



## How to Avoid the Worst Sector ETFs

Question: Why are there so many ETFs?

Answer: ETF providers tend to make lots of money on each ETF so they create more products to sell.

The large number of ETFs has little to do with serving your best interests. Below are three red flags you can use to avoid the worst ETFs:

### 1. Inadequate Liquidity

This issue is the easiest to avoid, and our advice is simple. Avoid all ETFs with less than \$100 million in assets. Low levels of liquidity can lead to a discrepancy between the price of the ETF and the underlying value of the securities it holds. Plus, low asset levels tend to mean lower volume in the ETF and larger bid-ask spreads.

### 2. High Fees

ETFs should be cheap, but not all of them are. The first step here is to know what is cheap and expensive.

To ensure you are paying average or below average fees, invest only in ETFs with [total annual costs](#) below 0.49%, which is the average total annual costs of the 225 U.S. equity sector ETFs we cover. The weighted average is lower at 0.27%, which highlights how investors tend to put their [money in ETFs with low fees](#).

Figure 1 shows PowerShares KBW High Dividend Yield Financial (KBWD) is the most expensive sector ETF and Schwab U.S. REIT ETF (SCHH) is the least expensive. PowerShares provides one of the most expensive ETFs while Fidelity (FSTA, FTEC, FNCL) ETFs are among the cheapest.

**Figure 1: 5 Most and Least Expensive Sector ETFs**

Ticker	Name	Sector	Total Annual Cost
<b>Most Expensive</b>			
KBWD	PowerShares KBW High Dividend Yield Financial	Financials	2.70%
HECO	EcoLogical Strategy ETF	Industrials	1.06%
UTES	Reaves Utilities ETF	Utilities	1.06%
FNG	AdvisorShares New Tech and Media ETF	Technology	0.94%
WEAR	Exchange Listed Funds WEAR ETF	Technology	0.94%
<b>Least Expensive</b>			
SCHH	Schwab U.S. REIT ETF	Real Estate	0.08%
USRT	iShares Core U.S. REIT ETF	Real Estate	0.09%
FSTA	Fidelity MSCI Consumer Staples Index	Consumer Non-cyclicals	0.09%
FTEC	Fidelity MSCI Information Technology Index	Technology	0.09%
FNCL	Fidelity MSCI Financials Index ETF	Financials	0.09%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings<sup>1</sup>. Fidelity MSCI Consumer Staples Index (FSTA) is the best ranked sector ETF in Figure 1. FSTA's Attractive [Portfolio Management rating](#) and 0.09% total annual cost earns it a Very Attractive rating<sup>2</sup>. State Street SPDR Consumer Staples Select Sector Fund (XLP) is the best ranked

<sup>1</sup> Ernst & Young's recent white paper "[Getting ROIC Right](#)" proves the superiority of our holdings research and analytics.

<sup>2</sup> Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).



sector ETF overall. XLP’s Attractive Portfolio Management rating and 0.14% total annual cost also earns it a Very Attractive rating.

On the other hand, iShares Core U.S. REIT ETF (USRT) holds poor stocks and earns our Unattractive rating, yet has low total annual costs of 0.09%. No matter how cheap an ETF, if it holds bad stocks, its performance will be bad. The quality of an ETFs holdings matters more than its price.

**3. Poor Holdings**

Avoiding poor holdings is by far the hardest part of avoiding bad ETFs, but it is also the most important because an ETF’s performance is determined more by its holdings than its costs. Figure 2 shows the ETFs within each sector with the worst holdings or [portfolio management ratings](#).

**Figure 2: Sector ETFs with the Worst Holdings**

Ticker	Name	Sector	Portfolio Management Rating
FMAT	Fidelity MSCI Materials Index ETF	Basic Materials	Unattractive
FDIS	Fidelity MSCI Consumer Discretionary Index ETF	Consumer Cyclical	Unattractive
PSCC	PowerShares S&P Small Cap Consumer Staples	Consumer Non-cyclical	Unattractive
PSCE	PowerShares S&P Small Cap Energy	Energy	Unattractive
PSCF	PowerShares S&P Small Cap Financials	Financials	Unattractive
BBP	Virtus Life Sciences Biotech Products	Healthcare	Unattractive
XTN	State Street SPDR S&P Transportation ETF	Industrials	Unattractive
PSR	PowerShares Active US Real Estate Fund	Real Estate	Unattractive
XWEB	State Street SPDR S&P Internet ETF	Technology	Unattractive
IYZ	iShares US Telecommunications	Telecom Services	Unattractive
PSCU	PowerShares S&P Small Cap Utilities Portfolio	Utilities	Unattractive

Sources: New Constructs, LLC and company filings

PowerShares (PSCC, PSCE, PSCF, PSR, PSCU) appears more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

iShares U.S. Telecommunications ETF (IYZ) is the worst rated ETF in Figure 2. PowerShares Active U.S. Real Estate Fund (PSR) and PowerShares S&P Small Cap Energy Portfolio (PSCE) also earn a Very Unattractive [predictive overall rating](#), which means not only do they hold poor stocks, they charge high total annual costs.

Our [overall ratings on ETFs](#) are on our [stock ratings](#) of their holdings and the total annual costs of investing in the ETF.

**The Danger Within**

Buying an ETF without analyzing its holdings is like buying a stock without analyzing its business and finances. Put another way, research on ETF holdings is necessary due diligence because an ETF’s performance is only as good as its holdings’ performance. Don’t just take our word for it, [see what Barron’s says](#) on this matter.

PERFORMANCE OF ETFs HOLDINGS = PERFORMANCE OF ETF

Analyzing each holding within funds is no small task. Our [Robo-Analyst technology](#) enables us to perform this diligence with scale and provide the [research needed](#) to [fulfill the fiduciary duty of care](#). More of the biggest names in the financial industry (see [At BlackRock, Machines Are Rising Over Managers to Pick Stocks](#)) are now embracing technology to leverage machines in the investment research process. Technology may be the only solution to the dual mandate for research: cut costs and fulfill the fiduciary duty of care. Investors, clients, advisors and analysts deserve the latest in technology to get the diligence required to make prudent investment decisions.

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2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

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Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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