Vanguard REIT Index ETF VNQ

Analyst Favorite ✔

Valuation	Last Price	Fair Value	Consider Buy	Consider Sell	Morningstar Rating	Expense Ratio	Coverage Rate	Volume	Category
Fairly Valued	57.39	52.06	41.50	63.29	★★★	0.13%	73%	1,824,893	Real Estate

Per share prices in USD

Vanguard REIT Index ETF is the lowest-priced fund for broad exposure to REITs.

by Morningstar Analyst

Pricing data through April 13, 2011
Rating updated April 13, 2011

Thesis 01-26-11 | Timothy Strauts

Suitability

Vanguard REIT Index ETF is the lowest-priced fund for broad exposure to publicly traded real estate investment trusts. REITs offer investors the ability to invest in a traditionally illiquid asset class--real estate--and receive stocklike returns with bondlike income streams. As many investors know, real estate can serve as a hedge against inflation through both asset appreciation and rising rents. While some investment professionals believe real estate should stand as a separate asset class with a 5% to 10% allocation within an average portfolio, we think a REIT fund is suitable as part of an equity allocation within a portfolio for most investors.

Over the past two decades, REITs were considered to be a source of diversification within a portfolio, demonstrated by their relative price stability, good dividend yields, and low correlation with equities. However, these positive qualities did not hold up during the recent financial and credit crisis. Thanks to a long period of low interest rates, REITs amassed significant amounts of debt to grow and boost returns. Not surprisingly, these highly leveraged REITs found themselves in a perilous position when the credit crisis and economic downturn set in. In 2007 and 2008, REIT stocks, in aggregate, lost more than half of their value, and over the past three years, the volatility of REIT stocks was more than double that of the S&P 500. In one of the worst bear markets in history, investors seeking diversification in REITs realized worse performance. The sector has rebounded strongly in the last two years but it is still well below the bubble peaks of late 2007.

There are unique tax implications of owning REITs in a taxable account. Typically, qualified dividends, such as cash dividends from common equities, are taxed up to 15% (at least through 2010). However, for REITs, a portion of a REIT dividend is subject to ordinary tax treatment up to the maximum rate of 35%. This is because REITs do not pay taxes at the operating level, so the tax burden is fully passed on to shareholders.

Fundamental View

Since the March 2009 low, real estate has been one of the best-performing sectors in the S&P 500, which is clearly evident in VNQ's 166% price rise. This outstanding market performance is not the result of fantastic fundamental growth; this is merely the recovery of a sector that was priced for bankruptcy. Even after the recent strong performance, VNQ would still need to rise 53% to reach its value in February 2007.

From the perspective of our equity analysts, VNQ remains overvalued. The current price/fair value of the portfolio is 1.12, while the S&P 500 has a price/fair value of only 0.95. The price/earnings ratio of VNQ is 41, which is the highest it has been in the past five years. The growth prospects of REITs are limited in the current economic environment. Ongoing high levels of unemployment and weak residential real estate prices continue to negatively affect retail, industrial, and office rents and occupancy rates.

In the long run, we think it will be difficult for REITs to perform as strongly as they did prior to the recent financial crisis. During the past decade, REITs benefited from increasing leverage, lower borrowing rates, rising property values, and strong growth in demand for properties. Looking forward, it is unlikely REITs will enjoy so many positive trends at the same time. And while interest rates remain low at this time, rates will eventually rise, and this will increase REITs' cost of capital, pressure asset values, and reduce cash flow. We think that investors looking to diversify a stock and bond portfolio should carefully consider these factors before looking to invest in a REIT ETF.

Portfolio Constructions

This ETF tracks the MSCI US REIT Index, which is a cap-weighted index and covers approximately two thirds of the U.S. REIT market. The fund holds about 100 names. This fund is fairly top-heavy, with the top 10 firms comprising more than 43% of total net assets. Top-three holdings include retail REIT Simon Property Group , office and retail REIT Vornado Reality Trust , and self-storage REIT Public Storage . Main subsector weightings are specialized REITs (27%--about half of this is health care), retail REITs (26%), and office REITs (16%). This index does not include mortgage REITs.

Fees

This fund's expense ratio of 0.13% is the lowest relative to similar U.S. REIT ETFs.

Alternatives

In addition to VNQ, there are three other large U.S. REIT and real estate funds. Overall, these four ETFs have very similar top 10 holdings and highly correlated share performance. IShares Dow Jones U.S. Real Estate Index is by far the most liquid of the group, but it is the most expensive with a management fee of 0.47%. IYR has the broadest portfolio of the four competing funds, as it holds timberland and mortgage REITs as well as real estate operating companies that are not REITs, whereas VNQ does not. IShares Cohen & Steers Realty Majors Index is a more concentrated ETF that holds only 30 of the largest and most liquid REIT companies. Given the current challenging operating environment for real estate firms, our favorite ETF in the REIT category is currently ICF, which has a higher-quality portfolio. More than two thirds of this fund's holdings are considered narrow-moat companies. ICF has a management fee of 0.35%. Finally, there is SPDR Dow Jones REIT ETF , which carries a management fee of 0.25%.

