February 2020

The ETF Review

Welcome to this month's ETF Review, a neat update of market news affecting ETFs, as well as a set of favourite funds chosen by the Intellidex team. We collaborate with Intellidex to bring you the latest insights on ETFs – probably the niftiest way to invest!

IN THIS ISSUE:

What happened in the markets in January?

The Intellidex portfolio of ETFs returned 9.9% outperforming a basket of JSE-listed ETFs which gained 3.4%.

Some of the main market themes covered in this month's newsletter:

- Coronavirus weighs on global equities
- Safe havens and commodities sparkle
- Fourth quarter economic data for the US, the eurozone and China
- Developments in SA's energy sector

- Our favourite ETFs
    - Domestic equities: CoreShares Scientific Beta Multifactor Index ETF
    - Foreign equities: Satrix MSCI World ETF and Satrix MSCI Emerging Markets
    - Bonds and cash: NewFunds TRACI 3 Month (short term); Satrix ILBI ETF, Stanlib Global Bond ETF and Ashburton World Government Bond ETF (long term)
    - Dividend/income funds: Stanlib SA Property ETF and Sygnia Itrix Global Property ETF
    - Commodities: Standard Bank Africa Rhodium ETF
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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:

We classify all ETFs into six broad categories:

- domestic equities
- international equities
- bonds and cash
- dividend or income-focused
- multi-asset
- commodities

Various empirical studies show that the bulk of equity returns stem from diversification among broad asset classes rather than from individual stock picking. As such, our grouping is done with a diversified portfolio in mind, ensuring appropriate exposure to different asset classes. First, we group the ETFs according to the three widely recognised asset classes – equities, bonds and cash. We further split equities into geographic groupings, then add a category for equity ETFs with an income theme.

Our picks should provide an investor with a relatively diversified portfolio, even if it was made up only of ETFs. However, asset

What's happened in the markets?

Fears about the economic impact of China's coronavirus weighed on global equities, which had a superb run in 2019. Developed market equities ended 0.6% lower, with the S&P 500 closing flat. Emerging markets, which seem to be the most vulnerable to the coronavirus, lost 4.7%.

But in what has become something of a trend, JSE-listed foreign ETFs were hedged by the rand, which dropped 7.3% month on month against the dollar. This saw a basket of international ETFs closing 6.31% higher in rand terms. A basket of local ETFs declined 2.25% in yet another disappointing performance. Safe havens and commodities performed very well. A basket of commodity ETFs gained an unassailable 22%. The diversified Intellidex portfolio returned an impressive 9.9%.

Local ETFs

Local risk assets struggled in January in line with global markets. The FTSE JSE All Share Index fell 2.3% as losses by financials (-5.8%) and resources (-3.7%) more than offset the 0.7% gain by industrials. The NewFunds Govi ETF was the top-performing non-commodity ETF after its share price rose 1.5%. The Satrix Indi 25 ETF was next best with growth of 1.4%. The NewFunds Inflation Linked Bond ETF (+0.7%), the NewFunds TRACI 3 month (+0.5%) and the Satrix Inflation Linked Bonds ETF (+0.2%) complete the top five performers for the month.

allocation is not a one-size-fits-all concept. You need to make sure that weights of different asset classes in your portfolio meet your unique risk-and-return objectives. Multi-asset ETFs, which are already diversified among asset classes, are analysed as a separate category.

