



## Investment Style Ratings For ETFs, Mutual Funds & Stocks

At the beginning of the third quarter of 2015, only the Large Cap Value and Large Cap Blend styles earn an Attractive-or-better rating. Our style ratings are based on the aggregation of our fund ratings for every ETF and mutual fund in each style.

Investors looking for style funds that hold quality stocks should look no further than the Large Cap Value and Large Cap Blend styles. These styles 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 investment style.

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

You can see our investment style ratings for 2Q15 [here](#).

**Figure 1: Ratings For All Investment Styles**

Style	Overall Rating
Small Cap Blend	Dangerous
Small Cap Growth	Dangerous
Small Cap Value	Dangerous
Mid Cap Blend	Dangerous
Mid Cap Growth	Neutral
Mid Cap Value	Neutral
All Cap Growth	Neutral
All Cap Value	Neutral
Large Cap Growth	Neutral
All Cap Blend	Neutral
Large Cap Blend	Attractive
Large Cap Value	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 rating.

Schwab U.S. Dividend Equity ETF (SCHD) is the top rated Large Cap Value fund and overall top rated style ETF. It gets our Very Attractive rating by allocating over 61% of its value to Attractive-or-better-rated stocks.

Microsoft Corporation (MSFT: \$45/share), a recent [Stock Pick of the week](#), is one of our favorite stocks held by SCHD. Over the last decade, Microsoft's after-tax profit ([NOPAT](#)) has grown by 13% compounded annually. The company currently earns a top-quintile return on invested capital ([ROIC](#)) of 48% and has generated positive [free cash flow](#) every year since 2002. Investors have failed to recognize Microsoft's position as a cash-generating machine and the stock remains undervalued. At the current price of ~\$45/share, Microsoft has a price to economic book value ([PEBV](#)) ratio of 0.9. This ratio implies that the market expects the company's profits to permanently decline by 10%. However, if Microsoft can [grow NOPAT by just 5% compounded annually for the next decade](#), the stock is worth \$69/share – a 53% upside. Despite the slowing PC market, Microsoft should be able to surpass such low market expectations as they focus on monetizing their cloud services and software offerings.

