Investment Fundamentals
Why Invest in BRICs?

06/2007

The BRIC countries – Brazil, Russia, India, and China – increasingly appear to be the engines of global economic growth for the first half of the twenty-first century…

WHY INVEST IN BRICS?

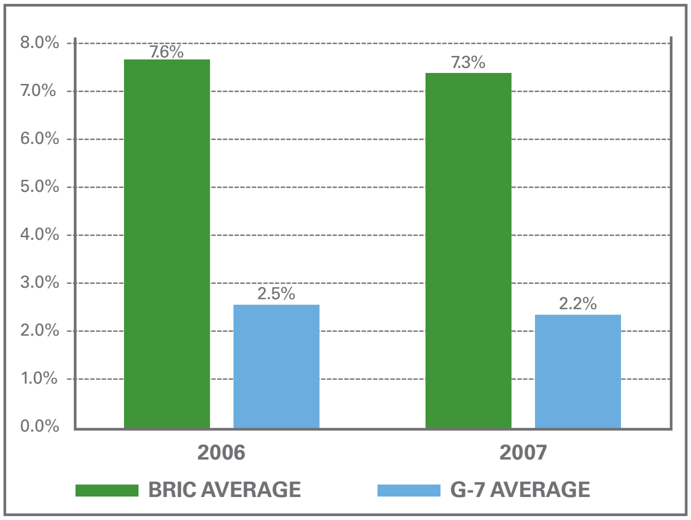
Emerging markets investors often ask: if I already have exposure to the BRIC (Brazil, Russia, India and China) countries through a broad emerging markets fund, why would I make a separate allocation to BRIC?

The answer lies in the difference between true emerging markets and mature emerging markets. True emerging markets, like the BRIC countries, typically have smaller stock market capitalization compared to their economic size, and often carry greater risk. In contrast, mature emerging markets (South Korea, South Africa, Taiwan and Mexico) have higher market capitalizations to gross national output ratios and historically behave more like developed markets[1]. As a result, when these two types of emerging markets are combined in a broad emerging markets vehicle, the mature emerging markets countries comprise nearly half of the weight of the entire fund, even though their share of world gross domestic product (GDP) is less than one-fifth that of BRIC markets. The result? An investor in a broadly diversified emerging markets fund is essentially underweighted in BRIC countries, as measured by those countries' growth potential. It's this difference that has sparked great interest in BRIC investment and, ultimately begins to make the case for BRIC exposure[2].

MAKING A CASE FOR BRIC

BRIC consists of four emerging economic powerhouses – Brazil, Russia, India, and China – that have been highlighted by economists for their potential growth and global impact. By 2050, the BRIC countries could displace some of the most powerful developed nations as the world's largest economies. In fact, by then, if economists' projections are correct, China could be the world's largest economy with India in third place, Brazil in fifth and Russia in seventh[3]. Country growth rates are predicted to be especially fast over the next 25 years[4]. In addition to GDP growth, economists foresee dramatic growth in BRICs' income per capita and long-term currency appreciation[5]. Figure 1 below shows World Bank estimates for economic growth of BRICs compared to developed countries represented by the G-7 countries (Canada, France, Germany, Italy, Japan, US, and U.K.).

FIGURE 1: GDP GROWTH OF BRICS VERSUS DEVELOPED MARKETS



Source: Standard & Poor's Calculations from April 2007 World Economic Output Report of IMF. Past performance is no guarantee of future results.

1 Srikant Dash, "BRIC Markets: Investment Rationale, Risks and Access Options," Standard & Poor's (June 2007), p. 3-4.
2 Srikant Dash, "BRIC Markets: Investment Rationale, Risks and Access Options," Standard & Poor's (June 2007), p. 7.
3 "How Solid are the BRICs?" Goldman Sachs Global Economics Paper No: 134 (December 1, 2005).
4-5 "Dreaming With BRICs: The Path to 2050," Goldman Sachs Global Economics Paper No: 99 (October 1, 2003).

If this argument sounds farfetched, then consider how far Japan and Germany have advanced over the sixty-plus years since their defeat in World War II. History has shown how less developed countries, with their lower levels of capital per worker, are often poised to enjoy higher returns on capital when more capital and advanced technology are introduced[6]. Moreover, currencies tend to appreciate as purchasing power parity rises on greater productivity. Thus, the BRICs have potential that many developed countries lack.

