The ETF Review

May 2023

Welcome to this month's ETF Review, a neat update of news affecting markets, 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!

Broad-based energy price and interest rate increases around the globe

IN THIS ISSUE:

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Locally, manufacturing production data for February was released in April and showed a -6.1% in food and beverages year-on-year. Basic iron & steel, non-ferrous products, metal products and machinery declined 5.3%. Petroleum, chemical and rubber & plastic products declined 4.7%. These declines are the ramifications of the power outages and add upward pressure to unemployment.

The selection of ETFs is made with the market themes above in mind:

- Satrix FINI ETF
- Satrix RESI ETF
- Sygnia Itrix MSCI Japan ETF
- Satrix MSCI World ESG Enhanced Feeder ETF
- FNB Government Inflation-Linked Bond
- CoreShares S&P Global Dividend Aristocrats ETF

Intellidex's favourite ETFs

Each month the investment gurus at Intellidex scan the market to come up with a list of their favourite ETFs.

Sabelo Mnisi, explains:

We take a portfolio construction approach and classify all ETFs into six broad categories:

- Domestic equities
- International equities
- Bonds and cash
- Dividend or income-focused
- Multi-asset
- Commodities

Various empirical studies conclude 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 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 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

What's happening in the markets?

April was a relatively quiet month in global markets as investors wondered if the banking crisis would spillover to the economy. Investors were also anticipating the Fed's interest rate decision in early May. As a result, indices such as the MSCI World and S&P 500 made modest gains, rising 1.6% and 1.5% respectively. Locally, the JSE was up 2.1%.

Gold was largely flat, ticking up 0.3% from a high base of 7.2% in March on the back of contagion from the banking crisis.

The economic environment

In November last year members of the federal open market committee warned that US economic growth will likely be subdued in 2023 due to steep interest rates. Some members of the Fed noted in April that they now expect a mild recession later this year partly due to the failure of Silicon Valley Bank and Signature Bank. Markets are nervous that the failure of these banks might lead to contagion risks.

Recessionary fears were also heightened by the 1.1% real GDP growth of the US in Q1 2023 (against market's expectation of 2%). This expansion was driven by consumer spending (+3.7%), exports (+4.8%) and federal government spending (+4.7%). Private residential investment was a drag on growth, dipping 4.2%. The housing market is one of the most sensitive to interest rates and this decline suggests that the Fed's hiking cycle is having a negative effect.

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.

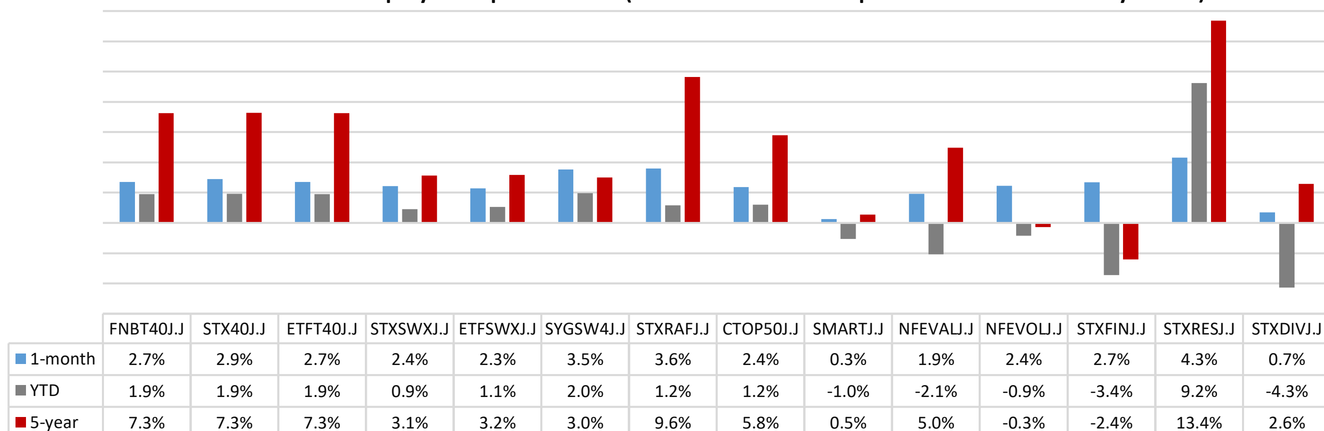
The favourites:

