Sector Ratings For ETFs & Mutual Funds

At the beginning of the fourth quarter of 2015, only the Consumer Staples sector earns an Attractive-or-better rating. Our sector ratings are based on the aggregation of our fund ratings for every ETF and mutual fund in each sector. See last quarter's Sector Ratings here.

Investors looking for sector funds that hold quality stocks should look no further than the Consumer Staples and Information Technology sectors. These sectors house the most Attractive-or-better rated funds. Figures 4 through 7 provide more details. The primary driver behind an Attractive fund rating is good portfolio management, or good stock picking, with low total annual costs.

Attractive-or-better ratings do not always correlate with Attractive-or-better total annual costs. This fact underscores that (1) cheap funds can dupe investors and (2) investors should invest only in funds with good stocks and low fees.

See Figures 4 through 13 for a detailed breakdown of ratings distributions by sector. See our ETF & mutual fund screener for rankings, ratings and reports on 7000+ mutual funds and 400+ ETFs. Our fund rating methodology is detailed here.

All of our reports on the best & worst ETFs and mutual funds in every sector are available here.

Figure 1: Ratings For All Sectors

Sector	Overall Rating
Energy	Dangerous
Health Care	Dangerous
Telecom	Neutral
Materials	Neutral
Financials	Neutral
Utilities	Neutral
Cons Disc	Neutral
Industrials	Neutral
Info Tech	Neutral
Cons Staples	Attractive

Source: New Constructs, LLC and company filings

To earn an Attractive-or-better Predictive Rating, an ETF or mutual fund must have high-quality holdings and low costs. Only the top 30% of all ETFs and mutual funds earn our Attractive or better ratings.

State Street SPDR Consumer Staples Select Sector Fund ETF (XLP) is the top rated Consumer Staples fund. It gets our Very Attractive rating by allocating over 39% of its value to Attractive-or-better-rated stocks.

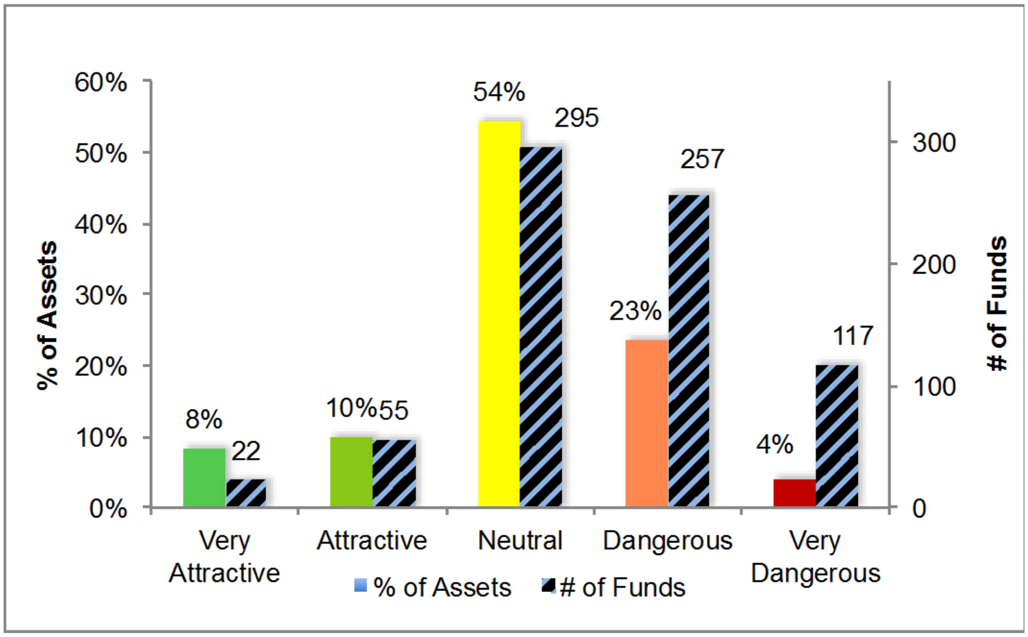
Wal-Mart Stores (WMT: $65/share) is one of our favorite stocks held by XLP, earns our Attractive rating, and was recently featured as a Long Idea. Since 1998, Wal-Mart has grown after-tax profit (NOPAT) by 9% compounded annually. Wal-Mart has been a staple of consistency in a highly competitive industry by generating a 12% or greater return on invested capital (ROIC) in every year since 1999. The market has not rewarded this consistency however, and WMT is significantly undervalued. At its current price of $65/share Wal-Mart has a price to economic book value (PEBV) ratio of 0.7. This ratio implies the market expects Wal-Mart's profits to permanently decline by 30%. Not only does this expectation ignore the track record of Wal-Mart, but it also discounts the steps being taken to remain the retail leader for long into the future. If Wal-Mart can grow NOPAT by just 2% compounded annually for the next five years, the stock is worth $108/share today – a 66% upside.

