

CONTRIBUTOR

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In recent years, the amount of dividends issued by companies listed in China's equity markets has gradually increased.

Accessing China's Growth via Dividends

The Chinese government appears to be committed to continuing structural reforms and supporting economic growth. Initiatives with these goals in mind are generally viewed as positive and may put China on a more sustainable growth trajectory in the long run. However, current reforms may be accompanied by volatility in the country's economy and capital markets. In such an environment, a focus on growing and sustainable dividends can offer a relevant approach to investing in China's equity markets. This could provide the opportunity to get a slice of the region's structural growth and its potential outperformance throughout the cycle.

This paper gives an overview of the current status of dividend payouts by Chinese companies, the unique features of dividend policies by state-owned enterprises (SOEs) and family-run businesses, and the dividend-related policies and regulations issued by the Chinese authorities. It then reviews the [S&P China A Share Dividend Opportunities Index](#), which is designed to offer a transparent, rules-based, and investable strategy for market participants looking for exposure to China's growth via dividends.

DIVIDEND PAYOUTS BY CHINESE COMPANIES

How China Has Evolved

In recent years, with the release and implementation of a series of dividend-encouraging policies issued by Chinese authorities, the amount of dividends issued by companies listed in China's equity markets has gradually increased. Furthermore, the total amount of dividends and the proportion of companies that issue dividends are increasing as well.

Exhibit 1 illustrates these improvements from 2011 to 2016. According to the 2016 financial reports and interim reports, there were 1,570 companies in the [S&P China A BMI](#) that declared dividends, representing 68% of the S&P China A BMI universe, much higher than the 54% reported in 2009. The size of the total dividend pool for companies in the S&P China A BMI was USD 94 billion in 2016, nearly four times the size of the dividend pool in 2009. The dividend payout ratio was 33.7% in 2016, 7.4% higher than in 2009.

Exhibit 1: Dividends – How China Has Evolved

YEAR	SIZE OF DIVIDEND POOL (USD BILLIONS)	DIVIDEND PER SHARE	EARNINGS PER SHARE	DIVIDEND PAYOUT RATIO (%)	% OF DIVIDEND-PAYING COMPANIES	TRAILING 12-MONTH DIVIDEND YIELD (%)
2009	24.36	0.11	0.43	26.3	53.6	0.72
2010	30.66	0.13	0.54	25.0	58.8	0.82
2011	42.82	0.18	0.67	27.8	63.3	1.34
2012	54.79	0.24	0.72	33.4	70.0	1.59
2013	63.41	0.20	0.70	29.2	71.0	1.77
2014	70.03	0.23	0.77	29.6	69.6	1.27
2015	81.24	0.23	0.70	33.4	68.00	1.15
2016	94.13	0.25	0.74	33.7	67.53	1.48

Source: S&P Dow Jones Indices LLC, FactSet. Data for S&P China A BMI constituents from Dec. 31 to 2009 to 2016. Dividend per share and earnings per share are reported in RMB. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

How China Compares With International Markets

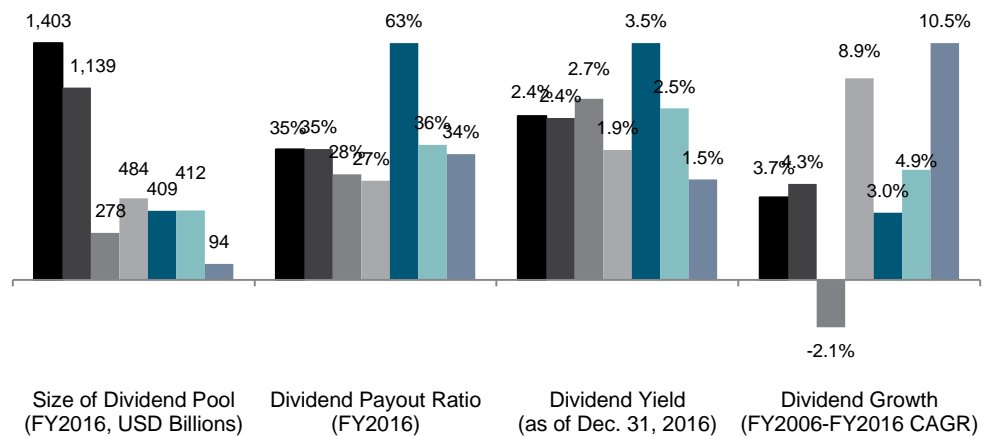
Compared with companies from other parts of the world, Chinese companies tend to offer faster dividend growth. Therefore, an allocation to Chinese dividend-paying equities could provide the opportunity to participate in the dividend growth trend among Chinese companies.

