etfSA Research

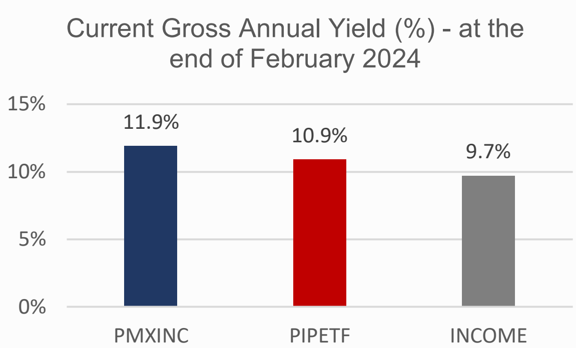
The Quest for Yield April 2024

SPOTLIGHT ON ACTIVELY MANAGED INCOME AMETFS

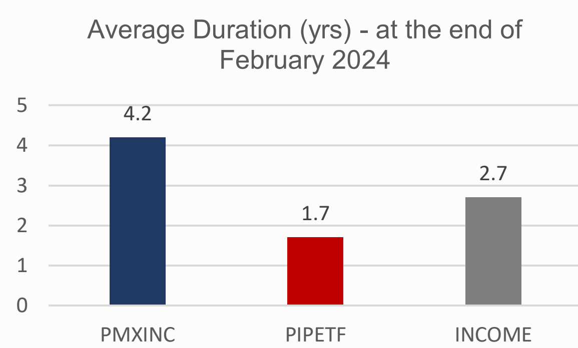
Actively Managed ETFs (AMETFs) have existed in global markets for many years and demand for a more flexible approach to fund management, has been on the rise, amid high inflation, higher-for-longer interest rates and slowing global growth. During these uncertain economic times, AMETFs could assist in navigating these concerns, by providing the flexibility for fund managers who can make portfolio adjustments as and when they see fit, rather than sticking to a more rigid Index structure, where portfolio changes are dictated by the Index and not by the asset manager. More recently AMETFs have been introduced to the JSE, including three actively managed income funds.

To assist in painting a clearer picture on investing in income-bearing assets in a local context, etfSA in partnership with the Investment Analysts Society, hosted a Masterclass on *The Quest for Yield* with three fixed income managers, who have recently listed actively managed income ETFs on the JSE. These product managers were: 10X Investments (INCOME), Portfoliometrix (PMXINC) and Prescient (PIPETF).

The graphs below show the diverse results offered by these three products.



Source: PortfolioMetrix, Prescient, 10X, etfSA (18 April 2024)



Source: PortfolioMetrix, Prescient, 10X, etfSA (18 April 2024)

Looking at the current yields of the three income AMETFs above, the PMXINC AMETF currently has the highest yield and is aligned with expectations due to the large weighting towards fixed rates bonds, coupled with the longer portfolio duration. Bonds with a longer duration typically offer higher yields, but it also comes at a cost of higher duration and credit risk. This is followed by the PIPETF AMETF, which has the lowest duration, but currently offers the second highest yield, due to the diverse nature of the current fund composition. The INCOME AMETF currently offers the lowest yield of the three but falling marginally behind the others, with the second highest duration. This is due to the large weighting towards fixed rate bonds and inflation-linked bonds. Inflation-linked bonds are currently not offering as attractive yields as fixed rate bonds, but also quite importantly, it comes with less duration and credit risk exposure, so you are essentially still obtaining attractive yields, but with much less risk.

The Masterclass took place online, on the 16th April 2024 and the recording is available on our website using the following link: www.etfsa.co.za -> Media Centre -> Presentations

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SPOTLIGHT ON ACTIVELY MANAGED INCOME AMETFS

PortfolioMetrix

To kick things off, Philip Bradford, Head of Investments at PortfolioMetrix set the scene by providing a high-level overview of the fixed income market in South Africa, by focusing on government bonds, floating rate notes, and credit bonds. One of the key aspects that Bradford identified is that the ALBI Index is concentrated to 20 bonds, so investors looking for opportunities broader than the ALBI Index, can consider actively managed options that have the potential to show decent outperformance with less volatility.

