ETF & Mutual Fund Rankings: Financials Sector

The Financials sector ranks fifth out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Financials sector ranked seventh. It gets our Neutral rating, which is based on an aggregation of ratings of 39 ETFs and 232 mutual funds in the Financials 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 Financials sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 24 to 570). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Financials 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				
IYG	35%	44%	19%	**Very Attractive**
KBWB	20%	60%	17%	**Very Attractive**
KBWR	16%	66%	13%	**Very Attractive**
IAT	5%	81%	9%	**Very Attractive**
QABA	25%	46%	18%	**Very Attractive**
Worst ETFs				
IYR	10%	24%	60%	**Neutral**
ROOF	9%	22%	40%	**Neutral**
PSR	8%	20%	59%	**Neutral**
KBWD	26%	26%	23%	**Dangerous**
FTY	11%	24%	63%	**Dangerous**

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

Sources: New Constructs, LLC and company filings

PowerShares KBW Property & Casualty Insurance Portfolio (KBWP), Oppenheimer Financials Sector Revenue ETF (RWW), and State Street SPDR S&P Capital Markets (KCE) 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				
DVFYX	34%	31%	23%	Very Attractive
FSRBX	27%	49%	15%	Very Attractive
DFFCX	34%	31%	23%	Very Attractive
RPFGX	34%	31%	23%	Very Attractive
FRBCX	18%	49%	9%	Attractive
Worst Mutual Funds				
KREAX	13%	4%	58%	Very Dangerous
DAREX	11%	26%	47%	Very Dangerous
RYHRX	11%	22%	52%	Very Dangerous
RYCRX	11%	22%	52%	Very Dangerous
RYREX	11%	22%	52%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

iShares U.S. Financial Services (IYG) is the top-rated Financials ETF and Davis Financial Fund (DVFYX) is the top-rated Financials mutual fund. Both earn a Very Attractive rating.

iShares Real Estate 50 (FTY) is the worst rated Financials ETF and Rydex Real Estate Fund (RYREX) is the worst rated Financials mutual fund. FTY earns a Dangerous rating and RYREX earns a Very Dangerous rating.

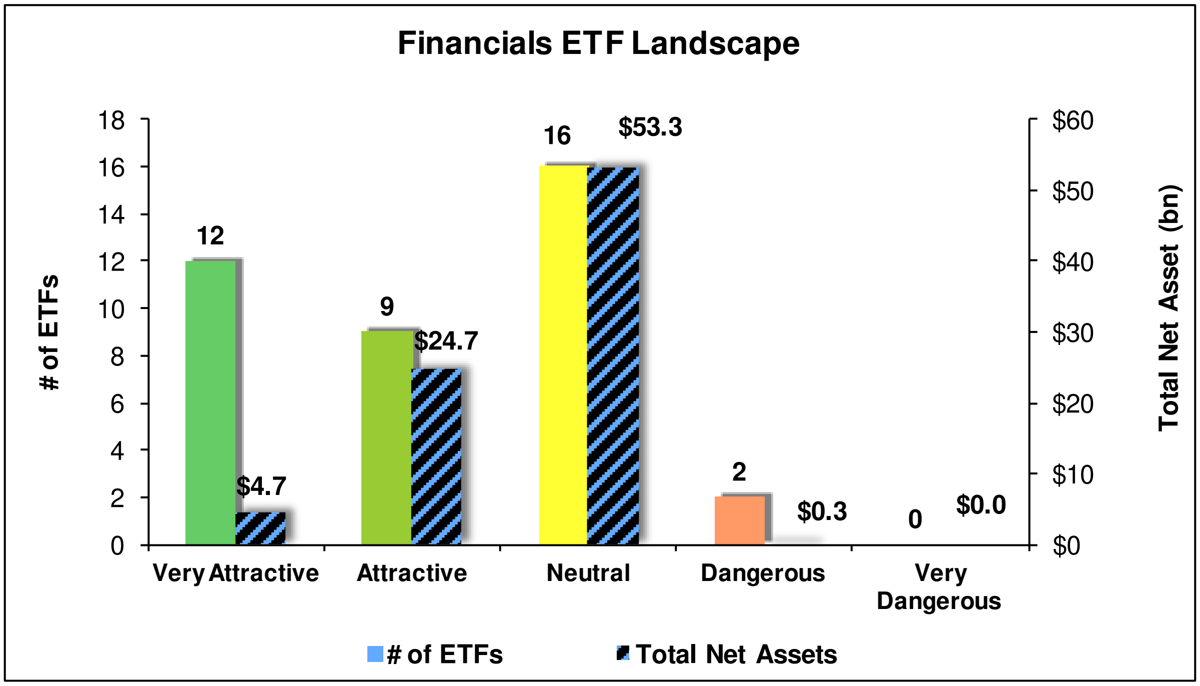
582 stocks of the 3000+ we cover are classified as Financials stocks.

