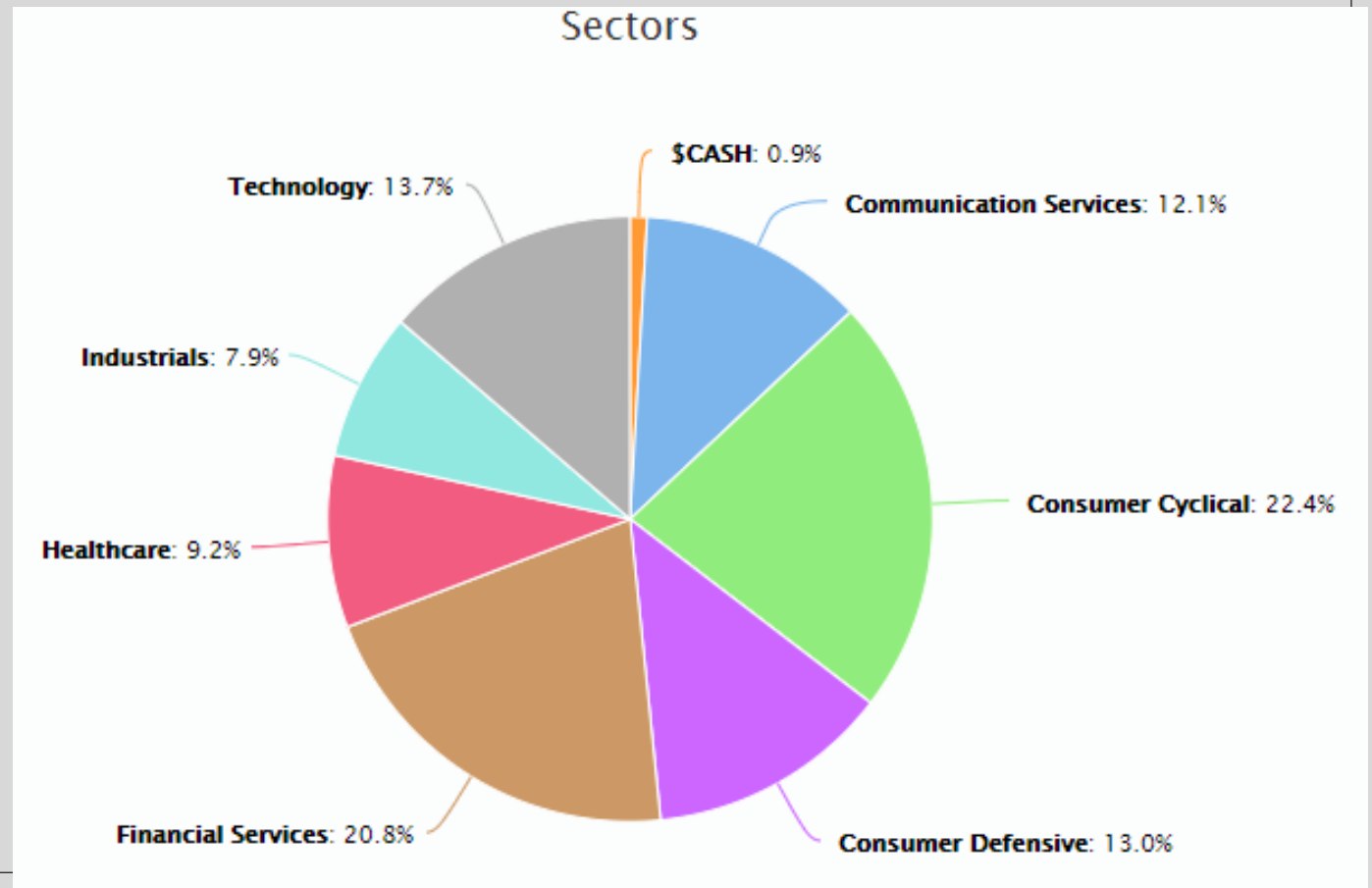# UNDERSTANDING SECTOR DIVERSIFICATION

Jack Finn

Yankee Chapter Model Club

November 14, 2020
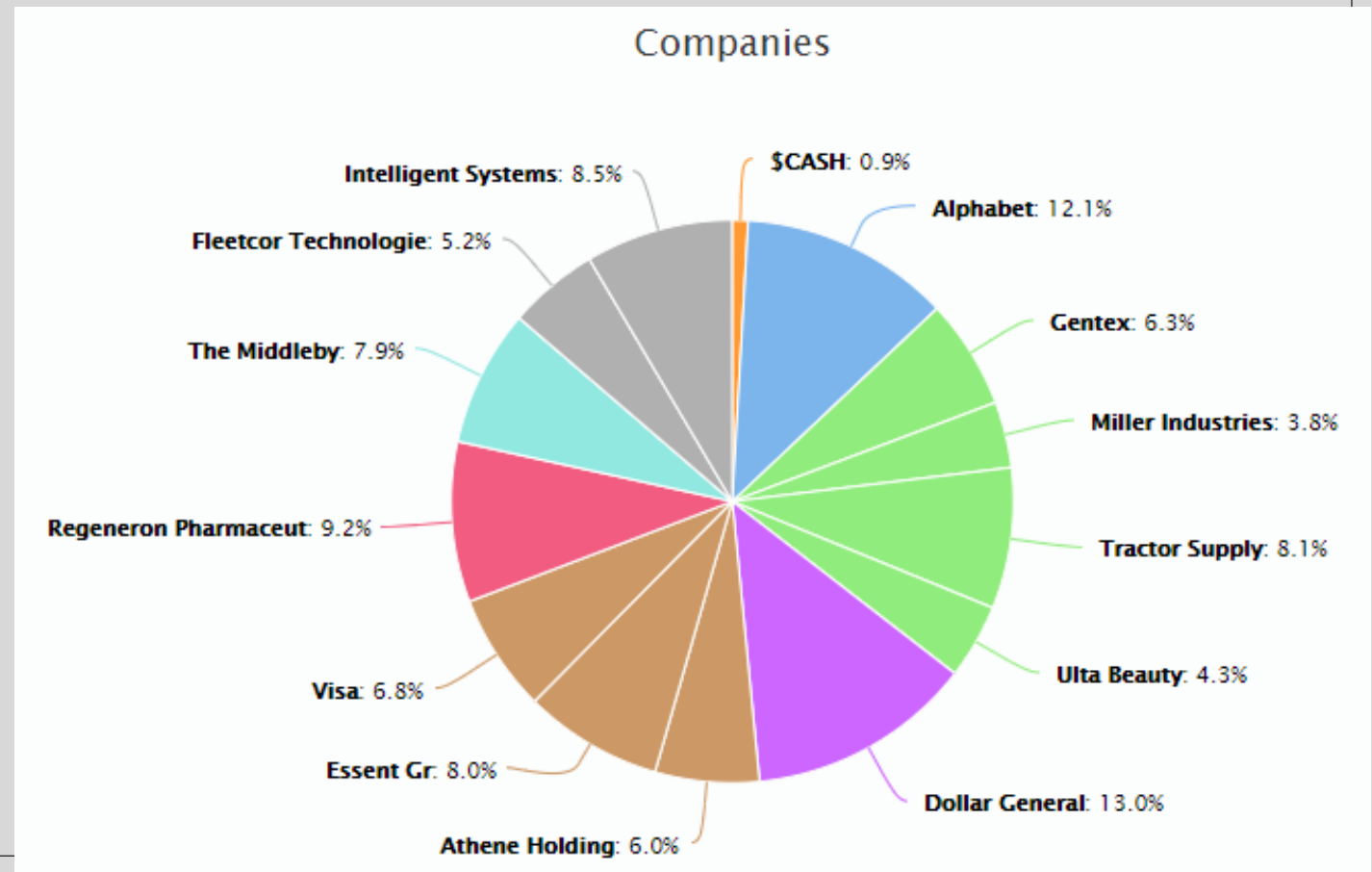
Sector Diversification according to BetterInvesting (Morningstar)

◦ BetterInvesting uses Morningstar's sectors (holdings as of 11/2)

◦ In this system, Dollar General (DG) is put into Consumer Defensive

◦ The portfolio covers 7 of the 11 sectors

Sectors

$CASH: 0.9%
Communication Services: 12.1%
Technology: 13.7%
Industrials: 7.9%
Healthcare: 9.2%
Financial Services: 20.8%
Consumer Defensive: 13.0%
Consumer Cyclical: 22.4%