Exhibit 2 is illustrative of this point. Over the past 10 years, Chinese equities provided an annual dividend growth rate of 10.5%, which is far higher than equities in Pan Asia, Europe, and the U.S. The growth was mainly driven by improved earnings rather than an increased dividend payout ratio (see Exhibit 1).

The Chinese companies' dividend payout ratio was 34% in 2016. This level is in line with or lower than international markets, implying higher sustainability of dividend payouts and the potential for a further increase in dividend payouts from one of the lowest global levels.

Compared with companies from other parts of the world, Chinese companies tend to offer faster dividend growth.

Exhibit 2: Dividends – How China Compares With International Markets



Source: S&P Dow Jones Indices LLC, FactSet. Data from 2006 to 2016. Regions are represented by the S&P Global BMI, the S&P Developed BMI, the S&P Emerging BMI, the S&P United States BMI, the S&P Europe BMI, the S&P Pan Asia BMI, and the S&P China A BMI. Dividend growth is based on the compound annual growth rate of index dividend per share. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

How SOEs and Family-Run Businesses Factor In

One unique characteristic of Chinese companies is that they tend to have more concentrated company ownership, either in the form of a founding family or a government-affiliated entity.

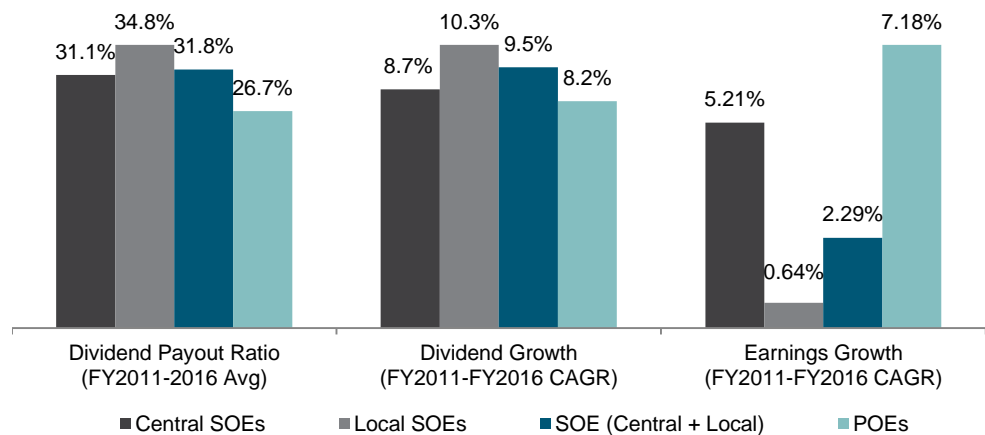
One unique characteristic of Chinese companies is that they tend to have more concentrated company ownership, either in the form of a founding family or a government-affiliated entity. Among companies in the [S&P China A BMI](#), the largest shareholder owned an average of 40% of the total shares in a given company, as of Dec. 31, 2016. This indicates a high concentration of ownership. The insider position was as high as 54% as of the same date. These are typically held by central or local governments, domestic financial institutions, SOEs, or a founding person or family.

The implications this highly concentrated ownership has on dividend investment are three-fold. First, many of China's initial public offerings (IPOs) are due to the privatization of large stakes in SOEs and family-run businesses. These are typically mature companies that pay dividends from the beginning of their public listings. This explains the fast growth of dividend pools in China.

Second, dividends may provide a sign of positive corporate governance in China. Under the conditions of high ownership concentration and weak legal protection for small- and medium-sized shareholders in China, the distribution of dividends can be used as a way to limit large shareholders' ability to expropriate minority shareholders' rights or improper government intervention in the listed companies. It demonstrates solid management and a respect for the rights of all shareholders, particularly individuals. As a result, discipline in relation to dividend policies can help identify healthy companies.

