Augustus 2019

Daar is mense wat sê dat ons soveel van ons bates as wat ons kan oorsee moet neem. Terwyl ons as maatskappy ten volle gerat is om u daarmee by te staan, is dit tog belangrik dat ons 'n gebalanseerde seining sal hê. Ons het Minette Weideman gevra om vir ons 'n sukkie hieroor te skryf. Uiteraard het ons dit bietjie geredigeer en dit in ons CSfin-styl verpak (ons vetrou die Engels verskaf u nie hoofbrekings nie).

Offshore investments

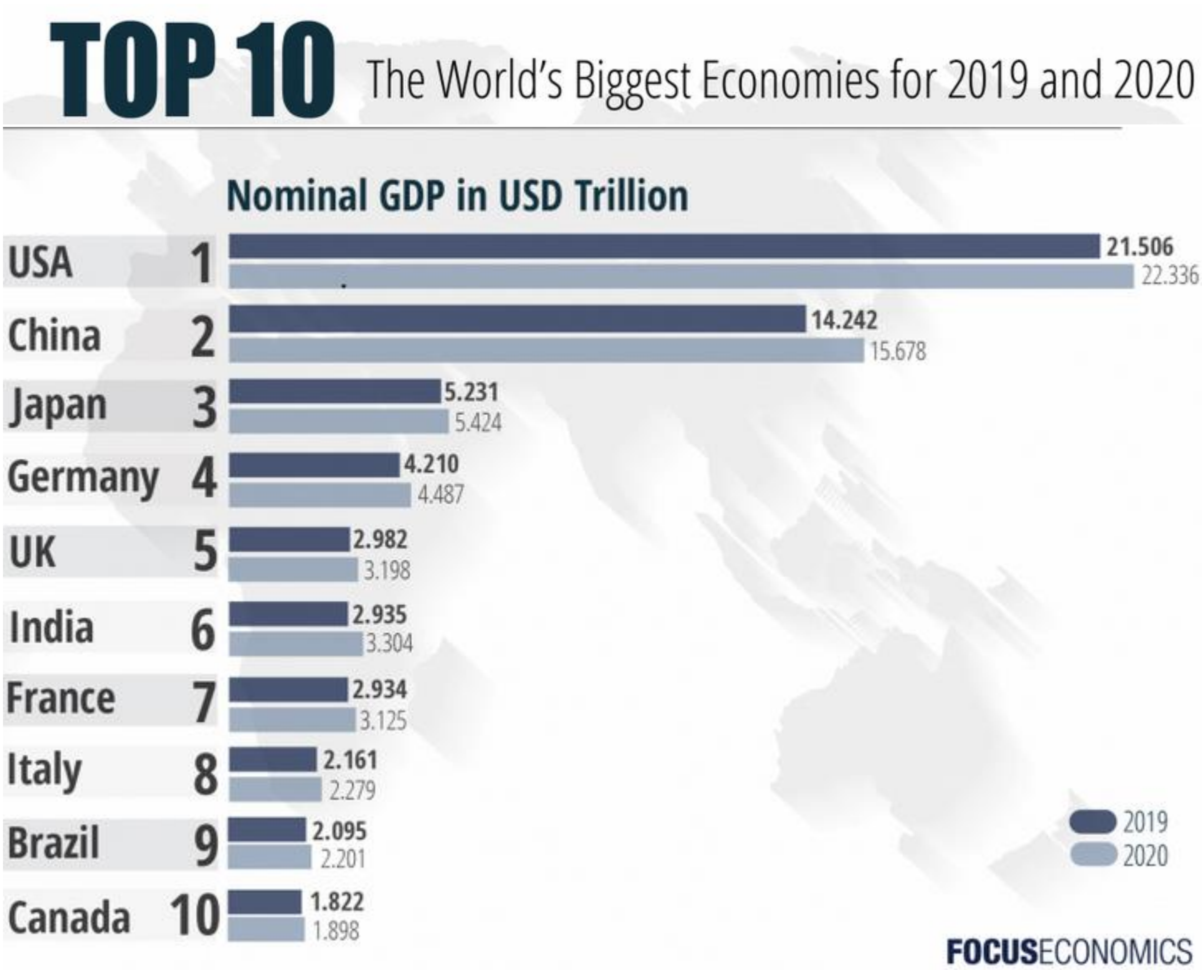
Local media and economic commentators preaching the end of South Africa and the dawn of a 'Zimbabwe-like' era is causing negative sentiment amongst investors, leaving them with a definitive question of 'should I take all my money offshore?'. The answer to this question is not simple and without perfect foresight into the future no one will be able to give you the 100% correct answer. The best advice that we can provide is that *you cannot plan for only one outcome.*

