How the New GICS Framework Could Affect Your Portfolio

Description

For the first time since 1999, the Global Industry Classification Standards (GICS) will adopt a new sector. The new real estate sector to be comprised of equity real estate investment trusts (REITs) as well as real estate management and development companies and their constituent sub-industries. Real estate will be elevated from an “industry group” within the financial sector to a standalone sector.

The new GICS structure will consist of 11 sectors, 24 industry groups, 68 industries, and 157 sub-industries. GICS is a joint classification system of MSCI and S&P which provides an organization framework for performance analysis to product development. It’s used by institutional investors, advisors, individual investors, and ETFs to distinguish between sectors when making investment decisions.

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Why is this important?

Not only is this the first time since its inception that a new sector has been added, it also highlights real estate’s significance as a distinct asset class. No longer will REITs be niche or alternative investments, but rather components of a standalone asset class. They should receive increased visibility as institutional investors, financial advisors, and individual investors who had zero percent weight in the space adjust their holdings.

There are mixed opinions on how quickly REITs will be adopted into funds, ETFs, and algorithmic trading strategies. Some investment professionals have indicated that this will probably be implemented in the next six to 12 months, considering most financial software is wired to perform analysis on the existing 10 sectors. These analytical tools will have to be reprogrammed with the new framework.

Other have expressed the opinion that this transition could be fairly quick with quantitative and algorithmic trading software being updated fairly quickly as long as there is an obvious split between it and the financial sector.

What REITs could be involved?

Three of Canada's prominent REITs are **RioCan Real Estate Investment Trust** (TSX:REI.UN) **Boardwalk Real Estate Investment Trust** (TSX:BEI.UN), and **H&R Real Estate Investment Trust** (TSX:HR.UN). All have diverse portfolios of real estate that stretch across Canada and into the U.S.

Boardwalk and RioCan has seen their share prices decline by about 10% over the last three months as negative sentiment in the real estate market due to low commodity prices and dismal economics numbers have pushed investors into more risk-adverse investments. H&R's share price has declined the least and is outpacing the S&P TSX REIT index over the last month. This could be directly attributed to an improvement in some of its U.S. holdings.

The low interest rate environment in Canada should make Canadian REITs more appealing to foreign investors. Their low correlation with returns on other equities and fixed-income investment provides additional benefits for investors looking to diversify their portfolios.

Conclusion

To the extent that this increased adoption of REITs persists, and as investors who've been significantly underweight in real estate look to achieve a market neutral position, the new capital flowing into the industry could be substantial. **J.P. Morgan** projected that active equity funds were so underweight toward REITs that the new sector could cause $100 billion to flow into the category.

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CATEGORY

1. Investing

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1. Editor's Choice

TICKERS GLOBAL

1. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)
2. TSX:HR.UN (H&R Real Estate Investment Trust)
3. TSX:REI.UN (RioCan Real Estate Investment Trust)

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