家之一。中国投资者习惯于在银行购买投资产品。这一切是如何变化发生的？散户投资者是否有足够的产品可进行投资？在投资产品种类方面是否存在一些空白？

目前银行作为中国金融体系的核心，在声誉、渠道和资源上占据先天的优势，因此在基金和其他投资产品的销售上依然发挥着主导作用。这样的局面在相当长的时间内还会存在。当然，ETF的主要渠道在券商，而且基金销售的牌照也在放开，这些都是新的变化。至于产品，我们认为目前产品数量已经非常多，但创新产品还有待进一步开发。事实也证明，创新产品更容易受到市场的欢迎。

DO YOU THINK THERE ARE SUFFICIENT INDICES ABOUT CHINESE ASSETS IN THE MARKET? WHAT DO INDEX PROVIDERS NEED TO UNDERSTAND BETTER ABOUT THE CHINESE MARKET?

The capital market has a history of more than 20 years in



China, and it has been 10 years since index management was launched. The domestic index market has been built up on the work of China Securities Index Co. and several other companies. There are many types of indices, including marketcap weighted indices, sector indices, theme and style indices. Many index companies, SZSE Market Index, MSCIBarra China and S&P have launched some indices for China's market. In our opinion, besides existing broad-based indices, products based on investable strategy indices will be popular with institutional investors.

你是否认为市场上有足够多数量的关于中国资产的指数？你认为指数提供商必须要在那些方面对中国市场加深认识？

国内资本市场发展20多年来，指数管理业务开展10年来，国内由中证指数公司等多家公司共同构建了国内指数提些，包括规模指数、行业指数、主题指数、风格指数等，除了中证指数公司之外，深证市场指数、MSCIBarra中国指数、标普指数等多家指数公司也开发了一些针对中国市场的指数。我们认为，国内未来除了现有的宽基之外，基于可投资策略指数的开发将是机构投资者等逐渐应用。

CAPITALISM WITH A CONSCIENCE VIEWS ON ESG INVESTING

Of the $65 trillion of long-term saving assets globally, about $32 trillion is invested according to the United Nations-backed Principles for Responsible Investment initiative (PRI). This proposal, devised by the investment community and launched in 2006, reflects the view that environmental, social and corporate governance issues can affect the financial performance of portfolios and should be incorporated into investment decisions so that investors can better align their objectives with those of society at large

STOXX Ltd. launched its STOXX Global ESG Leaders indices in 2011, extending the offering this year. We talked to two money managers, a researcher who provides sustainability data to investors and an academic to get their view on ESG investing.

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THE TRANSFORMATION FROM A SOCIETY WHERE MOST PRODUCTION IS LOCAL TO A GLOBAL SERVICE AND INFORMATION SOCIETY HAS LED TO THE SITUATION WHERE "NON-FINANCIAL" CAPITAL – FOR EXAMPLE HUMAN SOCIAL OR CULTURAL – PLAYS AN EVER MORE CENTRAL AND KEY ROLE IN THE SUCCESS OF A COMPANY.

MARCUS PRATSCH

WHEN YOU HEAR THE TERM ESG INVESTING, WHAT DOES IT MEAN TO YOU?

A. BASSEN: The term ESG captures extra financial factors of a company that are important to understand the business model and that have at least a long-term correlation with financial performance

M. JANTZI: ESG to me is the integration of environmental, social and governance factors into the investment decision making process. When someone says to me I do ESG investing, what it means is that they are performing that extra layer of due diligence when making that investment. They are looking beyond just financial information. If you think of a company as an iceberg, traditional financial analysis only looks above the surface. ESG is like a better-equipped sonar that gives you a total picture of the company – above and below sea level.

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ESG IS LIKE A BETTER-EQUIPPED SONAR THAT GIVES YOU A TOTAL PICTURE OF THE COMPANY – ABOVE AND BELOW SEA LEVEL

MICHAEL JANTZI

F. KLEIN: ESG is not just a term but it is a process that has a structure and a methodology. If you just take it literally, sustainability can mean more or less anything and it can have nothing to do with responsible investing. For us, ESG is a way of being responsible from an investors' point of view.

