Sector Ratings For ETFs & Mutual Funds

At the beginning of the first quarter of 2016, 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. See last quarter's Sector Ratings here.

Investors looking for sector funds that hold quality stocks should look no further than the Consumer Staples or Information Technology sectors. These sectors house the most Attractive-or-better rated funds with the most assets. 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
Utilities	Dangerous
Energy	Dangerous
Telecom	Dangerous
Financials	Dangerous
Health Care	Dangerous
Cons Disc	Neutral
Materials	Neutral
Info Tech	Neutral
Industrials	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.

State Street Select Sector SPDR Trust: Consumer Staples (XLP) is the top rated Consumer Staples fund. It gets our Very Attractive rating by allocating over 37% of its value to Attractive-or-better-rated stocks.

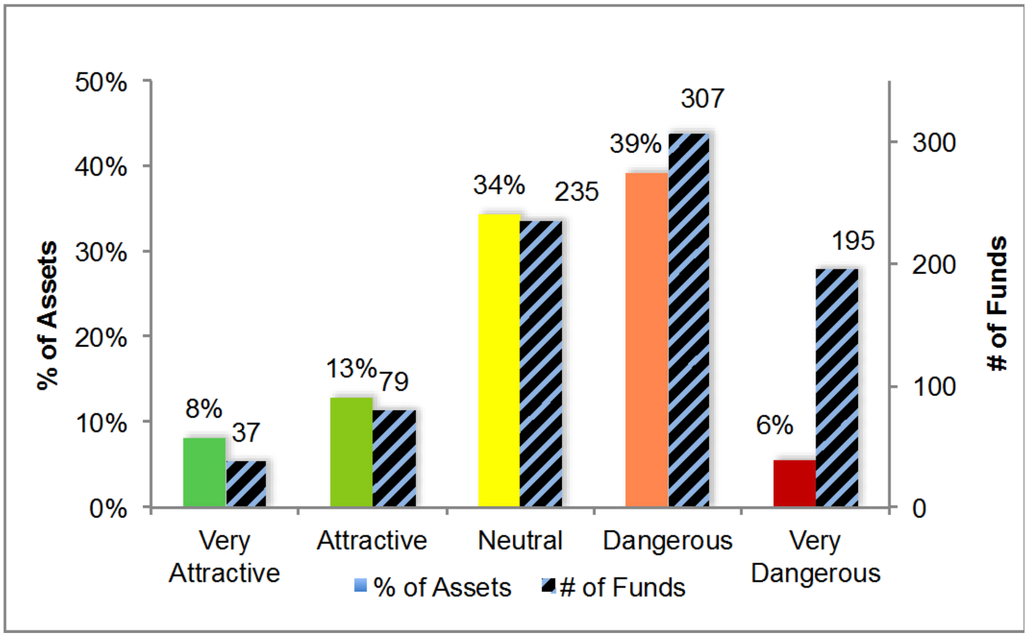
Proctor & Gamble (PG: $78/share) is one of our favorite stocks held by XLP and earns our Attractive rating. Over the past decade, Proctor & Gamble, one of the largest consumer goods companies in the world, has grown after-tax profit (NOPAT) by 6% compounded annually over the past decade. Since 2008, PG has maintained a double-digit return on invested capital (ROIC) and currently earns a 12% ROIC. In spite of declining revenues, Proctor & Gamble has generated a cumulative $64 billion in free cash flow over the past five years alone. Best of all, PG shares remain undervalued. At its current price of $78/share, PG has a price to economic book value (PEBV) ratio of 1.1. This ratio means the market expects Proctor & Gamble to grow NOPAT by only 10% over its remaining corporate life. However, if the company can grow NOPAT by just 3% compounded annually for the next decade, shares are worth $91/share today – a 17% upside.

ICON Utilities Fund (ICTVX) is the worst Utilities fund. It gets our Very Dangerous rating by allocating over 66% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors annual costs of 4.72%.

