

Investment Style Methodology



The Investnet platform was built to incorporate and logically flow from the sound investment concepts, philosophies and processes that are identified and developed by Investnet’s Investment Management and Research group. Our fundamental processes are grounded in the belief that appropriate asset allocation should underpin any rational investment approach. This belief is well supported by academic and practitioner research (Markowitz, 1952, 1959; Brinson, Hood & Beebower, 1986; Brinson, Singer & Beebower, 1991; Xiong, et al., 2010). One of the key premises of asset allocation is to identify and incorporate distinct yet representative asset classes¹ to use in the portfolio construction process.

There exist a number of ways to classify or categorize financial assets for investment purposes. As financial theory and investment sophistication has evolved during the 20th and now into the early 21st century, the choices for investors have similarly evolved from a simple model of selecting among stocks, bonds and cash, to today’s presentation of an increasing variety of investment choices. This proliferation of investment options parallels the explosive growth of choices we must sift through when selecting a car, groceries or cable channels.

To incorporate the requirements and preferences of our diverse client base while maintaining logical constraints on the variety of investment styles, this methodology paper seeks to explain our investment style classifications for the portfolios that are offered on the Investnet platform. These portfolio types include:

- Mutual Funds
- Exchanged-Traded Funds
- Separately Managed Accounts
- Stocks (Individual Equities)
- Bonds (Individual Fixed-Income Securities)

Mapping of Morningstar Categories

Mutual Funds, ETFs and Individual Stocks

The Investnet platform currently supports 48 investment style categories for use in product classifications and asset allocation proposals. After a comprehensive review and evaluation of data vendors in the marketplace, Investnet selected Morningstar as its source of product data. Currently, Morningstar identifies more than 120 category classifications. These Morningstar categories are, in most cases, categories that are equivalent to the investment styles supported by the Investnet platform. Examples would include large cap growth, large cap value and small cap value. There are a number of Morningstar categories that Investnet does not consider distinct investment style categories from an asset allocation perspective; however, for example, within the broad equity asset class, Morningstar supports a number of specialty fund categories including Financials,

¹ The concept of “Asset Class” is referred to as “Investment Style” on the Investnet platform. This terminology will be used throughout the methodology description.

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Health Care and Technology, among others. We consider these to be industry sectors that would be incorporated within a broader equity style.

As a further illustration, consider a small cap value fund that invests in industrial stocks, which Morningstar has classified in its Industrials Category. This fund would be expected to invest in a portfolio of small cap value stocks. However, in this case, it is restricted to those in the industrial sector. From an asset allocation perspective, our primary focus is gaining exposure to small cap value stocks as a distinct investment style category. The industry sectors that the fund invests in are typically a function of the portfolio manager's philosophy regarding the trade-off between adhering to the sector weights of the benchmark and investing in individual stocks perceived to be attractively priced regardless of sector.

This additional detail in Morningstar's category methodology highlights the distinction between how Envestnet categorizes and implements funds within an asset allocation framework and how Morningstar identifies and creates categories that represent "traditional" investment styles. The Envestnet style system needs to know that the stocks in which the portfolio manager invests have risk and return profiles similar to small cap value stocks. The additional information on the equity sector (in this case "Industrials"), however, is required for the Envestnet platform to make the appropriate investment style assignment.

Table 1 in the Appendix details the complete mapping as well as the underlying investment style category benchmark for non-alternative asset classes. Table 2 in the Appendix details the mapping and underlying investment style category benchmark for alternative investment styles. If a mutual fund/ETF is classified by Morningstar as either equity sector, then the style classification is assigned based on equity style as per the mapping provided in Map A (please refer to Table 3 in the Appendix for more information). For niche fixed-income mutual funds or ETFs assigned to certain Morningstar categories (e.g., multisector bond or single-state municipals), either Map B (see Table 3) or Map C (see Table 3) are used to map these funds from these Morningstar categories to an appropriate Envestnet investment style.

