

The Best & Worst Financials Sector 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.

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- **PowerShares KBW Property & Casualty Insurance Portfolio (KBWP) is our top pick for Financials sector ETFs.**
- **We provide predictive ratings for 26 Financials sector ETFs.**
- **We benchmark the individual ETFs against the entire Financials 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 Financials Sector ETFs

Fund/Benchmark	% of Fund Allocated to Each Rating					Overall Fund Rating
	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous	
KBWP	54%	22%	9%	2%	9%	Attractive
PIC	21%	24%	8%	32%	0%	Neutral
Overall Sector	4%	11%	19%	43%	23%	Dangerous
IAT	0%	5%	14%	70%	10%	Very Dangerous
KBE	0%	3%	11%	58%	28%	Very 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

Financials ETF Sector Overview

The Financials sector currently consists of 26 U.S. Equity ETFs with an average expense ratio of 0.39% and over \$13.9 billion in assets.

Figure 2: Top 10 U.S. Equity Financials Sector ETFs by Market Cap

ETF Symbol	ETF Name	Expense Ratio	Exposure	Index	Market cap
XLF	Financial Select Sector SPDR	0.20%	Long	Financial Select Sector	\$7,199,319,496
KBE	SPDR KBW Bank ETF	0.35%	Long	KBW Bank	\$1,519,721,828
FAS	Direxion Daily Financial Bull 3X Shares	0.95%	Triple Long	Russell 1000 Financial Services	\$1,444,092,792
UYG	ProShares Ultra Financials	0.95%	Double Long	Dow Jones US Financials	\$1,034,192,665
VFH	Vanguard Financials ETF	0.25%	Long	MSCI US Investable Market Financials 25/50	\$616,890,601
KRE	SPDR KBW Regional Banking ETF	0.35%	Long	KBW Regional Banking	\$511,674,133
IYF	iShares Dow Jones U.S. Financial Sector Index Fund	0.48%	Long	Dow Jones US Financials	\$462,590,000
IYG	iShares Dow Jones U.S. Financial Services Index Fund	0.48%	Long	Dow Jones US Financial Services	\$209,587,000
KIE	SPDR KBW Insurance ETF	0.35%	Long	KBW Insurance	\$193,895,000
REM	iShares FTSE NAREIT Mortgage REITs Index Fund	0.48%	Long	FTSE NAREIT All Mortgage Capped	\$177,099,000

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 Financials sector ETFs and benchmarks for (1) investors considering buying Financials sector ETFs and for (2) comparing individual ETFs to the Financials 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 (557 companies) based on data as of July 12, 2011¹. 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 Financials sector:

We recommend investors buy PowerShares KBW Property & Casualty Insurance Portfolio (KBWP). KBWP allocates a substantial amount of its value to Attractive-or-better-rated stocks and earns an Attractive Overall Risk/Reward Rating.

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 and Information Technology sector reports, which are the only sectors to earn an Attractive Overall Risk/Reward rating.

If you require exposure to a Financials ETF or an index ETF:

We recommend investors buy the following Financials ETFs over an S&P 500 ETF: KBWP or PIC. KBWP earns an Attractive Overall Risk/Reward Rating and although both the S&P 500 and PIC earn Neutral Overall Risk/Reward Ratings, PIC has more attractive quality of earnings and valuations ratings.

If you are looking for exposure to the best stocks in the market:

We recommend you buy our [Most Attractive Stocks](#).

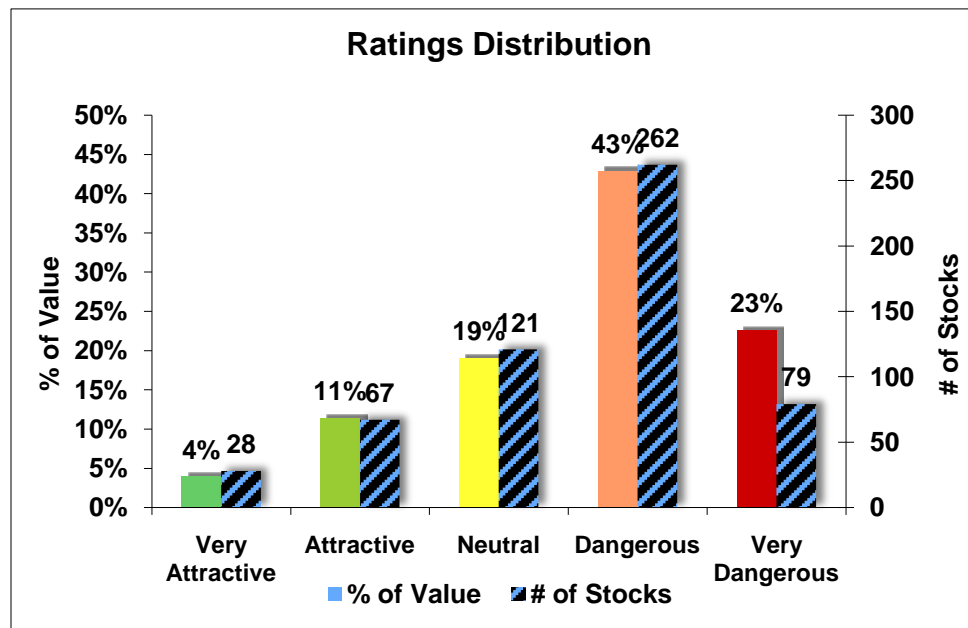
¹ For an explanation of the merits of using market-weighted averages in aggregation analysis instead of aggregate values, see Jeremy Siegel's WSJ article "[The S&P Gets Its Earnings Wrong](#)."

