

Frequently Asked Questions




SPA ETF is a global provider of fundamentally driven Exchange Traded Funds. The company was established to offer private and institutional investors access to Exchange Traded Funds tracking fundamental and enhanced indices, which will be listed in London, New York and a number of exchanges in Europe and Asia. With offices in London and New York, SPA ETF aims to become a leading provider globally.

The first family of ETFs that SPA offers track the performance of stock indices created by research provider MarketGrader's fundamental methodology.

SPA ETF is supported by London and Capital, a London based Investment and Fund manager, who provide research, quantitative analysis and regulatory support.

This report has been produced by London and Capital Asset Management on behalf of SPA ETF Europe Ltd.



ETFs are a relatively new investment tool and in this document, we answer some common questions about ETFs, the types of Indices they track and our index provider, MarketGrader.

What is an Exchange Traded Fund (ETF)?

An ETF is simply a basket of securities that trades like a single stock. It can track an index or a sample of an index. SPA ETFs will track MarketGrader's equally weighted fundamental indices.

How do ETFs work?

An ETF is essentially an Index Fund. By replicating the index that an ETF follows, it tends to own a basket of shares that mirror the index and therefore the value of the ETF changes with that of the underlying index. The creation/redemption process, which is explained below, typically seeks to ensure that the ETF's market price is in line with the Net Asset Value (NAV) of the fund, unlike closed end funds.

What are the benefits of ETFs?

- **Diversification** Through just one ETF share you can gain diversified market exposure
- **Liquidity** As ETFs trade in real time on stock exchanges, they are liquid and can provide greater investment flexibility than mutual funds, which tend to trade only once a day.
- **Transparency** With ETFs, information on underlying securities is published daily. With many types of pooled investments this is not possible.
- **Cost Efficiency** ETFs can be highly attractive as they tend to have relatively low annual expense ratios.

How do I invest in an ETF?

The most common way to buy or sell shares is through a broker in the way you would buy or sell other securities. Trading shares on an Exchange does not incur either a subscription or a redemption charge, although brokers commissions generally apply.

Alternatively, 'Authorised Participants' (generally institutional investors) are able to transact with the fund and trade a basket of securities for large blocks of shares called creation units. SPA ETF has set a minimum of 25,000 shares for a single creation unit and these trades will be carried out at the NAV, which is the market value of the fund's holdings on any given day.

Before investing in an ETF, you should always take appropriate advice and make sure you read the prospectus.



How is the trading price of an ETF determined?

Generally, an ETF is expected to trade close to the NAV of the underlying shares. If your transactions are with the fund itself, resulting in the creation or redemption of ETF shares, this will occur at the NAV.

If you're trading shares on an Exchange, then these trades will occur at market price rather than the NAV. The market price will fluctuate in accordance with changes in the NAV and the supply and demand for the ETF shares.

Why use an ETF rather than an index tracking mutual fund?

ETFs offer a number of benefits compared with tracking an index using a mutual fund. ETFs are generally more transparent, more liquid and they allow investors to obtain diversification across a market through one share. ETFs normally have lower management fees than mutual funds as they have lower operating and transaction costs.

Will SPA ETFs distribute dividends?

The income, earnings and gains of the company will be distributed annually to shareholders.

How liquid are SPA ETFs?

The relative liquidity of different ETFs depends to an extent on the liquidity of the underlying stocks. The more liquid the underlying stock is, the easier it is for Authorised Participants or Market Makers to assemble the creation units which facilitate trading. This means it is possible for ETFs to be liquid even if they have low trading volumes. All stocks selected by MarketGrader indices historically have 3-month daily average trading volumes of at least US\$2 million to provide liquidity for SPA's family of ETFs.



Index types and the MarketGrader approach

What are fundamental indices?

Typical stockmarket indices are weighted by the market capitalisation of a company i.e. the value of the current share price, multiplied by the number of shares outstanding (such as the S&P 500, Nasdaq, Dow Jones or Russell indices in the US). An index which selects by market capitalisation alone will often overweight stocks may be overvalued, and underweight undervalued stocks.

However, within a fundamental index, companies are selected using 'fundamental' criteria, such as profitability or growth, to compile an index of stocks with high performance potential.

What is equal weighting?

Stock selection using market capitalisation can also result in a small number of stocks making up a large percentage of the overall index. For example, at the end of 2006, the ten stocks with largest weighting in the S&P 500 accounted for 20% of the total index value. In an equally-weighted index, no particular stock is given a higher or lower weighting than another, which has the potential to provide stronger returns than weighting by market capitalisation.

Who is MarketGrader?

