TheStreet.com

The Best ETFs of 2008

Billy Fisher

December 23, 2008

The year 2008 made for a wild ride in the race for the best exchange-traded fund of the year.

Just how volatile has the year been? Consider this: At the midway point in this race, June 30, the United Stated Natural Gas Fund had established a strong lead with a year-to-date return of 73.7%, and the United States Oil Fund was up 46.9% at the half-way point. Fast-forward six months, and these two funds are now actually down 33.4% and 57.7% on the year as commodity ETFs have suffered quite the pullback.

Of the 857 ETFs tracked by Morningstar, only 66 are in positive territory; and 24 of the top 25 ETFs are, not surprisingly, inverse, or short, ETFs.

And the Winner Is ...

The top-performing ETF of 2008 with a year-to-date return of 98.9% is the UltraShort Russell MidCap Growth Fund. The fund is designed to deliver returns equal to twice the inverse of the Russell Midcap Growth Index which includes top holdings such as Yum! Brands, Express Scripts and St. Jude Medical.

So what lead to this ETF's breakaway performance? "Mid-cap growth stocks generally have more beta than the S&P 500, which would enhance the return or decline versus the S&P 500," said Tony Welch, a portfolio manager at Sarasota Capital Strategies, who specializes in ETFs. "In addition, mid-sized retail, banks and consumer-discretionary stocks have been hit particularly hard in this economic downturn."

Welch believes 2009 could be a better year for mid-cap growth stocks. "The bad economic numbers will be with us for some time, but markets usually turn before the economy does," he said. "The Russell Midcap Growth Index is heavily weighted toward the consumer and the huge fiscal stimulus plans, if implemented, should be very good for mid-caps."

Semis on Shaky Ground

Running neck and neck with SDK is the UltraShort Semiconductor ProShares Fund, which is up 96.0% in 2008. It is worth noting that Intel accounts for nearly 40% of this ETF's weight. With shares of Intel retreating 39.7% in 2008, this fund was a big winner. Intel wasn't the only chipmaker that experienced adversity in 2008 though. It was tough sledding for most of the industry. "Many semiconductor companies had over 50% of their sales coming from emerging market countries," said Eric Aanes, president of Titus Wealth Management. "The economic slowdown in the emerging markets enhanced the sell-off in these stocks."

Aanes believes that chip stocks are positioning for a recovery. "Many stocks in the sector are trading at 11 to 15 earnings, which is historically low," he said. "Tight cost controls will preserve profitability for top-tier companies. This sector will be one of the early sectors to lead us out of a defensive mode."

A Flight to Safety, Treasuries

In terms of non-inverse, non-leveraged ETFs, the top two performers in 2008 have been the Vanguard Extended Duration Treasury ETF and the iShares Barclays 20+ Year Treasury Bond Fund. Year to date, these ETFs have experienced respective returns of 55.1% and 33.8%.

Kevin Mahn, portfolio manager for the SmartGrowth Mutual Funds notes that these ETFs have benefited from investors becoming more risk averse. Mahn's SmartGrowth Lipper Optimal Conservative Index Fund, which is a fund of ETFs, is down only 7.5% this year. "At the end of Q3, TLT was only up 2.0%," he said. "The bulk of its gains came in November. I think this trend can be attributed to a flight to quality."

Mahn isn't sold on the notion that that these two ETFs will be able to maintain such strong momentum over the course of 2009. "Money that is on the sidelines in these funds right now will likely be moving into equities in 2009," he said.