3Q15 Sector Ratings For ETFs & Mutual Funds

At the beginning of the third quarter of 2015, only the Consumer staples sector earns an Attractive-or-better rating. Our sector ratings are based on the aggregation of our fund ratings for every ETF and mutual fund in each sector.

Investors looking for sector funds that hold quality stocks should look no further than the Consumer Staples and Information Technology sector. These sectors house the most Attractive-or-better rated funds. Figures 4 through 7 provide more details. The primary driver behind an Attractive fund rating is good portfolio management, or good stock picking, with low total annual costs.

Attractive-or-better ratings do not always correlate with Attractive-or-better total annual costs. This fact underscores that (1) cheap funds 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 our ETF & mutual fund screener for rankings, ratings and reports on 7000+ mutual funds and 400+ ETFs. Our fund rating methodology is detailed here.

All of our reports on the best & worst ETFs and mutual funds in every sector are available here.

Figure 1: Ratings For All Sectors

Sector	Overall Rating
Energy	Dangerous
Financials	Dangerous
Utilities	Dangerous
Telecom	Dangerous
Materials	Neutral
Health Care	Neutral
Cons Disc	Neutral
Industrials	Neutral
Info Tech	Neutral
Cons Staples	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 the top 30% of all ETFs and mutual funds earn our Attractive or better ratings.

Fidelity Select Consumer Staples Portfolio (FDFAX) is the top rated Consumer Staples mutual fund. It gets our Very Attractive rating by allocating over 38% of its value to Attractive-or-better-rated stocks.

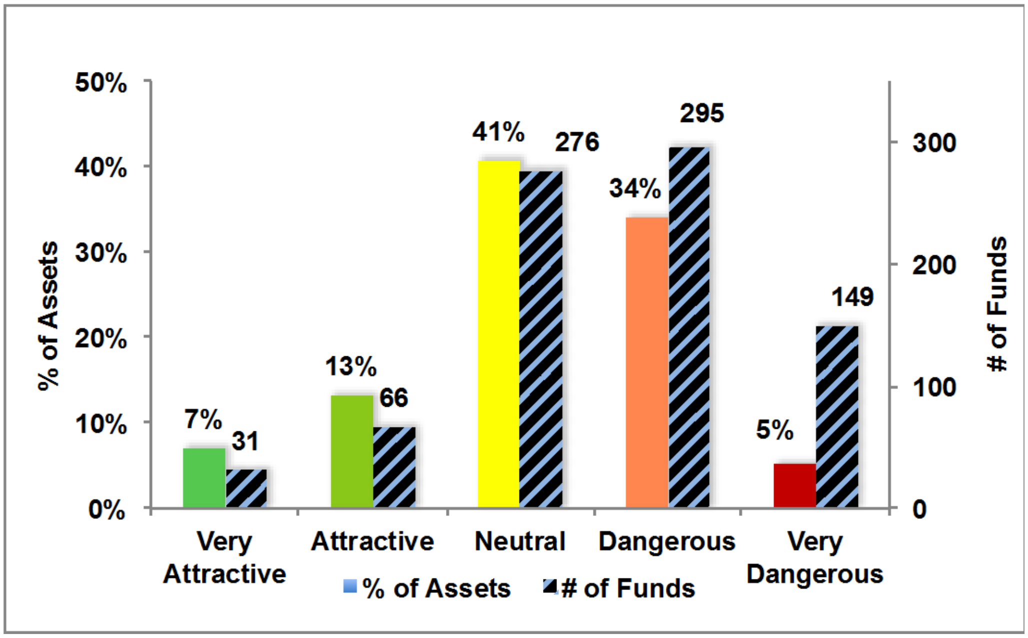
PepsiCo Inc. (PEP: $95/share) is one of our favorite stocks held by FDFAX and earns our Attractive rating. Over the last decade, PepsiCo has grown its after-tax profits (NOPAT) by 6% compounded annually. The company currently earns a healthy return on invested capital (ROIC) of 10%. Furthermore, PepsiCo has consistently generated positive economic earnings in every year of our model, which dates back to 1998. At its current price of $95/share, PEP has a price to economic book value (PEBV) of 1.2. This ratio implies that the market expects NOPAT growth of only 20% for the remainder of PepsiCo's corporate life. These are low expectations considering that the company grew profits by 6% compounded annually for the past ten years. If Pepsi can continue to grow NOPAT by 6% compounded annually for the next decade, the stock is worth $127/share- a 34% upside from current valuations.

