intellidex
Researching Capital Markets and Financial Services

ETF Insights.
Prepared for clients of EasyEquities

The ETF Review

April 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!

Concerns on global growth as loadshedding set to get worse in SA winter

IN THIS ISSUE:

Loadshedding continues to have a devasting impact on the local economy. Economic activity in the private sector fell in March as rolling blackouts and persistent inflationary pressures had a negative impact on business. The S&P Global South Africa Purchasing Managers' Index (PMI) declined to 49.7 points during March from 50.5 in February. Significantly, a level below 50 officially signals contraction.

Globally, inflation in the US continued to slow, coming in at 5% in March (6% in February and 6.4% in January) – below market expectations of 5.2% and much lower than the peak of 9.1% witnessed in June 2022. The inflation data followed the country's job report which revealed solid job growth in March with unemployment in the US declining back to 3.5%. As noted by Reuters, economists now anticipate the Federal Reserve will raise rates one more time in May before halting its fastest monetary tightening policy campaign since the 1980s.

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.

- FNB Top 40 ETF
- CoreShares Top50 ETF
- Satrix S&P 500 Feeder ETF
- Sygnia Itrix Euro Stoxx 50 ETF
- FNB Inflation Bond ETF
- CoreShares DivTrax 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?

Loadshedding continues to have a devasting impact on the local economy. Economic activity in the private sector fell in March as rolling blackouts and persistent inflationary pressures had a negative impact on business. The S&P Global South Africa Purchasing Managers' Index (PMI) declined to 49.7 points during March from 50.5 in February. Significantly, a level below 50 officially signals contraction.

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From an equities perspective, the MSCI World Index rose 2.8% and the S&P 500 also trended upwards, closing the month 3.5% in the green. However, equity markets in the UK and Europe faced pressures with the FTSE 100 declining 3.1% while the German Dax was up 1.6%. The French Cac 40 was flat at 0.7%.

Locally, the JSE all share index closed March 2.1% lower and the top 40 also fell 1.7%. SA bonds were slightly higher at 0.7%.

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.

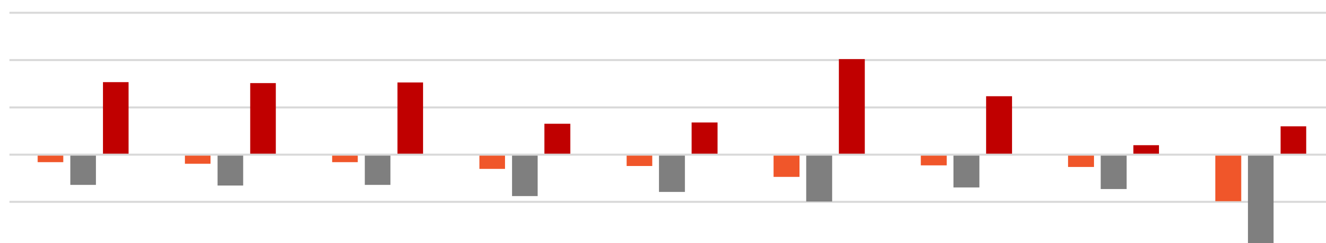
The favourites:

Domestic equity: FNB Top 40 ETF (FNBT40) and CoreShares Top50 ETF (CTOP50)

This month's local picks emphasise our view that an allocation to SA equities should focus on top quality stocks which will offer more resilience in the challenging economic environment. Hence, we focus on the **FNBT40 ETF** (-0.8% in March) which invests in the 40 largest companies on the JSE. The objective is to offer returns to investors which are linked to the performance of the FTSE/JSE Top 40 index with the ETF tracking the component equities of the index in proportion to the index weightings. Dividends or interest earned from the underlying shares are paid on a quarterly distribution. Given the nature of the fund, inherent risks include general market and company specific risks. The fund has a competitive total expense ratio of 0.13%, which compares well to its peers, the Sygnia Itrix Top 40 (0.18%) and 1nvest Top 40 (0.29%), while it is slightly higher than the Satrix 40 at 0.10%.

Our second pick is the **CoreShares Top50 ETF** (-1.1%), which tracks the S&P South Africa 50 Index as closely as possible. We chose this one to enhance investors' broad equity exposure to quality JSE stocks. Despite local challenges, we believe SA Inc still offers long-term value and dips in the local bourse provide buying opportunities. The index, which is constructed and maintained

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



	FNBT40J.J	STX40J.J	ETFT40J.J	STXSWXJ.J	ETFSWXJ.J	STXRAFJ.J	CTOP50J.J	SMARTJ.J	STXDIVJ.J
1-month	-0.8%	-0.9%	-0.8%	-1.5%	-1.2%	-2.3%	-1.1%	-1.3%	-4.9%
YTD	-3.2%	-3.2%	-3.2%	-4.4%	-3.9%	-4.9%	-3.5%	-3.6%	-9.7%
5-year	7.7%	7.6%	7.6%	3.3%	3.4%	10.1%	6.2%	1.0%	3.0%

Economic environment

For Q1 2023, global equities witnessed some gains underpinned by receding fears of recession in developed markets, led by the slowing inflation in the US. This was despite the volatility brought about in banking stocks on the back of the collapse of Silicon Valley Bank (SVB). Within fixed income, government bond yields fell as prices increased and growth stocks outperformed value stocks during the quarter.

