

Is the grass greener on the offshore side?

With local investor anxiety at persistently high levels for the past few years we have seen a steady flow of assets and increasing appetite to invest offshore. Being South African's we are often our own worst critic, and home-based pessimism is amplified when considering where to invest. It is difficult to be positive on domestic investing. But does this mean the grass is also greener on the other side? Below we take a tour through what it means to be a global investor by looking at what we are actually investing in and the new risks we are exposed to in the search for returns.

To understand offshore better, we start with looking at the local market first:

Local Equities

While the JSE is a reasonably large stock exchange by world standards (17th largest by market capitalization), we are starting to outgrow it as an investment market. On an effective basis, around 65% of our listed equity market derives its revenues offshore. This is concentrated in a relatively low number of shares, but increasing as domestic shares expand offshore. As listed companies outgrow their domestic growth prospects, it is natural for them to look outside of our borders for opportunities. This has been the case for a long time, however because our market has a relatively low number of shares, the composition can change, and has done, quite frequently. Ten years ago we had almost half of our equity market (and by extension, pension funds!) invested in commodity producers. Today this is much less, replaced by Naspers (Chinese tech platform), British American Tobacco (cigarettes), Anheuser (beer) and until recently, Steinhoff (European furniture). This has meant that in our 'local' investments, it is dominated by a select few offshore companies, so in many respects we are offshore investors before we even set foot offshore.

What then are the benefits of investing offshore, if we can already access it in our home market? There are a few key points:

- Diversification: being a smaller market it is highly concentrated in a few shares (eg. Naspers is 16% of the market), whereas offshore markets have huge range and depth of opportunities so we are not beholden to the successes (Naspers¹) and failures (Steinhoff) of a few.
- Diversification away from South African specific risks – economic, social and political.
- Access to new types of investment opportunity in sectors not represented locally. Examples would include biotech, energy, technology, utilities (electricity producers).
- Investment returns which are 'hard currency' based – ie returns earned in currencies which generally appreciate against the Rand such as the US Dollar, Euro and Pound Sterling.

Looking then at the range of global options available to us, we take a first step of asking what exactly it is that local investors require from their offshore portfolios? By doing this we ensure that they can gain exposure to the full range of opportunities, taking into account the fact that because the world is a big place, global managers have quite limiting biases in where they are comfortable investing. By looking at the world through a wider lens we can ensure that we correct for these biases.

Broadly, we look at global investing – specifically equities – as six separate sources of return which provide investors with alternative opportunities to what we have access to locally.

US Developed Equities

"the source of innovation" and the home of the large 'old world company'. The US accounts for over half of all listed equity on the planet, so it is hard to avoid a US bias in a portfolio. Not that this bias is necessarily a negative as companies listed there are subject to high corporate governance standards, and liquid capital markets, quality management and an entrepreneurial culture provide the platform for a broad and deep opportunity set for investors. Of late the US has migrated to a tech biased market with the FAANGS² increasing their share of the market as these new platform/tech businesses breach their respective tipping points. A more pragmatic take on this change would be that tech in itself is less of a sector in the future, and more of a business as usual underpin for the bulk of industries. Tech will become pervasive in our portfolios, like it or not. With their size and reach, many US companies derive their earnings outside of the US, with companies like Unilever as an example reliant on Emerging Markets for 57% of their revenues.



REDFIN WEALTH

INVESTMENT AND FINANCIAL CLARITY

November 2017

Around 40% of US company revenues are sourced globally. So investing in the US gives us exposure to stable old world companies, innovative new world companies, and a range of sectors not available locally, many of which are doing business globally. This is a direct product of the globalization of trade trend we have seen over the last couple of decades.

Rest of World Developed Equities

Around 35% of listed equity then sits within Europe, UK and Japan. This is a more diversified pool of investments compared with the US given the geographical spread of companies and the fact that multiple governments play a role in impacting the prospects of each market. Europe is still quite old world (consumer goods, financial services and all the oil companies – Total, BP, Shell). The UK is largely a global market, with a minority of revenues sourced domestically, and many of its listings based on commodity companies, much like SA. Japan was the equity powerhouse in the 80's with the advent of the personal computer and consumer electronics, but has faded over time. Today it gives us motor manufacturing (Toyota, Mitsubishi, Honda), and Sony amongst others.

