

# Concinnity Conscious Companies Index Methodology

## 1. Introduction

The Concinnity Conscious Companies Index (the “Index”) is designed to provide exposure to U.S.-listed companies that Concinnity Advisors, LP, (the “Index Provider”) believes appear to achieve financial performance in a sustainable and responsible manner, as measured by their ability to achieve positive outcomes that are consistent with a multi-stakeholder operating system (“MsOS”), as defined by the Index Provider. Concinnity Advisors, LP has developed this strategy that asserts “well-managed” companies are those that adopt a multi-stakeholder operating system (“MsOS”) as the nucleus for their long-term value creation process. These companies understand that successful performance in today’s marketplace largely depends on the quality of their relationships with the following stakeholders:

- Customers
- Employees
- Suppliers
- Stock and Debt Holders
- Communities in which the Company Operates

## 2. Constructing the Concinnity Conscious Companies Index

The Index creation methodology consists of two parts: 1) the construction of the annual Concinnity MsOS List, and 2) the construction of the Concinnity Conscious Companies Index from the annual Concinnity MsOS List.

### 2.1 Constructing the Concinnity MsOS List

#### Initial Universe:

The universe of companies eligible for the Concinnity Annual MsOS List include US-listed firms with a market capitalization >\$2 billion at the time of the initial screen. Only certain Common Stocks and REITs are eligible for inclusion in the Underlying Index.

#### First Screen:

The initial screening stage is comprised of ~40 information sources that recognize companies for achieving various positive outcomes typically expected from firms guided by a multi-stakeholder operating system. The outcome sources used in this initial screen include publicly available ranking lists such as:

- Best Companies to Work For (Fortune Magazine)
- Best Corporate Citizens (Corporate Responsibility Magazine)
- Most Sustainable Corporations (Forbes)
- Most Ethical Companies (Forbes)
- Most Innovative Companies (Fast Company)
- ~35+

These initial screening sources are vetted annually and weighted based on stakeholder focus, research methodology and third party or in-house analysis of a source’s potential as a leading indicator of corporate and/or stock performance. Of the approximately 1100 - 1400 companies that emerge from the initial universe, approximately 600 – 700 companies, most of which are the highest scoring companies, are further evaluated in a composite analysis.

## **Second Screen: Composite Analysis**

After the initial screening has identified the 600-700 companies, a composite analysis is used to apply a deeper level of scrutiny to these companies. The composite analysis uses Concinnity Advisors, LP’s data set, which has been developed over many years and updated as Concinnity Advisors, LP believes is appropriate. This data set combines ratings data from multiple research entities that specialize in various assessment categories. Companies are scrutinized through a series of scoring lenses that combine to form a composite score underpinned by several hundred criteria. Composite score rankings are then combined with initial screening scores to select a universe of potential portfolio candidates. This process is described in more detail below.

- **Composite Analysis Assessment Categories**

Below are a list of assessment categories describing the type of data and characteristics captured and evaluated in the composite analysis. The data used is public as well as proprietary data supplied by vendors. Most of the data is non-financial data, and not released by the underlying companies (i.e. 10-K, 10-Q...).

1. **Environmental, Societal/Community & Governance (ESG):** Ratings from multiple ESG data providers that include numerous assessment criteria.
2. **Employee Engagement:** Ratings derived from a combination of employee productivity metrics, employee turnover measures, employee perception surveys and the “human capital” and/or labor-management scores embedded within overall ESG ratings.
3. **Corporate Reputation Management:** Ratings derived from an intangible asset management data source that evaluates several key areas of business performance; such as ethics, innovation, quality, safety, sustainability and security.
4. **Innovation:** Combines innovation component scores within the intangible asset management analysis and innovation scores derived from customer perceptions.
5. **Executive Integrity:** Ratings derived by assessing the degree of honesty displayed by executives when communicating with analysts and investors, based on analysis and indicators developed by the national intelligence community.
6. **Management Capability:** Ratings derived from a methodology designed to evaluate the quality, skill and operating ability of management teams.
7. **Customer Relationship Quality:** Includes ratings based on measures of customer loyalty, social media proficiency, customer perception of value, pricing power and economic profitability of customer relationships.
8. **Supplier Relationship Quality:** Ratings derived from a supplier risk database that analyzes how a company’s supply chain management and practices are enabling or hindering its ability to meet customer needs.

9. **Labor & Human Rights (Supply Chain):** Scoring system based on evaluations from a global network of factory field auditors to gauge the risk of human rights and labor violations occurring within a company's supply chain.
10. **Culture:** A combination of all customer ratings and employee related ratings are used as proxies for appraising organizational culture.
11. **Quality of Financial Reporting:** Forensic accounting specialists are relied on to grade companies on the quality of their earnings and/or overall financial reporting.
12. **Efficiency and Fundamental Analysis (EFA):** A specific set of fundamental financial ratios are considered to evaluate multi-stakeholder operating system efficiency levels.

