

The Top ETFs Over Three Years: Real Estate Dominates

By Charles Rotblut, CFA

Article Highlights

- ETFs composed of real estate investment trusts had the five highest returns.
- Dividend-focused ETFs led many equity fund categories, as investors searched for yield.
- Weighting strategies vary by fund, with some using alternative strategies such as equal-weighting or dividend-weighting.

Exchange-traded fund (ETF) investors would have done well over the past three years by having a high allocation to real estate.

Five funds that focus on real estate investment trusts (REITs) beat all ETFs in terms of performance for the three-year period ending June 30, 2012. A sixth real estate ETF came in seventh place.

Preventing a clean sweep of the top 10 spots were two health care funds, a retail sector fund and one fund that invests in Thailand. This is not the mixture most investors held in their portfolios.

For the second consecutive year, I asked my colleagues to compile a list of the best-performing exchange-traded funds over the past three years. This list is designed to complement both “The Individual Investor’s Guide to Exchange-Traded Funds 2012” (published in the August 2012 *AALJ Journal*) and my annual article on mutual funds with the best five-year performance (see “The Top Funds Over Five Years: Bond Funds Take the Lead” in the March 2012 *AALJ Journal*). Given the growth of ETFs, I thought there would be continuing interest in an article that looks at the best-performing exchange-traded funds.

Caveats & Notes

Before I delve into the details, there are a few caveats and notes worth pointing out.

A three-year period has been used for ETFs because



many exchange-traded funds still lack five-year histories. This shorter time period prevents a direct, apples-to-apples comparison to the annual listing of the best-performing mutual funds, however. The time periods covered are also six months

off; though seemingly short, it can make a difference in terms of which fund categories are represented in the top-10 lists. Keep in mind that a six-month shift not only picks up six new months of performance, but it also drops six months of activity. (We use this split to keep the top fund data comparable between the ETF guide, which is published in July, and the mutual fund guide, which is published in February.)

The overwhelming majority of exchange-traded funds are passively managed. Though there are some actively managed ETFs, most are designed to track an index (passive management). With a few exceptions, actively managed ETFs have yet to attract significant amounts of investor dollars. As I stated in last month’s *AALJ Journal*, there are only three actively managed ETFs with assets of more than \$1 billion. In contrast, most mutual funds are actively managed, meaning their managers handpick the securities to invest in.

Nonetheless, there are similarities between the two types of investments. Both mutual fund and exchange-traded fund performance is significantly influenced by broad market, asset preference and category-specific trends. In some cases, passive strategies are the best way to take advantage of these trends, favoring ETFs. In other cases, active management is better, favoring mutual funds. Looking at the longer-term performance of both types of investments makes the decision

Table 1. Top ETFs Over Three Years

process easier by dampening the short-term market noise that can distort the numbers.

Always keep in mind that fund analysis involves more than just looking at total return. Performance relative to a fund's peers, the fund's volatility, the composition of the fund, the strategy used, expenses and size are all important factors. Proper diversification is also very important; you need to seek out the fund or security that best fulfills your diversification needs. Furthermore, look at the fund's portfolio, the index it is designed to follow and the weighting strategy used. An ETF's risk cannot be judged by the fund's name alone.

Which Funds Were Included

I largely restricted the list of ETFs to those with three years of annual return data and a minimum of \$200 million in assets. (Exceptions were made when the performance of a smaller fund warranted it.) Funds that use leverage to provide double or triple the return of their underlying index or that follow inverse strategies (they rise in price when the underlying index falls) were excluded from consideration. These funds are designed to be held for short periods of time, not