Domestic equity: Satrix FINI (STXFIN) and Satrix RESI (STXRES) ETFs

Financial stocks are well-positioned to benefit from the high interest rate environment. Companies such as banks tend to profit from high interest rates because they charge high interest rates on loans, which increases their revenue. This makes the **Satrix FINI ETF (2.7%)** to be our first pick from the local ETFs. The underlying index of this ETF consists of companies involved in mortgage finance, consumer finance, specialised finance, corporate lending, investment banking, insurance and corporate lending.

An attractive feature about this fund is that financial services companies pay regular dividends, which provide a steady stream of income. High interest rates increase net interest margins for financial companies that have a pool of cash. It is the only JSE-listed fund that tracks the financial sector, which helps justify its high total expense ratio (TER) of 0.43%. It has returned 23% over the last three years and 1.6% over the last five years. It is suitable for investors who want to benefit from the rising interest environment.

Our second pick is the **Satrix RESI ETF (4.3%).** This ETF invests in JSE-listed resource companies that



	FNBT40J.J	STX40J.J	ETFT40J.J	STXSWXJ.J	ETFSWXJ.J	SYGSW4J.J	STXRAFJ.J	CTOP50J.J	SMARTJ.J	NFEVALJ.J	NFEVOLJ.J	STXFINJ.J	STXRESJ.J	STXDIVJ.J
1-month	2.7%	2.9%	2.7%	2.4%	2.3%	3.5%	3.6%	2.4%	0.3%	1.9%	2.4%	2.7%	4.3%	0.7%
YTD	1.9%	1.9%	1.9%	0.9%	1.1%	2.0%	1.2%	1.2%	-1.0%	-2.1%	-0.9%	-3.4%	9.2%	-4.3%
5-year	7.3%	7.3%	7.3%	3.1%	3.2%	3.0%	9.6%	5.8%	0.5%	5.0%	-0.3%	-2.4%	13.4%	2.6%

Inflation in the US trended downward for the tenth consecutive period, coming in at annualised rate of 4.9% in April, from 5% in March. Core inflation – which excludes volatile items such as food and energy – eased to 5.5% from 5.6% in March. This is a sign that inflation may be sticky on the upside and suggests that it might be difficult to reduce inflation to close to 2% without aggressive hikes in the future.

Headline producer price inflation grew an annualised 2.7% in March, the lowest since January 2021's 1.6%, raising hopes that consumer prices will slowdown significantly over the near term.

The Fed raised the federal funds rate by 25 basis points in the beginning of May, which took the feds fund rate to 5.00%-5.25%, marking it as the tenth consecutive increase. Minutes from the federal open market committee indicate that although inflation is slowing down, mild interest rate hikes may be required to contain surging prices.

Locally, manufacturing production data for February was released in April and showed a -6.1% in food and beverages year-on-year. Basic iron & steel, non-ferrous products, metal products and machinery declined 5.3%. Petroleum, chemical and rubber & plastic products declined 4.7%. These declines are the ramifications of the power outages and add upward pressure to unemployment.

The producer price index dropped to 10.6% in March from 12.2% in February. Coke, petroleum, chemical, rubber, & plastic products grew an annualised 12.2% and added 3.3 percentage points to the headline figure. Food products, beverages and tobacco products was the second-largest contributor to headline PPI as it added 2.1 percentage points with its 8.1% year-on-year increase. This suggests that input

