S&P DOW JONES INDICES
McGRAW HILL FINANCIAL

PERSPECTIVES ON S&P EUROPE 350® PERFORMANCE IN 2013

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SPEED READ:

The UK contributed the most to positive performance in the European equity markets, as measured by the S&P Europe 350. France, Switzerland and Germany all punched above their weight.

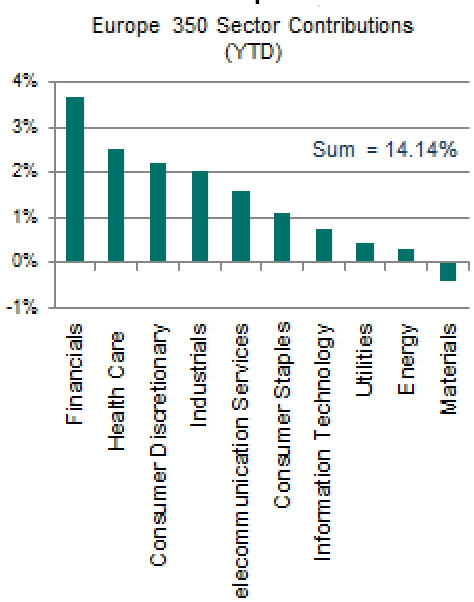
Companies from Germany, Ireland and Sweden were added to the S&P Europe 350. There is one fewer company in the index from each of Spain, the UK and the Netherlands.

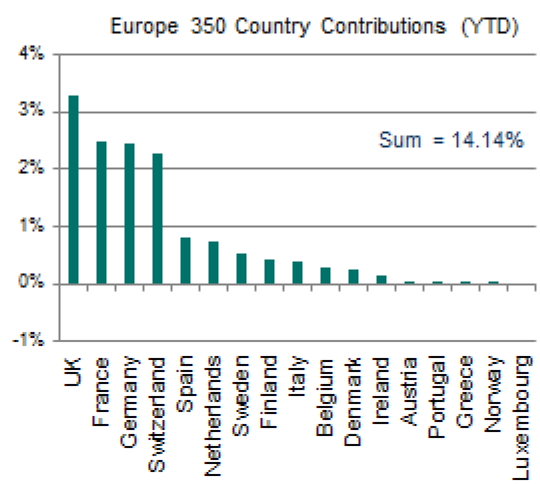
Alpha was available only in small doses; active equity strategies and indices tracked closer to each other than usual as single stocks registered historic lows in dispersion.

PERFORMANCE AND COUNTRY/SECTOR RETURN CONTRIBUTIONS

On a total return basis, the S&P Europe 350 has returned 14.14% year-to-date[1], posting positive returns in every month except June and December (so far). In November the total return index surpassed its previous highs, established back in July 2007. Excluding dividends, however, the S&P Europe 350 price index remains 30% below its pre-crisis levels, meaning there is some way to go before future expectations return to previous highs. Analysis accounting for the separate components of the total return contributed respectively by each country and sector illustrates the narrative (see Exhibit 1).

Exhibit 1: S&P Europe 350 Sector and Country Contributions





Source: S&P Dow Jones Indices. Data as of Dec. 13, 2013. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results.

[1] As of Dec. 13, 2013.

INDEX INVESTMENT STRATEGY

- Almost every country and every sector delivered a positive contribution to overall returns, with only one of each (Luxembourg and materials) posting a loss. This largely concerted movement is typical of environments characterized by low volatility and low dispersion, a topic we will revisit shortly in our analysis of alpha opportunities.

- France, Switzerland and Germany all delivered positive contributions considereably in excess of their index weights.

- The relatively large market cap of UK equities (comprising around a third of the S&P Europe 350's total market cap) meant that the UK delivered the largest positive contribution to returns, despite underperforming (in EUR terms) other major markets.

- Higher-beta sectors outperformed their lower-volatility peers while continued sluggishness in the commodity markets dragged down the materials and energy sectors.

