



## ETF & Mutual Fund Rankings: Information Technology Sector

The Information Technology sector ranks fourth out of the ten sectors as detailed in our [2Q16 Sector Ratings for ETFs and Mutual Funds](#) report. [Last quarter](#), the Information Technology sector ranked third. It gets our Neutral rating, which is based on aggregation of ratings of 29 ETFs and 122 mutual funds in the Information Technology sector as of April 18, 2016. See a recap of our [1Q16 Sector Ratings here](#).

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the sector. Not all Information Technology sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 384). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Information Technology sector should buy one of the Attractive-or-better rated ETFs or mutual funds from Figures 1 and 2.

**Figure 1: ETFs with the Best & Worst Ratings – Top 5**

Ticker	Allocation of ETF Holdings			Predictive Rating
	Attractive-or-better Stocks	Neutral Stocks	Dangerous-or-worse Stocks	
<b>Best ETFs</b>				
SMH	41%	26%	9%	Very Attractive
TDIV	64%	6%	19%	Very Attractive
VGT	49%	22%	19%	Very Attractive
FTEC	49%	22%	19%	Very Attractive
XLK	54%	19%	18%	Very Attractive
<b>Worst ETFs</b>				
PSCT	19%	32%	47%	Neutral
PTF	0%	30%	56%	Dangerous
ARKK	6%	14%	62%	Dangerous
PNQI	4%	23%	48%	Dangerous
FDN	6%	20%	60%	Dangerous

\* Best ETFs exclude ETFs with TNAs less than \$100 million for inadequate liquidity.

Sources: New Constructs, LLC and company filings

**Figure 2: Mutual Funds with the Best & Worst Ratings – Top 5**

Ticker	Allocation of Mutual Fund Holdings			Predictive Rating
	Attractive-or-better Stocks	Neutral Stocks	Dangerous-or-worse Stocks	
<b>Best Mutual Funds</b>				
FSDCX	63%	9%	13%	Very Attractive
VITAX	49%	22%	20%	Very Attractive
FDCPX	53%	18%	16%	Attractive
ROGSX	57%	20%	15%	Attractive
NWJEX	39%	29%	29%	Attractive
<b>Worst Mutual Funds</b>				
ITYAX	23%	17%	50%	Very Dangerous
GITAX	15%	16%	57%	Very Dangerous
RYINX	15%	24%	45%	Very Dangerous
RSIFX	6%	20%	46%	Very Dangerous
IFOAX	21%	21%	48%	Very Dangerous

\* Best mutual funds exclude funds with TNAs less than \$100 million for inadequate liquidity.

Sources: New Constructs, LLC and company filings

Five mutual funds are excluded from Figure 2 because their total net assets (TNA) are below \$100 million and do not meet our liquidity minimums. See our [mutual fund screener](#) for more details.

Van Eck Market Vectors Semiconductor ETF (SMH) is the top-rated Information Technology ETF and Fidelity Select Communications Equipment Portfolio (FSDCX) is the top-rated Information Technology mutual fund. Both earn a Very Attractive rating.

First Trust Dow Jones Internet Index Fund (FDN) is the worst rated Information Technology ETF and Invesco Technology Sector Fund (IFOAX) is the worst rated Information Technology mutual fund. FDN earns a Dangerous rating and IFOAX earns a Very Dangerous rating.

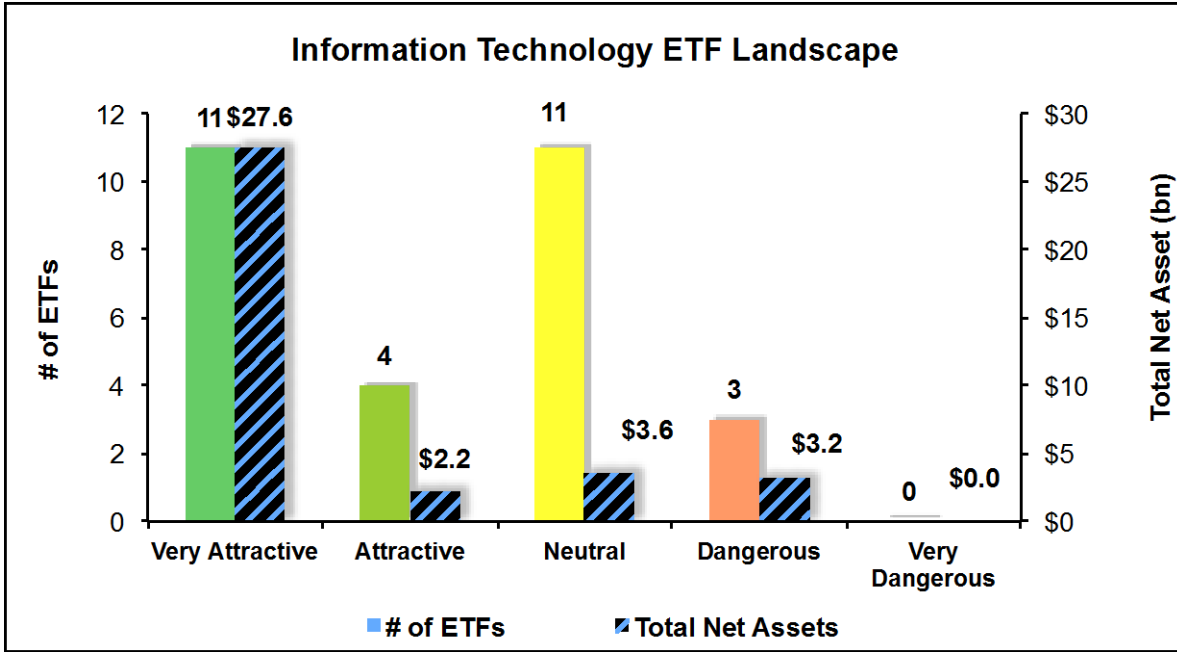
506 stocks of the 3000+ we cover are classified as Information Technology stocks.

