

**St. John's University**  
**Student Managed Investment Fund**  
**Presents:**  
**iShares Dow Jones US Pharmaceuticals Index**  
**Fund**



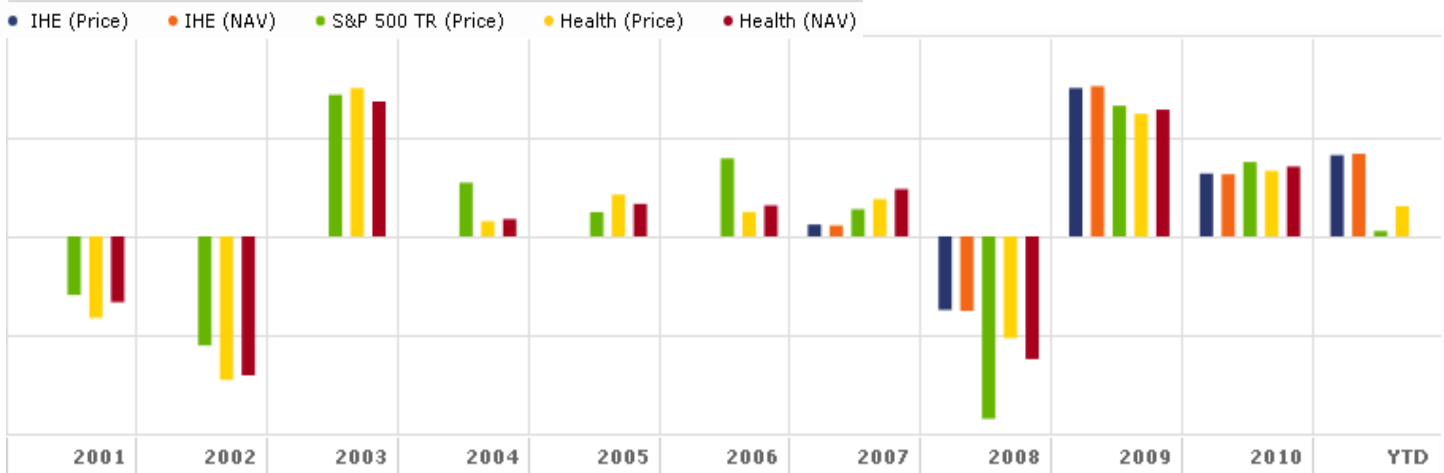
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**Fund Data(12/9/2011):**

Price:	\$74.47	Beta (5 Year):	0.84
Shares Outstanding:	3,950,000	52 Week High:	75.18
Market Capitalization:	\$294.16M	52 Week Low:	61.12
Expense Ratio:	0.47%	12-Month Yield:	1.28%
Total Holdings:	39		

**Annual Returns IHE**





## Executive Summary

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The iShares Dow Jones Pharmaceutical US Index Fund (IHE) should be considered as a buy option for the student managed investment fund based upon the various analyses conducted: analysis of industry performance, top ten holding analysis, iShares comparisons, competitive standing, and risk assessment.

IHE's performance has continued to excel in relation to various other health-care ETFs, as well as other health-care iShares. After tracking the performance of their top ten holdings we have decided IHE will experience significant long-term growth. Although there are risks associated with investing in the pharmaceutical sector, IHE's diversified holdings, including prescription and generic brand drugs, mitigates many of the outlying risks.

The healthcare sector as a whole has continued to perform relatively well, with positive projections for the future. In relation to other sectors healthcare has enjoyed substantial job growth, even through the past recession. Throughout the financial recession of 2008 to 2010, healthcare was one of the only sectors that experienced a slow but stable growth. This can be attributed to the required level of skilled human capital and the necessity for healthcare in the economy. In 2008, it accounted for \$2.3 trillion and 16.2% of the US economy.<sup>1</sup>

Due to the recent recession, there was a drop in the amount of people privately insured; however, ObamaCare has recently led to an increase in insurance subscriptions and spending. Besides insurance, pharmaceuticals are expected to grow by 4-6% with stronger near term growth in the US accompanied by an expansion of markets in emerging economies.<sup>2</sup> The expected growth in US markets is because of price increases, tighter inventory control and management<sup>3</sup>, and because of the aging US demographic.

We chose to invest in iShares for three strategic reasons. First off, iShares is the world's largest ETF provided, managed by BlackRock. There are more than 460 iShare ETFs globally, totaling approximately \$497 billion in assets.<sup>4</sup> Secondly, BlackRock is the largest asset management firm globally, which enables iShares to benefit significantly from economies of scale. The iShares focus heavily on tracking quality indexes. Lastly, iShares are transparent which enables investors to gauge their exposure on an ongoing basis, down to each individual holding, and respond accordingly to market activity.

