ETF & Mutual Fund Rankings: Small Cap Blend Style

The Small Cap Blend style ranks tenth out of the twelve fund styles as detailed in our 2Q16 Style Ratings for ETFs and Mutual Funds report. Last quarter, the Small Cap Blend style ranked eighth. It gets our Dangerous rating, which is based on aggregation of ratings of 24 ETFs and 702 mutual funds in the Small Cap Blend style as of May 4, 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 Small Cap Blend style ETFs and mutual funds are created the same. The number of holdings varies widely (from 21 to 2510). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Small 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				
EES	21%	32%	32%	**Attractive**
EZM	19%	42%	31%	**Neutral**
VB	12%	32%	43%	**Neutral**
IJR	13%	36%	44%	**Neutral**
VIOO	13%	36%	44%	**Neutral**
Worst ETFs				
JKJ	13%	31%	43%	**Neutral**
EQWS	10%	20%	49%	**Neutral**
PRFZ	12%	28%	46%	**Neutral**
SMDV	11%	28%	59%	**Neutral**
NASH	11%	35%	42%	**Dangerous**

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

Sources: New Constructs, LLC and company filings

First Trust Dow Jones Select MicroCap Index (FDM) and iShares FactorSelect MSCI USA Small-Cap ETF (SMLF) 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				
BOSOX	25%	49%	22%	Very Attractive
PXQSX	13%	50%	19%	Attractive
PQSCX	13%	50%	19%	Attractive
CSVIX	12%	42%	24%	Attractive
TSFIX	17%	39%	35%	Neutral
Worst Mutual Funds				
TPLNX	7%	25%	34%	Very Dangerous
CTVAX	10%	34%	33%	Very Dangerous
RYRHX	2%	6%	8%	Very Dangerous
RYROX	2%	6%	8%	Very Dangerous
RYRRX	2%	6%	8%	Very Dangerous

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

Sources: New Constructs, LLC and company filings

Lyons Small Cap Fund (LFSAX, LFSCX) and Oak Ridge Dynamic Small Cap Fund (ORSIX) are excluded from Figure 2 because their total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

WisdomTree SmallCap Earnings Fund (EES) is the top-rated Small Cap Blend ETF and Boston Trust Small Cap Fund (BOSOX) is the top-rated Small Cap Blend mutual fund. EES earns an Attractive rating and BOSOX earns a Very Attractive rating.

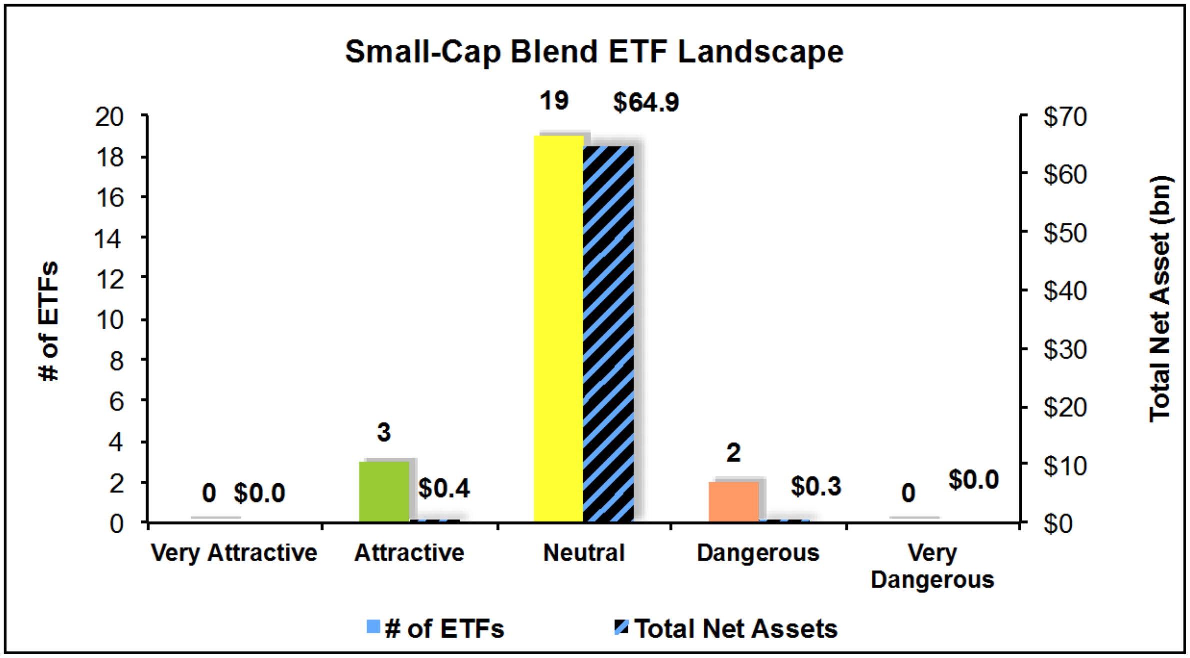
Nashville Area ETF (NASH) is the worst rated Small Cap Blend ETF and Russell 2000 Fund (RYRRX) is the worst rated Small Cap Blend mutual fund. NASH earns a Dangerous rating and RYRRX earns a Very Dangerous rating.

