Perspectives

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New Communication Services Sector

GICS RECLASSIFICATION OF TELECOMMUNICATION SERVICES REFLECTS A CHANGING BUSINESS LANDSCAPE

Effective after market close on September 21, 2018, S&P Dow Jones Indices and MSCI Inc. will implement a significant revision to the Global Industry Classification Standards (GICS) structure.

The telecommunication services sector is scheduled to undergo an expansion that will include several companies currently housed within the consumer discretionary and information technology sectors. The newly broadened telecommunication services sector will be renamed communication services and will contain two broad industry groups: telecommunication services and media & entertainment. The media industry group, previously categorized under consumer discretionary, will move to the communication services sector and be renamed media & entertainment. The reclassified media & entertainment industry group will contain a variety of industries engaged in modern media and entertainment channels. The purpose of this GICS structure change is to broadly include companies within one sector that facilitate communication and offer related content and information through various platforms. The change is an acknowledgement of consolidation occurring and overlapping services provided today within the media, telecommunications, and internet industries.

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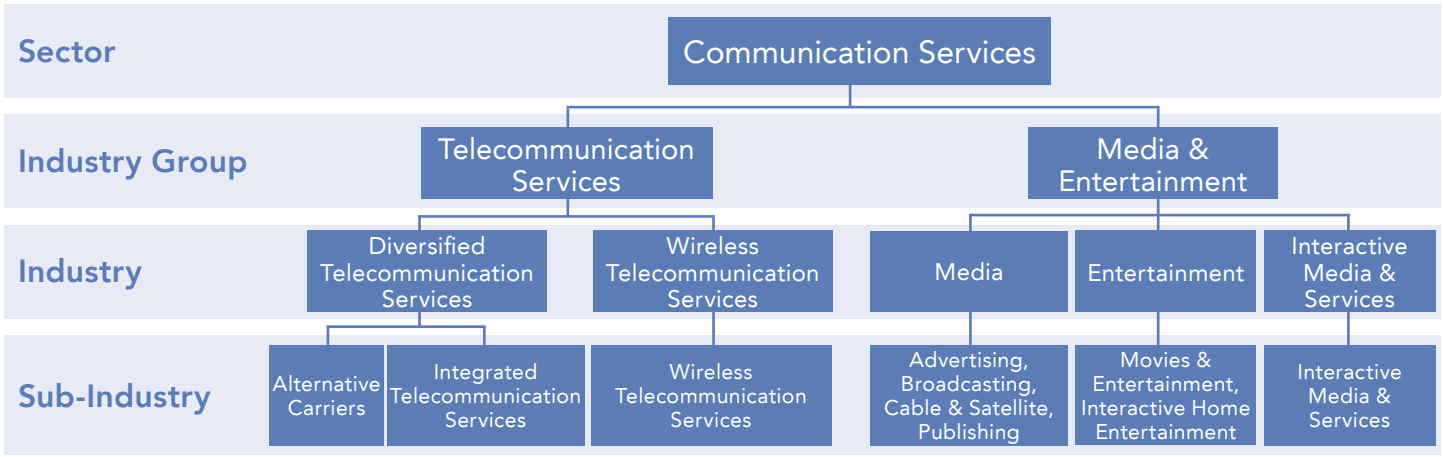
Exhibit 1: New Communication Sector Structure



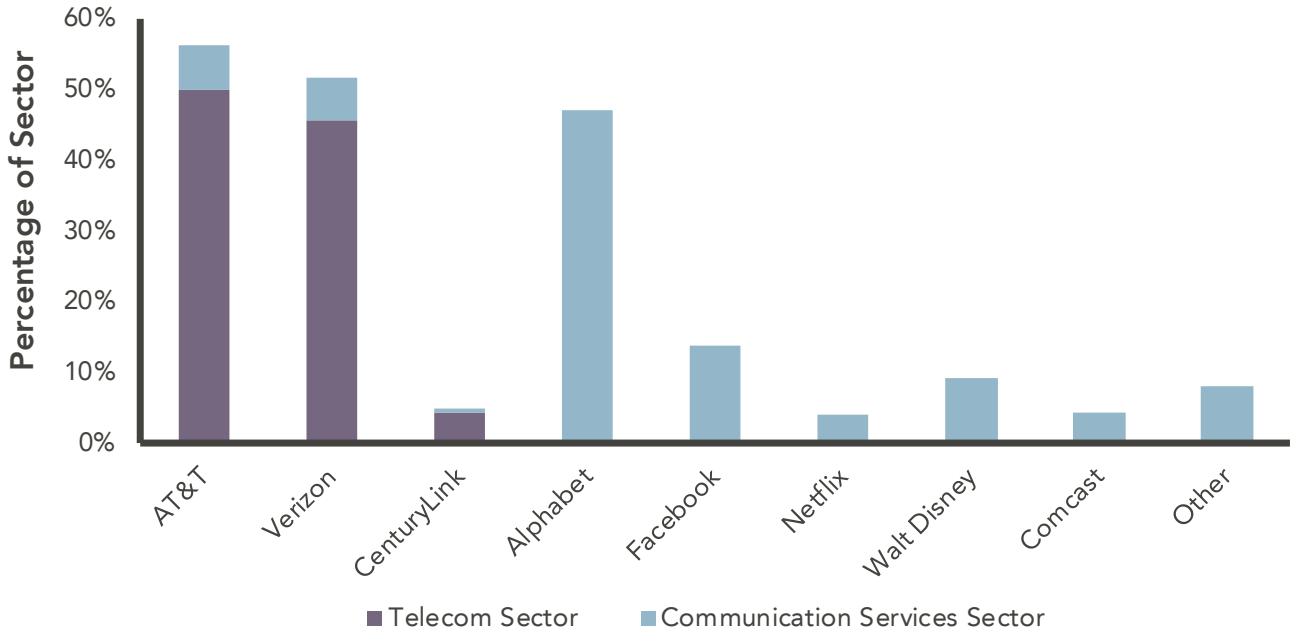
Source: S&P Dow Jones Indices; effective September 21, 2018

