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Satrix Quality SA Changes

December 2023

Satrix seeks best index design to capture 'Quality' and 'Intrinsic value' stocks

Satrix has recently announced changes to two of its smart beta ETF strategies aimed to capture different types of return profile from the simple market index or beta, namely their **'S&P Quality ETF' and their 'S&P GIVI (Global Intrinsic Value Index) ETF**'. In some respects, this further highlights the difficulties of running smart beta or factor strategies within the South African Equity market, which is a relatively small and illiquid market. But we commend Satrix on the pragmatic approach to the consolidation of the two ETFs to align with their unit trust. Their unit trust tracks a proprietary or in house index that also seeks to extract quality stocks, but which is optimised to take various risk factors into account such as: liquidity, tracking error (relative to Beta) and sector biases – these can go awry within some smart beta strategies if not proactively managed.

Herewith a detailed breakdown of the proposed changes:

1) Finalisation of Name Change – Satrix Quality South Africa Portfolio to Satrix Quality South Africa ETF

On the 13th September 2023, Satrix released a ballot voting procedure SENS announcement, on the proposed amendments to the name and investment policy of the **Satrix Quality South Africa Portfolio (STXQUA**). This change saw the name being changed from the **Satrix Quality South Africa Portfolio**, to the **Satrix Quality South Africa ETF** and will change the Index in which the ETF tracks, to the **Satrix Quality Index** from the**. S&P Quality South Africa Index**

Index Differences:

- The **S&P Quality South Africa Index** provides investors with exposure to companies that have a record of generating higher revenue and stable profitability than the average counterpart, which is based on their 1) Return on Equity (ROE), 2) accrual ratios, and 3) financial leverage.

- The **Satrix Quality Index** is a proprietary Index that provides investors with exposure to companies that exhibit positive quality characteristics and deviates from those that exhibit negative quality characteristics. Satrix defines quality as a composite of Profitability, using Return on Equity (ROE), and Balance Sheet quality, using Accruals to Operating Cash-Flow.

Satrix has highlighted the following reasons for the change in the named SENS announcement:

1. The Index is constructed using an optimisation tool to consider liquidity, sector, and tracking error risks.
2. Does not make use of low leverage characteristics as a measure of quality to capture excess returns in the South African market.
3. Places a limit on turnover at each semi-annual rebalance, which aids in lowering transaction and total investment costs.
4. Treats corporate events in accordance with the FTSE/JSE Index treatment, which reduces tracking errors.

The ballot has since been approved and as of 1st of December 2023, the new name and investment policy has taken effect. The JSE Code (STXQUA), ISIN and short name remains unchanged and the STXQUA ETF retains its financial and trading history. Investors will not be liable for any additional fees, taxes, or charges owing to the name and investment policy change.

2) Additionally, there is a Proposed Amalgamation of the Satrix S&P GIVI South African Top 50 ETF into the Satrix Quality South Africa Portfolio

On the 8th November 2023, Satrix released a ballot voting procedure SENS announcement, on the proposed amalgamation of the **Satrix S&P GIVI South African Top 50 ETF –STXT50** (previously known as the NewFunds S&P GIVI South Africa Top 50 Index ETF Portfolio), with the **Satrix Quality South Africa Portfolio - STXQUA.** The basis for this change comes off the back of capturing a more effective means of investing in high quality companies, which Satrix believes, is to directly target profitability and balance sheet quality measures. The SENS announcement highlighted concerns around the strategy of the STXT50 ETF, which Satrix has accessed to be offsetting, where measures of profitability and value were often negatively correlated.

The STXT50 ETF tracks the S&P GIVI South Africa Top 50 Index, which provides investors with exposure to 50 of the largest JSE-listed companies with the highest intrinsic value (a measurement of what an asset is worth using fundamental analysis) and lowest volatility, at lower costs, subject to constraints such as liquidity and the market cap of companies. Fundamental analysis includes an assessment of a company's profitability and balance sheet measures, but also considers the macro and microenvironment to identify a fair market value of securities that are may not be correctly priced by the market.

