

HEALTH AND TECHNOLOGY: HIGH-POWERED SECTOR FUNDS

By John Markese

Given the complexities of companies in the health and technology fields, funds focusing on these sectors provide specialized management and diversification for investors interested in commitments in these areas.

As the stock market gives up ground, which it inevitably will do from time to time, investors often think about what they missed in the last run-up and how to position their portfolios for the equally inevitable next run-up. Just as investors might increase their cash positions in anticipation of a market decline or move from more aggressive stock holdings to less volatile stocks, in anticipation of the next great market surge investor's thoughts often turn to the stocks and sectors with the greatest promise.

What might first come to mind? Health and technology—health because of the aging population, gene research, new pharmaceuticals and drugs, and the promise of biotech in general; technology because, whatever technology is, it is synonymous with growth.

Given the complexities of firms in these areas, sector funds in health and technology provide both specialized management and necessary diversification for investors interested in these sectors. It is often suggested, for example, when investing in biotech stocks that investing in one biotech stock is potentially disastrous, while a portfolio of biotech stocks is simply high risk. Few investors have the depth of knowledge or the experience in the health sciences to assemble a portfolio of 10 to 15 individual stocks in biotech, drugs and pharmaceuticals, and medical services and equipment. And the same is true for technology.

While building a mutual fund portfolio made up solely of a few volatile sector funds is far from optimal for just about any individual investor, adding a few sector funds to an already diversified portfolio to boost the portfolio weightings in industries with exceptional long-term growth potential is a reasonable approach for many. The difficulty for investors beyond the decision on the degree of portfolio commitment to any sector is deciphering just what specific sectors are in a health sector fund or a technology sector fund.

Table 1 lists the no-load and low-load sector funds reported in *The Individual Investor's Guide to Low-Load Mutual Funds* and the *Quarterly Low-Load Mutual Fund Update* that are health and technology related.

While the health sector funds run the gamut from biotechnology to medical services delivery, they all arguably fall within the health classification. Where to draw the line on technology sector funds, however, is problematic. Are telecommunication firms providers of technology, enhancers of technology or users of technology? MCI and Worldcom, for instance, are in the telecommunication services industry, which is high tech, of course, but are they technology stocks? Probably not, but close. Two telecommunications sector funds, Fidelity Select Developing Communications and Fidelity Select Telecommunications are included under technology in Table 1 for comparison, but reasonable arguments can be made that they are not truly technology funds. Investors must make the final cut after reviewing their existing portfolio to determine how any sector fund might create overlaps with existing holdings or fail to fill in portfolio sector gaps.

HEALTH

First, a look at the health sector funds. Listed are the top three sectors for

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TABLE 1. HEALTH AND TECHNOLOGY SECTOR FUNDS