Professionally Managed Portfolios BP Capital TwinLine Energy Fund (BPEAX) is the worst Energy fund. It gets our Very Dangerous rating by allocating over 49% of its value to Dangerous-or-worse-rated stocks. Making matters worse, it charges investors annual costs of 4.63%.

Patterson UTI Energy (PTEN: $14/share) is one of our least favorite stocks held by BPEAX and receives our Dangerous rating. While most oil & gas companies have had a troublesome 2015, Patterson's troubles began much earlier. Since 2011, Patterson's NOPAT has declined by 18% compounded annually while the company's ROIC has fallen to a bottom quintile 3% from 7%. Despite shares being down around 30% over this same timeframe, the expectations baked into the current stock price remain overly optimistic. To justify its current price of $14/share, Patterson must grow NOPAT by 7% compounded annually for the next 14 years. This expectation overlooks Patterson's NOPAT decline over the past few years as well as the current headwinds facing the entire oil & gas industry. Investors would be wise to avoid PTEN.

Figure 2 shows the distribution of our Predictive Ratings for all sector ETFs and mutual funds.

Figure 2: Distribution of ETFs & Mutual Funds (Assets and Count) by Predictive Rating



Source: New Constructs, LLC and company filings

Figure 3 offers additional details on the quality of the sector funds. Note that the average total annual cost of Very Dangerous funds is almost 11 times that of Very Attractive funds.

Figure 3: Predictive Rating Distribution Stats

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
# of ETFs & Funds	22	55	295	257	117
% of ETFs & Funds	3%	7%	40%	34%	16%
% of TNA	8%	10%	54%	23%	4%
Avg TAC	0.23%	0.47%	0.57%	1.24%	2.52%

* Avg TAC = Weighted Average Total Annual Costs

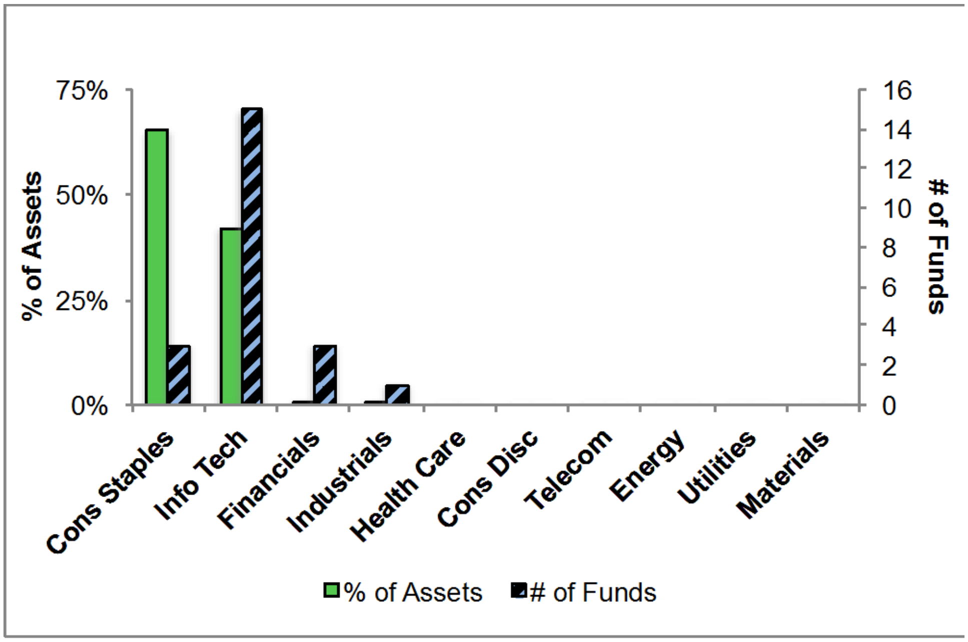
Source: New Constructs, LLC and company filings

This table shows that only the best of the best funds get our Very Attractive Rating: they must hold good stocks AND have low costs. Investors deserve to have the best of both and we are here to give it to them.

Ratings by Sector

Figure 4 presents a mapping of Very Attractive funds by sector. The chart shows the number of Very Attractive funds in each sector and the percentage of assets in each sector allocated to funds that are rated Very Attractive.

