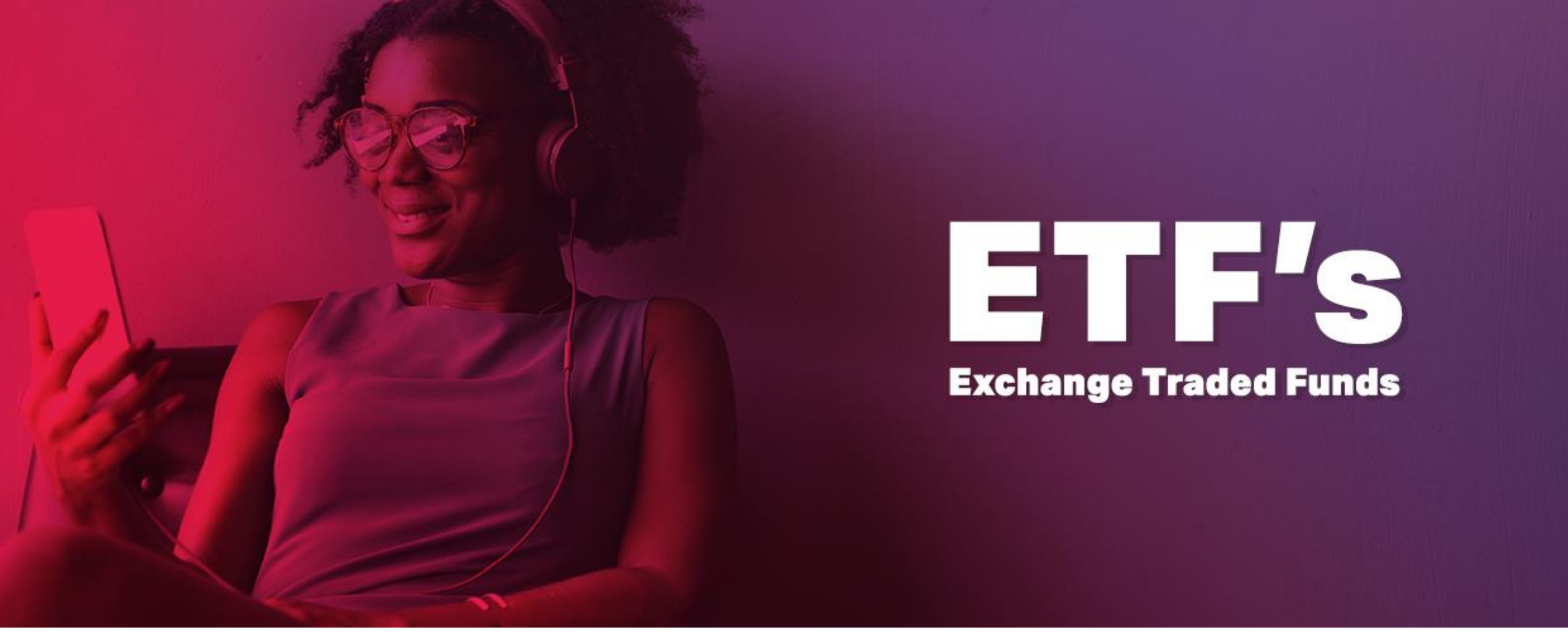


July 2018

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're collaborating with Intellidex to bring you the latest insights on ETFs.

IN THIS ISSUE:

What's happened in the markets?

- Global trade tensions escalate
- Rand hits 7-month low against the dollar

Our favourite ETFs

- Domestic equity: Satrix SA Quality ETF
- Foreign equities: Satrix MSCI World ETF and Satrix MSCI Emerging Markets ETF
- Bonds and cash: NewFunds TRACI 3 Month (short term); Satrix ILBI ETF, Stanlib Global Bond ETF & Ashburton World Government Bond ETF
- Dividend or income funds: Satrix Property ETF

New foreign ETFs

The surge in the listing of international-asset ETFs continues, with Stanlib and Satrix the latest firms to add to the menu.

