
Morningstar Medalist Rating™ for Australian Superannuation Funds Methodology

Morningstar Research

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Overview

Morningstar has conducted research on active and passive investment strategies and their associated vehicles since 1986. From November 2011, this research was expressed globally through the Morningstar Analyst Rating™ for funds, which Morningstar’s manager research analysts assigned to strategies and vehicles that they qualitatively analyzed.

In 2017, Morningstar expanded its manager research with the launch of the Morningstar Quantitative Rating™ for funds, which used algorithmic techniques to assign ratings to strategies and vehicles that Morningstar’s manager research analysts didn’t cover. The Morningstar Quantitative Rating was designed specifically to mimic analyst decision-making as much as possible via a quantitative approach.

In 2023, Morningstar combined the Morningstar Analyst Rating and the Morningstar Quantitative Rating into a single, encompassing forward-looking rating, the Morningstar Medalist Rating.™

The Morningstar Medalist Rating for Australian Superannuation Funds

An essential complement to Morningstar’s database of investment information and Morningstar’s suite of quantitative research tools, such as the Morningstar Rating™ (the “star rating”) and the Morningstar Style Box,™ the Morningstar Medalist Rating for Australian Superannuation Funds seeks to:

- ▶ Identify active strategies Morningstar believes should be able to outperform their Morningstar Category index (for example, Morningstar Moderate Target Allocation Index for strategies in the Australia fund multisector moderate category) on a risk-adjusted basis over time;
- ▶ Call out strategies that Morningstar expects to underperform their Morningstar Category index on a risk-adjusted basis over time;
- ▶ Help superannuation fund members and fund selectors understand the suitability of strategies for an intended purpose and give clear expectations for the likely behavior of strategies in different market environments;
- ▶ Place a strategy and its vehicles in comparative and historical context in terms of criteria such as expenses, manager tenure, investment style, and asset size; and
- ▶ Monitor strategies for changes that could materially affect the suitability and investment opinion.

Independent Research

Morningstar is committed to the principle of independence. Morningstar does not charge asset managers to rate their strategies and associated vehicles and does not permit asset managers to

commission ratings from us. Morningstar commercializes its manager research by including ratings and reports in various products and services and through licensing its intellectual property.

Morningstar produces this analysis for the benefit of superannuation fund members, advisors, and institutions, not asset managers. Morningstar separates its researchers from any commercial relationships the company may have with asset managers in order to avoid any real or perceived conflicts of interest. Morningstar's assessment aims to provide in-depth, accurate, and useful analysis that will help members select strategies that will outperform, avoid those that will underperform, and build more cohesive portfolios. This analysis is independent and objective, conveying Morningstar's genuine opinion of a strategy and associated vehicles, including negative views when warranted.

How Morningstar Makes Coverage Decisions








In making coverage decisions, Morningstar seeks to ensure that users of its research have access to analysis on a broad spectrum of vehicles that are important to them and meet their needs for portfolio construction. Hence, Morningstar doesn't determine coverage strictly based on quantitative screens of investment returns, net assets, or performance history. Moreover, analyst teams have ample discretion in determining their coverage universe, focusing on investment merit, member interest, and client demand.

Although these criteria can tilt coverage toward vehicles that are larger in terms of assets under management, analysts will cover newer and/or smaller vehicles if they have merit. In addition, Morningstar frequently canvasses its analyst team, internal consulting units, and external users of Morningstar's research to identify offerings that might merit coverage. Regional coverage committees internal to the manager research team must approve all coverage decisions.



Forward-Looking Analysis

The Morningstar Medalist Rating for funds is the summary expression of Morningstar's forward-looking analysis of investment strategies as offered via the specific vehicles. Vehicles can include but are not limited to open-end funds, closed-end funds, exchange-traded funds, and separately managed accounts domiciled throughout the world. The Medalist Rating does not express a view on a given asset class or peer group; rather, it seeks to evaluate each strategy and associated vehicle within the context of an appropriate benchmark and peer group.

