

# INSIGHTS

A QUARTERLY NEWSLETTER DEDICATED TO INDEX INNOVATION

---

## WINTER 2013

---

### WHAT'S INSIDE:

#### FEATURES

A Changing of the Guard 04

A Look at Housing and Consumer Finances  
Through an Indexing Lens 06

**SPECIAL FEATURE:** Why Rising Interest  
Rates May Not be a Bad Thing 08

S&P Dow Jones Indices Grabs the  
Muni Bond Megaphone 20

#### IN EVERY ISSUE

Market 360° with Howard Silverblatt:  
You Take My Breadth Away 24

Global Index News Feed 26

In the Know: Spruce up Your Knowledge  
on U.S. Preferreds 27

Index Roundup: Spotlight on New Launches 29

Upcoming Events 30

From Our Blogs 31

# Think all thought leadership is the same?



Spot the  
*difference.*

## **S&P DJI COMPLIMENTARY RESEARCH AND EDUCATION PROGRAM**

*Making sense of indexing trends and innovations relevant to today's global markets*

 PUBLICATIONS

 WEBINARS

 FORUMS

 VIDEOS

 PODCASTS

 BLOGS

**Subscribe today**

Use your favorite QR reader app and scan this QR Code



or visit [www.spdji.com/registration/](http://www.spdji.com/registration/)

---

# WHAT'S INSIDE | EDITOR'S NOTE



**CAROL CAMERON, DIRECTOR, MARKETING, S&P DOW JONES INDICES**

*Life is divided into three terms—that which was, which is, and which will be. Let us learn from the past to profit by the present, and from the present, to live better in the future.*

– William Wordsworth

Best wishes to all our readers for a happy and successful 2014! We're at the starting line of a brand new year, and along with it comes an opportunity to apply lessons learned as we set new aspirations. At S&P DJI, we're in the final stages of putting together our series of complimentary educational events and webinars for the year. The information shared by our high-caliber guest speakers—and our very own indexing professionals—can serve as a blueprint as you map out new objectives for 2014 and refine them along the way. We too took time to reflect on “that which was,” and are preparing to release new enhancements to our website. These enhancements will improve the way you explore and find indices that matter to you. Stay tuned for more and we thank you for visiting [www.spdji.com](http://www.spdji.com).

As we focus on 2014, many of the hot button issues of yesteryear still remain top-of-mind. The quandary over a rise in interest rates is certainly one of them. While there's no magic formula to predict the exact outcome, it never hurts to be prepared for the inevitable. “*Why Rising Interest Rates May Not be a Bad Thing*”—this issue's special feature—sheds light on this much-talked-about topic as some of our professionals discuss the impact of a rise in rates across asset classes and investment themes.

Housing and consumer finances are two other topics that consumers continue to ponder. There is certainly good news as home prices rose over 13%, and mortgage defaults are at pre-recession levels. Will the positive news continue? For consumers trying to decide, David M. Blitzer, Managing Director and Chairman of the Index Committee, points to two S&P Dow Jones index families that track trends in home prices and mortgage defaults in “*A Look at Housing and Consumer Finances Through an Indexing Lens*.” The S&P/Case-Shiller Home Prices Indices and S&P/Experian Consumer Credit Default Indices can help keep your finger on the pulse of these relevant indicators.

The U.S. municipal bond market also received a lot of air time in 2013, especially following Detroit's bankruptcy filing and valid concerns over Puerto Rico's ability to fund the territory. Despite recent turmoil, our focus has remained steadfast on building out our municipal bond indices. In 2013, we took the muni conversation on the road and hosted a successful half-day muni bond forum in New York City. As munis continue to be a topic of conversation, James “J.R.” Rieger, our Vice President of fixed income indices, sat down to give his take on this hot topic in “*S&P Dow Jones Indices Grabs the Muni Bond Megaphone*.” In his interview, J.R. responds to questions about the muni bond market in 2014, what the S&P Municipal Bond Puerto Rico Index tells us about the overall health of the Puerto Rican market and more. J.R. was on double-duty this quarter as he also discusses the impact of rising rates on fixed income in our special feature.

Lastly, I'm sure by now most of you are aware that McGraw Hill Financial—our parent company—has a new captain at its helm. This past November, Douglas L. Peterson succeeded Terry McGraw as President and CEO of McGraw Hill Financial. Be sure to read “*A Changing of the Guard*” for more on Doug's new role and his plans for sustainable growth for the company. Doug even shared a few tidbits about himself during the interview. For example, did you know that Doug is an art enthusiast and enjoys visiting art galleries? The art galleries in Sante Fe, New Mexico—his home town—are among his favorites.

We hope you enjoy reading our latest edition of *INSIGHTS*. As always, let us know what you'd like to read about in one of our upcoming issues by dropping me a line at [carol.cameron@spdji.com](mailto:carol.cameron@spdji.com).

Cheers to a new year of discovery, innovation and the achievement of personal and professional success.

Best wishes,

Carol Cameron

---

# A CHANGING OF THE GUARD

INTERVIEW BY CAROL CAMERON

*As 2013 drew to a close, McGraw Hill Financial ushered in a new era in a storied history dating back to the 1880s, a time when railroad infrastructure was just emerging. On November 1, 2013, Douglas L. Peterson succeeded Terry McGraw as President and CEO of McGraw Hill Financial, while Mr. McGraw remains as Chairman of the Board. In this exciting new chapter for the company, Doug is committed to leading its vision as a high-growth, high value-added, content and analytics company in the global capital and commodity markets.*

Doug joined McGraw Hill Financial in September 2011 as President of Standard & Poor's Ratings Services. Doug has led a distinguished career spanning almost three decades, much of that time spent at Citigroup in domestic and international roles. During his time there, Doug held various positions including Chief Operating Officer of Citibank N.A., Citigroup's principal banking entity that operates in more than 100 countries; CEO of Citigroup Japan; Country Manager for Costa Rica and Uruguay; and Chief Auditor of Citigroup. While at Citigroup, Doug transformed businesses and drove performance in investment and corporate banking, brokerage, asset management, private equity, and retail banking. Doug also serves on several boards including McGraw Hill Financial's.



*Doug Peterson (l.) seated with Alex Matturri, Chief Executive Officer, S&P DJI*

---

*Recently, Doug took time out of his busy schedule to speak with INSIGHTS about his now role and his plans for sustainable growth. He even shared a few tidbits about himself.*

**INSIGHTS: What was the driving force behind your decision to accept the position as President of Standard & Poor's Ratings Services back in September 2011?**

**Doug:** One of my philosophies has always been to take jobs where I can grow and learn the most. That has been the case throughout my career and it certainly was a motivating factor for joining Standard & Poor's Ratings Services and taking on my new position. The other driver was our pool of enormously talented employees.

**INSIGHTS: As the new President and CEO of McGraw Hill Financial, what is the most important message you'd like to communicate to employees, clients and shareholders?**

**Doug:** The first thing I'd like to point out is that I'm listening. I've been visiting our offices and meeting with employees in California, London, and in Washington, D.C. I've also meet with our customers and investors. The other point I'd like to make is that I'm incredibly optimistic about the future. There are significant growth opportunities in serving clients in the expanding capital and commodity markets around the world. So all of us should feel very good about where we are today and where we're headed.

**INSIGHTS: What do you see as the next challenge for McGraw Hill Financial as you begin your first full year in this role?**

**Doug:** The most critical question we need to continue to get right is whether we're deploying resources where they're most needed, in terms of businesses and geographies. We need to make sure we have the capabilities to serve complex, global markets. That means having the right talent, the appropriate processes and technology in place, and the proper balance for capital allocation to fund organic growth, acquisitions and return cash to shareholders.

**INSIGHTS: According to the company's mission statement, promoting sustainable growth is a primary focus moving forward. Can you talk about your plans for sustainable growth?**

**Doug:** We work from the premise that our credit ratings, indices, benchmarks and analytics inform investors' thinking and help create the transparency and insights necessary for markets to grow in a sustainable way, create jobs and economic growth. There are powerful and long-term trends in the financial markets, including globalization and disintermediation, from which we will continue to benefit. To capitalize on these market forces, we need to make sure our employees are attuned to market needs and are constantly innovating.



**INSIGHTS: McGraw Hill Financial boasts a stable of some of the most iconic brands in business and more specifically, finance. May I ask you to briefly describe where you see the main synergies between the various businesses that make up the company?**

**Doug:** There are lots of commonalities and complementary components here. For example, in November, S&P Ratings Services and S&P Dow Jones Indices co-hosted a symposium in Washington about the future of housing finance. Bob Shiller was the keynote speaker. It was an outstanding event and one that I think clearly demonstrates how our businesses can work together to produce a superior experience for our clients. Another example that I'd like to highlight is the work we are doing to leverage the technology skills we have across the company to develop mobile apps. We now have a data and technology committee, run by Lou Eccleston and our CFO Jack Callahan. I think data is like gold for us. It's so critical for us in two senses: one, is we have to protect it, so we can have the best and highest quality protection; and two, because we need to mine it. And, the way you mine it is with technology. We should be known as a company that has the highest quality standards for protecting and managing our data and mining it to provide innovative, creative and relevant solutions, products and services to our clients.

**INSIGHTS: Let's talk specifically about S&P Dow Jones Indices (S&P DJI) for a moment. According to company financials, from 1986 to 2011, revenue from the index business grew by a compound annual growth rate of 29%. In 2012, revenue increased by 20% [primarily due to revenue from the newly created S&P DJI joint venture]. What are your perspectives on continued growth for S&P DJI?**

**Doug:** There's no question the trend of rapid expansion continues. Through the first nine months of 2013<sup>1</sup>, S&P Dow Jones Indices produced 31% revenue growth. That is outstanding. We are focused on growth by covering new international markets and new asset classes. At the end of last year, there were more than 600 ETFs based on S&P Dow Jones Indices and that number continues to grow. In November, we announced the creation of the first S&P 500 ETF to be listed in China. As we've said before, our commitment is to provide an index for every kind of investment.

**INSIGHTS: In your opinion, what do you think sets S&P DJI apart globally, in terms of brand appeal, product offerings or unique capabilities?**

**Doug:** You're right to highlight the brand—it really does differentiate us. Having names like S&P and Dow Jones, backed by a rich history of innovation and independence is extremely helpful. We created S&P Dow Jones Indices in 2012 with our partner, the CME Group. It's a terrific partnership that creates new opportunities for growth and innovation as we expand in global markets, particularly with exchanges in Mexico, Brazil and Korea.

**INSIGHTS: Over the course of your career, you've worked in various countries around the globe, including Japan, Uruguay, Costa**

**Rica and Argentina. We understand you're fluent in Spanish and know a little Japanese. How do these language skills and cultural understanding play as assets in your new role, especially given S&P DJI's recent expansion into Latin America and acceleration of its investment in the Pan Asian markets?**

**Doug:** Being global is critical and it's a skill, a mindset that I have valued highly throughout my career. My experience does give me an appreciation for global markets. I'm impressed with S&P DJI's expansion into Latin America. For example, we now have the S&P MILA 40 to cover Chile, Colombia and Peru. As stock markets in emerging countries become more sophisticated and more liquid, the understanding we have of and the relationships in those markets will be critical to giving investors the confidence in knowing we can produce independent benchmarks.

**INSIGHTS: On a lighter note, as the new CEO, I'm sure everyone would like to get to know you a little better. Can you share three things about yourself that aren't solely work-related?**

**Doug:** You mentioned I speak Spanish. My wife is from Argentina and we speak Spanish at home. I'm from New Mexico and learned to appreciate Spanish at an early age. I always look forward to going home to New Mexico, not only to see my friends and family, but to visit art galleries in Santa Fe and our favorite restaurants.

One of my favorite hobbies is music, especially attending live performances. In school, I played various instruments including the tuba and bass in the orchestra and in a jazz band. I also played the electric bass when I was in college.

Another one of my interests is that I like to explore and travel with my family. When I travel, I like to visit archeological sites, history museums, art galleries and art museums.

**INSIGHTS: As we wrap up this interview, please finish this sentence. The characteristics of a strong leader are...**

A strong leader has a vision and a strategy that the whole organization is focused on and supports. Good leaders also must have integrity and accountability, which permeate throughout the whole organization, and guide the way it treats clients and employees. Strong leaders must also be good communicators, including being a good listener. Communication is the glue that holds an organization together.

McGraw Hill Financial is home to some of the most iconic brands in finance and business including: Standard & Poor's Ratings Services, S&P Capital IQ, S&P Dow Jones Indices, Platts, CRISIL, J.D. Power, and McGraw Hill Construction. McGraw Hill Financial was created following the completion of the sale of McGraw-Hill Education to Apollo Global Management, LLC in March 2013.

Read more about the company's history at [www.mhfi.com](http://www.mhfi.com).

<sup>1</sup> Full-year results were not available at the time of this interview.

# A LOOK AT HOUSING AND CONSUMER FINANCES THROUGH AN INDEXING LENS



**DAVID M. BLITZER**, MANAGING DIRECTOR AND CHAIRMAN OF THE INDEX COMMITTEE

*Falling home prices, rising mortgage debt, Lehman Brothers' bankruptcy and the U.S. Treasury's conservatorship of Fannie Mae and Freddie Mac all contributed to the major losses seen during the financial crisis and recession. Fast-forward five-plus years later and there is good news to report on both fronts: home prices are up more than 13% in the last year and mortgage defaults are back to pre-recession levels.*

Looking back at the financial crisis is interesting and educational; looking forward may be rewarding for investors. For consumers trying to decide whether the good news is likely to continue, there are two S&P Dow Jones index families that track current trends in home prices and mortgage defaults which can help: the S&P/Case-Shiller Home Prices Indices and the S&P/Experian Consumer Credit Default Indices.

The S&P/Case-Shiller Home Prices Indices track home prices nationally and in 20 major cities across the U.S. Creating an index of home prices poses some special challenges:

1. Houses differ from one another, so simply averaging the prices of homes provides little indication of their true value.
2. Unlike consumer goods, food, or stocks and bonds, most houses aren't sold every day or week. Rather, a house may not go on the market for several years.

The S&P/Case-Shiller Indices, originally developed by Robert Shiller from Yale University and Karl Case from Wellesley College, address these issues using an approach called repeat sales. Data on home sales going back several years are collected. Then, the history of each house is examined. Next, the last two times the house was sold are identified and the change in prices from the earlier sale to the later sale is calculated. The price changes, weighted by the value of the house and adjusted for the time between sales are combined to calculate the index. The result is an index analogous to a market-capitalization weighted equity index that measures the value of housing in a city. The index is called repeat sales because only houses sold twice—repeated—can be included. Given the need for a repeated sale, new never-sold-before homes cannot be included in the index. Since 2005, these indices have been widely followed and have also been used by the Federal Reserve in their bank stress tests.

