ETF & Mutual Fund Rankings: Consumer Discretionary Sector

The Consumer Discretionary sector ranks second out of the ten sectors as detailed in our 4Q16 Sector Ratings for ETFs and Mutual Funds report. Last quarter, the Consumer Discretionary sector ranked second as well. It gets our Attractive rating, which is based on an aggregation of ratings of 13 ETFs and 19 mutual funds in the Consumer Discretionary sector as of October 6, 2016. See a recap of our 3Q16 Sector ratings here.

Figures 1 and 2 show the five best and worst rated ETFs and mutual funds in the sector. Not all Consumer Discretionary sector ETFs and mutual funds are created the same. The number of holdings varies widely (from 25 to 386). This variation creates drastically different investment implications and, therefore, ratings.

Investors seeking exposure to the Consumer Discretionary 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

	Allocation of ETF Holdings			
Ticker	**Attractive-or-better Stocks**	**Neutral Stocks**	**Dangerous-or-worse Stocks**	**Predictive Rating**
Best ETFs				
PEJ	29%	41%	16%	Very Attractive
FXD	29%	40%	25%	Very Attractive
FDIS	27%	43%	25%	Attractive
VCR	27%	43%	25%	Attractive
XLY	31%	47%	20%	Attractive
Worst ETFs				
PSCD	19%	44%	27%	Attractive
XRT	34%	33%	30%	Attractive
RTH	36%	26%	34%	Attractive
IYC	28%	39%	29%	Attractive
PBS	8%	41%	48%	Neutral

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

Sources: New Constructs, LLC and company filings

Guggenheim S&P 500 Equal Weight Consumer Discretionary (RCD) and PowerShares Dynamic Retail Portfolio (PMR) 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				
FDLSX	6%	71%	15%	**Very Attractive**
FSRPX	27%	35%	32%	**Attractive**
VCDAX	27%	43%	25%	**Neutral**
FCNIX	28%	31%	32%	**Neutral**
FCECX	28%	31%	32%	**Neutral**
Worst Mutual Funds				
RYLCX	18%	51%	24%	**Neutral**
FACPX	28%	31%	32%	**Dangerous**
FCNAX	28%	31%	32%	**Dangerous**
RYRTX	34%	29%	31%	**Dangerous**
RYLSX	18%	51%	24%	**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.

PowerShares Dynamic Leisure & Entertainment Portfolio (PEJ) is the top-rated Consumer Discretionary ETF and Fidelity Leisure Portfolio (FDLSX) is the top-rated Consumer Discretionary mutual fund. Both earn a Very Attractive rating.

PowerShares Dynamic Media Portfolio (PBS) is the worst rated Consumer Discretionary ETF and Rydex Leisure Fund (RYLSX) is the worst rated Consumer Discretionary mutual fund. PBS earns a Neutral rating and RYLSX earns a Dangerous rating.

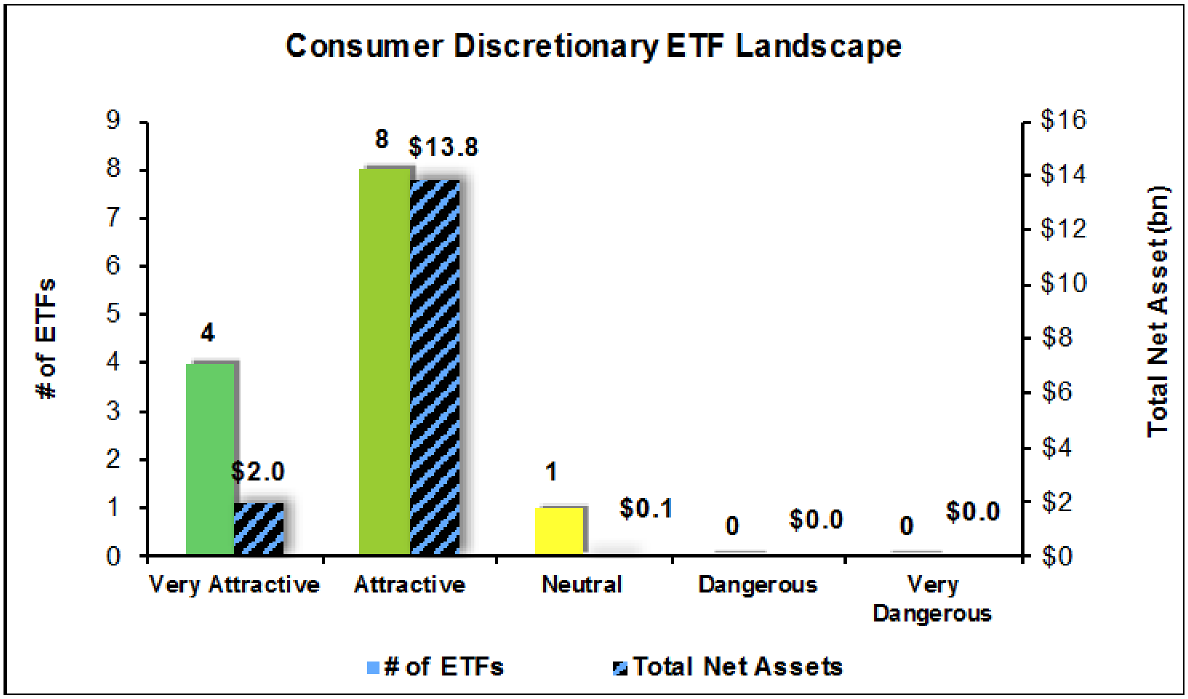
436 stocks of the 3000+ we cover are classified as Consumer Discretionary stocks.

