Figure 1.22. Emerging Market Benchmark-Driven versus Unconstrained Investors

Benchmark-driven investors tend to treat EMs as an asset class.

1. Schematic: EM Benchmark-Driven versus Unconstrained Investors

<table>
<thead>
<tr>
<th>Behavior toward Benchmarks</th>
<th>Tracking error a major constraint</th>
<th>Greater flexibility for off-benchmark investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global versus Country Factors</td>
<td>Greater focus on global factors</td>
<td>Greater focus on country-specific developments</td>
</tr>
</tbody>
</table>

Investment Vehicles

- Passive funds (index funds, ETFs)
- “Active” funds (for example, mutual funds)
- Unconstrained funds (for example, hedge funds, absolute return funds)

Ultimate Investors

- Retail investors
- Institutional investors

Benchmark-driven investors have a larger presence in hard currency debt than in local currency sovereign debt markets.

2. Assets Benchmarked to JP Morgan EM Indices and Market Capitalization (Billions of US dollars)

- Assets under management benchmarked to EM indices
- Market value of most popular index
- Market value of broadest index

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<thead>
<tr>
<th>2009</th>
<th>10</th>
<th>11</th>
<th>12</th>
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<tbody>
<tr>
<td>Hard currency sovereign</td>
<td>Local currency sovereign</td>
<td>Hard currency corporate</td>
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</table>

Passive investors are still only a small share of the overall asset class.

3. Share of ETFs and Passive Funds as a Percentage of Asset Class (Percent)

- EM equity
- US equity
- EM local sovereign (right scale)
- EM hard currency (right scale)
- US high yield (right scale)

Sources: EPFR Global; JPMorgan Chase & Co.; and IMF staff estimates.

Note: In panel 2, “broadest index” refers to the version of the JPMorgan Index without the diversification weighting scheme and with the largest available issuer coverage. “Most popular index” refers to the version of the JPMorgan Index that is most widely followed in its asset class. EM = emerging market; ETF = exchange-traded fund.