15 December 2017 –Report on the Impact of Steinhoff International on JSE-listed ETFs and etfSA.co.za Investments

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Investors in Steinhoff International Holdings found themselves on the receiving end of a dramatic loss of value early in December, when first the company was not able to release financial results approved by its auditors, followed by the shock resignation of the CEO, Markus Jooste, due to evidence of "accounting irregularities".

The impact on the share price was sharp and sudden – it collapsed by around 90% from R56.26 on 30-Nov-17 to a low of just R6.00 a week later. Since then the share price has seen some wild swings, even on an intraday basis, as new information and revelations are released to the market on a drip-feed basis. At the time of writing, the price was R8.03.

Many actively managed general equity unit trusts hold a relatively concentrated portfolio of shares with at least 3-5% exposure to each individual share. This is to improve their chance of achieving outperformance relative to the market benchmark. By contrast, indices, and index-tracking portfolios such as ETFs, generally hold a much more diversified, and less concentrated portfolio, reducing the impact from any one share, such as experienced from the collapse in the price of Steinhoff.

As at 30-Nov, Steinhoff was the 11th largest company on the JSE, when measured on a local free float market capitalisation basis. However, despite it being one of the biggest companies, it represented only 1.9% of the FTSE/JSE All Share Index, and 2.3% of the FTSE/JSE Shareholder Weighted Index (SWIX), which excludes the shares of dual-listed companies registered on foreign stock exchanges.

What this means, is that despite the massive loss of value in Steinhoff shares, the impact on the broad-based indices, and on a well-diversified portfolio that holds a relatively small exposure to Steinhoff, has been less than 2.5%.

Much has been said about the holdings of Steinhoff in actively managed unit trusts and in pension funds, but what is clear is that it is very difficult to get up-to-date information on the exposure in these investments. In many instances, the most recent information available is as at the 30th of September. This is because unit trust holdings are often only disclosed quarterly, or monthly at best, and always well after the period end.

One of the many advantages of ETFs is the transparency of holdings on a daily basis. It is therefore a simple exercise to identify the holdings of Steinhoff in specific ETFs, at any time. As this information is spread across the websites of all the ETF issuers, a summary follows on the next page.

Table 1. Exposure to Steinhoff International (SNH) in JSE-listed ETFs

Index	ETF(s)	SNH weight (%) as at 30-Nov-17
Broad market benchmarks, no ETFs		
FTSE/JSE All Share Index		1.9%
FTSE/JSE SWIX Index		2.3%
FTSE/JSE Capped SWIX Index		2.7%
Large Cap		
FTSE/JSE Top 40	STX40, ASHT40, STAN40, SYGT40	2.3%
FTSE/JSE SWIX 40	STXSWX, NFSWIX, STANSX, SYGSW4	2.8%
S&P SA Capped Top 50	CTOP50	1.9%
FTSE/JSE Equally Weighted Top 40	CSEW40	2.1%
"Smart" / Factor / Thematic Beta		
S&P GIVI SA Top 50	GIVISA	7.1%
FTSE/JSE RAFI 40	STXRAF	1.8%
FTSE/JSE Shariah Top 40	NFSH40	7.0%
S&P SA Dividend Aristocrats	DIVTRX	3.2%
FTSE/JSE Dividend Plus	STXDIV	—
S&P SA Low Volatility	LVLTRX	—
NewFunds Risk-Controlled WITS SA Momentum	NFEMOM	—
S&P Quality South Africa	STXQUA	—
FTSE/JSE NewSA	NEWFSA	—
Industrial Sector		
FTSE/JSE Industrial 25	STXIND	3.7%
S&P GIVI SA Industrial	GIVIND	11.8%
Multi-Asset		
NewFunds MAPPS Protect (40% SWIX, 15% GOVI, 35% ILBI, 10% Cash)	MAPPSP	1.4%
NewFunds MAPPS Growth (75% SWIX, 10% GOVI, 10% ILBI, 5% Cash)	MAPPSG	2.3%

Some interesting observations can be made:

- Most of the market cap weighted – or modified market cap weighted – ETFs had an exposure of less than 3%.
- Many of the so-called "smart" ETFs had no exposure to Steinhoff. The notable exception is the S&P GIVI (Global Intrinsic Value Index) methodology, which relies heavily on the published financials of companies. The two ETFs that are based on this methodology (GIVISA and GIVIND) are by far the most exposed. This is similar to the experience with many actively managed funds.
- The Shariah-compliant version of the FTSE/JSE Top 40 Index is the other one with an outsized exposure. This is because the index has only 15 constituents (the other 25 do not qualify under Shariah law), resulting in much bigger weights of each of the qualifying constituents.
- None of the factor-based ETFs that rely on market data in their index rules, such as dividend yields, low volatility, momentum, etc., had any exposure to Steinhoff.

