ETF & Mutual Fund Rankings: Health Care Sector

The Health Care sector ranks sixth out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Health Care sector ranked seventh. It gets our Neutral rating, which is based on aggregation of ratings of 22 ETFs and 88 mutual funds in the Health Care 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 Health Care sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 23 to 357). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Health Care 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				
IXJ	18%	30%	36%	Attractive
XLV	16%	33%	49%	Attractive
BBH	32%	8%	51%	Attractive
FHLC	14%	32%	50%	Neutral
VHT	14%	23%	51%	Neutral
Worst ETFs				
PBE	24%	12%	58%	Dangerous
PSCH	10%	14%	66%	Dangerous
XHE	4%	23%	59%	Dangerous
FBT	16%	7%	67%	Dangerous
BBP	14%	2%	72%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

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				
PHSYX	17%	21%	42%	**Attractive**
PHSRX	17%	21%	42%	**Attractive**
PCHSX	17%	21%	42%	**Attractive**
PHSBX	17%	21%	42%	**Attractive**
DLHIX	19%	16%	42%	**Neutral**
Worst Mutual Funds				
RYHEX	13%	28%	53%	**Very Dangerous**
ICHAX	16%	27%	39%	**Very Dangerous**
HGHBX	4%	14%	65%	**Very Dangerous**
PHLAX	7%	17%	56%	**Very Dangerous**
HGHAX	4%	14%	65%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

Live Oak Health Sciences Fund (LOGSX) and Saratoga Health & Biotechnology Portfolio (SBHIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

iShares Global Healthcare ETF (IXJ) is the top-rated Health Care ETF and Putnam Global Health Care Fund (PHSYX) is the top-rated Health Care mutual fund. Both earn an Attractive rating.

BioShares Biotechnology Products Fund (BBP) is the worst rated Health Care ETF and Hartford Healthcare Fund (HGHAX) is the worst rated Health Care mutual fund. Both earn a Very Dangerous rating.

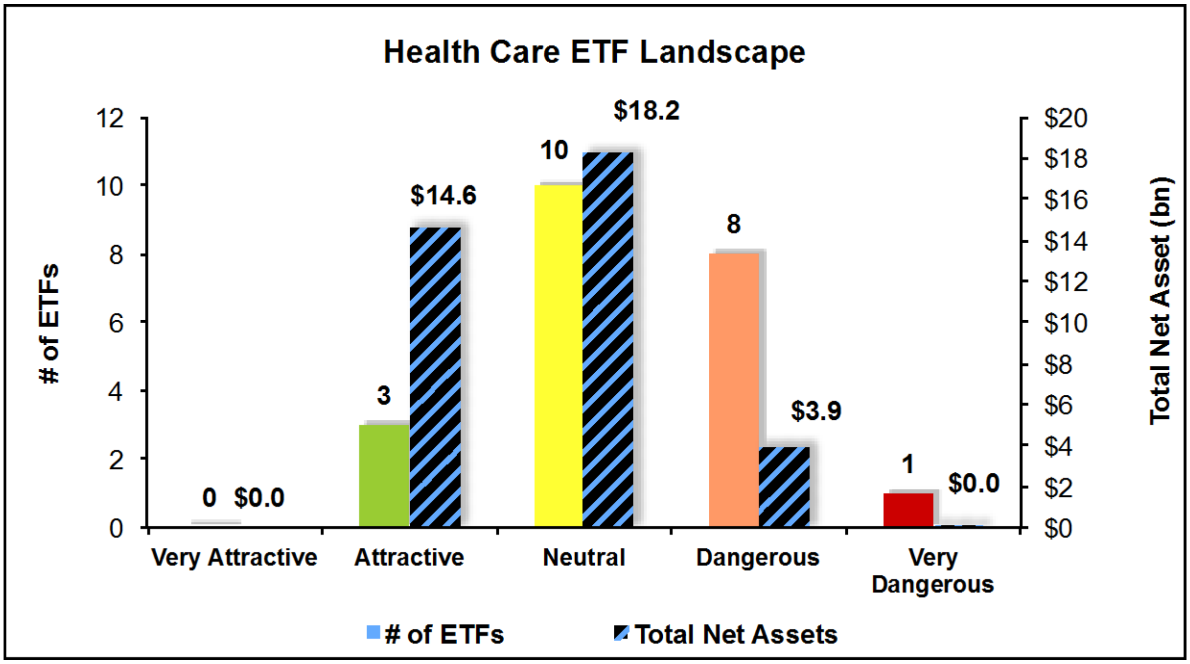
347 stocks of the 3000+ we cover are classified as Health Care stocks, but due to style drift, Health Care ETFs and mutual funds hold 357 stocks.