Emerging Markets

These are markets defined as 'developing' ie where there is reasonable infrastructure and governance to support growth and where the standard of living is in ascendance, currently holding around 15% of world equity exposure. These are generally seen as high growth sources of return as the underlying economies are developing at a higher rate than more mature markets like the US. While this is the theory, the reality has been somewhat more mixed in many cases. With political volatility and various social conflicts, emerging markets are not always a one-way bet. They are also beholden to the demand created by the developed markets. China for instance could be referred to as the manufacturer of the western world. Looking ahead less so, but certainly looking backwards. Countries include the 'BRICS' (Brazil, Russia, India, China and South Africa) as well as South Korea, Taiwan and Mexico. Emerging markets are increasingly dominated by the rise of China, which now accounts for over 30% of all listed Emerging Market equity. And within this, a huge bias towards technology via Tencent (the source of Naspers' success), Baidu and Alibaba - the Chinese equivalent of Facebook, Google and Amazon respectively. It is becoming difficult to avoid a Chinese tech bias inside an Emerging Markets portfolio. Other sectors providing opportunity in Emerging Markets include commodity producers, large growing consumer services based on growing middle classes, and the financial services needed to fund this growth. Many asset managers avoid investing in Emerging Markets given the complexity as well as the need to resource significant teams to cover this disparate universe of shares. This is one of the biases we consider when looking at client portfolios.

Frontier Markets

A recently termed market referring to lesser developed, prospective emerging markets. Current exposure is concentrated across Argentina, Kuwait, Vietnam and Nigeria where 60% of all listed shares are either in financial services or telecommunications – the Frontier markets provide high growth opportunities because they still have much to achieve so returns to investors need to be commensurately high to offset the investment risks of politics, liquidity and governance.

Smaller Companies

Some companies are small for a reason and will stay that way, but others are the 'large caps of the future'³. These shares are your typical high growth companies because they tend to be rolling out new, disruptive services to the market. Many of the current day disruptors are technology based, but this can cover any industry globally. This is another market often underinvested by asset managers due to the different mindset required and additional resources required. Examples here would include companies like Tesla. This asset class also tends to be quite US-heavy due to the focus on innovation which enjoys substantial support in that market.

Listed Property

Unlike locally where property tends to be quite homogenous - meaning that most of our investment options are bundled property companies across commercial, retail and industrial options, global counterparts are considerably more specialized. Companies can have a specific focus (eg datacenters, fast replacing retail shops due to online shopping), or a regional focus (for instance a property share which only invests in B-grade London commercial property). This provides substantial diversification opportunity for investors compared to history.

All of this results in tens of thousands of listed shares in which to invest globally. In the main markets this is narrowed down to around 2500-3000 shares once liquidity has been factored in. This range of diversification is the primary benefit to local investors – not being overexposed to few shares, singular governments, local currency or other risks such as terrorism, corporate fraud or the decline of an industry (think: horse and cart, or even commodities which is much closer to home).

With respect to equity investing going forward, it pays to think globally, and while there are equivalent risks globally to those which we face in SA, we are less exposed to any individual event permanently impacting our portfolios and the achievement of longer term objectives. In that respect, the grass is greener on the offshore side.

Pricing Spread: Bid-Bid • Data Frequency: Daily • Currency: US Dollars



¹ While from a diversification perspective Naspers dominating our market is not ideal, but it has been the primary driver of local equity returns over the past few years. Without it, local investors would be significantly poorer. The same can be said historically for shares like SA Breweries and the miners such as Anglo's historically.

