Health-Care and Biotech Funds Come Back to Life

The sector may face more volatility this year as political candidates take aim at drug prices

Photo: iStockphoto/Getty Images

Investors interested in health-care and biotech funds know all too well that the sector underperformed in the first quarter of 2016 after making a flashy run before that.

Following the awful start to the year, however, the sector is again showing signs of life.

In April, mutual funds and exchange-traded funds focused on health care and biotech rose 3.6%, one of the best-performing sectors tracked by Lipper Inc. That followed drops of 14% in the first quarter and 17% in the 12 months through March, as political scrutiny about drug prices weighed on the sector.

Journal Report

More in Investing in Funds & ETFs

Weighing on the sector is the fact that the U.S. presidential front-runners “have skewered biotechs for overcharging customers and suggested that it's ridiculous for Medicare to be unable to negotiate drug prices," says Randy Warren, chief investment officer of Warren Financial in Exton, Pa. "We expect these political headwinds to continue through the political process."

Don't overdo it

Still, advisers such as Steve Janachowski, president and chief executive of California-based wealth-management firm Brouwer & Janachowski, say the long-term story for the health-care and biotech sectors hasn't changed.

Health care and biotech are "long-term winning industries" and it is a matter of being in the right place at the right time, he says. The Health Care Select Sector SPDR ETF (XLV) dropped about 16% from mid-2015 through early 2016. It recovered most of that loss going into April, but it is still down significantly from its highs, he says. Biotech stocks as measured by SPDR S&P Biotech ETF (XBI), meanwhile, plummeted by almost 50% from mid-2015 through early 2016.

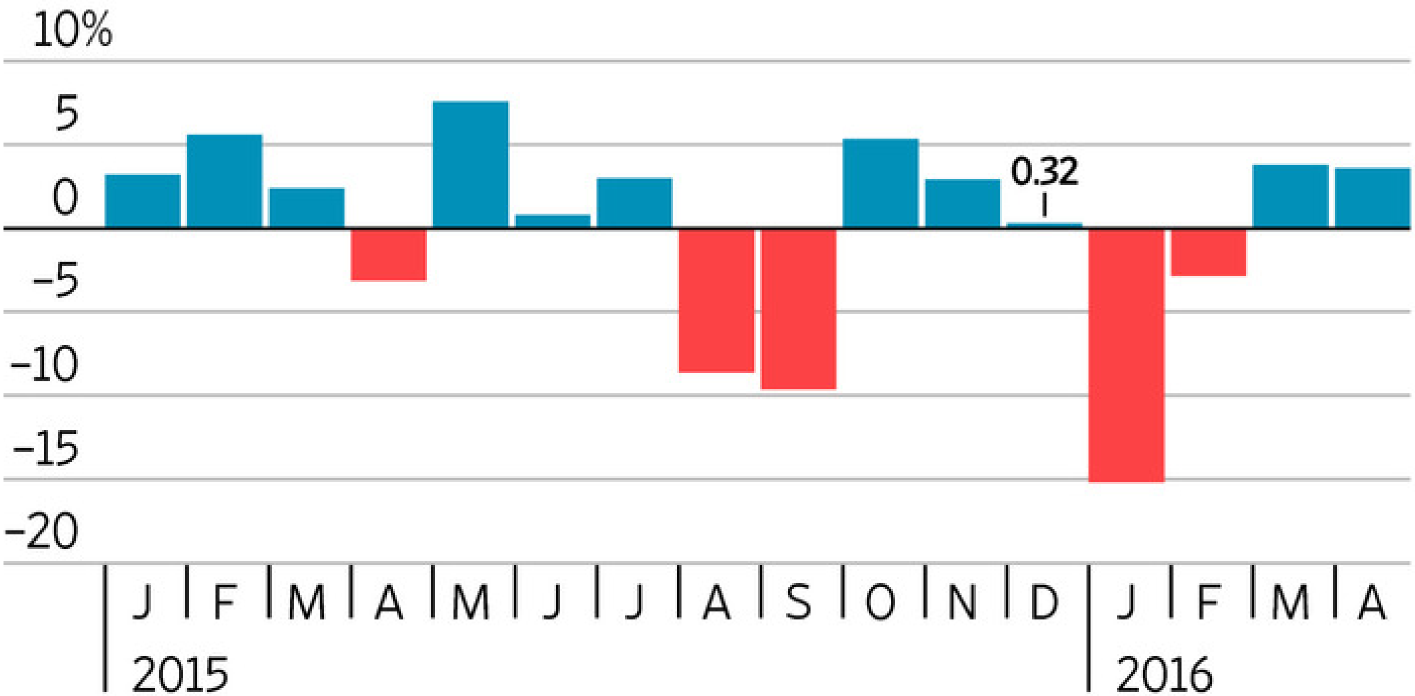
"Health care and biotech continue to be high-probability, long-term, successful growth sectors, [and] smart investors take advantage of these downdrafts by adding to their positions," Mr. Janachowski says. Still, he says, "biotech is extraordinarily volatile and is suitable for a small portion of a well-diversified portfolio."

Be patient

So what is the best move? Mr. Warren advises investors to "take previous overweight positions and go back to even weight." He says it is unlikely health care or biotech ETFs will retake their leadership role in the stock market this year, and it is important to search harder for the real growth winners within those industries. He believes fundamental growth eventually will overshadow political headwinds, but investors will need patience.

Recovered?

Health/biotech funds, total return by month



Source: Lipper THE WALL STREET JOURNAL.

Some experts say the $12.8 billion XLV fund is one worth considering. Todd Rosenbluth, director of mutual-fund and ETF research at S&P Global Market Intelligence, says his firm's equity research team considers nine of the top 10 holdings in the ETF to be undervalued. The fund also has a modest expense ratio at 0.14% and a tight bid/ask spread as of the end of April.

He says his firm believes many large-cap health-care companies are attractively valued. Its consensus forecasts are for 6% earnings growth in 2016, "ahead of the 0.3% for the S&P 500 index and second only to the consumer discretionary sector," he says. "We see investment opportunities in various subindustries, including pharmaceuticals, biotech and medical devices."

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