

METHODOLOGY FOR IQ[®] LEADERS INDEXES



Introduction

- This document sets forth the methodology for the following indexes (each an “Index”):
 - Indexes
 - IQ[®] Leaders GTAA Index (the “GTAA Index”)
 - IQ[®] Leaders World Bond Index (the “WB Index”)
- For each Index, IndexIQ uses a rules-based process (see “Leaders Construction Process” below) to select leading mutual funds in a particular investment category (“Leaders”).
- For each Index, IndexIQ uses a rules-based process (see “Index Construction Process” below) to select individual Index Components that, when combined together, produce an Index designed to replicate the risk-return characteristics of the Leaders.
- For any ETF based on a given Index, such Index will be calculated by Solactive AG or another established and unaffiliated calculation agent prior to the launch of such ETF, and the Index value on a price basis will be disseminated every 15 seconds to the Securities Industry Automation Corporation (SIAC) so that such Index value can print to the Consolidated Tape.

Leaders Construction Process

The process described below applies to each of the Indexes.

Annual selection of leading mutual funds

- IndexIQ identifies all mutual funds (“Funds”) that are classified in a particular investment strategy by an unaffiliated third party.
- Each Fund will have a minimum of 2 years of performance results to be eligible for potential inclusion.
- Each fund will have an investment objective consistent with the objective of the Leaders to be eligible for potential inclusion.
- Eligible funds are assigned scores (“Criteria Scores”) based upon their rankings on the following criteria:
 - Fund Size, as measured by assets under management
 - Fund Performance (Returns), as measured by 24 month total return
- Each Fund’s Criteria Scores are aggregated to create Composite Score (“Composite Score”) where the weights are as follows:

- 60% Fund Size
- 40% Fund Performance (Returns)
- The 10 Funds with the highest Composite Score that also meet the fund eligibility requirements constitute the Leaders.
- The returns of the Leaders are averaged to create the Leaders Series.
- The annual Leaders Construction Process will use information dated the last business day of February of the selection year to go into effect the last business day of March of the selection year.

Semi-Annual review of leading mutual funds

- The Semi-Annual review will occur six months after the annual selection. IndexIQ will eliminate any of the Leaders that have a six month return that is more than 2 standard deviations below the average return of the Leaders Series. The returns of the remaining Leaders are averaged to create the Leaders Series for the remainder of the year.

Index Eligibility Requirements

- All of the Index components (collectively, the “Components”) are exchange-traded funds (ETFs) registered under the Investment Company Act of 1940 or other exchange-traded vehicles issuing equity securities (ETVs) organized in the U.S., each with at least \$50 million in assets under management (“AUM”) as of the date of the annual Reconstitution (see below).
- All of the ETF and ETV Components are listed on one of the major U.S. exchanges (NYSE, NYSE Arca, NASDAQ).

Index Construction Process

The process described below applies to each of the Indexes.

Initial Selection of Components

- IndexIQ identifies all existing ETFs and ETVs that meet the Index Eligibility Requirements set forth above.
- IndexIQ calculates the correlation of the returns of each eligible ETF and ETV relative to the returns of the Leaders Series.

- IndexIQ conducts an analysis whereby it utilizes the publicly-available description of the eligible ETFs and ETVs to identify which of these ETFs and ETVs correspond, based on overlap of investment strategy and/or asset class exposure, to each Leaders Series that IndexIQ is seeking to replicate.
 - IndexIQ assigns a score to each eligible ETF and ETV based on the extent of the overlap of investment strategy and/or asset class exposure described above, with 3 being high overlap, 2 being moderate overlap, and 1 being low overlap.
- IndexIQ adds the correlation and the score for each ETF and ETV and then ranks the ETFs and ETVs, from highest to lowest, based on the resulting values.
- To the extent that more than one ETF or ETV provides substantially the same investment strategy or asset class exposure, IndexIQ selects the ETF or ETV with the highest AUM level or other objective factor to be representative of such investment strategy or asset class exposure for back testing purposes (see below for a description of the back test process).
- In order to select the Index Components pursuant to the back test process, IndexIQ includes in each Index the ETFs and ETVs (the “Primary Back Test Components”) with the greatest relevance to the Leaders Series, as calculated by the process described above.
- Using the Component Weightings process (as described below), IndexIQ conducts multiple back tests to calculate various statistics of a hypothetical Index using the Primary Back Test Components in different combinations. (To the extent that an ETF or ETV did not exist during the back test period, IndexIQ uses the returns of the index underlying such ETF or ETV.)
- In order to choose which of the hypothetical Indexes will constitute the actual Index, IndexIQ examines the following statistics and assigns each a weight factor as follows:

<u>Statistic*</u>	<u>Weight Factor</u>
1-Year Return	12
3-Year Annualized Return	36
5-Year Annualized Return	60
1-Year Standard Deviation	8
3-Year Standard Deviation	24
5-Year Standard Deviation	40
Tracking Error (vs. Leaders Series)	15
1-Year Correlation (vs. Leaders Series)	10
3-Year Correlation (vs. Leaders Series)	10
5-Year Correlation (vs. Leaders Series)	10
Maximum Aggregate Short Position	N/A
3-Year Turnover	N/A

* For returns and standard deviation, the statistic is the absolute value of the difference between the hypothetical Index and the Leaders Series so that the statistic measures the similarity between the hypothetical Index and the Leaders Series. The Correlation values are 100% less the correlation such that lower values indicate a higher level of positive correlation.

