

# The Russell 1000 Pure Domestic Exposure Index

## Targeted exposure to US economic growth

The economic outlook for the US is looking up. Since the Global Financial Crisis (GFC), the US economy has maintained steady, if not spectacular, growth with low inflation, low unemployment and low interest rates. The performance of foreign economies has been more mixed. As shown in Table 1, the most recent forecasts by the Organisation for Economic Cooperation and Development (OECD) suggest that the US economy will continue to outpace most of the developed world.

**Table 1. Real GDP forecasts**

	2017	2018
US	2.1%	2.4%
Eurozone	1.8%	1.8%
Japan	1.4%	1.0%
UK	1.6%	1.0%

Source: OECD as of June 30, 2017.

Furthermore, there are ongoing efforts in Washington to lower corporate tax rates, reduce regulatory hurdles and costs, and finance infrastructure investment — all with the potential of positively impacting bottom lines of US-focused companies.

As well, the Federal Reserve plans to steadily increase interest rates while other central banks do not have such plans for the near future. This will make US interest-bearing securities more attractive to foreign investors. All else equal, the inflow of foreign capital tends to strengthen the dollar against foreign currencies. So the appreciation of the dollar going forward is a distinct possibility. This could negatively impact the value of US company earnings from overseas that are brought back into the US.

Given all this, it is understandable that many market participants are looking for a targeted exposure to the US economy and the safety of the US dollar. One obvious option is a financial product that replicates a US-based index of public equities, such as the Russell 1000<sup>®</sup> Index. But a broad-based index such as that contains within it many multinational companies that, while domiciled in the US and priced in USD, have large portions of their business overseas. For these multinationals, a significant portion of their revenue is dependent on economic growth outside the US. Slower economic growth abroad may mean slower revenue growth for these firms. Also, the repatriated value of that foreign revenue will be reduced if the dollar appreciates.

The Russell 1000 Pure Domestic Exposure Index selects stocks within the Russell 1000 Index by the ratio of absolute domestic sales to total sales (domestic sales ratio) and then weights by their capitalization levels.<sup>1</sup> Table 2 shows a selection of well-known names that are included and a selection that is excluded. There are some interesting comparisons to note such as that Bank of America is included, while Citigroup is excluded, even though they seemingly are in the same business. Likewise, General Dynamics is included because a significant portion of its revenue is based on domestic defense contracts while Boeing is excluded because so much of Boeing's revenue depends on foreign sales. In general, the index is weighted toward Consumer Services, Utilities, Telecommunications and Financials ICB<sup>®</sup> Industries while being underweight to the Technology Industry, which tends to be dependent on foreign demand.

**Table 2. Selected stocks included and excluded in the Russell 1000 Pure Domestic Exposure Index**

Included Stocks		Excluded Stocks	
AT&T	Whole Foods	Goldman Sachs	Coca-Cola
Bank of America	Netflix	Citigroup	IBM
Union Pacific	Duke Energy	JP Morgan	Caterpillar
Wells Fargo	Sun Trust Banks	American Express	Blackrock
Time Warner Cable	Macy's	3M	Apple
Humana	MetLife	Boeing	Abbott Labs
Southwest Airlines	H&R Block	Hewlett-Packard	Pfizer
General Dynamics	PG&E	Exxon Mobil	Microsoft

