

## The Best & Worst Utilities Sector ETFs

### *Ratings of Investment Merit*

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

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- We recommend investors buy only the Very Attractive and Attractive stocks in the Utilities sector, not a Utilities ETF.
- We provide predictive ratings for 9 Utilities sector ETFs.
- We benchmark the individual ETFs against the entire Utilities sector and the S&P 500.
- This research enables investors to analyze funds as they analyze 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.
- We offer individual ETF reports on 400+ ETFs.



**Figure 1: The Investment Merit of the Best & Worst Utilities Sector ETFs**

Fund/Benchmark	% of Fund Allocated to Each Rating					Overall Fund Rating
	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous	
VPU	0%	4%	59%	34%	3%	Neutral
IDU	0%	4%	62%	32%	2%	Neutral
<b>Overall Sector</b>	<b>0%</b>	<b>4%</b>	<b>57%</b>	<b>36%</b>	<b>3%</b>	<b>Dangerous</b>
PUI	0%	10%	30%	52%	6%	Dangerous
RYU	0%	7%	49%	37%	7%	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

## Utilities ETF Sector Overview

The Utilities sector currently consists of 9 U.S. Equity ETFs with an average expense ratio of 0.25% and over \$6.2 billion in assets.

**Figure 2: Top 9 U.S. Equity Utilities Sector ETFs by Market Cap**

ETF Symbol	ETF Name	Expense Ratio	Exposure	Index	Market cap
XLU	Utilities Select Sector SPDR	0.20%	Long	Utilities Select Sector	\$4,575,353,068
VPU	Vanguard Utilities ETF	0.25%	Long	MSCI US Investable Market Utilities 25/50	\$777,332,152
IDU	iShares Dow Jones U.S. Utilities Index Fund	0.48%	Long	Dow Jones US Utilities	\$534,769,500
PUI	PowerShares Dynamic Utilities	0.60%	Long	Dynamic Utilities Intellidex	\$143,467,500
FXU	First Trust Utilities AlphaDEX Fund	0.70%	Long	StrataQuant Utilities	\$88,124,536
PSCU	PowerShares S&P SmallCap Utilities Portfolio	0.29%	Long	S&P SmallCap 600 Utilities	\$45,795,000
RYU	Rydex S&P Equal Weight Utilities ETF	0.50%	Long	S&P Equal Weight Utilities	\$27,485,000
UPW	ProShares Ultra Utilities	0.95%	Double Long	Dow Jones US Utilities	\$14,691,000
FUI	Focus Morningstar Utilities Index ETF	0.19%	Long	Morningstar Utilities	\$5,344,000

Sources: New Constructs, LLC

For a detailed description of an individual ETF's predictive ratings, purchase an [Individual ETF Report](#) for any of the 400+ ETF's we cover. Sample reports are available [here](#).

## Methodology

**Our Risk/Reward 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.**

This report offers recommendations on Utilities sector ETFs and benchmarks for (1) investors considering buying Utilities sector ETFs and for (2) comparing individual ETFs to the Utilities 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 (90 companies) based on data as of July 12, 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 [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 uniquely predictive ETF research in "[The Danger Within](#)".

## Recommendations Summary

### **If you require exposure to the Utilities sector:**

We recommend investors buy only the Very Attractive and Attractive-rated stocks in the Utilities sector as opposed to a Utilities ETF. The Utilities sector allocates 96% of its value 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 Utilities sector or any other ETF<sup>2</sup>.

### **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 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 Utilities ETF or an index ETF:**

We recommend investors buy one of the following S&P 500 ETF instead of a Utilities ETFs: SPY, IVV or VOO. See [Figure 11](#), which shows the Risk/Reward rating for the S&P 500 Index.

