

>: Must Own ETFs

Tuesday, October 9, 2007 / Jason Jovine

I have been chomping at the bit for a very long time waiting for a certain type of Exchange Traded Fund (ETF) to come to the market, and it is finally here!

If you have been reading *The Tycoon Report*, you should know what ETFs are at this point, and if you purchased and, more importantly, utilized the knowledge that was imparted to you in Teeka Tiwari's *ETF Master Trader*, then you should be very well versed in how to make money using them.

I am here today to beat the asset allocation drum once again and to tell you about another type of ETF that you should definitely own as part of your complete portfolio. Before I start, I want to quickly review asset allocation and the different asset classes available to you.

Main Asset Classes:

- I. Money market assets (cash equivalents)
- II. Fixed-income securities (primarily bonds)
- III. Stocks
- IV. Non-U.S. stocks and bonds
- V. Real Estate
- VI. Precious metals and other commodities

Now, because of ETFs, we are able to buy many different asset classes via their respective ETF proxy. ETFs trade like stocks. You can buy and sell them when you want to. In other words, ETFs enable you to own any slice of the market on your terms.

You buy what you want to buy when you want to buy it. The days of having to pay a ridiculous commission to take advantage of some exotic overseas market are over. So are the days of having to wait what seems like forever to liquidate your mutual fund. You don't have to do that anymore; the choice is yours.

You can take control of your portfolio right now if you want to! It's never been easier, folks.

We allocate our assets in the aforementioned asset classes because we know by now not to put all of our eggs into one basket. What percentage of your portfolio should be put into each asset class is based on your own unique circumstances.

One thing that I know for sure is that you should have a piece of every one of those asset classes. You know that these asset classes are hot one day and cold the next (e.g. real estate). By having a piece of each, you will do better over the long term. This has been clearly proven from research. As a matter of fact, approximately 96% of your investment returns over the long term depend on how your assets have been allocated.

That said, in asset class #2 mentioned above (Fixed-income securities, primarily bonds), they have not had any Municipal Bond ETFs ... until now!

As I have mentioned to you in a [previous article](#), municipal bonds are bonds issued by municipalities that are usually exempt from federal taxes. Most states also exempt the interest received from bonds issued by their state.

The more money you make, the more appealing these bonds should be to you. I urge you to read my previous article for more details and examples.

The new Muni ETFs

In the last several weeks, there have been two Muni ETFs launched. The first one was from Barclays Global Investors (symbol: MUB), and the second was from State Street Global Advisors (symbol: TFI). There should be more coming down the pike.

I wouldn't advise *trading* them (although you can). These should be looked at as an integral part of your portfolio. Like I said earlier, the higher the tax bracket that you are in, the more appealing what I am saying should be to you.

OK, Jason, they sound too good to be true. What about the Alternative Minimum Tax (AMT)?

The interest from these ETFs is generally not subject to the AMT. In other words, the holdings of the ETFs do not contain Private Activity Bonds

which are the types of munis that are subject to the AMT. The other types of munis are not subject to it (the bonds in these ETFs).

There you have it. You can basically take advantage of all asset and sub-asset classes through ETFs. What are you waiting for?

Until the next time, folks, spend your hard-earned money wisely.



Jason Jovine
Chief Investment Officer

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Wednesday, October 10

10:00 - Wholesale Inventories (for August): Consensus 0.3%

Big Picture: Wholesaler inventories' growth of 6% yoy is less than the 7% annual growth in sales. The inventory to sales ratio is at a record low 1.11 months as the correction over the last half year is past. The recent inventory drawdown was relatively quick and less of an interruption for the economy. Longer term trends reflect comfort at those I/S lows as technology allows for continued improvement in just-in-time inventory management. The smaller inventory swings from rebuilding and drawdowns leaves a steadier pace of domestic growth.

Implications: The wholesale trade report includes sales and inventory statistics from the second stage of the manufacturing process. The sales figures say close to nothing about personal consumption and therefore do not move the market. Wholesale inventories sometimes swing enough to change the aggregate inventory profile (aggregate inventory is the sum of inventory at the manufacturing, wholesale, and retail levels), which may affect the GDP outlook. In that event they can elicit a small market reaction. More often than not, however, this release goes unnoticed except by market economists.

