

Sector Rankings For ETFs & Mutual Funds

At the outset of the fourth quarter of 2012, only a single sector earns an attractive rating. My sector ratings are based on the aggregation of my [fund ratings](#) for every ETF and mutual fund in each sector.

Investors looking for quality sector funds that hold quality stocks should look no further than the Consumer Staples sector. None of the other sectors earn an Attractive-or-better rating. Figures 6 and 7 provide details. The primary driver behind an Attractive fund rating is good [portfolio management](#), or good stock picking, with low [total annual costs](#)

Note that the Attractive-or-better Predictive ratings do not always correlate with Attractive-or-better total annual costs. This fact underscores that (1) [low fees can dupe investors](#) and (2) investors should invest only in funds with good stocks and low fees.

See Figures 4 through 13 for a detailed breakdown of ratings distributions by sector. See my [free ETF & mutual fund screener](#) for free rankings and ratings on 7000+ mutual funds and 400+ ETFs. My fund rating methodology is detailed [here](#).

All of my reports on the best & worst ETFs and mutual funds in every sector and investment style are available [here](#).

Figure 1: Ratings For All Sectors

Sector	Predictive Rating	Portfolio Management Rating	Total Annual Costs Rating
Financials	Very Dangerous	Very Dangerous	Attractive
Utilities	Dangerous	Dangerous	Neutral
Telecom	Dangerous	Dangerous	Attractive
Cons Disc	Neutral	Neutral	Attractive
Materials	Neutral	Neutral	Attractive
Energy	Neutral	Neutral	Neutral
Industrials	Neutral	Neutral	Attractive
Health Care	Neutral	Neutral	Attractive
Info Tech	Neutral	Neutral	Neutral
Cons Staples	Attractive	Attractive	Very Attractive

Source: New Constructs, LLC and company filings

To earn an Attractive-or-better Predictive Rating, an ETF or mutual fund must have high-quality holdings and low costs. Only 30 sector ETFs and mutual funds meet these requirements, which is only 10% of all sector ETFs and mutual funds.

Health Care Select Sector SPDR (XLV) is my top Health Care ETF. It is the only ETF or Mutual Fund to get my Very Attractive rating by allocating over 67% of its value to Attractive-or-better-rated stocks.

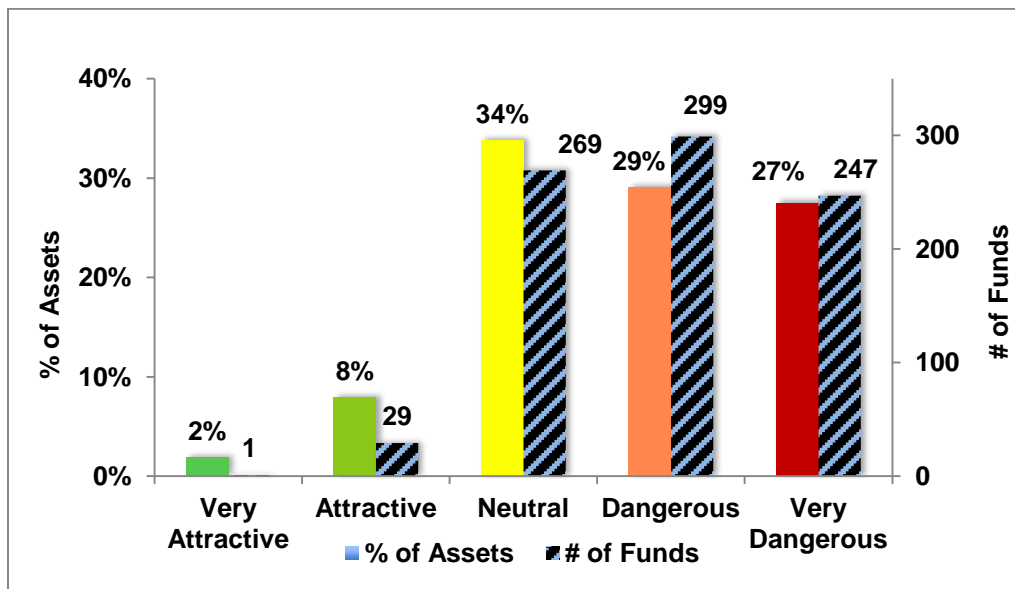
Johnson & Johnson (JNJ) is one of my favorite stocks held by XLV. Johnson & Johnson is essentially a holding company with over 250 units in three different operating segments: Consumer Products, Pharmaceuticals, and Medical Devices. Unlike some other large multinational holding companies, over the last decade JNJ has seen consistent [NOPAT](#) growth, widening margins, and [returns on invested capital](#) over 16% in every year of my model. Despite this track record of superb performance, the current market price implies JNJ's profits will decline 26% and never grow again. Low expectations for a great company make JNJ an attractive holding right now.