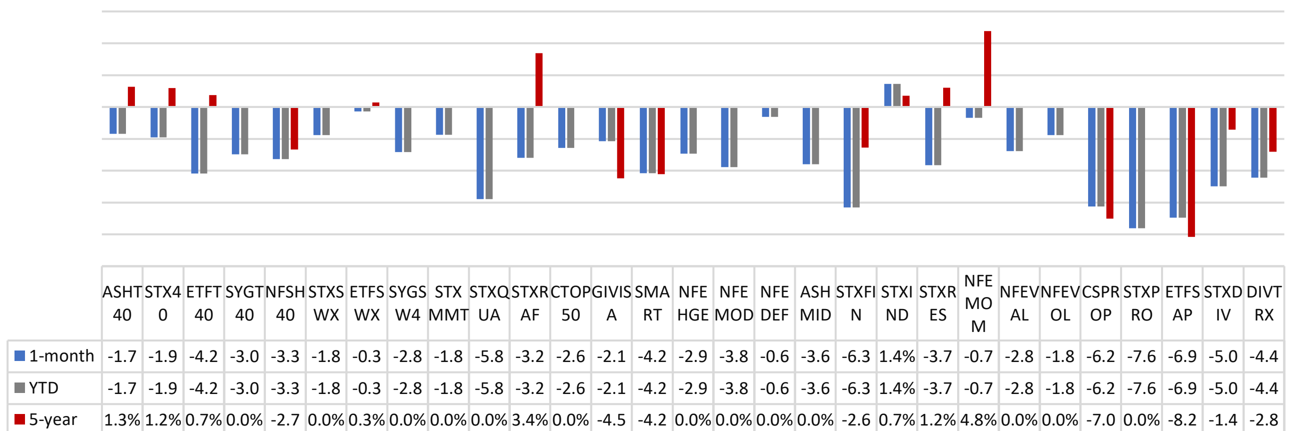
As a rule of thumb, we like ETFs that follow a watertight investment philosophy. They should also be tax smart, which means they should qualify to be in a tax-free savings account. To avoid overconcentration, a good ETF should cap its exposure to a single sector and/or a single counter. While competition among providers is intensifying and ETF costs are coming down, we look at this metric closely and prefer ETFs with low total expense ratios (TERs). An overview of our favourite funds for each category follows.

The favourites:

Domestic equity: CoreShares Scientific Beta Multifactor Index ETF

We maintain the CoreShares Scientific Beta Multifactor Index ETF as our pick for investors seeking exposure to local equities. The fund fits our mould of a good investment philosophy. Its methodology tends to favour quality stocks which are highly profitable – exactly what we think investors need under prevailing economic conditions. It also considers valuations (price multiples) of the counters in its selection process,

Domestic equity ETFs performance (share price returns annualised for periods of more than one-year %)



	ASHT40	STX40	ETFT40	SYGT40	NFSH40	STXSWX	ETFSWX	SYGSW4	STXMMT	STXQUA	STXRAF	CTOP50	GIVISA	SMART	NFEHGE
1-month	-1.7	-1.9	-4.2	-3.0	-3.3	-1.8	-0.3	-2.8	-1.8	-5.8	-3.2	-2.6	-2.1	-4.2	-2.9
YTD	-1.7	-1.9	-4.2	-3.0	-3.3	-1.8	-0.3	-2.8	-1.8	-5.8	-3.2	-2.6	-2.1	-4.2	-2.9
5-year	1.3%	1.2%	0.7%	0.0%	-2.7	0.0%	0.3%	0.0%	0.0%	0.0%	3.4%	0.0%	-4.5	-4.2	0.0%

	NFEMOD	NFEDEF	ASHMID	STXFIN	STXIND	STXRES	NFEMOM	NFEVAL	NFEVOL	CSPROP	STXPRO	ETFSAP	STXDIV	DIVTRX
1-month	-3.8	-0.6	-3.6	-6.3	1.4%	-3.7	-0.7	-2.8	-1.8	-6.2	-7.6	-6.9	-5.0	-4.4
YTD	-3.8	-0.6	-3.6	-6.3	1.4%	-3.7	-0.7	-2.8	-1.8	-6.2	-7.6	-6.9	-5.0	-4.4
5-year	0.0%	0.0%	0.0%	-2.6	0.7%	1.2%	4.8%	0.0%	0.0%	-7.0	0.0%	-8.2	-1.4	-2.8

Excludes funds which are less than one-year old

Satrix Property was the worst performer during January with a loss of 7.6% followed by its peer, 1nvest SA Property, which lost 6.9%. Other laggards were the Satrix Financials ETF (-6.3%), the recently reconfigured CoreShares SA Property Income ETF (-6.2%) and the Satrix Quality ETF (-5.8%). In a similar fashion to what we saw in 2019, commodities started the year in a terrific form, delivering unbelievable returns. Rhodium and palladium continued their strong runs. The Standard Bank Africa Rhodium ETF was the top performer with a return of 79.2% -- that's not a typo: 79.2%! The rhodium price skyrocketed from about $6,000 per ounce to $9,500/oz. The two palladium funds – 1nvestPalladium ETF and Absa NewGold Palladium ETF – returned 27.4% and 26.8% respectively. Gold funds also delivered double-digit returns.