Index Enhanced ETN	ETF Name (Ticker)	NAV Total Return (%)						12-Month Return (%)	
		YTD	2011	2010	2009	2008	2007	NAV	Market
Overall Three-Year Top Performers									
I	iShares FTSE NAREIT Resid Plus Cp Idx (REZ)	10.6	15.8	31.7	21.2	(25.2)	—	15.7	15.6
I	iShares Cohen & Steers Realty Majors (ICF)	13.8	10.2	29.1	25.3	(40.9)	(18.3)	12.0	11.9
I	SPDR Dow Jones REIT (RWR)	14.7	9.2	27.8	28.6	(38.9)	(17.8)	13.1	13.0
I	Vanguard REIT Index ETF (VNQ)	14.8	8.6	28.5	29.8	(37.0)	(16.4)	13.0	12.9
I	First Trust S&P REIT Idx (FRI)	14.6	7.9	27.8	27.9	(38.9)	—	12.5	12.2
I	PowerShares Dynamic Pharmaceuticals (PJP)	18.3	19.7	27.8	16.9	(10.6)	0.6	24.5	24.6
I	iShares Dow Jones US Real Estate (IYR)	14.7	5.6	26.4	30.2	(40.0)	(18.2)	10.3	10.1
I	SPDR S&P Retail (XRT)	12.9	9.7	37.1	77.6	(38.8)	(16.1)	11.6	11.9
I	iShares MSCI Thailand Invest Mkt Index (THD)	14.7	(4.2)	56.2	83.8	—	—	9.9	11.9
I	First Trust NYSE Arca Biotech Index (FBT)	34.2	(16.4)	36.9	44.9	(18.3)	3.7	0.0	(0.1)
Large-Cap Stock Category Average									
I	WisdomTree Equity Income (DHS)	9.2	13.9	17.7	17.7	(39.3)	(4.5)	14.8	14.8
I	WisdomTree Dividend ex-Financials (DTN)	5.6	11.9	21.4	26.0	(36.6)	0.1	8.5	8.5
I	Guggenheim S&P 500 Pure Growth (RPG)	9.3	0.3	27.1	50.2	(39.1)	6.3	(0.4)	(0.5)
I	PowerShares QQQ (QQQ)	15.3	3.4	19.9	54.4	(41.7)	19.1	13.4	13.2
I	First Trust Morningstar Div Leaders Idx (FDL)	8.3	14.4	16.0	14.2	(31.7)	(10.6)	14.9	15.0
Mid-Cap Stock Category Average									
I	Guggenheim S&P Midcap 400 Pure Growth (RFG)	7.4	0.4	34.7	59.8	(35.5)	9.9	(4.8)	(4.8)
I	WisdomTree MidCap Dividend (DON)	6.7	5.1	21.7	32.0	(32.6)	(5.5)	3.3	3.1
I	PowerShares DWA Technical Leaders (PDP)	10.8	1.8	26.4	27.4	(46.0)	—	1.6	1.6
I	iShares Dow Jones Select Dividend Index (DVY)	6.4	11.8	17.7	11.0	(32.9)	(5.4)	10.0	10.1
I	PowerShares Hi-Yield Eq Div Achievers (PEY)	3.4	8.7	20.6	3.7	(38.5)	(15.0)	10.5	10.7
Small-Cap Stock Category Average									
I	WisdomTree SmallCap Dividend (DES)	9.7	(1.8)	26.6	21.1	(27.6)	(12.9)	5.3	5.1
I	iShares S&P SmallCap 600 Growth (IJT)	8.6	3.5	27.8	28.2	(32.9)	5.5	1.1	1.4
I	PowerShares FTSE RAFI US 1500 Small-Mid (PRFZ)	8.1	(6.1)	29.1	56.3	(38.5)	(1.1)	(3.8)	(3.7)
I	Vanguard Small Cap Growth ETF (VBK)	9.5	(1.4)	30.9	42.0	(40.0)	9.7	(2.0)	(1.9)
I	Vanguard Small Cap ETF (VB)	9.1	(2.7)	27.9	36.3	(36.1)	1.3	(1.4)	(1.2)
Micro-Cap Stock Category Average									
I	iShares Russell Microcap Index (IWC)	12.8	(9.5)	28.8	24.8	(39.6)	(8.8)	(0.7)	(0.7)
Preferred Stock Category Average									
I	PowerShares Financial Preferred (PGF)	15.3	(1.6)	16.6	40.7	(28.4)	(16.0)	7.4	7.1
Stock Sector ETFs									
I	iShares FTSE NAREIT Resid Plus Cp Idx (REZ)	10.6	15.8	31.7	21.2	(25.2)	—	15.7	15.6
I	iShares Cohen & Steers Realty Majors (ICF)	13.8	10.2	29.1	25.3	(40.9)	(18.3)	12.0	11.9
I	SPDR Dow Jones REIT (RWR)	14.7	9.2	27.8	28.6	(38.9)	(17.8)	13.1	13.0
I	Vanguard REIT Index ETF (VNQ)	14.8	8.6	28.5	29.8	(37.0)	(16.4)	13.0	12.9
I	First Trust S&P REIT Idx (FRI)	14.6	7.9	27.8	27.9	(38.9)	—	12.5	12.2
I	PowerShares Dynamic Pharmaceuticals (PJP)	18.3	19.7	27.8	16.9	(10.6)	0.6	24.5	24.6
I	iShares Dow Jones US Real Estate (IYR)	14.7	5.6	26.4	30.2	(40.0)	(18.2)	10.3	10.1
I	SPDR S&P Retail (XRT)	12.9	9.7	37.1	77.6	(38.8)	(16.1)	11.6	11.9
I	First Trust NYSE Arca Biotech Index (FBT)	34.2	(16.4)	36.9	44.9	(18.3)	3.7	0.0	(0.1)
I	SPDR S&P Pharmaceuticals (XPH)	16.1	12.8	22.3	28.0	(9.2)	(1.4)	17.9	17.8
Commodities ETFs									
I	iShares Silver Trust (SLV)	(4.1)	(8.5)	79.4	56.6	(27.2)	13.9	(23.1)	(21.2)
I	PowerShares DB Precious Metals (DBP)	0.9	4.3	37.7	26.6	(3.0)	—	(1.0)	(1.0)
I	iShares Gold Trust (IAU)	4.3	8.6	27.9	23.5	5.4	30.9	5.9	6.3
I	SPDR Gold Shares (GLD)	1.3	11.2	27.3	27.1	3.0	31.1	5.8	6.3
I	PowerShares DB Gold (DGL)	1.5	8.6	27.8	22.0	2.8	—	5.1	5.0
Balanced Category Average									
I	iShares S&P Aggressive Allocation (AOA)	7.2	(1.8)	17.0	26.4	—	—	(0.2)	(0.5)
Global Stock Category Average									
I	First Trust DJ Global Select Dividend (FGD)	4.9	(2.2)	12.3	64.3	(50.5)	—	(5.4)	(5.5)
I	iShares MSCI Kokusai Index (TOK)	6.3	(4.3)	11.5	32.9	(41.3)	—	(4.5)	(4.6)

Data as of 6/30/2012.

