Fact Sheet: The Morningstar Rating for Stocks

Investor Benefits

- Provides an indication of whether a stock is overvalued or undervalued based on the forward-looking estimates of Morningstar's equity analysts
- Offers up-to-date, daily insight into the valuation of more than 2,000 companies globally
- Leads investors to well-run businesses trading at reasonable prices—not simply to fads or "story stocks"

When we launched the Morningstar Rating for stocks in August 2001, our goal was to help investors answer the most difficult question in stock investing: Is a company worth the price that the market is asking for its shares? To shed light on this question, we began to calculate star ratings that represent our opinion, on a risk-adjusted basis, of the firm's intrinsic value relative to its market price.

What It Means for Investors

There are three key components to the Morningstar Rating for stocks; our analysts' estimate of the stock's fair value; our assessment of the firm's business risk; and the stock's current market price. Our fair-value estimates are based on our projection of a company's future cash flows, and our estimate of the appropriate discount rate to apply to those cash flows. Our analysts follow their companies daily, and if their inputs change, we update our assessment of the stock's fair value. (See the Morningstar Investment Methodology for more information on how our analysts arrive at their estimates.)

In comparing our fair-value estimate to each stock's current market price, we also take the overall quality—and business risk—of the company into account. In other words, the more risky the company the cheaper it has to be to earn a 5-star rating. A firm with below-average business risk need only be 15% below our fair-value estimate to receive 5 stars, while an above-average risk stock requires a 35% discount to reach 5-star status. There are no predefined distributions of stars—that is, the percentage of stocks earning 5 stars can fluctuate daily—so the star ratings can also be used as a general gauge of the broader market's valuation.

Frequently Asked Questions

How does the Morningstar Rating for stocks differ from the Morningstar Rating for funds?

Because stocks and funds are very different types of investments, our stock and fund ratings are designed to do two different things. The Morningstar Rating for funds describes how well a fund has balanced return and risk or volatility in the past. The Morningstar Rating for stocks uses projections of a company's future operating performance to estimate whether the stock is currently overvalued or undervalued.

How do you choose the companies that receive a Morningstar Rating for stocks?

Currently, our coverage list exceeds 2,000 stocks. These are generally the largest companies in terms of market capitalization and sales across more than 130 industries globally. We also rate stocks that aren't as well known, but that we think have wonderful businesses that would make attractive investments at the right price.

What are the key factors in the Morningstar Rating for stocks?

The Morningstar Rating for stocks:

- Is a measure of whether or not the stock is over or undervalued based on forward-looking estimates
- Is risk adjusted
- Is based on both quantitative and subjective inputs—it includes analysts' opinions, which are embedded in their estimates of future cash flows
- Is calculated daily
- Does not divide stocks into comparison groups, nor does it have a fixed distribution of stars—the percentage of stocks receiving 5 stars will fluctuate daily

How do you measure the success of the rating?

We review the performance of our highest- and lowest-rated stocks on a regular basis, and publish the results here: http://global.morningstar.com/stocks

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