Sector ETF Strategic Roadmap

Only Two Attractive Sectors

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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.

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- **Investors looking to buy a sector ETF should first consider ETFs in the Information Technology and Consumer Staples sectors.**
- **The quality of individual ETFs varies greatly. See our sector ETF reports for recommendations on individual ETFs in each sector.**
- **Even Dangerous-rated sectors can have Attractive-rated sector ETFs by allocating to the best stocks in the sector.**
- **We offer reports on the Risk/Reward Ratings for any ETF, mutual fund, or portfolio.**
- **This report shows the percentage of each sector made up of Very Attractive-rated stocks, as well as all other ratings.**

Figure 1: Summary of Overall Risk/Reward Ratings – All Sectors as of July 12, 2011

		Quality of Earnings		Valuation		
Sector	**Overall Rating**	**Econ v Reported**	**ROIC**	**FCF Yield**	**Price-to-EBV**	**GAP**
Financials	Dangerous	Neutral EE	4th Quintile	Dangerous	Dangerous	Very Dangerous
Energy	Dangerous	Positive EE	3rd Quintile	Dangerous	Dangerous	Dangerous
Telecom	Dangerous	Positive EE	4th Quintile	Attractive	Very Dangerous	Dangerous
Utilities	Dangerous	Neutral EE	Bottom Quintile	Neutral	Attractive	Neutral
Materials	Neutral	Positive EE	2nd Quintile	Neutral	Dangerous	Dangerous
Industrials	Neutral	Positive EE	3rd Quintile	Neutral	Neutral	Dangerous
Consumer Disc	Neutral	Positive EE	2nd Quintile	Neutral	Dangerous	Dangerous
Health Care	Neutral	Positive EE	2nd Quintile	Attractive	Neutral	Neutral
Consumer Staples	Attractive	Positive EE	Top Quintile	Neutral	Attractive	Attractive
Info Tech	Attractive	Rising EE	Top Quintile	Attractive	Neutral	Neutral

Index	Overall Rating	Econ v Reported	ROIC	FCF Yield	Price-to-EBV	GAP
S&P 500	Neutral	Positive EE	Top Quintile	Neutral	Neutral	Dangerous
Russell 2000	Dangerous	Neutral EE	3rd Quintile	Dangerous	Very Dangerous	Very Dangerous

Source: New Constructs, LLC and company filings

Methodology

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

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

Our analysis is based on the market-weighted aggregation of our models on the 3000+ companies we cover in each sector, the S&P 500, and the Russell 2000 as of July 12th, 2011.[1] When we cannot replicate the holdings of proprietary investment vehicles, we provide benchmarks for their Risk/Reward based on the profitability and valuation of a reasonable proxy for the group of companies they hold.

This report provides clients with benchmarks from the S&P 500, Russell 2000, and all Sectors to aid in the analysis of individual companies as well as the major sector and index ETFs.

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".

Recommendation

We recommend investors buy ETFs from the Information Technology and Consumer Staples sectors, though any sector can have Attractive-or-better-rated ETFs based on their holdings. See Figures 4 through 13 for a detailed breakdown of ratings distributions by sector, or see our individual sector ETF reports for ETF recommendations by sector.

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

Please contact us if you would like access to an ETF of only the Very Attractive and Attractive-rated stocks for a particular sector or index.

We offer custom aggregation reports with Overall Risk/Reward Ratings for any ETF, mutual fund, or portfolio. We also offer recommendations to improve your portfolio's Overall Risk/Reward Rating by overweighting stocks with Attractive ratings and underweighting stocks with Dangerous ratings. Contact research@newconstructs.com for more information.

[1] 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."

Quality of Earnings Ratings by Sector

Figure 2 shows the quality of earnings component ratings for all sectors and the indices.

Figure 2: Quality of Earnings Ratings – All Sectors as of July 12, 2011

Sector	Overall Rating	Quality of Earnings: Econ v Reported	Quality of Earnings: ROIC
Financials	Dangerous	Neutral EE	4th Quintile
Energy	Dangerous	Positive EE	3rd Quintile
Telecom	Dangerous	Positive EE	4th Quintile
Utilities	Dangerous	Neutral EE	Bottom Quintile
Materials	Neutral	Positive EE	2nd Quintile
Industrials	Neutral	Positive EE	3rd Quintile
Consumer Disc	Neutral	Positive EE	2nd Quintile
Health Care	Neutral	Positive EE	2nd Quintile
Consumer Staples	Attractive	Positive EE	Top Quintile
Info Tech	Attractive	Rising EE	Top Quintile

Index	Overall Rating	Econ v Reported	ROIC
S&P 500	Neutral	Positive EE	Top Quintile
Russell 2000	Dangerous	Neutral EE	3rd Quintile

Source: New Constructs, LLC and company filings

The Financials and Utilities sectors earn a Neutral rating for Economic v Reported Earnings. They are the only 2 sectors with a Neutral-or-worse rating for Economic v Reported Earnings.