National Research Corp (NRCIB: $34/share) is one of our favorite stocks held by Health Care ETFs and mutual funds and earns a Very Attractive rating. NRCIB is on July's Most Attractive Stocks list. Over the past decade, NRCIB has grown after-tax profit (NOPAT) by 14% compounded annually. The company has improved its return on invested capital (ROIC) from an already impressive 18% in 2005 to a top-quintile 26% over the last twelve months. Despite the improving business, NRCIB remains undervalued. At its current price of $34/share, NRBIC has a price-to-economic book value (PEBV) ratio of 0.6. This ratio means that the market expects NRCIB's NOPAT to permanently decline by 40% from current levels. If NRCIB can grow NOPAT by just 8% compounded annually for the next five years, the stock is worth $73/share today – a 115% upside.

Boston Scientific Corp (BSX: $24/share) is one of our least favorite stocks held by HGHAX and earns a Dangerous rating. Over the past decade, Boston Scientific's NOPAT has declined by nearly 3% compounded annually. The company's ROIC has fallen from 24% in 2005 to a bottom-quintile 4% over the last twelve months. Worst of all, the company has generated negative economic earnings in every year since 2006. Despite these issues, BSX remains overvalued. To justify its current price of $24/share, BSX must grow NOPAT by 12% compounded annually for the next 13 years. This expectation seems overly optimistic given the past decade of declining profit.

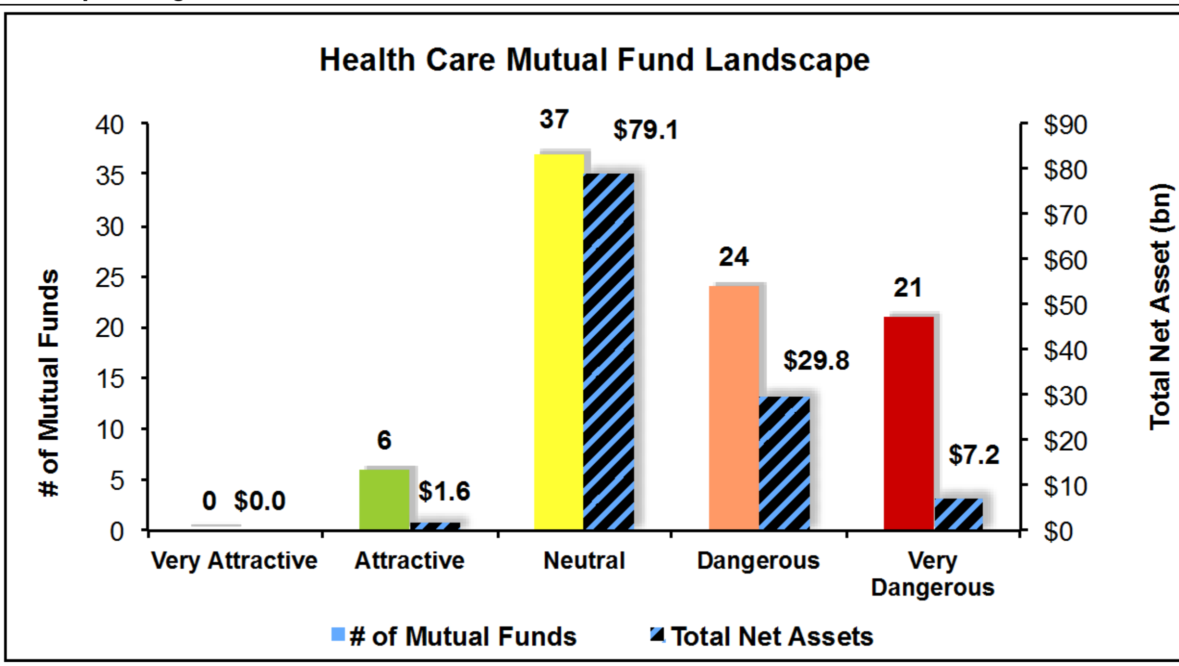
Figures 3 and 4 show the rating landscape of all Health Care ETFs and mutual funds.

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 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.

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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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