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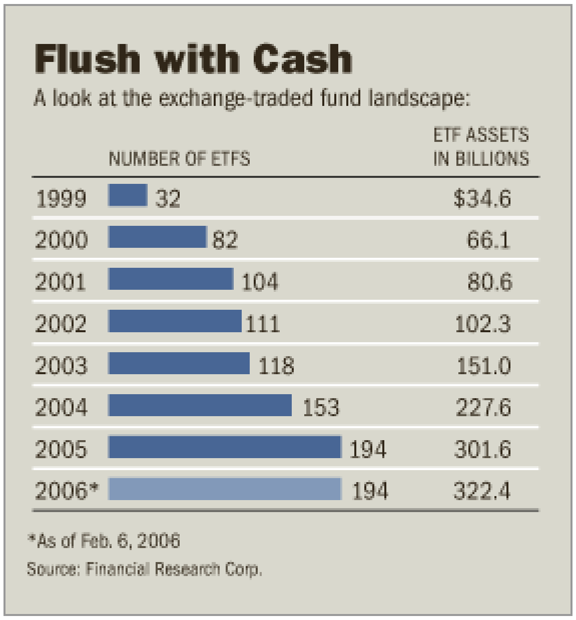
FUND TRACK



Too Narrow? 'Sector' ETFs Draw Investors

By DIYA GULLAPALLI
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New exchange-traded funds are diving into increasingly narrow investments -- ranging from medical devices to semiconductors to water treatment -- raising concerns that the funds are drifting too far from their roots.

For individual investors, the main selling point for ETFs, which resemble mutual funds but trade on an exchange like stocks, has been that they provide wide exposure to the market at lower costs than a similar mutual fund. Typically, ETFs have tracked a broad-based market index such as the Standard & Poor's 500-stock index.

Now ETF companies are taking advantage of the investments' popularity to roll out more narrowly focused offerings. Last month Boston-based **State Street Global Advisors** launched ETFs that focus on home builders and biotechnology. **Barclays** PLC's Barclays Global Investors, of San Francisco, is planning to launch an ETF that tracks silver (see article above) and has filed with regulators to release ETFs for brokerage firms and regional banks in coming months.

PowerShares Capital Management LLC, a Wheaton, Ill., issuer of ETFs, has launched funds focusing on genome research, nanotechnology, and microcap, that is, very tiny, stocks. It's also seeking regulatory approval on an Internet ETF and Brand Name ETF, which focuses on consumer-product companies like **Procter & Gamble** Co. and **Coca-Cola** Co.

More than 50 ETFs have been launched in just the past year. Currently there is $322 billion invested in ETFs, a number that is expected to jump to $1 trillion by 2010, according to Financial Research Corp., a Boston data firm. This compares with $9 trillion or so in mutual funds, but ETF assets are now about four times what they were in 2001.

"Sector" ETFs such as these are particularly hot. Last month, they had the largest increase in assets, and account for 11% of total ETF assets, says State Street's February research. Since launching in late 2004, State Street's streetTracks Gold Shares ETF has pulled in more than $6 billion.

For the average investor, specialized ETFs can make more sense than buying individual stocks in hot areas like gold or renewable energy because they offer exposure to a basket of companies. Still, they are most attractive when investors have at least a few thousand dollars to put in and are willing to hold the funds for a few years.

"When you look at $6 billion going into a gold fund, it reminds you of the mutual-fund world celebrating the launch of an Internet fund in the late '90s," says Don Phillips, managing director of **Morningstar** Inc., a fund-research company.

Since the burst of the dot-com stock bubble, traditional mutual-fund companies have been moving away from niche products and instead marketing packages of funds that diversify risk. "ETFs are going in the exact opposite direction," Mr. Phillips says.

Morningstar also says some issuers are chasing a fad. In a book this year called "Morningstar ETFs 100," it singled out PowerShares, saying the company has shown a "worrisome habit" of "launching trendy funds and chasing hot money."

PowerShares says its ETFs offer cost-effective exposure to stocks that might otherwise be tough to invest in, and points to a February Citigroup Inc. report noting that PowerShares' international-dividend and clean-energy ETFs were top performers recently. "We really don't agree" with Morningstar's characterization, says PowerShares President Bruce Bond. "Our ETFs offer pure and precise exposure" to investors who "don't just want blunt tools."

Some financial planners say they generally leave the narrowest ETFs to bigger institutional investors. "I stay away from those," says **Michael Black**, **CFP, CDFA**, a planner in Scottsdale, Ariz., whose firm has about 250 clients with $500,000 portfolios on average.

Some issuers concede the trend could be going too far. "I do wonder sometimes if we're getting too niche on certain things," says Jim Ross, a senior managing director at State Street Global Advisors. State Street's SPDR 500 Trust (which stands for Standard & Poor's Depositary Receipts) has been tracking the S&P 500-stock index since 1993 and is the oldest and biggest ETF.

Investors are "better sticking to broad styles," says Gus Sauter, chief investment officer at Vanguard Group, a mutual-fund company that specializes in index funds. Vanguard itself has some ETFs, which are created as share classes of its broad index funds. "We're probably closer to the end of our ETF development than the beginning," says Mr. Sauter. The firm saw its ETF assets almost double last year to $11.3 billion but launched only three new products, all internationally focused.

More are expected to hit the market. Rydex Investments, of Rockville, Md., has currency ETFs in the works and just released half a dozen ETFs that dice up S&P indexes. Most of New York-based WisdomTree Investments Inc.'s 20 or so proposed ETFs focus on dividends.

Barclays has several country ETFs, including a South Africa fund that was based on requests from a big university client interested in investing in mining companies, and has plans to launch more this year. "We're hearing requests for Eastern European and India ETFs," and are looking into those, says Valerie Corradini, a senior strategist for the iShares group at Barclays.