

S&P High Yield Dividend Aristocrats Index Methodology

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Introduction

Since 1926, dividends have contributed nearly a third of total equity return, while capital gains have contributed two-thirds. Sustainable dividend income and capital appreciation potential are both important to total return expectations.

The S&P High Yield Dividend Aristocrats index is designed to measure the performance of the 50 highest dividend yielding S&P Composite 1500 constituents, which have followed a managed-dividends policy of consistently increasing dividends every year for at least 25 years.

Highlights

The index is weighted by indicated annual dividend yield, with constituents being re-weighted every quarter. The High Yield Dividend Aristocrats constituent universe is reviewed every December.

The index methodology incorporates minimum market capitalization and liquidity criteria, as well as buffers to reduce turnover at index rebalancings. There are also concentration limits to prevent any stock from being more than 4% of the index weight at each quarterly rebalancing.

Companies included in the S&P High Yield Dividend Aristocrats index come from a broad spectrum of industries. Unlike indices that focus only on high dividend yields, which are typically from the Financials and Utilities sectors, the “Aristocrats” are well diversified across all sectors.

Eligibility Criteria

Index Eligibility

To qualify for membership in the S&P High Yield Dividend Aristocrats index, Standard & Poor's must first consider the company a "Dividend Aristocrat" by satisfying the following criteria:

- 1) Be a member of the S&P Composite 1500 index
- 2) Have increased dividends every year for at least 25 consecutive years

Calendar years and ex-dates are used for the dividend analysis, with the data being reviewed every December. New members are added to the Dividend Aristocrat universe on the fifth business day of December, based on a review of the dividend payments of all S&P Composite 1500 constituents. If the December review produces a list of fewer than 75 stocks in the qualifying universe, S&P Composite 1500 constituents that have increased dividends every year for 20 years shall supplement the universe.

A dividend initiation or re-initiation does not count as a dividend increase. Both regular and special dividend payments are considered. The initiation calendar year may include payment of all four quarterly dividends, or only one, two or three quarterly payments. Evaluations are made on a best-effort basis using *Standard & Poor's Compustat* and *Standard & Poor's Dividend Record* data.

Most dividend-oriented indices have 60% to 80% of their portfolio in the Financials and Utilities sectors. However, since the Dividend Aristocrats qualifying universe is diversified, sector concentration is not an issue and, therefore, no separate criteria is used to limit sector weights.

Timing of Changes

Index constituent weight adjustments occur after the closing of fifth business day of each quarter ending month.

Index constituent membership is reviewed in full once a year in December. The reference date for such additions and deletions is after the closing of the last trading date of November. Index constituent changes occur after the closing of fifth business day of December.

Additions

At each annual rebalancing, in December, a company is added to the index if it is a member of the S&P Composite 1500, has increased dividends every year for at least 25 consecutive years and is ranked as one of the top 50 stocks in the qualifying universe in terms of indicated annual dividend yield.

At each quarterly rebalancing, in March, June and September, a company is added to the index only if the index has fewer than 50 constituents. Companies will be added according to the rules found in the section *Index Maintenance*.

No additions are made to the index between rebalancings.

Deletions

Index constituents may be deleted from the index for the following reasons:

- During the December rebalancing, if the company's calendar year dividends did not increase from the previous calendar year.
- During the December rebalancing, if the company no longer ranks as one of the top 50 stock in the qualifying universe in terms of indicated annual dividend yield. (A rank of 1 is the company with the highest yield)
- During the quarterly rebalancings, in March, June and September, if the company ranks 60 or higher in terms of indicated annual dividend yield, where a "high" rank – 60, 61, 62, etc. – means a lower yield. (A rank of 1 represents the company with the highest yield)
- Between rebalancings, if the stock is removed from the S&P Composite 1500.

