

# Analyzing Your EIF

ETF are in the rage with investors now. But with so many new ones every day, how can you separate the winners from the losers, the undervalued from the overpriced? The same way that you should evaluate individual stocks. Cash Flow Analytics!

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## What is an ETF?

ETF is an acronym for "Exchange Traded Fund". An ETF represents a basket of stocks that reflect an index such as the S&P 500 or an Industry such as Software. For example, the GS Software ETF is comprised of the shares of 26 software companies, which include Microsoft and Oracle. By investing in the ETF you are making a diversified bet on an industry or group of stocks.

## How We Pick Them

The company I founded, StockDiagnosics.com, has proprietary software that enables it to analyze financial statement metrics and price ratios for ETFs. It can aggregate the data (public companies), which comprise each ETF. This allows an ETF to be viewed in the same way as one would the shares of an individual company. The software is able to compare an ETF's historical aggregated metrics

and ratios against its own historical comparables, as well as that of another ETF. Basically, we find the needles in the haystacks.

## The Race To The Top

In my most recent study, I was surprised to learn that the OJ Energy and the S&P Energy ETFs tied for first place among 24 ETFs, based on their computer rankings. The two ETFs beat all the others by a wide margin. They

StockDiagnosics.com Computerized ETF Metric Rankings and Overall Ranking

ETF	PIE	PIOT	P/CF	P/FC	ER %	Rev %	CF %	FC%	Overall Rank
S&P Sector-Energy	2	4	2	2	4	1	I	2	TI
Dow Energy	I	3	3	3	5	2	2	5	TI
OJ Utilities	8	I	4	22	17	5	7	22	3
GS Semiconductor	4	5	8	8	8	17	12	II	4
OJ Transportation	15	6	6	17	6	3	5	I	5
OJ Industrial	10	19	12	6	9	10	4	4	6
OJ Telecommunications	13	21	I	I	3	23	17	14	7
S&P Sector-Technology	12	14	7	5	10	21	14	13	8
GS Networking	21	13	22	13	7	8	3	3	9
OJ Basic Materials	6	7	10	16	20	9	16	17	10
GS Technology	9	10	15	4	15	22	15	12	II
S&P Sector-Industrial	14	20	9	12	14	II	6	6	12
GS Software	18	16	21	7	18	12	19	15	13
S&P Sector-Utilities	23	2	5	24	24	7	9	23	14
S&P Sector-Materials	5	8	11	IS	19	19	18	18	15
DJ Dividends	3	9	23	20	II	6	22	21	16
DJ Consumer Cyclical	7	II	13	19	I	18	21	19	17
OJ Healthcare	16	18	18	10	13	20	II	8	18
S&P Sector-Health Care	17	17	17	9	12	14	13	10	19
S&P Sector-Consumer Staples	11	23	16	14	16	15	8	9	20
INQ Biotechnology	24	22	24	18	22	4	10	7	21
S&P Sector-Consumer Discretionary	20	15	14	21	2	16	20	20	22
S&P Sector O-Strip	19	12	19	11	21	24	23	16	23
OJ Consumer Non-Cyclical	22	24	20	23	23	13	24	24	24

These **results** indicating that the Energy ETFs are the most **undervalued** based on their overall and individual metrics **were** especially revealing since most analysts and investors have concluded that energy shares **must** be overvalued, since they have been **outperforming** the overall market for the last **two** years.

did so by being ranked among the top four for each of the Study's Price Ratio metrics, which include the P/E (price/Earnings) Ratio, P/BT (price/Tangible Book Value) Ratio, P/CF (price/Cash Flow From Operations) Ratio and the P/FC (price/Free Cash Flow) Ratio. In total, the ETFs were ranked according to ten metrics, which include these eight and two proprietary metrics.

The two energy ETFs also ranked no lower than fifth among the four traditional annualized growth rate metrics—Revenue (Rev), Earnings (ER), Cash Flow From Operations (CF) and Free Cash Flow (FC).

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The two energy related ETFs dominated the P/E category, where they ranked first with the lowest (9.81) and second lowest (9.88) P/E Ratios. Third and fourth place went to the DJ Dividends ETF (14.1) and the GS Semiconductor ETF (15.3). It wasn't surprising to find that the ETF with the dubious honor of the highest P/E Ratio (55.9) was Q Biotechnology. The big surprise was that the ETF with the second highest P/E was the S&P Sector Utilities with a P/E Ratio of 36.25.

