ETF & Mutual Fund Rankings: Industrials Sector

The Industrials sector ranks fourth out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Industrials sector ranked third. It gets our Neutral rating, which is based on an aggregation of ratings of 20 ETFs and 16 mutual funds in the Industrials sector as of October 14, 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 Industrials sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 20 to 346). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Industrials 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				
XHB	20%	60%	17%	**Attractive**
RGI	17%	47%	33%	**Attractive**
IYT	31%	40%	29%	**Attractive**
FXR	18%	43%	35%	**Attractive**
FIDU	7%	52%	37%	**Neutral**
Worst ETFs				
PPA	0%	61%	34%	**Neutral**
ARKQ	16%	22%	43%	**Neutral**
IYJ	5%	53%	39%	**Neutral**
PKB	10%	37%	44%	**Neutral**
EVX	4%	27%	66%	**Dangerous**

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

Sources: New Constructs, LLC and company filings

U.S Global Jets ETF (JETS), EcoLogical Strategy ETF (HECO), and PowerShares DWA Industrials Momentum (PRN) 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				
FSDAX	1%	64%	27%	**Attractive**
FSRFX	19%	49%	24%	**Attractive**
VINAX	9%	51%	36%	**Neutral**
FCYIX	3%	42%	47%	**Neutral**
FCLIX	3%	42%	47%	**Neutral**
Worst Mutual Funds				
FCLTX	3%	42%	47%	**Neutral**
FSCGX	0%	40%	53%	**Neutral**
RYTSX	34%	33%	22%	**Dangerous**
FCLAX	3%	42%	47%	**Dangerous**
ICIAX	14%	41%	24%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

Five mutual funds are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums. See our mutual fund screener for more details.

State Street SPDR S&P Homebuilders ETF (XHB) is the top-rated Industrials ETF and Fidelity Select Defense and Aerospace Portfolio (FSDAX) is the top-rated Industrials mutual fund. Both earn an Attractive rating.

VanEck Vectors Environmental Services ETF (EVX) is the worst rated Industrials ETF and ICON Industrials Fund (ICIAX) is the worst rated Industrials mutual fund. EVX earns a Dangerous rating and ICIAX earns a Very Dangerous rating.

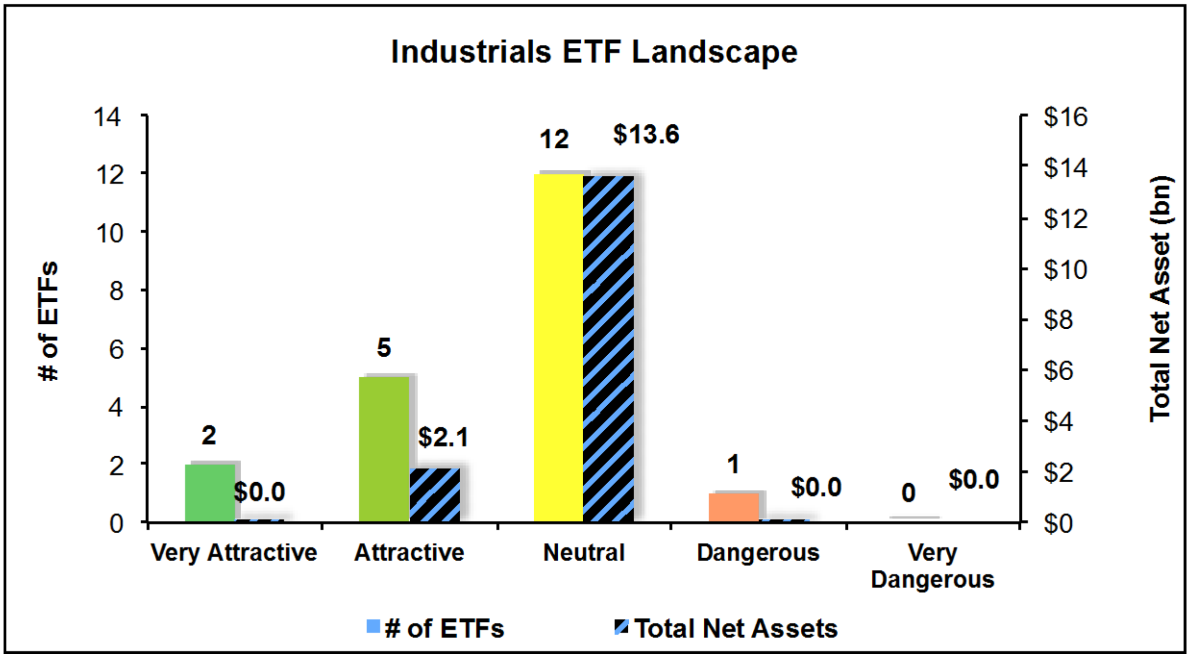
393 stocks of the 3000+ we cover are classified as Industrials stocks.

