THE NEWSLETTER OF

Style Research

SPRING 2004

GLOBAL EQUITY RESEARCH AND PORTFOLIO ANALYSIS

A New Way To Represent Global Styles

BECAUSE STYLE RETURNS ARE FREQUENTLY "CONTAGIOUS" from market to market and across regions, generally with local peculiarities and often with variable lags, today's serious investors need to be able to achieve a global perspective of the important similarities and differences among a wide collection of detailed Style factor rewards across a broad range of markets. With nearly 20 basic Style criteria, four major regions, and some important large markets, how can all the key aspects of Style returns be shown at once and still make sense?

It is tempting to accept the popular view that the major Style factors can be jumbled together to define broad Style aggregates; however, investors' experiences over the past cycle have clearly demonstrated that this is potentially a very dangerous simplification. While major Style factors generally do move together in Style groups and across geographic regions, there are significant episodes when these factors have sharply disengaged, providing divergent performances, and highlighting the importance of disaggregated analysis. The past 3 years offer convincing evidence. See Recent Perspectives, page 3.

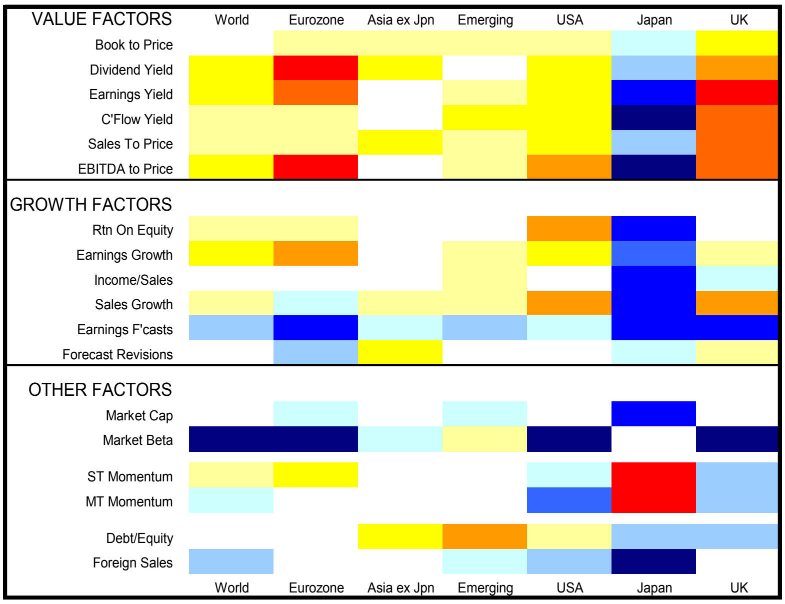
To identify and represent these nuances of performance differences among Style factors, and across global markets, Style Research has developed the *Style Heat Map*. The example below, taken from our recent Monthly Style Summary, shows the relative rewards of detailed Style factors across four major global regions and three important markets.

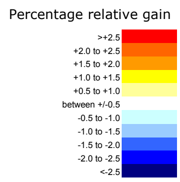
The global Style Heat Map will appear regularly in our Monthly Style Summary, each newsletter, and the London-based *Financial News*.

During the three months to the end of April, Value broadly outperformed Growth (more yellows and reds than blues) in most major markets and regions. However, returns within the US are more evenly balanced and, as is often the case, Japanese Styles appear to be heading in a different direction, with both Value and Growth characteristics underperforming and with Momentum appearing to offer the best recent gains. Note also that, globally, shares in smaller companies, high beta stocks and export-oriented company securities are providing lacklustre to poor performance.

STYLE HEAT MAP - 3 Months to April

Data generated by Style Research Online





▲ Each cell displays the relative return of the top half of the market for each Style factor. For example, on the "Book to Price" line, this is the return of the half of the market that has the higher Book to Price Values.

contents

“ At Mercer we find the Style Research Portfolio Analyzer helps us greatly with our preparation for research meetings, because it highlights things we ought to be asking the manager about. Lately we have been making a lot of use of the new Liquidity sheet in the output, which has helped us enormously to figure out which managers we need to be most concerned about from a capacity standpoint. ”

Bill Muysken
Mercer Investment Consulting

The Style Research Portfolio Analyzer: New Features and Enhancements

WITH THE LAUNCH OF VERION 3.50, we are introducing a number of important new features in the Style Research Portfolio Analyzer, enhancing both the fundamental holdings-based analysis and the returns-based facilities.

