intellidex
Researching Capital Markets and Financial Services

ETF Insights.

Prepared for clients of EasyEquities

The ETF Review

July 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!

Resilience in the local economy but limited improvement in the macroeconomic environment

IN THIS ISSUE:

The JSE was up 1.3% in the month of June led by shareholder-weighted and capped indices. Recovery in June was spearheaded by financials which rose by 11.4% with industrials 3.7% higher. However, resources were a drag on the JSE with losses of -8.2% during the period while banks and retailers gained 13.0% and 16.1%, respectively. On the back of a simplified structure, Naspers and Prosus both rose by 14.2% and 6.2%, respectively, while property was relatively flat at 0.9%.

For developed markets, June was mostly positive. The S&P500 was up 6.5% while the Nasdaq gained 6.6% with the MSCI World notching up gains of 5.9%. In the UK, the FTSE100 was up marginally by 1.1%, Germany's Dax rose 3.1%, France's CAC 40 was up 4.2% while the Hang Seng rose 3.7% during the period. Overall, the ETF picks below reflect our continued preference for diversified ETF portfolios, especially given our earlier indications of the risk of persistent inflation and the resultant possibility of higher volatility in equities.

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- Satrix FINI 15 ETF
- Satrix INDI 25 ETF
- Satrix S&P 500 Feeder ETF
- Satrix Emerging Markets 50 ETF
- FNB Inflation Bond ETF
- Satrix SA Divi Plus 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.

Tinashe Kambadza, 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

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 its exposure to a single sector and/or a single

What's happening in the markets?

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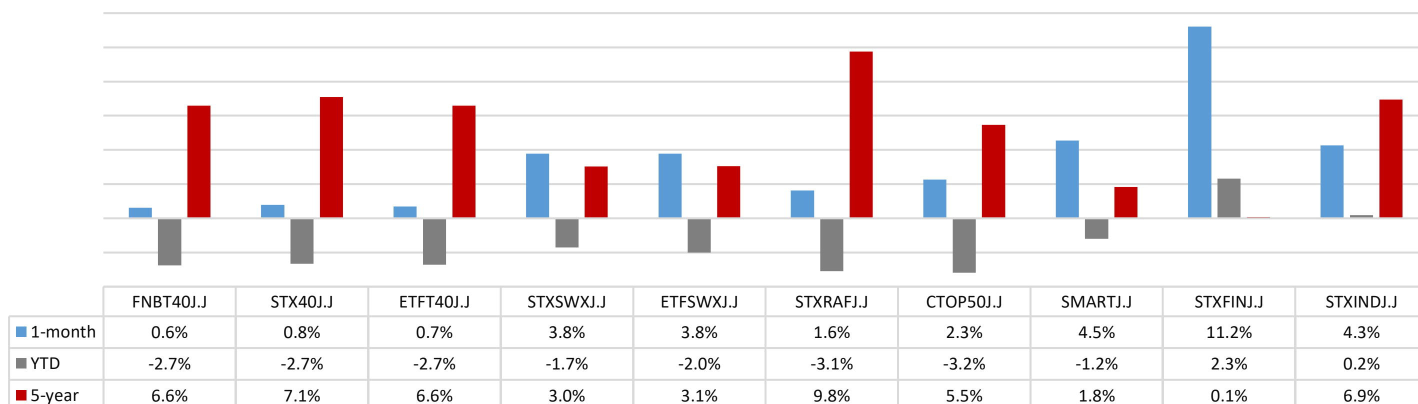
counter. While competition among providers is intensifying and ETF costs are coming down, we look at this metric closely and prefer ETFs with low total expense ratios (TERs). An overview of our favourite funds for each category follows.

The favourites:.

Domestic equity: Satrix FINI 15 ETF (STXFINI) and Satrix INDI 25 ETF (STXINDI)

This month's core pick reflects our view that any allocation to SA equities should remain diversified and resilient, given the persistent challenging stagflationary environment despite the recent decline in inflation. On this basis, the **Satrix FINI 15 ETF** (+11.2% in June) provides investors with the price performance of the FTSE/JSE Financial 15 index and also pays investors all dividends received from companies in the index, net of costs, on a quarterly basis. The Fund engages in scrip lending activities. Manufactured (taxable) dividends could arise from such transactions.

