

Fact Sheet: The Morningstar Equity Style Box™

Investor Benefits

- ▶ Analyzes the full equity portion of a fund or portfolio, including Canadian equities, U.S. equities, and stocks from around the world
- ▶ Describes securities in terms of their relative size and value-growth orientation
- ▶ Provides a powerful, fundamental lens for understanding stocks, funds, and portfolios
- ▶ Creates more accurate, stable classifications
- ▶ Helps investors construct and monitor diversified portfolios

Background

The Morningstar Equity Style Box™ was introduced in 1992 to help investors and advisors determine the investment style of a fund. The Style Box is a nine-square grid that classifies equities by size along the vertical axis and by value and growth characteristics along the horizontal axis. Different investment styles often have different levels of risk and can lead to differences in returns. Therefore, it is crucial that investors understand style and have a tool to measure their style exposure.

Morningstar’s equity style methodology uses a “building block,” holdings-based approach that is consistent with Morningstar’s fundamental approach to investing. Style is first determined at the stock level and then those attributes are aggregated to determine the overall investment style of a fund or portfolio. This unified framework can link what are often treated as separate processes—stock research, fund research, portfolio assembly, and market monitoring—in the belief that a shared analytical framework will lead to better portfolio construction and fund usage.

Building Better Portfolios

The Morningstar Style Box captures three of the major considerations in equity investing: size, security valuation and security growth. Value and growth are measured separately because they are distinct concepts.

A stock’s value orientation reflects the price that investors are willing to pay for the stock’s anticipated per-share earnings, book value, revenues, cash flow, and dividends. A high price relative to these measures indicates that a stock’s value orientation is weak, but it does not necessarily mean that the stock is growth-oriented. Instead, a stock’s growth orientation is

independent of its price and reflects the growth rates of fundamental variables such as earnings, book value, revenues, and cash flow.

Morningstar’s multi-factor approach produces more accurate and stable stock and fund style assignments. The use of both forward-looking and historical-based components ensures that information available to active fund managers is incorporated in the model. This robust approach to style analysis is a powerful lens for understanding stocks, funds, and portfolios.

A Global Approach

The Morningstar Style Box is applicable in all equity markets. A geographic framework ensures that style assignments are relevant to local investors everywhere. World equity markets are divided into seven style zones:

United States	Japan
Latin America	Asia ex-Japan
Canada	Australia/New Zealand
Europe	

The stocks in each style zone are further subdivided into large-, mid-, and small-cap groups for value-growth scoring. Style Box assignments for funds are based on the asset-weighted average of the style and size scores of the underlying stocks.

What It Means for Investors

The Morningstar Style Box lays the groundwork for better portfolio assembly and monitoring and is a useful tool for individual and professional investors. It provides a logical, completely integrated system and philosophy for analyzing stocks, funds, and portfolios.

The Morningstar Equity Style Box: What Does it Look Like?

Fund Investment Style

	Value	Blend	Growth
Size Large			
Mid			
Small			

The Morningstar Equity Style Box is a nine-square grid that illustrates the investment style of a security. Size (large, mid, or small) is displayed along the vertical axis and style is displayed along the horizontal axis. The “value” and “growth” investment styles are common to both stocks and funds. For stocks, the central column of the Style Box represents the

“core” style. Few or no funds contain only stocks with extreme value-growth orientations, and both value and growth managers often hold core stocks for diversification or other reasons. Therefore, for funds, the central column represents the “blend” style (a mixture of growth and value stocks or mostly core stocks).

Fact Sheet: The Morningstar Equity Style Box™

The Vertical Axis: Size

A stock is classified as large, mid, or small based on its position in the cumulative market capitalization of its style zone. Large-cap stocks are those that together account for the top 70% of the capitalization of each

style zone; mid-cap stocks represent the next 20%; and small-cap stocks represent the balance. The market caps that correspond to these breakpoints are flexible and may shift from month to month as the market changes.

The Horizontal Axis: Style

Value Score Components and Weights

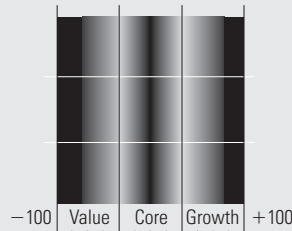
Forward looking measures	50.0%
▶ Price-to-projected earnings	
.....	
Historical based measures	50.0%
▶ Price-to-book	12.5%
▶ Price-to-sales	12.5%
▶ Price-to-cash flow	12.5%
▶ Dividend yield	12.5%

Growth Score Components and Weights

Forward looking measures	50.0%
▶ Long-term projected earnings growth	
.....	
Historical based measures	50.0%
▶ Historical earnings growth	12.5%
▶ Sales growth	12.5%
▶ Cash flow growth	12.5%
▶ Book value growth	12.5%

Determining the Style Score

⊖ Growth Score	0 to 100
⊖ Value Score	0 to 100
.....	
⊖ Style Score	-100 to 100

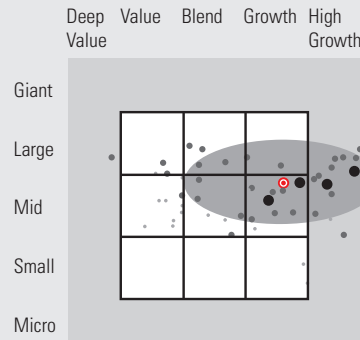


Stocks are given a value score based on five fundamental measures and a growth score based on five growth rates. Stocks are scored against their style zone and size peers (e.g. Latin American large-caps).

The difference between the stock's growth and value scores is the net style score. If the result is strongly negative, the stock's style is value. If the result is strongly positive, the stock is classified as growth. If the scores for value and growth are similar in strength, the stock is classified as "core."

On average, value, core, and growth stocks each account for approximately one-third of the total capitalization in a given scoring group.

Morningstar Ownership ZonesSM



The style and size scores for funds and stocks are the building blocks of the Morningstar Ownership Zone. An Ownership Zone is derived by plotting each stock in the fund's portfolio within the proprietary Morningstar Style Box. The ellipse represents the centre 75% of the assets in which the fund invests.

Investors can manage their exposure to different stock sizes and investment styles by comparing the Ownership Zones for several funds.