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Research News: CoreShares Yield Selected Bond ETF — June 2023

LAUNCH OF THE LATEST ETF ON THE JSE

A familiar, yet different ETF listed on the 31st of May 2023. The CoreShares Preference Share ETF (PREFTX) has been re-mandated to become the **CoreShares Yield Selected Bond ETF (JSE code: CSYSB),** effective 31st of May 2023. Even though the CSYSB ETF is going to replace the PREFTX ETF, the investment strategies of the two ETFs differ significantly. If you held the PREFTX ETF at the close of 31 May 2023, you do not need to action anything on your side to change into the new CSYSB ETF; it will automatically be moved into the new ETF, at a ratio of 1:1, so nothing further would be required from you for this change to take place.

The PREFTX ETF provided a source income in the form of dividends from preference shares. Preference shares were largely dominated by bank issuances, however due to changes in the Basel III regulatory framework that took place in 2012, if a specific term could not be included in the preference instruments, it could no longer be qualified as tier 1 capital; so, it became inefficient for the banks to issues these preference instruments in the market. This meant that the liquidity and investability of preference shares was affected because the banks had to redeem or buy back their issuances. This is why the PREFTX ETF ultimately had to be terminated. The CSYSB ETF replaces the PREFTX ETF, but still provides an income solution, not in dividends, but in the form of interest from high yielding bonds. This ETF is suitable for investors who are looking for high income and modest long-term capital growth.

Check out the etfSA Investor Podcast on this ETF (Episode 50), under the etfSA.co.za website > Media Center > Podcasts: The ETF Investor - Episode 50 - Actively Seeking Income Yield

The details of the new product are as follows:

ETP Name	JSE Code	MANCO	Listing Date	ISIN	Sector Exposure
CoreShares Yield Selected Bond ETF	CSYSB	CoreShares	31 May 2023	ZAE000318614	Specialist Securities – Income focused

OVERVIEW

The CoreShares Yield Selected Bond ETF (CSYSB) aims to track the yield and price performance of the S&P South African Yield Selected Nominal Bond Index, which is a custom Index that is independently calculated by the S&P Dow Jones. The Index consists of a fixed number of South African government bonds that offer the highest yield to maturity. It is a distributing ETF, which means that distributions will be paid out. Investments into this ETF are made in South African Rands.

- The management fee is 0.30% excl. VAT
- In terms of income distributions, it is a distributing ETF that pays out quarterly
- This ETF is suitable for investors with a long-term view and the risk profile is moderate

BENEFITS

According to CoreShares, the benefits of being invested in this custom high yielding ETF is as follows:

- Can be used as a useful asset allocation tool for investors: Can be used as a tool inside an investment solution when one is looking to grow the level of income that you have over extended periods of time
- Cost efficiency, transparency, and accessible: The benefits of investing in an ETF is that it is cost efficient, transparent, and easily accessible as it is listed on the JSE.
- Income generation and capital growth: Benefit of having an income component in your portfolio because of the potential level of predictability that it provides to the total return that you get from an investment, over the long term.
- Offers quarterly distributions that are paid out

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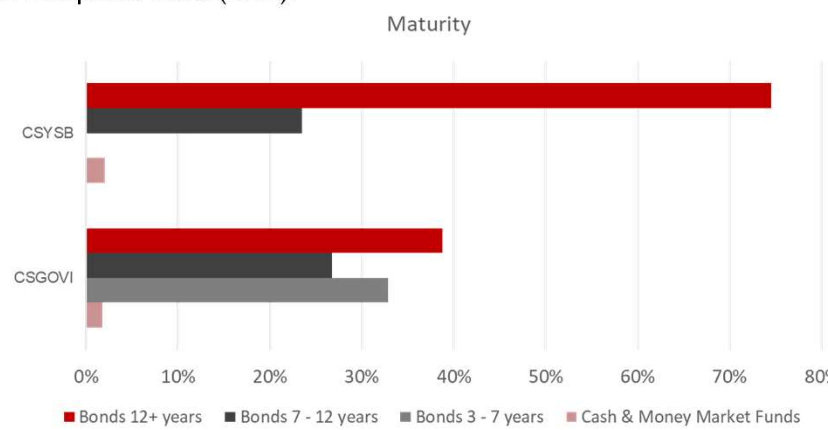
INDEX ANALYSIS

