ETF & Mutual Fund Rankings: Utilities Sector

The Utilities sector ranks eighth out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Utilities sector ranked last. It gets our Dangerous rating, which is based on an aggregation of ratings of nine ETFs and 39 mutual funds in the Utilities sector as of October 19, 2016. See a recap of our 3Q16 Sector Ratings here.

Figure 1 ranks from best to worst the eight Utilities ETFs that meet our liquidity standards and Figure 2 shows the five best and worst rated Utilities mutual funds. Not all Utilities sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 20 to 249). This variation creates drastically different investment implications and, therefore, ratings.

Investors should not buy any Utilities ETFs or mutual funds because none get an Attractive-or-better rating. If you must have exposure to this sector, you should buy a basket of Attractive-or-better rated stocks and avoid paying undeserved fund fees. Active management has a long history of not paying off.

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 (only 3)				
FUTY	1%	11%	85%	**Neutral**
VPU	1%	11%	84%	**Neutral**
XLU	0%	12%	88%	**Neutral**
Worst ETFs				
IDU	1%	11%	85%	**Neutral**
UTES	0%	8%	82%	**Neutral**
RYU	3%	9%	88%	**Dangerous**
PUI	4%	2%	92%	**Dangerous**
FXU	5%	10%	83%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

PowerShares S&P SmallCap Utilities (PSCU) is excluded from Figure 1 because its 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				
BULIX	18%	17%	62%	Neutral
VUIAX	1%	11%	84%	Neutral
FUFRX	0%	13%	76%	Neutral
FRUAX	0%	13%	76%	Neutral
EVUYX	1%	18%	67%	Neutral
Worst Mutual Funds				
ICTVX	2%	17%	77%	Very Dangerous
PUTBX	0%	5%	57%	Very Dangerous
PUTMX	0%	5%	57%	Very Dangerous
PUGIX	0%	5%	57%	Very Dangerous
RYUTX	1%	11%	76%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Fidelity MSCI Utilities Index ETF (FUTY) is the top-rated Utilities ETF and American Century Utilities Fund (BULIX) is the top-rated Utilities mutual fund. Both earn a Neutral rating.

First Trust Utilities Fund (FXU) is the worst rated Utilities ETF and Rydex Utilities Fund (RYUTX) is the worst rated Utilities mutual fund. Both earn a Very Dangerous rating.

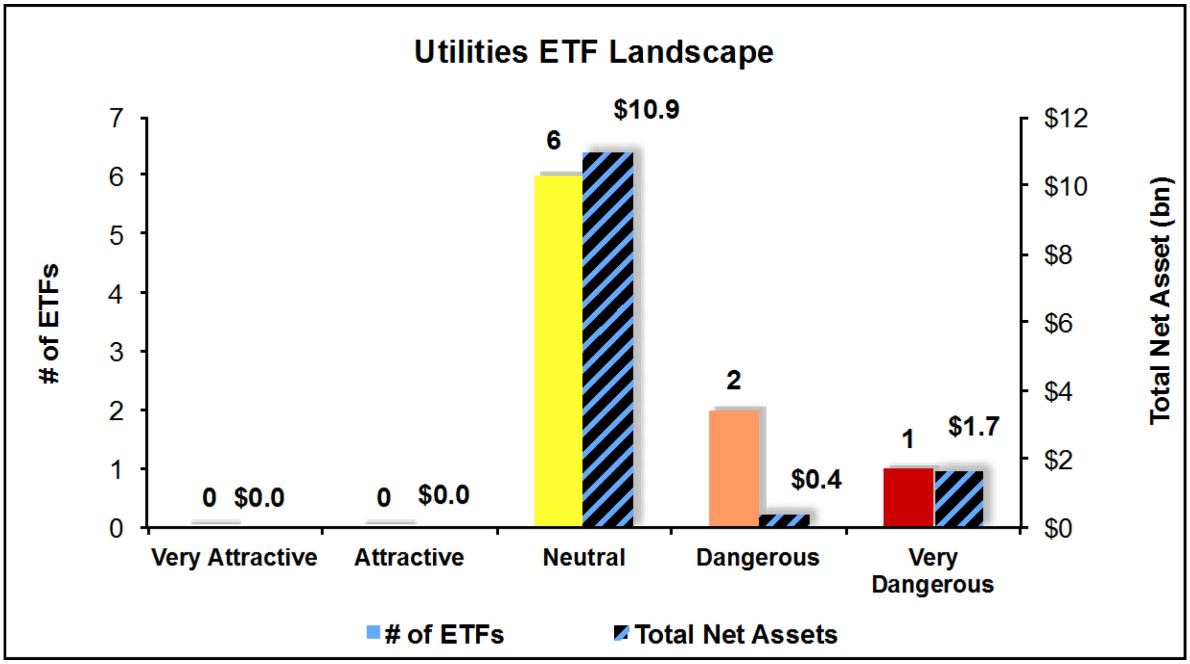
75 stocks of the 3000+ we cover are classified as Utilities stocks.

