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ETF Share Shrinks, as Managers Opt to Pick Stocks



It's finally looking more like a stock picker's market, after investors spent a significant amount of time avoiding specific stocks.

Exchange-traded funds' percentage of the total U.S. equities market trading volume now stands at about 35%, after peaking at 40% around late October, according to Barclays Global. The decline illustrates that institutional investors are relying less heavily on ETFs and getting back into stocks, a sign that risk tolerance is returning.

"We use ETFs to soak up cash and act as a hedge. They've been helpful in this market when stuff isn't trading. But if you really want to diversify with great companies, you don't want to also hold the mediocre ones," said Walter Prendergast, a president and portfolio manager with Paradigm Capital Management.

Money is still flowing into ETFs, which are a basket of securities that trade like individual stocks. In March, roughly \$8 billion went into ETFs, compared with \$4 billion for the first two months of the year, according to data provided by National Stock Exchange. Traders say most of that push in March was retail traders coming back into equities, thanks to the 20% rally in the broader indexes.

At the same time, institutional traders, which make up a much larger percentage of the daily volume, are slowing down their ETF trading in hopes of getting better returns. While an ETF can mitigate losses by essentially spreading out exposure, it also limits upside greatly. For example, the [Financial Select Sector SPDR Fund](#), a basket of brokers and lenders, is up 50% since March 9. It would have been better to hold several of its constituents, including [Citigroup Inc.](#), up more than 160% in that time, or [Bank of America Corp.](#), up roughly 100%.

In late 2008 and early 2009, institutions' hands were tied. With redemptions, nervous investors and a shattered market pushing trillions out of stocks, several traditional pockets of trading activity just didn't have the volatility and volumes necessary for traders. So, ETFs had to do for the short term, even if it wasn't their preference.

Lately, that trend has reversed, say traders. And even those still pushing ETFs are increasing their risk. More than \$1 billion has come into global emerging market equity funds in the past week, according to EPFR Global.

David Kreinces, a portfolio manager with ETF Portfolio Management, believes ETF activity for even institutions is more likely to grow than shrink in the long term. Mr. Kreinces believes investors will be tentative on stocks for years to come, making ETFs a more likely avenue for large pools of retail cash.

"Core, multi-asset class diversification is incredibly hard to beat," said Mr. Kreinces. "The big question is what percentage should be in gold, commodities or absolute return strategies. Really focusing on minute details of stocks isn't worth the time or energy."