

METHODOLOGY FOR IQ[®] CPI INFLATION HEDGED INDEX



Introduction

- This document sets forth the methodology for the following index (referred to as the “Index”):

IQ[®] CPI Inflation Hedged Index

- The Index is currently calculated by Standard & Poor’s and the Index value on a price basis is disseminated every 15 seconds to the Securities Industry Automation Corporation (SIAC) so that such Index value can print to the Consolidated Tape.
- The Index uses a rules-based process to select individual components of the Index (“Index Components”).

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.
- All of the ETF and ETV Components are listed on one of the major U.S. exchanges (NYSE, NYSE Arca, and NASDAQ).

Selection Criteria

- 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 CPI.
- 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 asset class exposure, to the CPI.
 - IndexIQ assigns a score to each eligible ETF and ETV based on the extent of the overlap of 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 the ETFs and ETVs (the “Primary Back Test Components”) with the greatest relevance to CPI, as calculated by the process described above.
- Using the Component Weighting 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. CPI)	15
1-Year Correlation of rolling 12 months returns (vs. YoY CPI)	10
3-Year Correlation of rolling 12 months returns (vs. YoY CPI)	10
5-Year Correlation of rolling 12 months returns (vs. YoY CPI)	10
% Rolling 12 month Real Returns < 0	60
Average Annual Turnover	N/A

* For returns, the statistic is the “Real Return” (or difference between the nominal return and CPI) versus the target Real Return. For standard deviation, the statistic is the absolute value of the difference between the standard deviation of the hypothetical Index and the standard deviation of the CPI so that the statistic measures the similarity between the hypothetical Index and CPI. 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 Average Annual Turnover.
- 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 Weighting

- IndexIQ calculates the constrained beta coefficients for each Component from an ordinary least squares (OLS) regression where the dependent variable is the Year over Year (YoY) change in the Consumer Price Index (“CPI”) plus a target real return and the independent variables are the rolling 12 month Component returns.
- The beta coefficients are scaled so that the sum of all beta coefficients is 1.
- All Component beta coefficients must be positive.
- The final Index is comprised of the Primary Back Test Components of the Low Back Tested Index, as well as any other ETFs or ETVs that are substantially similar to the investment strategies and/or asset class exposures of such Components. The 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. Such additional ETFs and ETVs, if any, may be added to the Index between Annual Reconstitutions.
- 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.

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 “Annual Reconstitution”) implemented no later than the second calendar quarter.

Monthly Rebalance

- The Indexes are rebalanced monthly (the “Monthly Rebalance”) and adjusted intra-month only in connection with certain ongoing maintenance, as described below.
- The Monthly Rebalance takes place on the business day (the “Monthly Rebalance Date”) on which the CPI is reported by the Bureau of Labor Statistics which is generally on or around the 15th calendar day of the month.
- The Monthly Rebalance is effective after the close of the 2nd business day following the Monthly Rebalance Date.

Index Formula

- The following formula is used to calculate the Index:

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

P_i = Price of security i

$IQWF_i$ = IndexIQ Weight Factor

D = Divisor

Ongoing Maintenance

Dividends

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

Extraordinary Circumstances

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

Base Date & Value

- The Base Date and Value of the Index is December 31, 2008 and 1000, respectively.

Rule Changes

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

Index Committee

- The Index 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 Index.

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