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

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



Sources: New Constructs, LLC and company filings

The Financials sector has 66% of its value invested in Dangerous-or-worse-rated stocks and only 15% invested in Attractive-or-better-rated stocks. The Financials 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 Financials sector ETFs, we chose the 26 U.S. Equity Financials sector ETFs where we cover at least 85% of the value of the ETF.

Figure 4: Holdings Count of Financials Sector ETFs

TICKER	ETF Description	Management Style	# of Holdings*
KBWP	PowerShares KBW Property & Casualty Insurance Portfolio	Passive	23
KIE	SPDR KBW Insurance ETF	Passive	23
KME	SPDR KBW Mortgage Finance ETF	Passive	23
KCE	SPDR KBW Capital Markets ETF	Passive	23
IAI	iShares Dow Jones U.S. Broker-Dealers Index Fund	Passive	24
KBE	SPDR KBW Bank ETF	Passive	24
PIC	PowerShares Dynamic Insurance	Passive	25
PJB	PowerShares Dynamic Banking	Passive	28
REM	iShares FTSE NAREIT Mortgage REITs Index Fund	Passive	37
KRU	ProShares Ultra KBW Regional Banking	Passive	49
KRE	SPDR KBW Regional Banking ETF	Passive	49
PFI	PowerShares Dynamic Financial	Passive	53
IAK	iShares Dow Jones U.S. Insurance Index Fund	Passive	54
IAT	iShares Dow Jones U.S. Regional Banks Index Fund	Passive	58
RYP	Rydex S&P Equal Weight Financial ETF	Passive	73
RWW	RevenueShares Financials Sector Fund	Passive	73
XLF	Financial Select Sector SPDR	Passive	73
PSCF	PowerShares S&P SmallCap Financials Portfolio	Passive	93
QABA	First Trust NASDAQ ABA Community Bank Index Fund	Passive	99
IYG	iShares Dow Jones U.S. Financial Services Index Fund	Passive	108
FXO	First Trust Financials AlphaDEX	Passive	135
FAS	Direxion Daily Financial Bull 3X Shares	Passive	175
FFL	Focus Morningstar Financial Services Index ETF	Passive	185
IYF	iShares Dow Jones U.S. Financial Sector Index Fund	Passive	230
UYG	ProShares Ultra Financials	Passive	234
VFH	Vanguard Financials ETF	Passive	417

* # of Holdings excludes cash

Sources: New Constructs, LLC

Figure 4 clearly shows that not all Financials 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 26 Financials 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	
KBWP	54%	22%	9%	2%	9%	Attractive
PIC	21%	24%	8%	32%	0%	Neutral
S&P 500	24%	19%	33%	19%	5%	Neutral
REM	4%	45%	30%	9%	1%	Neutral
KCE	0%	18%	34%	35%	9%	Neutral
IAK	18%	22%	10%	29%	7%	Neutral
KIE	19%	12%	19%	35%	8%	Dangerous
FXO	11%	16%	22%	29%	11%	Dangerous
IAI	3%	9%	28%	47%	11%	Dangerous
PFI	8%	19%	16%	37%	10%	Dangerous
IYF	4%	10%	14%	40%	23%	Dangerous
UYG	4%	10%	14%	40%	23%	Dangerous
FFL	4%	11%	16%	38%	23%	Dangerous
RYF	5%	11%	15%	40%	19%	Dangerous
FAS	4%	10%	16%	37%	22%	Dangerous
IYG	1%	8%	11%	45%	30%	Dangerous
XLF	3%	9%	14%	42%	26%	Dangerous
Overall Sector	4%	11%	19%	43%	23%	Dangerous
RWW	4%	8%	15%	43%	25%	Dangerous
PJB	0%	2%	27%	58%	7%	Dangerous
VFH	4%	11%	13%	41%	23%	Dangerous
PSCF	3%	10%	14%	43%	15%	Dangerous
KRU	0%	6%	20%	49%	23%	Dangerous
KRE	0%	6%	20%	49%	23%	Dangerous
KME	3%	7%	32%	48%	6%	Dangerous
QABA	1%	3%	29%	46%	16%	Dangerous
IAT	0%	5%	14%	70%	10%	Very Dangerous
KBE	0%	3%	11%	58%	28%	Very 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:

KBWP earns an Attractive Overall Risk/Reward rating and therefore, is the only U.S. Equity Financials ETF we recommend.

Neutral ETFs:

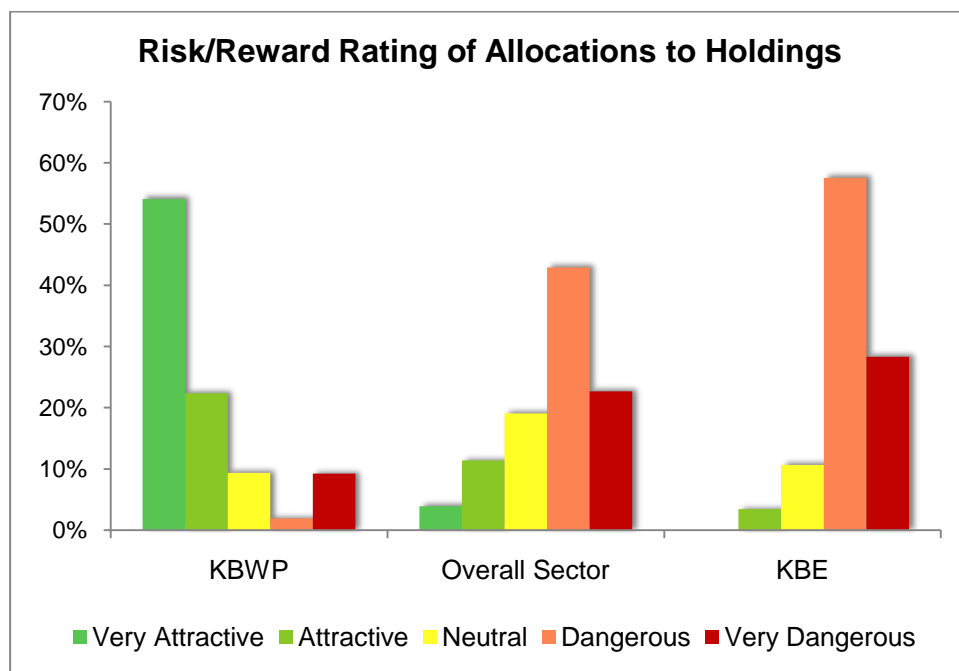
PIC, REM, KCE and IAK allocate their value in a way that earns them a Neutral Overall Risk/Reward rating. We recommend investors buy the Very Attractive and Attractive stocks in this sector before buying any of the U.S. Equity Financials ETFs except those we recommend. [Contact us](#) for the full list of 95 Financials stocks that earn an Attractive-or-better Overall Risk/Reward rating.

Dangerous ETFs:

We recommend investors avoid KIE, FXO IAI, PFI, IYF, UYG, FFL, RYF, FAS, IYG, XLF, RWW, PJB, VFH, PSCF, KRU, KRE, KME, QABA, IAT and KBE because of their Dangerous-or-worse Overall Risk/Reward rating.

Figure 6 contrasts the difference in investment merit between KBWP, KBE, and the overall sector.

Figure 6: Attractive and Very Dangerous Financials 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	KBWP	PIC
Name	PowerShares KBW Property & Casualty Insurance Portfolio	PowerShares Dynamic Insurance
Last Closing Quote	25.3	16.35
Expense Ratio	0.35%	0.60%
Market Cap	\$3,795,000	\$8,992,500
Avg. Daily Volume	197	1,232
Inception Date	12/2/10	10/26/05
Issuer	Invesco PowerShares	Invesco PowerShares
Geography	U.S.	U.S.
Avg. # of Components	23	25
Asset Class	Equity	Equity
Sector	Financials	Financials
Investment Metric Rank	99%	85%
Management Style	Passive	Passive
Underlying Index	KBW Property & Casualty	Insurance Intellidex
Exposure	Long	Long
Premium (Discount)	0.48%	0.62%

Sources: New Constructs, LLC

Sector Benchmark

Ratings Comparison

KBWP's quality of earnings is superior to the overall sector's quality of earnings. KBWP's Attractive-rated Economic vs Reported Earnings and ROIC of 11.9% outperform the overall sector's Neutral-rated Economic vs Reported Earnings and ROIC of 6.7%.

