

ETF Performance & Perspectives

From S&P Capital IQ MarketScope Advisor

APRIL 2013

Each month, we compile a selection of timely and actionable [Trends & Ideas](#) reports published on S&P Capital IQ [MarketScope Advisor](#).

The research reports inside include positive and negative implications for certain stocks, mutual funds and ETFs, and selected performance charts.



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[through March 31, 2013]

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Todd Rosenbluth
Director of ETF & Mutual Fund Research

S&P Capital IQ
MarketScope Advisor



ETF Insights with Todd Rosenbluth

According to BlackRock data, investors globally added a record \$70 billion to exchange-traded products in the first quarter of 2013, up from nearly \$66 billion a year earlier. While money still moved into bond products, 93% of the inflows were into equities. S&P Capital IQ has reports and rankings on over 750 equity ETFs listed in the U.S., based on a combination of holdings-based research and relative metrics about the ETF such as technical indicators and expenses. In addition, we are expanding our ranking coverage to include Fixed Income ETFs beginning in May 2013.

During March, S&P Capital IQ published 21 Trends & Ideas articles related to ETFs to help our clients find ways to play key investment themes. Below is a summary of some of the ones we are highlighting in this packet.

We think the strong investor interest in equity ETFs helped to push both the Dow Jones Industrial Average and the S&P 500 Index to all-time highs during March. While S&P Capital IQ's Equity Strategy Group believes equities should move higher in the next twelve months, the journey will likely be a volatile one. We are not alone with this thesis, as, in keeping with this theme, first-quarter inflows to low volatility ETFs grew 76%, from the prior year's first quarter, according to BlackRock data. In a piece titled How to Lower Your Volatility But Stay in the Market, we compared the distinctions between the two most popular "low-vol" products focused on the U.S. They have both performed well this year, but the sector exposure you get from each is quite different.

From a sector perspective, during the first quarter, the leaders were the defensive, largely dividend-focused ones, namely Health Care, Consumer Staples and Utilities. Each was up more than 11.5% year to date through March. We believe the 20% greater inflow into dividend-themed exchanged-traded products this year has been a contributor to the sector strength. But of course, not all dividend investments are the same. In a piece titled The Dividend Aristocrats of the Dow Jones Industrial Average, we highlighted companies that had long histories of raising their dividend annually, a theme that investors can play through a SPDR ETF.

Despite the more defensive slant in the U.S., investors also have continued to focus in 2013 on faster-growing international markets. In a piece titled Investing in Emerging Markets: Beyond BRIC, we discussed the potential appeal of frontier markets due to their exposure to secular consumer and infrastructure growth. Interestingly, the markets there are incurring less volatility than some more developed international ones. ETFs have continued to launch that target specific countries such as Argentina or Vietnam or that offer diversification in Africa or the Middle East, and in this piece we highlighted some of them.

Lastly, we regularly draw attention to things to be mindful of at the ETF level when sorting through the still-growing universe. In March, in a piece titled What Are the Costs to Watch For with ETF Investing, we dug into the important cost inputs that we use in our ETF ranking methodology. Besides using S&P Capital IQ equity analysts to provide holdings-level analysis, we compare an ETF's bid/ask spread, the premium or discount of the ETF's price to its net asset value, and its expense ratio, to the broader equity ETF universe. Smaller, less frequently traded ETFs tend to score worse in our ranking methodology and investors should be conscious of the challenges tied to them.

All of these pieces and more were previously published for clients either on MarketScope Advisor or through a feed. If you would like to receive them directly or to learn more about our ETF report expansion efforts, please let us know.

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ETF Model Portfolio Performance

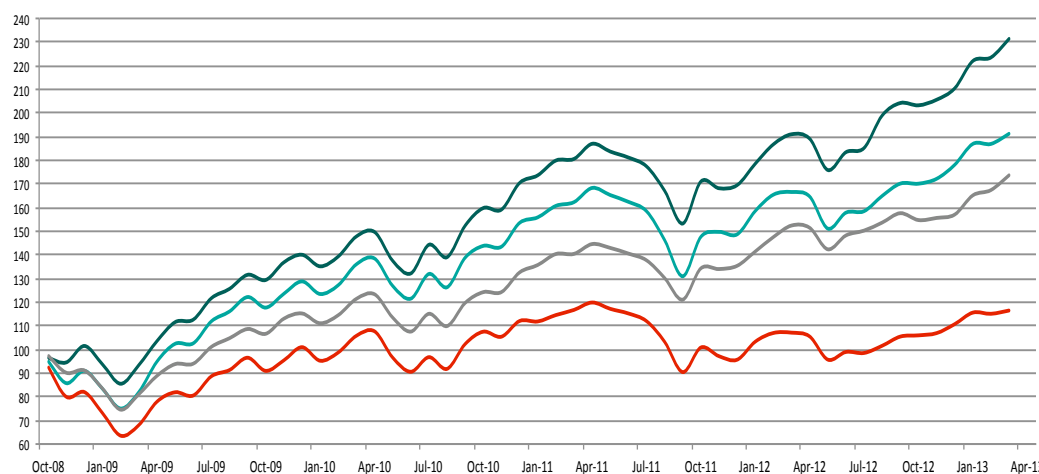
October 14, 2008 - March 31, 2013

ETF Model Performance Graph

AVGERAGE ANNUAL PERFORMANCE
Since 10/14/08

HYPOTHETICAL GROWTH OF \$100
Invested on 10/14/08

ETF Model	AVGERAGE ANNUAL PERFORMANCE Since 10/14/08	HYPOTHETICAL GROWTH OF \$100 Invested on 10/14/08
OVERWEIGHT	+20.7%	\$231
MARKETWEIGHT	+15.7%	\$191
S&P 500 TOTAL RETURN INDEX	+13.2%	\$174
UNDERWEIGHT	+3.5%	\$117



As of March 31, 2013

OVERWEIGHT

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Overweight has **OUTPERFORMED** the S&P 500 TOTAL RETURN INDEX.

MARKETWEIGHT

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Marketweight has **OUTPERFORMED** the S&P 500 TOTAL RETURN INDEX.

UNDERWEIGHT

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Underweight has **UNDERPERFORMED** the S&P 500 TOTAL RETURN INDEX.

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ETF ranking categories are models only. Please see the next page for additional important disclosures regarding the inherent limitations of model performance. Model performance is gross of all investor level fees and expenses. The S&P 500 index is the benchmark for the ETF model portfolios. The S&P 500 index assumes reinvestment of dividends. Indexes are unmanaged, statistical composites and their returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. It is not possible to invest directly in an index. Inclusion of fees and expenses in the model or S&P 500 index would lower performance. Past performance of the models or S&P 500 index is no indication of future results.