Index Construction

Index Calculations

The index is calculated by means of the divisor method used for all Standard & Poor's equity indices. The initial divisor is set to have a base index value of 1000 on December 7, 1999. The index value is simply the index market value divided by the index divisor:

$$\text{Index Value} = \frac{\text{Index Market Value}}{\text{Index Divisor}} \quad (1)$$

$$\text{Index Market Value} = \sum_{i=1}^N (\text{Index Shares})_i \times (\text{Price})_i \quad (2)$$

$$\text{Index Share}_i = \text{IWF}_i \times 1,000,000 \quad (3)$$

At each quarterly rebalancing, investable weight factors (IWFs) are set so that each constituent has a weight proportional to the indicated yield on the reference date. IWFs for all constituents are calculated using Equation 4, below.

$$(\text{IWF})_{i, \text{ after rebalance}} = (\text{Yield})_{i, \text{ Reference Date}} / (\text{Price})_{i, \text{ Rebalance Date}} \quad (4)$$

"Index Shares" and "Index Market Value" are artificial constructs. Index Shares shown in the equations here are artificial constructs bearing no relation to a stock's actual shares outstanding. These might include fractions, and might be less than 1. Therefore, the Index Market Value is also an artificial construct bearing no relation to the market capitalization of the stocks in the index.

At each rebalancing, constituents will be assigned Index Shares as given in Equation 3. In order to maintain index series continuity, it is also necessary to adjust the divisor.

$$(\text{Index Value})_{\text{ before rebalance}} = (\text{Index Value})_{\text{ after rebalance}} \quad (5)$$

Therefore,

$$(\text{Divisor})_{\text{ after rebalance}} = \frac{(\text{Index Market Value})_{\text{ after rebalance}}}{(\text{Index Value})_{\text{ before rebalance}}} \quad (6)$$

Index Maintenance

Major Rebalancing

The index undergoes a major rebalancing once a year in December, coinciding with annual review of Dividend Aristocrats qualifying universe. The following steps are taken during the December rebalancing:

1. All companies in the qualifying universe are ranked in decreasing order of indicated annual dividend yield.
2. Companies that have a market capitalization of less than US\$ 500 million are excluded.
3. Companies that have a 12-month average trading volume of fewer than 1,500,000 shares are excluded.
4. Out of the remaining companies the top 50, in terms of indicated yield, are selected as index members.
5. Index members are weighted according to their indicated yield as shown in Equation 4.

Minor Rebalancing

The index undergoes minor rebalancings in March, June and September. The following steps are taken for the minor rebalancings:

1. All companies in the universe are ranked in decreasing order of indicated annual dividend yield.
2. Index constituents that rank lower than 60, in terms of indicated yield, retain their membership. Index members that rank 60 or higher are dropped from the index. (A rank of 1 indicates the highest yield.) This 9 stock buffer is used to limit turnover.
3. If the remaining index members do not add up to 50, stocks from the qualifying universe are added in order of decreasing dividend yield until the number of constituents reaches 50. To be added, a stock must also have a minimum market capitalization of US\$ 500 million and have a 12-month average trading volume of more than 1,500,000 shares.
4. Index members are re-weighted according to their indicated yield.

The rebalancing effective date is after the close of the fifth trading date of the rebalancing month. The reference date for the indicated yield, market capitalization and average monthly volume is the close of the month prior to the rebalancing month. If there is a tie in yield ranks, the larger and more liquid stock is given higher preference.

Over the five years ending 2004, an average of 9 stocks have been replaced as index members per year. Most of the changes in membership occur during the major rebalancing, when Dividend Aristocrats membership is reviewed.

Concentration Limits

Limits are also placed in terms of stock concentration. At each rebalance:

1. No single stock will have a weight in the index of more than 4%. This prevents the index weight being concentrated in a few names.
2. No single stock will have its weight in the index greater than 5% times the stock's market cap in billions. This condition helps the index eliminate larger positions in smaller stocks.

If either of these criteria is violated, the indicated yield used to evaluate the stock's weight is reduced by a fourth.

Base Date

Daily returns are available from December 7, 1999. The base value for both the price return and total return series starting on that date is 1000. The index is calculated on a real time basis.

