



# These ETFs are not for the faint of heart

Exchange-traded funds based on a single country can be very volatile -- but can also be very rewarding, **ROB CARRICK** writes

**W**orldly investors, meet the raciest way yet to global exposure to your portfolio.

Forget gold, oil, metals, technology and all the other stuff you think of when it comes to top-performing sector investments. Exchange-traded funds that focus on the stock markets of individual countries are way hotter.

The iShares FTSE/Xinhua China 25 Index Fund was up 68.5 per cent for the year through Dec. 20, while iShares MSCI Spain and Mexico funds made 48 and 38.5 per cent, respectively. The Mexico ETF's three-year cumulative gain is 197.7 per cent, which compares with the 175.6 per cent returned by the second-place MSCI Brazil Index Fund.

There are more than 20 single-country ETFs listed on the New York and American stock exchanges and they're easily accessible through any discount or full-service broker. Amazingly profitable and hellaciously risky -- that's single-country ETFs. You probably shouldn't touch them in your portfolio unless, well, let's just say you need to be savvy enough to recognize the nitroglycerin-like qualities of these investments.

Single-country ETFs track national stock indexes as constructed by Morgan Stanley Capital International, a leader in constructing global indexes. Just to give you a flavour of how these indexes work, the top holdings of MSCI's Canadian index include Royal Bank of Canada, Manulife Financial Corp., EnCana Corp., Barrick Gold Corp. and Canadian National Railway Co.

Investors have made piles of money in single-country ETFs over the past five years, but some experts don't like them a bit.

"I'm just not a fan of the single-country ETFs, pretty much across the board," said Sonya Morris, an analyst with the investment research firm Morningstar Inc. in Chicago. "I think most long-term investors can do without them."

One problem that Ms. Morris has is the difficulty of examining the economic and political factors at work in individual countries and trying to use this data to pick winning funds on a consistent basis. She also warned about how dangerously concentrated the individual stock holdings can be in some of these ETFs.

Consider the iShares MSCI Belgium Index Fund, which has risen about 33 per cent this year. Ms. Morris said the top three holdings in the fund account for almost 50 per cent of its assets, and that each of the three stocks is in banking or insurance. The iShares MSCI Singapore Index Fund has close to half of its assets in its top four stocks, three of which are financials.

ETFs with highly concentrated holdings can be volatile, or in other words prone to big swings. We've seen that on the upside in recent years, but single-country ETFs can fall hard as well. While the iShares MSCI Mexico Fund is up solidly this year, it plunged 28 per cent in the late spring amid a broad pullback in the stock markets of emerging economies.

Asian single-country ETFs have been ferociously volatile in the past, notably during the difficulties those economies experienced in the late 1990s. The aforementioned Singapore ETF fell about 75 per cent from February, 1997, to September, 1998 -- from \$12.50 (U.S.) to \$3.50. The fund then rallied back to \$9 before plunging anew at the start of this decade to the \$3.80 range. Just this week, investors were reminded of this volatility in Asian markets when the Thai stock market plunged 15 per cent Tuesday and then quickly made back much of this loss the next day.

The appeal of exchange-traded funds as an investment class is that they allow individuals to buy the returns of dozens of different single-country, regional and international stock indexes in a single package that costs much less to own than traditional mutual funds. ETFs focusing on individual European and Asian countries are among the most expensive in the ETF universe, however.

While you can get ETF exposure to the U.S. market with a management expense ratio as low as 0.07 per cent, non-North American single-country funds cost 0.59 per cent for developed markets and 0.74 per cent for emerging markets.

A more obscure cost associated with single-country ETFs is the spread between the bid price, which is what investors are offering for a particular stock, and the ask price, which is what investors will accept. A bid-ask spread of more than a few cents suggests a thinly traded stock that will cost you a premium over the current market price to buy, and that may have to be sold at below the market price.

"When single-country ETFs first came out several years ago, I think they were very poor products," said Marvin Appel, a Great Neck, N.Y.-based money manager and author of



the new book *Investing with Exchange-Traded Funds Made Easy* (FT Press; \$29.99 Canadian). "There was low volume and the bid-ask spreads were very wide. I wouldn't have recommended them under any circumstances. Now, they've become much easier to trade for individual investors."

Mr. Appel cited the iShares MSCI Brazil Index Fund as an example -- it had a bid-ask spread of 2 cents (U.S.) at one point this week, which he described as being fine for an individual investor. At the other extreme was the iShares MSCI France Index Fund, which traded with a hefty spread of 18 cents. The market price at the time was \$34.40, the bid price was \$34.28 and the ask price was \$34.46.