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Performance Disclosure

The exchange-traded fund (“ETF”) model performance chart on the prior slide is only an illustration of S&P ETF research; it shows how all ETF’s that received a particular Overall S&P ETF ranking of Overweight, Marketweight or Underweight performed. The Overall S&P ETF rankings in the above chart are model portfolios only; they are not collective investment funds. (The ETF model portfolios are also collectively referred to as “model” or “model portfolio”.) Model performance has inherent limitations. The ETF model performance does not show how any actual portfolio has performed. ETF model performance does not represent the results of actual trading of investor assets. S&P maintains the model and calculates the model performance shown or discussed, but does not manage actual assets. Thus, the performance shown or discussed does not reflect the impact that material economic and market factors had or might have had on decision-making if actual investor money had been managed. Performance of an investor’s actual portfolio will not necessarily match the performance of the model portfolio due to differences in the weightings of the individual securities. In addition, the model results do not take into account timing differences between the selections by S&P and purchases that were or would have been made based on those selections by any advisor or by actual investors. While model performance for some or all ETF ranking categories may have performed better than the illustrative reference point for the period shown, the performance during any shorter period may not have, and there is no assurance that the model will perform better than the illustrative reference point in the future. The model does not take into account any particular investment objective, financial situation or need and are not intended as an investment recommendation or strategy. Investments based on the ETF methodology may lose money. Past performance of the ETF model is no guarantee of future results.

Performance is calculated daily using a time-weighted rate of return. The model performance calculation takes into account dividends and distributions but does not take into account reinvestment of dividends. ETF’s in each model will change over time, and some or all of the ETF’s that received rankings during the time period shown may not have maintained their ranking during the entire period.

For model performance calculation purposes, the ETF’s within each model at October 14, 2008 were equally weighted. Thereafter, additions to the composition of the ETF’s in each model are made at the average market value of the ETF model at the preceding month end with no rebalancing. The average market value of the ETF equals the total market value of the ETF model at the prior month-end divided by the number of ETFs in the ETF model at the prior month-end. The number of shares of the new ETF added equals the average value of an ETF in the ETF model at the preceding month-end divided by the price of the added ETF at the close of the day it was added. The number of shares remains fixed unless there is a subsequent distribution. Subsequent to the addition of the equity, the performance calculation is based on the number of shares and the daily closing prices. An ETF is deleted in its entirety, and the deletion is made at the closing price of the day that the deletion is made. ETF model performance reflects the fees and expenses of the underlying ETFs. The model performance does not consider taxes and brokerage commissions, nor does it reflect the deduction of any advisory or other fees charged by advisors or other parties that investors will incur when their accounts are managed in accordance with the model. The imposition of these fees and charges would cause actual performance to be lower than the performance shown. For example, if the model returned 10 percent on a \$100,000 investment for a 12-month period (or \$10,000) and an annual asset-based fee of 1.5 percent were imposed at the end of the period (or \$1,650), the net return would be 8.35 percent (or \$8,350) for the year. Over 3 years, an annual 1.5% fee taken at year end with an assumed 10% return per year would result in a cumulative gross return of 33.1%, a total fee of \$5,375 and a cumulative net return of 27.2% (or \$27,200).

An investment based upon any of the models should only be made after consulting with a financial advisor and with an understanding of the risks associated with any investment in securities, including, but not limited to, market risk, currency risk, political and credit risks, the risk of economic recession and the risk that issuers of securities or general stock market conditions may worsen, over time. Foreign investing involves certain risks, including currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, less liquidity and the potential for market volatility and political instability. As with any investment, investment returns and principal value will fluctuate, so that when redeemed, an investor’s shares may be worth more or less than their original cost.

Benchmark Disclosure

The S&P 500 index is the benchmark for the ETF model portfolios. Indexes are unmanaged, statistical composites and their returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. The methodology for calculating the return of the S&P 500 index differs from the methodology for calculating returns for the ETF ranking categories. The S&P 500 index has different risk characteristics than the ETF model portfolios, and its performance calculation takes into account reinvestment of dividends and distributions. Past performance of the S&P 500 Index is no guarantee of future results.

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Investing in Emerging Markets: Beyond BRIC

[3/27/2013] It's time to cast a wider net when looking overseas, according to Alec Young, S&P Capital IQ's global equity strategist. Even as BRIC (Brazil, Russia, India, China) equities are down 14% over the last three years, a frontier market like Columbia is up 46% and Turkey posted gains of 28%. Young thinks it's time for investors to pare back BRIC exposure in favor of smaller emerging markets and frontier markets.

"Not only do frontier markets boast a lower 55% S&P 500 correlation than the BRIC's 75%, frontier markets are up 7.5% year-to-date versus a 3.3% decline for BRIC," Young points out. "We think frontier markets offer the most exposure to secular consumer and infrastructure growth, while at the same time sporting a lower long-term deviation of 20 vs. 23.5 for emerging market equities."

Mutual funds offer one way to invest in frontier markets; choices include Harding Loevner Frontier Emerging Markets Portfolio [HLFMX 8 *****], Morgan Stanley Frontier Emerging Markets [MFMIX 16 *****], and Templeton Frontier Markets [TFMAX 17 *****].

There are a number of exchange-traded funds (ETFs) linked to frontier markets: Guggenheim Frontier Markets [FRN 19 NR], PowerShares MENA Frontier Countries Portfolio [PMNA 11 NR], and iShares MSCI Frontier 100 Index ETF [FM 29 NR]. [Reports for the first two are available at the ETF tab in MarketScope Advisor; overall S&P Capital IQ ETF rankings are unavailable due to lack of holdings information.]

Frontier markets make up only 0.7% of global equity market cap, and include 25 countries, according to MSCI, which launched the MSCI Frontier Market Index in May of 2002. The 25 countries are: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Lebanon, Lithuania, Kazakhstan, Mauritius, Nigeria, Oman, Pakistan, Qatar, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, Ukraine, United Arab Emirates, and Vietnam. Many of them have associated region-specific or country-specific ETFs for investors to consider: Market Vectors Vietnam [VNM 21 NR], Global X FTSE Argentina 20 ETF [ARGT 9 NR], Market Vectors Gulf States ETF [MES 22 NR], Middle East Dividend ETF [GULF 16 NR], or Market Vectors Africa [AFK 30 NR].

Gross domestic product growth in the frontier markets for 2013 and 2014 is expected to outpace that of the U.S., U.K., Europe, Australia, Japan, Switzerland, Canada, South Africa, and the world as a whole, according to IHS Global Insight, an economic forecasting firm. Meanwhile, frontier countries enjoy younger demographics, and still have plenty of room

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Using ETFs to Capitalize on Emerging and Frontier Market Growth Featuring Alec Young Global Equity Strategist Todd Rosenbluth, and Anthony Hohmann.

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for technology to drive growth, according to the World Bank.

“Emerging market equity indices tend to be dominated by BRIC-, Korea-, and Taiwan-based financial, mining, energy, and technology companies that are largely driven by global macroeconomic forces emanating from the developed world,” comments Young.

“This leaves less room for more domestic consumer-related stocks that offer better leverage to the secular growth themes driving developing economies. State ownership of large stakes in publicly-traded BRIC financial, mining, energy, and telecom companies is widespread, reducing transparency and liquidity and depressing valuations. Market inefficiencies are greater in smaller, less-discovered emerging and frontier markets, increasing the potential for outperformance. What’s more, frontier markets and smaller emerging markets have lower correlations with U.S., European, and Asian developed markets than BRIC, boosting their diversification appeal.”

The MSCI Frontier Market Index boasts a dividend yield of 4.2%, higher than the S&P 500, 400, or 600, and also higher than most developed or emerging markets. And based on monthly standard deviation, frontier markets have been less volatile than emerging markets.

