This ETF Lives up to Its Name

A recent look at the ETFs with more than $1 billion if inflows this year revealed that many investors are still chasing momentum instead of looking for value. For example, the iShares MSCI USA Momentum Factor ETF (MTUM) has taken in over $2.3 billion (which ranks eighth out of the 21 equity ETFs with $1 billion or more of net inflows in 2018). Investors are betting that momentum strategies will keep working for the foreseeable future.

By contrast, this value ETF has taken in just one-tenth of MTUM's inflows, as investors think value investing doesn't work anymore. However, as we've written before, value investing still works, it's just become much harder. Many value funds underperform because they attempt to execute value investing strategies that rely on overly simplistic metrics, like price to earnings or price to book, that don't measure value well.

Leveraging our Robo-Analyst technology[1], which analyzes the holdings of all 7,908 ETFs and mutual funds under coverage, we found this ETF with high quality holdings[2] that should appeal to sophisticated value investors. iShares Edge MSCI USA Value Factor ETF (VLUE) is this week's Long Idea.

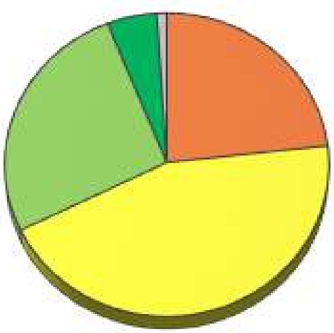
Ignore Momentum and Find Value

VLUE has taken in just $243 million in 2018, despite offering better risk/reward from a value investor's perspective. MTUM has outperformed so far – up 6.4% in 2018 vs. VLUE at 0% for the year – but we don't expect that outperformance to continue. Chasing momentum can have a devastating impact on one's portfolio when the momentum stops.

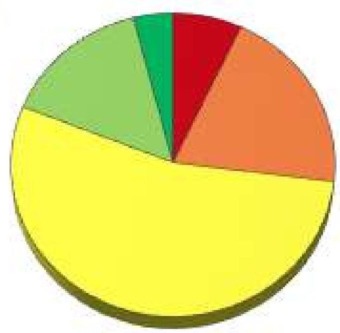
While the returns of MTUM may look appealing, investors looking for exposure to Large Cap stocks can find better holdings, and risk/reward, in VLUE.

Figure 1: VLUE Asset Allocation Compared to MTUM

Stock Rating Allocations vs Benchmark - iShares Edge MSCI USA Value Factor ETF



VLUE Allocations		MTUM Allocation:
0%	Very Unattractive	7%
23%	Unattractive	20%
44%	Neutral	54%
26%	Attractive	15%
5%	Very Attractive	4%
1%	Unrated	0%
--	Cash	--



Sources: New Constructs, LLC and company filings

Per Figure 1, VLUE allocates 31% of its assets to Attractive-or-better rated stocks compared to just 19% for MTUM. On the flip side, VLUE allocates 23% of its assets to Unattractive-or-worse rated stocks compared to 27% for MTUM. Given the higher allocation to Attractive-or-better rated stocks, and lower allocation to Unattractive-or-worse rated stocks, VLUE appears better positioned to capture upside potential while taking on less downside risk.

Beyond overall risk/reward rating, VLUE allocates to stocks that are more undervalued relative to MTUM. The price-to-economic book value (PEBV) ratio of stocks held by VLUE is just 1.4 vs. 3.9 for MTUM holdings. This ratio means the market expects the stocks held by MTUM to grow after-tax profit (NOPAT) more than two times that of VLUE's holdings. Similarly, the market-implied growth appreciation period of VLUE's holdings is 16 years

[1] Harvard Business School features the powerful impact of our research automation technology in the case New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.
[2] Ernst & Young's recent white paper "Getting ROIC Right" proves the superiority of our stock research and analytics.

vs. 43 years for MTUM. In other words, MTUM constituents have to grow economic earnings for 27 years longer than companies held by VLUE to justify their current stock prices.

In a market propped up by illusory earnings beats, holding such overvalued stocks adds unnecessary risk to investors' portfolios.

VLUE Finds Value Relative to its Benchmark as Well

VLUE also holds higher quality stocks when compared to its benchmark, the iShares Russell 1000 Value ETF (IWD), and the general market (S&P 500).

