Should South African's be investing offshore?

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Despite the current volatile nature of world markets offshore investments are continuing to attract South African investors, who are now able to invest ZAR 2 million offshore in their private individual capacities. Figures from the Association of Collective InvestmentsÂ show a net inflow of ZAR803 million in the last quarter of 2007 into foreign currency dominated retail funds, followed by a net investment of ZAR459 million during the first quarter of 2008.

Information from Sanlam Private Investments (SPI) corroborates the growing offshore investment trend, with two-thirds of all SPI business in the first two months of this year being placed offshore.Â

This leaves one nagging question: is offshore investment currently a sound investment policy for South Africans, or is it a desperate attempt to hedge one's bets driven by a combination of political and economic fear?

"It is true that both business and consumer confidence in the South African economy has been shaken in recent months following the change in the African National Congress leadership, the ongoing electricity crisis, the stubbornly persistent and sharp rise in food and fuel prices, and the resultant 450 basis point hike in interest rates.Â These uncertainties and harsh realities have been reflected in slower growth in domestic house prices, a volatile equity market and a significantly weaker rand. And concerns about economic prospects locally always tend to prompt interest in offshore investment," said Nicky Weimar, senior economistÂ at Nedbank.

Weimar advises that while it is always wise to diversify one's assets, for the protection gained by spreading the risk, it would also be prudent to bear in mind that the current global economy also seems shaky and vulnerable, and advises that offshore is a long-term investment.

Johan Botha from Standard Bank concurs. He advises that while the diversification of an investment portfolio is seen as a cornerstone of sound investment decisions, it is quite possible that foreign shores may also have a poor interest rate outlook, political uncertainties, high levels of crime, or other similar concerns. "Rushing headlong into foreign investment may not necessarily bring the rewards that that you anticipated. The key issues are that foreign investment should be part of your total investment portfolio, taking into account your preferred time horizon and your appetite for risk," said Botha.

"At the moment the unsettled international investment environment is possibly taking the edge off offshore investments for most South Africans, but a more volatile South Africa over the medium term may change the investment picture and call for investments offshore,"Â continued Botha,Â and suggested that those considering offshore options should consult an investment specialist.

US growth prospects have fallen, following the fallout in the US subprime mortgage market, to the point that the IMF believes that the US economy has already slipped into recession, while the UK faces similar challenges, but on a lesser scale.Â "Relatively high interest rates, tight lending conditions and an exceptionally strong euro are also undermining the EU's growth prospects, with most analysts believing that world growth over the next two years will be driven by fast-growing emerging markets such as China and India," said Weimar.

This situation presents both opportunity and problems to the potential South African offshore investor, explained Weimar: "The downturn in many developed countries such as the US and UK offers the opportunity of picking up assets, such as quality shares and especially property, very cheaply, but the problem is that the investors will have to sit out the short-term volatility in the US dollar, global equity markets and the US economy in general over the next two to three years.Â Such investments therefore are long-term investments by nature, and the short-term risks can still prove acute or even fatal depending on the choice of asset or instrument."Â

"The better decision, definitely in the short term, but also in the long term, is to seek exposure to fast-growing emerging markets of the East, Latin America, CIS countries.Â However, South Africa's investment products generally offer limited exposure to these economies, and most tend to be indirectly through exposure to commodities such as platinum, gold, steel, base metals.Â The choices on this front are therefore very limited, which also increases risks and reduces the attractiveness."

Most South African economists agree that offshore investments offer South Africans access to investments and markets that are not available locally, with some investments coming with the added benefit that they can be paid out anywhere in the world,Â with South African authorities having no jurisdiction over the assets. But they also agree that offshore investment involves a lot of paperwork, as well as a higher degree of risk, and should be part of a balanced investment portfolio and the view of a long-term investment. The elements of additional risk and investment balanceÂ make offshore investments potentially unsuitable for people with limited capital.

Paul Beadle, managing director of Justmoney.co.za, South Africa's online guide to money, suggested that the high rate of interest in South Africa at the moment meant that ordinary savers could probably earn more here than they would in similar investments offshore. "Relocating your money overseas is probably only relevant to a few very wealthy people in South Africa and should only be considered after getting advice from a qualified expert in offshore finance," he said.

"For the average person in the street, it would actually pay to put as much of your spare cash as you canÂ into paying off your mortgage, because this will probably give you a greater return on your investment than any other kind of high street investment vehicle. You will save money on your interest payments, pay off your home loan sooner - again saving you money - and will have your money secured in what is, over the long term at least, an appreciating asset," said Beadle.

He suggested that with the current global market volatility it would be foolhardy to invest your money in offshore vehicles simply because you believe foreign markets will deliver a greater return. Beadle believes it is likely that South Africa will not be as hard hit by the current economic downturn as other territories because our financial institutions have not been exposed to as much risky debt and have not been hit as hard hit by defaulters, and suggests, on that basis, that it makes sense to look at investment opportunities closer to home when considering financial plans.

In answering concerns about whether the apparent rise in offshore investments is detrimental to the local South African economy, Weimar noted that the direct impact of offshore investment is a capital outflow through the balance of payments; with the impact on the economy depending on the magnitude of net outflows. "If insignificant, which right now seems more likely, the impact will be very limited, perhaps only periodic pressure on the rand, but nothing long-lasting or persistent," she said. Larger outflows, however could affect the rand value, and eventually translate into higher inflation, potentially higher interest rates and slower economic growth for the South African economy.Offshore Investments for South Africans:There are three ways South Africans are able to legally invest offshore. One is to simply buy shares in a South African company that earns a fair portion of its income in foreign currency. This will give you some currency hedge for your rand invested. The second is to invest in a South African-registered asset swap unit trust - basically a South African company which reinvests your money in overseas shares, bonds, property and cash. This provides relatively easy and cost-effective access to international investments without actually taking your money offshore, and pays out a rand value equivalent of the investment's gains in South Africa. The third is to invest in foreign currency by applying to the South African Reserve Bank to invest up to ZAR2 million in foreign investments and to invest the money in the wide array of international assets available, either in shares, fixed deposits, and property or through an international asset manager. This offers the greatest investment control and flexibility, with higher potential returns, accompanied by a higher risk factor. To qualify for the third option your tax affairs must be in order as you will need a tax clearance certificate from the South African Revenue Services.