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Guard Against Down Days With This ETF

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On the surface, there are a lot of new ETFs that don't seem to make a lot of sense. However, it always pays to dig deeper.

Case in point: A company called **Sabrient** has licensed three indices to **Claymore Securities**, the third of which just listed as an ETF on Friday: the **Claymore/Sabrient Defender** (DEF) ETF, which is meant to do well in a down market.

The chart below shows the two other Claymore/Sabrient ETFs -- the **Stealth** (STH) and the **Insider** (NFO) -- compared with the **S&P 500** and the Russell 2000 for their very short trading lives.

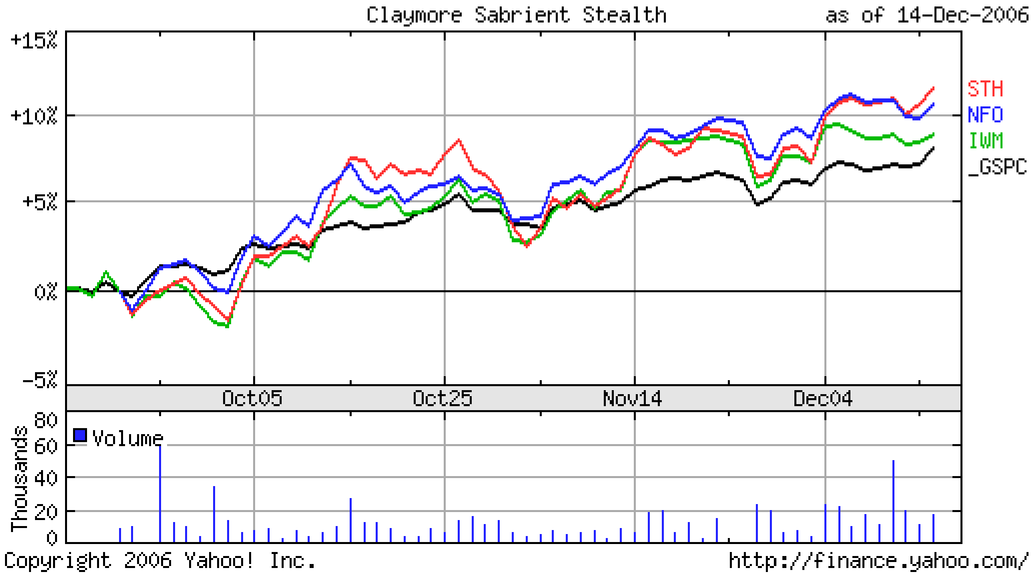
Claymore says it believes these funds will outperform, and so far they have. Clearly, three months do not provide a lot to look at, nor have those months included any type of stress test. The point here should be not to dismiss products just because they appear to be gimmicky.
The Defender ETF is not quite what I thought it would be when I first heard about it several months ago. The big picture is that it is supposed to do well in down markets. I took that to mean there would be a lot of food, utility and drug stocks in the fund and that at best it would be a proxy for companies with products that benefit from inelastic demand.

Um, well, no.

