Seed Weekly

Increasing Your Global Allocation by Cor

14 May 2021

Two of the most common questions we have received from our private clients over the last few years is 1) what would be my optimal allocation to global assets in an unconstrained portfolio, and 2) when would be a good time to increase my global allocation?

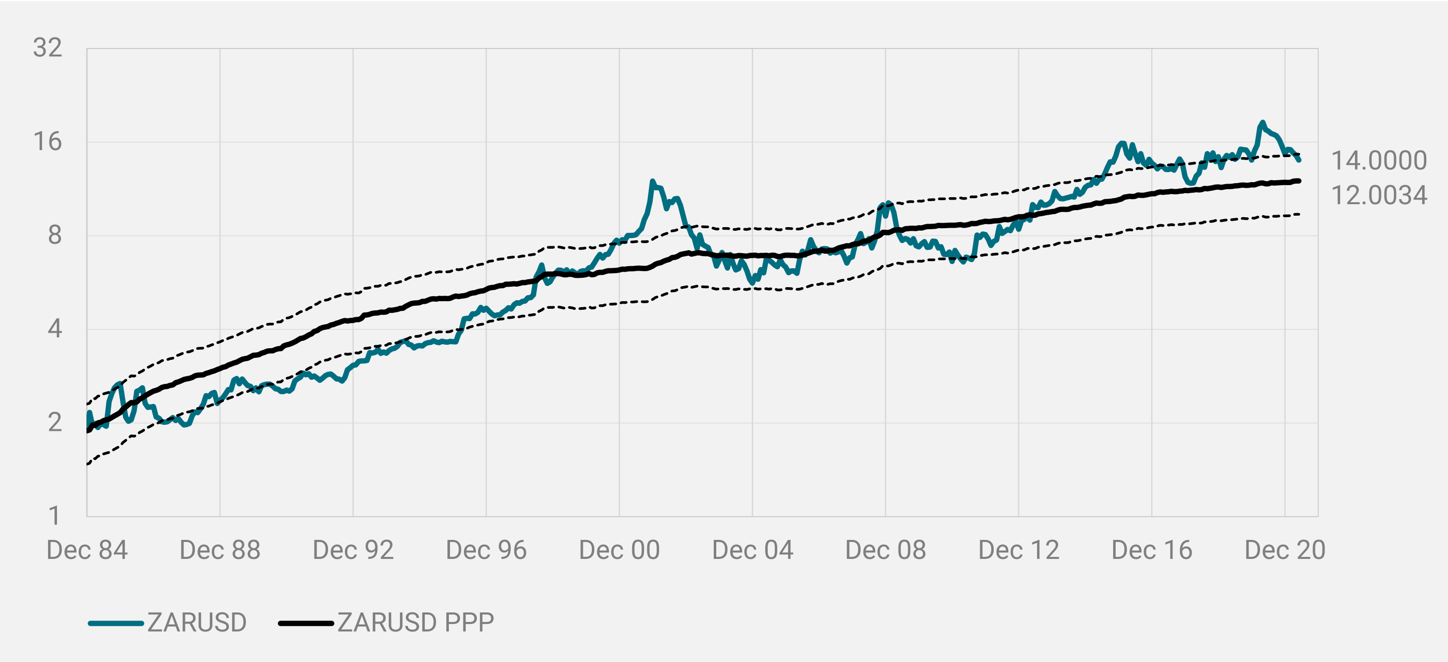
In his article Global Investing for South Africans Part 1, Mike looked at answering the first question for a balanced investor, based in South Africa and with at least 10 years to go before retirement. If you missed Mike's article, please head over to check that out.

Read Global Investing for South Africans - Part 1

The conclusion was that having 40% - 50% see-through exposure to global assets resulted in a better risk-adjusted return over the last 10 years and a less volatile portfolio over the last 30 years. The best way to achieve the 40%-50% global exposure is through a combination of 75% - 80% Regulation 28 compliant local balanced funds and 20%-25% global feeder funds or direct global funds.

The next question around timing is the most difficult, as the valuation levels of the rand, local markets and global markets all come into play. Naturally, investors will look to increase global exposure when the rand is strong - and hopefully not getting much stronger in the short term. Seed's view is that clients should not try and aim for perfect timing, and that getting the decision approximately right by getting the odds in your favour is better than not acting for years on end.

The rand has strengthened by around 30% over the last year (from a low of R19/$ in April 2020) and by 5% on a YTD basis, and currently trades at R14.00 to the USD. According to our Purchasing Power Parity (PPP) model – which is based on the law of one price and uses inflation differentials between SA and the US – the rand is currently 'mathematically-speaking' still 17% undervalued (weak) vs. the PPP rate of R12.00/$. But, given SA's structural growth constraints, we view the rand as close to fairly valued at this point.



Source : Seed Investments (30 April 2021)

The interplay between the currency's valuation, historical volatility, and SA's status as an emerging market results in a difficult choice for investors between two options:

1) Increase global allocation when opportune

If the rand continues to strengthen afterwards, the additional global portion will underperform in rand terms, but this will likely be offset by local assets doing well on the back of a buoyant economy and foreign inflows.

