intellidex
Researching Capital Markets and Financial Services

ETF Insights.
Prepared for clients of EasyEquities

The ETF Review

September 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:

SA was hit by the worst loadshedding on record in September, which severely undermined the manufacturing sector and business confidence. As widely expected, GDP for Q2 came in at an annualised -0.7%, largely as a result of the KwaZulu-Natal floods and the blackouts. Growth in SA is likely to remain subdued.

Equities remained under pressure on fears of economic slowdown as major central banks continued to raise interest rates aggressively in a bid to combat inflation. The interest rate cycle was positive for the dollar as the greenback reached historic highs and weighed on earnings for US companies that have global footprints. The IMF revised downward its global growth expectations for the fourth time this year. Restrictive monetary policy is likely to dominate financial markets in the medium term.

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

- Absa NewFunds Value
- Satrix Top40 ETF
- Satrix MSCI Emerging Markets ETF
- Sygnia Itrix S&P 1200 ESG ETF
- Absa NewFunds ILBI ETF
- Absa NewPalladium 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?

Inflation remained stubbornly high, forcing central banks to hike interest rates aggressively, thus inflicting further pain across markets.

The S&P 500 index lost 9.34% while the tech-heavy Nasdaq 100 tanked 9.2%, which was their worst September performance since 2002. Locally, the JSE All Share Index lost 5.25%. The MSCI All Country World Index shed 9.7%, signalling that the poor performance of equities was across the board.

The performance of commodities was mixed. Brent crude oil fell 5.5% to $103/barrel while gold shed 2.5%. Palladium increased 12.1%, platinum rose 2.2% and silver gained 2.6%.

The economic environment

Stage six loadshedding returned, prolonged by the breakdown of several generation units coupled with planned maintenance, bringing Eskom's generation capacity to almost half. The unplanned power outages required the utility to deploy its emergency generation units – the dam-storage and diesel-fired turbines – which worked overtime. These reserve units are almost exhausted and need to be refilled, necessitating blackouts for longer.

In a bid to minimise the severity of loadshedding, Eskom announced a plan to accelerate the procurement of additional 1,000MW from independent power producers. This is nowhere near the estimated 16,000MW power deficit.

The cash-strapped utility has applied to the National Energy Regulator of South Africa for a 32% tariff hike for implementation on 1 April 2023.

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:

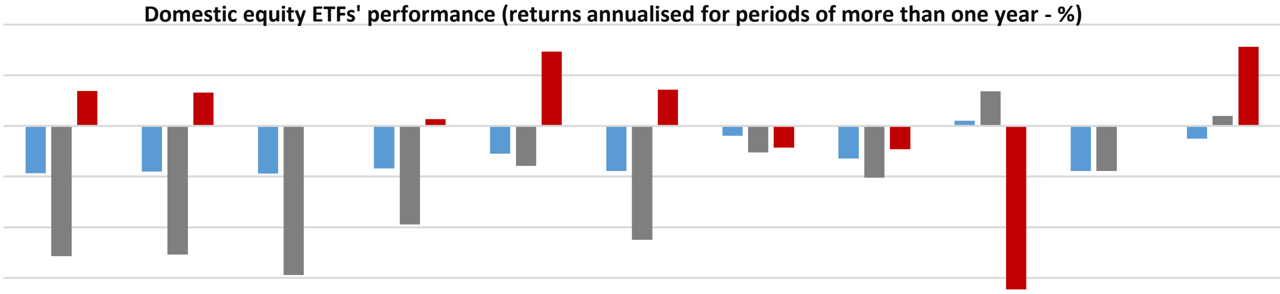
Domestic equity: Absa NewFunds Value (NFEVAL) and Satrix Top40 (STX40) ETFs

Most equity indices are in negative territory year-to-date on the back of low economic growth expectations. Inflation has remained elevated, necessitating central bank officials to raise interest rates aggressively, sending stock prices to bear market category. Some of the stocks are attractive at current valuations. Our first pick is the **Absa NewFunds Value Equity ETF** (0.5%). The fund provides investors with diversified exposure to 30 highly liquid stocks that exhibit value characteristics with reasonable market value.