The S&P/Case-Shiller Home Price Indices tell the story of the housing boom, bust and subsequent financial crisis. As shown in Chart 1, home prices began to climb during the 1990s, accelerated

early in the 2000s and peaked in July 2006. From January 2000 to mid-2006, the S&P/Case-Shiller 20 City Composite index doubled in those six and a half years. It then declined until March 2012 when it lost 35%. Looking across the 20 cities covered in the indices, Miami showed the largest gains, up 181% from January 2000 to December 2006, and subsequently lost 51% from December 2006 to April 2011. Las Vegas was the city with the largest loss, losing 62% from August 2006 to March 2012.

Mortgage difficulties and defaults were a large part of the financial crisis. Together with Experian, a credit reporting agency, S&P Dow Jones Indices publishes the S&P/Experian Consumer Credit Default Indices. These indices measure defaults on consumer borrowing through bank credit cards such as Visa® and Mastercard®, auto loans as well as first and second mortgages. The indices measure the percentage of current balances that default in each month. An index level of 5.0 means that 5% of the currently good balances were declared to be in default. Default is defined as 90 days past due for mortgages or auto loans and 180 days past due for bank credit cards. The national S&P/Experian Consumer Default Indices paint a picture of the financial crisis very much like the S&P/Case-Shiller Home Price Indices.

Here the current news is good—default rates are back to the normal or pre-recession levels. All four series are equal to or lower than their 2004 levels [see Chart 2]. The series with the highest default rates on bank cards is lower than anything seen since 2004 and continues to decline.

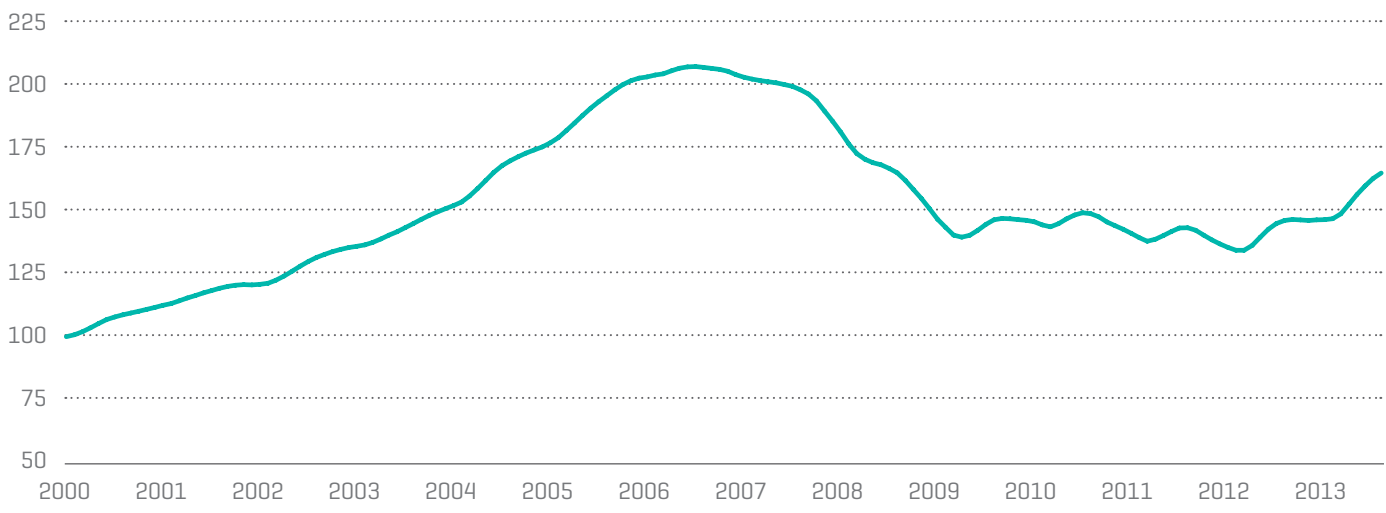
Comparing the auto and first mortgage default patterns shows an unusual aspect of the recent recession. In most downturns, consumers make large efforts to keep current on their home mortgage payments, even if they risk defaulting on car loans or other debts. In the 2007-2009 recession, this pattern shifted and consumers in many cases seem to have sacrificed their mortgage to hold onto their cars and credit cards.

The improving picture for both home prices and consumer credit are largely a result of the Fed's quantitative easing [QE1-2-3] policies put in place in the last few years. These programs of buying bonds on the open market have kept interest rates unusually low and led to rising asset prices for both houses and the stock market. The central bank can be directly credited for many of the gains in home prices. The gradual recovery in the economy and the associated decline in the unemployment rate, from 10% in October 2009 to 7.3% in October 2013, as well as low interest rates, contributed to the improved consumer credit default results. One related measure is the Federal Reserve's Debt Service Ratio, which shows the percentage of personal disposable income going towards debt service each month. The current figure, a bit under 10%, is the lowest

on record going back to 1980, compared to 13.7% at the worst moment during the recession.

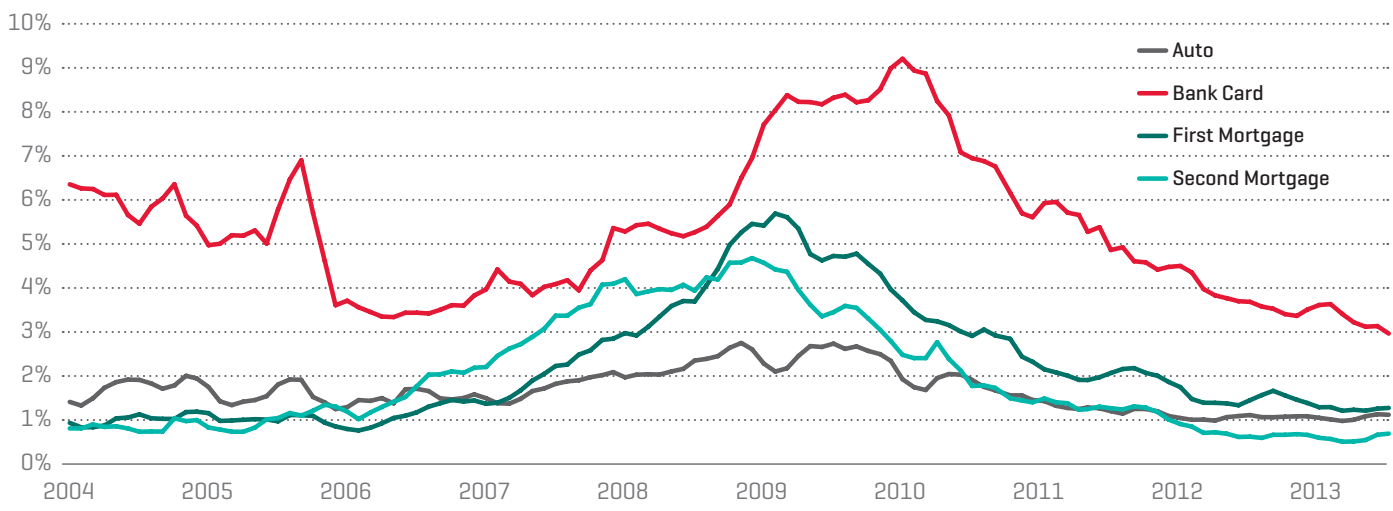
The good news on home prices and consumer defaults doesn't mean that all the damage of the recession and financial crisis is completely repaired. While current conditions are improving, the damage caused by falling prices, foreclosures and the recession still exists in many parts of the country. In normal times, about 1.0% to 1.5% of outstanding mortgages are in foreclosure. During the worst of the recession, this rose to over 4.5%. Currently it's down to 3.0%. Moreover, home prices remain about 20% below their highs and are roughly at the same level as in 2003-2004, ten years ago.

**CHART 1: S&P/CASE-SHILLER 20-CITY COMPOSITE INDEX**



Source: S&P Dow Jones Indices. Data as of October 1, 2013. This chart is provided for illustrative purposes only.

**CHART 2: S&P/EXPERIAN CONSUMER DEFAULT INDICES**



Source: S&P Dow Jones Indices. Data as of August 1, 2013. This chart is provided for illustrative purposes only.

# WHY RISING INTEREST RATES MAY NOT BE A BAD THING

In this special feature, our index industry professionals focus their attention on the impact of rising interest rates across asset classes and investment themes. Craig Lazzara, CFA, Senior Director at S&P Dow Jones Indices, kicks things off with his perspective in *"Rising Interest Rates: Conventional Wisdom and Unconventional Context."* Following Craig's explanation on why conventional wisdom dictates that rising rates are bad for stocks as well as more recent results that may indicate otherwise, our other contributors examine the potential impact of rising interest rates across U.S. equity, fixed income, commodities, REITs and strategy tilts.

## Rising Interest Rates: Conventional Wisdom and Unconventional Context



**CRAIG LAZZARA, CFA, SENIOR DIRECTOR, INDEX INVESTMENT STRATEGY**

*Craig Lazzara is global head of index investment strategy for S&P Dow Jones Indices. The index investment strategy team provides research and commentary on the entire S&P Dow Jones Indices product set, including U.S. and global equities, commodities, fixed income, and economic indices. Craig previously served as product manager for S&P Indices' U.S. equity and real estate indices.*

Conventional wisdom tells us that rising interest rates are bad for stocks. In recent months, any suggestion that the U.S. Federal Reserve might begin to allow interest rates to rise has been enough to roil the equity markets. Contrariwise, the Fed's September 18, 2013, announcement that the anticipated "tapering" of its stimulus program had been indefinitely postponed sparked an equity rally.

At some level, it's not surprising that investors are wary—it's been a long time since the U.S. market has seen a sustained rise in interest rates.<sup>1</sup> Exhibit 1 shows that since yields peaked in 1981, the three subsequent decades have witnessed a remarkable bull market for bonds. The yield on the 10-year Treasury bond fell from more than 15% in 1981 to its current level (June 2013) of less than 3%. This longer-term history<sup>2</sup> may be particularly useful because, although we're able to identify periods of rising interest rates over the past 20 years, they pale in comparison to the rising rates of the pre-1981 bond market.

**EXHIBIT 1: 10-YEAR TREASURY YIELD FROM 1953 THROUGH 2013**



Source: Federal Reserve. Data from April 1953 through June 2013.

<sup>1</sup> See Fei Mei Chan and Craig Lazzara, "Income Beyond Bonds," S&P Dow Jones Indices, March 2013, <http://us.spindices.com/documents/research/research-income-beyond-bonds.pdf>.

<sup>2</sup> The data start in 1953 since the Federal Reserve ended its control of government debt markets in mid-1951. [Controls had been instituted as a wartime measure in April 1942.] See Robert L. Hetzel and Ralph F. Leach, "The Treasury-Fed Accord: A New Narrative Account," Federal Reserve Bank of Richmond Economic Quarterly Volume 87/1 Winter 2001.



## Conventional Wisdom

There are good theoretical explanations<sup>3</sup> for why rising rates should be bad for stocks, and the long-term data support the theory. Since April 1953 (through June 2013), the average monthly return of the S&P 500® has been 0.94%. Of the 722 months covering this period, there were 347 months when the 10-year Treasury declined and 358 months when it rose.<sup>4</sup> In months when the 10-year Treasury declined, the average monthly return for the S&P 500 was 1.38%. This compares to an average monthly return of just 0.63% in months when the 10-year Treasury rose, less than half the return of the declining months. Consequently, **measured over the last 60 years, rising rates have indeed been bad for the stock market.**

Drilling down further, Exhibit 2 breaks the data into modified “quartiles.” When 10-year Treasury rates rose, the median increase was 14 basis points (bps)—we can use this breakpoint to refine our data sample into “large” increases and “small” increases. We can do the same for periods of falling rates, which lets us look at “large” and “small” rate declines separately.

**In the months when 10-year Treasury rates increased the most, the S&P 500 fell by an average of 0.12%.** This quartile—with relatively large interest rate increases—is the only quartile in which the S&P 500 declined on average. Contrariwise, in the 173 months when interest rates declined the most, the S&P 500 experienced the best monthly performance (1.50% on average). **Both results are consistent with the view that rising rates are bad for the stock market.**

### EXHIBIT 2: INTEREST RATES AND STOCK PERFORMANCE

	NO. OF MONTHS	AVERAGE MONTHLY CHANGE IN 10-YEAR TREASURY [BPS]	AVERAGE MONTHLY S&P 500 RETURN [%]
<b>Biggest Declines</b>	173	-33	1.50
<b>Moderate Declines</b>	174	-7	1.27
<b>Moderate Increases</b>	180	6	1.37
<b>Biggest Increases</b>	178	32	-0.12

Source: S&P Dow Jones Indices and Federal Reserve. Data from April 1953 through June 2013. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

## More Recent Results

Although results for the last 60 years are clear, we’ve begun to see exceptions to the conventional wisdom more recently. In the past 15 years, in fact, the exception has become the rule. Between 1953 and 1997, falling rates accompanied rising stock markets 80% of the time. Between 1998 and 2012, falling rates were associated with rising stocks only 27% of the time.

Exhibit 3 shows the performance of the S&P 500 in declining and rising interest rate environments—this time juxtaposing the data for the two different periods (1953-1997 and 1998-2013). **The behavior of equities in the most recent historical period is starkly different from that of both the more distant history and the period as a whole.**

### EXHIBIT 3: INTEREST RATE QUARTILES AND STOCK PERFORMANCE

	AVERAGE MONTHLY S&P 500		
	April 1953-Dec 1997 [%]	Jan 1998-June 2013 [%]	April 1953-June 2013 [%]
<b>10-Year Down</b>	2.15	-0.38	1.38
<b>10-Year Up</b>	0.30	1.81	0.63

Source: S&P Dow Jones Indices. Data from April 1953 through June 2013. This charts is provided for illustrative purposes only. Past performance is no guarantee of future results.

<sup>3</sup> In a dividend discount model, a stock’s discount rate should reflect both the risk-free rate of interest and a risk premium. If Treasury rates rise, that increase in the risk-free rate pushes the discount rate up and theoretical stock prices down.

<sup>4</sup> Of the total 722 months, there were 17 when the 10-year Treasury did not change.