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Satrix seeks best index design to capture ‘Quality’ and ‘Intrinsic value’ stocks…continued

The approval of the proposed amalgamation will see the STXT50 ETF cease to exist and will be absorbed into the now, newly named Satrix Quality South African ETF (STXQUA), with the new Index. Investors will be issued with replacement shares that will be equal to the market value of the shares that were held before to the amalgamation and because of this, there may be differences in the actual number of shares held, post the approval of the amalgamation. Both the STXT50 ETF and STXQUA ETF will distribute a special income declaration prior to the transfer taking place. Investors will not be liable to any additional fees, taxes, or charges owing to the amalgamation.

Ballot Timeline

The ballot process has started and the final date for investors to respond to the ballot letter, is the 20th December 2023. Should it be approved, the amalgamation will take place on the 26th January 2024.

Comparison

How Different Are These Quality Funds?

For starters, because all three ETFs have differing strategies, i.e., they track different Indices with different methodologies, their exposures may vary. Quality investing is all about financially healthy companies that have stable balance sheets and strong earnings. While the essence of quality investment is captured, the methodology in which constituents are selected however, can differ.

Proposed Amalgamation	→	Change of Name & Index	→	New Name & Index
Satrix S&P GIVI South Africa Top 50 ETF		**Satrix Quality South Africa Portfolio**		**Satrix Quality South Africa ETF**
STXT50		STXQUA		STXQUA
S&P GIVI SA Top 50 Index		S&P Quality South Africa Index		Satrix Quality Index

Looking at the methodologies summarised below, **the S&P GIVI SA Top 50 Index** focuses on companies with high intrinsic values and lower volatility. The means of achieving lower volatility excludes 30% of market capitalization with the highest Beta. **The S&P Quality South Africa Index** focuses on companies that have the highest quality score based on their individual profitability (ROE), earnings quality (accrual ratios), and balance sheet quality (financial leverage). The **Satrix Quality Index** also makes use of a quality scoring methodology but does not consider leverage as one of the quality selection criteria. The Index is constructed from a liquidity requirement position, that additionally incorporates risk controls that moderates the sector and constituent weight against the Capped SWIX Index, being the benchmark Index. By extension, it focuses on how tradable a stock is relative to the size of the portfolio that tracks this Index.

	Proposed Amalgamation	Change of Name & Index	New Name & Index
ETF Name	Satrix S&P GIVI South Africa Top 50 ETF	Satrix Quality South Africa Portfolio	Satrix Quality South Africa ETF
JSE Code	STXT50	STXQUA	STXQUA
Portfolio Benchmark	S&P GIVI SA Top 50 Index	S&P Quality South Africa Index	Satrix Quality Index
TER	0.35%	0.39%	0.40%
Distribution Methodolo	Distributing - Quarterly	Distributing - Quarterly	Distributing - Quarterly
Portfolio Methodology	•Companies are selected based on the largest intrinsic value and are subject to the following eligibility criteria: 1) minimum float adjusted market cap of at least R10 Bil, 2) minimum avg daily value traded of R15Mil, 3) preferred stocks not considered for inclusion. •The constituents are weighted according to their intrinsic value and the maximum weight of each constituent is capped at 10%. •To achieve lower volatility, the S&P GIVI series excludes 30% of market capitalisation with the highest beta in each country. •At rebalance, should there be less than 50 eligible companies, the minimum market cap and average daily value traded eligibility will be reduced by 5% until at least 50 companies are eligible.	•Companies are assigned quality scores based on their 1) ROE, 2) accrual ratios, and 3) financial leverage. •Each of these individual factor values have their outliers replaced with the highest closest value and z - scores are computed to obtain a combined single metric that is used to rank and pick the constituents. •The constituents are then weighted according to their quality score and free float market cap. •The Index applies a 40% sector cap and a single constituent cap limited to either 10% or 20 times its float adjusted market cap.	•The starting universe considered for inclusion in the index is the large cap and mid-cap sectors of the JSE, excluding listed property and small-cap companies •Companies are selected based on their individual Profitability and Balance Sheet score quality, which is determined as a percentile ranking between a minimum of 0 and a maximum of 1. For instance, companies with scores of 0.25, 0.5, and 0.75 would be classified within the lower quartile, median, and upper quartile, respectively. •The final Quality score takes an average score of the Profitability (ROE) and Accounting (Accrual to Operating Cash-Flow ratios) quality scores. •The weight of each holding is determined by an optimisation process, with the following objectives: oTargets a minimum tracking error of 4% from the Capped SWIX Index and selects companies with majority high scoring attributes, subject to constraints oEach constituent weight must be within 3% of its weight in the Capped SWIX benchmark oEach sector weight must be within 5% of its specific Tier 1 (Resources, Industrials, Financials) sector benchmark
Number of Holdings	53	18	38

The size of the ETFs also differ quite significantly. As of 30 November 2023, the STXT50 holds 53 constituents, excluding cash, STXQUA (old – S&P Quality SA Index) holds 18 constituents, and STXQUA (new – Satrix Quality SA Index) holds about 38 constituents, which is twice as much as the ‘old STXQUA’ and will hold between 35 – 45 constituents, in future.

