

Commentary



The effects of Rand Hedge shares

South Africa is in the midst of yet another turbulent time as we are witnessing the effects of President Zuma's latest Cabinet reshuffle (and the inevitable downgrade of our sovereign bond rating). Since the news broke, the Rand weakened by roughly 7.7% to the US Dollar.

However, South African investors have not necessarily suffered in their ability to earn returns.

Following the axing of former Finance Minister, Nhlanhla Nene, the JSE All Share index fell sharply, dropping to below 47 000 points during January 2016. In contrast, the JSE All Share index has in the days since March 30th this year increased by approximately 2.2% (as at April 11th, 2017), even though South Africa is experiencing similar political unrest.

As an analyst, we live to find anomalies such as this.

At the time of Nenegate, one of the contributors to what made the market's reaction so different, is that there was a very low global growth outlook. The unforeseen market shocks of 2016 had not happened yet such as the election of President Trump and Brexit, each having game changing effects on global markets.

However, following the recent Cabinet reshuffle the increase in the JSE All Share Index is largely due to the performance of the underlying Rand Hedge shares.

When President Trump was elected, it sparked a rise in small business confidence which is now at a near record high. Globally, this has transpired to an increase in the growth expectation for the year. Global share prices have been urged higher as investors are optimistic of higher returns due to the increase in foreseen growth.

When based on market capitalisation, around 70% of the shares listed on the JSE are Rand Hedge shares. Rand Hedge shares are different from pure local shares as they have revenue generating operations outside of South Africa and therefore earn revenue in other currencies.

As commodities are generally priced in US Dollars, most listed resource companies can also be seen as Rand Hedge shares. For Rand Hedge shares, there is generally an inverse correlation between the Rand and the shares performance for example if the Rand takes a tumble these shares are generally good performers, but as seen with Nenegate it is also dependant on the global outlook at that stage.

Some of the biggest Rand Hedge shares are shares such as Naspers, British American Tobacco (BAT), MTN, Richemont, Steinhoff, Aspen and Anheuser-Busch InBev.

There are also some shares that may be overlooked due to the South African footprint they have, namely Discovery, Distell, MediClinic, and Datatec.

To illustrate the rise of some of these Rand Hedge shares, below is a table depicting the shares individual price movement over this short-term period from March 30th, 2017 to April 10th, 2017.

Share	Price movement
Naspers	6.26%
British American Tobacco	8.48%
Mondi	6.49%
Richemont	7.98%
Steinhoff	6.07%
Aspen	3.99%
Anheuser-Busch InBev	8.03%

Source: www.za.investing.com

This is strikingly different from the performance of some of the financial shares listed on the JSE and South African Government bonds. The JSE Financial 15 index has fallen by around 6%, and the yield of the R186 (which is South Africa's flagship bond) has increased from 8.5% to 9% since March 30th, 2017.

Even financial shares such as Investec, which has a large offshore operation, fell sharply due to Standard and Poor's downgrade of South Africa's major banks' credit rating to sub-investment grade after the downgrade of South Africa's sovereign rating.

These effects have not been as severe as following Nenegate, possibly due to the higher amount of uncertainty globally. Post Nenegate the R186 yield had increased to above 10%. (This could be an indication that foreign investors are still seeing value in South Africa as a weaker Rand and the interest rate differential between South Africa and other first world countries widening adds to the attractiveness of our bond market).

One of the main benefits of investing in Rand Hedge shares is that the investor is able to earn a return during periods when the Rand weakens, therefore adding to the global diversification of an investor's portfolio. It is also fairly easy to achieve through the JSE-listed Rand hedge shares or unit trust funds that have underlying holdings within the funds, and the investor is then also able to benefit from the expertise of a fund manager.

As of the last quarter of 2016, below is a sample list of funds and some of their top holdings in Rand Hedge shares:

Fund	Large Rand Hedge Share Holdings
Allan Gray Balanced Fund	Sasol; BAT; Naspers
Foord Balanced Fund	BAT; Richemont; Aspen; BHP Billiton; Steinhoff and Capital & Counties
Nedgroup Stable Fund	BAT; Capital & Counties and Aspen
Investec Managed Fund	BAT; Richemont and Sasol
Coronation Balanced Defensive Fund	Naspers; Anheuser-Busch Inbev and Mondi Limited

Please note that this is a non-exhaustive list however it gives an indication of the many Rand Hedge shares held and traded by some of the local funds.

Another benefit is that the investor does not have to adhere to the tax regulations with regard to direct offshore investment.

It is also important to note that as per Regulation 28 for retirement savings, an investor is limited in exposure as follows:

- Local equity 75%
- Foreign equity 25%
- Property 25%

Through the utilisation of Rand Hedge shares in the underlying funds of the investor's retirement savings, as some of these shares are viewed as inward listed shares (foreign entities that are listed on the JSE) that the holding thereof will count towards your overall foreign equity holdings.

The effects of Rand hedge shares have been prevalent within funds that form part of the Global & Local House views, as we are seeing an increase in returns within the funds that hold a larger allocation in these shares. It has also provided a cushioning for the negative movements of other asset classes.

This once again sheds light on the importance of diversification of portfolio's in investment management. When invested in a well-balanced portfolio an investor is able to benefit from various different market movements during times such as these in an unpredictable market.

Sources:

Bloomberg

Old Mutual Wealth

Moneyweb.co.za

Funds respective fact sheets

Kind regards,
Technical Department