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Sizing Up the Industrials ETF Landscape

Even as the exchange-traded fund market continues to mature, industrials-sector ETF offerings remain remarkably scarce relative to other sectors. ….

Even rarer than industrials-sector ETFs, however, are ETFs focused solely on the industrials sector's transportation subsector. Relatively speaking, the broadest-based transportation ETF--and the only one with any meaningful amount of liquidity--is the iShares Dow Jones Transportation Average (IYT), which owns about 20 of the U.S.' largest, most-liquid transportation stocks. Holdings are price-weighted and include four rail companies such as Union Pacific (UNP) and Norfolk Southern (NSC), three trucking firms such as C.H. Robinson Worldwide (CHRW), and three delivery services players, FedEx Corporation (FDX), United Parcel Service (UPS), and Expeditors International of Washington (EXPD). At 0.47%, IYT is an attractively priced way to play the space, although as is the case with the broader industrials-sector ETFs above, IYT is composed solely of U.S. transportation companies and offers investors little access to global infrastructure growth or transportation trends involving emerging markets or even developed non-U.S. markets. Few other transportation ETFs are available to investors, all offering far less liquidity than IYT.
…, which has close to half of its holdings traded on non-U.S. stock exchanges, offers investors exposure to 30 firms that generate at least 80% of their profits from maritime shipping and charges 0.65%. PowerShares Global Progressive Transportation (PTRP) invests in an amalgamation of 40 companies believed to benefit from a societal transition toward cleaner, cheaper, and more-efficient transportation and charges 0.75%. ….

We continue to be believers in the idea of creating a pure machinery ETF, which would be designed to exclude the less cyclical aerospace and defense exposure in most industrials-sector ETFs and which also would omit companies with large financing arms and therefore no pure machinery exposure.

Beyond machinery, some other possible ETFs in the space spring to mind. In the transportation world, given the railroad industry's improved physical plants, recent attainment of the status of being able to cover its cost of capital, and increased on-time performance, we (along with Warren Buffett) see the rail space as a great way to play the U.S. economy in general and a recovery more specifically, through increased demand for coal for power generation, for containerized imports from Asia, and for ethanol-related traffic of corn, ethanol, and byproducts. Could an ETF provider construct a rail-only ETF? The answer is yes, which is somewhat surprising considering the massive rail-industry consolidation over the last four decades. IYT currently holds only the four largest publicly traded U.S. railroads: Union Pacific, Norfolk Southern, CSX, and Kansas City Southern (KSU). However, without much difficulty, an ETF provider could construct a concentrated ETF of 20 or so rail names by including the two large Canadian railroads, Canadian National Railway (CNI) and Canadian Pacific Railway (CP), and a host of smaller-cap names ….