



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 0.48%, – the average total annual cost of the 748 U.S. equity Style ETFs we cover. The weighted average is lower at 0.14%, which highlights how investors tend to put their [money in ETFs with low fees](#).

Figure 1 shows InfraCap Equity Income Fund ETF (ICAP) is the most expensive style ETF and JPMorgan BetaBuilders U.S. Equity Fund (BBUS) is the least expensive. Absolute Shares Trust (WBIF, WBIG) provides two of the most expensive ETFs while iShares Trust (VTI, ITOT) ETFs are among the cheapest.

Figure 1: 5 Most and Least Expensive Style ETFs

| Ticker | Name | Style | Total Annual Cost |
|------------------------|--|-----------------|-------------------|
| Most Expensive | | | |
| ICAP | InfraCap Equity Income Fund ETF | All Cap Value | 1.91% |
| WBIF | WBI BullBear Value 3000 ETF | All Cap Blend | 1.55% |
| WBIG | WBI BullBear Yield 3000 ETF | All Cap Blend | 1.48% |
| LBAY | Tidal Leatherback Long/Short Alternative Yield | All Cap Blend | 1.47% |
| DIP | BTD Capital Fund | Large Cap Value | 1.44% |
| Least Expensive | | | |
| BBUS | JPMorgan BetaBuilders U.S. Equity Fund | Large Cap Blend | 0.02% |
| VTI | iShares Core S&P 500 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% |
| VOO | Vanguard 500 Index Fund | Large Cap Blend | 0.03% |

Sources: New Constructs, LLC and company filings



Investors need not pay high fees for quality holdings.¹ Alpha Architect U.S. Quantitative Value ETF (QVAL) is the best ranked style ETF overall. QVAL’s Very Attractive [Portfolio Management rating](#) and 0.43% total annual cost earns it a Very Attractive rating.²

On the other hand, iShares Morningstar Small-Cap ETF (ISCB) holds poor stocks and earns our Unattractive rating, despite having low total annual costs of 0.04%. No matter how cheap an ETF looks, if it holds bad stocks, its performance will be bad. The quality of an ETF’s holdings matters more than its management fee.

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 ETFs 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 |
|--------|---|------------------|-----------------------------|
| DRN | Direxion Daily Real Estate Bull 3X Shares | All Cap Blend | Unattractive |
| BKIV | BNY Mellon Innovators ETF | All Cap Growth | Unattractive |
| RIET | Hoya Capital High Dividend Yield ETF | All Cap Value | Unattractive |
| MEME | Roundhill MEME ETF | Large Cap Blend | Unattractive |
| LCG | Sterling Capital Focus Equity ETF | Large Cap Growth | Unattractive |
| DIP | BTD Capital Fund | Large Cap Value | Unattractive |
| MRND | IQ U.S. Mid Cap R&D Leaders ETF | Mid Cap Blend | Unattractive |
| NUMG | Nuveen ESG Mid-Cap Growth ETF | Mid Cap Growth | Unattractive |
| NUMV | Nuveen ESG Mid-Cap Value ETF | Mid Cap Value | Unattractive |
| ISCB | iShares Morningstar Small Cap ETF | Small Cap Blend | Unattractive |
| BFTR | BlackRock Future Innovators ETF | Small Cap Growth | Unattractive |
| VIOV | Vanguard S&P Small Cap 600 Value Index Fund | Small Cap Value | Unattractive |

Sources: New Constructs, LLC and company filings

Nuveen (NUMG, NUMV) appear more often than any other providers in Figure 2, which means that they offer the most ETFs with the worst holdings.

BlackRock Future Innovators ETF (BFTR) is the worst rated ETF in Figure 2 based on our [predictive overall rating](#). Direxion Daily Real Estate Bull 3X Shares (DRN), BNY Mellon Innovators ETF (BKIV), Roundhill MEME ETF (MEME), IQ U.S. Mid Cap R&D Leaders ETF (MRND), and Hoya Capital High Dividend Yield ETF (RIET) 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.

$$\text{PERFORMANCE OF ETFs HOLDINGS} - \text{FEES} = \text{PERFORMANCE OF ETF}$$

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

² 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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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.

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