



Morningstar Qualitative Rating™ & Morningstar® Fund Research Report

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Overview - Key Benefits

- ▶ The Morningstar Qualitative Rating™ gives investors a clear statement of Morningstar's qualitative assessment of a fund's investment merits or lack thereof.
- ▶ The Morningstar® Fund Research Report, issued with the rating, gives a transparent, in-depth discussion of the rationale for the rating and also gives meaningful insight into current and future drivers of the fund's strategy and its likely performance biases in varying market conditions.
- ▶ Taken together, the new qualitative ratings help advisers to better focus their research into different funds, while the research reports are designed to help investors and advisers better understand the inner workings of each fund, to help them select the right funds for their individual needs and risk profile. The goal is to elevate the debate beyond "good fund" versus "bad fund" and help ensure that investors and their advisers understand how a fund can be used in a broader portfolio context.
- ▶ Morningstar does not seek or accept any compensation for issuing a report or rating, so investors can be sure the opinions are independent and objective

Morningstar's Qualitative Research

Given the global financial climate, the need for investors and their advisers to have access to objective, unbiased research borne of a completely transparent process has never been greater. Morningstar qualitative research provides forward-looking insight and assumptions into how a fund might behave under different market conditions, helping investors to maintain realistic performance expectations and manage their portfolios more wisely. Morningstar's Pan European and Asian research Team delivers its qualitative assessments in both an in-depth Morningstar® Fund Research Report and in one of five summary Morningstar Qualitative Rating™.

Morningstar's principles of qualitative research:

- ▶ **Independence.** Morningstar does not charge fund groups to be rated, nor can they commission research, providing investors and their advisers with truly independent, objective information. Morningstar's decision to report on a fund is driven by investor interest and analyst discretion.
- ▶ **Investors First.** Morningstar's analysts focus wholly on helping investors make better decisions.
- ▶ **Relevant Coverage.** Analysts determine coverage based on asset size, investment merit, and market demand to ensure they cover the funds that matter most to investors.
- ▶ **Comprehensive Scale.** Morningstar's Ratings scale has been developed to allow analysts to not only cover good funds, but also identify mediocre and poor funds through negative ratings. This approach provides far greater insight in helping investors when they often need it the most.
- ▶ **Local and global expertise.** Morningstar has a network of 28 fund analysts located in markets across Europe and Asia, who work closely with the company's global analyst teams in the United States, Canada, and Australia. Morningstar believes that local experts, who know their markets and can conduct interviews and write reports in their local languages, best serve investor needs.

The key goals of Morningstar's qualitative research are to:

- ▶ Issue a judgment on the fund's overall investment merit with an eye on selecting funds capable of outperformance
- ▶ Help investors understand how a fund fits into an investment portfolio
- ▶ Provide forward-looking insight and assumptions into how a fund might behave in different market conditions
- ▶ Compare a fund to its peers on fundamental criteria, such as expenses, manager tenure, and investment approach
- ▶ Help investors understand the true nature of a fund—aggressive or conservative, absolute- or relative-return oriented, growth or value, flexible or rigid
- ▶ Monitor the fund over time—assessing when a fundamental change has affected the fund's investment merit

Morningstar's aim is to help investors determine a fund's overall investment merit to help them construct diversified portfolios and achieve their goals. The Morningstar Qualitative Rating™ can be used within an investment decision making process by individuals, advisers, and institutional investors.

▶ **Research Methodology: the Five Pillars**

Morningstar evaluates funds based on five key pillars, which its analysts believe to be predictive of future performance. The approach notably puts only partial weight on past performance and backward-looking risk measures and does not dismiss funds that have underperformed or have limited track records. The approach serves not as a formula but as a robust analytical framework ensuring consistency across assessments. Analysts judge each pillar, as well as the entire fund, against peers. Morningstar does not enforce a particular distribution of ratings in a peer group. Assessing many funds and managers gives analysts a rich perspective and allows them to better weigh their relative merits.

- ▶ **People.** An assessment of the quality of a fund's managerial team has a significant influence on Morningstar's final investment opinion. Factors considered include experience, skills, temperament, workload, analytical support, and incentive structure. Analysts put considerable emphasis on understanding how information flows between a research staff and the manager.
- ▶ **Parent.** Morningstar believes the quality of the investment firm can have a meaningful impact on a fund's long-term chances for success. In analysing the fund company parent, analysts consider ownership structure, compensation schemes, and managerial stability. Analysts also assess the firm's culture, preferring those that treat fund shareholders as partners and emphasise the investment process over profits.
- ▶ **Process.** A fund's strategy is integral to its success, and Morningstar analysts spend considerable time evaluating the overarching investment strategy and its execution—both in terms of security selection as well as portfolio construction. Analysts consider whether the process dovetails with the fund's analytical support and plays to management's strengths. They also make significant use of Morningstar's holdings-based analytical tools to assess whether portfolio positioning reflects the process. In addition, analysts assess risks inherent to the strategy, looking not just at backward-looking measures of risk but forward-looking ones such as stock, sector, and geographic exposures, as well as valuation risk and asset size.