For investors looking for broad international (ex-U.S.) real estate exposure, we recommend the following funds. SPDR Dow Jones International Real Estate ETF is the largest and most liquid in the category but is the most expensive with a 0.59% management fee. Other similar options include iShares FTSE EPRA/NAREIT Developed Real Estate ex-U.S. Index and iShares S&P Developed ex-U.S. Property Index . Both of these funds carry a management fee of 0.48%. Broadly speaking, international real estate ETFs have significantly lower trading volumes than the U.S.-based real estate funds, so we advise investors to take that into consideration before placing any trades.

Bulls Case

- In a benign economy, REITs offer investors the potential toreceive stocklike returns with bondlike income streams.
- VNQ has the lowest expense ratio relative to similar real estate ETFs.
- This fund holds a number of REIT companies with high-quality assets. About 55% of the holdings of this fund have a narrow moat rating.

Bears Case

- A rise in long-term interest rates would increase REITs' cost of capital, pressure asset values, and reduce cash flow.
- REITs tend to be highly leveraged firms, which can be a source of risk, especially in an economic downturn.
- REIT correlations with the S&P 500 have steadily increased in the past decade. We question whether

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Fairly Valued	57.39	52.06	41.50	63.29	★★★	0.13%	73%	1,824,893	Real Estate

Per share prices in USD

REITs will provide meaningful diversification benefits over the longer term.

Release date 03-31-2011

Vanguard REIT Index ETF (USD)

Overall Morningstar Rtg™	Prem/Discount	Mkt Price	Morningstar Cat
★★★ 12 Real Estate	—	58.47	Real Estate

Performance 03-31-2011

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2009	-32.03	29.91	34.60	9.17	29.75
2010	10.07	-3.97	13.17	7.42	28.50
2011	6.47	—	—	—	6.47

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Std Mkt 03-31-2011	—	—	—	—	—
Std NAV 03-31-2011	28.50	—	3.22	—	6.88
Mkt Total Ret	24.24	3.00	1.79	—	7.63
NAV Total Ret	24.30	3.04	1.78	—	7.64
+/- S&P 500 TR	8.66	0.68	-0.85	—	—
+/- DJ US Select REIT	-0.14	1.56	1.12	—	—
% Rank Cat	57	10	1	—	
No. in Cat	15	12	4	—	

Performance Disclosure

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.

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 or redeemed, 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 800-662-7447 or visit www.vanguard.com.

Fees and Expenses

Fund Expenses

Management Fees %	0.09
Expense Ratio %	0.13
12b1 Expense %	NA

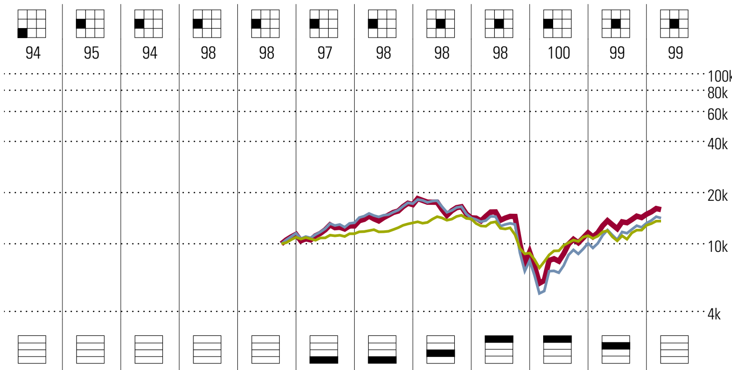
Risk and Return Profile

	3 Yr 12 funds	5 Yr 4 funds	10 Yr 2 funds
Morningstar Rating™	3★	3★	—
Morningstar Risk	+Avg	+Avg	—
Morningstar Return	+Avg	Avg	—

	3 Yr	5 Yr	10 Yr
Standard Deviation NAV	39.84	32.62	—
Standard Deviation MKT	39.65	32.52	—
Mean NAV	3.04	1.78	—
Mean MKT	3.00	1.79	—
Sharpe Ratio	0.27	0.16	—

MPT Statistics NAV	Standard Index S&P 500 TR	Best Fit Index DJ US Select REIT TR USD
Alpha	4.24	1.23
Beta	1.51	0.96
R-Squared	69.16	99.96

12-Month Yield	3.30%
30-day SEC Yield	5.11%
Potential Cap Gains Exp	—



Investment Style
Equity
Stock %

Growth of $10,000

- Vanguard REIT Index ETF: 15,877
- Cat Avg: Real Estate: 14,162
- Index: S&P 500 TR: 13,593

Performance Quartile
(within category)

