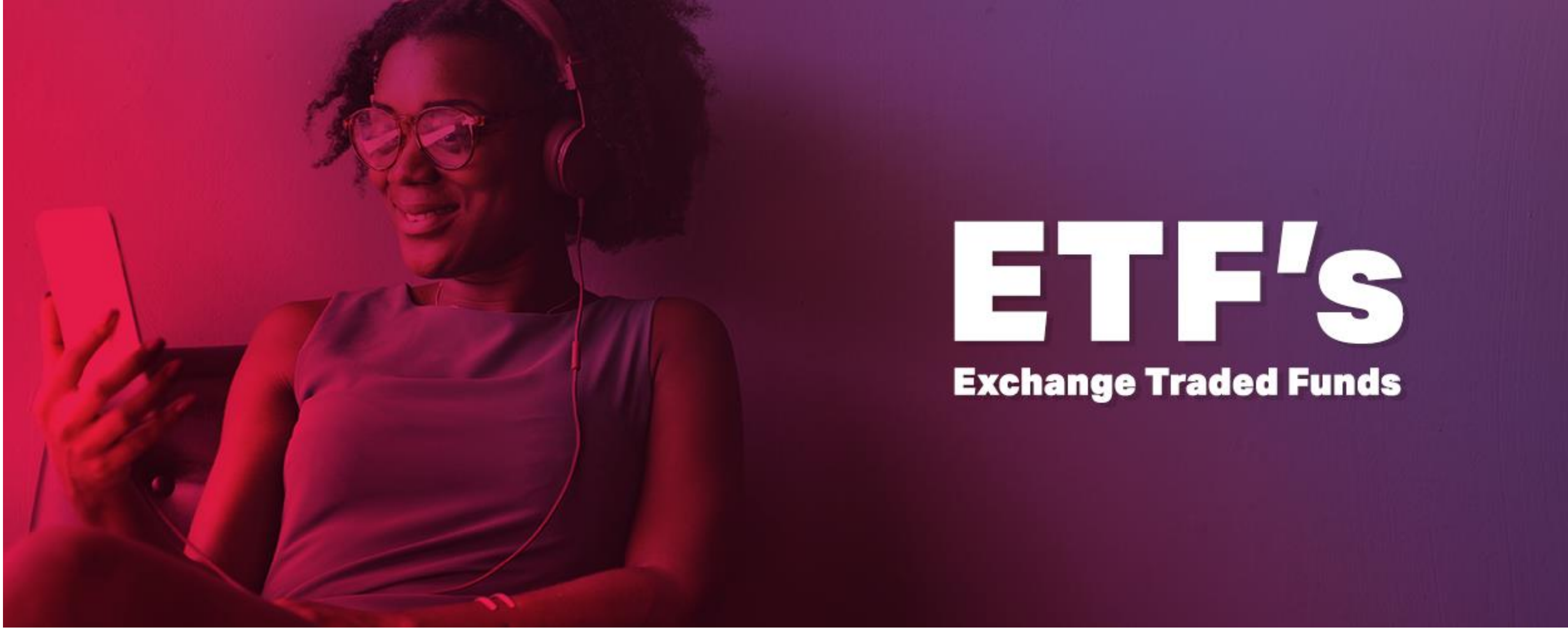

April 2018

The ETF Monthly Review

Welcome to the ETF Monthly 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, probably the niftiest way to invest out there!

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Absa adds two new ETFs to the menu

Absa, working with Wits University, introduced two new ETFs: NewFunds Low Volatility and NewFunds Value Equity. An interesting feature of these two new smart beta funds is that they are risk-weighted, which deviates from the usual market cap weighting.

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 five broad categories:

- domestic equity;
- international equity;
- bonds and cash;
- multi-asset; and
- dividend-focused.

We also split international equities into developed and developing markets. Not all categories are right for all investors; you want to choose asset classes that meet your unique risk and return objectives.

We believe a good ETF should be cheap. Cost differences, while appearing small on paper, can

What's happened in the markets?

The local bourse retreated during March, taking direction from the global markets which were spooked by a looming trade war. JSE heavyweight Naspers also took a knock as its most valuable asset, Chinese internet company Tencent, retreated on global pressure on tech companies. The JSE all share index tumbled 4.2%. The biggest loser was the consumer services sector, which houses Naspers, declining 8.9%. Financials lost 4%; industrials, 3.5%; and basic materials 1.2%. Only the consumer goods sector was positive, edging up 0.1%. And the rand was flat against the dollar during the period.

