ETF & Mutual Fund Rankings: Information Technology Sector

The Information Technology sector ranks third out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Information Technology sector ranked fourth. It gets our Neutral rating, which is based on aggregation of ratings of 28 ETFs and 142 mutual funds in the Information Technology sector as of October 17, 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 Information Technology sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 377). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Information Technology 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				
IXN	11%	52%	9%	Very Attractive
FTEC	13%	61%	18%	Very Attractive
VGT	13%	61%	18%	Very Attractive
XLK	17%	60%	16%	Very Attractive
IYW	16%	61%	15%	Very Attractive
Worst ETFs				
PNQI	5%	33%	47%	Neutral
PSCT	6%	38%	53%	Dangerous
XSD	11%	23%	57%	Dangerous
FDN	7%	32%	53%	Dangerous
ARKK	3%	9%	60%	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				
FSDCX	56%	12%	24%	Very Attractive
ROGSX	26%	44%	22%	Very Attractive
NWJEX	24%	43%	25%	Attractive
NWJFX	24%	43%	25%	Attractive
FDCPX	9%	48%	23%	Attractive
Worst Mutual Funds				
PGTAX	0%	35%	29%	Very Dangerous
RIFKX	4%	15%	54%	Very Dangerous
RINCX	4%	15%	54%	Very Dangerous
RYELX	23%	32%	36%	Very Dangerous
RSIFX	4%	15%	54%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Fidelity Advisor Communications Equipment Fund (FDMIX) and Saratoga Technology & Communications Portfolio (STPIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

iShares Global Tech ETF (IXN) is the top-rated Information Technology ETF and Fidelity Communications Equipment Portfolio (FSDCX) is the top-rated Information Technology mutual fund. Both earn a Very Attractive rating.

ARK Innovation ETF (ARKK) is the worst rated Information Technology ETF and Victory RS Science and Technology Fund (RSIFX) is the worst rated Information Technology mutual fund. ARKK earns a Dangerous rating and RSIFX earns a Very Dangerous rating.

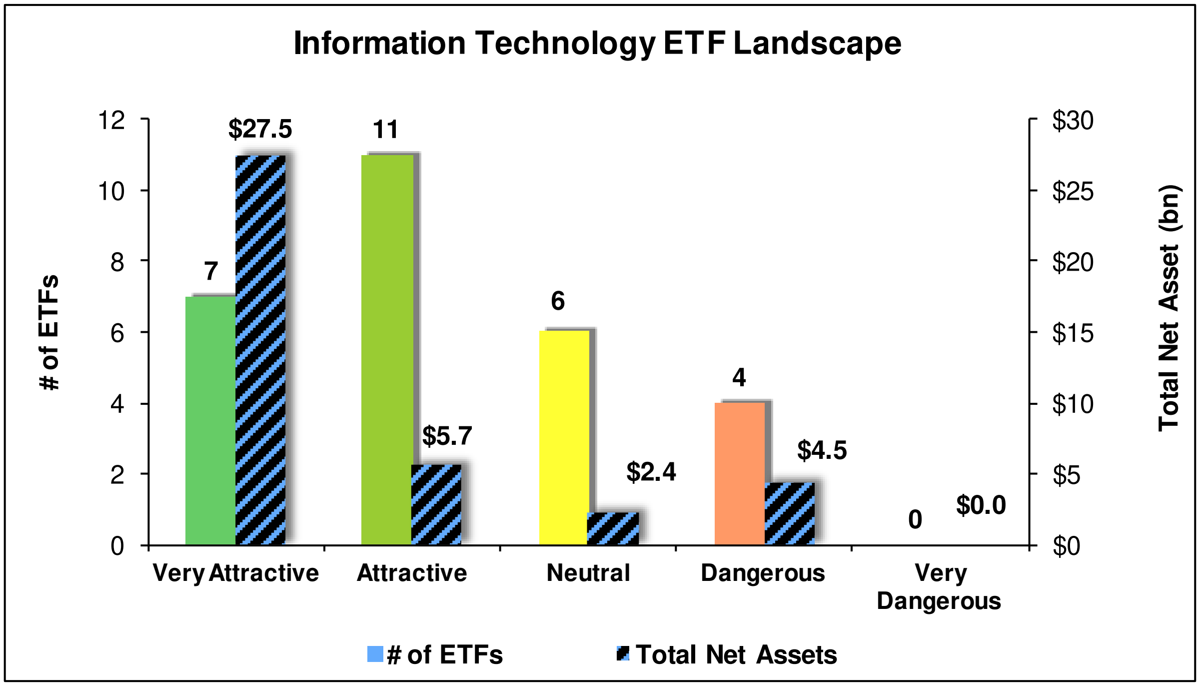
486 stocks of the 3000+ we cover are classified as Information Technology stocks.