How to interpret the views held by active managers:

- Any general equity fund which had more than 3% exposure to Steinhoff on 30-Nov, held an **active**, **positive** view on the outlook for the company – this indicates an expectation that the company will be a relative outperformer compared to the rest of the market.
- Any holding below this level (3%) is largely consistent with benchmark index exposure (so-called "passive"), thus **no active view**, also called "benchmark hugging".
- Funds with no exposure, held an **active**, **negative** view on Steinhoff, indicating an expectation of performance worse than the market, on average.

What about Multi-Asset, Balanced Funds, as required by Reg. 28 of the Pension Funds Act?

Balanced funds can be expected to have between 40% and 75% exposure to equities (shares). A "High Equity" Balanced Fund (75% in equities) can therefore be expected to have a "benchmark" exposure of around 2% to Steinhoff (75% of 2.7%, the exposure in the Capped SWIX, the *de facto* benchmark used by most fund managers), whereas a "Low Equity" Balanced Fund (40% in equities) can be expected to have no more than 1.1% exposure (40% of 2.7%).

In the case of the **etfSA Retirement Annuity Fund** and the **etfSA Living Annuity**, we can report that less than one-third of the funds held in the etfSA Wealth portfolios, have exposure to Steinhoff International shares. The aggregate exposure in each of the portfolios, and the impact due to the collapse in the Steinhoff share price, is summarised in the table below.

Table 2. Exposure to Steinhoff International (SNH) in etfSA Retirement Annuity Fund and etfSA Living Annuity

etfSA Wealth portfolio	Exposure to SNH as at 30-Nov-17 (%)	Loss in value up to 15-Dec-17 (%)
etfSA Retirement Annuity Fund		
Wealth Enhancer Portfolio (CPI+7% target)	1.9%	-1.6%
Wealth Builder Portfolio (CPI+5% target)	1.6%	-1.4%
Wealth Conservator Portfolio (CPI+3% target)	1.5%	-1.3%
Wealth Protector Portfolio (CPI target)	—	—
etfSA Living Annuity		
Wealth Maximiser Portfolio (CPI+10% target)	1.0%	-0.9%
Wealth Enhancer Portfolio (CPI+7% target)	1.8%	-1.5%
Wealth Builder Portfolio (CPI+5% target)	1.5%	-1.3%
Wealth Conservator Portfolio (CPI+3% target)	1.3%	-1.1%
Wealth Protector Portfolio (CPI target)	—	—

What does this mean? For every R100 invested in the RA Fund in the Wealth Enhancer Portfolio, for example, R1.90 was invested in Steinhoff, and R1.60 has been lost due to the collapse of Steinhoff. **Please note**: these losses are still just theoretical, or so-called "paper losses". Until positions in Steinhoff are sold, the losses have not yet been locked in, or realised. In the case of an index-tracking fund, that will only happen when Steinhoff falls out of the index.

How can I calculate the impact on my own ETF portfolio?

The best estimate of the loss in value in a particular ETF, is to multiply the exposure to Steinhoff in the particular ETF, as detailed in Table 1, by the loss in value in the Steinhoff share price since 30-Nov, being 85.7% as at 15-Dec.

For example: the loss in the Satrix INDI ETF attributable to the fall in the Steinhoff share price, is 3.2% (3.7% x 85.7%). Again, this means that for every R100 invested in the Satrix INDI ETF, R3.70 was invested in Steinhoff, and R3.20 has been lost. Any additional loss in the ETF is due to other factors, i.e. the decline in the prices of other companies in this ETF.

To calculate the impact on your overall ETF portfolio, repeat this exercise for each of the ETFs you hold, then calculate the weighted average loss in your portfolio as in this following example:

Table 3. ETF Portfolio example

ETF Code	Investment value	Weight in portfolio	Exposure to SNH as at 30-Nov-17 (%)	Loss in value up to 15-Dec-17 (%)
STXIND	R15,000	30%	3.7%	-3.2%
CTOP50	R25,000	50%	1.9%	-1.6%
NFEMOM	R10,000	20%	—	—
TOTAL	**R50,000**		**2.1%***	**-1.8%****

* 2.1% = 30%x3.7% + 50%x1.9% + 20%x0.0%

** 1.8% = 30%x3.2% + 50%x1.6% + 20%x0.0%

In this example, R1,050 of the portfolio of R50,000 was effectively invested in Steinhoff (that is 2.1% x R50,000). Of this, R900 (1.8% x R50,000) has been lost due to Steinhoff.

A final word

These past two weeks in the South African market have been quite extraordinary – the collapse in Steinhoff has been termed as one of the biggest corporate scandals in the history of the JSE. That is debatable, but it is not the first company to suffer such a fate, and unfortunately it is unlikely to be the last.

What is clear, is that many professional investors were not able to identify the impending collapse in advance, and for ordinary investors, the chance of always picking the right fund or fund manager, **in advance**, is even more unlikely.

This risk is best managed through a well-diversified ETF investment portfolio which can limit the extent of the loss, as demonstrated during recent events. Ultimately, it is the exposure to a broad-based selection of asset classes, rather than the selection of a few individual shares, that grow wealth over the longer term in a consistent and sustainable manner.