“Smaller emerging markets and frontier markets have lower correlations with developed equities than traditional emerging market equity indices, boosting overall equity portfolio diversification,” concludes Young.

Beth Piskora

S&P Capital IQ Editorial

TAKEAWAY

These mutual funds and ETFs offer exposure to frontier markets.

POSITIVE IMPLICATIONS

GLOBAL X FTSE ARGENTINA 20 ETF	NA	[ARGT]
GUGGENHEIMFRONTIER MARKETS ETF	NA	[FRN]
HARDING LOEVNER FRONTIER EMERGING MARKETS; INSTL	★★★★★	[HLFMX]
MARKET VECTORS AFRICA INDEX ETF	NA	[AFK]
MARKET VECTORS GULF STATES INDX ETF	NA	[MES]
MARKET VECTORS VIETNAM ETF	NA	[VNM]
MORGAN STANLEY FRONTIER EMERGING MARKETS;I	★★★★★	[MFMIX]
POWERSHARES MENA FRONTIER COUNTRIES PORTFOLIO	NA	[PMNA]
WISDOMTREE MIDDLE EAST DIVIDEND FUND	NA	[GULF]

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What are the Costs to Watch for with ETF Investing?



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[3/5/2013] There is a repeatedly shown wireless phone commercial about one company's 4G data services that claims, "It's not complicated. Bigger is better." For exchanged traded funds (ETFs), this is not always the case as there are a number of ETFs with asset bases below \$100 million that are ranked favorably by S&P Capital IQ. However, when looking at these ETFs, it is important to understand the cost factor implications because some of the smaller ETFs incur high costs.

While some investors may look for the ETF with the most assets within a given style, others that have long focused on mutual funds may be drawn in by an ETF's strong performance record. S&P Capital IQ believes both approaches miss out on a number of factors, including that ETFs with limited asset bases tend to have higher expense ratios, less liquidity due to limited trading activity, and trade above or below their net asset value, thus costing more. Less frequent trading can lead to wide bid/ask spreads, which is the gap between the price buyers are willing to pay for shares of an ETF and the price sellers are asking. The wider the spread, the bigger the bite taken out of investors' returns every time they buy or sell. A lack of liquidity also may cause the ETF to trade at a premium or discount to the net asset value (NAV) of the fund's underlying holdings. That means an investor buying the fund may overpay for that portfolio or the seller may get less than assets are worth. Ideally, you can find an ETF with a style you favor that has a tight bid/ask spread and trades in line with its NAV because you need to not only get in but also get out a later date. S&P Capital IQ uses these two cost factors, along with analysis of an ETF's expense ratio, to support our ranking process of 750 equity ETFs. According to BlackRock, over \$47 billion was added to equity exchange traded products in the first two months of 2013.

One such an example of high costs is in the small cap ETF space. While PowerShares has gathered assets for a number of their fundamentally driven ETFs (see below for one such example), PowerShares Fundamental Pure Small Cap Core Portfolio [PXSC 27 Underweight] is not one of them. PXSC has just \$15 million in assets and just over 800 shares trade hands on a daily basis. As a result, this ETF has relatively wide bid/ask spread and a high 1.22% gross expense ratio, though PowerShares has agreed to waive 0.83% of these costs until at least August 2013, in an attempt, we think, to make PXSC more competitive. So while PXSC's market price total return of 9.7% year to date through March 4 is encouraging, the ETF has unfavorable cost factors to S&P Capital IQ.

A larger and better alternative, according to S&P Capital IQ, is iShares Russell 2000 Index [IWM 91 Overweight]. IWM rose 8.1% year to date, narrowly lagging PXSC. While this ETF is a more traditional index ETF that is not tied to a benchmark that uses dividends or cash

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flow analysis, it is a lower cost, more actively traded option. IWM has \$19 billion in assets and trades over 30 million shares on a daily basis. The bid/ask spread is tight and the gross expense ratio is just 0.23%.

Another example where smaller is not better is RevenueShares Navellier Overall A-100 Fund [RWV 45 Marketweight]. RWV's NAV is up 13% year-to-date through March 4, putting it among the 50 top performing equity ETFs this year. The ETF is tied to an index that aims to identify the 100 highest quality stocks in the U.S. using factors such as earnings growth, free cash flow and return on equity. However, there is only \$7 million in assets in this ETF and the average daily volume is just 500 shares. Based on this, it should be no surprise that the bid/ask spread is relatively wide and the gross expense ratio of 1.42% [net of 0.60% after fee waiving] is above-average.

A lower cost, more established alternative is PowerShares S&P High Quality Portfolio [SPHQ 17 Overweight], which has just over \$200 million in assets. The ETF holds stocks with above-average S&P Quality Rankings of A- or higher [based on their strong earnings and dividend consistency and growth]. SPHQ is not only more diversified than RWV, but also has favorable cost factors. SPHQ trades over 45,000 shares daily and has a tight bid/ask spread. In addition, the gross expense ratio of 0.49% [net expense ratio of 0.29%] is much more reasonable than RWV's. While its 7.5% gain this year lags RWV's, it is ahead of the S&P 500 Index.

Since the beginning of 2012, there have been over 100 ETF closures, nearly all when the asset bases were below \$50 million as an ETF with a limited following can be expensive to run. While we do not believe PXSC and RWV are next to wind down, the costs of using them are much higher than larger, more liquid alternatives.

Todd Rosenbluth

S&P Capital IQ Director of ETF Research

TAKEAWAY

Despite the growth in ETF assets in recent years, some ETFs are traded infrequently and cost more than alternatives.

POSITIVE IMPLICATIONS

ISHARES RUSSELL 2000 INDEX FUND	OVERWEIGHT	[IWM]
POWERSHARES S&P 500 HIGH QUALITY PORTFOLIO	MARKETWEIGHT	[SPHQ]

NEGATIVE IMPLICATIONS

POWERSHARES FUNDAMENTAL PURE SMALL CORE PORTFOLIO	UNDERWEIGHT	[PXSC]
REVENUESHARES NAVELLIER OVERALL A-100 FUND	MARKETWEIGHT	[RWV]

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Appealing Mega-Cap Stocks in a Diversified Portfolio



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[3/25/2013] In times of perceived market volatility, one option is to move money out of equities and into fixed income. Another option is to focus on mega-cap companies, which, due to financial strength, tend to hold up well when the market pulls back. In addition, S&P Capital IQ believes many of them are currently undervalued.

According to S&P Capital IQ's Investment Policy Committee, both times the S&P 500 Index has challenged the mid-1500s, two historic bear markets ensued, so we believe some technical hesitation at the all-time closing high of 1565 this time is to be expected. S&P Capital IQ recommends a cautious stance near term, as we think the conditions for a 3%-5% pullback remain intact, before moving higher. From a fundamental standpoint, S&P Capital IQ has a Buy [****] or Strong Buy [*****] recommendation on 17 of the 30 largest companies in the S&P 500 Index. The "smallest" of these 30 heavyweights had a market capitalization of over \$90 billion. These companies also had a number of other favorable characteristics, in our view.

