Big Upside in This Small Cap ETF

Our forward-looking fund research consistently identifies mutual funds and ETFs that outperform their benchmarks and warns investors of funds most likely to underperform. After rigorous analysis of ~1,000 ETFs, we identified another ETF with quality holdings at cheap valuations. Pacer U.S. Small Cap Cash Cows 100 ETF (CALF) is this week's Long Idea.

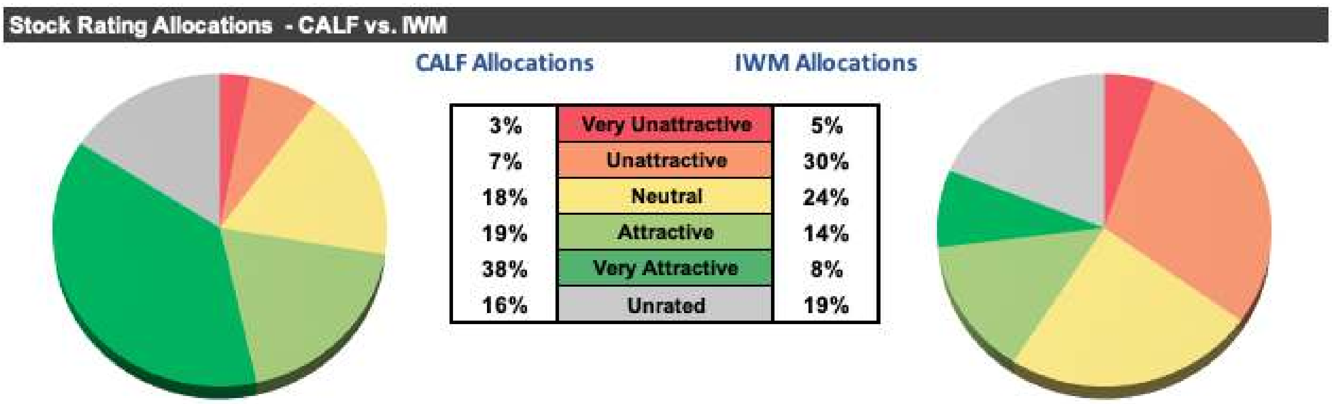
Forward-Looking Research Reveals a Very Attractive Fund

We leverage our Robo-Analyst technology[1] to analyze a fund's individual stock holdings and assess the overall quality of the fund. This uniquely rigorous approach enables us to create forward-looking ETF and mutual fund ratings based on the strength and valuation of the underlying businesses of the stocks held in a fund.

Our analysis of each of the holdings of CALF and its benchmark, the iShares Russell 2000 ETF (IWM), reveals CALF allocates more to highly profitable companies with cheap valuations than IWM. CALF earns our Very Attractive Predictive Fund Rating, while IWM earns an Unattractive rating.

Per Figure 1, CALF allocates 57% of its assets to Attractive-or-better rated stocks compared to just 22% for IWM. On the flip side, CALF allocates just 10% of its assets to Unattractive-or-worse rated stocks compared to 35% for IWM.

Figure 1: CALF Allocates Capital to Superior Holdings than IWM



CALF Allocations		IWM Allocations
3%	Very Unattractive	5%
7%	Unattractive	30%
18%	Neutral	24%
19%	Attractive	14%
38%	Very Attractive	8%
16%	Unrated	19%

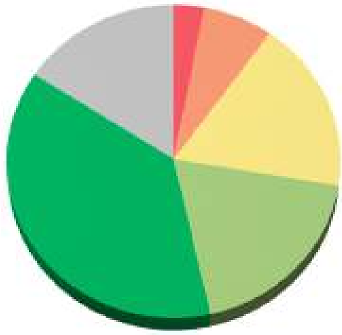
Sources: New Constructs, LLC and company filings

Per Figure 2, our holdings analysis also reveals CALF's portfolio is much higher quality than the S&P 500 as represented by State Street SPDR S&P 500 ETF Trust (SPY). 17% of SPY's portfolio is allocated to Unattractive-or-worse rated stocks, while just 37% is allocated to Attractive-or-better rated stocks.