The Utilities sector has a market-weighted ROIC of 4.7%, putting it in the bottom quintile of all Russell 1000 companies. By comparison, ROIC for the Information Technology sector is 47.7%, putting it in the top quintile of all Russell 1000 companies and earning it a Very Attractive ROIC rating. The Consumer Staples sector, the only other sector to earn a Very Attractive ROIC rating, has an ROIC of 15.5%.

See the individual sector/index ETF reports for more details on ETFs in each sector/index.

Valuation Ratings by Sector

Figure 3 shows the valuation component ratings for all sectors and the indices.

Figure 3: Valuation Ratings – All Sector ETFs as of July 12, 2011

		Valuation		
Sector	**Overall Rating**	**FCF Yield**	**Price-to-EBV**	**GAP**
Financials	Dangerous	Dangerous	Dangerous	Very Dangerous
Energy	Dangerous	Dangerous	Dangerous	Dangerous
Telecom	Dangerous	Attractive	Very Dangerous	Dangerous
Utilities	Dangerous	Neutral	Attractive	Neutral
Materials	Neutral	Neutral	Dangerous	Dangerous
Industrials	Neutral	Neutral	Neutral	Dangerous
Consumer Disc	Neutral	Neutral	Dangerous	Dangerous
Health Care	Neutral	Attractive	Neutral	Neutral
Consumer Staples	Attractive	Neutral	Attractive	Attractive
Info Tech	Attractive	Attractive	Neutral	Neutral

Index	Overall Rating	FCF Yield	Price-to-EBV	GAP
S&P 500	Neutral	Neutral	Neutral	Dangerous
Russell 2000	Dangerous	Dangerous	Very Dangerous	Very Dangerous

Source: New Constructs, LLC and company filings

The Consumer Staples sector is the only sector to earn an Attractive GAP rating. The Consumer Staples and Info Tech sectors are the only two sectors with an Attractive Overall Risk/Reward Rating – the two sectors we recommend investors explore first when looking for a sector ETF.

GAP measures the number of years implied by the stock price over which a company must maintain an edge over its current and future competitors. 9 of the 10 sectors have a Neutral-or-worse GAP rating, and both indices' GAPs are rated Dangerous or worse.

A Dangerous GAP rating indicates that the sector or index must maintain a competitive advantage for at least 20 years. An Attractive GAP rating indicates that the sector or index must maintain a competitive advantage for less than 10 years. The Consumer Staples sector needs to maintain a competitive advantage for a shorter period of time, making it more likely the sector can meet or beat the market's expectations.

See the individual sector/index ETF reports for more details on each sector/index.