M. PRATSCH: Integrating non-financial indicators – ecological, social and governance aspects – into investment decisions. The inclusion of ESG criteria in the evaluation of a company has developed against the background, above all, that sustainability is becoming ever more a strategic competitive factor for a corporation operating on a global scale. The transformation from a society where most production is local to a global service and information society has led to the situation where "non-financial" capital – for example human social or cultural – plays an ever more central and key role in the success of a company. "Non-financial" values have these days come to account for a substantial part of company value, particularly when viewed from a long-term perspective.

WHAT ARE THE MOST IMPORTANT FACTORS THAT AN ESG PORTFOLIO NEEDS TO CONSIDER?

A. BASSEN: The factors and their weighting generally depend on the industry. But there are some factors like engagement, a company's intellectual capital and other intangible assets, its strategies to cope with environmental or climate risks, or its compliance with laws that are relevant for all industries.

M. JANTZI: Sustainalytics does not manage money, but we help institutional investors who manage money. The answer to your question is, "it depends" as ESG is not a one-size-fits-all solution. From a sustainability perspective, we take both a thematic and sectoral approach. If you look at ESG KPIs they differ depending on the sector; thus key indicators in banking are not the same as those in oil and gas. In a thematic sense, water and human capital risks in supply chains are critical themes across a variety of sectors. For example, water is an important theme when considering beverage, fabricating or oil and gas companies.

F. KLEIN: There are different ways an ESG portfolio can be constructed and we do not consider one way as the right way but rather the philosophy that many roads can lead to an ESG portfolio.



DR. ALEXANDER BASSEN

is professor of capital markets and management at the University of Hamburg's Faculty of Business, Economics and Social Science. He holds doctoral degrees from the European Business School (Oestrich-Winkel) and the Technical University of Munich. He is head of the corporate governance commission and the investor relations commission of the Society of Investment Professionals Germany (DVFA), member of the advisory board of the German Shareholder Association (DSW) and member of the advisory panel for sustainability of DB Advisors/DWS. He has published eight books and more than 120 articles focused on ESG performance and investor relations.



MICHAEL JANTZI

is CEO of Sustainalytics, a global research firm which helps investors develop and implement responsible investment strategies. Jantzi has been involved in ESG research and analysis for more than two decades. The Jantzi Social Index (JSI), which he created in 2000 for Canadian companies, has slightly outperformed the S&P/TSX Composite and the S&P/TSX 60 in the past ten years.



FRANK KLEIN

is managing director at Investment Solutions Europe at DB Advisors (DBA). DBA has about a billion euros invested in ESG investments. That's about 1 percent of the approximately 90 billion euros invested in institutional investments in Frankfurt for the bank, Klein said. The global ESG portfolio contains about 150 stocks from around the world.



MARCUS PRATSCH

is head of Sustainable Investment Research at DZ Bank, an initiative that was started by the bank in 2009. Customers include institutional investors, churches, foundations and private investors from Germany, Switzerland, France, UK, Benelux, Scandinavia, Austria and the USA. In 2011 DZ Bank's Sustainable Investment Research launched its own sustainability rating concept which integrates an economic sustainability dimension into the ESG equation.

We combine selective exclusion criteria (for example, cluster bombs) and a best-in-class approach. After we reduce the possible investment universe by using selective exclusion criteria, we take our ESG rating, provided by an independent external ESG rating agency, into account.

With this ESG universe, we start to construct a portfolio based on a best in class approach. After we have identified the most attractive companies from an ESG point of view, we add our bottom-up research expertise from all internal analysts and portfolio managers to increase performance opportunities in the ESG portfolio.

Finally, we compare the overall ESG rating of the constructed portfolio with an ESG rating of a common benchmark (such as MSCI Europe or STOXX Europe) and do the same with the carbon footprint of the portfolio and the respective benchmark.