Health Sector Funds (Ticker)	Top 3 Sectors (Percentage of Portfolio)	Top 5 Stocks (Percentage of Portfolio)
Fidelity Select Biotechnology (FBIOX)	biotech 43%, drugs 17%, pharmac'l preparations 7%	Genentech 10.4%, Chiron 6.1%, Merck 5.7%, Schering-Plough 5.6%, Amgen 5.5%
T. Rowe Price Health Sciences (PRHSX)	pharmac'ls 25%, biotech 21%, hospital supply & med devices 16%	Collagen 3.7%, IDX Systems 3.7%, Warner-Lambert 2.7%, Natco 2.7%, NBTX 2.7%
INVESCO Strategic Health Sciences (FHLSX)	drugs 57%, medical equip 18%, biotech 5%	Merck 7.2%, Bristol-Myers Squibb 5.6%, Amgen 5.6%, Schering-Plough 5.6%, Abbott 5.6%
Vanguard Specialized Health Care (VGHCX)	drugs & pharmac'ls 51%, international 21%, medical & dental instruments & supplies 8.5%	Warner-Lambert 5.9%, Pfizer 5.9%, Bristol-Myers Squibb 4.8%, Merck 4.8%, Abbott 4.8%
Fidelity Select Health Care (FSPHX)	drugs 42%, medical supplies & appliances 12%, hospitals 4%	American Home Products 7.1%, Merck 5.9%, Bristol-Myers Squibb 5.9%, Abbott 5.9%, Pfizer 5.9%
Fidelity Select Medical Delivery (FSHCX)	hospitals 35%, HMOs & outpatient care 24%, medical servs 6%	United HealthCare 8.2%, HealthSouth 6.9%, Colson 6.9%, HCA 6.9%, HCA 6.9%
Technology Sector Funds (Ticker)		
Fidelity Select Electronics (FSELX)	semiconductors 29%, computers 23%, software & servs 13%	Gateway 2000 6.0%, Hewlett-Packard 4.5%, Microsoft 4.5%, ASM Litho 4.5%, Intel 4.5%
T. Rowe Price Science & Technology (PRSCX)	semiconductor 17%, commun'ns equip 14%, software 13%	Parametric Technology 4.0%, Network Assoc. 3.4%, First Data 3.4%, First Data 3.4%, First Data 3.4%
Fidelity Select Computers (FDCPX)	computers 44%, semiconductors 16%, software & servs 11%	Dell Computer 10.1%, EMC 4.1%, Compaq Computer 4.1%, Microsoft 4.1%, Intel 4.1%
Fidelity Select Technology (FSPTX)	software 16%, semiconductors 10%, microcomputers 5%	Microsoft 9.7%, Selectron 4.1%, Micron Technology 2.7%, Intel 2.7%, Intel 2.7%
Fidelity Select Software & Comput Servs (FSCSX)	software 54%, computer servs 10%, data process'g 6%	Microsoft 11.2%, PeopleSoft 4.0%, Siebel Systems 4.0%, CompuLink 4.0%, CompuLink 4.0%
Northern Technology (NTCHX)	software & servs 36%, commun'ns equip 21%, electrical & electron compon 20%	Cisco Systems 4.7%, Lucent 4.7%, Dell Computer 4.4%, Yahoo 4.4%, Yahoo 4.4%
Robertson Stephens Information Age (RSIFX)	software & servs 34%, semiconductors & compon 14%, commun'ns equip & servs 10%	Legato Systems 4.3%, Ameriquest 4.3%, SAP AG 3.7%, Vitesse Semiconductor 3.7%, Vitesse Semiconductor 3.7%
INVESCO Strategic Technology (FTCHX)	software & servs 25%, computer hardware 13%, data process'g servs 10%	IBM 4.3%, Lexmark Int'l 3.2%, CBT Group 2.8%, Ceridian 2.8%, Ceridian 2.8%
PBHG Technology & Communications (PBTCX)	technology 63%, services 24%, health care 2%	Ascend Comm 4.8%, J.D. Edwards 4.8%, Citrix Systems 4.0%, CompuLink 4.0%, CompuLink 4.0%
Fidelity Select Develop Commun (FSDCX)	telephone equip 14%, telephone servs 12%, wholesale electric appliances 10%	Cellstar 9.7%, Brightpoint 7.1%, Alcatel Alsthom 5.5%, Nokia 5.5%, Nokia 5.5%
Fidelity Select Telecommun (FSTCX)	phone servs 47%, data commun equip 6%, TV & radio commun equip 5%	WorldCom 8.6%, MCI Comm 5.0%, AT&T 5.0%, Global Telesys 5.0%, Global Telesys 5.0%

Source: Quarterly Low-Load Mutual Fund Update for statistics, with returns through Sept. 30, 1998; portfolio information supplied by the funds.

each fund with the percent of the portfolio by value invested in each sector. In terms of the health care spectrum, Fidelity Select Biotechnology, with 43% in biotech, is at one end, and Fidelity Select Medical

Delivery, with 35% of the portfolio invested in the hospital category, is at the other end. These funds are listed in rough order from those committed significantly to biotech, through those that include drugs and

pharmaceuticals, medical devices and, broader still, medical services. But funds report subsections and industries differently, so sector grouping may be something different for each fund.