American Express (AXP: $64/share) is one of our favorite stocks held by IYG and earns our Very Attractive rating. AXP is on October's Most Attractive Stocks list and we've previously proposed a strategy that could boost its value by $50 billion, which can be read here. Since 2010, American Express has grown after-tax profit (NOPAT) by 25% compounded annually. The company has improved its return on invested capital (ROIC) from 6% in 2010 to 14% over the last twelve months (TTM). Despite the strength in underlying fundamentals, AXP is priced for permanent profit decline. At its current price of $64/share, AXP has a price-to-economic-book value (PEBV) ratio of 0.8. This ratio means the market expects AXP's NOPAT to permanently decline by 20%. If AXP can grow NOPAT by just 3% compounded annually over the next decade, the stock is worth $94/share today – a 47% upside.

BGC Partners Inc. (BGCP: $9/share) is one of our least favorite stocks held by Financial ETFs and mutual funds and earns a Very Dangerous rating. BGCP is on October's Most Dangerous Stocks list as well. BGCP's economic earnings, the true cash flows of the business, have declined from -$26 million in 2005 to -$104 million in 2015. Economic earnings have declined further, to -$105 million TTM. The company's ROIC has fallen from 13% in 2010 to a bottom-quintile 2% TTM. Despite significant destruction of shareholder value, BGCP remains overvalued. In order to justify its current price of $9/share, BGCP must maintain TTM margins and grow NOPAT by 20% compounded annually for the next 17 years. This expectation seems overly optimistic given the deterioration in BCGP's fundamentals over the past decade. This scenario also assumes BGCP 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, BGCP's invested capital has grown on average $115 million (4% of 2015 revenue) per year over the past decade.

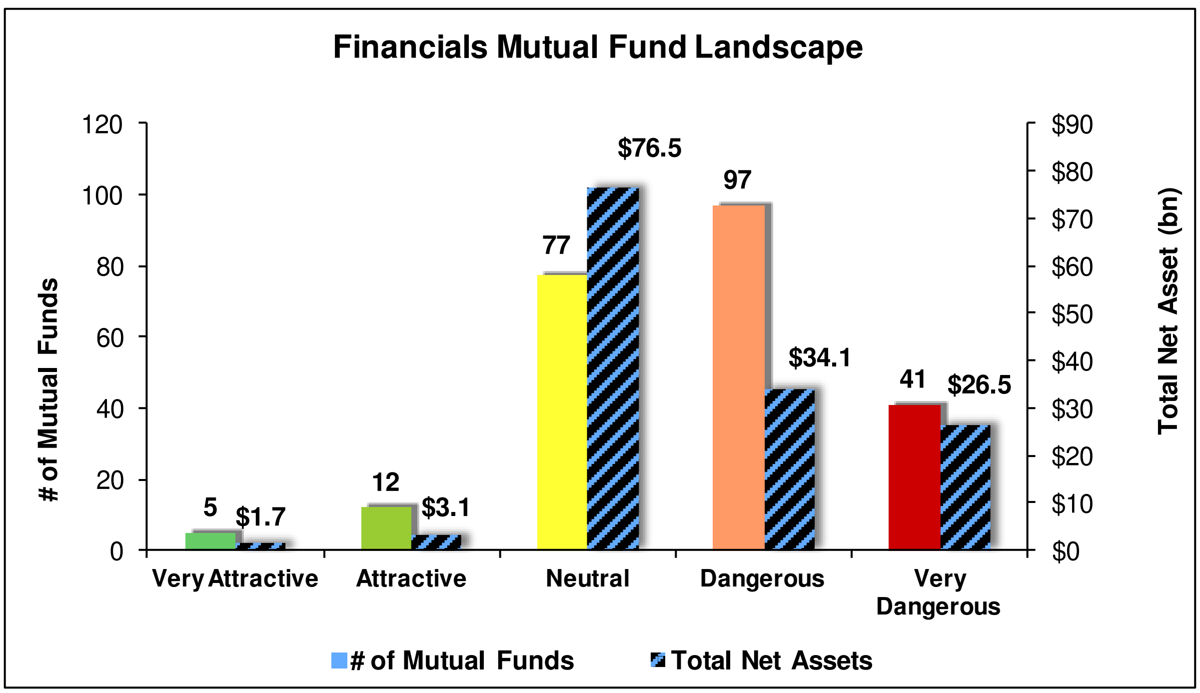
Figures 3 and 4 show the rating landscape of all Financials ETFs and mutual funds.

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 October 11, 2016.

Disclosure: David Trainer, Kyle Guske II, 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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