

Five reasons to invest offshore

Investors urging locals to take advantage of rand strength

Gareth Stokes

South Africans were late entrants to the local versus offshore investment debate. Pre-democracy we were limited by rigorous exchange controls — dating back to 1961 — as the National Party government attempted to stem private capital flows out of the country. In July 1997 exchange controls were relaxed and individuals were finally allowed to each invest R200 000 offshore. And the limit was upped in successive budget speeches to reach an impressive R750 000 each by 2000. The timing could not have been worse.

The significant increase in the individual offshore allowance coincided with a swift depreciation in the local currency against both the US dollar and British pound, panicking thousands of South Africans into utilising their full offshore allowances. They moved their cash into the US and UK equity markets at the tail-end of a very long bull market rally. "Global markets were trading significantly ahead of their long-term average price levels when investors went offshore in the late 1990s and early 2000s," says Pieter Koekemoer, head of Personal Investments at Coronation Fund Managers. Over the decade ending 31 December 2010, the rand return on these offshore investments is almost zero, a snip compared to the 18% compound annual return achieved by the JSE All Share index.

Today's investment landscape could not be further removed from that prevailing at the turn of the millennium.

The rand is strong, foreign capital is streaming into South Africa, commodities are on the run and shares in local markets are overvalued relative to those in developed economies worldwide. Can investors expect a better deal over the 10 years beginning 2011? "Now may be the right time to diversify your portfolio offshore to protect yourself against any of these trends reversing," says Chris du Toit, an analyst at Allan Gray, which invests offshore through its global asset management partner Orbis.



According to Pieter Koekemoer, head of Personal Investments at Coronation Fund Managers, global markets were trading significantly ahead of their long-term average price levels when investors went offshore in the late 1990s and early 2000s. Photo: Lucas Jackson/Reuters

"Now may be the right time to diversify your portfolio offshore to protect yourself against any of these trends reversing"

Local investors can now take up to R4 million offshore, an amount large enough to open new investment opportunities. "Investors can move this R4 million out of South Africa and into an appropriate bank account offshore. They are free to invest this money wherever they want to — across jurisdictions, markets and financial instruments," says Leon Campher, chief executive of the Association of Savings and Investments South Africa (ASISA). Coronation Fund Managers believes there are five good reasons to increase offshore exposure today — a view largely echoed by fund managers at other local investment institutions.

1: The past is not a guide to the future

Local investors are particularly wary of offshore opportunities due to the shocking performance outlined above. "It seems South Africans have been so scarred by their recent offshore experiences that they are determined to avoid offshore investments," notes Coronation.

These investors forget that the recent out-performance by domestic equities over US and world equities was preceded by a 20-year period, beginning 1980, when the reverse held. In much the same way as this year's best unit trust performer doesn't reflect next year's winner, past performances on global equity

markets should not be used as the basis for long-term investment decisions.

2: Global equities offer more relative value

"As value-based managers we find it easier to put together a decently-priced portfolio trading at a discount to long-term average price levels by investing in large-cap developed market shares rather than locally-listed equivalents," says Koekemoer. The MSCI World index, which includes companies from Europe, the Americas and Asia, boasts a long-term price-to-earnings ratio of between 16 and 17 times — yet investors can easily structure a portfolio of these shares trading at just 10 to 12 times today. In stark contrast, the JSE All Share index is trading at a price-to-earnings ratio of some 17 times, well ahead of its 13-times average.

3: The rand remains strong

Investors have been urged to take advantage of rand strength to diversify offshore. "One of the key factors influencing the strength of the rand is foreign appetite for emerging market shares and bonds," says Du Toit. If these capital inflows diminish or reverse, we could see a rapid devaluation in the local currency. "At around R6.85/\$ the rand is about as strong as it will get," says Chris Gilmour, an analyst at Absa Investments. He says

the currency should devalue over time, probably ending 2011 at around R7.50/\$. Over the longer term the currency should devalue consistently due to inflation differentials between local and offshore markets.

But investors should be cautious of basing their decision to go offshore on the currency argument. "When the currency strengthens, the talk quickly turns to taking money offshore," says Campher. A strong rand offers great opportunities to go offshore, but there are many non-currency matters affecting the investment decision.

Investors should spend time with their financial advisers and consider the likely returns from the range of available offshore investment classes. "If you had taken funds offshore over the past five years based on your belief in an overvalued rand, you would have been butchered," he says. Du Toit agrees: "It never makes sense to sell a cheap local asset measured in dollars to buy an expensive offshore dollar asset!"

4: A chance to diversify and optimise portfolios

The South African stock market is a minnow on the global investment stage. Our market accounts for less than 1% of global stock market capitalisation, with the US at 30.1%. Most fund managers suggest an offshore allocation of between 20% and 30%. But Gilmour is inclined to take between 10% and 15% offshore. "Diversification is fine in terms of lowering your overall risk, but in terms of the likely returns you'll get locally you might be better off here," he says.

5: Hedging against inflation

"Many items in a consumer's shopping basket are priced in foreign currency," says Coronation. As such, your exposure to offshore markets could be viewed as a form of protection from global inflation.

The experts agree a portion of local investors' funds should be held offshore. And they believe now is an appropriate time to review offshore portfolio allocations. But the move offshore is not without challenges. "No matter what type of investor you are, individual or institutional, there is a lack of knowledge of what is available offshore," says Gilmour. Consult with a professional financial adviser and make sure you investigate your opportunities thoroughly.