Third, many of the largest dividend-paying Chinese companies are SOEs with a high degree of direct or indirect government ownership. Therefore, the Chinese government influences the companies' earnings and dividends. Given the explicit government support to improve dividend policies, these companies tend to return a greater share of earnings to shareholders via dividends. Exhibit 3 shows the higher payout ratio by SOEs compared with private-owned enterprises (POEs) from 2011 to 2016 and the strong dividend growth rate of the SOEs with local governments as the largest shareholders. A skeptic might wonder if dividend growth can be relied on in an environment where it is driven by government—the stats of POEs may be more reliable because those companies presumably make economic decisions about dividend policies, and it is notable that those dividends have grown fastest.

Exhibit 3: Dividends – SOEs Versus POEs



Source: S&P Dow Jones Indices LLC, FactSet. Data from 2011 to 2016. Universe is the S&P China A BMI. Dividend growth and earnings growth are based on compound annual growth rate of index dividend per share and earnings per share. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The China Securities Regulatory Commission (CSRC) implements so-called “quasi-mandatory payout regulations”—meaning listed firms that wish to obtain refinancing in the future have to fulfill the requirement on dividend payouts.

Payout Regulations and Tax Policies in China

To encourage dividend payouts and increase long-term investment returns, Chinese authorities have released and implemented a series of policies in recent years, with a focus on improving listed companies' dividend policies and formulating tax policies related to dividends.

The China Securities Regulatory Commission (CSRC) implements so-called “quasi-mandatory payout regulations”—meaning listed firms that wish to obtain refinancing in the future have to fulfill the requirement on dividend payouts. The CSRC set a minimum payout level for the first time in 2006. Cumulative dividends (including cash dividends and stock dividends) paid during the three years before public financing should not be less than 20% of average net income over the same three-year period. In

2008, the CSRC modified this regulation by increasing the respective payout level to 30%, and it excludes the option for stock dividends.

Capital gains are not taxed in China, but dividends were taxed at 20% prior to 2005. The State Administration of Taxation (SAT) gradually removed the individual income tax rate on dividends. As shown in Exhibit 4, for individual investors who hold the stock for more than a year, the rate became 10% in 2005 and was further reduced to 5% in 2013, and the dividend tax was fully exempted as of Sept. 8, 2015. These policy changes are examples of important steps to increase the likelihood of companies making dividend payments, protect the interest of minority shareholders, and encourage public investment.

For readers interested in finding out the dividend tax rates of shares invested in China's A share market through the QFII, RQFII, and Shanghai Hong Kong Stock Connect Program, see the Appendix.

Exhibit 4: A Share Tax Rates for China's Onshore Individual Investors and Securities Investment Funds

TAX TYPE	HOLDING PERIOD OF SHARES	BEFORE 2005	2005 TO 2012	2013 TO SEPT. 7, 2015	AS OF SEPT. 8, 2015	CURRENT WITHHOLDING METHOD
Capital Gain	Any	0%	0%	0%	0%	Step 1: The listed company is required to temporarily withhold 0% upon distribution of dividends.
	≤ 1 month	20%	20%	20%	20%	
	1 month to 1 year	20%	10%	10%	10%	
Cash Dividend	>1 year	20%	10%	5%	0%	Step 2: China Securities Depository & Clearing Corporation (CSDCC) calculates the tax liability upon disposal of listed shares by individual investors. Any unpaid tax will be deducted from the individual's account and passed on to the listed company to file with its in-charge tax authority.