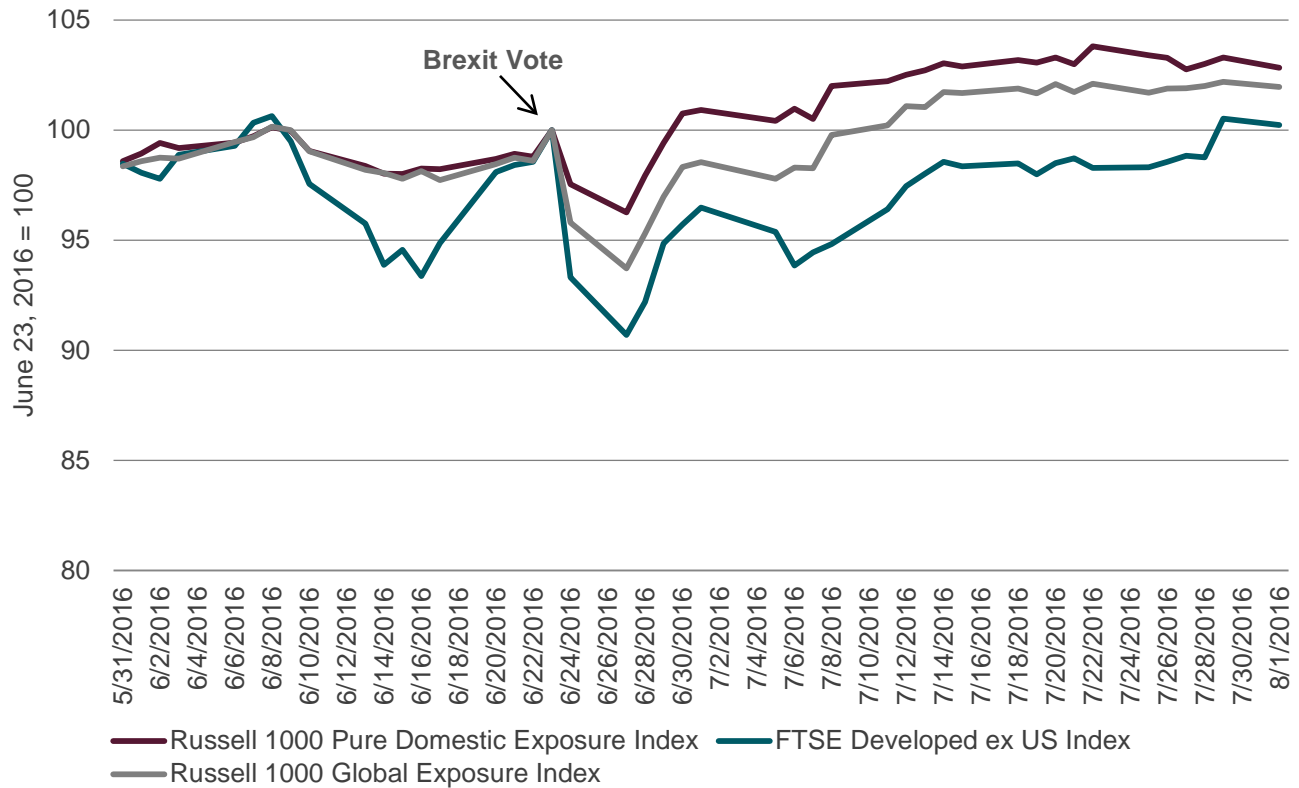
Source: FTSE Russell as of June 30, 2017.

## Pure Domestic provides insulation from unexpected foreign events and a strengthening dollar

By concentrating on stocks with mostly US sales revenue some of the unexpected events that have been impacting global markets can be at least partly dodged. A great example is the surprise vote to extract the UK from the EU (Brexit). As Chart 1 shows, non-US stocks (as represented by the FTSE Developed ex US Index) took a big hit in the days following the Brexit vote. The chart also shows the Russell 1000 Global Exposure Index, which includes US stocks that get a large portion of their sales revenue from abroad – it is the flip side of the Pure Domestic Exposure Index. The Russell 1000 Global Exposure Index outperformed the FTSE Developed ex US Index, but not the Russell 1000 Pure Domestic Index.

<sup>1</sup> In June 2017, the methodology of the Russell 1000 Pure Domestic Exposure Index changed. For details, please refer to <http://www.ftse.com/products/index-notices/home/getmethodology/?id=2193938>. The performance statistics of the new methodology is reflected in the data since June 2017, while the performance prior to June 2017 reflects the previous methodology.