Typically, rising interest rates imply higher income for banks. However, as the economy deteriorates, the question of sustainability cannot be ignored. It is increasingly a race between the endowment effect of net interest income versus the drag of rising impairments, credit losses, funding costs and a slowdown in the growth of the balance sheet. On aggregate the positive benefits of rising rates on net interest income have outweighed the negative impact of higher bank funding costs and rising impairments. But with interest rate increases plateauing and impairments rising, the next few months will be tough for bank profitability. However, on the assumption of the continued slowdown of



	FNBT40J.J	STX40J.J	ETFT40J.J	STXSWXJ.J	ETFSWXJ.J	STXRAFJ.J	CTOP50J.J	SMARTJ.J	STXFINJ.J	STXINDJ.J
1-month	0.6%	0.8%	0.7%	3.8%	3.8%	1.6%	2.3%	4.5%	11.2%	4.3%
YTD	-2.7%	-2.7%	-2.7%	-1.7%	-2.0%	-3.1%	-3.2%	-1.2%	2.3%	0.2%
5-year	6.6%	7.1%	6.6%	3.0%	3.1%	9.8%	5.5%	1.8%	0.1%	6.9%

Economic environment

In the US, equities closed the quarter higher, mainly due to gains in June. This was supported by moderation in inflation with signs of resilience in the US economy, despite elevated interest rates.

Underpinned by strong consumer spending, annual US GDP growth was revised upward to 2%, higher than the previous estimate of 1.3%. During Q2-2023, the economy gained traction growing by an annualised 2.4%, faster than the previous quarter and ahead of market expectations of 1.8%. For the period Q2-2023, the FTSE 100 returned 2.5%.

The Fed raised its repo rate by 25 basis points in May and then paused in June in assessing the economy and ultimately provided some relief. Despite this, there was subsequent indication of a possible 1-2 additional hikes of up to 50bps.

One of these hikes was confirmed in July with the Fed raising rates by another 25 basis points noting still-elevated inflation as the rationale for what is now the highest US central bank policy rate in 16 years, as indicated by Reuters.

Inflation in the US market continued to decline to 4% in May (lower than expectations of 4.1%) from 4.9% in April. The downward trend was further confirmed with inflation at 3% in June, a decline of 12 straight months. Because of this, there is growing optimism regarding the economy's outlook with consumer at its highest in nearly two years.

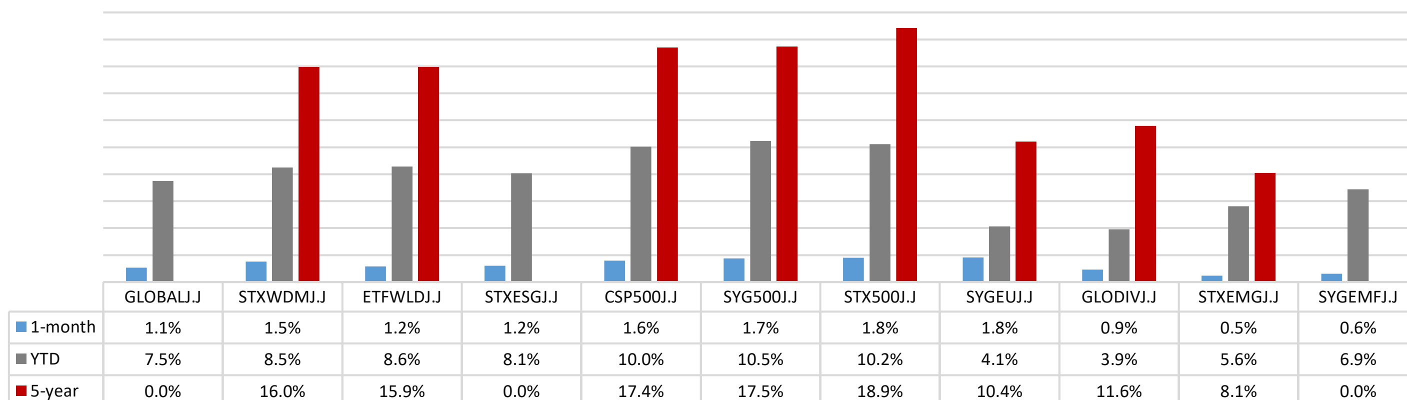
inflation during 2023, this may provide some relief for consumers and may limit impairments and credit losses for banks. This would potentially support income for banks and ultimately increase returns for investors invested in the Satrix FINI 15 ETF. However, drawbacks of the ETF include its high total investment cost (0.43%) and dividend yield (4.18%), which is below SA's 5.4% inflation rate.

