



Sector Indexes

Expanding investors' toolkit

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Learn how sector indexes can support investment strategies

Many institutional investors incorporate sector views in their investing strategy. Our research shows that many sectors have exhibited unique characteristics and returns regardless of their geographic location. In addition to their diversification potential, sector-based strategies may enable investors to target market segments that are aligned with their allocation views.

MSCI has developed a wide range of sector and industry indexes, across regions and countries, to support sector allocation decisions and incorporating tactical views into your portfolios.

The Shift From Country to Sectors As Key Return Drivers

MSCI's research¹ finds that global sectors/ industries and fundamental style factors now play a significant role in driving the cross-section of security returns in developed markets. While country factors dominated in the late 1990s, over the last decade industry factors have become as or more important drivers of developed market stock returns.

This finding highlights the increased importance of global sector allocation decisions relative to country allocation decisions to capture the diversification and return potential of global markets.

A deeper understanding of sectors can help investors make more informed decisions to align investments with their market outlook.

Valuable Sector Index Tools for Active and Passive Investors

In addition to using sector indexes as the basis for a passive approach to target sector exposure, sector indexes can also be a constructive source of information for active managers.

For stock pickers, while company specific characteristics like management and strategy are critical elements to define the investment case, sector membership can also help identify structural tailwinds (and headwinds) that could impact that company's performance.

Also, given the importance of diversification across sectors, active managers may need to be mindful of sector allocations at their overall portfolio level.



¹ Source: "Harvesting Sector Beta through Broad Sector Indices", October 2013

How Sector Views and Indexes can be used in Portfolios

There are different ways investors can incorporate sector views:

- » Tactical allocation: dedicate a portion of the portfolio to exploit specific sector opportunities.
- » Portfolio completion: target sectors that may be underrepresented in a current portfolio.
- » Sector rotation: an active investment approach that considers other factors, such as macro-economic views and/or momentum.

Sector rotation is a common strategy employed by institutional investors where they adjust their allocation to certain sectors depending on where we are in the economic cycle. The strategy is built on the belief that the economic cycle can be an important performance driver for sectors.

While business cycles may vary, historically they have exhibited common stages and how investors define those stages is essential. Our research^{2,3} has shown that using leading economic indicator series to define expansions and contractions has demonstrated important performance differentials between cyclical and defensive sectors. Cyclical sector indexes were shown to outperform the market in a growing or expanding economy, while defensive sectors were shown to outperform in a slowdown.

MSCI Sector Index Offering: Multi-Faceted and Extensive

At the core of MSCI's sector index offering lies the Global Industry Classification Standard (GICS®). GICS® is a classification framework that groups companies that engage in similar business activities into sectors based on the products or services they provide. Created in 1999 by MSCI and S&P Dow Jones Indices, it seeks to capture the breadth, depth, and evolution of industry sectors. The hierarchical industry classification system uses revenues as a key factor in determining a firm's principal business activity.

Categorization starts with sectors that can be divided into sub-sectors or industries, which facilitates construction of indexes that range from the most general across sectors and industries to the most specialized sub-industry. GICS® offers investors more granular information on the business models and activities of specific companies. Using the GICS® classification, MSCI has built a vast ecosystem of sector and industry indexes across regions and countries.

2 Source: "Index Performance in Changing Economic Environments", April 2014

3 Source: "Sector Performance Across Business Cycles", November 2009

MSCI Sector and Industry Indexes



› Energy



› Materials



› Industrials



› Consumer Discretionary



› Consumer Staples



› Health Care



› Financials



› Information Technology



› Communication Services



› Utilities



› Real Estate

In addition to the top-tier sector indexes is a vast array of indexes that cover specific industries and sub-industries within each sector. For example, the energy sector is comprised of companies that explore, produce, refine, market, store and transport oil and gas, coal, and other consumable fuels, which in turn will also be classified into industries and sub-industries.

The full GICS® framework encompasses 11 sectors, 24 industry groups, 69 industries and 158 sub-industries. The availability of industry and sub-industry indexes depends on the breadth and composition of country or regional economies.

If a specific sector or industry is not available in a specific market, investors can consider other regions or countries. It also can lead them to look deeper into their domestic market by including small caps.

Consider the United States, for example. The largest developed market country includes all 11 sector indexes and 24 industry group indexes. However, the 69 industry indexes are only available if we consider the full MSCI USA Investable Market Index (IMI) which encompasses large, mid and small cap segments. In contrast, the MSCI Australia IMI covers only 49 of the 69 industries⁴. If there is a specific investment thesis an investor wishes to pursue and the relevant industry is not available in their domestic market, they may consider investing in other regions or countries for this exposure.

Real Assets Indexes

These indexes target five categories of real assets: commodities, agriculture, timber, infrastructure, and real estate. There are nine index families within this range, as illustrated below:

	Commodities	MSCI Commodity Producers Indexes
	Agriculture	MSCI Agriculture & Food Chain Producers Indexes
	Timber	MSCI Timber Select Index
	Infrastructure	MSCI Infrastructure Indexes MSCI Core Infrastructure Indexes
	Real Estate	MSCI US REIT Index MSCI Real Estate Indexes MSCI Core Real Estate MSCI Factor Real Estate

These index families are constructed by aggregating select GICS® sub-industries. Investors include real assets in their portfolios commonly to provide potential diversification and inflation protection.

From an inflation protection perspective, our research⁵ reveals that, while equities in general have been viewed traditionally as an inflation-hedge asset, some real asset proxies, like commodity producers, have historically been even better inflation hedges compared to the full equity universe.



4 Source: MSCI, as of December 31st, 2021

Cyclical/Defensive Indexes

MSCI's Cyclical and Defensive Sectors Indexes are designed to track the performance of the opportunity set of global cyclical and defensive companies across various GICS® sectors.

To classify sectors as cyclical or defensive, we analyzed how each sector performed in expansion and contraction periods within the business cycle.⁶ This led to the following groupings:



Cyclical Sectors

Consumer Discretionary, Financials, Real Estate, Industrials, Information Technology, Materials, Communication Services



Defensive Sectors

Consumer Staples, Energy, Healthcare, Utilities

Investors may use these indexes in different ways depending on their goals and constraints, such as:

- » Understanding how cyclical or defensive their portfolio is by comparing returns and weights.
- » Incorporating a tactical allocation to a cyclical or defensive index fund for a particular region or country.

Considering the Value-Add Potential of Sector Indexes

In summary, viewing the global equity markets through a sector lens may reveal unique performance and diversification opportunities. MSCI's comprehensive and consistent sector index offerings allow for meaningful global views and regional comparisons.

MSCI has remained a market leader by expanding and enhancing our index offering to reflect the evolving and complex needs of the global investment community – with ground-breaking new products, innovative research, high quality data and dedicated client support.

5 "Hedging Inflation with Equities", July 2008

6 "Sector Performance Across Business Cycles", November 2009





About MSCI Inc.

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

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