² Facebook, Amazon, Alphabet, Netflix and Google

³ Source: Baillie Gifford, 2017

30 November 2017

data provided by Profile Data Analytics, Reuters and Datastream

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol	10yr Vol
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	6.9%	21.4%	22.5%	9.3%	12.7%	10.2%	11.0%	15.2%
FTSE/JSE SA Listed Property	ZAR	5.2%	12.4%	17.2%	10.6%	13.0%	14.2%	13.0%	15.0%
SA All Bond Index (ALBI)	ZAR	-2.2%	4.3%	6.0%	4.4%	5.6%	8.1%	7.8%	7.5%
SA Cash Index (SteFI)	ZAR	1.8%	6.9%	7.6%	7.1%	6.5%	7.2%	0.3%	0.5%
Balanced Benchmark	ZAR	5.5%	16.1%	16.9%	9.6%	12.3%	10.8%	7.1%	7.1%
SA Inflation (1 month lag)	ZAR	0.9%	4.1%	4.9%	5.3%	5.5%	5.8%	1.4%	1.4%
GLOBAL MARKET INDICES									
Global Equity (MSCI World)	USD	6.4%	20.8%	23.7%	8.2%	11.8%	4.8%	9.9%	16.3%
Emerging Markets Equity (MSCI EM)	USD	3.3%	32.5%	32.8%	6.1%	4.6%	1.4%	14.5%	22.8%
Global Bonds (Barclays Global Bond Index)	USD	-0.2%	7.0%	6.5%	1.7%	0.7%	3.0%	4.7%	5.8%
Global Cash	USD	0.3%	1.0%	1.0%	0.6%	0.4%	0.7%	0.1%	0.3%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	6.9%	21.4%	22.5%	9.3%	12.7%	10.2%	11.0%	15.2%
Global Equity (MSCI World)	ZAR	11.7%	20.5%	20.3%	16.1%	21.8%	12.3%	13.6%	14.0%
Emerging Markets Equity (MSCI EM)	ZAR	8.4%	32.2%	29.2%	13.9%	14.0%	8.7%	12.6%	15.7%
SA All Bond Index (ALBI)	ZAR	-2.2%	4.3%	6.0%	4.4%	5.6%	8.1%	7.8%	7.5%
Global Bonds (Barclays Global Bond Index)	ZAR	4.8%	6.8%	3.6%	9.1%	9.7%	10.5%	11.7%	14.5%
COMMODITIES									
Gold (US Dollars)	USD	-2.4%	11.7%	8.7%	0.8%	0.5%	0.3%	10.7%	7.6%
Gold (Rands)	ZAR	2.4%	11.7%	5.7%	9.5%	5.6%	2.8%	12.0%	8.5%
CURRENCIES									
Rand / Dollar	ZAR	-4.9%	0.3%	2.4%	-6.9%	-8.3%	-6.8%	13.1%	15.8%
Rand / GBP Pound	ZAR	-9.4%	-3.7%	-5.4%	-2.3%	-5.2%	-2.8%	14.8%	15.7%
Rand / Euro	ZAR	-5.1%	-11.0%	-8.8%	-5.5%	-6.7%	-4.8%	12.3%	13.6%
LOCAL UNIT TRUST SECTORS									
SA Equity - General	ZAR	5.7%	13.6%	15.1%	5.9%	10.1%	8.3%	9.3%	12.3%
SA Multi Asset - High Equity	ZAR	4.8%	11.6%	12.3%	7.0%	9.7%	8.3%	6.1%	7.1%
SA Multi Asset - Low equity	ZAR	3.3%	8.9%	9.6%	7.1%	8.2%	8.0%	3.4%	3.6%
SA Real Estate - General	ZAR	4.5%	10.3%	14.3%	9.8%	11.9%	12.7%	11.3%	13.0%
Global Equity - General	USD	5.1%	18.5%	20.9%	6.3%	9.2%	2.2%	9.9%	16.1%
Global Multi Asset - High equity	USD	3.2%	14.0%	15.6%	4.9%	6.9%	3.2%	7.6%	12.2%
Global Real Estate - General	USD	1.2%	9.0%	10.7%	1.8%	4.4%	1.5%	10.9%	21.1%

Spot Rates		30-Nov-17	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US\$	Rand	13.64	13.50	13.75	8.25	6.90	4.66
Rand/GBP	Rand	18.44	18.11	17.87	13.33	14.05	7.53
Rand/EUR	Rand	16.27	15.96	15.45	10.62	9.81	-
RATES							
Libor 6m \$	US\$	1.67	1.51	1.24	0.64	5.13	5.84
Repo Rate	Rand	6.75	6.75	7.00	5.00	10.00	-
Prime	Rand	10.25	10.25	10.50	8.50	13.00	20.25
All Bond Index Yield	Rand	10.01	9.32	9.12	7.10	-	-
COMMODITIES							
Gold (\$/oz)	US\$	1,279.13	1,283.83	1,321.51	1,774.45	743.50	333.05
Platinum	US\$	940.00	920.00	1,034.00	1,668.00	1,377.00	434.25
Oil (Brent Crude) \$	US\$	63.80	57.57	48.97	112.56	80.84	19.84
INFLATION							
SA Inflation	%	NA	5.1	6.1	5.5	5.8	9.4

Fundhouse is a leading investment adviser specialising in fund research, ratings and portfolio construction services. We help clients manage investments on behalf of the end investor. Our experienced team understands the complexities of the fund management world. We apply this knowledge alongside a client's first mindset to improve the outcome for the end investor.

Fundhouse was founded in 2007 by professionals from the investment management industry. We currently operate from offices in the United Kingdom and South Africa, where we cover the local and global fund industry first hand. Our business is 100% independent and owner managed which means we can offer objective advice and services in the best interests of our clients.