From a risk perspective, we believe it would be hard to find companies with stronger balance sheets, using Standard & Poor's Credit Ratings as the proxy, than the 30 largest companies in the the S&P 500. [S&P Capital IQ operates independently from Standard & Poor's Ratings Services.] While Apple [AAPL 453 *****] and Amazon [AMZN 253 ***] do not have such ratings [they have no long-term debt], the other 28 had investment-grade credit ratings of BBB+ or higher, and 13 had A+ ratings or higher. Separately, 15 of the top 30 have above-average S&P Quality Rankings of A- or higher, which signifies consistent growth of their dividends and earnings in the past 10 years; two stocks do not have an S&P Quality Ranking. The list of mega-cap stocks with strong financial profiles and that are currently considered undervalued according to S&P Capital IQ using these metrics includes Chevron [CVX 121 *****], Exxon Mobil [XOM 89 *****], General Electric [GE 23 ****], Johnson & Johnson [JNJ 79 ****], International Business Machines [IBM 212 ****] and Microsoft [MSFT 28 *****].

Investors could of course purchase shares of these recommended names and other stocks, but that could get pretty expensive rather quickly or limit the number of stocks they hold in their portfolio. A more diversified and low-cost way to play this theme, however, is through mega-cap focused ETFs. While at quick glance two ETFs focused on this theme [one from iShares and one from Vanguard] look rather similar, there are some differences worth understanding.

iShares S&P 100 Index [OEF 70 Overweight]

As the names suggests, OEF owns the 100 largest stocks in the S&P 500 Index and is

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more concentrated in the aforementioned mega-cap companies than the broader index as well as the Vanguard ETF we highlight below. OEF's top-10 holdings as of January 2013, comprised 30% of its assets, with AAPL and XOM comprising approximately 5% each, and about 2.5% each in CVX, GE, IBM and MSFT. Relative to the S&P 500 Index, the ETF's beta of 0.97 indicates it has been slightly less risky than the broader market. Overall, OEF ranks favorably for the S&P STARS, S&P Fair Value, S&P Quality Rankings and Standard & Poor's Credit Ratings inputs. With over \$4 billion in assets and more than 1 million shares traded on average daily, OEF is a highly liquid ETF, in our view.

From a sector perspective relative to the S&P 500 Index, OEF has greater exposure to Consumer Staples [13% vs. 11%], Energy [13% vs. 11%] and Information Technology [22% vs. 18%] and less exposure to Consumer Discretionary [10% vs. 12%] and Financials [14% vs. 16%]. Within particular sub-industries, Pharmaceuticals and Integrated Oil & Gas each made up 8% of OEF's assets [6% and 5%, respectively for the S&P 500 Index].

S&P Capital IQ Equity Research has a positive fundamental outlook for the Integrated Oil & Gas sub-industry for the next 12 months. Michael Kay, who covers these stocks for S&P Capital IQ, looks for integrated oils to benefit from superior earnings, cash flow and dividend quality and growth.

He sees continued M&A activity, notably onshore U.S. Integrated oils continue to restructure and downsize downstream operations. S&P Capital IQ's fundamental outlook for the Pharmaceuticals sub-industry is neutral, due to patent expirations on many top-selling drugs. However, Herman Saftlas, who covers these stocks for S&P Capital IQ, believes overall industry profits should hold up relatively well, helped by expanding sales of new innovative drug therapies and margin improvements accruing from cost restructurings and merger synergies. He also sees benefits accruing from significant expansion of the market stemming from new coverage provided to up to 32 million currently uninsured Americans starting in 2014.

Vanguard Mega Cap Index Fund [MGC 53 Overweight] - changing to CRSP index

MGC is the more diversified of the two mega-cap ETFs here, with approximately 300 positions. Its top-10 holdings are very similar to OEF's, but the weightings, collectively and individually, are lower based on the latest available full holdings. MGC's top-10 holdings

TAKEAWAY

Exposure to these attractive mega-cap companies can be obtained through two ETFs, but the weightings are different.

POSITIVE IMPLICATIONS

CHEVRON CORP	★★★★★	[CVX]
EXXON MOBIL	★★★★★	[XOM]
GENL ELECTRIC	★★★★	[GE]
INTL BUS. MACHINES	★★★★	[IBM]
ISHARES S&P 100 INDEX FUND	OVERWEIGHT	[OEF]
JOHNSON & JOHNSON	★★★★	[JNJ]
MICROSOFT CORP	★★★★★	[MSFT]
VANGUARD MEGA CAP INDEX FUND; ETF SHARES	OVERWEIGHT	[MGC]



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were just 22% of its assets at the end of December before Vanguard changed benchmarks (described below), with AAPL making up 4% and XOM 3%; the other eight were just under 2% each. We think the lower exposure to AAPL and XOM could impact MGC's performance relative to OEF. Year to date, AAPL has declined and XOM has risen only modestly compared to other mega-cap companies. This Vanguard ETF had a beta of 0.99, slightly higher than OEF. MGC's ranking is also helped by the favorable S&P STARS, S&P Quality Rankings and Standard & Poor's Ratings of its holdings. MGC is smaller than OEF, with approximately \$530 million in assets, and trades less frequently with nearly 60,000 shares traded on a daily basis in the past three months. However, this is offset by MGC's expense ratio of 0.12%, which is lower than its peer's 0.20%.

From a sector and industry perspective, MGC at year end looked more like than S&P 500 Index than OEF does. Consumer Staples and Energy were each at 11% of assets as of December, while Financials, at 15%, was slightly lower than the S&P 500 and Information Technology's 20% weighting was slightly higher. Pharmaceuticals and Integrated Oil & Gas are the two largest sub-industries, just as they are for OEF, but the weighting for both is 6%. However, at the end of January, Vanguard transitioned from its prior FTSE benchmark for this ETF to a CRSP one that is constructed differently. Vanguard's website shows that there are 18 fewer stocks as of February 2013, with slightly more in Financials and slightly less in Information Technology, though this could also be the result of sector performances. Top-10 holdings were still 22% of assets.

For investors seeking a way to gain exposure to mega-cap companies, many of which we believe have attractive valuations and strong financial profiles, in a low-cost, diversified way OEF and MGC are worthy of additional attention, in our opinion. But there are distinctions related to each ETF's holdings and costs that differentiate them.

Todd Rosenbluth

S&P Capital IQ Director of ETF Research

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How to Lower Your Volatility but Stay in the Market



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[3/19/2013] The Dow Jones Industrial Average is at record levels, the S&P 500 Index is nearing its own all-time high, and a consensus market poll of professional and retail sentiment recently registered 75%. With all of these signs of investor optimism, it might be surprising that low or minimum volatility equity exchange traded products have also experienced unusually strong demand and are performing quite well thus far in 2013.

According to BlackRock, in the first two months of 2013, the 34 low or minimum volatility exchange traded products gathered on average \$926 million in new assets each month, more than double what was added to them a year earlier. In this group are ETFs that offer exposure to U.S. markets, international markets and emerging markets. Most of the ETFs are from iShares and PowerShares, although in February 2013, SSGA launched two low volatility products tied to domestic Russell indices.

We think the appeal of these ETFs is that the benchmark they seek to replicate is not a broad one, but rather a narrow one that steers away from the most volatile stocks based on historical beta or standard deviation. Of course, a stock that has previously exhibited low-volatility traits could move more than the market for a variety of fundamental reasons, but a portfolio of 100 or more stocks dampens that possibility. [Please note that past performance is no guarantee of future results.]

