December 2018 ETF Review

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Each month, Intellidex scans the markets to come up with a list of its favourite ETFs. We classify all ETFs into five broad categories:

- Domestic equity
- International equity
- Bonds and cash
- Multi-asset
- Dividend-focused

Various empirical studies show 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. We then add a category for equity ETFs with an income theme.

Our picks should provide an investor with a relatively diversified portfolio, even if it was 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 simple but 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 its exposure to a single sector and/or a single counter. While ETF costs are still coming down as competition among local providers intensifies, 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.

What happened in the markets?

Overview

Global markets continue to be rattled by geopolitics and volatility has increased. Volatility on the JSE as measured by the Savi index was in the 20s for October and November, the first time it has been above 20 in almost two years. An equally weighted portfolio of non-commodity JSE-listed ETFs lost 1.74% in November. Funds that track local assets declined 0.69% on average while those that track global markets ended 3.36% down. Similarly, Intellidex's selection of ETFs, on an equally weighted basis, lost 2.04%.

Local funds and markets

Absa's NewFunds NewSA fund, which gives investors the opportunity to invest in companies with superior BEE credentials, was the top performer in November, climbing 5.21%. Similarly, top 40 Swix-weighted funds – which are relatively overweight in Naspers – performed well, averaging 3.27% as Naspers recovered from its October blues.

Contrarily, resources were hammered as the price of oil plummeted while the rand gained significant ground against the greenback. The NewFunds S&P GIVI SA Resource 15 fund was the worst performer, losing 8.68%.

Since the beginning of the year the performance of the JSE has been strongly correlated to the rand-dollar exchange rate, with the bourse showing strength when the rand exhibits some weakness. This is because global events on the JSE are reflected through the rand-dollar exchange rate.

Economically, we are beginning to see some green shots which should filter through to improved equity performance, if sustained. The big one was the economy growing by 2.2% in Q3 due to a broad-based recovery in manufacturing, agriculture and retail sales. Recent reports show that the momentum has continued into the fourth quarter with manufacturing output jumping by 3% (well ahead of the consensus forecast of 1%) in October compared with growth of 0.1% in September. This means factories are now producing more than at any time since June 2016. Mining also surprised, edging up by 0.5% in October, beating consensus forecasts of a decline. Furthermore, the Absa PMI rose to 49.5 index points in November from 42.4 in October. This was the first increase after three straight months of declines and brought the index to its best level since July 2018. This corroborates findings from the RMB/BER Business Consumer Index suggesting that economic growth might improve marginally in Q4.

Although Intellidex expects economic growth to improve next year to 1.7% from the 0.7% expected this year, we are cognisant of structural bottlenecks that need to be addressed before the economy can grow to levels around 5%. Bar the reforms needed to fix the economy, we believe the economy will be stuck in a low-growth trap of around 2% in the medium term.

Furthermore, unemployment remains stubbornly high with the economy shedding 16,000 jobs in the third quarter. And the consumer inflation rate inched up by 0.1 percentage points to 5.2% in November, somewhat vindicating the rate hike of 25 percentage points by the South African Reserve Bank.

International funds and markets

For funds containing international assets, the best performer, Sygnia's Itrix Global Property fund, rose 1.12%. At the other end of the continuum, the Sygnia/Itrix FTSE 100 ETF suffered a 5.32% loss on the back of the Brexit crisis. All other internationally focused funds, bar the Satrix MSCI Emerging Markets ETF, were in the red.

Global equities are dominated by US stocks which have outperformed other markets by quite a stretch. The US-Sino relations remain uncertain with a trade truce until March hanging in the balance. Making matters worse was the arrest in Canada of Huawei CFO Meng Wanzhou for allegedly violating US sanctions on Iran. These geopolitical developments have set global markets on a roller-coaster. However, early indications on the negotiations between US and China seem positive.