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	03-11	History
—	—	—	—	—	11.96	33.59	-16.51	-37.06	30.07	28.43	6.34	Mkt Total Ret %
—	—	—	—	—	12.01	33.49	-16.40	-37.04	29.75	28.50	6.47	NAV Total Ret %
—	—	—	—	—	7.10	17.69	-21.89	-0.04	3.29	13.44	0.55	+/- S&P 500 TR
—	—	—	—	—	-1.81	-2.49	1.16	2.16	1.30	0.43	-0.22	+/- DJ US Select REIT
—	—	—	—	—	75	100	60	19	17	46	—	% Rank Cat
—	—	—	—	—	5	5	6	12	13	14	16	No. of Funds in Cat
—	—	—	—	*0.06*	0.02	0.01	0.01	0.11	-0.17	0.03	—	Avg Prem/Discount %

Portfolio Analysis 12-31-2010

Asset Allocation %	Net %	Long %	Short %
Cash	0.56	0.56	0.00
US Stocks	99.44	99.44	0.00
Non-US Stocks	0.00	0.00	0.00
Bonds	0.00	0.00	0.00
Other/Not Clsfd	0.00	0.00	0.00
Total	100.00	100.00	0.00

Equity Style

Value Blend Growth
Large
Mid
Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	41.8	2.59	1.23
P/C Ratio TTM	—	—	—
P/B Ratio TTM	2.1	0.95	5.09
Geo Avg Mkt Cap $mil	5584	0.11	0.66

Fixed-Income Style

Ltd Mod Ext
High
Med
Low

Avg Eff Duration	—
Avg Eff Maturity	—
Avg Credit Quality	—
Avg Wtd Coupon	—
Avg Wtd Price	—

Credit Quality Breakdown —	Bond %
AAA	—
AA	—
A	—
BBB	—
BB	—
B	—
Below B	—
NR/NA	—

Regional Exposure	Stock %	Rel S&P 500 TR
Americas	100.0	1.00
Greater Europe	0.0	0.00
Greater Asia	0.0	—

Share Chg since 09-2010	Share Amount	Holdings: 104 Total Stocks , 0 Total Fixed-Income, 12% Turnover Ratio	% Net Assets
⊕	15 mil	Simon Property Group, Inc.	9.14
⊕	15 mil	Equity Residential	4.62
⊕	8 mil	Public Storage	4.60
⊕	9 mil	Vornado Realty Trust Shs of Benef	4.29
⊕	19 mil	HCP, Inc.	4.21
⊕	7 mil	Boston Properties, Inc.	3.76
⊕	35 mil	Host Hotels & Resorts, Inc.	3.72
⊕	5 mil	AvalonBay Communities, Inc.	3.01
⊕	8 mil	Ventas, Inc.	2.59
⊕	29 mil	ProLogis Trust	2.52
⊕	21 mil	Kimco Realty Corporation	2.30
⊕	8 mil	Health Care REIT, Inc.	2.17
☼	22 mil	General Growth Properties, Inc.	2.05
⊕	7 mil	Macerich Company	1.93
⊕	9 mil	AMB Property Corporation	1.67

Sector Weightings	Stocks %	Rel S&P 500 TR
Cyclical	**99.9**	**61.81**
Basic Materials	0.0	0.00
Consumer Cyclical	0.0	0.00
Financial Services	0.0	0.00
Real Estate	99.9	61.81
Sensitive	**0.1**	**0.01**
Communication Services	0.0	0.00
Energy	0.0	0.00
Industrials	0.1	0.01
Technology	0.0	0.00
Defensive	**0.0**	**0.00**
Consumer Defensive	0.0	0.00
Healthcare	0.0	0.00
Utilities	0.0	0.00

Operations

Family:	Vanguard	Total Assets:	$8,603.0 mil	Exchange:	NYSE ARCA
Manager:	Gerard O'Reilly	Ticker:	VNQ	NAV:	58.51
Tenure:	14.9 Years	Incept:	09-23-2004	Base Currency:	USD

Standardized and Tax Adjusted Returns Disclosure Statement

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 redeemed, 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 visit http://advisor.morningstar.com/familyinfo.asp

An investment in a money-market vehicle is not insured or guaranteed by the FDIC or any other government agency. The current yield quotation reflects the current earnings of the money market more closely than the total return quotation. Although money markets seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in them.

Standardized Returns assume reinvestment of dividends and capital gains. They depict performance without adjusting for the effects of taxation, but are adjusted to reflect sales charges and ongoing fund expenses.

If adjusted for taxation, the performance quoted would be significantly reduced.

For variable annuities, additional expenses will be taken into account, including M&E risk charges, fund-level expenses such as management fees and operating fees, contract-level administration fees, and charges such as surrender, contract, and sales charges.