S&P Capital IQ's Investment Policy Committee believes the S&P 500 Index will likely experience setbacks in prices both before and shortly thereafter establishing a new high, but will remain in a long-term bull market. We think investors wanting to stay invested in the market but protect some of their downside should look at one of these low volatility products as the benchmarks they seek to replicate have strong records in flat and down markets, while only lagging somewhat in recent up markets. For example, the S&P 500 Low Volatility Index [Low Vol] was down just 21.4% in 2008, compared to the 37.0% decline in the S&P 500 Index. In 2010, Low Vol was up 13.4%, vs. 15.1% in the broader index. But then in 2011, Low Vol Index rose 14.8% versus the 2.1% gain for the S&P 500 Index. In the five-year period ended February 2013, Low Vol's total return was 9.4%, much higher than 4.9% for the S&P 500 Index, while its standard deviation was 12.5 much lower than the 18.9 for the S&P 500 Index. [S&P Capital IQ operates independently from S&P/Dow Jones Indices.]

Interestingly the two largest, domestically focused ETFs in this space, both launched in 2011, are constructed quite differently. Whether one or the other fits best in your or your client's portfolio is not for us to say, but we hope to help showcase the distinctions.

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PowerShares S&P 500 Low Volatility [SPLV 30 Overweight] is the larger and more actively traded of the two. Since launching in May 2011, SPLV has grown considerably, with approximately \$4 billion in assets. Thus far in 2013, SPLV is up 9.9% (through March 18), compared to 9.3% for the SPDR S&P 500 [SPY 155 Overweight]; we are comparing it to an ETF and not an Index since the expenses are unavoidable. SPLV holds the 100 least volatile stocks in the S&P 500 Index, regardless of its sector representation. As such, the ETF will often have significantly high and low sector exposure relative to the traditional S&P 500 Index. For example, at the end of January, the more defensive Utility sector made up 31% of SPLV's assets [3.4% for the S&P 500 Index] while Consumer Staples was 27% [11%]. In contrast, the more cyclical Consumer Discretionary sector was 2.8% [11%] and the Information Technology sector was 3.6% [18%].

SPLV earns a risk consideration ranking input of Overweight from S&P Capital IQ. One main reason is that the S&P Quality Rankings of its holdings is favorably strong. Indeed, 7 of top 10 holdings had a Quality Ranking of A- or higher for their strong and consistent earnings and dividend record over the last 10 years; historically, above-average S&P Quality Ranked companies have incurred less

volatility than below-average companies. General Mills [GIS 46 Buy] and Wisconsin Energy [WEC 41 Hold] are two such holdings with S&P Quality Rankings of A. In addition, the gross expense ratio of 0.25% is favorably low and the bid ask spread is tight; approximately 1.7 million shares were traded daily in the past month. SPLV has a 2.8% yield.

iShares USA Minimum Volatility Index Fund [USMV 32 Marketweight] is the smaller of the two, but its \$1.8 billion in assets makes USMV the third most successful equity ETF to launch since May 2011. Thus far in 2013, USMV is up 9.7%, compared to 9.3% for the more broadly diversified iShares MSCI USA Index [EUSA 34 Overweight]. USMV holds 128 stocks out of the 605 stocks in EUSA. While the percentage of assets the top-10 holdings represents is similar for USMV [15%] and SPLV [13%], the sector weightings are much different. This is largely the result of the approach that MSCI uses for its minimum volatility index, where the sector weights will not deviate from the parent index by more than 500 basis points. USMV's largest sector weightings were in defensive sectors Health Care, with 17% of assets, [12% for the MSCI USA index] and Consumer Staples, with 16% [11%]. However relative to SPLV, USMV had much more in cyclical sectors such as Information Technology, at 14%, [18%] and Consumer Discretionary, at 8% [12%].

TAKEAWAY

Low volatility ETFs not only have strong risk considerations, according to S&P Capital IQ, but have performed well in '13.

POSITIVE IMPLICATIONS

ISHARES MSCI USA MINIMUM VOLATILITY INDEX FUND	OVERWEIGHT	[USMV]
POWERSHARES S&P 500 LOW VOLATILITY PORTFOLIO	OVERWEIGHT	[SPLV]

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Similar to SPLV, USMV earns a top risk considerations ranking from S&P Capital IQ in part for the high Quality Rankings of its holdings. Five of the top-10 positions are A- or higher, including Automatic Data Processing (ADP 64 Buy) and McDonalds (MCD 99 Buy). The expense ratio for USMV is also quite cheap, at 0.15%, and the bid ask spread is relatively tight; approximately 550,000 shares traded daily in the past month. USMV has a 1.8% yield.

All told, USMV is more diversified at the sector level than SPLV, but has less exposure to traditionally defensive sectors that typically hold up best in volatile markets. Both are inexpensive, by our analysis, and hold stocks that S&P Capital IQ views as incurring less risk. For investors looking to stay invested but hoping to reduce their risk profiles, we think both SPLV and USMV are worth further scrutiny. S&P Capital IQ ETF reports on them can be found at the ETF tab of MarketScope Advisor.

Todd Rosenbluth

S&P Capital IQ Director of ETF Research

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Pharmaceutical ETFs for Total Return



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[3/19/2013] S&P Capital IQ Investment Strategy has a marketweight recommendation on the S&P Pharmaceuticals sub-sector, which comprises about 44% of the S&P 500 Health-care sector, and about 5.2% of the total S&P 1500 Composite Index. Although pharmaceutical companies continue to face top-line pressure from patent expirations on many top-selling drugs, as well as from foreign exchange fluctuations and austerity pricing in Europe, we believe overall industry profits should hold up relatively well, helped by expanding sales of new innovative drugs and margin improvements accruing from cost restructurings and merger synergies. EPS comparisons should also benefit from common share buybacks.

After modestly underperforming the S&P Composite 1500 Index last year, drug stocks have performed better than the overall market so far in 2013, with the Pharmaceutical sub-sector rising 12.2% through March 15, versus a 9.7% gain in the S&P 1500. We attribute recent strength in the pharmaceutical space to several factors, including investor rotation to recession resistant sectors such as pharmaceuticals, and high yielding investments.

We also think the group should see easier year-to-year sales and earnings comparisons over the coming quarters, as the effects of last year's heavy patent expiration losses wind down. The sector sustained unprecedented generic erosion in 2012 with patents expiring on drugs generating close to \$47 billion in annual sales, based on data provided by IMS Health.

With the U.S. pharmaceutical industry deriving close to 40% of its sales abroad, foreign exchange is typically a significant factor affecting sales and profits. Although foreign exchange has been generally unfavorable in recent months, we think comparisons are likely to stabilize over the balance of the year. Results in 2013 should also benefit from the recent implementation of a new round of price increases, ongoing cost streamlining measures and common share repurchases. New product flow and dividend increases should also bolster drug stocks.

Another key factor supporting the drug sector, in our opinion, is improving investor perceptions with respect to the potential of an unfolding new product cycle. After several years of relatively lackluster R&D productivity, we see a new wave of therapies emerging, which should support the sector growth over the coming years.

