

Fixed-Income Style Box

Frequently Asked Questions

April 2019

What's Changing?

Morningstar is changing the source of the Fixed-Income Style Box from surveyed inputs to our enhanced calculated analytics. In the past, each fund company reported its funds fixed-income statistics to us at the fund level. Under our new methodology, we will calculate a value for each individual fixed-income holding and aggregate those values up to the fund level.

Additionally, we will be changing the product display default for six data points where we currently show the surveyed value to our calculated values. These data points have been available in products since 2017. The data points switching from surveyed values to calculated values are:

- Credit Quality Breakdown
- Average Credit Quality
- Effective Duration
- Modified Duration
- Effective Maturity
- Yield to Maturity

What's Not Changing?

Two main things will not be changed for this methodology update. First, we will not be adjusting the inputs to the calculation. We will still use Effective Duration and Average Credit Quality as inputs. However, we will change the source from surveyed to calculated. Second, the methodology of the Style Box will not be changing. We will continue to calculate the breakpoints and placement in one of the nine boxes in an identical manner.

Why Are We Changing?

The key benefit of making this switch is comparability. While Morningstar has always provided guidelines to fund companies that submit the fixed-income survey, it has never been possible for us to effectively ensure that everyone was following the same standards. By switching to our calculated values at a bond level, we will be able to provide a truly comparable set of analytics across fund companies, categories, and regions.

When Is It Changing?

Changes will go live in products on April 30, 2019.

Am I Affected?

If your workflow involves using any of the above fixed-income analytics, you may see changes. Depending on the investment type, you could see changes in either the portfolio value or our coverage following the release.

Where Will I See This?

This change will be made upstream from all products so there will be no impact to the location of any of the data points listed above. They will continue to flow into the same locations within products and reports that they always have.

Will You Still Survey?

Yes, Morningstar will continue to collect surveyed data from fund companies. However, we will no longer proactively survey as we continue to enhance and expand our calculated universe.

Can I Still See Surveyed Data?

We will continue to show the full history of surveyed data as well as any surveys that we receive moving forward. We will not run any calculations on this data. Therefore, there will be no Fixed-Income Style Box that is based on surveyed data and this data will not flow through automatically. If you wish to see the data in a specific product, please reach out to your support team with your requests and they can work to get the data added.

What's the Change in Coverage?

At this point in the process, we are estimating around a net gain of 7,000 funds globally from this change. It is important to note that not all funds with a surveyed value will continue to be calculated. Some funds will lose coverage, gain coverage, or maintain coverage. Common reasons we would not calculate a Style Box can be found below.

Why Would a Fund Not Have Calculated Values?

In order to receive a value, we must be able to calculate 75% of the market value of the fixed-income holdings. For the Style Box, if more than 25% of the holdings are either not rated or don't have an effective duration, the Style Box will show up blank. Some potential reasons that a holding would not be able to be calculated are:

- Not enough information on the holding is submitted to us by the fund company;
- Our primary fixed-income provider does not cover the terms of the instrument;
- The instrument is not issued a credit rating by at least one of the three credit ratings agencies we license data from;
- The instrument is an over-the-counter derivative, as we are still developing a methodology to cover them.

In addition to the coverage threshold, we also exclude funds that are either in the convertible bond Morningstar Category or from one of seven countries (see below).

What Countries Are Excluded From This Methodology, and How Are Those Handled?

Seven countries will continue to use their existing methodology after this release.

- **Canada** currently employs a similar holdings-based calculation for its Style Box. The key difference is the use of modified duration instead of effective duration. For that reason, we want to ensure a strong coverage parity of the full universe before making the switch.
- **Korea** currently uses a unique local data set to run style-box calculations, as with Canada.
- **India** has unique credit rating methodologies that do not conform with the rest of the world. Portfolio providers currently send us this special data in their portfolio templates, which we map to standard ratings.
- Like India, **Chile** uses a unique set of credit ratings for its securities. We use a third party to aggregate and calculate fixed-income statistics to use in the Style Box.
- **Mexico** makes use of local data and a third-party vendor to do calculations, as with Chile.
- Our coverage in **Australia and New Zealand** is abnormally low; they will continue using the legacy surveyed data for the time being.

In all these cases we are working toward enhancements that will bring all funds globally under a unified methodology in 2019 and the coming years.

How Is the Style Box Calculated?

The Style Box takes the calculated Average Credit Quality and Effective Duration for a fund and plots them in the box based on the defined breakpoints. For credit, these are:

- High Quality: AA or AAA
- Medium Quality: BBB or A
- Low Quality: Below BBB

For duration, we use different breakpoints depending on the type of fund:

- US taxable funds use a dynamic scale based on the effective duration of the Morningstar Core Bond Index;
- All other funds use one of two static breakpoint scales.

A full description of these breakpoints and the entire Style Box calculation can be found in the Fixed-Income Style Box methodology paper.

What Portfolio Effective Dates Are Affected?

All portfolios with an effective date of March 31, 2019, and after will have a Style Box based on calculated inputs. On April 30, our methodology will go live, and we will recalculate portfolios that we have already received with a date on or after March 31, 2019, in the days after the release.

What Happens for the Historical Style Boxes?

All funds with a portfolio date prior to March 31, 2019, will receive a surveyed Style Box when available, regardless of when we receive the portfolios. For example, if we receive two portfolios on May 15, 2019, one with a date of April 30, 2019, and one with a date of Dec. 31, 2018, the former will be eligible to receive a calculated Style Box, while the latter would get the survey-based Style Box.