The BRIC countries generally share most of the following potential factors:

- Growing, more educated populations (exception: Russia)
- Increasing political stability (possible exception: Russia)
- Access to natural resources (less true of India)
- Significant foreign currency reserves: together the BRIC countries account for an estimated 30+% of world foreign currency reserves, with China holding the largest reserves (see Figure 2: The BRICs: 2006 Snapshot)

In combination, the factors listed above may expand BRIC stocks' price to earnings (P/E) ratios – the ratio of share price to earnings per share and a commonly used measure of stock valuations. However, this is unlikely to apply to China, which has already experienced significant P/E expansion.

As shown in Figure 2: The BRICs: 2006 Snapshot, the GDP of each country has reached a significant size and is growing at an attractive rate when compared to that of the US. While BRIC GDP per capita pales beside statistics for developed countries, their economic growth could boost domestic demand considerably as income increases, especially in populous India and China. Statistics such as trade, Kurtzman opacity rank (a measure of the ease of doing business in 48 countries), and foreign direct investment (FDI or investment from investors outside the country) suggest room for improvements that could become sources for additional growth. For example, BRICs already account for 15% of global FDI, a figure that's three times higher than in 2000 and may indicate their potential for rapid growth. In fact, according to PriceWaterhouseCoopers LLC's 2006 survey of global CEOs, many global companies plan to increase their investments in the BRIC countries[7].

FIGURE 2: THE BRICs: A 2006 SNAPSHOT

	GDP (US $ BN)	2001–06 AVERAGE GDP GROWTH RATE %	GDP PER CAPITA (US$)	POPULATION (MM)	TRADE (% GDP)	FX RESERVES ($BILLION)	2005 KURTZMAN OPACITY RANK*	FDI (%GDP)
BRAZIL	1,064	2.3	5,085	187	22.7	90.8	29	1.7
RUSSIA	982	6.2	6,908	142	44.2	295.0	40	1.9
INDIA	909	7.2	696	1,281	29.3	173.1	38	0.8
CHINA	2,682	9.8	2,041	1,314	63.4	1,066.0	42	3.2

*A measure of ease of doing business in 48 countries
Past performance is no guarantee of future results.
Source: Goldman Sachs, IMF, May 2007.

The following potential catalysts exist for each of the BRIC countries.

- BRAZIL: Domestic economy could improve with further economic reforms and fiscal responsibility, having already brought budgets and inflation under control, boosted corporate earnings, and driven appreciation of the real, Brazil's national currency[8]. In addition, Brazil holds the world's largest non-precious metal reserves and is a leader in agricultural production.
- RUSSIA: Could benefit from price strength in oil and natural gas because it holds 20% of the world's crude oil reserves and 35% of the world's natural gas reserves.
- INDIA: Domestic demand for goods and services could accelerate if outsourcing to India increases. A world leader in information technology, the country enjoys a highly educated work force, as well as a massive and increasingly affluent population.
- CHINA: Economic expansion could be spurred by continued foreign direct investment. China could become the world's largest economy by 2040[9].

6 "Dreaming With BRICs: The Path to 2050," Goldman Sachs Global Economics Paper No: 99 (October 1, 2003).
7 "ETF Investing: BRIC," State Street Global Advisors presentation.
8 "Brazil's Bull Draws Fans," Wall Street Journal (June 8, 2007), p C2.
9 Standard and Poor's, 4/30/2007 (according to citation in "ETF Tactics: Investing in BRIC Countries," State Street Global Advisors).

SPDRs
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The case for investing in BRICs relies on:

- The broad opportunity set offered by stocks accounting for US $692 billion in investable market capitalization[10]
- Opportunity for – though no guarantee of – return enhancement (see Figure 3)
- Diversification (see Figure 4)
- Currency appreciation

As a proxy, the S&P® BRIC 40 Index illustrates how this block of countries has delivered strong historical returns compared to other popular emerging market benchmarks.

FIGURE 3: RETURN ANALYSIS: BRICS VS. OTHER EMERGING MARKET BENCHMARKS

ANNUALIZED RETURNS: MARCH 1957 - MAY 2007	1 Q	1 YEAR	3 YEARS	5 YEARS	SINCE INCEPTION[11]
S&P® BRIC 40 INDEX	11.3%	46.0%	44.8%	34.6%	23.4%
S&P®/CITIGROUP® BMI EMERGING MARKETS INDEX	13.8%	41.8%	36.9%	28.0%	9.8%
MSCI EMERGING MARKETS INDEX℠	14.3%	38.6%	36.8%	27.5%	15.6%
S&P 500® INDEX	9.3%	22.8%	13.0%	9.5%	12.2%

Source: Zephyr StyleADVISOR, State Street Global Advisors Strategy & Research, as of 5/31/2007

Index returns do not represent actual ETF performance and are for illustration purposes only. Index performance does not reflect charges and expenses associated with the fund or brokerage commissions associated with buying and selling exchange traded funds. Past performance is no guarantee of future results.

