

ETFs Trade idea

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Conflicting signals in the U.S. Time for caution?

ETFs S&P 500 High Yield Low Volatility ETF (ZYUS)
ETFs Physical U.S. Dollar ETF (ZUSD)

- The U.S. economy continues to surprise to the upside with markets rebounding strongly.
- Yet rising inflation, subdued long-term rates and geo-political risks remain a concern.
- For a defensive U.S. equity exposure, investors should consider **ZYUS**.
- Avoiding equity-risk and looking for currency? Consider **ZUSD**.



In this week's *ETFs Trade idea*, we look at the outlook in the U.S. for monetary policy, the economy and the dollar. We highlight two funds that can be used in different ways to play the U.S. story; **ZYUS** and **ZUSD**.

Rate rises on the horizon...

Market expectations for multiple rate rises from the U.S. Federal Reserve in the remainder of 2018 have firmed in recent weeks. The economy is still in expansionary territory, though inflationary concerns are becoming more pertinent. US Core CPI rose to 2.1% in March, its highest level in over a year, while March PPI numbers also exceeded expectations. The Fed Beige Book reported strong economic activity, but showed significant business concerns around Trump's planned steel and aluminium tariffs.

Figure 1 below shows the current probabilities the futures market is implying for Fed activity for the remainder of 2018, with two further hikes narrowly the most likely outcome

Table 1: Futures Implies Probabilities of Federal Reserve Activity in 2018

	1.50% - 1.75%	1.75% - 2.00%	2.00% - 2.25%	2.25% - 2.50%	2.50% - 2.75%	2.75% - 3.00%
Year-end Fed Funds target rate range	1.75%	2.00%	2.25%	2.50%	2.75%	3.00%
Probability	1.5%	14.9%	38.7%	33.1%	10.7%	1.1%

Source: Bloomberg data as at 19 April 2018. The current Fed Funds target range is 1.50% to 1.75%. At the start of 2018 the target range was 1.25% to 1.50%.

...but longer-term growth concerns are becoming more pronounced.

While short-term yields have been rising, the yield curve has seen a substantial flattening, with the difference between 2-year and 10-year Treasury yields at their lowest since late-2007 (see Figure 2). Speculation of a curve inversion is starting to emerge. Historically this would indicate that the peak of the current rate cycle is approaching and present a subdued outlook for growth.

U.S. dollar weakness continues...

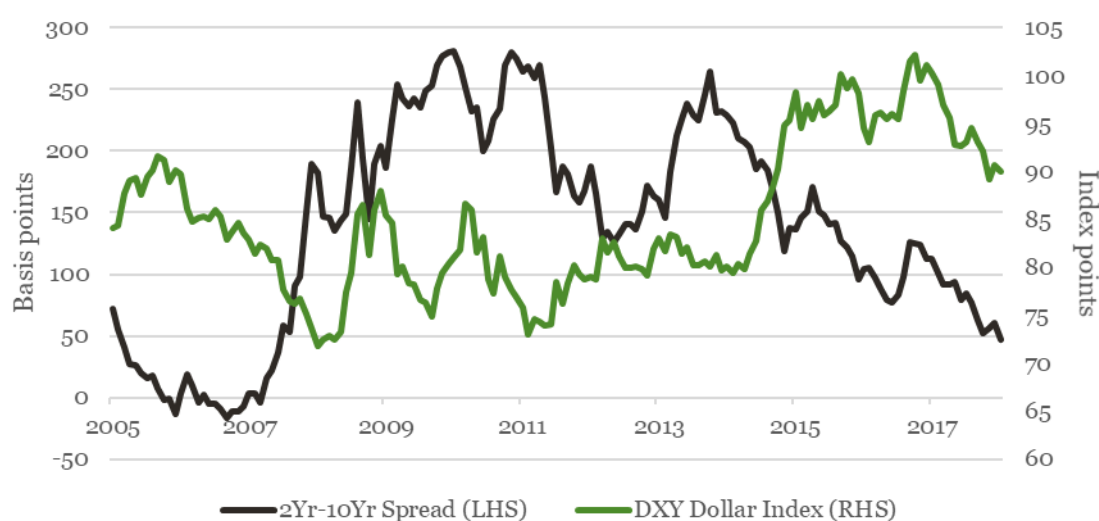
Despite rising short-term rates, the U.S. dollar has been in a steady down-trend since early 2017, as shown in Figure 2. This can be partly attributed to President Trump's rhetoric regarding trade and towards China, but also to a gradual unwinding of GFC-era flight-to-safety trades.

...but political risks could be a catalyst

With the impositions of tariffs and a potential trade with China, military action in Syria, sanctions against Russia and talks with North Korea on the horizon and February's equity market volatility still fresh in the memory, there is no shortage of event risk candidates looming. With external events and any evidence of

longer-term U.S. economic strength both likely to have a positive impact on the dollar, it appears that near-term risks may lie to the upside.

