EFFICIENT GROUP

ECONOMIC COMMENTARY
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THE RAND AND YOUR LONG-TERM INVESTMENT STRATEGY

We have been getting a lot of questions about the rand:

+ Why is it strengthening against major currencies?
+ Will it continue to strengthen?
+ Should I take my money out now?
+ Why did you take my money out at these levels?

These are some of our favourites. This week we will attempt to clear up some of the confusion and concerns investors might have.

First of all, it is worth saying that no one can accurately predict the short-term exchange rate of the rand over a long period; although I admit some technical analysts have come close. Usually, would-be investors can get it right a couple of times, even for a couple of years. But, remember, even a broken clock is correct twice a day. What is important for any investor is to remember your long-term strategy. Short-term volatility, within one standard deviation (+-6-8% for the ZAR/USD), if you want to get technical, should not upset you too much. Because over the long-term the rand must depreciate against developed-market currencies like the USD, simply because of inflation differentials which deteriorate the rand's buying power. We expect the ZAR/USD inflation differential to be 2.5% over the long-term, i.e. the next 6 years. Usually, an additional factor also weighs in on the rand's persistent trend of depreciation: sentiment.

Our research shows that this contributes an additional annual depreciation of 2%-4% over the long-term; the total annual depreciation of the ZAR/USD should therefore be 4%-6% over the next 6 years. Up until 2015 political influence (a form of sentiment) did not have a direct impact on the rand. However, after the controversial firing of then minister of finance, Nhlanhla Nene, the rand (and markets for that matter) experienced a structural break. Since then, political turmoil and poor policies (another form of sentiment) have had a direct, and in our case negative, impact on the rand. As a result, the rand has consistently been more depressed, measured against its average level of undervaluation, even at its current levels of R16.25.

An emerging consensus in seminal research is that the rand can and should strengthen against the USD over the next 12-18 months. We might even see the rand around R15.00 levels next year. Because of this, some (long-term) investors feel they will miss out if they buy USD now and invest offshore. But remember, your goal is not to time the currency (no one can do that), but to diversify your portfolio and protect against local uncertainty, that same uncertainty that has fundamentally changed the value of our rand and markets. Rather consider the long-term persistent depreciation of the rand which should have the rand back at R19-levels in 2025, 5-6 years after you have made the exchange. But what is even more important is to remind yourself of your investment objectives; diversification, risk mitigation and growth are usually among the top objectives. What we have seen from the rand, and local markets for that matter, is that it is anyone's guess if, and when, they will appreciate. What we know from offshore markets is that there are thousands of opportunities to invest compared to what local markets allow. This is true even if you are scared of technology or some other bubble and exclude some of the growth-miracles from your portfolio.

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