Five New Factors for Portfolio Analysis

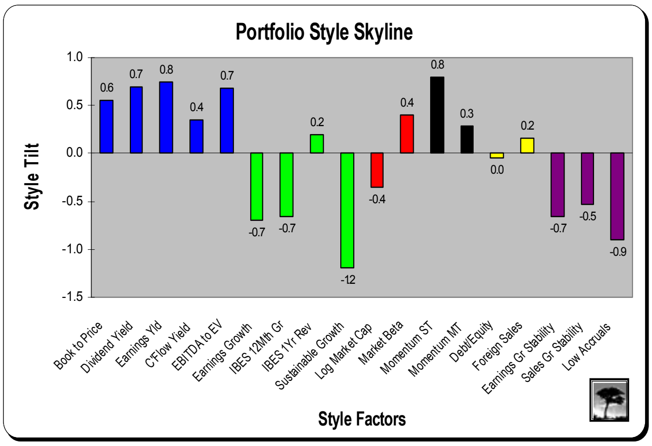
■ **Sustainable Growth** - Defined from the Return on Equity and the corporate reinvestment rate, this factor provides a measure of a company's future growth potential.

■ **Accruals (Low Accruals)** - High accruals can indicate that business managers are not running a company as tightly as they should and/or that earnings fugures are being manipulated to influence market perception. Either way, academic research shows that analysts do not tend to pick this up, and that there is often disappointment ahead for investors.

■ **Instability of Earnings Growth and Sales Growth** - These “Quality factors are calculated as the negative of the standard deviation of Earning Growth and Sales Growth over the most recent 3 years of growth data.

■ **Log of Market Cap** - This factor is calculated by taking the natural log of each stock's market capitalization. It offers an alternative to the default “fat tailed” Market Cap factor and is less susceptible to the extremes of very large and very small stocks.

Skyline with New Factors



◄ Customized Skyline chart incorporating the new factors. A low Quality, high Value, low Growth profile. Probably an out-performer during 2003 and early 2004.

Portfolio/Benchmark Construction Module

Users can now design and create portfolios and customized benchmarks using the internal database of stocks and fundamental factors as well as externally imported security lists. Customized portfolios and benchmarks can be created by screening on fundamental factors, Styles and sectors or by market region or country.

This facility is particularly useful when public benchmarks are unavailable, inappropriate, or otherwise impractical. For example, the module can be used to generate a small/midcap Value benchmark across the Eurozone excluding France

New Graphics in the Returns-Based Analysis

The Returns-based Portfolio Style Analysis facility now includes a number of important new graphics representing various levels of manager decision-making skill. Included now are:

■ **Style Horizon** - The traditional returns-based analysis showing the evolution of the imputed Style structure together with detailed statistics revealing the integrity of the analysis.

■ **Portfolio vs. Benchmark Returns** - Providing an overall assessment of portfolio performance.

■ **Portfolio Style vs. Benchmark Returns** - Giving evidence of the effectiveness of a portfolio manager's Style Allocation process.

■ **Portfolio vs. Style Model Returns** - Providing an assessment of a manager's Stock Selection skills.

■ **Portfolio Beta & Alpha Estimates** - Based on rolling periods of 24 months, to further quantify a manager's risk strategy and overall performance.

Further Enhancements

Version 3.50 further improves the production of multiple analyses. Enhancements include: additional portfolio benchmark edit and view facilities, new user interface options to make batch editing easier and faster, and extra “snail trail” definition features. The Liquidity Analysis is significantly extended and now permits greater flexibility in the choice of feasible transaction volumes; and there are also a number of general operational and security improvements and data management efficiencies.

