

CONNECTION

December 2013 | *Data as of November 2013*

Exchange-Traded Funds (ETFs) in Focus:

Where to Position Mid to Late Cycle?

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Exchange-Traded Funds (ETFs) in Focus: Where to Position Mid to Late Cycle?

An Aging Economic Expansion by Historical Standards

The current economic expansion is aging and approaching the average of the post-war period. The Great Recession ended in June of 2009 and at the end of November 2013, the expansion was 53 months long.¹ Looking back to 1913, the average economic expansion has lasted 50 months.¹ However, economic expansions have been longer since World War II lasting an average of 58 months.¹

Since 1945, there have been five economic expansions exceeding 53 months.¹ The two longest expansions occurred between March 1991 and March 2001 (120 months) and February 1961 to December 1969 (106 months), while the shortest of the five expansions occurred between March 1975 and January 1980 (58 months).

Monetary policy remains extremely easy and supportive to economic growth, while deleveraging and the shock of the Great Recession has restrained economic excesses from forming during the current business cycle. Limited economic imbalances could add to the longevity of the current economic expansion, although surprises are always a possibility. Limited excesses are confirmed by high unemployment and low inflation. The October unemployment rate was 7.3% and well above the 4.4% low seen prior to the Great Recession, while consumer prices were up just 1.0% year over year through October.² Rising home prices may provide the best exception to signs of limited excesses. The median home prices rose 12.7% year over year in October.³ Home prices are rising much faster than income growth questioning the ability of home prices to continue their strong rise. Disposable personal income was up 2.9% year over year through September 2013.⁴

Where to Position

Given the maturity of the current expansion it might be worth looking at which market factors may perform best in the middle to latter half of an economic expansion. A study was conducted to isolate factor performance during mature economic cycles. The study is a complement to the November Connection Report which discussed the performance of the momentum investment factor developed by Carhart, and small cap and value factors created by Fama/French in an environment of rising long-term interest rates. In the November Connection Report, momentum and small cap were noted as the strongest performing factors in a rising-rate environment. However, rising rates are a different scenario than the age of an economic expansion. Mature economic expansions have seen periods of stable, rising and falling long-term interest rates.

An analogy was built matching the age of the current expansion to the age of similar expansions of the past. The factors were analyzed in periods of economic expansion from 53 months old to the end of the expansion (start of recession). The process strives to isolate the periods in time which are potentially similar to what the investment environment could look like in the coming months or years.

The table below displays the results:

Select Returns* in Mid to Late Economic Expansions:

Start of Similar Period	End of Expansion	Months to Recession	Momentum	Factors Small Cap	Value	Small Cap-Large Cap	Interest Rates
Aug-65	Dec-69	53	13.29%	12.76%	-0.68%	12.73%	Rising
Aug-79	Jan-80	5	86.05%	11.53%	-14.54%	12.15%	Rising
May-87	Jul-90	39	9.24%	-5.21%	-0.53%	-5.55%	Mixed
Sep-95	Mar-01	67	16.87%	-3.86%	-2.29%	-3.34%	Mixed
Apr-06	Dec-07	20	8.51%	-7.35%	-7.48%	-8.44%	Mixed
Nov-13	?						
	Average	36.75	26.79%	1.57%	-5.10%	1.51%	
	Median	32.74	13.29%	-3.86%	-2.29%	-3.34%	
	ST Dev.	24.72	33.30%	9.74%	5.98%	10.14%	
	Avg/ST Dev.	NMF	0.80	0.16	-0.85	0.15	

*All returns are Annualized unless otherwise stated.

An investor cannot invest directly in an index. **Index returns do not represent fund returns. Past performance is no guarantee of future results.** French high momentum contains a momentum factors, constructed from six value-weighted portfolios formed using independent sorts on size and prior returns of NYSE, AMEX, and NASDAQ stocks. French Value is constructed using the book to market value ratio of value stocks relative to growth stocks. The small cap factor is constructed using market equity and NYSE breakpoints.

