



## S&P INDICES VERSUS ACTIVE FUNDS SCORECARD [SPIVA<sup>®</sup> AUSTRALIA SCORECARD]

### Summary

- A majority of active funds underperformed their respective benchmarks across all asset classes studied in the SPIVA Australia Scorecard. With the exception of the Australian equity small-cap category, at least 70% of active retail funds underperformed the benchmark over the last year. The same is true for the three-year period.
- Over the last five years, approximately 69% of active retail Australian equity general funds failed to beat the S&P/ASX 200 Accumulation index. The portion of funds that failed to beat the index increased to an even larger majority across the one-year and three-year time periods, with at least 72% of active Australian equity funds failing to beat the index.
- Active Australian equity small-cap funds significantly outperformed the benchmark across all periods studied in this report. Over the last five years, almost 80% of active Australian equity small-cap funds outperformed the S&P/ASX Small Ordinaries Index. Both the equal- and asset-weighted average returns of the active fund category far outperformed the S&P/ASX Small Ordinaries Index across all periods studied.
- Almost 90% of active international equity general funds underperformed relative to the benchmark over the last year. Over both three- and five-year periods, at least 72% of international equities general funds failed to beat the index. The asset-weighted returns of this category are also converging closer toward equal-weight returns for the first time since the SPIVA Australia Scorecard was introduced in August 2009, suggesting that larger funds are not performing as well as they did in previous periods.
- All active retail Australian bond funds studied in this report failed to beat the S&P/ASX Australian Fixed Interest Index over the last year. Similarly, 92% of funds in this category underperformed the index over a five-year period, which is also consistent with the poor survivorship rates for the category. Over the last five years, active Australian bond funds suffered the lowest survivorship rate across the universe of funds studied in this report, as approximately 30% of active bond funds failed to survive.
- In spite of the poor peer group performance of active Australian bond funds relative to the index, the equal-weighted average return of the peer group outperformed other asset classes over a five-year period.

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#### Contributor:

Simon Karaban

Director, Channel Management

[simon\\_karaban@spdji.com](mailto:simon_karaban@spdji.com)

Guy Maguire

Head of Index Services Australia

[guy\\_maguire@spdji.com](mailto:guy_maguire@spdji.com)

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- Approximately 86% of active Australian A-REIT funds failed to beat the S&P/ASX 200 A-REIT Index over the last year. However, the portion that underperformed falls to approximately 65% over a five-year period. Active Australian equity A-REIT funds enjoyed among the highest survivorship rates when compared to the other active categories covered in the SPIVA Australia Scorecard.
- The asset-weighted returns of all peer groups observed in this report are higher than their respective equal-weighted returns across nearly every time period that has been observed, indicating that larger funds generally perform better in each of these peer groups.

## A UNIQUE SCORECARD FOR THE ACTIVE VERSUS PASSIVE DEBATE

The S&P Dow Jones Indices Active Versus Passive Funds Scorecard (SPIVA Australia Scorecard) presents the performance of actively managed mutual funds as compared to relevant benchmark indices. Covering funds in Australia and comparing them to various Australian market indices in their respective categories, the popularity of SPIVA stems from a few unique attributes:

- **Survivorship bias correction:** Many funds might be liquidated or merged during a period of study. However, for someone making an investment decision at the beginning of the period, these funds are part of the opportunity set. Unlike other commonly available comparison reports, the SPIVA Scorecard accounts for the entire opportunity set – not just the survivors – thereby eliminating survivorship bias.
- **Apples-to-apples comparison:** Fund returns are often compared to those of popular benchmarks regardless of their investment category. SPIVA Scorecards avoid this pitfall by measuring a fund's returns against the returns of a benchmark appropriate for that particular investment category.
- **Asset-weighted returns:** Average returns for a fund group are often calculated using only equal weighting, which results in the returns of an AUD 10 billion fund affecting the average in the same manner as the returns of an AUD 10 million fund. Equal-weighted returns measure average fund performance, while asset-weighted returns measure the performance of the average invested dollar. The SPIVA Scorecard offers both equal- and asset-weighted averages.

The SPIVA Australia Scorecard builds upon the reputation and success of the SPIVA Scorecard in the United States, where it has been widely recognized among financial advisors, institutional investors and the media. Like its global counterparts, the SPIVA Australia Scorecard does not make investment recommendations or offer comments on the suitability of either index or active investing. The Scorecard simply reports periodic data according to the SPIVA methodology and provides a brief analysis. To better understand how the data is derived, please see the methodology beginning on page 3 of this document.