After-tax returns are calculated using the highest individual federal marginal income tax rates, and do not reflect the impact of state and local taxes. Actual after-tax returns depend on the investor's tax situation and may differ from those shown. The after-tax returns shown are not relevant to investors who hold their fund shares through tax-deferred arrangements such as 401(k) plans or an IRA. After-tax returns exclude the effects of either the alternative minimum tax or phase-out of certain tax credits. Any taxes due are as of the time the distributions are made, and the taxable amount and tax character of each distribution are as specified by the fund on the dividend declaration date. Due to foreign tax credits or realized capital losses, after-tax returns may be greater than before-tax returns. After-tax returns for exchange-traded funds are based on net asset value.

Annualized returns 03-31-2011

Standardized Returns (%)	7-day Yield	1Yr	5Yr	10Yr	Since Inception	Inception Date	**Max Front Load %**	**Max Back Load %**	**Net Exp Ratio %**	**Gross Exp Ratio %**
Vanguard REIT Index ETF (USD)-NAV	—	28.50	3.22	—	6.88	09-23-2004	**NA**	**NA**	**0.13**	**0.13**
Vanguard REIT Index ETF (USD)-Market	—	—	—	—	—	09-23-2004	**NA**	**NA**	**0.13**	**0.13**
BarCap US Agg Bond TR USD	**—**	**5.12**	**6.03**	**5.56**	**—**	**—**				
DJ US Select REIT TR USD	**—**	**24.44**	**0.66**	**11.25**	**—**	**—**				
MSCI EAFE NR USD	**—**	**10.42**	**1.30**	**5.39**	**—**	**—**				
S&P 500 TR	**—**	**15.65**	**2.62**	**3.29**	**—**	**—**				
USTREAS T-Bill Auction Ave 3 Mon	**—**	**0.15**	**2.08**	**2.14**	**—**	**—**				

Return after Tax (%)	On Distribution					On Distribution and Sales of Shares			
	1Yr	5Yr	10Yr	Since Inception	Inception Date	1Yr	5Yr	10Yr	Since Inception
Vanguard REIT Index ETF (USD)-NAV	26.85	1.61	—	5.19	09-23-2004	18.43	1.79	—	4.95

Our Key Investing Concepts
- Company Quality
- Consider Buying/Consider Selling
- Coverage Rate
- Expected Return
- Fair Value
- Hurdle Rate
- Margin of Safety
- Valuation

Our approach to evaluating ETFs is multi-faceted, reflecting the various ways ETFs can be used.

For instance, given their diversification and low cost, ETFs are good candidates to anchor a portfolio. Alternatively, narrowly focused ETFs like region- or sector-specific funds can be used to plug holes in a portfolio. ETFs can also be worthwhile alternatives to positions in individual securities. Instead of buying a healthcare stock, for example, an investor might opt for a healthcare ETF that owned an assortment of firms.

This versatility informs the way we analyze ETFs. for investors using ETFs to build more efficient portfolios ("Portfolio-Builders"), our analysis coalesces around a fund's role and utility in a portfolio. For those investing opportunistically in certain areas that they think are poised to beat the market ("Market-Beaters"), we focus on the fundamental attractiveness of the securities that an ETF owns.

Portfolio-Builders

Investors trying to construct a low-cost, well-diversified portfolio are likely to focus on a few key attributes when selecting ETFs.

Cost: An ETF's stated expense ratio is crucial in that costs drag on a portfolio's returns. For that reason, we generally recommend investing in ETFs that levy the lowest expense ratios.

Portfolio Construction: There are innumerable ways to build a portfolio using ETFs. Ultimately, the "right" ETF is the one that's best suited to an investor's needs. Therefore, we typically consider an index's breadth (the variety of securities it holds) and depth (the weight of those securities in the portfolio) in evaluating an ETF's usefulness.

Tax Efficiency: ETFs should be more tax-efficient than comparable open-end mutual funds. With that in mind, we typically monitor whether an ETF has kept a lid on taxable capital gains distributions.

Performance: An ETF's returns and risk are important, but not a divining rod. We consider an ETF's past performance in gleaning insights into the fund's tendencies--does it lag in rallies and hold its ground during downturns? This can shed light not only on how the fund is likely to perform in the future, but also how it might complement other portfolio holdings.
All told, we favor low-cost, tax-efficient ETFs which are founded on prudent strategies that lend themselves to portfolio construction.

Market-Beaters

Our approach to opportunistic investing with ETFs starts from a central premise: An investment in a stock ETF isn't a wager on the value the market places on a piece of paper; it's a stake in the dozens of businesses the fund owns.

Thus, we think investors seeking to beat the market using ETFs should focus on the intrinsic worth of the businesses concerned. When the market is fairly valuing those firms, then an investor is getting her money's worth. But when the market significantly undervalues those businesses, then an investor stands to reap a market-beating return.

Of course, estimating the value of hundreds of businesses is no mean feat. To that end, Morningstar's equity analysts cover 2,000-plus stocks spanning numerous industries and geographic locales. To estimate a firm's fair value, our analysts conduct extensive fundamental research, examining its competitive profile, the durability of any advantages it might boast, and the economics of the markets in which it operates.

