March 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?

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

- Coronavirus forces global central banks to open their taps
- Equities trumped by safe-haven investments and commodities
- Weak 2019 GDP growth for SA
- Some 2020 budget highlights and implications

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, 1nvest Global Bond ETF and Ashburton World Government Bond ETF (long term)
- Dividend/income funds: 1nvest SA Property ETF and Sygnia Itrix Global Property ETF
- Commodities: 1nvest 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?

Risk assets, which make up the bulk of the underlying investments in ETFs, were hammered in February, with most of the damage coming in the final week of the month. Investors were compelled to reconfigure expectations on the impact of the coronavirus, with the contagion accelerating outside China. The virus has now hit all continents, and more recently SA, with most authorities raising the risk level to high alert.

The MSCI World Index, which tracks the dollar performance of developed market equities, fell 8.6%, while the MSCI Emerging & Frontier Index tanked 12.1%. With safe-haven assets becoming more attractive, gold and global bonds closed February 6.7% and 0.7% stronger respectively. Interestingly, rhodium and palladium, which are not considered safe havens, were the only risk assets holding onto gains by month-end as demand continues to outstrip supply.

Locally, the equities rally induced by the 2020 budget announcement fizzled out as soon as it started. The JSE tracked global equities lower and the all share index closed the month down 9%. SA government bonds were flat.

Against this backdrop, average returns for JSE-listed local and foreign asset ETFs were negative, though losses of the latter were curbed by the weakening rand. A basket of all local ETFs fell 8.3% while the basket of all JSE-listed international ETFs declined 4%.

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.

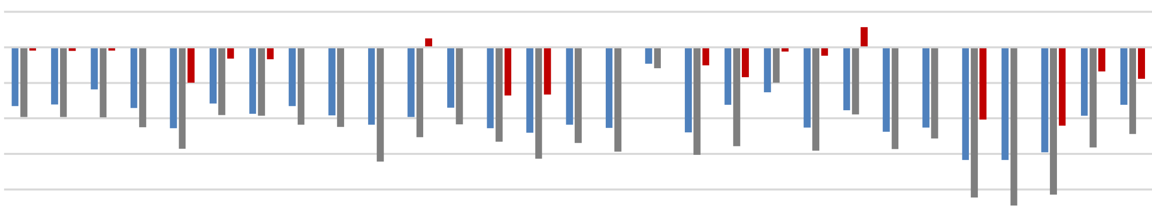
As a rule of thumb, we like ETFs that follow a watertight investment philosophy. They should also be tax smart, which means they should qualify to be in a tax-free savings account. To avoid overconcentration, a good ETF should cap its exposure to a single sector and/or a single counter. While competition 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
1-month	-8.3%	-8.1%	-5.9%	-8.5%	-11.4	-7.9%	-9.4%	-8.3%	-9.6%	-10.9	-9.8%	-8.5%	-11.4	-12.0
YTD	-9.8%	-9.8%	-9.8%	-11.3	-14.3	-9.5%	-9.6%	-10.9	-11.2	-16.1	-12.7	-10.9	-13.3	-15.7
5-year	-0.5%	-0.5%	-0.5%	0.0%	-5.0%	-1.6%	-1.7%	0.0%	0.0%	0.0%	1.3%	0.0%	-6.8%	-6.6%

	NFEHGE	NFEMOD	NFEDEF	ASHMID	STXFIN	STXIND	STXRES	NFEMOM	NFEVAL	NFEVOL	CSPROP	STXPRO	ETFSAP	STXDIV	DIVTRX
1-month	-10.9	-11.4	-2.3%	-12.0	-8.1%	-6.3%	-11.3	-8.8%	-11.9	-11.3	-15.9	-15.8	-14.8	-9.6%	-8.1%
YTD	-13.5	-14.7	-2.9%	-15.1	-13.9	-5.0%	-14.5	-9.5%	-14.3	-12.8	-21.1	-22.3	-20.7	-14.1	-12.2
5-year	0.0%	0.0%	0.0%	-2.5%	-4.2%	-0.6%	-1.2%	2.8%	0.0%	0.0%	-10.2	0.0%	-11.0	-3.4%	-4.4%

In contrast, the basket of commodity ETFs rose 8.8%. Consequently, Intellidex's equally weighted ETF portfolio, which is built from these three broad JSE ETF categories, declined 1.41% while its benchmark of all JSE-listed ETFs was worse, down 4.8%.

Local and commodity ETFs

All broad JSE equity categories fell, with the biggest casualty being industrials which tanked 14.5%, followed by resources (-11.6%) and financials (-9.5%). The top-five bond ETF returns were between 1% and -0.5%.

The worst performers, however, came from the property sector. Property funds have been under persistent pressure for the past two years as the South African economy faltered. Vacancy rates are on the rise and rentals are under pressure. The bottom five funds saw returns ranging from -15.9% to -12%.