Ivy Funds: Ivy Real Estate Securities Fund (IRSAX) is my worst rated Financials mutual fund. It gets my Very Dangerous rating by allocating over 89% of its value to Dangerous or Very Dangerous rated stocks, and does not hold any stocks that we rate Attractive-or-better. To make matters worse, IRSAX charges annual costs of 4.29%, higher than more than 95% of all ETFs and mutual funds. Investors should not pay such a high price to own Dangerous-or-worse rated stocks.

Simon Property Group (SPG) is one of my least favorite stocks held by IRSAX. SPG earns my Very Dangerous rating. One of the reasons why it's so dangerous is that SPG's [returns on invested capital](#) have not exceeded its [WACC](#) in a single year of my model. Companies must earn an ROIC greater than WACC in order to create value for their shareholders. Worst of all, SPG's stock is expensive right now. In order to justify its current valuation, SPG needs to grow its profits by 15% compounded annually for the next 15 years. Those are lofty expectations for a company with mediocre-at-best profits.

Figure 2 shows the distribution of our Predictive Ratings for all Sector-based ETFs and mutual funds.

Figure 2: Distribution of ETFs & Mutual Funds (Assets and Count) by Predictive Rating



Source: New Constructs, LLC and company filings

Figure 3 offers additional details on the quality of the sector funds. Note that the average Total Annual Cost of Very Dangerous funds is almost 6 times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	1	29	269	299	247
% of ETFs & Funds	0.12%	3.43%	31.83%	35.38%	29.23%
% of TNA	1.83%	7.90%	33.74%	29.04%	27.49%
Avg TAC	0.20%	0.32%	0.73%	1.38%	1.16%

* Avg TAC = Weighted Average Total Annual Costs

Source: New Constructs, LLC and company filings

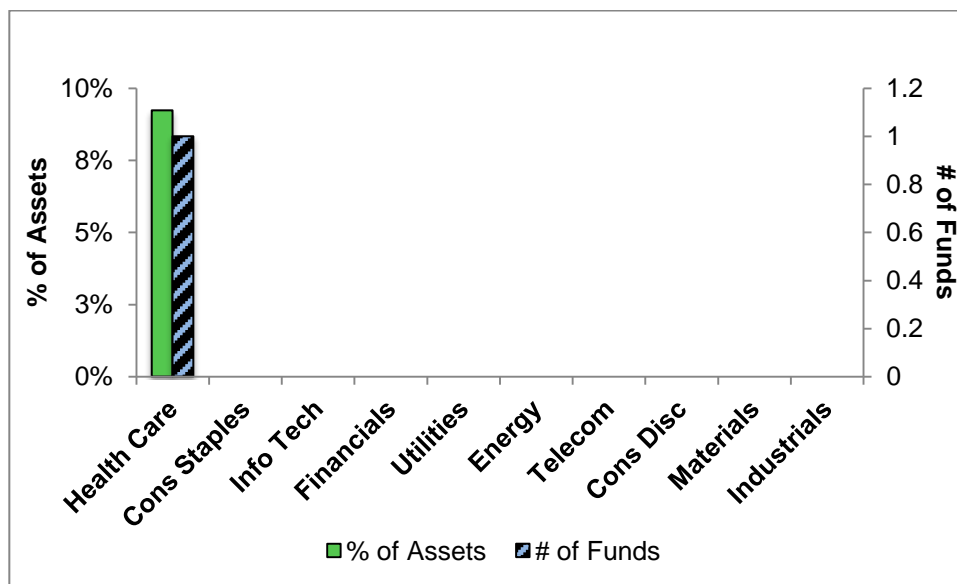
This table shows that only the best of the best funds get our Very Attractive Rating: they must hold good stocks AND have low costs. Investors deserve to have the best of both and we are here to give it to them.

Ratings by Sector

Figure 4 presents a mapping of Very Attractive funds by sector. The chart shows the number of Very Attractive funds in each sector and the percentage of assets allocated to Very Attractive-rated funds in each sector.

