**VIEWPOINT**

# Investec Worldwide Flexible Fund: An optimal investment solution?

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As a general rule investors seek to maximise investment returns, while minimising any associated risk. In so doing they need to address a number of key questions:

– Which asset class(es) should they invest into?
– When should they invest offshore?
– How much should they invest offshore?
– Who can they trust to manage a truly unconstrained fund?

We examine each question in turn.

## Which asset class or classes should we invest in?

While financial studies show that investing in growth assets (equities and property) is the best way to beat inflation over the long term, determining the top performing asset class over the shorter term is extremely difficult.

The following table details the annual performance of various local and international asset classes for the period 1995 to date. The relative ranking of the annual performance of these asset classes appears random; during this 21 year period all asset classes - bar South African cash - have been the top performing asset class at least once, and all asset classes have been the worst performing asset class at least once.

Figure 1: Local and offshore asset class returns in ZAR[1]

| | ALSI | ALBI | SA CASH | OFFSHORE EQUITIES | OFFSHORE CASH | OFFSHORE BONDS |
|---|---|---|---|---|---|---|
| 2015 | 5.1% | -3.9% | 6.5% | 30.8% | 34.1% | 29.2% |
| 2014 | 10.9% | 10.2% | 5.9% | 15.1% | 10.6% | 9.9% |
| 2013 | 21.4% | 0.7% | 5.2% | 51.6% | 23.6% | 18.5% |
| 2012 | 26.7% | 16.0% | 5.5% | 22.0% | 5.3% | 6.8% |
| 2011 | 2.6% | 8.9% | 5.7% | 13.1% | 22.2% | 29.8% |
| 2010 | 19.0% | 15.0% | 6.9% | 1.2% | -10.0% | -5.5% |
| 2009 | 32.1% | -1.0% | 9.1% | 7.2% | -20.2% | -18.3% |
| 2008 | -23.2% | 17.0% | 11.7% | -21.8% | 38.5% | 50.0% |
| 2007 | 19.2% | 4.2% | 9.4% | 8.2% | 2.2% | 7.5% |
| 2006 | 41.2% | 5.5% | 7.4% | 34.5% | 16.9% | 18.0% |
| 2005 | 47.3% | 10.8% | 7.1% | 24.8% | 16.4% | 4.8% |
| 2004 | 25.4% | 15.3% | 8.0% | -2.7% | -14.4% | -6.9% |
| 2003 | 16.1% | 18.1% | 12.3% | 4.2% | -21.3% | -10.6% |
| 2002 | -8.3% | 16.0% | 11.6% | -42.3% | -27.2% | -14.5% |
| 2001 | 32.6% | 17.8% | 10.2% | 32.8% | 65.1% | 56.9% |
| 2000 | 0.4% | 19.2% | 10.9% | 5.5% | 31.0% | 24.9% |
| 1999 | 70.8% | 29.4% | 15.6% | 32.4% | 10.2% | 0.2% |
| 1998 | -5.9% | 4.8% | 17.3% | 50.3% | 27.7% | 39.4% |
| 1997 | -6.9% | 28.7% | 17.0% | 20.4% | 10.0% | 4.3% |
| 1996 | 9.5% | 6.3% | 15.2% | 45.6% | 35.4% | 33.0% |
| 1995 | 8.8% | 29.7% | 13.7% | 24.2% | 9.1% | 22.4% |

Source: Morningstar as at 31.01.16

[1]BofAML USD Libor used as proxy for Offshore Cash; Citi WGBI used as proxy for Offshore Bonds; MSCI ACWI used as proxy for Offshore Equities; STeFI Composite used as proxy for SA Cash. Returns based in ZAR

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It is also worth noting the magnitude of the movement in asset class returns from one year to the next. Consider, for example, that the return for South African equities was -5.9% in 1998, making it the worst performing asset class, whereas the best performing asset class, offshore equities, delivered a rand return of 50.3% in the same year. The following year (1999), South African equities returned 70.8%, making it the top performing asset class, and then in 2000 SA equities only returned 0.35%, once again making it the worst performing asset class!

