

# Sector Analysis

Investors who want to look at the “broad picture” often start by examining the condition of the economy and the stock market in general, and then look, in order, at industry sectors, at industries within a sector, and then at companies within an industry.

Value Line began dividing the more than 90 industries we cover into sectors about a year ago, and beginning with this issue, we are ranking those sectors in order of attractiveness, from 1 (Highest) to 10 (Lowest). The sector ranks are based on the Timeliness ranks of the individual stocks within the sectors, and we plan to update this information at least every quarter.

Not surprisingly, the Healthcare sector is currently ranked at the top. The 155 companies that make up this group have generally been growing much faster than the economy. The underlying trend in effect is that consumers are spending a greater portion of their income on medical care. This trend will likely remain in place well into the future as the population ages and the cost of developing new drugs is passed along to patients. Typically, a new drug often takes ten years to develop, with associated costs of up to \$800 million. Another broad trend benefiting the group is improved technological capabilities. Certain procedures once only performed in the hospital can now be done in the home, for example. Valuation of the Healthcare sector has been supported for most of the past decade by a decline

VALUE LINE SECTOR RANKINGS	
BY TIMELINESS	
Sector	Rank
Healthcare	1
Technology	2
Consumer Staples	3
Consumer Cyclical	4
Telecommunications	5
Industrial	6
Financial	7
Basic Materials	8
Energy	9
Utilities	10

in fears that far-reaching legislation might rein in profits. Recently, however, worries over price controls have prompted a few drug makers to institute discounts for seniors.

The second most highly ranked sector is Technology. Innovations brought to market by the 173 companies in this group have contributed to major changes in the way people do their jobs and live their lives over the years. Nowadays, it’s difficult to imagine a daily routine that doesn’t include use of a computer, the Internet, or fax machine. Possibilities for growth are greater here than for most sectors, since businesses are likely to continue employing a combination of hardware and software to improve productivity. Growth in applications for the consumer segment is still rising rapidly as well, as many households are just beginning to discover the convenience afforded by shopping online. Investors often tend to favor the

Technology sector owing to the possibility that further breakthroughs will eventually arise here.

Number three in terms of Timeliness is the Consumer Staples sector. This group normally does well during slow economic times, such as experienced of late, since demand for food, beverages, and household goods remains firm regardless of business conditions.

Down at the bottom is the Utility sector. New electricity, natural gas, and water hookups generally expand with the annual rate of population growth, which has been about 1% in the United States over the past decade. That type of low growth prevents the group from attaining much of a Timeliness score. Utilities are traditionally perceived to be more sensitive to interest-rate changes.

## Market Cap

An examination of market capitalization is useful for investors wishing to apportion a greater weighting to sectors of the economy that are expected to have a better chance to outperform.

SECTORS		
BY STOCKS AND MARKET CAP		
Sector	% Total Stocks	% Total Mkt Cap
Financial	11.6	16.1
Consumer Cyclical	20.1	15.7
Healthcare	9.1	13.9
Technology	10.2	13.8
Industrial	21.6	10.4
Telecommunications	4.8	8.7
Energy	4.9	8.1
Consumer Staples	6.0	7.8
Basic Materials	6.5	3.3
Utilities	5.2	2.2

As can be seen from the table above, sector market caps are far from evenly distributed.

The Industrial sector is made up of the largest number of stocks, but it makes

**SECTOR INVESTING**

To implement a “sector approach” to investing, do the following:

1. Select the three or four sectors that are most attractive from the above table.
2. Select the most attractive industries within the sectors. Our sector groups are shown on the facing page. Industry Timeliness ranks may be found in the tables on the front cover, or on page 24 of the *Summary & Index*.
3. Select one or two of the most attractive stocks within those industries. The table called “Timely Stocks in Timely Industries” on page 25 of the *Summary & Index* is a good starting place.

up much less of percentage of the total market cap. Likewise, the Telecommunications Sector has the fewest companies, but is not the least in terms of stock market capitalization. The market cap of a company is determined by multiplying the number of common shares outstanding by the stock price, and a sector's market cap is the sum of those calculations. So it's clear that the share base of a sector's component companies as well as the respective stock's valuations affects the results presented here.

The following table lists each sector in order of its relative size. We divided the percentage market capitalization for each sector by the percentage of companies in each sector that makes up our 1700 stock universe. In other words, the Telecommunications sector accounts for nearly 9% of the total market cap,

SECTORS	
BY RELATIVE WEIGHT	
Sector	Relative Weighting
Telecommunications	1.8
Energy	1.7
Healthcare	1.5
Financial	1.4
Technology	1.4
Consumer Staples	1.3
Consumer Cyclical	0.8
Basic Materials	0.5
Industrial	0.5
Utilities	0.4

even though it makes up less than 5% of the stocks covered, for a relative measure of 1.8. Similarly, the relative size of the Financial sector is 1.4, based on its 16% market cap while constituting about 11.5% of our stock universe. A

sector's relative weighting is mainly determined by the size of its component companies. Some of the world's largest telephone and integrated oil companies make up the Telecommunications and Energy sectors, respectively. After that, valuation probably plays more of a role in determining market cap, as fewer big companies are found in the remaining sectors. Again, the market favors sectors such as Healthcare and Technology, presumably because of their favorable long-term business trends. We note that the sectors that are not accorded a premium relative valuation are generally cyclical in nature, usually with mature growth prospects. We will discuss these topics in greater detail in future reports.