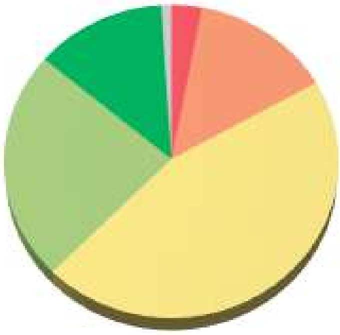
[1] Our Robo-Analyst technology provides superior fundamental data, as proven in The Journal of Financial Economics, and a novel source of alpha.

Figure 2: CALF Allocates Capital to Superior Holdings than SPY

Stock Rating Allocations - CALF vs. SPY



CALF Allocations		SPY Allocations
3%	Very Unattractive	3%
7%	Unattractive	14%
18%	Neutral	46%
19%	Attractive	24%
38%	Very Attractive	13%
16%	Unrated	1%



Sources: New Constructs, LLC and company filings

Selection Process Finds Quality and Value

Similar to its large cap counterpart Pacer Funds U.S. Cash Cows 100 ETF (COWZ), which we made a Long Idea in March 2019 and highlighted again in April 2020, CALF adheres to a simple strategy that leads it to select a large number of stocks with an Attractive-or-better rating. CALF managers select the 100 companies with the highest trailing twelve month (TTM) free cash flow (FCF) yields from the S&P SmallCap 600 and weights them by FCF yield.

Focusing on FCF yield puts CALF's managers on the right track to identifying companies with quality cash flows and cheap valuations. Unlike traditional metrics such as price-to-earnings (P/E) ratios, FCF yield provides a much more accurate measure of value.

CALF's FCF yield focused methodology isn't just good on paper, but in practice too. The average FCF yield of CALF's holdings is 6%, which is greater than -1% for IWP and triple the FCF yield for the S&P 500. See details below.

Quality Stocks Drive Very Attractive Risk/Reward Rating

Taking a closer look at each of CALF's holdings reveals the strength of its selection methodology. Out of the 89 of CALF holdings under coverage:

- 100% have a positive ROIC
- 82% have a positive free cash flow yield
- 79% have a positive PEBV ratio of 1.3 or less
- 71% have a growth appreciation period (GAP) of 10 years or less
- 90% receive a Risk/Reward rating of Neutral-or-better

Figure 3 contains our detailed rating for CALF, which includes each of the criteria we use to rate all ETFs under coverage. These criteria are the same for our Stock Rating Methodology, because the performance of an ETF's holdings equals the performance of the ETF after fees. Figure 3 also compares CALF's criteria ratings with those of IWM and SPY.

Figure 3: Pacer U.S. Small Cap Cash Cows 100 ETF Fund Breakdown

Risk/Reward Rating	Portfolio Management: Quality of Earnings: Economic vs Reported EPS	ROIC	Valuation: FCF Yield	Price to EBV	Market-Implied 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						
CALF	Rising EE	18%	6%	0.8	15 yrs	0.7%
Benchmarks						
Style ETF (IWM)	Positive EE	7%	-1%	2.9	29 yrs	0.2%
S&P 500 ETF (SPY)	Positive EE	32%	2%	2.4	19 yrs	0.1%
Small Cap ETF (IWM)	Positive EE	7%	-1%	2.9	29 yrs	0.2%

Sources: New Constructs, LLC and company filings

CALF's holdings are superior to IWM (click here for our report on IWM) in all five criteria that make up our holdings/Portfolio Management rating and are superior to SPY in four out of five criteria. Specifically:

- CALF's economic earnings are positive and rising, unlike IWM and SPY
- CALF's return on invested capital (ROIC) is 18% and greater than the 7% earned by IWM
- CALF's free cash flow (FCF) yield of 6% is higher than IWM at -1% and SPY at 2%
- the price-to-economic book value (PEBV) ratio for CALF is 0.8, which is much less than the 2.9 ratio for IWM and 2.4 for SPY
- our discounted cash flow analysis reveals an average Market-Implied GAP of just 15 years for CALF's holdings compared to 29 years for IWM and 19 years for SPY

The stocks held by CALF generate higher-quality cash flows and have lower valuations than IWM. Market expectations for stocks held by CALF imply profits will fall 20% from current levels (measured by PEBV ratio) while the expectations embedded in IWM's holdings imply profits will grow by 190%.

