
November 2019

# 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 October?

The Intellidex portfolio of ETFs has returned 22.39% year-to-date, outperforming the portfolio of all JSE-listed ETFs' return of 14.01%.

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

- Global indices hit historical highs on renewed optimism over US-China trade talks
- Resource counters pull up the local bourse
- Moody's downgrades SA's outlook following a disappointing medium-term budget policy and an underwhelming Eskom policy paper
- 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 (long term)
- Dividend/income funds: Satrix Property ETF and Sygnia Itrix Global Property ETF
- Commodities: Standard Bank Africa Rhodium ETF

## Intellidex's favourite ETFs

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

Phibion Makuwerere, 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?

This is our last note of the year and global equities look set to close on a high if sentiment remains upbeat – but we think markets are still fickle. Including the JSE all share index, most global equity indices closed October higher on renewed optimism over trade talks, a US interest rate cut and a decent start to the third quarter global earnings season. This has seen bonds retreating with yields recovering.

Earnings of international companies that have reported so far are mixed but net positive, and it helps that market expectations are not too taxing. Financial data provider FactSet says analysts expect 2019 earnings to grow by less than 1%. Behemoths that form a big part of some of our JSE-listed foreign ETFs, including Apple, Microsoft, Netflix and JP Morgan, have reported positive surprises while the likes of HSBC and Alphabet (Google) have disappointed. Locally, both the medium-term budget statement and the Eskom policy paper were disappointing, but the bourse got a boost from mining heavyweights. There was some relief for SA as Moody's retained its investment grade status – the only international credit rating agency that has not junked SA's sovereign credit rating. However, Moody's did downgrade the country's outlook to negative from stable.

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.

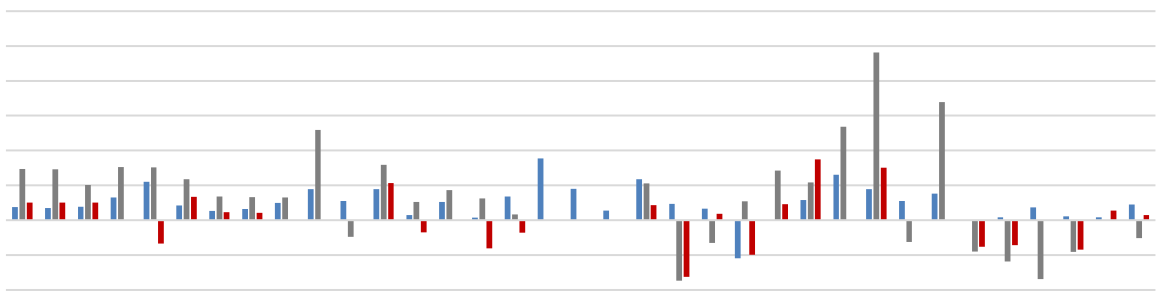
As a rule of thumb, we like ETFs that follow a watertight investment philosophy. They should also be tax smart, which means they should qualify to be in a tax-free savings account. To avoid overconcentration, a good ETF should cap its exposure to a single sector and/or a single counter. While competition 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 November favourites:

**Domestic equity: CoreShares Scientific Beta Multifactor Index ETF**

With the local economy facing numerous challenges, robust risk management practices should be employed in portfolios. While we feel the Satrix SA Quality ETF implicitly achieves this through its multi-dimensional approach to the

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



| | ASHT40 | STX40 | ETFT40 | SYGT40 | NFSH40 | NFSWIX | STXSWX | ETFSWX | SYGSW4 | STXMMT | STXQUA | STXRAF | NEWFSA | CTOP50 | GIVISA | SMART | NFEHGE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1-month | 1.9% | 1.7% | 1.9% | 3.2% | 5.5% | 2.1% | 1.3% | 1.6% | 2.5% | 4.5% | 2.7% | 4.5% | 0.7% | 2.6% | 0.4% | 3.4% | 8.8% |
| YTD | 7.4% | 7.3% | 5.0% | 7.6% | 7.6% | 5.9% | 3.4% | 3.3% | 3.3% | 12.9 | -2.4 | 8.0% | 2.6% | 4.3% | 3.1% | 0.8% | |
| 5-year | 2.5% | 2.5% | 2.5% | | -3.4 | 3.4% | 1.2% | 1.1% | | | | 5.3% | -1.8 | | -4.1 | -1.8 | |

