

# Fact Sheet: The New Morningstar Style Box™ Methodology

## Investor Benefits

- ▶ Better measures the characteristics of individual stocks—more in line with the way portfolio managers look at stocks
- ▶ Creates more accurate, stable classifications
- ▶ Lays the groundwork for better portfolio assembly, market monitoring, and fund usage
- ▶ Remains useful and easy to understand for individual and professional investors

## Background

The Morningstar Style Box™ was introduced in 1992 and quickly gained favor within the investment community. For the first time, individual and professional investors had a way to quickly understand the investment positioning of a mutual fund. By providing an easy-to-understand visual representation of fund characteristics, the Morningstar Style Box™ allowed informed comparisons and portfolio construction based on what funds actually held, rather than assumptions based on a fund’s name or how it was described by its marketers. In time, the Style Box™ became the basis for Morningstar’s style-based fund categories, a move later followed by other fund trackers.

## Building Better Portfolios

Morningstar’s original style evaluation methodology was designed primarily for categorizing equity mutual funds. The new style evaluation methodology introduces a “building block” system that links what are often treated as four 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.

The new methodology begins with a determination of the style of individual stocks. The style attributes of stocks within a fund are then “rolled up” to determine the overall investment style of the fund. A portfolio of two or more funds can now be constructed based on knowledge of the characteristics—the style factor exposures—of all of its component stocks: thus, style-controlled portfolios can now be accessible to all investors. And finally, the behavior of stocks of different styles can be monitored on an up-to-the-minute basis using Morningstar’s style-based market indexes.

Understanding the behavior of different stock types is a crucial input to decision making when selecting an individual fund or constructing a diversified, style-controlled portfolio.

## Moving Seamlessly from Stocks to Funds to Portfolios to Markets

A fund is an aggregation of individual stocks. By plotting all of a fund’s stocks on the stock style grid, the range of stock styles included in the fund immediately becomes apparent. An asset-weighted average of the stocks’ net value/growth scores determines the fund’s overall style.

Investors wishing to manage their exposure to different stock sizes and investment styles can combine the Style Box™ plots of several funds to get a precise picture of the resulting portfolio. Morningstar currently provides several tools to help investors determine stock size and style preferences (Stock Selector<sup>SM</sup> and Fund Selector<sup>SM</sup>), and monitor their portfolios for changes (Portfolio X-Ray<sup>SM</sup>).

## When and Where

The new Style Box™ methodology will be implemented in all Morningstar products this year.

In addition, Morningstar recently announced it is launching a family of 16 equity indexes, covering all nine Style Box™ assignments and combinations. Each of the nine style-based sub-indexes contains a weighted combination of the stocks that belong to that style. Investors can monitor the returns and risk of different types of stocks on a minute-by-minute basis. This is a powerful tool in understanding the behavior of individual funds as well as portfolios.

## The New Morningstar Style Box™: What Does it Look Like?

### Fund Investment Style

Value Blend Growth


Size  
Large  
Mid  
Small

The Morningstar Style Box™ remains a nine-square grid—three stock investment styles for each of three size categories: small, mid and large. Two of the three style categories are “value” and “growth,” common to both stocks and funds. However, the third, central column definition differs. For stocks, the central column

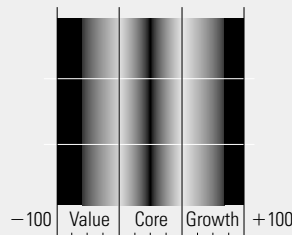
of the Style Box™ will represent the core style (those for which neither value or growth characteristics dominate); for funds, it will represent the blend style (a mixture of growth and value stocks or mostly core stocks).

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The Horizontal Axis: Style	Value Score Components and Weights		Growth Score Components and Weights	
		<b>Forward looking measures</b>	<b>50.0%</b>	<b>Forward looking measures</b>
	▶ Price-to-projected earnings		▶ Long-term projected earnings growth	
	<b>Historical based measures</b>	<b>50.0%</b>	<b>Historical based measures</b>	<b>50.0%</b>
	▶ Price-to-book	12.5%	▶ Historical earnings growth	12.5%
	▶ Price-to-sales	12.5%	▶ Sales growth	12.5%
	▶ Price-to-cash flow	12.5%	▶ Cash flow growth	12.5%
	▶ Dividend yield	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



The value score is subtracted from the growth 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 not substantially different, the stock is classified as "core."

The dividing points between value, core and growth stocks vary to some degree over time, as the distribution of stock styles changes in the market. However, on average, each of the three stock styles accounts for approximately one-third of the total free float in a given size category.

The Vertical Axis: Market Capitalization	Value	Growth
Currently Morningstar defines the largest 250 U.S. stocks as large cap, the next largest 750 stocks as mid cap, and the remaining stocks as small cap. The new methodology defines large-cap stocks as those that account for the top 70% of the capitalization of the	Morningstar domestic stock universe; mid-cap stocks represent the next 20%; and small-cap stocks represent the balance. The Morningstar stock universe represents approximately 99% of the U.S. market for actively traded stocks.	

### What It Means for Investors

The new Morningstar Style Box™ lays the groundwork for better portfolio assembly and monitoring and remains a useful and easy-to-understand tool for individual and professional investors. The appearance of the box itself is not changing. A modest number of funds will change their Style Box™ classification. In some cases, their Morningstar Category™ (based on a fund's holdings during the three previous years) will change as well.

With the new methodology in place, investors can look forward to more accurate and more stable classifications. But the ultimate advantage of the new methodology is a logical, completely integrated system and philosophy for stock and fund research, portfolio construction, and market monitoring. ■■■