PLACING SCREENS ON SUSTAINABILITY

SELECTING THE BEST: ESG FIRMS WITH THE LOWEST VOLATILITY AND HIGHEST DIVIDENDS

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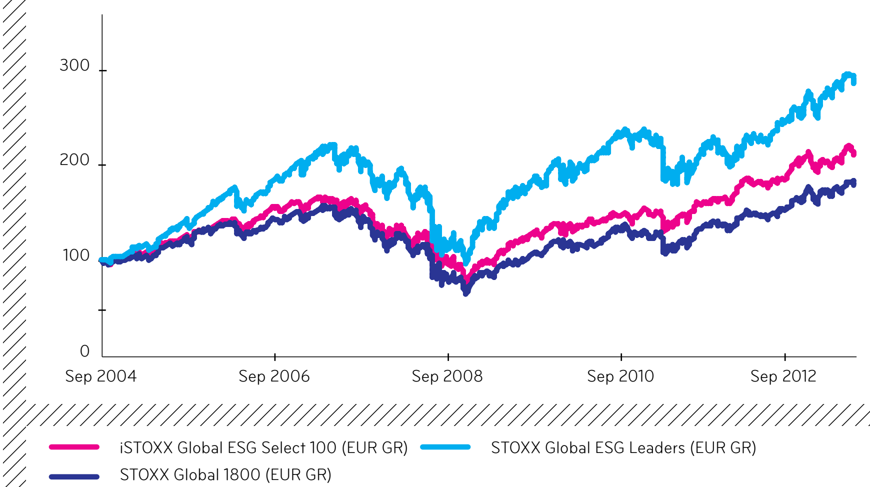
STOXX Ltd. introduced the iSTOXX ESG Select 100 Index in December, 2013. The index selects 100 stocks with the lowest volatility and highest dividends from the universe of the STOXX Global ESG Leaders Index.

STOXX Ltd. talked to Guillaume Flamarion, a London-based equity derivatives structurer at J.P. Morgan, to ask him about applying screens to a sustainability index and what that means for investors.

Flamarion joined J.P. Morgan in October, 2011. He has more than 7 years of experience in equity solutions structuring. He graduated from the Ecole des Mines de Paris in 2006.

	iSTOXX Global ESG Select 100	STOXX Global ESG Leaders	STOXX Global 1800
Performance (annualized)	7.3%	10.6%	5.7%
Volatility (annualized)[1]	14.5%	17.5%	15.7%
Maximum drawdown	50.2%	52.8%	53.7%
Sharpe ratio[1]	0.43	0.55	0.31
Gross dividend yield	4.4%	3.6%	3.0%

iSTOXX GLOBAL ESG SELECT 100 SHOWS LOWER VOLATILITY AND HIGHER DIVIDEND THAN BENCHMARKS



1) EONIA rate used as proxy for riskless returns. Gross dividend yield calculated from Dec. 11, 2012 to Dec. 11, 2013
Source: STOXX daily data from Sep. 20, 2004 to Dec. 9, 2012. For iSTOXX Global ESG Select, data is backtested until Nov. 21, 2013. For STOXX ESG Leaders, data is backcasted until Apr. 2011

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THIS ESG FILTER IS MAINLY A QUALITATIVE FACTOR WHICH CAN BE COMBINED WITH MORE QUANTITATIVE GAUGES, LIKE LOW VOLATILITY AND HIGH DIVIDENDS.

Guillaume Flamarion

WHAT IS THE BENEFIT OF APPLYING SCREENS FOR LOW VOLATILITY AND HIGH DIVIDENDS ON A SUSTAINABILITY INDEX?

I would like to emphasize that first of all, an ESG index tracks the returns of a basket of sustainable stocks. Companies that implement strict controls on Environmental, Social and Governance (ESG) standards are usually better positioned to deliver consistent performance in the long term. This ESG filter is mainly a qualitative factor which can be combined with more quantitative gauges, like low volatility and high dividends.

Investing in low volatility stocks has been very popular among investors recently. Usually, high volatility stocks are relatively overpriced as mutual fund managers, who might have limitations on the use of leverage, are tilting towards high volatility stocks to generate performance. Moreover, stocks with low historical volatility, exhibit historically superior risk-adjusted returns (Sharpe ratio).

Companies that pay high dividends are generally seen as stable, generating consistent earnings and returns in the long term. A high dividend yield can indicate undervaluation of the stock because the stock's dividend is high relative to its price. Moreover, in a low interest rate environment, high dividend stocks can provide consistent income to investors.

DON'T ESG AND SUSTAINABLE INDICES ALREADY HAVE COMPANIES THAT PAY RELATIVELY HIGH DIVIDENDS AND WHOSE SHARES DISPLAY RELATIVELY LOWER VOLATILITY? OR IS THAT JUST AN ASSUMPTION, AND HENCE THE NEED TO APPLY THESE SCREENS TO AN ESG INDEX?

Stocks from the ESG universe are generally stable companies which could be seen as already displaying lower volatility and paying relatively high dividends. The ESG filters are mainly non-financial qualitative criteria which can be balanced efficiently with two financial quantitative gauges – low volatility and high dividends.

Theoretically, orthogonal (independent) factors would form a complete and diversified set of investments. In practice, it is difficult to associate completely independent factors. The three levels of selection within the index achieve their objective of complementing each other efficiently: qualitative and quantitative, quality and stability, potential growth and regular income. However, investors must not forget that while this selection process exhibits efficiencies in theory, there is no guarantee that the iSTOXX Global ESG Select 100 Index will necessarily outperform its benchmark.

In a nutshell, the iSTOXX Global ESG Select 100 Index intends to combine these three complementary factors: quality (ESG filter), low risk (low historical volatility) and value (high dividend).

CAN THE PERFORMANCE OF BROAD OR OTHER TYPES OF INDICES BE ENHANCED BY APPLYING SCREENS TO THESE INDICES? HOW?

The demand for low volatility and high dividend strategies has grown significantly over the past few years due to strong risk-adjusted performance and increased investors' appetite for smarter equity exposure. In fact, recent ETF launches have gathered considerable assets, and today most index providers have flagship low volatility and select dividend indices. However the combination of both is still rare.

As explained, low volatility and select dividends are two complementary factors within an index like the iSTOXX Global ESG Select 100 Index. This concept could be extended to STOXX indices other than ESG, for example on benchmark indices (EURO STOXX 50, STOXX Europe 50, STOXX Europe 600), thematic indices (STOXX Strong Quality index family), or sector indices. It is important to remember that there is no guarantee that quantitative factors will always enhance performance.«