The ETF Review

January 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!

Opportunities in equities despite prevailing macroeconomic challenges

IN THIS ISSUE:

As the year 2022 closed out, global equities declined by 18% whilst bonds fell by 16% as markets grappled with inflationary pressures and reactive rate hikes. The Russia-Ukraine war resulted in an energy crisis and worsened supply-chain disruptions caused by Covid-19.

During 2022, the MSCI World, a gauge for global equities, declined by 19.4%. Following a similar trend, the S&P500, also fell by the same margin of 19.4%, its worst return since the Great Recession in 2008. During December 2022, the MSCI World and S&P500 were the worst performers amongst our selected foreign indices declining by 4.3% and 5.9%, respectively.

Domestically, the JSE All share was relatively flat and declined just 0.9% for 2022 after clawing back a 6% return in the second half of 2022. The overall negative macroeconomic sentiment was reflected in sectoral performances across equities in December 2022. Key sectors such as financials, mining and industrials all experienced negative returns at 5.3%, 3.6% and 0.2%, respectively.

The selection of ETFs is made with these respective market themes and diversification in mind:

- NewFunds S&P GIVI South Africa Top 50 ETF
- Sygnia Itrix New China Sectors ETF
- Satrix MSCI China Feeder
- Satrix ILBI ETF
- CoreShares S&P Dividend Aristocrats

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
- 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?

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During 2022, the MSCI World, a gauge for global equities, declined by 19.4%. Following a similar trend, the S&P500, also fell by the same margin of 19.4%, its worst return since the Great Recession in 2008. During December 2022, the MSCI World and S&P500 were the worst performers amongst our selected foreign indices declining by 4.3% and 5.9%, respectively. The negative sentiment was reflected in other developed markets in Germany (Dax) and France (Cac 40), which declined by 12.3% and 9.5%, respectively. Interestingly, the UK's Ftse 100 was flat and inched 0.9% higher.

Domestically, the JSE All share was relatively flat and declined just 0.9% for 2022 after clawing back a 6% return in the second half of 2022. It initially endured a tough first half with losses of around 11%. However, during December 2022 the index fell by 2.4% with the market potentially weighing up the ongoing impact of loadshedding on SA's economy. The overall negative macroeconomic sentiment was reflected in sectoral performances across equities in December 2022. Key sectors such as financials, mining and industrials all experienced negative returns at 5.3%, 3.6% and 0.2%, respectively.

The economic environment

Globally, growth was subdued throughout 2022 as disruptions in supply chains caused inflationary

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:

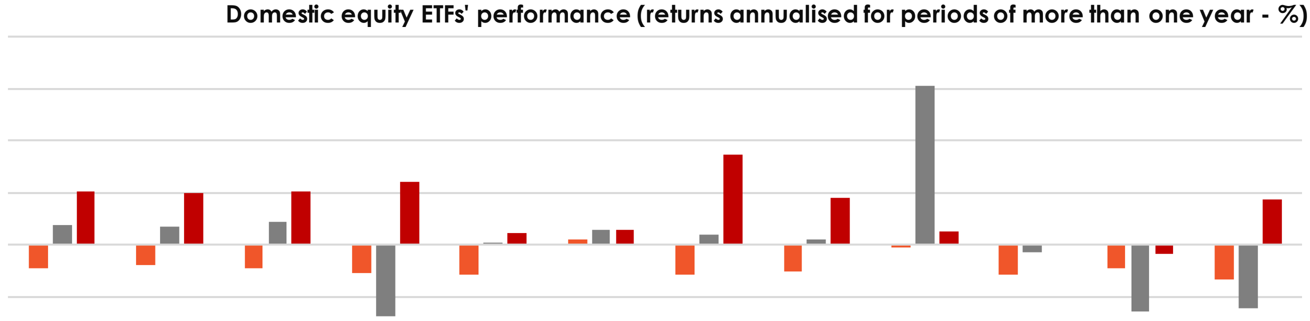
Domestic equity: NewFunds S&P GIVI South Africa Top 50 ETF (GIVISA)

We noted an improvement in SA output in our previous newsletter to 50.6 points in November from 49.5 in October. However, output declined in December with the S&P Global South Africa PMI noting a drop to 50.2 due to weaker growth in the private sector with new orders declining for the third time in four months. This in our opinion, is reflective of the impact of loadshedding and we believe this trend is likely to continue in the short term as rolling blackouts persist. Furthermore, slowdown international demand affected export orders as output fell for the fourth straight month.

