ETF & Mutual Fund Rankings: Telecom Services Sector

The Telecom Services sector ranks eighth out of the ten sectors as detailed in our 3Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Telecom Services sector ranked eighth as well. It gets our Dangerous rating, which is based on an aggregation of ratings of six ETFs and 12 mutual funds in the Telecom Services sector as of July 15, 2016. See a recap of our 2Q16 Sector Ratings here.

Figures 1 and 2 rank all five ETFs and all 9 mutual funds in the sector that meet our liquidity standards. Not all Telecom Services sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 24 to 57). This variation creates drastically different investment implications and, therefore, ratings.

Investors should not buy any Telecom Services ETFs or mutual funds because none get an Attractive-or-better rating. If you must have exposure to this sector, you should buy a basket of Attractive-or-better rated stocks and avoid paying undeserved fund fees. Active management has a long history of not paying off.

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 ETF				
IXP	16%	1%	61%	**Neutral**
Worst ETFs (only 4)				
XTL	21%	10%	59%	**Neutral**
VOX	30%	0%	68%	**Dangerous**
FCOM	28%	0%	64%	**Dangerous**
IYZ	20%	0%	79%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

iShares North American Tech-Multimedia Networking ETF (IGN) is excluded from Figure 1 because its 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 (only 4)				
TTMIX	8%	21%	42%	**Neutral**
PRMTX	8%	21%	42%	**Neutral**
FWRLX	15%	17%	38%	**Neutral**
FSTCX	13%	2%	77%	**Very Dangerous**
Worst Mutual Funds				
FTUIX	13%	2%	77%	**Very Dangerous**
FTUCX	13%	2%	77%	**Very Dangerous**
RYTLX	34%	7%	48%	**Very Dangerous**
FTUTX	13%	2%	77%	**Very Dangerous**
FTUAX	13%	2%	77%	**Very Dangerous**

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

Sources: New Constructs, LLC and company filings

Rydex Series Telecommunications Fund (RYMIX, RYMAX) is excluded from Figure 2 because its total net assets (TNA) are below $100 million and do not meet our liquidity minimums.

iShares Global Telecom ETF (IXP) is the top-rated Telecom Services ETF and T Rowe Price Media & Telecommunications Fund (TTMIX) is the top-rated Telecom Services mutual fund. Both earn a Neutral rating.

iShares US Telecommunications ETF (IYZ) is the worst rated Telecom Services ETF and Fidelity Advisor Telecommunications Fund (FTUAX) is the worst rated Telecom Services mutual fund. Both earn a Very Dangerous rating.

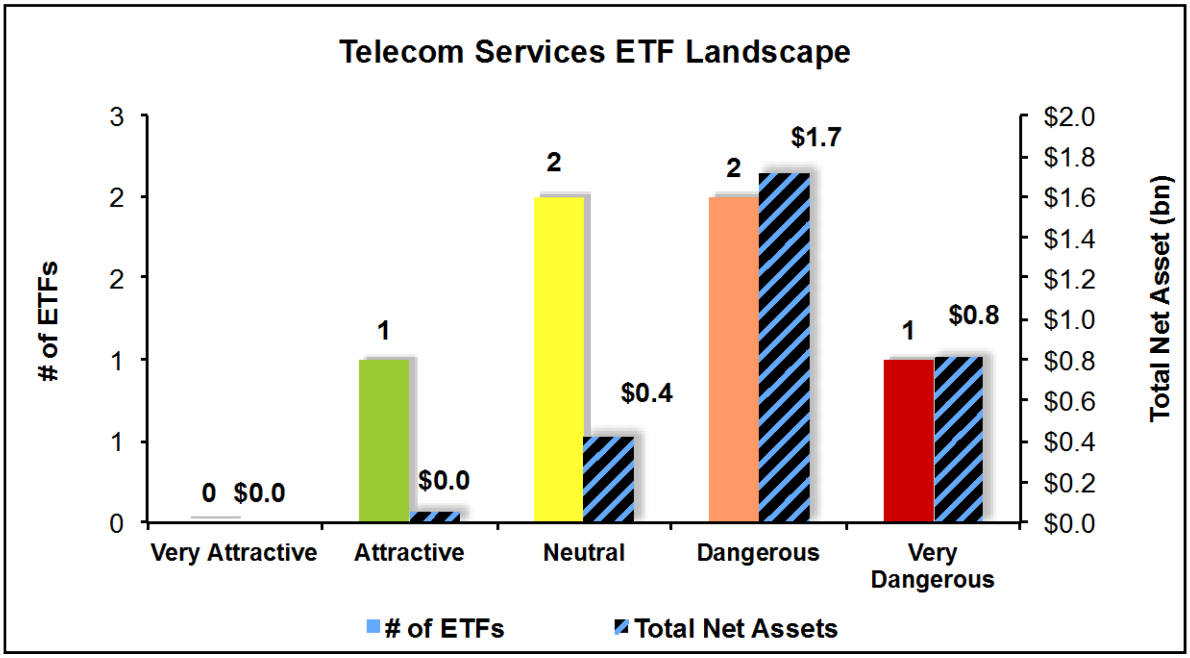
46 stocks of the 3000+ we cover are classified as Telecom Services stocks, but due to style drift, Telecom Services ETFs and mutual funds hold 57 stocks.

