Investment Style Ratings For ETFs, Mutual Funds & Stocks

At the beginning of the fourth quarter of 2016, only the Large Cap Blend and All Cap Blend styles earn an Attractive-or-better rating. Our style ratings are based on the aggregation of our fund ratings for every ETF and mutual fund in each style. See last quarter's Style Ratings here.

Investors looking for style funds that hold quality stocks should look no further than the Large Cap Blend and All Cap Blend styles. 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 investment style. 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 investment style are available here.

Figure 1: Ratings For All Investment Styles

Style	Overall Rating
Small Cap Value	Dangerous
Small Cap Growth	Dangerous
Small Cap Blend	Dangerous
Mid Cap Value	Dangerous
Mid Cap Growth	Neutral
Mid Cap Blend	Neutral
All Cap Growth	Neutral
All Cap Value	Neutral
Large Cap Growth	Neutral
Large Cap Value	Neutral
All Cap Blend	Attractive
Large Cap Blend	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 rating.

Nuveen Concentrated Core Fund (NCARX) is the top rated Large Cap Blend fund. It gets our Very Attractive rating by allocating over 52% of its value to Attractive-or-better-rated stocks.

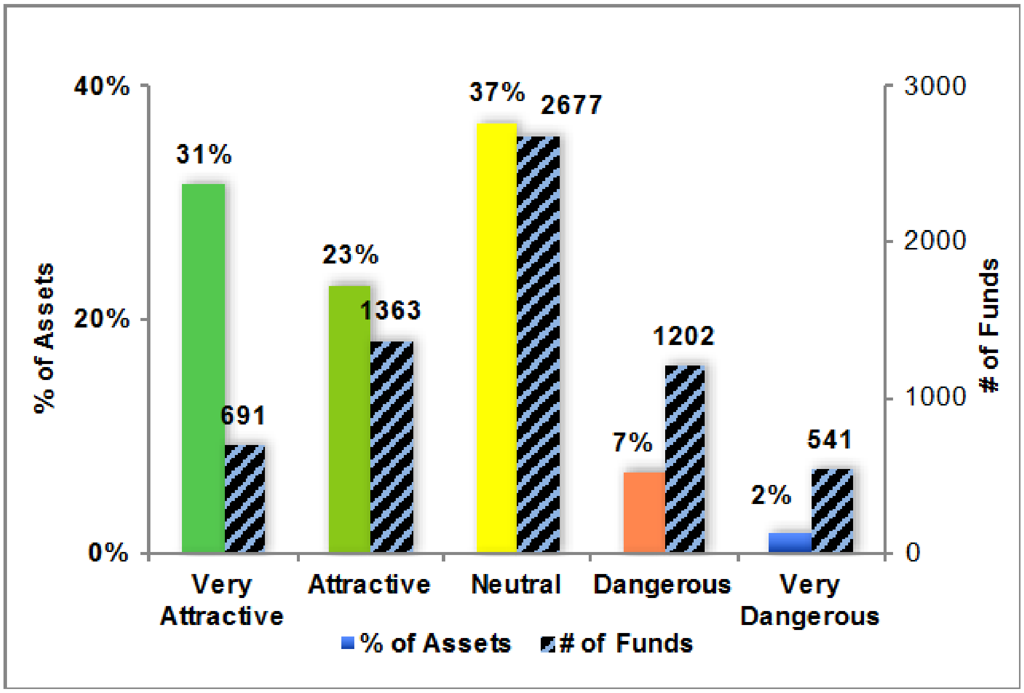
Southwest Airlines Company (LUV $42/share) is one of our favorite stocks held by NCARX and earns a Very Attractive rating. Southwest was a featured Long Idea in July, is on October's Most Attractive Stocks list, and also on October's Executive Compensation Aligned with ROIC model portfolio. Over the past decade, Southwest has grown after-tax profit (NOPAT) by 17% compounded annually to $2.8 billion in 2015, and to $3 billion over the last twelve months (TTM). Southwest has increased its return on invested capital (ROIC) from 6% in 2005 to a top-quintile 19% TTM. Despite the improving fundamentals, Southwest remains undervalued. At its current price of $42/share, LUV has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects LUV's NOPAT to permanently decrease by 20%. If LUV can grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $62/share today – a 48% upside.