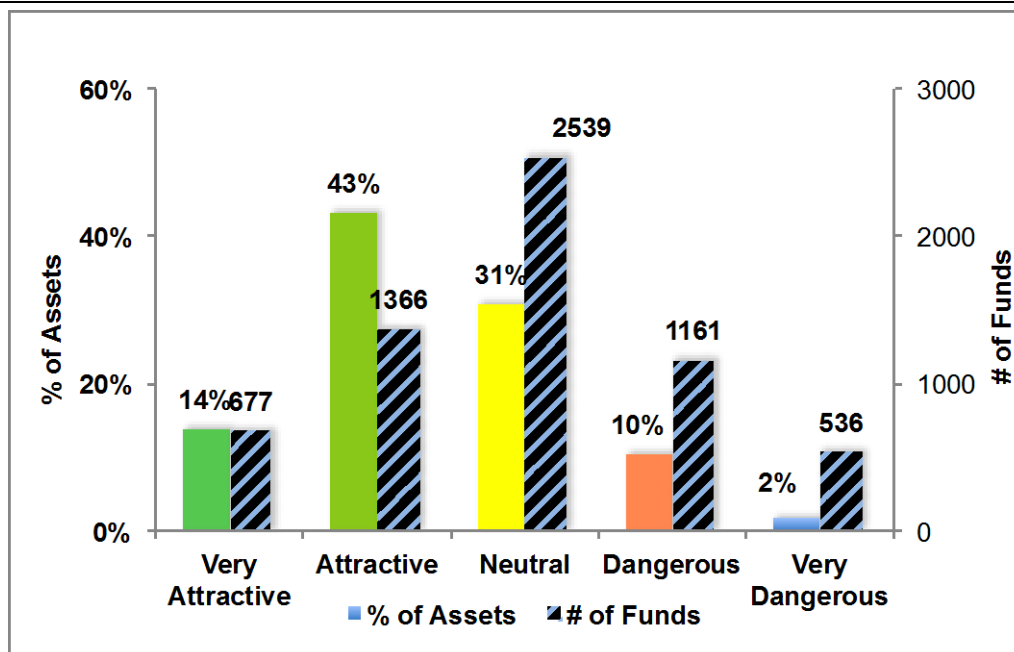


Investment Managers Series Chartwell Small Cap Value Fund (CWSVX) is the worst rated Small Cap Blend fund. It gets our Very Dangerous rating by allocating over 62% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors total annual costs of 5.22%.

ESCO Technologies (ESE: \$38/share) is one of our least favorite stocks held by CWSVX. ESCO's NOPAT has fallen by 8% compounded annually since 2011. The company earns a ROIC of only 6%, which is well below the 10% achieved in the mid 2000's. While ESE is only up 3% year to date, the stock price is still overvalued. To justify its current price of ~\$38/share, ESCO must [grow NOPAT by 14% compounded annually for the next 17 years](#). This expectation is very optimistic considering the business has not grown profits at all the past four years. Investors would be better off looking at quality stocks, such as Microsoft, and avoiding ESE.

Figure 2 shows the distribution of our Predictive Ratings for all investment style 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 investment style funds. Note that the average total annual cost of Very Dangerous funds is more than three times that of Very Attractive funds.

**Figure 3: Predictive Rating Distribution Stats**

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	677	1366	2539	1161	536
% of ETFs & Funds	11%	22%	40%	18%	5%
% of TNA	14%	43%	31%	10%	2%
Avg TAC	0.91%	0.44%	1.51%	1.17%	2.75%

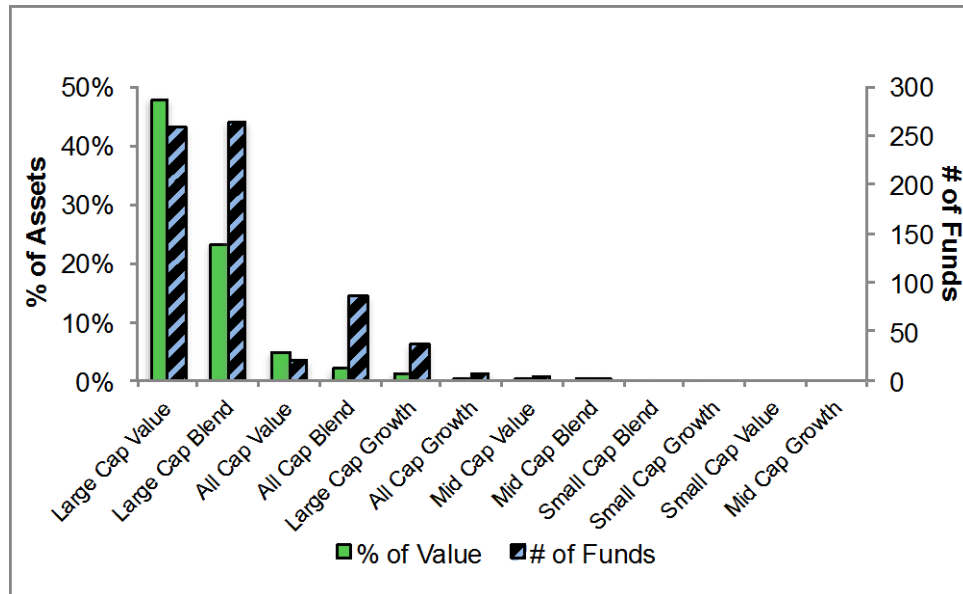
\* Avg TAC = Weighted Average Total Annual Costs

