Sector Ratings For ETFs & Mutual Funds

At the beginning of the fourth quarter of 2016, only the Consumer Staples and Consumer Discretionary sectors earn an Attractive-or-better rating. Our sector ratings are based on the aggregation of our fund ratings for every ETF and mutual fund in each sector. See last quarter's Sector Ratings here.

Investors looking for sector funds that hold quality stocks should look no further than the Consumer Staples and Consumer Discretionary sectors. These sectors house the highest rated funds. Figures 4 through 7 provide more details. The primary driver behind an Attractive fund rating is good portfolio management, or good stock picking, with low total annual costs.

Attractive-or-better ratings do not always correlate with Attractive-or-better total annual costs. This fact underscores that (1) cheap funds can dupe investors and (2) investors should invest only in funds with good stocks and low fees.

See Figures 4 through 13 for a detailed breakdown of ratings distributions by sector. See our ETF & mutual fund screener for rankings, ratings and reports on 7000+ mutual funds and 400+ ETFs. Our fund rating methodology is detailed here.

All of our reports on the best & worst ETFs and mutual funds in every sector are available here.

Figure 1: Ratings For All Sectors

Sector	Overall Rating
Energy	Dangerous
Telecom	Dangerous
Utilities	Dangerous
Health Care	Dangerous
Materials	Dangerous
Financials	Neutral
Industrials	Neutral
Info Tech	Neutral
Cons Disc	Attractive
Cons Staples	Attractive

Source: New Constructs, LLC and company filings

To earn an Attractive-or-better Predictive Rating, an ETF or mutual fund must have high-quality holdings and low costs. Only the top 30% of all ETFs and mutual funds earn our Attractive or better ratings.

Consumer Staples Select Sector SPDR Fund (XLP) is the top rated Consumer Staples fund. It gets our Very Attractive rating by allocating over 19% of its value to Attractive-or-better-rated stocks.

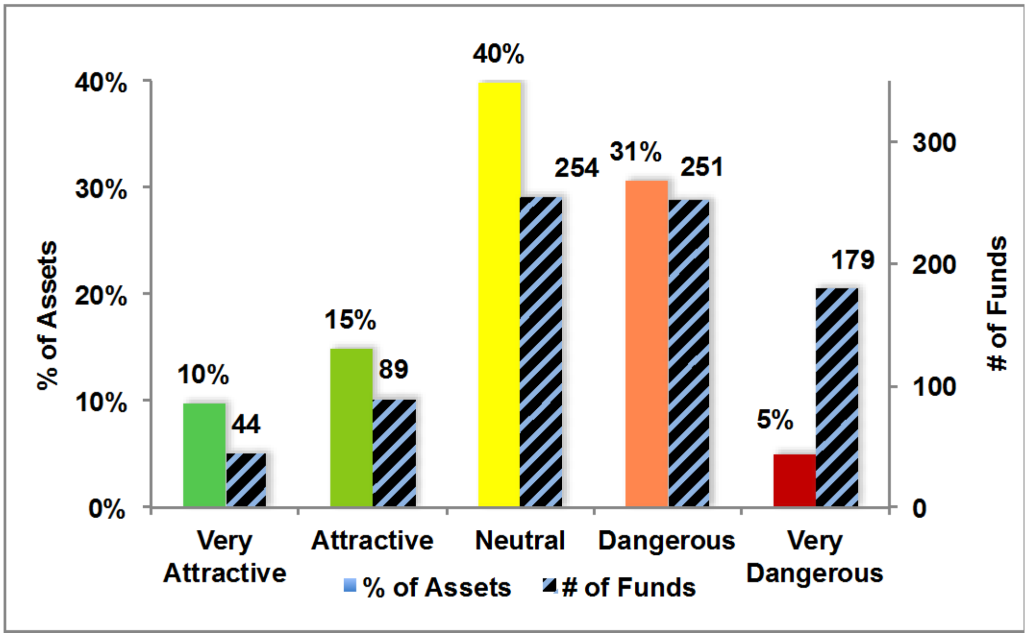
ConAgra Foods, Inc. (CAG: $48/share) is one of our favorite stocks held by XLP and earns an Attractive rating. Since 2008, CAG has grown after-tax operating profit (NOPAT) by 9% compounded annually. At the same time, the company has improved its return on invested capital (ROIC), from 7% in 2008 to 8% over the last twelve months (TTM). Further showcasing the strength of CAG's business, it has generated cumulative $1.7 billion in free cash flow (FCF) over the past five years. Despite the fundamental strength of the business, CAG remains undervalued. At its current price of $48/share, CAG has a price to economic-book-value (PEBV) ratio of 1.1. This ratio means that the market expects ConAgra's NOPAT to grow by only 10% over its remaining corporate life. This expectation seems rather pessimistic given ConAgra has grown NOPAT by 9% each year since 2008. If CAG can maintain 2016 NOPAT margins (12%) and grow NOPAT by only 5% compounded annually for the next decade, the stock is worth $68/share today – a 42% upside.