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M. PRATSCH: As there is no standardization yet, this question is tough to answer. The sustainability rating of DZ Bank Sustainable Investment Research is the result of a multi-stage, integrated analysis process taking around 180 sustainability factors (traditional ESG + economic sustainability) into consideration.

HOW DO YOU USE ESG PRINCIPLES AS PART OF YOUR INVESTMENT DECISIONS?

M. JANTZI: As I said, Sustainalytics does not make investment decisions, but we work with clients to help them integrate ESG into their investment decision-making processes. ESG principles are integrated in a myriad of different ways. Some of our clients use ESG information to identify broad trends in the economy, or to identify which industries to allocate their assets. ESG analysis is also used to evaluate country risk, especially on the fixed-income side. Other clients are focused on ESG integration at the securities level, wanting to understand whether or not a company is managing its ESG risk and is positioned to capture ESG opportunities. Finally, it is also important to note that ESG is not just being used by practitioners to decide whether or not to buy

a security. ESG is becoming an increasingly important part of the ownership arsenal, with investment managers and companies engaging in dialogue on sustainability issues.

F. KLEIN: We are also a long-term signatory of the UNPRI. As far as the main portfolios are concerned, 99 percent of our money is invested in conventional portfolios. ESG is just a minor part still. But for our conventional portfolios, we do have a proprietary database that is used by our analysts, portfolio managers to help them choose attractive investments that are also socially responsible. Yes, this is not pure ESG investing for our conventional portfolios but this database allows them to pick socially responsible investments.

M. PRATSCH: DZ Bank has developed its own sustainability rating. The integrated sustainability concept of DZ Bank's Sustainable Investment Research goes beyond the pure ESG approach and its exclusive evaluation of environmental, social and governance factors. Sustainability is an investment issue. The focus of any company is commercial success. The aim of every investor is to achieve a return. This also applies to pure sustainability investors. Consequently, it is essential to include the economic perspective into a sustainability analysis. The result is a four-dimensional analysis model that takes into account the interests of all the stakeholders of a company.

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WE TELL CLIENTS THAT THEY DO NOT SACRIFICE PERFORMANCE BY COMMITTING TO ESG INVESTMENTS. ESG IS NOT BETTER BUT ALSO NOT WORSE THAN THE CONVENTIONAL MONEY WE MANAGE.

FRANK KLEIN

ESG FACTORS, WHEN INTEGRATED INTO INVESTMENT DECISIONS, MAY OFFER INVESTORS LONG-TERM PERFORMANCE ADVANTAGES, RESEARCH SHOWS. HOW HAVE YOUR ESG PORTFOLIOS PERFORMED OVER THE SHORT AND LONG TERM?

M. JANTZI: Much of the academic literature out there shows that if you integrate ESG into a portfolio in a comprehensive, systematic and intelligent way, performance will be better in the long term. You will sometimes see some short-term differences, but over the long run you will see very competitive performance.

F. KLEIN: Our clients don't want to sacrifice performance just because they have chosen ESG as the preferred investment method. They give us a clear structure of what they want. For example, some of our non-profit clients want to exclude pharmaceutical companies and utilities that generate revenue through nuclear power.

We measure our ESG investments against conventional benchmarks such as MSCI Europe or STOXX Europe and also against ESG indices like the STOXX Global Leaders ESG index.

On the equity side, there are good and bad years. In total, on the global side we have been below the MSCI world benchmark and on the European side we have been above the MSCI Europe and STOXX EUROPE benchmark. Beside the return aspect, volatility is an important measurement. Generally speaking, volatility on the ESG portfolios was and still is lower than in conventional portfolios.

We tell clients that they do not sacrifice performance by committing to ESG investments. ESG is not better but also not worse than the conventional money we manage. Mostly, ESG investments, from a risk-adjusted point of view, are favourable compared to conventional portfolios.

M. PRATSCH: Backtesting shows at least the same performance as traditional portfolios. In most cases sustainability portfolios have outperformed traditional portfolios when considering an investment horizon of a few years or longer.