Individual equities are classified based on the following logic: for domestic stocks, the classification is based on equity styles defined in Map A (please refer to Table 3 in the Appendix for more information); for international stocks, the classification is based on the country code. If the country is USA, the classification will be similar to domestic stocks. If the country is listed as Australia, Austria, Belgium, Canada, Switzerland, Germany, Denmark, Spain, Finland, France, United Kingdom, Greece, Hong Kong, Italy, Ireland, Japan, the Netherlands, Norway, New Zealand, Portugal, Singapore or Sweden, it will be classified based on the equity style box of the company as shown in Map D, utilizing the foreign style box assignment as opposed to the U.S style box. International stocks that are missing a foreign equity style box will be classified as Intl Developed Markets. All others will be classified as emerging markets.

The following are some additional details on the mapping process:

1. Specialty funds are classified by Envestnet based on the Morningstar equity style box (please refer to Table 3 in the Appendix for more information). This is consistent with Envestnet's investment style framework.
2. Stable value funds are fixed-income funds with durations close to zero and are categorized in the short-term bond investment style.
3. All money market type funds (taxable, tax-free, foreign money market) have been categorized as cash.
4. All high yield styles (domestic, international, muni high yields) have been categorized as high yield.
5. World allocation, asset allocation and global asset allocation funds have all been categorized under the "balanced" investment style. This is consistent with Morningstar's methodology of including these categories under its more broadly defined "balanced" asset class.

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6. For domestic fixed-income categories, wherever reference has been made to “Map B” for the style box field and if the style box information is missing, the category will default to Envestnet’s intermediate-term bond investment style (please refer to Table 3 in the Appendix for more information).
7. For muni fixed-income categories, wherever reference is made to “Map C” for the style box field and if the style box information is missing, the investment style will default to intermediate-term muni (please refer to Table 3 in the Appendix for more information).

SMA's and Individual Bonds

Separately managed accounts that reside on the Envestnet platform with an “available” status have categories determined by the manager upon addition to the platform. When assigning categories, the list of choices available to the manager is based on our 48 investment styles. An available SMA will keep this investment style until the money manager asks the Envestnet operations team to change it to another style, or if the Investment Research team’s process determines that its status should be changed from “available” to “approved”. All approved-SMA's follow the mapping process described in the section “Mapping of Morningstar Categories” when the quantitative research process is applied. However, in certain exceptions, the PMC research analyst responsible for that SMA's style category may decide to change it to a more appropriate, analyst chosen style category.

Individual fixed-income security classification is based on one or more parameters, such as international status, Moody’s rating, S&P rating, issue status, next call date, maturity date, duration and modified duration. Envestnet receives this data via our IDC data feed. The bonds are then classified as part of the bond refresh job which is scheduled to run every week. This classification may reclassify bonds depending on the data available after bond data has been refreshed from IDC. Any change in the style type of a security will be logged to the security change log, and advisor alerts will be generated for advisors with reclassified bonds in their models. The flow chart in the Appendix (please refer to Table 4 in the Appendix for more information) details bond classification logic provided for individual fixed-income securities.

Benchmark Assignments

This section covers the assignment of platform benchmarks to Envestnet’s investment styles.

The majority of investment style categories available on the Envestnet platform are widely used within the industry, and the choice of the associated benchmark for each category is fairly straightforward (e.g., Russell Indices for domestic equity investment styles). However, there are a few categories and associated indices that required a more subjective, judgmental approach.

Commodities

Two widely used indices represent commodities: the Goldman Sachs Commodity Index and the Dow Jones UBS Commodity Index. The Goldman Sachs Commodity Index is heavily weighted to oil, while the Dow Jones UBS Commodity Index is representative of a more broadly based basket of commodities. Envestnet prefers the Dow Jones UBS Commodity Index for this reason.

Alternatives

Starting in 2016, Envestnet will use an auto mapping process based on a security’s Morningstar Category assignment, to assign an Envestnet alternative style category. An investment’s Envestnet style will be determined by its Morningstar Category, as shown in table 2 below. This will bring in line alternative style category assignment in the same way in which all other ENV investment styles are assigned.

This will replace the mapping formerly implemented in the “Liquid Alternatives and Approval Methodology” document, which will no longer be in effect.

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Other

In some cases, a particular fund does not fit into any of the Investnet investment style categories and is not categorized by Morningstar. This could happen for a number of reasons; most often, it results from a fund's short track record or the fact that the fund is newly launched. In these cases, the fund will be assigned to the "other" investment style. Investnet assigns a 60% Russell 1000 Index / 40% Barclays Aggregate Bond blended benchmark to this category. This allows the fund to be modeled within an asset allocation proposal and have a fairly neutral impact on a moderate allocation.

