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Volatility kills appetite for narrow, sector-focused mutual funds

SHIRLEY WON
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Once all the rage a decade ago, industry sector mutual funds continue to lose traction, with more slated to be shut down or merged into broader offerings in coming weeks.

CI Investments Inc. yesterday became the latest player to cut back on several of its sector funds. On Aug. 14, it plans to merge its Global Biotechnology Corporate Class into CI Global Health Sciences Corporate Class. CI Global Consumer Products Corporate Class and CI Global Financial Services Corporate Class will be merged into CI Global Value Corporate Class.

"There is a growing recognition on the part of the industry that investors were not all that well served by sector funds, which come with a higher level of volatility," said Dan Richards, president of Strategic Imperatives Corp., a firm that offers advice to financial advisers. "At the end of the day, you are not doing advisers and investors any favours by encouraging them to chase hot sectors."

The fund arm of Manulife Financial Corp. also this week said it plans to terminate its Manulife Global Real Estate Fund. And Invesco Trimark Ltd. recently proposed merging its Trimark Global Technology and Trimark Discovery funds into the Trimark U.S. Companies Fund.

"[CI] started these funds when sector funds were really popular, and there was an interest by advisers and their clients to invest in certain sectors," Peter Anderson, chief executive officer of CI Investments, said in an interview. "Looking at the sales we have, there is a larger interest in broader-based funds." It's also no longer economical to run them because their assets are relatively small, he added, referring to the fact the three CI offerings have a total of just $74-million in assets.

Industry sector mutual funds took off from about 1996 to 2000 during the technology bubble, and when the Canadian fund industry was attracting most of its net sales. The pioneer in this area in Canada was GT Global Canada, which launched funds focusing on everything from telecommunications to health care. (The firm was later acquired by Invesco Trimark in 1998.)

With the proliferation of sector funds, the offerings became even more concentrated so investors could buy so-called Internet-focused funds as opposed to technology funds or a biotechnology play as opposed to health sciences funds, Mr. Richards recalled.

"The problem with sector funds is that they cater to the most counterproductive elements of investor psychology in terms of chasing what has worked well over the last little while, and tapping into greed." Investors have been retrenching because "there is growing awareness on the part of investors and advisers of the level of volatility that you get with these sectors funds," Mr. Richards said, referring to the hot returns of one year turning to losses the next year.

Morningstar Canada analyst Philip Lee agreed that sector funds tend to be launched at the top of their sector cycles only to disappoint investors. "Fund companies were launching these products at or near the peaks of their valuations," he recalled of technology and real estate funds.

If investors bought technology funds at the peak and held them since, "they are still at a fraction of what they were worth," Mr. Lee said.

Independent fund analyst Dave Paterson suggested that a lot of financial advisers are also now focusing on building core portfolios for their investors following last year's global stock market collapse.

"I think that is what spurred a lot of advisers to go back and focus on the basics," said Mr. Paterson, adding that many of them are also feeling the strain of following 300 to 400 funds.

Some advisers are trying to move toward building a business based on putting clients into already designed investment portfolios depending on risk tolerance and investment objectives, he said.

"They like that because it frees up their time. They can focus more on serving their clients, or building up their business. From a business standpoint, it makes a lot more sense to them than to have a fully customized portfolio for every client."

Some analysts also suggest that sector mutual funds are facing greater competition from exchanged-traded funds (ETFs) listed in Canada or the United States. "Is there any point having a financial services fund if there is an ETF out there?" asks independent analyst Peter Loach. "Not really."

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Industry sector mutual funds set to bite the dust

				(As of May 31)			
Name	**Category**	**Assets (millions)**	**Latest MER**	**YTD**	**1YR**	**5YR**	**10YR**
Trimark Discovery	Science and Tech	47.6	2.84	1.4%	-24.6%	-9.5%	-8.0%
Trimark Global Tech	Science and Tech	24.4	2.93	0.6%	-24.9%	-10.3%	-10.5%
Manulife Global Real Estate	Real Estate	6.2	2.70	1.2%	-33.0%		
CI Global Fin Services CI	Fin. Sevices	26.7	2.33	-6.5%	-26.9%	-8.4%	-2.7%
CI Global Consumer Products CI	Miscellaneous	10.1	2.33	-6.8%	-20.2%	-4.1%	3.1%
CI Global Biotechnology CI	Health Care	36.4	2.33	-9.8%	-1.0%	-8.5%	
MSCI World ($ Cdn)				-4.0%	-27.7%	-3.2%	-2.8%
S&P 500 Composite				1.8%	-34.4%	-3.9%	-3.4%
S&P/TSX Composite Index				15.4%	-29.5%	4.3%	4.2%

Source: Globe Investor