The hot topic has been investing overseas, following the relaxation of offshore investment limits; now investors can take up to 45% overseas

Venturing overseas

16 May 2022

by Andrew Hardy, CFA

With the skies and borders mostly open for international travel again, I've been visiting our parent company's home market of South Africa this past week, a welcome opportunity to catch up with colleagues and clients in person. The hot topic has been investing overseas, following the local central bank's recent relaxation of offshore investment limits; now investors can take up to 45% overseas. One of the many questions this brings into focus – for investors there but also around the world – is the risks that come with having so much of a portfolio invested overseas, and how best to manage them.

The high-level risks one must consider fall into the same categories as those found in the domestic market (macroeconomic, political, market related, geological etc.) but now with many more underlying shapes and colours. While the number of risks is multiplied across many geographies and regions, they're of course not additive due to diversification benefits.

It's important to remember that risks aren't necessarily all bad; investing is all about deliberately exposing oneself to many such risks on the basis that they are rewarded over the long term. For instance, over a very long period of the last 122 years, investors in US equities have achieved approximately a 7% annual real (above inflation) return[1] – handsome reward for bearing the associated risks!

Currency risk is often the first thing investors worry about when going overseas, however it's by no means unique to international portfolios. Consider the contrasting fortunes (on average) of net importing business in the domestic market, relative to net exporters for a given move in the domestic currency. This is the manifestation of an indirect currency exposure. The greater concern attached to direct exposure to international currencies is reasonable, given it can be one of the more volatile risk factors in the short term, however, it usually has less impact over the long run.

Often risks can lie undetected beneath the surface; a portfolio of hundreds of stocks across multiple geographies might appear well diversified but could still be heavily exposed to a common underlying risk factor, such as if they were all heavy importers of a certain raw material. Another more subtle example would be taking an overweight to 'value' stocks while underweighting interest rate duration – both are likely to detract from performance at the same time e.g., when bond yields are falling.

The key to more effective and successful risk management in any portfolio, domestic or international, is to understand and monitor the various risks, while ensuring the right level of exposure to each. Asset allocation is a key part of this solution, but not everything. A well-constructed portfolio should capture as much of the benefits of the desired rewarded risks as possible (for a given overall risk budget), while diversifying as much of the associated volatility away as is possible by mixing in un/low correlated assets as far as possible.

A good case can be made for strategically allocating to a broad basket of defensive or diversifying assets at any given time, especially given the range of choices an international universe brings. The allocation of a multi-asset portfolio to this area could fluctuate over time depending on the opportunities in other asset classes, but diversifying your diversifiers beyond just government bonds, to include areas such as precious metals, real assets, hedge fund strategies etc. brings huge diversification benefits for portfolios.

The various risk factors an international portfolio is exposed to will manifest themselves to varying degrees through time and will drive divergence in returns relative to other asset classes, countries, or broad benchmarks. Rather than fearing this, the associated volatility can be welcomed by those in a position to take advantage of the valuable tactical asset allocation opportunities it brings.

As a current example, we believe the Japanese equity market represents an exciting long term investment opportunity. In aggregate the market appears undervalued relative to its earnings power and asset values, but a position becomes more compelling when you factor in that the economy and stock market is relatively lowly correlated to Western markets. On top of that, there's arguably a greater potential reward for active management there, due to the depth, breadth, complexity, and low sell side coverage of the market.

The bottom line is that international investment risks can and should be managed, not eliminated. As with investments in the domestic market, good risk management requires a long term, consistent process with carefully considered and deep diversification across asset classes, strategies and currencies. Furthermore, we believe in always having a very deep understanding of the strategies or securities we hold before investing in them, as being selective about what you hold in the first place is one of the best and most underappreciated forms of risk management. Most of us have encountered our share of surprises or troubles on foreign expeditions, and have learnt it pays to set off well prepared...

Source: Momentum Global Investment Management, Bloomberg Finance L.P.., [1] Yale University, http://www.econ.yale.edu/~shiller/data.htm

Market Focus

- **Global equities declined 2.1% last week**
- **Goldman Sachs have cut US growth forecasts**
- **Brent crude fell 0.7% to $111.5 a barrel**
- **Gold fell by 3.8% to $1811.8 per ounce**

US

- US equities fell by -2.4% last week. Pharmaceuticals and Consumer Staples outperformed while Metal Miners and Oil/ Gas underperformed. Jerome Powell acknowledged being behind the curve in tightening policy, saying, "It probably would have been better for us to have raised rates a little sooner."
- Goldman Sachs cut its US growth forecast due to the recent tightening in financial conditions which they expect to persist as the Fed hikes rates. Economists, including Jan Hatzius, see GDP growing +2.4% in 2022 vs the prior +2.6% forecast and 1.6% in 2023, from +2.2%.
- Initial jobless claims for the week ending 7May were 203k (vs. 195k forecast).
- US Producer Price Index for April was +0.5%, in line with estimates.

Rest of the World/Asia

- The benchmark Global Emerging Markets Index fell by 2.6% last week
- Japanese equities fell by 2.7% last week
- Chinese equities fell by 0.4%, with industrial production collapsing year-on-year for April to -2.9% (vs. +0.4% estimate), and retail sales shrank 11.1%
- China cut the minimum mortgage interest rates for first-time homebuyers to 4.4% from 4.6% to revive the property market.
- Russian inflation surged 17.99% yearly in April, accelerating from 16.69% while slowing to 1.7% month on month.

