

Rocaton

INSIGHTS

*GICS Changes: Introduction of the
Communication Services Sector*

October 2018

203.621.1700 | rocaton.com

© 2018, Rocaton Investment Advisors, LLC

EXECUTIVE SUMMARY

- The Global Industry Classification Standard (“GICS”) is a widely-used industry/sector classification system that was developed by MSCI and S&P in 1999. GICS is a tool that market participants use to appropriately interpret, understand and summarize industry/sector relationships and movements.
- Since global markets constantly evolve and change, the indices used to represent and measure those markets must also evolve. Perhaps the most visible example is the periodic reconstitution of market indices, a process that consists of adding, removing and reweighting stocks to ensure they are an up-to-date reflection of the market capitalization and investment style of the companies within the universe the index is targeting.
- One of the more notable evolutions in markets over the last decade has been with regard to how people communicate, share information and entertain themselves. Technology, media and telecom companies often look to combine distribution capacity with ownership of content creation. Evidence of the trend is perhaps most apparent in the increased number of mergers and acquisitions and consolidation in the space.

Introduction of the Communications Services Sector

On September 28th the Global Industry Classification Standard (“GICS”) underwent a major structural change (the largest in its 19-year history). The result of the change is the broadening and renaming of the Telecommunication Services sector, which is now known as Communication Services. The change is meant to acknowledge that the way people communicate, share information and entertain themselves has fundamentally changed, as a result of the convergence of technology, media and telecom. This change was agreed upon jointly by MSCI and S&P Dow Jones.

The new Communication Services sector includes:

- All those companies formerly in the Telecom sector (including AT&T, Verizon, Softbank, China Mobile, etc.)
- Those companies formerly in the Information Technology sector that are in the business of facilitating communication, where technology is not the key driver of the business, but rather just the medium of delivery (the most notable of which include Alphabet, Facebook, Tencent, Twitter)
- Media companies formerly in the Consumer Discretionary Sector (e.g. Comcast, Disney and Netflix)

As part of this change, a number of online retailers (e.g. Ebay and Alibaba) moved from the Information Technology sector to the Consumer Discretionary sector.

Figure 1:

Projected Top Ten Holdings in the Communication Services Sector in the MSCI ACWI IMI

Company	Former Sector	Weighting
Alphabet	Information Technology	17.2%
Facebook	Information Technology	9.6%
Tencent Holdings Li (CN)	Information Technology	5.7%
AT&T	Telecommunication Services	5.3%
Verizon Communications	Telecommunication Services	4.9%
Disney	Consumer Discretionary	3.9%
Comcast Corp A	Consumer Discretionary	3.7%
Netflix	Consumer Discretionary	3.4%
Naspers	Consumer Discretionary	2.4%
Softbank Group Corp	Telecommunication Services	1.6%

A structural change of this magnitude impacts the fundamental characteristics of those sectors mentioned (for example, Communications Services does not resemble what was the Telecommunications Services sector). Within the S&P 500, more than 10% of the market value shifted sectors (globally

Figure 2:
Current and Projected Sector Weights

Sector	Former Structure	New Structure
MSCI ACWI IMI Projected Sector Weightings		
Information Technology	18.9%	14.9%
Consumer Discretionary	12.4%	10.7%
Communication Services (formerly Telecom)	2.5%	8.2%
S&P 500 Projected Sector Weightings		
Information Technology	25.6%	20.1%
Consumer Discretionary	12.7%	10.0%
Communication Services (formerly Telecom)	1.9%	10.2%

the change impacted over 2100 companies). Although broad based indices did not incur meaningful turnover (as stocks held were just be reclassified into other sectors), there will be cash flows necessary from sector-based index funds and exchange traded funds (“ETFs”) that track

the benchmarks that adhere to GICS. Additionally, many active strategies that are managed in a benchmark-relative manner may likely need to make adjustments to their portfolios. In discussions with investment managers regarding how they will respond to the change, many have commented that research responsibilities are not aligned with GICS sectors and have reflected the relationship between the companies that will comprise the communication sector for some time (and thus no changes are necessary). In some cases, investment guidelines were revisited. Also, many investment managers chose to begin rebalancing portfolios towards this new structure some time ago. For MSCI indices, these changes will be implemented starting from the November 2018 Semi-Annual Index Review. For S&P, these changes were implemented with its quarterly rebalance, as of the open on September 24th.

Conclusion

Rocaton believes that the aforementioned changes to the GICS classification standard are appropriate given how global markets have changed over the last decade. It seems intuitive that the evolution will continue and further demonstrate the purpose of the change. Clients should be aware of the change and how it may affect exposure for more benchmark aware investment managers, as well as for performance reporting purposes.

Rocaton

GICS Changes: Introduction of the Communication Services Sector

Rocaton is registered as an investment adviser with the U.S. Securities and Exchange Commission. Rocaton's Form ADV, Part 2 is available upon request. The information included in this publication has been taken from sources considered reliable. No representations or warranties are made as to the accuracy or completeness of this information and no responsibility or liability (including liability for consequential or incidental damages) is assumed for any error, omission or inaccuracy in this information. This information is subject to change over time. This publication is not intended as investment advice. Before acting on any information contained in this material you should consider whether it is suitable for your particular circumstance. Any opinions expressed in this publication reflect our judgment at this date and are subject to change. No part of this publication may be reproduced or redistributed in any manner without the prior written permission of Rocaton Investment Advisors, LLC.

[Performance Information and Return Expectations](#)

The analysis contained in this document may include projections of long-term return and risk expectations. There is no guarantee that the projected returns or risk will be realized. The projections are based in part on historical performance of various asset classes, and past performance is no guarantee of future performance. The projections include assumptions, including those regarding risk and return. These assumptions are used for modeling purposes only and may not be realized. Because the analysis is based on assumptions and projections, there can be no warranties or guarantees.

203.621.1700 | rocaton.com

© 2018, Rocaton Investment Advisors, LLC