Style Research

GLOBAL EQUITY RESEARCH AND PORTFOLIO ANALYSIS

SUMMER 2005
NEWSLETTER

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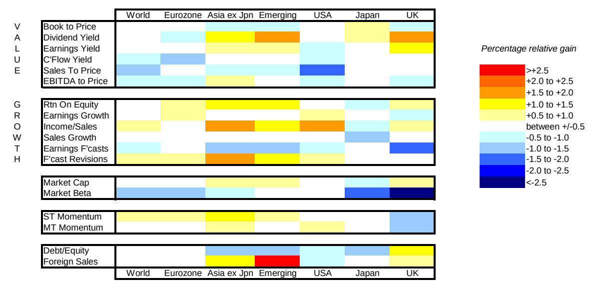
It is now possible to examine the style characteristics of equity portfolios according to performance, two methods of analysis of portfolio structure, as well as the style characteristics implicit in the decomposition of portfolio risk.

Style Review

It always seems too early to announce a turn in a cycle simply on the basis of a month or two's data; but then it soon becomes too late. With this in mind, the recent global Style return patterns provide some very interesting thoughts for consideration.

Style Map - 3 Months to May 2005

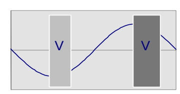


The 3 month returns of genuine Growth factors have now narrowly overtaken Value globally, across the Eurozone and Asia Pacific, and in the United States. In addition, even in many of the areas where Value is still ahead, key Growth themes are also strengthening.

Putting this in perspective against the economic and market fundamentals, it is also becoming clear that we are currently in an environment which is likely to be conducive to the favorable development of Growth opportunities.

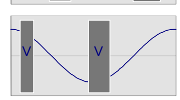
Forecasting the Major Styles—Some 'Stylized' Facts

Market Cycle



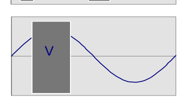
Value benefits during Growth pull-back and, *possibly* in initial rise.

Economic Cycle



Value gains in economic rebound; Growth suffers amid fears of recession.

Interest Rate Cycle



Value stocks, are more "valued" during periods of high longer-term rates.

On the basis of our knowledge of the influences of the basic Economic, Equity Market and Long Yield cycles on Value (and Growth) returns, the current fundamentals offer much promise for Growth. The configuration of low (some would say strangely low) long bond yields, moderate (perhaps even moderating) economic growth, and the hope that equities may be on a gradual (perhaps uninspiring) rise, are broadly reminiscent of the prevailing patterns of the mid 1990s. During this period genuine Growth themes (importantly not simply high priced securities with inflated valuations) were gradually gaining and building the foundation for the strong Growth surge and the extended underperformance of Value that unfolded just a few years later.

2005 Presentations

'Style and Style Analysis in Global Equity Markets'
A series of special presentations given for:

The Society of Investment Analysts of Ireland, Dublin, January 2005

The Hong Kong Society of Financial Analysts, Hong Kong, March 2005

The Security Analysts Association of Japan, Tokyo, March 2005

The Singapore Society of Financial Analysts, Singapore, March 2005

The Securities Institute of Australia, Sydney & Melbourne, March 2005

The Italian Society of Investment Professionals, Milan, May 2005

Style Research Performance Attribution Module Now 'Live'

The new Performance Attribution Module for the Portfolio Analyzer has been launched. It provides unique insights into what has driven a portfolio's returns, enabling users to determine whether, for example, a manager's returns have arisen through Style positioning, or whether value has been added from picking the right stocks. Key to its benefits are its multi-faceted approach to slicing and dicing performance, including user-defined flexible Styles.

Over any given period, the analysis starts with the overall relative performance of the portfolio against its benchmark. At this stage, months or sub-periods of particular interest may be identified and further studied. In addition, the top and bottom ten stock contributions to relative performance (ignoring all other factors) are displayed. If requested, all the data for every stock for every month can be reported. This includes local and base currency returns, active positions, and contributions, along with much more detailed attribution data.