Europe

- European equities rallied by 0.8% last week, with Retail and Household Staples outperforming, while Basic Resources and Healthcare underperformed.
- German ZEW Economic Sentiment stands at -34.3 for May (vs. -42 forecast).
- Finland and Sweden have announced plans to join NATO in response to the Ukraine invasion.
- According to draft projections from the European Council, the EU plans to cut its prediction for 2022 growth and almost double its estimate for inflation in today's spring update. It sees euro-area GDP expanding 2.7% this year and 2.3% in 2023, down from February estimates of +4% and +2.7%. Inflation is predicted at a rate of+ 6.1% for this year, faster than the previous +3.5%.
- The US House passed a Ukraine bill to fund weapons and provide economic aid that exceeds $40Bn.

UK

- UK equities rallied by 0.6% last week, and Gilts 2.5%.
- UK GDP Quarter-on-quarter fell to 0.8% (vs. 1.0% forecast).
- Manufacturing production for March was -0.2% (vs. -0.5% forecast).

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

Market Summary

Asset Class / Region	Currency	Cumulative returns Week ending 13 May	Month to date	YTD 2022	12 months
Developed Markets Equities					
United States	USD	-2.4%	-2.6%	-15.3%	-1.2%
United Kingdom	GBP	0.6%	-1.3%	4.4%	13.5%
Continental Europe	EUR	0.8%	-3.5%	-12.4%	-0.8%
Japan	JPY	-2.7%	-1.9%	-5.3%	3.2%
Asia Pacific (ex Japan)	USD	-2.6%	-6.6%	-16.6%	-19.7%
Australia	AUD	-1.6%	-4.6%	-3.3%	5.4%
Global	USD	-2.1%	-3.2%	-15.9%	-5.3%
Emerging Markets Equities					
Emerging Europe	USD	-2.7%	-6.9%	-75.6%	-74.2%
Emerging Asia	USD	-2.6%	-6.9%	-19.4%	-22.5%
Emerging Latin America	USD	0.3%	-2.8%	7.6%	-2.9%
BRICs	USD	-1.7%	-7.6%	-23.5%	-30.4%
China	USD	-0.4%	-7.3%	-23.7%	-36.4%
MENA countries	USD	-6.7%	-6.8%	9.1%	21.5%
South Africa	USD	0.7%	-6.5%	-1.9%	-9.4%
India	USD	-4.3%	-8.7%	-12.2%	3.4%
Global emerging markets	USD	-2.6%	-6.6%	-18.0%	-20.6%
Bonds					
US Treasuries	USD	1.0%	-0.2%	-8.4%	-7.0%
US Treasuries (inflation protected)	USD	0.4%	-2.2%	-6.8%	-1.5%
US Corporate (investment grade)	USD	0.6%	-0.7%	-13.4%	-10.8%
US High Yield	USD	-1.2%	-2.4%	-10.4%	-7.4%
UK Gilts	GBP	2.5%	1.2%	-9.1%	-6.4%
UK Corporate (investment grade)	GBP	1.6%	0.5%	-9.3%	-8.0%
Euro Government Bonds	EUR	1.6%	0.0%	-8.9%	-8.2%
Euro Corporate (investment grade)	EUR	0.8%	-0.5%	-8.1%	-8.0%
Euro High Yield	EUR	0.3%	-1.5%	-8.4%	-7.1%
Japanese Government	JPY	0.2%	-0.2%	-2.1%	-2.0%
Australian Government	AUD	0.7%	-1.4%	-9.2%	-8.8%
Global Government Bonds	USD	0.7%	-0.7%	-12.0%	-13.4%
Global Bonds	USD	0.4%	-0.8%	-12.6%	-14.0%
Global Convertible Bonds	USD	-4.0%	-5.2%	-17.5%	-18.8%
Emerging Market Bonds	USD	0.1%	-1.3%	-23.2%	-22.6%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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Market Summary

Asset Class / Region	Currency	Week ending 13 May	Month to date	YTD 2022	12 months
		Cumulative returns			
Property					
US Property Securities	USD	-3.1%	-7.5%	-15.4%	5.4%
Australian Property Securities	AUD	-2.6%	-10.5%	-16.9%	1.3%
Asia Property Securities	USD	-1.5%	-2.8%	-6.0%	-12.9%
Global Property Securities	USD	-2.7%	-6.8%	-14.5%	-3.5%
Currencies					
Euro	USD	-1.5%	-1.3%	-8.6%	-13.8%
UK Pound Sterling	USD	-1.0%	-2.7%	-9.6%	-12.8%
Japanese Yen	USD	0.8%	0.2%	-11.1%	-15.4%
Australian Dollar	USD	-2.5%	-2.3%	-4.9%	-10.4%
South African Rand	USD	-1.3%	-2.5%	-1.5%	-12.8%
Swiss Franc	USD	-1.6%	-3.0%	-9.1%	-9.6%
Chinese Yuan	USD	-1.8%	-2.7%	-6.4%	-5.0%
Commodities & Alternatives					
Commodities	USD	-1.1%	0.0%	32.8%	52.8%
Agricultural Commodities	USD	0.9%	-0.1%	23.8%	37.5%
Oil	USD	-0.7%	2.0%	43.4%	66.4%
Gold	USD	-3.8%	-4.5%	-1.0%	-0.8%
Hedge funds	USD	-1.7%	-2.0%	-4.2%	-2.8%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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