**Chart 1. Comparative index return before, during, and after the Brexit vote May 31, 2016 – August 1, 2016**

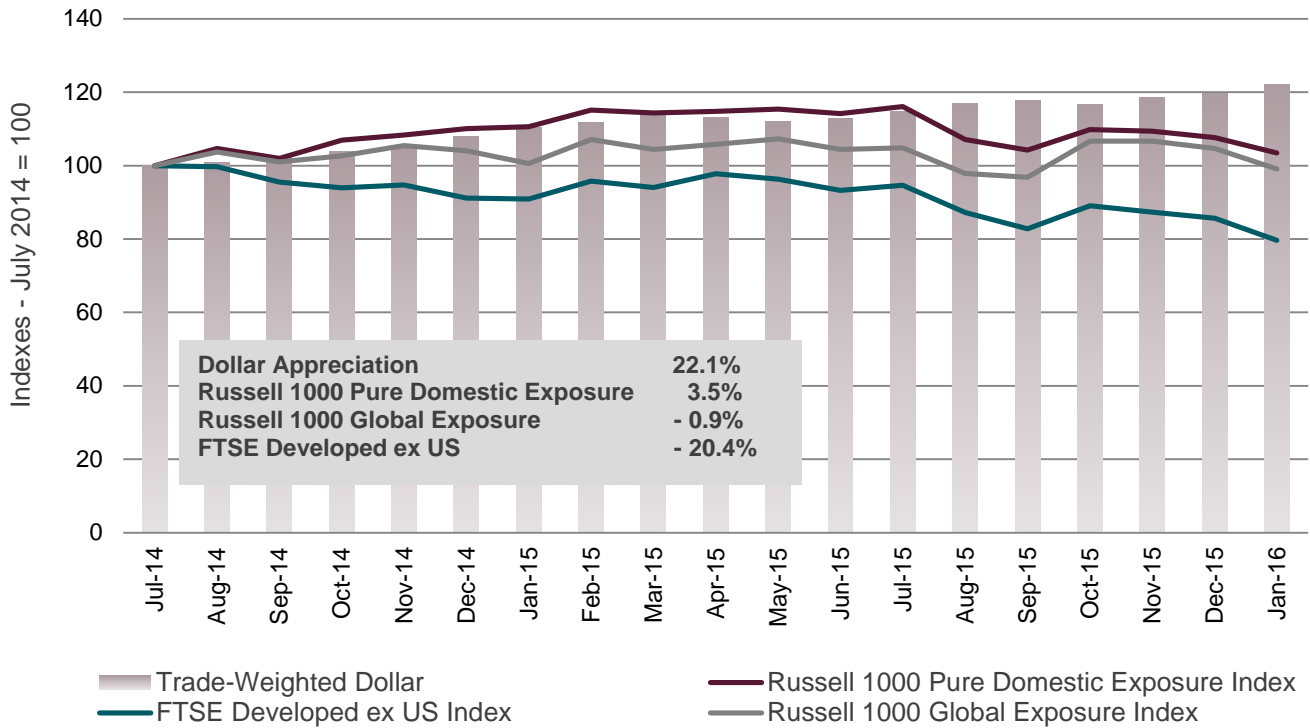


Source: FTSE Russell. Data from May 31, 2016 to August 1, 2016. Data shown may reflect hypothetical historical data. Past performance is no guarantee of future results. Please see the end for important legal disclosures.

As we said at the beginning, there are good reasons why the dollar might get stronger going forward. We can look at recent history to see how these indexes might respond. Between July 2014 and January 2016 the trade-weighted dollar appreciated by 22.1%.<sup>2</sup> This hurt investors in unhedged foreign stocks and, as Chart 2 shows, it also hurt investors in stocks with large exposures to foreign revenue even though the stocks themselves were priced in USD. The Russell 1000 Global Exposure Index's value decreased 0.9% whilst the Russell 1000 Pure Domestic Exposure Index's value actually increased by 3.5%.

<sup>2</sup> USD data from Bank of International Settlements. Data from July 2014 to January 2016.

