Sector Rankings For ETFs & Mutual Funds

At the outset of the second quarter of 2013, 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 sector funds that hold quality stocks should focus on the Consumer Staples sector. Only this sector has enough Attractive-or-better rated funds to earn my Attractive 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 rankings, ratings and free reports on 7000+ mutual funds and 400+ ETFs. My fund rating methodology is detailed here.

Reports on the best & worst ETFs and mutual funds in every sector and investment style are here.

Figure 1: Ratings For All Sectors

Sector	Predictive Rating	Portfolio Management Rating	Total Annual Costs Rating
Financials	Dangerous	Dangerous	Attractive
Utilities	Dangerous	Dangerous	Neutral
Energy	Dangerous	Dangerous	Neutral
Telecom	Dangerous	Dangerous	Attractive
Materials	Neutral	Neutral	Attractive
Cons Disc	Neutral	Neutral	Attractive
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 10 sector ETFs and mutual funds meet these requirements, which is only 6% of all sector ETFs and mutual funds.

Consumer Staples Select Sector SPDR (XLP) is my top Consumer Staples ETF. It gets my Attractive rating by allocating over 67% of its value to Attractive-or-better-rated stocks.

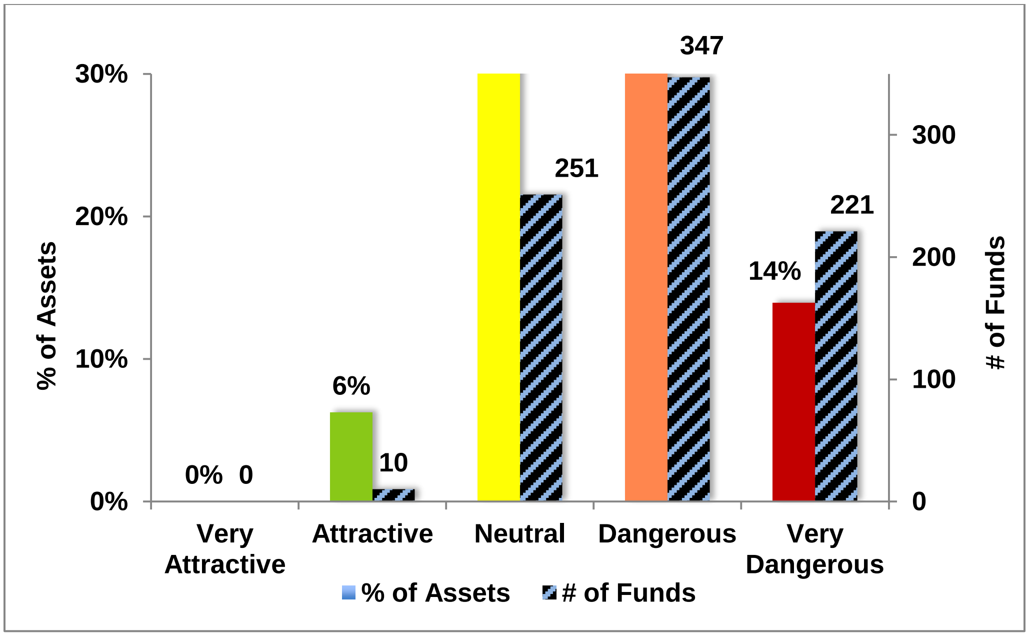
Wal-Mart Stores, Inc. (WMT) is one of my favorite stocks held by XLP and earns my Attractive rating. WMT is one of the most consistent companies we cover. The business has, grown after tax profit (NOPAT) by 11% compounded annually for the past 15 years. NOPAT increased every single year during that time. Such consistency typically commands a high valuation, but the market has curiously low expectations for WMT. Trading at ~$78.12/share, the stock has a price to economic book value ratio of 0.8, meaning the market is expecting WMT's NOPAT to permanently decline by 20%. For a company with a proven track record of growth, such pessimistic expectations seem unwarranted. WMT's low valuation, combined with its impressive historical performance, offers investors a high potential reward with very little risk.

Rydex Series Funds: Real Estate Fund (RYREX) is my worst rated Financials mutual fund. It gets my Very Dangerous rating by allocating over 88% of its value to Neutral-or-worse-rated stocks, and to make matters worse, charges investors total annual costs of 8.36%.