SPIVA Scorecards are the only comprehensive, periodic and publicly available sources of such data, and can be found online at [www.spindices.com/spiva](http://www.spindices.com/spiva).

## UNDERSTANDING BEFORE INVESTING

Like all forms of investing, managed fund investing must begin with understanding not only the funds, but also the fund categories being considered. SPIVA Scorecards go beyond providing simple performance data for each fund category to offer detailed apples-to-apples comparisons corrected for survivorship bias, as well as asset- and equal-weighted peer averages.

We believe that planners, brokers and investors should be aware of the overall objectives and costs of their actively managed funds, and should understand the experience, investment styles and strategies of their fund managers. They should also understand the strengths and weaknesses of the funds' performance benchmarks and available passive investment vehicles. The SPIVA Scorecards serve as clean, unbiased reports on the ongoing active versus passive debate. Readers will need to make their own judgments about where to invest, and just as importantly, where not to invest. The Nobel Prize-winning professor, William F. Sharpe, sums it up:

*Should everyone index everything? The answer is resoundingly no. In fact, if everyone indexed, capital markets would cease to provide the relatively efficient security prices that make indexing an attractive strategy for some investors. All the research undertaken by active managers keeps prices closer to values, enabling indexed investors to catch a free ride without paying the costs. Thus there is a fragile equilibrium in which some investors choose to index some or all of their money, while the rest continue to search for mispriced securities.*

*Should you index at least some of your portfolio? This is up to you. I only suggest that you consider the option. In the long run, this boring approach can give you more time for more interesting activities such as music, art, literature, sports, and so on. And it very well may leave you with more money as well.*

**William F. Sharpe, 2002<sup>1</sup>**

## SPIVA METHODOLOGY

### Data

We obtain a data feed of monthly fund data from Morningstar<sup>®</sup> Australia covering all managed funds for which data are available for a given month-end date during the performance period. The data feed includes the most comprehensive Australian data on active, closed and finalized (merged or liquidated) funds over the chosen period. We apply the following filters to ensure that an equitable comparative analysis is made:

- Only open-end unlisted retail unit trusts are selected.
- Small funds with less than AUD 5 million in market capitalization are excluded in an effort to report on fund performance that predominantly relates to investor experience. To this end, we remove as many versions, or share classes, of a fund as possible.

The following identifiers are available on a monthly basis:

- Fund name
- Fund identifier
- Month and year
- Fund returns for the month, including distributions
- Fund assets under management in that month
- Fund categorization in that month
- Management type, i.e., whether the fund is indexed or actively managed

We then limit our subset using the following filters:

- We choose funds that are actively managed, excluding index funds.

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<sup>1</sup> [www.stanford.edu/~wfsarpe/art/talks/indexed\\_investing.htm](http://www.stanford.edu/~wfsarpe/art/talks/indexed_investing.htm)

- We remove funds that lack information on assets under management for any three-month range within the previous sixty months. Therefore, if a fund is missing net asset data for a given month, a search is conducted over three months in an effort to populate that data field. Should a three-month search fail to yield net asset data, the fund is then removed from the analysis. We remove these funds because the report on asset-weighted returns cannot be computed without fund asset information, and we wish to use a consistent data set across the four main reports provided in the SPIVA Australia Scorecard.

## Fund Categories

We choose funds that have, at any point in the previous 60 months, been classified in at least one of the following categories:

- Australian Equity General
- Australian Equity Small-Cap
- Australian Equity Real Estate
- International Equity General
- Australian Fixed Income

These categories, we believe, represent the primary categories of interest for Australian fund investors and were derived from the Morningstar Australia fund classification policy. The Morningstar classification system produces narrow style-based classifications for funds, particularly in relation to Australian and international equities. We have consolidated the style-based categories in order to generate a larger sample size and develop a broad-market comparison to market-based benchmarks. A narrow style-based comparison would yield a limited sample size given that distinct value and growth style segments are not consistently discernible over the last five years. We have mapped Morningstar categories to SPIVA peer groups in the following manner:

Morningstar Category	SPIVA Category
Equity Region Australia Large Value	<b>Australian Equity General</b>
Equity Region Australia Large Blend	
Equity Region Australia Large Growth	
Equity Region Australia Mid/Small Value	<b>Australian Equity Small-Cap</b>
Equity Region Australia Mid/Small Blend	
Equity Region Australia Mid/Small Growth	
Equity Region World Large Value	<b>International Equity General</b>
Equity Region World Large Blend	
Equity Region World Large Growth	
Australian Bonds	<b>Australian Bond</b>
Equity Sector Australia - Real Estate	<b>Australian Equity A-REIT</b>

It is very unlikely that funds will change from one category to another due to the broad nature of the groups that have been selected, which allows the SPIVA Scorecards to provide consistent comparisons over time.