Sanderson Farms (SAFM: $91/share) remains one of our favorite stocks held by EES and earns an Attractive rating. Sanderson Farms was a featured Long Idea in August 2015, and is up 26% since. Over the past decade, Sanderson Farms has grown after-tax profit (NOPAT) by 12% compounded annually. The company has significantly improved its return on invested capital (ROIC), which is up from 7% in 2012 to a top-quintile 15% over the last twelve months. Despite the price increase since our original report, SAFM remains undervalued. At its current price of $91/share, Sanderson Farms has a price-to-economic book value (PEBV) ratio of 0.9. This ratio means that the market expects Sanderson's NOPAT to permanently decline by 10% from its current levels. If Sanderson can grow NOPAT by just 6% compounded annually for the next five years, the stock is worth $186/share today – a 104% upside.

Kennedy-Wilson Holdings (KW: $21/share) is one of our least favorite stocks held by CTVAX and earns a Very Dangerous rating. Since 2009, despite reporting increasing GAAP net income, Kennedy-Wilson's economic earnings have declined from -$10 million to -$212 million in 2015. Over the same time, the company's ROIC has fallen from an already low 4% in 2009 to a bottom-quintile 2% in 2015. Despite the destruction of shareholder value, KW is up over 100% since going public in 2009. Such a price increase has left KW significantly overvalued. To justify its current price of $21/share, Kennedy-Wilson must grow NOPAT by 16% compounded annually for the next 11 years. Considering the decline in economic earnings, such lofty expectations for future cash flows make the downside risk of this stock too large.

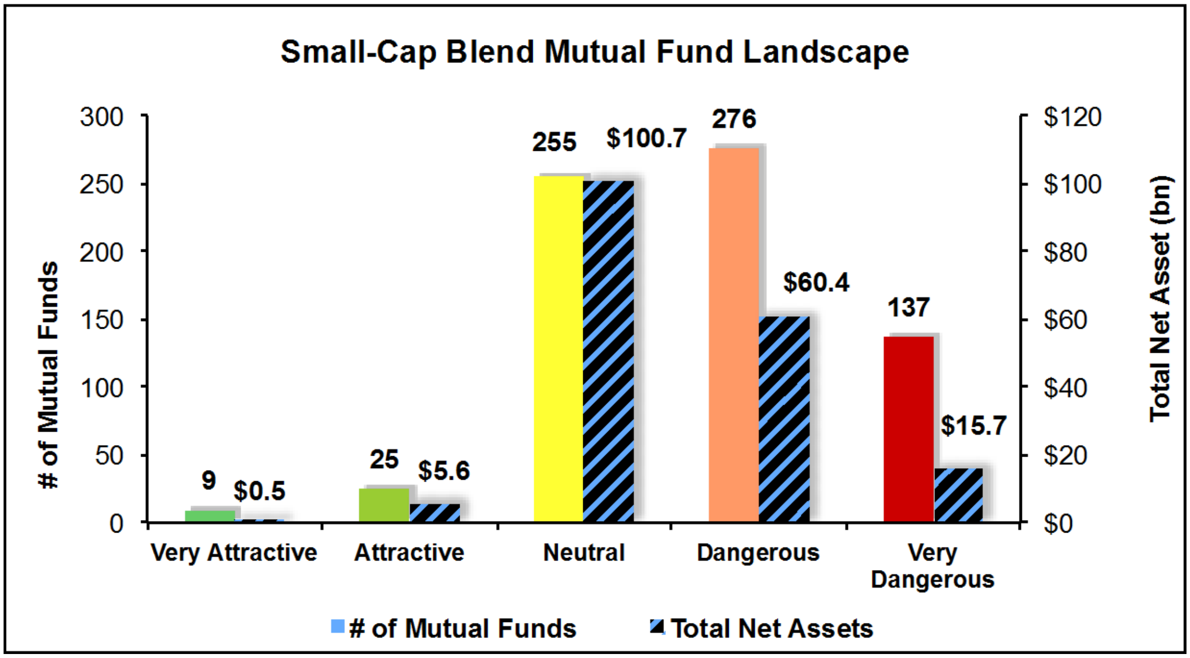
Figures 3 and 4 show the rating landscape of all Small Cap Blend ETFs and mutual funds.

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.

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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.

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