

# Fund Score Method: The Importance of Fund Selection

At Nasdaq Dorsey Wright we grade ETFs and mutual funds using the Fund Score Methodology. Fund scores are used to assess overall technical strength by using a combination of trend analysis, market relative strength, and peer relative strength. Beneath these three buckets are nineteen individual data points that have varying weightings towards the overall fund score, but each of the major categories of trend analysis, market relative strength, and peer relative strength make up roughly a third of the overall score which ranges from 0 – 6, with six being a perfect score. For many, finding the right sector or size & style is enough for portfolio construction, but selecting the correct fund for that exposure is often overlooked. Whether it is familiarity with a certain provider or is the fund one has always used for certain exposure, the selection process can be neglected in favor of routine or timeliness. Fund scores offer an objective and efficient method for choosing technically sound candidates by simplifying the process into a single data point. For those that would like more information on fund scores from an academic perspective, please read our whitepaper on the subject [here](#).

Since mid-February of this year, basic materials has been one of the strongest sectors from a relative strength perspective as its one of the top-ranked sectors on the NDW platform. However, if one were to default using the SPDR sector fund for basic materials (XLB) they would be leaving quite a bit on the table in terms of performance compared to other available options in the same sector. Compared to four other options, XLB is the worst performing on the year and possesses the lowest fund score. In the same camp as XLB is the Vanguard Materials ETF (VAW) which has a similar fund score and performance to XLB. Each of these funds also have consistently had fund scores below 3.0, the threshold used to determine if a fund is acceptable to buy or hold. Most the sector funds had similar scores leading up to the beginning of February, with the lone exception of the Invesco S&P Equal Weight Materials ETF (RTM).

## Fund Score History

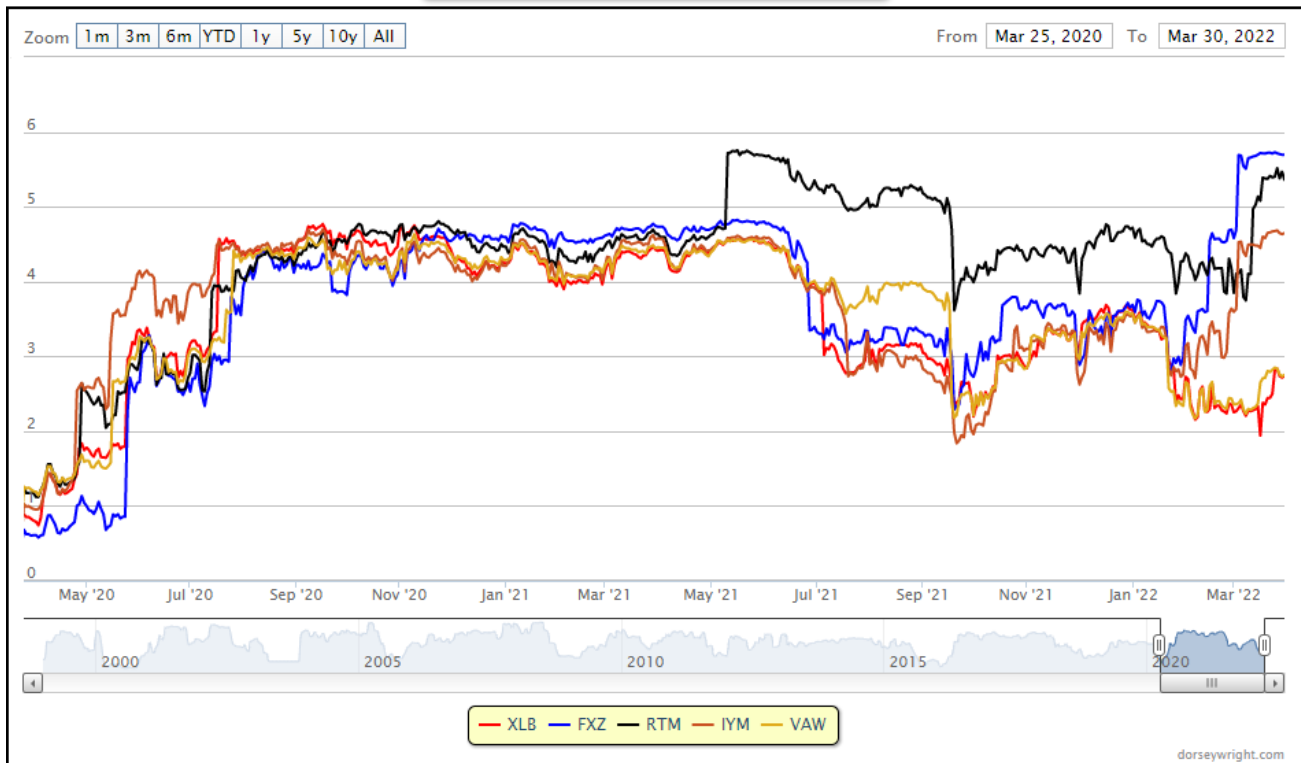


Image Source: NASDAQ DORSEY WRIGHT

The First Trust Materials AlphaDEX Fund (FXZ) and the iShares U.S. Basic Materials ETF (IYM) both saw quick improvement in their respective fund scores through February and March. FXZ gained the highest fund score on February 15<sup>th</sup> and has also been the best performing of the five ETFs since that time returning 12.20% through 3/31/2022 compared to XLB which posted a return of 3.90%. The mid-February time frame is also when the basic materials sector moved into overweight territory in both of NDW's major asset allocation tools, the Dynamic Asset Level Investing tool and the Asset Class Group Scores. Both funds outpaced the S&P 500 Index's return of 1.33%, but the fund with the highest score turned out to post the best returns while the worst scoring fund posted the worst returns. So, buying any of the five basic materials funds lead to outperformance versus the S&P 500, but there was extra alpha to be gained by simply choosing the fund with the highest fund score.

