cadiz
ASSET MANAGEMENT

Offshore Investing: A South African perspective

As South Africans, we have only been allowed to invest offshore for the past 23 years. Pre-democracy, we were limited by rigorous exchange controls as the then National Party government attempted to stem private capital flows out of the country.

Thankfully, in July 1997, exchange controls were relaxed, and individuals were allowed to invest R200 000 offshore. This limit has been upped in successive budget speeches to reach the current R10 000 000 per calendar year for individuals of 18 years and older, subject to obtaining a SARS tax clearance certificate. In addition, individuals of 18 years and older are permitted to transfer up to the limit of R1 000 000 per calendar year without the requirements to obtain a tax clearance certificate. Individuals younger than 18 years have a travel allowance of R200 000 per calendar year.

The significant increase in the individual offshore allowance has coincided with the swift depreciation in the local currency against both the US dollar and British pound.

Notably, offshore investments are a key factor that many investors overlook until the rand takes another steep dive and then invest offshore impulsively rather than while the rand is strengthening, as we are seeing currently.

But why invest offshore?

Key reasons to invest offshore include diversification of risk, geographic spread, increased investment opportunities and rand hedging.

- **Diversification**. Diversification allows investors an opportunity to spread risk over more than one market with investments in both established (traditionally lower risk) and emerging (traditionally more volatile) markets. A balance of both higher-risk and lower-risk market exposures can provide the growth investors need without taking on excessive risks. Investment planning should involve spreading the risks, whether across currencies, investment vehicles, or markets.

- **Geographic spread**. Geographic spread is investing in different countries at different stages of their growth cycles. Diversifying across several economies is regarded as a way of smoothing-out returns. The South African stock market constitutes around 1% of the world stock market capitalisation, with emerging markets being about 8%, thus it is prudent to invest in larger and more mature markets and not only in emerging markets.

- **Increased investment opportunities**. The offshore investment arena provides increased opportunities, since investors can invest in various countries, products and industries. These opportunities range from foreign currency bank deposits, foreign government and corporate bonds, to shares listed on different stock markets.

- **Rand-hedging**. Inflation has changed investors' attitude towards investments, with the need to continuously generate inflation-beating returns. Diversifying globally could increase inflation-beating returns. When exchange controls were relaxed in 1997, the rate of exchange was R4.60 to the US dollar. Today's valuation represents approximately a 180% depreciation of the rand against the US Dollar over the past 22 years. The long-term trend line indicates that the rand will continue to devalue against the major developed currencies, thereby creating additional inflation protection.

Yet investors do not always fully understand the different ways to incorporate offshore assets into their portfolios. Below are three ways to incorporate offshore investments in your portfolio.

- **Asset Swaps**. Most asset managers, life insurance companies and stockbrokers are allowed to invest a portion of their assets offshore. Should they not utilise the full allowance of their capacity it is often sold or allocated to investors. Your funds are physically invested offshore in a vehicle of your choice, in your chosen currency, but the institution would need to repatriate your funds back to South Africa when you want to redeem funds. The funds form part of the balance sheet of the institution you enter the asset swap arrangement with.

- **Feeder Funds**. This is a local unit trust that invests all its assets into an offshore fund or fund-of-funds, with a small portion retained in rand to provide liquidity. The investment is made in rand, is reported in rand and redeemed in rand, while enjoying the gain or loss from both the performance of the fund and the movements in the underlying currency.

- **Foreign capital allowance**. All taxpaying individuals in good standing with SARS over 18 years of age have a single discretionary allowance of R1 million and a foreign investment allowance of R10 million available for investment purposes. The funds are physically invested offshore and may be invested into a broad range of assets, similar to the asset swap, except that the funds do not need to be repatriated, unless you choose to do so.

The three options described above largely achieve the same results, however, there are some important differences, and you should consult with your financial advisor to discuss these and the other important differences. For example:

- Your foreign investment allowance may be retained offshore indefinitely.
- Feeder funds may be taxed on the rand gains or losses when you redeem all, or part, of your investment.
- Asset swaps and foreign investment allowances are generally taxed on the base currency gains or losses.

Offshore investments need to be part of your investment portfolio and should form part of your overall long-term financial plan.

At Cadiz, we expect to see the long-term weakening trend of the rand and believe that investment portfolios should be positioned to take advantage of this trend, while accepting that there may be periods of short-term rand strength in between.

By Adrian Meager

CIO and MD, Cadiz Asset Management

Disclaimer: The information, opinions and recommendations contained herein are and must be construed solely as statements of opinion and not statements of fact. No warranty, expressed or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such recommendation or information is given or made by Cadiz in any form or manner whatsoever. Each recommendation or opinion must be weighed solely as one factor in any investment or other decision made by or on behalf of any user of the information contained herein and such user must accordingly make its own study and evaluation of each strategy/security that it may consider purchasing, holding or selling and should appoint its own investment or financial or other advisers to assist the user in reaching any decision. This document is for information only and do not constitute advice or a solicitation for funds. Investors should note that the value of an investment is dependent on numerous factors which may include, but not limited to, share price fluctuations, interest and exchange rates and other economic factors. Performance is further affected by uncertainties such as changes in government policy, taxation and other legal or regulatory developments. Past performance provides no guarantee of future performance.

Cadiz Funds (Pty) Ltd (Registration number 2013/118580/07). An authorised financial services provider (FSP 45442)