

STANDARD
& POOR'S

S&P CURRENCY ARBITRAGE INDEX

INDEX METHODOLOGY

February 2008

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Introduction

The S&P Currency Arbitrage Index seeks to model a carry trade strategy. The index consists of positions in the G10 currencies based on their relative interest rates versus the U.S. Dollar. The currencies included are the Australian Dollar, British Pound, Canadian Dollar, Euro, Japanese Yen, New Zealand Dollar, Norwegian Krone, Swedish Krona and the Swiss Franc. The U.S. Dollar is excluded.

Highlights

Carry trade strategies are designed to take advantage of the forward rate bias in the currency markets. Since high yielding currencies tend not to depreciate to the extent that would offset interest rate differentials with low yielding currencies, it has been a profitable strategy to invest long in high yielding currencies and short in low yielding currencies.

The S&P Currency Arbitrage Index consists of positions in nine of the G10 currencies, excluding the U.S. Dollar. The index takes a long position in currencies that have a higher interest rate than the U.S. Dollar and a short position in currencies that have a lower interest rate than the U.S. Dollar.

The weight of each currency is directly proportional to its interest rate spread and inversely proportional to its volatility. This increases weights of currencies with higher spreads and lower volatility.

The index employs an Index Volatility Modifier, which serves to keep the volatility of the index similar to that of the S&P 500.

The index is rebalanced monthly, generally after the close two trading days prior to the last trading day of each month in the U.S. markets, based on 3-month interest rates as published by Reuters.

The index is calculated on a daily basis.

S&P would like to thank Morgan Stanley for its significant contribution to the development of the S&P Currency Arbitrage Index.

Index Family

The Index belongs to the S&P Arbitrage Index Family. Other indices in the family are the S&P Long-Only Merger Arbitrage Index and the S&P 500 Volatility Arbitrage Index.

Eligibility Criteria

Index Eligibility

At any given time, the index consists of positions in each of nine of the ten G10 currencies. The U.S. Dollar is excluded. The currencies included are the Australian Dollar, British Pound, Canadian Dollar, Euro, Japanese Yen New Zealand Dollar, Norwegian Krone, Swedish Krona, and the Swiss Franc.

Index Construction

Approaches

The methodology assumes that one-month currency forward contracts are entered into after the close of trading on each rebalancing date. The index is generally rebalanced after the close two trading days prior to the last trading day of each month. The data reference day for the rebalancing is generally after the market close three trading days prior to the last trading day of the month. Spot and forward exchange rates used for all currencies are in relation to the U.S. Dollar.

Constituent Weightings

$$W_i = K * RateDifferential_i / Vol_i \quad (1)$$

where:

W_i	Weight of currency i
$RateDifferential_i$	The difference in the 3-month interest rate of currency i and the U.S. Dollar.
K	The Index Volatility Modifier, defined as the ratio of the standard deviation of the prior 60 monthly returns of the S&P 500 and the S&P Currency Arbitrage index. This ratio serves to keep the volatility of the strategy index similar to the volatility of the S&P 500.
Vol_i	The standard deviation of the last 20 daily returns of currency i , where currency i is defined as the currency's spot rate against the U.S. Dollar.

The source data for exchange rates used in equation (1) is WM/Reuters via the Reuters pages WMRA. WM/Reuters foreign exchange rates are taken daily at 4:00 PM Greenwich Mean Time (GMT) and are calculated by the WM company based on Reuters data.

The source data for interest rates used in equation (1) is Reuters. The following RICS are used for each country as representative of the corresponding 3-month interest rate:

Currency	RIC	Description
Australian Dollar	AU3MBB=RR	Australian Bank Bill 3-Month Mid Rate
British Pound	GBPLIBOR3M=	3-Month British Pound London Interbank Offered Rate
Canadian Dollar	CA3MBAFIX=	Canada Banker's Acceptance 3-Month Rate
Euro	EURLIBOR3M=	3-Month Euro London Interbank Offered Rate
Japanese Yen	JPYLIBOR3M=	3-Month Yen London Interbank Offered Rate
New Zealand Dollar	NZD3MFSR=	New Zealand 3-Month Bank Bill
Norwegian Krone	OINOK3MD=	3-Month Norway Interbank Offered Rate
Swedish Krona	SEK3MFSR=	3-Month Stockholm Interbank Offered Rate
Swiss Franc	CHFLIBOR3M=	3-Month Swiss Franc London Interbank Offered Rate
U.S. Dollar	USDLIBOR3M=	3-Month U.S. Dollar London Interbank Offered Rate

Index Calculations

The index is rebalanced on the last trading day of each month. On any date, t , the index is calculated as a weighted average of month-to-date constituent returns:

$$Index\ Value_t = IndexValue_{rb} * (1 + \sum_{i=1}^9 (W_i) * (Return_{i,t}))$$

(2)

where:

$IndexValue_{rb}$ Index value as of the last rebalancing.

W_i Weight of currency i in the index as of the last rebalancing.

$Return_{i,t}$ Return of currency i from the prior rebalancing to t .

$Return_{i,t}$ is calculated as follows:

$$Return_{i,t} = \left(\frac{\text{Interpolated 1M Forward Rate}_{i,t}}{\text{1M Forward Rate}_{i,rb}} - 1 \right) / DF_t \quad (3)$$

where:

$$DF_t = (1 + Days\ left / 360 * LIBOR_t)$$

$LIBOR_t$ The one-month USD LIBOR rate as of date t .

$1M\ Forward\ Rate_{i,rb}$ The one-month forward rate of currency i as of the last rebalancing.

$Interpolated\ 1M\ Forward\ Rate_{i,t}$

The value, as of the close of date t , of a one-month forward contract of currency i entered into at the close of the prior rebalancing. It is calculated in the following manner:

$$Interpolated\ 1M\ Forward\ Rate_{i,t} = Spot\ Rate_{i,t} + (1M\ Forward\ Rate_{i,t} - Spot\ Rate_{i,t}) * (Days\ left) / (Days\ in\ month)$$

(4)

where:

$Spot\ Rate_{i,t}$ Spot rate of currency i on date t

<i>1M Forward Rate_{i,t}</i>	One-month forward rate of currency <i>i</i> on date <i>t</i>
<i>Days left</i>	Calendar days between date <i>t</i> and the date of the next rebalancing.
<i>Days in month</i>	Calendar days between the previous rebalancing and the next rebalancing.

The source data for forward and spot rates used in (3) and (4) is WM/Reuters via the Reuters pages WMRA. WM/Reuters foreign exchange rates are taken daily at 4:00 PM Greenwich Mean Time (GMT) and are calculated by the WM company based on Reuters data. The history prior to February 2008 rebalancing does not reflect the minor changes caused by present value discounting implied by the denominator in equation 3.

Index Maintenance

Rebalancing

Frequency. Index rebalancings generally occur after the closing two trading days prior to last trading date of each month. The data reference date is generally the close three trading days prior to the last trading date of each month. For the historical calculation of the index through January 2008 the rebalancing date was assumed to be the last trading day of each month and the reference date was assumed to be two days prior to the last trading date of the month.

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

Base Date

The index base date is December 31st, 1997. The base value of the index is 100. Daily returns are available from December 31st, 1997.

Index Governance

Index Committee

The S&P Arbitrage Index Committee maintains the S&P Currency Arbitrage Index. The Index Committee meets regularly. At each meeting, the Index Committee reviews any significant market events. In addition, the Index Committee may revise index policy covering rules for including currencies, timing of rebalancing or other matters.

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

Index Policy

Announcements

Rebalancing announcements are made one day prior to the rebalancing date.

Holiday Schedule

The index is calculated daily, throughout the calendar year. The only days the index is not calculated are on days when WM Reuters' exchange rates services are not published.

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

Index Dissemination

Complete data for index replication are available through Standard & Poor's index data group for subscription via FTP.

Tickers

	Bloomberg	Reuters
S&P Currency Arbitrage Index	SPARBC	.SPARBC

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