The Case For Global Diversification

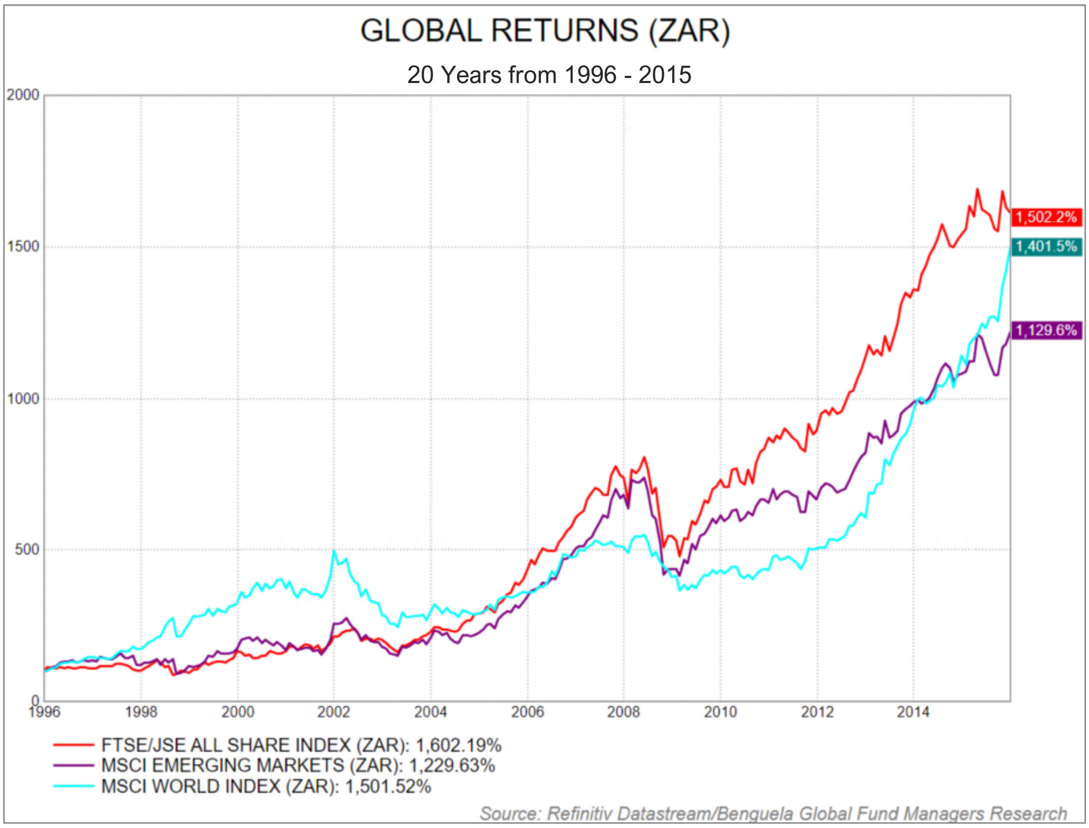
By Thandi Zwambila

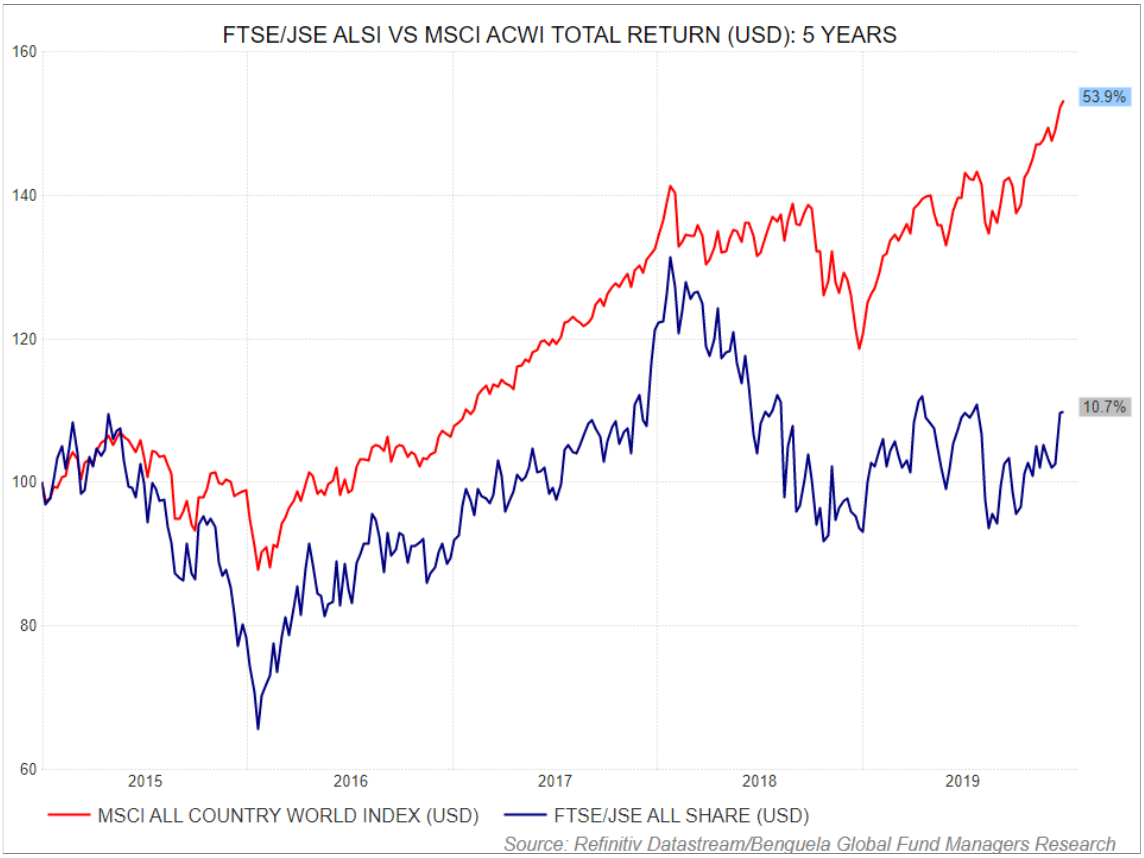
Business Development Manager

What is the case for global investment and does partnering with an overseas-based global investment management firm equate to better returns?

The Case for Global: Why You Should Include Global Equities in Your Portfolio

From the mid-1990s until the start of 2015, the JSE rewarded investors with unbelievable returns (*figure 1*); returns that have not been seen since, nor are they likely ever to be repeated.





2015, however, marked a tipping point with the All Share Index returning just 5.1% in rands and a depressing -21.5% when measured in dollars. In December that year, with the unforgettable covert ops-style sacking of Finance Minister Nhlanhla Nene and cabinet reshuffle, the rand began its downward trajectory and this pattern of weaker dollar returns versus local currency returns would become the new normal. Since then, returns have been anaemic with 2018 being the worst calendar year since the financial crisis of 2008 – the market returning -11% in rands (-24% in dollars). The glorious years of strong double-digit returns, to which South Africans had become accustomed, were over. 2019 was marked by abnormal returns from mining stocks (*see table, right*) with larger, quality companies lagging meaningfully and the Capped Swix Index returning a humble 6.8%.

Make no mistake, we at Benguela are not rand pessimists, nor are we the soon-to-emigrate naysayers who cannot see anything good in South Africa. Quite the contrary, we remain hopeful for the future although South Africa is faced with a myriad of challenges. Therefore, our case for global is not premised on the demise of South Africa but rather on the following.

2019 Top Performers	
Share	**2019 Return**
Impala Platinum	291.3%
Sibanye Gold	258.2%
Northam Platinum	185.8%
Anglo American Platinum	148.8%
Harmony Gold	103.2%
Royal Bafokeng Platinum	99.5%
Gold Fields	96.4%
Lonmin	75.2%
AngloGold Ashanti	75.0%
Cartrack Holdings	70.5%