Investnet periodically reviews the funds assigned to the "other" investment style category and identifies a more appropriate fit when possible.

Bonds

Short-, intermediate- and long-term bond investment styles are assigned to the Barclays Government/Credit Indices that directly correspond to these durations. The Barclays US Government/Credit Index is a widely recognized benchmark that features a blend of US Treasury, government-sponsored (US Agency and supranational) and corporate securities.

Appendix

Table 1.

Morningstar Category Name	Investnet Investment Style	Investnet Parent Style	Platform Benchmark
Allocation 85% + Equity	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Allocation-70% to 85% Equity	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Allocation-50% to 70% Equity	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Allocation-30% to 50% Equity	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Allocation 15 - 30% Equity	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Retirement Income	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target-Date 2000-2010	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2015	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2020	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2025	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2030	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2035	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2040	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2045	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target Date 2050	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target-Date 2055	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target-Date 2060+	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Target-Date Retirement	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
Tactical Allocation	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern
World Allocation	Balanced	Other	60% Russell 1000/40% Barclays Govt/Credit Intern

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Table 1 continued.

Morningstar Category Name	Envestnet Investment Style	Envestnet Parent Style	Platform Benchmark
Bank Loan	Bank Loan	Fixed Income	S&P/LSTA Leveraged Loan TR
Prime Money Market	Cash	Cash	Citi Treasury Bill 3 Mon
Taxable Money Market	Cash	Cash	Citi Treasury Bill 3 Mon
Tax-Free Money Market	Cash	Cash	Citi Treasury Bill 3 Mon
Commodities Agriculture	Commodities	Other	Bloomberg Commodity Index TR
Commodities Broad Basket	Commodities	Other	Bloomberg Commodity Index TR
Commodities Energy	Commodities	Other	Bloomberg Commodity Index TR
Commodities Industrial Metals	Commodities	Other	Bloomberg Commodity Index TR
Commodities Miscellaneous	Commodities	Other	Bloomberg Commodity Index TR
Commodities Precious Metals	Commodities	Other	Bloomberg Commodity Index TR
Equity Precious Metals	Commodities	Other	Bloomberg Commodity Index TR
Natural Resources	Commodities	Other	Bloomberg Commodity Index TR
Emerging Market Local Currency Bond	Emerging Markets Bond	Fixed Income	JPM EMBI Global TR USD
Emerging Markets Bond	Emerging Markets Bond	Fixed Income	JPM EMBI Global TR USD
China Region	Intl Emerging Markets	International	MSCI EM NR
Diversified Emerging Mkts	Intl Emerging Markets	International	MSCI EM NR
India Equity	Intl Emerging Markets	International	MSCI EM NR
Latin America Stock	Intl Emerging Markets	International	MSCI EM NR
Pacific/Asia ex-Japan Stk	Intl Emerging Markets	International	MSCI EM NR
World Stock	Global Equity	International	MSCI World NR
High Yield Bond	High Yield	Fixed Income	Barclays US Corporate High Yield
High Yield Muni	High Yield	Fixed Income	Barclays US Corporate High Yield
World Bond	International Bond	Fixed Income	Barclays Global Aggregate
Muni California Intermediate/Short	Intermediate Muni	Fixed Income	Barclays Municipal 5 Yr 4-6
Muni National Interm	Intermediate Muni	Fixed Income	Barclays Municipal 5 Yr 4-6
Muni New York Intermediate/Short	Intermediate Muni	Fixed Income	Barclays Municipal 5 Yr 4-6
Muni Single State Intermediate	Intermediate Muni	Fixed Income	Barclays Municipal 5 Yr 4-6
Foreign Large Blend	Intl Developed Markets	International	MSCI EAFE NR
Foreign Large Growth	Foreign Large Cap Growth	International	MSCI EAFE Large Growth NR USD
Foreign Large Value	Foreign Large Cap Value	International	MSCI EAFE Large Value NR USD
Foreign Small/Mid Growth	Foreign Small Mid Cap Growth	International	MSCI EAFE Mid Growth NR USD
Foreign Small/Mid Value	Foreign Small Mid Cap Value	International	MSCI EAFE Mid Value NR USD
Foreign Small/Mid Blend	Foreign Small Mid Cap Core	International	MSCI EAFE Mid NR USD
Intermediate Government	Intermediate Bond	Fixed Income	Barclays US Govt/Credit Interm
Intermediate-Term Bond	Intermediate Bond	Fixed Income	Barclays US Govt/Credit Interm
Large Blend	Large-Cap Core	Equity	Russell 1000
Large Growth	Large-Cap Growth	Equity	Russell 1000 Growth
Large Value	Large-Cap Value	Equity	Russell 1000 Value

