

STANDARD
& POOR'S

S&P 500 130/30 STRATEGY INDEX

INDEX METHODOLOGY

July 2008

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Introduction

Active extension strategies relax the long-only constraint for active positions, allowing the fuller expression of active weights. The S&P 500 130/30 Strategy Index is designed to measure the performance of an investment strategy that establishes over- and under-weight positions relative to the S&P 500, its parent index. Constituents of the over-weight basket each have their weight increased by 1% relative to the S&P 500, while stocks in the under-weight basket each have their weights decreased by 1% relative to the S&P 500. For stocks with less than 1% weight in the parent index, under-weight positions, therefore, result in short positions. The Index provides exposure to a set of fundamental factors emphasizing Standard & Poor's STock Appreciation Ranking System (STARS) recommendations. Over- and under-weight positions are referred to as the Long and Short Baskets, respectively. As of each reference date, there are 30 constituents in each Basket.

Highlights

STARS recommendations are derived by analysts in the S&P Global Equity Research Group. They employ a scale of 1 to 5, with 1 equating to “strong sell” and 5 to “strong buy”. STARS is utilized in the Index construction process to establish the universes from which Long and Short Baskets are generated each quarter. Long Basket constituents must be ranked 4 or 5 STARS, while Short Basket constituents must be ranked 1, 2, or 3 STARS.

STARS is a highly regarded, independent method of providing bottom-up fundamental investment recommendations, with a top-down overlay. U.S. STARS recommendations have a robust, verifiable track record dating back to January 1987. Over that time period, 4 and 5 STARS have outperformed the S&P 500, while 1 and 2 STARS have underperformed.

To finalize Basket constituents, S&P identified two quantitative fundamental variables that serve as a basis for ranking stocks within the STARS-segmented universes. These variables are Industry Relative External Financing (IREF) and Industry Relative Valuation (IRV).

Using the S&P 500 weights as the benchmark as of each reference date, each member of the Long Basket has its weight increased by 1%, while each member of the Short Basket has its weight decreased by 1%. Because the initial benchmark weights of all 30 constituents are positive, the maximum aggregate short position for the Index at each reconstitution is always less than 30%.

Index weights are reconstituted once every quarter, with the third Friday of February, May, August, and November being the data reference dates. The rebalancing date is after the close of the 5th trading day following each reference date.

Eligibility Criteria

Index Eligibility

As of the reference date, all S&P 500 constituents are eligible to be included in the index.

Timing of Changes

Index membership and weighting are reviewed quarterly. The data reference date is after the close of trading on the third Friday of February, May, August, and November. The rebalancing date is after the close of the 5th trading day following each reference date.

Additions. No additions are made between rebalancings. At each rebalancing, stocks added to the S&P 500 during the previous quarter are added to the eligible constituents list for the index.

Deletions. Stocks removed from the S&P 500 are removed from the index simultaneously.

