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Researching Capital Markets and Financial Services

Prepared for clients of EasyEquities

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CoreShares Scientific Beta Multifactor ETF (JSE:SMART)

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Fund suitability

This ETF is suitable for investors who would like to like to invest in equities using a multifactor approach over a long-term horizon

Fees

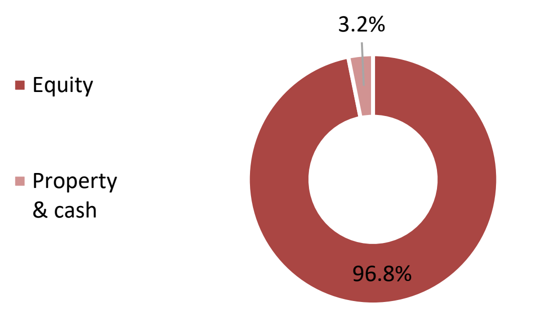
The fund's total investment charge is 0.72%.

Alternative funds

None

"A bottom-up, multifactor approach to equity investing results in a portfolio of 'all-rounder' stocks with maximum exposure to each factor"

Asset allocation (%)



The MSCI World Growth, Value, Low Volatility and Momentum indices were down by an average of 2.2% in February as Russia began its war on Ukraine. Given the fluid situation on the ground and the volatility in global markets, it is difficult to determine the outlook for equities.

The devastating humanitarian cost is clear though and the war will also have lasting effects on the real economy. Regarding the latter, commodity price increases will benefit SA but at the cost of a spike in inflation for already strained consumers.

Rising inflation was already problematic and probably one of the single most prominent risks to the global economic recovery, especially towards the end of 2021. Specifically, price levels were driven higher by supply chain issues globally and increasing energy costs. Broadly, energy costs have been rising due to strong post-pandemic demand and low supply as a result of under-investment in fossil fuel industries due to climate change commitments.

Despite the inflationary backdrop, one of the main features of the global economic recovery was market expectations of a rotation out of growth into value shares. Underpinned by the global economic recovery, value shares were seen as favourable as they are more closely tied to the economic cycle (industrials, utilities etc) and would benefit from interest rate increases (eg, banks).

The latter is especially useful as markets started grappling with the timing and magnitude of tightening monetary policy in the US. Arguably, the volatility and uncertainty within global equities makes it difficult to stick to just one style, which leads us to this week's ETF pick.

The CoreShares Scientific Beta Multifactor ETF exposes investors to well-researched styles (also known as factors) known to influence the return of stock prices. It tracks the performance of the Scientific Beta CS SA 6F EW Index. The index provides equal exposure to value, size (medium capitalisation), low volatility, momentum (high), high profitability and low investment styles (high cash flow) within the SA equities universe.

The case for a multifactor approach lies in the cyclicality of returns when choosing one style. Research by S&P Dow Jones Indices finds that while choosing a single factor (eg, S&P500 momentum) can lead to outperformance over the long term, that cyclicality can lead to underperformance for long periods throughout the investment horizon.

Consequently, the research recommends a "bottom-up" approach to multifactor portfolios by combining the individual factor scores and assigning a score to each stock.

The result is a portfolio with exposure to all-rounders – shares that rank well across all factors. When comparing the performance of the multifactor portfolio with the index of indices and single factor indices, S&P Dow Jones Indices reports that the multifactor portfolio outperformed both its counterparts over five, 10 and 15 years.

CoreShares applied this bottom-up approach to the SA market. Using data from July 2002 to April 2018, it found that the Scientific Beta CS South Africa 6F EW Index returned 17.7% relative to the 13.5% and 14.7% returned by the FTSE/JSE Top 40 and Swix 40 indices. This was achieved with a lower risk and maximum drawdown (single loss over the period) but with an increased amount of constituents.

However, given the outperformance of both studies, it is important to highlight that this approach is not without risk. When the correlations (co-movement) of factors deviate from normal levels, as may be the case during times of market distress, then investors may endure long periods of underperformance.

Also, multifactor strategies are not prevalent in SA, which combined with the fund's small size may explain its relatively high cost of 0.72%. However, it somewhat makes up for this with a decent dividend yield of 3.1%.

