"Value players have become growth players, growth players have become momentum players, and momentum players are out of their minds."

Barry Hyman, Ehrenkrantz King Nussbaum, December 22, 1999

At a time when old rules no longer seem to apply and the New Economy runs at Internet speed, momentum strategies dominate the investment scene. Over the past decade, 58 of the top 100 mutual funds were growth-oriented while just 4 stuck to value. The remaining 38 were sector-specific and blend – no doubt well represented by technology funds.

Is it time to join the momentum crowd or jump off the bandwagon before it goes over the cliff?

One method for evaluating momentum investors is to track the behavior of sector fund players. Fidelity Investments was the first to offer these funds in the early 1980s. Their Select Funds provide a reliable proxy for examining the behavior of the hot money crowd.

Fidelity introduced the first three sector funds on July 14, 1981: Select Energy, Select Precious Metals, and Select Technology. Although popular at the time, all three underperformed the bull market of the 1980s. Energy and precious metals even managed to lag the 1990s bull market, when technology finally found its legs. By the end of the 1980s, there were a total of 32 sector funds plus a money market fund. All of the major sectors were represented: consumer goods, energy, financial services, health care, precious metals, and technology.

At the end of 1989, momentum investors were still reeling from the ’87 crash and worried about the twin deficits and Japanese competition. They placed their bets accordingly: 24.9% of total assets in money market funds, 23.3% in precious metals funds, 10.2% in technology, and 2.2% in financial services. One measure of risk aversion showed 55.1% in defensive funds (money market, gold, utilities) and just 27.5% in aggressive funds (financial, health care, technology). Ten years ago the ultimate trend followers were prepared for Armageddon. What they got was probably the greatest decade for stocks in history.

By the end of 1991, the biotechnology frenzy was in full force and the go go crowd was convinced it had much further to go. They piled 57.0% of their assets into health care funds, and nearly half of that into the speculative biotechnology fund. Health care owners were treated to the bursting of the biotech bubble in 1992 and a Clinton attempted takeover of the industry in 1993.

By the end of 1994, the stock market had more than recouped its ’87 crash losses, but pessimism was still the order of the day. The hot money was climbing out of its shell, but remained cautious. Assets in aggressive funds were up to 54.4% while defensive
funds captured 27.5%. Money market fund assets were still above normal at 11.3%. Momentum investors were prepared for mediocre returns. They had no idea the Dow would triple over the next five years.

![Fidelity Sector Fund Assets](image)

Today – surprise – the momentum crowd is pegging the risk meter. They clearly see the greatest risk in being under-invested in stocks. A record high 91.8% of assets are now in aggressive funds versus a record low 4.5% in defensive funds. Money market funds make up 2.2% while precious metals funds account for just 0.7%, both record lows. Favorite sector? You guessed it: technology is the sector of choice at 69.7%, another record. If biotechnology is included, the science and technology category accounts for 82.4% of assets.

Momentum investors are not always wrong. After all, markets tend to move in trends. The uptrend of the past few years has been unusually long and momentum investors have been well rewarded over this period (although they did raise a fair amount of cash during the July-96, March-97, and August-98 corrections). They’ve also grown in numbers and daring. But, like most contrary indicators, they tend to be dead wrong at major turning points.

It is obvious that the hot money is betting the ranch that we truly live in a New Economy, technology trees will grow to the sky, safety is for wimps, and the Great Bull Market has the life expectancy of the Energizer Bunny. From the evidence, it appears now is an excellent time to bet against them: sell technology stocks, buy gold stocks, raise cash, and prepare for the mother of all bear markets.
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