Rydex: Energy Services Fund (RYESX) is the worst Energy fund. It gets our Very Dangerous rating by allocating over 72% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors total annual costs of 6.35%.

RPC Inc. (RES: $17/share) is one of our least favorite stocks held by RYESX and earns a Dangerous rating. RPC's economic earnings have declined from $27 million in 2005 to -$230 million in 2015, and further declined to -$281 million over the last twelve months. RPC's ROIC has declined from 22% in 2005 to a bottom-quintile -14% TTM. Despite the deteriorating fundamentals, RPC remains significantly overvalued. To justify its current price of $17/share, RPC must immediately achieve 14% pre-tax margins (average over the last five years, compared to -29% TTM) and grow revenue by 14% compounded annually for the next 13 years. This expectation seems overly optimistic given RPC's decade of shareholder value destruction. This scenario also assumes RPC can grow revenue and NOPAT without spending on working capital or fixed assets, which is highly unlikely, but allows us to create a very optimistic scenario. For reference, RPC's invested capital has grown on average $83 million (7% of 2015 revenue) per year over the last five years.

Figure 2 shows the distribution of our Predictive Ratings for all sector ETFs and mutual funds.

Figure 2: Distribution of ETFs & Mutual Funds (Assets and Count) by Predictive Rating



Source: New Constructs, LLC and company filings

Figure 3 offers additional details on the quality of the sector funds. Note that the average total annual cost of Very Dangerous funds is almost ten times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	44	89	254	251	179
% of ETFs & Funds	5%	11%	31%	31%	22%
% of TNA	10%	15%	40%	31%	5%
Avg TAC	0.30%	0.35%	0.60%	0.81%	2.91%