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 Investment Style**

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

**Figure 4: Very Attractive ETFs & Mutual Funds by Investment Style**

Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4

**Figure 5: Very Attractive ETFs & Mutual Funds by Investment Style**

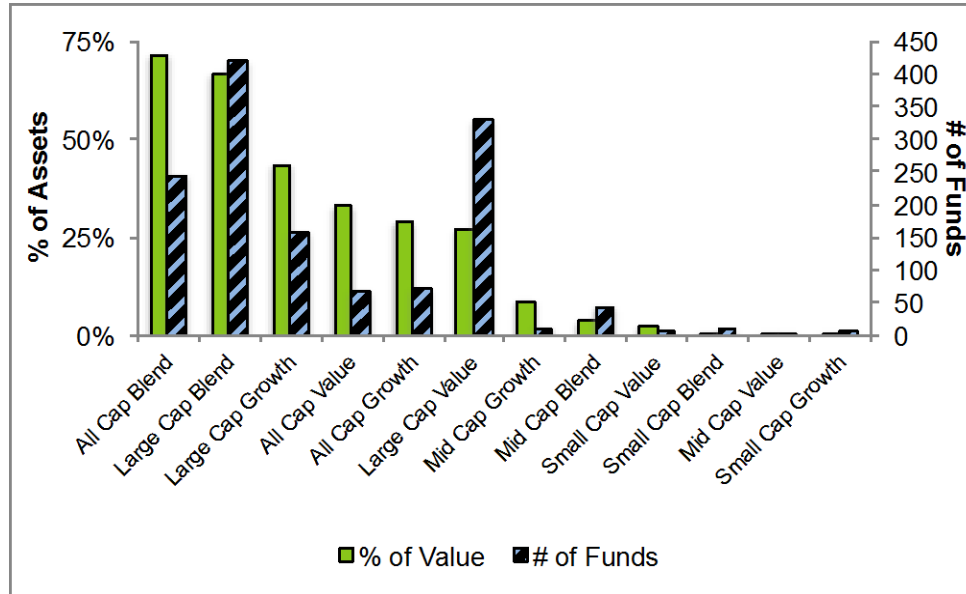
Style	% of Style Assets	# of Very Attractive Funds	% of Very Attractive Funds in Style
Large Cap Value	48%	258	29%
Large Cap Blend	23%	263	29%
All Cap Value	5%	21	8%
All Cap Blend	2%	86	12%
Large Cap Growth	1%	37	6%
All Cap Growth	1%	7	1%
Mid Cap Value	0%	4	3%
Mid Cap Blend	0%	1	0%
Mid Cap Growth	0%	0	0%
Small Cap Blend	0%	0	0%
Small Cap Growth	0%	0	0%
Small Cap Value	0%	0	0%

