Advantages of ETF Trading

Exchange Traded Funds or ETFs are portfolios of stocks, bonds, currencies or commodities that trade as a single stock on a stock exchange. ETFs first traded in 1993. They have gained enormous popularity over the last decade. ETFs are not mutual funds, but they offer some of the same advantages as mutual funds while trading like a stock. ETFs hold a pool of securities and are structured to track a specific index, sector, currency or commodity. There are over 740 ETFs that track numerous market indexes or sectors. Some of the well known indexes would include the S&P 500, Dow Jones Industrial Average, and the NASDAQ Composite. There are sector ETFs that track market sectors such as technology, healthcare, financial, foreign equity markets, foreign currencies and even commodities. In simplest terms, ETFs are funds that track the performance of these indexes or sectors.

In my experience, the biggest advantage of ETFs is that unlike mutual funds they don't distribute capital gains to their shareholders. This makes the tax accounting for ETFs much easier than mutual funds which require you to account for distributions. In the past, I have owned mutual funds that have had a negative performance but I wound up paying taxes on the fund's capital gains from prior periods.

There has never been a better time for investors to profit from global market trends than now. There are currently major bullish and bearish price trends in effect in global currencies, commodities and equities markets. I use the ***G****lobal* ***P****owerTrend* ***S****ystem* (GPS) is to identify major price trends when trading ETFs.

I have been trading ETFs almost since the inception of ETFs with my seasonal and cycle systems. I listed the numerous advantages of trading ETFs below.

Distinct Advantages of ETF Trading

1) **Allows you to invest in the global currency, commodity and equity markets that have the greatest profit potential**

2) **Allows you to diversify your investments across a wide range of asset classes**

3) **Allows you to trade from the long or short side which increases profit opportunities**

4) **Reduces the market risk of owning individual stocks**

5) **GPS trades are limited risk trades**

Diversified Global Markets

Exchange Traded Funds now cover a wide range of asset classes including fixed income, energy, currency, commodity and equity. A sampling of some of the different types of ETF asset classes follows.

Currency ETFs

- **Australian Dollar Trust ETF (FXA)**
- **British Pound Sterling Trust ETF (FXB)**
- **Canadian Dollar Trust ETF (FXC)**
- **Euro Trust ETF (FXE)**
- **Japanese Yen Trust ETF (FXY)**
- **Mexican Peso Trust ETF (FXM)**
- **Swedish Krona Trust ETF (FXS)**
- **Swiss Franc Trust ETF (FXF)**
- **EUR/USD Exchange Rate ETN (ERO)**
- **GBP/USD Exchange Rate ETN (GBB)**
- **JPY/USD Exchange Rate ETN (JYN)**
- **US Dollar Index Bearish Fund (UDN)**
- **US Dollar Index Bullish Fund (UUP)**

Commodity ETFs

Market Vectors Coal (KOL)

Grains Total Return ETN (JJG)

UltraShort Basic Materials ETF (SMN)

DB Agriculture Fund (DBA)

Market Vectors Steel (SLX)

Copper Total Return ETN (JJC)

Energy Total Return ETN (JJE)

Industrial Metals Total Return ETN (JJM)

Natural Gas Total Return ETN (GAZ)

Crude Oil Total Return ETN (OIL)

Gold Trust ETF (IAU)

Silver Trust ETF (SLV)

Base Metals Fund (DBB)

Basic Materials Sector Fund (DBN)

Precious Metals Fund (DBP)

Silver Fund (DBS)

Oil Fund (USO)

U.S. Basic Materials Sector Index Fund (IYM)

Materials Sector Fund (XLB)

Equity ETFs

Emerging Markets 50 ADR Index ETF (ADRE)

Emerging Markets Portfolio ETF (PXH)

MSCI BRIC Index Fund (BKF)

Emerging Markets Index Fund (EEM)

Market Vectors Russia ETF (RSX)

Short MSCI EAFE ETF (EFZ)

UltraShort MSCI Emerging Markets ETF (EEV)