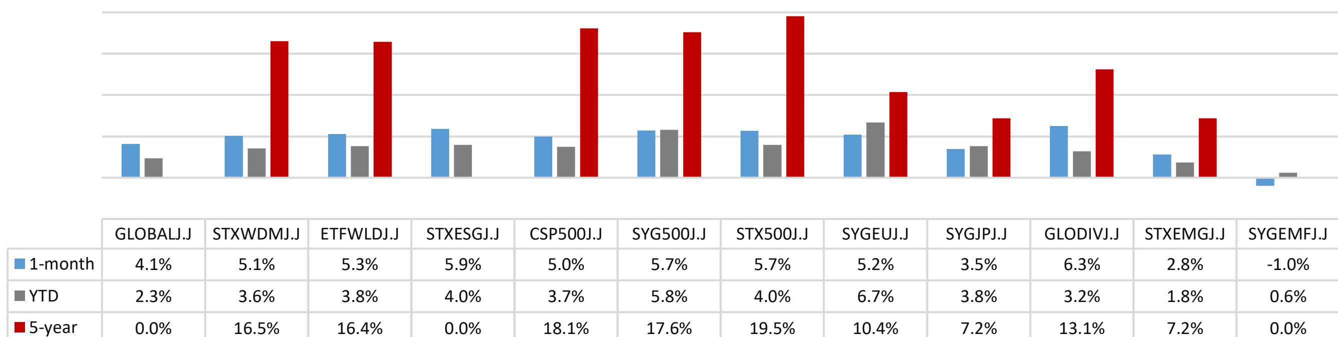
are involved in general mining of gold and other commodities. Mining companies benefited from high commodity prices over the last few years, which enabled them to pay high dividends and higher taxes to the government. Gold surged 10.7% year to date on the back of a weaker dollar, recessionary fears and as a safe haven in the unfortunate event that the failure of Credit Suisse, Silicon Valley Bank and Signature Bank spreads to other banks and other economies.

If recessionary fears persist, gold might hold onto gains, which will benefit mining companies that are involved in gold. This ETF is the only JSE-listed fund that purely tracks the resources sector. It comes at a TER of 0.44% and has returned 29.2% over the last three years and 19.2% over the last five years. It is suitable for risk-tolerant investors as commodities tend to be cyclical.

Foreign equity: Sygnia Itrix MSCI Japan (SYGJP) and Satrix MSCI World ESG Enhanced Feeder (STXESG) ETFs

Overseas, we favour diversified ETFs such as the **Sygnia Itrix MSCI Japan ETF (3.5%)** which aims to provide investors with exposure to large and mid-cap segments of the Japanese market. It invests in diverse sectors such as industrials, consumer staples, information technology, financials and healthcare. Various asset managers such as Lombard, Schroders and Invesco are bullish on Japan equities. Companies in the industrials sector have set

International equity ETFs' performance (returns annualised for periods of more than one year - %)



	GLOBALJ.J	STXWDMJ.J	ETFWLDJ.J	STXESGJ.J	CSP500J.J	SYG500J.J	STX500J.J	SYGEUJ.J	SYGJPJ.J	GLODIVJ.J	STXEMGJ.J	SYGEMFJ.J
1-month	4.1%	5.1%	5.3%	5.9%	5.0%	5.7%	5.7%	5.2%	3.5%	6.3%	2.8%	-1.0%
YTD	2.3%	3.6%	3.8%	4.0%	3.7%	5.8%	4.0%	6.7%	3.8%	3.2%	1.8%	0.6%
5-year	0.0%	16.5%	16.4%	0.0%	18.1%	17.6%	19.5%	10.4%	7.2%	13.1%	7.2%	0.0%

cost pressures are easing for producers. Contrary to PPI, headline inflation grew 7.1% in March from 7.0% in February. Food and non-alcoholic products increased 14% and were the biggest contributor to the headline figure by adding 2.4 percentage points. Other categories recorded single-digit inflation increases such as transport (8.9%), housing and utilities (4%). Core inflation – SARB's preferred measure of inflation – came in at 5.2%, which is within the inflation target range of 3%-6%.

Intellidex expects headline inflation to return to SARB's target range by end 2023. However, inflationary risks remain on the upside given the electricity tariff increase of 18.65% granted to Eskom effective from 1 April 2023. Households and businesses which purchase electricity from municipalities will likely face a bigger increase as local governments tend to add their own markup and rates. This will have a negative effect on disposable incomes for households and on operating costs for companies.

The SARB hiked the repo rate by 50 basis points - against consensus forecast of 25 – and took the repo rate and prime lending rate to 7.75% and 11.25%, respectively. The SARB governor, Lesetja Kganyago, argued that while this increase is painful, it will help protect the value of the rand and will benefit the poor.

