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Style management in practice: part 1

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A clear sense of style is not only important in fashion, but more and more so in equity management as well. But what does “style” mean in equity management? Do stylistic preferences change over time, like in fashion? If so, what triggers those changes? Questions upon questions, but before we go into detail in part 2 of this series, let us first clarify what we mean by style(s):

When we talk about style, we refer to a portfolio of shares that have certain features in common. These features are decisively different from the overall universe of all shares. If all shares have said feature(s) in common, the portfolio has it/them too. We call that style or factor.

There are numerous styles around, and they were at first created by academics and later taken over by financial professionals.

Value:

Value denotes a portfolio that consists of shares with a low PE (price/earnings ratio) and/or a low PBV (price/book value ratio). We should like to point out that “value” and “undervalued” are not the same thing. A PE of 10x for a share gives no indication as to whether the share is undervalued or overvalued.

Growth:

Growth refers to shares that show above-average earnings growth, ideally in the future rather than in the past. Of course, the future values can only be estimated, i.e. they cannot be measured. Some index providers equate growth (shares) with “expensive”, e.g. an above-average PBV in the MSCI. This approach is not ideal, although there is probably no ideal approach in this context.

Quality:

In contrast to growth, quality is more easily measurable. These are companies with above-average profitability (e.g. return on equity, i.e. ROE), low leverage, and stable earnings. Here, earnings only have to be stable, not necessarily above-average.

Momentum:

Momentum-shares are those that have outperformed the market in the past, e.g. in the past three, six, or twelve months. There is no standardised definition. The assumption is that outperformers in the past will also be outperformers in the future.

High dividend:

As the name suggests, this group of shares offers an above-average dividend yield.

Size:

Size in this context means market capitalisation. Shares tend to be put into the categories: small caps, mid-caps, and large caps; occasionally, more detailed categories are used. At this point, the categorisation into small caps and large caps shall suffice for us.

Styles and funds:

A clear sense of style in a fund context means that every fund investor knows what style is dominant in the fund. There are fund managers who time the factors according to market assessment, while others stick to one specific style. It is important to know the style because an investment in the fund is tantamount to a market assessment.

If the investor buys a value fund, (s)he implicitly believes in a strong economy with rising inflation and yields. The preference of growth or quality, on the other hand, indicates a belief in moderate economic growth and continued low inflation and interest rates as well as a flat yield curve.

The ideal funds for investors with no opinion of the market (i.e. a neutral stance) and unwilling to form one are so-called blend funds, i.e. funds that are broadly diversified and have no bias either way.

How do I get information on the style of a fund?

Fact sheets and KIIDs (Key Investor Information Documents) are available on the internet for every fund. These documents inform about the way a fund manager goes about managing any specific fund and ideally also contain information on the style, including its definition.

In addition, the website of Morningstar (www.morningstar.at) has information on funds available. It also features the so-called Morningstar Style Box. This chart shows in what segment a fund focuses its investments. In our example below, the fund is mostly invested in large caps/growth.

Sample Morningstar Style Box:

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