UGI Corporation (UGI: $45/share) is one of our favorite stocks held by Utilities ETFs and mutual funds and earns an Attractive rating. Over the past decade, UGI has grown after-tax profit (NOPAT) by 7% compounded annually to $610 million in 2015 and even further, to $773 million over the last twelve months (TTM). The company's return on invested capital (ROIC) has improved from 4% in 2012 to 8% TTM. Despite the improvement in underlying fundamentals, UGI remains undervalued. At its current price of $45/share, UGI has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means that the market expects UGI's NOPAT to permanently decline by 10%. This expectation seems rather pessimistic given that UGI has grown NOPAT by 8% compounded annually over the past decade. If UGI can grow NOPAT by 7% compounded annually for the next decade, the stock is worth $56/share today – a 24% upside.

Chesapeake Utilities Corp (CPK: $61/share) is one of our least favorite stocks held by Utilities ETFs and mutual funds and earns a Very Dangerous rating. CPK has generated negative economic earnings in every year of our model (dates back to 1998) and economic earnings have declined from -$8 million in 2005 to -$28 million TTM. The company's ROIC has fallen from 6% in 2010 to 5% TTM. Despite the shareholder value destruction, CPK is still priced for significant profit growth. To justify its current price of $61/share, CPK must grow NOPAT by 10% compounded annually over the next 13 years. This expectation seems overly optimistic given CPK's inability to generate true profits over the past decade.

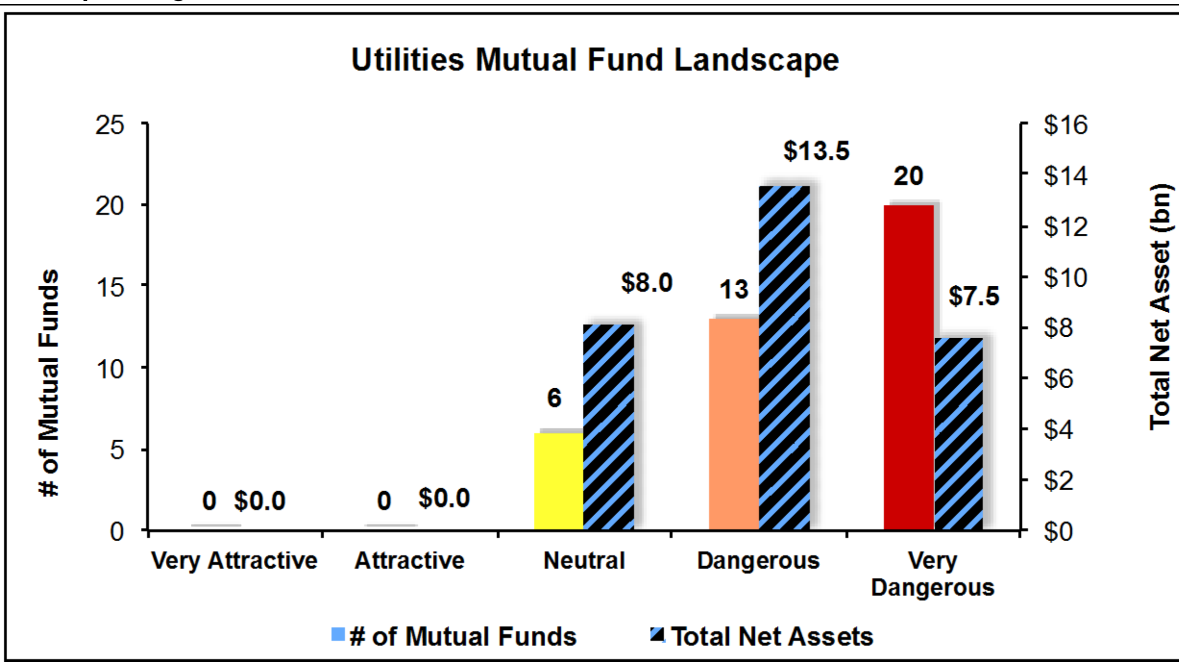
Figures 3 and 4 show the rating landscape of all Utilities ETFs and mutual funds.

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.

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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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