ETF Performance & Perspectives

From S&P Capital IQ MarketScope Advisor

JANUARY 2014

Each month, we compile a selection of timely and actionable Trends & Ideas reports published on S&P Capital IQ MarketScope Advisor.

The research reports inside include positive and negative implications for certain stocks, mutual funds and ETFs, and selected performance charts.

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ETF Insights with Todd Rosenbluth

Aided by a strong December, investors poured over $235 billion into global exchange-traded products in 2013, according to BlackRock. The heavy lifting came from not only U.S equities, as demand increased for diversified large-cap and cyclical sector exposure, but also developed Europe and Asian equities. Meanwhile, within fixed income, asset flows diverged depending on the duration focus of the products. All this occurred as ETFs gained traction versus more established mutual funds.

In December, S&P Capital IQ published 20 Trends & Ideas articles for our clients that had favorable or unfavorable ETF implications. The topics ranged from U.S. sector investing, an area that continues to grow in popularity and in breadth of offerings, to European equities, which we believe will outperform the U.S., to fixed income, which has seen ebbs and flows depending upon the direction of the 10-year Treasury yield and expected actions by the Federal Reserve. Below, we highlight some of the more popular stories, based on relative viewership.

Investors poured an additional $1.3 billion into U.S. sector-focused products in December and over $35 billion in all of 2013. S&P Capital IQ equity analysts profiled three different sectors that are notable. Within Health Care, we looked at the health insurance industry, which we think is poised to benefit from the implementation of the Affordable Care Act and a growing insurance population. We highlighted favorably the large diversified Sector SPDR in this sector along with an industry-focused offering from iShares.

For Information Technology, the second most popular of the sectors in 2013, we decided to compare the holdings, performance and costs of some of the largest ETFs with the largest mutual funds. S&P Capital IQ has rankings on both types of funds, but since ETFs are largely passive, we believe their track record is much less meaningful relative to the underlying holdings. Lastly, we dug into one of the Energy sub-industries to see what stocks we believe are positioned to benefit from rising crude oil production and for an ETF offering appealing exposure.

Within fixed income, we tackled two topics that have been on the minds of investors. First, how to use short-term ETFs to help allocate assets now that the Federal Reserve is beginning to taper its bond buying program. Second, whether the pension issues tied to Detroit’s bankruptcy make municipal bond ETFs more or less worthy of attention.

To learn more about our overall ETF rankings on approximately 885 securities or to receive our Trends & Ideas content in a timelier manner, please contact us.

Todd Rosenbluth
Director of ETF & Mutual Fund Research

Todd Rosenbluth
S&P Capital IQ Director, ETF Research
@ToddSPCAPIQ
Equity ETF Model Portfolio Performance
October 14, 2008 - December 31, 2013

ETF ranking categories are models only. Please see the next slide for additional important disclosures regarding the inherent limitations of model performance and additional disclosures on the benchmark. Model performance includes dividends and is gross of all investor level fees and expenses. The S&P 500 index is the benchmark for the ETF model portfolios. Indexes are unmanaged, statistical composites and their returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. It is not possible to invest directly in an index. Inclusion of fees and expenses in the model or S&P 500 index would lower performance. Past performance of the models or S&P 500 index is no indication of future results.

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Overweight has OUTPERFORMED the S&P 500 TOTAL RETURN INDEX.

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Marketweight has OUTPERFORMED the S&P 500 TOTAL RETURN INDEX.

A model portfolio comprised of ETFs with an overall S&P Capital IQ ETF ranking of Underweight has UNDERPERFORMED the S&P 500 TOTAL RETURN INDEX.

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Performance Disclosure

The exchange-traded fund ("ETF") model performance chart on the prior slide is only an illustration of S&P ETF research; it shows how all ETF’s that received a particular Overall S&P ETF ranking of Overweight, Marketweight or Underweight performed. The Overall S&P ETF rankings in the above chart are model portfolios only; they are not collective investment funds. (The ETF model portfolios are also collectively referred to as "model" or "model portfolio"). Model performance has inherent limitations. The ETF model performance does not show how any actual portfolio has performed. ETF model performance does not represent the results of actual trading of investor assets. S&P maintains the model and calculates the model performance shown or discussed, but does not manage actual assets. Thus, the performance shown or discussed does not reflect the impact that material economic and market factors had or might have had on decision-making if actual investor money had been managed. Performance of an investor's actual portfolio will not necessarily match the performance of the model portfolio due to differences in the weightings of the individual securities. In addition, the model results do not take into account timing differences between the selections by S&P and purchases that were or would have been made based on those selections by any advisor or by actual investors. While model performance for some or all ETF ranking categories may have performed better than the illustrative reference point for the period shown, the performance during any shorter period may not have, and there is no assurance that the model will perform better than the illustrative reference point in the future. The model does not take into account any particular investment objective, financial situation or need and are not intended as an investment recommendation or strategy. Investments based on the ETF methodology may lose money. Past performance of the ETF model is no guarantee of future results.

Performance is calculated daily using a time-weighted rate of return. The model performance calculation takes into account dividends and distributions but does not take into account reinvestment of dividends. ETF's in each model will change over time, and some or all of the ETF’s that received rankings during the time period shown may not have maintained their ranking during the entire period.