## Unconventional Context

One of the distinctive elements of today's economic environment is the unprecedented importance of the Federal Reserve system. Exhibit 4 shows that, over the past six years, the Fed's balance sheet has ballooned from USD 869 billion to over USD 3.9 trillion.

EXHIBIT 4: TOTAL ASSETS OF THE FEDERAL RESERVE SYSTEM



Source: Board of Governors of the Federal Reserve System, [http://www.federalreserve.gov/monetarypolicy/bst\\_recenttrends.htm](http://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm).

Some of the growth was in response to the 2008 financial crisis. Since that time, the Fed has continued its activist policy. It is unquestionably true that its policies have caused both short- and long-term interest rates to be significantly lower than they would otherwise be. The Fed has always been a substantial influence on the national and global economies—but its current degree of importance is unprecedented. **Whatever happens next to interest rates won't happen by accident, but by the considered decision of the Federal Open Market Committee.**

That said, to what degree should the prospect of Federal Reserve tapering unsettle equity investors? The evidence does not allow a definitive answer. There are good historical reasons to believe that the prospective increase in interest rates will be bad for the stock market, but there are also reasons to believe the opposite.

Consider a scenario in which the economy, having been in the doldrums, begins to perform better. This might well trigger an increase in interest rates, which on its own should cause stock prices to fall. But there are potentially countervailing factors:

- If the resurgent economy causes earnings growth forecasts to increase, that might imply a higher level of stock prices.
- If corporate boards and managements feel more confident, they may increase dividend payout ratios, leading to a further support for increased equity prices.

These factors might make it possible for interest rates and stock prices to rise at the same time. In this scenario, rather than rates causing stocks to move, it's better to consider that rates and stock prices can both be driven by the same set of exogenous economic variables. **It's possible that the same variables that will lead the Fed to increase rates will also support higher equity prices.**

# 5 Views on the Effect of Rising Interest Rates on Asset Classes and Investment Themes



## 1. THE U.S. EQUITY PERSPECTIVE

**PHILIP MURPHY, CFA, VICE PRESIDENT, U.S. EQUITY PRODUCT MANAGEMENT**

*Phil is responsible for U.S. equities product management at S&P Dow Jones Indices and has over 20 years of experience in the financial services industry.*

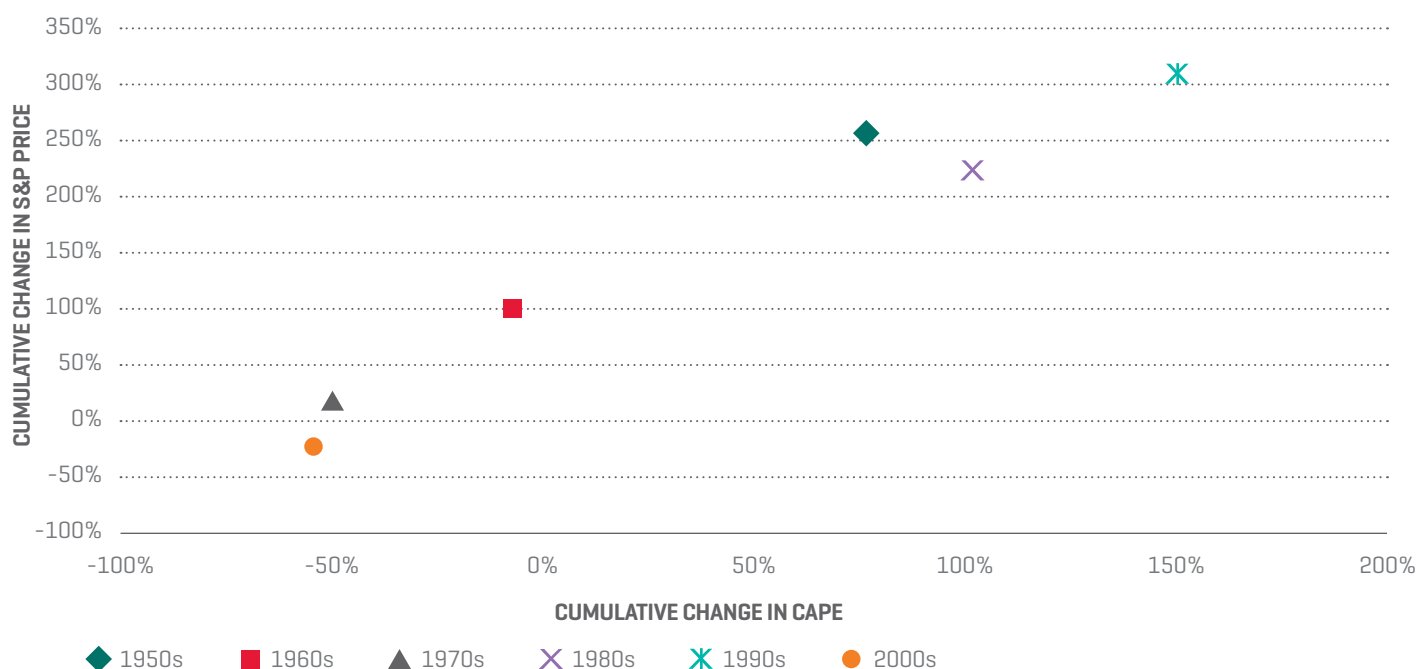
In their recent whitepaper, “*Much Ado About Interest Rates*,” Craig Lazzara and Fei Mei Chan at S&P Dow Jones Indices astutely illustrate the pitfalls of one-dimensional thinking with respect to the relationship of stock returns and interest rates. Since 1991, several periods of rising rates (as measured by the constant maturity 10-year treasury rate) have coincided with positive performance generated by the S&P 500®. However, prior to 1991, conventional wisdom that stock performance and rates are inversely related seemed to prevail. As Fei Mei and Craig point out, stocks and rates are both affected by exogenous variables. There are economic forces at work which will affect both—sometimes rendering a positive relationship and sometimes an inverse one. In short, the relationship may be less causal than commonly believed.

Stocks and rates (being an alternative expression of on-the-run risk-free bond prices) both represent financial claims. Therefore,

factors generally affecting the value of financial claims will influence stocks as well as rates. The single variable (though it can be measured any number of ways) that links financial claims to real goods and services, i.e., that we consume, live in, wear, and ultimately need to survive, is the prevailing and expected level of inflation. Ed Easterling’s research indicates why inflation may yield further insight<sup>5</sup> into stock returns (also the topic covered here). Of course, expected inflation is a component (now observable via the breakeven inflation rate which is the difference between TIPS and nominal treasuries of the same tenor) of prevailing risk-free rates, so it is fitting to consider it as part of a wider rates discussion.

The transmission mechanism between expected inflation and equity returns is market valuation. Exhibit 1 shows that valuation was the primary driver of stock returns in each decade since the 1950s.

**EXHIBIT 1: CUMULATIVE PRICE CHANGE FOR THE S&P 500 (Y AXIS) AND CUMULATIVE CHANGE IN SHILLER’S CYCLICALLY ADJUSTED PRICE EARNINGS RATIO (CAPE)**



Source: S&P Dow Jones Indices’ calculations using data from Robert Shiller’s website, <http://www.econ.yale.edu/~shiller/>. This chart is provided for illustrative purposes only.

<sup>5</sup> See “Financial Physics” at [www.crestmontresearch.com](http://www.crestmontresearch.com).

Changes in interest rates often coincide with changes in inflation (with expected inflation a component of rates as pointed out earlier). Yet, the two do not move in lockstep. Real rates (the other principal component of nominal rates) respond to the supply and demand of capital, which in turn, is a function of perceived economic growth opportunities and planned investment.

In the 1950s, market valuation expanded concurrently with interest rates. This was in the presence of modest and stable inflation. In the 1960s, market valuation contracted while rates increased. The high inflation of the 1970s contracted market multiples. The percentage change in rates through this period was much less than the 1950s or 1960s—so it was not rate increases per se, but inflation, that drove the P/E contraction and meager equity returns. With the turnaround of inflation during the 1980s came a doubling of the market valuation and handsome stock returns. Both trends continued through the

1990s. In the 2000s, for the first time since the 1950s, rates and valuation again moved in the same direction. But this time they both contracted because of the danger of deflation.

In environments of modest and stable inflation, valuations may become elevated—in part because there is little uncertainty regarding the purchasing power of expected cash flows generated by stocks. However, in times of high and unstable inflation it may not be clear which listed companies will have the pricing power to pass on higher costs to customers, so valuations for those cash flows have historically declined. Conversely, in times of deflationary threats, it may not be clear which listed companies will be able to survive given outstanding debt loads and declining nominal revenue. As such, valuations for the cash flows of publicly listed companies have historically declined in these periods. Given the current situation, investors may want to keep their eyes focused on the inflationary/deflationary outlook more than on rates per se.

EXHIBIT 2: CUMULATIVE CHANGES IN INFLATION, 10-YEAR INTEREST RATES, AND STOCK MARKET VALUATION OVER SIX DECADES

CUMULATIVE CHANGE	CPI	RATES	CAPE
1950s	24.58%	102.23%	76.88%
1960s	28.23%	63.11%	-6.97%
1970s	103.45%	35.82%	-49.53%
1980s	64.41%	-24.54%	101.83%
1990s	33.47%	-19.90%	150.42%
2000s	28.31%	-42.83%	-54.04%

Source: S&P Dow Jones Indices’ calculations using data from Robert Shiller’s website, <http://www.econ.yale.edu/~shiller/>. This chart is provided for illustrative purposes only.



## 2. THROUGH THE FIXED INCOME LENS

**JAMES “J.R.” RIEGER, VICE PRESIDENT, FIXED INCOME PRODUCT MANAGEMENT**

*With over 30 years of fixed income experience, J.R. leads S&P Dow Jones Indices’ effort to reach into areas of the capital markets beyond traditional equity, overseeing the creation and management of fixed income indices.*

Just like the well-known insurance commercial hyping the phrase, “15 minutes can save you 15% or more ...,” everyone is quite familiar with the undisputed wisdom that states, “When yields go up, bonds go down.” Of course, this is also true for fixed-rate bonds. After all, the price of a bond is simply the sum of the present value of its future cash flows. As the discount rate (yield) rises, the present value will fall, a result of indisputable mathematics, making the converse true as well.

## Duration, Duration, Duration

How much the price of an individual bond changes—given a change in its yield—is a function of the bond’s duration. The longer the duration, the more the price will change. Duration is, in turn, a function of the term structure of a bond and includes the periodic coupon, maturity date and the potential effect of early redemption provisions. This becomes a bit more complicated but is also the result of indisputable mathematics.

Modified durations calculated based on index constituents can tell us a lot about the theoretical shift in prices given a shift in yields. Exhibit 1 shows the weighted average duration of various asset classes tracked across various fixed income indices. If we use

the S&P National AMT-Free Municipal Bond Index with a duration of just under 5.5 years, as an example, a shift of 100 bps in yields would result in a change in the average price of bonds in the index by approximately 5.5%. Shorter-duration bonds would see their prices move less and longer-duration bonds would see their prices move to a greater degree.

Term structure plays a very important role in determining how much a bond’s price will rise or fall when interest rates change. All things being equal, given a shift in interest rates, premium bonds—bonds priced above par—will not fall as fast as bonds priced below par. Again, indisputable bond math is at work here.

### EXHIBIT 1: VARIOUS FIXED INCOME INDICES AND THEIR WEIGHTED AVERAGE DURATION

INDEX	DURATION
S&P Short Term National AMT-Free Municipal Bond Index	1.97
S&P/BGCantor US Treasury Bond Index	3.75
S&P U.S. Issued High Yield Corporate Bond Index	4.83
S&P International Corporate Bond Index	5.35
S&P National AMT-Free Municipal Bond Index	5.44
S&P Eurozone Sovereign Bond Index	6.20
S&P U.S. Issued Investment Grade Corporate Bond Index	6.30
S&P US Treasury TIPS Index	6.90
S&P Eurozone Sovereign Bond 7-10 Years Index	7.18
S&P/BGCantor 7-10 Year US Treasury Bond Index	7.60
S&P Municipal Bond 20+ Year Index	8.60
S&P/BGCantor 20+ Year US Treasury Bond Index	16.90

*S&P Dow Jones Indices. Data as of December 31, 2013. Chart provided for illustrative purposes only. Past performance is no guarantee of future results.*

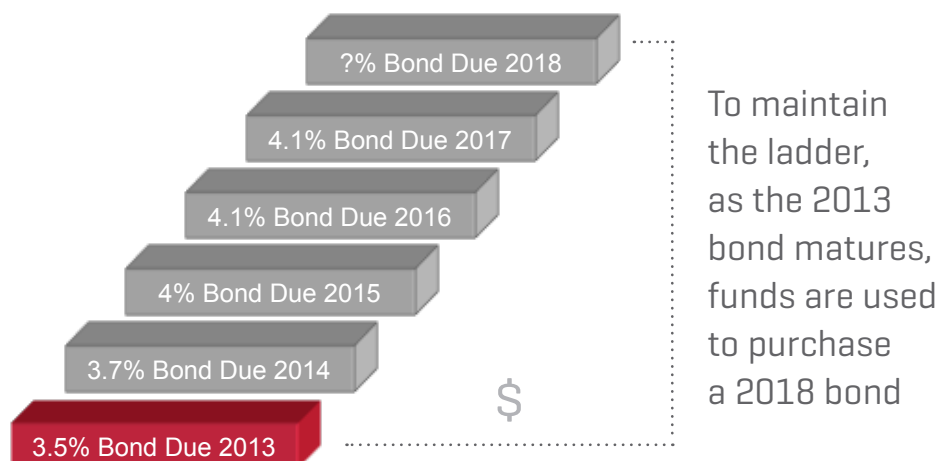
## Duration Management

Like most bond funds, the indices listed in Exhibit 1, for example, are perpetually tracking the markets they measure. However, duration management often means having more certainty around cash flows of investments. As such, developing indices that mature like bonds is a direct result of that need. For example, the S&P AMT-Free Municipal Series indices are designed to track very specific maturity segments of the municipal bond market and are good representations of this evolution in indexing. The Municipal Series has an index for each year (2014 through 2023). Each year, a new 10-year index is launched. The 2024 index, for example, will launch in 2014 when there are enough non-callable bonds to populate the index.