Index Construction

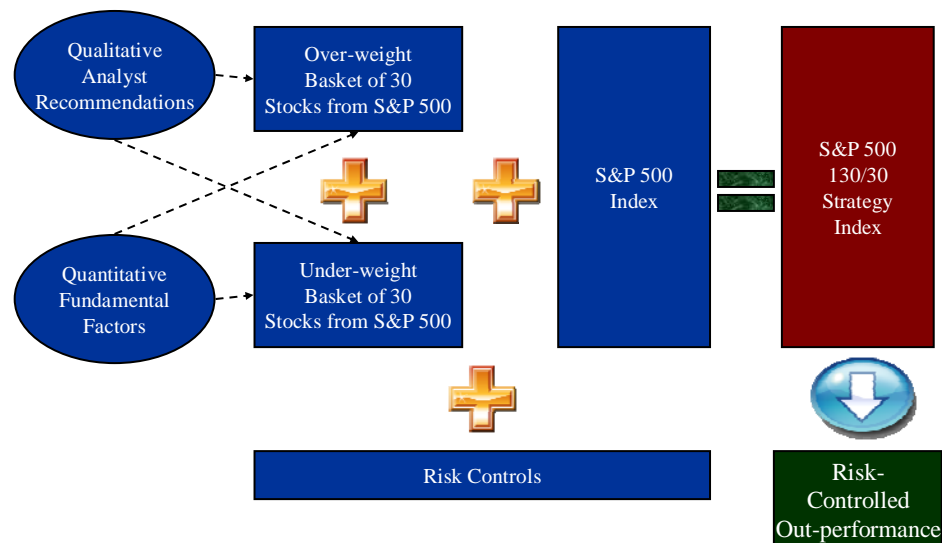
Framework

The S&P 500 130/30 Strategy Index is rebalanced quarterly and, at each rebalancing, is comprised of:

- A core 100% long position in the S&P 500 (the parent index),
- 1% under-weight positions in 30 S&P 500 constituents stocks (the Short Basket),
- 1% over-weight positions in 30 S&P 500 constituents stocks (the Long Basket).

For stocks with less than 1% weight in the parent index, an under-weight position results in a short index weight. The aggregate short position and corresponding leveraged long position are always less than 30% in absolute terms because all stocks begin with a positive parent index weight. In back-testing, the absolute level of leveraged longs/shorts has generally been in the 20 – 25% range. Exhibit 1 displays an overview of the Index construction process.

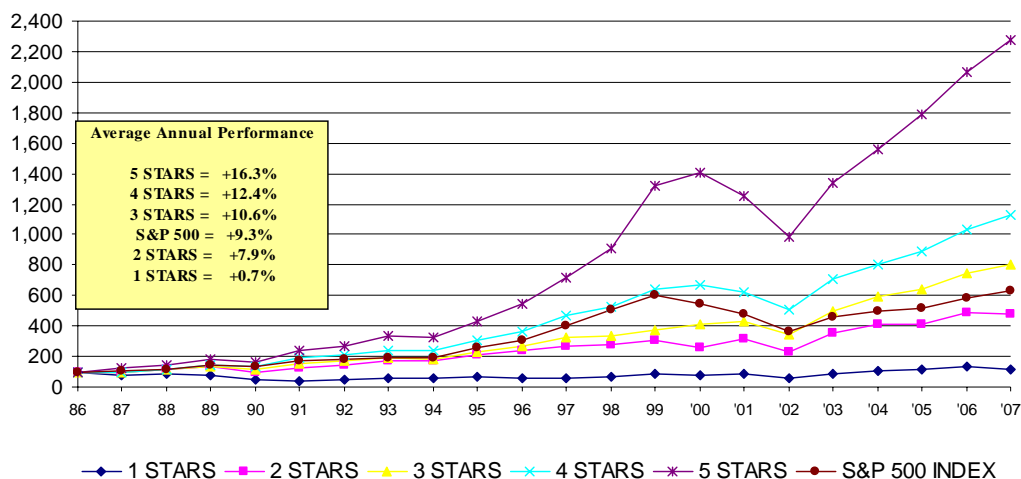
Exhibit 1 – S&P 500 130/30 Strategy Index Construction



Long and Short Universe Establishment

The S&P Global Equity Research Group is responsible for Standard & Poor's STARS rankings, a highly regarded, independent approach to providing bottom-up fundamental equity investment recommendations. S&P's core equity research philosophy is best described as growth at a reasonable price (GARP). The firm's approach to valuation is to combine intrinsic, relative (peer group), and sum-of-the-parts techniques. Inputs to these models cover a wide array of considerations including micro and macro-economic factors, top-down guidance from S&P investment professionals, industry trends, and competitive positioning. Analysts are charged with determining a target price and investment recommendation for each stock they cover. In making that determination they are granted discretion with respect to which fundamental and technical factors to weigh most significantly. Overall industry characteristics typically play an important role in developing a consistent approach for individual stocks within particular segments of the economy. Historical performance of U.S. STARS has been favorable, as shown in Exhibit 2.