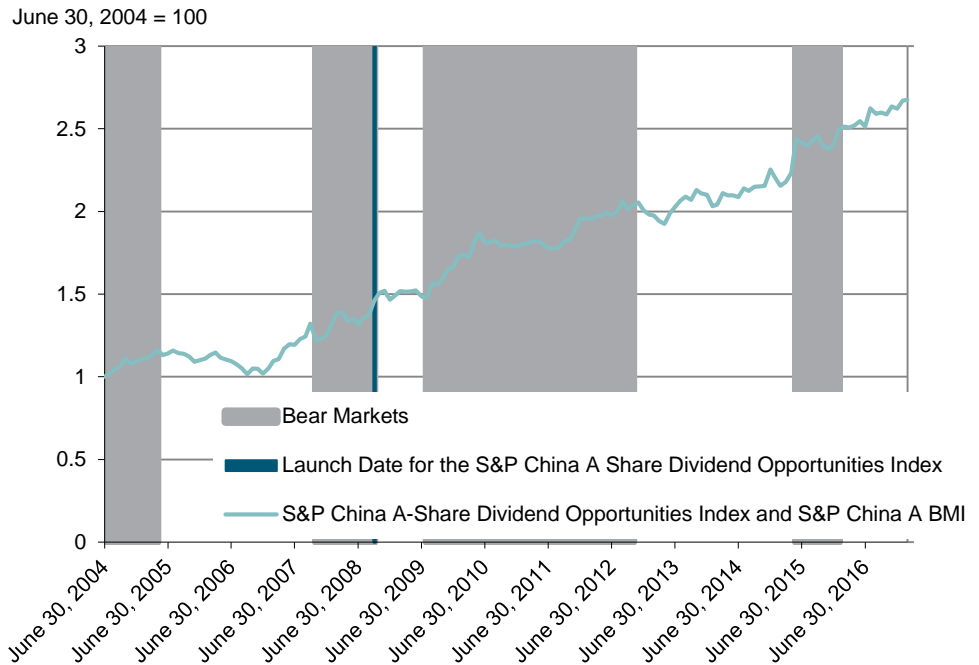
Source: S&P Dow Jones Indices LLC. Notice on Some Issues Regarding Implementation of Different Individual Income Tax Policies of Dividends and Bonuses in Listed Companies, Caishui (2015) No. 101 (Circular 101), jointly issued by the MOF, SAT, and CSRC on Sept. 7, 2015. Notice on Some Issues Regarding Implementation of Different Individual Income Tax Policies of Dividends and Bonuses in Listed Companies, Caishui (2012) No. 85 (Circular 85), jointly issued by the MOF, SAT, and CSRC on Nov. 16, 2012. Notice on Policies Relating to Individual Income Tax on Dividends and Bonuses, Caishui (2005) No. 102 (Circular 102), jointly issued by the MOF, SAT, and CSRC on June 13, 2005. Table is provided for illustrative purposes.

S&P CHINA A SHARE DIVIDEND OPPORTUNITIES INDEX

The S&P China A Share Dividend Opportunities Index seeks to offer a transparent, rules-based, diversified, tradable strategy for market participants looking for exposure to China's growth via dividends. The index seeks to measure high-yielding, A share stocks traded on the Shanghai or Shenzhen Stock Exchanges. The index was launched on Sept. 11, 2008, showing a seven-year live track record of consistent outperformance against the benchmark, the [S&P China A BMI](#) (see Exhibit 5).

The S&P China A Share Dividend Opportunities Index seeks to offer a transparent, rules-based, diversified, tradable strategy for market participants looking for exposure to China's growth via dividends.

Exhibit 5: Wealth Curve – The S&P China A Share Dividend Opportunities Index and the S&P China A BMI



The index aims to achieve “quality yields” by requiring stocks to have positive trailing 12-month earnings, positive three-year earnings growth, and stable or increasing three-year dividend growth.

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2017. USD monthly total return versions of the indices are used. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The [S&P China A Share Dividend Opportunities Index](#) not only seeks to track stocks with high dividend yield, but it also applies quality assurance for the sustainability of yields. The index aims to achieve “quality yields” by requiring stocks to have positive trailing 12-month earnings, positive three-year earnings growth, and stable or increasing three-year dividend growth. Because of this construction methodology, the index may be attractive to market participants for its total return, income generation, and potential for downside protection.