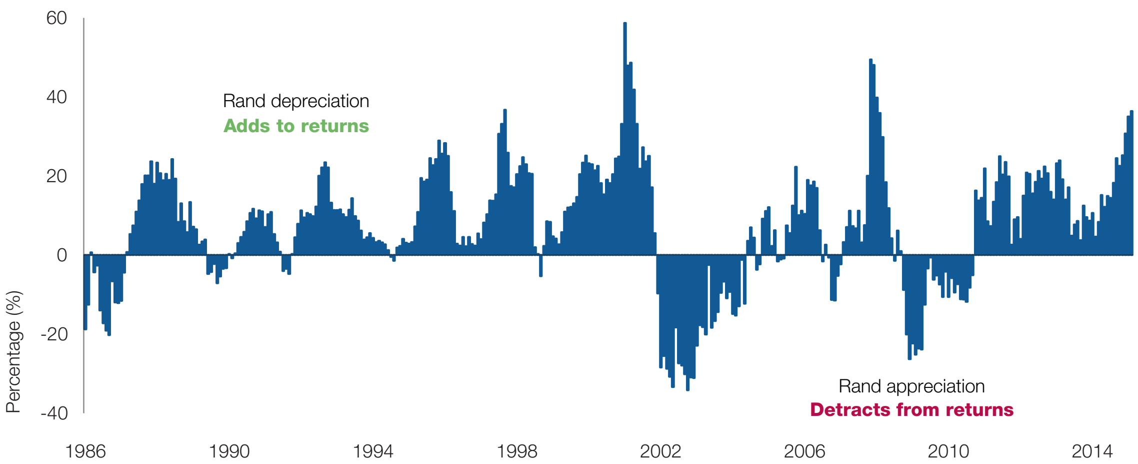
The table clearly demonstrates how difficult it is for the average investor to select the best performing asset class in the shorter term. In recognition of this, professional investors, including Investec Asset Management, offer what are termed managed or balanced portfolios, where this complex asset allocation decision is made by the portfolio manager on behalf of the investor.

## When should we invest offshore?

The impact of exchange rate risk on a foreign investment is an important consideration, as rand weakness can work in your favour but, critically, it is not a one-way bet. This is illustrated in the following chart, which shows the performance of the rand versus the dollar. Unfortunately, many South Africans got burnt when they invested offshore in 2001 and 2002, when the rand traded at around R12 to the US dollar. The rand then appreciated back to around R6 to the US dollar, resulting in significantly negative rand returns for these investors.

Importantly, studies have shown that when considering the historical returns of foreign investments, the impact of the exchange rate is uncertain and volatile, and that when measured over shorter time horizons, the exchange rate can have a significant impact on the investment return in rands. Research indicates that it is only over longer time horizons that the underlying investment contributes more to the return than the exchange rate. Therefore, we are of the opinion that when investing offshore, investors need to take a long term view to fully benefit from the return potential of the international assets in which they are invested.

