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Shopping by Sector, Then by Country

By ZUBIN JELVEH

IN a world where stock markets often move in tandem, how can internationally inclined investors make intelligent decisions?

The answer, at least for now, appears to be to look first at the world's stocks by industry sectors - and only then by individual countries, according to a study by Vihang R. Errunza, director of the finance research center at McGill University in Montreal, and Francesca Carrieri and Sergei Sarkissian, two assistant professors at McGill.

The reason is that even though the economies of the world's developed markets have become more integrated, the correlation among returns of different global sectors has grown much more slowly than that of different international markets, the study said. That means that investors who want to beat the market may be able to do so by finding the right global sectors. Those who just want to reduce portfolio volatility can do so by making sure that many different sectors are represented.

One example of this phenomenon is found in the energy sector. While the Standard & Poor's 500-stock index has remained mostly flat this year, energy stocks in the United States have gained about 20 percent, following a pattern set by global oil prices. Energy stocks abroad have performed similarly, following a different global pattern than, say, financial or health care stocks.

"It's fair to say globalization will increase these types of patterns around the world," said Dan Lefkovitz, a Morningstar fund analyst.

Many investment firms have already restructured their research teams around global sectors.

Alistair Lowe, head of global asset allocation at State Street Global Advisors, said that he had seen more firms organizing their research around global rather than regional sectors. "They are recognizing that they can get much better results by comparing a Japanese bank versus an American bank" than by first focusing on the region, he said.

With investors hungry for global and foreign investments - flows into those types of funds rose nearly 70 percent this year through July - how can they use this strategy?

One way is offered by Jeremy J. Siegel, a professor at the Wharton School of the University of Pennsylvania, in his book, "The Future for Investors." He looked at S.& P. 500 returns from 1957 to 2003 and found that the health care, consumer staples and energy sectors outperformed the index over that period.

Based on this evidence, Mr. Siegel concludes that as globalization progresses, these sectors will be likely to benefit from more correlated markets. He recommends tapping into these sectors through exchange-traded funds that track the S. & P. Global 1200 index, which comprises the S.& P. 500 and six other major international indexes and covers 70 percent of the world's stock markets.

E.T.F.'s that track global sectors through the S.& P. 1200 are currently offered by Barclays. Its iShares S.& P. Global Sector Index funds track five sectors: energy, financials, health care, technology and telecommunications.

Global sector investing has been slow to reach the mutual fund universe, but two fund families that offer a wide variety of global sector funds are Gartmore and Hartford Mutual Funds.

Mr. Errunza of McGill suggests that investors seek stocks in the tightly correlated global sectors. For the United States, a 2004 Morgan Stanley report found that these included information technology, industrials and technology hardware and equipment; those with the least global integration were real estate, health care equipment and retailing.

TRACKING the sentiment of fund managers is another way to select sectors. A Merrill Lynch survey in August of global portfolio fund managers showed that they expected pharmaceutical and energy sectors to be the best performers over the next year, while utilities, banks and discretionary spending were sectors that were expected to underperform.

When it comes to emerging markets, however, global sector trends do not yet apply entirely, said Jeffrey A. Everett, manager of the Franklin Templeton World funds. The movements of emerging markets "like South Korea, Brazil and Russia are still largely independent," he said.

Despite the global sector trends, Arijit Dutta, a mutual fund analyst at Morningstar, recommends that the average individual investor stay away from pure sector plays.

He recommends finding funds that focus on a company's performance rather than its industry or region.

Two such funds, he said, are MFS Research International, which gained 18.9 percent in the 12 months through September, and Templeton World, up 24.7 percent.