INVESTING OFFSHORE
– have you ticked the boxes?

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Amidst a tide of reports of doom and gloom for the local economy supported recently by confirmation that South Africa is officially now in a "technical recession" due to two successive negative quarters of economic growth, financial planners are faced with the dilemma of what to do with their clients' long-term investments and savings. An area that certainly deserves attention and could benefit investors handsomely is to diversify their portfolios into global markets. However, many South African investors are hesitant to approach offshore investing and consider it an intimidating process.

While there is definitely a good case for diversifying offshore, it is crucial in times of heightened uncertainty, both domestically and abroad, to stick to the basic principles of investing and remember to keep a long-term view and investment time horizon.

Set out below are a few suggestions for investors looking to diversify offshore to think about and ensure that they have "ticked their boxes" before making any final investment decisions.

1. Choose investments that are appropriate to your risk profile

Before making any decisions, take time out to do some thorough research. Be realistic about your current financial position, your risk profile and your long-term investment objectives. Try and match up the appropriate offshore funds that meet your requirements and do a fair comparison between them. Consulting with a financial advisor can be very helpful in this exercise as they would have had exposure to several funds and can guide you in your thinking.

A quick visit to the website of any investment company will expose an investor to a wealth of information and data about specific funds – including performance, fees, monthly fund commentary and other news articles. There may also be educational articles to help investors learn more about their investment philosophy and current economic environment.

Time spent doing sound investment research and ensuring you have a proper understanding of the funds that one invests into is crucial and certainly time well spent. It will ensure that once you are invested you have peace of mind and can withstand much more easily times of any short term underperformance that the fund manager may experience. It is imperative to stay invested in your chosen funds for as long as possible and to ride out any short periods of capital drawdowns or underperformance. Many investors tend to switch between funds and try and time the market during periods of increased volatility and uncertainty. This inevitably leads to value destruction and a loss of returns – it is way more beneficial to do your detailed research and then stay fully invested with that fund through long term investment cycles in order for them to deliver on their investment potential.

2. Choose a credible investment partner

When investing offshore you will in all likelihood be exposed to markets that may be unfamiliar to you. As a result it's crucial to make sound fund selection choices. One wants to make sure that your investment will be managed by a fund manager that has a credible and proven track record but one that also has sound risk and operational procedures in place.

Do not focus solely on recent past performance either! Industry awards and ratings based on solid short and medium term performance are a good indicator of recent performance. However, past-performance is not necessarily an indicator of future performance and one should rather focus on consistency in performance over the longer term and have comfort that you believe that the fund manager has a sound investment process, stable research team and the ability to generate new investment ideas or themes on a consistent basis. Although difficult, one needs to try and distinguish between "luck" and "skill" in terms of performance. Often a skilful manager is one who has a robust investment process that is repeatable and consistent over time with an emphasis on protecting capital in falling markets and follows a valuation type approach to buying assets.

Other indicators that investors should look at when choosing an investment management company are: the company's access to industry expertise and information, their investment stewardship principles and whether or not they put clients first in terms of their decision making; commitment to maintaining a well-resourced research team and, importantly, transparency of communication to investors.

Another factor to be aware of is whether the fund has been "approved" by the South African Financial Services Board" (FSB) for marketing and distribution within the country. The FSB has certain criteria that it looks at when assessing offshore domiciled funds – if the fund has been given approval by the FSB it does provide an added layer of comfort and protection to investors.

3. Diversification

One of the best ways to protect against large capital losses and reduce volatility is to ensure that you have a well-diversified portfolio. There are three main asset classes – cash (money market), bonds (government and corporate fixed income instruments) and equities (large, medium and small cap equities as well as developed versus emerging market equities). One can get exposure to these asset classes via South African domiciled funds as well as offshore domiciled funds or listed instruments.

Ideally one wants exposure to both domestic and global assets across all the various asset classes mentioned above. What the exact mix of these assets should be is dependent on your age, risk profile, income requirements, investment time horizon and aversion to risk. Speak with a financial advisor on how to come up with the optimal mix in order to provide the best diversified portfolio possible. Different asset classes perform differently under changing economic cycles – hence the benefits that diversification brings in reducing the volatility of ones investments.

4. Avoid making emotional decisions

In the current fluid market environment it is near impossible to be able to forecast with any degree of certainty what the short term holds in terms of investment returns. Therefore investors need to take a measured approach to investing and to avoid over-reacting to any negative public sentiment and allowing one's emotions to drive your investment behaviour. Spend time doing the correct research and wealth planning, but once you have made your investment decisions try and stick with them for the longer term. Regular fund switches and shifts in asset allocation which have occurred out of short-term panic generally lead to a loss of investment returns in the long run.

Pessimists have been predicting the collapse of the South African economy for decades and we should remind ourselves that the Johannesburg Stock Exchange was one of the best performing stock markets in the world measured in both South African rands and US dollar terms for the past twelve years.

Another good example is the Rand – notwithstanding all the current political dramas in South Africa at the moment – with Guptagate and state capture reports, investment downgrades to "junk" status, and declining economic growth and recession – we have actually seen the Rand strengthen 5% against the USD year to date – when most people were predicting its collapse.

5. Remember that valuation drives long-term return

When markets are erratic or in a downturn it is easy to forget that valuation drives investment returns over the long term. This is why investment managers look for pockets of value to drive consistent performance over time. Your entry price is one of the biggest drivers of future returns.

There will always be several excellently run businesses with fantastic growth prospects and management who allocate capital efficiently both domestically and internationally. These businesses, when identified, will provide one with numerous investment opportunities that over time will result in great positive returns.

It is often in times of the greatest level of uncomfortableness or pessimism that one should actually be investing and increasing ones exposure to "risk" assets, as this is when valuations are stretched and providing the best probability of sound returns in the future. Greed and fear are the two key emotions that drive markets and one needs to ensure you don't fall into the trap of following the herd – it is precisely when fear is at its maximum that fund managers often look to increase their market exposure.

6. Don't base your decision on currency alone

Investors in South Africa tend to be very sensitive and concerned when it comes to the Rand exchange rate on the day but we would urge you to not base your financial and investment decisions on currency fluctuations in isolation.

Rand movements can have a material effect on one's rand investment returns. However, predicting currency movements is also extremely difficult, and certainly getting it right on a consistent basis is even more so. The current exchange rate of the Rand should be just one of the factors that investors take into consideration, along with valuation, diversification and personal circumstances.

7. Seek advice

Potential investors should speak to their financial planners to ensure that they have a well-diversified portfolio with both domestic and offshore exposure. Investors can gain offshore exposure by investing in Rands via rand-denominated feeder funds or alternatively by using their foreign allowance money to invest in foreign funds. There are nuances to which approach is best take and the benefits of each so again seeking professional guidance from a qualified advisor is preferable. Ask your advisor the questions raised in this article – and hopefully once the "boxes are all ticked" you can enjoy many years of fruitful offshore investing ahead. ■