## Benchmarks

The chosen benchmarks are shown in the table below. All index returns are total returns (i.e., include dividend reinvestment) in Australian dollars. There has been no deduction from index returns to account for fund investment expenses. Active fund returns are after expenses, but do not include loads and entry fees.

SPIVA Category	Market Index
Australian Equity General	S&P/ASX 200 Index
Australian Equity Small-Cap	S&P/ASX Small Ordinaries Index
International Equity General	MSCI World Ex Australia Index
Australian Bond	S&P/ASX Australian Fixed Interest Index
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index

The benchmarks chosen are the most commonly adopted benchmarks for funds that fall into the respective fund peer groups. In some instances, a fund may not adopt the benchmarks stipulated above. However, a vast majority do set their performance hurdle based on the assigned benchmarks in this report, ensuring that the study is robust and fair.

## SCORECARD RESULTS

### *Australian Equity General Funds: Active Funds Underperform*

The performance of Australian equity funds has been of particular interest to Australian investors, who tend to allocate a large portion of their fund investments to domestic equities. The Australian equity market is significantly concentrated in that almost two-thirds of the market is allocated between Resources and Financials, and the top 50 stocks account for nearly 70% of the capitalization of the S&P/ASX 200. As a result, a large majority of the tradable opportunity set in Australia is heavily researched and considered highly efficient.

The S&P/ASX 200 Accumulation Index posted a positive first half for 2012 by returning 7.74%. However, this result was not enough to offset the negative end to 2011. As result, the index is down by 6.7% for the one-year period (June 2011 – June 2012), signaling another difficult year for domestic equity investors. With heightened uncertainty and variability of returns, it is evident that active funds have failed to establish any clear advantage over the benchmark index since a clear majority of funds failed to beat the index across all periods observed in the report. Report 1 shows that as of 30 June 2012, 72.73% of funds failed to beat the benchmark index YTD. Over the five-year period, the index beat 69% of active Australian equity funds, which is consistent with observations made in previous editions of the Scorecard. Report 3 and Report 4 show that the asset-weighted returns of active Australian equity funds (indicating the average return of an invested dollar) exceeded the equal-weighted returns (indicating the average return of a fund) across all periods observed in the report. Therefore, there is evidence to suggest that larger funds are performing better than smaller funds. When compared to other categories studied in this report, the active Australian equity general funds suffered the lowest equal-weighted returns over the last year.

As shown in Report 2, active funds displayed an 81.56% survivorship rate over the five-year period, which is largely consistent with other peer groups observed in this report.

### *Australian Equity Small-Cap Funds: Strong Active Performance*

Stocks within the small-cap opportunity set are relatively under-researched when compared to large-cap stocks, better enabling active asset managers to take advantage of any mispricing opportunities in the market. The S&P/ASX Small Ordinaries Index is also much less concentrated when compared to the S&P/ASX 200 Index, meaning that the small-cap equity market is not holding a large portion of funds within relatively few securities. The notion that small-cap stocks are relatively under-researched has panned out in the Australian market, where the S&P/ASX Small Ordinaries Index failed to beat a very large majority of active Australian Equity Small-Cap funds across all time periods. Almost 80% of all Australian equity small-cap funds beat the index over periods of one year or more. Equal- and asset-weighted average returns in Report 3 and Report 4 also show that active funds in this category outperformed the index across all time periods by a significant margin. Asset-weighted returns are moderately higher when compared to equal-weighted returns across all periods observed in this report. The peer group demonstrated superiority over the index and the equal-weight returns also show that Australian equity small-cap funds outperformed all other equity peer groups in this report over a five-year period. Survivorship of active

funds in this peer group is relatively robust, at 82.89% over the five-year period, ranking highest among other peer groups over the same period.

## *International Equity General Funds: Investors Find Quality Among Poor Performers*

In addition to equity risk, many international equity funds carry currency risk. Foreign exchange markets can have a profound impact on the risk profile of international equity funds, and therefore, influence the comparative fund returns within the peer group, which does not distinguish between funds that hedge their currency exposure and those that don't. As shown in Report 1, close to 73% of funds failed to beat the MSCI World Accumulation Index over the last five years, increasing to approximately 88% when only the last year is taken into account. Report 3 shows that in equal-weighted terms, active funds in this peer group consistently underperformed relative to the index across all time periods. Report 4 shows that the asset-weighted returns of the international equity general peer group substantially outperformed the index over a five-year period. However, the asset-weighted returns of this category are also converging closer toward equal-weight returns for the first time since the Scorecard was introduced, suggesting that larger funds are not performing as well as they did in previous periods. Report 2 shows that funds in this category also have among the lowest survivorship rates over periods of three years or more.

