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.

Get the best fundamental research

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 0.44%, which is the average total annual cost of the 448 U.S. equity Style ETFs we cover. The weighted average is lower at 0.14%, which highlights how investors tend to put their money in ETFs with low fees.

Figure 1 shows Exchange Traded Forensic Accounting Long-Short (FLAG) is the most expensive style ETF and State Street SPDR Portfolio Large Cap (SPLG) is the least expensive. WBI Investments provides two of the most expensive ETFs while State Street ETFs are among the cheapest.

Figure 1: 5 Most and Least Expensive Style ETFs

Ticker	Name	Style	Total Annual Cost
	Most Expensive		
FLAG	Exchange Traded Forensic Accounting Long-Short	All Cap Blend	1.70%
GARD	Reality Shares DIVCON Dividend Guard ETF	All Cap Blend	1.44%
CCOR	Cambria Core Equity ETF	Large Cap Value	1.35%
WBIA	WBI BullBear Rising Income 2000	Small Cap Blend	1.20%
WBIL	WBI BullBear Quality 1000	All Cap Blend	1.19%
	Least Expensive		
SPLG	State Street SPDR Portfolio Large Cap	Large Cap Blend	0.03%
VOO	Vanguard 500 Index Fund	Large Cap Blend	0.03%
SPTM	State Street SPDR Portfolio Total Stock Market	All Cap Blend	0.03%
SCHX	Schwab U.S. Large Cap	Large Cap Blend	0.03%
ITOT	iShares Core S&P Total U.S. Stock Market	All Cap Blend	0.03%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings.[1] State Street SPDR Portfolio Large Cap (SPLG) is the best ranked style ETF in Figure 1. SPLG's Neutral Portfolio Management rating and 0.03% total annual cost earns it

[1] This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

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an Attractive rating.[2] Alpha Architect U.S. Quantitative Value ETF (QVAL) is the best ranked style ETF overall. QVAL's Very Attractive Portfolio Management rating and 0.54% total annual cost also earns it a Very Attractive rating.

On the other hand, Vanguard Mid Cap Growth Index Fund (VOT) holds poor stocks and earns our Unattractive rating, yet has low total annual costs of 0.08%. 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 ETFs 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
UYM	ProShares Ultra Basic Materials	All Cap Blend	Unattractive
FPX	First Trust U.S. Equity Opportunities	All Cap Growth	Unattractive
AMCA	iShares Russell 1000 Pure U.S. Revenue	All Cap Value	Unattractive
OSIZ	Invesco Russell 1000 Size Factor	Large Cap Blend	Unattractive
VUG	Vanguard Growth Index Fund	Large Cap Growth	Unattractive
XSHD	Invesco S&P Small Cap High Dividend Low Volatility	Large Cap Value	Unattractive
SCHM	Schwab U.S. Mid Cap ETF	Mid Cap Blend	Unattractive
BOSS	Global X Founder Run Companies	Mid Cap Growth	Unattractive
VOE	Vanguard Mid Cap Value Index Fund	Mid Cap Value	Unattractive
EWSC	Invesco S&P Small Cap 600 Equal Weight	Small Cap Blend	Unattractive
FYC	First Trust Small Cap Growth AlphaDEX Fund	Small Cap Growth	Unattractive
RZV	Invesco S&P Small Cap 600 Pure Value	Small Cap Value	Unattractive

Sources: New Constructs, LLC and company filings

Invesco appears more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

ProShares Ultra Basic Materials (UYM is the worst rated ETF in Figure 2. First Trust Small Cap Growth AlphaDEX Fund (FYC) also earns a Very 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 on our stock ratings of their holdings and the total annual costs of investing in the ETF.

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

[2] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.

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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4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

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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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