ETF & Mutual Fund Rankings: Financials Sector

The Financials sector ranks seventh out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Financials sector ranked sixth. It gets our Neutral rating, which is based on an aggregation of ratings of 38 ETFs and 235 mutual funds in the Financials sector as of July 12, 2016. See a recap of our 2Q16 Sector Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the sector. Not all Financials sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 22 to 565). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Financials 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				
IYG	45%	41%	15%	Very Attractive
KBWB	23%	58%	16%	Very Attractive
KBWR	26%	60%	8%	Very Attractive
KIE	29%	47%	20%	Very Attractive
XLF	30%	29%	29%	Very Attractive
Worst ETFs				
SRET	20%	22%	35%	Neutral
FREL	9%	16%	60%	Neutral
IYR	9%	17%	63%	Neutral
PSR	7%	12%	63%	Dangerous
KBWD	28%	18%	30%	Dangerous

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

Sources: New Constructs, LLC and company filings

State Street SPDR S&P Capital Markets (KCE), PowerShares KBW Property & Casualty Insurance (KBWP), and Oppenheimer Financials Sector Revenue (RWW) are excluded from Figure 1 because their 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				
DVFYX	42%	26%	21%	Very Attractive
FSRBX	32%	51%	8%	Very Attractive
DFFCX	42%	26%	21%	Very Attractive
RPFGX	42%	26%	21%	Very Attractive
FSLBX	18%	47%	27%	Very Attractive
Worst Mutual Funds				
KREAX	8%	18%	49%	Very Dangerous
DAREX	12%	13%	54%	Very Dangerous
RYHRX	10%	17%	58%	Very Dangerous
RYCRX	10%	17%	58%	Very Dangerous
RYREX	10%	17%	58%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

iShares US Financial Services ETF (IYG) is the top rated Financials ETF and Davis Financial Fund (DVFYX) is the top rated Financials mutual fund. Both earn a Very Attractive rating.

PowerShares KBW High Dividend Yield Financial Portfolio (KBWD) is the worst rated Financials ETF and Rydex Series Real Estate Fund (RYREX) is the worst rated Financials mutual fund. KBWD earns a Dangerous rating and RYREX earns a Very Dangerous rating.

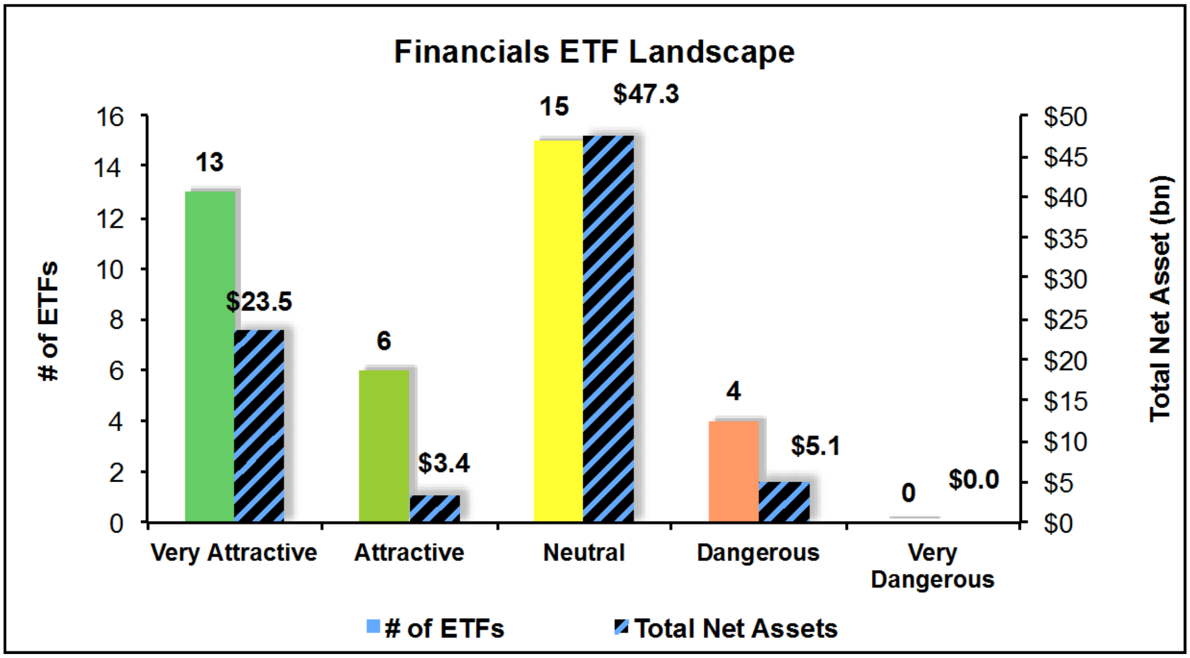
587 stocks of the 3000+ we cover are classified as Financials stocks.

