

Exchange-Traded Funds: Attractive Investments in Today's Markets

Introduction to Exchange-Traded Funds

In light of the current economic turmoil and its impact on financial markets, many investors are turning to exchange-traded funds (ETFs) to capitalize on market or asset price swings. Exchange-traded funds are securities that offer proportional ownership of a portfolio of assets such as equity indices, commodities, bonds, or currencies. ETFs are similar to both open-end mutual funds, in which value is based on underlying assets, and also stocks, since they are freely tradable on an exchange and can be sold short or bought on margin. ETFs are attractive investment options as they offer investors a low-cost and tax-efficient chance to participate in underlying asset price movements without holding multiple securities. Like mutual funds, ETFs can offer instant diversification and can therefore help eliminate non-systemic risk.

Types of ETFs

ETFs invest in a variety of asset classes and are primarily designed to mimic the performance of specific indexes. They provide investors an opportunity to invest in an assortment of stocks or instruments constituting a specific index through a single security purchase. The major types of ETFs are:

Broad-Based Equity Index ETFs hold securities similar to those representing the index and attempt to mirror the performance of a stock market index.

Sector/Industry Equity Index ETFs focus on specific sectors or industries such as technology, healthcare, financial services and real estate.

Regional/International Equity Index ETFs maintain their focus on a specific country or region.

Bond Index ETFs track U.S. Treasury bonds or corporate bond indices.

Commodity ETFs invest in commodities such as precious metals, energy, and commodity futures.

Currency ETFs track various major currencies.

Leveraged ETFs seek to outperform or underperform the underlying index by a specified multiple.

Short ETFs return the opposite performance of their target securities.

How ETFs Work

An ETF is created and managed by the fund sponsor after deciding on a basket of securities, representing a target index, to be included in the particular ETF. The fund sponsor then contacts institutional investors, or authorized participants, to buy the target basket of securities on the open market and deposit them with a specially designated custodial bank in exchange for "creation units." The authorized participants either keep their shares of the ETF or sell them on the open market, where retail and other institutional investors can trade the ETF on the exchange just like any other listed stock. Authorized participants can redeem ETF shares for the underlying basket of securities constituting the ETF from the fund sponsor, which ensures that ETFs are efficiently priced.

Benefits of ETFs

ETFs can offer the same benefits of diversification as mutual funds, such as eliminating the risk of holding too few securities. However, unlike many mutual funds, ETFs maintain transparent portfolios and are priced frequently throughout the trading day. In addition, ETFs enjoy stock-like features, as they can be bought or sold anytime

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during trading hours, bought on margin, sold short, and traded using stop and limit orders. ETFs offer much needed flexibility to investors during this time of market volatility.

Unlike open-end mutual funds which are bought and sold on end-of-day net asset values (NAV) less commissions, the price of ETFs is continuously determined by the forces of supply and demand on the exchange. Since authorized participants have the right to redeem ETF shares for the underlying securities or vice versa, the share price of ETFs tends to closely match the intraday net asset value. Because ETFs are not actively managed, underlying fees are typically a fraction of mutual fund fees and since ETFs are tradable on an exchange, there are no load fees.

Investment Considerations

Exchange-traded funds offer a convenient means to construct a diversified portfolio covering various equity, fixed-income, and alternative asset classes. ETFs are typically low-cost, efficiently priced, and easy to trade. However, since ETFs trade on an exchange, they are subject to the same brokerage commissions as stocks. This means that if you invest in the same security every month (dollar-cost averaging), a mutual fund will likely end up having lower fees in the long run. Mutual funds do not typically charge brokerage fees, making them a better choice for gradual investments. Actively managed mutual funds can also offer talented portfolio managers, whereas ETFs are usually passively managed and designed to mimic a benchmark index.

If you are looking for instant exposure to a specific asset class or index, an ETF may offer a liquid and low-cost solution. Depending on your investment considerations, ETFs can be used in the long run as part of a strategically allocated portfolio or in the short run to capture expected movements in a target sector. Some ETFs also offer unique investment themes, including leveraged returns (such as double long gold), inverse returns (such as short long-term Treasuries), or a combination of leveraged and short (such as triple short financial services).

Below is a list of the 50 most actively traded ETFs as of February, 2009. As the list is not intended to represent specific trade ideas, please contact your LOM Investment Advisor for recommendations tailored to your investment needs.