For model performance calculation purposes, the ETF’s within each model at October 14, 2008 were equally weighted. Thereafter, additions to the composition of the ETF's in each model are made at the average market value of the ETF model at the preceding month end with no rebalancing. The average market value of the ETF equals the total market value of the ETF model at the prior month end divided by the number of ETFs in the ETF model at the prior month-end. The number of shares of the new ETF added equals the average value of an ETF in the ETF model at the preceding month-end divided by the price of the added ETF at the close of the day it was added. The number of shares remains fixed unless there is a subsequent distribution. Subsequent to the addition of the equity, the performance calculation is based on the number of shares and the daily closing prices. An ETF is deleted in its entirety, and the deletion is made at the closing price of the day that the deletion is made.

ETF model performance reflects the fees and expenses of the underlying ETFs. The model performance does not consider taxes and brokerage commissions, nor does it reflect the deduction of any advisory or other fees charged by advisors or other parties that investors will incur when their accounts are managed in accordance with the model. The imposition of these fees and charges would cause actual performance to be lower than the performance shown. For example, if the model returned 10 percent on a $100,000 investment for a 12-month period (or $110,000) and an annual asset-based fee of 1.5 percent were imposed at the end of the period (or $1,650), the net return would be 8.35 percent (or $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 33.1%, a total fee of $5,375 and a cumulative net return of 27.2% (or $27,200).

An investment based upon any of the models should only be made after consulting with a financial advisor and with an understanding of the risks associated with any investment in securities, including, but not limited to, market risk, credit risk, political and credit risks, the risk of economic recession and the risk that issuers of securities or general stock market conditions may worsen, over time. Foreign investing involves certain risks, including currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, less liquidity and the potential for market volatility and political instability. As with any investment, investment returns and principal value will fluctuate, so that when redeemed, an investor’s shares may be worth more or less than their original cost.

Benchmark Disclosure

The S&P 500 index is the benchmark for the ETF model portfolios. Indexes are unmanaged, statistical composites and their returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. The methodology for calculating the return of the S&P 500 index differs from the methodology for calculating returns for the ETF ranking categories. The S&P 500 index has different risk characteristics than the ETF model portfolios, and its performance calculation takes into account reinvestment of dividends and distributions. Past performance of the S&P 500 Index is no guarantee of future results.
Fixed Income ETF Model Portfolio Performance
May 17, 2013 - December 31, 2013


<table>
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<tr>
<th>ETF Ranking</th>
<th>Hypothetical Growth of $100 Invested on 5/17/13</th>
<th>Model Performance from 5/17/13 to 12/31/13</th>
</tr>
</thead>
<tbody>
<tr>
<td>FI OVERWEIGHT</td>
<td>$99</td>
<td>-1.0%</td>
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<tr>
<td>FI MARKETWEIGHT</td>
<td>$97</td>
<td>2.0%</td>
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<tr>
<td>Barclays US Aggregate TR</td>
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<td>-2.0%</td>
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<tr>
<td>FI UNDERWEIGHT</td>
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OVERWEIGHT
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MARKETWEIGHT
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Performance Disclosure

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Benchmark Disclosure

The Barclay's U.S. Aggregate Total Return bond index is the benchmark for the ETF model portfolios. Indexes are unmanaged, statistical composites and their returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. The methodology for calculating the return of the index differs from the methodology for calculating returns for the ETF ranking categories. The index has different risk characteristics than the ETF model portfolios. Past performance of the index is no guarantee of future results.
**Is There A Silver Lining Behind Motown’s Woes?**

(12/09/2013)

“This once proud and prosperous city can’t pay its debts. It’s insolvent. It’s eligible for bankruptcy. But it also has an opportunity for a fresh start.”

Those words, uttered by Federal Bankruptcy Judge Steven W. Rhodes, helped set a plan in place to allow Detroit to formally enter bankruptcy proceedings. That Detroit is bankrupt is no surprise. That a Federal Bankruptcy judge would expressly declare that Detroit’s public employee pensions are not protected in a bankruptcy filing (despite being protected under the Michigan state constitution) and are now vulnerable to being restructured, along with Detroit’s other obligations, is a surprise -- and one with enormous ramifications for the municipal bond market, in our view.

While the state’s financial woes have been well documented, Michigan is far from alone in its pension shortfall. Indeed, according to a recent report prepared by State Budget Solutions (SBS), a non-profit public policy organization, the funding gap in public employee pension plans (or the difference between the pension obligations and the amount states have set aside for those obligations) is a staggering $4.1 trillion. While there are other estimates that claim the funding shortfall is much less, it’s important to note that the $4.1 trillion estimate assumes a 3.2% rate of return on pension assets; many of the rosier scenarios assume rates of return in the range of 6% to 9%.

There are also several ways to measure a particular state’s pension shortfall. One is on a per capita basis. Another is to look at a pension plan’s funded ratio, or the plan’s assets as a percentage of its liabilities. It is also constructive to view a particular state’s unfunded liability as a percentage of that state’s gross state product.

Combining the rankings of per-capita unfunded liabilities with unfunded liabilities as a percentage of a state’s gross state product yields nine states that have the dubious distinction of being near the top of both lists: Illinois, Ohio, New Jersey, Oregon, Connecticut, Nevada, New Mexico, Hawaii, and Alaska.

Shortly after the Michigan bankruptcy decision was announced, Illinois governor Pat Quinn signed into law a pension reform bill aimed at closing some of his state’s pension shortfall. While most labor unions are preparing lawsuits to contest both the Michigan and Illinois decisions, these moves may empower other state legislators to take similar steps.