### **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](#)."

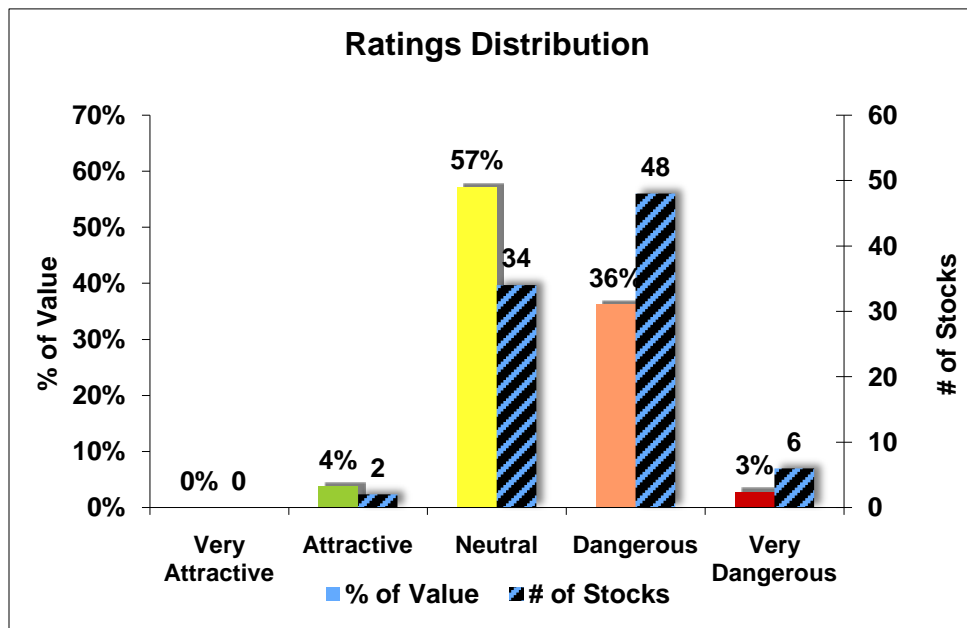
<sup>2</sup> We offer custom aggregation reports with our ratings for any ETF, mutual fund, or portfolio. We help improve your portfolio's ratings by overweight stocks with Attractive ratings and underweighting stocks with Dangerous ratings. [Contact us](#) for more information.

**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 Information Technology and Consumer Staples sectors are the best places to shop due to their Attractive Overall Risk/Reward ratings. Figure 3 shows how the Utilities sector's stocks and the market value attributed to them stack up under the microscope of our risk/reward rating system.

**Figure 3: Utilities Sector – Allocation & Holdings by Risk/Reward Rating**



Sources: New Constructs, LLC and company filings

The Utilities sector has 39% of its value invested in Dangerous-or-worse-rated stocks and 4% invested in Attractive-or-better-rated stocks. The Utilities sector's heavy allocation to Dangerous-or-worse-rated stocks and its low weighting of Attractive-or-better-rated stocks create large opportunities for Dangerous-or-worse-rated ETFs.

When analyzing the Utilities sector ETFs, we chose the 9 U.S. Equity Utilities sector ETFs where we cover at least 85% of the value of the ETF.

**Figure 4: Holdings Count of Utilities Sector ETFs**

TICKER	ETF Description	Management Style	# of Holdings*
PSCU	PowerShares S&P SmallCap Utilities Portfolio	Passive	22
XLU	Utilities Select Sector SPDR	Passive	33
RYU	Rydex S&P Equal Weight Utilities ETF	Passive	41
FXU	First Trust Utilities AlphaDEX Fund	Passive	50
PUI	PowerShares Dynamic Utilities	Passive	58
IDU	iShares Dow Jones U.S. Utilities Index Fund	Passive	70
UPW	ProShares Ultra Utilities	Passive	72
FUI	Focus Morningstar Utilities Index ETF	Passive	72
VPU	Vanguard Utilities ETF	Passive	84

\* # of Holdings excludes cash

Sources: New Constructs, LLC

Figure 4 clearly shows that not all Utilities 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.

[Contact us](#) for details on our ratings for any stocks in any equity ETF.

We analyzed the investment merit of each ETF based on how it allocates value to each stock it holds. Figure 5 shows how the 9 Utilities 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 5: Investment Merit Based on Holdings and Allocations**

Fund/Benchmark	% of Fund Allocated to Each Rating					Overall Fund Rating
	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous	
<b>S&amp;P 500</b>	<b>24%</b>	<b>19%</b>	<b>33%</b>	<b>19%</b>	<b>5%</b>	<b>Neutral</b>
VPU	0%	4%	59%	34%	3%	Neutral
IDU	0%	4%	62%	32%	2%	Neutral
XLU	0%	4%	67%	27%	2%	Neutral
FUI	0%	4%	59%	34%	3%	Neutral
<b>Overall Sector</b>	<b>0%</b>	<b>4%</b>	<b>57%</b>	<b>36%</b>	<b>3%</b>	<b>Dangerous</b>
UPW	0%	4%	62%	31%	3%	Dangerous
FXU	0%	7%	47%	41%	5%	Dangerous
PSCU	2%	3%	24%	69%	2%	Dangerous
PUI	0%	10%	30%	52%	6%	Dangerous
RYU	0%	7%	49%	37%	7%	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

**Attractive ETFs:**

We find no Attractive-or-better-rated Utilities ETFs.

