How to Find the Best Sector ETFs

Finding the best ETFs is an increasingly difficult task in a world with so many to choose from. How can you pick with so many choices available?

Get the best fundamental research

Don't Trust ETF Labels

There are at least 63 different Technology ETFs and at least 265 ETFs across eleven sectors. Do investors need 24+ choices on average per sector? How different can the ETFs be?

Those 63 Technology ETFs are very different. With anywhere from 20 to 388 holdings, many of these Technology ETFs have drastically different portfolios, creating drastically different investment implications.

The same is true for the ETFs in any other sector, as each offers a very different mix of good and bad stocks. Telecom Services rank first for stock selection. Real Estate ranks last. Details on the Best & Worst ETFs in each sector are here.

How to Avoid Paralysis by Analysis

We think the large number of Technology (or any other) sector ETFs hurts investors more than it helps because too many options can be paralyzing. It is simply not possible for the majority of investors to properly assess the quality of so many ETFs. Analyzing ETFs, done with the proper diligence[1], is far more difficult than analyzing stocks because it means analyzing all the stocks within each ETF. As stated above, there can be as many as 388 stocks or more for one ETF.

Anyone focused on fulfilling the fiduciary duty of care recognizes that analyzing the holdings[2] of an ETF is critical to finding the best ETF. Only our research utilizes the superior data and earnings adjustments featured by the Harvard Business School and MIT Sloan paper, "Core Earnings: New Data and Evidence." Figure 1 shows our top-rated ETF for each sector.

Figure 1: The Best ETF in Each Sector

Ticker	Name	Sector	Assets ($mm)
FXZ	First Trust Materials AlphaDEX Fund	Basic Materials	$156
XLY	State Street Consumer Discretionary Select Sector SPDR	Consumer Cyclicals	$14,363
VDC	Vanguard Consumer Staples Index Fund	Consumer Non-cyclicals	$5,596
TPYP	Tortoise North American Pipeline Fund	Energy	$492
IAT	iShares U.S. Regional Banks ETF	Financials	$413
PJP	Invesco Dynamic Pharmaceuticals	Healthcare	$382
XHB	State Street SPDR S&P Homebuilders ETF	Industrials	$756
SCHH	Schwab U.S. REIT ETF	Real Estate	$6,104
TDIV	First Trust NASDAQ Technology Dividend Index Fund	Technology	$1,126
IYZ	iShares U.S. Telecommunications	Telecom Services	$389
FXU	First Trust Utilities AlphaDEX Fund	Utilities	$1,253

* Best ETFs exclude ETFs with TNAs less than $100 million for inadequate liquidity
Sources: New Constructs, LLC and company filings

1 This paper compares our analytics on a mega cap company to Bloomberg and Capital IQ (SPGI) in a detailed appendix.

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

Amongst the ETFs in Figure 1, iShares U.S. Regional Banks ETF (IAT) ranks first overall, Vanguard Consumer Staples Index Fund (VDC) ranks second, and State Street SPDR S&P Homebuilders ETF (XHB) ranks third. Schwab U.S. REIT ETF (SCHH) ranks last.

How to Avoid "The Danger Within"

Why do you need to know the holdings of ETFs before you buy?

You need to be sure you do not buy an ETF that might blow up. Buying an ETF without analyzing its holdings is like buying a stock without analyzing its business and finances. No matter how cheap, if it holds bad stocks, the ETF's performance will be bad. Don't just take my word for it, see what Barron's says on this matter.

PERFORMANCE OF FUND'S HOLDINGS = PERFORMANCE OF FUND

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.

If Only Investors Could Find Funds Rated by Their Holdings

Our ETF ratings leverage our stock coverage. We rate ETFs based on the aggregated ratings of the stocks each ETF holds.

iShares U.S. Regional Banks ETF (IAT) is not only the top-rated Financials ETF, but is also the overall top-ranked sector ETF out of the 265 sector ETFs that we cover.

The worst ETF in Figure 1 is Schwab U.S. REIT ETF (SCHH), which gets a Neutral rating. One would think ETF providers could do better for this sector.

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Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, or theme.

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Footnotes adjustments matter. We are the ONLY source.

We provide ratings, models, reports & screeners on U.S. 3,000 stocks, 700 ETFs and 7,000 mutual funds.

HBS & MIT Sloan research reveals that:

- **Markets are inefficiently assessing earnings because no one reads the footnotes.**
- **Corporate managers hide gains/losses in footnotes to manage earnings.**
- **Our technology brings the material footnotes data to market for the first time ever.**

Combining human expertise with NLP/ML/AI technologies (featured by Harvard Business School), we shine a light in the dark corners (e.g. footnotes) of hundreds of thousands of financial filings to unearth critical details.

The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

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

Learn more.

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

"…the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications." – page 20

Pick better stocks:

"Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year." – Abstract

Avoid losses from using other firms' data:

"…many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat…" – page 14

Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

"An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A." – page 33-34

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