The historical values for this index were calculated based on the current S&P BRIC 40 Index methodology using historical component-level data. The historical values were designed to reflect the performance of what would have been the actual components of the Index at the time. Securities meeting the required criteria for inclusion according to the methodology were included; no discretion was employed in the selection outside of applying the criteria. The full methodology for the index is published on www.spdretfs.com.

Broad emerging markets indexes have dominated the emerging market allocations of US investors. Such broad diversification made sense in the wake of the emerging markets currency crisis of 1998. However, since then, emerging markets have improved dramatically in terms of foreign currency reserves and other measures of economic and political responsibility. This is especially true of the four BRICs, which also offer a low correlation with popular emerging markets indices.

FIGURE 4: ASSET CLASS CORRELATION* ANALYSIS: BRICs VS. POPULAR DOMESTIC & INTERNATIONAL BENCHMARKS

CORRELATION

MARCH 2001 - MAY 2007

	S&P BRIC 40 INDEX	S&P/CITIGROUP BMI EMERGING MARKETS INDEX	MSCI EM (EMERGING MARKETS) INDEX	DOW JONES WILSHIRE 5000 INDEX	S&P 500 INDEX
S&P BRIC 40 INDEX	1.00				
S&P/CITIGROUP BMI EMERGING MARKETS INDEX	0.87	1.00			
MSCI EMERGING MARKETS INDEX	0.88	0.98	1.00		
DOW JONES WILSHIRE 5000 INDEX™	0.77	0.78	0.82	1.00	
S&P 500 INDEX	0.75	0.75	0.79	0.99	1.00

Source: Zephyr StyleADVISOR, State Street Global Advisors Strategy & Research, as of 5/31/2007

*Correlation is defined as a single number that describes the degree of the relationship between two variables.

10 In the S&P BRIC 40 Index.

11 Inception dates follow for all indexes mentioned in this piece: S&P BRIC 40 Index (inception date: 2/1/2001); S&P/Citigroup BMI Emerging Markets Index (inception date: 12/30/1994); MSCI Emerging Markets Index (inception date: 4/1/1998); S&P 500 Index (inception date: 3/4/1957); Dow Jones Wilshire 5000 Index (inception date: 12/31/1980); MSCI BRIC Index (inception date: 12/6/2005); FTSE BRIC 50 Index (inception date: 3/26/2007); DaxGlobal BRIC Index (inception date: 6/6/2006); Dow Jones BRIC 50 Index (inception date: 12/31/2002); BoNY BRIC 50 Index (inception date: 6/5/2006); S&P CNX 50 Index (inception date: 11/3/1995); FTSE/Xinhua 25 Index (inception date: 4/19/2001). Sources: www.standardandpoors.com, www.msci.com, www.dowjones.com, www.bankofnewyork.com, www.ftse.com, and http://deutsche-boerse.com.

BRIC RISKS MAY BE MODERATED BY A WELL-DIVERSIFIED PORTFOLIO

Investing in emerging markets carries risks that may prevent these markets from rising and could even cause them to fall. That's particularly true when one narrows in on BRIC markets. It's reflected in historical standard deviation and beta statistics (see Figure 5), which are measures of the variability of returns. Risks for the BRICs include:

- They may not realize the potential that economists predict.
- They may falter in terms of macroeconomic policies, political institutions, openness to trade/FDI, and education[12].
- There may be a weak relationship between rapid GDP growth and equity market returns.
- Like all emerging markets, BRIC markets may be prone to corrections following reversals in investor sentiments.

Despite their risks, BRICs have historically delivered attractive risk-adjusted returns when used in a diversified portfolio as a complement to broader emerging markets exposure. It is important to note, however, that the benefits of a diversified portfolio do not ensure a profit or guarantee a loss. Given the potential volatility of BRICs, they generally make the most sense as part of a long-term, strategic allocation. However, when the short-term outlook is attractive, BRIC investment may be useful for tactical moves.