Often when there are a lot of negative sentiment an interest in foreign assets sparks. This is typically when the Rand is weak, and the local assets are considered cheap on a valuation basis. When the Rand is strong and positive sentiment is driving the local market interest in foreign assets are low. When this sentiment-driven approach is followed and investors sell their local assets and buy foreign assets, they are effectively selling low and buying high. This is in direct contradiction to our basic investment principle of buying low and selling high. When considering whether to invest offshore a good starting point is to assess your motive. If you are driven by fear of the current circumstances or of the future, I would like to refer you to the last sentence of the first paragraph, … *you cannot plan for only one outcome*. It is possible that your fear is well founded, but there is also a probability that the current circumstances are providing you with a great investment opportunity. The answer to this scenario is that of diversification.

We cannot only plan for a Zimbabwe-type crash

South Africa as an economy only represents a very small portion of the global economy, with our GDP being 0.59% of the total world GDP. This fact suggest that one should look further than South Africa when deciding where to invest.

The SA economy in a global perspective



Investing in local unit trust funds, however, already gives significant offshore exposure. The JSE (our local bourse) provides exposure to global factors through global companies like British American Tobacco that are basically offshore companies that have secondary listings here. Some of our local companies like Naspers have exposure to large businesses elsewhere in the world like China. It is estimated that approximately 60% of the earnings on the JSE are so called Rand hedged, which means that it is earned abroad (this means that a weakening Rand will have a positive impact on the earnings). Thus, a local investor might already be diversified more than they think.

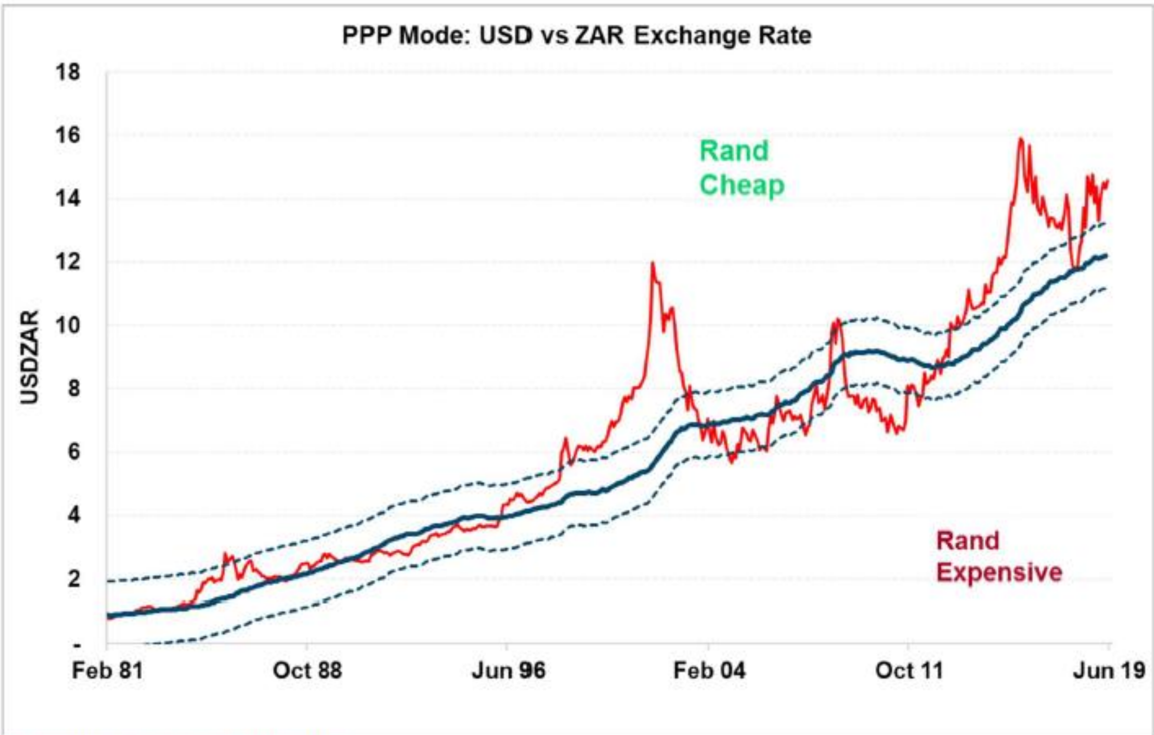
Further, most of the South African unit trust funds that we use as part of our investment strategy can have an offshore allocation of up to 30% and tactically make use of this allocation based on their views on relative valuation between offshore and local assets as well as their view on the currency.

What drives your returns from your offshore investments?