| | NFEMOD | NFEDEF | ASHMID | GIVFIN | STXFIN | GIVIND | STXIND | GIVRES | STXRES | NFEMOM | NFEVAL | NFEVOL | PTXSPY | CSPROP | STXPRO | ETFSAP | STXDIV | DIVTRX |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1-month | 4.51 | 1.4% | 5.9% | 2.3% | 1.7% | -5.5 | -0.1 | 2.9% | 6.5% | 4.47 | 2.8% | 3.8% | 0.1% | 0.4% | 1.8% | 0.6% | 0.4% | 2.3% |
| YTD | | | 5.3% | -8.7 | -3.3 | 2.7% | 7.1% | 5.4% | 13.4 | 24.1 | -3.1 | 17.0 | -4.5 | -5.9 | -8.5 | -4.5 | 0.0% | -2.6 |
| 5-year | | | 2.2% | -8.1 | 0.9% | -5.0 | 2.3% | 8.7% | 0.1% | 7.5% | | | -3.8 | -3.6 | | -4.2 | 1.4% | 0.7% |

October's equal-weighted portfolio of all JSE-listed ETFs returned 2.04% (year-to-date: 14.01%) while Intellidex's ETF portfolio grew 1.63% (ytd: 22.39%). Note however that our portfolio has changed slightly over the period as we switched ETFs in some categories. Local-asset ETFs averaged a return of 2.02% in October while international-asset ETFs – which also derive part of their return from the rand/dollar exchange rate movement – increased by 1.66%. The rand was steady against the greenback over the month, marginally appreciating by 0.3%. Commodity ETFs were up 3.29% on average.

**Local ETFs**

Locally, resource counters drove the all share index, with the gold and platinum indices climbing 22% and 16.7% respectively in October. The financial and industrial indices posted small gains. The 8.8% growth by the NewFunds Volatility Managed High Growth Equity fund was the best ETF performance of the month followed by Satrix Resi, which rose 6.5%. Midcaps staged a comeback with the Ashburton MidCap fund increasing 5.9%.

On the flipside, NewFunds S&P GIVI South African Industrial lost 5.5% followed by CoreShares PrefTrax, which retreated 1.4%. Among commodities, the palladium funds rose more than 7% in October while the rhodium fund was almost flat, edging up 0.9%. However, the rhodium fund has been the best-performing fund on JSE by a long shot since the beginning of the year, up 125.7%. The Standard Bank palladium fund is a distant second but still with very attractive growth of 49.5% year to date.

selection of its constituents, there is a new (rebranded) multifactor ETF which explicitly takes volatility into account as one of six factors it employs in fund construction.

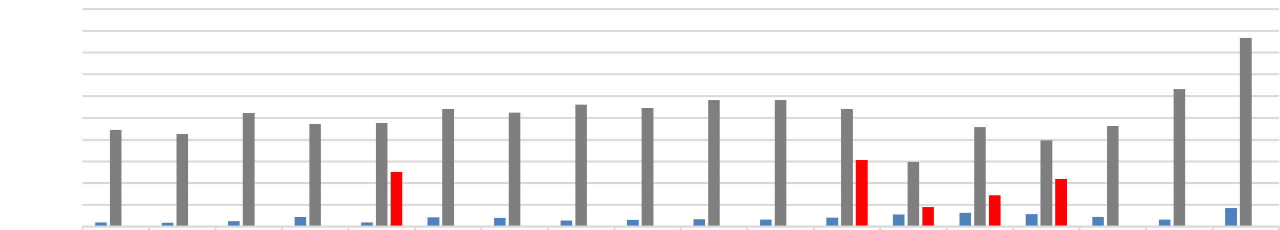
The CoreShares Scientific Beta Multifactor Index ETF fits our mould of a good investment philosophy as it is built with risk factors in mind. It was launched in May and has a great back-tested track record. We maintain our choice for local broad-based equity exposure with this new multifactor fund. The fund was up 3.4% in October.

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 (up 4.5% in October) is worth considering. It has performed far ahead of other equity funds under all market extremes in the past five months and has a year-to-date return of 18.8%.

**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 2.1% in October. A good

**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 | 0.9% | 0.9% | 1.3% | 2.2% | 1.0% | 2.1% | 1.9% | 1.4% | 1.5% | 1.7% | 1.6% | 2.0% | 2.8% | 3.1% | 2.9% | 2.2% | 1.6% | 4.2% |
| YTD | 22.2% | 21.3% | 26.1% | 23.6% | 23.8% | 27.0% | 26.2% | 28.0% | 27.2% | 29.0% | 29.0% | 27.1% | 14.8% | 22.8% | 19.8% | 23.1% | 31.6% | 43.4% |
| 5-year | | | | | 12.6% | | | | | | | 15.3% | 4.5% | 7.2% | 11.0% | | | |

## International ETFs

Offshore, the Japanese Nikkei 225 index produced a strong performance, climbing 5.4%. Similarly, other indices including the S&P 500 (US), the Dax (Germany) and CAC40 (French) posted positive gains. It was the first time that the S&P 500 index closed a month above the 3,000-point level and it has since repeatedly hit historical highs in November. Unsurprisingly, the UK's FTSE 100 retreated on the back of more Brexit uncertainty.

