Investment Style Ratings For ETFs, Mutual Funds & Stocks

At the beginning of the fourth 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. See last quarter's Style Ratings here.

Investors looking for style funds that hold quality stocks should look no further than the Large Cap Blend and Large Cap Value styles. Not only do these styles receive our Attractive rating, they also 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. 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 investment style are available 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 Growth	Dangerous
Mid Cap Blend	Dangerous
Mid Cap Value	Dangerous
All Cap Growth	Neutral
Large Cap Growth	Neutral
All Cap Value	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.

State Street SPDR Dow Jones Industrial Average ETF (DIA) is the top rated Large Cap Value fund. It gets our Very Attractive rating by allocating over 51% of its value to Attractive-or-better-rated stocks.

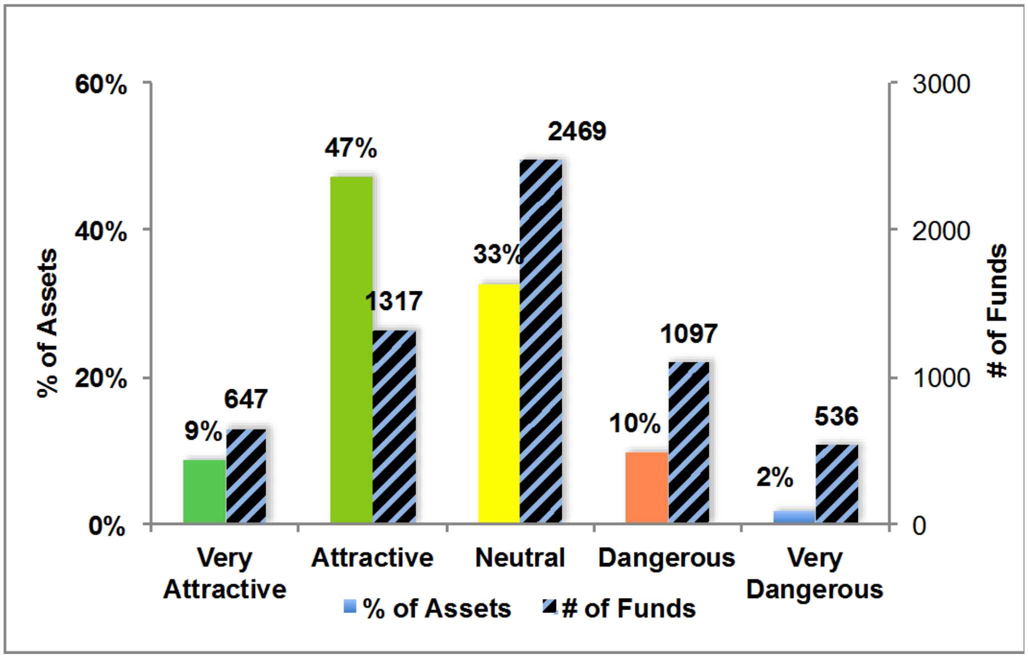
International Business Machines (IBM: $148/share) is one of our favorite stocks held by DIA and receives our Attractive rating. Over the last decade, IBM has grown after-tax profit (NOPAT) by 8% compounded annually while doubling NOPAT margins. In addition to strong NOPAT growth, IBM has improved its return on invested capital (ROIC) to 12%, from 9% in 2005. Despite the strength in its business, IBM shares remain undervalued. At its current price of $148/share, IBM has a price to economic book value ratio (PEBV) of 0.8. This ratio implies that the market expects IBM's NOPAT to permanently decline by 20%. Even if IBM can only grow NOPAT by 2% compounded annually for the next five years, the stock is worth $211/share today – a 43% upside.

ProFunds: Small-Cap ProFund (SLPSX) is the worst rated Small Cap Blend fund and overall worst-rated style mutual fund. It gets our Very Dangerous rating by allocating 20% of its value to Dangerous-or-worse-rated stocks and 60% held in cash. Making matters worse, it charges investors total annual costs of 5.50%. Why should investors pay such high fees when over half their assets are held in cash?

Denny's Corporation (DENN: $11/share) is one of our least favorite stocks held by Small Cap ETFs and mutual funds and earns our Dangerous rating. Over the last five years, the company's NOPAT has declined by 7% compounded annually. The company currently earns a 6% ROIC. Despite declining profits, DENN has soared over the past five years and shares are up nearly 250%. This price appreciation has left DENN significantly overvalued. To justify its current price of $11/share, Denny's must grow NOPAT by 10% compounded annually for the next 15 years. This expectation seems rather optimistic given Denny's failure to grow profits over the past five years.