Name of Portfolio)	No. of Stocks	Portfolio Turnover (%)	Expense Ratio (%)	Maximum Load (%)	Annual Return (as of 9/30/98)			One-Month Returns Last Three Years		Total Risk Index
					One-Year (%)	Three-Year (%)	Five-Year (%)	High-est (%)	Low-est (%)	
2%, Genzyme 5.8%, gh 4.4%	62	162	1.49	3.00% front	-1.0	11.5	10.6	16.7	-15.4	1.56
s 3.2%, Pfizer 2.7%, onal Data 2.4%	77	133	1.35	none	0.5	na	na	12.5	-15.4	na
Squibb 6.4%, Warner-Lambert 6.4%, merican Home Products 5.3%	56	143	1.08	none	24.3	22.4	23.3	11.4	-10.5	1.26
r 5.2%, Pharmacia & Upjohn 5.1%, Abbott Laboratories 3.6%	99	10	0.40	1.00% redemption fee	19.7	27.0	26.5	10.0	-10.5	0.96
9%, Warner-Lambert 7.6%, Squibb 4.9%, Schering-Plough 4.9%	62	59	1.33	3.00% front	29.3	27.1	29.7	11.6	-10.4	1.09
alth Management Assoc. 8.0%, mbia/HCA Healthcare 5.7%, Tenet Healthcare 5.6%	49	109	1.57	3.00% front	-17.0	6.3	14.6	12.0	-22.6	1.61
t-Packard 5.9%, graphy 4.5%, Texas Instruments 3.3%	104	435	1.18	3.00% front	-25.6	11.2	25.4	17.4	-19.9	2.27
, Analog Devices 3.5%, Data 3.3%, Maxim Integrated Products 3.2%	51	125	0.97	none	-15.5	4.4	15.6	14.9	-22.6	1.87
7.7%, Quantum 5.9%, Microsoft 4.1%	71	333	1.40	3.00% front	5.5	17.8	29.7	23.1	-14.0	2.29
2%, Dell Computer 4.0%, HBO & Co. 2.4%	108	556	1.38	3.00% front	-4.2	11.9	20.2	17.5	-17.5	2.04
7.5%, BMC Software 6.8%, puware 3.3%	67	145	1.44	3.00% front	12.0	19.0	20.1	22.1	-18.3	1.96
Technologies 4.5%, America Online 4.4%, o 4.3%	70	74	1.25	none	5.8	na	na	18.0	-20.2	na
ica Online 4.3%, Netword Assoc 3.7%, iconductor 3.2%	46	369	1.82	none	-16.0	na	na	20.8	-24.4	na
%, Int'l Game Technology 3.2%, 2.8%	120	237	1.05	none	-9.3	12.5	16.0	10.9	-17.7	1.52
dwards 4.6%; uware 3.9% Saville Systems 3.6%	64	259	1.30	none	-19.7	21.6	na	17.3	-16.6	2.04
3%, Anicom 6.8%, a 4.3%	55	383	1.61	3.00% front	-4.1	5.5	13.3	14.1	-20.3	1.96
nun 7.5%, Tel-Save Holdings 6.6%, stems Group 3.6%	31	157	1.51	3.00% front	7.1	12.5	13.4	14.2	-22.9	1.61
S&P 500 Index					9.0	22.5	19.9	8.0	-14.4	1.12
S&P MidCap 400 Index					-6.2	14.1	13.6	9.9	18.6	1.32
Russell 2000 Small-Cap Index					19.0	6.8	9.0	11.1	-19.4	1.42

As for individual stocks, Merck is the most prevalent in the top five holdings, but all the major drug/pharmaceuticals makers are there: Warner-Lambert, Bristol-Myers Squibb, Schering-Plough, Pfizer,

Pharmacia & Upjohn, and America Home Products. Fidelity Select Biotechnology and T.Rowe Price Health Sciences tend to hold more biotech drug companies—higher risk, higher return, drug development

stocks.

How diversified are these sector funds? A diversified sector fund is surely an oxymoron, but the underlying question is: how concentrated is the portfolio? Fidelity Select

Biotechnology, for example, holds 62 stocks, but 43% of the portfolio is in biotech and 10.4% is in one stock, Genentech, while the top five stocks make up 32.5% of the portfolio. Contrast this with T.Rowe Price Health Sciences, which has 77 stock holdings, 25% in pharmaceuticals as the top sector holding, Collagen as the top stock at 3.7%, and the top five stocks totaling only 14.7% of the portfolio. Even among sector funds, diversification is an issue that should be addressed. The more concentrated the sectors, top stocks and number of total stocks, the more likely the fund is to have higher risk.