Total Return

Exhibit 6 provides a detailed comparative overview of the S&P China A Share Dividend Opportunities Index versus the [S&P China A BMI](#), the benchmark. The exhibit reveals that the S&P China A Share Dividend Opportunities Index has outperformed the benchmark in terms of absolute return and various measures of risk-adjusted returns, including the Sharpe, Sortino, and MAR ratios¹ over the past 10, 5, and 3 years. Over the 10-year period, the S&P China A Share Dividend Opportunities Index

¹ The Sharpe ratio reports the annual excess return of an index or strategy over the annualized return of the three-month U.S. Treasury Bill, divided by the annualized standard deviation of monthly returns. The Sortino ratio reports the annual excess return of an index or strategy over the annualized return of the three-month U.S. Treasury Bill, divided by the annualized standard deviation of negative asset returns. The MAR ratio measures the annualized return over the maximum drawdown over the measurement period.

produced a significant and positive alpha (76 bps per month or 9.6% per year) against the benchmark. The performance gap does not decrease when shorter and more recent time periods are examined—the index shows consistent performance characteristics over the years.

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Exhibit 6: Statistical Summary – The S&P China A Share Dividend Opportunities Index Versus the S&P China A BMI

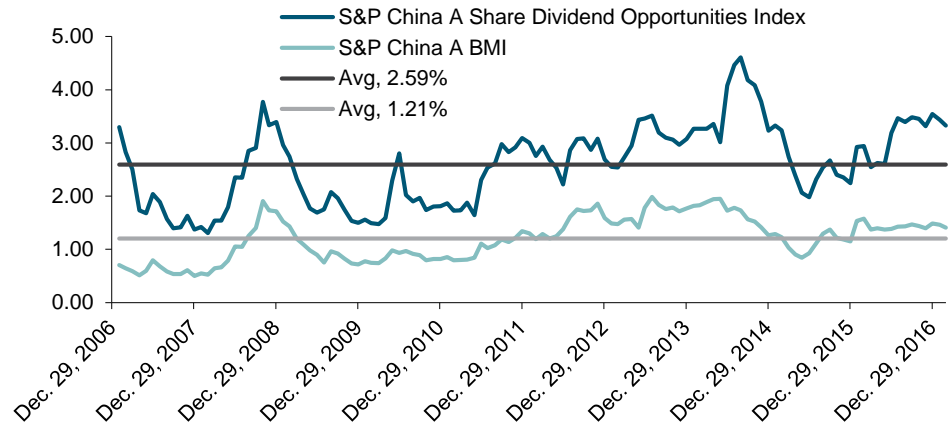
SUMMARY STATS	PAST 10 YEARS		PAST 5 YEARS		PAST 3 YEARS	
	S&P CHINA A SHARE DIVIDEND OPPORTUNITIES INDEX	S&P CHINA A BMI	S&P CHINA A SHARE DIVIDEND OPPORTUNITIES INDEX	S&P CHINA A BMI	S&P CHINA A SHARE DIVIDEND OPPORTUNITIES INDEX	S&P CHINA A BMI
Annual Return (%)	19.80	9.58	16.81	9.69	27.73	16.73
Maximum Drawdown (%)	-60.60	-65.40	-36.90	-37.40	-36.90	-37.40
Annual Volatility (%)	34.72	33.33	29.61	28.26	33.27	31.18
Annual Downside Volatility (%)	19.98	20.69	17.64	18.49	19.44	20.54
Annual Skewness	0.02	-0.08	-0.01	-0.12	-0.06	-0.19
Monthly Alpha Against the S&P China A BMI (%)	0.76	-	0.54	-	0.75	-
T-Stats of Alpha	3.42	-	1.88	-	1.83	-
Beta to the S&P China A BMI	1.01	-	1.01	-	1.03	-
Correlation With the S&P China A BMI	0.97	-	0.97	-	0.97	-
Sharpe Ratio	0.55	0.27	0.56	0.34	0.83	0.53
Sortino Ratio	0.96	0.43	0.95	0.52	1.42	0.81
MAR Ratio	0.33	0.15	0.40	0.22	0.65	0.38

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2017. USD monthly total return versions of the indices are used. Annualized returns are reported unless the time period is shorter than one year. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Income Generation

Exhibit 7 shows the trailing 12-month dividend yield of the [S&P China A Share Dividend Opportunities Index](#) and the [S&P China A BMI](#). During the period studied, the yield of the S&P China A BMI ranged between approximately 50 bps and 150 bps; while the yield of the S&P China A Share Dividend Opportunities Index was generally between 200 bps and 300 bps.