Figure 2: rolling 12 month % change of rand/US$



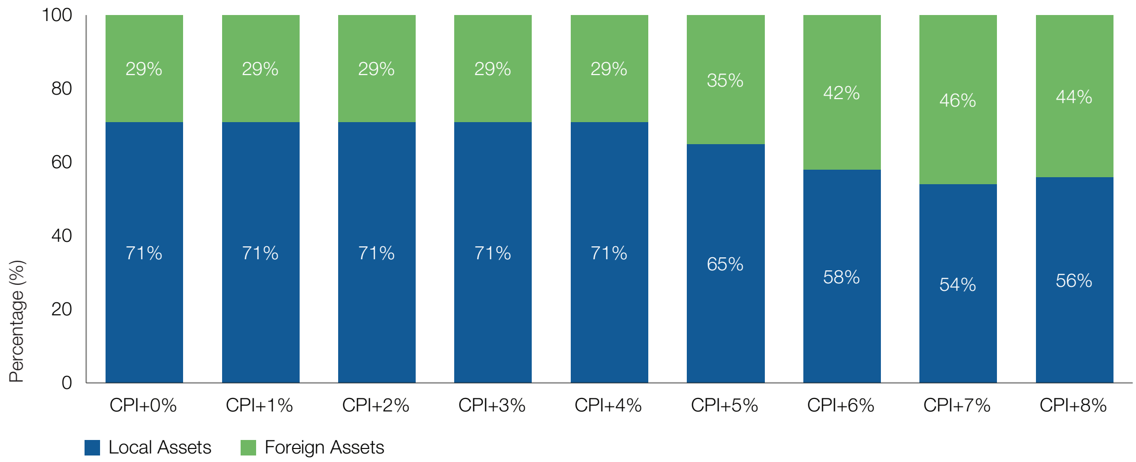

Source: I-Net as at 31.01.16

So, while we believe there are compelling reasons for South Africans to invest offshore, which include diversification benefits, reduced emerging market and currency risk and the maintenance of hard currency spending power, deciding on when to invest offshore is a critical and difficult decision and also best left to a professional investment manager.

## How much should we invest offshore?

While this is not an easy question to answer, as there have been times when South African assets have outperformed global assets and vice versa, the short answer is that for many individuals it is more than the somewhat arbitrary 25% allowed in terms of Regulation 28 of the Pension Funds Act. While this may seem intuitive, it is supported by research conducted by Professor Dave Bradfield, et al[2] based on 40 years of data. Following much analysis, they concluded that for all real return mandates a strategic allocation of at least 29% to foreign assets, rising to above 40% as the required return rises, is optimal. These results are illustrated in the following chart.

Figure 3: Optimal blend for 3-year investment horizon



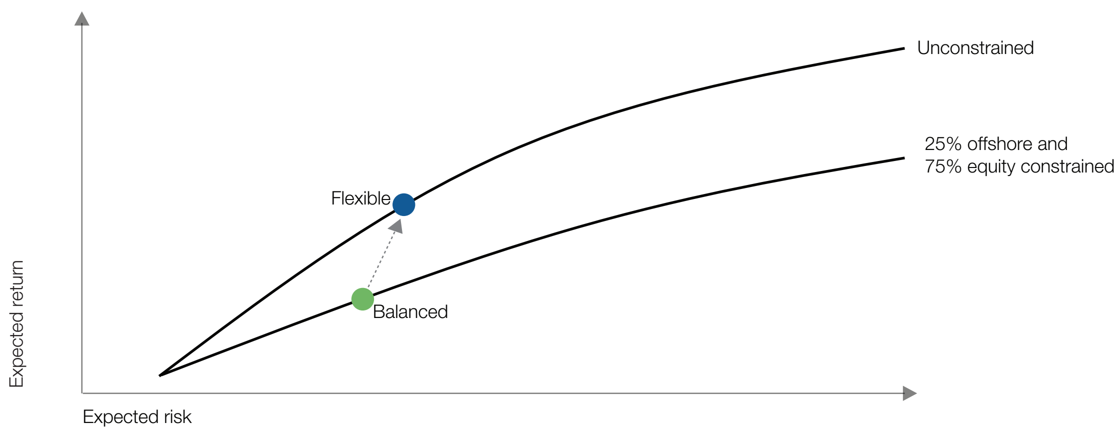

Source: Professor Dave Bradfield, Brian Munro and Dieter Hendricks, Cadiz Securities, 2010

Clearly, while the optimal strategic allocation to foreign assets will depend on each investor's personal circumstances, risk profile and longer-term financial planning objectives, the evidence suggests that, for many, it is at least a third of their assets and therefore a Regulation 28 compliant multi-asset high equity fund may not be the most efficient solution.

