DAVE MOHR
INVESTMENT ANALYST

FUND PERSPECTIVE: SIS INFLATION PLUS 5–7% FUND OF FUNDS

THE AIM OF THE FUND

The SIS Inflation Plus 5-7% Fund of Funds is a multi-managed high equity balanced fund that aims to deliver 5% to 7% per year more than inflation over rolling seven-year periods. To achieve such a return, the fund will typically invest around 75% in local and international shares, and a further 12% in listed property (local and international). These are the 'growth assets' in the fund. Historically, only equities and property have generated 5% to 7% real returns. Cash and bonds have almost never achieved such returns over longer-term periods, but do outperform equities from time to time and are therefore included in the fund for diversification purposes. Since inception in 1999, the fund has delivered the required return over 67% of the rolling seven-year periods. Over one year periods, the fund has missed this target more often.

RECENT DISAPPOINTING RETURNS IN PERSPECTIVE

Over the twelve months to end June 2017, the fund returned only 3.3%, but the seven-year return was 13.6% per year (see table), still ahead of the inflation target.

TABLE 1: SIS INFLATION PLUS 5-7% ANNUALISED RETURNS

	1 year	3 years	5 years	7 years
Fund return	3.3%	5.9%	12.9%	13.6%
Inflation plus 6%	11.4%	11.7%	11.9%	11.8%

To understand this disappointing performance, one needs to consider the asset allocation of the fund and view it in the context of recent movements in equity markets and currencies in particular.

FUND ASSET ALLOCATION

Although the fund is currently about 58% invested in JSE-listed companies, one needs to bear in mind that more than half of the revenues generated by these companies is international. In addition, 25% of the fund (the maximum allowed by regulations) is invested directly in international markets. **So, the effective international exposure of the total fund is more than 50%.**

IMPACT OF THE STRONGER RAND

Over the 12 months to end June, international equity markets surged, returning 19% in US dollars. However, over the same period, the rand appreciated 13% against the dollar, reducing the rand return of global equities to 6%. The stronger currency also depressed the returns of rand-hedge JSE-listed companies. Viewed in dollar terms, the returns from local equities was about 14% over the 12 months to end June, but almost zero in rand.

The overall **impact of the stronger rand on the fund's one-year performance is significant,** probably reducing returns around an estimated 6%. Put differently, if the rand was flat against the US dollar, the return would likely have been in the region of 9% to 10%. However, since the dollar value of the global portion of the fund has increased, it means that, should the rand weaken again (which is bound to happen at some stage), investors should benefit from a larger base of hard currency assets.

TABLE 2: CURRENT ASSET ALLOCATION AND MANAGERS

Asset class	Asset Allocation	Fund Managers
SA Equity	53%	Prudential, Coronation & Visio Boutiques (Laurium, Steyn, 36One & Bateleur)
SA Fixed Income (cash and bonds)	11.6%	Prudential & Coronation
SA Inflation-linked bonds	1.5%	Prudential & Prescient
SA Listed Property	5%	Catalyst & Sesfikile
Global Equity	21%	Orbis, Coronation, Harris, GinsGlobal & Baillie Gifford
Global Property	5%	Catalyst & Black Rock
Global Fixed Income	0%	Investec

As at end June 2017

We expect the domestic economy to improve moderately and companies that primarily generate their profits locally should benefit from this. However, should the domestic economy remain in the doldrums, the impact on fund returns would not be disastrous. This is because, as it is currently positioned, only around 23% of the fund (i.e. locally listed companies that make their profits in the local economy) is exposed to domestic economic conditions. However, in a weak economy, the allocation to domestic bonds/fixed income should do well, particularly if the SA Reserve Bank cut rates later this year.

ASSET MANAGERS ADDING VALUE

We select asset managers for each asset class (i.e. for bonds, equities, property etc.) who have track records of consistent outperformance. They are listed in table 2 above. We expect these managers to continue adding value to the fund's overall long-term performance and we are not envisaging any changes in the near term.

OLDMUTUAL WEALTH

LOOKING AHEAD (AND REMEMBERING THAT THE TIME HORIZON OF THE FUND IS SEVEN YEARS)

- We believe equity should deliver the best returns over time (as it did in the past year, before currency movements are taken into account). We remain overweight global equities within the regulatory constraints.
- Property companies should be able to deliver returns above inflation as rental income grows.
- Bond yields are attractive with inflation falling (and scope for the Reserve Bank to cut rates), and local bond returns should beat inflation.
- The fund remains heavily exposed to international assets and should benefit from any rand weakness.