Thursday, October 11

8:30 - Export Prices ex-Ag (for September): Consensus NA, Import Prices ex-Oil (for September): Consensus NA

Big Picture: Core import and export prices are running close to the same pace -- 2.3% yoy and 2.4% yoy respectively. The movement in the volatile petroleum import prices and surging agricultural export prices provide the swing. The strong 18% yoy rise in agricultural export prices reflect the increased demand for grains that are now being increasingly used as alternative fuels. Petroleum prices are just 2% yoy given the

high prices of a year ago.

Implications: Though not a market-moving release, export/import prices are a useful indication of inflation pressures created by changes in foreign exchange rates. For example, when the dollar is strong, import prices tend to be under downward pressure. If an item in Japan costs 500 yen and the exchange rate is 100 yen to the dollar, the US\$ price \$5. If the dollar then strengthens to Y120, the US\$ price falls to \$4.17. Because US exports must compete with foreign goods, there is also downward pressure on export prices when the dollar is strong. Economists typically look at import prices excluding oil and export prices excluding agricultural. In each case, the category in question is excluded because prices for those items are volatile and the swings are unrelated to foreign exchange rates. Oil prices tend to swing in response to OPEC decisions, and agricultural prices are often affected by weather, neither of which say much about long-term trends in traded goods prices.

8:30 - Initial Claims (for 10/6): Consensus NA

Big Picture: Weekly initial claims can be volatile as the trends reflect some easing in the tight labor market. Layoffs (seen in initial claims) remain subdued given the lean supply of available workers as hiring (seen in continued claims) has cooled as reflected in the 20-month high in the early September 4-week average and the dip in August payroll growth. Claims provide a nearly real time read on layoffs and the labor market as the low 4.6% unemployment reflects the broader combined read of layoffs and hiring.

Implications: Initial jobless claims measure the number of filings for state jobless benefits. This report provides a timely, but often misleading, indicator of the direction of the economy, with increases (decreases) in claims potential signalling slowing (accelerating) job growth. On a week-to-week basis, claims are quite volatile, and many analysts therefore track a four-week moving average to get a better sense of the underlying trend. It typically takes a sustained move of at least 30K in claims to signal a meaningful change in job growth.

8:30 - Trade Balance (for August): Consensus -\$59.0B

Big Picture: The August 2006 deficit reached a record high -\$68.6 bln, as lower energy prices provided the initial fall. The weak dollar and strong global growth now provide a strong upward trend for exports. From a year ago, exports have risen 15% as imports have risen just 5%. Import growth carries a larger effect as they are about 45% larger than exports. The massive size of the deficit is eyed for effects on the dollar and interest rates. The trade deficit demands an equal but opposite investment inflow as the weaker dollar value reflects the massive size of the trade deficit.

Implications: The trade report is most widely watched for trends in the overall trade balance. But trends in both exports and imports of goods and services bear watching as well. The export data in particular are important to watch for indications that a strengthening competitive position at home and/or strengthening economies overseas are boosting U.S. growth. Imports provide an indication of domestic demand, but given the severe lag of this report relative to other consumption indicators, it is not particularly valuable for this purpose.

14:00 - Treasury Budget-May be Delayed (for September): Consensus \$100.0B

Big Picture

: Strong tax receipt growth continues to leave a path toward lower deficits given the economy, profits and income growth. Spending was cut back significantly in FY07 despite the continued spending in Iraq. The FY05 improvement sliced away a quarter of the record \$413 bln FY04 deficit as FY06 sliced away another \$71 bln. We expect FY07 will erase another \$87 bln to leave a deficit near \$161 bln -- just 1.2% of GDP. The initial outlook for FY08 comes from the CBO at -\$155 bln.

Implications: The monthly Treasury budget data follow strong seasonal patterns which produce huge month-to-month fluctuations in the deficit. These fluctuations tell us little about long term budget trends. To the extent that the market analyzes the monthly Treasury data, the focus is on year/year changes in receipts and outlays, since the data are not seasonally adjusted. Only in April, the most important month for tax inflows to the Treasury, does the market pay any attention to this report. The data can be predicted with reasonable accuracy by using daily data in the Daily Treasury Statement.