Ivy Small Cap Value Fund (IYVIX) is the worst rated Small Cap Value fund. It gets our Very Dangerous rating by allocating over 57% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors total annual costs of 4.95%.

FormFactor Inc. (FORM $10/share) is one of our least favorite stocks held by style ETFs and mutual funds and earns a Very Dangerous rating. FORM is on October's Most Dangerous Stocks as well. Over the past decade, FORM's NOPAT has declined by 10% compounded annually to $4 million in 2015, and declined further, to -$8 million TTM. FORM's ROIC has declined from 43% in 2006 to a bottom-quintile -2% TTM. Despite the clear deterioration in business operations, FORM remains priced for significant profit growth. To justify its current price of $10/share, FORM must grow NOPAT by 23% compounded annually for the next 16 years. This expectation seems overly optimistic given FORM's history of declining profits.

Figure 2 shows the distribution of our Predictive Ratings for all investment style 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 investment style funds. Note that the average total annual cost of Very Dangerous funds is almost 18 times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	691	1363	2677	1202	541
% of ETFs & Funds	11%	21%	41%	19%	8%
% of TNA	31%	23%	37%	7%	2%
Avg TAC	0.18%	0.70%	1.21%	2.08%	3.15%

* Avg TAC = Weighted Average Total Annual Costs

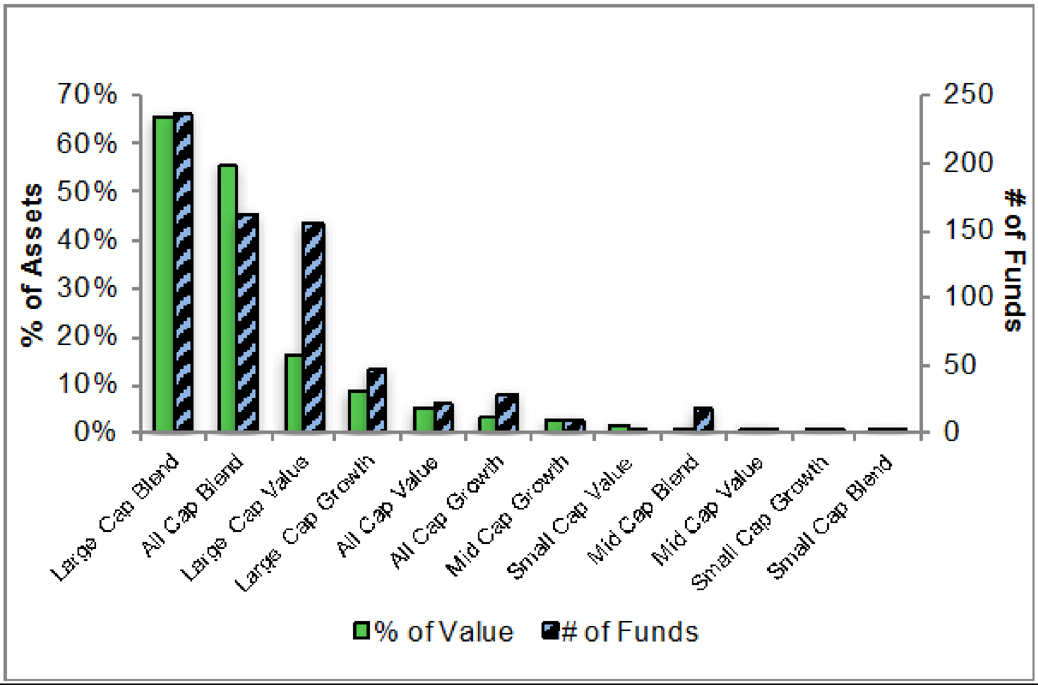
Source: New Constructs, LLC and company filings