¹ National Bureau of Economic Research and Invesco PowerShares, as of November 29, 2013

² Bureau of Labor Statistics as of November 29, 2013

³ National Association of Realtors, as of November 29, 2013

⁴ Bureau of Economic Analysis, as of November 29, 2013

- The momentum factor appears to be the strongest performer mid to late cycle outperforming small cap and value. Momentum posted a positive return in each period and a median gain of 13.29%.⁵ Of interest, momentum performed especially well during the turn of 1979/1980 when the expansion was on its last legs and quickly came to an end.
- Value was the worst performing sectors posting negative excess performance in each of the periods.
- Small cap posted mixed results showing strength in the mid to late cycle expansions of the 1960's and the 1979/1980 period. However, small caps performed poorly during mid to late cycles in recent periods. Given the strong performance of small caps over the last year, the uneven mid to late cycle weakness may be worth noting. Based on the findings discussed in the November Connection report and the current study, it appears that small caps may have a stronger chance of posting strength mid to late cycle if long-term interest rates are rising during the same time frame. The 10-year Treasury yield did rise significantly between August 1965 and December 1965 and August 1979 and January 1980.⁶ In contrast, there were periods of up, down, and sideways rates between May 1987 and July 1990, September 1995 and March 2001, and April 2006 to December 2007.⁶
- The table also displays the performance of small cap relative to large cap. Notice that small caps lagged large caps mid to late cycle in the last three of those periods. The direction of the 10-year Treasury yield was mixed during the last three mid to late cycle periods, but the 10-year yield rose between August and December of 1965 and between August 1979 and January 1980. It seems that small caps can perform more strongly relative to large caps in an increasing rate environment.
- On a side note, we believe the median and average months to a recession suggest the current economic expansion could last another two and half to three years.

Conclusion

When positioning portfolios for mid to late cycle economic activity, the momentum factor historically had a stronger track record of performance than either small cap or value in generating return. It appears that the maturity of the economic cycle may benefit companies which are showing price strength and are able to leverage economic conditions present in a mature economic expansion. The **Invesco PowerShares DWA Momentum Portfolio (PDP)** is based on a momentum strategy. We believe it may be an appropriate investment vehicle for mid to late cycle investing based on the historical performance of the momentum factor. *Past performance is not a guarantee of future results.*

Furthermore, the late cycle strength of the momentum factor complements the findings of the November Connection report which indicated that the momentum factor tended to perform strongly during periods of rising interest rates. The current economic landscape is one where the economic recovery is mature and there is a threat of higher interest rates due to the expected end of the Federal Reserve's program of purchasing long term Treasuries. The momentum factor has a history of outperformance during periods of higher rates and a mature economic expansions. As a result, PDP may benefit from the macro economic backdrop present in the U.S.

PowerShares DWA Momentum Portfolios

PIZ PowerShares DWA Developed Markets Momentum Portfolio

PIE PowerShares DWA Emerging Market Momentum Portfolio

PDP PowerShares DWA Momentum Portfolio

DWAS PowerShares DWA Small Cap Momentum Portfolio

Investing in securities of small-sized companies may involve greater risk than is customarily associated with investing in large companies. Effective on or about Oct. 4, 2013, the name of the Funds changed from PowerShares DWA SmallCap Technical Leaders to PowerShares DWA SmallCap Momentum Portfolio; PowerShares DWA Technical Leaders to PowerShares DWA Momentum Portfolio; PowerShares DWA Developed Markets Technical Leaders to PowerShares DWA Developed Markets Momentum Portfolio and PowerShares DWA Emerging Markets Technical Leaders to PowerShares DWA Emerging Markets Momentum Portfolio.

⁵ Fama/French Library and Invesco PowerShares, as of November 29, 2013
⁶ Bloomberg L.P., as of November 29, 2013

November 2013

ETF Assets November Δ

▲ **1.8%**

ETF November Net Flows

▲ **\$12.8 Billion**

Decrease in # of ETFs in November

1

ETF Assets and Net Flows by Provider (Ranked by November Assets)