Tech-heavy funds outperformed, with the Stanlib S&P 500 Info Tech Index Feeder and Satrix Nasdaq 100 both rising by 4.2%. Other strong performers included Satrix Emerging Markets (+3.7%), Sygnia Itrix EuroStoxx50 (+3.1%) and Sygnia Itrix MSCI Japan Index (+2.9%). Laggards include Cloud Atlas Africa Real Estate (down 3.7%) and Stanlib Global Govt Bond Index Feeder fund (-0.8%).

## Macroeconomic review and outlook

Our country is at a critical point with failing government finances and limited political will/power to implement much-needed reforms. This is being felt on the JSE which has remained largely flat over the past five years, in contrast to high-performing offshore equities. The underwhelming medium-term budget and Eskom policy paper were followed by the downgrading of our outlook to negative from stable by Moody's, although we maintained our sovereign credit rating at investment grade.

Government's debt metrics have deteriorated faster than projected at the beginning of the year. While retaining Moody's investment grade buys us a few months to sort out the mess, it's difficult to see government taking drastic measures given that it has failed to act decisively since 2018. While some SA assets enjoyed a bounce because we were not junked straight away, it may just be a precursor to an inevitable downgrade. The risk of being junked after the 2020 budget in February has increased substantially.

Due to a lack of policy cohesion within the ruling ANC, President Cyril Ramaphosa failed to ride the positive wave of sentiment following his ascendancy to the helm of both the ANC and the country at the end of 2017.

alternative, though, is the Ashburton Global 1200 Equity ETF (up 2.2%) 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.

**Developing markets foreign equities: Satrix MSCI Emerging Markets ETF**

For developing market exposure we choose the Satrix MSCI Emerging Markets ETF (+3.7%) 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 (+2.6%), 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 (0.8%) is more conservative, usually suitable for older savers. Mapps Growth ETF (1.6%) 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 which has a brilliant diversification approach. For foreign property funds we like the Sygnia Itrix Global Property ETF (+0.9%). 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%.

Compared with the strong sentiment that characterised the beginning of 2018, the consumer confidence gauge has since fallen back to levels last seen in the Zuma era. National Treasury has slashed its 2019 GDP growth forecast to 0.5% from 1.5% and unemployment is at its highest level in more than a decade. We believe nothing short of action in reform implementation will cut it, otherwise a downgrade seems inevitable.

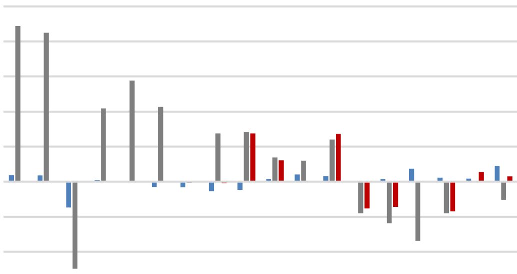
In this context, we think SA-facing stocks, even at these low valuations which are somewhat justified by broad-based poor earnings, will remain unloved in the foreseeable future – as will government debt. However, the all share index will likely get support from the big mining counters and companies that generate the bulk of their earnings outside SA, as the rand is set to remain on a losing streak.

On the international front, we are witnessing the longest equities bull run in history, which began in 2009.  However, there are some concerns over the quality of company earnings as some have been driven by financial engineering including share buybacks, rather than new investments and profit growth. To bring some perspective, we revisit one of the main themes that dominated the year – the inverted yield curve, where short-term yields on US Treasuries (bonds) are higher than long-term yields.

Historically, this has been followed by a downturn. which recently reported a loss of R21bn in its year to end-March. A more recent trend in the US equities markets has strikingly similar implications to the inverted yield curve, and in some ways, it flashes warning lights. Bloomberg News editor Cormac Mullen notes that the small-cap Russell 2000 index is 8% below its historical high set in 2018, while indices dominated by big cap stocks, for instance the S&P 500, are hitting new highs.

Mullen reckons that historically, periods where small cap shares have failed to match new highs of large cap stocks have been followed by poor results for the broader equity market. Like the inverted yield curve which indicates that investors are worried by near-term prospects, this shows investor aversion of small counters which are riskier than large-cap stocks.

