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# Construction Rules for the Morningstar<sup>®</sup> US Dividend Growth Index<sup>SM</sup>

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## Morningstar Indexes

April 2014

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### Overview

The Morningstar<sup>®</sup> US Dividend Growth Index<sup>SM</sup> is designed to provide exposure to U.S.-based securities with a history of uninterrupted dividend growth. The index is a subset of the Morningstar US Market Index, a broad market index representing 97% of U.S. equity market capitalization. It is a benchmark consisting of securities that:

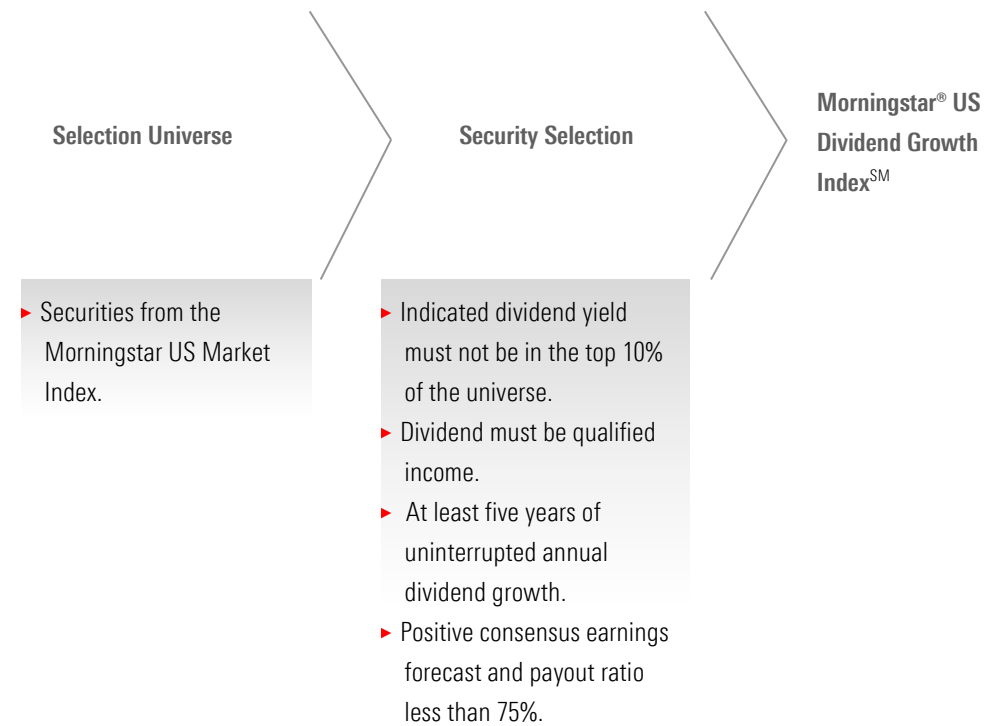
- (i) pay qualified dividends.
- (ii) are screened for a minimum of five years of uninterrupted annual dividend growth.
- (iii) have a significant margin to continue growing dividends.

### Index Inception Date and Performance Inception Date

The inception date of the index is April 7, 2014, and the performance inception date of the index is December 19, 2003, when the first back-tested index value was calculated.

## Index Construction

**Exhibit 1** Morningstar US Dividend Growth Index Construction Process



For additional details, refer to the "Assigning Stocks to the Index" section.

### Assigning Stocks to the Index

#### Selection Universe

At each reconstitution, securities for the Morningstar US Dividend Growth Index are derived from the Morningstar US Market Index (benchmark). For more details on benchmark construction, refer to the construction rules of the [Morningstar US Market Index](#).

#### Security Selection

To be eligible for the index, all constituents must meet the following criteria in sequence:

- ▶ Security's dividend must be qualified income; for example, real estate investment trusts are excluded.
- ▶ Security's indicated dividend yield must not be in the top 10% of the universe, defined by the above criteria. Indicated dividend yield is calculated by taking the product of the most recent dividend per share paid and the announced frequency divided by the current price.
- ▶ Security must have a positive consensus earnings forecast and a payout ratio less than 75%. Payout ratio is forward-looking and calculated by the forward 12-month indicated dividend divided by the forward 12-month consensus earnings per share forecast.

- ▶ Security must be currently paying dividends and have at least five years of uninterrupted annual dividend growth; dividend growth condition is considered met if either the current annualized dividend rate or the trailing 12 months aggregated dividend increased from the previous to the current reconstitution date.
- ▶ In the case of a spin-off, the spun-off company will remain in the index, but will require continued dividend growth starting with the next year. The parent company will not require dividend growth in the spin-off year where "year" is the 12-month period between annual index reconstitutions.
- ▶ If a current index constituent fails to raise its dividend but does not decrease its dividend and executes share repurchases in the preceding 12 months, resulting in a net decrease in its shares outstanding, the constituent will remain in the index.

### **Number of Stocks**

The number of stocks in the index is subject to the selection and eligibility criteria at the time of reconstitution.