The expected economic slowdown changes the question from "where to hide?" to "how to hide?" as a sell-off in stock markets generally accompanies a recession. We believe that holding good quality and highly liquid stocks in a portfolio will be beneficial in the long term when inflation cools off and interest rates come down. The fund is costly though, coming at a total expense ratio (TER) of 0.50%.

Satrix Top 40 ETF (-4.7%) is one of the largest ETFs by total portfolio size listed on the JSE. The companies within the underlying index represent about 80% of the JSE all share index, making it a

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



	STX40	ETFT40	SYGT40	ETFSWX	STXRAF	CTOP50	GIVISA	SMART	NFEVAL	NFEVOL	STXDIV
1-month	-4.7%	-4.5%	-4.7%	-4.2%	-2.7%	-4.4%	-1.0%	-3.2%	0.5%	-4.4%	-1.3%
YTD	-12.8%	-12.7%	-14.7%	-9.7%	-4.0%	-11.2%	-2.6%	-5.1%	3.4%	-4.4%	1.0%
5-year	3.4%	3.3%	0.0%	0.7%	7.3%	3.6%	-2.2%	-2.3%	-16.1%	0.0%	7.8%

Initially, Eskom had applied for a 20.5% increase for 2023, but the regulator approved only 9.61%. The 32% is a reapplication and energy experts are of the view that the addendum submitted by Eskom might be approved this time around.

The S&P Global SA PMI for August was in expansion territory as it came in at 51.7, creating expectations of a decent economic performance in Q3. However, the power cuts are devastating for an already weak economy and therefore threaten manufacturing production. The RMB/BER Business Confidence Index for Q3 fell to 39 from 42, suggesting that six out of 10 respondents were dissatisfied with prevailing business conditions. Meanwhile, the FNB/BER Consumer Confidence Index rose just five index points to -20 amid high inflation.

Headline inflation did ease slightly to 7.6% year on year in August, from a 13-year high of 7.8% in July. Food and non-alcoholic beverages, housing utilities and transport were among the biggest contributors to the high inflation rate, contributing 1.9, 1.0 and 2.9 percentage points respectively.

The core inflation rate, which excludes volatile items such as food and energy, slowed to 4.4% from 4.6%. This is the SARB's preferred measure of inflation and is comfortably within the target range of 3-6%.

However, the current core inflation figures are not enough to convince the SARB to leave interest rates unchanged. Its monetary policy committee hiked the repo rate by 75 basis points in September to 6.25%, still lower than January 2019's 6.75%. The governor emphasised that one of the reasons for the rate hike amid low growth is to anchor inflation expectations and prevent secondary inflationary effects in which consumers increase borrowing to supplement incomes.

reasonable gauge of the market. While in the US the S&P 500 and the Nasdaq 100 are down more than 20% year-to-date, the JSE Top 40 index is down a comparatively moderate 14%. Most companies in the index generate sizeable revenue outside SA which exposes them to exchange rate movements, thus a rand depreciation leads to an increase to earnings, holding other things equal.

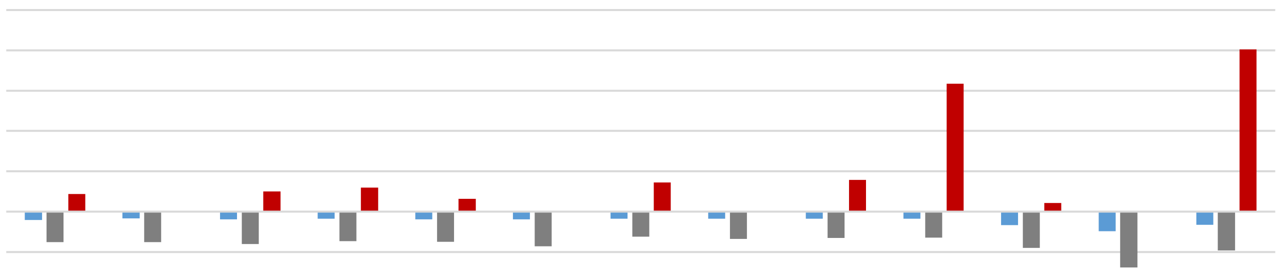
Sentiment is bearish on SA because of structural issues such as high unemployment and loadshedding. However, we believe the sell-off has been overdone. The index is trading at levels last seen in October 2021. The fund has a low TER of 0.10% and a tracking error of 0.09%, suggesting that the fund is rebalanced frequently to match the underlying index.