From an equities perspective, recent results from some companies in key sectors such as food producers, construction and diversified industrials showed resilience despite ongoing challenges to revenue growth and profitability. Investors with appetite for some risk and long-term returns should be investing in equities, specifically in companies that have attractive medium-term prospects.

As a result, we think broad exposure through the **NewFunds S&P GIVI South Africa Top 50 ETF** (-0.2% in December) would be a good core equity ETF

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



	FNBT40J.J	STX40J.J	ETFT40J.J	NFSH40J.J	STXSWXJ.J	ETFSWXJ.J	STXRAFJ.J	CTOP50J.J	GIVISAJ.J	NFEVOLJ.J	FNBMIDJ.J	STXDIVJ.J
1-month	-2.2%	-2.0%	-2.3%	-2.8%	-2.9%	0.5%	-2.8%	-2.6%	-0.2%	-2.9%	-2.3%	-3.3%
YTD	1.9%	1.8%	2.2%	-6.9%	0.2%	1.4%	0.9%	0.5%	15.2%	-0.7%	-6.4%	-6.2%
5-year	5.1%	5.0%	5.1%	6.1%	1.2%	1.5%	8.7%	4.6%	1.3%	0.0%	-0.9%	4.4%

pressures, which were compounded by the Russia-Ukraine war. This prompted a response by central banks to raise interest rates to curb inflation. However, as noted by global fund manager Blackrock, central bank policy rates are not tools to resolve production constraints, they can only affect demand in their economies. This implies that initiatives by central banks to fight inflation may take time to be effective, hence they may be a lag before inflationary pressures begin to ease.

Annual inflation in the **US** continued to slowdown for a fifth consecutive month to 7.1% in November 2022 (below forecasts of 7.3%) having peaked at 9.1% in June 2022. Going forward in the immediate short-term in Q1 2023, US inflation is expected to be 6.4%, according to Trading Economics. Excluding food and energy, the consumer price index rose by 0.2% in November to 6% from a year previously – this core CPI is typically a better gauge of underlying inflation compared to the headline measure.

As indicated by Bloomberg, the US CPI witnessed the slowest monthly increase in more than a year showing that the worst of inflation in the market has potentially passed. Consequently, this validates an anticipated slowing in the pace of Federal Reserve interest rate hikes. Officials at the Federal Reserve's December 13-14 meeting agreed that the US central bank should slow the pace of its rate hikes enabling them to continue raising the cost of credit to control inflation in a gradual manner meant to limit risks to economic growth, as noted by Reuters.

holding. The ETF offers investors a diversified exposure to fifty of the largest JSE-listed stocks selected by intrinsic value and low volatility, at lower costs. It replicates the price performance of the S&P GIVI SA Top 50 Index, an Index which represents the fifty stocks from the S&P GIVI SA composite with the largest intrinsic value and lower volatility, subject to certain constraints such liquidity and market capitalisation of stocks.