American Electric Power (AEP: $58/share) is one of our least favorite stocks held by ICTVX and earns our Dangerous rating. AEP's capital-intensive business has destroyed shareholder value for many years. In fact, American Electric Power's invested capital has expanded from $37 billion in 2004 to $61 billion on a trailing twelve-month basis while its economic earnings have been negative in every year of our model, which dates back to 1998. The company currently earns a bottom quintile ROIC of only 4%. Despite the poor economics of this business, AEP's valuation is already baking in significant profit growth. To justify its current price of $58/share, AEP must grow NOPAT by 8% compounded annually for the next 12 years. This expectation seems highly unlikely given AEP's long history of destroying shareholder value.

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 Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	37	79	235	307	195
% of ETFs & Funds	4%	9%	28%	36%	23%
% of TNA	8%	13%	34%	39%	6%
Avg TAC	0.31%	0.35%	0.71%	0.82%	2.91%

* Avg TAC = Weighted Average Total Annual Costs

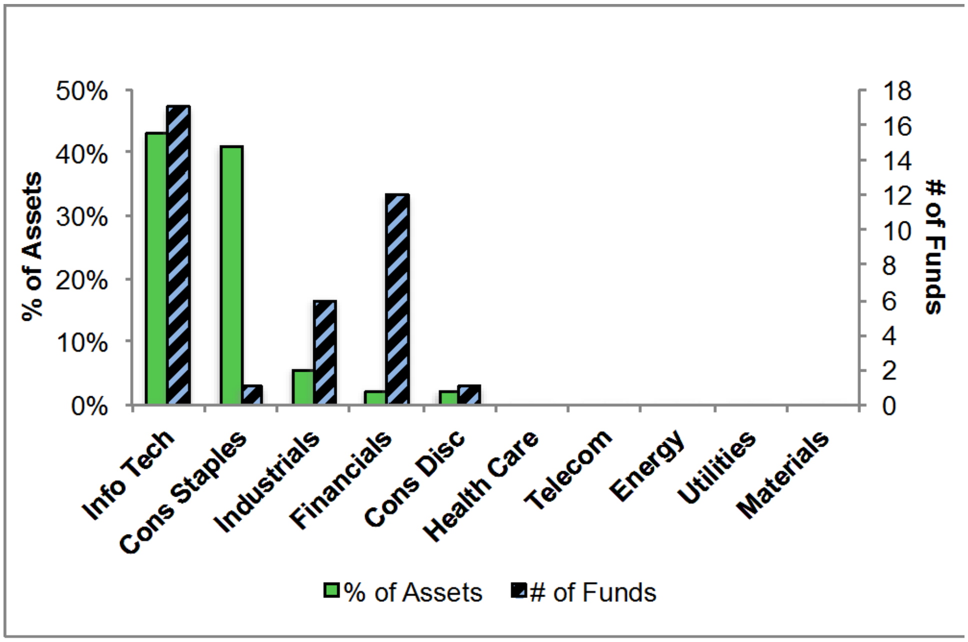
Source: New Constructs, LLC and company filings

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.

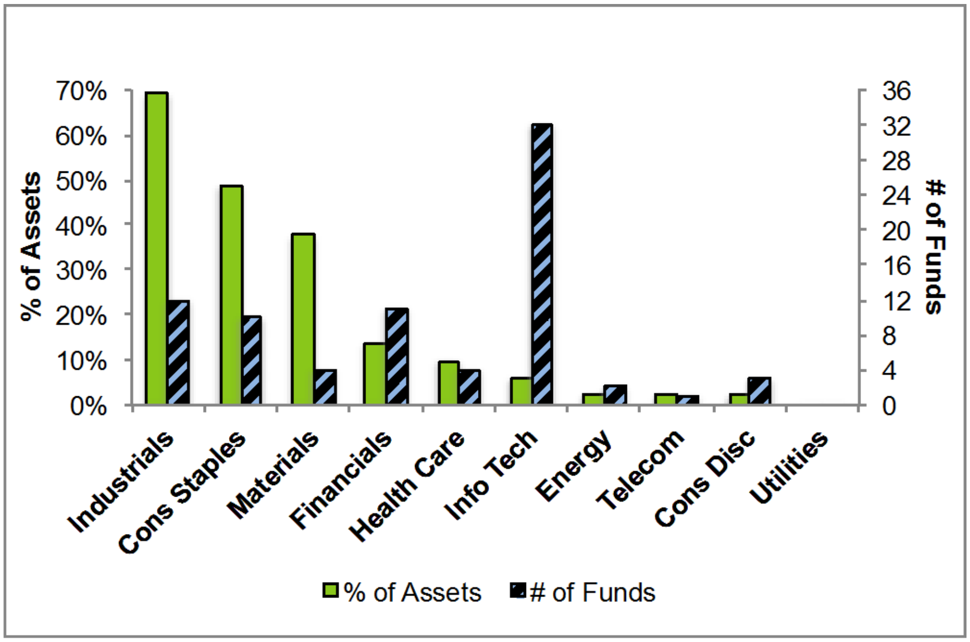
Figure 5: Very Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Info Tech	43%	17	12%
Cons Staples	41%	1	4%
Industrials	6%	6	14%
Financials	2%	12	4%
Cons Disc	2%	1	3%
Health Care	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.