Figure 4: Very Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 5 presents the data charted in Figure 4.

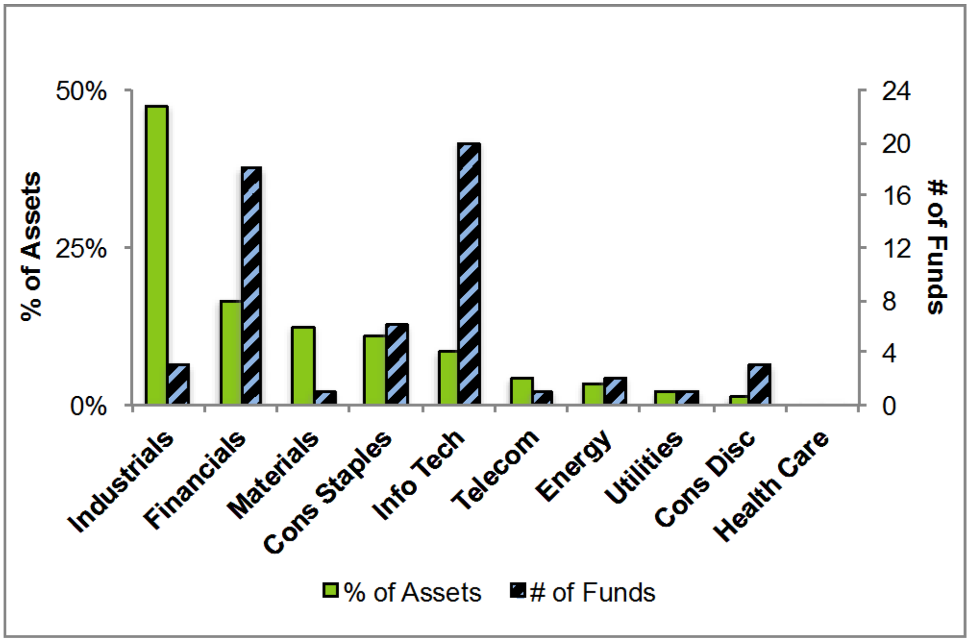
Figure 5: Very Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Cons Staples	65%	3	17%
Info Tech	42%	15	10%
Financials	1%	3	1%
Industrials	0%	1	2%
Health Care	0%	0	0%
Cons Disc	0%	0	0%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%
Materials	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 6 presents a mapping of Attractive funds by sector. The chart shows the number of Attractive funds in each sector and the percentage of assets allocated to Attractive-rated funds in each sector.

Figure 6: Attractive ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 7 presents the data charted in Figure 6.

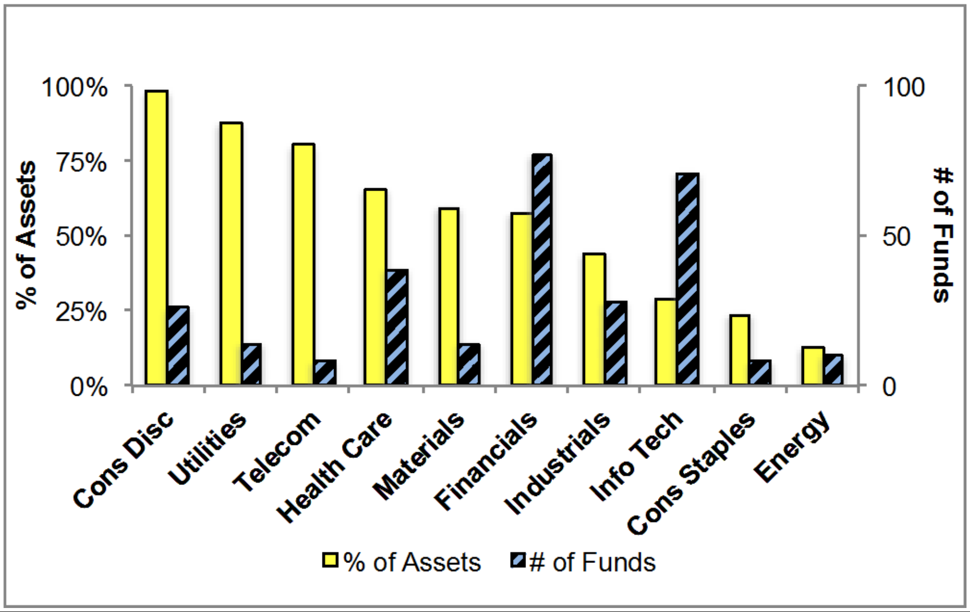
Figure 7: Attractive ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Industrials	47%	3	7%
Financials	16%	18	7%
Materials	12%	1	4%
Cons Staples	11%	6	33%
Info Tech	8%	20	14%
Telecom	4%	1	5%
Energy	3%	2	3%
Utilities	2%	1	3%
Cons Disc	1%	3	8%
Health Care	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 8 presents a mapping of Neutral funds by sector. The chart shows the number of Neutral funds in each sector and the percentage of assets allocated to Neutral-rated funds in each sector.