Index Adjustments

S&P Composite 1500 action	Adjustment made to Aristocrats	Divisor adjustment for Aristocrats
Constituent change	If the constituent being deleted is a member of the Aristocrats, it is removed from the Aristocrats index.	A divisor adjustment is made to ensure the index level after the deletion is equal to the index level before the deletion.
Share changes between quarterly share adjustments	None.	None.
Quarterly share changes	There is no direct adjustment. However, on the same date the index rebalancing will take place, with each stock's IWF assigned as per Equation 4.	The rebalancing causes an adjustment as calculated in Equation 6.

Index Adjustments (continued)

Corporate Action	Adjustment made to Aristocrats	Divisor adjustment for Aristocrats
Spin-Off	The price is adjusted to Price of Parent Company minus (Price of Spin-off company/Share Exchange Ratio). The IWF changes so that the weight of the company is the same as before the spin-off.	None.
Rights Offering	The price is adjusted thus: $([\text{Ratio Received} * \text{Rights Price}] + [\text{Ratio Held} * \text{Close Price}]) / [\text{Ratio Received} + \text{Ratio Held}] * \text{Close Price}$. The IWF changes so that the weight of the company is the same as before the rights offering.	None.
Stock Split	Index Shares are multiplied by and price is divided by the split factor.	None.
Share Issuance or Share Repurchase	None.	None.
Special Dividends	The price of the stock making the special dividend payment is reduced by the per-share special dividend amount after the close of trading on the day before ex-date.	A divisor adjustment is made to ensure the index level after the price adjustment is equal to the index level before the price adjustment.

Index Data

Total Return Index

The index has a total return counterpart, which assumes dividends are reinvested in the index after the close on the ex-date. On any given date t :

$$\text{Total Return Multiplier}_t = \frac{[\text{Index Value}_t + \text{Index Dividend Points}_t]}{\text{Index Value}_{t-1}} \quad (7)$$

$$\text{Total Return Index Value}_t = (\text{Total Return Index Value}_{t-1}) \times (\text{Total Return Multiplier}_t) \quad (8)$$

$$\text{Index Dividend Points}_t = \sum_{i=1}^N (\text{Index Shares})_{i,t} \times (Ex - dividends)_{i,t} / \text{Divisor}_t \quad (9)$$

Index Governance

Index Committee

The U.S. Index Committee maintains Standard & Poor's U.S. indices. The members of the committee are full-time professional members of Standard & Poor's staff. The Index Committee meets monthly. At each meeting, the Index Committee reviews pending corporate actions that may affect index constituents, statistics comparing the composition of the indices to the market, companies that are being considered as candidates for addition to an index, and any significant market events. In addition, the Index Committee may revise index policy covering rules for selecting companies, treatment of dividends, share counts or other matters.

Standard & Poor's considers information about changes to its U.S. indices and related matters to be potentially market moving and material. Therefore, all Index Committee discussions are confidential.

Index Policy

Announcements

Announcements of the rebalancings for the S&P High Yield Dividend Aristocrats Index are made at 5:15 p.m. U.S. Eastern Time. There are no separate corporate action announcements other than rebalancing announcements. For regular corporate action activity on S&P Composite 1500 constituents, please refer to S&P Composite 1500 announcements.

Holiday Schedule

The S&P High Yield Dividend Aristocrats Index is calculated when the U.S. equity markets are open.

A complete holiday schedule for the year is available on Standard & Poor's Web site at www.indices.standardandpoors.com.

Unscheduled Market Closures

In situations where an exchange is forced to close early due to unforeseen events, such as computer or electric power failures, weather conditions or other events, Standard & Poor's will calculate the closing price of the indices based on (1) the closing prices published by the exchange, or (2) if no closing price is available, the last regular trade reported for each stock before the exchange closed. In all cases, the prices will be from the primary exchange for each stock in the index. If an exchange fails to open due to unforeseen circumstances, the index will use the prior day's closing prices. If all exchanges fail to open, Standard & Poor's may determine not to publish the index for that day.

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