### **Index Weighting**

The index is indicated dividend dollar weighted with 5-3-50 capping. For more details, refer to the [Morningstar Indexes Calculation Methodology rulebook](#).

## **Index Maintenance and Calculation**

### **Scheduled Maintenance**

The index is reconstituted annually and implemented after the close of business on the third Friday of December and effective the following Monday. If Monday is a holiday, reconstitution is effective on the immediate following business day. The market data used for reconstitution is as of the last trading day of November.

The index is rebalanced quarterly and implemented after the close of business on the third Friday of March, June, September, and December and is effective the following Monday. If Monday is a holiday, rebalancing is effective on the immediate following business day. The market data used for rebalancing is as of the last trading day of February, May, August, and November.

### **Note**

- ▶ Because the reconstitution of the Morningstar US Dividend Growth Index is less frequent than the parent index, the securities excluded from the parent index at the reconstitution effective date would also be deleted from the Morningstar US Dividend Growth Index.
- ▶ Refer to Appendix 1 for details on reconstitution and rebalancing.

### **Corporate Action**

The treatment of corporate actions can be found in the [Morningstar Indexes Corporate Actions Methodology rulebook](#).

### **Index Calculation and Price Data**

Details about index calculations and price data can be found in their respective rulebooks: [Morningstar Indexes Calculation Methodology](#) and [Equity Closing Prices Used for Index Calculation](#).

### **Methodology Review and Index Cessation Policy**

The index methodology is continually reviewed to ensure it achieves all stated objectives. These reviews take into account corporate action treatment, selection, and maintenance procedures. Subscribers to the index will be notified before any methodology changes are made. For more details, refer to the [Morningstar Index Methodology Change Process](#).

Morningstar also notifies all subscribers and stakeholders of the index that circumstances might arise that require a material change to the index, or a possible cessation of the index. Circumstances that could lead to an index cessation include, but are not limited to, market structure change, product definition change, inadequate supply of data, insufficient revenue associated with the index, insufficient number of clients using the index, and/or other external factors beyond the control of the Morningstar Index Committee.

Because the cessation of the index or benchmark index could disrupt subscriber products that reference this index, all subscribers are encouraged to have robust fallback procedures if an index is terminated. For more details, refer to the [Morningstar Index Cessation Process](#).

### **Data Correction and Precision**

#### **Intraday Index Data Corrections**

Commercially reasonable efforts are made to ensure the accuracy of data used in real-time index calculations. If incorrect price or corporate action data affect index daily highs or lows, they are corrected retroactively as soon as is feasible.

#### **Index-Related Data and Divisor Corrections**

Incorrect pricing and corporate action data for individual issues in the database will be corrected upon detection. In addition, an incorrect divisor of an index, if discovered within five days of its occurrence, will always be fixed retroactively on the day it is discovered to prevent an error from being carried forward. Commercially reasonable efforts are made to correct an older error subject to its significance and feasibility.

For more details, refer to the [Recalculation Guidelines](#).

#### **Computational and Reporting Precision**

For reporting purposes, index values are rounded to two decimal places and divisors are rounded to appropriate decimal places.

## Appendixes

### Appendix 1: Glossary

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Terms	Description
<b>Reconstitution</b>	During each reconstitution, the steps mentioned in the index construction process are performed, resulting in membership reset.
<b>Rebalance</b>	During each rebalancing, the weights are adjusted for updated free-float and shares outstanding data.

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**About Morningstar, Inc.**

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. Morningstar offers an extensive line of products and services for individual investors, financial advisors, asset managers, and retirement plan providers and sponsors. Morningstar provides data on approximately 510,000 investment offerings, including stocks, mutual funds, and similar vehicles, along with real-time global market data on more than 17 million equities, indexes, futures, options, commodities, and precious metals, in addition to foreign exchange and Treasury markets. Morningstar also offers investment management services through its investment advisory subsidiaries.

**About Morningstar Indexes**

Morningstar® Indexes combine the science and art of indexing to give investors a clearer view into the world's financial markets. Our indexes are based on transparent, rules-based methodologies that are thoroughly back-tested and supported by original research. Covering all major asset classes, our indexes originate from the Morningstar Investment Research Ecosystem—our network of accomplished analysts and researchers working to interpret and improve the investment landscape. Clients such as exchange-traded fund providers and other asset management firms work with our team of experts to create distinct, investor-focused products based on our indexes. Morningstar Indexes also serve as a precise benchmarking resource.

**Morningstar Index Committee**

The [Morningstar Index Committee](#) is currently comprised of senior officials who possess the appropriate levels of knowledge in relation to Indexes. A wide array of business groups are represented to allow for a broad voice to be heard and for a wider view to be expressed in evaluating all subjects brought up during Committee meetings. The Committee seeks to create indexes of the highest quality that meet the recognized qualities of a good benchmark.

**For More Information**

For any queries, reach out to us via our [communication page](#).



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