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How Paying Attention To Sectors Can Help Manage Portfolio Risk

By Steven Lewis

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In 1992, a very popular presidential strategist once said, "It's the economy, stupid." Admittedly, I fully agreed with Mr. James Carville back then, and it's still true today. Still, allow me to be equally as blunt when I say, "It's the sectors of the economy, stupid." Presidential politics aside, to achieve success in asset wealth management, you must pay close attention to the sectors of the economy in order to stay ahead of the markets. Even more importantly, you need to know how your financial consultant handles market changes. Are they an asset gatherer or an asset manager?

Have you ever glanced at a sector return chart? If you have, what word comes to mind? Inconsistent, perhaps? This report features 11 sectors, such as health care, information technology, financials, etc., and each one is broken down across 88 industries.[1]

Sector returns can vary widely – over the last 10+ years the average difference between the best performing and worst performing sectors has been more than 30% per year.

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019[1]*
Industrials 27.82	Utilities 19.51	Financials 28.51	Consumer Discretionary 42.72	Utilities 28.59	Consumer Discretionary 9.94	Energy 28.01	Technology 34.28	Health Care 6.29	Technology 31.17
Consumer Discretionary 27.46	Consumer Staples 14.00	Consumer Discretionary 23.58	Health Care 41.24	Health Care 25.18	Health Care 6.86	Financials 22.69	Materials 23.94	Utilities 4.03	Real Estate 29.60
Energy 21.78	Health Care 12.42	Health Care 17.53	Industrials 40.44	Technology 17.75	Consumer Staples 6.83	Industrials 19.95	Industrials 23.84	Consumer Discretionary 1.65	Utilites 25.18
Materials 20.55	Consumer Discretionary 5.95	S&P 500 16.00	Financials 35.37	Consumer Staples 15.86	Technology 5.63	Materials 16.66	Consumer Discretionary 22.77	Technology -1.57	Consumer Staples 23.26
Equal Sector 16.11	Equal Sector 3.30	Technology 15.46	S&P 500 32.39	Financials 15.03	S&P 500 1.38	Utilities 16.00	Financials 22.04	Real Estate -2.27	Consumer Discretionary 23.17
S&P 500 15.06	Energy 2.98	Industrials 14.86	Equal Sector 30.81	S&P 500 13.69	Equal Sector -1.37	Technology 14.82	S&P 500 21.83	S&P 500 -4.38	Industrials 22.40
Consumer Staples 13.79	Technology 2.67	Equal Sector 14.78	Consumer Staples 26.27	Equal Sector 13.41	Financials -1.60	Equal Sector 14.31	Health Care 21.70	Equal Sector -6.74	Communication Services 20.76
Financials 11.91	S&P 500 2.11	Materials 14.74	Energy 26.16	Industrials 10.45	Industrials -4.25	S&P 500 11.96	Equal Sector 18.27	Consumer Staples -8.00	S&P 500 20.55
Technology 11.39	Industrials -1.02	Consumer Staples 10.72	Technology 25.97	Consumer Discretionary 9.49	Utilities -4.86	Consumer Discretionary 5.88	Consumer Staples 12.92	Financials -13.09	Equal Sector 20.25
Utilities 5.30	Materials -10.97	Energy 5.21	Materials 25.83	Materials 7.31	Materials -8.58	Consumer Staples 5.00	Utilities 12.02	Industrials -13.10	Financials 19.46
Health Care 3.30	Financials -17.16	Utilities 1.10	Utilities 13.00	Energy -8.60	Energy -21.46	Real Estate 3.19	Real Estate 10.70	Materials -14.78	Materials 16.91
						Health Care -2.83	Energy -1.06	Communication Services** -16.98	Energy 5.94
								Energy -18.15	Heath Care 5.56

*Numbers show percentages. Sector Returns Year 2010-2019 Source: Bloomberg

Inconsistent sector movements can wear on one's portfolio, especially if an asset gatherer controls your financial strategy. Let's take a moment to discuss the differences between asset gatherers and asset managers. Asset gatherers differ from asset managers because they don't manage assets. These individuals maintain a rather passive approach and can ignore sector and industry movements. In *many* cases, asset gatherers are paid a commission on trades and many do not provide investment advice.[2]

In 2009, I attended a symposium at a highly regarded investment advisory firm. During those three days, what surprised me the most was the fact that nothing was discussed regarding investment management. Instead, the conference spent three days sharing ideas and tactics on how to obtain new clients. At that moment, I realized I was in a hive of asset gatherers, not asset managers. It infuriated me, but I learned something over those three days. Investment advisors from very large firms have little to no autonomy. If an advisor disrupts a modeled portfolio, then in many cases, the advisor doesn't get paid. Also, these investment advisors, or asset gatherers, rarely view their clients' holdings.

On the other hand, you have asset managers who are extremely involved in their clients' portfolios. Due to this involvement, sector inconsistencies don't bother an asset manager. They're constantly trying to discover ways around negative trend lines within both the sectors and related industries to find the positive. This is called seeking alpha.[3] Unless specified by the client, an asset manager's goal is to beat the market. How can you identify an asset manager? A telltale characteristic of an asset manager is a high portfolio turnover rate during volatile sessions within the markets. It wouldn't be unusual for an asset manager to average a portfolio turnover percentage that exceeds 75 percent during volatile market conditions.[4] Asset gatherers (who support a buy and hold strategy) might average less than 5 percent in portfolio turnover. It's important for a professional to consistently manage assets, anticipate market changes, and not sit on your assets while hoping for the best.

To help you identify asset managers, consider the following when reviewing your portfolio:

The Six C's of Investing

1. **Cut back on all mutual funds.** Try investing in stocks and exchange-traded funds (ETFs) if you're looking for lower-cost options and sector as well as industry isolation.
2. **Center your investment behavior around the sectors.** There are 11 sectors within the S&P 500, and not all are "winners" every year.
3. **Consistency wins.** Investment management should be competent and intentional when creating a portfolio. An engine has intentional parts, and so should your portfolio.
4. **Consider employing trail stops (a pre-determined selling price) on all stocks and equities.** This set measure allows for a portfolio to carry necessary risk without the floorless downside.[5]
5. **Critique your investment plan often.** The markets are constantly in flux, so remember your portfolio holdings need to be fluid, as well.
6. **Cash.** When the markets go awry, consider using this asset class.

[1-5] For sourcing and more information, please visit https://www.forbes.com/sites/impactpartners/2020/01/22/how-paying-attention-to-sectors-can-help-manage-portfolio-risk/#1b70b67e75db.

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