ETF & Mutual Fund Rankings: Energy Sector

The Energy sector ranks last out of the ten sectors as detailed in our 2Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Energy sector ranked ninth. It gets our Very Dangerous rating, which is based on aggregation of ratings of 22 ETFs and 100 mutual funds in the Energy sector as of April 15, 2016. See a recap of our 1Q16 Sector Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the sector. Not all Energy sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 144). This variation creates drastically different investment implications and, therefore, ratings.

Investors should not buy any Energy ETFs or mutual funds because none get an Attractive-or-better rating. If you must have exposure to this sector, you should buy a basket of Attractive-or-better rated stocks and avoid paying undeserved fund fees. Active management has a long history of not paying off.

Figure 1: ETFs with the Best & Worst Ratings – Top 5

	Allocation of ETF Holdings			
Ticker	Attractive-or-better Stocks	Neutral Stocks	Dangerous-or-worse Stocks	Predictive Rating
Best ETFs				
OIH	14%	55%	26%	Neutral
IEZ	13%	46%	32%	Neutral
PHO	0%	30%	45%	Neutral
XES	17%	27%	50%	Neutral
RYE	7%	15%	70%	Dangerous
Worst ETFs				
XLE	5%	14%	77%	Dangerous
IYE	5%	13%	80%	Dangerous
VDE	5%	14%	79%	Very Dangerous
FENY	4%	13%	79%	Very Dangerous
IEO	9%	6%	79%	Very Dangerous

* Best ETFs exclude ETFs with TNAs less than $100 million for inadequate liquidity.

Sources: New Constructs, LLC and company filings

Four ETFs are excluded from Figure 1 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums. See our ETF screener for more details.

Figure 2: Mutual Funds with the Best & Worst Ratings – Top 5

	Allocation of Mutual Fund Holdings			
Ticker	**Attractive-or-better Stocks**	**Neutral Stocks**	**Dangerous-or-worse Stocks**	**Predictive Rating**
Best Mutual Funds				
CRZZX	13%	16%	44%	Neutral
FSESX	15%	33%	33%	Neutral
INRSX	7%	30%	37%	Dangerous
IGNIX	7%	30%	37%	Dangerous
PGRYX	2%	34%	35%	Dangerous
Worst Mutual Funds				
GHAAX	7%	16%	56%	Very Dangerous
ICBAX	10%	26%	48%	Very Dangerous
RYENX	7%	13%	63%	Very Dangerous
BPEAX	10%	14%	49%	Very Dangerous
SBMBX	17%	20%	54%	Very Dangerous

* Best mutual funds exclude funds with TNAs less than $100 million for inadequate liquidity.

Sources: New Constructs, LLC and company filings

Rydex Series Energy Service Portfolio (RYVIX) is excluded from Figure 2 because its total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

Market Vectors Oil Services ETF (OIH) is the top-rated Energy ETF and MainStay Cushing Renaissance Advantage Fund (CRZZX) is the top-rated Energy mutual fund. Both earn a Neutral rating.

iShares US Oil & Gas Exploration & Production ETF (IEO) is the worst rated Energy ETF and Saratoga Advantage Energy and Basic Materials Portfolio (SBMBX) is the worst rated Energy mutual fund. Both earn a Very Dangerous rating.

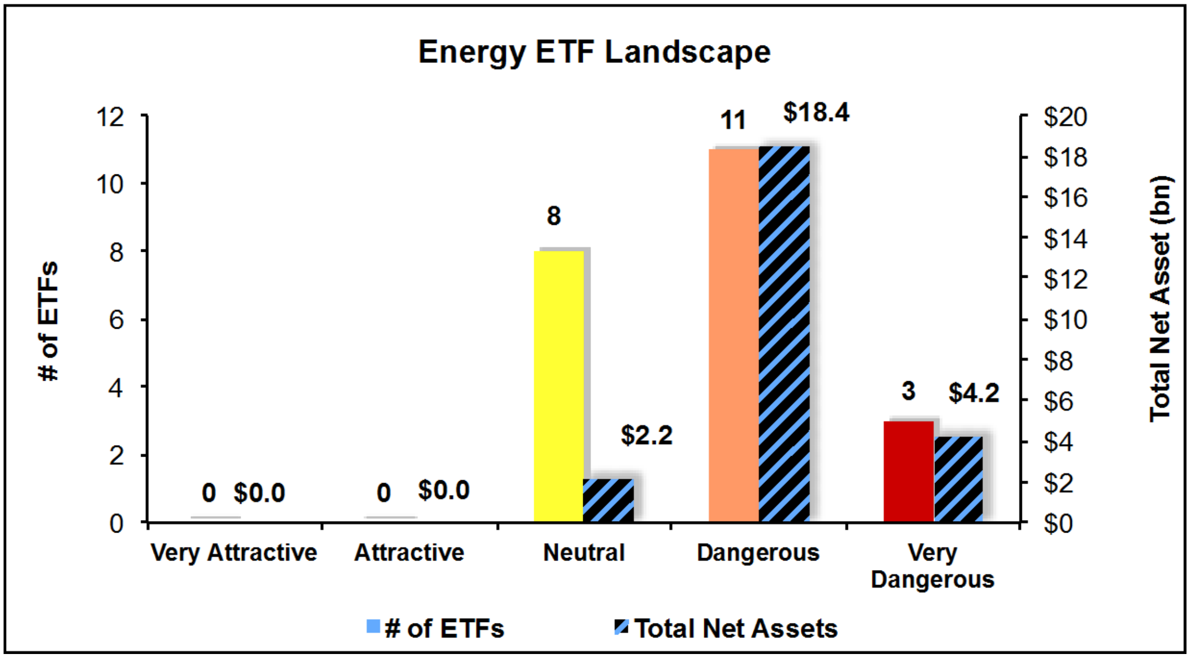
178 stocks of the 3000+ we cover are classified as Energy stocks.

