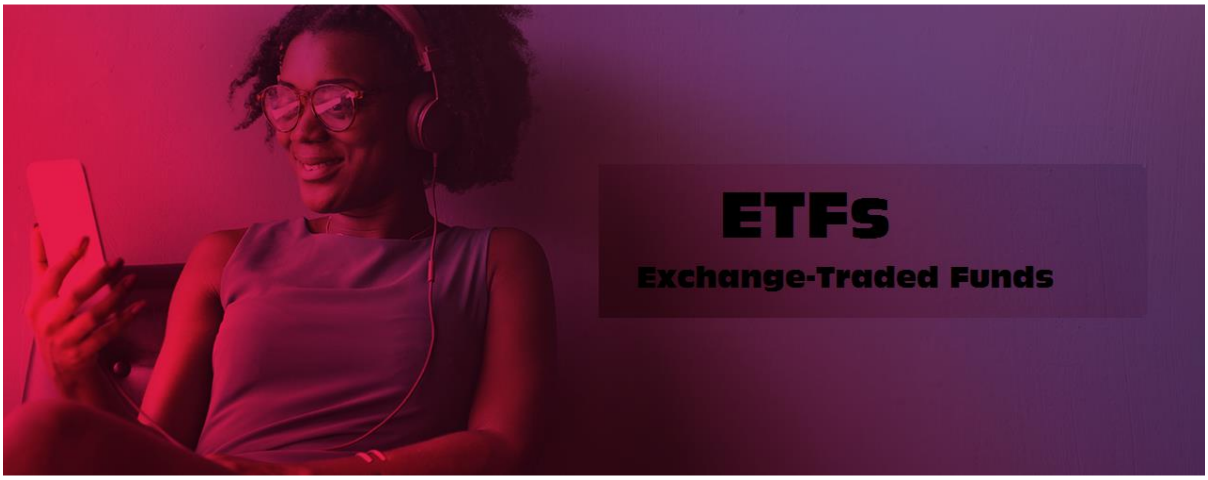


13 November 2018

The ETF Monthly 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's happened in the markets?

- Former governor Tito Mboweni replaces Nhlanhla Nene as finance minister
- Medium-term budget policy statement (MTBPS) fails to inspire investors and credit ratings agencies
- Investor conference gets R290bn worth of investment promises
- Stock market sell-offs intensifies

Our favourite ETFs

- Domestic equities: CoreShares Equally Weighted Top 40 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: Satrix 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 market?

The stock market pullback that started towards the end of September continued during October. An equally weighted portfolio of non-commodity JSE-listed ETFs lost 2.87% in October. Funds which track local assets declined 3.43% on average while those which track global markets ended 2.01% down. Intellidex's selection of ETFs, on an equally weighted basis, was not spared but fared better losing 0.78%.

Local markets

Domestic headlines during October were centred on the resignation of Nhlanhla Nene as finance minister and the subsequent appointment of former Reserve Bank governor Tito Mboweni as his replacement, the Medium-Term Budget Policy Statements (MTBPS) and the investment conference.

We were somewhat disappointed by the MTBPS which is a "mini budget" halfway through the year from the main February budget. Government's overall financial position deteriorated when compared to the February budget. The budget also underperformed Moody's qualitative expectations which increases chance of a downgrade. In our view, though, that will happen only after next year's general election, though a negative outlook on the rating could be announced before the end of this year. Revenue and growth estimates are broadly credible in the short-term, but we think too

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

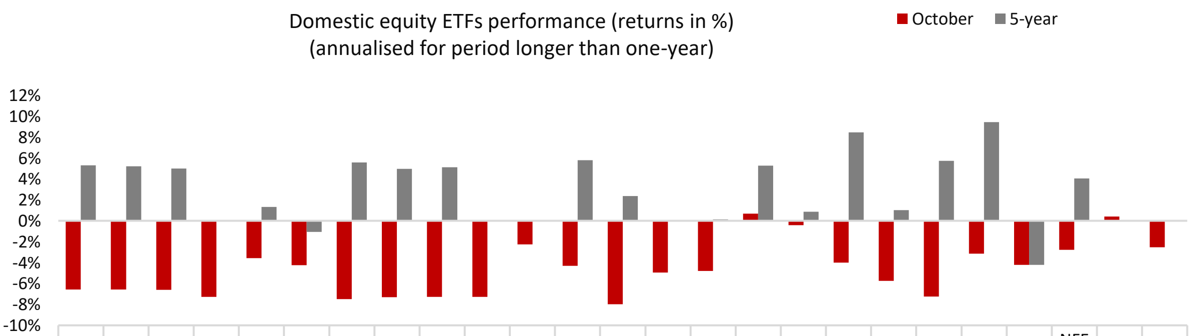
Our picks should provide an investor with a relatively diversified portfolio, even if it was made up only of ETFs. However, asset allocation is not a one-size-fits-all concept. You need to make sure that weights of different asset classes in your portfolio meet your unique risk and return objectives. 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 October favourites:

Domestic equity: CoreShares Equally Weighted Top 40 ETF



	ASHT40	STX40	STAN40	SYGT40	CSEW40	NFSH40	NFSWIX	STXSWX	STANSX	SYGSW4	STXQUA	STXRAF	NEWFSA	CTOP50	GIVISA	ASHMID	GIVFIN	STXFIN	GIVIND	STXIND	GIVRES	STXRES	NFEMOM	NFEVAL	NFEVOL
October	-6.5	-6.5	-6.6	-7.2	-3.5	-4.2	-7.4	-7.3	-7.2	-7.2	-2.2	-4.3	-7.9	-4.9	-4.7	0.69	-0.4	-3.9	-5.7	-7.2	-3.1	-4.2	-2.7	0.41	-2.5
5-year	5.30	5.21	4.99		1.33	-1.0	5.58	4.98	5.11			5.79	2.37		0.12	5.27	0.88	8.47	1.03	5.74	9.43	-4.2	4.04		

optimistic in the medium-run. We find it difficult to see how the government's main debt ratios will stabilise.

Another important takeaway from the MTBPS is that the National Treasury expects the economy to grow slower than its February projection. This downgrade was largely expected by the market considering poor GDP figures for the first half.

Economic data released during October shows the economy is still struggling. Vehicle sales were disappointing with sales for September declining 1.9% year-on-year (y-o-y). Manufacturing production, which had grown 1.3% y-o-y during August, surprised strongly to the downside, coming in at 0.1% y-o-y against consensus expectations of 1.9%. Mining production also disappointed, slipping further by 1.8% y-o-y (August: -6.7% y-o-y). Unemployment worsened to 27.5% in quarter 3 (2018Q3) versus 27.2% in quarter 2.

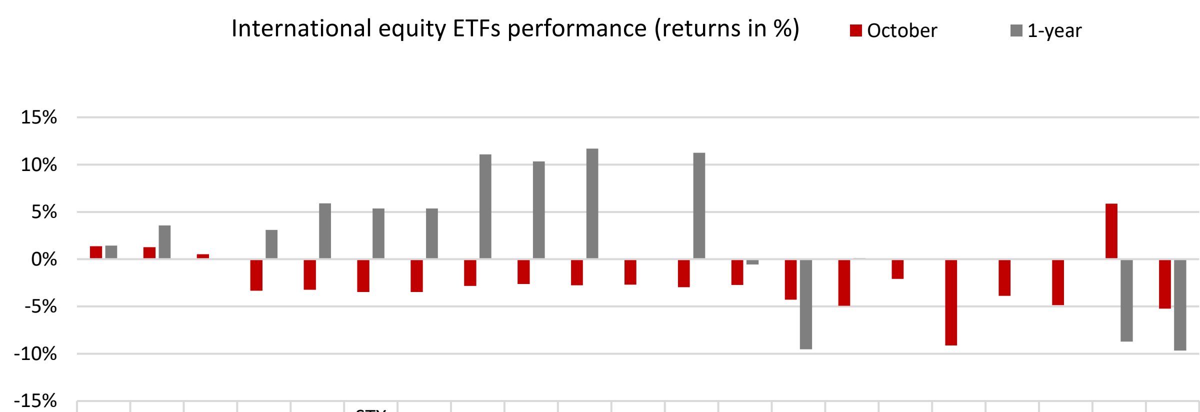
Investors reacted negatively to these and other issues. The JSE all share index ended the month 5.9% lower, the largest month-on-month decline since February 2009. Most top 40 equity funds lost more than 6% on average. At sector level, Satrix Capped Indi ETF was the biggest loser with a return of -7.25%. Financials and resources also reported

CoreShares Equally Weighted Top 40 ETF retains its top position for domestic equities despite facing strong competition from Absa NewFunds Low Volatility ETF during our review. Absa NewFunds Low Volatility is the only fund on the market which selects stocks based on volatility attributes. Given a steep rise in the South African Volatility Index Top 40 during October, which implies that investors are anticipating markets to be volatile, low volatility funds were taken into consideration this month.