The governor also noted that although core inflation is within the target range, he is concerned that headline inflation will stay outside the target range for too long. This implies that the hiking cycle is not over yet.

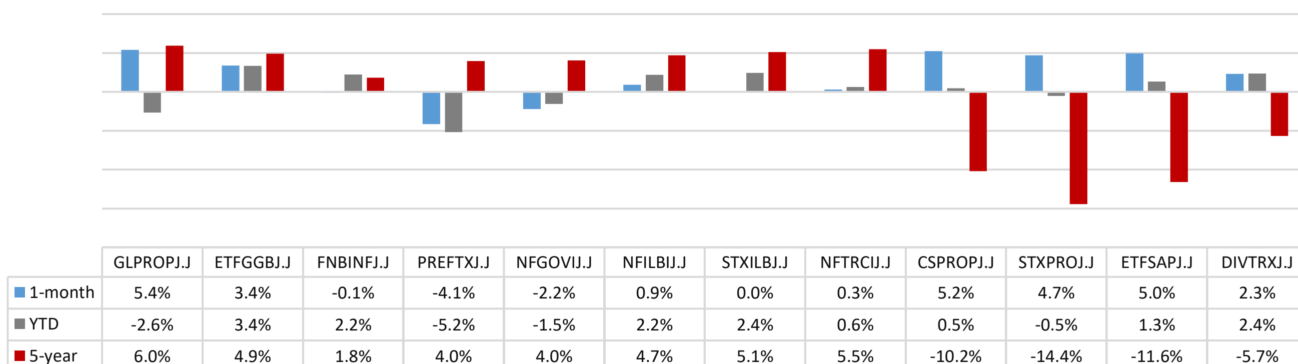
aside significant amounts of capital expenditure to ramp up automation, according to Invesco, a move that might potentially benefit investors over the long term.

This ETF is suitable for risk-tolerant investors who want to diversify their portfolio outside of SA. The fund returned 12.4% over the last year and 7.7% over the last five years. It is the only JSE-listed fund that tracks the Japan market, which is probably the reason for its steep TER of 0.88%.

Our second pick is the **Satrix MSCI World ESG Enhanced Feeder ETF (5.9%).** The sustainability financing gap or the capital amount needed to achieve the UN's Sustainable Development Goals, increased 56% to $3.9tn in 2020, according to the OECD's 2023 global outlook on financing for sustainable development. This suggests there is room for growth for ESG funds. The Satrix ETF is one of the simplest ways to gain exposure to ESG flows.

This fund invests in securities of companies with the highest ESG ratings representing 50% of the market capitalisation in each sector of the MSCI ACWI Index. Companies invested in alcohol, gambling, tobacco, nuclear power, civilian firearms, fossil fuels extraction, thermal coal power and weapons are excluded. The fund has a reasonable TER of 0.34%, which is lower than the 0.38% that one would pay on Sygnia Itrix S&P Global 1200. It returned 11.72% over the last year and is suitable for investors who want exposure to the rise of ESG funds.

Bond and income theme ETFs' performance (returns annualised for periods of more than one year - %)



	GLPROPJ.J	ETFGGBJ.J	FNBINFJ.J	PREFTXJ.J	NFGOVIJ.J	NFILBIJ.J	STXILBJ.J	NFTRCIJ.J	CSPROPJ.J	STXPROJ.J	ETFSAPJ.J	DIVTRXJ.J
1-month	5.4%	3.4%	-0.1%	-4.1%	-2.2%	0.9%	0.0%	0.3%	5.2%	4.7%	5.0%	2.3%
YTD	-2.6%	3.4%	2.2%	-5.2%	-1.5%	2.2%	2.4%	0.6%	0.5%	-0.5%	1.3%	2.4%
5-year	6.0%	4.9%	1.8%	4.0%	4.0%	4.7%	5.1%	5.5%	-10.2%	-14.4%	-11.6%	-5.7%

By increasing interest rates, the SARB aims to reduce secondary inflationary effects, a case in which households increase borrowing to keep pace with inflation. In addition, the SARB aims curb demand to help ease pressure on prices. An increase in interest rates sends a message that the SARB wants to remain credible in its goal of taming inflation and that it is concerned about inflation turning into hyperinflation, a phenomenon which will be dire for the poor.