In the US, the SVB debacle hit equity prices in March before recovering to close out the month and the quarter in positive territory. Confidence in the resilience of the US banking sector was expressed by the Fed having raised rates by 25bps in both February and March, ultimately taking the cost of borrowing to its highest since 2007. As noted by Schroders, however, inflation rose at a slower rate during March which resulted in speculation of limited further rate hikes by the Fed.

Within the eurozone, stock markets closed out Q1-2023 with gains despite volatility among banking shares. The gains were led by consumer discretionary, communication services and IT while losses were experienced in real estate and energy. Volatility among the euro financial stocks was also prevalent on the back of the SVB failure and this was exacerbated by the acquisition of Credit Suisse by UBS. Nonetheless, the sector within the region still managed to finish the quarter with some gains, with issues around Credit Suisse largely contained. However, losses were recorded in real estate on the back of higher financing costs as well as subdued occupancy rates.

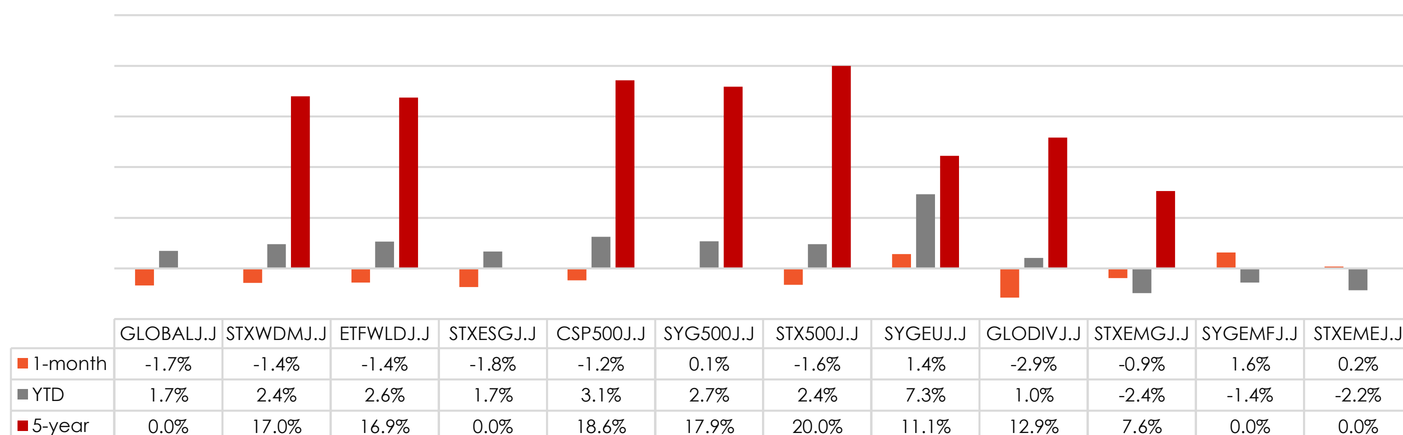
by S&P Dow Jones Indices, provides exposure to the largest 50 companies on the JSE by float-adjusted market cap and constituent weightings are capped at 10% (as at the quarterly rebalancing date).

Both our ETF picks have the benefit of both sector and geographic diversification, which should serve investors well. From a sector point of view, the funds are invested in basic materials, financials and consumer cyclicals with average exposures of 31%, 23% and 18% respectively. Based on our analysis, basic materials has outperformed all other sectors (including the all share index) in the SA market on a one-month (+28.5%) and six-month (+22.9%) period, despite declining commodity prices. While financials endured negative returns over one month (-4.6%), across six months the sector gained 12.8%. Taking note of the SVB and Credit Suisse issues, Intellidex South Africa CEO Roy Havemann says South African banks do not face the same risks as the US and European banks, with financial results confirming that SA banks are well-capitalised and profitable.

