ETF & Mutual Fund Rankings: Health Care Sector

The Health Care sector ranks seventh out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Health Care sector ranked sixth. It gets our Dangerous rating, which is based on an aggregation of ratings of 23 ETFs and 85 mutual funds in the Health Care 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 Health Care sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 23 to 352). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Health Care 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				
IXJ	21%	26%	34%	Attractive
FHLC	23%	25%	44%	Attractive
VHT	23%	26%	45%	Attractive
XLV	27%	25%	44%	Attractive
BBH	35%	4%	53%	Attractive
Worst ETFs				
XHE	1%	32%	53%	Dangerous
PTH	1%	26%	54%	Dangerous
XBI	12%	3%	56%	Very Dangerous
FBT	16%	3%	67%	Very Dangerous
BBP	13%	0%	68%	Very 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				
PHSYX	21%	21%	31%	Attractive
SWHFX	30%	18%	32%	Attractive
PHSRX	21%	21%	31%	Attractive
PCHSX	21%	21%	31%	Attractive
PHSBX	21%	21%	31%	Attractive
Worst Mutual Funds				
AHSBX	5%	22%	51%	Very Dangerous
HGHAX	3%	15%	60%	Very Dangerous
AHSAX	5%	22%	51%	Very Dangerous
PHLAX	3%	12%	60%	Very Dangerous
RAGHX	10%	20%	51%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Live Oak Health Sciences Fund (LOGSX) and Saratoga Health & Biotechnology Portfolio (SBHIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

iShares Global Healthcare ETF (IXJ) is the top-rated Health Care ETF and Putnam Global Health Care Fund (PHSYX) is the top-rated Health Care mutual fund. Both earn an Attractive rating.

BioShares Biotechnology Products Fund (BBP) is the worst rated Health Care ETF and AllianzGI Health Sciences Fund (RAGHX) is the worst rated Health Care mutual fund. Both earn a Very Dangerous rating.

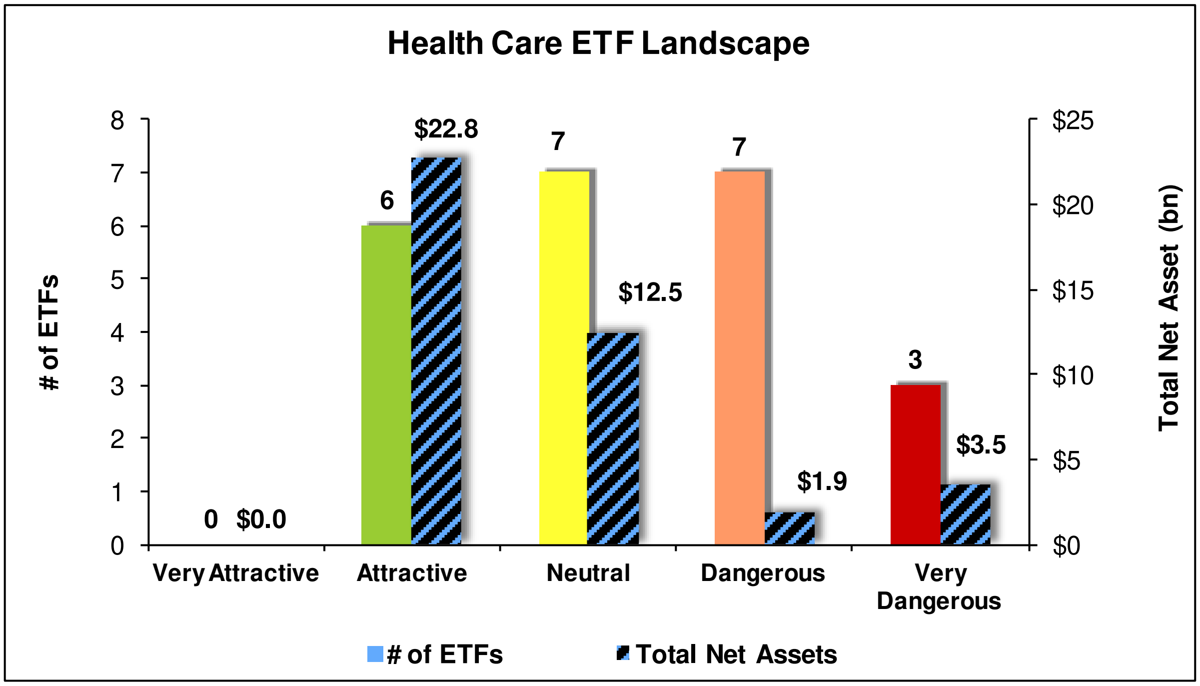
340 stocks of the 3000+ we cover are classified as Health Care stocks, but due to style drift, Health Care ETFs and mutual funds hold 352 stocks.

