



Style Research is a global independent research firm that provides clear and practical Style, Risk, and Performance analysis of equity portfolios and markets.

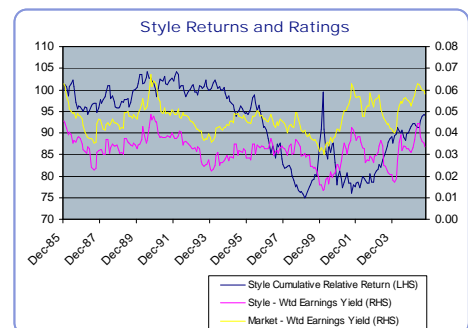
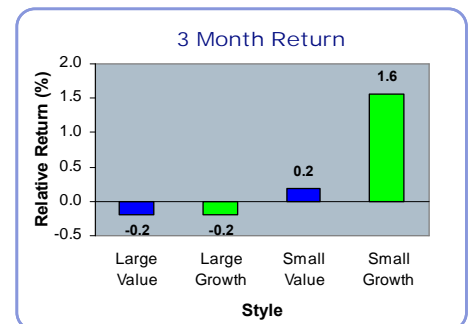
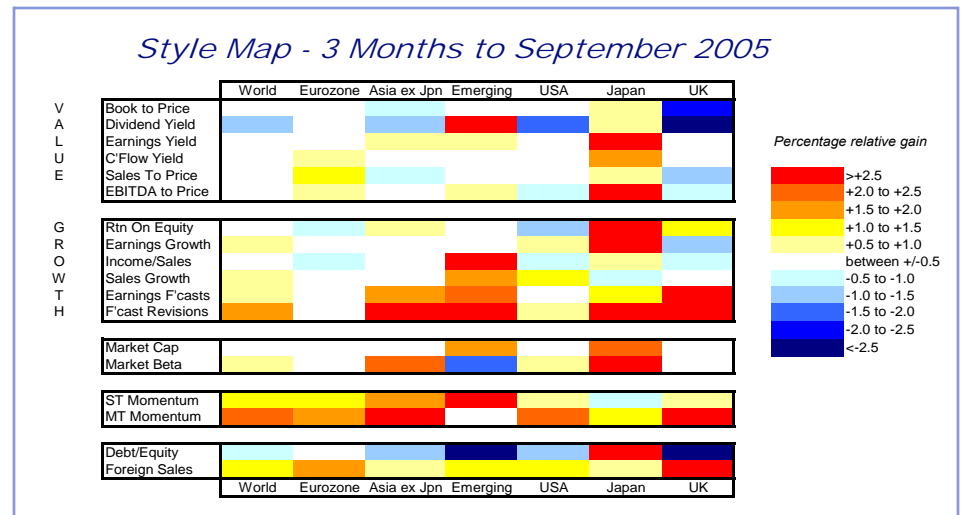
Style Commentary

Most of the key Growth factors have strengthened significantly across many of the major markets and regions over the past few months. This pattern of returns is most likely a reflection of the gaining consensus that, despite recent energy cost gyration and the continuing disruptions from global terrorist/insurgent activities, the global economic outlook remains broadly favorable, even if uninspiring. As in previous cycles, such a low inflation–low growth forecast environment encourages investors to extend their investment horizons further into the future and so supports the performance of longer duration, Growth orientated, securities.

Within the broad Styles a discrete analysis reveals even more. Looking at the Large Value, Small Value, Large Growth, Small Growth sectors (defined by market capitalization and a composite Value measure using book to market and earnings yield), it appears that across the developed markets Small Growth stocks have delivered the largest gains over the past quarter. This pattern of returns is repeated in virtually all major markets and regions (with the exception of Japan). Over the past quarter, Small Growth stocks have been a striking global outperformer.

A critical assessment of the relative valuations of the key Styles, based on earnings yields, shows that while the recent gains in Small Growth have pushed its valuations to premium levels against the rest of the market, the sector is still not overvalued against its own historic range.

The longer term performances of the key Styles are undoubtedly linked to the prospects for earnings and the markets' appetite for risk within each sector, but this may be too long term a view. Should equity markets continue to move favorably and the economic prognosis remain "reassuringly" dull, there could continue to be attractive opportunities within the global Small Growth stocks sector for many months yet.