Some of the more promising new products for which we foresee blockbuster potential include canagliflozin, a novel treatment for type 2 diabetes from Johnson & Johnson [JNJ 79 ****]; empagliflozin, another new diabetes therapy from Eli Lilly [LLY 55 ***]; elotu-

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zumab for multiple myeloma from Bristol-Myers Squibb [BMJ 39 ***]; suvorexant, a novel type of sleeping pill from Merck [MRK 44 ****]; Xeljanz, a novel oral therapy for rheumatoid arthritis from Pfizer [PFE 28 ****]; Eliquis, a potential best in class blood thinning agent co-developed by Pfizer and Bristol-Myers Squibb; and potential breakthrough therapies for hepatitis C from Abbvie [ABBV 38 ****] and Bristol-Myers Squibb.

U.S. health care reform legislation is expected to continue to hamper industry profitability, primarily through price discounting in the Medicare Part D prescription drug program, and higher fees. However, we believe these drawbacks should be largely offset by benefits accruing from significant expansion of the market, with new coverage potentially being provided for up to 30 million currently uninsured Americans. The latter program is expected to begin to be phased in during 2014. On the negative side, we note that the government's new sequestration program is likely to result in cutbacks in utilization and pricing in drugs used by Medicare beneficiaries.

The U.S. Big Pharma group (excluding a few outliers) presently trades at 13.5X our 2013 EPS estimate, representing about a 6% discount from the 14.3X multiple for the S&P 1500 Index. Pharma dividends are also highly attractive, in our view, with average yields ranging in the 4%-5% area. We believe strong cash flow generation should provide support for dividends, which remain a high investor priority.

For investors seeking exposure in pharmaceuticals, we suggest investors consider the following three pharmaceuticals specific ETFs: iShares Dow Jones US Pharmaceuticals Index Fund [IHE 95 Overweight], PowerShares Dynamic Pharmaceuticals Portfolio [PJP 38 Marketweight], and SPDR S&P Pharmaceuticals ETF [XPH 62 Marketweight]. In terms of portfolio composition, both IHE and PJP are heavily weighted toward Big Pharma names such as Pfizer, Merck, Johnson & Johnson and Eli Lilly in terms of their top ten holdings. XPH, on the other hand, is more focused on smaller generic and specialty pharmaceutical stocks.

S&P Capital IQ uses three proprietary broad input categories to calculate the overall rankings for ETFs. These include: Performance Analytics, based on S&P's STARS, Fair Value and Technical Indicators; Risk Considerations, which looks at Quality Rank, Risk Assessment, Standard & Poor's Credit Rating [which is derived independently of S&P Capital IQ] and Standard Deviation; and Cost Factors, which looks at the expense ratio and Price to NAV.

TAKEAWAY

We believe drug stocks provide investors long-term growth and generous dividend income.

POSITIVE IMPLICATIONS

ABBVIE INC	★★★★	[ABBV]
BRISTOL-MYERS SQUIBB	★★★	[BMY]
ISHARES DOW JONES US PHARMACEUTICALS INDEX FUND	OVERWEIGHT	[IHE]
JOHNSON & JOHNSON	★★★★	[JNJ]
LILLY [ELI]	★★★	[LLY]
MERCK & CO	★★★★	[MRK]
PFIZER, INC	★★★★	[PFE]
POWERSHARES DYNAMIC PHARMA PORTFOLIO	MARKETWEIGHT	[PJP]
SPDR S&P PHARMACEUTICALS ETF	OVERWEIGHT	[XPH]

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We have an overall overweight ranking for IHE based on its overweight scores in performance analytics and cost factors, which more than offset a marketweight score in risk considerations. However, PJP and XPH are ranked as overall marketweights, as both have only marketweight rankings for risk considerations and cost factors, more than offsetting their overweight scores in performance analytics.

Herman Saftlas

S&P Capital IQ Equity Analyst

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The Dividend Aristocrats of the Dow Jones Industrial Average



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[3/19/2013] Consider these facts: 1) the Dow Jones industrial average recently hit an all-time high; 2) U.S. corporations have record levels of cash on their balance sheets and are increasingly bestowing that cash on shareholders in terms of dividends; 3) investors are yield-hungry, as the bond market continues to offer relatively low yields.

S&P Dow Jones Indices Senior Index Analyst Howard Silverblatt considered those facts and decided to construct a screen to determine the best potential investments to take advantage of these trends. He started with the 30 stocks in the Dow Jones industrial average, then screened for those that increased their dividends annually for at least 30 years.

The result is what Silverblatt has dubbed the "Dow 30-30" or the "magnificent seven": 3M [MMM 106 ****], Coca-Cola [KO 39 *****], ExxonMobil [XOM 89 *****], Johnson & Johnson [JNJ 79 ****], McDonald's [MCD 100 ****], Procter & Gamble [PG 77 ***], Wal-Mart Stores [WMT 73 ***].

The concept is similar to the "Dividend Aristocrats" compiled by S&P Dow Jones Indices. Silverblatt notes there are 105 issues in the S&P 1500 Dividend Aristocrats. To be an S&P 1500 Dividend Aristocrat, a company must be a constituent of the S&P 1500, and it must have increased its dividend every year for the last 20 years. There are 54 issues in the S&P 500 Dividend Aristocrats, which must have at least 25 years of annual increased dividend payments. An exchange-traded fund, SPDR S&P Dividend ETF [SDY 65 Overweight], invests in Dividend Aristocrats.

Silverblatt notes the S&P 500 indicated annual dividend rate has reached \$300 billion for the first time ever. "The record \$300.2 billion indicated annual dividend rate for the 500 companies in the index is 18.8% above the June 2008 level of \$252.7 billion, its last peak before it began its decline," he says. "It is 59.5% above its \$188.2 billion bottom level it reached in July of 2009."

"U.S. companies are showering investors with a record windfall in the form of dividends and share buybacks, helping to propel the stock market's rally," reported The Wall Street Journal on March 8, adding, "The Federal Reserve on Thursday [3/7/13] paved the way for more activity. In its 'stress tests' of banks' financial health, the Fed said 17 of the largest U.S. financial groups have enough capital to keep lending even if the economy were to take a sharp downturn. Several banks are now expected to boost dividends and share buybacks."

That represents a significant turnaround for the financial services sector, where many companies were forced to cut their dividends in the aftermath of the financial crisis in

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2008/2009. While many investors may be looking for income from financial services equities, a different approach would be to stick with the long-term consistent dividend payers.

For example, S&P Dow Jones Indices' Silverblatt notes, "if you would have invested \$1,000 in each of the 'magnificent seven' at the end of 1982, your \$7,000 investment would have been worth \$425,581 at the end of 2012, a 14.7% annualized return."

Silverblatt notes that the Dow Jones Industrial Average is dividend rich to begin with, boasting a higher current yield [2.5%] than the yield on the S&P 500 index [2.1%].

Silverblatt says dividend yields remain very competitive compared to other investments. "Investors have few choices as income remains low," he observes. He also notes the tax deal that was part of the "fiscal cliff" negotiations was a blessing for individual investors. "I remember when dividends were taxed at 70%, and that was before New York state and New York City got a hold of you," he says. Under the fiscal cliff compromise reached several months ago, dividend taxes will rise to 20% this year from 15% for

people making more than \$450,000 a year. For those earning less than \$450,000 per year, dividend taxes remain 15%. Additionally, those with high incomes will also pay a 3.8% surcharge to fund Obamacare. However, dividend recipients dodged a big tax hit: dividend tax rates were scheduled to rise to 39.6% before the fiscal cliff deal was struck.

