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The Home of Retirement Funds

ETF Insights: Understanding Costs, Taxes & Performance

etfSA.co.za
Investment Seminars
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Agenda

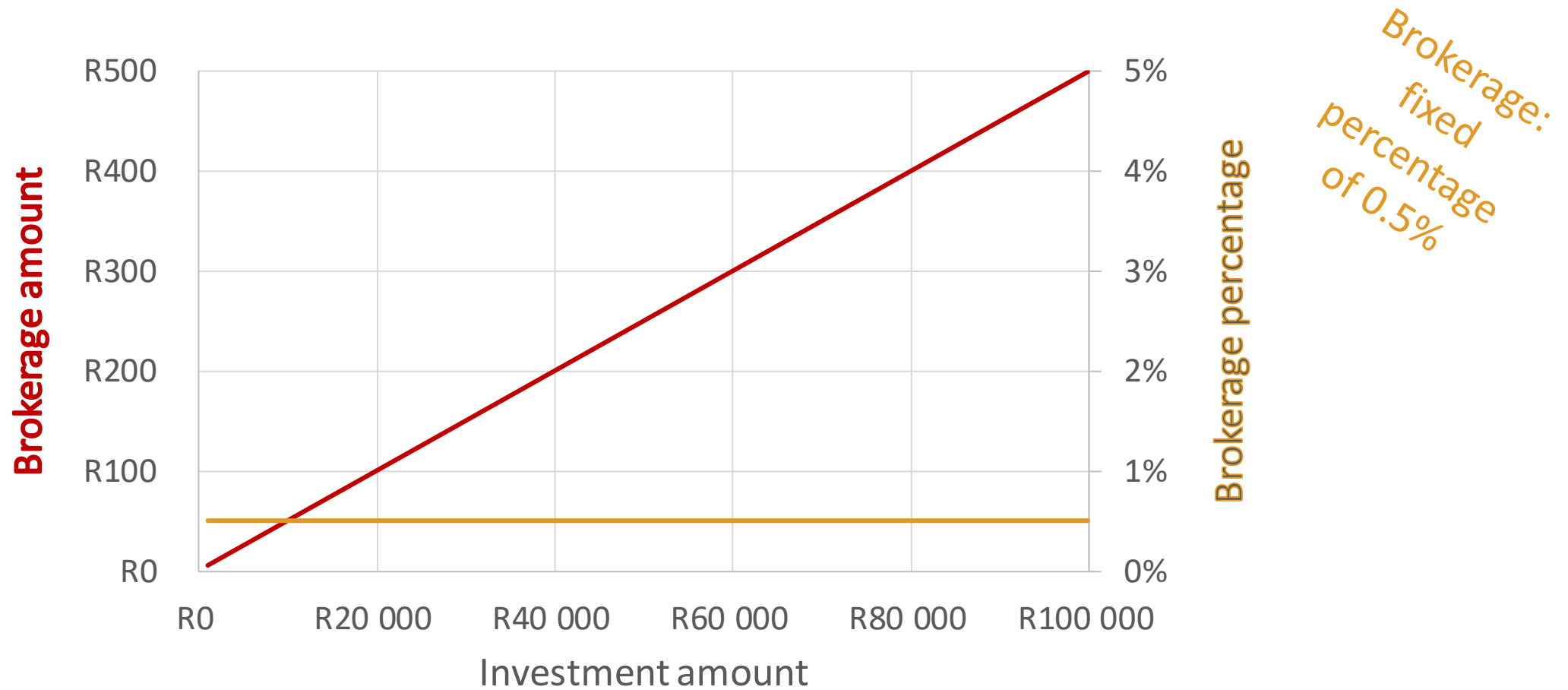
- Part I – Insights
 - Understanding the impact of **costs**
 - Understanding the impact of **tax**
 - Understanding **performance** measurement
- Part II – Index changes, New ETFs
 - FTSE/JSE
 - Changes to **index methodology**
 - **SABMiller** delisting
 - **New ETFs** on the horizon
 - Satrix
 - CoreShares

Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**

Understanding the impact of costs



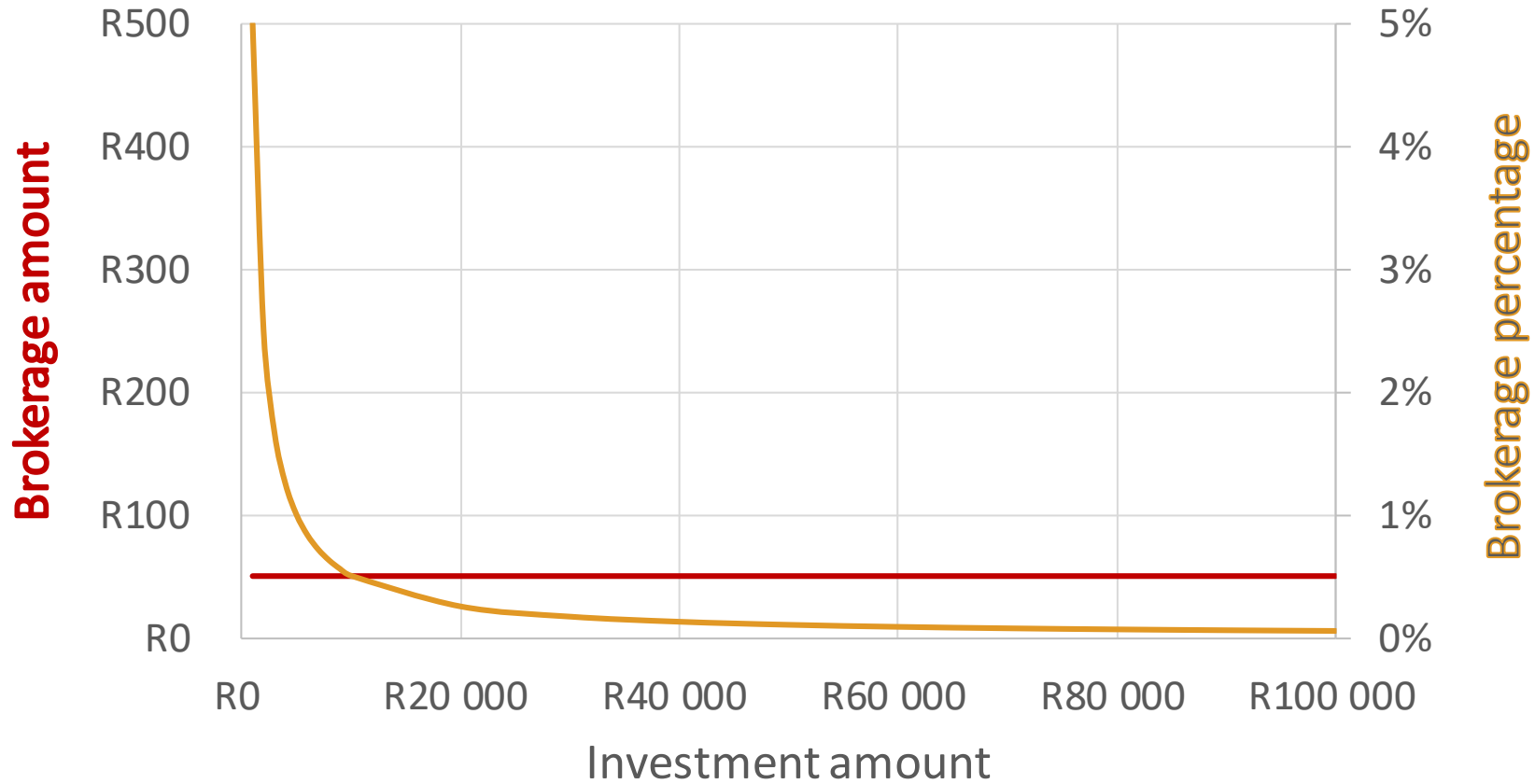
Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**
 - The **bigger** the investment amount, the **bigger** the brokerage amount
 - Best suited for **small** investment amounts and **frequent** investments
 - Brokerage of **R50**

