



# SECTOR ETF TRADER

*A Profitable Approach To Sector Investing.*

March 2009

## TWO TRADES FOR A 'DEFENSIVE' MARKET

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#### **Biotech Industry**

Big biotech's on the hunt for weak firms with juicy pipelines. See how the rich get richer.

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#### **Gold Miners**

Prices are up and costs are down. Jump on this bandwagon and let it run.

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#### **QUESTIONS OR COMMENTS?**

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Welcome to the inaugural issue of *Sector ETF Trader*!

What's the one word summing up my (and probably yours too) feelings about last week's market rally?

Finally!

But as the euphoria of a few positive days wears off one question begs to be answered. Where do we go from here? My thoughts are; if we haven't hit bottom yet, we're close.

There are two pieces of information that caught my attention last week. And they could be a sign the worst is behind us.

First off, GE's stock went up on negative news. When negative news has a positive impact it's a sign the worst is already priced into it. The bottom's close when expectations are worse than reality.

Second we finally got a *positive* surprise from a market indicator. A nice change from the steady run of negative surprises we've seen over the last few months.

March's reading on consumer confidence moved higher from February and beat estimates. Consumer confidence usually starts to rise at the same time we hit the bottom of a recession.

So there's two good signs we're nearing a bottom.

I'll keep my eyes open for a few more to confirm the bottom is in. Until then, I've identified two ETFs that should do well regardless of what the rest of the market does.

## TRADE ALERT 1:

# BIG BIOTECH GETTING BIGGER

Biotech stocks were one of the markets strong points throughout the first part of 2009. Then President Obama came out with a budget calling for major health care reforms. The uncertainty created by the announcement sent health care stocks down across the board.

However, this industry is recovering from the initial knee-jerk reaction. Providing us with an ideal entry point.

**Macro/Economic Trend: Big Biotech is going on a spending spree.**

Biotech is currently divided between the 'the hunters and the hunted'. The large companies have cash. The smaller ones don't.

This division is typical for the industry. The small companies' burn through lots of cash until one of their products hits big. But time is running out for many of them.

Right now, many small firms are in desperate need of new financing. But the credit crunch is limiting access to new capital. The only way for them to stay afloat is by going into survival mode. Some are reserving cash by suspending operations; others are already facing bankruptcy.

The companies with good project pipelines (new treatments/drugs not on the market yet) are prime takeover targets.

This is spurring some unexpected **M&A (merger and acquisition) activity** in the industry.

Normally, you benefit by owning stock of the company being bought. But this time, the buyer should get a boost as well.

Here's why... big companies are able to pick up smaller ones at a great price. Buying up cash strapped companies below market value and adding them to the balance sheet *immediately* boosts valuations.

As a result, the rich are getting richer.

The Biotech ETF that stands to benefit the most from this M&A activity is the **SPDR S&P Biotech ETF (XBI)**.

**Fundamentals: A closer look at XBI**

XBI holds 23 large and mid-cap biotech companies. And it has a relatively small expense ratio of 0.35%.

The top 5 holdings and percentage weight for XBI are –

Company Name	Ticker	% Weight
Myriad Genetics	MYGN	6.88%
Genentech	DNA	6.08%
Biogen Idec	BIIB	5.67%
Vertex Pharmaceuticals	VRTX	5.32%
Alexion Pharmaceuticals	ALXN	5.30%

3/13/09

Right now the valuations of these biotech companies are low by many measures. A **low valuation** limits downside risk, something we're always interested in.

Further, XBI sports solid **earnings growth rate** of more than 24% over the last 5 years. It's no surprise they continue to grow earnings. They're being pushed by an irreversible mega trend, the aging population. This growth rate is particularly impressive when compared to the S&P 500's rate of around 10%.

There aren't many silver linings to this recession, but Biotech could be it.

**Technical: The charts lead the way**

When was President Obama's budget calling for health care reform announced? Here's a hint: look for something that looks like a rocky cliff in the chart below.



You can see in the chart above just how quickly it bounced off the lows. Now two indicators are showing strong momentum for this turnaround.