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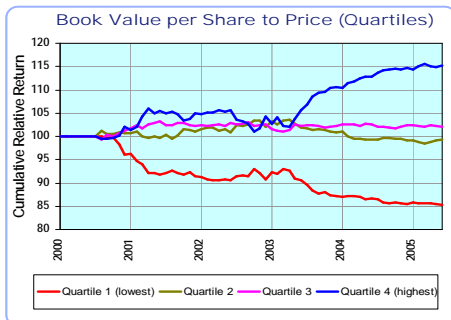
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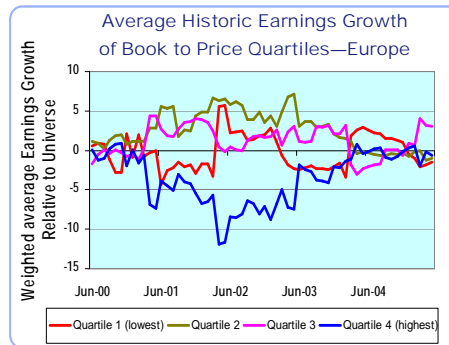
Style Research Online: 'Perform Study' feature added

In a continuing effort to help streamline the research process, we have added a 'Perform Study' feature to Style Research Online, our holdings-based equity research engine. This provides a more comprehensive analysis previously only achievable from multiple runs of the system.

The 'Perform Study' option appears within the Factor Sort section when creating a Style Research Online request. With this option, a market, region, or user-defined universe may be segmented into quartiles, quintiles, or deciles based on any of our underlying factors (or indeed linear combinations of factors). For example, a quartile study using the Book/Price factor (B/P), across, say, Europe may be produced using just one run of the system. Here's such a study, all quartiles being defined at a local industry level:



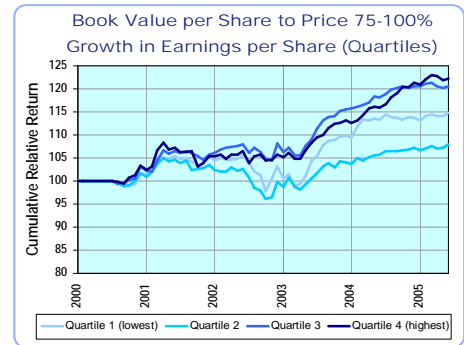
▲ *The strong performance of the highest quartile ('Value Stocks') and underperformance by the bottom (low B/P — or high P/B) quartile, especially since 2003, is clearly evident. And these results are independent of Country and Sector effects, so this 'Value' outperformance is a pure Style effect.*



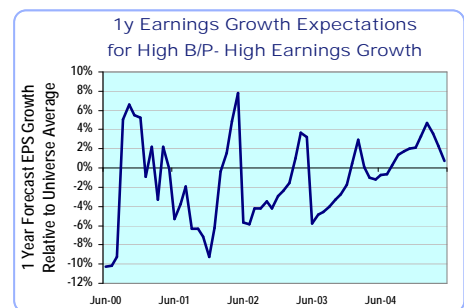
▲ *Furthermore, by requesting additional statistics for the quartiles we may examine some other characteristic. In this run, the average Earnings Growth was reported for each quartile. Those companies in the cheapest quartile also had the worst historic earnings at around about the time they started to take off. This differential with the other quartiles has greatly narrowed since then, as the companies have returned to average levels of growth.*

Perhaps this is evidence of the 'contrarian' value strategy paying off because investors had not taken into account the improving growth rates of these cheaper companies. Whatever the true reasons for the Value rally, such charts are easy to produce using the new 'Perform Study' Feature. Before this latest enhancement, this kind of analysis could only have been performed by running four separate requests. So the 'Perform Study' feature makes such research projects much easier to set up.

The 'Perform Study' feature is also available in a two step sort, providing the means to slice and dice the market/region. This could be quartiles within quartiles, quartiles within quintiles and so on. A simple example might be the study of the interaction between quartiles defined by B/P, and quartiles of Earnings Growth. Here are some results, once again for the European market, focusing on the high B/P quartile.



▲ *The best performing stocks in the high B/P quartile have relatively good Earnings Growth from within that quartile. Combining 'cheapness' with reasonable growth has been a powerful strategy over this period in this quartile.*



▲ *Furthermore, by requesting an additional characteristic, we can view the prospective 1 year EPS growth of the high B/P- high Earnings Growth portfolio. The earnings expectations of this portfolio relative to the market as a whole have been rather mixed over the period. However, they appear to have been improving over the last couple of years to the point where they match those of the rest of the market. Evidence that perhaps the Value revival has run its course?*

These simple examples barely scratch the surface of what can be achieved using the Style Research Online service. Please contact Style Research if you require more details or would like to trial the service.

