intellidex
Researching Capital Markets and Financial Services

ETF Insights.

Prepared for clients of EasyEquities

The ETF Review

November 2022

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!

Broad-based energy price and interest rate increases around the globe

IN THIS ISSUE:

The Medium-Term Budget Policy Statement made headlines as its announcement of better-than-expected revenue was welcomed by ratings agencies such as Moody's, but the agency warned that SA's economic growth prospects will remain bleak until structural issues are dealt with. The windfall revenue also enabled the national treasury to provide financial support to some of the ailing SOEs such as SANRAL and Transnet.

The country recorded a trade balance surplus of R19.70bn for September, owing to exports which were 22% higher than September 2021's according to SARS. This can be partially attributed to the weaker rand, which generally encourages exports. While the trade balance surplus is welcomed, it presents a conundrum for the SARB as SA imports goods at far higher prices (due to the weaker rand), thus leading to high and persistent inflation which implies that interest rates will be higher for longer.

The selection of ETFs is made with the market themes above in mind:

- Absa NewFunds Low Volatility ETF
- Satrix FINI ETF
- Satrix Global Infrastructure ETF
- Sygnia Itrix S&P 1200 ESG ETF
- Satrix ILBI ETT
- CoreShares S&P Dividend Aristocrats ETF

Intellidex's favourite ETFs

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

Sabelo Mnisi, 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?

Monetary policy officials continued their efforts to tame inflation by aggressively increasing interest rates despite weaker economic growth prospects.

The S&P 500 index bounced back 8.1% as investors took comfort from Jerome Powell’s remarks that the Federal Reserve might scale back on the pace of its tightening program in the months ahead. The Dow Jones Industrial Average rose 14.1%, while the tech-heavy Nasdaq 100 gained 4%. The energy sector was the best performer soaring 25% on the back of OPEC’s decision to curtail oil production. Locally, the JSE All Share Index expanded 4.0%.

The dollar lost some ground against major currencies except the Chinese yuan as the Communist Party Congress signalled that it would not let go of the country’s zero Covid policy.

Gold shed 1.8% - its seventh consecutive monthly decline. Iron ore prices also continued to tank amid weaker demand from top importer China. Prolonged weakness in the Chinese property sector is among the key factors weighing on the demand for the commodity.

The economic environment

Globally, there was a lot to digest in the month of October, while the locally the MTBPS drew significant attention. Enoch Godongwana delivered a mini budget in which fiscal projections trended higher, mainly supported by revenue overruns. The budget deficit for 2022/23 has been revised downward to 4.9% from 6.0%.

If tax receipts proceed along this path of higher trajectory, government revenue will exceed non-

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.

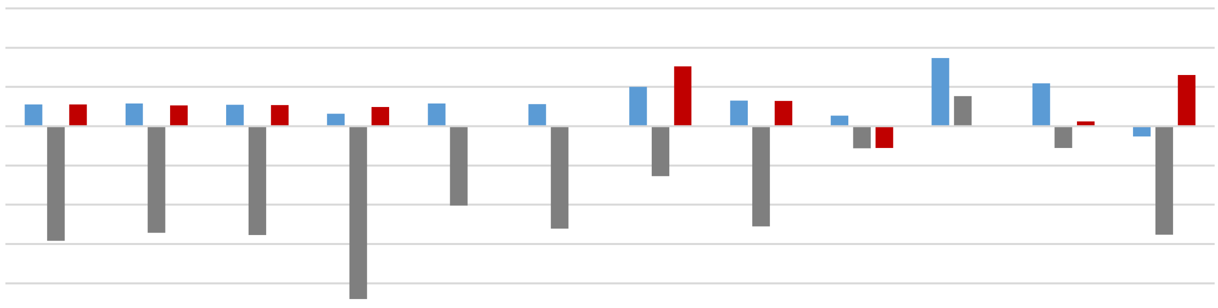
The favourites:

Domestic equity: Absa NewFunds Low Volatility (NFEVOL) and Satrix FINI (STXFIN) ETFs

As volatility persists, we advocate for low volatility ETFs such as the Absa NewFunds Low Volatility ETF (+8.7%). The fund is one of the few who have yielded positive returns year-to-date. It invests in 20 highly liquid stocks that exhibit low volatility and low correlation with the overall market. It is relatively costly though, coming a Total Expense Ratio (TER) of 0.50%. The ETF consists of defensive sectors such as healthcare, consumer goods and telecoms. Some of the stocks within these sectors are attractive at current valuations. The fund has a fairly low net asset value of R124m.