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



| | GLPROP | SYGP | AMIRE | ASHWGB | DCCUSD | ETFGGB | ASHINF | PREFTX | NFGOVI | NFILBI | STXILB | NFTRCI | PTXSPY | CSPROP | STXPRO | ETFSAP | STXDIV | DIVTRX |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1-month | 0.9% | 0.9% | -3.7 | 0.3% | -0.1 | -0.8 | -0.8 | -1.4 | -1.2 | 0.4% | 1.0% | 0.8% | 0.1% | 0.4% | 1.8% | 0.6% | 0.4% | 2.3% |
| YTD | 22.2 | 21.3 | -12. | 10.4 | 14.4 | 10.7 | -0.1 | 6.9% | 7.1% | 3.5% | 3.0% | 6.0% | -4.5 | -5.9 | -8.5 | -4.5 | 0.0% | -2.6 |
| 5-year | | | | | | | 0.1% | -0.2 | 6.9% | 3.0% | | 6.8% | -3.8 | -3.6 | | -4.2 | 1.4% | 0.7% |

**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 0.8%) 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 (1.0%), 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 (-1.2%).

As with equities, investors also need to diversify their bond portfolios internationally. Our choice is the Stanlib 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.

**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

Having raised some alarm bells, we turn our attention to positive developments on the trade negotiations front which might support growth in the short term. In our previous notes we have highlighted the biggest threat to global growth being the tariff trade wars between the US and China and the unresolved Brexit. Both discourage business investment, which is important for global growth. Some good news is that the US and China are saying they are getting closer to reaching an agreement on the first phase of a trade deal.

The US is reported to be considering scrapping tariffs on $112bn worth of goods while China has promised to boost imports of various US agricultural products. Should a deal be struck between the two economic superpowers, it is likely to propel stocks to new highs.

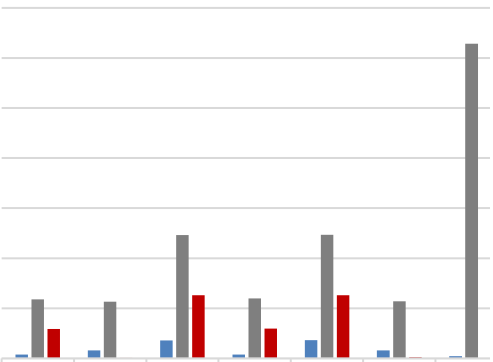
A separate, interesting issue is the imminent listing of Saudi Aramco, the world's single biggest producer of oil. Aramco is deemed the world's most profitable company and its valuation is expected to be between $1.6trn and $1.8trn, which will make it the world's most valuable company.

While it is expected to initially list on the Riyadh Stock Exchange before the end of the year, listings on other global bourses are expected to follow. This means the stock will likely feature in various ETFs, hopefully in the not too distant a future.

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 | ETFRH( |
|---|---|---|---|---|---|---|---|
| 1-month | 1.5% | 3.1% | 7.2% | 1.5% | 7.3% | 3.2% | 0.9% |
| YTD | 23.6% | 22.7% | 49.2% | 23.9% | 49.5% | 22.8% | 125.7% |
| 5-year | 11.7% | 0.4% | 25.2% | 11.9% | 25.2% | 0.4% | |

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

Other positive developments on the global stage include:

- Encouraging progress on US trade deals with Europe and Japan regarding automobiles, which may mean tariffs can be avoided on vehicles imported into the US
- US employment and consumer confidence remains strong
- The US Federal Reserve cushioned the cooling economy with another 0.25-point interest rate cut and promised to remain accommodative
- Various other central banks are also maintaining an accommodative monetary stance.

Bears factors include:

- A synchronised slowdown in global growth with a downward revision of 2019 growth to 3% by the IMF, the lowest since the global financial crisis
- Brexit uncertainty remains

- Manufacturing in the eurozone is the weakest it's been in seven years, but latest German factory orders reversed the decay of the last two months with an increase of 1.3%.
- China's economy grew by the slowest pace in the second quarter in almost three decades, pointing to weakness in the short term.

Overall, an ideal case for local and global growth is for SA to implement reforms; the US and China to strike a trade deal; and the Britons to sort out Brexit.

## ETF strategy

Given this backdrop we think South African-facing stocks will remain under pressure, with the JSE generally marked by high volatility and low liquidity. This underscores a need for offshore diversification. Locally we think investors should tilt their portfolios towards income-focused assets to cushion the lack of capital appreciation. We discuss our picks for this strategy in detail below.