Friday, October 12

8:30 - Retail Sales (for September): Consensus 0.2%, Retail Sales ex-Auto (for September): Consensus 0.3%

Big Picture: Retail sales are slowing under the weight of high gas prices and falling home prices. The housing recession drags consumer durable goods (e.g. furniture, building equipment, appliances) as auto sales have been surprisingly weak. Despite the low unemployment rate and strong income growth the Fed's tightening and high energy prices have had a deflating effect on consumer spending and big ticket durable goods purchases particularly. Strong income growth and the low unemployment provides support and is the best read on the future sales pace.

Implications: The retail sales report is a measure of the total receipts of retail stores. The changes in retail sales are widely followed as the most timely indicator of broad consumer spending patterns. Retail sales are often viewed ex-autos, as auto sales can move sharply from month-to-month. It is also important to keep an eye on the gas and food components, where changes in sales are often a result of price changes rather than shifting consumer demand. Retail sales can be quite volatile and the advance reports are subject to rather large revisions. Retail sales do not include spending on services, which makes up over half of total consumption. Total personal consumption is not available until the personal income and consumption reports are released, typically two weeks after retail sales.

8:30 - PPI (for September): Consensus 0.4%, Core PPI (for September): Consensus 0.2%

Big Picture: September 2005 PPI growth of 6.9% yoy stood at a 15-year high and stands at a 2.2% yoy gain currently. The core also stands at 2.2% yoy from July 2005's decade high of 2.8%. The producer pipeline pressures are not providing any lift to finished goods as energy prices provide the volatility. The directional trends for commodity-based producer prices aren't providing any lift to core commodity prices in CPI which are lower than a year ago.

Implications: The Producer Price Index measures prices of goods at the wholesale level. There are three broad subcategories within PPI: crude, intermediate, and finished. The market tracks the finished goods index most

closely, as it represents prices for goods that are ready for sale to the end user. Goods prices at the crude and intermediate stages of production often provide an indication of coming (dis)inflationary pressures, but the closer you get to crude goods, the more that these prices track commodity prices which are already available in traded indexes such as the CRB (Commodity Research Bureau). At all stages of production, the market places more emphasis on the index excluding food and energy, referred to as the core rate. Food and energy prices tend to be quite volatile and obscure trends in the underlying inflation rate. Though the market reaction is determined by the month/month changes, year/year changes are also noted by analysts. The index is not revised on a monthly basis, but annual revisions to seasonal adjustment factors can produce small adjustments to past releases.

10:00 - Business Inventories (for August): Consensus 0.3%

Big Picture: The inventory to sales ratio stands at 1.26 months just above the record low 1.25 months in January 2006. The inventory drawdown in late 2006 and early 2007 is now past. The long trend toward smaller I/S ratios and the tighter range leaves less of a resulting effect on economic growth as the drawdowns or restocking takes place over a quarter or two. The large inventory drag on GDP in Q4 and Q1 turned to a gain in Q2 2007 as Q3 appears to be coming in a bit weaker.

Implications: The business inventories report includes sales and inventory statistics from all three stages of the manufacturing process (manufacturing, wholesale, and retail). But by the time it is released, all three of its sales components and two of its inventory components have already been reported. Because retail inventory is the only new piece of information it contains, the market usually ignores the business inventories report. However, sometimes retail inventories swing enough to change the aggregate inventory profile. This may affect the GDP outlook. When it does, the report can elicit a small market reaction. The aggregate sales figures are dated and they say little about personal consumption. They are actually a good coincident indicator, but the market is far more interested in forward-looking statistics.

10:00 - Michigan Sentiment-prel (for October): Consensus 84.0

Big Picture: The push to a two-year high in January was largely tied to the drop in gasoline prices. Plunging equity prices and economic fears have pushed the index down -14% since. The University of Michigan survey is significantly smaller (500 phone calls, just 250 in preliminary) than the Conference Board's, includes a longer outlook (for expectations) as questions are focused on the household compared to the business heavy CB survey. The index far better tracks the consumers' mood than spending habits better indicated through interest rates and income growth.

Implications: The Michigan index is almost identical to the Conference Board Consumer Confidence index, though there are two monthly releases, a preliminary and final reading. Like the Conference Board index, it has two subindexes -- expectations and current conditions. The expectations index is a component of the Conference Board's Leading Indicators index.

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