



## Sector Ratings For ETFs & Mutual Funds

At the beginning of the second quarter of 2016, no sectors earn 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 focus on the Consumer Staples and Information Technology sectors. These sectors, despite not earning an Attractive rating overall, contain the highest percentage of assets allocated to 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	Very Dangerous
Utilities	Very Dangerous
Telecom	Dangerous
Health Care	Dangerous
Financials	Neutral
Cons Disc	Neutral
Info Tech	Neutral
Cons Staples	Neutral
Materials	Neutral
Industrials	Neutral

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.

U.S. Global Jets ETF (JETS) is the top rated Industrials fund. It gets our Very Attractive rating by allocating over 66% of its value to Attractive-or-better-rated stocks.

Southwest Airlines (LUV: \$44/share) is one of our favorite stocks held by JETS and earns a Very Attractive rating. LUV was [recently featured as a new stock](#) on March's Most Attractive stocks list and remains on [April's Most Attractive Stocks list](#). Over the past decade, Southwest Airlines has grown after-tax profit (NOPAT) by 17% compounded annually. During this time period, the company's return on invested capital (ROIC) improved from 6% in 2005 to a top quintile 17% over the last twelve months. However, LUV is only up 6% over the past year, and shares have become undervalued. At its current price of \$44/share, LUV has a price to economic book value (PEBV) ratio of 0.9. This ratio means that the market expects Southwest's NOPAT to permanently decline by 10%. If Southwest can [grow NOPAT by just 5% compounded annually for the next decade](#), the stock is worth \$65/share today – a 48% upside.

Saratoga Advantage Energy & Basic Materials Portfolio (SBMBX) is the worst Energy fund. It gets our Very Dangerous rating by allocating over 55% of its value to Dangerous-or-worse-rated stocks. Making matters worse,

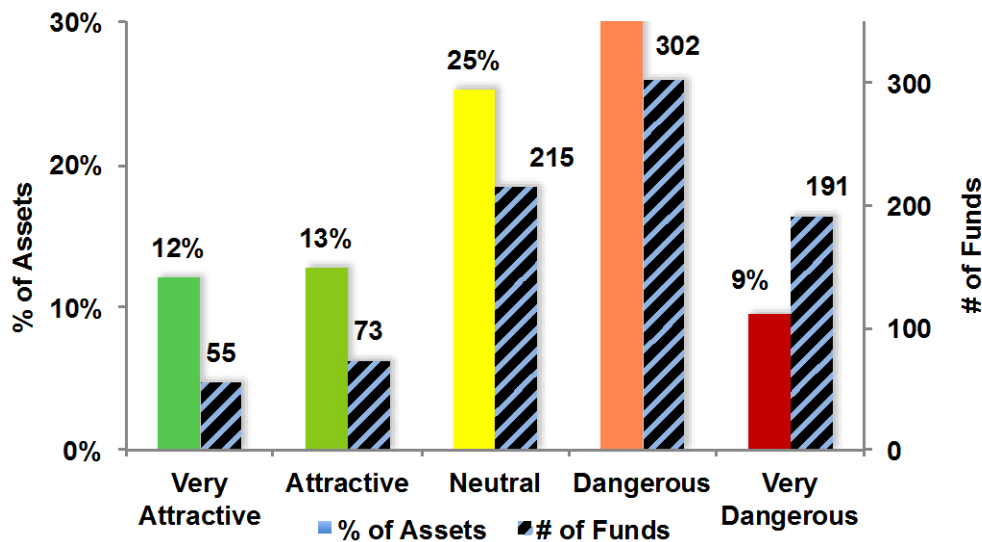


its total annual costs are a whopping 6.26%.

ConocoPhillips (COP: \$39/share) is one of our least favorite stocks held by SBMBX and earns a Dangerous rating. ConocoPhillips' business has been deteriorating for quite some time. Over the past decade, the company's NOPAT has declined from \$15.8 billion to -\$586 million. Over the same time frame, its ROIC fell from 18% in 2005 to a bottom quintile 0% in 2015. Unfortunately for investors, the price decline over the past two years has not been enough and COP remains overvalued. To justify its current price of \$39/share, COP must [grow revenue by 20% compounded annually for the next 16 years](#). Keep in mind that COP's revenues have declined each of the last four years and it's easy to see just how optimistic the expectations baked into COP remain.

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 over seven times that of Very Attractive funds.