- Currency valuation
- Asset allocation (equities and fixed income)

Currency valuation

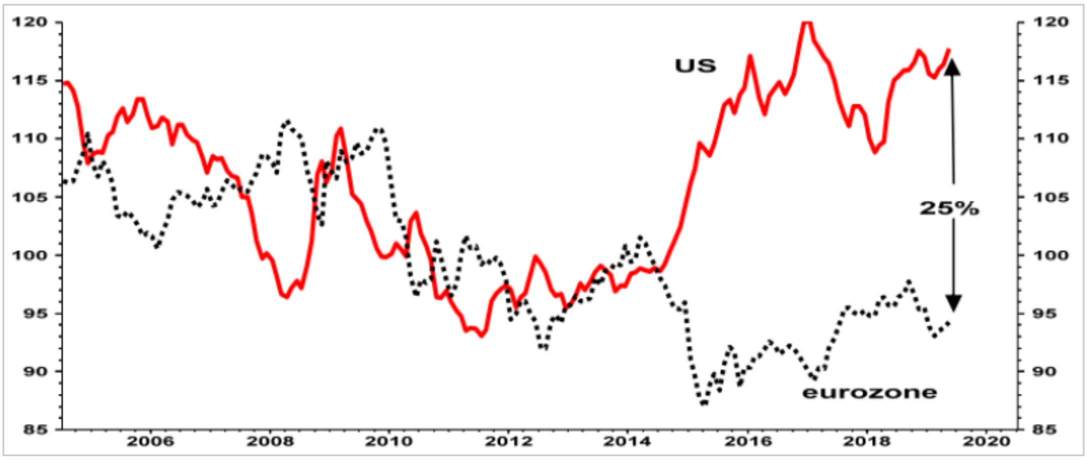
On a Purchasing Power Parity basis, against the US dollar, the Rand is undervalued or cheap (see the graph below).



Source: Bloomberg as at 31 May 2019

However, this must be seen in the context of the current level of the US dollar vs the Euro.

Dollar is 25% Too Strong vs the Euro – Real Effective Exchange Rates (CPI-based, 2010=100)



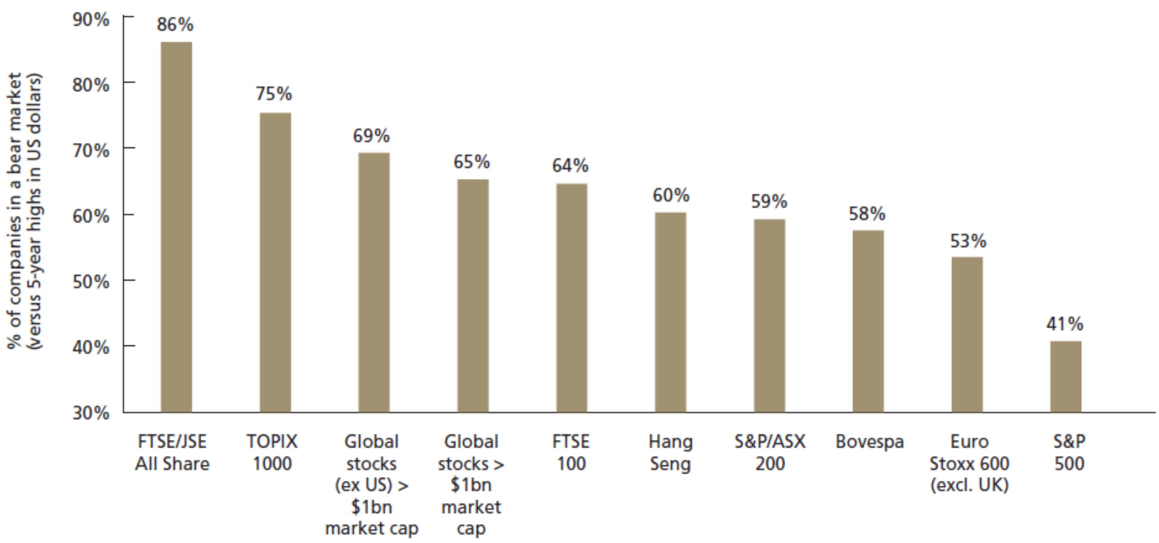
Source: Datastream

Within the context of the two graphs above, it is clear that the US dollar is overvalued. As with any investment, starting valuations matter for subsequent returns. If the US dollar should weaken (which is Trump's economic agenda) South Africa, as an emerging market, would benefit due to our current account deficit and reliance on commodity prices. The effect would be a stronger Rand/US dollar exchange rate. However, for an investor this would mean losses in Rand although their underlying investments could have performed well. This means that if you invest at an exchange rate of say R14.50 to the Dollar and the Dollar weakens, the Rand can appreciate to say R13.50 to the Dollar. That means that one will get less Rands for the Dollars that one had invested.