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 almost four times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	647	1317	2469	1097	536
% of ETFs & Funds	11%	22%	41%	18%	9%
% of TNA	9%	47%	33%	10%	2%
Avg TAC	0.75%	0.55%	1.25%	1.50%	2.92%

* Avg TAC = Weighted Average Total Annual Costs

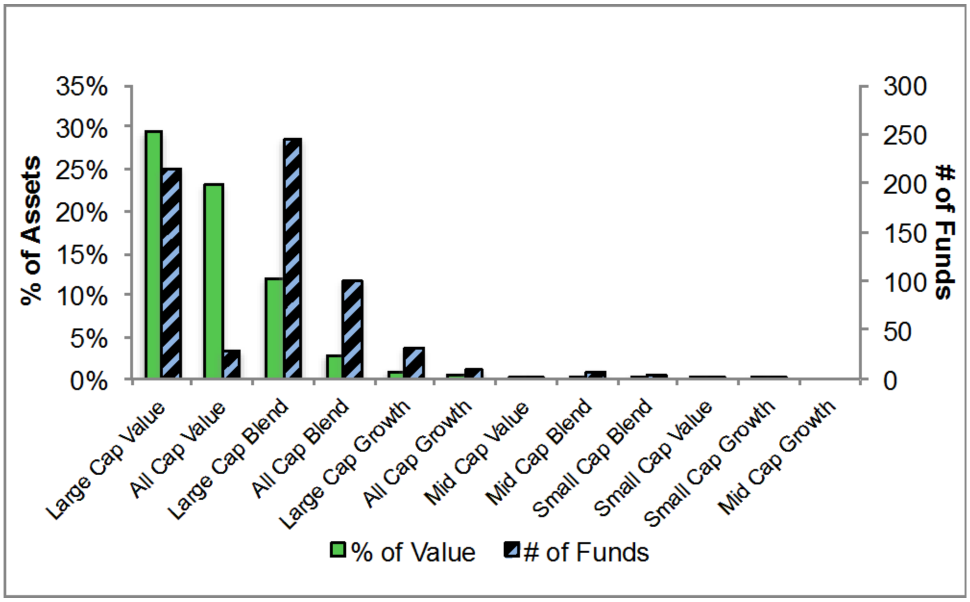
Source: New Constructs, LLC and company filings

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

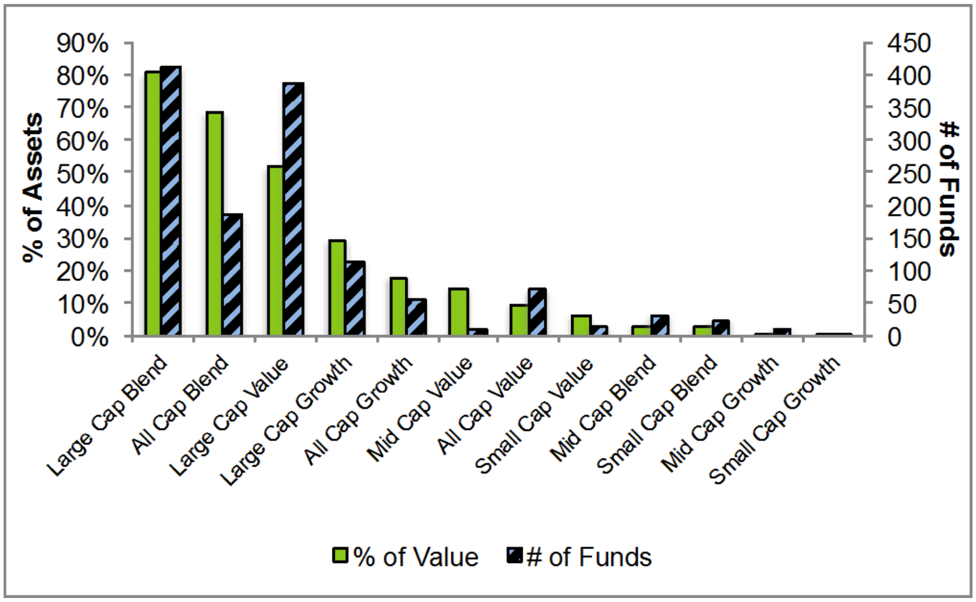
Figure 5: Very Attractive ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Very Attractive Funds	% of Very Attractive Funds in Style
Large Cap Value	29%	215	24%
All Cap Value	23%	29	12%
Large Cap Blend	12%	245	27%
All Cap Blend	3%	101	16%
Large Cap Growth	1%	32	5%
All Cap Growth	1%	9	2%
Mid Cap Value	0%	3	2%
Mid Cap Blend	0%	7	2%
Small Cap Blend	0%	4	1%
Small Cap Value	0%	1	0%
Small Cap Growth	0%	1	0%
Mid Cap Growth	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.