MarketGrader is an independent research provider based in the US and covers more than 5,700 US-listed companies. MarketGrader's research is used by some of the world's leading investment houses and is a research contributor to BNY Jaywalk, the independent equity research consultancy of The Bank of New York. Complete performance information about MarketGrader's ratings is available at www.investars.com. Investars is a research and performance measurement firm that follows stock recommendations and ratings across all types of research firms in the US.

What are the MarketGrader Indices?

MarketGrader has created indices which focus on US equities and which seek to outperform the major US indices. All MarketGrader indices are:

- **Fundamentally driven** companies are selected on the strength of their fundamentals
- **Equally weighted** to extract performance from each stock
- **Diversified** on the basis of sound portfolio diversification
- **Automated** computer-generated algorithms with no subjective bias
- **Regularly re-balanced** at least twice each year

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Growth	Value	Profitability	Cash Flow
Long Term Market Growth	Capital Structure	Asset Utilisation	Cash Flow Growth
Short Term Market Growth	P/E Analysis	Capital Utilisation	EBITDA Margin
Growth Potential	Price/ Book Ratio	Operating Margins	Debt/ Cash Flow Ratio
Relative Price Strength	Price/Cash Flow Ratio	Relative Margins	Interest Coverage Capacity
Earnings Momentum	Price/Sales Ratio	Return on Equity	Economic Value
Earnings Surprise	Market Value	Quality of Revenues	Retention Rate

Each stock is systematically graded between 0-100 using this fundamental analysis and then ranked in order. Only those with the highest grading are chosen for an index, provided they comply with the specific rules of that index.

How often do the MarketGrader indices re-balance?

MarketGrader indices are re-balanced semi-annually or quarterly depending on the index. This ensures stocks which have become overvalued are replaced in favour of more attractive, undervalued opportunities.

How do the rules of each MarketGrader index differ?

All MarketGrader Indices follow certain common rules. For example, all stocks must have a three-month average daily trading value of at least US\$2 million to ensure liquidity and companies must have reported quarterly or annual figures no later than six months prior to the selection date to be eligible for inclusion. Additionally, there is some variation between the rules of each index.

A full summary of the rules for each index can be found in the table below:

Index	Sector rules	Market cap rules	Re-balanced	Earnings
MG40 40 stocks	No economic sector can represent more than 30% of the entire index and no sub-sector can represent more than 15% of the entire index No Utilities or REITS are included in the index	At least USD \$100m At least 25% above USD \$10bn No more than 25% can have market cap below USD \$1bn All stocks must have 3 month daily average trading dollar value of at least USD \$2m	Quarterly, February, May, August and November	Must have met analyst earnings estimates during earnings report immediately preceding the Index selection Must have reported quarterly/annual figures no later than six months prior to the selection date
MG100 100 stocks	No economic sector can represent more than 25% of the entire index and no sub-sector can represent more than 12% of the entire index. No Utilities or REITS are included in the index	At least USD \$100m At least 25% above USD \$10bn No more than 25% can have market cap below USD \$1bn All stocks must have 3 month daily average trading dollar value of at least USD \$2m	Semi-Annually, in February and August	Must have at least met analyst earnings estimates during earnings report immediately preceding the Index selection Must have reported quarterly/annual figures no later than six months prior to the selection date
MG200 200 stocks	No economic sector can represent more than 20% of the entire index No REITS are included in the index	Total market capitalisation above USD \$250m At least 25% above \$3bn All stocks must have a three month average daily trading dollar value of at least USD \$2m	Semi-Annually, in March and September	Must have reported quarterly/annual figures no later than six months prior to the selection date
MG Large Cap 100 stocks	No economic sector can represent more than 25% of the entire index No REITS are included in the index	Total market capitalisation above USD \$4 bn All stocks must have a three month average daily trading dollar value of at least USD \$2m	Semi-Annually, March and September	Must have reported quarterly/annual figures no later than six months prior to the selection date
MG Mid Cap 100 stocks	No economic sector can represent more than 25% of the entire index No REITS are included in the index	Total market capitalisation above USD \$1bn and below USD \$10 bn All stocks must have a three month average daily trading dollar value of at least USD \$2m	Semi-Annually, in March and September	Must have reported quarterly/annual figures no later than six months prior to the selection date
MG Small Cap 100 stocks	No economic sector can represent more than 25% of the entire index No REITS are included in the index	Total market capitalisation above USD \$250m and below USD \$2bn All stocks must have a three month average daily trading dollar value of at least USD \$2m	Semi-Annually, in March and September	Must have reported quarterly/annual figures no later than six months prior to the selection date

Maintenance

Any stock deleted from the index as a result of a corporate action such as a merger, acquisition, spin-off, de-listing or bankruptcy is not replaced until rebalancing.



a 4 Triton Square, Regent's Place,
London, NW1 3HG, UK

t +44 (0)20 7396 3270

f +44 (0)20 7396 3201

spa-etf.com

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