

A nighttime photograph of a city skyline reflected in water. In the foreground, a large, illuminated sculpture of concentric loops stands on a pier. The background features several tall skyscrapers with lit windows, including a prominent one with a grid-like facade. The sky is a deep blue.

OLDMUTUAL

OLD MUTUAL INTERNATIONAL NEWSLETTER

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For Financial Advisers



INTERNATIONAL

DOES THE EXCHANGE RATE REALLY MATTER WHEN INVESTING OFFSHORE FOR THE LONGER TERM?

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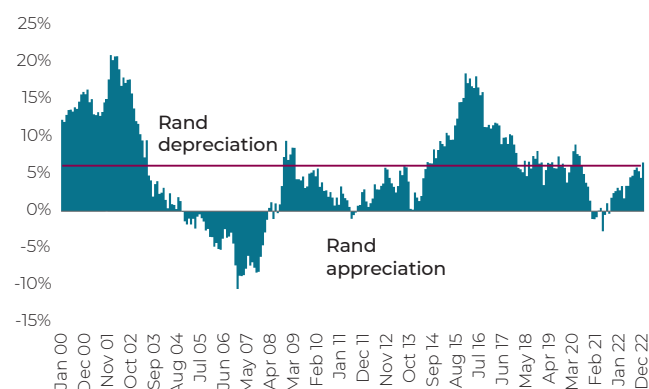
THE FAST VIEW

- There are compelling reasons for investing offshore; however, many investors fixate on trying to time the currency.
- On average, the rand has depreciated by approximately 6% p.a. over rolling five-year periods, contributing to an offshore investment's overall rand return.
- Our analysis illustrates that the rand/dollar exchange rate at the time of initial investment (i.e. whether the rand had appreciated or depreciated over the preceding year, used as a proxy for investors' perception of where the currency will go) does not make a material difference to the overall longer-term return of an offshore investment.
- When investing offshore, investors should take a longer-term view and look past the shorter-term movements in the currency.
- Where you choose to invest offshore is therefore more important than the shorter-term movements in the currency.

While investors accept that there are compelling reasons for investing offshore: diversification benefits; access to asset classes, industries and companies not available in South Africa; reduced emerging market and SA-specific risk; and maintenance of 'hard' currency spending power, they tend to spend an inordinate amount of time trying to call the direction of the currency.

Over the longer term, the performance of the rand contributes to an offshore investment's overall rand return. Rand depreciation adds to the offshore investment's total return calculated in rands, and rand appreciation detracts from the overall return. Figure 1 shows that over rolling five-year periods, the rand has experienced periods of both

depreciation (81% of the time) and appreciation (only 19% of the time) against the US dollar. On average, however, the rand has depreciated by approximately 6% per annum over rolling five-year periods, over the last 22 years.



Source: Morningstar, as at 31 December 2022.

TIMING THE CURRENCY, DOES IT MATTER OVER THE LONGER TERM?

Many investors are fixated on the exchange rate when making an offshore investment. We therefore analysed the performance of the [Ninety One Global Franchise Fund](#) (available via the Old Mutual International Global Core Flexible Fund) from April 2007¹ to December 2022 to determine whether the movement of the rand/dollar exchange rate (i.e. whether it appreciated or depreciated) in the year prior to an initial investment matters. Note that we used the 12 months prior as a proxy for investors' views on where the rand/dollar exchange rate is likely to move in future.

The analysis split the data into two series:

The investments allocated to either of the two series are then held from their respective inception dates to 31 December 2022. The annualised results are summarised in Figure 2.