Ventas Inc. (VTR) is one of my least favorite stocks held by RYREX and gets my Very Dangerous rating. VTR has benefited from the rapidly aging US population as over 50% of its business is providing senior housing facilities. However, its business model is now under pressure from increasing competition in the industry, as small new firms are jumping into the market and driving down margins and returns on invested capital (ROIC). VTR has seen its ROIC decline from 177% in 2003 down to 3.5% in 2012. Declining ROIC has lead to VTR making negative economic earnings for the past two years. The market, though, is focusing on the demographic changes and rising GAAP net income to project very high expectations onto VTR. The company's current share price of ~$75.53 implies 20% growth in NOPAT over 16 years. Betting on that kind of growth, for any company, is a risky proposition. For more analysis on VTR see "Danger Zone 3/18/2013: Ventas Inc. (VTR)".

Figure 2 shows the distribution of our Predictive Ratings for all sector 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 10 times that of Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	0	10	251	347	221
% of ETFs & Funds	0.00%	1.21%	30.28%	41.86%	26.66%
% of TNA	0.00%	6.25%	32.73%	47.09%	13.93%
Avg TAC	0.0%	0.20%	0.68%	0.92%	1.95%

* Avg TAC = Weighted Average Total Annual Costs

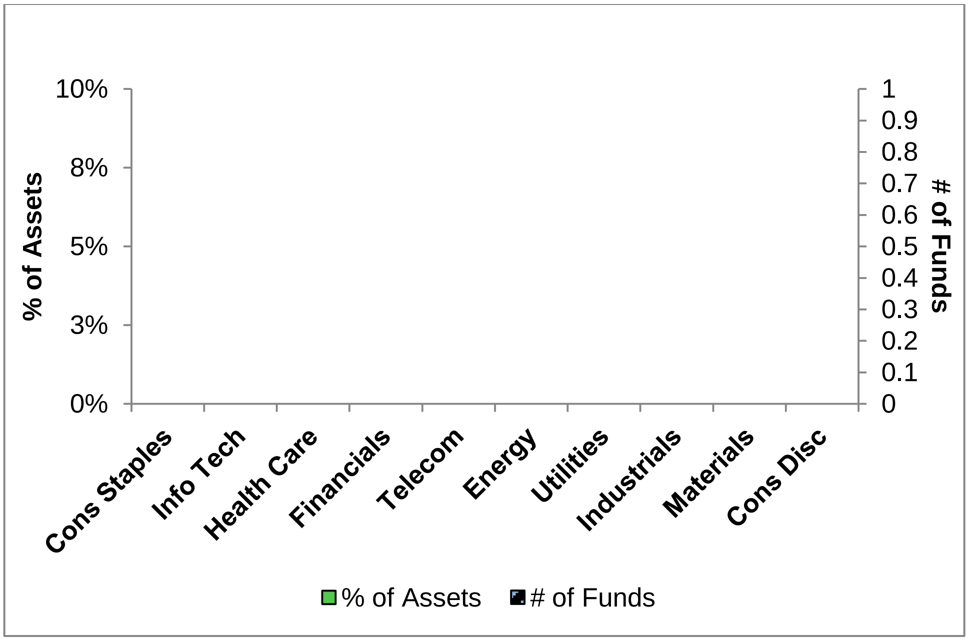
Source: New Constructs, LLC and company filings

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 in each sector allocated to funds that are rated Very Attractive.

No sector ETFs or mutual funds earn my Very Attractive rating. This is unusual. Normally, at least one or two sector funds allocate sufficiently to Attractive and Very Attractive stocks to earn my highest 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
Cons Staples	0%	0	0%
Info Tech	0%	0	0%
Health Care	0%	0	0%
Financials	0%	0	0%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%
Industrials	0%	0	0%
Materials	0%	0	0%
Cons Disc	0%	0	0%

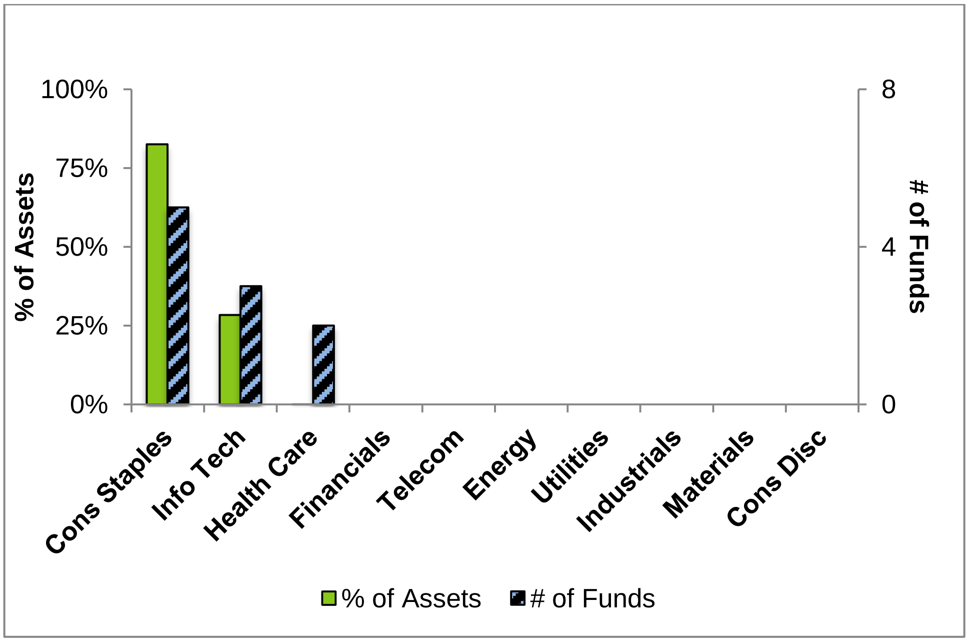
Source: New Constructs, LLC and company filings

