

Sectors in the World of Global Investing

Globalization Leads to a Focus on Sectors

Since the mid-1980s, equity investing has become increasingly global and, as a result, sector classification has begun to overshadow nationality as a useful tool for thinking about the equity markets. The 1987 market crash, when developed markets around the world collapsed in unison, was an early hint that nationality was becoming less important. The sector classification trend -- increasing significance for sectors and lessening the importance of nationality -- is well in place. The technology boom of the late 1990s and the subsequent bear market in 2000-2002 are two historical events that show how sectors have become key factors in understanding the markets. A more recent event is the market turmoil of 2008. Looking at the indices that comprise the S&P Global 1200, their 2008 performances ranged from -38.5% for the S&P 500[®] to -45.4% for the S&P/TSX 60, with the S&P Global 1200 down 41.9% (all measured in U.S. Dollars and excluding dividend reinvestment). Global sectors show an even wider range of results when compared to regions. Among sectors in the S&P Global 1200, Health Care and Consumer Staples were down 23.2% and 24.0%, respectively, while Financials plunged 56%.

We can mark some other historical occurrences where the sector classification trend demonstrated its staying power. For instance, the introduction of the Euro and the convergence of laws and securities regulation in Europe are two good examples. The Euro helped shift the world's focus to three principal currencies: the U.S. Dollar, the Euro and the Yen. Even if one expands the picture to include the British Pound, and looks forward

The Global Industry Classification Standard (GICS[®]) is a partnership of S&P and MSCI Barra and is an entirely collaborative effort. This article is by two professional staff of Standard & Poor's; all information and opinions about GICS are from S&P's perspective.

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to a day when the Chinese RMB is not encumbered with capital controls, the entire world will have no more than five principal currencies. A limited number of currencies tends to limit the importance of nationality in investing. A counterargument occasionally heard is the growing investor interest in emerging markets, a very important aspect of globalization. Most emerging market economies are focused on one or two sectors, however, and these sectors are often one of the best ways to understand the trends occurring in those markets. The close link of the Russian equity market with the broader the Energy sector is just one example.

Until the mid-1990s the world of indices and sectors was straightforward: U.S. analyses depended on the S&P 500 and its sectors and industry groups whereas non-U.S. equity investments were based on MSCI EAFE and its sectors. The FTSE indices focused on the UK markets, Dow-Jones focused on the Dow 30, and Russell was focused on small cap U.S. stocks. Moreover, security analysts were finding that the Standard Industry Classification (SIC) codes and their successors, such as the North American Industry Classification System (NAICS), did not meet their needs because there was not enough detail in service industries and too much detail in industrial areas. Additionally, they were not designed with equity investment as their primary use.

Development of the Global Industry Classification Standard (GICS®)

With the growing importance of sectors combined with the need for consistent analyses across countries, the demand for globally consistent sectors became clear in the 1990s. Among the index providers, both S&P and MSCI Barra had sector and industry classification systems which had evolved over time and were tailored to their particular needs. Around 1995, S&P recognized that it had three or more similar, but not identical, industry classification systems for different equity products. Some consolidation was obviously needed. Simultaneously, MSCI Barra recognized that its industry classification system was also due for a review. The result was a cooperative effort to develop a single classification standard and a joint commitment to maintain its accuracy and keep it up to date.

In August 1999, Standard & Poor's and MSCI Barra announced their agreement to co-develop the Global Industry Classification Standard (GICS[®]). Understanding the ever-evolving dynamics in the global equity market and the market's inherent impact on investors, the two leading global equity index providers co-developed this methodology to provide the financial community one accurate, complete and standard set of industry definitions across the global markets.

