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Exchange-traded funds already were thriving when the recent burst of volatility enhanced their popularity. Four veterans discuss their strategies.

A Trading Play Whose Time *Really* Has Arrived

By Mike Hogan

The following has been excerpted.

ON SEPT. 29, AS THE PINBALL-LIKE DOW bounced around by hundreds of points before that day's game ended down 777.68, traders sought shelter in exchange-traded funds. ETF volume accounted for 36% of all equity trades, according to Barclay's Global Investors.

"A lot of people talk about them as a retirement-diversification tool, but ETFs have become the go-to product for traders who need to move in and out of the market quickly," says Matt Hougan, editor of ETF news site IndexUniverse (www.indexuniverse.com [http://www.indexuniverse.com]).

"They really have become an essential piece of the puzzle for traders on Wall Street," he adds.

Hedge-fund managers, swing traders who make short-term momentum bets and other sophisticated investors are using ETFs for pair trades, leveraged short bets like **UltraShort QQQ ProShares** (ticker: QID), and other creative risk-management tactics, notes Scott Burns, director of ETF analysis for Morningstar (www.morningstar.com [http://www.morningstar.com]).

Broad-market ETFs like the **SPDR S&P 500** (SPY) are liquid enough to be bought and sold in large lots without affecting spreads. And among the 800 ETFs now available are those that offer access to sometimes hard-to-reach markets such as currencies, commodities and offshore securities. "Before ETFs, if you wanted oil, you had to buy large commodity contracts and understand [futures' price patterns, such as] contango and backwardation," notes Burns. Likewise, ETFs spread risk and accelerate trading.

Dave Moser for *Barron's*

Clark Capital's Clark: "All the bad financial news is not out yet," but "the market is still hanging in there. We believe the market is bottoming."

A basket of, say, Irish securities can be bought via the **New Ireland Fund** (IRL) in a morning trade and sold in the afternoon—with a commission each way.

Other ETFs provide early entree into emerging areas like wind power or carbon credits, adds Hougan. These might include the **First Trust ISE Global Wind Energy Index** Fund (FAN) or the **iPath Global Carbon ETN** (GRN).

Barron's recently chatted with several established hands in the marketplace, which is on track to double in trading volume this year, according to Hougan. Here's what they've been doing, and what they plan to do.

Sean Clark
Chief Investment Officer
Clark Capital Management Group

This is an extremely tough market to navigate, but Clark Capital is in it—rain or shine—and even sees a few buying opportunities.

"We're overweight health care," Sean

(over please)

Clark says. His firm has been using the **Health Care Select Sector SPDR** (XLV), *iShares Dow Jones U.S. Medical Devices* (IHI) and **iShares Dow Jones U.S. Healthcare Provider**. Clark is also long retail, via the **SPDR S&P Retail** (XRT).

Average cash in the company's 60-plus portfolios, usually around 5%, is up to about 15%—still very low for most ETF specialists in these trying times.

Clark Capital's clients—wealthy investors and broker-dealers—expect the firm to make money in good times and bad. That's quite a challenge in a year when everything that was working—energy, international markets, materials and other resource-based investments—suddenly reversed in mid-July without clear long or short choices into which to rotate.

Then came September.

"Where else but the market are you going to find alpha?" asks Clark.

Clark Capital has logged an annual 8.64% return over the last three years through September 23, beating the Standard & Poor's 500's 4.4% annualized gain in that time. The firm addresses volatility by using mostly ETFs of noncorrelated assets for the core of its portfolios managed to match the beta, or market risk, of their segments. Clark lost 16.15% this year through September 23, while the S&P 500 fell 17.8% in that time span.

And Clark uses ETFs exclusively to build what he calls the "explore" portion of its portfolios—those intended to generate alpha, or market-beating returns. "We blend U.S. stocks, fixed-income securities and internationals with alternatives like real estate, commodities, currencies, hedge funds and funds-of-funds," explains the 38-year-old son of Harry Clark, founder and president of the family-run Philadelphia firm.

Their initial screen of investment prospects is based on relative-strength measures that vary by asset type. Clark Capital's complex models focus on proper asset allocation; positions are typically held for one to three months—and longer in bull markets.

Since July, the firm's models have been pointing toward U.S. issues, particularly small-caps.

Clark also anticipates an upswing in cyclicals. Besides retail, it's long **Consumer Discretionary SPDR** (XLY) and transports via **iShares Dow Jones Transportation Average** (IYT), which is heavy on rails and shippers and light on airlines.

It's getting exposure to homebuilders and insurance through **SPDR S&P Homebuilders** (XHB) and **SPDR KBW Insurance ETF** (KIE). And it is long the **SPDR KBW Regional Banking ETF** (KRE), while avoiding the **Financial Select Sector SPDR** (XLF), which is dominated by big banks with exposure to mortgage-backed securities.

Clark also is dipping into REITs through **iShares Cohen & Steers Realty Majors** (ICF) and **SPDR Dow Jones Wilshire REIT ETF** (RWR).

Clark, a chartered financial analyst with a degree in economics and an MBA from the University of Delaware, sees positive signs to power the market's eventual recovery—record amounts of cash in money-market funds coupled with negative investor and consumer confidence indexes that could reverse as gross domestic product, corporate earnings and the U.S. dollar gain.

Observes Clark: "For all the negative news—and even though all the bad financial news is not out yet, the market is still hanging in there and could trade higher. We believe the market is bottoming."

The Longs and the Shorts of It

Below is a sampling of some of the exchange-traded funds that these specialists have been using. It should be noted that all have been heavily in cash equivalents of late.

Sean Clark

Company	Ticker
Health Care Select Sector SPDR	XLV
iShares Dow Jones US Medical Devices	IHI
iShares Dow Jones US Healthcare Provider	IHF
SPDR S&P Retail	XRT
Consumer Discretionary SPDR	XLY
iShares Dow Jones Transportation Average	IYT
SPDR S&P Homebuilders	XHB
SPDR KBW Insurance ETF	KIE
SPDR KBW Regional Banking ETF	KRE
iShares Cohen & Steers Realty Majors	ICF
SPDR Dow Jones Wilshire REIT ETF	RWR