# **Russell 2000 Index ETFs**

## Ratings of Investment Merit

#### **Trust**

We deliver the whole truth by incorporating critical data from the Financial Footnotes and MD&A that other firms miss.

#### **Performance**

The value and success of our ratings are unrivaled. Click here for proof.

#### **More Reports**

Click here and enter a ticker to buy more of our reports.







- We recommend investors buy only the Very Attractive and Attractive stocks in the Russell 2000, not a Russell 2000 ETF.
- Russell 2000 ETFs have Dangerous Overall Risk/Reward Ratings because the index offers more downside risk than upside potential.
- This research enables investors to analyze funds as they analyze stocks.
- We offer custom and enhanced ETFs based on our topranked stock rating system.
- Our analysis is based on aggregation of models for companies in the Russell 2000 and weighted according to the ETFs' allocations to those companies.
- We offer individual ETF reports on 400+ ETFs.

Figure 1: New Constructs' Risk/Reward Rating - Russell 2000 Index ETFs

Overall	Quality of	Earnings	Valuation		
Risk/Reward Rating	Econ v Reported Earnings	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	n/a	9.6%	-0.9%	3.8	49

Sources: New Constructs, LLC and company filings

#### Russell 2000 ETF Overview

There are currently 4 Russell 2000 ETFs with an average expense ratio of 0.58% and over \$12 billion in assets. These ETFs have nearly identical holdings and weightings. The Risk/Reward ratings and weighted-average values in this report apply to each of these ETFs.

Figure 2: Top 4 U.S. Equity Russell 2000 ETFs by Market Cap

ETF Symbol	ETF Name	Expense Ratio	Exposure	Index	Market cap
IWM	iShares Russell 2000 Index Fund	0.28%	Long	Russell 2000	\$12,510,949,000
UWM	ProShares Ultra Russell2000	0.95%	Double Long	Russell 2000	\$144,480,000
URTY	ProShares UltraPro Russell2000	0.95%	Triple Long	Russell 2000	\$56,249,500
VTWO	Vanguard Russell 2000 ETF	0.15%	Long	Russell 2000	\$24,660,000

Source: New Constructs, LLC

For a detailed description of an individual ETF's predictive ratings, purchase an <u>Individual ETF Report</u> for any of the 400+ ETF's we cover. Sample reports are available here.

# Our stock ratings have a solid track record of outperformance for investors.

Barron's ranked us #1 for stock-picking.

Custom ETFs: Contact us for best-of-breed and enhanced ETF products for a particular sector or index.

# Methodology

This report offers recommendations on Russell 2000 ETFs and benchmarks for (1) investors considering buying Russell 2000 ETFs and for (2) comparing individual ETFs to the S&P 500 index. Our analysis is based on aggregating results from our models on each of the companies included in the Russell 2000 (1610 companies) based on data as of October 5, 2011<sup>1</sup>. We aggregate results for the ETFs in the same way the ETFs are designed. Our goal is to empower investors to analyze ETFs in the same way they analyze individual stocks.

To make an informed ETF investment decision, investors must consider the ETF's investment merit. An ETF's investment merit is determined by the quality of the ETF's holdings. We apply our stock rating system to each ETF's holdings to determine its investment merit.

Given the <u>success</u> of our rating system for individual stocks, we believe its application to groups of stocks (i.e. ETFs and funds) helps investors make more informed ETF and mutual fund buying decisions. Barron's featured our uniquely predictive ETF research in "<u>The Danger Within</u>".

## Recommendations Summary

#### If you require exposure to the Russell 2000:

We recommend investors buy only the Very Attractive and Attractive-rated stocks in the Russell 2000 as opposed to a Russell 2000 ETF. Per <u>Figure 5</u> below, Russell 2000 ETFs allocate 80% of their values to holdings in Neutral-or-worse-rated stocks. Please contact us if you would like access to an ETF of only the Very Attractive and Attractive-rated stocks for the Russell 2000 or any other ETF<sup>2</sup>.

#### If you require exposure to a sector ETF:

We recommend investors review our <u>Sector ETF Roadmap</u> report or our <u>10 sector ETF reports</u>, beginning with our Information Technology and Consumer Staples sector reports, which are the only sectors to earn an Attractive Overall Risk/Reward rating.

#### If you require exposure to a market ETF:

Investors seeking diversification with a single position or investors looking to buy a market ETF should consider an S&P 500 ETF over a Russell 2000 ETF. See the next section below, which compares Russell 2000 ETFs to S&P 500 ETFs.

If you are looking for exposure to the best stocks in the market: We recommend you buy our Most Attractive Stocks.

<sup>1</sup> For an explanation of the merits of using market-weighted averages in aggregation analysis instead of aggregate values, see Jeremy Siegel's WSJ article "The S&P Gets Its Earnings Wrong."

<sup>&</sup>lt;sup>2</sup> We offer custom aggregation reports with our ratings for any ETF, mutual fund, or portfolio. We help improve your portfolio's ratings by overweight stocks with Attractive ratings and underweighting stocks with Dangerous ratings. Contact us for more information.

# Market ETF Benchmark

Click <u>here</u> for more info on risk/reward rating system and our approach to equity research.

