

How To Avoid the Worst Style ETFs

Question: Why are there so many ETFs?

Answer: ETF providers tend to make lots of money on each ETF so they create more products to sell.

The large number of ETFs has little to do with serving your best interests. Below are three red flags you can use to avoid the worst ETFs:

1. Inadequate Liquidity

This issue is the easiest issue to avoid, and our advice is simple. Avoid all ETFs with less than \$100 million in assets. Low levels of liquidity can lead to a discrepancy between the price of the ETF and the underlying value of the securities it holds. Plus, low asset levels tend to mean lower volume in the ETF and larger bid-ask spreads.

2. High Fees

ETFs should be cheap, but not all of them are. The first step here is to know what is cheap and expensive.

To ensure you are paying at or below average fees, invest only in ETFs with [total annual costs](#) below 0.45%, which is the average total annual cost of the 273 U.S. equity Style ETFs we cover. The weighted average is lower at 0.15%, which highlights how investors tend to put their [money in ETFs with low fees](#).

Figure 1 shows ETF Series AlphaClone Alternative ETF (ALFA) is the most expensive style ETF and Schwab U.S. Large Cap ETF (SCHX) is the least expensive. No single ETF sponsor recurs among the most expensive ETFs while Schwab (SCHX, SCHB) and iShares (ITOT, IVV) ETFs are among the cheapest.

Figure 1: 5 Least and Most Expensive Style ETFs

Ticker	Name	Style	Total Annual Cost
Most Expensive			
ALFA	ETF Series AlphaClone Alternative ETF	All Cap Blend	2.47%
FLAG	WeatherStorm Forensic Accounting Long-Short ETF	All Cap Value	1.81%
FWDD	AdvisorShares Madrona Domestic ETF	All Cap Blend	1.39%
ERX	Direxion Daily Energy Bull 3x Shares	All Cap Blend	1.20%
WBIL	WBI Tactical LCS Shares	All Cap Blend	1.17%
Least Expensive			
SCHX	Schwab U.S. Large Cap ETF	Large Cap Blend	0.03%
SCHB	Schwab U.S. Broad Market ETF	All Cap Blend	0.03%
ITOT	iShares Core S&P Total U.S. Stock Market ETF	All Cap Blend	0.03%
IVV	iShares Core S&P 500 ETF	Large Cap Blend	0.04%
VOO	Vanguard 500 Index Fund	Large Cap Blend	0.04%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings. Schwab U.S. Dividend Equity ETF (SCHD) earns our Very Attractive rating and has low total annual costs of only 0.08%.

On the other hand, Schwab U.S. Small Cap ETF (SCHA) holds poor stocks and earns our Unattractive rating, yet has low total annual costs of 0.06%. No matter how cheap an ETF, if it holds bad stocks, its performance will be bad. The quality of an ETFs holdings matters more than its price.



3. Poor Holdings

Avoiding poor holdings is by far the hardest part of avoid bad ETFs, but it is also the most important because an ETF's performance is determined more by its holdings than its costs. Figure 2 shows the ETFs within each style with the worst holdings or [portfolio management ratings](#).

Figure 2: Style ETFs with the Worst Holdings

Ticker	Name	Style	Portfolio Management Rating
DIG	ProShares Ultra Oil & Gas	All Cap Blend	Unattractive
FPX	First Trust Equity Opportunities	All Cap Growth	Unattractive
VONV	Vanguard Russell 1000 Value Index Fund	All Cap Value	Neutral
EQAL	PowerShares Russell 1000 Equal Weight Portfolio	Large Cap Blend	Unattractive
JKE	iShares Morningstar Large-Cap Growth	Large Cap Growth	Neutral
VAMO	Cambria Value and Momentum ETF	Large Cap Value	Unattractive
RYJ	Guggenheim Raymond James SB-1 Equity ETF	Mid Cap Blend	Unattractive
VOT	Vanguard Mid Cap Growth Index ETF	Mid Cap Growth	Unattractive
IWS	iShares Russell Mid Cap Value ETF	Mid Cap Value	Unattractive
EQWS	PowerShares Russell 2000 Equal Weight Portfolio	Small Cap Blend	Unattractive
JKK	iShares Morningstar Small Cap Growth ETF	Small Cap Growth	Unattractive
VTWV	Vanguard Russell 2000 Value Index Fund	Small Cap Value	Unattractive

Sources: New Constructs, LLC and company filings

Vanguard (VONV, VOT, VTWV) and iShares (JKE, IWS, JKK) appear more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

ProShares Ultra Oil & Gas (DIG) is the worst rated ETF in Figure 2. First Trust Equity Opportunities (FPX), iShares Morningstar Small Cap Growth (JKK), Guggenheim Raymond James SB-1 Equity (RYJ), Vanguard Russell 2000 Value Index (VTWV), and PowerShares Russell 2000 Equal Weight (EQWS) also earn an Unattractive [predictive overall rating](#), which means not only do they hold poor stocks, they charge high total annual costs.

Our [overall ratings on ETFs](#) are based primarily on our [stock ratings](#) of their holdings.

The Danger Within

Buying an ETF without analyzing its holdings is like buying a stock without analyzing its business and finances. Put another way, research on ETF holdings is necessary due diligence because an ETF's performance is only as good as its holdings' performance. Don't just take our word for it, [see what Barron's says](#) on this matter.

PERFORMANCE OF ETFs HOLDINGS = PERFORMANCE OF ETF

Analyzing each holding within funds is no small task. Our [Robo-Analyst technology](#) enables us to perform this diligence with scale and provide the [research needed](#) to [fulfill the fiduciary duty of care](#). More of the biggest names in the financial industry (see [At BlackRock, Machines Are Rising Over Managers to Pick Stocks](#)) are now embracing technology to leverage machines in the investment research process. Technology may be the only solution to the dual mandate for research: cut costs and fulfill the fiduciary duty of care. Investors, clients, advisors and analysts deserve the latest in technology to get the diligence required to make prudent investment decisions.

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1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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