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S&P 500[®] Bond Index: Simplifying the U.S. Corporate Bond Market

INTRODUCTION

Since it was first established as an index in 1957, the S&P 500 has been widely adopted by the financial community as the barometer of the large-cap U.S. equity market. As of Dec. 31, 2014, over USD 7.8 trillion is estimated to be benchmarked against the index, with indexed (passively managed) assets making up approximately USD 2.2 trillion. Just as the equity shares of the companies in the S&P 500 represent the performance of domestic large-cap equities, bonds issued by the same companies may be used to gauge the performance of the U.S. corporate bond market.

An index comprising bonds issued by S&P 500 companies could be used to provide a comparison between the equity and bond markets.

An index comprising bonds issued by S&P 500 companies could be used to provide a comparison between the equity and bond markets, given that a significant portion of the constituents of the S&P 500 Bond Index are also members of the S&P 500.¹ Furthermore, the fact that the constituents are issued by the household names of the S&P 500, which are already familiar to the investing community, allows for a higher degree of transparency and measurability in the opaque bond market, features that should be evaluated as part of the characteristics a good benchmark should possess.²

Against that conceptual backdrop, we introduce the recently launched S&P 500 Bond Index, a corporate bond counterpart of the S&P 500. In this paper, we demonstrate that the S&P 500 Bond Index exhibits characteristics and systematic risk factor exposures that are similar to those of existing broad-based, investment-grade corporate bond indices, and that the index can be effectively used to measure the performance of the sector. Furthermore, our analysis shows that the S&P 500 Bond Index has

¹ Based on over 20 years of back-tested data, at each monthly rebalance, approximately 255 companies that are in the S&P 500 issue debt. As of July 31, 2015, approximately 430 of the S&P 500's members have debt issuances, totaling around USD 3 trillion in debt outstanding.

² The CFA Institute curriculum identifies the following as characteristics of a good benchmark:

- Unambiguous
- Investable
- Measurable
- Appropriate
- Reflective of current investment opinions
- Specified in advance.

consistently delivered a higher risk/reward ratio than its peer indices, regardless of the measurement horizon.

S&P 500 Bond Index Methodology Key Points

The S&P 500 Bond Index is a market-value-weighted index that seeks to measure the performance of USD-denominated corporate debt issued by companies in the S&P 500 (and their subsidiaries). In addition, subindices are available by sector and investment-grade or high-yield segmentation. The S&P 500 Bond Index was launched on July 8, 2015 and is rebalanced on a monthly basis. Index history is available starting from Dec. 30, 1994.

Over the past 20 years, the U.S. corporate bond market has undergone rapid growth.

Exhibit 1: Main Eligibility Criteria³

Maturity	Greater than or equal to one month
Country of Issuance	U.S.
Currency	USD
Coupon Type Included	Fixed, zero, step-up, fixed to float (at least one month prior to float date)
Credit Rating	Must be rated by at least one rating agency of S&P Ratings Services, Moody's, and Fitch
Size	A minimum par of USD 250 million for investment-grade bonds
	A minimum par of USD 100 million for high-yield bonds
Exclusion	Bills, floating-rate issues, STRIPS

Source: S&P Dow Jones Indices LLC. Table is provided for illustrative purposes.

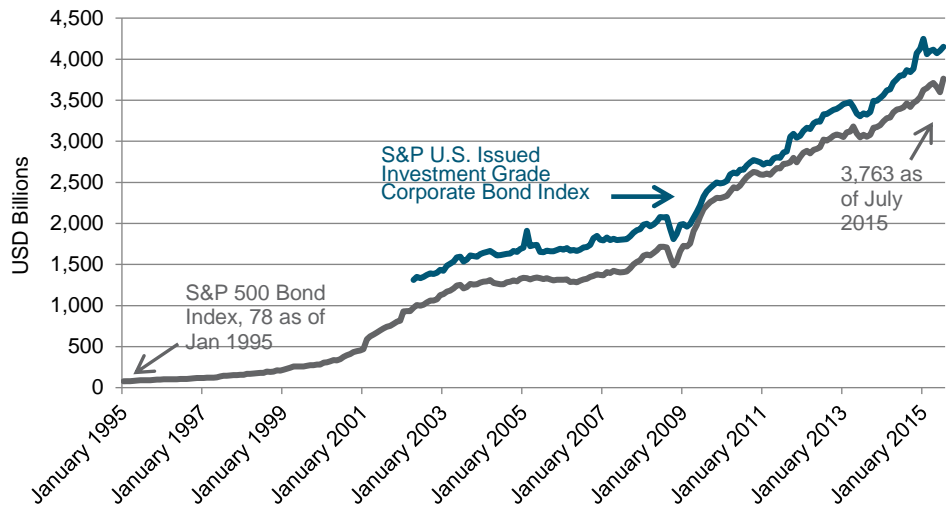
Representing the Broad, Investment-Grade Corporate Bond Market