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Ticker	Name	Objective	ETF Underl. Idx Ticker	Currency	Leverage	Avg Volume 30 Day (mm)
510050 CH	CHINA 50 ETF	Value-not Market Cap dependent	SSE50	CNY	No	757.76
SPY US	SPDR TRUST SERIES 1	Growth-Large Cap	SPX	USD	No	380.32
XLF US	FINANCIAL SELECT SECTOR SPDR	Sector Fund-Financial Service	IXM	USD	No	240.54
UYG US	PROSHARES ULTRA FINANCIALS	Sector Fund-Financial Service	DJUSFN	USD	Yes	173.84
QQQQ US	POWERSHARES QQQ	Growth-Large Cap	NDX	USD	No	167.01
2823 HK	ISHARES A50 CHINA TRACKER	Index Fund-Large Cap	XIN50	HKD	No	135.19
510880 CH	AIG HUATAI DIVIDEND ETF	Income Equity	SSEDIV	CNY	No	129.55
159901 CH	E FUND SI100 INDEX FUND	Value-not Market Cap dependent	SI100	CNY	No	110.44
FAS US	DIREXION FINANCIAL BULL 3X	Sector Fund-Financial Service	RGUSFL	USD	Yes	106.48
SSO US	PROSHARES ULTRA S&P500	Growth-Large Cap	SPX	USD	Yes	90.08
EEM US	ISHARES MSCI EMERGING MKT IN	Emerging Market-Equity	NDUEEGF	USD	No	81.27
IWM US	ISHARES RUSSELL 2000	Growth-Small Cap	RTY	USD	No	72.24
SDS US	PROSHARES ULTRASHORT S&P500	Growth-Large Cap	SPX	USD	Yes	50.92
IYR US	ISHARES DJ US REAL ESTATE	Sector Fund-Real Estate	DJUSRE	USD	No	43.87
XLE US	ENERGY SELECT SECTOR SPDR	Sector Fund-Energy	IXE	USD	No	41.22
USO US	UNITED STATES OIL FUND LP	Commodity	N.A.	USD	No	40.04
159902 CH	CHINA SME ETF	Growth-not Market Cap dependent	SMEBI	CNY	No	40.01
FXI US	ISHARES FTSE/XINHUA CHINA 25	Country Fund-China	XIN01	USD	No	39.58
DXO US	POWERSHARES DB CRUDE OIL 2X	Commodity	DBOLIX	USD	Yes	37.34
QLD US	PROSHARES ULTRA QQQ	Growth-Large Cap	NDX	USD	Yes	36.10
EFA US	ISHARES MSCI EAFE INDEX FUND	International Equity	NDDUEAFE	USD	No	35.31
DIA US	DIAMONDS TRUST SERIES I	Growth-Large Cap	INDU	USD	No	33.67
EWJ US	ISHARES MSCI JAPAN INDEX FD	Country Fund-Japan	NDDUJN	USD	No	32.12
SKF US	PROSHARES ULTRASHORT FINANCI	Sector Fund-Financial Service	DJUSFN	USD	Yes	31.52
NAFTRAC MM	NAFTRAC - 02	Growth-Large Cap	MEXBOL	MXN	No	30.54

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QID US	PROSHARES QQQ ULTRASHORT	Growth-Large Cap	NDX	USD	Yes	24.99
URE US	PROSHARES ULTRA REAL ESTATE	Sector Fund-Real Estate	DJUSRE	USD	Yes	24.14
GLD US	SPDR GOLD TRUST	Commodity	N.A.	USD	No	23.68
SRS US	PROSHARES ULTRASHORT REAL ES	Sector Fund-Real Estate	DJUSRE	USD	Yes	23.35
HOU CN	HORIZONS BETAPRO NYMEX CRUDE	Sector Fund-Financial Service	N.A.	CAD	Yes	22.11
EWZ US	ISHARES MSCI BRAZIL	Country Fund-Brazil	NDUEBRA	USD	No	21.87
DIG US	PROSHARES ULTRA OIL & GAS	Sector Fund-Energy	DJUSEN	USD	Yes	19.66
FAZ US	FINANCIAL BEAR 3X SHARES	Sector Fund-Financial Service	RGUSFL	USD	Yes	18.93
XIU CN	ISHARES CDN S&P/TSX 60 INDX	Growth-not Market Cap dependent	SPTSX60	CAD	No	18.32
BGU US	DIREXION LARGE CAP BULL 3X	Growth-Large Cap	RIY	USD	Yes	17.86
DUG US	PROSHARES ULTRASHORT OIL & G	Sector Fund-Energy	DJUSEN	USD	Yes	17.12
0050 TT	POLARIS TAIWAN TOP50 TRACKER	Growth-Large Cap	TW50	TWD	No	16.98
SMH US	SEMICONDUCTOR HOLDRS TRUST	Sector Fund-Technology	XSH	USD	No	16.37
DDM US	PROSHARES ULTRADOW30	Growth-Large Cap	INDU	USD	Yes	15.66
UCO US	PROSHRE ULT DJ-AIG CRUDE OIL	Commodity	DJAIGCL	USD	Yes	14.69
2800 HK	TRACKER FUND OF HONG KONG	Index Fund-Large Cap	HSI	HKD	No	14.34
IYF US	ISHARES DJ US FINANCIAL SECT	Sector Fund-Financial Service	DJUSFN	USD	No	13.78
DXD US	PROSHARES ULTRASHORT DOW30	Growth-Large Cap	INDU	USD	Yes	13.50
OIH US	OIL SERVICES HOLDRS TRUST	Sector Fund-Energy	OXH	USD	No	12.43
XLI US	INDUSTRIAL SELECT SECT SPDR	Sector Fund-Undefined Equity	IXI	USD	No	12.43
SLV US	ISHARES SILVER TRUST	Commodity	SLVRLN	USD	No	12.14
ISF LN	ISHARES PLC-ISHARES FTSE 100	Growth & Income-Large Cap	UKX	GBP	No	11.89
GDX US	MARKET VECTORS GOLD MINERS	Sector Fund-Precious Metals	GDM	USD	No	11.60
TNA US	DIREXION SMALL CAP BULL 3X	Growth-Small Cap	RTY	USD	Yes	11.49
EWT US	ISHARES MSCI TAIWAN INDEX FD	Region Fund-Geo Focused-Eqty	NDEUSTW	USD	No	11.05