Pure Style Indices: How Different Are They?

Style indices traditionally have been constructed by grouping the investment universe into value and growth components. These components are based on a number of factors as defined by the index provider and as reflective of the respective investment styles. The first generation of style indices from S&P Indices and Russell Investments was constructed using all the stocks in the corresponding parent index universe, grouping them into growth and value classifications using multiple factors, and utilizing the conventional market cap weighting scheme.

S&P Pure Style indices employ a more robust definition of style and have improved discriminatory power to differentiate between growth and value.

In 2005, S&P Indices introduced a unique set of pure style indices. These pure style indices employ a more robust definition of style and have improved discriminatory power to differentiate between growth and value. The pure style indices include only stocks with pure growth and pure value characteristics. There are no overlapping stocks and the indices avoid the size bias induced by market cap weighting, since stocks are weighted in proportion to their relative style attractiveness.

Exhibit 1 below highlights the differences in stock selection rules and weighting mechanisms between Style and Pure Style indices. The methodology differences have contributed to long-term performance divergence between the two sets of indices.

Exhibit 1: Review of Index Mechanics

	Style Indices	Pure Style Indices
Universe Coverage	Exhaustive. All parent index stocks are included.	Selective. Only pure style stocks are included.
Presence of Overlapping Stocks in Growth and Value Indices	Yes. Stocks that do not fit into pure style baskets have their market cap distributed between Growth and Value indices.	No. Stocks are classified as either Pure Value or Pure Growth; since not all stocks can be so classified, not all stocks are included.
Weighting Scheme	Market cap	Style score
Breadth	Broader	Narrower

Source: Standard & Poor's. Charts are provided for illustrative purposes and only highlight some of the differences between the different styles. For more information on these different styles, please visit our website at www.indices.standardandpoors.com.

Impact on Strategic Asset Allocation

The long-term performance differentials between the style and pure style indices significantly affect investors' long-term capital market expectations. These expectations, in turn, affect strategic asset allocation decisions for asset allocation models that use style ETFs as building blocks.

Exhibits 2, 3 and 4 on the following page highlight the annualized risk/return profile of S&P Indices' and Russell's Style indices versus the S&P Pure Style indices over various investment horizons. There is one exception: the S&P Pure Style indices have outperformed their style counterparts in all three market cap ranges.

While S&P Pure Style indices boast higher returns than the Style indices in general, they also exhibit greater volatility, as demonstrated by the annualized standard deviation.

Commodity-based equities are driven more by fundamentals in the commodity market than those in the equity market.

Exhibit 2: Risk/Return Profile – Large-Cap Style and Pure Style Indices (Data from 05/31/2001 to 05/31/2011)

	Value			Growth		
	S&P Value	S&P Pure Value	Russell Value	S&P Growth	S&P Pure Growth	Russell Growth
Annualized Returns						
3 Year	-1.22%	7.54%	-0.41%	2.92%	9.49%	2.92%
5 Year	1.13%	4.05%	1.70%	5.41%	8.79%	5.55%
10 Year	2.30%	8.20%	3.97%	2.84%	4.72%	2.15%
Annualized Standard Deviation						
3 Year	24.11%	37.79%	22.87%	20.38%	25.16%	21.62%
5 Year	19.53%	30.10%	19.12%	17.04%	20.50%	18.24%
10 Year	17.26%	24.63%	16.30%	15.21%	21.30%	16.67%

Source: Standard & Poor's and Bloomberg. Data as of May 31, 2011. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Large cap indices are represented by the S&P 500 and the Russell 1000 Indices.

Exhibit 3: Risk/Return Profile – Mid-Cap Style and Pure Style Indices (Data from 05/31/2001 to 05/31/2011)

	Value			Growth		
	S&P Value	S&P Pure Value	Russell Value	S&P Growth	S&P Pure Growth	Russell Growth
Annualized Returns						
3 Year	4.41%	6.71%	3.99%	7.46%	15.98%	4.47%
5 Year	5.14%	5.79%	4.68%	8.89%	13.31%	6.54%
10 Year	7.92%	9.97%	8.56%	8.20%	9.59%	5.70%
Annualized Standard Deviation						
3 Year	26.00%	38.24%	26.87%	25.42%	27.30%	25.88%
5 Year	21.27%	30.38%	22.10%	21.07%	22.51%	21.56%
10 Year	17.97%	24.02%	18.25%	18.90%	21.21%	20.28%

Source: Standard & Poor's and Bloomberg. Data as of May 31, 2011. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Mid-Cap Indices are represented by the S&P Midcap 400 and the Russell Midcap Index.

