WHAT ARE ETFS AND HOW MAY THEY BE USED DURNG MARKET UPTRENDS AND DOWNTRENDS?

Exchange traded funds, referred to as ETFs , have a value based upon a collection of stocks within a given category. There are the broad based ETFs which mimic broad stock averages such as the S&P500 or the Nasdaq Composite. Other ETFs concentrate on collection of stocks in a subcategory such as finance, technology, and energy. Unlike mutual funds ETFs operate on a very low management fee(about 0.7% or less annually) , are very liquid, and can be traded on the open market just like individual stocks. There are ETFs of use in bull markets and those which are of value during bear markets.The best known of these ETFs for bull markets is the spyder SPY. It is a broad based ETF representing all stocks in the S&P500 Index. One SPY share equals essentially 1/10th of the daily closing price of the S&P500 Index. Thus last Friday (April 5, 1018) the S&P500 closed at $2604.47 down $58.37 for the day. The corresponding SPY closed at $259.72 down $5.92 for the day.

The second most actively traded ETF based on the product of price times volume is QQQ. Its value is based on the Nasdaq 100 stock index. Last Friday it closed at $156.63 down 2.5% for the day. The Nasdaq 100 closed at 6433.21 down 2.45% for the day. A comparison of QQQ and Nasdaq100 over the last three month follows-

COMPARISON OF THE QQQ ETF AND THE NASDAQ100 OVER THE LAST THREE MONTH

Here QQQ is represented by red and the NASDAQ 100 by blue. The correspondence between the two normalized prices is almost identical. The data for the graph was gotten from YAHOO finance

Other broad based ETFs for bull markets are IWN which mimics the Russel 2000 small cap stock average and the diamond DIA which tracks the Dow Jones Industrial Average.

During bear markets one does not want to be holding any of the above mentioned ETFs as their values only rise in bull markets. To have gains in bear markets one wants to deal with ETFs which short their underlying stocks. Using such ETFs is ideal for bear markets since they have less risk than shorting individual stocks. Some broad based ETFs ideal for bear markets are contained in the following list which I constructed early this year(2018) prior to the market downturn-

S&P500

UPRO (3x) Ultrapro S&P 500 Proshares	+30.09%
SSO (2x) Ultra S&P 500 Proshares	+19.28%
SPY (1x) S&P 500 SPDR	+9.14%
SH (-1x) S&P 500 Short Proshares	-8.60%
SDS (-2x) Ultrashort S&P 500 Proshares	-16.61%
SPXU (-3x) Ultrapro Short S&P 500 Proshares	-23.92%

NASDAQ100

TQQQ (3x) Ultrapro QQQ Proshares	+36.01%
QLD (2x) Ultra QQQ Proshares	+23.20%
QQQ (1x) Nasdaq QQQ ETF	+11.31%
PSQ (-1x) QQQ Short Proshares	-10.25%
QID (-2x) Ultrashort QQQ Proshares	-19.89%
SQQQ (-3x) Ultrapro Short QQQ Proshares	-28.66%

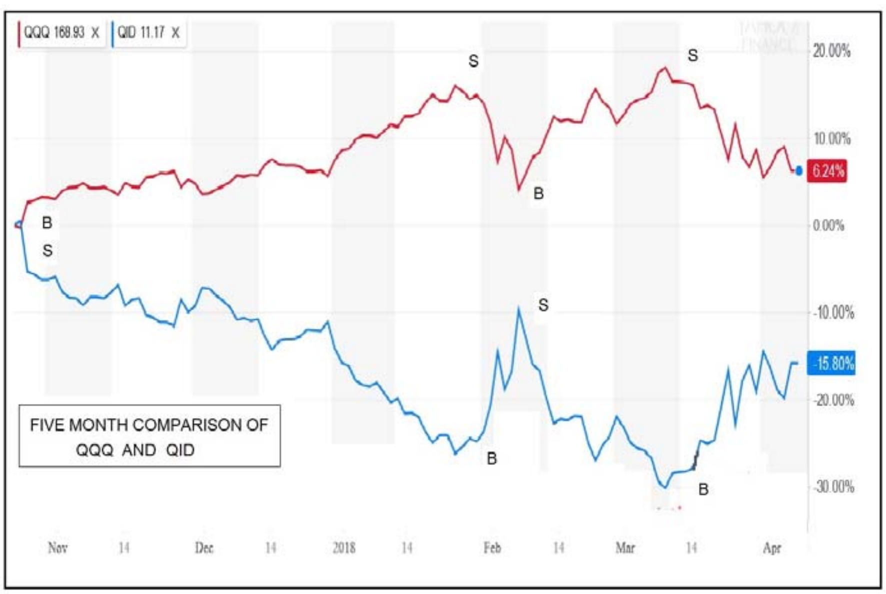
They derive from the high volume-price ETFs SPY and QQQ. Those issues shown with losses (red) are precisely the ETFs to be shorted in a bear market. If one wishes to leverage such transactions those with a 2x and 3x designation are ideal. I would consider SDS or QID to be ideal ETF shorts in a bear market. The SDS exchange traded fund has gone from $36.05 on Jan 28, 2018 when a new bear market was first indicated by a lag curve based on a three month S&P500average to this last Friday's value of $42.00. That is, one has a 16.5% return in a little over two months. At the moment SDS is still in an uptrend and so should be held for further gains. The only drawback one has with shorting stocks via appropriate ETFS is that the daily volume for these is typically not very large and so could cause problems with liquidity.

In all of the above discussions we have only dealt with ETFs based on broad market averages. There is a whole other group of ETFs which concentrate on particular sub-sectors such as finance and energy. These types are more speculative but offer the incentive of larger returns. Take for example the financial sector exchange traded fund XLE. It should be used only during bull markets. Its short counterpart is DRIP to be used during bear markets. The following gives a list of appropriate ETFs to use during bull and bear markets-

Catagory	ETF for Bull Markets	ETF for Bear Markets
Broad Based Averages	QQQ	QID
“ “ “	SPY	SDS
“ “ “	IWM	RWM
“ “ “	DIA	DOG
Financials	XLF	FAZ
Energy	XLE	DRIP
Emerging Markets	EEM	EEV

This list was obtained from a list of 1520 ETFs found at barcharts.com. Each of these ETfs have at least a daily volume of 500,000sh. Other ETFs in the short category often have values less than this and so should not be considered because of potential liquidity problems.

With the information given above , one is now in a position of showing how up-market (long) ETFs may be used in conjunction with down-market(short) ETFs to participate in the stock market. We typically like to deal only with broad market ETFs having high volume. One such possibility among many is to take the QQQ-QID pair and graph them over a chosen length of time. Below we show such a graph using a five month time period from the end of October of 2017 through the beginning of April of this year-



The red line graph represents a normalized version of QQQ and the blue line the normalization of QID. The graph clearly shows when we had a bull phase during which QQQ should be held. A bear market, which began on January 28th , suggests that all QQQ shares should be sold at that point and the QID bought. A reversal took place couple of weeks later so the QQQ should have been re-bought at this point while the QIP sold. The B and S points located along the graph tells one which type of the two ETFs one should own at any given moment. For the latest date of April 6th we still have the market in a bear phase but one may be getting close to a sell point for the QID and a buy point for QQQ.

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