Portfolio turnover ratios give some indication of how aggressive these funds transact. Portfolio turnover is the lower of purchases or sales as a percentage of portfolio value on an annual basis. A 100% turnover, about the average for a stock fund, indicates a complete turnover of the portfolio by value, not necessarily a change in all stock holdings, however. Vanguard Specialized Health Care is barely actively managed, with a 10% turnover, while Fidelity Select Biotechnology at 162% is aggressively managed—two different investment management styles. Beyond brokerage costs, which are small per share at institutional rates, there is still the cost of the bid-ask spread, the difference between the buy price and sell price, a quarter point (0.25%) or less for large liquid stocks but higher for less liquid smaller stocks. Brokerage costs and spreads reduce fund returns. The more turnover the greater the transaction costs, brokerage fees, and spread for a fund.

The expense ratio is a measure of portfolio return drag. Expressed as a percentage of the portfolio value, the expense ratio includes all management fees and fund costs, including, if the fund assesses one, the annual 12b-1 distribution (marketing) charge, but does not include brokerage costs and front-end loads, back-end loads, or redemption charges.

The average expense ratio for aggressive growth funds, how most of these funds would be classified, is 1.3%. Vanguard Specialized Health Care, demonstrating its fund family's philosophy, has a very low 0.40% ratio. The only fund noticeably higher than the average is Fidelity Select Medical at 1.57%, although not high enough to sound an alarm. Returns for mutual funds are reported net of expenses, so the expense ratio in essence has already been subtracted from the performance figures.

For each of these health sector funds, one-year, three-year, and five-year annualized returns are reported and for comparison the returns for the Standard & Poor's 500 index (large stock benchmark) and the Standard & Poor's 400 (mid-sized benchmark) are given. Two risk measures are provided to judge these fund's returns. The first risk measure is simple: What is the best and worst one-month return over the last three years? The second risk measure is a ratio of the return volatility of the fund to the average return volatility of all mutual funds. A 1.00 ratio would be equal to the average total mutual fund risk, and a ratio of 2.00 would be twice as volatile, for example.

With the exception of Vanguard Specialized Health Care, and to a lesser extent, Fidelity Select Health Care, these are volatile sector funds. A drop of 10.0% in a month during a period without a bear market would take the breath away from many investors. But these funds also have the upside, 12% and even 16% in a month. As a group over the last three years, those funds invested in the large drug stocks did the best, hospital/medical delivery probably the worst and biotech somewhere in between, three patterns within one growth sector.

TECHNOLOGY FUNDS

Technology breaks down into three primary subsections based

upon the holdings of these sector funds: semiconductors, software, and computer hardware. The technology sector funds are roughly listed in this order so that funds with related sector allocations are close by for easier comparisons. Looking at the top five holdings column, it is clear that many holdings are Microsoft and the computer makers: Gateway 2000, Dell, Compaq, and IBM. And Internet stocks have a presence with America Online, Yahoo and others. Remember that the two telecommunication sector funds, Fidelity Select Developing Communications and Fidelity Select Telecommunications, don't really fit the category; they are a stretch to call technology but are here for comparisons and information.

As a group, technology sector funds are more spread out by industry and stock holdings than the health sector, getting back to the question of just what is technology. For example, PBHG Technology and Communications has 63% in technology, however they define technology.

About a third of these funds hold more than 100 stocks. INVESCO Strategic Technology holds 120 stocks, far more than required to be diversified, and its top five stock holdings add up to only 16.3% of the portfolio.

Portfolio turnover ratios of some of these sector funds can be shockingly high; 556%, 435%, 383%. These are aggressive funds investing in high growth, high-risk stocks, and the technology area has been in constant evolution, reshaping itself rapidly. And some of these expense ratios—Robertson Stephens Information Age at 1.82%, for example—are on the high side. As a group, technology funds have higher transaction costs and expenses, which are easily forgotten if they perform well.

Some of these funds beat the S&P 500, a tough benchmark to best, recently and over five years. But the risks were equally tough to beat.