Greenbrier Companies, Inc. (GBX: $37/share) is one of our favorite stocks held by Industrials ETFs and mutual funds and earns a Very Attractive rating. GBX is on September's Exec Comp Linked to ROIC list as well. Since 2011, GBX has grown after-tax profit (NOPAT) by 61% compounded annually to $271 million in 2015 and to $320 million over the last twelve months (TTM). The company has improved its return on invested capital (ROIC) from 4% in 2011 to a top-quintile 22% TTM. Despite the improvement in the fundamentals of the business, GBX remains undervalued. At its current price of $37/share, GBX has a price-to-economic book value (PEBV) ratio of 0.4. This ratio means that the market expects GBX's NOPAT to permanently decrease by 60%. If GBX can grow NOPAT by just 1% compounded annually for the next decade, the stock is worth $51/share today – a 38% upside.

Encore Wire Corp (WIRE: $36/share) is one of our least favorite stocks held by Industrials ETFs and mutual funds and earns a Very Dangerous rating. WIRE is on October's Most Dangerous Stocks list as well. Over the past decade, WIRE's NOPAT has declined by 14% compounded annually to $16 million in 2015 and declined further, to $10 million TTM. The company's ROIC has fallen from 40% in 2006 to a bottom-quintile 2% over the last twelve months. Despite the clear deterioration of the business, WIRE remains priced for significant profit growth. To justify its current price of $36/share, WIRE must grow NOPAT by 15% compounded annually for the next 14 years. This expectation seems rather optimistic given WIRE's declining NOPAT over the past decade.

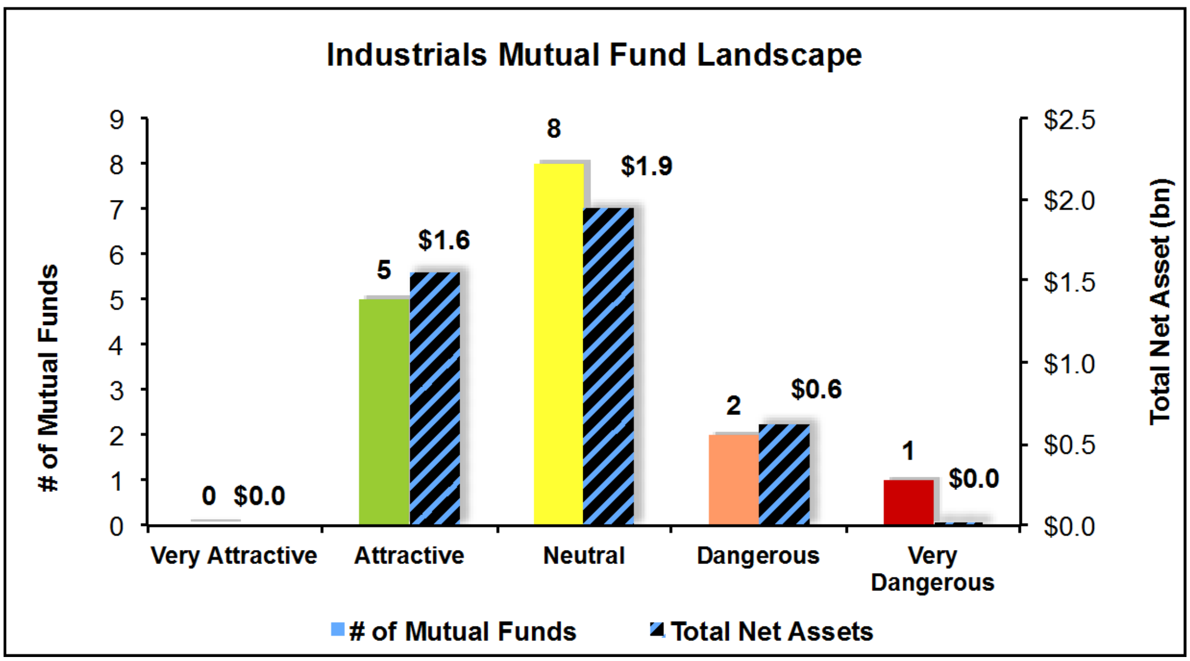
Figures 3 and 4 show the rating landscape of all Industrials ETFs and mutual funds.

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 14, 2016.

Disclosure: David Trainer, Kyle Martone, and Kyle Guske II 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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