Exhibit 2 – U.S. STARS Cumulative Performance, Dec 1986 – Sep 2007



Source: Standard & Poor's

STARS recommendations are made with reference to a hypothetical 6–12 month time horizon and are applied using the following scale:

- 5 Stars = Strong Buy
- 4 Stars = Buy
- 3 Stars = Hold
- 2 Stars = Sell
- 1 Star = Strong Sell

In the construction of the Index, S&P utilizes STARS to establish Long and Short Universes, from which Long and Short Baskets are, respectively, derived. At each reference date, those stocks with ranks of 4 or 5 constitute the Long Universe and those with ranks of 3, 2 or 1 constitute the Short Universe.

Basket Construction

To finalize over- and under-weight exposure, S&P applies two quantitative fundamental variables to the Long Universe and Short Universe, respectively. The first is Industry Relative External Financing (IREF) and the second is Industry Relative Valuation (IRV). This process is explained in detail below.

To quantitatively rank each stock in the Long Universe, Standard & Poor's does the following:

- Calculate and take the difference between the current and one-year prior levels of external funding, defined as:
 - $[\text{Debt in Current Liabilities}] + [\text{Long-Term Debt}] + [\text{Common Equity}] + [\text{Preferred Stock}] - [\text{Cash and Short-Term Equivalents}]$
 - Deflate by the average total assets,
 - Cross-sectionally standardize this measure by industry, replacing missing values with 0.
 - Multiply by -1 to arrive at the Long Basket *Industry Relative External Funding* ($IREF_L$).
- Calculate the current price-to-sales ratio, defined as:
 - $\text{Closing Price} / \{ [4\text{-Quarter Sum of Net Sales}] / [\text{Common Shares Outstanding}] \}$
 - Cross-sectionally standardize this measure by industry, replacing missing values with 0.
 - Multiply by -1 to arrive at the Long Basket *Industry Relative Valuation* (IRV_L).
- Sum $IREF_L$ and IRV_L to arrive at the Long Score.
- Rank each stock in the Long Universe by its Long Score.
- Take the top 30 as the Long Basket.

Similarly, for each stock in the Short Universe, Standard & Poor's does the following:

- Calculate and take the difference between the current and one-year prior levels of external funding, defined as:
 - $[\text{Debt in Current Liabilities}] + [\text{Long-Term Debt}] + [\text{Common Equity}] + [\text{Preferred Stock}] - [\text{Cash and Short-Term Equivalents}]$
 - Deflate by the average total assets,
 - Cross-sectionally standardize this measure by industry, replacing missing values with 0 to arrive at the Short Basket *Industry Relative External Funding* ($IREF_S$).
- Calculate the current price-to-sales ratio, defined as:
 - $\text{Closing Price} / \{ [4\text{-Quarter Sum of Net Sales}] / [\text{Common Shares Outstanding}] \}$
 - Cross-sectionally standardize this measure by industry, replacing missing values with 0 to arrive at the Short Basket *Industry Relative Valuation* (IRV_S).
- Sum $IREF_S$ and IRV_S to arrive at the Short Score.
- Rank each stock in the Short Universe by its Short Score.
- Take the top 30 as the Short Basket.

Index Weights

The benchmark weights for the index are the weights of the S&P 500. If we denote W_i and B_i as the following:

W_i = Index weight

B_i = Benchmark weight as of the reference date

Then, the weight of each stock in the S&P 500 130/30 Strategy Index is arrived at in the following manner:

For stocks in the Long Basket:

$$W_i = B_i + 1\% \tag{1}$$

For stocks in the Short Basket:

$$W_i = B_i - 1\% \tag{2}$$

For stocks in neither basket:

$$W_i = B_i \tag{3}$$

Because the initial benchmark weights of all constituents are positive, the maximum short position for the index basket at each reconstitution is always less than 30%.

