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In spite of their shortcomings and the development of alternative indices, cap-weighted and debt-weighted indices remain the reference for European institutional investors and asset managers

EDHEC-Risk Institute releases results of European survey on use of equity and bond indices by institutional investors

In a new survey which elicited responses from 104 European institutional investment professionals, EDHEC-Risk Institute analyses the current uses of and opinions on equity and fixed-income indices.

Among the most prominent results of the survey:

- Liquidity, objectivity and transparency are the most important quality criteria investors have for indices. However, respondents suggest that a buy-and-hold character is not a requirement for an index–only slightly more than 50% of respondents find it important or very important. This finding is interesting as the dominance of cap-weighted indices in various asset classes is often attributed to their buy-and-hold nature. This new attitude from investors opens the door to new approaches based on dynamic rebalancing rules, as long as these are transparent and systematic.
- Addressing confusion between indexing and "passive investing," 58% of respondents do not think that indices should only reflect passive strategies. Respondents do however indicate that indices should not be based on alpha (75.2%).
- Sub-segment indices are of relatively little importance to equity investors – where broad market indices dominate - but are of prime importance to bond index users. In the equity arena, the style or sector approaches are not close to competing with geographical approaches for European institutional investors.
- Equity investors are mainly concerned that standard cap-weighted indices overinvest in overpriced stocks and provide poor diversification within the constituent universe. In contrast, fixed-income index users pay more attention to reliable duration exposure and are concerned with liquidity issues.
- Adoption of alternative weighting schemes is higher (45.2%) among respondents for equity indices than in the bond index area (17.6% for government bond indices and 12.5% for corporate bond indices). However, these adoption rates are not consistent with the large majority of respondents who criticise traditional cap-weighted (68%) or debt-weighted (53%) indices. Moreover, the amounts invested in the alternative forms of indices remain relatively marginal in institutional investors' allocations. Ultimately, investors consider that cap-weighted indices remain the reference and even when they

adopt alternative forms of indices, they continue to compare the performance of the latter to that of the former.

Overall, the results show that European institutional investors are aware of a range of important issues with existing standard indices in the equity and fixed income arena. As long as indices remain transparent, objective and focused on beta management rather than alpha generation, respondents are open to exploring new ways of designing indices that match their investment objectives. This opening towards new forms of indices is occurring through relative risk and performance compared to cap-weighted indices, rather than the latter disappearing or being replaced.

Contact:

For further information, please contact **Séverine Anjubault**:

Tel.: **+33 (0)4 93 18 78 63** – E-mail: **severine.anjubault@edhec-risk.com**

About EDHEC-Risk Institute

EDHEC-Risk Institute is part of EDHEC Business School, one of Europe's leading business schools and a member of the select group of academic institutions worldwide to have earned the triple crown of international accreditations (AACSB, EQUIS, Association of MBAs). Established in 2001, EDHEC-Risk Institute has become the premier European centre for financial research and its applications to the industry. In partnership with large financial institutions, its team of 66 permanent professors, engineers and support staff implements six research programmes and fourteen research chairs and major strategic research projects focusing on asset allocation and risk management in the traditional and alternative investment universes. The results of the research programmes and chairs are disseminated through the three EDHEC-Risk Institute locations in London, Nice and Singapore.

EDHEC-Risk Institute validates the academic quality of its output through publications in leading scholarly journals, implements a multifaceted communications policy to inform investors and asset managers on state-of-the-art concepts and techniques, and forms business partnerships to launch innovative products. Its executive education arm helps professionals to upgrade their skills with advanced risk and investment management seminars and degree courses, including the EDHEC-Risk Institute PhD in Finance.

www.edhec-risk.com

EDHEC–Risk Institute
393 promenade des Anglais
BP 3116 - 06202 Nice Cedex 3
France

EDHEC Risk Institute—Europe
10 Fleet Place - Ludgate
London EC4M 7RB
United Kingdom

EDHEC Risk Institute—Asia
1 George Street
#07-02
Singapore 049145