

Look through cycles to gain a long-term perspective on investing offshore

Possibly the main advantage of investing offshore is the diversification benefit. This benefit may come through either enhanced returns, or reduced risk, or some combination of the two. One way to assess this is to calculate the annualised rand return per unit risk (the annualised standard deviation of returns, also known as volatility) one achieves by adding foreign assets to a portfolio of local assets. If the return per unit risk rises when adding foreign assets, the portfolio is benefiting from the offshore exposure on a risk adjusted basis. Similarly, it would not have been beneficial if adding the offshore exposure reduced the return per unit risk.

The performance of the South African market relative to world markets changes over different periods

The graph plots the annualised return per unit risk for different mixes of local assets (represented by the FTSE/JSE ALSI) and foreign assets (represented by the MSCI All Country Index), assuming quarterly rebalancing. The graph shows the return per unit risk achieved by a portfolio over three time periods:

- The 10 years to 30 June 2008 (**black line**)
- The previous 10 years to 30 June 1998 (**grey line**)
- The combined 20 years to 30 June 2008 (**red line**)

Point A shows the return per unit risk for a portfolio comprising 100% invested in South Africa's All Share Index (ALSI) over the different time periods with no exposure to the Morgan Stanley Capital International (MSCI) Index.

Points B show the return per unit risk for a portfolio comprising 60% ALSI and 40% MSCI over the three time periods.

Points C comprise 100% MSCI with no exposure to the ALSI. What is interesting is how the shape of the graph changes for different time periods. This is because the performance of the ALSI relative to the MSCI changes over the different time periods.

1998-2008: South African markets performed better than world markets

Looking at the black line for the most recent 10 years, it could be argued that investing in foreign assets relative to local assets has not been beneficial from a return per unit risk perspective (Point A is well above Point C). This is because over the last 10 years, emerging markets (including South Africa) have performed better than world markets at lower levels of volatility.

1988-1998: World markets outperformed South Africa

Likewise, looking at the grey line, it could be argued that it would have been better to have foreign assets relative to local assets in the preceding 10 years (Point C is well above Point A). This is because the MSCI significantly outperformed South Africa (and emerging markets) partly as a result of the emerging market crises experienced during this period. However both of these periods look at only part of the overall cycle.

1988-2008: World markets and the South African market delivered similar returns

The red line shows the combined 20-year period to 30 June 2008. During this period, portfolios comprising 100% ALSI or 100% MSCI would have delivered a similar return per unit risk. However, the red line shows that there were portfolio combinations of the ALSI and the MSCI that would have resulted in higher return per risk than either could have delivered on their own.

Be careful of only looking at part of an investment cycle when making long-term investment decisions

This analysis uses historic performance to look through cycles to provide a long-term perspective. This is important as only looking at part of a cycle may result in different decisions. For example, investors who looked at the grey line and decided to invest fully in the MSCI would have underperformed the ALSI over the next 10 years as shown by the black line.

We believe that offshore assets are currently more attractive than local assets and that the rand remains expensive at current levels. As such, from a return-risk perspective over the long term, we believe that given the current environment, it is attractive to diversify one's portfolio with exposure to offshore assets.

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The performance of the ALSI and MSCI 1988-2008