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SECTOR GROUPS			
BY INDUSTRY			
<p><b>BASIC MATERIALS</b></p> <ul style="list-style-type: none"> <li>Chemical (Basic)</li> <li>Chemical (Diversified)</li> <li>Chemical (Specialty)</li> <li>Metal &amp; Mining (Div.)</li> <li>Paper &amp; Forest Products</li> <li>Precious Metals</li> <li>Steel (General)</li> <li>Steel (Integrated)</li> </ul>	<p><b>CONSUMER-CYCLICAL</b></p> <ul style="list-style-type: none"> <li>Advertising</li> <li>Apparel</li> <li>Auto Parts</li> <li>Auto &amp; Truck</li> <li>Cable TV</li> <li>Educational Services</li> <li>Entertainment</li> <li>Entertainment Technology</li> <li>Foreign Electron/Entertn</li> <li>Furniture/Home Furnishings</li> <li>Home Appliance</li> <li>Homebuilding</li> <li>Hotel/Gaming</li> <li>Manuf Housing/Rec Veh</li> <li>Newspaper</li> <li>Publishing</li> <li>Recreation</li> <li>Restaurant</li> <li>Retail Building Supply</li> <li>Retail (Special Lines)</li> <li>Retail Store</li> <li>Shoe</li> </ul>	<p><b>CONSUMER STAPLES</b></p> <ul style="list-style-type: none"> <li>Beverage (Alcoholic)</li> <li>Beverage (Soft Drink)</li> <li>Food Processing</li> <li>Food Wholesalers</li> <li>Grocery</li> <li>Household Products</li> <li>Tobacco</li> <li>Toiletries/Cosmetics</li> </ul>	<p><b>ENERGY</b></p> <ul style="list-style-type: none"> <li>Canadian Energy</li> <li>Coal</li> <li>Natural Gas (Diversified)</li> <li>Oilfield Services/Equip</li> <li>Petroleum (Integrated)</li> <li>Petroleum (Producing)</li> </ul>
<p><b>FINANCE</b></p> <ul style="list-style-type: none"> <li>Bank</li> <li>Bank (Canadian)</li> <li>Bank (Midwest)</li> <li>Financial Svcs (Div.)</li> <li>Insurance (Life)</li> <li>Insurance (Prop/Casualty)</li> <li>Investment Co.</li> <li>Investment Co. (Foreign)</li> <li>R.E.I.T.</li> <li>Securities Brokerage</li> <li>Thrift</li> </ul>	<p><b>TELECOMMUNICATIONS</b></p> <ul style="list-style-type: none"> <li>Foreign Telecom</li> <li>Telecom Equipment</li> <li>Telecom Services</li> <li>Wireless Networking</li> </ul>	<p><b>HEALTHCARE</b></p> <ul style="list-style-type: none"> <li>Biotechnology</li> <li>Drug</li> <li>Health Info Services</li> <li>Medical Services</li> <li>Medical Supplies</li> <li>Pharmacy Services</li> </ul>	<p><b>INDUSTRIAL</b></p> <ul style="list-style-type: none"> <li>Aerospace/Defense</li> <li>Air Transport</li> <li>Building Materials</li> <li>Cement &amp; Aggregates</li> <li>Diversified Co.</li> <li>Electrical Equipment</li> <li>Electronics</li> <li>Environmental</li> <li>Human Resources</li> <li>Industrial Services</li> <li>Information Services</li> <li>Machinery</li> <li>Maritime</li> <li>Metal Fabricating</li> <li>Office Equip &amp; Supplies</li> <li>Packaging &amp; Container</li> <li>Power</li> <li>Precision Instrument</li> <li>Railroad</li> <li>Textile</li> <li>Tire &amp; Rubber</li> <li>Trucking/Trans Leasing</li> </ul>
<p><b>TECHNOLOGY</b></p> <ul style="list-style-type: none"> <li>Computer &amp; Peripherals</li> <li>Computer Software &amp; Svcs</li> <li>E-Commerce</li> <li>Internet</li> <li>Semiconductor</li> <li>Semiconductor (Cap Equip)</li> </ul>	<p><b>UTILITIES</b></p> <ul style="list-style-type: none"> <li>Electric Utility (Central)</li> <li>Electric Utility (East)</li> <li>Electric Utility (West)</li> <li>Natural Gas (Distrib)</li> <li>Water Utility</li> </ul>		