ASISA

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Rand strength drives institutional investors into foreign equity funds

A strong Rand continued to fuel offshore diversification into foreign equity funds during the third quarter this year, resulting in one of the highest ever net quarterly inflows into foreign currency unit trust funds registered with the Financial Services Board (FSB). These funds have been available to South African investors since the end of 1998.

Foreign currency unit trust funds are denominated in currencies such as the dollar, pound, euro and yen and are offered by foreign unit trust companies. These funds can only be actively marketed to South African investors if they are registered with the FSB. Local investors wanting to invest in these funds must comply with Reserve Bank regulations and will be using their foreign capital allowance, which was recently increased from R2-million to R4-million per individual.

Leon Campher, CEO of the Association for Savings and Investment South Africa (ASISA), says the foreign collective investment scheme (CIS) statistics for the third quarter of this year show net inflows of R2.8-billion, bringing to just over R6-billion the total net inflows for 2009. The net inflows for the third quarter are slightly higher than for the second quarter, when foreign currency unit trust funds attracted net inflows of just over R2.7-billion

He points out, however, that institutional investors were doing most of the buying in the third quarter, with individual investors contributing around 20% of the net inflows.

"Although the strong Rand has been presenting investors with an ideal opportunity to diversify offshore, individual investors were not tempted to rush their money into foreign funds."

Treading carefully

Campher notes that local investors have only recently started to swap the perceived safety of money market funds for the potentially higher returns of local equities. It is therefore not surprising that individuals have not rushed offshore.

While net inflows for foreign unit trust funds have picked up significantly this year compared to recent years, flows into foreign unit trust funds remain low compared to net investments into domestic unit trust funds. Net inflows into local funds amounted to R15.6-billion for the third quarter of this year.

Foreign currency funds held assets under management of R103.9-billion at the end of the third quarter this year, with 382 funds being available to local investors wanting to diversify their investments using their foreign exchange allowance. Domestic unit trust funds were managing assets of R747-billion by the end of the third quarter this year, offering 903 funds.

Foreign equities appeal

Campher says in direct contrast to the asset split in the local unit trust industry, the bulk of assets under management in the foreign currency unit trust funds are in equity funds. At the end of the third quarter 69% of assets were held in foreign equity funds, 18% in foreign asset allocation funds, and only 13% in foreign fixed interest funds.

The asset split for domestic unit trust funds shows 23% of assets in equity funds, 27% in asset allocation funds and 50% in fixed interest funds.

He says given the disparity in returns offered by foreign money market funds versus local money market funds, this is not surprising. On average returns offered by foreign money market funds are between 0.5% and 1%.

"Given the carnage in world markets over the past year, investors are turning to foreign equity unit trust funds for exposure to investments offering good growth prospects."

As a result foreign fixed interest funds experienced net outflows of R80-million in the third quarter, driven mainly by institutional disinvestments. Institutional investors also abandoned asset allocation funds.

Relaxed exchange controls and diversification

Campher's view is that investors should not invest offshore simply because the foreign capital allowance has increased, but because they truly require diversification.

"Your decision to diversify offshore should be based on a view that a part of your portfolio will perform better offshore than if you had kept the money in South Africa. When you invest offshore, you are taking the view that the Rand is likely to weaken over time against the currency that you are investing in. This bet will only pay off if you are planning on bringing your money back eventually."

Campher says the time to diversify offshore is when the Rand is strong. However, individual investors tend to panic and rush their money offshore when something goes wrong and the Rand goes into freefall. If, for example, you took your money offshore on 2001 when the Rand plunged to R13.85 to the dollar, you would still not have recovered your losses.

"A well diversified portfolio is the only way to achieve inflation beating investment returns over the long-term. But you need to decide on the right level of diversification with the help of a trusted financial adviser. This decision should be based on your investment needs and your risk profile and not on the foreign capital allowance available to you."

Ends

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ASISA represents the majority of South Africa's asset managers, collective investment scheme management companies, linked investment service providers, multi-managers, and life insurance companies. ASISA was formed in 2008 by members of the Association of Collective Investments (ACI), the Investment Management Association of South Africa (IMASA), the Linked Investment Service Providers Association (LISPA) and the Life Offices' Association (LOA).