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 equity
- International equity
- Bonds and cash
- Multi-asset
- Dividend-focused

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

What's happened in the markets?

June was largely a decent month for ETFs. The rand, which weakened 7.8% against the dollar and 6.8% against the euro, fuelled a strong performance from foreign ETFs. The recently launched CoreShares S&P Global Property ETF and Stanlib Global REIT ETFs were the star performers, rising 12.40% and 11.81% respectively. The MSCI World Index, which is the barometer for the performance of developed markets, was up 8.57%. However, without the help of the rand, which was hit by the threat of global trade wars, the index would have been largely flat.

Most of the domestic broad equity market ETFs ended the month in positive territory while domestic bonds and property ETFs struggled. The JSE top 40 index continued its roller coaster ride but finished 3.95% up, with resource stocks having a huge say in its performance. After gaining 4.11% in May, the 10 largest resources counters rose 8.3% in June. The Satrix Resi 10 which tracks those companies benefited and has advanced an impressive 42.53% over the past 12 months.

The domestic all bond index and the SA listed property index ended down 1.27% and 2.76% respectively.

Our picks in the above categories 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 want to choose asset classes that 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 over-concentration, a good ETF should cap its exposure to a single sector and/or a single counter. While costs may no longer be a big issue in developed markets where they have declined significantly and do not differ much across different products, they still are an issue in SA. We prefer ETFs with low total expense ratios (TERs).

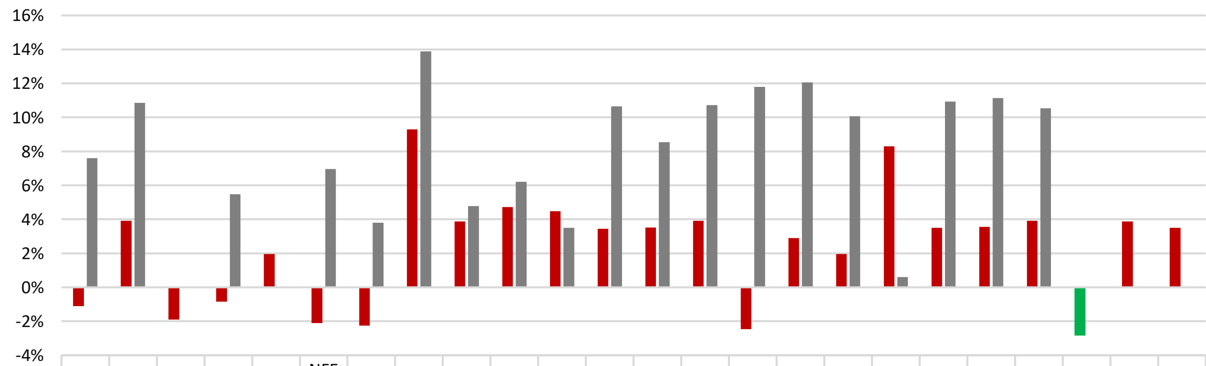
An overview of our favourite funds for each category follows.

The July favourites:

Domestic equity: Satrix SA Quality ETF

The Satrix SA Quality ETF has been disappointing over the past few months. It lost 11% over the past three months on the back of poor performances from its top three investments: Tiger Brands (down 15%), Sanlam

Domestic equity ETFs: annualised returns to end-June:



	ASH MID	ASHT 40	LVLT RX	CSE W40	CTOP 50	NFE MO M	GIVFI N	GIVR ES	GIVIS A	GIVI ND	NFSH 40	NFS WIX	NEW FSA	STX4 0	STXFI N	STXI ND	STXR AF	STXR ES	STXS WX	STAN SX	STAN 40	STXQ UA	SYGT 40	SYGS W4
June return	-1%	4%	-2%	-1%	2%	-2%	-2%	9%	4%	5%	4%	3%	4%	4%	-2%	3%	2%	8%	4%	4%	4%	-3%	4%	4%
5-year	8%	11%		5%		7%	4%	14%	5%	6%	4%	11%	9%	11%	12%	12%	10%	1%	11%	11%	11%			

Local developments

A raft of domestic data released during June suggests that the economy, which contracted during the first quarter of this year, started the second quarter on a weak footing. Mining production fell by 4.3% year-on-year in April. Annualised retail sales also disappointed, increasing a pedestrian 0.5% in April, its slowest pace in 15 months.