**Figure 3: Predictive Rating Distribution Stats**

	Very Attractive	Attractive	Neutral	Dangerous	Very Dangerous
<b># of ETFs &amp; Funds</b>	55	73	215	302	191
<b>% of ETFs &amp; Funds</b>	7%	9%	26%	36%	23%
<b>% of TNA</b>	12%	13%	25%	40%	9%
<b>Avg TAC</b>	0.29%	0.45%	0.67%	0.77%	2.18%

\* Avg TAC = Weighted Average Total Annual Costs

Source: New Constructs, LLC and company filings

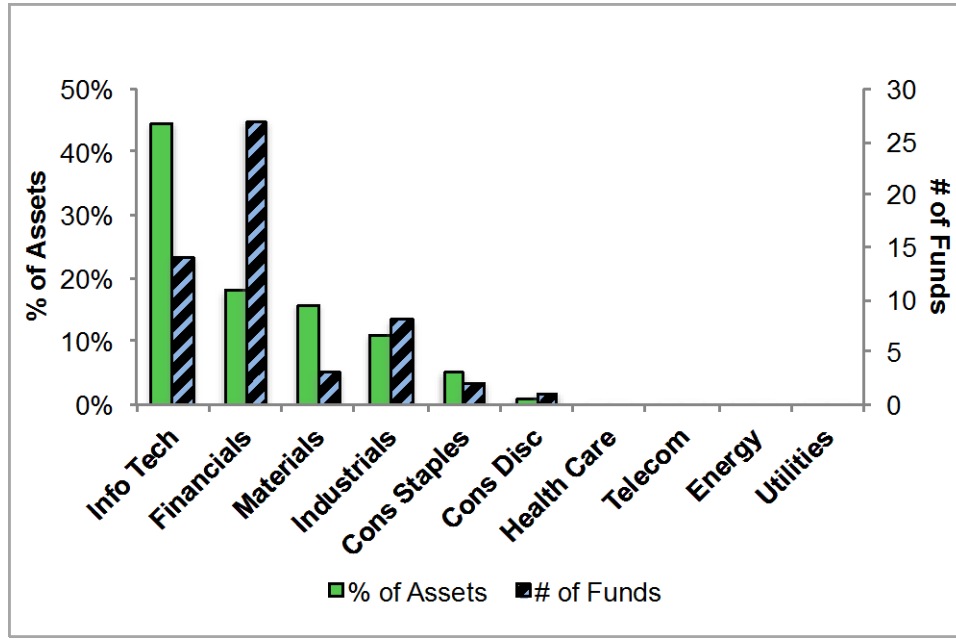
This table shows that only the best of the best funds get our Very Attractive Rating: they must hold good stocks AND have low costs. Investors deserve to have the best of both and we are here to give it to them.



*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**

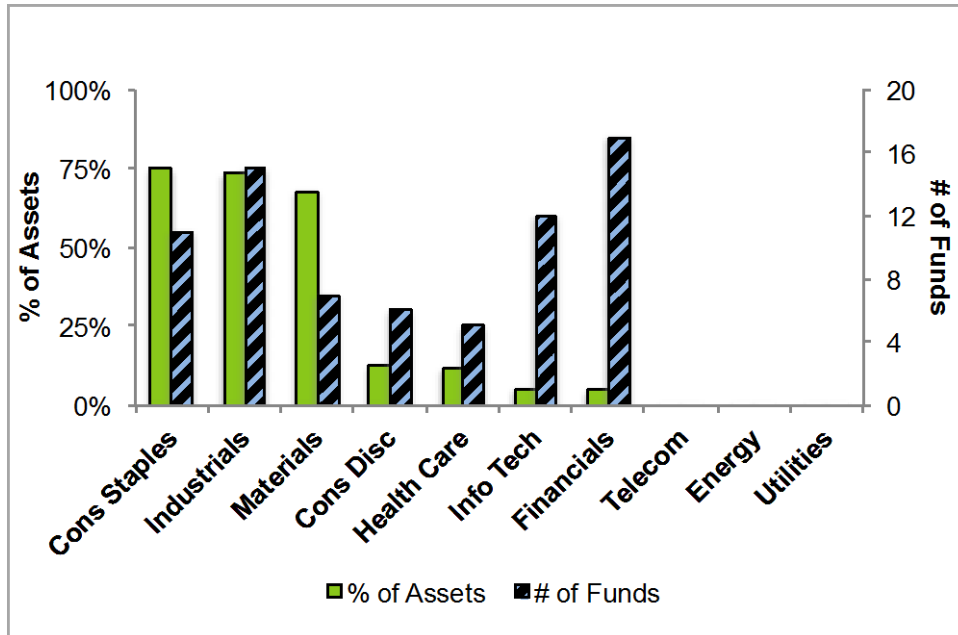
Sector	% of Sector Assets	# of Very Attractive Funds	% of Very Attractive Funds in Sector
Info Tech	45%	14	9%
Financials	18%	27	10%
Materials	16%	3	14%
Industrials	11%	8	22%
Cons Staples	5%	2	8%
Cons Disc	1%	1	3%
Health Care	0%	0	0%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%

