ETF & Mutual Fund Rankings: Large Cap Blend Style

The Large Cap Blend style ranks second out of the twelve fund styles as detailed in our 2Q16 Style Ratings for ETFs and Mutual Funds report. Last quarter, the Large Cap Blend style ranked first. It gets our Attractive rating, which is based on aggregation of ratings of 37 ETFs and 845 mutual funds in the Large Cap Blend style as of May 3, 2016. See a recap of our 1Q16 Style Ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the style. Not all Large Cap Blend style ETFs and mutual funds are created the same. The number of holdings varies widely (from 16 to 3810). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Large Cap Blend style 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

	Allocation of ETF Holdings			
Ticker	**Attractive-or-better Stocks**	**Neutral Stocks**	**Dangerous-or-worse Stocks**	**Predictive Rating**
Best ETFs				
DIA	40%	43%	17%	Very Attractive
EPS	36%	40%	20%	Very Attractive
DLN	33%	34%	31%	Very Attractive
FTCS	28%	60%	11%	Very Attractive
USMV	18%	50%	29%	Very Attractive
Worst ETFs				
NOBL	24%	54%	16%	Neutral
PXLG	17%	50%	32%	Neutral
DSI	29%	41%	25%	Neutral
EQAL	16%	34%	42%	Neutral
FMK	25%	33%	41%	Neutral

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

Sources: New Constructs, LLC and company filings

WisdomTree Total Earnings Fund (EXT), FlexShares U.S. Quality Large Cap Index Fund (QLC), and State Street SPDR MSCI USA Quality Mix ETF (QUS) are excluded from Figure 1 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

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

	Allocation of Mutual Fund Holdings			
Ticker	Attractive-or-better Stocks	Neutral Stocks	Dangerous-or-worse Stocks	Predictive Rating
Best Mutual Funds				
VVPLX	44%	44%	0%	Very Attractive
CBBZX	47%	32%	15%	Very Attractive
CBBIX	47%	32%	15%	Very Attractive
CBBYX	47%	32%	15%	Very Attractive
CMIIX	39%	34%	6%	Very Attractive
Worst Mutual Funds				
IFCSX	17%	48%	20%	Dangerous
STQIX	25%	31%	35%	Dangerous
BLPSX	13%	17%	13%	Very Dangerous
STQUX	25%	31%	35%	Very Dangerous
STQAX	25%	31%	35%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

State Street SPDR Dow Jones Industrial Average ETF Trust (DIA) is the top-rated Large Cap Blend ETF and Financial Investors Trust Vulcan Value Partners Fund (VVPLX) is the top-rated Large Cap Blend mutual fund. Both earn a Very Attractive rating.

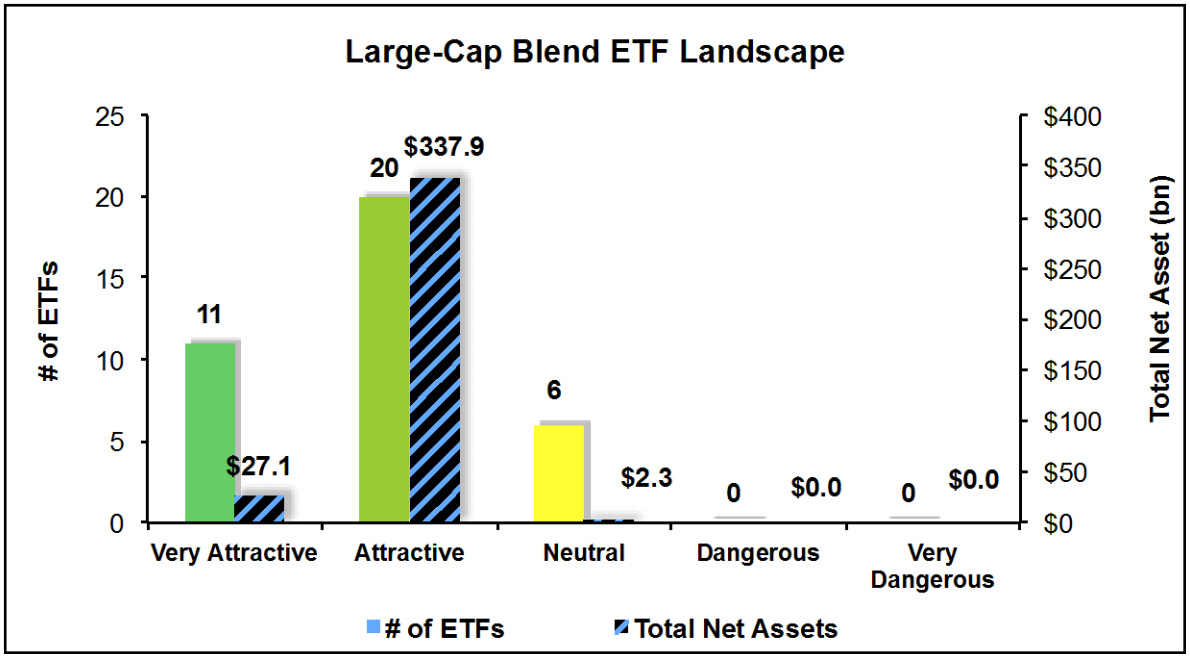
First Trust Mega Cap AlphaDEX Fund (FMK) is the worst rated Large Cap Blend ETF and AmericaFirst Seasonal Trends Fund (STQAX) is the worst rated Large Cap Blend mutual fund. FMK earns a Neutral rating and STQAX earns a Very Dangerous rating.

