ETF & Mutual Fund Rankings: Small Cap Growth Style

The Small Cap Growth style ranks eleventh out of the twelve fund styles as detailed in our 3Q16 Style Ratings for ETFs and Mutual Funds report. Last quarter, the Small Cap Growth style ranked eleventh as well. It gets our Dangerous rating, which is based on an aggregation of ratings of 12 ETFs and 410 mutual funds in the Small Cap Growth style as of August 4, 2016. See a recap of our 2Q16 Style Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the style. Not all Small Cap Growth style ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 2482). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Small Cap Growth style 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				
SLYG	13%	38%	42%	Attractive
RFG	11%	45%	39%	Attractive
VIOG	12%	38%	43%	Neutral
IJT	12%	38%	43%	Neutral
DWAS	15%	37%	36%	Neutral
Worst ETFs				
VTWG	10%	25%	45%	Neutral
IWO	10%	25%	45%	Neutral
JKK	5%	29%	48%	Neutral
RZG	13%	37%	42%	Neutral
PXSG	9%	21%	46%	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				
NRGSX	11%	51%	29%	Attractive
NBGIX	11%	51%	29%	Attractive
NBGNX	11%	51%	29%	Attractive
VSCRX	18%	54%	10%	Attractive
NBGEX	11%	51%	29%	Attractive
Worst Mutual Funds				
IHSAX	5%	22%	45%	Very Dangerous
GAMAX	10%	16%	46%	Very Dangerous
FRMPX	11%	20%	49%	Very Dangerous
ANOAX	2%	24%	49%	Very Dangerous
PQUAX	2%	14%	22%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Boston Trust Walden SMID Cap Fund (WASMX) is excluded from Figure 2 because its total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

State Street SPDR S&P 600 Small Cap Growth (SLYG) is the top-rated Small Cap Growth ETF and Neuberger Berman Genesis Fund (NRGSX) is the top-rated Small Cap Growth mutual fund. Both earn an Attractive rating.

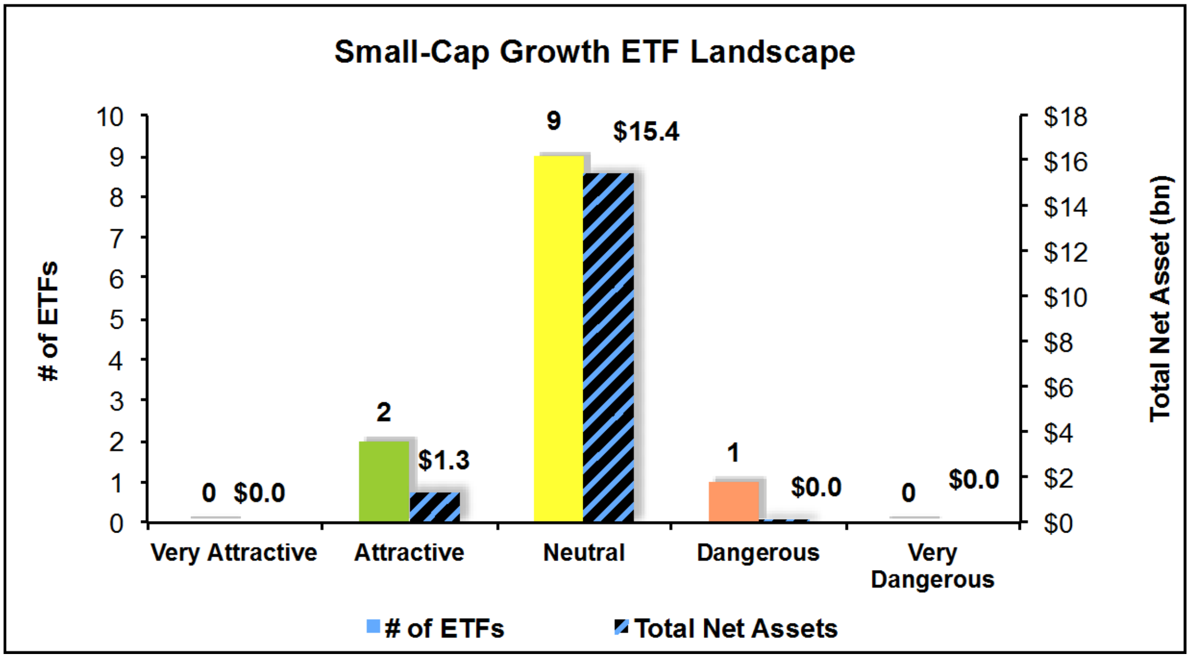
PowerShares Russell 2000 Pure Growth Portfolio (PXSG) is the worst rated Small Cap Growth ETF and PACE Small/Medium Co Growth Equity Investments (PQUAX) is the worst rated Small Cap Growth mutual fund. PXSG earns a Dangerous rating and PQUAX earns a Very Dangerous rating.