Over the past 20 years, the U.S. corporate bond market has undergone rapid growth. The total amount of corporate debt outstanding rose dramatically from USD 1.93 trillion at the end of 1994 to USD 7.85 trillion at the end of 2014.⁴ Reflecting the growth of the corporate bond sector, the market capitalization of the S&P 500 Bond Index also grew from USD 78 billion as of Jan. 31, 1995, to USD 3.76 trillion as of July 2015 (see Exhibit 2). Similarly, the number of bonds covered by the index rose from 232 to 4,751 during the same period (see Exhibit 3), with the majority of the constituents rated as investment grade.

³ The detailed methodology of the index can be found at www.spindices.com.

⁴ The data is obtained from SIFMA (Securities Industry and Financial Markets Association) website.

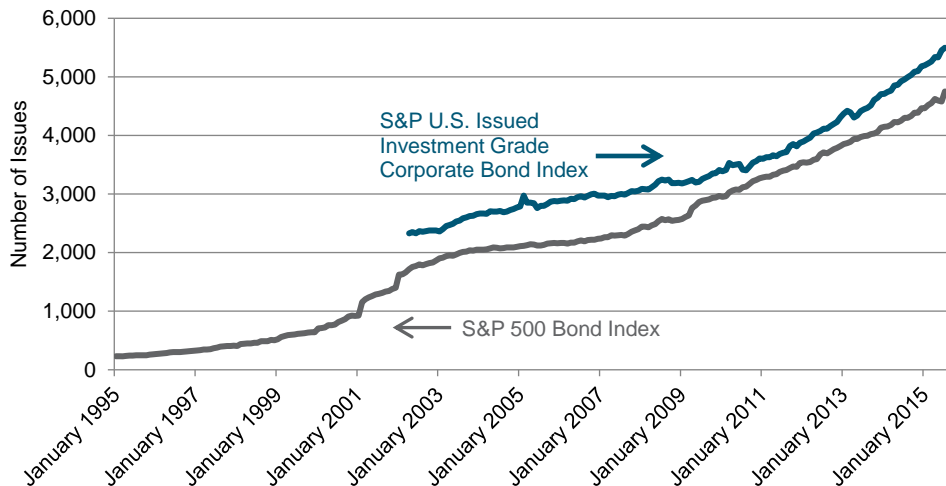
Exhibit 2: Index Market Cap



Source: S&P Dow Jones Indices LLC. Data as of July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The market capitalization of the investment-grade component of the S&P 500 Bond Index is 83% of that of the S&P U.S. Issued Investment Grade Corporate Bond Index.

Exhibit 3: Number of Issues in Indices



Source: S&P Dow Jones Indices LLC. Data as of July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Compared with the S&P U.S. Corporate Bond Indices, which are designed to measure the performance of the broad-based, USD-denominated corporate bond market and comprise bonds issued by U.S and foreign issuers, the market capitalization of the S&P 500 Bond Index is 52% of the market capitalization of the S&P U.S. Corporate Bond index family, and 71% of that by the U.S. issuers. The comparison highlights that the majority of U.S. corporate bonds are issued by constituents of the S&P 500. Furthermore, the market capitalization of the investment-grade component of the S&P 500 Bond Index is 83% of that of the S&P U.S. Issued Investment Grade Corporate Bond Index. Given the large market capitalizations of S&P 500 companies, the S&P 500 Bond Index can be

used as a barometer for the performance of a broad universe of U.S. investment-grade corporate bonds.