'Brinson' Attributions by Country, Sector or Style

Attribution includes a Brinson-type breakdown, where allocation effects, stock picking ability and their interaction can be viewed. Allocation is by Country, by Sector or by Style. For example, using the default settings for Style, **Chart 1** reveals that much of the outperformance for this manager came from allocating to the right Styles, and that once these have been taken into account, stock picking was comparatively weak.

Further tables enable the user to identify the source of this Style outperformance/Stock underperformance. For instance, the cumulative contribution from allocation to each Style may be charted, along with the returns for each category, and the active positions. The tables in **Chart 2** indicate that the manager has been systematically overweight Value at both ends of the Size spectrum with a commensurate underweight in Large Growth. This has really paid off over the period, with the Growth underweight contributing as much as the Value overweight.

In addition, there is ample scope for drilling down into the data. In the above example, it appears that stock selection was particularly poor in May 2005. Not only is it easy to identify the Style of stocks that produced this underperformance, but also the offending stocks may be quickly isolated and their active weights, returns and contributions examined within each Style block.

A 'First' – Flexible Style Definitions

The user has control over the definition of how to carve up the market by Style. Instead of using the default Large/Small/Value/Growth settings, any of our underlying characteristics may be used in isolation or in combination with another. So 'Style' could be defined as e.g. deciles of Market Cap (to test whether the manager's returns are derived from Size allocation) or, perhaps, High/Low Accruals *and* Short Term Momentum. The latter combination might be appropriate for a manager emphasizing quality and recent trading history. It would show whether there was any stock-picking value added after the effects of, say, picking high quality, strongly trending securities.

Throughout the rest of the Portfolio Analyzer output reports, we don't believe that a single view necessarily captures everything about a portfolio. In the same spirit, the Performance Attribution Module permits many different views of the sources of returns, providing a better understanding of what's driving performance. The Brinson attribution

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Portfolio managers and consultants can now generate Risk & Style analysis *and* Performance Analysis & Attribution along the *same* dimensions providing a comprehensive holdings-based portfolio analysis.

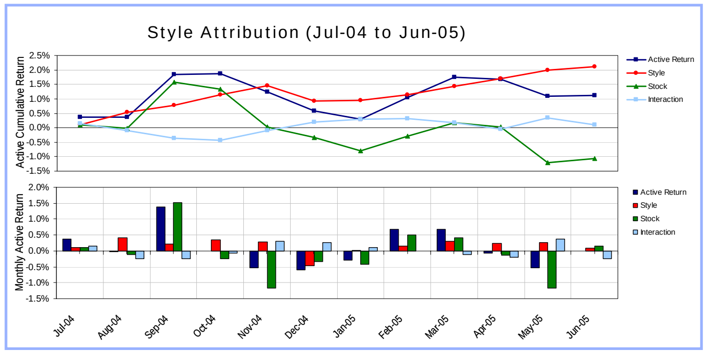


Chart 1: Attribution includes a Brinson-type breakdown where allocation effects, stock picking ability, and their interaction can be viewed. Allocation is by Country, by Sector or by Style.