There are no sectors that earn my Very Attractive rating. Only one fund in my entire coverage universe earns my Very Attractive rating.

Figure 4: Very Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4

Figure 5: Very Attractive ETFs & Mutual Funds by Sector

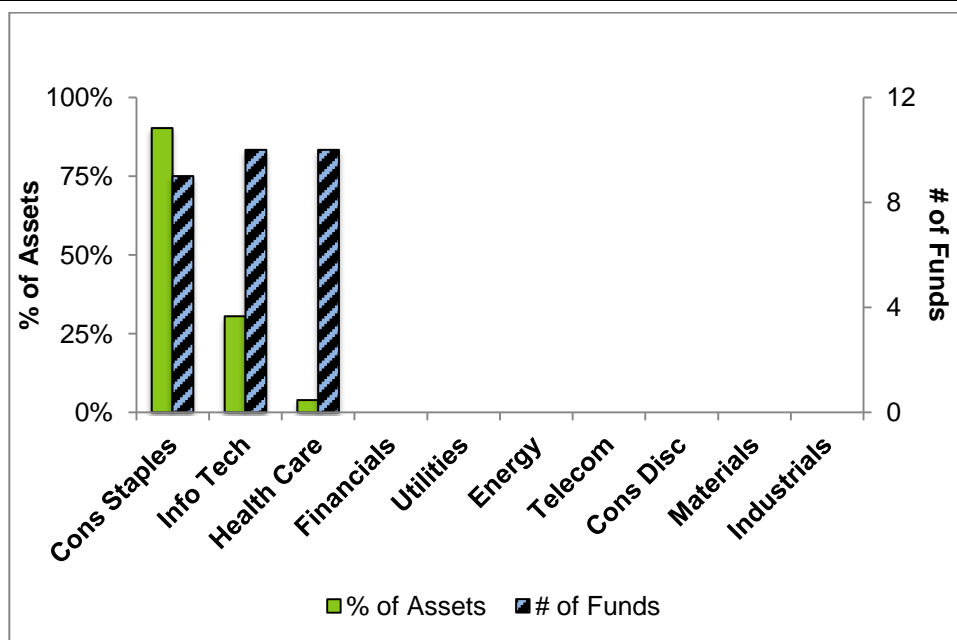
Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Health Care	9%	1	1%
Cons Staples	0%	0	0%
Info Tech	0%	0	0%
Financials	0%	0	0%
Utilities	0%	0	0%
Energy	0%	0	0%
Telecom	0%	0	0%
Cons Disc	0%	0	0%
Materials	0%	0	0%
Industrials	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 6 presents a mapping of Attractive funds by sector. The chart shows the number of Attractive funds in each sector and the percentage of assets allocated to Attractive-rated funds in each sector.

Note that Consumer Staples, Information Technology, and Health Care are the only sectors with Attractive-rated funds.

Figure 6: Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

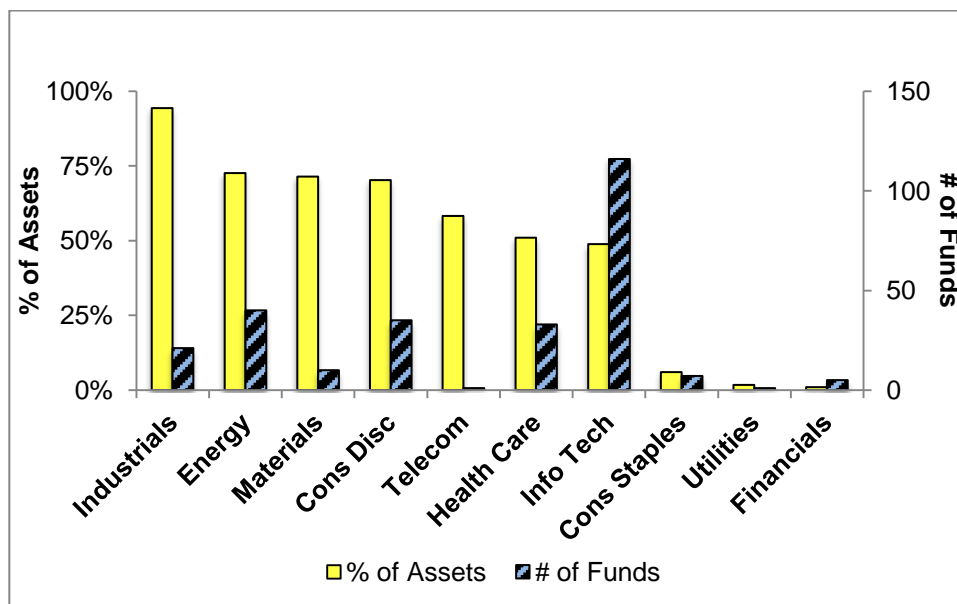
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Cons Staples	90%	9	50%
Info Tech	31%	10	6%
Health Care	4%	10	9%
Financials	0%	0	0%
Utilities	0%	0	0%
Energy	0%	0	0%
Telecom	0%	0	0%
Cons Disc	0%	0	0%
Materials	0%	0	0%
Industrials	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 8 presents a mapping of Neutral funds by sector. The chart shows the number of Neutral funds in each sector and the percentage of assets allocated to Neutral-rated funds in each sector.