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<sup>1</sup> <http://www.reuters.com/article/2010/01/05/us-usa-healthcare-spending-idUSTRE6040MP20100105>

<sup>2</sup> <http://www.imshealth.com/portal/site/imshealth/menuitem.a46c6d4df3db4b3d88f611019418c22a/?vgnnextoid=500e8fabedf24210VgnVCM100000ed152ca2RCRD&cpsextcurrchannel=1>

<sup>3</sup> <http://www.imshealth.com/portal/site/imshealth/menuitem.a46c6d4df3db4b3d88f611019418c22a/?vgnnextoid=500e8fabedf24210VgnVCM100000ed152ca2RCRD&cpsextcurrchannel=1>

<sup>4</sup> [http://us.ishares.com/understand\\_etf/why\\_ishares/index.htm](http://us.ishares.com/understand_etf/why_ishares/index.htm)



**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006

With the projected growth of the healthcare sector and IHE’s strong holding allocation, it is our belief that 340 shares of IHE should be purchased for the student managed investment fund portfolio.

## Recommendation: BUY (340 Shares)

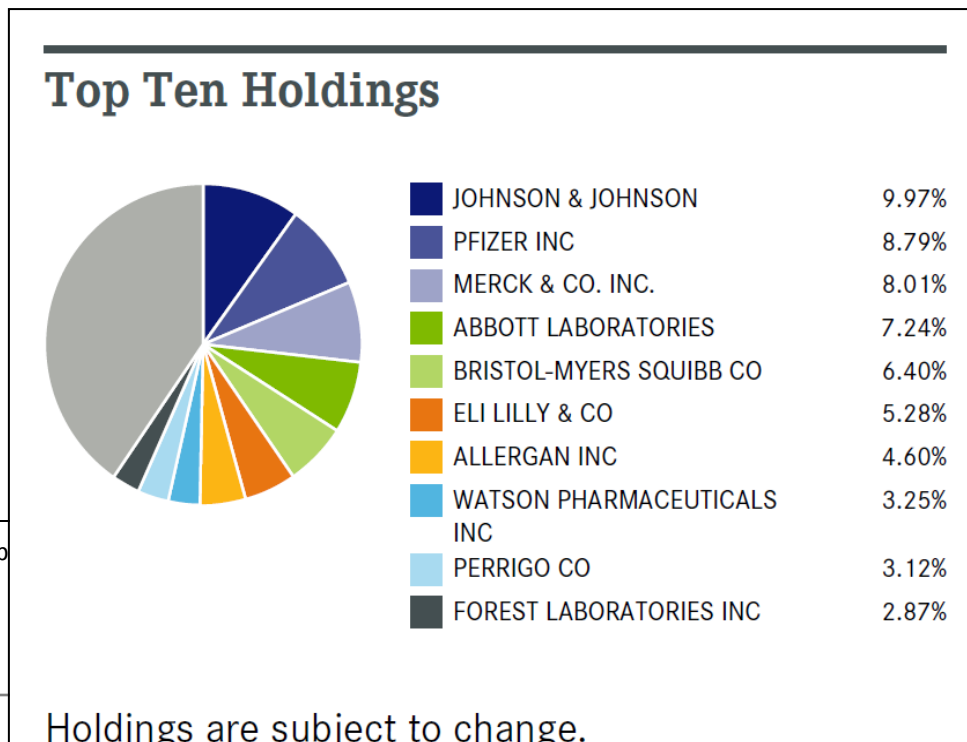
### Fund Overview<sup>5</sup>

“The iShares Dow Jones U.S. Pharmaceuticals Index Fund seeks investment results that generally correspond to the price and yield performance, before fees and expenses, of the Dow Jones U.S. Select Pharmaceuticals Index (iShares).” The Index measures the performance of the pharmaceuticals sector of the United States equity market, and includes pharmaceutical companies such as manufacturers of prescription or over-the-counter drugs or vaccines, but excludes producers of vitamins.

The Fund’s investment advisor is BlackRock Fund Advisors.

As of 12/09/2011, IHE’s top 10 holdings, or 59.53% of the fund, consist of large pharmaceutical companies; however IHE’s total holdings are dispersed amongst large and small pharmaceuticals.

Below shows the top 10 holding allocations, as of 12/9/2011:



<sup>5</sup> http



**Johnson & Johnson (JNJ)<sup>6</sup>:**

Johnson & Johnson stands alone as the leader of the major health-care industries. Johnson & Johnson ranks as the world's largest and most diverse health-care company. They are comprised of three divisions: pharmaceutical, medical devices, and diagnostics and consumer. The pharmaceutical division represents 36% of total sales.

Johnson & Johnson maintains a diverse revenue base, a strong research pipeline, and very strong cash-flow generation. They have experiencing patent losses on antipsychotic Risperdal and neuroscience drug Topamax which have weighted on their recent performance.

**Price (12/09/2011):** \$64.53  
**52-Week Range:** 57.50-68.05  
**Market Cap:** 178.3B  
**Forward P/E (12/09/2011):** 15.7

**Pfizer Inc. (PFE)<sup>7</sup>:**

Pfizer holds onto their sturdy foundation due to their strong cash flows generated from an array of diverse drugs. Pfizer is a research-based global pharmaceutical company, whose main focus is discovery, development, manufacturing and marketing of prescription medicines for both humans and animals.