Understanding the impact of costs

Brokerage:
fixed cost
of R50



Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**
 - The **bigger** the investment amount, the **bigger** the brokerage amount
 - Best suited for **small** investment amounts and **frequent** investments
 - Brokerage of **R50**
 - The **bigger** the investment amount, the **bigger** the brokerage %
 - Best suited for **large** investment amounts and **lump sum** investments

Understanding the impact of costs

Administration charges

- **Annual** fee, typically payable on a monthly or quarterly basis, **throughout the year**
- Can be a fixed **percentage** of your total investment amount or a fixed **rand** amount
- Impact as for brokerage – **BUT** you **cannot add** the two **together** to get a **total cost**

Understanding the impact of costs

Transaction costs and Administration charges combined

▪ Lump sum example:

- Invest R12,000 at 0.5% brokerage and 0.5% admin fee p.a.
- Brokerage: 0.5% of R12,000 = R60
- Admin fee payable quarterly, total of R60*:
 - Q1: $R12,000 * 0.5\% / 4 = R15.00$
 - Q2: $R12,000 * 0.5\% / 4 = R15.00$
 - Q3: $R12,000 * 0.5\% / 4 = R15.00$
 - Q4: $R12,000 * 0.5\% / 4 = R15.00$
- Total for brokerage + admin = R120
- Percentage of investment amount = 1%

* Assume no growth in investment

Understanding the impact of costs

Transaction costs and Administration charges combined

▪ Debit order example:

- Invest R1,000 p.m. at 0.5% brokerage and 0.5% admin fee p.a.
- Brokerage: $12 \times 0.5\%$ of R1,000 = R60
- Admin fee payable quarterly, total of R37.50*:
 - Q1: $R3,000 \times 0.5\% / 4 = R3.75$
 - Q2: $R6,000 \times 0.5\% / 4 = R7.50$
 - Q3: $R9,000 \times 0.5\% / 4 = R11.25$
 - Q4: $R12,000 \times 0.5\% / 4 = R15.00$
- Total for brokerage + admin = R97.50
- Percentage of investment amount = 0.81%

* Assume no growth in investment

Understanding the impact of costs

What is the **cheapest**? It **depends!**

- **General rules** to remember:

- **Transaction** costs increase in rands and decrease in % as

- investment **amount** increases
 - investment **frequency** increases
 - **number** of transactions (number of ETFs) increases

- **Administration** costs are typically

- **accrued** on a daily basis and **paid** on a monthly basis
 - paid out of **distributions** / cash held
 - **rand amount** increases as investment value increases

- Don't forget about cost of **reinvestment of dividends** and **VAT**

Understanding the impact of costs

Total Expense Ratio (TER)

- This is **not a "cash flow expense"**
 - You do not pay for it **directly**
 - You effectively **"pay for it"** through **lower performance**
- Assume an investment **return** before costs of **10%**
 - If the **TER = 0.5%**, your investment will only return **9.5%**
 - If the **TER = 1.5%**, your investment will only return **8.5%**
 - The **higher** the TER, the **lower** your investment return
- **Active** management attempts to give you more **"alpha"** than the **TER impact**, but this is **seldom the case***

* 85% of active managers fail to beat the index – SPIVA Report, S&P Dow Jones

Understanding the impact of costs

What is included in the **TER**?

- **Fixed costs**
 - Trustee fee; audit fee; regulatory charges; licensing fees, etc.
 - The **smaller** the fund, the **bigger** this is **as a %** of fund size
- **Variable costs**
 - **Manco** fee (issuing company) – relatively small, and standard
 - **Asset management** fee – varies significantly according to investment style, incl. active vs. index-tracking
 - **Performance** fee – can be **significant**, especially if the “hurdle” is inappropriate
- **Trading** costs – varies significantly according to level of activity; **often excluded**

Understanding the impact of costs

Comparative Total Expense Ratios (TERs)

- Average TER for **actively** managed unit trusts
1.52% per annum
- Average TER for Exchanged Traded Products (ETPs)
0.33% per annum

Just remember that the TER does NOT include all costs!

