The Best & Worst Industrials Sector ETFs

Structural Integrity – and – Investment Merits

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- **We recommend investors avoid all Industrials sector ETFs.**
- **Investors should buy only Attractive-or-better-rated stocks in the Industrials Sector. Contact us for a custom Industrials ETF with an Attractive Overall Risk/Reward rating.**
- **We rate the investment merit of the top 6 Industrials sector ETFs.**
- **We benchmark the individual ETFs against the entire Industrials sector and the S&P 500.**
- **This research enables investors to analyze ETFs and mutual funds as they do stocks.**
- **We offer custom and enhanced ETFs based on our top-ranked stock rating system.**
- **Our ETF analysis is based on aggregation of models for companies held by the fund and weighted according to the fund's allocations to those companies, excluding cash.**

Figure 1: The Investment Merit of the Top Industrials Sector ETFs

	% of Fund Allocated to Each Rating					
Fund/Benchmark	**Very Attractive**	**Attractive**	**Neutral**	**Dangerous**	**Very Dangerous**	**Overall Fund Rating**
DIA	35.3%	25.5%	22.9%	10.8%	5.6%	Neutral
PPA	5.2%	39.1%	40.1%	10.5%	3.4%	Neutral
VIS	4.3%	17.3%	48.7%	21.8%	4.2%	Neutral
Overall Sector	**4.2%**	**18.4%**	**49.9%**	**23.3%**	**4.2%**	**Neutral**
IYT	0.0%	12.7%	47.9%	20.2%	19.1%	Dangerous

* % may not add up to 100% due to the exclusion of cash and holdings not in our coverage universe.

Sources: New Constructs, LLC and company filings

Our Risk/Reward ratings have a solid track record of outperformance for investors.

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

Methodology

This report offers recommendations on Industrials sector ETFs and benchmarks for (1) investors considering buying Industrials sector ETFs and for (2) comparing individual ETFs to the Industrials sector and the S&P 500. Our analysis is based on aggregating results from our models on each of the companies included in every ETF and the overall sector (429 companies) based on data as of April 19th, 2011. 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, investors must consider:

1) **Structural Integrity**: ability of an investment vehicle to fulfill its stated objective. We use XTF, an ETF research firm, to find the top 6 Industrials sector ETFs with the best structural integrity rating.
2) **Investment Merit**: investment quality of the ETF based on its holdings. We apply our stock rating system to each ETF's holdings to determine its investment merit.

Given the success 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 unique ETF research in "The Danger Within".

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

We find no suitable Industrials sector ETFs, but we can build one for you.

Recommendations Summary

If you require exposure to the Industrials sector:
Due to the Industrials sector's Neutral Overall Risk/Reward rating and the Neutral-or-worse ratings of the 6 ETFs highlighted in this report, we recommend investors buy only the Attractive-or-better-rated stocks in the Industrials sector such as: ALK, DLX, and MMM. Contact us for the full list of Overall Risk/Reward ratings.

If you require exposure to any other sector:
We recommend investors review our Sector ETF Roadmap report or our 9 other sector ETF reports, beginning with our Consumer Staples, Consumer Discretionary and Health Care sector reports, which are the only sectors to earn an Attractive Overall Risk/Reward rating.

If you require exposure to an Industrials ETF or an index ETF:
We recommend investors buy the following Industrials ETFs over an S&P 500 ETF: DIA, PPA. The S&P 500, DIA, and PPA earn Neutral Overall Risk/Reward ratings but DIA and PPA allocate a higher percentage of value to Attractive-or-better-rated stocks.