* Avg TAC = Weighted Average Total Annual Costs

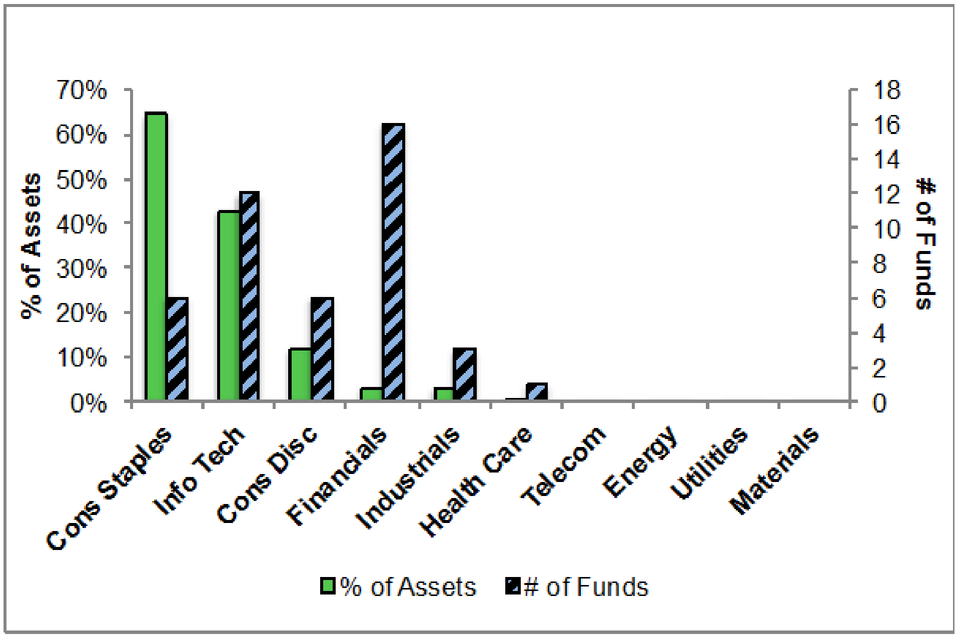
Source: New Constructs, LLC and company filings

This table shows that only the best of the best funds get our Very Attractive Rating: they must hold good stocks AND have low costs. Investors deserve to have the best of both and we are here to give it to them.

Ratings by Sector

Figure 4 presents a mapping of Very Attractive funds by sector. The chart shows the number of Very Attractive funds in each sector and the percentage of assets in each sector allocated to funds that are rated Very Attractive.

Figure 4: Very Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4.

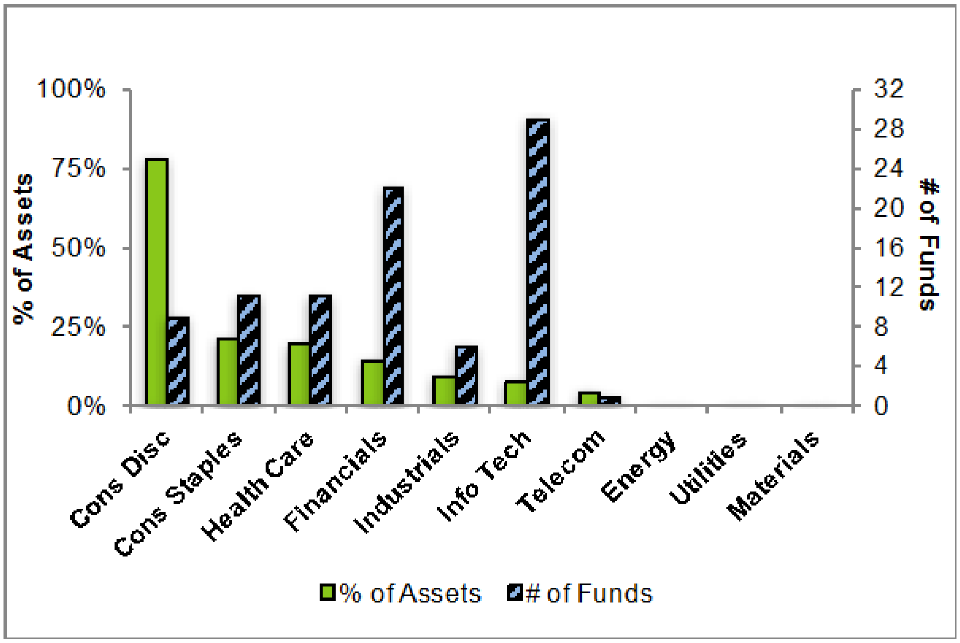
Figure 5: Very Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Cons Staples	64%	6	27%
Info Tech	43%	12	8%
Cons Disc	12%	6	19%
Financials	3%	16	6%
Industrials	3%	3	8%
Health Care	0%	1	1%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%
Materials	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 6 presents a mapping of Attractive funds by sector. The chart shows the number of Attractive funds in each sector and the percentage of assets allocated to Attractive-rated funds in each sector.