By aggregating these fair value estimates, we can also estimate a stock ETF's intrinsic worth. We can begin to evaluate an ETF's attractiveness by comparing its market price with our fair value estimate.

This process culminates in our ETF "valuation ratings", which denote the attractiveness of a stock ETF based on the valuation of its underlying holdings. For instance, if an ETF is trading meaningfully below our fair value estimate, then we'll assign it an "undervalued" rating. By contrast, if it's trading at a substantial premium to our fair value estimate, we'll give it an "overvalued" rating.

Following is a guide to some of the important themes in our ETF research.

Company Quality: High-quality firms boast intractable competitive advantages, or "economic moats", that confer economic benefits to shareholders for years and years. Scale in an industry where cost leadership is paramount (ExxonMobil, Wal-Mart), intellectual property protection (Merck, 3M), and brand equity (Coca Cola, Procter & Gamble) are examples. The wider a firm's moat, the more defensible its advantages and, thus, the higher its quality. Since higher-quality firms are worth more, an ETF that's chock full of wide-moat businesses is more valuable than a fund that invests in lower-quality firms in an intensely competitive industry.

Consider Buying/Consider Selling: The "consider buying" price is the market price at which we would recommend investing in an ETF (i.e., when it receives an "undervalued" rating). The "consider buying" price will vary depending on an ETF's risk. Generally speaking, the riskier the ETF, the lower the "consider buying" price relative to the fair value estimate. The opposite is true for less-risky ETFs. The "consider selling" price is the counterpart to the "consider buying" price, marking the price at which we would recommend selling an ETF.

Coverage Rate: This is the percentage of an ETF portfolio's assets that our analysts cover. Generally speaking, we only estimate an ETF's fair value when we cover stocks representing 70% or more of the fund's assets.

Expected Return: An ETF's expected return measures the pre-tax, pre-fee annualized return an investor would stand to realize if the ETF's price converged to our time-adjusted fair value estimate over a three-year time horizon.

Fair Value: A stock ETF's fair value estimate is our estimate of what the portfolio is worth in aggregate. We derive an ETF's fair value estimate by aggregating the fair value estimates that our analysts place on the fund's constituent stock holdings. The more valuable an ETF's holdings, the higher those stocks' fair value estimates and, in turn, the higher the ETF's aggregate fair value estimate.

Hurdle Rate: An ETF's hurdle rate is the sum of its portfolio's weighted-average cost of equity (COE), its annual expense ratio and, in certain cases, an incremental risk premium. The COE expresses a firm's intrinsic risk as a percentage (e.g., 10%). It represents the minimum return an investor would accept in exchange for purchasing the stock.

Margin of Safety: The gap between the "consider buying" price and the fair value estimate, the margin of safety affords protection should our fair value estimate end up being off the mark. It's a margin of error that varies depending on an ETF's risk; the riskier the ETF concerned, the wider the margin of safety we'd demand, and vice versa.

Valuation: An ETF's valuation rating can take three forms--"undervalued", "fairly valued", and "overvalued". ETFs trading at a meaningful discount to our fair value estimate receive an "undervalued" rating while those trading at a substantial premium get an "overvalued" rating. ETFs hovering near our fair value estimate are rated "fairly valued".

ETF Detail Report
Disclosure Statement

The Exchange-traded Fund (ETF) Detail report is supplemental sales literature, and therefore must be preceded or accompanied by the fund's current prospectus or an equivalent statement. Please read this information carefully. In all cases, this disclosure statement should accompany the ETF Detail Report. Morningstar is not itself a FINRA-member firm. All data presented is based on the most recent information available to Morningstar.

ETFs trading on a secondary market may trade at, above, or below their net asset value (NAV). If an ETF's shares trade at a price above their NAV they are said to be trading at a "premium." Conversely, if they are trading at a price below their NAV, they are said to be trading at a "discount."

Holding company depository receipts (HOLDRs) are similar to ETFs, but they focus on narrow industry groups. HOLDRs initially own 20 stocks, which are unmanaged, and can become more concentrated due to mergers, or the disparate performance of their holdings. HOLDRs can only be bought in 100-share increments. Investors may exchange shares of a HOLDR for its underlying stocks at any time.

The market price noted on the Detail Report is the price of the ETF as of the close of trading on the last business day at month-end. This date is listed at the top of the Detail Report.

Performance
The performance data given represents past performance and should not be considered indicative of future results. Principal value and investment return will fluctuate, so that an investor's shares, when sold, may be worth more or less than the original investment. Portfolio statistics change over time. ETFs and HOLDRs are not FDIC-insured, may lose value, and are not guaranteed by a bank or other financial institution.

For ETFs, standardized total return is reflected as of month- and quarter- end time periods. It depicts performance without adjusting for brokerage commissions and the effects of taxation, but is adjusted to reflect all actual ongoing ETF expenses and assumes reinvestment of dividends and capital gains. If adjusted, the effects of brokerage commissions and taxation would reduce the performance quoted.