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Table 1 continued.

Morningstar Category Name	Envestnet Investment Style	Envestnet Parent Style	Platform Benchmark
Muni California Long	Long Muni	Fixed Income	Barclays Municipal 10 Yr 8-12
Muni National Long	Long Muni	Fixed Income	Barclays Municipal 10 Yr 8-12
Muni New York Long	Long Muni	Fixed Income	Barclays Municipal 10 Yr 8-12
Muni Single State Long	Long Muni	Fixed Income	Barclays Municipal 10 Yr 8-12
Long Government	Long Bond	Fixed Income	Barclays US Govt/Credit Long
Long-Term Bond	Long Bond	Fixed Income	Barclays US Govt/Credit Long
Mid-Cap Blend	Mid-Cap Core	Equity	Russell Mid Cap
Mid-Cap Growth	Mid-Cap Growth	Equity	Russell Mid Cap Growth
Mid-Cap Value	Mid-Cap Value	Equity	Russell Mid Cap Value
Small Blend	Small-Cap Core	Equity	Russell 2000
Small Growth	Small-Cap Growth	Equity	Russell 2000 Growth
Small Value	Small-Cap Value	Equity	Russell 2000 Value
Muni National Short	Short Muni	Fixed Income	Barclays Municipal 3 Yr 2-4
Muni Single State Short	Short Muni	Fixed Income	Barclays Municipal 3 Yr 2-4
Short Government	Short Bond	Fixed Income	Barclays US Govt/Credit 1-3 Yr
Short-Term Bond	Short Bond	Fixed Income	Barclays US Govt/Credit 1-3 Yr
Stable Value	Short Bond	Fixed Income	Barclays US Govt/Credit 1-3 Yr
Ultrashort Bond	Short Bond	Fixed Income	Barclays US Govt/Credit 1-3 Yr
Inflation-Protected Bond	TIPS / Inflation-Protected Bond	Fixed Income	Barclays US Treasury US TIPS
Global Real Estate	REITs	Equity	DJ US Select REIT
Infrastructure	REITs	Equity	DJ US Select REIT
Real Estate	REITs	Equity	DJ US Select REIT
	All Cap	Equity	Russell 3000
	Foreign Large Cap Core	International	MSCI EAFE Large NR USD
	Other	Other	60% Russell 1000/40% Barclays Govt/Credit Intern

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Table 2.

Morningstar Category Name	Investnet Investment Style	Investnet Parent Style	Platform Benchmark
Convertibles	Alternative	Alternatives	HFRX Global Hedge Fund Index
Nontraditional Bond	Alternative Fixed Income	Alternatives	Index IQ: Hedge Fixed Income Arbitrage Beta Index
Bear Market	Bear Market	Alternatives	HFRX EH: Short Bias Index
Diversified Arbitrage*	Event Driven ¹	Alternatives	HFRX Event Driven
Event Driven*	Event Driven ¹	Alternatives	HFRX Event Driven
Market Neutral	Equity Market Neutral ²	Alternatives	HFRX Equity Market Neutral Index
Currency	Global Macro	Alternatives	HFRX Macro/CTA
Single Currency	Global Macro	Alternatives	HFRX Macro/CTA
Long/Short Equity	Hedged Equity	Alternatives	HFRX Equity Hedge Index
Options Based	Hedged Equity	Alternatives	HFRX Equity Hedge Index
Trading-Inverse Commodities	Inverse	Alternatives	S&P 500
Trading-Inverse Debt	Inverse	Alternatives	S&P 500
Trading-Inverse Equity	Inverse	Alternatives	S&P 500
Trading-Leveraged Commodities	Leveraged	Alternatives	S&P 500
Trading-Leveraged Debt	Leveraged	Alternatives	S&P 500
Trading-Leveraged Equity	Leveraged	Alternatives	S&P 500
Trading-Miscellaneous	Leveraged	Alternatives	S&P 500
Volatility	Leveraged	Alternatives	S&P 500
Long/Short Credit	Long/Short Credit	Alternatives	HFRX Fixed Income – Credit
Managed Futures	Managed Futures	Alternatives	Barclay CTA Index
Multialternative	Multi-Strategy	Alternatives	HFRX EH: Multi-Strategy Index