Figure 6: Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

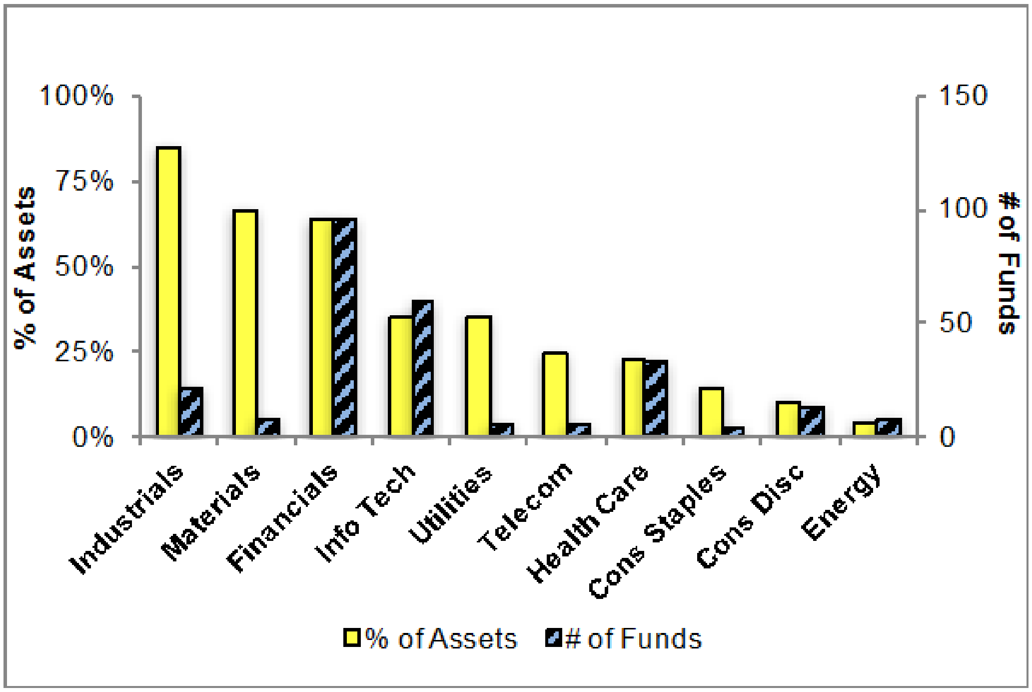
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Cons Disc	78%	9	28%
Cons Staples	21%	11	50%
Health Care	19%	11	11%
Financials	14%	22	8%
Industrials	10%	6	17%
Info Tech	8%	29	19%
Telecom	5%	1	5%
Energy	0%	0	0%
Utilities	0%	0	0%
Materials	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 8 presents a mapping of Neutral funds by sector. The chart shows the number of Neutral funds in each sector and the percentage of assets allocated to Neutral-rated funds in each sector.

