Morningstar Select Equity Portfolios
High-Conviction Stock Ideas with Competitive Advantages
Select Equity Portfolios

Our High-Conviction Stock Ideas Seek Companies with Competitive Advantages

Morningstar Select Equity portfolios are a series of focused, Separately Managed Account (SMA) strategies rooted in a valuation-driven investment approach and built for the long term. The structure of an SMA can provide full transparency and greater control through direct ownership of the underlying investments. Customization is also available in SMAs.¹

Why Invest

Focused Selection

At Morningstar Investment Management LLC, we build Select Equity portfolios from the bottom up, seeking to hold what we believe are the most attractive stocks for the long run. Each portfolio is relatively focused, with 20 to 50 holdings (International Equity ADR 20-70 holdings, U.S. Sustainability Moat Focus 40-80 holdings).

Investing in Moats (Competitive Advantages)

We believe companies with sustainable competitive advantages, or moats, should be able to defend or grow their market position over time.²

High-Quality³ Companies Trading at Attractive Discounts

As long-term investors, we prefer, and therefore seek, high-quality companies with steady profits, strong free cash flows, and solid balance sheets that trade at attractive discounts to their intrinsic value.

¹ At sector and security level. Customization availability may vary.
² The Morningstar Economic Moat Rating is not a credit or risk rating. It is a subjective evaluation performed by the equity research analysts of Morningstar. The Morningstar Economic Moat Rating should not be used as the sole basis in evaluating a security. Morningstar ratings involve unknown risks and uncertainties which may cause Morningstar’s expectations not to occur or to differ significantly from what we expected.
³ We define “high-quality companies” as those with durable competitive advantages, as measured by the Morningstar Economic Moat Rating, and strong balance sheets.
Why Separately Managed Accounts?

Like a mutual fund or exchange-traded fund (ETF), SMAs can offer diversification and professional management. However, SMAs give investors more control through direct ownership of the underlying investments.

<table>
<thead>
<tr>
<th>Portfolio of Investments</th>
<th>Mutual Fund</th>
<th>Exchange-Traded Fund</th>
<th>Separately Managed Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actively Managed</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Institutional Market Access</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Transparency of Portfolio Transactions</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Opportunity for Portfolio Customization</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Direct Ownership of Underlying Securities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Key Features of an SMA

- **Full Transparency**
- **Greater Control**
- **Direct Ownership**
- **Customization**
- **Tax Efficiency**

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4 Customizations availability may vary.

5 The U.S. Sustainability Moat Focus Portfolio currently does not have tax advantages, and it is best suited for tax-deferred accounts. This is for informational purposes only and should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.
Focused Selection

Our Select Equity portfolios generally consist of stocks from a variety of industries with a range of investment characteristics. We believe our approach of investing in 20 to 50 of our highest-conviction stock ideas across numerous industries provides sufficient diversification for the equity investor.

We don’t think it makes sense to invest in our 101st-best idea to pad the portfolio with a bunch of securities to give the illusion of diversification. An inherent feature of our concentrated portfolios is that our portfolio managers can throw the full weight of their conviction behind every stock they purchase and closely monitor the portfolio companies for opportunity.

In a 1968 study, Evans and Archer concluded that a portfolio of 15 randomly chosen stocks would be no riskier than the overall market. As stocks are more volatile than they used to be, a portfolio of 40-50 securities is what is now needed to achieve diversification in the U.S. stock market.6

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How We Invest

Built Upon Morningstar Equity Research
Our investment process leverages Morningstar’s Equity Research group, whose independent, global insights of 100+ equity research analysts and quantitative models lay the groundwork for how we analyze investment options.

Equity Analysts
Morningstar’s Equity Analysts apply a consistent, forward-looking, and global methodology that focuses on long-term fundamental valuation, competitive advantages (economic moats), risk, financial health, and stewardship.

Morningstar’s Investment Management group7
Morningstar’s Research group8

Our Security Selection Process

Identify Opportunities
Our portfolio managers select only those stocks that align with our rigorous standards, leveraging insights from internal Morningstar resources and equity-research teams.8

Analyze
In-depth research on the company and its industry dynamics. We assess the firm’s economic moat, financial health, and stewardship, which allows us to estimate a stock’s intrinsic value.

Validate Thesis
Our portfolio managers debate and document the investment opportunities and risks as well as the valuation assessment of each stock.

Peer Review
Vet the company with the team to help ensure the investment idea aligns with the portfolio’s objectives and parameters. We select only our highest-conviction stock ideas for our concentrated portfolios.