Equities

Interest rate expectations, especially in the US, cannot be ignored when considering the overall state of the market. The recent hints by the US Fed about reducing interest rates have provided support to the S&P500 at a time when trade war concerns were negatively affecting the market. The policy that the Fed will implement will definitely have an impact on the overall sentiment in the market.

Further, global equity performance was largely that of global and specifically US growth stocks (shares of big companies like Amazon or Johnson and Johnson that are fully priced, i.e. they are expensive). Other areas of the market have been struggling and the divergence between the valuations of these growth stocks and other companies is significant. The graph below indicates the percentage of



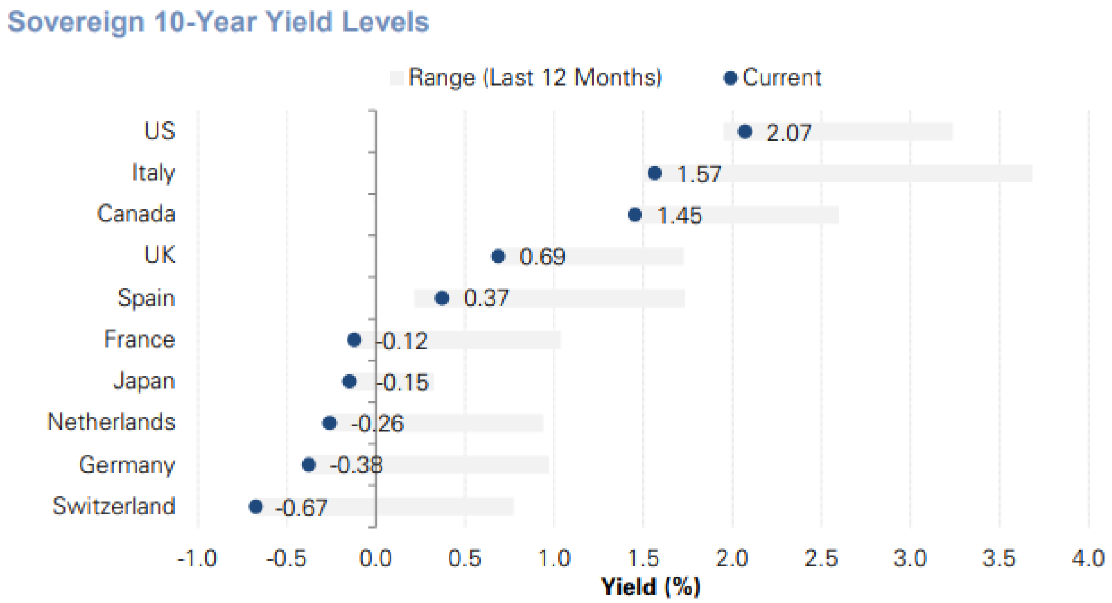
Sources: PSG Asset Management, Bloomberg (prices as at 24 June 2019) companies' (on the different exchanges) that are technically in a bear market. A bear market can be defined as a more than 20% decline from its five-year high share price.

It is important to note that the shares/sectors that have delivered the exceptional performance are not necessarily (and most unlikely) to deliver the same returns in the future. The divergence between the 'expensive' and 'cheap' parts of the market are presenting good investment opportunities (the cheap parts can present a good buying opportunity).

Fixed Income

Global bonds (money that we lend to the government or big companies) were the best performing asset class in 2018 for local investors. However, the stellar performance was due to a weakening Rand over the same period. In hard currency it looks a bit different.

The graph below (source: Goldman Sachs Asset Management) provides an illustration of the ten-year sovereign (government) bond yield (interest rate) for various countries. The highest yield is that of the US, which offers a return of 2.07%.



If you get only 2.07% interest on your Dollar investment and the local money market offers +-7,5% it means that the exchange rate must depreciate by at least 5,43% per annum to deliver the same return in Rands over a period of one year. This will also be at elevated levels of volatility (the Rand does not move in a straight line but has many ups and downs).

What Is the Best Approach?

In order to avoid being driven by fear or greed, the best approach is to consider in the context of your overall portfolio and within your financial plan *the optimal strategic allocation to offshore assets*. Once you have obtained your ideal strategic allocation to offshore assets, you must devise a tactical plan to get to your strategic allocation over time. Decisions made from fear in the short term typically do not add the most value over the long term.

Nuus uit die CSfin kantoor

Ons wens Marlene Van Der Merwe alle sterkte toe met haar eksamen begin September. Ons vertrou dat Marlene hierna die Nagraadse Diploma in Finansiële Beplanning agter haar naam sal kan skryf.

Ek vertrek DV die 15de September na Kanada om my nuwe kleindogter te besoek.

Groete van die CSfin span. U terugvoer word, soos altyd, waardeer.