IMPACT OF THIS CHANGE

With nearly 12% of the S&P 500 index's market cap projected to be reclassified, the September 21st revision will be the largest change to the GICS structure since its creation in 1999. It is important to note that the weight of affected securities within S&P and MSCI indices will not change, instead the securities along with their respective market cap weightings will simply be reclassified.

In total, fourteen consumer discretionary and six information technology companies from the S&P 500 will be reclassified to the newly renamed communication services sector. AT&T, Verizon, and CenturyLink comprise the current telecommunication services sector within the S&P 500 and occupy close to a 2% weighting. These companies will remain within communication services under the telecommunication services industry group. With the communication services reclassification, approximately 24% of the consumer discretionary weighting and 31% of the information technology weighting in the S&P 500 will join the three current telecommunication services companies in the newly established sector. The addition of consumer discretionary and information technology companies to communication services will increase the communication services sectors weighting to 13.7% of the S&P 500's total market cap based on July 31, 2018 market cap weights. The composition of the communication services sector relative to the former telecommunication services sector will significantly change because of this reclassification. The new sector will contain approximately 63% information technology, 24% consumer discretionary, and 13% telecommunication stocks based on July 31st month-end market cap weights.

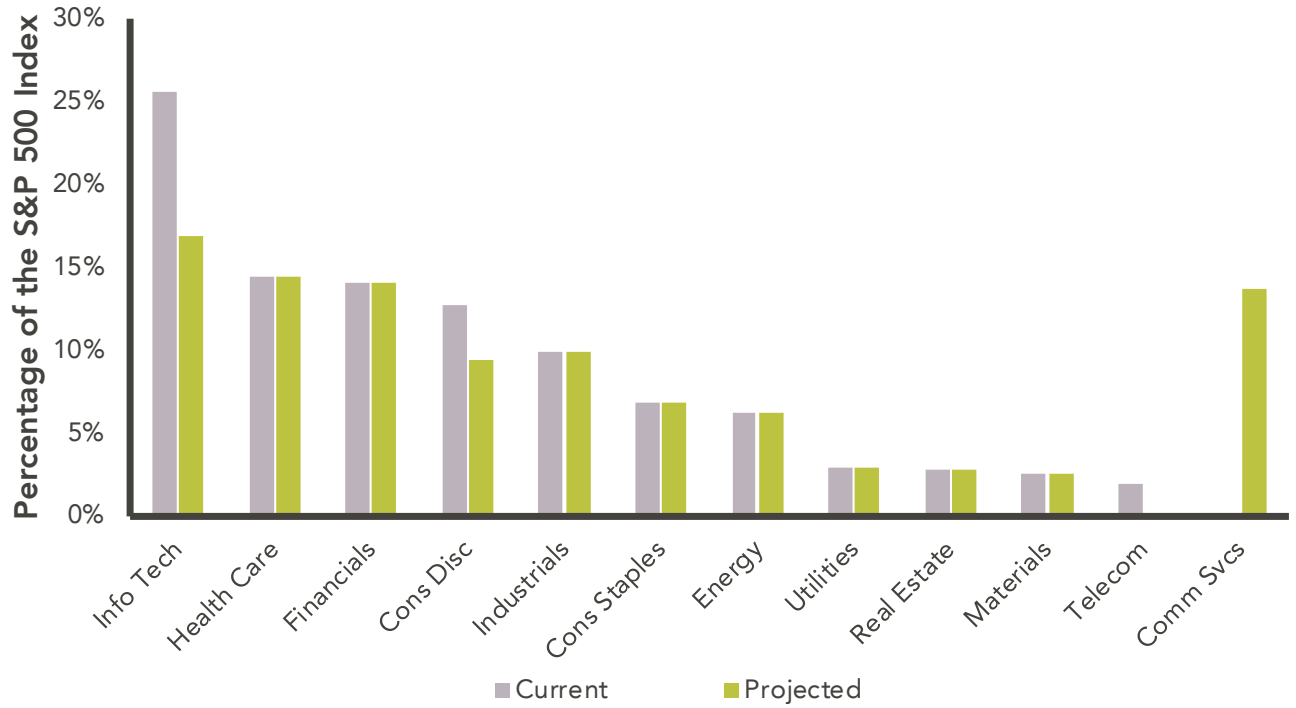
Exhibit 2: Broadening of the Telecommunication Sector



Source: Bloomberg as of July 31, 2018

As seen in Exhibit 2, the new communication services sector will contain most of the popular acronym FAANG stocks (Facebook, Apple, Amazon, Netflix, and Google/Alphabet) which have been a key driver for equity returns in 2018. Specifically, three of the five FAANG stocks (Facebook, Netflix, and Google/Alphabet) will move to communication services. Amazon will remain in the consumer discretionary sector and Apple will continue being classified within the information technology sector.

