ETF & Mutual Fund Rankings: Telecom Services Sector

The Telecom Services sector ranks eighth out of the ten sectors as detailed in our 2Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Telecom Services sector ranked eighth as well. It gets our Dangerous rating, which is based on aggregation of ratings of six ETFs and 15 mutual funds in the Telecom Services sector as of April 20, 2016. See a recap of our 1Q16 Sector Ratings here.

Figure 1 ranks from best to worst the five Telecom Services ETFs that meet our liquidity standards and Figure 2 shows the five best and worst rated Telecom Services mutual funds. Not all Telecom Services sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 24 to 59). This variation creates drastically different investment implications and, therefore, ratings.

Investors should not buy any Telecom Services 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 ETF				
XTL	23%	12%	56%	**Neutral**
Worst ETFs (Only 4)				
VOX	28%	2%	65%	**Dangerous**
FCOM	27%	1%	61%	**Dangerous**
IYZ	16%	3%	73%	**Dangerous**
IXP	17%	1%	61%	**Dangerous**

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

Sources: New Constructs, LLC and company filings

iShares North American Tech-Multimedia Networking ETF is excluded from Figure 1 because its total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

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				
FWRLX	30%	6%	36%	Neutral
TTMIX	6%	23%	45%	Neutral
PRMTX	6%	23%	45%	Neutral
VTCAX	28%	2%	65%	Dangerous
FSTCX	16%	2%	73%	Very Dangerous
Worst Mutual Funds				
FTUCX	16%	2%	73%	Very Dangerous
RYTLX	33%	8%	46%	Very Dangerous
FTUTX	16%	2%	73%	Very Dangerous
FTUBX	16%	2%	73%	Very Dangerous
FTUAX	16%	2%	73%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Five funds are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums. See our mutual fund screener for more details.

State Street SPDR S&P Telecom ETF (XTL) is the top-rated Telecom Services ETF and Fidelity Select Wireless Portfolio (FWRLX) is the top-rated Telecom Services mutual fund. Both earn a Neutral rating.

iShares Global Telecom ETF (IXP) is the worst rated Telecom Services ETF and Fidelity Advisor Telecommunications Fund (FTUAX) is the worst rated Telecom Services mutual fund. IXP earns a Dangerous rating and FTUAX earns a Very Dangerous rating.

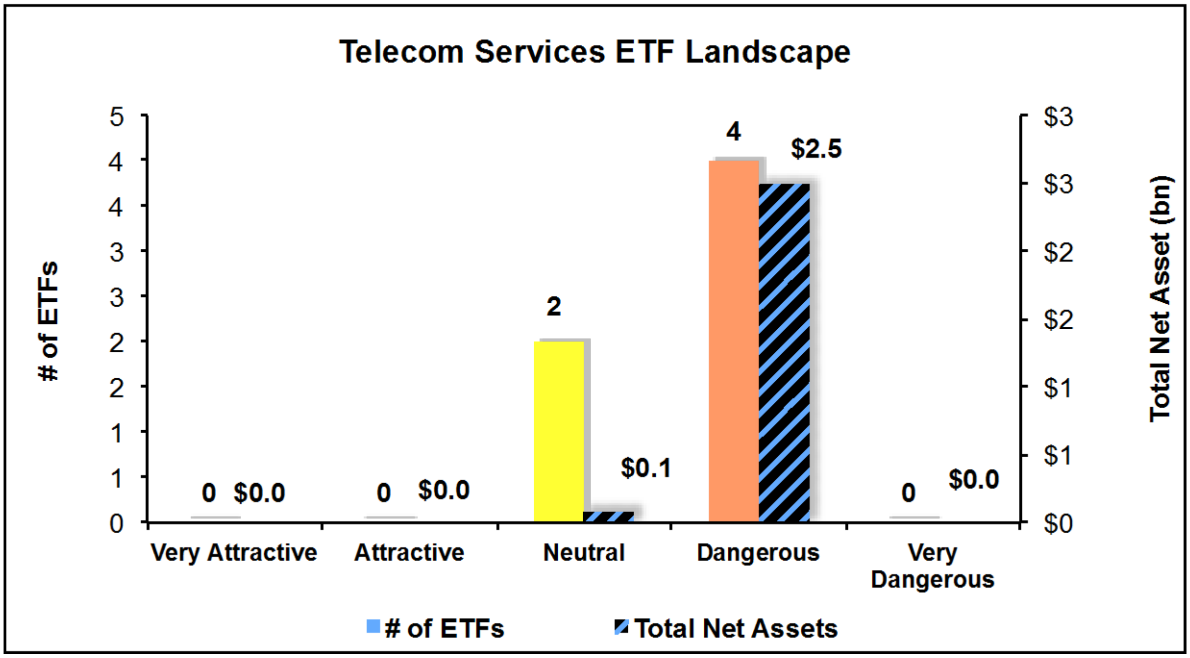
45 stocks of the 3000+ we cover are classified as Telecom Services stocks, but due to style drift, Telecom Services ETFs and mutual funds hold 59 stocks.

