



3 October 2008

Offshore diversification

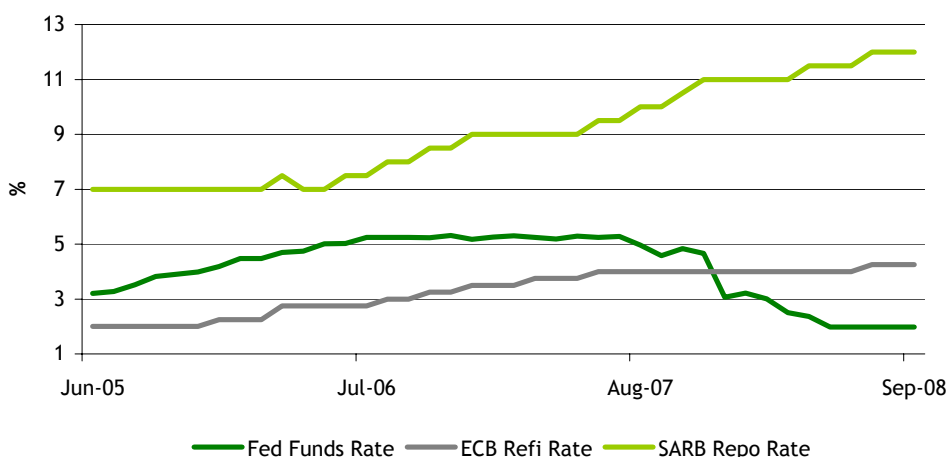
As part of a diversified portfolio, offshore investing fundamentally makes sense. Yet it seems that investors are shying away from this important aspect of portfolio diversification.

Why should investors consider diversifying a part of their investment portfolios offshore?

Statistics show that South African investors have shied away from investing abroad in recent times. While they may have had valid reasons, here are a few important points all investors should consider.

Since local bond, cash, property and equity markets are all linked to the same economy, they are thus affected by the same policy changes, though not necessarily in the same way. A rise in interest rates is good for cash and bad for bonds. A change in the corporate tax rate will affect companies on the JSE regardless of whether they are banks or manufacturers. Diversifying offshore insulates one from poor policy decisions that pertain to specific economies (such as under-investing in electricity generation, for instance).

Graph 1: Policy interest rates of South Africa, the Eurozone and the United States

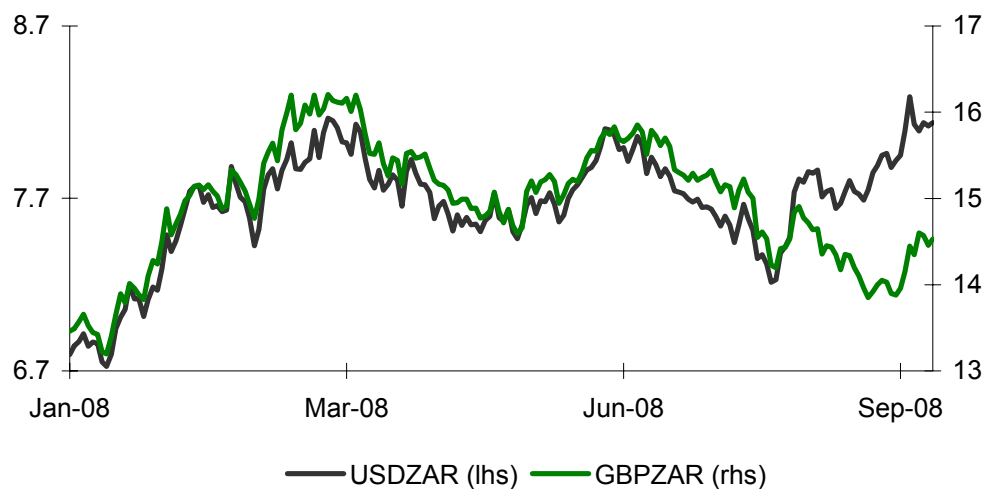


Take the graph above as a very simple example. It is clear that over past three years, interest rates have moved in different directions between Europe and America. The South African Reserve Bank (SARB) moved interest rates in the same direction as the European Central Banks- namely up - but at a much faster pace. South African rates also started out much higher. Different economies thus follow different cycles, which will influence returns on asset classes in those countries. A portfolio with an offshore money market component for instance

allows you to benefit from, say, rising interest rates abroad if local interest rates fall.

Offshore investments should reduce the volatility of a portfolio if invested in economies and markets with little correlation to our domestic markets and the local economy. This is particularly true of economies and markets that are not influenced as much by movements in commodity prices as ours are. The JSE is dominated by a few large-cap shares, and by the resource sector in particular. Most general equity or balanced funds inevitably invest in the likes of Anglo American, BHP Billiton, Anglo Platinum, Sasol and SABMiller, the largest five on the JSE in that order. Thus investing offshore gives access to investment options that are not available in our concentrated (and small) equity market.

Graph 2: Rand exchange rates



Another very important reason for investing abroad is that offshore assets also provide protection against a weaker rand. If the rand depreciates, these assets will be worth more in local terms. Given our large current account deficit (7.3% of GDP for the second quarter of 2008), the rand is expected to remain vulnerable over the longer term, especially in the current environment of global risk aversion, intensifying the case for increasing offshore exposure. However, as the graph above shows the rand is a very volatile currency. The value of offshore investments will thus fluctuate along with the relevant exchange rate and investors thus need to be aware of this particular risk.

One last important point to make is that, when considering offshore exposure, investors should follow the same basic principles of sound investment:

- A. Don't put all your eggs into one basket – diversify.
- B. Invest for an appropriately long period of time; over shorter periods, returns from offshore investments can be very volatile.
- C. Don't be driven by fear or greed. When the rand crashed in 2001, many investors moved money offshore either in a panic, or because they thought they would make a fortune. Many of them burnt their fingers when the rand subsequently appreciated again.

What funds does Fairbairn Capital provide to assist in constructing a portfolio that has offshore diversification?

Fairbairn Capital offers a wide range of funds that provide offshore exposure for investors. These include rand-denominated offshore funds providing access to offshore investment in the full range of asset classes, as well as local funds that contain an element of offshore diversification in their underlying investments.

For more information on all the funds, visit the Fairbairn Capital website at www.fairbairncapital.com.

Next week we unpack another way that clients can diversify their investment portfolios using the range of solutions available on Fairbairn Capital.