3-Yr Ann'lzd Return (%)		Total Return (%)			Yield (%)	Tax-Cost Ratio (%)	Risk Index		Total Assets (\$ Mil)	Avg Daily Trading Volume (Thous)	Portfolio (%)				% of Port in Foreign Issues	Port Turnover Ratio (%)	Number of Hldgs	% of Port in Top 10 Hldgs	Exp Ratio (%)
NAV	Market	5-Year Ann'lzd	Bull* Mkt	Bear* Mkt			Cat (X)	Total (X)			Stock	Bond	Other	Cash					
34.3	34.4	4.1	199.8	(59.3)	3.0	1.1	0.92	1.23	204	25	100	0	0	0	0.0	—	34	66	0.48
33.9	34.0	1.4	214.1	(68.5)	2.9	1.1	1.06	1.43	2,914	605	100	0	0	0	0.0	16	31	61	0.35
33.2	33.3	1.9	208.8	(66.4)	2.9	1.1	1.05	1.41	1,960	212	100	0	0	0	0.0	10	84	49	0.25
33.0	33.1	3.1	206.0	(64.5)	3.3	1.3	1.04	1.39	13,219	2,476	99	0	0	1	0.0	10	115	46	0.10
32.3	32.4	1.8	200.6	(65.7)	1.8	0.7	1.03	1.39	388	279	100	0	0	0	0.0	—	119	46	0.50
30.3	30.3	12.5	137.7	(28.1)	0.7	0.3	0.87	0.96	275	93	100	0	0	0	0.0	23	30	46	0.63
30.2	30.3	0.8	186.4	(65.0)	3.5	1.3	1.00	1.34	4,125	8,042	100	0	0	0	0.9	14	84	43	0.47
30.2	30.0	7.6	221.5	(47.5)	1.0	0.4	1.04	1.41	558	7,884	102	0	(2)	0	1.1	69	96	12	0.35
29.8	30.9	—	262.1	—	2.8	0.4	1.14	1.71	623	276	99	0	1	0	99.4	22	85	60	0.59
27.4	27.4	12.9	132.8	(29.7)	0.0	0.0	1.77	1.95	250	64	100	0	0	0	5.0	—	20	56	0.60
16.8	16.7	0.8	110.5	(50.4)	1.7	0.5	1.00	1.07	2,531	2,004	100	0	0	0	1.9	25	460	29	0.37
23.1	23.1	(0.8)	143.8	(62.0)	3.4	1.3	0.83	0.88	482	67	99	0	0	1	0.0	—	346	46	0.38
22.2	22.1	1.6	149.2	(57.0)	3.5	1.3	0.82	0.88	1,079	115	99	0	0	1	0.0	—	88	20	0.38
21.9	21.9	4.7	150.9	(49.2)	0.6	0.2	1.19	1.27	309	42	100	0	0	0	0.0	21	135	14	0.35
21.7	21.6	6.8	150.9	(49.7)	0.8	0.3	1.14	1.23	31,937	46,373	100	0	0	0	3.6	29	100	57	0.20
20.3	20.3	(0.5)	130.4	(58.6)	3.2	1.4	0.71	0.76	569	328	100	0	0	0	0.0	—	96	59	0.45
18.4	18.4	0.3	127.7	(52.9)	1.1	0.3	1.00	1.26	987	130	100	0	0	0	1.9	49	396	13	0.41
23.5	23.5	7.9	184.6	(46.9)	0.1	0.0	1.06	1.34	506	43	100	0	0	0	0.0	45	101	22	0.35
23.3	23.4	2.0	148.3	(53.5)	2.7	1.0	0.92	1.16	341	40	99	0	0	1	0.2	—	355	12	0.38
22.3	22.4	0.6	123.7	(55.5)	0.3	0.1	0.97	1.23	551	286	100	0	0	0	3.2	96	101	27	0.60
21.0	21.0	(0.9)	114.1	(54.8)	3.5	0.6	0.68	0.87	10,341	1,281	100	0	0	0	0.0	16	101	22	0.40
20.7	20.7	(5.1)	124.1	(64.2)	3.7	1.5	0.75	0.94	288	220	100	0	0	0	0.0	35	51	28	0.50
19.3	18.4	1.1	148.0	(53.9)	1.2	0.3	1.00	1.45	889	1,207	100	0	0	0	0.6	56	661	9	0.34
21.4	21.3	0.7	145.6	(55.4)	3.4	1.3	0.86	1.25	316	32	99	0	0	1	0.1	—	621	11	0.38
