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South Africa's Hidden Offshore Exposure

by Michael Caroline

It is commonly debated what the optimal allocation to offshore assets should be in a South African investment portfolio. Given the tendency of individuals to overweight negative news and the abundance of such news in South Africa, the layman's answer would probably be; "as much as possible." This generally comes from a position based on the diversification benefits of offshore assets and the fear associated with the risks of holding South African assets. This stance, however, relies on the assumption that the South African market is reasonably independent from global markets. Given the high degree of integration of many financial markets, including that of South Africa's, this assumption may not necessarily hold.

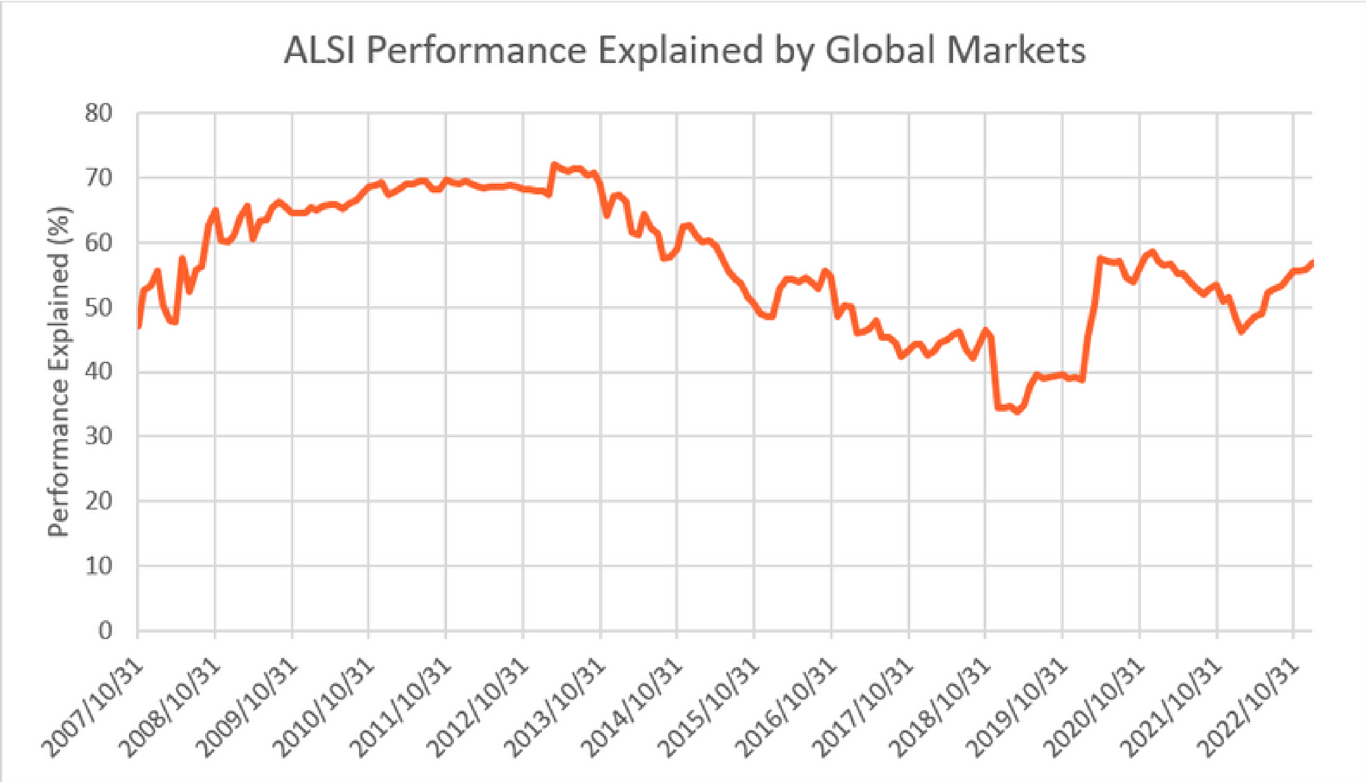
Although Rands are used to buy and value local equities, the companies that these securities represent do not necessarily generate all their revenue from South Africa and are therefore not completely dependent on the South African economy. Consider the top 10 holdings of the S&P South Africa 50 Index, a subset that makes up about 53% of the index.

Company Name	Index Weight	Percentage of Revenue in South Africa
Compagnie Financière Richemont S.A.	11.21%	7.40%
Anglo American Plc	9.03%	3.30%
Naspers Ltd N	8.66%	14.22%
FirstRand Ltd	5.84%	77.46%
Standard Bank Group Ltd	3.74%	67.90%
Prosus	2.95%	0.96%
Sasol Ltd	2.95%	48.38%
Gold Fields Ltd	2.88%	12.49%
Capitec Bank Holdings	2.78%	100.00%
Impala Platinum	2.78%	39.66%

Source: CoreShares Top 50 daily holdings & relevant financial statements

If an equity portfolio is constructed out of these shares, the revenue generated in South Africa by the underlying companies makes up only 28% of the total revenue. This shows that the majority of the value of this portfolio is derived from the global economy rather than South Africa. Additionally, a weaking Rand will benefit the investor since offshore revenues will increase in Rand terms.

An approximation of the offshore exposure gained through locally listed equities can also be determined by considering a regression analysis of the performance of the ALSI against the MSCI ACWI as proxy for the global equity markets. The percentage explained is evaluated using 5 year rolling windows and also incorporates the ZARUSD exchange rate. The following chart illustrates the output of this analysis demonstrating how, although the percentage of performance explained varies over time, it rarely goes below 30% and has an average of around 57%.



Source: S&P Capital IQ

From this it can be seen that local equities are closely tied to the broader global economy. This can be through revenue entirely generated through offshore operations or by exporting locally produced goods. Although one may feel apprehension towards investing in South African equities, one must keep the high degree of implicit offshore exposure in mind. This, in conjunction with the relative simplicity of investing locally, as well as the great valuations currently on offer, makes South African equity investments an attractive option for local investors.

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