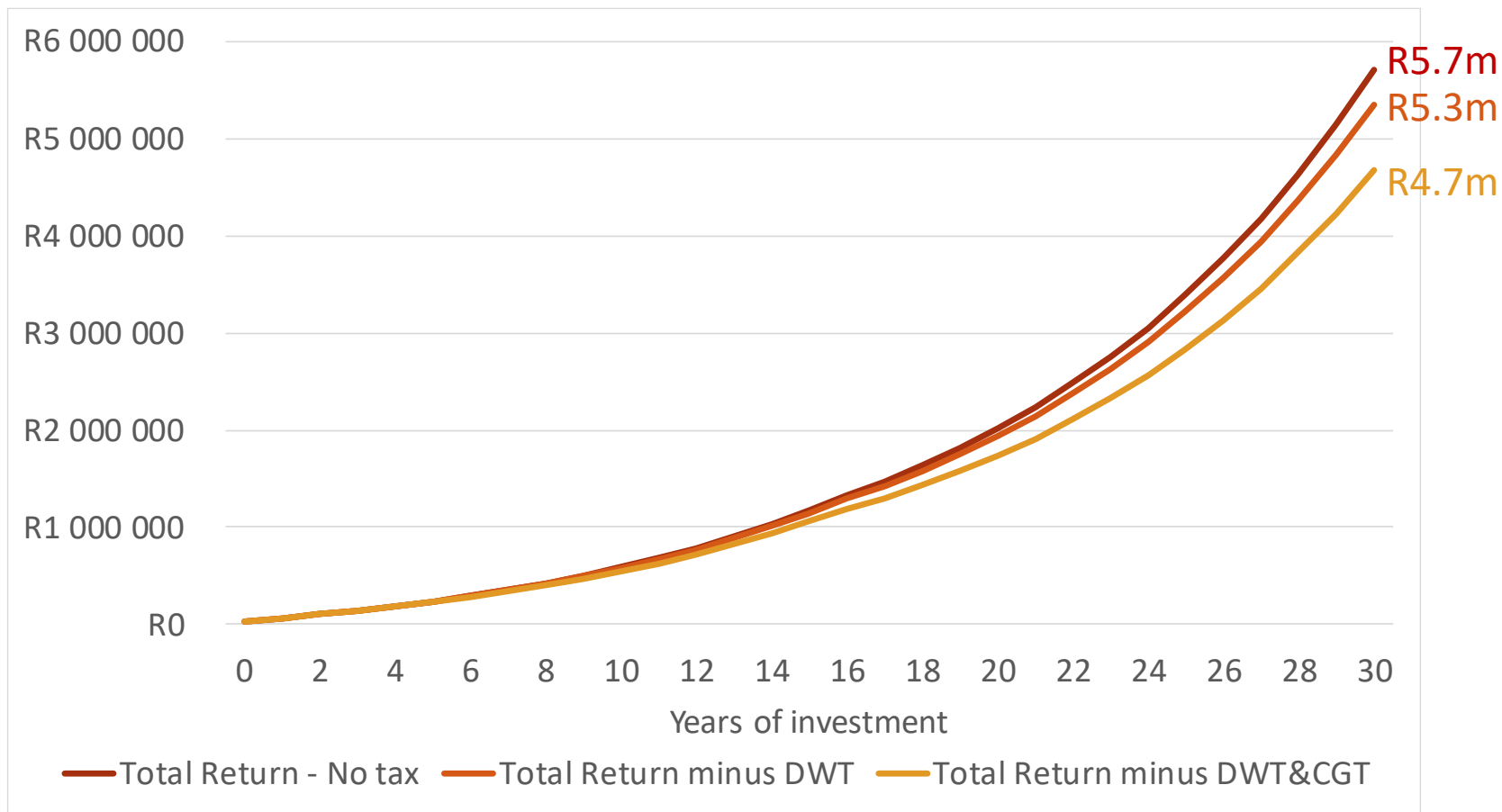
Understanding the impact of tax

Discretionary investments

- All contributions are made with after-tax money
- All distributions are taxable
 - Dividend Withholding Tax (DWT) of 15%
- All growth is taxable
 - Capital Gains Tax (CGT) of up to 16.7%
- BUT there are no constraints on how much, where and what you can invest in

Understanding the impact of tax

Assumption: invest R30,000 per year up to R500,000



Discretionary investments

- Dividends (DWT)
 - Reduces total return by **6.4%** after 30 years
- Capital gains (CGT)
 - Reduces total return by a further **11.6%** after 30 years
- Total reduction of **18.0%**

Note: Based on total return of 11% (9% capital gain and 2% dividend yield)

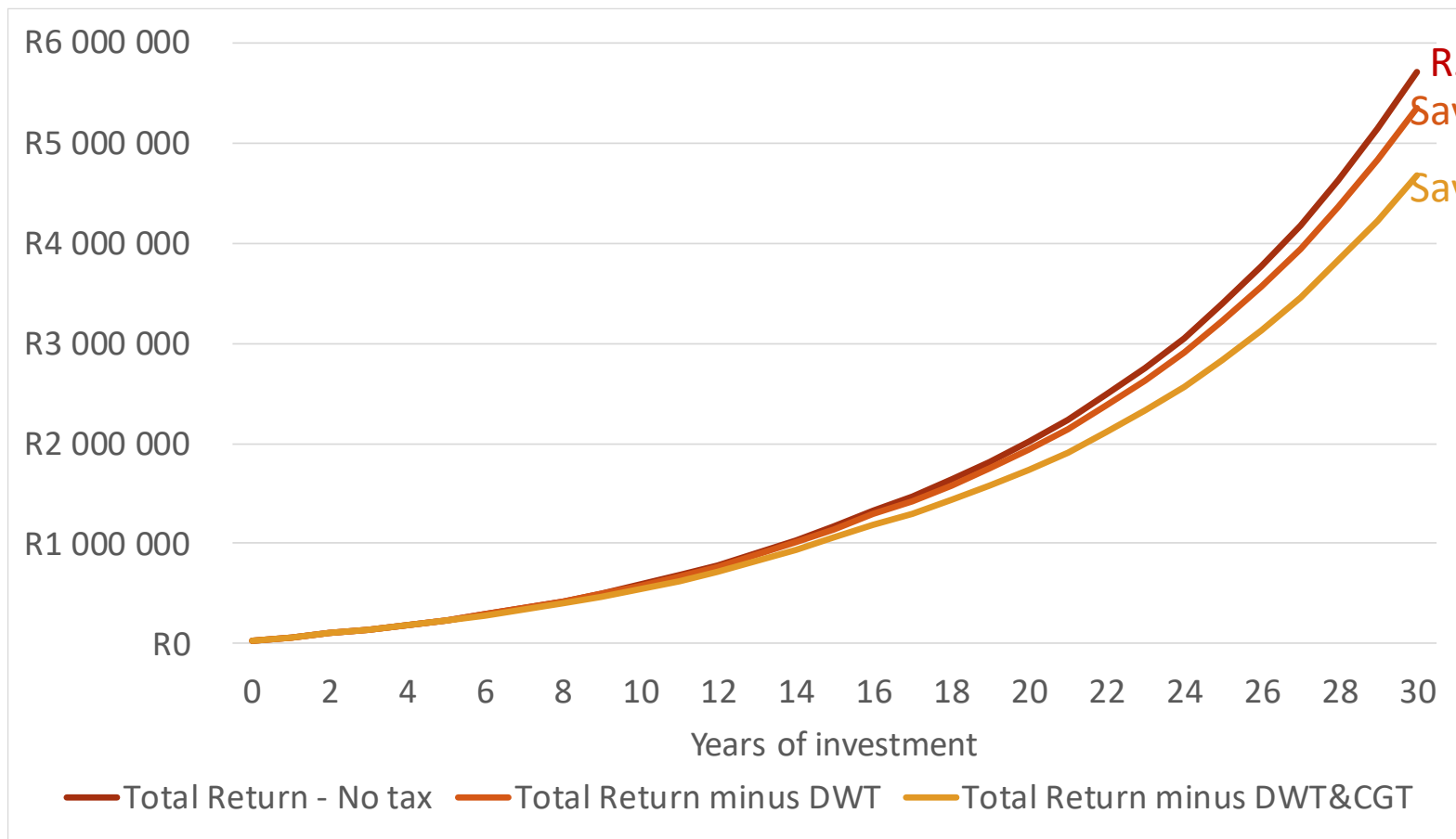
Understanding the impact of tax

Tax free investments

- **ALL proceeds** are tax free:
 - Dividends
 - Interest
 - Capital gains!
- The **full benefit** only comes after years of **compounding**
- Although you are **allowed to withdraw** from a tax free account, you are “**robbing your future self**” by doing so
- **BUT** there is an annual and lifetime limit on how much you can invest

Understanding the impact of tax

Assumption: invest R30,000 per year up to R500,000



Tax free investments

- No DWT payable
 - Save 6.4% after 30 years
- No CGT payable
 - Save another 11.6% after 30 years
- Total tax free benefit of 18.0% after 30 years

± R1million!

Note: Based on total return of 11% (9% capital gain and 2% dividend yield)

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Understanding the impact of tax

Retirement Annuities

- **Tax deduction upfront** (contributions are tax deductible)
 - If your tax rate is **18%**, you **save R90,000** in tax on **R500k**
- **ALL growth** is tax free:
 - Dividends
 - Interest
 - Capital gains
- **BUT** the **proceeds are taxable** at your income tax rate
- Unless you pay less than **18%** tax in retirement, you are **better off in a tax free** investment!

“Where do I start?”