However, we decided against NewFunds Low Volatility ETF for two reasons. First, the fund is too exposed to counters which generate most of their earnings from the local economy. Given the prevailing negative narrative around the SA economy, sectors which are favoured by this fund such as financials, healthcare and consumer staples, are likely to struggle. Second, the fund's small size increases risk of early liquidation. Top 40 funds, albeit having higher volatility measures, overcome these weaknesses.

The CoreShares Equally Weighted Top 40 ETF beats other top 40 funds on diversification. The fund CoreShares Equally Weighted Top 40 ETF allocates its funds equally to all 40 constituents which reduces risk of concentrating in a few counters. CoreShares Equally Weighted Top 40 ETF declined 3.56% during October, outperforming its direct

International equity ETFs performance (returns in %)



	GLPROP	SYGP	ETFGRE	ASHGEQ	SYGWD	STXWDM	ETFWLD	CSP500	SYG500	STX500	ETF500	SYGUS	SYGUK	SYGEU	SYGJP	GLODIV	SYG4IR	ETF5IT	STXNDQ	AMIB50	STXEMG
October	1.38	1.25	0.52	-3.3	-3.2	-3.4	-3.4	-2.8	-2.6	-2.7	-2.6	-2.9	-2.7	-4.2	-4.9	-2.0	-9.1	-3.8	-4.8	5.86	-5.2
1-year	1.45	3.57		3.09	5.90	5.36	5.36	11.0	10.3	11.6		11.2	-0.5	-9.5	0.12					-8.7	-9.6

negative returns. Interest bearing funds fared better than equities. All the inflation-linked bond ETFs posted positive returns. Absa NewFunds Govi, the only local vanilla bond fund, was 1.9% down. The rand was also under pressure weakening 4.2% against the US dollar and 1.7% against the euro.

International markets:

In the **US**, the economy grew at a faster-than-expected 3.5% quarter-on-quarter (q-o-q) in the third quarter (2018Q3) on strong consumer spend. Unemployment remained on a 48-year low of 3.7% clocked in September despite adding 250,000 new non-farm payroll jobs during October. Inflation for October remained at 2% y-o-y in September, consistent with the Fed's 2% inflation target.

Despite robust economic data, investors offloaded US equities seemingly in favour of bonds. The Sygnia 4th Industrial Revolution ETF was the biggest loser, shedding 9.11% of its value. Other US Equity ETFs lost between 2.64% (Sygnia S&P 500) and 4.87% (Satrix Nasdaq 100). The global equity trackers that have a strong bias towards the US also suffered. Bond ETFs returned an average of 3.6%.

Data from other major economies was sparse. In the **Eurozone** the preliminary data shows that economic growth for

peers. However, the Ashburton MidCap ETF was the top performer in the segment with a return of 0.69%.

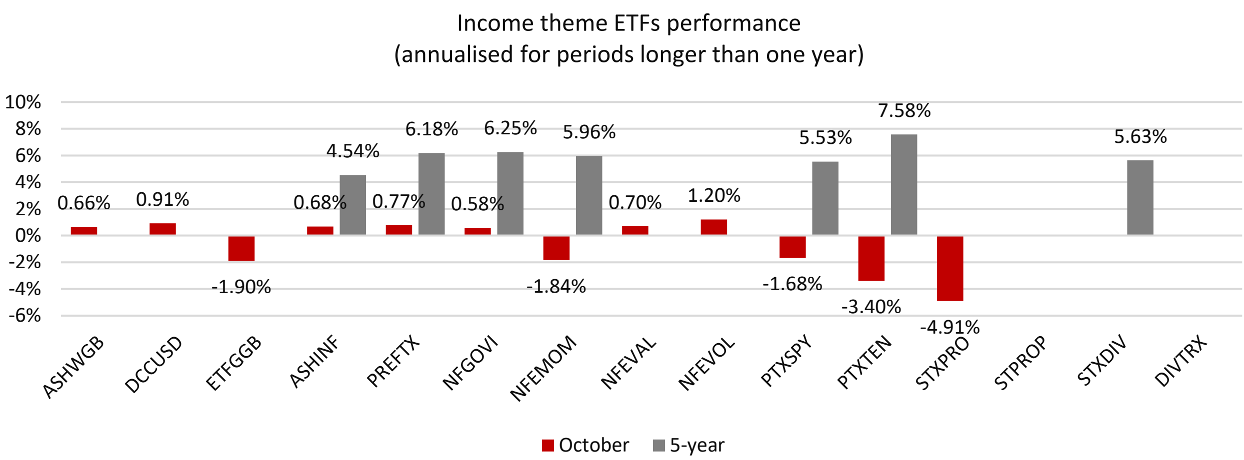
Foreign equities developed markets: Satrix MSCI World ETF

While developed markets are experiencing some serious sell-offs, we still think robust economic growth prospects from those markets and a negative rand outlook still support a continuation of the offshore investing theme.

