RAFI® Fundamental US Style Index Rules Book

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Introduction

The Fundamental Index methodology is a patented, innovative indexing approach developed by Research Affiliates, LLC (RA). The methodology weights companies based on their economic footprint as measured by accounting variables rather than their market footprint as measured by market capitalization. This approach delinks a security's weight from its price while preserving the broad market representation, high capacity, and low turnover characteristics that investors expect from a passive investment strategy.

The core Research Affiliates Fundamental Index® (RAFI®) methodology is designed to be rules-based, objective, transparent, and replicable. The RAFI® Fundamental US Style Index Series partitions the largest 2,500 U.S. companies as measured by fundamental weight solely to one of three size tiers and one of three styles. The top 70% of cumulative fundamental weight comprises the large tier, the next 20% of fundamental weight comprises the middle tier, and the final 10% comprises the small tier. Within each of the size tiers, companies are sorted by style then assigned solely to one of three styles: growth, core, and value. Style is determined for each company by a combination of fundamental growth rates and fundamental valuation ratios.

Construction Methodology

Eligible Securities

The RA U.S. Equity Universe consists of all common equity securities traded on primary exchanges issued by companies assigned to the United States by RA as of the date of annual reconstitution. The rules for country assignment are based on country of primary listing, domicile, and incorporation.

Fundamental Weights

For the RAFI Fundamental US Style Index Series, four accounting variables are used to compute fundamental factor scores for all eligible companies. Factor values for sales, cash flow, and dividends are computed as the average of the most recently available five annual reporting periods. If less than five years of annual accounting data are available for a company, then the most recently available annual periods are used with a minimum of one year of data. The book value factor is defined as the value from the most recently available annual reporting period.

A factor score is computed as the value of the factor for each company divided by the sum of the factor values for all companies in the universe. An aggregate fundamental score is computed for each company by equal weighting the factor scores for each of the four factors. If a company pays no dividends over the relevant five years, then the aggregate score is computed as the equal-weighted average of the other three factor scores. Aggregate fundamental scores are converted into index weights by dividing each company score by the sum of the scores of the companies in the Index.

Float Adjustment

The RAFI methodology calculates fundamental weights using financial measures of company size. The entire stock in any given company is not, however, always available to equity investors. Therefore, RA calculates a company free float factor. The company free float factor is defined as the ratio of the total market capitalization of the shares of the company in free float to the total market capitalization of the company. This measure of free float is equivalent to the aggregation of the security-level free float factors across all the security lines of the company's stock. The company-level free float factor is applied as an adjustment to the company's fundamental score.

Style Scores

For the RAFI Fundamental US Style Index Series, style scores are computed for all eligible companies. Style scores are computed for each company as the difference between a composite growth score and a composite value score.

Growth scores are based on companies' fundamental growth. For each company, factor growth rates are computed as the average of the past five annual percentage changes in each of the four fundamental factors. The universe is then sorted and each company is ranked by each of the four factor growth rates. The composite growth score is computed for each company as the average of its four factor growth rate percentile ranks.

Valuation scores are based on companies' fundamental valuation. For each company, factor valuation ratios are computed as the four fundamental factor values, as described above, with each factor value divided by current equity market value. The universe is then sorted and each company is ranked by each of the four factor valuation ratios. The composite value score is computed for each company as the average of its four fundamental valuation ratio percentile ranks.

If a company pays no dividends over the relevant five years, then its composite growth and value scores are computed as the average of the percentile ranks of the other three factors.

Size and Style Partitions

The RAFI Fundamental US Style Index Series partitions the largest 2,500 U.S. companies as measured by fundamental weight solely to one of three size tiers. The universe is sorted by descending fundamental score. The top 70% of cumulative fundamental weight comprises the large tier, the next 20% of fundamental weight comprises the middle tier, and the final 10% comprises the small tier. The composition of market capitalization weight is expected to approximately match this 70%, 20%, 10% composition of fundamental weight.

Companies with very large differences between fundamental and capitalization weights are excluded from the Index series. Companies with capitalization rank at or below the lower half of the middle tier are excluded from the large tier. Companies with capitalization rank at or below the lower half of the small tier and companies with capitalization rank at or above the upper half of the large tier are excluded from the middle tier. Companies with capitalization rank at or above the upper half of the middle tier are excluded from the small tier. Although the number of companies in each size tier will vary, the large tier is expected to average over time approximately 200 to 250 companies, the middle tier approximately 500 companies, and the small tier approximately 1,700 companies.

Within each of the size tiers, companies are then assigned solely to one of the three styles. Each size tier is sorted by descending style score. The top 20% of cumulative fundamental weight sorted by style score within each size tier comprises the growth style, the next 30% of fundamental weight comprises the core style, and the final 50% of fundamental weight comprises the value style. The composition of market capitalization weight across the three styles will vary but is expected to average over time approximately one-third each.