Both Standard & Poor's and MSCI Barra understood that investors use indices and index products across different geographies and for many different tasks, such as asset management, client account reporting, equity peer analysis, portfolio strategy, and industry research. The intent of GICS was (and still is) to add clarity to the indexing and portfolio management process by providing one unique company classification to be applied across all S&P and MSCI Barra indices, index products, and related financial data products and services. The initial design was set out with a few fundamental rules: it had to be global; it had to be evolutionary; and it had to be largely driven by the way equity markets trade, not by a pure rule-based measurement. The classification methodology largely follows a revenue model (i.e. businesses tend to be classified in alignment with their primary source of revenues), but substantial weight is also given to a company's earnings and how a company trades in comparison to its peers. The classification is an investment-based, analytic exercise, not a pure statistical categorization, and a constant dialogue with users' guide revisions in the system over time.

At Standard & Poor's, direct access to the equity markets via both our clients and team of securities analysts plays an important role in the framework behind the GICS design, and helps to influence both company classifications and the evolution of the GICS structure. Had S&P not sought input from clients, equity analysts, and sometimes even companies themselves, GICS would have been in danger of becoming another classification system with limited use. It also would have run the risk of meeting the same fate as the three classification systems previously used at Standard & Poor's, which fit a custom need but lacked global relevance and impact.

Ten years later, it is apparent that GICS did not follow the same path. Much of GICS' success can be attributed to client input. Client panels, discussions, and consultations have been the primary drivers behind changes to the GICS structure over the past decade. When first introduced, GICS was a four-tier structure with an eight-digit taxonomy – 10 Sectors, 23 Industry Groups, 59 Industries and 123 Sub-Industries. Through the practice of annual client consultations, the structure has evolved into 10 Sectors, 24 Industry Groups, 68 Industries and 154 Sub-Industries, while keeping the eight-digit taxonomy intact. These changes were the direct results of input from the global equity markets.

The evolving nature of GICS makes it a valuable tool for monitoring changes in the global equity markets. Viewing the markets through the GICS system lens illustrates how much the world can change within a few years and how different the sector mix is globally at any given point in time. All of this sector differentiation becomes very relevant information when making an investment decision.

What the Data Show

In the past two decades, global investing has become easier for investors as they have gained fairly easy, cost-efficient access to most developed markets. The dominance of, and need for, sector specialization becomes apparent when looking across sectors around the world. Tables 1, 2 and 3 show that in both the U.S. and Europe Consumer Discretionary companies have lost about 40-50% of their relative weight over the past 20 years, whereas the sector has grown by almost 40% in Japan. The Information Technology boom/bust scenario was most prevalent in the U.S. and Japan, where the Information Technology sector accounted for about 25-30% of these markets, as opposed to Europe, where it accounted for less than 10% of the market (as measured by the 1999 peak). Japan, on the other hand, essentially lacks an Energy sector, demonstrated by the 1% or less relative weight in that sector throughout time.

Table 1: S&P 500, GICS Sector Weights

	31-Dec-1989	31-Dec-1994	31-Dec-1999	31-Dec-2004	31-Aug-2009
Consumer Discretionary	14.6%	14.9%	12.7%	11.9%	9.1%
Consumer Staples	11.6%	13.2%	7.2%	10.5%	11.5%
Energy	12.6%	10.0%	5.6%	7.2%	11.7%
Financials	8.8%	10.7%	13.0%	20.6%	15.4%
Health Care	8.4%	9.2%	9.3%	12.7%	13.5%
Industrials	14.4%	13.0%	9.9%	11.8%	10.0%
Information Technology	5.9%	8.6%	29.2%	16.1%	18.5%
Materials	7.9%	7.1%	3.0%	3.1%	3.4%
Telecommunication Services	9.8%	8.6%	7.9%	3.3%	3.2%
Utilities	6.1%	4.8%	2.2%	2.9%	3.8%

Table 2: S&P Euro 350, GICS Sector Weights

	31-Dec-1989	31-Dec-1994	31-Dec-1999	31-Dec-2004	31-Aug-2009
Consumer Discretionary	15.1%	12.5%	9.9%	9.3%	7.3%
Consumer Staples	12.4%	12.1%	7.2%	9.5%	11.5%
Energy	10.2%	8.8%	9.8%	11.3%	10.8%
Financials	23.8%	23.1%	24.6%	29.5%	25.8%
Health Care	5.9%	9.2%	8.2%	9.2%	10.2%
Industrials	10.3%	9.2%	6.5%	6.5%	9.0%
Information Technology	2.1%	2.6%	9.5%	3.8%	2.9%
Materials	9.9%	9.0%	4.9%	6.2%	8.1%
Telecommunication Services	5.2%	7.0%	14.3%	9.3%	7.2%
Utilities	5.1%	6.4%	5.2%	5.3%	7.1%