**Neutral ETFs:**

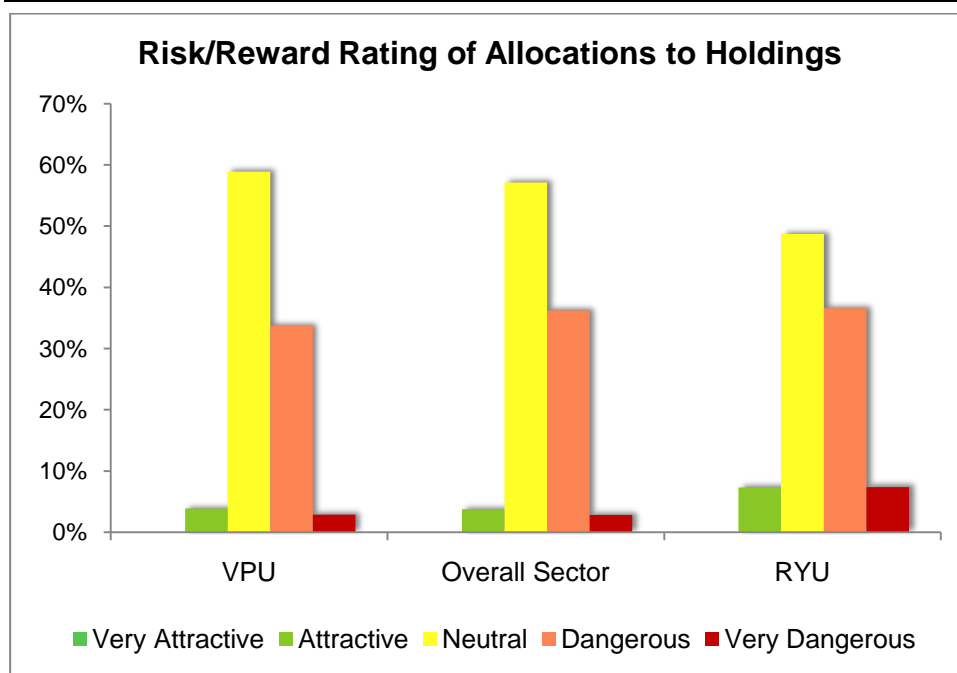
VPU, IDU, XLU, and FUI allocate their value in a way that earns them a Neutral Overall Risk/Reward Rating. We recommend investors buy the Very Attractive and Attractive stocks in this sector before buying any of the U.S. Equity Utilities ETFs except those we recommend. [Contact us](#) for the list of 2 Utilities stocks that earn an Attractive-or-better Overall Risk/Reward Rating.

**Dangerous ETFs:**

We recommend investors avoid UPW, FXU, PSCU, PUI, and RYU because of their Dangerous Overall Risk/Reward Rating.

Figure 6 contrasts the difference in investment merit between VPU, RYU, and the overall sector.

**Figure 6: Neutral and Dangerous Utilities Sector ETFs**



Sources: New Constructs, LLC; and company filings

Figure 7 provides a comparison of basic stats for the 2 highest rated ETFs covered in this report.

**Figure 7: ETF Stat Comparison**

Ticker	VPU	IDU
<b>Name</b>	Vanguard Utilities ETF	iShares Dow Jones U.S. Utilities Index Fund
<b>Last Closing Quote</b>	72.28	82.91
<b>Expense Ratio</b>	0.25%	0.48%
<b>Market Cap</b>	\$777,332,152	\$534,769,500
<b>Avg. Daily Volume</b>	52,925	35,019
<b>Inception Date</b>	1/26/04	6/12/00
<b>Issuer</b>	Vanguard	iShares
<b>Geography</b>	U.S.	U.S.
<b>Avg. # of Components</b>	84	70
<b>Asset Class</b>	Equity	Equity
<b>Sector</b>	Utilities	Utilities
<b>Investment Metric Rank</b>	44%	44%
<b>Management Style</b>	Passive	Passive
<b>Underlying Index</b>	MSCI US Investable Market Utilities 25/50	Dow Jones US Utilities
<b>Exposure</b>	Long	Long
<b>Premium (Discount)</b>	0.06%	0.01%

Sources: New Constructs, LLC

**Sector Benchmark**

**Ratings Comparison**

VPU has a better Overall Risk/Reward Rating than the Utilities sector. VPU has a market-implied Growth Appreciation Period (GAP) of 9 years compared to the overall sector's GAP of 11 years. VPU's shorter GAP makes it a more attractive investment than the overall sector.

