

Trade Bonds Like ETFs

With not too many fixed-income ETFs on the market, Ameristock's new products aim to bring competition and choice for investors. The concept behind the ETFs, which track a different index, includes the ability to play the yield curve, pure style, and limited expenses. The move is the next logical step for a company that already has products tracking the prices of oil and natural gas as reflected in their futures

Q: What's the investment philosophy behind the Ameristock exchange-traded funds? How they differ from the other ETF products available?

A: We are launching five new fixed-income ETFs that track the Ryan Treasury Indexes. We decided to launch the fixed-income ETFs to bring competition to this market and choice for the advisors. When we initiated the process, there were hundreds of equity ETFs and only one family of fixed-income ETFs – the iShares of Barclays. In the meantime, more competition appeared as Vanguard and State Street also came out with fixed-income ETFs.

However, all of those products are based on the Lehman Indexes and have similar expense ratios, while our ETFs track the Ryan Treasury Indexes and we have capped the expenses. So although we are not the first, second, or third fixed-income ETF anymore, our products give real choice to investors. Because of the different indexes, our ETFs act differently, and provide more clarity to advisors about what they get.

Q: What are the significant differences between the Ron Ryan and Lehman indices?

A: Ron Ryan is the person who created some of the very first Lehman Index years ago. Then he started his own firm, Ryan ALM, which is an institutional money manager. The new indexes are based entirely on the on-the-run Treasuries, while the Lehman Index is based on all the issues, including the on-the-runs and off-the-runs. That strategy results in "bullet" bonds that provide more than 80% of the total return

of the old Lehman Indexes in an inexpensive and easier way.

While the Lehman 1-3 Year Index is a conglomeration of securities with maturity between one and three years, the Ryan 1 Year Index provides exposure to maturity of exactly one year. Similarly, the Ryan 2 Year Index has maturity of exactly two years, etc. That strategy gives the exact maturity that the index investors get, and that helps to match the liability and to play the yield curve better.

Overall, as interest rates move up and down, the yield curve doesn't always move in a straight line, it wiggles, fluctuates, and goes steep to normal to inverse or flat. If you have a conglomerate of many securities, you don't really know how the portfolio or the index is going to react to the fluctuations of interest rates. On the other hand, the Ryan indexes don't depend on the fluctuations and you have predictability of the reaction.

We believe that an ETF tracking the Ron Ryan 1-Year Index is cash equivalent. It maybe suitable to replace the cash in an asset allocation for the investors who want to earn additional interest without taking credit risks. Since it invests 100% in Treasuries, there's no credit risk. As an ETF, it is very liquid, tax efficient, and we have capped the expense ratio at 15 basis points.

That's an easy way to invest cash for the nominal cost of the ticket, regardless of the size of the investment. Also, unlike in CDs, there are no penalties. If you buy a



NICHOLAS D. GERBER Ameristock founder co-manages the Ameristock Mutual Fund. Prior to establishing Ameristock, Gerber served as a portfolio manager with Bank of America Capital Management, where he was responsible for the daily stewardship of four funds with a combined value in excess of \$240 million.

Before joining Bank of America, Gerber was Managing Director of the Marc Stevens Futures Index Fund. It was there that he created and managed a futures index fund that was ultimately purchased by Newport Commodities.

Gerber's two decades of experience in institutional investment include a successful stint as a floor trader on the New York Futures Exchange. Gerber holds an MBA in finance from the University of San Francisco and a BA from Skidmore College.

“The exchange traded funds alleviate the hurdles in trading bond and futures, and I believe that we help broaden the market.”