Our satellite pick is the **Satrix INDI 25 ETF** (+4.3% in June), which provides investors with the price performance of the FTSE/JSE Capped Industrial 25 index (J311) as well as pays out, on a quarterly basis, all dividends received from companies comprising the index, net of cost. In order to reduce costs and minimise tracking error, the fund engages in scrip lending activities.

Manufactured (taxable) dividends could arise from such transactions. Manufacturing production in South Africa increased by 2.5% year-on-year in May of 2023, following an upwardly revised 3.6% surge in the prior month and above market forecasts of a 2.3% rise. The ETF has a TIC of 0.44% and a projected yield of 1.19%.

Foreign equity: Satrix S&P 500 Feeder ETF (STX500) and Satrix Emerging Markets 50 ETF (STXEMG)

Our core global equities pick is the **Satrix S&P 500 ETF** (+1.8% in June) which tracks the value of the S&P 500 Index. The Funds is an index



	GLOBALJ.J	STXWDMJ.J	ETFWLDJ.J	STXESGJ.J	CSP500J.J	SYG500J.J	STX500J.J	SYGEUJ.J	GLODIVJ.J	STXEMGJ.J	SYGEMFJ.J
1-month	1.1%	1.5%	1.2%	1.2%	1.6%	1.7%	1.8%	1.8%	0.9%	0.5%	0.6%
YTD	7.5%	8.5%	8.6%	8.1%	10.0%	10.5%	10.2%	4.1%	3.9%	5.6%	6.9%
5-year	0.0%	16.0%	15.9%	0.0%	17.4%	17.5%	18.9%	10.4%	11.6%	8.1%	0.0%

In the UK, equities fell during the quarter dragged down by diversified energy and basic materials amid weakness in commodity prices and concerns regarding China's economic outlook. The economy narrowly avoided a recession registering 0.1% q-o-q growth with resilience in consumer demand but consequently sparking fears of a possible recession due to the further potential rate hikes to curb inflation.

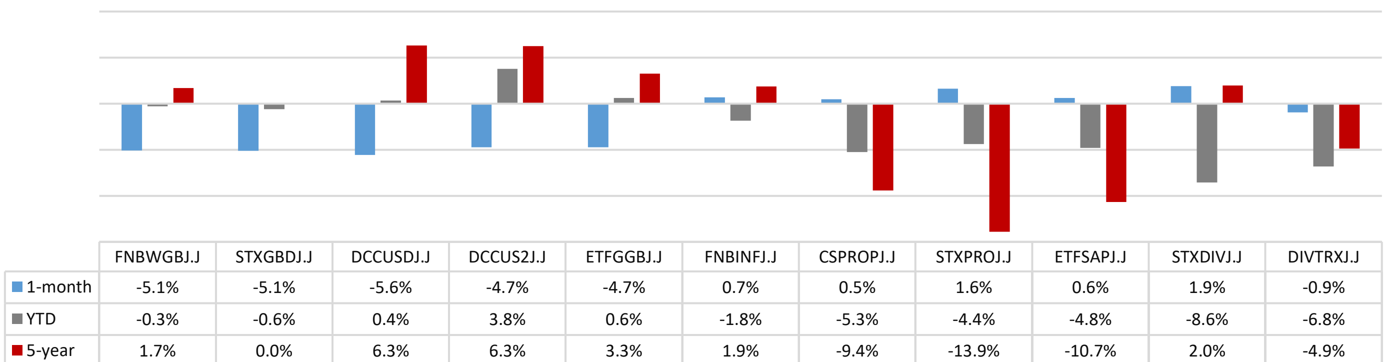
In contending with high inflation of 8.7% in May, the Bank of England (BOE) hiked rates by 50 bps in June to put them at the highest level since 2008. However, more recently inflation fell by more than expected in June to 7.9%, its lowest in over a year, as noted by Reuters. Core inflation (excluding food, energy and tobacco) which is used by the BOE as a gauge for underlying prices also fell with the latest reading at 6.9% in June from the three-decade high of 7.1% in May.