Figure 8: Neutral ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

Figure 9: Neutral ETFs & Mutual Funds by Sector

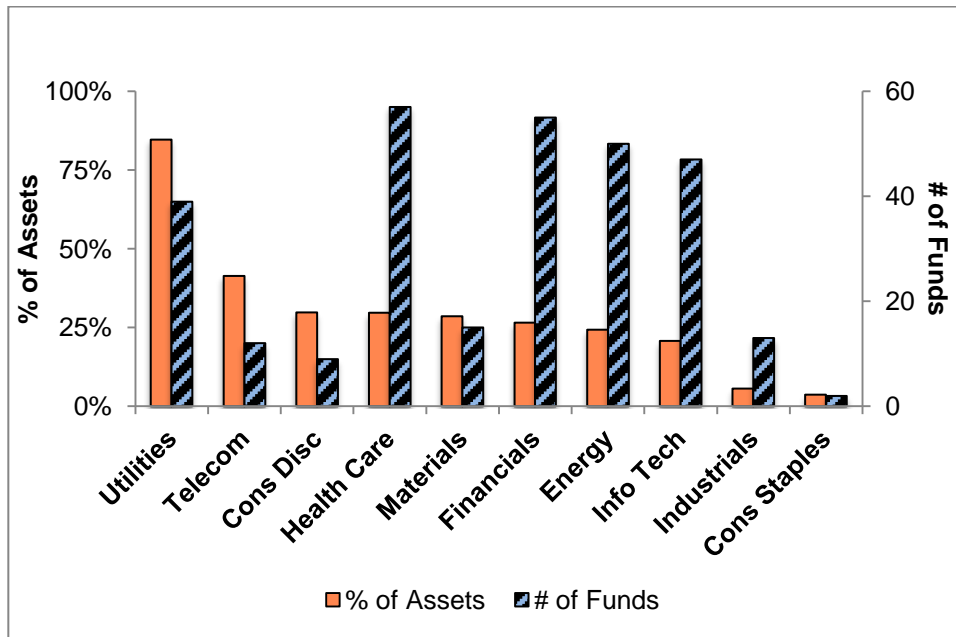
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Industrials	94%	21	62%
Energy	73%	40	41%
Materials	71%	10	40%
Cons Disc	70%	35	80%
Telecom	58%	1	6%
Health Care	51%	33	30%
Info Tech	49%	116	67%
Cons Staples	6%	7	39%
Utilities	2%	1	2%
Financials	1%	5	2%

Source: New Constructs, LLC and company filings

Figure 10 presents a mapping of Dangerous funds by fund sector. The chart shows the number of Dangerous funds in each sector and the percentage of assets allocated to Dangerous-rated funds in each sector.

Utilities ETFs and mutual funds should be avoided. 83% of assets in Utilities ETFs and mutual funds are allocated to Dangerous stocks.