Table 3: S&P/TOPIX 150, GICS Sector Weights

	31-Dec-1989	31-Dec-1994	31-Dec-1999	31-Dec-2004	31-Aug-2009
Consumer Discretionary	13.9%	18.8%	23.8%	21.7%	19.3%
Consumer Staples	2.9%	3.8%	4.8%	5.7%	5.6%
Energy	1.0%	0.7%	0.3%	0.7%	1.0%
Financials	25.4%	26.8%	13.1%	17.6%	18.1%
Health Care	2.1%	2.5%	3.6%	5.7%	4.6%
Industrials	18.0%	18.2%	11.0%	16.3%	19.7%
Information Technology	16.7%	10.2%	25.4%	15.1%	13.7%
Materials	8.3%	8.4%	3.8%	7.5%	8.3%
Telecommunication Services	3.8%	3.9%	10.8%	4.7%	4.6%
Utilities	8.1%	6.7%	3.4%	5.0%	5.1%

Differences between developed and emerging markets are illustrated in Table 4. Brazil, India, and especially Russia have very large Energy sectors. All four BRIC nations have relatively small Consumer Discretionary and Consumer Staples sectors compared to developed nations, but have relatively large Telecommunication Services sectors. Only the U.S. has a substantial Health Care sector, an economic activity in many countries that is government funded and controlled. A more detailed view of these contrasts can be seen in Table 5, which is based on the S&P Global 1200. The first row of each section of the table shows the number of companies, the second row shows the regional index's sector market cap as percentage of that Global 1200 sector, and the third row shows the percentage of market value within the relevant regional index. For example, 72.1% of the total S&P Global 1200 Information Technology sector comes from the S&P 500, while the sector is 18.5% of the S&P 500. The second to last row at the bottom of the table shows the proportions of market value for the component indices of the S&P Global 1200 sector weights for the index are shown on the far right.

Table 4: S&P Global BMI, GICS Sector Weights as of August 31, 2009

Sector	US	Canada	UK	Australia	Brazil	Russia	India	China
Consumer Discretionary	9.9%	4.2%	7.3%	3.7%	5.2%	0.6%	5.4%	5.6%
Consumer Staples	10.3%	2.9%	13.5%	9.1%	7.8%	1.8%	5.8%	4.1%
Energy	10.9%	25.2%	19.2%	8.5%	22.5%	62.8%	18.6%	15.6%
Financials	17.4%	33.1%	22.8%	40.8%	22.9%	8.1%	21.2%	31.7%
Health Care	13.5%	0.5%	8.6%	3.6%	0.4%	0.6%	3.7%	1.2%
Industrials	10.4%	6.0%	7.0%	6.9%	4.5%	0.4%	11.0%	11.0%
Information Technology	18.6%	4.4%	1.6%	0.7%	1.2%	9.4%	13.0%	9.1%
Materials	3.9%	19.4%	9.9%	24.5%	25.8%	12.3%	8.5%	6.8%
Telecommunication Services	1.0%	2.7%	6.3%	0.8%	3.3%	4.1%	6.6%	12.8%
Utilities	4.1%	1.6%	3.7%	1.4%	6.4%	3.8%	6.1%	2.0%

Table 5: S&P Global 1200, Components and GICS Sector Weights (As of August 31, 2009)