Foreign equity: Satrix S&P 500 Feeder ETF (STX500) and Sygnia Itrix Euro Stoxx 50 ETF (SYGEU)

Our first global equities pick is the **Satrix S&P 500 Feeder ETF** (-1.6%), an index-tracking fund listed on the JSE with a mandate is to track, as closely as possible, the value of the S&P 500 in rand terms. The S&P 500 index measures the performance of the large capitalisation sector

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	GLODIVJ.J	STXEMGJ.J	SYGEMFJ.J	STXEMEJ.J
1-month	-1.7%	-1.4%	-1.4%	-1.8%	-1.2%	0.1%	-1.6%	1.4%	-2.9%	-0.9%	1.6%	0.2%
YTD	1.7%	2.4%	2.6%	1.7%	3.1%	2.7%	2.4%	7.3%	1.0%	-2.4%	-1.4%	-2.2%
5-year	0.0%	17.0%	16.9%	0.0%	18.6%	17.9%	20.0%	11.1%	12.9%	7.6%	0.0%	0.0%

Inflation in the region continued to slow down during the quarter, declining to 6.9% in March (from 8.5% in February). Despite this, core inflation, which excludes food and energy related costs, was slightly up to 5.7% from 5.6%. In contending with the inflationary environment, the European Central Bank raised rates by 50bps in both February and March. With regards to the policy environment, the French government announced plans to increase the retirement age, which resulted in widespread protests in the country with president Emmanuel Macron surviving a no-confidence vote by a small margin.

In the UK, data from the Office for National Statistics showed that the country avoided a contraction in Q4-2022, in contrast to expectations. Subsequently, the economy escaped a recession following a contraction experienced in Q3-2022. Despite this, the Bank of England (BOE) still anticipates the UK economy will enter an recession during 2023, based on its most recent quarterly estimates. From the bank's perspective, this anticipated recession however, is not expected to be as severe as was initially estimated when the BOE announced it previous forecasts in November 2022. This was mainly due to a decline in energy costs during Q1-2023. Nonetheless, the BOE noted that inflation still remains a significant risk and is therefore expected to continue raising rates.

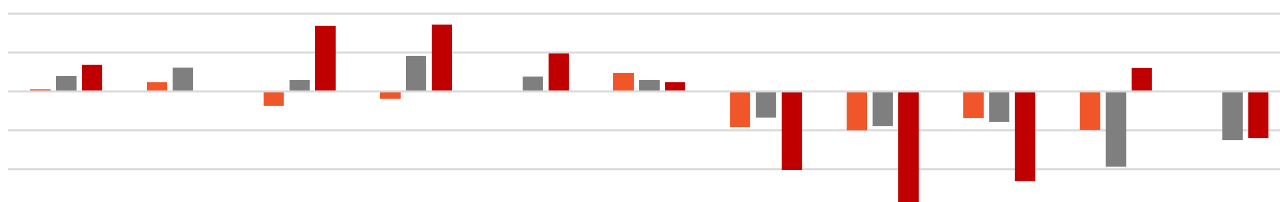
of the US equity market which comply with size, liquidity and free float criteria. To replicate the index performance, the Satrix S&P 500 ETF invests in the iShares Core S&P 500 UCITS ETF (the underlying fund). The investment objective of the underlying fund is to provide investors with a total return, taking into account both capital and income returns, which reflects the return of the S&P 500 Index.

The US is expected to grow 1.6%, 0.2 percentage points more than in the prior projection. The IMF cut its growth expectations for emerging markets and developing economies – which have a bigger weighting than advanced nations based on purchasing power parity – to 3.9%, 0.1 percentage point lower than its prior projection.

Our satellite, or higher risk pick, remains the **Sygnia Itrix Euro Stoxx 50 ETF** (+1.4%), which is a passively managed index tracking fund and is listed on the JSE as an ETF. The investment objective of the ETF is to track the Euro Stoxx 50 Index as closely as possible.

According to the S&P Global, the eurozone manufacturing PMI was at 47.3 points in March, falling from 48.5 in February to a four-month low. Even though this reflects worsening health of the region's manufacturing sector, much of the month-on-month decline was due to the Suppliers' Delivery Times Index (which is inverted in the calculation of the headline PMI) surging

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	0.3%	1.2%	-1.8%	-0.9%	0.0%	2.4%	-4.5%	-5.0%	-3.5%	-4.9%	0.0%
YTD	2.0%	3.1%	1.5%	4.6%	1.9%	1.5%	-3.4%	-4.5%	-3.9%	-9.7%	-6.2%
5-year	3.5%	0.0%	8.4%	8.6%	4.9%	1.2%	-10.1%	-14.3%	-11.5%	3.0%	-6.0%

The world's second-largest economy China, officially expanded by 3.0% in 2022, lower than the 5.5% target set in March 2022. However, as we mentioned in our previous newsletter, growth of 2.9% achieved in Q4-2022 was above market expectations. Recently, the government announced a target of about 5% for 2023, taking a cautious tone on the outlook having ended the bulk of Covid restrictions. As noted by Moody's, the conservative growth target is cognisant of headwinds still facing the economy such as slower global growth affecting the country's exports as well as risks in the property sector and local government debt.

