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FNB MidCap ETF (JSE:FNBMID)

26.05.2023

Fund suitability

This ETF suits investors with a high-risk appetite seeking exposure to SA equities over a long-term investment horizon.

Fees

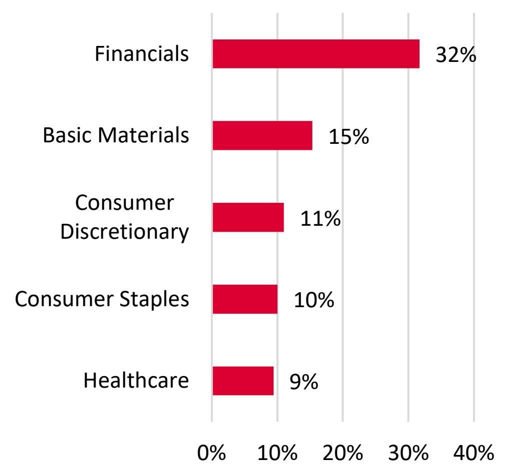
The fund has a total expense ratio of 0.72%.

Alternative funds

None

"Interest rates have soared by 475 basis points since the SARB first began its current rate-hiking cycle in November 2021."

Top sectors (%)



In what is undoubtably another blow to SA's already strained consumer, the SA Reserve Bank (SARB) hiked the repo rate by 50 basis points in its May monetary policy meeting. This brings the repo rate to 8.25%. Interest rates have soared by 475 basis points since the SARB first began its current rate-hiking cycle in November 2021.

From a consumer perspective, the prime rate – which is the baseline rate commercial banks charge consumers for vehicle, home and other forms of credit finance – now sits at an eye-watering 11.75%.

The SARB, whose main role is to stabilise inflation and to protect the value of the currency, says risks to the inflation outlook remain on the upside. As such, SA's latest annual inflation reading, which moderated to 6.8% in April (7.1% in March), appears to indicate some light at the end of the tunnel as lower inflation increases the likelihood of the central bank easing consumer pressures by pausing rate hikes.

From an equities perspective, the FTSE/JSE all share index is down 2.8% month-to-date. We believe that factors such as the latest interest rate hike, SA's diplomatic saga involving the US and Russia and the chronic power outages are exacerbating global factors that affect local equites. In addition, we think that load-shedding is one of many factors that continue to dim hopes of improvement in the local economy's prospects leading up to next year's national elections.

Load-shedding, which is a feature of SA's increasingly poor macroeconomic condition, has dealt a heavy blow to the operations of "SA Inc" across the board. According to recent trading updates and financial results, companies in the food producing industry are being hit particularly hard.

Integrated poultry producer Astral Foods, in its interim results to end-March 2023, reported an 89% slump in headline earnings to just R1.63/share. Astral says that its struggles over the period came down to soaring raw material costs, load-shedding and failing municipal infrastructure, which affects its operations.

The SARB has increased its estimate of the number of days of expected load-shedding in 2023 to 250 days from 100 days. As such, historical (eg, year-to-date) and future costs of damage to the SA economy can be calculated based on the estimated average stage of load-shedding and cost-to-GDP per stage-day.

Solar energy company Hohm Energy estimates that SA has been on an average of stage 4 every day for 2023. Using our internal estimates of costs to the economy, (R150m for stage 4) and 250 days of expected power cuts (SARB), a rough estimate for this year is R37.5bn worth of lost output – that is a sizeable 0.8% of real GDP. **For context, SA's real GDP grew 2% in 2022, highlighting the real risk of continued blackouts to SA's output.**

Consequently, we believe that while the SARB's attempts to quell inflation are undoubtably unpleasant for the consumer, that SA's fiscal policy (which includes how Eskom is run) plays a much larger role in the current failure and potential future success of the economy. We think that the necessary private and public sector collaboration needed to resolve SA's deepening energy crisis and to address other aspects of the ailing local economy are not in place, which paints a bleak picture for the outlook of companies included in the FNB Mid Cap ETF.

The fund, which tracks the FTSE/JSE MidCap Index, provides investors with exposure to the mid-cap shares listed on the JSE. Shares are weighted after liquidity and free-float market capitalisation screens to ensure that the index is tradeable.

The ETF has a tracking error of 0.21% which suggests relative efficiency at tracking the benchmark. It is dominated by financials (32%) which include SA's largest commercial banks. Nedbank led the pack of financials at 5.1% in April. In its FY22 results to end-December, headline earnings increased 20% to R28.86/share, supported by rising interest rates (which makes loans issued more profitable) and a recovery from the pandemic, which increased financial and economic activity across its business units.

However, as interest rates increase and peak at higher levels, we believe that more consumers will default on debts. Data from the Momentum/Unisa Consumer Financial Vulnerability Index show that consumer's ability to service debt deteriorated in Q1 2023 compared to Q1 2022.

From an ETF investment perspective, we think that SA equities may become increasingly cheap due to bearish sentiment. However, to minimise the effects of investment in low-quality companies, we think that holding the FNB Mid Cap ETF as part of an overall portfolio with a healthy allocation to other emerging and developed markets may be a prudent overall equities strategy.