BRIC 40 ETF (BIK)

Emerging Europe ETF (GUR)

Emerging Markets ETF (VWO)

Asia Pacific Portfolio ETF (PUA)

Chindia Index Fund (FNI)

Asia 50 Index Fund (AIA)

Pacific ETF (VPL)

China 25 Index Fund (FXI)

Hong Kong Index Fund (EWH)

UltraShort FTSE/Xinhua China 25 ETF (FXP)

EURO STOXX 50 ETF (FEZ)

Europe Portfolio ETF (PEH)

Europe Portfolio ETF (PEF)

MSCI EMU Index Fund (EZU)

European ETF (VGK)

Trading Markets with the Best Profit Opportunities

One of the big advantages of ETFs is that they allow you to trade global markets with the best profit opportunities. This year US stocks have been very volatile. The increased volatility has made profiting from the long or short side very difficult. The stock price graphs that follow for Alpha Natural Resources (ANR), Walter Industries (WLT) and Cleveland Cliffs (CLF) are examples of the volatile price moves in US stocks (charts courtesy of Yahoo Finance).

Volatile US Stocks

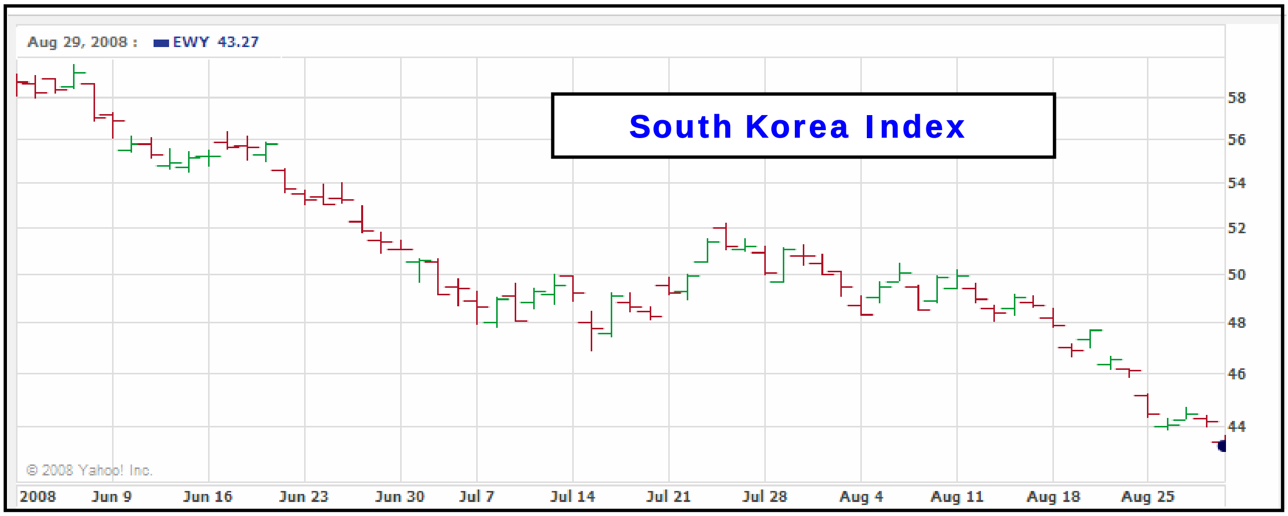
The percent gains and losses for Cleveland Cliffs stock over the past 7 weeks are listed below:

28.9% ***gain*** followed by a
33.8% ***loss*** followed by a
41.3% ***gain*** followed by a
24.0% ***loss*** followed by a
33.3% ***gain***

The net result of these volatile moves was that the price CLF stock was virtually unchanged over the 7 week period. If you purchased CLF stock or options you would have been "whipsawed" by the volatile moves. If you purchased a CLF put option, the value of the put would have decreased dramatically during the 28.9%, 41.3% and 33.3% gains in CLF stock. And the value of a call option would have decreased dramatically during the 33.8% and 24.0% losses in CLF stock. On any given day, the price of a US stock can increase ***or*** decrease 10% to 20% in one day, making profits from the long or short side very difficult.