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 Investment Style

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

Figure 4: Very Attractive ETFs & Mutual Funds by Investment Style



Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4

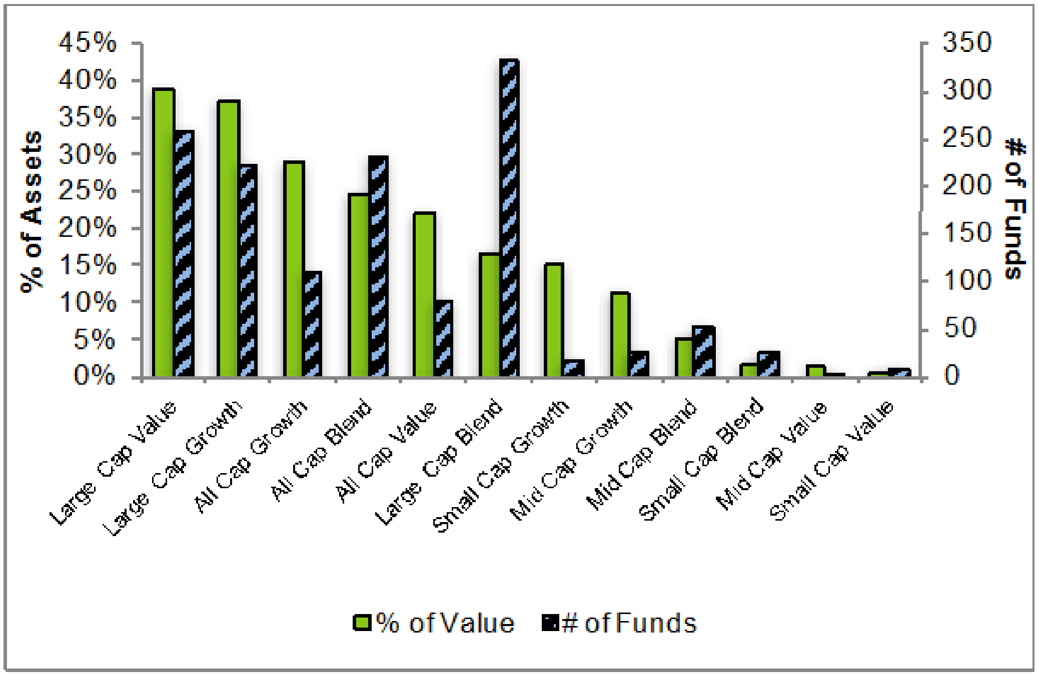
Figure 5: Very Attractive ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Very Attractive Funds	% of Very Attractive Funds in Style
Large Cap Blend	65%	236	26%
All Cap Blend	55%	161	20%
Large Cap Value	16%	156	17%
Large Cap Growth	8%	48	7%
All Cap Value	5%	21	6%
All Cap Growth	3%	29	5%
Mid Cap Growth	3%	10	3%
Small Cap Value	1%	4	1%
Mid Cap Blend	1%	17	4%
Mid Cap Value	0%	2	2%
Small Cap Growth	0%	3	1%
Small Cap Blend	0%	4	1%

Source: New Constructs, LLC and company filings

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

Figure 6: Attractive ETFs & Mutual Funds by Investment Style



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

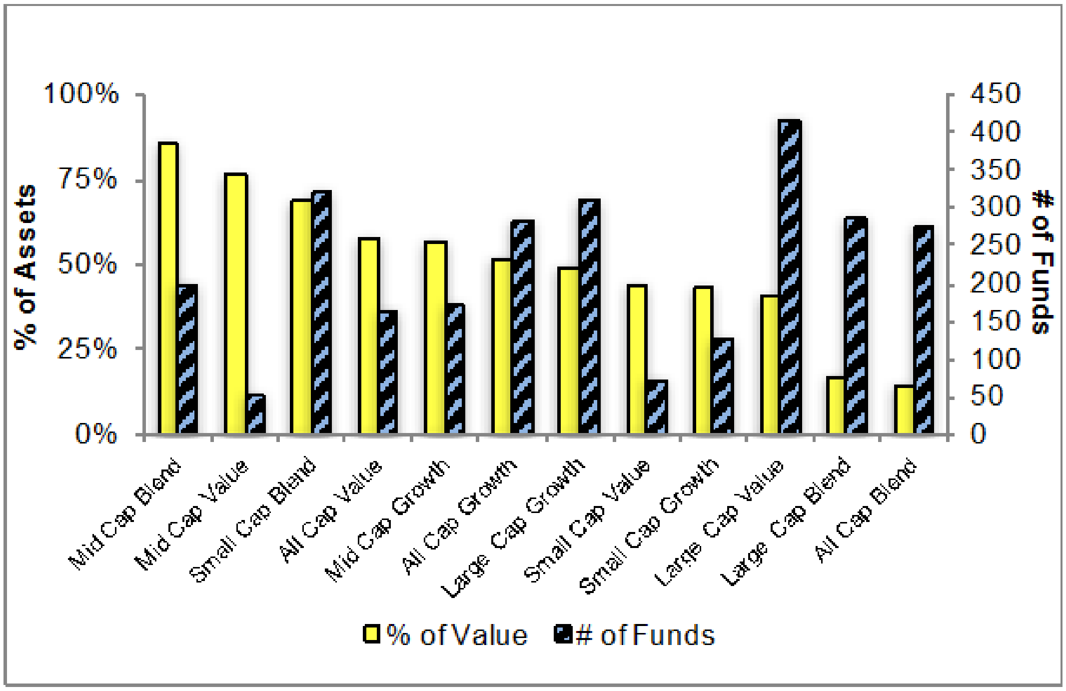
Figure 7: Attractive ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Attractive Funds	% of Attractive Funds in Style
Large Cap Value	39%	258	28%
Large Cap Growth	37%	223	33%
All Cap Growth	29%	109	20%
All Cap Blend	25%	232	30%
All Cap Value	22%	79	23%
Large Cap Blend	17%	333	37%
Small Cap Growth	15%	15	4%
Mid Cap Growth	11%	25	7%
Mid Cap Blend	5%	53	13%
Small Cap Blend	2%	25	3%
Mid Cap Value	2%	3	3%
Small Cap Value	1%	8	3%