Foreign equity: Satrix MSCI Emerging Markets Feeder (STXEME) and Sygnia Itrix S&P 1200 ESG (SYGESG) ETFs

It has been difficult year for global equity markets as a result of a more hawkish stance by the US Federal Reserve and other central banks to combat inflation, which is at historic highs for most countries. Most indices have had a meaningful contraction, leaving investors with limited places to hide their money. Meanwhile energy stocks have outperformed as a result of high oil prices.

While the sell-off has been severe and painful, we believe it has resulted in price dislocations and opened the door for investors to pick up

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



	SYGESG	GLOBAL	SYGWD	STXWDM	ETFWLD	STXESG	CSP500	SYG500	STX500	ETF500	STXEMG	SYGEMF	STXEME
1-month	-4.1%	-3.4%	-3.8%	-3.5%	-3.8%	-3.8%	-3.5%	-3.5%	-3.5%	-3.5%	-6.7%	-9.7%	-6.5%
YTD	-15.2%	-15.1%	-16.1%	-14.6%	-15.0%	-17.1%	-12.5%	-13.6%	-13.1%	-12.9%	-18.0%	-27.8%	-19.2%
5-year	8.8%	0.0%	9.9%	11.9%	6.4%	0.0%	14.4%	0.0%	15.7%	63.5%	4.2%	0.0%	80.5%

The other reason for the steep increase is to minimise interest rate differentials with trading partners and to attract an inflow of funds from global investors.

GDP for Q2 shrank 0.7%, after two consecutive quarters of positive growth. This was largely expected as loadshedding disrupted productivity. The manufacturing industry slid an annualised 5.9%, contributing -0.7 of a percentage point to GDP growth. The agriculture industry declined 7.7% and contributed -0.2 percentage points to GDP growth. The mining industry was also one of the hardest hit – it declined 3.5%, which is its fourth consecutive contraction.

Real output of the tertiary sector grew 0.7%, supported by growth in transport, storage and communication as well as in finance, insurance, real estate and business services.
Inflation in the US remained elevated despite easing to an annualised 8.3% in August from 8.5% in July.

Core inflation ticked up to 6.3% from 5.9%, indicating that the price increases were broad-based, which was worrying for the Fed as it prefers to use core inflation to gauge price increases. The high inflation saw the Fed increase the federal funds rate by 75 basis points for the third consecutive time.

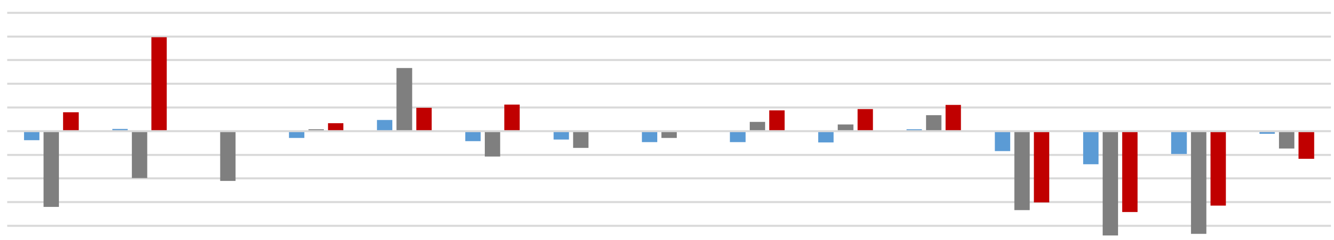
Liz Truss took over as UK prime minister in early September. Just days later her office delivered a mini budget, signalling intent to cut taxes for the rich. This raised concerns about the country's ability to raise revenue and reduce debt.

stocks at depressed prices. Sentiment on developed markets is quite bearish, especially in Europe as the region is experiencing extreme price pressures particularly on energy, thus bringing us to our first pick which is the **Satrix MSCI Emerging Markets Feeder ETF** (-6.7%). The underlying index consists of stocks from 27 emerging market countries such as Brazil, Chile, Taiwan, Thailand and United Arab Emirates and holds key sectors such as consumer staples, financials and information technology. Sectors such as consumer staples and financials are relatively well positioned to shield investors against price and interest rate increases respectively.