	# ETFs	Assets - \$Mil.			Net Flows - \$Mil.	
		11/30/13	Nov Δ	YTD Δ	Nov '13	YTD
iShares	295	655,048	8,458	97,047	3,034	36,613
State Street	124	380,908	7,595	51,725	1,752	8,250
Vanguard	67	328,013	5,096	83,580	2,882	51,676
PowerShares (Total)	131	93,902	2,263	23,760	452	11,633
WisdomTree	55	34,114	1,247	15,828	873	13,631
ProShares	144	26,419	670	5,271	400	5,330
Van Eck	53	22,486	-1,254	-5,077	-152	761
Guggenheim	70	20,931	1,322	8,726	984	6,268
First Trust	77	18,257	1,092	10,075	688	7,128
Schwab	21	16,135	799	7,582	551	5,514
PIMCO	20	13,275	-283	4,171	-257	4,367
ALPS	13	8,526	241	3,774	302	3,179
Northern Trust FlexShares	15	6,634	218	4,340	232	4,312
Direxion Shares	52	6,456	-107	518	1	1,086
ETF Securities	7	3,007	-220	-1,064	-40	-255
United States Commodities Funds	12	2,623	147	-517	91	-598
Global X Management	37	2,549	99	1,060	145	1,283
Emerging Global Shares	12	1,507	7	414	42	459
AdvisorShares	18	1,021	34	410	38	451
IndexIQ	11	859	4	279	4	265
DB ETFs	16	857	279	717	258	660
Exchange-Traded Concepts	9	771	409	665	414	657
RevenueShares	7	650	28	229	6	76
Fidelity Funds	11	507	43	332	28	257
GreenHaven	1	344	-4	-131	-	-83
Cambria	1	172	20	172	17	156
Precidian	1	165	34	-36	25	-61
Pyxis Capital	1	122	8	90	8	90
ArrowShares	1	84	4	57	6	59
Teucrium Trading LLC	7	74	3	15	5	33
VelocityShares	6	61	1	61	-	58
Pax ETFs	1	54	8	29	7	22
Columbia	5	31	0	5	-0	1
Huntington Strategy Shares	2	30	1	14	-0	8
Renaissance Capital	1	29	1	29	-	29
Franklin Templeton	1	25	25	25	25	25
Russell	1	9	0	6	-	4
Rydex Funds	1	8	-0	8	-	8
FactorShares	5	8	-1	-6	-	1
QuantShares	4	7	-1	-20	-1	-20
Total	1,322	1,646,696	28,291	314,157	12,826	163,329

ETF assets. In November, total assets in US-listed ETFs increased by 1.8% or \$28.3 billion to \$1.65 trillion.

ETF net flows. ETF flows were positive in November with a total net inflow of \$12.8 billion. US sector/industry funds led flows with \$3.4 billion entering the segment.

Product-related news.

The number of ETFs fell by one in November with 11 new funds launched.

The net flow numbers by ETF sponsor is an approximate calculation based on outstanding shares and NAV available on Bloomberg. Δ represents change.

Total ETF Assets

\$1.6 Trillion

Most Inflows in November by Investment Objective

US Sector/Industry

▲ \$3.4 Billion

Most Outflows in November by Investment Objective

Commodity

▼ \$1.5 Billion

ETF Assets and Net Flows by Investment Objective (Ranked by November Net Flows)

	# ETFs	Assets - \$Mil.			Net Flows - \$Mil.	
		11/30/13	Nov Δ	YTD Δ	Nov '13	YTD
US Sector/Industry	175	191,538	6,249	62,904	3,390	33,550
US Mkt. Cap	48	348,090	13,051	104,025	3,326	33,017
Global Region/Country	220	317,669	1,705	46,312	2,798	31,821
US Style	74	148,501	6,060	48,753	1,982	17,419
US Broad	41	132,327	5,190	44,784	1,291	17,828
Global Specialty/Industry	168	49,181	-145	7,332	924	11,109
US Specialty	57	9,927	918	6,675	660	5,327
Leveraged/Inverse	198	33,763	453	5,803	296	6,492
Dividend	64	95,829	1,417	37,296	102	23,808
Currency	17	3,392	-103	-156	-52	13
Fixed Income	220	253,333	-1,596	209	-396	9,815
Commodity	40	63,145	-4,909	-49,778	-1,494	-26,871
Total	1,322	1,646,696	28,291	314,157	12,826	163,329

Net flows by investment objective. US sector/industry products saw the largest amount of inflows in November increasing by \$3.4 billion, followed by US market-cap funds with inflows of \$3.3 billion. Commodity products saw the largest outflows in November with a decrease of \$1.5 billion followed by fixed income funds decreasing \$396 million.

Δ represents change.