Figure 8: Neutral ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

Figure 9: Neutral ETFs & Mutual Funds by Sector

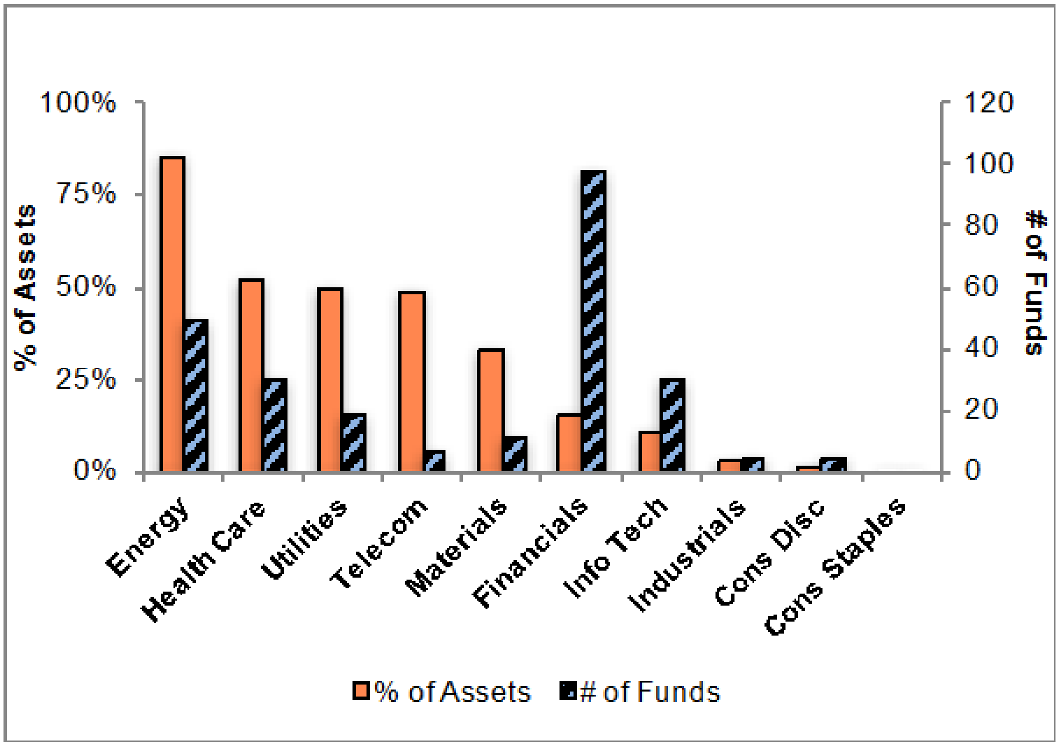
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Industrials	85%	22	61%
Materials	67%	8	38%
Financials	64%	96	35%
Info Tech	36%	59	40%
Utilities	35%	5	13%
Telecom	25%	6	27%
Health Care	23%	33	33%
Cons Staples	14%	4	18%
Cons Disc	10%	13	41%
Energy	4%	8	6%

Source: New Constructs, LLC and company filings

Figure 10 presents a mapping of Dangerous funds by fund sector. The chart shows the number of Dangerous funds in each sector and the percentage of assets allocated to Dangerous-rated funds in each sector.

The landscape of sector ETFs and mutual funds is littered with Dangerous funds. Investors in Energy funds have put over 86% of their assets in Dangerous-rated funds.

Figure 10: Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

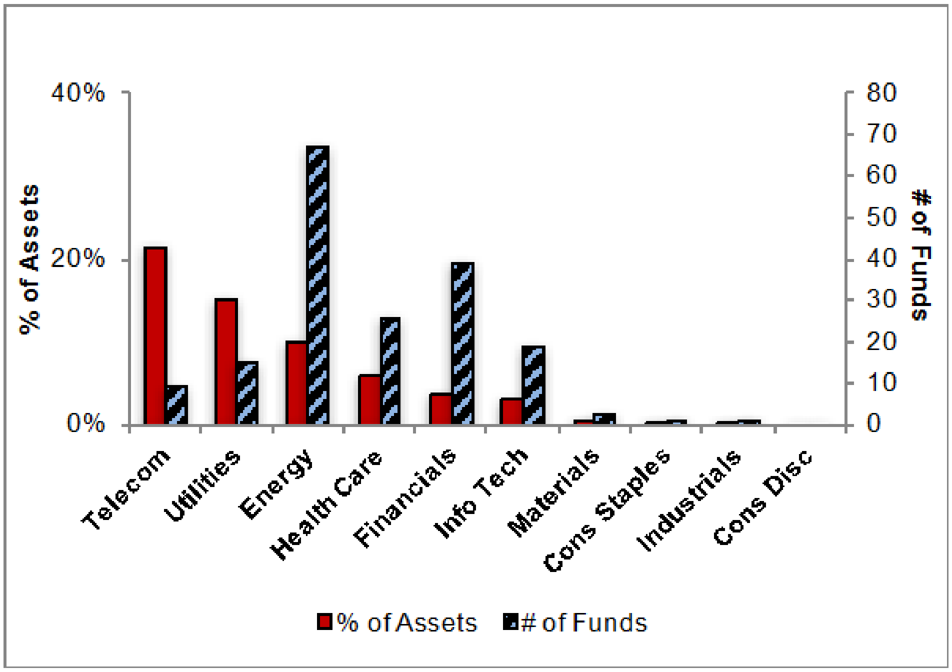
Figure 11: Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Energy	86%	49	40%
Health Care	85%	30	30%
Utilities	50%	19	49%
Telecom	49%	6	27%
Materials	33%	11	52%
Financials	15%	98	36%
Info Tech	11%	30	20%
Industrials	2%	4	11%
Cons Disc	1%	4	13%
Cons Staples	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 12 presents a mapping of Very Dangerous funds by fund sector. The chart shows the number of Very Dangerous funds in each sector and the percentage of assets in each sector allocated to funds that are rated Very Dangerous.