Note on ETF liquidations

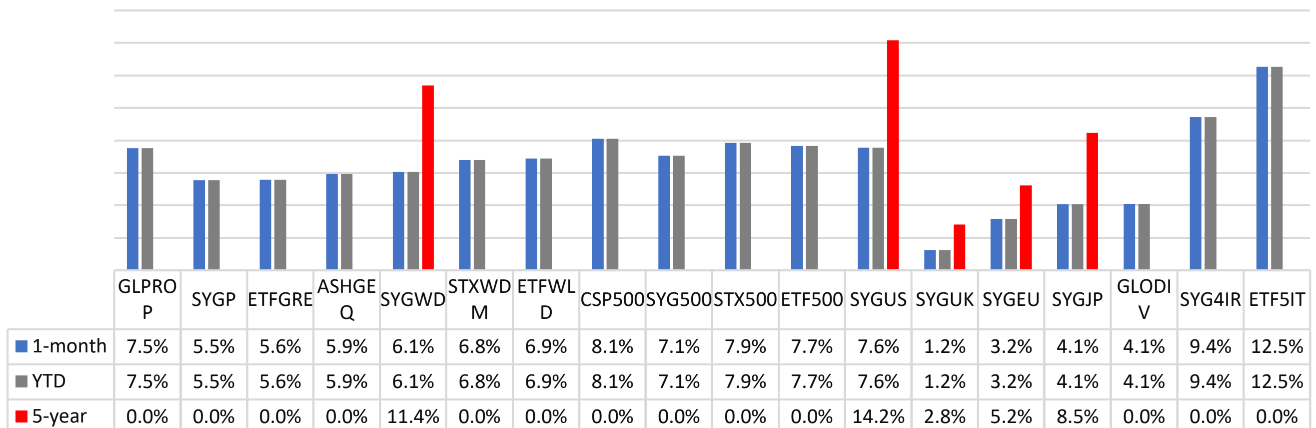
There has been an increase in delistings or reconfigurations of ETFs on the JSE over the past few years as asset managers review their offerings in a flat market. CoreShares has been at the forefront of this. It delisted the CoreShares Low Volatility ETF in late 2018, replaced the Equally Weighted Top 40 ETF with the Scientific Beta Multi Factor ETF, and more recently merged the CoreShares PropTrax Sapy ETF and the CoreShares PropTrax Ten ETF into CoreShares SA Property Income ETF. Absa's NewFunds also recently delisted all its sector funds – NewFunds S&P GIVI South Africa Resources ETF, NewFunds S&P GIVI South African Industrial ETF and NewFunds S&P GIVI South African Industrial ETF – as well as the NewSA ETF.

which we think is important. The fund also has a decent amount of assets under its management. The only gripe we have with the CoreShares Scientific Beta Multifactor Index ETF is its high total expense ratio of 0.45%. There are extensions to this core local equity exposure that can be added in a tactical sense as a satellite fund. The NewFunds Equity Momentum fund (down -0.7% in January) is worth considering. It has performed far ahead of other equity funds in the past few months and has a 12-month return of 18.2%, which is phenomenal considering that the local bourse has been largely flat over the past few years.

Developed markets Foreign equities: Satrix MSCI World ETF

We maintain our exposure to the broad-based Satrix MSCI World Equity Feeder ETF, which is dominated by US equities. We think US stocks are more resilient than other developed market equities during turbulence, given the relatively stronger US economy. We are, however, cognisant of the elevated US valuations relative to other developed markets. The Satrix MSCI World Equity Feeder ETF grew 6.1% in January. A good alternative, though, is the Ashburton Global 1200 Equity ETF (up 5.5%) but it has a higher total expense ratio. Other more focused international equity themes include property, dividend and technology funds. These are worth considering for tactical or other investor-specific reasons.