ETF with Highest Net Inflows in November

IVV

iShares Core S&P 500 ETF

▲ \$3.0 Billion

ETF with Highest Net Outflows in November

VWO

Vanguard FTSE Emerging Markets ETF

▼ \$2.3 Billion

10 Products with Highest Net Inflows in November (\$M)

Ticker	Name	Flows	Ending AUM
IVV	iShares Core S&P 500 ETF	3,017	51,558
EFA	iShares MSCI EAFE	2,755	51,626
SPY	SPDR S&P 500 ETF	1,619	163,585
SSO	ProShares Ultra S&P500	1,463	3,165
XLI	Industrial Select Sector SPDR	837	8,611
VOO	Vanguard S&P 500 ETF	699	13,699
EWJ	iShares MSCI Japan	683	13,350
BND	Vanguard Total Bond Market	679	17,479
EZU	iShares MSCI EMU	627	7,348
VGK	Vanguard MSCI European ETF	538	12,742

10 Products with Highest Net Outflows in November (\$M)

Ticker	Name	Flows	Ending AUM
VWO	Vanguard FTSE Emerging Markets ETF	-2,268	48,447
UWM	ProShares Ultra Russell 2000	-1,577	265
EEM	iShares MSCI Emerging Markets	-1,549	42,455
IWM	iShares Russell 2000	-1,378	26,541
GLD	SPDR Gold	-1,153	33,955
LQD	iShares iBoxx Investment Grade Corp Bond	-912	15,630
DVY	iShares Dow Jones Select Dividend	-766	12,685
SDY	SPDR S&P Dividend	-703	12,443
EWZ	iShares MSCI Brazil	-661	4,739
MDY	Midcap SPDR Trust Series 1	-572	15,852

Major Market Performance Summary

Best Performance in November

▲ **MSCI China**
4.9%

Worst Performance in November

▼ **Gold**
-5.3%

Major Market Index Performance

	Nov '13	YTD
US Broad Equity Indexes		
DJ Industrial Average	3.48%	24.33%
NASDAQ Composite Index	2.64%	25.68%
S&P 500	3.05%	31.31%
Dow Jones US Total Stock Market	2.92%	32.29%
Market Cap		
Russell 1000	2.81%	31.80%
Russell Midcap	1.66%	33.13%
Russell 2000	4.01%	38.97%
Growth and Value		
Russell 1000 Growth	2.82%	32.07%
Russell 1000 Value	2.79%	31.33%
Russell Mid Cap Growth	2.21%	33.88%
Russell Mid Cap Value	1.05%	32.10%
Russell 2000 Growth	4.11%	43.40%
Russell 2000 Value	3.90%	34.72%
US Sectors		
S&P Consumer Discretionary	3.47%	42.62%
S&P Consumer Staples	1.57%	26.79%
S&P Energy	0.87%	23.82%
S&P Financials	4.57%	34.60%
S&P Health Care	4.71%	42.01%
S&P Industrials	3.58%	37.46%
S&P Information Technology	3.97%	25.98%
S&P Materials	1.30%	22.24%
S&P Telecommunications Services	-2.55%	13.05%
S&P Utilities	-1.90%	13.74%

	Nov '13	YTD
International Equity Markets		
MSCI AC World	1.46%	22.23%
MSCI EAFE	0.77%	20.83%
MSCI EM (Emerging Markets)	-1.46%	-1.17%
MSCI Europe	1.21%	23.22%
MSCI EM Latin America	-4.44%	-11.07%
MSCI AC Asia Pacific	-1.03%	4.90%
MSCI FM Frontier Markets	1.71%	19.08%
MSCI China	4.86%	7.61%
MSCI India	-1.78%	4.58%
MSCI World ex USA	0.17%	14.28%
MSCI Japan	1.49%	25.62%
Commodity Markets		
CRB Commodity Index	-1.07%	-6.70%
Oil	-3.80%	2.11%
Gold	-5.26%	-24.30%
Fixed Income Markets		
10-Year Treasury	-1.29%	-6.21%
Long Term Treasury (10+ Yrs)	-2.41%	-11.41%
High Yield Corp	0.44%	6.82%
US High Grade Corporate	-0.30%	-1.48%
Municipal Bonds	-0.23%	-2.54%
USD Emerging Market Sov Plus	-2.11%	-6.16%
US TIPS	-1.27%	-8.18%
Developed Mkt Gov't Bonds	-2.11%	-7.63%
Currencies		
EU euro (vs. USD)	0.05%	2.84%
Japanese yen (vs. USD)	-3.98%	-16.15%
UK sterling (vs. USD)	2.04%	1.33%

US equities rose 3.1% in November. All style segments of the US markets were up, most notably the Russell 2000® Growth Index, up 4.0%.

All US sectors were up in November with the exception of telecom and utilities. Healthcare increased the most up 4.7% while telecom saw the largest decline losing 2.6%.

