Fact Sheet: The New Morningstar® Sector Structure

Investor Benefits

- Allows for better portfolio construction by helping investors more easily compare and understand the sector exposures of funds and portfolios
- Makes it easier to understand investment choices being made by portfolio managers
- Creates a more useful way to evaluate common stocks

Background

Portfolio diversification is generally thought of in terms of market capitalization and investment style (large growth, small value, etc.), yet sector diversification is equally important. As demonstrated in recent years, pursuing a growth investment style via Internet stocks leads to substantially different portfolios—and results—than pursuing growth via healthcare stocks.

Standard sector systems, however, have several drawbacks. Most classification systems define some sectors by the types of businesses in which companies are engaged, such as technology or healthcare, and others by the expected behavior of stocks, e.g. consumer cyclical. Such methods also imply that cyclicality exists only in certain sectors. Moreover, most systems—which require investors to juggle percentages for 10 or more sectors—make it difficult for individuals to quickly grasp a fund's sector tilt.

Morningstar's New Sectors

Morningstar is introducing a new sector structure that is more unified and consistent than existing approaches, allows for intelligent portfolio diversification, and makes it easier to understand the investment choices being made by portfolio managers.

This new structure divides the economy into three "Super Sectors:" the Information Economy, the Service Economy, and the Manufacturing Economy. Each Super Sector contains four sectors, for a total of 12. Within each sector, industry groups composed of individual industries allow for more in-depth analysis.

While several of the sector names remain the same, most are new and represent a substantial overhaul of the previous categorizations. Perhaps the most significant change is the replacement of the "technology" sector—which included a broad range of companies with different performance trends—with separate sectors for software, hardware, and telecommunications.

The result is a unified system that is applicable to both funds and portfolios. It allows investors to quickly evaluate the similarities and differences of funds and portfolios by comparing exposure to the three Super Sectors, but also permits further examination of holdings at a granular level.

When and Where

Morningstar will begin using its new sector structure in the third quarter of 2002, in products such as Morningstar.com®, Morningstar® Mutual Funds™, and Morningstar® Advisor Workstation™.

What It Means for Investors

The new Morningstar sector structure provides easier comparisons of funds and portfolios. It allows for better portfolio construction by clearly showing if a new fund would complement current holdings or simply overlap the current sector exposure of an investor's portfolio. Finally, it provides better insight into the strategies and decisions of portfolio managers, and serves as a basis for understanding relative fund performance.

The New Morningstar Sector Structure

Information Economy	Service Economy	Manufacturing Economy
Software	Healthcare	Consumer Goods
Hardware	Consumer Services	Industrial Materials
Media	Business Services	Energy
Telecommunications	Financial Services	Utilities

Each company within the Morningstar stock universe, which accounts for approximately 97 percent of the market capitalization of the U.S. stock market, is assigned to a sector by Morningstar's team of stock analysts. Sector classifications are reviewed annually.

Information Economy

Software

Companies engaged in the design and marketing of computer operating systems and applications. Examples include Microsoft, Oracle, and Siebel Systems.

Hardware

Manufacturers of computer equipment, communication equipment, semiconductors, and components. Examples include IBM, Cisco Systems, and Intel.

Media

Companies that own and operate broadcast networks and those that create content or provide it to other media companies. Examples include AOL Time Warner, Walt Disney, and The Washington Post.

Telecommunications

Companies that provide communication services using fixed-line networks or those that provide wireless access and services. Examples include SBC Communications, AT&T, and Alltel.

Service Economy

Healthcare

Includes biotechnology, pharmaceuticals, research services, HMOs, home health, hospitals, medical equipment and supplies, and assisted living companies. Examples include Abbott Laboratories, Merck, and Cardinal Health.

Consumer Services

Includes retail stores, personal services, home builders, home supply, travel and entertainment companies, and educational providers. Examples include Wal-Mart, Home Depot, and Expedia.

Business Services

Includes advertising, printing, publishing, business support, consultants, employment, engineering and construction, security services, waste management, distributors, and transportation companies. Examples include Manpower, R. H. Donnelley, and Southwest Airlines.

Financial Services

Includes banks, finance companies, money management firms, savings and loans, securities brokers, and insurance companies. Examples include Citigroup, Washington Mutual, and Fannie Mae.

Manufacturing Economy

Consumer Goods

Companies that manufacture or provide food, beverages, household and personal products, apparel, shoes, textiles, autos and auto parts, consumer electronics, luxury goods, packaging, and tobacco. Examples include PepsiCo, Ford Motor Co., and Kraft Foods.

Industrial Materials

Includes aerospace and defense firms, and companies that provide or manufacture chemicals, machinery, building materials, and commodities. Examples include Boeing, DuPont, and Alcoa.

Energy

Companies that produce or refine oil and gas, oilfield services and equipment companies, and pipeline operators. Examples include Exxon Mobil, Schlumberger, and BP Amoco.

Utilities

Electric, gas, and water utilities. Examples include Duke Energy, Exelon, and El Paso.