ETF & Mutual Fund Rankings: Materials Sector

The Materials sector ranks fifth out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Materials sector ranked second. It gets our Neutral rating, which is based on an aggregation of ratings of nine ETFs and 11 mutual funds in the Materials sector as of July 14, 2016. See a recap of our 2Q16 Sector Ratings here.

Figure 1 ranks from best to worst all nine Materials ETFs and Figure 2 shows the five best and worst-rated Materials mutual funds. Not all Materials sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 23 to 122). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Materials sector should buy one of the Attractive-or-better rated ETFs from Figure 1.

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				
FMAT	6%	49%	42%	Attractive
XLB	4%	55%	37%	Attractive
IYM	7%	53%	38%	Attractive
FXZ	11%	42%	44%	Attractive
VAW	5%	48%	41%	Neutral
Worst ETFs (only 4)				
RTM	3%	46%	47%	Neutral
PYZ	11%	40%	48%	Neutral
PSCM	4%	31%	52%	Neutral
XME	0%	8%	91%	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				
FMFEX	10%	42%	35%	**Neutral**
FSDPX	10%	42%	35%	**Neutral**
FSCHX	10%	50%	26%	**Neutral**
VMIAX	5%	48%	41%	**Neutral**
FMFCX	10%	42%	35%	**Neutral**
Worst Mutual Funds				
FMFAX	10%	42%	35%	**Neutral**
RYBIX	6%	37%	45%	**Neutral**
RYBAX	6%	37%	45%	**Dangerous**
RYBCX	6%	37%	45%	**Dangerous**
RYBMX	6%	37%	45%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

Fidelity MSCI Materials Index (FMAT) is the top-rated Materials ETF and Fidelity Advisor Materials Fund (FMFEX) is the top-rated Materials mutual fund. FMAT earns an Attractive rating and FMFEX earns a Neutral rating.

State Street SPDR S&P Metals & Mining ETF (XME) is the worst rated Materials ETF and Rydex Series Basic Materials Fund (RYBMX) is the worst rated Materials mutual fund. XME earns a Dangerous rating and RYBMX earns a Very Dangerous rating.

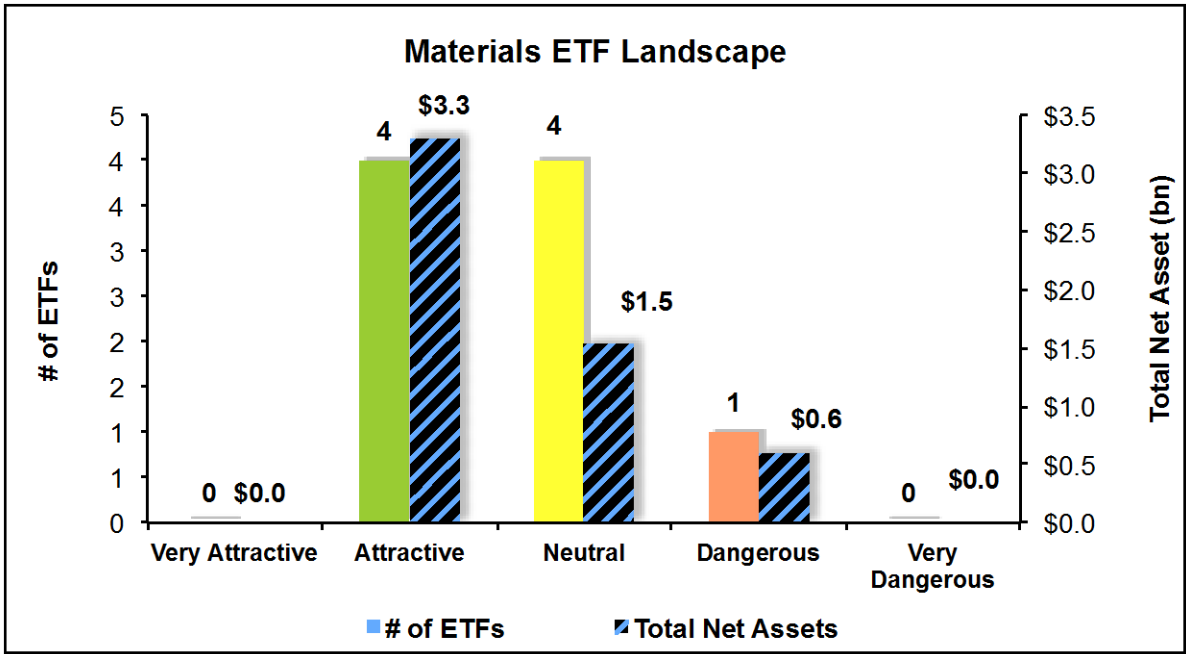
158 stocks of the 3000+ we cover are classified as Materials stocks.

