How to Avoid the Worst Style ETFs

Question: Why are there so many ETFs?

Answer: ETF issuance is profitable, so Wall Street keeps cranking out more products to sell.

The large number of ETFs has little to do with serving your best interests as an investor. More reliable & proprietary fundamental data, proven in The Journal of Financial Economics, drives our research and analysis of ETF holdings and provides investors with a new source of alpha. We leverage this data to identify three red flags you can use to avoid the worst ETFs:

1. Inadequate Liquidity

This issue is the easiest 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. Small ETFs also generally have lower trading volume, which translates to higher trading costs via larger bid-ask spreads.

2. High Fees

ETFs should be cheap, but not all of them are. The first step is to benchmark what cheap means.

To ensure you are paying at or below average fees, invest only in ETFs with total annual costs below 0.46%, – the average total annual cost of the 1,009 U.S. equity Style ETFs we cover. The weighted average of ETFs we have assets under management data for is lower at 0.14%, which highlights how investors tend to put their money in ETFs with low fees.

Figure 1 shows Infrastructure Capital Equity Income ETF (ICAP) is the most expensive style ETF and Gabelli Love Our Planet & People ETF (LOPP) is the least expensive. No one provider provides more than one of the most expensive ETFs while Gabelli ETFs are among the cheapest.

Figure 1: 5 Most and Least Expensive Style ETFs

Ticker	Name	Style	Total Annual Cost
Most Expensive			
ICAP	Infrastructure Capital Equity Income ETF	Large Cap Blend	3.62%
CBLS	Clough Hedged Equity ETF	All Cap Blend	2.13%
RULE	Adaptive Core ETF	All Cap Blend	2.06%
WBIG	WBI BullBear Yield 3000 ETF	Large Cap Value	1.78%
CCOR	Core Alternative ETF	All Cap Blend	1.44%
Least Expensive			
LOPP	Gabelli Love Our Planet & People ETF	Mid Cap Blend	0.00%
GCAD	Gabelli Commercial Aerospace and Defense	Large Cap Blend	0.00%
SPYM	State Street SPDR Portfolio S&P 500	Large Cap Blend	0.02%
VTV	Vanguard Value ETF	Large Cap Value	0.03%
IVV	iShares Core S&P 500 ETF	Large Cap Blend	0.03%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings.[1] Alpha Architect U.S. Quantitative Value ETF (QVAL) is one of the best ranked style ETFs overall. QVAL's Neutral Portfolio Management rating and 0.32% total annual cost earns it a Very Attractive rating.[2]

On the other hand, Gabelli Love Our Planet & People ETF (LOPP) holds poor stocks and earns our Unattractive rating, despite having low total annual costs of 0.00%. No matter how cheap an ETF looks, if it holds bad stocks, its performance will be bad. The quality of an ETF's holdings matters more than its management fee.

3. Poor Holdings

Avoiding poor holdings is by far the hardest part of avoiding 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 portfolio management ratings, a function of the fund's holdings.

Figure 2: Style ETFs with the Worst Holdings

Ticker	Name	Style	Portfolio Management Rating
PFXF	VanEck Preferred Securities Ex Financials	All Cap Blend	Unattractive
UPGR	Xtrackers U.S. Green Infrastructure Select Equity	Large Cap Blend	Unattractive
CRED	Columbia Research Enhanced Real Estate ETF	Large Cap Growth	Unattractive
RDIV	Invesco S&P Ultra Dividend Revenue ETF	Large Cap Value	Unattractive
CSD	Invesco S&P Spin-Off ETF	Mid Cap Blend	Unattractive
ACES	ALPS Clean Energy ETF	Mid Cap Growth	Unattractive
IVOV	Vanguard S&P Mid Cap 400 ETF	Mid Cap Value	Unattractive
UFO	Procure Space ETF	Small Cap Blend	Unattractive
DWAS	Invesco Dorsey Wright Small Cap Momentum	Small Cap Growth	Unattractive
VTWV	Vanguard Rusell 2000 Value Index	Small Cap Value	Unattractive

Sources: New Constructs, LLC and company filings

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

VanEck Preferred Securities Ex Financials (PFXF) is the worst rated ETF in Figure 2 based on our predictive overall rating. Procure Space ETF (UFO), ALPS Clean Energy ETF (ACES), Xtrackers U.S. Green Infrastructure Select Equity (UPGR), and Invesco Dorsey Wright Small Cap Momentum (DWAS) also earn 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 model 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. Don't just take our word for it, see what Barron's says on this matter.

PERFORMANCE OF ETFs HOLDINGs – FEES = PERFORMANCE OF ETF

[1] Three independent studies from respected institutions prove the superiority of our data, models, and ratings. Learn more here.
[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 technology to get the diligence required to make prudent investment decisions.

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

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It's Official: We Deliver the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. The stock market is missing footnotes – and only we have that critical data.
2. Legacy fundamental datasets suffer from significant inaccuracies, omissions, and biases.
3. Our proprietary drives novel alpha. Our measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

In The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

Ernst & Young features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Harvard Business School. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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