Against this backdrop it was generally not a great month for both local and global ETFs. Our local broad top 40-based funds retreated. Our favourite, the Satrix SA Quality ETF, declined 3.28%. However, the CoresShares S&P Top50 ETF recorded a positive gain of 3.5%.

The international view

On the international scene trade wars, a tech backlash and monetary policy tightening dominated headlines during March. The former two were largely responsible for the poor showing of the S&P500 and other global markets.

make a huge impact on an investor's returns when compounded over time. We also 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. Generally, to avoid overconcentration, a good ETF should cap its exposure to a single sector and/or a single counter. Below we provide an overview of our favourite funds for each category.

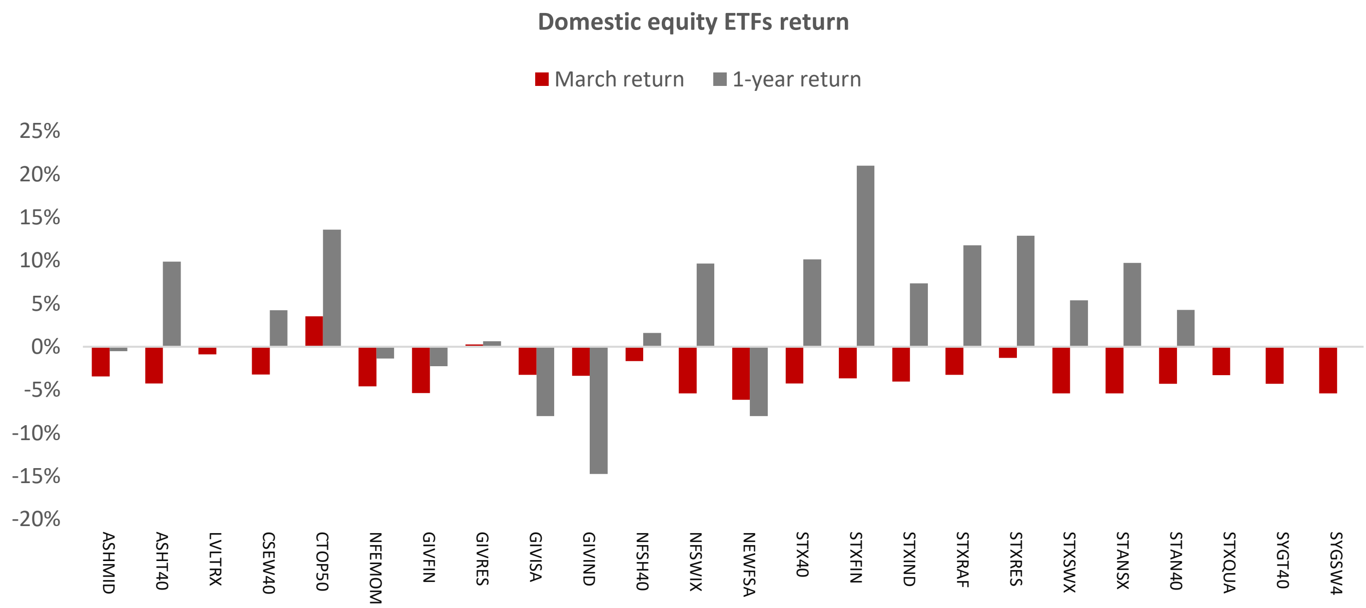
Generally, they are the same funds from month to month and we make changes to this list when new and better ETFs (in terms of the criteria explained above) are listed, fees change or there is some other material fundamental change.

This month we add Absa NewFunds Govi in addition to Satrix ILBI under the bonds & cash investment category.

The April favourites:

Domestic equity: Satrix SA Quality ETF

The Satrix SA Quality ETF is less than a year old. It lost 3.28% during March, in line with the overall market, but it is still up 23.16% over the past six months. We like this ETF because it reduces the concentration risk that has come to dominate the top 40 index as it caps the weight of each counter and sector.



US President Donald Trump caused shivers throughout global markets by imposing steel and aluminium tariffs on $50bn worth of Chinese imports. China retaliated by imposing tariffs on $3bn worth of US imports, and the US upped the ante with more counter measures. However, Trump's top economic adviser, Larry Kudlow, and US Commerce Secretary Wilbur Ross both indicated willingness to resolve the impasse.

Meanwhile, Facebook is in a quagmire following revelations of data breaches linked to Cambridge Analytica, a political consulting firm which data-mined private information from millions of users for political purposes. This has put tech stocks under pressure and contributed to the weakness in global equities.