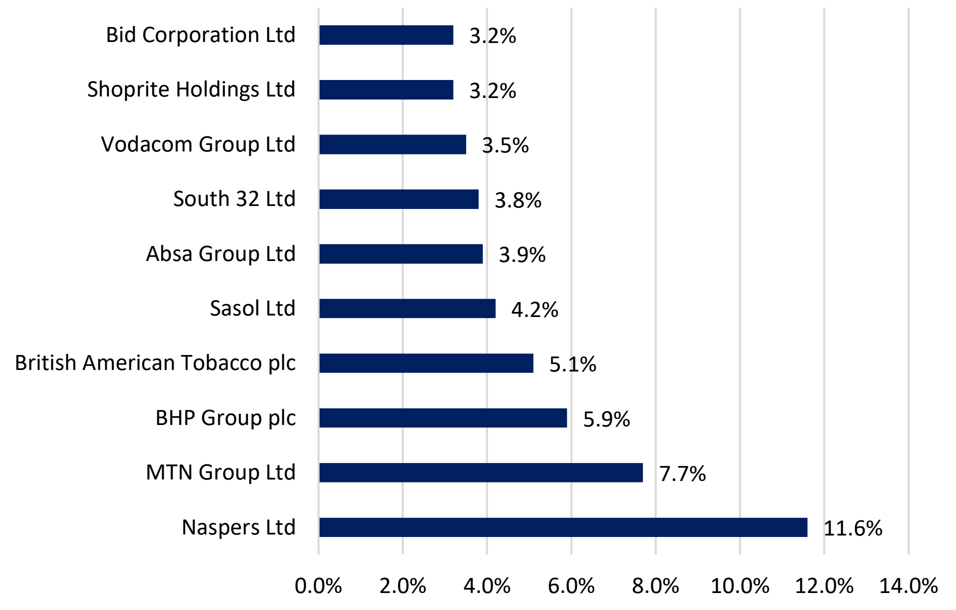
Overall, we expect global equities to remain under pressure in the foreseeable future, as companies grapple with the effects of the war on global trade, the supply chain and input costs.

In SA, non-mining, consumer-facing companies are in for a potentially challenging time as these effects will exacerbate the already tough economic conditions. In such an environment, throwing the dice at more than just one factor may be useful for investor portfolios.

Investment approach and portfolio composition

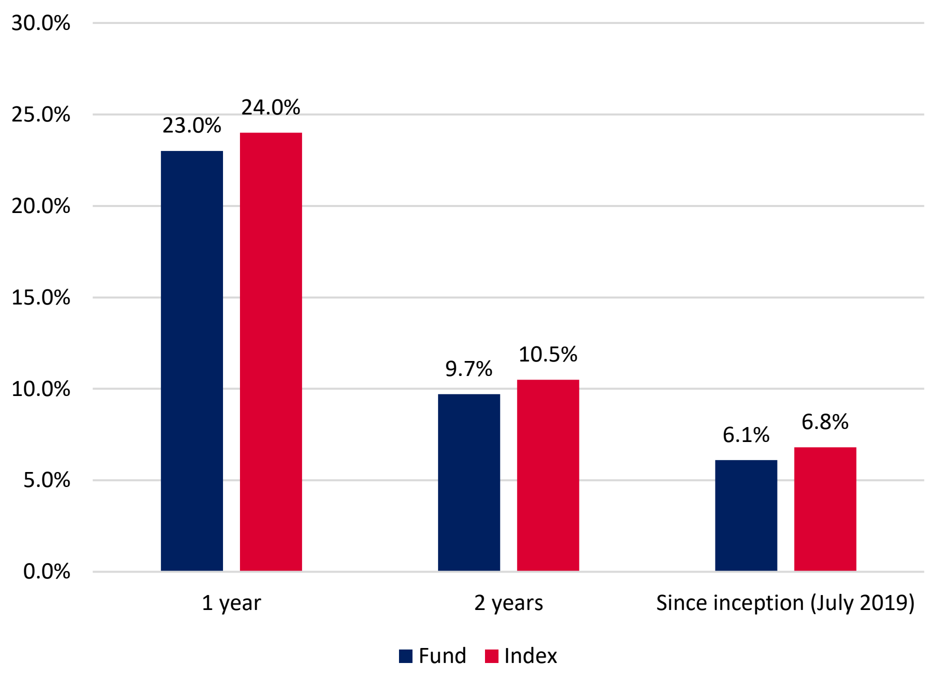
The CoreShares Scientific Beta Multi Factor ETF tracks the performance of the Scientific Beta CS South Africa 6F EW Index before fees and expenses.

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	10 July 2019
Trading symbol (JSE)	SMART
Weighted average market cap.	R128m
Total investment charge	0.72%
Risk rating	High
Benchmark	Scientific Beta CS South Africa 6F EW Index

Market data: 08 March 2022

Spot price	R47.53
One-year high	R51.22
One-year low	R42.23
Ave monthly volume	55,366
Dividend yield (estimated)	3.1%

Source: www.etfsecurities.com.au, yahoo finance