- ▶ **Performance.** Morningstar takes a holistic view of performance analysis, with the knowledge that past returns are not predictive and that luck and skill are difficult to distinguish. Morningstar evaluates performance in the context of the fund’s investment objectives and focuses on the drivers of performance. Analysts focus on performance over a full investment cycle to gain insight about how a fund might perform in the future under a variety of market environments.
- ▶ **Price.** Morningstar research has established a strong relationship between fund expenses and future performance. Consequently, a fund’s total expense ratio (TER) can have a significant impact on an analysts’ opinion.

Morningstar Qualitative Rating™

Morningstar analysts assign a Morningstar Qualitative Rating™ to funds using a five-point scale ranging from Elite to Impaired. Analysts rate funds on a relative basis, against a pan-European and Asian universe of funds in a similar peer group. The ratings scale is unique from other firms because it includes negative ratings which allow analysts to assess and rate poor funds, as well as good funds. Investors will be able to screen and filter their fund choices using the qualitative ratings. The ratings are as follows:



Elite: These funds represent Morningstar analysts’ highest conviction picks. Morningstar awards the rating to funds that it believes are capable of outperforming their peers over the long term. To earn this rating, a fund must be significantly better than its peers in most key respects.



Superior: Funds in this category are those Morningstar analysts believe are above average and capable of producing peer-beating returns. While these are worthy funds, analysts don’t see them as the very best.



Standard: These funds are not standouts, but nor are they deeply flawed. Morningstar analysts do not have a high degree of conviction that they can outperform.



Inferior: These funds are thought to be deficient relative to their peers in key respects. Morningstar analysts believe these funds are likely to underperform their peers through time.



Impaired: Morningstar analysts believe that a severe structural defect at the parent organisation or the fund make these offerings extremely poor investments.

Under Review: Morningstar analysts will also place a fund “under review” when the fund has experienced a fundamental change requiring a reassessment. This is not a rating.

The ratings reflect Morningstar analysts’ conviction in the fund’s ability to outperform over the long term. The rating is not an individualised recommendation; the best emerging markets equity fund, for instance, might not fit with a particular investor’s risk appetite, time horizon, and other portfolio holdings. While the rating is a useful short-hand, investors must read the underlying report to gain a full understanding of the fund.

Morningstar® Fund Research Report

The four-page report contains the analyst's written opinion on the fund's strengths and weaknesses. The overview of the fund is supported with the analyst's opinion on the Five Pillars – People, Parent, Process, Performance and Price. The qualitative opinion is presented with quantitative statistics showing the fund's style, performance, and the quantitative Morningstar Rating™ for comparison. Because future outperformers are not necessarily the same as in the past, Morningstar does not limit coverage to funds meeting certain performance criteria or track record history. The goal is to paint a full picture for investors and give them meaningful insights into current and future drivers of the fund and its future outcomes. Each section of the report is supported by data that is dynamically updated each month.

Ratings Universe

Morningstar aims to rate and report on 3,000 funds in Europe and Asia which would increase the total number of funds worldwide for which the company provides written analyses to more than 5,000. In addition, Morningstar tracks performance and operational data on approximately 110,000 funds globally.

Process

A team of 28 Morningstar fund analysts in Europe and Asia will join the 53 Morningstar fund analysts in the United States, Canada, Australia, and mainland China to provide insight on global investments. In addition, fund analysts can draw on the team of 130 Morningstar equity analysts worldwide for an independent perspective on the merits of individual fund holdings. Morningstar uses a detailed process to evaluate each fund receiving a research report and rating, including:

- ▶ Acquire basic information via a Fund Company Questionnaire sent to all potential funds to be included in the research and ratings
- ▶ Analyse holdings and returns using Morningstar tools
- ▶ Assess the five pillars systematically, using all available sources
- ▶ Interview the fund manager, usually conducted face to face and with multiple analysts present
- ▶ Consult Morningstar's team of global analysts
- ▶ Ensure the consistent application of standards through a ratings committee meeting, in which a group of senior analysts from across Europe review the analysis and collectively decide upon the Morningstar Qualitative Rating™
- ▶ Construct a report with robust analytical content, as well as regularly updated risk and returns statistics, Morningstar proprietary holdings based graphics, and data points
- ▶ Issue reports through regional and global distribution channels
- ▶ Track ratings systematically and continually review for consistency and unwanted bias

Distribution

Morningstar clients will be able to access the new ratings and research through Morningstar® Adviser WorkstationSM, Morningstar DirectSM —its flagship institutional platform— Morningstar Workstation, and across its various retail Web sites.

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