

## RAFI™ Diversity & Governance Index Series

### Indices

RAFI Diversity & Governance Developed (RADGDEVT)

RAFI Diversity & Governance Europe (RADGEURT)

RAFI Diversity & Governance US (RADGUST)

### Objective

The RAFI Diversity & Governance Index Series combines the Fundamental Index™ methodology with measures of diversity, governance, financial discipline and low volatility to allocate to well-managed companies.

### Background

Diversity, financial discipline, strong governance, and low volatility create a proxy for quality to identify companies with sound management practices and a healthy company culture.

**Diversity** Companies with a strong commitment to diversity tend to make better decisions and are able to achieve a higher level of collective intelligence. Criteria related to gender diversity (percentage of women in management, the c-suite, and company boards, for example), are used to assess corporate intent and outcomes. Gender diversity data are provided by Vigeo Eiris with a methodology developed by Leaderxxchange.

**Governance** Strong corporate governance increases accountability and limits headline risk. Governance data are provided by Vigeo Eiris.

**Financial Discipline** Companies with strong financial discipline (defined as high profitability, low investment, low issuance/dilution, and low accounting accruals) have a strong alignment with long-term value creation and sustainable growth. In addition, strong financial discipline has historically led to better company performance.<sup>1</sup>

**Low Volatility** Downside risk is limited through the addition of low volatility. In addition, high volatility stocks have not provided commensurate returns relative to low volatility stocks historically.<sup>2</sup>

## RAFI™ Fundamental Index™ Methodology

The RAFI Fundamental Index methodology is built on the principles of contrarian investing and disciplined rebalancing. Security weights are determined by using fundamental measures of company size (adjusted sales, cash flow, dividends + buybacks, and book value) rather than price (market cap). By using a company's fundamental weight as the rebalancing anchor, the fundamental weighting approach rebalances out of securities whose prices have increased and into securities whose prices have fallen.

## RAFI Diversity & Governance Index Methodology

### 1. Segment Companies by Region and Size

- Start with five regional equity markets: US, UK, Japan, Europe ex UK, and Other Developed.
- Within each region determine eligible securities by selecting the top 86% by RAFI weight
- RAFI weight is the equally weighted average of the following four fundamental measures:

<i>Adjusted Sales</i>	<i>Cash Flow</i>
<i>Dividends + Buybacks</i>	<i>Book Value</i>

### 2. Security Selection

- Within each region, calculate the percentile rank of each security by their Diversity Score (D), Governance Score (G), Financial Discipline Score (FD),<sup>3</sup> and Low Volatility Score (LV).
- After ranking securities by individual scores, remove companies in the bottom 20% by RAFI weight for each D, G, FD, and LV score.

### 3. Apply Exclusions

- Exclude companies with major involvement in the following industries:
- |             |                |
|-------------|----------------|
| <i>Coal</i> | <i>Tobacco</i> |
|-------------|----------------|
- Exclude companies with zero women on company board.

### 4. Weighting

- Calculate company composite score:
 
$$\frac{1}{4} \times (D + G + LV + FD)$$
- Final index is RAFI weight tilted toward stocks with high composite scores.
 
$$\text{Tilted Weight} = \text{RAFI Weight} \times (1 + \text{Composite Score})$$

### 5. Rebalance

- Rebalance index on a quarterly staggered basis (i.e., rebalance a quarter of the index back to target rebalance weight every three months).

<sup>1</sup> Hsu, Kalesnik and Kose (2017).

<sup>2</sup> Hsu, Li (2013).

<sup>3</sup> The Financial Discipline score is calculated within each region and sector.

