

PORTFOLIO POSITIONING FOR VOLATILE MARKETS

Global markets have experienced material volatility over the last week with the FTSE/JSE All Share Index not being spared. For South African investors, we have the added volatility of our exchange rate which is following other emerging markets in further devaluations. It's hard to know whether this is the start of a material market correction or a short term adjustment in market levels, but the uncertainty of global and local markets is unsettling.

The cause of the market volatility has been placed at China's door with their reserve bank's devaluation of their currency being seen as the 'catalyst' for the fall in markets. Certainly the Shanghai Composite has had a material correction on the back of the intervention, albeit from levels where most agreed that the market had entered bubble territory following a meteoric rise in excess of 150% since July 2014 to its peak in June this year.

However many market commentators believe that it is the state of the broader global economy that has led to the past week's market volatility. While the US economy appears to be showing signs of recovery, this has been offset by the general consensus that US rates will have to start rising with the potential for dramatic consequences on asset prices if implemented too quickly. Add to this the continued concern around the Eurozone with Greece at the centre of it, and you have concerns across the globe. Up until now, higher valuation levels have had support but it appears that we are starting to see that breakdown.

We have been concerned about market levels for a while now and have therefore applied a level of conservatism when constructing model portfolios. This view is implemented by increasing the weighting to managers that have a philosophy, process and track record that points to an ability to provide downside protection when markets are weak. The outcome is that we are generally overweight offshore assets (given concerns regarding the rand) and underweight risky assets.

The table below highlights our positioning across all our portfolios for the major asset classes.

Asset class	Model portfolio holding
SA Equity	Materially underweight
SA Fixed Interest	Small overweight
SA Property	Small underweight
SA Cash	Materially overweight
Offshore Equity	Overweight
Offshore Fixed Interest	Materially underweight
Offshore Property	Materially underweight
Offshore Cash	Materially overweight
Total risk assets	Materially underweight

The second layer of protection is through the performance of the underlying share portfolios making up the SA and Offshore equity blocks of the model portfolio. We would expect that the higher allocation to more defensive managers will result in a lower drawdown in equity performance relative to the market.

On the whole, we believe the model portfolios are well positioned to protect your clients through periods of market weakness. However, looking ahead we will closely monitor the portfolio positioning if markets continue to decline as this should give rise to investment opportunities that we have not seen for some time.

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