Pfizer's large size gives them a significant competitive advantage in the development of new drugs. Due to this unmatched size, and their large portfolio of patent-protected drugs, Pfizer has built a strong empire for themselves in the health-care industry.

**Price (12/09/2011):** \$20.56  
**52-Week Range:** 16.59-21.45  
**Market Cap:** 160.9B  
**Forward P/E (12/09/2011):** 16.1

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<sup>6</sup> <http://quote.morningstar.com/stock/s.aspx?t=jnj>

<sup>7</sup> <http://quote.morningstar.com/stock/s.aspx?t=pfe>



**Merck & Co. (MRK)<sup>8</sup>:**

Merck manufactures pharmaceutical products to treat conditions in a number of therapeutic areas that include: cardiovascular disease, asthma, infections, and osteoporosis. Merck also has a substantial vaccine business with various treatments to prevent hepatitis B and pediatric diseases along with HPV and shingles.

Merck has recently experienced some difficulties including increased competition, patent losses, and a pipeline of late-stage drugs with poor chances of approval. In order to overcome these obstacles, Merck has acquired Schering-Plough.

**Price (12/09/2011):** \$35.68  
**52-Week Range:** 29.47-37.65  
**Market Cap:** 110.3B  
**Forward P/E (12/09/2011):** 26.2

**Abbott Laboratories (ABT)<sup>9</sup>:**

Abbott Laboratories focuses on manufacturing and marketing pharmaceuticals, medical devices, blood glucose monitoring kits, and nutritional health-care products. Their products include prescription drugs, coronary and carotid stents, and nutritional liquids for infants and adults. With their recent acquisition of Advanced Medical Optics, Abbott also markets eye-care products.

Abbott holds a wide range of patent-protected drugs, a leading diagnostic business, nutritional division, and a top-tier vascular group. Abbott has also decided to split its company into two which will most likely result in a drug company and a diversified health-care company. Abbott currently generated slightly less than 60% of revenue of pharmaceuticals.

**Price (12/09/2011):** \$54.57  
**52-Week Range:** 45.07-55.61  
**Market Cap:** 85.6B  
**Forward P/E (12/09/2011):** 18.7

<sup>8</sup> <http://quote.morningstar.com/stock/s.aspx?t=mrk>

<sup>9</sup> <http://quote.morningstar.com/stock/s.aspx?t=abt>



**Bristol-Myers Squibb Co. (BMY)<sup>10</sup>:**

Bristol-Myers Squibb Co. focuses on the discovery, development, and marketing of pharmaceuticals for various diseases, such as: cardiovascular and infectious diseases, cancer, and psychiatric disorders. After their partnership, Bristol-Myers has built a substantial portfolio of drugs and a hearty pipeline.

Beginning in 2012 Bristol-Myers will be experiencing major patent losses. However, their new generation of drugs are expected to fill the patent holes over the next ten years.

**Price (12/09/2011):** \$33.54  
**52-Week Range:** 24.97-33.72  
**Market Cap:** 57.2B  
**Forward P/E (12/09/2011):** 17.1

**Eli Lilly & Co. (LLY)<sup>11</sup>:**

Eli Lilly & Co. is a pharmaceutical company which focuses on neuroscience, endocrinology, oncology, and cardiovascular therapeutic area. Lilly's key products include: antipsychotic Zyprexa, Cymbalta for depression and fibromyalgia, Alimta for cancer, Evista and Forteo for osteoporosis, Humalogm, Humulin, and Byetta for diabetes, and Cialis for erectile dysfunction.

Many of Lilly's patents will be expiring within the next three years, with more than 40% of its current sales encountering generic competition.

**Price (12/09/2011):** \$39.27  
**52-Week Range:** 33.46-40.13  
**Market Cap:** 45.9B  
**Forward P/E (12/09/2011):** 9.4

<sup>10</sup> <http://quote.morningstar.com/stock/s.aspx?t=BMY>

<sup>11</sup> <http://quote.morningstar.com/stock/s.aspx?t=lly>



**Allergan Inc. (AGN)<sup>12</sup>:**

Allergan Inc. focuses on the development of pharmaceuticals and medical devices for therapeutic and cosmetic purposes. Allergan's pharmaceutical division accounts for 83% of its total revenue. This division produces Botox, the world's leading neuromodulator, and other treatments for skin-care, overactive bladder, and eye conditions. Their remaining revenue comes from Allergan's medical device segment, which sells products for breast aesthetics, facial aesthetics, and obesity intervention.

**Price (12/09/2011):** \$83.49  
**52-Week Range:** 68.03-89.25  
**Market Cap:** 25.9B  
**Forward P/E (12/09/2011):** 28.5

**Watson Pharmaceuticals Inc. (WPI)<sup>13</sup>:**

Watson Pharmaceuticals Inc. is the world's fourth largest global generic pharmaceutical manufacturer. Their branded pharmaceutical division specializes primarily in women's health and urology, and Anda, a drug distribution subsidiary.