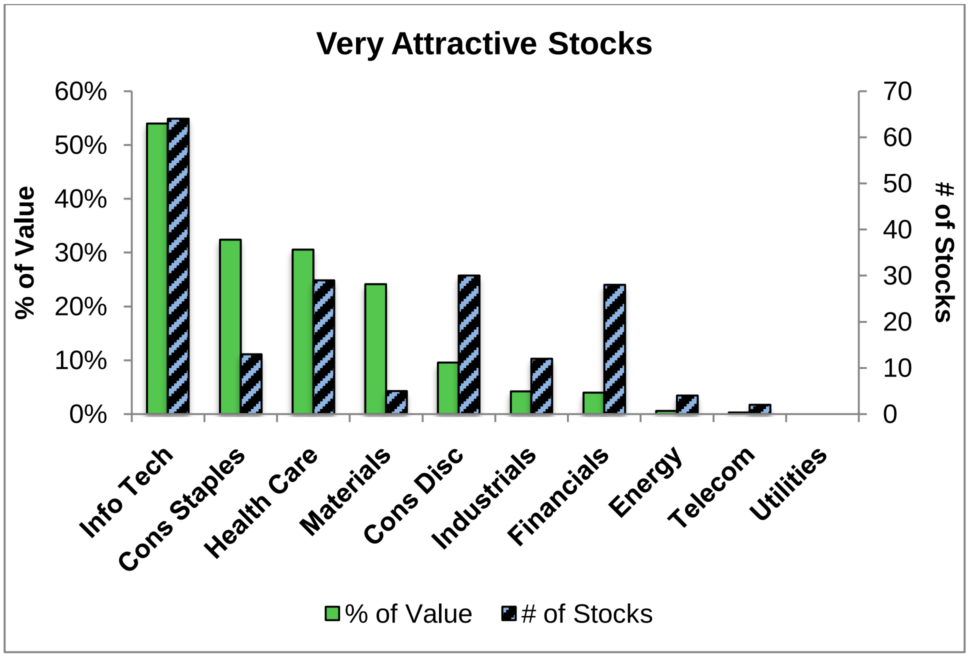
Ratings by Sector

Figure 4 presents a mapping of Very Attractive stocks by sector. The chart shows the percentage of the value of each sector made up of Very Attractive stocks, as well as the total number of Very Attractive stocks in each sector.

64 Very Attractive stocks make up 54% of the Information Technology sector's value and represents 11% of the companies in the sector. The Information Technology sector as a whole has an Attractive rating, but the prevalence of Very Attractive stocks in the sector means that individual Info Tech ETFs can be rated Very Attractive by overweighting those stocks.

Very Attractive stocks make up 30% or more of the value of the Information Technology, Consumer Staples, and Health Care sectors, putting them meaningfully above other sectors in terms of value invested in Very Attractive stocks.

Figure 4: Distribution of Very Attractive Stocks by Sector



Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4.

Figure 5: Distribution of Very Attractive Stocks by Sector

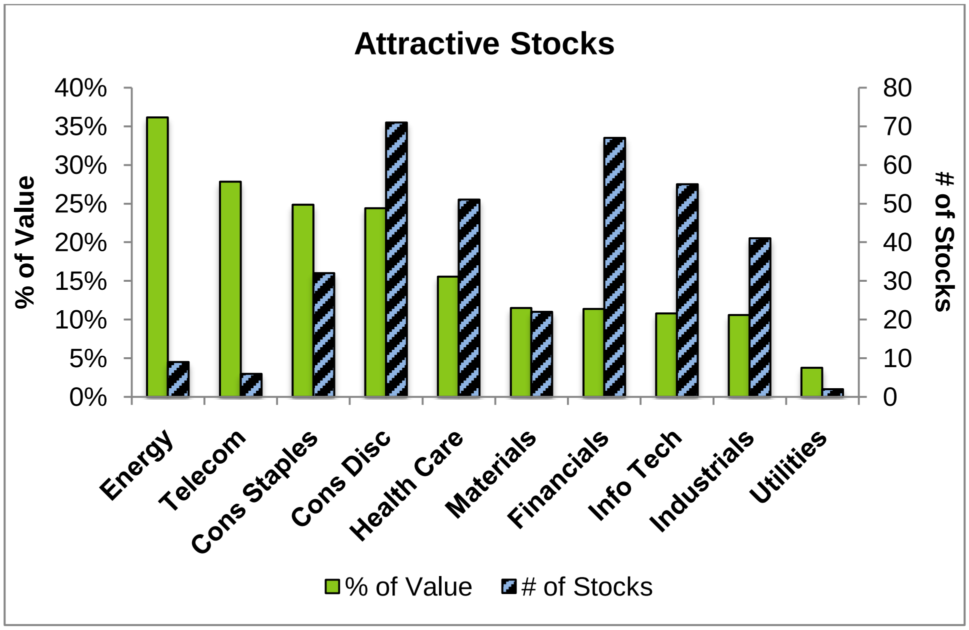
Sector	% of Sector Value	# of Very Attractive Stocks	# of Stocks in Sector	% of Very Attractive Stocks in Sector
Info Tech	54%	64	574	11%
Cons Staples	32%	13	125	10%
Health Care	31%	29	416	7%
Materials	24%	5	149	3%
Cons Disc	10%	30	483	6%
Industrials	4%	12	438	3%
Financials	4%	28	557	5%
Energy	1%	4	192	2%
Telecom	0%	2	46	4%
Utilities	0%	0	90	0%

Source: New Constructs, LLC and company filings

Figure 6 presents a mapping of Attractive stocks by sector. The chart shows the percentage of the value of each sector made up of Attractive stocks, as well as the total number of Attractive stocks in each sector.

9 companies in the Energy sector have an Attractive rating and make up 36% of the sector's value. The sector has a Dangerous rating overall due to its Dangerous-or-worse-rated holdings.

