ETFs for the Long Run

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How Did ETFs Fare in Market Turmoil

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With cries of financial Armageddon and headlines screaming "heaven help us," it shouldn't have surprised anyone that the stock market took a head dive today. The refusal of the House of Representatives to pass the $700 billion Wall Street bailout sent shivers through Wall Street. Everyone realizing the golden days are over made a mad dash for the exits.

"The first problem is the administration gave it the wrong name," says Jerry Slusiewicz, president of Pacific Financial Planners of Newport Beach, Calif. "They should have called it the 'economic stabilization plan' or 'liquidation enhancement plan," instead they called it a 'bailout' and that was bad news. No one wants to bail out Wall Street."

So, how did exchange-traded funds hold up amid the market turmoil?

"The ETFs followed the market," says Kevin Mahn, chief investment officer of SmartGrowth Mutual Funds, which runs funds of ETFs. "The SPDR Gold Shares (GLD) was up as well as a lot of the short products from ProShares."

The truth of the matter is the ETF is only as good as the assets it's holding. And if your ETF tracks the Dow Jones Industrial Average the day it plunges 777 points, like it did Monday in the largest one-day decline in history, you're going to feel some pain, $6.40, or 5.76%, to be exact. Surprisingly, the Diamonds Trust, the ETF which holds every stock in the Dow, actually performed better than the index itself, which sank 6.98%. Who knew tracking error could work in your favor?

The same thing happened with the SPDR (SPY), the most heavily traded ETF on the market today, with 460 million shares trading hands. While its tracking index, the S&P 500 plummeted 8.79%, the SPDR tumbled just 7.84%, or $9.47.

The iShares S&P 500 Value Index Fund (IVE) beat the broader benchmark, and the growth sector, falling 6.76% to $57.85, on volume of 3.6 million shares, while the iShares S&P 500 Growth Index Fund (IVW) also beat it, sliding 7.1% to $54.66. And both closed at a premium to their net asset value, which was $56.34 for the value fund and $53.93 for growth, according to iShares.

And what of the fundamentally-focused ETFs which claim to do better than market-cap ETFs? How did they perform? PowerShares FTSE RAFI 1000 Portfolio (PRF) narrowly beat the S&P 500, with a decline of 7.46% to $44.02 on volume of 251,884 shares. The WisdomTree LargeCap Dividend Fund (DLN) slid 6.4% to $45.13 on 38,000 shares and the Spa MarketGrader LargeCap 100 (SZG) dropped just 5.34% to $17.55, with only 400 shares traded. All the fundamental ETFs also closed significantly higher than their NAVs.

"The House vote was basically a vote of no confidence for the credit markets," says Slusiewicz. "Credit is drying up for short-term cash for the economy. We've backed ourselves into a corner."

Overall the flight to quality led to an interesting divergence in the bond ETFs.

"The 0.4% move in the BIL was a hefty move," says Jim Porter, the portfolio manager of Aston/New Century Absolute Return ETF Fund (ANENX). "It broke out four days ago as there was definitely a sign of movement into the T-Bill ETFs. Meanwhile the Vanguard Intermediate Term Bond was actually down today. It's obvious that no one wants to own the Intermediates. But the T-Bills and the long bonds are OK."

n The SPDR Lehman 1-3 Month T-Bill ETF (BIL) gained 20 cents, or 0.43%, to $46.24. This sent the yield down to 1.46% from 2.73%

on Aug. 31.

n The iShares Lehman 1-3 year Treasury Bond ETF (SHY) edged up 0.6% to $83.89, yielding 3.69%, up from 3.48% on Aug. 31.

n The iShares Lehman 20+ year Treasury Bond ETF (TLT) climbed 2.9% to yield 4.68%, up from 4.53% on Aug. 31.

n Meanwhile the Vanguard Intermediate Term Bond (BIV) fell 31 cents, or 0.42%, to 74.37. Since Aug. 31, when it yielded 4.63%, the BIV's yield has plunged to a negative 1.64%.

So, what can we expect for the rest of the week? With the Jewish New Year occurring Tuesday and Wednesday, Congress won't tackle any business until Thursday. In addition, with many market participants out, volume will probably be low, but that could create large price moves. The third quarter ends on Tuesday, so it should be an interesting day for mutual fund managers who need to shore up their portfolios for end-of-quarter reports.

"A lot of what we saw erased today will come back when the bill gets passed," says SmartGrowth's Mahn. "But there will be a lot of trepidation over the next few weeks to see if another bank fails and if this bailout works and how quickly it works."

Slusiewicz of Pacific Financial Planners thinks Congress will try to revive the deal because everyday that passes without one will see more market declines. He says the CBOE Volatility Index, or VIX, posting on Monday was "one of the top ten days for the fear index. The big fear number is an indication of a bottom. And the bottom will come with the passing of a new bailout bill."

But, if there's no bill Slusiewicz expects more days like Monday. With no bill, he predicts potential declines of 100 points on the S&P 500, 200 points on the NASDAQ and 700 points on the Dow.

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1 response so far ↓

- **lewy14** // October 7, 2008 at 8:57 am

  ETFs are trading at a premium to NAV? Wow. Closed end funds are trading at a discount. Why?

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