New Constructs®

U.S. EQUITY ETF

4/20/11

The Best & Worst Financials Sector ETFs

Structural Integrity – and – Investment Merits

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Performance

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- **We recommend investors avoid all Financials Sector ETFs.**
- **Investors should buy only Attractive-or-better-rated stocks in the Financials Sector. Contact us for a custom Financials ETF with an Attractive Overall Risk/Reward rating.**
- **We rate the investment merit of the top 9 Financials sector ETFs.**
- **We benchmark the individual ETFs against the entire Financials sector and the S&P 500.**
- **This research enables investors to analyze ETFs and mutual funds as they do stocks.**
- **We offer custom and enhanced ETFs based on our top-ranked stock rating system.**
- **Our ETF analysis is based on aggregation of models for companies held by the fund and weighted according to the fund's allocations to those companies, excluding cash.**

Figure 1: The Investment Merit of the Top Financials Sector ETFs

	% of Fund Allocated to Each Rating					
Fund/Benchmark	**Very Attractive**	**Attractive**	**Neutral**	**Dangerous**	**Very Dangerous**	**Overall Fund Rating**
KIE	18.9%	16.7%	14.0%	36.1%	7.7%	Dangerous
KCE	0.0%	10.9%	31.8%	39.3%	9.0%	Dangerous
Overall Sector	**3.7%**	**12.9%**	**17.6%**	**37.8%**	**28.0%**	**Dangerous**
RKH	0.0%	0.0%	0.0%	55.4%	44.6%	Dangerous
KRE	0.0%	5.5%	16.1%	49.0%	27.1%	Very Dangerous

* % may not add up to 100% due to the exclusion of cash and holdings not in our coverage universe.

Sources: New Constructs, LLC and company filings

Methodology

Our Risk/Reward ratings have a solid track record of outperformance for investors.

Barron's ranked us #1 for stock-picking.

This report offers recommendations on Financials sector ETFs and benchmarks for (1) investors considering buying Financials sector ETFs and for (2) comparing individual ETFs to the Financials sector and the S&P 500. Our analysis is based on aggregating results from our models on each of the companies included in every ETF and the overall sector (531 companies) based on data as of April 19th, 2011. We aggregate results for the ETFs in the same way the ETFs are designed. Our goal is to empower investors to analyze ETFs in the same way they analyze individual stocks.

To make an informed ETF investment, investors must consider:

1) **Structural Integrity**: ability of an investment vehicle to fulfill its stated objective. We use XTF, an ETF research firm, to find the top 9 Financials sector ETFs with the best structural integrity rating.
2) **Investment Merit**: investment quality of the ETF based on its holdings. We apply our stock rating system to each ETF's holdings to determine its investment merit.

Given the success of our rating system for individual stocks, we believe its application to groups of stocks (i.e. ETFs and funds) helps investors make more informed ETF and mutual fund buying decisions. Barron's featured our unique ETF research in "The Danger Within."

Recommendations Summary

Custom ETFs: Contact us for best-of-breed and enhanced ETF products for a particular sector or index.

We find no suitable Financials sector ETFs, but we can build one for you.

If you require exposure to the Financials sector:
Due to the Financials sector's Dangerous Overall Risk/Reward rating and the Dangerous-or-worse ratings of the 9 ETFs highlighted in this report, we recommend investors buy only the Attractive-or-better-rated stocks in the Financials sector such as: TRV, CB, and NNI. Contact us for the full list of Overall Risk/Reward ratings.

If you require exposure to any other sector:
We recommend investors review our Sector ETF Roadmap report or our 9 other sector ETF reports, beginning with our Consumer Staples, Consumer Discretionary, and Health Care sector reports, which are the only three sectors to earn an Attractive Overall Risk/Reward rating.

If you require exposure to a Financials ETF or an index ETF:
We recommend investors buy an S&P 500 ETF over a Financials ETF. All Financials ETFs covered in this report earn a Dangerous-or-worse Overall Risk/Reward rating, while the S&P 500 earns a Neutral rating.

