Pieter Hugo
MD Prudential Unit Trusts

FEBRUARY 2019

Offshore diversification pays off in 2018

In 2018, most investors who had offshore exposure in their portfolios would likely have been gratified to have it, since they would have benefited from the diversification it offered. Thanks largely to the much weaker rand, global bonds, global property and global equities returned 15.5%, 6.3% and 11.1%, respectively (in rand terms), all beating inflation. This helped to partly offset the shocking -25.3% and -8.5% delivered by SA property and SA equities.

Yet while the principle of diversification makes sound sense for any portfolio, it should not be done for the wrong reasons. Moving money offshore should ideally never be the result of a reaction to short-term changes in the local environment or a sudden depreciation of the rand. Unfortunately, South Africans have a history of reacting emotionally and taking money offshore after the rand has depreciated significantly, often resulting in subsequent losses. Rather, offshore exposure should be driven by your own investment goals and how best to achieve them within a longer-

term financial plan. In general terms, including some international exposure in a portfolio has been shown to be beneficial for almost all long-term investors.

How much should you invest offshore? This depends very much on your long-term investment goals. Generally, the offshore portion of your portfolio will be larger the higher your targeted investment return (and therefore the higher the risk required). For example, if you have a more aggressive return target of inflation+7%, you would tend to need between 35%-40% offshore. A return target of inflation+6%, meanwhile, is more in line with a typical "balanced" fund with around 30% offshore. Finally, a more conservative target of inflation+2%-3% would generally dictate offshore exposure of only 10%-20%. These are only general guidelines, however.

Why invest offshore? Diversification across countries, industries and companies, as well as asset classes and currencies, is the primary benefit. It reduces the risk of a portfolio for the same expected rate of return, resulting in a more "optimal" portfolio by spreading risk across many different investments. At the same time, offshore equities help reduce the risk inherent in the local equity market, which is among the world's most concentrated. International markets also offer more growth opportunities. The stocks listed on the JSE represent less than 1% of the world's total listed equity market capitalisation - so if you invest only in South African equities you are missing out on 99% of the global equity universe. There are many fast-growing industries under-represented on the local exchange like pharmaceuticals, biotechnology and alternative energy. There are innumerable world-class companies in which to invest.

Finally, you may have offshore goals. If you spend significant time outside the country or buy lots of imported goods, or if you want to retire abroad or send your children to school outside South Africa, higher-than-average offshore exposure could prove invaluable. Investments in hard currencies like US dollars, euros, sterling and yen act as protection against a depreciating rand and other South Africa-specific risks. This effectively ensures you match your longer-term offshore "liabilities" with equivalent assets.

To find out more about our offshore offering, speak to your financial adviser or contact our Client Services Team on **0860 105 775** or at query@prudential.co.za.