Index Calculations

The index is calculated by means of the divisor method used in Standard & Poor's equity indices. The initial divisor is set to have a base index value of 100 on November 21, 1996. The index value is simply the index market value divided by the index divisor:

$$\text{Index Value} = \text{Index Market Value} / \text{Index Divisor} \quad (4)$$

$$\text{Index Market Value} = \sum_{i=1}^N (\text{Index Shares})_i * (\text{Price})_i \quad (5)$$

$$\text{Index Share}_i = \text{IWF}_i * 1,000,000 \quad (6)$$

At each quarterly rebalancing, investable weight factors (IWFs) are set so that each constituent has a weight as implied in Equations 1, 2, and 3 on the reference date. IWFs for all constituents are calculated using Equation 7, below.

$$(\text{IWF})_{i, \text{ after rebalancing}} = W_{i, \text{ reference date}} / (\text{Price})_{i, \text{ rebalancing date}} \quad (7)$$

"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.

In order to maintain index series continuity, it is also necessary to adjust the divisor.

$$(\text{Index Value})_{\text{ before rebalancing}} = (\text{Index Value})_{\text{ after rebalancing}} \quad (8)$$

Therefore,

$$(\text{Divisor})_{\text{ after rebalancing}} = \frac{(\text{Index Market Value})_{\text{ after rebalancing}}}{(\text{Index Value})_{\text{ before rebalancing}}} \quad (9)$$

Index Maintenance

Rebalancing

The index undergoes rebalancing once a quarter. Index constituents and weights are reconstituted, with the third Friday of February, May, August, and November being the data reference dates. The rebalancing date is after the close of the 5th trading day following each reference date. At each rebalancing:

1. The benchmark weights are derived from S&P 500 constituents as of the reference date.
2. The Long and Short Baskets are established.
3. Index members are allocated weights based on Equations 1, 2 and 3.

Base Date

Daily returns are available from November 21, 1996. The base value for both the price return and total return series starting on that date is 100. The index is calculated on a real time basis.

Benchmark Index Adjustments

S&P 500 Adjustments	Adjustment made to strategy index	Divisor adjustment for strategy index
Constituent change	The constituent being deleted from the S&P 500 is dropped. No additions are made intra-quarter.	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	None	None

Corporate Action Adjustments

Corporate Action	Adjustment made to strategy index	Divisor adjustment for strategy index
Spin-Off	The price is adjusted to the Price of the Parent Company minus (the Price of the Spin-off Company/Share Exchange Ratio).	None
Rights Offering	The price is adjusted to the Price of the Parent Company minus (the Price of the Rights Subscription/Rights Ratio).	None
Stock Split	Index Shares are multiplied by and the 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 :

$$\text{Total Return Multiplier}_t = \frac{[\text{Index Value}_t + \text{Index Dividend Points}_t]}{\text{Index Value}_{t-1}} \quad (10)$$

$$\text{Total Return Index Value}_t = (\text{Total Return Index Value}_{t-1}) * (\text{Total Return Multiplier}_t) \quad (11)$$

$$\text{Index Dividend Points}_t = \sum_{i=1}^N (\text{Index Shares})_{i,t} * (\text{Ex - dividends})_{i,t} / \text{Divisor}_t \quad (12)$$

Index Governance

Index Committee

The U.S. Index Committee maintains Standard & Poor's U.S. indices. The members of the Index 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

Rebalancing announcements for the S&P 500 130/30 Strategy Index are made at 05:15 PM Eastern Time. There are no separate corporate action announcements other than rebalancing announcements. For regular corporate action activity on the S&P 500 constituents, please refer to S&P 500 announcements.

Holiday Schedule

The S&P 500 130/30 Strategy 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.

Index Dissemination

Market-sensitive announcements, including the additions or deletions of stocks in indices, are normally made when markets are closed. In general, announcements for markets in the U.S. are made at 05:15 PM Eastern Time.

Tickers

Daily index values can be viewed on Bloomberg and Reuters. The tickers are as below:

	Bloomberg	Reuters
S&P 500 130/30 Strategy Index	SPSLUSD	.SPSLUSD
S&P 500 130/30 Strategy Index - Net Return	SPSLUSDN	.SPSLUSDN
S&P 500 130/30 Strategy Index - Total Return	SPSLUSDT	.SPSLUSDT

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