Morningstar assigns Morningstar Medalist Ratings at the vehicle level to accurately capture the impact of fee differences on expected net-of-fee alpha between different types of vehicles, including different share classes of the same fund. Morningstar's research and academic studies have repeatedly shown that a vehicle's ability to outperform erodes as fees become higher. Morningstar's analysis of each specific vehicle under coverage ensures the most precise accounting possible of fees. For open-end funds, for example, this means that share classes of the same fund that charge different amounts may receive different Morningstar Medalist Ratings.

Morningstar expresses the Morningstar Medalist Rating on a five-tier scale running from  **Gold** to **Negative**. For actively managed funds, Morningstar assigns  **Gold**,  **Silver**, and  **Bronze** ratings to vehicles expected to add value, or “positive alpha,” over the long term when compared with a relevant Morningstar Category index after accounting for fees and risk. For passive strategies, Morningstar assigns  **Gold**,  **Silver**, and  **Bronze** ratings to vehicles expected to deliver alpha that exceeds the lesser of the category median net alpha, or zero, over the long term. (Morningstar defines “long term” as periods lasting at least five years.)

Morningstar Medalist Ratings should be interpreted as follows:

Rating	Actively Managed Vehicles	Passively Managed Vehicles
 Gold Morningstar’s top recommendations, these investments are expected to add the most value within their Morningstar Category.	Expected to deliver positive net alpha (versus the category index) that ranks among the top 15% of all active investments in the Morningstar Category expected to generate positive net alpha.	Expected to deliver net alpha (versus the category index) that exceeds the lesser of the Morningstar Category median net alpha or zero and ranks among the top 15% of all passive investments in the Morningstar Category expected to achieve the same.
 Silver Just below Gold but still expected to add significant value within their Morningstar Category.	Expected to deliver positive net alpha (versus the category index) that ranks among the next 35% of all active investments in the Morningstar Category expected to generate positive net alpha.	Expected to deliver net alpha (versus the category index) that exceeds the lesser of the Morningstar Category median net alpha or zero and ranks among the next 35% of all passive investments in the Morningstar Category expected to achieve the same.
 Bronze Not expected to perform as well as Gold or Silver but should add at least some value within their Morningstar Category.	Expected to deliver positive net alpha (versus the category index) that ranks in the bottom half of all active investments in the Morningstar Category expected to generate positive net alpha.	Expected to deliver net alpha (versus the category index) that exceeds the lesser of the Morningstar Category median net alpha or zero and ranks in the bottom half of all passive investments in the Morningstar Category expected to achieve the same.
Neutral Not expected to outperform within their Morningstar Category but shouldn’t subtract as much value as Negative.	Expected to deliver negative net alpha (versus the category index) that ranks in the top 70% of all active investments in the Morningstar Category expected to generate no alpha or negative net alpha.	Expected to deliver net alpha (versus the category index) that falls shy of the lesser of the Morningstar Category median net alpha or zero and ranks in the top 70% of all passive investments in the Morningstar Category expected to fall shy.
Negative Expected to be the worst performers, subtracting significant value within their Morningstar Category.	Expected to deliver negative net alpha (versus the category index) that ranks in the bottom 30% of all active investments in the Morningstar Category expected to generate negative net alpha.	Expected to deliver net alpha (versus the category index) that falls shy of the lesser of the Morningstar Category median net alpha or zero and ranks in the bottom 30% of all passive investments in the Morningstar Category expected to fall shy.
Under Review Denotes a change at a rated strategy that requires further review to determine its impact on the rating.	N/A	N/A

Methodology

In more than two decades of manager research, Morningstar's global analyst team has identified three key areas that evidence suggests are crucial to predicting the future gross performance of strategies and their associated vehicles: People, Parent, and Process. These three pillars form the spine of Morningstar's research approach, with analysis coalescing around an evaluation of the strategy's management team, the parent firm, and the underlying investment process itself. In this way, the analysis considers not just each pillar in isolation, but also the interaction between them, which is crucial to understanding a vehicle's overall merit.

