STANDARD & POOR'S

S&P FORWARD INTEREST RATE ARBITRAGE INDICES

INDEX METHODOLOGY

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Introduction

The S&P Forward Interest Rate Arbitrage Indices are designed to model the outcome of a forward interest rate arbitrage strategy that seeks to profit from the commonly observed tendency for forward interest rates to be overstated by the spot yield curve.

The indices seek to model the outcome of holding a long position in three-month interest rate futures contracts with one year remaining to maturity. In most interest rate markets, long-term interest rates tend to be higher than short term-interest rates (a “normal” yield curve). Since a long-term rate can be replicated by holding and rolling over a series of short-term rates, this implies that forward short term rates are generally priced at higher yields than equivalent spot short term rates. As short-term rates have an equal chance of increasing or decreasing over time, future short term rates are, on average, overpriced in the market. Thus, it may be profitable to invest in forward starting short term deposits and unwind as the deposit comes closer to maturity.

Highlights

The S&P Forward Interest Rate Arbitrage Indices measure the return from a long position in the three-month interest rate futures contract maturing 12 months after the end of the current quarterly cycle.

The indices roll on a quarterly basis in March, June, September and December, based on the settlement schedule of three-month interest rate futures contracts.

A total return version of each index is calculated, which includes interest accrual on the notional value of the index based on the three-month interbank bid rate and reinvestment into the index.

Index Family

The S&P Forward Interest Rate Arbitrage indices consist of indices representing each of the G10 currencies for which a liquid futures contract exists on an applicable three-month interest rate. The S&P Forward Interest Rate Arbitrage indices currently include the S&P Australian Dollar Forward Arbitrage Index, the S&P British Pound Forward Arbitrage Index, the S&P Canadian Dollar Forward Arbitrage Index, the S&P Euro Forward Arbitrage Index, the S&P Japanese Yen Forward Arbitrage Index, the S&P Swiss Franc Forward Arbitrage Index and the S&P U.S. Dollar Forward Arbitrage Index.

The S&P Forward Interest Rate Arbitrage indices are part of the S&P Arbitrage Index Family. This family also includes the S&P 500 Volatility Arbitrage, the S&P Currency Arbitrage, and the S&P Long Only Merger Arbitrage Indices.

Index Construction

Approaches

Interest rate futures contracts are futures contracts with an interest bearing instrument as the underlying asset. Interest rate futures allow for the hedging of interest rate risks as well as for speculation based on a perceived level of future interest rates. A particular futures contract represents the expected level of the underlying interest rate at the maturity of the futures contract in question. For example, a 12*15 interest rate futures contact (the fifth quarterly contract) represents the three-month interest rate in twelve months' time. The S&P Forward Interest Rate Arbitrage Indices model the return from a long futures position in the 12* 15 interest rate futures contract that is rolled on a quarterly basis at the expiration of the current near-term futures contract. The total return version of the index incorporates interest accrual on the notional value of the index. Interest accrues based on the local three-month interbank bid rate.

Each index is calculated after the official closing price of each of the relevant futures contracts is available. Thus, indices within the index family may be calculated at different times. Trading hours for each of the contracts are specified below.

Calculation of the Forward Interest Rate Arbitrage Index Excess Return (ER)

On any business day, *t*, the index ER is calculated as follows:

$$IndexER_t = IndexER_{t-1} * (1 + CDR_t) \quad (1)$$

where:

$IndexER_{t-1}$ = The Excess Return Index level on the preceding business day, defined as any date on which the index is calculated.

CDR_t = Contract Daily Return, as determined by the following formula:

$$CDR_t = \frac{DCRP_t}{DCRP_{t-1}} - 1 \quad (2)$$

where:

t-1 = the preceding business day.

$DCRP_t$ = Daily Contract Reference Price of the 12*15 futures contract. The official close, as designated by the relevant exchange, is used.

The following contracts are used for each of the indices:

Index	Contract Reference Level	Trading Venue	Trading Hours
S&P Australian Dollar Forward Interest Rate Arbitrage Index	Australian Bank Bill 3 Month Rate	Sydney Futures Exchange	08:28 – 16:30 Sydney time
S&P British Pound Forward Interest Rate Arbitrage Index	3 Month Sterling Rate	London International Financial Futures and Options Exchange	7:30 – 18:00 London time
S&P Canadian Dollar Forward Interest Rate Arbitrage Index	3 Month Canadian Dollar Bank Acceptance Rate	Montreal Exchange	06:00 – 16:00 Montreal time
S&P Euro Forward Interest Rate Arbitrage Index	3 Month Euribor Rate	London International Financial Futures and Options Exchange	01:10 – 21:00 London time
S&P Japanese Yen Forward Interest Rate Arbitrage Index	3 Month Euroyen Rate	Tokyo Financial Exchange	08:45 – 20:00 Tokyo time
S&P Swiss Franc Forward Interest Rate Arbitrage Index	3 Month Euroswiss Rate	London International Financial Futures and Options Exchange	7:30 – 18:00 London time
S&P U.S. Dollar Forward Interest Rate Arbitrage Index	3 Month Eurodollar Rate	Chicago Mercantile Exchange	17:00 – 16:00 Chicago time

Contract Rebalancing

The index rolls on a quarterly basis each March, June, September and December, in conjunction with the settlement schedule of the underlying contracts. On each contract roll date the old 12*15 contract is sold and the new 12*15 contract is purchased. For example, at the March roll the March contract of the following year is sold and the June contract of the following year is purchased.

