ETF FOCUS

Pushing the envelope

First Claymore ETFs straddle line between active and passive

By John Spence, MarketWatch
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BOSTON (MarketWatch) -- Claymore Securities Inc. is the latest entrant to the thriving exchange-traded fund business.

On Thursday the Lisle, Ill., firm launched a quintet of ETFs on the American Stock Exchange, some of which arguably feature the most "active" strategies seen yet in ETFs.

One of the new offerings is designed to buy low-key stocks that receive little or no analyst coverage from Wall Street. Conversely, another hunts for companies that have seen analyst ratings upgrades and recent insider buying.

Claymore's debut ETFs also include a portfolio that rotates between stock-market sectors based on macro trends, a dividend-focused strategy and a so-called BRIC fund that invests in a basket of emerging market economies.

Although Claymore manages closed-end funds, unit investment trusts, mutual funds and separate accounts, this is its first foray into ETFs.

Like some of the newer players in the booming ETF business, Claymore is looking to gain a foothold with distinctive funds that crunch company-specific data in an attempt to provide index-beating performance.
Yet Claymore's managing director of product development David Cohen balked at the "active" label some are ascribing to the firm's inaugural ETFs.

"They use truly systematic investment processes based on fundamental investment philosophies," Cohen said. "An ETF by definition is passive because it tracks an index and takes the emotions out of the investment equation."

Still, some are urging caution on the new batch of "fundamentally-weighted" ETFs.

David Fry, editor of investment newsletter ETF Digest, said it may take as long as five years and a full market cycle to accurately judge their performance.

"They're based on back-tested models and you just don't know," said Fry. "They may end up being the greatest thing since sliced bread, but until then I'm sticking to the basics in ETFs."

Stealth mission

The Claymore/Sabrient Stealth ETF follows an index developed by investment research firm Sabrient Systems LLC that tracks about 150 U.S.-traded stocks and American Depository Receipts (ADRs) that fly under the radar screen of Wall Street analysts. The ETF seeks to outperform, adjusted for risk, the Russell 2000 Index (RUT: **718.63**, -8.50, -1.2%) and other small-cap benchmarks.

Scott Martindale, senior managing director at Sabrient, in an interview this summer said there is substantial research in the academic world about the "neglected-stock effect."

Stocks that are not heavily followed and not widely owned tend to be available at a lower price and outperform over time," he noted.

Most of the stocks will be culled from the small and microcap range with market capitalizations under $1 billion, according to regulatory filings. Martindale said companies in the index will have either one or no analysts covering the stock.

Meanwhile, the Claymore/Sabrient Insider ETF intends to hold a basket of 100 companies compiled by Sabrient "reflecting favorable corporate insider buying trends (determined via the public filings of such corporate insiders) and Wall Street analyst upgrades" with an eye on topping the S&P 500 (SPX: **1,314.78;** -3.15, -0.2%) and other broad-market indexes, according to the prospectus.

"We're looking for positive sentiment on a stock by the people closest to it -- the insiders who work within the company and their buying trends, and the analysts who follow the company," said Sabrient's Martindale. "Our work has shown these two factors seem to be a good predictor of future performance."

"It makes sense to buy stocks where insiders are buying because they are obviously well-positioned to see long-term value in the company," said Claymore's Cohen.

The Claymore ETFs have expense ratios capped at 0.6% of assets according to regulatory documents, somewhat higher than the more plain-vanilla ETFs tracking broad market-cap weighted stock indexes, but on par with more specialized offerings.

Hogging it up

Claymore has tapped another research outfit, Zacks Investment Research, for the indexes behind a "sector rotation" portfolio and a dividend-oriented fund, a popular trend in ETFs.

The Claymore/Zacks Sector Rotation ETF will hold 100 stocks with the tracking index programmed to overweight outperforming sectors.

Zacks breaks the stock market into 16 sectors such as consumer staples, basic materials, finance, utilities and other industries. The weighting for any one sector can range between zero and 45% of the index, according to filings.

The methodology overweights cyclical sectors before anticipated periods of economic growth, and loads up on noncyclical sectors prior to expected pullbacks in the economy.

Another Claymore fund seeks to gorge itself on the ETF dividend craze. The Claymore/Zacks Yield Hog ETF focuses on 125 to 150 companies that provide high income through dividend payouts. One interesting wrinkle: it can invest in traditional preferred securities, master limited partnerships and closed-end funds.

Thick as a BRIC?

Finally, Claymore on Thursday launched a BRIC ETF -- as emerging-markets funds that specialize in Brazil, Russia, India and China are known -- tied to an index managed by Bank of New York Co (BK: **34.81**, -0.22, -0.6%).
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Several fund companies have launched BRIC funds, a term first made popular by a 2003 Goldman Sachs Group Inc. (GS: **167.52,** +0.37, +0.2%) report, in recent years as investors have piled money into outperforming emerging markets. Several index managers such as Standard & Poor's, Dow Jones & Co (DJ: **33.30**, +0.43, +1.3%) and Morgan Stanley Capital International (MSCI) have recently introduced BRIC indexes.

Like the dividend ETF, Claymore looks to be chasing a strategy that's become fashionable in recent years.

"This is very much en vogue -- BRIC funds have gotten a lot of coverage in the financial press," said Fry, the newsletter editor.

Still, the Claymore/Sabrient BRIC ETF is the first of its kind, and there currently aren't any ETFs tracking India or Russia, although there are funds that invest in China and Brazil.

The Bank of NY index as of Sept. 15 held 75 securities and had 50% in Brazilian companies, 6% in Russian stocks, 18% in Indian companies and 26% in Chinese stocks, according to a regulatory filing.

The ETF may not be "as diversified as it sounds" with the heavier focus on Brazil and China, while in terms of sectors it has a tilt to energy and telecomm stocks, said Marta Norton, analyst at investment research company Morningstar Inc.

Like emerging-markets ETFs such as iShares Emerging Markets (EEM: **94.76**, -1.22, -1.3%) , BRIC funds have performed well the past few years but can see volatile periods like the market correction this spring on interest-rate fears, Norton added.

The Claymore ETF won't invest directly in overseas markets; rather it will use U.S.-listed ADRs and Global Depository Receipts. That approach potentially limits the ETF's coverage, but ADRs must meet a stricter U.S. regulatory structure, which provides added safety, observers say.

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