66 **Over the last five years, Style Research has been an essential part of our risk monitoring process, in both the blending and analysis of managers and communicating internally as well as to clients. We rate Style Research very highly.** 99

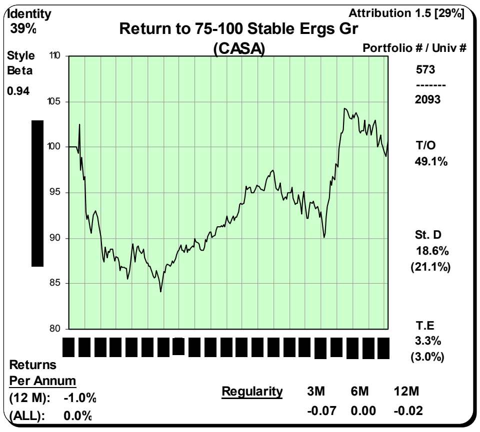
Navik Patel
Coutts & Co.

Style Research Online: New Research Capabilities

THE FIVE NEW FACTORS that have been introduced in the Style Research Portfolio Analyzer are now also available on Style Research Online (see page 2).

Sustainable Growth
Accruals (Low Accruals)
Stability of Earnings Growth
Stability of Sales Growth
Log of Market Cap

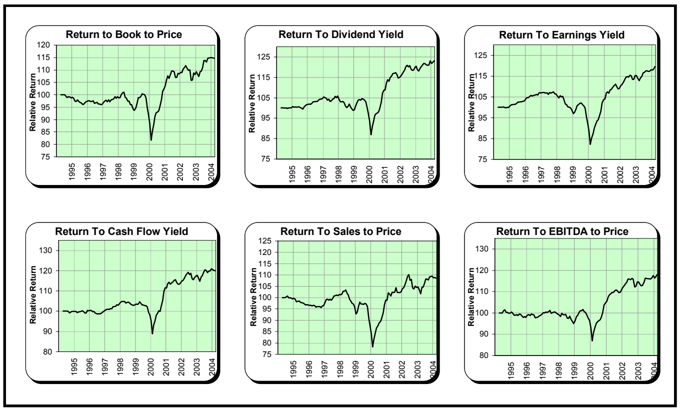
The analysis shown demonstrates that within the Euro-zone (on a Country and Sector Adjusted basis) companies with stable earnings growth outperformed from 1990 until the bull market really got going. These companies underperformed through the late 90s bull market and the dot com bubble, but rebounded sharply as the bubble burst. Recently, these stable growth, higher Quality companies have again underperformed.



The Global Style Advisor: Recent Perspectives

AS GLOBAL EQUITY MARKETS collapsed from early 2000 onwards, the six key Value factors uniformly outperformed. However, in clear contrast, the performances among the six key Growth factors sharply diverged. Forward-looking measures of growth potential together with historic evidence of the ability to manage earnings growth in the past tumbled while the returns to current or sustainable growth measures continued to outperform. This was likely owing to the belief that during times of change and economic decline, neither past performance nor overly optimistic expectations count for much; a strong P&L and sustainable profit margins count for a lot more.

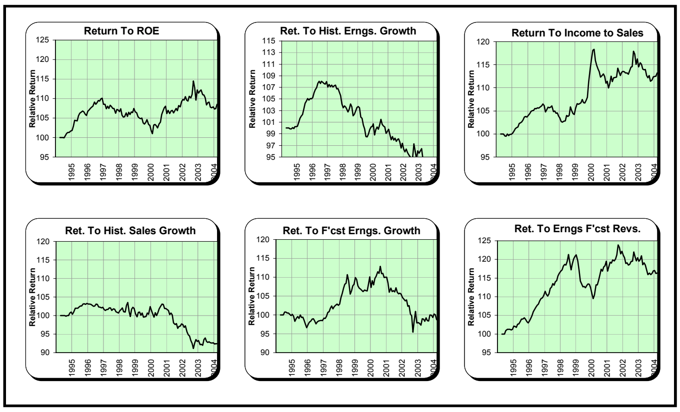
This important and quite logical difference in the direction of Growth factors rewards determined clear performance differences among Growth managers in the immediate aftermath of the market downturn, and through the difficult years that followed.



