

Intelligent Indexing

Founded with the ambition to change the ETF industry, PowerShares has combined three concepts to carry out “the Intelligent ETF Revolution.” The three elements of its strategy are: the development of ETFs with the characteristics of quantitative rules-based indices; the implementation of fundamental indexing; and the availability of “intelligent access” to thematic investment areas.

Q: What’s your investment philosophy?

A: The founders of PowerShares believe in the concept of intelligent indexing. An Intelligent index selects securities for inclusion based on investment merit—rather than the traditional benchmark index approach—which typically selects stocks to create a representative sampling of the overall market. The Intellidex index methodology has become the basis for 35 PowerShares ETF portfolios. The specialized indexes evaluate stocks on 25 different criteria such as fundamental growth, valuation, timeliness, and risk factors. The securities with the highest capital appreciation potential are selected for inclusion in the index quarterly to assure a consistent and accurate representation of a specific market segment.

PowerShares was founded in 2002 by Bruce Bond and a small group of financial service executives that viewed exchange-traded funds (ETFs) as an industry changing investment vehicle. Tax efficiency, relatively low costs, ease of trading and transparency were seen as real advantages when compared to existing products available. They also envisioned a real opportunity for innovation through intelligent indexing.

Q: What are the key elements of the strategy that you use?

A: PowerShares was founded on this opportunity that we refer to as “Leading

The Intelligent ETF Revolution,” Invesco PowerShares does this in three ways. The first is with ETF portfolios that replicate quantitative rules-based indexes. This means that whether it is core exposure or size and style exposure to the market you seek, there are PowerShares available that deliver a more intelligent way to access that type of exposure.

For example, the Russell family of indices was built to gauge how they were doing as an institutional consultant. The Russell 1000 Growth & Value Indexes use two factors to separate growth and value. Not only do they have 30% overlap, but they actually have an 80% correlation to each other. For people who are doing size and style investing, these types of investment characteristics would be inappropriate.

The size and style family of PowerShares were developed to provide investors a more precise exposure to markets. The ETF portfolios have zero overlap, and they use 10 different factors to separate growth and value. The PowerShares Intellidex correlation is closer to 45% versus 80%. These ‘power tools’ are for advisors that are looking to get a well-rounded asset allocation portfolio.

A second area where PowerShares leads the Intelligent ETF Revolution is in fundamental indexing. Fundamental indexes provide an alternative to cap weighted in-



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Prior to State Street, Brooks was Senior Vice President Director of Sales at Van Kampen Investments, where he was responsible for sales and marketing efforts. He has extensive experience selling a broad product mix including ETFs, mutual funds and separately managed accounts.

“The concept of intelligent indexing was developed because most indexes were originally built to gauge the market and they weren’t necessarily built to be investments. As traditional indexes became extrapolated as investments through replication by index mutual funds and ETF portfolios, there arose a real need for more intelligent indexing approaches.”