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**

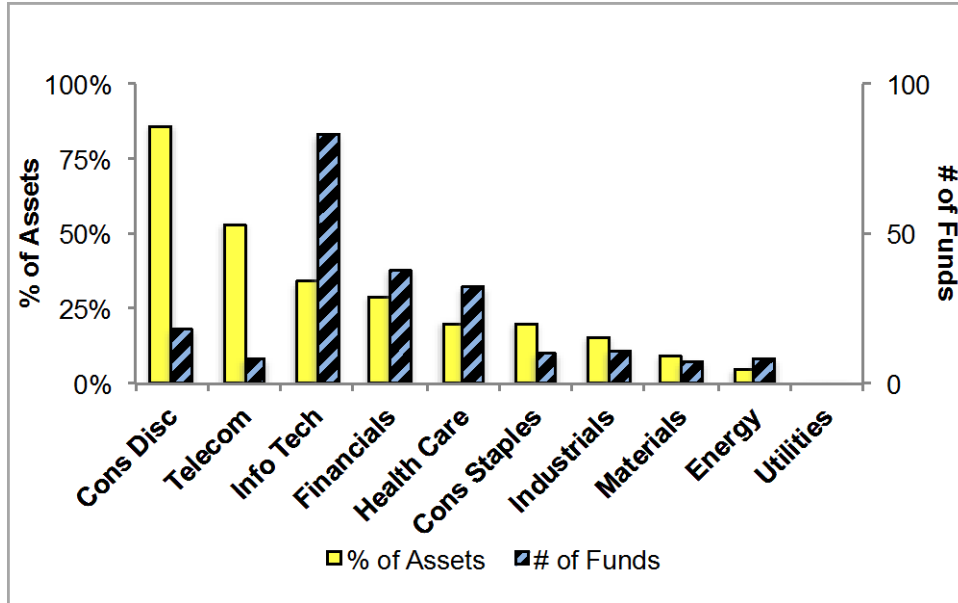
Sector	% of Sector Assets	# of Attractive Funds	% of Attractive Funds in Sector
Cons Staples	75%	11	46%
Industrials	73%	15	41%
Materials	68%	7	33%
Cons Disc	12%	6	19%
Health Care	11%	5	5%
Info Tech	5%	12	8%
Financials	5%	17	6%
Telecom	0%	0	0%
Energy	0%	0	0%
Utilities	0%	0	0%

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**

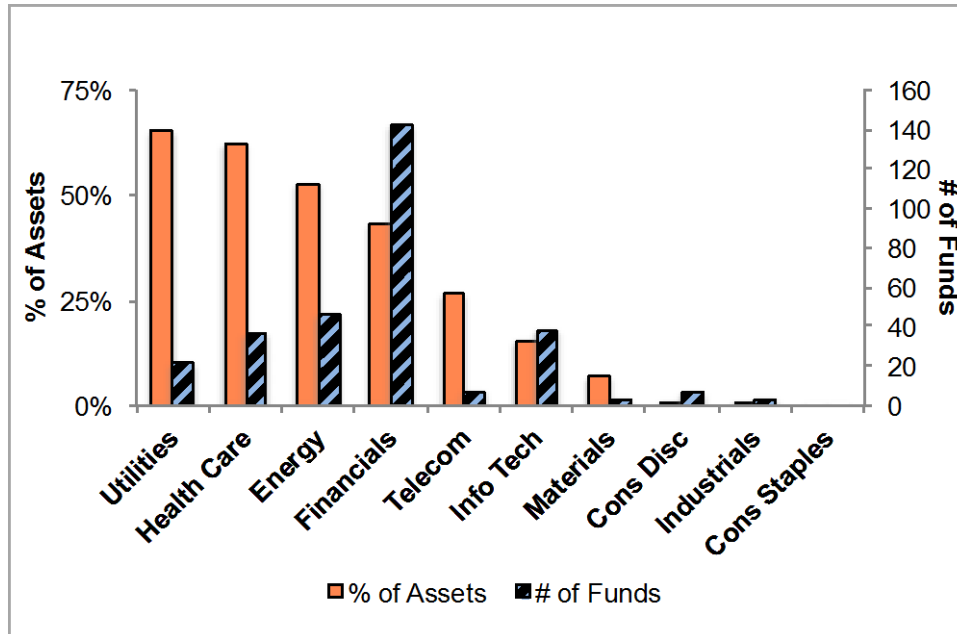
Sector	% of Sector Assets	# of Neutral Funds	% of Neutral Funds in Sector
Cons Disc	86%	18	56%
Telecom	53%	8	33%
Info Tech	34%	83	54%
Financials	29%	38	14%
Health Care	20%	32	31%
Cons Staples	20%	10	42%
Industrials	15%	11	30%
Materials	9%	7	33%
Energy	5%	8	7%
Utilities	0%	0	0%

