ETF & Mutual Fund Rankings: Small Cap Growth Style

The Small Cap Growth style ranks eleventh out of the twelve fund styles as detailed in our 4Q16 Style Ratings for ETFs and Mutual Funds report. Last quarter, the Small Cap Growth style ranked eleventh as well. It gets our Dangerous rating, which is based on an aggregation of ratings of 12 ETFs and 383 mutual funds in the Small Cap Growth style as of November 8, 2016. See a recap of our 3Q16 Style Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the style. Not all Small Cap Growth style ETFs and mutual funds are created the same. The number of holdings varies widely (from 22 to 1843). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Small Cap Growth style 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				
SLYG	13%	41%	38%	Attractive
IJT	13%	41%	37%	Attractive
RFG	11%	45%	39%	Attractive
VIOG	13%	41%	36%	Attractive
JKK	7%	26%	51%	Neutral
Worst ETFs				
IWO	11%	26%	43%	Neutral
JKK	7%	25%	51%	Neutral
RZG	15%	39%	35%	Neutral
DWAS	10%	31%	46%	Neutral
PXSG	8%	22%	46%	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				
VSCRX	19%	40%	23%	Very Attractive
PKSFX	19%	40%	23%	Very Attractive
PKSCX	19%	40%	23%	Attractive
NRGSX	15%	51%	26%	Attractive
NBGIX	15%	51%	26%	Attractive
Worst Mutual Funds				
NSPAX	7%	28%	50%	Very Dangerous
FCAGX	6%	21%	44%	Very Dangerous
FRMPX	8%	23%	48%	Very Dangerous
AEGAX	9%	23%	50%	Very Dangerous
PQUAX	3%	12%	23%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Walden SMID Cap Fund (WASMX) is excluded from Figure 2 because its total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

SPDR S&P 600 Small Cap Growth ETF (SLYG) is the top-rated Small Cap Growth ETF and Virtus Small-Cap Core Fund (VSCRX) is the top-rated Small Cap Growth mutual fund. SLYG earns an Attractive rating and VSCRX earns a Very Attractive rating.

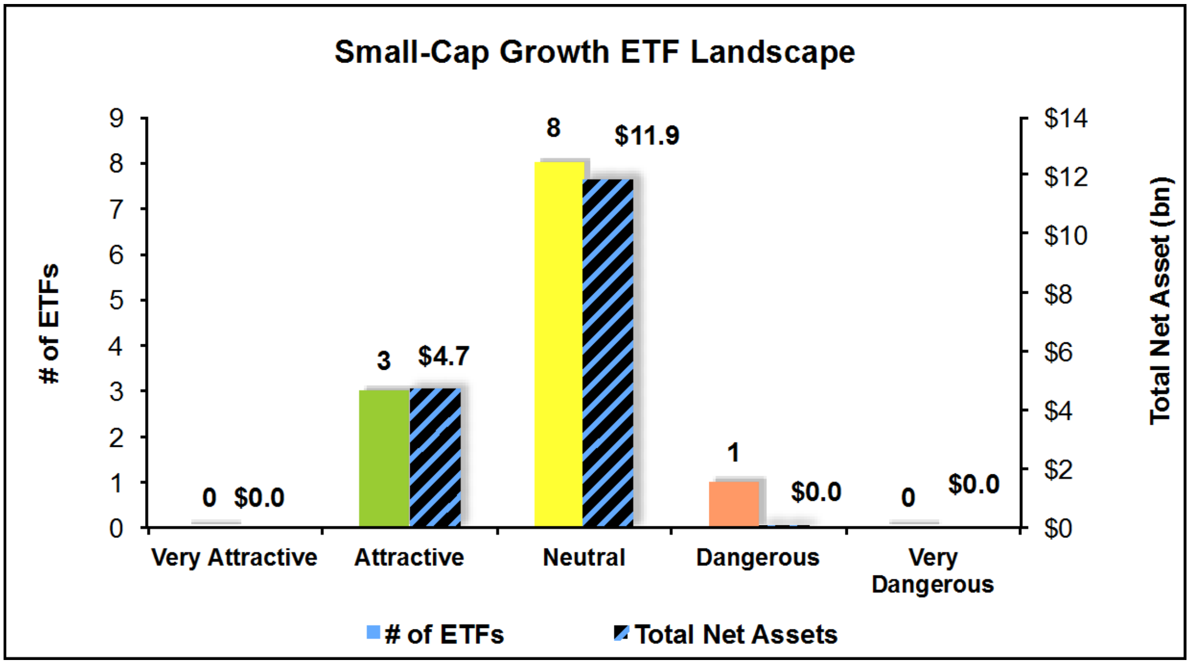
PowerShares Russell 2000 Pure Growth Portfolio (PXSG) is the worst rated Small Cap Growth ETF and PACE Small/Medium Growth Equity Investments (PQUAX) is the worst rated Small Cap Growth mutual fund. PXSG earns a Dangerous rating and PQUAX earns a Very Dangerous rating.