PowerShares ETFs

Fund Name	Ticker Symbol	Inception Date	Market Price Returns Since Inception
DOMESTIC ETFs			
ACTIVELY MANAGED			
Active Alpha Multi-Cap Fund	PQZ	04/11/08	N/A
Active AlphaQ Fund	PQY	04/11/08	N/A
Active Low Duration Fund	PLK	04/11/08	N/A
Active Mega-Cap Fund	PMA	04/11/08	N/A
BROAD MARKET			
Dynamic MagniQuant Portfolio	PIQ	10/12/06	-3.15%
Dynamic Market Portfolio	PWC	05/01/03	12.24%
Dynamic OTC Portfolio	PWO	05/01/03	9.46%
FTSE RAFI US 1000 Portfolio	PRF	12/19/05	3.80%
FTSE RAFI US 1500 Small-Mid Portfolio	PRFZ	09/20/06	-1.75%
COMMODITY & CURRENCY			
DB Agriculture Fund	DBA	01/05/07	37.09%
DB Base Metals Fund	DBB	01/05/07	8.85%
DB Commodity Index Fund	DBC	02/03/06	20.49%
DB Energy Fund	DBE	01/05/07	49.43%
DB G10 Currency Harvest Fund	DBV	09/18/06	3.68%
DB Gold Fund	DGL	01/05/07	35.99%
DB Oil Fund	DBO	01/05/07	46.50%
DB Precious Metals Fund	DBP	01/05/07	34.11%
DB Silver Fund	DBS	01/05/07	28.26%
DB US Dollar Bearish Fund	UDN	02/20/07	17.60%
DB US Dollar Bullish Fund	UUP	02/20/07	-9.03%
EQUITY INCOME			
Buyback Achievers Portfolio	PKW	12/20/06	-10.72%
Dividend Achievers Portfolio	PFM	09/15/05	4.38%
Financial Preferred Portfolio	PGF	12/01/06	-6.25%
High Growth Rate Dividend Achievers Portfolio	PHJ	09/15/05	-0.05%
High Yield Equity Dividend Achievers Portfolio	PEY	12/09/04	-2.56%
FIXED INCOME			
1-30 Laddered Treasury Portfolio	PLW	10/11/07	N/A
Emerging Markets Sovereign Debt Portfolio	PCY	10/11/07	N/A
High Yield Corporate Bond Portfolio	PHB	11/15/07	N/A
Insured California Municipal Bond Portfolio	PWZ	10/11/07	N/A
Insured National Municipal Bond Portfolio	PZA	10/11/07	N/A
Insured New York Municipal Bond Portfolio	PZT	10/11/07	N/A
Preferred Portfolio	PGX	01/31/08	N/A
VRDO Tax-Free Weekly Portfolio	PVI	11/15/07	N/A
INVESTMENT STYLE & COMPANY SIZE			
Dynamic Aggressive Growth Portfolio	PGZ	12/20/06	-3.45%
Dynamic Deep Value Portfolio	PVM	12/20/06	-4.80%
Dynamic Large Cap Growth Portfolio	PWB	03/03/05	3.51%
Dynamic Large Cap Portfolio	PJF	12/01/06	-0.22%
Dynamic Large Cap Value Portfolio	PWV	03/03/05	8.73%
Dynamic Mid Cap Growth Portfolio	PWJ	03/03/05	10.85%
Dynamic Mid Cap Portfolio	PJG	12/01/06	-4.17%
Dynamic Mid Cap Value Portfolio	PWP	03/03/05	3.80%
Dynamic Small Cap Growth Portfolio	PWT	03/03/05	-0.50%
Dynamic Small Cap Portfolio	PJM	12/01/06	-7.53%
Dynamic Small Cap Value Portfolio	PWY	03/03/05	2.06%
Zacks Micro Cap Portfolio	PZI	08/18/05	-3.20%
Zacks Small Cap Portfolio	PZJ	02/16/06	-4.78%
SPECIALIZED			
DWA Technical Leaders Portfolio	PDP	03/01/07	2.17%
FTSE NASDAQ Small Cap Portfolio	PQSC	04/03/08	N/A
NASDAQ-100 BuyWrite Portfolio	PQBW	06/12/08	N/A
NASDAQ NextQ Portfolio	PNXQ	04/03/08	N/A
S&P 500 BuyWrite Portfolio	PBP	12/20/07	-2.26%
Value Line Industry Rotation Portfolio	PYH	12/01/06	3.16%
Value Line Timeliness Select Portfolio	PIV	12/06/05	0.17%
TARGET ALLOCATION			
Autonomic Balanced Gro. NFA Gl. Asset Portfolio	PAO	05/20/08	N/A
Autonomic Balanced NFA Global Asset Portfolio	PCA	05/20/08	N/A
Autonomic Growth NFA Global Asset Portfolio	PTO	05/20/08	N/A

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dexes, and use sales, cash flow, dividends, and book value to more accurately measure a company size and resulting weight within an index. This methodology was developed by Rob Arnott of Research Affiliates.

Q: What's the premise to this index?

A: The premise of the Fundamental Index is that in cap weighting you have a tendency to overweight overvalued companies and underweight undervalued companies. Fundamental Indexing looks at a company's sales, cash flow, book value, and dividends and weights a company based on these fundamentals.

