ETF Observer

October 2014

Contents

ETF Insight

A September to Remember

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It was a September to remember. The highlight of the month for us was our fifth annual Morningstar ETF Conference, which was held from September 17-19 at the Sheraton Chicago Hotel & Towers. The conference was our biggest and best yet (I'm obviously biased here). We had three days packed with terrific insights and lively debate. The high point of the event for me personally was having the privilege to share the stage with Gene Fama for an entertaining and candid discussion that covered everything from his monumental body of research to his Nobel experience. I want to thank everyone who attended, presented, participated in panels, covered the event, or otherwise contributed to its success in one form or another. For those who couldn't make it, you can access our full conference coverage here.

Also, be sure to pencil next year's Morningstar ETF Conference in your calendar. Our 2015 event will be held from September 29 – October 1 at the Chicago Sheraton Hotel & Towers—we hope to see you there!

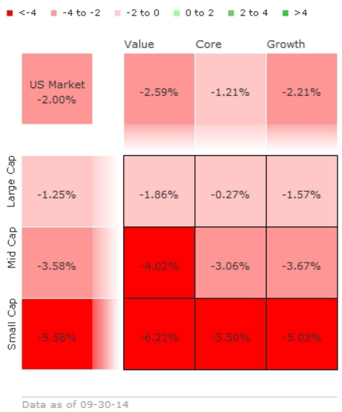
September ended with the manager change heard round the world as Bill Gross announced he'd be leaving PIMCO to join Janus. Our Manager Research team has been working quite literally around the clock to assess the impact of Gross' departure and to update our Morningstar Analyst Ratings for the affected funds. On September 29, we reduced our rating for PIMCO Total Return (PTTRX) from Gold to Bronze. Senior Analyst Eric Jacobson writes that the fund's Bronze rating, "reflects Morningstar's high level of confidence in PIMCO's resources and overall abilities but also the uncertainty as to exactly how all of these parts will mesh in the wake of Gross' departure." You can access Eric's full report here.

This month's installment of ETF Observer features four articles and two fund spotlights from our Passive Strategies research team. In the first article, Mike Rawson examines Strategic Beta equity exchange-traded products' historical risk-adjusted performance through the lens of the Morningstar Rating or "Star Rating". Patty Oey follows with a look at U.S. investors' current appetite for emerging-markets stocks. In general, it would appear that most U.S. investors are underweight emerging-markets equities and might be anchoring to an outdated view of the investment risks and opportunities present in developing economies. Alex Bryan contributes a pair of articles this month. In the first, he looks at some useful implements that investors might consider adding to their performance evaluation toolkits. His second article is a deep dive on a popular duo of dividend-oriented funds from Vanguard—Vanguard Dividend Appreciation ETF (VIG) and actively managed Vanguard Dividend Growth (VDIGX). Alex argues that choosing between the two boils down to investors' conviction in the ability of VDGIX's team to continue to beat their bogy (VIG's benchmark index, the NASDAQ U.S. Dividend Achievers Select Index) over the long haul. Lastly, this month we spotlight PIMCO Total Return ETF (BOND) and iShares Global Materials ETF (MXI).

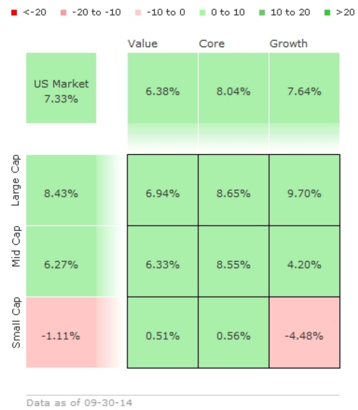
Best,

U.S. Market Barometer

1 Month



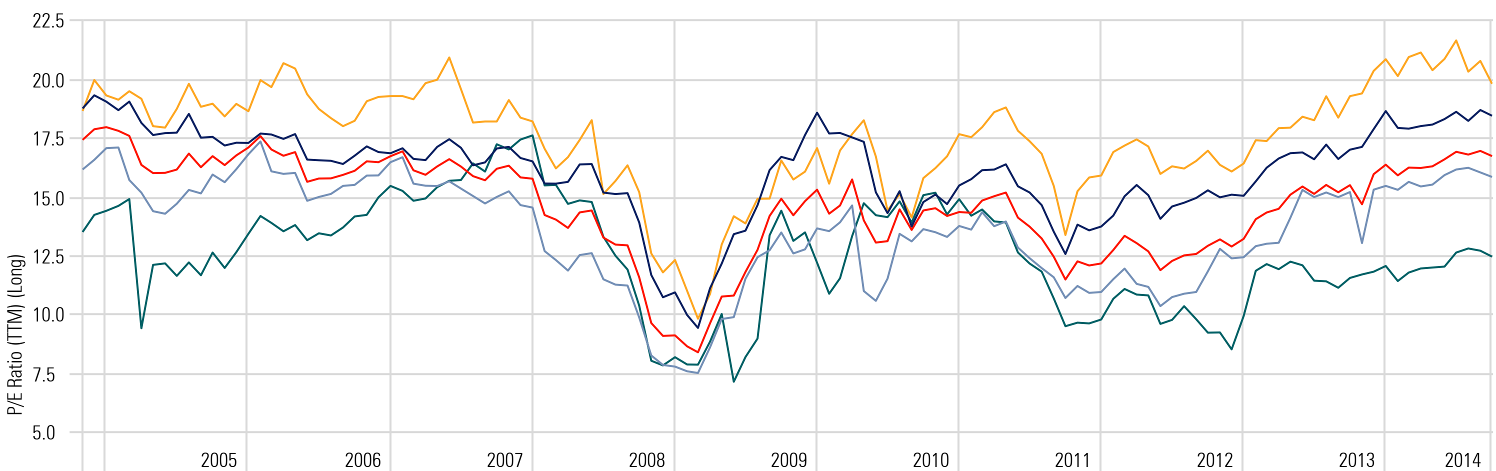
1 Year



3 Year Annualized

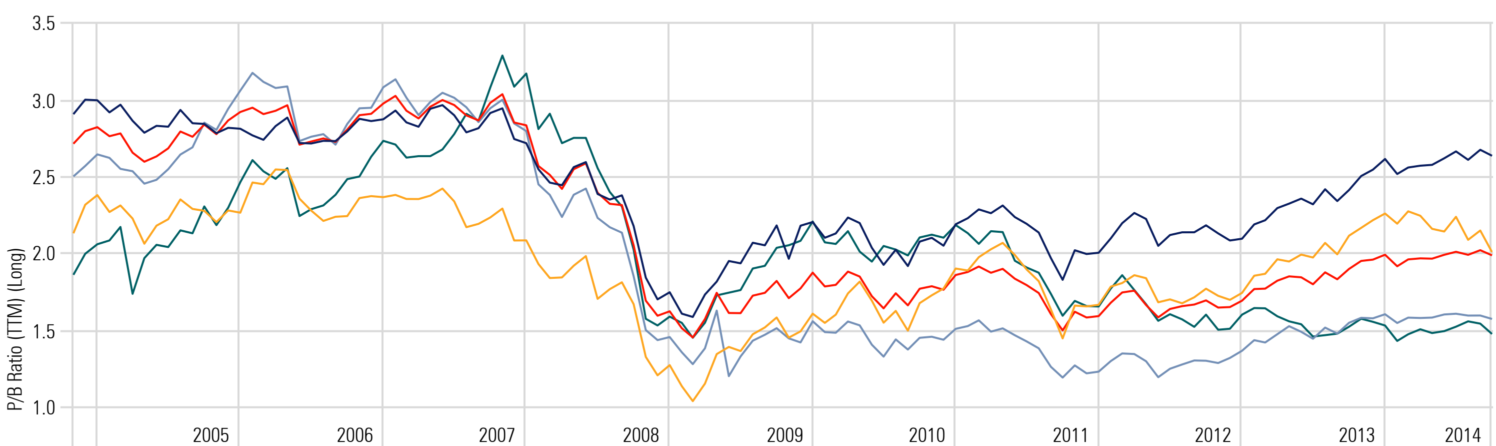
Price/Earnings

Time Period: 10/1/2004 to 9/30/2014



Price/Book Value

Time Period: 10/1/2004 to 9/30/2014



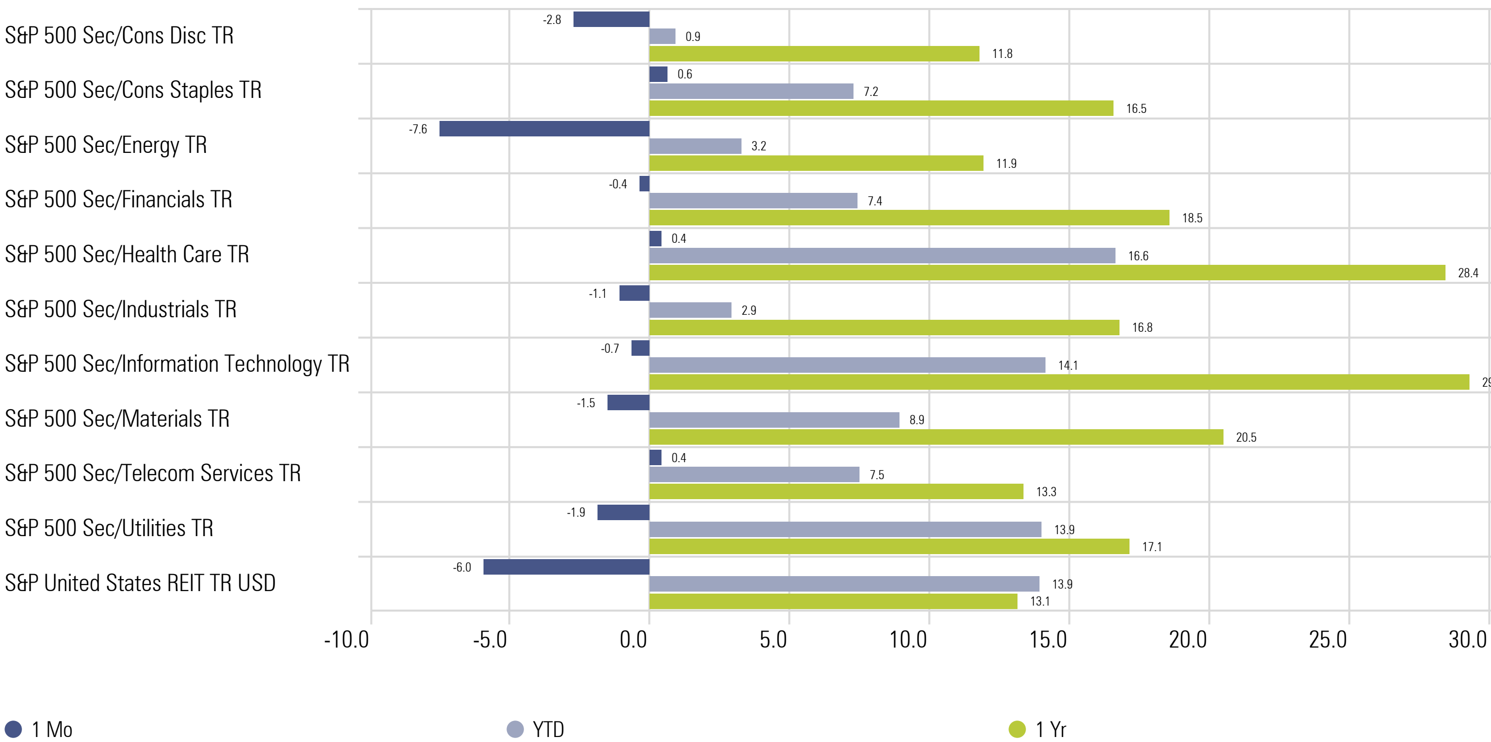
● S&P 500 TR USD ▲ Russell 2000 TR USD ▼ MSCI ACWI NR USD
◄ MSCI EAFE NR USD ► MSCI EM NR USD

Market Performance

Trailing Total Returns

U.S. Equity Market	1 Month	YTD	1 Year	3 Yr Annlzd	5 Yr Annlzd	10 Yr Annlzd	15 Yr Annlzd
S&P 500 TR USD	-1.40	8.34	19.73	22.99	15.70	8.11	4.87
Wilshire 5000 Total Mkt TR USD	-2.03	7.08	17.91	22.82	15.66	8.49	5.56
DJ Industrial Average TR USD	-0.23	4.60	15.29	19.02	14.85	8.15	5.85
NASDAQ 100 TR USD	-0.75	13.83	27.52	25.36	20.01	12.00	4.13
Russell 2000 TR USD	-6.05	-4.41	3.93	21.26	14.29	8.19	7.93
Global Equity Market							
MSCI ACWI NR USD	-3.24	3.73	11.32	16.61	10.07	7.28	4.33
MSCI EAFE NR USD	-3.84	-1.38	4.25	13.65	6.56	6.32	3.87
MSCI EM NR USD	-7.41	2.43	4.30	7.19	4.42	10.68	9.01

S&P 500 Sectors



Trailing Total Returns

U.S. Fixed Income Market	1 Month	YTD	1 Year	3 Yr Annlzd	5 Yr Annlzd	10 Yr Annlzd	15 Yr Annlzd
Barclays US Agg Bond TR USD	2.32	9.49	13.02	4.85	4.97	3.33	3.66
Markit iBoxx Liquid IG TR USD	1.16	11.89	17.41	8.50	7.68	4.43	4.48
BofAML US HY Master II TR USD	0.86	8.97	16.58	13.57	11.30	6.87	5.53
Morningstar Short-Term US Govt TR	2.92	5.78	9.38	2.92	2.15	1.58	1.88
Morningstar Short-Term Corp TR	2.75	6.68	11.00	5.61	4.27	2.41	2.85
Morningstar Intermediate US Govt TR	2.42	7.64	10.18	3.44	4.35	3.23	3.67
Morningstar Intermediate Corp TR	2.10	9.10	13.97	8.12	7.03	4.33	4.71
Morningstar Long-Term US Govt TR	1.42	16.93	17.55	4.30	6.99	4.92	5.26
Morningstar Long-Term Corp TR	0.51	15.24	20.79	9.43	9.12	5.60	5.80
S&P Preferred Stock TR USD	2.23	17.44	22.05	13.06	10.52	3.69	—

ETF News

Fidelity Launches 3 Actively Managed Bond ETFs

The firm's first actively managed exchange-traded funds mirror strategies found in its mutual funds.