Those state and local governments that are successful at taming the upward spiral of pension liabilities may see their efforts rewarded in the form of a healthier fiscal balance sheet. Investors have already started to respond favorably, lifting prices for the bonds of many of these issuers.

Although we believe the rising tide of pension reform may lift a number of entities, we think investors would be wise to diversify among holdings in this space. One effective way to achieve this is through the use of municipal exchange traded funds (or ETFs).

Two of the largest municipal bond ETFs are the SPDR Nuveen Barclays Municipal Bond ETF (TFI 23...
Overweight) and the iShares National AMT-Free Muni Bond ETF [MUB 104 Overweight]. TFI has assets of approximately $930 million and seeks to track the price performance of the underlying holdings in the Barclays Municipal Managed Money Index. As of October 31, 2013, it had a 20.65% exposure to New York, 13.84% to California, 7.32% to Texas, 5.04% to Florida, 4.58% to Massachusetts. Illinois accounted for 3.35% of the ETF’s assets. MUB, with assets of some $3 billion, seeks to track the performance of the underlying holdings in the S&P National Municipal Bond Index. At October 31, 2013, MUB had a 22.12% exposure to California, 18.92% to New York, 7.93% to Texas, 5.56% to New Jersey, and 5.16% to Massachusetts.

For investors seeking exposure to the high yield portion of the municipal bond market, two ETF options are the Market Vectors High-Yield Municipal Index ETF [HYD 29 Marketweight] and the SPDR Nuveen S&P High Yield Municipal Bond ETF [HYMB 52 Marketweight]. HYD has total assets of just over $800 million, with exposures in Texas (7.09%), New Jersey (6.19%), New York (5.76%), Illinois (5.07%), and Ohio (4.82%). HYMB has assets of some $177 million and is much more exposed to California, with that state accounting for nearly 18% of its holdings; Florida (7.61%), Colorado (6.46%), Ohio (5.56%) and New Jersey (5.49%) round out its top five state exposures.

S&P Capital IQ ETF reports on these and other municipal bond offerings can be found on this platform.

Cathy Seifert
S&P Capital IQ ETF Analyst
Investors looking for exposure to the Information Technology sector have a number of choices at their disposal. One could simply look through the 1,627 stocks in the Information Technology sector and choose a few. If you don’t have the time for that, you could narrow down the field. Looking at just the 242 stocks given full analytical coverage by S&P Capital IQ equity analysts would take far less time. And of that group, 76 have STARS recommendations of buy or strong buy. That might still lead to an unwieldy portfolio for all but the most dedicated investors. If one were to stick with the companies with the largest market caps, there would be six names including such bellwethers as Apple Inc. (AAPL 565 ***) and International Business Machines Corp. (IBM 177 ***). On this end of the spectrum, however, we might arrive at a portfolio that would be too narrowly focused for many investors. For diversification and simplification, investors can turn their attention to investing in funds. But wait! What kind of funds? Exchange traded or mutual?

To examine the major fund types while keeping an eye toward technology stocks, we decided to concentrate on some of the largest, most widely held offerings in each group. For ETFs, we looked for those with Overweight recommendations in the Information Technology GICS Sectors group. For mutual funds, we narrowed our choices to funds in the Science & Technology peer group that are open to new investors, while excluding institutional share classes. We then chose the two largest funds from each category. (We have excluded PowerShares QQQ Trust [QQQ 86 Overweight], given its 20% stake in Consumer Discretionary and 13% weighting in Health Care.) In size order, they are: Select Sector Technology Select Sector SPDR Fund [XLK 35 Overweight], which has a market cap of $12.9 billion; Vanguard Information Technology Index Fund [VGT 87 Overweight], with a market cap of $4.2 billion; Fidelity Select Software and Computer Services Portfolio [FSCSX 118 ****], with total net assets of $3.0 billion; and T Rowe Price Science & Technology Fund [PRSCX 37 ****] with total net assets of $2.8 billion.

In our view, the biggest factor to examine when comparing ETFs to mutual funds is the question of a passively managed portfolio versus an actively managed one. The lack of change in the ETF portfolios can be demonstrated by their turnover rates of 5% and 6%, respectively, for XLK and VGT. In sharp contrast, the turnover rates for FSCSX and PRSCX are 96% and 50%, and these numbers are both below the peer group average of 147%. There is one place where these different turnover rates will quickly manifest themselves: costs. The expense ratios [gross] for the ETFs average 0.16%, while the gross expense ratios [current] for the mutual funds average 0.85%. Again, we point out that the mutual fund peer group has a noticeably higher average (1.73%). Investors might be willing to put up with the additional trading and associated costs if the performance merits it.
Since we are looking at only a small sample size, it is difficult to draw a firm conclusion. However, the total returns point to outperformance by the actively managed funds over the passive ones. Over the trailing five years ended December 6, the two actively managed funds returned 26.3% on average annually, compared with 21.4% for the two passively managed ones. For the year to date period, the outperformance is even more stark: 39.9%, versus 24.2%.

In addition to higher expenses, there is another price to pay for the additional performance from these mutual funds, which is increased volatility. Using the standard deviation over the trailing three years through the end of November, the ETFs were decidedly less volatile than their actively traded mutual fund cousins (13.4, versus 16.9).