Exhibit 7: Trailing 12-Month Yield – The S&P China A Share Dividend Opportunities Index Versus the S&P China A BMI



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2017. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

During the four bear markets that Chinese equities have gone through, the S&P China A Share Dividend Opportunities Index always provided some level of protection.

Although Chinese stocks have had lower yields than those of the international markets, the additional yield provided by the [S&P China A Share Dividend Opportunities Index](#) has still added value to total long-term equity returns. Over the past 10 years, 19.6% of the [S&P China A BMI's](#) total return has been due to the reinvestment of dividends; the contribution has been 28.9% for the S&P China A Share Dividend Opportunities Index.

Potential for Downside Protection

Exhibit 8 illustrates the performance of the S&P China A Share Dividend Opportunities Index versus the S&P China A BMI during bull and bear markets over the past 11.5 years. During the four bear markets that Chinese equities have gone through, the S&P China A Share Dividend Opportunities Index always provided some level of protection. Take the 2008-2009 global financial crisis as an example. The S&P China A BMI dipped 65% from November 2007 to October 2008, while the S&P China A-Share Dividend Opportunities Index lost 57% over the same period (it saved 8%).

During the bull markets, on the other hand, the S&P China A Share Dividend Opportunities Index did not always outperform the S&P China A BMI. One time it underperformed was from November 2008 to July 2009. However, the underperformance was considered marginal, given the high return of both indices over the 11-month period.

Exhibit 8: Performance in Bull and Bear Markets

ANNUAL RETURN (%)*	BEAR	BULL	BEAR	BULL	BEAR	BULL	BEAR	BULL
	AUG. 2004-MAY 2005*	JUNE 2005-OCT. 2007	NOV. 2007-OCT. 2008	NOV. 2008-JULY 2009*	AUG. 2009-NOV. 2012	DEC. 2012-MAY 2015	JUNE 2015-JAN. 2016*	FEB. 2016-FEB. 2016
S&P China A Share Dividend Opportunities Index	-14.16	133.42	-56.89	129.29	0.00	64.73	-42.10	24.75
S&P China A BMI	-22.23	125.96	-64.99	133.68	-9.42	53.91	-37.27	16.25
ANNUAL VOLATILITY (%)								
S&P China A Share Dividend Opportunities Index	21.24	35.31	46.35	21.78	23.73	29.14	38.58	17.27
S&P China A BMI	20.50	29.05	43.23	19.70	25.18	25.16	42.05	16.98

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2017. USD monthly total return versions of the indices are used. *Annualized returns are reported unless the time period is shorter than one year. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Market participants may find the S&P China A Share Dividend Opportunities Index to be useful if they are more concerned with negative divergences than positive ones.

Further evidence of downside protection provided by the [S&P China A Share Dividend Opportunities Index](#) is the downside volatility measure. As illustrated in Exhibit 6, the volatility of the S&P China A Share Dividend Opportunities Index has been higher than that of the [S&P China A BMI](#) in different time periods. However, the downside volatility showed the opposite. Market participants may find the S&P China A Share Dividend Opportunities Index to be useful if they are more concerned with negative divergences than positive ones.

CONCLUSION

Although China's economic growth expectations have been lowered and some short-term turbulence has been seen within the country's equity markets, there is a generally positive outlook on the country in the long run, and underlying dividends could be expected to grow further. The S&P China A Share Dividend Opportunities Index offers a relevant approach to obtain exposure to the Chinese onshore equity markets in such an environment, offering a combination of quality dividends with the aim of capturing long-term growth prospects.

APPENDIX

Dividend Tax for QFII, RQFII, and Shanghai Hong Kong Stock Connect Program Investors

For non-tax resident investors who have been investing in China's A share market through the QFII and RQFII schemes or the Shanghai Hong Kong Stock Connect Program, the dividends received from Chinese securities are subject to a withholding tax at a rate of 10%. Exhibits 9 and 10 illustrate the Corporate and Individual Income Tax treatments on dividends received from A share companies through the QFII and RQFII schemes as well as the Shanghai Hong Kong Stock Connect Program (Northbound).