The National Development and Reform Commission (NDRC) believes consumption could be a key driver for China's growth in the short term, noting that government has tools to boost such spending. Such thoughts have been echoed by the Bank of China which said that given the weakening impact of the pandemic, recovery in retail sales alone can drive growth.

The South African economy continues to be battered by loadshedding. While companies have been resilient in contending with the rolling blackouts, the impact of loadshedding is taking its toll on profitability due to higher operational costs. Intellidex believes that loadshedding will increase sharply in Q2-2023 to stage 6 (and possibly beyond) during winter as demand is higher.

Furthermore, consumers remain under pressure as inflationary pressures persist. Inflation in SA rose slightly above market expectations with prices being driven by the power cuts, a point which is being reiterated by Reuters. Inflation was at 7% in February, slightly up from 6.9% in the previous month and reflecting the first increase in four months. However, the biggest concern for consumers is with food prices which rose to the highest level since April 2009 with food and non-alcoholic beverages reaching 13.6%. Sharp increases were noted in key food items such as maize meal (+35%) and meat (+11%) in the year to February.

to a survey record. Nonetheless, key indicators measuring factory health such as output, new orders and employment were virtually unchanged in the period. Interestingly, the most solid performances were from markets such as Greece (with the strongest improvement) followed by Spain and Italy while headline PMIs for Germany and Austria declined to their lowest levels in about three years.

Bonds and cash: FNB Inflation Bond ETF (FNBINF)

Given the likelihood of moderate or persistent inflation and our preference for diversification, our income pick is the **FNB Inflation Bond ETF** (+2.4%). The investment objective 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. Despite this, investors should be cognisant that the fund is relatively expensive with a total expense ratio of 0.37%.

Outlook and portfolio strategy

The World Bank revised its global outlook for 2023 slightly upwards to 2% (from 1.7% in January). Nonetheless, debt distress among developed markets was noted, particularly due to the slowdown from strong growth witnessed in 2022. The revision is mainly underpinned by improved prospects for China. In addition, developed markets such as the UK and the eurozone are also faring better than initially expected back in January, as noted by World Bank president David Malpass.

While the World Bank raised its forecast for global growth, the International Monetary Fund has lowered its outlook for 2023 to 2.8% and 3% in 2024. This is 0.1 percentage point less than its initial estimates in January and compares to 3.4% in 2022.

The IMF notes that high risks and uncertainties in the financial sector are adding pressure from tighter monetary policy and Russia's invasion of Ukraine. Furthermore, the fund estimates global inflation at 7% for 2023 (0.4% higher than its January forecast), which is lower than 2022's 8.7%, mainly due to the impact of rate hikes and declining commodity prices.

Dividends: CoreShares DivTrax ETF (DIVTRX)

The **CoreShares DivTrax ETF** (0.0%) is our dividend pick for this month, which tracks the S&P South Africa Dividend Aristocrats Index. The index, which is constructed and maintained by S&P Dow Jones Indices, is designed to measure the performance of constituents of the S&P South Africa Composite Index that have followed a policy of increasing or maintaining stable dividends for seven consecutive years.

As a benefit to investors, shares which are included in this ETF typically have a reliable track record offering consistent income to investors and looks at actual dividends instead of just dividend yields. Furthermore, companies which are consistent in paying out dividends usually have resilient fundamentals. However, investors should take note that this ETF is relatively expensive with a total investment cost of 0.56% and also has a high tracking error.

While the IMF's downward revision in growth is marginal, it is more bearish about the outlook than it was in January. Back then its view was that 2023 would be a "turning point" for the global economy with risks more balanced. However, it now warns that growth over the next five years will be subdued due risks of economic fragmentation caused by geopolitical tensions.

In terms of its revised outlook for SA, the IMF is quite conservative, downgrading its forecast for 2023 to 0.1% from 1.1% in its previous forecast. Intellidex, in our recent *What we think Q2* note, also downgraded our 2023 SA GDP forecast to 0.9%, from 1.1% in our previous January forecast. However, capital markets head Peter Attard Montalto says the risks are not hugely to the downside on this number given the low base of last year and also with the adaptation to loadshedding and increased investment in energy.

All in all, while inflation is showing signs of slowing in the US and other global markets, concerns around growth still remain. Locally, loadshedding will be the biggest risk for all stakeholders. Hence we stick with our view of well diversified ETF and equity portfolios, believing in a healthy allocation to offshore equities.

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