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7 Morningstar’s Investment Management group includes Morningstar Investment Management LLC, a registered investment adviser and subsidiary of Morningstar, Inc., and Morningstar Investment Services LLC, a registered investment adviser and subsidiary Morningstar Investment Management LLC. Globally, other affiliates or subsidiaries of Morningstar, Inc. can provide consulting or investment advisory services in Europe, Africa, Asia, and Australia.

8 Investment research is produced and issued by subsidiaries of Morningstar, Inc. including, but not limited to, Morningstar Research Services LLC, registered with and governed by the U.S. Securities and Exchange Commission.
Quality Companies

We prefer, and therefore seek what we believe to be high-quality companies that have sustainable competitive advantages. Businesses are constantly evolving and adapting as attractive profit pools are pursued by both existing competitors and new entrants. Therefore, we focus on investing in quality companies with economic moats that we believe have the potential to fend off such competition. Valuation is important, so we invest in companies we deem to trade at discounts to our estimate of intrinsic value.

What are Quality Companies?

Durable Competitive Advantages (Economic Moats)
Signals the company has the potential to outlast the competition for the long-term.

Steady Profits Over Market Cycles
Indicate the success a company has had over time.

Strong Cash Flow Generation
Signal the financial strength and liquidity of the company.

Solid Balance Sheets
Illustrate the financial health of the business. We typically focus only on investment-grade rated companies.

Valuation-Driven Investments

Our experienced portfolio managers ask themselves two questions about every stock they consider:

1. Is this a business we’d like to own?
2. How much would we pay for it?

This fundamental methodology guides our valuation-driven approach to investing and results in powerful analysis and our high convictions for every stock we buy.
Economic Moat

The Morningstar Economic Moat Rating represents a company’s sustainable competitive advantage. We believe a company with an economic moat can fend off competition and has the potential to earn return on capital for many years to come.

Wide Moat Rating
A company whose competitive advantages Morningstar expects to last more than 20 years.

Narrow Moat Rating
A company whose competitive advantages Morningstar expects to last more than 10 years.

No Moat Rating
A firm with either no advantage or one that Morningstar thinks will quickly dissipate.

Morningstar has Identified Five Sources of Moat

Switching costs are obstacles that keep customers from changing from one product to another.

Network effect occurs when the value of a good or service increases for both new and existing users as more people use that good or service.

Intangible assets are things such as patents, government licenses, and brand identity that keep competitors at bay.

Cost advantage helps a company produce goods or services at a lower cost, allowing them to undercut their competitors or achieve higher profitability.

Efficient scale benefits companies operating in a market that only supports one or a few competitors, limiting rivalry.
Select Equity Portfolio Snapshots

**Morningstar All-Cap Equity Portfolio**
Seeks Undervalued Stocks Across the Entire Market Spectrum

<table>
<thead>
<tr>
<th>Inception</th>
<th>November 7, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Style</td>
<td>All-Cap</td>
</tr>
<tr>
<td>Benchmark</td>
<td>Morningstar U.S. Market Index</td>
</tr>
<tr>
<td>Minimum Investment</td>
<td>$75,000</td>
</tr>
<tr>
<td>Number of Holdings</td>
<td>20–50</td>
</tr>
</tbody>
</table>

The All-Cap Equity Portfolio seeks undervalued stocks across the entire market spectrum and may invest in select common stocks and American Depositary Receipts (ADRs).

**Morningstar Dividend Portfolio**
Seeks Companies with Established Moats and Strong Competitive Positions

<table>
<thead>
<tr>
<th>Inception</th>
<th>November 17, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Style</td>
<td>Large-Cap Value</td>
</tr>
<tr>
<td>Benchmark</td>
<td>Dow Jones U.S. Select Dividend Index</td>
</tr>
<tr>
<td>Minimum Investment</td>
<td>$75,000</td>
</tr>
<tr>
<td>Number of Holdings</td>
<td>20–50</td>
</tr>
</tbody>
</table>

The Dividend Portfolio takes a concentrated, best-ideas approach when investing in select common stocks of dividend-paying companies and other securities. It seeks firms with wide or narrow moats that we believe are in a stronger competitive position than their peers and that are trading at a reasonable price.

**Morningstar Hare Portfolio**
Seeks Exposure to Fast-Growing Companies with Expanding Moats

<table>
<thead>
<tr>
<th>Inception</th>
<th>November 17, 2008</th>
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<tbody>
<tr>
<td>Style</td>
<td>Large-Cap Growth</td>
</tr>
<tr>
<td>Benchmark</td>
<td>S&amp;P 500 Index</td>
</tr>
<tr>
<td>Minimum Investment</td>
<td>$75,000</td>
</tr>
<tr>
<td>Number of Holdings</td>
<td>20–50</td>
</tr>
</tbody>
</table>

The Hare Portfolio invests in common stocks and other securities focusing on companies with strong and growing competitive advantages, as measured by their Morningstar Economic Moat Rating. Using “growth at a reasonable price,” Hare seeks companies with above-average earnings-per-share.