LyondellBasell Industries NV (LYB: $77/share) is one of our favorite stocks held by FMAT and earns a Very Attractive rating. Since 2011, LYB has grown after-tax profit (NOPAT) by 10% compounded annually. The company has improved its return on invested capital (ROIC) from 17% in 2011 to a top-quintile 23% over the last twelve months. Furthermore, the company has generated cumulative free cash flow of $14.8 billion from 2012-2015 and currently earns an 8% FCF yield. Despite the improving profits and profitability, LYB is significantly undervalued. At its current price of $77/share, LYB has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means that the market expects LyondellBasell's NOPAT to permanently decline by 30%. If LYB can grow NOPAT by just 2% compounded annually for the next decade, the stock is worth $119/share today – a 55% upside.

Cliffs Natural Resources (CLF: $7/share) is one of our least favorite stocks held by XME and earns a Very Dangerous rating. Over the past decade, Cliffs' NOPAT has declined by 14% compounded annually. Additionally, the firm's ROIC has fallen from a once impressive 24% in 2010, to a bottom-quintile 0% over the last twelve months. Despite the fundamental deterioration, CLF is priced for significant profit growth. To justify its current price of $7/share, CLF must grow NOPAT by 16% compounded annually for the next 12 years. This expectation seems overly optimistic given the past decade of profit declines and makes CLF one to avoid.

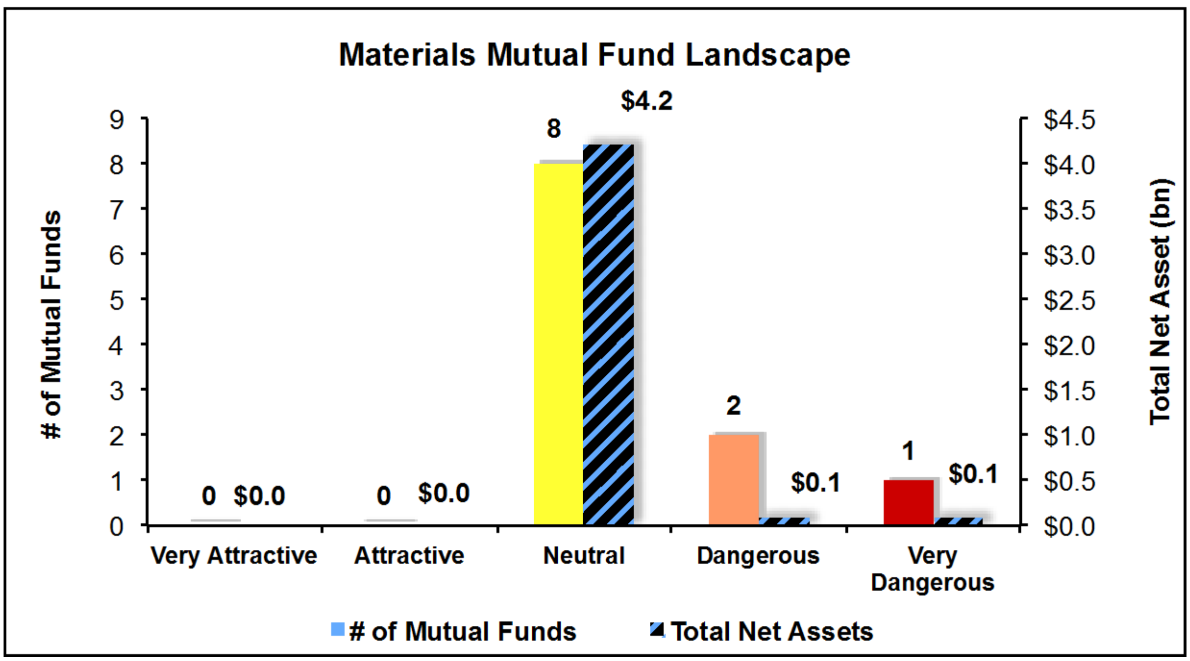
Figures 3 and 4 show the rating landscape of all Materials ETFs and mutual funds.

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.

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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