The two funds that far outdid the S&P 500 (19.9%) over five years were Fidelity Select Computers (29.7%) and Fidelity Select Electronic (25.4%), but they had total risk ratios of 2.29 and 2.27 respectively, well more than twice the risk ratio of the 1.12 for the S&P 500. And don't overlook the month extremes, a few up over 20.0% in a month and those same ones down over 14.0% in another. That is volatility that few funds ever display.

A SECTOR FUND CHECKLIST

Additions of health and technology funds are sure to alter a portfolio's character with the promise of high returns and the likelihood of occasional nose dives. Before you invest in any sector fund, make sure you get an annual report and prospectus and check off these points:

- What is the investment objective of the fund (how does the fund characterize its sector)?
- What are the top three subsectors

and what percentage do they represent of the portfolio?

- Do these subsector weightings match the investment objective as you understand it?
- What are the major stock holdings?
- Does this fund fill in gaps in your portfolio or is it overlapping?
- How has this fund performed against similar sector funds and against basic market benchmarks?
- How jarring have the performance potholes hit by the fund been and can you stand the ride? ♦

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TABLE 1. HEALTH AND TECHNOLOGY SECTOR FUNDS

Health Sector Funds (Ticker)	Top 3 Sectors (Percentage of Portfolio)	Top 5 Stocks (Percentage of Portfolio)	No. of Stocks	Portfolio Turnover (%)	Expense Ratio (%)	Maximum Load (%)	Annual Return (as of 9/30/98)			One-Month Returns (Last Three Years)			Total Risk Index
							One-Year (%)	Three-Year (%)	Five-Year (%)	Year est (%)	High (%)	Low (%)	
Fidelity Select Biotechnology (FBIOX)	biotech 43%, drugs 17%, pharmaceutical preparations 7%	Genentech 10.4%, Chiron 6.2%, Genzyme 5.8%, Merck 5.7%, Schering-Plough 4.4%	62	162	1.49	3.00% front	-1.0	11.5	10.6	16.7	-15.4	1.56	
T. Rowe Price Health Sciences (PRHSX)	pharmaceuticals 25%, biotech 21%, hospital supply & medical devices 16%	Collagen 3.7%, IDX Systems 3.2%, Pfizer 2.7%, Warner-Lambert 2.7%, National Data 2.4%	77	133	1.35	none	0.5	na	na	12.5	-15.4	na	
INVESCO Strategic Health Sciences (FHLSX)	drugs 57%, medical equipment 18%, biotech 5%	Merck 7.2%, Bristol-Myers Squibb 6.4%, Warner-Lambert 6.4%, Schering-Plough 5.6%, American Home Products 5.3%	56	143	1.08	none	24.3	22.4	23.3	11.4	-10.5	1.26	
Vanguard Specialized Health Care (VGHXC)	drugs & pharmaceuticals 51%, international 21%, medical & dental instruments & supplies 8.5%	Warner-Lambert 5.9%, Pfizer 5.2%, Pharmacia & Upjohn 5.1%, Bristol-Myers Squibb 4.8%, Abbott Laboratories 3.6%	99	10	0.40	1.00% redemption fee	19.7	27.0	26.5	10.0	-10.5	0.96	
Fidelity Select Health Care (FSPHX)	drugs 42%, medical supplies & appliances 12%, hospitals 4%	American Home Products 7.9%, Warner-Lambert 7.6%, Merck 5.9%, Bristol-Myers Squibb 4.9%, Schering-Plough 4.9%	62	59	1.33	3.00% front	29.3	27.1	29.7	11.6	-10.4	1.09	
Fidelity Select Medical Delivery (FSHCX)	hospitals 35%, HMOs & outpatient care 24%, medical services 6%	United Healthcare 8.2%, Health Management Assoc. 8.0%, HEALTHSOUTH 6.9%, Columbia/HCA Healthcare 5.7%, Tenet Healthcare 5.6%	49	109	1.57	3.00% front	-17.0	6.3	14.6	12.0	-22.6	1.61	
