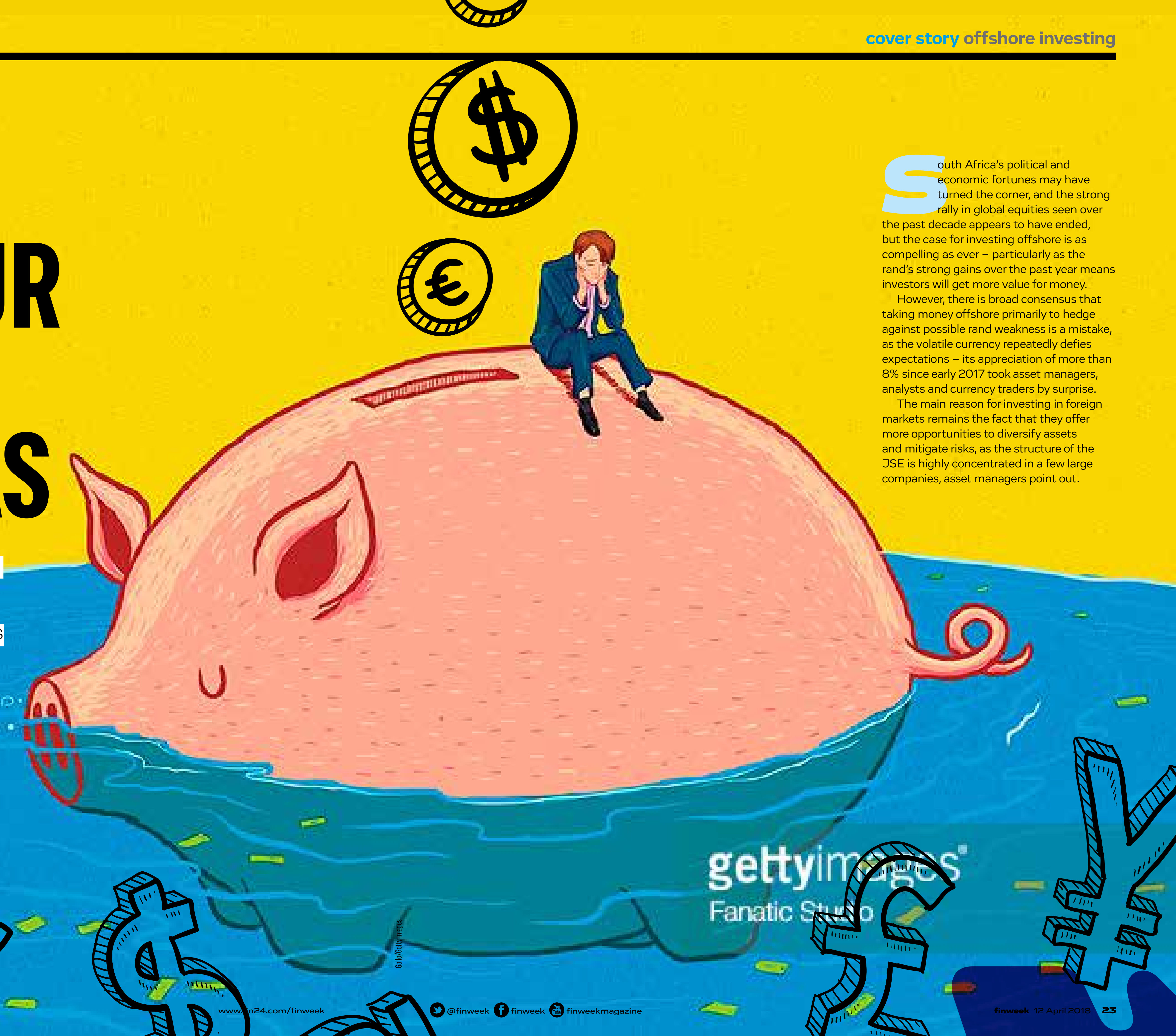
cover story offshore investing

By Mariam Isa

HOW TO TAKE YOUR MONEY OVERSEAS

There's a huge variety of investment options beyond South Africa's borders. In this comprehensive guide, we provide an overview of the vehicles you can use to do just that. We also consider which asset classes you should look at and what the risks are, as well as which countries and regions look promising.



