The ETF Review

June 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!

SA asset prices down as local economic woes intensify

IN THIS ISSUE:

While global equities recorded a mixed performance in May, local stocks were dragged lower by intensifying load-shedding and SA's diplomatic fallout with the US in relation to Russia. The rand had a torrid month, depreciating to R19.92/dollar, losing 7.8%. Economic growth continues to moderate globally as monetary conditions tighten, with PMI data showing a divergence between the services and manufacturing industries across major economies.

Overall, the ETF picks below reflect our continued preference for defensive, diversified ETF portfolios with a healthy allocation to offshore equities given SA's progressively poor economic outlook. However, we have also included an allocation to local equities for risk-seeking investors, given that "SA Inc" equities have become cheaper. Other emerging market equities are also attractively valued with potentially better economic prospects than SA, which we think bodes well for investor portfolios.

- CoreShares Sci-Beta Multi-Factor
- FNB MidCap
- CoreShares World Stock Feeder
- Sygnia Emerging Markets 50
- Satrix ILBI
- Satrix Divi Plus

Intellidex's favourite ETFs

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

Gershwyn Benjamin, 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?

South African equity and bond prices came under pressure in May – the top 40 index reversed its April gains, posting a 3.6% loss while the all bond index dropped 5.8%. This as SA's chronic power outages and its diplomatic fallout involving the US and Russia shocked financial markets, including the rand.

The diplomatic situation resulted from SA being accused by the US that it supplied weapons to Russia, which continues its war against Ukraine. While a detailed analysis of this diplomatic situation is beyond the scope of this research note, it comes as no surprise that SA asset prices reacted sharply to the events.

The rand lost 7.8% of its value in May, depreciating to almost R20/dollar (high of R19.92/dollar during the month) as the diplomatic situation ebbed and flowed, adding to the woes that the local economy already faces. Overall, the FTSE/JSE All Share index was down 4% during May, with the mid-cap index (which contains shares of companies mostly exposed to SA) dropping 8%.

Developed market equities had a mixed month – the US-based S&P500 was flat (+0.2%) while the tech-heavy Nasdaq composite gained 5.8%. In the UK, the FTSE100 lost 5.4% while the German Dax declined 1.6%. In Hong Kong and Paris, the Hang Seng and Cac 40 were down 8.3% and 5.2% respectively.

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:

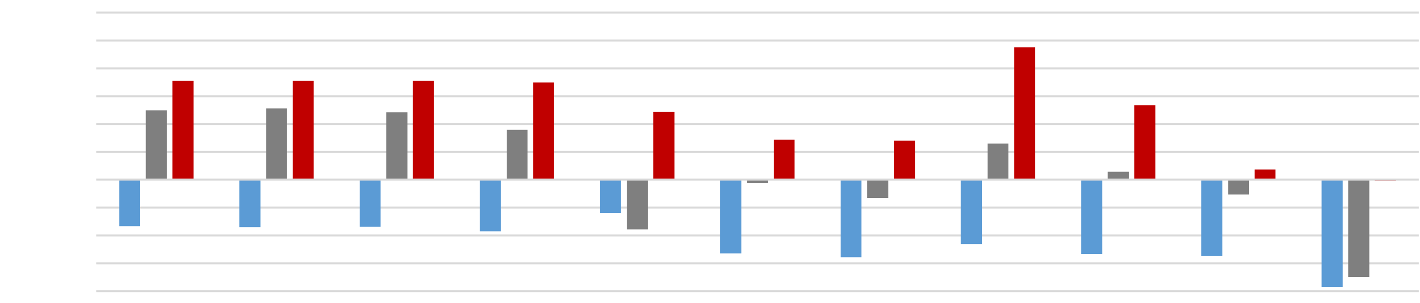
Domestic equity: CoreShares Sci-Beta Multi-Factor (SMART) and FNB MidCap (FNBMID) ETFs

This month's core pick reflects our view that any allocation to SA equities must be diversified, given the local economy's deteriorating condition. Accordingly, the **CoreShares Sci-Beta Multi-Factor ETF** (-5.5% in May) exposes investors to six investment styles (also known as factors). This enables investors to generate smoother, rather than volatile returns that often result from exposure to one single factor (especially prominent styles such as value or growth).

One of the companies included in the ETF is international food services giant Bidcorp, which was spun out of diversified services, trading and distribution company Bidvest Group in 2016. Bidcorp has operations in SA, the UK, Europe, Australasia and emerging markets.