For HOLDRs, the standardized total return reflects performance at market price, without adjusting for the effects of taxation or brokerage commissions. These returns are adjusted to reflect all ongoing expenses and assume reinvestment of dividends and capital gains. If adjusted, the effects of taxation would reduce the performance quoted.

The 12-month yield is derived by summing the trailing 12-months' income distributions and dividing the sum by the last month's ending NAV, plus any capital gains distributed over the same period. Income refers only to interest payments from fixed-income securities and dividend payoffs from common stocks.

Growth of 10,000
This graph compares the growth of an investment of 10,000 (in the base currency of the fund) with that of an index and with that of the average for all funds in its Morningstar category. The NAV total returns are not adjusted to reflect the effects of taxation, but they are adjusted to reflect actual ongoing fund expenses and assume reinvestment of dividends and capital gains. If adjusted, the effect of taxation would reduce the performance quoted. Please note, while the investor obtaining an ETF through the secondary market does not obtain it at NAV, the purpose in presenting this graph based on NAV is to provide an illustration of the historical performance of the ETF strategy. In no way should this performance be considered indicative of or a guarantee of the future performance of this ETF nor should it be viewed as a substitute for an actual investor experience.

The index is an unmanaged portfolio of specified securities, and cannot be invested in directly. The index and the category average do not reflect any initial or ongoing expenses. A fund's portfolio may differ significantly from the securities in the index. The index is chosen by Morningstar.

Risk Measures
The risk measures below are calculated for ETFs with at least a three-year history.

Standard deviation is a statistical measure of the volatility of the ETF's NAV returns.

Mean represents the annualized geometric NAV return for the period shown.

The Sharpe ratio uses standard deviation and excess return to determine reward per unit of risk.

Alpha measures the difference between an ETF's NAV returns and its expected performance, given its level of risk as measured by beta. Alpha is often seen as a measure of the value added or subtracted by a portfolio manager.

Beta is a measure of an ETF's sensitivity to market movements. A portfolio with a beta greater than 1 is more volatile than the market, and a portfolio with a beta less than 1 is less volatile than the market.

R-squared reflects the percentage of an ETF's movements that is explained by movements in its benchmark index, showing the degree of correlation between the ETF and the benchmark. This figure is also helpful in assessing how likely it is that alpha and beta are statistically significant.

Best fit index: Alpha, beta, and R-squared statistics are presented for a broad market index and a "Best fit" index. The Best-Fit index identified in this report was determined by Morningstar by calculating R-squared for the fund against approximately 100 indexes tracked by Morningstar. The index representing the highest R-squared is identified as the best-fit index. The best-fit index may not be the fund's benchmark, nor does it necessarily contain the types of securities that may be held by the fund.

Asset Allocation
The weighting of the portfolio in various asset classes, including "Other" is shown in the table. "Other" includes security types that are not neatly classified in the other asset classes, such as convertible bonds and preferred stocks.

In the table, allocation to the classes is shown for long positions, short positions, and net (long positions net of short) positions. These statistics summarize what the managers are buying and how they are positioning the portfolio. When short positions are captured in these portfolio statistics, investors get a more robust description of the funds' exposure and risk.

Most managed product portfolios hold fairly conventional securities, such as long positions in stocks and bonds. Other portfolios use other investment strategies or securities, such as short positions or derivatives, to reduce transaction costs, enhance returns, or reduce risk. Some of these securities and strategies behave like conventional securities, while others have unique return and risk characteristics.

Most portfolios take long positions in securities. Long positions involve buying the security outright and then selling it later, with the hope that the security price rises over time. In contrast, short positions are taken to benefit from anticipated price declines. In this type of transaction, the investor borrows the security from another investor, sells it and receives cash, and then is obligated to buy it back at some point in the future. If the price falls after the short sale, the investor will have sold high and can now buy low to close the short position and lock in a profit. However, if the price of the security increases after the short sale, the investor will experience losses by buying it at a higher price than the sale price.

The strategy of selling securities short is prevalent in specialized portfolios, such as long-short, market-neutral, bear-market, and hedge funds. Most conventional portfolios do not typically short securities, although they may reserve the right to do so under special circumstances. Funds may also short derivatives, and this is sometimes more efficient than shorting individual securities. Short positions produce negative exposure to the security that is being shorted. This means that when the security rises in value, the short position will fall in value and vice versa. Morningstar's portfolio statistics will capture this negative exposure. For example, if a fund has many short stock positions, the percent of assets in stocks in the asset allocation breakdown may be negative. Funds must provide their broker with cash collateral for the short position, so funds that short often have a large cash position, sometimes even exceeding 100% cash.

Note that all other portfolio statistics presented in this report are based on the long holdings of the fund only.

Style Analysis

The Morningstar Style Box reveals a fund's investment style as of the date noted on this report.

For equity funds the vertical axis shows the market capitalization of the long stocks owned and the horizontal axis shows investment style (value, blend, or growth).

