How investors can separate real megatrends from market hype

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Longevity and wellness trends are driving long-term growth across the health-care sector.

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Investors who bought internet stocks at the peak of the dot-com boom were right about the future.

E-commerce, cloud computing and digital advertising went on to reshape the economy. But many of those investors lost money because they paid prices that assumed years of outsized profits before those gains actually arrived.

The distinction is newly relevant as investors consider a slew of emerging megatrends like artificial intelligence, electrification, defence spending, and supply chain realignment.

“One of the biggest mistakes investors can make is when they confuse a transformational technology with a good investment,” says Ben Kizemchuk, senior investment advisor and portfolio manager at Stonehaven Wealth Management in Aurora, Ont., part of Wellington-Altus Private Wealth.

The challenge is threefold, he says: distinguish structural change from a market narrative; decide what part of the trend to own; and keep a compelling story from overwhelming portfolio discipline.

When assessing opportunities, Theresa Shutt, chief investment officer at Harbourfront Wealth Management in Toronto, begins with a basic test. “Is this trend or megatrend being pulled forward by structural forces, or is it really pushed forward by sentiment and momentum?”

Structural forces can include demographics, technology costs, capital-spending cycles, government budgets and multi-year contracts. They should be observable beyond a single company’s share price, she says.

Several dominant themes have such evidence. NATO members have committed to raising defence and security-related investment to 5 per cent of GDP by 2035. The International Energy Agency (IEA) expects global data-centre electricity consumption to more than double by 2030, with AI the most important driver. In the United States, health-care spending is projected to reach nearly US$9-trillion by 2034, accounting for one-fifth of the gross domestic product (GDP) in the world’s biggest economy.

Mr. Kizemchuk sees health care as an instructive, less-celebrated megatrend, one that's large in scale and less dependent on economic cycles. "Ultimately, this demand is not optional. You are going to be spending on this as a society."

Structural demand can establish that a trend is real, though it does not mean every company exposed to it is a winner. "Valuation itself shouldn't really impact whether you believe in a trend or not," Ms. Shutt says. "It should influence when you buy it, the timing and how you size the position."

That could mean starting small, averaging in, or waiting for a pullback, rather than buying on fear of missing out.

AI contains more than one investment story. Its application layer includes platforms and software, while its physical layer encompasses semiconductors, memory, data centres and power.

Mr. Kizemchuk warns that hardware can behave like a commodity industry: strong demand encourages new capacity, eventually pressuring margins and valuations. "The question isn't really whether AI succeeds. The question is, 'Do today's stock prices already assume that success?'"

Market concentration is another concern. Information technology represents 38 per cent of the S&P 500 versus 9.3 per cent for health care. Lower market capitalization alone does not prove the sector is undervalued, Mr. Kizemchuk says, but combined with robust and rising spending across a deeply developed industry it represents a durable investment that should grow over time.

Investors don't have to predict which specific AI model, defence contractor or energy technology will flourish. They can also own businesses supplying equipment and infrastructure across an industry.

"Neither is categorically better than the other," Ms. Shutt says. Headline companies can offer more direct upside and volatility, while suppliers of chips, data centres, power and machinery can broaden and diversify total exposure.

She describes 10 per cent to 15 per cent as a suitable weight for thematic positioning. Regular reviews of portfolio holdings can lead to rebalancing allocations as winners tilt overall exposure or risk too far in one direction.

Before adding a position or allocation to a portfolio, investors should determine how much exposure they already own. The same technology company can appear in a broad index, an AI exchange-traded fund, a growth fund or as an individual holding.

"I don't think the S&P 500 is what you want to use as a broad diversifier any more," Ms. Shutt says.