Exhibit 9: A Share Tax Rates for Corporate and Individual Investors Through QFII and RQFII Schemes

TAX TYPE	HOLDING PERIOD OF SHARES	NOV. 17, 2009 TO NOV. 16, 2014	AS OF NOV. 17, 2014	CURRENT WITHHOLDING METHOD
Capital Gain	Any	10%	0%	The listed company is required to withhold 10% upon distribution of dividends. If the recipient of the dividend is entitled to a lower treaty rate, they can apply to the in-charge tax bureau of the payer for a refund.
Cash Dividend	Any		10%	

Source: S&P Dow Jones Indices LLC. Notice on the Issues of Temporary Corporate Income Tax Exemption for Capital Gains Derived from the transfer of PRC Shares and Equity Interests for QFIIs and RQFIIs, Caishui (2014) No. 79 (Circular 79), jointly issued by the MOF, SAT, and CSRC on Nov. 14, 2014. Notice of the SAT Concerning Corporate Income Tax Issues on Dividends Paid by Resident Enterprises to QFIIs, Guoshuihan (2009) No.47 (Circular 47), jointly issued by the MOF, SAT, and CSRC on Jan. 23, 2009. Table is provided for illustrative purposes.

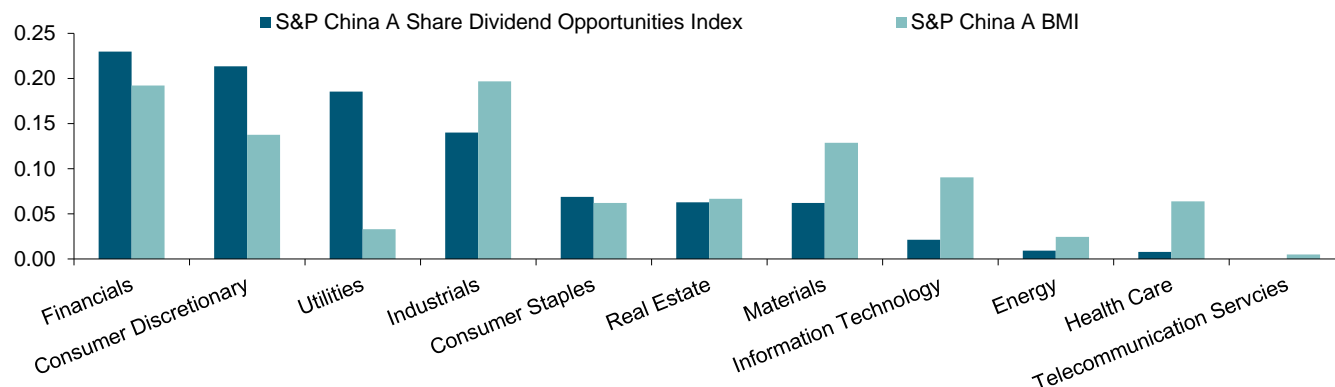
Exhibit 10: A Share Tax Rates for Corporate and Individual Investors Through the Shanghai Hong Kong Stock Connect Program (Northbound)

TAX TYPE	HOLDING PERIOD OF SHARES	AS OF NOV. 18, 2014	CURRENT WITHHOLDING METHOD
Capital Gain	Any	0%	The listed company is required to withhold 10% upon distribution of dividends. If the recipient of the dividend is tax resident in a country other than Hong Kong and entitled to a lower treaty rate, they can apply to the in-charge tax bureau of the payer for a refund.
Cash Dividend	Any	10%	

Source: S&P Dow Jones Indices LLC. Notice on relevant Tax Treatment for the Pilot Program of Shanghai-Hong Kong Stock Connect, Caishui (2014) No. 81 (Circular 81), jointly issued by the MOF, SAT, and CSRC on Nov. 14, 2014. Table is provided for illustrative purposes.

Sector Decomposition of the S&P China A Share Dividend Opportunities Index Versus the S&P China A BMI

Exhibit 11: Sector Decomposition



Source: S&P Dow Jones Indices LLC. Data as of Sept. 30, 2015. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

PERFORMANCE DISCLOSURE

The S&P China A Share Dividend Opportunities Index was launched on September 11, 2008. The S&P China A BMI was launched on November 27, 2013. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. Complete index methodology details are available at www.spdji.com.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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