The portfolios of the quartet are remarkably similar within the top 10, as all four agree on investing in Google Inc. (GOOG 1079 ***) and Microsoft Corp. (MSFT 38 ***). However, we note that the mutual funds invest in companies that may be technology related, but are in other sectors, including consumer discretionary, health care, or industrials. Regarding the ETFs, although VGT is strictly invested in information technology names, XLK has a wider base, with 12.4% of assets invested in telecommunication services companies.

When it comes to ETFs versus mutual funds, there is no wrong answer, in our view. The key is knowing what your goals are and analyzing multiple aspects of each investment possibility, including performance, risk, and costs.

To see reports on the ETFs mentioned above, visit the ETF tab of MarketScope Advisor. At the Funds tab of MarketScope Advisor, you can review reports on these and many other Science & Technology Funds.

Dylan Cathers
S&P Capital IQ Equity Analyst
Diving Into Deepwater Energy Services

(12/11/2013)

Offshore drilling has gotten a bit of a black eye in recent years, according to S&P Capital IQ. It was only slightly more than three years ago that the oil spill occurred in deepwater U.S. Gulf of Mexico, creating an environmental nightmare, regulatory uncertainty, and a legal mess that is still being sorted out. More recently, sometimes it feels like the massive increase in U.S. onshore crude oil production has started to push offshore energy onto the back pages. Not to mention renewable energy, which continues to make strides, particularly in solar, where more experience is helping move down the cost curve and increasing its competitiveness against fossil fuels.

Still, in the near to medium term, we believe the need to ramp up fossil-fuel supply to meet ever-present global energy demand should be robust. And it is in deepwater where the largest new finds are likely to be located, in our view. In November, offshore-drilling leader Transocean [RIG 49 ****] cited data from management-consulting firm McKinsey noting that deepwater and ultra-deepwater production growth is anticipated to grow at a compound annual growth rate (CAGR) in the 7% - 9% range between 2013 and 2025. This compares very favorably with midwater depth production [2% - 5% forecasted CAGR] and shallow water [projected CAGR of approximately 0% - 3%].

As a result, we like exposure within oil services to those companies with deepwater drilling business. Portfolio exposure may be achieved either directly through the companies that own and operate the offshore drilling rigs themselves or indirectly via the capital-equipment names that manufacture the individual parts of deepwater drilling rigs, plus ancillary needs such as downhole tools that can operate in deepwater. We think a subset of four companies makes for reasonable exposure in this area: Transocean and Ensco [ESV 59 ****] are two larger and deepwater-focused offshore drilling plays that we like. Meanwhile, National Oilwell Varco [NOV 79 ****] is the industry juggernaut in oilfield capital equipment, and competitor Cameron International [CAM 55 ****] is a major player in this space as well, along with being at the cutting edge of technology development by virtue of its OneSubSea joint venture with industry behemoth Schlumberger [SLB 87 ****].

One way to gain exposure to these four S&P Capital IQ buy-ranked names would simply be to acquire shares of each individually. However, a growing number of investors are looking to ETFs for selections in their portfolios. In our view, the investment appeal of these securities is their diversified holdings, transparency, intraday liquidity and relatively low costs, relative to actively managed mutual funds. S&P Capital IQ believes it is important to assess an ETF’s performance, risk, and cost considerations, including a fundamental analysis of its underlying holdings. We incorporate 10 analytical elements when producing the output for our overall ETF rankings.

Using the ETF screener available on S&P Capital IQ MarketScope Advisor, we surveyed the landscape of equity ETFs that own these four names within their top-10 holdings. We found two of them and then selected the Market Vectors Oil Services ETF [OIH 48 Overweight], because it’s the one with the greatest aggregate exposure to them.

Looking under the hood of OIH, we note that it’s a relatively new ETF, now approaching the two-year

Key Takeaways

We believe deepwater-focused energy services will likely benefit from rising crude oil production.

POSITIVE IMPLICATIONS

<table>
<thead>
<tr>
<th>COMPANY</th>
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<tbody>
<tr>
<td>CAMERON INTL</td>
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<tr>
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<tr>
<td>TRANSOCEAN LTD</td>
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The recommendations contained in this Takeaway box are current, and may have changed since the original story was published.
anniversary of its inception date, December 20, 2011. Nonetheless, it is of more than reasonable size and liquidity, in our view, with a market cap of $1.6 billion and trading an average of 4.5 million shares per day. Based on its top-10-holdings data, the four S&P Capital IQ buy-recommended stocks we highlighted above comprise 21% of the ETF's assets. Overall, 76% of OIH is comprised of stocks in the oil & gas equipment & services sub-industry [to which NOV and CAM belong], and the remaining 24% is comprised of names in the oil & gas drilling sub-industry to which RIG and ESV belong. Thus, 100% of the ETF is comprised of energy holdings.

OIH receives an overweight ranking in the performance analytics category, partly due to favorable scores on S&P Capital IQ Fair Value and S&P Capital IQ Technical data, and a neutral outlook for the S&P Capital IQ STARS rankings of the underlying holdings. However, being 100% focused on the energy sector comes at a price, namely an underweight ranking for its risk considerations, led by a negative score for the S&P Capital IQ Risk Assessment input. Regarding cost factors, OIH scores well, with an overweight assessment helped by a small bid/ask spread. OIH receives an Overall ETF Ranking of Overweight.