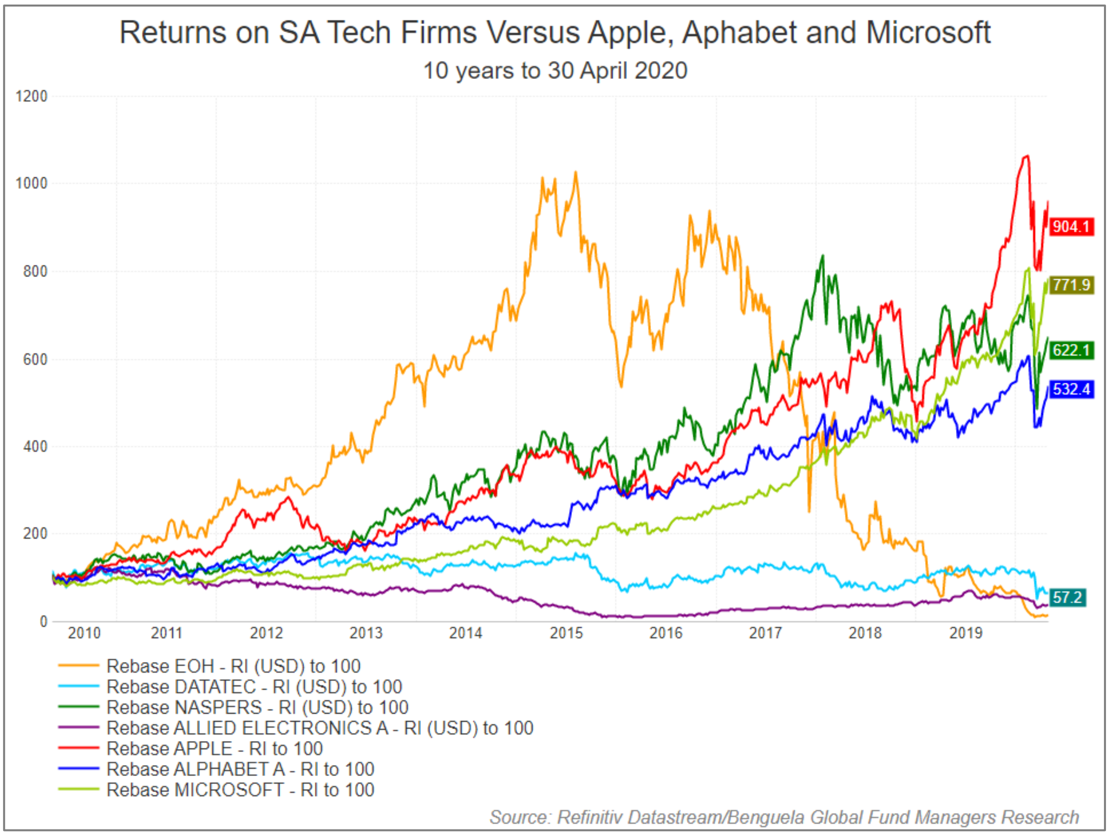
1. Low Quality Concentration on the JSE:

The Johannesburg Stock Exchange has 344 listings. When we consider how many of those listed companies are high quality, we apply our proprietary Benguela Quality Score to objectively calibrate quality and consistently apply our assessment of quality across different firms. By our last measurement, only 10 stocks are high quality while just one counter is considered very high quality. Very scary is that only 30 companies are medium quality, illustrating our local market offers very little choice and the danger of large concentration risk to investors seeking to invest in a purist Quality portfolio.

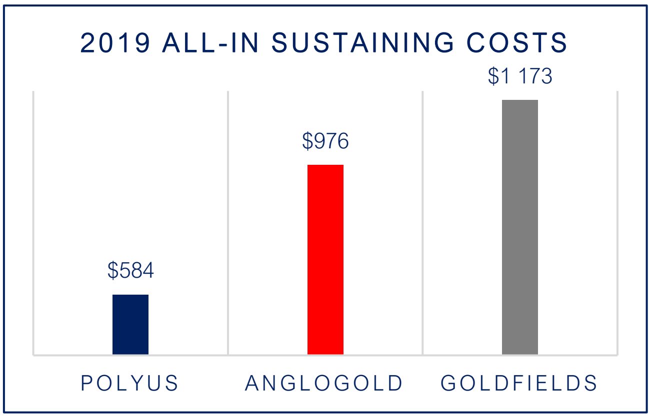
Whereas when we screen globally, again using the Benguela Quality Score, even tightening the screeners to our strictest criteria, more than 210 companies are very high quality in the global universe.

2. A Range of Opportunities Abroad:

No matter how fast-growing our economy, the fact is we do not have listed on our exchange the likes of Apple, Coca-Cola, Alibaba and Microsoft or other global giants that have delivered stellar, hard currency returns to investors. Additionally, better sector diversification is enabled by including a global allocation in one's portfolio. As an example, the tech sector is underrepresented on the JSE, so if you wanted exposure to technology, your choices are among Naspers, EOH, Datatec, Cartrack and Altron (depending on your definition of technology). When we compare our local tech options' returns against a few global tech firms, only Naspers stands up.