Franklin Resources (BEN: $38/share) is one of our favorite stocks held by VVPLX and earns a Very Attractive rating. Over the past decade, Franklin Resources has grown after-tax profit (NOPAT) by 8% compounded annually. The company has improved its return on invested capital (ROIC) from 21% in 2005 to a top-quintile 26% over the last twelve months. Possibly most impressive, Franklin has generated positive economic earnings in every year since 2003. Despite the success, BEN remains undervalued. At its current price of $38/share, Franklin Resources has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means that the market expects Franklin's NOPAT to permanently decline by 20%. If Franklin Resources can grow NOPAT by 3% compounded annually over the next decade, the stock is worth $60/share today – a 58% upside.

NRG Energy (NRG: $15/share) is one of our least favorite stocks held by EQAL and earns a Dangerous rating. Since 2006, NRG's NOPAT has declined by 1% compounded annually. The company's ROIC has fallen from 9% in 2006 to a bottom-quintile 2% over the last twelve months. Additionally, over the past five years, NRG has generated a cumulative -$10.8 billion in free cash flow. Despite these operational struggles, NRG remains overvalued. To justify its current price of $15/share, NRG must grow NOPAT by 9% compounded annually for the next 11 years.

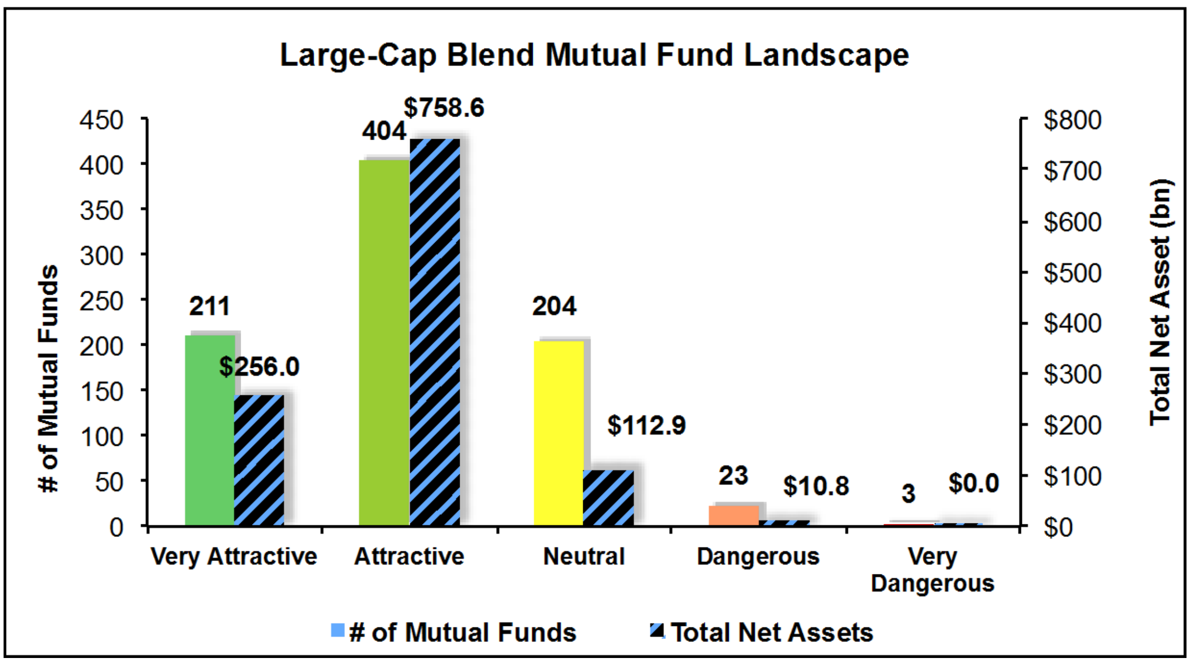
Figures 3 and 4 show the rating landscape of all Large Cap Blend ETFs and mutual funds.

Figure 3: Separating the Best ETFs From the Worst Funds



Sources: New Constructs, LLC and company filings

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



Sources: New Constructs, LLC and company filings

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

New Constructs® – Profile

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.

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