Global Markets with Clearly Defined Trends

In contrast to the volatile price moves in US stocks, over the same time period most global markets have experienced clearly defined, consistent trends. The price graphs that follow show that these four global markets were in clearly defined down trends and presented much better profit opportunities from short positions than US stocks which were very volatile over the same time period. These examples demonstrate that Global ETFs allow traders to trade markets with the best profit opportunities. The *GPS* has allowed me to take full advantage of the profit opportunities available in these global markets buy purchasing short ETFs and put options which profit from the decline in price of their underlying ETF. On balance, a short position in a global ETF currently represents a much better trading opportunity than a long or short position in the volatile US market (charts courtesy of Yahoo Finance).


Aug 29, 2008 : EWY 43.27
South Korea Index
58
56
54
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48
46
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2008
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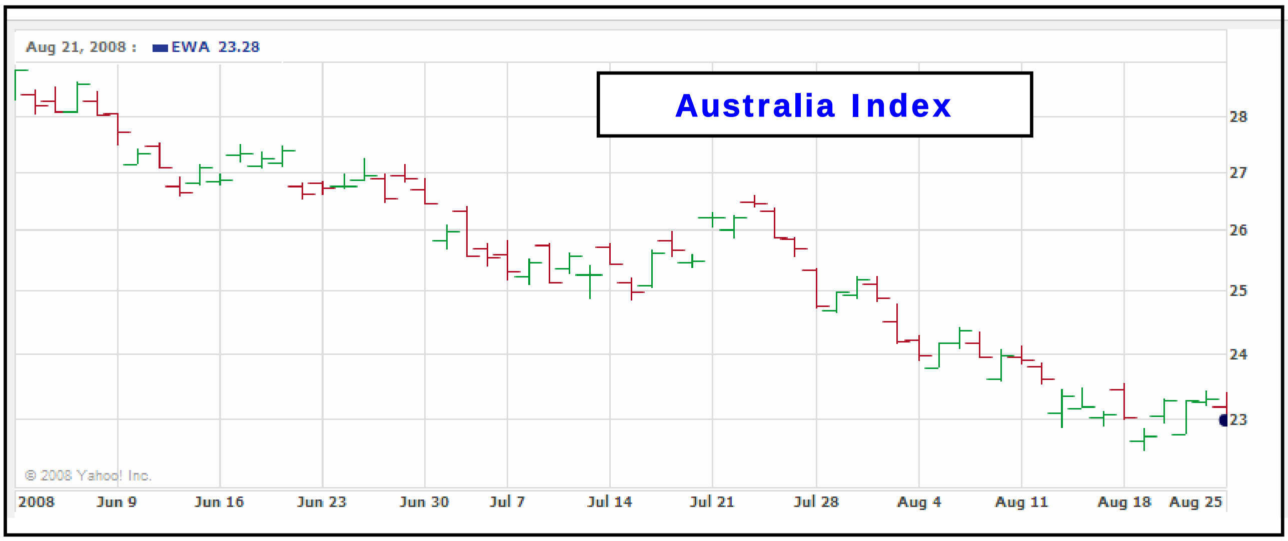
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Australia Index
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© 2008 Yahoo! Inc.
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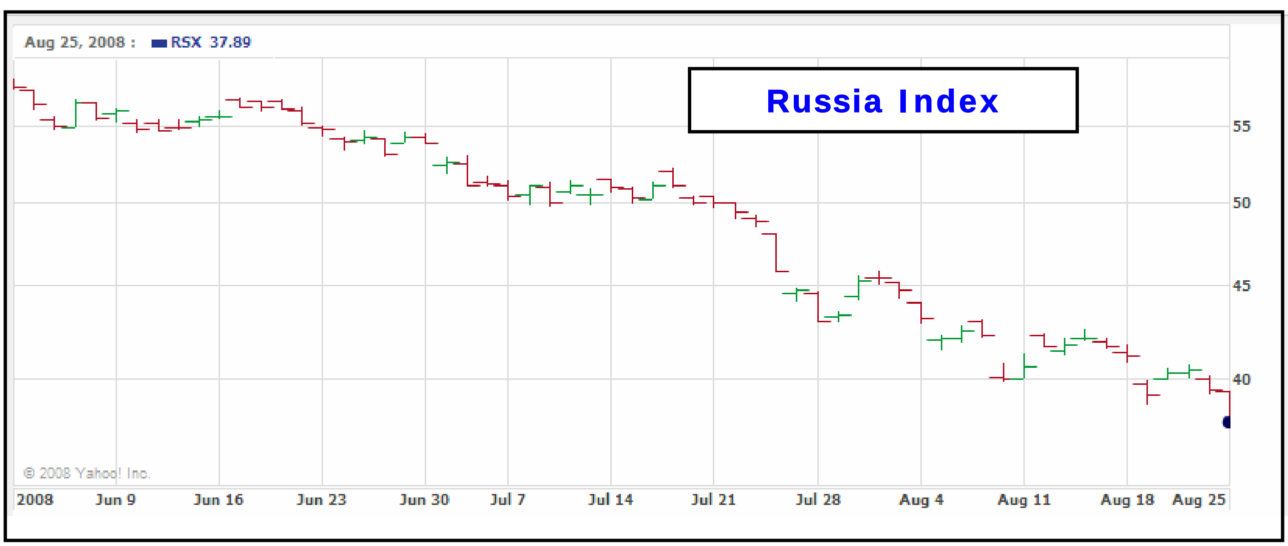
Aug 25, 2008 : RSX 37.89
Russia Index
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40
© 2008 Yahoo! Inc.
2008
Jun 9
Jun 16
Jun 23
Jun 30
Jul 7
Jul 14
Jul 21
Jul 28
Aug 4
Aug 11
Aug 18
Aug 25

