

XTF's Herman Explains ETF Rating System

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With more than a thousand ETFs on the market and new ones debuting constantly, how do you decide which ones to buy?

CEO Mel Herman of Marco Polo XTF, an investment research and advisory firm, developed a website — XTF.com — in hopes of doing all the homework for you with its ETF rating system.

IBD: How do you go about rating ETFs?

Herman: The goal of the XTF ratings methodology is to present an objective and easy-to-understand framework for investors to evaluate ETFs. We have evaluated every ETF listed on U.S. exchanges and rate all ETFs with a minimum of six months of trading history.

Our ETF rating service is comprised of a Structural Integrity ranking and an Investment Metric ranking, which together make up the overall XTF Rating. They are based on 14 different factors including expense ratio, liquidity, tracking error, dividend yield, risk, total return and tax efficiency.

These factor values are calculated and ranked on a percentile basis to rate each ETF with respect to all other ETFs within the same asset class. Using XTF's ratings allows you to easily understand how well the ETF is doing its intended job of tracking a specific benchmark and evaluate its overall risk, performance and suitability. It exposes all the costs, both explicit and implicit.

IBD: How can investors use your system to pick ETFs?

Herman: XTF's ETF Explorer research tool allows you to quickly navigate through more than 1,000 ETFs according to their investment objective and then make a comparison of those ETFs. You can choose from categories specifying asset class, sector, geography, leverage and much more according to your investment objective.

XTF's proprietary Similar ETFs algorithm allows you to make an educated decision as to which is the best ETF to purchase among ETFs that may at first seem very similar. Many of them have similar objectives that overlap and some have the exact same objective.

When these ETFs are compared against each other, there are often subtle but important differences, which can greatly affect the overall performance and risk of your investment portfolio. XTF categorizes every ETF according to its specific investment objective as stated in the prospectus.

Then the objectives are hierarchically organized with major objectives such as asset class, leverage and investment philosophy given the highest weight, followed by correlation of 30-day returns and overlap of the net asset value (NAV) as determined by the fund holdings. The Comparison Tool then enables you to look at each of these ETFs side-by-side and see the exact distinctions that make each of these different.



XTF's rating service identifies 53 ETFs that offer exposure to the auto industry in China, where Zhejiang Geely Holding Group makes cars. Mu sen -... [View Enlarged Image](#)

IBD: If I buy high-rated ETFs, should I expect higher returns than from low-rated ETFs? What has been the performance of low-rated vs. high-rated ETFs over the past one, three and five years?

Herman: ETFs are designed to track specific sectors or slices of the market and are expected to track the performance of those sectors even if that performance is negative. If you want to gain exposure, for example, to the energy sector, then all ETFs designed to follow that sector should closely track the energy sector's performance and volatility on a daily basis; the ETF should deliver that sector's return and risk over time. The key issue here is that you must know if the ETF is doing its intended job.

If the energy sector had a 20% return over the past year, then you would expect an energy-sector ETF to have a similar return. If it did not, then either the ETF is not doing the job it was intended to do or you are holding an ETF that you chose incorrectly.

XTF ratings are based purely on historical data. There are no inputs in the ratings methodology attempting to predict an ETF's future performance.

In summary, ETFs are designed to track their underlying indexes as closely as possible, and most of them do this quite well. That, in most cases, is their primary objective, but the subtleties vary widely. As a result, ETFs that track very well or that have performed well in the past six months will tend to have high XTF Ratings. Both factors have a relatively large influence on the overall rating.

IBD: What else does your website offer?

Herman: Two important tools we would like to highlight are our ETF Marketplace, and the XTF Thematic Global Heatmaps.

The ETF Marketplace gives a quick summary on many aspects of the U.S.-listed exchange traded products market. The page is updated every day, and all of our data is represented either in plain English or in easy-to-manipulate tables. The information architecture allows you to search throughout the site, connecting all relevant information to generate ideas and explore the ETF universe adeptly.

We provide dozens of top 10 lists, so the cream of the crop always rises to the surface. We track the flow of funds into and out of every ETF and across every sector, so you can see where everyone else is investing and gain a sense of understanding along the way.

The XTF Thematic Heatmaps leverages off the innate transparency of ETFs providing insight into the performance and trends that are occurring within the world. Users can visually track the

performance and flow of funds as they occur within every country, region, asset class, sector and industry down to the individual ETF level.

Using the Heatmaps, one can also figure out exactly how to gain exposure to any specific combination of geography/sector, and determine which is the most appropriate ETF or security which will give you that exposure. The main idea is to allow users to invest in the same way we think about the world and follow trends. You can, for the first time, test your ideas thematically.

Imagine the following scenario: You have just finished reading an Investor's Business Daily article about the Chinese automobile industry, and believe that this is an area that could see double-digit growth over the next few years. But how do you invest in it, and is this a new trend or is it already occurring?

Having no additional knowledge, but using our Heatmaps, you can answer both questions in a few seconds by visually locating China on the map, and then finding the performance of the Automobile Manufacturing Industry within China.

We can see using the charts, the one-month performance of China is +7.8%. The one-year performance of the Consumer, Cyclical sector in China is -20.2%. And the one-day performance of the Automobile Manufacturing industry is +0.95%. There are 53 ETFs that can give you exposure to this industry, and the current assets in ETFs exposed to this sector are \$401 million.