Ultimately, this is an ETF that focuses on energy services and invests in a fairly concentrated manner. For instance, its top-10 holdings account for about 72% of the ETF's assets. We like the exposure to NOV, CAM, RIG and ESV, but we acknowledge that the energy services group can be fraught with volatility, exposed at least indirectly to changes in crude oil prices. In addition, OIH's portfolio is top-heavy; the top-two holdings, SLB and Halliburton [HAL 49 ***] comprise more than 32% of the ETF's assets. Finally, in the case of Transocean, it should be noted that it was this company's deepwater rig [the Deepwater Horizon] that was involved in that oil spill three years ago. While we believe that the company and the offshore industry are now relatively safer than before the accident, spurred by a number of regulatory changes, we also note that Transocean's legal battle is not yet over, nor can there be unassailable certainty that no such large-scale deepwater spill will ever occur again in the offshore industry.

For more details on the S&P Capital IQ ETF Methodology and to learn about all the inputs or to view the ETF report on OIH, see the ETF Tab of S&P Capital IQ Marketscope Advisor.

Stewart Glickman
S&P Capital IQ Equity Analyst
How to Play Expected Improvements in Europe

[12/11/2013]

European exchange traded products continued to gather fresh money in November with the addition of $2.3 billion, an amount greater than developed Asia Pacific products. S&P Capital IQ believes investors will continue to focus on this region in 2014, aided by economic improvement, earnings growth and the need to stay diversified relative to U.S. stocks. There are a range of ETFs for investors to choose from that are either well diversified or focused on a region or sector, most with modest cost factors.

S&P Capital IQ’s Chief European Equity Strategist Robert Quinn sees double digit returns for the major European indices in 2014 due to a combination of a multi-year economic expansion, double digit earnings growth led by cyclical sectors, fundamental improvement by European banks and likely favorable actions by the European Central Bank. S&P Capital IQ’s European Economics team projects GDP growth in the Eurozone of 0.9% and 1.3% in 2014 and 2015, respectively, led by Germany and France, but improving growth in Italy and Spain. Meanwhile, for the United Kingdom, growth of 2.1% and 2.0% are forecasted. In particular, S&P Capital IQ Equity Research believes earnings momentum should drive European Union banks, with French banks BNP Paribas [BNPP Strong Buy] and Societe Generale [GLE Buy], for example, enjoying material improvement in ‘14 and ‘15 due to less pressure on deleveraging and asset quality.

In addition to a favorable view on Banks, Quinn also prefers cyclical areas of the market such as Autos & Parts, Construction Materials, Industrials Good & Services, Insurance, Media, and Travel & Leisure, where in most cases there are expectations of margin improvement by our analytical team. In particular, Quinn believes Autos & Parts will be a direct beneficiary of European growth due to its high operational leverage, and earnings here will be aided by an expected weaker euro relative to the U.S. dollar. Meanwhile, Construction Materials should be helped by improving confidence and price-to-book values below the long-term average, according to S&P Capital IQ. In contrast, S&P Capital IQ is less positive on most defensive areas of the market, namely Food & Beverages, Telecommunications Services and Utilities. However, investors that own broadly diversified European and country-specific ETFs should be mindful that there will be exposure to a range of these sectors/industries.

While Quinn sees growth in France, Germany and the United Kingdom, he also notes a favorable outlook for Italy and Spain, which despite improvement in ‘13 still has weaker valuations. If European financials continue to perform well in ‘14, as S&P Capital IQ expects, this should help the “periphery markets” more given their relative weightings in their indices and related ETFs. For example, the iShares MSCI Spain [EWP 37 Underweight] has 44% weighting in Financials, much higher than the 17% stake in iShares MSCI Germany [EWG 30 Marketweight].

Besides the country specific ETFs mentioned above, S&P Capital IQ has rankings and research on a number of ETFs that can benefit from the trends Quinn highlights in his full report. From a broadly diversified perspective, Vanguard European Stock Index Fund [VGK 56 Overweight], the most popular of the European ETFs in 2013, is a great investment idea. It is well diversified at both the country and sector level, including offering exposure to the United Kingdom and the Eurozone, and low costs with a $0.12 expense ratio.

Key Takeaways

A stronger outlook from S&P Capital IQ for Europe bodes well for these ETFs, in our opinion.

NEGATIVE IMPLICATIONS

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<thead>
<tr>
<th>ETF</th>
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<td>ISHARES MSCI GERMANY ETF</td>
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<td>[IPD]</td>
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<td>VANGUARD EUROPEAN STOCK INDEX FUND; VANGUARD FTSE EUROPE ETF</td>
<td>[VGK]</td>
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ratio and tight bid/ask spread of a penny; Financials is the largest sector at 22% of assets. For investors looking for exposure to just the Eurozone and thus greater exposure to Italy and Spain, the iShares MSCI EMU ETF (EZU 39 Marketweight) is a good option. Again you get the sector diversification with Financials at 22% of assets, but the country weights are distinct. There is no United Kingdom exposure and Spain and Italy are a combined 18% for this ETF, which also has a penny bid/ask spread.

Meanwhile, investors seeking to hone in on the tactical European industry views of S&P Capital IQ might want to look at SPDR S&P International Consumer Discretionary (IPD 39 Marketweight). While there is a combined 39% weighting toward Japan and South Korea, Germany, United Kingdom and France are well represented. Meanwhile there is a 34% combined weighting in Automobile Manufacturers and Auto Parts & Equipment, with top-10 positions in S&P Buy recommended Daimler AG (DAI) and Volkswagen (VOW). The ETF is much smaller and less actively traded than the others highlighted in this article and has a wider bid/ask spread.