| SYMBOL | NAME                                   | LAST (\$) | ROLLING CUMULATIVE RETURNS |        |        |       | CUSTOM<br>(02/15/22 TO<br>03/31/2022) |
|--------|----------------------------------------|-----------|----------------------------|--------|--------|-------|---------------------------------------|
|        |                                        |           | 7 DAY                      | 30 DAY | 90 DAY | YTD   |                                       |
| FXZ    | First Trust Materials AlphaDEX Fund    | 71.63     | -2.23                      | 11.52  | 15.24  | 15.24 | 12.20                                 |
| IYM    | iShares U.S. Basic Materials ETF       | 149.56    | -0.43                      | 10.49  | 6.67   | 6.67  | 9.72                                  |
| RTM    | Invesco S&P Equal Weight Materials ETF | 184.67    | 0.01                       | 8.62   | 2.58   | 2.58  | 4.88                                  |
| VAW    | Vanguard Materials ETF                 | 194.05    | -0.58                      | 7.83   | -1.44  | -1.44 | 4.31                                  |
| XLB    | Materials Select Sector SPDR Fund      | 88.15     | -0.17                      | 8.21   | -2.72  | -2.72 | 3.90                                  |
| SPX    | S&P 500 Index                          | 4,530.41  | 0.23                       | 5.21   | -4.95  | -4.95 | 1.33                                  |

**Image Source: NASDAQ DORSEY WRIGHT**

When it comes to funds, names and labels can be deceiving. All five funds are basic materials funds but have seen varying results just over the past year. Fund methodology is often overlooked and it's important to "know what you own" when choosing funds. There's quite a bit of overlap in the holdings themselves, but the weight of the stocks and subsectors in each fund varies quite significantly. By comparing performance attributions of the stocks and subsectors between the funds, these differences become much more noticeable. In the image below, FXZ's overweighting of the steel subsector compared to XLB was a major difference maker and contributed to 7.80% of the fund's overall return over the period (2/15/2022 – 3/31/2022).

**First Trust Materials  
AlphaDEX Fund (FXZ)**

**Materials Select SPDR Fund  
(XLB)**

| Subsector                                        | Avg % Wgt | Total Return (%) | Contribution to Return (%) |
|--------------------------------------------------|-----------|------------------|----------------------------|
| Steel                                            | 25.20     | 34.23            | 7.80                       |
| Commodity Chemicals                              | 17.83     | 5.71             | 1.01                       |
| Specialty Chemicals                              | 11.33     | -5.54            | -0.78                      |
| Fertilizers & Agricultural Chemicals             | 7.06      | 34.75            | 2.25                       |
| Copper                                           | 6.69      | 13.42            | 0.89                       |
| Diversified Chemicals                            | 5.90      | -2.36            | -0.16                      |
| Gold                                             | 5.55      | 28.21            | 1.42                       |
| Paper Products                                   | 4.43      | -15.94           | -0.85                      |
| Trading Companies & Distributors                 | 4.00      | 10.81            | 0.45                       |
| Paper Packaging                                  | 3.58      | -2.27            | -0.12                      |
| Aluminum                                         | 3.19      | 21.74            | 0.64                       |
| Industrial Machinery                             | 2.13      | -11.38           | -0.28                      |
| Industrial Gases                                 | 1.36      | 1.49             | 0.01                       |
| Not Classified                                   | 0.92      | 0.01             | 0.00                       |
| Aerospace & Defense                              | 0.83      | 5.72             | 0.05                       |
| <b>First Trust Materials AlphaDEX Fund (FXZ)</b> |           |                  | <b>12.34</b>               |

| Subsector                               | Avg % Wgt | Total Return (%) | Contribution to Return (%) |
|-----------------------------------------|-----------|------------------|----------------------------|
| Specialty Chemicals                     | 27.16     | -7.56            | -2.35                      |
| Industrial Gases                        | 21.27     | 5.15             | 1.10                       |
| Fertilizers & Agricultural Chemicals    | 9.90      | 25.06            | 2.25                       |
| Paper Packaging                         | 8.88      | -0.28            | -0.03                      |
| Commodity Chemicals                     | 7.45      | 3.45             | 0.26                       |
| Copper                                  | 7.21      | 13.90            | 0.94                       |
| Gold                                    | 6.04      | 26.46            | 1.40                       |
| Construction Materials                  | 4.97      | -1.29            | -0.07                      |
| Steel                                   | 3.96      | 22.67            | 0.82                       |
| Metal & Glass Containers                | 3.05      | -1.79            | -0.05                      |
| Not Classified                          | 0.13      | 0.02             | 0.00                       |
| <b>Materials Select SPDR Fund (XLB)</b> |           |                  | <b>4.29</b>                |

Image Source: NASDAQ DORSEY WRIGHT

Data Source: Bloomberg  
Data Date Range: (2/15/2022 - 3/31/2022)

XLB’s largest subsector exposure was specialty chemicals which proved to be one of the worst performing subsectors over the period and contributed -2.35% to the fund’s overall performance. Going through the list of subsector exposure for each fund, there are vastly different exposure profiles for two broad based basic materials funds which lead stark differences in overall performance. This isn’t to say XLB’s format is worse as there will be periods where its overweight towards certain subsectors will be beneficial while FXZ’s overweighted sectors may drag the portfolio in the future. The important takeaway is that by just identifying the right sector to allocate towards can leave quite a bit of performance on the table. Fund scores allow for a quick way to take the extra step of selecting the technically strongest fund for the desired exposure whether that be sector, broad market, international, or any other classification of funds.

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