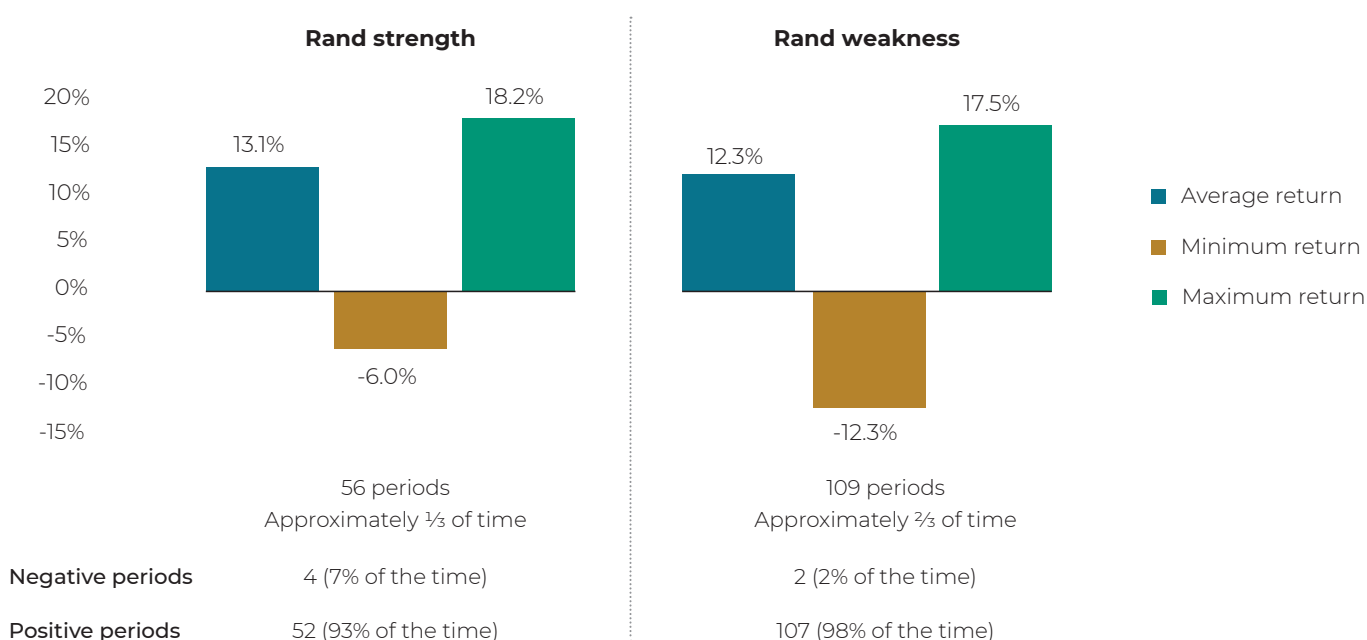
SERIES 1

Periods where the rand was stronger in the year preceding when an investment into the fund was made, continued rand strength being what investors are concerned about and attempting to avoid.

SERIES 2

Periods where the rand was weaker in the year preceding when an investment into the fund was made, continued rand weakness being what investors are trying to benefit from.

Figure 2: Performance of the Ninety One Global Franchise Fund following periods of rand weakness and rand strength



Source: Morningstar and Ninety One, various dates to 31 December 2022. Performance is based on a lump sum investment, NAV to NAV net of fees, gross income reinvested. For illustrative purposes only.

Some key observations:

- Of the 165 one-year periods, 56 (or approximately one-third) were periods where the rand strengthened and 109 (approximately two-thirds) where the rand weakened (this outcome should not be unexpected).
- The average annualised return was similar for periods of rand strength (13.1% p.a.) and rand weakness (12.3% p.a.).
- Many investors would have expected a lower return for investments made following periods of rand strength, but they forget that the performance of the hard currency asset also matters.
- This result suggests that the exchange rate entry point is not as material a consideration as many investors may think.
- The maximum annual return was also very similar (18.2% for periods when investments were made following rand strength and 17.5% when it weakened).
- Again, many would have expected more material outperformance for investments made following periods of rand weakness.
- The difference in the minimum annual return was more meaningful. But even at -6% following a period of rand strength, this is not a significantly negative number or cause for concern for a growth-oriented investor. The minimum return following a period of rand weakness was -12.3%. This is somewhat surprising but coinciding with the 2022 bear market in global equities, where the MSCI All Country World Index was down 18.4% (US dollar).