Oracle Corporation (ORCL: $38/share) is one of our favorite stocks held by FTEC and earns a Very Attractive rating. In February, we proposed a strategy to boost the firm's value by $64 billion. Over the past decade, Oracle has grown after-tax profit (NOPAT) by 12% compounded annually. Oracle has consistently earned an impressive return on invested capital (ROIC) and currently earns a top-quintile 24% over the last twelve months (TTM). Despite the impressive profit growth Oracle has achieved, the firm remains undervalued. At its current price of $38/share, ORCL has a price-to-economic book value (PEBV) ratio of 1. This ratio means that the market expects Oracle's NOPAT to never increase from current levels. If Oracle can grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $48/share today – a 26% upside.

athenahealth Inc. (ATHN: $126/share) is one of our least favorite stocks held by ARKK and earns a Very Dangerous rating. We put Athenahealth in the Danger Zone in April 2015. Athenahealth's economic earnings have declined from $1 million in 2010 to -$71 million TTM. The company's ROIC fallen from 11% in 2010 to a bottom-quintile 1% TTM. Despite the deterioration of the business, ATHN remains priced for significant profit growth. To justify its current price of $127/share, ATHN must immediately achieve 2.6% NOPAT margins (average last five years compared to 1.1% TTM) and grow NOPAT by 57% compounded annually for the next 14 years. This expectation seems overly optimistic for nearly any company, much less one with a history of shareholder value destruction.

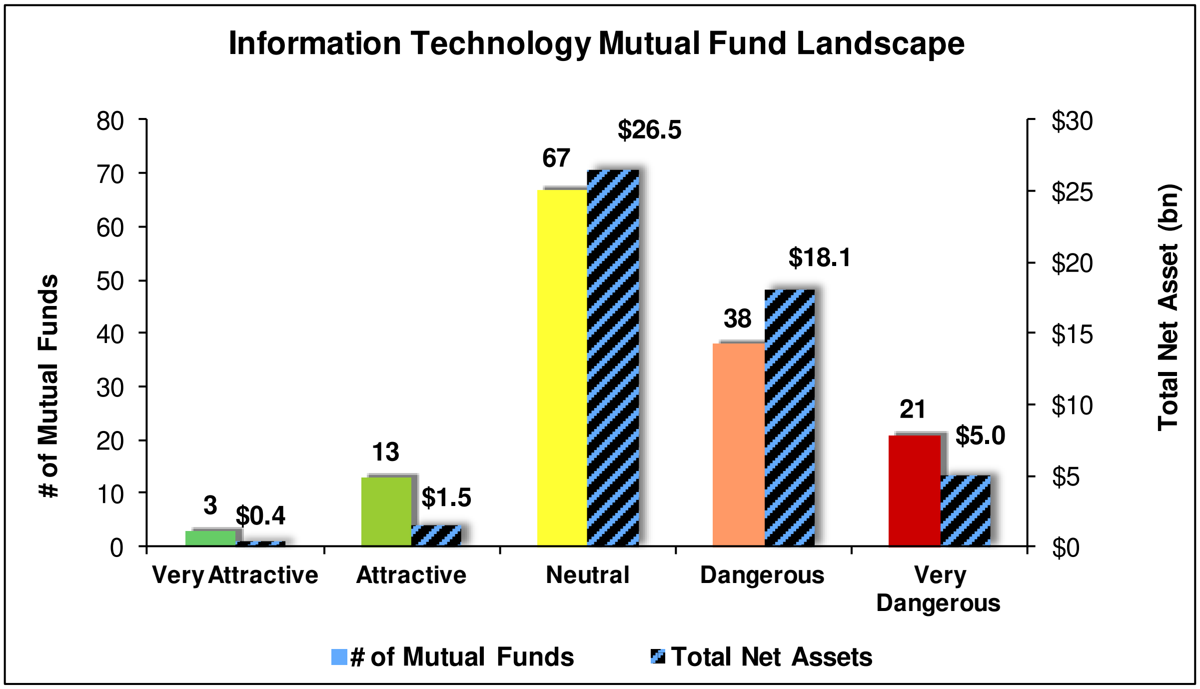
Figures 3 and 4 show the rating landscape of all Information Technology ETFs and mutual funds.

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, Kyle Martone, and Kyle Guske II 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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