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Fair Value Adjusted Russell Global Indexes Information

Tracking error is an estimate of the dispersion between a mutual fund's returns and the returns of a comparable benchmark index. It is often used by investors to gauge how much risk the fund manager is taking on in order to achieve similar or better returns in comparison to the benchmark index, and can be an important tool to help in: identifying and measuring relative risk, attribution analysis, analyzing portfolio management, and enhancing the overall marketability of the fund. In White Paper #14 *Apples to Oranges? Reducing Tracking Error Noise with Fair Value Adjusted Benchmark Indices*, Interactive Data demonstrated the potentially misleading effect on tracking error measurements when a mutual fund that uses fair value adjustments with respect to its holdings in international equity securities is compared to a benchmark index calculated using only local closing prices.¹ Interactive Data's research showed that tracking error is amplified during times of higher general market volatility and could be significantly reduced if comparisons were made using fair value adjusted benchmark index data. To help address this issue, Interactive Data and Russell Investments are making available fair value adjusted information for select Russell global indexes designed to assist mutual funds investing in foreign equity securities with performance measurement.

Funds may choose to consider the fair value adjusted benchmark index information in the context of their internal fair value procedures to facilitate a more apples-to-apples comparison of fund returns to benchmark returns, improving the effectiveness of performance metrics such as tracking error and peer fund performance comparisons. The following is provided as an example of how a fund investing in international equity securities might consider this information in connection with fund performance measurements.

1. Calculate the periodic returns for the Standard Index and Fair Value Adjusted Index using the formula: (ending value – beginning value) / beginning value, as well as the fund's corresponding returns over the period.

Example 1 / Calculating Index returns and NAV returns

Date	Standard Index	Fair Value Adjusted Index	International Fund NAV	Standard Index Returns	Fair Value Adjusted Index Returns	NAV Returns
31-Dec-08	100.000	100.477	25.000			
31-Jan-09	105.403	105.962	26.497	5.40%	5.46%	5.99%
28-Feb-09	99.110	98.188	24.552	-5.97%	-7.34%	-7.34%
31-Mar-09	94.044	92.934	23.184	-5.11%	-5.35%	-5.58%
30-Apr-09	101.722	101.839	25.281	8.16%	9.58%	9.05%
31-May-09	116.545	115.798	28.837	14.57%	13.71%	14.07%
30-Jun-09	132.614	134.043	33.233	13.79%	15.76%	15.24%
31-Jul-09	132.386	132.162	32.954	-0.17%	-1.40%	-0.84%
31-Aug-09	148.713	148.807	36.968	12.33%	12.59%	12.18%
30-Sep-09	151.012	150.866	37.653	1.55%	1.38%	1.85%
31-Oct-09	155.645	158.015	39.320	3.07%	4.74%	4.43%
30-Nov-09	148.906	145.083	36.010	-4.33%	-8.18%	-8.42%
31-Dec-09	160.001	160.762	40.250	7.45%	10.81%	11.77%

This hypothetical example is for illustration only and is not intended to reflect the return of any actual investment.

¹ White Paper #14, *Apples-to-Oranges? Reducing Tracking Error Noise with Fair Value Adjusted Benchmark Indices*, Robert Haddad (August 5, 2008)

Excess Return can be determined by calculating the fund's return and subtracting the index return. Positive excess return suggests outperformance of the fund's returns as compared with the benchmark's returns.

$$\text{Standard Index Annual Return} = (160.001 - 100.00) / 100.00 = 60.00\%$$

$$\text{Fair Value Adjusted Index Annual Return} = (160.762 - 100.477) / 100.477 = 60.00\%$$

$$\text{International Fund Annual Return} = (40.25 - 25.00) / 25 = 61.00\%$$

$$\text{Excess Returns vs. Standard Index} = 61.00\% - 60.00\% = 1.00\%$$

$$\text{Excess Returns vs. Fair Value Adjusted Index} = 61.00\% - 60.00\% = 1.00\%$$

2. Estimate the Tracking Error between the fund returns and fair value adjusted index. Tracking error can be calculated using the following formula:

$$\text{Annualized Tracking Error} = \text{Square Root} (\text{SUM}(\text{NAV returns} - \text{Index returns})^2) * \text{Square Root}(12)$$

Example 2 / Estimating Tracking Error

Month	(NAV returns - Standard Index returns) ²	(NAV returns - Fair Value Adjusted Index returns) ²
January 2009	0.000034	0.000028
February 2009	0.000187	0.000000
March 2009	0.000021	0.000005
April 2009	0.000078	0.000029
May 2009	0.000026	0.000013
June 2009	0.000212	0.000026
July 2009	0.000044	0.000032
August 2009	0.000002	0.000017
September 2009	0.000009	0.000022
October 2009	0.000185	0.000010
November 2009	0.001671	0.000005
December 2009	0.001868	0.000093
Annualized Tracking Error	22.82%	5.80%

3. The Information Ratio can then be estimated. The information ratio normalizes the excess return to provide a metric which is useful for fund-to-fund performance comparisons, or fund-to-benchmark performance comparisons. In general, the higher the information ratio, the higher the perception in the quality of the fund's returns. The information ratio can be calculated using the following formula:

$$\text{Information Ratio} = \text{Excess Return} / \text{Tracking Error}$$

$$\text{Information Ratio using Standard Index} = 1.00\% / 22.82\% = \mathbf{0.044}$$

$$\text{Information Ratio using Fair Value Adjusted Index} = 1.00\% / 5.80\% = \mathbf{0.173}$$

Note that in this example, since the excess returns against both indices are identical, the tracking error becomes the more critical component of the information ratio calculation.

Interactive Data's Fair Value Information Service

Interactive Data's Fair Value Information Services are designed to provide subscribers with various information that can be used to estimate a price for an equity security, equity index futures contract, or equity option that would likely prevail in a liquid market, in view of market information available at the time of evaluation. Currently, more than 175 fund complexes subscribe to the Fair Value Information Service. In 2007, Interactive Data was awarded a patent by the U.S. Patent and Trademark Office for Fair-Value Pricing of a Financial Asset. Additional information about the Fair Value Information Service is available at www.interactivedata-prd.com.

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