Source: New Constructs, LLC and company filings

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

Figure 8: Neutral ETFs & Mutual Funds by Investment Style



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

Figure 9: Neutral ETFs & Mutual Funds by Investment Style

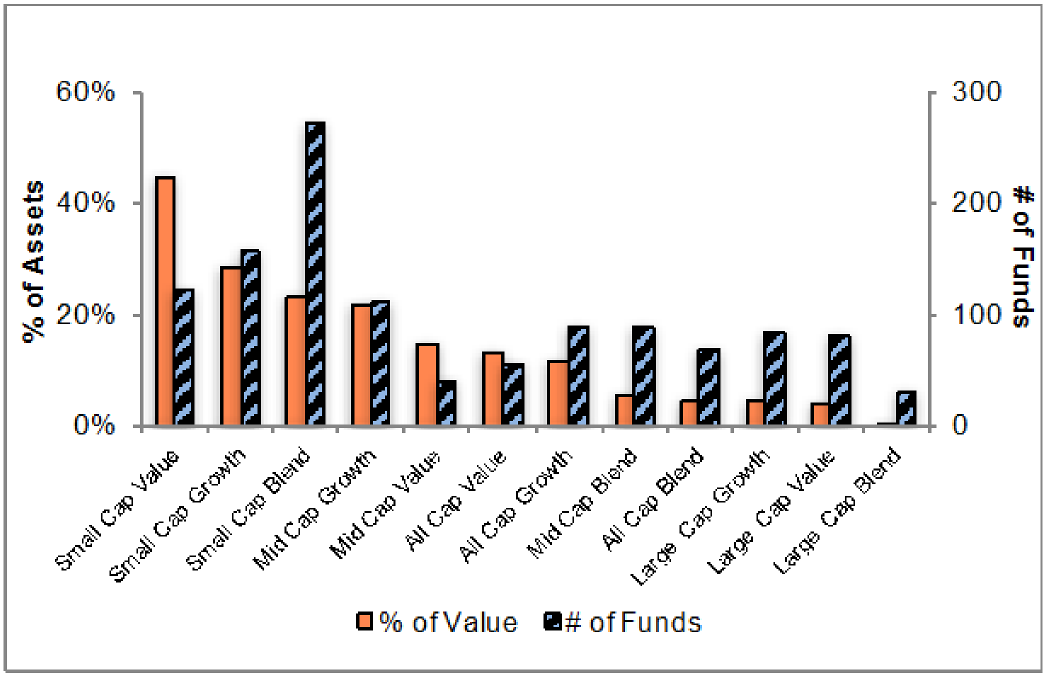
Style	% of Style Assets	# of Neutral Funds	% of Neutral Funds in Style
Mid Cap Blend	86%	200	50%
Mid Cap Value	76%	53	48%
Small Cap Blend	69%	321	42%
All Cap Value	57%	162	48%
Mid Cap Growth	57%	172	47%
All Cap Growth	52%	281	52%
Large Cap Growth	49%	311	46%
Small Cap Value	44%	73	26%
Small Cap Growth	43%	125	32%
Large Cap Value	40%	418	45%
Large Cap Blend	17%	286	32%
All Cap Blend	14%	275	35%

Source: New Constructs, LLC and company filings

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

The landscape of style ETFs and mutual funds is littered with Dangerous funds. Investors in Small Cap Value have put over 44% of their assets in Dangerous-rated funds.