21.2	21.3	3.3	139.0	(51.4)	0.9	0.2	0.91	1.32	1,622	133	100	0	0	0	0.0	43	330	10	0.25
20.9	21.0	2.9	177.2	(55.7)	1.1	0.3	1.10	1.59	438	29	100	0	0	0	3.3	15	1,500	2	0.39
20.9	21.0	3.1	150.5	(53.4)	0.5	0.1	1.03	1.49	2,018	115	100	0	0	0	1.9	40	957	5	0.10
19.9	19.9	1.9	142.5	(53.2)	1.3	0.4	0.99	1.44	4,170	361	99	0	0	1	1.5	17	1,746	3	0.16
13.9	13.8	(5.4)	102.2	(58.7)	1.8	0.3	1.00	1.56	135	31	100	0	0	0	1.6	49	717	5	0.67
16.4	16.3	(2.7)	116.9	(57.5)	1.6	0.2	0.99	1.55	449	96	100	0	0	0	1.6	31	1,364	3	0.67
14.7	14.5	2.6	159.1	(58.3)	6.3	2.2	1.00	0.72	2,549	640	10	3	87	0	10.2	21	133	29	0.51
15.9	15.7	2.5	205.0	(62.3)	6.7	2.6	1.22	0.89	1,645	336	17	2	81	0	17.7	6	50	50	0.60
34.3	34.4	4.1	199.8	(59.3)	3.0	1.1	0.92	1.23	204	25	100	0	0	0	0.0	—	34	66	0.48
33.9	34.0	1.4	214.1	(68.5)	2.9	1.1	1.06	1.43	2,914	605	100	0	0	0	0.0	16	31	61	0.35
33.2	33.3	1.9	208.8	(66.4)	2.9	1.1	1.05	1.41	1,960	212	100	0	0	0	0.0	10	84	49	0.25
33.0	33.1	3.1	206.0	(64.5)	3.3	1.3	1.04	1.39	13,219	2,476	99	0	0	1	0.0	10	115	46	0.10
32.3	32.4	1.8	200.6	(65.7)	1.8	0.7	1.03	1.39	388	279	100	0	0	0	0.0	—	119	46	0.50
30.3	30.3	12.5	137.7	(28.1)	0.7	0.3	0.87	0.96	275	93	100	0	0	0	0.0	23	30	46	0.63
30.2	30.3	0.8	186.4	(65.0)	3.5	1.3	1.00	1.34	4,125	8,042	100	0	0	0	0.9	14	84	43	0.47
30.2	30.0	7.6	221.5	(47.5)	1.0	0.4	1.04	1.41	558	7,884	102	0	(2)	0	1.1	69	96	12	0.35
27.4	27.4	12.9	132.8	(29.7)	0.0	0.0	1.77	1.95	250	64	100	0	0	0	5.0	—	20	56	0.60
26.9	26.9	12.1	132.3	(24.5)	0.8	0.3	0.90	0.99	463	193	100	0	0	0	0.0	50	29	44	0.35
24.2	25.8	16.1	141.8	(8.3)	0.0	0.0	1.26	2.77	8,548	13,022	0	0	100	0	0.0	—	1	100	0.50
19.7	19.6	17.3	81.7	9.4	0.0	0.0	0.72	1.58	338	59	0	0	104	(4)	0.0	—	14	104	0.75
19.6	19.5	19.4	74.8	18.2	0.0	0.0	0.63	1.38	9,300	5,687	0	0	100	0	0.0	0	1	100	0.25
19.1	19.4	19.2	72.5	19.9	0.0	0.0	0.59	1.29	65,735	11,335	0	0	100	0	0.0	0	1	100	0.40
18.3	18.1	17.4	69.0	14.7	0.0	0.0	0.61	1.34	343	136	0	0	105	(5)	0.0	0	13	105	0.75
10.6	9.7	—	63.7	(30.3)	2.3	0.6	1.00	0.72	36	9	52	31	2	15	18.9	21	102	79	0.56
14.0	13.9	—	91.3	—	2.2	0.4	1.47	1.07	88	10	80	16	0	3	20.9	13	10	100	0.33
10.5	10.5	(5.3)	95.2	(56.5)	3.9	0.8	1.00	1.25	428	80	92	0	7	0	53.8	26	666	27	0.54
15.7	15.5	—	148.2	—	5.3	1.6	1.03	1.28	175	73	99	0	1	0	82.4	—	103	17	0.60
12.2	12.0	—	92.9	—	2.6	0.3	0.99	1.24	586	4	100	0	0	0	40.7	4	1,276	12	0.25

