ETF & Mutual Fund Rankings: Industrials Sector

The Industrials sector ranks third out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Industrials sector ranked first. It gets our Neutral rating, which is based on an aggregation of ratings of 20 ETFs and 22 mutual funds in the Industrials 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 Industrials sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 20 to 345). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Industrials 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				
IYT	34%	37%	29%	Very Attractive
RGI	24%	43%	31%	Very Attractive
XLI	21%	45%	31%	Attractive
XHB	19%	60%	18%	Attractive
ITA	16%	46%	27%	Attractive
Worst ETFs				
PRN	8%	59%	31%	Neutral
PKB	17%	36%	39%	Neutral
PPA	8%	55%	32%	Neutral
ARKQ	7%	27%	44%	Dangerous
EVX	4%	18%	72%	Dangerous

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

Sources: New Constructs, LLC and company filings

U.S. Global Jets ETF (JETS), EcoLogical Strategy ETF (HECO), and PowerShares S&P SmallCap Industrials Portfolio (PSCI) 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				
FSRFX	30%	44%	22%	Attractive
FSDAX	12%	65%	17%	Neutral
VINAX	18%	42%	36%	Neutral
FSCGX	9%	42%	41%	Neutral
FCYIX	9%	43%	37%	Neutral
Worst Mutual Funds				
PGIVX	4%	27%	32%	Dangerous
FCLAX	10%	43%	37%	Dangerous
PGIHX	4%	27%	32%	Dangerous
ICIAX	17%	38%	27%	Very Dangerous
PGIAX	4%	27%	32%	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 Transportation Fund (RYPIX, RYPAX, RYCNX, RYTSX), Fidelity Select Environment and Alternative Energy (FSLEX), and ICON Industrials Fund (ICTRX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

iShares Transportation Average ETF (IYT) is the top-rated Industrials ETF and Fidelity Select Transportation Portfolio (FSRFX) is the top-rated Industrials mutual fund. IYT earns a Very Attractive rating and FSRFX earns an Attractive rating.

VanEck Vectors Environmental Services (EVX)) is the worst rated Industrials ETF and Putnam Global Industrials Fund (PGIAX) is the worst rated Industrials mutual fund. EVX earns a Dangerous rating and PGIAX earns a Very Dangerous rating.

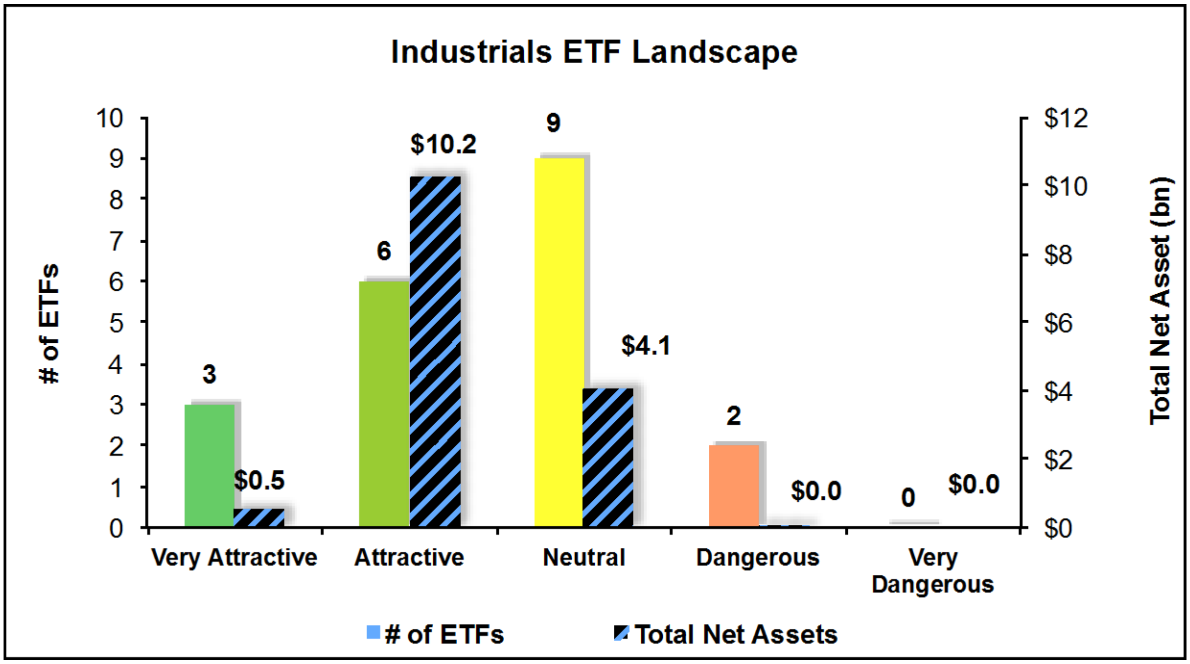
394 stocks of the 3000+ we cover are classified as Industrials stocks.