Figure 2: 2yr-10yr U.S. Treasury yield spread (LHS) versus DXY Dollar Index (RHS)



Source: Bloomberg data as at 19 April 2018.

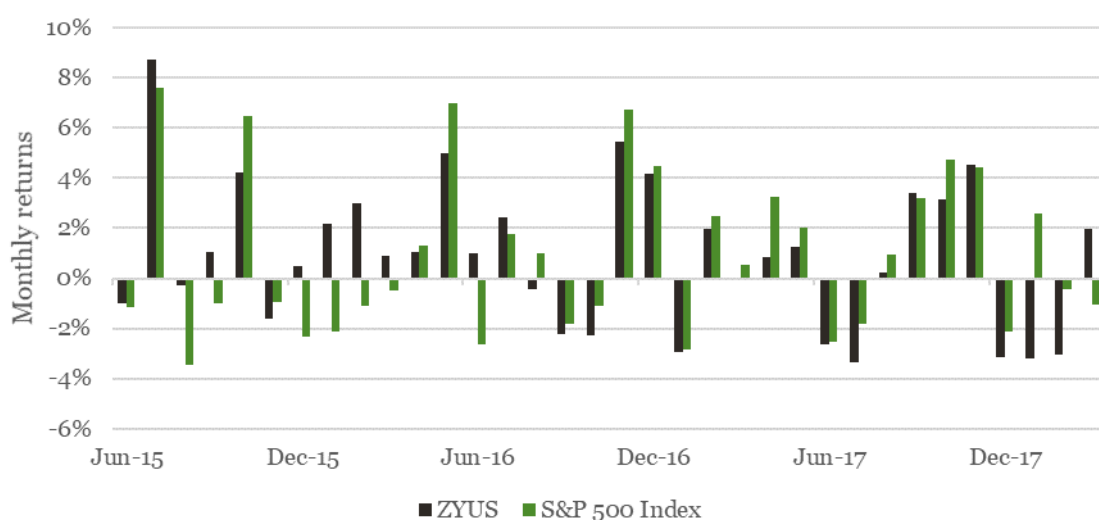
Why ZYUS?

ZYUS invests in U.S. stocks from the S&P 500 screened for both high yield and low volatility. As such, the fund tends to be overweight defensive sectors like utilities and real estate and underweight more volatile sectors like technology and financials. The S&P 500 Low Volatility High Dividend Index, which **ZYUS** tracks, has outperformed the S&P 500 by over 3.6% per annum over the past 10 years and has outperformed on a monthly-basis in over 70% of months during which the S&P 500 has posted a negative return.

After underperforming the S&P 500 by over 9.5% in 2017, mainly due to its underweight to technology, **ZYUS** has recently picked up. Outperformance in March 2018 was over 3% as volatility hit the tech sector and risk-aversion appeared.

ZYUS should be considered by investors wanting to maintain U.S. equity exposure, but take a more cautious view on growth and the landscape ahead.

Figure 3: Comparative monthly returns of ZYUS against the S&P 500 Index since inception (9-Jun-2015)



Source: Bloomberg data as at 19-Apr-2018



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Why **ZUSD**?

Investors looking for pure exposure to the U.S. dollar strengthening against the Australian dollar without taking on any equity risk may consider **ZUSD**, which tracks the exchange rate by investing in short-term USD deposits.

How **ZYUS** invests

ETFS S&P 500 High Yield Low Volatility ETF (ZYUS) is well positioned for investors for the following reasons:

- **ZYUS** captures the performance of a selection of 50 high yielding U.S shares selected from the S&P 500 Index and rebalanced twice annually.
- **ZYUS** initially screens stocks based on dividend yield, reducing the 500 stocks down to 75.
- **ZYUS** then selects the 50 stocks with the lowest volatility for inclusion and weights them according to their dividend yield.
- **ZYUS** has an MER of 0.35% p.a.
- **ZYUS** has a Recommended rating by Lonsec.

[ETFS S&P 500 High Yield Low Volatility ETF factsheet](#)

How **ZUSD** invests

ETFS Physical U.S. Dollar ETF (ZUSD) is well positioned for investors for the following reasons:

- **ZUSD** captures the performance of the U.S. dollar against the Australian dollar, by investing all of its assets in U.S. dollar bank deposits.
- **ZUSD** currently holds overnight USD deposits with Australia and New Zealand Banking Group Limited (ANZ), earning interest at 1.30% p.a.
- **ZUSD** has an MER of 0.30% p.a., making it the lowest cost U.S. dollar exposure available on the ASX.
- **ZUSD** has a Recommended rating by Lonsec.

[ETFS Physical U.S Dollar ETF factsheet](#)

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