

The New S&P 500 Sector – Communications Services

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S&P Dow Jones Indices will implement new GICS sector classifications after the market closes on September 28, 2018 (MSCI Inc. will follow on November 30) that will change the sector classification for some individual technology, media, telecom, and internet-related companies. This sector reshuffling will affect approximately 10% of the S&P 500 Index constituents and involves several well-known and widely held companies including Alphabet (GOOGL), Disney (DIS), Facebook (FB), and Netflix (NFLX).



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Importantly, although some stocks are shifting sectors, their weights in the overall S&P 500 index are not changing. The same principal applies to client portfolios, as some individual stocks will show up in a different sector than in previous periods, but the individual position size in the portfolio will be unchanged. While we don't believe the sector reshuffle itself will prove to be a substantial market mover, the size of the reclassification and the importance of companies involved suggests that a proliferation of several new ETFs and coverage by Wall Street on the topic will build as we approach the end of September.

GICS and “Communication Services” – Why the Change?

GICS stands for Global Industry Classification Standard and is the global system by which S&P Dow Jones Indices and MSCI Inc. categorize public companies into smaller groupings. The GICS system consists of 11 primary sectors – Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, Telecommunication Services, and Utilities. S&P and MSCI regularly update the GICS system, with the most recent major change occurring in August 2016 with the creation of the Real Estate sector. GICS sectors are used in the construction of most global indices and serve as the basis for most sector and industry-constructed exchange-traded funds (ETFs).

After the market closes on September 28, the *Telecommunications Services* sector will be renamed *Communication Services* and expanded to include companies that focus on the facilitation of communication and distribution of media and content. Some of the largest and most popular companies in the U.S. equity market, including Facebook (FB), Alphabet (GOOGL), Netflix (NFLX), and Disney (DIS), will become constituents of the new sector. Other sector adjustments include moving e-commerce companies EBay, Etsy, and Alibaba from *Technology* to *Consumer Discretionary* (where Amazon has long been classified).

The table below maps specific companies in the S&P 500 from their current GICS sector to the new *Communications Services* sector.

We believe the new *Communication Services* sector will more accurately reflect how communications, media, and entertainment groups have evolved over time. As a result of the changes, the *Communication Services* sector market capitalization will increase from 2% to 10% of the S&P 500 Index and have greater exposure to growth factors than the old Telecom sector, prove less defensive, and trade at a higher valuation.

The *Technology* sector weight will decline as a percentage of the S&P 500 by nearly 5 percentage points from approximately 26% to 21%, and the *Consumer Discretionary* sector weight will be reduced by more than 2.5% to an approximate weight of 10%.

New S&P 500 Communications Services Sector

Current Sector	Ticker	Market Cap Weight In S&P 500	New Classification Sector
Telecom Services	CTL	0.2%	COMMUNICATION SERVICES
	T	1.0%	
Consumer Discretionary	VZ	0.9%	
	OMC	0.1%	
	IPG	0.0%	
	CBS	0.1%	
	DISCA	0.1%	
	CMCSA	0.7%	
	CHTR	0.2%	
	DISH	0.0%	
	NWSA	0.0%	
	NFLX	0.6%	
	DIS	0.7%	
	FOXA	0.3%	
	VIAB	0.0%	
TRIP	0.0%		
Information Technology	ATVI	0.3%	
	EA	0.1%	
	TTWO	0.1%	
	GOOGL	2.9%	
	FB	1.6%	
	TWTR	0.1%	

Data as of 9.14.2018

Source: S&P Dow Jones Indices, Goldman Sachs Global Investment Research

S&P 500	Current Sector Weights %	New Sector Weights %	Change +/-
Technology	26.2	21.1	-5.1
Healthcare	14.6	14.6	
Financials	13.7	13.7	
Consumer Discretionary	12.9	10.3	-2.6
Industrials	9.8	9.8	
Consumer Staples	6.9	6.9	
Energy	5.8	5.8	
Utilities	2.9	2.9	
Materials	2.5	2.5	
Real Estate	2.7	2.7	
Communications Services	2	10	8.0
	100.0	100.0	

Data as of 9.14.2018

Source: S&P Dow Jones Indices

Short-Term Impacts on Equity Markets, ETFs

The sector realignment will garner significant attention due to the size of the reclassification and the recent relative importance of the sectors involved, but we do not anticipate significant impacts on overall broad market performance. While ETFs that passively track S&P 500 sectors will have the most activity due to reshuffling, the changes have been well telegraphed, and companies affected by the reclassification are trading in both their current sector ETFs as well as their new (soon to be offered in) sector ETFs. S&P has taken the unusual step of dual-trading because of the confusion that followed the move of Real Estate companies and Real Estate Investment Trusts (REITs) from *Financial Services* into its own sector classification in September 2016.