Table 1. Top ETFs Over Three Years (con't)

several years.

Table 1 on pages 28 through 31 shows the top ETFs by category. Three-year performance was calculated through June 30, 2012, to match the statistics displayed in "The Individual Investor's Guide to Exchange-Traded Funds 2012," which was published in the August 2011 *AII Journal*.

In addition to three-year performance, returns for the year to date, the last 12 months and each of the past five years (where available) are displayed, along with returns for the most recent bull market (March 1, 2009, through March 31, 2012) and bear market (November 1, 2007, through February 28, 2009). Returns that are in the top 25% of all ETFs within their investment category are shown in boldface. Other pertinent information is presented, including yield, tax-cost

Index Enhanced ETN	ETF Name (Ticker)	NAV Total Return (%)						12-Month Return (%)	
		YTD	2011	2010	2009	2008	2007	NAV	Market
	Foreign Stock Category Average	1.8	(12.5)	11.6	40.2	(44.0)	11.7	(15.4)	(15.3)
I	PowerShares Intl Dividend Achievers (PID)	2.4	(2.6)	13.6	37.0	(46.5)	12.1	(6.2)	(6.4)
I	iShares Dow Jones Intl Select Div Idx (IDV)	4.1	(6.8)	10.4	69.3	(54.4)	—	(10.7)	(10.9)
	Foreign Stock: Europe Category Average	1.9	(16.8)	5.5	43.9	(49.5)	12.3	(22.0)	(22.1)
I	iShares MSCI Sweden Index (EWD)	5.4	(15.9)	33.8	63.7	(49.5)	0.4	(16.1)	(16.0)
I	iShares MSCI Switzerland Index (EWL)	3.8	(7.3)	13.7	25.9	(29.8)	7.0	(11.0)	(11.4)
I	iShares MSCI United Kingdom Index (EWU)	3.1	(3.0)	8.1	42.1	(48.5)	7.6	(5.1)	(5.0)
	Foreign Stock: Latin America Cat Average	2.4	(20.7)	30.6	92.4	(46.4)	45.8	(15.8)	(16.6)
I	iShares MSCI All Peru Capped Index (EPU)	9.9	(21.1)	60.0	—	—	—	13.6	15.9
I	iShares MSCI Mexico Investable Mkt Idx (EWW)	14.9	(12.3)	27.5	55.7	(41.6)	12.2	(0.2)	(0.1)
I	Market Vectors Brazil Small-Cap ETF (BRF)	0.6	(27.5)	25.6	—	—	—	(25.3)	(26.4)
	Foreign Stock: Pacific/Asia Cat Average	4.5	(19.9)	15.8	56.4	(43.0)	21.8	(15.6)	(16.0)
I	iShares MSCI Thailand Invest Mkt Index (THD)	14.7	(4.2)	56.2	83.8	—	—	9.9	11.9
I	Market Vectors Indonesia Index ETF (IDX)	(4.1)	0.2	40.9	—	—	—	(12.3)	(12.8)
I	iShares MSCI Malaysia Index (EWM)	4.3	(0.6)	36.2	51.3	(41.3)	45.2	(3.5)	(2.9)
	Foreign Stock: Emerging Mkts Cat Average	4.3	(20.9)	19.3	63.7	(50.3)	40.6	(15.9)	(15.7)
I	iShares MSCI Turkey Invest Mkt Index (TUR)	29.2	(36.2)	23.5	107.7	—	—	(10.1)	(10.1)
I	iShares MSCI South Africa Index (EZA)	4.7	(14.9)	33.3	56.0	(39.0)	17.2	(7.2)	(7.0)
I	WisdomTree Emerging Markets Equity Inc (DEM)	2.2	(9.8)	23.4	61.3	(36.9)	—	(11.4)	(11.5)
	General Bond: Short-Term Category Average	1.8	1.4	3.0	5.0	2.6	—	1.3	0.9
I	iShares Barclays 1-3 Year Credit Bond (CSJ)	1.7	1.3	3.7	10.8	(0.1)	—	1.6	1.5
	General Bond: Interim-Term Cat Average	3.9	6.3	7.6	8.1	3.1	6.5	8.0	8.0
I	Vanguard Intermediate-Term Bond ETF (BIV)	4.0	10.6	9.5	6.8	5.1	—	11.1	11.1
	General Bond: Long-Term Category Average	5.2	15.4	10.1	6.9	4.1	3.7	16.7	17.0
I	Vanguard Long-Term Bond Index ETF (BLV)	5.1	22.1	10.4	1.8	8.7	—	24.6	25.2
I	iShares iBoxx \$ Invest Grade Corp Bond (LQD)	5.7	8.9	9.1	12.1	(0.3)	3.7	11.4	11.4
	Corporate Bond: High-Yield Category Average	5.8	4.5	11.9	41.3	(29.1)	—	6.4	6.0
I	SPDR Barclays Capital High Yield Bond (JNK)	6.1	4.7	14.0	50.5	(30.1)	—	6.5	6.4
I	iShares iBoxx \$ High Yield Corporate Bd (HYG)	6.1	5.9	12.1	40.7	(23.9)	—	7.4	7.5
	Inflation-Protected Bond Category Average	3.1	12.6	6.0	11.2	(2.4)	11.4	10.9	10.8
I	SPDR Barclays Capital TIPS (IPE)	4.1	13.8	6.1	11.2	(2.3)	—	12.0	12.1
I	iShares Barclays TIPS Bond (TIP)	3.9	13.4	6.1	11.4	(2.5)	11.5	11.5	11.7
	Gov't Bond: Short-Term Category Average	0.0	2.6	1.4	0.4	3.7	7.3	0.9	0.8
I	iShares Barclays 1-3 Year Treasury Bond (SHY)	0.1	1.4	2.2	0.5	6.6	7.3	0.7	0.7
	Gov't Bond: Interim-Term Cat Average	2.9	16.1	9.0	(0.6)	12.2	—	14.9	14.9
I	iShares Barclays 3-7 Year Treasury Bond (IEI)	1.3	8.1	6.5	(1.8)	13.1	—	6.4	6.5
	Gov't Bond: Long-Term Category Average	5.2	44.8	10.1	(16.0)	28.8	10.1	48.1	47.0
I	Vanguard Extended Dur Trs Idx ETF (EDV)	6.1	55.8	10.2	(36.7)	55.4	—	64.4	64.6
I	iShares Barclays 20+ Year Treas Bond (TLT)	4.2	33.6	9.2	(21.5)	33.8	10.1	37.0	37.4
	Muni National Bond: Short-Term Cat Average	0.5	2.2	1.1	4.3	4.2	—	1.3	1.1
I	Market Vectors Short Municipal Index ETF (SMB)	1.3	4.5	2.2	6.7	—	—	3.3	3.3
	Muni National Bond: Interim-Term Cat Average	1.8	7.8	2.3	10.7	(0.6)	—	6.0	5.9
I	Market Vectors Intermediate Muni ETF (ITM)	3.0	12.6	2.4	10.7	(0.7)	—	10.7	10.9
	Muni National Bond: Long-Term Cat Average	5.8	17.3	2.2	14.3	(4.3)	—	16.1	16.6
I	Market Vectors Long Municipal Index ETF (MLN)	6.1	15.3	(0.6)	18.0	—	—	15.0	15.8
I	PowerShares Insured National Muni Bond (PZA)	5.5	13.0	0.1	18.2	(11.6)	—	13.5	13.6
	Muni National Bond: High Yield Cat Average	9.9	9.4	2.6	—	—	—	15.0	18.0
I	Market Vectors High-Yield Muni ETF (HYD)	10.8	9.4	2.6	—	—	—	16.3	16.8
	International Bond: General Category Average	5.6	0.7	3.1	12.5	4.4	—	3.3	2.7
I	SPDR DB Intl Govt Infl-Protected Bond (WIP)	4.2	2.5	6.8	18.5	—	—	(0.7)	(1.4)
	International Bond: Emerging Cat Average	4.5	2.8	11.5	30.2	(13.2)	—	2.6	2.6
I	PowerShares Emerging Mkts Sovereign Debt (PCY)	8.2	8.3	11.7	33.3	(14.6)	—	11.8	12.2