This should provide some relief by easing pressure on the BOE. On this basis, Reuters notes that markets now expect a quarter-percentage point rate hike on August 3 as opposed to the half-percentage hike which had initially been priced-in. Equities in the eurozone witnessed gains in Q2-2023 led by financials and IT sectors. However, this was offset by underperforming energy and communication sectors. The European Central Bank (ECB) raised interest rates twice in the quarter, taking the main refinancing rate to 4.0%.

tracking fund, registered as a CIS, and is also listed on the Johannesburg Stock Exchange as an ETF. The portfolio will invest in participatory interest of the iShares Core S&P 500 UCITS ETF. The iShare Core S&P 500 UCITS ETF replicates the constituents of the S&P 500 Index by holding all the securities comprising the S&P 500 Index in a similar proportion to their weightings in the S&P 500 Index. The investment objective of the underlying fund is to provide investors with a total return, taking into account both capital and income returns.

This ETF has its largest exposure to the technology sector, which accounts for c.33% of the industry sector weighting while the investment by country is mainly in the US with a weighting of c.97%. Therefore, performance is subsequently by macroeconomic factors in this market. As stated above, inflation in the US has continued to trend downwards with revised upward economic growth underpinned by solid consumer spending. Further evidence of the state of good health of the US economy has been revealed in the results of technology giants Alphabet (Google) and Microsoft. Alphabet's second-quarter profits exceeded market expectations while Microsoft benefitted from product upgrades which resulted in its 4th-quarter revenue and profit surpassing Wall Street expectations. Performance of these tech giants underpin the rally of the S&P 500 of around 19% on a year-to-date basis. As such,

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



	FNBWGBJ.J	STXGBDJ.J	DCCUSDJ.J	DCCUS2J.J	ETFGGBJ.J	FNBINFJ.J	CSPROPJ.J	STXPROJ.J	ETFSAPJ.J	STXDIVJ.J	DIVTRXJ.J
1-month	-5.1%	-5.1%	-5.6%	-4.7%	-4.7%	0.7%	0.5%	1.6%	0.6%	1.9%	-0.9%
YTD	-0.3%	-0.6%	0.4%	3.8%	0.6%	-1.8%	-5.3%	-4.4%	-4.8%	-8.6%	-6.8%
5-year	1.7%	0.0%	6.3%	6.3%	3.3%	1.9%	-9.4%	-13.9%	-10.7%	2.0%	-4.9%

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In June, the ECB hiked rates by 25 basis points (which was in line with market expectations) and also raised both growth and inflation forecasts. Another hike was implemented in July by 25 basis points noting that inflation is set to remains too high for too long and going forward raised the possibility of a potential pause in rate hikes in September.Headline inflation declined during the period, with annual inflation at 5.5% in June (still above the ECB's target of 2.0%), falling from 6.1% in May. Despite this, the core inflation rate (which excludes energy, food, alcohol and tobacco prices) was marginally higher at 5.4% compared to 5.3% in May.

Data revealed that the region endured a mild recession during winter. This after GDP declined in both Q4-2022 and Q1-2023 by -0.1% with estimates pointing towards a slowdown in the eurozone economy. The composite purchasing managers' index (PMI) fell to 50.3 in June (52.8 in May) representing a 5-month low and ultimately raising fears of stagnation in the region. However, for Q2-2023 markets such as France's CAC 40 gained 4.0% while Germany's DAX returned 3.8%.

China's economy delivered a somewhat underwhelming GDP performance of 4.5%. Owing to weakening consumer confidence in the midst of slowing retail sales, and declining new borrowing and inflation, momentum was lost during Q2-2023. Data released in May indicated that industrial growth was at 3.5% year-on-year, a touch slower from the 3.6%. This subsequently resulted in downward revisions in GDP forecasts ranging between 4.5% and 6.5%.

While the Chinese government is aiming for 5% growth in 2023, youth unemployment, a weak property sector and constrained consumer demand continue to stifle such growth prospects. Therefore, the response by the PBOC (People's Bank of China) to slush both short and medium rates to stimulate growth was unsurprising.