First, The Stochastic Oscillator dropped into the oversold area last week. Then a bullish crossover indicated the **downward trend reversed**.

And the MACD (moving average convergence divergence) also had a bullish crossover. Indicating **buying momentum is increasing**.

This a classic technical double cross. Two bullish crossovers signal a strong possibility of continuously rising price. And that's great news for this trade.



### Trade Alert

**Buy:** SPDR S&P Biotech ETF (XBI) up to \$51.50

**Recent Price:** \$48.32

**Price Target:** \$60.00

**Stop Loss:** \$43.15

**Remember:** This trade's biggest risk is political. Bad news coming out of Washington could trigger another sell off. Barring that we should see a nice run to the upside. The strongest floor of support is at \$46.50. Watch your stop loss closely if we break below this level.

## TRADE ALERT 2: PANNING FOR GOLD

As you know, gold tends to do well in times of uncertainty. And we're still facing uncertainty on multiple fronts: bank solvency, derivatives, inflation, deflation, and currency devaluations just to name a few.

**Macro/Economic Trend: Gold Miners have a huge window of opportunity.**

The price of gold has been on a tear lately. Higher prices for the yellow stuff is good news for those that dig it... no pun intended.

First let's take a look at the big picture.

The world's suffering its worst economic slowdown in generations. And investors are turning to gold as a safe haven.

The price of gold should move even higher as long as uncertainty hangs around. And with gold prices at this level, mines are hugely profitable. As a result, miners are cranking up production.

**The other major positive factor for miners is cost.**

About 25% of the cost for a mining operation is energy. As you can imagine it takes huge amounts fuel to power the machinery and trucks used to mine, refine, and haul ore. And I'm sure you've noticed the price of oil has plummeted since July.

The other reason costs are down is the currencies of gold producing countries have fallen against the dollar. This means when costs are translated back into dollars they're lower... sometimes as much as 40% in countries that have seen big devaluations of their currency.

**Lower oil costs and currency conversions should help the bottom line for miners even if the price of gold doesn't improve.**

Simply put, combining lower costs and high gold prices creates a recipe for explosive profits. To get in on this modern day gold rush we like the **Market Vectors Gold Miners ETF (GDX)**.

**Fundamentals: A closer look at GDX**

GDX holds 32 companies engaged in acquisition, production, and exploration of gold properties. The expense ratio for this ETF is a very manageable 0.59%.

The top 5 holdings and percentage weight for GDX are –

Company Name	Ticker	% Weight
Barrick Gold	ABX	13.62%
Goldcorp	GG	10.93%
Newmont Mining	NEM	8.79%
Kinross Gold	KGC	5.77%
Agnico Eagle Mines	AEM	5.29%

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As I mentioned earlier, mining costs are down and gold prices are up! It doesn't take an accountant to know this is good for business, as it's bound to improve profit margins.

And miners reaping the benefits of large profit margins will accelerate production and invest heavily in exploration. Which should lead to an increasing earnings growth rate.

**Technical Analysis: The charts lead the way.**

As you can see from the chart below GDX marched higher for almost 4 months before pulling back in mid February. This pullback mirrored gold prices.

A quick note on gold's technicals. Gold is currently right above a firm floor of support. As long as this strong support level holds it should prevent GDX from moving lower.



Back to GDX, the 50 day moving average (MA) has been trending up since mid December. This trend alone gives a good indicator to buy this ETF on any pullback.

But it gets better... the 200 day moving average is coming out its downtrend and flattening out just above the 50 day. The last time we saw a set-up like this the 50 day MA crossed the 200 day MA and GDX went up 38% over the next few months.



### Trade Alert

**Buy:** Market Vectors Gold Miners ETF (GDX) up to \$35.50

**Recent Price:** \$33.08

**Price Target:** \$45.50

**Stop Loss:** \$28.15

**Remember:** GDX is impacted by volatility in gold and oil prices. Any changes to these volatile commodities will be reflected in this ETF. It's also facing resistance of both the 50 and 200 day MA. But if the 50 day MA crosses the 200 day MA watch out this could run.