High interest rates benefit SA by attracting investment flows, which help appreciate the rand somewhat. The rand appreciated slightly to R17.82 per dollar on the 30th of March (when the SARB hiked the repo rate) from a previous close of R18.11. A strong rand is good for SA as it reduces the price we pay for imports, which also reduces inflationary pressures. However, the rand has depreciated markedly since March-end mainly due to the ongoing power outages.

High interest rates increase interest payments for indebted households and businesses, which weighs on disposable incomes and net profits respectively.

Outlook and portfolio strategy

In its April edition of the world economic outlook, the IMF says it expects global growth to slow to 2.8% in 2023 from 3.4% in 2022. This forecast is slightly higher than the 2.7% predicted in October last year and assumes that bank failures do not spill ripple through the global economy.

Advanced economies such as the US and Eurozone are expected to have more pronounced slowdowns and grow 1% and 0.7% respectively in 2023. Emerging markets and developing economies are expected to expand 4.5% this year, with India and China accounting for about half of that growth. From a country allocation perspective, this implies that investors should consider allocating a sizeable weight of assets toward emerging markets.

Furthermore, the IMF expects global inflation to slow to 7% in 2023 from 8.7% last year based on lower oil prices. Core inflation is expected to remain sticky for most advanced economies and may not fall to 2% until 2025. This suggests that it is essential for investors to invest in non-cyclical companies that are able to pass input costs onto customers. Companies in sectors such as consumer staples, healthcare and utilities have pricing power and tend to not move in tandem with

Bonds and cash: FNB Government Inflation-Linked Bond ETF (FNBINF)

SA's inflation appears to be sticky on the upside and the country remains vulnerable to external shocks that feed through its volatile exchange rate. As a result, our bond pick is the **FNB Government Inflation-Linked Bond ETF (-0.1%)**. Inflation-linked bonds are designed to help protect investors from inflation. These bonds are indexed to inflation so that the principal and interest payments fluctuate with the rate of inflation. They offer additional benefits in a broader portfolio context.

SA bonds are attractive because they pay a premium for being rated as sub-investment grade. It is necessary for investors to pay attention to the growth of their investments along with the inflation rate. The fund has returned 10.3% over the last three years and 4% over the last five years. It comes at a TER of 0.36%, which is a bit higher than Satrix ILBI ETF's 0.32%. It is suitable for investors who want to hedge against inflation.

Dividends: CoreShares S&P Global Dividend Aristocrats ETF (GLODIV)

In January this year, the SARB governor argued that 2023 will be one of the most uncertain years. During uncertain times, we advocate for the **CoreShares S&P Global Dividend Aristocrats ETF (2.3%),** which has risen 12.5% over the last three years and 4.3% since inception (14 April 2014). It is suitable for investors who rely on regular income from investments. The underlying index has significant weighting to consumer staples, financials and energy. This ETF invests in high dividend-paying companies that are listed offshore. It has a TER of 0.57%, which is higher than the locally listed Satrix DIVI ETF's 0.41%.

Dividend stocks yield capital returns in addition to regular income, which makes them less volatile than the overall market. Because of their lower volatility, dividend stocks often appeal to investors looking for lower-risk investments, especially those in or

the economy because they provide non-discretionary goods and services.

Locally, the SARB expects SA to grow 0.2% in 2023, slightly lower than January's forecast of 0.3%. It noted that the ongoing power outages and logistical constraints deduct about 2 percentage points from annual GDP. In addition to resolving the energy crisis, structural reforms in the logistics, communications and infrastructure development sectors will be essential in lifting SA's economic growth, according to the SARB.

Overall, we advocate for defensive companies with strong fundamentals, resilient cash-generation supported by solid balance sheets and with sustainable dividend policies.
We also advocate for financial services such as banks and insurance companies as they are well positioned to benefit from higher interest rate increases. Profit margins for banks tend to widen as they charge higher interest rates on loans. We also favour SA bonds because they yield premium returns for being rated as sub-investment grade.
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