

Who's Buying ETFs? Active Traders Equal To Big Institutions.

Less Company-Based Risk

Fund trading crackdown pushes individuals into flexible, low-fee options.

By Murray Coleman Investors Business Daily

Money is surging into exchange traded funds. Much of it is coming from traders who got the cold shoulder from mutual funds or are simply looking to get into a market sector without buying individual stocks.

So far this year, investors have poured \$33.2 billion into ETFs, the baskets of equities that trade like stocks on major exchanges. That's up from \$1.1 billion at the same time two years ago.

By comparison, \$156.7 billion has gone into more widely owned mutual funds, basically flat with inflow in 2003 and 2004.

Institutional managers were the big early adopters of ETFs.

But individuals are increasingly turning to them. Retail investors are buying at least half of all ETFs, estimates Financial Research Corp. which tracks fund and ETF assets.

Wave Of The Future

"I've moved totally over to ETFs from mutual funds," said Jerry Slusiewicz, president of Pacific Financial Planners, based in Newport Beach, Calif. "I'm doing it for my clients as well; ETFs are the wave of the future."

ETFs let investors move cheaply and quickly in and out of various market sectors without having to buy individual names.

"Active stock traders are by far the ones using ETFs the most in retail markets," said Carolyn Stewart, vice president of Charles Schwab's funds product development nit. "Like institutional investors, they use more sophisticated strategies."

Schwab runs the industry's largest independent marketplace for mutual funds. The discount brokerage says it's also the top U>S> third-party distributor of ETFs.

Rise of ETFs

Assets in mutual funds vs. exchange-traded funds, in billions.

Year	Index funds	Active Funds	ETFs
1995	\$56	\$1,970	\$1
1996	94	2,396	2
1997	158	3,000	7
1998	245	3,548	16
1999	360	4,305	34
2000	356	4,196	66
2001	344	3,872	83
2002	301	3,472	102
2003	418	4,478	151
2004	511	5,149	227

Regulators and distributors increasingly are erecting barriers to rapid mutual fund trades. Fund managers say hot money ruins their investment strategy by flooding in and out at inopportune times.

The fund scandals that began in 2003 spurred regulatory changes that also curbed timers.

That has encouraged investors who desire unlimited flexibility to move into ETFs.

ETFs also fit the bill for those who want to buy and hold passively managed indexes. And with 187 ETFs and growing investors have plenty of choices.

For both active and passive investors, the ETF basket approach removes company risk from their buy decisions.

Even mutual funds sometimes buy an ETF to jump into a sector, either temporarily or until they can work out who the winners are likely to be.

The rush into ETF's, which began in 1993 with the S&P 500 SPDRs, doesn't seem to be taking much steam from traditional mutual funds.

"Rather than cannibalizing older products, ETFs are filling a need that wasn't getting addressed in the past by traditional mutual funds," said Deborah Fuhr, a JPMorgan analyst.

ETF assets could grow at an average annual rate of 29% over the next five years, Financial Research says. Mutual funds are expected to rise 10% a year and hedge funds at an 18% clip.

Actively managed mutual funds still account for 87% of all U.S. fund and ETF assets, says Strategic Insight, though that's down from 92% in early 2000.

ETFs now hold just 4.25% of the \$7.94 trillion market. But five years ago, ETFs made up 1%.

Regular open-end index funds' share has climbed to nearly 9% from 7.6% in early 2000.

"It's important to consider ETFs along with index funds when looking at overall trends," said Matthew Snowling, an analyst at FBR & Co. "They're both riding many of the same coattails."

Like traditional Index funds, ETFs track specific benchmarks. Both typically charge a fraction of the average 1.52% annual fee for actively managed funds. ETFs charge an average 0.44%.

That's caught the eye of fee-only advisers. They charge a set rate, based on time spent overseeing or managing a portfolio.

"Advisers have become huge early adopters of ETFs," said David Fry, founder of the ETF Digest.

"It's a way they can compete more directly with managers at big fund shops in terms of costs."

Instead of paying an active manager 1% to 2% a year, individuals can hire an independent adviser who uses passively managed products. The savings can be big.

Counting his own management fee plus those charged by distributors of ETFs and index funds, Michigan-based adviser Rick Ferri says his average client pays annual fees of less than 0.5%.

Mutual funds will probably remain the top choice among buy and hold investors, say Stewart.

But Schwab's ETF business is growing at a similar pace as its stock sales. "Some stock investors who aren't familiar enough with specific sectors, especially overseas markets, are using ETFs as a flexible and inexpensive way to broadly include those types of stocks in their portfolios," Stewart said.