The international equities offering of the JSE has been expanding. It started off with broad-based themes but now includes property funds and, more interestingly, technology funds. These focused themes are worth looking at, but our finalists in the international category are the world funds – the Satrix MSCI World Equity Feeder ETF and the Ashburton Global 1200 Equity ETF. We like these because they diversify their exposure to the US, which is by far the most interesting developed market now, with exposures to Europe, Japan, Canada and Australia. With more than half of the funds invested in US stocks, investors will still have a very substantial exposure to the US. Satrix MSCI World beats Ashburton Global 1200 Equity ETF on costs. Both Satrix MSCI World ETF and Ashburton Global 1200 Equity lost 3.3% during October.

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. Cloud Atlas AMI Big50 was the best performer during



2018Q3 is likely to underperform expectations at 0.2% q-o-q (seasonally adjusted) in 2018Q3, from 0.4% in Q2. This reading will be the lowest since 2014Q2.

Sygnia Eurostoxx 50 ETF, the only fund with a 100% exposure to the Eurozone, lost 4.27% during October. Stock markets in **China and other emerging markets** followed trends in developing markets. The MSCI China, measured in Chinese yuan, lost 11.3%. **Japanese** and **UK** markets were also under pressure.

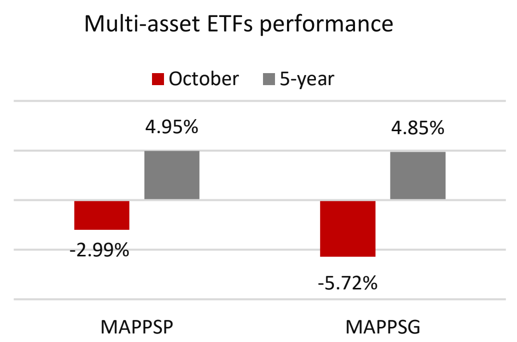
Dividend or income theme funds

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. Naturally, Satrix Dividend Plus and CoreShares S&P South Africa Dividend Aristocrats come to mind here, but similarly, property funds are high dividend payers.

We maintain our choice of the capped fund **Satrix Property ETF** (up 1.2% in October). It has a dividend yield of 5.87% and its TER is expected to be the lowest in the segment. However, investors can also consider foreign property ETFs. The **Sygnia Itrix Global Property ETF** (up 1.25% in October), with a TER of 0.25%, is by far the cheapest of the three.

Multi-asset ETFs

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. They are the **NewFunds Mapps Protect ETF** and the **NewFunds Mapps Growth ETF**. They are designed to meet two different risk appetites: Mapps Protect is more conservative, suitable for conservative, usually older, savers. Mapps Growth suits investors with a long-term horizon. They declined 2.99% and 5.72% respectively in October.



October after growing 5.86%. Nonetheless, we retain Satrix MSCI Emerging Markets because of its diversification. Unlike Cloud Atlas AMI Big50 which invests in African stocks only, Satrix MSCI Emerging Markets invests in a wider range of emerging economies. It invests in stocks in some of the fastest growing markets such as China and India. With a TER of 0.4% the Satrix MSCI Emerging Markets ETF is also cheaper than its peer in this category, which is on a TER of 0.75%.

Bond and cash funds

Typically, fixed-income products such as bonds perform well during periods of low economic growth since they offer fixed interest. However, that is unlikely to be the case for SA bonds. The slow economic growth and the lack of political appetite for fiscal consolidation (in our view), increases the risk of a credit downgrade which is negative for bonds.

Nonetheless, bonds and cash are good additions to portfolios. If you are investing for a very short period, usually less than a year, then the **NewFunds TRACI 3 Month** (up 0.58% in October) 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.

However, for a longer investment horizon, protecting your investment against inflation is paramount. We therefore maintain our choice of the **Satrix ILBI ETF** (up 0.77% in October), which has the lowest expense ratio in this category. Furthermore, nominal bonds add a add a unique risk-return dimension that differs from inflation-linked bonds and improves overall portfolio performance.

As we did in equities, investors also need to diversify their bond portfolios internationally. We think investors can choose between **Stanlib Global Bond ETF** (up 3.85% in October) or **Ashburton World Government Bond ETF** (up 0.66% in October). They track investment-grade sovereign bonds mostly issued by the US, UK, Japan, and selected European countries. Their TERs differ by just 0.05 percentage points with the **Stanlib Global Bond ETF** being the cheapest.

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