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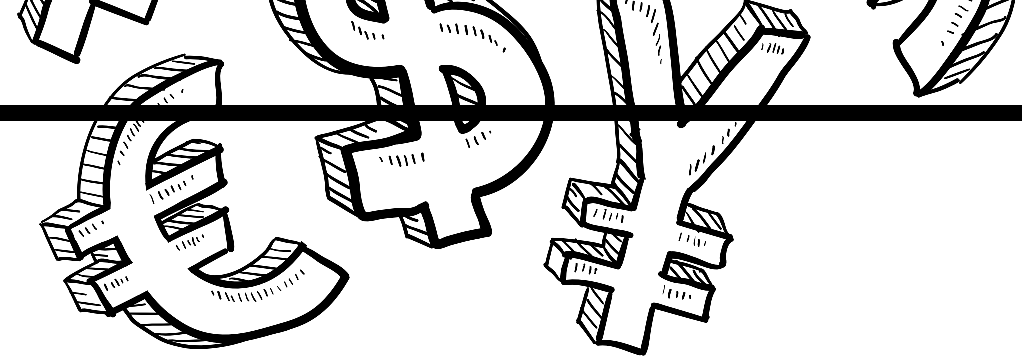
South Africa's political and economic fortunes may have turned the corner, and the strong rally in global equities seen over the past decade appears to have ended, but the case for investing offshore is as compelling as ever – particularly as the rand's strong gains over the past year means investors will get more value for money.

However, there is broad consensus that taking money offshore primarily to hedge against possible rand weakness is a mistake, as the volatile currency repeatedly defies expectations – its appreciation of more than 8% since early 2017 took asset managers, analysts and currency traders by surprise.

The main reason for investing in foreign markets remains the fact that they offer more opportunities to diversify assets and mitigate risks, as the structure of the JSE is highly concentrated in a few large companies, asset managers point out.



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"If you invest offshore now, you do it from a position of rand strength," says Rhynhardt Roodt, the co-head of Investec's 4Factor global equity team. "But it's more about diversification – people often miss how small the South African investment market is – there's a whole world out there."

Another factor to consider is that for the first time since the global financial crisis in 2008, there is synchronised global growth, the main factor that drives corporate profits and share prices.

Attractive opportunities

Although markets are likely to remain volatile this year after a spectacular plunge in January, the trend in global equities is likely to remain upwards – so if your investment horizon is more than 10 years, the best place to be is in equities, Roodt adds.

Hywel George, director of investments at Old Mutual Investment Group, says he believes that equity market valuations are generally not "unduly expensive", particularly outside the US, towards which most SA investors gravitate.

He shares the broad view that European markets are more attractive, both in terms of price and the fact that they are export-orientated. "If global growth is going to be strong, you want someone who can export into that very effectively. I think profits are going to surprise on the upside in Europe."

Germany is the accepted favourite on the continent, with what is arguably the best-managed economy, industrial sophistication, productivity, and the euro – which is expected to continue strengthening against the dollar this year.

"People often miss how small the South African investment market is – there's a whole world out there."

Asset managers are also keener on emerging markets than they have been in the past, with inflows so far this year undisturbed by rising US interest rates, which normally signal a risk-off environment and trigger capital flight from developing economies.

Emerging markets will drive global economic growth this year. The World Bank forecasts their pace of growth at between 4.3% and 4.5% this year and next, compared with just 2.3% and 2.2% in developed economies over the same period.

Old Mutual Investment Group SA says global equity remains its preferred asset class, with expected real return of 4.5% over each of the next five years. In SA, it anticipates real returns lower than the average of 6.1% over the past five years. Nonetheless the ability of government to implement its planned growth-enhancing reforms could boost returns over the next few years.

Although the JSE rose by 21% last year, when large multinational companies like Naspers are stripped out, local stocks have gone "nowhere" and therefore offer better value, says Mark Lindhiem, head of strategy at Alexander Forbes Investments. "South Africa is a much more attractive place now than it was three to four months ago," he adds.

Mark Lindhiem
Head of strategy at Alexander Forbes Investments

Adrian Saville
Chief executive of Cannon Asset Managers

Gallo/Getty Images

Emerging markets are widely seen as the place to invest this year – even though SA is part of this asset class, it only accounts for about 7% of the emerging-market benchmark, so you would get 90% of your exposure on other emerging markets, says George.