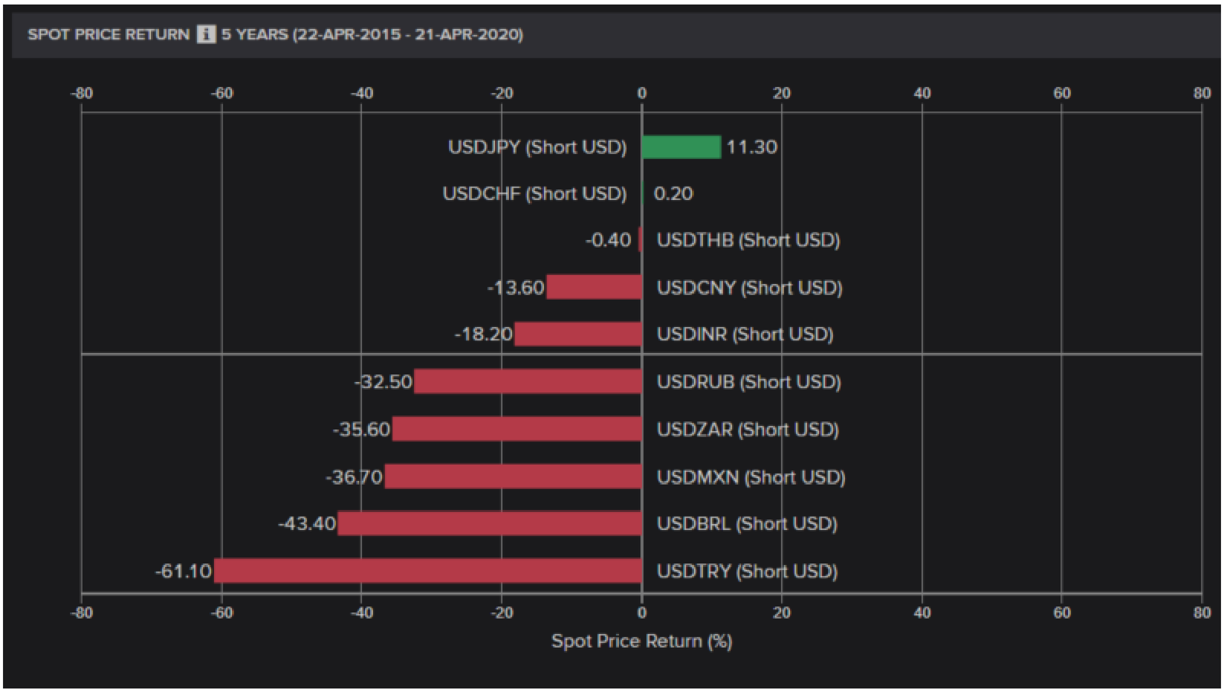
Similarly, if you were looking to include an allocation to gold miners, many of our local options are of poor quality. Gold mines in SA are some of the deepest mines in the world, old and costly, presenting investors with an unappealing "opportunity" to invest in a short life of mine and globally uncompetitive all-in sustaining costs. We pit AngloGold Ashanti (the most decent Quality of the Golds) and Goldfields against Russian-based, London-listed gold mine Polyus – no comparison.



Source: Annual Reports

3. Hard Currency and Geographic Diversification:

Finally, there is the rand. Ignoring our long-term view on the rand, if currency movement is a component of return, then diversification across currencies is important in lowering volatility of returns. Another important factor in currency diversification is the need to build hard currency wealth to reduce standard of living risk as hard currencies have historically been less volatile and have demonstrated a superior ability to maintain purchasing power. The below table shows the performance of the rand and other emerging currencies against the USD and evidence suggests that emerging currencies are, and will likely always be, susceptible to large currency swings (relative to developed currencies):



Source: Refinitiv/Benguela Global Research

Implementing Your Global Investment Strategy: Easier Than You Think

There are undisputable merits to global diversification, not just from a returns perspective but as an important risk reduction tool. Next is the decision on how to implement your global investment. Many people make the mistake of thinking they need millions of rands to invest globally – this is not so, although having larger sums to invest provides greater flexibility to choose different ways to implement your strategy. The primary decision is choosing whether to invest directly in offshore currency or to retain rand exposure.

