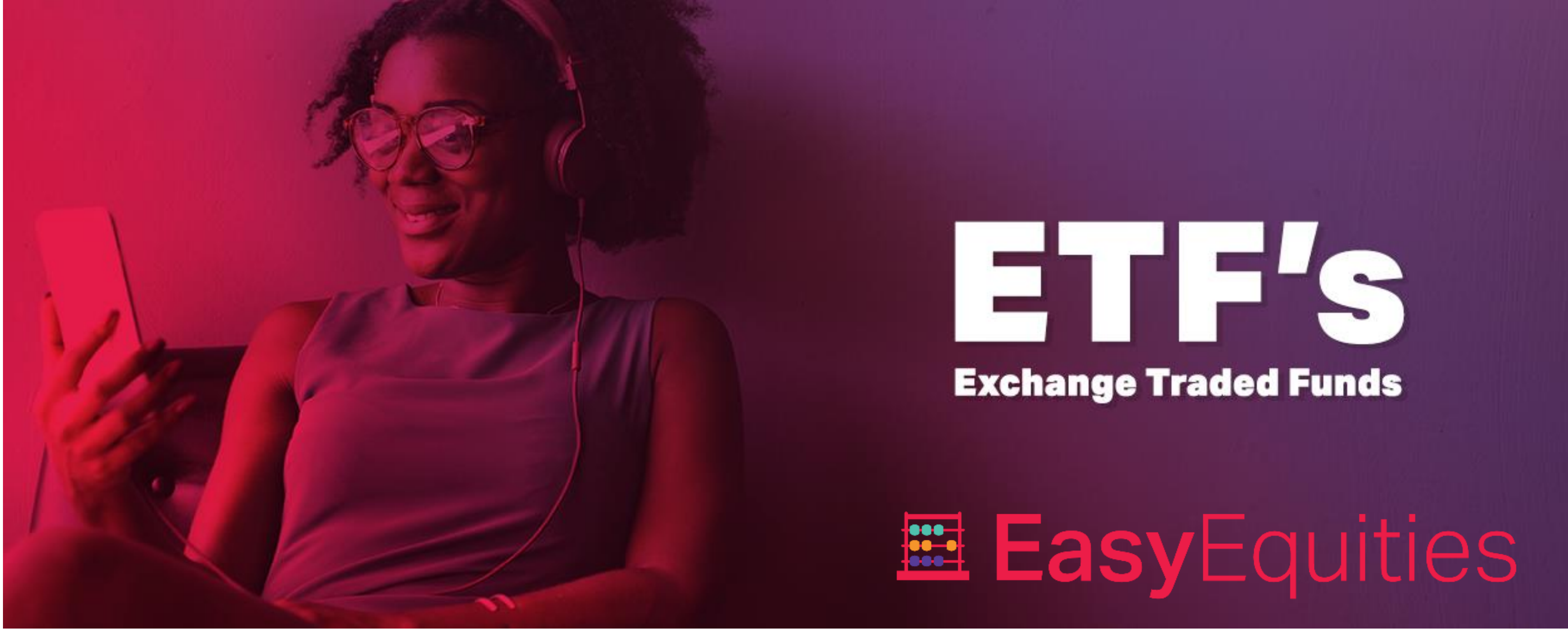


March 2018

The ETF Monthly Review

Welcome to the second ETF Monthly Review, a neat monthly update of market news affecting ETFs, as well as a set of favourite funds chosen by the Intellidex team. We're collaborating with Intellidex to bring you the latest insights on ETFs, probably the niftiest way to invest out there!

IN THIS ISSUE:

What's happened in the markets?

- Global markets irked by US inflation data
- Rand firms on positive political developments and a bold national budget

Our favourite ETFs

- Domestic equity: Satrix SA Quality ETF
- Foreign equities: Ashburton Global 1200
- Bond and cash funds, short term: NewFunds TRACI 3 Month
- Bond and cash funds, long term: Satrix ILBI ETF

ETF Investment Thoughts

Portfolio completion. The ultimate objective for any investor is to have an optimised portfolio that balances risk and returns to fit the investor's needs in the most rational way. In this note we consider how to use ETFs in a holistic context in conjunction with a core portfolio.

Intellidex's favourite ETFs

Each month the investment gurus at Intellidex scan the market to come up with a list of their favourites.

Orin Tambo, CFA, explains:

This month, we discuss our favourites in three categories:

- Domestic equity
- International equity
- Bonds and cash

Not all categories are right for all investors; you want to choose asset classes that meet your unique objectives. These are our favourite funds within each of those three broad fund categories.

We believe a good ETF should be cheap. Cost differences, while appearing small on paper, can make a huge impact to an investor's returns when compounded over time. We also like ETFs that follow a simple but watertight investment philosophy. They should also be tax-smart, which means they should qualify to be in a tax-free savings account. To avoid over-concentration, a good ETF should cap its exposure to a single sector and or a single counter. Below we provide an overview of our favourite funds for each category.