It sells food and renders food-related services and generated over half of its FY22 revenue from sales to hotels and quick-service restaurants across its geographical segments. In its latest set of results (1H23), Bidcorp's SA-based businesses performed well, with revenue and profitability exceeding pre-Covid levels due to pent-up demand for dining and a recovery in hotel

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



	FNBT40J.J	STX40J.J	ETFT40J.J	SYGT40J.J	NFSH40J.J	STXSWXJ.J	ETFSWXJ.J	STXRAFJ.J	CTOP50J.J	SMARTJ.J	FNBMIDJ.J
1-month	-3.3%	-3.4%	-3.4%	-3.7%	-2.4%	-5.3%	-5.6%	-4.6%	-5.3%	-5.5%	-7.7%
YTD	5.0%	5.1%	4.8%	3.6%	-3.6%	-0.2%	-1.3%	2.6%	0.6%	-1.1%	-7.0%
5-year	7.1%	7.1%	7.1%	7.0%	4.9%	2.9%	2.8%	9.5%	5.3%	0.7%	-0.1%

Economic environment

Globally, May was dominated by developments related to lifting of the **US** economy's debt ceiling. At the time of writing, the US Senate had voted to approve a bipartisan deal that would increase the country's debt ceiling, clearing the bill's last major hurdle before it reaches the desk of President Joe Biden. This avoids a situation in which the US government is unable to pay its bills, which would have a devastating effect on the global economy.

While the process of lifting the debt ceiling included political wrangling for concessions between the two major parties (Democrats and Republicans), the market expected an eventual solution. Accordingly, the volatility (VIX) index (which measures the risk level in equities markets using the S&P500 index) rose just 0.4% and ended the month at the lower end of its post-pandemic trading range.

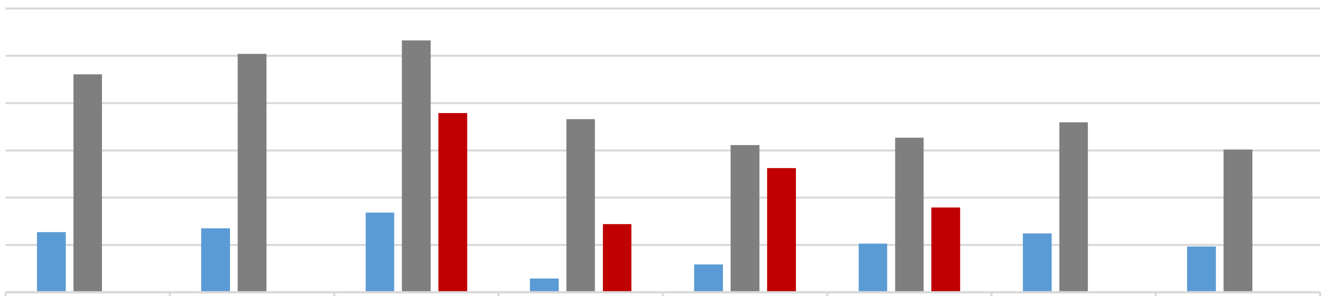
US economic data shows that the labour market remains tight while output is on the rise. Specifically, data from the Bureau of Labour Statistics show that the US economy added 339,000 jobs in May, which was far beyond market expectations of 190,000. In addition, the S&P Global US Flash Purchasing Managers Index rose to 54.5, up from 53.4 in April, signalling a faster expansion in private sector business activity.

occupancy levels. However, these businesses remain exposed to load-shedding which it expects to persist for the rest of FY23. However, we believe Bidcorp remains well positioned to perform as the services sectors in the global economy continue to drive activity. We also expect any long-term economic recovery from peaking (and then declining) interest rates globally to support consumer demand, boosting Bidcorp's performance as well as the ETF. However, drawbacks of the ETF include its high total investment cost (0.7%) and dividend yield (4.4%), which is below SA's 6.8% inflation rate.

Our satellite pick is the **FNB MidCap ETF** (-7.7%), which exposes investors to the mid-cap section of SA's equities market. This section of the market consists of "SA Inc" firms, some of which are being battered by load-shedding and SA's often self-imposed economic and political own goals. However, the de-rating of SA equities in recent times means that shares have become cheaper (and present attractive entry points to some equities which still offer value despite the challenging macro-environment), which is always a good time to build portfolio positions, especially for risk-seeking investors. The ETF is, however, expensive with a TIC of 0.72%.