Saratoga Advantage Energy and Basic Materials Portfolio (SBMBX) is the worst rated Energy mutual fund. It gets our Very Dangerous rating by allocating over 45% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors annual costs of 5.96%.

Exxon Mobil (XOM: $83/share) is one of our least favorite stocks held by SBMBX and earns our Dangerous rating. Since 2011, Exxon's NOPAT has declined by 27% compounded annually. Exxon's ROIC has fallen from 13% to a bottom quintile 5% in 2014. On a trailing twelve-month basis, ROIC has fallen even further to only 3%. Despite the issues Exxon has faced, the stock still remains overvalued. To justify its current price of $83/share, Exxon must grow NOPAT by 10% compounded annually for the next 13 years. This expectation seems optimistic given the current market landscape and Exxon's inability to grow NOPAT at all over the last four years. Investors would be wise to steer clear of this oil & gas giant.

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 more than five times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	31	66	276	295	149
% of ETFs & Funds	4%	8%	34%	36%	18%
% of TNA	7%	13%	41%	34%	5%
Avg TAC	0.43%	0.37%	0.82%	0.87%	2.35%

* Avg TAC = Weighted Average Total Annual Costs

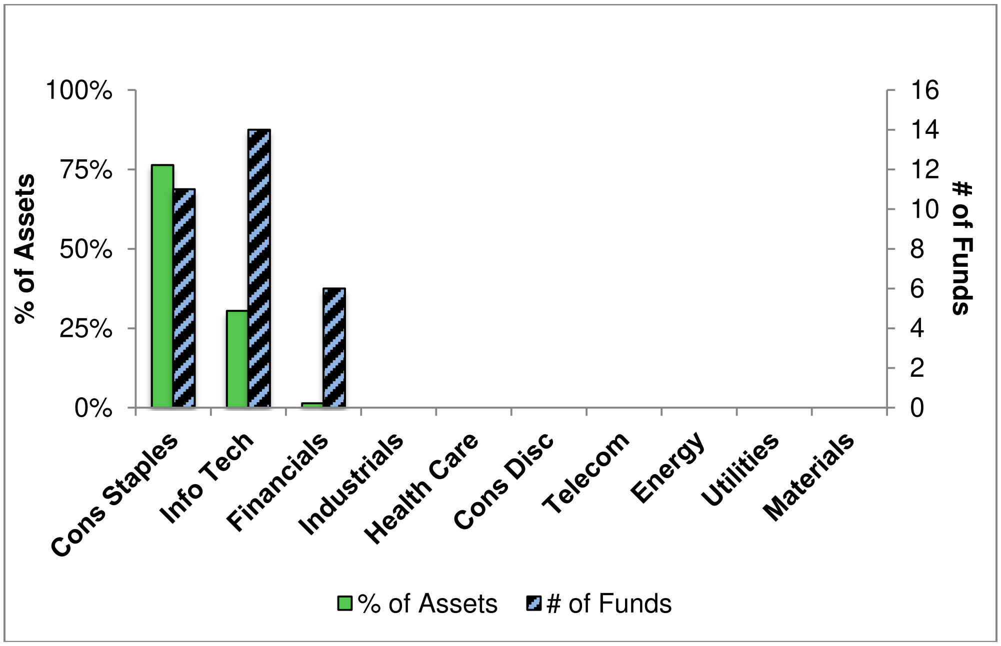
Source: New Constructs, LLC and company filings

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

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.

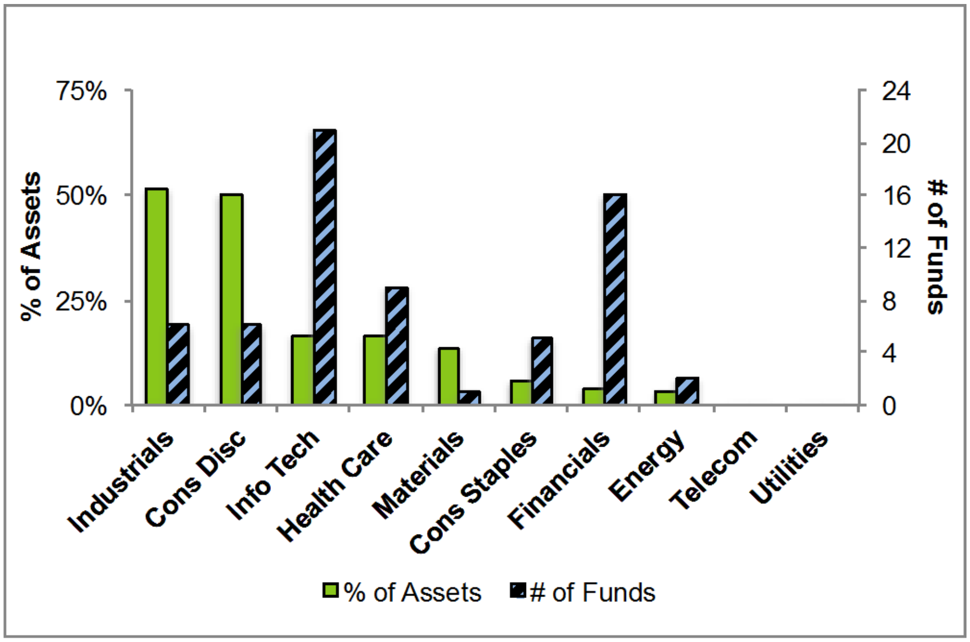
Figure 5: Very Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Cons Staples	76%	11	46%
Info Tech	30%	14	9%
Financials	1%	6	2%
Industrials	0%	0	0%
Health Care	0%	0	0%
Cons Disc	0%	0	0%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%
Materials	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.