DO YOU PERCEIVE ESG RISKS ARE GREATER IN EMERGING MARKETS THAN IN DEVELOPED MARKETS? AND HOW DO YOU THINK EMERGING MARKETS CAN BETTER INCORPORATE ESG PRINCIPLES INTO THEIR BUSINESS PRACTICES?

A. BASSEN: The implementation and transparency of ESG factors is lower in emerging markets as compared to developed markets. Therefore the announcement effect of positive and negative ESG events like e.g. oil spills, child labor might be higher.

In a further step of implementation, it is important to determine the effect of different ESG factors in the value chain. That enables companies to assess more precisely the potential risks and opportunities of ESG.

M. JANTZI: Not necessarily. That being said, we face a major challenge because of a lack of ESG disclosure in emerging markets broadly speaking, so in that sense not fully understanding how companies are dealing with ESG issues obviously presents risks to investors. It's not dissimilar to the disclosure challenges we face with respect to financial data in some emerging economies. The good news is that ESG disclosure is improving; a trend I expect to accelerate as emerging markets receive more attention and increased asset allocations from European and North American investors.

I would also say that while ESG risks might not necessarily be larger in emerging markets, they are unquestionably different in a lot of cases. Things we often take for granted in developed economies, like food safety or bribery/corruption, are sometimes more significant ESG risks in emerging markets.

Finally, we need to keep in mind that the term "emerging markets" is all encompassing and captures regions of the world with very different ESG profiles. We need to understand that ESG risks in China are not only different from those in western Europe, but also from issues in Brazil or eastern Europe. More importantly, let's be careful to not equate a lack of understanding of emerging markets with the belief that ESG risks are more prominent there. Sustainalytics' commitment is to provide our clients with leading-edge ESG analysis of global companies, which we can only do if we have analysts with local expertise. That's why we have a team located in Asia, in addition to several partnerships there, and someone in Latin America.

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F. KLEIN: I think another way of looking at this is that generally speaking emerging markets are just less transparent than developed markets as information is not disclosed to the same extent and that is the reason for more investment still going to developed markets rather than emerging markets on both the conventional and ESG side.

That said, I think corporates in emerging markets have to take ESG more seriously, especially focus a lot more on the environmental criteria and the social criteria.

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M. PRATSCH: Yes, due to lower transparency. Stakeholder-orientated communication needs to be improved.

A MAJOR CONCERN REGARDING SOCIALLY RESPONSIBLE INVESTMENTS IS THAT THERE IS NO STANDARDIZED METHODOLOGY THAT ALLOWS FOR AN ACCURATE COMPARISON BETWEEN COMPANIES. DO YOU THINK IMPROVEMENTS ARE NEEDED IN ESG DISCLOSURE BY COMPANIES AND CALCULATION TO STANDARDIZE THE PROCESS?

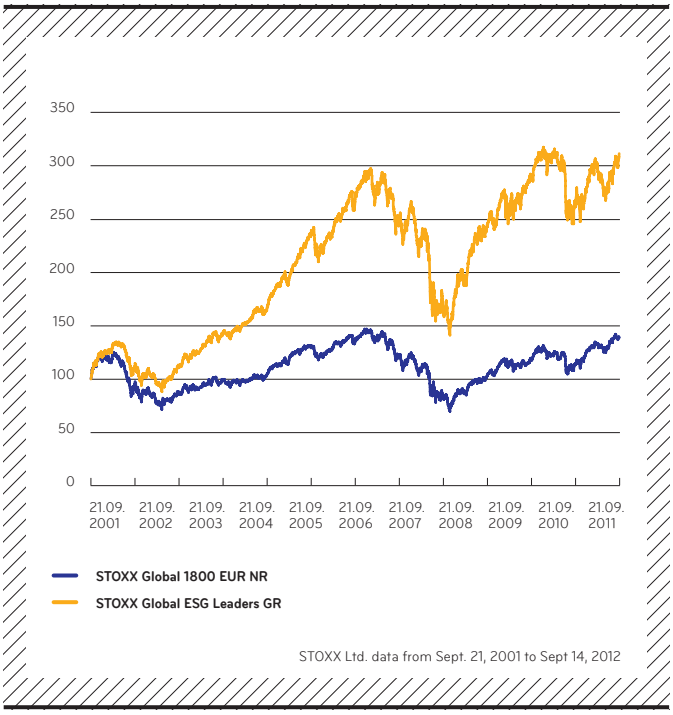
A. BASSEN: The level of disclosure has increased significantly over the last 10 years. However, there is still scope for improvement, especially for smaller companies. In particular, the level and share of quantitative measures as compared to descriptive information is not yet satisfactory. Unfortunately, existing reporting standards put more emphasis on narrative information. Good examples for quantitative information are the EFFAS KPIs or the German Sustainability Code.

