



How To Avoid the Worst Style ETFs

Why are there so many ETFs? The answer is: because ETF providers are making lots of money selling them. The number of ETFs has little to do with serving investors' best interests. Below are three red flags investors can use to avoid the worst ETFs:

1. Inadequate Liquidity

This is the easiest issue to avoid, and my advice is simple. Avoid all ETFs with less than \$100 million in assets. Low levels of liquidity can lead to a discrepancy between the price of the ETF and the underlying value of the securities it holds. In addition, low asset levels tend to mean lower volume in the ETF and large bid-ask spreads.

2. High Fees

ETFs should be cheap, but not all of them are. The first step here is to know what is cheap and expensive.

To ensure you are paying at or below average fees, invest only in ETFs with total annual costs below 0.50%, which is the average total annual cost of the 274 U.S. equity ETFs I cover.

Figure 1 shows the most and least expensive style ETFs in the U.S. equity universe based on [total annual costs](#). QuantShares provides three of the most expensive style ETFs while Schwab ETFs are among the cheapest.

Figure 1: 5 Least and Most-Expensive Style ETFs

Ticker	Name	Style	Total Annual Cost	Overall Rating
Most Expensive				
MOM	QuantShares U.S. Market Neutral Momentum	Mid Cap Growth	1.66%	2 Stars
SIZ	QuantShares U.S. Market Neutral Size	Small Cap Blend	1.66%	3 Stars
CHEP	QuantShares U.S. Market Neutral Value	Mid Cap Value	1.66%	3 Stars
FWDD	AdvisorShares Madrona Forward Domestic	All Cap Blend	1.39%	3 Stars
WBIB	WBI SMID Tactical Value Shares	All Cap Blend	1.11%	3 Stars
Least Expensive				
SCHX	Schwab U.S. Large Cap ETF	Large Cap Blend	0.04%	5 Stars
SCHB	Schwab U.S. Broad Market ETF	All Cap Blend	0.04%	5 Stars
VOO	Vanguard S&P 500 ETF	Large Cap Blend	0.06%	5 Stars
VTI	Vanguard Total Stock Market ETF	All Cap Blend	0.06%	5 Stars
SCHD	Schwab U.S. Dividend Equity ETF	Large Cap Blend	0.08%	5 Stars

Sources: New Constructs, LLC and company filings

However, investors need not pay high fees for good holdings. Schwab U.S. Dividend Equity ETF (SCHD) is my second rated style ETF and earns my Very Attractive rating. It also has low total annual costs of only 0.08%.

3. Poor Holdings

Avoiding poor holdings is by far the hardest step to finding the best ETFs, but it is also the most important because an ETF's performance is determined more by its holdings than its costs. Figure 2 shows the ETFs within each style with the worst holdings or [portfolio management ratings](#).

There are no ETFs in the All Cap Growth or All Cap Value styles.

**Figure 2: Style ETFs with the Worst Holdings**

Ticker	Name	Style	Portfolio Management Rating	Overall Rating
PZI	PowerShares Zacks Micro Cap ETF	Small Cap Value	Dangerous	1 Star
VTWG	Vanguard Russell 2000 Growth ETF	Small Cap Growth	Dangerous	2 Stars
IWC	iShares Russell Micro Cap Index Fund	Small Cap Blend	Dangerous	1 Star
IVOV	Vanguard S&P Mid Cap 400 Value ETF	Mid Cap Value	Dangerous	3 Stars
RFG	Guggenheim S&P Mid Cap 400 Pure Growth	Mid Cap Growth	Dangerous	3 Stars
RSCO	State Street SPDR Russell Small Cap Completeness	Mid Cap Blend	Dangerous	2 Stars
RWG	Columbia RP Focused Large Cap Growth	Large Cap Growth	Dangerous	3 Stars
VXF	Vanguard Extended Market ETF	All Cap Blend	Dangerous	2 Stars
RSP	Guggenheim S&P Equal Weight	Large Cap Blend	Dangerous	3 Stars
VONV	Vanguard Russell 1000 Value ETF	Large Cap Value	Dangerous	3 Stars

Sources: New Constructs, LLC and company filings

Vanguard appears more often than any other providers in Figure 2, which means that they offer the most style ETFs with the worst holdings.

My [overall ratings on ETFs](#) are based primarily on my [stock ratings](#) of their holdings. New Constructs covers over 3000 stocks and is known for the due diligence done on each stock we cover.

Beware of the Danger Within

Buying an ETF without analyzing its holdings is like buying a stock without analyzing its business and finances. Put another way, research on ETF holdings is necessary due diligence because an ETF's performance is only as good as its holdings' performance.

PERFORMANCE OF ETF's HOLDINGS = PERFORMANCE OF ETF

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Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.



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