

THIS SEASON, IN STYLE

An iShares ETF guide to style investing
and implementation



WHAT AM I GETTING WITH THIS EQUITY FUND?

Investors for a generation have tended to answer in the language of the “style box,” the nine-square classification grid that measures securities by size, and places them somewhere between “growth” and “value” based on business metrics.¹ An advantage of the style box is simplicity. Its methodology makes it easy to assess a stock’s potential risk and return. The same is true at the portfolio level, since the style box is widely used as a means to gauge how different funds might interact. This makes the style box a potent tool for investors, since academic research has shown that high-level allocation decisions — for instance how much and which type of equities to own — are most critical to long-term performance.²

¹ Morningstar Inc., a fund research company, introduced The Morningstar Style Box in 1992.

² BlackRock, “Time to get your core in shape,” 2018.

Style box investing: what you need to know

The style box can help asset allocators at the portfolio level in three ways:

- 1 Equity allocations can be tailored to match investor objectives
- 2 Actual allocations can more precisely match allocation models
- 3 Portfolio diversification can be readily calibrated

Index providers take varying approaches to determine if a stock is growth or value, so it's important to understand the differences in order to minimize the risk of overlapping securities or exposure gaps in a portfolio.

To help ensure investors' style box equity allocations align with their expectations, this piece covers:

- The fundamentals of style box investing
- Different methodologies across leading style box index providers
- Key considerations when choosing style box indexes and ETFs

Growth vs. value: the basics

As the name implies, growth stocks are shares in a company that is anticipated to grow at an above-average rate. Value stocks tend to trade at a lower price relative to fundamentals, such as earnings and sales. Growth and value stocks are categorized as such based on a distinct set of characteristics. (Figure 1)

FIG. 1

Growth and value characteristics

Growth stocks	Value stocks
Expected to grow at a rate above the market average	Priced relatively 'cheap'
Characteristics	
Above average earnings growth Above average sales growth Positive price momentum	Trades at a low price relative to: <ul style="list-style-type: none">• Earnings (P/E)• Sales (P/S)• Book value (P/B)

A tailored approach for different risk and return profiles

Investors may make allocation decisions across the style box based on time horizon and risk tolerance. Consider the following hypothetical investor profiles:



INVESTOR PROFILE 1

25-year-old entrepreneur with a long time horizon

	Value	Blend	Growth
Large			
Mid			
Small			

With a greater risk tolerance, the investor may overweight growth-oriented companies in search of greater capital appreciation



INVESTOR PROFILE 2

60-year-old nearing retirement

	Value	Blend	Growth
Large			
Mid			
Small			

With less tolerance for risk, the investor may overweight larger, value-oriented companies in seeking to generate greater levels of income and maintain capital appreciation.

These examples highlight how a style box approach to equity allocation can be used to target specific risk and return objectives. They are for illustrative purposes only and are not a recommendation regarding any specific investment or investment strategy.

Style box for improving diversification

The style box can also help improve diversification. Value stocks have historically behaved differently than growth stocks over different phases of the business cycle. (Figure 3) As such, the style box can help investors improve diversification and tailor their asset allocation based on their expectations and market outlook, allowing them to smooth out returns over time.

FIG. 3
Style box annual returns (%)

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Large Value 17.0	Large Growth 32.6	Large Growth 13.5	Large Growth 8.1	Large Value 16.1	Large Growth 31.9	Large Growth (-0.52)	Large Growth 36.48	Large Growth 39.34	Large Growth 31.24	Large Value -5.13
Large Growth 15.0	Large Value 32.1	Large Value 12.9	Large Value (-3.4)	Large Growth 6.9	Large Value 13.8	Large Value (-6.22)	Large Value 26.36	Large Value 1.64	Large Value 23.46	Large Growth -29.74

Source: Morningstar as of 12/31/2022. Large Growth represents the Russell Top 1000 Growth Index, Large Value represents the Russell Top 1000 Value Index, Mid Growth represents the Russell Midcap Growth Index, Mid Value represents the Russell Midcap Value Index, Small Growth represents the Russell 2000 Growth Index and Small Value represents the Russell 2000 Value Index. **Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**



Distinctions between style box and factor investing

The advent of style box index funds and ETFs allowed investors to implement strategic allocations based on size and value, or tactically tilt towards a style based on market outlook, in a low cost and tax efficient way. While style box investing has served investors well for almost 30 years, our knowledge about other factors — broad persistent drivers of returns — beyond size and value has increased.

A large body of academic work has shown that quality, momentum and minimum volatility also have historically enhanced returns or reduced risk relative to market-capitalization index benchmarks. There are differences between style box and factor strategies that are important to consider. For example, single factor strategies are generally not designed to mirror the broad market when combined.

Index providers have varying style index methodologies

All indexes within a given style box seek to achieve a common objective. However, each index provider has its own construction methodology and a unique way of measuring value and growth. For example, two leading equity index providers take considerably different approaches to style classification, ranking the U.S. equities in their size indexes by varying growth and value metrics. (Figure 4) Once stocks are ranked, index providers also differ in their approach to distributing stocks assigned to growth, value or blend.