Meanwhile, mixed global economic data have failed to inspire a sustained recovery in the markets. The IMF has revised global growth downwards to 3.7% from 3.9%. A development with widespread consequences is the fast decline in the world oil price, which tumbled more than 23% in November due to a supply glut, to less than $60/barrel for the first time in more than a year.

In the US, the Federal Reserve chair hinted at a more cautionary stance towards further rate hikes as the policy interest rate is just below a level that would be neutral for the economy. Although this supported an equities recovery for a while it was overshadowed by escalating geopolitical tensions. News from the US Federal Reserve, combined with slower job growth, point to the likelihood of fewer interest rate hikes in 2019 than previously expected. Overall, the US economy remains on a firmer footing despite the marginal softening of its IHS Markit composite PMI output index to 54.4 in November, down from 54.9 in October.

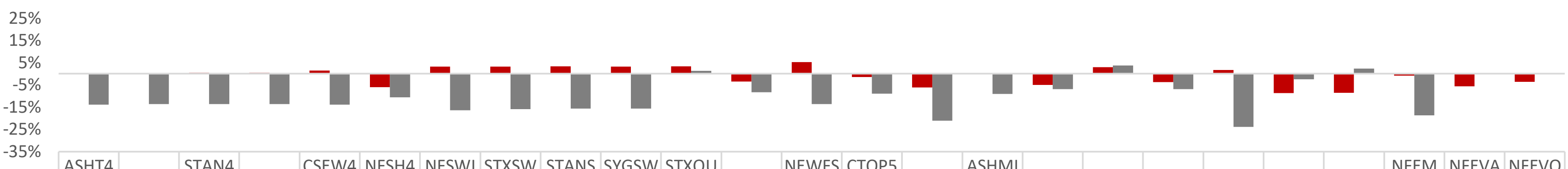
The eurozone continues to weaken with the IHS Markit composite PMI falling to an almost four-year low of 52.4, from 53.1 in October. This is reflected in the Sygnia/Itrix EuroStoxx50 fund, which fell 4.79%.

Across to the east, we see China continuing to slow down. The Chinese official composite PMI fell to 52.8 points from 53.1 in November. Its first subcomponent, the official manufacturing PMI, edged down by 0.2 points to 50 index points, which is considered to be a neutral level. The official non-manufacturing PMI performed better, but still declined for a second straight month to 53.4 in November. The November survey reflected further weakness in both domestic and export demand. However, the Caixin Services PMI showed that China's services sector grew at its quickest pace in five months in November. The index tracking new orders rose to 53.8 from 50.8 in October, well above the neutral 50-point mark. The Caixin Manufacturing PMI edged up in to 51.9 in November from 50.5 in October.

***Domestic equity**: CoreShares Equally Weighted Top 40 ETF*

We maintain our inclination towards the CoreShares Equally Weighted Top 40 ETF. This ETF beats other top 40 funds on diversification. It allocates its investments equally to all 40 constituents, which reduces risk of concentrating in a few counters. CoreShares Equally Weighted Top 40 ETF increased by 1.43% during November, underperforming its peers, which are overweight in Naspers.

For the more risk-averse investor, Absa has added two volatility-weighted funds, which are the only ones worth considering in this category: the NewFunds Value Equity ETF and NewFunds Low Volatility ETF. However, they are small funds so they do present some liquidation risk.



	ASHT40	STX40	STAN40	SYGT40	CSEW40	NFSH40	NFSWIX	STXSWX	STANSX	SYGSW4	STXQUA	STXRAF	NEWFSA	CTOP50	GIVISA	ASHMID	GIVFIN	STXFIN	GIVIND	STXIND	GIVRES	STXRES	NFEMOM	NFEVAL	NFEVOL
November	0.35%	0.35%	0.37%	0.38%	1.43%	-6.04%	3.23%	3.26%	3.30%	3.27%	3.32%	-3.52%	5.21%	-1.42%	-6.18%	-0.25%	-5.02%	2.98%	-3.77%	1.74%	-8.68%	-8.56%	-0.79%	-5.65%	-3.59%
1-year	-13.88	-13.60	-13.68	-13.69	-13.88	-10.62	-16.37	-15.96	-15.68	-15.71	1.33%	-8.33%	-13.62	-8.92%	-21.12	-9.08%	-6.97%	3.70%	-6.97%	-23.85	-2.43%	2.30%	-18.73		