What's happened in the markets?

Local shares were largely subdued during February despite some positive developments on the political front. The all share index fell 0.6% month on month, erasing the 0.2% gain recorded during the month of January. Positive month-on-month returns from consumer services (0.2%), financials (4.3%), telecoms (0.9%) and health care (-2.2%) were more than offset by resources (-3.7%), industrials (-1.3%), consumer goods (-7.2%) and technology (-1.1%).

Financials gained 4.3%, benefiting from the positive political and economic narrative and a bold national budget which might have staved off a Moody's credit ratings downgrade when it meets later this month. The consumer goods segment was dragged down by some poor performances from global majors British American Tobacco and Richemont, thanks to the stronger rand.

In the bond market, yields have responded positively. The yield of the benchmark government 10-year bond, which had skyrocketed to around 9.55% during 2017, has softened to around 8.10%. The rand is holding on to levels below R12/dollar. The improvement in bonds and the stronger rand reflect investor confidence in Ramaphosa and the national budget.

International view:

February wasn't a good month for global equities. Most international indices suffered heavy losses following the

We only change this list when new ETFs are listed, fees change or there is some other material change to the way ETFs work.

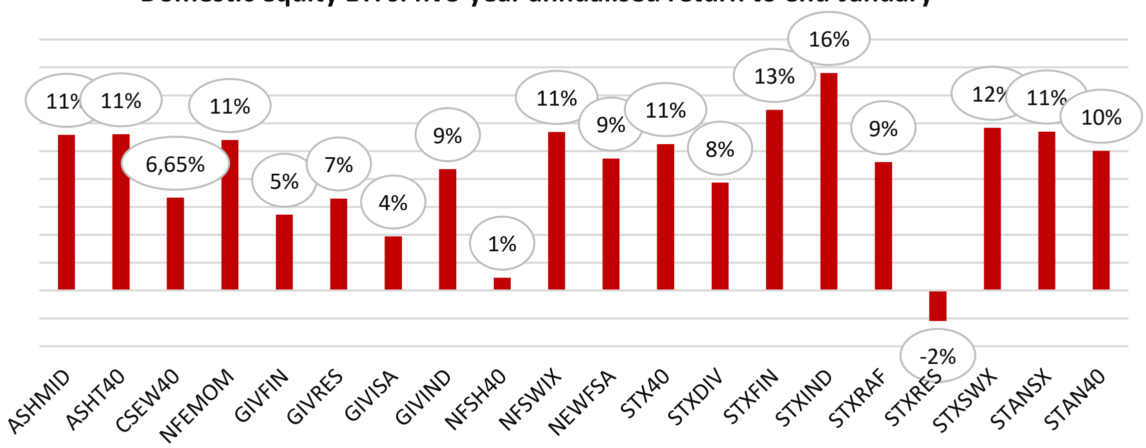
The March favourites:

Domestic equity: Satrix SA Quality ETF

Satrix SA Quality ETF remains our choice for investors seeking exposure to domestic equities. We like its investment philosophy. Satrix SA Quality is one of the few funds in this segment which uses key financial ratios in screening potential investments. The fund screens stocks based on a quality metric which is derived from a company's return on equity, liquidity and leverage. This methodology ensures that the fund is always invested in highly profitable and financially sound counters.

We also like that it has rules which limit or cap its exposure to a single stock or sector. So, while it might hold fewer counters than, say, the top 40 funds, it is likely to have lower concentration risk. The fund even invests in some small caps. This feature is interesting for two reasons. First, it means the fund is exposed to some of the fast-growing stocks which most funds on the bourse wouldn't normally have exposure to. Second, it makes sense from a portfolio diversification point of view, given that the bulk of savings invested in local managers are already heavily invested in blue chips.

Domestic equity ETFs: five-year annualised return to end-January



release of a key US inflation report which showed that the consumer price index (CPI) leaped 0.5% in January, stronger than the consensus forecast of 0.4%.

The MSCI All World index tumbled 7.5% a few days after the release of the data. However, it recovered slightly and ended the month 3.1% lower than January. Developed markets stocks also fell 3.1%. The European and Japanese equity markets extended losses with the Eurostoxx falling 4.5% and the Nikkei 225 plunging 7.4%. The MSCI Emerging Markets index ended 3.3% lower, weighed heavily by Asian stocks.

The higher-than-expected inflation figures stoked fears of a more rapid tightening of interest rates in the US, which led to a sell-off in the global markets. That said, Purchasing Managers Index (PMI) data released during February showed global growth remained relatively strong. The PMI readings for the Eurozone (57.1), Japan (54.8) and US (60.8) remained above 50 pointing to continued growth. The PMI tracks business trends across both the manufacturing and services sectors. A PMI reading of more than 50 represents an expansion over the previous month while a reading under 50 represents a contraction.

We see global markets remaining volatile in the short to medium term. Trump's plan to impose tariffs on steel and aluminium imports is likely to fuel trade wars, which might have devastating effects on global markets. The European Union has indicated that it will retaliate by imposing tariffs on some US goods if Trump implements his plans. The ongoing tensions between the US and North Korea also remain a huge risk to global stability.

