



## How to Avoid the Worst Style 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.

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The large number of ETFs has little to do with serving your best interests. The [best fundamental data](#) in the world, proven in [The Journal of Financial Economics](#), drives our research and analysis of ETF holdings. We leverage this data to identify three red flags you can use to avoid the worst ETFs:

### 1. Inadequate Liquidity

This issue is the easiest issue 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 at or below average fees, invest only in ETFs with [total annual costs](#) below 0.41%, which is the average total annual cost of the 721 U.S. equity Style ETFs we cover. The weighted average is lower at 0.13%, which highlights how investors tend to put their [money in mutual funds with low fees](#).

Figure 1 shows WBI BullBear Value 3000 ETF (WBIF) is the most expensive style ETF and JPMorgan BetaBuilders U.S. Equity ETF (BBUS) is the least expensive. Absolute Shares Trust (WBIF, WBIE, WBIL, WBIG) provides 4 of the most expensive ETFs while JP Morgan provides the cheapest (BBUS).

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

Ticker	Name	Style	Total Annual Cost
Most Expensive			
WBIF	WBI BullBear Value 3000 ETF	All Cap Blend	1.39%
WBIE	WBI BullBear Rising Income 3000 ETF	All Cap Blend	1.38%
WBIL	WBI BullBear Quality 3000 ETF	All Cap Blend	1.37%
LGH	HCM Defender 500 Index ETF	Large Cap Blend	1.37%
WBIG	WBI BullBear Yield 3000 ETF	All Cap Blend	1.27%
Least Expensive			
BBUS	JPMorgan BetaBuilders U.S. Equity	Large Cap Blend	0.02%
SPTM	SPDR Portfolio S&P 1500 Composite	All Cap Blend	0.03%
ITOT	iShares Core S&P Total U.S. Market	All Cap Blend	0.03%
SCHB	Schwab U.S. Broad Market ETF	All Cap Blend	0.03%
VTI	Vanguard Total Stock Market Index	All Cap Blend	0.03%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings.<sup>1</sup> State Street SPDR Portfolio S&P 1500 Composite (SPTM) is the best ranked style ETF in Figure 1. SPTM's Neutral [Portfolio Management rating](#) and 0.03% total annual

<sup>1</sup> Three independent studies from respected institutions prove the superiority of our data, models, and ratings. Learn more [here](#).



cost earns it an Attractive rating.<sup>2</sup> American Century STOXX U.S. Quality Value ETF (VALQ) is the best ranked style ETF overall. VALQ's Attractive Portfolio Management rating and 0.32% total annual cost also earns it a Very Attractive rating.

On the other hand, no matter how cheap an ETF, if it holds bad stocks, its performance will be bad. The quality of an ETF's 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 style with the worst holdings or [portfolio management ratings](#).

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

Ticker	Name	Style	Portfolio Management Rating
MJ	ETF Managers ETFMG Alternative Harvest	All Cap Blend	Unattractive
ENTR	ERShares Entrepreneur 30 ETF	All Cap Growth	Unattractive
SPHB	Invesco S&P 500 High Beta ETF	All Cap Value	Unattractive
NULC	Nuveen ESG Large Cap ETF	Large Cap Blend	Neutral
MTUM	iShares MSCI U.S.A. Momentum Factor ETF	Large Cap Growth	Unattractive
SPYD	State Street SPDR Portfolio S&P 500 High Dividend ETF	Large Cap Value	Unattractive
SCHM	Schwab U.S. Mid Cap ETF	Mid Cap Blend	Unattractive
BOSS	Global X Founder-Run Companies ETF	Mid Cap Growth	Unattractive
IWS	iShares Russell Mid Cap Value ETF	Mid Cap Value	Unattractive
SCHA	Schwab U.S. Small Cap ETF	Small Cap Blend	Unattractive
MFMS	MFAM Small Cap Growth ETF	Small Cap Growth	Unattractive
SMLV	State Street SPDR SSGA U.S. Small Cap Low Volatility	Small Cap Value	Unattractive

Sources: New Constructs, LLC and company filings

iShares (MTUM & IWS), State Street (SMLV & SPYD), and Schwab (SCHA & SCHM) appear more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

MFAM Small Cap Growth ETF (MFMS) is the worst rated ETF in Figure 2. ETF Managers ETFMG Alternative Harvest ETF (MJ) also earns a Very Unattractive [predictive overall rating](#), which means not only does it hold poor stocks, it charges 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

<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](#).



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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Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Below, we present three different papers from both the public and private sectors that prove the superiority of our proprietary fundamental data, earnings models, investment ratings, and research for stocks, bonds, ETFs, and mutual funds.

### **Best Fundamental Data in the World**

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves the superiority of our [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by *IBSPI Adjustments*, *OIADP Adjustments*, or *OPE Adjustments* individually.” – pp. 14, 1<sup>st</sup> para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2<sup>nd</sup> para.

### **Superior Models**

A top accounting firm features the superiority of our [NOPAT](#), [Invested Capital](#), and [ROIC](#) research on four mega-cap companies in “[Getting ROIC right: how an accurate view of ROIC can drive improved shareholder value](#)”.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [the New Constructs method] can investors get an accurate calculation of ROIC.” – pp. 8, 5<sup>th</sup> para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2<sup>nd</sup> para.

See the [Appendix](#) for direct comparison of our analysis of DOW’s 2015 results to Capital IQ and Bloomberg.

### **Superior Stock Ratings**

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3<sup>rd</sup> para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3<sup>rd</sup> para.

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