So, if you were to take the PowerShares FTSE RAFI US 1000 ETF, which is U.S. core exposure, it would have most of the same constitutes as the Russell 1000, and it would be very highly correlated to the Russell 1000 or the S&P 500; however, you would not weight the companies by their capitalization. You break that link between price and its weighting, and you have an index that has given a 2% outperformance historically dating back to 1960 with a lower standard deviation. The methodology was developed so you don't participate in every bubble, as with cap based indexes. .

Q: And what's the other area where PowerShares is leading the intelligent ETF revolution?

A: The last area is what we call 'Intelligent Access'. There are areas of the market that are difficult to access, and even though advisors and their clients want exposure to these areas, they might not have the right investment vehicle. We provide intelligent access to areas such as alternatives to clean energy or thematic macro trends such as the scarcity of water and water resources. The PowerShares water resources portfolio - PHO - is based on a U.S. based water index, and we also have a global version PIO - the PowerShares Global Water Portfolio. These ETFs for example both provide investors a way to access a macro theme which is the scarcity of water and effectively capitalize on the growing need of supplying clean water.

Invesco PowerShares has a full series of these 'intelligent access' ETFs as well. Our formula is to add value for investors by using a more intelligent index and the benefit rich ETF structure.

Q: Could we discuss some of your large products by asset base?

A: I'll give you an example from each of our categories. The exchange traded fund, PWC is our broad-based fund with the U.S. exposure. It's benchmarked to the S&P Index and has close to \$650 million in assets. It was launched in May 2003 and it has outperformed the S&P 500 by about 250 basis points over those five years with almost the same beta and a lower standard deviation. It uses 25 different factors and starts with a universe of 2,000 stocks and delivers a portfolio of 100 securities that rebalances on a quarterly basis. This quantitative rules-based index is designed to outperform the S&P 500.

An ETF from the intelligent exposure category is PowerShares FTSE_RAFI US 1000 Portfolio (PRF) which has approximately \$850 million in assets. For institutions or advisors using a core satellite approach, this is a core fundamental-weighted ETF portfolio that provides U.S. exposure only. We also have the international version of the FTSE RAFI, based on a developed markets ex-U.S. index, and it would be benchmarked to the MSCI EAFE Index.

One of our big success stories is the PowerShares Wilderhill Clean Energy Portfolio (PBW) which provides investors access to the clean energy theme. The ETF invests in companies involved with alternative sources of energy whether they be bio-fuels, solar, wind, all the companies that are driving the alternatives to either carbon-based or oil energies. Performance until this year has been exceptional, averaging probably 20% plus per year.

Another big product is the PowerShares Water Resources Portfolio (PHO). The ETF provides exposure to companies in water filtration, desalination, and other technolo-