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 the Consumer Staples, Information Technology, and Health Care sectors are the only sectors that house Attractive-rated funds. The Consumer Staples sector is the only one to have more than 50% of its assets allocated to Attractive rated funds.

The extremely small allocation by investors to Attractive funds in the Health Care sector is troubling. It suggests that investors are struggling to find the high quality funds in that sector.

Figure 6: Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

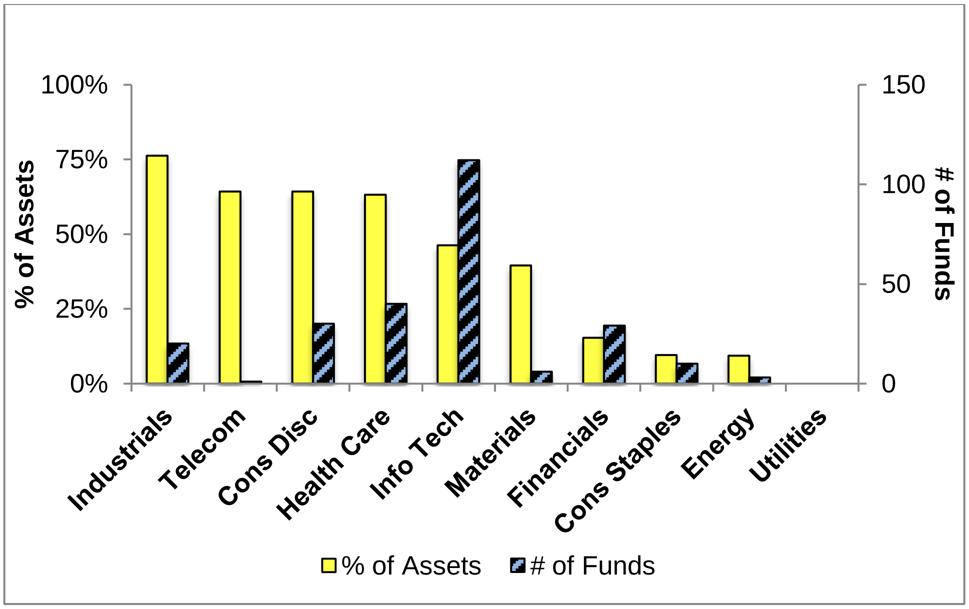
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Cons Staples	82%	5	29%
Info Tech	28%	3	2%
Health Care	0%	2	2%
Financials	0%	0	0%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%
Industrials	0%	0	0%
Materials	0%	0	0%
Cons Disc	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