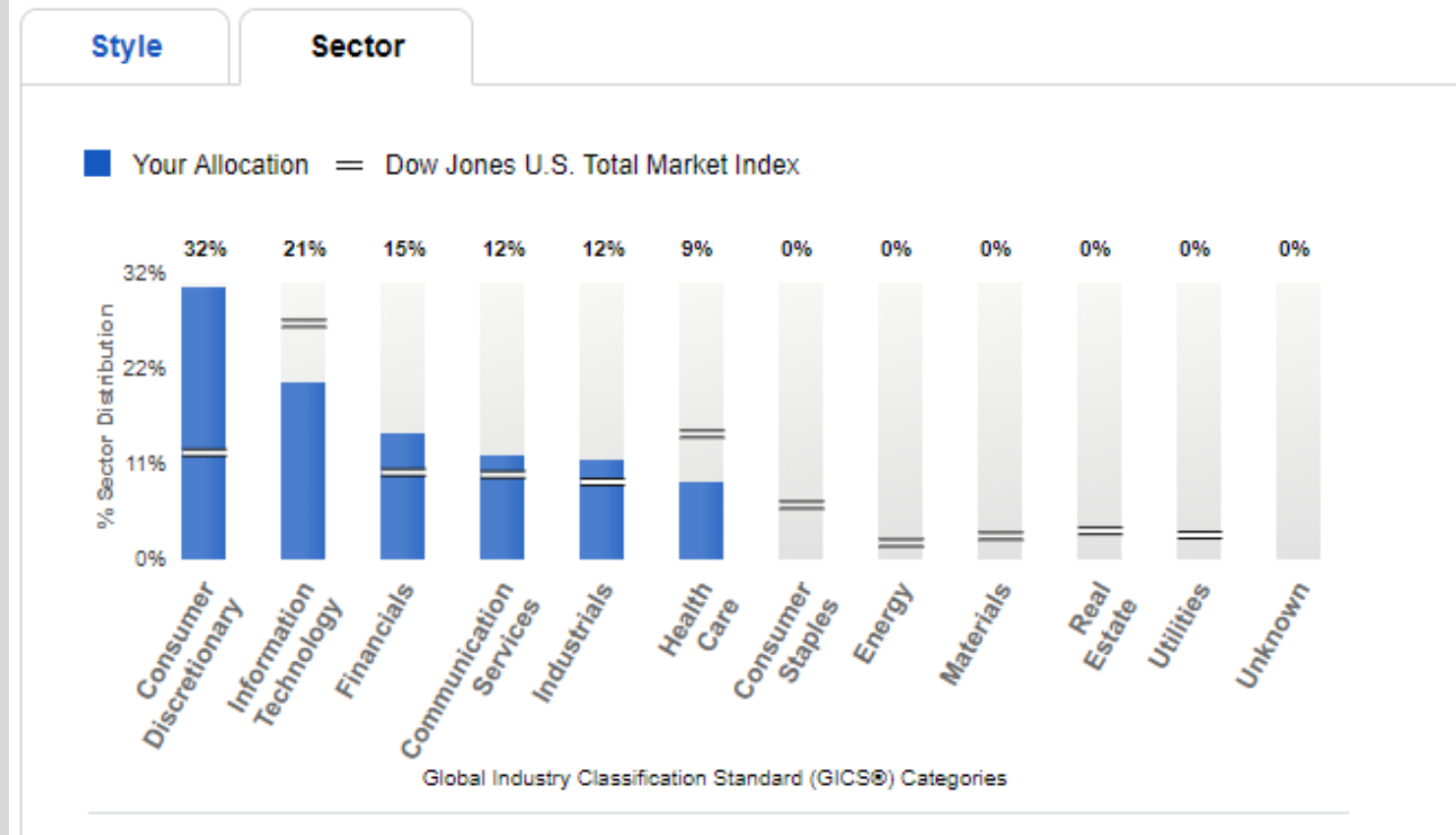# Sector Diversification according to BetterInvesting (Morningstar)

- BetterInvesting uses Morningstar's sectors (holdings as of 11/2)
- In this system, Dollar General (DG) is put into Consumer Defensive

Companies

Intelligent Systems: 8.5%
$CASH: 0.9%
Alphabet: 12.1%
Fleetcor Technologie: 5.2%
Gentex: 6.3%
The Middleby: 7.9%
Miller Industries: 3.8%
Regeneron Pharmaceut: 9.2%
Tractor Supply: 8.1%
Ulta Beauty: 4.3%
Visa: 6.8%
Dollar General: 13.0%
Essent Gr: 8.0%
Athene Holding: 6.0%

Sector Diversification according to Fidelity (GICS)

- Fidelity uses Global Industry Classification Standard (GICS) (S&P and MSCI Inc.)

- Club seems to be overweight Consumer Discretionary and underweight Cons. Staples!