Value Criteria

66 **Style Research is widely used by many different areas of our business. The analysis is transparent and easy to interpret. The software is easy to use, and the additional features that have been added to the analysis have improved the output. It has provided an intuitive insight into the style tilts in our portfolios and how they change over time.** 99

Belinda Boa
Merrill Lynch Investment Management



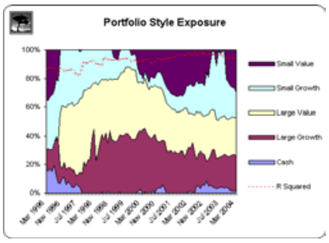
Growth Criteria

STYLE NEWS

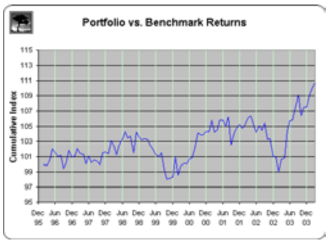
New Product Developments

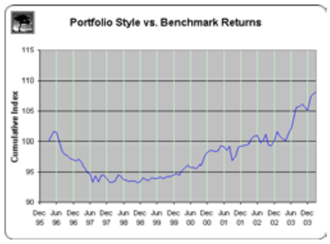
FOLLOW THE LINK to our test site to try out our new Funds Research Online analysis facility.

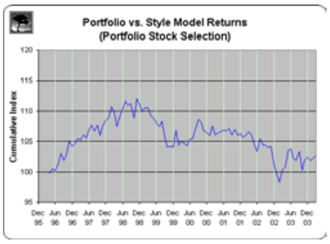
Funds Research Online currently provides detailed returns-based Style analysis of approximately 1800 funds registered for sale in the United Kingdom. The analysis includes the traditional Style Horizon (together with the critical rolling *goodness of fit* statistics) as well as the same graphic representations of manager decision-making skill as the returns-based Style analysis module within the Portfolio Analyzer (See page 2, and alongside).

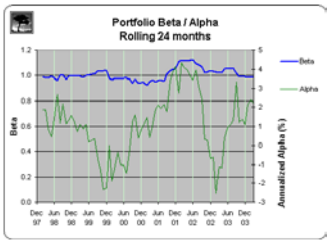


We are currently working on a variety of new features and regional extensions to this service and would value all comments about its current structure and presentation and regarding future development possibilities.









Who's Who at Style Research

WE ARE VERY PLEASED TO WELCOME Dr. Stan Beckers to the Style Research Panel of Advisors. Stan is one of our industry's most skilled and experienced specialists in market and portfolio analysis, having previously served as Chief Investment Officer of WestLB Asset Management and Managing Director of Barra Europe. Stan is also Professor of Finance at the Catholic University of Leuven. As a point of interest, some 20+ years ago, Robert Schwob of Style Research was one of Stan's first clients for Barra services in the UK.

Our panel of advisors also includes Dr. Stephen Satchell, Cambridge University and Professor Peter Pope, Lancaster University and meets regularly to discuss new concepts and developments affecting our industry.

"The analysis from Style Research makes it very easy to demonstrate to clients and senior management the major investment themes and ideas in portfolios."

Peter Lockyer, Global Head of Portfolio Risk Control
Allianz Dresdner Asset Management

Conferences and Presentations

"Current Perspectives on Risk and Portfolio Risk Analysis"
Pensions Management Institute/UKSIP
Pensions Investment Essentials for 2004
London, February 2004

"Style Investing in a Difficult Market"
Institutional Fund Management 2004
Geneva, February 2004

"Style in the Manager Selection Process"
European Fund Management Selection
Zurich, April 2004

"Style Characteristics within the South African Stock Market"
Style Benchmarks in South Africa (FTSE Sponsored)
Johannesburg and Cape Town, June 2004

"Using Style within a Global Investment Process"
Asset Allocation Summit
London, June 2004

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