

Sarb ETF announcement catches asset managers off guard

By [Magda Wierzycka](#)

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The recent South African Reserve Bank (Sarb) circular that reclassified exchange traded funds (ETFs) referencing foreign assets as domestic assets caught everyone by surprise. It even went as far as to list the categories of investors who can now treat these instruments as domestic, including institutional investors, trusts, partnerships and companies.



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In essence, all retirement funds, retirement annuities and preservation funds can invest more than 30% offshore using ETFs that track international indices, such as the S&P 500 Index or the MSCI World Index, says

In an environment in which the returns from South African equities have been bleak, and with Naspers and Prosus constituting 21% of the market on the back of Tencent exposure, achieving inflation-beating returns has become challenging, with many companies opting to delist from the JSE. This fairly gentle relaxation of foreign exchange controls means that investors can diversify their investment strategies in a low-cost manner utilising index-tracking funds.

From the perspective of an active asset manager this is ostensibly a disaster. Currently, only two significant providers of ETFs reference foreign assets on the JSE: Sygnia and Satrix.

Active asset managers cannot launch these products, as it would be seen as an acknowledgement of the failure of active management. And where ETFs charge low management fees for their market certain returns, active managers charge high fees for the possibility of outperforming the market. Furthermore, if institutional and retail investors choose to take more money offshore using ETFs, that money is likely to flow from the “domestic” portion of their savings, which is mostly managed by active asset managers.

Some investors may also become aware of how much more attractive an offshore passive proposition is and move their offshore allocation to passive strategies. This will translate into lower profits and lower bonuses, so no active asset manager is likely to celebrate the recent Sarb declaration.

In fact, I expect they will do everything in their power to stall this development, issuing dire warnings of a weakening rand and a lack of funding for South African corporates.

Arguments

Both opinions are hugely flawed. Given our ballooning debt-to-GDP ratio, a weaker rand is arguably not the worst thing that could happen, and this relaxation also comes at a time when most developed market debt instruments are offering nil to negative yields, so any outflows are likely to be more than matched by inflows into the South African bond market. At the same time, many South African corporates are considering delisting or can access funding via the corporate bond market, and a lot of money is also moving to privately held companies.

There is another view, of course. If I were an active asset manager, I would view this as an opportunity to diversify my own investment strategy.

There is nothing to stop a manager from incorporating offshore ETFs in their domestic equity or global balanced portfolios as part of an actively managed strategy. While there is some small cost to such a move, the returns offered to their clients may be greatly enhanced. Time will tell whether logic prevails or self-interest dominates. In the short term, expect a lot of noisy bleating.

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