# ETF & Mutual Fund Rankings: Consumer Discretionary Sector

The Consumer Discretionary sector ranks second out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Consumer Discretionary sector ranked fifth. It gets our Neutral rating, which is based on aggregation of ratings of 13 ETFs and 19 mutual funds in the Consumer Discretionary sector as of July 11, 2016. See a recap of our 2Q16 Sector Ratings here.

Figure 1 ranks all eight ETFs that meet our liquidity standards and Figure 2 shows the five best and worst rated Consumer Discretionary mutual funds. Not all Consumer Discretionary sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 393). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Consumer Discretionary sector should buy one of the Attractive-or-better rated ETFs or mutual funds from Figures 1 and 2.

**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 (only 4)** | | | | |
| PEJ | 35% | 34% | 28% | Very Attractive |
| FXD | 25% | 45% | 22% | Attractive |
| VCR | 22% | 51% | 22% | Attractive |
| XLY | 22% | 57% | 18% | Attractive |
| **Worst ETFs** | | | | |
| FDIS | 21% | 51% | 24% | Neutral |
| XRT | 27% | 41% | 28% | Neutral |
| RTH | 27% | 44% | 25% | Neutral |
| IYC | 23% | 50% | 25% | Neutral |

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

Sources: New Constructs, LLC and company filings

Five 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** | | | | |
| FDLSX | 12% | 59% | 20% | Attractive |
| VCDAX | 22% | 51% | 21% | Attractive |
| FSCPX | 18% | 42% | 24% | Attractive |
| FSRPX | 23% | 41% | 30% | Neutral |
| FBMPX | 9% | 54% | 16% | Neutral |
| **Worst Mutual Funds** | | | | |
| FCNAX | 17% | 43% | 23% | Neutral |
| ICCAX | 27% | 53% | 5% | Neutral |
| RYRCX | 29% | 38% | 28% | Dangerous |
| RYLSX | 19% | 49% | 21% | Dangerous |
| RYRTX | 29% | 38% | 26% | Very Dangerous |

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

Sources: New Constructs, LLC and company filings

ICON Consumer Discretionary Fund (ICCCX) and Rydex Leisure Fund (RYLIX, RYLAX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

PowerShares Dynamic Leisure & Entertainment Portfolio (PEJ) is the top-rated Consumer Discretionary ETF and Fidelity Select Leisure Portfolio (FDLSX) is the top-rated Consumer Discretionary mutual fund. PEJ earns a Very Attractive rating and FDLSX earns an Attractive rating.

iShares US Consumer Services ETF (IYC) is the worst rated Consumer Discretionary ETF and Rydex Series Retailing Fund (RYRTX) is the worst rated Consumer Discretionary mutual fund. IYC earns a Neutral rating and RYRTX earns a Very Dangerous rating.

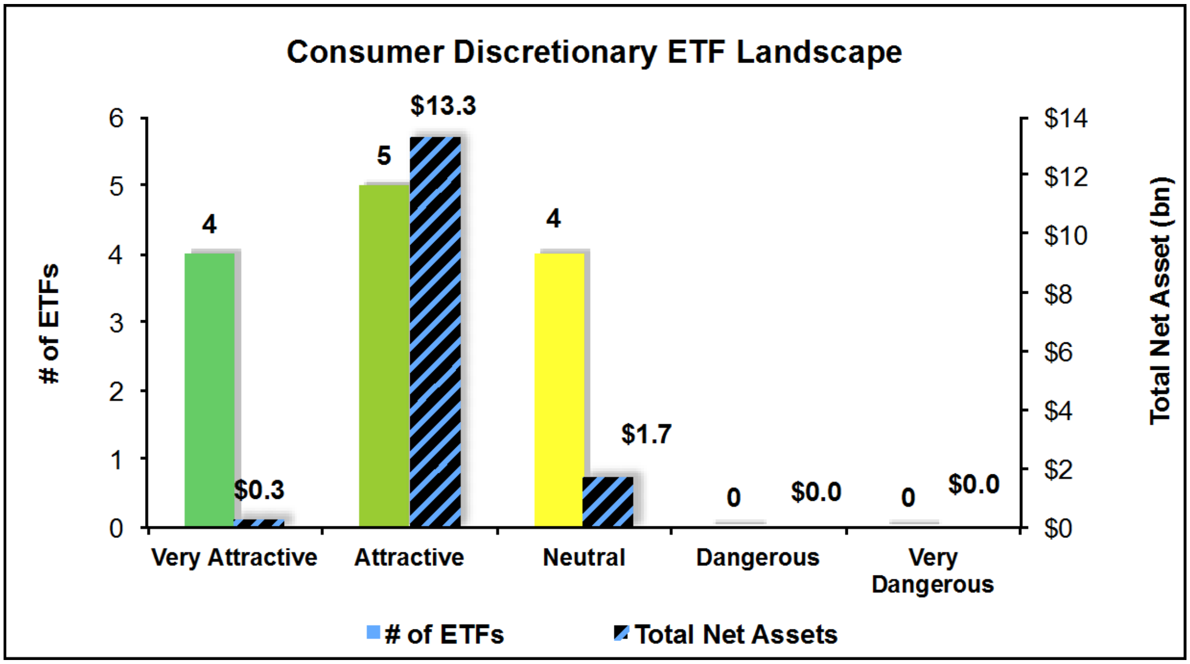
443 stocks of the 3000+ we cover are classified as Consumer Discretionary stocks.