Exhibit 4: Risk/Return Profile – Small-Cap Style and Pure Style Indices (Data from 05/31/2001 to 05/31/2011)

	Value			Growth		
	S&P Value	S&P Pure Value	Russell Value	S&P Growth	S&P Pure Growth	Russell Growth
Annualized Returns						
3 Year	4.43%	9.68%	4.41%	7.48%	11.09%	6.92%
5 Year	3.35%	3.26%	3.00%	6.64%	7.22%	6.26%
10 Year	7.98%	10.15%	8.22%	8.71%	10.07%	5.14%
Annualized Standard Deviation						
3 Year	28.51%	48.80%	28.34%	26.64%	29.74%	27.52%
5 Year	23.03%	38.74%	23.43%	21.82%	24.09%	23.06%
10 Year	20.27%	30.30%	20.37%	19.79%	22.03%	22.37%

Source: Standard & Poor's and Bloomberg. Data as of May 31, 2011. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance. Small-cap Indices are represented by the S&P SmallCap 600 and the Russell 2000 Index.

What explains the excess returns? Exhibit 5 analyzes the average annual excess return of the S&P Pure Style indices relative to the S&P Style indices over the ten-year period ending December 31, 2010 by decomposing the excess return into two components. Those components are the average excess return derived from ***style purity*** (i.e., the selection of stocks that are classified as either pure value or pure

growth) and the average excess return derived from ***weighting*** (i.e., weighting stocks by their value or growth scores, rather than by capitalization). While both factors have contributed to the excess return of the S&P Pure Style indices, weighting has typically been much more powerful than selection.

For most style boxes, both style purity and weighting scheme have contributed to outperformance, with the latter contributing more.

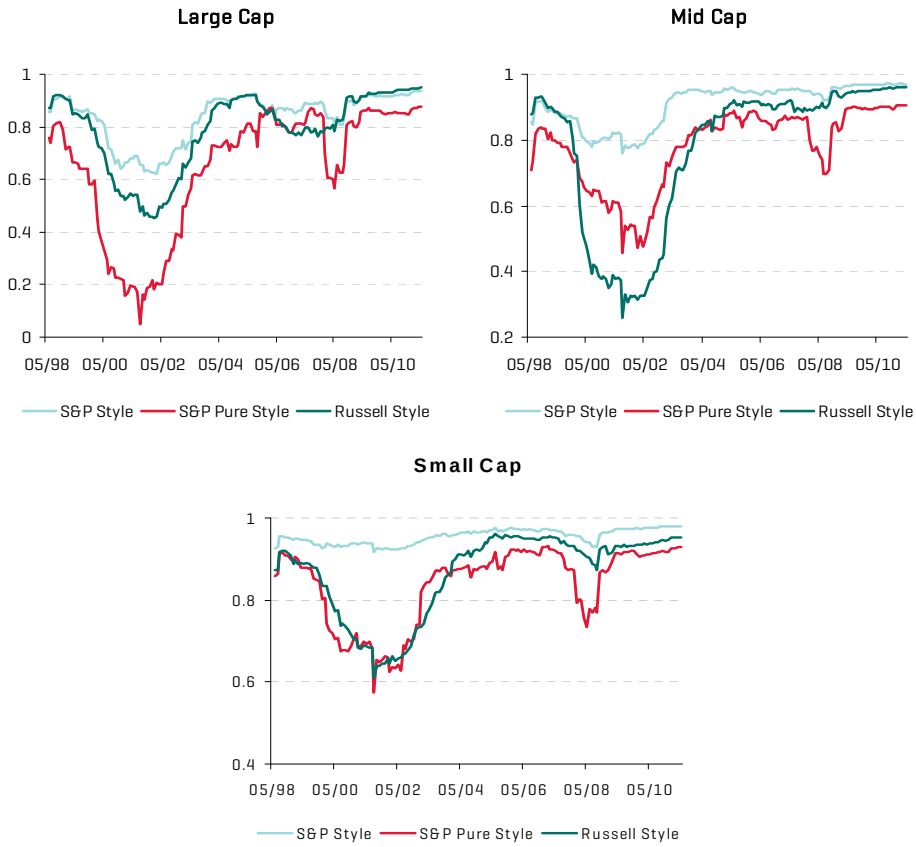
Exhibit 5: Average Annual Excess Return Breakdown (Data from 12/31/2000 to 12/31/2010)