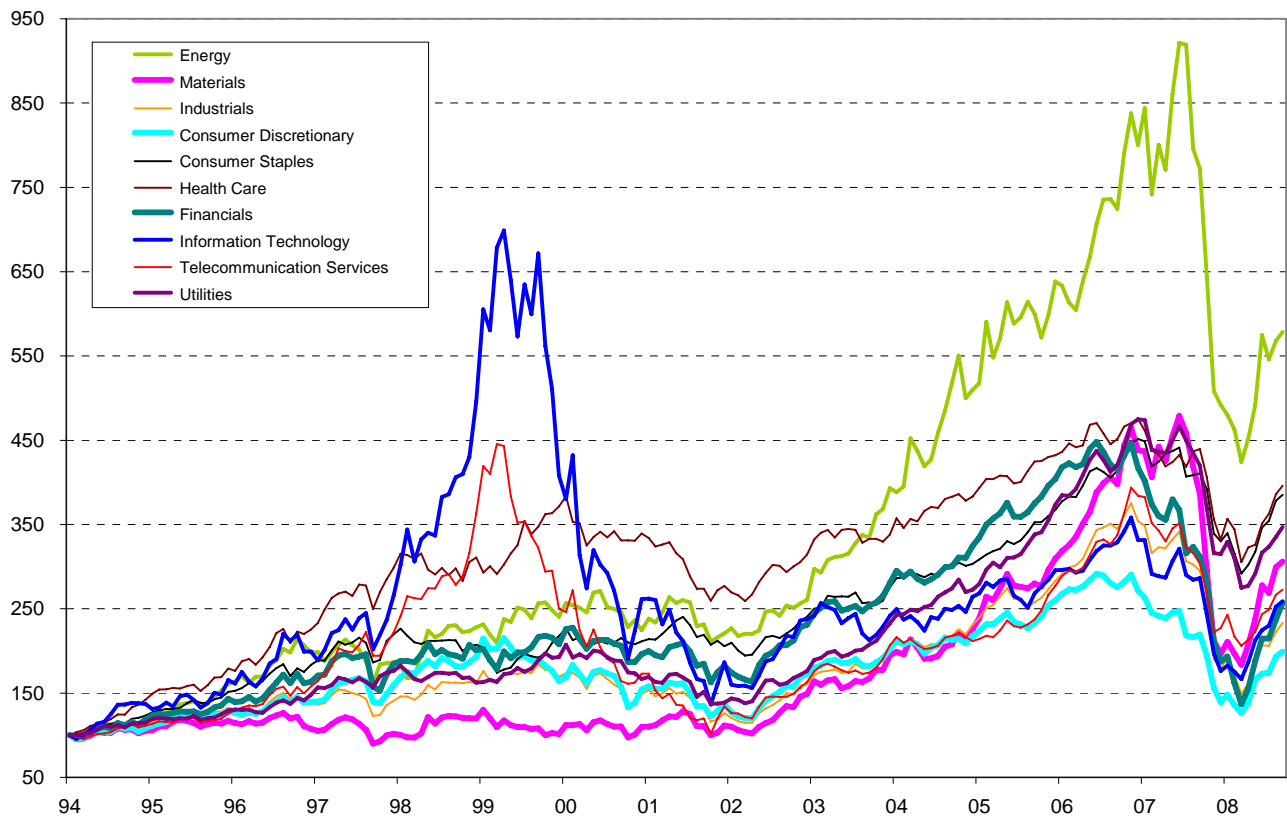
Sector	Data	S&P 500	S&P Asia 50	S&P Europe 350	S&P LAC 40	S&P/ASX 50	S&P/TOPIX 150	S&P/TSX 60	S&P Global 1200
Consumer Discretionary	Number of Companies	80	4	61	3	2	20	8	178
	Weight in the Global 1200	48.4%	2.4%	26.9%	0.7%	0.4%	19.3%	1.9%	100.0%
	Weight in the Regional Index	9.1%	5.2%	7.4%	3.4%	0.9%	19.3%	3.8%	8.6%
Consumer Staples	Number of Companies	41	2	30	6	4	12	5	100
	Weight in the Global 1200	52.2%	1.0%	35.9%	1.8%	3.4%	4.7%	1.1%	100.0%
	Weight in the Regional Index	11.5%	2.6%	11.5%	9.9%	9.4%	5.6%	2.5%	10.1%
Energy	Number of Companies	40	3	12	3	5	3	14	80
	Weight in the Global 1200	49.4%	2.3%	31.5%	2.8%	2.4%	0.8%	10.8%	100.0%
	Weight in the Regional Index	11.7%	6.4%	10.8%	16.4%	7.2%	1.0%	27.0%	10.9%
Financials	Number of Companies	79	15	73	5	16	19	10	217
	Weight in the Global 1200	32.7%	6.0%	37.7%	1.9%	7.5%	7.2%	7.0%	100.0%
	Weight in the Regional Index	15.4%	33.0%	25.8%	21.7%	44.5%	18.2%	34.6%	21.6%
Health Care	Number of Companies	53		20		2	6	2	83
	Weight in the Global 1200	62.4%	0.0%	32.5%	0.0%	1.1%	4.0%	0.1%	100.0%
	Weight in the Regional Index	13.5%	0.0%	10.2%	0.0%	3.0%	4.6%	0.3%	10.0%
Industrials	Number of Companies	58	6	64	5	7	41	4	185
	Weight in the Global 1200	46.9%	2.3%	29.1%	0.7%	1.7%	17.2%	2.2%	100.0%
	Weight in the Regional Index	10.0%	5.7%	9.0%	3.8%	4.5%	19.7%	5.0%	9.8%
Information Technology	Number of Companies	76	8	14	1	1	20	1	121
	Weight in the Global 1200	72.1%	8.3%	7.7%	0.2%	0.2%	10.0%	1.6%	100.0%
	Weight in the Regional Index	18.5%	24.9%	2.9%	1.0%	0.5%	13.7%	4.3%	11.8%
Materials	Number of Companies	29	5	36	8	10	20	11	119
	Weight in the Global 1200	21.8%	4.5%	35.7%	5.6%	12.3%	10.0%	10.1%	100.0%
	Weight in the Regional Index	3.4%	8.1%	8.1%	21.8%	24.3%	8.3%	16.6%	7.2%
Telecommunication Services	Number of Companies	9	4	16	3	2	3	3	40
	Weight in the Global 1200	28.1%	7.9%	43.4%	5.7%	3.3%	7.5%	4.2%	100.0%
	Weight in the Regional Index	3.2%	10.5%	7.2%	16.0%	4.8%	4.6%	5.1%	5.3%