Retail sales figures show consumer spending remains sluggish, held back by an uptick in inflation, the value-added tax hike on 1 April and rising fuel prices. President Cyril Ramaphosa has promised measures to ease the burden of rising costs on consumers. While hard-pressed consumers would welcome any such move, we don't think the government has enough wiggle room to make any meaningful interventions.

SA is already skating on thin ice following the lower-than-expected first quarter GDP numbers and the recent three-year wage deal for the public-sector which exceeds the provision for salary adjustments made in the 2018 medium-term expenditure framework by R30bn.

International markets

On the international scene, trade conflicts between the US, China, Canada and the European Union (EU) escalated during June and the first week of July. The US implemented duties on $34bn of Chinese imports, and Beijing retaliated proportionately. Canada also began imposing tariffs on $12.6bn of US goods while the EU is still planning to impose tariffs on selected US imports.

So far, the trade conflicts seem to have hurt emerging markets the most. The MSCI Asia ex-Japan and MSCI Emerging Markets indices

(down 13.2%) and Mr Price (down 17.4%). The three counters account for close to 30% of the fund. Despite that poor performance, the fund remains our favourite for local equities. From the big batch of domestic broad-based equity funds on offer, we like this ETF because it reduces the concentration risk that has come to dominate the top 40 indices because it caps the weight of each counter and sector.

The fund selects constituent companies using a set of quality metrics, including return on equity, liquidity and the leverage of the balance sheet. The top 20% of all JSE-listed companies with the highest scores based on those criteria are included in the fund and weighted by market capitalisation, then capped each 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.

We believe Satrix SA Quality has potential to accumulate returns ahead of inflation and other asset classes over longer periods. It holds stocks that we believe can deliver good growth in future.

Foreign equities developed markets: Satrix MSCI World ETF

We change our pick for this category from Ashburton Global 1200 Equity ETF to the newer Satrix MSCI World ETF. Both ETFs offer efficient exposures to the global equity markets, but the Satrix ETF stands out in terms of costs. The fund promises a TER of 0.35%, which will be the cheapest among ETFs which track global indices. Ashburton Global 1200 ETF has a TER of 0.45%.

Most ETFS in this category are overweight either in the US, UK, Europe or Japan equities. The MSCI World Index somewhat neutralises the influence of the US by including large and mid-cap stocks from 22 other developed markets. The Ashburton ETF goes a little further than Satrix fund as it includes some emerging markets indices in Asia and Latin America.

declined 3.1% and 3.4% respectively in the quarter to end-June. Currencies for most emerging markets have also been under pressure.

The US and EU equity markets, though, seem to have been resilient. In the quarter to end-June, the S&P 500 gained 3.4%, the UK FTSE 9.6% and MSCI Europe ex UK 2.7% over the quarter to end-June.

Prospects for international ETFs remain strong. The rand is likely to remain weak given ongoing weak economic data, policy uncertainty and the trade wars. The US Federal Reserve adjusted its interest rate outlook and now sees two further rate hikes being implemented this year as opposed to one previously, which is also negative for the local currency.

The IHS Markit flash composite (services and manufacturing) purchasing managers index (PMI) for June in the US and eurozone both still point to reasonably robust growth in the second quarter of 2018, although the US index was somewhat lower compared with May. In China, the Caixin general manufacturing PMI reading for May came in at 51.1 points, signalling continued expansion in China's manufacturing sector.

The PMI is an indicator of economic health for manufacturing and service sectors. A PMI reading above 50 points represents expansion over the previous month while under 50 represents a contraction. A reading at 50 indicates no change.