*Morningstar Institutional Category

¹ Previously called “Equity Arbitrage”

² Previously called “Market Neutral”

Table 3.

		MAP A	
Morningstar Category Name	Refer to Morningstar Equity Style Box Mapping	Morningstar Equity Style Box	Investnet Investment Style
Communications	MAP A	Large Value	Large-Cap Value
Consumer Defensive	MAP A	Large Blend	Large-Cap Core
Consumer Cyclical	MAP A	Large Growth	Large-Cap Growth
Energy Limited Partnership	MAP A	Mid Value	Mid-Cap Value
Equity Energy	MAP A	Mid Blend	Mid-Cap Core
Financial	MAP A	Mid Growth	Mid-Cap Growth
Health	MAP A	Small Value	Small-Cap Value
Industrials	MAP A	Small Blend	Small-Cap Core
Leveraged Net Long	MAP A	Small Growth	Small-Cap Growth
Miscellaneous Sector	MAP A	If information is missing	Other
Technology	MAP A		
Utilities	MAP A		

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Table 3 continued.

Morningstar Category Name	Refer to Morningstar Fixed Income Style Box Mapping
Corporate Bond	MAP B
Multisector Bond	MAP B
Preferred Stock	MAP B

Morningstar Category Name	Refer to Morningstar Fixed Income Style Box Mapping
Muni Massachusetts	MAP C
Muni Minnesota	MAP C
Muni New Jersey	MAP C
Muni Ohio	MAP C
Muni Pennsylvania	MAP C
Muni Florida	MAP C

Morningstar Category Name	Refer to Morningstar International Equity Style Box Mapping
Diversified Pacific/Asia	MAP D
Europe Stock	MAP D
Japan Stock	MAP D
Miscellaneous Region	MAP D

MAP B	
Morningstar Fixed Income Style Box	Investnet Investment Style
Short-Term High Quality	Short Bond
Intermediate-Term High Quality	Intermediate Bond
Long-Term High Quality	Long Bond
Short-Term Medium Quality	Short Bond
Intermediate-Term Medium Quality	Intermediate Bond
Long-Term Medium Quality	Long Bond
Short-Term Low Quality	High Yield
Intermediate-Term Low Quality	High Yield
Long-Term Low Quality	High Yield
If information is missing	Intermediate Bond

