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FUND WATCH

Index Funds With Style

Two new designer indexes will track unique slices of the market.

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Think index funds are boring? Claymore Securities, a Lisle, Ill., investment firm, and Sabrient Systems, a Santa Barbara, Cal., quantitative research firm, are trying to make them more exciting. Next month Sabrient will publish two new indexes -- one that tracks stocks with significant insider buying and another that tracks stocks with little following in the analyst community. Claymore wants to create exchange-traded funds based on these indexes.

Clearly, these are not your grandfather's index funds, which traditionally have tracked well-known market barometers, such as Standard & Poor's 500-stock index or the MSCI EAFE index. The **Sabrient Insider Sentiment index** picks 50 stocks ranked by stock purchases made by company directors, executives and major shareholders. The thinking is that those in positions of authority know best what is happening at their companies and that if they're buying, they must be confident about the company's future.

But insider trades aren't the only ingredients that go into the Insider Sentiment sausage. The index also takes into account analyst upgrades. "You are getting a double thumbs-up from the people closest to that company: the analysts that follow it and the people that actually run the company," says Scott Martindale, a Sabrient senior managing director. It will select stocks from all major exchanges. The proposed ETF based on this index aims to outperform Standard & Poor's 500-stock index.

The **Sabrient Stealth index** follows 250 stocks with one or no analysts covering them. In this case, the theory is that stocks with little analyst coverage tend to be neglected and undervalued, which makes them good buys. The index also screens out stocks that could be overpriced and firms with low growth expectations. Claymore's proposed ETF seeks to beat the Russell 2000-stock index, which tracks small-company stocks.

Sabrient scores stocks based on more than 400 different factors, Martindale says. The company creates filters from multiple factors and monitors which screens are performing well in the current market, Martindale says. The company hopes to publish several more indexes within the next year. The Sabrient index represents a trend toward creation of more-exotic indexes. In the past few years, a number of firms have concocted indexes that rank companies on such factors as sales, cash flow, dividends distributed and book value, or assets minus liabilities. Some analysts contend that traditional indexes, such as the S&P 500, give too much weight to overvalued stocks because these indexes weight their constituents by market capitalization. The new so-called fundamental indexes seek to reduce the number of overvalued companies found within an index.

Of course, just because the new indexes have performed well in the past doesn't mean that they will continue to perform well in the future. "Historically, the new index construction methodologies all look good," says Paul Lohrey, a principal with the Vanguard Group, which is a major player in traditional index funds. "Prospectively, it's going to be difficult to predict which ones really will deliver what they promise."