PowerShares ETFs		CONTINUED	Market Price Returns Since Inception
Fund Name	Ticker Symbol	Inception Date	
SECTOR & INDUSTRY			
Aerospace & Defense Portfolio	PPA	10/26/05	12.28%
Cleantech Portfolio	PZD	10/24/06	16.71%
Dynamic Banking Portfolio	PJB	10/12/06	-16.34%
Dynamic Basic Materials Sector Portfolio	PYZ	10/12/06	23.20%
Dynamic Biotechnology & Genome Portfolio	PBE	06/23/05	4.93%
Dynamic Building & Construction Portfolio	PKB	10/26/05	3.57%
Dynamic Consumer Discretionary Sector Portfolio	PEZ	10/12/06	-9.00%
Dynamic Consumer Staples Sector Portfolio	PSL	10/12/06	5.37%
Dynamic Energy Exploration & Prod. Portfolio	PXE	10/26/05	18.65%
Dynamic Energy Sector Portfolio	PXI	10/12/06	23.35%
Dynamic Financials Sector Portfolio	PFI	10/12/06	-7.07%
Dynamic Food & Beverage Portfolio	PBJ	06/23/05	5.56%
Dynamic Hardware & Consumer Elect. Portfolio	PHW	12/06/05	-0.21%
Dynamic Healthcare Sector Portfolio	PTH	10/12/06	0.90%
Dynamic Healthcare Services Portfolio	PTJ	10/12/06	-5.64%
Dynamic Industrials Sector Portfolio	PRN	10/12/06	7.84%
Dynamic Insurance Portfolio	PIC	10/26/05	2.01%
Dynamic Leisure & Entertainment Portfolio	PEJ	06/23/05	0.96%
Dynamic Media Portfolio	PBS	06/23/05	-4.66%
Dynamic Networking Portfolio	PXQ	06/23/05	-0.80%
Dynamic Oil & Gas Services Portfolio	PXJ	10/26/05	21.42%
Dynamic Pharmaceuticals Portfolio	PJP	06/23/05	5.53%
Dynamic Retail Portfolio	PMR	10/26/05	0.83%
Dynamic Semiconductors Portfolio	PSI	06/23/05	0.86%
Dynamic Software Portfolio	PSJ	06/23/05	4.27%
Dynamic Technology Sector Portfolio	PTF	10/12/06	-5.82%
Dynamic Telecom. & Wireless Portfolio	PTE	12/06/05	1.55%
Dynamic Utilities Portfolio	PUI	10/26/05	8.86%
FTSE RAFI Basic Materials Sector Portfolio	PRFM	09/20/06	19.54%
FTSE RAFI Consumer Goods Sector Portfolio	PRFG	09/20/06	-1.75%
FTSE RAFI Consumer Services Sector Portfolio	PRFS	09/20/06	-5.68%
FTSE RAFI Energy Sector Portfolio	PRFE	09/20/06	27.85%
FTSE RAFI Health Care Sector Portfolio	PRFH	09/20/06	-3.72%
FTSE RAFI Financials Sector Portfolio	PRFF	09/20/06	-16.18%
FTSE RAFI Industrials Sector Portfolio	PRFN	09/20/06	9.07%
FTSE RAFI Telecom & Tech. Sector Portfolio	PRFQ	09/20/06	0.08%
FTSE RAFI Utilities Sector Portfolio	PRFU	09/20/06	7.11%
Listed Private Equity Portfolio	PSP	10/24/06	-13.04%
Lux Nanotech Portfolio	PXN	10/26/05	-3.34%
Water Resources Portfolio	PHO	12/06/05	10.63%
WilderHill Clean Energy Portfolio	PBW	03/03/05	7.94%
WilderHill Progressive Energy Portfolio	PUW	10/24/06	3.57%
INTERNATIONAL ETFs			
DWA Dev. Market Technical Leaders Portfolio	PIZ	12/28/07	-4.44%
DWA Emerging Mkts Technical Leaders Portfolio	PIE	12/28/07	-12.86%
Dynamic Asia Pacific Portfolio	PUA	06/13/07	-2.26%
Dynamic Dev. Int'l Opportunities Portfolio	PFA	06/13/07	-11.73%
Dynamic Europe Portfolio	PEH	06/13/07	-13.11%
FTSE RAFI Asia Pacific ex-Japan Portfolio	PAF	06/25/07	2.75%
FTSE RAFI Asia Pacific Ex-Japan Sm-Mid Portfolio	PDQ	09/27/07	-15.51%
FTSE RAFI Dev. Mkts ex-U.S. Sm-Mid Portfolio	PDN	09/27/07	-10.85%
FTSE RAFI Dev. Mkts ex-U.S. Portfolio	PXF	06/25/07	-6.67%
FTSE RAFI Emerging Markets Portfolio	PXH	09/27/07	-10.56%
FTSE RAFI Europe Small-Mid Portfolio	PWD	09/27/07	-9.87%
FTSE RAFI Europe Portfolio	PEF	06/25/07	-3.43%
FTSE RAFI International Real Estate Portfolio	PRY	12/28/07	-11.84%
FTSE RAFI Japan Portfolio	PJO	06/25/07	-10.70%
Global Clean Energy Portfolio	PBD	06/13/07	0.47%
Global Nuclear Energy Portfolio	PKN	04/03/08	N/A
Global Water Portfolio	PIO	06/13/07	-11.82%
Golden Dragon Halter USX China Portfolio	PGJ	12/09/04	18.86%
India Portfolio	PIN	03/05/08	-3.99%
International Dividend Achievers Portfolio	PID	09/15/05	11.93%
International Listed Private Equity Portfolio	PFP	09/27/07	-15.53%

DATA THROUGH: 03/31/2008

gies that are providing clean water for individuals. It's also an infrastructure play as well because, even in the U.S., the infrastructure of water needs tremendous amounts of investment.