## SECTOR SNAPSHOTS



### **Consumer Discretionary (-4.1%)**

The carrot must be rotten. Businesses and governments alike continue to dangle carrots in front of customers but they're just not interested. Price discounts and stimulus bill be damned consumers are unwilling to part with their greenbacks. Instead they're opting to stash cash in the mattress.

As long as consumer confidence remains low this sector is going to suffer.



### **Consumer Staples (-4.6%)**

More of the same here. This defensive sector's upward surge has run its course. We're seeing the pull back we knew was coming. The sector is down 4.6% this month on the shoulders of weak consumer spending.

No doubt about it, consumers are becoming more fickle about their purchases. This will lead to a compressing of margins and squeezing of earnings.

This sector is off limits for now.



### **Energy (-11.7%)**

Fill 'er up. China wants as much 'black gold' as they can get their hands on. They're filling their strategic reserves with cheap oil. And the temporary low oil prices are providing an opportunity for China to do just that.

The true supply of oil may be falling off sharply. New oil well drilling is down, the number of rigs in operation has fallen, and OPEC has cut production.

If we get any signals that supply and demand is tipping back toward demand we'll look to add a position in this sector. As a group oil companies have taken a beating. When the commodity rebounds the sector is poised for a breakout.



### Financials (-7.5%)

Well, financials finally had a rally last week but I'm not interested.

There's still too much uncertainty with government stress tests still being administered. At some point we may look back at this as a great buying opportunity. But trying to time your entry is like diving into an empty pool. You may look good going in but it's going to hurt when you hit the bottom.

Do yourself and your portfolio a favor, stay away from financials.



### Healthcare (-9.5%)

Healthcare took a beating at the hands (or should I say mouth) of politics this month.

Exactly how healthcare reform in Washington plays out remains unclear and the resulting uncertainty sparked a sell off.

However, the outlook for this sector remains solid. We're adding a position in the biotech industry this month (see page 4 for more details).



### Industrials (-15.9%)

Can I get some stimulus?

Infrastructure spending will have a major impact on this sector in the coming months. But how and when “The American Recovery and Reinvestment Act” makes its way to the private sector is still a bit cloudy.

\$111 billion in US infrastructure spending will make its way into someone’s pocket. As we find out more details we’ll pinpoint the ETFs most likely to benefit.



### **Technology (-4.4%)**

The water’s still a little too cold for us to jump into tech just yet. We believe tech’s going to lead us out of the downturn. But there’s no reason to get too excited right now.

We’d like to see capital markets stabilize a bit. This should start to loosen the corporate purse strings. When business investment starts to pick up we’ll see more dollars flowing into this sector. Until then we’ll keep a close eye on it.



### **Materials (-5.7%)**

Oh, beautiful gold.

We’re recommending the Gold Miners ETF (GDX) this month on the back of continued strength in gold prices (see page 7 for more details)

The rest of this sector appears to have reached a stabilizing point. However, it’ll require a boost in the economy before we see any improvement.



### **Utilities (-16.7%)**

The market can use some energy but it’s not going to get it from utilities.

The dividend yield of utilities is still attracting new investment dollars. At least they're paying better than most money market funds.

My big concern is production's fired up as demand's fallen off. An oversupply of energy will pressure margins and could put some dividends in jeopardy.

This defensive sector's run its course in this business cycle. We expect prices to come down as dividend yields revert back to their historical norm.

## SECTOR ETF TRADER PERFORMANCE

### Performance Chart

Date	Company	Buy Price	Current Price	Peak Price	Peak Return	Status
3-17-09	SPDR S&P Biotech ETF (XBI)	\$48.32	NEW	NEW	NEW	Buy up to \$51.50
3-17-09	Market Vectors Gold Miners ETF (GDX)	\$33.08	NEW	NEW	NEW	Buy up to \$35.50

### Portfolio Changes

- This month we're buying XBI and GDX...

Performance Table Notes:

- 1) Buy price is the closing price on the date the recommendation was released. These prices have been adjusted for dividends. Your price may be higher or lower.
- 2) Peak price is the highest price a recommendation has traded.

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