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M. JANTZI: I'm in favor of improving ESG corporate disclosure, especially in emerging markets, but I can be quite cynical about standardization because it doesn't lead necessarily to better analytical outcomes. For example, we have global accounting standards, and they have not always been helpful in getting a true picture of what a company is doing. At the end of the day, international ESG standards are necessary, but not sufficient, to get a sense of a company's ESG performance.

Moreover, the suggestion that there is no standardized methodology in ESG assessment is not entirely accurate. Increasingly, there are standard ESG KPIs, spurred on by the excellent work of the Global Reporting Initiative, the DVFA (Society of Investment Professionals in Germany) and EFFAS (European Federation of Financial Analysts Societies), among others.

Does it mean that all companies like Sustainalytics that provide sustainability research are looking at the same thing? Absolutely not. ESG sell-side research firms compete in the market, in part, based on their ability to evaluate ESG performance better than their competitors. That creates a vibrant market and allows for a variety of views. Are we asking the "mainstream" sell-side to create a single, standardized methodology and standard?



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F. KLEIN: We have come a long way in the process. Yes if you compare ESG to something like IFRS or GAAP accounting, which are global standards, there is nothing like that in ESG yet. But in Europe, we have developed KPIs on the financial reporting side; EFFAS KPIs were established as a European standard two years ago. The EU last year announced an initiative to incorporate ESG into mainstream investing and to train investment professionals in ESG investing.

But yes, I think, we do need a global, united way of approaching and analyzing corporations and ESG KPIs as well as the global Integrated Reporting initiative are steps into the right direction.

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M. PRATSCH: Yes, based on a dialogue between the Global Reporting Initiative (GRI), The European Federation of Financial Analysts Societies (EFFAS) and SD-M Sustainable Development Management for example. The GRI Sustainability Reporting Guidelines, the KPIs for ESG 3.0 and the Sustainable Development Key Performance Indicators (SD-

KPIs) are all very good reporting frameworks from our point of view.

WHAT WOULD BE THE NEXT STEP/TREND/DEVELOPMENT IN THE ESG INVESTING SPACE?

A. BASSEN: The latest development has been the increasing differentiation of ESG factors for different asset classes. This reflects investors' need for asset diversification. Overall, as more and more financial institutions became signatories of the UNPRI, more investors will have to take ESG information into account in their investment decisions. However, as of today there is no generally established process for integrating ESG information into the investment process. Also the integration of ESG factors in the valuation model of analysts and investors is incomplete.

M. JANTZI: I see three. First, I think we are going to continue to see a mainstreaming of this space, with an increasing number of institutional investors, assets owners, Sovereign Wealth Funds and buy-side firms looking at these types of issues in a more comprehensive way. I think investors will do it because it will help them fulfill their fiduciary obligations and mandates by making more informed decisions.
Second, we're going to see ESG spread from developed markets, where it is better established, especially western Europe, the UK and Australia, and gain more traction in other parts of the world. We are going to see a lot more focus on ESG in Asia.

