ETF & Mutual Fund Rankings: Information Technology Sector

The Information Technology sector ranks fourth out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Information Technology sector ranked fourth as well. It gets our Neutral rating, which is based on an aggregation of ratings of 29 ETFs and 123 mutual funds in the Information Technology sector as of July 14, 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 Information Technology sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 383). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Information Technology 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				
TDIV	47%	28%	22%	Very Attractive
FTEC	30%	33%	23%	Very Attractive
XLK	35%	36%	22%	Very Attractive
RYT	33%	34%	28%	Very Attractive
IYW	32%	36%	23%	Very Attractive
Worst ETFs				
PNQI	4%	20%	52%	Neutral
PTF	4%	28%	52%	Neutral
ARKW	0%	14%	61%	Dangerous
FDN	6%	17%	64%	Dangerous
ARKK	0%	10%	70%	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

Ticker	Allocation of Mutual Fund Holdings: Attractive-or-better Stocks	Neutral Stocks	Dangerous-or-worse Stocks	Predictive Rating
Best Mutual Funds				
FSDCX	67%	9%	11%	Very Attractive
FDCPX	18%	54%	15%	Very Attractive
ROGSX	39%	33%	20%	Very Attractive
VITAX	30%	38%	23%	Attractive
NWJEX	29%	33%	32%	Attractive
Worst Mutual Funds				
USTBX	14%	22%	41%	Very Dangerous
UNSCX	14%	22%	41%	Very Dangerous
RYINX	13%	24%	47%	Very Dangerous
RSIFX	7%	11%	53%	Very Dangerous
DTGRX	14%	22%	57%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Fidelity Advisor Communications Equipment Fund (FDMIX, FDMCX, FDMTX) and Saratoga Advantage Technology & Communications Portfolio (STPIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

First Trust NASDAQ Technology Dividend Index Fund (TDIV) is the top-rated Information Technology ETF and Fidelity Select Communications Equipment Portfolio (FSDCX) is the top-rated Information Technology mutual fund. Both earn a Very Attractive rating.

ARK Innovation ETF (ARKK) is the worst rated Information Technology ETF and Dreyfus Technology Growth Fund (DTGRX) is the worst rated Information Technology mutual fund. ARKK earns a Dangerous rating and DTGRX earns a Very Dangerous rating.

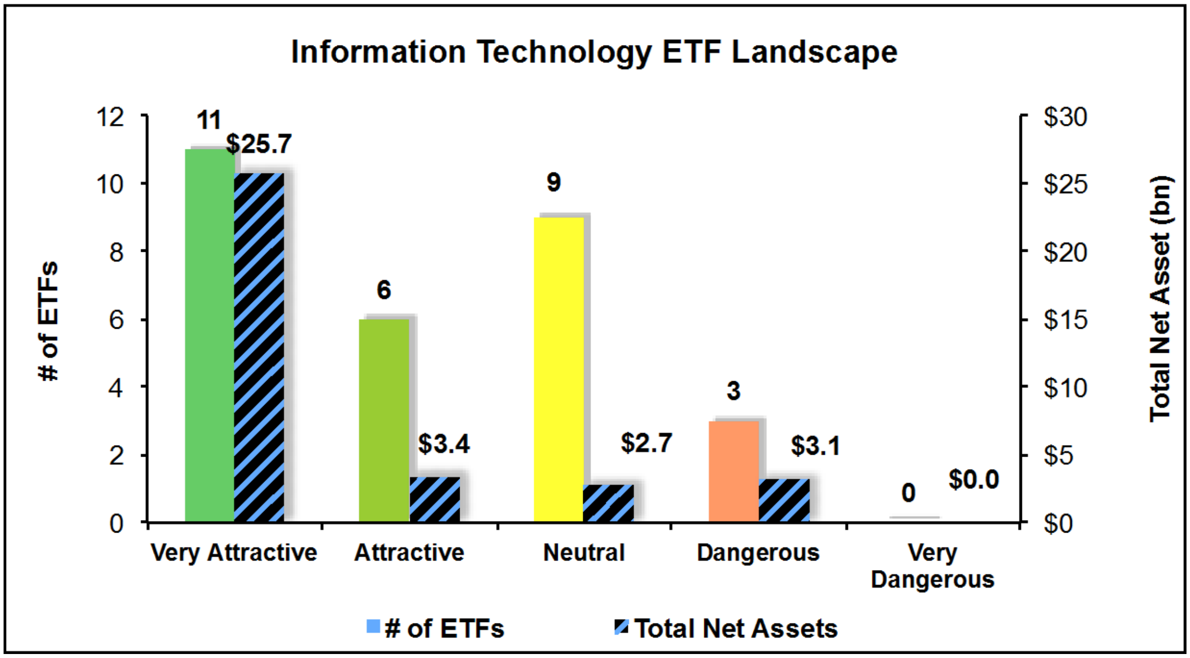
491 stocks of the 3000+ we cover are classified as Information Technology stocks.