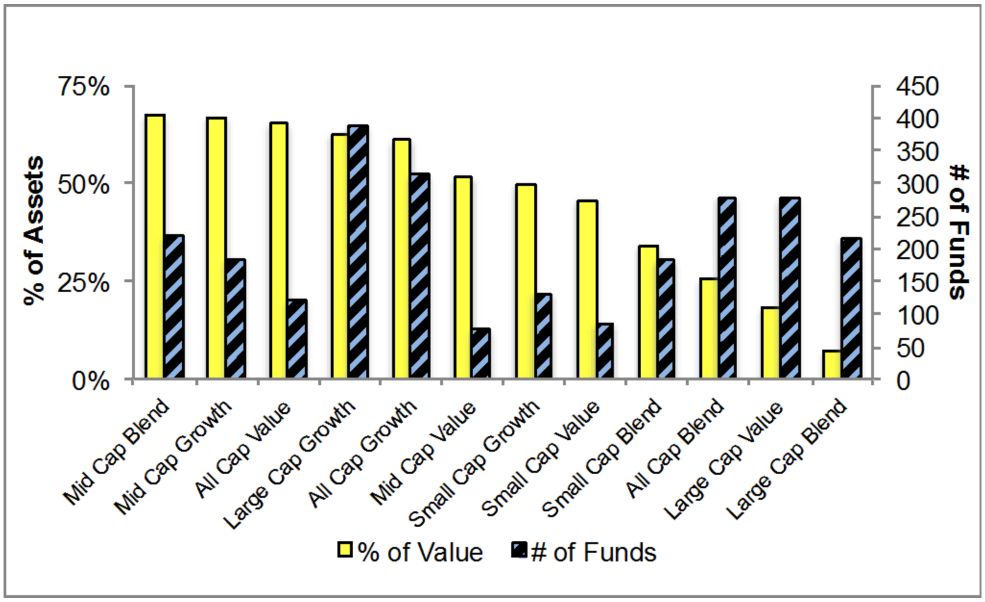
Figure 7: Attractive ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Attractive Funds	% of Attractive Funds in Style
Large Cap Blend	80%	411	46%
All Cap Blend	68%	185	29%
Large Cap Value	52%	385	43%
Large Cap Growth	29%	114	18%
All Cap Growth	18%	55	11%
Mid Cap Value	15%	11	8%
All Cap Value	10%	71	28%
Small Cap Value	6%	15	6%
Mid Cap Blend	3%	31	9%
Small Cap Blend	3%	24	4%
Mid Cap Growth	0%	11	3%
Small Cap Growth	0%	4	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

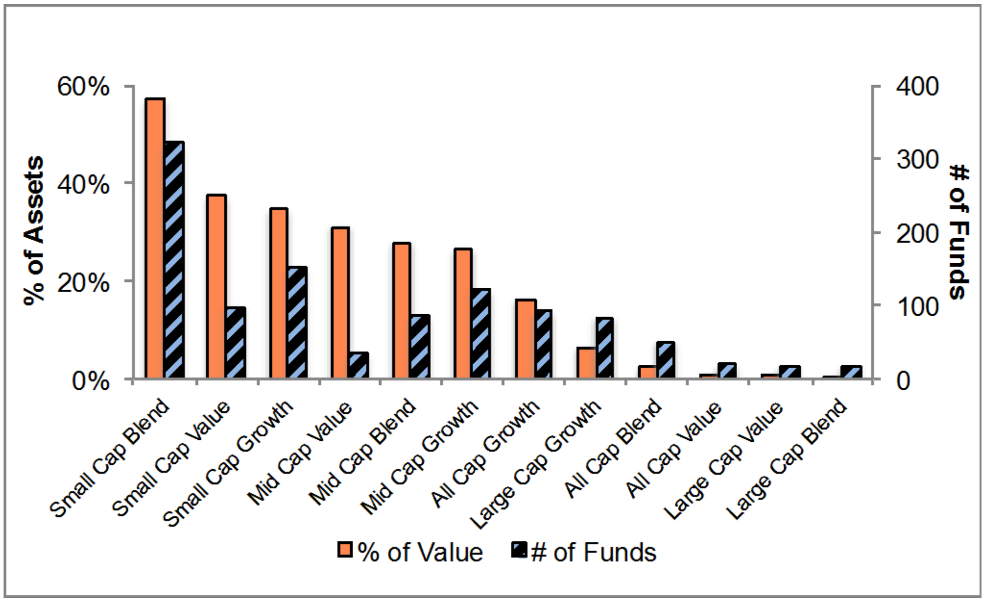
Style	% of Style Assets	# of Neutral Funds	% of Neutral Funds in Style
Mid Cap Blend	67%	218	60%
Mid Cap Growth	67%	184	52%
All Cap Value	65%	123	49%
Large Cap Growth	62%	388	62%
All Cap Growth	61%	313	62%
Mid Cap Value	52%	76	57%
Small Cap Growth	49%	131	29%
Small Cap Value	46%	85	31%
Small Cap Blend	34%	182	27%
All Cap Blend	26%	279	43%
Large Cap Value	18%	275	31%
Large Cap Blend	7%	215	24%