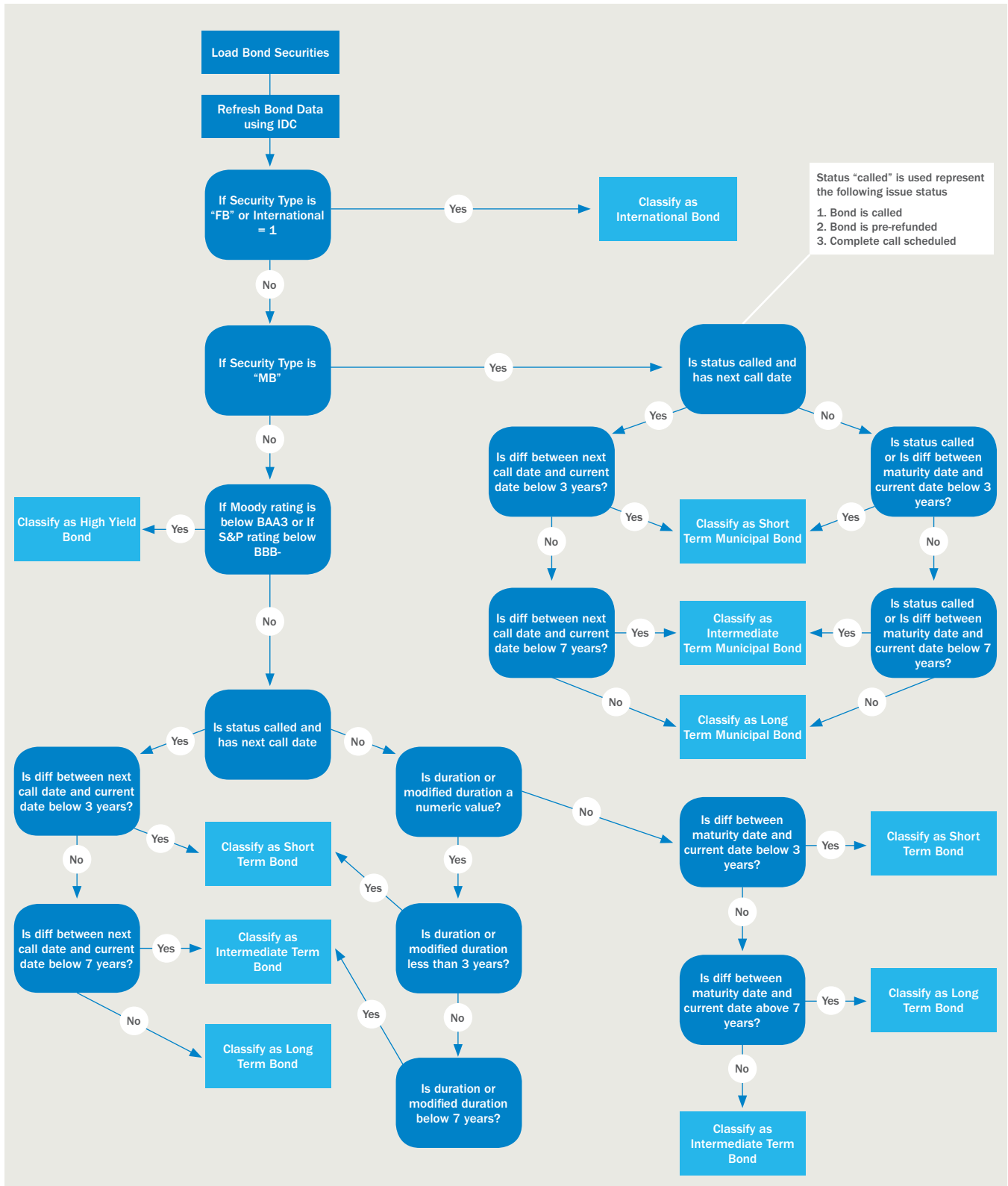
MAP C	
Morningstar Fixed Income Style Box	Investnet Investment Style
Short-Term High Quality	Short Muni
Intermediate-Term High Quality	Intermediate Muni
Long-Term High Quality	Long Muni
Short-Term Medium Quality	Short Muni
Intermediate-Term Medium Quality	Intermediate Muni
Long-Term Medium Quality	Long Muni
Short-Term Low Quality	High Yield
Intermediate-Term Low Quality	High Yield
Long-Term Low Quality	High Yield
If information is missing	Intermediate Muni

MAP D	
Morningstar International Equity Style Box	Investnet Investment Style
Large Value	Foreign Large Cap Value
Large Blend	Intl Developed Markets
Large Growth	Foreign Large Cap Growth
Mid Value	Foreign Small Mid Cap Value
Mid Blend	Foreign Small Mid Cap Core
Mid Growth	Foreign Small Mid Cap Growth
Small Value	Foreign Small Mid Cap Value
Small Blend	Foreign Small Mid Cap Core
Small Growth	Foreign Small Mid Cap Growth
If Information is missing	Intl Developed Markets

*Map D to also be used for all foreign domiciled stocks

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Table 4.



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Disclosures

You should consider the investment objectives, risks, fees and expenses of any exchange traded fund or mutual carefully before investing. This and other important information is available in the funds' prospectus and summary prospectuses, which you may obtain at the appropriate funds' websites. Please read the prospectus and summary prospectuses carefully before investing.

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