Figure 2 contains our detailed fund rating for VLUE, which includes each of the criteria we use to rate all ETFs under coverage. These criteria are very similar to our Stock Rating Methodology, because the performance of an ETF's holdings equals the performance of an ETF. The results of this analysis reveal important information for investors in VLUE.

Figure 2: iShares Edge MSCI USA Value Factor ETF Rating Breakdown

iShares Trust: iShares Edge MSCI USA Value Factor ETF (VLUE)

Closing Price: $84.90 (May 24, 2018)
Dividend Yield: 2.2%
Style: Large Cap Value

	Portfolio Management					
	Quality of Earnings		Valuation			
Risk/Reward Rating	Econ vs Reported EPS	ROIC	FCF Yield	Price to EBV	GAP	Total Annual Costs
Very Unattractive	Misleading Trend	Bottom Quintile	<-5%	>3.5 or -1<0	>50	>4%
Unattractive	False Positive	4th Quintile	-5%<-1%	2.4<3.5 or <-1	20<50	2%<4%
Neutral	Neutral EE	3rd Quintile	-1%<3%	1.6<2.4	10<20	1%<2%
Attractive	Positive EE	2nd Quintile	3%<10%	1.1<1.6	3<10	0.5%<1%
Very Attractive	Rising EE	Top Quintile	>10%	0<1.1	0<3	<0.5%
Actual Values						
VLUE	**Neutral EE**	**21%**	**3%**	**1.4**	**16 yrs**	**0.2%**
Benchmarks						
Style ETF (IWD)	Neutral EE	7%	2%	2.3	25 yrs	0.2%
S&P 500 ETF (SPY)	Positive EE	18%	2%	3.1	30 yrs	0.1%
Small Cap ETF (IWM)	Positive EE	6%	-1%	3.2	36 yrs	0.2%

Sources: New Constructs, LLC and company filings

As Figure 2 shows, VLUE's holdings are superior to IWD and SPY in four out of the five criteria that make up our holdings analysis:

- The return on invested capital (ROIC) for VLUE's holdings is 21%, just above the 18% ROIC earned by companies held by SPY and three times the 7% earned by IWD holdings.
- The 3% free cash flow (FCF) yield of VLUE's holdings is greater than the 2% earned by SPY and IWD stocks.
- The PEBV ratio for VLUE is 1.4, while the PEBV ratio for IWD is 2.3 and for SPY is 3.1.
- Our discounted cash flow analysis reveals an average market-implied growth appreciation period of 16 years for VLUE holdings compared to 25 years for IWD and 30 years for SPY.

Ultimately, the stocks held by VLUE generate superior cash flows compared to IWD and SPY, yet the market projects IWD and SPY stocks will grow profits at a faster rate and for a longer period of time.

VLUE Is the Value in Large Cap Value

VLUE is the best when compared to large cap value ETFs, such as the Vanguard Value Index Fund (VTV), Vanguard Dividend Appreciation Fund (VIG), Vanguard High Dividend Yield Index Fund (VYM), iShares Select Dividend ETF (DVY) and State Street SPDR S&P Dividend ETF (SDY). Per Figure 3, VLUE has the highest ROIC (best quality of earnings) and lowest PEBV ratio (cheapest valuation) in this group.

Despite its holdings being more profitable and cheaper, VLUE has just $3.3 billion in assets. This asset level is dwarfed by the group in Figure 3, which has anywhere from $16 billion to $36 billion in assets. Investors searching for true value should take a closer look at VLUE.

Figure 3: VLUE Rating Breakdown Vs. Largest Large Cap Value ETFs

ETF	Ticker	ROIC	FCF Yield	PEBV	GAP
iShares Edge MSCI USA Value Factor ETF	VLUE	21%	3%	1.4	16
Vanguard Dividend Appreciation Index Fund	VIG	13%	1%	1.8	23
Vanguard High Dividend Yield Index Fund	VYM	11%	2%	1.7	27
Vanguard Value Index Fund	VTV	9%	2%	1.5	25
State Street SPDR S&P Dividend ETF	SDY	9%	0%	1.6	13
iShares Select Dividend ETF	DVY	8%	1%	1.7	18

Sources: New Constructs, LLC and company filings.