### Performance (through 3/31/19)

Index	QTD	1 Yr	3 Yr	3-Yr Volatility	3-Yr Sharpe Ratio	3-Yr Tracking Error	3-Yr Info Ratio
RAFI Diversity & Governance Developed	11.86%	14.55%	10.60%	9.32%	0.96	1.90%	-0.66
MSCI World	14.68%	14.58%	11.86%	10.17%	1.00	N/A	N/A
RAFI Diversity & Governance Europe	11.28%	7.86%	8.12%	9.60%	0.67	2.09%	0.18
MSCI Europe	13.00%	6.14%	7.74%	10.11%	0.60	N/A	N/A
RAFI Diversity & Governance US	13.40%	21.53%	12.60%	11.30%	0.97	2.79%	-0.53
Russell 1000	16.06%	19.72%	14.08%	11.85%	1.05	N/A	N/A

Note: All returns are gross total returns in EUR. All returns prior to inception are simulated. Please see disclosures for important information related to simulated data. The RAFI Diversity & Governance Index Series was launched on September 28, 2018. Source: RAFI Indices, LLC, based on data from FactSet.

### Characteristics (as of 3/31/19)

Index	# Securities	Price/Earnings	Price/Book	Price/Sales	Price/Cash Flow	Dividend Yield	Weighted Average Market Cap
RAFI Diversity & Governance Developed	363	16.00	1.96	1.05	8.53	3.29	101.98
RAFI Diversity & Governance Europe	124	16.40	1.76	0.95	6.94	3.96	56.74
RAFI Diversity & Governance US	154	18.20	2.83	1.20	10.62	2.82	151.13

Note: Weighted Average Market Cap is in EUR. Source: RAFI Indices, LLC, based on data from FactSet.

### Developed Markets (as of 3/31/19)

Sector	Weight	Top 10 Holdings	Weight
Basic Materials	4.56%	1 Exxon Mobil	2.64%
Consumer, Cyclical	13.74%	2 AT&T	2.24%
Consumer, Non-Cyclical	13.73%	3 Procter & Gamble	2.02%
Energy	6.24%	4 Verizon	1.85%
Financial	19.94%	5 Johnson & Johnson	1.76%
Health Care	10.51%	6 IBM	1.74%
Industrial	10.91%	7 Microsoft	1.72%
Technology	8.82%	8 Wal-Mart	1.68%
Telecommunications	10.48%	9 Merck & Co	1.50%
Utilities	1.08%	10 Cisco Systems	1.47%

Source: RAFI Indices, LLC, based on data from FactSet.

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## Europe (as of 3/31/19)

Sector	Weight	Top 10 Holdings	Weight
Basic Materials	8.58%	1 Unilever	4.47%
Consumer, Cyclical	7.57%	2 Nestle	4.09%
Consumer, Non-Cyclical	19.55%	3 Allianz	3.75%
Energy	5.82%	4 Total	3.28%
Financial	22.02%	5 Lloyds Banking Group	3.18%
Health Care	9.79%	6 GlaxoSmithKline	3.08%
Industrial	8.03%	7 Diageo	2.99%
Technology	4.17%	8 BASF	2.96%
Telecommunications	12.68%	9 Vodafone	2.60%
Utilities	1.79%	10 Sanofi	2.60%

Source: RAFI Indices, LLC, based on data from FactSet.

Source: RAFI Indices, LLC, based on data from FactSet.

## United States (as of 3/31/19)

Sector	Weight	Top 10 Holdings	Weight
Basic Materials	2.18%	1 Exxon Mobil	5.10%
Consumer, Cyclical	16.12%	2 AT&T	4.34%
Consumer, Non-Cyclical	13.61%	3 Procter & Gamble	3.92%
Energy	6.92%	4 Verizon	3.58%
Financial	11.40%	5 Johnson & Johnson	3.41%
Health Care	13.10%	6 IBM	3.37%
Industrial	12.58%	7 Microsoft	3.33%
Technology	13.76%	8 Wal-Mart	3.26%
Telecommunications	9.37%	9 Merck & Co	2.89%
Utilities	0.96%	10 Cisco Systems	2.85%

Source: RAFI Indices, LLC, based on data from FactSet.

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