These are just a handful of ETFs that are worthy of note, but you can find others on MarketScope Advisor.

Todd Rosenbluth
S&P Capital IQ  Director, ETF Research
@ToddSPCAPIQ
Playing the Surging Health Insurance Industry Via ETFs

(12/20/2013)

The managed health care sub-industry outperformed most sub-industry groups year to date to December 13, 2013 (up 37.4%, vs. a 25.0% increase in the S&P 1500 index). We think this outperformance by the health insurers, also known as managed care organizations [MCOs], has been driven by a few factors. One was the April 2013 decision by the federal government to raise the 2014 Medicare Advantage [MA; health plan] benchmark rate. This meant that MCOs will face mid-single-digit reductions in MA payment rates [which are also determined by other factors], versus the expected high-single-digit cuts. Another we see has been earnings growth that has been above our and Capital IQ consensus estimates during the first nine months of 2013. Finally, we think investors view positively the MCOs’ intermediate- to long-term growth prospects, fueled by their expanding Medicaid and Medicare populations, and an eventual reduction of the under 65-year-old uninsured population as a result of the Affordable Care Act [ACA; healthcare reform law], despite ACA policies and regulations that can restrict their earnings growth.

We look for group-wide EPS growth in 2013 well in excess of 20%. The better-than-expected EPS growth seen so far in 2013 has been aided by lower-than-expected medical cost ratios [MCRs; medical costs as a percentage of premiums], reflecting the continuation of moderated medical cost trends and favorable accounting adjustments (the reduction of latest-period medical costs on the income statement due to the overestimation of prior-period medical costs). Other drivers include internal enrollment growth, price hikes, acquisitions, and fixes to company-specific issues that hurt certain MCOs’ 2012 performance.

Looking at 2014, we expect commercial [including individual] enrollment trends to remain relatively light, with only 4 million-5 million uninsured individuals obtaining insurance through the ACA-mandated public health care exchanges, by March 31 of that year, out of the 25 million the Congressional Budget Office expects to gain insurance via the public exchanges by 2016. That is partly due to the exchanges’ software issues. We also look for the Medicaid managed care population to grow by 7 million-8 million people on ACA-recommended higher eligibility standards adopted so far by 25 states and D.C. We expect MA membership to continue to rise with the aging of the large baby-boomer population.

The MCOs that have provided some details on their 2014 prospects believe medical cost trends will remain moderate, but could expand slightly. The more-diversified MCOs expect overall MCRs to decline on their ability to pass along the non-tax deductible, ACA-mandated health insurer fee in the commercial and Medicaid premiums, albeit not in MA premiums. However, the reduced MCR will be mostly offset and, in some cases, be outweighed by the inclusion of the total fee amount in SG&A expenses and the resulting higher tax rate.

Key Takeaways

These ETFs provide some exposure to relatively outperforming managed health care stocks.

POSITIVE IMPLICATIONS

<table>
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<tr>
<th>ETF</th>
<th>Rating</th>
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<tr>
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All told, we see deceleration in earnings growth for the group as a whole to the low- to mid-single digits in 2014, excluding one outlier. So far, Humana Inc. [HUM 102 ****], which has a heavy MA concentration, expects an approximate 14% drop in EPS from its projected 2013 EPS due to the fee and incremental internal investments, while well-diversified UnitedHealth Group Inc. [UNH 72 ****] and Aetna Inc. [AET 67 ****] see flat to slightly higher EPS. Cigna Corp. [CI 85 ****] expects EPS to rise, but has yet to elaborate. We expect Medicaid-focused MCOs - Molina Healthcare, Inc. [MOH 32 ****] and WellCare Health Plans, Inc. [WCG 67 ****] - to benefit from their ability to pass along the fee.

We think investors have continued to favor MCO stocks on their view that the tailwinds of the ACA, including a growing insured population, Medicaid expansion and medical cost control, will outweigh the headwinds. Moreover, in our view, the larger MCOs have the scale, diversity, strong free cash flow, and improving revenue leverage over operating costs to increasingly outweigh the impact of the fee on earnings subsequent to 2014. We also expect the larger MCOs to remain industry consolidators, and to use their cash flows to acquire additional health care-related product or service offerings in the U.S. or internationally.

Health-care ETFs are predominantly weighted toward pharmaceutical companies, but one with a relatively meaningful weighting in health insurers is iShares US HealthCare Providers ETF [IHF 90 Overweight]. We also wish to highlight the more-diversified Health Care Select Sector SPDR Fund [XLV 55 Overweight]. We view both as attractive choices. As of December 19, IHF was overweight for Performance Analytics, while XLV was marketweight. However, IHF was marketweight for Risk Considerations and Cost Factors, while XLV was overweight in both categories. Both ETFs were in the top quartile of their asset classes for their S&P STARS and Fair Value. IHF carries a gross expense ratio of 0.46, while XLV’s is 0.18. In addition, XLV has low volatility, while IHF’s more closely matches that of the overall market.