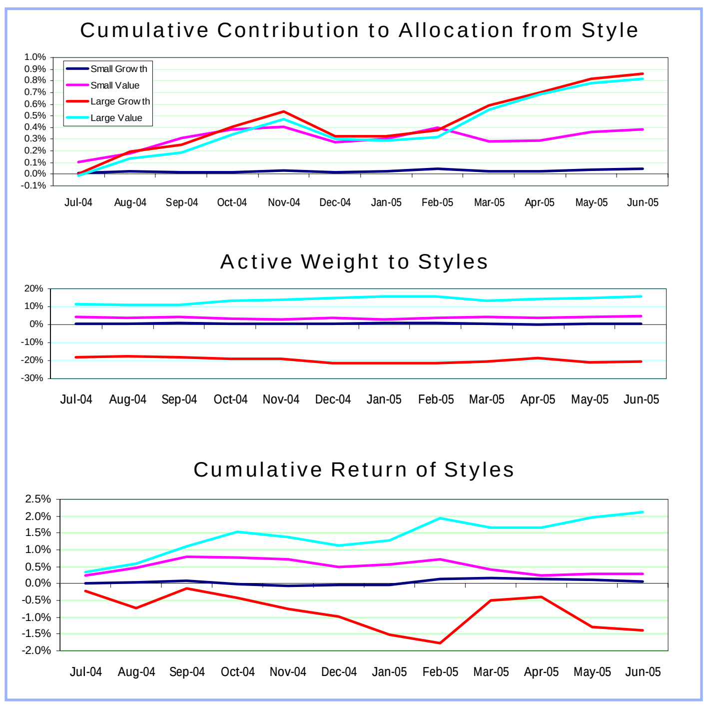
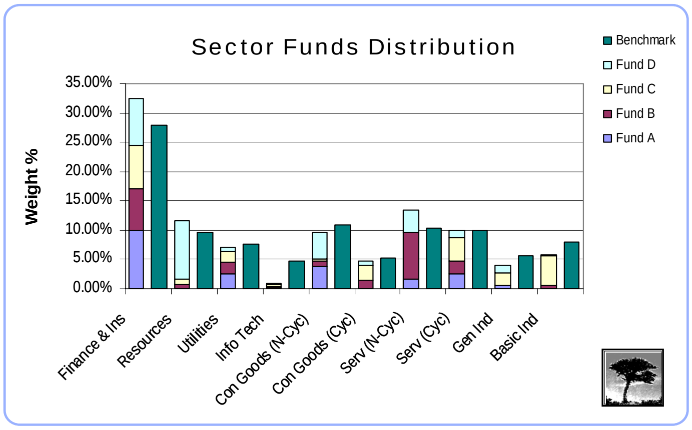


Chart 2: Further tables enable the user to identify the source of Style outperfomance/Stock underperformance. For instance, the cumulative contribution from allocation to each Style may be charted, along with the returns for each category, and the active positions.

New Fund of Funds Analysis

Fund of Funds managers are now able to gain further insights into the structure and risk elements of their fund constructions. Version 5.10 Portfolio Analyzer introduces detailed fund of funds breakdowns of country positions, sector positions, risk and coverage, and contributions to Style tilt.



▲ **Country / Sector Funds Distribution:** **Sector (and Country) Fund Distributions display fund by fund contributions to overall fund construction and clearly highlight any imbalances. In the Sector Fund Distribution chart, the large 32% position in the Financials sector is seen to be evenly distributed among the 4 funds of the composite, whereas in other sectors, particularly Resources and Basic Industries, the individual fund positions are much more disparate.**

Style Tilt Contribution by Fund: **An additional fund of funds Style tilt contribution report has been added to the new output. This report provides the contributions to the total Style tilt of each holding in each fund; it gives the vital detail that managers require to structure Style based fund of funds products.**

Decomposition of Tracking Variance

Funds	Total Risk	Market Risk	Sector X'Term	Sector Risk	Style X'Term	Style Risk	Equity X'Term	Equity Risk
Fund A	6.95	6.00	-2.51	0.69	0.27	0.93	0.24	1.32
Fund B	1.58	0.53	-0.62	0.66	-0.05	0.69	-0.01	0.37
Fund C	1.62	0.24	0.17	0.14	0.49	0.17	0.10	0.31
Fund D	3.31	0.24	0.73	0.55	-0.04	0.38	0.03	1.41
Total	13.45	7.02	-2.23	2.04	0.68	2.18	0.36	3.42

▲ **Risk Decomposition and Tracking Error Analysis by Fund:** **Version 5.10 provides a full analysis of the contributions to each level of risk by each fund within a composite, as well as full fund by fund correlation, coverage and tracking error matrices. This analysis highlights those funds contributing more (or less) of Stock Specific Risk, Style Risk or Sector and Market Risk and makes it easier for fund of funds managers to construct a balanced composite with a structured distribution of risk among the constituent funds.**

Performance Attribution Module . . .