LyondellBasell Industries (LYB: $88/share) is one of our favorite stocks held by CRZZX and earns a Very Attractive rating. Over the past five years, LYB has grown after-tax profit (NOPAT) by 10% compounded annually. Over the same time period, Lyondell's return on invested capital (ROIC) has improved from 17% to a top-quintile 22%. Additionally, over the past four years, LYB has generated a cumulative $14.8 billion in free cash flow. Despite the strength of the business, LYB is undervalued. At its current price of $88/share, LYB has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means that the market expects LYB's NOPAT to permanently decline by 20% from current levels. If LYB can grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $139/share today – a 58% upside.

Hess Corporation (HES: $57/share) is one of our least favorite stocks held by IEO and earns a Dangerous rating. Contrary to GAAP net income, which has fluctuated wildly over the past decade, Hess' NOPAT has only worsened by declining from $1.7 billion in 2005 to -$859 million in 2015. Over the same time period, Hess' ROIC has fallen from 11% to -2%. In a large disconnect from reality, HES has risen over 50% over the past three months, which has made shares more overvalued. In order to justify its current price of $57/share, Hess must immediately achieve positive pre-tax margins (from -22% in 2015) and grow revenue by 20% compounded annually for the next 20 years. In this scenario, 20 years from now Hess would be generating $254 billion in revenue, which would nearly equal oil giant Exxon's 2015 revenue. The expectations already embedded in HES are unrealistically high.

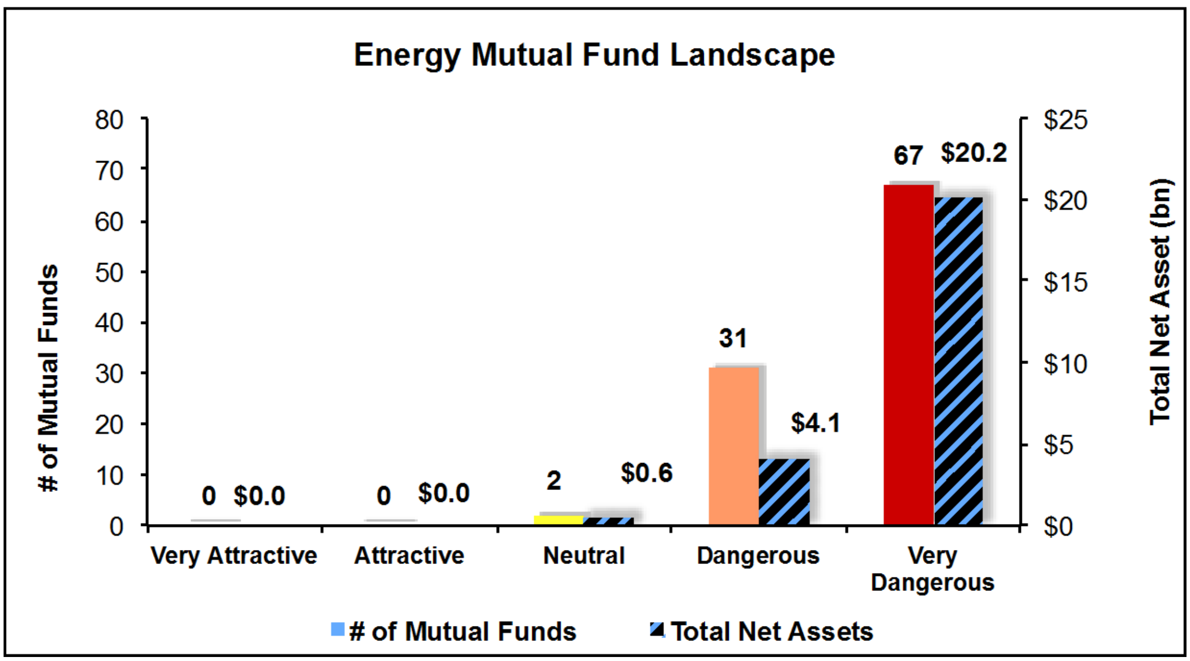
Figures 3 and 4 show the rating landscape of all Energy ETFs and mutual funds.

Figure 3: Separating the Best ETFs From the Worst ETFs



Sources: New Constructs, LLC and company filings

Figure 4: Separating the Best Mutual Funds From the Worst Mutual Funds



Sources: 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.

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.

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