International equity ETFs performance (share price returns annualised for periods of more than one-year %)



	GLPROP	SYGP	ETFGRE	ASHGEQ	SYGWD	STXWDM	ETFWLD	CSP500	SYG500	STX500	ETF500	SYGUS	SYGUK	SYGEU	SYGJP	GLODIV	SYG4IR	ETF5IT
1-month	7.5%	5.5%	5.6%	5.9%	6.1%	6.8%	6.9%	8.1%	7.1%	7.9%	7.7%	7.6%	1.2%	3.2%	4.1%	4.1%	9.4%	12.5%
YTD	7.5%	5.5%	5.6%	5.9%	6.1%	6.8%	6.9%	8.1%	7.1%	7.9%	7.7%	7.6%	1.2%	3.2%	4.1%	4.1%	9.4%	12.5%
5-year	0.0%	0.0%	0.0%	0.0%	11.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	14.2%	2.8%	5.2%	8.5%	0.0%	0.0%	0.0%

In most cases funds were discontinued because they had failed to gain traction, which somewhat speaks to poor or unpopular methodologies. That is why we emphasise that investors should thoroughly scrutinise investment philosophies of the funds before investing. Generally, the larger the fund in terms of assets under management, the lower the chance of liquidation.

International ETFs

International ETFs started the year on a strong footing, thanks to the rand. All foreign ETFs delivered positive returns during January, led by tech funds: 1nvest S&P 500 Info Tech Index Feeder was up 12.5%, Satrix Nasdaq 100 ETF (+11.4%) and Sygnia/Itrix 4th Industrial Revolution (9.4%). The FirstRand US Dollar Custodian Certificate ETF (9.2%) and CoreShares S&P 500 Exchange Traded Fund (8.1%) complete the top five.

The Africa-focused fund – Cloud Atlas Africa Real Estate ETF – was the worst performer with a return of 0.4%. Other funds in the bottom five were the Satrix MSCI Emerging Markets ETF (1%), Sygnia Itrix FTSE 100 (1.2%), Sygnia Itrix EuroStoxx50 (3.2%) and Sygnia Itrix MSCI Japan Index (4.1%).

Macroeconomic review and outlook

The biggest driver of investor sentiment in January was undoubtedly the outbreak of the coronavirus which originated in Wuhan, China. To date, more than 24,324 people have contracted the disease, with 490 confirmed deaths. Cases have been confirmed in several other countries including Australia, France, Japan, Singapore, South Korea, Thailand, the US and Canada, with a total of 175 infections globally (excluding mainland China).

The outbreak overshadowed a brief flare-up in US-Iranian tensions which occurred during the month and what we think was largely positive economic data from China, the US and the eurozone. China grew at 6.0% year on year (y-o-y) in the fourth quarter of 2019, signalling that the Chinese economy is stabilising. Its December retail sales continued to grow at 8.0% y-o-y,

Developing markets foreign equities: Satrix MSCI Emerging Markets ETF

For developing market exposure we choose the Satrix MSCI Emerging Markets ETF (+1%) as our core portfolio for developing market exposure. It invests in a wide range of emerging economies including some of the fastest-growing markets such as China and India. The Cloud Atlas AMI Big50 (+5.5%), which focuses on African equities, can be used as a satellite fund to the core Satrix MSCI Emerging Markets fund. However, the Cloud Atlas AMI Big50 ETF has been extremely volatile since its listing on the JSE.

Diversified funds

If you find the process of diversifying your portfolio daunting, two ETFs can do it for you. They combine equities and bonds to produce a diversified portfolio for two investor archetypes with differing risk appetites: Mapps Protect ETF (-0.2%) is more conservative, usually suitable for older savers. Mapps Growth ETF (-0.8%) suits investors with a longer-term horizon. Notably, both funds invest in SA-listed assets, thus lack an offshore flavor.

Dividend or income-theme funds

If you rely on your investment income for day-to-day expenses, you may want to allocate a portion of your portfolio to ETFs that have a high distribution ratio. Property funds tend to have the highest payout ratios. Our pick here is the Satrix Property ETF (-7.6%) which has a brilliant diversification approach. For foreign property funds we like the Sygnia Itrix Global Property ETF (+5.5%). It has an aggressively low total expense ratio (TER) of 0.19% that significantly undercuts its competitors, whose charges range from 0.34% to 0.52%.

