Morningstar Indexes

Morningstar Global Wide Moat Focus Indexes

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Shaped by the forward-looking insights of Morningstar's equity analysts, the Morningstar Global Wide Moat Focus Indexes are designed to deliver high conviction portfolios of stocks with durable competitive advantages and attractive valuations. Unconstrained by traditional style classifications, the positioning of these indexes moves wherever the most attractive opportunities are found. This unique approach combines fundamental insights with objective portfolio construction, which facilitates consistency and investability.

Morningstar Equity Research

Morningstar is the largest provider of independent sell-side equity research globally, with over 100 equity research analysts covering more than 1,500 stocks. Morningstar's analysts assign each company a Morningstar® Economic Moat Rating,™ which reflects the strength and durability of its competitive position. Analysts also create fair value estimates for companies based on a three-staged discounted cash flow model that incorporates their in-depth knowledge and expectations for future growth. This forward-looking valuation assessment reflects long-term cash flow forecasts, which many traditional valuation metrics, like price/earnings, may not be as well-equipped to capture.

What is an economic moat?

An economic moat is a durable competitive advantage that allows a firm to keep competitors at bay and generate economic profits over an extended period. To help investors identify companies that possess an economic moat, Morningstar's equity research team assigns one of three economic moat ratings: "wide," "narrow," or "none." There are two major criteria that must be satisfied for a company to earn a moat rating of "wide": 1) it must be likely to generate returns on invested capital above its weighted average cost of capital for at least the next twenty years; and 2) it must enjoy one of the following economic moat sources, each of which is a driver of structural competitive advantage:

- Network effect—Present when the value of a network increases for new and existing users as the network grows.
- Cost advantage —Allows a firm to sell at the same price as competition but still enjoy economic profits thanks to lower unit costs of production.
- Efficient scale—When a company serves a market limited in size, new competitors may not have an incentive to enter, particularly when the cost of market entry is high. New entrants would cause returns for all players to fall well below the cost of capital.
- Intangible assets—Brands, patents, and regulatory licenses that block competition and/or convey meaningful pricing power.
- Switching costs—Whether in time or money, the expenses that a customer would incur to change from one producer/provider to another.

Portfolio construction

The Morningstar Global Wide Moat Focus Indexes derive their constituents from the Morningstar Global Markets Indexes. To be eligible for inclusion, constituents from the parent index must be assigned a fair value estimate and an economic moat rating of "wide" by Morningstar's analysts. Companies must also meet liquidity requirements. As a precaution to limit exposure to stocks with negative momentum, eligible stocks are ranked on their price returns over the past 12 months, and those that fall in the bottom 20% are removed from the index universe. The remaining stocks are then ranked on their price/fair value ratios. Those trading at the largest discount to fair value are selected until the index reaches its fixed target constituent count, with buffers applied to favor existing index members. Each Morningstar Global Wide Moat Focus Index consist of two sub-portfolios, and the stocks within each sub-portfolio are equally weighted, subject to sector and country constraints.

Reconstitution

The Morningstar Global Wide Moat Focus Indexes reconstitute semi-annually on a staggered quarterly schedule. Therefore, half of each index reconstitutes quarterly. This allows for the inclusion of undervalued stocks on a more frequent cadence than a traditional semi-annual reconstitution schedule would provide. Additionally, this approach reduces turnover by approximately 50% when compared to alternative reconstitution approaches. Because of the staggered reconstitution schedule, the overall number of constituents can deviate from the target count, and the weightings at the portfolio level may not always be equal. The two sub-portfolios are brought back to equal weight in the overall index portfolio every December and June.

Construction process

Selection universe	Eligibility criteria	Portfolio construction	
• Morningstar Global Markets Indexes • Represents 97% of the investable market	• “Wide” economic moat rating • Fair value estimate assigned by a Morningstar analyst • Momentum screen: Stocks must not rank in the bottom 20% of the eligible group • Liquidity screen: Minimum ADTV of $5 million	• Select N eligible stocks with the lowest price/fair value ratios • Equal weight constituents • Apply sector capping and turnover buffers • Staggered rebalance	Morningstar Global Wide Moat Focus Indexes

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.