The fund has a total expense ratio of 0.40% and a low tracking error of 0.05%, suggesting that the fund is rebalanced frequently to match the index.

The elevated oil prices have nudged policy makers and investors alike to pay attention to renewables and socially responsible investing. Our second pick is the **Sygnia Itrix S&P Global 1200 ESG ETF** (-4.1%) whose underlying index holds stocks that meet sustainability criteria. ESG investments 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, Joe Biden signed the Inflation Reduction Bill into law in August 2022. The bill directs about $370bn towards producing

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



	GLPROP	STXGBD	ETFGGB	FNBINF	PREFTX	NFGOVI	STXGOV	ETFBND	NFILBI	STXILB	NFTRCI	CSPROP	STXPRO	ETFSAP	DIVTRX
1-month	-1.9%	0.4%	0.1%	-1.4%	2.4%	-2.1%	-1.8%	-2.3%	-2.3%	-2.4%	0.4%	-4.2%	-7.0%	-4.8%	-0.6%
YTD	-16.0%	-9.9%	-10.5%	0.4%	13.3%	-5.4%	-3.5%	-1.4%	2.0%	1.4%	3.4%	-16.7%	-22.0%	-21.7%	-3.7%
5-year	4.0%	19.9%	0.0%	1.7%	4.9%	5.6%	0.0%	0.0%	4.4%	4.6%	5.5%	-15.0%	-17.1%	-15.7%	-5.9%

The budget sent the pound to historic lows and the Bank of England intervened in the capital markets to inject liquidity and protect the value of the pound.

Outlook and portfolio strategy

The IMF this week downgraded its global growth expectations for the fourth time. The institution estimates that countries that account for about one-third of the world economy will experience at least two consecutive quarters of contraction. It expects that even if some of those countries record positive growth, it will feel like it is a recession because of shrinking real incomes as a result of inflation.

The World Bank expects inflation to remain elevated, especially for commodities where Russia or Ukraine are key exporters. The uptick in the prices of commodities such as oil leads to an increase in production and input costs for agriculture, 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, restrictive monetary policy will continue to dominate financial markets. Fed chair Jerome Powell stated that the committee will "do whatever it takes to beat inflation" and admitted that it will inflict some pain to households and businesses. The strong jobs report in September was interpreted as a green light for the Fed to raise interest rates even further in the future as the economy appears to be strong enough to withstand higher rates.

In light of the higher prices, we advocate for companies that are able to pass on inflation to consumers. Financial services such as banks and insurance companies 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. There is a saying in the market that there can be a good market or good prices, but the two are mutually exclusive.
While market participants are trying to predict the speed and magnitude in which the Fed will raise rates, InvesTech Research believes that the terminal rate – the point at which central bank officials think they will stop raising interest rates – is

clean energy. The fund has a total expense ratio of 0.36% and a low tracking error of 0.05%.

Bonds and cash: Absa NewFunds ILBI (NFILBI)

We continue to favour SA bonds as they pay a premium for being rated as sub-investment grade. The **Absa NewFunds ILBI ETF** (-2.3%) is compelling in the current inflationary environment. Inflation is causing headaches for monetary policymakers, businesses and consumers alike locally and internationally as it eats into purchasing power, profit margins and disposable incomes. An open economy that is a net importer of manufactured goods, such as SA, is always vulnerable to inflationary pressures that feed through a 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 7.6% year on year in August, from an over 13-year high of 7.8% in July.

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

On dividends, we go for **CoreShares S&P Global Dividend Aristocrats ETF** (2.7%). The underlying index is down a mild 3.58% year-to-date and has significant weighting to consumer staples, financials and energy. It invests in high dividend-paying companies. Financial companies such as banks and insurance companies are well positioned to benefit from interest rate hikes. Dividend stocks yield capital returns in addition to regular income, which makes them to be 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.

just as important. The Fed predicts that the federal funds rate will reach 4.4% from its current 3.25%. Consumption expenditure by households is likely to remain subdued as a result of inflationary pressures and low disposable incomes. The rising interest rates are likely to eat into earnings of indebted companies by increasing interest payments. Companies that generate earnings offshore will be affected by global events which we expect to be dominated by monetary policy in developed countries, the Russia-Ukraine war and the progress of China's economy.

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.

[Ends]