## *Australian Bond Funds: Index Superiority with a Nuance*

The S&P/ASX Australian Fixed Interest Index outperformed a vast majority of the active diversified bond funds in the Australian market across all time periods. As shown in Report 1, the index outperformed all of the active funds observed in this Scorecard over the last year. The result moderately improves for the active fund category over the three-year period, with 75.76% of funds delivering returns below the benchmark. Australian bond funds also have the lowest survivorship rate of all the asset classes, as illustrated in Report 2, which shows a 73.68% survivorship rate over the last five years. This is the lowest survivorship rate that has been observed since the Scorecard was first introduced to the Australian market. Report 3 and Report 4 show asset-weighted returns consistently higher than equally-weighted returns, offering some evidence that larger active Australian bond funds perform better than smaller Australian bond funds. The asset-weighted returns of the peer group, however, still fail to beat the index returns across all periods observed. Before drawing sweeping conclusions about the merits of bond-based indices and active bond funds, it is important to consider that unlike a stock index, a broad bond index is not truly replicable; it is a measure of the market, rather than a replicable passive portfolio. Typically, passive bond portfolios hold only a small fraction of the index's securities and use optimization algorithms to match benchmarks, not unlike active funds' use of quantitative screens to beat benchmarks.

## *Australian Equity A-REIT Funds: Survival of the Fittest?*

As shown in Report 1, the S&P/ASX 200 A-REIT Index outperformed approximately 86.42% of active funds in the last year. However, the proportion that was outperformed by the index decreased to approximately 65.12% over five years. This active fund category enjoys the highest survivorship rate over a three-year period, as well as the second-highest survivorship rate of the last five years when compared to other peer groups, as shown in Report 2. Report 4 shows that the peer group marginally outperformed the index on an asset-weighted basis over the last five-years. However, the index prevailed as the clear winner across all other periods observed.

## REPORTS

### *Report 1: Percentage of Funds Outperformed by the Index*

This report corrects for any survivorship bias and shows the percentage of funds that were outperformed by the comparison benchmark index over the quarter, as well as the one-, three- and five-year periods. We begin with the funds listed in a category at the beginning of the period and report the percentage of funds that have underperformed the index. The fund's category at the end of the period is not considered, since the category of interest is the one at the beginning of the holding period. Therefore, fund category changes do not unduly impact the results in this report.

<b>Report 1: Percentage of Funds Outperformed by the Index</b>					
<b>Fund Category</b>	<b>Comparison Index</b>	<b>QTR (%)</b>	<b>One-Year (%)</b>	<b>Three-Year (%)</b>	<b>Five-Year (%)</b>
Australian Equity General	S&P/ASX 200 Accumulation Index	72.59	72.73	81.12	69.01
Australian Equity Small-Cap	S&P/ASX Small Ordinaries Index	16.00	15.79	20.73	20.78
International Equity General	MSCI World Ex Australia Index	84.25	88.37	80.99	72.92
Australian Bonds	S&P/ASX Australian Fixed Interest Index	90.32	100.00	75.76	92.11
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index	93.59	86.42	88.37	65.12

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2012. Charts are provided for illustrative purposes. Past performance is not a guarantee of future results.

## Report 2: Survivorship

This report shows the number of funds that existed in a particular category at the beginning of the period in question, as well as the percentage of funds that survived until the end of the period. Once again, the fund's category at the end of the period is not considered, since the category of interest is the one at the beginning of the holding period.

<b>Report 2: Survivorship</b>		
<b>Fund Category</b>	<b>No. of Funds at Start</b>	<b>Survivorship (%)</b>
<b>QTR</b>		
Australian Equity General	262	93.51
Australian Equity Small-Cap	75	94.67
International Equity General	127	95.28
Australian Bonds	31	100.00
Australian Equity A-REIT	78	93.59
<b>One-Year</b>		
Australian Equity General	265	92.45
Australian Equity Small-Cap	76	93.42
International Equity General	129	93.02
Australian Bonds	31	100.00
Australian Equity A-REIT	80	91.25
<b>Three-Year</b>		
Australian Equity General	286	84.27
Australian Equity Small-Cap	81	83.95
International Equity General	141	83.69
Australian Bonds	33	84.85
Australian Equity A-REIT	85	85.88
<b>Five-Year</b>		
Australian Equity General	282	81.56
Australian Equity Small-Cap	76	82.89
International Equity General	143	76.92
Australian Bonds	38	73.68
Australian Equity A-REIT	85	82.35

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2012. Charts and graphs are provided for illustrative purposes.