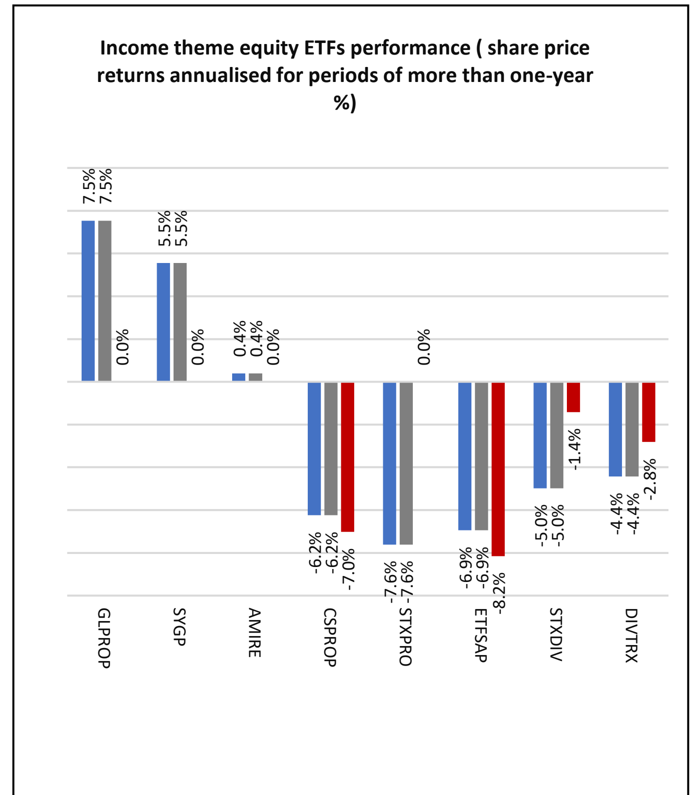
while industrial production picked up 0.7 percentage points to 6.9% y-o-y. The US economy grew at an annualised pace of 2.1% in the final quarter of 2019 which is also solid. The eurozone experienced growth of 0.1% in the final quarter of 2019.

Locally, the energy sector took centre stage. Eskom resumed load-shedding and warned that the country should brace itself for more frequent power cuts over the next 18 months as the power utility steps up overdue maintenance on ageing coal power stations.

On a positive note, Mineral Resources and Energy Minister Gwede Mantashe told delegates at the Mining Indaba in Cape Town on Monday that government had conceded that it must allow mining companies to produce energy for their own use. At present, private companies and private individuals have been able to produce only minimal amounts. Anything more would require registration. He also hinted at the creation of a second power generation company parallel to Eskom. Both announcements were sentiment positive though they were received cautiously by investors who focus more on policy implementation and less on policy promises.

In terms of economic data, factory output declined by more than markets had expected in November 2019. Annual production fell by 3.6% -- its sixth consecutive decline. That is in line with the Absa PMI which lost 1.9 points to hit 45.2 points in January, the lowest level since September 2019. Mining production fell 3.1% y-o-y in November.

As expected, consumer price inflation ticked up to 4.0% y-o-y in December, from an almost nine-year low of 3.6% in November. Consumer confidence remain in the doldrums: the FNB/BER Consumer Confidence Index stayed unchanged during the fourth quarter of 2019 at -7 points despite a reprieve from the central bank, which cut the repo rate by 25 basis points in its first meeting of the year.



**Excludes fund which are less than one-year old*

Fixed income and cash

Fixed income securities should find their way into a well-diversified portfolio due to their risk-diversification attributes. If you are investing for a short period, usually less than a year, then the NewFunds TRACI (up 0.5%) is a natural choice because it is least sensitive to adverse interest rate movements. For a longer investment horizon, protecting your investment against inflation is paramount. We maintain our choice of the Satrix ILBI ETF (+0.2%), which has the lowest expense ratio in this category. Furthermore, nominal bonds add a unique risk-return dimension that differs from inflation-linked bonds and improves overall portfolio performance.

The only option for local nominal bonds is the Newfunds GOVI ETF (1.5%). As with equities, investors also need to diversify their bond portfolios internationally. Our choice is the 1nvest Global Bond ETF (-0.8%), which tracks investment-grade sovereign bonds mostly issued by the US, UK, Japan and selected European countries. The Stanlib Global Bond ETF has the lowest TER in this category.

Outlook

SA is locked onto a low-growth path. Intellidex economic forecasting models project measly 0.6% GDP growth this year and 1% in 2021. Load-shedding remains one of the key risks to SA's economy. There has been much focus on self-generation and new generation announcements at the recent mining Indaba which was held in Cape Town. We think both are being overplayed. The path on each is very long and complex. Self-generation requires many regulatory changes and consultations and concurrence from the National Energy Regulator of South Africa on the registration process.