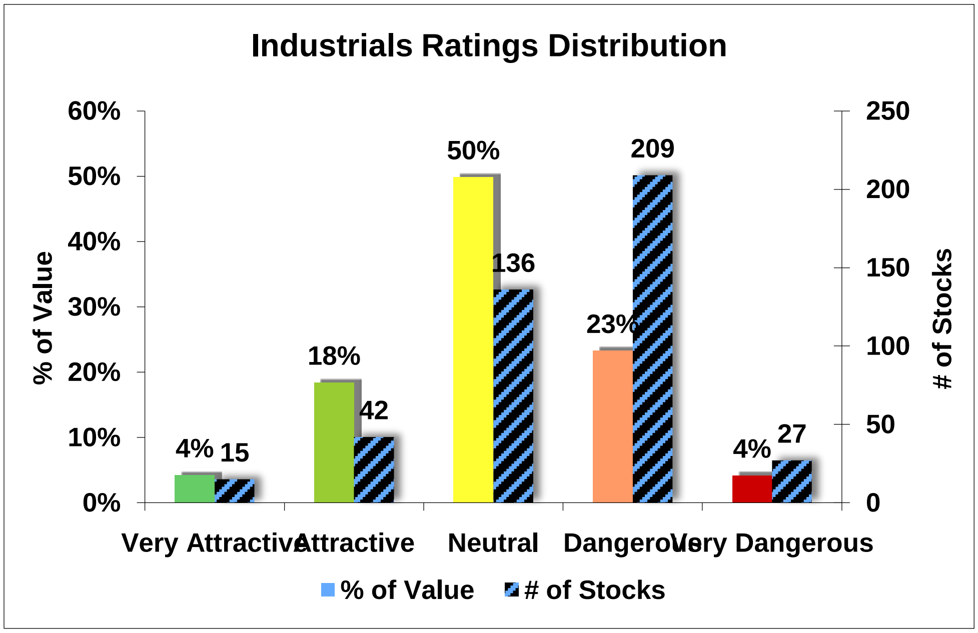
If you are looking for exposure to the best stocks in the market:
We recommend you buy our Most Attractive Stocks.

Recommendations Detail

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

If you want to be in a sector ETF, the Consumer Staples, Consumer Discretionary and Health Care sectors are the best places to shop due to their Attractive Overall Risk/Reward ratings. Figure 2 shows how the Industrials sector's stocks and the market value attributed to them stack up under the microscope of our risk/reward rating system.

Figure 2: Industrials Sector – Allocation & Holdings by Risk/Reward Rating



Sources: New Constructs, LLC and company filings

The Industrials sector has 27% of its value invested in Dangerous-or-worse-rated stocks and 22% of its value invested in Attractive-or-better-rated stocks. Although the Industrials sector only earns a Neutral Overall Risk/Reward rating, its large number of Attractive-or-better-rated stocks creates the opportunity for Attractive-or-better-rated ETFs.

The Industrials sector has 50% of its value in Neutral-rated stocks and most Industrials ETFs overweight these Neutral-rated stocks. It is possible that an Industrials ETF not covered in this report could earn an Attractive-or-better Overall Risk/Reward rating. However, if the ETF is not covered in this report, its structural integrity, as determined by XTF, is not sound or we do not cover over 90% of the value of the ETF's constituents. Of the ETFs we covered in this report, we find none with acceptable investment merits. ETFs like IYT that overweight Dangerous-or-worse-rated stocks should be avoided or sold short.

When analyzing the Industrials sector ETFs, we started by identifying those ETFs with acceptable structural integrity as measured by XTF. We chose the 6 ETFs with an XTF rating above the sector average XTF rating where we cover at least 90% of the value of the ETF. For details on the XTF structural integrity ratings as well as the holdings and weightings for each ETF, see XTF.com.

Figure 3: Industrials ETFs With Acceptable Structural Integrity

TICKER	ETF Description	# of Holdings *	XTF RATING
DIA	SPDR Dow Jones Industrial Average ETF	30	9.9
XLI	Select Sector SPDR-Industrial	59	9.5
VIS	Vanguard Industrial Index	368	9.3
IYJ	iShares Dow Jones US Industrial	243	9.2
IYT	iShares Dow Jones Transportation Average	20	7
PPA	PowerShares Aerospace & Defense	55	7

* # of Holdings excludes cash

Sources: New Constructs, LLC; XTF and company filings

Contact us for details on our ratings for any stocks in any equity ETF.