For fixed-income funds, the vertical axis shows the credit quality of the long bonds owned and the horizontal axis shows interest rate sensitivity as measured by a bond's effective duration.

Morningstar seeks credit rating information from fund companies on a periodic basis (e.g., quarterly). In compiling credit rating information, Morningstar instructs fund companies to only use ratings that have been assigned by a Nationally Recognized Statistical Rating Organization (NRSRO). If two NRSROs have rated a security, fund companies are to report the lowest rating; if three or more NRSROs have rated the same security differently, fund companies are to report the rating that is in the middle. For example, if NRSRO X rates a security AA-, NRSRO Y rates the same security an A and NRSRO Z rates it a BBB+, the fund company should use the credit rating of 'A' in its reporting to Morningstar. PLEASE NOTE: Morningstar, Inc. is not itself an NRSRO nor does it issue a credit rating on the fund. An NRSRO rating on a fixed-income security can change from time-to-time.

For credit quality, Morningstar combines the credit rating information provided by the fund companies with an average default rate calculation to come up with a weighted-average credit quality. The weighted-average credit quality is currently a letter that roughly corresponds to the scale used by a leading NRSRO. Bond funds are assigned a style box placement of "low", "medium", or "high" based on their average credit quality. Funds with a low credit quality are those whose weighted-average credit quality is determined to be less than "BBB-"; medium are those less than "AA-", but greater or equal to "BBB-"; and high are those with a weighted-average credit quality of "AA-" or higher. When classifying a bond portfolio, Morningstar first maps the NRSRO credit ratings of the underlying holdings to their respective default rates (as determined by Morningstar's analysis of actual historical default rates). Morningstar then averages these default rates to determine the average default rate for the entire bond fund. Finally, Morningstar maps this average default rate to its corresponding credit rating along a convex curve.

For interest-rate sensitivity, Morningstar obtains from fund companies the average effective duration. Generally, Morningstar classifies a fixed-income fund's interest-rate sensitivity based on the effective duration of the Morningstar Core Bond Index (MCBI), which is currently three years. The classification of Limited will be assigned to those funds whose average effective duration is between 25% to 75% of MCBI's average effective duration; funds whose average effective duration is between 75% to 125% of the MCBI will be classified as Moderate; and those that are at 125% or greater of the average effective duration of the MCBI will be classified as Extensive.

For municipal bond funds, Morningstar also obtains from fund companies the average effective duration. In these cases static breakpoints are utilized. These breakpoints are as follows: (i) Limited: 4.5 years or less; (ii) Moderate: more than 4.5 years but less than 7 years; and (iii) Extensive: more than 7 years. In addition, for non-US taxable and non-US domiciled fixed income funds static duration breakpoints are used: (i) Limited: less than or equal to 3.5 years; (ii) Moderate: greater than 3.5 and less than equal to 6 years; (iii) Extensive: greater than 6 years.

Equity Portfolio Statistics

The referenced data elements below are a weighted average of the long equity holdings in the portfolio.

The Price/Earnings ratio is a weighted average of the price/earnings ratios of the stocks in the underlying fund's portfolio. The P/E ratio of a stock is calculated by dividing the current price of the stock by its trailing 12-months' earnings per share. In computing the average, Morningstar weights each portfolio holding by the percentage of equity assets it represents.

The Price/Cash Flow ratio is a weighted average of the price/cash-flow ratios of the stocks in a fund's portfolio. Price/cash-flow shows the ability of a business to generate cash and acts as a gauge of liquidity and solvency.

The Price/Book ratio is a weighted average of the price/book ratios of all the stocks in the underlying fund's portfolio. The P/B ratio of a company is calculated by dividing the market price of its stock by the company's per-share book value. Stocks with negative book values are excluded from this calculation.

The geometric average market capitalization of a fund's equity portfolio gives you a measure of the size of the companies in which the mutual fund invests.

Fixed-Income Portfolio Statistics

The referenced data elements below are a weighted average of the long fixed income holdings in the portfolio.

Duration is a time measure of a bond's interest rate sensitivity. Average effective duration is a weighted average of the duration of the underlying fixed income securities within the portfolio.

Average effective maturity is a weighted average of all the maturities of the bonds in a portfolio, computed by weighting each maturity date by the market value of the security.

Average weighted coupon is generated from the fund's portfolio by weighting the coupon of each bond by its relative size in the portfolio. Coupons are fixed percentages paid out on a fixed-income security on an annual basis.

Average weighted price is generated from the fund's portfolio by weighting the price of each bond by its relative size in the portfolio. This number reveals if the fund favors bonds selling at prices above or below face value (premium or discount securities, respectively). A higher number indicates a bias toward premiums. This statistic is expressed as a percentage of par (face) value.

Credit quality breakdowns are shown for corporate-bond holdings and depict the quality of bonds in the underlying portfolio. The report shows the percentage of fixed-income securities that fall within each credit quality rating as assigned by an NRSRO. Bonds not rated by an NRSRO are included in the not rated (NR) category.