**Morningstar International Equity ADR Portfolio**
Seeks Exposure to Undervalued Stocks Outside the U.S.

<table>
<thead>
<tr>
<th>Inception</th>
<th>November 7, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Style</td>
<td>Large-Cap Value</td>
</tr>
<tr>
<td>Benchmark</td>
<td>MSCI ACWI ex USA</td>
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<tr>
<td>Minimum Investment</td>
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<tr>
<td>Number of Holdings</td>
<td>20–70</td>
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</table>

The International Equity ADR Portfolio typically invests in non-U.S. companies, measured by domicile or revenue exposure. This strategy may also invest in foreign companies that have listed their shares on an U.S. exchange, and occasionally use exchange-traded funds (ETFs).
Morningstar Small/Mid-Cap Equity Portfolios
Seeks to Invest in Undervalued Small and Mid-Sized Firms

The Small/Mid-Cap Equity Portfolio seeks to buy shares of companies at a discount to our estimate of their intrinsic value, including those we believe to be undervalued firms with competitive niches and, selectively, further discounted shares of lesser-quality businesses.

<table>
<thead>
<tr>
<th>Inception</th>
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<tbody>
<tr>
<td>Style</td>
<td>Small-Mid Cap</td>
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<tr>
<td>Benchmark</td>
<td>Morningstar U.S. Small-Mid Cap Index</td>
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<tr>
<td>Minimum Investment</td>
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<tr>
<td>Number of Holdings</td>
<td>20–50</td>
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</table>

Morningstar Tortoise Portfolio
Seeks to Invest in High-Quality Companies at a Discount

The Tortoise Portfolio invests in stocks and other securities of undervalued companies that possess durable competitive advantages, as measured by their Morningstar Economic Moat Rating, and strong balance sheets.

<table>
<thead>
<tr>
<th>Inception</th>
<th>November 17, 2008</th>
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</thead>
<tbody>
<tr>
<td>Style</td>
<td>Large-Cap Core</td>
</tr>
<tr>
<td>Benchmark</td>
<td>S&amp;P 500 Index</td>
</tr>
<tr>
<td>Minimum Investment</td>
<td>$75,000</td>
</tr>
<tr>
<td>Number of Holdings</td>
<td>20–50</td>
</tr>
</tbody>
</table>

Morningstar U.S. Sustainability Moat Focus Portfolio
ESG-focused Companies with Competitive Advantages

The Morningstar U.S. Sustainability Moat Focus Portfolio seeks to invest in companies with moderate to low ESG risk and long-term competitive advantages that are undervalued within an equity-focused, Separately Managed Account (SMA).

<table>
<thead>
<tr>
<th>Inception</th>
<th>March 31, 2021</th>
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<tbody>
<tr>
<td>Minimum Investment</td>
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<tr>
<td>Index</td>
<td>Morningstar U.S. Sustainability Moat Focus Index</td>
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<tr>
<td>Sustainability Rating</td>
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</tr>
<tr>
<td>Moat Ratings</td>
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</tr>
</tbody>
</table>

9 We define “lesser-quality” as companies with limited or no competitive advantages (as measured by their Morningstar Economic Moat Rating) and/or weaker balance sheets.
10 As of January 1, 2022. The Morningstar Sustainability Rating™ is intended to measure how well the issuing companies of the securities within a fund’s portfolio holdings are managing their environmental, social, and governance, or ESG, risks and opportunities relative to the fund’s Morningstar Category peers. The Rating is depicted by globe icons ranging from low (1 globe) to high (5 globes).
Our Select Equity Portfolios are designed to put your needs front and center—where they belong. To select a portfolio, talk to your financial advisor, who can help you build a wealth strategy focused on your long-term goals.
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Individual index performance is provided as a reference only. Each index is unmanaged and is not available for direct investment. Since indexes and/or composition levels may change over time, actual return and risk characteristics may be higher or lower than those presented. Although Index performance data is gathered from reliable sources, Morningstar Investment Management cannot guarantee its accuracy, completeness or reliability.

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Morningstar Equity Style Box
The Morningstar Equity Style Box reveals a portfolio’s investment strategy. The vertical axis shows the market capitalization of the long stocks owned, and the horizontal axis shows the investment style (value, blend, or growth). A darkened square in the style box indicates the weighted average style of the portfolio.

