

METHODOLOGY FOR IQ ALPHA HEDGE INDEX



Introduction

- This document sets forth the methodology for the IQ Alpha Hedge Index (the “Composite Index”)
- The Composite Index is calculated and disseminated end of day by Standard & Poor’s.
- The Composite Index is an optimized combination of six IndexIQ sub indexes (the “Sub Indexes”), each of which seeks to replicate the risk-adjusted return characteristics of a specific hedge fund strategy as represented by a hedge fund index (each a “Hedge Fund Style Index”) published by unaffiliated providers of hedge fund performance data.

Eligibility Requirements

- All Composite Index components are highly liquid U.S.-based exchange-traded funds (ETFs), exchange-traded notes (ETNs), or exchange-traded vehicles (ETVs) with at least \$50 million in assets under management.
- All Composite Index components are traded on one of the major U.S. exchanges (NYSE, NYSE ARCA, AMEX, or NASDAQ).

Sub Index Construction Process

The process described below applies to each of the Sub Indexes.

- In the first quarter of each calendar year, IndexIQ identifies the relevant asset classes and investment strategies for each Hedge Fund Style Index.
- IndexIQ then uses statistical analysis to select the securities (the “Index Components”) to be included in the Sub Indexes that serve as proxies for the asset classes and investment strategies for each Hedge Fund Style Index.
- Any change in Components (additions or deletions) is implemented no later than the first rebalance day of the second quarter.
- IndexIQ rebalances the Component weights for each Sub Index on a monthly basis using a regression process.
- The monthly rebalance of the Sub Indexes is effective after the close of the 3rd business day of each month.

Composite Index Construction Process

The process described below applies to the Composite Index, which is an optimized composite of the six Sub Indexes.

- The Components of the Composite Index include only the Components of the Sub Indexes.
- Each Sub Index weight in the Composite Index is determined by a proprietary algorithm whose objective is to find the optimal combination of Sub Indexes that best allows the Composite Index to attempt to achieve its investment objectives.
- For each Sub Index, each Component's weight within the Sub Index is multiplied by the weight of such Sub Index within the Composite Index. The resulting values are summed across all Sub Indexes to determine each Component's base weight in the Composite Index.
- The Composite Index may then employ leverage such that the net position of the Composite Index may exceed 100% but will not exceed 200%.
- The Component weights for the Composite Index are rebalanced on a monthly basis pursuant to the process described in "Component Weightings" above.
- The monthly rebalance of the Composite Index is effective after the close of business on the 3rd business day of each month.

Index Formula

- Leveraged Index Return_t =

$$K * (UI_t / UI_{t-1} - 1) - (K-1) * (\text{Borrowing Rate} / 360) * D_{t,t-1}$$

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

K ($K \geq 1$) = Leverage Ratio

- $K=1$, no leverage
- $K=2$, Exposure = 200%

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

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

- Leveraged Index Value_t = Leveraged Index Value_{t-1} * [1 + Leverage Index Return_t]

Index Committee

- The Index methodology is maintained by the Index Committee. The Index Committee meets annually to review the Annual Reconstitution and as necessary on an ad hoc basis to make any extraordinary decisions regarding the Indexes.

Ongoing Maintenance

Dividends

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

Extraordinary Circumstances

- In the event of an extraordinary circumstance in which a 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.

Base Date & Value

- The Base Date and Value of the Composite Index is October 31, 2007 and 1000, respectively.

Rule Changes

- Any change in the Composite Index rules may be made only following 60 days public notice.

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