Cisco Systems (CSCO: \$28/share) is one of our favorite stocks held by FSDCX and earns a Very Attractive rating. Cisco is on [April's Most Attractive Stocks](#) list. Over the past decade, Cisco has grown after-tax profits (NOPAT) by 7% compounded annually. Cisco has improved its return on invested capital (ROIC) from 14% in 2005 to a top-quintile 17% in 2015. The company has generated a cumulative \$32 billion in free cash flow (FCF) over the past five fiscal years. However, in spite of the operational strength exhibited by Cisco, CSCO is undervalued and presents an excellent buying opportunity. At its current price of \$28/share, Cisco has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means that the market expects Cisco's NOPAT to permanently decline by 20%. If Cisco can [grow NOPAT by just 6% compounded annually for the next decade](#), the stock is worth \$43/share today – a 54% upside.

ServiceNow (NOW: \$63/share) remains one of our least favorite stocks held by IFOAX and earns a Dangerous rating. ServiceNow was placed in the [Danger Zone in November 2015](#). Since going public in 2012, ServiceNow's NOPAT has declined from -\$29 million to -\$154 million while its ROIC declined from -29% to -41% over the same time frame. The drastic decline in profits and profitability is in stark contrast to ServiceNow's revenue growth, as the company adopted a "grow revenue at all costs strategy," which clearly ignores profits. Making matters worse, when we placed NOW in the Danger Zone, its valuation implied significant profit growth and despite NOW falling 21% since the publish date of our report, those expectations remain unrealistically high. To justify its current price of \$63/share, ServiceNow must grow immediately achieve 15% pre-tax margins (-15% in 2015) and [grow revenue by 23% compounded annually for 13 years](#). In this scenario, 13 years from now, ServiceNow would be generating over \$14 billion in revenue, slightly below Facebook's (FB) 2015 revenue. It's clear how the expectations embedded in NOW remain overly optimistic.

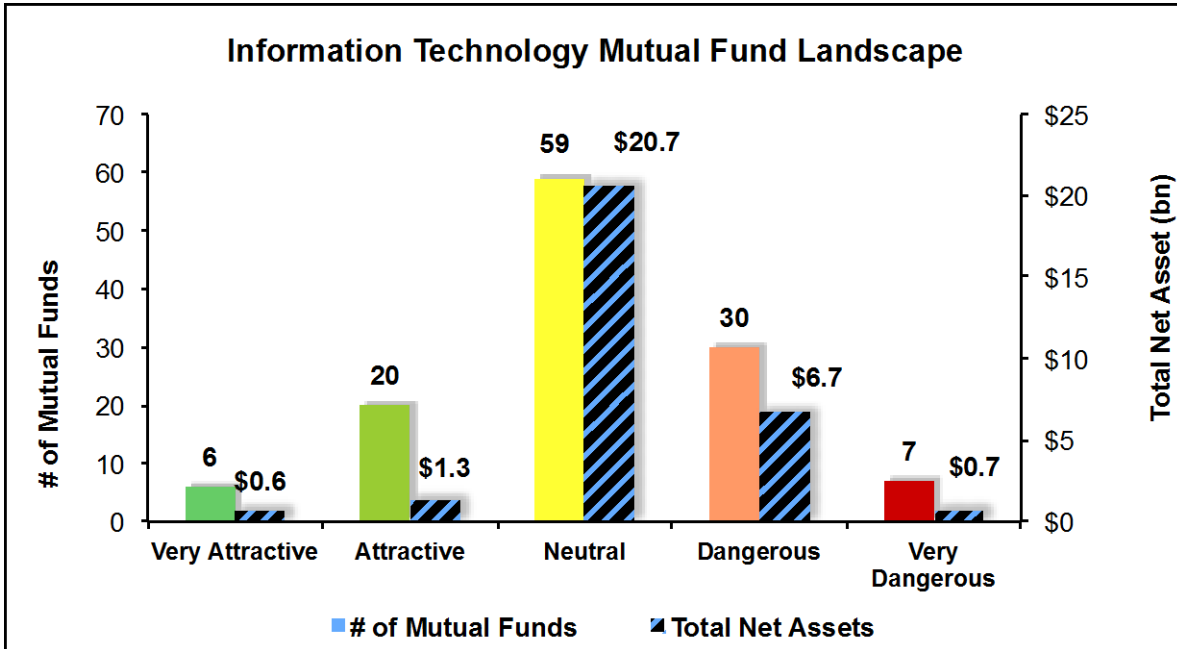
Figures 3 and 4 show the rating landscape of all Information Technology ETFs and mutual funds.

**Figure 3: Separating the Best ETFs From the Worst ETFs**



Sources: New Constructs, LLC and company filings

**Figure 4: Separating the Best Mutual Funds From the Worst Mutual Funds**



Sources: 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.*

## ***New Constructs® – Profile***

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### ***How New Constructs Creates Value for Clients***

We find it. You benefit. Cutting-edge technology enables us to scale our [forensic 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.

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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***

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