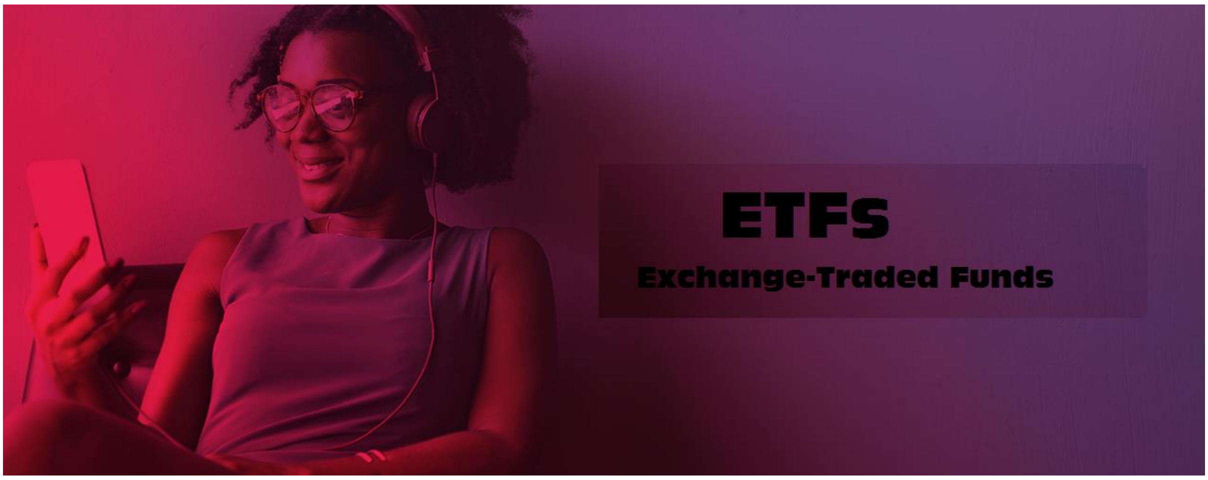


February 2019

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 February?

- Equities climb as risk appetite increases
- China rolls out a stimulus package while the Fed signals a rate pause
- SA's state of the nation address and the national budget

Our favourite ETFs

- Domestic equities: Satrix SA Quality 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

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 five broad categories:

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

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.

What's happened in the markets?

Apart from a few declines in the local bond and property markets, most ETFs extended their new year rally during February as, internationally, risk-on sentiment which started at the beginning of the year persisted. Investors' appetite for risk is driven by the US Federal Reserve Bank's pivot on interest rates, ongoing US/China trade talks and a rollout of Chinese stimulus measures. Those more than offset negative domestic issues including Eskom and SA's national budget.

The value of an equally weighted portfolio of non-commodity JSE-listed ETFs climbed 4.26% during February, slightly ahead of Intellidex's selection of ETFs which gained 3.05%. Funds that track local assets increased 2.59% on average while those that track global markets grew 6.93%. Returns on international funds were boosted by rand weakness.

Local markets

Equities outperformed our expectations with the JSE all share index gaining 3.4%. The trend of large-capitalisation stocks outperforming small- and mid-caps rolled on in February, suggesting that while investors' risk appetite has increased as reflected by a shift from bonds to equities, they are still cautious.

Large caps advanced 3.78% thanks to resources and industrials, which covered up for the slack in financials. Small caps declined 2.41% while mid-caps gained 2.92%. The JSE resources index and the resources 10 index gained 7.84% and 6.7% respectively, driven by precious metals miners – Impala Platinum (55.27%),

We then add a category for equity ETFs with an income theme.

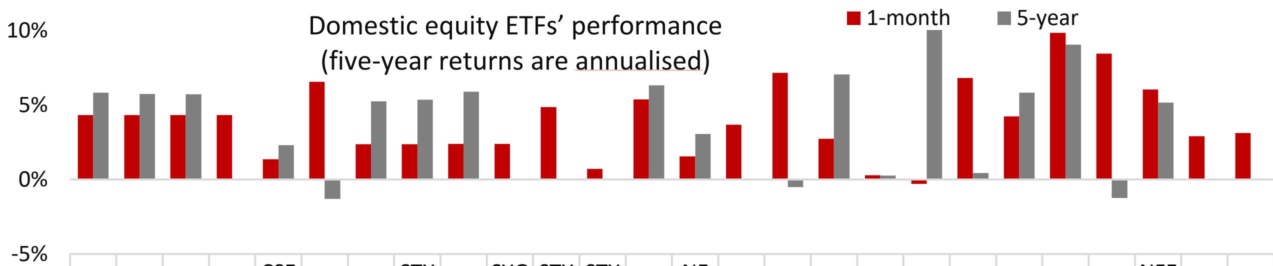
Our picks should provide an investor with a relatively diversified portfolio, even if it was made up only of ETFs. However, asset allocation is not a one-size-fits-all concept. You need to make sure that weights of different asset classes in your portfolio meet your unique risk and return objectives. 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 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 overconcentration, a good ETF should cap its exposure to a single sector and/or a single counter. While ETF costs are still coming down as competition among local providers intensifies, 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 January favourites:

Domestic equity: Satrix SA Quality ETF

We retain the Satrix SA Quality ETF as our pick in this segment. The ETF selects constituent companies using a set of quality metrics, including return on equity, liquidity and leverage. The top 20% of all JSE-listed companies with the highest scores based on those criteria are included in the fund and weighted



	ASHT40	STX40	STAN40	SYGT40	CSEW40	NFSH40	NFSWIX	STXSWX	STANSX	SYGSW4	STXMMT	STXQUA	STXRAF	NEWFSA	CTOP50	GIVISA	ASHMID	GIVFIN	STXFIN	GIVIND	STXIND	GIVRES	STXRES	NFEMOM	NFEVAL	NFEVOL
1-month	4.32	4.32	4.31	4.32	1.35	6.54	2.37	2.36	2.39	2.38	4.85	0.71	5.37	1.55	3.67	7.15	2.74	0.29	-0.2	6.80	4.23	9.83	8.44	6.04	2.91	3.11
5-year	5.82	5.74	5.71	0.00	2.31	-1.3	5.25	5.34	5.88	0.00	0.00	0.00	6.32	3.06	0.00	-0.5	7.05	0.26	10.2	0.44	5.81	9.04	-1.2	5.16	0.00	0.00

Lonmin (44.83%), Sibanye Gold (36.83%) and Anglo-American Platinum (23.05%) – which benefited from strong prices for precious metals and a weaker rand. The industrials 25 advanced 4.38% as heavyweights Richemont, BAT and AB INBEV grew 13.3%, 9.3% and 7.5% respectively.

After a strong January performance, financials came under pressure in February with the financial 15 index dropping 1.19%. Capitec, the sixth-largest constituent in this index, put in the best performance with an impressive 12.99% return. However larger constituents – First Rand (-6.47%), Sanlam (-5.28%), Absa (-.2.55%) – dragged the financials index down. On ETFs, the NewFunds S&P Givi SA Resources and the Satrix Resi led with gains of 9.83% and 8.44% respectively.

The "laggards" were Stanlib SA property and CoreShares Property Index Tracker SAPY, with losses of 3.45% and 3.51% respectively. Funds that track top 40 stocks closed out February with gains ranging between 1.35% (CoreShares Top 40 Equally Weighted ETF) and 6.54% (NewFunds Shariah Top 40). Bond funds were under pressure with those that track inflation-linked bonds ending in the red while the only fund that tracks vanilla bonds gained slightly.

by market capitalisation but capped at 10% of the fund.

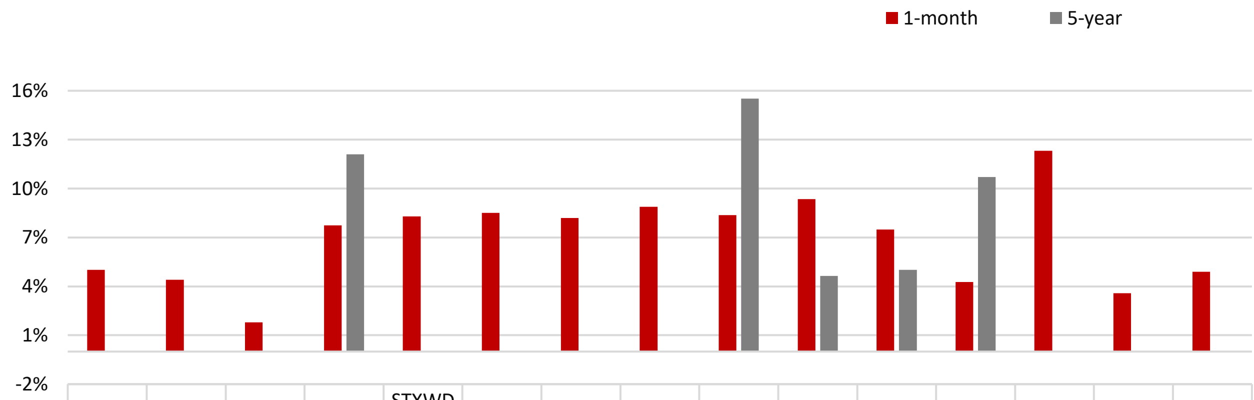
Empirical evidence shows that portfolios sorted on factors such as profitability and earnings quality generate high risk-adjusted returns relative to a market portfolio. However, the size of the premium varies, depending on the metrics used to calculate the quality score. The Satrix fund is a perfect fit for our 2019 outlook of a volatile equity market. It returned 0.71% during February.