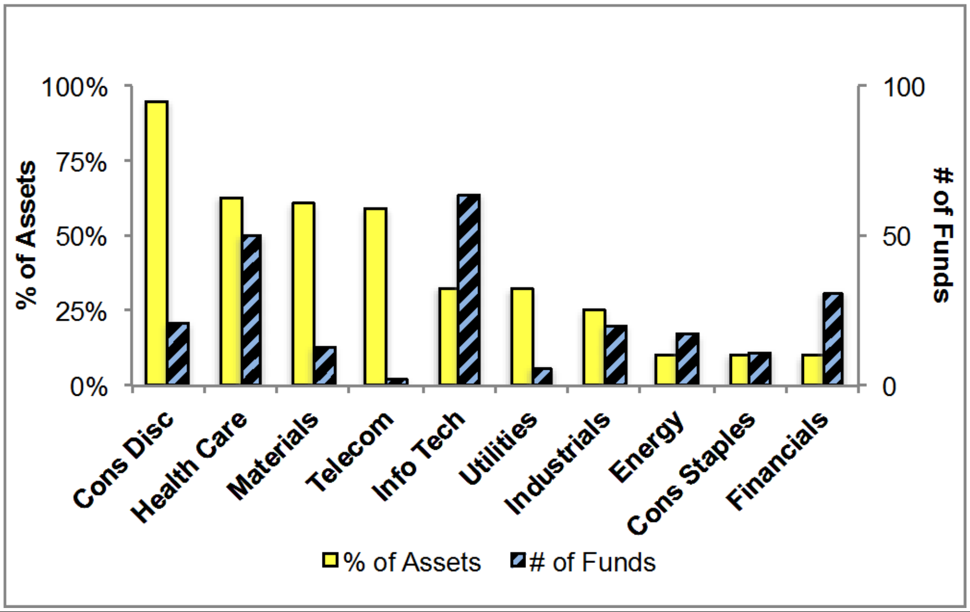
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Industrials	69%	12	28%
Cons Staples	49%	10	42%
Materials	38%	4	16%
Financials	14%	11	4%
Health Care	10%	4	4%
Info Tech	6%	32	23%
Energy	2%	2	1%
Telecom	2%	1	5%
Cons Disc	2%	3	9%
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

