

# Let professionals decide on assets

The best way to maximise long-term investment returns is to get the mix of assets correct

Gareth Stokes

**A** long-term study of domestic asset class performance always ranks equities top of the pile, with the silver, bronze and "finisher's prize" going to listed property, bonds and cash — in that order. Over shorter periods it is not uncommon for bonds and cash to trounce stock market investments; but over 10 or more years you cannot go wrong with good old listed shares.

Candice Paine, head of Sanlam Investment Managers (SIM) Retail says that the bulk of an investment portfolio's performance is generally accepted to be driven by the asset allocation within the fund, though this is not the only source of return. A fund will typically generate return from three sources, namely the return from the asset allocation decision, the return from being invested in the market (as opposed to cash) and the return from specific security selection. The fees charged against the portfolio and market timing should also be considered. "The retail investor can maximise their return through a multi-asset class fund that gives access to fund manager expertise in adjusting asset allocation and security selection through different market conditions," she says.

"Asset allocation and diversification are the biggest drivers of portfolio performance in both the long and the short-term," says Pieter Koekemoer, head of Personal Investments at Coronation Fund Managers. "Over the years there have been many studies to pinpoint portfolio returns — all have different findings — but agree on one point: asset allocation determines the greatest part of portfolio returns."

Coronation Fund Managers expects global equities to return between 13% and 15% annually, in rand terms, over the current decade. This compares rather favourably with the 9% to 11% annual return forecast for local equities over the same period. They expect softer returns from local



**A man walks past a Vodacom container. High dividend stocks, such as Vodacom, African Bank and Oceana Fishing are proving popular with asset managers.**

Photo: David Harrison

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bonds, cash and property — in the region of 8% per annum. A quick look at SIM's asset allocation view suggests they have similar expectations. The group is neutral on SA equities, but holds an overweight position in global equities, primarily through potions in European large capitalisation stocks, which, they believe offer the best value.

As 2011 gets underway South African fund managers have adopted a diversification first, asset allocation later strategy. The most important short-term decision is how much of their capital goes offshore... Only then do they need to fill in the asset allocation checkboxes locally and abroad.

If we consider the "value" debate then the emphasis is clearly on taking investor funds offshore. "The local equity market is no longer cheap relative to many other global markets — we see it as fully valued," says Peter Brooke, head of the Macro Strategy Investments boutique at Old Mutual Investment Group SA (OMIGSA). The group expected 6% per annum real returns locally over the next five years, versus 6.5% per

annum globally. The group believes local investors should consider moving as much as 30% of their investment portfolio offshore.

John Biccard, fund manager of the Investec Value Fund, expects "substantially lower returns" in the ten years ending December 2020. "The price-to-earnings ratio of the JSE All Share index has expanded from 13 times to the current level of 17 times, while earnings only grew at a compound rate of around 12%." And that's fund manager speak for "local equities are expensive right now!" The poor expectation for local equities makes it difficult for equity-only managers such as Biccard to generate return from asset allocation strategies. A bottom-up share selection methodology gives the fund manager an edge in this case. "We are steering clear of the expensive domestic sectors (retailers, banks and most industrials) and sticking with high dividend yield domestic stocks (Vodacom, African Bank and Oceana Fishing)," he says. He also favours rand hedge stocks trading on relatively low valuations and gold shares.

Allan Gray believes in bottom-up analysis as a foundation for their asset allocation too. "A bottom-up asset allocation process links the asset allocation process to the stock selection process and allows the asset manager the freedom to pursue an absolute return approach," says Jeanette Marais, Director of Distribution and Client Service at Allan Gray. A manager who follows an absolute investment philosophy will focus on identifying good quality assets that are priced below their intrinsic value, thus minimising the risk of capital loss while achieving positive, above average returns irrespective of the asset class invested in.

How do fund managers go about "structuring" their portfolios? "The asset allocation process is part of the portfolio construction process and decisions regarding local and offshore allocations depend on the client mandate and legislative requirements," says Koekemoer. "At Coronation we continually assess the relative attractiveness of all the asset classes and make changes when valuations are compelling."