**Figure 8: VPU – Risk/Reward Rating**

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	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	4.6%	-0.2%	1.5	9

Sources: New Constructs, LLC and company filings

**Figure 9: Utilities Sector – Risk/Reward Rating**

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	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	4.7%	-0.2%	1.5	11

Sources: New Constructs, LLC and company filings

**Allocation Comparison**

VPU more effectively allocates capital than the overall Utilities sector. Per [Figure 5](#) above, VPU allocates 63% of its value to Neutral-or-better-rated stocks while the sector allocates 61%. VPU also allocates 37% of its value toward Dangerous-or-worse-rated stocks compared to the sector's Dangerous-or-worse weightings of 39%.

For explanation and details behind our risk/reward rating system, see one of our Individual ETF Reports, which are available for free [here](#).



**Market Benchmark**

**Ratings comparison**

VPU outperforms the S&P 500 in valuation ratings. VPU has a Price-to-EBV of 1.5, earning it an Attractive rating, and a GAP of 9 years compared to the S&P 500's Price-to-EBV of 2.0 and GAP of 22 years.

VPU underperforms the S&P 500 in quality of earnings ratings. VPU's ROIC of 4.6% earns it a Very Dangerous rating while the S&P 500's ROIC of 18.4% earns it a Very Attractive rating.

**Figure 10: VPU – Risk/Reward Rating**

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	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	4.6%	-0.2%	1.5	9

Sources: New Constructs, LLC and company filings

**Figure 11: S&P 500 – Risk/Reward Rating**

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	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	18.4%	2.1%	2.0	22

Sources: New Constructs, LLC and company filings

**Allocation Comparison**

The S&P 500 allocates capital more effectively than VPU. Per [Figure 5](#) above, VPU allocates 4% of its value to Attractive-or-better-rated stocks while the S&P 500 allocates 43%. VPU also allocates 37% of its value toward Dangerous-or-worse-rated stocks compared to the S&P 500's Dangerous-or-worse weightings of 24%.

**Utilities Sector Overview**

Figure 12 lists the top 25 companies in the Utilities sector by market capitalization representing about 70% of the overall sector.

**Figure 12: Top 25 Utilities Sector Companies by Market Cap.**

Ticker	Company Name	Industry	P/E Ratio	% of Sector
SO	The Southern Company	Electric Utilities	17.1	6%
EXC	Exelon Corporation	Electric Utilities	11.2	5%
D	Dominion Resources, Inc.	Multi-Utilities	10.2	5%
DUK	Duke Energy Corp	Electric Utilities	19.1	5%
NEE	NextEra Energy, Inc.	Electric Utilities	12.1	5%
AEP	American Electric Power Co, Inc.	Electric Utilities	15.1	3%
PCG	PG&E Corporation	Multi-Utilities	15.3	3%
PEG	Public Service Electric & Gas Company	Multi-Utilities	10.4	3%
ED	Consolidated Edison, Inc.	Multi-Utilities	15.5	3%
PGN	Progress Energy, Inc.	Electric Utilities	16.3	3%
PPL	PPL Corporation	Electric Utilities	12.9	3%
FE	FirstEnergy Corporation	Electric Utilities	17.1	3%
EIX	Edison International	Electric Utilities	10.2	2%
SRE	Sempra Energy	Multi-Utilities	17.5	2%
ETR	Entergy Corporation	Electric Utilities	10.1	2%
XEL	Xcel Energy, Inc.	Multi-Utilities	15.0	2%
AES	The AES Corp	Independent Power Producers & Energy Traders	1080.9	2%
DTE	DTE Energy Company	Multi-Utilities	13.4	2%
CNP	CenterPoint Energy, Inc.	Multi-Utilities	18.2	2%
EQT	EQT Corporation	Gas Utilities	34.3	2%
OKE	ONEOK Inc.	Gas Utilities	23.8	1%
CEG	Constellation Energy Group, Inc.	Independent Power Producers & Energy Traders	-7.9	1%
WEC	Wisconsin Energy Corp	Multi-Utilities	16.3	1%
CPN	Calpine Corporation	Electric Utilities	253.4	1%
AEE	Ameren Corporation	Multi-Utilities	49.6	1%
<b>Total</b>				<b>70%</b>

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.

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

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

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

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

<b>Price-to-EBV Ratio</b>	<b>Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.</b>
>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

<b>Growth Appreciation Period (yrs)</b>	<b>Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.</b>
>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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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**

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