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On Oct. 9, Fidelity debuted its first actively managed exchange-traded funds: a trio of bond ETFs whose strategies mirror those of three of Fidelity's actively managed mutual funds.

Fidelity first filed paperwork with the SEC seeking permission to create actively managed ETFs in December 2012. Fidelity has been in the passively managed ETF space since 2003 with its Fidelity Nasdaq Composite Index Tracking Stock ONEQ, although it wasn't until October 2013 that the firm rolled out a broad set of passively managed U.S. equity sector ETFs.

Now, Fidelity is tapping its existing managers and 40 years of fixed-income research experience to manage the new lineup of actively managed ETFs. Fidelity Total Bond ETF FBND will be managed by Ford O'Neil, Pramod Atluri, and Michael Foggin. O'Neil is the lead manager of Fidelity Total Bond FTBFX, which carries a Morningstar Analyst Rating of Gold. For investors interested in a shorter-duration strategy, Fidelity Limited Term Bond ETF FLTB will be managed by Rob Galusza and David Prothro, who also manage Fidelity Limited Term Bond FJRLX. Fidelity Corporate Bond ETF FCOR will be managed by Prothro and Michael Plage, who also run Fidelity Corporate Bond FCBFX.

All three ETFs have an annual fee of 0.45%, which is a very competitive price for an actively managed bond ETF. The fees are also identical to those Fidelity levies for the Institutional share classes of these strategies in the mutual fund wrapper.

For Fidelity, the new ETFs represent an opportunity to expand these strategies' distribution, while for investors, the ETFs trade on a commission-free basis on Fidelity's brokerage platforms. Investors interested in these funds should pay close attention to the portfolios' compositions. As has been the case with PIMCO Total Return ETF BOND and PIMCO Total Return PTTRX, the Fidelity bond ETFs are not expected to be clones of the corresponding mutual funds. Instead, while the goal is to have the ETFs broadly mirror the same investment themes, it's likely that the ETF versions of those strategies will have larger issuer concentrations than the mutual funds.

Our expectation is for more activity from Fidelity in the actively managed ETF realm. In late September, Fidelity became the latest traditional mutual fund manager to file a request with U.S. regulators for permission to create nontransparent actively managed ETFs. While the SEC has yet to allow any nontransparent active ETF structure, we expect that such structures would be used for funds holding equities. Indeed, that September filing indicated that Fidelity Active ETF, which is Fidelity's first proposed actively managed nontransparent ETF, would hold common stocks.

ETF News

Source Enters the U.S. ETF Market with a Europe Blue-Chip Fund

Goldman eyes active ETFs, Direxion shutters 5 ETFs, and two unique ETPs launch.

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On Sept. 23, Source, a major exchange-traded fund issuer in Europe, launched its first U.S.-listed ETF, a passively managed fund focused on an index of Europe's largest public companies.

With a 0.16% price tag, Source EURO STOXX 50 ETF ESTX takes aim at the popular incumbent ETF SPDR EURO STOXX 50 ETF FEZ, which tracks the exact same index and charges 0.29%. The cap-weighted benchmark contains 50 blue-chip European companies from 12 developed Eurozone countries. The index tilts heaviest to financial companies, which make up about 27% of the fund's assets.

Goldman Sachs Seeks to Issue Actively Managed ETFs
Last month, Goldman Sachs GS, which issues no ETFs right now but which has had applications before the SEC to issue passively managed ETFs dating back to late 2009, filed with U.S. regulators for permission to create actively managed ETFs. Unlike a host of other would-be active ETF issuers, Goldman is not seeking nontransparent actively managed ETFs. The bank only is requesting fully transparent actively managed ETFs at this time. The bank's first actively managed ETF would be named the Goldman Sachs Equity Dividend Fund, although that may be a placeholder. The bank also is seeking SEC permission to self-index passive ETFs.

Goldman also markets indexes and issues one ETN, GS Connect S&P Enhanced Commodity Total Return GSC.

Direxion Liquidates 5 Triple-Inverse ETFs
In August, Direxion liquidated five small and thinly traded, triple-inverse "bear" ETFs that offered three times the inverse, or opposite, return of indexes covering five narrow strategies -- Brazil, Japan, South Korea, Europe, and natural gas -- but that had difficulty gaining traction with investors.

Direxion joined several other ETF issuers -- including PIMCO, iShares, and Emerging Global Advisors -- that since Aug. 1 have either liquidated or have announced plans to liquidate funds. In total, more than two dozen ETFs have been affected.

Barclays Launches 'Return on Disability' ETN
On Sept. 11, Barclays rolled out an ETN that offers the exposureto an index of 100 large-cap U.S. companies that have demonstrated efforts toward recruiting employees with disabilities, making their workplaces disability-friendly, and creating products that people with disabilities find easy to use.

Barclays Return on Disability ETN RODI, which charges 0.45%, is the latest exchange-traded product to come to market to focus on corporations' practices and attitudes toward a specific demographic group. In February, ALPS rolled out ALPS Workplace Equality ETF EQLT, which tracks an equal-weight index of companies that support workplace equality for lesbian, gay, bisexual, and transgendered employees. And in July, Barclays debuted Barclays Women in Leadership ETN WIL, which tracks an index of U.S. companies with gender-diverse executive leadership and governance.

'Deep Value' ETF Launches
Last month, ETF Series Solutions rolled out a passively managed ETF that tracks an index that identifies the 20 most undervalued, dividend-paying firms in the S&P 500 Index with positive earnings and returns on capital. Deep Value ETF DVP tracks an index developed by Tiedemann Wealth Management. The fund's advisor is Exchange Traded Concepts and its subadvisor is Mellon Capital. DVP charges 0.80%.

U.S. ETF Industry Data Dashboard

Morningstar data as of October 1, 2014

Industry Vitals	
Total # of ETPs Currently Listed	1652
ETFs	1442
Total Assets	$1,837,375,984,392
ETNs	210
Total Assets	$27,953,493,650
Total ETP Assets	$1,865,329,478,042

Active ETFs	
Actively managed ETFs	107
Total Assets	$16,998,393,739
% of total ETP assets	0.91%
New Active ETFs Launched in September	0

Coming and Going	September	YTD
New Launches	19	155
Delistings/Closures	13	51
Net Change	6	104
Pending closures	23	

Notable ETF Filings in September
- ETF Series Solutions filed for the DH Valuation-Weighted 500 ETF
- PowerShares filed for the PowerShares Russell 1000 Equal Weight Portfolio
- State Street filed for the SPDR MSCI [ACWI] Low Carbon [Target] ETF
- ETFis filed for the InfraCap REIT Preferred ETF
- IShares filed for the iShares MSCI International Developed Quality Factor ETF
- IShares filed for the iShares MSCI International Developed Momentum Factor ETF
- State Street filed for the State Street Global Managed Volatility Portfolio
- CSOP filed for the CSOP FTSE China A50 ETF
- Deutsche Bank files for Deutsche X-trackers High Yield Corporate Bond -
- Deutsche Bank filed for the Deutsche X-trackers MSCI Eurozone Hedged Equity ETF
- IShares filed for the iShares MSCI China A ETF
- ETFis filed for the BioShares Biotechnology Clinical Trials Fund and BioShares Biotechnology Products Fund

Perspective

Strategic-Beta ETFs Seeing Stars

The Morningstar Rating shows that the past performance of these funds has been solid.

3 September 2014

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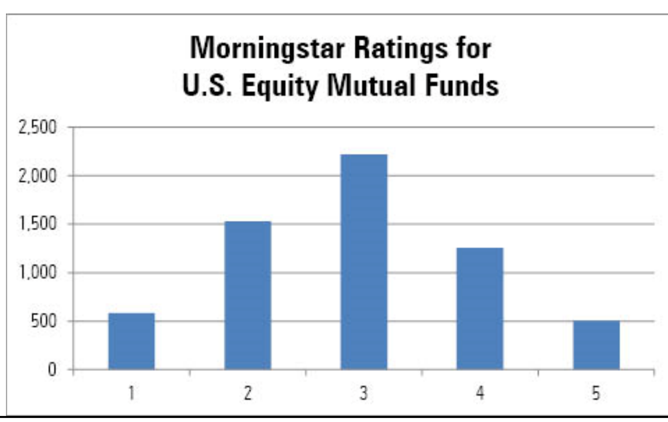
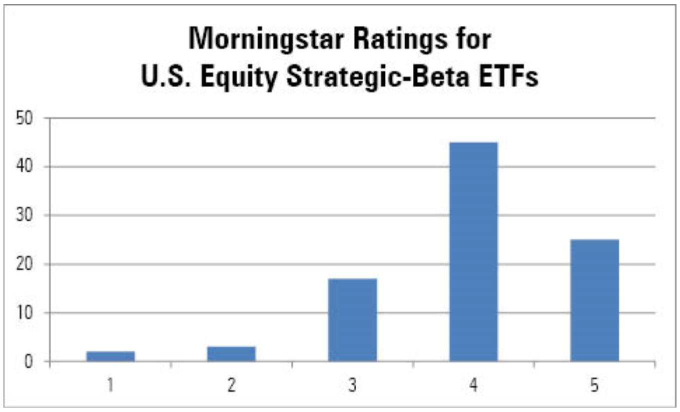
We are all familiar with the saying that past performance is no guarantee of future results. But that doesn't stop investors from picking funds this way. Before fund data became widely available and in order to facilitate meaningful comparisons, Morningstar developed a performance measure called the Morningstar Rating for funds. Unfortunately, some investors heavily rely on it when picking new funds, and investment flows consistently accrue to 4- and 5-star funds. However, the star rating is only one tool to evaluate funds, and it was not designed to have predictive ability about future performance. Certain characteristics that correlate with the rating, such as fees and risk, tend to persist, while performance is fleeting.

Given their attractive performance, strategic-beta funds--index funds that make active bets--have attracted a lot of attention. It is only natural for investors to want to evaluate a live performance record before investing rather than blindly trusting a back-test. It is common for investment consultants to wait until an active manager has at least a three-year track record before investing. Many strategic-beta exchange-traded funds now have records of more than five years, and their performance has been pretty good. The Morningstar Rating for funds is one tool investors can use to evaluate their performance. However, before we look at that rating as applied to strategic-beta ETFs, it is important to understand what it is and how it differs for ETFs and mutual funds.

The Morningstar Rating ranks funds based on risk-adjusted return compared with funds in the same Morningstar Category. Funds are given 1 to 5 stars, and the distribution of stars approximately follows a bell curve, with just 10% of funds receiving the highest 5-star or lowest 1-star ratings and 35% receiving the middle rating of 3 stars. The rating is a quantitative assessment of past performance and not an opinion about future performance. Morningstar is completely transparent with the methodology and does not have any editorial input into individual ratings. All funds with at least a three-year record are ranked, except for those in a handful of categories, such as alternative categories or categories that do not have enough funds to form a valid comparison group.