INS AND OUTS

Four spots in the index were opened up via mergers and acquisitions this year, while two spots were created by removing index laggards.

- UK marketing group **Aegis** was acquired in March by Japanese advertising company Dentsu. Since Aegis was no longer considered European, its place in the S&P Europe 350 was taken by the UK-based **Aberdeen Asset Management**.
- The merger in May of **Glencore** and **Xstrata**, both of which were already index members, created a spot that was taken by German chemical distributor **Brenntag** in May.
- Sweden's weight in the index was raised in June as Swedish technology group **Hexagon** replaced German construction company **Hochtief**.
- The spin-off from Siemans of lighting manufacturer **Osram** in July created a USD 4.3 billion company, which took the place of Spanish steel-manufacturer **Acerinox** in the index.
- In the year of its 260th anniversary, coffee producer **Douwe Egberts** joined Peet's Coffee as another acquisition in privately listed **Joh. A. Benckiser**'s stable; the **Bank of Ireland** was included in its place.

Other important events included Fiat Industrial's final acquisition of CNH Global (completing Fiat's objective of spinning off its non-core activities).

ALPHA, STRATEGY AND BUMPS IN THE ROAD

Despite a few imported bumps in the road due to U.S. fiscal and political uncertainty in June and December, the story of the year was one of positive performance and low volatility (see Exhibit 2).

Exhibit 2: S&P Europe 350 Rolling 90-Day Price Volatility

Source: S&P Dow Jones Indices. Data as of Dec. 13, 2013. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results.

In such scenarios, one expects strategies with high leverage and/or high beta to deliver above-average returns. This was broadly true from the perspective of sectors. However, focusing attention on two strategies that have attracted much broad attention and investment in recent years, both low volatility and dividend strategies outperformed on a risk-adjusted basis (with low volatility also providing a marginally superior absolute return, see Exhibit 3).

Exhibit 3: Performance of the S&P Europe 350 and Related Indices

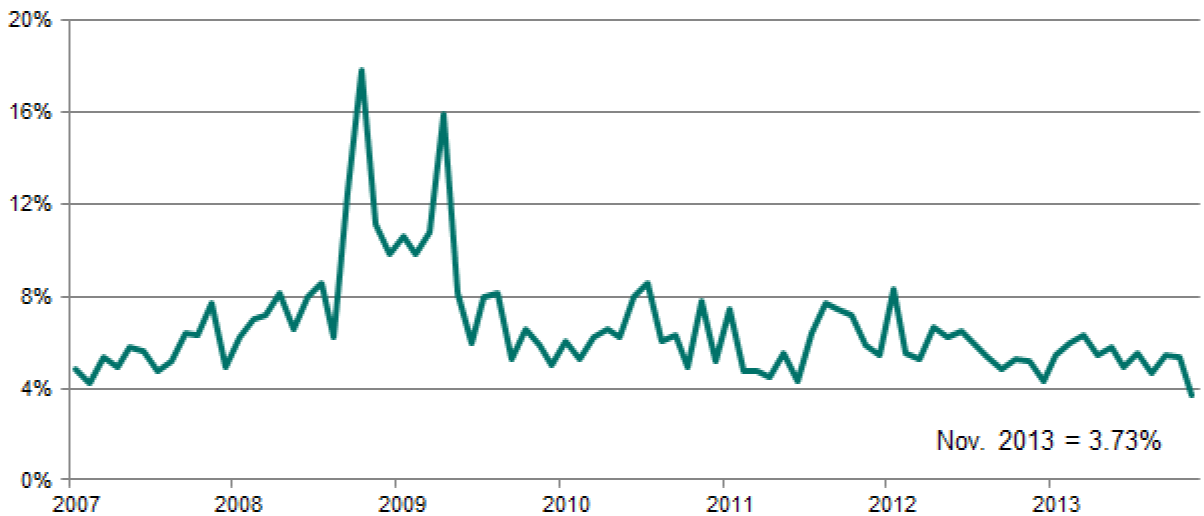
2013 Performance	Total Return (%)	Volatility (%)	Return / Risk
Europe 350	14.1	11.8	1.20
Europe 350 Dividend Aristocrats	13.0	9.8	1.33
Europe 350 Low Volatility	14.4	9.6	1.51

Source: S&P Dow Jones Indices as of Dec.13, 2013. Past performance is not a gurantee of future results.

