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"It's choice – not chance – that determines your destiny."[1]

The gradual relaxation of exchange controls has substantially improved South Africans' choice over where to invest their savings. Unfortunately this choice has caused anxiety and losses for many investors, because of the big moves in the value of the Rand since the year 2000. Nevertheless, choice should be welcomed as an opportunity to shape one's destiny.

The range of Allan Gray unit trusts has been expanded to include two offshore funds, which are invested through Orbis, our sister company. By combining the various Allan Gray unit trusts in different proportions, our retail clients can essentially tailor their own offshore exposure to be anything between 0 – 100%[2]. Investors should note that the offshore exposure of both the Allan Gray Balanced and Allan Gray Stable Funds is being maintained as close as practically possible to the maximum level allowed by their mandates, which is 15% offshore.

In choosing an offshore exposure appropriate to their needs, investors may want to consider some of the following observations:

1. The All Share Index (ALSI) has more than tripled over the last three years, when measured in US dollars or Euros. This extraordinary return is due to the happy confluence of rising Rand share prices and a strengthening of the value of the Rand.

2. The valuation gap between South African and foreign shares has closed. The price to earnings (PE) multiple of South African shares is now 15.2x, which is comparable with a global average PE of 17.2x, and Brazil (11x), Mexico (15.2x), Australia (15.3x), Korea (10.3x), Hong Kong (14.8x), Japan (29.3x), UK (14.8x), USA (17.5x)[3].

3. The aggregated earnings of the ALSI companies are above their long-term trend-line, and the profitability (measured by return on equity) of many consumer-focused South African companies is at an all-time high.

4. South Africa's current account deficit has widened to over 4% of GDP. Deficits of this magnitude have only been sustained for a total of 9 years since 1960. The deficit has been widening despite very strong dollar commodity prices, and would theoretically widen even further were commodity prices to fall (all else being equal). The deficit is being funded mainly by foreign portfolio investment into South Africa. If the deficit were to close (as it has in the past), the most obvious self-correction mechanism is a weakening Rand, which would discourage imports by making them more expensive for South Africans.

5. Global investors are now attaching very low risk premiums to emerging market investments by historical standards. The spread between emerging market bond yields and developed market yields has fallen from over 13% in 1998 to around 2% today. This optimism has substantially benefited South African asset prices, but sentiment towards emerging market investments has historically been very volatile.

Commentary by Ian Liddle, Portfolio Manager

[1] Jean Nidetch, Weight Watchers
[2] subject to our offshore funds retaining South African Reserve Bank approval to remain open for investment
[3] FTSE All-World Review, March 2006. The Review's 15.2 PE for South Africa excludes dual-listed companies.