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Sector Overview

An overview of the sector exposure, as at 30 November for the STXT50 ETF and the old STXQUA ETF; and as at 1 December 2023 for the new STXQUA ETF, is illustrated below:

STXT50 ETF has a larger weighting (above 20%) towards:

- Basic Materials - largely owed to industrial metals and mining,
- Consumer staples – largely owed to beverages,
- Financials – largely owed to banks.

The biggest holdings are in Anheuser-Busch at 10.5%, Prosus at 10.3%, and BHP Group at 10%.

‘STXQUA old’ ETF has the largest weighting (above 20%) towards:

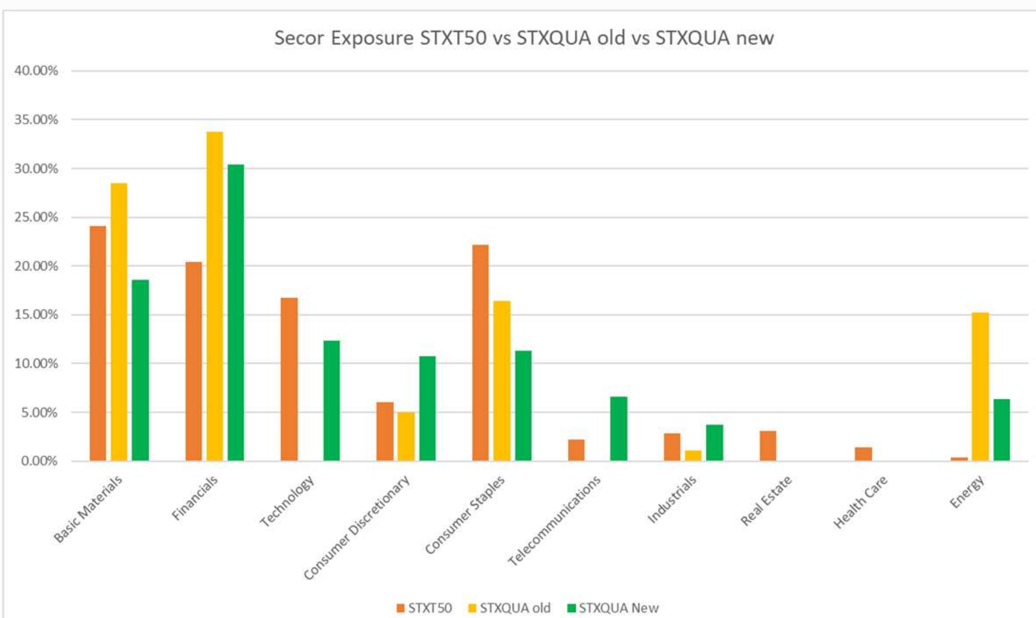
- Financials –about an even split between banks, non-life insurance companies, and investment banking and brokerage services,
- Basic Materials – largely owed to industrial metals and mining.

The biggest holdings are in Capitec at 12.4%, Outsurance at 11.3%, and Clicks at 10.5%

‘STXQUA new’ ETF has the largest weighting (above 20%) towards:

- Financials – largely owed to banks.

While the ‘STXQUA new’ ETF also has the largest exposure to financials, in banks, it offers a broader spread of exposures to most sectors in comparison to the ‘STXQUA old’ ETF.
The biggest holding here is Naspers, at 8.4%, followed by Firstrand and Capitec at 8.4% and 5.6% respectively, which illustrates the absolute and relative risk control measures in the ‘STXQUA new’ ETF.