Even though the CoreShares Yield Selected Bond ETF (CSYSB) provides exposure to South African government bonds, this ETF does not look like your typical bond fund. The S&P South African Yield Selected Nominal Bond Index, which is what the CSYSB ETF tracks, is a custom Index that provides exposure to a select number of high yielding local nominal government bonds.

The CSYSB ETF aims to place an investor in the same position and weightings of the S&P South African Yield Selected Nominal Bond Index. By means of a comparison, the CoreShares GOVI ETF (CSGOVI), which tracks the FTSE/JSE All Bond Government Index (GOVI), has been included in this analysis for illustrative purposes only. The GOVI Index is comprised of all local government nominal bonds that fall into the top 10 positions of the ALBI Composite Index (ALBI).

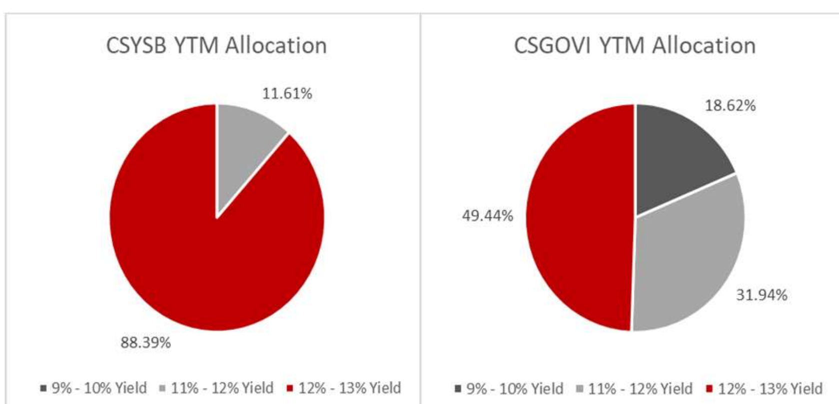
Looking at the maturity profile of the CSYSB ETF, it is comprised of longer dated bonds. Approximately 75% of the ETF consists of local government bonds with maturities of twelve-years-or-more, and the balance is in nominal government bonds with maturities of between seven-to-twelve years. Nominal government bonds with the highest Yield To Maturity (YTM) are considered for inclusion, and the ETF targets the long end of the bond index. The CSGOVI ETF, on the other hand, has a broader exposure to nominal government bonds, with varying maturities from three-years to twelve-or-more years.



Source: CoreShares (31 May 2023)

Understanding the relationship between bond maturities and their associated yields is vital. A bond's YTM refers to the overall expected rate of return, or interest rate, of a bond that an investor can expect to receive; if it is held until its maturity date, with all coupon payments made and the principal (initial amount) fully repaid. Coupon payments refer to the periodic interest rate payments that bondholders receive for holding the bond over its term to maturity

Looking at the allocation towards the YTM below, the CSYSB ETF largely consists of bonds with yields that are returning between 12% and 13%. This yield coincides with the maturity period, as the longer dated bonds are currently returning higher yields, when held to maturity. The CSGOVI, on the other hand, has varying maturities, of which almost 40% of the fund is invested in longer dated bonds. This is reflected in the YTM Allocation where the fund has a significant allocation towards bonds that are yielding between 12% and 13%. The CSGOVI ETF does not apply a capped weighting methodology, so a higher weighting towards a particular bond may be implemented. The CSYSB ETF, on the other hand, does apply a capping methodology, so the weightings of all the bonds in the index, and ETF, are almost the same.