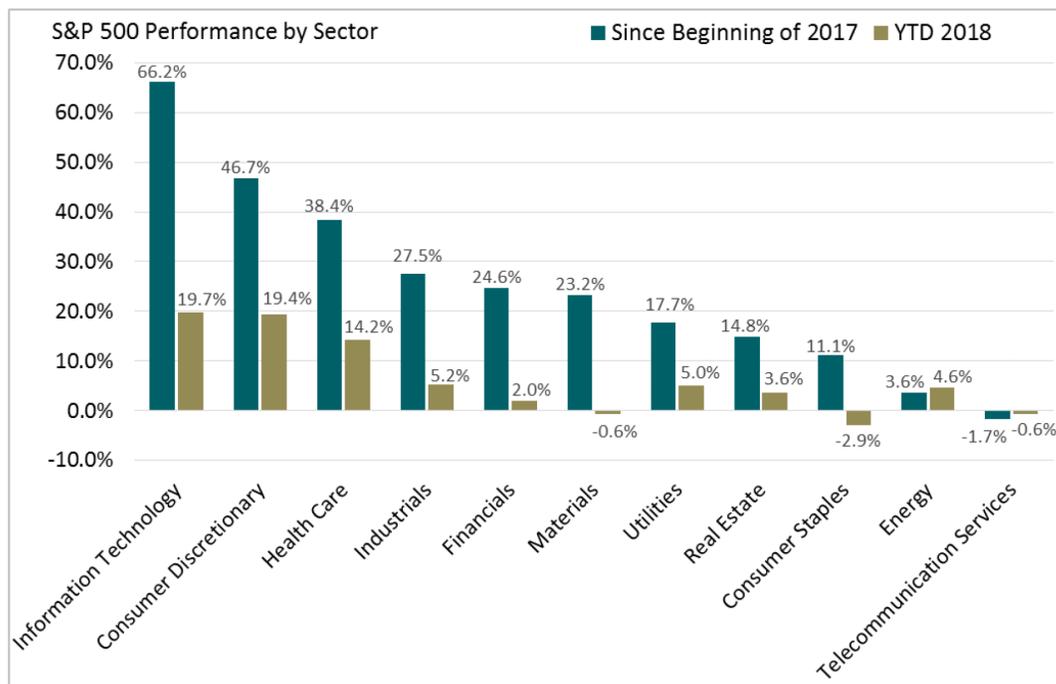
Vanguard, Blackrock, and State Street (the 3 ETF giants) have been preparing for the change with overhauls to their sector-specific index funds and have been tracking custom benchmarks leading up to the restructuring to help mitigate market impact. State Street will begin rebalancing after the close on September 21, one week before the reclassification goes into effect, and Vanguard has been gradually rebalancing throughout the quarter.

Importantly, sector ETFs like XLK (Technology Select SPDR Fund) and XLY (Consumer Discretionary Select SPDR Fund) are dwarfed by the enormous full index ETFs like SPY (S&P 500 SPDR

Trust) and QQQ (Invesco NASDAQ 100 ETF) – these index ETFs will be unaffected by the sector reclassification.

The *Technology* and *Consumer Discretionary* sectors have led U.S. equity markets since the beginning of 2017 and are the more widely held sector ETFs.

Market leadership, however, has been concentrated in a handful of companies within these two sectors – a portion of which will now shift into the new *Communications Services* sector classification.



Data as of 9.18.2018
Source: Bloomberg

Will My Portfolio Be Affected?

The forthcoming sector reclassification does not alter the individual holdings or the respective weights of these holdings in client portfolios. Additionally, our fundamental outlook for the businesses are not altered by the nominal sector shifts. We seek to own advantaged businesses with strong fundamentals, durable brands, and exposure to expanding, robust, and addressable markets across all components of the S&P 500. For clients, this change is cosmetic; whereby as of the end of the 3rd quarter, select individual stocks will show up as held in a different sector than previously reported.

The top 10 companies by market capitalization that make up each sector post-reclassification are highlighted below. Collectively, these 30 names account for approximately 30% of the S&P 500 total market capitalization. Several of these companies are also Top 10 holdings in client portfolios.

CONSUMER DISCRETIONARY

Amazon
Home Depot
McDonald's
Nike
Lowe's
Bookings Holdings
Starbucks
TJX
Target
General Motors

INFORMATION TECHNOLOGY

Apple
Microsoft
Visa
Cisco
Intel
Mastercard
NVIDIA
Oracle
Adobe
IBM

COMMUNICATION SERVICES

Alphabet
Facebook
AT&T
Verizon
Comcast
Disney
Netflix
21st Century Fox
Activision Blizzard
Charter Comm

Source: Factset

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