## Ratings comparison

Russell 2000 ETFs underperform S&P 500 ETFs in quality of earnings ratings. Russell 2000 ETFs' ROICs of 9.6% place them in the 3<sup>rd</sup> quintile while S&P 500 ETFs' ROIC of 21.4% place them in the top quintile.

Russell 2000 ETFs also underperform S&P 500 ETFs in valuation ratings. Russell 2000 ETFs have Price-to-EBVs of 3.8, earning them Very Dangerous ratings, and GAPs of 49 years compared to S&P 500 ETFs' Neutral Price-to-EBVs of 1.7 and Dangerous GAPs of 16 years.

Figure 3: Russell 2000 ETFs - Risk/Reward Rating

	Quality o	f Earnings	Valuation		
Predictive Rating	Econ v Reported Earnings	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	n/a	9.6%	-0.9%	3.8	49

Sources: New Constructs, LLC and company filings

Figure 4: S&P 500 ETFs - Risk/Reward Rating

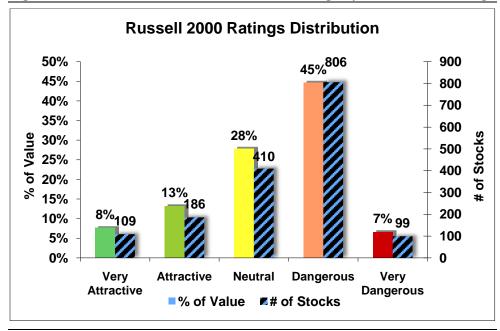
	Quality of Earnings		Valuation		
Predictive Rating	Econ v Reported Earnings	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	n/a	21.4%	2.7%	1.7	16

Sources: New Constructs, LLC and company filings

## Allocation Comparison

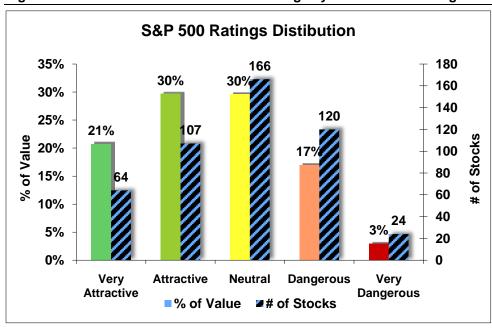
S&P 500 ETFs allocate capital more effectively than Russell 2000 ETFs. Per Figures 5 and 6 below, Russell 2000 ETFs allocate 21% to Attractive-or-better-rated stocks while S&P 500 ETFs allocate 51%. Russell 2000 ETFs also allocate 52% of their values toward Dangerous-or-worse-rated stocks compared to S&P 500 ETFs' Dangerous-or-worse weightings of 20%.

Figure 5: Russell 2000 ETFs – Allocation & Holdings by Risk/Reward Rating



Sources: New Constructs, LLC and company filings

Figure 6: S&P 500 ETFs - Allocation & Holdings by Risk/Reward Rating



Sources: New Constructs, LLC and company filings

# Russell 2000 ETFs Overview

Figure 7 lists the top 25 companies in the Russell 2000 by market capitalization representing about 8% of the overall index.

Figure 7: Top 25 Russell 2000 Companies by Market Cap.

Ticker	Company Name	Industry	P/E Ratio	% of Index
QSII	Quality Systems, Inc.	Systems Software	41.8	0.6%
INT	World Fuel Services Corp	Oil & Gas Refining & Marketing	15.2	0.6%
PRA	ProAssurance Corporation	Property & Casualty Insurance	10.5	0.6%
THS	TreeHouse Foods, Inc.	Packaged Foods & Meats	24.8	0.5%
BMR	BioMed Realty Trust, Inc.	Office REIT	87.8	0.5%
HME	Home Properties, Inc.	Residential REIT	105.7	0.5%
CLC	CLARCOR Inc.	Industrial Machinery	22.8	0.5%
NETL	NetLogic Microsystems, Inc.	Semiconductors	-43.9	0.3%
ROL	Rollins Inc.	Environmental & Facilities Services	30.8	0.3%
CLH	Clean Harbors, Inc.	Environmental & Facilities Services	20.0	0.3%
ACC	American Campus Communities, Inc.	Residential REIT	138.0	0.3%
CPHD	Cepheid	Biotechnology	-412.7	0.3%
JKHY	Jack Henry & Associates, Inc.	Application Software	18.2	0.3%
NUS	Nu Skin Enterprises, Inc.	Personal Products	19.1	0.2%
GAS	Nicor Inc.	Gas Utilities	17.8	0.2%
SGEN	Seattle Genetics, Inc.	Biotechnology	-31.0	0.2%
APAGF	Apco Oil & Gas International, Inc.	Oil & Gas Exploration & Production	89.1	0.2%
TGI	Triumph Group, Inc.	Aerospace & Defense	14.8	0.2%
ARUN	Aruba Networks, Inc.	Alternative Carriers	35.6	0.2%
IDCC	InterDigital Inc.	Communications Equipment	14.2	0.2%
MRX	Medicis Pharmaceutical Corp	Pharmaceuticals	19.5	0.2%
TBL	The Timberland Company	Footwear	23.6	0.2%
ASNA	Ascena Retail Group, Inc.	Apparel Retail	15.8	0.2%
DRQ	Dril-Quip Inc.	Oil & Gas Equipment & Services	20.8	0.2%
CNK	Cinemark Holdings, Inc.	Movies & Entertainment	14.3	0.2%
Total				8.2%

Sources: New Constructs, LLC and company filings

# Appendix: Risk/Reward Rating System

Our Risk/Reward Rating System assigns a rating to every stock we cover according to what we believe are the 5 most important criteria for assessing the risk versus reward of stocks. See table that follows for details.