KBWP also outperforms in valuation ratings with a Very Attractive-rated FCF Yield of 12.8% and Price-to-EBV of 0.8 compared to the overall sector's Dangerous-rated FCF Yield of -2.0% and Price-to-EBV of 3.4.

Figure 8: KBWP – 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	11.9%	12.8%	0.8	13

Sources: New Constructs, LLC and company filings

Figure 9: Financials 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	6.7%	-2.0%	3.4	63

Sources: New Constructs, LLC and company filings

Allocation Comparison

KBWP more effectively allocates capital than the overall Financials sector. Per [Figure 5](#) above, KBWP allocates 76% of its value to Attractive-or-better-rated stocks while the sector allocates only 15%. KBWP also allocates only 11% of its value toward Dangerous-or-worse-rated stocks compared to the sector's Dangerous-or-worse weightings of 66%.

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

KBWP underperforms the S&P 500 in quality of earnings ratings. The S&P 500's Very Attractive-rated ROIC of 18.4% outperforms KBWP's Attractive-rated ROIC of 11.9%.

KBWP's valuation ratings are superior to the S&P 500's valuation ratings. KBWP's Very Attractive-rated FCF Yield of 12.8% and Price-to-EBV of 0.8 outperform the S&P 500's Neutral-rated FCF Yield of 2.1% and Price-to-EBV of 2.0.

Figure 10: KBWP – 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	11.9%	12.8%	0.8	13

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

KBWP allocates capital more effectively than the S&P 500. Per [Figure 5](#) above, KBWP allocates 76% of its value to Attractive-or-better-rated stocks while the S&P 500 allocates 43%. KBWP also allocates only 11% of its value toward Dangerous-or-worse-rated stocks compared to the S&P 500's Dangerous-or-worse weightings of 24%.

Financials Sector Overview

Figure 12 lists the top 25 companies in the Financials sector by market capitalization representing about 58% of the overall sector.

Figure 12: Top 25 Financials Sector Companies by Market Cap.

Ticker	Company Name	Industry	P/E Ratio	% of Sector
BRK.A	Berkshire Hathaway, Inc.	Property & Casualty Insurance	14.3	8%
JPM	JPMorgan Chase & Company	Other Diversified Financial Services	9.9	7%
WFC	Wells Fargo & Company	Diversified Banks	12.4	6%
C	Citigroup Inc.	Other Diversified Financial Services	11.0	5%
BAC	Bank of America Corp	Other Diversified Financial Services	-27.8	4%
GS	Goldman Sachs Group, Inc.	Investment Banking & Brokerage	9.9	3%
AXP	American Express Company	Consumer Finance	15.6	3%
AIG	American International Group, Inc.	Multi-line Insurance	2.5	2%
USB	US Bancorp	Diversified Banks	14.4	2%
MET	MetLife Inc.	Life & Health Insurance	13.8	2%
SPG	Simon Property Group, Inc.	Retail REIT	56.9	2%
MS	Morgan Stanley	Investment Banking & Brokerage	8.3	1%
BK	The Bank of New York Mellon Corp	Asset Management & Custody Banks	12.2	1%
PNC	PNC Financial Services Group, Inc.	Regional Banks	10.0	1%
BEN	Franklin Resources, Inc.	Asset Management & Custody Banks	20.8	1%
TRV	The Travelers Companies, Inc.	Property & Casualty Insurance	8.8	1%
BLK	BlackRock Inc.	Asset Management & Custody Banks	17.4	1%
COF	Capital One Financial Corp	Consumer Finance	8.7	1%
STT	State Street Corp	Asset Management & Custody Banks	14.4	1%
ACE	ACE Ltd.	Property & Casualty Insurance	7.1	1%
AFL	AFLAC Inc.	Life & Health Insurance	9.1	1%
CME	CME Group, Inc.	Specialized Finance	20.2	1%
SCHW	The Charles Schwab Corp	Investment Banking & Brokerage	40.5	1%
EQR	Equity Residential	Residential REIT	65.5	1%
CB	The Chubb Corp	Property & Casualty Insurance	9.2	1%
Total				58%

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.
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

New Constructs® – Profile

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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.

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](#).

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