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# Construction Rules for the Morningstar® Wide Moat Focus Index<sup>SM</sup>

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## Morningstar Indexes

March 2021

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## Overview

The Morningstar® Wide Moat Focus Index<sup>SM</sup> provides exposure to companies with Morningstar® Economic Moat™ Ratings of wide that are trading at the lowest current market price/fair value ratios. Moat ratings and fair value estimates are determined through independent research conducted by the Morningstar Equity Research team.

For more information on the moat rating process and fair value estimation performed by Morningstar Equity Research, refer to [Morningstar Equity Research Methodology](#).

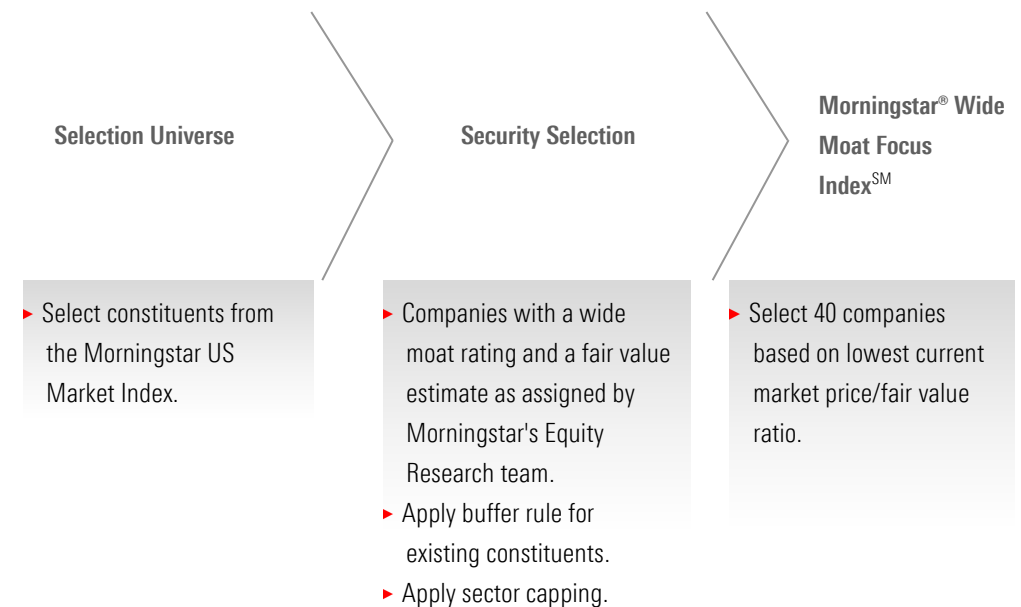
This index does not incorporate Environmental, Social, or Governance (ESG) criteria.

## Index Inception Date and Performance Inception Date

The inception date of the index is February 14, 2007, and the performance inception date of the index is September 30, 2002, when the first back-tested index value was calculated.

## Index Construction

**Exhibit 1** Morningstar Wide Moat Focus Index Construction Process



For additional details, refer to the "Assigning Stocks to the Index" section.

### Assigning Stocks to the Index

The Morningstar Wide Moat Focus Index consists of two subportfolios of 40 companies each.

#### Selection Universe

At each reconstitution, constituents of the Morningstar Wide Moat Focus Index are derived from the Morningstar US Market Index (benchmark). For more details on benchmark construction, refer to the [Construction Rules for Morningstar US Market Index](#).

#### Security Selection

To be eligible for the index, all constituents must meet the following criteria in sequence:

- ▶ Analyst Data
  - ▶ Company is assigned an economic moat rating of wide by Morningstar's Equity Research team.
  - ▶ Company is assigned a fair value estimate by Morningstar's Equity Research team.
  - ▶ Company's fair value estimate is not under review at the time of reconstitution.
    - ▶ A company may go under review, either because the analyst is incorporating new information into the valuation model or because of a transition in analyst coverage.

- ▶ Morningstar's Equity Research team strives to minimize the amount of time a fair value estimate is under review, particularly for moat-rated stocks, and therefore it is expected to be rare for a stock to drop out of the index for this reason.
- ▶ If a company has more than one eligible share class:
  - ▶ Select the one that is a current index constituent.
  - ▶ Otherwise, select the most liquid share class determined by Morningstar Indexes.
- ▶ Buffer Rules  
Index constituents of the subportfolio ranked within the top 150% of target count in the eligible universe based on current market price/fair value ratio are given preference in subsequent steps.
- ▶ Sector Capping  
The maximum weight of an individual sector is capped at its corresponding weight in the benchmark + 10% or 40%, whichever is higher.

$$\text{Maximum Sector Weight} = \text{Max}(40\%, \text{benchmark weight} + 10\%)$$

- ▶ Portfolio Selection  
At this stage, all buffered constituents are retained in the index. From among the remaining companies, those representing the lowest current market price/fair value ratios are included in the index until the number of constituents reaches 40. The two subportfolios are consolidated to form the aggregate portfolio.

