VICTORIA
Capital Management, Inc.

Weekly Market Missive

Don't Make Big Sector Bets

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We are all familiar with the idea that making money in stocks is grounded in the historical returns of equity markets. In the extreme, as John Bogle of Vanguard always said: Buy a diversified index fund like the S&P 500 and don't look at it again for 35 years. History supports Bogle's investment strategy. The key attribute of his advice was and is diversification. Even with the historical returns of that index portfolio, there are legions of investors who believe they can do better than a passively managed portfolio. These investors continue to experiment with other strategies and sometimes they win and sometimes they lose. The question is whether retirement plans should be exposed to the risks inherent in active management – especially if the portfolio has allocations to mutual funds, exchange-traded funds, hedge funds or alternatives.

When individual investors buy a stock, they own a share in a company. Over time, the price of this stock will fluctuate, and the long-term investor will remain invested even during those tough market declines. History tells us that such hard times eventually pass and that a diversified stock portfolio produces reasonable long-term returns.

Once an investor is tempted by short-term returns of an active investment manager, he or she enters a potentially risky situation. One example is making investments in sector funds or those funds that are well-diversified but are concentrated in one sector or area of the stock market. One sector that has always garnered a large number of investors is the biotechnology sector. Historically, this sector has been a major contributor to the growth in an investment portfolio. Unfortunately, the markets have not been kind to biotechnology funds this year. According to a Wall Street Journal article, a biotech fund has lost 30% so far this year while the overall market as measured by the S&P 500 index is up about 25%. This difference in returns is huge and unlikely to recover in any short period of time. Another similar fund that concentrates in the healthcare sector with $18 billion under management, has lost 40% this year!

Losses of this magnitude are scary given the positive returns generated by the overall stock market. The bigger risk is when these funds also suffer major withdrawals, and the fund manager must sell more and more stock to pay leaving shareholders. Some funds even have to liquidate the fund and give the remaining shareholders a fraction of their investment. For those investors, there is not going to be a rebound when that sector returns to a normal growth path. Where does the investor go to try and recapture their savings?

The investment world continues to evolve. Such novel ideas as crypto currencies and NFT (non-fungible tokens) are stoking a new flurry of investor speculation—with no historical benchmark of returns. If you are thinking of "investing" in these entities, please sleep on it.