Ameristock ETFs

Name	% of Net Assets	Coupon	Maturity	Modified Duration (yrs)	"Yield to Maturity"
AMERISTOCK/RYAN 1 YEAR TREASURY ETF (SYMBOL: GKA)					
Treasury (912828EZ9)	28%	4.6250%	03/31/08	0.637	4.930%
Treasury (912828BK5)	72%	3.1250%	09/15/08	1.074	4.741%
GKA				0.952	4.794%
Ryan 1 Year Index				0.953	4.811%
AMERISTOCK/RYAN 2 YEAR TREASURY ETF (SYMBOL: GKB)					
Treasury (9128274V1)	30%	4.7500%	11/15/08	1.224	4.744%
Treasury (912828DB3)	70%	3.5000%	11/15/09	2.153	4.559%
GKB				1.874	4.615%
Ryan 2 Year Index				1.888	4.546%
AMERISTOCK/RYAN 5 YEAR TREASURY ETF (SYMBOL: GKC)					
Treasury (912828FW5)	29%	4.6250%	10/31/11	3.775	4.586%
Treasury (912828AP5)	71%	4.0000%	11/15/12	4.664	4.580%
GKC				4.406	4.582%
Ryan 5 Year Index				4.417	4.593%
AMERISTOCK/RYAN 10 YEAR TREASURY ETF (SYMBOL: GKD)					
Treasury (912828FF2)	42%	5.1250%	5/15/16	6.967	4.785%
Treasury (912810EG9)	58%	8.7500%	8/15/20	8.321	4.965%
GKD				7.752	4.889%
Ryan 10 Year Index				7.742	4.759%
AMERISTOCK/RYAN 20 YEAR TREASURY ETF (SYMBOL: GKE)					
Treasury (912810ES3)	48%	7.5000%	11/15/24	10.461	5.015%
Treasury (912810FE3)	52%	5.5000%	8/15/28	12.382	4.992%
GKE				11.498	5.003%
Ryan 20 Year Index				11.506	4.835%

DATA THROUGH: 07/31/07

1-year CD, you're locked in for a year, while with the 1-Year Ryan ETF you can take out your money at any time with no penalty. Compared to money-market funds, it should provide a higher yield under normal market conditions because money-market funds can't invest that far out.

But, above all, the beauty of these products is that they are pure in style. You know exactly what you're going to get; everything is very transparent and the holdings will be available through Ameristock.com, while nobody has any idea exactly what's in those iShare ETFs.

Q: Could you explain the on-the-run concept?

A: The on-the-run security is always the newest Treasury bill, note, or bond. The Treasury comes out with a new 2-year note a few times a year. That new two-year note becomes the on-the-run security. It is very popular because it is the benchmark not just for the Treasury yield curve, but for all the yield curves, regardless whether corporate, municipality, or sub-prime.

The on-the-run issue is very liquid because it is always the point along the yield curve that people are looking at. Because it is so popular, it is also more expensive than the old issues. As a result, two bonds with the same maturity may be trading at different prices. For example, many people are always willing to pay an extra penny for the newest tomato because they think it is fresher, even though the other tomatoes are still very good. So the new Treasury issue is a bit more expensive than the more seasoned issues with maturity right around it.

Q: How many securities will be there be at any given time in each of the funds?

A: The Ryan Index is based entirely on the on-the-run issue, so it is comprised of one or two securities (for the 1 and 20 years). However, our strategy includes investing in some of the seasoned issues right around it, so we'll probably have between two and five securities in a portfolio. In that way, the total return remains the same, the risk is the same, but we are able to cut down

the turnover and the expenses and, ultimately, to add some alpha.

So we aren't going to exactly own the index but we'll aim to match the total return of the index. If we own exactly the index, the total return would be the index minus the 15 basis points expense ratio. But if we buy securities that are similar and a bit cheaper, we may get the same return with an improvement of some basis points over time.

Nevertheless, our ETF products are still index funds. We are staying true to the index and we're not trying to beat it. We are just trying to keep the costs low and to add some alpha without adding any risk. Our investors want to know what they get and we do not want to surprise them.

Q: The exchange-traded funds are known as difficult products due to liquidity concerns. Do you agree that the number of the specialists who make markets for the ETFs are decreasing?

A: Certainly, the dynamics of the specialists in the ETF world has been changing over the last few years and the window of opportunity is closing quickly. We feel very privileged that we are releasing our ETF products now; it would be much more difficult if we were just starting the process.

But the liquidity concerns are hardly relevant for our fixed-income ETFs, which are based 100% on the U.S. Treasury market. This is the world's largest financial market and the most liquid one. You can trade 24/7, so we don't envision any problems buying or selling the underlying securities. Moreover, our specialist Kellogg plans to make a very tight market by hedging itself well in this liquid market.