The chart below illustrates the bell-curve distribution of ratings for 6,088 share classes of 1,811 U.S. equity mutual funds. Just 29% of funds had 4- or 5-star ratings. It is important to note that ETFs are ranked separately, after mutual funds are ranked and the breakpoints are determined. This was done back when there were too few ETFs to rank among themselves. Consequently, strategic-beta ETF ratings do not have to follow a bell curve, and indeed they do not, as 63% of the 51 non-strategic-beta U.S. equity ETFs and 76% of the 92 strategic-beta U.S. equity ETFs have 4- or 5-star ratings.





The star rating is based on a ranking of the Morningstar Risk-Adjusted Return. This starts with the Morningstar Return, which is the load-adjusted return in excess of the risk-free rate. ETFs benefit because they do not charge loads while many retail share classes of mutual funds do. ETFs also benefit from lower expense ratios, which is one of the biggest determinants of relative performance. The tables below show some characteristics of funds with each rating. The average expense ratio for U.S. equity mutual funds with a rating of 1 star is 1.62% compared with 1.11% for funds rated 5 stars. The expense ratio advantage of ETFs is clear: Even the lowest-rated ETFs have lower expense ratios than the highest-rated mutual funds.

Morningstar Risk uses a risk adjustment that penalizes downside risk more than upside volatility in assigning risk scores. Lower risk values are better. On average, ETFs have less risk than the average mutual fund, but many equity mutual funds maintain a small cash position that helps to buffer downside volatility. While fully invested ETFs can make up for the higher downside risk with better upside capture, the utility function for the rating more severely penalizes downside risk. This penalty results in a higher risk and a lower ranking for many ETFs compared with mutual funds that have the same level of volatility. Morningstar Risk-Adjusted Return combines both the return and risk through a utility function with an assumed level of risk aversion appropriate for the average investor.

U.S. Equity Mutual Funds

Morningstar Rating	Average Prospectus Net Expense Ratio (%)	Average Morningstar Return 5-Year (%)	Average Morningstar Risk 5-Year (%)	Average Morningstar Risk-Adj Return 5-Year (%)
1	1.62	11.9	2.9	9.1
2	1.41	14.2	2.7	11.5
3	1.26	15.9	2.7	13.2
4	1.03	17.3	2.7	14.7
5	1.11	19.6	2.9	16.7

Source: Morningstar Direct.

U.S. Equity Strategic-Beta ETFs				
Morningstar Rating	Average Prospectus Net Expense Ratio (%)	Average Morningstar Return 5-Year (%)	Average Morningstar Risk 5-Year (%)	Average Morningstar Risk-Adj Return 5-Year (%)
1	0.48	14.7	4.7	9.9
2	0.60	15.1	3.3	11.8
3	0.36	16.1	2.6	13.5
4	0.35	17.6	2.6	15.0
5	0.42	19.2	2.4	16.8

Source: Morningstar Direct.

While past performance may not tell you everything you need to know, it can be a useful data point among others in a more comprehensive analysis. In contrast to the historical performance rating, the Morningstar Analyst Rating is based on a five-pillar framework that evaluates a fund's prospects. These pillars include Price, People, Parent, Process, and Performance. Investors should evaluate the suitability of a fund in the context of their portfolio and their investing objectives. It is also important to have a fundamental view on the economic case for the fund if it is a short-term tactical holding, rather than a long-term buy-and-hold investment.

Perspective

What Is Your Emerging-Markets Allocation?

Investors' average 3% to 4% allocation is low given the rising importance of emerging markets.

10 September 2014

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Using aggregated Morningstar fund data (which includes U.S.-domiciled equity and bond mutual funds and exchange-traded funds) as a proxy for the average U.S. investor, as of August 2014, investors have about a 3% to 4% allocation in emerging-markets equities and just less than a 1% allocation in emerging-markets debt. These weightings are in line with what we see in some of the largest world-allocation funds, such as American Funds Capital Income Builder CAIBX and BlackRock Global Allocation MDLOX. Given the rising importance of emerging-markets economies, and their faster growth rates relative to the developed world, these allocations seem a bit low.

The State of Emerging-Markets Allocations

The main argument for investing in international securities is for diversification through exposure to different countries and economies, slightly different sector weightings, and foreign currencies. Using the Morningstar Moderate Target Risk Index (a global portfolio with a 60/40 mix of stocks and bonds) as a benchmark for the average investor, a target allocation to emerging-markets equities (including stocks from Taiwan and South Korea) would be 4.5% of the value of a 60/40 stock-bond portfolio, or about 8% of the equity portion of that portfolio. This 8% allocation is slightly below a market-capitalization-based weighting, as emerging-markets equities account for 10% of the global equity market, as represented by the MSCI All-Country World Investable Market Index. Regardless of how one measures market weight, these figures are all significantly below emerging markets' collective share of global GDP, which is approximately 35%. This figure provides some perspective on the asset class' long-term growth potential.

Investors who eschew emerging-markets funds in favor of broader international-equity funds generally have a very small allocation in emerging markets. According to Morningstar fund data, foreign large-blend funds have an average 8% allocation in emerging-markets equities, which is actually slightly lower than the 10% average during the last five years. This decline is partly due to emerging markets' relative underperformance during the last few years and a reluctance to rebalance, as emerging-markets equities continue to underperform and U.S. equities continue to outperform. Within the MSCI All-Country World ex USA Investable Market Index (a cap-weighted index of stocks from 45 countries, excluding the U.S.), emerging markets account for 20%.

Investors do receive indirect exposure to growth in emerging markets via developed-world large caps, such as Apple AAPL, Nestle, and HSBC HSBC. According to MSCI, about 21% of the revenue from large- and mid-cap stocks from the developed world came from emerging markets as of December 2011, up from 10% in 2002. While emerging markets are certainly a source of revenue and earnings growth for these companies, these firms are global multinationals and are generally more correlated to developed equity markets than those in developing economies.

As for bonds, the Morningstar Moderate Target Risk Index has a 5% allocation in non-U.S. bonds, with no specific allocation to emerging-markets bonds. At this time, we estimate the average investor has about a 1% allocation in emerging-markets debt, using Morningstar fund data. Emerging-markets bonds are a rapidly evolving asset class (more details can be found in my colleague Karin Anderson's article Combing Through the Emerging-Markets Debt Category. While most investors hold emerging-markets debt funds that invest in hard-currency (U.S. dollar or euros) bonds, the local-currency bond market is actually far larger. According to Bank of America Merrill Lynch, local-currency bonds account for 86% of the total fixed-income market in the developing world. Over the long term, faster economic growth and maturing financial-services industries (investing, insurance, retirement planning) will be secular growth drivers for emerging-markets debt. However, in the near term, fickle foreign fund flows can add another dimension of risk (see my article Hidden Risks in Emerging-Markets Debt? for additional details).

A Larger Slice

Jerome Booth, who recently retired from his position as head of research at Ashmore Investment Management, recently wrote Emerging Markets in an Upside Down World. In his book, Booth lays out a series of arguments for a larger allocation to emerging markets. Many of his fundamental arguments are well known by the investment community. Emerging markets account for more than 85% of the human population and the bulk of industrial production, energy consumption, and economic growth. And though emerging markets' contribution to global GDP is currently around 35%, Booth estimates that this figure will rise to 50% during the next decade. The savers and investors of tomorrow live in emerging markets, and they will be a major driver of the growth and maturation of local capital markets.

Booth's more interesting arguments are related to his view that current allocations are a reflection of an outdated and perhaps even inaccurate view of the risks present in and the importance of emerging markets vis a vis the developed world. Emerging-markets securities are believed to carry more risks given their higher levels of observable political uncertainty and corruption, and this, to some degree, is priced into local securities markets. While the developed world also carries risks, such as financial repression and its impact on investment returns, it is possible that they may not be reflected in securities' prices, as this will likely be a very slow and almost imperceptible trend.

Booth also discusses what he calls "Core/Periphery Disease"--the belief that the core (the developed world), as a source of demand for exports and a supplier of capital, has a significant impact on the periphery (the emerging markets). In fact, the emerging world is growing more interconnected through trade and financial links, which, in the long run, could reduce the role of the U.S. dollar as a global reserve currency. And with emerging-markets central banks holding about $2 trillion of U.S. debt, any significant reduction in these holdings may impact the value of the dollar and U.S. interest rates, which in turn could have an impact on the U.S. economy.

Medalist Funds

There are 19 Morningstar Medalists among the current crop of emerging-markets equity funds. Five emerging-markets debt funds have positive Morningstar Analyst Ratings. Our positive ratings (Gold, Silver, and Bronze) indicate that our analysts expect these funds to deliver above-average performance relative to their category peers over a full market cycle.

Morningstar Medalist Emerging-Markets Equity Funds

			Morningstar Risk-Adjusted Return Quartile Rank	
	Ticker	Morningstar Analyst Rating	5-Year	10-Year
American Funds New World	NEWFX	Gold	First	First
Aberdeen Emerging Markets	ABEMX	Silver	First	—
DFA Emerging Markets Core Equity	DFCEX	Silver	Second	—
DFA Emerging Markets	DFEMX	Silver	Second	First
DFA Emerging Markets Value	DFEVX	Silver	Fourth	Second
GMO Emerging Markets	GMOEX	Silver	Third	Third
Harding Loevner Emerging Markets	HLEMX	Silver	First	First
Invesco Developing Markets	GTDDX	Silver	First	First
Lazard Emerging Markets Equity	LZOEX	Silver	First	First
Oppenheimer Developing Markets	ODMAX	Silver	First	First
Virtus Emerging Markets Opportunities	HEMZX	Silver	First	First
Acadian Emerging Markets	AEMGX	Bronze	Second	Second
Delaware Emerging Markets	DEMAX	Bronze	First	First
JPMorgan Emerging Markets Equity	JFAMX	Bronze	Third	Second
Strategic Advisers Emerging Markets	FSAMX	Bronze	—	—
T. Rowe Price Emerging Markets Stock	PRMSX	Bronze	Second	Third
Thornburg Developing World	THDAX	Bronze	—	—
Vanguard Emerging Markets Stock Index	VEIEX	Bronze	Second	Second
VY JPMorgan Emerging Markets Equity	IJEAX	Bronze	Third	Third

Source: Morningstar Direct.

Morningstar Medalist Emerging-Markets Debt Funds	Ticker	12-Month Yield (%)	Effective Duration	Tot Annualized Ret, 3-Year (%)	Analyst Rating
Hard Currency					
PIMCO Emerging Markets Bond	PEBIX	4.9	6.0	6.8	Gold
Fidelity New Markets Income	FNMIX	4.5	7.8	8.2	Silver
TCW Emerging Markets Income	TGEIX	4.8	5.7	6.5	Bronze
T. Rowe Price Emerging Mkts Bond	PREMX	5.4	5.7	5.9	Bronze
Local Currency					
PIMCO Emerging Local Bond	PELBX	4.8	4.5	0.6	Gold

Source: Morningstar Direct.

Morningstar does not provide Analyst Ratings for ETFs. However, the following funds are solid options for emerging-markets equity or emerging-markets bond exposu...

Emerging-Markets Equity ETFs	Ticker	Expense Ratio (%)	Tot Annualized Ret, 5-Yr (%)*	Tot Annualized Ret, 10-Yr (%)*
EGShares Emerging Mkts Consumer	ECON	0.84	17.6	—
iShares Core MSCI Emerging Mkts	IEMG	0.18	8.1	12.4
iShares MSCI EM Minimum Volatility	EEMV	0.25	13.4	15.6
MSCI Emerging Markets Index	—	—	7.9	12.2

Source: Morningstar Direct.
*Return data is index returns.

Emerging-Markets Debt ETFs	Ticker	12-Month Yield (%)	Effective Duration	Tot Annualized Ret, 3-Year (%)	Expense Ratio (%)
Hard Currency					
iShares JPMorgan USD EM Bond	EMB	4.4	7.1	6.1	0.60
PowerShares EM Sovereign Debt	PCY	4.3	8.7	6.9	0.50
Local Currency					
Market Vectors EM Local Curr Bond	EMLC	5.4	4.5	0.2	0.47
WisdomTree EM Local Debt	ELD	3.3	5.1	-0.6	0.55
iShares EM Local Currency Bond	LEMB	2.5	4.3	NA	0.60

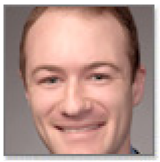
Source: Morningstar Direct.

Perspective

Performance Evaluation Tool Kit

The appropriate tools may help investors distinguish luck from skill.