Watson pursues a less aggressive acquisition strategy which is the opposite of the industry trend as a whole. This approach has enabled Watson to maintain strong returns on capital and high free cash flows; however Watson now lags behind on scale advantages, an international footprint, and lower cost operations via vertical integration. These factors place it at greater risk in comparison to its competitors.

**Price (12/09/2011):** \$61.52  
**52-Week Range:** 48.20-73.35  
**Market Cap:** 7.9B  
**Forward P/E (12/09/2011):** 42.0

<sup>12</sup> <http://quote.morningstar.com/stock/s.aspx?t=AGN>

<sup>13</sup> <http://quote.morningstar.com/stock/s.aspx?t=wpi>



**Perrigo Co. (PRGO)<sup>14</sup>:**

Perrigo Co. is the largest store-brand over-the-counter pharmaceutical and infant formula manufacturer. Perrigo operates in four different segments: consumer health care, nutrition, prescription pharmaceuticals, and active pharmaceutical ingredients. Perrigo operates internationally with approximately 20% of sales from international markets.

**Price (12/09/2011):** \$99.63  
**52-Week Range:** 62.31-101.94  
**Market Cap:** 9.5B  
**Forward P/E (12/09/2011):** 27.7

**Forest Laboratories, Inc. (FRX)<sup>15</sup>:**

Forest Laboratories, Inc. is a pharmaceutical company that focuses on in-licensing drugs and development. Forest Labs has a strong focus on central nervous system drugs, including antidepressants Celex, Lexapro, Viibryd, Alzheimer's drug Namenda, fibromyalgia drug Savella, and beta blocker BYstolic. Forest Labs primarily sells drugs in the US with a small presence overseas. Many of Forest Labs' patents are expiring in the upcoming years, which is causing them to transform their business structure and diversify their portfolio.

**Price (12/09/2011):** \$29.66  
**52-Week Range:** 28.56-40.52  
**Market Cap:** 7.9B  
**Forward P/E (12/09/2011):** 7.3

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<sup>14</sup> <http://quote.morningstar.com/stock/s.aspx?t=prgo>

<sup>15</sup> <http://quote.morningstar.com/stock/s.aspx?t=frx>





**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006

## iShare Comparison

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### **IHE vs. Other Healthcare iShares**

Once we decided upon investing in a Healthcare iShares, we had to decide on which iShare to choose. We did this by looking at all Healthcare iShares, according to various factors, and chose the iShare that we felt performed the best. The seven Healthcare iShares consist of:

1. MSCI ACWI ex US Health Care Sector Index Fund (AXHE)
2. Nasdaq Biotechnology Index Fund (IBB)
3. Dow Jones US Pharmaceuticals Index Fund (IHE)
4. Dow Jones US Healthcare Providers Index Fund (IHF)
5. Dow Jones US Medical Devices Index Fund (IHI)
6. S&P Global Healthcare Sector Index Fund (IXJ)
7. Dow Jones US Healthcare Sector Index Fund (IYH)

Of these seven funds, IHE is the only fund with a five star rating, according to Morningstar. All of the others are 2 or 3 star funds. All expense ratios were the same, stated at either 0.47% or 0.48%. Because of this consistency in Expense Ratios, we did not use this factor in determining which iShare to choose. IHE also had strong returns, high yields, and competitive ratios, which will be explained in further detail below.



# Performance Comparison

## I. Longer-Term

### Annualized Returns- IHE vs. Healthcare iShares:

Symbol Asset Class	iShares Fund Name	Annualized Returns (%)				
		1 Yr	3 Yr	5 Yr	10 Yr	Since Inception
AXHE	MSCI ACWI ex US Health Care Sector Index Fund	2.95	--	--	--	8.87
IBB	Nasdaq Biotechnology Index Fund	8.28	5.01	5.02	2.40	-0.53
IHE	Dow Jones U.S. Pharmaceuticals Index Fund	9.81	12.29	6.32	--	6.86
IHF	Dow Jones U.S. Healthcare Providers Index Fund	4.58	4.85	-0.33	--	1.01
IHI	Dow Jones U.S. Medical Devices Index Fund	5.00	-0.40	4.05	--	2.59
IXJ	S&P Global Healthcare Sector Index Fund	5.28	3.49	0.43	--	1.90
IYH	Dow Jones U.S. Healthcare Sector Index Fund	5.03	3.43	1.48	1.94	1.89

### 5 Year Returns:





**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006

In looking at returns over the intermediate and long-term horizons, IHE had the highest Annualized Returns out of all HealthCare iShares. For 1-year returns, IHE had 9.81% which was the greatest return. Among 3-year returns, IHE also has the greatest return, by far, at 12.29%. In terms of 5-year returns, IHE also had the greatest return at 6.32%. The fund’s closest competitor in each category was IBB, a two-star fund according to Morningstar, which still did not match the returns of IHE. Annualized, IHE also has the greatest returns since Inception on 05/01/2006<sup>16</sup> at 6.86%.