### Number of Stocks

Each reconstituted subportfolio targets 40 constituents based on a transparent ranking system subject to selection and eligibility criteria at reconstitution. However, if securities fall short of the selection and eligibility criteria or if securities are added or deleted as a result of corporate actions after reconstitution, the subportfolio can hold more or fewer than 40 companies. In addition, securities that are deleted from the Morningstar US Market Index after June and December reconstitutions are simultaneously deleted from the Morningstar Wide Moat Focus Index. The aggregate portfolio can contain between 40 and 80 constituents.

### Index Weighting

The index is equal weighted. For more details, refer to the [Morningstar Indexes Calculation Methodology rulebook](#).

### Index Maintenance and Calculation

#### Scheduled Maintenance

The subportfolios are reconstituted semiannually with a quarterly staggered schedule. Consequently, about half of the total index membership is reset every quarter in March, June, September, and

December on the Monday following the third Friday. If Monday is a holiday, it is effective on the immediate following business day. In addition, the subportfolio weights are reset to 50% each in June and December. Refer to Appendix 2 for the staggered reconstitution implementation process.

The analyst data (moat rating and fair value estimates) used to reconstitute the index is as of the Tuesday before the second Friday of the reconstitution month.

Refer to Appendix 1 for details on reconstitution and rebalancing.

### **Corporate Action**

The treatment of corporate actions can be found in the [Morningstar Indexes Corporate Actions Methodology rulebook](#).

### **Index Calculation and Price Data**

Details about index calculations and price data can be found in their respective rulebooks: [Morningstar Indexes Calculation Methodology](#) and [Equity Closing Prices Used for Index Calculation](#).

### **Methodology Review and Index Cessation Policy**

The index methodology is continually reviewed to ensure it achieves all stated objectives. These reviews take into account corporate action treatment, selection, and maintenance procedures. Subscribers to the index will be notified before any methodology changes are made. For more details, refer to the [Morningstar Index Methodology Change Process](#).

Morningstar also notifies all subscribers and stakeholders of the index that circumstances might arise that require a material change to the index, or a possible cessation of the index. Circumstances that could lead to an index cessation include, but are not limited to, market structure change, product definition change, inadequate supply of data, insufficient revenue associated with the index, insufficient number of clients using the index, and/or other external factors beyond the control of the Morningstar Index Committee.

Because the cessation of the index or benchmark index could disrupt subscriber products that reference this index, all subscribers are encouraged to have robust fallback procedures if an index is terminated. For more details, refer to the [Morningstar Index Cessation Process](#).

### **Data Correction and Precision**

#### **Intraday Index Data Corrections**

Commercially reasonable efforts are made to ensure the accuracy of data used in real-time index calculations. If incorrect price or corporate action data affect index daily highs or lows, they are corrected retroactively as soon as is feasible.

**Index-Related Data and Divisor Corrections**

Incorrect pricing and corporate action data for individual issues in the database will be corrected upon detection. In addition, an incorrect divisor of an index, if discovered within five days of its occurrence, will always be fixed retroactively on the day it is discovered to prevent an error from being carried forward. Commercially reasonable efforts are made to correct an older error subject to its significance and feasibility.

For more details, refer to the [Recalculation Guidelines](#).

**Computational and Reporting Precision**

For reporting purposes, index values are rounded to two decimal places and divisors are rounded to appropriate decimal places.