What Our Clients Are Saying

► Laketon Investment Management

"The analysis provided by Style Research has proven to be invaluable in helping us better define and articulate the style biases and risks embedded within our various equity strategies. The user-friendly analysis is relied upon by our portfolio managers and by the marketing team to communicate more effectively with clients, prospects and the consulting community. We have been very impressed with Style Research's knowledge and level of ongoing client support."—Alex Macdonald, President

Analyzing Dispersions Across Portfolios

Tracking Error (% p.a.)					
	Port 1	Port 2	Port 3	Port 4	Port 5
Port 1	0.0				
Port 2	0.3	0.0			
Port 3	0.6	0.7	0.0		
Port 4	0.6	0.6	0.8	0.0	
Port 5	1.0	1.0	1.0	1.2	0.0
Benchmark	5.4	5.5	5.5	5.4	5.8

Total Weight Deviation (%)					
	Port 1	Port 2	Port 3	Port 4	Port 5
Port 1	0.0				
Port 2	2.6	0.0			
Port 3	3.1	4.0	0.0		
Port 4	4.3	3.9	5.3	0.0	
Port 5	6.7	6.4	8.1	7.1	0.0
Benchmark	89.4	89.5	89.4	89.5	89.5

Number of Different Stock Names					
	Port 1	Port 2	Port 3	Port 4	Port 5
Port 1	0				
Port 2	1	0			
Port 3	2	3	0		
Port 4	2	1	4	0	
Port 5	3	2	5	3	0

Number of Stock Names in Common					
	Port 1	Port 2	Port 3	Port 4	Port 5
Port 1	50				
Port 2	49	49			
Port 3	48	47	48		
Port 4	48	48	46	48	
Port 5	47	47	45	46	47
Benchmark	50	49	48	48	47

An investment manager with many separate accounts having the same benchmarks and performance objectives needs to ensure that the returns delivered by these funds are similar. Having one client outperform the benchmark while a different client with the same investment objective significantly underperforms is clearly unacceptable.

With the increasing importance of investment firms being CFA-GIPS compliant (Global Investment Performance Standards), many senior investment and client facing professionals not only want to know whether individual portfolios are currently taking a risk budget appropriate to their performance objective (by using the Style Research Portfolio Analyzer "Risk Report" or "League Reports"), but whether the predicted tracking error *between portfolios* is sufficiently low based on the underlying holdings.

Risk management reports containing this type of information should also include common-sense related metrics in order to help assist with the interpretation to clients. So, as well as pairwise tracking error, it will also be useful to show the percentage of overlapping stock weights, and the stock names in common, for every pair of portfolios.

All of this can now be monitored using the Style Research Portfolio Analyzer.

Instead of selecting just one portfolio for analysis, the user simply selects all of the portfolios for the required comparative analysis (similar to a Fund of Funds analysis). The weights can be left at a notional 100% in each fund. In the "Output format" the user then selects the "Fund of Funds Analysis." In the example below, a US equity manager is comparing five portfolios which have the same

performance objective versus the S&P500. Below are extracts from the resulting notional "Fund of Funds" Report.

The **"Tracking Error"** table shows that, based on the current holdings, the pairwise tracking error between Portfolios 1 and 2 is 0.3% p.a. so these portfolios are likely to show similar prospective returns. In this example the manager has a guideline that any portfolios with a pairwise tracking error higher than 0.5% p.a. should be checked.

More simple metrics are also shown. For example, the **"Total Weight Deviation"** table shows the stock weighting differences between each pair of portfolios (i.e. the sum of the absolute active weights). We can also see the number of different stock names between each portfolio pair.

Overall, Portfolio 5 is the most out of line with the other portfolios. In this example, closer investigation of the holdings revealed that Portfolio 5 had a client restriction of not being allowed to own their own stock – this accounted for most of the difference as the other four portfolios had a large weighting in that particular stock. Portfolios 3 and 4 needed slight rebalancing to bring the portfolios more into line.

This same type of analysis can even be used by fund of funds managers, multi-managers and pension fund consultants to check whether new candidate portfolios are already very similar to existing sub-funds. And they can also go one step further and run a fund of funds optimization to see how candidate portfolios would provide diversification benefits to the fund of funds, or whether they should even be included.