The representation of the S&P 500 Bond Index within the broad, investment-grade corporate bond universe can be seen in Exhibit 4. The S&P 500 Bond Index and its peer bond indices exhibit comparable exposures to fixed income systematic risk factors. The index has yield, coupon, and duration characteristics that are similar to that of the outstanding, broad-based, investment-grade corporate bond indices.

Exhibit 4: Index Comparison

CATEGORY	S&P 500 BOND INDEX			S&P U.S. CORPORATE BOND FAMILY		S&P U.S. ISSUED CORPORATE BOND FAMILY	
	INVESTMENT GRADE AND HIGH YIELD	INVESTMENT GRADE	HIGH YIELD	S&P U.S. INVESTMENT GRADE CORPORATE BOND INDEX	S&P U.S. HIGH YIELD CORPORATE BOND INDEX	S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	S&P U.S. ISSUED HIGH YIELD CORPORATE BOND INDEX
Market Cap	3,763	3,464	299	5,593	1,709	4,152	1,165
Market Cap as % of S&P U.S. Corporate Bond Family	52	62	17	-	-	-	-
Market Cap as % of S&P U.S. Issued Corporate Bond Family	71	83	26	-	-	-	-
Yield-to-Worst	3.25	3.09	5.11	3.17	6.74	3.13	6.59
Yield-to-Maturity	3.28	3.11	5.29	3.18	6.98	3.14	6.91
Weighted Coupon	4.41	4.27	5.98	4.24	6.64	4.25	6.69
Weighted Modified Duration	6.59	6.71	5.20	6.33	4.67	6.63	4.73

Source: S&P Dow Jones Indices LLC. Data as of July 31, 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

In addition, over long-term investment horizons, such as 10 and 20 years, the S&P 500 Bond Index is closely correlated to its peer indices (see Exhibit 5).

Over long-term investment horizons, such as 10 and 20 years, the S&P 500 Bond Index is closely correlated to its peer indices

Exhibit 5: Correlation Analysis

10 YEAR	S&P 500 BOND INDEX	S&P U.S. INVESTMENT GRADE CORPORATE BOND INDEX	S&P U.S. HIGH YIELD CORPORATE BOND INDEX	S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	BARCLAYS U.S. INVESTMENT GRADE CORPORATE BOND INDEX
S&P 500 BOND INDEX	1.00	-	-	-	-
S&P U.S. INVESTMENT GRADE CORPORATE BOND INDEX	0.99	1.00	-	-	-
S&P U.S. HIGH YIELD CORPORATE BOND INDEX	0.68	0.59	1.00	-	-
S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	0.99	0.99	0.62	1.00	-
BARCLAYS U.S. INVESTMENT GRADE CORPORATE BOND INDEX	0.99	0.99	0.66	0.99	1.00
20 YEAR	S&P 500 BOND INDEX	S&P U.S. INVESTMENT GRADE CORPORATE BOND INDEX	S&P U.S. HIGH YIELD CORPORATE BOND INDEX	S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	BARCLAYS U.S. INVESTMENT GRADE CORPORATE BOND INDEX
S&P 500 BOND INDEX	1.00	-	-	-	-
S&P U.S. INVESTMENT GRADE CORPORATE BOND INDEX	0.99	1.00	-	-	-
S&P U.S. HIGH YIELD CORPORATE BOND INDEX	0.61	0.50	1.00	-	-
S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	-	-	-	-	-
BARCLAYS U.S. INVESTMENT GRADE CORPORATE BOND INDEX	0.99	0.98	0.56	-	1.00

Over the past two decades, approximately 90% of the S&P 500 Bond Index's market capitalization has resided in investment-grade bonds.