- **Tax Free Investment**
 - **Contribute** the **maximum** allowance – currently **R30,000 p.a.**
 - **Resist** the **temptation** to **withdraw early** – this is not an emergency savings fund!
- **Retirement Annuity**
 - **Contribute** the **maximum** tax deductible allowance – currently **27.5% of your gross taxable income**
 - Use the tax **savings to fund** your tax free investment
- **Discretionary Investment**
 - Invest **whatever remains** – the more the better!

Understanding performance measurement

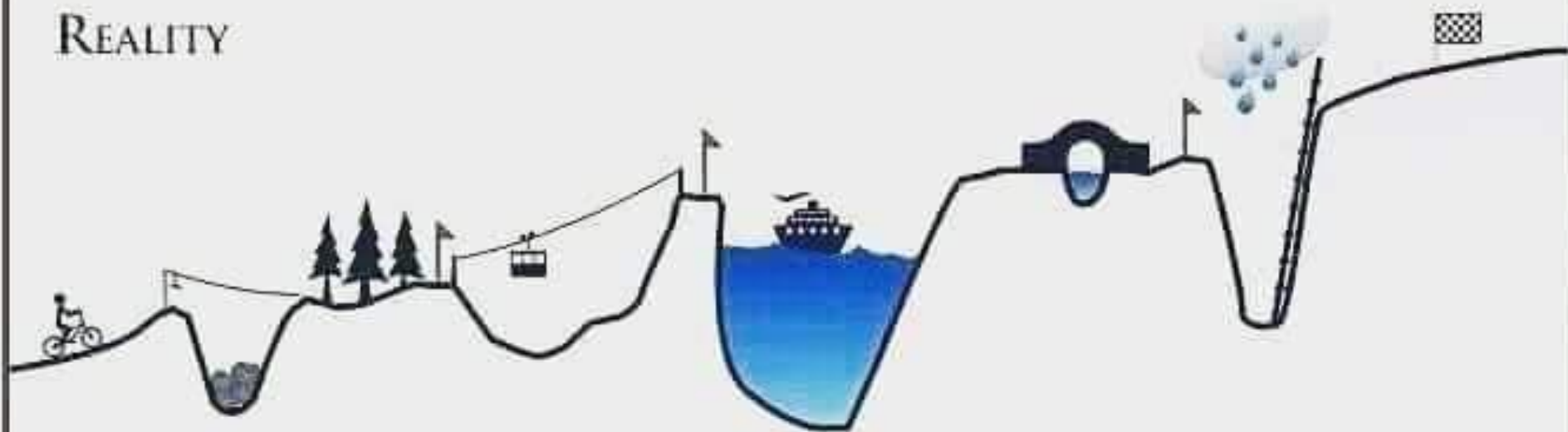
Some concepts:

- **Fund / Share price returns**
 - Measured from **point to point**
 - 'Path' has **no impact** on calculation
- **Portfolio / Investment returns**
 - Internal rate of return (**IRR**) takes **cash flows** into account
 - Performance calculation is **path-dependent**
- Be careful of **comparisons**
 - **Like-with-like**
 - **Annualised** (if <12months treat with caution)

