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Absa NewFunds ILBI ETF (JSE:NFILBI)

09.12.2022

Fund suitability

This ETF is suitable for investors with a low risk appetite seeking exposure to bonds.

Fees

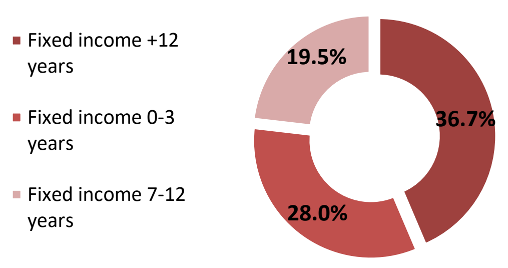
The fund has a total expense ratio of 0.35%.

Alternative funds

Satrix ILBI (TER:0.25%)

"Inflation will likely remain a cause for concern over the medium term and restrictive monetary policy will not be adequate to address it."

Sector allocation– top 3 (%)



What's happening in the markets?

Many countries continue to face record-high inflation. Higher-than-expected prices created recessionary fears earlier this year, weighing on global equities. However, prices have since moderated - consumer inflation decreased to 7.7% annually in October and to 10% in November in the US and EU, respectively.

However, any geopolitical escalations such as in the Russia-Ukraine war may lead to higher inflation for longer, which may lead to volatility in equities.

As a result, our chosen pick for this week is the **Absa NewFunds ILBI ETF** which aims to protect investors against inflation and improve portfolio diversification.

Investment environment

SA headline inflation climbed an annualised 7.6% in October from 7.5% in September, contrary to consensus estimates which predicted a moderate decline. Food and non-alcoholic beverages continued to edge higher as they increased an annualised 12%, adding 2.1 percentage points to the headline figure. Transport contributed 2.4 percentage points while housing utilities added 1.1 percentage points.

The high inflation prompted the SARB to hike the repo rate by a further 75 basis points to take the repo rate to 7%. SA's economy proved to be resilient despite power outages and higher interest rates as Q3 GDP came out an annualised 1.6% largely supported by the agriculture, forestry and fisheries sectors which grew 19.2%.

The Federal Reserve also increased the fed funds rate by 75 basis points, which helped the dollar to rally strongly as investors were looking for a safe haven.

The stronger dollar hurts US conglomerates by making dollar-denominated goods more expensive, thus reducing the affordability of customers outside the US. Amazon, Apple, Nike, Microsoft and Tesla are some of the companies which labelled a stronger dollar as a headwind to revenue and earnings.

Inflation will likely remain a cause for concern over the medium term and restrictive monetary policy will not be adequate to address it. Global supply chain disruptions, the Russia-Ukraine war and elevated energy prices are some of the main contributors to global inflation. It is against this backdrop that investors should consider inflation-linked bonds. These bonds offer protection against soaring prices.

As the name suggests, inflation-linked bonds are indexed to inflation so that interest and principal payments correlate with the rate of inflation. Moreover, these bonds offer diversification benefits in a broader portfolio context. Generally, the performance of government bonds is closely linked to a country's sovereign credit rating. Rating agencies such as Moody's and S&P Global look at a multitude of factors such as political stability, the current account balance, debt to GDP ratio, economic growth and revenue base.

The Absa NewFunds ILBI ETF invests solely in SA government bonds, which have a low probability of default although rated as sub-investment grade by S&P Global, Moody's and Fitch Ratings.

S&P kept SA's credit rating unchanged and left its outlook as positive in November. The rating agency pointed that although Eskom remains the country's single biggest risk, that it expects government enabling increased private sector participation in the energy space to support growth over the next two to three years. It also warned that although high commodity prices and better-than-expected revenue collection helped provide windfall revenue, that these tailwinds are not sustainable.