Commodities were down overall in November with gold dropping the most falling 5.3%.

Fixed-income performance was down overall in November with the exception of high-yield corporate bonds up 0.4%. Long-term Treasury notes were the worst performer dropping 2.4%.

Performance data quoted represents past performance. Past performance is not a guarantee of future results; current performance may be higher or lower than performance quoted. Index returns do not represent Fund returns. An investor cannot invest directly in an index.

PowerShares ETFs

November 2013

PowerShares ETF with Highest Net Inflows in November

PKW

PowerShares Buyback Achievers Portfolio

▲ \$196 Million

10 PowerShares ETFs with Highest Net Inflows in November (\$M)

Ticker	Name	Flows	Ending AUM
PKW	PS Buyback Achievers Portfolio	196	2,252
PWV	PS Dynamic Large Cap Value Portfolio	183	887
BKLN	PS Senior Loan Portfolio	174	6,242
PJP	PS Dynamic Pharmaceuticals Portfolio	57	875
PDP	PS DWA Momentum Portfolio	49	1,123
PRF	PS FTSE RAFI US 1000 Portfolio	48	2,627
PIZ	PS DWA Dev Mkts Momentum Portfolio	41	552
DWAS	PS DWA SmallCap Momentum Portfolio	34	565
PXF	PS FTSE RAFI Dev Mkts ex-U.S. Portfolio	30	672
PRN	PS Dynamic Industrials Sector Portfolio	23	117

Past 12 Months

PowerShares ETF with Highest Net Inflows in the Past 12 Months

BKLN

PowerShares Senior Loan Portfolio

▲ \$4.9 Billion

10 PowerShares ETFs with Highest Net Inflows in the Past 12 Mo. (\$M)

Ticker	Name	Flows	Ending AUM
BKLN	PS Senior Loan Portfolio	4,897	6,242
QQQ	PS QQQ	2,512	42,614
PKW	PS Buyback Achievers Portfolio	1,779	2,252
PRF	PS FTSE RAFI US 1000 Portfolio	656	2,627
DWAS	PS DWA SmallCap Momentum Portfolio	489	565
PIZ	PS DWA Dev Mkts Momentum Portfolio	401	552
SPHB	PS S&P 500 High Beta Portfolio	338	552
PJP	PS Dynamic Pharmaceuticals Portfolio	335	875
PXF	PS FTSE RAFI Dev Mkts ex-U.S. Portfolio	279	672
PWV	PS Dynamic Large Cap Value Portfolio	277	887

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PowerShares ETF with Highest Net Outflows in November

QQQ

PowerShares QQQ

▼ \$244 Million

10 PowerShares ETFs with Highest Net Outflows in November (\$M)

Ticker	Name	Flows	Ending AUM
QQQ	PS QQQ	-244	42,614
DBA	PS DB Agriculture Fund	-119	1,342
PCY	PS Emg Mkts Sovereign Debt Portfolio	-60	1,882
SPLV	PS S&P 500 Low Volatility Portfolio	-56	3,923
DBC	PS DB Commodity Index Tracking Fund	-46	6,021
PGF	PS Financial Preferred Portfolio	-36	1,488
UUP	PS DB US Dollar Bullish Fund	-30	690
BAB	PS Build America Bond Portfolio	-18	662
DBB	PS DB Base Metals Fund	-16	247
PGX	PS Preferred Portfolio	-16	2,089

PowerShares ETF with Highest Net Outflows in the Past 12 Months

PCY

PowerShares Emg Mkts Sov Debt Portfolio

▼ \$760 Million

10 PowerShares ETFs with Highest Net Outflows in the Past 12 Mo. (\$M)

Ticker	Name	Flows	Ending AUM
PCY	PS Emg Markets Sovereign Debt Portfolio	-760	1,882
DBO	PS DB Oil Fund	-507	320
BAB	PS Build America Bond Portfolio	-350	662
PZA	PS Insured Nat'l Municipal Bond Portfolio	-329	564
DGL	PS DB Gold Fund	-242	151
PHB	PS Fundamental High Yield Corporate Bond	-189	633
DBA	PS DB Agriculture Fund	-165	1,342
PGF	PS Financial Preferred Portfolio	-133	1,488
DBV	PS DB G10 Currency Harvest Fund	-113	208
PVI	PS VRDO Tax-Free Weekly Portfolio	-100	195

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Note: Not all products available through all firms.

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