- **Data Aggregation**

Data from the above assessment categories are weighted and combined into four aggregated scores.

1. **ESG** - Environmental, Societal, and Governance
2. **ESC** - Employee, Supplier, and Customer
3. **Quality of Management**
4. **Intangible Asset Management**

- **MsOS Score**

Modeling techniques are used to weight and combine the data from the aggregated categories (including adjustments for industry variation of stakeholder importance) into a single score for each company. This score reflects the degree to which a company is considered MsOS proficient by the research process.

- **Valuation Score**

Each company receives a valuation score which is determined using a set of fundamental financial ratios.

- **Risk Balancing**

The risk balancing process measures the sector exposure, beta, and tracking error of the equal weighted Concinnity MsOS List as compared to the Solactive US Large Cap Index to ensure a balanced outcome. Each stock on the list is also checked for:

1. Excessive debt
2. Excessive leverage
3. Bankruptcy risk
4. Recent negative news

## **Annual MsOS List**

The Concinnity MsOS List is created by evaluating the MsOS Score, the Valuation Score, and the risk balancing process. The final output ultimately comprises the Concinnity Annual MsOS List, which consists of 300-350 companies.

## 2.2 Constructing the Concinnity Conscious Companies Index

The Index is derived from the Concinnity Annual MsOS List. A fundamental tenet of the Concinnity research approach is to attempt to identify companies where the MsOS has become embedded in the firm's DNA. As a result, a critical component and key differentiator of the methodology is the requirement that companies must have appeared at least three consecutive years on the MsOS List ("Three Year Repeaters") in order to be included in the Index.

In the final component of the Index's annual construction process, the Three Year Repeaters are screened again for a minimum market capitalization of \$2 billion and a minimum average daily trading value for the last 30 days of greater than or equal to \$4 million. The remaining Three Year Repeaters are compiled and are weighted.

To determine each stock's final weight in the Conscious Companies Index, the stock's weight in an equal weighted Index is compared to its weight in the Solactive US Large Cap Index. If a stock in the equal weighted index is underweight the Solactive US Large Cap Index by more than -1%, its weight in the index is increased to a -1% active underweight. After this adjustment is complete, all remaining stocks in the Index are equal weighted.

This results in "top heavy" stocks to be underweighted by -1%, minimizing these underweights which would have resulted in large stock specific risk in these Mega Cap stocks. For example, if AAPL is 5% of the Solactive US Large Index, its weight is increased to 4%, and the rest of the stocks in the index are equal weighted to make up the last 96% of the weight in the index.

Finally, the same process that is used to balance the annual MsOS List is then used on the list of Three Year Repeaters to balance sectors, beta, and tracking error vs the Solactive US Large Cap Index. The Concinnity Conscious Companies Index is balanced only by removing companies, rather than adding any non-Three Year Repeaters. The remaining Three Year Repeaters are equal-weighted, and the final output of this process is the creation of the Concinnity Conscious Companies Index, which in past years has consisted of 125-175 companies.

## 2.3 Rebalance Frequency

The Index will be reconstituted annually using the process described in sections 2.1 and 2.2 above. The Index reconstitution selection day is five trading days prior to the last trading day of October. The Index reconstitution adjustment day is the last trading day of October, effective at the close. Announcement of the reconstituted Index constituents will be made five trading days before the Index reconstitution adjustment day.

The Index will be rebalanced quarterly. Rebalance is defined as any necessary deletion of constituents, then equal weighting (with adjustments for extreme underweight exposures) of the remaining constituents. Constituents can be deleted from the Index at the quarterly rebalance for:

- 1) Falling below a \$1.5 billion market cap
- 2) Having a minimum average daily trading value for the last 30 days of less than \$3 million
- 3) Extraordinary events relating to a company's treatment of one (or more) of the five stakeholders defined in the Introduction section, as determined by Concinnity Advisors, LP.

The Index rebalance selection day will be five trading days prior to the last trading day of each of the following months, January, April, and July. The Index rebalance adjustment day is the last trading day of January, April, and July, effective at the close. Announcement of the rebalance index constituents will be made five trading days before the index rebalance adjustment day.

The index weights are determined on the Selection Day and allowed to float by performance until the close of the Adjustment Day.

### **3. Decision-Making Bodies**

Concinnity Advisors, LP is responsible for decisions regarding the composition of the Concinnity Conscious Companies Index as well as any amendments to the methodology for the creation of the Concinnity Conscious Companies Index. The composition of the Concinnity Conscious Companies Index is set on the selection dates. Concinnity Advisors, LP may at any time make changes to the composition of the Index or to the guidelines while maintaining the Index's stated objectives.