Recently, in March, we launched The PowerShares India Portfolio (PIN), which is based on the Indus India Index. Foreign ownership of Indian securities has traditionally been very challenging due to strict foreign ownership limits. Once those limits are reached foreign investors cannot purchase additional shares. PIN is based on an intelligent rules based index that considers the amount of shares available for foreign investment in its construction. Additionally, companies that have reached their foreign investment limits are immediately removed maintaining an index that can be faithfully replicated by US based portfolio managers. The ETF launched on March 6th and has already garnered over \$40 million in assets.

Q: Do fundamental weighted indexes also suffer from overweight of companies with rising earnings as capital weighted indexes suffer from overweight of stocks that are popular at the time?

A: Fundamental weighted indexes do have higher concentration of stocks with rising earnings but the surge and declines tend to be less pronounced than in the cap weighted indexes.

The FTSE RAFI fundamental indexes will have a higher percentage and higher weighting in energy companies today than it would have in financial companies. But it's not as skewed from an exposure standpoint as it would be with cap weighting and the reason being is that this index is not seeking alpha.

It's actually seeking to give a more intelligent exposure to the market by determining what is believed to be a more accurate measure of company's actual size, or economic footprint. The index

does not make investment merit decisions.

I think what institutional investors and retail investors, are looking at with regard to indexing is efficient exposure to the market. And many believe that there are efficiencies in the market and it's very difficult for an active manager to outperform. PowerShares fundamental ETFs provide investors what we believe is a more intelligent exposure to the market by weighting companies within the index using measures of the firm's economic footprint versus its cap weighting.

Q: You mentioned that you do quarterly rebalancing. Can you describe the guidelines that you have for rebalancing?

A: Not all of the indexes that we replicate rebalance quarterly. But in the intelligent indexing space the Dynamic Series of PowerShares rebalance on a quarterly basis. This quantitative rules-based indexing process has 25 different factors that rank universal securities.

I'll use the example of the PWC which is a universe of 1,000 securities. It ranks these companies quantitatively every single quarter, and it's a disciplined rebalance. Basically, it's a very repeatable process because you are using the exact same factors and the same way of ranking a company.

The Intellidexes can have upwards of 100% turnover; probably the average is about 70%. The turnover of securities can be handled very efficiently in an ETF portfolio due to in-kind transfer of securities. PowerShares equity and fixed-income based ETF portfolios have never distributed a capital gains to shareholders since inception. It potentially could happen, but ETFs are very tax efficient.

Q: What is your view on risk control? How do you balance or mitigate risks?

A: With PowerShares Intellidex based

ETFs, there are 25 underlying factors that can be broken down into four broad areas. They are fundamentals, valuation, risk, and timeliness and each one of these has different factors. So there are roughly 6 or 7 risk factors that we use in terms of stock selection with PowerShares Intellidex quantitative rules based portfolios.

Additionally, using an ETF portfolio provides you with another area of risk control which is diversification. For instance, in clean energy, many of these alternative energy companies are smaller companies, and not every one of these companies is profitable today. So, if you wanted to get involved in an area such as bio-fuels, it would be very risky to buy one or two companies. You diversify your risks by buying a basket and, therefore, you are diversifying your exposure and your risks to that area in the market.

There are certainly risks in cap weightings. You have the risk of participating and the price is at times inefficient. You participate in every bubble, but you are 100% invested in every thrust as well.

I think that the last area of risk control is that we have the ability to rebalance and take securities out on a quarterly basis with the Intellidex. With the RAFI series of indexes you are basically buying the whole index, but it's just not weighted by the capitalization. It's weighted by its economic footprint and that rebalances on an annual basis. **T**

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Disclosure

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