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**Satrix Rafi 40 ETF (JSE:STXRAF)**

18.03.2022

**Fund suitability**

This ETF is suitable for investors who would like to gain exposure to equities through fundamental analysis using an ETF.

**Fees**

The fund's total investment charge is 0.57%.

**Alternative funds**

None

The equity market is driven purely by fundamentals – something that's ideal for non-technical investors. Fundamental investing, specifically within equities, involves analysing and researching as much publicly available information about companies as possible when deciding to buy or sell their shares.

Financial statements are at the core of fundamental investing, as financial analysis includes the calculation and forecasting of key variables such as profitability (gross and operating), solvency (debt:equity) and cash flow (free-cash flow yield) ratios. While many investors pour over financial statements and non-financial information as part of their fundamental equity research, others employ technical analysis.

While not the focus of this week's ETF pick, technical analysis is a solid method in its own right. Investors analyse trading and volume patterns of share prices for trends to inform buy or sell decisions when using this approach to investing. Resistance and support levels are some of the many concepts in the toolkit of a technical investor – the former refers to a point on a price chart where the prospect of a share price increasing is limited by investors or the market's inclination to start selling. The latter is the opposite, a short term price level where the market is inclined to start stocking up on the share price as it is deemed relatively attractive at such levels.

But do fundamentals drive share prices? Yes, but the results are mixed across global equity markets. Research by Steyn (2019) analyses the JSE over a 20-year period from 1997-2018 using data from

the top five sectors - mining, banking, life insurance, mobile telecommunications and real estate investment trusts (REITs).

Steyn found that financial ratios had a statistically significant relationship with the movement in share prices across the five sectors. For example, return on equity, dividend yield and debt:assets were three of the six ratios found to influence share prices in the mining sector.

Of course, no study is without limitations as the author rightly points to the fact that fundamentals cannot be used in isolation in equity investing. From a broader market perspective, unexpected company scandals (who will ever forget Steinhoff), macroeconomic, or geopolitical factors often trump the fundamentals, resulting in high volatility which may lead to periods of underperformance. Russia's intensifying and cynical invasion of Ukraine is a case in point and the resultant volatility in equity markets is a test of investors' resolve.

The explanatory power of fundamentals informs the week's ETF pick. The Satrix FTSE Rafi 40 ETF tracks the performance of the FTSE/JSE Rafi 40 Total Return Index. The index assigns weights to shares using fundamentals such as sales, cash flow, book value and dividends. This results in a portfolio which includes the highest ranking companies through fundamentals.

Investors would have been rewarded for following this strategy in the last year, as the fund returned 39% to end-January 2022 relative to its Top 40 counterpart managed by Satrix that returned 23%.

While past performance is not indicative of future performance, we believe that an allocation to a fundamentally-weighted ETF is useful. It can potentially identify the best performing companies for ETF investors without the higher cost of active management which also seeks to find potential outperformers.

However, it is important to note two key differences: the ETF relies on historical information to include its constituents and basic fundamentals. An active manager uses historical information to forecast estimates of the fundamentals, which is forward-looking.

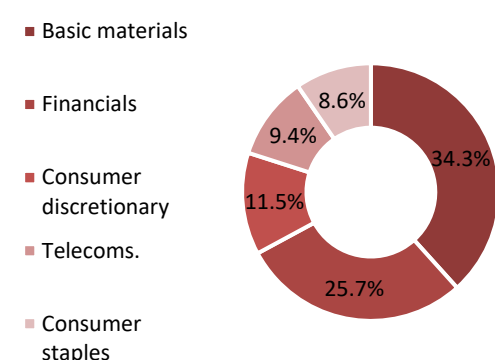
In addition, the financial research is typically more sophisticated. Calculating free cashflow is a useful example. According to Research Affiliates, the patent owner of the Rafi methodology for this ETF, cash flow is calculated by adding depreciation and amortisation to operating income.

While useful, this measure does not capture the highly important effect of the day-to-day funding of a business, known as working capital. It also excludes another important drain on cash - capital expenditure. These two factors form part of a more sophisticated measure of free cash flow used in active management.

The ETF has an estimated total investment cost of 0.57%, which is slightly expensive in our view. Again, investors may be able to counter this by adding it to an overall ETF portfolio with the potential of decent returns when fundamentals are driving equity market returns.