Overall Risk/Reward Ranking	The Overall Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.
Very Dangerous	FCF Yield is not included in the average.
Dangerous	FCF Yield is not included in the average.
Neutral	All criteria are equal-weighted in the average calculation.
Attractive	All criteria are equal-weighted in the average calculation.
Very Attractive	All criteria are equal-weighted in the average calculation.

Economic vs Reported Earnings	Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.	
Laminys		
Very Dangerous	Negative and declining Economic Earnings despite positive and rising Reported Earnings	
Dangerous	Same as above except Reported Earnings are not rising or	
Dangerous	Reported Earnings are not positive	
Neutral	Negative Economic and Reported Earnings	
Attractive	Economic Earnings are positive	
Very Attractive	Economic Earnings are positive and rising	

Return on Invested Capital (ROIC)	Rates stocks based on their ROIC. Values based on Latest Fiscal Year.
Bottom Quintile	Very Dangerous = the bottom 20% of Russell 1000 companies
4th Quintile	Dangerous = the bottom 40% of Russell 1000 companies
3rd Quintile	Neutral = the middle 20% of Russell 1000 companies
2nd Quintile	Attractive = the top 40% of Russell 1000 companies
Top Quintile	Very Attractive = the top 20% of Russell 1000 companies

FCF Yield	Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.	
<-5%	Very Dangerous = less than or equal to -5%	
-5%<-1%	Dangerous = more than -5% but less than or equal to -1%	
-1%<3%	Neutral = more than -1% but less than or equal to +3%	
3%<10%	Attractive = more than +3% but less than or equal to +10%	
>10%	Very Attractive = more than +10%	

Price-to-EBV Ratio	Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.
>3.5 or -1>0	Very Dangerous = greater than or equal to 3.5 or less than 0 but greater than -1
2.4>3.5 or <-1	Dangerous = greater than or equal to 2.4 but less than 3.5 and less than or equal to -1
1.6>2.4	Neutral = greater than or equal to 1.6 but less than 2.4
1.1>1.6	Attractive = greater than or equal to 1.1 but less than 1.6
0>1.1	Very Attractive = greater than or equal to 0 but less than 1.1

Growth Appreciation Period (yrs)	Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.
>50	Very Dangerous = greater than or equal to 50 years
20>50	Dangerous = at least 20 years but less than 50
10>20	Neutral = at least 10 years but less than 20
3>10	Attractive = at least 3 years but less than 10
0>3	Very Attractive = at least 0 years but less than 3

## New Constructs® - Profile

#### How New Constructs Creates Value for Clients

- Superior Recommendations Our <u>stock picks</u> consistently outperform. See our track record in our <u>stock-picking accolades</u> and <u>Proof Is In Performance</u> reports.
- 2. **More Accurate Research** Our <u>patented Research Platform</u> for <u>reversing accounting distortions</u> and <u>discounted cash flow analysis</u> leverages better data to deliver smarter research.
- Time Savings We check the fine print in thousands of corporate filings so you don't have to. As reported by <u>Barron's</u>, our expertise in analyzing SEC filings delivers <u>Hidden Gems and Red Flags</u> that drive long-term stock-picking success.
- 4. **Transparency** We are proud to share the results of our analysis of over 50,000 10Ks. See the <u>Corporate Disclosure Transgressions</u> report we provided the SEC. Our reports detail all data and assumptions. Company Models enable users to change them.
- Objectivity New Constructs is an independent research firm, not tied to Wall Street or investment banking services. Our models are driven by comprehensive high-quality data not stories. See our presentation to the Senate Banking Committee, the SEC and many others in DC.

## Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

- 1. Based on the complete set of financial information available.
- 2. Standard for all companies.
- 3. A more accurate representation of the true underlying cash flows of the business.

#### Additional Information

Incorporated in July 2002, New Constructs is an independent publisher of investment research that provides clients with consulting, advisory and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. NOPAT, Invested Capital, and WACC, to create economic earnings models, which are necessary to understand the true profitability and valuation of companies. Visit the Free Archive to download samples of our research. New Constructs is a BBB accredited business and a member of the Investorside Research Association.

## **DISCLOSURES**

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

New Constructs is affiliated with Novo Capital Management, LLC, the general partner of a hedge fund. At any particular time, New Constructs' research recommendations may not coincide with the hedge fund's holdings. However, in no event will the hedge fund receive any research information or recommendations in advance of the information that New Constructs provides to its other clients.

## **DISCLAIMERS**

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.