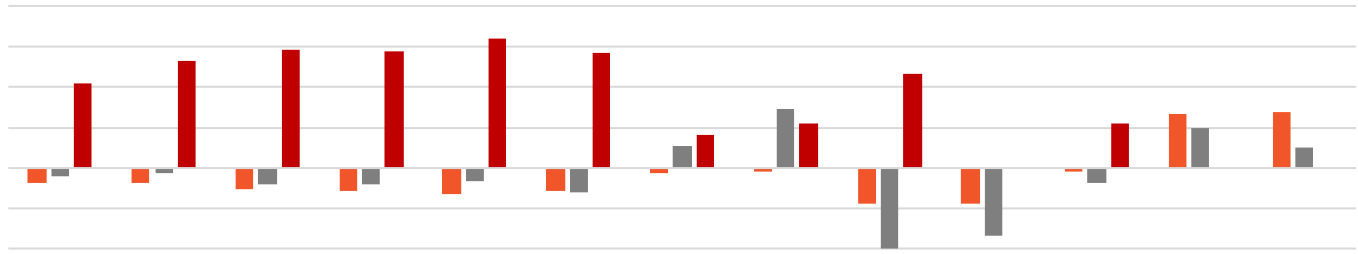
Foreign equity: Sygnia Itrix New China Sectors ETF (SYGCN) and Satrix MSCI China Feeder (STXCHN)

As mentioned above, the outlook for China in 2023 is positive on the back of easing of Covid-19 restrictions, support for the subdued property market – all with emphasis on growing the economy. Despite rising infections, there is a general positive sentiment regarding growth prospects for Asian markets.

The Hang Seng index (HSI) started off 2023 with gains last seen in the first trading session of a year since 2018 signalling the improved outlook of the Asian giant. As noted by Refinitiv, property and technology stocks supported the index with stocks such as Country Garden, Longfor Group and Cifi Holdings Group amongst the top gainers, on the back of expected policy support from the government. Rallies were also witnessed in stocks such as Alibaba, Tencent, Bilibili, and Baidu.

According to Guotai Junan Securities, the Hang Seng Index may lead other major indices

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



	FNBEQFJ.J	STXWDMJ.J	CSP500J.J	SYG500J.J	STX500J.J	SYGUSJ.J	SYGUKJ.J	SYGEUJ.J	SYG4IRJ.J	ETF5ITJ.J	STXEMGJ.J	SYGCNJ.J	STXCHNJ.J
1-month	-1.9%	-1.8%	-2.7%	-2.7%	-3.1%	-2.9%	-0.7%	-0.5%	-4.4%	-4.3%	-0.5%	6.7%	6.9%
YTD	-1.1%	-0.5%	-2.1%	-2.0%	-1.7%	-3.0%	2.7%	7.3%	-10.0%	-8.4%	-1.7%	4.8%	2.6%
5-year	10.5%	13.1%	14.6%	14.3%	16.0%	14.1%	4.2%	5.5%	11.6%	0.0%	5.5%	0.0%	0.0%

US manufacturing activity slowed down to 49 in November for the first time since May 2020, as noted by the Institute of Supply Management's Manufacturing Purchasing Manager Index (ISM Manufacturing). Despite this, services remained resilient with the ISM Services PMI rising to 56.5 in November from 54.4 in October. Goldman Sachs further notes that even though US short-term inflation expectations remain relatively high, much of this is reflective of elevated commodity prices. Hence these expectations should fall as commodity prices decline.

Across the pond in the **UK**, annual inflation slowed down to 10.7% in November 2022 from 11.1% in the previous month and below consensus estimates of 10.9%. Within the **Euro Area**, inflation was 10.1% year-on-year in November, a slight upward revision from the initial forecast of 10.0%, as noted by Trading Economics. Despite remaining significantly higher than the Euro Central Bank's mid-point target range of 2.0%, this was the first time it eased (since June 2021) from October's peak of 10.6%. The main reason for the much higher inflation in both the UK and Euro Area, compared to the US, is energy costs, which as noted by Bloomberg, has been threatening business productivity and government policy.

As noted in our previous newsletter, **China** announced relaxations of its zero-Covid restrictions. China, the second largest economy by nominal GDP at around $17 trillion, is the last major country to move toward treating Covid-19 as endemic. The implemented containment initiatives slowed the economy to its lowest growth rate in about half a century, disrupting global trade and supply chains in the process.