Liquidity and Capacity Screens

RA assumes a certain notional amount is invested in each index and computes an implied holding for each security. The fundamental weight of each security is reduced, if necessary, to limit the implied amount of average daily trading volume free float.

Maintenance

Corporate Actions

This section is to be read in conjunction with the current [Guide to the Dow Jones Global Total Stock Market Indexes] document. Where a conflict exists, this Rules Book controls the Guide document. In the event of a corporate action, an Index will be adjusted as follows:

Merger between two Components (stock consideration): The target company is deleted from the Index and the shares of the acquiring company are adjusted such that the weight of the acquiring company equals the sum of the two companies prior to the acquisition. The deleted company is not replaced.

Merger between two Components (cash and stock consideration): The target company is deleted from the Index and the shares of the acquiring company are adjusted such that the weight of the acquiring company equals the sum of the two companies prior to the acquisition less the amount of the cash consideration. The deleted company is not replaced.

Merger between two Components (cash consideration): The target company is deleted. The deleted company is not replaced.

Merger between Non-component and Component: The target company is deleted. The deleted company is not replaced.

Extraordinary Deletion (bankruptcy, delisting): The target company is deleted. The deleted company is not replaced.

Spin-off: The child is added and the weight of the parent company is adjusted such that the sum of the parent and child equals the weight of the parent prior to spin-off. The child is added with the weight of the parent company multiplied by the spin-off ratio such that the sum of the adjusted parent and child equals the weight of the parent prior to spin-off.

Rights Offering: Any rights received are sold on the ex-date of the rights transaction. The number of shares remains unchanged. The proceeds from selling the rights entitlement are re-invested in the Index resulting in a divisor adjustment.

Stock Split/Stock Dividend: The shares are adjusted based on a ratio of the stock split/stock dividend to maintain the same weight for the company in the Index.

Special Cash Dividend: The price is adjusted by the amount of the special cash dividend on the ex-date resulting in a divisor adjustment.

Regular Cash Dividend: Gross dividends will be applied to the companies in the Index.

Reconstitution

The Index is reconstituted after the close of trading on the third Friday of March, at which time new constituents are implemented and exiting constituents are rebalanced back to their fundamental weights.

Dissemination

Publication

As of May 1, 2011, the RAFI® Fundamental US Style Index Series is computed by Dow Jones Indexes, the marketing name and a licensed trademark of CME Group Index Services LLC ("CME Indexes"). CME Indexes can provide the following information to licensed parties:

- Closing values of the indexes on a price and total return basis;
- Updated closing divisor of the indexes;
- Closing values of the constituents and their weight in the respective index;
- Share factors with respect to the constituents; and
- Advance notice of upcoming corporate actions with respect to the constituents.

CME Indexes also can provide on an annual basis, five (5) business days' notice of Annual Reconstitution changes.

Tickers

The RAFI Fundamental US Style Index Series is available on Bloomberg.

Name	Tickers
RAFI® Fundamental Large Growth Index	RAFILG, RAFILGTR
RAFI® Fundamental Large Core Index	RAFILC, RAFILCTR
RAFI® Fundamental Large Value Index	RAFILV, RAFILVTR
RAFI® Fundamental Mid Growth Index	RAFIMG, RAFIMGTR
RAFI® Fundamental Mid Core Index	RAFIMC, RAFIMCTR
RAFI® Fundamental Mid Value Index	RAFIMV, RAFIMVTR
RAFI® Fundamental Small Growth Index	RAFISG, RAFISGTR
RAFI® Fundamental Small Core Index	RAFISC, RAFISCTR
RAFI® Fundamental Small Value Index	RAFISV, RAFISVTR

Contact Information

Licensing

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Methodology

For information with regard to Index methodology, please contact Chris Brightman, Head of Investment Management at Research Affiliates, LLC, at brightman@rallc.com or call U.S. +1 949.325.8746.

Production

For documentation of data sources, pricing, divisor calculations, computational precision, and data corrections, see the Guide to the Dow Jones Global Total Stock Market Indexes or email djindexsupport@djindexes.com or call U.S. +1 609.520.7249; Asia +86.10.8400.7774; Europe +49.69.29.725.180.

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Fundamental Index® concept, the non-capitalization method for creating and weighting of an index of securities, is patented and patent-pending proprietary intellectual property of Research Affiliates, LLC (US Patent Nos. 7,620,577; 7,747,502; and 7,792,719; Patent Pending Publ. Nos. US-2007-0055598-A1, US-2008-0288416-A1, US-2010-0191628, US-2010-0262563, WO 2005/076812, WO 2007/078399 A2, WO 2008/118372, EPN 1733352, and HK1099110).