Continued from page 2

methodology by Country, by Sector, or by Style (with its flexible definitions), provides many options so that the most appropriate view(s) may be employed.

On top of this, another approach to performance attribution is supplied. (See **Chart 3** below). This 'Hierarchical' view of performance mirrors closely the breakdown we use when decomposing risk. In tandem with the risk reports, it provides a useful way to see whether such risks paid off. The default version of the Hierarchical approach breaks down returns into Currency, Market, Sector, Style, and Stock elements simultaneously. As such, it is an extension of the Brinson approach to multiple levels. The Style tier uses Large/Small/Value/Growth, but this too could be refined to reflect the manager's approach, as before. Moreover, the ordering of the hierarchy is also flexible, so that, say, Sectors could be nested above Markets, or 'Global Styles' could be at the top. A Pan-European manager, who ignores country boundaries, might prefer to use the hierarchy: Sectors, then Style, then Stocks.

In our example, the Style allocation has proved positive throughout the period, while stock selection has been negative. However, the extra information here has revealed that Sector allocation has been increasingly successful over the last six months. A pre-configured pivot table provides the user with a means of drilling further into the data to identify which Sectors or Styles have been delivering the good returns. And there are many other 'behind the scenes' tables of data which may be utilized, including easy access to all the stock by stock data.

Fully integrated into the Portfolio Analyzer, the Performance Module opens up a whole new area of reporting/investigation. We believe it is an extremely powerful addition to the suite of reports. For further information about the Performance Analysis Module, including details about pricing, please contact Style Research.

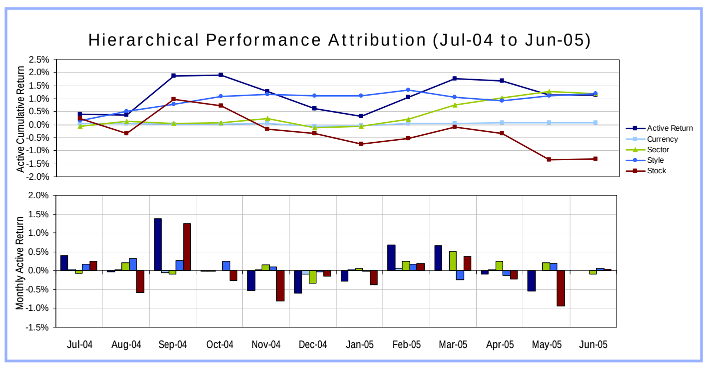


Chart 3: **This "Hierarchical" view of performance attribution mirrors closely the breakdown we use when decomposing risk. In tandem with the risk reports, it provides a useful way to see whether such risks paid off.**

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Data from Style Research Services

Benchmarks within the Style Research Portfolio Analyzer

Style Research clients are now able to receive detailed benchmark data integrated within the Style Research Portfolio Analyzer service. Subscribers to MSCI, FTSE and Russell can now arrange to receive the key benchmarks from these suppliers directly from Style Research, ready for immediate use in constructing portfolio analyses or for further benchmark analysis. Subject to additional conditions, FTSE has also made it possible for clients of Style Research who might not (yet) be direct subscribers to FTSE benchmarks to receive comprehensive and fully integrated FTSE benchmark data over a restricted horizon from Style Research. Please contact Style Research for further information.

Fundamental Securities Data within Style Research Online

Style Research Online provides comprehensive and detailed information about Style reward histories and the key elements of Style substructure incorporating more than 30 fundamental factors over more than 20 years of history and across 53 markets. It will very soon be possible to use Style Research Online to access, review and download fundamental data for individual securities over the entire breadth, depth and horizon of available information from the Thomson Financial and Style Research databases. Please contact Style Research for further information.

2005 Seminars & Conferences

"The Development of Style Concepts & Applications, Theory and Practice"
Student seminars at:
Reading University January 2005
Cranfield College April 2005, July 2005
The London Business School, February 2005

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"Defining Style & Avoiding Ambiguity"
Co-presented with Brockhouse Cooper
Fund Manager Selection & Oversight Conference
Toronto, June 2005