**Chart 2. Trade-weighted dollar, comparative index performance, July 2014 – January 2016**

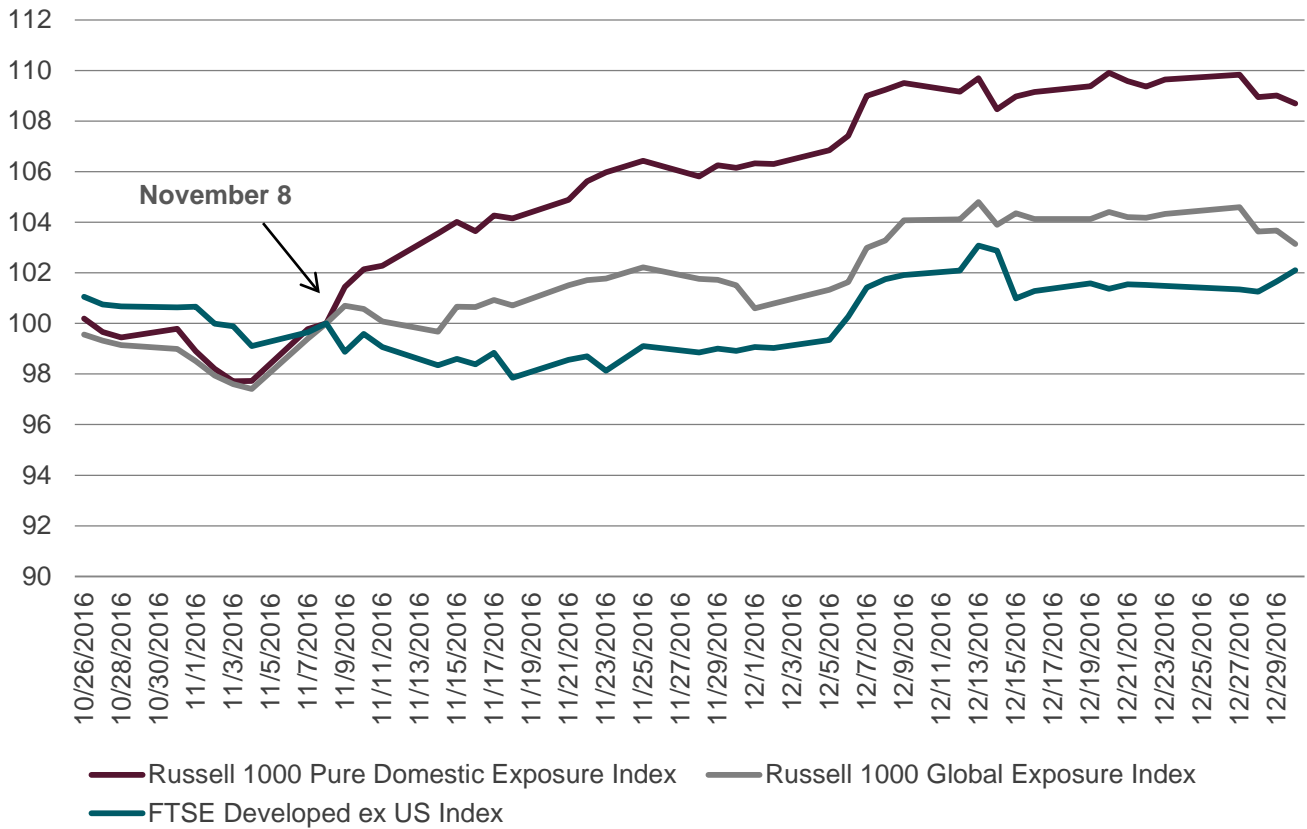


Source: Index data from FTSE Russell; trade-weighted USD data from Bank of International Settlements. Data from July 2014 to January 2016. Data shown may reflect hypothetical historical data. Past performance is no guarantee of future results. Please see the end for important legal disclosures.

## Russell 1000 Pure Domestic Exposure Index should increase in a growing US economy

It is very intuitive that companies with the bulk of their business within the US will benefit the most from positive US economic growth. That potential was well-illustrated with the surprise election results in the US last November 8. While this could not be called an economic event, there was an expectation by many market participants that the agenda of lower taxes, less regulation, new infrastructure spending and new trade restrictions would be implemented fully and swiftly, benefiting domestically focused companies the most. The result is illustrated in Chart 3. Putting aside how much of the economic agenda will be implemented, the larger point is that actual and expected positive US economic growth would likely be reflected by a positive increase of the pure domestic index.