High-flying commodities, however, continued their terrific form. The 1nvest Rhodium ETF climbed 21.2%, with the Absa NewGold Palladium ETF following closely at 20.8%. Gold funds were up 6.7%, but platinum funds faltered, losing up to 5.7%.

The rhodium fund is up a staggering 117.1% since the beginning of the year and has climbed 313.5% in the past 12 months – we are pleased to have had it in out portfolio since last year.

International ETFs

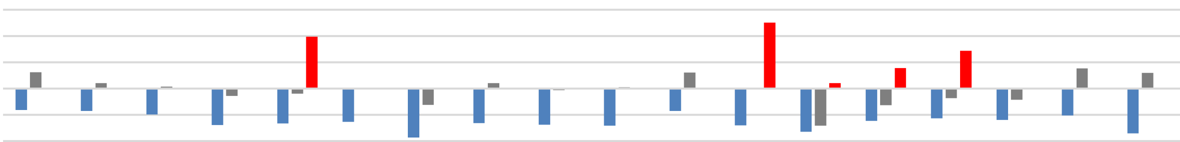
Major International equity indices fell between 5.9% and 10.4%. Bonds performed well, with the FirstRand US Dollar Custodial Certificates surging 7.2%. In a complete U-turn, the Africa-focused Cloud Atlas Africa Real Estate ETF saw the only positive return in the offshore equity category, up 4.2%.

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 8.8% in February) which follows one of the five factor investing strategies widely regarded in finance literature. Global empirical evidence in the last decade shows that momentum investing on average was the second-best investing strategy – behind low-volatility and ahead of its three cousins: value, size and quality. To its credit, the fund has performed better than other JSE broad equity funds over the past five years. The data also suggest investors should consider investing in various volatility-weighted funds on the JSE. However, previous performance is not an indication of future performance.

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 fell 6.3% in February. A good alternative, though, is the Ashburton Global 1200

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	-4.1%	-4.3%	-4.9%	-6.9%	-6.6%	-6.3%	-9.3%	-6.6%	-6.9%	-7.1%	-4.3%	-7.0%	-8.2%	-6.1%	-5.6%	-6.0%	-5.1%	-8.5%
YTD	3.1%	1.0%	0.4%	-1.4%	-1.0%	0.0%	-3.1%	1.0%	-0.3%	0.2%	3.1%	0.0%	-7.1%	-3.2%	-1.8%	-2.1%	3.8%	3.0%
5-year	0.0%	0.0%	0.0%	0.0%	9.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	12.5%	1.1%	3.9%	7.2%	0.0%	0.0%	0.0%

The 1nvest MSCI World ETF was the worst performer, falling 9.3%. Other poor performers include the 1nvest S&P 500 Info Tech Index Feeder ETF (-8.5%) and Sygnia/Itrix FTSE 100 (-8.2%).

Macroeconomic review and outlook

Locally, the economy remains under tremendous pressure, growing a meagre 0.2% in 2019, the worst since the financial crisis over a decade ago. Officially, we are in a technical recession as the economy shrank in the last two quarters of last year. While challenges at home seem insurmountable, the coronavirus is taking centre stage globally, which serves to expose SA further.

The much anticipated 2020 budget was not short on surprises, but as expected government's debt trajectory deteriorated further. National Treasury now expects the economy to grow just 0.9% this year, but with downside risks high, that seems a generous estimate. Specifically, Eskom and other SOEs have become a perennial drag on the fiscus, worsened by the fact that government has struggled to implement the actions needed to reverse the decay.

The budget provided a little relief to consumers with no major tax hikes but an adjustment to account for bracket creep. The ambition to save R160bn by cutting the government wage bill over the next three years was a major highlight. However, Intellidex reckons it's a hard ask, given union opposition, and is unlikely to materialise. Moody's didn't buy it either, issuing a statement that was highly sceptical of the plan being implemented, which raises the probability of a sovereign credit downgrade to junk status.

The rand, which is intricately linked to the South African economy and politics, is also bound to continue being volatile.

The obvious casualties of the coronavirus are companies linked to travel and consumer spending, while it is also disrupting global supply chains. The OECD was quick to slash its 2020 global GDP growth forecasts by half to 1.5% from 3%, the worst forecast cut since the 2008 financial crisis.

Equity ETF (down 6.9%) 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 (-2.5%). 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 (-2.4%), 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, which is somewhat expected given its frontier status.

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 (-12%) is more conservative, usually suitable for older savers. Mapps Growth ETF (-5.9%) 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 (-15.8%) which has a brilliant diversification approach. For foreign property funds we like the Sygnia Itrix Global Property ETF (-4.3%). It has an aggressively low total expense ratio (TER) of 0.19% that significantly undercuts its

We have summarised how the virus has or is going to affect economic activity:

- Millions in China are under lockdown

- The International Air Transport Association forecast that airlines would lose between $63bn to $113bn in revenue this year.
- The trillion-dollar companies Apple and Microsoft have issued sales warnings, citing supply chain challenges
- In SA, big retailers Shoprite and Woolworths warned that their supply chains could be affected. Shoprite says initial estimates show a loss of R100m in sales.
- Global tech behemoths including Google, Facebook and Amazon have cancelled events and conferences and have asked employees to work from home.
- Italy has closed schools and universities and restricted public gatherings, including sporting events.

