

A Moneynews and Newsmax Special Report

If You Could Invest in Only One ETF for the Next 12 Months

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If You Could Invest in Only One ETF for the Next 12 Months, a Good Bet Would Be SPDR KBW Bank ETF (KBE)

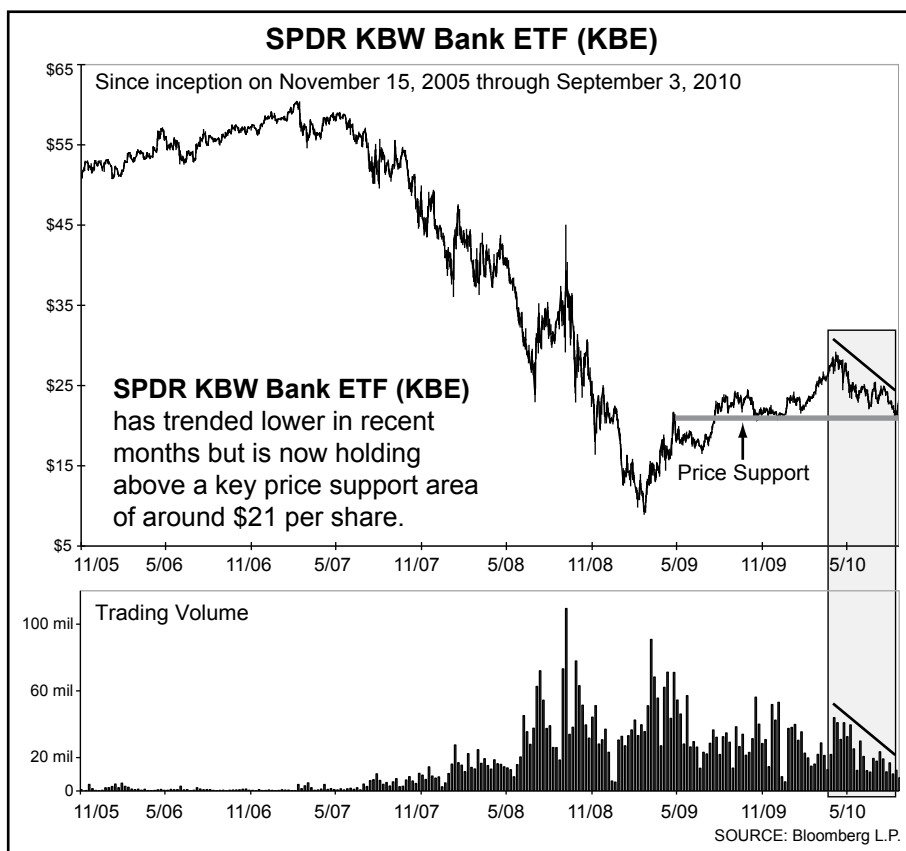
Sept. 3, 2010

The last time that I wrote this type of report — on March 25, 2009 — most of my readers thought that I had lost my mind when I recommended the **iShares FTSE/Xinhua China 25 Index Fund (FXI)**.

That's because at that time countries around the globe were in the midst of the worst economic recession since the 1930s, stock prices had fallen sharply during the previous 15 months, and growth in China had declined to the slowest pace in nearly 10 years.

Yet investors who followed my advice on FXI experienced a 42 percent return on that exchange-traded fund (ETF) during the 12 months following that report. Subscribers to my advisory service, **The ETF Strategist**, realized an even greater return on FXI.

Subscribers who bought that ETF when I recommended it for purchase on Nov. 11, 2008, were able to capture a 75 percent return on FXI between then and the day that I recommended to sell it, Oct. 27, 2009.



I now see a similar opportunity in **SPDR KBW Bank ETF (KBE)**.

Just like in March 2009, many of you probably think that I'm crazy to recommend a commercial bank ETF during this tumultuous period of both economic and political uncertainty. However, my research suggests just the opposite — that now is an ideal time to invest in stocks of large commercial banks.