Third, we're also going to see the adoption of ESG factors across a broader range of asset classes. Until now, the two major asset classes incorporating ESG have been equity and fixed income, but I think you are going to see private equity, infrastructure and real estate increasingly adopt ESG principles as well.

F. KLEIN: From the product-suite point of view, it all started in the 1960s/1970s, with equities. Later bonds, small caps and indices were introduced to measure ESG. From an investment point of view, bonds, corporate bonds in particular, will be the name of the game going forward, meaning that ESG principles will be applied to corporate bonds. Even hedge funds will start incorporating ESG into their investment decisions, because hedge fund managers are used to pair-trades which can be derived from an ESG best-in-class approach.

In addition, as more and more indices get developed, and with increasing liquidity on the derivatives side, ESG overlay will be introduced to manage risks. Meaning that, derivatives, such as options or futures, will be bought over the index to mitigate the risk exposure of the underlying ESG investments.

M. PRATSCH: Movement from niche to mainstream, using ESG factors as a general risk component in mainstream investing.

WHAT DO YOU THINK IS STILL MISSING OR UNDERREPRESENTED IN ESG INVESTING?

A. BASSEN: The most challenging task will be the integration of ESG factors into the whole value chain of financial institutions as this will require a genuine change of mindset.

M. JANTZI: Compared to Europe and Australia, the adoption of ESG in North America has been slower. One reason for this is in Europe and Australia the regulatory framework is much more supportive of ESG investment and there is a more evolved understanding of fiduciary responsibility. So, while there are a number of pension funds in the United States and Canada that are sophisticated ESG investors, there is tremendous opportunity for growth.

» THE MOST CHALLENGING TASK WILL BE THE INTEGRATION OF ESG FACTORS INTO THE WHOLE VALUE CHAIN OF FINANCIAL INSTITUTIONS AS THIS WILL REQUIRE A GENUINE CHANGE OF MINDSET.

DR. ALEXANDER BASSEN

F. KLEIN: What is still missing is a corporate commitment investing in ESG on the asset management side. While all major corporations publishing CSR reports, sustainability studies etc., from a financial point of view, the majority of those companies are not yet investing their employee pensions into ESG investments to an adequate extend. They are committed to ESG on the operating side and that needs to be extended to the investment side.

M. PRATSCH: The integration of the economic perspective. Regardless of the perspective from which the issue of sustainability is viewed, the main concern of any company is always commercial success. Nearly all companies with sustainable commitments openly disclose on their websites that these social and environmental commitments are also carried out for the company's own strategic purposes.
The same is true on the investor side. Sustainable investors want to invest with a good conscience but in no way wish to forgo a return and want to increase their investment just like conventional investors. Consequently, the traditional investment targets of profitability, security and liquidity also apply for sustainable investors. «

WILL EUROPEAN EQUITIES RECOVER?
ATTRACTIVE VALUATIONS JUSTIFY BUYING EUROPEAN SHARES

European equities have provoked fear and trepidation for years. The financial crisis, the likelihood of Greece and others exiting the euro, the European Central Bank's mandate which does not allow it to finance debt held by member countries and the move toward fiscal austerity have decimated European stocks as investors have rushed to the exits.

The EURO STOXX 50, a blue-chip index of the 50 biggest companies from 12 eurozone countries, has lost more than 40 percent in the past five years. The STOXX Europe 600, which includes large, mid and small cap companies from 18 European countries, has fallen nearly 27 percent in the same time.

While many have fled European equities, others say the time is right to add European shares to investment portfolios as stocks in the region are at the cheapest levels they have been in a long, long time.

"I think many companies are oversold, so in those sectors where you see good valuations, right now is a good point to go in," Massimo "Max" Cassia, head of equity at Sella Gestioni SGR SpA in Milan, told STOXX Pulse in an interview. Cassia manages about 1.5 billion euros in equity.

"There are sectors and areas of interest in the medium term, but investors must diversify with selectivity," Cassia said, adding that the luxury, industrial and energy sectors are good areas to buy shares.