To provide a consistent repeatable framework for the Morningstar Medalist Ratings, reflective of the opportunity set within their Morningstar category, Morningstar assigns ratings in three steps: 1) Assess the opportunity to add value; 2) Score pillars; 3) Derive the rating. Those three steps are described in further detail below.

Assess the Opportunity to Add Value

Different investment styles offer more or fewer opportunities to derive alpha from active management. US large-cap blend equity strategies, for example, have typically had a very difficult time generating alpha versus a relevant index such as the Russell 1000, and thus alphas in the category have a relatively low dispersion. On the other hand, global small-cap strategies have typically displayed a wider dispersion of alphas, indicative of a broader opportunity set.

To systematically assess the opportunity to add value, it is necessary to first define relevant peer groups that correspond to different investment styles. To do this, Morningstar aggregates Morningstar categories that have been assigned a similar Morningstar Category index. For example, Morningstar rolls up all US large-cap blend equity categories from vehicle universes in Europe, Asia, Australia, and the United States into a single aggregate group. This ensures similar vehicles are treated consistently worldwide and makes the peer groups more robust. These aggregate peer groups are used solely to assess the alpha opportunity for categories following highly similar indexes. (As further explained in this methodology, the remainder of ratings setting takes place within a vehicle's assigned Morningstar category.)

To assess the opportunity to add value within the aggregate peer group, Morningstar runs rolling three-year regressions of each constituent vehicle's gross-of-fee returns against the index chosen for the aggregate peer group concerned. From these regressions, Morningstar derives each vehicle's three-year gross alpha versus the index, repeating this for each rolling period and compiling this series of gross alphas for all other vehicles that are part of the aggregate peer group. (Morningstar runs these regressions on a periodic basis, adding new rolling three-year measurements to the historical series with the passage of time. The start date for the regression series is Jan. 1, 2002, or the first date thereafter in the case of peer groups created subsequently.)

Morningstar then uses the resulting range of gross alphas to estimate the potential that funds in the peer group can generate positive gross-of-fee alpha. This alpha-potential estimate, or APE, is the factor

used by Morningstar to adjust its estimate of a vehicle's gross alpha up or down based on the pillar ratings that it assigns to the vehicle. Higher pillar ratings push Morningstar's estimate higher by the magnitude of the APE, while, conversely, lower pillar ratings pull the estimate down by the amount of the APE.

These adjustments will be larger in categories that have higher APEs and lower in those with lower APEs. This ensures the impact of the pillar ratings on a vehicle's rating is proportionate to the size of the opportunity set in the peer group.

Morningstar calculates separate APEs for active and passive strategies in each aggregated peer group. These separate APEs are then applied to active and passive funds, respectively, in the relevant Morningstar Categories.

Score Pillars

Morningstar assigns scores to the People, Process, and Parent Pillars ranging from negative 2 to positive 2. Those scores correspond to the pillar ratings assigned to a vehicle based either on an analyst's qualitative assessment or the use of algorithmic techniques (as explained in further detail in the "Pillar Evaluation" section of this methodology). The pillar ratings take the form of Low, Below Average, Average, Above Average, and High.