Asset managers favour China over India, as the Indian market has performed better on the back of faster growth, and valuations are much more expensive as a result. They also see good opportunities in South America and Mexico.

"The best thing to do is to buy an emerging-markets fund and get that diversified exposure. It's a highly technical call, so it's an area where you would really like to entrust a professional investment firm to make those calls for you," George says.

Asset managers estimate the amount that investors should hold offshore at between

35%
and
50%.

The big question, as always, is how much of your portfolio to invest offshore. There is no magic formula, as this depends on your future goals – which country you plan to retire in, whether you will send your children overseas and whether you like going on overseas holidays.

Adrian Saville, chief executive of Cannon Asset Managers, has the contrarian view that this makes currency the most important consideration in your allocation. "You must choose a currency that is likely to do better than your own currency in time – choose countries and currencies that are well managed," he recommends.

Although they are reluctant to provide general guidelines, asset managers estimate the amount that investors should hold offshore at between 35% and 50%.

WHERE ARE THE RAND AND THE INTEREST RATE HEADED?

Investor sentiment shot up when Cyril Ramaphosa took the reins from Jacob Zuma, but until government implements drastic economic reforms, the country's growth outlook remains questionable.

The ousting of former president Jacob Zuma at the start of this year and the swift action taken by his successor, Cyril Ramaphosa, to root out corruption and address government mismanagement sparked a surge in business confidence, which has significantly improved South Africa's growth outlook.

But the dramatic turnaround in sentiment has yet to translate into the reforms needed to generate enough private investment to make significant inroads into unemployment, restore social cohesion and put the economy on a sustainable path of significantly faster growth.

The decision by Moody's Investors Service to keep the country's sovereign credit rating at investment grade and change the outlook on its assessment to stable from negative has removed the threat of a foreign sell-off in government bonds, boosting the rand and prompting a welcome interest rate cut by the Reserve Bank. (Also see page 31.)

But minister of finance Nhlanhla Nene, restored to his post in a Cabinet reshuffle in February, has cautioned against the groundswell of euphoria. "I would want to call this a honeymoon phase, and it is for that reason we cannot be complacent about it [...] We do need to take our agenda forward," he said in an interview on the radio station 702 on 26 March.

Standard and Poor's made that point in a report released the following day, even though it doubled its growth forecast for the country this year to 2% – well above the Reserve Bank's latest forecast – and boosted its estimate for next year to 2.1% from 1.7%.

It questioned how quickly reform efforts would ease the structural constraints to economic growth – notably labour and product-market inefficiencies, poor education outcomes and a skills shortage. Nonetheless, the rating agency said it no longer saw SA as among the "fragile five" emerging markets, which would be most vulnerable to higher interest rates in developed economies.

Reserve Bank governor Lesetja Kganyago was also circumspect when he announced the monetary policy committee's decision on 28 March to trim its key repo rate to 6.5%, warning that while the growth outlook was more positive, it was "still challenging", as it was driven mainly by increased confidence.

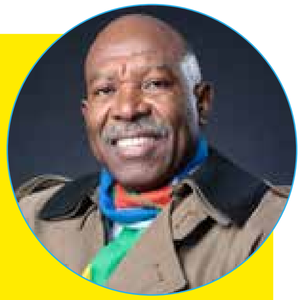
He also noted that the rand, which had appreciated by 4.8% to the dollar in the past two months, was "somewhat overvalued" and further strengthening potential was probably limited. He told reporters after the announcement that there had been "heated debate" over the decision to cut the repo rate, with four of the MPC arguing for the step and three in favour of holding it steady.

That means further interest rate cuts are unlikely this year, and there could even be hikes in 2019, which will dampen business and consumer optimism.

"The private sector underinvested for the last three years," said Stanlib chief economist Kevin Lings. "Because the currency is strong, this is a good time to upgrade machines – there is restocking of inventory levels across most sectors.