FIG. 4

Index provider value and growth metrics

Index provider	Value metrics	Growth metric
Russell	<ul style="list-style-type: none"> • Price to book 	<ul style="list-style-type: none"> • Forecasted 2 year growth • 5 year sales growth
Morningstar	<ul style="list-style-type: none"> • Price to forward earnings • Price to book • Price to sales • Price to cash flow • Dividend yield 	<ul style="list-style-type: none"> • Long-term projected earnings growth • Historical earnings growth • Sales growth • Cash flow growth • Book value growth

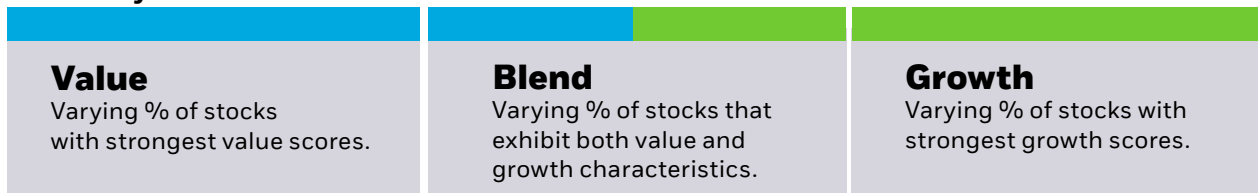
Source: Russell, Morningstar.

Russell style classification breakdown

While Russell also includes stocks that have a blend of growth and value characteristics in both of its style indexes, the index provider does not set a predetermined percentage for its value or growth classifications. (Figure 6) While these percentages can vary, in general about 70% of stocks are classified as pure value or pure growth and the remaining 30% fall in the middle.

FIG. 6

Russell style classification

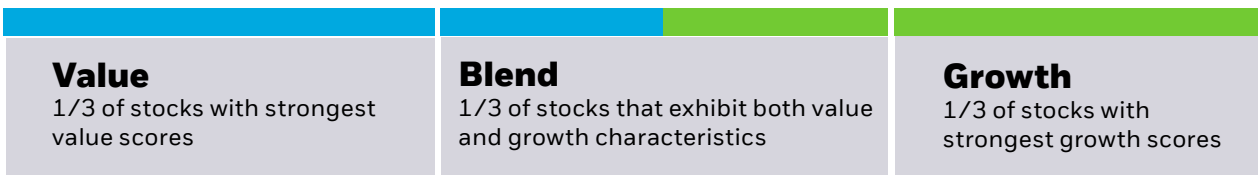


Morningstar style classification breakdown

Morningstar takes a similar approach as Russell. To ensure their indexes efficiently represent the target investment style, Morningstar places the top 1/3 of stocks with the highest value scores exclusively in the value index and the top 1/3 of stocks with the highest growth scores exclusively in the growth index. The middle 1/3 are considered blend and can be found in both style indexes based on their relative style skew. This process prevents blend stocks from dominating a value or growth index.

FIG. 7

Morningstar style classification



Different methodologies make for different indexes

As detailed above, construction methodology differs across index providers. As a result, two indexes with similar names may exhibit materially different characteristics. Investors should keep this in mind and look under the label to determine which exposure best matches their desired allocation. To illustrate the importance, consider the differences between the MSCI USA Value and Russell 1000 Value indexes.

Choosing the right style box index series

When implementing an asset allocation, investors should consider which index series aligns best with their model benchmark. For example, if the Russell 1000 is used as the U.S. equity benchmark, then it makes sense to allocate to growth and value through Russell 1000 growth and Russell 1000 value ETFs. This will allow for efficient style tilts without creating unnecessary tracking error to the benchmark, effectively reducing implementation risk.

To ensure no gaps in exposure or unintentional security overlap, it is also good practice to maintain consistency

within index families. For example, if the S&P 500 is being used in the large space, then using the S&P 600 style index for small cap would ensure full market coverage without creating overlap within the portfolio.

Ultimately, the instruments an investor chooses to fill in the style box will be critical in driving success. And the “right” solution may be different for two similar investors based on their models or the way they define growth and value. This is why iShares offers style box ETFs which seek to track indexes from multiple index providers.

Style box implementation with iShares ETFs

Popular benchmarks such as the S&P 500 and Russell 1000 help create the core of many investor portfolios. Style box funds are available which split these popular benchmarks into value and growth styles. These style box ETFs extend the core to enable more precision exposures that could better align with an investor’s market outlook.



iShares ETFs for style box investing

US DOMICILED

EMEA DOMICILED

Ticker	Name	Expense ratio (%)	Ticker	Name	Expense ratio (%)
Styles					
IWF	iShares Russell 1000 Growth ETF	0.18	R1GR	iShares Russell 1000 Growth UCITS ETF	0.18
IWD	iShares Russell 1000 Value ETF	0.18	R1VL	iShares Russell 1000 Value UCITS ETF	0.18
Single Factor					
SIZE	iShares MSCI USA Size Factor ETF	0.15	IUSZ	iShares Edge MSCI USA Size Factor UCITS ETF USD (Acc)	0.20
VLUE	iShares MSCI USA Value Factor ETF	0.15	IUVL	iShares Edge MSCI USA Value Factor UCITS ETF USD (Acc)	0.20
US Core					
IVV	iShares Core S&P 500 ETF	0.03	CSPX	iShares Core S&P 500 UCITS ETF USD (Acc)	0.07
IJR	iShares Core S&P Small-Cap ETF	0.06	IDP6	iShares S&P SmallCap 600 UCITS ETF USD (Dist)	0.40

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