In this special report, I explain the reasons behind that statement and show you how my research indicates that if you could invest in only one ETF for the next 12 months, KBE should be at the top of your list.

SPDR KBW Bank ETF (KBE) is an exchange-traded fund that holds the stocks of 24 large money center banks and regional banking institutions, including Wells Fargo, SunTrust Banks, and Fifth Third Bancorp. The fund's top three holdings are Citigroup, JPMorgan, and Bank of America. Other holdings include U.S. Bancorp, BB&T Corp., and Northern Trust.

After getting clobbered between June 2007 and in the first two months of 2009, KBE rallied sharply from March 6, 2009 to April 23 of this year, returning a whopping 216 percent during that period. However, KBE pulled back considerably during the past few months, falling from a close of \$28.72 April 23 to an intra-day low of \$21.19 on Aug. 25.

On a positive note, KBE has held up above a key price-support area of around \$21 and the trading volume for this ETF has trended substantially lower since it traded at a current business-cycle high during April.

Meanwhile, fundamental factors that affect the financial condition and operating results of commercial banks improved substantially during the past couple of years and several economic indicators suggest that the recession that began during December 2007 will end by June 2011.

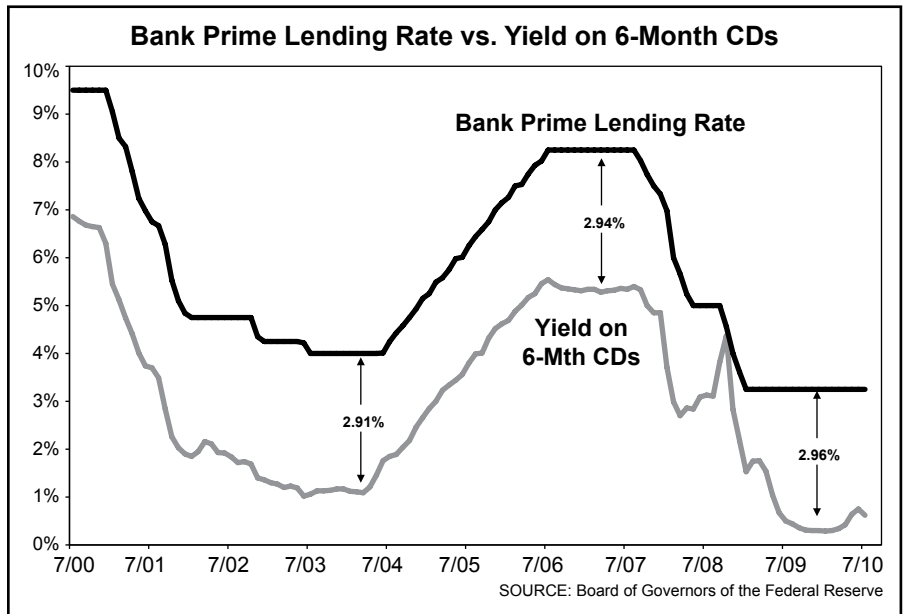
For example, many of our nation's banks have reduced their operating costs substantially, closed or sold unprofitable branch offices, and significantly reduced their debt burdens

since the onset of the financial crisis that began during 2007. During that same period, financially weakened banks that held questionable assets merged with much stronger banks.

In addition, large U.S. banks like the ones held by KBE made substantial improvements to their risk-based capital ratios during the past two years.

For example, this ETF's top 10 holdings had an average risk-based capital ratio of 14.7 percent, ranging from 12.3 percent to 17.5 percent.

That's a very positive factor considering that the Federal Reserve requires U.S. Banks to have a risk-based capital ratio of at least 8 percent.



Favorable Interest Rate Environment And Substantial Amounts of Loanable Funds

In addition to the factors mentioned above, banks are currently operating in a very favorable interest-rate environment, whereby they're charging significantly higher lending rates on the loans that they extend to their customers than the rates that they're paying on their customers' deposits.