## Report 3: Equal-Weighted Fund Returns

This report shows the equal-weighted average returns of funds in a particular category for the quarter as well as the one-, three- and five-year periods. The eligible population in a given category is determined on a monthly basis.

For every month in the period, we calculate the simple average return of all the existing funds in each category. We then compound the returns from all the months in the period. These returns are compared to the respective benchmark index returns. Note that the population of funds used in the averaging process one month might differ from that used the next month since some funds could have merged or liquidated, new funds could have been formed and some funds could have switched categories.

Most reports that purport to show average active fund performance report on the funds in a category at the end of the period, and then take the average of their historical returns. The SPIVA methodology offers a more accurate picture of active fund performance by calculating the average performance of the active funds in existence in a given category each month – not just at the end of the period.

Report 3: Equal-Weighted Fund Returns				
Index/Peer Group	QTR (%)	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	-4.68	-6.71	5.65	-4.00
Australian Equity General	-5.62	-7.58	4.29	-4.27
S&P/ASX Small Ordinaries Index	-15.30	-14.61	3.39	-8.89
Australian Equity Small-Cap	-10.54	-7.15	11.22	-3.47
MSCI World Ex Australia Index	-3.83	0.10	3.01	-6.10
International Equity General	-5.38	-3.63	1.22	-7.22
S&P/ASX Australian Fixed Interest Index	4.78	13.09	8.91	8.51
Australian Bonds	3.86	10.35	8.28	7.20
S&P/ASX 200 A-REIT Index	8.76	11.04	12.27	-12.26
Australian Equity A-REIT	7.96	9.83	11.02	-12.85

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30 2012. Charts are provided for illustrative purposes. Past performance is not a guarantee of future results.

## Report 4: Asset-Weighted Fund Returns

This report shows the asset-weighted average returns of funds in a particular category for the quarter as well as the one-, three- and five-year periods. The eligible population in a given category is determined on a monthly basis.

For every month in the period, we calculate the average return by weighting each fund's return by its month-end assets. We then compound the returns from all the months in the period and compare the returns to the benchmark returns. Note that the funds used in the averaging process in one month might not be the same as those used the next month since some funds could have merged or liquidated, new funds could have been formed and some funds could have switched categories.

<b>Report 4: Asset-Weighted Fund Returns</b>				
<b>Index/Peer Group</b>	<b>QTR (%)</b>	<b>One-Year (%)</b>	<b>Three-Year Annualized (%)</b>	<b>Five-Year Annualized(%)</b>
S&P/ASX 200 Accumulation Index	-4.68	-6.71	5.65	-4.00
Australian Equity General	-5.28	-7.09	4.45	-3.80
S&P/ASX Small Ordinaries Index	-15.30	-14.61	3.39	-8.89
Australian Equity Small Cap	-10.00	-6.02	11.62	-3.03
MSCI World Ex Australia Index	-3.83	0.10	3.01	-6.10
International Equity General	-5.21	-2.97	1.05	-5.02
S&P/ASX Australian Fixed Interest Index	4.78	13.09	8.91	8.51
Australian Bonds	3.94	10.94	8.77	7.63
S&P/ASX 200 A-REIT Index	8.76	11.04	12.27	-12.26
Australian Equity A-REIT	7.60	9.76	11.06	-12.22

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2012. Charts are provided for illustrative purposes. Past performance is not a guarantee of future results

## Index Research & Design Contact Information

<b>Global Head</b>		
Frank Luo	+1 212-438-5057	frank_luo@spdji.com
<b>New York</b>		
Berlinda Liu	+1 212-438-7834	berlinda_liu@spdji.com
Aye Soe	+1 212-438-1677	aye_soe@spdji.com
Peter Tsui	+1 212-438-1493	peter_tsui@spdji.com
<b>Beijing</b>		
Liyu Zeng	+86 10-6569-2947	liyu_zeng@spdji.com
<b>Hong Kong</b>		
Priscilla Luk	+852 2532-8050	priscilla_luk@spdji.com
<b>London</b>		
Xiaowei Kang	+020 7176-8443	xiaowei_kang@spdji.com
Daniel Ung	+44 (0) 207 176 8340	daniel_ung@spdji.com
<b>Sydney</b>		
Simon Karaban	+ 61 2 9255 9847	simon_karaban@spdji.com

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