*Bull market is defined as 3/1/2009 through 3/31/2012. Bear market is defined as 11/1/2007 through 2/28/2009.
Source: "The Individual Investor's Guide to Exchange-Traded Funds 2012," August 2012 AII Journal.
Data from Morningstar Inc. is through June 30, 2012.

Go to www.aaii.com/guides/etf-guide for the complete list of ETFs covered by AII.

Data as of 6/30/2012.

3-Yr Ann'lzd Return (%)		Total Return (%)			Yield (%)	Tax-Cost Ratio (%)	Risk Index		Total Assets (\$ Mil)	Avg Daily Trading Volume (Thous)	Portfolio (%)				% of Port in Foreign Issues	Port Turnover Ratio (%)	Number of Hldgs	% of Port in Top 10 Hldgs	Exp Ratio (%)
NAV	Market	5-Year Ann'lzd	Bull* Mkt	Bear* Mkt			Cat (X)	Total (X)			Stock	Bond	Other	Cash					
7.6	7.6	(5.2)	86.3	(57.1)	3.3	0.9	1.00	1.40	1,231	565	98	0	1	1	97.7	22	650	19	0.50
12.4	12.2	(3.5)	108.1	(61.7)	3.5	1.2	0.86	1.20	657	167	100	0	0	0	88.0	33	66	31	0.50
12.2	12.5	(4.7)	127.4	(65.6)	5.4	0.8	1.06	1.48	917	259	100	0	0	0	99.8	38	113	29	0.50
4.5	4.5	(8.4)	75.8	(61.7)	3.6	0.7	1.00	1.73	318	527	99	0	1	1	98.7	12	91	52	0.54
15.4	15.2	(2.7)	146.4	(61.4)	3.6	0.5	1.10	1.91	285	167	99	0	1	0	98.5	9	37	60	0.51
11.6	11.4	(0.6)	84.7	(46.4)	2.9	0.3	0.75	1.29	520	373	100	0	0	0	99.9	7	42	78	0.52
10.9	10.7	(5.1)	85.8	(59.1)	3.8	0.5	0.78	1.35	1,299	1,592	100	0	0	0	99.5	4	110	47	0.52
14.6	14.5	1.3	144.3	(56.6)	2.7	0.7	1.00	1.74	543	1,123	96	0	4	1	94.3	35	58	53	0.67
21.7	21.6	—	—	—	2.6	0.6	0.94	1.63	403	212	100	0	0	0	89.3	9	31	73	0.59
20.1	20.3	1.6	171.6	(59.3)	1.5	0.2	0.87	1.52	1,112	2,568	100	0	0	0	99.8	5	43	72	0.52
17.7	17.3	—	—	—	2.8	1.5	1.24	2.15	468	134	101	0	(1)	0	101.0	64	79	35	0.59
7.4	7.7	(1.7)	105.4	(55.7)	2.2	0.6	1.00	1.49	444	716	98	0	0	1	97.9	25	155	44	0.64
29.8	30.9	—	262.1	—	2.8	0.4	1.14	1.71	623	276	99	0	1	0	99.4	22	85	60	0.59
24.5	24.5	—	323.1	—	1.7	0.3	1.16	1.73	360	473	100	0	(0)	0	100.4	18	43	56	0.57
19.9	20.6	7.3	130.1	(41.3)	3.8	1.0	0.77	1.14	880	1,532	100	0	0	0	99.7	49	44	54	0.52
7.5	7.5	(0.1)	104.9	(58.0)	2.8	0.7	1.00	1.52	2,126	1,702	99	0	1	0	98.7	21	235	34	0.63
14.0	14.2	—	157.0	—	2.2	0.4	1.53	2.33	404	158	99	0	1	0	98.7	12	97	61	0.59
13.9	14.0	3.9	140.9	(55.8)	3.3	0.5	1.07	1.62	475	257	100	0	0	0	99.3	4	52	54	0.59
13.9	14.3	—	128.7	(46.7)	4.1	1.3	0.90	1.37	3,729	805	98	0	0	2	98.3	—	236	32	0.63
2.4	2.1	4.3	10.0	4.6	1.2	0.5	1.00	0.07	2,271	182	0	68	1	31	19.9	78	465	16	0.20
3.6	2.9	4.1	16.9	1.9	1.7	0.8	1.36	0.09	9,707	410	0	95	0	5	35.2	8	814	7	0.20
7.7	7.7	7.1	28.4	3.4	2.6	1.3	1.00	0.22	2,064	178	8	92	0	(1)	23.7	112	1,164	27	0.26
9.9	9.8	8.7	33.6	5.0	3.7	1.5	1.39	0.30	3,649	299	0	99	0	1	11.4	61	1,249	27	0.11
12.8	12.9	9.4	44.4	(1.0)	4.2	1.8	1.00	0.48	2,729	249	0	98	0	2	16.8	38	571	12	0.18
14.3	14.4	11.1	45.6	2.3	4.2	1.8	1.24	0.59	726	63	0	99	0	0	12.1	45	1,251	27	0.11
11.0	10.6	7.8	43.3	(4.3)	4.1	1.7	0.69	0.33	22,576	2,004	0	99	0	1	20.5	4	970	5	0.15
14.0	13.2	6.4	76.3	(24.1)	5.1	2.8	1.00	0.59	1,521	590	0	88	0	12	10.2	34	149	49	0.50
15.3	14.6	—	93.1	—	7.3	3.3	1.13	0.67	10,745	5,267	0	98	1	1	18.1	40	225	11	0.40
14.3	13.5	6.4	72.8	(24.1)	7.2	2.8	1.04	0.62	14,581	3,567	0	98	0	2	12.1	13	619	5	0.50
9.5	9.4	8.3	35.4	0.9	2.2	1.1	1.00	0.32	1,899	131	(13)	94	0	19	(13.1)	23	16	185	0.39
9.6	9.6	8.4	35.7	0.9	2.8	1.1	1.02	0.33	733	75	0	100	0	0	0.0	21	34	45	0.18
9.4	9.4	8.3	35.2	1.0	3.1	1.2	1.00	0.32	23,047	1,318	0	99	0	1	0.0	15	36	45	0.20