Figure 6: Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

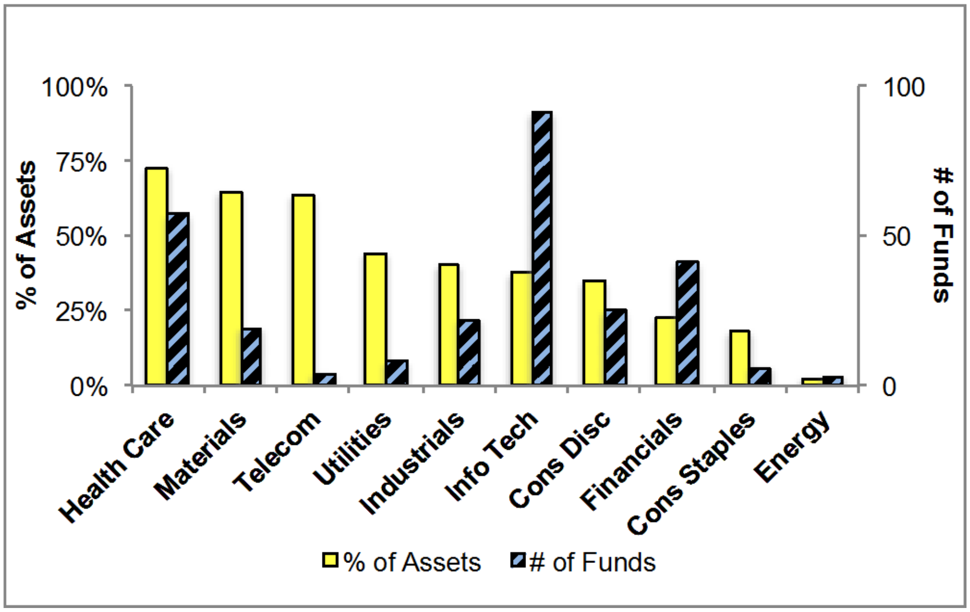
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Industrials	51%	6	17%
Cons Disc	50%	6	16%
Info Tech	17%	21	13%
Health Care	16%	9	8%
Materials	13%	1	4%
Cons Staples	5%	5	21%
Financials	4%	16	6%
Energy	3%	2	2%
Telecom	0%	0	0%
Utilities	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