PACCAR Inc. (PCAR: $51/share) is one of our favorite stocks held by Industrials ETFs and mutual funds and earns a Very Attractive rating. PACCAR is on July's Most Attractive Stocks list. Since rebounding from the 2008-2009 economic crisis, PCAR has grown after-tax profit (NOPAT) by 32% compounded annually from 2010-2015. The company has improved its return on invested capital (ROIC) from 7% in 2010 to a top-quintile 19% over the last twelve months. Despite the solid growth in fundamentals, PCAR remains undervalued. At its current price of $50/share, PCAR has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means that the market expects PCAR's NOPAT to decrease by 10% over the remaining life of the company. If PCAR can grow NOPAT by just 3% compounded annually for the next 10 years, the stock is worth $62/share today – a 24% upside.

Navigant Consulting, Inc. (NCI: $16/share) is one of our least favorite stocks held by Industrials ETFs and mutual funds and earns a Very Dangerous rating. NCI is on July's Most Dangerous Stocks list. Over the past decade, NCI's economic earnings have declined from -$49 million in 2005 to -$64 million in 2015. Worse yet, economic earnings have declined even further to -$85 million over the last twelve months and have never been positive in any year of our model, which dates back to 1998. NCI has never earned a quality ROIC. The best ROIC was 6% in 2006. Now, it earns a bottom-quintile 3% ROIC. Despite the clear deterioration of the business, NCI remains overvalued. To justify its current price of $16/share, NCI must grow NOPAT by 9% compounded annually for the next 15 years. For reference, NCI has grown NOPAT by less than 2% compounded annually over the last decade. Such high expectations already baked into the stock make NCI one to avoid.

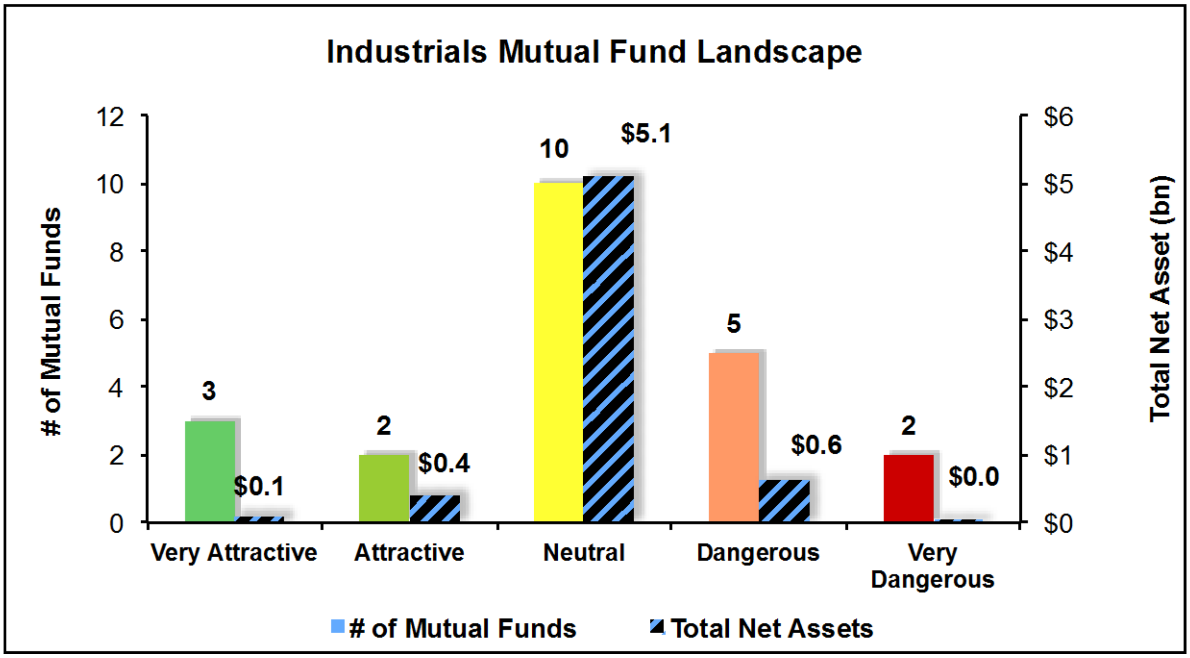
Figures 3 and 4 show the rating landscape of all Industrials ETFs and mutual funds.

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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