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 Utilities funds have put over 65% 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**

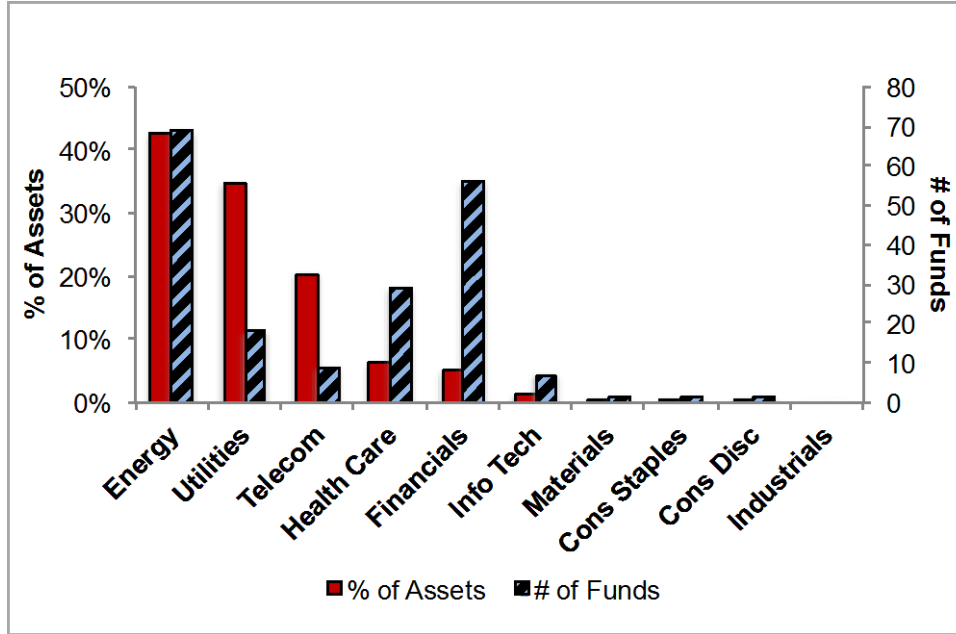
Sector	% of Sector Assets	# of Dangerous Funds	% of Dangerous Funds in Sector
Utilities	65%	21	54%
Health Care	62%	36	35%
Energy	53%	46	37%
Financials	43%	142	51%
Telecom	26%	7	29%
Info Tech	15%	38	25%
Materials	7%	3	14%
Cons Disc	1%	6	19%
Industrials	0%	3	8%
Cons Staples	0%	0	0%

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	43%	69	56%
Utilities	35%	18	46%
Telecom	20%	9	38%
Health Care	6%	29	28%
Financials	5%	56	20%
Info Tech	1%	7	5%
Materials	0%	1	5%
Cons Staples	0%	1	4%
Cons Disc	0%	1	3%
Industrials	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					Cash Allocation	Total Annual Costs
	Business Strength		Valuation				
	Quality of Earnings	Return on Invested Capital	FCF Yield	Price to Economic Book Value	Market-Implied Duration of Growth		
<b>Very Dangerous</b>	Misleading Trend	Bottom Quintile	< -5%	>3.5 or -1<0	> 50	> 20%	> 4 %
<b>Dangerous</b>	False Positive	4th Quintile	-5% < -1%	2.4<3.5 or <-1	20 < 50	8% < 20%	2% < 4%
<b>Neutral</b>	Neutral EE	3rd Quintile	-1% < 3%	1.6 < 2.4	10 < 20	2.5% < 8%	1% < 2%
<b>Attractive</b>	Positive EE	2nd Quintile	3% < 10%	1.1 < 1.6	3 < 10	1% < 2.5%	0.5% < 1%
<b>Very Attractive</b>	Rising EE	Top Quintile	> 10%	0 < 1.1	0 < 3	<1%	< 0.5%





## ***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.

### ***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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