As a result, the market now anticipates additional cuts and stimulus initiatives such as easier lending requirements together with extended financing for infrastructure. Given issues facing the country, local markets ended Q2-023 in the red with the Hang Seng falling by -5.9% and the MSCI China also declining by -9.6%.
Locally, the SARB (South African Reserve Bank) hiked rates by 50 basis points in May, a move which had been unexpected by the market. This was due to concerns around inflation with the

we think that the Satrix S&P 500 ETF's exposure to the strong US market and innovative technology sector, enables investors to invest in top-quality global equities while participating in any sustainable technological advancements over the medium to long term.

Our satellite (or higher risk pick) is a typical value play. **The Satrix Emerging Markets 50 ETF** (+0.5% in June) is a high-risk, passively managed index-tracking fund registered as a collective investments scheme and listed on the Johannesburg Stock Exchange as an exchange traded fund.

The objective of the fund is to achieve long term capital appreciation in tracking the performance of the MSCI Emerging Markets 50 (MSCI EM 50 Index) (benchmark index). It also aims to replicate the price and yield performance of the MSCI Emerging Markets 50 Index as closely as possible by holding a portfolio of securities equivalent to the basket of securities that comprise the Index, and in similar weightings to the Index.

Bonds and cash: FNB Inflation Bond ETF (FNBINF)

We favour an inflation-linked bond ETF in which the principal price of the bonds (as well as the interest payments) rise and fall with the rate of inflation, thus protecting the purchasing power of investors. In addition, bonds may improve the diversification of portfolios given their low correlation with equities.

Accordingly, the **FNB INF ETF** (+0.7% in June) is our pick for this month. The investment objective of the ETF is to provide investors with a real rate of return above inflation (CPI), through exposure to a diversified portfolio of government inflation-linked bonds. The ETF invests in bonds based on the value issued by National Treasury and the listed value on the JSE. The ETF aims to track the performance of the FTSE/JSE IGOV Index.

The IGOV is a weighted basket of South African government inflation-linked bonds. The ETF tracks the component bonds of the index in proportion to the index weightings. Inflation returns interest to investors quarterly. The ETF has a TIC of 0.37% and a projected yield of 2.78%.

SARB indicating the possible need for rates to go higher and stay there for longer. However, at its latest MPC meeting, the SARB left rates unchanged after 10 hikes in a 21-month period to curb inflation.

Inflation was slower at 6.3% in May from 6.8% in April. This then prompted expectations of further easing in June with the SARB estimating inflation to be within the 3-6% range in Q3-2023 or Q4-2023.

However, the latest inflation figures for June revealed inflation has fallen further and is back in the range at 5.4% for the first time since April 2022. This was supported by lower fuel prices with transport inflation significantly falling to 1.8% in June from 7.0% in May.

Outlook and portfolio strategy

Going forward in SA, the SARB now anticipates headline inflation for 2023 at 6.0% (previous estimate 6.2%).

With regards to growth, the central bank upgraded its GDP forecast for 2023 to 0.5% (previous 0.3%). From our perspective as Intellidex and noted in our recent What We Think-Q3 report, that we expect GDP to print at 0.8% in 2023 and headline inflation at 5.9%.

In its latest update, the International Monetary Fund (IMF) revised SA's GDP for 2023 to 0.3% in July (from 0.1% in April). This was on the back of resilience in the economy, despite ongoing loadshedding. SA's growth however is still anticipated to be the weakest among leading emerging markets. Overall emerging market growth is expected at about 4%.

The IMF further notes that the global economy is expected to grow by about 3% on the back of gradual recovery from the pandemic and Russia's invasion of Ukraine.

Dividends: Satrix SA Divi ETF (STXDIV)

The **Satrix SA Divi Plus ETF** (+1.9% in June) is our dividend pick for this month. The investment objective of the ETF is to track the FTSE/JSE Dividend Plus index. ETF is an index tracking fund, registered as a Collective Investment Scheme and is also listed on the JSE Securities Exchange as an Exchange Traded Fund.

The Fund provides investors with the price performance of the FTSE/JSE Dividend Plus index (J259) as well as pays out, on a quarterly basis, all dividends received from companies comprising the index, net of cost.

In order to reduce costs and minimise tracking errors, the fund engages in scrip lending activities. Manufactured (taxable) dividends could arise from such transactions.
The ETF has a TIC of 0.41% and a projected yield of 8.72%, which is above the SA inflation rate of 5.4%.

[Ends]

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