Investment Risks

International/Emerging Market Equities: Investing in international securities involve special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

Sector Strategies: Portfolios that invest exclusively in one sector or industry involve additional risks. The lack of industry diversification subjects the investor to increased industry-specific risks.

Non-Diversified Strategies: Portfolios that invest a significant percentage of assets in a single issuer involve additional risks, including share price fluctuations, because of the increased concentration of investments.

Small Cap Equities: Portfolios that invest in stocks of small companies involve additional risks. Smaller companies typically have a higher risk of failure, and are not as well established as larger blue-chip companies. Historically, smaller-company stocks have experienced a greater degree of market volatility that the overall market average.

Mid Cap Equities: Portfolios that invest in companies with market capitalization below $10 billion involve additional risks. The securities of these companies may be more volatile and less liquid than the securities of larger companies.

High-Yield Bonds: Portfolios that invest in lower-rated debt securities (commonly referred as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default.

Tax-Free Municipal Bonds: The investor should note that the income from tax-free municipal bond funds may be subject to state and local taxation and the Alternative Minimum Tax.

Bonds: Bonds are subject to interest rate risk. As the prevailing level of bond interest rates rise, the value of bonds already held in a portfolio decline. Portfolios that hold bonds are subject to declines and increases in value due to general changes in interest rates.

HOLDRs: The investor should note that these are narrow industry-focused products that, if the industry is hit by hard times, will lack diversification and possible loss of investment would be likely. These securities can trade at a discount to market price, ownership is of a fractional share interest, the underlying investments may not be representative of the particular industry, the HOLDR might be delisted from the AMEX if the number of underlying companies drops below nine, and the investor may experience trading halts.

Hedge Funds: The investor should note that hedge fund investing involves specialized risks that are dependent upon the type of strategies undertaken by the manager. This can include distressed or event-driven strategies, long/short strategies, using arbitrage (exploiting price inefficiencies), international investing, and use of leverage, options and/or derivatives. Although the goal of hedge fund managers may be to reduce volatility and produce positive absolute return under a variety of market conditions, hedge funds may involve a high degree of risk and are suitable only for investors of substantial financial means who could bear the entire loss of their investment.

Bank Loan/Senior Debt: Bank loans and senior loans are impacted by the risks associated with fixed income in general, including interest rate risk and default risk. They are often non-investment grade; therefore, the risk of default is high. These securities are also relatively illiquid. Managed products that invest in bank loans/senior debt are often highly leveraged, producing a high risk of return volatility.

Short Positions: When a short position moves in an unfavorable way, the losses are theoretically unlimited. The broker may demand more collateral and a manager might have to close out a short position at an inopportune time to limit further losses.

Long-Short: Due to the strategies used by long-short funds, which may include but are not limited to leverage, short selling, short-term trading, and investing in derivatives, these funds may have greater risk, volatility, and expenses than those focusing on traditional investment strategies.

Liquidity Risk: Closed-end fund, ETF, and HOLDR trading may be halted due to market conditions, impacting an investor’s ability to sell a fund.

Market Price Risk: The market price of ETFs, HOLDRs, and closed-end funds traded on the secondary market is subject to the forces of supply and demand and thus independent of the NAV. This can result in the market price trading at a premium or discount to the NAV which will affect an investor’s value.

Market Risk: The market prices of ETF’s and HOLDRs can fluctuate as a result of several factors, such as security-specific factors or general investor sentiment. Therefore, investors should be aware of the prospect of market fluctuations and the impact it may have on the market price.

Target-Date Funds: Target-date funds typically invest in other mutual funds and are designed for investors who are planning to retire during the target date year. The fund's target date is the approximate date of when investors expect to begin withdrawing their money. Target-date fund's investment objective/strategy typically becomes more conservative over time primarily by reducing its allocation to equity mutual funds and increasing its allocations in fixed-income mutual funds. An investor's principal value in a target-date fund is not guaranteed at anytime, including at the fund's target date.

High double- and triple-digit returns were the result of extremely favorable market conditions, which may not continue to be the case. High returns for short time periods must not be a major factor when making investment decisions.

Benchmark Disclosure

BarCap US Agg Bond TR USD

This index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns we publish for the index are total returns, which include reinvestment of dividends.

DJ US Select REIT TR USD

This index consists of U.S. publicly traded Real Estate Investment Trusts. It is a subset of the Wilshire Real Estate Securities Index.

MSCI EAFE NR USD

This Europe, Australasia, and Far East index is a market-capitalization-weighted index of 21 non-U.S., industrialized country indexes.

S&P 500 TR

A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. TR (Total Return) indexes include daily reinvestment of dividends.

USTREAS T-Bill Auction Ave 3 Mon

Three-month T-bills are government-backed short-term investments considered to be risk-free and as good as cash because the maturity is only three months. Morningstar collects yields on the T-bill on a weekly basis from the Wall Street Journal.