Banks currently charge their best business customers a 3.25 percent borrowing rate while paying only a 0.62 percent rate of return to customers that invest in six-months CDs. Although the spread between those rates — the difference between bank lending rates and bank CD rates — is a bit lower than it was a few months ago, that's still near the highest level that it has been during the past several years. (See chart on this page.)

The fact that banks made substantial improvements to their capital base during the past couple of years suggests that banks will begin to take advantage of the large spread between the rates that they charge on their customers' loans and the rates of interest that they pay on their customers' deposits — as soon as they're convinced that the economy will enter a period of sustainable growth.

The fact that banks currently have the largest amount of loanable funds since the creation of the Federal Reserve System in 1913 supports that view. Our nation's banks currently have more than \$1

trillion available for lending.

In comparison, during September 2009 banks had only \$60 billion worth of loanable funds and they had only \$1.8 billion worth of such funds, on average, during the five-year period leading up to that date.

It's true that businesses and individuals alike have been hesitant to take out new loans since the beginning of the current recession. Yet those entities are in much better shape than they've been in many years to borrow money from financial institutions.

For example, household debt as a percentage of household after-tax income is currently at the lowest level since November 1998. Recent household borrowing and spending statistics suggest that household debt as a percentage of household income will continue to decline during the months ahead as Americans use a large portion of their incomes to pay off debt.

U.S. businesses are in a much better position than they were a few years ago to take out new loans, with businesses, in the aggregate, currently having nearly the largest amount of cash and short-term accounts receivable since 2003 to pay their recurring monthly bills.

In addition, businesses also are much more solvent than they were a few years ago. Total liabilities of U.S. businesses fell to just 9.7 percent of their total assets, on average, during the quarter ended June 30 of this year, from 11.4 percent at the end of 2006 and a recent high of 15.1 percent during the second quarter of 1999.

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Indicators Suggest That the U.S. Economy Will Begin A Sustainable Recovery in the Second Half of 2011

Of utmost importance, the readings on several economic indicators suggest that the current recession will end during the second quarter of 2011 and that the U.S. economy will enter a period of sustainable growth during the second half of 2011.

For example, the housing market appears to be bottoming, with the construction of new homes falling during June to the lowest level since at least 1959, when the U.S. Department of Commerce began collecting data on that economic series. Meanwhile, the net worth of American households improved during each of the past five quarters after falling during March 2009 to the lowest level since December 2003.

Separately, recent comments and actions taken by the Federal Reserve indicate that the Fed will increase its efforts to grow the amount of money that circulates in the economy, thus leading both U.S. households and businesses to increase their borrowing and spending.

Finally, the recent slowdown in the so-called economic recovery and the purported “failure” of the American Reinvestment and Recovery Act of 2009 suggests that many of the socialist-leaning members of the U.S. Congress will be kicked out of office during the upcoming November elections, and that the newly elected representatives who replace them will enact more fiscally responsible economic measures.

Although I expect the economy to grow at a slow pace during the next couple of years, the factors and developments mentioned above suggest that the U.S. economy will be much healthier during the next several years than it has been since the 1990s.

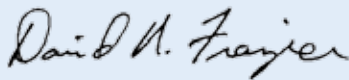
In light of the fact that stock prices tend to bottom approximately six to nine months before overall economic conditions improve, my experience suggests that now is a good time to invest in **SPDR KBW Bank ETF (KBE)**.

KBE's Recent Trading Action Suggests That Now Is An Ideal Time to Buy This ETF

As I mentioned on page two of this report, KBE pulled back considerably during the past few months, but it has held up above a key price-support area of around \$21. Meanwhile, the trading volume for KBE trended substantially lower during the past few months, which suggests that large institutional investors have continued to hold this ETF.

Due to the favorable fundamental developments discussed in this report and the recent trading action in KBE, my experience suggests that now is an ideal time to establish a position in this ETF.

Sincerely,



David N. Frazier, Editor, **The ETF Strategist**