

Thought for the Week: Monday, March 29th, 2010

Tilting the Odds: A Healthy Chart

The DIAS Management team aims to ‘**Tilt the Odds**’ in its favor by selectively investing in areas where their investment research suggests an Edge exists. **An Edge** may be anything which we believe will lead a **sector or asset class to perform ahead of a broad market or index**.

Performing ahead of a broad market isn’t just about chasing gains, it’s also **about investing in areas which are less susceptible to capital loss**.

Healthcare Investment Edge

In the Healthcare sector we felt the worry of Government intervention caused a sell-off of stocks in 2009, thereby creating broad undervaluation – this was an Edge we felt we could benefit from. In our view, Government reform would not be as quick or as comprehensive as initially thought and therefore **Healthcare stocks would recover faster** than the broad S&P500 stocks.

Moreover, when we analyzed the companies that comprised the bulk of this sector, we saw very **strong balance sheets and cash flows**; the kind of quality we are attracted to.

The chart below shows how our Healthcare investment has performed (blue line) relative to the S&P500 Index (red line) for the approximate holding period. IYH is the iShares US Dow Jones Healthcare ETF we use to invest in the U.S. Healthcare index.



Bottom Line:

Our Healthcare Investment Edge provided approximately **3% outperformance PLUS a much smoother ride** for our investors.

Reviewing the Chart

The chart above shows our investment in **Healthcare consistently outperformed the S&P500** during a period when very few investment managers recognized the under valuation of the sector.

However, we didn't predict the aggressive manner in which the administration pushed through legislation and we therefore didn't exit the position before the legislation passed.

We could have sold the position earlier and made a very nice profit – instead we are **still sitting at a 'healthy' gain**.

Hindsight is 20/20, but imagine if the Healthcare Bill wasn't passed - the sector would have enjoyed a return to double digit premiums over the S&P500 and our investors would have done even better. In our opinion, it was worth keeping the investment for this reason.

Being an investment manager is often a balance between wondering why you didn't buy more and asking yourself why you bought it in the first place!

Healthcare Prognosis

The Healthcare Bill will create winners and losers and the ETF which we have used to Tilt our portfolios towards the Healthcare sector (IYH) holds both winners and losers.

Although we have opinions on the companies that may do well going forward, to invest in them in the lower risk portfolios would mean taking a position in a single individual company, where we would rather **invest in a number of companies to spread the risk**.

Spreading the Risk is one of reasons we use **ETFs as they cost-effectively incorporate investments in a range of companies**. Investing in an individual company as a DIAS Tilt involves additional risks and unpredictability, such as missing earnings: Risks we try to avoid.

We might also **invest in a smaller ETF** containing investments in companies from a smaller subset of the Healthcare sector. Although such investments exist, they do not pass our **Security Quality Approval Requirements** and therefore do not qualify for selection in DIAS.

Trading Notes:

- **We have sold our Healthcare ETF (IYH) taking the profit over the S&P500.**
- **We have added to our Energy sector investment including Oil Services which may exploit Obama's new Drilling Rules and to Japan via the EWJ ETF.**
- **In our Equity-based portfolios, we invested in two of the highest quality companies in the Healthcare space: TEVA and Merck. We feel these will continue to perform.**

TEVA is the strongest supplier of generics in the world – the new healthcare regime will favor generics. E.g. TEVA has a generic Viagra coming out soon which may add 40 cents to their earnings.

Merck is the last of the large pharmaceuticals with a large pipeline of new drugs (New Drug Applications).