

USING ETFs TO “BUY THE MARKET” IN SOUTH AFRICA

Nerina Visser, Mike Brown - etfSA.co.za

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Many investors look to achieve the average returns of the equity, bond, listed property or other investment markets, by purchasing index tracking products, such as Exchange Traded Funds (ETFs). The index measures the average return of the market and by buying an ETF, which exactly replicates the index, the investor can participate in the market's investment performance.

The most widely followed index in South Africa is the **FTSE/JSE Top 40 index**, which constitutes the investment performance of the top forty blue chip companies, listed on the JSE. As some 90% on average of all trade on the JSE takes place in these large capitalisation shares, by owning an ETF, which tracks the Top 40 index, you are in effect “buying the market”.

This article seeks to investigate the different types of Top 40 indices that are used in South Africa and the ETFs that are available for these various top 40 indices.

The Top 40 Index (Top40)

It is fairly common practice amongst stock exchanges and index providers to group shares according to size “buckets” such as large cap, mid cap and small cap stocks. The FTSE/JSE Top 40 index is the flagship tradable index of the JSE, and although it consists of only 40 companies (one quarter of those included in the ALSI), at R6 trillion it represents around 83% of the free float market cap. For many investors, the cost efficiencies of investing in “only” 40 shares far outweigh the “lost opportunity” presented by the 17% of the market in which they are not invested.

Examples of ETFs that track this index are:

- Satrix 40 (STX40)
- RMB Top 40 (RMBT40)
- Stanlib Top 40 (STAN40)

The Shareholder Weighted Top 40 Index (SWIX)

Shares that are listed on more than one stock exchange only have a portion of their shares available for trade on the JSE. The SWIX free float represents the proportion of a company's share capital that is registered on the South African share register, maintained by Strate. Once the SWIX free float has been taken into consideration, the available market capitalisation is less than half of the original number, around R5,6 trillion. This is by design intended to represent the investment opportunity set for the domestic equity investor.

Examples of ETFs that track the SWIX index are:

- NewFunds (Absa/Barclays) SWIX Top 40 (NFSWIX)
- Satrix SWIX Top 40 (STXSWX)
- Stanlib SWIX (STANSX)

Other Top 40 ETFs

Equally Weighted Top 40 Index

Unlike the market capitalisation methodology, which weights index constituents according to their size (market capitalisation), the equally weighted Top 40 has exactly the same 40 constituents, but weights the allocation to each of these companies equally, at 2,5% each. This reduces some of the volatility associated with market capitalisation indices.

The BettaBeta Equally Weighted Top 40 (BBET40) is an example of an ETF in this index.

Fundamentally Weighted Index

These indices (RAFI indices) are designed to weight companies in the index based on fundamental values (sales, cash flows, book value and dividends) rather than purely on size or free float. This leads to significant differences in the weighting of companies in the index, which can affect investment performance materially.

The Satrix RAFI 40 ETF (STXRAF) is an example.

Shari'ah Weighted Index

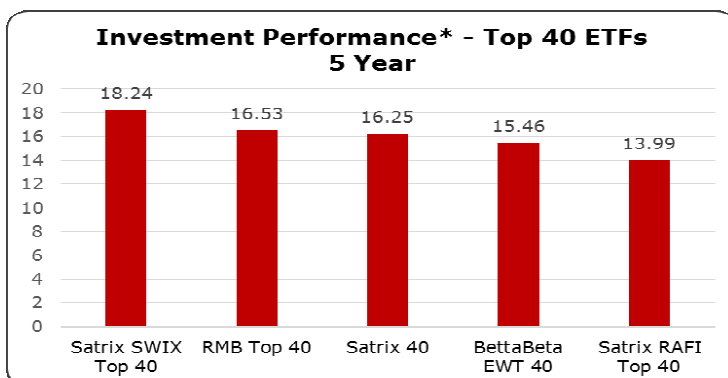
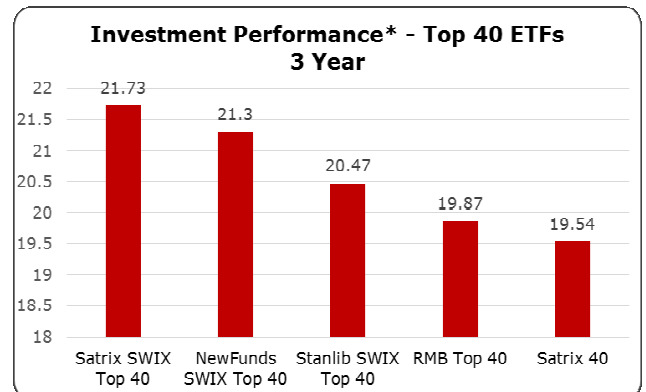
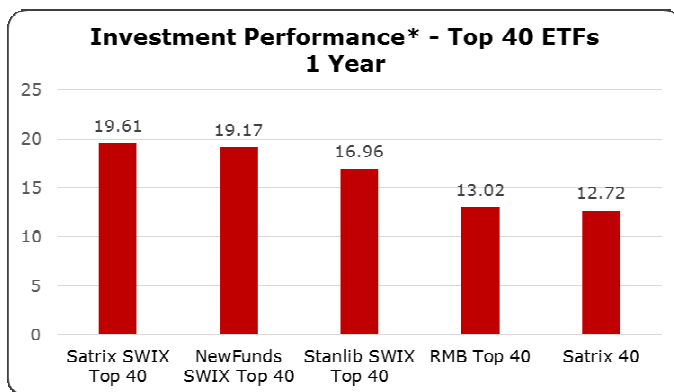
This Top 40 index excludes any companies that do not meet strict Islamic investment criteria. As a result, only 15 of the top 40 companies are included in the Shari'ah Top 40 index and these companies are then weighted on market capitalisation criteria.

The NewFunds Shari'ah Top 40 ETF (NFSH40) tracks this index.

Top 50 Indices

A new product, only listed in May 2015, tracks the S&P Top 50 index of South African equities. This index includes 10 additional shares, selected from mid cap companies, which creates a wider universe of companies, with greater diversification.

The CoreShares S&P Top 50 ETF (CTOP50) has recently joined the ETFs listed on the JSE.



* Total return performance (with dividends reinvested).

Source: Profile Data (30 April 2015).

Based on historic total return investment performance over periods from 1 to 5 years, the SWIX Top 40 products appear to have the clear edge in investment performance. By reducing the weighting held in the indices by dual listed companies (mainly mining shares), the SWIX ETF investor is rewarded by superior investment returns.

This article is based on a more comprehensive Study by Nerina Visser – to see this report, please click here:

http://www.etfSA.co.za/news/_latest/How%20to%20buy%20the%20market_NV.pdf

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