Source: Satrix, etfSA (30 November 2023)

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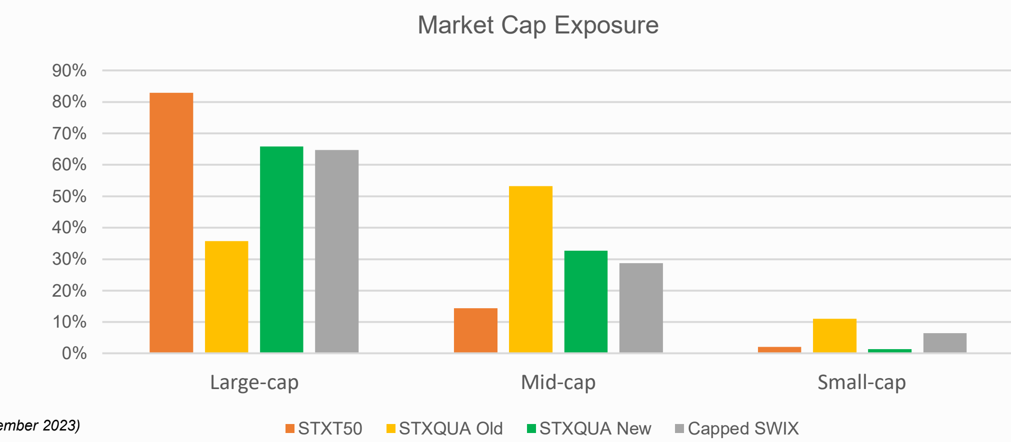
Satrix Quality SA Changes December 2023

Market Cap Exposure

In South Africa, our market share is relatively small and concentrated, this, coupled with concerns of stock delistings that have been on the rise, means that the drivers of returns make it difficult for a strategy such as quality investing, to flourish on a consistent basis. To illustrate the difference of the three strategies, a snapshot of the market cap weighting between the STXT50 and the STXQUA (old and new Index), against the Capped SWIX (Capped SWIX All Share Index), is shown in the graph below. A brief explanation of the market share exposure is detailed below:

- Large-cap stocks tend to be well-established and generally more stable because they have been around for many years, which also means that they may not fluctuate as much as mid- and small-cap stocks. Investing in large-cap stocks could increase in share value and ultimately reward shareholders with dividend payments.
- Mid-cap stocks are often in the midst of rapid growth and becoming established. Investing in mid-cap stocks could provide potential growth, however, also has the potential for greater downturns.
- Small-cap stocks generally consists of younger companies with the potential for high growth, but just as much potential for significant losses.

The market cap exposure of the STXT50 ETF, as at 30 November 2023, had a significant weighting towards large-cap stocks, whereas STXQUA (old & new Index) offers a broader market cap exposure. The new STXQUA ETF, as at 1 December 2023, had a targeted focus towards large- and mid-cap stocks, due to liquidity screening requirements. Furthermore, in accordance with the strategy of the new STXQUA ETF, each constituent weight must be within 3% of its weight in the Capped SWIX Index and 5% of each sector weight in the Capped SWIX Index. This is why the market share exposure of the new STXQUA ETF, is similar to that of the Capped SWIX Index. This is in comparison to the old STXQUA ETF, which had a focus towards mid-cap stocks, as at 30 November 2023, with the highest exposure to small-cap stocks in comparison to the other ETFs, as well as the Capped SWIX Index.



Source: Satrix, etfSA (1 December 2023)

RISK PROFILE

The risk profile of the Satrix Quality South Africa ETF, post the name and Index change, remains high risk. Investors should be aware of their risk appetite and should be mindful of the risks associated with investing in this ETF. Be sure to obtain the latest information and risk considerations of the ETF from the fund manager's website and/or fund fact sheet.

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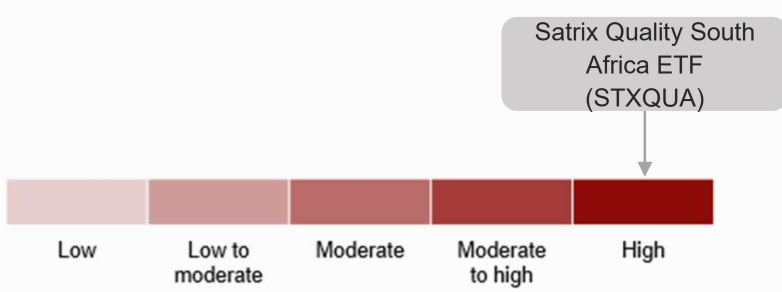

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