As another example, the S&P AMT-Free Municipal Series 2018 only tracks fixed-rate, non-callable, tax-free, investment-grade municipal bonds maturing in June, July and August of 2018. On August 31, 2018, all bonds in the index would have matured, and due to the quality of the bonds in the index, the interest in principal would have been paid out. The resulting effect is simple: a diversified basket of bonds all maturing in a tight timeframe with no uncertain cash flows between now and that point in time. With this series, a tool has been created to help manage duration, and more specifically laddering.



## EXHIBIT 2: SIMPLE EXAMPLE OF A SHORT-TERM BOND LADDER



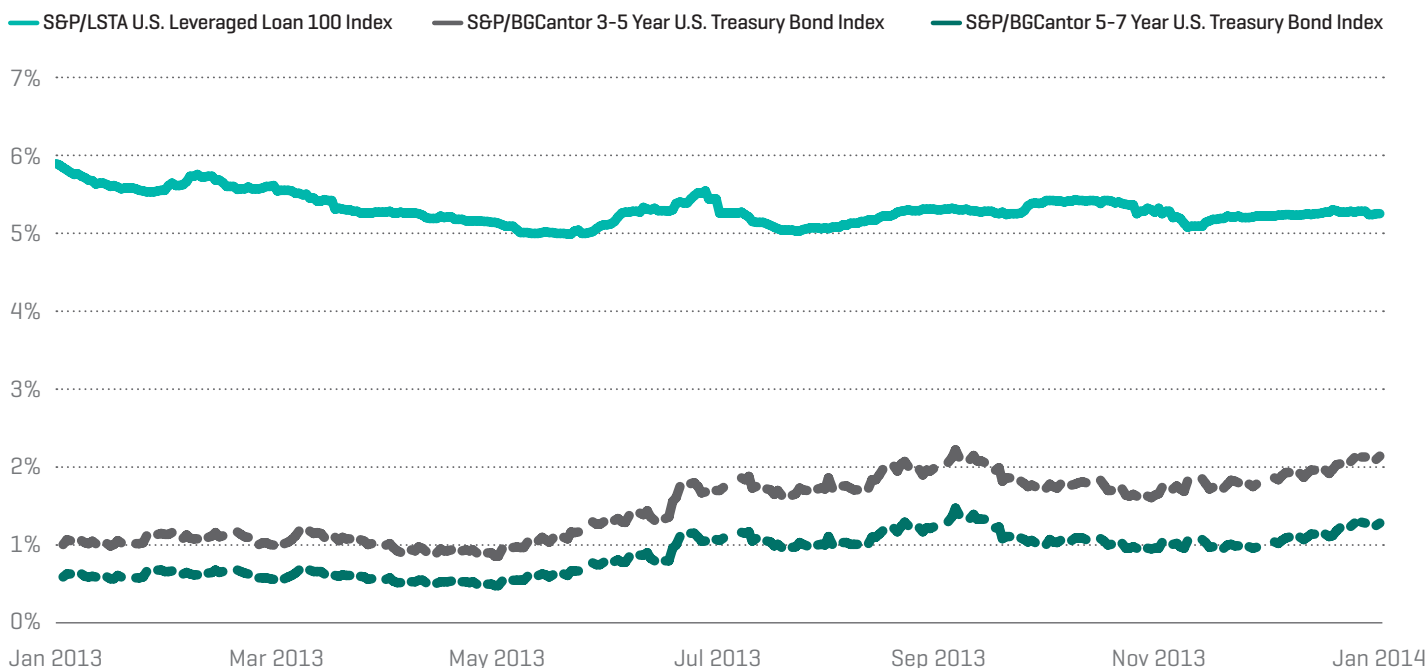
Source: S&P Dow Jones Indices. Charts are provided for illustrative purposes.

## Fixed Rate Versus Floating Rate

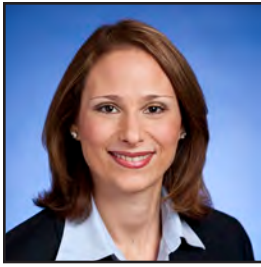
A quick look at floating-rate debt reveals a totally different story. The S&P/LSTA U.S. Leveraged Loan 100 Index is a good example, as the interest owed to investors on the loans tracked in this index is based on spreads over LIBOR. As interest rates rise and fall the interest rates paid to the lenders change.

Looking at performance in the rising interest rate environment seen in 2013, U.S. Treasury bond yields have risen, impacting the performance of U.S. Treasury bonds. Floating-rate debt has seen yields come down and prices rise, partially due to the demand for floating-rate debt and their term structure.

## EXHIBIT 3: YIELDS AND PERFORMANCE OF SENIOR LOANS AND U.S. TREASURY BONDS (2013 YTD)



Source: S&P Dow Jones Indices. Data as of December 31, 2013. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.



### 3. THE COMMODITIES ANGLE

**JODIE GUNZBERG, CFA, VICE PRESIDENT, COMMODITY INDICES**

*Jodie is responsible for the product management of S&P DJI Commodity Indices, which include the S&P GSCI® and DJ-UBS Commodities Index, the most widely recognized commodity benchmarks in the world.*

Commodities have historically been influenced by many factors that drive the supply and demand. Together, these factors determine pricing. Some of these factors are specific to single commodities or sectors like the weather, pipeline bursts, technology advancements, and even mad cow disease. These “market surprises” drive the component of return called expectational variance. This component contributes to patterns of returns that differ from equities and also gives the exposure to unexpected inflation. However, some factors are more macro in nature like GDP growth, inflation, the U.S. dollar as well as interest rates. While these factors are difficult to isolate (as it relates to determining their impact on commodity prices), interest in these influences does exist. Since rising interest rate environments are often an area of concern, a review of their potential impact on commodity prices may be useful.

The most direct and measurable impact of interest rates on commodities can be observed from the formal relationship between spot and futures prices, as defined by the theory of storage equation, which can be written as:

$$F_{0,T} = S_0 \exp[(r+c-y)T]$$

Where:

$F_{0,T}$  = the futures price today for delivery at time T;

$S_0$  = the spot price today;

$r$  = the riskless interest rate, expressed in continuous time;

$c$  = the cost of physical storage per unit time, expressed in continuous time;

$y$  = the convenience yield, expressed in continuous time.

This equation is often used to explain the futures price in terms of the spot price, the interest rate, the cost of storage and the convenience yield as discussed by Gunzberg and Kaplan [2007].<sup>6</sup>

Although the interest rate and cost of storage are straightforward, the convenience yield is more complex. It's defined by the flow of benefits to inventory holders from a marginal unit of inventory. Generally,

inventory levels have an inverse relationship with convenience yield. This means that there is a low convenience yield when inventories are high. However, as inventory levels fall, the convenience yield increases at an accelerated pace as inventories are depleted. Simply put, there is a price consumers are willing to pay to have immediate access to a commodity due to shortages. As an example, a refiner is likely to pay a premium to have oil when there is a shortage so that its production of gas is not disrupted.

Storage can be used by both producers and consumers to fill gaps between production and sales, or between purchases and consumption. When a commodity is placed in storage to be delivered at a set time in the future at the futures price, then the opportunity to earn interest from selling that commodity in the spot market, and then investing in a Treasury bill is lost. Also, there are storage facility costs plus the gain (or loss) from the difference between the spot price and futures price.

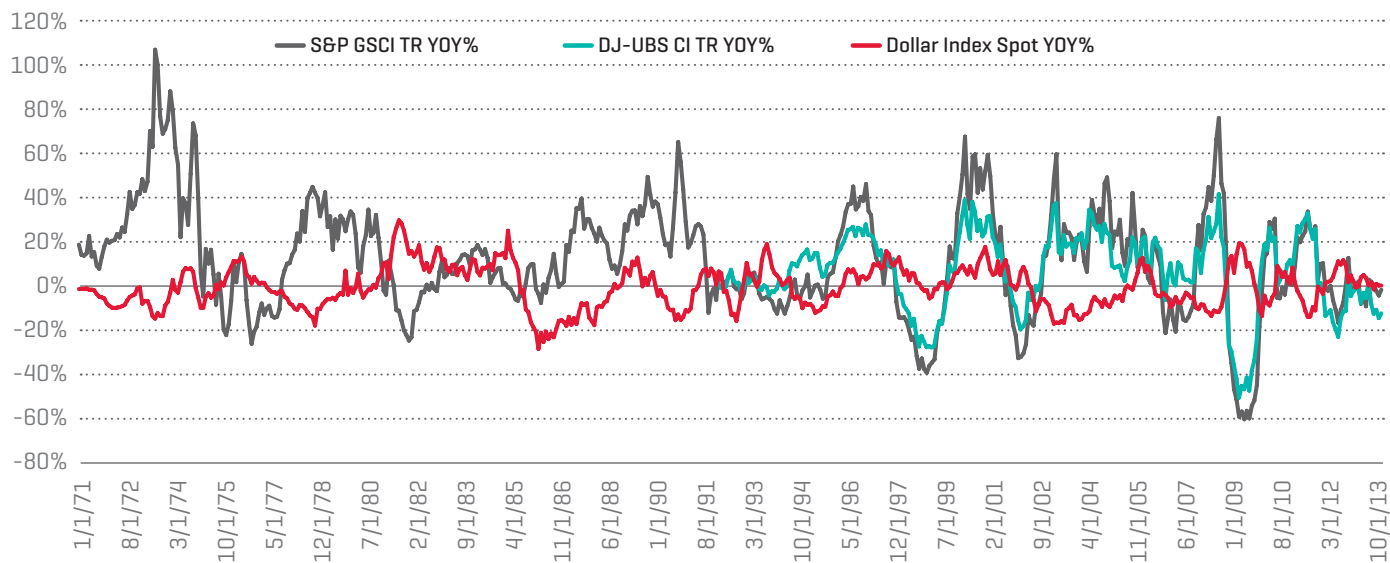
Based on the above theory, two probable implications can be drawn about the effect of rising interest rates on commodities:

1. Futures prices rise, and
2. By storing, the opportunity cost is higher from the forgone interest, diminishing the incentive to store. In addition to diminishing this incentive, the rising rates may motivate investors to shift investments from commodities into yield-generating capital assets.

A reduction in quantitative easing, which might strengthen the U.S. dollar, is another factor that can potentially impact commodities as a result of rising interest rates. As the U.S. dollar strengthens, goods priced in this currency become more expensive in other currencies (see Exhibit 1).

<sup>6</sup> “The Long and Short of Commodity Index Investing”, by Jodie Gunzberg and Paul Kaplan, *Intelligent Commodity Investing*, edited by Hilary Till and Joe Eagleeye.

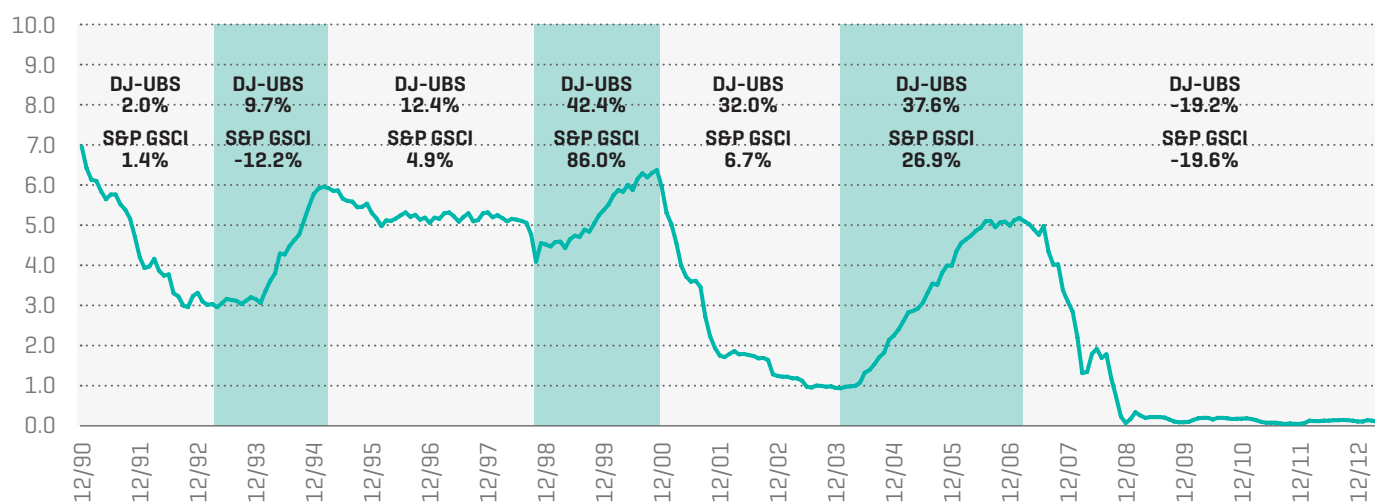
## EXHIBIT 1: THE INVERSE RELATIONSHIP BETWEEN COMMODITIES AND THE U.S. DOLLAR



Source: S&P Dow Jones Indices, Bloomberg. Data from January 1971 to October 2013. Past performance is no guarantee of future results. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. The S&P GSCI was launched in or about May 1991 and the DJ-UBS Commodity Index was launched in or about July 1998. All information presented prior to the Launch Date is back-tested. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com).

However, there are reasons why commodities appear attractive in a rising interest rate environment, as the current combination of economic growth and rising rates may be a powerful backdrop for commodities. The growth of emerging economies supports demand for commodities, which are the raw materials that are inputs to finished goods. Although it is difficult to derive the actual impact of falling and rising interest rates on commodities (see Exhibit 2), one conclusion can be drawn—there is the potential for higher returns in times of rising interest rates.

## EXHIBIT 2: COMMODITY INDEX PERFORMANCE DURING PERIODS OF RISING AND FALLING INTEREST RATES



Source: S&P Dow Jones Indices and Federal Reserve. Data from December 1990 through June 2013. Past performance is no guarantee of future results. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. The S&P GSCI was launched in or about May 1991 and the DJ-UBS Commodity Index was launched in or about July 1998. All information presented prior to the Launch Date is back-tested. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com).

Lastly, total return versions of commodity indices, such as the DJ-UBS Commodity Index and the S&P GSCI® are, by definition, positively impacted by rising interest rates that earn interest on the collateral of the futures contracts. Since these indices are fully collateralized, this means that no leverage is used to gain exposure to the commodities through futures. As such, for every dollar of exposure, there is 100% cash in margin earning interest. The benefits of a total return version include the expected inflation plus real rate of return and an increase in the total return as interest rates rise.