NVR Inc. (NVR: $1,770/share) is one of our favorite stocks held by FXD and earns a Very Attractive rating. NVR is also on June's Linking Executive Comp to ROIC Model Portfolio. Over the past five years, NVR has grown after-tax profit (NOPAT) by an impressive 30% compounded annually. Over this same time, NVR has improved return on invested capital (ROIC) from 12% in 2011 to a top-quintile 20% over the trailing twelve months (TTM). Most impressive is that NVR has earned positive economic earnings in every year of our model, which dates back to 1998. Despite the strong fundamentals, the stock remains undervalued. At its current price of $1,770/share, NVR has a price to economic book value (PEBV) ratio of 1.1. This ratio means the market expects NVR's profits to grow only 10% from current levels over the remaining life of the business. If NVR can grow NOPAT by 7% compounded annually for the next decade, the stock is worth $2,600/share today – a 47% upside.

Sears Holdings Corp (SHLD: $13/share) is one of our least favorite stocks held by Consumer Discretionary ETFs and mutual funds and earns a Very Dangerous rating. Sears Holdings was in the Danger Zone in April 2013 and the stock remains overvalued. Sears' NOPAT has declined from $1.4 billion in 2006 to -$911 million in 2016. Over the trailing twelve months, NOPAT has declined even further to -$1.3 billion. Similarly, Sears' ROIC has declined from 9% in 2006 to a bottom quintile -9% TTM. Despite the issues at SHLD being widely known, and the stock falling drastically, the stock remains overvalued. To justify its current price of $13/share, SHLD must immediately achieve pre-tax margins of 5% (highest level ever achieved in our model, compared to -6% TTM) and grow revenue by 11% compounded annually for the next 13 years. For reference, Sears last achieved positive revenue growth in 2007 and consensus estimates expect revenue declines for the next two years. We think it is safe to say the expectations for future profits baked into the current stock price appear too high.

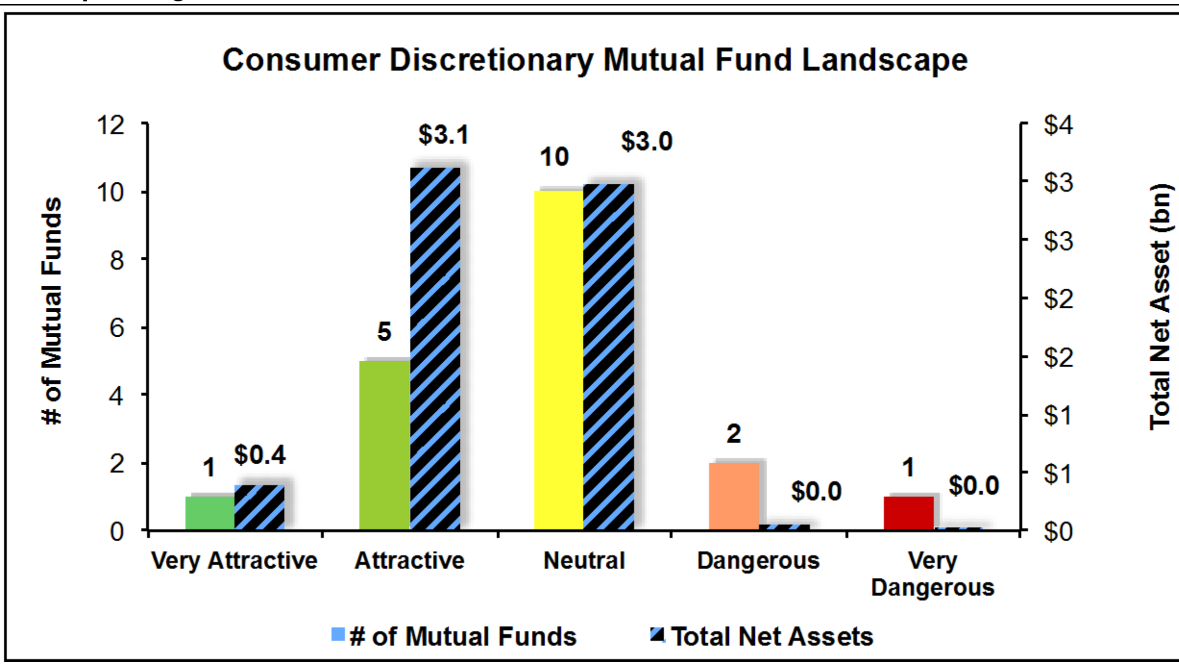
Figures 3 and 4 show the rating landscape of all Consumer Discretionary ETFs and mutual funds.

**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

*This article originally published [here](#) on July 12, 2016.*

*Disclosure: David Trainer and Kyle Martone 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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