FIGURE 5: RISK/RETURN COMPARISON

RISK-RETURN ANALYSIS: TABLE 1

MARCH 2001 - MAY 2007: ANNUALIZED SUMMARY STATISTICS

	RETURN (%)	STD DEV (%)	BETA VS. MARKET	SHARPE RATIO
S&P BRIC 40 INDEX	23.4	24.4	1.4	0.8
S&P/CITIGROUP EMERGING BMI EMERGING MARKETS INDEX	21.4	19.1	1.1	1.0
DJ WILSHIRE 5000 INDEX	6.6	13.3	1.0	0.3
70% DJ WILSHIRE 5000 INDEX 20% S&P/CITIGROUP BMI EMERGING MARKETS INDEX 10% S&P BRIC 40 INDEX	11.3	14.7	1.1	0.6
70% DJ WILSHIRE 5000 INDEX 30% S&P/CITIGROUP BMI EMERGING MARKETS INDEX	11.1	14.3	1.0	0.6

Source: Zephyr StyleADVISOR, State Street Global Advisors Strategy & Research, as of 5/31/07

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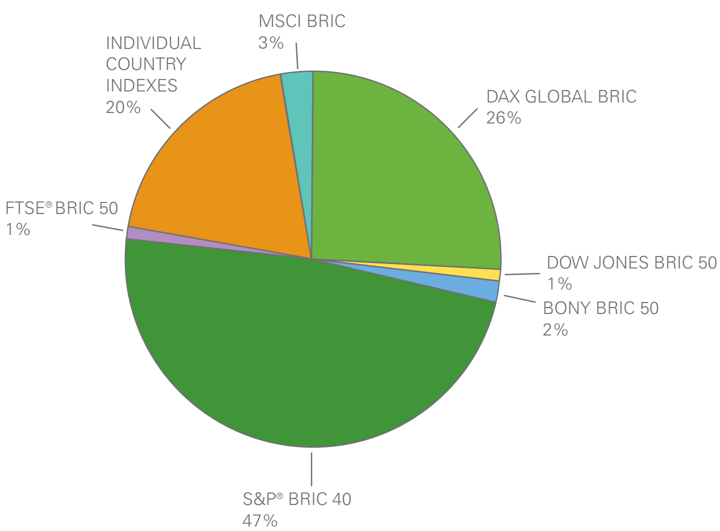
12 "Dreaming With BRICs: The Path to 2050," Goldman Sachs Global Economics Paper No: 99 (October 1, 2003), p. 14.

WHY THE S&P BRIC 40 INDEX WORKS BEST

BRIC indices fall into two categories—broad market benchmarks like the MSCI BRIC Index and investable indices like the S&P BRIC 40 Index. Broad market benchmarks are a useful gauge for measuring overall market performance. However, they are not fully replicable and require discretionary optimization by portfolio managers. They may also have higher frictional costs. Investable indices are narrower, fully replicable and based on accessibility to foreign investors[13].

The S&P BRIC 40 Index is an investable, float-adjusted index that has emerged as one of the most popular indices for BRIC products and institutional mandates because it is fully replicable, focused on liquidity and may provide excellent market access[14]. In fact, about half of all index-linked BRIC products are tied to the S&P BRIC 40 Index[15] (see Figure 6).

FIGURE 6: MARKET SHARE OF BRIC INDICES AMONG BRIC INDEX PRODUCTS



Source: Standard & Poor's calculations based on structured product data for all equity index-linked BRIC products with a launch date in www.structuredretailproducts.com and ETF filings. Individual country index products are based on combination of single market indices such as S&P CNX 50, Bovespa, FTSE/Xinhua 25, RTS etc.

The S&P BRIC 40 Index may be an attractive option for tapping the diversification potential of BRIC countries. It tracks 40 of the leading companies domiciled in BRIC countries. These securities only trade on developed market exchanges and pass through a threshold screen to ensure liquidity relative to the market – an advantage compared to other indexes that include stocks that are only readily available to local investors[16]. Since the index's inception in May 2006, these characteristics have made the S&P BRIC 40 Index the dominant index for suitable institutional investors considering the investable universe of BRIC stocks[17].

SPDR® S&P® BRIC 40 ETF

The SPDR S&P BRIC 40 ETF is based on the S&P BRIC 40 Index and can provide easy, cost-effective access to this asset class[18]. This ETF seeks to fully replicate the index by investing in all forty of its stocks. It has an expense ratio of 40 basis points[19].

Investment in the BRICs alone may be too limited, even as an emerging markets investment. Depending on a particular investor's goals, the SPDR S&P BRIC 40 ETF might be combined with the SPDR® S&P® Emerging Markets ETF (GMM), or with more narrowly focused SPDRs℠ regional emerging market ETFs.