Source: CoreShares (31 May 2023) *Bond yields as at 31 May 2023*

It is important to note that longer dated bonds are more sensitive to interest rate changes than shorter dated bonds. Interest rates and bond prices have an inverse relationship – when interest rates rise, bond prices fall (and vice versa), and in the case of a longer dated bond that has a greater duration, a lot more coupon payments remain than shorter dated bonds that are closer to maturity. If the bond is also sold prior to the maturity date in a rising rate environment, the price at which it is sold could be less than the price it was purchased at, so you could potentially lose out. Even in a rising rate environment, longer dated bonds are still currently offering attractive yields.

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METHODOLOGY

Understanding the investment strategy is vital to know what you will be investing in. The CoreShares Yield Select Bond ETF (CSYSB) intends to achieve a similar risk low profile to the PREFTRAX ETF, as well as to provide income, just in the form of interest rather than dividends. The income of these two ETFs, however, differ. Preference shares pay dividends, whereas interest is taxed as income, which is subject to one's marginal tax rate.

The CSYSB ETF focuses on a bond's yield, specifically its Yield To Maturity (YTM). The local government bonds included in the ETF are weighted according to their yield and only a select number of bonds, with the highest yields, are considered for inclusion. The bonds with the highest yield will have the highest weight in the fund's weighting, of which a capping rule of 15% applies. This means that no one constituent can have a weighting larger than 15% in the fund. The capping methodology is overlayed on the fund for liquidity risk and spread purposes. The CSYSB ETF is reviewed semi-annually and is reweighted to the Index quarterly.

With a targeted focus on the long end of the bond Index, the ETF is designed to have yields higher than the typical government bond Index, in a normal interest rate environment. Due to the Index applying a yield-selected methodology, it is adaptive in selecting the highest yielding bonds. Any changes to the ETF would take place because of a consistent inversion of the yield curve or when the shorter dated bonds become a lot more attractive from a yield perspective. The concept of the fund already exists in the form of a unit trust and is now available in an ETF form.

Source: CoreShares (3 May 2023)

RISK PROFILE

Like all investments, investing into bonds are not without risk. CoreShares highlights the following risks to be aware of when investing in this fund:

- **Index Tracking Risk** – The fund's returns may not match the index returns due to operating costs.
- **Liquidity & Capital Risk**: An investment in the fund involves risks like those of investing in any fund of bond instruments such as liquidity risk and capital risk.
  - **Liquidity Risk**: A risk that an investment cannot be bought or sold on time to prevent or minimise a loss
  - **Capital Risk**: A risk that part, or all of an investment results in a loss

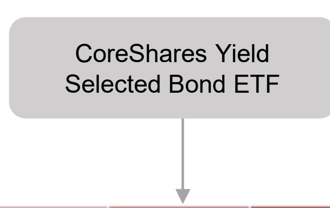
The additional risks highlighted below are some of the factors that investors should consider. These factors are not intended to be comprehensive or exhaustive. Various other risks may also apply. Investors should be aware of their risk appetite and should be mindful of the risks associated with investing in this ETF. Be sure to obtain the latest information and risk considerations of the ETF from the managing company. etfSA.co.za classifies the risk profile of the CSYSB ETF as moderate.

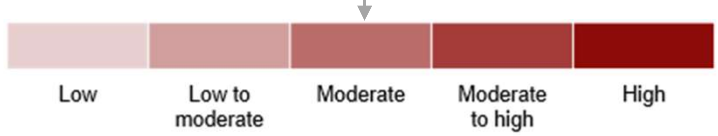
Market Risk: Market risk exists because of price changes. As the portfolio will always be exposed to markets, it is effectively exposed to market-related volatility

Inflation Risk: Inflation reduces the purchasing power of a bond's future coupons and principal. Inflation may also lead to higher interest rates, which causes a bond's price to fall.

Credit Risk: The risk that the issuer may not make coupon or principal payments on time, therefore defaults.

Interest Rate Risk: Interest rate changes can affect a bond's value in price. Rising interest rates will cause a bond's price to fall. If it sold before maturity, the bond may be worth more or less than the face value.





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