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positive or negative returns. The analysis revealed that the behaviour of asset classes is dynamic and affected by a myriad of factors. Correlations are different in different regimes. Using historical data in a simplistic manner, without forward-looking views and insight into the drivers of historical returns, is therefore not an optimal manner in which to make asset allocation decisions.

That said, from the perspective of correlations, SMMI’s conditional correlation analysis is broadly in line with the findings of Avior and Legae. US fixed-income assets (cash and bonds) were a good negative correlator to domestic equities.

SMMI’s analysis is therefore generally in agreement with that of Avior and Legae with respect to the expectation that US fixed-income assets will act as good diversifiers to domestic equities and protectors of wealth in the case of rand weakness. It also confirmed that the behaviour of rand-leverage and rand-hedge stocks does not display a stable or directionally clear relationship to periods of rand weakness. It would seem that other drivers of returns for these stocks are more significant. In particular, we can hypothesize that for strong returns from rand-leverage stocks, an environment of positive economic growth expectations and demand for commodities is a far more important driver than the effects of the rand/dollar exchange rate on earnings.

However, SMMI’s research also highlights that, from a longer-term perspective and taking into account the imperative of driving total returns, there is empirical evidence for utilising global equities (US and Japanese in particular). This is particularly so when one considers that, in order to achieve real growth, one needs to achieve the difficult balance of risk and return. Indeed, in all three regimes analysed by SMMI, while the correlations to domestic equities were always positive, they ranged over time from low to moderately high and the total returns were also always positive and above those of domestic equities, except in the 2nd regime in which the JSE experienced positive returns and the rand strengthened too.

An important and powerful aspect of this argument rests on the vast opportunity set available in global equity markets. The depth and breadth of markets, and the countries, currencies, sectors, industries and individual stocks which a global investor may exploit, are simply not available to an investor who is only able to transact in the South African equity market.

When determining the ideal blend of assets in a portfolio, particularly in relation to the competing objectives of return and risk, there are likely to be occasions when offshore equities present compelling opportunities, especially relative to domestic equities. Therefore to simply exclude global equities based on positive correlations to domestic equities would seem sub-optimal.

The drivers of returns of any particular asset are extremely complex and diverse. Thoughtful asset allocation needs to apply forward-looking views and judgement to investment decisions, as well as insights into the causes of observed past behaviour. Correlations are not static and evidence suggests that the negative correlation between equities and bonds may be changing.

The starting yield on US bonds reduced from 6.7% on 31 January 2000 to as low as 1.45% on 29 July 2016 and has traded in range from 1.5% to 3.1% since that low. It is no wonder that US bonds have produced generally strong returns and were negatively correlated to global and domestic equities, particularly when the US Federal Reserve had the luxury of lowering yields aggressively in a stimulatory response to global risk-off macro events. Today, that luxury has been severely diminished, because the absolute level of yields is so low and the level of US government indebtedness is so high. US bonds may not be as protective and negatively correlated in the future as they have been in the past.

Nevertheless, the empirical historical research supports the contention that a local investor should be circumspect in the use of both domestically-listed rand-hedge stocks and offshore equities to manage the risks of rand weakness and its effect on the returns of domestic equities. Research indicates that assets such as local and global bonds, implied volatility and short-term fixed-income assets may be far more effective from the point of view of risk control. However, in balancing the requirements of risk and return, global equities have definite merit and should be considered as an element of a well-diversified portfolio.