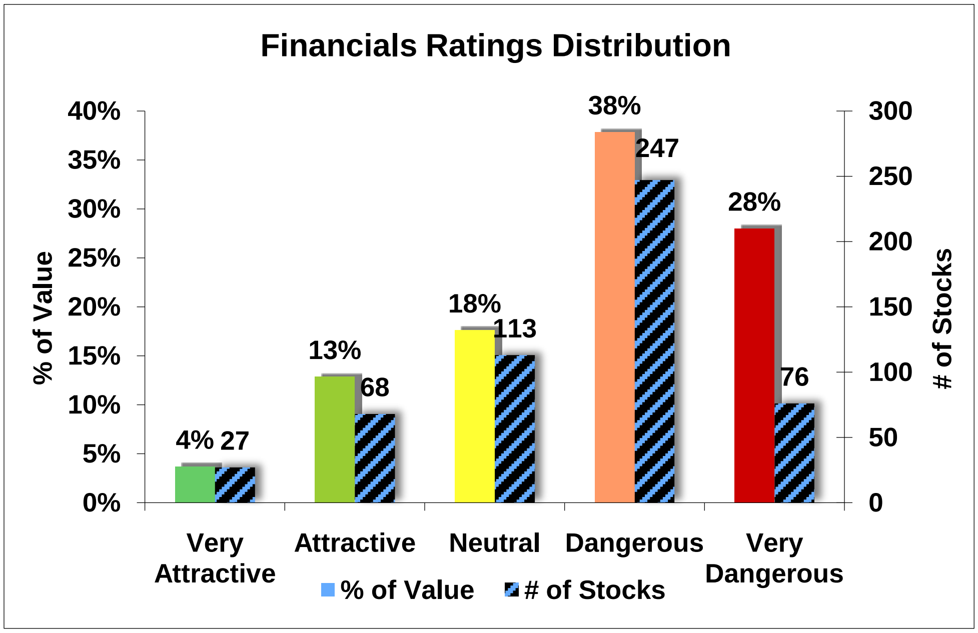
If you are looking for exposure to the best stocks in the market:
We recommend you buy our Most Attractive Stocks.

Recommendations Detail

Click here for more info on risk/reward rating system and our approach to equity research.

If you want to be in a sector ETF, the Consumer Staples, Consumer Discretionary and Health Care sectors are the best places to shop due to their Attractive Overall Risk/Reward ratings. Figure 2 shows how the Financials sector's stocks and the market value attributed to them stack up under the microscope of our risk/reward rating system.

Figure 2: Financials Sector – Allocation & Holdings by Risk/Reward Rating



Sources: New Constructs, LLC and company filings

The Financials sector has 66% of its value invested in Dangerous-or-worse-rated stocks and only 17% of its value invested in Attractive-or-better-rated stocks. Contact us for a custom Financials sector ETF that only includes Attractive-or-better-rated stocks.

The key takeaway is that the Financials sector is littered with poor investment opportunities and most Financials ETFs overweight Dangerous-or-worse-rated stocks. It is possible that a Financials ETF not covered in this report could earn an Attractive-or-better Overall Risk/Reward rating. However, if the ETF is not covered in this report, its structural integrity, as determined by XTF, is not sound or we do not cover over 90% of the value of the ETF's constituents. Of the ETFs we covered in this report, we find none with acceptable investment merits. ETFs like KRE and RKH that overweight Dangerous-or-worse-rated stocks should be avoided or sold short.

When analyzing the Financials sector ETFs, we started by identifying those ETFs with acceptable structural integrity as measured by XTF. We chose the 9 ETFs with an XTF rating above the sector average XTF rating where we cover at least 90% of the value of the ETF. For details on the XTF structural integrity ratings as well as the holdings and weightings for each ETF, see XTF.com.