**“Financial statements, which are at the core of fundamental investing, are used to calculate key profitability, solvency and cash-flow ratios”**

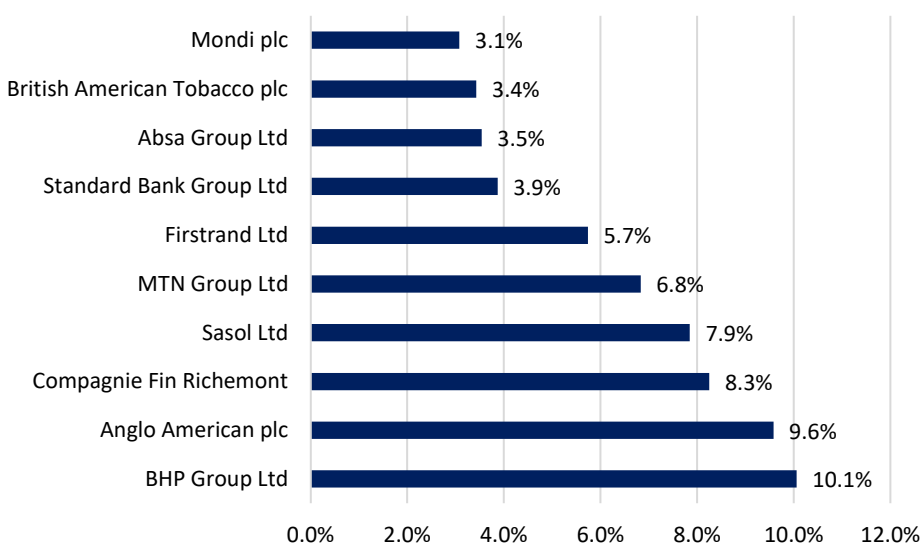
**Sector allocation – top 5 (%)**



**Investment approach and portfolio composition**

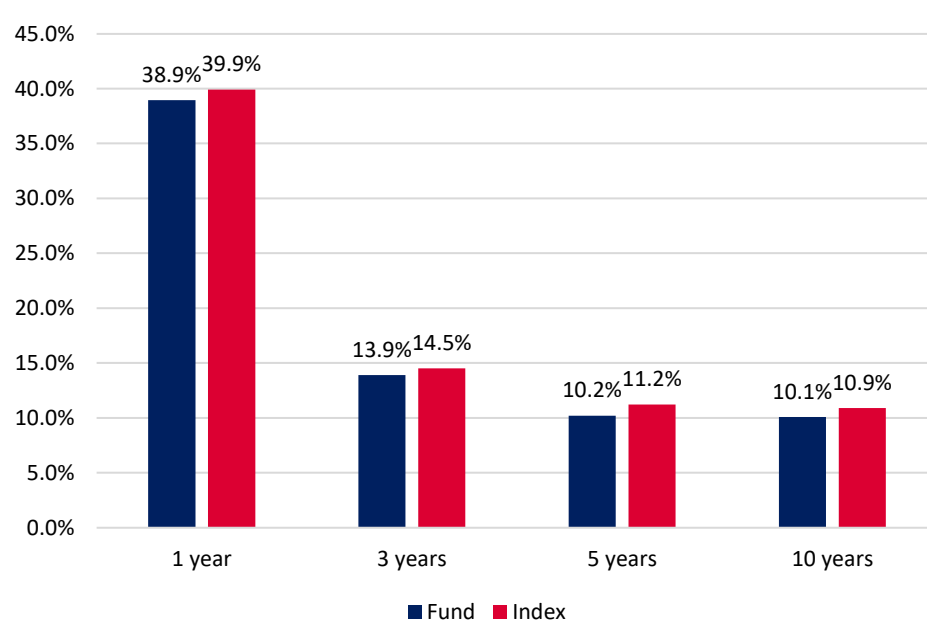
The Satrix Rafi 40 ETF tracks the performance of the FTSE/JSE Rafi 40 Total Return Index before fees and expenses.

**Top holdings (%)**



**Performance**

**ETF and index performance to end-January 2022 (annualised for periods longer than one year; with dividends reinvested).**



**Fund information: 31 January 2022**

Launched on	16 October 2008
Trading symbol (JSE)	STXRAF
Weighted average market cap.	R1.2bn
Total investment charge	0.57%
Risk rating	High
Benchmark	FTSE/JSE Rafi 40 Total Return Index

**Market data: 17 March 2022**

Spot price	R21.52
One-year high	R22.46
One-year low	R15.65
Ave monthly volume	846,660
Dividend yield (estimated)	2.7%

Source: [www.etfsecurities.com.au](http://www.etfsecurities.com.au), yahoo finance

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