1 October 2014



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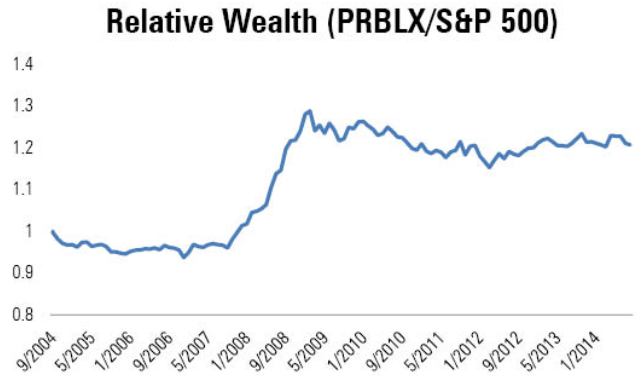
Most investors pay lip service to the idea that past performance is not indicative of future results. But it's tempting to use past performance to gauge manager skill and form expectations for the future. Unfortunately, raw performance doesn't say much about skill. An unskilled manager can outperform if he is lucky (or vice versa) or takes more risk to boost returns, which may not continue to pay off in the future. While raw performance does not tell the whole story, it is possible to uncover useful information from past performance with the appropriate tools.

Selecting the appropriate benchmark is one of the most crucial steps of performance evaluation. The benchmark should be transparent, investable, and representative of the fund's investment style. The most appropriate benchmark is not necessarily the one listed on the fund's prospectus. For example, Dodge & Cox Income's (DODIX) primary prospectus benchmark, the Barclays U.S. Aggregate Bond Index, skews more heavily toward government bonds and is not truly representative of the fund's investment style as a result. In fact, the return pattern of the Barclays U.S. Credit Index more closely fits the fund's over the past decade. Because this fund is taking more credit risk than the Barclays Aggregate Bond Index, it should earn higher returns as compensation, but that does not mean the manager is doing a good job. It is easy to take more credit risk at lower cost through a corporate-bond index fund. While it may not be possible to find a perfect benchmark, it is important to identify and control for differences in risk between the benchmark and the fund.

That still leaves the challenge of disentangling luck from skill. Because a broad index is simply the weighted average of all active investors' bets, it might be reasonable to expect close to half of all managers to outperform a representative benchmark by chance in any given year. Over longer periods, fewer managers should outperform by luck alone. But even a long record of outperformance is not sufficient evidence of skill. A fund's 10-year performance record could look great due to a handful of good--or lucky--calls in a concentrated period. For example, Parnassus Core Equity Investor's (PRBLX) 10.4% return over the trailing 10 years through August 2014 looks pretty good compared with the S&P 500's 8.4% return. But most of that superior performance was concentrated in 2008, owing to the fund's limited exposure to the financial-services industry, better stock selection in that sector, and meaningful cash balance. That positioning may have been the result of shrewd management, or merely luck.

The more consistent a fund's outperformance is, the less likely that it is due to luck. A relative wealth chart offers an effective way to gauge consistency. It shows the timing and magnitude of a fund's outperformance relative to the benchmark. An investor can create such a chart by dividing the growth of $1 invested in a fund by the growth of $1 invested in its benchmark, plotted against time. When the line is upward sloping, the fund is outperforming, and when it is downward sloping, it is underperforming. It should trend upward over time for consistent outperformers.

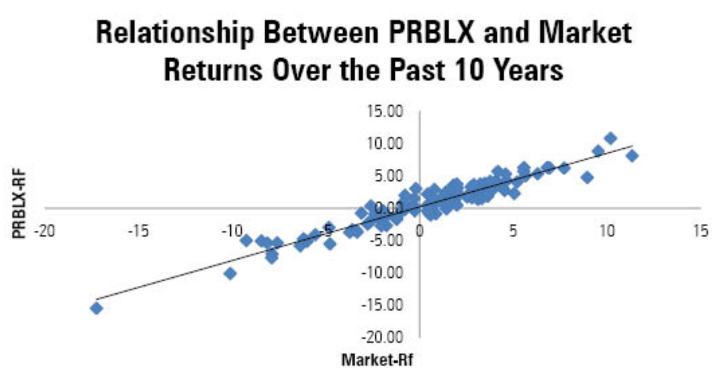
The chart on the next page clearly illustrates that nearly all of Parnassus Core Equity's outperformance relative to the S&P 500 over the past decade occurred from October 2007 through February 2009, the period leading up to and including the financial crisis.



Factor Analysis

Consistent performance is a good sign, but there are plenty of good managers who may lag for years because it can take a long time for their investment theses to play out. It may be more useful to study the underlying drivers of a fund's performance to more accurately assess skill and understand how a fund will likely behave in the future. A fund's returns can be broken into its component parts with a powerful tool known as factor analysis.

Let's start with the basics. A small portion of every fund's returns is simply compensation for the time value of money, which investors can approximate with the risk-free rate or return on short-term Treasuries. We subtract this risk-free rate from the fund's returns to account for this source of return. Its sensitivity to the market risk premium (the return on a broad index portfolio less the risk-free rate), can usually explain most of the rest. For example, there is a fairly strong relationship between the market risk premium and the returns of Parnassus Core Equity over Treasuries, as the chart below illustrates.



Drawing a best-fit line through the data allows us to estimate the fund's sensitivity to the market risk premium (the slope of the line), and whether it earned any returns above what we would expect for the level of market risk it took (the intercept). This is known as a single factor regression. The table on the next page shows an abbreviated regression output from Microsoft Excel.

In this case, the slope of the line (also called beta) was 0.83. This means that the fund increased in value 0.83% for each 1% increase in the value of the market and declined by 0.83% for each 1% decline in the value of the market. In other words, it is taking less risk. In this light, it is impressive that the fund was able to keep up with the market during the better times. This simple model attributes this feat to skill, which we infer from the positive intercept. In financial speak, this is called alpha. The p-values next to the coefficients tell us how likely that those values are different than zero due to chance. For example, the 0.05 p-value next to the intercept indicates that there is a 5% chance that this manager is actually not skilled. Generally, any coefficient with a p-value of 0.05 or less is worth paying attention to. The Adjusted R-squared indicates how well the model fit the data. This simple model explained 91% of the variance of the fund's returns.

While the market risk premium is usually the most important factor, a few investments styles can also help explain asset returns. For instance, value managers may outperform the market when value stocks are in favor, even if they are not skilled. Investors can get exposure to value stocks more cheaply through an index fund, like Vanguard Value ETF VTV. It does not make sense to give a manager credit for the returns to investment styles that investors can replicate through mechanical rules. Historically, value, small-cap, momentum, and quality (companies with high and stable profits) stocks have outpaced their counterparts with the opposite characteristics over the long run. In order to study these effects, researchers have constructed portfolios that go long stocks with each of these characteristics and short stocks with the opposing characteristics. We can add these as additional factors to the simple model described above. This allows us to create a custom best-fit benchmark that controls for a fund's style tilts. The table below illustrates the results of this multifactor regression for Parnassus Core Equity.

Multifactor Analysis

Regression Statistics				
Multiple R	0.96			
R-squared	0.92			
Adjusted R-squared	0.92			
Standard Error	1.08			
Observations	120			
	Coefficients	Std Error	t Stat	P-value
Intercept	0.12	0.10	1.18	0.24
Mkt-RF	0.91	0.04	25.66	0.00
SMB	-0.03	0.05	-0.50	0.62
HML	0.06	0.05	1.13	0.26
UMD	-0.02	0.02	-0.97	0.33
QMJ	0.20	0.07	2.94	0.00

Controlling for its exposure to quality, small-cap, value, and momentum stocks, Parnassus Core Equity has a market beta of 0.91, which indicates that it is still taking less market risk than average. The fund did not have appreciable exposure to the small-cap (SMB), value (HML), or momentum (UMD) factors, as the p-values next to these coefficients are greater than 0.05. However, it did have meaningful exposure to quality stocks (QMJ). Holding everything else constant, the fund tended to increase in value by 0.20% when high quality stocks outperformed their lower quality counterparts by 1%. But investors who simply want exposure to quality stocks could get it more cheaply and consistently through iShares MSCI USA Quality Factor (QUAL).

This quality tilt explained away some of the manager's outperformance. The intercept--the monthly return attributable to skill--has declined from 0.21% in the single factor model to 0.12%, and it is no longer statistically significant. There is a 24% chance that this "skill" was no more than luck. It is of course still economically significant, representing outperformance of 1.4% annualized.

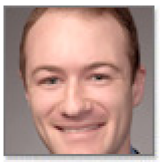
Evidence of skill and style tilts can change over time. A manager who was able to skillfully avert the worst of the financial crisis may or may not be able to do the same during the next downturn. Controlling for value, size, momentum, and quality, very few managers seem to consistently outperform. Sometimes it might make sense to get exposure to these styles through an index fund, which is likely to be cheaper. But it could still be worth hiring managers who don't show statistically significant evidence of skill, if they offer desirable style tilts that are hard to replicate.

Perspective

A Tale of Two Dividend Growth Funds

While these two funds pursue similar strategies, the active fund may have an edge over its index-based counterpart.

26 September 2014



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Expense ratios are one of the best predictors of relative fund performance. This lends support to low-cost index investing. But sometimes it can be beneficial to pay a little more for active management. Vanguard Dividend Appreciation ETF VIG and Vanguard Dividend Growth VDIGX offer an excellent case in point. Both funds target stocks with strong records of dividend growth, but where the exchange-traded fund tracks an index, Vanguard Dividend Growth applies active management to achieve the same goal. Yet despite its higher expense ratio, Vanguard Dividend Growth has outpaced its ETF counterpart by 1.3% annualized since April 2006, when Vanguard launched the ETF (and its associated mutual fund share classes).

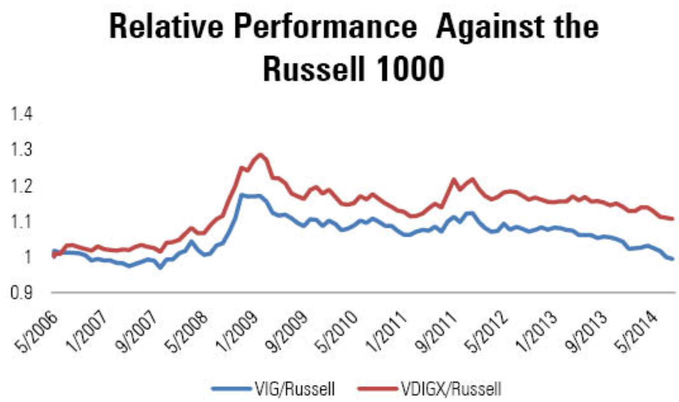
Don Kilbride, the manager of Vanguard Dividend Growth, shops for stocks that are trading at reasonable valuations with a history of dividend growth and the capacity to sustain that growth. Vanguard Dividend Appreciation attempts to replicate this strategy with mechanical rules. It simply invests in stocks that have increased their dividends in each of the past 10 years and applies some proprietary screens to filter out stocks that may not be able to continue that growth. This fund weights its holdings by market capitalization, subject to a 4% cap.

This mechanization can improve consistency over time, largely mitigating the impact of manager changes on the fund's performance. It also reduces cost. Vanguard Dividend Appreciation charges a razor-thin 0.10% expense ratio, where Vanguard Dividend Growth charges 0.31%. That's still significantly lower than most actively managed funds in the large-blend category. For the additional 21 basis points, Vanguard Dividend Growth takes qualitative considerations into account and may react to changing fundamentals in a more flexible way than the rules-based ETF can. For example, until the third quarter of 2013, both funds invested in PepsiCo PEP. But Kilbride sold his position last year over concerns about the outlook for the firm's soft-drink business and its valuation, not about the firm's dividend. Pepsi continued to raise its dividend in 2014 and so remained in Vanguard Dividend Appreciation.

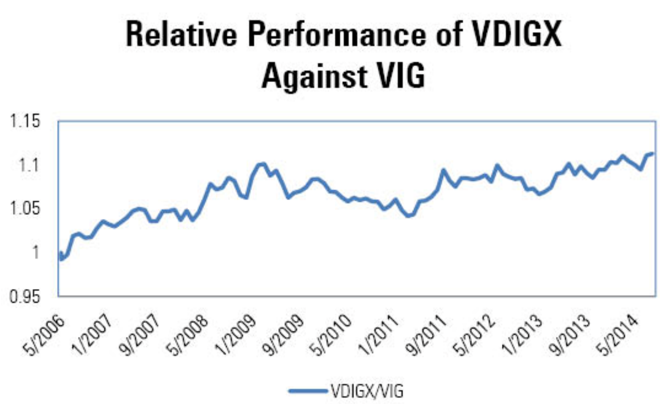
Despite their focus on dividend growth, neither of these funds offers a particularly high dividend yield. The estimated dividend yield for VIG (2%) is lower than the corresponding figure for the S&P 500 (2.3%), while Vanguard Dividend Growth offers an only slightly higher yield (2.4%). This reflects the fact that these are really more quality-oriented than they are dividend income strategies. The types of companies that can raise their dividends for 10 years running tend to enjoy sustainable competitive advantages, relatively stable businesses, and strong profitability. More than 63% of VIG's assets are invested in companies with wide economic moats, Morningstar's assessment that a firm carries a durable competitive advantage. The corresponding value for the Russell 1000 Index is 41%. Vanguard Dividend Growth boasts an even more moat-heavy portfolio--69% of its assets are invested in wide-moat companies. This may explain why these funds' holdings generated higher returns on invested capital than the average company in the Russell 1000 Index over the trailing 12 months through June.