Juniper Networks (JNPR: $23/share) is one of our favorite stocks held by FSDCX and earns a Very Attractive rating. JNRP is on July's Most Attractive Stocks list as well. Over the past decade, Juniper has grown after-tax profit (NOPAT) by 12% compounded annually. Juniper has improved its return on invested capital (ROIC) from 4% in 2005 to 12% in the last twelve months. Furthermore, the company generates significant free cash flow, $3.9 billion over the last decade. Despite the fundamental strength of the firm, JNPR remains undervalued. At its current price of $23/share, JNPR has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means that the market expects Juniper's NOPAT to permanently decline by 30%. If Juniper can grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $33/share today – a 43% upside.

ACI Worldwide (ACIW: $20/share) is one of our least favorite stocks held by UNSCX and earns a Very Dangerous rating. ACIW was recently featured in the Danger Zone as well. Over the past decade, ACIW's economic earnings have declined from $3 million in 2005 to -$26 million in 2015. Over the last twelve months, economic earnings have fallen even further to -$48 million. The company's ROIC peaked in 2006 at 14% and has since declined to a bottom-quintile 5%. Despite the deterioration of the business, ACIW is priced for significant profit growth. To justify its current price of $20/share, ACIW must grow NOPAT by 10% compounded annually for the next 11 years. This expectation seems overly optimistic compared to ACIW guiding for 4-7% organic revenue growth in 2016 and achieving organic revenue growth of only 3% in 2015 and -2% in 2014.

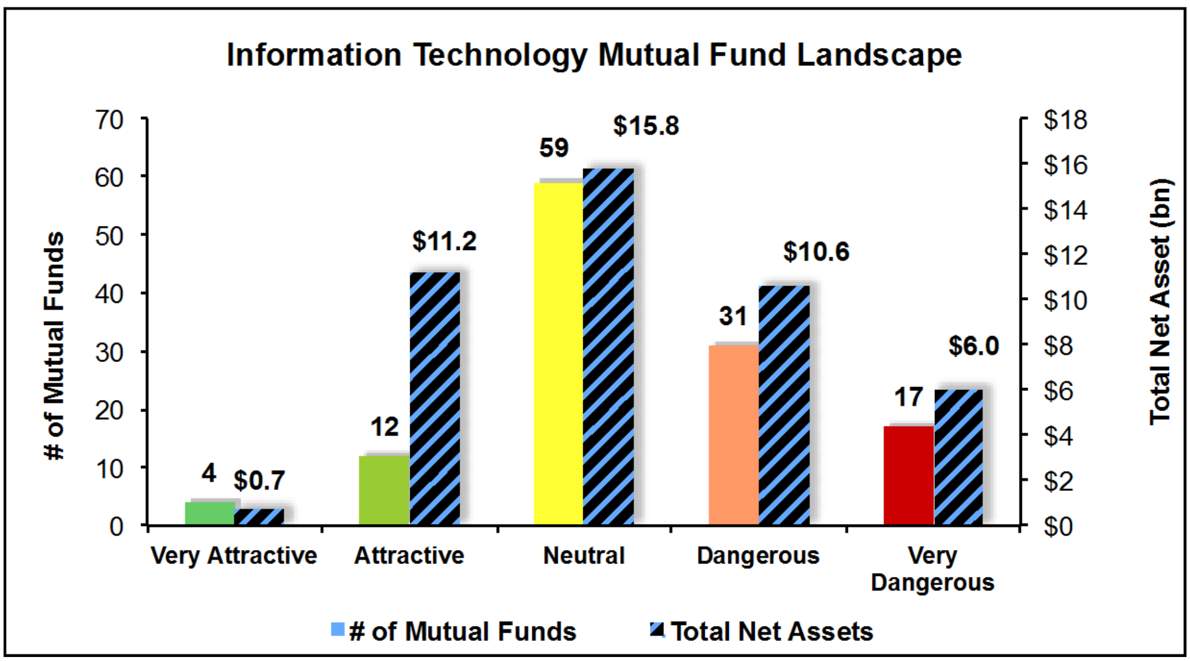
Figures 3 and 4 show the rating landscape of all Information Technology ETFs and mutual funds.

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 15, 2016.

Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, sector or theme.

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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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