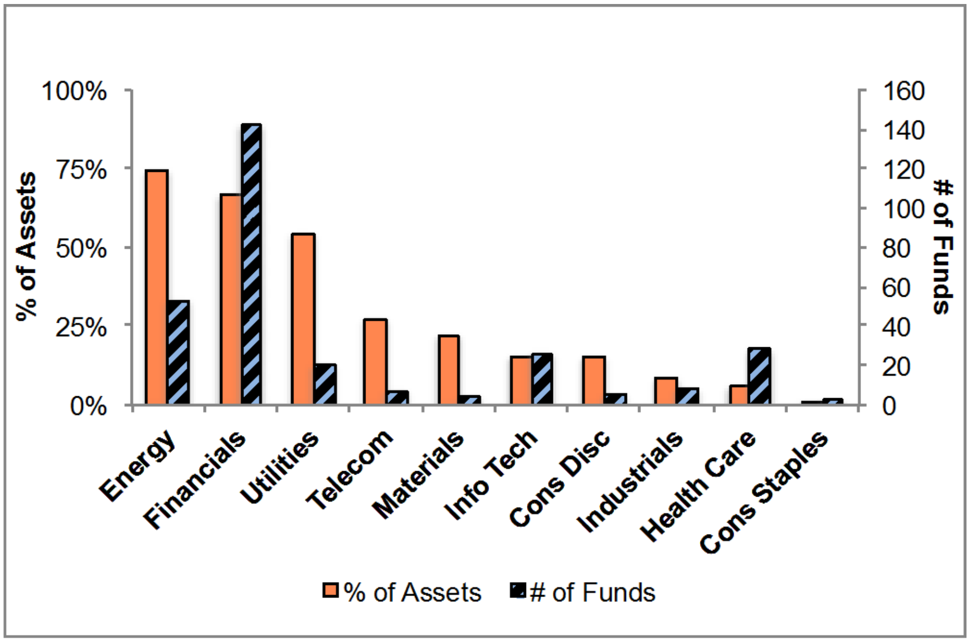
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Health Care	73%	57	53%
Materials	65%	19	73%
Telecom	63%	4	22%
Utilities	44%	8	23%
Industrials	40%	22	61%
Info Tech	37%	91	58%
Cons Disc	35%	25	68%
Financials	23%	41	15%
Cons Staples	18%	6	25%
Energy	2%	3	3%

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 have put over 75% of their assets 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.

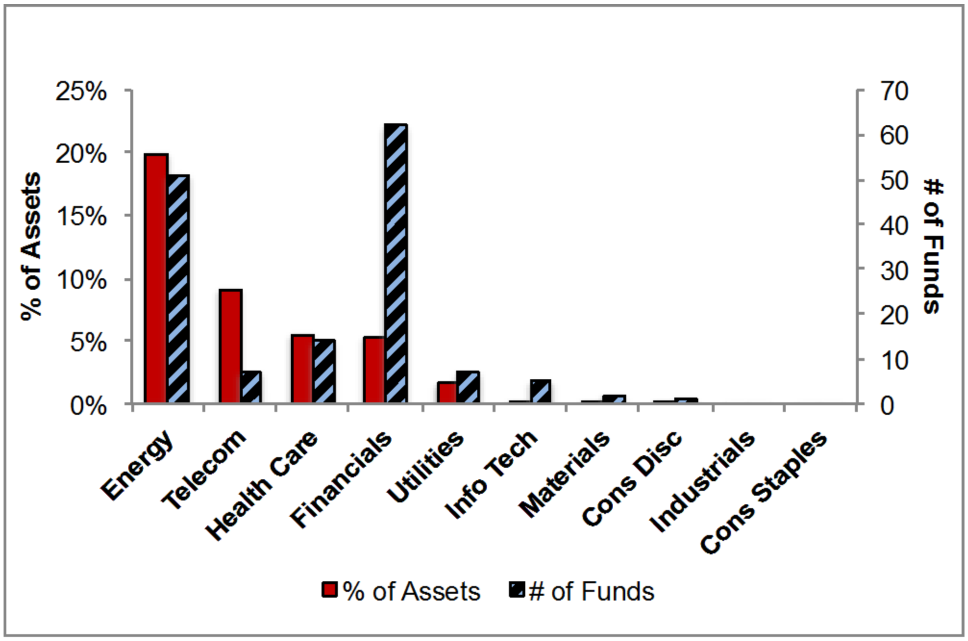
Figure 11: Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Energy	75%	53	49%
Financials	67%	142	53%
Utilities	54%	20	57%
Telecom	27%	7	39%
Materials	22%	4	15%
Info Tech	15%	26	17%
Cons Disc	15%	5	14%
Industrials	8%	8	22%
Health Care	6%	28	26%
Cons Staples	0%	2	8%

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.

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
Energy	20%	51	47%
Telecom	9%	7	39%
Health Care	6%	14	13%
Financials	5%	62	23%
Utilities	2%	7	20%
Info Tech	0%	5	3%
Materials	0%	2	8%
Cons Disc	0%	1	3%
Industrials	0%	0	0%
Cons Staples	0%	0	0%

Source: New Constructs, LLC and company filings

Disclosure: David Trainer and Max Lee 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. Finally, we rank the fund compared to all other funds to identify the best and worst funds in the market.

Intuitively, there are two drivers for future fund performance.

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

Our Predictive Fund Rating is based on these drivers and the fund's ranking:

1. Top 10% = Very Attractive Rating
2. Next 20% = Attractive Rating
3. Next 40% = Neutral Rating
4. Next 20% = Dangerous Rating
5. Bottom 10% = Very Dangerous 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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Our Philosophy About Research

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

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