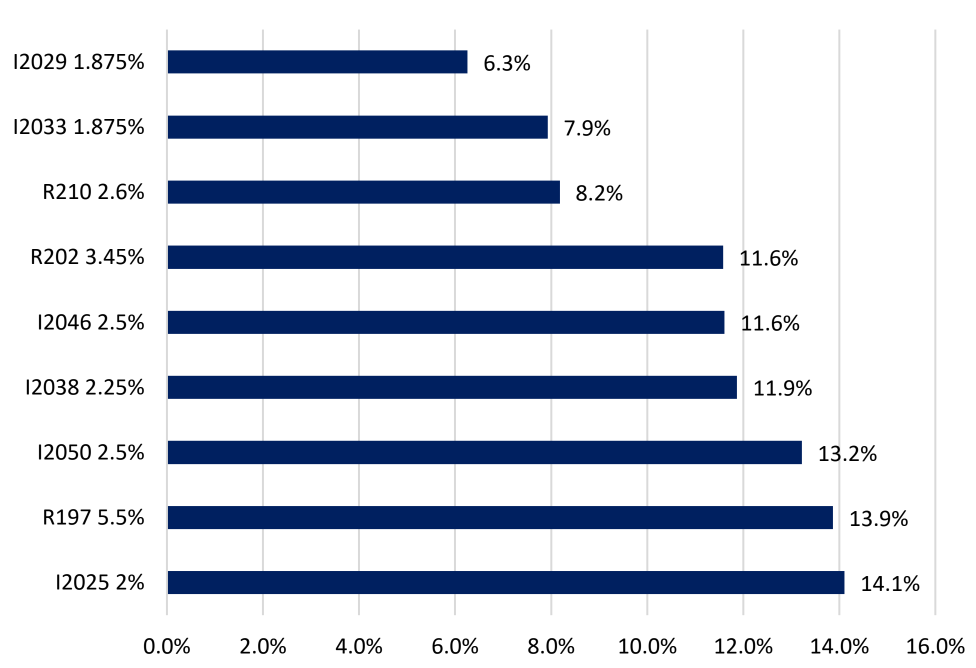
Fitch Ratings also affirmed a BB- rating (sub-investment grade) on SA's long term foreign currency issuer default rating with a stable outlook. In line with S&P, Fitch welcomed the better-than-expected revenue but was wary on its sustainability. It also mentioned that power outages remain one of the key risks to this rating. Fitch expects real GDP to grow by a mild 1.6% and 1.1% in 2022 and 2023, respectively.

The ETF returned an annualised 6.4% over the past year and 5.2% over the last five years. It has a reasonable total expense ratio of 0.35% and tracking error of 0.1%, suggesting that the fund tracks its index very closely. In addition, the fund has a moderate portfolio size of R115m. It is suitable for risk-averse investors who seek downside protection against inflation.

Investment approach and portfolio composition

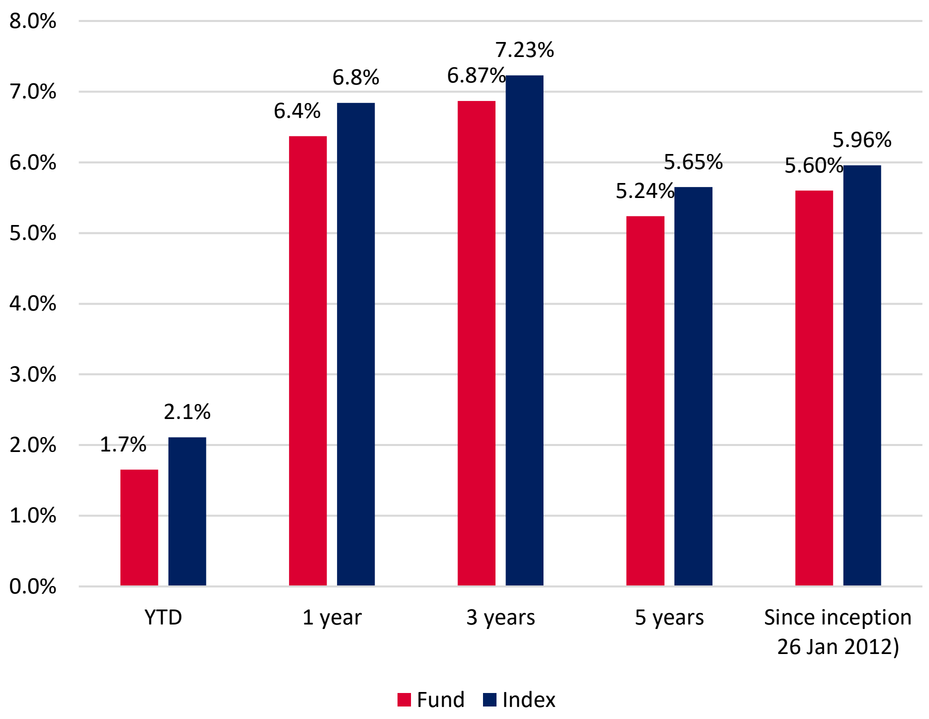
The Absa NewFunds ILBI ETF tracks the Barclays/Absa South African Government Inflation-Linked Bond Index to protect investors against downside risk of inflation.

Top holdings (%)



Performance

Index performance to end-November 2022 (annualised for periods longer than one year; with dividends reinvested)



Fund information as at 30 November 2022

Launch date	26 January 2012
Trading symbol (JSE)	NFILBI
Weighted average market cap.	R115m
Total expense ratio	0.35%
Risk rating	Medium
Benchmark	Barclays/Absa South African Government Inflation-Linked Bond Index

Market data: 08 December 2022

Spot price	R80.90
12-month high	R84.66
12-month low	R78.81
Average monthly volume	3,221
Gross dividend yield	2.87%

Source: Infront, yahoo finance