Source: New Constructs, LLC and company filings



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

**Figure 6: Attractive ETFs & Mutual Funds by Investment Style**



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

**Figure 7: Attractive ETFs & Mutual Funds by Investment Style**

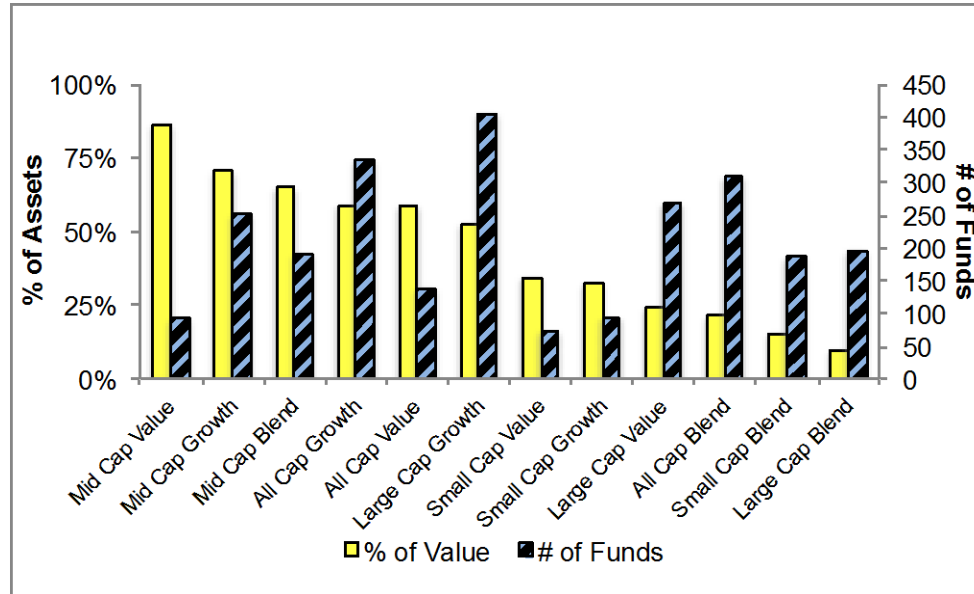
Style	% of Style Assets	# of Attractive Funds	% of Attractive Funds in Style
All Cap Blend	71%	245	33%
Large Cap Blend	67%	419	46%
Large Cap Growth	44%	157	24%
All Cap Value	33%	67	26%
All Cap Growth	29%	71	14%
Large Cap Value	27%	329	37%
Mid Cap Growth	9%	11	3%
Mid Cap Blend	4%	44	13%
Small Cap Value	2%	5	2%
Small Cap Blend	0%	9	1%
Mid Cap Value	0%	4	3%
Small Cap Growth	0%	5	1%

Source: New Constructs, LLC and company filings



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

**Figure 8: Neutral ETFs & Mutual Funds by Investment Style**



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

**Figure 9: Neutral ETFs & Mutual Funds by Investment Style**

Style	% of Style Assets	# of Neutral Funds	% of Neutral Funds in Style
Mid Cap Value	86%	92	59%
Mid Cap Growth	70%	252	64%
Mid Cap Blend	65%	191	54%
All Cap Growth	59%	334	68%
All Cap Value	59%	139	54%
Large Cap Growth	53%	405	63%
Small Cap Value	35%	73	26%
Small Cap Growth	33%	94	19%
Large Cap Value	24%	268	30%
All Cap Blend	21%	309	42%
Small Cap Blend	15%	186	27%
Large Cap Blend	10%	196	22%

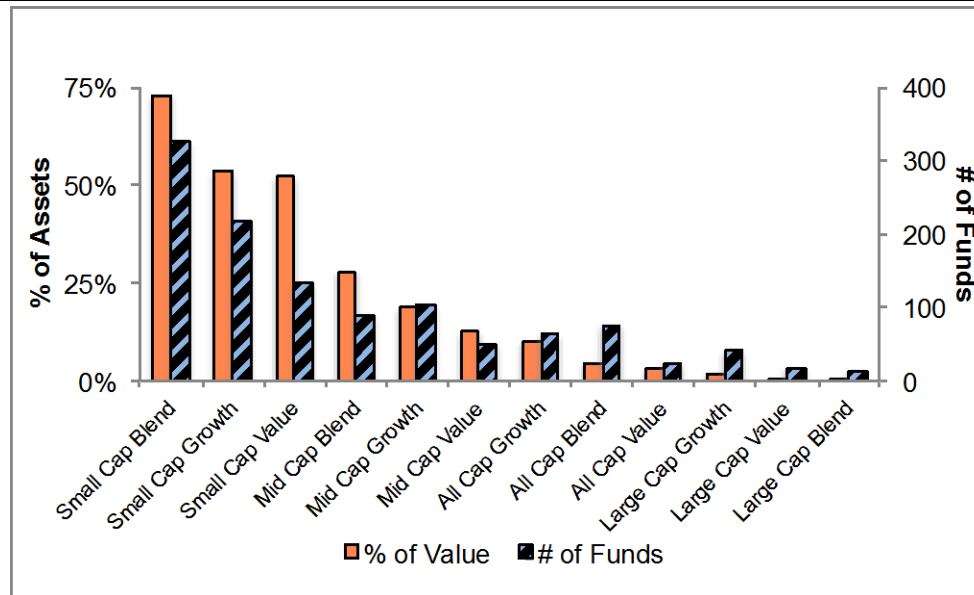
Source: New Constructs, LLC and company filings



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

The landscape of style ETFs and mutual funds is littered with Dangerous funds. Investors in Small Cap Blend have put over 73% of their assets in Dangerous-rated funds.