Figure 3: Financials ETFs With Acceptable Structural Integrity

TICKER	ETF Description	# of Holdings *	XTF RATING
XLF	Select Sector SPDR-Financial	82	8
KIE	KBW Insurance ETF	24	7.9
RKH	Regional Bank HOLDRS	17	7.8
VFH	Vanguard Financials Index Fund	495	7.6
IAI	iShares Dow Jones US Broker-Dealers	26	6.9
IYG	iShares Dow Jones US Financial Services	113	6.8
KRE	KBW Regional Banking ETF	50	6.8
KCE	KBW Capital Markets ETF	24	6.6
KBE	KBW Bank ETF	24	6.4

* # of Holdings excludes cash

Sources: New Constructs, LLC; XTF and company filings

Contact us for details on our ratings for any stocks in any equity ETF.

Figure 3 clearly shows that not all Financials ETFs are made the same. Different ETFs have meaningfully different numbers of holdings and, therefore, different allocations to holdings. Given the differences in holdings and allocations, these ETFs will likely perform quite differently.

After determining the structural integrity, we analyzed the investment merit of each ETF based on how it allocates value to each stock it holds. Figure 4 shows how the 9 Financials sector ETFs stack up versus each other, the overall sector and the S&P 500 based on their Overall Risk/Reward Ratings and the allocation of their holdings by rating.

Figure 4: Investment Merit Based on Holdings and Allocations

	% of Fund Allocated to Each Rating					
Fund/Benchmark	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous	Overall Fund Rating
S&P 500	**21.2%**	**21.1%**	**34.0%**	**16.9%**	**6.8%**	**Neutral**
KIE	18.9%	16.7%	14.0%	36.1%	7.7%	Dangerous
KCE	0.0%	10.9%	31.8%	39.3%	9.0%	Dangerous
VFH	3.9%	12.3%	11.0%	35.2%	27.7%	Dangerous
Overall Sector	**3.7%**	**12.9%**	**17.6%**	**37.8%**	**28.0%**	**Dangerous**
IAI	0.0%	11.3%	18.8%	52.3%	11.5%	Dangerous
XLF	2.5%	11.5%	12.5%	35.2%	32.3%	Dangerous
IYG	1.0%	9.6%	10.4%	36.3%	38.1%	Dangerous
KBE	0.0%	7.8%	9.8%	51.2%	31.2%	Dangerous
RKH	0.0%	0.0%	0.0%	55.4%	44.6%	Dangerous
KRE	0.0%	5.5%	16.1%	49.0%	27.1%	Very Dangerous

* % may not add up to 100% due to the exclusion of cash and holdings not in our coverage universe.

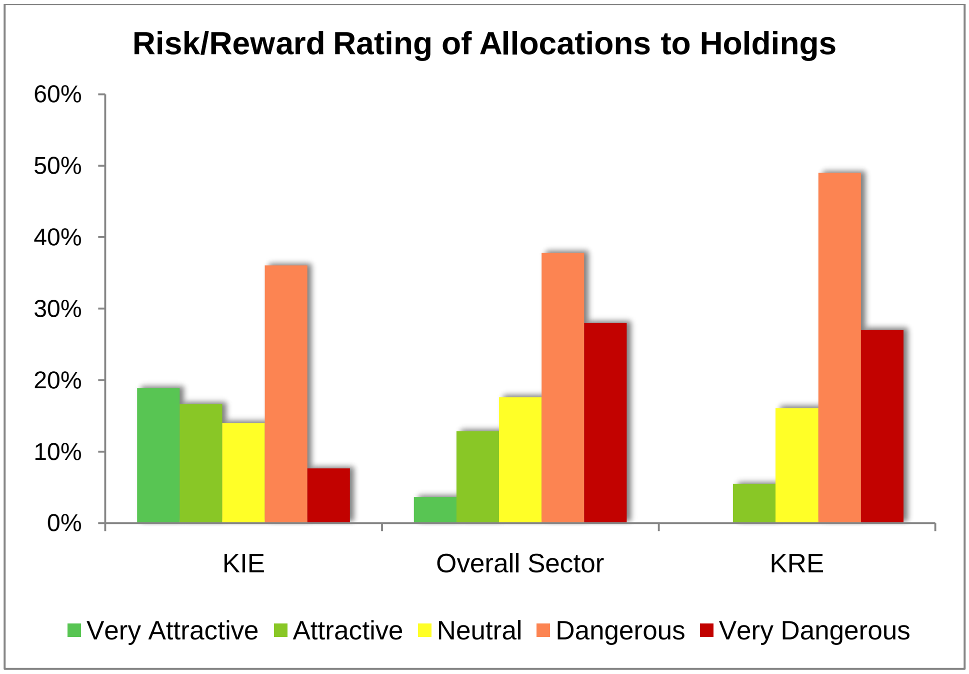
Sources: New Constructs, LLC; XTF and company filings

