Talking Points
Should I move my investments offshore?

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For Financial Advisors and their Clients

Given the challenges the South African economy is facing and the underperformance of local risk assets relative to its global peers, one can appreciate why some investors are considering investing the bulk of their wealth in offshore assets. As the saying goes, discretion is the better part of valour, and investors would do well to remember to be cautious when making big changes to their investment portfolio(s).

Although times are tough and confidence is low, investors must remember to remain focused on the fundamentals and not be led by emotion. Fear and panic can force us as investors into making mistakes with our money. Buying quality assets at discounted prices not only gives investors the best chance of achieving superior returns in the long run but also offers a margin of safety, which is critical from a risk control point of view.

When we think about returns from a total return perspective, we believe total returns arise from three components:

1) Growth (i.e. growth in the earnings potential of the asset in question)
2) Yield (i.e. the cash flows - such as the dividends you receive - relative to the price of the asset)
3) Ratings change (the change in valuation i.e. the price appreciation/depreciation of the asset in question.)

When taking a closer look at the current return prospects of local and offshore assets, there is a range of factors to take into consideration from a valuation perspective.

On the global front, current yields for global assets are less compelling, in part due to asset prices being on the high side. These high prices (relative to historical prices) would suggest that, over time, the prices of these assets will move back to the mean (i.e. the average price). If investors were to buy in at current prices and the prices reverted to the mean, it would lead to investors losing value.

To be clear, we are not suggesting that a collapse in asset prices is imminent or is the next sequential step for global assets. Instead, we acknowledge the possibility that asset prices could rally further (i.e. become more expensive), which in our view, incrementally adds to the risk of capital loss.

Careful consideration needs to be given to risks that arise from having exposure to different geographies when you invest offshore. These risks range from currency to asset and liability mismatches. For instance, the currency tailwind that one enjoys when the rand weakens can easily be a headwind when the rand strengthens. Currency risk is significant and unpredictable when one considers the volatile nature of exchange rates. We remind investors that the rand can strengthen in the absence of positive local developments. The rand can easily appreciate on the relative weakness of major currencies, i.e. non-South African specific reasons. Risk should, therefore, be continuously monitored and managed.

Local asset prices have conservative growth estimates. The yield component is attractive owing to compelling dividend yields on the back of depressed asset prices. Further to this, there is potential for a reversionary re-rating to current multiples which could further enhance returns. But what of the dire situation the local economy finds itself in? How will companies grow earnings when there is a clear lack of demand and pricing power in the local economy?

A struggling economy does not necessarily equate to bad investment outcomes. Even in tough economies, there are well-run businesses that can maintain and grow profits. Some local businesses are well-diversified geographically in terms of both revenue and operations, which gives them exposure to offshore earnings streams and makes them less reliant on local macro conditions.

With that said, it's also important to acknowledge that there will be losers amongst local businesses as some will struggle to cope with the macro-economic backdrop. The current scenario presents an opportunity for superior performance - for investors that are willing to discover and exploit good investment opportunities as well as tolerate the discomfort and stay the course.

It is especially during times like these that investors are faced with emotional and behavioural challenges on their investment journey. One of these challenges is dealing with and separating their emotions when it comes to making decisions about their investments. Most investors are, with good and admirable reason, emotionally invested in the affairs of our country, sometimes to the detriment of their investment decision making. They often fail to recognise good investment opportunities, due to the negativity surrounding the current status quo. We all need to strive to make rational decisions based on sound principles and facts, and not emotions if we are to increase our odds of investing successfully.

We urge investors to take a holistic approach when it comes to investing, i.e. to adopt a total portfolio approach to investing in order to diversify and minimize investment risk. Investors should strive for broad diversification and carefully assess the risk and reward characteristics that competing assets introduce to their investment portfolios.

While we see opportunities in select S.A. asset classes, in our regulation 28 compliant portfolios, we remain close to fully invested in global equities as part of our overall portfolio construction process to maximise the reward for risk.

Both local and offshore investments have their pros and cons. This is why it is important to have a well-diversified portfolio that will protect and grow your investments in a variety of different market conditions. Going forward, it would be advisable to place more focus on expected future returns and risk management. Investors must focus on remaining patient, staying the course and avoid making investment decisions in a panic.

At Morningstar, we continue to follow a valuation driven approach when allocating capital. This includes taking a holistic approach to portfolio construction, by allocating to unloved and cheap assets with a wide margin of safety. It is often during times when these assets are completely out of favour that the best opportunities for future returns present themselves.

Risk Warnings

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