Global Markets Offer More Profit Opportunities

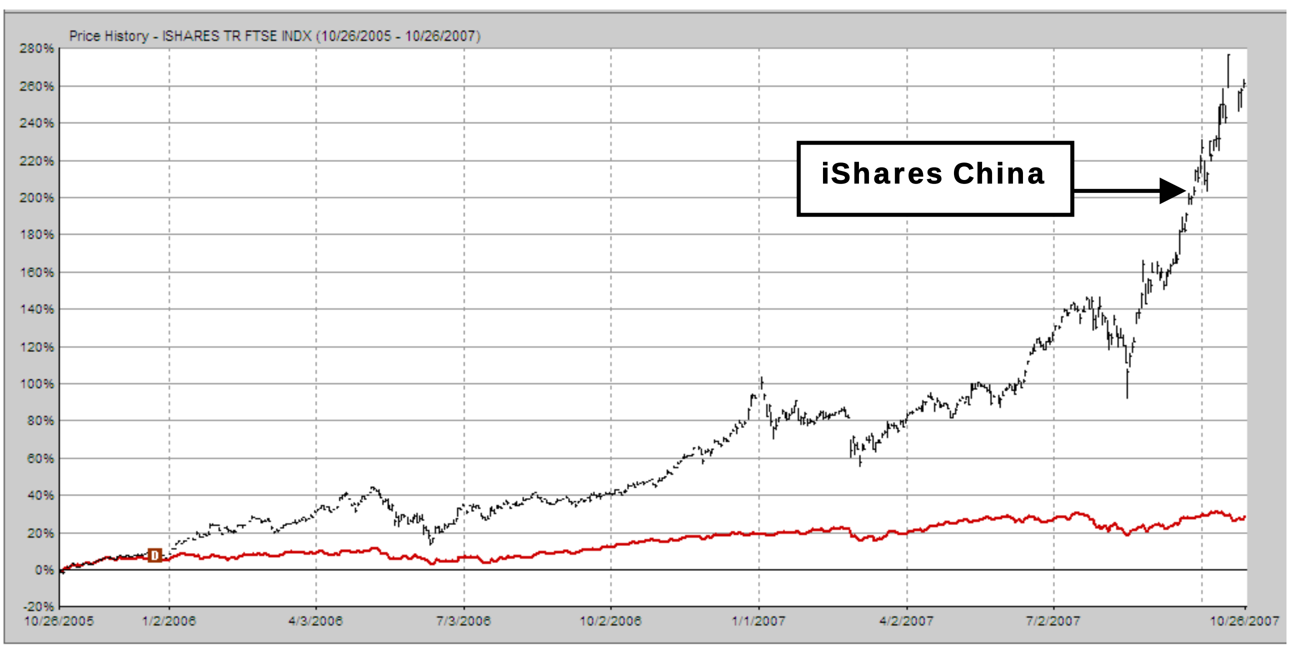
ETFs allow you to trade global markets with the best profit opportunities. Many global equity, currency and commodity markets offer much better returns than the US stock market. Many global economies are growing at a much faster rate than the U.S. economy and as a result global corporate profits are also growing at a faster rate. The infrastructure build-out in developing countries is leading to strong demand for energy, basic materials, bank financing and wireless communications resulting in record corporate profits and price gains for many global stocks. The table below compares the return for the U.S. broad based S&P 500 Index to returns for a sampling of global stock markets over the two year period from 10/26/05 through 10/26/07.