Silverblatt also points out corporate payouts remain low at 36% compared to the historical 52% rate. "Corporate cash is at an all-time high, with strong cash-flow, even as earnings have recently lacked growth," he notes.

In the S&P 500, 406 companies pay dividends, the most since November 1999, when 407 companies were paying dividends. Silverblatt estimates that more than 60% of the S&P 500 issues will pay more in 2013 than in 2012.

Barney Brodie
S&P Capital IQ Editorial

TAKEAWAY

Companies are returning record amounts of cash to shareholders in dividends.

POSITIVE IMPLICATIONS

3M CO	★★★★	[MMM]
COCA-COLA CO	★★★★★	[KO]
EXXON MOBIL	★★★★★	[XOM]
JOHNSON & JOHNSON	★★★★	[JNJ]
MCDONALD'S CORP	★★★★	[MCD]
PROCTER & GAMBLE	★★★	[PG]
SPDR S&P DIVIDEND ETF	OVERWEIGHT	[SDY]
WAL-MART STORES	★★★	[WMT]

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Offshore Drillers' Cash Flow Appears Buoyant

There is a race taking place in the world of oil and gas drilling - namely, to build new drilling rigs that customers are willing to lease out, at attractive dayrates. The race itself is not new, as the start of the current generation of "newbuilds" really started to accelerate in 2006, but we think it still has many laps to go.

First, some context. Using data from IHS Petrodata, an industry data and research provider, we find that there are 787 offshore drilling rigs worldwide. This includes the oldest unit still in existence (built in 1958) as well as seven new units delivered so far in 2013. What's noteworthy about this number is that it includes both the 'marketed' rigs (the units where the unit is working, or where the rig owner is actively seeking new work for it) as well as non-marketed rigs. This latter category essentially includes cold-stacked units, which are rigs that have no real chance at going back to work because they would require too much shipyard work to bring them back into service. For the most part, this group includes old iron. Thus, taking into account only the marketed units, the global supply drops to 728, implying 59 units not being marketed. Of these 59 units, 51 were built in the last great newbuild heyday of 1974-1983, and only one non-marketed unit was built in the last 25 years. As this group ages, we expect that the prevalence of cold-stacking will increase as well. Of the 728 actively marketed rigs, 686 units are currently working, yielding a utilization rate of 94%.

The pace of newbuilding activity picked up again in 2006. As of late February 2013, there were 184 units either on order or under construction, implying about a 25% addition to the current marketed supply. While this initially may sound like a lot, in our view, there is room for more. The period 1974-1983 ushered in 379 new units, and excluding the 51 not being marketed, that still leaves 328 older units from the last great newbuild cycle. These 328 units will need to be replaced at some point, and the 184 being built only gets us 56% of the way there.

So while there appears to be a need for more offshore rigs, and while the offshore drillers are already at various stages of organic growth, are these drillers in any position to be building more than they already are? In our view, yes. We looked at Capital IQ consensus estimates for five of the larger offshore drillers in our coverage universe, namely Transocean (RIG 53 ***), Ensco plc (ESV 59 ****), Noble Corp. (NE 36 ***), Diamond Offshore (DO 69 ***) and Rowan Companies (RDC 35 ****). We looked at consensus estimates of cash from operations, capital spending and dividends, to get a sense for available free cash flows after eliminating some alternate uses of cash (we did not include potential share repurchases here, as we view them as largely unpredictable and opportunistic). Based on these data, we calculate an aggregate estimate of \$22 billion in free cash flow

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between 2013 and 2017. Notably, estimated free cash flows appear negative in 2013, but are seen recovering to positive territory in 2014-2017, indicative of much spending occurring this year and then tapering off thereafter.

What can \$22 billion buy you today? A fair number of offshore drilling rigs. The price points vary tremendously depending on whether we are talking about shallow water jackups [recently built in the \$200 million area] or ultradeepwater floaters [\$600 million area]. To keep this simple, we'll presume that new rig additions are roughly split 50/50 between jackups and floaters, which is consistent with the current order book [48% jackups, 52% floaters]. Allowing for \$11 billion apiece, that could allow these five offshore drillers to construct 55 new jackups and 18 new floaters, or 73 new units combined. In other words, there's enough cash flow out there to expand the order book by about 40%, and that's just focusing on five of the larger offshore drillers, which collectively account for about 40% of global supply.

TAKEAWAY

The newbuild drilling cycle still has legs to it, in our view.

POSITIVE IMPLICATIONS

ENSCO PLC CL'A'	★★★★	[ESV]
MARKET VECTORS OIL SERVICES ETF	OVERWEIGHT	[OIH]

Who else could benefit from new rig orders? How about the oilfield capital equipment companies who make many of the individual components on these rigs. National Oilwell Varco [NOV 68 *****] and Cameron International [CAM 55 ***] both are major providers in this regard. A drilling package on a new floater, for example, could result in additions to backlog in the \$200 million area.

Finally, one way we see to play these names cited here, in a cost-efficient manner, is via ETFs, or exchange traded funds. The Market Vectors Oil Services ETF [OIH 43 Overweight] includes four of the above names in its current top 10 holdings and has a net expense ratio of just 0.35%.

Stewart Glickman, CFA

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ETFs That Should Benefit from Positive Consumer Finance Trends



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[3/13/2013] Tough lessons appear to have been learned from the 2008-2009 financial crisis as we see record low loss rates at some of the biggest consumer finance companies that we follow. We would characterize the US consumer as reformed, prudently cautious, and view its financial profile as improving. We also believe many publicly traded lenders fit the same profile; therefore, we have a positive view on the consumer finance sub-sector. We have seen the consumer deleverage and household savings rates rise, and consumers appear to be prudently cautious in taking on new debt. Also helpful, the housing market appears to be rebounding. Some of the key statistics that have historically driven profitability of the consumer finance business have included consumer confidence, consumer credit growth, and positive employment trends. Many of those key drivers are looking up.

The Conference Board Consumer Confidence Index rebounded in February to 69.6, from 58.4 in January and up from the trough of under 28 since the index was started in 1967. Consumers' outlook for jobs was also more positive. According to the Conference Board, those anticipating more jobs in the months ahead improved to 16.7% in February from 14.4% in January. Unemployment fell to a four-year low of 7.7% in February, the lowest rate that we have seen since December 2008 and down from the October 2009 peak of 10%. When annualized and seasonally adjusted, consumer credit outstanding grew 7.0% in January, up from 5.9% growth in 2012; this reveals an acceleration from 3.4% growth posted in 2011, a 1.3% decline in 2010 and a 4.5% decline in 2009. Non-revolving loan growth has been vibrant, and revolving credit has been essentially stable over the past year or so. [This is a recovery from the 7% and 9% declines in revolving credit seen in 2010 and 2009, respectively.] Auto finance is among the fastest growing segments of the non-revolving loan marketplace, and while we are cautious as we are hearing that loan terms are lengthening, we are not overly concerned at this stage as loan-to-value ratios appear to be holding up and there is healthy demand for used cars. When managed carefully, consumer finance loans can be more profitable than commercial loans due to the ability to charge relatively high interest rates. The Federal Reserve recently reported that interest rates on 24-month personal loans were around 10.6% in January, while credit card interest rates averaged 11.9% and 48-month new car loans were 4.8%.