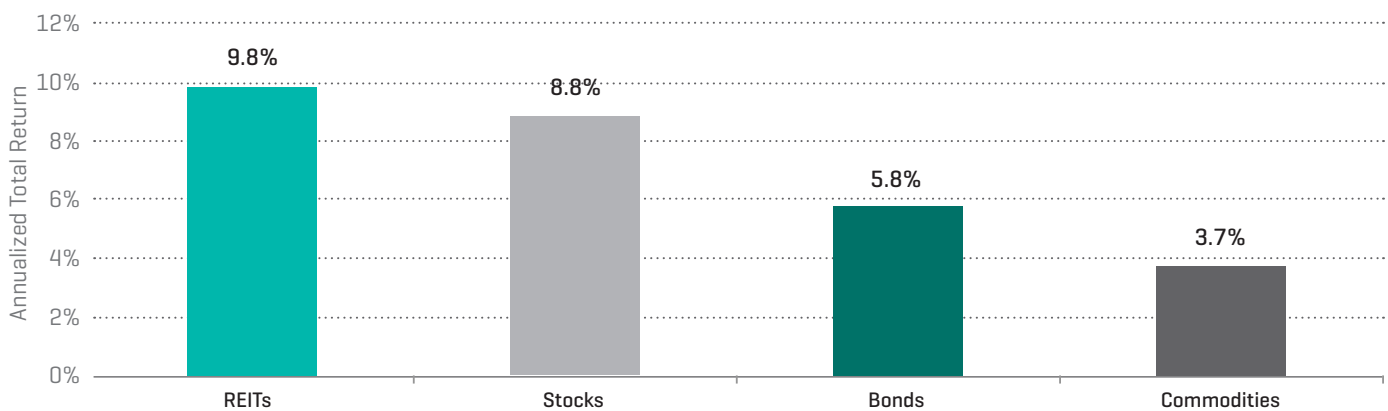
## 4. THE REITs TAKE

**MICHAEL ORZANO, CFA, ASSOCIATE DIRECTOR, GLOBAL EQUITY INDICES**

*Mike is responsible for the design and methodology governing all S&P Dow Jones global equity indices, focusing on creating new benchmarks for international equity markets and promoting their use amongst global clients.*

Over the past two decades, real estate investment trusts (REITs) have emerged as a popular and efficient way for investors of all stripes to access the real estate asset class. Strong long-term total returns, combined with other key investment characteristics such as liquidity, high dividend yield, and REITs' potential to increase diversification and be seen as a hedge against inflation have contributed to their appeal. Today, however, there is growing concern about how REITs will perform when interest rates ultimately rise from their current subdued levels.

### EXHIBIT 1: REITS OUTPERFORM OTHER MAJOR ASSET CLASSES (SEP 1993 – SEP 2013)



Source: S&P Dow Jones Indices, Barclays Capital. Data as of September 30, 2013. REITs, Stocks, Bonds and Commodities are represented by the Dow Jones U.S. Select REIT, S&P 500, Barclays Capital U.S. Aggregate and S&P/GSCI Indices, respectively. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

It is commonly asserted that REITs are destined to underperform when interest rates rise. However, an examination of the historical record suggests that this is a misconception. Although interest rates certainly impact real estate values, and therefore, the performance of REITs, rising interest rates do not necessarily lead to poor returns.

Since the early 1970s, there have been six periods where U.S. Treasury yields rose significantly. In four of those six periods, U.S. REITs earned positive total returns and in half of the periods, U.S. REITs outperformed the S&P 500®. In an additional period, U.S. REITs and the S&P 500 essentially posted identical performance, and in only two periods did the S&P 500 outperform U.S. REITs.

### EXHIBIT 2: REIT PERFORMANCE DURING PERIODS OF RISING INTEREST RATES

Time Period	10-YEAR TREASURY YIELD			CUMULATIVE TOTAL RETURN OVER PERIOD		
	Beginning Yield	Ending Yield	Change	REITs	Stocks	Difference
<b>Dec 1976 – Sep 1981</b>	6.9	15.3	8.5	137.4	46.0	91.4
<b>Jan 1983 – Jun 1984</b>	10.5	13.6	3.1	35.6	16.5	19.1
<b>Aug 1986 – Oct 1987</b>	7.2	9.5	2.4	-10.1	10.9	-21.0
<b>Oct 1993 – Nov 1994</b>	5.3	8.0	2.6	-10.3	0.1	-10.3
<b>Oct 1998 – Jan 2001</b>	4.5	6.7	2.1	27.4	27.8	-0.4
<b>Jun 2003 – Jun 2006</b>	3.3	5.1	1.8	108.2	37.6	70.6

Source: S&P Dow Jones Indices, Bloomberg, Federal Reserve. REIT Total returns are based on the FTSE/NAREIT Equity Index from December 31, 1971 – December 31, 1986 and the Dow Jones U.S. Select REIT Index after December 31, 1986. Stock total returns are based on the S&P 500. Charts are provided for illustrative purposes. Past performance is no guarantee of future results.

Undoubtedly, rising interest rates pose challenges for REITs. All else being equal, higher interest rates tend to decrease the value of properties and increase REIT borrowing costs. In addition, higher interest rates make the relatively high dividend yields generated by REITs less attractive when compared to lower-risk fixed income securities, reducing their appeal to income-seeking investors.

While it would require a much more detailed study to attempt to determine why REITs have generally fared well in rising interest rate environments, it is clear that rising interest rates are associated with other factors that positively impact their fundamentals. For example, rising interest rates are frequently associated with economic growth and rising inflation, both of which are likely to be positive for real estate investments. Healthy economic growth tends to translate

into greater demand for real estate and higher occupancy rates, supporting their growth in earnings, cash flow and dividends. In inflationary periods, real estate owners typically have the ability to increase rents. As a result, REITs' dividend growth has historically exceeded the rate of inflation.

Ultimately, rising or falling interest rates do not seem to be a key driver behind REITs' performance. Rather, the more important dynamics to address are the underlying factors that drive rates higher. If interest rates are rising due to a strengthening in the underlying economy and inflationary activity, stronger REIT fundamentals may very well outweigh any negative impact caused by rising rates.



## 5. FROM A STRATEGY INDEX STANDPOINT

**VINIT SRIVASTAVA, SENIOR DIRECTOR, STRATEGY INDICES**

*Vinit focuses on alternative beta strategies including factor-based indices, dividends and volatility, as well as quantitative, thematic, and asset-allocation strategies.*

It's the middle of a unique period in history, one where zero-bound rates are the norm and the hunt for yield has led the investment community to unlikely places. While growth projections for developed markets may extend the period of low rates in the near-term, at some point rates will rise, validating concerns over yield strategies in such a likely scenario.

The concerns surrounding the performance of dividend strategies in a rising rate environment come from two places:

1. Most dividend strategies, because of their selection and weighting—some indices, not all—are driven by the value factor. The general consensus is that, as markets shift from value to growth, the performance of these strategies would suffer.
2. A lot of pure yield strategies are concentrated in sectors like utilities, consumer staples and financials and as an overall market rotates into growth sectors, it would negatively impact the performance of such dividend strategies.

While some concern is relevant, a deep understanding of the differences across dividend strategies is needed to better frame the decision-making process.

In the U.S and other developed markets [Canada, United Kingdom, the Eurozone, and developed Europe], dividend growth companies have demonstrated that they can not only pay out a portion of their income through very difficult market conditions, but also grow the payouts.

It shows that in addition to having the ability to grow their stream of available cash flows, those companies are disciplined to grow payouts. In "[Much Ado About Interest Rates](#)," a whitepaper written by Craig Lazzara and Fei Mei Chan at S&P Dow Jones Indices, the Gordon growth model is discussed—

$$P = D / (k - g)$$

where P is the fair value of a stock, D, its current dividend, k is the appropriate discount rate, and g is the projected growth rate of dividends.

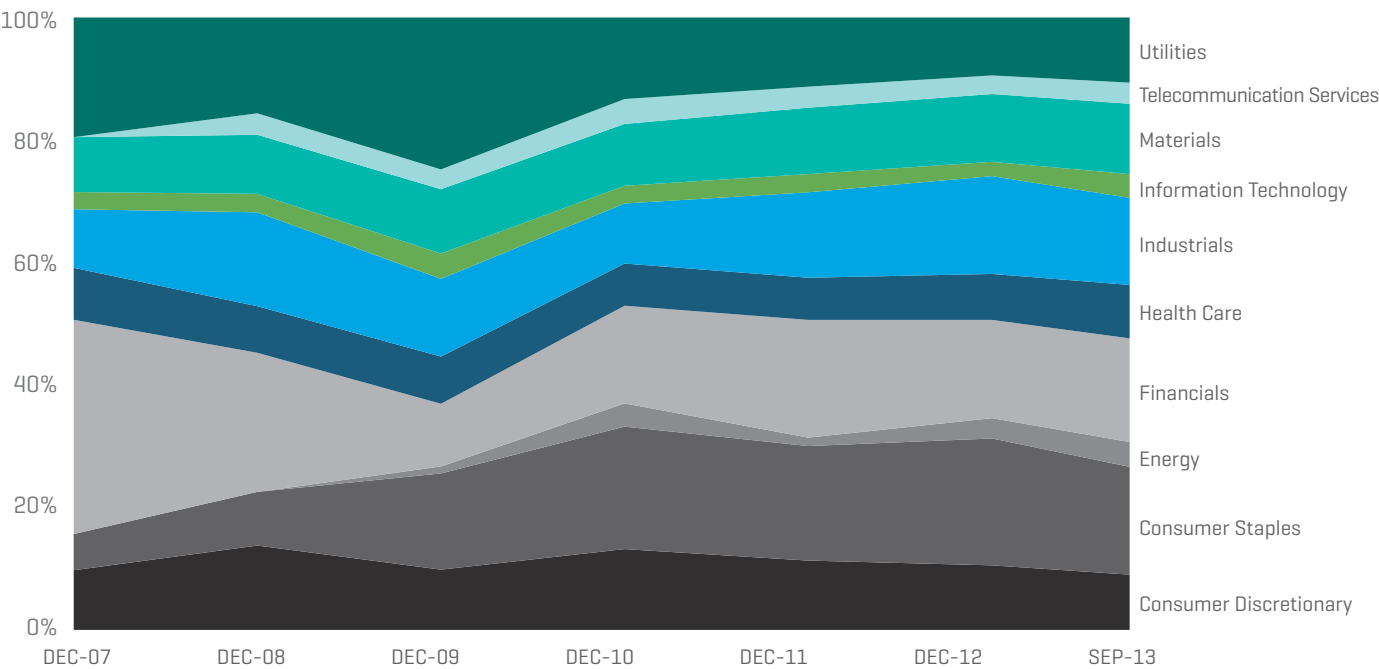
It has been demonstrated that a stock that has the ability to counter the growth in the rise of cost of capital [due to a rise in risk-free rates or expansion in risk premium] would be able to defend or expand its fair value in the future, based on growth of its dividend stream. Stocks that have a demonstrated record of doing so over, say 25 or 20 years, as is the case with the S&P 500® Dividend Aristocrats® indices, are more likely to do so.

Lastly, another consequence of dividend growth based selection that is innate to the Dividend Aristocrats series of indices and worth mentioning is sector diversification. Dividend aristocrat strategies tend to be very well-diversified across sectors [see Exhibits 1 and 2]. In addition to the underlying fundamental strength of the companies that make up these indices, this sector diversification would help if there were large moves in performance in particular sectors.



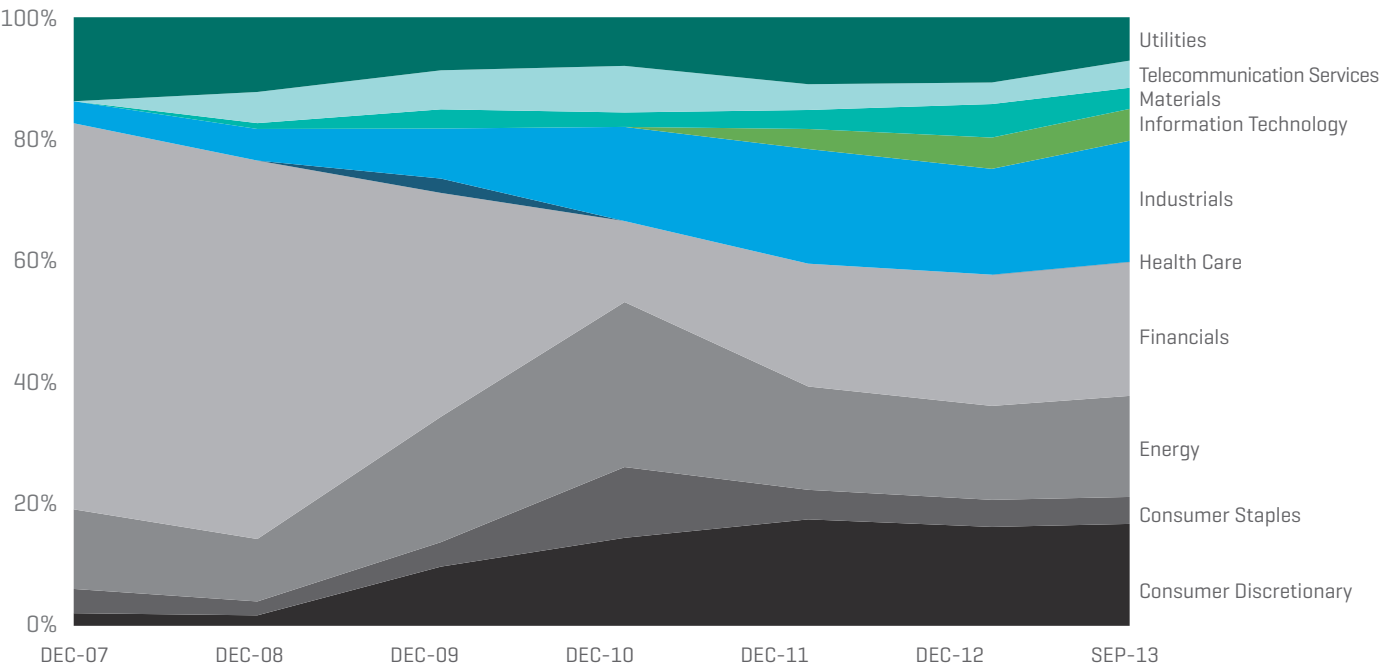
To summarize, market participants need to look under the hood and understand how these indices are constructed in order to truly assess their suitability in certain environments. Evidence shows that dividend growth strategies tend to be relevant in a rising rate environment.