General Communication (GNCMA: $17/share) is one of our favorite stocks held by Telecom Services ETFs and mutual funds and earns an Attractive rating. Since 2009, General Communication's after-tax profit (NOPAT) has grown by 20% compounded annually. The company has improved its return on invested capital (ROIC) from 3% in 2009 to 7% over the last twelve months. Despite the improvement in fundamentals, GNCMA is undervalued. At its current price of $17/share, GNCMA has a price-to-economic book value (PEBV) ratio of 0.8. This ratio means the market expects General Communication's NOPAT to permanently decline by 20%. If GNCMA can grow NOPAT by just 4% compounded annually for the next decade, the stock is worth $33/share today – a 94% upside.

Telephone & Data Systems (TDS: $32/share) is one of our least favorite stocks held by Telecom Services ETFs and mutual funds and earns a Dangerous rating. Over the past decade, TDS' NOPAT has declined by 2% compounded annually to $219 million in 2015. Over the last twelve months, NOPAT is even lower at $126 million. Following the same trend, TDS' ROIC has fallen from an already low 4% in 2005 to a bottom-quintile 1% over the last twelve months. Despite the declining profitability, TDS remains priced for perfection. In order to justify its current price of $32/share, TDS must grow NOPAT by 8% compounded annually for the next 13 years. This expectation seems rather optimistic given the past decade of profit decline.

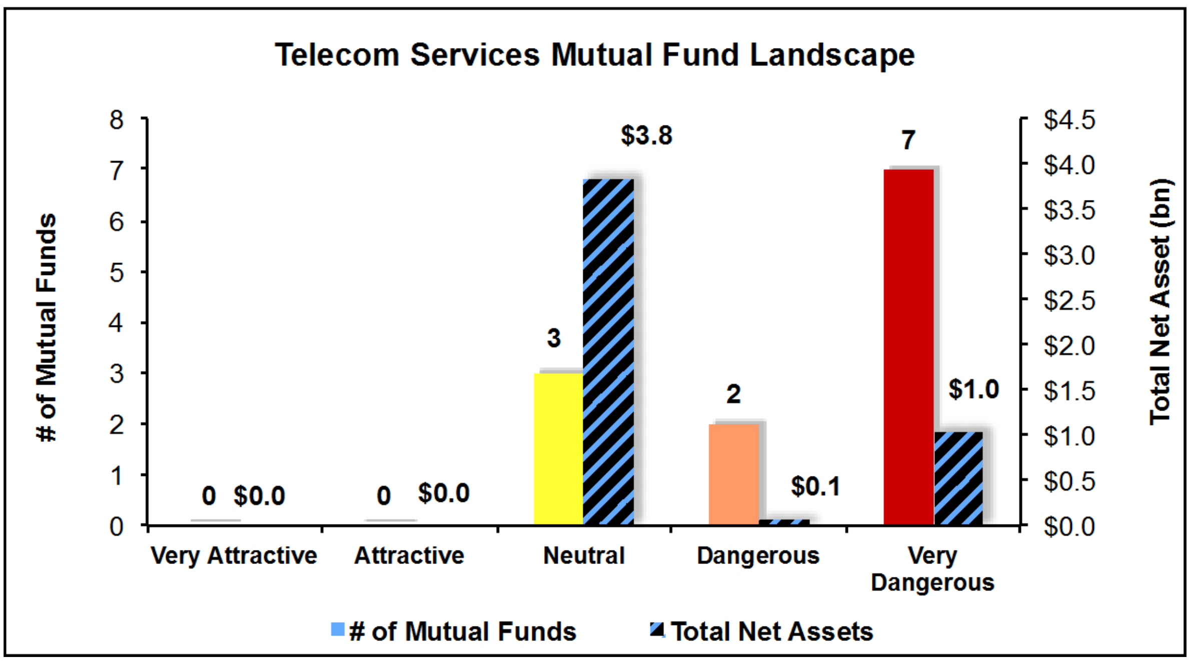
Figures 3 and 4 show the rating landscape of all Telecom Services ETFs and mutual funds.

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

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

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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.

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Our Philosophy About Research

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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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