We expect inflation to persist until supply chain disruptions and the war in Ukraine are resolved. These challenges will require more than monetary and fiscal policy to resolve. As a result, we favour the Satrix FINI ETF (+11.5%). The underlying index consists mainly of financial companies. Financials such as banks and insurers stand to gain from a rising interest rate environment because they generally have a sizeable amount of cash on their balance sheets or are able to lend to customers at higher interest rates. The fund comes at a reasonable TER of 0.43% and it is the only one of its kind which invests solely in

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	2.8%	2.9%	2.7%	1.6%	2.9%	2.8%	5.0%	3.3%	1.3%	8.7%	5.5%	-1.3%
■ YTD	-14.6%	-13.6%	-13.9%	-22.0%	-10.1%	-13.0%	-6.4%	-12.7%	-2.8%	3.8%	-2.8%	-13.8%
🟥 5-year	2.8%	2.6%	2.7%	2.4%	0.0%	0.0%	7.6%	3.2%	-2.8%	0.0%	0.6%	6.5%

interest government expenditure in 2023/24 for the first time in 15 years. In addition to lowering the budget deficit, the additional revenue allowed national treasury to extend the social relief distress grant to March 2024. Further to this, the extra revenue created room for the government to provide financial support to some of the ailing state-owned enterprises such as SANRAL and Transnet who will receive R23.7bn and R5.8bn respectively.

The national treasury also stated that it will take over a sizeable portion of Eskom's debt, which is almost R400bn. Although the bailout amount is unclear, the national treasury has reassured investors that the debt relief will put Eskom's debt on a sustainable path and will ensure no bailouts going forward.

Moody's Investor Service believes that while the debt relief will support the power utility's balance sheet, it is not enough to resolve maintenance and operational challenges, which add to some of the key impediments to SA's long-term sustainable economic growth. The rating agency already accounts for Eskom's debt when computing SA's debt to GDP ratio, implying no immediate change for the Ba2 (sub-investment) credit rating. However, Moody's commended the country's commitment to fiscal consolidation – thanks to improved revenue collection – but expects economic growth to be around 1% to 1.5% over the coming years unless structural issues such as infrastructure development are dealt with.

Transnet went on an 11-day strike, costing exporters of coal, iron ore, chrome, ferrochrome and manganese about R815m a day as they were unable to transport goods by rail on to ships, according to the Minerals Council SA. This was a big blow for the revenue of the cash-strapped SOE and SARS.

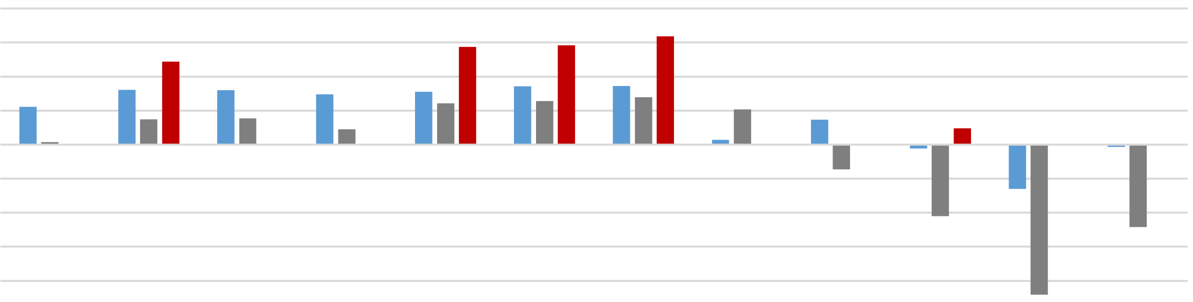
financials. While sentiment is quite bearish on SA, our banking and insurance sectors rank as one of the best by global standards due to their respective safety and soundness. The ETF has returned an impressive 11.2% year-to-date and is well capitalised with a net asset value of R980m.

Foreign equity: Satrix Global Infrastructure (STXIFR) and Sygnia Itrix S&P 1200 ESG (SYGESG) ETFs

While stock markets have had to contend with minimal to negative returns year-to-date, one of the key areas that remain on the rise is infrastructure. President Joe Biden and former president Donald Trump have approved major infrastructure programmes in recent years. The global infrastructure market was valued at $2.2bn in 2021 and was forecast to reach $3.4bn by 2027, according to Mordor Intelligence. ETFs are a good access point to investments in the sector. This brings us to our first offshore ETF pick which is the **Satrix Global Infrastructure ETF (+4.0%).** Launched in September 2021, the fund has yielded a return of 7.8%, with a relatively high TER of 0.77%. It has a specific focus on worldwide companies involved in core infrastructure activities, including development, ownership, operation, operation, management and maintenance of structures.