Yankee Model Club Holdings as of 11/2

Stock Analysis 100% ($160,166)

| Style | **Sector** |

■ Your Allocation   ═ Dow Jones U.S. Total Market Index

Consumer Discretionary: 32%
Information Technology: 21%
Financials: 15%
Communication Services: 12%
Industrials: 12%
Health Care: 9%
Consumer Staples: 0%
Energy: 0%
Materials: 0%
Real Estate: 0%
Utilities: 0%
Unknown: 0%

% Sector Distribution

Global Industry Classification Standard (GICS®) Categories

Sector Classifications in North America

- Standard Industrial Classification (SIC)
  - Developed in 1937 by the U.S. government
  - Still in use by The Securities & Exchange Commission (SEC)
  - SIC Code List
    - Bank of America: a national bank: SIC Code 6021
    - State banks: SIC code 6022

- North American Industry Classification System (NAICS)
  - Developed by a committee representing Mexico, Canada and the US in 1997
  - Revised every 5 years (latest revision: 2017)
  - Example NAIC codes:
    - 52 – Finance and Insurance
    - 522110 – Banks, Commercial
    - 522130 – Credit Unions

Industry Classification Benchmark (ICB)

○ Comprehensive classification framework for global equity markets

○ Launched by FTSE (Financial Times Stock Exchange Group) and Dow Jones in 2005

○ In 2011, FTSE became the sole owner of ICB (latest revision: 2019)

○ Structure:

  ○ 11 Industries
  ○ 20 Supersectors
  ○ 45 Sectors
  ○ 173 Subsectors

○ FTSE and Russell Indexes based on ICB

Global Industry Classification Standard (GICS)

◦ Structure consists of four levels ([2018 revision spreadsheet](#)):

  ◦ 11 economic Sectors

  ◦ 24 Industry Groups

  ◦ 68 Industries

  ◦ 157 Sub-industries

◦ Each stock has a code to identify it at all four levels

◦ Developed jointly by Morgan Stanley Capital International ([MSCI](#)) and Standard & Poor's

Global Equity Classification Standard (GECS)

- Structure consists of four levels ([2010 article](), [2011 factsheet]()):
  - 3 Super-sectors
  - 11 Sectors
  - 69 Industry Groups
  - 148 Industries
- Each stock has a code to identify it at all four of these levels
- Developed by Morningstar, Inc. in 2010. Revised in 2018

Morningstar Sector Structure

Cyclical

- Basic Materials
- Consumer Cyclical
- Financial Services
- Real Estate

Defensive

- Consumer Defensive
- Healthcare
- Utilities

Sensitive

- Communication Services
- Energy
- Industrials
- Technology

Cyclical Super Sector
Sectors that roll up into the Cyclical Super Sector are highly sensitive to business cycle peaks and troughs.

Defensive Super Sector
Sectors that roll up into the Defensive Super Sector are anticyclical stocks.

Sensitive Super Sector
Sectors that roll up into the Sensitive Super Sector have moderate correlations with business cycles.

Comparison of Sector Classification Systems

ICB (FTSE, Russell)	GICS (Fidelity)	Morningstar (BI)	Morningstar Super Sector
Basic Materials	Materials	Basic Materials	Cyclical
Consumer Discretionary	Consumer Discretionary	Consumer Cyclical	Cyclical
Financials	Financials	Financial Svcs.	Cyclical
Real Estate	Real Estate	Real Estate	Cyclical
Cons. Staples	Cons. Staples	Cons. Defensive	Defensive
Health Care	Health Care	Healthcare	Defensive
Utilities	Utilities	Utilities	Defensive
Tele-communications	Communication Svcs.	Communication Svcs.	Sensitive
Energy	Energy	Energy	Sensitive
Industrials	Industrials	Industrials	Sensitive
Technology	Info. Technology	Technology	Sensitive

Should DG be in Consumer Staples or Consumer Discretionary?

◦ In the pandemic, it has acted like a defensive sector stock (Morningstar)

◦ Tractor Supply (TSCO) has too! (Consumer Discretionary)

◦ Companies are assigned to sectors based upon revenues

◦ What to do about problem companies that cross sector boundaries?
  ◦ Apple
  ◦ Amazon
  ◦ Google
  ◦ General Electric

Sector Definitions Are Only a Guide!

- Some companies are so diverse (conglomerates) they are practically mutual funds
  - For example: GE, Comcast
- Companies make money in new ways
  - For example: Amazon, Apple, Alphabet, Facebook
- Classifications of companies are always inexact, and somewhat subjective
- Companies change!
- Use sectors as a guide, but use your judgement about each company!