¹ Fund launch date: 4 July 2009. Performance is based on the UK-domiciled Global Select Equity Fund from 10 April 2007 which then merged into the Luxembourg-domiciled Global Franchise Fund on 4 July 2009. Performance prior to 4 July 2009 has been simulated.

So, even though the rand depreciated by more than 6% against the dollar over the year, it could not protect investors fully from the collapse in global equity prices.

WHY THIS MAY BE THE CASE

The rand tends to be a risk-on/risk-off currency (i.e. a cyclical asset). Simplistically, in a risk-on environment, investors switch exposure from developed markets (DMs) to emerging markets (EMs), depressing DM asset prices and strengthening EM asset prices and currencies like the rand. In a risk-off environment, the reverse is true, with investors moving their allocation back to DM assets, resulting in a weakening rand, which then acts as a 'shock absorber' for an offshore investment.

So, what the rand may give you in terms of a potential offshore investment entry point, offshore asset valuations (and asset price momentum) tend to take away, and vice versa.

The rand tends to be a risk-on/risk-off currency (i.e. a cyclical asset).

When investing offshore, we would therefore argue that investors take a longer-term view and look past the shorter-term movements of the currency. Furthermore, the majority

of South Africans investing offshore should look to global equities or high-equity global multi-asset solutions with long-term track records that have proven their mettle through investment.

Interestingly, Clyde Rossouw, Portfolio Manager of the [Ninety One Global Franchise](#) Fund, continues to favour select global equities despite the expected slowdown in global growth:

*"While 2022 was undoubtedly a tough year for investors, the fall in asset prices resulted in improved prospective return expectations. This is especially true for the high-quality global companies we hold. Despite the fall in their share prices, the fundamentals of these businesses remain strong. They are ideally positioned to navigate the tough macroeconomic environment that lies ahead. Their strong pricing power and low debt levels are a formidable bulwark against inflation and rising interest rates. We remain confident about the runway for growth and the ability of these companies to compound their cash flows. Given these factors, we are increasingly optimistic about the prospective returns from the global equities we hold. Global equity remains our preferred asset class."*²

This talks to the benefit of paying attention to the offshore assets selected rather than the currency.

² Ninety One Opportunity Fund Manager commentary, as at 31 December 2022.

³ Applicable to the 2022/2023 tax year. Taxed in the individual policyholder fund.



PROTECTED* NOTES, AN ADDITIONAL INVESTMENT OPTION WITHIN OLD MUTUAL INTERNATIONAL'S (OMI'S) EXTENSIVE INVESTMENT RANGE

SAMANTHA NAIDOO | OLD MUTUAL INTERNATIONAL PRODUCT SOLUTIONS



As part of OMI's extensive investment offering, Protected* Notes offer a unique investment proposition for clients. In times where markets are volatile and returns uncertain, these structured products provide clients with peace of mind through their valuable protection element.

This was especially evident in 2023 as the OMI Protected Return funds that matured provided clients with performance beyond capital protection. The four maturities year-to-date have provided clients with the following returns over their respective five-year periods:

Fund code	Fund name	Return over five-year period
54345	OMIM USD Protected* Return Fund - Issue 1	22.06%
54346	OMIM GBP Protected* Return Fund - Issue 1	14.78%
54359	OMIM USD Protected* Return Fund, Issue 2	23.80%
54361	OMIM USD Protected* European Equity Issue 2	52.50%

*Past performance is not an indicator of future performance.

Given the success of these Protected* Notes and the increased demand from clients and advisers, OMI has launched four issues of the USD Protected* Global Equity Index Fund since 2022. Issue 5 launched on 2 October 2023,

we spoke to an expert in structured products, Andrej Ogorevc, Chief Investment Officer at Causeway Securities, to help unpack these funds and answer some often-asked questions.