Another reason for caution with single-country ETFs is the very fact that they have delivered such astronomical returns in the past several years. You need a very strong rationale for buying an asset that has appreciated a total 396.6 per cent over the past five years, as the iShares Austria Index Fund has.

It's in this context that the iShares MSCI Japan Index Fund looks so interesting right now. This fund is far and away the laggard among single-country ETFs this year with a gain of just 3.6 per cent, and its three-year cumulative return is among the weakest of its single-country peers at 52.7 per cent. Mr. Appel said he likes the Japan fund, and so did Wilf Hahn of Victoria-based Hahn Investment Stewards, which builds ETF-based portfolios for clients. Mr. Hahn questioned the value of many single-country ETFs because their returns can closely resemble the performance of more diversified -- and thus less risky -- regional funds. However, he sees value in the Japan and China ETFs because they appear to be less correlated to other indexes. "Japan is one example of an ETF that can make a lot of sense in a diversified portfolio," Mr. Hahn said.

The way to use single-country ETFs in your portfolio is through a "core and satellite," where you start with a diversified global equity fund or ETF and then add additional exposure to another country or two. Before picking a single country, make sure your diversified global fund doesn't already have a big weighting in it.

The MSCI Europe Australasia Far East (EAFE) Index, which you can invest in through ETFs listed on both the Toronto and New York stock exchanges, has a weighting in Japan of about 25 per cent and a 5-per-cent helping of Australian stocks. You'd want to be careful in adding additional Japan exposure, but it might in theory make sense to add some Australian exposure.

Whichever country you invest in directly through ETFs, buy only a little. Single-country ETFs are comparatively expensive to own, they're sometimes illiquid and they're

subject to political and economic forces you may only think you understand. On top of that, these ETFs are coming off years of stunning gains. The smart money will be looking to buy after the inevitable pullback comes.

**The country club**

You can invest in the stock markets of more than 20 individual countries through exchange-traded funds listed on the New York and American stock exchanges. Here's an inventory of these ETFs, along with details on the huge returns almost all of them have generated in the past few years.

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Company	Symbol	Latest price (\$U.S.)	Dividend Yield	Year-to-date	3-years	5-years
iShares FTSE/China 25	FXI-N	\$103.85	0.00%	68.50%	-	-
iShares MSCI Spain	EWP-N	53.5	0.7	48.1	97.40%	163.10%
iShares MSCI Sweden	EWD-N	31.79	1.1	40	110.1	145.1
iShares MSCI Mexico	EWV-N	49.47	0.9	38.5	197.7	228.3
iShares MSCI Brazil	EWZ-N	45.26	1.9	35.8	175.6	270.3
iShares MSCI Singapore	EWS-N	10.9	2.8	38	84.4	120.2
iShares MSCI Austria	EWO-N	36.4	0.8	31.9	175.5	396.6
iShares MSCI Germany	EWG-N	26.75	1.9	31.7	69.3	85.1
iShares MSCI Belgium	EWK-N	25.53	1.7	32.9	90.4	142.7
iShares MSCI France	EWQ-N	33.8	1.4	30.1	69.6	84.8
iShares MSCI Switzerland	EWL-N	24.74	0.8	28.1	70.9	100
iShares MSCI Italy	EWI-N	32.86	2	28.5	61.1	107.7
iShares MSCI Malaysia	EWM-N	8.93	2.2	31.1	41.9	82.4
iShares MSCI Netherland	EWN-N	26.11	1.7	28.5	62.9	58.6
iShares MSCI Australia	EWA-N	23.22	4.6	23.7	76.6	152.7
iShares MSCI Britain	EWU-N	23.25	3.4	25.1	49.4	60.7
iShares MSCI Hong Kong	EWH-N	15.67	2	24.2	58.6	71.3
iShares MSCI Canada	EWK-N	25.33	0.6	16.1	83.7	132.2
iShares MSCI Taiwan	EWT-N	14.21	2.1	13.9	29.1	39.3
iShares MSCI South Africa	EZA-AMEX	112.78	2.2	14.5	106.2	-
iShares MSCI South Korea	EWY-N	49.73	0.7	11.1	101.7	202.1
iShares MSCI Japan	EWJ-N	14.01	0.7	3.6	52.7	79.3