**Figure 10: Dangerous ETFs & Mutual Funds by Investment Style**



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

**Figure 11: Dangerous ETFs & Mutual Funds by Investment Style**

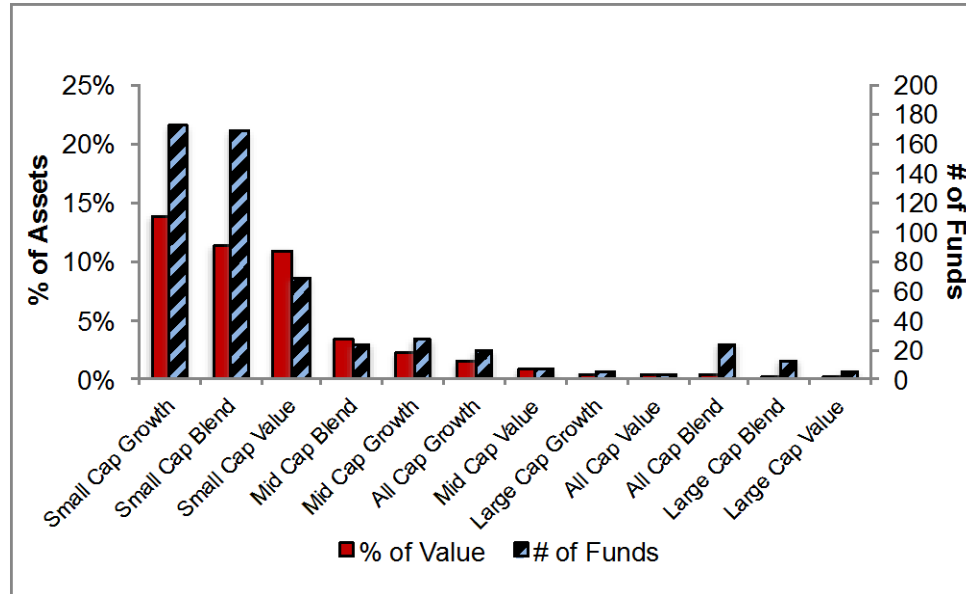
Style	% of Style Assets	# of Dangerous Funds	% of Dangerous Funds in Style
Small Cap Blend	73%	326	47%
Small Cap Growth	53%	218	45%
Small Cap Value	52%	133	48%
Mid Cap Blend	28%	91	26%
Mid Cap Growth	19%	103	26%
Mid Cap Value	12%	50	32%
All Cap Growth	10%	63	13%
All Cap Blend	5%	77	10%
All Cap Value	3%	26	10%
Large Cap Growth	2%	42	7%
Large Cap Value	1%	19	2%
Large Cap Blend	0%	13	1%

Source: New Constructs, LLC and company filings



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

**Figure 12: Very Dangerous ETFs & Mutual Funds by Investment Style**



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

**Figure 13: Very Dangerous ETFs & Mutual Funds by Investment Style**

Style	% of Style Assets	# of Very Dangerous Funds	% of Very Dangerous Funds in Style
Small Cap Growth	14%	172	35%
Small Cap Blend	11%	168	24%
Small Cap Value	11%	69	25%
Mid Cap Blend	3%	24	7%
Mid Cap Growth	2%	27	7%
All Cap Growth	2%	19	4%
Mid Cap Value	1%	6	4%
Large Cap Growth	0%	5	1%
All Cap Value	0%	4	2%
All Cap Blend	0%	24	3%
Large Cap Blend	0%	13	1%
Large Cap Value	0%	5	1%

Source: New Constructs, LLC and company filings

*Disclosure: David Trainer owns MSFT. 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%





## *New Constructs® – Profile*

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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 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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