

# Morningstar Indexes

September 16, 2024

## Consultation on Target Volatility Methodology Enhancements

Morningstar Indexes is considering a pair of methodology enhancements to the Morningstar Target Volatility indexes listed [here](#).

1. Updating the excess return calculation that the target volatility indexes reference. The new formula would present excess return as the difference between total return and SOFR:  $ER = TR - SOFR$ . This would be a change from the current approach where  $ER = ((1 + TR)(1 - SOFR)) - 1$ , and it more closely aligns with industry standard practices.
2. Allowing weights to drift from the target within the tolerance range to mitigate turnover and referencing those drifted weights rather than the previous target for the tolerance band to determine when to reset the targets. For example, suppose the initial equity target weighting is 90% and there is a 5% tolerance around that threshold. If the equity target weight on T+1 would be 88%, the index is within the tolerance band under the current methodology (which compares 90% to 88%), so the target remains at 90% and the equity portion is reset back to 90%. However, under the new proposal, the equity weight would be allowed to drift from the target. For example, suppose the equity weight increases to 94% due to market price movements. That drifted weight (94%) would be compared against the new target (88%), and in this case, the index would fall outside the tolerance band and would be rebalanced to 88%.

The first change is expected to have minimal impact on performance, while the second would be more material, as summarized in the results provided through the link above. These changes would be applied prospectively and would have no impact on the historical levels or constituents. Morningstar Indexes is seeking feedback on these proposed changes.

### Submit your responses and questions

Responses to this consultation can be submitted [here](#).

General questions about the consultation may also be sent to [indexes@morningstar.com](mailto:indexes@morningstar.com).

### Key dates

- **Consultation:** The consultation will be open for response from September 16, 2024, to September 30, 2024.
- **Decision announcement:** Final decisions will be announced by October 31, 2024.
- **Proposed implementation:** December 20, 2024

## Questions

1. Should Morningstar Indexes change the excess return calculation to  $ER = TR - SOFR$ ?
  - a. Yes
  - b. No, stick with the current approach:  $ER = ((1 + TR)(1 - SOFR)) - 1$
  - c. Other, please explain
2. Should Morningstar Indexes update the target volatility indexes to allow the equity weights to drift from the target and to reference the drifted weights for the tolerance band to determine when to reset the targets?
  - a. Yes
  - b. No, stick with the current approach (reset to the previous target weight daily in case tolerance is not breached, and reference the previous target weight for the tolerance band)
  - c. Other, please explain
3. If Morningstar Indexes adopts one or both of these changes, are there any concerns about implementing the changes on or around December 20, 2024?
  - a. No concerns
  - b. Delay implementation until March 2025
  - c. Other, please explain
4. What other factors should Morningstar Indexes consider in making this decision?

## About Morningstar Indexes

Morningstar Indexes has been designing modern solutions for 20 years, but what makes us truly unique has been more than three decades in development. Our rich history began in 1984, when Morningstar was founded on a promise to empower investors with data and research that is independent and objective. Over time, our collection of data has expanded considerably—and so has its application. Today, Morningstar Indexes draws on unique IP to unlock an extensive range of emerging opportunities for investors of every kind, while providing a robust institutional beta platform for core investing.

## Contact Us

[MorningstarIndexesAlerts@morningstar.com](mailto:MorningstarIndexesAlerts@morningstar.com) is a no-reply email address. For questions concerning this notification, please contact us at [Indexes@morningstar.com](mailto:Indexes@morningstar.com).

**MORNINGSTAR** Indexes

This email contains privileged and confidential information and is intended only for the use of the person(s) named above. Any dissemination, distribution, or duplication of this communication without prior written consent from Morningstar is strictly prohibited. If you have received this message in error, please contact the sender immediately and delete the materials from any computer.