Figure 3 clearly shows that not all Industrials ETFs are made the same. Different ETFs have meaningfully different numbers of holdings and, therefore, different allocations to holdings. Given the differences in holdings and allocations, these ETFs will likely perform quite differently.

After determining the structural integrity, we analyzed the investment merit of each ETF based on how it allocates value to each stock it holds. Figure 4 shows how the 6 Industrials sector ETFs stack up versus each other, the overall sector and the S&P 500 based on their Overall Risk/Reward ratings and the allocation of their holdings by rating.

Figure 4: Investment Merit Based on Holdings and Allocations

	% of Fund Allocated to Each Rating					
Fund/Benchmark	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous	Overall Fund Rating
DIA	35.3%	25.5%	22.9%	10.8%	5.6%	Neutral
PPA	5.2%	39.1%	40.1%	10.5%	3.4%	Neutral
S&P 500	**21.2%**	**21.1%**	**34.0%**	**16.9%**	**6.8%**	**Neutral**
XLI	4.8%	22.4%	48.8%	15.8%	4.6%	Neutral
IYJ	6.1%	19.0%	45.9%	20.9%	4.3%	Neutral
VIS	4.3%	17.3%	48.7%	21.8%	4.2%	Neutral
Overall Sector	**4.2%**	**18.4%**	**49.9%**	**23.3%**	**4.2%**	**Neutral**
IYT	0.0%	12.7%	47.9%	20.2%	19.1%	Dangerous

* % may not add up to 100% due to the exclusion of cash and holdings not in our coverage universe.

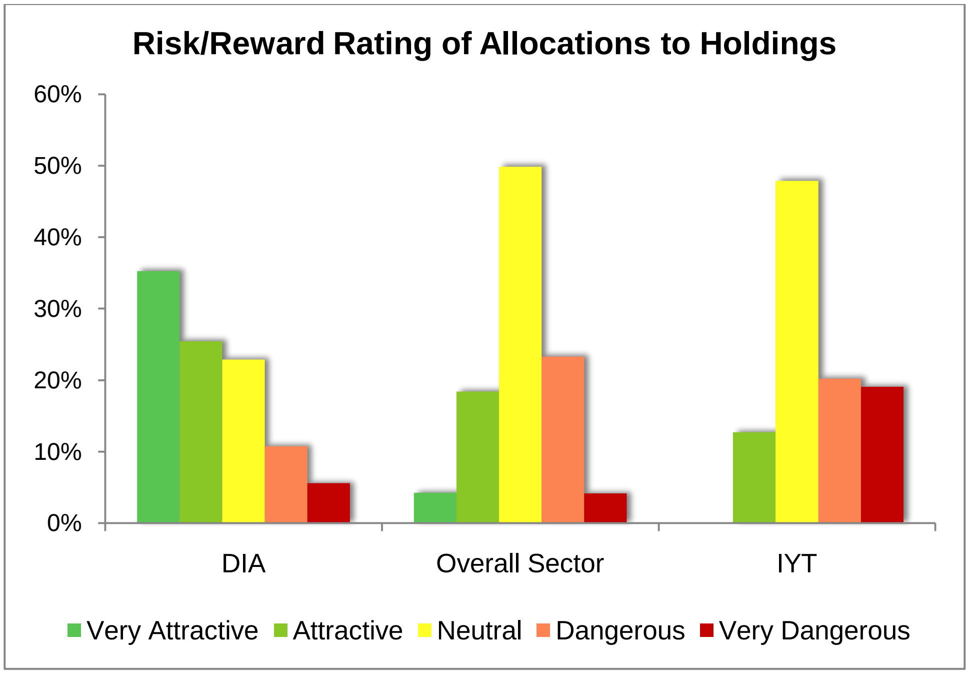
Sources: New Constructs, LLC; XTF and company filings

Attractive ETFs:
We find no Attractive-or-better-rated Industrials ETFs.

Neutral ETFs:
DIA, PPA, XLI, IYJ and VIS allocate the value of their funds in a way that earns them a Neutral Overall Risk/Reward rating. We recommend investors buy the Very Attractive and Attractive stocks in this sector before buying any of the Industrials ETFs we cover in this report. Contact us for the full list of the 57 Industrials companies that earn an Attractive-or-better Overall Risk/Reward rating.