Figure 10: Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

Figure 11: Dangerous ETFs & Mutual Funds by Sector

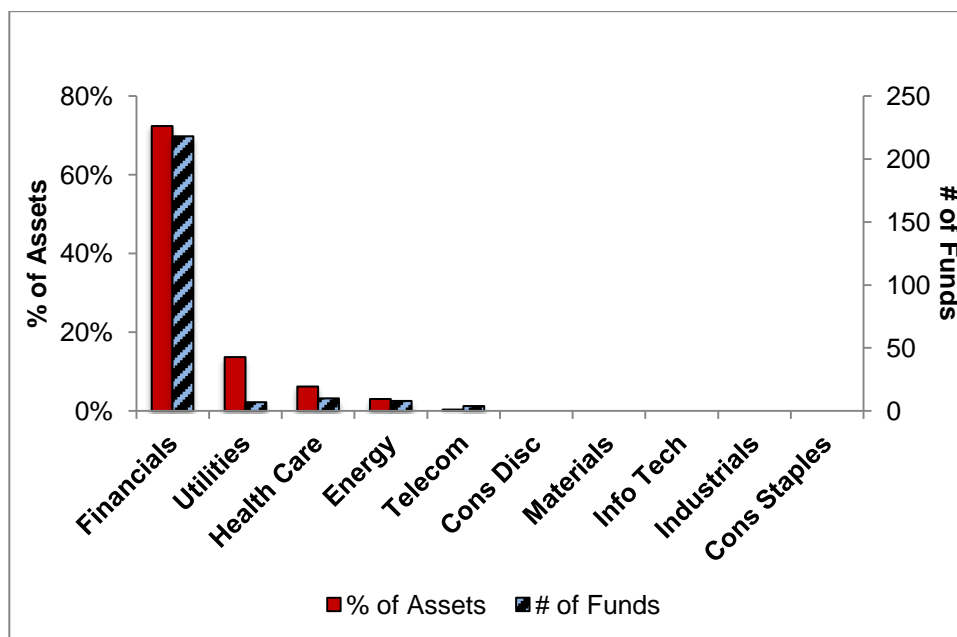
Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Utilities	85%	39	83%
Telecom	41%	12	71%
Cons Disc	30%	9	20%
Health Care	30%	57	51%
Materials	29%	15	60%
Financials	27%	55	20%
Energy	24%	50	51%
Info Tech	21%	47	27%
Industrials	6%	13	38%
Cons Staples	4%	2	11%

Source: New Constructs, LLC and company filings

Figure 12 presents a mapping of Very Dangerous funds by fund sector. The chart shows the number of Very Dangerous funds in each sector and the percentage of assets allocated to Very Dangerous-rated funds in each sector.

Financials ETFs and mutual funds hold the greatest number Very Dangerous stocks, making Financials the only Very Dangerous sector category. 78% of Financials ETFs and mutual funds earn my Very Dangerous rating.

Figure 12: Very Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

Figure 13: Very Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Dangerous Funds	% of Very Dangerous Funds in Sector
Financials	72%	218	78%
Utilities	14%	7	15%
Health Care	6%	10	9%
Energy	3%	8	8%
Telecom	0%	4	24%
Cons Disc	0%	0	0%
Materials	0%	0	0%
Info Tech	0%	0	0%
Industrials	0%	0	0%
Cons Staples	0%	0	0%

Source: New Constructs, LLC and company filings

Disclosure: I own JNJ. I receive no compensation to write about any specific stock, sector or theme.

Appendix: Predictive Fund Rating System

New Constructs' [Predictive fund Ratings](#) enable smarter investing by assessing the key drivers of future fund performance. We start by analyzing every funds' holdings based on New Constructs' stock ratings, which are regularly featured as among the [best by Barron's](#). Next, we measure and rank the all-in fund expenses.

Intuitively, there are two drivers for future fund performance.

1. Stock-picking ([Portfolio Management Rating](#)) and
2. Fund expenses ([Total Annual Costs Rating](#))

The figure below details the criteria that drive our Predictive Rating system for funds. The two drivers of our predictive ratings system are Portfolio Management and Total Annual Costs. The Portfolio Management ratings (detail [here](#)) is the same as our Stock Rating (detail [here](#)) except that we incorporate Asset Allocation (details [here](#)). The Total Annual Costs Ratings (details [here](#)) captures the all-in costs of being in a fund over a 3-year holding period, the average period for all mutual funds.

Predictive Rating	Portfolio Management Rating						Total Annual Costs
	Business Strength		Valuation			Cash Allocation	
	Quality of Earnings	Return on Invested Capital	FCF Yield	Price to Economic Book Value	Market-Implied Duration of Growth		
Very Dangerous	Misleading Trend	Bottom Quintile	< -5%	>3.5 or -1<0	> 50	> 20%	> 4 %
Dangerous	False Positive	4th Quintile	-5% < -1%	2.4<3.5 or <-1	20 < 50	8% < 20%	2% < 4%
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20	2.5% < 8%	1% < 2%
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10	1% < 2.5%	0.5% < 1%
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3	<1%	< 0.5%

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How New Constructs Creates Value for Clients

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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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