AmerisourceBergen Corp (ABC: $79/share) is one of our favorite stocks held by Health Care ETFs and mutual funds and earns a Very Attractive rating. Over the past decade, ABC has grown after-tax profit (NOPAT) by 13% compounded annually. The company has improved its return on invested capital (ROIC) from 6% in 2005 to a top-quintile 16% over the last twelve months. Despite the improving fundamentals, ABC remains undervalued. At its current price of $79/share, ABC has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects ABC's NOPAT to permanently decline by 10% from current levels. If ABC can grow NOPAT by just 6% compounded annually for the next decade, the stock is worth $101/share today – a 28% upside.

Amedisys (AMED: $47/share) is one of our least favorite stocks held by Health Care ETFs and mutual funds and earns a Very Dangerous rating. AMED is on October's Most Dangerous Stocks list as well. Over the past five years, Amedisys' NOPAT has declined by 16% compounded annually. The company's ROIC has fallen from 12% in 2010 to a bottom-quintile 4% TTM. Despite the deteriorating business fundamentals, AMED remains priced for significant profit growth. To justify its current price of $47/share, AMED must grow NOPAT by 10% compounded annually for the next 11 years. This expectation seems rather optimistic given AMED's declining profit over the past five years. This scenario also assumes AMED 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, AMED's invested capital has grown on average $88 million (7% of 2015 revenue) per year over the past decade.

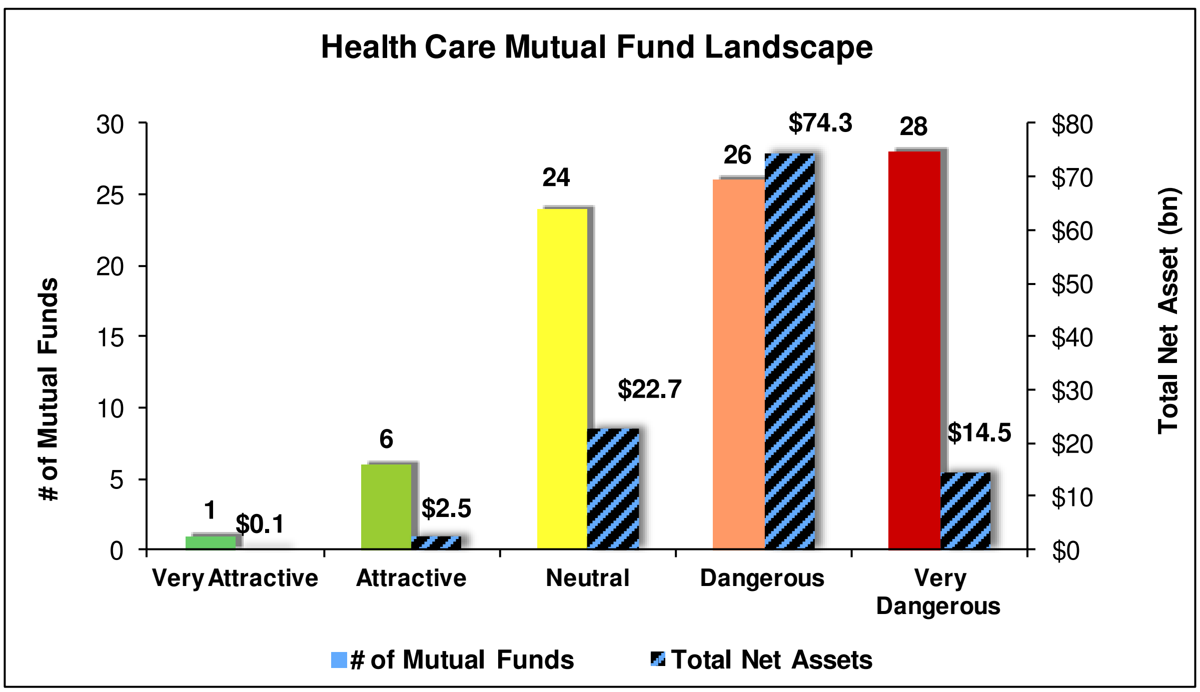
Figures 3 and 4 show the rating landscape of all Health Care ETFs and mutual funds.

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 Martone receive no compensation to write about any specific stock, sector or theme.

New Constructs® – Profile

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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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