Foreign equities, emerging markets: Satrix MSCI Emerging Markets ETF

The choice in this segment is limited to two funds: Satrix MSCI Emerging Markets ETF (up 4.17% in June) and the Cloud Atlas AMI Big50 (up 2.43%). Our choice for the Satrix fund is motivated by its diversification as well as its low costs. The ETF provides exposure to high-growth economies such as China and India, which are not included in any of the developed market funds, thus offering further diversification at a TER of just 0.4%. The Cloud Atlas ETF invests only in selected African markets and has a TER of 0.75%.

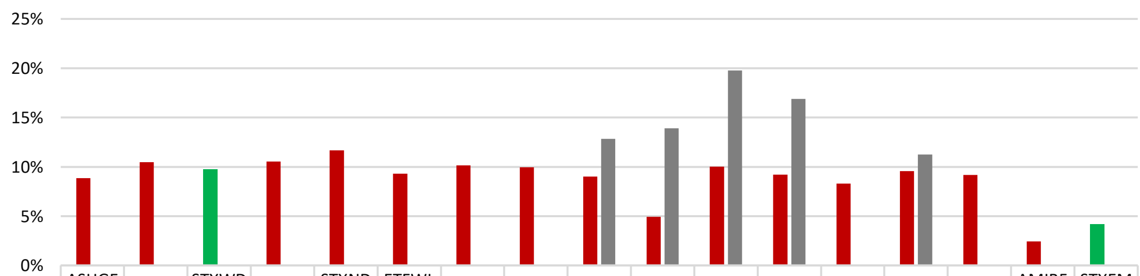
Bonds and cash funds

Bonds and cash are good additions to portfolios not only because of their diversification qualities but also for their ability to enhance returns. The recent launch of two new ETFs by Stanlib and Ashburton that track foreign sovereign bond markets widens the choice in the segment.

If you are investing for a very short period, usually less than a year, then the domestic NewFunds TRACI 3 Month (NFTRCI) is a natural choice because it is least sensitive to sudden adverse interest rate movements. It is similar to earning interest on your cash at the bank with a minimal possibility of capital loss. Its return was 0.55% in May.

However, for a longer investment horizon, protecting your investment against inflation is paramount. We therefore maintain our choice of the Satrix ILBI ETF.

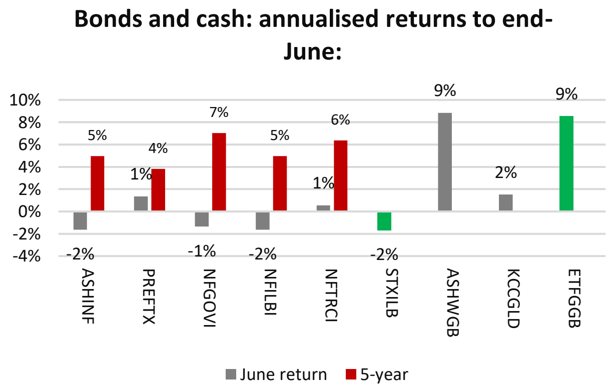
Foreign equity ETFs: annualised returns to end-June:



	ASHGEQ	CSP500	STXWDM	STX500	STXNDQ	ETFWLD	ETF500	SYG500	SYGEU	SYGJP	SYGUS	SYGWD	SYG4IR	SYGUK	AMIRE	AMIB50	STXEMG
June return	8.8%	10.5%	9.8%	10.5%	11.7%	9.3%	10.2%	10.0%	9.0%	4.9%	10.0%	9.2%	8.3%	9.6%	9.2%	2.43%	4.17%
5-year									12.9%	13.9%	19.8%	16.9%		11.3%			

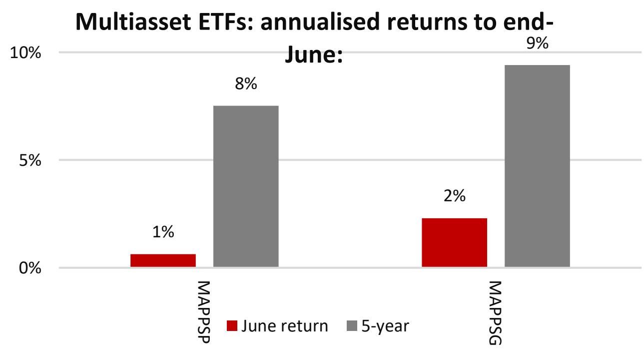
With a TER of 0.22%, Satrix ILBI ETF offers a relatively cheap exposure to the domestic inflation linked bonds. The fund declined 1.67% in June.