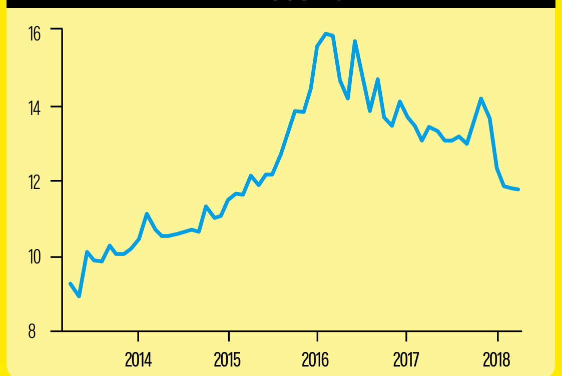
"What we are not hearing is significant expansion plans. The government balance sheet prevents it from stimulating the economy – it has to come from the private sector." ■

Nhlanhla Nene
Minister of finance



Lesetja Kganyago
Reserve Bank governor

RAND VERSUS DOLLAR



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Key risks

But there are big risks. At present, the biggest threat is that US interest rates will rise faster than expected as momentum in the economy builds and inflation climbs. This will hit treasuries hard and have a negative impact on global equities – including those in SA and other emerging markets, so no market will escape the fallout.

Most asset managers advise against investing in global bonds. This is because they are expected to deliver negative returns over the next five years despite the understanding that they're less volatile.

The other big threat to investing offshore – although it will also affect SA – is the risk of a global trade war sparked by US President Donald Trump, who slapped tariffs on all steel and aluminium imports at the start of March and then announced an additional $60bn in tariffs on some Chinese imports.

But this risk appears to have receded, after many countries were exempted from the steel and aluminium tariffs, and the Chinese opted to respond less aggressively. The US and China are now negotiating on trade, and Trump secured a trade deal with South Korea – the type of bilateral arrangement that he wants.

At the same time, the US stock markets have clawed back much of the losses triggered by mounting concern over the impact of Trump's threats.

It might be a good idea, however, to avoid the technology sector – at least in the short term – which has suffered amid concerns over regulatory oversight, especially in terms of advertising revenue following the backlash against Facebook after the data-harvesting exposé. ■

Donald Trump
US President

Gallo/Getty Images

But what about taxes?

Dividends from offshore investments are taxed the same way they are locally, but there are some considerations to make if you want to invest in a tax-smart way.

South Africans must pay the same level of tax on dividends, interest income and capital gains on offshore investments as they do for assets within the country, but there are factors to consider when deciding whether to use the rand or a foreign currency in the investment.

Any offshore dividends are taxed at 20%, the same level as within South Africa, while offshore interest earnings are taxed at the individual's marginal tax rate. Capital gains tax of 18% is also levied when individuals dispose of foreign assets.

However, in the case of a direct holding in an offshore fund, the gain is converted into rand at the spot market rate and taxed accordingly, while in a rand-denominated South African feeder fund, the currency movement is taken into account when calculating the capital gain. This means that if the rand weakens, it is more tax efficient to have invested directly in an offshore unit trust, while if it strengthens, you will pay less tax in a rand-denominated feeder fund.

> Any offshore dividends are taxed at **20%,** the same level as within South Africa, while offshore interest earnings are taxed at the individual's marginal tax rate.

The same tax considerations apply to individuals who invest in unit trusts through a linked investment service providers (LISP) platform, an institution that packages multiple unit trusts together, giving the investor a single entry into a selection of funds with different risk profiles. The difference, however, is that the asset will not go into probate in the foreign country, which is the legal process through which a will is reviewed for authenticity.

Estate duties can be an issue for South Africans with assets abroad – although it is levied at 20% on worldwide assets of less than R30m and 25% on assets of more than R30m. If the assets are domiciled in places such as the US or Great Britain, they can also be subject to a foreign inheritance tax or estate duty.

Individuals with high tax rates can have a tax advantage if they invest in insurer endowments or sinking funds through the offshore branch of an SA Life office. Investors must use their foreign investment allowance, but the assets are taxed in the individual policyholder fund of the SA insurer, where income tax is 30% and capital gains are 12%.

SA investors over the age of 18 can take R1m offshore for investment each year without a tax clearance certificate from the SA Revenue Service, but for higher amounts of up to R10m they need to apply for one. ■

How do I start investing offshore?

Investing offshore can be a "very daunting exercise", and it is vitally important to make use of the correct vehicle and underlying investments in order to maximise the effectiveness and growth of your offshore investment, advises Magnus de Wet, director of Vista Wealth Management.

He explains that the reasons why people invest offshore can vary: "With SA currently only contributing 1% of global GDP, other markets can provide investors with access to industries and sectors that are not well represented by the SA economy." Examples include the biochemical, aerospace and medical device sectors.


