Wide portfolio cushions against volatility

The million-dollar question for South African investors is the exchange rate.

The reason for this is that 50% of the JSE's overall earnings is now generated from overseas. A weaker Rand translates into higher earnings and thus higher share valuations. Of course, conversely, a stronger Rand has the opposite effect.

On top of this, and directly affected by the currency, is the fact that any well diversified portfolio will have anything from 25% to 50% invested in offshore assets.

Economists tell us the fair value of the Rand is around R12 to the US dollar. This is based on an economic purchasing power parity theory – however, at the time of writing the rate is closer to R13,60/US$.

This discount or weakness is the political risk premium the market is currently placing on the Rand. To reach fair value the Rand will need to strengthen approximately 12% from current levels.

What will it take to close this discount? We need a change in government. More specifically, we need a convincing win by Cyril Ramaphosa at the ANC year-end conference.

His appointment must be supported by the majority of the ANC and not result in a party split. Cyril will need to restore confidence, starting with concerns around property rights, the mining charter and then the big one, tackling the SOE rot and corruption.

The snowball effect will come into play supported by the Reserve Bank, which will cut interest rates, and which will drive growth underpinned by the current favourable international backdrop. Growth attracts investment, creating jobs and generating taxes reversing our fiscal decline.

Money Matters

Mark Williams

In this scenario, the Rand could strengthen to fair value and we may even avoid the much talked about downgrade.

Counter-intuitively and taking a short-term view, investors might not be very happy as the strengthening Rand wipes outs 10 to 12% of their offshore assets and rand hedge share values.

Personally, I would be quite happy to take a 10% knock with the knowledge that SA Inc is now on a sustainable path to recovery. However, offshore exposure and risk of Rand strength should be viewed as a premium against a bad political outcome for SA Inc.

In fact, I am more concerned that the market has underpriced the political risk premium, which could see the Rand weaken materially from current levels.

The run-up to the elections is likely to be very "noisy" for investors and the Rand, something you need to be conscious of and not let this affect your decision making and long-term planning. A well, diversified portfolio will deliver the required long-term objectives, irrespective of short-term volatility and a "noisy" SA. – *www.markwilliams.co.za.*