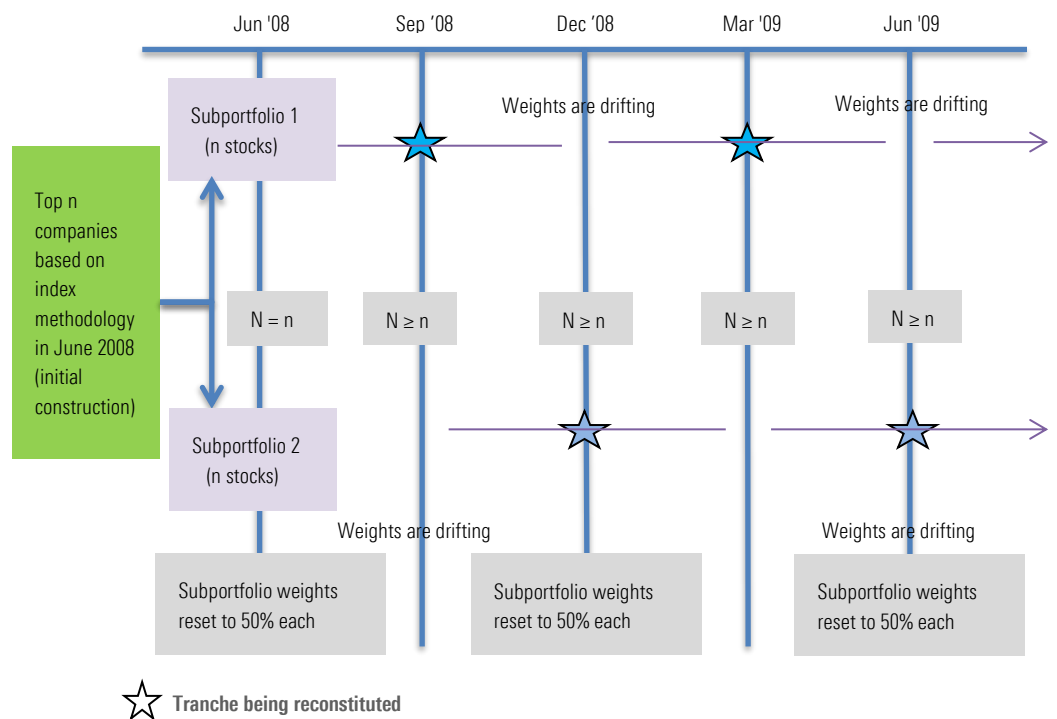
## Appendixes

### Appendix 1: Glossary

Terms	Description
<b>Reconstitution</b>	During each reconstitution, the steps mentioned in the index construction process are performed, resulting in membership reset.
<b>Rebalance</b>	During each rebalancing, the weights are reset and adjustments are made for updated free-float and shares outstanding data.

### Appendix 2: Staggered Reconstitution Process

Exhibit 2 Staggered Reconstitution Schematic



The portfolio construction process is described below.

1. At initial construction (eg. June 2008), both of the subportfolios are reconstituted at the same time and therefore have an identical portfolio composition. The subportfolios are set to equal weights at 50% each.
2. In September, the first subportfolio is reconstituted, while the second is not (drifted leg). As a result, the composition of the subportfolios may not remain identical.

3. In December, the second subportfolio is reconstituted and the first forms the drifted leg. In addition, the subportfolio weights are reset to 50% each and distributed among the securities within them in proportion to their weights.
4. In March, the first subportfolio is reconstituted again.
5. In June, the second subportfolio is reconstituted. In addition, the subportfolio weights are reset to 50%.
6. The process is repeated (go to Step 2).

### Appendix 3: Modification to Rule book

Section	Description	Update Date
<b>Overview</b>	Removed Morningstar Equity Research's analyst data assignment process and started referring to it in a separate document.	April 2015
<b>Assigning Stocks to the Wide Moat Index</b>	Removed reference made to the Morningstar Wide Moat Index and linked it to the Morningstar US Market Index.	April 2015
<b>Index Construction</b>	As announced in April 2016, methodology changes to the index were implemented for the June 2016 reconstitution. Current index levels that have been published will not be adjusted retroactively and only the index levels from June 20 on will reflect the updated methodology.	June 2016

### Appendix 4: Strategies Based on the Index

The portfolio is used as a base index for the following strategies:- Morningstar® Wide Moat Focus Target Volatility Indexes. For details on calculation methodology, please refer to the Morningstar Target Volatility Methodology Paper.

**About Morningstar, Inc.**

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. Morningstar offers an extensive line of products and services for individual investors, financial advisors, asset managers, and retirement plan providers and sponsors. Morningstar provides data on approximately 510,000 investment offerings, including stocks, mutual funds, and similar vehicles, along with real-time global market data on more than 17 million equities, indexes, futures, options, commodities, and precious metals, in addition to foreign exchange and Treasury markets. Morningstar also offers investment management services through its investment advisory subsidiaries.

**About Morningstar Indexes**

Morningstar® Indexes combine the science and art of indexing to give investors a clearer view into the world's financial markets. Our indexes are based on transparent, rules-based methodologies that are thoroughly back-tested and supported by original research. Covering all major asset classes, our indexes originate from the Morningstar Investment Research Ecosystem—our network of accomplished analysts and researchers working to interpret and improve the investment landscape. Clients such as exchange-traded fund providers and other asset management firms work with our team of experts to create distinct, investor-focused products based on our indexes. Morningstar Indexes also serve as a precise benchmarking resource.

**Morningstar Equity and Credit Research**

With more than 120 equity and credit analysts, Morningstar is one of the largest independent sources of equity and credit research in the world. The analysts evaluate companies using a methodology built on fundamental analysis that scrutinizes a company's competitive advantages.

**Morningstar Index Product Committee**

The Morningstar Index Product Committee is comprised of members who possess a wide array of knowledge in relation to Indexes. The Product Committee is responsible for the governance over the creation and maintenance of all Morningstar branded Indexes, ensuring the highest standards are continuously met. Any matters arising from exceptional or undocumented events will be resolved at the discretion of the Morningstar Index Product Committee.

**Morningstar Index Oversight Committee**

The Morningstar Index Oversight Committee is comprised of informed and qualified professionals who are responsible for the process governance of Morningstar branded Indexes. The Oversight Committee assesses and where appropriate challenges the decisions of Morningstar Indexes with regards to benchmark decisions.

**For More Information**

For any queries, reach out to us via our [communication page](#).





22 West Washington Street  
Chicago, IL 60602 USA

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