Reuters Datastream data from June showed that the EURO STOXX 50 index traded at 7.9 times 12-month forward earnings, well below a 10-year average of 11.4. The broader STOXX Europe 600 traded at 9.2 times expected earnings, well below a 10-year average of 12.5. That compared with P/E ratios of 11.8 for Wall Street's S&P 500 index and 9 for the MSCI Emerging index.

"From a long-term valuation perspective, a number of European markets look attractive, with for example P/E ratios or P/B ratios well-below their long-term averages," Julien Seetharamdoo, senior economist and investment strategist at HSBC Global Asset Management Ltd. in London, told STOXX Pulse.

"However, valuation tends to work as a long-term investment signal, so investors should be prepared for considerable volatility in the meantime," he added. "We think the eurozone crisis will require a multi-year workout similar to the Latin American debt crisis. It will ebb and flow, with



MASSIMO CASSIA
Sella Gestioni SGR SpA, Milan



JULIEN SEETHARAMDOO
HSBC Global Asset Management Ltd., London

times when the crisis looks very worrying and times when it looks as if progress is being made towards a solution, with the chance that this generates shorter-term rallies."

Another strategy to pick European stocks involves selecting European companies that do good business in emerging markets and North America. "Companies with more international exposure are to be looked at, especially those that do business in emerging markets," Cassia said. "Consumer goods is a good sector, but you have to look stock by stock."

For example, the DAXplus Export Strategy index, which includes the top 10 export companies on the DAX and MDAX, has returned nearly 32 percent in the past three years. The 10 companies in the index, including EADS, Siemens AG, Merck AG and Hochtief AG, benefit most from increasing demand in foreign countries.

"It is difficult to talk about safe investments in the European context, rather we focus on value and risk-reward, but our key recommendation would be to remain well-diversified, while favoring export sectors and countries with strong export companies, such as Germany, and therefore less exposed to domestic weakness in the eurozone," HSBC's Seetharamdoo said.

Cassia said it is hard to look at European equities on the basis of which country is safer than the others. Investors

EUROPEAN STOCKS TUMBLE DURING CRISIS

INDEX	CLOSE ON SEPT. 21, 2007	CLOSE ON SEPT. 20, 2012	DECLINE
EURO STOXX 50	4,370.35	2,541.83	-42%
STOXX EUROPE 600	376.74	274.27	-27%

(Data from STOXX Limited)

"should look more at valuations than safer countries," lest they miss out attractively valued stocks in Greece just because there are fears the country could exit the euro.

According to data from EPFR Global, stock funds in Europe attracted $233 million in inflows for the week ended August 22, after seeing outflows for seven weeks, a sign that European equities may have been oversold on concern about the region's debt crisis. But when and by how much will European shares rise is a question that remains unanswerable.

"I have no predictions," Cassia said. "But I don't believe that Europe will end. I don't know if this is the worst market performance ever in Europe, but it is the worst political crisis and the renewal of the European social model must start. But that will take a lot of time." «

EUREX ICAP SWAP SPREADS PROVIDE TRANSPARENT BENCHMARK TO TRADERS

Eurex ICAP Swap Spreads, a real-time benchmark for Euro yield spreads, is available from October to December via a free trial for Reuters and Bloomberg subscribers. The benchmark delivers key bond future and interest rate swap yield spreads for the European market.

The data includes mid-yields for German BUND, BOBL and SCHATZ futures traded on Eurex, swap rates for 3-month and 6-month Euribor interest rate swaps from ICAP, as well as the spreads between the future mid-yields and the swap rates. Updated every 250 milliseconds, the data is calculated by the market data division of Deutsche Boerse.

"Eurex ICAP Swap Spreads provides the only neutral benchmark information for real-time Euro yield spreads," said Georg Gross, head of Front Office Data & Analytics at Deutsche Boerse.

"Currently, buy- and sell-side traders use various methods to calculate prices themselves," he added. "Our benchmark significantly increases transparency and it gives market participants confidence that they are looking at objective data based on information from the most liquid European markets." «



GEORG GROSS

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