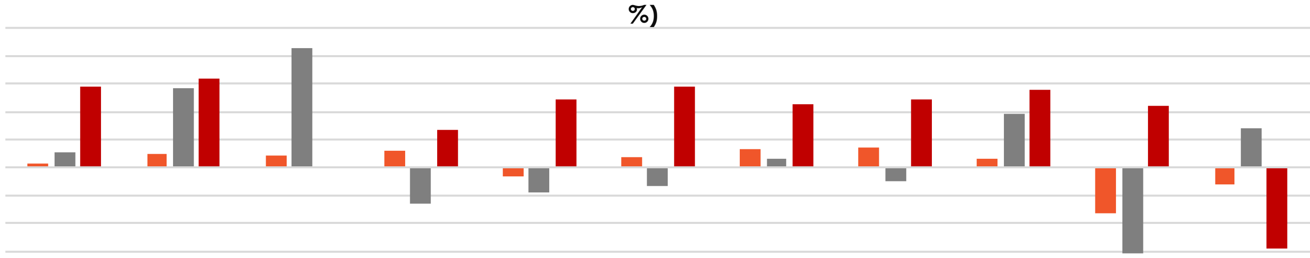
in 2023 with a 30% expected return and with further rerates expected in a recovery to its previous level prior to June 2022. On this basis, our picks amongst the foreign ETFs are the **Sygnia Itrix New China Sectors ETF** (+6.7%) and **Satrix MSCI China Feeder** (+6.9%).

The mandate of the Satrix MSCI China Feeder Portfolio (Satrix MSCI China Feeder ETF) is to track, as closely as possible, the value of the MSCI China Index in ZAR. To replicate the index performance the Satrix MSCI China Feeder ETF invests in the iShares MSCI China UCITS ETF (the underlying fund). With regards to the Sygnia Itrix New China Sectors ETF, its objective is to achieve long-term capital appreciation tracking the performance of the S&P New China Sectors Index. The S&P New China Sectors Index measures the performance of China- and Hong Kong-domiciled companies in consumption- and service-oriented industries. All Chinese share classes, including A-shares and offshore listings, are eligible for inclusion. To achieve this objective, the fund tracks the S&P New China Sectors Index as closely as is practically and feasibly possible by buying the securities that substantially make up the index in similar weightings to the index.

Bonds & Income: Satrix Inflation-Linked Bond (STXILB)

Inflationary pressures in the SA market are likely to persist especially in the short-to-medium term with persistent loadshedding adding costs to both consumers and businesses. As noted by Trading Economics, inflation in South Africa is

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



	DCCUSDJ.J	DCCUS2J.J	NFNAMBJ.J	FNBINFJ.J	PREFTXJ.J	NFGOVIJ.J	NFILBIJ.J	STXILBJ.J	NFTRCIJ.J	STXDIVJ.J	DIVTRXJ.J
1-month	0.2%	1.0%	0.9%	1.1%	-0.7%	0.7%	1.3%	1.4%	0.6%	-3.3%	-1.2%
YTD	1.0%	5.6%	8.5%	-2.7%	-1.8%	-1.4%	0.7%	-1.0%	3.8%	-6.2%	2.8%
5-year	5.8%	6.3%	0.0%	2.7%	4.8%	5.8%	4.5%	4.9%	5.5%	4.4%	-5.8%

As noted by the World Bank, outbreaks and economic slowdowns were followed by uneven recoveries of activity in China during 2022. Based on the recent increases of Covid-19 cases in the country, Goldman Sachs expects weak annualised growth of 1.2% in Q4 2022. The one year negative return of 15.5% of the Hang Seng Index in 2022 is reflective of the challenges faced by China. However during December 2022, the index rallied 6.4%, outperforming all other indices within the basket of selected foreign indices.