On the monetary front, the US Federal Reserve hiked interest rates by a largely anticipated 25 basis points (bps), and the committee revised its growth outlook upwards. However, this was followed by subdued US employment and manufacturing data – manufacturing also slowed in the eurozone and China. Meanwhile, the Bank of England is also on course to hike rates in May as annual inflation for February came in at 2.7%, breaching its 2% target. In addition, manufacturing data in Europe softened in March as the euro strengthened, which weighed on exports.

This resulted in our global pick, the Ashburton Global 1200 ETF, declining 1.3% in March.

The local view:

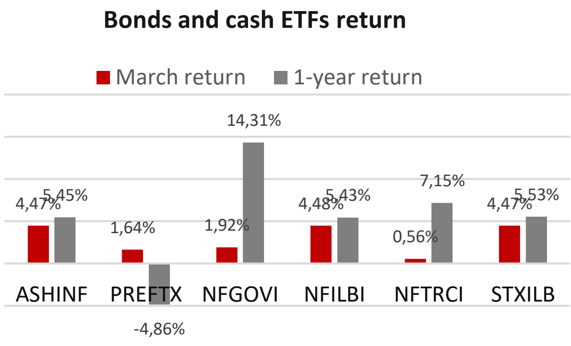
It was a huge relief that Moody's affirmed SA's foreign and local currency investment grade credit ratings, and revised the outlook on the ratings from negative to stable. This means that all three major credit rating agencies (Fitch and S&P are the others) now have a stable outlook on SA's ratings. For the near future, this removes the risk that SA bonds will fall out of key global bond indices. Moody's says a halt in the deterioration of SA's institutional framework, an improved GDP growth outlook and the fiscal consolidation measures

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 or a multi-factor model. However, the size of the premium varies, depending on the metrics used to calculate the quality score.

Foreign equities, developed markets: Ashburton Global 1200 ETF

This is another young fund, less than six months old. During March it lost 1.3% as global markets reacted to the US and China trade wars.

Most diversified global funds tend to be overweight in US equities, reflecting their dominance in global equities markets in terms of capitalisation. However, we maintain our exposure to this fund because in addition to the US, it gives exposure to other developed markets.



Here is its universe: S&P 500 (US); S&P Europe 350; S&P TOPIX 150 (Japan); S&P/TSX 60 (Canada); S&P/ASX All Australian 50; S&P Asia 50; and S&P Latin America 40.

Foreign equities, developing markets: Satrix MSCI Emerging Markets ETF

The fund is less than one year old. During March it lost 0.36% and has shed 4.75% in the past six months.

announced in the February budget were the key drivers of the positive rating decision.

That rating decision as well as a February inflation reading of 4%, the lowest in almost three years, influenced the Reserve Bank to cut the repo rate by 25bps. Together with the setting aside of the stringent credit regulation of 2015 by the South Gauteng High Court, the scene could be set for renewed consumer demand. However, that is counterbalanced by higher value-added tax from 1 April and a hike in the price of fuel.

The local bourse weakened in March, taking its cue from global markets but compounded by Naspers's falling share price following an announcement that it will dispose of two percentage points (worth about $10bn) of its 33% stake in its Hang Seng listed-subsidiary, Tencent. Pressure further mounted on Naspers as Tencent suffered from a global techlash.

The fund 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. The Satrix MSCI Emerging Markets ETF tracks the MSCI Emerging Markets Investable Markets index, which captures companies across 23 countries.

Bond 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.

If you are investing for a very short period, usually less than a year, then the 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 0.56% in March.

