Morningstar Target Value Indexes

Value investing is based on the intuitive premise that stocks trading at low prices relative to their fundamentals should offer higher future returns than their more expensive counterparts. Stocks may trade at low valuations for several reasons: they have poor growth prospects, a challenging competitive landscape, high risk, or they may just be oversold. Value stocks may be priced to offer compensation for their risk or lack of curbside appeal.

The Morningstar Target Value Indexes are designed to provide exposure to the value factor by targeting stocks with low valuations and improving earnings outlooks. The indexes aim to offer stronger exposure to the value factor, with less sector concentration, than a traditional market cap-weighted value index.

Measuring value
The Morningstar Target Value Indexes target a fixed count of stocks with strong value characteristics. Each eligible stock is assigned a Weighted Average Fundamental Factor Rank, or WAFFR, based on five metrics.

- Price/trailing 12-month earnings

- Price/trailing 12-month cash flow

- Price/current book value

- Price trailing 12-month sales

- 3-month EPS estimate revision

Together, these metrics paint a more complete picture of each stock, mitigating the biases any single metric might introduce. For example, price/book is one of the most widely used valuation metrics in academic literature, but it does not account for profits or intangible assets. Price/earnings addresses profitability but could be influenced by account choices, which is less of an issue for price/cash flow and sales. The earnings per share revision metric favors stocks with earnings likely to improve, reducing the risk of targeting stocks with deteriorating fundamentals.

Index eligibility and portfolio construction
The Morningstar Target Value Indexes derive their constituents from the corresponding regional benchmark from the Morningstar Global Markets Indexes, which represent the top 97% of the investable equity market. To be eligible for inclusion stocks must pass market capitalization and liquidity screens, both of which improve investment capacity.

Qualifying stocks are ranked on their WAFFR and the highest-ranked stocks are selected until the target constituent count is reached, subject to sector and regional constraints to limit concentration. Current constituents are favored over new stocks to mitigate unnecessary turnover. The indexes are equal weighted.

Reconstitution
The Morningstar Target Value Indexes are reconstituted and rebalanced quarterly.

Construction process

Starting universe ❯ **Eligibility** ❯ **Portfolio construction** | Morningstar Target Value Indexes

- Morningstar Global Markets Index
  - Represents top 97% of the investment market

- Liquidity and market cap filters are applied
- Must have a weighted average fundamental factor rank (WAFFR)

- The top N ranked stocks based on WAFFR are targeted for inclusion
- Buffer rules are applied
- Sector and regional constraints are applied
- Constituents are equal weighted

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Index	Target Constituent Count
Morningstar Canada Target Value Index	30
Morningstar Developed Markets ex-North America Target Value Index	200
Morningstar Emerging Markets Target Value Index	150
Morningstar US Target Value Index	100

About Morningstar Indexes

Morningstar Indexes was built to keep up with the evolving needs of investors—and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers and advisors in navigating investment opportunities across major asset classes, styles and strategies. From traditional benchmarks and unique IP-driven indexes, to index design, calculation and distribution services, our solutions span an investment landscape as diverse as investors themselves.

Please visit indexes.morningstar.com for more information.

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