Locally, the South African economy continued to endure inflation, interest rates and loadshedding. The ongoing loadshedding has resulted in slowdowns in sectors such as mining and manufacturing with production falling by 10.4% and 6.3% month-on-month in October, respectively. Consumer demand remained weak as reflected in contracted retail sales of 0.6% year-on-year in October - reflective of the adverse impact of inflationary pressures as well as interest rates. However, a decline in fuel prices resulted in a slight reprieve - local inflation declined to 7.4% annually in November 2022 from 7.6% in October.

Outlook and portfolio strategy

Inflationary pressures and rate hikes by central banks across the world to contain elevated prices whilst limiting risks to growth, will be the likely theme throughout 2023. In line with this, Goldman Sachs believes that the US will likely narrowly avoid a recession expecting the core CPI to slow from 5% now to 3% in late 2023 with the Fed hiking rates by another 125 basis points peaking at 5%-5.25% during the forecast period.

Furthermore, Goldman Sachs notes that the Euro Area and the UK are already in recession territory, owing to the impact of energy costs on real incomes. However, with the region having managed to reduce its exposure to Russian gas imports, the impact of the recession is expected to the minimal. Weather may even play a role here with mild temperatures expected across northwest Europe in January 2023 and may provide relief to consumers and businesses from the energy crisis.

With regards to China, its reopening should result in increased economic growth in 2023, despite expected at around 7.5% in Q1 2023. Given the challenges associated with loadshedding, we anticipate subdued economic growth in the SA market.

Consequently, in this stagflationary environment our pick is the **Satrix ILBI ETF** (+1.4%) as this inflation linked bond should provide reasonable and stable returns. The bond tracks the performance of the S&P South Africa Sovereign Inflation-linked Bond 1+ Year Index. This index is a market-value weighted index of South African Rand-denominated inflation-linked securities, which are bonds of which the principal is indexed to the local inflation rate. As such, the security typically guarantees a return above inflation if held to maturity.

Dividends: CoreShares S&P SA Dividend Aristocrats ETF (DIVTRX)

As mentioned in our previous newsletter, the **CoreShares S&P SA Dividend Aristocrats ETF** (-1.2%) remains our pick for this month with the ETF tracking the S&P South Africa Dividend Aristocrats Index. This index represents companies that have increased or maintained stable dividends for the past seven years running. A company that fails to pay a dividend is excluded from the index when the index is reviewed.

Investors can benefit from the shares of companies included in this ETF due to their steady track record of dividend payments, which provides consistent income for portfolios. Furthermore, companies which pay out dividends consistently typically have strong fundamentals and despite contending with loadshedding and a generally weak macroeconomic backdrop, 'SA inc' has shown some resilience in recent years.

likely increased Covid-19 cases in the initial phase of reopening. Goldman Sachs believes that China's growth will be subdued in the first half of 2023. It also expects the actual reopening around April and anticipates annualised economic growth of 2% in 2Q-23. However, the investment bank anticipates a boost in China's growth in the second half, with above consensus growth forecasts for that period.

To provide a boost to growth, the country has also stepped up efforts to support the subdued property sector. As noted by Saxo Capital Markets, China has given property developers access to equity financing and credit which was not accessible in 2022. This supports our view of a positive outlook for China in 2023.

Locally, loadshedding will continue to restrict growth and add pressure to both households and businesses. Based on our forecasts at Intellidex, we expect real GDP growth of 1.6% for 2022 and some recovery to 2.1% in 2023. Inflation is anticipated to average 5.5% in 2023 after being expected to average 6.8% in 2022.

As noted by JP Morgan, the widespread sell-off in equities has left some stocks with strong earnings potential at low valuations with opportunities in emerging markets. This includes SA where value shares may be at discount. Given the challenges in the local economy, we take a cautiously optimistic view and note that prudence is required by investors in the prevailing environment. On this basis, our ETF picks below reflect our view of diversified core equity and ETF portfolios providing investors with opportunities in the markets potentially resulting in higher risk-adjusted returns.

[Ends]