Foreign equities developed markets: Satrix MSCI World ETF

In this category we like the Satrix MSCI World Equity Feeder ETF (up 8.29% in February) and the Ashburton Global 1200 Equity ETF (up 7.03%). They diversify their exposure across the US, Europe, Japan, Canada and Australia. With more than half of the funds invested in US stocks, investors will still have substantial exposure to the US.

Satrix MSCI World beats Ashburton Global 1200 Equity ETF on costs. Other more focused international equity themes include property and technology funds. These are worth considering for tactical or other investor-specific reasons.

International equity ETFs' performance



	GLPROP	SYGP	ASHGEQ	SYGWD	STXWDM	CSP500	SYG500	STX500	SYGUS	SYGUK	SYGEU	SYGJP	SYG4IR	AMIB50	STXEMG
1-month	5.01%	4.40%	1.80%	7.74%	8.29%	8.51%	8.19%	8.89%	8.38%	9.36%	7.49%	4.27%	12.32%	3.58%	4.90%
5-year	0.00%	0.00%	0.00%	12.10%	0.00%	0.00%	0.00%	0.00%	15.51%	4.64%	5.01%	10.71%			

**Excludes funds which are less than one-month old. 5-year returns are annualised.*

Perhaps the most positive news released during February was the imports/exports data where SA recorded a surplus trade balance of R17.2bn during December 2018. The unemployment rate ticked down to 27.1% from 27.5% during the third quarter, which is also positive. On the negative side, retail trade sales and mining output for December contracted 1.4% and 4.8% respectively year on year.

However, more consequential were the state of the nation address (Sona) and the national budget. We think the Sona was largely “sentiment positive” with a commitment to continue and accelerate the clean-up. However, we felt it offered nothing to bolster SA ‘s economic growth. The national budget reflected a strong will by the government to contain expenditure under very difficult conditions. The all-government bond index and the all share index declined soon after the delivery of the budget but recovered to close the month in the positive territory.

While equities have outperformed our expectations so far, we still feel that the chances of a pullback during the year are high. Earnings results and guidance released by most heavyweights outside of the resources sector on the JSE show they are under pressure. We still feel investors should cushion their portfolios by

Foreign equities, developing markets: Satrix MSCI Emerging Markets ETF

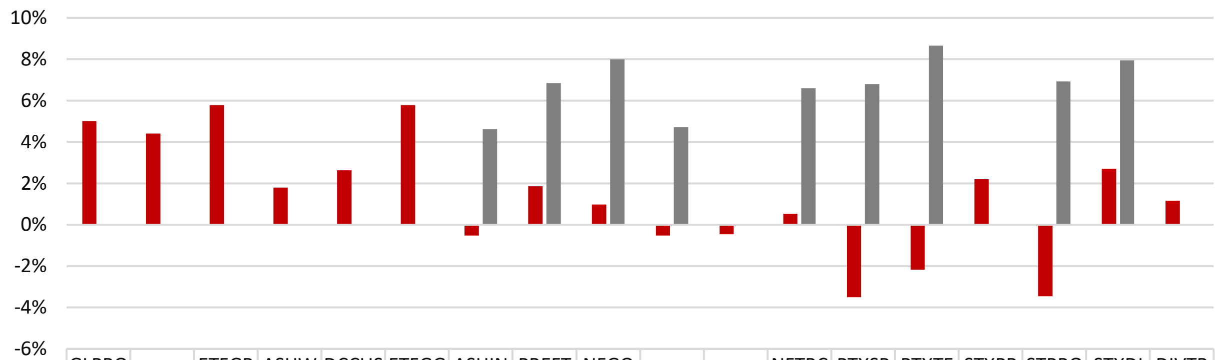
The choice in this segment is limited to two funds: Satrix MSCI Emerging Markets and the Cloud Atlas AMI Big50. The Satrix fund was the best performer last month, returning 4.9% against 3.58% for the Atlas fund. Unlike the Cloud Atlas fund which invests in African stocks only, the Satrix fund invests in a wider range of emerging economies, including some of the fastest-growing markets such as China and India. In addition, the fund is the cheapest within its category, boasting a TER of 0.4%.

