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ETF RESEARCH

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How To Avoid the Worst Style ETFs

Question: Why are there so many ETFs?

Answer: ETF providers tend to make lots of money on each ETF so they create more products to sell.

The large number of ETFs has little to do with serving your best interests. Below are three red flags you can use to avoid the worst ETFs:

1. Inadequate Liquidity

This issue is the easiest issue to avoid, and our 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. Plus, low asset levels tend to mean lower volume in the ETF and larger 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 0.48%, which is the average total annual cost of the 298 U.S. equity Style ETFs we cover. The weighted average is slightly lower at 0.17%, which highlights how investors tend to put their money in ETFs with low fees.

Figure 1 shows that AdvisorShares Madrona Domestic ETF (FWDD) is the most expensive style ETF and Schwab U.S. Large Cap (SCHX) is the least expensive. Absolute Shares Trust (WBIB, WBID, WBIC, and WBIG) provides four of the most expensive ETFs while Schwab (SCHX and SCHB) and Vanguard (VOO and VTI) ETFs are among the cheapest.

Figure 1: 5 Least and Most Expensive Style ETFs

Ticker	Name	Style	Total Annual Cost
Most Expensive			
FWDD	AdvisorShares Madrona Domestic ETF	All Cap Blend	1.39%
WBIB	Absolute Shares WBI Tactical SMV Shares	Mid Cap Value	1.19%
WBID	Absolute Shares WBI Tactical SMS Shares	Mid Cap Growth	1.19%
WBIC	Absolute Shares WBI Tactical SMY Shares	Large Cap Value	1.16%
WBIG	Absolute Shares WBIT Tactical LCY Shares	Large Cap Value	1.14%
Least Expensive			
SCHX	Schwab U.S. Large Cap ETF	Large Cap Blend	0.03%
SCHB	Schwab U.S. Broad Market ETF	All Cap Blend	0.03%
ITOT	iShares Core S&P Total U.S. Stock Market ETF	Large Cap Blend	0.03%
VOO	Vanguard 500 Index Fund	Large Cap Blend	0.06%
VTI	Vanguard Total Stock Market Index Fund	All Cap Blend	0.06%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings. State Street SPDR S&P 500 Buyback ETF (SPYB) earns our Very Attractive rating and has low total annual costs of only 0.39%.

On the other hand, a fund such as iShares Core U.S. Growth ETF (IUSV) holds poor stocks. No matter how cheap an ETF (0.08% TAC), if it holds bad stocks, its performance will be bad. The quality of an ETFs holdings matters more than its price.

3. Poor Holdings

Avoiding poor holdings is by far the hardest part of avoid bad ETFs, but it is also the most important because an ETFs 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.

Figure 2: Style ETFs with the Worst Holdings

Ticker	Name	Style	Portfolio Management Rating
LTL	ProShares Ultra Telecommunications	All Cap Blend	Dangerous
QQXT	First Trust NASDAQ-100 Ex-Technology Sector	All Cap Growth	Dangerous
IUSV	iShares Core US Value ETF	All Cap Value	Neutral
EQAL	PowerShares Russell 1000 Equal Weight Portfolio	Large Cap Blend	Dangerous
MTUM	iShares MSCI USA Momentum Factor ETF	Large Cap Growth	Dangerous
DIV	Global X Super Dividend US ETF	Large Cap Value	Dangerous
VXF	Vanguard Extended Market Index Fund	Mid Cap Blend	Dangerous
VOT	Vanguard Mid-Cap Growth Index Fund	Mid Cap Growth	Dangerous
PXMV	PowerShares Russell Midcap Pure Value Portfolio	Mid Cap Value	Dangerous
EQWS	PowerShares Russell 2000 Equal Weight Portfolio	Small Cap Blend	Dangerous
VTWG	Vanguard Russell 2000 Growth Index Fund	Small Cap Growth	Dangerous
RZV	Guggenheim S&P SmallCap 600 Pure Value ETF	Small Cap Value	Dangerous

Sources: New Constructs, LLC and company filings

PowerShares (EQAL, PXMV, and EQWS) appears more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

ProShares Ultra Telecommunications (LTL) is the worst rated ETF in Figure 2. PowerShares Russell MidCap Pure Value (PXMV), PowerShares Russell 2000 Equal Weight (EQWS), Vanguard Russell 2000 Growth Index (VTWG), Global X Super Dividend U.S. (DIV), and Guggenheim S&P Small Cap 600 Pure Value (RZV) also earn a Dangerous predictive overall rating, which means not only do they hold poor stocks, they charge high total annual costs.

Our overall ratings on ETFs are based primarily on our stock ratings of their holdings.

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 ETFs HOLDINGs = PERFORMANCE OF ETF

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

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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