Derive the Rating

Active Strategies:

Morningstar starts with the assumption that a vehicle will deliver a gross-of-fee alpha of 0. The pillar scores are then used in conjunction with set pillar weights and the APE for the vehicle's assigned category to derive a gross-of-fee expected alpha. For superannuation funds, Morningstar analysts have determined that a higher weight on the Parent pillar is required given the importance of the Parent to ongoing management. Given their role in funding retirement income and the high proportion of Australian household wealth they manage, superannuation funds are subject to elevated regulatory scrutiny. They must navigate a more complex, evolving regulatory landscape in which there is a strong impetus for increased investment sophistication and economic scale. Additionally, superannuation members will remain within the sector ecosystem for decades, meaning the long-term viability of a super fund parent is of increased importance. The pillars are therefore weighted as follows for actively managed vehicles:

People: 25%

Process: 50%

Parent: 25%




The equation to derive an actively managed vehicle's expected gross-of-fee alpha is thus:

$$\begin{aligned}
 & (0.25 * \text{People Score} * \text{APE}) \\
 & + (0.50 * \text{Process Score} * \text{APE}) \\
 & + (0.25 * \text{Parent Score} * \text{APE}) \\
 & = \text{Expected gross-of-fee alpha} \\
 & \quad \text{where "APE" = Alpha potential estimate for the peer group}
 \end{aligned}$$

To obtain expected net-of-fee alpha, Morningstar subtracts the relevant cost ratio from its estimate of expected gross-of-fee alpha.

$$\begin{aligned}
 & \text{Expected gross-of-fee alpha} \\
 & - \text{Expense ratio} \\
 & = \text{Expected net-of-fee alpha}
 \end{aligned}$$

Arithmetically, this means that expenses have as much weight in the net alpha calculation as the other three pillars combined.

Once Morningstar has estimated a vehicle's expected net-of-fee alpha, it compares that vehicle's expected net alpha with that of all other actively managed investments in the relevant Morningstar fund category, over a 12-month average. For superannuation funds, Morningstar compares their net alpha with those of all other actively managed investments in a regular fund rather than superannuation-specific categories. The vehicle's estimated net alpha must be positive for it to be eligible for a  **Gold**,  **Silver**, and  **Bronze** rating; otherwise, it will be assigned a **Neutral** or **Negative** rating. Morningstar assigns ratings to actively managed vehicles as follows:

Gold

Top 15% of actively managed vehicles with positive expected net-of-fee alpha over a 12-month average.

Silver

Next 35% of actively managed vehicles with positive expected net-of-fee alpha over a 12-month average.

Bronze

Bottom 50% of actively managed vehicles with positive expected net-of-fee alpha over a 12-month average.

Neutral

Top 70% of actively managed vehicles with negative or zero expected net-of-fee alpha over a 12-month average.

Negative

Bottom 30% of actively managed vehicles with negative or zero expected net-of-fee alpha over a 12-month average.

To prevent frequent ratings changes when actively managed offerings are near the threshold between ratings levels, Morningstar applies a buffer. If there are no changes to a vehicle's pillar rating, and if the vehicle's fee has not changed by more than 5 basis points since the last rating was assigned, then the vehicle's expected net alpha must cross a rating's threshold by at least 0.05% annualized, or 5% of the category APE, before the rating will change. (The "threshold" refers to the expected net alpha at each relevant percentile. For active vehicles expected to generate positive net alpha, it is the 15th percentile for Gold/Silver and the 50th percentile for Silver/Bronze. With respect to active vehicles not expected to generate positive net alpha, it is the 30th percentile for Neutral/Negative.)

Performance and Price

Morningstar evaluates a vehicle's performance as part of its overall assessment. However, performance is not a distinct pillar. Rather, Morningstar considers performance within the context of the other pillar assessments it conducts, notably People and Process. For superannuation funds, to the extent performance is relevant to regulatory testing, it is also considered within the context of the Parent Pillar. This ensures that performance doesn't play an outsized role in the overall assessment while tying performance analysis to factors that Morningstar's research has found are better predictors of future outcomes, like the prudence and repeatability of a vehicle's investment approach; the depth, breadth, and continuity of the management team implementing the strategy; and the member-centricity of the parent superannuation fund that stands behind the vehicle concerned.

