ETF & Mutual Fund Rankings: Energy Sector

The Energy sector ranks last out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Energy sector ranked ninth. It gets our Dangerous rating, which is based on aggregation of ratings of 22 ETFs and 102 mutual funds in the Energy sector as of October 11, 2016. See a recap of our 3Q16 Sector Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the sector. Not all Energy sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 142). This variation creates drastically different investment implications and, therefore, ratings.

Investors should not buy any Energy ETFs or mutual funds because none get an Attractive-or-better rating. If you must have exposure to this sector, you should buy a basket of Attractive-or-better rated stocks and avoid paying undeserved fund fees. Active management has a long history of not paying off.

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				
PHO	0%	18%	71%	**Neutral**
FCG	0%	0%	83%	**Neutral**
OIH	7%	18%	76%	**Neutral**
XOP	6%	5%	77%	**Dangerous**
XES	12%	22%	64%	**Dangerous**
Worst ETFs				
XLE	0%	4%	96%	**Dangerous**
IEO	2%	6%	86%	**Dangerous**
IYE	1%	4%	93%	**Dangerous**
FIW	0%	21%	77%	**Dangerous**
PXE	8%	5%	76%	**Dangerous**

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

Sources: New Constructs, LLC and company filings

Five ETFs are excluded from Figure 1 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums. See our ETF screener for more details.

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				
FSESX	6%	6%	60%	Dangerous
FSNGX	3%	0%	72%	Dangerous
SGLSX	3%	0%	69%	Dangerous
BPEIX	6%	7%	64%	Dangerous
VGELX	0%	1%	72%	Dangerous
Worst Mutual Funds				
ICEAX	7%	9%	62%	Very Dangerous
RYENX	4%	7%	78%	Very Dangerous
RYVCX	11%	16%	72%	Very Dangerous
SBMBX	7%	8%	75%	Very Dangerous
RYESX	11%	16%	72%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Tortoise North American Energy Fund (TNPIX) and Select Opportunity Fund (TOPIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

PowerShares Water Resources Portfolio (PHO) is the top-rated Energy ETF and Fidelity Energy Service Portfolio (FSESX) is the top-rated Energy mutual fund. PHO earns a Neutral rating and FSESX earns a Dangerous rating.

PowerShares Dynamic Energy Portfolio (PXE) is the worst rated Energy ETF and Rydex Energy Services Fund (RYESX) is the worst rated Energy mutual fund. PXE earns a Dangerous rating and RYESX earns a Very Dangerous rating.

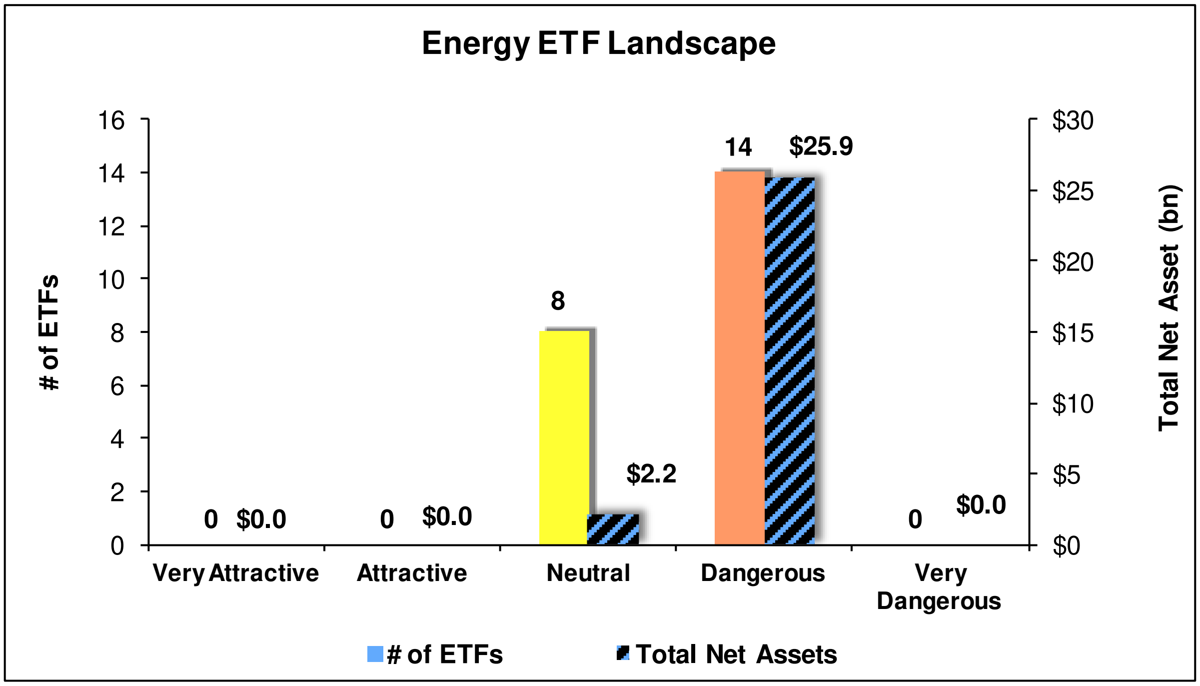
171 stocks of the 3000+ we cover are classified as Energy stocks.

