

Using ETFs to Identify Quality Stocks



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If one were to survey investors about what traits make a stock attractive, the top of the list would include an attractive valuation, a reasonable expectation of a price increase (particularly sooner rather than later), a sound underlying business model and good fundamentals. The first two traits are easy to identify: seek out below-average valuations and above-average momentum. The last two, referred to as “quality,” are harder to pin down.

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Most people have a general idea of what quality is: profitable, low-to-manageable level of debt, adequate cash flow, etc. Quantifying the traits in a stock screen is difficult, however. Require too many traits and too few stocks will pass your screen. If you're not restrictive enough, however, you may end up with junky companies or companies that are otherwise riskier than you desire. The line is easy to trip over when screening for stocks.

I'm trying to strike the right balance myself as I work to create my new stock strategy. I have the cornerstones narrowed down: low price to book with either low price to sales or low price to earnings. I'm also requiring an above-average level of momentum, as defined by relative strength rank. I'm trying to weed out the junky stocks without making the screen too restrictive where I'm running into challenges. One of the ways I'm seeking to resolve this problem is to look at what exchange-traded funds (ETFs) focused on quality are doing.

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- **Piotroski: High F-Score Screen** – Joseph Piotroski used a variety of criteria to separate junk companies from quality companies among deep-value stocks.
- **What Works: Key New Findings on Stock Selection** – James O’Shaughnessy shared the strategies he uses to identify value, financial strength and earnings quality.

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Highlights from the *AAll Journal*

- **Analyzing a Stock by Its Dividend and Shareholder Yield** – Both dividends and share buybacks can be used to assess a stock’s attractiveness, as I explain in this month’s *AAll Journal*.
- **A Simple Formula for Calculating “Safe” Retirement Spending** – Dividing your age by 20 can reveal the percentage of savings a person can spend over and above Social Security, pension and annuity-type income.

AAll Sentiment Survey

Bullish sentiment is above 30% for the fifth time in six weeks; similar such streaks have only occurred two other times over the past 12 months. [More about this week’s results.](#)

What’s Trending on AAll

1. **The Individual Investor’s Guide to the Top Mutual Funds 2016**
2. **Why Buy Bonds If Interest Rates Will Rise?**
3. **Analyzing a Stock by Its Dividend and Shareholder Yield**

The Week Ahead

Earnings season winds down, with just 20 members of the S&P 500 reporting. Included in this group are Dow Jones industrial average components Home Depot (**HD**) on Tuesday, Cisco Systems (**CSCO**) on Wednesday and Wal-Mart Stores (**WMT**) on Thursday. Several other retailers will also report, including Lowe’s (**LOW**) and Target (**TGT**) on Wednesday.

The week's first economic reports of note will be the August Empire State manufacturing survey and the August housing market index, which will be released on Monday. Tuesday will feature the July Consumer Price Index (CPI), July housing starts and building permits and July industrial production and manufacturing capacity. The Federal Open Market Committee (FOMC) will release the minutes from its July meeting on Wednesday. Thursday will feature the Philadelphia Federal Reserve's business outlook survey for August.

Three Federal Reserve officials will make public appearances: Atlanta president Dennis Lockhart on Tuesday, St. Louis president James Bullard on Wednesday and San Francisco president John Williams on Thursday.

The Treasury Department will auction \$14 billion of five-year Treasury inflation-indexed securities (TIPS) on Thursday.

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