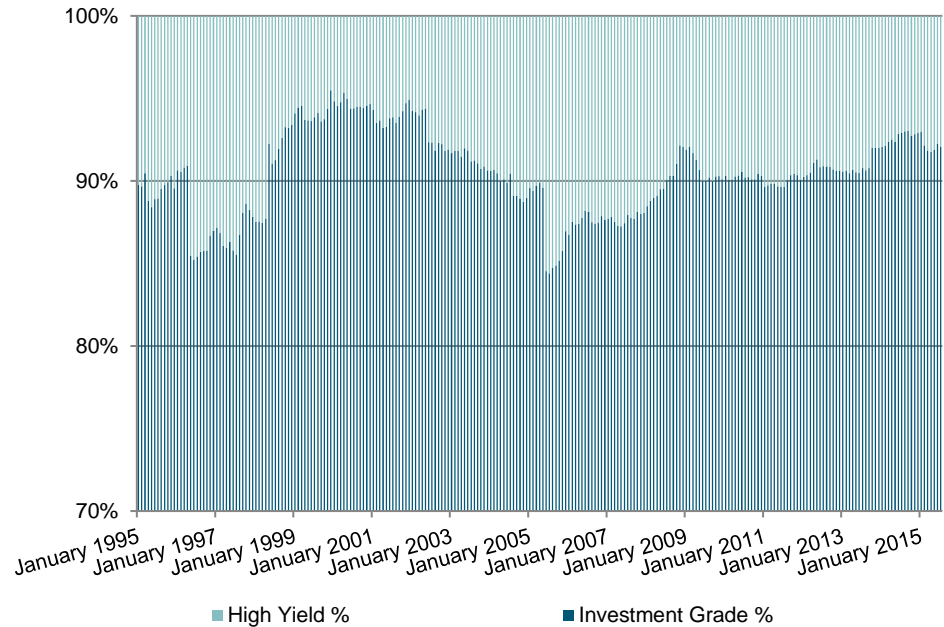
Source: Barclays Capital, S&P Dow Jones Indices LLC. Data as of July 31, 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Note: S&P U.S. Issued Investment Grade Corporate Bond Index does not have 20 years of history.

Characteristics

As the S&P 500 Bond Index is designed to track bonds issued by large-cap, blue-chip, domestic companies, it comes as no surprise that the majority of the index constituents are investment grade. Over the past two decades, approximately 90% of the S&P 500 Bond Index's market capitalization has resided in investment-grade bonds, with the remaining belonging to high-yield bonds (see Exhibit 6). It is also important to note the weighted average rating of the index, according to Standard & Poor's Ratings Services, has been stable between A and A- throughout the index's history.

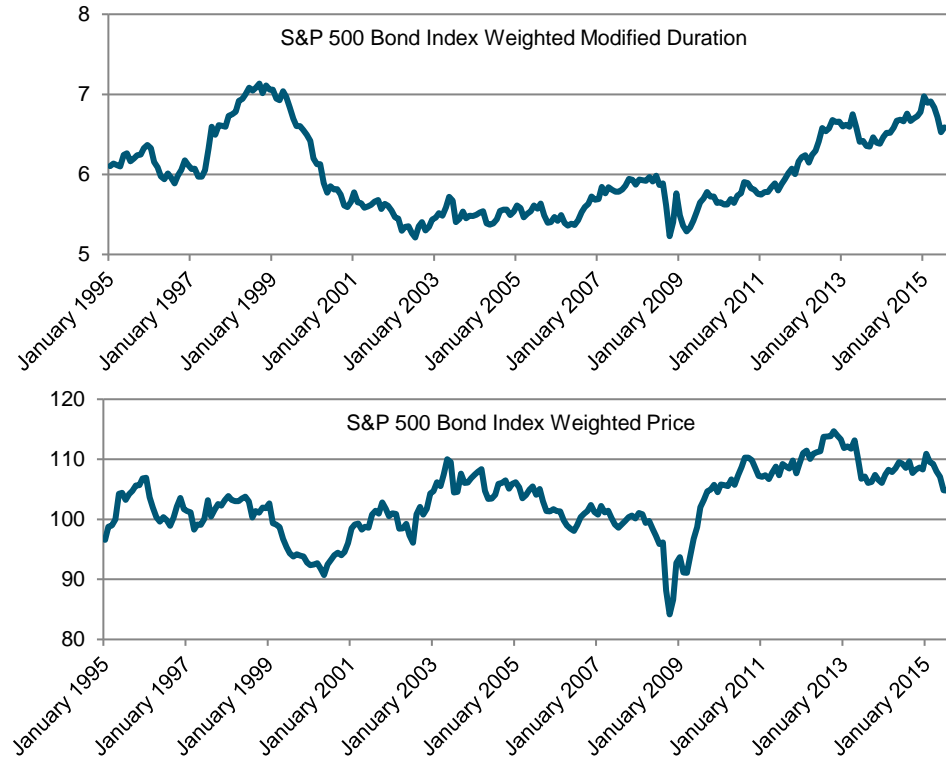
Exhibit 6: S&P 500 Bond Index: Investment Grade and High Yield Segments by Market Capitalization