Tamryn Lamb
Allan Gray's head of retail distribution and Orbis in South Africa


Sonia du Plessis
Investment planner at Brenthurst Wealth

Tamryn Lamb, Allan Gray's head of retail distribution and Orbis in South Africa, agrees. (Orbis is Allan Gray's offshore investment partner.) She says South Africans need to make sure they are investing offshore for the "right reasons". These include the need to diversify your portfolio and broaden your exposure and not a weakening rand or negative news headlines, she cautions.

"Investing offshore should never be a knee-jerk reaction to events, but rather a decision taken as part of an overall financial plan," she says.

Sonia du Plessis, investment planner at Brenthurst Wealth, stresses that what is most important is that the investor's risk profile allows for offshore investments. Brenthurst Wealth recommends an investment horizon of eight to 10 years for offshore investments, as these can be "volatile".

As an investor you have two options when you want to invest offshore: You can either take money out of the country by converting it into hard currency such as pounds, euros or US dollars, and then invest it overseas, or you can choose a rand-denominated investment via a South African unit trust, says Maarten Ackerman, chief economist and advisory partner at Citadel.

The investor's money is placed in a rand-denominated asset-swap fund, with the unit trust using that money to invest offshore. The money has to be repatriated to SA in the future and will be paid out in rand.

Du Plessis says that investors who are dealing in large amounts tend to use the hard currency exchange, while investors with smaller amounts tend to go the rand-denominated route via a unit trust.

Political uncertainty and the exchange rate may also have an influence on whether investors pick direct or indirect offshore investments, adds De Wet.

"Politically risk-averse investors will prefer to make use of direct offshore investing, as with this option the investor never has to repatriate or convert their investment back to rands," he says. "With a weakening rand, direct offshore investing would be the preferred investment approach."

According to De Wet, in theory, the returns from either investment option should be the same, with only a difference in cost and capital gains taxes when you dispose of the investment.

"The difference in the capital gains tax between a direct and indirect offshore investment lies in the method that is used to translate the capital gains or losses into rand," he explains.

If you opt to go the hard currency route, it's important to note the exchange control limits. South Africans are allowed to take R1m out of the country every calendar year without a tax clearance certificate, and up to R10m a year with tax clearance. ■

– Lloyd Gedye

I WANT TO INVEST R500 A MONTH OFFSHORE. ARE THERE ANY OPTIONS AVAILABLE?

Most foreign-denominated currency investments have a minimum investment requirement from $10 000 upwards, leaving those who want to set aside small amounts every month to invest in a rand-denominated offshore product, says Magnus de Wet, director of Vista Wealth Management.

Investing offshore using a debit order is difficult and expensive, as you'd have to convert rands into US dollars every time your debit order goes off, explains Warren Ingram, executive director of Galileo Capital. The transaction costs will make up a larger percentage of the money you're investing.

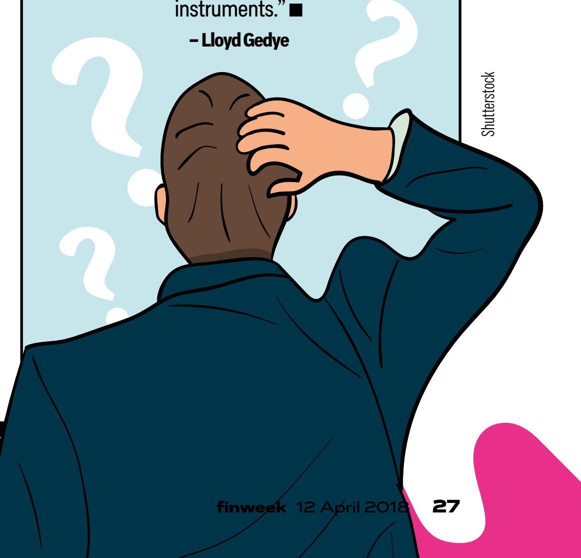
A rand-denominated offshore investment is therefore much more user friendly if you want to invest as little as R500 a month, Ingram says.

De Wet says that investors that have R500 a month to spare can put in place a debit order investment on a linked investment service provider platform.