**II. Nearer-term**

**Cumulative, Short-term Returns- IHE vs. Healthcare iShares:<sup>17</sup>**

Symbol ^ Asset Class >	iShares Fund Name >	Cumulative Returns (%) ⓘ				
		YTD >	1 Mo >	3 Mo >	6 Mo >	Since Inception >
■ AXHE	MSCI ACWI ex US Health Care Sector Index Fund	0.29	-5.70	-9.96	-2.38	10.92
■ IBB	Nasdaq Biotechnology Index Fund	-0.02	-3.05	-12.48	-6.82	-5.48
■ IHE	Dow Jones U.S. Pharmaceuticals Index Fund	4.77	-4.02	-9.29	0.63	43.28
■ IHF	Dow Jones U.S. Healthcare Providers Index Fund	-4.31	-8.75	-20.92	-16.80	5.57
■ IHI	Dow Jones U.S. Medical Devices Index Fund	-3.97	-7.83	-15.58	-12.01	14.83
■ IXJ	S&P Global Healthcare Sector Index Fund	2.09	-4.87	-10.01	-2.32	20.43
■ IYH	Dow Jones U.S. Healthcare Sector Index Fund	1.19	-4.55	-10.99	-4.67	23.57

Over shorter, near-term horizons, IHE has performed much better than the other iShares as well. Year-to-date, IHE has cumulative returns of 4.77%, while the closest competitor in this category (IXJ), only has returns of 2.09%. Among 6-month returns, IHE is the only one with a positive cumulative return at 0.63%. It is clear to see that IHE exhibits the best performance out of all Healthcare iShares, as illustrated in the annualized and cumulative returns.

<sup>16</sup> [http://us.ishares.com/product\\_info/fund/overview/IHE.htm](http://us.ishares.com/product_info/fund/overview/IHE.htm)

<sup>17</sup> [http://us.ishares.com/product\\_info/fund/overview/IHE.htm](http://us.ishares.com/product_info/fund/overview/IHE.htm) (Reported as of 9/30/2011)



**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006

### **III. Key Fundamentals**

After documenting that IHE has performed the best, we looked at other key fundamentals to ensure that IHE was not only the best in terms of performance, but competitive all around. IHE has a 12-Month Yield of 1.28%<sup>18</sup> which is right in the middle of all the others. This shows it may not have the highest yields, but it does certainly have strong, competitive yields. Its Price/Earnings ratio is also right in the middle at 21.34, exhibiting strong, competitive earnings. IHE has a 5 Year Adjusted Beta of 0.84 and a Standard Deviation of 2.61, which is also right in the middle of the funds. From this information, it is clear to see that IHE is not as volatile as some of its competitors, yet more volatile than others. IHE is less risky than the market and tends not to deviate from its returns too greatly.

In terms of these Key Fundamentals, IHE may not have the highest numbers, but it is certainly does have numbers in the middle, or upper-middle, of the range. The performance of IHE is the best of all funds, which was already proven, and the other key fundamentals only prove that, although not the best at all the components other than performance, it exhibits strong, competitive characteristics all around. Overall, IHE is the greatest fund by performance, and one of the strongest funds by other key fundamentals.

### **IV. Other Competitor Comparison**

After selecting IHE as the healthcare iShare of choice, we compared IHE to all other healthcare ETF's to see how well it stacked up amongst the others. In total, there are 16 healthcare ETFs, consisting of iShares, SPDRs, PowerShares, HOLDRs, Vanguard, and First Trust. Considering we have previously identified the iShare that we believe to be best choice, we will not be comparing IHE to the other iShares again, and will only be focusing on the other healthcare ETFs. In order to best compare IHE to its closest competitors, biotechnology ETFs were not included in this analysis, as the main focus was geared to the pharmaceutical industry. The remaining five ETFs, all in the healthcare or pharmaceuticals industry, were used to complete an analysis of IHE. The ETFs we chose as comparables are:

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<sup>18</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/05/2011)