The need for a new generation company was mooted only a few weeks ago, raised in the ANC lekgotla and then at the mining indaba, but the department of mineral resources and energy has done no work on it at all. Overall, we think the announcements were more about public relations and investors should be cautious. Policy in this area is atomised with the energy "war room" barely meeting at all. There is no cohesiveness of thought in the governing party, which is pulling in many different directions.

Still on the local economy, we are also pricing in a downgrade of SA's credit rating to junk this year by Moody's, which will have direct effects on the economy and financial markets. We still believe that reforms will boost the economy, but we do not see them being implemented speedily. It seems the political choice has been made that the governing party is happy with the balance between reform and political risk and this is not going to change before 2022 at the ANC's next elective conference.

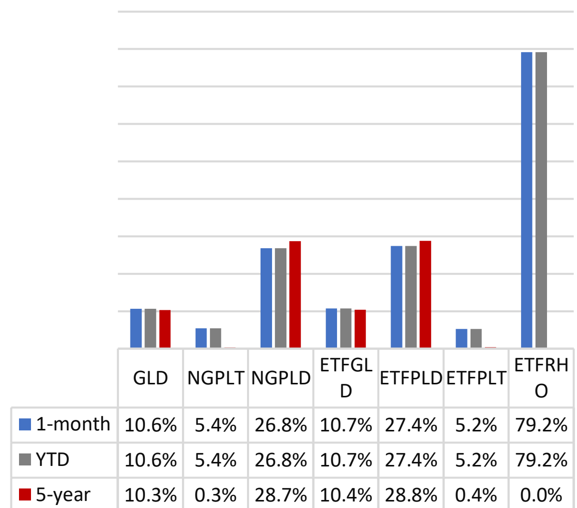
The rand, which is intricately linked to the South African economy and politics, is also bound to continue being volatile. Globally, economic growth is expected to soften but will remain credible. Initial fears of a recession have dissipated on better-than-expected economic data across regions. There is also a feeling that major central banks are set to remain accommodative with monetary policy in the coming year, which will support growth.

Commodities: Standard Bank Africa Rhodium ETF

Adding a commodity ETF to your portfolio improves diversification because commodities march to the beat of their own drum – they are not in synch with broader markets. Traditionally, gold is the preferred addition to an investor's portfolio because over longer periods it has shown to be the least correlated with other assets. However, our preference based on our medium-term outlook is between rhodium and palladium.

The new vehicle emission laws in Europe and China are driving demand for both commodities and this is expected to continue in the foreseeable future. We are slightly more inclined towards rhodium because it is scarcer, with lower extraction rates from PGM ore. The primary production of rhodium is somewhat inelastic and is expected to decline moderate moderately over the medium term. Palladium funds gained northwards of 7.0% during October.

Direct commodities ETFs performance (share price returns annualised for periods of more than one-year %)



	GLD	NGPLT	NGPLD	ETFGLD	ETFPLD	ETFPLT	ETFRHO
1-month	10.6%	5.4%	26.8%	10.7%	27.4%	5.2%	79.2%
YTD	10.6%	5.4%	26.8%	10.7%	27.4%	5.2%	79.2%
5-year	10.3%	0.3%	28.7%	10.4%	28.8%	0.4%	0.0%

Important note: This ETF does not qualify for a tax-free saving account.

The World Bank is projecting global GDP growth of 2.5% which is not bad, particularly for those eyeing assets in developed markets where most of this growth is expected to emanate. However, with the coronavirus in the mix, things may change. While it is still too early to predict its full impact, there is a consensus that it will have a short-term drag on growth in China and its neighbours, as infrastructure networks shut down and more people remain at home. However, the impact will also depend on China's response. A concerted policy response from the Chinese authorities seems likely, which may assist a recovery in the coming quarters. We have already seen it with its central bank pumping $173bn into the economy to cushion the shock to financial markets from the outbreak.

ETF strategy

The are no clear macroeconomic catalysts to lift risks assets and investor sentiment on the JSE. We are likely to see further flight of foreign capital. As a result, we remain in favour of quality, low volatility and defensive equity strategies and bonds. We also think a good argument can be made in favour of value strategies given the downward rerating of the JSE over the past few months. For offshore exposure we emphasise diversification across developed markets.

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