Figure 6: Distribution of Attractive Stocks by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

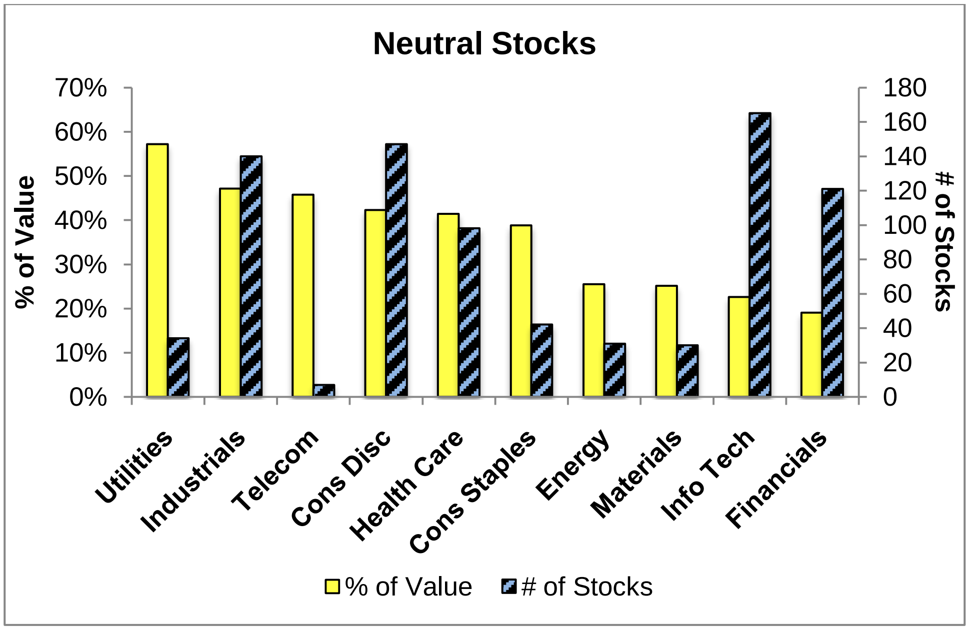
Figure 7: Distribution of Attractive Stocks by Sector

Sector	% of Sector Value	# of Attractive Stocks	# of Stocks in Sector	% of Attractive Stocks in Sector
Energy	36%	9	192	5%
Telecom	28%	6	46	13%
Cons Staples	25%	32	125	26%
Cons Disc	24%	71	483	15%
Health Care	16%	51	416	12%
Materials	12%	22	149	15%
Financials	11%	67	557	12%
Info Tech	11%	55	574	10%
Industrials	11%	41	438	9%
Utilities	4%	2	90	2%

Source: New Constructs, LLC and company filings

Figure 8 presents a mapping of Neutral stocks by sector. The chart shows the percentage of the value of each sector made up of Neutral stocks, as well as the total number of Neutral stocks in each sector.

Figure 8: Distribution of Neutral Stocks by Sector



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

Figure 9: Distribution of Neutral Stocks by Sector

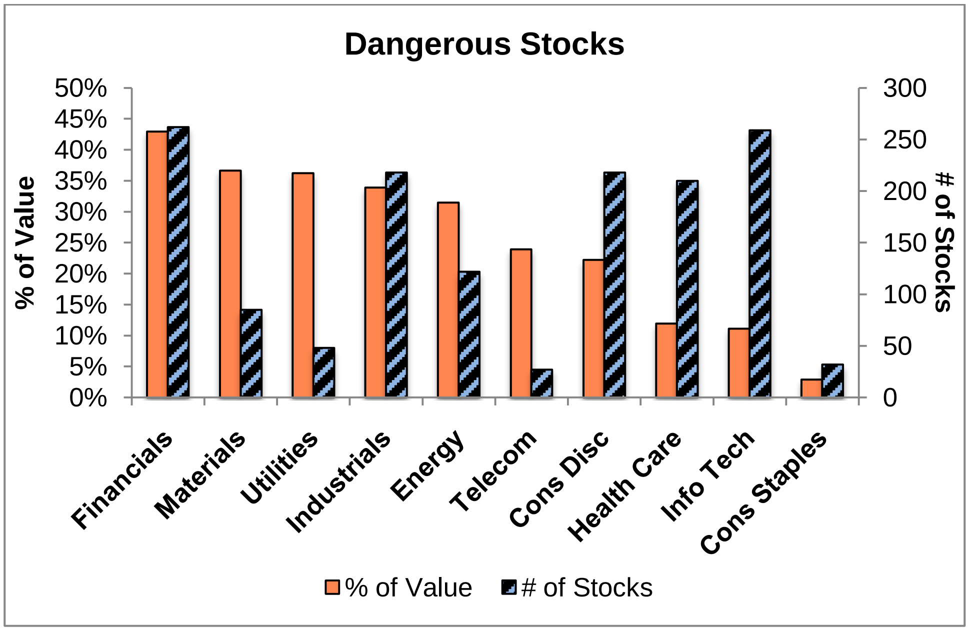
Sector	% of Sector Value	# of Neutral Stocks	# of Stocks in Sector	% of Neutral Stocks in Sector
Utilities	57%	34	90	38%
Industrials	47%	140	438	32%
Telecom	46%	7	46	15%
Cons Disc	42%	147	483	30%
Health Care	41%	98	416	24%
Cons Staples	39%	42	125	34%
Energy	25%	31	192	16%
Materials	25%	30	149	20%
Info Tech	23%	165	574	29%
Financials	19%	121	557	22%