YOUR PLAN

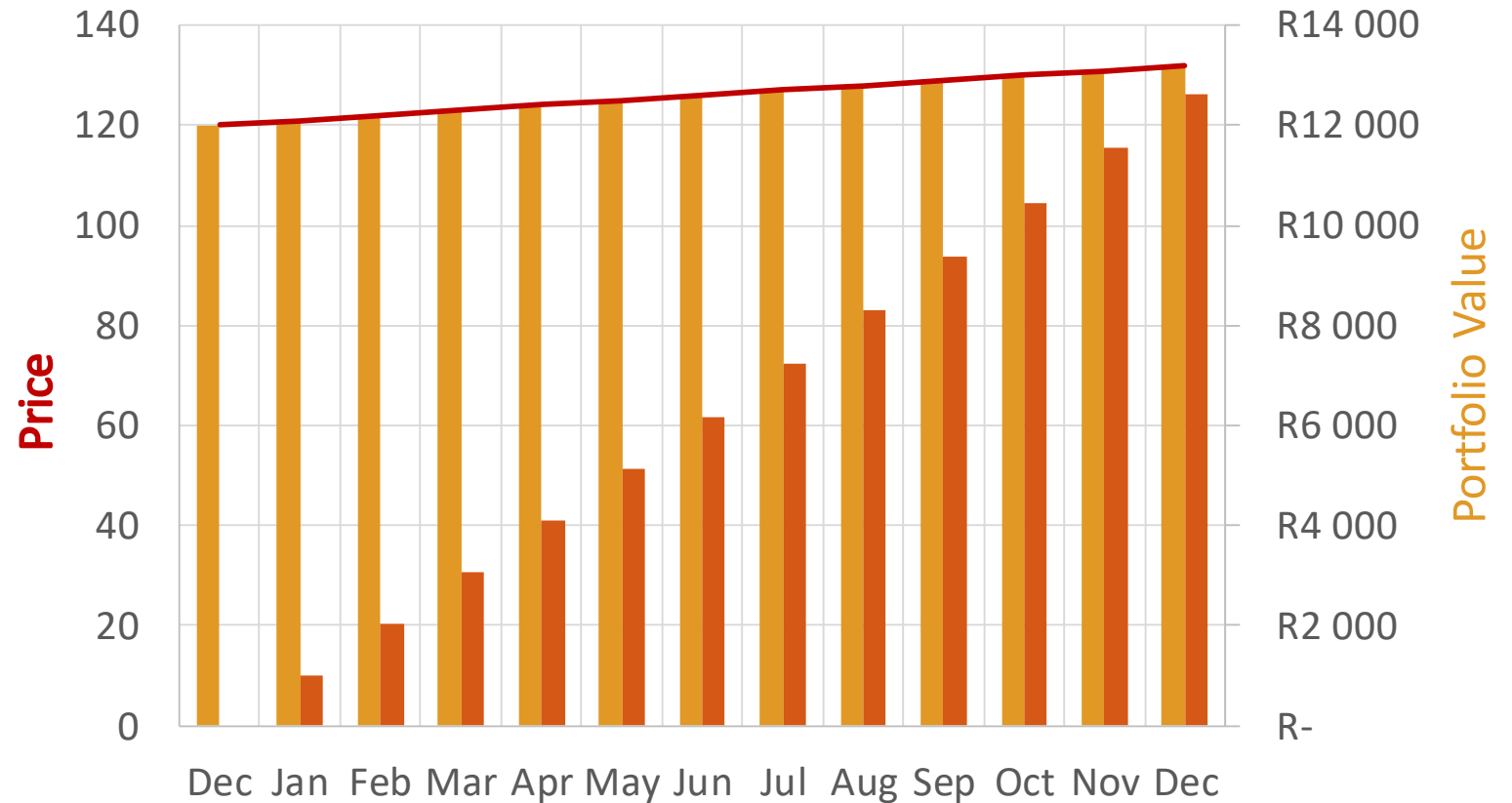


REALITY



Understanding performance measurement

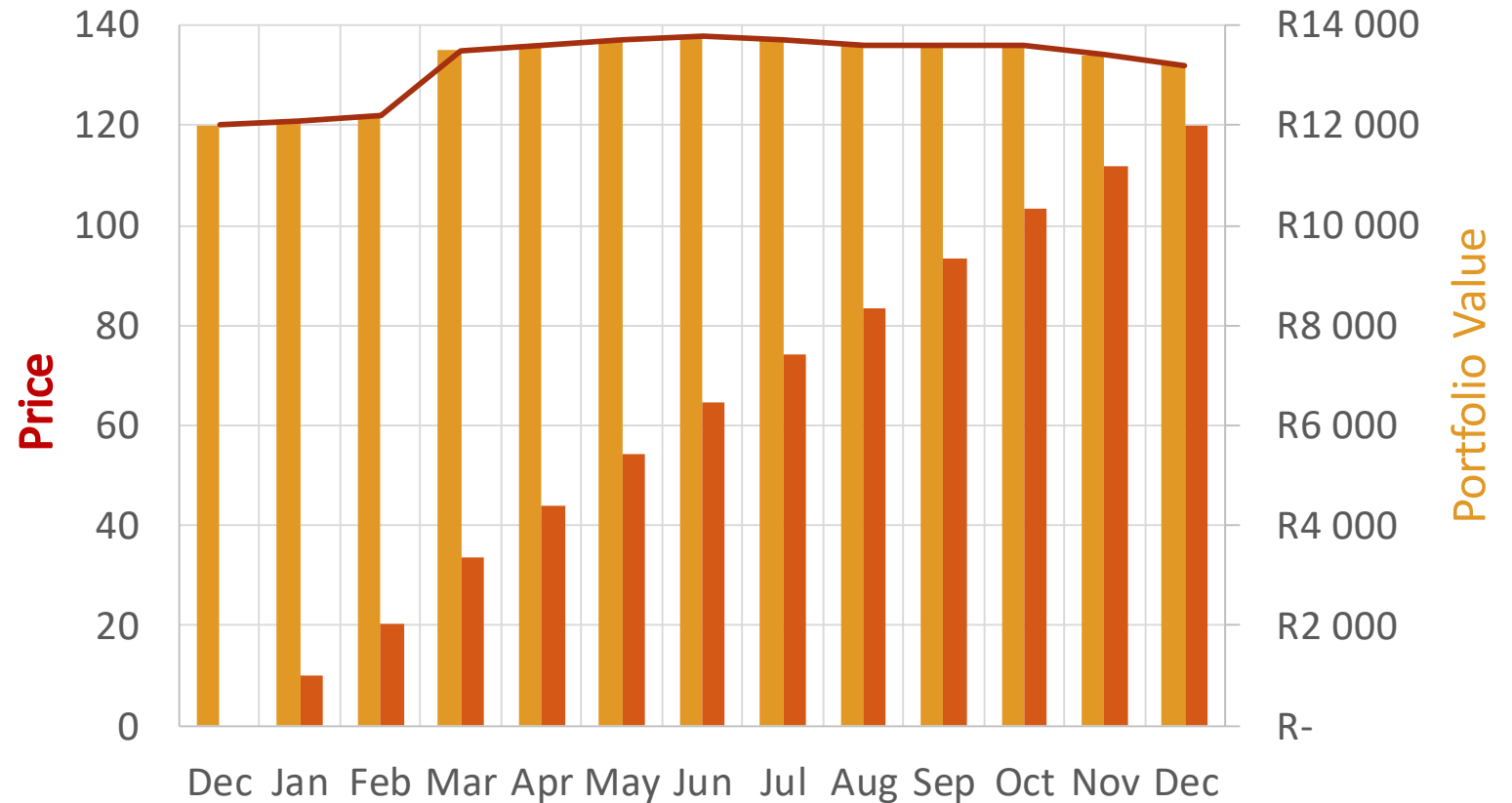
- **Lump sum investment performance**
 - = **fund** returns
 - e.g. IRR = 10%
- **Debit order investment performance**
 - < **fund** returns in **rising** market – buying at higher prices
 - e.g. IRR = 9.8%
 - > **fund** returns in **falling** market – buying at lower prices



Understanding performance measurement

Market rises then falls

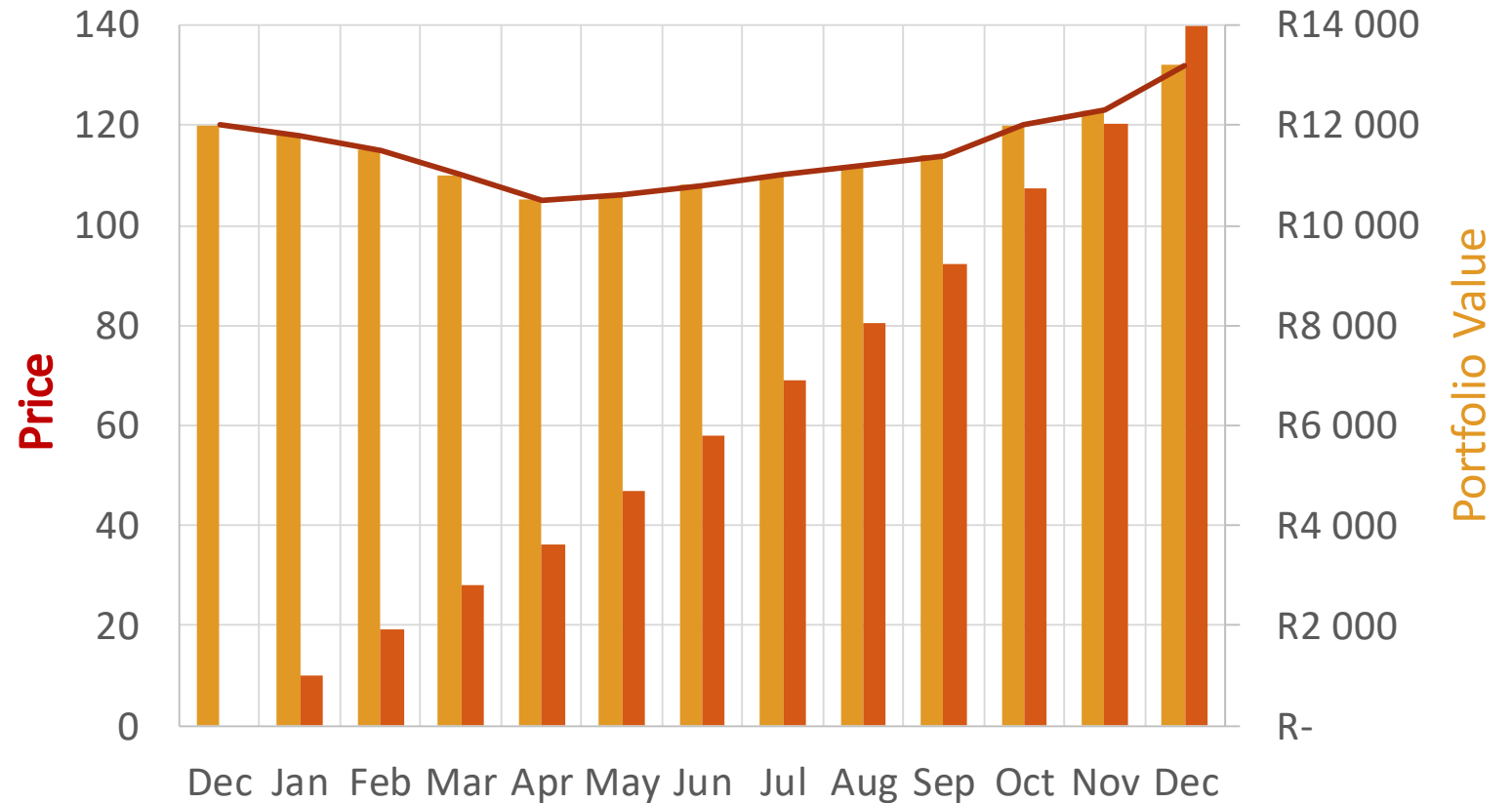
- **Lump sum** investment performance
 - = **fund** returns
 - e.g. IRR = 10%
- **Debit order** investment performance
 - **bought more at higher prices**, so **performance is lower**
 - e.g. IRR = 0%