Figure 8: Neutral ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 9 presents the data charted in Figure 8.

Figure 9: Neutral ETFs & Mutual Funds by Sector

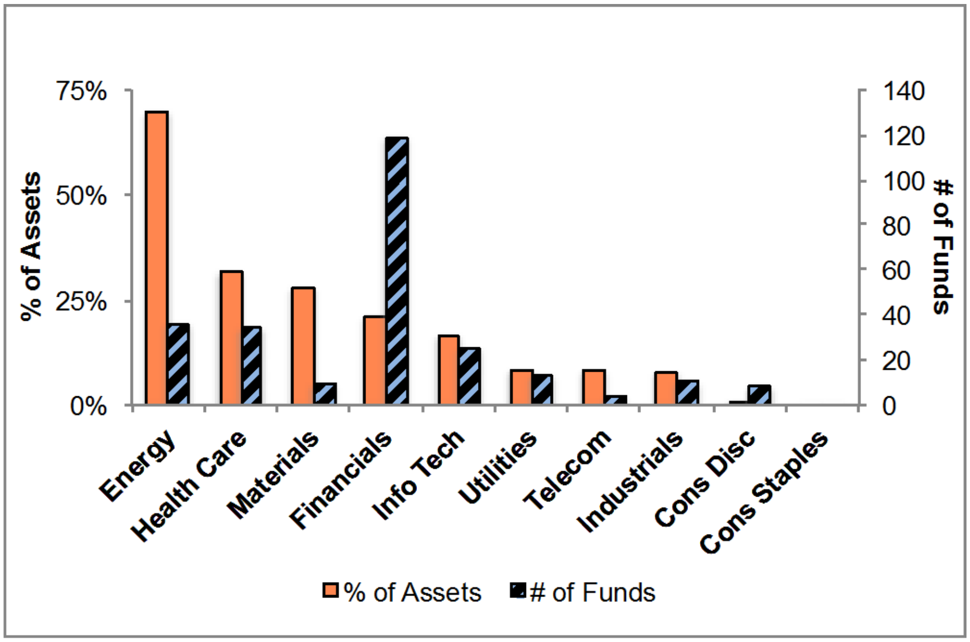
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Cons Disc	98%	26	70%
Utilities	88%	14	41%
Telecom	80%	8	40%
Health Care	66%	39	46%
Materials	60%	14	54%
Financials	58%	77	29%
Industrials	44%	28	67%
Info Tech	29%	71	50%
Cons Staples	24%	8	44%
Energy	13%	10	13%

Source: New Constructs, LLC and company filings

Figure 10 presents a mapping of Dangerous funds by fund sector. The chart shows the number of Dangerous funds in each sector and the percentage of assets allocated to Dangerous-rated funds in each sector.

The landscape of sector ETFs and mutual funds is littered with Dangerous funds. Investors in Energy funds have put over 70% of their assets in Dangerous-rated funds.

Figure 10: Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 11 presents the data charted in Figure 10.