Skechers USA (SKX: $21/share) is one of our favorite stocks held by RFG and earns a Very Attractive rating. SKX was featured as a Long Idea in April 2016 and is on this month's Most Attractive Stocks list. Over the past decade, Skechers has grown after-tax profit (NOPAT) by 19% compounded annually. The company has improved its return on invested capital (ROIC) from an already impressive 11% in 2005 to a top-quintile 17% over the last twelve months (TTM). Despite the long-term improvement in the business fundamentals, SKX remains significantly undervalued. At its current price of $21/share, SKX has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means the market expects SKX's NOPAT to permanently decline by 10%. If SKX can grow NOPAT by just 8% compounded annually over the next decade, the stock is worth $34/share today –a 62% upside.

SPS Commerce (SPSC: $62/share) is one of our least favorite stocks held by PQUAX and earns a Very Dangerous rating. SPCS was also placed in the Danger Zone in August 2016. SPSC's economic earnings have declined from $2 million in 2010 to -$5 million TTM. The company's ROIC has fallen from an impressive 24% in 2010 to a bottom-quintile 4% TTM all while the company has burned through $81 million in free cash flow since 2011. Despite the business operations heading in the wrong direction, SPSC remains priced for significant profit growth. To justify its current price of $62/share, SPSC must grow NOPAT by 18% compounded annually for the next 24 years. These expectations seem awfully high for a business that is currently losing money.

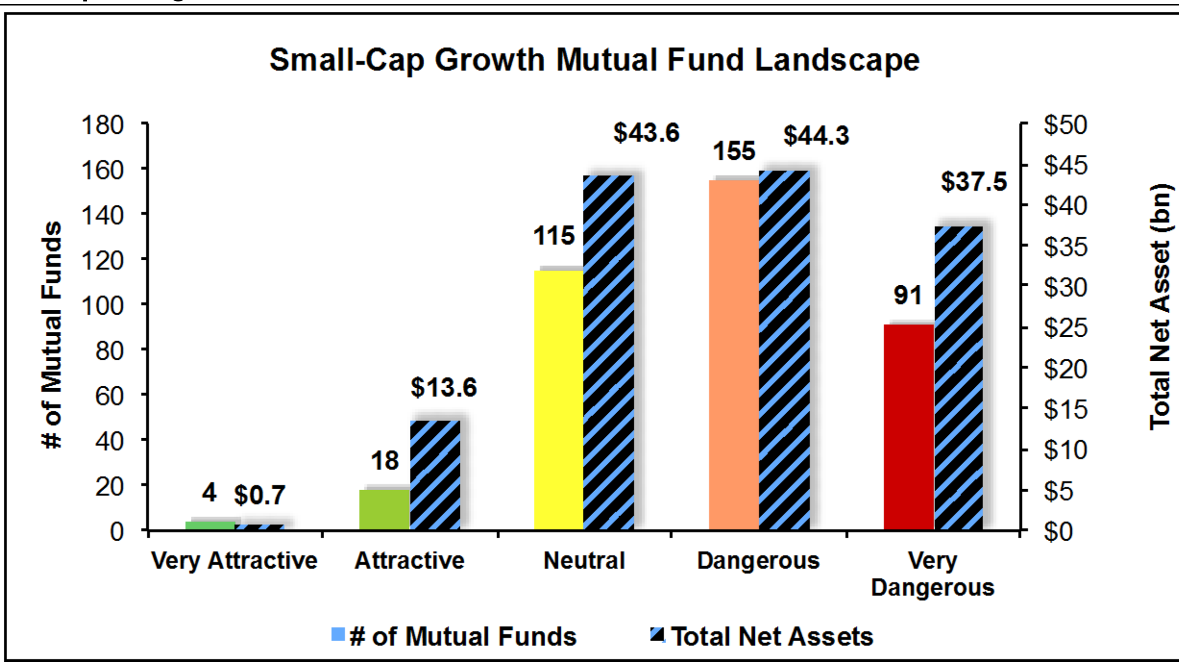
Figures 3 and 4 show the rating landscape of all Small Cap Growth ETFs and mutual funds.

Figure 3: Separating the Best ETFs From the Worst Funds



Sources: New Constructs, LLC and company filings

Figure 4: Separating the Best Mutual Funds From the Worst Funds



Sources: New Constructs, LLC and company filings

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Disclosure: David Trainer, Kyle Guske and Kyle Martone receive no compensation to write about any specific stock, style, or theme.

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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.

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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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