Sector Funds

Last week oil prices were sharply lower in volatile trading, weighed down by equity markets as China signaled readiness to escalate the trade war with the United States, stoking concerns that an ongoing stand-off could hurt demand.

Supply constraints linked to the Organization of the Petroleum Exporting Countries' output cuts and political tensions in the Middle East offered little support.

The market continues to be stuck between supply outages on the one hand and fears of a softening economy reducing demand on the other. That was the same dynamic for much of May. In addition we now will likely be looking at a global slowdown because of the trade tariffs.

S&P downgraded Schlumberger’s (SLB) credit rating by one notch to A+. It also gave Halliburton (HAL) a Negative outlook, down from Stable. Both oilfield service companies are being negatively impacted by the slowdown in drilling activity in North America. SLB and HAL are two largest holdings for Fidelity Select Energy Services (FSESX).

The oil stocks and especially the oil driller stocks have not followed the commodities price rally. In addition, the rig count in the U.S. is now down to its lowest level of the last 12 months.

Fidelity Select Energy Services (FSESX) has now traded back down to where it started the year. Although oil historically does well during the month of June it usually peaks in early July and goes sharply lower over the later summer and fall months. It’s perplexing how negative the sentiment is on this sector.

Eventually the day will come where this sector will soar. Unfortunately, that day is not likely to occur in the near future and its hard to handle the pain while we wait. Potentially, later in year during the fourth quarter, we might see a better entry-point for this sector.

FSESX started the year well, gaining almost 20%, but has given all those gains back, and parachutes for this sector have now opened.

While we wait for the trade tariffs to unwind, one safety trade in a declining market is Gold. Fidelity
Select Gold (FSAGX) is among the worst performing Sector Funds YTD. The Fund was the best performing sectors during December only to give back all those gains when the market rallied from January through April. FSAGX, which has been relatively flat since the beginning of the market sell-off, rallied the last three trading days, finishing the month with a small gain. One thing that can keep Gold from rallying is the strong U.S. dollar. Although interest rates have fallen in the U.S., interest rates are sharply lower overseas in Europe. When this happens, investors often scurry to the safety and better yield of the U.S. dollar. If the U.S. trade war is prolonged, the Fed will cut interest rates, and that will send the dollar lower and Gold significantly higher.

The 3\textsuperscript{rd} quarter is usually the best quarter for Gold. Although we might be entering this position a little early, if the trade war escalates, Gold should have some upside. EIS recommends transferring FSESX to FSAGX. This trade will remain in place until the trade war with China is resolved.

As mentioned earlier, the Utility sector is trading at all time highs. FSUTX has been recommended since the beginning of the year and the fund has produced positive returns for last five consecutive months, but did show some weakness near month’s end. Investors are pouring money into this sector because of its history of low volatility and safety during weak markets. However, the sector is approaching an overbought condition. As a result EIS recommends transferring FSUTX to Fidelity Real Estate Investment Trust (FRESX). Like FSUTX this fund rallies in a declining interest rate environment. This fund is mainly in commercial real estate and is a good defensive alternative for FSUTX.

Another investment that works when interest rates drop is to invest in funds that mirror the movement of Treasury Notes. i-Share 20-Year Treasury Bond (TLT) and US Government Plus ProFund (GVPIX) rally when interest rates fall. If the economy and the market continue to struggle this will result in the Fed cutting interest rates. One caveat on this trade is that Treasury Notes are trading at levels not seen since September 2017, so the economy is going to have to get significantly worst to continue to push down Treasury Notes.

Fidelity Select Retail (FSRPX), although above its parachute levels, will most likely be affected
by the trade tariffs. The increase in price of goods and services will likely result in slower sales. This is the sector where the customer will see the effect of tariffs hit them head on. FSRPX declined about 7% during May. As a result, we need to choose a fund that’s less affected by the trade tariffs.

Normally when a fund is chosen in midyear the procedure to pick a new fund is to go back one full year from the date the change is made and choose the fund that was the best performer over that 12-month period. Using this procedure, the top-performing sector that meets the criteria is Fidelity Select Communication Services (FBMPX). This fund was formerly known as Fidelity Select Multimedia, and changed its name last year. The top two holdings of this fund are Alphabet (GOOGL) and Facebook (FB). These two stocks have minimal investment in China, so will be less adversely affected than the overall market.

GOOGL stock missed first quarter earnings and stock has declined about 12% from its highs. The last two weeks of May the stock stabilized and is rated as outperform by both Credit Suisse and Ned Davis Research. FB, which has received quite a bit of negative news for security issues, had outstanding 1st quarter earnings and the stock has rallied 30% YTD. This stock is also rated as outperform by Credit Suisse and Ned Davis Research. Clearly these two stocks dwarf all other media and have held up much better than the overall market.

The remaining holdings of FBMPX include Disney, Activision Blizzard, Electronic Arts and T-Mobile. The majority of these also have very little interaction with the Chinese market. Shares of FSRPX should be transferred to FBMPX.

Summarizing the Sector Funds changes

The Williams’ Sector Strength fund now becomes Fidelity Select Gold (FSAGX), while the Diversified Williams’ Sector Funds becomes:

40% Fidelity Select Gold (FSAGX)

30% Fidelity Select Real Estate Investment (FRESX)

30% Fidelity Select Communications Services (FBMPX)