Figure 10: Dangerous ETFs & Mutual Funds by Investment Style



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

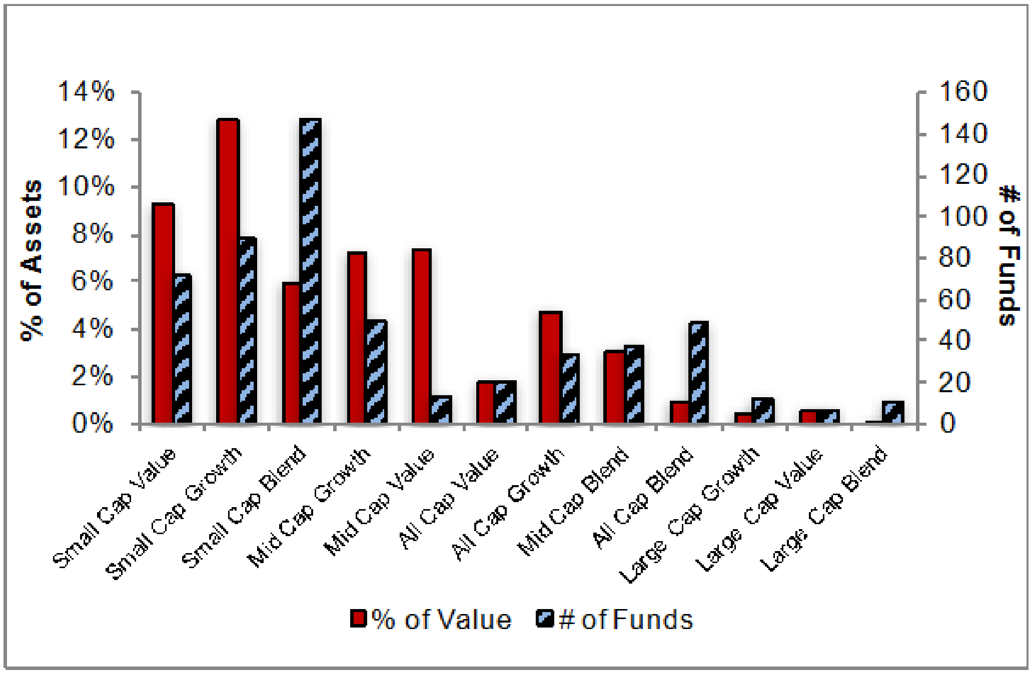
Figure 11: Dangerous ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Dangerous Funds	% of Dangerous Funds in Style
Small Cap Value	45%	123	44%
Small Cap Growth	29%	157	40%
Small Cap Blend	23%	273	35%
Mid Cap Growth	22%	112	30%
Mid Cap Value	15%	39	35%
All Cap Value	13%	55	16%
All Cap Growth	11%	90	17%
Mid Cap Blend	6%	90	23%
All Cap Blend	4%	69	9%
Large Cap Growth	4%	84	12%
Large Cap Value	4%	80	9%
Large Cap Blend	1%	30	3%

Source: New Constructs, LLC and company filings

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

Figure 12: Very Dangerous ETFs & Mutual Funds by Investment Style



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

Figure 13: Very Dangerous ETFs & Mutual Funds by Investment Style

Style	% of Style Assets	# of Very Dangerous Funds	% of Very Dangerous Funds in Style
Small Cap Value	9%	72	26%
Small Cap Growth	13%	89	23%
Small Cap Blend	6%	147	19%
Mid Cap Growth	7%	50	14%
Mid Cap Value	7%	13	12%
All Cap Value	2%	20	6%
All Cap Growth	5%	34	6%
Mid Cap Blend	3%	38	10%
All Cap Blend	1%	49	6%
Large Cap Growth	0%	12	2%
Large Cap Value	1%	7	1%
Large Cap Blend	0%	10	1%

Source: New Constructs, LLC and company filings

This article originally published [here](#) on October 21, 2016.

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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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

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