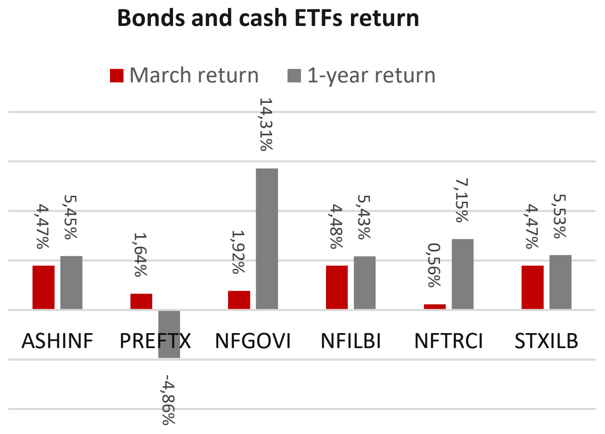
Summary review of Absa's two new ETFs

Absa, working with Wits University, recently introduced two new ETFs: Absa NewFunds Low Volatility and Absa NewFunds Value Equity. An interesting feature of these two new smart beta funds is that they are risk-weighted, which deviates from the usual market-cap weighting. Risk is the chance that an investment's actual return will differ from its expected return. When people talk of risk they are usually referring to the possibility of losing some or all of the original investment, due to its fall in market value, but this isn't actually how risk is seen in financial theory. Generally, risk is measured by calculating the deviation of an asset's historical series of price points from the average price of those historical price points – a measure known as standard deviation. If an asset's price regularly deviates by a big magnitude from its average price it will exhibit high volatility, meaning that it has high risk. This is caused by both upside and downside deviations, so a stock that is prone to frequent upside swings can also be seen as high risk. Generally, higher-risk stocks are thought to provide higher returns as compensation for taking on the risk, but as we discuss below, there is an anomaly that these funds intend to exploit. Both of these new funds will add constituents to the fund by applying equal risk weighting. This means assets that have high standard deviation or volatility will occupy a small portion of the fund. Both funds suit an investor with low tolerance for risk.

Absa NewFunds Low Volatility: The fund gives exposure to 20 highly liquid securities in the South African equity market that exhibit the lowest volatility as well as a low beta to the market in their performance. It tracks the Absa Wits Risk-Controlled SA Low Volatility Index where the constituent security's weights are determined by applying an equal risk contribution weighting scheme.

Traditionally, assets with high volatility are considered to offer high return. However, research conducted by Wits shows that that low-volatility stocks outperformed high-volatility stocks. Such an occurrence is called an anomaly because it goes against traditional knowledge. Beta and volatility are similar concepts. However, beta is a measure comparing the movements of a stock's price against the market as a whole. Similarly, low beta would mean that the stock is less risky.

Absa NewFunds Value Equity: The fund provides exposure to 30 highly liquid constituents securities in the South African equity market that exhibit value characteristics (low price-to-earnings and price-to-book ratios) in their performance. The fund tracks the Absa Wits Risk-Controlled SA Value Index. The weight of each constituent is determined by applying equal risk contribution weighting scheme.

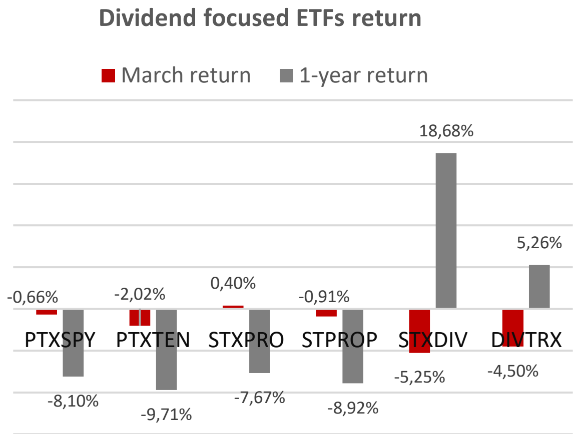


However, for a longer investment horizon, protecting your investment against inflation is paramount. So we maintain our choice of the Satrix ILBI ETF, less than a year old, it promises to have the lowest expense ratio of 0.22% compared with peers. It made a return of 4.47% in March.

In the past we were preoccupied by inflation when the economy was under the reigns of Jacob Zuma. However, we think the government's credit outlook will continue to improve, and thus exposure to government interest rate bonds is sensible. The only fund in this category is the Absa NewFunds Govi. In addition, it improves diversification of the overall fund because its return properties differ from those of inflation-linked bonds. It returned 1.92% during March.

Dividend focused

Naturally, Satrix Dividend Plus and CoreShares S&P South Africa Dividend Aristocrats come to mind here, but similarly, property funds are high dividend payers. There are two investable property indices available: SA listed property and the capped property index. We maintain our choice the capped fund Satrix Property ETF. The fund has an expected TER of 0.30%, which makes it the cheapest in the segment. However, the property sector has fallen on hard times lately but we believe it is transitory. The Satrix Property fund made a marginal return of 0.4% in March.



Multi-asset ETFs

If you find the process of diversifying your portfolio daunting, there are two ETFs that are diversified already. They combine equities and bonds yielding a diversified portfolio for two investor archetypes. The two listed funds for this are the NewFunds Mapps Protect ETF and the NewFunds Mapps Growth ETF. They are designed to meet two different risk appetites: Protect is more conservative, suitable for older savers nearing retirement. Growth suits younger savers with a long-term horizon.

Mapps Protect made a minor loss of 0.32% in March while Mapps Growth lost 3.37%.