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Satrix SA Bond ETF (JSE: STXGOV)

26.04.2022

Fund suitability

This ETF is suitable for investors medium risk investors who would like to diversify their ETF portfolios

Fees

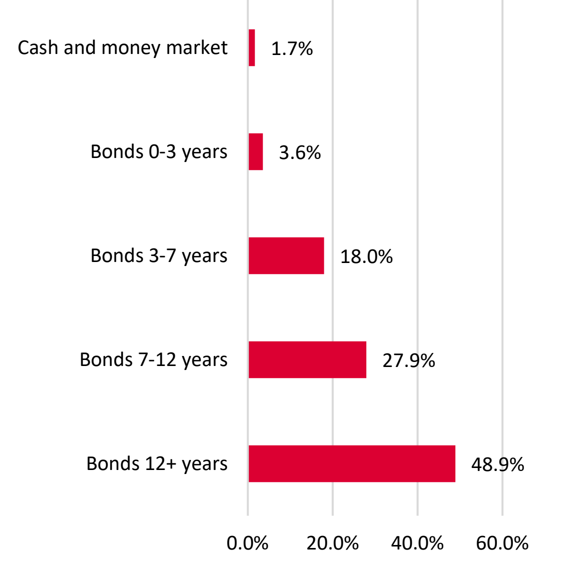
The fund's estimated total expense ratio is 0.25%

Alternative funds

1nvest SA Bond (TER:0.29%); NewFunds GOVI (TER:0.33%).

"The Satrix SA Bond ETF is useful for investors with a medium risk profile looking to diversify their ETF portfolios"

Maturity allocation – top 5 (%)



Local bonds have had a tough time of late as the South African Reserve Bank's rate hiking cycle is well on its way. Specifically, the SARB has increased its repo rate a cumulative 75 basis points since November, putting pressure on bonds as they have an inverse relationship with interest rates.

Russia's war on Ukraine has not helped matters, as the upward oil and commodity price shocks in response to the conflict have increased core inflation expectations locally, hence the SARB's hawkish outlook. Core consumer price index (and inflation) readings strip out volatile items like food, non-alcoholic beverages, fuel and energy. This enables market participants and the SARB to understand underlying price movements – when they are on the rise this shows signs of sustained price increases.

Given the role increased interest rates play in stabilising inflation and given that financial markets are typically forward-looking, investors often form outlooks and base investment decisions relative to broader market expectations of interest rate changes.

In the fixed income asset class context, investors can look at future interest rates in derivative markets (where the future price of an underlying asset is determined) that indicate the extent to which the broader market expects increases in the local interest rates.

Simply put, investors (whether active or passive) can choose to position their portfolios accordingly: for example, if the broader market is pricing in what appears to be too aggressive an interest rate path, then investors can position themselves by buying more bonds in anticipation of a less-aggressive rate-hiking cycle as yields have already spiked, making bonds cheap.

If investors prove to be correct in their assessment, the market's demand may increase due to adjustment to the less-aggressive interest rate path which makes bonds relatively more attractive, thus benefitting the investors who made the initial assessment of market conditions through research. The downside is that the ebb and flow of market factors can prove investors wrong, which may lead to a loss in returns, thus emphasising the need for a well-researched and long-term investment approach.

Interestingly, our example above appears to be the case with SA's nominal bond market. In its quarterly asset allocation publication, local fund manager Anchor Asset Management (Anchor) reports that the local derivatives market is pricing in 180 basis points of interest rate hikes for the rest of 2022 and another 70 basis points in 2023 – that would bring the repo rate to 6.75% by the end of next year.

However, Anchor forecasts a more moderate interest rate path due our milder inflationary backdrop relative to global peers. It expects hikes of 75 basis points more for this year and 100 basis points in 2023, which would increase the repo rate to 6.00%. Intellidex economists forecast the same increase in 2022 and another 75 basis points in 2023, with heightened risk of a 50 basis points hike in May. However, the current path of the forecast brings the repo rate to 5.75% in 2023.

Given the less-aggressive Anchor and Intellidex forecasts relative to the market, Anchor accordingly forecasts a 12-month 10% return from SA government bonds (9.3% from yield and 0.7% from capital gains).

Effectively, Anchor's view is based on SA's strong trade surplus that has been underpinned by a slump in imports at the height of the pandemic (2020) and strong commodity exports from late 2020 and most of 2021. Although imports have recovered as the economy has slowly reopened, this trend has continued into 2022 as commodity prices were further boosted by the Russia-Ukraine war and the rand's resultant strength in Q1 2022.

The strong trade surplus is a useful source of tax revenue for SA's strained fiscus and although this does not do enough to meaningfully reduce SA's debt burden and the risk of a debt trap (rising debt and poor economic growth), it does support a cautiously optimistic investment view relative to bearish market expectations.

The downside risk to this investment view though is that SA's headline inflation continues its upward trend – it increased to 5.9% annually in March 2021. Higher than expected inflation readings will increase the likelihood of interest rate hikes, thus putting further upward pressure on bond yields and negatively affecting bond prices.