**EXHIBIT 1: SECTOR EXPOSURE HISTORY FOR THE S&P HIGH YIELD DIVIDEND ARISTOCRATS**



Source: S&P Dow Jones Indices. Data as of September 30, 2013. Charts are provided for illustrative purposes.

**EXHIBIT 2: SECTOR EXPOSURE HISTORY FOR THE S&P/TSX CANADIAN DIVIDEND ARISTOCRATS**



Source: S&P Dow Jones Indices. Data as of September 30, 2013. Charts are provided for illustrative purposes.

---

# S&P DOW JONES INDICES GRABS THE MUNI BOND MEGAPHONE

For the past several years, S&P Dow Jones Indices has been aggressively building out its municipal bond index business while substantially raising visibility of its research, analysis, products, and data in the media. The results of these efforts have contributed to strong ETF AUM and persistent, high-level visibility amongst clients and investors. A few months ago, S&P Dow Jones Indices [S&P DJI] hosted a half-day municipal bond forum in New York City. The event drew an attendance of over 1,100 online and nearly 100 more in person—a testament to how far the business has come in the municipal bond market.

*Our Director of Communications, Dave Guarino, recently sat down with James “J.R.” Rieger, Vice President of fixed income indices, to discuss the U.S. municipal bond market and our relentless pursuit to grab the industry megaphone.*



**J.R. REIGER**  
Vice President,  
Fixed Income Indices  
S&P Dow Jones Indices

**Dave: J.R., as background, when did S&P Dow Jones Indices launch its family of municipal bond indices, and what has been its evolution since?**

**J.R.:** The municipal bond index family has been running as live indices for nearly 13 years. The initial family of indices was launched in December 2000. In 2007, S&P DJI adapted the original 48 municipal bond indices and began to grow the index family to meet the changing needs of benchmark users as well as the needs of the investing public. We now calculate and publish over 200 daily municipal bond indices, which include all states and territories along with a variety of sector and quality-based indices.

In 2007, we also launched the S&P National AMT-Free Municipal Bond Index. The index was designed to meet specific liquidity and issuer concentration/diversification requirements for product providers. As of today, there are more assets directly indexed to the S&P National AMT-Free Municipal Bond Index than any other muni bond index in the industry.

**Dave: Approximately how much in AUM is directly indexed to the flagship S&P National AMT Free Municipal Bond Index? How have assets grown over the past few years and to what would you attribute this growth?**

**J.R.:** The S&P National AMT-Free Municipal Bond Index and its subindices have over USD 4.7 billion directly indexed by ETFs. Investing in municipal bonds via ETFs has increasingly gained attention due to the lower cost of ETFs versus many other fund options. Assets in municipal bond ETFs have grown year-over-year with 2013 being an exception as the municipal bond market experienced outflows. This was largely due, in part, to the headlines of defaults and increased credit risk.

**Dave: Puerto Rico municipal bonds have been dominating the news over the past few months with the Tier 1 media consistently using the S&P Municipal Bond Puerto Rico Index as its primary gauge of performance. What does this index tell us about the overall health of the Puerto Rico muni bond market?**

**J.R.:** The economic health of Puerto Rico and the ramifications for bond holders have been in the news for most of 2013 with very negative headlines starting in July. Puerto Rico is a big issuer of municipal bonds and the bonds are held in many state-based mutual funds. Since we track all states and territories, our indices show how bonds from each state and territory are performing relative to each other and the overall market. Each index also provides characteristics data such as weighted average yields, duration, and quality. The S&P Municipal Bond Puerto Rico Index not only reflects bond performance [down 16% ytd as of 12/2/2013], but also that yields have risen on average 240 bps as compared to the investment-grade market, which moved cheaper but only by 90 bps.

**Dave: What do you think were some of the biggest issues impacting the U.S. municipal bond market in 2013, and what headwinds could we potentially expect to see in 2014?**

**J.R.:** “Headwinds” is a good term for the current environment as headline risk was prevalent in 2013. Municipal bonds have been affected by the “taper on” and “taper off” type of macro events seen all last year. Also weighing heavily on investors was Detroit’s bankruptcy, uncertainty about the prospects for types of bonds—called tobacco settlement bonds—as well as negative news about the quality of the Puerto Rico municipal bond segment.

The car commercial slogan, “This is Not Your Father’s Oldsmobile,” can easily be related to the municipal bond market. This is not the sleepy bond market it was once known to be. Last year proved to be a year that illustrated that the municipal bond market isn’t one homogenous market, but rather a complex and dynamic marketplace. Our indices have the depth and breadth to help raise the transparency of the various segments of the municipal bond market. There is a lot to watch out for in 2014 including the impact of a potential increase in supply of bonds, possible rising interest rates, developments in the tobacco settlement sector, and default trends.

**Dave: You recently published a report, “Unveiling the Hidden Costs of Retail Bond-Buying,” which has drawn significant, public attention. Can you recap the findings of this report and the key takeaway points?**

**J.R.:** Municipal bonds are bought and sold based on price and yield but transaction markups or commissions are not disclosed to the individuals buying bonds. By using the S&P National AMT-Free Municipal Bond Index as a tool, we have been able to add transparency into transaction costs.

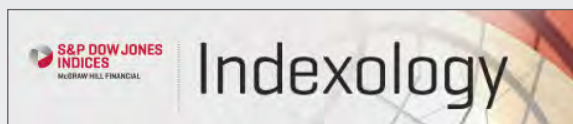
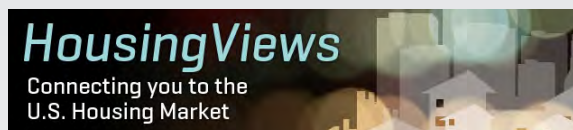
The S&P National AMT-Free Municipal Bond Index excludes sectors that have the highest risk, such as tobacco bonds and housing bonds. As a result, the index consists of mainly general obligation and essential purpose bonds that are all investment-grade. With this homogenous group of bonds, we then compare trades to and from retail investors on the same day and calculate the average difference between a retail “buy” and “sell” of an individual bond. We found that, on average, the difference (or transaction cost) is approximately 160 bps for each trade, illustrating that buying individual bonds has a cost. This is information we feel the marketplace may benefit from having, so when choices are presented, such as buying individual bonds or bond funds or UITs, the investor is better informed.

**Dave: S&P DJI recently hosted a half-day forum in New York City focusing on the municipal bond market that drew in excess of 1,100 online registrants and nearly 100 in person. How would you define S&P DJI’s success and growing role in the muni bond market?**

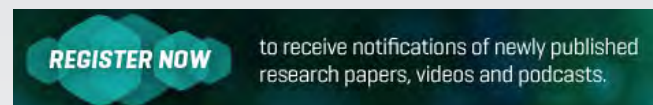
**J.R.:** Independence and governance play an important role along with the deep and unique sets of data our indices provide—all of this adds transparency into the market. Since the events around LIBOR unfolded, the marketplace has increasingly recognized the importance of independent index providers such as S&P DJI. Our rules-based indices are run and governed separately from commercial activities, are free of conflicts of interest, and serve as symbols of fairness, transparency and trust in the capital markets. Finally, the comprehensive sets of data these indices provide are available to anyone without charge on our website, at [www.spdji.com](http://www.spdji.com), revealing important information about the characteristics of, not only the overall market, but also the many segments that compose it—our role is to help market participants read the markets more clearly.

## CONNECT WITH US!

Blogs:



## Subscribe to Our Thought Leadership Program



[www.spdji.com/registration](http://www.spdji.com/registration)

A rich resource of educational content and upcoming complimentary events

Find us on:



# DOW JONES INDUSTRIAL AVERAGE 2013 AT A GLANCE

## WHEN ALL IS SAID AND DONE

The Dow Jones Industrial Average finished the year at 16,576.66, up 26.50%. That performance leaves us with the latest in a series of record closes, the best annual percentage gain since 1995 and the largest annual point gain in history.

### INDUSTRY PERFORMANCE

#### Top 3 Performance Contributors

1. Industrials 2. Financial Services 3. Consumer Services

### ▲ THE GOOD ▲

**Biggest single-day gain occurred on October 10 [+2.18%].**

Despite finding themselves on Day 8 of the U.S. government shutdown, investors were heartened by indications that House Republicans would offer a deal to raise the debt ceiling.

### ▼ THE NOT SO GOOD ▼

**Biggest single-day loss occurred on June 20 [-2.34%]**

when the market had an—ahem—adverse reaction to Bernanke's comments about tapering of the Fed's bond-buying program.

### ODDS AND ENDS

There were **146** days  
when the session ended up

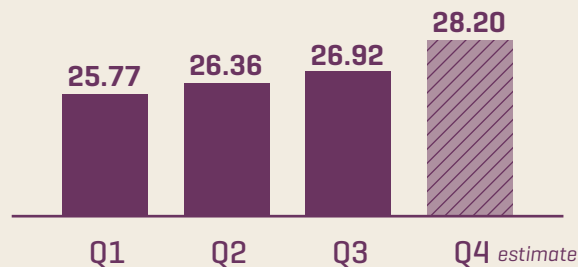
There were **4** days  
when all 30 stocks  
ended the session higher

**31**<sup>\*</sup>  
components  
contributed gains to the index

# S&P 500®: A LOOK BACK AT A VERY GOOD YEAR

THE  
S&P 500  
HAD ITS BEST  
YEAR SINCE  
1997

S&P 500 operating earnings set  
all-time highs in the first 3 quarters.



## \$300B+

Regular cash dividend  
payments set a record  
of USD 312 billion.



Sales growth  
was very slow,  
and record-high margins  
helped produce  
modest earnings growth



Investors started to return to the  
market in 2013, encouraged by the  
U.S. not falling off the fiscal cliff.

Despite worries that Obamacare  
would hurt performance, healthcare  
was the S&P 500's second-  
best-performing sector in 2013.



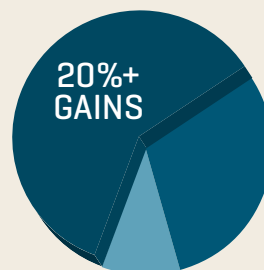
HISTORICAL AVG.

## 52%

While dividends set a record, companies have  
not been generous; the historical payout of  
earnings via dividends is 52%, while companies  
paid out 36% in 2013.

2013

## 36%

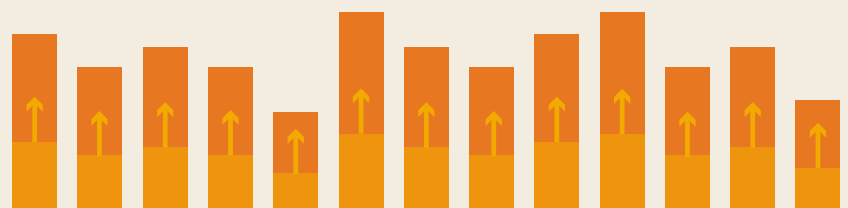


91.4% of the issues posted  
gains, setting a modern-day  
record, **with two thirds**  
**gaining at least 20%.**



Buybacks were all the rage,  
as companies authorized  
higher amounts.

However, less than half  
of them reduced  
share count.



13 stocks that declined by double digits in 2012  
came back to gain at least 50% in 2013.



# YOU TAKE MY **BREADTH** AWAY



**HOWARD SILVERBLATT, SENIOR INDUSTRY ANALYST, INDEX INVESTMENT STRATEGY, S&P DOW JONES INDICES**

*Data for the S&P 500® shows that breadth—defined as the number of issues advancing compared with the number declining—was extremely strong in 2013. Breadth is significant because it indicates the depth of the current market and the U.S. economic recovery. For 2013, 457 of the S&P 500's issues were up [with 41 down], which is the second best performance on an annual basis since 458 issues improved in 2003 [although the total return of 32.39% in 2013 was better than the 28.69% in 2003]. The 2003 number is the highest on record since 1980, which is when our data series starts.*

In the late 1990s, the market aggregates became dominated by the technology sector, which grew on faith and “hits” versus sales and cash flow. This dynamic was manifested in large gains for technology issues and relatively low breadth. In 1998, the market stock returned 26.67%, yet only 57.8% of S&P 500 issues [289] posted gains, and in 1999 the market grew 19.53%, but less than half of the issues [48.2%, or 241 issues] saw improvement. In 2013, 91.4% [457] of the index's issues posted gains for the year, with the S&P 500 up 29.60% [total return: 32.39%]. In the index, 272 issues outperformed the aggregate, with 181 issues up at least 40% on the year.

The number of issues advancing isn't the only thing that differentiated 2013 and 2012 from 1998 and 1999. Unlike in the late 1990s, performance today isn't top-heavy. In 1998, the top 10 issues by market value averaged a 68.15% gain, with 6 of the 10 gaining at least 50%—a 41.48% differential from the index's 26.67% return. In 1999, the top 10 averaged a 58.59% return, with 6 issues gaining at least 50%, resulting in a 39.16% differential from the index's 19.53% return. In 2013, only one issue, Google, was up at least 50% [58.4%], and Apple—the largest issue in the index—was up just 5.4%. Even more importantly, the top-10

average in 2013 was 28.63%, which is 0.97% below the index. In 2012, the top-10 average was 8.90%, which was 4.51% below the index average. These statistics speak to the depth of the gains, and paint a picture of broad market participation in the gains, rather than a top-heavy market reminiscent of the tech bubble years.

At the beginning of 2013, when we did not go over the financial cliff, investors poured billions into the market [the Jan. 2, 2013 increase of 2.54% remains the best day since the 2.98% increase on Dec. 20, 2011]. The influx was motivated by not only relief, but also pent-up frustration due to a lack of return in 2012, a year when many stayed out of the market [the market was up 13.41%, or 16.00% with dividends, in 2012]. Investors were therefore quickly drawn to broad, not top-heavy, gains. In 2013, this trend persisted, and actually intensified, as the breadth of the market rose to near-record levels.

When a critical mass of investors chases returns, the short-term impact is more buying and higher prices. If the market stays anywhere near its current record level, we may see another massive inflow and another short-term uptick in prices.