Franklin Resources Inc. (BEN: $32/share) is one of our favorite stocks held by Financial ETFs and mutual funds and earns a Very Attractive rating. Since 2009 BEN has grown after-tax profit (NOPAT) by 16% compounded annually. Franklin Resources has improved its return on invested capital (ROIC) from 15% in 2009 to a top-quintile 26% over the last twelve months. Despite the fundamental strength, BEN is undervalued. At its current price of $32/share, BEN has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means that the market expects BEN's NOPAT to permanently decline by 30%. IF BEN can grow NOPAT by 1% compounded annually for the next decade, the stock is worth $49/share today – a 53% return.

American Campus Communities (ACC: $52/share) is one of our least favorite stocks held by DAREX and earns a Very Dangerous rating. Over the past decade, ACC's economic earnings, its true cash flows, have declined from -$13 million to -$126 million. The company's ROIC has fallen from 5% in 2005 to a bottom-quintile 2% over the last twelve months. Despite the clear destruction of shareholder value, ACC remains priced for significant profit growth. In order to justify its current price of $52/share, ACC must stop destroying shareholder value and grow NOPAT by 11% compounded annually for the next 13 years. This expectation seems rather optimistic given ACC's shareholder destruction over the past decade.

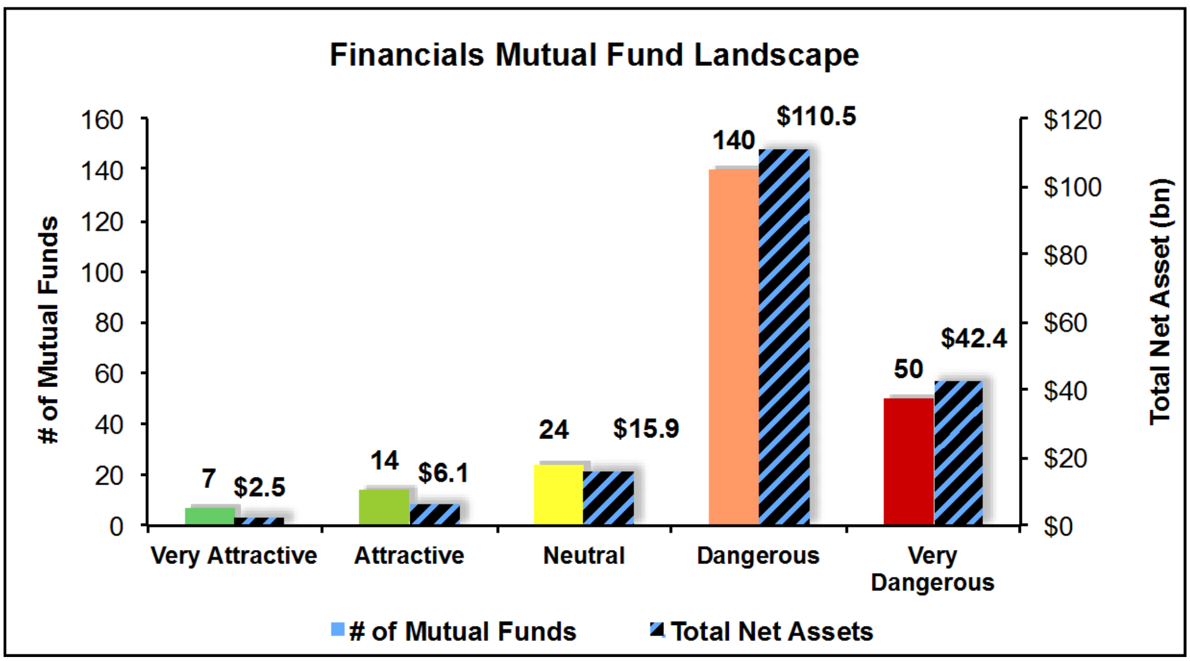
Figures 3 and 4 show the rating landscape of all Financials ETFs and mutual funds.

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

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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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