Hibbett Sports (HIBB: $34/share) is one of our favorite stocks held by Small Cap Blend ETFs and mutual funds and earns a Very Attractive rating. HIBB was on July's Linking ROIC to Exec Comp Model Portfolio, which means executive compensation is aligned with shareholders' best interests. Over the past decade, HIBB has grown after-tax profit (NOPAT) by 9% compounded annually. The company has improved its return on invested capital (ROIC) from 12% in 2010 to a top-quintile 15% over the last twelve months. Concerns across the entire retail sector have left HIBB down 25% over the past year, and the current valuation implies permanent profit decline. At its current price of $34/share, HIBB has a price-to-economic book value (PEBV) ratio of 0.7. This ratio means the market expects HIBB's NOPAT to permanently decline by 30%. If HIBB can grow NOPAT by just 5% compounded annually for the next decade, the stock is worth $68/share today – a 100% upside.

SPS Commerce (SPSC: $66/share) is one of our least favorite stocks held by PQUAX and earns a Very Dangerous rating. Since 2010, SPSC's economic earnings have declined from $2 million to -$5 million over the last twelve months. The company's ROIC has fallen drastically: from 24% in 2010 to a bottom-quintile 4% TTM. Additionally SPSC has burned through $82 million in free cash flow over the last five years. Despite the clear deterioration of the business, SPSC is up 270% over the last five years, which has left shares significantly overvalued. To justify its current price of $66/share, SPSC must grow NOPAT by 27% compounded annually for the next 17 years. Nearly 30% profit growth for almost two decades would not only make SPSC one of the most successful firms in history, but also seems highly unlikely given its history of profit decline.

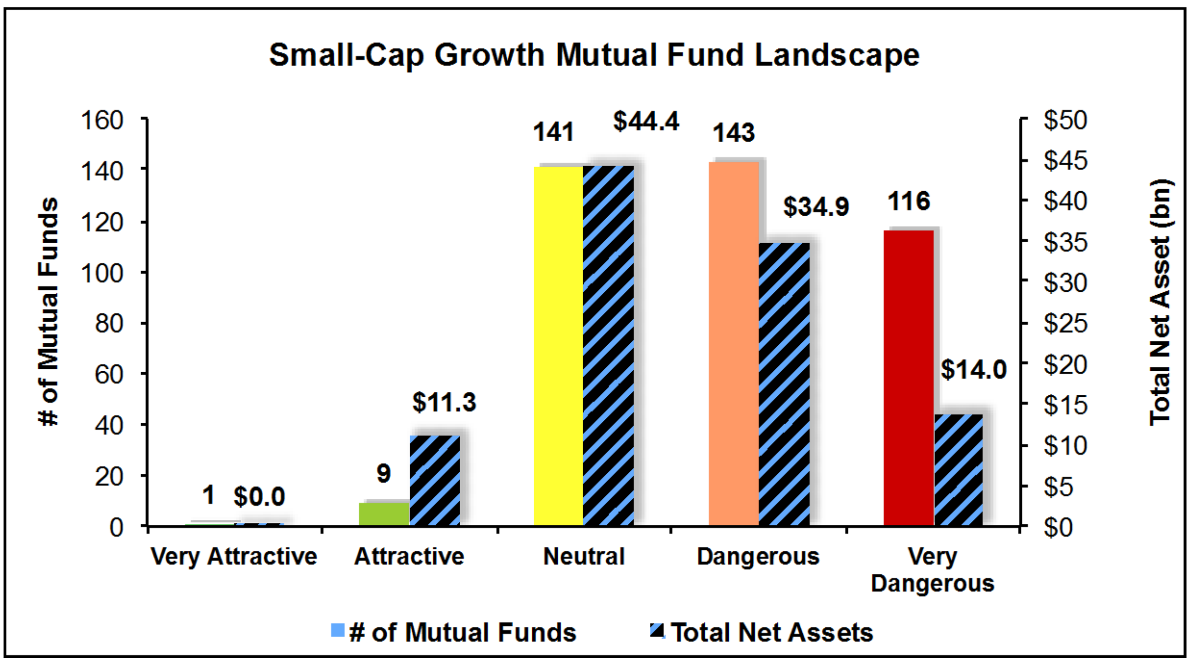
Figures 3 and 4 show the rating landscape of all Small Cap Growth ETFs and mutual funds.

Figure 3: Separating the Best ETFs From the Worst Funds



Sources: New Constructs, LLC and company filings

Figure 4: Separating the Best Mutual Funds From the Worst 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, style, or theme.

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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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