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Get up to **35** free trades
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By John Spence

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BOSTON (MarketWatch) -- Almost every major stock index is locked up by an exchange-traded fund, spurring ETF providers to develop new areas such as funds tied to dividend-paying stocks and international growth, value and small-cap stocks, as well as U.S. microcap companies.

Also on tap: funds based on commodities and alternative investments such as oil, silver and world currencies.

As ETF managers explore initiatives for the second half of the year and beyond, they're hoping these new funds will deepen relationships with financial advisers, who are increasingly using low-cost ETFs to enhance portfolio returns.

"Advisers are talking a lot about alternative asset classes, so that's where ETFs seem to be headed," said Dan Culloton, a fund analyst at investment research firm Morningstar Inc.

The largest firms in the ETF business say there's room to expand into

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such nontraditional asset classes.

"We've heard demand for growth- and value splits of the iShares MSCI EAFE ([EFA](#)) [a broad international stock ETF], and also foreign small-caps," said Valerie Corradini, senior strategist at Barclays Global Investors.

The San Francisco-based unit of British banking giant Barclays Plc ([BCS](#)) is also contemplating forays into high yield- and municipal-bond ETFs. But Corradini noted the more thinly-traded sectors of the bond market present operational and regulatory hurdles.

Trading in new places

Hedge funds are also another area of great interest, but hardly a slam dunk. "It's challenging to come up with a broad index for hedge funds because the space is so big and the strategies are so varied, and there are also transparency issues," Corradini said.

ETF managers are also pursuing U.S. microcap stocks because of their diversification benefits, since they tend not to move in tandem with the broad U.S. market.

Barclays has filed an initial registration statement for a fund tracking the new Russell Microcap Index, and Dow Jones & Co. recently unveiled a microcap benchmark that has been licensed by First Trust Advisors as the basis of a future ETF. (Dow Jones is the parent company of MarketWatch, the publisher of this report.)

Other notable recent filings include products that, if approved, would invest in crude oil, silver and foreign currencies.

Rydex Investments has filed for a currency ETF that would track the price of the euro by holding euros in a bank.

Another money manager, Standard Asset Management, proposed an exchange-traded fund that would track the price of crude oil. The fund, the first of its kind, would invest in light sweet crude futures contracts traded on the New York Mercantile Exchange, as well as other derivatives.

Plus, Barclays Global Investors hopes to launch the first ETF to track the price of silver bullion. The fund appears similar to existing ETFs tied to the price of gold.

Power play

The quarter was busy for Wheaton, Ill.-based PowerShares Capital Management. The firm is seeking to break from the pack with ETFs that track sophisticated indexes designed to beat the market rather than mimic it.

In early March the company rolled out six "style box" funds investing in broad slices of the U.S. market, such as large capitalization growth stocks, as well as one tracking "green" energy companies: PowerShares WilderHill Clean Energy Portfolio ([PBW](#)).

PowerShares also recently introduced eight sector ETFs that utilize an

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Stock Symbol	Prev. Cls.	Price Chg.	Vol. Chg.	Research Rating	Market Value
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SIRI	\$7.92	+2.17	+405		\$1.2B
ZLD	\$6.81	+0.57	+372		\$0.5B
GIGI	\$7.92	+2.17	+405		\$0.5B

Investor Education



"enhanced indexing" strategy.

The firm has several other industry-specific funds set to launch, as well as three dividend-oriented ETFs -- one focused on non-U.S. stocks. PowerShares is also exploring the microcap space.

"We're looking at areas of the market with low correlation with U.S. stocks, but still with good relative returns," said Bruce Bond, president of PowerShares.

However, he noted the firm is in no rush to get products to market first, and that he wants to make sure new offerings bring value.

"ETFs are not appropriate for everything under the sun," Bond said.

Like its competitors, PowerShares wants attention from financial advisers. But Bond says his firm faces extra hurdles because the complex strategies behind the ETFs can be hard to explain.

PowerShares recently crossed the \$1 billion threshold for assets under management. Still, the firm is small compared to behemoths like Barclays, State Street Global Advisors and the Vanguard Group.

"We're building a foundation," Bond said, "but it's not quite time to hang the chandeliers."

State Street's spider web

During the second quarter, ETFs saw robust inflows compared to traditional mutual funds. Barclays manages four of the quarter's five top-performing ETFs, including funds tracking Latin America, Mexico, and U.S. real estate. Meanwhile, State Street Global Advisors' sector funds were the recipients of large amounts of cash.

The Select Sector SPDRs or "Spiders," which carve up the Standard & Poor's 500 Index (\$SPX) by industry, have seen assets under management increase by 28% to about \$12 billion over the past six months, said Dan Dolan, director of wealth management strategies at the Select Sector SPDR Trust.

The Select Sector Energy SPDR ([XLE](#)) in particular has benefited from investors trying to cash in on higher oil prices. The ETF garnered roughly \$800 million in new assets during the second quarter, according to TrimTabs Investment Research. The energy fund rose 6.1% in the second quarter and 23.2% for the first half of the year.

Priced lower than competing sector ETFs at 0.25% of assets, the Select Sector SPDR family is the clear leader in both assets and trading volume.

"They're cheaper, and investors can take a long-term position on a sector without exposing themselves to single-stock risk," said Greg Ehret, co-head of adviser strategies at State Street Global Advisors.

State Street plans to expand its ETF lineup with funds tracking fixed-income and international stocks, and the firm is exploring dividend indexes and broad-based commodities products, he added.

The company is also reaching out to financial advisers, Ehret said, "to

show intermediaries that ETFs don't have to part of a pure index approach -- they can be used in conjunction with active strategies."

Top five ETFs in the second quarter

ETF (ticker)	2Q return
iShares S&P Latin America 40 Index	17.4%
iShares Cohen & Steers Realty Majors	15.3%
StreetTracks Wilshire REIT Fund	14.6%
iShares Dow Jones US Real Estate	14.1%
iShares MSCI Mexico (Free) Index	13.2%

Source: Morningstar Inc. (Data through 6/30/05)

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Waiting for the Fog to Lift By Fisher Investments

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