



Fund Categories

In 1992, the Morningstar Style Box was introduced to aid decision makers with the investment style of a fund (Morningstar, 2004). This could be useful for investors because different investment styles may have different levels of risk and returns. It can also be used to determine how an investment fits into an investment portfolio (Investopedia, 2022). In particular, the domestic equity style box a tool used for evaluating mutual funds.

As seen in Figure 1 below, the style box coordinates securities by investment style on the horizontal axis and by size on the vertical axis (Morningstar, 2004). Size on the vertical axis is classified according to the market capitalization of the fund. These classifications include small, mid, or large based on an investment's position in its style zone's cumulative market cap. Large caps account for the top 70% of capitalization in its style zone, while the next 20% is accounted for by mid-caps, and the last 10% include small caps.

On the horizontal axis, stocks are scored according to the difference amongst its growth and value scores (Figure 2). Growth score components includes 50% long term projected earnings growth, which is forward looking. Historical based components include historical earnings growth, sales growth, book value growth, and cash flow growth, at 12.5% each. On the other hand, value score components include 50% price to projected earnings for forward looking, and 12.5% for each of the historical based components: price to book, dividend yield, price to cash flow, and price to sales.

Both growth and value components receive a score of 0 to 100, and their difference yields the style score (Figure 2). High negative style scores represent value stocks, while high positive scores represent growth stocks. Last, if both growth and value scores are similar in strength, the stock is categorized as blended.

Outside of the style box, value and growth stocks could also be classified according to their market to book ratio. This ratio is comprised of their market value of equity, also known as market capitalization, divided by their book value of equity, also known as the equity value



found on their balance sheet. (Berke, 2019). A company with a high ratio indicates a value stock, whereas a low ratio indicates a growth stock.

Mutual funds can be categorized into one of nine categories: large value, large blend, large growth, medium value, medium blend, medium growth, small value, small blend, and small growth (Investopedia, 2022). A value orientation depicts the price that investors would pay for a stock's predicted per share earnings, revenues, cash flows, dividends, and book value (Morningstar, 2004). On the other hand, a growth-oriented fund reflects the growth rates of book value, cash flows, revenue, and earnings. Growth oriented funds also are independent of price. Taken together, a mixture of value and growth stocks generate the blend style. Blend style stocks can also be considered core stocks.

There is also the international equity style box, as well as the fixed income style box (Investopedia, 2022). The former also has market cap on the vertical axis and valuation on the horizontal axis. While it may look similar to the domestic equity style box, they use different specifications for calculating valuations and market caps. In the international style box, valuations do not use price to earnings, but rather the price to cash flow ratio, making it easier to compare securities, since earnings data may be computed differently depending on the location. Additionally, market caps are calculated according to the median market cap of the assets in a fund. Each asset is measured and factored into the whole.

The fixed income style box categorizes investments into one of nine categories. The horizontal axis measures the duration of the bonds in the portfolio to calculate the interest rate sensitivity. Duration is categorized into short, intermediate, and long. The vertical axis measures an investments credit quality as low, medium, or high. Since each bond in a fund has a distinctive maturity date and credit quality rate, this categorization is easy.

References

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Investopedia. (2022, January 31). "Understanding the Mutual Fund Style Box" *Investopedia*, <https://www.investopedia.com/articles/basics/06/stylebox.asp>.

Morningstar. (2024). "Fact Sheet: The Morningstar Style Box" *Morningstar*, https://wealthtrack.com/wp-content/uploads/2018/12/MorningstarStyleBox_FactSheet.pdf.

Appendices

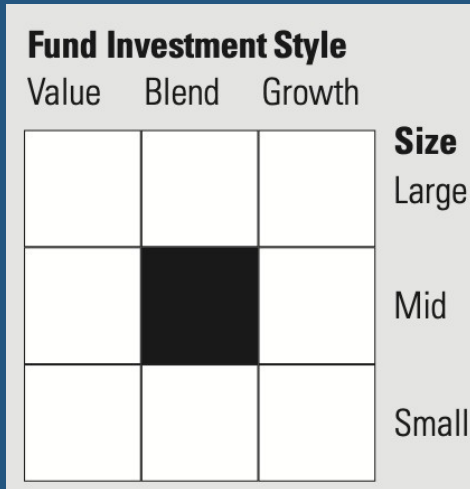


Figure 1. Fund Investment Style.

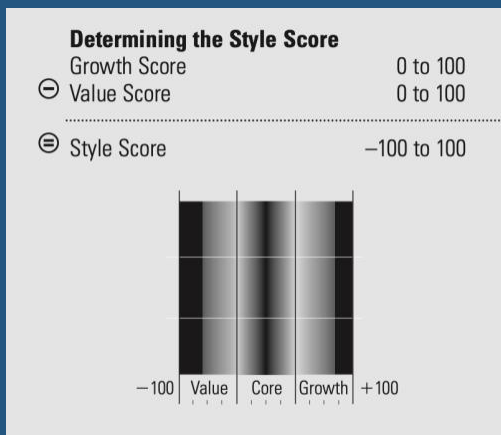


Figure 2. Determining the Style Score.