Understanding performance measurement

Market falls then rises

- **Lump sum** investment performance
 - = **fund** returns
 - e.g. IRR = 10%
- **Debit order** investment performance
 - **bought more at lower prices**, so **performance is higher**
 - e.g. IRR = 32%



Changes to Index Methodology FTSE/JSE

- **Selection** of constituents of **size based** indices, e.g. Top40
 - **Old**: based on **full** market cap
 - **New**: based on **free float** / **SWIX** market cap
 - Impact on **Top40**:
 - **New** inclusions: Gold Fields, Bidvest, Sibanye Gold, Life Healthcare
 - Dropped **out**: Capitec, Rand Merchant Ins., Angloplats, Capital & Counties
 - Impact on **SWIX40**:
 - **New** inclusions: Bidvest, Sibanye Gold, Gold Fields, Life Healthcare, Spar
 - Dropped **out**: Capitec, RMI, Angloplats, Intu Properties, Capital & Counties
- **Inward listing** qualify if SA register **>1%** of shares
 - Impact: **Glencore**, **South32**, etc. now included; **AB-InBev** not yet
- New **capped (10%) SWIX** index – **new active benchmark?**

Changes to Index Methodology FTSE/JSE

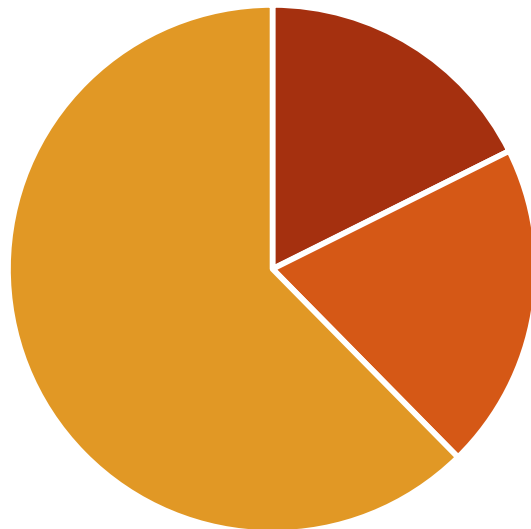
- **Top40** Index (STX40, ASHT40, STAN40)

Old		New – also ex SAB	
Top 10 holdings (%)	65.9	Top 10 holdings (%)	62.2
NPN Naspers -N	17.1	NPN Naspers -N	19.2
SAB SAB Miller	13.8	BIL BHPBilliton	8.2
CFR Richemont	7.1	CFR Richemont	7.9
BIL BHPBilliton	6.6	BTI BAT	4.7
BTI BAT	4.6	AGL Anglo American	4.3
SNH Steinhoff	3.8	SOL Sasol	3.9
MTN MTN	3.5	MTN MTN	3.9
SOL Sasol	3.4	SNH Steinhoff	3.8
AGL Anglo American	3.3	OML Old Mutual	3.2
OML Old Mutual	2.9	SBK Standard Bank	3.2

Changes to Index Methodology FTSE/JSE

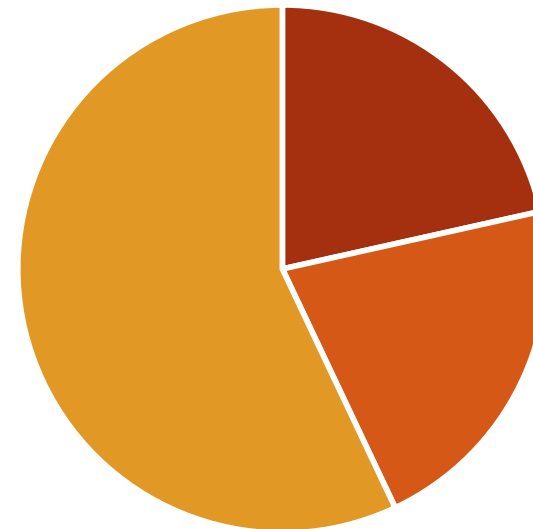
- **Top40** Index (STX40, ASHT40, STAN40)

Old



■ Resources ■ Financials ■ Industrials

New – also ex SAB



■ Resources ■ Financials ■ Industrials

Changes to Index Methodology FTSE/JSE

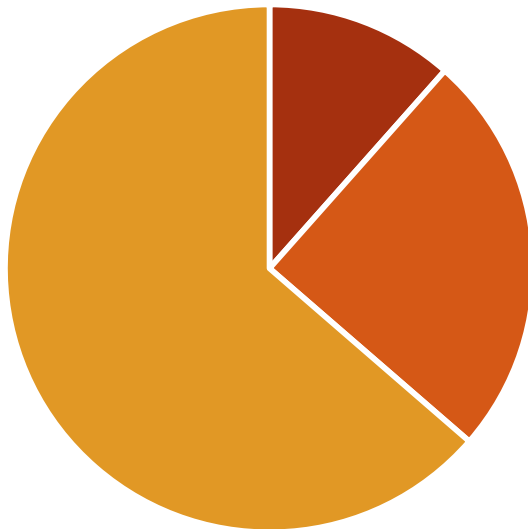
- **SWIX40** Index (STXSWX, NFSWIX, STANSX)

Old			New – also ex SAB	
Top 10 holdings (%)	60.8		Top 10 holdings (%)	59.7
NPN Naspers -N	23.5		NPN Naspers -N	24.0
BTI BAT	6.3		BTI BAT	5.9
SNH Steinhoff	5.2		SOL Sasol	4.9
MTN MTN	4.8	<i>Very little impact</i>	MTN MTN	4.9
SOL Sasol	4.7		SNH Steinhoff	4.8
SAB SAB Miller	4.2		SBK Standard Bank	4.0
SBK Standard Bank	3.7		FSR Firstrand	3.4
FSR Firstrand	3.0		SLM Sanlam	2.6
REM Remgro	2.8		REM Remgro	2.6
APN Aspen	2.7		OML Old Mutual	2.6

