

DJ CANADA TIP SHEET: Nothing Passive About ETFs For Berman

By Ben Dummett
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TORONTO (Dow Jones)--Who says exchange-traded funds, or ETFs, are only for passive investing?

For many investors, this is the primary role for ETFs because the fund's portfolio reflects a market index, allowing it to mimic the returns of a particular benchmark. By comparison, active managers typically invest in individual stocks and bonds, believing they can generate profits by identifying mispriced securities.

However, Larry Berman uses ETFs to actively manage the newly created C\$7 million GPS Fund L.P. As opposed to investing in individual securities, this approach eliminates single-stock risk that active managers would otherwise face.

"You don't run the risk of your company missing earnings (and the resulting decline in the stock price) where everything else has been good in the sector. So overall, that's going to improve your risk-adjusted returns because your equity curve is going to be a lot smoother," Berman explained.

That doesn't mean this type of active investing is for everyone. "The downside might be if you are an adrenaline junkie, you don't have enough volatility in the ETFS as you do in individual stocks," Berman said.

Typically, the fund will hold on average 10 to 20 positions in a variety of ETFs to generate a diversified portfolio that the manager believes will produce "the best risk-adjusted returns."

In Canada, the fund holds a core position in the iShares Cdn S&P/TSX 60 Index fund (XIU.T), augmented by what Berman refers to as alpha holdings, or those positions that emphasize certain sectors of the S&P/TSX index that Berman believes will generate relatively stronger returns.

One of Berman's favorite alpha positions is the iShares Canadian S&P/TSX Capped REIT Index fund (XRE.T). He is attracted to its dividend yield and its relatively low price.

He notes the index is down about 30% from its peak, yet the Canadian real-estate market has held up relatively well compared with its U.S counterpart and interest rates in Canada are declining.

The fund also holds the iShares CDN S&P/TSX Capped Financials Index fund (XFN.T) for similar reasons. It offers a "decent yield" and allows the manager to take advantage of a rebound in the beat-up sector.

Another alpha holding is represented by a bearish hedge on the energy sector, through the fund's holding of the Horizons BetaPro Capped Energy Bear Plus ETF (HED.T). The S&P/TSX 60 Index hit a 52-week high last week, largely on the back of gains in materials and energy stocks, "so when you want to hedge out the market correcting, you go to the sectors that are most overbought," Berman said.

That said, Berman would consider building back his position in the energy sector if the iShares CDN S&P/TSX Capped Energy Index fund (XEG.T) fell to the 92-to-94-point level. In Toronto Thursday, this index is at 98.25.

Berman said the fund is about market to slightly underweight Canada and overweight the U.S. By comparison, the fund is "quite underweight" Europe because of the currency risk if the U.S. dollar strengthens against the Euro in the wake of a significant sell-off over the last couple of years.

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