WHAT ARE THE BENEFITS OF INVESTING IN A PROTECTED* NOTE? WHY WOULD SOMEONE BE INTERESTED IN PURCHASING A NOTE OVER OTHER INVESTMENTS IN THE MARKET?

Protected* Notes allow clients to access the equity markets without the risk of losing capital should equity markets decrease. This does not mean that the Protected* Note is without risk as clients are still exposed to the credit risk of the issuing entity, the additional credit entity, and the guarantor.

The OMI USD Protected* Global Equity Index Fund also enhances the returns of the global equity basket with the participation above 100%. The participation in the first three issues was above 150% which means that if at maturity the basket has grown by 30% the note will return more than 45%.

WHEN WOULD YOU SUGGEST THAT AN ADVISER CONSIDERS THIS INVESTMENT FOR THEIR CLIENTS?

This type of investment is appropriate for clients who want to boost long-term returns when they do not expect global equity markets to increase by more than 10% - 12% p.a. year-on-year for the next five years while at the same time wanting to protect the invested capital should equity markets decline.

THESE NOTES OFFER PROTECTION BUT ALSO LEVERAGED RETURNS, SOUNDS TOO GOOD TO BE TRUE?

These investments allow clients to access the markets with a different risk-return profile than the traditional route via funds. With this investment, clients are giving up some of the high return potential they could get from investing directly in equities and/ or bonds with the associated potential dividends, in exchange for protection and boosted returns.

WHY IS THE PARTICIPATION RATE ONLY DETERMINED AFTER THE SUBSCRIPTION PERIOD?

The participation rate depends on a few market parameters with the presiding interest rate being one of the most important ones. Having the participation rate determined at the end of the subscription period allows us to offer the investment at the same issue price to all investors during the subscription period. This approach maintains the intended benefits, such as capital protection aligning with the initial investment, safeguarded against potential adverse price movements. A fixed participation rate from the outset would expose the investment to market fluctuations, eroding the advantages of a defined return approach.

THE CURRENT SET OF NOTES REFERENCES AN INDEX BASKET, WHY WAS THIS BASKET SELECTED AND HOW CAN I EXPECT IT TO PERFORM OVER THE FIVE-YEAR PERIOD?

The reference index basket offers global equity market exposure while providing the necessary diversification across different regions. Expected long-term returns for equity investments can vary based on a range of factors, including global economic conditions, market performance, geopolitical events, and more. Historically, equities have generally provided higher returns compared to other asset classes over the long term, but these returns can fluctuate

significantly over different timeframes and regions. It's important to note that past performance is not necessarily indicative of future results.

While past performance is no guarantee of future performance, the long-term average annual returns for equities in the past were:

1. Global Equities: Historically, global equities have yielded an average annual return of around 7% to 10% over the long term. This figure takes into account various market cycles, including periods of high growth and periods of economic downturn.
2. Regional Equity Returns:
 - a) United States: U.S. equities have generally provided an average annual return of around 7% to 9% over the long term.
 - b) Europe: European equities have historically yielded an average annual return of approximately 6% to 8% over the long term.
 - c) Asia: Equities in Asian markets, such as Japan and emerging economies, have seen average annual returns of around 8% to 10% over the long term.
 - d) Developed Markets: Equities in other developed markets have typically generated returns similar to the global average, ranging from 7% to 10%.

THE USD PROTECTED* GLOBAL EQUITY INDEX FUND BROCHURE MENTIONS THAT THE NOTE IS ISSUED AT A PRICE OF 95%. WHAT DOES THIS MEAN?

The note in the fund has a nominal value of \$1. This means that at maturity the fund will redeem at least \$1, subject to the credit risk of the issuer, the credit entity and the guarantor. The price that the client pays for this is \$0.95, thus allowing 5% to remain in a cash fund which can be used to cover adviser fees and product charges. In other words, this investment can help pay advisers and product costs while providing boosted exposure to the equity markets without the equity downside.