0.9	0.8	1.7	2.5	4.7	0.3	0.2	1.00	0.03	1,704	384	0	71	0	29	0.1	196	52	31	0.21
1.5	1.5	3.2	4.6	8.2	0.6	0.4	2.00	0.06	10,832	1,988	0	91	0	9	0.0	72	48	57	0.15
9.6	9.6	6.4	12.5	13.6	1.1	0.8	1.00	0.48	473	59	0	126	0	(26)	49.9	85	65	90	0.37
5.8	5.8	7.0	14.8	14.7	1.3	0.7	0.51	0.24	3,195	328	0	100	0	0	0.0	38	59	44	0.15
15.5	15.4	11.2	25.2	17.0	1.7	1.5	1.00	1.19	687	817	0	124	0	(24)	38.7	62	27	96	0.40
19.3	18.9	—	26.6	—	2.8	3.0	1.41	1.68	203	42	0	100	0	0	0.0	22	56	25	0.13
14.0	14.1	12.4	24.9	19.8	2.9	1.3	0.84	1.00	3,683	10,629	0	100	0	0	0.0	26	20	77	0.15
2.3	2.0	—	7.7	8.4	0.9	0.0	1.00	0.08	313	55	0	87	0	13	0.4	20	228	24	0.26
3.9	3.7	—	12.7	—	1.8	0.0	1.83	0.14	150	70	0	94	0	6	0.0	23	248	12	0.20
5.1	5.1	—	15.5	—	2.0	0.0	1.00	0.24	118	28	0	98	0	2	0.0	11	220	20	0.31
7.8	7.8	—	23.5	—	3.0	0.0	1.46	0.36	504	141	0	99	0	1	0.0	—	604	7	0.24
8.2	8.2	—	27.2	0.4	4.0	0.0	1.00	0.38	770	111	0	99	(1)	2	2.3	49	428	22	0.43
9.6	10.1	—	33.0	—	4.2	0.0	1.22	0.47	92	36	0	99	0	1	0.0	—	173	15	0.24
9.0	9.0	—	31.0	(6.9)	4.3	0.0	1.09	0.42	762	233	0	99	0	1	0.0	—	190	28	0.28
12.6	11.8	—	46.9	—	5.2	0.0	1.00	0.47	382	125	0	99	0	1	0.0	33	178	14	0.39
12.6	11.9	—	46.9	—	5.2	0.1	1.00	0.47	668	224	0	99	0	1	0.0	—	244	14	0.35
3.4	2.9	—	26.2	(3.6)	2.1	0.7	1.00	0.64	177	24	1	93	3	3	81.9	43	144	32	0.53
7.2	6.6	—	49.7	—	3.6	0.9	1.09	0.69	1,274	123	0	97	3	0	96.9	23	86	33	0.50
13.2	12.8	—	63.6	(14.7)	3.8	1.8	1.00	0.48	564	128	0	92	1	7	88.8	6	81	34	0.53
13.7	13.3	—	66.4	(14.7)	5.1	2.0	1.03	0.50	1,856	710	0	100	0	0	99.5	—	65	22	0.50

ratio, risk, portfolio composition and expenses. Risk numbers that are in the lowest 25% of all ETFs within the investment category are also shown in boldface. Twelve-month and three-year annual total returns based on market value have been added this year to show how closely each fund's price performance matches its net asset value (NAV) performance. The bigger the difference, the larger the premium or discount shares of the fund have traded at over the period.

Some of the categories used here combine two or more separate categories from last issue's ETF Guide. This was done in cases where there were not a significant number of qualifying funds and combining individual categories made sense. When categories were combined, category averages are not displayed.

The online version of this article, available on AAII.com, contains data on a larger number of top-performing funds.

The Top Real Estate ETFs

As stated at the beginning of this article, real estate ETFs dominated the list of top-performing funds, accounting for six of the top seven spots.

iShares FTSE NAREIT Residential Plus Capped Index Fund (REZ) claimed the top spot with a three-year annualized return of 34.3%. The fund holds REITs that invest in residential properties (apartments), health care properties (hospitals, nursing homes, etc.) and self-storage real estate. Though the fund delivered a 15.8% return to investors in 2011 and gained 10.6% during the first half of 2012, the impact of the calendar cannot be ignored. This fund lost 59.3% of its value during the last bear market period, setting the stage for the current impressive three-year performance. The bull market return period is very close to the trailing three-year return period ending in June. We are using performance from March 1, 2009, through March 31, 2012, to measure bull market performance.