Utilities	Number of Companies	35	3	24	6	1	6	2	77
	Weight in the Global 1200	36.8%	3.0%	47.4%	2.3%	0.6%	9.2%	0.8%	100.0%
	Weight in the Regional Index	3.8%	3.7%	7.1%	6.0%	0.7%	5.1%	0.9%	4.8%
	Number of Companies	500	50	350	40	50	150	60	1200
	Weight in the Global 1200	46.0%	3.9%	31.6%	1.9%	3.6%	8.6%	4.4%	100.0%
	Weight in the Regional Index	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Sectors can indeed explain some recent investment shifts. Certainly someone looking for a global technology play would look to the U.S.; however, the S&P Asia 50 and the S&P/TOPIX 150 are also over-weighted in Information Technology. Less obvious, the U.S. is underweight in Financials compared to the rest of the world, while Australia, Asia and Canada's Financials' weight approaches and exceeds twice the global weight. That

fact alone may explain why the U.S. equity market, the center of the global financial crisis, fared better in 2008 when compared to some of its global counterparts.

The relative differences in global sectors can be seen in the chart below. The chart plots the 10 S&P Global BMI Sectors, rebased to 1994. While the chart itself is busy, one can see the relative out- and underperformance of global sectors through time. The chart details sector performance though the IT boom and its consequent bust in 1998-2001, the extraordinary outperformance of the Energy sector from about 2004-2008, the 2004-2008 surge of the Materials sector after about 10 years of relatively flat results, the relative underperformance of the Consumer Discretionary sector through time, and the recent rise and fall of the global Financials sector. While stocks as a whole move together through business cycles, the distinctions among sectors do matter and should be important considerations in all investment decisions.

Chart 1: S&P Global BMI Sector Indices By Year



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