Economic Moat
The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm’s long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define excess economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm’s cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality no-moat companies will see their normalized returns gravitate toward the firm’s cost of capital more quickly than companies with moats.

To assess the direction of the underlying competitive advantages, analysts perform ongoing assessments of the moat trend. A firm’s moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don’t anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

All the moat and moat trend ratings undergo periodic review and any changes must be approved by the Morningstar Economic Moat Committee, comprised of senior members of Morningstar’s equity research department.

Sustainalytics
Sustainalytics is an environmental, social, and governance research, ratings, and analysis firm. Morningstar, Inc. acquired Sustainalytics in 2020. Sustainalytics provides ESG risk scores on companies and tracks and categorizes ESG-related controversial incidents on companies. Morningstar uses Sustainalytics’ company level ESG analytics to calculate ratings for managed products and indexes using Morningstar’s portfolio holdings database.

Morningstar Sustainability RatingTM
Morningstar Sustainability RatingTM is intended to measure how well the issuing companies of the securities within a fund’s portfolio holdings are managing their financially material environmental, social, and governance, or ESG, risks relative to the fund’s Morningstar Global Category peers.

The Morningstar Sustainability Rating calculation is a five-step process. First, each fund with at least 67% of assets covered by a company-level ESG Risk Score from Sustainalytics receives a Morningstar Portfolio Sustainability core. The Morningstar Portfolio Sustainability Score is an asset-weighted average of company-level ESG Risk Scores. The Portfolio Sustainability Score ranges between 0 to 100, with a higher score indicating that a fund has, on average, more of its assets invested in companies with high ESG Risk.

Second, the Historical Sustainability Score is an exponential weighted moving average of the Portfolio Sustainability Scores over the past 12 months. The process rescales the current Portfolio Sustainability Score to reflect the consistency of the scores. The Historical Sustainability Score ranges between 0 to 100, with a higher score indicating that a fund has, on average, more of its assets invested in companies with high ESG Risk, on a consistent historical basis.
Third, the Morningstar Sustainability Rating is then assigned to all scored funds within Morningstar Global Categories in which at least thirty (30) funds receive a Historical Sustainability Score and is determined by each fund’s Morningstar Sustainability Rating Score rank within the following distribution:

- High (highest 10%)
- Above Average (next 22.5%)
- Average (next 35%)
- Below Average (next 22.5%) and
- Low (lowest 10%)

Fourth, we apply a 1% rating buffer from the previous month to increase rating stability. This means a fund must move 1% beyond the rating breakpoint to change ratings.

Fifth, we adjust downward positive Sustainability Ratings to funds with a high ESG Risk scores. The logic is as follows:

- If Portfolio Sustainability score is above 40, then the fund receives a Low Sustainability Rating
- If Portfolio Sustainability score is above 35 and preliminary rating is Average or better, then the fund is downgraded to Below Average
- If Portfolio Sustainability score is above 30 and preliminary rating is Above Average, then the fund is downgraded to Average
- If Portfolio Sustainability score is below 30, then no adjustment is made.

The Morningstar Sustainability Rating is depicted by globe icons where High equals 5 globes and Low equals 1 globe. Since a Sustainability Rating is assigned to all funds that meet the above criteria, the rating it is not limited to funds with explicit sustainable or responsible investment mandates.

Morningstar updates its Sustainability Ratings monthly. The Portfolio Sustainability Score is calculated when Morningstar receives a new portfolio. Then, the Historical Sustainability Score and the Sustainability Rating is calculated one month and six business days after the reported as-of date of the most recent portfolio. As part of the evaluation process, Morningstar uses Sustainalytics’ ESG scores from the same month as the portfolio as-of date.

Please click on http://corporate1.morningstar.com/SustainableInvesting/ for more detailed information about the Morningstar Sustainability Rating methodology and calculation frequency.

**About Indexes**

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The S&P 500 Index or the Standard & Poor’s 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

The MSCI ACWI ex USA Index captures large and mid-cap representation across 23 Developed Markets (DM) countries (excluding the U.S.) and 26 Emerging Markets (EM) countries.

The Dow Jones U.S. Select Dividend Index measures the performance of 100 high dividend-paying companies, excluding REITs, that meet specific criteria for dividends, earnings, size and liquidity.

The Morningstar U.S. Small-Mid Cap Index provides a comprehensive depiction of the performance and fundamental characteristics of the Small-Mid Cap segment of U.S. equity markets.

The Morningstar U.S. Market Index measures the performance of U.S. securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index.