In speaking to “the quest for yield”, Bradford highlighted that in combining floating rate bonds (bonds that move up or down based on the interest rate moves), with the fixed rate bonds, you can create a portfolio with a decent yield, without as much volatility as the ALBI Index. This overview contexualised the current positioning of the Portfoliometrix Active Income Prescient Actively Managed ETF (PMXINC), which is an actively managed ETF that provides exposure to high levels of income, with a focus on capital preservation. This AMETF aims to generate similar returns to that of the ALBI Index, but with less volatility. The PMXINC AMETF currently has a large weighting towards fixed rate bonds and floating rate bonds, with a marginal allocation to money market instruments.

Prescient

Henk Kotze, Head of Fixed Income at Prescient spoke to the application of multi-asset income as a category, by analysing their method used to identify opportunity sets and the risks thereof in the market to achieve their return objective. The Prescient methodology covered the aspects such as the analysis of various drivers of real return, as well as analysing the use of credit, preference shares, property and derivatives in a portfolio to best extract value in the fixed income and yield space.

Kotze discussed that from an income fund perspective, Prescient sees their objective as a CPI-plus-type portfolio. The Prescient Income Provider Feeder Actively Managed Exchange Traded Fund (PIPETF) is an actively managed ETF that targets CPI + 3%, as a real return target, and aims to provide a high level of current income as is consistent with capital preservation and liquidity. On the risk side, he emphasized that objective of the fund is not to lose money over any 3-month period, but to generate and compound positive real returns.

10X Investments

Anton Eser, Chief Investment Officer at 10X Investments, contextualized this by talking to the AMETF structure and benefits of on-market access for investors, including non-SA exposure, (currency) hedging opportunities, and analysing the various use cases for these sorts of funds.

The 10X Income AMETF (INCOME) provides exposure to a wide range of local and global interest-bearing assets and targets a return of CPI+2.5% over rolling 3-year periods. The AMETF aims to deliver a high level of income and long-term stability on capital invested. Eser discussed how real yields are currently attractive and obtainable from inflation-linked bonds, so it provides value in aiming to generate above bond-like returns with less risk. Looking at the INCOME AMETF from a diversification perspective, the opportunity set goes beyond the duration curve play with the inclusion global interest-bearing assets.

The one aspect that was emphasized quite a bit across all three speakers was the opportunity, whereby direct investors would not have access to purchase the full spectrum of fixed and flexible income instruments. Actively managed ETFs give you access to diversified interest-rate instruments that you would not have otherwise be able to purchase.

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ACTIVELY MANAGED INCOME AMETFS

The three actively managed income products discussed in this masterclass webinar, is summarised below:

Code	**PMXINC**	**PIPETF**	**INCOME**
Fund Name	Portfoliometrix Active Income Prescient AMETF	Prescient Income Provider Feeder AMETF	10X Income AMETF
Fund's objective	To achieve a high level of sustainable income and stability of capital invested.	To obtain as high a level of current income as is consistent with capital preservation and liquidity, by aiming never to lose capital over any rolling 3 month period	To deliver a high level of income and long-term stability on capital invested.
Strategy	Aims to generate returns similar to that of the ALBI Index, but with less volatility	Targets a return of CPI + 3% overrolling 3-month periods	Targets a return of CPI + 2.5% over rolling 3-year periods
Asset Class Exposure	Predominantly interest-bearing securities and money market instruments. May include equity, property, preference shares, and assets in liquid form	Local and offshore money market, bonds, property, preference shares, inflation-linked bonds and derivatives	A range of local and global interest-bearing assets, including equity, bonds, money, or property markets both locally and abroad
Suitability	Suitable for investors who seek local bond-like returns with active risk management and a short- to medium-term investment horizon.	Suitable for investors who seek diversified high income exposure, primarily from local money and bond markets, and those with a short- to medium-term investment horizon.	Suitable for investors who seek diversified high income exposure to a range of local and global interest-bearing assets, and those with a medium-to-long term investment horizon.
Management Fee (Ex-VAT)	0.58%	0.40%	0.38%
Distribution Frequency	Quarterly	Monthly	Quarterly

Source: PortfolioMetrix, Prescient, 10X, etfSA (18 April 2024)