Atlantic Tele-Network (ATNI: $73/share) is one of our favorite stocks held by Telecom Services ETFs and mutual funds and earns an Attractive rating. Over the past five years, Atlantic Tele-Network has grown after-tax profit (NOPAT) by 13% compounded annually. The company has improved its return on invested capital (ROIC) from 5% in 2010 to 10% in 2015 while NOPAT margins have increased from 5% to 17% over the same time period. This impressive fundamental growth could help explain why ATNI is up over 90% over the past five years. However, shares remain undervalued. At its current price of $73/share, ATNI has a price-to-economic book value (PEBV) ratio of 1.1. This ratio means that the market expects ATNI's to grow its NOPAT by only 10% over its remaining life. If Atlantic Tele-Network can grow NOPAT by just 10% compounded annually for the next five years, the stock is worth $98/share today – a 36% upside.

CenturyLink (CTL: $33/share) is one of our least favorite stocks held by FTUAX and earns a Dangerous rating. CenturyLink was placed in the Danger Zone in February 2015. CTL at one point was down over 40% since the Danger Zone was published, but has since rebounded and has become significantly overvalued again. Over the past decade, CenturyLink's economic earnings have declined from -$152 million to -$1.2 billion. In fact, the company has never generated positive economic earnings in any year of our model, which dates back to 1998. The company's ROIC peaked in 2009 at 7% and has since fallen to a bottom-quintile 4%. Despite the deterioration of CenturyLink's business, the stock is priced for impressive profit growth. To justify its current price of $33/share, CTL must grow NOPAT by 8% compounded annually for the next 11 years. Given the decline in CTL's operations, this expectation seems overly optimistic.

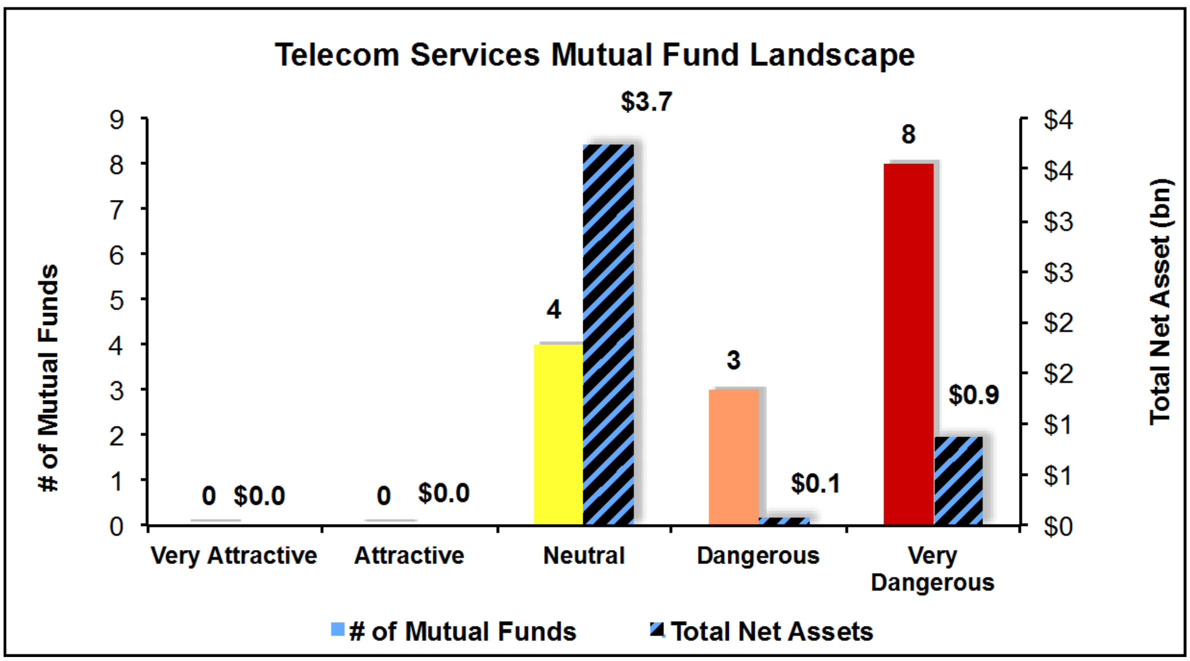
Figures 3 and 4 show the rating landscape of all Telecom Services ETFs and mutual funds.

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.

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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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