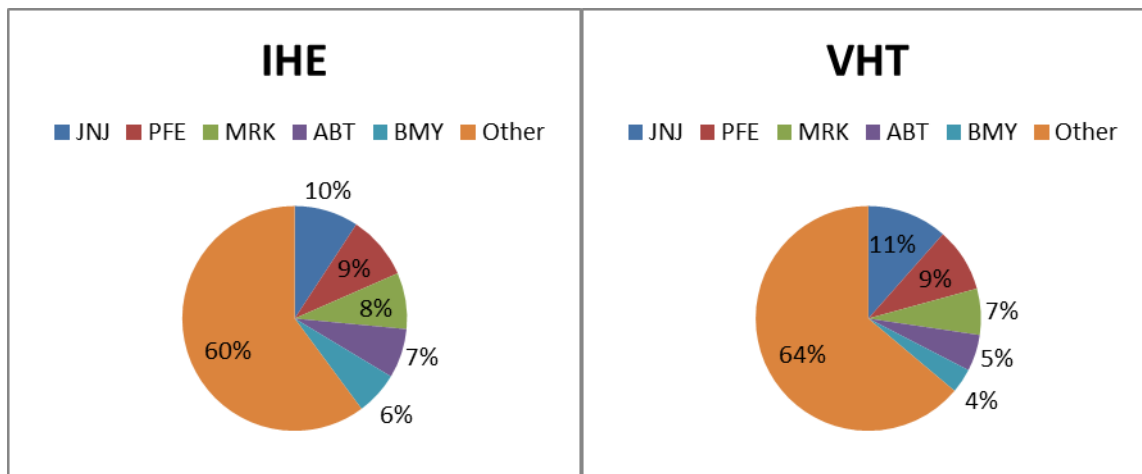


1. Health Care Select Sector SPDR (XLV)
2. Vanguard Healthcare ETF (VHT)
3. SPDR S&P Pharmaceuticals (XPH)
4. PowerShares Dynamic Healthcare (PTH)
5. PowerShares Dynamic Pharmaceuticals (PJP)

We specifically chose these five as comparables because they were the most closely related competitors of the 16 total. These five represent the portion of healthcare and pharmaceutical ETFs, excluding biotechnology or iShares.

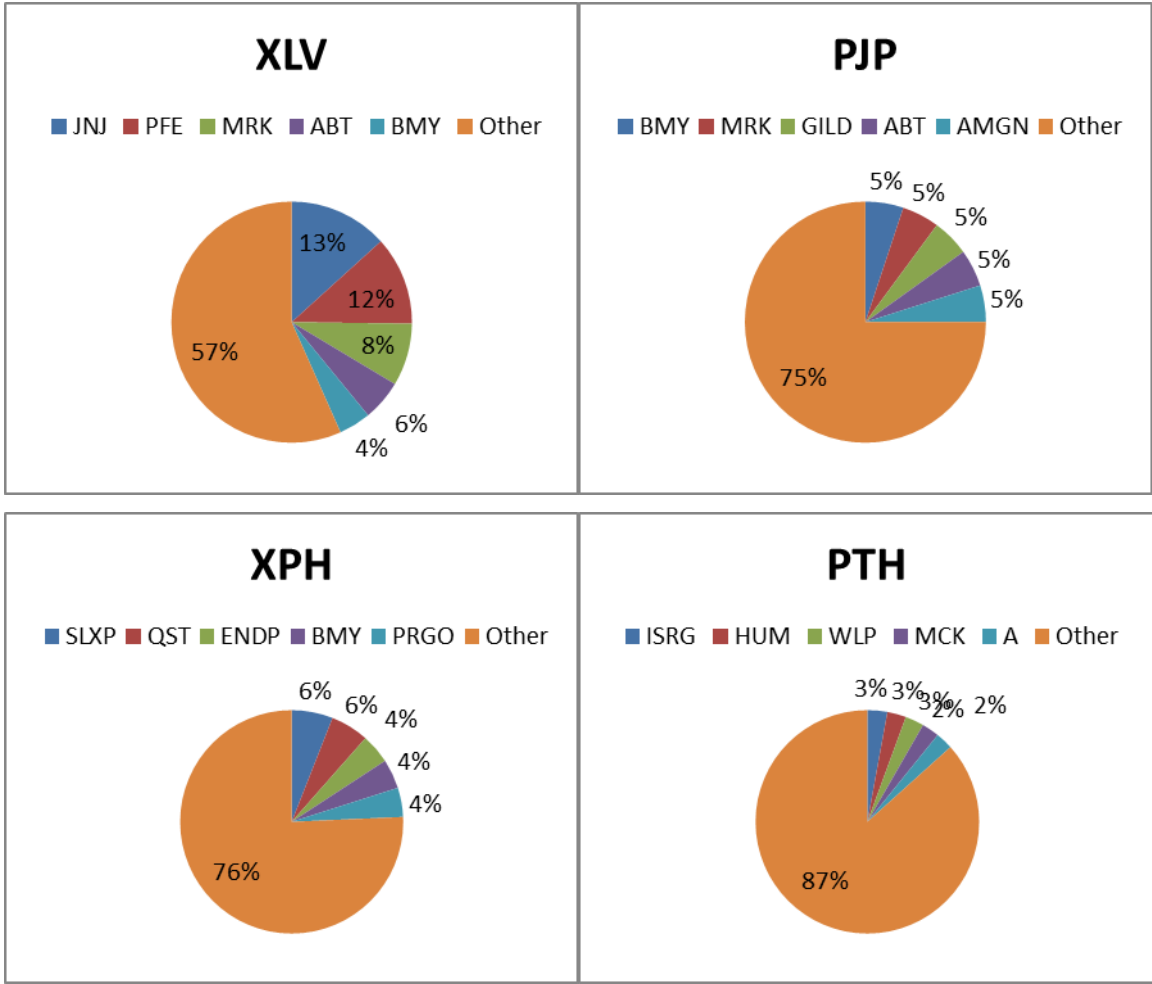
**IHE Top Holdings vs. Other Healthcare ETFs**

In order to get a better idea of what type of companies each fund focuses on, how it is performing, and how it will be expected to perform in the future, we looked into the top five holdings, or the companies in which the portfolio hold its largest allocations in order to see whether they were larger capitalization or middle capitalization.