**EXHIBIT 1: BREADTH OF CHANGE**

PERIOD	UP ISSUES	UNCHANGED ISSUES	DOWN ISSUES	PRICE CHANGE	DIVIDEND COMPONENT	TOTAL RETURN	AVG TOP 10 BY MKT VAL	TOP 10 - INDEX
<b>2013</b>	<b>457</b>	<b>2</b>	<b>41</b>	<b>29.60%</b>	<b>2.79%</b>	<b>32.39%</b>	<b>28.63%</b>	<b>-0.97%</b>
2012	390	3	107	13.41%	2.60%	16.00%	8.90%	-4.51%
2011	232	3	265	-0.0025%	2.11%	2.11%	11.05%	11.05%
2010	390	1	109	12.78%	2.28%	15.06%	11.21%	-1.57%
2009	425	2	73	23.45%	3.01%	26.46%	27.84%	4.39%
2008	25	5	470	-38.49%	1.49%	-37.00%	-20.12%	18.37%
2007	245	9	246	3.53%	1.96%	5.49%	20.93%	17.40%
2006	369	11	120	13.62%	2.17%	15.79%	13.91%	0.29%
2005	286	1	213	3.00%	1.91%	4.91%	1.52%	-1.48%
2004	378	2	120	8.99%	1.89%	10.88%	6.04%	-2.95%
2003	458	1	41	26.38%	2.30%	28.69%	33.40%	7.02%
2002	131	1	368	-23.37%	1.26%	-22.10%	-21.40%	1.97%
2001	213	2	285	-13.04%	1.15%	-11.89%	6.05%	19.09%
2000	273	7	220	-10.14%	1.04%	-9.10%	-0.06%	10.08%
1999	241	3	256	19.53%	1.51%	21.04%	58.69%	39.16%
1998	289	5	206	26.67%	1.91%	28.58%	68.15%	41.48%
1997	400	4	96	31.01%	2.35%	33.36%	33.03%	2.02%
1996	364	6	130	20.26%	2.70%	22.96%	48.27%	28.01%
1995	424	9	67	34.11%	3.47%	37.58%	44.13%	10.02%
1994	202	4	294	-1.54%	2.86%	1.32%	4.59%	6.13%
1993	326	6	168	7.06%	3.02%	10.08%	7.01%	-0.05%
1992	330	4	166	4.46%	3.16%	7.62%	1.44%	-3.02%
1991	401	5	94	26.31%	4.16%	30.47%	40.85%	14.54%
1990	133	8	359	-6.56%	3.46%	-3.10%	9.52%	16.08%
1989	379	2	119	27.25%	4.44%	31.69%	33.56%	6.31%
1988	361	2	137	12.40%	4.21%	16.61%	12.93%	0.53%
1987	229	4	267	2.03%	3.07%	5.10%	11.16%	9.13%
1986	337	3	160	14.62%	3.94%	18.56%	25.31%	10.68%
1985	421	1	78	26.33%	5.24%	31.57%	24.39%	-1.94%
1984	233	4	263	1.40%	4.70%	6.10%	7.49%	6.09%
1983	393	0	97	17.27%	5.11%	22.38%	20.75%	3.48%
1982	355	3	142	14.76%	6.68%	21.44%	13.24%	-1.53%
1981	227	4	269	-9.73%	4.72%	-5.01%	13.64%	23.37%
1980	353	3	144	25.77%	6.50%	32.27%	55.38%	29.60%

Source: S&P Dow Jones Indices. Data as of December 31, 2013. Past performance is not a guarantee of future results.

# GLOBAL INDEX NEWS FEED

A FOURTH-QUARTER 2013 RECAP OF SOME OF OUR RECENT NEWS AND HAPPENINGS FROM AROUND THE WORLD.

## NEW LICENSING OPPORTUNITIES

**KOREA:** A memorandum of understanding was signed between S&P Dow Jones Indices (S&P DJI) and the **Korea Exchange (KRX)**, one of the world's leading exchanges. S&P DJI will work alongside KRX to develop new global marketing and sales initiatives for KRX indices, which include the flagship index, the KOSPI200. The KOSPI200 is the premier benchmark covering the South Korean equity market. Plans to form a joint team to develop new indices are in the works. S&P DJI will also draw on its renowned experience in global sales and marketing for future licensing opportunities.

**JAPAN:** The **Dow Jones Industrial Average™ Hedged JPY Inverse Index** and the **Dow Jones Industrial Average Hedged JPY Leveraged 2X Index** were licensed to **Nomura Securities Co., Ltd.** Both indices are the latest versions of the iconic Dow Jones Industrial Average and take into account the performance of the Japanese Yen against the U.S. dollar. The indices provide Japanese investors with important benchmarks that measure blue-chip U.S. equities while seeking to hedge out currency risk. Nomura has issued ETNs on the indices which are listed on the Tokyo Stock Exchange.

**LATIN AMERICA:** A new ETF tracking the S&P MILA 40 has emerged. The **S&P MILA 40** was the first in a series of indices for Latin America's second largest market. The index gauges the returns of the largest and most liquid stocks trading on the Mercado Integrado Latinoamericano (MILA) platform, an integrated trading venture formed by the Chile, Colombia and Peru stock exchanges. The ETF, which was launched by **Horizons ETFs Group**, is the first Andean equity focused ETF available in Columbia and is listed on the Bolsa de Valores de Colombia.

**AUSTRALIA:** **State Street Global Advisors** issued ETFs based on three S&P DJI indices: the **S&P Global Dividend Aristocrats**, **Dow Jones Global Select Real Estate Securities** and the **S&P Emerging LargeMidCap** index. The ETFs are listed on the Australian Securities Exchange. These ETFs will address Australian investors looking for greater global equity diversification.

**CHINA:** Strengthening its presence in China, S&P DJI launched the first-ever S&P 500®-based ETF in November 2013. The ETF, launched by **Bosera Asset Management**, is based on the premier measure of the U.S. stock market performance, the S&P 500, and enables Chinese investors to express their views on the U.S. market. The launch of China's first ETF based on the S&P 500 signals an acceleration of the ETF market and a larger and more diversified range of investment opportunities for Chinese investors. The total asset under management of ETFs listed in mainland China (Shanghai and Shenzhen) rose to over 150 billion Yuan (about USD 25 billion) in Q3 2013 with close to 80 ETFs available in the market.

## S&P DJI EXPANDS ITS GLOBAL FOOTPRINT

S&P DJI continues to expand its local presence in key global markets with the opening of its first office in **South Africa**. The new **Johannesburg** location (number 19 worldwide), is part of S&P DJI's strategic growth efforts in Africa. S&P DJI already has a number of leading indices covering the region including the **S&P Pan Africa**, **S&P Access Africa**, **S&P Africa 40**, and **S&P Nigeria Select**. S&P DJI's African index series is the most comprehensive index suite available with history dating back to 1988.

## AWARDS

The **S&P 500 Dynamic VEQTOR Index** was named **Index Innovation of the Year** at the William F. Sharpe Indexing Achievement Awards at the annual IMN's Global Indexing & ETFs conference in Scottsdale, Arizona. The index dynamically allocates long-only exposure between the S&P 500, the S&P 500 VIX Short-Term Futures Index and cash in order to measure broad equity market exposure with an implied volatility hedge. The index is designed to mitigate risk between equity and volatility and helps hedge downside protection in volatile markets.

**S&P DJI, along with S&P Capital IQ** won the **2013 iCMG Enterprise & IT Architecture Excellence Award for Best Enterprise & IT Architecture in Banking, Financial Services, and Insurance**. The global award honors architects and enterprises in the discipline of architecture, whose work demonstrates a combination of talent, vision, and workmanship, creating successful and enduring systems and enterprises.

# SPRUCE UP YOUR KNOWLEDGE ON U.S. PREFERRED

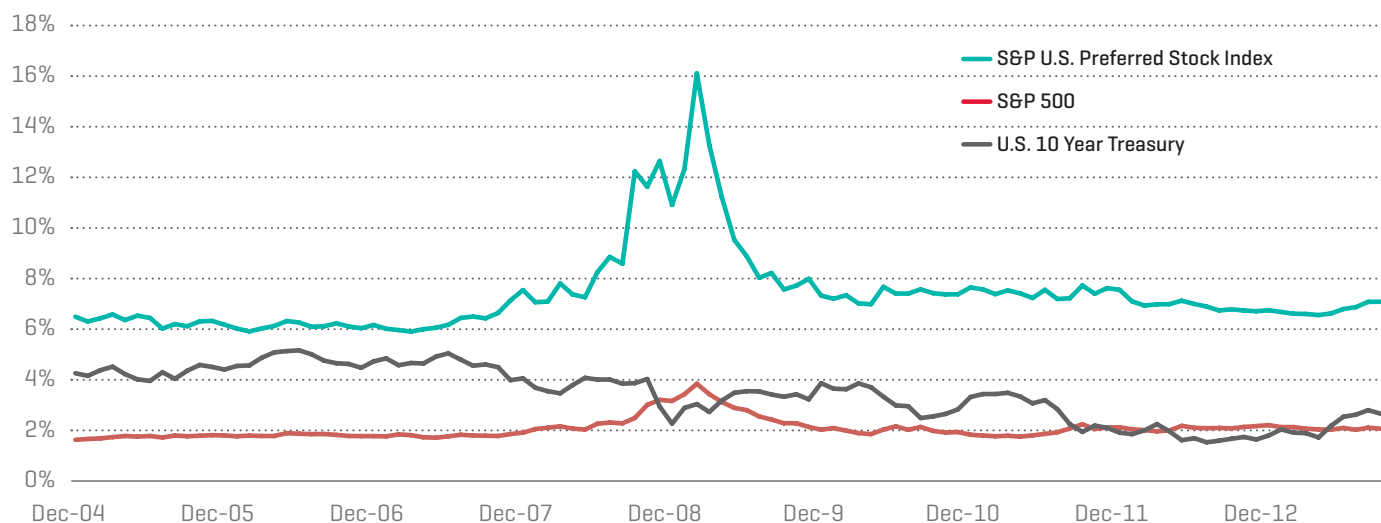
The U.S. preferred market has grown exponentially in the past 20 years. In fact, since 1990 it has increased more than 400% to USD 221 billion from USD 53 billion in 1990. Though a small chunk of the USD 20.48 trillion equity market as a whole, preferreds have sturdy legs in this space.

## POTENTIAL PERKS

Here are three key advantages to help boost your understanding of these equity securities:

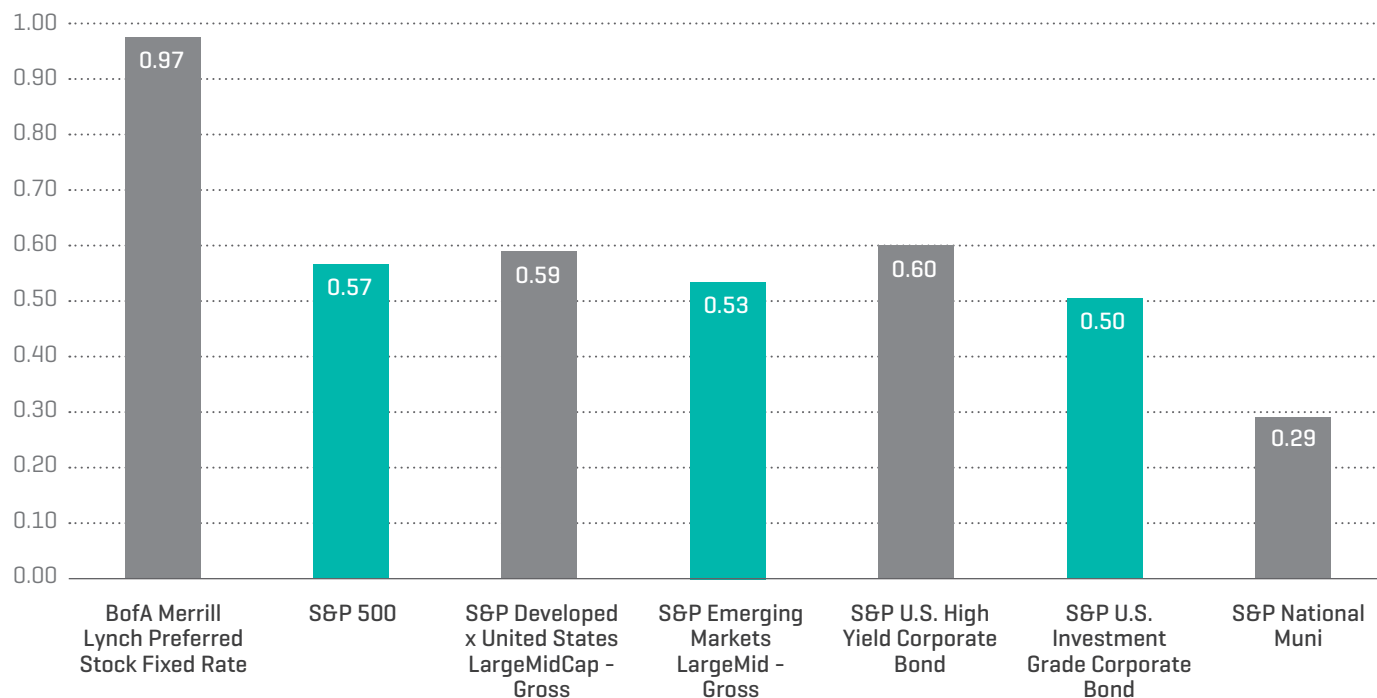
- 1. Income generation.** Preferreds provide current income in the form of dividend payments, which tend to have higher yields than those of common stocks. Due to their seniority in a company's capital structure, preferred shareholders also have a higher claim to company assets than common shareholders in case of company liquidation. Also, since most preferreds provide a fixed dividend payment, an investor will know what amount to expect at the next payment date. In times of poor performance, a company will be more likely to either cut the common dividend amount or cancel the dividend altogether, rather than cut the preferred dividend amount.
- 2. Yields.** Preferreds tend to have higher yields than other asset classes, including money market accounts, common stocks and bonds. As of Sept. 30, 2013, the S&P Preferred Stock Index's yield was 7.07%. The index yield has remained relatively stable between approximately 6% and 8%, with the exception of the 2008-2009 market downturn, during which the index yield rose significantly to a maximum of 16.11% in February 2009 (Exhibit 1).
- 3. Low correlations with other asset classes.** Preferreds can serve as a potential diversification and risk-reduction investment. Exhibit 2 charts the 10-year correlation of preferred securities, as represented by the S&P U.S. Preferred Stock Index, to other asset classes. It is important to note that preferred securities tend to exhibit higher correlation with high-yield bonds and equities (more sensitive to credit), and lower correlation with investment-grade corporate and municipal bonds (more sensitive to interest rate risk).