Likewise, Morningstar takes fees into account when assigning ratings to vehicles but does not maintain a separate Price Pillar. The reason for this is that Morningstar accounts for fees arithmetically, subtracting them from its estimate of a vehicle's expected gross alpha. In this way, fees have as much weight in the calculation as the other three pillars combined and are incorporated in a way that mirrors how they reduce gross investment returns basis point for basis point in practice. Fees are considered within the context of the Parent Pillar as a reflection of how well the parent serves its members.

Pillar Evaluation

Morningstar assigns pillar ratings to superannuation vehicles in one of two ways:

Approach	Description
Directly, by Analysts	Pillar ratings assigned by analysts to vehicles they cover, based on their qualitative assessment. When analysts cover a vehicle, they assign all three pillars: People, Process, and Parent.
Indirectly, by Analysts	Pillar ratings assigned to vehicles that are not covered directly by analysts.

Pillar ratings assigned indirectly by analysts are mapped from analyst covered vehicles to uncovered vehicles that are related in some way to the covered vehicles. These relationships can take a few forms, such as when an uncovered vehicle follows the same strategy as a covered vehicle, when an uncovered vehicle is managed by the same team that runs a covered vehicle, or when an uncovered vehicle shares the same superannuation parent as a covered vehicle.

Pillar Assignment

This section explains how Morningstar determines which vehicles it will assign to analysts for coverage and provides an overview of the assessments analysts make when evaluating the People, Process, and Parent Pillars in assigning ratings to the vehicles they cover.

People

The overall quality of a strategy's investment team is a significant key to a strategy's ability to deliver superior performance relative to its benchmark and/or peers. Evaluating an investment team requires that analysts assess, among other things, the individuals who make the key decisions on the portfolio; if there is more than one person in charge, how conflicts are resolved; resources that directly support the managers' work on the strategy; other resources that are not part of the team, including asset consultants, their skills and experience and the extent to which People resources from within the asset consultant are applied to the particular superannuation fund; the expertise and relevance of available resources to the strategy; and how incentive pay influences decision-making and team stability.

The relevant personnel, including external people resources utilized, are judged along several axes:

- ▶ Experience & ability
- ▶ Fit & structure
- ▶ Workload
- ▶ Communication/information flow
- ▶ Temperament
- ▶ Alignment of interests
- ▶ Key-person risk
- ▶ Team stability

Process

Morningstar analysts are style-agnostic, meaning that, for equity strategies, they do not prefer value to growth or momentum, or vice versa. For fixed-income strategies, both high-quality and credit-sensitive styles are viable. For multi-asset strategies, a wide range of approaches to asset allocation can succeed. Some input may be provided by external sources such as asset consultants. Analysts look for strategies with a performance objective and investment process (for both security selection, manager selection, risk management, and portfolio construction) that is sensible, clearly defined, and repeatable. It must also be implemented effectively. In addition, the portfolio should be constructed in a manner that is consistent with the investment process and performance objective. Analysts seek to understand the

context in which managers think about risk and how this is expressed when constructing the portfolio. Morningstar analysts make extensive use of Morningstar's global database and holdings-based analytical capabilities to evaluate the portfolio. Analysts look for strategies with a process distinctive enough to generate standout results in the future. Both a superannuation fund's internal investment processes and those of the external asset consultants it uses, along with the extent to which they are used, are all considered in the evaluation of the process.

More specifically, analysts seek to understand, as applicable, with analysis extending to the use of external consultants where relevant:

- ▶ The investment philosophy that underpins the strategy;
- ▶ Elements that are systematic and repeatable, if any;
- ▶ The fit of the process with the resources backing the strategy and with the size of the asset base tied to the strategy (including all vehicles across all domiciles);
- ▶ Whether the process has been consistently applied, as demonstrated by the composition of the portfolio over time;
- ▶ The key "edge" of the process as executed by the manager relative to peers;
- ▶ The rigor of capital markets assumptions and their use in driving asset allocation;
- ▶ Strategic asset-allocation process;
- ▶ Dynamic asset-allocation process;
- ▶ Due diligence skill on manager selection;
- ▶ Due diligence skill on security selection;
- ▶ Risk management including rebalancing process back to SAA and sell discipline on securities;
- ▶ Scenario testing for both investment stress tests and liquidity stress tests;
- ▶ Liquidity risk, including but not limited to the presence of unlisted assets in the portfolio and member demographic profile;
- ▶ The valuation process for assets not quoted on public markets, including the valuation governance framework, the valuation methodology, the use of independent valuation sources, the frequency of valuation updates, and the timely execution of ad hoc valuation updates to reflect events material to a valuation input;
- ▶ The risks entailed in the process, from a portfolio-bias point of view and from an ability-to-execute point of view;
- ▶ Analysts' expectations for performance in different market environments assuming the process is adhered to;
- ▶ Whether there is reason to believe the process can add value across the cycle versus the relevant benchmark or category on a risk-adjusted basis;
- ▶ The suitability of the strategy for different types of members given the risks one would expect to see in its portfolio; and
- ▶ Any historical changes in approach or style, and the reasons for those changes.

Parent

Morningstar believes the Parent organization is important in evaluating both active and passive funds. Although other factors may have more immediate impact, they would not be durable without backing

from the superannuation fund. Further, the asset manager and its management set the tone for key elements of Morningstar's evaluation, including capacity management, risk management, recruitment and retention of talent, and firmwide policies, such as incentive pay, which drive or impede the alignment of the superannuation fund's interests with those of fund members.

Beyond these operational areas, Morningstar analysts prefer superannuation funds that have a culture of stewardship and put members first to those that are too heavily weighted to salesmanship. The former tend to operate within their circle of competence, do a good job of aligning manager interests with those of members in their funds, charge reasonable fees, communicate well with strategy members, and treat members' capital as if it were their own. Superannuation funds oriented to putting their own interests too much to the fore might be characterized by their view of members as sales opportunities—they tend to offer faddish products in an attempt to gather assets and have higher charges and incentive programs that do a poor job of aligning managers' interests with those of members. Although relatively few superannuation funds fall obviously to one extreme or another, determining where an asset manager falls on the spectrum is a key part of the Parent research approach.

Key areas of evaluation include:

- ▶ Recruitment and retention of talent
- ▶ Organizational structure
- ▶ Capacity management
- ▶ Organizational and business strategy
- ▶ Quality of product lineup
- ▶ Alignment of interests with members
- ▶ Regulatory compliance, including performance in regulatory tests
- ▶ Investment/group culture
- ▶ Fund-level net flows and member growth

About Morningstar Manager Research

Morningstar Manager Research provides independent, fundamental analysis on managed investment strategies. Morningstar views are expressed in the form of Morningstar Medalist Ratings, which are derived through research of three key pillars— People, Process, and Parent. The Morningstar Medalist Rating is the summary expression of Morningstar’s forward-looking analysis of investment strategies as offered via specific vehicles using a rating scale of Gold, Silver, Bronze, Neutral, and Negative. A global research team issues detailed research reports on strategies that span vehicle, asset class, and geography.

Medalist Ratings are not statements of fact, nor are they credit or risk ratings, and should not be used as the sole basis for investment decisions. A Medalist Rating is not intended to be nor is a guarantee of future performance.

About Morningstar Manager Research

Morningstar Manager Research Services combines the firm's fund research reports, ratings, software, tools, and proprietary data with access to Morningstar's manager research analysts. It complements internal due-diligence functions for institutions such as banks, wealth managers, insurers, sovereign wealth funds, pensions, endowments, and foundations. Morningstar’s manager research analysts are employed by various wholly owned subsidiaries of Morningstar, Inc. including but not limited to Morningstar Research Services LLC (USA), Morningstar UK Ltd, and Morningstar Australasia Pty Ltd.



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