Asset Classes and Historical returns

Broadly speaking, an asset class is a category of financial assets. Asset classes are the engine that drives returns in any investment. Each asset class has different levels of risk, liquidity and return potential.

When it comes to investments, there are five main asset classes which are available locally and offshore:

- **Cash/money market (risk 1)**
- **Bonds (risk 2)**
- **Property (risk 3)**
- **Equities (risk 4)**
- **Alternatives (risk 5)**

We typically risk rate each asset class from 1 to 5 (1 is low risk and 5 is high risk)

Asset allocation refers to how an investment is spread across the different asset classes. A well-balanced investment portfolio will be diversified across asset classes, offering downside protection by removing the risk associated with being exposed to only one asset class.

**Local Money Market:** This is sometimes referred to as ‘cash’, due to the fact that it is readily accessible as cash. However, money market instruments are fixed interest investments that aim to offer investors better interest rates than a savings account.

**Local Fixed Interest:** These are investments that yield a regular return. The most common examples of these are corporate or government bonds. Bonds are a form of debt that is issued when the issuer (borrower) needs to raise capital.

**Local Property:** Equities are also referred to as shares or stocks. Local equities are shares in South African companies that are listed on the JSE.

**Global Property:** Also referred to as listed property. Global property includes both property management companies and property unit trusts that are listed on the JSE.

**Local Equity:** Equities are also referred to as shares or stocks. Local equity includes shares in South African companies that are listed on the JSE.

**Alternatives:** Examples are commodities, gold, hedge funds, private equity, art and venture capital and usually have no correlation to equities.

**Foreign Other:** This refers to: foreign money markets, which offers exposure to foreign currencies; foreign fixed interest, which refers to investments such as bonds issued by non-South African governments and companies; and foreign property, which refers to property companies listed on foreign stock exchanges.

**Foreign Equity:** Equities are also referred to as shares or stocks. Foreign equity includes shares in companies that are listed on a stock exchange in a country other than South Africa.

Equity over time has consistently outperformed other asset classes for the simple reason that shares/stocks are physical portions of a listed company that generates profits and declares dividends. Equity is the asset class of choice to beat inflation over the long term but carry more risk. Bonds and cash form part of the fixed interest asset class where returns are linked to the market interest rate. Listed Property carries more risk than fixed interest but has handsomely outperformed in the current low interest rate environment.

**Diversification (Table 2, Source: OMIGSA)**

Different asset classes tend to behave differently under different economic conditions, and their performance may bear no correlation to one another (the benefit of diversification is the fact that asset classes are not correlated). Long-term asset allocation is one of the most important decisions that investors make. In other words, your selection of individual instruments (which share to buy) is secondary to the way you allocate your investment into cash, bonds, property, and equities which will be the principal determinant of your investment results.

Table 2 below is an indication of Real returns expected over the next 5 years considering the local and international investment climate.

**Table 2: Long-term asset allocation view**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Real return</th>
<th>View</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>6.5%</td>
<td>Neutral</td>
<td>Fair rate on an absolute basis. Expect a Lobby for 6%</td>
</tr>
<tr>
<td>Property</td>
<td>5.0%</td>
<td>Neutral</td>
<td>Good yield offset by negative reversion risk</td>
</tr>
<tr>
<td>Bonds</td>
<td>2.0%</td>
<td>Neutral</td>
<td>Attractive carry vs. cash and improving technical outlook</td>
</tr>
<tr>
<td>Cash</td>
<td>0.5%</td>
<td>Neutral</td>
<td>Lower for longer periods lower real returns</td>
</tr>
</tbody>
</table>

**Alternative**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Real return</th>
<th>View</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>6.5%</td>
<td>Neutral</td>
<td>Good dividend yield offset by diminishing earnings momentum</td>
</tr>
<tr>
<td>Bonds</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cash</td>
<td>-1.0%</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

- South African and International Equities are still the preferred asset class for long term growth. The global economy is currently in a low return environment and dividends play an important part in growth when capital is muted.
- Local Listed Property provides a consistent flow of income and has experienced large capital growth because of foreign investors.
- Global and local interest rates have been kept low to stimulate economies in these difficult times. Bonds and cash are influenced by the interest rate and are currently not keeping up with inflation. Bonds are a good alternative to cash as it provides a higher yield with potential capital growth.

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