These portfolios of quality holdings tend to exhibit less volatility and weather market downturns better than their less advantaged peers. Since May 2006, Dividend Growth and Dividend Appreciation exhibited low market betas (a measure of market sensitivity) of 0.78 and 0.82, respectively, and lower standard deviations of return than the Russell 1000 Index. They also both lost considerably less (25.6% and 26.5%, respectively) than the Russell 1000 Index (37.6%) in 2008. However, they have generally lagged during strong bull markets. That's not surprising because quality firms tend to be less sensitive to the business cycle than average and should experience smaller swings in fundamental value.

The chart below illustrates the growth of $1 invested in each of these two funds divided by the growth of $1 invested in the Russell 1000 Index. When the line is upward sloping, the corresponding fund is outperforming this index, and when it is downward sloping, the fund is lagging. While these two funds did well in 2008, they slightly trailed the market over the past five years. Historically, the protection that quality stocks offer during market downturns has more than made up for their shortfalls during better times.



Although Vanguard Dividend Growth did better than the ETF over the past several years, absolute performance comparisons do not tell the whole story. A handful of lucky trades in a concentrated period could explain superior performance over a long horizon, but it may not be reasonable to expect that outperformance to continue. Therefore, it is important to evaluate the consistency of outperformance. The chart below shows the performance of Vanguard Dividend Growth relative to Vanguard Dividend Appreciation in the same manner as described for the previous chart. Though it experienced its best period of relative performance prior to March 2009, Vanguard Dividend Growth exhibited reasonably consistent outperformance. This should give investors greater confidence that this performance edge was not merely the product of luck. Superior stock selection in the health-care sector accounted for a large portion of the fund's outperformance.



Kilbride is paid to beat Vanguard Dividend Appreciation's index. Vanguard pays Wellington, the fund's subadvisor, a management fee with a performance adjustment based on the fund's three-year performance relative to the NASDAQ U.S. Dividend Achievers Select Index, VIG's benchmark. That gives Kilbride and his colleagues a nice incentive to make meaningful active bets relative to this benchmark. Only about 42% of the fund's holdings' assets are invested in stocks that are also included in Vanguard Dividend Appreciation. It also has a more concentrated portfolio of 50 holdings. This focus allows Vanguard Dividend Growth to profit from its best ideas and look different from VIG, which includes 163 holdings. Despite its narrower portfolio, Vanguard Dividend Growth has a smaller portion of its assets invested in its top 10 holdings (27%) than does VIG (37%).

There are other notable differences between these two funds' portfolios. Vanguard Dividend Growth tilts toward larger firms relative to Vanguard Dividend Appreciation, as the table below illustrates. These firms tend to be more profitable and less volatile than their smaller counterparts. The funds' sector weightings also look a bit different. For instance, relative to the ETF, Vanguard Dividend Growth overweights the more volatile consumer cyclical and financial services sectors, and underweights consumer defensive stocks. This is partially offset by its larger stake in relatively stable health-care stocks and smaller exposure to cyclical industrial stocks. The table below summarizes some of the salient characteristics of each fund's portfolio.

	VIG	VDIGX	Russell 1000
Number of Holdings	163	50	1,000
ROIC (TTM Through 6/14)	15.4	17.7	13.5
Wide Moat (% of Assets Invested)	63	69	41
Average Market Cap ($Billion)	52	81	52
P/E Forward (as of 6/14)	17.5	17.3	17.7
Beta	0.82	0.78	1
Standard Deviation	13.6	12.9	16.1

And the Winner?

While one fund isn't categorically better than the other, Vanguard Dividend Growth has a reasonable chance of outpacing the ETF. It has a relatively modest cost hurdle to overcome and its manager is specifically incentivized to beat the index Vanguard Dividend Appreciation tracks. It also has greater flexibility to respond to changing fundamentals and take into account qualitative information that the ETF ignores. That said, Vanguard Dividend Appreciation's consistent rules-based approach may well be difficult to beat over the long term, particularly if Kilbride or any of the key analysts at Wellington leave the firm. It largely captures the essence of Vanguard Dividend Growth's strategy. Therefore, Vanguard Dividend Appreciation is a fine choice for investors who are skeptical of Kilbride's ability to consistently identify index-beating securities (or of Vanguard's ability to retain him).

ETF Spotlights

Spotlighting an Actively Managed Bond ETF That's Been Capturing Headlines and a Materials ETF

Morningstar analyst insight, plus two complimentary full-length ETF research reports.

October 6, 2014

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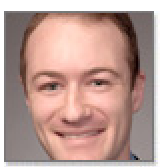
PIMCO Total Return ETF BOND

The last week of September was a bad one for PIMCO Total Return ETF BOND. On Sept. 23, The Wall Street Journal reported that the Securities and Exchange Commission was looking into whether PIMCO had been artificially boosting the exchange-traded fund's performance by buying small, illiquid mortgage bonds at discounted prices then valuing them higher using outside pricing services. Later that week, on Sept. 26, PIMCO co-founder Bill Gross announced he would be decamping to Janus JNS. PIMCO hastily promoted Dan Ivascyn to "group chief investment officer" and announced that existing PIMCO managers Mark Kiesel, Mihir Worah, and Scott Mather would take over the Total Return strategy, including this ETF.

Gross' departure came just eight months after then chief executive officer and heir apparent Mohamed El-Erian unexpectedly resigned. The two were the dominant personalities on PIMCO's Investment Committee, the body that determines the broad risk exposures of the firm's strategies. However, Ivascyn and other members of PIMCO's Investment Committee are longtime firm veterans and well-regarded. Ivascyn said he expects the firm's committee-driven process to remain intact, including the quarterly cyclical and annual secular forums it convenes to determine the firm's macroeconomic forecasts.

Although Morningstar does not assign Morningstar Analyst Ratings to ETFs, PIMCO Total Return's PTTRX was downgraded to Bronze from Gold in the aftermath of Gross' departure. Bronze is our lowest-conviction positive rating but indicates Morningstar believes the fund will outperform its category peers on a risk-adjusted basis over a full market cycle. Morningstar also maintains a positive view on the quality of the fund's new portfolio managers and its existing investing process, which is unlikely to change significantly. BOND remains a fine core bond fund.

October 2, 2014



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IShares Global Materials ETF MXI

Materials companies make the raw ingredients for nearly every product on the market. Many of these companies have significant operating leverage, which can make them sensitive to small changes in economic activity. Consequently, their performance is highly cyclical. Investors can get diversified global exposure to this sector through iShares Global Materials MXI. It invests in large-cap companies operating in the metals and mining, chemicals, paper and forest products, containers and packaging, and construction materials industries. Most of these holdings sell into commodity markets and are susceptible to cyclical demand. On the cost side, they have to contend with volatile raw-material and energy prices and high fixed costs. As a result, during the past five years, the fund was about 43% more volatile than the S&P Global 1200 Index.

This fund is appropriate for investors who are looking for a high-risk, high-reward way to position for global economic growth. It could also serve as a hedge against a declining U.S. dollar because it offers exposure to both globally priced commodities and non-dollar-denominated assets.

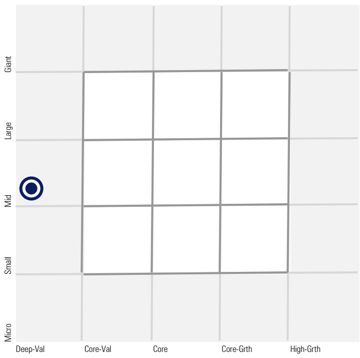
The fund's global reach allows it to own many of the low-cost metals and mining companies, including Rio Tinto RIO and Vale VALE, which are not available to U.S. materials sector funds. This gives it greater exposure to the metals and mining industry and less exposure to the chemicals industry relative to its U.S. focused counterparts. Yet, durable competitive advantages are difficult to establish in both of these industries. Less than half of the fund's assets are invested in companies with economic moats, Morningstar's assessment that a firm enjoys a sustainable competitive edge. Because of its industry concentration, this fund would be most suitable as a tactical holding in a diversified portfolio.

PIMCO Total Return ETF BOND

Overall Morningstar Rating™

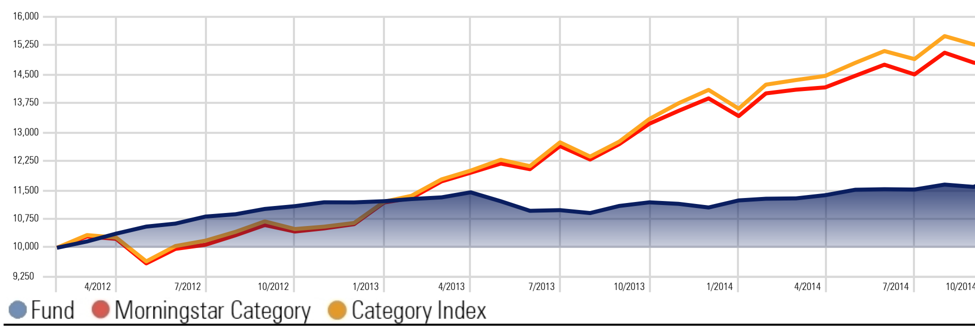
Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Intermediate-Term Bond	S&P 500 TR USD	Not Benchmarked

Style Map



Performance Since Inception - Growth of 10,000

Time Period: 3/1/2012 to 10/8/2014



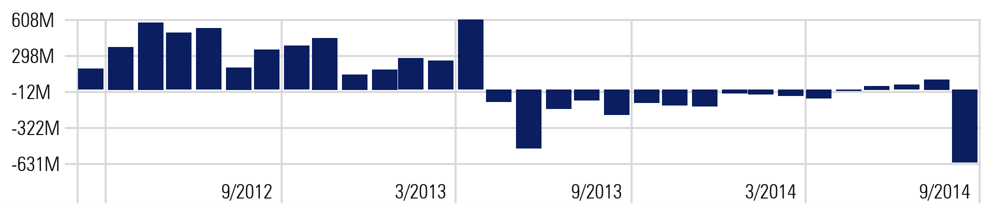
Snapshot

Inception Date	2/29/2012
Gross Expense Ratio	0.55
Assets (millions USD)	2,706
Avg Dly Vol (3 Mo)	415,295
12 Month Yield %	1.59
30-Day SEC Yield	2.54
30-Day Unsubsidized Yield	—
Portfolio Date	10/8/2014
Distribution Freq	Monthly
Exchange Traded Note	No
Replication Method	Not Applicable
Fund Lgl Structure	Open Ended Investment Company

Annual Total Returns %

*annualized returns	Inception*	2009	2010	2011	2012	2013	YTD
PIMCO Total Return ETF	5.83	—	—	—	—	-1.18	4.82
S&P 500 TR USD	17.79	26.46	15.06	2.11	16.00	32.39	8.34
US ETF Large Blend	16.26	31.32	18.48	2.91	14.90	30.72	6.87

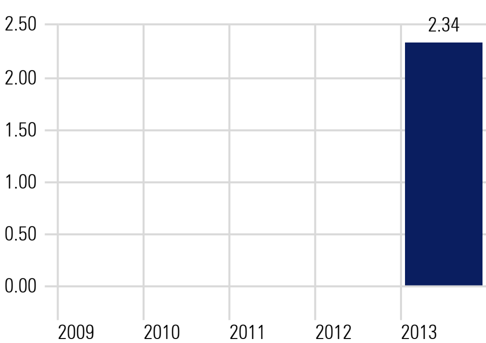
Monthly Fund Flows (millions USD)



***Performance Disclosure:** The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold, may be worth more or less than their original cost. Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call **(866) 746-2602** or visit **www.pimco.com**.*

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

Annual Income Return %



Risk/Return Analysis (3 years)

	ETF	Cat Index	Cat Avg
Standard Deviation %	—	10.57	10.71
Arithmetic Mean %	—	1.78	1.70
Sharpe Ratio	—	2.02	1.90
R-Squared	—	—	94.00
Beta	—	—	0.98
Alpha %	—	—	-0.65
Treynor Ratio	—	—	22.15
Sortino Ratio	—	4.55	4.20

Suitability

By Samuel Lee 10/6/2014

The last week of September was a bad one for PIMCO Total Return ETF BOND. On Sept. 23, The Wall Street Journal reported that the Securities and Exchange Commission was looking into whether PIMCO had been artificially boosting the exchange-traded fund's performance by buying small, illiquid mortgage bonds at discounted prices then valuing them higher using outside pricing services. Later that week, on Sept. 26, PIMCO co-founder Bill Gross announced he would be decamping to Janus. PIMCO hastily promoted Dan Ivascyn to "group chief investment officer" and announced that existing PIMCO managers Mark Kiesel, Mihir Worah, and Scott Mather would take over the Total Return strategy, including this ETF.