What Our Clients Are Saying

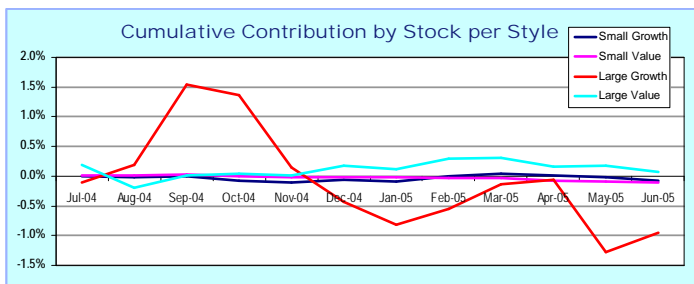
► McLean Budden

"We have been using Style Research on a consistent basis for many years to provide us with clear, concise and easily interpreted analytical information. We have found Style Research to be invaluable to track our various strategies through time and the output to be extremely useful to both portfolio managers as well as clients. In addition to the straightforward analytical data, the Style Research Portfolio Analyzer software provides an ease of use and navigation across its many functions."

—Brad Haughey, Vice President

Tips and Tricks

■ **Performance Analysis Module**—There are many ways in which you can dig into the background data in the new Performance Attribution Module. Suppose that a manager has had a poor contribution from stock selection—where did this come from? It may be tempting to go straight to the detailed stock by stock contributions, but there is an intermediate level which is very useful. In the 'Agg Perf History' sheet, all the component data from the various Brinson decompositions are available, both monthly and cumulatively. In the case where, say, stock selection was poor after having taken account of Style allocation, it might be interesting to look at the stock selection contribution broken out by Stock Style. Near the bottom of the 'Agg Perf History' sheet there is a table entitled "Cum. Contribution from Stock Selection." Using e.g. the *Excel Chart Wizard*, this may be graphed to produce a chart such as the following: ▼



This level of attribution has proved useful as it reveals immediately the source of the underperformance: Stock selection in Large Growth Stocks.

Further investigation of such data can be useful at the stock level too. If you've run the Performance Attribution report and selected 'Show Stock Data Over' the desired period, an additional data sheet entitled 'Perf Stock Level Data' is produced. It is easy to interrogate this data using the Excel *AutoFilter* feature. Click anywhere in the data and then select the Excel options *Data/Filter/AutoFilter*. Drop down menus will appear at the top of each column of data, and these may be used to filter the data onto selections of interest. In the above example it would be useful to filter on *a) Date*—May 2005, *b) Style (Brinson)*—Large Growth. The column headed 'Contribution to Stock Return (Brinson by Style)' will then sum to the Large Growth stock level underperformance for Large Growth stocks in May, an unhealthy -1.1% in our example. This may be sorted to reveal the individual contributors, their returns, active positions and so on.

■ **Portfolio Analyser Batch Facility**—Back in the Style Research Portfolio Analyser itself, there's a facility to view a summary

of all the analyses that have been run recently. Within the 'Batch Record Facilities' there's an option to *View/Analysis Log* (also accessible using *Ctrl-G*). The default shows only those jobs run by the current user during the most recent month. However, there are filters to show all analyses or specific choices of run date/analysis date/user/batch file/region or benchmark. Whichever view is chosen, the log shows some key data from the analyses. In addition to basic information regarding the portfolio/benchmark and region used, the log contains summary data for a few important statistics. These include some tilt and risk information. One useful application of this feature is the ability to create an instant league. Suppose you wanted to view the range of Tracking Errors across all portfolios benchmarked against the FTSE All Share during 2004. This may be produced by setting the filters to the above date/benchmark combination, and then clicking the 'Filter/Refresh' button. The *Analysis Log* then displays the list of appropriate runs, which can be sorted or saved to file.

Additional Papers and Articles

[Four Faces of Style](#)

[Avoiding Style's Risk Traps](#)

[Style and Style Analysis from a Practitioner's Perspective](#)

[Style and Style Factors Within & Across Europe](#)

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What Our Clients Are Saying

► **TAL Global Asset Management**

"The analysis from Style Research has been great to help us understand and validate a portfolio manager's style & risk characteristics—especially his or her consistency over time through the 'snail trail' reports. The scaled style factors truly demonstrate significance and the visual presentation is easily understood by all our users. Also, the variety of available style factors and reports gives us the flexibility to really tell the 'story' of any equity manager."—*Faruk Patel, Risk Manager*