"The investment can be a normal discretionary investment or even a tax-free investment account," he adds. The current annual limit on tax-free investments is R33 000 per tax year, and no interest, dividend or capital gains tax is payable on the product.

"The underlying investment vehicle in the above discretionary or tax-free accounts can be a rand-denominated feeder fund, fund of funds, index fund or an exchange-traded fund," De Wet says. "These vehicles in turn could have 100% exposure to foreign equity, commodity, real estate, bonds and/or money market instruments." ■

– Lloyd Gedye



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What are my options if I want a direct offshore non-rand-denominated investment?

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If you want to physically take your rands offshore in a foreign-denominated currency investment, you first have to decide if you want to invest directly in shares or exchange-traded funds (ETFs), or if you want to invest in foreign unit trusts, says Magnus de Wet, director of Vista Wealth Management.

"When directly investing in shares or ETFs on a foreign stock exchange, the investor would be required to pick the share/ETFs themselves or make use of a stockbroker," he explains. "By investing in unit trusts, the investor leaves the hard decisions like foreign country weightings and asset allocation to the foreign unit trust manager.

"By investing directly in foreign shares, the investor however saves the asset manager fee, which could be substantial," De Wet says. "But be aware, unlike our local stock market there are scores of shares and ETFs to pick from when you go international."

You can also consider an offshore endowment policy, where you pay tax within the product at a flat rate of 30%, says Sonia du Plessis, investment planner at Brenthurst Wealth. These endowment structures, also known as "offshore life wrappers", are issued by local life insurance companies.

The life company is responsible for the calculation, collection and administration of any tax due, and this frees the investor of additional personal tax liability or administration.

However, Du Plessis stresses that this is only for investors in the highest tax brackets: "This is only for individuals who are being taxed at a rate higher than 30%. Otherwise it will increase your tax liability."

The offshore endowment will protect your estate against foreign inheritance tax, which can be as high as 40% and doesn't require the creation of an offshore estate, an offshore will and is not subject to executor fees. "You can nominate beneficiaries, and upon death the money will be paid out to the beneficiaries," says Du Plessis. "It doesn't go through the estate."

> "By investing in unit trusts, the investor leaves the hard decisions like foreign country weightings and asset allocation to the foreign unit trust manager."

The potential savings on executor's fees can be almost 4% of the investment value in SA. De Wet adds: "Offshore investment not in an endowment structure could even attract two sets of executors' fees, in both the foreign and local country."

He adds that, in the case of an offshore estate, difficulties often arise after the investor dies.

"These problems occur because many overseas jurisdictions do not recognise your South African will," he says. "With an offshore endowment structure, these problems and the need for an offshore executor are removed as the proceeds of the offshore endowment policy will be paid out to the beneficiaries you name in the policy or into your local estate." ■

– Lloyd Gedye

Should you consider opening a bank account abroad?

You don't need an overseas bank account to invest abroad, says Warren Ingram, executive director of Galileo Capital. "You can convert your rands into dollars and put the money straight into the bank account of your product provider," he explains. "I don't see the benefit, in all honesty."

For South African citizens with no connections overseas it is extremely difficult to open a bank account abroad, says Magnus de Wet, director of Vista Wealth Management. An easier and more cost-efficient option is to open a foreign currency bank account with an SA bank, he says.

While most offshore investment platforms have minimums with regard to initial and top-up investments, there are no minimums involved with converting your rands to your foreign currency bank account, says De Wet.

"We advise clients wanting to invest directly offshore to open a foreign currency bank account as the first step towards an offshore direct investment," he says. "These days you can open a foreign-denominated currency bank account electronically within three days."

Some banking providers would provide you with a rand- and a foreign-denominated currency bank account, adds De Wet: "The investor would then first pay their rands into their rand bank account with this institution." Once the rands are deposited, the investor just contacts their conversion agent to convert their rand payment and put it into their foreign-denominated currency bank account.

This holds several benefits for investors:

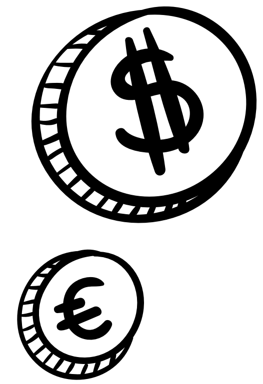
Time:
"As this is the first step in the offshore investment process, it gives investors more time to do homework on where and how they want to invest while already locking in the exchange rate," De Wet says. However, he stresses that due to the interest rates in these accounts being zero, it is not recommended to leave money in a foreign-denominated currency bank account for an extended period.