2-Year Return Comparisons Global Stock Markets Versus S&P 500 Index 10/26/05 – 10/26/07

S&P 500 Index	**29%**
iShares Brazil	**175%**
Emerging Markets	**114%**
iShares China	**268%**
iShares Singapore	**111%**

The price chart below compares the price movement for the iShares China Fund to the S&P 500 Index over the same two year period from October 2005 through October 2007. The iShares China Fund out performed the S&P 500 Index by more than a 9 to 1 margin (chart courtesy of MSN.com).

2-Year Price Chart iShares China versus S&P 500 Index



ETF Option Produces 130% Return Over 6 Week Period

My brokerage account Profit/Loss Report below shows a $23,502.75 profit which translates to a 130% return for the Emerging Market ETF option over a 6 week period. The *GPS Option Strategies* I used to take this trade will be covered in Chapter 5.

Account Reports: Profit/Loss Report PRINT

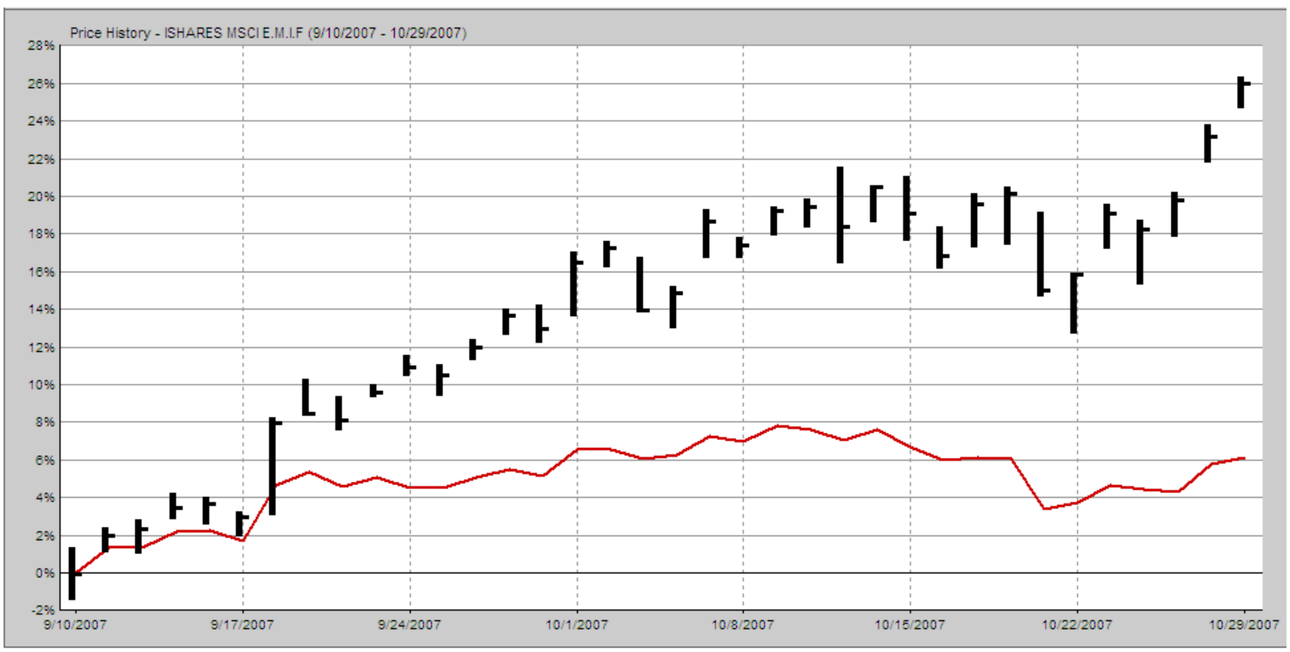
Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.