While the sell-off has been protracted, we believe it has resulted in price dislocations and opened room for investors to pick up stocks at

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



	GLOBALJ.J	STXWDMJ.J	ETFWLDJ.J	STXESGJ.J	CSP500J.J	SYG500J.J	STX500J.J	GLODIVJ.J	STXNDQJ.J	STXEMGJ.J	SYGEMFJ.J	STXEMEJ.J
🟦 1-month	5.5%	8.0%	8.0%	7.4%	7.8%	8.6%	8.6%	0.7%	3.7%	-0.6%	-6.5%	-0.3%
■ YTD	0.4%	3.7%	3.8%	2.3%	6.0%	6.4%	7.0%	5.2%	-3.6%	-10.5%	-22.0%	-12.1%
🟥 5-year	0.0%	12.2%	0.0%	0.0%	14.3%	14.6%	15.9%	0.0%	0.0%	2.4%	0.0%	0.0%

These are among the structural issues that dampen investor sentiment. It will be interesting to assess how the strike influenced SA's trade balance for October once those statistics become available. Trade balance is crucial as it is one of the keymetrics used by rating agencies when making a credit assessment of a country.

While September's trade balance surplus of R19.70bn is welcomed, it presents a conundrum for the SARB as SA imports goods at far higher prices (due to the weaker rand), thus leading to high and persistent inflation.

SA's economy is relatively small, which makes Headline inflation eased for the second consecutive month to 7.5% year-on-year in September from 7.6% in August, still higher than the target range of 3 to 6%. Food and non-alcoholic beverages, housing utilities and transport were among the biggest contributors to the high inflation rate, as was the case in August, contributing 2.0, 1.0 and 2.5 percentage points respectively. The core inflation rate - which excludes volatile items such as food and energy – ticked up slightly to 4.7% from 4.4%.

Producer price inflation also eased printing at 16.3% from 16.6% in August, suggesting that producers are absorbing a significant portion of price increases, which will likely squeeze their profit margins. Petroleum, rubber and plastic products contributed 8.6 percentage points to PPI, while food products added 3.1 percentage points.

Retail trade sales increased by 2.0% year-on-year in August 2022. Positive annual growth rates were recorded for general dealers (6.4%), retailers in textiles, clothing, footwear and leather goods (4.8%), retailers in household furniture, appliances and equipment (2.7%) and all other retailers (1.0%).

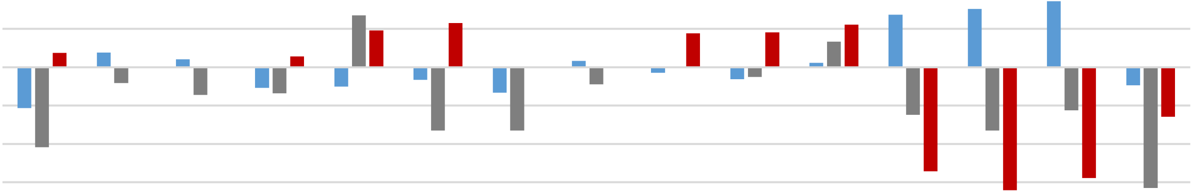
attractive prices, which brings us to our second pick which is the **Sygnia Itrix S&P Global 1200 ESG ETF (7.8%)**.

Sentiment is quite bearish on developed markets, especially in Europe as the region is experiencing extreme price pressures as a result of its dependence on Russian oil and gas supplies. What's exciting about this ETF is that it holds stocks that meet a sustainability criteria. ESG ETFs have seen net inflows of $4.5 billion through the end of May, according to data from Trackinsight. There have been over 25 new global ESG ETFs that have launched so far this year, with climate change and carbon transition remaining a popular theme. These funds are aimed at taking advantage of investment pledges made by asset managers and governments to reduce carbon emissions. For example, President Biden signed the Inflation Reduction Bill into law in August 2022. The bill directs about $370bn towards producing clean energy. The fund comes at a low TER of 0.36%, which is attractive for an offshore fund.