The timing of the period reviewed also favored the five other real estate

ETFs that appear on the top-10 list. For example, iShares Cohen & Steers Realty Majors (ICF), SPDR Dow Jones REIT (RWR) and Vanguard REIT Index (VNQ) had bear market losses of 68.5%, 66.4% and 64.5%, respectively. In the three-year period starting in July 2009, the three rebounded with annualized gains of 33.9%, 33.2% and 33.0%, respectively.

It wasn't just the easing of the credit crunch and the corresponding bottoming of real estate that helped these funds; falling interest rates also played a role. REITs pay higher yields, making these funds attractive to income-seeking investors. The downside of the impressive price performance is that yields on these funds now only range between 2.9% to 3.3%—higher than the S&P 500 index, but potentially lower than some REIT investors would prefer. (By means of comparison, at the end of 2008, yields for these funds ranged between 7.1% and 8.9%.)

The Other Top 10 ETFs

Two healthcare funds are in this year's top-10 list. PowerShares Dynamic Pharmaceuticals Portfolio (PJP) prevented real estate funds from also claiming the sixth spot, elbowing its way in with a 30.3% annualized return over three years. First Trust NYSE Arca Biotechnology Index (FBT) claimed the 10th spot with a 27.4% annualized return. Though in the same sector, these two funds are very different.

PowerShares Dynamic Pharmaceuticals Portfolio fund invests in pharmaceutical companies, with Bristol-Myers Squibb Co. (BMY), Amgen (AMGN), Merck & Company (MRK), Johnson & Johnson (JNJ), Eli Lilly and Co. (LLY) and Abbott Laboratories (ABT) making up 30% of the portfolio. In other words, this fund holds established pharmaceutical companies and gives a larger weighting to some companies than others.

In contrast, First Trust NYSE Arca Biotech Index fund is an equal-weighted fund. Rather than following the traditional indexing methodology of giving

more weight to larger companies, the portfolio is evenly allocated to all stocks held by the fund. The advantage of such weighting strategies is that they prevent a single or a small group of stocks from significantly influencing the performance of the index or the fund following that index. The downside is that such strategies can lead to more volatility and higher expenses. Furthermore, this ETF targets smaller biotech companies, such as Regeneron Pharmaceuticals (REGN), Life Technologies (LIFE) and United Therapeutics (UTHR). Biotech stocks have historically been more risky than their larger drug company brethren because the companies often depend on just a few existing or experimental drugs.

SPDR S&P Retail (XRT) and iShares MSCI Thailand Investable Market Index (THD) took the eighth and ninth spots with annualized returns of 30.2% and 29.8%. SPDR S&P Retail, which is also an equal-weighted fund, benefited from the rebound in consumer spending over the past three years. iShares MSCI Thailand, as its name implies, invests in Thailand-based companies. Country-specific funds, especially those of smaller, emerging economies, carry several risks, including limited information about the foreign economy, political instability and currency fluctuations. In addition, during the past 12 months, this ETF has traded at a premium to its underlying assets, with an annualized market return of 11.9%, compared to a net asset value return of 9.9%. This means investors have paid more than a dollar for a dollar's worth of assets. (As I was writing this in mid-August, THD was trading at a 0.83% premium.)

Dividend Funds Lead Several Categories

The quest for income led investors not only to real estate funds, but also to dividend funds. ETFs that tracked dividend-oriented stock indexes were the top performers in the large-cap, small-cap, global and foreign stock categories.

Leading the domestic large-cap dividend funds over three years was

WisdomTree Equity Income (DHS). This fund follows a dividend-weighted index that seeks out stocks with high yields and then weights them by their aggregate cash dividends. This is one of several types of alternative strategies that some funds follow. Such strategies seek to weight stocks by a component other than market capitalization with the intention of generating better performance. They are a hybrid between passive and active strategies because, although the ETF does track an index, the index itself is based on a manager's idea to achieve better performance through an alternative method.

Look Beyond Performance

There is always a temptation to look more favorably at the best-performing

funds. Though performance does matter, it is just one factor to consider.

You should also consider your portfolio needs. A basic allocation of ETFs holding domestic stocks with varying market capitalizations, international stocks, government bonds, corporate bonds and international bonds will serve most investors well. Once this basic portfolio allocation is established, other asset classes—such as real estate and commodities—and more specialized funds can be added.

Sector and country funds can boost a portfolio's returns, but prudence is required when using them. Make sure you understand the factors that have driven a sector's performance over the past few years and how likely it is that those trends will continue in the future. You cannot safely navigate a

windy road by only using a rear-view mirror. Country-specific ETFs can allow you to target specific markets, but can be more volatile and expose you to exchange-rate risks.

Be sure you fully understand the index that the ETF is designed to follow. Similar sounding indexes can have different return characteristics. They can also either hold different stocks or weight the same stocks differently. A quick visit to an ETF family's website can give you the list of current holdings.

Finally, use this rule of thumb when looking at ETFs: "Just because you can invest in something doesn't mean you should." Buy only those ETFs that you fully understand; avoid those tracking indexes or investing in sectors or countries with risks that you cannot identify. ▲

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