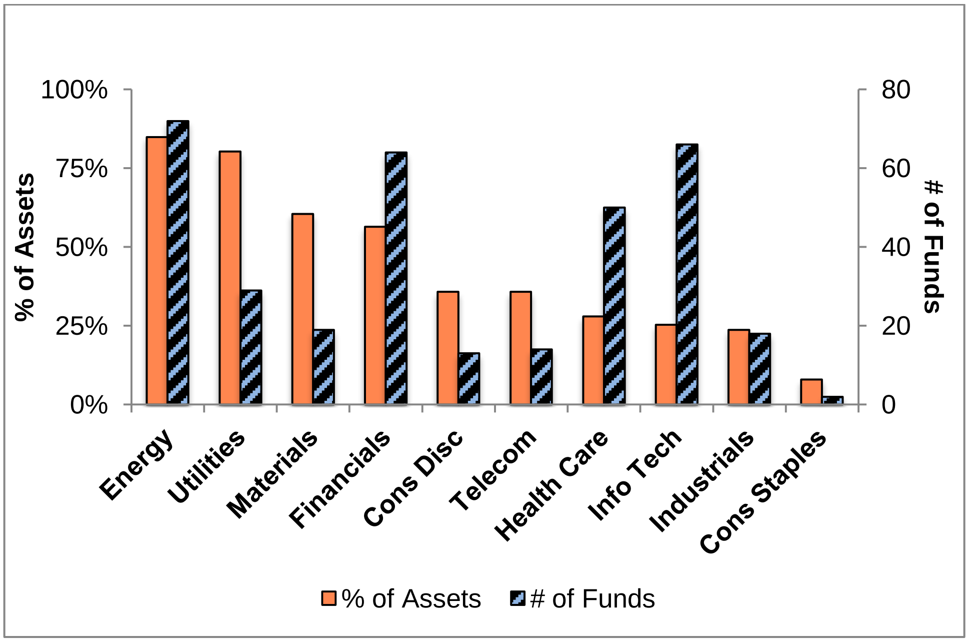
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Industrials	76%	20	50%
Telecom	64%	1	6%
Cons Disc	64%	30	70%
Health Care	63%	40	38%
Info Tech	46%	112	62%
Materials	39%	6	24%
Financials	15%	29	11%
Cons Staples	10%	10	59%
Energy	9%	3	3%
Utilities	0%	0	0%

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.

The landscape of sector ETFs and mutual funds is littered with Dangerous funds. Investors in Energy and Utilities funds have over 75% of their assets invested in Dangerous-rated funds.

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

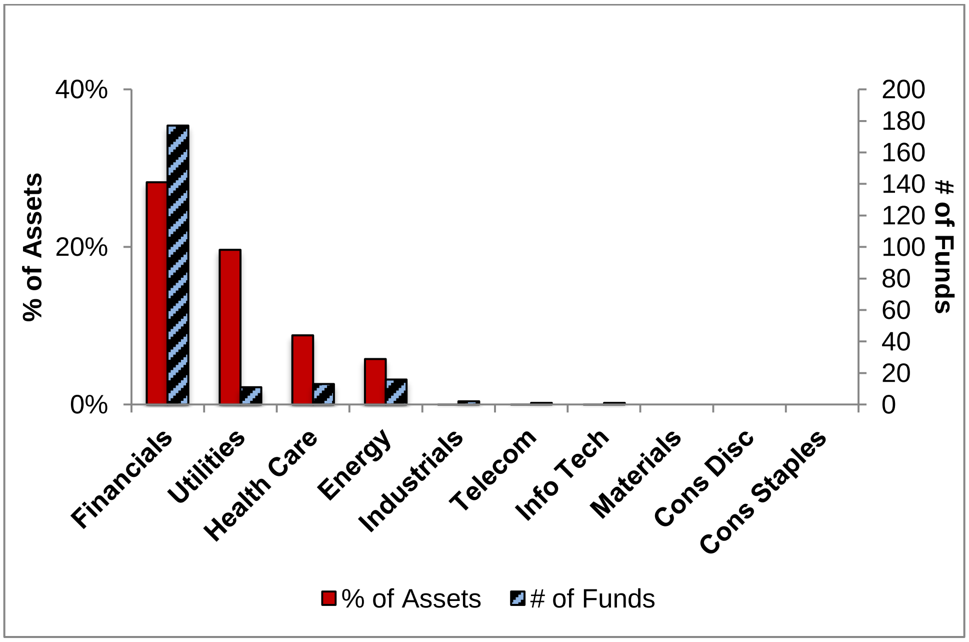
Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Energy	85%	72	79%
Utilities	80%	29	73%
Materials	61%	19	76%
Financials	56%	64	24%
Cons Disc	36%	13	30%
Telecom	36%	14	88%
Health Care	28%	50	48%
Info Tech	25%	66	36%
Industrials	24%	18	45%
Cons Staples	8%	2	12%

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 in each sector allocated to funds that are rated Very Dangerous.

The fact that there are 177 Very Dangerous funds in the Financials sector is troubling. Investors have to look very hard to find the quality funds in the midst of all the poor ones.

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	28%	177	66%
Utilities	20%	11	28%
Health Care	9%	13	12%
Energy	6%	16	18%
Industrials	0%	2	5%
Telecom	0%	1	6%
Info Tech	0%	1	1%
Materials	0%	0	0%
Cons Disc	0%	0	0%
Cons Staples	0%	0	0%

Source: New Constructs, LLC and company filings

Sam McBride contributed to this report.
Disclosure: David Trainer owns WMT. David Trainer and Sam McBride 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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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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