Dangerous ETFs:
We recommend investors avoid or sell short IYT because of its Dangerous Overall Risk/Reward rating. Figure 5 contrasts the difference in investment merit between DIA, IYT, and the overall sector.

Figure 5: Neutral and Dangerous Industrials Sector ETFs



Sources: New Constructs, LLC; XTF and company filings

Benchmark Comparisons

Sector Benchmark

DIA outperforms the overall Industrials sector in quality of earnings ratings. Both DIA and the sector earn Very Attractive Economic vs. Reported Earnings ratings because their Economic Earnings are positive and rising. DIA earns an Attractive ROIC rating with an ROIC of 11.8% compared to the sector's ROIC of 9.2%.

DIA also outperforms the sector in valuation ratings. DIA has a GAP of 17 years, earning it a Neutral rating, and a Price-to-EBV of 1.1 compared to the overall sector's GAP of 31 years and Price-to-EBV of 1.5.

Figure 6: DIA – Risk/Reward Rating

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Econ v Reported Earnings (bn)	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	$3.13 / $9.80	11.8%	2.8%	1.1	17

Sources: New Constructs, LLC and company filings

Figure 7: Industrials Sector – Risk/Reward Rating

Overall Risk/Reward Score	Quality of Earnings		Valuation		
	Econ v Reported EPS	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	$0.36 / $3.02	9.2%	2.9%	1.5	31
Median	$-0.25 / $1.11	6.3%	2.3%	2.2	30

Sources: New Constructs, LLC and company filings

DIA more effectively allocates capital than the overall Industrials sector. Per Figure 4 above, DIA allocates 60.7% of its value to Attractive-or-better-rated stocks while the sector only allocates 22.7%. DIA also only allocates 16.4% of its value toward Dangerous-or-worse-rated stocks compared to the sector's Dangerous-or-worse weightings of 27.5%.

For explanation and details behind our risk/reward rating system, see one of our Company Valuation reports, which are available for free here.

Market Benchmark

The S&P 500 outperforms DIA in quality of earnings ratings. The S&P 500 and DIA earn Very Attractive Economic vs. Reported Earnings ratings because their Economic Earnings are positive and rising. The S&P 500 earns a Very Attractive ROIC rating with an ROIC of 18.3% compared to DIA's ROIC of 11.8%.

DIA outperforms the S&P 500 in valuation ratings. DIA has a GAP of 17 years, earning it a Neutral rating, and a Price-to-EBV of 1.1 compared to the S&P 500's Dangerous-rated GAP of 24 years and Price-to-EBV of 1.4.

Figure 8: DIA – Risk/Reward Rating

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Econ v Reported Earnings (bn)	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	$3.13 / $9.80	11.8%	2.8%	1.1	17

Sources: New Constructs, LLC and company filings

Figure 9: S&P 500 – Risk/Reward Rating

Overall Risk/Reward Score	Quality of Earnings		Valuation		
	Econ v Reported EPS	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	$0.74 / $4.06	18.3%	2.4%	1.4	24
Median	$0.26 / $2.24	7.9%	3.2%	1.4	12

Sources: New Constructs, LLC and company filings

DIA more effectively allocates capital than the S&P 500. Per Figure 4 above, DIA allocates 60.7% of its value to Attractive-or-better-rated stocks while the S&P 500 only allocates 42.3%. DIA also only allocates 16.4% of its value toward Dangerous-or-worse-rated stocks compared to the S&P 500's Dangerous-or-worse weightings of 23.7%.

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.
Very Dangerous	Negative and declining Economic Earnings despite positive and rising Reported Earnings
Dangerous	Same as above except Reported Earnings are not rising or 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

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4. **Transparency** – We are proud to share the results of our analysis of over 50,000 10Ks. See the Corporate Disclosure Transgressions report we provided the SEC. Our reports detail all data and assumptions. Company Models enable users to change them.
5. **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.

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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.

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