**EXHIBIT 1: HISTORICAL 12-MONTH TRAILING YIELD**



Source: S&P Dow Jones Indices, FactSet. 12-month trailing dividend yield data from December 31, 2004 to September 30, 2013. The launch date of the S&P U.S. Preferred Stock Index is September 1, 2006. Charts are provided for illustrative purposes. Past performance is not a guarantee of future results. Some of the data referenced in this chart reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this publication for more information on the inherent limitations associated with back-tested performance.

## EXHIBIT 2: 10-YEAR CORRELATION WITH S&P U.S. PREFERRED STOCK INDEX



Source: S&P Dow Jones Indices, FactSet. The S&P U.S. High Yield Corporate Bond Index history begins April 30, 2004; to get 10-year history for this category, monthly returns from Barclays US High Yield Index were used from September 2003 to April 2004. Data from September 30, 2003 to September 30, 2013. Charts are provided for illustrative purposes. Past performance is not a guarantee of future results. Some of the data referenced in this chart reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this publication for more information on the inherent limitations associated with back-tested performance.

## POTENTIAL PITFALLS

*Potential risks of preferred stocks fall into three main buckets: the interest rate environment, issuer's credit quality and liquidity:*

- 1. Interest rate risk.** Due to their bond-like fixed dividend payments, preferreds are vulnerable to changes in interest rates.
- 2. Reinvestment risk.** A preferred investor who does not seek high current income in dividend payments would be faced with the risks and associated costs of reinvesting the regular dividend payments.
- 3. Liquidity risk.** Because preferred shares are less liquid than common shares, trading involves higher market impact costs and bid-ask spread costs.
- 4. Credit risk.** Unlike bondholders, preferred shareholders have little recourse if a company does not pay the dividend.
- 5. Sector concentration risk.** Financial companies are the primary issuers of preferreds in the U.S. A portfolio of preferred securities would be subject to the sector-specific risk factors of the financial sector.

Want to become more acquainted with the U.S. preferred market and the S&P U.S. Preferred Stock Index that is designed to serve as an investable benchmark representing this market? Read our whitepaper, "[Digging Deeper into the U.S. Preferred Market](#)" on our website: [www.spdji.com](http://www.spdji.com).



**CAPPED COMPONENT VERSION OF S&P GSCI®  
SINGLE COMMODITY FAMILY**

*Asset Class: Commodities*

*Launch Date: October 17, 2013*

This new family of indices is based on the S&P GSCI Single Commodities and applies the Capped Component rules according to the ESMA guidelines on UCITS issues. Currently, the S&P GSCI includes 24 commodities that form 18 components, where three of the components, Petroleum, Wheat, and Cattle, include more than one commodity. For every S&P GSCI Single Capped Component, the namesake commodity is allocated 32%, with the remaining 68% equally distributed among the remaining commodities in the other components.

The launch of the S&P GSCI Single Capped Component Family expands the offerings for clients interested in diversification as a core requirement to their investing or benchmarking programs. The S&P GSCI is the first major investable commodity index. It is one of the most widely recognized benchmarks that is broad-based and production-weighted to represent the global commodity market beta.

**S&P MENA BOND & SUKUK INDEX**

*Asset Class: Fixed Income*

*Launch Date: October 10, 2013*

S&P DJI launched the S&P MENA Bond & Sukuk Index and its subindices, the S&P MENA Bond Index and S&P MENA Sukuk Index. With the exception of the S&P MENA Bond Index, each of these indices is screened for Shariah compliance. The S&P MENA Bond & Sukuk Index comprises a universe of U.S. dollar denominated debentures that seeks to measure the

performance of bonds and Islamic fixed income securities—also known as sukuk—in the Middle East and North Africa [MENA] markets. The index measures the performance of companies domiciled in Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates and Yemen.

**S&P GSCI SOYBEAN MEAL DYNAMIC ROLL  
S&P GSCI SOYBEAN OIL DYNAMIC ROLL**

*Asset Class: Commodities*

*Launch Date: October 1, 2013*

These indices are designed to alleviate negative roll yield from contango while aiming to minimize turnover. They follow the S&P GSCI Dynamic Roll methodology, which utilizes a two-part process to determine the optimal futures contract to be held every month. After contracts pass a liquidity screen for inclusion, the first step is to measure which of those contracts have the highest implied roll yield, indicating the least contango or most backwardation. The second step is to check whether the incumbent contract has a high enough implied roll yield rank to continue to be held, aiming to minimize turnover.

The launch of the S&P GSCI Soybean Meal Dynamic Roll and S&P GSCI Soybean Oil Dynamic Roll expands the S&P GSCI Dynamic Roll family. The S&P GSCI is the first major investable commodity index. It is one of the most widely recognized benchmarks that is broad-based and production-weighted to represent the global commodity market beta.

**To take advantage of these new data and licensing opportunities, email us at: [index\\_services@spdj.com](mailto:index_services@spdj.com)**

# Take the Temperature



## Introducing S&P Healthcare Claims Indices

*A new, innovative index designed to bring unprecedented transparency to rising healthcare costs. **Learn more >>***

## Complimentary Events Hosted by S&P Dow Jones Indices

**Thank you!** As we prepare to bring you another exciting year filled with index education and innovation we wanted to take this opportunity to say thank you for attending our webinars, forums and events held across the globe in 2013. We're pleased to have been able to provide you with the latest information on topics, trends and issues impacting the indexing universe today. We appreciate your support and look forward to another great year ahead.

Stay tuned for more upcoming events. In the meantime, view our webinars on-demand by clicking on the "Archive" tab at [www.us.spindices.com/events/sp-webinar/](http://www.us.spindices.com/events/sp-webinar/).

Here's a sampling of some of our more recent on-demand webinars.



### WHAT YOU MAY NOT KNOW ABOUT INDEXING CORE

Recorded: November 14, 2013

Audience: Financial Advisors

*What if there's more to building core beyond large-caps? During this webinar, our well-versed panelists presented a more modular approach to constructing a core portfolio while maintaining tax and cost efficiencies.*



### IS OUTCOME THE NEW ALPHA?

Recorded: October 24, 2013

Audience: Global

*The traditional lines between active and passive management have become blurred over the past decade, leading to a shifting focus in the investment community from individual asset classes and products to multi-asset solutions that address investors' specific needs. Learn from our panel of leading industry thinkers as they discuss the trends and challenges in multi-asset investing.*



### THE TRUTH ABOUT FACTOR-BASED AND ALTERNATIVELY WEIGHTED INDICES

Recorded October 10, 2013

Audience: Financial Advisors

*Gene Fama and Ken French launched a trend in finance when they wrote that adding small and value factors to portfolios under CAPM explained 90% of market returns. Through our research in indexing, we've added to the discussion by documenting several other potential factors such as quality, volatility and momentum that contribute to these returns. In practice, is it possible to gain exposure to these risk factors with rules-based indices? With the mix of views surrounding factor-based indices and alternatively weighted indices, this webinar categorized and compared some of these approaches and cleared up some of the mystery surrounding them.*



### ARE DIVIDENDS THE ANSWER TO GROWTH FOR INCOME HUNTERS?

Recorded: July 18, 2013

Audience: Financial Advisors

*In nearly all market and business cycles, dividend growth strategies are considered practical options, particularly for investors nearing retirement. Learn how dividend benchmarks have performed in bull and bear markets and how they've been seen as a reliable measure for income-seekers.*

Our blogs aim to ignite conversations around three key areas: indexing [[Indexology®](#)], U.S. housing markets [[HousingViews®](#)] and the implied volatility across global financial markets [[VIX®Views](#)]. They serve as forums for sharing your thoughts and ideas and for leveraging the knowledge shared by our thought leaders and renowned, subject matter professionals. [Join the conversation.](#)

Here's a roundup of some of our posts.

# Indexology®

## The Dow Jones Industrial Average in 2013? Yeah, that went well...

JANUARY 3, 2014 | BY JAMIE FARMER, MANAGING DIRECTOR, INDEX INVESTMENT STRATEGY & DATA SERVICES, S&P DJI

A steadily improving economy, and no small amount of performance-enhancing stimulus from the Fed, re-enthused equity investors in 2013, leading the Dow Jones Industrial Average to finish in record territory. Let's go to the tape: Impressive Climb—The DJIA finished the year at 16,576.66, up 3,472.52 or 26.50%. That performance leaves us with the latest in a series of record closes, the best annual percentage gain since 1995 and the largest annual point gain in history. Leader & Laggard—Boeing (BA) was the standout contributor of the Dow, adding 444.47 points in 2013. IBM subtracted 27.48 points to finish as the biggest detractor. Industry Performance—All industries added to the DJIA's advance in 2013—Industrials led, followed by Financials and Consumer Services...

## ETFs Poised to Overtake Hedge Funds in 2014

DECEMBER 31, 2013 | BY TIMOTHY EDWARDS, DIRECTOR, INDEX INVESTMENT STRATEGY, S&P DJI

If current trends continue, 2014 will herald a significant milestone for the ETF and hedge fund industries, as the total amount of capital invested in the former threatens to overtake the latter.

Hedge funds search relentlessly to deliver on a promise of alpha while their privileged investors—supplying notoriously high fees and the tactical burden of illiquidity—hope to gain advantage from partnering with the 21st century's investment titans. Once the darlings of the asset management industry, hedge funds are seeing their pre-eminent status challenged by a diametrically opposite segment of the investment spectrum, as the cheap, liquid and transparent value proposition of ETFs continues to attract substantial investment from across the globe. Appropriately perhaps for an infamously opaque industry, official estimates of total hedge fund assets...

Read more at [>>](http://www.indexologyblog.com)

# HousingViews®

## Why Bubbles Aren't as Dangerous Today

JANUARY 2, 2014 | BY DAVID BLITZER, CHAIRMAN OF THE INDEX COMMITTEE, S&P DJI

Both the surprisingly strong 2013 U.S. stock market performance and the surging rebound in U.S. home prices are sparking fears of another round of bursting bubbles among many investors and market pundits. While we don't know the chances that either stocks or home prices will plunge in 2014, the collateral damage from either will be less than it was in 2008 because the underlying leverage in the economy is substantially smaller today than it was back then.

The financial crisis was a two-step (or double dive) event. First home prices collapsed, wiping out about a third of the value of American homes. Second, a lot of the mortgage debt collateralized by those homes failed creating a cascade of defaults, foreclosures and worse. The higher the loan to value ratio on a home with a mortgage, the smaller the price drop needed to put the mortgage under water. The chart shows the loan to value ratio for...

For more, visit [>>](http://www.housingviews.com)

## INSIGHTS Staff

**Carol Cameron**

carol.cameron@spdji.com

**Emily Wellikoff**

emily.welikoff@spdji.com

**Theresa Baggs**

theresa.baggs@spdji.com

**Andrea Roth**

andrea.roth@spdji.com

[www.spdji.com](http://www.spdji.com) | [www.djindexes.com](http://www.djindexes.com)

Except where indicated, all information as of December 31, 2013.

Copyright © 2013 by S&P Dow Jones Indices LLC, a part of McGraw Hill Financial, and/or its affiliates. All rights reserved. Standard & Poor's, and S&P are registered trademarks of Standard & Poor's Financial Services LLC ("S&P"), a part of McGraw Hill Financial. Dow Jones is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). Trademarks have been licensed to S&P Dow Jones Indices LLC.

Redistribution, reproduction and/or photocopying in whole or in part are prohibited without written permission. This document does not constitute an offer of services in jurisdictions where S&P Dow Jones Indices LLC, Dow Jones, S&P or their respective affiliates [collectively "S&P Dow Jones Indices"] do not have the necessary licenses. All information provided by S&P Dow Jones Indices is impersonal and not tailored to the needs of any person, entity or group of persons. S&P Dow Jones Indices receives compensation in connection with licensing its indices to third parties. Past performance of an index is not a guarantee of future results.

It is not possible to invest directly in an index. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Dow Jones Indices does not sponsor, endorse, sell, promote or manage any investment fund or other investment vehicle that is offered by third parties and that seeks to provide an investment return based on the performance of any index. S&P Dow Jones Indices makes no assurance that investment products based on the index will accurately track index performance or provide positive investment returns. S&P Dow Jones Indices LLC is not an investment advisor, and S&P Dow Jones Indices makes no representation regarding the advisability of investing in any such investment fund or other investment vehicle. A decision to invest in any such investment fund or other investment vehicle should not be made in reliance on any of the statements set forth in this document. Prospective investors are advised to make an investment in any such fund or other vehicle only after carefully considering the risks associated with investing in such funds, as detailed in an offering memorandum or similar document that is prepared by or on behalf of the issuer of the investment fund or other vehicle. Inclusion of a security within an index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, nor is it considered to be investment advice.

These materials have been prepared solely for informational purposes based upon information generally available to the public from sources believed to be reliable. No content contained in these materials (including index data, ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse-engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Dow Jones Indices. The Content shall not be used for any unlawful or unauthorized purposes. S&P Dow Jones Indices and its third-party data providers and licensors [collectively "S&P Dow Jones Indices Parties"] do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Dow Jones Indices Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON AN "AS IS" BASIS. S&P DOW JONES INDICES PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Dow Jones Indices Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses [including, without limitation, lost income or lost profits and opportunity costs] in connection with any use of the Content even if advised of the possibility of such damages.

S&P Dow Jones Indices keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P Dow Jones Indices may have information that is not available to other business units. S&P Dow Jones Indices has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

In addition, S&P Dow Jones Indices provides a wide range of services to, or relating to, many organizations, including issuers of securities, investment advisers, broker-dealers, investment banks, other financial institutions and financial intermediaries, and accordingly may receive fees or other economic benefits from those organizations, including organizations whose securities or services they may recommend, rate, include in model portfolios, evaluate or otherwise address.

### Performance Disclosure

Past performance 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](http://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. It is not possible to invest directly in an Index.

Another limitation of back-tested hypothetical information is that generally the back-tested calculation is prepared with the benefit of hindsight. Back-tested data reflect 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 (or 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.

The index returns shown do not represent the results of actual trading of investor assets. Standard & Poor's maintains the indices and calculates the index levels and performance shown or discussed, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause actual and back-tested performance to be lower than the performance shown. In a simple example, if an index returned 10% on a US \$100,000 investment for a 12-month period (or US\$ 10,000) and an actual asset-based fee of 1.5% were imposed at the end of the period on the investment plus accrued interest [or US\$ 1,650], the net return would be 8.35% [or US\$ 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 33.10%, a total fee of US\$ 5,375, and a cumulative net return of 27.2% [or US\$ 27,200].

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency on their products. 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 Web site 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.