DHT Holdings Inc. (DHT: $4/share) is one of our favorite stocks held by Energy ETFs and mutual funds and earns a Very Attractive rating. DHT is also on this month's Most Attractive Stocks list. Since 2009, DHT has grown after-tax profit (NOPAT) by 22% compounded annually to $136 million in 2015. Over the last twelve months, NOPAT has grown to $166 million. The company's return on invested capital (ROIC) has improved from 10% in 2009 to 12% over the last twelve months. Despite the impressive profit growth, DHT is significantly undervalued. With margins reaching levels last seen in 2009, it's understandable to expect some reversion to the mean. However, at its current price of $4/share, DHT has a price-to-economic book value (PEBV) of 0.2. This ratio means that the market expects DHT's NOPAT to permanently decline by 80%. If DHT can limit NOPAT contraction to just a 2% compounded annual decrease over the next decade, the stock is worth $6/share today – a 50% upside.

Golden Ocean Group Limited (GOGL: $4/share) is one of our least favorite stocks held by Energy ETFs and mutual funds and earns a Dangerous rating. Over the past decade, GOGL's NOPAT has declined from $48 million in 2005 to -$57 million in 2015. The company's ROIC has fallen from a once impressive 15% in 2005 to a bottom-quintile -3% in 2015. Despite the issues noted above, GOGL remains priced for significant profit growth. To justify its current price of $4/share, GOGL must immediately achieve 6% NOPAT margins (compared to -30% in 2015) and grow revenue by 19% compounded annually for the next 16 years. These expectations seem overly optimistic given the profit decline over the past decade. This scenario also assumes GOGL is able to grow revenue and NOPAT without spending on working capital or fixed assets, which is unlikely but allows us to create a very optimistic scenario. For reference, GOGL's invested capital has grown on average $205 million (>100% of 2015 revenue) over the last 10 years.

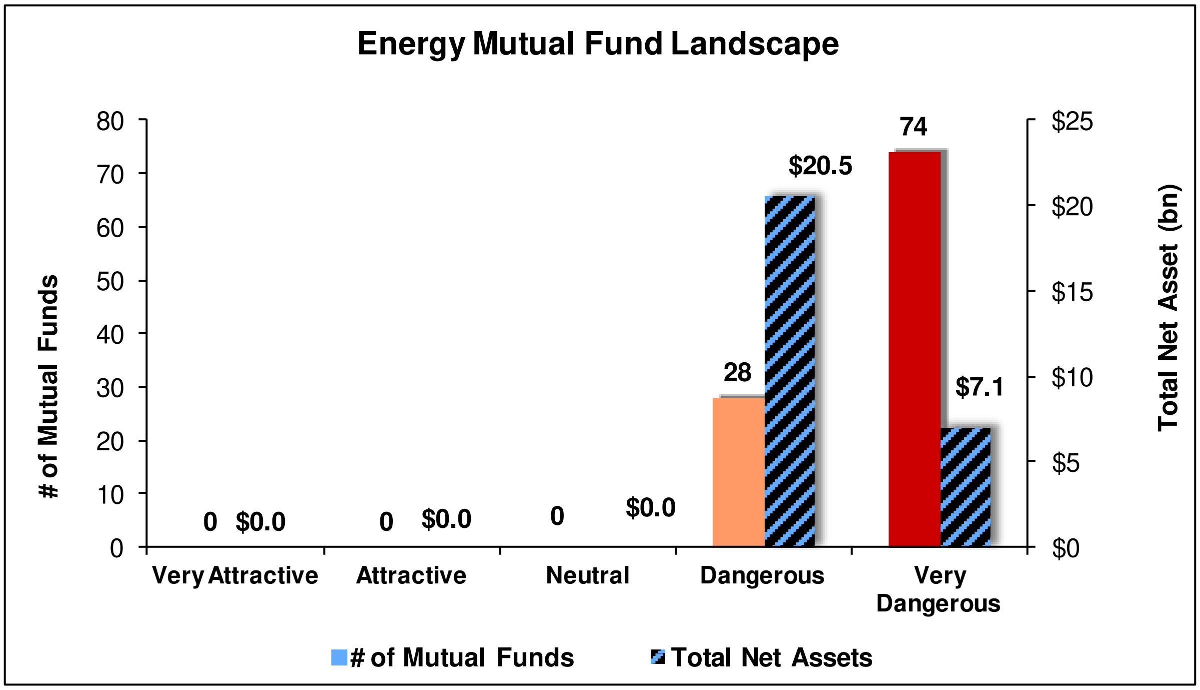
Figures 3 and 4 show the rating landscape of all Energy ETFs and mutual funds.

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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David Trainer and Kyle Martone receive no compensation to write about any specific stock, sector or theme.

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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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