

Construction Rules for the Morningstar® US Dividend and Buyback IndexSM

Morningstar Indexes

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Overview

In recent decades, share buybacks have emerged as a significant mechanism that corporations use to supply excess cash flow to shareholders. Buybacks now rival dividends as the dominant source of payout in the U.S. stock market. Morningstar Investment Management research¹ provides evidence that total payouts (dividends plus buybacks) are the key drivers of long-run stock market returns, and advocates for their use in lieu of pure dividends in long-term valuation of U.S. equities. Morningstar US Dividend and Buyback Index is designed to provide exposure to U.S.-based companies that return capital to shareholders through either dividend payments or share buybacks. The index consists of companies providing the largest dividend and buyback programs in the market by dollar value. In aggregate, index constituents represent 90% of the total shareholder capital distribution of the Morningstar US Market Index benchmark.

This index does not incorporate Environmental, Social, or Governance (ESG) criteria.

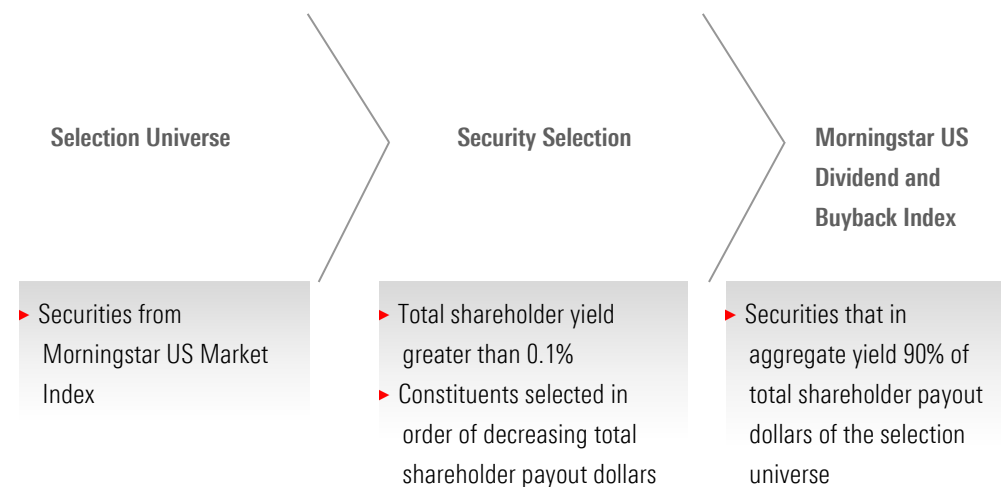
Index Inception Date and Performance Inception Date

The inception date of the index is September 25, 2017, and the performance inception date of the index is June 19, 2006, when the first back-tested index value was calculated.

¹ Philip U. Straehl and Roger G. Ibbotson, "The Long-Run Drivers of Stock Returns: Total Payouts and the Real Economy," Financial Analysts Journal, Third Quarter 2017, Vol. 73, No. 3

Index Construction

Exhibit 1 Morningstar US Dividend and Buyback 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 index are derived from the constituents of the Morningstar US Market Index, the benchmark. For more details on benchmark construction, refer to the construction rules of the [US Market Index](#)

Security Selection

Securities are selected based on total shareholder yield, which is a combination of dividend yield and net buyback yield. A security's dividend is not required to be qualified income; for example, real estate investment trusts are included. Net buyback yield is averaged over eight trailing quarters. Securities with total shareholder yield above 0.1% are eligible for the portfolio. Securities are selected in the priority order of decreasing total shareholder payout dollars, until 90% coverage of the aggregate total shareholder payout dollars of the benchmark is achieved. (Securities with negative total shareholder yield do not participate in the aggregate calculation). See Appendix 2 for a detailed definition of total shareholder yield and total shareholder payout dollars.

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 weighted by total shareholder payout dollars. This is an adjusted float market-cap-weighted scheme, where market-cap weight is adjusted by a total shareholder yield multiplier. The index weights are further constrained by maximum security capping at 4.9%. Since total shareholder yield can become negative or zero, companies with non-positive yield are removed from the index at rebalancing and do not participate in the weighting algorithm. 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 June and is 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 May.

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, rebalance is effective on the immediate following business day. The market data used for rebalance is as of the last trading day of February, May, August, and November.

Note

- ▶ Refer to Appendix 1 for details on reconstitution and rebalancing (for both formats).

Corporate Action

The index follows an "alternatively weighted" corporate action treatment policy. 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

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

Appendix 2: Total Shareholder Yield Definition

Term	Description
Trailing 12-Month Dividend Yield	Sum of corporate action-adjusted dividends per-share paid in the 12 months before the data cutoff date, divided by the share price on the cutoff date.
Trailing 8-Quarter Buyback Yield, Annualized	Negated sum of net cash flow from share issuance from the eight most recent company quarterly reports available on the data cutoff date, divided by 2, divided by market capitalization of the company. The ending date of the most recent report of net cash flow from share issuance cannot be more than six months before the data cutoff date.
Total Shareholder Yield	Sum of trailing 12-month dividend yield and trailing 2-year buyback yield, annualized.
Total Shareholder Payout Dollars	Total shareholder yield multiplied by float-adjusted market capitalization of the company.

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 Product Committee

The Morningstar Index Product Committee is comprised of members who possess a wide array of knowledge in relation to Indexes. The Product Committee is responsible for the governance over the creation and maintenance of all Morningstar branded Indexes, ensuring the highest standards are continuously met. Any matters arising from exceptional or undocumented events will be resolved at the discretion of the Morningstar Index Product Committee.

Morningstar Index Oversight Committee

The Morningstar Index Oversight Committee is comprised of informed and qualified professionals who are responsible for the process governance of Morningstar branded Indexes. The Oversight Committee assesses and where appropriate challenges the decisions of Morningstar Indexes with regards to benchmark decisions.

For More Information

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



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