Bonds and cash: Absa NewFunds ILBI (STXILB)

We continue to favour SA bonds as they pay a premium for being rated as sub-investment grade. The **Satrix ILBI (-1.6%)** is compelling in the current inflationary environment. It has the lowest TER (0.25%) in its class and a net asset value of about R500m. Inflation has been a cause for concern for monetary policy officials, businesses and consumers alike locally and internationally as it eats into purchasing power, profit margins and disposable incomes. A small economy such as SA is always vulnerable to inflationary pressures that

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



	GLPROPJ.J	STXGBDJ.J	ETFGGBJ.J	FNBINFJ.J	PREFTXJ.J	NFGOVIJ.J	STXGOVJ.J	ETFBNDJ.J	NFILBIJ.J	STXILBJ.J	NFTRCIJ.J	CSPROPJ.J	STXPROJ.J	ETFSAPJ.J	DIVTRXJ.J
🟦 1-month	-5.3%	1.9%	1.0%	-2.7%	-2.5%	-1.7%	-3.3%	0.8%	-0.7%	-1.6%	0.6%	6.9%	7.6%	8.6%	-2.4%
■ YTD	-10.4%	-2.0%	-3.6%	-3.4%	6.8%	-8.3%	-8.2%	-2.2%	-0.1%	-1.3%	3.3%	-6.2%	-8.2%	-5.6%	-15.7%
🟥 5-year	1.9%	0.0%	0.0%	1.4%	4.8%	5.8%	0.0%	0.0%	4.4%	4.6%	5.6%	-13.5%	-16.0%	-14.5%	-6.5%

Inflation continued to dominate investor sentiment particularly in the US and Eurozone. Inflation in the US slowed for the third successive month to 8.2% in September, still substantially above the desired level of around 2%. Core inflation was reported higher at 6.6% from 6.3%. Investors believe that the federal funds rate (currently 3.75 to 4.0%) will need to be above core inflation in order to see a meaningful reduction in the inflation rate.

Outlook and portfolio strategy

We expect central bank officials to continue raising rates aggressively in a bid to contain inflation. With effects of the pandemic still present, the war in Ukraine is adding upward pressure on food and energy prices, which is likely going to influence developing countries the most. The OECD expects world economic growth to slow mainly due to tighter monetary conditions.

In line with the OECD, the IMF expects world GDP to slow to 3.2% in 2022 from 6.0% in 2021, before easing to 2.7% in 2023 – the weakest growth forecast since 2001. The institution is of the opinion that central bank officials should stay on the path of taming inflation while fiscal policy should aim to ease the pressure of rising prices, particularly on poor households.

Going forward, the institution estimates that countries which account for about one-third of the world economy will experience at least two consecutive quarters of contraction. Overall, the IMF believes its economic growth forecasts are firmly tilted to the downside, with a high probability of world GDP to fall below the 2% mark.

The World Bank expects inflation to remain elevated, especially for commodities where Russia or Ukraine is a key exporter. The uptick in the prices of commodities such as oil leads to an increase in production and input costs in the agricultural sector, which pushes food prices upward. Similarly, soaring energy prices increase the costs of extracting and refining metal ores such as aluminium, steel and iron ore. In turn, this drives up the cost of renewable energy technologies.

As a result, we expect tighter monetary policy conditions to dominate financial markets over the medium term. While delivering a fourth consecutive

feed through the volatile exchange rate. It is necessary for investors to pay attention to the growth of their investments along with the inflation rate.

Inflation-linked bonds are designed to help protect investors from inflation. These bonds are indexed to inflation so that the principal and interest payments fluctuate with the rate of inflation. They offer additional benefits in a broader portfolio context. Headline inflation eased slightly to 7.5% year-on-year in September, from 7.6% in August.

Dividends: CoreShares S&P Global Dividend Aristocrats ETF (GLODIV)

As we did last month, we still advocate for the **CoreShares S&P Global Dividend Aristocrats ETF (+0.7%)**. The fund is up 5.2% year-to-date and has risen 7.8% over the last three years. It is suitable for investors who rely on regular income from investments. The underlying index is is in the red year-to-date and has significant weighting to consumer staples, financials and energy. It invests in high dividend-paying companies.

Dividend stocks yield capital returns in addition to regular income, which makes them less volatile than the overall market. Because of their lower volatility, dividend stocks often appeal to investors looking for lower-risk investments, especially those in or nearing retirement.

75 basis points increase in early November, the Fed signalled that future rate increases might be less aggressive because inflation appears to have peaked. However, markets believe that inflation is not likely to cool down until both the Russia-Ukraine conflict and supply chain disruptions are resolved.

Overall, we continue to favour companies that are able to pass on inflation to consumers. We also advocate for financial services such as banks and insurance companies as they are well positioned to benefit from the sharp interest rate increases. Profit margins for banks tend to widen as they charge higher interest rates on loans.

In the meantime, however, our ETF picks are once again made with a diversified portfolio in mind. This will enable investors to stomach the volatility and short-term losses that may ensue from current conditions. Encouragingly, the recent sell-off means that some sectors and parts of the market have become cheaper, which may reward investors willing to take advantage.

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