Calculation of the Forward Interest Rate Arbitrage Index Total Return (TR)

A total return version of each of the indices is calculated, which includes interest accrual on the notional value of the index based on the local three-month interbank bid rate, as follows:

$$IndexTR_t = IndexTR_{t-1} * \left(1 + CDR_t + IR_t\right) \qquad (3)$$

where:

$IndexTR_{t-1}$ = The Total Return Index level on the preceding business day.

CDR_t = Contract Daily Return as defined in equation (2).

IR_t = Interest return, as determined by the following formula:

$$IR_t = R_{t-1} * \left(\frac{days}{daycount} \right) \quad (4)$$

days = the number of calendar days since the immediately preceding business day.

daycount = the day count convention of the interest rate in question, generally 360 or 365.

R_{t-1} = the local interbank bid rate as on the immediately preceding business day.

The following interest rates are used for each of the indices:

Index	Interest Rate	Day Count Convention
S&P Australian Dollar Forward Bias Index	90 Day Australian Bank Bill Rate (Bloomberg Ticker BBSW3M)	Actual/365
S&P British Pound Forward Bias Index	3 Month GBP London Interbank Bid Rate (Bloomberg ticker LBID03M)	Actual/365
S&P Canadian Dollar Forward Bias Index	3 Month Canadian Banker's Acceptance Rate (Bloomberg ticker CDOR03)	Actual/365
S&P Euro Forward Bias Index	3 Month EUR London Interbank Bid Rate (Bloomberg ticker LIEBB03M)	Actual/360
S&P Japanese Yen Forward Bias Index	3 Month Tokyo Interbank Domestic Yen Offered Rate (Bloomberg Ticker TI0003M)	Actual/365
S&P Swiss Franc Forward Bias Index	3 Month CHF London Interbank Bid Rate (Bloomberg ticker LISF03M)	Actual/360
S&P U.S. Dollar Forward Bias Index	3 Month USD London Interbank Bid Rate (Bloomberg ticker LIBMB03M)	Actual/360

Base Date

The base dates of the S&P Forward Interest Rate Bias indices are as follows:

Index	Base Date	Base Value
S&P Australian Dollar Forward Bias Index	1/2/1990	100
S&P British Pound Forward Bias Index	1/2/1990	100
S&P Canadian Dollar Forward Bias Index	12/16/1991	100
S&P Euro Forward Bias Index	1/4/1999	100
S&P Japanese Yen Forward Bias Index	11/17/1995	100
S&P Swiss Franc Forward Bias Index	6/18/1996	100
S&P U.S. Dollar Forward Bias Index	1/2/1990	100

Index Governance

Index Committee

The S&P Fixed Income Index Committee maintains the S&P Forward Interest Rate Arbitrage Indices. The Index Committee meets on an as-needed basis. At each meeting, the Index Committee reviews any significant market events. In addition, the Index Committee may revise index policy for timing of rebalancings 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

Announcements of the daily index values are made after the market close each day.

Holiday Schedule

Each index is calculated daily when the relevant exchange (Chicago Mercantile Exchange, London International Financial Futures and Options Exchange, Montreal Exchange, Sydney Futures Exchange, and Tokyo Financial Exchange) is open, excluding holidays and weekends.

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 value of the index based on the most recent prior closing futures price published by the exchange, and the roll for that day will be carried to the next business day as described in the Contract Rebalancing section. If the exchange fails to open due to unforeseen circumstances, Standard & Poor's may determine not to publish the index for that day.

Delisting of Futures Contracts

If one or more futures contracts included in one of the indices are no longer listed, Standard & Poor's may choose to cease publication of the effected index at that time.

Index Dissemination

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

Tickers

	Bloomberg	Reuters
Excess Return Indices		
S&P Australian Dollar Forward Interest Rate Arbitrage	SPARAUDP	.SPARAUDP
S&P British Pound Forward Interest Rate Arbitrage	SPARGBPP	.SPARGBPP
S&P Canadian Dollar Forward Interest Rate Arbitrage	SPARCADP	.SPARCADP
S&P Euro Forward Interest Rate Arbitrage	SPAREURP	.SPAREURP
S&P Japanese Yen Forward Interest Rate Arbitrage	SPARJPYP	.SPARJPYP
S&P Swiss Franc Forward Interest Rate Arbitrage	SPARCHFP	.SPARCHFP
S&P U.S. Dollar Forward Interest Rate Arbitrage Index	SPARUSDP	.SPARUSDP
Total Return Indices		
S&P Australian Dollar Forward Interest Rate Arbitrage	SPARAUD	.SPARAUD
S&P British Pound Forward Interest Rate Arbitrage	SPARGBP	.SPARGBP
S&P Canadian Dollar Forward Interest Rate Arbitrage	SPARCAD	.SPARCAD
S&P Euro Forward Interest Rate Arbitrage	SPAREUR	.SPAREUR
S&P Japanese Yen Forward Interest Rate Arbitrage	SPARJPY	.SPARJPY
S&P Swiss Franc Forward Interest Rate Arbitrage	SPARCHF	.SPARCHF
S&P U.S. Dollar Forward Interest Rate Arbitrage	SPARUSD	.SPARUSD

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