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OFFSHORE INVESTING: A LOST DECADE, BUT DON'T GIVE UP NOW

South Africans who put their savings into offshore equity markets when exchange controls were eased in the late 1990s have been badly disappointed over the past decade: the MSCI World Index has returned 2.8% per year in rand terms and the average SA unit trust in the Foreign Equity sector returned only 3.3% per year in the 10 years to 30 September 2009, leaving investors with little to show for their offshore portfolios.

However, according to Anil Thakersee, portfolio manager with Macro Strategy Investments (MSI), which manages R20 billion in third-party assets, despite this "lost decade", investors should not turn their backs on foreign equities now, as he believes this asset class looks set to be the strongest performer of all the major asset classes over the next five years.

"Those who invested overseas when they were allowed to take a portion of their savings offshore did so for sound reasons at the time, as everyone expected the developed equity markets to outperform the JSE over the next few years, there were concerns over rand volatility, and the diversification reasons were also very strong," notes Thakersee. "However, this wasn't what actually transpired: the dot-com bust of 2000 followed by the bear market in 2002, a sharp correction in residential housing in many countries and the subsequent sub-prime crisis, together with a decade of rand strength over the period, all combined to create a 'perfect storm' in offshore investments. So in retrospect, the peak of offshore unit trust popularity among SA retail investors – the late 1990s and early 2000's – coincided with a period that was not favourable for investing offshore."

According to ASISA, the average unit trust in the Foreign Equity category returned only 3.3% per year in the past 10 years to September 2009, below CPI of 7.0% y/y and significantly underperforming the next weakest asset class, which was cash at 9.7% per year.

However, Thakersee says, it is important for investors not to be discouraged by this history and instead to focus on the current long-term prospects for offshore investments, which are positive. "Current conditions make it a good opportunity to invest offshore for the long-term, or for investors who already have offshore exposure to maintain it – remain patient. This isn't a good time to repatriate existing offshore holdings."

His view is backed by analysis that shows that offshore equities in general are now offering fair value. In developed country equity markets like the US, despite the

strong market rebound from mid-March, dividend yields are still attractive (at levels last seen 50 years ago) compared to US bond yields. Emerging market valuations are mixed bag as they remain a diverse group of countries; however, in general emerging markets continue to have higher forecasts for economic growth over the next few years. He believes it prudent to have exposure to both developed and emerging markets.

At the same time, by historic measures the rand is no longer cheap and looks fair value to overvalued at current levels.

"This combination of valuations means investors who use the opportunity to increase their offshore exposure now and invest for the long term will be using a relatively strong rand to buy reasonably priced assets," Thakersee explains. "To sell now would be to lock in losses in both the rand and offshore equities.

"And even more importantly, the outlook for the asset class is a relatively strong one," he points out. "In MSI's five-year view, offshore equities is our preferred asset class – we expect it to produce a real return of 8.0% per year, compared to local equities at 7.0% per year."

As a result MSI have been gradually increasing the offshore exposure in the asset allocation funds they manage. For example, the Old Mutual Balanced Fund has moved from a 12.8% foreign holding at the end of 2007 to 17.9% currently, nearing the 20% maximum offshore exposure allowed by legislation.

"Although we can't predict short-term moves in the rand or equity markets, our long-term forecasts say SA investors will be rewarded for holding offshore equities over the next five years," Thakersee adds. "Plus we can't forget the classic benefits of offshore diversification to any portfolio which still hold true. Despite the disappointments of the past decade, the next 10 years look much more promising, so don't give up on offshore investments."

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