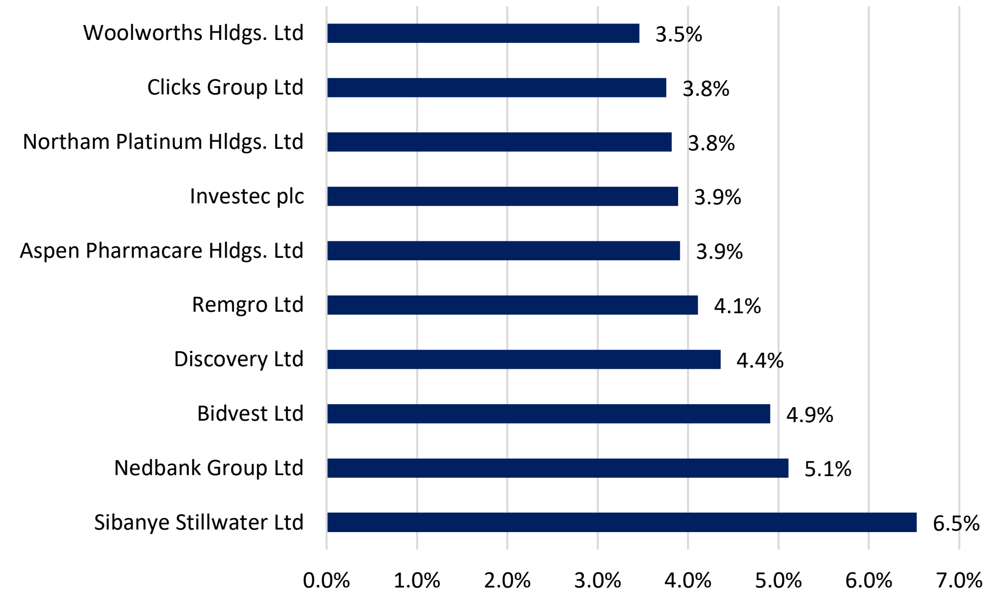
Investment term of the week: headline earnings

A company's earnings after excluding items that are non-core to the business such as a disposal of property, plant and equipment. This provides insight to the earnings generated from core business activities.

Investment approach and portfolio composition

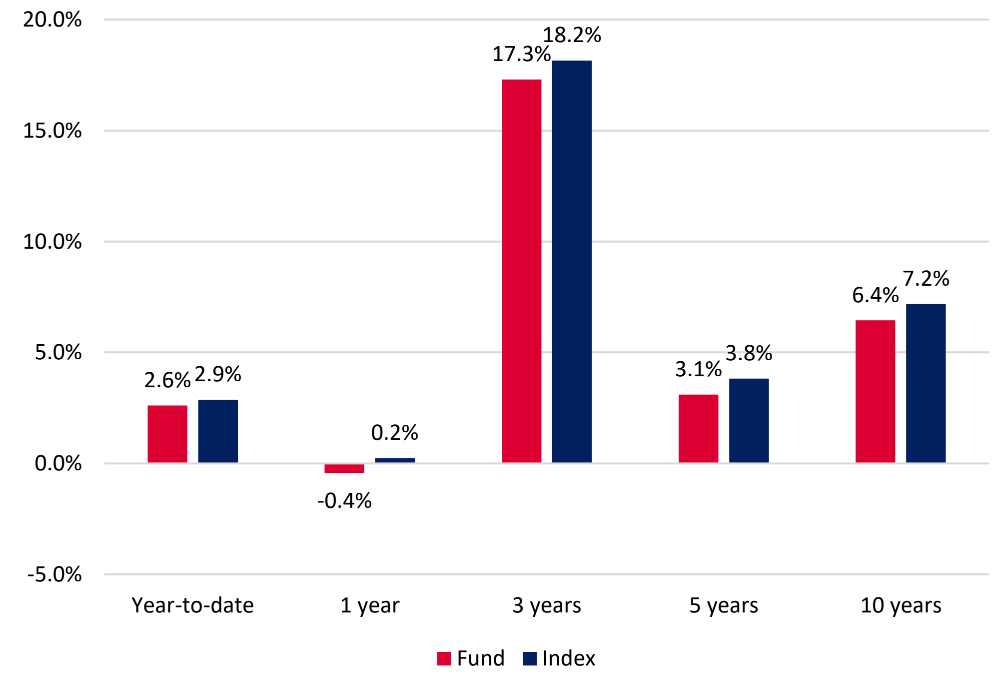
The objective of the FNB MidCap ETF is to track the FTSE/JSE MidCap Index before fees and expenses.

Top holdings (%)



Performance

Fund and index performance to end-April 2023 (annualised for periods longer than one year; with dividends reinvested).



Fund information: 30 April 2023

Launched on	15 August 2012
Trading symbol (JSE)	FNBMID
Total assets	R571m
Total investment cost	0.72%
Risk rating	High
Benchmark	FTSE/JSE MidCap Index

Market data: 25 May 2023

Spot price	R7.31
One-year high	R8.38
One-year low	R7.00
Average monthly volume	3,343,678
Estimated dividend yield	4.5%
Tracking error (3-year)	0.21%

Source: Infront, yahoo finance

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