**Chart 3. Comparative index performance before, during and after US election**  
**October 2016 – December 2016**

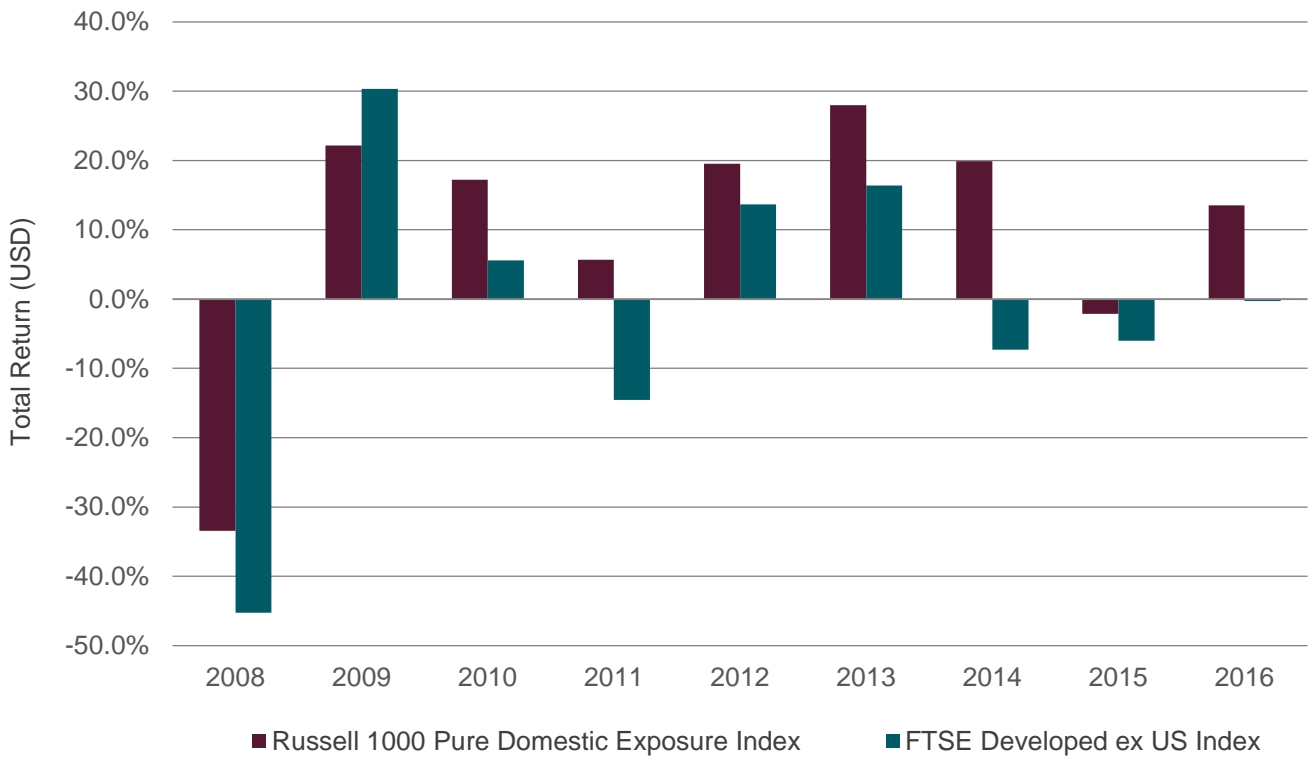


Source: FTSE Russell. Data from October 26, 2016 to December 29, 2016. Past performance is no guarantee of future results. Data shown may reflect hypothetical historical data. Please see the end for important legal disclosures.

