



## How to Avoid the Worst Style ETFs

Question: Why are there so many ETFs?

Answer: ETF issuance is profitable, so Wall Street keeps cranking out more products to sell.

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The large number of ETFs has little to do with serving your best interests as an investor. More [reliable](#) & [proprietary](#) fundamental data, proven in [The Journal of Financial Economics](#), drives our research and analysis of ETF holdings and provides investors with a [new source of alpha](#). 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 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. Small ETFs also generally have lower trading volume, which translates to higher trading costs via larger bid-ask spreads.

### 2. High Fees

ETFs should be cheap, but not all of them are. The first step is to benchmark what cheap means.

To ensure you are paying at or below average fees, invest only in ETFs with [total annual costs](#) below 0.46%, – the average total annual cost of the 699 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 ETFs with low fees](#).

Figure 1 shows Convergence Long/Short Equity ETF (CLSE) is the most expensive style ETF and JPMorgan BetaBuilders U.S. Equity ETF (BBUS) is the least expensive.

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

Ticker	Name	Style	Total Annual Cost
<b>Most Expensive</b>			
CLSE	Convergence Long/Short Equity ETF	All Cap Blend	1.74%
LBAY	Leatherback Long/Short Alternative Yield ETF	All Cap Blend	1.60%
MBCC	Monarch Blue Chips Core ETF	Large Cap Blend	1.39%
MGMT	Ballast Small/Mid Cap ETF	Small Cap Blend	1.22%
SENT	AdvisorShares Alpha DNA Equity Sentiment ETF	Mid Cap Blend	1.20%
<b>Least Expensive</b>			
BBUS	JPMorgan BetaBuilders U.S. Equity ETF	Large Cap Blend	0.02%
USPX	Franklin U.S. Equity Index ETF	All Cap Blend	0.03%
SCHB	Schwab U.S. Broad Market ETF	All Cap Blend	0.03%
ITOT	iShares Core S&P Total U.S. Stock Market ETF	All Cap Blend	0.03%
VTI	Vanguard Total Stock Market Index Fund; ETF Class Shares	All Cap Blend	0.03%

Sources: New Constructs, LLC and company filings



Investors need not pay high fees for quality holdings.<sup>1</sup> iShares Morningstar Value ETF (ILCV) is the best ranked style ETF with low costs. ILCV's Neutral [Portfolio Management rating](#) and 0.04% total annual cost earns it a Very Attractive rating.<sup>2</sup> First Trust SMID Cap Rising Dividend Achievers ETF (SDVY) is the best ranked style ETF overall that meets our liquidity minimums. SDVY's Attractive Portfolio Management rating and 0.66% total annual cost also earns it a Very Attractive rating.

### 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 [portfolio management ratings](#), a function of the fund's holdings.

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

Ticker	Name	Style	Portfolio Management Rating
BYOB	SoFi Be Your Own Boss ETF	All Cap Blend	Unattractive
ZGEN	EA Series Trust: Generation Z ETF	All Cap Growth	Unattractive
RIET	Hoya Capital High Dividend Yield ETF	All Cap Value	Unattractive
QQQN	VictoryShares Nasdaq Next 50 ETF	Large Cap Blend	Unattractive
AILG	Alpha Intelligent - Large-Cap Growth ETF	Large Cap Growth	Unattractive
SURE	AdvisorShares Insider Advantage ETF	Large Cap Value	Neutral
TMFX	Motley Fool Next Index ETF	Mid Cap Blend	Unattractive
FRTY	Alger Mid Cap 40 ETF	Mid Cap Growth	Unattractive
IMCV	iShares Morningstar Mid Cap Value ETF	Mid Cap Value	Unattractive
NSCS	Nuveen Small-Cap Select ETF	Small Cap Blend	Unattractive
ISCG	iShares Morningstar Small Cap Growth	Small Cap Growth	Unattractive
VTWV	Vanguard Russell 2000 Value Index Fund	Small Cap Value	Unattractive

Sources: New Constructs, LLC and company filings

iShares appears more often than any other provider in Figure 2, which means that they offer the most ETFs with the worst holdings.

EA Series Generation Z ETF (ZGEN) is the worst rated ETF in Figure 2. SoFi Be Your Own Boss ETF (BYOB), Hoya Capital High Dividend Yield ETF (RIET), and Alger Mid Cap 40 ETF (FRTY) 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 model 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. Don't just take our word for it, [see what Barron's says](#) on this matter.

PERFORMANCE OF ETFs HOLDINGS – FEES = PERFORMANCE OF ETF

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

<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 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. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
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3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

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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, 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 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, 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.

### **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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