Worst Market Sectors TO TRADE THIS YEAR

TAKE EXTREME CAUTION IF TRADING THESE BROKEN SECTORS

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Top Sectors To Avoid This Year

Towards the end of every year, it's fairly common to see investment analysts produce "Top Sectors for the New Year" reports. These are the reports where they point out why buying stocks in certain sectors is a good idea because of some trend or other catalyst.

Not quite as common are the "Top Sectors to Avoid Next Year" since many analysts are long-only by nature. However, even the analysts who produce the sectors-to-avoid type of reports don't typically give very compelling reasons.

It's usually something like "there will be less demand" or "political strife could hurt production" or something equally as vague. Even if these statement are true, it's hard to apply them across an entire sector. And, investors may miss out on good opportunities with such broad statements.

Do you want to know a more predictable reason to avoid a sector? Volatility. Whether a sector or industry goes up or down, most investors don't want to deal with high volatility. It's hard to stomach. Even if the end result at year's end is positive, you'd probably have been a lot more comfortable during the year staying in cash.

This is especially true for options traders. Typically, we want there to be enough volatility to give us opportunities for profit. However, too much volatility can be a recipe for disaster. With that mind, let's look at two sectors which options traders should avoid in the coming year.

Biotechnology

Technically speaking, biotech is more of an industry than a sector. However, biotech stocks definitely don't trade the same way as other healthcare stocks, so I'm going to break it out for the purpose of this report.

Frankly, biotech makes my avoid list every year. The problem with biotech trading is the results tend to be binary to the extreme. You are either 100% right or 100% wrong. The FDA either approves the new drug or it doesn't. A drug either makes it through a clinical trial or it doesn't. With options trading, this is a difficult situation to trade.

If you look at an options chain for a biotech stock with an upcoming trial result or FDA decision, you'll notice the options will be incredibly expensive. What's happening is that a large move is already priced in, for either direction. Options traders may not know what the trial/FDA results are going to be, but they know the stock is going to skyrocket or plummet based on the results.

In other words, to make money trading options on a biotech stock, you generally have to get the direction and magnitude absolutely correct - a very difficult scenario for any trader. To put it in different terms, buying options in biotech stocks is usually too expensive while selling options is too risky. There really isn't an in between.

That's not to say that the bigger, established biotech companies like **Amgen** (AMGN) or **Gilead** (GILD) should be avoided. But, as a whole, I don't recommend trading the industry, especially companies that are relying on drugs in the experimental phase.

Financials

The prevailing logic on financial companies is they tend to make more money when interest rates go higher. Because of this feature, the financial sector is a good one to own during a rising rate environment - and essentially provides a hedge versus other sectors.

Here's the problem with this thought process... it's no longer entirely relevant. You see, the financial sector is made up largely by banks. It's true that banks used to make more money in a high interest rate environment... back when the main function of a bank was to take deposits and make loans.

However, banks are a lot more complex and diverse these days. The loan business isn't what it used to be (a lot more competition) and there are many alternatives to income generating products besides bank CDs.

Basically, while banks may make more money on some products as interest rates rise, they have an equal amount of potential to lose money if higher rates slow the economy. Several other products and services banks provide are at risk if the economy slows down.

So what does this mean for options traders?

There aren't necessarily going to be any trends or obvious floors (or ceilings) in financials despite a potentially higher interest rate environment next year. Financials will fluctuate with economics news and earnings and could be far from predictable.

While financials aren't likely to be as volatile as some other sectors, I don't think financial companies will be stable enough for the type of options strategies most traders like to use. You're better off saving your bullets for more predictable sectors in clear trends or with more compelling mean reversion characteristics.