Movado Group (MOV: $21/share) is one of our favorite stocks held by Consumer Discretionary ETFs and mutual funds and earns a Very Attractive rating. Over the past decade, Movado has grown after-tax profit (NOPAT) by 5% compounded annually. Movado has improved its return on invested capital (ROIC) from 9% in 2006 to 13% over the last twelve months (TTM). Despite the fundamental improvement, the stock remains undervalued. At its current price of $21/share, MOV has a price to economic book value (PEBV) ratio of 0.7. This ratio means the market expects MOV's profits to permanently decline by 30%. If MOV can grow NOPAT by just 3% compounded annually for the next decade, the stock is worth $38/share today – an 81% upside.

Expedia (EXPE: $119/share) is one of our least favorite stocks held by Consumer Discretionary ETFs & mutual funds and earns a Dangerous rating. Expedia was also featured in the Danger Zone in September 2015. Since 2010, Expedia's NOPAT has declined 2% compounded annually to $457 million in 2015, and further declined to $226 million TTM. Similarly, the company's ROIC has declined from 8% in 2010 to a bottom-quintile 3% TTM. Despite the deteriorating fundamentals, EXPE remains priced for significant profit growth. To justify its current price of $119/share, EXPE must immediately achieve 2015 pre-tax margins of 9% (compared to 4% TTM), and grow NOPAT by 16% compounded annually for the next 11 years. This expectation seems rather optimistic given the profit decline EXPE has experienced over the past five years.

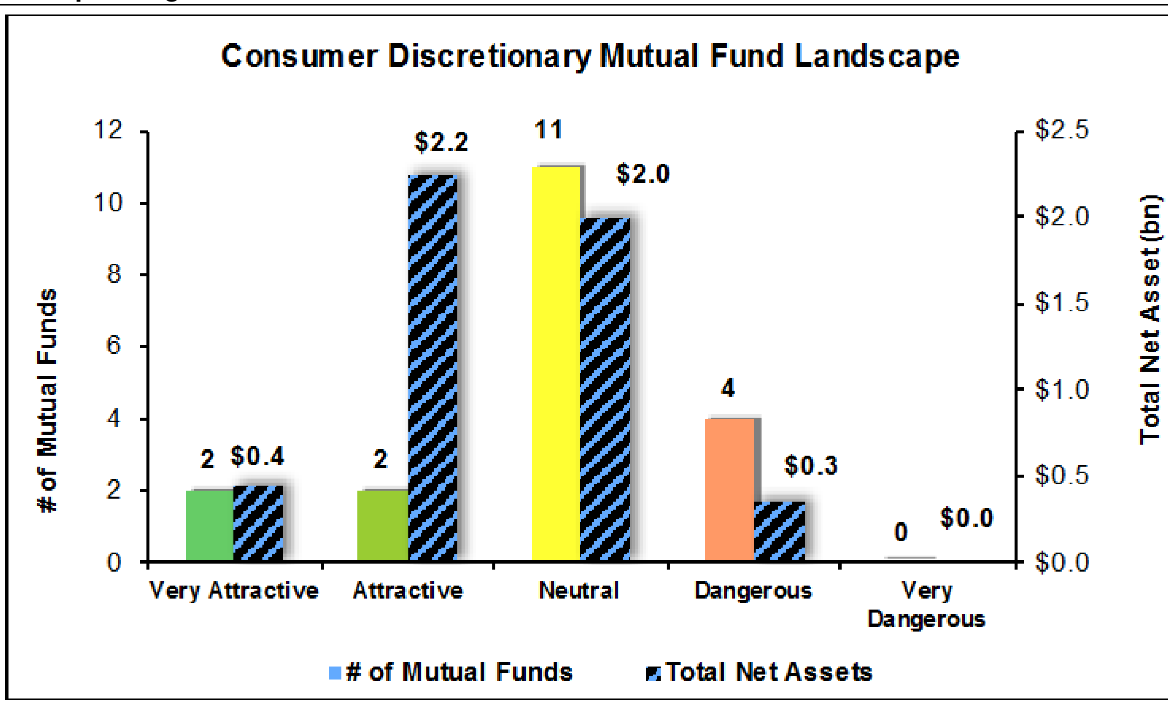
Figures 3 and 4 show the rating landscape of all Consumer Discretionary ETFs and mutual funds.

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 Martone receive no compensation to write about any specific stock, sector or theme.

New Constructs® – Profile

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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

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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