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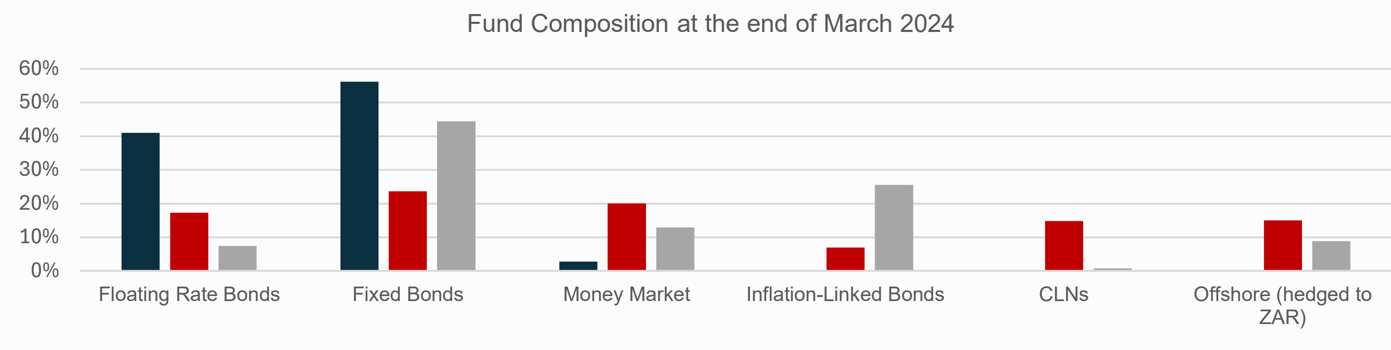
FUND COMPOSITION

The summary of the managed income options illustrates how even though there is a shared objective of aiming to achieve a high level of income and capital stability across all three actively managed funds, their strategies differ. This in effect, means that investors would need to align their own objectives with that of the strategy of the fund that is best suited for them. It also means that different strategies would provide different exposures to income, as highlighted in the masterclass webinar and in the fund composition graph below.

The select fund composition for each fund shown below, is as at the end of March 2024. Only the largest exposures are reflected in the graph. Straightaway, it can be seen how vastly different these strategies are in terms of their current exposure. Please take note that **this is only a snapshot at the end of March** and because all three funds are actively managed, the exposures may change at any time, at the discretion of the respective fund managers.



Source: PortfolioMetrix, Prescient, 10X, etfSA (18 April 2024)

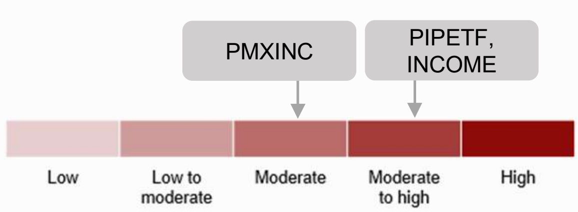
RISK CONSIDERATIONS

All three income AMETFs are uniquely positioned to provide investors with exposure to a wholistic income offering using multi-asset classes. Investors should be aware of their risk appetite and should be mindful of the risks associated with investing in these AMETFs. The masterclass covered some important aspects when looking at income. Thus far, the quest for yield has been contextualized, but it was also emphasized that this comes at a “cost” per say, which is essentially risk.

Details on some of these risks are listed below. Please take note that this list is not exhaustive and there are various other aspects that may apply.

- **Credit Risk:** The risk that the issuer is unable or unwilling to meet its obligations, resulting in a financial loss
- **Default Risk:** The risk that the issuer may not be able to repay the loan amount borrowed or may not be able to meet interest payments on time.
- **Interest Rate Risk:** The risk that fixed income securities may fluctuate in value due to changes in interest rates. A fund with a longer average portfolio duration will be more sensitive to changes in interest rates than a fund with a shorter average portfolio duration.
- **Spread Risk:** The risk that spreads widen or narrow leading to an adverse bond price change.
- **Currency Risk**: The Portfolio may be exposed to currency risk in relation to the valuation of assets held in other currencies besides the Rand
- **Liquidity Risk**: A risk that an investment cannot be bought or sold on time to prevent or minimise a loss

etfSA.co.za classifies the risk profile of each income AMETF as follows:



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