Recent Long Idea, General Motors (GM), is one of VLUE's top holdings and makes up 3.1% of its portfolio. As we noted in our original report, the expectations baked into GM's stock imply the firm's profits will permanently fall by 50%. Such an expectation seems beyond pessimistic given that GM is best positioned to excel in the future of self-driving and electric vehicles. Given the gloom and doom baked into the stock, GM presents attractive risk/reward.

If pre-tax margins fall to 2010 levels (5.7%) and NOPAT declines by 2% compounded annually for the next five years, the stock is worth $75/share today (more than double the current price). See the math behind this dynamic DCF scenario here. Essentially, investors have a chance to double their money even if profits decline over the next five years.

Finding stocks with strong fundamentals and undervalued stock prices is a staple of value investing. GM, as well as VLUE's other holdings, clearly represent Value in Large Cap Value ETFs.

VLUE Looks Positioned to Continue Outperforming

Beyond holdings analysis, one must also analyze the costs of investing in a particular fund, as high costs can destroy any potential return. As a passively managed ETF, one would expect VLUE's total annual costs to be much lower than an actively managed counterpart, and they are. With total annual costs (TAC) of 0.17%, VLUE's expenses are lower than 98% of the 1033 Large Cap Value style ETFs and mutual funds under coverage. Coupled with its quality holdings, below average fees make VLUE more attractive and outperformance more likely.

While we recognize that past performance is no guarantee of future results, VLUE's quality holdings and low costs have led to outperformance relative to its benchmark (IWD) over the past one, three, and five-year periods. VLUE is also the only ETF of the group identified in Figure 3 to outperform the general market (SPY) over the past one-year period and perform inline over the past five-year period. Figure 4 has the details.

Figure 4: iShares Edge MSCI USA Value Factor Trailing Returns

		Trailing Returns			
ETF	**Ticker**	**YTD**	**1-Year**	**3-Year**	**5-Year**
iShares Edge MSCI USA Value Factor ETF	VLUE	-0.2%	15.1%	9.9%	12.9%
State Street SPDR S&P 500 ETF	SPY	-0.5%	13.2%	10.5%	12.9%
Vanguard Value Index Fund	VTV	-2.0%	11.4%	9.7%	11.9%
iShares Select Dividend ETF	DVY	-1.5%	8.7%	10.7%	11.6%
Vanguard High Dividend Yield Index Fund	VYM	-2.8%	9.7%	9.3%	11.2%
State Street SPDR S&P Dividend ETF	SDY	-3.2%	7.6%	10.5%	11.2%
Vanguard Dividend Appreciation Index Fund	VIG	-1.5%	11.6%	9.9%	10.7%
iShares Russell 1000 Value ETF	IWD	-2.7%	7.3%	7.5%	10.3%

Sources: New Constructs, LLC and Yahoo Finance return data

The Importance of Holdings Based Fund Analysis

Investors have many options when looking to invest in Large Cap stocks. However, one does not have to chase risky momentum strategies or simply buy the largest ETF available. Through diligent holdings analysis, investors can find greater value.

Our Robo-Analyst technology helps perform this diligence by analyzing the holdings of all 2681 Large Cap focused ETFs and mutual. Our diligence on holdings led us to an ETF, VLUE, with a portfolio that suggests future performance will be strong.

Each quarter we rank the 11 sectors in our Sector Ratings for ETF & Mutual Funds and the 12 investment styles in our Style Ratings For ETFs & Mutual Funds report. This analysis allows us to find ETFs and mutual funds that investors using traditional fund research may overlook, such as the iShares Edge MSCI USA Value Factor ETF (VLUE).

This article originally published on May 30, 2018.

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

Follow us on Twitter, Facebook, LinkedIn, and StockTwits for real-time alerts on all our research.

New Constructs® - Research to Fulfill the Fiduciary Duty of Care

Ratings & screeners on 3000 stocks, 450 ETFs and 7000 mutual funds help you make prudent investment decisions.

New Constructs leverages the latest in machine learning to analyze structured and unstructured financial data with unrivaled speed and accuracy. The firm's forensic accounting experts work alongside engineers to develop proprietary NLP libraries and financial models. Our investment ratings are based on the best fundamental data in the business for stocks, ETFs and mutual funds. Clients include many of the top hedge funds, mutual funds and wealth management firms. David Trainer, the firm's CEO, is regularly featured in the media as a thought leader on the fiduciary duty of care, earnings quality, valuation and investment strategy.

To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
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.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

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.

DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first 15 days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.