Quality Stock Selection Is Worth Paying For

CALF's 0.65% total annual costs (TAC) are above the 0.4% simple average and 0.2% weighted average of the 69 other Small Cap Blend ETFs under coverage. CALF's managers' ability to identify high-quality stocks at cheap valuations help to justify the fund's above-average fees. Figure 4 shows our breakdown of CALF's total annual costs, which is available for all of the ~6,700 mutual funds and 1,000+ ETFs under coverage.

Figure 4: CALF Total Annual Costs Breakdown

Total Annual Costs	
Expense Ratio	0.59%
Total Annual Costs	0.65%
Rank (percentile)	32%

Sources: New Constructs, LLC and company filings

The Importance of Sector and Holdings Based Fund Analysis

We offer clients in-depth reports for all the 7,700+ ETFs and mutual funds under coverage. Click below for a free copy of CALF's standard ETF report.

Free copy of our CALF report

Simply buying an ETF or mutual fund based on past performance does not necessarily lead to outperformance. Only through holdings-based analysis can one determine if a mutual fund is allocating to stocks with businesses with high earnings quality and low valuations, as CALF does.

Most investors don't realize they can already get the sophisticated fundamental research that enables investors to overcome inaccuracies, omissions, and biases in legacy fundamental datasets. Our Robo-Analyst technology analyzes the holdings of all mutual funds and ETFs under coverage to avoid "the danger within." Our diligence on holdings allows us to cut through the noise and find mutual funds, like Pacer U.S. Small Cap Cash Cows 100 ETF, with a portfolio that suggests future performance will be strong.

Build an Even Better Fund For Yourself

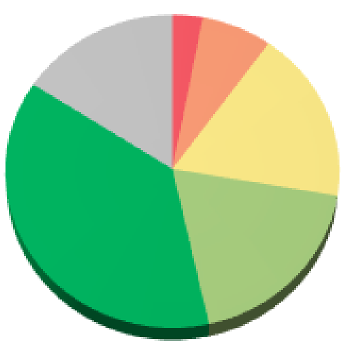
As we showed in The Paradigm Shift to DIY ETFs, new technologies enable investors to create their own fund without any fees while also enabling better, more sophisticated weighting methodologies. If we reallocate the fund's holdings according to economic earnings, a more accurate picture of the true cash flows of a business, our customized fund allocates:

- 94% of assets to Attractive-or-better rated stocks (compared to 57% for CALF)
- 0% of assets to Unattractive-or-worse rated stocks (compared to 10% for CALF)

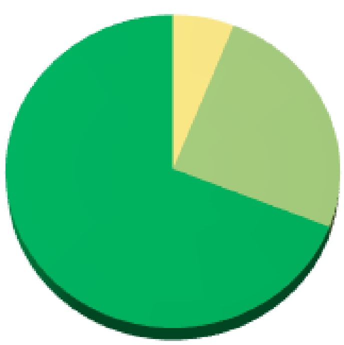
Compare the quality of stock allocation in our customized version of CALF vs. as-is CALF in Figure 5.

Figure 5: Pacer U.S. Small Cap Cash Cows 100 ETF Allocation Could Be Improved

Stock Rating Allocations - CALF vs. Custom



CALF Allocations		Custom Allocation
3%	Very Unattractive	0%
7%	Unattractive	0%
18%	Neutral	6%
19%	Attractive	25%
38%	Very Attractive	69%
16%	Unrated	0%



Sources: New Constructs, LLC, company, and ETF filings

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

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior 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 *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st 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, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

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 [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th 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, 2nd para.

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, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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