Unrealized P&L on Open Positions

Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+EEMAD	Ishares Tr Msci Emerg Mkt Jan 2008 120.00 Call	9	$20.0858	$18,077.25	$41,580.00	Stock Option	$23,502.75

The price graph that follows compares the price action of the Emerging Market ETF to the S&P 500 Index over the 6 week holding period for my option trade. The Emerging Market ETF allowed me to trade a global market with better profit opportunities than the US markets (chart courtesy of MSN.com).

Emerging Market ETF versus the S&P 500 Index over 6 Week Period



Diverse Asset Allocation

ETF trading allows you to diversify your investments across a wide range of global asset classes including fixed income, foreign currencies, energy, precious metals, commodities and foreign equities. The non-correlation of investment returns between these various asset classes allows you to reduce portfolio risk and smooth out your investment returns. When you invest in non-correlated asset classes, a loss in one asset class will normally be off set by a profit in a different asset class which reduces portfolio risk.

Asset allocation should be the foundation of every sound investment portfolio. It is a long term plan strategically designed to profit during any type of market. With ETFs not only can you diversify across asset classes but you can take short positions as well. There is always a bear market somewhere! This greatly increases the benefits of asset allocation.

According to the *Financial Analysts Journal*, asset allocation accounts for 90% of the total return of a diversified investment portfolio over the long term. This finding is based on two sophisticated studies of the long-term performance of pension funds. The studies found that which stock or bond you pick isn't so important. What matters over the long run is how you mix your assets among stocks, bonds, and commodities.