Attractive ETFs:
We find no Attractive-or-better-rated Financials sector ETFs.

Neutral ETFs:
We also find no Neutral-rated Financials sector ETFs. We recommend investors buy the Very Attractive and Attractive stocks in this sector before buying any of the Financials ETFs we cover in this report. Contact us for the full list of 95 Financials companies that earn an Attractive-or-better Overall Risk/Reward rating.

Dangerous ETFs:
We recommend investors avoid or sell short KIE, KCE, VFH, IAI, XLF, IYG, KBE, RKH, and KRE because of their Dangerous-or-worse Overall Risk/Reward ratings. Figure 5 contrasts the difference in investment merit between KIE, KRE, and the overall sector.

Figure 5: Dangerous and Very Dangerous Financials Sector ETFs



Sources: New Constructs, LLC; XTF and company filings

Benchmark Comparisons

Sector Benchmark

The overall Financials sector outperforms KIE in quality of earnings ratings. The sector earns a Very Attractive Economic vs. Reported Earnings ratings compared to KIE's Neutral rating.

KIE outperforms the overall Financials sector in valuation ratings. KIE has a Price-to-EBV of 0.6, earning it a Very Attractive rating, compared to the Financials sector's Price-to-EBV of 1.4. KIE's GAP of 47 years earns it a Dangerous rating while the Financials sector's GAP of 65 years earns it a Very Dangerous rating.

Figure 6: KIE – Risk/Reward Rating

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Econ v Reported Earnings (bn)	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	$-0.68 / $1.17	7.1%	-1.0%	0.6	47

Sources: New Constructs, LLC and company filings

Figure 7: Financials Sector – Risk/Reward Rating

Overall Risk/Reward Score	Quality of Earnings		Valuation		
	Econ v Reported EPS	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	$160.97 / $651.71	6.9%	-1.1%	1.4	65
Median	$-0.82 / $0.78	5.1%	1.5%	2.1	83

Sources: New Constructs, LLC and company filings

KIE allocates capital more effectively than the overall Financials sector. Per Figure 4 above, KIE allocates 35.6% of its value to Attractive-or-better-rated stocks while the sector only allocates 16.6%. KIE also only allocates 43.7% of its value toward Dangerous-or-worse-rated stocks compared to the sector's Dangerous-or-worse weightings of 65.8%.

For explanation and details behind our risk/reward rating system, see one of our Company Valuation reports, which are available for free here.

Market Benchmark

The S&P 500 significantly outperforms KIE in all components of the Overall Risk/Reward Rating except for Price-to-EBV. KIE's relatively low Price-to-EBV does not offset its significantly worse quality of earnings ratings and other valuation ratings.

The S&P 500's market-weighted average ROIC is 18.3%, earning it a Very Attractive rating compared to a Dangerous-rated 7.1% for KIE. The S&P 500 also has a Very Attractive Economic vs. Reported Earnings rating because its Economic Earnings are positive and rising while KIE's Economic Earnings are negative.