***Foreign Equities ETFs**: Satrix MSCI World ETF & Satrix MSCI Emerging ETF*

Foreign equities developed markets: Satrix MSCI World ETF

Since October, developed markets have experienced a massive selloff. It is not unexpected for equities to experience short-term volatility. However, over a longer horizon they have produced inflation-beating returns. The intermittent selloffs often present buying opportunities for discerning investors.

In this category we like the Satrix MSCI World Equity Feeder ETF (down 2.97%) and the Ashburton Global 1200 Equity ETF (down 3.68%). They diversify their exposure across the US, Europe, Japan, Canada and Australia. With more than half of the funds invested in US stocks, investors will still have substantial exposure to the US. Satrix MSCI World beats Ashburton Global 1200 Equity ETF on costs.

Other more focused international equity themes include property funds and technology funds. These are worth considering for tactical or other investor-specific reasons.

Foreign equities, emerging markets: Satrix MSCI Emerging Markets ETF

The choice in this segment is limited to two funds: Satrix MSCI Emerging Markets and the Cloud Atlas AMI Big50. October's best performer, Cloud Atlas AMI Big50, was the dog of November, tanking by more than 11%. Nonetheless, we retain the Satrix MSCI Emerging Markets ETF (up marginally by 0.63%) because of its diversification. Unlike Cloud Atlas AMI Big50 which invests in African stocks only, the Satrix fund invests in a wider range of emerging economies, including some of the fastest-growing markets such as China and India. In addition, the fund is the cheapest within its category, boasting a TER of 0.4%.

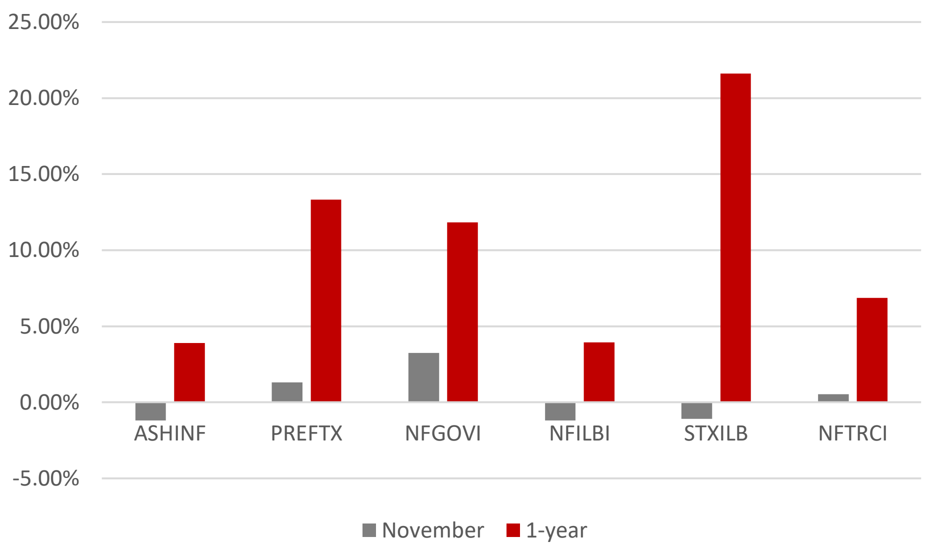
	GLPROP	SYGP	ETFGRE	ASHGEQ	SYGWD	STXWDM	ETFWLD	CSP500	SYG500	STX500	ETF500	SYGUS	SYGUK	SYGEU	SYGJP	GLODIV	SYG4IR	ETF5IT	STXNDQ	AMIB50	STXEMG
November	-2.20%	1.12%	-2.19%	-3.68%	-2.97%	-2.97%	-2.31%	-3.31%	-2.29%	-2.22%	-1.51%	-2.38%	-5.32%	-4.79%	-4.19%	-3.31%	-2.35%	-4.42%	-3.27%	-11.79%	0.63%
1-year	0.92%	4.81%		-0.68%	2.07%	1.18%		5.34%	8.68%	6.68%		7.12%	-5.00%	-12.20%	-5.27%	5.34%				-12.30%	-8.68%