Local view:

February was a busy month for South Africa. The key highlights included the resignation of Jacob Zuma as president and the election of Ramaphosa, the cabinet reshuffle and the national budget. These events seem to have set SA on a positive path. There is great optimism that Ramaphosa will deliver good governance, tackle corruption, address the crises at the parastatals and put in place policies that support economic growth.

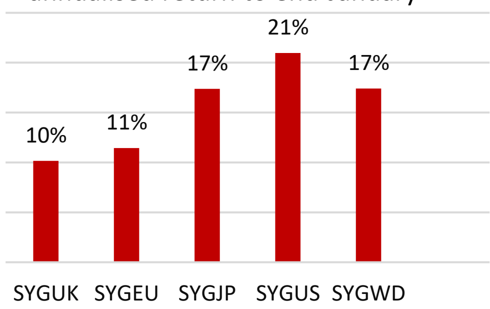
The improved sentiment towards the local economy, the continued strengthening of the rand and higher-than-expected GDP growth numbers for 2017 bolster the investment case for the fund. Data released by Stats SA earlier this week show the economy grew by 1.3% in 2017 year on year, which is ahead of National Treasury's expectation of 1%. Importantly, there was strong growth in the second half of 2017. If that momentum is maintained, Satrix SA Quality stands to benefit because it is largely a South African play – the bulk of its constituents generate more than three quarters of their income from South Africa.

Foreign equities: Ashburton Global 1200 ETF

Unlike in the domestic equities segment, most international ETFs use the same factor in screening investments – market capitalisation. Instead of taking exposure to a single market – US, Europe, Japan, Asia or the UK – we have decided to take a global view. Of the two funds which offer global exposure, we like the Ashburton Global 1200 ETF. It beats its competitor, the Sygnia MSCI World, in that it invests in both developed and emerging markets, while the Sygnia ETF invests only in developed markets.

The fund combines seven indices in developed and emerging markets. All that for an expected total expense ratio (TER) of 0.45%, which is competitive.

International equity ETFs: five-year annualised return to end-January



Ramaphosa's new cabinet, which eliminated most ministers who were implicated in the Public Protector's state capture report, was largely welcomed by investors even though there were concerns about some obviously incompetent ministers who were not fired. Nhlanhla Nene and Pravin Gordan, both previously fired by Zuma, were appointed to the finance and public enterprises ministries respectively. Both are well respected and competent individuals.

The former finance minister, Malusi Gigaba, tabled the 2018 budget which we think was positive. The main highlights on the expenditure side included R57bn allocated to fund free tertiary education over the next three years. This was balanced by a proposed R85bn reduction of other expenditure items. On the revenue side, Treasury increased valued added tax from 14% to 15%. While this is going to bite consumers, it was a necessary measure to manage government debt.

Bond and cash funds

There are now seven listed funds in this category:

1. NewFunds GOVI ETF
2. NewFunds ILBI ETF
3. NewFunds TRACI 3 Month ETF
4. Ashburton Government Inflation ETF
5. Satrix ILBI ETF (recently listed fund)
6. CoreShares PrefTrax
7. FNB US Dollar Custodian Certificate

They each track different things: 1 and 7 track government bonds; 2, 4 & 5 track inflation-linked government bonds; 3 tracks short-term money market instruments; and 6 tracks listed preference shares.

ETF Investment Thoughts

Using ETFs to complete a portfolio

Who can use a completion strategy? This is ideal for investors who may have gaps in their existing portfolios — perhaps with little or no exposure to certain asset classes, market segments or sectors. It is also useful for an investor who might want to quickly gain exposure to specific sectors, styles or asset classes without having to obtain the prerequisite expertise in these areas. This can be done in two simple steps as shown below.

Step 1: Identify holes in portfolio. The first step is to identify the gaps. For example, an investor might own their home and have a pension fund structured for a long-term investment strategy. That would provide (concentrated) property and riskier equities exposure, but leaves gaps for assets like bonds, cash and commodities.

Step 2: Fill the gaps with ETFs. After identifying holes in the portfolio, the next step is to look for the right ETFs to fill them. With so many ETFs on the market today, it can be tough to determine which product will work best in your portfolio, but most are designed to focus on a specific asset class category.

If you are investing for a very short period, usually less than a year, then the **NewFunds TRACI 3 Month** (NFTRCI) is a natural choice because it is least sensitive to sudden adverse interest rate movements. It is similar to earning interest on your cash at the bank with a minimal possibility of capital loss.

However, for a longer investment horizon, the motivation is to protect your investment against inflation. Because the **Satrix ILBI ETF** promises to have the lowest expense ratio of 0.22%, it is our choice here. It does not have a performance history as it was launched only recently but should mimic the performance of other inflation-linked bond funds.

Bonds and cash ETFs: five-year annualised return to end-January