**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006



After reviewing the top holdings, it was noted that many of the funds hold the same companies in its top holdings as IHE, some with greater weights than others. Nonetheless, each ETF had top holdings in healthcare/pharmaceutical companies, either mid to large capitalization.

**Key Fundamentals- IHE vs. Other Healthcare/Pharmaceutical ETFs**

IHE was compared to each of the five different chosen Healthcare ETFs in terms of key fundamentals such as Star Ratings, 12 Month Yields, Returns, Betas, Expense ratios, and star ratings.



Star Ratings<sup>19</sup>:

<u>ETF</u>	<u>Star Rating</u>
IHE	★ ★ ★ ★ ★
PJP	★ ★ ★ ★ ★
XPH	★ ★ ★ ★ ★
VHT	★ ★ ★
XLV	★ ★ ★
PTH	★ ★

The star rating provided by Morningstar combines return and risk measures to form a comprehensive evaluation of each fund. The overall star rating is a weighted average of three time periods (3, 5, 10 years). Morningstar's star rating expresses the relative attractiveness of a fund's risk/reward profile in comparison to all other funds.

IHE, the fund of choice, has a five star rating along with PJP and XPH. Considering the next funds are three and two stars, there is a large gap in the rating of these funds compared to the rest. According to the analysts at Morningstar, IHE, PJP, XPH are the best funds of this group.

12-Month Dividend Yields:<sup>20</sup>

<u>ETF</u>	<u>12-Month Yield (%)</u>
XLV	1.94
VHT	1.61
IHE	1.28
XPH	0.91
PJP	0.63
PTH	0.00

<sup>19</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/11/2011)

<sup>20</sup> FactSet (As of 12/06/2011)



**Dow Jones U.S. Pharmaceuticals Index Fund**  
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The 12-Month Yield is a sum of the fund’s total trailing 12-month interest and dividend payments divided by the last month’s ending price. Any capital gains distributed over the same period are then added to this number. The 12-Month Yield gives an investor a good idea of the yield, or interest and dividend payments, the fund is currently paying.

As per the chart above, one can see that IHE, although not yielding the highest dividends, is still yielding strong and competitive dividends compared to this group. PTH has a 0.00% yield, as it does not offer any dividends.

YTD Returns:<sup>21</sup>

The YTD Returns are the Returns to date for 2011, through 12/06/2011. IHE has the highest YTD Returns, closely followed by PJP.

<u>ETF</u>	<u>YTD Returns</u>
IHE	16.84
PJP	16.11
XPB	10.25
XLV	8.60
VHT	7.40
PTH	5.48

<sup>21</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/06/2011)





**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006



1 Year Returns:<sup>22</sup>

The 1-year return is the return on the investment over the past 12 months, as of 12/06/2011. IHE has the highest returns and, once again, only followed by PJP.

<u>ETF</u>	<u>1 Year Returns</u>
IHE	20.17
PJP	18.57
XPH	11.93
XLV	11.32
VHT	10.25
PTH	7.45

<sup>22</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/06/2011)



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3-Year Returns, Annualized:<sup>23</sup>

The 3-year returns are the returns over the past 3 Years. The top three, XPH, PJP, IHE, delivered similar performance and IHE is only very slight behind.

<u>ETF</u>	<u>3 Year Returns</u>
XPH	23.78
PJP	22.87
IHE	22.35
PTH	15.46
VHT	14.23
XLV	12.79

<sup>23</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/06/2011)



**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006



5-Year Returns, Annualized:<sup>24</sup>

The 5-year returns are the average annualized returns on the investment over the past 5 years. In terms of 5 Year Returns, IHE is not the absolutely highest, but is right behind both PJP and XPH.

<b>ETF</b>	<b>5 Year Returns</b>
PJP	9.24
XPH	9.18
XLV	8.60
IHE	8.15
VHT	7.40
PTH	1.93

<sup>24</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/06/2011)



**Dow Jones U.S. Pharmaceuticals Index Fund**  
Inception Date 5/1/2006





Beta:<sup>25</sup>

<u>ETF</u>	<u>Beta</u>
PTH	0.88
XPH	0.86
IHE	0.84
VHT	0.82
XLV	0.82
PJP	0.81

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. It is calculated using regression analysis and can serve as a measure of the tendency of a security's returns vary with swings in the market. A beta of 1 indicates that the security's price will move exactly in line with the market on average. A beta of less than 1 means that the security will be less volatile than the market and if the beta is greater than 1, vice versa. For example, if a stock's beta is 1.2, it is theoretically 20% more volatile than the market on average.