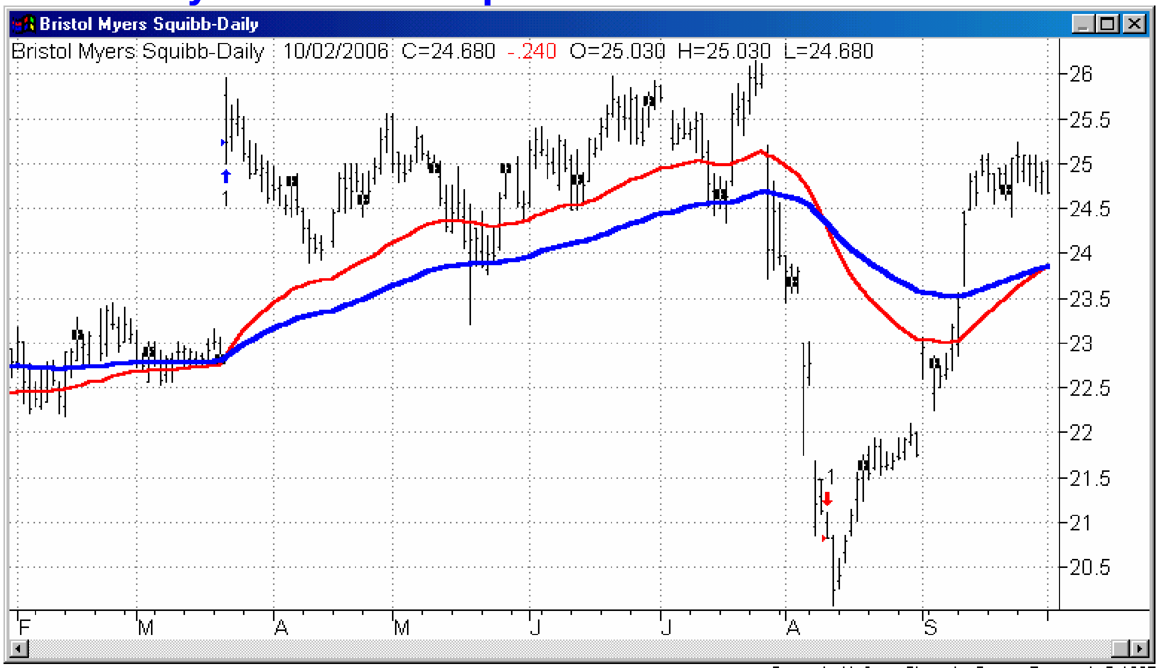
Trading from Long or Short Side with Limited Risk

One of the great advantages of ETF trading is that it allows you to take both long and short positions with limited risk. Unlike short selling, there are short or inverse ETFs that allow you to short a market sector without actual short selling. Short selling is high risk and can result in margin calls if your short stock increases in price. You are also responsible for paying dividends when you are short a stock. Short or inverse ETFs are limited risk trades and you can’t lose more money than you invest. This is a very important distinction especially with the current volatile markets. If you are a short seller, an adverse market move can wipe out your trading account and result in margin calls requiring you to wire money to you broker to cover losses.

Reducing Market Risk

ETFs consist of baskets of stocks that track a market sector. Owning an ETF instead of individual stocks can reduce risk. Individual stocks are always susceptible to market risk with unfavorable news or earnings reports that are stock specific. For example, the drug company Bristol Myers recently reported disappointing earnings and the stock was pummeled losing 23% of its value over a short period of time. Bristol Myers is part of the Pharmaceuticals HLDRS ETF and you can see from the price graphs that follow that over the same period of time the drop in Bristol Myers stock had little effect on the Pharmaceuticals HLDRS ETF which went on to make new high prices. This is a good example of how an ETF was much less susceptible to the market risk associated with owning individual stocks.

Bristol Myers Price Graph



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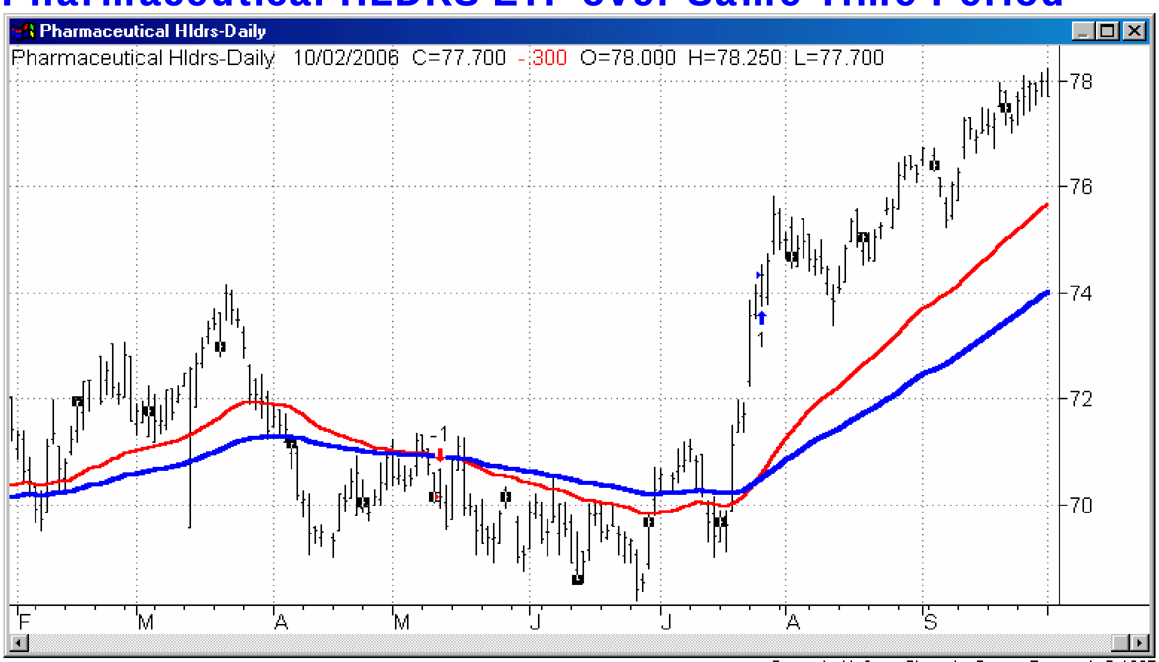
Pharmaceutical HLDRS ETF over Same Time Period