The top two ETFs for Earnings growth (EG) for the last reported 12 months were the Dow Jones Consumer Cyclical (96.5%) and the S&P Sector-Consumer Discretionary (72.8%) ETFs. The worst performing ETFs for this category were the S&P Sector Utilities ETF (-45.7%), which came in at dead last for earnings growth and the DJ Consumer Non-Cyclical ETF (-28.1%) which came in at 23.

The two energy ETFs were also dominant for both of the Cash Flow oriented price ratios, Price to Cash Flow (P/CF) and Price to Free Cash Flow (P/FC). The S&P Sector Energy ETF ranked second for both (7.2 and 16.01 respectively) and the DJ Energy ETF ranked third (7.3 and 16.02 respectively) for

both as well. The award winning performance for the highest ranking or the lowest P/CF and P/FC Ratios went to the same ETF, DJ Telecommunications. The GS Semiconductor ETF gets honorable mention as the only ETF with its P/CF and P/FC Ratios resting on ten-year lows. Those with the lowest rankings and the highest P/FC (Price to Free Cash Flow) Ratio came in with DJ Consumer Non-Cyclical (109.7) at 23rd and S&P Sector Utilities ETF (214.2), which came in last. For the P/CF (price to Cash Flow From Operations) Ratio, the lowest rankings for the highest ratio went to DJ Dividends (20.0) at 23rd and NQ Biotechnology (23.2) at 24th.

**EQUITIES Tip:** *It's worrisome when a dividend oriented investor, such as the OJ Dillie/md ETF has free cash flow decelerating by 58% (it ranked 22nd for FC growth) since dividends can only be paid out of Free Cash Flow.*

Six of the ETFs generated double-digit Cash Flow From Operations growth over the last reported 12 months. One of them, the GS Networking ETF could be a great opportunity because its P/CF (price to Cash Flow) Ratio is at 40 quarter or 10 year low and finding an investment that has both rapid growth and is trading at a historically low price valuation is a rare occurrence. There were also five that posted double digit cash flow declines over the same period. Of these, the S&P Sector-Consumer Discretionary ETF, the DJ Consumer Cyclical and the DJ Dividends ETF each have P/CF Ratios that are at least at four-year highs. One should exercise caution with these three ETFs since high historical valuations for investments that have rapidly declining cash flows can be a recipe for disaster.

Ranked first and second for Revenue or Sales Growth over the last reported 12 months, were the S&P Sector Energy (22.8%) and the DJ Energy (20.5%) ETFs. The worst performing ETFs were S&P Sector O-Strip ETF

(-19.8%) and DJ Telecommunications ETF (-13.4%).

After excluding the dominant energy related ETFs—which ranked first and second overall—ETFs that rounded out the top ten included DJ Utilities, GS Semiconductor, DJ Transportation, DJ Industrial, DJ Telecommunications, S&P Sector-Technology, GS Networking and DJ Basic Materials. Of these, the DJ Transportation, GS Semiconductor and DJ Industrial ETFs look the most interesting. For instance, The DJ Transportation ETF's rate of revenue growth of 15.89% for its last reported 12 months is its highest since July of 2001. GS Semiconductor ETF's P/E Ratio of 15.3 is its lowest since January of 1998, and the DJ Industrials ETF's P/E Ratio of 18.1 is the lowest it has been over its most recent 40 quarters.

Conspicuously absent from the top ten overall rankings were the Health Care and Consumer related ETFs. All of them were ranked among the bottom 15 overall. Only two of them, the DJ Consumer Cyclical ETF with a P/E ranking of 7 and the S&P Sector Health Care with a P/FC (price to Free Cash Flow) ranking of 9 were able to break into the top ten of any of the individual Price Ratio rankings.

#### And The Winners Are...

The cash flow metrics that we monitor tells us that the Energy ETFs are significantly undervalued when compared to all other 22 ETFs. The DJ Transportation, DJ Industrial, GS Semiconductor and GS Networking ETFs are also poised to outperform the remaining ETFs. The Health Care and Consumer oriented ETFs appear to be among the weakest ETFs. Specifically, the S&P Sector-Consumer Discretionary ETF, DJ Consumer Cyclical ETF and the DJ Dividends ETF are the most risky because they're experiencing double digit declines in cash flow and are trading at cash flow ratios that are currently at four year highs.

ETFs - Highest declining Cash Flow	P/CF	% Decline
S&P Sector-Consumer Discretionary	12.22	-18.34
OJ Consumer Cyclical	11.33	-19.9
OJ Dividends	20.04	-19.96
S&P Sector O-Strip	15.12	-20.4
OJ Consumer Non-Cyclical	15.56	-29.21