## Worldwide flexible funds: the optimal solution?

The Regulation 28 current hard limit of a maximum of 25% exposure to offshore assets effectively ties the portfolio manager's hands. This is evident in the following chart, which illustrates how an unconstrained mandate improves the return characteristics of a multi-asset (balanced) portfolio at marginally higher risk. In short, by applying the same investment philosophy and process, investors can achieve a higher return at similar risk, as diversification benefits are not constrained.

Figure 4: Risk/return characteristics of offshore constrained and unconstrained portfolios

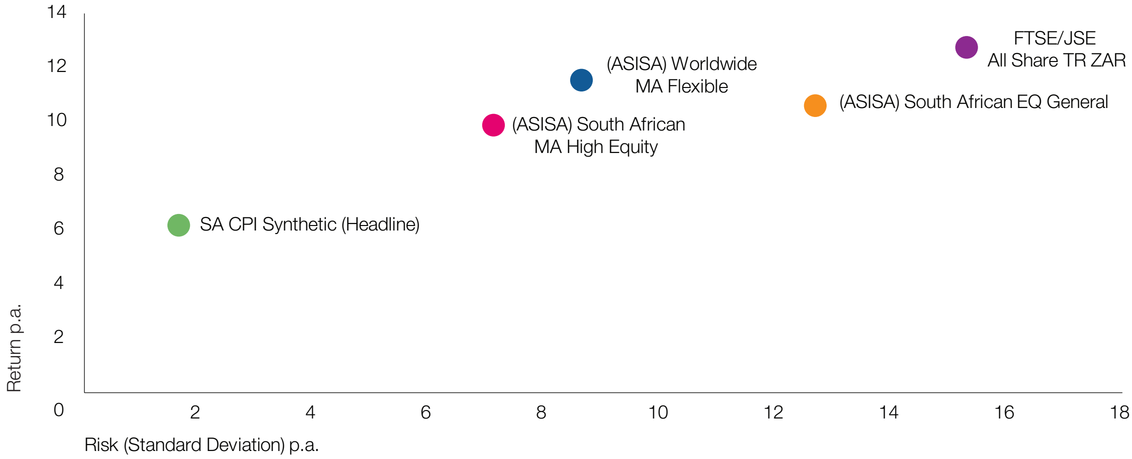



Source: Investec Asset Management. For illustrative purposes only.

[2]Source: Professor Dave Bradfield, Brian Munro and Dieter Hendricks, Cadiz Securities, 2010

In fact, the following Morningstar risk / return scatterplot further illustrates this point. The chart shows that the average Worldwide Multi-Asset Flexible fund has outperformed the average South African Multi-Asset High Equity fund by almost 3% pa over the 10 years to 31 January 2016, albeit at slightly higher risk. Worldwide flexible funds, on average, also outperformed the average General Equity fund at significantly lower risk.

Figure 5: 5-year risk/return scatterplot




Source: Morningstar; 31.01.16. For illustrative purposes only. Past performance is not necessary a guide for future performance.

This unconstrained approach therefore potentially offers investors more upside than traditional balanced funds.

## Why the Investec Worldwide Flexible Fund?

The Investec Worldwide Flexible Fund is a multi-asset solution that is not constrained by geographical or asset class limits. The process and philosophy of the Fund is the same as that the Investec Balanced strategy (the best performing balanced mandate over the past 10 years as per Alexander Forbes Large Manager Watch, 31 December 2015), which to date has only been available to large institutional investors. It harnesses Investec Asset Management's best ideas from multiple local and global strategies. The fund is managed by an experienced investment team with a consistent long term track record, being the SA Multi-Asset & Equity team, with Rhynhardt Roodt and Rüdiger Naumann as portfolio managers, who leverage off a global research framework.

Given the broad, unconstrained mandate of a worldwide flexible fund, we believe it is critical that the portfolio manager have the proven expertise and track record to manage both local and global multi-asset mandates. As a global specialist asset manager with investment hubs and 178 investment professionals (analysts and portfolio managers) in London, Cape Town, Hong Kong, Singapore and New York, we believe Investec Asset Management is ideally positioned to manage such an unconstrained mandate.

## Important information



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