Many ETFs come out as illiquid because they invest in illiquid securities, such as foreign or exotic markets. In those cases, the specialists have to take a lot of risk to make markets every day because some stocks may trade only once a week. That's why they need a fairly wide bid/ask to take on the underlying illiquidity risk. Kellogg, on the other hand, can offset a large order in the Treasury market within a basis point or two. That's why they are able to give a tighter market to the investors.

Q: Could you explain to our readers the dynamics of the ETF market?

A: A few years ago, when there were just a handful of ETFs, it was not unusual to see a specialist to provide \$40 or \$60 million dollars into an ETF on the first day of trading. In essence, the specialist was funding the ETF and making it profitable on day one. That was a very nice business model for the fund sponsors. Because the ETFs were new and exciting for investors, the specialists could sell their positions fairly quickly and there was a good spread.


Now investors are much more comfortable trading the ETFs and the spreads have narrowed down. You can buy them not just on the NYSE or the AMEX, but also on ECN markets like BAT and Archipelago. The spreads are very thin on the third-party markets and the trading is fast. Hedge funds are also using them for arbitrage between buying and selling the underlying security or buying one ETF and selling another.

So the opportunity for the specialists to profit has slowly declined in this competitive marketplace. Many of them have left the ETF business or have gone out of business. But because now there are fewer specialists, they can dictate the terms better. They start to lower the amount that they are willing to put in, and at the same time there are more ETFs. So the dynamics of the marketplace is quickly switching the power to the specialist. That means that you cannot just put the ETF on the wall and hope it sticks. You have to go out and sell it with a strong underlying economic reason for the investors.

I expect that now, when the specialists have the upper hand, other people will try to take that power away. We'll start seeing the plan sponsor putting up money for the first trade, no longer relying on the specialist to provide liquidity. Or, we may find the sponsor bringing in financing from private equity groups, for example. In another scenario, it may be the trading desk funding the trade because they're making a market and having inventory anyway, but they might get paid for this by the fund sponsor. If it's a long term relationship, it may be part of the management fee. That's where I expect the next evolution of the market.

Q: Is the short-side dynamics substantially different?

A: No. The beauty of the ETFs is that, all of a sudden, bonds trade like stocks. Shorting a bond is not that easy for the average investor, but is quite easy with an ETF. Because we provide five different ETFs exactly along the yield curve, if the interest rates fluctuate as opposed to just going up or down, you can go long for the 20-year ETF and short the 1-year ETF. Therefore, you don't really care if interest rates go up or down.

Because it is so easy to go long and short with ETFs, investors may play the yield curve, not just invest along the curve. The investors with a ladder strategy would not need to monitor the portfolio because we rebalance each time the next on-the-run security comes out. So they don't have to worry about a 5-year bond becoming a 4, 3, 2 or 1-year bond. It stays at 5 years. 

Ameristock/Ryan Treasury ETFs

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ETF FAMILY FACTS	
Total Net Assets*	\$25.5
Total Number of ETFs	5

AMERISTOCK/RYAN 1 YEAR TREASURY ETF	
Ticker Symbol	GKA
Total Net Assets*	\$5.03
Index	Ryan 1 Yr

AMERISTOCK/RYAN 2 YEAR TREASURY ETF	
Ticker Symbol	GKB
Total Net Assets*	\$5.06
Index	Ryan 2 Year

AMERISTOCK/RYAN 5 YEAR TREASURY ETF	
Ticker Symbol	GKC
Total Net Assets*	\$5.11
Index	Ryan 5 Year

AMERISTOCK/RYAN 10 YEAR TREASURY ETF	
Ticker Symbol	GKD
Total Net Assets*	\$5.14
Index	Ryan 10 Year

AMERISTOCK/RYAN 20 YEAR TREASURY ETF	
Ticker Symbol	GKE
Total Net Assets*	\$5.17
Index	Ryan 20 Year

*millions	
Data through: 07/31/07	
Source: Company Documents	

Ticker staff searches for funds for their consistency in performance and durability of investment style.

Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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