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 funds have put over 57% 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.

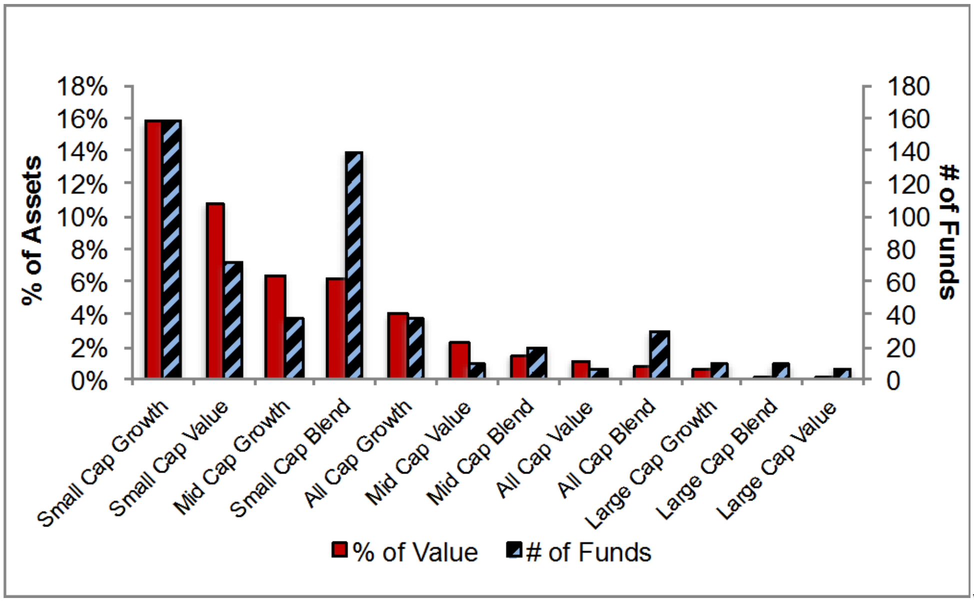
Figure 11: Dangerous ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Dangerous Funds	% of Dangerous Funds in Style
Small Cap Blend	57%	321	48%
Small Cap Value	37%	99	37%
Small Cap Growth	35%	152	34%
Mid Cap Value	31%	34	25%
Mid Cap Blend	28%	86	24%
Mid Cap Growth	27%	121	34%
All Cap Growth	16%	92	18%
Large Cap Growth	7%	84	13%
All Cap Blend	2%	51	8%
All Cap Value	1%	20	8%
Large Cap Value	1%	19	2%
Large Cap Blend	0%	18	2%

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	16%	158	35%
Small Cap Value	11%	71	26%
Mid Cap Growth	6%	38	11%
Small Cap Blend	6%	139	21%
All Cap Growth	4%	38	7%
Mid Cap Value	2%	10	7%
Mid Cap Blend	1%	20	6%
All Cap Value	1%	7	3%
All Cap Blend	1%	29	4%
Large Cap Growth	1%	10	2%
Large Cap Blend	0%	9	1%
Large Cap Value	0%	7	1%

Source: New Constructs, LLC and company filings

Disclosure: David Trainer and Thaxston McKee 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

How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensics accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

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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