In order to account for this otherwise surprising outperformance, it is helpful to understand two dynamics that influenced European equity investors this year and speak to the wider availability of alpha within the market. These two dynamics are the remarkably low level of dispersion among company returns in 2013, and the dismal performance of the most volatile stocks.

Our preferred measure of market opportunity for alpha generation relates to the extent to which different stocks perform versus the average, calculated via the market-cap-weighted, cross-sectional standard deviation between single-stock returns (see Exhibit 4). As such, dispersion remained resolutely low throughout the year (the long-term average is around 7%) and posted a record monthly low in November.

Exhibit 4: S&P Europe 350 Single-Stock Dispersion

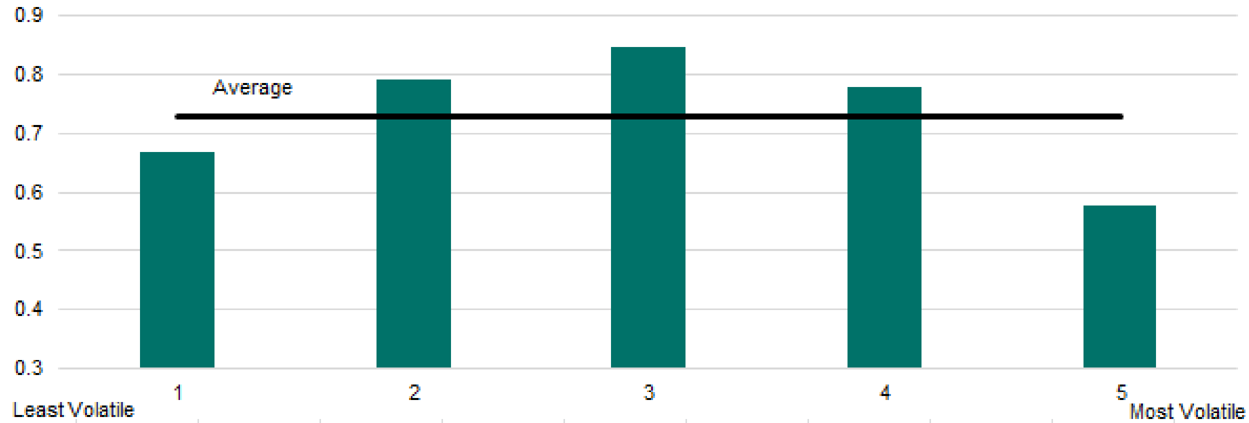


Source: S&P Dow Jones Indices. Data as of Nov. 2013. Charts and graphs are provided for illustrative purposes. Past performance is no guarantee of future results.

In periods of low dispersion, the absolute impact of deviation from benchmark weightings is lower. Record low dispersion this year meant a swath of strategies posted total returns very close to the benchmark performance, despite reflecting very different portfolios.

Digging deeper into risk-adjusted performance, aggregated single-stock characteristics again provide several clues. To determine this, we ranked every ticker included in the S&P Europe 350 by its 2013 volatility and examined the average risk/return ratio of each quintile. While initially it seems that return does rise with volatility, at the extreme it is clear that the most volatile stocks were best avoided (see Exhibit 5).

Exhibit 5: Risk/Return Ratio by Volatility Quintile



Source: S&P Dow Jones Indices. Stock total return and volatility Dec. 31, 2012 to Dec. 13, 2013. Charts and graphs are provided for illustrative purposes.

Moreover, the lowest-volatility stocks performed close to average in terms of risk-adjusted returns. This market dynamic explicitly rewarded the risk-adjusted performance of portfolios that avoided the most volatile stocks and—together with low dispersion—provided market-matching returns and lower volatility for defensive strategies.

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