Technology Sector Funds (Ticker)													
Fidelity Select Electronics (FSELX)	semiconductors 29%, computers 23%, software & services 13%	Gateway 20.0%, Hewlett-Packard 5.9%, Microsoft 4.5%, ASM Lithography 4.5%, Texas Instruments 3.3%	104	435	1.18	3.00% front	-25.6	11.2	25.4	17.4	-19.9	2.27	
T. Rowe Price Science & Technology (PRSCX)	semiconductor 17%, communications equipment 14%, software 13%	Parametric Technology 4.0%, Analog Devices 3.5%, Network Assoc. 3.4%, First Data 3.3%, Maxim Integrated Products 3.2%	51	125	0.97	none	-15.5	4.4	15.6	14.9	-22.6	1.87	
Fidelity Select Computers (FDCPX)	computers 44%, semiconductors 16%, software & services 11%	Dell Computer 10.1%, EMC 7.7%, Quantum 5.9%, Compaq Computer 4.1%, Microsoft 4.1%	71	333	1.40	3.00% front	5.5	17.8	29.7	23.1	-14.0	2.29	
Fidelity Select Technology (FSTPX)	software 16%, semiconductors 10%, microcomputers 5%	Microsoft 9.7%, Selectron 4.2%, Dell Computer 4.0%, Micron Technology 2.7%, HBO & Co. 2.4%	108	556	1.38	3.00% front	-4.2	11.9	20.2	17.5	-17.5	2.04	
Fidelity Select Software & Computer Servs (FSCSX)	software 54%, computer services 10%, data processing 6%	Microsoft 11.2%, PeopleSoft 7.5%, BMC Software 6.8%, Siebel Systems 4.0%, Compuware 3.3%	67	145	1.44	3.00% front	12.0	19.0	20.1	22.1	-18.3	1.96	
Northern Technology (NTCHX)	software & services 36%, communications equipment 21%, electrical & electronic components 20%	Cisco Systems 4.7%, Lucent Technologies 4.5%, America Online 4.4%, Dell Computer 4.4%, Yahoo 4.3%	70	74	1.25	none	5.8	na	na	18.0	-20.2	na	
Robertson Stephens Information Age (RSIFX)	software & services 34%, semiconductors & communications equipment & services 10%	Legato Systems 4.3%, America Online 4.3%, Network Associates 3.7%, SAP AG 3.7%, Vitesse Semiconductor 3.2%	46	369	1.82	none	-16.0	na	na	20.8	-24.4	na	
INVESCO Strategic Technology (FTCHX)	software & services 25%, computer hardware 13%, data processing services 10%	IBM 4.3%, Lexmark Intl 3.2%, Intl Game Technology 3.2%, CBT Group 2.8%, Ceridian 2.8%	120	237	1.05	none	-9.3	12.5	16.0	10.9	-17.7	1.52	
PBHG Technology & Communications (PBTCX)	technology 63%, services 24%, health care 2%	Ascend Comm 4.8%, J.D. Edwards 4.6%, Citrix Systems 4.0%, Compuware 3.9%, Saville Systems 3.6%	64	259	1.30	none	-19.7	21.6	na	17.3	-16.6	2.04	
Fidelity Select Develop Commun (FSDCX)	telephone equipment 14%, telephone services 12%, wholesale electric appliances 10%	Cellstar 9.7%, Brightpoint 7.3%, Anicom 6.8%, Alcatel Alsthom 5.5%, Nokia 4.3%	55	383	1.61	3.00% front	-4.1	5.5	13.3	14.1	-20.3	1.96	
Fidelity Select Telecommun (FSTCX)	phone services 47%, data communications equipment 6%, TV & radio communications 5%	WorldCom 8.6%, MCI Commun 7.5%, Tel-Save Holdings 6.6%, AT&T 5.0%, Global TeleSystems Group 3.6%	31	157	1.51	3.00% front	7.1	12.5	13.4	14.2	-22.9	1.61	
Source: Quarterly Low-Load Mutual Fund Update for statistics, with returns through Sept. 30, 1998; portfolio information supplied by the funds.													
				S&P 500 Index	9.0	22.5	19.9	8.0	-14.4	1.12			
				S&P MidCap 400 Index	-6.2	14.1	13.6	9.9	18.6	1.32			
				Russell 2000 Small-Cap Index	19.0	6.8	9.0	11.1	-19.4	1.42			