The extended low interest rate environment following the 2008 financial crisis has been favorable for corporate debt issuers to borrow money.



Source: S&P Dow Jones Indices LLC. Data from January 1995 to July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The extended low interest rate environment following the 2008 financial crisis has been favorable for corporate debt issuers to borrow money, as shown by the record-high amount of corporate debt issuance and the duration extension of newly issued bonds. At the same time, the prices of U.S. corporate bonds have rallied back to the pre-crisis levels last seen in 2003. The weighted modified duration and the weighted price of the S&P 500 Bond Index have been rising steadily since 2009, reflecting the dynamics of the corporate bond market. Exhibit 7 shows those characteristics of the S&P 500 Bond Index.

Exhibit 7: S&P 500 Bond Index Weighted Modified Duration and Weighted Price

The index consistently showed higher returns and lower volatility than other investment-grade bond indices, resulting in higher risk/reward ratios regardless of the investment horizons.

Source: S&P Dow Jones Indices LLC. Data from January 1995 to July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Risk/Return Profile and Performance Attribution

The long-term cumulative performance of the S&P 500 Bond Index is comparable to those of other existing investment-grade corporate bond indices. When measured over different time periods, we noted that the index consistently showed higher returns and lower volatility than other investment-grade bond indices, resulting in higher risk/reward ratios regardless of the investment horizons (see Exhibit 8). The risk-efficient manner in which the S&P 500 Bond Index is designed to offer beta exposure to the domestic investment-grade bond universe may potentially offer higher diversification and risk-budgeting opportunities.

Exhibit 8: Historical Risk/Return Profile

ANNUALIZED RETURNS	S&P 500 BOND INDEX	S&P 500 INVESTMENT GRADE CORPORATE BOND INDEX	S&P 500 HIGH YIELD CORPORATE BOND INDEX	S&P U.S. ISSUED INVESTMENT GRADE CORPORATE BOND INDEX	BARCLAYS U.S. INVESTMENT GRADE CORPORATE BOND INDEX
1-Year (%)	1.91	1.81	2.90	1.80	1.49
3-Year (%)	2.70	2.39	5.79	2.46	2.49
5-Year (%)	4.83	4.52	7.83	4.76	4.84
10-Year (%)	5.45	5.16	8.36	5.29	5.37
20-Year (%)	6.41	6.09	9.48	-	6.28
ANNUALIZED RISK					
3-Year (%)	3.83	3.90	4.22	3.89	4.17
5-Year (%)	3.86	3.93	4.76	3.88	4.29
10-Year (%)	5.58	5.58	8.78	5.42	6.01
20-Year (%)	5.04	5.06	8.84	-	5.42
RISK/REWARD RATIO					
3-Year	0.70	0.61	1.37	0.63	0.60
5-Year	1.25	1.15	1.64	1.23	1.13
10-Year	0.98	0.92	0.95	0.98	0.89
20-Year	1.27	1.21	1.07	-	1.16