WHAT ABOUT TAX?

The fund can be accessed through the Investment Portfolio+. This is a capital redemption contract issued by the Old Mutual Isle of Man branch of Old Mutual Life Assurance Company (South Africa) Limited and is taxed in the hands of the insurer according to the South African five-fund tax applicable to South African life insurers. The tax payable is at beneficial rates and payable in hard currency. However, as the Old Mutual Isle of Man branch pays all tax on your behalf, you will receive after-tax proceeds at maturity.

If you would like to find out more about Protected Notes and how you can use it in your clients' portfolios, please contact your Old Mutual International Regional Offshore Manager or send an email to ominternationalservice@omwealth.co.za

* Please note that where we refer to 'Protected' we mean initial investment is protected in the absence of:

- (i) a Credit Event occurring with respect to corporate counterparties (as Credit Entity); and
- (ii) a bankruptcy or payment default of the Issuer of the Certificate and the Guarantor.

GROW AND PROTECT* YOUR CLIENT'S MONEY BY SMART INVESTING.

OLD MUTUAL INTERNATIONAL (OMI) USD PROTECTED* GLOBAL EQUITY INDEX FUND, ISSUE 5

CURRENCY	USD
INVESTMENT TERM	5 years
UNDERLYING INDEX	Index Basket: 40% S&P 500 (SPX) 25% Euro Stoxx 50 (SX5E) 15% Nikkei 225 (NKY) 10% FTSE 100 (UKX) 10% iShares MSCI Emerging Markets ETF The Index basket provides a global and diversified exposure to equity markets.
PARTICIPATION RATE	Target of 150% (final participation to be determined at end of subscription period and depends on prevailing market rates and may be higher or lower).
AVERAGING	The time period between the Strike date and the calculated average basket level over last 3 months (4 observation dates).
MATURITY	Invested amount x Participation rate x minimum (Index Basket Return, 40%) subject to protection.
ISSUER	BNP Paribas B.V.
MINIMUM INVESTMENT	Subject to the minimum contribution requirements of the Investment Portfolio+.
OPEN FOR INVESTMENT	2 October 2023
CLOSED FOR INVESTMENT	17 November 2023
STRIKE DATE	30 November 2023
MATURITY DATE	3 January 2029
FUND IDENTIFIER	9900240

CLOSING 17 NOVEMBER 2023

* Please note that where we refer to "Protected" or "Protect" we mean initial investment is protected in the absence of:

- (i) a Credit Event occurring with respect to corporate counterparties (as Credit Entity); and
- (ii) a bankruptcy or payment default of BNP Paribas Issuance B.V. (the Issuer of the Certificate) and BNP Paribas (the Guarantor).

THE HYPE AROUND INVESTING OFFSHORE IS BACK AT THE EUPHORIC LEVELS OF THE MID-NINETIES – BUT IS IT DIFFERENT THIS TIME?

SHELDON HOLDSWORTH | OMI REGIONAL OFFSHORE SPECIALIST



Offshore investing trends in the mid-1990s differed hugely from today. Fund choices open for South Africans extended to no more than five options, yet almost every application form received, allocated the funds, whether on a recurring premium basis or as a lump sum, to asset swap/feeder funds*.

Gradually, as the relaxation of exchange control limits began, investors had the option to use their newly introduced lifetime offshore allowance limits to invest directly offshore, in hard currency (US dollar, British pound, euro or Swiss franc), and access assets around the world. Investors, or their heirs, could redeem their investments anywhere in the world.

These investments could physically leave South Africa, via perfectly legal means, and would be held in jurisdictions generally within the Channel Islands. The factor which attracted many investors to this option was protection against political risk, which was an important consideration when investing offshore but not the only reason to bear in mind.