	Total Average Annual Excess Return	Average Annual Excess Return from Style Purity	Average Annual Excess Return from Weighting Scheme
S&P 500 Pure Value	6.33%	0.97%	5.36%
S&P 500 Pure Growth	5.68%	-0.11%	5.79%
S&P MidCap Pure Value	4.17%	1.01%	3.16%
S&P MidCap Pure Growth	6.47%	3.83%	2.64%
S&P SmallCap Pure Value	7.69%	2.52%	5.17%
S&P SmallCap Pure Growth	7.01%	3.32%	3.68%

Source: Standard & Poor's. Data as of December 31, 2010. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

In addition, S&P Pure Style value and growth sub-indices exhibit lower correlation than their traditional Style counterparts, providing potential portfolio diversification benefits. Exhibit 6 illustrates the correlation between value and growth indices across the three market cap segments, for the S&P Style, Russell Style and S&P Pure Style indices.

Exhibit 6: Rolling 36-Month Correlation between Style and Pure Style Indices (Data from 05/31/1998 to 05/31/2011)



Source: Standard & Poor's and Bloomberg. Data as of May 31, 2011. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Impact on Tactical Asset Allocation

Style indices and ETFs based on those indices are often used for opportunistic or tactical allocations to style boxes based on expected short- or medium-term performance. When used in such situations, it is important that there be a sharp performance differentiation between growth and value.

Exhibit 7 below illustrates the average 12-month rolling spread of the Style and Pure Style indices for the large-, mid- and small-cap segments. As the performance of the value and growth indices moves in cycle over time, investors can make tactical adjustments to take advantage of short-term deviations in the asset class values. The discriminatory power of the S&P Pure Style indices allows for more effective style rotation strategies as well as hedging tools.

Pure Style indices have had wider spreads and lower correlations between growth and value, compared to traditional Style indices.

During the periods in which one style is strongly favored over another, the spreads of the S&P Pure Style indices are significantly wider than those of the Style indices. The finding is consistent across all three market cap ranges.

Exhibit 7: Average Monthly Spread between Style and Pure Style Indices
Data as of 05/31/2001 – 05/31/2011

Source: Standard & Poor's. Data as of May 31, 2011. Charts are provided for illustrative purposes. This chart may reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Conclusion

Both Style and Pure Style indices can serve as effective tools for expressing an investor's point of view on a particular style. Due to differences in index construction, the two sets of indices offer significantly different return and risk characteristics, which have implications for an investor's asset allocation decisions. Over a long-term investment horizon, Pure Style indices have exhibited greater returns and volatility, lower correlation and wider spreads than the traditional Style indices.

Exhibit 8: U.S. Listed ETFs Linked to S&P Pure Style and Core Indices

Market Cap	Style		
	Growth	Core	Value
Large-Cap	RPV	SPY, IVV, VOO	RPG
Mid-Cap	RFG	MDY, IJH, IVOO	RFV
Small-Cap	RZG	IJR, SLY, VIOO	RZV

Source: Standard & Poor's. Charts are provided for illustrative purposes.

Additional Resources

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Performance Disclosure

The inception date of the S&P Pure Style indices was December 19, 2005 at the market close. All information presented prior to the index inception 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.indices.standardandpoors.com.

Past performance is not an indication of future results. Prospective application of the methodology used to construct the S&P Pure Style indices 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.standardandpoors.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.

Also, another limitation of hypothetical information is that generally the index 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.

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