The New York Times

April 6, 2013

Health Policy Is in Flux, and So Are 2 Health Funds

By TIM GRAY

THE Affordable Care Act, a k a Obamacare, isn't the only upheaval in the health care sector lately. Health care mutual funds have experienced tumult, too.

The two largest such funds, Vanguard Health Care and T. Rowe Price Health Sciences, recently lost their longtime managers. Edward P. Owens, who ran the Vanguard fund for nearly 30 years, retired in December, and Kris H. Jenner quit T. Rowe Price in February. Two analysts who worked with Dr. Jenner, who is a physician, left, too; the three are pursuing a new investment venture.

For investors, the departures offer a chance to assess whether these funds can continue to put up good returns and whether they — or any other health care funds — have a place in an equity portfolio. Health care has long been considered a defensive investment because the sector accounts for about one-sixth of gross domestic product, and demand for it is fairly stable. People fall ill in good economic times and bad, and the United States population, like those throughout the developed world, is aging.

But an investor with a diversified portfolio — anchored, say, by a Standard & Poor's 500 index fund, probably has enough health care investments already, said Campbell R. Harvey, a professor of international business at Duke University.

"It is hard to make the case for an individual investor overweighting the health care sector," Professor Harvey said. If anything, health care growth may slow as the United States tries to bring its higher-than-average spending into line with that of other developed countries. "The health care industry will be under enormous pressure over the next few years to reduce costs," he said.

The Vanguard and T. Rowe Price funds loom large within this niche. Vanguard's fund holds about $25 billion in assets, and T. Rowe Price's fund about $6 billion. Combined, they control more than the sum of the assets in all the other health funds tracked by Morni
15 years through March, they also outperformed many peers: Vanguard's fun
percent, annualized, while the comparable figure for T. Rowe Price's fund, whi
took over in 2000, is 11.8 percent. That compares with 8.3 percent for the ave

and 4.3 percent for the S.& P. 500 over the same period.

The two managers ran their funds differently. Mr. Owens hunted for bargains and hung on to holdings for years; his turnover ratio was typically about 10 percent. Dr. Jenner was more of a highflier. He sleuthed among early-stage innovators, especially biotech companies, and shied away from the big drug makers that are the bedrock of many health portfolios. Thus, the T. Rowe Price fund did not have Johnson & Johnson, Merck or Pfizer among its recent top 10 holdings, though these tend to be stalwarts in competing funds. Vanguard's fund, for example, owned Merck, its top holding, and Pfizer. The two funds' only common top-10 holdings were the UnitedHealth Group and McKesson.

Both Mr. Owens and Dr. Jenner were replaced by colleagues. Wellington Management in Boston, which oversees investments for the Vanguard fund, promoted Jean M. Hynes. She had been associate manager since 2008 and an analyst on the fund for two decades. She declined to be interviewed for this article.

T. Rowe Price named Taymour R. Tamaddon to replace Dr. Jenner. Mr. Tamaddon, an analyst on the fund for nine years, predicted no change in strategy.

"My investment process has been driven by my experiences of working with Kris," he said. "We focus the fund on innovation and therapies that can satisfy unmet medical needs."

An example is Pharmacyclics, a recent top holding. It is developing a cancer drug, ibrutinib, that hasn't shown the toxicity of other chemotherapies. "It's unbelievably safe, which means duration of use will be longer," Mr. Tamaddon said. "In cancer, a drug's market size stems from how many cancers it works with and how long patients can be on it."

Todd L. Rosenbluth, director of exchange-traded and mutual fund research at S&P Capital IQ, said investors typically should hold off buying into a fund during a managerial transition. Waiting gives time to observe strategy changes like, say, a reshuffling of a portfolio. But continuity seems likely at the Vanguard and T. Rowe Price funds, he said.

Even so, both current and prospective investors will want to monitor performance, he said. If they notice a sustained dip, they should check their fund's numbers against those of competitors. "Does the fund lag for reasons that are hard to explain?" he asked. "If pharma does well and a fund lags, then you'd want to look more closely."

AS for the larger question of whether anyone needs a health care fund, Mr. Rosenbluth said S&P Capital IQ favors the sector. "If you're going to increase your bet toward defensive sectors, health care is the one we like the most," he said, because of its stability and growth. If you're considering such a move, first determine how much health care you have among your existing investments. If you are already in a fund like the Vanguard 500 Index fund, he said, “you’re getting 12 percent exposure, and you’re getting Merck, Pfizer and Johnson & Johnson in heavy weightings.”

Managers of other well-known health care funds say that while domestic economic numbers matter, they aren’t what determine the health sector’s promise for investors. Trends abroad, especially in emerging markets, are creating new opportunities.

“The emerging middle classes are starting to want more health care,” said Eddie Yoon, manager of the Fidelity Select Health Care Portfolio. “That’s a stable demand driver. In some of the emerging countries, there’s policy that they want health care spending to grow — they want to take it from X percent of G.D.P. to Y percent. China has said it wants to build 5,000 hospitals.”

American companies should benefit, as they are seen worldwide as leaders and innovators. “Health care is a big export industry for U.S. companies,” Mr. Yoon said. “About half their sales are generated outside of the United States.”

Samuel D. Isaly, manager of the Eaton Vance Worldwide Health Sciences fund, also pointed to growth abroad as a reason to overweight health care. He has wagered his investors’ money on that view, putting about a third of his fund’s assets in foreign companies.

“You’re too localized when you talk about health care just in terms of the S.& P. 500,” Mr. Isaly said. The index’s health weighting may seem high, but that’s not the sort of number that matters most to him. What matters, he said, is 2 percent — the percentage of G.D.P. that China spends on health care, even as its population, too, has begun to age.

“You could come to the conclusion that health care has to go up,” he said, “and you want to invest in something that’s going up.”