2) Delay the decision and maintain mostly local exposure

Local investors have become used to the rand weakening dramatically over short periods, and then taking a longer time to recover. A weakening rand could be the result of a local political shock or global risk-off sentiment that affects all emerging markets or commodity producers. Investors who are underweight global assets in such a scenario will be faced with a double negative:

a) They will be unable to benefit fully from a weakening rand via global assets
b) Local assets will also come under pressure

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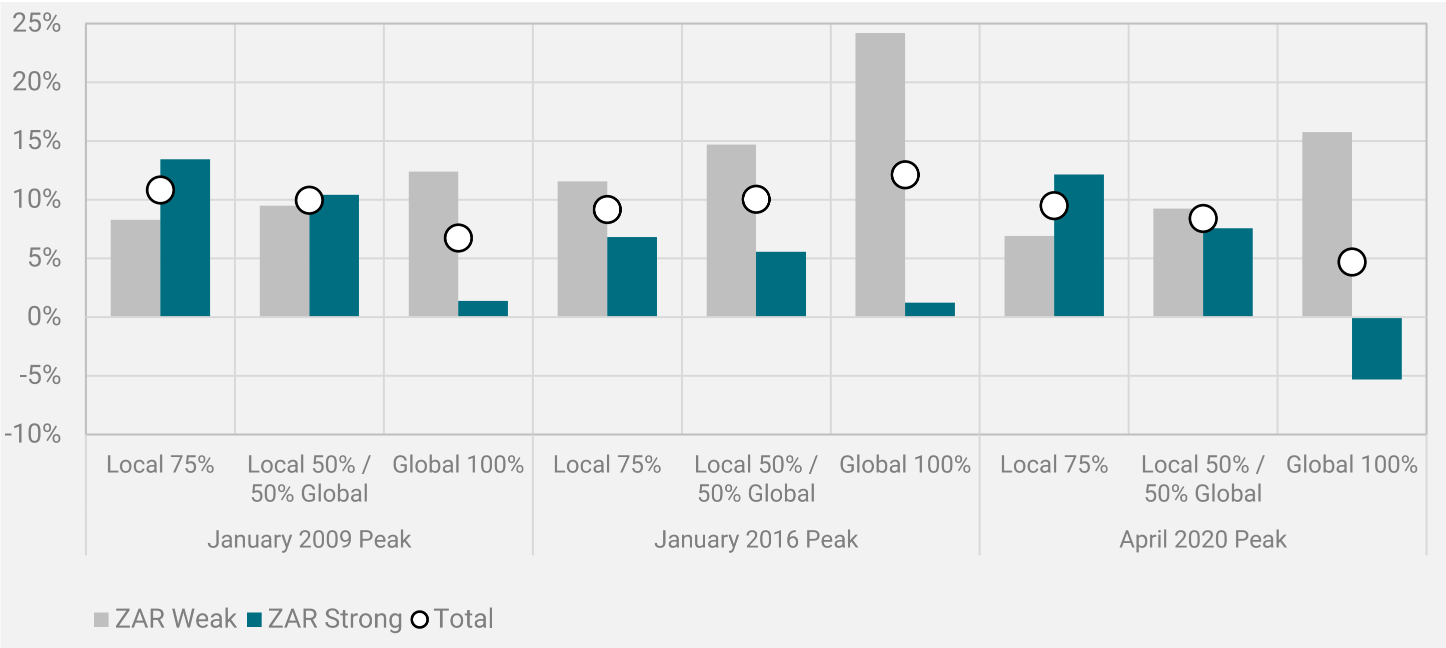
The chart below compares the performances for three illustrative portfolios during the previous three major rand cycles. In each case we display the annualised returns for 3 years leading up to and 3 years following the currency's lows in January 2009 (R10.20/$), January 2016 (R15.86/$) and April 2020 (R18.53/$).

It is clear that the 100% Global portfolio is the most volatile and underperforms markedly during the 3-year periods of rand strength. The 75% Local portfolio lags during the periods of ZAR weakness, but makes up during the up cycles and produced the highest overall returns during the 2009 and 2020 cycles.

The equal blend between Local and Global assets is - as expected - the most consistent, and produced similar returns during the weakening and strengthening cycles in 2009 and 2020.



Source : Seed Investments (30 April 2021)

We recognise that each client has their own unique investment goals and risk appetite, and the optimal allocation to global assets will differ accordingly. For clients currently sitting way below their target exposure, the current rand strength might offer a good opportunity to get a bit closer.

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The Seed Global Fund and Seed Global Prescient Feeder Fund is the ideal solution for investors looking to increase their global exposure via a well-diversified, multi-asset solution. For more information on how to access these Funds, please contact the Seed Team on +27 21 914 4966 or send an email to investmentteam@seedinvestments.co.za.

Kind regards,

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Portfolio Manager

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