### Performance and downside protection

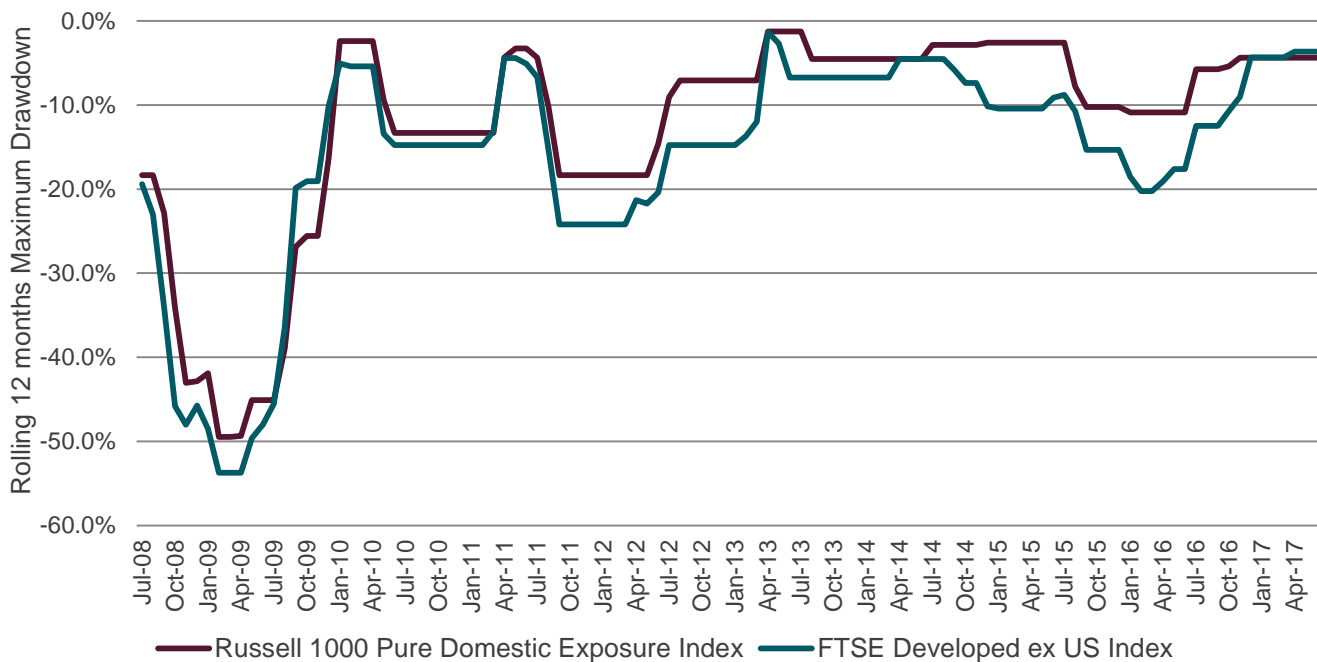
Historically, the Russell 1000 Pure Domestic Exposure Index has had better annual total returns than the FTSE Developed ex US Index in eight of the last nine full years, as shown in Chart 4. Also, the Pure Domestic Exposure Index has had consistently better downside protection than the developed ex US index, as shown in Chart 5. Finally, as shown in Table 3, the historical volatility of the Russell 1000 Pure Domestic Exposure Index has generally, except for the recent time period, been lower than the FTSE Developed ex US Index.

**Chart 4. Annual total return (USD), Russell 1000 Pure Domestic Exposure, FTSE Developed ex US Indexes 2008-2016**



Source: FTSE Russell. Data as of December 31 of each year. Past performance is no guarantee of future results. Data shown may reflect hypothetical historical data. Please see the end for important legal disclosures.

**Chart 5. Russell 1000 Pure Domestic Exposure, FTSE Developed ex US Indexes, rolling 12 month maximum drawdown January 2008-April 2017**



Source: FTSE Russell. Data from January 2008 to April 2017. Past performance is no guarantee of future results. Data shown may reflect hypothetical historical data. Please see the end for important legal disclosures.

**Table 3. Historic performance and volatility (standard deviation)**

		<b>Russell 1000 Pure Domestic Exposure Index</b>	<b>FTSE Developed ex US Index</b>
YTD – June 2017	Return	5.1%	11.3%
	Standard Deviation	5.3%	3.8%
1 year	Return	14.7%	20.4%
	Standard Deviation	8.5%	6.2%
3 year annualized	Return	7.8%	-0.7%
	Standard Deviation	10.3%	12.3%
5 year annualized	Return	14.0%	5.2%
	Standard Deviation	9.8%	11.5%
Aug 2007 - June 2017 annualized	Return	7.4%	-1.8%
	Standard Deviation	18.2%	18.8%

Source: FTSE Russell. Data from August 2007 to June 2017. Past performance is no guarantee of future results. Data shown may reflect hypothetical historical data. Please see the end for important legal disclosures.

## **An index that connects directly to US economic growth**

By selecting only those stocks that are both domiciled within the US and also do most of their business within the US, the Russell 1000 Pure Domestic Exposure Index connects directly to the engines of US economic growth. It is intimately tied to that potential growth going forward while partly insulating against dollar strengthening and global shocks. The index can be used as a tool by market participants looking for potential ways to enhance returns or diversify a global portfolio by replicating the index into an investment product.

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