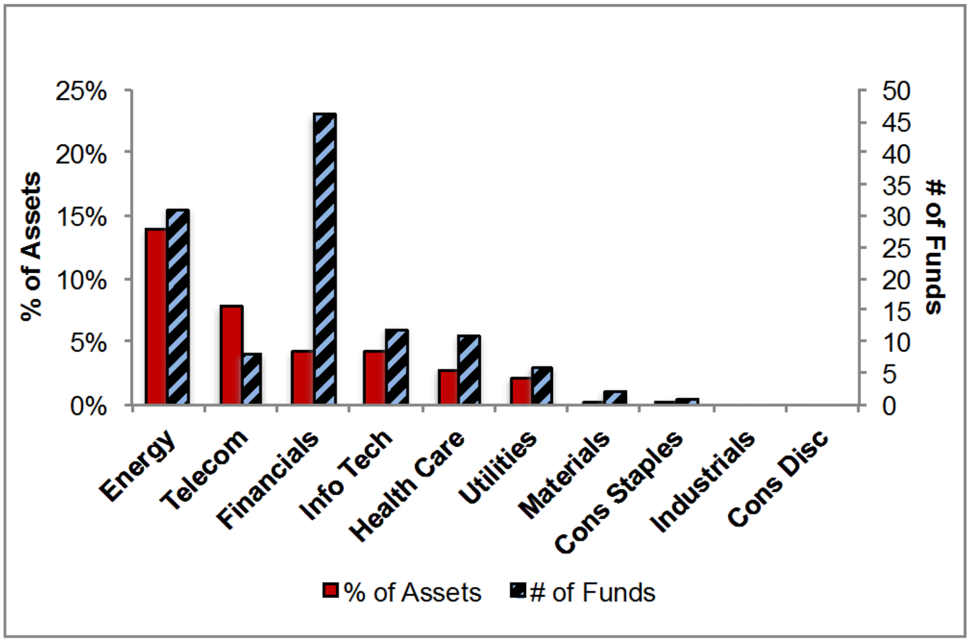
Figure 11: Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Energy	70%	36	46%
Health Care	32%	34	40%
Materials	28%	9	35%
Financials	21%	119	45%
Info Tech	16%	25	17%
Utilities	8%	13	38%
Telecom	8%	3	15%
Industrials	8%	10	24%
Cons Disc	1%	8	22%
Cons Staples	0%	0	0%

Source: New Constructs, LLC and company filings

Figure 12 presents a mapping of Very Dangerous funds by fund sector. The chart shows the number of Very Dangerous funds in each sector and the percentage of assets in each sector allocated to funds that are rated Very Dangerous.

Figure 12: Very Dangerous ETFs & Mutual Funds by Sector



Source: New Constructs, LLC and company filings

Figure 13 presents the data charted in Figure 12.

Figure 13: Very Dangerous ETFs & Mutual Funds by Sector

Sector	% of Sector Assets	# of Very Dangerous Funds	% of Very Dangerous Funds in Sector
Energy	14%	31	39%
Telecom	8%	8	40%
Financials	4%	46	17%
Info Tech	4%	12	8%
Health Care	3%	11	13%
Utilities	2%	6	18%
Materials	0%	2	8%
Cons Staples	0%	1	6%
Industrials	0%	0	0%
Cons Disc	0%	0	0%

Source: New Constructs, LLC and company filings

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

Appendix: Predictive Fund Rating System

New Constructs' Predictive fund Ratings enable smarter investing by assessing the key drivers of future fund performance. We start by analyzing every funds' holdings based on New Constructs' stock ratings, which are regularly featured as among the best by Barron's. Next, we measure and rank the all-in fund expenses. Finally, we rank the fund compared to all other funds to identify the best and worst funds in the market.

Intuitively, there are two drivers for future fund performance.

1. Stock-picking (Portfolio Management Rating) and
2. Fund expenses (Total Annual Costs Rating)

Our Predictive Fund Rating is based on these drivers and the fund's ranking:

1. Top 10% = Very Attractive Rating
2. Next 20% = Attractive Rating
3. Next 40% = Neutral Rating
4. Next 20% = Dangerous Rating
5. Bottom 10% = Very Dangerous Rating

The figure below details the criteria that drive our Predictive Rating system for funds. The two drivers of our predictive ratings system are Portfolio Management and Total Annual Costs. The Portfolio Management ratings (detail here) is the same as our Stock Rating (detail here) except that we incorporate Asset Allocation (details here). The Total Annual Costs Ratings (details here) captures the all-in costs of being in a fund over a 3-year holding period, the average period for all mutual funds.

Predictive Rating	Portfolio Management Rating						Total Annual Costs
	Business Strength		Valuation			Cash Allocation	
	Quality of Earnings	Return on Invested Capital	FCF Yield	Price to Economic Book Value	Market-Implied Duration of Growth		
Very Dangerous	Misleading Trend	Bottom Quintile	< -5%	>3.5 or -1<0	> 50	> 20%	> 4 %
Dangerous	False Positive	4th Quintile	-5% < -1%	2.4<3.5 or <-1	20 < 50	8% < 20%	2% < 4%
Neutral	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20	2.5% < 8%	1% < 2%
Attractive	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10	1% < 2.5%	0.5% < 1%
Very Attractive	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3	<1%	< 0.5%

New Constructs® – Profile

How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our forensics accounting expertise across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our stock rating methodology instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our forward-looking fund ratings are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating (details here) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

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

Incorporated in July 2002, New Constructs is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. NOPAT, Invested Capital, and WACC, to create economic earnings models, which are necessary to understand the true profitability and valuation of companies. Visit the Free Archive to download samples of our research. New Constructs is a BBB accredited business and a member of the Investorside Research Association.

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