Bond and cash funds

Bonds and cash were star performers in 2018. This is because of their low-risk attributes: investors tend to gravitate to lower-risk asset classes in choppy markets. Despite performing badly during February, we think bonds will remain investors’ favourites in 2019. If you are investing for a very short period, usually less than a year, then the NewFunds TRACI 3 Month (up 0.53% during February) is a natural choice because it is least sensitive to sudden adverse interest rate movements.

It is like earning interest on your cash at the bank with a minimal possibility of capital loss. For a longer investment horizon, protecting your investment against inflation is paramount. We therefore maintain

Income theme funds (five-year returns are annualised)



	GLPRO P	SYGP	ETFGR E	ASHW GB	DCCUS D	ETFGG B	ASHIN F	PREFT X	NFGO VI	NFILBI	STXILB	NFTRC I	PTXSP Y	PTXTE N	STXPR O	STPRO P	STXDI V	DIVTR X
1-month	5.0%	4.4%	5.8%	1.8%	2.6%	5.8%	-0.5%	1.9%	1.0%	-0.5%	-0.5%	0.5%	-3.5%	-2.2%	2.2%	-3.5%	2.7%	1.2%
5-year	0.0%	0.0%	0.0%				4.6%	6.9%	8.0%	4.7%	0.0%	6.6%	6.8%	8.7%	0.0%	6.9%	8.0%	0.0%

increasing exposure to funds that are concentrated in quality and defensive stocks as well as smart beta ETFs, which are focused on lower volatility and value factors.

International markets:

Global equites climbed during February with most major indices which are tracked by funds listed on the JSE enjoying year-to-date growth of between 6% and 13.5%. The Stanlib S&P 500 Info Tech Index Feeder was the top performer with a return of 12.4% in February, followed by Sygnia 's 4th Industrial Revolution, which returned 12.32%. Ashburton Global 1200 was at the bottom of the table with a return of 1.8% during February.

The risk-on behaviour can be credited to several factors. First, the US-China trade talks seem to be progressing well. The US delayed a planned hike in tariffs that was scheduled for 1 March, citing progress in trade talks. Second is the dovish pivot by the US Federal Reserve. Minutes from the Fed's latest meeting signalled that it was ready to pause in its campaign of steadily hiking interest rates. The UK, Brazil, Mexico and Russia also held their policy rates steady.

Third, Chinese policymakers are implementing a mix of fiscal and monetary measures to support growth. These developments combine to lower the risks that most investors were worried about coming into 2019. However, the flow of company earnings and earnings guidance for the first quarter is telling us something else. In the US, almost three quarters of the 103 S&P500 companies that have issued earnings guidance for the first quarter so far have been negative.

Analysts continue cutting their 2019 earnings targets for US companies. Morgan Stanley analysts lowered their S&P500 earnings growth target for 2019 to 1% from 4.3%. FactSet consensus for the S&P500 was slashed significantly with earnings for the first quarter now expected to decline by 3.4%, a huge drop from a consensus growth forecast of 6% growth issued as recently as November. Outside of the US, economic and sentiment data releases during February were soft. Preliminary figures show the eurozone GDP expanded by 0.2% quarter on quarter in the fourth quarter of last year, bringing full-year growth to 1.8%, the weakest pace in four years. The latest flash PMI readings also point to a continued slowdown in manufacturing output growth in advanced economies.

our choice of the Satrix ILBI ETF (down 0.52%), 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. As with equities, investors also need to diversify their bond portfolios internationally. We think investors can choose between Stanlib Global Bond ETF or Ashburton World Government Bond ETF. They track investment-grade sovereign bonds mostly issued by the US, UK, Japan and selected European countries. However, the Stanlib Global Bond ETF has the lowest TER. Both are less than a year old.

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. Two funds come naturally to mind: the Satrix Dividend Plus and CoreShares S&P South Africa Dividend Aristocrats.

However, property funds tend to have even higher pay-out ratios. We maintain our choice of the **Stanlib SA Property ETF** (down -3.45%). The Stanlib fund boasts the lowest TER in the segment. For foreign property funds. The **Sygnia Itrix Global Property ETF** (up 5.78%) is the cheapest in this category.

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** is more conservative, usually suitable for older savers. **Mapps Growth ETF** suits investors with a long-term horizon. They climbed 0.99% and 1.88% respectively in 2018.

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