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ETF'S

A TOP TEN ETF LIST YOU CAN USE - by Neal Frankle, CFP®

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When I finally understood what my editor really wanted, I froze. I'd been asked to write an article detailing the top ETFs for 2006, so I did my research and came up with the goods without too much hassle. "That was easy," I thought. But then I sat back and realized what I'd really been asked to do. We all know that the reason many people read top-ten investment lists is to consider investing in those funds. My quick list could then be misunderstood as a set of recommendations. Yikes. Now do you see why I tensed up? A simple review of the best performing funds is not only useless to you, dear reader, but it could actually get you into hot water.

Let me explain.

In any particular year, the best performing ETF stock or fund is likely to be a high-risk proposition. If the investment didn't carry big risks, it wouldn't be able to deliver such amazing results. Unfortunately, some of the people who read these lists end up blindly buying the highest rated fund. They tell themselves, "Wow! This fund made 85% last year! If it only makes half that much this year, I'll be delighted." These people seldom consider the chances they're taking when they make such a choice. As a result, they expose themselves to undue risk and are often sadly disappointed. On the other hand, sophisticated investors don't put a large percentage of their assets in high-risk funds. For those people, a top-ten list of high-risk funds is useless. To avoid making a useless list—or worse yet, a dangerous one—I'm offering you a hybrid: along with the top five funds overall in 2006, I'm providing a list of the top five funds in the moderate-risk level. These funds are consistent with what prudent investors might choose to invest a portion of their portfolio in. This way you can have a better benchmark by which to measure and decide how to invest in 2007. And, at the end of the day, if you still decide to invest in the high-risk funds, you'll at least do so from an informed position.

Overall top funds

It comes as no surprise that international exchange traded funds were the top overall performers in 2006. China's booming economy helped push Chinese ETFs to the top two spots

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ETF's

Avoid blindly following the advice of yet another top-ten list: author and financial advisor Neal Frankle gives prudent investors sound advice on choosing the best performing ETF in both the moderate and high-risk level.

Central Europe

Coffeeheaven has struck gold by creating a specialty coffee/sandwich bar that caters to the tastes of the Central European market. Travel and investment writer, Sven Lorenz, explains why North American investors should take note of this booming European enterprise.

Interview

A no-holds-barred interview with Connie Kuhn, publisher of the KonLin Letter. Discover how this leading market analyst learned the ropes, and see what advice he has to offer investors. Be sure not to miss Kuhn's carefully handpicked, low-priced stock recommendations!

China

Although China's prospects look promising, wise investors want to know whether there's anything they should keep an eye out for. James Oberweis, manager of the Oberweis China Opportunities fund, gives us the scoop on what to expect.

Cover

Based on Select Information Exchange's study of over 300 diverse investment newsletters, in this article we single out which top-performing newsletters can best suit your individual needs.

for the year. iShares FTSE/Xinhua China 25 Index (FXI) and PowerShares Golden Dragon (PGJ) rocketed up 83% and 53% respectively. China needs to build infrastructure, so of course they're lapping up all the construction materials they can. In addition, this infrastructure expansion is fueling a thriving middle-class.

These newly minted consumers have a real yen to purchase items they couldn't afford only a few short years ago. Chinese infrastructure growth creates plentiful jobs. This puts more money in the pockets of the employees and allows Chinese consumers to satisfy their pent-up demands. This translates into greater profits for Chinese companies and higher stock market prices. Turning West, Spain hosts one of the fastest growing economies in Europe. They're experiencing a surge in mergers and acquisitions. They're also experiencing a surge in construction and a boom in real estate. iShares MSCI Spain (EWP) ended the year up 49.2%. With the world's busiest port, Singapore benefits from China and Asia's strength. iShares MSCI Singapore (EWS) is a fair representative of the area, and it ended up 45.8% in 2006, finishing in fourth place. Rounding out the top five for overall performance, iShares Mexico (EWW) joined the list, up 43% for the year. Despite political turmoil, the Mexican economy boomed as a result of exploding trade and huge infrastructure investments.

Moderate risk ETFs

Let's turn our attention to the more diversified moderate-risk funds. To determine the best performers, I excluded sector funds (those investing exclusively in one country or industry). I did this because broadening the investment base inherently reduces risk.

It shouldn't surprise anyone that international funds took the top five spots. What may be surprising is that these funds were Europe-based rather than Asia-based. The weakening dollar versus the Euro helped Euro-denominated funds do very well. Coming in first was iShares MSCI (EZU), which invests in Europe but excludes the United Kingdom (which is not Euro denominated). EZU returned 35.5% in 2006. Next was Vanguard Europe (VGK) with a 33.1% return. iShares S&P Euro 350 (IEV) came in a close third with 32.6%, followed by Dow Jones Euro Stoxx (FEZ) with a 31.5% return. The fifth best performing moderate-risk ETF was iShares MSCI EAFE Value fund (EFV), returning 30.3%. This is a European large-cap value fund.

I want to point out two very important principles that are demonstrated by last year's performance:

First, notice that in the moderate-risk class, the top five had similar returns, while the higher-risk overall top performers had a huge variance between the funds. In the twenty-five years I've been in this business, I've noticed that with the moderate-risk category, it's much more important to be in the right general area of the

market (Europe, in this case) than to pick the exact best fund. A moderate-risk investor can be in the right neighborhood, go to the wrong house, and still be invited in for a spot of tea. As you'll see, if a more aggressive investor is in the right neighborhood, but goes to the wrong house, he or she will likely get mugged.

Second, I think it's also instructive to notice the geographic differences between the top performers in each category. Within the higher-risk group, the funds were mainly Asian or Latin American. Only one fund was from Europe. Yet in the moderate-risk group we only found European funds. The conclusion is that Europe, as a whole, was strong in 2006. Some Asian and Latin American countries were outstanding, while others must have been real dogs. (Had all of Asia or Latin America been strong, we would have seen more broader-based Asian and/or Latin American funds on the moderate list of top performers.) This indicates that when it comes to high-risk investing, you take a very real risk of experiencing big losses if you get it wrong.

Keep in mind that the market did quite well last year —you'd almost have to have been trying to earn less than a double-digit return. But don't let this lull you into a false sense of comfort or make you cavalier about your investment choices. The past really is no guarantee of future results. When you make your investment decisions for 2007, please don't blindly rely on top-ten lists (including this one).

Be clear on what kind of investor you are. If you're only willing to take moderate risks, then stay away from the overall top performers because they expose you to undue risks. For long-term success, it's vitally important to develop tools to help you identify strong and weak markets. For a free white paper on how to do this —how to “take the market's temperature” — e-mail me at neal@wealthresourcesgroup.com

Neal Frankle is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. To receive a free report on how to hire the right financial advisor, contact him by sending an e-mail to: Neal@WealthResourcesGroup.com

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