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BOND is run in a very similar style to the PIMCO Total Return mutual fund. Both combine PIMCO's macroeconomic views with security selection and, in theory, are allocated many of the same active bets pro rata. BOND beat its mutual fund sibling by more than 3% in its first three months in early 2012. Duri...

PIMCO Total Return ETF BOND

Overall Morningstar Rating™

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Intermediate-Term Bond	S&P 500 TR USD	Not Benchmarked

Fundamental View

PIMCO tightly manages the Total Return strategy's monthly tracking error against its benchmark, the Barclays U.S. Aggregate Bond Index, a proxy for taxable, U.S.-dollar-denominated, investment-grade bonds. Tracking error is defined as the standard deviation of the differences in returns between a portfolio and its benchmark. Total Return's tracking error since its inception in 1987 is 1.6%. Most of the time PIMCO keeps tracking error much closer to 1%, ramping up its bets dramatically when it has a high-conviction call, such as in 2008 and 2011.

PIMCO attempts to beat its benchmark by making duration, sector, currency, credit, country, and volatility bets. Many of the securities and derivatives PIMCO uses are not contained in the benchmark.

As of this writing, the Barclays U.S. Aggregate Bond Index yields a little more than 2%. Starting yield is an excellent long-term predictor of high-quality bond performance. Historically, the Barclays Aggregate has experienced de minimis credit losses and has in recent years behaved like a Treasury portfolio with some credit risk. PIMCO aims to add about 1% over this after fees, for a total nominal expected return of 3%.

Because of the multitude of tools at its disposal, PIMCO has been able to capture many different return streams and earn steady excess returns. Since inception, Total Return has beaten its benchmark by a little more than 1% annualized, for an excellent information ratio (defined as excess return over annualized tracking error) of about 0.67.

According to the fund's former manager Gross, about 0.75% of Total Return's excess returns can be attributed to three structural tilts: 1) short-duration credit risk (which has provided exceptional risk-adjusted returns historically), 2) targeting intermediate maturity bonds and "rolling down the yield curve" to earn extra capital gains, and 3) selling volatility through option sales and "bulleted" portfolios. However, in the past decade, 74% of Total Return's excess returns have come from "factor timing," a polite name for market-timing, according to an analysis by PIMCO portfolio manager Mihir Worah. In this period, much of PIMCO's outperformance came in late 2008 to early 2011, in large part driven by mortgage-backed securities it had bought during the depths of the crisis.

Because Total Return earns part of its keep by taking on more volatility and credit risk, the fund is biased to underperform when markets fall or when interest rates unexpectedly move, unless the firm has correctly anticipated these movements. In the years since the financial crisis, Total Return's active bets picked up quite a bit. It felt good when things were working, but in 2011 PIMCO made a disastrous bet against U.S. Treasuries anticipating rising rates when the second round of Federal Reserve's quantitative easing was to end. Total Return has since clamped down on its active bets, and tracking error has reverted back to historical levels.

According to PIMCO's "New Neutral" secular forecast, unveiled in May, interest rates, inflation, and growth will remain low for a long time, meaning bonds and stocks look fairly priced. As a consequence, PIMCO has ramped up allocations to credit sectors in many ...

Morningstar Fundamental Analysis

Fair Value Estimate	—
Valuation Rating	—
Price/Fair Value	—
# of Holdings Covered	—
# of Holdings	554

Economic Moat %

Wide Moat	—
Narrow Moat	—
No Moat	—

Key Fundamental Ratios

	ETF	Cat Index	Cat Avg
Net Margin %	—	14.12	15.74
Return on Equity %	—	20.97	22.01
Return on Assets %	—	8.18	9.14
Debt to Capital %	—	35.89	34.95

Value and Growth Measures

	ETF	Cat Index	Cat Avg
Price/Prospective Earnings	—	18.42	17.87
Price/Book	—	2.63	2.65
Price/Sales	—	1.75	1.95
Price/Cash Flow	—	11.24	11.42
LT Earnings Growth %	—	9.93	6.38
Sales Growth %	—	3.06	0.56
Cash Flow Growth %	—	6.32	5.68
Book Value Growth %	—	7.49	-5.85

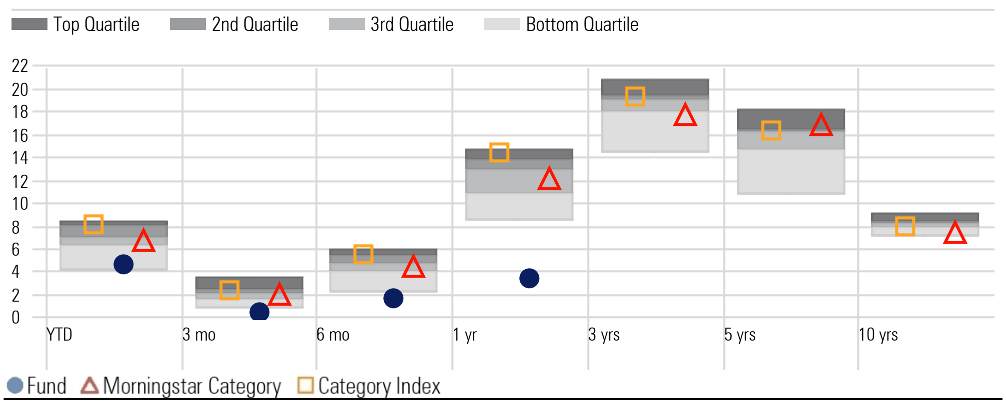
Market Performance Statistics

Time Period: 3/1/2012 to 9/30/2014

	ETF	Cat Index	Cat Avg
Up Capture Ratio %	19.48	100.00	94.90
Down Capture Ratio %	-13.16	100.00	101.36
Max Drawdown %	-4.69	-6.60	-7.03
Max Gain %	16.36	60.48	57.06
Best Month %	1.99	5.18	5.34
Worst Month %	-2.21	-6.01	-6.39

Trailing Total Returns Relative to Peer Group %

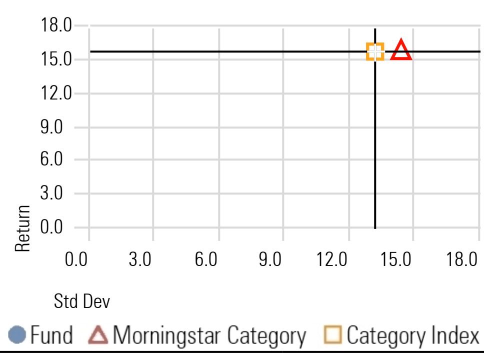
Peer Group (5-95%): Exchange Traded Funds - U.S. - Large Blend



	YTD	3 mo	6 mo	1 yr	3 yrs	5 yrs	10 yrs
PIMCO Total Return ETF	4.82	0.59	1.88	3.57	—	—	—
S&P 500 TR USD	8.34	2.54	5.64	14.47	19.40	16.43	8.01
US ETF Large Blend	6.87	2.11	4.62	12.26	17.93	16.90	7.51
Peer group rank	37	34	36	39	35	6	12
# of investments ranked in peer group	59	64	60	58	45	34	14

Risk-Reward

Time Period: 10/1/2009 to 9/30/2014



PIMCO Total Return ETF BOND

Overall Morningstar Rating™

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Intermediate-Term Bond	S&P 500 TR USD	Not Benchmarked

Portfolio Construction

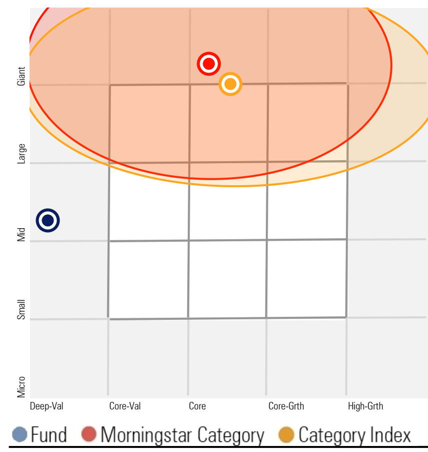
As of the end of September, BOND has an estimated yield-to-maturity of 3.6%, considerably higher than the index's 2% yield. This yield is associated with an effective duration of 5.25 years, slightly lower than benchmark Barclays US Aggregate Bond Index's 5.29 years duration. According to its prospectus, BOND will keep its duration within two years of the benchmark's and it may invest up to 10% of its total assets in junk bonds rated B or higher, 30% in foreign-currency-denominated securities, and 15% in emerging-markets securities. The fund can also own equities and equitylike securities with up to 10% of its assets. The fund can now invest in derivatives, a restriction that was recently lifted by the Securities and Exchange Commission.

BOND uses its latitude to own nonagency mortgage-backed securities, junk bonds, and Treasury Inflation-Protected Securities. It has a small net short position in cash, indicating that it is somewhat leveraged in the financial sense, but this number can over- or understate the fund's true economic riskiness.

Despite substantial outflows in all Total Return-related strategies, which have quickly moderated, most of the markets that PIMCO trades in are highly liquid and replicable with many different instruments. While there was some pressure on PIMCO's big positions by traders anticipating redemptions, we do not expect outflows to harm long-term shareholders.

	ETF	Cat Index	Cat Avg		ETF	Cat Index	Cat Avg
Avg Market Cap (mil)	—	44,425	11,725	Turnover Ratio %	577.00	—	25.14
12 Month Yield %	1.59	—	—	% Asset in Top 10	21.14	8.49	47.90
Market Price	109.28	183.41	—	# of Holdings	554	2,449	542

Holdings Based Style Map



Market Cap %

	ETF	Cat Index	Cat Avg
Giant	—	51.40	69.71
Large	—	35.72	11.14
Mid	—	12.88	16.35
Small	—	0.00	2.67
Micro	—	0.00	0.13

Equity Sector Breakdown History

Current Equity Sector Breakdown %

	ETF	Cat Index	Cat Avg
Basic Materials	—	3.36	3.76
Consumer Cyclical	—	10.34	10.58
Financial Services	—	14.74	15.48
Real Estate	—	1.99	1.70
Consumer Defensive	—	9.82	9.67
Healthcare	—	13.40	13.61
Utilities	—	2.98	2.55
Communication Services	—	4.11	3.60
Energy	—	10.61	10.40
Industrials	—	10.93	11.95
Technology	—	17.71	16.71

Top 10 Holdings

Portfolio Date: 10/9/2014

	Ticker	Portfolio Weighting %	Morningstar Rating	Total Ret YTD
NYSE/Liffe 10 Year US Treasury Note Future Dec14	—	11.07	—	—
Irs Gbp 1.500 03/18/15-2y* Cme	—	-10.94	—	—
US Treasury Note 2.5%	—	5.14	—	—
US Treasury TIP	—	3.64	—	—
US Treasury Note 2.375%	—	2.82	—	—
Ghm 2007-2x Aa 3mlib+14	—	2.20	—	—
Slm Studnt Loan Tst 03-7	—	2.07	—	—
Kbc Bank Nv Sr Sub	—	1.89	—	—
US TREASURY TIP	—	1.87	—	—
General Elec Cap Corp Mtn Be FRN	—	1.87	—	—

Equity Region %

	ETF	Cat Index	Cat Avg
North America	—	98.28	95.29
Latin America	—	0.00	0.03
Japan	—	0.00	0.18
Australasia	—	0.00	0.06
Asia Developed	—	0.10	0.24
Asia Emerging	—	0.00	0.10
United Kingdom	—	0.44	1.38
Europe Developed	—	1.18	2.59
Europe Emerging	—	0.00	0.01
Africa/Middle East	—	0.00	0.13

PIMCO Total Return ETF BOND

Overall Morningstar Rating™

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Intermediate-Term Bond	S&P 500 TR USD	Not Benchmarked

Fees

BOND charges a 0.55% expense ratio, 0.09 percentage points higher than the institutional shares of PIMCO Total Return PTTRX but still much lower than the fund's A and D share classes. BOND is a better option than most of PIMCO Total Return's noninstitutional share classes. If PIMCO maintains its historical 1% excess return, PIMCO's fee as a percentage of gross excess returns is about 30%.