IHE has a Beta of 0.82, right in the middle of this the Healthcare ETF group, which may be good for our portfolio. A beta that is not too volatile may be better suited for this portfolio, as there is less risk but still high returns inherent in IHE.

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<sup>25</sup> FactSet (as of 12/07/2011)



Expense Ratio:<sup>26</sup>

<u>ETF</u>	<u>Expense Ratio (%)</u>
PJP	0.67
PTH	0.60
IHE	0.47
XPH	0.35
VHT	0.24
XLV	0.20

The expense ratio is a measure of what it costs an investment company to operate the fund. The number is determined through an annual calculation, where a fund's operating expenses are divided by the average dollar value of its assets under management. These operating expenses are paid for by being taken out of a fund's assets, which will lower the return to a fund's investors, by the expense amount.

Depending on the type of fund, operating expenses will vary widely. The different components of operating expenses consist of the fee paid to a fund's investment manager, recordkeeping, custodial services, taxes, legal expenses, and accounting and auditing fees. There also may be a marketing fee in the expense cost which is referred to as a 12b-1 fee. A fund's trading activity, the buying and selling of portfolio securities, is not included in the calculation of the expense ratio, but some funds will charge an added fee if the allocations change.

IHE is not the lowest ratio, however it is right in the middle and, ultimately, performs better than the ETFs with the lower ratios. The 0.47% operating expense is the only fee charged for the fund and no additional charges will be added if the allocation of the fund changes.

Considering many of the Healthcare ETFs are very much alike, such as IHE and PJP, the expense ratio plays a big part in the differentiation amongst the funds. PJP has the same top holdings as IHE, very similar returns, similar betas, and IHE has a greater 12-Month Yield. However, PJP is 20 basis points

<sup>26</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/07/2011)



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higher at an Expense Ratio of 0.67 than IHE at an Expense Ratio of 0.47. This fund is virtually the same as IHE, only more expensive. If one were to choose a fund out of these two, IHE is the clear choice as it is virtually the same fund as PJP, only much more cost efficient.

XPH, another close competitor, is also very similar in terms of returns and its beta. IHE is yielding a higher 12-Month Yield than XPH, but XPH has expense ratio 12 basis points lower than IHE. Although XPH is less expensive than IHE, IHE has a higher dividend yield, greater year-to-date returns, and very similar 3 and 5-year returns. Considering the expense ratio is not that much different, yet the performance of IHE is much greater, IHE is the better choice. XPH also focuses top holdings on mid to large capitalization as seen in the above charts, while IHE focuses on large capitalization.



## Portfolio Recommendations

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After revisiting Assignment 1 to review the SMIF portfolio sector allocations, and updating the S&P 500 and S&P 600 sector allocations, it is clear to see that the SMIF portfolio is right on target with the S&P, in relation to the healthcare sector weights, however only slightly underweighted. The weight of the SMIF healthcare sector of the entire portfolio is currently 9.155%, and of equity only, 11.656%. As of 11/29/2011, the healthcare sector allocated in the S&P 500 is 11.697% and the S&P 600 is 12.566%.

We determined the impact of adding IHE to the SMIF's healthcare sector allocation and with the addition of 340 shares of IHE, the health care sector weight would be increased to 10.631%. The percentage of the SMIF portfolio health care in equity only would be increased to 13.288%. In equity only, the portfolio will be slightly over weighted in comparison to S&P 500 and 600, however, we believe the healthcare sector will perform well with positive projections for the future. With that being said, a slight overweight in health care will benefit our portfolio.

In order to evaluate how much of IHE we should purchase, we looked at the 340 iShares of the Russell Midcap Growth, which is already in the SMIF portfolio. Considering there are currently 340 iShares in the portfolio, we propose to double this number and purchase 340 shares of IHE. This is a conservative number, as it is not too great that it will overexpose the portfolio to IHE, but large enough to effect the performance and returns of the portfolio. This number will also help to increase the allocation of the healthcare sector.

At the current trading price of \$74.47, the total cost for 340 shares of IHE would precisely total \$25,319.80.<sup>27</sup> At a first glance, we thought to sell off shares of SPY in order to obtain cash for the purchase of IHE. However, SPY is performing well since inception in the SMIF portfolio and it would not be beneficial to reduce the number of shares, and its weight in the portfolio, of this ETF. Furthermore, we expect the market to perform well in the near future and stress the importance of keeping our shares of SPY. The 12-Month Yield is 1.96%, and returns are high. If we were to deduct \$25,319.80 out of SPY, we would have to sell off approximately 191 shares out of 887. This would significantly reduce

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<sup>27</sup> [www.morningstar.com](http://www.morningstar.com) (As of 12/11/2011)





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the percentage of shares allocated to SPY. It would be more beneficial to take the \$25,319.80 out of cash, as we currently have \$187,137.08 in cash. Deducting the cost of 340 shares of IHE, there would still be precisely \$161,949.88 left over in the cash account, which does not significantly change the cash on hand in the portfolio.