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INVESTMENT MANAGEMENT

Pre-election jitters to push SA offshore investments over R1 trillion

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Political uncertainty in the build-up to the elections and longer-term structural economic concerns have seen investors eager to invest offshore. This is reflected in the R73 billion increase in the total assets invested in foreign collective investment schemes to R928 billion in the first quarter of this year from R854.8 billion in the fourth quarter of 2023.

For many investors, the timing of their offshore investments is influenced by the rand, with most funds seen going offshore when the rand is strong and slowing down when it is weak. However, the pre- and post-election period is a keen reminder of how volatile the rand can be, ranging from its fearful 5% depreciation to almost R19 to the dollar ahead of the elections to its immediate 5.3% appreciation to below R18 to the dollar after the Cabinet announcement.

It then retraced 3.2% to mid-R18 territory, influenced by a combination of factors: recognition of the challenges a coalition-led government may face in the years ahead and a stronger dollar.

What does this mean for investors considering investing offshore? Often, investors base their timing decisions on the rand, predominantly investing when the rand is strong. However, research shows that investing when the rand is relatively strong has no meaningful impact on offshore portfolio returns in the long term.

Investors should consider more important factors when externalising their assets, including determining their investment goals, understanding how much risk they can tolerate, and establishing what this means for where they should invest.

When going offshore, most investors tend to invest in equities, which contrasts with local investor behaviour. Most investors investing in domestic funds opt for multi-asset class funds because they offer diversified investment exposure that protects capital against a decline in any single asset class.

The latest Association of Savings and Investment South Africa statistics show the extent of the difference in global investment behaviour. By the end of the first quarter of this year, 67.3% of assets were invested in foreign equity funds, 28.2% in asset allocation funds and 4.5% in bond funds.

While stock markets in most developed countries, particularly the US, experienced a strong run over the last three quarters since bottoming in October last year, uncertainty and unpredictability still prevail globally, exposing investors with only equity funds to more risk than those in multi-asset class funds.

Financial markets have been highly responsive to ongoing shifts in the interest rate outlook over the past year. They have rallied on more optimistic expectations of rate cuts and declined when central banks have made it clear they need to see inflation come down sustainably before they move to relax monetary policy. At the start of the year, markets expected six interest rate cuts. They are now factoring in only one cut in 2024.

Counterintuitively, US stock markets have experienced a record-breaking run, reaching more than 30 all-time highs in the first half of the year. On the surface, this rally looks attractive, but beneath the surface, the picture is more complicated. The S&P 500's performance has been predominantly driven by the mega technology stocks, which invest heavily in artificial intelligence and are expected to grow significantly in the years ahead.

However, with just a few companies driving the rally in equities, individuals investing in equity funds with significant exposure to these names run the risk of these companies not delivering on the market's optimistic expectations, resulting in a stock market sell-off.

The arguments in favour of investing in multi-asset class funds also apply globally and are particularly compelling now. Investors considering moving money offshore should thus seriously consider investing in balanced funds aligned with their risk-return profiles and investment goals.

South African investors can either invest in hard-currency-based multi-asset class funds or feeder funds denominated in rand but benefit from global investment opportunities in developed markets that are traditionally less volatile.

Investors also get meaningful exposure to growth assets like equities in global balanced funds, like the Prescient Global Balanced Fund. This fund has a moderate risk-return profile, and targets returns of 5% to 6% above inflation over the long term.

The fund has around 40% in equities, 30% in government bonds, and the rest in income-generating assets to take advantage of current high yields. With interest rates at multi-decade highs, bonds also present a great investment opportunity because returns will likely be attractive in a declining interest rate environment.

Pre-election jitters will likely have pushed SA foreign investments well over the R1 trillion mark, and offshore investments are unlikely to wane. However, it's worth bearing in mind that uncertainty is not just a South African phenomenon—and, as such, decisions about where to invest must necessarily consider global risks along with return considerations.

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