Source: New Constructs, LLC and company filings

Figure 10 presents a mapping of Dangerous stocks by sector. The chart shows the percentage of the value of each sector made up of Dangerous stocks, as well as the total number of Dangerous stocks in each sector.

Every sector except the Health Care, Consumer Staples, and Information Technology sectors has over 20% of its value invested in Dangerous-rated stocks.

Figure 10: Distribution of Dangerous Stocks by Sector



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

Figure 11: Distribution of Dangerous Stocks by Sector

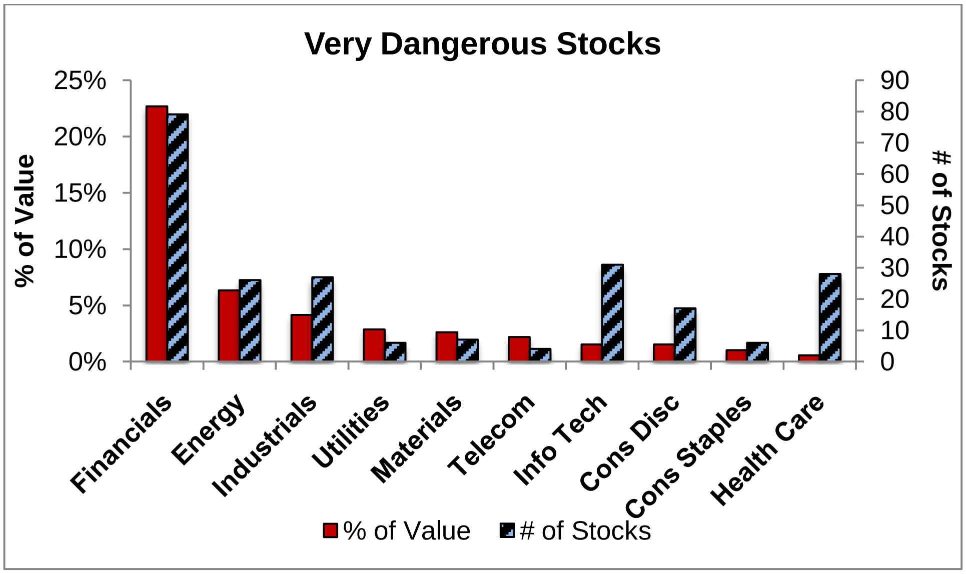
Sector	% of Sector Value	# of Dangerous Stocks	# of Stocks in Sector	% of Dangerous Stocks in Sector
Financials	43%	262	557	47%
Materials	37%	85	149	57%
Utilities	36%	48	90	53%
Industrials	34%	218	438	50%
Energy	31%	122	192	64%
Telecom	24%	27	46	59%
Cons Disc	22%	218	483	45%
Health Care	12%	210	416	50%
Info Tech	11%	259	574	45%
Cons Staples	3%	32	125	26%

Source: New Constructs, LLC and company filings

Figure 12 presents a mapping of Very Dangerous stocks by sector. The chart shows the percentage of the value of each sector made up of Very Dangerous stocks, as well as the total number of Very Dangerous stocks in each sector.

The Financials sector has 23% of its value invested in stocks with Very Dangerous ratings while all the other 9 sectors have 6% or less of their value in Very Dangerous stocks.

Figure 12: Distribution of Very Dangerous Stocks by Sector



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

Figure 13: Distribution of Very Dangerous Stocks by Sector

Sector	% of Sector Value	# of Very Dangerous Stocks	# of Stocks in Sector	% of Very Dangerous Stocks in Sector
Financials	23%	79	557	14%
Energy	6%	26	192	14%
Industrials	4%	27	438	6%
Utilities	3%	6	90	7%
Materials	3%	7	149	5%
Telecom	2%	4	46	9%
Info Tech	2%	31	574	5%
Cons Disc	2%	17	483	4%
Cons Staples	1%	6	125	5%
Health Care	1%	28	416	7%

Source: 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 EPS	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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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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