The value of a well-diversified investment portfolio cannot be overstated and the fact that both the markets and the currency could be cyclical, also need to be considered in planning when and where to invest offshore. If not, when these cycles go against you, many investors make poor decisions driven by fear, when patience and resilience are required.

It is however always so easy to reflect on these issues in hindsight, forgetting the factors in play at that specific time – especially in terms of political uncertainty. And while we are often reminded that past performance shouldn't be an indicator of future growth, it is so tempting to invest in all the areas where money has been made most recently, as we often then feel like we are the only ones missing out on this opportunity.

And while we as South Africans had previously been excluded from accessing these global economies, markets around the world had experienced amazing returns, since the early eighties. Looking at these hard currency returns and for so long been unable to participate in this bull run, it is no surprise that South African investors jumped in boots and all. And just to add more incentive, the depreciation of the rand over that previous decade was yet another bonus when considered over and above the hard currency returns achieved. For example; the Cape Town Olympic bid to host the 2004 Olympics was based on an exchange rate of 25/1, and investors therefore expected a rand depreciation of at least 10 % per annum going forward.

Looking back now however, you, as the adviser, could easily argue that the timing of the relaxation of exchange control, was a perfect storm. The eighteen-year bull run in offshore assets had created an expensive market, and the commodity super cycle driven primarily by the incredible demand for commodities from China, resulted in significant benefits for South Africa as a resource-based economy. In line with this, we saw the rand appreciate from a level just over R14 to the US dollar to just below R 7 over the coming decade. This impact also saw the SA market rally with returns of around 13 % per annum from the turn of the century up until 2013, while offshore markets ran flat over that time period with the added impact of the subprime crisis of 2008. We then once again witnessed offshore markets rally hard post the financial crisis over the proceeding 12 years, and with a drop in demand for commodities, the SA market and the rand were under pressure once again.



At this point you may feel more confused and uncertain than before you started reading this article, and leaving your clients' money in the bank may seem like a pretty good idea. Or alternatively simply investing in the perceivably low-risk property market – at least they can see the asset, and many investors have become very wealthy over the last thirty years plus. How many times at a braai have you heard someone bragging about buying a property and flipping it a year later, doubling their money. Although property is a good asset class to include in a diversified investment portfolio, liquidity remains an issue.

But fear not, as there are solutions to manage these daunting decisions, and while we would like it to be as simple as possible, and the fundamentals remain fairly aligned, they will inevitably differ from client to client and in many instances not simply based on objective financial planning but could also include some very emotive issues. Nevertheless, the ultimate way to establish financial independence and security in retirement, is to invest across a diversified portfolio of assets. Yes, that's the boring route, and you, or your clients, will never be able to be the person around the braai with the legendary tale of making quick money, but you will be the people who will be at the braai every year, while the 'big talkers' may not.

FINANCIAL ADVICE IS KEY

I do believe that when constructing a diversified portfolio, it is prudent to take the risks mentioned above into consideration. It's also important to consider your clients' overall assets and not just their discretionary funds. When deciding what portion of funds should be invested offshore. Once you have assessed your clients needs and objectives, you can determine how much of your clients' discretionary money can be invested offshore.

In closing, to answer the question on it being different this time, the risks associated with markets may continue to be cyclical and the rand may remain volatile. However, the big question is how high the political risk barometer is and what impact it will have on our markets and currency going forward.

It would be so easy to list these issues, but scaremongering should not cloud your decisions when putting your client's financial plan together into focussing on one option such as putting everything all your clients' discretionary money offshore. By providing your clients with an appropriately constructed financial plan, and a well-diversified portfolio, you give your clients the best chance of it being different this time.

*Asset Swaps

Asset swaps arise when a company uses its offshore investment allocation on behalf of clients to invest funds across a much broader range of assets around the world. These funds are ultimately only redeemable in South Africa rand and cannot be paid out abroad.