The consumer finance sub-industry group rose 29.9% in price in 2012, substantially outperforming the 13.7% posted by the S&P 1500, as credit quality metrics hovered around levels of historical strength leading to attractive profits. So far this year, the consumer finance index has lagged the broader market. Year to date, the consumer finance subsector gained 6.2% compared to 8.9% for the S&P 1500. Larger cap companies included in the consumer finance sub-industry group are American Express Company (AXP 65 *****),

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Capital One Financial [COF 55 ****], Discover Financial Services [DFS 42 ***] and SLM Corp [SLM 19 ***].

In our view, lenders also learned from major lending mistakes pre-crisis. Lenders tightened up credit standards during the recession through lower loan to value ratios [LTVs], shorter term lengths, higher FICO score requirements, and better overall understanding of the consumer. And due to de-leveraging goals and an extra nudge from regulators, we think balance sheets are in pretty good shape. On March 7, 2013, results of the Federal Reserve's stress tests were released. The 18 bank holding companies evaluated that have significant consumer finance businesses and earned a "well capitalized" assessment included American Express, Capital One Financial, Citigroup [C 48 ****], JPMorgan Chase [JPM 51 ****], Bank of America Corporation [BAC 12 ***], Wells Fargo & Company [WFC 37 ***] and U.S. Bancorp [USB 34 ***]. Thus, the next challenge is generation of loan growth in a risk-averse marketplace. In our view, the key to unlocking appetite for loan growth may be less about marketing [as was the case pre-recession] and more about consumer confidence, home values, the ability to sell a home, having a job that pays more than the bills, and having job options.

With that, we assessed the ETF screening function in MarketScope Advisor. We searched for exchange traded funds that were focused on financials [there were 86 funds to choose from] ranked as Overweight [taking our choice down to 15 funds], with over \$50 million in assets and over three years old [taking us down to eight funds], and that were heavy on stocks that we believed had a tie to the consumer's financial outlook. We identified two funds from the BlackRock fund advisors family- the iShares Dow Jones US Financial Sector Index Fund [IYF 68 Overweight] and iShares Dow Jones US Financial Services Index Fund [IYG 67 Overweight], both of which also happened to be among the three most mature funds in the group.

Both funds use the Dow Jones US Financial Services Index as their benchmark and have been trading since 2000. While they appear to compete with each other, we discovered the following significant differences: as of January 2013, IYG was 100% equity while IYF was

TAKEAWAY

Consumers drive 2/3 of GDP, so consider investing in an ETF with consumer finance exposure.

POSITIVE IMPLICATIONS

AMER EXPRESS	★★★★★	[AXP]
BANK OF AMERICA	★★★	[BAC]
CAPITAL ONE FINANCIAL	★★★★★	[COF]
CITIGROUP INC	★★★★★	[C]
DISCOVER FINANCIAL SVCS	★★★★★	[DFS]
ISHARES DOW JONES US FINANCIAL SECTOR INDEX FUND	OVERWEIGHT	[IYF]
ISHARES DOW JONES US FINANCIAL SERVICES INDEX FUND	OVERWEIGHT	[IYG]
JPMORGAN CHASE & CO	★★★★★	[JPM]
MASTERCARD INC'A'	★★★	[MA]
SLM CORP	★★★	[SLM]
U.S. BANCORP	★★★	[USB]
VISA INC'A'	★★★	[V]
WELLS FARGO	★★★	[WFC]

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76% domestic equity, 4% international equity and 20% real estate. Also, the IYF ETF had higher liquidity with 369,311 average daily volume, 12.3 million shares outstanding and \$833 million market cap as of March 8, compared to IYF's 49,324 average daily volume, 7.3 million shares outstanding and \$481 million market cap. Within the top 10 holdings as of March 8, 2013, both exchange traded funds included JP Morgan Chase, Wells Fargo, Citigroup, Bank of America Corp, Visa Inc. [V 161 ***], Goldman Sachs Group Inc [GS 153 ***], US Bancorp and American Express. Both funds carried a gross expense ratio of 0.47%, higher than some of the other financial services ETFs that we looked at, which ranged from 0.18%-0.35%. Both funds posted total returns of over 11% year-to-date as of March 8. Also, IYF held 260 positions in its fund, more than double IYG's 113 holdings as of January 31, 2013. Yet, IYG had an average price/earnings ratio of just 19X, a 17% discount to IYF's 23X as of January 31, 2013.

Of the three primary factors that S&P uses to rank ETFs, IYG was awarded overweight for performance analytics and cost factors and marketweight for risk factors. As of January 31, 2013, the top 10 holdings of IYG represented 60% of the ETF's assets, and stocks were 71% mega cap, 20% large cap, and 9% mid-cap. In addition to the shared top holdings as mentioned earlier, IYG included MasterCard Inc [MA 530 ***] and Capital One Financial. As of January 31, 2013, the IYG fund was 90% financials, over 9% information technology and less than 1% industrials and other. The fund had turnover of 4% as of March 8. For the key three-year track record, the CAGR return was almost 7% while the 12-month return was 27% as of March 8.

Of the three primary factors that S&P uses to rank ETFs, IYF received overweight ranks for cost factors and marketweight for performance analytics and risk considerations. As of January 31, 2013, the top 10 holdings of IYF represented 39% of the ETF's assets and stocks were 48% mega cap, 31% large cap, 14% mid cap and the remainder not specified, and the fund was 94% financials, 5% information technology [such as Visa and MasterCard] and the remainder industrials and other. In addition to the shared top holdings as mentioned earlier, IYF also included Berkshire Hathaway Inc. [BRK.B 104 NR] and American International Group Inc. [AIG 40 ****]. The fund had turnover of 6% as of March 8. For the key three-year track record, the CAGR return was 9% while the 12-month return was 25% as of March 8.

Historically, the consumer has been responsible for around two-thirds of GDP in the US, so assuming economic improvement continues, positive consumer trends should help fuel the ETFs with higher emphasis on consumer finance.

Sonia Parechanian

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Media Mentions

A compilation of news clippings highlighting S&P Capital IQ's influence in the ETF marketplace.

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March 4, 2013

"Commentary: Many Offerings have little or no management track record."



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"Foreclosure starts are rising for the first time since 2009, and we see higher home prices inviting more sellers to the market, pressuring sales of new homes."



[Here's What Fidelity ETF Might Look Like](#)

March 14, 2013

"Rosenbluth says Schwab's attempt to gain market share has been hampered by the fact that its stock ETFs are still too new to have 3-year performance records."



[Avoid Europe Stock Market ETFs: Strategists](#)

March 18, 2013

"S&P Capital IQ downgraded its rating on the S&P Europe 350 Index to "underweight," noting that price-earnings ratios have reached a multi-year high. Excess liquidity, inflation expectations and low interest rates have driven stock prices in recent years."



[Which ETFs to Play After the Cyprus Surprise](#)

March 18, 2013

"Investors would do better now to invest in Europe indirectly through specific sector funds, Rosenbluth pointed out. Companies involved with food and beverages, personal and household goods, technology, and travel and leisure are most attractive, he said. Conversely, Rosenbluth advised lightening up on chemicals, media, telecom and utilities stocks."



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