While this list is not exhaustive it does paint a picture of risks and potential losses. However, global central banks and governments are taking steps to reduce the coronavirus impact. Measures already taken or that might be taken include:

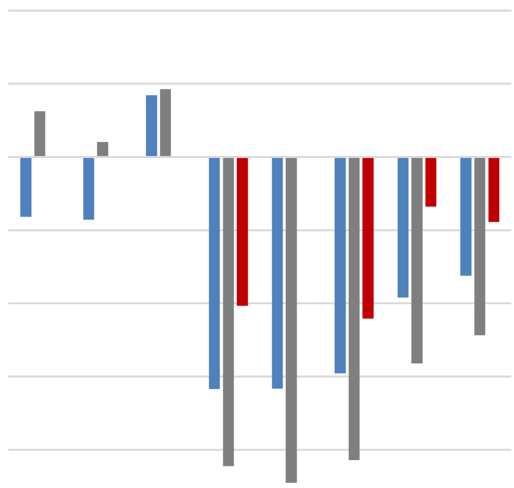
- China was first to implement expansionary fiscal and monetary measures.
- That was followed by interest rate cuts from the US Federal Reserve, Bank of Canada, the Hong Kong Monetary Authority and the Reserve Bank of Australia. The central banks of the EU, England and Japan have expressed their readiness to follow suit. With this latest round of cuts, we have hit the lowest average interest rate on record globally.
- Additionally, the South Korean government has unveiled $9.8bn to help businesses, while US lawmakers agreed on a $7.8 bn emergency package to respond to the outbreak.
- Opec and other oil-producing countries will discuss oil production cuts.

These steps could help reduce the blow on the global economy, but it is difficult to predict how things will play out.

Overall, local equities are showing value, based on their historical averages of various ratios. However, most companies are experiencing flat or declining earnings and if the local economy does not improve, the low valuations will persist.

competitors, whose charges range from 0.34% to 0.52%.

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



	GLPROP	SYGP	AMIRE	CSPROP	STXPRO	ETFSAP	STXDIV	DIVTRX
1-month	-4.1%	-4.3%	4.2%	-15.9%	-15.8%	-14.8%	-9.6%	-8.1%
YTD	3.1%	1.0%	4.6%	-21.1%	-22.3%	-20.7%	-14.1%	-12.2%
5-year	0.0%	0.0%	0.0%	-10.2%	0.0%	-11.0%	-3.4%	-4.4%

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 (+0.6%) 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 (+0.9%), 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 (-0.5%). As with equities, investors also need to diversify their bond portfolios internationally. Our choice is the 1nvest Global Bond ETF (+5.7%), which tracks investment-grade sovereign bonds mostly issued by the US, UK, So while there are risks to both the upside and downside, downside risks are more pronounced given SA's current trajectory. However, in the short term, SA's fixed-income assets might attract foreign flows given their relatively stronger yields.

Globally, while equity prices have been consistently hitting new highs, Bloomberg editor Cormac Mullen reckons they remain more attractive than fixed-income securities. In the US, the spread between the 12-month forward dividend yield on the S&P 500 Index and the 10-year US Treasury yield is at its widest on record and a similar trend is observed in Europe. This means global equities are likely to remain investors' preferred asset class. But again, risks to the downside have increased due to the coronavirus. Other important risks to keep in mind are Brexit and the somewhat fragile US-China trade relations.

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. We encourage offshore exposure to hedge against rand weakness and the ailing South African economy. However, with the offshore outlook also muddied, we emphasise diversification across developed markets.

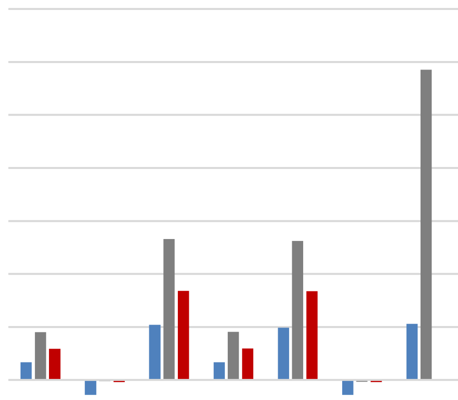
Japan and selected European countries. The 1nvest Global Bond ETF has the lowest TER in this category.

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 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 19.7% during February.

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



	GLD	NGPLT	NGPLD	ETFGLD	ETFPLD	ETFPLT	ETFRHO
1-month	6.7%	-5.6%	20.8%	6.7%	19.7%	-5.7%	21.2%
YTD	18.1%	-0.5%	53.2%	18.1%	52.5%	-0.7%	117.1%
5-year	11.8%	-0.9%	33.6%	11.9%	33.5%	-0.8%	0.0%

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

EasyEquities ETF Review