Changes to Index Methodology FTSE/JSE

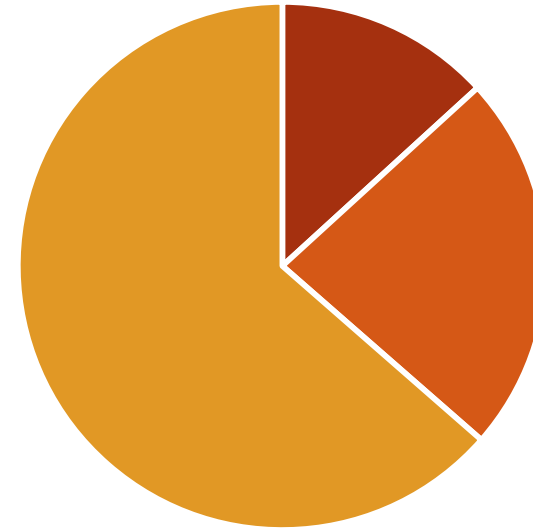
- **SWIX40** Index (STXSWX, NFSWIX, STANSX)

Old



■ Resources ■ Financials ■ Industrials

New – also ex SAB



■ Resources ■ Financials ■ Industrials

Source: FTSE/JSE; etfSA calculations. As at 30-Sep-16

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New ETFs from Satrix & CoreShares

■ Satrix

- Re-entry into ETF market
- Expand to other asset classes
 - 1st phase – listed property, fixed interest (bonds)
 - 2nd phase – international assets
- Expand to “smart” beta

■ CoreShares

- Expand to international assets – listing date 4-Nov-16
 - S&P 500 ETF
 - S&P Global Property ETF

New Satrix ETFs



Asset Class	Fund	Index
Listed Property	Satrix Property ETF	S&P SA Composite Property Capped Index
Fixed Interest	Satrix ILBI ETF	S&P SA Sovereign Inflation-Linked Bond Index

*regulatory approvals pending



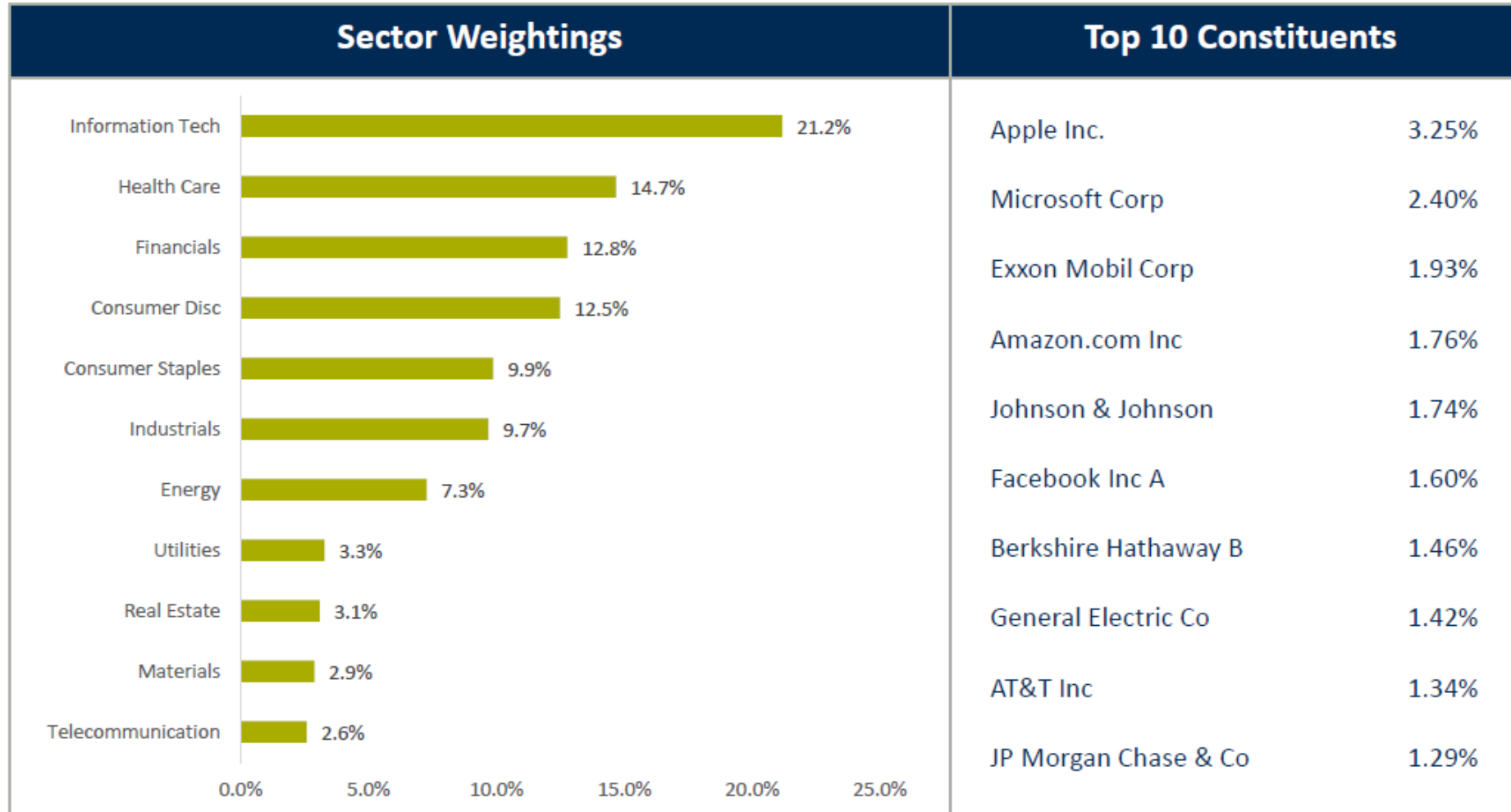
Comparative Listed Property Indices

- An alternative property index

FTSE/JSE (PTXSPY, STPROP)	<i>Less concentration</i>	S&P (New Satrix)	
Top 10 holdings (%)	84.8	Top 10 holdings (%)	87.1
GRT Growthpoint	20.0	HYP Hyprop	11.1
RDF Redefine	14.2	GRT Growthpoint	10.8
NEP NEPI	10.5	RDF Redefine	10.2
RES Resilient	9.4	ITU IntuProp	9.9
HYP Hyprop	9.2	RES Resilient	9.8
FFB Fortress B	6.1	ATT Attacq	8.4
ROC Rock Castle	4.8	CCO CapCountry	8.1
FFA Fortress A	3.8	RPL Redefine Int'l	6.9
SAC SA Corporate	3.5	VKE Vukile	6.2
ATT Attacq	3.2	SAC SA Corporate	5.9