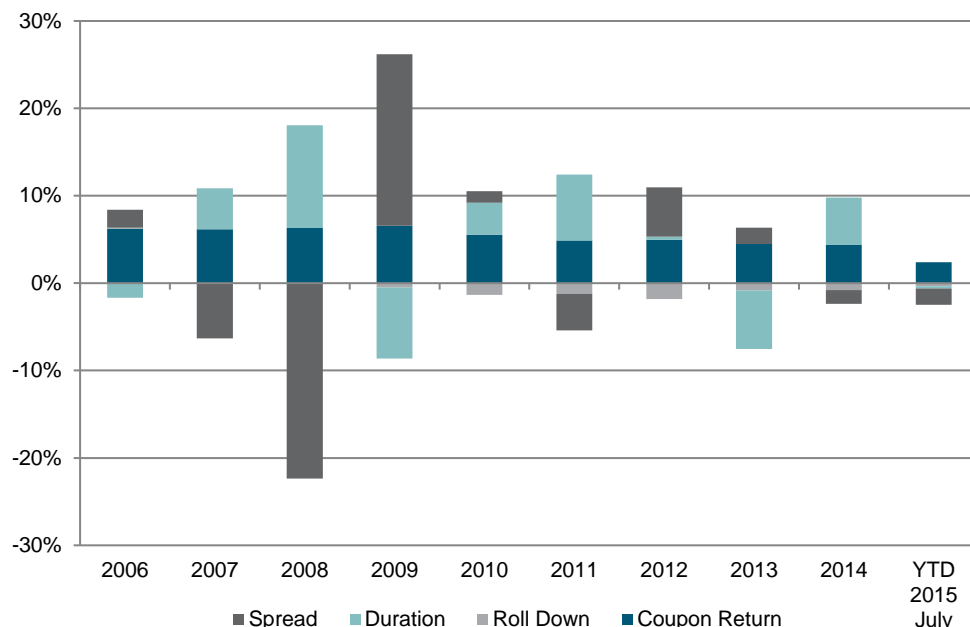
Source: S&P Dow Jones Indices, Barcap. Data as of July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Coupon return has been a consistent main driver and a significant source of return over the long-term investment horizon.

The performance of the S&P 500 Bond Index can be further decomposed to highlight the sources or subcomponents of return. For corporate bonds, total return can be decomposed into accrued interest, curve roll down, return due to credit spreads, and yield curve changes. Based on the availability of curve data, we show the performance attribution of the index since 2006 (see Exhibit 9). The data shows that coupon return has been a consistent main driver and a significant source of return over the long-term investment horizon, with spread return and duration return⁵ showing the tendency to offset each other. However, it should be noted that since the 2008 financial crisis, coupon return has declined noticeably from 6.25% in 2006 to 2.38% as of July 31, 2015, reflecting the prolonged low interest rate environment.

⁵ We group shift return, twist return, and shape return into one principle subcomponent of duration return.

Exhibit 9: Performance Attribution for the S&P 500 Bond Index



Source: S&P Dow Jones Indices LLC, FactSet. Data from July 2006 to July 2015. Chart is provided for illustrative purposes. Past performance is not a guarantee of future results. Index information prior to launch date is hypothetical. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

CONCLUSION

The S&P 500 Bond Index makes the meaningful distinction of aiming to track bonds issued by S&P 500 blue-chip companies.

While there is no shortage of indices that seek to measure the domestic investment-grade corporate bond sector, the S&P 500 Bond Index makes the meaningful distinction of aiming to track bonds issued by S&P 500 blue-chip companies. Since the constituents are issued by the household names of the S&P 500, which are already familiar to the investing community, a higher degree of transparency and measurability can be achieved. In addition to the aforementioned equity brand recognizability factor, our analysis shows that the S&P 500 Bond Index is representative of a broad-based, USD-denominated, investment-grade corporate bond market in the U.S., and the index can be used to provide insight into the performance of the sector. The index also has exhibited risk-efficient properties, delivering higher returns with lower volatility, compared with the existing investment-grade corporate bond indices, thereby providing potentially higher diversification benefits.

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PERFORMANCE DISCLOSURE

The S&P 500 Bond Index, the S&P 500 Investment Grade Corporate Bond Index, the S&P 500 High Yield Corporate Bond Index were launched on July 8, 2015. The S&P U.S. Investment Grade Corporate Bond Index and the S&P U.S. High Yield Corporate Bond Index were launched on May 1, 2014. The S&P U.S. Issued High Yield Corporate Bond Index was launched on April 9, 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.

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