The advantage of externalising money is that your global investment will be denominated in the currency of your remittance. For many investors, the ability to see their various portfolios in their respective base currencies is important as they may want to assess performance in currency. Some investors may take comfort in knowing that their global investments are custodied outside of South Africa, as a means of reducing political or other country-specific risk. Other investors may have children or legatees based overseas or look to send their children to universities abroad, necessitating an appropriately denominated investment pool.

Still, many investors may not want to go through the schlep or administrative burden of externalisation. For these investors the global exposure, and not the currency of reporting, is important. In these cases, Feeder Funds (ZAR-denominated unit trusts, which invest in directly offshore investment products) allow the individual to invest in offshore strategies that are suited to their risk and return objectives but keep the vehicle local and denominated in rands.

For example, Benguela's flagship global offering is our Global Equity UCTIS Fund (denominated in USD and domiciled in Ireland); however, we have the rand-based Benguela Global Equity Feeder Fund which invests in our UCITS. These feeders offer investors the advantages of investing offshore while providing the added benefits of administrative and reporting ease and cost-effective entry into the market (available from R500 per month debit order or R5,000 lump sum).

Stay Local in Investing in Global Equity

People often think that going global requires investments with large New York or London-based financial conglomerates in order to bring them the best investment outcomes. To the contrary, many South African firms have brought compelling solutions to suit the specific needs of the South African investor. As implied in the name Benguela Global Fund Managers, we had every intention from the start to be global. What "global" means to us is simple: it is having local talent with global capabilities. We launched the Benguela Global Equity Fund in November 2015 and, nearly five years later, Benguela is proving to the world that a South African team can stand up against established global fund managers. Last year we launched our Benguela Global Equity ACI Feeder Fund, which invests directly in the Global Equity UCITS Fund to bring our clients more flexibility in choosing how to execute their global wealth creation.

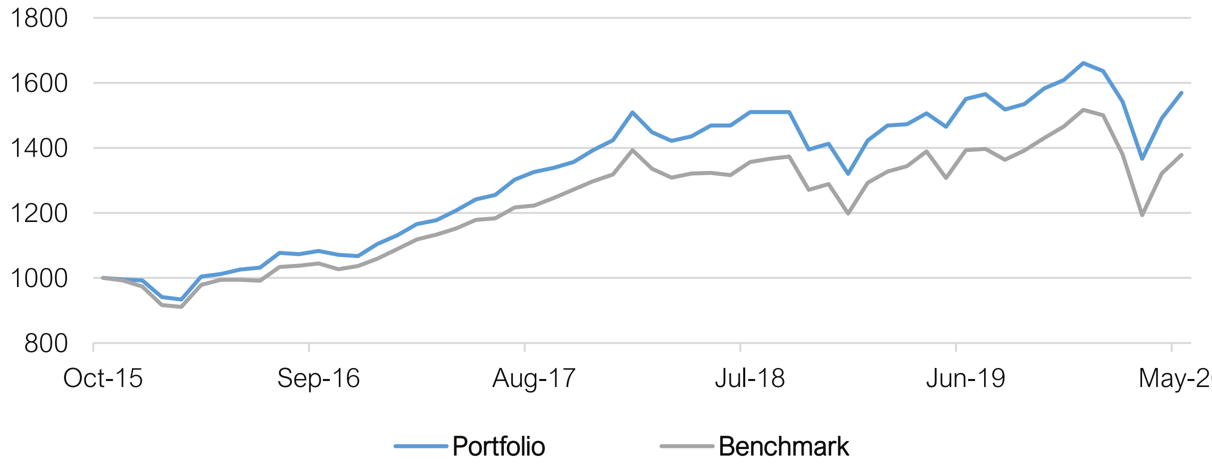
You may be wondering how a local team competes against large global players with huge workforces. Tom Goodwin explains it best: "*Uber, the world's largest taxi company, owns no vehicles. Facebook, the world's most popular media owner, creates no content. Alibaba, the most valuable retailer, has no inventory. And Airbnb, the world's largest accommodation provider, owns no real estate.*" Is it therefore surprising that the use of proprietary technology and advanced automation, no doubt a source of our competitive advantage, are the secret sauce that enables our lean team to deliver superior investment outcomes for our clients?

