ALWAYS A STEP ABOVE

COMMENTARY

April 07, 2011

The NASDAQ-100 Index includes 100 of the largest domestic and international non-financial securities listed on The Nasdaq Stock Market based on market capitalization. Although the index is market cap based, there are proprietary adjustment factors applied to individual securities which can result in securities' weightings becoming markedly different from their market cap. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology.

The Nasdaq-100 index will be rebalanced on May 2nd, to reduce the weight of Apple's stock by about 40%. Apple currently represents 20.5% of the index. On May 2nd, Apple weight will be reduced to 12.3%. The rebalancing will increase the weight of other tech stocks, including Microsoft and Google. Microsoft will make up 8.3% of the index, more than double its current share of 3.4%. Google's weight will rise to 5.8% from 4.2%.

In contrast RAFI Funds use firm fundamentals as Cash Flow, Total Sales, Book Equity Value and Gross Dividends to derive weights which are much more stable and not prone to volatility induced by market price moves. At the end of February 2011 Apple represented 1.11% in RAFI A and 1.19% in RAFI E. The weight of Apple (and other stocks) in RAFI has been very stable owing to the fundamental indexing methodology used to calculate weights and rebalance the portfolio.

As a result of this announcement Apple shares were sold and Microsoft and Google shares bought by the funds that need to match the weight of the NASDAQ 100 i.e. ETFs and Mutual funds that mimic the index. This activity is likely to be repeated over the next few weeks. While it is difficult to exactly ascertain the price impact this will have on the stock, the corresponding impact on cap weighted funds that hold the stock will decidedly be most pronounced. For a hypothetical 5% price impact as a result of the market activity, a cap weighted ETF would realize a 1% loss and RAFI funds would realize a 5 bps loss.

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Such market actions further represent the multidimensional approach to index construction used by RAFI, which represents improvements over traditional cap or price weighted indices.

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