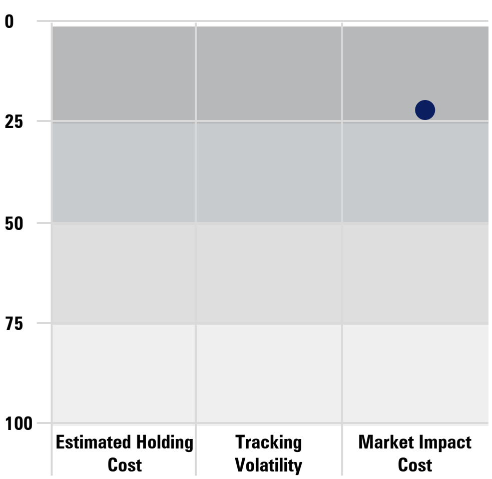
Economically, investors pay more than the 0.55% expense ratio. Bonds, for example, usually aren't sold with explicit commissions. Broker-dealers generate revenues through the bid-ask spread, the difference between the prices at which they're willing to buy (the bid) and sell (the ask) bonds. Bid-ask spreads for less-liquid bonds can be much bigger than the explicit commissions that equity investors pay. Investors also pay for swaps, which are also not reported in the expense ratio. Index funds also pay implicit costs beyond the expense ratio, though the exact magnitudes of such costs are hard to estimate.

BOND is expensive by ETF standards, but it also offers exposures to strategies and asset classes that are hard ...

Expenses

	ETF	Cat Avg
Gross Expense Ratio %	0.55	0.44
Net Expense Ratio %	0.55	0.38
Expense Waiver	—	—
Expense Waiver Expiration Date	—	—
Expense Waiver Type	—	—
Prospectus Date	9/29/2014	—

Percentile Rank Relative to ETF Universe



Total Cost Analysis Data Points

Estimated Holding Cost %	—
Tracking Volatility %	—
Market Impact Cost %	0.01

Estimated Holding Cost is essentially the difference between the ETF return and the benchmark return and represents the realized cost of replicating the benchmark. Lower costs indicate that the ETF is doing a better job of matching its benchmark while minimizing costs.

Tracking Volatility measures the uncertainty with which an ETF tracks a benchmark. A higher tracking error indicates a wider confidence interval for expected performance around the benchmark. Lower numbers and ranks are better.

Market Impact Cost represents the liquidity of the ETF and is based on the average market price movement in percent caused by a $100,000 trade in the ETF. Calculated as the residual volatility unexplained by movements in NAV and the previous day's premium or discount, scaled by average dollar volume traded. Lower numbers and ranks are better.

Alternatives

Investors are no doubt pondering whether to stick with PIMCO's flagship strategy after Gross' departure. A natural alternative is simply to own the benchmark. The biggest fund tracking it is the Vanguard Total Bond Market Index, which charges 0.20% for its investor share class (VBMFX) and 0.08% for its exchange-traded fund share class (BND). The Vanguard fund tracks a float-adjusted version of the Barclays US Aggregate Index that removes from consideration bonds held by the government. IShares Core US Aggregate Bond AGG is the second-biggest ETF tracking the index and also charges 0.08%. Both funds behave almost identically, but the Vanguard fund owns much more of the index's underlying securities. Despite Total Return's publicized woes, as of Sept. 30, BOND has beaten its benchmark since inception, over the trailing year and for the year to date.

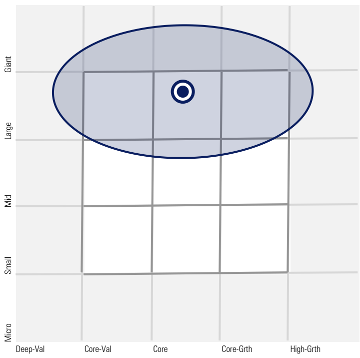
For investors seeking the potential for excess returns, the total return mandate run by Tad Rivelle's team at Metropolitan West is a good option. The team runs Metropolitan West Total Return Bond MWTIX and TCW Total Return Bond TGLMX. The two are not exact clones but offer similar exposures and return potential. The MetWest fund has a Morningstar Analyst Rating of Gold, while the TCW fund is rated Bronze. They charge 0.45% and 0.49%, respectively, for their institutional shares. Rivelle favors mortgage-backed securities, particularly those not backed by government guarantees. His substantial stake in the sector has helped drive outperformance over the past several years.

iShares Global Materials MXI

Overall Morningstar Rating™
★★

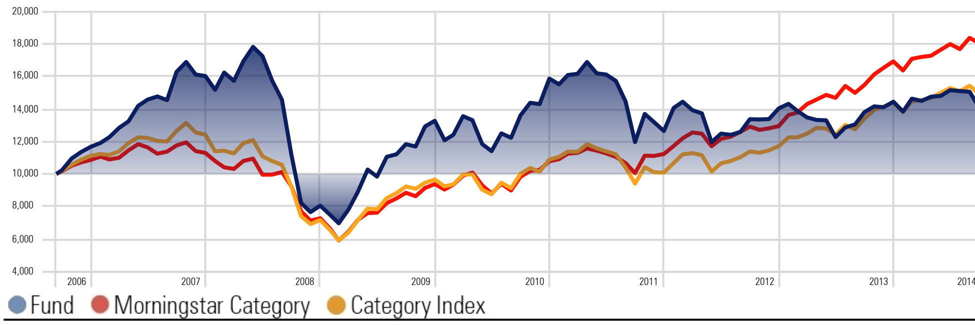
Morningstar Category	Category Index	Prospectus Benchmark
US ETF Natural Resources	S&P 500 TR USD	S&P Global 1200 Materials Sector NR USD

Style Map



Performance Since Inception - Growth of 10,000

Time Period: 9/13/2006 to 10/8/2014



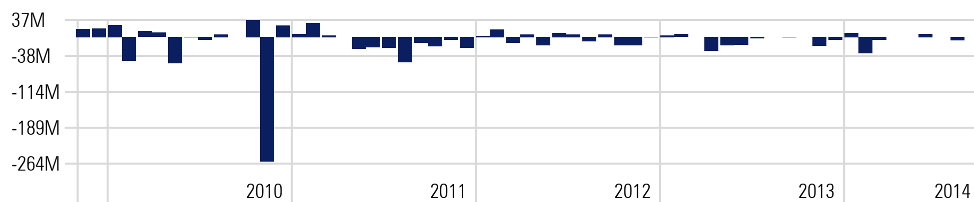
Snapshot

Inception Date	9/12/2006
Gross Expense Ratio	0.48
Assets (millions USD)	334
Avg Dly Vol (3 Mo)	22,301
12 Month Yield %	2.12
30-Day SEC Yield	—
30-Day Unsubsidized Yield	—
Portfolio Date	10/8/2014
Distribution Freq	Semi-Annually
Exchange Traded Note	No
Replication Method	Physical-Sample
Fund Lgl Structure	Open Ended Investment Company

Annual Total Returns %

*annualized returns	Inception*	2009	2010	2011	2012	2013	YTD
iShares Global Materials	4.09	64.65	19.51	-20.29	10.99	2.92	-2.31
MSCI ACWI NR USD	4.88	34.63	12.67	-7.35	16.13	22.80	3.73
US ETF Large Blend	6.97	31.32	18.48	2.91	14.90	30.72	6.87

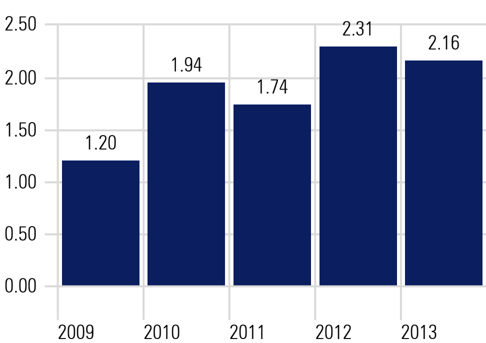
Monthly Fund Flows (millions USD)



****Performance Disclosure:*** The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold, may be worth more or less than their original cost. Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call **1-800-474-2737** or visit **www.ishares.com**.*

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

Annual Income Return %



Risk/Return Analysis (3 years)

	ETF	Cat Index	Cat Avg
Standard Deviation %	17.36	12.14	10.71
Arithmetic Mean %	0.58	1.35	1.70
Sharpe Ratio	0.40	1.33	1.90
R-Squared	78.80	—	94.00
Beta	1.27	—	0.98
Alpha %	-13.56	—	-0.65
Treynor Ratio	4.41	—	22.15
Sortino Ratio	0.64	2.43	4.20

Suitability

By Alex Bryan 10/2/2014

Materials companies make the raw ingredients for nearly every product on the market. Many of these companies have significant operating leverage, which can make them sensitive to small changes in economic activity. Consequently, their performance is highly cyclical. Investors can get diversified global exposure to this sector through iShares Global Materials MXI. It invests in large-cap companies operating in the metals and mining, chemicals, paper and forest products, containers and packaging, and construction materials industries. Most of these holdings sell into commodity markets and are susceptible to cyclical demand. On the cost side, they have to contend with volatile raw-material and energy prices and high fixed costs. As a result, during the past five years, the fund was about 43% more volatile than the S&P Global 1200 Index.

This fund is appropriate for investors who are looking for a high-risk, high-reward way to position for global economic growth. It could also serve as a hedge against a declining U.S. dollar because it offers exposure to both globally priced commodities and non-dollar-denominated assets.

The fund's global reach allows it to own many of the low-cost metals and mining companies, including Rio Tinto RIO and Vale VALE, which are not available to U.S. materials sector funds. This gives it greater exposure to the metals and mining industry and less exposure to the chemicals industry relative to its U.S. focused counterparts. Yet, durable competitive advantages are difficult to establish in both of these industries. Less than half of the fund's assets are invested in companies with economic moats, Morningstar's assessment that a firm enjoys a sustainable competitive edge. Because of its industry concentration, this fund would be most suitable as a tactical holding in a diversified portfolio.

iShares Global Materials MXI

Overall Morningstar Rating™
★★

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Natural Resources	S&P 500 TR USD	S&P Global 1200 Materials Sector NR USD

Fundamental View

The mining industry is a tough business. Miners often invest to expand capacity during commodities rallies. However, it can take years for these firms to bring additional capacity on line, by which time commodity prices may have fallen. Because of their operating leverage, miners cannot quickly adjust production as prices fluctuate. Consequently, they can offer significant upside when commodity prices are rising. But they can also expose investors to significant losses as commodity prices slide.

Chinese infrastructure development has a significant impact on the demand for industrial metals. However, Chinese demand for industrial metals may soften over the long-run, as the country starts to shift away from its investment-driven growth model. As a result of potentially weakening demand and growth in supply, Morningstar equity analysts believe that iron and copper prices may decline, which could hurt the fund's holdings in this industry.

While falling iron prices may help steelmakers' costs, they may also put similar downward pressure on steel prices. As a result, they may not have a significant impact on these firms' profitability. The steel industry has been plagued by oversupply, as growth of production and capacity, particularly in China, has outpaced demand growth. Morningstar equity analysts believe that this excess supply will continue to weigh on steel prices in the near term.

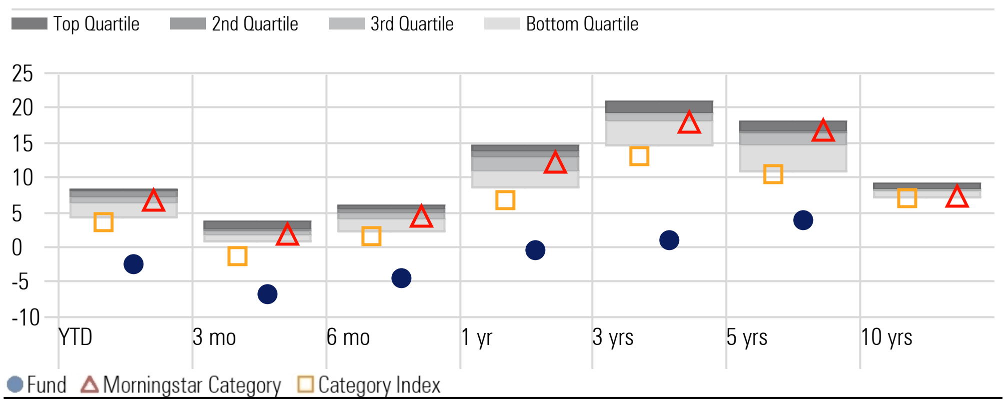
The outlook for chemical companies is a little better. Oil and natural gas prices can have a significant impact on these companies' operating costs and profitability. The shale gas boom has reduced feedstock costs for North American chemical producers relative to chemical manufacturers in Europe, which are more dependent on higher-cost naphtha (a heavy crude-based feedstock). However, industry margins could contract as chemical producers continue to add new capacity in low-cost regions. Cyclical demand also poses a challenge. In order to reduce the volatility of their earnings, some of the fund's chemical holdings are shifting toward less-cyclical, higher-margin specialty products, though most are still dependent on cyclical basic chemicals. DuPont and Dow Chemical DOW have taken steps to divest a portion of their commodity chemicals businesses. These two companies have also developed significant agricultural chemical and genetically modified seed businesses to reduce their dependence on commodity chemicals.