More international

CoreShares S&P500 ETF



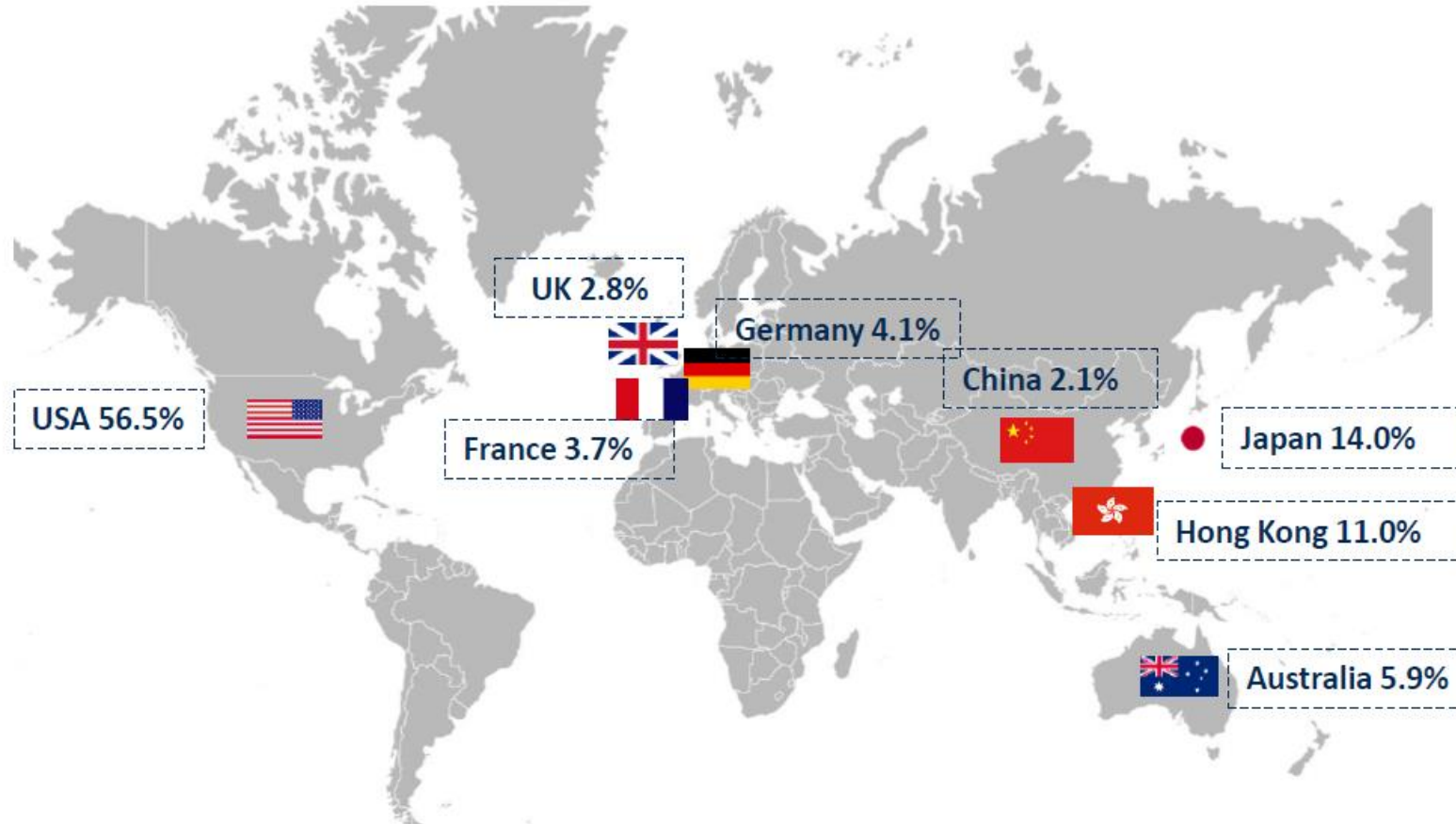
Source: CoreShares; As at 30-Sep-16

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CoreShares S&P Global Property ETF

S&P Global Property 40 Index Country Composition

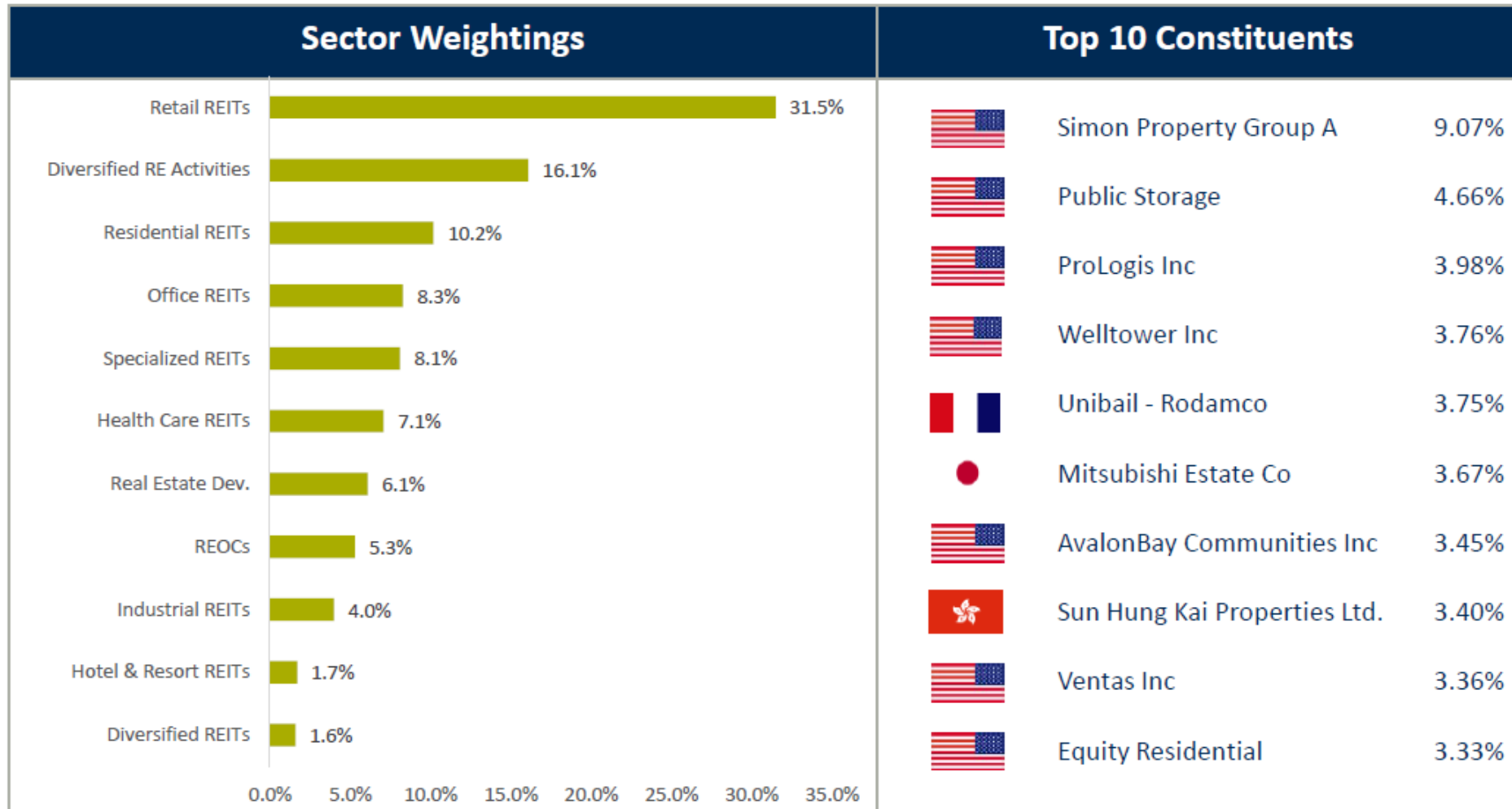


Source: CoreShares; As at 30-Sep-16

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CoreShares S&P Global Property ETF



Source: CoreShares; As at 30-Sep-16

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Question time



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