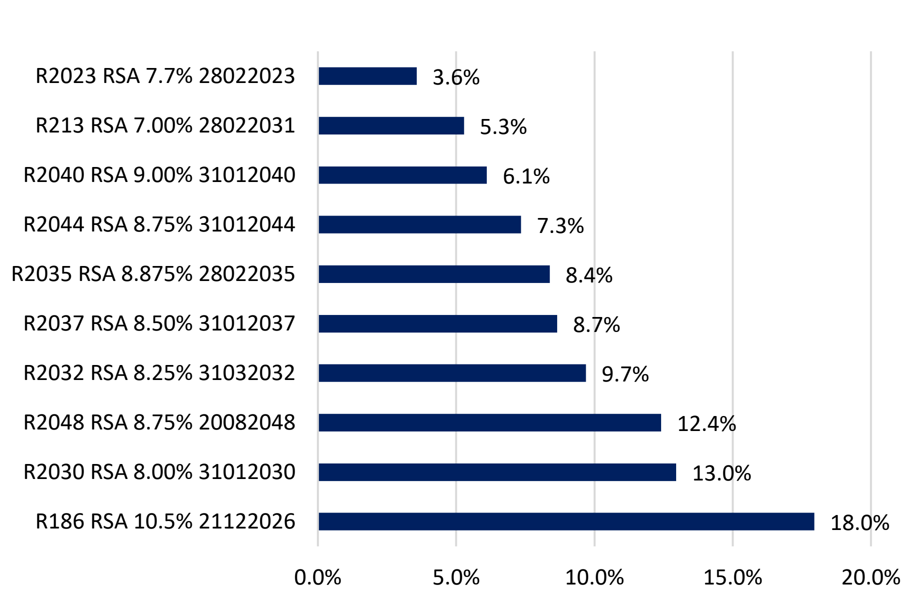
Given the investment view above, the Satrix SA Bond ETF is this week's pick. It tracks the performance of the S&P SA Sovereign Bond 1+Year Index. The index invests in SA government debt with maturities of one or more years in local currency and weights are assigned using the market cap method.

The ETF has best total expense ratio (0.25%) among its peers (1nvest SA Bond ETF – 0.29%; NewFunds GOVI – 0.33%) and a healthy dividend yield of 8.6%. The fund is useful for investors with a medium risk profile looking to diversify their ETF portfolios.

Investment approach and portfolio composition

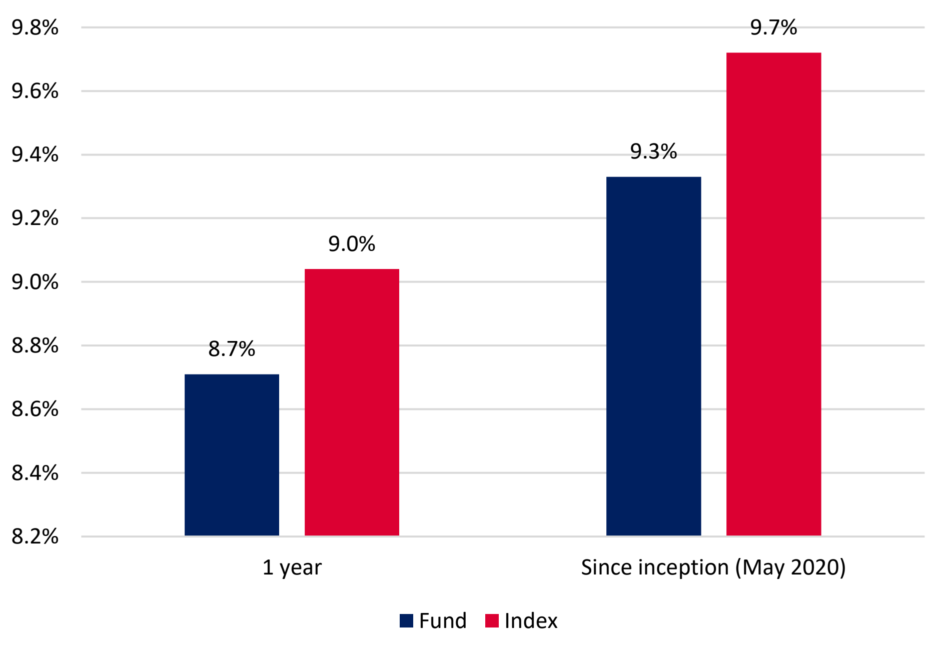
The Satrix SA Bond ETF tracks the performance of the S&P SA Sovereign Bond 1+Year Index before fees and expenses.

Top holdings (%)



Performance

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



Fund information: 28 February 2022

Launched on	7 May 2020
Trading symbol (JSE)	STXGOV
Weighted average market cap.	R618m
Total expense ratio	0.25%
Risk rating	Medium-High
Benchmark	S&P SA Sovereign Bond 1+Year Index

Market data: 25 April 2022

Spot price	R8.47
One-year high	R9.50
One-year low	R7.79
Average monthly volume	27,938,677
Gross dividend yield	8.6%

Source: Infront, yahoo finance