The fund also has exposure to the agricultural industry through pure play agriculture chemical and fertilizer makers. Crop prices can have a significant impact on demand for yield-enhancing seeds, chemicals, and fertilizer in the short term because farmers' incomes are closely tied to them. But over the long term, growth in global population and meat consumption will likely increase demand for yield-enhancing products, which should benefit these holdings.

Based on Morningstar equity analysts' fair value assessments of the fund's underlying holdings, it is trading at a price/fair value multiple of 1.01, as of this writing. Because its holdings face significant risks, it may be worthwhile to wait until the fund trades at a discount to fair value before buying.

Trailing Total Returns Relative to Peer Group %

Peer Group (5-95%): Exchange Traded Funds - U.S. - Large Blend



	YTD	3 mo	6 mo	1 yr	3 yrs	5 yrs	10 yrs
iShares Global Materials	-2.31	-6.54	-4.34	-0.34	1.03	3.90	—
MSCI ACWI NR USD	3.73	-1.11	1.65	7.02	13.10	10.60	7.08
US ETF Large Blend	6.87	2.11	4.62	12.26	17.93	16.90	7.51

Morningstar Fundamental Analysis

Fair Value Estimate	58.99
Valuation Rating	Fairly Valued
Price/Fair Value	0.99
# of Holdings Covered	80
# of Holdings	129

Economic Moat %

Wide Moat	8.19
Narrow Moat	40.36
No Moat	27.03

Key Fundamental Ratios

	ETF	Cat Index	Cat Avg
Net Margin %	8.46	13.85	15.74
Return on Equity %	13.55	17.93	22.01
Return on Assets %	5.78	6.96	9.14
Debt to Capital %	33.31	34.25	34.95

Value and Growth Measures

	ETF	Cat Index	Cat Avg
Price/Prospective Earnings	17.21	16.71	17.87
Price/Book	1.79	1.98	2.65
Price/Sales	0.99	1.35	1.95
Price/Cash Flow	8.77	9.78	11.42
LT Earnings Growth %	11.48	10.71	6.38
Sales Growth %	-2.98	-17.37	0.56
Cash Flow Growth %	3.86	4.10	5.68
Book Value Growth %	3.28	-21.04	-5.85

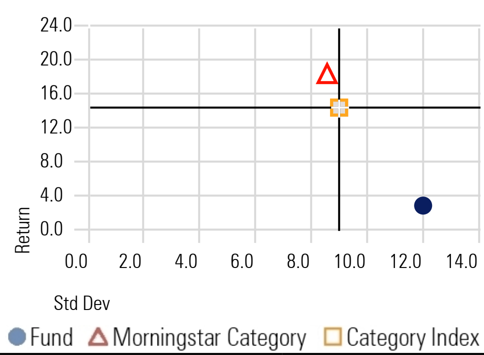
Market Performance Statistics

Time Period: 10/1/2006 to 9/30/2014

	ETF	Cat Index	Cat Avg
Up Capture Ratio %	121.00	100.00	97.87
Down Capture Ratio %	127.90	100.00	88.36
Max Drawdown %	-60.82	-54.92	-54.30
Max Gain %	141.89	160.44	229.02
Best Month %	15.35	11.80	13.46
Worst Month %	-26.62	-19.82	-19.00

Risk-Reward

Time Period: 10/1/2012 to 9/30/2014



iShares Global Materials MXI

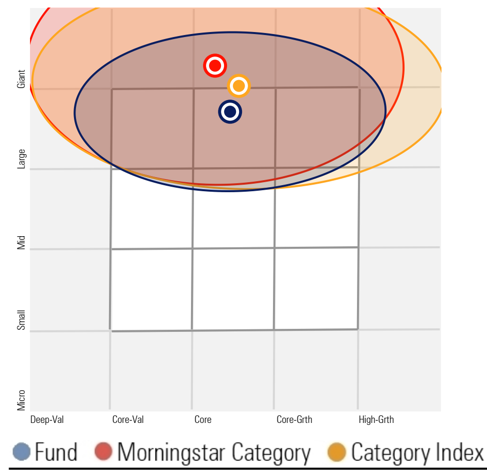
Overall Morningstar Rating™
★★

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Natural Resources	S&P 500 TR USD	S&P Global 1200 Materials Sector NR USD

Portfolio Construction

The fund employs full replication to track the float-adjusted, market-cap-weighted S&P Global 1200 Materials Sector Index. This benchmark includes all the stocks in the materials sector (based on the Global Industry Classification Standard) in the S&P Global 1200 Index, which captures approximately 70% of the world's market capitalization. This sweeps in more than 100 stocks. The top-10 holdings account for about 35% of the fund's assets. Top country weights belong to the United States (35%), United Kingdom (13%), Australia (8%), and Japan (8%). However, many of the fund's holdings have global operations, so these country weights are not necessarily indicative of the fund's geographic exposure. Chemicals companies represent approximately half of the portfolio, metals and mining (38%), construction materials (5%), containers and packaging companies (3%), and paper and forest products (2%). Like most of its peers, MXI does not hedge its currency exposure.

Holdings Based Style Map

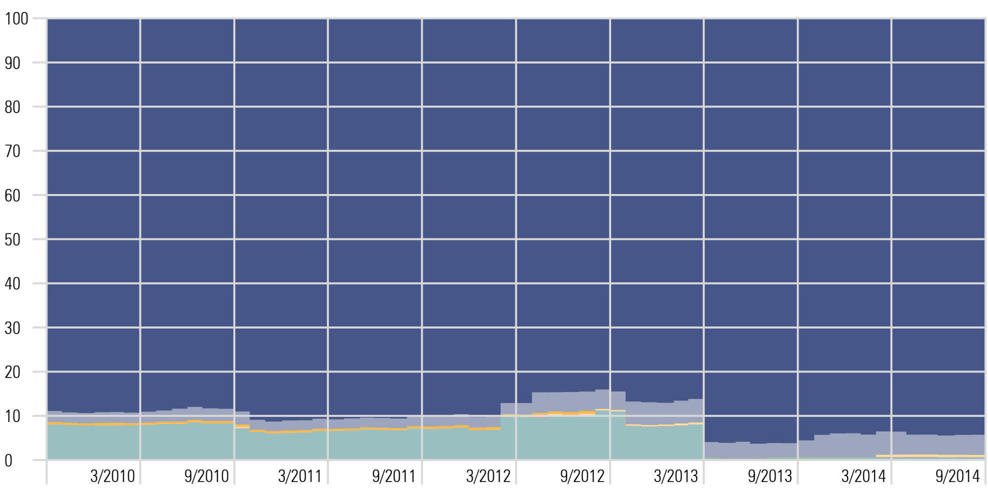


	ETF	Cat Index	Cat Avg		ETF	Cat Index	Cat Avg
Avg Market Cap (mil)	26,220	44,425	97,838	Turnover Ratio %	13.00	—	21.31
12 Month Yield %	2.12	—	—	% Asset in Top 10	34.50	8.49	46.79
Market Price	57.11	183.41	—	# of Holdings	129	2,449	476

Market Cap %

	ETF	Cat Index	Cat Avg
Giant	28.25	52.58	69.71
Large	58.45	34.46	11.14
Mid	13.29	12.82	16.35
Small	0.00	0.07	2.67
Micro	0.00	0.07	0.13

Equity Sector Breakdown History



Current Equity Sector Breakdown %

	ETF	Cat Index	Cat Avg
Basic Materials	94.34	6.31	3.76
Consumer Cyclical	4.32	10.39	10.58
Financial Services	0.00	19.06	15.48
Real Estate	0.00	2.81	1.70
Consumer Defensive	0.00	9.61	9.67
Healthcare	0.61	10.72	13.61
Utilities	0.00	3.20	2.55
Communication Services	0.00	4.94	3.60
Energy	0.00	9.85	10.40
Industrials	0.72	10.32	11.95
Technology	0.00	12.78	16.71

Top 10 Holdings

Portfolio Date: 10/9/2014

	Ticker	Portfolio Weighting %	Morningstar Rating	Total Ret YTD
BHP Billiton Ltd	BHP	5.39	★★★★	-13.75
Basf SE	BAS	4.57	★★★	-17.52
E I du Pont de Nemours & Company	DD	3.53	★★★	5.71
Rio Tinto PLC	RIO	3.51	★★★	-11.63
Glencore PLC	GLEN	3.30	★★	0.65
BHP Billiton PLC	BLT	3.26	★★★★	-11.93
Monsanto Co	MON	3.24	★★★★	-6.07
Dow Chemical Co	DOW	3.10	★★★	11.13
LyondellBasell Industries NV	LYB	2.41	—	26.03
Air Liquide SA	AI	2.36	★★★	-14.95

Equity Region %

	ETF	Cat Index	Cat Avg
North America	38.94	52.11	95.29
Latin America	3.01	1.97	0.03
Japan	7.83	7.57	0.18
Australasia	9.55	2.99	0.06
Asia Developed	4.21	4.80	0.24
Asia Emerging	0.00	3.70	0.10
United Kingdom	14.43	8.10	1.38
Europe Developed	22.04	16.64	2.59
Europe Emerging	0.00	0.95	0.01
Africa/Middle East	0.00	1.18	0.13

iShares Global Materials MXI

Overall Morningstar Rating™
★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Natural Resources	S&P 500 TR USD	S&P Global 1200 Materials Sector NR USD

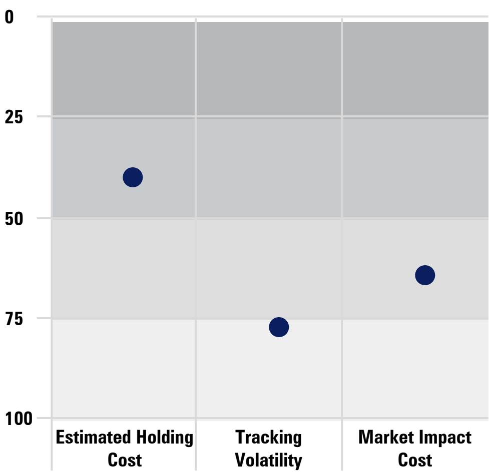
Fees

MXI's 0.48% expense ratio is comparable to similar international-sector funds. BlackRock engages in securities lending, the practice of lending out the fund's underlying shares in exchange for a fee. It passes 75% of the gross proceeds to investors, which partially offsets the fund's expenses. Over the past three years, the fund lagged its benchmark by 0.28% annualized, less than the amount of its expense ratio.

Expenses

	ETF	Cat Avg
Gross Expense Ratio %	0.48	0.41
Net Expense Ratio %	0.48	0.36
Expense Waiver	—	—
Expense Waiver Expiration Date	—	—
Expense Waiver Type	—	—
Prospectus Date	7/31/2014	—

Percentile Rank Relative to ETF Universe



Total Cost Analysis Data Points

Estimated Holding Cost %	0.22
Tracking Volatility %	0.65
Market Impact Cost %	0.05

Estimated Holding Cost is essentially the difference between the ETF return and the benchmark return and represents the realized cost of replicating the benchmark. Lower costs indicate that the ETF is doing a better job of matching its benchmark while minimizing costs.

Tracking Volatility measures the uncertainty with which an ETF tracks a benchmark. A higher tracking error indicates a wider confidence interval for expected performance around the benchmark. Lower numbers and ranks are better.

Market Impact Cost represents the liquidity of the ETF and is based on the average market price movement in percent caused by a $100,000 trade in the ETF. Calculated as the residual volatility unexplained by movements in NAV and the previous day's premium or discount, scaled by average dollar volume traded. Lower numbers and ranks are better.

Alternatives

MXI is currently the only global materials sector ETF available with good liquidity. However, there are a few U.S. materials sector alternatives, including Materials Select Sector SPDR XLB (0.16% expense ratio), Vanguard Materials ETF VAW (0.14% expense ratio), and iShares US Basic Materials IYM (0.45% expense ratio). These funds offer greater exposure to the chemicals industry and less exposure to the metals and mining industry relative to MXI. Of these three U.S. focused funds, we prefer XLB and VAW over the more expensive IYM. XLB is the most-liquid materials sector ETF available. It invests in every materials company in the S&P 500 Index, which gives it a more highly concentrated portfolio than MXI. VAW and IYM climb further down the market-cap ladder and offer broader portfolios than XLB. Because small-cap companies in this sector tend to lack competitive advantages, these two funds have historically have been a little more volatile than XLB.

Investors looking for broad commodity-linked equity exposure might also consider a natural-resources fund, such as SPDR S&P Global Natural Resources ETF GNR (0.40% expense ratio). GNR tracks the world's 90 largest stocks in the energy, agriculture, and metals and mining industries. In order to improve diversification, it allocates a third of the portfolio to each sector.

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