Transparency:
There is a cost involved with converting your rands to a foreign-denominated currency, and the process is transparent, he adds. The conversion fee is "mostly a percentage-based fee and is collected by adding a few cents to the price you're paying for the foreign currency".

Staggering:
Having a foreign currency bank account allows you to stagger the conversion of your rands into a foreign-denominated currency, De Wet explains. "With the volatility of the rand, we recommend that investors stagger their buying of foreign currency and not convert all at once, as no one knows whether the rand is at that point at its top/bottom," he says.

Flexibility:
"Once your funds are in your own foreign currency bank account, you can invest in multiple financial institutions and are therefore not tied to one specific institution," he adds. "You can also use your foreign currency bank account for debtors, creditors or other expenses you might have outside the country." ■

– Lloyd Gedye



Warren Ingram
Executive director of Galileo Capital.

> "These days you can open a foreign-denominated currency bank account electronically within three days."

Magnus de Wet
Director of Vista Wealth Management

By Simon Brown

ETFs: Get offshore easily with diverse options

Exchange-traded funds are a cheap and simple way to get money offshore. They track a variety of indices, and you can invest in them according to which countries, regions or sectors appeal to you.

When I was first learning how to invest in the 1980s, the only way to invest offshore was to be a smuggler. South Africa had a crazed finger-wagging president, a dual currency exchange rate (the financial rand was quoted differently for corporates), sanctions and severe exchange controls. So anyone who wanted to get money offshore had to slip Krugerrands in their toothpaste or stick R20 notes in their underwear before heading on an overseas trip.

But luckily times have changed, and since Deutsche Bank launched its offshore exchange-traded funds (ETFs) in 2009, it literally just takes a few clicks. The past year has seen an explosion of new offshore ETFs being listed, with over 20 across a wide range of assets and geographies now available for investors.

The most popular are the S&P500 and MSCI World ETFs, with the former having four issued and the latter two. These two indices are largely the same – while the S&P500 tracks the largest US stocks and the MSCI tracks developed-market exchanges with some 1 600 stocks, they're all global companies. A S&P500 stock is not only doing business in the USA, so if we look at the geographical breakdown for revenue between the two indices, we end up with pretty much the same split with the US dominating at some 55%. In terms of sectors, the S&P500 has tech as the largest with just over 25% and financials at around 15%, while the MSCI has both tech and financials at around 18%.

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Another general offshore ETF is the global ETF from Ashburton, which covers the largest 1 200 stocks, representing 70% of the global market cap. This ETF also includes a smattering of emerging markets but no direct African exposure, and also has tech and financial stocks at about 18% each.

Lastly, in the general space is the newly listed Global Dividend Aristocrats, which has virtually the same geographic split as the first two mentioned but has consumer staples as the top sector at around 21%. Tech is a modest 5%, and financials come in at just over 9%. The sector differences in this ETF are due to consistent dividends being the key metric.

For example, US stocks need 25 years of dividend payments to be considered for inclusion, and most of the large tech stocks haven't even been in existence for that long.

As JSE investors we can also get more niched, with global property ETFs and two recently listed global bond ETFs. There are also country- or regional-specific offshore ETFs with the geography being a factor of listing, rather than where revenue is earned. Itrix offers a European ETF that is dominated by stocks listed in Germany and France, but again these are global businesses earning profits all over the globe.

Staying with niche products, there are also two ETFs from Cloud Atlas focusing on Africa excluding SA. The first is a general equity ETF, while one with a property focus has just been launched. An emerging-market ETF from Satrix tracking the MSCI Emerging Market Index is also available. Here a quarter of the index is made up by China, with South Korea at 15% and India at 10%. This ETF makes a great addition to a more generic developed-market ETF such as the S&P500 or MSCI World.

Lastly, we have a recently listed S&P Tech ETF, which focuses exclusively on technology stocks, and this would fit well with the tech-light Global Dividend Aristocrats.

So the smuggling days are over – we can get money offshore cheaply and easily from the comfort of a local JSE trading account. Of course, another advantage is that we can buy ETFs within a tax-free savings account. ■

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