Foreign equity: CoreShares Total World Stock Feeder (GLOBAL) & Sygnia Emerging Markets 50 (SYGEMF) ETFs

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



	GLOBALJ.J	STXESGJ.J	SYGUSJ.J	SYGUKJ.J	GLODIVJ.J	STXEMGJ.J	SYGEMFJ.J	STXEMEJ.J
1-month	6.4%	6.8%	8.4%	1.5%	2.9%	5.1%	6.2%	4.8%
YTD	23.0%	25.2%	26.6%	18.3%	15.6%	16.3%	18.0%	15.1%
5-year	0.0%	0.0%	19.0%	7.2%	13.1%	9.0%	0.0%	0.0%

The index, which reflects the overall direction in economic activity (above 50 indicates expansion), showed the sharpest increase in output since April 2022. This was led by the services sector, which reported stronger demand conditions. Although manufacturers registered growth in production, it was only marginal and slowed from the previous survey period.

Headline inflation in the **Eurozone** dropped to its lowest level since February 2022, coming in at 6.1% yearly (May) from 7% in April, exceeding expectations of a 6.3% reading. However, inflation remains persistent as shown by the European Central Bank's decision to increase its key interest rate by 25 basis points to 3.75% in May.

Overall activity in the EU indicates that the economy is slowing down with another notable divergence between the service and manufacturing industries. Specifically, the S&P Global Hamburg Commercial Bank (HCOB) composite PMI dropped to a three-month low of 53.3 in May from 54.1 in April. The services sector version of the PMI dropped to 55.9, which although positive, is a two-month low.

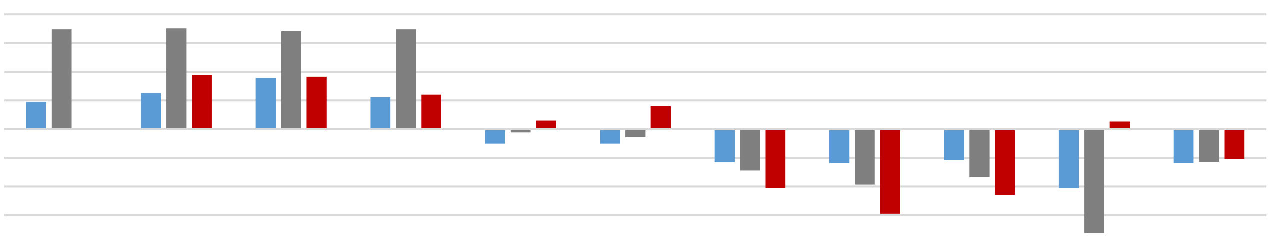
The performance of Germany (Europe's largest economy) is particularly important. The latest figures show that monthly industrial production dropped 3.4% in March from an upwardly revised 2.1% increase in February – worse than market forecasts of a 1.3% decline.

Our core global equities pick is the **CoreShares Total World Stock Feeder ETF** (+6.4%). It tracks the performance of the FTSE Global All Cap Index by investing in the Vanguard Total World Stock ETF. The fund has a relatively low total expense ratio of 0.29%. Data from the Vanguard Total World Stock ETF indicate that the index was trading at a reasonable price:earnings (PE) ratio of 16.2x and that 59% of assets were invested in the US at the end of May.

What we also like is that the index/ETF has 7,122 constituents, which enables returns to come from multiple shares or sectors. This differs from the current trend driving key US indices – in recent months, artificial intelligence (AI) has become a buzzword in the developed business world, enabling growth shares to outperform value shares.

This is due to market participants' expectations of innovation and productivity gains from AI-driven applications. The trend's prominence drove the performance of the tech-driven Nasdaq 100 and Russell 1000 indices during May. However, in its recent financial markets update, Nasdaq (US-based-investment analytics firm) cautioned about market breadth as only a few tech-driven stocks have contributed to index returns, which we believe is a risk from a portfolio perspective.

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



	STXGBDJ.J	DCCUSDJ.J	DCCUS2J.J	ETFGGBJ.J	FNBINFJ.J	STXILBJ.J	CSPROPJ.J	STXPROJ.J	ETFSAPJ.J	STXDIVJ.J	DIVTRXJ.J
1-month	4.7%	6.3%	8.9%	5.6%	-2.5%	-2.5%	-5.7%	-5.9%	-5.4%	-10.3%	-5.9%
YTD	17.4%	17.5%	17.0%	17.4%	-0.6%	-1.4%	-7.2%	-9.7%	-8.4%	-18.1%	-5.7%
5-year	0.0%	9.5%	9.1%	6.0%	1.5%	4.0%	-10.2%	-14.7%	-11.4%	1.4%	-5.2%

The automotive sector was the biggest drag, with a 6.5% slump in the output of motor vehicles and parts after a 6.9% jump in February.

China's economy is showing mixed signals, making the exact timing of the market's expected post-lockdown (from late last year) recovery uncertain. According to economic forecaster Bureau for Economic Research (BER), the Asian giant's industrial production rose 5.6% annually in April after a 3.9% increase in March. However, this was lower than expected given the low base due to strict Covid-19 restrictions in April last year. In addition, industrial production fell 0.5% monthly.