Created with SuperCharts by Omega Research © 1997

All GPS Trades are Limited Risk Trades

The *GPS Trading Program* utilizes the *Major Trend Strategy* and *Short Term Trend Strategy* to identify buy and sell signals in the global currency, commodity and equity markets. Four types of trades are used:

1) **Purchasing Long and Short ETFs**

2) **Purchasing ETF Call and Put Options**

3) **ETF Buy Writes**

4) **ETF Bullish and Bearish Option Spreads**

All of the *GPS* strategies utilize limited risk trades. With limited risk trades the most you can lose is your initial investment regardless of adverse market moves. Limited risk trading is absolutely essential when trading volatile markets. You won't receive a 'margin call' from your broker or be asked to add funds to your brokerage account to avoid the forced liquidation of your positions.

High Risk Investments

The investments listed in the table below are what I categorize as 'high risk' investments because you can lose more than your initial investment. An adverse market move could wipe out your initial investment and could trigger a margin call that would require you to add funds to your account. You would be legally liable to pay back any and all losses that are sustained in your brokerage account. It only takes one unexpected overnight world event to wipe out a highly leveraged trading account.

High Risk Investments

Investment
Futures Trading
Forex Trading
Shorting Stocks
Buying Stocks on Margin
Selling Uncovered or 'Naked' Options
Put Selling

Futures trading usually involves 10 to 1 or 20 to 1 leverage. Forex trading can involve 100 to 1 or even 200 to 1 leverage. It doesn't take much of an adverse market move for you to lose all of the cash in your account and worse yet owe your broker money in a margin call. You may think the odds are low that this could happen to you but as we used to say in the Air Force "Sierra Hotel"! It can happen. It only has to happen once and you are out of the game.

The # 1 Rule of Trading

Never Put Yourself in a Position to Lose More Money than You Invest

Lehman Brothers, Bear Sterns and AIG did not go bankrupt because there was a 5% default rate in mortgages. A 5% default rate could easily be absorbed with 1 to 1 leverage. They went bankrupt because they were highly leveraged and risked more money than they invested. The world financial system collapsed because the # 1 Rule of Trading was violated. Limited risk trading is essential for your trading success.

After taking a good look at ETFs, one would be foolish not to place them in their investment portfolio. ETFs give you the power to invest in markets that have the greatest profit potential and the ability to diversify your investments across a wide range of asset classes. They provide you with the opportunity to trade from the long and short side while reducing the market risks of owning individual stocks. There is a lot to like! By utilizing the *GPS* your trades are now limited risk. *GPS* will guide you to safety and security while ensuring you the best profit potential. In a tumultuous market, limiting risk and safety is the name of the game!

“The Gods cannot help those who do not seize opportunities”

Chinese proverb