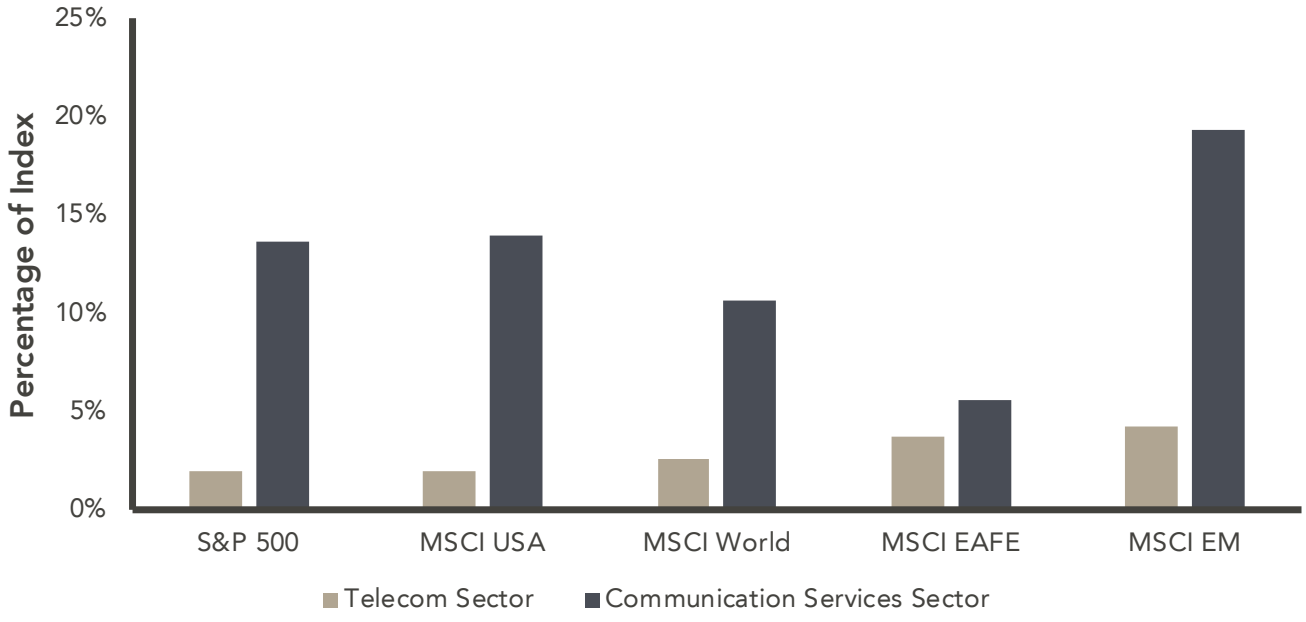
Exhibit 3: Current & Projected S&P 500 Sector Weights



Source: Bloomberg as of July 31, 2018

Exhibit 3 shows current and projected sector weightings of the S&P 500 based on July month-end market cap weights. Based on this analysis, the new communication services sector is set to become the fourth largest GICS sector in the S&P 500 at a projected weight of 13.7%. Information technology is moving from a 25.6% weighting in the S&P 500 to 16.9% yet remains the largest weighted sector in the index. Consumer discretionary is moving from 12.7% to a 9.4% weighting.

Exhibit 4: Projected Impact to Major Asset Classes



Source: Bloomberg as of July 31, 2018

While the specific list of securities affected for all S&P and MSCI indices has not been released, we can estimate what projected weightings will be based on the known industry group changes set to occur. As can be seen, the upcoming GICS reclassification will have a significant impact across all major asset classes. The anticipated change within emerging markets is of note with the sector moving from a 4.3% weighting to a projected 19.4% weighting. Stocks such as Tencent, Alibaba, and Baidu are the main drivers for the increase in emerging markets' weighting to the new communication services sector.

For passive equity strategies that track a broad market index, the weight of securities within these is not changing; only the sector classification is different. Thus, the total return of a broad market index will be unaffected. The largest potential impact of this change comes from active equity strategies whose portfolio construction parameters may necessitate an increased allocation to the sector or if active strategies find the new sector characteristics of greater appeal than the former telecommunication services sector. Within the S&P 500, the addition of three out of five FAANG stocks along with several additional consumer discretionary and information technology stocks will have a significant change to the characteristics of the sector. The new communication services sector will have a greater growth tilt and offer less of a yield-orientation than telecommunication services has historically provided. As the market adjusts to the new GICS classification system, we will continue to monitor the investment landscape and its potential impact on client portfolios.

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