Bonds and cash funds

Bonds and cash are good additions to portfolios. If you are investing for a very short period, usually less than a year, then the NewFunds TRACI 3 Month (up 0.54%) is a natural choice because it is least sensitive to sudden adverse interest rate movements. It is like earning interest on your cash at the bank with a minimal possibility of capital loss.

For a longer investment horizon, protecting your investment against inflation is paramount. We therefore maintain our choice of the Satrix ILBI ETF (down 1.09%), which has the lowest expense ratio in this category.

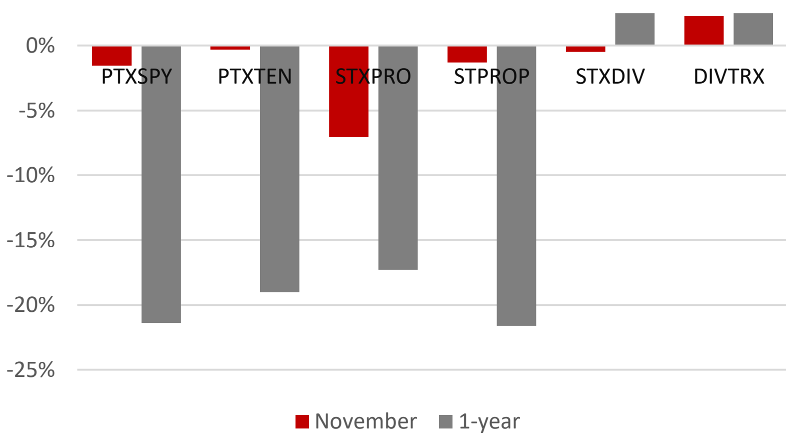
Furthermore, nominal bonds add a add a unique risk-return dimension that differs from inflation-linked bonds and improves overall portfolio performance. As with equities, investors also need to diversify their bond portfolios internationally. We think investors can choose between Stanlib Global Bond ETF (down 4.14%) or Ashburton World Government Bond ETF (down 5.60%). They track investment-grade sovereign bonds mostly issued by the US, UK, Japan, and selected European countries. However, Stanlib Global Bond ETF has the lowest TER. .



Dividend or income theme funds

If you rely on your investment income for day-to-day expenses, you may want to allocate a portion of your portfolio to ETFs that have a high distribution ratio. Two funds come naturally to mind: the Satrix Dividend Plus and CoreShares S&P South Africa Dividend Aristocrats. But property funds tend to have even higher payout ratios.

We change our choice to the Stanlib SA Property ETF (down 1.30) from the Satrix Property ETF (down 7.05%). The Stanlib fund now boasts the lowest TER in the segment. However, investors can also consider foreign property ETFs. The Sygnia Itrix Global Property ETF (up 1.22%) is the cheapest in this category.



Diversified funds

If you find the process of diversifying your portfolio daunting, two ETFs can do it for you. They combine equities and bonds to produce a diversified portfolio for two investor archetypes. They are the NewFunds Mapps Protect ETF and the NewFunds Mapps Growth ETF. They are designed to meet two different risk appetites: Mapps Protect is more conservative, usually suitable for older savers. Mapps Growth suits investors with a long-term horizon. They gained 1.34% and 2.76% respectively in November.