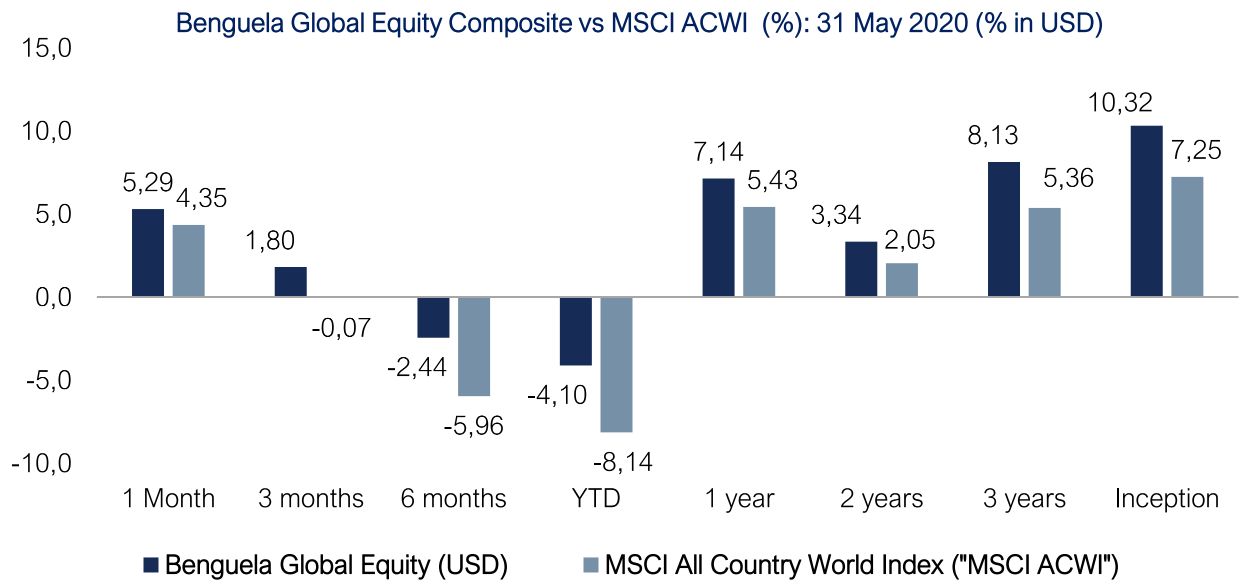
And the proof is in the pudding. Our tech and automation drive enhanced screening that points us towards some unique investments. We are not buying the same old stocks and favourites you will commonly find across global equity solutions popular in South Africa. Instead, eight of our top 10 holdings comprise unusual and exceptional high-quality companies as listed below:

TOP 10 EQUITY HOLDINGS	% of Portfolio	2019 Performance
China Overseas Property	5.95%	112.1%
Northrop Grumman	3.03%	39.2%
Gentex	2.88%	42.7%
China Maple Leaf	2.88%	5.4%
Universal Health Services	2.85%	20.6%
Republic Services Inc	2.77%	23.5%
Oracle Corp	2.68%	16.4%
Afreeca TV	2.59%	77.3%
Microsoft Corp	2.51%	60.9%
Lockheed Martin Corp	2.35%	48.8%

And to complement our differentiated underlying holdings, we offer a sound and proven Quality investment strategy that delivers reliable long-term performance and serves as a viable diversifier to value and growth investing. We highlight the since inception performance of our Global UCITS Fund below.

Benguela Global Equity Portfolio vs MSCI ACWI – 31 May 2020





And if demonstrable global capabilities weren't sufficient to whet the appetite, then the proposition of such capabilities at a competitive price might entice. When we review our fees against peers, our structure is quite appealing.

Manager	Direct Retail Fee* (TIC)
Benguela Global Equity A	1.06%
Manager A	1.66%
Manager B	1.68%
Manager C	1.46%
Manager D	1.25%

Our unbending investment discipline has stood our clients in good stead, both over the long term and in the first quarter of 2020 in which global markets suffered substantial losses. Given the depth on offer by global markets we can implement our Quality investment philosophy on a purist basis. Therefore, we view our Global Equity suite as an expression of our best views, an ode to Quality. So, you need not look beyond our borders or invest beyond our borders when a compelling solution lies right here.

**To suit the different needs of our institutional clients, we offer competitive fee options between a performance-based fee class and a clean class*