

Investing offshore key to offsetting slowing markets

ANYONE with even a passing interest in investing should by now be familiar with the mantra 'past performance is no guarantee of future performance'.

Indeed, if one believes in the cyclical nature of markets, exactly the opposite is as likely to be true.

This principle is nowhere more relevant than offshore investing, where many local investors are still smarting from investments made a decade ago that have often lost money even after all this time.

As Rafiki famously said in *The Lion King*, "it's time to put the past in your behind".

There is almost no analyst today who would not find better value in offshore markets than the local market. However, this carries two provisos. Firstly,

currencies are so volatile today that even the least risky offshore investment becomes high risk once currency volatility is added to the equation.

Secondly, value investors insist that much of the good performance of the JSE has been restricted to growth stocks, leaving value stocks offer as much value as ever.

However, these two provisos apply to all markets today and are not differentiators.

The JSE may offer value in pockets, but foreign exchanges offer even more value and across the board.

Karl Leinberger, Coronation's chief investment officer, says South Africans have become used to poor performances from offshore investments over the past decade. "These markets delivered risk similar to South Africa's mar-

kets at the time, but produced significantly lower returns in the process." This is because our growth projections exceed theirs. As a result, many local investors are still loathe to take their chances offshore.

However, Leinberger says a number of changing factors should convince investors to reassess their offshore allocation. One of these is the value of the rand.

For instance, Craig Massey, head of stockbroking at Sanlam Private Investments (SPI), says: "Most fair value measures indicate the rand is overvalued on a purchasing power parity (PPP) basis when compared to the basket of currencies of countries we trade with."

He reckons the rand could soften to about R8/US dollar as global investors shift their fo-

cus away from emerging markets and back to developed markets. On this basis alone, he says, investors should take the opportunity to invest offshore to their maximum ability if they have not already done so.

It's time to put the past in your behind

Others believe the rand is as much as 25 percent overvalued. That means that returns over inflation could be significant if the rand reverts to fair value. Leinberger says that such a reversion would give investors substantial additional returns in rand terms on an offshore portfolio.

Of course, there is the caveat to this that the rand

could strengthen further before it returns to fair value, as it has already done many times. While the currency is an important source of volatility in investment return, Leinberger points out that the rand has over the longer term been relatively stable for the past decade and is therefore not a long-term factor, whereas the major motivation for investing offshore remains diversification. Nonetheless, he points out the current over-value of the rand makes the present timing fortuitous.

A typical South African investor will have all his assets in an emerging market (his home one) doubling the need to diversify into offshore assets. The question is only one of, which assets?"

"We're bearish on government bonds which is one asset

class where the price does not reflect the risks in the economy. It is the same story with corporate bonds, though there is some value in bank bonds.

"Our favoured asset class is global equities, notwithstanding the risk of a double dip recession which we believe is increasingly being priced into the market. Even the dividend yield on most blue chip equities exceeds the return on government bonds, at 2-3 percent – so equities need do nothing for a decade and would still outperform."

However, Leinberger says he expects a lot better performance than that.

Adding to that viewpoint, Massey explains that there has historically been a 50 percent risk premium built into local over foreign equities – a premium which has reversed in

the current market and therefore represents a mispricing of risk. For instance, Walmart is currently on a price/earnings (PE) valuation of 12 and Pick 'n Pay 23. Logic dictates that the PEs should be a lot closer to each other.

He attributes the mispricing to foreign investors chasing the emerging markets story and pushing prices to the extent that they no longer reflect the risks inherent in an emerging market.

"In contrast, Corporate US balance sheets are in good shape. It is easy for them to raise debt often cheaper than its dividend yield to repay shareholders, thereby leveraging up the equity yield," says Massey.

SPI favours equities of developed markets over emerging markets because of the margin

of safety they exhibit at current valuations.

Whereas Leinberger says he is surprised at how well commodities have held up, Massey believes the boom cycle remains intact and is being supported by continued strong growth in India and China.

Leinberger adds: "In property, there is little value to be had in the UK and US though some value exists in continental Europe and Asia, where the yields are good."

JP du Plessis, portfolio manager at Prescient Investment Management, says he is wary of investing in Europe at the moment. "The euro region sovereign debt issue is a very real worry that is nowhere near being resolved. It holds massive implications for growth in the euro region, and therefore also the rest of the world."