

Overview

We view ETFs primarily as instruments for asset allocation purposes. As such, a rigorous recommendation scheme will need to combine the outlook for the underlying industry or asset class with the specific attributes of the individual ETF. And that's exactly what the Zacks ETF Rank does.

Zacks Forecasts for Future Asset Class Returns

Asset class forecast is the main input in calculation of Zacks ETF Rank. We have forecasts for:

1. Equity returns for the broader U.S. equity market, large cap/small cap groups, value/growth groups and major market sectors
2. Equity returns for all geographic regions and 20 major countries outside of U.S.
3. Fixed income rates for U.S. treasury, mortgage and corporate bonds
4. Foreign exchange rates for all major currencies
5. Commodity rates (metals, energy and agricultural commodities)

In making these forecasts, we rely primarily on a Zacks quarterly survey of sell-side investment strategists and buy-side chief investment officers (CIOs).

Additionally, we get inputs from a) senior investment strategists at Zacks and b) Consensus Economics, a London based economic publication.



A Zacks ETF report with the Zacks ETF Rank in the top corner.

The Zacks ETF Rank provides a recommendation for the ETF in the context of our outlook for the underlying industry, sector, style box, or asset class. Our proprietary quantitative model takes into account a number of fundamental and technical factors about the ETF and the Zacks forecast for the underlying industry or asset class.

Other Elements of the Zacks ETF Rank

Expense Ratio

Expense Ratio--expressed a percentage of the total assets--is the annual fee that the investors have to pay for the fund's operating expenses.

Bid-Ask Ratio

Bid-Ask ratio--calculated as the difference between the bid and ask prices as a percentage of the ETF's mid price--measures the implicit cost of trading an ETF. Bid-Ask Ratio is inversely related to the liquidity of the ETFs; hence the higher the liquidity, the lower the bid-ask ratio, resulting in lower trading costs for the investors.

Momentum

We calculate momentum as the velocity of price change over the past three months. Momentum indicates relative price strength of a particular ETF within an asset class.

Duration**

Duration is a measure of the sensitivity of the bonds to the changes in interest rates. Bonds'/ Bond ETFs' prices move inversely to the interest rates. Duration has to be taken into account in the context of our outlook for the interest rates.

Credit Rating**

Most bonds issued by the companies and sovereigns are analyzed and rated by the credit rating agencies. We use average credit rating for the bond ETFs as one of the factors in our analysis.

Yields

Dividend or coupon payouts made by an ETF need to be taken into account in calculating the total return for an ETF investor.

ETF Holdings

While we focus on the macro picture, we do not ignore the micro picture either. So "what's inside of an ETF" is an important factor in many of our ETF ranks.

Arriving at the ETF Rank

Each ETF is assigned a score for each of the above factors and then total score is arrived at by adding the weighted scores of all factors, using the factor weights assigned by our proprietary ranking model. Total score is used to assign rating from #1 through #5 within an asset class.

The methodology also takes into account the risk preferences of the investors and divides each set of ETFs following a similar investment strategy (style box/industry/asset class) into three risk categories- High, Medium, and Low. The aim of our models is to select the best ETFs within each risk category.

- Zacks Rank **1** **Strong Buy**
- Zacks Rank **2** **Buy**
- Zacks Rank **3** **Hold**
- Zacks Rank **4** **Sell**
- Zacks Rank **5** **Strong Sell**

As such, each ETF has a Zacks Rank and a measure of its associated risk. For example, an ETF may have a Zacks # 1 Rank and be deemed High Risk or it may be Zacks # 1 Rank and Low Risk, or any of the different Rank/Risk combinations. These risk categories reflect multiple fundamental factors, including expected price volatility.

We have ranks for U.S. Equity, U.S. Fixed Income— Treasury and Corporate Bonds, Currency, Commodity and International ETFs with a minimum six months of performance history.

Time-horizon of the ETF Ratings

The Zacks ETF Rank and Risk ratings have a time horizon of 6 months. However, we continually assess the ranks and ratings and update them every quarter.

Leveraged and Inverse ETF

We believe that leveraged and inverse ETFs are short term trading vehicles suitable for sophisticated investors only. Given the complexities of these instruments, investors need to be extra cautious in considering them for anything other short-term tactical reasons. We do not rank these securities.

For More Information:

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