Figure 12: Very Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

Figure 13: Very Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Dangerous Funds	% of Very Dangerous Funds in Sector
Telecom	21%	9	41%
Utilities	15%	15	38%
Energy	10%	67	54%
Health Care	6%	26	26%
Financials	4%	39	14%
Info Tech	3%	19	13%
Materials	0%	2	10%
Cons Staples	0%	1	5%
Industrials	0%	1	3%
Cons Disc	0%	0	0%

Source: 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.

Appendix: Predictive Fund Rating System

New Constructs' Predictive fund Ratings enable smarter investing by assessing the key drivers of future fund performance. We start by analyzing every funds' holdings based on New Constructs' stock ratings, which are regularly featured as among the best by Barron's. Next, we measure and rank the all-in fund expenses. Finally, we rank the fund compared to all other funds to identify the best and worst funds in the market.

Intuitively, there are two drivers for future fund performance.

1. Stock-picking (Portfolio Management Rating) and
2. Fund expenses (Total Annual Costs Rating)

Our Predictive Fund Rating is based on these drivers and the fund's ranking:

1. Top 10% = Very Attractive Rating
2. Next 20% = Attractive Rating
3. Next 40% = Neutral Rating
4. Next 20% = Dangerous Rating
5. Bottom 10% = Very Dangerous Rating

The figure below details the criteria that drive our Predictive Rating system for funds. The two drivers of our predictive ratings system are Portfolio Management and Total Annual Costs. The Portfolio Management ratings (detail here) is the same as our Stock Rating (detail here) except that we incorporate Asset Allocation (details here). The Total Annual Costs Ratings (details here) captures the all-in costs of being in a fund over a 3-year holding period, the average period for all mutual funds.

Predictive Rating	Portfolio Management Rating						Total Annual Costs
	Business Strength		Valuation			Cash Allocation	
	Quality of Earnings	Return on Invested Capital	FCF Yield	Price to Economic Book Value	Market-Implied Duration of Growth		
Very Dangerous	Misleading Trend	Bottom Quintile	< -5%	>3.5 or -1<0	> 50	> 20%	> 4 %
Dangerous	False Positive	4th Quintile	-5% < -1%	2.4<3.5 or <-1	20 < 50	8% < 20%	2% < 4%
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20	2.5% < 8%	1% < 2%
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10	1% < 2.5%	0.5% < 1%
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3	<1%	< 0.5%

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.

Additional Information

Incorporated in July 2002, New Constructs is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. NOPAT, Invested Capital, and WACC, to create economic earnings models, which are necessary to understand the true profitability and valuation of companies. Visit the Free Archive to download samples of our research. New Constructs is a BBB accredited business and a member of the Investorside Research Association.

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