FOR MORE INFORMATION

For more information about the SPDR S&P BRIC 40 ETF [ticker: BIK] or our other ETF and mutual fund offerings, please visit www.spdretfs.com.

13-14 Standard & Poor's, "BRIC Markets: Investment Rationale, Risks and Access Options," June 2007.
15 50% of BRIC assets are linked to this index. The next closest index accounts for 20% of BRIC assets. Standard & Poor's, "BRIC Markets: Investment Rationale, Risks and Access Options," June 2007.
16 Roughly 50%-60% of MSCI's BRIC index is not accessible to foreign investors because of unavailability of liquid stocks in Brazil, custody issues in Russia, tax issues for foreign investors in India, and other issues. Standard & Poor's, "BRIC Markets: Investment Rationale, Risks and Access Options," June 2007.
17 Srikant Dash, "BRIC Markets: Investment Rationale, Risks and Access Options," Standard & Poor's (June 2007), p. 7.
18 Frequent trading of ETF's could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.
19 The Advisor has contractually agreed to waive its advisory fee and reimburse certain expenses, until June 19th, 2008, so that the Fund's Net Annual and Operating Expenses are limited to 0.40% of the Fund's average daily net assets. Unless renewed prior to the waiver expiration, the expense ratio will revert to 0.50%.

INDEX DEFINITIONS

S&P BRIC 40 INDEX

The S&P BRIC 40 Index represents four emerging equity markets: Brazil, Russia, India and China, which together are known as the BRIC countries. This index includes 40 large and liquid stocks that trade in developed market exchanges: Hong Kong Stock Exchange, London Stock Exchange, NASDAQ and NYSE.

S&P/CITIGROUP BMI EMERGING MARKETS INDEX

Market capitalization-weighted index that defines and measures the investable universe of publicly-traded companies domiciled in emerging markets as defined by Standard and Poor's.

MSCI EMERGING MARKETS INDEX

Market capitalization-weighted index capturing 85% of the total market capitalization of emerging markets, as defined by MSCI.

S&P 500 INDEX

Market capitalization-weighted, price-only index composed of 500 widely held common stocks listed on the NYSE, AMEX and OTC market.

DOW JONES WILSHIRE 5000 INDEX

Designed to represent the performance of all US-headquartered equity securities with readily available price data.

MSCI BRIC INDEX

Market-capitalization weighted index designed to provide an objective representation of the overall performance of the four BRIC countries.

FTSE BRIC 50 INDEX

Represents the performance of 50 of the largest companies by full market capitalization that trade as either depository receipts for Brazilian, Indian or Russian companies, or H Shares for Chinese companies.

DAXGLOBAL BRIC INDEX

DAXglobal BRIC Index expands the young DAXglobal index family and provides investable access to the emerging markets Brazil, Russia, India and China. DAXglobal indices are completely transparent and rule-based. DAXglobal indices are based on equities only as well as on multi-asset classes.

DOW JONES BRIC 50 INDEX

The Dow Jones BRIC 50 Index is a blue-chip measure that includes 50 of the largest and most actively traded stocks in these countries. The China portion of the index is made up of offshore stocks-H-shares and U.S.-listed ADRs/ADSes

BONY BRIC 50 INDEX

Market-capitalization weighted, comprised strictly of ADRs, the BoNY BRIC 50 Index is a subset of The Bank of New York ADR index.

S&P CNX 50 INDEX

The S&P CNX Nifty (nicknamed Nifty 50 or simply Nifty) (Ticker NSE:^NSEI), is the leading index for large companies on the National Stock Exchange of India. S&P CNX Nifty is a well diversified 50 stock index accounting for 22 sectors of the economy. It is used for a variety of purposes such as benchmarking fund portfolios, index based derivatives and index funds. (The 'Nifty 50' nickname should not be confused with the Nifty 50 set of 50 leading stocks on the New York Stock Exchange in the 1970s.)

FTSE/XINHUA 25 INDEX

A real-time, tradable index which offers the optimal representation of China blue chip stocks. It includes the largest 25 Chinese companies comprising H Shares and Red Chip Shares, ranked by total market capitalization. Index constituents are capped at 10% of the total index. Includes stocks listed on the Hong Kong stock exchange.

Sources: www.standardandpoors.com, www.msci.com, www.dowjones.com, www.bankofnewyork.com, www.ftse.com and http://deutsche-boerse.com.

ETFs trade like stocks, are subject to investment risk and will fluctuate in market value.

Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Non-diversified funds that focus on a relatively small number of stocks/issuers tend to be more volatile than diversified funds and the market as a whole.

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