In addition to the local bond ETFs, investors now have an option to add foreign bond ETFs to their portfolios. There are three foreign bond ETFs on the JSE: Stanlib Global Bond ETF, Ashburton World Government Bond ETF and the FirstRand Dollar Custodian Certificate ETF. Of the three we are indifferent between **Stanlib Global Bond ETF** and **Ashburton World Government Bond ETF**. Both are feeder funds which tracks the performance of fixed-rate, local currency, investment-grade sovereign bonds mostly issued by the US, Japan, UK, Japan and selected European countries. Their TER differs by just 0.05 percentage points with Stanlib Global Bond ETF being the cheapest.



Multi-asset ETFs

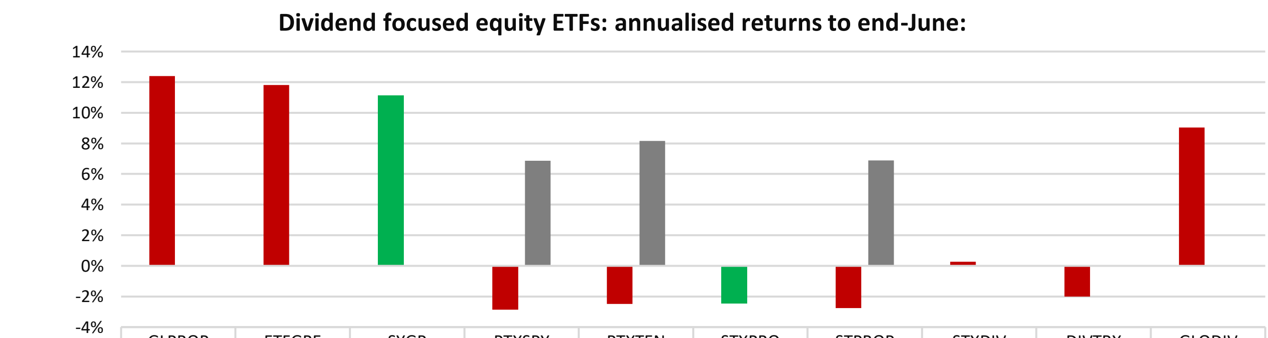
If you find the process of diversifying your portfolio daunting, two ETFs will do it for you. They combine equities and bonds to produce a diversified portfolio for two investor archetypes. They are the NewFunds Mapps Protect ETF and NewFunds Mapps Growth ETF. These funds are designed to meet two different risk appetites: Protect is more conservative, suitable for conservative savers. Growth suits investors with a long-term horizon. Mapps Growth and Mapps Protect grew 2.3% and 0.63% respectively during June.



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, the Satrix Dividend Plus and CoreShares S&P South Africa Dividend Aristocrats ETFs come to mind here.

Property funds are also high dividend payers. There are two investable property indices available: SA listed property and the capped property index. We maintain our choice of the capped fund Satrix Property ETF, with the lowest expected TER in the segment. However, investors with a stomach for exchange rate volatility can consider foreign property ETFs. The Itrix Global Property ETF, which has a TER of 0.25%, is by far the cheapest of the three.



	GLPROP	ETFGRE	SYGP	PTXSPY	PTXTEN	STXPRO	STPROP	STXDIV	DIVTRX	GLODIV
June return	12.4%	11.8%	11.1%	-2.9%	-2.5%	-2.5%	-2.8%	0.3%	-2.0%	9.0%
5-year				6.9%	8.2%		6.9%			