Fixed investment dropped by 0.6% monthly but was up 4.7% yearly. However, private fixed investment grew just 0.4%. Conversely, the BER states that low base effects contributed to China's annual retail sales jumping 18.4%, with sales up 0.5% monthly. The services sector continued its recovery as the Index of Services Production increased 13.5% annually in April. Accommodation and catering output soared 48.7% yearly as travel activity increased. This indicates that while consumer spending on goods and services continues to support post-Covid growth, lower industrial production decreased optimism about the economic outlook.

Locally, the better-than-expected performance of key macroeconomic data points during the quarter (manufacturing and mining data) enabled SA to post positive real GDP growth of 0.4% for Q1 2023. The growth figure, which was in line with consensus, was driven by growth in manufacturing, transport, storage & communication and construction. However, output growth slowed sharply to just 0.2% annually for Q1 2023 from a downwardly revised 0.8% (the weakest pace of expansion since Q1 2021), mainly due to the debilitating effects of record power cuts imposed by Eskom.

As such, we think that the CoreShares Total World Stock Feeder ETF's broad exposure to the US and the rest of the world enables investors to bulk up on global equities while participating in any sustainable AI-driven theme over the medium to long term.

Our satellite (or higher risk pick) is a typical value play. The **Sygnia Emerging Markets 50 ETF** (+6.2%) provides exposure to emerging market economies (EMs). Emerging market economies face lower economic growth rates from persistent inflation and high interest rates, according to global fund manager Lazard Asset Management.

However, Lazard also believes that EMs have already borne the brunt of tightening monetary conditions and their effects on growth and that despite some volatility from global banking shocks, EMs may be first to recover globally as monetary conditions peak and gradually subside. Accordingly, data from global index provider MSCI show that the MSCI EM 50 Index traded at a relatively attractive forward PE ratio of 12.8x and a dividend yield of 2.9%. As such, we think an allocation to EM equities would be useful for ETF portfolio purposes.

Bonds and cash: Satrix ILBI ETF (STXILB)

Investors are rightly concerned about the potential damage of load-shedding to SA's economic growth. Our internal estimates show that load-shedding could lead to an output loss of R37.5bn this year. This equates to 0.8% of SA's real GDP growth rate which came in at 2% in 2022.

However, while growth implications are worth considering, we also think that load-shedding will lead to even more persistent inflation given the increased costs associated with blackouts.

Outlook and portfolio strategy

Despite positive GDP growth, we believe the prices of local equities and other asset classes have derated to reflect the market's view of SA's progressively poor macroeconomic and company prospects. Regarding the latter, recent financial results and trading updates have laid bare the devastating effect of load-shedding on company operations. In the food retail space, we estimate that major players Pick n Pay (FY23), Shoprite (1H23) and Woolworths Food (1H23) spent an average of R437m on diesel and load-shedding related costs across an average of 1,522 stores.

Combined with entrenched state corruption, this inefficiency and increasingly unstable coalition governments in key metros across the country (which is accelerating the decline of municipalities) solidifies investor perceptions of tougher times ahead. As such, we believe that local investors should continue to invest in diversified equity and broader portfolios. Within equities, we favour a healthy allocation to offshore equities, where economic and company prospects are relatively attractive.

Emerging markets are displaying attractive "value" characteristics which we think will benefit investors over the medium-term as global consumer conditions start to improve. For investors with a higher risk appetite, an allocation to SA "Inc" companies (which have become cheaper) with resilient business models may also be an attractive opportunity.

As such, 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. In SA's case, the All Bond and All Share indices have a correlation coefficient of just 0.55. Accordingly, the **Satrix ILBI ETF** (-2.5%) is our pick for this month.

Dividends: Satrix SA Divi Plus ETF (STXDIV)

The **Satrix SA Divi Plus ETF** (-10.3%) is our dividend pick for this month. The fund tracks the performance of the FTSE/JSE Dividend+ Index, which selects the top 30 stocks by a one-year forecasted dividend yield. The constituents' weightings within the index are determined by their dividend yield as opposed to market capitalisation.

This provides a forward-looking estimate of expected dividends, which is advantageous relative to peer indices that may use trailing dividend yield measures. However, the risk of forecasting error may be a disadvantage to investors when investing in the ETF. In addition, it is also relatively expensive with a total investment cost of 0.61%. Coal miner Exxaro, which is employing a coal-export strategy to fund its diversification from fossil fuels, is one of the leading companies in the ETF. It has a healthy dividend yield of 6.8% based on its FY22 payout of R11.36/share.

[Ends]