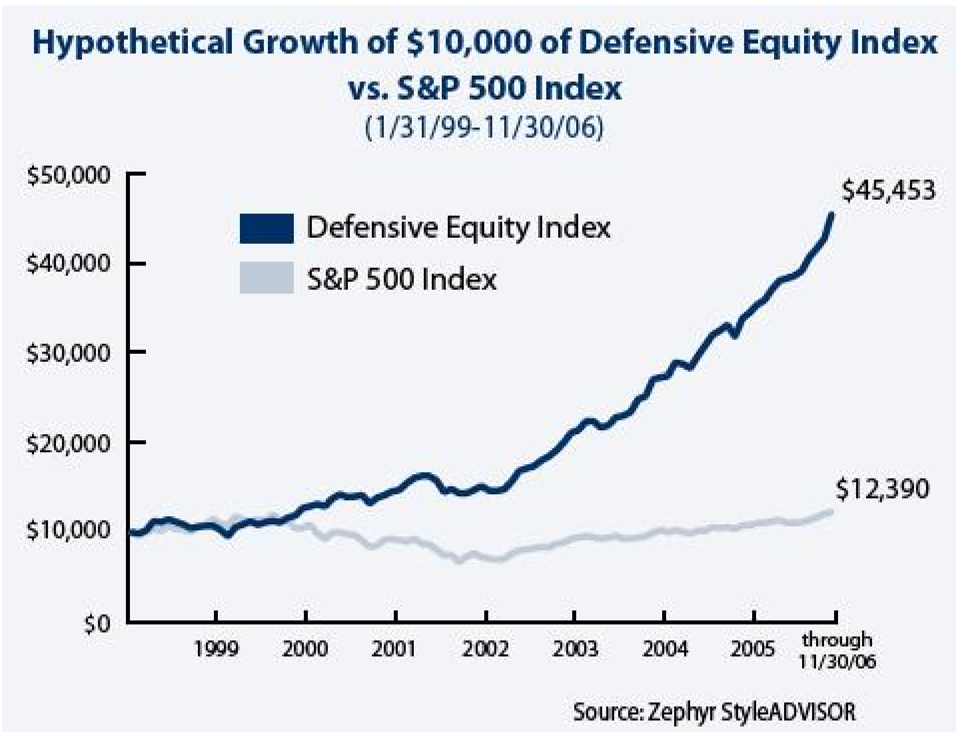
The specifics of the methodology are proprietary, but in general terms, the fund is rebalanced quarterly by looking back at the last quarter and seeing what did well on the down days. This approach gives the chance for current events to help dictate composition instead of blindly relying on what worked in past cycles.

The chart of the back-test shows outperformance so good it is hard to believe. I do not doubt the work, but I can't recall another back-test with that sort of result. This brings up another point about this fund vs. so-called defensive stocks. In an up market, you might expect Nilla Wafer and relish stocks to lag, but the Claymore/Sabrient idea of defense appears to have outperformed even during a great year, 2003.

The sector makeup is heaviest in financials at 31%, followed by discretionary at 15% and telecom at 12%. There are 100 stocks that are equal-weighted, and, as mentioned above, the fund rebalances every quarter. The expenses are capped at 0.6%. I was not able to get an exact number on the dividend, but it is expected to be close to 2% initially, and at other times during the history of the back-test it has been closer to 4%.



At this point, I have to confess I do not know exactly what to make of this. There appears to be a stretch in 2001 -- a big chunk of the most-recent heavy-stress test -- where the fund did worse than the S&P 500, but 2002 was a bad year for the S&P, yet the back-test was spectacular.



Personally, I would not expect the magnitude of the back-test's outperformance to be repeated. I think the way to look at this fund -- and we are starting to see more of this in new funds that list -- is for the secondary effect it might deliver.

As a function of the defensive nature of the stock selection, it is possible that this fund will become a proxy for large-cap value. Throughout most of the back-test, value outperformed growth, and back in the early part of the back-test when growth was the leader, the fund offered no outperformance.

In studying the actual results of the fund going forward, it might make more sense to compare it with **iShares S&P 500 Value** (IVE) than with the broader **S&P 500 SPDR** (SPY) . I believe the value of some of the newer "gimmicky" funds will be this secondary effect. For do-it-yourselfers who use market-cap and style ETFs, the Defender fund could turn out to be the best proxy for large-cap value -- or not.

But you will never know if you simply dismiss it as a gimmick.

At the time of publication, Nusbaum held no positions in the stocks mentioned, although positions may change at any time.

Roger Nusbaum is a portfolio manager with Your Source Financial of Phoenix, Ariz., and the author of Random Roger's Big Picture Blog. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks. Nusbaum appreciates your feedback; click here to send him an email.