- IndexIQ excludes all hypothetical Indexes that have excessive 3-Year Turnover or excessive Maximum Aggregate Short Positions.
- For each remaining hypothetical Index, IndexIQ multiplies the statistic value times the weight factor to calculate its “back test score.”
- The hypothetical Index that has the lowest back test score (the “Low Back Tested Index”) forms the basis for the final Index.

Component Weightings

- For each Index, IndexIQ calculates the constrained beta coefficients for each Primary Back Test Component from an ordinary least squares (OLS) regression where the dependent variable is the Leaders Series return and the independent variables are the Index Component returns.
- The beta coefficients are scaled so that the sum of all beta coefficients is 1.
- Beta coefficients can be either positive or negative indicating either a long or short exposure, respectively.
- The final Index is comprised of its Primary Back Test Components of the Low Back Tested Index, and may include any other ETFs or ETVs that (i) meet the Eligibility Requirements and (ii) are substantially similar to the investment strategies and/or asset class exposures of such Primary Back Test Components. The Primary Back Test Components and the additional ETFs and ETVs, if any, are weighted within a given investment strategy or asset class in the final Index proportionately based on their relative AUM levels.
- IndexIQ seeks to limit the sum of the weights of those Components that generate non-qualifying income under Subchapter M of the Internal Revenue Code to no more than 10% of the total Index weight.

Monthly Rebalance

- IndexIQ rebalances the Component weights for each Index on a monthly basis pursuant to the process described in “Component Weightings” above.
- The monthly rebalance for the Indexes is effective after the close of the 3rd business day of each month.

Annual Reconstitution

- IndexIQ conducts an annual review of all Index Components once a year during the first calendar quarter, with any change in Components (additions or deletions) (the “Reconstitution”) implemented no later than the second calendar quarter.
- The Reconstitution process is the same as the process described above under “Initial Selection of Components” with consideration given to new ETFs and ETVs that have been launched and/or existing ETFs and ETVs that have, since the last Reconstitution, met the Index Eligibility Requirements.
- To the extent the back testing process, with the addition or deletion of one or more ETFs and ETVs, yields better replication results than the existing Index, as measured by “back test scores”, the Components of the given Index are adjusted accordingly.

Index Formula

- Index Return_t =

$$\begin{aligned}
 & K1 * (UI_t / UI_{t-1} - 1) \\
 & - (K-1) * ((Borrowing Rate + Spread) / 360) * D_{t,t-1} \\
 & - (K2-K1) * (Spread / 360) * D_{t,t-1}
 \end{aligned}$$

Where:

$$UI = \frac{\sum_{i=1}^n (P_i \times IQWF_i)}{D_i}$$

P_i = Price of security i
 IQWF_i = IndexIQ Weight Factor
 D_i = Divisor

K1 (K1 ≥ 1) = Net Exposure

- $K=1$, Net Exposure=100%
- $K=2$, Net Exposure = 200%

$K2$ ($K2 \geq 1$) = Gross Exposure (i.e. sum of the absolute value of all long and short exposures)

Borrowing Rate = Overnight LIBOR in the U.S. or EONIA in Europe

Spread = The amount above the Borrowing Rate paid to obtain synthetic exposure to an asset class

$D_{t,t-1}$ = the number of calendar days between t and $t-1$

- $\text{Index Value}_t = \text{Index Value}_{t-1} * [1 + \text{Index Return}_t]$

Ongoing Maintenance

Dividends

- Dividend payments by Components are treated as if they are reinvested in the Indexes in calculating total returns for the Indexes.

Extraordinary Circumstances

- In the event of an extraordinary circumstance in which an Index Component no longer conforms to the objectives of a particular Index, the Index Committee may elect to eliminate the Component from the Index. In such a situation, the Index Committee will seek to find a replacement Component that best conforms to the objective of the Index pursuant to the process set forth above.

Spin-Offs

- In the event of a spin-off from an existing Index component, the spun-off component may remain within the index provided the spun-off component meets the eligibility requirements and selection criteria for inclusion in the index and is consistent with the objective of the index.

Base Date & Value

- The Base Date and Value of the Indexes is June 30, 2015 and 1000, respectively.

Rule Changes

- Any material change in the Index rules may be made only following 60 days public notice published on the IndexIQ website at <http://www.IndexIQ.com>.

Index Committee

- The Indexes are maintained by the Index Committee. There are four members of the Index Committee. The Index Committee meets annually and as necessary on an ad hoc basis to make any extraordinary decisions regarding the Indexes.

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