Figure 8: KIE – Risk/Reward Rating

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Econ v Reported Earnings (bn)	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	$-0.68 / $1.17	7.1%	-1.0%	0.6	47

Sources: New Constructs, LLC and company filings

Figure 9: S&P 500 – Risk/Reward Rating

Overall Risk/Reward Score	Quality of Earnings		Valuation		
	Econ v Reported EPS	ROIC	FCF Yield	Price-to-EBV	GAP (yrs)
Very Dangerous	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	More than 50
Dangerous	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	Less than 3
Market-Weighted Avg	$0.74 / $4.06	18.3%	2.4%	1.4	24
Median	$0.26 / $2.24	7.9%	3.2%	1.4	12

Sources: New Constructs, LLC and company filings

The S&P 500 allocates capital more effectively than KIE. Per Figure 4 above, the S&P 500 allocates 42.3% of its value to Attractive-or-better-rated stocks while KIE only allocates 35.6%. The S&P 500 also only allocates 23.7% of its value toward Dangerous-or-worse-rated stocks compared to KIE's Dangerous-or-worse weightings of 43.7%.

Appendix: Risk/Reward Rating System

Our Risk/Reward Rating System assigns a rating to every stock we cover according to what we believe are the 5 most important criteria for assessing the risk versus reward of stocks. See table that follows for details.

Overall Risk/Reward Ranking	The Overall Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.
Very Dangerous	FCF Yield is not included in the average.
Dangerous	FCF Yield is not included in the average.
Neutral	All criteria are equal-weighted in the average calculation.
Attractive	All criteria are equal-weighted in the average calculation.
Very Attractive	All criteria are equal-weighted in the average calculation.

Economic vs Reported Earnings	Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.
Very Dangerous	Negative and declining Economic Earnings despite positive and rising Reported Earnings
Dangerous	Same as above except Reported Earnings are not rising or Reported Earnings are not positive
Neutral	Negative Economic and Reported Earnings
Attractive	Economic Earnings are positive
Very Attractive	Economic Earnings are positive and rising

Return on Invested Capital (ROIC)	Rates stocks based on their ROIC. Values based on Latest Fiscal Year.
Bottom Quintile	Very Dangerous = the bottom 20% of Russell 1000 companies
4th Quintile	Dangerous = the bottom 40% of Russell 1000 companies
3rd Quintile	Neutral = the middle 20% of Russell 1000 companies
2nd Quintile	Attractive = the top 40% of Russell 1000 companies
Top Quintile	Very Attractive = the top 20% of Russell 1000 companies

FCF Yield	Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.
<-5%	Very Dangerous = less than or equal to -5%
-5%<-1%	Dangerous = more than -5% but less than or equal to -1%
-1%<3%	Neutral = more than -1% but less than or equal to +3%
3%<10%	Attractive = more than +3% but less than or equal to +10%
>10%	Very Attractive = more than +10%

Price-to-EBV Ratio	Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.
>3.5 or -1>0	Very Dangerous = greater than or equal to 3.5 or less than 0 but greater than -1
2.4>3.5 or <-1	Dangerous = greater than or equal to 2.4 but less than 3.5 and less than or equal to -1
1.6>2.4	Neutral = greater than or equal to 1.6 but less than 2.4
1.1>1.6	Attractive = greater than or equal to 1.1 but less than 1.6
0>1.1	Very Attractive = greater than or equal to 0 but less than 1.1

Growth Appreciation Period (yrs)	Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.
>50	Very Dangerous = greater than or equal to 50 years
20>50	Dangerous = at least 20 years but less than 50
10>20	Neutral = at least 10 years but less than 20
3>10	Attractive = at least 3 years but less than 10
0>3	Very Attractive = at least 0 years but less than 3

New *Constructs® – Profile*

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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.

Additional Information

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