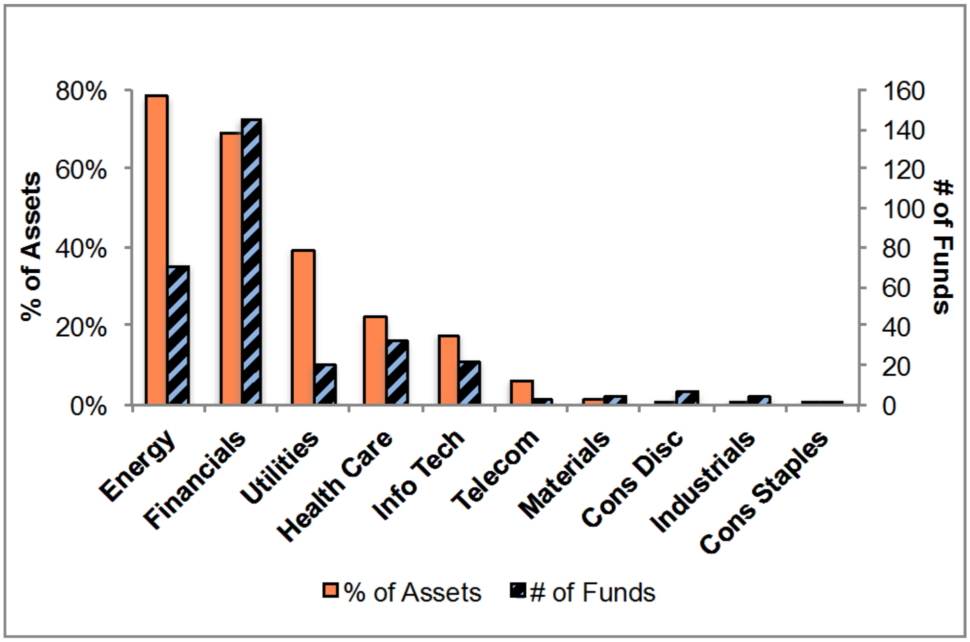
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Cons Disc	95%	21	66%
Health Care	63%	50	48%
Materials	61%	13	52%
Telecom	59%	2	11%
Info Tech	33%	64	45%
Utilities	32%	6	14%
Industrials	25%	20	47%
Energy	10%	17	13%
Cons Staples	10%	11	46%
Financials	10%	31	11%

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 the Energy sector have put over 78% 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.

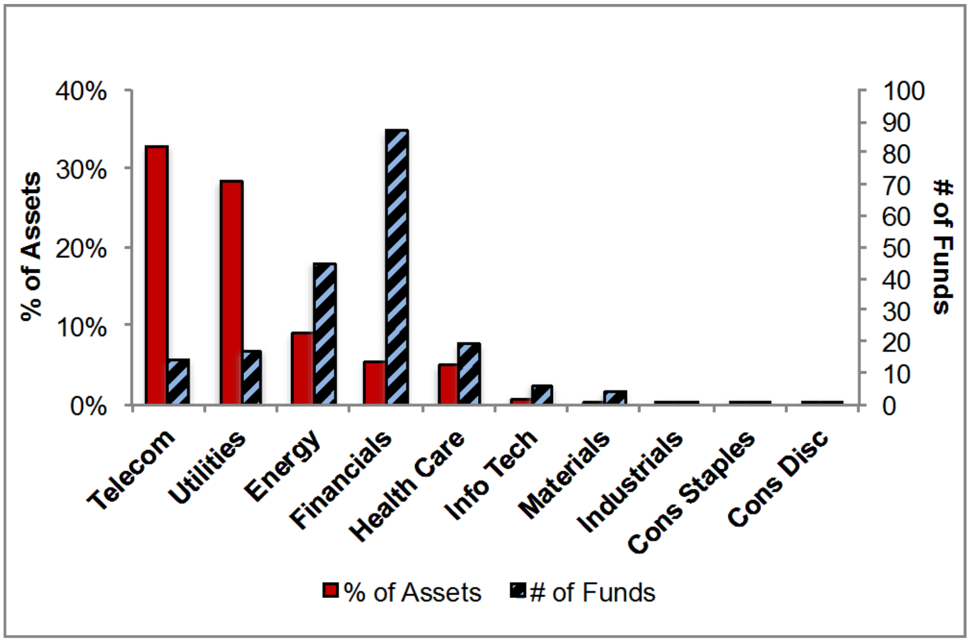
Figure 11: Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Energy	78%	71	53%
Financials	69%	145	51%
Utilities	39%	20	47%
Health Care	22%	32	30%
Info Tech	18%	22	16%
Telecom	6%	2	11%
Materials	1%	4	16%
Cons Disc	1%	6	19%
Industrials	0%	4	9%
Cons Staples	0%	1	4%

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
Telecom	33%	14	74%
Utilities	28%	17	40%
Energy	9%	45	33%
Financials	5%	87	30%
Health Care	5%	19	18%
Info Tech	1%	6	4%
Materials	0%	4	16%
Industrials	0%	1	2%
Cons Staples	0%	1	4%
Cons Disc	0%	1	3%

Source: New Constructs, LLC and company filings

Disclosure: David Trainer and Kyle Guske II 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 forensic 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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