As of December 19, IHF had total assets of $374.3 million. Its managed health care stocks accounted for 43.77% of its total holdings (as of November 30), with UNH, AET, CI, HUM and WellPoint Inc. [WLP 89 ****] among its top-10 holdings. XLV had total assets of $8.6 billion, with managed care stocks accounting for just 7.73% of its total holdings (as of October 31), and only one MCO stock, UNH, among its top-10 holdings. Over the past 12 months, IHF had a total return of 31.32%, and XLV, a return of 37.26%. The MCO stocks were among the principal drivers of both ETFs’ 12-month returns.
These ETFs Should Help You To Not Fear the Fed

(12/23/2013)

Amid months of speculation about potential Federal Reserve action, investors pulled $22 billion out of broad-maturity U.S. fixed-income exchange-traded products in the first 11 months of 2013 and plowed $30 billion into short-maturity products, according to BlackRock. The speculation ended last week as the Fed initiated a “token taper,” elective to cut the amount of total bond purchases starting in January 2014 by $10 billion.

The Fed voted to reduce Treasuries to $40 billion from $45 billion, and mortgages to $35 billion from $40 billion. S&P Capital IQ’s Investment Policy Committee (IPC) believes this action signaled that the U.S. economy is currently strong enough - with inflation remaining sufficiently below the 2.0–2.5% level - to withstand this reduction in stimulus. The Fed, in what our IPC thinks many interpret as dovish commentary, also indicated that it will hold off tightening short-term interest rates until unemployment falls well below their initial 6.5% level. They were quick to remind investors, however, that this is a threshold, and not a trigger. They also expect inflation, which remains of concern, to increase gradually.

According to the IPC, from a technical perspective, the 10-year Treasury pulled back to test a rising trendline off the lows since early November, and bounced. It appears to us that yields are now headed for key chart support at 3% [on Friday, they closed at 2.89%]. S&P Capital IQ think yields could then fall as they complete a possible cup-and-handle base. If yields break strongly above 3%, which S&P Capital IQ sees happening, we would then expect a measured move up to around 3.5%, where the next piece of chart support lies. More important, according to S&P Capital IQ, is that the long-term trendline support off of the peaks since 1987 sits up at 3.5%. Looking well into 2014, if yields finally break out of their long-term descending channel, the IPC thinks that from a technical standpoint, the 30-plus year bull market in Treasurys would be over.

While investors have been focusing on the shorter end of the fixed-income ETF market for months, we think there are a number of appealing products that have modest expense ratios, minimal interest-rate sensitivity (duration) and other favorable characteristics. In ranking nearly 200 fixed-income ETFs, S&P Capital IQ uses duration as a key risk considerations factor.

Using the ETF screening tool on MarketScope Advisor, today we find 42 ETFs that have duration less than 3 years - meaning that for every 100 basis point move higher in interest rates, investors can expect a 300 basis point decline in the ETF. In our opinion, these ETFs will hold up better than most if S&P Capital IQ’s IPC is right about the direction of interest rates. However, just 23 of them have an Overweight ranking, which involves nine other assessments of the ETF and its holdings, including Yield, Credit Quality, Expense Ratio and Bid/Ask spread.

The two largest of the ETFs, based on assets, are Vanguard Short-Term Bond Index [BSV 80 Overweight] and iShares 1–3 Year Credit Bond [CSJ 105 Overweight], which each have over $11 billion in assets, helped by strong inflows thus far in 2013. Although the 30-day SEC yields for both are below 1%, both rank favorably for their low durations and tight bid/ask spreads. With an expense ratio of

Key Takeaways

These ETFs rank favorably by S&P Capital IQ for their low duration, modest expense ratios and more.

**POSITIVE IMPLICATIONS**

| ISHARES 1–3 YEAR CREDIT BOND ETF | OVERWEIGHT | [CSJ] |
| SPDR BARCLAYS SHORT TERM CORP. RATE BOND ETF | OVERWEIGHT | [SCPB] |
| VANGUARD SHORT-TERM BOND INDEX FUND; ETF SHARE | OVERWEIGHT | [BSV] |

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0.10%, BSV is half as expensive as CSJ, but thus far in 2013 is up only 0.3% compared to CSJ’s 1.0% gain.

While not as big as BSV and CSJ, SPDR Barclays Short-Term Corporate Bond (SCPB, 31 Overweight) has been a strong performer thus far in 2013, rising 1.2%. SCPB, which has a modest expense ratio of 0.13%, has most of its assets invested in bonds rated A by ratings agencies that operate independently from S&P Capital IQ, whereas CSJ has higher exposure to bonds rated AAA and AA.

The S&P Capital IQ list of top-ranked fixed-income ETFs with duration of less than three years also includes ETFs from Guggenheim, PIMCO and Schwab, as well as others from iShares, State Street and Vanguard. To see the full list, we encourage you run the screen yourself or contact wealth@spcapitaliq.com for more information about S&P Capital IQ’s fixed income ETF research.

Todd Rosenbluth
S&P Capital IQ Director, ETF Research
@ToddSPCAPIQ
Some Newer ETFs Attract Considerable Interest
(12/23/2013)

Including more than 100 exchange-traded funds (ETFs) launched in 2013, the ETF landscape continues to change, with some of the newer ETFs attracting considerable interest. By our calculation, the 20 largest equity or fixed income ETFs debuting in 2013 recently had aggregate net assets or market capitalization of about $4.2 billion. This includes five ETFs that were each at more than $200 million.

Our MarketScope Advisor (MSA) reports offer a tool for looking under the hood at what ETFs own, plus analytics related to performance, risk and cost. Also, within a few months of an ETF’s debut, we can offer an Overall Ranking on an ETF within its asset class, based on our proprietary analytical models.

MSA’s database includes 819 equity ETFs, including 85 that launched in 2013. Of these newer equity ETFs, we already have an Overall Ranking on 56. Of the 216 fixed income ETFs in MSA, 33 debuted in 2013, and we have an Overall Ranking on 26 of these newer ETFs. Going back further, MSA shows 236 equity or fixed income ETFs launched since the start of 2012, of which S&P Capital IQ currently has an Overall Ranking on 180 (76%).

Among the Class of 2013, we have an Overall Ranking of Overweight on 16 of the 85 equity ETFs, including four with a recent market capitalization of more than $100 million -- iShares MSCI USA Quality Factor ETF (QUAL 56, Overweight), iShares MSCI USA Momentum Factor ETF (MTUM 60, Overweight), iShares MSCI USA Value Factor ETF (VLUE 59, Overweight), and iShares MSCI USA Size Factor ETF (SIZE 57, Overweight). While only one (VLUE) of the four is Overweight in our Performance Analytics category, all of them are Overweight in Cost Factors, and one (QUAL) of them is Overweight in Risk Considerations. Of these four equity ETFs, the largest, QUAL, had a market cap of $248 million, following its launch in July.

For equity ETFs, S&P Capital IQ’s proprietary equity ETF rankings utilize up to 10 analytical inputs. The more than 800 reports that S&P Capital IQ provides on equity ETFs offer details on how much coverage is available on the five holdings-based analytics utilized in the ranking system. The other five analytical inputs relate to the ETF security itself.

For an equity ETF, our analysis bubbles up to an Overall S&P ETF Ranking (Overweight, Marketweight, or Underweight) of an ETF security relative to all other equity ETFs on which we have an Overall Ranking. S&P Capital IQ’s analytics include assessments of both an ETF’s holdings and of characteristics pertaining to the ETF security. Six of the 10 analytical metrics are proprietary to S&P Capital IQ or McGraw Hill Financial. The 10 analytical elements for equity ETFs include three for Performance Analytics that are all proprietary, including S&P Capital IQ equity analyst STARS opinions on stocks of companies owned by the ETFs.

Among 31 taxable and two tax-free fixed income ETFs launched in 2013, we have an Overall Ranking of Overweight on six, the largest of which -- iShares Short Maturity Bond ETF (NEAR 50, Overweight) -- recently had a market cap of $165 million. NEAR, which was launched in September, does not have a Performance Analytics ranking, but is Overweight in the Risk Considerations category, and Marketweight

Key Takeaways
S&P Capital IQ has rankings on many of the equity and fixed income ETFs that have launched in 2013.

POSITIVE IMPLICATIONS

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<tr>
<th>ETF</th>
<th>MARKETWEIGHT</th>
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in Cost Factors. The potential inputs in the Performance Analytics category for fixed income ETFs include a relative one-year track record and technical evaluation, neither of which was available for NEAR. The third Performance Analytics input is 30-day SEC yield. (We note that for both equity and fixed income ETFs, there may be varying amounts of analytical inputs available).

For fixed income ETFs, in the Risk Considerations category, our analytics include assessments from Standard & Poor’s Ratings Services and other nationally recognized securities rating organizations; priority is given to Standard & Poor’s Ratings Services if information is available. We view the credit rating component as a key offset of the 30-day SEC yield component used in the Performance Analytics ranking, as yield and credit quality generally have an inverse relationship. Also, S&P Capital IQ adds a rated credit coverage metric to the ranking model. If the ETF invests a large percentage of assets in securities that receive no rating -- more likely in domestic high yield or emerging markets -- the ETF ranking will be negatively affected. In addition, we assess the weighted average effective duration of the securities in the portfolio compared to other fixed income funds, to measure the bond prices’ responsiveness to changes in the prevailing interest rates. We also utilize a liquidity measure in which an ETF’s average trading volume is divided by its market capitalization.

The three Cost Factor inputs for fixed income ETFs -- expense ratio [gross], price to NAV, and bid/ask spread -- are identical to what we utilize for equity ETFs, but with greater relative importance than the Cost Factors category in the equity ranking model.

As of December 23, 2013, S&P Capital IQ is providing an Overall Ranking on 693 equity ETFs, with 174 of them receiving an overall appraisal of Overweight. In addition, there was an Overall Ranking on 193 fixed income ETFs, of which 49 received an Overweight appraisal. Within each asset class, the distribution of Overall Rankings (Overweight, Marketweight, Underweight) generally reflects a normalized distribution curve.

As with all investments, S&P Capital IQ believes that investors should look to make selections that are suitable for their objectives and risk profiles. ETFs that have similar overall rankings may have very different characteristics, including differences in the analytical inputs that go into our rankings, and factors such as what the ETFs own, their size, and their trading volume. Also, note that S&P Capital IQ’s analytical inputs for assessing ETFs are constantly being updated. More details on characteristics and analytical inputs related to ETFs can be found in reports on individual ETFs in MarketScope Advisor, or through the MSA screener.

Tom Graves, CFA
S&P Capital IQ ETF Analyst
Media Mentions
A compilation of news clippings highlighting S&P Capital IQ’s influence in the ETF marketplace.

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Todd Rosenbluth, Director of Exchange Traded Fund (ETF) and Mutual Fund Research visits Fox Business News’ Markets Now to talk about ETF exposure in Puerto Rico.

Todd Rosenbluth, Director of Exchange Traded Fund (ETF) and Mutual Fund Research discusses what’s ahead for ETF trends in 2014.